Russian and Baltic Economies - The Week in Review is a brief compilation of leading economic news items in Russia and the Baltics.
Contents 2002

4.1.2002 Week 1/2002
- Rouble makes calm transition to 2002.
- Russian share prices rise at year's end.
- Russian government approves plan to reform housing costs.
- Russian enterprises continue to reduce payment arrears
- Russia's centrist parties unite.
- Progress in Russian judicial reform.
- Estonian GDP grew 5 % y-o-y in the third quarter.
- Lithuanian GDP also up 5 % y-o-y in the third quarter.
- Performance of Baltic share prices in 2001 quite mixed.

11.1.2002 Week 2/2002
- VAT to provide largest revenue stream in Russia's 2002 budget, social spending biggest expenditure item.
- Russian GDP grew 5 % in first three quarters of 2001.
- Russian inflation 18.6 % y-o-y in December.
- Russian current account surplus shrank in 2001.
- Estonian government resigns.
- Current account deficits rise in Estonia and Latvia, fall in Lithuania.

- Continued strong growth in private consumption and investment.
- Russian currency reserves stable, rouble declines.
- Russia's new labour code replaces 1970s legacy.
- Hike in Russian excise taxes.
- Putin wants more support for small businesses.
- Latvia gets new laws on business and competition.
- Estonian government scrubs sale of stake in Narva power plants to NRG Energy.
- While EU accession talks progress, accession support varies widely.

- Russian industrial output grew 4.9 % last year.
- CBR raises its interest on commercial bank deposits.
- Exports tariffs lowered on oil and oil products.
- Russia eliminates export tariffs for several goods categories.
- Putin considers shift to all-volunteer military.
- Busy spring session ahead for Duma.
- Siim Kallas takes over as Estonian prime minister.
- Tallinn bourse will hold off on shift to HEX trading system until late February.
- New framework agreed on privatisation sale of Latvian Shipping Company (LASCO)
- Polish unemployment continues to rise.
1.2.2002 Week 5/2002
- Growth in construction and retail accelerated last year.
- Russian government decides on 2002 increases in natural monopoly tariffs.
- Russian government seeks to restructure Soviet-era commercial debt.
- Russian share prices rise in January.
- Estonia's new government.
- Euro peg for the litas.
- Lithuania's and Latvia's currency reserves rose last year, Estonia's reserves shrank.

8.2.2002 Week 6/2002
- New data indicate Russian GDP grew 9 % in 2000 and 5 % in 2001.
- Russian inflation accelerates in January.
- Russia's WTO membership talks continue.
- Further lowering of Russian export tariffs.
- Putin approves plans to revise Vneshtorgbank ownership structure.
- Russia still on the FATF blacklist.
- Russia favouring domestic ports over Baltic ports.
- Litas pegged to the euro last Saturday (2.2.).
- Baltic budgets balance improves last year.
- Polish inflation hits new lows.

15.2.2002 Week 7/2002
- Russian imports from non-CIS countries grew briskly in 2001.
- Services' share of Russian GDP increased slightly last year.
- Russian government revises its 2002 growth estimate.
- Russian unemployment was 9 % in December.
- Summary of Russia's privatisation activities in 2001…
- …and privatisation plans for 2002.
- Unexpected January jump in Baltic inflation.
- Baltic year-end industrial output growth exceeds forecasts.

22.2.2002 Week 8/2002
Overview of revenue and expenditure on consolidated 2001 regional budgets in Russia.
- Uneven rise in Russian producer prices last year.
- Russian money supply expanded quickly in 2001.
- Russia plans to implement deposit insurance fund in two phases.
- Russian labour market organisations and the government sign general agreement on income policy and employment for 2002 -2004.

1.3.2002 Week 9/2002
- Economic growth of Russian industry slowed in January.
- Russia posts large budget surplus in 2001.
- Russian real incomes rose last year.
- S-account holders offered more foreign currency auctions and higher investment limits
- CBR lowers minimum capital requirements for foreign-owned banks in Russia.
- No consensus yet on Caspian Sea issues.
- Tallinn bourse connects with Helsinki exchange's trading system.
- Privatisation of Latvian gas company completed.
- Sale of LASCO for privatisation coupons begins.
- Nord/LB to buy Lithuanian Agricultural Bank.
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8.3.2002 Week 10/2002
- Russian on-month inflation slowed to 1.2% in February.
- Investments in oil sector lead in 2001.
- Russian regions experience difficulties in paying wages.
- Termination of power-sharing agreements between centre and regions.
- Implementation of energy sector reforms begins.
- Baltic bank lending up in 2001.
- Lithuania's new value-added tax.
- Economic growth still strong in CIS countries last year.

15.3.2002 Week 11/2002
- FDI inflows to Russia dwindle in 2001.
- Russia's foreign debt contracted substantially in 2001.
- Minor reduction in Russian domestic debt last year.
- Russia relaxes rules on exporting foreign currency.
- Estonia posts highest Baltic inflation in February.
- Baltic wages rose last year.
- Lithuanian unemployment continues to rise.

22.3.2002 Week 12/2002
- Sergei Ignatiev takes over as CBR chairman.
- Russian industrial output growth slowed in February.
- Little change last year in Russian companies' reliance on barter or payment arrears situation.
- Russian government approves draft proposal on sale and purchase of agricultural land.
- Changes in Russian export tariffs.
- Foreign direct investment inflows last year nearly covered Estonia's current account deficit.
- Latvian GDP rose 7.6% last year.

28.3.2002 Week 13/2002
- Russian economic growth slowed in February.
- Profits of Russian enterprises down in 2001.
- Russia promises to curb crude oil exports during second quarter.
- Russian government proposes tax code amendments.
- Bumpy road for Russian pension reform.
- Russian election dates.
- Estonia has lowest government debt among the Baltics.
- Finnish HEX Group offers to purchase majority stake in Riga Stock Exchange.
- Poland's GDP grew just 1.1% last year.

5.4.2002 Week 14/2002
- Rouble weakened moderately last month.
- Russia's Supreme Court decision would modify CBR currency controls.
- Russia's consolidated 2001 budget shows large surplus.
- Russian government approves 2002 investment program for natural gas producers.
- Opposition rolls to victory in Ukraine's parliamentary election.
- Country risk rankings of transition economies continue to improve.
12.4.2002  Week 15/2002
- Russia and Germany agree on Soviet-era debt.
- Russia monthly inflation 1.1 % in March.
- CBR lowers refinancing rate.
- Russia's current account surplus shrinks in first quarter.
- Bank deposits and lending in Russia in 2001.
- Baltic inflation slows in March.
- Current account deficit rises in Latvia, falls in Lithuania.

19.4.2002  Week 16/2002
- Russian industrial output revived slightly in March.
- Russian share prices continue to climb.
- Russia's grey economy said to employ nearly 13 % of labour force.
- Tax relief proposed for Russia's small firms.
- LASCO privatisation moves ahead.
- Williams and YUKOS resume talks on Mazeikiu Nafta.

26.4.2002  Week 17/2002
- Russian economic growth recovered in March.
- Putin's state-of-the-nation address emphasises acceleration of economic reform.
- IMF says Russia's economic policies headed in the right direction.
- Minimum wage to rise from the first of May.
- Lithuania's privatisation agency approves German consortium's bid for Lietuvos Dujos gas company.
- EU accession talks increasingly focus on toughest chapters.

3.5.2002  Week 18/2002
- Russian unemployment fell slightly in first quarter.
- Russia's population continued to decline in 2001.
- Duma reversed the amended version of central bank bill to second reading.
- CBR gets new deputy chairmen.
- Progress in reform of Russia's natural monopolies.
- Katanandov continues to lead Karelia.
- Lithuania's latest eurobond placement.
- Polish economic growth remains low.

10.5.2002  Week 19/2002
- Russian on-month inflation was 1.2 % in April.
- Little change in forecasts of Russian economic growth this year; inflation estimates raised slightly.
- Russia's regional and local budgets near balance in the first quarter.
- Rapid rise in Russian real incomes continued in first quarter.
- Turnover of Russian labour force has increased since the 1998 financial crisis.
- IMF mission gives positive appraisal of Estonia's economic development.
- Transhipments from Russia via Estonia increased in the first four months of 2002.

17.5.2002  Week 20/2002
- Despite first-quarter slowing, growth of Russian imports from non-CIS countries remained strong.
- Russian government sees fast growth unlikely in the short term.
- Russia's WTO membership talks continue.
- Economic reform keeps Duma busy.
• Growth in Baltic industrial output falls in first quarter.
• Estonia posts highest Baltic inflation rate again.
• Baltic exports hit by drop in Western European demand.
• Latvian parliament amends language law, reduces burden on non-Latvian speakers.
• IMF underlines the need to proceed with structural reforms in Ukraine.

24.5.2002  Week 21/2002
• Solid majority of Duma backs first reading of agricultural land bill.
• Russian industrial output growth recovers in April.
• Russia’s insurance boom begins to slow.
• Mandatory motor vehicle third-party liability insurance required in Russia next year.
• Russia lifts oil export restrictions.
• Russia increases export tariffs on crude oil.
• Presidents of Russia and Kazakhstan sign agreement on exploitation of natural resources in northern Caspian Sea.
• IMF pleased with Latvia’s strong economic growth.
• Bank lending up in the Baltic countries in the first quarter.

31.5.2002  Week 22/2002
• Last weekend’s Russia-US summit in Moscow.
• NATO countries and Russia form joint council.
• EU recognises Russia as market economy.
• CBR’s currency and gold reserves up substantially.
• Russian bank lending rises faster than deposits.
• FitchIBCA lifts Russia’s credit rating.
• Lithuania rejects World Bank second half of loan.
• Baltics displeased with agricultural quotas proposed by EU.

7.6.2002  Week 23/2002
• Putin outlines budget goals 2003.
• Russia’s federal budget in surplus in first quarter.
• Russian monthly inflation rate hits 1.7 % in May.
• Rise in Russian producer prices accelerated in April.
• FDI inflows to Russia fall in the first quarter.
• Estonian parliament approves supplementary budget.
• Initial agreement on new ownership arrangements for Mazeikiu Nafta.
• Legal battle over Lattelekom continues between Latvian state and Tilts Communications.

14.6.2002  Week 24/2002
• Government proposes changes to this year’s budget
• No merger of Vneshtorgbank and Vneshekonombank
• Rise in Russian oil exports and in machinery and equipment imports
• Investments in oil production constituted larger share of total investments in first quarter
• US grants Russia market economy status
• Russia releases long-term rural development program
• Estonian inflation still highest in Baltics
• Baltics push ahead in EU membership talks
- Russian government approves 2003 budget framework.
- Federation Council votes 125 – 8 to reject amendments to Russia’s central bank act.
- Russian share prices fall after long rise.
- Finnish-Russian trade gap.
- Kaliningrad issue hurts Russia-EU relations.
- Estonia issued 5-year 100 million eurobond.
- Latvia’s economic growth slowed in the first quarter.
- 51 % stake in LASCO on auction next week.
- Privatisation of gas distributor Lietuvos Dujos proceeds.

- Duma approves third reading of bill on buying and selling of agricultural land.
- Russian GDP growth slowed in the first quarter of this year.
- Russian industrial output growth continued in May.
- Russia to remain on FATF blacklist at least until October.
- Russia’s natural monopolies to implement rate hikes next week.
- Easier repatriation of frozen funds in S-accounts.
- President Putin holds major press conference.
- YUKOS acquires stake in Mazeikiu Nafta.
- 51 % stake in Latvian Shipping Company sold.
- Finnish exports to the Baltics fall.

5.7.2002  Week 27/2002
- Russian economic growth down a bit in May.
- Russia becomes full-fledged G8 member.
- Little progress in Russia’s WTO membership talks.
- Russian government decides import tariffs.
- Russian government names tax ministry as keeper of company registry.
- Drops in world financial markets bring prices of Russian shares and bonds slightly down.
- Duma overrides Federation Council attempt to modify central bank bill.
- Estonian economy slows.
- Lithuanian GDP grew 4.5 % in the first quarter.
- Helsinki Stock Exchange acquires nearly 93 % of Riga bourse.

12.7.2002  Week 28/2002
- Private consumption drives Russian GDP growth in the first quarter.
- Russian consumer prices up nearly 15 % y-o-y in June.
- Ruble suffers same fate as dollar against the euro.
- Duma approves legislation on taxation of small companies.
- Russian government approves guiding framework for forest industry development program.
- Russia and Ukraine sign natural gas storage agreement.
- Baltic inflation slows in June.
- Estonia posts largest Baltic current account deficit in the first quarter.
- IMF praises Lithuania’s robust economic development.
- Poland’s finance minister resigns.
19.7.2002  Week 29/2002
- Russian industrial output tracks modest growth path
- Russian current account surplus shrinks, but so do capital outflows
- Putin signs central bank act
- Russian Federation Council approves several reform bills
- Changes in the structure of bank deposits and loans in Russia
- Latvia to grant three UMTS licenses
- EU accession talks enter final stretch

26.7.2002  Week 30/2002
- Russia’s federal budget continues to run surplus.
- Russia’s foreign debt decreased slightly.
- Mixed earnings reports from Russian companies.
- Real incomes continue to rise.
- Russian unemployment falls slightly.
- IMF and Latvia agree to continue stand-by credit arrangement.
- Hong Kong beats out Moscow as world’s most expensive city.

2.8.2002  Week 31/2002
- Putin signs laws.
- Russia’s creditworthiness upgraded.
- Russia raises oil export tariffs.
- Growth in major Russian economic sectors slowed in first half of 2002.
- Sale of LUKoil shares postponed.
- Baltic budget performances on track.
- Lithuanian unemployment remains highest in Baltics.
- EU grants Estonia extra time to reform of its energy sector.

- Progress in reform of Russian monopolies.
- Mild rise in Russian consumer prices.
- CBR lowers refinancing rate.
- Use of non-monetary payment methods continues to decline in Russia.
- Baltic rail freight volumes increased in the first half of 2002.
- Growth of Baltic loan stocks slows.
- Estonia leads transition countries in index of economic freedom rankings.

16.8.2002  Week 33/2002
- Russian finance ministry expects smaller 2002 budget surplus.
- Russian import growth continued to slow in second quarter.
- Russian producer prices climb rapidly.
- CBR lowers its rates for commercial bank deposits.
- Eastern Europe’s largest banks ? Vneshtorgbank and Sberbank.
- Russian banking sector assets up from last year.
- Lithuania posts lowest Baltic inflation.
- Latvian and Lithuanian exports revive, Estonian exports continue to slide.
- Baltic industrial output perked up in second quarter.
23.8.2002  Week 34/2002
- Putin pushes for Russia-Belarus unification.
- Russian government approves draft version of 2003 federal budget.
- Russian output growth picked up in July.
- European Commission to grant market economy status to Russia.
- July amendments to Russia’s central bank act increase powers of National Banking Council.
- Baltic current account deficits increase.
- Real estate sales up in Estonia.
- Williams sells its stake in Mazeikiu Nafta to Yukos.

30.8.2002  Week 35/2002
- CBR releases draft of 2003 monetary policy framework.
- Russian money supply growth slowed slightly in first half.
- CBR changes forex surrender rules.
- Putin issues strict ethical guidelines to public officials.
- Latvia’s creditworthiness improves.
- Only two telecoms show interest in buying Latvian UMTS licenses.
- Slovenia the least corrupt transition country.
- Latvia ranking up slightly in UN survey of living standards.

6.9.2002  Week 36/2002
- Russian consumer price inflation slows in August.
- Russian fuel exports up; increased imports of machinery and food.
- Russian government prepares to support grain farmers.
- Russia’s budget surpluses shrink in the first half of 2002.
- Foreign direct investment in Russia continues to slide.
- Russian government doubles used car import tariff.
- Tourists spend more nights in Baltics.
- Lithuanian government approves Mazeikiu Nafta’s new ownership structure.

- Russian consolidated regional budget surplus shrinks.
- Russian unemployment down substantially from a year ago.
- Rouble exchange rate tracks unique path in relation to the dollar and other major currencies.
- Real incomes in Russia continue to rise.
- Russian government triples salaries of top-level bureaucrats.
- Changes in structure of Russian investment.
- Baltic consumer prices fall in August.
- Baltic construction activity remains strong.

20.9.2002  Week 38/2002
- Russian economic growth picked up slightly in the second quarter.
- Slower growth in Russian industrial production.
- Russian central bank continues liberalisation of forex markets.
- Russian sovereigns gain investor interest.
- Russia raises export tariff on crude oil.
- Duma set to debate reform of Russian energy sector.
- Estonian parliament set to consider deficit budget.
- Estonia’s central bank seeks to restrain lending.
- Latvian economic growth remained strong in second quarter.
- Lithuania applies for OECD membership.
27.9.2002  Week 39/2002
- Russian Duma approves first reading of 2003 federal budget.
- Russian state plans to increase its domestic borrowing.
- Russian pensions up in real terms, but still below 1998 pre-crisis levels.
- Russia and Azerbaijan agree on Caspian border areas.
- Duma says yes to competition law amendments.
- Estonian parliament approves second supplementary budget this year.
- Lithuania’s approaching memberships in EU and NATO cause increases in next year’s budget.
- YUKOS buys out Williams Mazeiku Nafta holdings.
- Most country risk rankings of transition economies continue to climb.

4.10.2002  Week 40/2002
- Growth forecast for Russian economy revised upwards.
- Russia tightens rules to prevent money laundering.
- Duma approves additional 2002 budget funds to support domestic grain interventions.
- Duma appoints CBR board members to new four-year terms.
- Government takes control of Vneshtorgbank from CBR.
- Latvia readies for parliamentary elections tomorrow.
- Estonian GDP up 7 % in the second quarter.
- Lithuanian GDP up 6.9 % in the second quarter.

11.10.2002  Week 41/2002
- Little change in Russian inflation rate.
- Duma approves first reading of power sector restructuring package.
- Russia and US hold energy summit in Houston.
- Duma approves proposed amendments to bankruptcy act in third reading.
- Low inflation in Estonia and Latvia, deflation in Lithuania.
- Centre-right parties strongly represented in Latvian new parliament.
- FDI inflows to Latvia and Lithuania growing.
- Coal terminal planned for Muuga harbour.
- European Commission recommends admission of ten countries to the EU in 2004.

18.10.2002  Week 42/2002
- Russian industrial output development mixed in third quarter.
- Russia dropped from FATF blacklist.
- Russian government approves 2003 privatisation program.
- Slavneft to be privatised this year.
- Federation Council rejects bill on regulation of electricity and heating tariffs.
- CBR lifts restrictions on transactions involving Latvian goods and investments.
- Russia experiments with all-volunteer army, parliamentarians still have no idea where most defence spending goes.
- Russia and Ukraine make preliminary agreement on setting up an international gas consortium.
- Local elections in Estonia on Sunday.
- Latvian parliament approves the head of anti-corruption bureau.
25.10.2002 Week 43/2002
- Consumer spending sustains Russian growth.
- Russia’s current account revenues and expenditures rose in the third quarter.
- 2003 budget process moves ahead in Russian Duma.
- Russian government considers export development program.
- Russian grain harvest nearly complete.
- Ruling coalition parties make strong showing in Estonia’s municipal elections.
- Lithuanian parliament approves national energy strategy.
- Lithuania lists strategic economic enterprises.

1.11.2002 Week 44/2002
- EU and Russia discuss Russia’s WTO membership bid.
- Oil and gas companies dominate list of Russia’s largest enterprises.
- Russia’s oil and food industries lead industrial output growth in first three quarters of 2002.
- Russian corporate governance improves, but poor behaviour still widespread.
- Early results from Russian census.
- Finnish companies increased direct investment in Russia and the Baltics in 2001.
- Baltic states and Russian border agreements still open.
- Lithuania tones down law on foreign exchange.
- Polish industrial output started to rise in September.

8.11.2002 Week 45/2002
- Russian inflation up 15 % y-o-y in October.
- Robust domestic demand underpins Russian economic growth.
- Gazprom announces cuts in natural gas deliveries to Belarus.
- Changes in Russia’s public wage system.
- New law on legal status of foreigners in Russia takes effect.
- Popularity of funded pension scheme set to increase Estonian state expenditures next year.
- Latvia’s new centre-right government.
- Latvian parliament approves supplementary budget.

15.11.2002 Week 46/2002
- Russia and EU agree on travel rights for Kaliningrad.
- Russian exports up, growth of Western imports slows in third quarter.
- Growth of Russian bank lending slows slightly.
- Russia raises oil export tariffs.
- Corruption on the rise in Russia.
- Russia and Belarus agree on gas deliveries.
- CBR eliminates more Latvian restrictions.
- Baltic inflation in October.
- Baltic industrial output growth remains strong.
- Baltic exports grew briskly in third quarter.

22.11.2002 Week 47/2002
- Growth of Russian industrial output slows.
- EU grants market economy status for Russia.
- Rouble’s real exchange rate quite stable.
- Russia restructures the remaining Soviet-era debt.
- Estonia records largest Baltic current account deficit.
- Further delays in privatisation of Lietuvos Dujos.
- Estonia compares well internationally in terms of economic growth, competitiveness and economic freedom.
29.11.2002  Week 48/2002
- Good harvest supports Russian economic growth.
- Russia’s 2003 federal budget approved in third Duma reading.
- CBR eliminates ceiling on aggregate foreign capital for banking sector.
- CBR cracks down on Sberbank and Vneshtorgbank lending to Gazprom.
- Gazprom decides to go with northern pipeline route.
- Baltics invited to join NATO.
- Moody’s ups credit ratings of EU applicants.
- Ukraine to have new government.

5.12.2002  Week 49/2002
- CBR develops new monetary policy tools.
- CBR relaxes foreign currency exchange requirements for exporters, further changes expected.
- Russian fuel exports as well as machinery and equipment imports continue to rise.
- Finnish businesses optimistic about development of Russian trade and Russian economy.
- European Commission lowers its economic growth projections for EU acceding countries.
- Support for EU membership varies considerably among aspirants.

- Little change in Russian inflation.
- Duma approves 2003 federal budget bill.
- Russia’s 2002 federal budget surplus holds up.
- EU Commission chairman rolls out ‘Proximity Policy for a Wider Europe’.
- Russia and European Investment Bank sign framework agreement on finance.
- Russian government successfully sells its 6% stake in LUKoil.
- IRU to suspend TIR coverage for Russian road freight.
- State Customs Committee eases local customs clearance practice in Russia.
- Russian National Banking Council (NBC) convenes.
- Baltic inflation nearly unchanged in November.
- Estonian parliament approves 2003 budget.
- Lithuanian parliament approves next year’s budget.

- Russian GDP growth remained steady in third quarter of 2002.
- Russian industrial output growth continues to slow.
- Slavneft sold.
- Maturities on bank deposits and loans continue to lengthen in Russia.
- Russia’s credit rating upgraded.
- Russia’s State Customs Committee and the International Road Transport Union agree on TIR coverage.
- Latvia’s robust economic growth continues.
- Lithuania will hold presidential and municipal council elections on Sunday.
- EU enlargement set for May 2004.
Rouble makes calm transition to 2002. In the final week of 2001 the rouble recovered somewhat from a relatively sharp weakening in mid-December. On 1 January, the Central Bank of Russia’s official exchange rate for the rouble stood at 30.14 roubles to the dollar. The next unified trading session, on which the official exchange rate is based, will be held next week.

Interbank rouble lending rates rose substantially last week – even more than at the end of 2000. For example, the one-day and one-week rates rose to over 40%. The increases reflect uncertainty over the rouble’s exchange rate. Interest rates returned to December levels (around 20%) when the markets reopened yesterday (3 Jan.).

Russian share prices rise at year’s end. The Moscow Stock Exchange’s leading share index, the RTS, rose some 10% in the second half of December. The index ended the year at 257, its highest level since May 1998. During 2001, the RTS index rose 80%. Compared to early 2000, the index was up 45%.

The late-December rise in the RTS was driven by oil company share prices, reflecting anticipation that OPEC countries, Russia and other non-OPEC oil producers would agree on production cuts to support world oil prices. Three large oil companies (Surgutneftegaz, IL-Koil and YUKOS) represent half of the EUR 77 billion market capitalisation of the RTS. The shares of next-largest companies (electric power producer UES and nonferrous metal producer Norilsk Nickel) also rose in December. RTS component Sherbank posted one of December’s largest rises, around 60%. The increase was influenced by the announcement of a plan by the CBR and the government to give foreigners a right to purchase small stakes in Russian banks without having to go through a prior approval. Shares of Gazprom, which are listed on the Moscow bourse, gained over 10% in December.

Russian government approves plan to reform housing costs. The government program now seeks to shift the entire burden of housing costs to residents by the start of 2010. An earlier draft of the program envisioned a transition period of just two to three years. Despite the long transition, some cities (including Moscow, Nizhni Novgorod and Tyumen) apparently intend to burden residents with all housing costs already starting this month. The government has approved for this year a scale for determining maximum housing costs per square meter in all of Russia’s 89 administrative regions. According to this scale, average housing costs should be about 19 roubles per square meter. However, actual costs vary substantially among regions.

In any case, when housing costs exceed 22% of a household’s income, the household is entitled to social support. State supports paid earlier to enterprises will be eliminated, and housing support channelled directly to needy residents. About 17% of Russia’s population is estimated to require housing assistance. Last year, residents paid an average of 40% of housing costs after housing assistance. Housing-related subsidies account for 40 – 90% of local budget revenues.

Russian enterprises continue to reduce payment arrears. The State Statistics Committee reports that companies continued to whittle away at their payment arrears during the third quarter. As of end-September, total arrears stood at around RUB 1.700 billion (EUR 63 billion), which corresponded to under 20% of the previous twelve months’ GDP. The reduction was steady for both arrears owed to other enterprises (9% of GDP) as well as those owed to public sector budgets (8%). Most enterprise arrears to other enterprises were owed by companies involved in wholesale and retail trade, housing, electrical power production, machinery and equipment manufacture, and transport. The largest arrears to public budgets were owed by companies involved in machinery and equipment manufacture, agriculture, transport, electrical power production and construction.

Payment arrears owed by Russian enterprises as a percentage of GDP

Russia’s centrist parties unite. In December, three midde-of-the-road parties (Unity, chaired by Russia’s emergency minister Sergei Shoigu; Fatherland, chaired by Moscow mayor Yuri Luzhkov, and All Russia, chaired by Tatarstan president Mintimer Shaimiyev) formed a new centre-right coalition Unity and Fatherland, also known as United Russia. Sergei Shoigu will lead the new party, which is expected to be a major supporter of Vladimir Putin’s policies. The new party could take as much as a third of Duma seats in the 2005 elections.

Progress in Russian judicial reform. At the end of November, the Russian government accepted a program to develop the Russian judicial system during 2002 – 2006. In December, as part of the program, president Putin approved amendments to laws concerning the judicial system, the status of judges and the supreme court. The changes enter into force this week. The reform aims at democratisation of the process of judicial appointments, clarification of the duties of judges and greater independence for the justice system. The terms for court chairman
and vice chairmen will be six years, and the same person can serve in the office only two consecutive terms. The upper age limits for judges serving on constitutional courts is 70 years and 65 years in other courts.

Estonian GDP grew 5\% y-o-y in the third quarter. A rapid increase in fixed investments (29\%) drove economic growth. Exports of services, predominantly transport and travel services, grew 11\%. Exports of goods fell 21\%. Despite a substantial increase in nominal wages, private consumption rose only 4\%. Consumption was dampened by tight fiscal policy and high inflation in the first half of last year.

Estonian GDP grew 5.3\% in the first three quarters of 2001. In November, the Bank of Estonia lowered its 2001 growth forecast from around 5.5\% to 4.7\% and predicted continued slowing of economic growth due to the troubled world economy. Revival of industrial output in October-November and a slowing in the reduction in goods exports have slightly brightened the outlook, however.

Lithuanian GDP also up 5\% y-o-y in the third quarter. GDP growth slowed slightly from 5.7\% in the second quarter. In the first three quarters, GDP growth was 5.1\%. In November, the finance ministry revised its estimate for 2001 GDP growth upwards from 3.7\% to 4.8\%. The higher growth was propelled by high growth in exports and construction activity (9\%). Private consumption rose only 2\% y-o-y in the third quarter due to a fall in real wage and persistent high unemployment. Lithuanian industrial output increased 12\% y-o-y in the third quarter, and continued to grow briskly during October and November. Retail sales rose 7\%, while the transport and communication sector was up 4\%. Agricultural output contracted 6\%.

Performance of Baltic share prices in 2001 quite mixed. Share prices on the Tallinn Stock Exchange on average finished the year at almost the same levels as they started the year. For 2001, the TALSE index showed a gain of 5\%. Although the TALSE index declined to a level 20\% below its start-of-the-year level at the end of September, it subsequently recovered. The market capitalisation of the Tallinn bourse at the end of the year was EEK 26.1 billion (EUR 1.7 billion).

The DJRSE index, which tracks leading shares on the Riga Stock Exchange, rose 44\% last year. In August, the DJRSE was even higher, driven by the high prices for shares in Latvijas Gaze. Latvijas Gaze has the highest market capitalisation of all the companies listed on the Riga bourse, so movements in its price are clearly reflected in the general index. At the end of 2001, the total market capitalisation of the Riga bourse was LVL 434 million (EUR 780 million).

The Vilnius LITIN index fell rather steadily throughout 2001, and ended the year down 30\%. At the end of December, the market capitalisation of the Vilnious bourse was LTL 4.8 billion (EUR 1.3 billion).
VAT to provide largest revenue stream in Russia’s 2002 budget, social spending biggest expenditure item. Over 80 % of revenues to this year’s federal budget will come from taxes, especially the value-added tax which is expected to amount to RUB 774 billion (7.1 % of GDP) this year. Other major revenue sources will be customs tariffs (3 % of GDP) and excise taxes (2.1 % of GDP). The profit tax, which was lowered from the start of this year, will provide revenues equal to 1.9 % of GDP, compared to 2.3 % of GDP in January-October 2001 and 2.6 % of GDP in 2000. Revenues from the unified social tax, which for the first time will be channelled via the budget, are expected to reach RUB 281 billion or 2.6 % of GDP. These revenues will be transferred to the Pension Fund and will be treated separately from other tax revenue items. Total revenues to the 2002 federal budget are RUB 2,126 billion (19.4 % of GDP, USD 67 billion).

Social-sector spending represents by far the largest expenditure category (RUB 430 billion, 3.9 % of GDP, and a fifth of all expenditures) but it includes the pass-through of the unified social tax. When the unified social tax is excluded, social-sector spending would actually be RUB 149 billion (1.4 % of GDP). Over RUB 300 billion (2.7 % of GDP) will go to the military. This amount includes funds for reform of Russia’s military, which in the budget are indicated as a separate item. Other significant expenditure items are interest payments on state debt (RUB 285 billion, 2.6 % of GDP) and supports regional budgets (RUB 265 billion, 2.4 % of GDP). Spending on education will be increased substantially, rising from under RUB 50 billion last year to over RUB 80 billion this year. Expenditures total RUB 1,947 billion (17.8 % of GDP). The RUB 179 billion (1.6 % of GDP) budget surplus will go to either paying down state debt this year (RUB 69 billion) or into a special Reserve Fund (RUB 110 billion).

Russian GDP grew 5 % in first three quarters of 2001. The State Statistics Committee reports that GDP growth slowed slightly in the third quarter to 4.9 % y-o-y (5.3 % in Q2 2001). As for GDP output components, growth in construction and agriculture accelerated in the third quarter to over 10 % y-o-y. Industrial growth slowed to 4.5 % y-o-y. The growth in private services slowed to below 3 % from 6 % y-o-y in the first half, while growth of the trade sector in the services category slowed to 4 %. Industrial output in the first three quarters represented less than 30 % of GDP while private services were about 40 %.

Russian inflation 18.6 % y-o-y in December. Inflation slowed slightly in 2001 from 2000, when consumer prices rose 20.2 %. Food prices rose slightly more than 17 % last year (18 % in 2000), while the rise in the prices of other goods slowed to below 13 % (over 18 % in 2000). Underlying the developments were the continued relatively brisk rise in agricultural producer prices and a distinct slowing in industrial producer prices. The prices of consumer services accelerated slightly to 37 % (34 % in 2000). This was due primarily to hikes in officially regulated prices for services, which lifted prices for housing-related services 57 %. However, regulated prices were frozen throughout the autumn at the federal level and to some extent also at local and regional levels.

Russian current account surplus shrank in 2001. Preliminary balance-of-payments data released by the CBR indicate the current account surplus for 2001 was slightly over USD 34 billion or EUR 38 billion (down from USD 46 billion in 2000). The surplus corresponded to 10 – 11 % of GDP (18 % in 2000). In Q4 2001, the surplus fell to 6 – 7 % of GDP.

The surplus in goods trade shrank to about USD 50 billion in 2001 (USD 60 billion in 2000). Export revenues from goods and services fell about 2 % (to USD 113 billion) and in the fourth quarter were down about 15 % from a year earlier. Revenues from natural gas exports rose last year, while other export revenues fell (see table). Expenditures on goods and services increased 22 % in euro terms and 18 % in dollar terms (to USD 74 billion). Growth in imports slowed in the fourth quarter to about 15 %. The services deficit rose last year to over USD 10 billion mainly as Russians made more trips abroad.

The balance-of-payments figures stated that FDI inflows into Russia last year amounted to USD 2.9 billion (USD 2.7 billion in 2000). The preliminary balance-of-payments data also showed that the total financial account deficit fell slightly from 2000 as net capital outflows in the corporate and banking sectors fell to about USD 6 billion (some USD 15 billion in 2000). The statistical error item in the balance of payments, which reflects unrecorded capital flows, fell to USD -8.5 billion, as well as in relation to revenues and expenditures on the current account.

<table>
<thead>
<tr>
<th>% change from 2000, in USD</th>
<th>Share of revenues %</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total revenues from exports of goods and services</td>
<td>-2</td>
</tr>
<tr>
<td>- Crude oil</td>
<td>-4</td>
</tr>
<tr>
<td>- Oil products</td>
<td>-7</td>
</tr>
<tr>
<td>- Natural gas</td>
<td>5</td>
</tr>
<tr>
<td>- Other exports</td>
<td>-4</td>
</tr>
</tbody>
</table>

Estonian government resigns. Prime minister Mart Laar announced his resignation on Tuesday (8 Jan.). Under Estonian law, resignation of the prime minister calls for the resignation of the entire cabinet. Laar announced his intention to resign last month after differences arose between the Fatherland Union (the party Laar heads) and the government’s coalition partner, the Reform Party. Presi-
dent Arnold Rüütel must name a prime minister candidate within two weeks.

Current account deficits rise in Estonia and Latvia, fall in Lithuania. In Q3 2001, Estonia’s current account deficit rose to 5.8% of GDP (3.7% of GDP in Q3 2000), while Latvia’s rose to 10.5% of GDP (6.2%). The growth in both current account deficits was due mainly to widening trade gaps. Exports to an economically struggling Western Europe lagged while domestic demand increased imports. Lithuania’s current account deficit in Q3 2001 was just 0.4% of GDP (down from 3.4% of GDP a year earlier). The improvement was due mainly to a brisk rise in goods exports (16%), driven by an increase in exports of refined oil products. All Baltic countries showed increases in their services surpluses as revenues from transport and travel services grew. The current account deficit for the first three quarters amounted to 5.7% of GDP (4.3% of GDP a year earlier) in Estonia, 7.1% of GDP (5.9%) in Latvia, and 3.3% of GDP (5.1%) in Lithuania.

FDI inflows to the Baltics in 3Q 2001 were clearly higher than a year earlier. FDI inflows to Estonia amounted to EUR 170 million (12.1% of GDP), Latvia EUR 125 million (5.9%) and Lithuania EUR 120 million (3.4%).

Estonia posts highest Baltic inflation in 2001. Estonian inflation slowed towards the end of last year as domestic demand weakened and oil prices fell. Consumer prices in December were up 4.2% y-o-y. The largest increases in prices were registered in health care services (10%), housing (9%) and food (8%).

Latvian consumer prices were up 3.2% y-o-y in December. The largest rises were noted in food (8%), education (7%) and health services (6%). Lower crude oil prices caused a slight drop in transport sector costs.

Lithuanian inflation remained low throughout 2001. Consumer prices ended the year up 2%, driven mainly by higher prices for food (6%) and phone calls (21%). Lower oil prices cut costs in the transportation sector 11%.

12-month inflation in the Baltics, % change

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Lithuanian inflation remained low throughout 2001. Consumer prices ended the year up 2%, driven mainly by higher prices for food (6%) and phone calls (21%). Lower oil prices cut costs in the transportation sector 11%.
Continued strong growth in private consumption and investment. The State Statistics Committee reports that private consumption growth, despite a slowing from the second quarter, still increased nearly 10% in the third quarter of 2001. Fixed investments grew almost 8% in the 3Q 2001, even faster than in the first half of the year.

Private consumption amounted to 48% of GDP during the first three quarters of 2001 (compared to 46% a year earlier), while fixed investment rose slightly to over 17% of GDP (16%). Similarly to 1998–2000 inventories grew in the first nine months of 2001 (5% of GDP). Net exports as a share of GDP fell in January–September to under 15% (over 20% in the same period a year earlier). This was because the share of exports decreased to 38% of GDP (46%), while imports only fell slightly to 23% of GDP (25%). In 3Q 2001, net exports represented over 11% of GDP.

Russian GDP, consumption and investment, change from corresponding quarter in the previous year, %

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Hike in Russian excise taxes. The rouble-denominated excise taxes on nearly all products were adjusted upward 12% at the beginning of this year. The increases also apply to products imported to Russia. Excises were also raised 12% in summer 2001.

Putin wants more support for small businesses. After a burst of small-business formation in the early years of Russia’s economic transition, creation of small businesses slowed substantially. Today, small firms generate 10–11% of Russian GDP. In the EU the figure exceeds 60% and in the USA over 50%. President Vladimir Putin recently spoke out in support of small business, expressing the hope that they will become the primary motor of national economic growth. Representatives of small-businesses want to see bureaucracy eliminated and an easing of the tax burden. Finance minister Alexei Kudrin said that tax breaks for small businesses should be implemented this year. Two new chapters of the tax code devoted exclusively to taxation of small businesses are being drafted. The federal program of small-business support has operated since 1999.

Latvia gets new laws on business and competition. Latvia’s business law has been in agreement with EU regulation since the start of this year. The new law replaces and integrates several earlier laws governing business activities. The new law is hoped to improve Latvia’s business environment through e.g. improving the status of creditors and minority shareholders. The new law reduces the number of company types and requires in some cases that companies modify their articles of incorporation and information in the national company register. The Latvian parliament approved the law in April 2000, but postponed to put it into force several times.

The beginning of the new year also saw the introduction of a new competition law. It obliges companies to inform the Competition Council about any merger where at least one party holds a dominant market position in its field or a party’s annual turnover exceeds LVL 25 million (EUR 40 million). Latvia’s Competition Council rules on the legality of mergers and has the power to fine companies for violations of the law.

Estonian government scrubs sale of stake in Narva power plants to NRG Energy. Last week (8 Jan.), the government announced it was cancelling its August 2000 deal with US-based NRG Energy on the sale of a 49% stake in the Narva power plants. The deal was scrapped as NGR Energy failed to arrange the financing for refurbishing the plants by the December 2001 deadline. NRG
Energy was supposed to provide an EUR 285 million loan to finance the modernisation so that the shale-oil burning plants could be brought into compliance with EU environmental regulations. The providing of the loan was a condition NRG Energy had to meet for the Estonian state to divest a 49% stake. The Narva plants generate enough power to meet some 90% of Estonia’s energy needs.

While EU accession talks progress, accession support varies widely. During Belgium’s six-month EU presidency (July-December 2001), Slovenia, Latvia and Lithuania made the greatest progress in closing chapters of the *acquis communautaire*. The European Commission reports that ten countries (Cyprus, Latvia, Lithuania, Malta, Poland, Slovakia, Slovenia, Czech Republic, Hungary and Estonia) could be ready for EU membership as early as 2004. All have preliminarily closed between 20 and 26 of the 29 chapters in the *acquis*. Bulgaria and Romania have closed the fewest chapters.

The progress during the autumn included closing of what were expected to be rather difficult chapters. For example, the free movement of labour has now been agreed with all candidates except Estonia, Bulgaria and Romania. Hungary, Slovenia, Latvia and Lithuania have all closed the transportation chapter, and Slovenia and the Czech Republic have agreed on the taxation chapter. Spain, which currently holds the EU presidency, is striving for European Commission members to reach a common view on the vast agriculture chapter by June. The EU also still lacks consensus on the regional policy and budget chapters.

A poll commissioned by the European Commission and taken last October found 65% of people in EU candidate countries supported membership, while 18% opposed it. Baltic countries (particularly Estonia) and Malta were most critical of membership, while Bulgaria and Romania were most favourable.

The poll also revealed that less than a third of those interviewed felt adequately informed about EU enlargement or their own country’s efforts to join the EU. Baltic citizens were more likely to consider themselves poorly informed on EU matters than people in other countries surveyed.

<table>
<thead>
<tr>
<th>EU membership*</th>
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<td>December 2001</td>
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<tr>
<td>Cyprus</td>
<td>24 22</td>
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<td>Hungary</td>
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<td>Czech Rep.</td>
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<td>Bulgaria</td>
<td>14 10</td>
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<td>Romania</td>
<td>9 6</td>
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*Eurobarometer 2001
Russian industrial output grew 4.9% last year. Industrial output growth slowed in the second half of 2001 and was just over 4% in the fourth quarter. Highest growth in Russia’s main industrial sectors was registered in food (over 8%), machinery and equipment (over 7%), chemicals and petrochemicals (6.5%), and fuel (over 6%). Construction materials production rose 5.5%, while the forestry products were up less than 3%. Crude oil output for the year increased nearly 8% to 349 million tonnes, while natural gas output fell 0.5% to 581 billion cubic metres. Electricity production rose over one percent.

On-year change (%) in output of Russia’s main industrial sectors, 2000 and 2001

Putin considers shift to all-volunteer military. President Vladimir Putin first expressed willingness to moving to an all-volunteer army last December during a conversation with prime minister Mikhail Kasyanov. The government expects the move to a professional military to take ten years or longer, depending on economic conditions. Defence minister Sergei Ivanov said that Russia should only consider a professional military after its forces have been properly outfitted and equipped with modern weapons systems. Army general Anatoly Kvashnin, chief of general staff, likes the idea of using professional military personnel in e.g. permanent strike forces, because it means conscripts do not have to be sent into battle during peace time.

