

RUSSIAN AGRARIAN SECTOR: DEVELOPMENT AND PROSPECTS

By invitation

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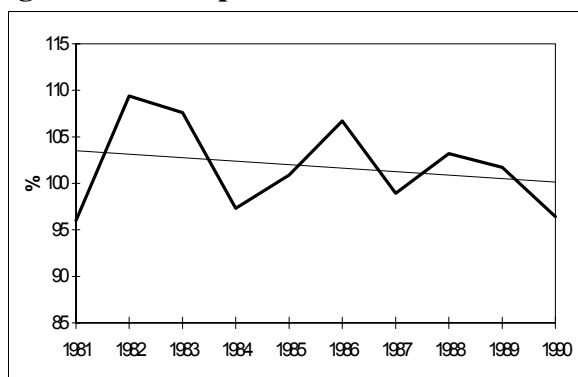
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This special report covers major development and trends in Russia's agricultural sector during the transition. The reasons for the output decline in the 1990s can be traced back to the legacy of Soviet rule, and economic liberalisation did not prevent further deterioration and the resulting crisis in this sector. While overall output fell dramatically, agriculture suffered a smaller decline compared to other sectors. Institutional reforms within agriculture are not covered in this report, and although such reforms are often considered to be slow and insignificant, it is worth mentioning that the agricultural sector is gradually adapting to a new economic environment. With the real devaluation of the rouble, Russian agriculture has become more competitive, and therefore a small window of opportunity was created. Whether this opportunity will be taken advantage of depends on government policy at all levels, and the readiness of the agricultural producers to take advantage of this situation.

The post-Soviet development of the agricultural sector

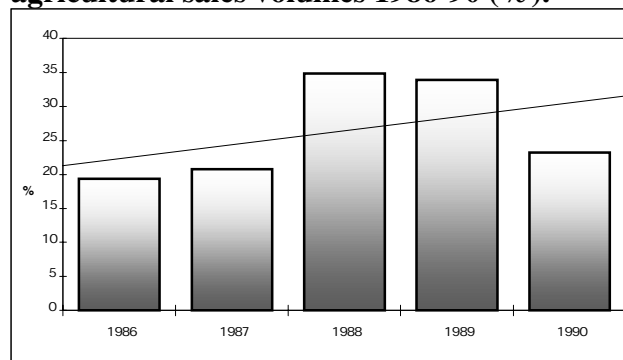
Already during the Soviet era agriculture faced significant problems. In the final years of Soviet power the situation within agriculture and the food industry continued to deteriorate with annual growth rates close to zero (which can be viewed as negative growth considering the propagandistic nature of Soviet statistics). Productivity of the agricultural sector in Russia was very low for an industrial country, and food shortages were becoming an increasingly acute problem. The gap between artificially low retail prices for food products, on the one hand, and steadily growing producer prices, combined with growing nominal income of the household on the other hand, called for subsidies to both consumers and producers (Fig. 2 & 3). Subsidies to the agricultural sector and consumers accounted for one third of federal expenditures, and were rapidly becoming an unbearable burden for the country.

Figure 1: Annual growth rates of gross agricultural output 1981-90.



Source: Goskomstat

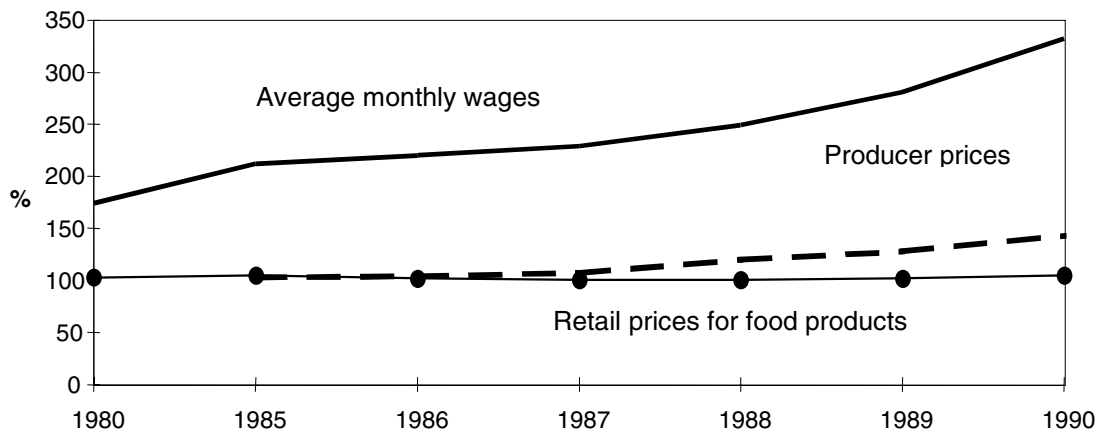
Figure 2: Share of government subsidies to agricultural sales volumes 1986-90 (%).