Pay scales for enlisted personnel will be adjusted from July 1, 2002, so that they match comparable rates for other federal civil servants. With the change, however, soldiers will lose some of their current benefits (e.g. they will be subject to income taxes). Over the coming three years, Russia wants to reduce the strength of its active duty armed forces from the current 1.3 million to 900,000. Russia also wants to reduce the number of civilian posts in the defence forces and save money by closing bases in Cuba and Vietnam. President Putin also demanded elimination of redundant structures in “power” ministries.

Busy spring session ahead for Duma. The Duma is likely to spend considerable time in the coming months on the agricultural land bill. Despite long preparation in government committee, Duma members are expected to review at least five versions of the bill. The Land Code was approved last October on the condition that a separate law on agricultural land would be drafted. Duma deputies will also be considering bills on deposit insurance, funding of work pensions, use of municipal land, use of foreign labour, voluntary health insurance contributions, as well as four versions of the nationalisation act.

Amendments to acts on securities, pensions, taxation of small business and customs are also expected. The Duma’s immediate tasks include consideration of proposals on modifying the status of the central bank and housing sector reform.

Prime minister Mikhail Kasyanov says that the Russian government’s primary tasks in the economic arena are tariff policy (including natural monopoly tariffs), the banking sector, energy production and railway reform, as well as development of new strategies for the defence, automobile, forest and metals industries. The government would also like to improve the investment and business climate through measures to reduce the bureaucratic burden on firms and develop corporate governance.

Siim Kallas takes over as Estonian prime minister. In a vote of 62 to 31, the Estonian parliament approved Reform Party chairman Siim Kallas as Estonia’s new prime minister on Tuesday (Feb. 22). Mr. Kallas served as finance minister in the previous coalition government headed by
Mart Laar. He has also held the posts of foreign minister and governor of the Bank of Estonia.

In his parliamentary address, Kallas said the new government’s main task was to reduce the widening social and economic divide in Estonian society. He intends to increase pensions, slow the rise in electricity prices, introduce free lunches in schools and give more money to local governments. He noted that the new government has no plans for fundamental changes in the tax structure, and that it remains committed to the key goals of Estonian foreign policy: membership in the EU and NATO.

Kallas will next present his new cabinet selections to the parliament. Kallas’ Reform Party is expected to partner with the Centre Party (led by Edgar Savisaar) in the new coalition government.

Tallinn bourse will hold off on shift to HEX trading system until late February. The Tallinn Stock Exchange has decided to postpone listings in the Helsinki Stock Exchange’s HEX trading system until February 25. The delay is expected to give members of the Tallinn bourse time to complete their technical preparations for the system changeover.

New framework agreed on privatisation sale of Latvian Shipping Company (LASCO). Despite active efforts by the Latvian state to privatise LASCO since 1996, the lack of investor interest and uncertainties over the privatisation process have caused sale deals to fall through several times. This time around, Latvia’s privatisation agency, rather than attempting to sell a majority stake in the shipping company to a strategic investor, hopes to sell 51% of LASCO shares on the Riga stock exchange. Another 32% will be traded for privatisation coupons, while a 10% stake will be transferred to the state pension fund and 6% will be sold to current and retired employees. Latvia’s privatisation agency will retain a 1% stake in LASCO. New owners will be obliged to preserve the LASCO’s current business activities and crews must continue to be manned mostly by Latvian nationals. The privatisation should be completed by July, and the government expects to raise some LVL 110 million (€190 million) from the sale. LASCO is among Europe’s largest shipping companies, and has nearly 40 vessels currently in service. In the first eleven months of 2001, LASCO showed a profit of some LVL 17 million.

Polish unemployment continues to rise. Poland’s Central Statistics Office reports unemployment rose to a record level in December. Unemployed persons comprised 17.4% of the labour force at the end of December, up from 15.1% a year earlier. The Statistics Office noted that, while the number of persons officially registered as unemployed stood at 3.12 million at the end of 2001, only about 20% had the right to claim unemployment benefits. The substantial slowing of Polish economic growth (about 1% in 2001 compared to 4% in 2000) has contributed to higher unemployment. The largest jumps in unemployment were registered in the western and northern parts of Poland.

Russia: RUB/EUR & RUB/USD exchange rates (CBR)

Russia: 31 – 90 days interbank rate (Mibor), % p.a. (CBR)

Russian share prices (RTS)

Baltic share prices (Estonia and Latvia the left scale, Lithuania the right scale)

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Growth in construction and retail accelerated last year. The State Statistics Committee’s indicator for economic activity in five key sectors rose 5.7 % in 2001 (10.2 % in 2000). Four of the five sectors experienced slowing growth compared to 2000. The exception was retail sales, which rose last year about 11 %. Construction also continued to boom and grew around 10 % thanks to a nearly 9 % increase in investments. Agricultural output rose nearly 7 %, industrial output about 5 % and transport some 3 %.

In Q4 2001, construction was up nearly 14 % y-o-y, with investment rising about 10 %. Retail sales growth exceeded 12 %. Growth in the other three sectors moderated to 3 – 4 %.

Quarterly growth of Russia’s main economic sectors 2000-01, on-year change, %

Russian government decides on 2002 increases in natural monopoly tariffs. Under the government’s decision, the wholesale price for electricity from Unified Energy Systems (UES) will rise 20 % at the start of March. Consumer prices for electricity will go up an average of 18 %, but the increases may vary from region to region. Natural gas prices will also go up 20 % in mid-March. Tariffs on rail freight will go up 16 % on 15 February. The rates will be harmonised in the second half of this year. Prime minister Mikhail Kasyanov said further increases could be considered in the second half, but only in special cases. The exception is the price of natural gas, which could change as soon as Gazprom finalises its budget plan for this year.

The rates announced are nowhere near those requested by Russia’s natural monopolies. Just last December they sought hikes for this year ranging from 40 to 70 %. At that time, the government imposed an average ceiling of 35 % on tariff increases. Economy and trade minister German Gref said the decision to raise tariffs was made with consumer interests in mind. In his opinion, natural monopolies need to focus on cutting costs rather than passing on their high operating costs to consumers. President Vladimir Putin reiterated Mr. Gref’s words. The government has set its inflation target for this year in the range of 10 to 13 %.

Russian government seeks to restructure Soviet-era commercial debt. Under a decree approved in early January, commercial debts inherited from the Soviet era will be transformed into Russian government eurobonds, assuming foreign creditors approve the arrangement. The government decree details the conditions for the debt restructuring. The plan is to issue a maximum of USD 2 billion in government bonds in March and April. These bonds would mature in either 2010 (overdue interest payments) and 2030 (principal and accrued interest). The overdue interest payments will be converted to eurobonds and will be discounted about 10 % from their nominal value. The discount on principal and accrued interest represents more than a third of nominal value. According to deputy finance minister Sergei Kolotukhin, a second USD 2.5 billion eurobond issue could be released in July. Estimates on the size of total Soviet-era commercial debt vary. Mr. Kolotukhin said at the end of last year that the debt amounted to about USD 6.5 billion, of which about half was principal and half was accrued interest. In April 2001, Russia and its commercial creditors reached an agreement on partial debt forgiveness and postponement of debt servicing.

Russian share prices rise in January. In the first three weeks of January, Russia’s leading share price indicator, the RTS index, rose 15 % to 300. The RTS subsequently fell 6 %, finishing January at 285 – 290. The daily trading volumes of RTS shares averaged USD 24 million, a level rarely matched last year, when daily volumes averaged only USD 18 million. Some market players said January’s activity reflected buying by foreign investors, who then retreated in face of uncertainty appeared on, e.g. US exchanges.

The share prices of the largest oil companies included in the RTS, and Gazprom, which is listed on the Moscow Stock Exchange, as well as the oil and gas share indices Skate and AKM, rose in January over 15 %. Despite low world oil prices and a drop in oil prices, the share prices of Russian oil and gas companies have risen on gradually improving corporate governance. Moreover, price-to-earnings ratios remain substantially lower than those of similar Western companies. The rise in UES shares at the beginning of the month collapsed after the Russian government announced it would rein in rising electricity prices this spring. The telecommunications sector indices of Skate and AKM rose nearly 25 % in January. Observers say the jump was caused by telecom-sector mergers under planning. Indices for the machine-building sector also rose about 20 %.

Estonia’s new government. A minority government formed by the Reform Party and the Centre Party was sworn in on Monday (28.1.). The Reform Party of prime minister Siim Kallas took six cabinet posts (including the foreign minister post that went to Kristiina Ojuland). The Centre Party got eight portfolios (including finance minister Harri Õunapuu). Centre Party chairman Edgar
**Savisaar** will continue as Tallinn’s mayor. The new coalition parties control 46 seats in Estonia’s 101-member parliament. The new government will retain the main economic policy goals of the previous government. It will also actively continue to seek its chief foreign policy goals, i.e. memberships in the EU and NATO. The new government’s goals include reducing economic and social differences in society. Estonia will hold its next parliamentary elections in 2003.

**Euro peg for the litas.** The Lithuanian litas will be pegged to the euro at the official exchange rate set by the European Central Bank today (1.2.). The Bank of Lithuania will announce the new rate for the litas at press conference starting at 5 p.m. The new peg becomes effective on Saturday (2.2.). The litas was originally pegged to the US dollar in April 1994. The re-pegging from the dollar to the euro stems from Lithuania’s commitment to closer economic and political ties with the EU.

**Lithuania’s and Latvia’s currency reserves rose last year, Estonia’s reserves shrank.** The gold and currency reserves held by Estonia’s central bank stood at €930 million at year’s end, a drop of 6% from a year earlier. The lower reserves reflect new rules from the Bank of Estonia, whereby banks were allowed from the start of 2001 to invest up to one fourth of their reserves in highly rated, euro-denominated securities. Estonia’s reserves are sufficient to cover about two months worth of imports of goods and services.

**Latvia’s gold and currency reserves at year’s end stood at €1.4 billion, about a third higher than a year earlier. The reserves cover over three months of imports of goods and services to Latvia.**

**Lithuania’s reserves stood at €1.9 billion at last year’s end, a 23% rise from a year earlier. The amount is sufficient to cover three months of imports of goods and services to Lithuania.**

### Russia: RUB/EUR & RUB/USD exchange rates (CBR)

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<thead>
<tr>
<th>Date</th>
<th>EUR</th>
<th>USD</th>
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<tbody>
<tr>
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<td></td>
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### Russia: 31 – 90 days interbank rate (Mibor), % p.a. (CBR)

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<th>Date</th>
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<td>2001</td>
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### Baltic share prices

Estonia and Latvia the left scale, Lithuania the right scale

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<tr>
<th>Date</th>
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<th>Latvia</th>
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New data indicate Russian GDP grew 9% in 2000 and 5% in 2001. The State Statistics Committee also reports private consumption rose about 9% last year, or nearly the same pace of growth registered in 2000. Fixed capital formation (investments) increased last year 11.5% (figures for 2000 were revised downwards from over 15% to over 13%). Public consumption fell 1% last year.

GDP for 2001 was estimated at RUB 9,041 billion (€345 billion or $310 billion). Private consumption’s share of GDP rose to 50%, while public consumption’s share remained under 15%. Fixed capital formation’s share rose from under 16% to nearly 18%. The GDP share of net exports shrank from 20% to 13%, because exports’ share fell from 44% to 37% while imports’ share remained at 24%.

Russian inflation accelerates in January. Monthly inflation in January was 3.1% and on-year inflation about 19%. In January 2001 inflation was 2.8%, while in January 2000 it was 2.3%. The prices for services rose fastest last month (up 7.5%), led by price hikes in telecommunications and housing-related services (18% and 8.8%, respectively). Food prices were up 2.8% for the month, while the prices of other goods were up 1.2%. The prices of fruit and vegetables rose 16.6%. January price inflation in both Moscow and St. Petersburg exceeded the national average (5.8% and 3.8%).

Russia’s WTO membership talks continue. Russia has had to deal with many diverse issues in its WTO negotiations, not just at its talks in Geneva at the end of last month, but in many earlier bilateral talks with WTO members. Among the basic issues discussed were reform of Russia’s customs regulations and problems with customs operations, Russia’s export restrictions and technical barriers to trade. Despite progress in customs tariff talks, open issues include customs levels for automobile, aerospace and forest industries. With attention focused on industrial subsidies, such as low domestic energy prices, Russian officials have become increasingly sensitive to the possibility to use agricultural supports, especially export subsidies. Regarding access to its service markets, Russia is considering limiting access of foreign investors in the telecom area (which would not affect current investors) and preservation of Rostelekom’s monopoly on international calls for perhaps as long as ten more years.

The WTO accession working group hopes to discuss its first draft report at its next meeting in April. Regarding WTO chairman Michael Moore’s recent statement that Russia could be admitted to WTO membership as soon as mid-2003, deputy economy minister Maxim Medvedkov, who leads Russia’s membership negotiation team, said the estimate was optimistic.

Further lowering of Russian export tariffs. According to an earlier decision, the export tariffs on crude oil and certain unrefined oil products were lowered at the start of February from €23.40 to €8 a tonne. Now the government has also decided to lower the export tariff on heavy fuel oil, which will fall at the beginning of March from €20 a tonne to €10 a tonne. In addition, export tariffs on diesel oil and light and medium raffinates were reduced from €39 to €25 a tonne. The economy ministry could further lower export tariffs if the domestic oil glut does not abate.

Putin approves plans to revise Vneshtorgbank ownership structure. According to the government’s plan, the CBR will reduce its stake in Vneshtorgbank and the Russian government will become a new owner. The two will continue to hold the majority stake in Vneshtorgbank. A third owner, possibly the EBRD, would take on a 10–20% stake. The EBRD is ready to begin official negotiations on the matter. The central bank is to divest its ownership stake in Vneshtorgbank by the end of 2004.

Russia still on the FATF blacklist. At its recent meeting in Hong Kong, the Financial Action Task Force (FATF) on money laundering decided to keep Russia on its blacklist for a while longer because Russia’s anti-money laundering efforts were considered still not sufficient. Russia’s act on preventing money laundering only entered into force at the beginning of this month. In addition, the new anti-money-laundering Committee for Financial Monitoring has only just begun its work. The FATF will review its blacklist at its next meeting in June.

Russia favouring domestic ports over Baltic ports. Rail freight tariffs imposed last August by Russia have affected the Baltic transport sector by causing Russian enterprises to favour domestic ports and shipping terminals. The tariffs imposed by Russia on transporting freight via foreign harbours are 11% higher than for using domestic ports. Russia initially promised to eliminate this discrepancy by March, but now wants to postpone the harmonisation. These protectionist measures to help Russian domestic ports are strongly at odds with WTO principles.

Latvia’s transport sector benefited most last year from Russia’s favourable economic development and the resulting increase in transhipments via the Baltics. Although the move to Russian domestic ports slowed growth towards the end of last year, the total amount of cargo handled at Latvian ports in 2001 rose 10% and rail freight was up 4%. A large share of cargo was oil being transshipped from Russia to Western Europe. At the largest ports, Ventspils and Riga, cargo volumes grew steadily. At Estonia’s main port, the Port of Tallinn, cargo freight increased last year about 10%, while rail freight fell slightly. Lithuanian rail freight also declined last year, but freight volumes at national ports remained essentially unchanged. Baltic transit shipping is expected to decline slightly this year due to the continued imposition of Russian transport tariffs, as well as Russia’s lower oil output and the opening of the new Primorsk oil terminal by the Gulf of Finland.
Litas pegged to the euro last Saturday (2.2.). The litas was fixed at a rate of 3.4528 litas to the euro, based on the official rate posted by the European Central Bank on 1 February. The repegging of the litas from the dollar to the euro reflects Lithuania’s increasing close economic relations with EU member and candidate countries. The Bank of Lithuania said that pegging to the euro should reduce exchange rate fluctuations in relation to Lithuania’s main trading partners, EU countries, as well as provide a stable environment for economic growth. Lithuania’s central bank also said that a needed amount of the country’s currency reserves had already been changed from dollars to euros.

Baltic budgets balance improves last year. Estonia’s public sector surplus last year was EEK 400 million (€25 million), or 0.4 % of estimated GDP. Estonia’s state budget surplus exceeded one billion kroons due to higher-than-expected tax revenues. Municipal budgets, in contrast, continued in the red.

Latvia’s public sector deficit shrank last year to LVL 87 million (€160 million) and was about 1.8 % of estimated GDP. The deficit slightly exceeded the ceiling of 1.75 % of GDP agreed with the IMF.

Lithuania’s state budget deficit contracted last year despite lower-than-expected tax revenues. Preliminary figures put the deficit at LTL 730 million (€210 million) or about 1.5 % of GDP. Lithuania and the IMF agreed last autumn on a public sector deficit ceiling of 1.3 % of GDP.

Polish inflation hits new lows. The rise in Polish consumer prices slowed in December to 3.6 % y-o-y (8.5 % y-o-y in December 2000), and was easily below the year’s inflation target of 6 – 8 %. The largest price rises in December were registered in housing (7.4 %), mainly due to higher energy prices. Cheaper crude oil, on the other hand, caused transport sector prices to fall nearly 3 %. A good harvest helped keep food prices in check (2.2 % y-o-y). Unexpectedly low inflation was also caused by weak domestic demand and a strong zloty.

Baltic state budget deficits and surpluses, 1996 – 2001, % of GDP

*) preliminary figures
Russian imports from non-CIS countries grew briskly in 2001. The Central Bank of Russia reports Russia’s total revenues from goods exports fell about 2.5% to USD 103 billion last year. In 4Q 2001, exports were down 16% from a year earlier. Exports to non-CIS countries fell 4% last year, while exports to CIS countries increased over 7%. Imports grew 19% last year to over USD 53 billion, and were up 16% y-o-y in the fourth quarter. Imports from non-CIS countries rose 28% in dollar terms to USD 40 billion and 32% in euro terms. Imports from CIS countries fell 2%. Nearly a quarter of all imports mentioned by the CBR are excluded from Russian customs data for 2001.

Russian exports and imports, USD billion / quarter

![Graph showing Russian exports and imports](image)

**Services’ share of Russian GDP increased slightly last year.** The State Statistics Committee reports that the share of services in GDP was 55% (54% in 2000). Private services increased their share to 47% share. The share of public services fell slightly and was a bit over 8%. Goods production corresponded to 45% of GDP, while industry’s share of GDP was 29%. On the other hand, the added value from goods production rose 6-7% in real terms, while services only added 3-4%.

**Russian government revises its 2002 growth estimate.** Last week the government presented a 3.5% estimate of GDP growth this year. This scenario assumes the world price for Urals-grade crude oil will average $18.50 per barrel in 2002. The government also noted an optimistic scenario, where the oil price would average $23.50 a barrel and GDP would grow 4.3%. In its more pessimistic version, the oil price falls to $16.50 a barrel and GDP grows just 3.1%. The mid-range scenario estimates the rouble’s exchange rate will weaken to 33.80 roubles to the dollar by the end of this year, while the other two see the dollar’s price up or down a rouble. In all three scenarios, consumer prices are expected to rise 12-14%. The rouble’s real exchange rate is expected to stay quite stable (in the mid-range scenario, it weakens over one per cent in relation to dollar and strengthens 1-2% in the higher oil price scenario). Imports are expected to rise just 2-6% this year.

**Russian unemployment was 9% in December.** Figures released by the State Statistics Committee and prepared in accordance with ILO methods indicate that Russian unemployment rose in the second half of 2001, reaching 9% in December (8.5% in June 2001). About 6.4 million persons were unemployed in December 2001. Some of the rise in unemployment was seasonal in nature. In December 2000, there were 7 million unemployed and the unemployment rate was 9.6%. Some 1.3 million persons were officially registered as unemployed in December (1.2 million in December 2000). Russia’s labour force shrank last year from 72 million to 71.4 million, and the number of persons employed remained at around 65 million.

**Summary of Russia’s privatisation activities in 2001…**

In 2001, the state divested stakes in 125 enterprises. About 95% of these stakes were sold at auction. Nearly 80% of the sales involves stakes of less than 25%. The privatisation sales added nearly RUB 10 billion to the 2001 federal budget, along with an additional RUB 120 million for land and intangible property. The largest privatisation deal was the sale of a near 80% stake in the Kazbassugol coal company in two auctions for over RUB 5 billion. The sale of the Rosgosstrakh insurance company also brought in over a billion roubles. Most of the ten largest privatisation deals in 2001 involved coal and oil companies.

While privatisation sales in 2000 earned over RUB 31 billion and privatisation activity fell off substantially last year, the income from state assets (dividends, rental income, profits) was substantially higher last year than in 2000 (RUB 29 billion vs. RUB 19 billion). As of January this year, the state had privatised nearly 130,000 enterprises, which is over two-thirds of all the companies to be privatised since the privatisation process began.

**…and privatisation plans for 2002.** Privatisation sales of state holdings are planned this year for 426 corporations and 150 unincorporated entities (FGUP, federalnoye gosudarstvennoye unitarnoye predpriyatie). The sale of these firms is expected to bring in about RUB 35 billion. Whether the privatisation sales actually take place, however, will depend on the economic situation. The government announced that it would implement the program in full only if the timing is right. The largest sales would involve the sale of a 20% stake in oil and gas producer Slavneft and a 6% stake in the Lukoil oil company. The sale of these two stakes is expected to bring in over 85% of this year’s planned privatisation revenues.

The government has charged the privatisation ministry and the privatisation fund with the task of preparing an additional privatisation plan, whereby another 500 corporations and 1,500 unincorporated entities would be privatised this year. Most of the firms involved are small and practically worthless, meaning that their sale will have little impact on the budget. Under the new privatisation
law that comes into force in this April, the president would have to grant separate approvals for privatisation of companies of strategic importance and thus such firms are not mentioned in the 2002 privatisation plan.

**Unexpected January jump in Baltic inflation.** Food prices, especially fruits and vegetables, rose fastest last month. Housing costs were also up. January consumer prices were up 4.2% y-o-y in Estonia (December 4.2%), 3.5% y-o-y in Latvia (3.2%), and 3.2% y-o-y in Lithuania (2.0%). The on-month change in prices in January was 1.3% in Estonia, 0.9% in Latvia and 1.0% in Lithuania.

**Baltic year-end industrial output growth exceeds forecasts.** Estonian industrial output as measured in sales rose 7% last year. Growth was stable through much of the year, although a slight slowdown was noted in many fields in December. Among the main production sectors, the food industry grew 6% last year, mechanical wood processing 8%, textile industry 19% and furniture manufacture 8%. High growth was also experienced by plastics producers and the metals industry, as well as equipment and machinery (mostly manufacturing of mobile phones, which suffered in 2H 2001 due to lower exports).

While Latvian industrial output rose over 8% last year, the country also witnessed the sharpest slowdown in growth among the Baltics towards the end of the year. By December, industrial output was up just 1.6% y-o-y. The country’s main production sectors – food and textiles – revived towards the end of the year, while growth in mechanical wood processing slowed. The highest growth last year registered by a major sector was the furniture industry – up 22% between January and November.

Growth in Lithuania’s industrial output continued strong through the end of the year. Overall, industrial output measured in sales was up 17% last year. The country’s all-important oil refining activity was up 47% for the year. Textile manufacturing rose 16%, electrical power generation and distribution 29%, and manufacture of vehicles and vehicle parts an impressive 125%. Food production, another critical sector, saw output drop slightly. The Lithuanian Statistics Department preliminarily reports that Lithuanian GDP growth accelerated in the fourth quarter to 7.9% and that GDP grew 5.7% for all last year.

**Baltic industrial output, 1995 = 100**

**Russia: RUB/EUR & RUB/USD exchange rates**

**Russia: 31 – 90 days interbank rate (Mibor), % p.a.**

**Russian share prices (RTS)**

**Baltic share prices**

(Estonia and Latvia the left scale, Lithuania the right scale)
Overview of revenue and expenditure on consolidated 2001 regional budgets in Russia. Revenues last year to consolidated regional budgets (combined regional and local budgets) consisted mainly of tax revenues, which accounted for 67 % of total revenues. Uncompensated revenue transfers amounted to 17 % of the total, while 11 % of revenues went to budgetary funds. The main tax revenue stream was corporate profit tax (23 % of total revenues) and personal income taxes (19 %). Both are “federal taxes” that the central government shares with the regions. The largest purely regional tax in 2001 was the property tax, which funded 7 % of consolidated regional budgets.

The largest expenditures of consolidated regional budgets in 2001 were housing-related expenditures (18 %), education (18 %) and health care (13 %). Their impact on expenditure items, however, was quite different on regional and local budgets. For Russia’s 89 regions, they accounted for only 25 % of total spending, while for local budgets they accounted for nearly 70 % of total expenditures. Debt-servicing costs amounted to only one percent of all expenditures on consolidated regional budgets.

Uneven rise in Russian producer prices last year. The State Statistics Committee reports that the rise in producer prices slowed in various economic sectors last year. Rapid rises, however, were posted for prices of electricity, natural gas and rail freight. Since the 1998 financial crisis, these regulated prices lagged behind price increases generally. Domestic prices for crude oil fell last autumn.

Percentage change in Russian producer prices

<table>
<thead>
<tr>
<th></th>
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<tbody>
<tr>
<td>Industry</td>
<td>-10.7</td>
<td>31.6</td>
</tr>
<tr>
<td>- oil production</td>
<td>-2.9</td>
<td>58.0</td>
</tr>
<tr>
<td>- power generation</td>
<td>30.2</td>
<td>39.9</td>
</tr>
<tr>
<td>- gas production</td>
<td>41.5</td>
<td>63.1</td>
</tr>
<tr>
<td>Agriculture</td>
<td>17.5</td>
<td>22.2</td>
</tr>
<tr>
<td>Construction</td>
<td>14.4</td>
<td>35.9</td>
</tr>
<tr>
<td>Transport</td>
<td>38.6</td>
<td>51.5</td>
</tr>
<tr>
<td>- rail freight</td>
<td>34.4</td>
<td>69.3</td>
</tr>
</tbody>
</table>

Russian money supply expanded quickly in 2001. The rouble money supply (rouble-M2), which includes both cash and rouble deposits in Russian banks, grew 40 % last year (60 % in 2000). The broader gauge of money supply, which also includes foreign currency deposits in Russian banks, grew 36 %. Russian inflation does not fully reflect money supply growth; Russian inflation in 2000 and 2001 ran in the range of 19 – 20 %.

Both main categories of rouble money grew at the same rate last year. Cash accounted for 36 % of rouble-M2 (€22 billion). Rouble-denominated deposits in Russia at the beginning of the year were nearly €40 billion and currency deposits about €20 billion. Russians are estimated to hold far more foreign currency cash than rouble cash, however.

Russia plans to implement deposit insurance fund in two phases. The government and the CBR jointly approved a development strategy for the Russian banking sector on 30 December 2001. During the first phase, bank participation in the deposit insurance fund would be optional. Mandatory participation of deposit-taking banks would come at earliest a year after Russia shifts to IAS accounting standards. The shift to IAS is supposed to start in 2004. Predominantly state-owned Sberbank, which holds most Russian deposits, is currently the only bank where deposits are protected by the state. Thus, a separate arrangement is planned for Sberbank’s shift to the new deposit insurance scheme. The proposed deposit insurance scheme is slated for government review in March and an act on deposit insurance is expected this year.

Russian labour market organisations and the government sign general agreement on income policy and employment for 2002 – 2004. The agreement, signed at the end of 2001, covers economic policy and incomes policy, as well as development of labour markets, social security, occupational safety, and special treatment of workers in northern regions.

The agreement’s main goals are developing the tax system and pension system, lowering interest rates, restructuring wage and payment arrears, reducing administrative obstacles to entrepreneurship, changing the structure of exports to include more products with high value-added, analysis of price formation of monopolies, and fending off possible negative impacts from WTO membership.

The signatories want to create at least a million new jobs during the three-year agreement period. Special attention has been paid to promoting small businesses. The agreement seeks to keep the average unemployment period below 6½ months and hold the unemployment rate below 8.8 % in 2002, 9.1 % in 2003, and 9.4 % in 2004. Unemployment was 9 % at the end of 2001. Companies that create jobs will be eligible for tax relief. The government promised to submit a bill on state-funding of certain unemployment benefits, and committed for the first time to increasing wages of state employees faster than inflation.

Alexander Pochinok, minister of labour and social development, emphasised that the agreement must be viewed in the context of current fiscal realities. Russia currently lacks the resources to fully support its northern regions as the law proposes or to raise the minimum wage to the level of the subsistence minimum.

Growth in Baltic exports slowed towards end of 2001. Estonian exports fell in the second half of 2001 due to...
lower demand in Finland and Sweden, its two main trading partners. The contraction in exports began in July 2001 and continued for the rest of the year. In the fourth quarter, exports fell 12%. Re-exports after inward processing, such as of mobile phones, declined most. Thanks to a successful first half, however, exports for the year were still up 7%. Estonia’s top exports included machinery and equipment, wood and wood products, and textiles. The share of exports going to EU countries fell below 70% (77% in 2000), while the share of exports to Russia and other CIS countries rose slightly to over 4%. Imports contracted at the end of last year as demand fell for parts and components in Estonia. For all of 2001, imports rose just 4% and according to preliminary estimates, the trade deficit fell to about 18% of GDP (21% of GDP in 2000).

Latvia’s Central Statistical Bureau reports that Latvian exports grew 11% last year, even if Latvia’s leading exports (wood and wood products) showed almost no growth. Among other key export fields, textiles grew 14%, machinery and equipment 29%, chemical products 11% and metal products 6%. Some 61% of Latvian exports went to EU countries (65% in 2000), while CIS countries’ share of exports grew to over 10% (9% in 2000). Food exports benefited most from 55% export growth to Russia. Imports to Latvia rose 14% last year. The greatest increases were seen in imports of machinery and equipment and transport vehicles. The trade deficit grew to about a fifth of GDP (18% of GDP in 2000).

Lithuanian exports rose 20% last year despite slowing growth in the final months. Lithuania succeeded in increasing exports to Eastern Europe in the face of declining demand in Western Europe. Last year 11% of Lithuanian exports went to Russia, with substantial increases in exports of machinery and equipment, transport vehicles and parts, and food. Record amounts of electricity were sold to Poland, Belarus and Estonia. Lithuania’s leading export (refined oil products) saw an increase of 34% with most going to EU countries. In recent years, slightly less than half of total Lithuanian exports went to the EU. Lithuania’s largest export partner last year was Great Britain, which buys Lithuanian oil products and e.g. textiles. Although imports rose 15% last year, the trade deficit contracted to 14% of forecast GDP (15% of GDP 2000).

Baltic exports, percentage change from previous year

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**Russia: RUB/EUR & RUB/USD exchange rates (CBR)**

**Russia: 31 – 90 days interbank rate (Mibor), % p.a. (CBR)**

**Russian share prices (RTS)**

**Baltic share prices (Estonia and Latvia the left scale, Lithuania the right scale)**

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Information herein is compiled and edited from a variety of sources. The Bank of Finland assumes no responsibility for the completeness or accuracy of the information.
Economic growth of Russian industry slowed in January. The State Statistics Committee reports that while industrial output in January was up 2.2 % y-o-y, seasonally adjusted industrial output contracted in December and January. Russia’s economic output indicator, which is based on the performance of five major sectors, was up 3 % y-o-y in January. The retail trade sector was the fastest growing component, up 10 % y-o-y, while construction rose 4 %. Investment was up just 0.5 % y-o-y in January.

Russia posts large budget surplus in 2001. Last year’s federal budget surplus exceeded RUB 280 billion, an amount equivalent to 3.1 % of GDP. Realised budget revenues were RUB 1,591 billion (£61 billion) or 17.6 % of GDP. Expenditures were RUB 1,310 billion (£50 billion) or 14.5 % of GDP. The primary surplus, which excludes interest payments on debt, was 5.7 % of GDP. Tax revenues accounted for over 90 % of all revenues. By far the most important revenue stream was the value-added tax, which accounted for over 40 % of total revenues (7.1 % of GDP). In 2000, VAT’s share of revenues was 33 % (5.1 % of GDP). Customs tariffs represented over 20 % of total revenues, while profit taxes represented nearly 14 %.

The largest spending area was defence (19 % of total expenditures or 2.7 % of GDP), an amount the finance ministry said was 10 % above budget for 2001. The additional defence spending was financed by extra budget income and partly used to buy weapons. Expenditures for paying interest on debt (domestic and foreign) and regional supports each represented about 18 % of expenditures or 2.5 % of GDP. Non-interest expenditures stayed in the range of 10 – 13 % of GDP for most of the year, but rose to over 20 % of GDP in December. For the year, they were 11.9 % of GDP.

Russian real incomes rose last year. Russian real disposable incomes (income minus mandatory payments and adjusted for inflation) increased 5.9 % in 2001. Per capita income averaged 2,878 roubles a month. Wages rose 19.8 % in real terms from 2000 and the average wage in Russia in 2001 was 3,262 roubles a month (£125). Strongest growth in real terms was posted by pensions – up 21.4 %. However, the average pension amounted to less than 30 % of the average wage and was just 1,137 roubles a month in December 2001. Late last year real income was at about the same level as before Russia’s 1998 financial crisis. Real wages were 5 % below and pensions 15 % below the 1998 pre-crisis level. Some 24 % of the population (about 35 million persons) earned less than the subsistence minimum. At the start of 2001, this group included about 37 % of the population (53 million).

S-account holders offered more foreign currency auctions and higher investment limits. The Central Bank of Russia held two auctions, each offering $50 million for sale, to S-account holders in December and February. Received bids at both auctions were in the range of $95 – 96 million in both cases. The minimum sales price for a dollar at the December auction was 32.50 roubles, while at the February auction the price of a dollar was 32.20 roubles.

Since 1999, one billion dollars have been sold at 18 forex auctions arranged for S-account holders. S-accounts of foreign investors contain assets frozen from Russian T-bills and transferred to S-accounts in the wake of Russia’s 1998 financial crisis. Recent estimates put the amount of assets still frozen in S-accounts at around $3 billion. About 30 Russian banks are authorised to hold S-accounts. It has also been possible to invest assets in these accounts in officially approved shares or loans as long as the investor stays within defined limits. This year the CBR raised the limit to RUB 10 billion (about USD 300 million) from RUB 2 billion last year.

CBR lowers minimum capital requirements for foreign-owned banks in Russia. The basic capital requirement for foreign-owned banks was lowered last week from €10 million to €5 million – the same level as for Russian-owned banks.

No consensus yet on Caspian Sea issues. Russia invited representatives from the five countries with Caspian Sea coastline as well as US representatives to a meeting this week (26-27 Feb.) in Moscow to express their views on territorial demarcation and use of Caspian resources. Azerbaijan and Kazakhstan and Russia in principle agree on demarcation, while Turkmenistan and Iran disagree. Iran, in particular, wants common sovereignty over the sea. It thus opposes bilateral agreements between coastal states and any unilateral measures in the Caspian Sea until its legal regime is settled. Iran supports common use of the Caspian Sea, but in case it is impossible, it may accept dividing the sea area into equal 20 % areas for each coastal state.

Russia and Kazakhstan have made a bilateral agreement on exploitation of sea-bottom resources in the sea’s northern region. Russia and Kazakhstan support common use of the sea surface and waters. Azerbaijan is the only coastal state with a constitutional clause reserving the national right to define its own off-shore sector. Russia opposes dividing into sectors by drawing lines to the Sea’s central point. While awaiting resolution of the Caspian’s legal regime, Russia and Kazakhstan have proposed a bioresource treaty to protect Caspian Sea sturgeon stocks.

Tallinn bourse connects with Helsinki exchange’s trading system. In conjunction with Monday’s (25 Feb.) link up of the two exchanges, the group of the Tallinn bourse and Estonia’s central securities depository was renamed HEX Tallinn. Estonian shares are now traded in
euro prices and traders have the option of using Estonian brokers or HEX member brokers with membership in the Tallinn exchange. The reform is expected to promote interest in shares of Estonian companies and make Estonian shares more liquid.

**Privatisation of Latvian gas company completed.** The Latvian state has sold its remaining 3% stake in Latvijas Gaze (nearly 1.2 million shares) for privatisation vouchers. Nearly 10,000 persons tendered subscription bids, which drove the share price to 10.85 lats (€19.50) – well above the officially set minimum of 7 lats. In accordance with the Latvian privatisation agency’s guidelines, one buyer was limited to purchases of no more than 200 shares. The largest shareholders in the Latvijas Gaze, which hold a monopoly in Latvia, are the Russian GAZprom, Florida-based Itera, and the German Ruhrgas and Eon. Last November, the Latvian government approved a plan to deregulate the domestic natural gas market in coming years.

**Sale of LASCO for privatisation coupons begins.** In accordance with conditions set forth by the Latvian privatisation agency in January, a 32% stake in LASCO (64 million shares) will be sold in the public offering for privatisation vouchers. Potential buyers must announce their interest in shares by 22 March. The minimum price of a single share was initially set at 1 lat (€1.80), but the final price will be set on 8 April when the shares were auctioned on the Riga stock exchange.

Later this year, 51% of LASCO shares will be auctioned for cash on the Riga stock exchange. Another 10% of shares will be transferred to a pension fund. Starting last week, the shipping company’s current and former employees were offered a 6% stake. LASCO is one of the world’s largest oil shippers. Its CEO preliminarily estimates last year’s profit at close to €30 million.

**Nord/LB to buy Lithuanian Agricultural Bank.** The German Nord/LB, after winning last autumn’s bidding competition and acceptance of its offer by the Lithuanian government, will now go ahead with the purchase of a 76% stake in Lithuanian Agricultural Bank (Zemes Ukio Bankas). In addition to a sales price of LTL 71 million (€21 million), Nord/LB must invest LTL 65 million in the bank. Agricultural Bank is Lithuania’s third largest bank and the only remaining state-owned bank. It holds about 11% of the country’s deposits. Nord/LB is Germany’s tenth largest bank.
Russian on-month inflation slowed to 1.2 % in February. In contrast, on-month inflation in February 2001 was 2.3 %. The on-year rise in February was below 18 %. The prices for food and other goods were up 0.8 – 0.9 % from January. Prices for services rose 2.7 %.

Monthly change in consumer prices in Russia, %

Investments in oil sector lead in 2001. Last year, total investment in Russia rose nearly 9 %. Investment in industrial sector rose over one percentage point to nearly 43 % of total investments. The rise was driven by investments in oil extraction and refining, the share of which rose to 16– 17 %. Metallurgy’s share remained around 5– 6 % and the natural gas industry’s share at 5 %. The food industry and the machine-building industry each only garnered 3 % shares of total investment.

The transport sector’s share (mostly investments in pipelines) fell slightly to 23 %, while the housing sector’s share shrank substantially to around 13 %. The share of investment in construction and telecommunications both rose to 3 % respectively, while agriculture’s share remained below 3 %.

Russian regions experience difficulties in paying wages. Although public sector wages were hiked 60– 70 % on average at the start of last December, fewer than half of Russia’s 89 regions have been able to pay according to the new wage scales. Indeed, the increased wage burden has driven many regional budgets into the red – for example, over 70 % of expenditures in the Karelia region’s budget go to wages. Given the payment difficulties, wage arrears rose nearly 10 % in January. The State Statistics Committee reports that wage arrears at the beginning of February totalled nearly RUB 33 billion (€1.2 billion), of which public sector wage arrears were about RUB 4 billion. Under a new labour law, employees are entitled to cease their work if they have not received their full salary within 15 days after payday.

President Vladimir Putin has encouraged the government to act quickly to correct the situation and give the regions more financial aid and loans.

Termination of power-sharing agreements between centre and regions. During the 1990s, Russia’s central government and regions signed some 42 power-sharing agreements. Now President Vladimir Putin wants to cancel the arrangements, because they violate the principle of equal status for all regions and are unconstitutional. Last summer, Mr. Putin established the Kozak Commission to propose new rules for power-sharing between the centre and the regions to revoke all unconstitutional agreements. As of mid-February, nine agreements had been terminated and ten agreements were in the process of being terminated. Some regions have announced that they want to keep their agreements, while others have said they would only be willing to terminate their agreements under certain conditions. Those opposing the ending of their current power-sharing arrangements include Moscow, St. Petersburg, the Sverdlovsk oblast, Tatarstan and Bashkortostan.

Implementation of energy sector reforms begins. On 28 February, the Russian government approved a proposed draft of an energy bill, as well as amendments to the energy-savings act, tariffs act and the second part of the civil code. They also submitted proposals to the Duma on a new competition act and an act on natural monopolies. The government also approved most of the energy sector’s 2002 investment program, valued at RUB 102 billion (€3.7 billion).

Electricity monopoly UES, which currently has 682,000 employees, will downsize 17 % this year. The estimated 116,000 job cuts mainly reflect divestment of service and repair units (101,000 persons). The company will also sell other side businesses; e.g. stakes in banks and insurance companies, shops and healthcare facilities. UES seeks to reduce its costs about RUB 10 billion (€350 million) this year.

A government resolution in July 2001 launched the broad reform of Russia’s energy sector. A wholesale market for electricity was established in November 2001.

Baltic bank lending up in 2001. The expansion of bank lending was particularly strong in Latvia and Estonia. In Lithuania, lending growth accelerated only late last year. The loan stock of Estonian banks at the end of 2001 was EEK 40.7 billion (€2.6 billion). Loan stocks totalled LVL 1.6 billion (€2.9 billion) in Latvia and LTL 9.5 billion (€2.8 billion) in Lithuania. Latvia posted an impressive expansion in lending last year of 51 %. Similar growth was 19 % in Estonia and 12 % in Lithuania.

The consolidated assets of Baltic banking systems in 2001 amounted to EEK 68.4 billion (€4.4 billion) in Estonia, LVL 3.5 billion (€6.2 billion) in Latvia and LTL 15.2 billion (€4.3 billion) in Lithuania.

Lithuania’s new value-added tax. On Tuesday (5 Mar.), the Sejm passed a new VAT act. The act harmonises Lithuania’s legislation with EU directives and
comes into effect at the beginning of July. It will simplify declaration and payment of VAT. The standard VAT rate is 18%, but certain goods will be taxed at lower rates. For example, from 2004 a 5 percent tax will be levied on pharmaceuticals and medical supplies, which currently are VAT-free in Lithuania. The 5% rate will also apply to taxes on magazines and newspapers.

Economic growth still strong in CIS countries last year. Although GDP and industrial output growth in 2001 was on average lower than in 2000, it was still quite robust. Last year GDP growth averaged 6% (8% in 2000) in CIS countries, while industrial output growth averaged 7% (11%). Highest GDP growth was registered in Kazakhstan and Tajikistan. Industrial output growth was highest in Tajikistan, Ukraine and Moldova. The Interstate Statistics Committee of the CIS (CISStat) reports that the growth in industrial output in CIS countries mainly reflected better utilisation of existing capacity rather than new investment. There were large differences in inflation rates among CIS countries last year. Inflation in 2001 in CIS countries was lowest in Azerbaijan and highest in Belarus.

Change in GDP, industrial output and consumer prices in CIS countries in 2001

<table>
<thead>
<tr>
<th>Country</th>
<th>GDP</th>
<th>Industrial output</th>
<th>CPI</th>
</tr>
</thead>
<tbody>
<tr>
<td>Armenia</td>
<td>9.6</td>
<td>3.8</td>
<td>3.1</td>
</tr>
<tr>
<td>Azerbaijan</td>
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<td>5.1</td>
<td>1.1</td>
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<td>Belarus</td>
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<td>5.4</td>
<td>61.1</td>
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<tr>
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<td>-1.1</td>
<td>4.7</td>
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<tr>
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<tr>
<td>Moldova</td>
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<td>9.6</td>
</tr>
<tr>
<td>Russia</td>
<td>5.7</td>
<td>4.9</td>
<td>18.6</td>
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<tr>
<td>Tajikistan</td>
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<td>Turkmenistan</td>
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<tr>
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<td>12.0</td>
</tr>
<tr>
<td>Uzbekistan</td>
<td>4.5</td>
<td>3</td>
<td>1</td>
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</tbody>
</table>

1) no figures available 2) based on index of key economic activities (industry, agriculture, construction, transport and retail trade) 3) January-September 2001 4) December to December
FDI inflows to Russia dwindle in 2001. The State Statistics Committee reports that foreign direct investment inflows to Russia last year amounted to $4 billion, or 1.3 % of GDP. This figure was down from $4.4 billion in 2000 (CBR balance-of-payments figures, however, indicate FDI inflows to Russia in 2000 and in 2001 were slightly less than $3 billion in each year). The share of FDI going to industrial investments rose slightly last year to around 45 %. The food industry’s share fell to 13 %, while FDI directed at crude-oil production stayed around 10 %. Machinery and equipment industry’s share grew to 8 %. The trade sector’s share rose to 27 %, while the transport sector’s share fell to 17 %.

The Statistics Committee also noted that regarding Russia’s total FDI stock of about $18 billion, 22 % originates from the US and about 20 % from Cyprus. Some 12 % of FDI came from the Netherlands, while 10 % came from the UK and 8 % from Germany.

Changes in the structure of Russian foreign trade in 2001. There was a slight drop in Russian export earnings last year (about 2 % in dollar terms). Export earnings diminished substantially in the fourth quarter (down 16 % y-o-y) due mainly to a drop in export prices. For example, the export price of Urals crude was 25 % lower in December than in December 2000, while fuel oil prices were 35 – 40 % lower. The export price of natural gas started to slip last autumn and in December was down 8 % y-o-y. Prices of key export metals were also down 10 – 30 %. There was uneven development in export volumes of key export products. Export volumes of crude oil increased about 10 %, while export volumes of oil products were up 14 % on average (both grew 7 – 9 % in 2000). Natural gas exports contracted to 7 % (down 6 % in 2000) and exports of key metals fell 5 – 10 %. In 2001, crude oil accounted for 24 % of Russia’s earnings from goods exports, while fuel oils accounted for 8 % and natural gas about 17 %. The three groups together constitute about half of Russian exports. Metals accounted for another 12 %. The value of machinery and equipment exports rose 10 % and their total share of export earnings was 10 %.

Imports rose 19 % overall, led by a 32 % increase in imports of machinery and equipment. Machinery imports from non-CIS countries rose 28 %, while non-CIS equipment imports were up nearly 40 %. The share of machinery and equipment as registered by the State Customs Committee (which do not include about a quarter of total imports according to CBR figures) rose to one-third of total imports. Their share of imports from non-CIS countries rose to 37 % (including a doubling in car imports). The share of foods and materials for food preparation from non-CIS countries remained at 24 %, while the share of chemical products was 20 %.

The State Customs Committee reports that, among the key importers to Russia, China saw its imports rise nearly 70 %. Imports from Germany, Turkey, Japan and Italy were up 40 – 45 %, while imports from Poland and Finland increased over 30 %.

Russia’s main import and export partners in 2001

<table>
<thead>
<tr>
<th>Country</th>
<th>Imports, USD billion</th>
<th>Import growth, %</th>
<th>Exports, USD billion</th>
<th>Export growth, %</th>
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</thead>
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<tr>
<td>Germany</td>
<td>5.7</td>
<td>46</td>
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<td>3.9</td>
<td>6</td>
<td>5.2</td>
<td>-5</td>
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<tr>
<td>Ukraine</td>
<td>3.8</td>
<td>5</td>
<td>5.3</td>
<td>5</td>
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<td>17</td>
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<td>-10</td>
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<td>21</td>
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<td>Italy</td>
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<td>39</td>
<td>7.4</td>
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<tr>
<td>China</td>
<td>1.6</td>
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<td>5.7</td>
<td>8</td>
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<tr>
<td>France</td>
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<td>28</td>
<td>2.2</td>
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<td>Finland</td>
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<td>3.1</td>
<td>0</td>
</tr>
<tr>
<td>UK</td>
<td>1.0</td>
<td>14</td>
<td>4.3</td>
<td>-8</td>
</tr>
<tr>
<td>Poland</td>
<td>0.9</td>
<td>32</td>
<td>4.2</td>
<td>-7</td>
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<tr>
<td>Netherlands</td>
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<td>18</td>
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<tr>
<td>Japan</td>
<td>0.8</td>
<td>42</td>
<td>2.8</td>
<td>2</td>
</tr>
</tbody>
</table>

Source: State Customs Committee

Russia’s foreign debt contracted substantially in 2001. According to finance ministry figures, Russia’s foreign debt at the beginning of January stood at $130.1 billion (€148 billion or 43 % of GDP), a decline from $143.3 billion at the start of January 2001. The amount includes Russia’s inherited Soviet-era debt. The largest portion of the debt, which totals $45 billion, consists of eurobonds and other foreign-currency-denominated debt. Debt owed to the Paris Club of sovereign creditors stands at around $41 billion. Other debt categories are considerably smaller. Russia owes nearly $15 billion to international credit institutions and $12 billion to former CMEA countries. Additionally, $6.5 billion is trade debt inherited from the Soviet era, $6.4 billion is debt to the central bank and $3.8 billion is debt owed to Paris Club non-members.

Russia’s finance ministry says it has managed to whittle down the 2003 debt-servicing spike from $20 billion to $15 – 17 billion through various measures. The ministry denied speculation that it had been actively buying back paper maturing in 2003, but noted that certain state-owned Russian banks have had the possibility to buy bonds and that the finance ministry could consider doing so in the future. The ministry estimates that Russia’s foreign debt will shrink to around $122 billion by the end of this year.

Minor reduction in Russian domestic debt last year. Starting 2001 at nearly RUB 560 billion, Russia’s domestic debt fell to RUB 531 billion (about €20 billion) by year’s end. The debt consisted almost entirely of GKO and OFZ treasuries.

Russia relaxes rules on exporting foreign currency. A regulation change from the State Customs Committee at the end of February now allows private Russian citizens
to take up to $10,000 in legitimately earned foreign currency out of the country at one time. For amounts less than $1,500, the origins of the money do not need to be documented.

**Estonia posts highest Baltic inflation in February.** In February, consumer prices were up 4.4 % y-o-y (4.2 % y-o-y in January) in Estonia, 3.3 % (3.5 %) in Latvia and 2.8 % (3.2 %) in Lithuania. The on-month rise in prices in February was 0.5 % in Estonia, while prices fell on-month 0.3 % in Latvia and 0.2 % in Lithuania. In Estonia, the fastest price rise was food prices. The largest drops were prices for food, clothing and footwear in Latvia and Lithuania.

**Baltic wages rose last year.** In the fourth quarter of last year, the average gross monthly wage in Estonia was 5,900 kroons (380 euros), in Latvia 170 lats (305 euros) and in Lithuania 1,100 litas (310 euros). Nominal wages rose 11 % y-o-y in Estonia, 9 % in Latvia and 1.3 % in Lithuania. Highest wages were paid in the financial sector, while the lowest wages were in agriculture.

The average monthly old-age pension in 4Q 2001 was 100 euros in Estonia, 105 euros in Latvia and 90 euros in Lithuania. Last year pensions rose most in Estonia (4 %) and least in Lithuania (1 %).

**Lithuanian unemployment continues to rise.** Unemployment rates for 4Q 2001 as calculated with ILO methods were 11.9 % in Estonia, 12.9 % in Latvia and 17.5 % in Lithuania. An improved employment situation helped lower unemployment last year in Estonia. Latvian unemployment fell slightly as the labour force shrunk while the number of jobs remained unchanged. A rapid loss of jobs in the agricultural sector has been the main driver in increasing Lithuanian unemployment.

Unemployment rates are clearly higher in rural areas. The Baltic states have also had problems with youth unemployment and long-term unemployment.

**Unemployment rates (ILO) in Baltic countries, % of workforce**
Sergei Ignatiev takes over as CBR chairman. In a vote of 290 to 40, the Duma approved on Wednesday (20 Mar.) president Putin’s nomination of Sergei Ignatiev (54) as the new head of the Central Bank of Russia. Mr. Ignatiev’s résumé includes posts as deputy minister of economy and finance, CBR vice chairman, aide to president Boris Yeltsin and most recently first deputy finance minister. Ignatiev, who is from St. Petersburg, recently announced that he intended to continue policies geared towards stability of the rouble.

The CBR’s long-time chairman Viktor Gerashchenko (64) headed the central bank already in the Soviet era. Gerashchenko took over at the helm of the CBR in summer 1992 until autumn 1994. He was reappointed to head the CBR in autumn 1998, a position he held until he was replaced last Friday. His current term was officially slated to end in September. Mr. Gerashchenko had recently been at odds with the government and president on issues that included central bank independence, relaxation of currency controls, divestment of central bank holdings in commercial banks and reform of Russia’s banking sector.

Russian industrial output growth slowed in February. Industrial output grew only 2 % y-o-y in February, although the workday-adjusted figure was 3.8 %. The trend for seasonally adjusted industrial output, however, declined for the fifth month in a row. The industrial sectors registering highest growth in the first two months of the year were non-ferrous metallurgy and the food industry (up 8 to 9 % y-o-y). Fuel production rose 6 %, while crude oil output increased 8.5 % and natural gas production revived to 2 % growth. Production levels in ferrous metallurgy and the chemical industry fell slightly. Production of machinery and equipment contracted 3 %.

Little change last year in Russian companies’ reliance on barter or payment arrears situation. According to the Russian Economic Barometer, the share of barter fell in the couple of hundred industrial firms it tracked in the first half of 2001, but the share of such transactions levelled off at around 14 % during last autumn. The State Statistics Committee’s monitoring of Russia’s largest tax-paying enterprises and monopolies, found that among those firms the share of non-monetary exchanges averaged between 22 – 23 % throughout 2001. Offsets included in this figure, hovered around 10 %, while IOU’s stood at 7 – 8 %. In the State Statistics Committee’s broader monitoring of large and medium-sized enterprises, payment arrears of such firms to other firms increased in relation to GDP last autumn at the same modest pace as during autumn 2000. At the end of 2001 such arrears stood at about RUB 750 billion (about 12 % of the enterprise sector’s total working capital; the share in 2000 was just under 15 %).

The State Statistics Committee’s broader survey also found that the nominal value of payment arrears to public sector budgets fell in autumn 2001 by around 10 % to under RUB 630 billion. The tax ministry, however, reports that debts owed to various budgets are on the order of RUB 1,600–1,700 billion, of which late payment penalties constitute at least a third. The government initiated a campaign last year to get defaulting companies to petition for adjusted payment schedules on arrears of RUB 500–600 billion. The deadline for applying for a rescheduling of arrears payments was originally last December, but the deadline was moved to 1 April, 2002 for companies involved in agriculture and defence. The government has planned to initiate bankruptcy proceedings against firms that fail to apply for restructuring of their arrears.

Russian government approves draft proposal on sale and purchase of agricultural land. The proposal now goes to the Duma, where deputies have also prepared another five versions of the farmland bill. Once approved, the new law would complement the land code passed last autumn, which was silent on sales of agricultural land. Nearly a quarter of all Russia’s land area is classed as agricultural land – and that does not include forestlands. Some 61 % of farmland is owned by the federal government or local administrations, while about 30 % belongs to private individuals and a few per cent to private enterprises. The government’s draft proposal would permit foreign ownership of agricultural land except in border regions to be later specified by the president. The land must be kept for agricultural purposes, or it will be seized. The draft gives Russian regional or local administrations pre-emptive purchase rights on all agricultural land. Regional and local administrations also have the power to set limits on how much land a particular landowner can own in a given administrative raion. The draft bill says that the ceiling on ownership can be set no lower than 35 % of a raion’s total agricultural land. The draft bill also contains a clause on land privatisation that could be interpreted as giving regions the right to postpone implementation of the law.

Changes in Russian export tariffs. From the beginning of April, export tariffs on oil and certain unrefined oil products will be raised from a current $8.00 a tonne to
$9.20 a tonne. The changes in oil export tariffs are linked to changes in oil prices on a certain scale. The new export tariffs are based on an average price of $18.60 a barrel for Urals-grade crude in the period January-February.

At the start of next month, export tariffs on select iron and steel products will fall from 5 % to 3 %. In mid-March, the export tariff on nickel was lowered from 10 % to 5 %.

Foreign direct investment inflows last year nearly covered Estonia’s current account deficit. Net foreign direct investment in Estonia was EEK 6.1 billion in 2001. The current account deficit was 6.5 % of GDP, the same level as in 2000. Estonia’s trade balance remained in deficit. Although exports started to shrink last summer, the trade deficit remained at the same level as in 2001 as imports also fell. Growth in the service sector surplus was driven by expansions in transport and tourism. The current account deficit also increased due to substantially higher profits paid out from Estonia to investors abroad mainly as earnings on foreign direct investments. Current transfers to Estonia, e.g. support paid out of EU funds, rose to EEK 3.5 billion (€220 million).

FDI inflows to Estonia last year reached a record EEK 9.4 billion. Reinvested profits accounted for a substantial share of investments. The largest FDI inflows came from Finland and Sweden. The main share of investments went to the financial sector, municipal infrastructure, manufacturing and the trade sector. FDI outflows from Estonia tripled last year and went mainly to Lithuania and Latvia.

**Latvian GDP rose 7.6 % last year.** Despite slight slowing in growth at the end of the year, Latvian GDP still grew briskly in the fourth quarter (6.3 %). Growth is likely to slow further this year, and Latvia’s current growth projection for all-2002 is around 5 %. Latvian per capita GDP in 2001 amounted to 2,016 lats (3,600 euros).

Services accounted for 70 % of GDP last year, with retail, transport and communications, real estate and corporate services constituting the largest sectors. Manufacturing continued to account for 15 % of GDP, while agriculture accounted for 2.5 % of GDP.

Among the largest service industries last year, real estate and corporate services rose 14 % and retail was up 11 %. The brisk 10 % on-year growth in transport and communications slowed towards the end of the year as growth in volumes of cargo handled at ports and rail freight slowed. Manufacturing growth (10 %) also slowed towards year-end. Growth in agricultural output, on the other hand, revived towards the end of the year and finished overall up 5 %.

**Latvian GDP growth by sector, percentage change**

![Graph of Latvian GDP growth by sector, percentage change](image)

**Russia: RUB/EUR & RUB/USD exchange rates (CBR)**

![Graph of Russia: RUB/EUR & RUB/USD exchange rates (CBR)](image)

**Russia: 31 – 90 days interbank rate (Mibor), % p.a. (CBR)**

![Graph of Russia: 31 – 90 days interbank rate (Mibor), % p.a. (CBR)](image)

**Russian share prices (RTS)**

![Graph of Russian share prices (RTS)](image)

**Baltic share prices (Estonia and Latvia the left scale, Lithuania the right scale)**

![Graph of Baltic share prices (Estonia and Latvia the left scale, Lithuania the right scale)](image)
Russian economic growth slowed in February. The State Statistics Committee’s index of output by Russia’s five main economic sectors rose 2.8 % y-o-y in February compared to 3 % y-o-y in January. Growth in industrial output was a relatively modest 2 % y-o-y in February, but agricultural output was up in February over 4 % y-o-y just like the month before. Transport growth revived to over 5 % in February (2 % in January). Growth in retail sales was 9 %, a slight drop from 10 % in January. Construction activity was up 1 % y-o-y in February (4 % in January). Investments were virtually unchanged from a year earlier in February (up 0.1 %) and January (up 0.5 %). However, the economy ministry’s workday-adjusted and seasonally adjusted figures for February show industrial output, retail sales, investments and transport rose slightly from January.

Profits of Russian enterprises down in 2001. The State Statistics Committee reports that the enterprise sector (not including small firms, banks and insurers) posted a net profit last year of RUB 1,145 billion (nearly €44 billion), or a bit less than 13 % of GDP. Net profits increased in nominal terms only about 1 % from the year 2000, when they corresponded to over 15 % of GDP. According to the Statistics Committee, its figure for net profits last year reflects the profitable performances of about 69,000 firms (RUB 1,314 billion) and losses of around 43,000 firms (RUB 169 billion).

Industry’s share of net profits last year fell to 53 % (from nearly 70 % in 2000), mainly due to lower profits from non-ferrous and ferrous metallurgy, whose share shrank from 20 % to 11 %, and crude oil production, which fell from nearly 25 % to under 20 %. In real terms (inflation adjusted), net profits were up in firms involved in machinery and equipment (7 % share) and the food industry (4 % share). The fastest growth in profitability was in the trade sector, which rose to 20 % of the total. This includes foreign trade, which increased its share to 13 %. The transport sector continued to account for about 10 % of net profits.

Russia promises to curb crude oil exports during second quarter. Following the meeting with some OPEC leaders early in March and the leaders of Russia’s largest oil companies last week, prime minister Mikhail Kasyanov announced that the 150,000 barrels-a-day cut in crude oil exports in the first quarter of this year will continue in the second quarter. Several assessments have found that Russia is having difficulties in monitoring the export cuts and suggest the cuts may lead to increased export of oil products. World prices for crude oil rose in March. Recently, the price of Brent crude has been running at 24 – 25 dollars a barrel, while Urals crude has been around 23 – 24 dollars a barrel. Energy minister Igor Yusufov said Russia expects crude oil production to rise to 352–360 million tonnes this year, which translates to a level of 7.1–7.2 million barrels a day and represents a 1–3 % increase over last year.

Russian government proposes tax code amendments. The Russian government has drafted amendments to the second part of the tax code with a view to increasing revenues to regional budgets. Elimination of the road tax at the start of 2003 is expected to reduce revenues to regional and local budgets about 10 %. To make up for the loss, the government has proposed introduction of a new traffic tax at the start of 2003 that would combine the current road tax and the property tax on vehicles owned by individuals. Under the plan, a ceiling on the traffic tax will be imposed at the federal level, while the regions would be allowed to set a lower traffic tax or a graduated traffic tax. The government also will try to boost revenues to regional budgets with a 15 % increase in rouble-denominated excise taxes at the beginning of 2003. The excise on certain products would be larger, e.g. the excise on beer would go up 25 % and cigarettes and motor fuels would increase 70 %. The government wants an 80 % increase on land taxes from the start of 2003 and will transfer the resulting tax revenues from the federal budget to regional budgets. The government has also proposed reducing the share of profit taxes now going to the federal budget from 7.5 percentage points to 6 percentage points and redirecting the difference to the regions. All these measures, however, will still not fully cover the losses to regional budgets caused by the elimination of the road tax.

Bumpy road for Russian pension reform. The revised pension scheme introduced at the beginning of this year has so far failed to perform according to plan. The largest dispute relates to investment of mandatory pension contributions. The first reading of a bill on the matter was only approved last December. Since there is no law yet, the funds obviously cannot be invested. On 18 March, the government made an interim decision stating that assets allocated to mandatory pension contributions could be invested in Russian government bonds. The Pension Fund will now make its decision based on the finance ministry’s approval. The draft bill would allow private pension funds, starting in 2004 at the earliest, to compete for investment of mandatory contributions. Several Duma deputies believe this should happen sooner rather than later. The Union of Russian Industrialists and Entrepreneurs, as well as the Russian Chamber of Commerce and Industry have also taken the matter to president Putin. Pension Fund director Mikhail Zurabov and deputy economy minister Mikhail Dmitriyev support rapid approval of the act’s savings sections, with separation of the disputed parts dealing with private pension funds to be treated as a separate act.
**Russian election dates.** Russia’s central election board announced that the legislated days for the next Duma election will be 21 December 2003 and the next presidential election on 7 March 2004. Under the Russian constitution, the president designates Duma elections and the parliament’s upper-house Federation Council designates presidential elections.

**Estonia has lowest government debt among the Baltics.** Estonia’s government debt at end-January was EEK 2.5 billion (€160 million), of which about half was foreign debt. The government debt shrank slightly last year to below 3% of estimated GDP.

Latvia’s government debt at end-January was LVL 710 million (€1.3 billion), which corresponded to nearly 15% of GDP. Foreign debt represented LVL 450 million. Latvia’s foreign debt increased substantially last November when the government issued €200 million in eurobonds.

Lithuania’s government debt stood at LTL 12.9 billion (€3.7 billion) at the end of January, which corresponds to about a quarter of GDP in 2001. The debt rose 2% from a year earlier. The largest part of the debt, nearly LTL 10 billion, was foreign debt.

**Finnish HEX Group offers to purchase majority stake in Riga Stock Exchange.** Last week (18 Mar.), the HEX Group, which operates the Helsinki Stock Exchange, offered to buy at least 75% of the company that operates the Riga Stock Exchange. A condition of the sale is that the Riga Stock Exchange must acquire the shares of the Latvian Central Securities Depository. If the deal goes through, it would create a combined Latvian bourse and securities depository based on structure similar to that in place in Finland and Estonia. The deal is expected to increase interest in owning Latvian shares. The HEX Group bought a majority stake in the Tallinn bourse last year.

**Poland’s GDP grew just 1.1% last year.** The Central Statistical Office of Poland reports economic growth slowed towards the end of last year, and GDP only grew 0.3% in the fourth quarter. GDP per capita last year was 18,700 zloty (5,100 euro).

Industrial output, which accounts for over 20% of GDP, fell 0.6% last year. Construction (7% of GDP) fell 7.6% y-o-y. Private services, which represent about 45% of GDP, rose about 4%, matching its growth in 2000.

Growth of the Polish economy has been driven by investment (fixed capital formation) for years, so the drying up of investment last year (down about 10%) had a distinct impact on growth. Reasons for the slowdown include lower profits of Polish firms and high interest rates (the central bank’s reference rate is about 7% in real terms and the lending rates to firms about 13%). Economic growth was sustained by about 2% in private consumption and faster growth in exports than in imports.
Rouble weakened moderately last month. While the exchange rate of the rouble continued to dip in relation to the US dollar during March, the rouble’s decline was less than in January and February. The drop in relation to the euro was steeper in March, reflecting euro strengthening. During January-March, the rouble’s exchange rate in relation to the dollar weakened at a rate of slightly more than one per cent a month. The basic scenario used in developing the government’s economic outlook (in February) for this year assumes the rouble will lose a bit less than 1 % of its value against the dollar each month or just under 11 % for the year.

Changes in rouble exchange rate, January-March 2002

<table>
<thead>
<tr>
<th>Month</th>
<th>In relation to the US dollar</th>
<th>In relation to the euro</th>
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</thead>
<tbody>
<tr>
<td>January</td>
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</tr>
<tr>
<td>February</td>
<td>-0.8</td>
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</tr>
<tr>
<td>March</td>
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<tr>
<td>January-March</td>
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</table>

Russia’s Supreme Court decision would modify CBR currency controls. The Central Bank of Russia’s currency controls now require that exporters sell 50 % of their foreign currency earnings via one of eight authorised currency exchanges or directly to the central bank. At the beginning of April, the Russian Supreme Court declared that the CBR did not have the authority to limit a firm’s choice as to where it sells its export earnings. The Court found that the CBR instruction violated several laws and that those parts that did not conform to the law should be voided as soon as the court’s decision takes effect. This means that although the CBR’s currency sales instruction would still stand, exporters would decide to whom they sell their export earnings. The CBR is likely to appeal the ruling, claiming that the current arrangement provides it with a valuable exchange rate policy tool and helps stabilise the rouble’s external value. The Moscow Stock Exchange (MFB) originally brought suit challenging the validity of the CBR instruction.

Russia’s consolidated 2001 budget shows large surplus. Russia’s 2001 consolidated budget – the combined total of federal and regional budgets – showed a surplus of RUB 267 billion or roughly 3 % of GDP. Total revenues were RUB 2,674 billion (29.6 % of GDP) and expenditures RUB 2,408 billion (26.6 % of GDP). Compared to 2000, revenues in relation to GDP increased, and governments succeeded in reducing expenditure about one percentage point of GDP. Nearly 90 % of revenues came from taxes. The single largest revenue stream was the value-added tax, which accounted for a quarter of all revenues. The profit tax (19 % of total revenues) and customs tariffs (12 %) also provided sizeable revenue streams. The flat 13 % income tax income tax introduced at the start of 2001 did not diminish budget revenues. Instead, income taxes collected were up both in relation to GDP (2.8 % of GDP in 2001) and as a share of consolidated budget revenues (nearly 10 %).

The largest spending item by far was social and culture expenditures, which accounted for over 30 % of total spending in 2001. Spending on debt interest and the military each accounted for about 10 % of consolidated budget expenditures. Relatively speaking, the largest growth in expenditures occurred in the industry, construction and energy sectors, which represented nearly 7 % of total expenditures in 2001 compared to just 3 % in 2000. Revenues and expenditures of budget funds contracted substantially after the elimination of ten federal budget funds.

Russian government approves 2002 investment program for natural gas producers. The program, valued at RUB 157 billion (€5.7 billion), includes some RUB 140 billion in investments by gas giant Gazprom. Gazprom said that even with the investment program it still faces a RUB 15 billion shortfall due to Russia’s current low domestic prices on natural gas. The company has asked for an increase in domestic rates from the start of July. Gazprom’s main investment targets this year are its gas pipeline running from Zapolyarnoe to Urengoi, construction on its main pipeline to Torzhok in order to bypass Ukraine, increasing the capacity of the Yamal to Europe pipeline and construction of the Blue Steam pipeline, which will run from Russia to Turkey. Gazprom expects to raise at least RUB 9 billion in additional financing this year by selling off side businesses. Gazprom’s natural gas production target this year is 520 billion cubic metres (523 billion cubic metres in 2000).

The government earlier approved investment programs for two other natural monopolies: RUB 83 billion to electrical power producer and distributor UES and RUB 94 billion to the national railways.

Estonia and Lithuania enjoyed robust economic growth in 2001. Estonia’s GDP grew 5.4 % last year. Economic growth showed a surprising pick-up towards the end of the year, with GDP growth reaching 5.7 % year-on-year in the fourth quarter. Estonian GDP per capita last year rose to EK 70,000 (€4,450). Estonian economic growth last year was driven mainly by domestic demand: fixed capital investments increased 17 % and private consumption rose over 3 %. Public consumption remained at the previous year’s level. Service exports grew 9 % last year, while goods exports fell 6 %. Domestic demand will mainly determine economic growth this year and GDP is projected to grow about 4 %.

The service sector continued to account for about 65 % of GDP. All main service sectors – traffic, retail, and corporate and real estate services – grew about 6 % last year. Hotels, restaurants and financial services grew 9 %. Manufacturing, which accounted for 18 % of GDP, grew 8 % last year. Agricultural output rose 5 % and its share of
GDP was just under 4%. Construction activity increased nearly 6% last year.

Lithuania’s GDP also grew a bit faster than anticipated – 5.9% for the year. GDP growth accelerated in the fourth quarter, reaching 7.9% y-o-y. Growth for the year was driven by fixed capital investment, which grew 10.6%. Public consumption was practically unchanged from 2000, while private consumption rose 3%. Lithuanian GDP per capita in 2001 was estimated at LTL 13,750 (€3,540).

Opposition rolls to victory in Ukraine’s parliamentary election. Nearly 70% of Ukraine’s 36 million eligible voters turned out for last Sunday’s (31 Mar.) parliamentary election. Initial returns indicated that the Our Ukraine bloc, led by former prime minister Viktor Yushchenko, fared best, garnering 112 seats in Ukraine’s 450-seat parliament (70 from party lists and 42 from single representative districts). The For a United Ukraine bloc, which supports President Leonid Kuchma, won 102 seats (36 + 66), the Communists took 66 seats, the Socialists 24, and the Social Democrats 23. The biggest upset of the election was scored by former deputy premier Julia Timoshenko’s bloc, which took 21 seats. Ukraine’s next parliament will also include 93 independent deputies and deputies from four tiny factional parties.

Country risk rankings of transition economies continue to improve. Like in last September’s survey, the semi-annual country creditworthiness ratings in March issue of Euromoney covered 185 countries. Institutional Investor’s survey saw its number of countries rated rise from 145 last September to 151 last month. Estonia, Lithuania, Poland and Slovakia saw their rankings rise in both surveys. Latvia and the Czech Republic gained in the Euromoney rankings, while Hungary rose in the Institutional Investor survey. Russia’s ranking improved substantially in the Institutional Investor survey, but fell in the Euromoney survey. Institutional Investor upped Ukraine’s assessment.

### Country risk rankings of select transition countries

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#### Russia: RUB/EUR & RUB/USD exchange rates (CBR)

#### Russian share prices (RTS)

#### Baltic share prices

5.4. 25.4. 18.5. 7.6. 28.6. 18.7. 5.8. 23.8. 12.9. 2.10. 24.10. 12.11. 30.11. 21.12. 5.1. 4.2. 22.2. 18.3. 5.4.

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Information herein is compiled and edited from a variety of sources. The Bank of Finland assumes no responsibility for the completeness or accuracy of the information.
Russia and Germany agree on Soviet-era debt. At a two-day meeting in Weimar, Germany this week (9-10 Apr.), Russian president Vladimir Putin and German chancellor Gerhard Schröder reached agreement on how Russia would pay off Soviet-era debts originally owed to East Germany. The debt was originally valued as 6.4 billion transferable roubles. Under the agreement Russia would pay €350 million, of which €500 million would be paid by the end of this year and the rest in two subsequent payments by February 2004. Germany, in turn, committed to double its ceiling on export credits to Russia granted through Hermes export credit agency to €1 billion. In talks between Putin and Schröder last year, Germany demanded the exchange rate of the transferable rouble to be valued at about one US dollar, while Russia was only willing to accept a third of that. In the new agreement one transferable rouble is worth of about 7 US cents. The agreement has no effect on Russia’s $40 billion Soviet-era debt owed to Paris Club creditors. Russia owes Germany about 40% of that amount.

Russia monthly inflation 1.1% in March. On-month inflation was 3.1% in January and 1.2% in February. In March, the 12-month rise in consumer prices was about 17%. In the first quarter of 2002, prices rose 5.4% (7.1% in 1Q 2001). The sharpest gains in March were registered in prices for services (up 3.7% m-o-m), driven mainly by higher housing costs (6.3% m-o-m). Food prices increased 0.5% m-o-m and other goods 0.7%. Since December 2001 prices have risen most in the service sector. Housing costs have risen nearly 20%, telecommunication tariffs 19% and passenger traffic fares nearly 11%. Among foodstuffs, vegetable prices have risen most (up nearly 23%) compared to December 2001. The largest prices rise in other goods was in pharmaceuticals (up 10%).

CBR lowers refinancing rate. On Tuesday (9 Apr.), the CBR lowered its refinancing rate from 25% to 23%. Market analysts said the move would have hardly any impact on Russia’s financial markets. In recent years, the refinancing rate has not been reflected in e.g. yields on GKO treasuries, which have averaged around 13% since 2000. In January 2002, the average interest on deposits of under one year was 4.9% and the interest on loans of less than a year was 18.2%. The refinancing rate was last adjusted in November 2000.

Bank deposits and lending in Russia in 2001. Growth of bank deposits represented just 4.5% of GDP last year, compared to nearly 6% of GDP in 2000. Although growth in deposits by households increased to over 25% of GDP, growth in enterprise deposits slowed to 1.5% of GDP. At the same time, the rouble-cash supply circulating outside banks grew by nearly 2% of GDP. The deposit stock in Russian banks corresponded to 17% of GDP at the end of 2001. Of that, about 7.5% were deposits from households. Rouble-denominated deposits corresponded to 11% of GDP and foreign currency deposits 6% of GDP. Roublle cash in circulation represented about 6.5% of GDP.

Growth of bank lending recovered slightly last year. Total receivables owed to Russian banks by firms and households grew by under 6% of GDP (5% of GDP in 2000). Rouble-denominated loans to firms continued to grow at the 2000 pace (3.5% of GDP), and growth of foreign currency loans to enterprises rose to nearly 1.5% of GDP. Lending to households also rose and corresponded to 0.6% of GDP. The stock of loans and other receivables owed to banks by firms and households stood at 16% of GDP at the end of 2001. Of that, 9% was rouble-denominated loans to enterprises, 4% was foreign currency loans to enterprises, and 1% was loans to households.
Baltic inflation slows in March. The rise in consumer prices in March was 4.3% y-o-y in Estonia (4.4% in February) and 3.2% y-o-y in Latvia (3.3%). Lithuanian inflation slowed to 1.6% y-o-y (2.8% in February), and prices fell 0.7% m-o-m in March. The drop in prices was mainly due to lower prices for food and phone calls. Consumer prices in March were up 0.3% m-o-m in Estonia and 0.4% in Latvia.

Current account deficit rises in Latvia, falls in Lithuania. Latvia’s current account deficit rose last year to 10.1% of GDP. The increase was due mainly to the widening trade deficit as imports grew faster (18%) than exports (12%). Strong domestic consumption and large investment projects such as fleet additions by the Latvian Shipping Company (LASCO) increased imports. Latvia’s service sector surplus grew last year as the important transport sector benefited from favourable economic developments in Russia. Volumes of oil transit freight increased substantially. FDI inflows into Latvia last year amounted to less than LVL 130 million (€220 million) – just half of FDI in 2000. Last year’s FDI was only sufficient to cover about 25% of the current account deficit. The lower-than-expected investment level was caused in part by delays in numerous large privatisation sales.

Lithuania’s current account deficit last year equalled 4.8% of GDP. The country’s large trade deficit was reined in as exports grew faster than imports, particularly in the first nine months of 2001. The rising service sector surplus was driven by growth in the transport sector. FDI inflows into Lithuania last year increased to LTL 1.8 billion ($510 million), which was sufficient to cover nearly 80% of the country’s current account deficit.

Baltic countries’ current account deficits, % of GDP

Russia: RUB/EUR & RUB/USD exchange rates (CBR)

Russia: 31 – 90 days interbank rate (Mibor), % p.a. (CBR)

Russian share prices (RTS)

Baltic share prices

(Tallinn, Riga and Tallinn, Latvia the left scale, Lithuania the right scale)
Russian industrial output revived slightly in March. Growth in industrial output in March was 3.7% y-o-y and the workday-adjusted figure exceeded 5% y-o-y (compared to less than 4% in February and just over 2% in January.) Industrial output was up 2.6% y-o-y in the first quarter and the workday-adjusted figure was 3.7%. After several consecutive months of decline, the seasonally adjusted trend in industrial output rose in March.

The growth in industrial output in the first quarter was led by non-ferrous metallurgy (up nearly 9% y-o-y), the food industry (7%) and the fuel industry (6%). Crude oil production, part of the fuel industry figure, rose nearly 9%, while natural gas production was up nearly 2%. As for the other large industries, machinery and equipment grew less than 1%, while chemical and petrochemical production showed no change. Ferrous metallurgy fell nearly 1%, while electricity and heating production was down nearly 5%.

Statistics Committee releases fourth-quarter GDP data for 2001. GDP growth slowed in the fourth quarter to 4.3% y-o-y. Growth in private consumption fell to around 7% from more than 8% in the third quarter. Fixed capital formation, on the other hand, rose over 16% in the fourth quarter, which was a substantially higher rate than in any other quarter last year. The figures for all 2001 remained unchanged so far, i.e. GDP grew 5%, private consumption rose just under 9% and fixed capital formation was up nearly 12%.

Growth in Russian GDP, private consumption and fixed capital formation, percentage change from four quarters previous

Russia’s grey economy said to employ nearly 13% of labour force. The State Statistics Committee reports slightly over 8 million Russians work in the grey economy. Of those, about 80% get their main income from the grey economy. The remaining 20% get supplemental income from grey economy activities. The grey economy is more prevalent in rural areas than in urban areas. Nearly a quarter of Russia’s rural labour force are somehow involved in the grey economy, compared to 9% of workers in cities and towns. Grey labour is most common in wholesale and retail trade and food services (which together account for 40% of all grey economic activity). Nearly a third of workers involved in the grey economy work in agriculture or forestry. The Statistics Committee’s figures on the grey economy are from November 2001 and based on the Committee’s own survey.

Tax relief proposed for Russia’s small firms. The Russian government has approved draft amendments pertaining to taxation of small companies for eventual submission to the Duma. Deputy finance minister Sergei Shatalov said the government wants to lower the taxation on small firms 50–75% and eliminate the bureaucratic red tape that currently hinders their operations. The changes would only apply to firms employing less than 21 people and with annual revenues below RUB 10 million (€364,000). The new rules would not apply to banks, securities firms or regulated gambling activities. Small firms in certain fields (retail shops, building renovation, etc.) would be subject to an estimated tax. Small companies operating in other fields would be allowed to select one of two taxation schemes in 2003–2004: either a flat 8% sales tax, or alternatively a 20% tax on gross income from which certain expenses could be deducted. The chosen scheme would then replace the VAT, profit tax, sales tax, property tax and social tax small firms are currently obligated to pay. Some 30% of taxes collected
from small firms go to the federal budget, 15 % to regional budgets and 45 % to local budgets. The remaining 10 % of income would go to cover health care and social insurance costs. By reducing the tax burden and red tape faced by small firms, the government hopes to encourage firms to operate within the law. The tax ministry estimates that the RUB 25 billion presently collected from small firms will rise to RUB 100 billion with the changes. The amendments should be enacted by the beginning of 2003.

LASCO privatisation moves ahead. On 8 April, a 32 % stake in the Latvian Shipping Company (LASCO) was sold for privatisation coupons at auction. Over 64 million shares were sold at a bid price of 1.11 lats (2 euros) per share, i.e. slightly more than the initial minimum asking price of 1 lat. Latvia’s privatisation agency is expected to affirm the auction results by the end of this month. The next step in the privatisation plan will be to sell 51 % of LASCO shares on the Riga bourse. The international investment bank Williams de Broen has been selected as consultant for the sale.

Williams and YUKOS resume talks on Mazeikiu Nafta. US-based Williams International and Russia’s number-two oil company YUKOS reported progress last week in talks on revising the ownership structure of Lithuania’s Mazeikiu Nafta oil company. Currently, the negotiating parties are awaiting a go-ahead from Mazeikiu Nafta’s largest stakeholder, the Lithuanian state, for their talks to continue. Although Williams and YUKOS reached preliminary agreement on a new ownership structure and oil deliveries nearly a year ago, the talks faltered at the end of last year. In January, the firms agreed to restart their negotiations.

Under the currently proposed deal, YUKOS would purchase 26.85 % of Mazeikiu Nafta shares for a price of LTL 300 million (€90 million) and lend an equal amount to the company for refinery modernisation. YUKOS would also commit to supplying Mazeikiu Nafta with nearly 5 million tonnes of crude oil annually over the next ten years. Williams would continue to handle Mazeikiu Nafta’s operations, but YUKOS would participate in corporate decision-making. Williams’ stake would fall to 26.85 %, while the Lithuanian state will have a 40.66 % stake.

Mazeikiu Nafta is Lithuania’s largest company. It has lost money in recent years because of its aged refinery and interruptions in crude oil supplies. The company posted a loss of LTL 270 million (€80 million) in 2001. This year, the refinery has processed considerably less crude oil than in 2001 and refining margins have been running below forecast. The amounts of crude pumped through Mazeikiu Nafta’s pipeline have also fallen. The company’s Butinge oil terminal, which was closed last November after an oil spill, reopened at the end of March.
Russian economic growth recovered in March. The State Statistic’s Committee’s indicator of growth based on five key sectors of the Russian economy rose in March 4 % y-o-y. In January and February, the index showed growth of 3 % y-o-y. For the first quarter of 2002, growth was 3.3 % y-o-y. Retail trade increased 9 % in the first quarter, while agricultural output was up over 5 % and transportation 4 %. Industrial output and construction activity slowed to below 3 %. Investment rose just 1 %.

Growth in five key economic sectors in Russia 2000 – 2002, percentage change from four quarters previous

Putin’s state-of-the-nation address emphasises acceleration of economic reform. In his annual state-of-the-nation address to the Russian parliament last Thursday (18 Apr.), president Vladimir Putin said Russia’s main goals (development of democracy, well functioning markets, a constitutional state and raising living standards) remain the same. His recitation of major achievements in 2001 included the continued economic growth, job creation, an increase in real incomes (especially higher pensions), the budget surplus and passage of important legislation.

He warned that difficult problems remain unsolved. For example, some 40 million Russians still live in poverty. Moreover, Russia needs to strive for faster growth track than current government estimate (3.5 – 4.6 %) and greater efficiency is needed in the public and private sectors. Topping the list of needed reforms are administrative reforms, elimination of bureaucracy and corruption, and reform of the judiciary. In the enterprise sector, work needs to continue on creating operating conditions conducive to smaller firms, as well as reform of natural monopolies.

As in last year’s address, Putin touched on relations between the centre and the regions, where the biggest problem is the allocation of authority and responsibility among various levels. Attention also needs to focus on development of local administration. Putin considers Russia’s membership in the WTO an important step in integrating Russia into the world economy. In the foreign policy sphere, the president stressed the importance of cooperation with CIS states and the EU, as well as maintaining an active dialogue with the US. He stated, “Russia seeks to change the quality of its relationship with NATO.”