Source: Ministry of Agriculture

The intensified attempts to reform the agricultural sector in the 1980s did not yield even temporary success. As a result the crisis in agriculture was a major contributor to the overall social and economic decline in the country.

Figure 3: Variations in retail prices for food products, wages and producer prices for agricultural products (1970=100%)*



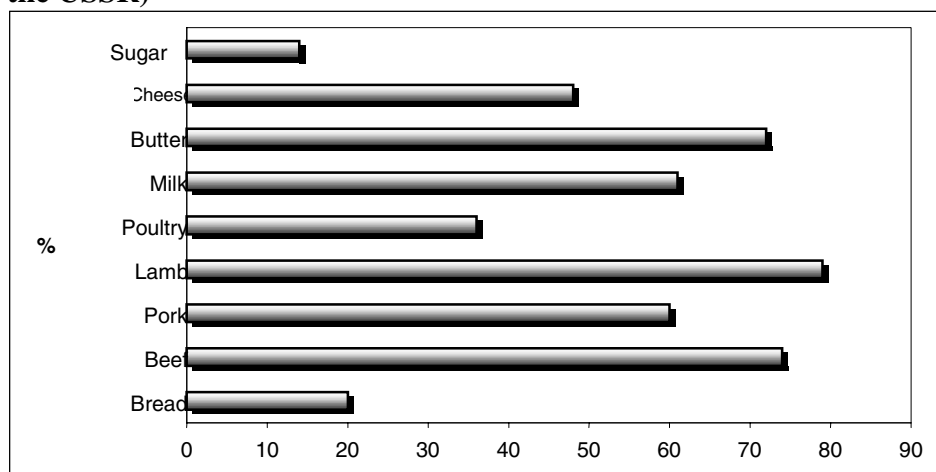
* For producer prices 1983=100%

Source: S.Sinelnikov. *Budget Crisis in Russia, 1985-1995*. Moscow: Evrasia. 1995. Pp. 20, 24., Goskomstat.

Reasons for output decline in the 1990s

Radical economic reforms initiated at the end of 1991 and the beginning of 1992 led to a dramatic deterioration of Russia's agricultural sector. First, as prices were liberalised subsidies for food, which before had amounted to 60-80% of the retail price, were reduced dramatically (Fig. 4). This combined with a general reduction of real income of households, which was a direct consequence of inflation, resulted in a significant drop in the demand for food and agricultural products.

Figure 4: Government subsidies as a share of retail prices for major food products 1989 (for the USSR)

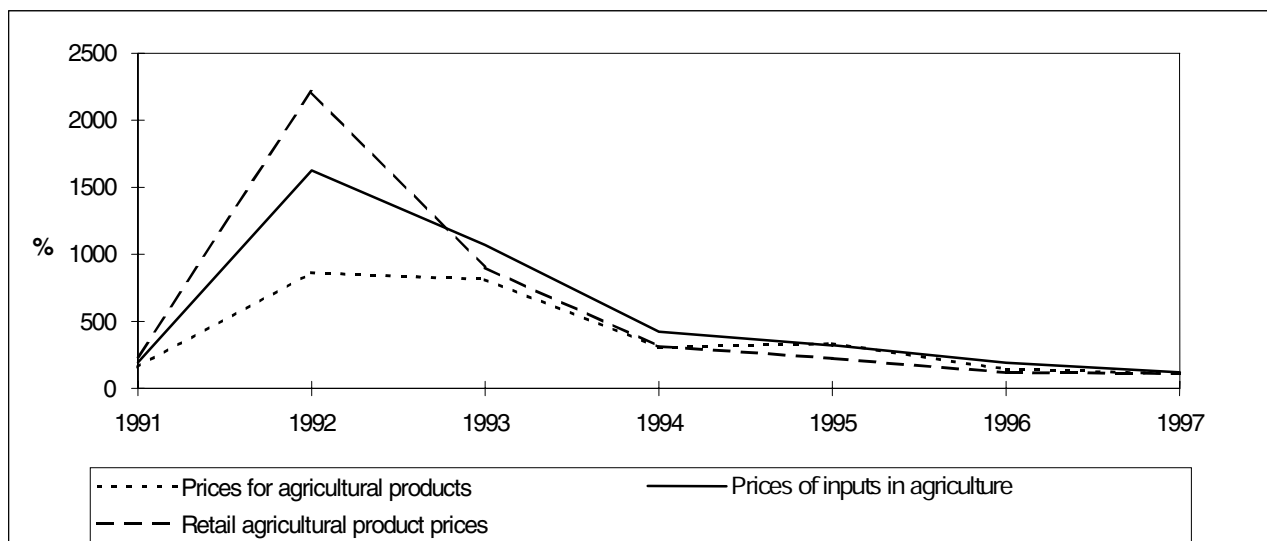


Source: *Strategy of reforms in Food and Agrarian Industries of the Former USSR*. Washington: World Bank. 1993. P. 253.

Another factor that had a strong negative, although predictable, effect on the state of the agrarian sector was the rapid growth of price disparity. In the Soviet economy agricultural products were overpriced compared to inputs used in agricultural production, and this ratio was several times higher than the average World indicators. As a result of price liberalisation, already in the first year the increase in input prices far exceeded that of agricultural output prices. Besides, during Soviet times the profits in sector III of the agro-industrial complex, i.e. processing, storage, and sales had been forced below those enjoyed in agriculture. Price liberalisation here led to a change in the economic environment unfavourable for agricultural production (Figure 5). Thus, within one year the agricultural sector had lost its entire working capital. The situation was aggravated by a high inflation, which meant higher interest rates, and with access to only short-term credits farmers and food producers were faced with a liquidity problem. This intensified the problem as agriculture is characterised by long-term production cycles.

Later, relationship between these prices normalised at world levels, but the financial problems of Russian agriculture still have not been resolved.

Figure 5: Annual price indices for agricultural products, agricultural factors of production, and food retail price indices.



Source: Goskomstat

Thirdly, the underdeveloped market infrastructure contributed to the recession in agriculture. In the Soviet Union, the government was administering and controlling the distribution of food in the country. In 1992, at the start of reforms, federal authorities left the agricultural products market to fend for itself. By virtue of inertia regional authorities continued controlling this market using old methods but soon, i.e. already by 1994, this type of state involvement in distribution diminished significantly. Nevertheless, having abandoned the distribution sphere, the government had not left any satisfying market conditions. This almost immediately resulted in a situation where producers were unable to sell their output, resulting in an unsatisfied demand, continuous shortages, and unstable domestic food supplies. This process took place when foreign trade was already liberalised, resulting in massive imports of food products from abroad.

Inadequate development of the market infrastructure in the country significantly increased

transaction costs in the agricultural-industrial complex, thus affecting price competitiveness of domestic products. Despite the fact that during the first years of reforms prices for domestic agricultural and food products were significantly lower than those for imported goods, the risk of non-deliveries or incomplete deliveries, problems of identifying reliable suppliers, severance of established ties, etc. resulted in a situations whereby, for instance, Moscow meat-processing facilities preferred imported meat deliveries to domestic purchases though sometimes the price difference was as high as 100 times in favour of Russian suppliers.