IMF says Russia’s economic policies headed in the right direction. Following Article IV consultations between Russian and the IMF this winter, the IMF early this month released its staff report. According to the report, sound fiscal policies have helped produce a substantial budget surplus, which in turn eased the burden on monetary policy to contain inflation. The IMF noted, Russia’s planned mild relaxation of its fiscal stance this year is justified to sustain economic growth in a weakening external environment, but budget expenditures need to be flexible to overcome unexpected drops in revenue and the budget situation is to be carefully monitored. Russia’s efforts to curb the rise in the rouble’s real exchange rate was supported by the IMF, as growth in sectors other than energy production is crucial to overall economic growth. The report said monetary policy should be applied to permanently lower inflation and that Russia should refrain such measures as delaying hikes in administratively regulated prices as a way to reduce inflation.

The implementation of economic reforms was seen as especially challenging for Russia. The IMF encouraged caution in tax reduction to assure that costs of reform activities could be financed. Regarding the banking sector, the IMF warned that Russia preferably should hold off on its planned introduction of a deposit insurance scheme until adequate regulation of banking activities and financial supervision are in place. Moreover, Russian needs to emphasise the importance of central bank independence in setting monetary policy in the current round of amendments to the central bank law. The IMF encouraged Russia to continue its progress and set a timetable for phasing out currency controls introduced after the 1998 financial crisis.

Minimum wage to rise from the first of May. Russia’s new minimum monthly wage will rise to 450 roubles (16 euros) at the beginning of next month. The minimum wage is used in setting e.g. state sector salaries, social payments and student stipends. The minimum wage was last raised in July 2001 from 200 roubles a month to the current 300 roubles.

Lithuania’s privatisation agency approves German consortium’s bid for Lietuvos Dujos gas company. A consortium of German Ruhrgas and Eon submitted the sole bid on a 34 % stake in Lietuvos Dujos. Although Lithuania’s privatisation officials announced the German companies won the bidding competition at the beginning of April, the deal still awaits the Lithuanian government’s approval. The bid figure was not released. Once the strategic investor selection is finalised, another 34 % stake will be sold to a natural gas supplier.
EU accession talks increasingly focus on toughest chapters. With the exception of Bulgaria and Romania, all EU candidates have completed chapters of the *acquis communautaire* on freedom of movement of goods, persons, services and capital in the Internal Market. A few countries still have sticking points mostly regarding chapters on competition policy, taxation, and justice and home affairs. Otherwise, the biggest hurdles of the talks – the chapters on agriculture, regional policy, and the EU budget – now loom close. The EU’s joint position on the budget chapter is still open, but the EU has issued a preliminary common position on regional policy with respect to certain candidate countries. In April, the European Commission sent member countries a draft of its common position on agriculture. The EU proposes that direct agricultural supports from the EU to new members would increase incrementally so that in 2004 new members would be allotted 25% of the agricultural support received by established member states and by 2013 they would receive full allotments.

In April, the European Commission opened initial talks on the institutions chapter, bringing the number of negotiable chapters in the *acquis* to 30. Cyprus currently leads the standings, having closed 27 chapters already. Central and Eastern European countries that seek to complete their talks this year and join the EU in 2004 have reach preliminary agreements on 23 – 26 chapters. While Bulgaria and Romania do not belong to this group, Bulgaria made substantial progress in its negotiations this spring.

The European Commission has just published its forecast of economic development in accession candidate countries for 2002 and 2003. Last year GDP growth in EU candidates in Central and Easter Europe averaged 3.1%. This year the Commission expects growth to slow to 2.9%. The global downturn reduced economic growth in candidate countries in the second half of 2001 and will influence growth figures this year. The Commission believes exports from accession candidates will recover this year and next year, and forecasts economic growth will average around 4% in 2003.

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<th>Country</th>
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*European Commission forecast released 24.4.2002
Russian unemployment fell slightly in first quarter. The State Statistics Committee reports that, as of end-March, unemployment calculated using ILO methodology stood at 6.3 million persons, or 8.9% of the labour force. Some 50,000 fewer persons were unemployed than at end-2001, when the unemployment rate was 9%. The number of persons employed also fell by 150,000 persons in the first quarter and the labour force by 200,000 workers. The State Statistics Committee said there were 70.6 million persons in the labour force as of end-March.

Unemployed persons, percentage of labour force

Russia’s population continued to decline in 2001. There were 1.3 million births and 2.2 million deaths last year in Russia. The natural population decline was thus 0.9 million persons, or the same rate as in 1999 and 2000. Net immigration, however, was down. Last year over 120,000 persons emigrated from Russia, while nearly 200,000 persons immigrated to Russia. Thus, there was a net gain of around 70,000 persons. Natural population decline has reduced the Russian population by nearly 8 million since the beginning of 1992. Recorded net immigration, in turn, has added nearly 3.5 million, i.e. nearly 4 million people have left Russia and over 7 million have moved to Russia. At the beginning of this year, the Russian population stood at 144 million.

Duma reversed the amended version of central bank bill to second reading. Had the amendments been accepted in the third reading (Apr. 26), Russia’s central banking system would have become subject to a national banking council. The amendments would also have weakened central bank independence. Although the national banking council was supposed to refrain from making central bank policy, it would still get to approve the CBR’s financial statements and annual spending on personnel and investments. The national banking council would have also had the right to decide central bank holdings in other credit institutions, select the central bank’s auditors, supervise annual reports of the CBR board on monetary and foreign exchange policies and banking supervision. Both the Russian government and the CBR’s board opposed the proposed amendments.

CBR gets new deputy chairmen. The Central Bank of Russia’s new chairman Sergei Ignatyev named Oleg Vyugin and Andrei Kozlov as his first deputies. Mr. Vyugin’s earlier posts include deputy finance minister and most recently head economist at the Troika-DIALOG investment bank. He will now be responsible for monetary and foreign exchange policy. Mr. Kozlov, who served earlier as a CBR deputy chairman, will oversee banking supervision and currency controls. On Wednesday 24 Apr., the Duma also approved the appointments of Vyugin and Kozlov to the CBR board of directors.

Progress in reform of Russia’s natural monopolies. The Russian government has prepared a package of four bills on reform of Russia’s railways (act on managing and controlling railway assets, railway transport act, as well as amendments to rail transport regulations and the natural monopolies act). The government submitted its proposals to the Duma last week. The most controversial aspect of the government’s proposal is the allocation of RUB 1,500 billion out of the state railways total assets of RUB 2,500 billion (over €90 billion) to set up a railways corporation.

The government has also clarified its proposal to reform Russia’s energy sector. The government last week submitted to the Duma its full draft of an energy bill, an energy conservation bill, and amendments to the natural monopolies act and the civil code.

Katanandov continues to lead Karelia. Initial returns from Sunday’s (28 Apr.) elections indicate that the Karelian Republic’s incumbent president Sergei Katanandov has won re-election, taking over 50% of vote in the first round. If the results are confirmed, he will be declared the winner and there will be no runoff. The closest challengers were the Duma deputy Artur Mikki and businessman Vasili Popov. Each received about 10% of the vote. Voter turnout was about 50%. The next elections for republic president will be held in four years.

Lithuania’s latest eurobond placement. Lithuania issued euro-denominated eurobonds last week. The eurobonds have a nominal value of €400 million and maturity of ten years. The money raised will be used to finance e.g. the budget deficit and investment projects. The eurobond carries a coupon of 5.875%, substantially less than the last eurobond placement a year ago (6.625%).

On 22 April, Standard & Poor’s raised Lithuania’s foreign currency long-term issuer credit rating from BBB- to BBB. S&P note its decision was mainly based on Lithuania’s disciplined fiscal policy and speed-up in structural reforms. Lithuania also earned kudos for its rapid progress in EU accession talks, which has led to
reforms in national administration and legislation. Fitch IBCA affirmed Lithuania’s credit rating on long-term foreign currency government bonds at BBB-, at the end of February. Moody’s rates Lithuania’s foreign currency long-term government bonds at Ba1.

Polish economic growth remains low. The Central Statistics Office of Poland announced there were no signs of economic recovery in the first quarter. According to a preliminary estimate from the statistics office, GDP increased at best just 0.3 % y-o-y in the first three months of this year, matching the rate of growth registered in 4Q01. Industrial output fell 1.6 % in 1Q02 (+2.6 % in 4Q01). Manufacturing fell 2.3 % and construction declined 15.6 %. The slowdown is the result of still ongoing dearth of investment. Investment goods manufacturing production fell about 6%, while consumer goods manufacturing production grew about 3 %. Retail sales rose 5.8 % y-o-y in the first quarter (+3.7 % in 4Q01).

Even though private consumption has supported growth, growth in imports continued to slow. According to central bank balance-of-payments figures, imports fell over 10 % y-o-y in the first quarter. At the same time exports fell 6.8 %, after averaging growth above 10 % in 2001. The decline in imports reflected weak investment demand. Demand for exports, on the other hand, was dampened by a strong zloty and recession in the EU, particularly Germany. Two-thirds of Polish exports go to EU countries. NBP figures showed a current account deficit of 4.1 % of GDP in March, about the same as at the end of last year.

Most of Poland’s economic woes are homemade. Investments have dried up mainly due to high real interest rates. The central bank’s key reference rate is now 9.5 %, while 12-month inflation was running at 3.3 % in March. Analysts generally agree Poland’s economy will begin to recover in the second half of this year and the forecasts for Polish GDP growth this year range from just over 1 % to just under 2 %.

Polish industrial output measured by sales 1998-2002, percentage change from four quarters previous

![Graph showing industrial output change](image-url)

Russia: RUB/EUR & RUB/USD exchange rates (CBR)

![Graph showing exchange rates](image-url)

Russia: 31 – 90 days interbank rate (Mibor), % p.a. (CBR)

![Graph showing interest rates](image-url)

Russian share prices (RTS)

![Graph showing share prices](image-url)

Baltic share prices (Estonia and Latvia the left scale, Lithuania the right scale)

![Graph showing share prices](image-url)
Russian on-month inflation was 1.2% in April. Monthly consumer price inflation in April remained at the same level as in February and March. The prices for services rose fastest (up 2.4% from March), with housing costs gaining 3.6%. Food prices rose 1%. Consumer prices in April were up 16% y-o-y. The on-year change was under 13% for food prices, 11% for other goods and over 38% for services. Housing-related costs were up nearly 60%.

Little change in forecasts of Russian economic growth this year; inflation estimates raised slightly. Several leading forecasts see Russian GDP growing at a rate of 3.5–4% this year. In its spring outlook of the world economy, the IMF raised its estimate for Russian growth to 4.4%, while the OECD’s corresponding survey lowered its figure to 3.5%. Their estimates see the oil price averaging around 23–24 dollars a barrel this year. The latest Russian and western consensus estimates, compiled from forecasts of banks, enterprises and research institutions, expect Russian GDP to rise 3.5% this year.

The IMF estimates Russia’s consumer price inflation will slow this year to 14%; the OECD estimate is 15%. Consensus forecasts expect prices to rise 16%. The IMF and OECD estimate that Russia’s current account surplus this year will come in at 7–8% of GDP. Consensus forecasts see the growth in Russian imports slowing to 6–9%.

Russia’s regional and local budgets near balance in the first quarter. In the first quarter of this year, regional budgets averaged slight surpluses, while local budgets posted modest deficits. The consolidated regional budget was thus slightly in surplus, continuing a pattern established in 2001. Transfers from other budget levels were the most significant revenue items for regional and local budgets. These transfers accounted for nearly 30% of revenues to regional governments in the first quarter and over 40% of revenues to local governments. The main tax revenue stream was income tax (15% of revenues to regional budgets and 24% for local budgets). Revenues from the corporate profit tax (18% of regional and 11% of local budgets) slipped from 1Q01, especially for local budgets. The share of local taxes in local budget revenues, which has never been significant, also dropped substantially. Revenues from exploitation of natural resources increased, while revenues from budget funds fell.

How money is spent at regional and local levels differs. Regional budgets pass on most of their transfers to other budget levels – mainly to local budgets (27% of all expenditures in the first quarter). At the regional level, the share of health care and budget fund expenditures are each around 10%. Expenditures on each of the other items were well below 10%. The three largest items in local budgets, in contrast, were education (37%), housing and municipal services (20%) and health care (17%).

Rapid rise in Russian real incomes continued in first quarter. The real incomes of Russians rose nearly 9% y-o-y, exceeding even the pace of 2001. The rise in wages slowed only slightly from last year, however. Nominal wages increased 40% y-o-y in the first quarter, while real wages were up nearly 19%. Pensions increased nearly 50% in nominal terms and 25% in real terms. The real wage in March regained the level of wages before the 1998 financial crisis. The average monthly wage in March was just under 4,200 roubles or 134 euros and the average monthly pension a bit over 1,300 roubles or 43 euros.

Development of disposable incomes, wages and pensions in real terms in Russia, July 1998 = 100

Turnover of Russian labour force has increased since the 1998 financial crisis. The State Statistic Committee reports that the number of workers leaving their jobs for various reasons began to rise in 2000. The Committee’s figures only cover workers at large and medium-sized firms (about 43 million persons). Another 20 million persons are estimated to work in small firms, as self-employed persons or in the grey economy. Hiring of employees has increased since 1999. Moreover, since 1999 the number of hirings and terminations have been nearly in balance. Before 1999, there were far fewer hirings than departures. In 2001, there were 12 million hirings, of which about 5% were hirings to new jobs. Some 12.4 million persons left their jobs. Officially, workers voluntarily resigned in 75% of these cases. In reality, employers often use voluntary departures as a way to avoid difficulties and expenses when the worker was actually fired. In 2001, the largest net loss of jobs, 300,000, was in agriculture (nearly 7% of agricultural workers) and 280,000 in industry (2.3% of industrial workers). The financial sector saw a net increase of over 50,000 persons (8.2% of its workforce).
IMF mission gives positive appraisal of Estonia’s economic development. The concluding statement of a recent IMF mission to Estonia praised the country’s resilient economic development in recent months. The IMF explained that the factors underlying the positive developments were the result of Estonian economic policy, which promotes markets function freely and unhindered foreign trade. The IMF encouraged Estonia to continue along its current path in creating an investment-friendly business environment.

According to the IMF, Estonia’s recent success in sustaining solid economic growth was remarkable, given that its main export markets in Western Europe have been dogged by recession. Economic growth has been sustained through domestic demand, due to an improved employment situation and higher salaries. The IMF noted that the unemployment rate is still high, however, and encouraged Estonia to take measures to improve the flexibility of its labour market. Flexibility was seen as extremely important in Estonia’s case as its monetary policy leans on a currency board arrangement. The IMF noted that the currency board has served the Estonian economy well and should be continued.

The mission praised Estonia’s fiscal prudence, which has kept public deficits under control in recent years, but remarked that that the country had little room for relaxing its fiscal stance in coming years as both EU and NATO memberships will likely increase spending. The IMF forecasts Estonian GDP growth overall this year will come in at around 4.5 %. Inflation is expected to average around 5 % due to strong domestic demand, high oil prices and hikes in administered prices.

Transhipments from Russia via Estonia increased in the first four months of 2002. The volume of transit cargo moving through the Tallinn harbour increased by about 25 % y-o-y in the period January-April. In particular, the volumes of oil and grain shipped via Estonia rose substantially. Transit volumes are now so high that constraints on capacity can be seen in Russia’s railways.

The volume of freight moving through Latvia declined slightly in the first quarter. Oil shipped via the Ventspils terminal fell 8 % from a year earlier.

The volumes of cargo handled at Lithuanian harbours also fell in the first quarter. The development may be a sign that Russia wants to direct more of its shipments via its ports in the Gulf of Finland.
Despite first-quarter slowing, growth of Russian imports from non-CIS countries remained strong. Figures released by the Central Bank of Russia show earnings on goods exports fell 13 % y-o-y in 1Q02. Imports increased 10 % y-o-y, slightly less than a year ago. Despite the slowing, imports from non-CIS countries grew 20 % in dollar terms and 25 % in euro terms. Imports from CIS countries fell 15 %.

**Development of Russian exports and imports, percentage change in euros for same quarter one year previous**

![Graph showing the development of Russian exports and imports, percentage change in euros for same quarter one year previous.](image)

Russian government sees fast growth unlikely in the short term. Government representatives said there is no likelihood soon that Russia would reach the higher economic growth demanded by president Vladimir Putin in his mid-April state-of-the-nation address. The key to higher growth is acceleration of structural reforms, but the impact of those reforms takes a while to be felt. Economy minister German Gref stated that the government seeks to do its best, but there is little point to setting excessively high growth targets. The economy ministry has stated that economic growth might reach 3.4 – 5.6 % in 2003 – 2005. Its earlier annual growth forecasts were in the range of 3.5 – 4.5 %. Prime minister Mikhail Kasyanov said that the government could review its growth figures in August in connection with the start of the 2003 budget process.

Russia’s WTO membership talks continue. The first version of a report on Russian accession to the WTO was discussed at a regular meeting of the working group at the end of April. At the time of the meeting, the leader of Russia’s negotiating team, deputy economy minister Maxim Medvedkov, said that the report and accession plans still contain certain impediments. Ahead of the working group’s meeting, WTO director general Michael Moore said he hopes that Russia will gain WTO membership during 2003. The next working group meeting is planned for June.

Economic reform keeps Duma busy. Before the end of spring session, Russia’s lower-house Duma is wrestling with economic reform issues that include the buying and selling of agricultural land, treatment of small and medium-sized companies, a new currency act, amendments to the central bank act and the bankruptcy act, as well as modernization of the energy sector and the railways.

**Growth in Baltic industrial output falls in first quarter.** Estonian industrial output in March fell 6 % y-o-y and in the first quarter output measured by sales stood at the previous year’s level. The key wood and wood products industry and the textile industry continued to grow, while the food and metal industries, as well machinery and equipment manufacture, fell.

Latvian industrial output fell 5.5 % y-o-y in March. In 1Q 2002, output declined 1.2 % y-o-y. Growth came to a halt in the country’s key production sectors (the food industry and the wood and wood products industry), while production of furniture and textiles continued to grow.

Lithuanian industrial output was up 1.7 % y-o-y in the first quarter. The country’s important oil refining industry saw output drop substantially in January and February (due in part to scheduled maintenance of the Mazeikiu Nafta refinery), but revived in March. Production of furniture and textiles continues to increase this year.

**Estonia posts highest Baltic inflation rate again.** Consumer prices in April rose 4.6 % y-o-y (4.3 % in March) in Estonia, 2.9 % (3.2 %) in Latvia and 1.3 % (1.6 %) in Lithuania. The on-month rise in April was 0.9 % in Estonia and 0.1 % in Latvia. Prices in Lithuania remained at their March level. While gasoline prices put upward pressure on Baltic prices in April, they were countered by lower food prices. Estonia had the highest Baltic inflation rate primarily because of a hike in electricity prices. At the beginning of April, energy monopoly Eesti Energia increased electricity prices about 20 %.

**Baltic exports hit by drop in Western European demand.** Estonian and Latvian exports to EU countries were particularly affected during the first quarter. Exports to Russia and other CIS countries, however, continued to grow. According to balance-of-payments figures from the Bank of Estonia, Estonian exports fell 25 % in 1Q 2002 y-o-y. Since the contraction in exports began last summer, the greatest drop has been experienced in the machinery and equipment category, which reflect a drop in exports of mobile phones. The volumes of other key export products (wood and wood products, textiles and food) remained at the same level as in 1Q 2001.

Balance-of-payments information reports no on-year change in the level of Latvian exports in the first quarter as slow growth at the start of the year decayed to a contraction by March. Exports of Latvia’s top export goods (wood and textiles) fell slightly in the first quarter. Food
producers enjoyed modest growth thanks to a boom in exports to Russia.

Lithuanian exports declined in January and February due mainly to a drop in exports of refined oil products and fertilizers. Causes of the lower oil exports included the two-week maintenance at the Mazeikiu Nafta refinery in February. In March, refined oil exports resumed and exports overall grew. The volume of exports for 1Q 2002 remained essentially unchanged from a year earlier. Exports to Russia increased an impressive 66 % y-o-y, due mainly to a big jump in exports of food, vehicles and vehicle parts.

Latvian parliament amends language law, reduces burden on non-Latvian speakers. In a vote of 67 to 13, the Latvian parliament approved an amendment to a law requiring that candidates for parliament and local councils demonstrate fluency in the Latvian language. Several international bodies have demanded a change in the law as the language requirement was seen to conflict with the International Human Rights Treaty. Approval of the amendment is seen as an important step towards Latvia’s NATO and EU memberships. The Estonian parliament approved a similar amendment last November.

IMF underlines the need to proceed with structural reforms in Ukraine. In its Article IV consultation report released last week, the IMF board advises Ukraine to maintain prudent macroeconomic policy and stay on track with systematic structural reforms to achieve sustainable economic growth. The executive board said Ukraine still needs to focus on reducing its fiscal deficit, clearing VAT refund arrears and eliminating tax privileges. The IMF warmly greeted Ukraine’s new budget code and improvements in tax administration, but warned Ukraine to be prepared to implement tighter monetary policy if inflationary pressure emerged. It encouraged Ukraine to handle its foreign exchange rate policy flexibly. The IMF said that if Ukraine wants to attract more foreign and domestic investment, it should develop its business environment. Banking supervision also needs to be intensified. In the energy sector, the Fund advised Ukraine to resolve the debt situation and maintaining payments discipline in the electricity and gas sector. For 2001, Ukrainian GDP growth rose to 9 %, while inflation fell to 6 %.

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Solid majority of Duma backs first reading of agricultural land bill. Of seven proposals under consideration by the Duma, the government’s version prevailed. The communists, who oppose the government’s bill, submitted their own bill calling for a national vote on the sale of agricultural land. The second reading of the agricultural land bill is scheduled for 19 June and the third for 5 July. The new law would legalise the sale of agricultural land nationwide and supersede the disparate rules on the sale of agricultural land already implemented in some regions.

Russian industrial output growth recovers in April. Industrial output growth rose over 4% y-o-y in April, although the workday-adjusted figure for industrial output showed an increase of only slightly more than 1%. The seasonally adjusted trend for industrial output was up 3% y-o-y. For the first four months of the year, industrial output was up 3% y-o-y.

Russian industrial output growth rose over 4% y-o-y in April, although the workday-adjusted figure for industrial output showed an increase of only slightly more than 1%. The seasonally adjusted trend for industrial output was up 3% y-o-y. For the first four months of the year, industrial output was up 3% y-o-y.

Russia’s insurance boom begins to slow. Russia’s finance ministry reports there were 1,366 insurance companies in Russia at the beginning of April. Insurance companies collected about RUB 277 billion (about €10 billion) in premiums last year – an increase of 60% from 2000. Growth has slowed, however, during the past three years. In 2001, insurance claims paid out by insurance companies amounted to RUB 172 billion, an increase of about 40% over 2000.

More than 85% of all paid insurance premiums were on voluntary insurance policies, the share of which increasingly dominates total policies. The premiums paid on such policies corresponded to less than 1% of GDP in 1996, but were 2.6% of GDP last year. The remaining share of premium payments (about 15%) went to mandatory insurance, mainly pension contributions.

Over half of all Russian insurance premiums go to life insurance, while a fifth go to property insurance. The strongest growth in 2001 was in premiums for voluntary health insurance and accident insurance, which together represented about 10% of total insurance premiums.

Mandatory motor vehicle third-party liability insurance required in Russia next year. Based on a new law, the government set at the beginning of April upper and lower limits on motor vehicle insurance premiums. Each premium is defined according to a basic payment to which is added or subtracted various amounts depending on the vehicle’s technical features, intended use and the principal geographic area where the car is used. The act on mandatory motor vehicle third-party insurance will be implemented incrementally from 1 July 2003. Any company with a license to sell insurance can sell motor vehicle insurance as long as it has a representative in each of Russia’s 89 administrative regions.

Russia lifts oil export restrictions. After a meeting with heads of Russia’s major oil companies on 17 May, prime minister Mikhail Kasyanov said that Russia would return to normal levels of oil production and exports within the next two months. At the end of last year, Russia indicated to OPEC producers it would cut its crude oil exports by 150,000 barrels a day. Russia later agreed to keep the regime in place during the second quarter of this year. The reference level for the cuts was export volumes during the third or fourth quarter of last year. Figures from the State Statistics Committee indicate Russia exported less crude on average during January and February this year than it did during the second half of last year. Nevertheless, Russian crude oil exports were up 9% y-o-y in January-February, or nearly 300,000 barrels a day. Crude oil exports to non-CIS countries rose 1% and about 70% to CIS countries. Crude oil output in Russia was up over 8% y-o-y in the first four months of this year.

Russia increases export tariffs on crude oil. The Russian government decided to increase the export tariff on crude oil and certain unrefined oil products from $9.20 to $20.70 a tonne. The new tariff goes into force on 1 June and applies solely to exports to countries outside the CIS customs union.

Presidents of Russia and Kazakhstan sign agreement on exploitation of natural resources in northern Caspian Sea. Under the deal, northern Caspian seabed oil and gas deposits will be considered the common property of Russia and Kazakhstan and the two countries will cooperate in their exploitation. Iran claims bilateral agreements between Caspian states complicates reaching an overall agreement among all five states. Russia and Kazakhstan said their agreement does not violate an earlier Iranian-Soviet agreement on use of Caspian Sea waters.

Despite numerous attempts after the break-up of the Soviet Union, the five Caspian shoreline countries have yet to reach agreement on demarcation and exploitation of the Caspian’s abundant natural resources.
**IMF pleased with Latvia’s strong economic growth.**

The IMF mission that visited Latvia earlier this month, congratulated Latvia on its robust economic growth and stable public finances in 2001 and the first quarter of this year. The IMF raised its 2002 GDP growth forecast for Latvia from 4.5 % to 5 %. It also expects annual inflation to remain at around 3 %. The IMF reminded Latvia of the importance of maintaining strict fiscal discipline so that the current account deficit does not exceed 8.5 % of GDP, even if external demand remains sluggish.

Last autumn, the IMF and Latvia failed to agree on a ceiling for the projected 2002 budget deficit. In response, the IMF withheld Latvia’s stand-by arrangement at the beginning of this year. In the first quarter of this year, Latvia’s budget deficit was around LVL 3 million (€5.6 million), far less than the maximum LVL 20 million agreed with the IMF. Thus, the IMF mission and Latvian officials now believe that this year’s target of holding the public deficit below 1.8 % of GDP is possible. The IMF could reinstate the stand-by arrangement in mid-June if the favourable economic trends continue.

**Bank lending up in the Baltic countries in the first quarter.**

The loan stock of banks in Estonia at end-March was EEK 42.7 billion (€2.7 billion). In Latvia, the loan stock was LVL 1.7 billion (€3.0 billion), while in Lithuania the figure was LTL 9.9 billion (€2.9 billion). The growth of bank lending was the fastest in Latvia, 47 % y-o-y. The loan stock at end-March had grown 24 % y-o-y in Estonia and 17 % y-o-y in Lithuania.

The private sector’s share of the loan stock in Lithuania was LTL 5.7 billion at end-March, which translated to growth of 7 % y-o-y. The loan stock to private firms was EEK 18.2 billion in Estonia and LVL 0.8 billion in Latvia, which corresponded to growth of 13 % y-o-y in Estonia and 43 % y-o-y in Latvia. Claims on private persons were EEK 9.7 billion in Estonia and LVL 0.2 billion in Latvia. As of end-March, claims on private persons were up 37 % y-o-y in Estonia and 56 % y-o-y in Latvia.

In the first quarter, the total assets of the banking systems were EEK 71 billion (€4.6 billion) in Estonia, LVL 3.6 billion (€6.4 billion) in Latvia and LTL 15 billion (€4.4 billion) in Lithuania. Interest rates fell significantly in all Baltic countries last year.

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**Baltic 3-month interbank rates**

![Graph showing 3-month interbank rates for Baltic countries](image-url)

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**Russia: RUB/EUR & RUB/USD exchange rates (CBR)**

![Graph showing exchange rates](image-url)

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**Russian share prices (RTS)**

![Graph showing share prices](image-url)

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**Baltic share prices**

![Graph showing share prices](image-url)

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**Last weekend’s Russia-US summit in Moscow.** Presidents Vladimir Putin and George Bush signed a treaty on two-thirds reductions of their nuclear arsenals to between 1,700 and 2,200 warheads each by the end of 2012. In addition, the presidents issued public statements on developing economic relations, an expanded energy dialog, closer strategic relations, promoting contact between citizens of each country and the situation in the Middle East.

**NATO countries and Russia form joint council.** President Putin hailed the agreement signed in Rome on 28 May as the beginning of a new era of cooperation between Russia and NATO. He emphasised Russia will strictly adhere to international agreements, as well as UN and OSCE decisions.

Russia joins 19 NATO members on the council in a consultative role. Russia will have no decision-making or veto powers in NATO matters. The council will deal with issues such as preventing terrorism and the spread of weapons of mass destruction, crisis management, arms control, measures to boost confidence and mitigation of emerging threats and crises.

**EU recognises Russia as market economy.** EU Commission president Romano Prodi announced the EU acknowledges Russia as market economy. The conferral of market-economy status is seen as a political gesture of regional integration and expected to strengthen Russia’s desire for implementing economic reforms. The recognition should also give Russia better standing in anti-dumping cases. As a market economy, dumping will be measured in the first place on the basis of Russia’s own producer costs and market prices. EU-imposed anti-dumping sanctions are based on a third-country reference. Market-economy status could expedite Russia’s WTO-membership talks. The US is also expected to decide by mid-June on whether to grant Russia market-economy status.

**CBR’s currency and gold reserves up substantially.** The currency and gold reserves held by the Central Bank of Russia have risen by $4 billion since the beginning of April. From January to the start of April CBR reserves rose $1 billion. On 24 May, the CBR’s reserves stood at $41.7 billion, an amount sufficient to cover more than six months of imports of goods and services. The increase mainly reflects the fact that Russia had fewer payments on foreign debt principal and interest in April and May (the finance ministry says just over $1 billion) than in January-March (about $4 billion). Observers note that the rise in world oil prices since the beginning of March also boosted Russia’s export earnings, which forced the CBR to buy currency to curb excess appreciation of the rouble. In contrast, the CBR intervened on several occasions last winter to check rouble depreciation.

**Russian bank lending rises faster than deposits.** The nominal value of the deposit stock of banks operating in Russia rose nearly 30% y-o-y in March. In real terms (CPI deflated), the deposit stock grew 10% y-o-y in March (13% during 2001), when the amount of rouble cash in circulation grew nearly 19% in real terms (18% in 2001). Rouble-denominated time deposits were by far the fastest growing type of deposit (real growth over 35%). Rouble-denominated demand deposits and various foreign currency deposits grew 1 – 2%. At the beginning of April, the money stock, which consists of bank deposits and rouble cash in circulation (rouble M2 + foreign currency deposits) was nearly 23% of annual GDP (21% a year ago), of which bank deposits represented nearly 17% of GDP (16%) and rouble cash 6% (5%). Bank receivables from enterprises and households, which consist mainly of lending, grew nearly 35% y-o-y in real terms by the end of the first quarter and was 16% of GDP.

**Deposit stocks of banks operating in Russia, receivables from enterprises and households, rouble cash in circulation, 1 Jan. 1999 – 1 Apr. 2002, % of annual GDP**

**FitchIBCA lifts Russia’s credit rating.** At the beginning of May, international credit rating agency FitchIBCA raised its rating for Russia’s long-term foreign-currency borrowing and eurobonds to BB-. The rating for short-term foreign-currency borrowing remained unchanged at B. FitchIBCA said its decision was based on Russia’s improved ability to service its foreign debt in 2003 and prudent spending of increased budget revenues in recent years. Russia’s overall debt burden has been reduced (due in part to an agreement with Germany on Soviet debt owed to the former GDR) both in relation to export earnings and GDP.

**Lithuania rejects World Bank second half of loan.** Lithuanian finance minister Dalia Grybauskaite announced this week that her country would not be taking a €53.6 million structural adjustment loan from the World Bank. The loan was the second part of a €108.3 million loan granted in 2000 to help finance reform in pensions, business, energy and the agricultural sector, as well as help with budget financing.
Ms. Grybauskaite also reported that Lithuania’s budget deficit has been reduced and the state could now borrow directly from the markets at rates comparable to credit from the World Bank. The World Bank representative in Lithuania said the World Bank is quite satisfied with Lithuania’s management of its economy, implementation of social reforms and private sector development. The representative added, however, that efforts to make agriculture more efficient and further privatisation of the energy sector were still needed.

Baltics displeased with agricultural quotas proposed by EU. All Baltic countries have made good progress in their EU-membership negotiations. Lithuania has already closed 26 chapters of the 31 chapters of the acquis communautaire. Latvia and Estonia have both completed 24 chapters. The most contentious chapters — agriculture and regional policy — remain, however.

The Baltics are particularly dissatisfied with Commission’s proposed production quotas for sugar, milk and grain. At the beginning of May, the three Baltic agriculture ministers expressed their concerns in a joint statement that claimed the grain quotas offered by the Commission would force two-thirds of arable land in the Baltics to lie fallow and seriously impact rural areas.

Estonia has taken issue with the Commission’s suggested 562,600 tonne milk quota, which is only about 80% of the country’s average milk production between 1997 and 2000. Estonia is also dissatisfied with the proposed area of land allowed for cultivation. Latvia not only rejects the proposed milk quota, which corresponds to only half of average annual production in recent years, it is also disappointed with the proposed sugar quota, only 47% of what Latvia asked for. Lithuania is unhappy with the milk quota offer of 1,400,000 tonnes (80% of national production), as well as the proposed sugar quota.

Every Baltic country opposes the Commission’s proposed 10-year incremental transition to full agricultural subsidies.

Agriculture’s share of GDP fell throughout the 1990s. Last year, agriculture’s share of GDP was 4% in Estonia and Latvia, and 7% in Lithuania.

Agriculture’s share of GDP in the Baltic countries, %

<table>
<thead>
<tr>
<th>Year</th>
<th>Estonia</th>
<th>Latvia</th>
<th>Lithuania</th>
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<tbody>
<tr>
<td>2001</td>
<td>20%</td>
<td>22%</td>
<td>25%</td>
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<tr>
<td>2002</td>
<td>18%</td>
<td>19%</td>
<td>22%</td>
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![Graph of Agriculture’s share of GDP in the Baltic countries, %](image)
Putin outlines budget goals 2003. In his yearly talk on the budget, president Vladimir Putin discussed the main accomplishments of fiscal policy last year and looked ahead to 2003. The speech set the tone for cabinet discussion on the 2003 budget proposal next week.

Mr. Putin praised policies that have achieved budget stability and successful debt management in recent years. The president’s list of goals for budget policy next year included budget planning for the longer term, and more specifically, that the government approve a framework for spending over three years. He also emphasised completion of tax reforms (e.g. deciding on taxation of production-sharing agreements, on small businesses and on real estate), elucidation of the budgetary rights and duties at various administrative levels, clarification of the operating principles of the financial reserve and creation of a comprehensive system for administering state debt.

Regarding revenue policy, the president proposed that any amendments to current tax laws or approval of new tax laws had to be completed by the first quarter of previous year if they are to affect the budget of next year. He stated that the government should give up its ownership shares in nearly all banks and firms in the finance sector, particularly where its ownership stakes are small.

Putin stressed the need to rationalise spending, and said he supports spending increases only in those areas which support spending reductions in long term. The president declared it was time to get rid of non-funded duties imposed by the central government on regional and local budgets, and that the different administrative levels need to agree for the long term on rights related to taxes and the sharing of tax revenues.

Russia’s federal budget in surplus in first quarter. The federal budget surplus in January-March was 4.6 % of GDP (revenues 20.9 % and expenditures 16.3 % of GDP). Excluding the new social tax from the figure, the surplus was 3.3 % of GDP. The primary surplus (excluding interest paid on debt, but including social tax revenues) was 8.1 % of GDP. The value-added tax provided the largest revenue stream to the federal budget (33 % of total revenues). Other major revenue sources were the social tax (19%), customs tariffs (15%) and excise taxes (12%). Compared to 1Q01, profit tax revenues and revenues from customs tariffs have fallen considerably in relation to GDP.

Social sector spending, consisting mainly of social tax contributions to the pension fund, was the largest expenditure item, amounting to 29 % of total expenditures. Interest paid on domestic and foreign debt represented about a fifth of total expenditures. Transfers to regional and local levels were 18 % of total expenditures, while defence spending had a 12 % share. Compared to 1Q01, the amount paid on debt interest in relation to GDP has fallen, while non-interest expenditures have risen rapidly.

Russian monthly inflation rate hits 1.7 % in May. In February, March and April, the monthly rise in consumer prices held in the range of 1.1 – 1.2 %. Moreover, ignoring a January spike in prices, the May increase was the largest monthly rise since May 2001. The acceleration in inflation was due to a seasonal rise in vegetable prices, causing the food category in the consumer goods basket to rise 2.2 %. The prices of other goods rose 1.2 %. There was a less than 1 % change in prices for services. May consumer prices were up about 16 % y-o-y.

Rise in Russian producer prices accelerated in April. Industrial producer prices rose an average of 2.2 % m-o-m in April – the fastest rise in 18 months. Prices were stagnant in the first months of this year, and were up less than 7 % y-o-y in April. The slowing in the rise of producer prices was due to the on-going drop in domestic producer prices for crude oil that began last summer. Although the price of oil rose slightly in April, it was still over 20 % cheaper than a year ago. The fastest rise in producer prices was in natural gas output, up nearly 30 % since the start of the year and over 90 % y-o-y. Producer prices for electricity were about 25 % higher in April than a year earlier. Prices for rail freight rose in February for the first time since last summer (over 15 %). In April, freight transport prices were up 56 % y-o-y. The rise in agricultural producer prices slowed to 6 % y-o-y in April.

FDI inflows to Russia fall in the first quarter. According to the State Statistics Committee, foreign direct investment inflows into Russia in 1Q02 amounted to $830 million. FDI inflows in 1Q01 were about $960 million. Some 50 % of investments went to industry, of which the fuel sector received 30 %. The trade sector received 36 % of investments. At the end of the first quarter, Russia had a total FDI stock worth $17 billion. Of that, 23 % was from the US, 20 % from Cyprus and 12 % from the Netherlands.
Estonian parliament approves supplementary budget. Estonia’s current budget surplus is due to higher-than-expected revenues from taxes and sales of state property. The EEK 411 million (€26 million) supplementary budget approved at the beginning of June will give more money to e.g. pension disbursements, municipalities, basic education, and covering the costs of hosting the Eurovision song contest.

Estonian prime minister Siim Kallas announced that another supplementary budget may even be possible this year as long as state revenues continue strong. During the first five months of this year, Estonia raised 41.3 % of the budget revenue target for this year. The corresponding figure last year was 37.4 %. Estonian state’s total budget for 2002 is EEK 33.5 billion (€2.1 billion).

Initial agreement on new ownership arrangements for Mazeikiu Nafta. On 30 May, the Lithuanian government, the operator of Mazeikiu Nafta (US-based Williams International) and Russian oil company YUKOS reached a preliminary accord on the YUKOS stake in Lithuanian Mazeikiu Nafta, as well as the Russian company’s investment obligations. The Sejm is currently considering the agreement, which is the product of long negotiations. Certain amendments to existing laws must be passed and a Mazeikiu Nafta shareholders’ meeting must be held before the final agreement can be signed.

Under the preliminary agreement, YUKOS will purchase a 26.9 % stake in Mazeikiu Nafta for $75 million and grant a loan of equivalent size to Mazeikiu Nafta for refurbishing of its refinery. The Russian company also commits to deliver 4.8 million tonnes of crude oil annually over the next ten years. A benchmark price for crude oil was also initially agreed.

Mazeikiu Nafta booked a loss of LTL 105 million (€30 million) in the first quarter, i.e. about 20 % more than a year earlier. Company management explained that the loss was mainly due to lower margins on oil refining, lower sales of light oil products in Lithuania, and the shutdown of the Butinge oil terminal, which, due to an oil leak, lasted from November to end-March.

Legal battle over Lattelekom continues between Latvian state and Tilts Communications. On 29 May, the Finnish Sonera, which, through its Danish subsidiary Tilts Communications A/S, owns a 49 % stake in the Latvian phone company Lattelekom, issued a press release stating both sides had presented damage claims in arbitration proceedings. Tilts seeks to recover LTL 88 million (€150 million) from the Latvian state, which holds 51 % stake in Lattelekom. The Latvian government wants LVL 600 million from Tilts. The central demand of Tilts is reimbursement from the Latvian state for lost profits caused by a decision by the Latvian government to end Lattelekom’s monopoly status on the fixed-line network from the beginning of next year. In 1994, Tilts and the Latvian state agreed monopoly status would continue up to 2013. Among the Latvian state’s claims is a claim that Tilts failed to digitalise Lattelekom’s phone network by the agreed deadline.
Government proposes changes to this year’s budget. The Russian government has approved changes proposed last week to the current budget by the finance ministry. The changes call for increased spending totalling RUB 39 billion (€1.3 billion). Under the proposal, the extra money would go to salary increases for members of the military and certain federal workers, higher regional supports, as well as numerous smaller items. The money represents an RUB 18 billion windfall resulting from lower-than-anticipated interest costs, and a nearly RUB 21 billion transfer from RUB 68 billion in reserves set aside earlier for a supplementary budget in 2002 if budget revenues developed favourably. The government also approved an amendment to the budget act that would allow a RUB 42 billion domestic bond issue to buy the CBR’s 99.9 % stake in Vneshtorgbank. The Duma has yet to approve the government’s proposals.

President Vladimir Putin’s decree states that military wages and pensions will be raised in two steps; first on 1 July 2002 and again on 1 January 2003 for a total hike of 30–90 %. In exchange for higher pay, members of the military will give up benefits such as low income tax rates and subsidised housing and municipal services.

No merger of Vneshtorgbank and Vneshekonombank. On Monday (10 Jun.), Russian prime minister Mikhail Kasyanov called off efforts to merge Vneshtorgbank (VTB) and Vneshekonombank (VEB). Earlier plans would have shifted all of VEB’s operations to VTB by January 2003. VEB will now continue as a state debt management agency and VTB will be privatised. VEB’s president Andrei Kostin now becomes chairman of VTB’s board, while Vladimir Chernuhin replaces him as VEB’s head.

Rise in Russian oil exports and in machinery and equipment imports. Russian export earnings fell during the first quarter (down 13 % y-o-y in dollar terms), due mainly to key Russian export prices, which were substantially lower than year earlier despite a slight rise at the beginning of the year. Export prices for crude oil, oil products, and natural gas in Q1Q2 were down some 20 % y-o-y. The volume of crude oil exports rose 16 % y-o-y in the first quarter, while export volumes of oil products were up 11 %. Natural gas deliveries fell again in Q1Q2 and were down 2 % y-o-y.

The State Customs Committee reports that imports of machinery and equipment (excluding passenger cars) rose 20 % y-o-y in Q1Q2, well above the 10 % overall growth. Imports of machinery and equipment from non-CIS countries rose 33 % y-o-y, while total imports from non-CIS countries were up 20 %. The share of machinery and equipment (excluding passenger cars) rose to 32 % of total imports and nearly 34 % of imports came from non-CIS countries. A quarter of total imports were food products and basic foodstuffs. Imports from non-CIS countries rose 24 % and their share of total imports grew to 27 %.

Investments in oil production constituted larger share of total investments in first quarter. The slowing in investment growth (January-April) to 1.6 % y-o-y included a structural shift in investments. For January-March, 18 % of all investments went to crude oil production. The share of other industries shrank accordingly to 30 %, a figure that includes the food industry. The transport sector’s share of investments fell substantially to 16 %. While the increases in the shares of telecommunications and agriculture rose substantially, they are still only represent 3–4 % of total investments. Housing investment rose to 14 %. Firms increasingly preferred to finance investments out-of-pocket (nearly 54 % of total investments). Public sector budget and bank credits financed investments share fell slightly (18 % and about 4 %).

US grants Russia market economy status. Market economy status puts Russia on equal footing with other US trading partners in anti-dumping disputes. The upgrade is expected to ease the trade barriers between Russia and the US and help advance Russia’s entry into the WTO.

Russia releases long-term rural development program. The program seeks to reduce by 2010 the gap in living standards between city residents and people living in rural areas and raise the standard of living of rural inhabitants to a targeted minimum.

Some 40 million of Russia’s 144 million residents live in rural areas. Fewer than half of rural dwellings have central heating, indoor plumbing or sewage treatment. Populations in rural areas also have less access to hospitals and over half of outer districts lack schools. A third of rural dwellings lie off paved roads and a third are not hooked up to the general telephone network.

The development program has eleven points, including improvements in housing, education and health care, electrification of rural areas, construction of a natural gas network, construction of roads and telecommunications infrastructure, and promotion of cultural and sports activities. Realisation of the development program is expected to cost RUB 168 billion (€5.7 billion), of which 11 % will come out of central government’s budget, 42 % from regional budgets and 45 % from other sources. For example, the central government will pay 30 % of the costs of housing improvements, regional administrations 40 % and housing owners 30 %.

Estonian inflation still highest in Baltics. In May consumer prices in Estonia were up 4.1 % y-o-y (April 4.6 %), 2.0 % y-o-y (2.9 %) in Latvia and 0.5 % (1.3 %) in Lithuania. The deceleration of inflation in Estonia and Lithuania was due e.g. to appreciation of the kroon and the litas, which are pegged to euro. The slowing of Latvian inflation was due mainly to a moderated rise in food prices. In May, prices were up 0.3 % m-o-m in Estonia.
and 0.2 % in Latvia. In Lithuania, a large drop in food prices cause the price level to fall 0.3 % m-o-m.

**Baltics push ahead in EU membership talks.** The Baltics, currently in negotiations on some of the toughest chapters in the *acquis communautaire*, showed progress at the membership discussions at held on Monday and Tuesday (10-11 Jun.) as Spain is finishing its six-month EU presidency. The countries reached agreement e.g. on the chapter on regional policy.

**Estonia** closed chapters on regional policy and institutions. Estonia’s foreign minister Kristiina Ojuland announced that it was satisfied with the EU’s offer to Estonia of €3.6 billion regional supports for 2004 – 2006. Estonia has presently completed 26 chapters of 31 in the *acquis*. Estonia still faces negotiations on energy, taxation, agriculture and budgetary provisions. The coming talks are expected to be tough as Estonia has requested a transition period for its protected shale oil industry and expressed dissatisfaction with the agricultural quotas offered by the EU.

With the closing of chapters on justice and internal affairs, regional policy and taxation, Latvia now has completed a total of 27 chapters. The country has yet to reach agreement on chapters concerning agriculture, budgets and institutions. Latvia will get €1.6 billion in regional supports during 2004 –2006. Further, all of Latvia will be classed as a type-1 support region, i.e. a region where GDP per capita is less than 75 % of the EU average. Finance minister Gundars Berzins is satisfied with the long transition period granted by the EU, which allows harmonisation of tobacco taxes.

**Lithuania** and EU foreign ministers have agreed on shutdown of the disputed Ignalina second nuclear reactor by 2009. The EU considers the reactor dangerous and has made decommissioning of the reactor a condition for closing negotiations on the energy sector. However, it is still unresolved how the costs of the reactor shutdown will be financed. Lithuanian estimates put the costs of decommissioning at €2.4 – 3 billion and wants the EU to increase its financial support. The EU spending projections published at the end of January set aside €105 million for the Ignalina decommissioning in 2004 and €70 million in 2005 and 2006. The EU will also contribute to an €200 million decommissioning fund administered by the EBRD. Lithuania is already committed to closing the first reactor by 2005. The Ignalina power plant is Lithuania’s main electricity generator; a sizeable share of its output is exported.

With agreements on the energy and regional support chapters, Lithuania has closed a total of 28 chapters. Talks on the budget provisions and agriculture lie ahead.
Russian government approves 2003 budget framework. The planned 2003 federal budget is expected to produce a slight surplus (0.8% of GDP), or about half the surplus projected for this year’s budget (1.6% of GDP). Next year’s revenues of RUB 2,370 billion will amount to about 18.4% of GDP, while expenditures of RUB 2,271 billion will represent some 17.7% of GDP. Annual inflation is expected to slow to 10–12%. The 2003 budget assumes an average exchange rate of 34 roubles to the dollar, an average price of $21.50 per barrel for Urals-grade crude, annual GDP growth in the range of 3.4–4.4% and increase in industrial output of 3.2–4.1%. Russia also hopes to pay off $10.8 billion in foreign debt and $6.4 billion in related interest.

Federation Council votes 125–8 to reject amendments to Russia’s central bank act. The rejection means that the amendments to the bill passed in the Duma earlier this month will now have to be reconciled by a conciliatory committee of Duma and Federation Council members. Final changes are not expected until late autumn.

The Duma wants to increase parliamentary oversight of central bank activities, but has yet to agree on the scope of such oversight with the government and the central bank’s board. The most controversial amendments concern the scope of authority and number of members that will sit on a National Banking Council to oversee central bank activities. Current proposals on the number of board members range between 12 and 15. Another issue is the number of inspections that the CBR could perform on commercial banks during each financial year.

This week the Russian Banking Association announced it wishes to join the ranks of entities controlling the central bank. The Banking Association’s new president Garegin Tosunyan says the Association wants to supervise CBR inspections of commercial banks to assure their legitimacy, and therefore the Association would like to have its own representatives sitting on the yet-to-be-formed National Banking Council.

Russian share prices fall after long rise. The tireless rise in share prices that began last autumn finally lost steam in mid-May. Russia’s leading share index, the RTS, spiked about 15% from mid-April to mid-May; thereafter, it fell 15% to a level of 360–370. Even with the setback, the RTS index is still up about 70% from twelve months ago.

The volumes of shares traded increased substantially in May. The average value of daily trading in the RTS rose to $28 million a day, while the volume of shares traded on the MICEX exceeded $170 million a day. Volumes then dropped considerably at the start of this month as share prices fell. Some observers say that the market rose until mid-May as the undervaluation of core stocks diminished and otherwise it was affected by such events as fluctuations in world oil prices. Compared to the tireless rise in share prices from last autumn, the performance of major shares in the last two months has been more mixed. The market capitalisation of the Russian stock market as of mid-June was about $120 billion, of which the 16 largest companies accounted for over $110 billion.

Market capitalisations of Russia’s largest listed companies, March-June 2002, US$ billion (Troika Dialog)

Finnish-Russian trade gap. Finnish customs authorities report that Russia was Finland’s third largest source of imports last year and fifth largest export market. Imports from Russia remained little changed in 2001, but Finnish exports to Russia rose 30%. Finland continues to run a trade deficit with Russia. Russia’s share is currently about 7.5% (about €6,220 million) of Finnish foreign trade. Near 64% of Finland’s imports from Russia were energy, followed by 13% for wood and 8% for chemical products. About 42% of Finnish exports were machinery and equipment, 22% other manufactured goods and 13% chemical products. Machinery and equipment exports, up nearly 40% led export growth.

Kaliningrad issue hurts Russia-EU relations. Russia and the EU have not yet agreed on travel policies for residents of the Kaliningrad enclave. President Vladimir Putin chastised the EU for threatening Russia’s sovereignty and criticised the suggestion from EU foreign ministers of granting Kaliningrad residents cheap, long-term, multi-entry visas. Mr. Putin said Kaliningrad residents should be allowed the possibility to travel without a visa to Russia via Lithuania or Poland.

Although Kaliningrad’s 900,000 inhabitants have been free to visit Russia (via Poland or Lithuania) without a visa since 1995, the EU wants countries preparing to join the EU to introduce passage visas to Kaliningrad residents in compliance with the Schengen agreement. From the beginning of July 2003, people will not be allowed to travel without such visa between Russia and Kaliningrad, if their route takes them through Lithuania or Poland. Discussion of ways to handle the Kaliningrad problem will be brought up at the meeting of EU ministers 21–22 June in Seville.

Estonia issued 5-year 100 million eurobond. The Estonian state will use the money to refinance earlier loans
and to install a new NATO-compatible air surveillance radar system for Estonia. The bond carries a coupon of 5%.

Last spring, Lithuania issued a ten-year eurobond with a coupon of 5.875%. At the end of 2001, Latvia issued a seven-year eurobond with a coupon of 5.375%. Estonia’s currency long-term credit rating is currently ranked Baa1 by Moody’s, A- by Fitch IBCA and A- by Standard & Poor’s.

Latvia’s economic growth slowed in the first quarter. Latvian GDP grew 3.8% y-o-y in 1Q02, a substantial slowing from the 7.7% y-o-y GDP growth in 2001. The slow growth in foreign demand was a major reason for the overall slowing. A critical sector to the Latvian economy, transportation and telecommunication, grew less than 2% y-o-y in the first quarter, reflecting a decline in transhipments of crude oil and oil products. Growth in manufacturing (3%) was also clearly lower than a year earlier. The service sector is the big motor for growth of the Latvian economy at present. Retail trade was up 9% in the first quarter while financial services showed a brisk 6% growth. Construction was up 7% y-o-y and agricultural output 5%.

51% stake in LASCO on auction next week. Last April, the Latvian state allowed small investors to exchange their privatisation coupons for a 32% stake in the Latvian Shipping Company (LASCO). Next Tuesday (25 Jun.), a 51% stake will be offered at auction against cash. Under the plan approved by Latvia’s privatisation agency, the initial prices for the 102 million shares offered should range between 0.3 and 0.45 lats (77 euro cents), while the shares offered to international investors should range between 48 and 72 US cents. At last year’s failed attempt to auction LASCO shares, the shares were offered at a starting price of 0.51 lats per share.

LASCO was incorporated as a public joint stock venture at the beginning of June. Its shares were also listed on the Latvian Central Depository, and shareholders may have traded shares freely as of 11 June.

Privatisation of gas distributor Lietuvos Dujos proceeds. The Lithuanian government’s next step in the privatisation of Lietuvos Dujos involves the sale of a 34% stake to a gas supplier. Suppliers interested in purchasing a share in Lietuvos Dujos should announce their intent to submit bids by mid-July. Initial bids for Lietuvos Dujos shares must be submitted on 10–11 September and final bid on 11–12 November. The government hopes to seal the deal by the end of this year. No minimum bid price has yet been announced. In May the Lithuanian state sold 34% of the company shares to a German consortium at a price of LTL 116 million (€34 million). The German company is further committed to invest an additional LTL 70 million in the company over the next six years, as well as pay the Lithuanian state LTL 34 million, if the state caves on the company’s demand in gas prices.

Russia: RUB/EUR & RUB/USD exchange rates (CBR)

Russia: 31 – 90 days interbank rate (Mibor), % p.a. (CBR)

Russian share prices (RTS)

Baltic share prices (Estonia and Latvia the left scale, Lithuania the right scale)

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Duma approves third reading of bill on buying and selling of agricultural land. The proposed law bans the sale of Russian agricultural land to private foreign individuals, foreign firms and firms in which foreigners own more than 50% of the company. The bill allows foreigners, however, to lease as much land as they want for up to 49 years. If the Federation Council approves the bill and president Putin signs it, the act would enter into force half a year after its official publication.

Russian GDP growth slowed in the first quarter of this year. The State Statistics Committee reports that GDP grew 3.7% y-o-y in January-March (GDP grew 5% in 2001). The goods production component of GDP managed to rise less than 3% y-o-y, far less than the 6.5% rise last year. The lower figure reflected slowdowns in industrial output, agricultural output and construction. Output of the private services sector, however, rose 4.7% y-o-y, matching growth a year earlier.

Russian industrial output growth continued in May. Industrial output rose 2.8% y-o-y in May, down from over 4% y-o-y in April. On the other hand, workday-adjusted output growth was 4.4% y-o-y, when it was just over 1% in April. In the first five months of the year, industrial output grew 3% y-o-y, or workday-adjusted 3.3%. The largest growth among Russia’s leading industrial sectors in January-May was registered in nonferrous metallurgy (up 9.1% y-o-y), the food industry (8.1%) and the fuel industry (5.6%).

Russia to remain on FATF blacklist at least until October. At its meeting in Paris last week (19-21 June), the financial action task force on money laundering (FATF) preferred to keep Russia on its blacklist. The working group lists countries that have not put enough to fight money laundering. The FATF will review its list at its next meeting in October.

Russia’s natural monopolies to implement rate hikes next week. The Russian government announced last week that it was letting Gazprom raise its domestic wholesale rates for natural gas in the second half of this year by only 15% instead of the 20% originally proposed by the economy ministry. The government also permitted electricity monopoly UES to raise its wholesale prices 2.4% and will allow rail freight rates tariffs to go up 6.8%. Next month’s rate hikes are the second round of price hikes this year. The economy ministry proposed that next year wholesale prices of natural gas should be boosted 20% and the wholesale price of electricity increased 15%.

Easier repatriation of frozen funds in S-accounts. Foreign investors, who had their assets frozen in so-called S-accounts after the 1998 financial crisis, will, according to a decision by the Central Bank of Russia at the beginning of June, be allowed to repatriate assets via clearing accounts after a four month wait, rather than the previous twelve month wait. In addition, S-account holders will now be allowed to transfer frozen funds invested in shares and bonds monthly to other S-accounts. CBR first vice chairman Oleg Vyugin expects the current limits on application of frozen funds to be eased during this year.

The main way to repatriate assets in S-accounts has been to bid for foreign currency offered by the CBR at specially arranged auctions. At end-May, the CBR offered $50 million at auction to S-account holders and received bids worth $61 million. The minimum selling price was 32.10 rubles to the dollar and the average price was 32.53 or about 4% above the official exchange rate for that day. At the previous auction in February, bids exceeded $95 million on the $50 million offered. At that time the average exchange rate bid was 32.47 rubles to the dollar or about 5% above the day’s official rate. Estimates of the assets remaining in S-accounts range between $3 billion and $4.5 billion.

President Putin holds major press conference. On Monday (24 June), president Vladimir Putin spent more than two hours fielding questions from about 700 journalists. The spectrum of enquiries ranged from problems of individual regions to foreign policy issues such as WTO membership. Mr. Putin said most of Russia’s industries support WTO membership, adding that it was hard to respond to Russia’s interests to remain outside the WTO and delays beyond 2004 could complicate Russia’s accession efforts. Nevertheless, he warned, such complications may be unavoidable unless greater unanimity can be found through negotiations. Concerning EU relations, the questions focused on the status of the Kaliningrad enclave. Putin repeated his stand, whereby Russia will not accept any solution that violates Russia’s territorial unity. Travel between Kaliningrad and the rest of Russia must be free and unencumbered by visa requirements. When the union of Russia and Belarus came up, the president stated that there was nothing to last week’s much-publicised news of differences between the countries. Putin said the aim of the union is a united country with a single government and parliament, which nevertheless acknowledges the sovereignty of both Russia and Belarus, as well as allows for territorial unity and veto power to any joint parliamentary decisions. Domestic issues included Chechnya, corruption, pension reforms and relations between the centre and regions.

YUKOS acquires stake in Mazeikiu Nafta. On 18 June, the Lithuanian government, Russia’s number-two oil company YUKOS and the American Williams International signed an agreement that lets YUKOS purchase a 27% stake in Mazeikiu Nafta. In addition to paying $75 million for its stake, YUKOS also granted an equal-sized loan to Mazeikiu Nafta to finance the modernisation of its refinery. The Lithuanian state guarantees the loan. YUKOS is further committed to delivery of 4.8 million
tonnes of crude oil annually to the Mazeikiu Nafta oil refinery over the next ten years. With the agreement, the Lithuanian state’s holdings in Mazeikiu Nafta fell to 41%. Williams reduced its holdings in Mazeikiu Nafta to 27%, but will continue to have administrative control in the company.

Mazeikiu Nafta is Lithuania’s largest concern. It has a refinery, oil pipelines and the Butinge oil terminal. One big reason for the company’s inability to turn a profit in recent years has been its antiquated refinery. Mazeikiu Nafta says the upcoming initial phase of the refinery’s modernisation, designed to improve the quality of raffinates, will take four years and cost about $400 million. Currently 60% of the gasoline produced at the refinery and 100% of its diesel fuel output meet EU requirements.

51% stake in Latvian Shipping Company sold After several unsuccessful attempts over the past years to sell off its holdings in the Latvian Shipping Company (LASCO), the Latvian state successfully sold at auction 51% of the LASCO’s shares on the Riga Stock Exchange on Tuesday (25 June) in accordance with a plan approved last winter. 32% of the company’s shares were sold in April to holders of state privatisation coupons. One share at auction fetched 0.35 lats (60 eurocents). Overall, the Latvian state raised LVL 35.7 million (€61 million) from Tuesday’s auction. Prior to the auction, the shares were counted for about 3.6% of Finland’s total goods imports (about €1.3 billion). 

Estonia’s share of the Finland’s Baltic trade was about 80%. Latvian share of Baltic trade was nearly 13% and Lithuania’s share about 8%. Finland had a trade deficit with Estonia, but produced surpluses with Latvia and Lithuania.

About 44% of Finnish exports to the Baltics were machinery and transport vehicles, 23% other manufactured goods and 9% chemical products. About 57% of imports to Finland were machinery and transportation vehicles, 14% textile goods and 13% other manufactured goods. The drop in exports was caused mainly by a nearly 40% drop in exports of machinery and transport vehicles.

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Russian economic growth down a bit in May. Russia’s leading indicator of five economic sectors was up 3.2% y-o-y in May and 3.6% y-o-y for the period January-May. Industrial output climbed 3% in January-May, while agricultural output and transport increased about 4.5%. Growth in retail sales was strong in January-May (up 8.5%), slowing slightly to 6% y-o-y in May. Construction rose less than 3% in January-May, as investments increased only 1.7%. The State Statistics Committee reports private services grew less than 2% y-o-y in January-May.

Russia becomes full-fledged G8 member. At last week’s G8 meeting of leading industrialised nations in Canada, Russia received full member status in the G8 club. Russia will even host the G8 meeting in 2006. Russia was also granted a $20 billion support package from other G8 members to eliminate its aging nuclear arsenal and other weapons of mass destruction. The program will run for the next ten years.

Little progress in Russia’s WTO membership talks. The working group handling Russia’s membership met in Geneva in the latter half of June. Russia’s lead negotiator, deputy economy minister Maxim Medvedkov, said the talks had reached a complicated phase. He noted that Russia wants to use import tariffs to protect specific industries (e.g. aircraft and auto manufacturing), restrict the exposure of the agriculture sector since some countries extensively subsidize agriculture, and limit foreign ownership in the telecommunications, insurance and finance sectors. He also stated that discussions about Russia’s domestic energy prices have become a sticking point. Some WTO members are uncomfortable with the fact that Russian authorities currently set prices for electricity and natural gas at levels far below world prices. Medvedkov noted that legislation demanded for WTO membership would be in place by mid-2003. WTO director-general Mike Moore said the most important pending legislation in Russia’s case was a new customs code, laws to protect intellectual property and increased regulation of the service sector. Medvedkov expects the next meeting of the working group handling Russia’s WTO membership to take place towards the end of the year.

Russian government decides import tariffs. On 30 May, the government affirmed its decision of last November on import tariffs. The decision, which had to take effect on 1 July, covers a wide range of goods categories, for which customs tariffs will now have a permanent basis. A shorter list contains import tariffs continued for a period of nine months. Only a few tariffs were raised from the November decision.

Russian government names tax ministry as keeper of company registry. On 1 July, company registration act of August 2001 entered into force. Based on this act, the government decreed that company information used in determining the tax base is to be consolidated from 4,500 registers into a single registry. All firms must announce themselves to the register by the end of this year. The tax ministry also wants individuals who practice professions and other non-corporate entities on the registry.

Drops in world financial markets bring prices of Russian shares and bonds slightly down. Russia did not escape the worldwide decline in shares and bonds completely (and Brazil in particular) in the second half of June. The prices of Russian government foreign-currency bonds maturing between 2005 and 2030 lost 3-8% of their value around 20 June. Bond prices then recovered, but as of 4 July were still off a couple of percent. Bonds maturing in 2003 lost less than one percent during the event. Russian leading stock market index, the RTS, plummeted to below the 340 level on 20 to 26 June but has since recovered to a range of 350-370. In May, the RTS hit 425, its highest level since Russia’s 1998 financial crisis.

Duma overrides Federation Council attempt to modify central bank bill. The Duma rejected a proposal from the upper-house Federation Council to increase the number of members from 12 to 15 on the new National Banking Council, which will oversee the central bank’s activities. The Federation Council earlier used its veto to strike Duma amendments to the central bank bill. The upper house also sought to raise the number of CBR inspections of commercial banks from one to two per financial year. A reconciliation commission accepted the increase in inspections, but denied the Council’s wish for more members on the National Banking Council. Following the veto override, the bill next goes to the president for his signature. On the other hand, the Duma has requested that the budget committee draft for autumn a new proposal on the number of inspections.

Estonian economy slows. Estonia’s real GDP grew 3.2% y-o-y in 1Q02. Growth slowed as forecasted at the beginning of the year and should revive towards the end of the year.

The largest growth in the first quarter was recorded in construction (up 13% y-o-y), trade (7%), manufacturing (5%) and transport and communications services (4%). Agricultural production fell 4%, while warm weather reduced electricity, natural gas and water consumption 7%.
Rapid growth in inventories in the first quarter (120% y-o-y) reflected a burst in ongoing investment projects. Private consumption increased slower than expected, about 3%. The impact of rapid investment growth on GDP was less than expected, since investments fed imports. The growth in public sector consumption, which began at the end of last year, picked up in the first quarter (5%) and is expected to continue to rise as elections approach. Due to reduced foreign demand goods exports fell 22%, while exports of services increased 17%.

Lithuanian GDP grew 4.5% in the first quarter. Despite slowing, Lithuania continues to have the highest growth in the Baltics. Growth in exports, which sustained economic growth last year, slowed slightly to 16% y-o-y in the first quarter. Domestic demand growth increased from last year 4% in the first quarter. Fixed capital investments were up 8% y-o-y.

Lithuania’s key service sectors, traffic and communications (10%) and trade (8%), grew in the beginning of the year. Construction output increased 9%. Manufacturing growth was essentially stagnant in the first quarter.

Helsinki Stock Exchange acquires nearly 93% of Riga bourse. On 28 June, 15 shareholder-owners of the Riga Stock Exchange (RSE) signed an agreement on sale of their shares to the HEX Group, which operates the Helsinki Stock Exchange. In March, HEX offered to buy a minimum 75% stake in the Riga Stock Exchange on the condition that the RSE acquire a controlling interest in the Latvian Central Depository of Securities (LCDS). The RSE subsequently acquired an 81% stake in the LCD. The Latvian state, which retains a 19% stake, reportedly intends to sell off all its holdings by the end of this year. The deal creates an integrated market for securities and central depository and follows the model already used in Finland and Estonia. The HEX Group purchased a majority stake in the Tallinn Stock Exchange in March 2001.

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**Baltic GDP growth, %-change from the same quarter of the previous year**

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**Russia: RUB/EUR & RUB/USD exchange rates (CBR)**

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**Russia: 31 – 90 days interbank rate (Mibor), % p.a. (CBR)**

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**Russian share prices (RTS)**

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**Baltic share prices** (Estonia and Latvia the left scale, Lithuania the right scale)

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Editor Timo Harell
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Private consumption drives Russian GDP growth in the first quarter. The State Statistics Committee reports that Russia’s first quarter growth of 3.7 % y-o-y was driven mainly by private consumption (up 5.4 % y-o-y). Public consumption increased nearly 2 %, after a decrease last year. Fixed capital formation in January-March was up 2 % y-o-y.

Russian GDP, private consumption and fixed capital formation, percentage change from four quarters previous.

Russian consumer prices up nearly 15 % y-o-y in June. Monthly inflation slowed in June to 0.5% (down from 1.7 % m-o-m in May). The drop in inflation was led by a fall in food prices, particularly vegetables and milk products. Prices of other goods rose 1.1 % and services were up 1.6 %. Prices for services generally increased 20.3 % during January-May, and one component, housing-related services, increased about 28 %.

Rouble suffers same fate as dollar against the euro. The rouble even outmatched the dollar’s decline in recent months, falling 4 % against the dollar in the second quarter. Against the euro, the rouble lost nearly 13 % of its value in the second quarter – almost 6% in June alone.

Duma approves legislation on taxation of small companies. The Duma has added two new articles concerning taxation of small companies to the tax code. The legislation is designed to simplify taxes for small businesses and consolidate taxes. The amendments apply to companies employing between 30 and 100 people and having annual turnovers of less than RUB 15 million (€500,000). The goal is to lighten the burdens of bureaucracy and taxes on small firms, and switching to the new taxation regime is voluntary. Firms in the system can replace five taxes (profit tax, property tax, sales tax, the unified social tax and value-added tax) with a single tax. The combined tax may be determined as either 6 % of total turnover or as 15 % of total turnover minus expenses. After the new regime small firms continue to make their mandatory pension fund contributions, but are allowed to deduct an amount based on their chosen combined tax rate. The rest of social contributions would be made up from the federal budget. The change is scheduled to enter into force on 1 January 2003.

Russian government approves guiding framework for forest industry development program. The program extends to 2010 and aims at extricating Russia’s forest industry from its current troubles. Although Russia possesses roughly a quarter of the world’s forests, it only accounts for a tiny share of the world’s raw timber markets. The Russian forest industry is notorious for its low levels of value added and investment rates. The program seeks to stimulate production of forest products with higher value-added by lowering export tariffs on processed products and incrementally raising export tariffs on raw wood products. Similar incentives will be applied to direct investment to the sector. Additionally, the lease time limits on forest land will be extended from a few years to 49 years. Eventually, lease times could be raised to 80–100 years.

A concrete action plan is expected in coming weeks and the government is expected to give its final blessing to the plan by early September. Ilya Khlebanov, minister for industry, science and technology, said implementation of the plan would cost $20–25 billion and would occur between 2010 and 2015. The plan is expected to quadruple output of processed forest products and triple the value of such exports to around $14.5 billion annually.

Russia and Ukraine sign natural gas storage agreement. Under an agreement signed between Russia and Ukraine on 1 July, Russia gains the right to store natural gas underground at 13 sites in Ukraine. The agreement complements an agreement signed in June between the Russian Gazprom and the Ukrainian Naftogaz on transporting natural gas across Ukrainian territory. Under the transport agreement, Russia has the right to annually ship 110 million cubic metres of gas via Ukraine for ten years (2003–2013).

At the beginning of June, presidents Vladimir Putin and Leonid Kuchma signed a memorandum on creation of a joint venture between Gazprom and Naftogaz by end-August. The new company will focus on modernisation of Ukraine’s gas pipeline network. Firms from Germany, Italy and France will also be invited to participate in the venture.

Baltic inflation slows in June. Consumer prices rose 3.9 % y-o-y in Estonia and 0.9 % y-o-y in Latvia. Consumer prices in Lithuania fell 0.5 % y-o-y. From May to June, consumer prices decreased 0.1 % in Estonia, 0.6 % in Latvia and 0.3 % in Lithuania. The slowdown in inflation in Lithuania and Estonia reflected the rise in the currencies of the two countries with respect to the dollar. Both the litas and kroon are pegged to the euro. In Latvia, June prices were held down in part by a decline in mobile phone rates. Lower oil prices reduced price pressure on transportation costs. Food prices were also down on-month in June throughout the Baltics.

Estonia posts largest Baltic current account deficit in the first quarter. Estonia’s current account deficit in the first quarter reached 14.5 % of GDP – double the level of

Russian & Baltic Economies
The Week in Review
28.2002
A burgeoning trade gap appeared as exports shrank faster than imports. Increased travel abroad by Estonians helped shrink the services surplus. The net inflow of foreign direct investment (EEK 1.8 billion or €110 million) fell sharply last year and was sufficient to cover only about half of the current account deficit. Monthly figures indicate that both the trade and current account deficits continued to rise in April.

Latvia’s current account deficit in the first quarter amounted to 3.9% of GDP, which was slightly less than in 1Q01. The increase in Latvia’s trade deficit was driven by growth in imports outpacing growth in exports. The growing trade deficit, however, was balanced by an increased services surplus. Latvia saw FDI inflows take off. Their net value of LVL 81 million (€140 million) was sufficient to cover nearly 80% of the current account deficit. Monthly figures indicate that the current account deficit rose slightly in April due to a widening trade gap.

Lithuania’s current account deficit in the first quarter shrank to 3.9% of GDP caused by a narrowing of the trade gap as growth in exports outpaced import growth. The transportation sector helped sustain Lithuania’s services surplus. FDI inflows amounted to LTL 320 million (€90 million), an amount sufficient to cover nearly 80% of the current account deficit. According to monthly figures, import growth accelerated in April, thereby adding to the current account deficit slightly.

IMF praises Lithuania’s robust economic development. On 27 June, the IMF board declared satisfaction with Lithuania’s economic development and released a $16 million loan tranche to Lithuania as part of a stand-by credit arrangement granted last year. The board had particular praise to Lithuania’s rapid economic expansion, low inflation, and shrinking current account deficit, noting these positive developments have continued this year along with progress in structural reform of e.g. the tax system and privatisation. The Fund also announced it was raising its forecast for Lithuanian GDP growth this year to 4.4%. The IMF warned municipal finances still need improvement and stressed the need for rigid discipline in public finances in the face of increased expenditures from e.g. memberships in NATO and the EU and pension reform. Lithuania’s public sector deficit last year rose to 1.9% of GDP, above the 1.4% limit agreed with the IMF.

It is unlikely that Lithuania will ever use the $110 million in stand-by credit available to it under the 2001 agreement. Instead, the availability of such credit is seen as the Fund’s affirmation of the policies pursued by Lithuania. This it the fifth, and likely last, stand-by facility the IMF will provide to Lithuania during its economic transition.

Poland’s finance minister resigns. Finance minister Marek Belka tendered his resignation on 2 July after the government accepted a proposal to raise the ceiling on next year’s budget deficit from an earlier agreed PLZ 40 billion to PLZ 43 billion (10.7 billion). Grzegorz Kolodko, who served as finance minister from 1994 to 1997, was named as Belka’s successor.

Russia: RUB/EUR & RUB/USD exchange rates (CBR)

Baltic share prices

(Estonia and Latvia the left scale, Lithuania the right scale)
Russian industrial output tracks modest growth path. The State Statistics Committee reports that industrial output increased 3.2 % y-o-y in the first half of this year. In workday-adjusted terms, industrial output grew 3.8 %. The workday-adjusted industrial output figure for June was up nearly 5 % over the May figure. Strongest growth in the first half of this year was registered in non-ferrous metallurgy (10 %) and the food industry (8 %). Crude oil production rose 8.4 %, while heat production was up about 6 %. Electrical power production fell 2 % y-o-y in the first half.

**Russian current account surplus shrinks, but so do capital outflows.** Preliminary balance of payments figures released by the Central Bank of Russia indicate that the current account surplus contracted to $1 billion in the first half. The amount corresponds to slightly over 9 % of GDP (15 % of GDP in 1H01). The trade surplus for goods fell to $20 billion, while the trade surplus in services rose to $4 billion. Russia’s export earnings fell 5 % y-o-y. The share of crude oil, oil products and natural gas in total exports of goods and services remained at 45 %.

The capital account deficit fell below $7 billion in January-June according to the preliminary figures. Notably, the net outflow of private capital contracted substantially. The net errors and omission entry, generally considered an indicator of unrecorded capital flows, was remarkably small in the first half of 2002.

In the first half of this year, foreign direct investment in the Russian enterprise sector (excluding banks) amounted to $1 billion ($1.2 billion in 1H01). The CBR’s foreign currency and gold reserves rose nearly $8 billion in the first six months of this year. Since 1 July, the rules for calculating foreign currency reserves have changed so that the CBR no longer includes its short-term foreign currency commitments. Using the new calculation rules, the CBR’s foreign currency reserves stood at $42.2 billion on 1 July.

**Summary of Russia’s balance of payments figures, US$ billion**

<table>
<thead>
<tr>
<th>2002</th>
<th>2001</th>
</tr>
</thead>
<tbody>
<tr>
<td>April-June</td>
<td>January-June</td>
</tr>
<tr>
<td>(estimate)</td>
<td>(estimate)</td>
</tr>
<tr>
<td>Current account</td>
<td>January-June</td>
</tr>
<tr>
<td>- Exports</td>
<td>7,4</td>
</tr>
<tr>
<td>- Goods</td>
<td>28,8</td>
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<tr>
<td>- Services</td>
<td>25,7</td>
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<tr>
<td>- Imports</td>
<td>3,1</td>
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<tr>
<td>- Goods</td>
<td>20,1</td>
</tr>
<tr>
<td>- Services</td>
<td>14,8</td>
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<tr>
<td>Capital account</td>
<td>5,3</td>
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<tr>
<td>Net flow of private capital</td>
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<tr>
<td>Net errors and omissions</td>
<td>-0,3</td>
</tr>
<tr>
<td>Net errors and omissions</td>
<td>-0,1</td>
</tr>
</tbody>
</table>

**Putin signs central bank act.** The act establishes a new 13-member national banking council. The president, Duma and government each name three members, the Federation Council appoints two and the CBR one. The national banking council will oversee CBR activities, approving, for example, annual personnel expenditures, investments and financial statements.

**Russian Federation Council approves several reform bills.** On the final day of its spring session, 10 July, the Federation Council approved several bills seen as critical to economic reform. The approvals included bills on the sale of agricultural land, taxation of small businesses, and revisions to the bankruptcy act. The 1998 version of the bankruptcy act suffered from numerous loopholes, including some that allowed otherwise healthy firms to be liquidated. The new law seeks to tighten the rules on bankruptcy administrators, slightly raise the threshold for bankruptcy eligibility and increase the rights of debtors in a bankruptcy. The Federation Council also accepted bills on military service for conscientious objectors and dealing with extremist elements. The bills must be signed by president to become law.

**Changes in the structure of bank deposits and loans in Russia.** The latest CBR figures on deposit-taking and lending by Russian banks (which do not include accounts in Vneshekonombank and corporate demand accounts) indicate that in May the deposit stock had risen 20 % y-o-y in real terms. Household deposits increased 34 %, while corporate deposits fell. Growth of household deposits focused on currency accounts (up nearly 50 %). Their share of total household deposits rose to 60 %. While household deposits rose about 25 % at Sberbank, they increased nearly 60 % at other banks. Sberbank held 70 % of all household deposits at the beginning of May (down from 75 % in May 2001). Maturities on both rouble and foreign-currency deposits of both companies and households have lengthened since last autumn.

The stock of loans from banks to companies and households in May was up about 30 % y-o-y in real terms.

**Latvia to grant three UMTS licenses.** Latvia is the first Baltic country to set out the bidding rules for licenses to operate UMTS, or third-generation, wireless networks. The Latvian government will grant three UMTS licenses. They will first be offered to the country’s two current mobile operators: Latvijas Mobilais Telefonis, or LMT (jointly owned by the Swedish Telia and the Finnish Sonera) and Tele2 (owned by the Swedish NetCom). They will have the opportunity to purchase the UMTS licenses at a price of LVL 5.8 million (€9.8 million) apiece. If they balk, the licenses will be offered at auction in September. The government has set a starting price of LVL 7.6 million (€12.8 million) per license. The government wants to see a launch of commercial UMTS services by end-2003. Estonia is preparing for the sale of a four UMTS licenses in early 2003. The license will be offered at auction with a starting price pf EEK 50 million (€3.2 mil-
Almost all EU aspirants have seen modest improvements in their purchasing-power-adjusted GDP per capita, putting them closer to the EU average.

## EU accession talks enter final stretch.

At the EU summit in Seville at the end of last month, EU members agreed that the current field of accession candidates would be limited to Estonia, Latvia, Lithuania, Poland, the Czech Republic, Slovakia, Hungary, Slovenia, Cyprus and Malta. They could become members and arrange EU parliamentary elections in 2004 if membership negotiations are completed before the Copenhagen summit in December.

The timetable is very tight, however. No accession candidate has yet closed what are generally considered the toughest chapters of the *acquis communautaire* — agriculture and the EU budget. Moreover, current EU members have yet to accept a proposal of the EU Commission last autumn on agricultural subsidies for new entrants. The applicant countries, too, demand higher subsidies and production quotas than those offered by the Commission. Meanwhile, a separate debate rages within the EU on reform of agricultural policy generally.

Lithuania and Cyprus lead the negotiations, having preliminary closed 28 of the 31 chapters in the *acquis*. Although Bulgaria and Romania did not make the first enlargement round, it was decided at the Seville summit that accession timetables for them would be presented in December in Copenhagen.

### Number of *acquis* chapters already closed.

<table>
<thead>
<tr>
<th>Country</th>
<th>June 2002</th>
<th>December 2002</th>
<th>EU-15 = 100</th>
</tr>
</thead>
<tbody>
<tr>
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<td>28</td>
<td>24</td>
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<tr>
<td>Lithuania</td>
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<td>23</td>
<td>35</td>
</tr>
<tr>
<td>Slovenia</td>
<td>27</td>
<td>26</td>
<td>66</td>
</tr>
<tr>
<td>Latvia</td>
<td>27</td>
<td>23</td>
<td>28</td>
</tr>
<tr>
<td>Estonia</td>
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<td>Slovakia</td>
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<tr>
<td>Czech Rep.</td>
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<td>24</td>
<td>62</td>
</tr>
<tr>
<td>Poland</td>
<td>25</td>
<td>20</td>
<td>37</td>
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<tr>
<td>Hungary</td>
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<td>24</td>
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</tr>
<tr>
<td>Malta</td>
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<td>55</td>
</tr>
<tr>
<td>Bulgaria</td>
<td>20</td>
<td>14</td>
<td>28</td>
</tr>
</tbody>
</table>

* Eurostat
Russia’s federal budget continues to run surplus. Preliminary figures released by finance ministry on the federal budget’s performance in the first six months of this year show revenues of RUB 987 billion and expenditures of RUB 909 billion. The surplus at the half-year mark was on track with the budget forecast, i.e. RUB 77 billion or 1.6 % of GDP.

The revenue figures seem to reflect the impact of recent tax reforms. Revenues from the new consolidated social tax surpassed budget projections by about a quarter to total RUB 170 billion. Only RUB 155 billion of that went to the pension fund. Other tax revenues, however, were slightly below target and totalled RUB 517 billion. The introduction of the new corporate income tax at the beginning of the year may have something to do with the lower tax take. The act lowered the corporate tax rate from 35 % to 24 % eliminated numerous exemptions and increased the range of deductible items. Revenues from customs duties and tariffs were about RUB 260 billion, which was in line with forecast.

Russia’s foreign debt decreased slightly. The finance ministry reports that the debt of the Russian Federation at the end of the first quarter of 2002 was RUB 4,636.3 billion ($149 billion), some $132 billion of which was foreign-currency-denominated debt. Since the beginning of the year, foreign-currency debt has fallen one billion dollars. Central Bank of Russia figures show that in the first quarter the federal government’s foreign debt, i.e. paper held by foreign investors or institutions, amounted to $110 billion, about $2 billion less than at the start of the year. The CBR’s figure for foreign debt of the Russian state, enterprises and financial institutions stood at $150 billion at end Q2.

Mixed earnings reports from Russian companies. 2001 was a banner year for electricity monopoly UES. The company’s financial statements, prepared in accordance with International Accounting Standards (IAS), showed a profit before taxes of $1.3 billion in 2001 ($18.6 million in 2000). The improved financial result mainly reflected successful debt restructuring. For the first nine months of 2001, gas giant Gazprom showed a profit before taxes (IAS) of $1.1 billion, or about $250 million less than in the same period a year earlier.

Oil company earnings fell from 2000, reflecting lower world oil prices, higher excise taxes and export tariffs. Lukoil’s profit in 2001 fell 36 % to $2.1 billion, while Yukos posted a profit before taxes of $3.5 billion, a drop of 6 %.

Russia’s largest carmaker, Avtovaz, saw its profits climb 300 % last year. Its IAS financial statements show a profit before taxes of $459 million, up from $116 million in 2000. Sberbank’s 2001 profit before taxes rose 125 % to $896 million. A revaluation of Sberbank’s securities portfolio drove the gain.

The State Statistics Committee reports that 61.6 % of Russian firms showed profits last year, up from 58.4 % in 2000. While earnings of industrial firms on average weakened in 2001, improvements were seen in the fields of electrical power generation, construction, automobile manufacture, and glass and porcelain industries.

Real incomes continue to rise. Figures released by the State Statistics Committee indicate that the real incomes of Russian workers rose 8 % y-o-y in the first half of the year. The average monthly wage in June was RUB 4,522 (€143), up about 40 % from a year ago. The average wage in real terms rose about 20 % from last year and now stands at the same level as before the 1998 financial crisis. Wage arrears have risen slightly since the beginning of the year. The State Statistics Committee says that wage arrears affected 7.7 million workers in June. Over 70 % of arrears were owed to persons working the social sector (e.g. education, health care, housing).

Russian unemployment falls slightly. The State Statistics Committee reports that the average number of persons unemployed during the first half of 2002 was 5.9 million, or about 10 % fewer than in 1H01. For the period January-June, the number of unemployed fell 3 %. The number of persons officially registered as unemployed in June was 1.2 million, about 20 % more than a year ago. Unemployed as a share of the labour force stood at 8.2 % as of end-June, while Russia’s labour force was estimated to be 72.5 million, about a half of the population.

IMF and Latvia agree to continue stand-by credit arrangement. On 12 July, the IMF’s executive board expressed satisfaction with Latvia’s economic development and released a $31 million (€31.4 million) tranche of a $44 million (€44.6 million) standby credit facility granted in 2001. Last autumn, the IMF withheld a loan tranche when Latvia and the IMF could not agree on a budget deficit ceiling for 2002.

The board members now praised Latvia’s progress in structural reforms, efforts to fight corruption, robust economic growth and low inflation, and noted that Latvia now ranks among the best-developed EU candidate countries. The Fund continued to stress the importance of maintaining a prudent fiscal stance, so that the current account deficit does not exceed 8.5 % of GDP. Moreover, they stressed the need to restrain public spending in anticipation of the added costs of EU and NATO membership. During January-June, Latvia’s budget deficit was slightly over LVL 2.3 million (€3.7 million). The IMF also cautioned Latvia to show greater concern over growing municipal budget deficits. The deficit of consolidated municipal budgets in the first half was LVL 8.9 million (€14.8 million), and Riga’s budget deficit alone was LVL 13 million (€21.6 million). Latvia has no plans to use its standby credit; rather it is seen as an affirmation of support for its economic policies.
Hong Kong beats out Moscow as world’s most expensive city. A just released study by Mercer Human Resource Consulting of 144 major cities found that Moscow is Europe’s most expensive city to live and second as most expensive in the world. The study, which compared prices of 200 goods and services, also found St. Petersburg to be Europe’s second most expensive city (eighth overall) and London the third most expensive (tenth overall). Among the Baltics, Riga ranked 22nd, Tallinn 80th and Vilnius 86th place.
Putin signs laws. Perhaps the most important law recently signed by the president concerns agricultural land. The new law will take effect at the end of January 2003. Although the law does not apply to housing plots, gardens or orchards, it still nevertheless affects nearly a fourth of Russia’s land area. The law bars the regions from enacting separate laws on ownership of agricultural land, but gives regional governments the pre-emptive right of purchase of agricultural land except when such land is offered at public auction.

The law sets no ceiling on the amount of land that can be owned, but it prevents the breaking up of parcels smaller than 10% of a given district’s total farmland. The act calls for applying the civil code rules to still collectively owned former kolkhoz and sovkhoz lands, so that jointly held lands will be subject to the rules of private ownership. The law gives persons with a share of jointly held land the right to separate their plot. Foreigners may only lease land.

Russia’s corporations code and new law on arbitration courts entered into force on 27 July. Amendments to part two of the tax code pertaining taxation of small firms entered into force at the beginning of August. An act on farm supports entered into force on 13 July. It gives heavily indebted farmers the right to once receive debt rescheduling. On 24 July, the president signed an act on investment of labour pension funds. That act entered into force on Wednesday (30 Jul).

Russia’s creditworthiness upgraded. On 26 July, international credit rating agency Standard & Poor’s raised its ratings on the Russian Federation’s long-term foreign-currency and rouble-denominated bonds from B+ to BB-. S&P said the upgrade was justified by the country’s good progress in structural reforms and strict federal budget discipline, which have improved the country’s ability to service its debts. S&P also bumped up to BB- the ratings for long-term foreign-currency bonds issued by Moscow and St. Petersburg.

A rating of BB indicates that Russia’s ability to service its debts is currently adequate, but could weaken substantially in the face of negative changes in the working environment. In other words, Russian papers still carry some risk, so investment should be considered speculative. Fitch IBCA raised its rating of the Russian Federation’s long-term bonds in early May to BB-. Fitch IBCA noted that Russia’s increased ability to pay reflected its progress in structural reform, political stability and improved macroeconomic developments. At that time, Fitch IBCA also raised to BB- its ratings for long-term bonds of Moscow and St. Petersburg.

Russia raises oil export tariffs. On 1 August, the Russian government raised the export tariff on crude oil from €20.40 to €21.90 per tonne. The export tariff increase was based on an average Urals-grade price of €23.60 a barrel during June and July.

Export tariffs for crude oil are reviewed bimonthly and adjusted to reflect prevailing prices.

In mid-September, the export tariff on heavy fuel oil will be hiked from €10 to €20 a tonne. The head of the economy ministry’s tariff regulation department, Andrei Kushnirenko, reports that the increase is intended to assure the normal function of cogeneration plants this autumn and winter.

The government also plans to increase the export tariff on motor fuels from €25 to €35 a tonne. The government hopes the increase will restrain the rise in domestic prices and assure an adequate fuel supply during the harvest season.

Russia exports nearly 420,000 tonnes of crude oil daily and about 70 million tonnes of refined oil products annually.

Growth in major Russian economic sectors slowed in first half of 2002. The production index of the State Statistics Committee, which is based on the performance of five key sectors of the Russian economy, showed growth of 3.7% y-o-y in the first half of 2002, a slowdown of 1.6 percentage points from 1H01.

Growth in retail sales in the first half was still a strong 8.4%, but nevertheless failed to match the figure of 9.6% y-o-y in 1H01. Industrial output slowed from a rate of 5.5% y-o-y to 3.2%, while construction growth fell from 6.4% to 2.8%. Agricultural output grew 4% in the first half of this year, compared to 2.9% in 1H01. Growth in the transport sector accelerated from 2.5% a year earlier to 4.3% in the 1H02.

Sale of LUKoil shares postponed. Although Russia’s State Property Fund had hoped to sell a 5.9% stake in LUKoil to private investors through the issue of Global Depository Receipts on the London Stock Exchange on Wednesday (31 Jul.), an unfavourable market forced it to delay the sale at the last minute.

Baltic budget performances on track. Preliminary figures show Estonia’s public sector surplus in January-June was EEK 1.2 billion (€76 million), or 1.1% of GDP. The state surplus was EEK 1.3 billion, while the municipal budgets netted a deficit of EEK 112 million. Last year, the consolidated public sector surplus was 0.4% of GDP.

Latvia’s success in holding to strict budget discipline in the first half exceeded expectations. The Latvian state produced a surplus of LVL 2.3 million, while municipal budgets showed a net deficit of LVL 8.9 million. Latvia’s consolidated public sector deficit in the first half amounted to LVL 3.8 million (€6.4 million). This, according to preliminary figures, equals 0.2% of GDP, which is well below the deficit ceiling of 1.8% of GDP agreed with the IMF. The IMF decided to reinstate lending to Latvia’s economic program after differences over budget limits caused the IMF to withhold release of a loan.
tranche at the start of the year. In 1H01, Latvia’s public sector deficit was 2.1 % of GDP.

Lithuania’s state revenues were 2.6 % ahead of budget for the first six months of this year, while municipal revenues were running 0.8 % ahead of budget. State expenditures essentially conformed to budget, producing, according to preliminary figures, a net surplus in the first half equivalent to 0.5 % of GDP. Lithuania has agreed with the IMF on a public sector (state + municipalities) deficit ceiling this year of 1.5 % of GDP. Lithuania’s public sector deficit last year was 1.9 % of GDP. In early July, the Sejm approved a supplementary budget authorising LTL 122 million in state expenditures. Total expenditure on the new budget for 2002 is LTL 10 billion (€2.9 billion).

Lithuanian unemployment remains highest in Baltics. Unemployment rates in 1Q02 based on ILO methods were 11.2 % in Estonia and 13 % in Latvia. Preliminary figures indicate Lithuania’s unemployment rate was 17.2 % for the period, which was higher than a year earlier. In contrast, Estonian unemployment has fallen in recent years, with notable improvement of the employment situation in Tallinn. In northeast Estonia, unemployment remains higher than in the rest of the country. There was little change in Latvia’s unemployment rate. The employment situation is poorest in eastern Latvia and best in Riga. In Lithuania, employment was higher in large towns than in rural areas. Throughout the Baltics, unemployment is highest among young people.

The above figures are based on statistical samplings used in labour force surveys. The official monthly unemployment rate based on the number of persons registered as unemployed gives a consistently lower figure, and the methods used are not comparable to international figures due to differences in statistical methodology. The registered unemployment rate has fallen since March throughout the Baltics. At end-May, it stood at 6.0 % in Estonia (down 0.4 percentage points from March) and 11.1 % (-1.5 percentage points) in Lithuania. The similar figure in Latvia at end-June was 7.9 % (-0.3).

EU grants Estonia extra time to reform of its energy sector. On Tuesday (30 Jul.), the EU granted a transition period to Estonia’s energy sector as part of ongoing membership talks. The EU recognised the social, regional and economic importance of the shale oil industry to Estonia and agreed to Estonia’s request that its energy sector be fully opened to competition no earlier than end-2012. Currently, only 10 % of Estonia’s energy markets face open competition and Estonia has committed to opening up 35 % of its market to competition by 2009. Estonia has now closed initial negotiations on 28 chapters in the acquis. Agriculture is one of three chapters yet to be negotiated.
Progress in reform of Russian monopolies. Hundreds of amendments to the package of reform bills concerning electrical power monopoly UES (including the civil code, electricity act, monopolies act, energy conservation act and competition act) are now under consideration by a joint working group of representatives of the government, Duma and Federation Council. Last month, president Vladimir Putin encouraged lawmakers to do their work quickly so that reforms of the energy sector would not be delayed. Among key disputes are the extent of state participation in new companies and the division of authority between the centre and regions. The group hopes to complete its work on the legislative package by August 26. Practical problems facing power companies, such as improving economy, lowering costs and restructuring debts, will be dealt with later. Reform of Russia’s energy sector is scheduled to be in place by the first half of 2004.

At the beginning of September, Russia will launch a trial program that requires all wholesale buyers of electricity to purchase at least 15 % of their electricity on the open market. Up to 85 % can be purchased from the state-regulated market.

Progress in restructuring Russia’s railway monopoly has been slow. On June 26, ahead of adjourning for summer vacation, the Duma approved the first reading of a four-bill package on national railway reforms.

At the beginning of August, president Putin refused to sign amendments passed by the Duma and Federation Council to the 1998 bankruptcy law. The president proposals include the point that creditors be excluded from bankruptcy auctions and that the government retain the possibility to influence the selection of bankruptcy administrators of companies it considers strategic.

Mild rise in Russian consumer prices. The State Statistics Committee reports that 12-month inflation was 15.2 % in July. July consumer prices were up overall 0.7 % m-o-m, while food prices rose 0.4 %, price of other goods 0.6 % and prices of services 1.8 %.

CBR lowers refinancing rate. On Wednesday (Aug. 7), the Central Bank of Russia lowered its refinancing rate two percentage points to 21 %. The move follows a similar lowering in April. After the Russia’s 1998 financial crisis, the refinancing rate was mainly a symbolic indicator and tended to follow market rates. The recent lowerings and statements by CBR officials, however, may signal that the CBR wants to use the refinancing rate actively as a monetary policy tool. The refinancing rate remains substantially higher than market rates. On August 8, for example, the average three-month Moscow interbank offered rate was 16.32 %.

Use of non-monetary payment methods continues to decline in Russia. The State Statistics Committee reports that during January-May only about 18 % of the sales income reported by the largest taxpayers and monopoly firms was received in forms other than cash (IOUs, securities, offset-sets and barter). In 2001, the share of non-monetary payment methods in sales income was 20 – 25 %. The Russian Economic Barometer, which tracks several major industrial sectors, found that the share of barter in relation to sales income of industrial firms had fallen to around 13 % at the beginning of the year (compared to 18 % a year earlier). With the breakdown of the payments system in 1998, barter accounted for about 50 % of sales income of industrial firms.

According to the State Statistics Committee, the stock of intracompany arrears showed little change in January-April compared to the same period a year earlier, and stood at about RUB 750 billion at end-April. Figures released by the tax ministry indicate tax debt on the consolidated budget at end-June stood at RUB 530 billion, a nominal increase of 12 % since the start of the year.

Baltic rail freight volumes increased in the first half of 2002. In the first half of 2002, rail freight volume in Estonia reached 21 million tonnes, an increase of 5.6 % y-o-y. The volume of transshipped freight rose 20 % y-o-y to 18 million tonnes. About 80 % of transit freight originated in Russia and the respective volume increased 17 % y-o-y.

In Latvia, rail freight volume in the first half climbed to 21 million tonnes, an increase of 4.7 % y-o-y. Transit freight was 18 million tonnes, a rise of 20 % y-o-y.

In Lithuania, the state railways carried 17 million tonnes of cargo in the first half of this year, an increase of 20 % y-o-y. Transit freight grew 34 % y-o-y. The large jump came mainly from increased freight volumes between Russia and the Kaliningrad enclave.

Growth of Baltic loan stocks slows. At end-June, the loan stock of banks in Estonia was EEK 45.7 billion (€2.9 billion). The total lending stock in Latvia was LVL 1.8 billion (€3 billion) and LTL 10.1 billion (€2.9 billion) in Lithuania. While growth in loan stocks slowed in all Baltic countries compared to a year earlier, it was still brisk: up 29 % y-o-y in Latvia, 21 % in Estonia and 12 % in Lithuania. Latvia and Estonia saw notable increases in loans granted to private individuals and firms. Bank lending to their finance companies was up strongly in Estonia.

Total assets of banks as of end-June were EEEK 75.2 billion (€4.8 billion) in Estonia, LVL 3.7 billion (€6.2 billion) in Latvia and LTL 15.1 billion (€4.4 billion) in Lithuania.

Interest rates have generally fallen throughout the Baltics. At end-July, three-month interbank lending rates stood at 3.88 % in Estonia, 4.24 % in Latvia and 3.47 % in Lithuania. Interest rates have fallen about two percentage points in all Baltic counties over the past twelve months.
Estonia leads transition countries in index of economic freedom rankings. The US-based Cato Institute, in cooperation with economic institutes in 55 other countries, yearly assesses the “economic freedom of the world.” Its index of economic freedom is based on 37 criteria that evidence e.g. economic progress and the state’s role in the economy.

Hong Kong, Singapore and New Zealand topped the list as the world’s freest economies. Of the 123 countries surveyed in the 2002 report, the highest-ranking transition countries were Estonia (35) and the Czech Republic (38). The other Baltics also had fairly high rankings: Latvia was 47th and Lithuania 60th. Russia ranked at 116.

### Economic freedom index rankings

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Russian finance ministry expects smaller 2002 budget surplus. Finance ministry revised downwards its 2002 budget surplus projection to RUB 58 billion (0.5 % of GDP), about a third of the budget act’s targeted RUB 178 billion (1.6 % of GDP). The realised 2001 budget surplus was RUB 216 billion (2.4 % of GDP). Finance minister Alexei Kudrin explained that the shrinking surplus reflected both higher expenditures and lower-than-expected revenues (excluding social tax). He noted that government spending was increased by such factors as loans granted to regions to pay public sector salaries and raises for the military. Diminishing profit and value-added taxes are expected to hurt revenues. The lower profit tax revenues reflect an elimination of corporate investment incentives, while sped up processing of refunds to exporters cut into VAT revenues.

Some observers say the 2003 budget debate and the upcoming 2004 presidential election are the real causes of the higher expenditures. Critics say the government wants to impress parliamentarians that there is no room for increased expenditure next year while increasing spending this year to secure support of regional officials in the presidential elections.

Russian import growth continued to slow in second quarter. Central Bank of Russia figures indicate Russia’s total earnings from goods exports in the first half fell 7% y-o-y, despite a slowing decline in export earnings in the second quarter. Russian goods imports rose over 7% y-o-y in the first half, but less than 5% y-o-y in the second quarter. Imports from non-CIS countries increased nearly 20% y-o-y in the first half with growth slowing to 17% in the second quarter. Measured in euros, growth in imports from non-CIS countries slowed in the second quarter to just over 10%. Imports from CIS countries fell by about 20% in the first half.

Russian producer prices climb rapidly. Industrial producer prices in June rose 3% m-o-m, after running between 2–2.5% in April and May. The rise in producer prices was due largely to a recovery in domestic prices for oil and oil products in the spring. A drop in domestic oil prices was the main factor restraining industrial producer prices between summer 2001, when a near steady decline commenced, and April 2002 when prices began to recover.

CBR lowers its rates for commercial bank deposits. Last week’s rate cut affects rates on deposits for one-week and longer. For example, the rate for a one-week deposit fell from 7% to 5% and the rate on a one-month deposit fell from 13% to 11%. Having lowered these rates several times since April, some see this as an indication the CBR wants to increase liquidity in rouble markets to make rouble weakening more pronounced. Bank deposits with the central bank grew substantially this summer. Moreover, the rouble has weakened very little against the dollar since late spring.

Eastern Europe’s largest banks – Vneshtorgbank and Sberbank. The Banker magazine’s popular ranking of the world’s top 1000 banks in its July 2002 issue found that Eastern Europe’s largest bank was the Russian Vneshtorgbank (VTB). The survey compares banks in terms of Tier 1 capital, or shareholders’ equity available to cover actual or potential losses. At the beginning of 2002, VTB had Tier 1 capital of $1.9 billion, while Eastern Europe’s number-two bank, Russia’s state-owned Sberbank, had Tier 1 capital of $1.7 billion. The only Baltic bank to make the top-1000 list was the Estonian Hansapank, with Tier 1 capital of $391 million. US-based Citigroup, with Tier 1 capital of $58 billion, headed the list.

Russian banking sector assets up from last year. As of end-June, 1,281 licensed banks operated in Russia. The number showed no change from last year. Some 1,211 banks had licenses to take general deposits, while 820 had permission to engage in foreign currency operations.

The CBR reports that the Russian banking sector’s total assets at the beginning of June amounted to RUB 3,500 billion (€119 billion), compared to RUB 2,700 billion (€109 billion) in June 2001. Some 65% of total banking sector assets were held by Russia’s thirty largest banks and just 149 banks had total assets exceeding RUB 300 million (€10 million).

Sberbank’s assets alone amounted to RUB 950 billion (€30 billion) in June. As of January 2002, Sberbank had granted nearly a third of all business loans in Russia and held about 70% of all deposits of private individuals.
Lithuania posts lowest Baltic inflation. Consumer prices in July were up 3.1% y-o-y in Estonia, 1.0% in Latvia and 0.1% in Lithuania. July prices fell on month 0.3% in Estonia, 0.4% in Latvia and 0.3% in Lithuania. The largest declines were registered in food prices, particularly prices for fruits and vegetables. In Lithuania and Estonia, the price decrease was also caused by the appreciation of their euro-pegged currencies against the dollar in July.

Latvian and Lithuanian exports continue to slide. Balance-of-payments figures show that in the second quarter the value of Estonian exports fell 9% y-o-y, while the value of imports rose 3% y-o-y. The decline in exports was due to a 43% drop in machinery and equipment, and particularly in exports of mobile phones and components to Finland, Estonia’s key trade partner. Other important exports – wood products, textiles and agricultural products – were up on year in the second quarter.

Latvian export growth accelerated to 5% in the second quarter. Exports to EU countries rose 6% y-o-y and CIS countries 13%. Russian export growth boosted food industry exports in the first half and the key wood and wood products sector returned to growth. Imports to Latvia rose 15%.

Lithuanian exports returned to growth in the second quarter with exports up 8% y-o-y. Exports of mineral products, mainly refined oil, fell as most other sectors boosted exports. The largest gains were registered in exports of vehicles (up 52% y-o-y) and wood products (up 20%). Exports to EU countries rose 7% and to CIS countries, mainly Russia, 30%. The transhipping of used cars from Western Europe to Russia via Lithuania made Russia Lithuania’s second most important trading partner after the UK. Imports to Lithuania grew 17%.

Baltic industrial output perked up in second quarter. Estonian industrial output rose 7% y-o-y in the second quarter. Growth in output accelerated from January-March, when output remained at last year’s level. Textiles and minerals continued to be the growth-leading industrial sectors, while growth was stagnant in mechanical wood processing, the food industry, as well as distribution of electricity, water and gas.

Latvian industrial output growth revived in the second quarter to about 6% y-o-y. Growth accelerated in the second quarter in the most important sectors – food, textile and mechanical wood processing industries.

Lithuanian industrial output measured in sales rose 8% y-o-y in the second quarter. According to preliminary figures, Lithuanian GDP also grew faster in the second quarter than in the first. Oil refining activity rebounded in the second quarter along with the food and furniture industries. Manufacture of transport vehicles was one of Lithuania’s fastest growing industries (up 34% y-o-y).
Putin pushes for Russia-Belarus unification. Last week, President Vladimir Putin presented a plan involving national referendums in Russia and Belarus, whereby citizens would be asked if they want a unified state, where rights, freedoms and equality among regions would be defined in accordance with Russia’s current constitution. If the unification is approved, elections of a new unified parliament would be held in December 2003 and election of a president in spring 2004. Mr. Putin also proposed that Belarus adopt the Russian rouble at the start of 2004, a year earlier than the two countries had agreed at the end of 2000.

Putin’s proposals failed to please Belarus president Alexander Lukashenko, who visited Moscow last week. Mr. Lukashenko said unification under the Putin proposal was out of the question, and any union must conform to guidelines agreed between Lukashenko and Boris Yeltsin in the unification treaty signed by the two nations at the end of 1999. Under that treaty, the constitutions of both countries would be harmonised and the highest decision-making body would be a council alternatively led by each nation’s president.

Russian government approves draft version of 2003 federal budget. In the latest version of next year’s proposed budget, revenues are RUB 2,400 billion (18.5 % of GDP) and expenditures are RUB 2,328 billion (17.9 % of GDP), generating a surplus of RUB 72 billion (0.6 % of GDP). $10.8 billion would go to paying down principal on foreign debt, while $6.5 billion will go to servicing interest payments. The top spending priorities are the military, development of the judicial system, social policy, education and scientific research.

Large changes are expected in the structure of budget revenues. At the beginning of 2003, the road tax will be abolished, the share of profit tax revenues going to regional budgets will be increased, and other tax revenues will also be redirected to the regions. The goal is to eliminate “federal mandates” or duties imposed by the central government on the regions without the needed funding. The first Duma reading of the budget bill is slated for late September.

Russian output growth picked up in July. Industrial output rose nearly 8 % y-o-y in July, while the figure for workday-adjusted industrial output grew over 6 %. The seasonally adjusted trend for industrial output showed growth in July for the fourth consecutive month. In the first seven months of 2002, industrial output grew about 4 % y-o-y.

The revived industrial output was reflected in the indicator of five key industrial sectors, which showed an overall rise of 6.4 % y-o-y in July. Retail sales also grew over 10 % in July. In the period January-July, the five leading sectors grew over 4 % y-o-y. Retail sales were up nearly 9 %, while construction grew nearly 3 % and investments 2.6 %.

European Commission to grant market economy status to Russia. The European Commission announced this week that it had approved changes in an anti-dumping statute, paving the way for recognition of Russia as a market economy. Under the amendments, dumping will be measured in terms of Russian companies’ own costs and prices instead of costs and prices of third-country producers. Also the model for determining the competitive advantage gained from export subsidies will be modified. The European Council is expected to formally approve the changes in autumn, after which they will become part of EU law.

July amendments to Russia’s central bank act increase powers of National Banking Council. The amendments were designed to increase central bank transparency, and in the future the National Banking Council will adopt the CBR’s annual report, approve annual budgets for personnel, investments and other administrative costs, as well as decide on CBR participation in other credit institutions. The Council will determine the scope of the CBR’s audit and select the auditor. The CBR’s independence is affirmed by the statement, which says that the central bank’s activities are independent of other government agencies.

The amendment also raises the number of members on the Council to 12, which includes an extra two seats for presidential representatives and one more seat for a Duma representative. In the future, the Duma will decide (upon proposal by the Council) the central bank’s inspections carried by the comptroller’s office. The central bank must now divest its holdings in Vneshtorgbank by January 1, 2003. After long negotiations, the Duma decided to limit central bank inspections on one matter of a credit institution to once a year. The central bank will implement its banking regulation and supervision functions via a Banking Supervision Committee.

Baltic current account deficits increase. Monthly figures show Estonia’s current account deficit in the second quarter climbed to EEK 2.7 billion (€170 million) or nearly 10 % of forecast GDP. In 2Q01, the current ac-
count gap was less than 2 % of GDP. The deficit widening was driven by the trade deficit, which reflected lower exports and higher imports. Foreign direct investment inflows to Estonia were EEK 2 billion, while FDI outflows from Estonia were EEK 0.7 billion. Estonia’s current account deficit in the first half was equivalent to about 12 % of GDP.

Latvia’s current account deficit in the second quarter was LVL 110 million (€190 million) or nearly 9% of GDP. In 2Q01, the current account was just over 6 % of GDP. Despite a growing services surplus, the deficit continued to rise as growth in imports outpaced export growth. The net inflow of FDI to Latvia was LVL 90 million, substantially more than a year ago. Latvia’s current account deficit in the first half was about 6% of GDP.

According to monthly figures, Lithuania’s current account deficit grew in the second quarter to LTL 1.1 billion (€310 million) or 8.5 % of GDP. A year ago, the deficit was just 4 % of GDP. Imports to Lithuania grew faster than exports. The services surplus grew 7 % y-o-y. FDI inflows to Lithuania were clearly more than a year earlier, LTL 990 million. Moves that included privatisation of the national gas company and sale of a stake in the Mazeikiu Nafta oil refinery lifted investments. Lithuania’s current account deficit in January-June exceeded 6 % of GDP, slightly more than a year earlier.

**Real estate sales up in Estonia.** Last year some 20,400 officially notarised real estate deals took place in Estonia, a 39 % increase from 2000. The total value of these real property transactions was EEK 9.5 billion (€600 million). The most real estate deals were sealed in northern and southern Estonia, the fewest were done in northeastern Estonia. The highest sales volume involved un-renovated properties and private apartments.

Increased housing demand in the Tallinn region has steadily pushed up prices, with the greatest demand for small apartments. Housing loans rose 47 % y-o-y, Estonia’ stock of housing loans stood at EEK 7.4 billion (€500 million) at end-June.

**Williams sells its stake in Mazeikiu Nafta to Yukos.** US-based Williams International announced Tuesday (Aug. 20) its intention to sell a 27 % stake in Lithuanian oil refiner Mazeikiu Nafta to the Russian Yukos for $85 million. The sale has yet to be approved by the Lithuanian government and Russian officials. Williams purchased a stake in Mazeikiu Nafta in 1999. The Lithuanian state owns 41 % of the company; Yukos bought a 27 % stake earlier this summer. Mazeikiu Nafta, which owns an oil refinery, an oil pipeline and the Butinge oil terminal, has operated at a loss in recent years. During the first half of 2002, the company’s losses were nearly LTL 140 million (€40 million).
CBR releases draft of 2003 monetary policy framework. The draft was prepared in cooperation with the government, which has accepted the main policy points. According to the draft, the Central Bank of Russia’s top medium-term aim will be containing inflation. Since the CBR’s monetary tools do not affect all components of consumer price inflation, it will seek to hold the so-called base inflation to 7.5–8.5% p.a. in 2003. If successful, that would translate to consumer price inflation in the range of 9–12%.

The CBR also wants to increase the significance of interest rate policy as a monetary policy instrument and keep Russia’s floating exchange rate stable. The central bank says the rouble’s real exchange rate with respect to Russia’s main trading partners has room to strengthen not more than 4–6% next year, when the rouble’s nominal exchange rate is expected to be 33.7–34 roubles to the dollar (annual average). The CBR seeks to promote development of banks and financial markets and promote their roles in the national economy.

Russian money supply growth slowed slightly in first half. The rouble money supply (rouble M2), which includes rouble cash in circulation and rouble deposits and other accounts in Russian banks, was up 35% y-o-y at the beginning of July (40% y-o-y in December 2001). A broader money concept, which also includes foreign currency deposits with Russian banks, increased 31% (36% in 2001).

The supply of rouble cash was up 36% y-o-y at the start of July, while rouble-denominated deposits grew by 35%. The stock of rouble cash in circulation at the beginning of July equalled about 6.5% of annual GDP (compared to less than 6% a year earlier) and rouble and currency-denominated accounts exceeded 17% of GDP (just over 16% a year earlier).

CBR changes forex surrender rules. Before the decision by the CBR’s board on August 23, exporters had to sell 50% of their export earnings on one of Russia’s eight foreign currency exchanges or directly to the CBR. Now, this part of export earnings may also be sold to the seller’s bank directly or on interbank markets outside the currency exchanges. The decision will take effect upon official publication. Under a supreme court ruling last spring, the CBR’s former rule restricting where exports earnings could be sold violated several statutes.

Putin issues strict ethical guidelines to public officials. The August 12 presidential decree was seen as an indication to state officials of measures the president expects incorporated into the public officials’ act currently under preparation in the Duma. Under the decree, public officials are required in the course of performing their duties to respect civil rights, be independent and non-partisan, and keep their personal interests separate from their obligations to society. The president also wants public officials to treat members of the press with respect.

Latvia’s creditworthiness improves. On August 20, international credit rating agency Standard & Poor’s (S&P) raised its rating on Latvia’s long-term foreign-currency bonds to BBB+, or one notch better than the previous BBB rating. S&P said the main reasons for Latvia’s improved credit rating were its continued economic growth in spite of the weakened outlook for the global economy and stable fiscal policies. S&P praised Latvia’s strong investment activity and implementation of structural reforms. The ratings agency believes that Latvia’s approaching EU-membership will support economic growth in the medium-term. S&P said Latvia’s main weakness was its persistent large current account deficit and sizeable external financing deficit. In July, Fitch IBCA confirmed Latvia’s sovereign credit rating to BBB.

Ratings for long-term foreign-currency bonds of Baltic countries

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<th>Country</th>
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<th>Moody’s</th>
<th>Standard &amp; Poor’s</th>
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Only two telecoms show interest in buying Latvian UMTS licenses. Latvia’s two current wireless GSM network operators, Latvijas Mobilais Telefons, which is partly owned by the Swedish Telia and the Finnish Sonera, and the Swedish NetCom Tele2, have announced their intentions to apply for third-generation broadband wireless (UMTS) licenses. The Latvian government has offered licences for LVL 5.8 million (€10 million) apiece. The government hoped to auction a third UMTS license in September, but no other operators showed interest by the deadline. The original starting bid price was LVL 7.6 million per license.
Slovenia the least corrupt transition country. On Wednesday (Aug. 28), Transparency International published its annual country rankings based on its Corruption Perceptions Index (CPI). The CPI reflects how prevalent business people and country analysts see corruption affecting national administration in 102 countries. The research combines the results of 15 polls by nine institutions and measures corruption on a scale of 0–10. Zero would signify an absolutely corrupt state. Finland again topped the list as the world’s least corrupt country.

<table>
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<th>Country</th>
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Latvia ranking up slightly in UN survey of living standards. Latvia gained one place to 53 in the UN Development Programme’s latest rankings based on 2000 data. Russia, Estonia and Lithuania saw no change in their rankings. The survey of 173 countries measured living standards in terms of a Human Development Index, which considers income per capita, quality of education and health care, and the average life expectancy. Norway had the highest HDI score; Finland ranked tenth.

**Human Development Index trends for select transition economies**

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<th>Survey year</th>
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*Human Development Report 2002, UN Development Programme*
Russian consumer price inflation slows in August. The State Statistics Committee reports 12-month inflation in August was 15%, and that consumer prices rose just 0.1% m-o-m. Food prices fell about 1% from July, reflecting the seasonal decrease in prices of fruits and vegetables. Prices of other goods rose 0.7% and prices for services were up 2.5%. Housing and housing-related services rose 4% in August and were up 50% y-o-y.

Monthly change in consumer prices in Russia, %

![Graph showing monthly change in consumer prices in Russia, % from 2000 to 2002.](image)

Russian fuel exports up; increased imports of machinery and food. Russian export earnings fell 1% y-o-y in the second quarter, bringing the overall drop for the first half to 7%. Volumes of key export items rose sharply in the second quarter. Crude oil exports, for example, increased 13% y-o-y, or nearly the same pace as in the first quarter. Growth in exports of oil products accelerated to 17% and natural gas exports, after falling for about two years, grew 13%. Export volumes of basic forest industry products also grew. Higher oil prices also boosted export earnings. The export price of Russian crude was 20% higher in the second quarter than in the first. The decline of natural gas prices halted in the second quarter. Crude oil, oil products and natural gas accounted for slightly over half of all Russian exports in the first half of 2002.

Figures from the State Customs Committee show that imports (excluding passenger cars) grew over 15% y-o-y in the first half (compared to 7% growth for imports overall), although growth slowed in the second quarter. Imports of machinery and equipment from non-CIS countries were up over 25% in the first half, while total imports from non-CIS countries grew slightly less than 20%. The share of machinery and equipment (excluding cars) rose to 32% of total imports and 34% of non-CIS imports. Imports of food products and ingredients increased by one quarter. Their share rose to 25% of total imports and 27% of non-CIS imports.

Russian government prepares to support grain farmers. In recent weeks, the demands of governors in agriculture-intensive regions for government support of sagging grain prices have grown louder. Despite official forecasts that this year’s grain harvest will only reach 75–77 million tonnes, some observers see this harvest exceeding last year’s near-record 85 million tonnes. Plenty of last year’s grain harvest still remains in storage. With this year’s harvest looking increasingly abundant, grain prices have collapsed at a time when prices for fertilisers, spare parts and fuel are rising rapidly.

At end-August, the government decided that the state would buy wheat and rye at set minimum prices. Agriculture minister Alexei Gordeyev reports that some RUB 6–7 billion will be needed, although the current budget only reserves RUB 1 billion for this purpose. Various ministries are presently trying to devise a practical buying scheme and find funding. Observers expect the purchases to begin in early October. The government will decide on the scheme’s details on September 19, when it also will consider a grain market development program for the rest of this decade.

Russia’s budget surpluses shrink in the first half of 2002. The surpluses for both the consolidated budget (combined federal and regional budgets) and the federal budget contracted in relation to the first half of 2001. Excluding effects from the new social tax (its revenues are transferred via the federal budget to the national pension fund), the consolidated budget surplus at end-June equalled 3% of GDP, down from 4.5% a year earlier. The federal budget surplus fell during the same period from 4.1% of GDP to 2.6%. The decline reflects a decline in some major tax revenues and increased government spending. In relation to GDP, profit taxes, customs tariffs and excise taxes have been hit hardest. Income taxes revenues grew, however. The largest spending increases occurred in the “social and cultural expenditure” category, and represented in the consolidated budget an amount equivalent to 9.6% of GDP (8% of GDP in 2001). In the federal budget, regional supports increased substantially, while debt-servicing costs fell in relation to GDP.

Foreign direct investment in Russia continues to slide. The State Statistics Committee reports that $1.9 billion in FDI flowed into Russia in the first half of 2002. In 1H01, FDI was $2.5 billion (these figures differ from the central bank’s balance-of-payments figures, which show FDI inflows of about $1 billion in 1H02 and $1.2 billion in 1H01). Some 40% of FDI in the first half went to the trade sector. Another 13% went into crude oil production, while 10% went to machinery and equipment manufacture and a similar amount to food production. State Statistics Committee’s figures showed Russia’s FDI stock at mid-year amounted to $18.6 billion. The US continued to account for over a fifth of Russia’s FDI, while FDI from Cyprus represented slightly less than a fifth. The next largest providers of FDI were the Netherlands (12%), Great Britain (11%) and Germany (8%).
**Russian government doubles used car import tariff.** After a year of complaints from Russian carmakers, the government finally caved in to their demands and raised import duties on passenger cars older than seven years. The higher tariffs will remain in force for nine months starting at the beginning of October. They will vary based on engine volume from €1.40 to €3.20 per cubic centimetre. The government hopes the tariff hike will provide the Russian car industry with a reprieve ahead of Russia’s expected WTO membership.

**Tourists spend more nights in Baltics.** In the first half of the year, 1.4 million foreigners visited Estonia, a slight decrease from the same period a year earlier. The average length of tourist visits to Estonia increased to nearly two days, which increased overall spending on lodging. Over half of all tourists arrived from Finland. Foreign visitors were estimated to have spent some EEK 12 billion (€740 million) during their visits, or an amount equivalent to 12% of GDP. With the approach of EU membership, Estonia’s tourism sector faces the loss of tax-free sales on Baltic ferries. Estonia petitioned the EU for an extension to 2009, but it was rejected by the EU in June.

**Lithuanian government approves Mazeikiu Nafta’s new ownership structure.** On Wednesday (Sept. 4), the Lithuanian government chose not to exercise its preemptive right to repurchase Mazeikiu Nafta shares offered by US-based Williams International. Thus, Russian oil company YUKOS will acquire Williams’ 27% stake in Mazeikiu Nafta, making it the majority owner (54%) of the Lithuanian oil refinery. The Lithuanian government retains its 41% stake.
Russian consolidated regional budget surplus shrinks. For January-July, the surplus of consolidated regional budgets (combination of municipal and local budgets) equaled 0.5 % of GDP, down from 0.8 % of GDP a year earlier. Revenues in the first seven months of this year corresponded to 18 % of GDP, while expenditure was 17.5 % of GDP (for the same period in 2001 the figures were 14.5 % and 13.7 %, respectively). Tax revenues in relation to GDP increased, although the revenue streams from various taxes shifted emphasis. For example, revenues from income taxes were up substantially, while the take from corporate profit taxes fell. Although profit taxes and transfers from the central government continue to be very important, income taxes were the single largest revenue source for regional budgets in the first seven months of this year. Transfers from the central government also increased from last year.

In the first seven months of 2002, the three largest spending items – education, housing and health care – accounted for about 43 % of all regional expenditures, down from nearly 50 % in 2001. In relation to GDP, education and health care costs rose sharply, while housing costs fell as a bigger share of the burden was transferred to residents.

Russian unemployment down substantially from a year ago. The State Statistics Committee, which uses ILO methods, reports that as of end-July 5.5 million persons were unemployed (7.6 % of the labour force). As of end-July 2001, there were 6.1 million unemployed persons (8.6 % of the labour force). Only 1.2 million persons were officially registered as unemployed in July 2002.

Russian unemployment, percentage of labour force

Rouble exchange rate tracks unique path in relation to the dollar and other major currencies. The rouble’s monthly average exchange rate fell in July and August just a half percent in relation to the dollar, which was slightly slower than earlier in the year. The nominal exchange rate has weakened nearly 5 % since December. The rouble’s real exchange rate in relation to the dollar rose in January-August nearly 3 % and was up over 5 % from August 2001. The rouble’s exchange rate has somewhat tracked the dollar’s fluctuations in relation to the euro. It was down over 4 % against the euro in July, but rose slightly in August. Because of the euro’s strengthening, the rouble’s real exchange rate weakened over 2 % in January-August and over 1 % from August 2001 in relation to the currencies of Russia’s main trading partners.

Real incomes in Russia continue to rise. According to the State Statistics Committee, real disposable incomes were 10 % higher in July 2002 than a year earlier. The average gross monthly wage in July was 4,520 roubles (146 euros), which in nominal terms was an increase of nearly 35 % from a year earlier. In real terms, the average wage grew 17 % y-o-y. Highest wages were paid in the gas and oil industry, where wages are three to four times the average wage. Lowest wages were in agriculture and light industry, where they were less than half the average wage.

Russian government triples salaries of top-level bureaucrats. On Wednesday (Sept. 11), the government decreed a 200 % extra wage hike retroactive to June 30 for top executive civil servants. The stated basis of the hike was the special nature of civil service.

Changes in structure of Russian investment. While investment only grew slowly (2.6 % y-o-y in January-July), there were changes in the structure of investment in the first half. The share of investment in crude oil production and oil refining fell to less than 17 % of total investments (18 % in 1H01), while strongest investment growth in industry took place in metallurgy. The transport sector’s share was 19 %, substantially less than in recent years. On the other hand, the housing sector’s share rose to 15 % of total investments, and completed housing space was up 15 % from 1H01. The shares of telecommunications and agriculture in overall investments also grew (4 % and 5 %, respectively). Companies relied even more heavily on their own funds to finance investments (nearly 52 % of the total), while bank loans increased their share in 1H02 (to a still rather insignificant 4.5 %). Public sector budgets provided 19 % of funding, almost the same amount as in 2001.

Baltic consumer prices fall in August. Consumer prices in August were down 0.5 % m-o-m in Estonia, 0.8 % in Latvia and 0.6 % in Lithuania. The biggest drops were registered in food prices. In Estonia, 12-month inflation slowed in August to 2.6 % y-o-y (3.1 % in July) and 0.9 % in Latvia (1.0 % in July). Lithuania’s low inflation in July (0.1 % y-o-y) turned to deflation in August, when prices were 1.1 % lower than a year earlier. Estonian and Lithuanian import prices have fallen this year, reflecting the euro’s rise against the dollar, and...
Baltic consumer price inflation, percentage change from 12 months earlier

Baltic construction activity remains strong. In nominal terms, construction output in Estonia was up 33% y-o-y in the first half. Measured in terms of building volume, the leading sectors were transport, restaurants and trade. The number of apartments built rose substantially from a year ago, although the apartments tend to be quite a bit smaller than earlier. Over 80% of apartments were built in the Tallinn region, and construction generally tended to focus on the Tallinn and Tartu regions.

In the first half, construction activity in Latvia rose 7% y-o-y. Apartment construction was particularly brisk. There were large increases in the number of building permits for manufacturing buildings and warehouses, as well as hotel and transport sectors. The number of building permits granted to the trade sector fell.

The nominal production value of Lithuanian construction companies rose 25% y-o-y in the first half. The largest gains were seen in apartment construction, trade sector construction, as well as in the hotel and restaurant sector. In contrast, construction of industrial facilities, warehouses, office buildings and agricultural structures fell. Nearly half of all construction occurred in the capital region.

Despite the strong rise in construction activity, building costs have remained under control. In June, construction costs were up 4% y-o-y in Estonia and 0.5% y-o-y in Lithuania. Costs fell 4% y-o-y in Latvia.

Thus the external values of the kroon and litas, which are pegged to the euro. Tighter competition in domestic markets was also seen as a reason for lower inflation.
Russian economic growth picked up slightly in the second quarter. The State Statistics Committee reports that GDP rose 4.1% y-o-y in the second quarter (3.7% in 1Q02). Although still below 4%, the goods production component of GDP rose slightly faster in the second quarter than in the first quarter. The pick-up in goods production reflected higher levels of industrial and construction activity. Growth in the services component of GDP also accelerated in the second quarter to a rate of 4.5% y-o-y. Unlike in previous years, service sector growth outstripped goods production. Private services grew 5% y-o-y in the second quarter despite a slowdown in the trade sector. Public services grew about 2%.

Goods production as a share of GDP fell to 40% in the first half (down from a 42% share in 1H01), while industry’s contribution to GDP fell below 30%. Trade’s (part of the service sector) share of GDP fell to 23%, while the shares of other private services grew substantially. The share of public services also increased.

Russian GDP growth, growth of goods and services components, percentage change from four quarters previous

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Slower growth in Russian industrial production. The State Statistic Committee reports industrial output rose 3.4% y-o-y in August, which was slightly lower than in June or July. Workday-adjusted growth was 4.9% y-o-y. For the first eight months of 2002, industrial output increased 3.8% y-o-y or 4.2% in workday-adjusted terms. Industrial production increased fastest in August in export-focused industries, i.e. fuel, chemicals and non-ferrous metals. Each industry grew at about 7% y-o-y.

Russian central bank continues liberalisation of forex markets. The Central Bank of Russia will end costly foreign exchange practices its currently applies to commercial banks. The problem is that when export firms surrender 50% of their foreign exchange earnings to banks for sale, the bank must, in turn, deposit the sum in a non-interest-bearing account at the foreign currency exchange ahead of the auction. Beginning in December, banks will no longer be required to make such deposits. Earlier, the CBR decided to permit the sale of foreign currency income also elsewhere besides foreign currency exchanges as of the beginning of December.

Russian sovereigns gain investor interest. Prices for sovereign Eurobonds and MinFin bonds dropped in June and late July in response to uncertainty elsewhere e.g. economic developments in Latin America. Bond prices, however, rebounded in August. The prices on short-term eurobonds (maturing between 2005 and 2010) have risen 2–4%, returning to levels last seen in late spring. Longer-term bonds currently show prices roughly 2% below late-spring levels.

Russia raises export tariff on crude oil. From the beginning of October, the Russian government will boost export tariffs on crude oil and crude oil products from $21.90 to $26.20 a tonne. Export tariffs are reviewed every other month to make sure they reflect crude oil prices on the world market. Russian custom’s figures indicate crude oil exports from Russia rose to about 103 million tonnes, or 12% y-o-y, in the first seven months of 2002.

Duma set to debate reform of Russian energy sector. A legislative package on energy sector reform hammered out by the government with the Duma and Federation Council was submitted this week to the Duma for consideration. The main refinements in the bills concern the break-up of electricity monopoly UES, giving regions the decision power in certain energy matters, conditions that would allow power companies to cut off service to deadbeat customers, tariff ceilings and rules allowing companies in some cases to be simultaneously involved in generation, transmission and distribution of electricity. Under the reform proposal, regional officials would determine transmission rates, district heating rates (excluding cogeneration plants), use of water bodies for power generation, siting of power plants, as well as oversee the enforcement of regulated pricing schemes. Regions would also be able to influence future investment in the national grid.

Energy prices would remain partly under government regulation until the transition period ends. In the first phase, the state would own 52% of the national grid and UES distribution companies. Later the government would raise its stake to 75%.

The Duma’s largest bloc, the centrist Fatherland – All Russia, responded with demands that the price of electricity sold to households continue to be low, that the government decide power rates in conjunction with preparation of the annual budget and that the state own all power companies outright.
Estonian parliament set to consider deficit budget. The Estonian government has approved a version of next year’s budget showing expenditures of EEK 38.7 billion (€2.5 billion) and revenues of EEK 38.5 billion. Thus, this draft budget proposes Estonia’s first deficit budget (0.3 % of GDP) since 1991. The government explained the exceptional deficit was due to spending on pension reform. Expenditures in the 2003 budget are about 15 % higher in nominal terms than in this year’s budget.

State revenues this year have exceeded the budget, which showed a surplus for the first seven months of 2002. The surplus has been partly applied to two supplementary budgets; the second one still awaits parliamentary approval.

Estonia’s central bank seeks to restrain lending. On September 12, the Bank of Estonia announced that the government was shifting about one billion kroons (€64 million) of its deposits with commercial banks to the central bank. The move is intended to dampen growth in lending, which now clearly outstrips growth in deposits. In coming weeks, the central bank and financial supervision authority will issue new recommendations and proposals for commercial banks on lending terms.

The loan stock of Estonian banks has grown since the start of 2000 and stood at EEK 45.4 billion (€2.9 billion) as of end-July (an increase of 18 % y-o-y). In the first half of the year, lending was up 28 % y-o-y.

Latvian economic growth remained strong in second quarter. Latvian real GDP in April-June grew 4.9 % y-o-y. Growth in the first half was 4.4 % y-o-y. Strong domestic demand in the second quarter drove higher growth in nearly all production sectors in comparison to the first quarter.

The service sector grew at a rate of 5% in second quarter and accounted for 71 % of Latvian GDP. Among the major service categories, trade, real estate and corporate services continued to post strong growth. Growth in the transport sector was just 2 %, reflecting a drop in oil transhipments. Manufacturing output grew 8% y-o-y, substantially faster than in the first quarter.

According to preliminary estimates, second-quarter GDP growth was 6.5 % in Estonia and 6.9 % in Lithuania. More detailed figures will be released at the end of this month.

Lithuania applies for OECD membership. The Lithuanian government has submitted its official application for OECD membership. Lithuania is the first Baltic state to express formal interest in joining the organisation. The Organisation for Economic Cooperation and Development currently consists of 30 industrialised states.
Russian Duma approves first reading of 2003 federal budget. Wednesday’s (Sept. 25) first reading of the 2003 draft budget focused on setting targets for revenue and expenditure, and underlying assumptions for inflation and GDP growth. A wide majority of Duma deputies supported a revenue target of RUB 2,418 billion (€78 billion or 18.5 % of GDP) and an expenditure target of RUB 2,346 billion (€76 billion or 18 % of GDP). The unified social tax, which was introduced at the start of the year, is included in both revenue and expenditure targets. The draft budget shows a surplus of RUB 72 billion (0.6 % of GDP), of which RUB 51 billion will go to paying down debt and RUB 21 billion will be set aside in the financial reserve. The budget assumes a target range for annual inflation next year of 10–12 %; GDP is estimated to reach RUB 13,050 billion. The second reading of the budget is scheduled for October 18.

Russian state plans to increase its domestic borrowing. The finance ministry expects to borrow RUB 200 billion from domestic market this year, about twice its original plan for 2002. In the coming months the government would issue RUB 58 billion in medium-term bonds and RUB 42 billion in ten-year bonds. Part of the money raised from the sale of medium-term bonds may go to building up the financial reserve. The Russian state will use the money from the 10-year bonds to buy out the central bank’s 99.9 % stake in Vneshtorgbank. Domestic borrowing should continue to feature prominently in the government’s plans next year as well. The budget draft projects some RUB 160 billion (with interest and other costs deducted) will be raised from the sale of government bonds, some RUB 50 billion of which represents net domestic borrowing.

Russian pensions up in real terms, but still below 1998 pre-crisis levels. The State Statistics Committee reports that the average pension in July was 1,340 rubles (43 euros), a 14 % increase in real terms over July 2001. For the first seven months of this year, real pensions were up 20 % y-o-y and corresponded to about a third of the average wage. Real pensions in July 2002 were still 13 % smaller than real pensions in July 1998, however.

Russia and Azerbaijan agree on Caspian border areas. Under the treaty signed on September 23, Russia and Azerbaijan will designate rights to the Caspian sea floor resources with a median line. Russia earlier penned a similar treaty with Kazakhstan, and Azerbaijan and Kazakhstan also have their own bilateral agreement. The treaties concern the use of sea-bottom mineral deposits, leaving sea surface and the water body itself for common use by all countries.

Turkmenistan and Iran, which also share Caspian shoreline, have their own views on demarcation. Iran strongly opposes bilateral agreements among coastal states, as well as unilateral actions by any country before overall jurisdiction of the sea is determined. Iran prefers joint use of the Caspian Sea by shoreline states, but if that is impossible, division of sea bottom on a “20%” basis with each state gaining an identical share. Under the median line approach preferred by Russia, Kazakhstan and Azerbaijan, Iran would get access to about 0.9 billion tonnes of estimated oil reserves below the Caspian Sea floor. Under the 20 % arrangement, it would gain approximately one billion additional tonnes of oil.

Duma says yes to competition law amendments. At last week’s (Sept. 18) third reading, the Duma approved amendments to Russia’s act regulating competition and monopolistic behaviour in the market. The amendments, which have been under preparation for a year, clarify the roles of the state and the competition office.

Estonian parliament approves second supplementary budget this year. On Wednesday (Sept. 25), the Estonian parliament approved its second supplementary budget this year in a vote of 56 to 20. Most of the EEK 778 million (€50 million) supplementary budget will go to providing support for the disabled, a drama theatre renovation, acquisition of an office building in Brussels and funding compensation to farmers that suffered in this summer’s drought.

Estonian tax revenues this year have exceeded the budget and are sufficient to cover both the first supplementary budget passed in June and this second supplementary budget. Supplementary spending this year will total EEK 1.2 billion or about 3 % of the 2002 state budget.

Lithuania’s approaching memberships in EU and NATO cause increases in next year’s budget. The Lithuanian government approved the 2003 budget proposal on Wednesday (Sept. 25). The draft budget shows expenditures of LTL 12.2 billion (€3.5 billion) and revenues of LTL 10.9 billion. Thus, the projected budget deficit is below the ceiling of 1.5 % of GDP agreed with the IMF. It assumes Lithuanian GDP will grow 4.9 % next year.

Nominal budget expenditures will rise about 10 % next year. The government says next year’s added spending mainly reflects costs connected with preparations for EU and NATO memberships. Lithuania expects to be invited into NATO at the upcoming Prague summit in November and has already budgeted the equivalent of 2 % of GDP for defence.

YUKOS buys out Williams Mazeikiu Nafta holdings. Last week (Sept. 19) US-based Williams International and the Russia’s number-two oil company, YUKOS, signed an agreement, whereby YUKOS acquired Williams’ entire 27 % stake in Mazeikiu Nafta for a price of
$85 million. YUKOS now controls 53% of the Lithuanian company and oversees daily operations. As part of the deal, YUKOS reimbursed Williams for a $75 million loan it earlier granted to Mazeikiu Nafta and assumed the loan itself. YUKOS plans to continue with the modernisation of the Mazeikiu Nafta refinery and expects the company to produce a profit within three to five years. Before finalising the deal, the Seimas gave its approval of YUKOS as a strategic investor in Mazeikiu Nafta.

Most country risk rankings of transition economies continue to climb. *Euromoney* magazine’s September country risk poll surveyed the same 185 countries it did last March. *Institutional Investor* magazine’s poll continued to include 151 countries. Russia and Ukraine moved up considerably in both polls. EU accession candidates Slovenia, Lithuania and Romania also rose clearly in the rankings. Especially Bulgaria and also Hungary saw more improvement in the *Euromoney* poll, while Estonia and Latvia did notably better in the *Institutional Investor* poll. Poland moved down slightly in both polls. Slovakia dropped significantly in the *Euromoney* poll.

### Country risk rankings for transition economies
September 2002, March 2002 and September 2001

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### Russia: RUB/EUR & RUB/USD exchange rates (CBR)

### Russia: 31 – 90 days interbank rate (Mibor), % p.a. (CBR)

### Baltic share prices
(Estonia and Latvia the left scale, Lithuania the right scale)

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Editor Timo Harell
Information herein is compiled and edited from a variety of sources. The Bank of Finland assumes no responsibility for the completeness or accuracy of the information.
Growth forecast for Russian economy revised upwards. Prime minister Mikhail Kasyanov now expects the Russian economy will grow about 4% this year, up from the 3.6% growth forecast earlier. The revision reflects higher-than-expected economic growth in the second and third quarters. The state statistics committee reports that total output grew 4.1% y-o-y in the second quarter. The index of five key sectors used to forecast total output grew 3.9% y-o-y in August. The September issue of the IMF’s World Economic Outlook predicts Russia’s total output will grow 4.4% this year.

Russian investment and related economic growth are still governed to a large extent by trends in world oil prices. Total output growth slowed at the beginning of the year in line with lower investment growth, which, in turn reflected a drop in oil prices during the second half of 2001. The present pick-up in economic growth occurs mainly on the heels of rising oil prices in the first half of this year.

Russia tightens rules to prevent money laundering. In second and third readings held September 27, the Duma finalised changes to the anti-money-laundering act that came into force in February this year. One amendment increases the number of organisations that must report suspect transactions. Thus, besides banks, insurance companies and companies involved in securities trading, the duty to report will now also extend to e.g. investment funds, pension funds, precious metals dealers and casinos. As before, transactions below RUB 600,000 (about $19,000) are not subject to the mandatory reporting requirement.

Russia’s anti-money-laundering laws continue to be tightened in response to demands from the OECD’s Financial Action Task Force (FATF). Once the measures of the amended act are in place, Russia wants the FATF to remove it from its blacklist of countries failing to fight vigorously enough against money laundering. FATF experts visited Moscow last week to evaluate the current situation in Russia.

Duma approves additional 2002 budget funds to support domestic grain interventions. On September 27, Russia’s lower-house Duma approved in all three readings a government-proposed amendment to the 2002 budget act that provides an additional RUB 6 billion to support domestic grain prices. The bill, designed to lift depressed grain prices, calls for government grain purchases to begin already this month. The original 2002 budget only set aside one billion roubles for grain-market interventions. Two consecutive good harvests and an overall drop in demand for domestic grain have driven down grain prices. Grain stores also hold grain from last year.

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Duma appoints CBR board members to new four-year terms. Returning incumbents appointed to new terms were CBR first deputy chairmen Arnold Voilukov and Tat'yana Paramonova, deputy chairman Victor Mel'nikov, chief accountant Lyudmila Gudenko, head of the CBR’s Moscow branch Konstantin Shor and head of the CBR’s St. Petersburg branch Nadezhda Savinskaya.

Deputy chairman Konstantin Korishchenko is a new addition to the CBR’s twelve-member board. The current board also includes CBR chairman Sergei Ignatiev, as well as four appointments from earlier this year: first deputy chairmen Oleg Vyugin and Andrei Kozlov, deputy chairman Georgi Luntovski and consolidated economic department director Nadezhda Ivanova.

Government takes control of Vneshtorgbank from CBR. The long-planned transfer of Vneshtorgbank’s ownership from the central bank to the state is part of a process of getting the CBR out of the business of owning banks. Russia’s finance ministry reported that an agreement on the conditions of sale of Vneshtorgbank was signed on September 27 and that the deal will be final next week. Under the arrangement, the central bank sells its 99.9% stake in the bank to the Russian government and receives in return payment of RUB 42 billion in ten-year bonds (maturing in 2012). The government has wanted to make the Vneshtorgbank transfer a condition to selling part of the bank’s shares to a foreign investor. The EBRD is reportedly still interested in taking a minority stake in the bank. Prime minister Mikhail Kasyanov recently predicted the government would complete its plan to divest itself of Vneshtorgbank within 5–7 years.

Another aspect of the arrangement is that state-owned Vnesheconombank will transfer its commercial banking operations to Vneshtorgbank. Before the deal, Vneshtorgbank was Russia’s second largest bank as measured in total assets (over $6 billion) and Vnesheconombank was Russia’s third largest bank (nearly $4 billion in total assets).

Latvia readies for parliamentary elections tomorrow. Some 1,022 candidates representing 20 parties and movements are running in this Saturday’s (Oct. 5) parliamentary elections. Over a quarter of candidates are women. At the moment the largest party in the 100-member Saeima is the centrist People’s Party with 25 deputees. It has formed a coalition government with the centre-right Fatherland and Freedom Party (16 deputees) and Latvia’s Way (21 deputees). The New Era Party, founded by Einars Repše, the former governor of the Bank of Latvia, is participating in the election for the first time. Polls show the leftist PCTVL (For Human Rights in a United Latvia) is currently among Latvia’s strongest blocs. The election outcome is not expected to alter the course of Latvian foreign policy, which aspires to memberships in the EU and NATO. The only block critical of EU membership is the election alliance of the Greens and the Farmers.
Estonian GDP up 7% in the second quarter. Driven by exceptionally strong domestic demand, real GDP growth accelerated from first quarter growth of 3.2% y-o-y. In April-June, fixed investment rose 26% y-o-y. Private consumption was up 11% y-o-y, reflecting rapid wage growth, as well as increased bank lending to households. Public sector consumption grew 4% in the second quarter. A 7% increase in foreign demand was due to a brisk growth in services exports (24%). Goods exports continued to contract.

Growth picked up in all economic sectors, except agriculture and energy production. Manufacturing output grew 13% and construction 14%. Growth exceeded 10% in several service sectors, including trade and finance. Transport and telecommunication grew about 6% y-o-y. The service sector generates nearly 70% of Estonian GDP.

Lithuanian GDP up 6.9% in the second quarter. Lithuania’s economic growth also accelerated in the second quarter as compared to the first quarter, when real GDP grew 4.4%. Exports of goods and services led economic growth (up 14% y-o-y). Domestic demand also boomed as fixed investments rose 26%, and higher wages drove private consumption, which rose 6%.

Most sectors of the Lithuanian economy experienced output growth in the second quarter. In most cases, growth accelerated in comparison to the first quarter. The highest sectoral growth in the second quarter was registered in construction (up 17% y-o-y). Manufacturing, which represents about a fifth of Lithuanian GDP, rose 7%. The key service sectors, trade, transport and telecommunication, grew about 10%. Services account for about 60% of Lithuanian GDP.

Baltic GDP growth, percentage change from four quarters previous

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Little change in Russian inflation rate. Consumer prices rose 14.9% y-o-y in September, i.e. at a rate that has basically held steady since June. As in previous months, the fastest rise was in prices for services, particularly services related to education, culture and telecommunications. The seasonal drop in food prices, particularly vegetables, helped mitigate inflation.

Russia’s central bank expects annual inflation this year will be in the range of 14–15%, exceeding the government’s inflation target of 12–14%. In the period January to end-September, consumer prices were up already 10.3%.

Duma approves first reading of power sector restructuring package. The Duma approved a bill on electrical power, a bill on tariffs charged by natural monopolies, amendments to the civil code and bills concerning tariffs for electricity and district heating, natural monopolies and energy conservation. The Duma rejected the restructuring package in its first reading last June, so the bills were refined in a conciliatory commission comprised of representatives of the government, Duma and Federation Council.

The purpose of the legislation is to promote competition in the electricity sector and thereby increase incentives for efficient operations and attract private investment to the sector. The electricity monopoly UES is to be broken up into separate companies involved in transmission and system operation, as well as create ten regional power generation companies. Moreover, tariffs charged by natural monopolies will be state regulated and specified each year before approval of the coming year’s budget. The government approves a list of services provided by natural monopolies where regulation applies. Wholesale prices for electricity would be deregulated after the parliamentary and presidential elections in mid-2005.

The second reading of the legislation is scheduled for November. The package should be approved by the end of this year.

Russia and US hold energy summit in Houston. Topics discussed at the first US-Russia commercial energy summit included possibilities for the US to purchase Russian crude to replenish US strategic reserves and output and reliable oil deliveries in the future.

Duma approves proposed amendments to bankruptcy act in third reading. The Duma approved a revised bill in a vote of 293 to 104 (the bill was earlier returned to the Duma following a presidential veto in early August). Russia’s current bankruptcy act has long been criticised as being overly tough on debtors as it allowed creditors to force companies to declare insolvency for relatively minor reasons. The amendments cover such issues as hostile takeovers, creditor participation in bankruptcy proceedings, openness of the bankruptcy process and the state’s possibilities to determine estate trustees for “strategic” companies. The bill does not apply to state-owned enterprises. The chairman of the Duma’s property committee Victor Pleskachevski said that thanks to the amendments debtors in Russia now can become full-fledged participants in the bankruptcy process.

Low inflation in Estonia and Latvia, deflation in Lithuania. In Estonia, September consumer prices were up 2.7% y-o-y (2.6% in August); in Latvia, they were up 1.0% y-o-y (0.9%). Consumer prices in Lithuania fell 1.5% y-o-y (down 1.1% in August). September prices rose 0.1% m-o-m in Estonia and 0.8% in Latvia. Latvian inflation was driven by seasonal fluctuations in prices of clothing and footwear. Food prices also rose in Latvia, but fell in Estonia. Consumer prices fell in Lithuania 0.6% m-o-m, reflecting a drop in food prices.

Centre-right parties strongly represented in Latvian new parliament. Voter turnout was 72.5% for last Saturday’s (Oct. 5) parliamentary elections. Unconfirmed results give the New Era party 26 seats of the 100-seat Saeima. In its first election appearance, the new party garnered 23.5% of the vote. The leftwing Alliance For Human Rights in a United Latvia (PCTVL) received nearly 19% of votes, increased its presence to 24 seats (up 8 seats). The centrist People’s Party won 21 seats (-4), while the christian Latvia’s First Party won 10 seats (+10). The Union of Greens and Farmers took 12 seats (+12), while the Fatherland and Freedom Party held on to just seven seats (-8). Latvia’s Way, which has been represented in all Latvian former governments, received just 4.8% of the vote (-20 seats), below the 5% threshold required for at least one seat. Both the Social Democratic Worker’s Party (-12) and the Union of Social Democrats (-5) were also knocked out of parliament.

FDI inflows to Latvia and Lithuania growing. In the first half of this year, foreign direct investment inflows to Estonia were down a third from the same period a year earlier. Net FDI flows slightly exceeded EEK 2 billion (€130 million), as FDI outflows from Estonia also fell. As usual, most FDI came from Finland and Sweden. Moreover, most investment went to the usual sectors –
trade, manufacturing, finance, transportation and communications. Investment in real estate rose this year.

FDI inflows into Latvia rose substantially in the first half to nearly LVL 160 million (€280 million). Continuing the trend, most investments were made by German, Swedish, American or Danish companies. Most investment went to the financial sector, real estate, wholesale trade, manufacturing and communications.

FDI inflows into Lithuania in the first half reached LTL 1.6 billion (€460 million), up nearly 50% compared to H101. Danish and Swedish companies led investment in Lithuania. About 30% of investments went to manufacturing. Sizeable investment also flowed into companies involved in finance, trade or communications.

Foreign direct investment in the Baltics, % of GDP

Coal terminal planned for Muuga harbour. The Port of Tallinn and the Russian Kuzbassrazrezugol have agreed on construction of a coal terminal at Muuga harbour. Completion of the terminal is expected in 2005. It will have an annual capacity of 5 million tonnes and increase the overall capacity at the Port of Tallinn about 10%. The project is valued at EEK 1.1 billion (€70 million). Kuzbassrazrezugol, Russia’s second largest coal producer, excavated about 36 million tonnes of coal last year.

European Commission recommends admission of ten countries to the EU in 2004. On Wednesday (Oct. 9) the European Commission released its regular monitoring reports of applicant countries and named the countries it considers eligible for EU accession at the beginning of 2004. This group includes Cyprus, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Malta, Poland, Slovakia and Slovenia. According to the Commission, these countries meet the political requirements for membership and are expected to meet the economic and legislative criteria for accession by 2004. The Commission noted, however, that meeting accession criteria still requires considerable effort on the part of membership candidates.

The Commission gave its support to the candidacies of Bulgaria and Romania and their goal of joining the EU in 2007. The Commission remarked on Turkey’s progress in membership preparations, but gave no timetable for Turkey’s accession talks. At the end of this month, the European Council will make its decision, based on the reports, as to which countries wrap up their membership negotiations this year.
Russian industrial output development mixed in third quarter. Russian industrial output growth picked up to 5.5 % y-o-y (workday-adjusted figure 5 %) in the third quarter, rising from a rate of 2.6 % y-o-y in 1Q02 and 3.9 % y-o-y in 2Q02. Industrial output growth slowed as the third quarter wore on, however. In September, the workday-adjusted growth figure was just 4.1 %. For the first nine months of the year, growth was 4% y-o-y (workday-adjusted 4.2 %). Fastest growth was registered in nonferrous metallurgy, food processing and fuel production.

Russia dropped from FATF blacklist. At its meeting last week (9 – 11. Oct.), the OECD’s Financial Action Task Force (FATF) voted to remove Russia from its list of non-cooperating countries in the fight against money laundering and financing of international terrorism. Following its FATF blacklisting in summer 2000, Russia enacted anti-money-laundering legislation and established a special agency to investigate suspicious transactions.

The FATF’s current eleven-country blacklist contains only one transition country – Ukraine. At its meeting, the FATF decided to introduce counter-measures against Ukraine at year’s end if the country does not act swiftly to implement anti-money-laundering laws.

Russian government approves 2003 privatisation program. Under the 2003 program, the state would sell off its stakes in over 600 joint stock companies and over 400 state or municipally owned unitary enterprises (unitarnoye predpriiatie). Some of the latter will be incorporated prior to their sale. Many enterprises involved in agriculture, energy and defence are included in the slate of companies to be privatised next year. The divesting of telecommunications company Svyazinvest will also be postponed to 2003. Privatisation sales are expected to raise RUB 51 billion (€1.6 billion) for the Russian state in 2003.

Slavneft to be privatised this year. The Russian government has decided to go ahead this year with its auction of 75 % stake in Slavneft. An earlier plan sought to sell only a 20 % stake in the first round. The starting price for the 75 % stake is $1.3 billion. Experts expect the sale to raise $1.5 – 2.0 billion for the Russian state. Russia’s largest privatisation sale to date was in 1997 and involved the sale of a 25 % stake in Svyazinvest for $1.8 billion. Russian oil companies Sibneft, YUKOS, LUKoil and Surgutneftegaz, as well as several Western oil companies have expressed interest in Slavneft. Sibneft is a member of a consortium that holds a 13 % stake in Slavneft. The Belarus government owns 11 % of Slavneft.

Federation Council rejects bill on regulation of electricity and heating tariffs. The version of the bill approved by the Duma in its third reading last week calls for the government to set electricity and district heating tariffs every year ahead of the first reading of the budget bill in the Duma. Federation Council members opposing the bill said it was unfinished in many respects and conflicted with certain laws. Because Russia lacks parallel legislation regulating prices for coal, natural gas and heavy fuel oil, opponents argue that setting electricity tariffs will hamper power industry operations. An arbitration committee has been set up to work out a compromise version of the bill.

CBR lifts restrictions on transactions involving Latvian goods and investments. The decision, which enters into force this month, eliminates restrictions implemented in 1998 that e.g. require Russian banks involved in banking operations with Latvian banks, firms and private individuals, to maintain larger-than-average reserves. For certain product groups, export credits and prepayments for imports exceeding 180 days to Latvians were also restricted until now. Several sources expect the restriction against Russian banks making direct investments or portfolio investments in Latvia will also be lifted. Restrictions on Russian banks maintaining branch offices in Latvia, as well as restrictions on Latvian banks maintaining representative offices, subsidiary banks or branches in Russia will remain in place. Latvia continues to be listed by the CBR as an “offshore zone,” which includes nearly 50 countries.

Russia experiments with all-volunteer army, parliamentarians still have no idea where most defence spending goes. A trial with enlisted servicemen began last month with a Pskov airborne division. The experiment, which has a budget of RUB 2.7 billion (€87 million), should end in 2004. According to armed forces general staff, a gradual move to an all-volunteer army could be complete by 2010. The minimum tour of duty in the all-volunteer army would be three years. The costs of making the transition are estimated at RUB 300–400 billion (€10–13 billion).

A separate proposal from the Union of Rightwing Forces (SPS) argues the transition to an all-volunteer army can be completed by 2004 for just RUB 30 billion.

On a separate matter, deputy prime minister Alexei Kudrin promised to respond before the first reading of the 2003 budget bill to demands from the SPS and Yabloko Duma’s groups on where RUB 345 billion, i.e. 90 % of defence spending, is to be used. In the end, the promise meant little, as deputies were only told about 10 % of the application of defence funds. Defence spending is Russia’s largest budget item, representing nearly 16 % of all federal spending.

Russia in July approved a law that allows conscientious objectors the option of performing social work in lieu of military service. It enters into force at the beginning of 2004.

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Russia and Ukraine make preliminary agreement on setting up an international gas consortium. The preliminary agreement was signed on 7 October at a summit of heads of CIS countries held in the Moldovan capital of Chisinau. The consortium would manage the gas pipeline grid that runs from Siberia through Ukraine to Western Europe. The jointly owned consortium of Russia and Ukraine will have its headquarters in Kiev. Later the equal partners hope to attract Western European investors. Registration of the consortium in Ukraine, preparation of an operations plan and arrangement of financing should take about a year.

Russia annually pipes 100 billion cubic metres of natural gas, worth about €10 billion, via Ukraine to Western Europe. As transit payment, Ukraine receives 30 billion cubic metres of gas annually.

Local elections in Estonia on Sunday. This Sunday (Oct. 20), Estonia holds local elections. Preliminary voting began on Monday (14 Oct.). The Centre Party won the largest number of offices in the last local elections, which were held in October 1999.

Latvian parliament approves the head of anti-corruption bureau. On 10 October, the Latvian parliament approved Guntis Rutkis to head the Corruption Prevention Bureau. Mr. Rutkis currently serves as deputy chief of the Latvian security police.

The anti-corruption bureau was established in July to meet EU and NATO membership criteria. With its leader now designated, the bureau can begin actual operations. Finding the right director was seen as important to Latvia’s EU and NATO memberships. The parliament earlier rejected four government nominees to the post.
Consumer spending sustains Russian growth. Retail sales, a reflection of private consumption, were up nearly 10 % y-o-y in September. For the first nine months of 2002, retail sales rose 9 % y-o-y. The strength in private consumption reflects higher disposable incomes, up 7 % y-o-y in the first nine months of this year. In September, however, real income growth slowed to around 3 % y-o-y. Investment growth was less than 3 % y-o-y in September and just 2.5 % y-o-y for the first nine months of the year.

The composite indicator of performance of Russia’s five main economic sectors (which reflects GDP trends), remained below 3 % y-o-y in September for the second month in a row. Growth has slowed since the beginning of the year. For January-September, growth was 4 % y-o-y. In the first three quarters, industrial output was up 4 % y-o-y and freight transport 5 %. Agricultural production in January-September was down 1.6 % y-o-y.

Russia’s current account revenues and expenditures rose in the third quarter. Preliminary balance-of-payments figures released by the Central Bank of Russia show a current account surplus of $21 billion for the first nine months of this year. The surplus corresponds to 8-9 % of GDP (down from $28 billion, or over 12 % of GDP, a year earlier). The trade surplus for goods contracted to $32 billion, while the deficit in services rose above $7 billion. Russia’s earnings on exports of goods and services fell less than 1 % y-o-y in January-September, bolstered by increased export earnings in the third quarter. Earnings on goods exports fell 3 % in January-September. Their third-quarter growth reflected both higher prices and higher export volumes for crude oil and oil products. For all January-September, earnings on natural gas exports fell, while earnings from crude oil, oil products and other exported goods held at levels very similar to a year earlier. Earnings on service exports rose 20 % y-o-y in the first nine months of 2002. Russian spending on imports of goods and services rose 13 % (and 15 % y-o-y in the third quarter).

The capital account deficit in January-September was preliminarily estimated at just over $7 billion. The deficit was mainly the result of the government’s foreign debt repayments. The net outflow of private capital fell from over $4 billion a year ago to $1.5 billion. “Net errors and omissions” for January-September were minus $2.5 billion (minus $6.5 billion for the same period in 2001). The figure mainly reflects unrecovered capital outflows.

Foreign direct investment in Russian companies (excluding banks) fell in January-September to $1.8 billion (down from $2 billion a year earlier). The CBR’s foreign currency and gold reserves have risen about $10 billion since the beginning of the year, and stood at $45.6 billion at the beginning of October.

2003 budget process moves ahead in Russian Duma. Last Friday (Oct. 18), the Duma approved the second reading of the 2003 federal budget bill by a large majority. The second reading was devoted to allocating budget spending by category and resulted in only minor changes to the government’s proposal.

The largest budget expenditure item is transfers to regional budgets (about 30 % of budget spending). However, over half of this item consists of transfers to the Pension fund (unified social tax). Defence spending represents 15 % of the budget, while interest payments on domestic and foreign debt represents about 12 %. Spending on the justice system and internal security represents a substantial 10 % of total expenditures. In connection with approval of the second reading, the government revealed extensive information on until now secret categories of defence spending. The Duma will consider the budget in third and fourth readings before the budget bill moves on for approval by the Federation Council and the president. Distribution of expenditures within categories will be decided in the third reading of the budget on November 22.

Russian government considers export development program. The economy ministry’s proposed export development program focuses on measures to increase exports of industrial products. Trade policy measures are covered by noting the need for WTO membership. Concrete administrative measures, for example, would be to lengthen the time exporters have to repatriate their export earnings (six months for other than raw material exports) and simplify VAT refunds to exporters. A cornerstone of reordering the organisations that support exporters involves transfer of export credit bank Roseximbank in part to state-owned Vneshtorgbank and part to commercial banks. The state would also take a 100 % stake in the export guarantee bureau Roseximgarant.

Russian grain harvest nearly complete. As of mid-October, Russia’s gross grain harvest for this year was nearly 93 million tonnes, or about 86 million tonnes in net terms. The net grain harvest in 2001 was 85 million tonnes. The agriculture ministry reports this year’s harvest is nearly complete.

Under a government decision, state interventions to raise domestic grain prices will begin early next month. The government will buy wheat and rye. It also plans to increase import duties on wheat and rye from 5 % to 20 % during the intervention period planned to last three months. Russia has exported a considerable amount of grain this year. According to estimates, grain exports during the period July 2002 to June 2003 will reach 10 million tonnes, up from 7 million tonnes in the same period in 2001 – 2002. However, the EU is considering
quotas to limit grain imports and Russia is struggling with inadequate rail and port capacity to handle higher export levels.

**Ruling coalition parties make strong showing in Estonia’s municipal elections.** The Centre Party garnered 26% of the vote and continues as Estonia’s largest party. Its government coalition partner, the rightwing Reform Party, took 12% of the vote. The centre-right Res Publica Party, founded less than a year ago, received 15% of the vote. The Pro Patria Union saw its support drop below 7%. Toomas Hendrik Ilves, chairman of the social democratic Moderate Party, announced his resignation after his party won just over 4% of the vote. Voter turnout for last Sunday’s (Oct. 20) municipal elections was 52.4%, up from just under 50% in the 1999 municipal elections.

**Lithuanian parliament approves national energy strategy.** On October 10, the Seimas approved a strategy extending the deadline for shutting down the Ignalina nuclear power facility in the event the EU and other international donors fail to come up with adequate funds to decommission the facility. In June, Lithuania promised to shut down Ignalina’s two reactors by 2005 and 2009. In exchange, the EU, which considers the reactors dangerous, promised to allocate financing for the decommissioning the facility. The energy program does not provide a specific estimate of Ignalina’s decommissioning costs, but the government has estimated that the total cost will probably reach €3 billion. To date, the EU has committed to €70 million a year during 2004–2006. The EU is also the major contributor to a multi-lateral fund, which has so far dedicated more than €200 million to covering the costs of decommissioning the Ignalina facility. Last year, Ignalina generated nearly 80% of Lithuania’s electrical power supply. A share of Ignalina’s production is exported, mainly to Belarus, the Kaliningrad enclave and Latvia.

The energy strategy notes that Lithuania’s partly outdated power transmission and distribution grid is in critical need of modernisation. The grid will be connected via the Polish grid to the Western European grid. According to the strategy, building a new nuclear reactor is also possible.

**Lithuania lists strategic economic enterprises.** The Seimas has approved a bill that assigns strategic significance to certain enterprises and facilities. The list gives ten objects with high strategic significance that shall not be privatised. These include the Ignalina nuclear power plant and the Vilnius airport. The Lithuanian state will retain its majority stakes in eight other utilities. These include the railways, the TV and radio center, the grain reserve, Lietuvos Energija (which maintains the national power grid) and the Klaipeda oil terminal. There are also companies considered strategically vital, but on which no ownership restrictions were imposed. These include Mazeikiu Nafta, Lietuvos Telekomas, Lietuvos Dujos and the electrical power grid.
EU and Russia discuss Russia’s WTO membership bid. EU trade commissioner Pascal Lamy held talks in St. Petersburg last week with Russian economy minister German Gref. Mr. Lamy noted a key issue to be resolved before WTO membership was the service sector – specifically, the lack of foreign access to Russian markets due to Russia’s regulation of its banking, insurance, telecommunications, and transport sectors. The EU has been embarrassed by Russia’s communications ministry proposal to extend its restrictions for foreign telecoms during the four-year transition period after Russia gains WTO membership.

According to Lamy, the EU wants Russia to acknowledge officially that market mechanisms will eventually determine Russian domestic energy prices. Economy minister Gref responded that Russia cannot link its WTO membership to elimination of the difference between domestic and foreign energy prices. Gref also said the main obstacles in eliminating import duties were in agriculture, civil aviation and automobiles.

Production of construction materials was another industrial category that saw above-average growth (just under 5%). Light industry was up less than 1%, while the food industry grew about 8%.

Oil and gas companies dominate list of Russia’s largest enterprises. A survey by Russia’s Ekspert business magazine found that nearly half of Russia’s 200 largest firms operate in the oil and gas industry. In terms of net sales, gas giant Gazprom is by far Russia’s largest company. Gazprom’s net sales rose over 18% in 2001 to over $20 billion and the company employed 300,000 people. Companies in the top ten also included electrical power monopoly UES, oil companies LUKoil, YUKOS, Surgutneftegaz and Tyumen Oil, as well as nonferrous metals producers Rusal and Norilsk Nickel and carmaker AvtoVAZ.

The top marching order of Russia’s largest firms has remained roughly the same for several years. However, the number of process industries in the top 200 has grown. The latest list includes nearly 50 newcomers. About half are involved in machine building or the food industry. In terms of market capitalisation, Russia’s three largest companies are YUKOS, Gazprom and LUKoil.

Russia’s oil and food industries lead industrial output growth in first three quarters of 2002. Crude oil production was up 8% y-o-y in the first nine months of this year. Oil refining rose just 2% as most crude oil was exported directly. Natural gas production was up 3.5% while coal production was down nearly 6% and electricity production down more than 1%.

Production in the chemicals and petrochemicals industrial category that saw above-average growth (just under 5%). Light industry was up less than 1%, while the food industry grew about 8%.

Russian corporate governance improves, but poor behaviour still widespread. Russia’s Institute of Corporate Law and Corporate Governance released in mid-October its corporate governance survey for the second quarter of 2002. The survey of Russia’s 25 largest enterprises in terms of market capitalisation found that 22 had violated law or interfered with shareholder rights at their annual shareholder meetings.

Telecommunications company Vimpelcom topped the list with a corporate governance score of 84 out of a possible 100 points. Next was Lenenergo with 67 points and electrical power monopoly UES with 66 points. Despite recent criticism from small investors, UES picked up points for improved transparency. The criticism stems from a UES reform plan that may threaten small investor rights. Some large Russian companies ranked high: YUKOS ranked 5th, LUKoil 9th and Gazprom 11th. Generally corporate governance in Russia has developed favourably. Criteria used to rank firms include information disclosure, equity structure, basic shareholder rights, corporate governance history and risk assessment.

Early results from Russian census. Russia’s first post-Soviet census provoked many hot comments. The State Statistics Committee told in the census it tracked down 93% of Russia’s population, which currently stands at 143.3 million people. While Statistics Committee chairman Vladimir Sokolin considered the overall results of the census good, he expressed surprise over the disarray of population registers. Since Russia’s last census in 1989, migration in the country has been high and many people have moved from the municipality where they are officially registered. The population in the capital Moscow is currently about 10.4 million, an increase of nearly 2 million from 1989.

The census questions were answered anonymously, and there was no penalty for incomplete census responses or false information. The first official results will be ready next March or April, and the final results issued during 2003.

Finnish companies increased direct investment in Russia and the Baltics in 2001. A survey by the Bank of Finland found that the net capital outflows last year from Finnish corporations were €141 million to Russia, €85 million to Estonia and €20 million to Latvia. Subsidiaries of Finnish firms in Lithuania repatriated €10 million more to their parent companies than the parents invested in Lithuania last year. At the end of 2001, the stock of investments from Finland to Russia was €460 million. The value of investments in Estonia was €550 million.
while investments in Latvia amounted to €160 million and in Lithuania €120 million.

The Bank of Finland survey further found that the number of people working in Finnish subsidiaries and branches last year was 6,300 in Russia, 15,900 in Estonia, 2,900 in Latvia and 1,900 in Lithuania. Last year’s net sales of Finnish subsidiaries operating in Russia amounted to €920 million, in Estonia €1,300 million, in Latvia €440 million and in Lithuania €250 million.

Baltic states and Russian border agreements still open. At a lecture at Estonia’s Concordia University on October 17, Russia’s ambassador to Estonia Konstantin Provalov pledged Russia would conclude a border agreement with Estonia in the first half of next year. The ambassador also reported that Russia would likely grant Estonia most-favoured trade status next year and eliminate the current double taxation regime imposed on Estonian goods. Estonia is the only Baltic country Russia has not granted most-favoured trading status. Russia has not ratified a border agreement with any Baltic country.

Lithuania tones down law on foreign exchange. Last week (Oct. 22), the Seimas voted to eliminate restrictions on use of foreign currency in Lithuania. Currently, the litas is required in any transaction where the other party is not a foreign legal or natural person. Under the amended law, it will be possible to make payments other than cash in any currency agreed between parties. The euro may even be used in cash payments. The amendment is aimed at improving Lithuania’s business environment.

Polish industrial output started to rise in September. Industrial output in September rose 6.7 % y-o-y and 8.2 % m-o-m. Growth was clearly higher than at any time last year (-1 % for the year) or this year. Industrial output was still falling in August (-1.1 % y-o-y) and grew only 0.5 % during the first nine months of this year. Poland’s GDP rose about 0.7 % in the first half of 2002. Unemployment climbed to 17.6 % in September, up from 16.3 % in September 2001.
**Russian inflation up 15 % y-o-y in October.** October consumer prices rose 1.1 % m-o-m and 15 % y-o-y, a rate essentially unchanged since last summer. Prices for services rose fastest in October. The largest monthly increases were seen in public transport – subway fares were up on average over 20 %, tram fares 10 % and bus fares 7 – 9 %.

**Robust domestic demand underpins Russian economic growth.** The Manufacturing Purchasing Managers’ Index (Manufacturing PMI) and the corresponding Services PMI, based on monthly surveys financed by the Moscow Narodny Bank, were positive for October. The Manufacturing PMI rose modestly in October mainly in response to strong domestic demand. Overall demand slowed slightly, however, due to flagging export orders. The 300-member survey panel reported the slowing reflected uncertainty on world markets. Price inflation for inputs, especially energy, remained high, despite the fact that it was at its lowest point in five months.

The outlook for the services sector was brighter than for industry, despite a similar rise in input cost pressures. The rise in the Services PMI in October reflected improving demand and increased returns from ongoing investment. The Services PMI is compiled from reports of trends in real activity rates in a representative sample consisting of 300 service sector companies. It does not cover retail, public sector services or distribution services.

**Gazprom announces cuts in natural gas deliveries to Belarus.** Under its current agreement, Gazprom is committed to deliver to its Belarus counterpart, Beltransgaz, over 10 billion cubic metres of gas at Russian domestic prices, i.e. at prices 60 – 80 % below those paid by end-users in Western Europe. With the contract about to expire, Gazprom said will cut supplies by half, noting that the old contract price was barely enough to cover production and transport costs. In addition, Beltransgaz has failed to pay for 50 % of gas deliveries in dollars as agreed. It currently owes Gazprom over $220 million. Belarus, which is almost completely dependent on Russian gas, called the announcement political and dispatched its energy minister to Moscow to discuss the matter.

**Changes in Russia’s public wage system.** On Wednesday (Nov. 6), the Russian government approved the broad parameters for a shifting away from civil service wage schedules to salary systems based on organisational functions. Introduction of the new system will on average lift wages of federal civil servants about a third and help better take into account regional differences in pay scales. The changeover will cost nearly RUB 11 billion. Federal workers should be under the new system at the start of October 2003, while civil servants paid from regional budgets will see the change by the start of 2004 at the latest. Detailed contents of the new wage system should be resolved by the start of 2003. Russia’s public sector employs approximately 15 million people, about a fifth of the employed labour force.

**New law on legal status of foreigners in Russia takes effect.** The head of Russia’s Federal Migration Service, Andrei Chernenko, expects the new law, which entered into force last Friday (Nov. 1), will clarify the status of foreigners in Russia and establish an at-law permit system. Russia is to introduce a single entry registration system and databases for residence and work permits for foreigners. Foreigners must carry their migration card at all times. Interior minister Boris Gryzlov expects the system to be fully operational by May 2003. Some 40,000 enterprises that have invited and plan to invite in future foreign workers must register with the interior ministry. Some observers find the new law in conflict with other Russian legislation and expect it to increase corruption.

The government has set the national work permit quota for 2003 at 530,000. Within that number, regions can determine their own foreign worker quotas. Russia currently has about 300,000 foreign workers with permits and perhaps 3 – 4 million foreign workers without permits. Most illegal workers come from former Soviet republics. Labour minister Alexander Pochinok said the main reason for quotas is to find out the amount of foreign labour force. Firms relying on highly educated foreign workforce argue that quotas will interfere with their access to labour.

The law’s implementation still requires almost 20 separate government decrees. Of these, the government has already approved list of territories and objects forbidden to foreigners and what jobs foreigners cannot hold.

**Popularity of funded pension scheme set to increase Estonian state expenditures next year.** As of end-October, over 207,000 Estonians, nearly a third of the national workforce, had signed up to participate in a new type of pension funds from next January. A 2 % contribution withheld from the worker’s gross salary will be augmented with a 4 % contribution from the state. The popularity of funded pensions will increase 2003 budget expenditures by over EEK 300 million (€20 million). Initial budget projections foresaw only 100,000 participants in the funded pension program in 2003.

Estonia’s pension system reform has been underway for several years. Its goal is to create a system that will cope with an aging population, a so-called “three pillar” system. The scheme augments the old system with mandatory and voluntary pension funds. The old system was based on a “pay as you go” principle, whereby money collected from people in the workforce was used to pay current pensions. Estonian workers have been allowed to participate in fully voluntary private pension funds, the
“third pillar”, since 1998. The funds that are subsidised by the government started to operate in July. Participation in these second pillar funds is compulsory for all persons born during or after 1983 and voluntary for older workers. Six financial institutions, including Finnish Sampo, are authorised to operate second pillar funds. The Estonian Central Depository for Securities oversees funded pension schemes.

**Latvia’s new centre-right government.** On Thursday (Nov. 7), Latvia’s new parliament voted 55 to 43 to support a new government headed by New Era party leader Einars Repše. The coalition government includes four centre-right parties: New Era, the Green and Farmers’ Union, the Christian Latvia First party and the Fatherland and Freedom bloc. Together, they control 55 seats the 100-seat Saeima. New Era, the largest party in parliament, took the prime minister’s post and eight portfolios, including finance minister, interior minister and foreign minister.

The government program stresses streamlining public administration, pushing for full-fledged membership in the EU and NATO, creating a strong, independent judiciary, and cracking down on corruption and crime. The government will also pursue development of an information society, balanced development among regions and reduction of the country’s high unemployment.

**Latvian parliament approves supplementary budget.** At the end of its last session on October 31, Latvia’s parliament approved an amendment to the current budget act increasing expenditures this year by LVL 20 million (€33 million). Among other things, the money will go to compensating drought-stricken farmers and raising the salaries of health care workers. The change will increase the fiscal deficit this year by LVL 11 million to LVL 151 million (€250 million), or 2.7 % of GDP. However, outgoing finance minister Gundars Berzins pointed out that tax revenues have been running substantially higher than forecast, so the fiscal deficit is unlikely to exceed the 1.8 % of GDP ceiling agreed with the IMF.
Russia and EU agree on travel rights for Kaliningrad. An agreement, worked out between EU leaders and Russia, would grant travel rights to Russian citizens moving by land via Lithuanian territory between the Kaliningrad enclave and Russia proper. The agreement takes force from the beginning of July 2003. The facilitated transit documents for travel back and forth between Kaliningrad and Russia would be available either as a multiple entry pass, which must be applied for, or as a single entry pass, obtainable in conjunction with the purchase of a ticket. Neither document would allow users to disembark in Lithuania. Lithuania would accept Russian domestic passports until end-2004. Thereafter, transit travellers would have to carry international passports.

Lithuania wants a say in the final transit arrangement to assure it does not conflict with Lithuanian accession to the Schengen agreement or impose additional costs on Lithuania.

Kaliningrad goods transit will be discussed under the partnership and cooperation agreement signed in 1994 between Russia and the EU.

Russian exports up, growth of Western imports slows in third quarter. The Central Bank of Russia reports that Russia’s earnings on goods export, which fell sharply in the first half, rose 12 % y-o-y in the third quarter. Higher world oil prices and higher oil export volumes drove growth. The growth of Russian goods imports accelerated in the third quarter to nearly 20 % y-o-y from about 9 % y-o-y in the first half. The rise reflected increased imports from CIS countries in the third quarter. They rose for the first time since mid-2001. Imports from non-CIS countries rose in the third quarter about 20 % in dollar terms, but less than 10 % in euro terms.

Growth of Russian bank lending slows slightly. The stock of rouble-denominated and foreign currency deposits continued to expand in the third quarter at the same rate as in the first half. Growth of rouble-denominated deposits was up 15 % y-o-y in real terms, boosted by a 40 % increase in rouble-denominated time deposits. Third-quarter growth in foreign currency deposits accelerated and was up 10 % y-o-y. The stock of rouble cash in circulation fell 10 %. The amount of rouble cash in circulation at the beginning of October corresponded to 6.5 % of GDP, while rouble deposits were 11 % of GDP and foreign currency deposits over 6 % of GDP.

The growth in bank lending slowed in the third quarter, and bank claims on private firms and households at the beginning of October were up 25 % y-o-y in real terms (at the beginning of July they were up 33 % y-o-y). Last spring, bank claims on state-owned enterprises, which by comparison were only 6 % of claims on private sector enterprises, began to increase after a year-long stagnation. The CBR recently suggested overall growth in bank lending was unsustainably rapid. Bank claims on the private sector at the beginning of October amounted to about 16.5 % of GDP.

Russia raises oil export tariffs. In response to a rise in world oil prices in early autumn, the Russian government decided to increase the export tariff on crude oil from 26.20 dollars to 29.80 dollars a tonne. The increase enters into force on December 1 and applies only to exports to countries outside the CIS customs union. During the first eight months of this year, 35 % of Russian exports were crude oil or oil products. Energy sector exports represented over 60 % of total exports.

Corruption on the rise in Russia. The October regional survey of corruption by Russian think-tank INDEM in cooperation with Transparency International concludes that the situation in the Russian regions has worsened since the last survey in May. The survey covered 40 regions and included responses from nearly 6,000 citizens and 2,000 small and medium-sized enterprises. According to the findings, corruption costs Russia about RUB 500 billion ($16 billion) a year. The most corrupt regions were Krasnodar, Saratov, Primorsk, Udmurtia and Karelia. The least corrupt regions were Bashkortostan, Arkhangelsk, Kemerovo, Tyumen and Yaroslav. The corruption situation in capital Moscow is slightly worse than the average.

Russia and Belarus agree on gas deliveries. Negotiations between prime minister Gennadiy Novitski of Belarus and Mikhail Kasyanov of Russia produced a deal whereby Belarus will soon repay some $80 million in overdue gas bills for this year. Belarus owes Russia well over $200 million for natural gas deliveries. Belarus promised to fast-track parliamentary consideration of a bill to create a joint Russia-Belarus gas distributing company. The countries earlier agreed to establish by July 1, 2003 a joint enterprise to oversee the common cross-border gas distribution grid. Conflicting reports on this year’s gas deliveries to Belarus have circulated recently. The Russian gas supplier Itera has been suggested as a possible alternative to Gazprom, but Itera apparently charges a much higher price for gas than Gazprom. Gas deliveries for next year will be agreed at the beginning of December.

CBR eliminates more Latvian restrictions. The Central Bank of Russia moved to eliminate the restriction on Russian banks establishing branches in Latvia, and correspondingly, the ban on Latvian banks setting up representative offices, subsidiary banks or branches in Russia. The CBR eliminated other Latvia-related restrictions in October. Latvia, however, remains on the CBR’s list of offshore countries.

Baltic inflation in October. Consumer prices in October rose 3.2 % y-o-y in Estonia (2.7 % in September) and 1.6 % y-o-y in Latvia (1.0 %). Prices in Lithuania fell
1.1 % y-o-y (down 1.5 % in September). October prices were up 0.5 % m-o-m in Estonia, 0.8 % in Latvia and 0.6 % in Lithuania. The acceleration of October inflation was due in part to higher prices for seasonally sensitive items such as clothing and footwear. Prices for health care services, transport services and education also rose.

Baltic industrial output growth remains strong. Estonian industrial output was up 8 % y-o-y in the third quarter. In the key textile industry, production was up about 25 %, while production volumes of the wood processing industry and the food industry were little changed from a year ago. The fastest expansions (30 – 50 %) were seen in metal products, pulp and paper, and manufacturing of electrical devices.

Latvian industrial output was up 7 % y-o-y in the third quarter. Growth was quite modest in the important food industry and mechanical wood processing industry. Production of pulp, paper and paper products, as well as chemical products increased 10 – 15 %.

Industrial output in Lithuania grew in July-September 5 % y-o-y, or slightly slower than in 2Q02. Oil refining activity continued to fall and was down 7 % y-o-y in 3Q02. While growth in the food industry was quite modest, production of furniture was up 17 % y-o-y in the first three quarters, while textiles were up 8 %.

Baltic exports grew briskly in third quarter. Estonian exports started to grow again in July. In the third quarter, the value of exports was up 14 % y-o-y. Exports of machinery and equipment, which had fallen up to June, were up 24 % y-o-y in the third quarter and represented about a quarter of Estonian exports. Exports of wood and wood products, as well as metal and metal products grew 12 % y-o-y. A quarter of Estonian exports went to Finland and another 15 % to Sweden.

Latvian export growth accelerated considerably in third quarter to an estimated 23 % y-o-y. Strongest growth was registered in exports of metal and metal products, wood and wood products and food products. Export growth to Russia slowed, while export growth to the EU accelerated in the third quarter. Some 60 % of Latvian exports went to EU countries – mainly Germany, the UK and Sweden. About 5 % of Latvian exports went to Russia.

Lithuanian export growth slowed slightly in the third quarter, but was still up 7 % y-o-y. A key export product, refined oil, continued to fall (down 10 % y-o-y in 3Q02). Most sectors enjoyed export growth, however. Vehicles and associated equipment, metal and metal products, chemical products and wood products all grew briskly. Lithuanian exports growth to Russia slowed during the summer. In the third quarter, Lithuanian exports to CIS countries rose 7 % and to EU countries 10 %.
Growth of Russian industrial output slows. The State Statistics Committee reports industrial output climbed 3.9% y-o-y in October. For the first ten months of this year, industrial output grew 4.0% y-o-y. Growth has slowed since summer. The seasonally adjusted trend for industrial output has remained unchanged for the last three months.

**Russian industrial output, December 1995 (100) to October 2002**

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EU grants market economy status for Russia. The decision was officially declared by EU Commission president Romano Prodi at last May’s EU-Russia summit and took effect this month. The recognition will have an immediate impact on anti-dumping cases facing Russia. The “normal value” of goods used to measure dumping will usually be defined in terms of the Russian company’s own costs and pricing rather than costs and pricing of a comparable producer in a third country with market economy status.

Further guidelines on EU anti-dumping measures were also released. Under the new guidelines, certain market situations – for example, where domestic market prices are artificially low or barter is common – will use a normal value defined on the basis of the company’s actual production costs. If this fails, the costs will be adjusted or costs of similar companies in the same country or information from other markets will be used. Similar clarifying guidelines were also issued for the EU decree on protection against subsidised imports.

Rouble’s real exchange rate quite stable. During September and October, the rouble’s nominal exchange rate fell about half of a per cent in relation to the dollar, its reference currency. The rate of fall was slightly slower than earlier this year. Rising oil export revenues supported the external value of the rouble in the third quarter. The euro’s strengthening against the dollar caused the rouble’s average monthly exchange rate to weaken in September and October faster in relation to the euro than the dollar. The rouble has weakened nearly 7% against the dollar and 14% against the euro since October 2001. The rouble’s real exchange rate, however, has risen 5% against the dollar since October 2001. Partly due to the euro’s strengthening, the rouble’s real exchange rate against the currencies of Russia’s main trading partners has weakened 1% in the same period.

Russia restructures the remaining Soviet-era debt. Last Saturday (Nov. 16), the government moved to convert the commercial debt of Soviet-era foreign trade organisations owed to foreign goods suppliers into eurobonds. The move is similar to Russia’s debt restructuring agreement with the London Club of commercial creditors in 2000: about a third of the debt is to be forgiven and the remainder will be converted to eurobonds maturing in 2010 and 2030. The total debt involved, including accrued interest, is estimated at $4–6 billion. It has been more than a decade since the collapse of the Soviet Union, and in the interim many of the original creditor companies have assigned their contracts to speculative investors, who now hope to see some return from the restructuring plan.

Restructuring of Soviet-era debt is an important step in Russia’s efforts to improve its image on international financial markets. The markets currently expect international credit rating agencies to upgrade Russia’s creditworthiness.

Estonia records largest Baltic current account deficit. Estonia’s current account deficit in the third quarter amounted to 12% of estimated GDP for the period. The current account deficit was clearly larger than a year earlier, but similar in size to the previous two quarters this year. As in previous quarters this year, the widening current account deficit in the third quarter was driven by a growing trade deficit in which goods imports increased 18% and exports 14%. Despite a 24% rise in the export of services, the services surplus shrank as imports of services rose 44% y-o-y. There was an especially large jump in foreign travel by Estonians. For the first nine months of 2002, the current account deficit was 12% of GDP for the period. FDI inflows into Estonia were EEEK 4.7 billion (€300 million), enough to cover about half of the current account deficit. At the same time, FDI outflows from Estonia were about EEEK 1.7 billion.

Latvia’s current account deficit in the third quarter was 9% of estimated GDP. The current account deficit contracted slightly from a year ago. The trade deficit rose a bit as imports grew 17% y-o-y and exports 23%. Imports were valued at LVL 640 million (€1.1 billion) and exports LVL 420 million (€0.7 billion). The growth in export of services stalled due to troubles in the transport sector, primarily reduced oil cargo volumes. Current transfers, mainly from the EU, were substantially higher than a year ago and helped reduce the current account deficit. Latvia’s current account deficit in January-September was 7% of GDP. FDI inflows held steady and were sufficient to cover about 80% of the current account deficit.

Lithuania’s current account deficit in 3Q02 was 3% of GDP and for the first nine months of this year 5% of GDP. The trade deficit in the third quarter rose compared to 3Q01, while imports were up 13% and exports just
7%. The services surplus grew slightly. Direct foreign investments were sufficient to completely cover the current account deficit for the first nine months of the year.

**Further delays in privatisation of Lietuvos Dujos.** The Lithuanian government has given the Russian Gazprom and its local strategic partner in Lithuania, Dujotekana, until the end of February to submit a final offer for purchase of a 34% stake in the national gas utility Lietuvos Dujos. The Gazprom-Dujotekana partnership was the only interested buyer in the competitive bidding organised for gas suppliers last July. The Lithuanian government accepted the preliminary bid in September. The bid amount has not been published. Earlier this year, Lithuania sold a 34% stake in Lietuvos Dujos to a consortium headed by the German Ruhrgas.

**Estonia compares well internationally in terms of economic growth, competitiveness and economic freedom.** The latest “Global Competitiveness Report” from the Switzerland-based World Economic Forum compares 80 countries using two separate indices that describe a country’s potential for economic growth over the next five years (Growth Competitiveness Index) and current competitiveness (Microeconomic Competitiveness Index). According to the report, Estonia earned the highest ranking among transition economies for growth outlook and was third in terms of current competitiveness. Lithuania and Slovenia have climbed most in the rankings in recent years, while the rankings of Ukraine, Romania and Poland have fallen most. Russia dropped slightly in both rankings.

The Index of Economic Freedom published by the US-based Heritage Foundation and the Wall Street Journal is compiled from 50 indicators and covers 161 countries. Estonia tied with the US for sixth place, a far better performance than any other transition country. Ukraine, Russia and Romania ranked towards the bottom.

**Transition country rankings in competitiveness comparison**

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<th>Country</th>
<th>Outlook for economic growth</th>
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<th>Economic freedom</th>
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Information herein is compiled and edited from a variety of sources. The Bank of Finland assumes no responsibility for the completeness or accuracy of the information.
**Good harvest supports Russian economic growth.** The latest figures from the State Statistics Committee show that aggregate growth of five key economic sectors accelerated to 4 % y-o-y. The acceleration in growth mainly reflected higher agricultural output, up 5.5 % y-o-y. The pace of growth slowed or was more or less flat in other key sectors: industrial output growth slowed to below 4 % and that of freight transport to about 3 %. Construction growth remained below 2 % and retail sales growth at about 10 %.

Preliminary figures indicate this year’s gross grain harvest as of end-October was 93 million tonnes (compared to 92 million tonnes at end-October 2001). Some 87 % of grain was produced on large farms, while small private plots accounted for most vegetable production (e.g. 93 % of potatoes and 82 % of leafy vegetables). One indicator of some structural reform in the Russian agricultural sector can be seen in a rise in the share of small independent farms. This year these farms accounted e.g. for 13 % of grain production and 8 % of sugar beet production.

**Russia’s 2003 federal budget approved in third Duma reading.** The Duma made few changes to the 2003 budget bill at last Friday’s (Nov. 22) third reading, which focused on allocation of spending within budget categories. The most important amendments were approved separately in a decree as a recommendation to the government. The Duma proposed that the government allocate at least RUB 3 billion more for fighting terrorism. The Duma also approved an amendment requiring the government to decide 2003 price caps on tariffs charged by natural monopolies by the end of December. The government does not need to submit its decision to the Duma for approval. Although the government earlier agreed to cap rate hikes for gas at 20 %, electricity rates at 14 %, and rail tariffs at 12 %, it has later indicated the need to reconsider the limits. The matter will be dealt at government meeting on December 11. The Duma will hold its fourth and final reading of the 2003 budget on the same day.

**CBR cracks down on Sberbank and Vneshtorgbank lending to Gazprom.** The CBR is seeking to enforce a regulation that says no single borrower may borrow an amount exceeding 25 % of a bank’s own capital. Some estimates put the shares of loans to Gazprom from CBR majority-owned Sberbank and government-owned Vneshtorgbank at about 40 % of the capital of each bank. The CBR has given both banks until June to get their Gazprom exposure within the legal limit. The failure of the two banks to comply with the regulation may have provided other banks with an excuse for their own non-compliance.

**Gazprom decides to go with northern pipeline route.** On November 18, Gazprom’s board decided to start preparations for construction of a natural gas pipeline running from Siberia to the Gulf of Finland and under the Baltic Sea to Germany. The new pipeline would increase the annual volume of Russian natural gas supplies to Western Europe from the current 130 billion cubic metres to nearly 200 billion cubic metres by 2010. Gazprom’s announcement stated the new pipeline would be ready in 2007 and cost $8 – 10 billion. Gazprom had an earlier plan for a southern pipeline running through Ukraine, Belarus and Poland, which, according to the company, though far cheaper to build, involved excessive country risks.

**Baltics invited to join NATO.** On Thursday, November 21, at its summit in Prague, NATO invited seven new countries (Estonia, Latvia, Lithuania, Bulgaria, Romania, Slovakia and Slovenia) to become members. The parliaments of the candidates must ratify the protocols of accession during 2003. Memberships are expected to become effective in May 2004.

**Moody’s ups credit ratings of EU applicants.** This month international credit rating agency Moody’s upgraded the credit ratings on sovereign long-term foreign currency loans of eight EU accession candidates to the same level as long-term domestic currency loans. Moody’s explained the improved ratings reflect ongoing convergence with EU economies, which substantially lowers their currency risk. Moody’s believes the eight membership candidates will experience further improvements in monetary stability and finance policies as they pursue participation in Economic and Monetary Union (EMU) between 2006 and 2008. As currency risk vanishes when the countries join EMU, their future credit ratings will depend mainly on the size of their public sector debts. Credit rating agencies Standard&Poors and
Fitch will continue to distinguish between ratings for long-term loans issued in domestic currencies and foreign currencies.

Moody’s credit ratings for long-term currency loans

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Ukraine to have new government. President Leonid Kuchma disbanded the government last week, accusing its members of being unable to solve Ukraine’s social problems. The new prime minister, Donetsk regional governor Victor Yanukovich, was personally chosen by the president. Mr. Yanukovich promised to name several cabinet posts this week. On Monday (Nov. 25) president Kuchma also recommended that the parliament dismiss central bank governor Vladimir Stelmakh.

The change of government hits Ukraine at a politically troubled time. In the Ukrainian capital, Kiev, public protests against corruption and demanding Kuchma’s resignation have continued in the autumn. US-Ukraine relations have chilled due to claims that Ukraine supplied radar systems to Iraq. Indeed, Kuchma was not even invited to the NATO summit in Prague on November 21 – 22, although he was allowed to participate at the last moment. The summit saw the Ukraine-NATO standing commission approve a program for continuing Ukraine-NATO cooperation.

The Ukrainian economy has generally developed positively since the 1998 Russian financial crisis. GDP grew nearly 6 % in 2000, 9 % in 2001 and is projected to grow about 4.5 % this year. Underlying last year’s strong growth were a rise in industrial output and a good grain harvest. Annual inflation dropped from 26 % in 2000 to about 2 % in the first half of 2002. The hryvna’s nominal exchange rate to the dollar has remained relatively stable since 2000. In addition, real incomes have grown quickly, although the income level in Ukraine is still low (in summer 2002 the average wage was just 74 euros a month).

Budget-related problems, particularly reduced revenues from privatisation sales, and foot-dragging on structural reform caused the IMF to decide in August 2002 against the release of the final tranche of an EFF loan agreed with Ukraine in 1998. Talks on a new precautionary stand-by credit facility, which would give the country access to credit in the event of an economic downturn, should commence after approval of the 2003 budget.
CBR develops new monetary policy tools. Last month, the Central Bank of Russia introduced repo transactions (repurchase agreements). These allow commercial banks to borrow money on the short term from the central bank against their government bonds (GKO and OFZ). In the same vein, the bank also launched reverse repo transactions, whereby commercial banks purchase government bonds from the CBR to hold for a specific period. Interest rates are based on bids from commercial banks and thus reflect the market situation. The central bank also started holding deposit auctions with commercial banks last month. Since September, commercial banks have been able to make currency swaps with the CBR.

These new monetary policy tools aim at increasing the role of market-oriented approaches to regulating liquidity in financial markets. They also give commercial banks greater flexibility in controlling their liquidity. The instruments were used by the CBR before Russia’s 1998 financial crisis.

To date, the CBR’s main tool for regulating market liquidity has been to grant credit to commercial banks and take deposits from them at fixed rates. Last month, the CBR unified interest rates on all fixed deposits. It also ceased to accept fixed rate deposits with maturities exceeding one week.

CBR relaxes foreign currency exchange requirements for exporters, further changes expected. A new central bank regulation, which entered into force at the beginning of this month, lets enterprises exchange their export earnings in foreign currency to roubles directly at commercial banks, on the interbank forex market or, as earlier, on the MICEX. The regulation only applies to the 50% of export earnings companies must exchange for roubles. The amendment simplifies the sale of foreign currency and reduces exporters’ transaction costs.

The CBR and the government are currently drafting a major overhaul of legislation governing foreign exchange practices with a view to a near-complete liberalisation of capital movements by 2007. The bill, which has been under preparation for over two years, is expected to be submitted to the Duma in the near future.

Russian fuel exports as well as machinery and equipment imports continue to rise. The over-10% rise in Russian export earnings in the third quarter was driven by higher prices and higher export volumes of Russia’s key export commodities. Crude oil exports were up nearly 10% y-o-y, while exports of oil products climbed over 20% and natural gas exports rose slightly. Russian crude oil prices in 3Q02 were clearly higher than in 2Q02 and 3Q01. The export price of natural gas also rose sharply in the third quarter. Russia’s export earnings for January-September were unchanged from the same period in 2001. Crude oil exports rose 13%, exports of oil products 17% and exports of natural gas over 3%. Export volumes of certain metals increased, as did volumes of primary forest products. Wheat exports increased nearly eight times.

Russia’s total imports grew 12% y-o-y in the first nine months of this year. Imports of machinery and equipment (excluding passenger cars) rose 25%. Imports of machinery and equipment from non-CIS countries were up nearly 30%, while total imports from non-CIS countries grew 20%. Machinery and equipment (excluding passenger cars) represented 33% of total imports. Processed foods and food ingredients accounted for less than a quarter of imports during the first three quarters of 2002.

Finnish businesses optimistic about development of Russian trade and Russian economy. An October survey by the Finnish-Russian Chamber of Commerce found that over half of Finnish companies exporting to Russia experienced growth in exports during the previous six months and that over 60% expected exports to continue to increase during the coming six months. Over half of Finnish companies operating in Russia also reported increased business and over 60% of them expected growth to continue. Nearly 80% of Finnish firms expect the Russian economy to grow in the near future.

Finnish entrepreneurs noted that some of the biggest barriers to business efficiency were Russia’s customs practices at the border, its peculiar corporate cultures and a spotty statutory framework.

Finnish exports to Russia grew 14% y-o-y during the first nine months of this year, although export growth slowed steadily. During the period, Russia accounted for almost 7% of Finnish exports and was the fourth largest destination for Finnish exports.

European Commission lowers its economic growth projections for EU acceding countries. A sluggish global economy forced the European Commission to revise downwards its 2002 GDP growth forecasts for acceding countries in Central and Eastern Europe to a weighted average of 2.1%. Last year, their GDP growth averaged 2.5%. The Commission expects economic growth to revive in 2003 with further recovery in 2004. The forecast assumes higher growth in exports (4.4% in 2002 and over 7% in 2003) as well as increased investment in fixed assets (from zero growth this year to 4.6% in 2003).

Slower economic growth has lowered employment. This year the unemployment rate is expected to remain at 14.6% of the work force, before dropping below 14% in 2004. Inflation rates have fallen this year faster than expected. The Commission expects inflation to pick up in the next two years and current account deficits are expected to shrink slightly to below 4%.
European Commission forecasts for 2002 – 2004

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Support for EU membership varies considerably among aspirants. The European Commission-sponsored Candidate Countries Eurobarometer for November 2002 found that 61% of citizens in candidate countries support EU membership. The Maltese, Latvians and Estonians were most wary of EU membership, while support for accession was strongest in Romania, Bulgaria and Hungary. Compared to 2001, this latest Eurobarometer showed sharp increases in support for EU membership in Hungary and Lithuania.

On November 18, EU foreign ministers also voted to invite ten new members into the EU at the beginning of May 2004. Although accession was earlier planned for the beginning of 2004, the ministers felt it wise to delay admission slightly to give national parliaments time to consider and ratify the enlargement treaty.

Support for EU membership in candidate countries

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Little change in Russian inflation. Consumer prices in November were up about 15 % y-o-y – holding to approximately the same inflation pace since July. Inflation is distinctly lower than in H2 01, when it ran at 19 – 21 %. In November 2002, prices were up 1.6 % m-o-m.

Duma approves 2003 federal budget bill. In the fourth and final reading on Wednesday (Dec. 11), the Duma approved the 2003 budget. Next year’s budget will show a smaller surplus than this year’s budget. The surplus will be used to pay down debt (RUB 51 billion) and build up reserves (RUB 21 billion). The largest expenditure item is transfers to other budgets (30 % of expenditures), which includes unified social tax (UST) funds transferred to the Pension Fund. UST transfers represent about 17 % of expenditures, while transfers to regional budgets represent an approximately 13 % share. Defence spending accounts for about 15 % of next year’s budget, while upkeep of the justice system and security will take about 10 % of expenditures. Interest payments on debt represent almost 12 % of total expenditures. Next year Russia plans to repay foreign debt by nearly $11 billion.

2002 and 2003 federal budgets, RUB billion (% of GDP), unless otherwise noted

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<td>Interest</td>
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<td>Surplus</td>
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<td>Avg. oil price, Urals grade (dollars per barrel)</td>
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Russia’s 2002 federal budget surplus holds up. In the first nine months of 2002, Russia’s federal budget surplus remained at 3.1 % of GDP or 5.5 % of GDP excluding debt-servicing costs. Nearly 35 % of revenues came from value-added tax, which continued to provide the budget’s single largest revenue stream. The next largest income sources were customs duties, which accounted for 14 % of total revenues. Excise taxes provided 10 % of revenues, while natural resource payments brought in a 9 % share. The share of the profit tax, which was modified this year, fell to just 8 % in the first three quarters. The unified social tax (UST), which gets transferred to the Pension Fund, represented 16 % of total budget revenues. UST revenues in the first three quarters ran substantially above target.

Expenditures in the social and cultural sector, including UST transfers, represented 29 % of total spending. However, excluding UST, the share was below 14 %. Some 17 % of the federal budget expenditure was transfers to regional budgets, while defence and debt servicing each accounted for 14 %.

EU Commission chairman rolls out ‘Proximity Policy for a Wider Europe.’ In a recent speech, EU Commission chairman Romano Prodi called for implementation of a “Proximity Policy.” He noted EU enlargement cannot go on forever if the EU is not to become merely a free-trade area. According to Prodi, within the concept of the EU’s proximity policy, neighbouring countries would be offered the chance to share everything with the EU, except its institutions. In the focus, they would have access to the single market, open investment rules, harmonisation of legislation, integration of networks and use of the euro as a reserve and reference currency. To illustrate proximity policy, Prodi mentioned proposed common economic area with Russia, which would initially focus on adoption of EU standards and model regulatory codes.

Russia and European Investment Bank sign framework agreement on finance. The agreement derives from a resolution at the EU summit in March 2001, whereby the EIB is to finance environmental projects up to €100 million as part of the EU’s Northern Dimension. The framework agreement signed at the beginning of December affirmed some of the conditions. These include participation of other international financial institutions in the projects, 100 % loan guarantees from the Russian government and Russia’s timely servicing of its debts to the Paris Club of sovereign creditors. The EIB’s Board of Governors has to date approved bank funding for two projects (water and waste-water treatment facilities) in St. Petersburg and Kaliningrad.

Russian government successfully sells its 6 % stake in LUKoil. Demand for shares on the London Stock Exchange clearly exceeded supply, and the entire stake was sold at a price of $775 million. The funds will be placed in the State Reserve Fund. Experts generally considered the sale of LUKoil shares a success this time around. The sale was cancelled in August, when total bids amounted to $100 million less.

IRU to suspend TIR coverage for Russian road freight. The International Road Transport Union (IRU), and the insurers who work with it, have decided to suspend granting TIR carnets and insurance coverage within Russian territory from December 24. The reason is a disagreement with Russia’s State Customs Committee, which has introduced a new interpretation of the TIR agreement, whereby insurance companies would be automatically liable for any customs infractions in Russia carried out under the TIR system. The IRU further accused Russia of violating agreement rules, including inspection of TIR cargoes at the border. About 60 % of Russian road shipments are done under TIR system carnets.

State Customs Committee eases local customs clearance practice in Russia. According to a Customs Committee regulation introduced December 9, importers can clear customs for goods at their actual destination, rather than in the company’s domicile municipality as earlier. The new rule also applies to export of goods. Limitations on certain, specifically listed goods remain in place.
Russian National Banking Council (NBC) convenes. After its status was upgraded last summer, the NBC held its first meeting December 11. The NBC is in charge e.g. of the CBR’s annual financial statements, approval of the CBR’s annual personnel expenditures, investments and other administrative costs, as well as a resolution on central bank participation in other credit institutions. The NBC also decides on the auditing of the central bank and the auditors.

President Vladimir Putin’s interests on the NBC are represented by the deputy head of the presidential administration Dmitri Medvedev, economic adviser Andrei Ilarionov and head of the economic department of the presidential administration Anton Danilov-Danilyan. The cabinet’s interests are represented by economy minister German Gref, finance minister Alexei Kudrin and deputy finance minister Alexei Ulyukayev. The Federation Council’s interests are overseen by Sergei Vasilyev and Gleb Fetisov. Only one of the Duma’s three representatives has been selected so far. Pavel Medvedev represents the Fatherland – All Russia bloc in the Duma. CBR chairman Sergei Ignatyev, by virtue of his position, also has a seat on the NBC.

Baltic inflation nearly unchanged in November. November consumer prices in Estonia were up 3.1 % y-o-y (3.2 % in October), and 1.6 % (1.6 %) in Latvia. In Lithuania, prices fell 1.0 % y-o-y (down 1.1 % in October). On-month, prices were down 0.2 % in Estonia due to a drop in fuel prices. In Latvia, November prices were up 0.2 % m-o-m and in Lithuania 0.1 %. The fastest rises in prices were for food in Latvia and clothing in Lithuania.

Estonian parliament approves 2003 budget. December 11, the Estonian parliament approved its first deficit budget since 1991. Budget expenditures are EEK 38.8 billion (€2.5 billion), about 8 % more in nominal terms than this year. The budget deficit is EEK 320 million or 0.3 % of GDP. Budget expenditures will be increased with the costs of NATO membership, preparations for EU membership and pension reform. Salaries for teachers and policemen will be raised, support for local administrations will be increased, and free schools lunch programs will be continued. The budget assumes Estonian GDP will grow 4.3 % next year and annual inflation will be 3.5 %.

Lithuanian parliament approves next year’s budget. The budget assumes 4.9 % GDP growth in 2003. State expenditures will rise next year about 8 % in nominal terms to LTL 10.9 billion (€3.1 billion). Higher budget spending will be caused by the country’s recent NATO membership and preparations for EU accession, which will especially increase government expenditures on defence and state administration. The budget deficit will grow next year to LTL 1.3 billion, or 2.5 % of GDP. Budgets at the local level are expected to remain balanced with revenues and expenditures just about LTL 1.5 billion. The budget for Sodra, the social security fund, will be in surplus, however. The total public sector deficit is expected to remain at 1.5 % of GDP, or the 2001 level.
Russian GDP growth remained steady in third quarter of 2002. Preliminary figures from the State Statistics Committee indicate GDP grew 4.3% y-o-y in the third quarter, compared to 4.1% in the second quarter and 3.7% in the first quarter. Observers now expect GDP to rise slightly more than 4% this year. GDP grew 5% in 2001.

In the first nine months of 2002, services represented 58% and goods production 42% of total output. Services increased their share of economic activity three percentage points compared to the same period a year earlier. Trade and catering accounted for 22% of GDP, while transport and telecommunications services represented 11%. Industry made a 28% contribution to GDP, construction accounted for 7% and agriculture 6%.

Russian industrial output growth continues to slow. The workday-adjusted figure for industrial output growth in November was 2.4% y-o-y, down from the 3.9% rates posted in September and October. For the first eleven months of the year, industrial output was up 4% y-o-y. Growth during the period was led by non-ferrous metallurgy, the food industry, glass and porcelain production and the fuel industry. On-year growth slowed substantially during the year in both non-ferrous metallurgy and the food industry.

Slavneft sold. At the privatisation auction on Wednesday (Dec. 18), Invest-Oil submitted a winning bid of nearly $1.9 billion for a 75% stake in the Slavneft oil company. Invest-Oil is owned by Sibneft and Tyumen Oil, each of which will contribute half of the purchase price. Sibneft earlier acquired an 11% stake in Slavneft held by the Belarus state for $200 million.

Seven companies participated in the auction. Many consider the final purchase price for Slavneft fairly low. Ahead of the auction, the stake was valued at $2 – 2.5 billion. Before the auction the Duma made an appeal for excluding companies that are over 25% state owned (including foreign and joint ventures) from participating in the auction. Thus, the Russian Rosneft and the Chinese CNPC, which had previously expressed interest in participating in the auction, could not submit bids even though both were apparently prepared to offer substantially more than Invest-Oil’s winning bid.

After the auction, the state competition ministry issued a press release stating that the deal could harm competition in Northwest Russia. As a result, the ministry wants Invest-Oil to regularly provide it with certain information on the market situation.

Maturities on bank deposits and loans continue to lengthen in Russia. The latest CBR data on bank deposits and loans indicate household bank deposits continued their rise in the third quarter. At quarter’s end, household deposits in real terms were up a third from a year earlier. Meanwhile, corporate bank deposits continued to fall. These figures do not include other corporate accounts or Vnesheconombank. Since summer, the stock of household deposits has exceeded corporate deposits and other corporate accounts at banks.

Foreign currency deposits (up 50% y-o-y in real terms at the beginning of October) drove the increase in household deposits. Deposits in both roubles and foreign currencies with maturities between six months and three years continued to gain ground. Household deposits at Sberbank, in which the CBR holds the majority stake, rose one quarter, while the bank’s share of household deposits fell to 69%. The next 29 banks combined held 15% of household deposits.

While the stock of bank loans to households at the beginning of October was up over 40% y-o-y in real terms, they still only represent about a tenth of the stock of bank loans to corporations. Corporate loans, up 25%, have increasingly focused on maturities of 1 – 3 years and on shortest-term rouble loans. Sberbank’s stock of corporate loans grew slightly slower than the overall rate of corporate lending by banks. At the beginning of October, Sberbank share of corporate loans was about 30% and the 29 next largest banks combined was about 40%.

Russia’s credit rating upgraded. This month, international credit rating agencies Standard & Poor’s and Moody’s both notched up their ratings for Russian long-term foreign currency debt. Even with the upgrades, however, both agencies kept Russia in the high-risk category, which will prevent many institutional investors from investing in Russian paper due to their investment rules.

The agencies noted the creditworthiness upgrades reflect Russia’s three-year track record of pursuing prudent economic policies, which has made the country’s economic outlook more predictable. State finances are healthier, with debt servicing now handled routinely. While both agencies saw the return to large federal deficits unlikely, they admonished Russia to continue to concentrate on its outstanding problems such as low investment rate and slowness of economic reforms.

Russia’s State Customs Committee and the International Road Transport Union agree on TIR coverage. The IRU’s threatened Christmas Eve suspension of TIR carnets and insurance coverage for international road freight in Russia was avoided when the parties reached an agreement last Tuesday (Dec. 17) on insurance companies’ liabilities for customs violations under the TIR system.

Latvia’s robust economic growth continues. Latvia posted real GDP growth of 7.4% y-o-y in the third quarter. For the first nine months of this year, GDP increased 5.4% y-o-y. Growth accelerated from the start of the year in nearly all production sectors. Growth in the transport sector, however, remained slow (2% in 3Q02) due to an
on-year drop in oil transhipments. Trade was the fastest growing major sector in the third quarter, up 17 % y-o-y. Manufacturing output and construction activity were both up 8 % y-o-y.

Strong domestic demand underpinned the robust economic growth, as both investments grew and wages rose. Fixed investments climbed 14 % y-o-y in the third quarter. Over one-fourth of investments went to industry, while another fourth went to the transport sector. The trade sector garnered 13 % of total investment. Latvian goods exports rebounded strongly in the third quarter with balance-of-payments figures showing a 23 % increase.

Lithuania will hold presidential and municipal council elections on Sunday. 17 candidates are standing in the first round of the presidential election on December 22. The field includes current president Valdas Adamkus, parliamentary speaker Arturas Paulauskas and the parliament’s deputy speaker Vytenis Andriukaitis. If no candidate obtains more than 50 % of votes, a second-round runoff between the two leading candidates will take place on January 5. The presidential term in Lithuania is five years.

Representatives for 60 municipal councils will also be selected on Sunday. Over 10,000 candidates from 25 parties are standing for election. The winning party in the last municipal elections, held in spring 2000, was the centre-left New Union. Voter turnout was 52 %.

EU enlargement set for May 2004. Ten countries, including Estonia, Latvia and Lithuania, successfully concluded their EU accession talks last week. The European Council has decided that these countries can accede to the EU on May 1, 2004. The accession candidates will sign their membership agreements next April. These must then be ratified by the European parliament, the parliaments of EU incumbents and the parliaments of each applicant state. The national referendum on EU accession will be held in Estonia on Sept. 14, 2003. Lithuania plans to hold its referendum in May and Latvia next autumn.

Nearing the finishing line of accession talks, the Baltic countries focused on agricultural production quotas, production supports and budget-related issues. For example, the EU increased its offer on milk production quotas from its offer last spring. In 2004, the level of the direct agricultural payments for new members is set at the rate equivalent of 25 % of what is currently paid to EU incumbents. These supports will thereafter be increased incrementally over ten years until they match the prevailing EU level. New members can augment their supports until 2006 using EU rural development funds and from 2007 by paying the supports out of their own national budgets.

The EU increased the amount of funding to €285 million during 2004 – 2006 in assistance to Lithuania for decommissioning of the Ignalina nuclear power facility. The EU will also give Lithuania €10 million to arrange for transit traffic between the Kaliningrad enclave and Russia proper.
### Central Bank of Russia

**Venäjän keskuspankki**

Currency rates

Valuuttakursseja

Source: http://www.cbr.ru/eng/currency_base/dynamics.asp

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