The Soviet economy agriculture was characterised by a system of producer price differentiation whereby, for instance, the price for grain in Murmansk was much higher than for grain in Krasnodar. With almost zero transportation costs this generated an irrational specialisation of regions and a tendency towards autarky. Thus, during the last years of socialism the cattle-stock grew predominantly in the Murmansk, Magadan, and Kamchatka, i.e. in regions where cattle farming is dependent on delivered fodder. Elimination of the price differentiation system and growth of transportation costs resulted in a dramatic decline in production, particularly in such regions.

In addition to these obvious reasons for the decline in agricultural production, another important factor was that managers and employees in agricultural firms were mentally unprepared to work under the new conditions. The rural population traditionally represents a more conservative stratum of the population, and their adaptation takes longer than for city inhabitants. Although Russia, at the beginning of reforms was faced with the problem of over-production, it continued to subsidise food imports and limiting their export. It was not until the end of 1993 that Russian producers became aware of competition laws and started demanding protectionist measures. Irrespective of a general attitude towards protectionist measures, one has to admit that such change in mentality of agricultural producers was revolutionary.

On the other hand, the agricultural production policy, both at federal and regional levels, was mainly *ad hoc* and worked to slow down the adjustment process. For instance, compensatory payments for purchased inputs (fertilisers, etc.) yielded a temporary growth of price disparity (these are not seen from Figure 5, since it does not show quarterly variations). Inter-regional trade barriers prevented the formation of Russia's goods markets. And furthermore, financial discipline was jeopardised by massive write-offs of debt.

When analysing the slow-down in agricultural production, one should also be aware of statistical irregularities. In the Soviet economy profit was not the main incentive for producers. The main parameter for evaluating enterprise efficiency was the fulfillment of its plan. The major objective of a collective farm manager was to secure a lower plan target and then report over-fulfillment of it. This led to overestimation of real agricultural production on a large scale. Today, when up to 20% of turnover takes place in the shadow economy, real production suffers from under-reporting. Consequently, the current decline in agricultural production, compared to the Soviet period, is likely to be statistically overestimated.

The current state of the agricultural sector

As stated above, Russian agricultural production suffered a significant decline, and the majority of companies in this industry are in a dire financial position. Furthermore, shadow turnover and counter-trade play an important role. In that respect this sector of the economy is not much different

from many others. Nevertheless, some specific features can be identified. In particular, it is worth noticing that during the transition the fall in agricultural production has been less significant than in other sectors of the economy. Compared to industrial goods, the demand for food products is still less elastic with respect to income (during reforms the share of household expenditures spent on food exceeded 50%). Another specific feature of the crisis is that agriculture, as a share of the national economy, has fallen. The fall in agriculture as a share of GDP is primarily a result of price disparity. The sectoral structure of GDP in fixed prices is not officially reported, but estimates indicate that the share of the agricultural sector has not changed significantly (Table 1 and 2).

Table 1: Share of agriculture in the economy

Share (%) of agriculture in:	1991	1992	1993	1994	1995	1996	1997
GDP	13.7	7.2	8.1	7.0	8.9	8.8	6.5*
Employment	13.2	14.0	14.3	14.5	15.0	15.0	no data
Fixed capital	11.7	16.1	16.9	13.6	12.8	No data	no data
Investments	17.8	10.8	7.9	5.0	3.5	3.3	no data
Import**	no data	no data	no data	27.7	27.9	24	26.3
Export**	no data	no data	no data	2.2	1.7	2	1.8

* *estimate of the Ministry of agriculture*

** - *share of agricultural products related to total volume of imports and exports.*

Source: Agricultural Production in Russia: Trends and Efficiency. (1970-1996). M.:CEK. 1997. P.5. Estimates of the Institute for Transition Economics.

Table 2: Annual growth indices for GDP, industrial and agricultural production in Russia

	1992/ 1991	1993/ 1992	1994/ 1993	1995/ 1994	1996/ 1995	1997/ 1996	1997/ 1991
GDP	81	88	87	96	94	100.4	56
Industrial products	82	84	79	97	95	101.9	51
Agricultural products	91	96	88	92	93	100.1	66

Source: Goskomstat

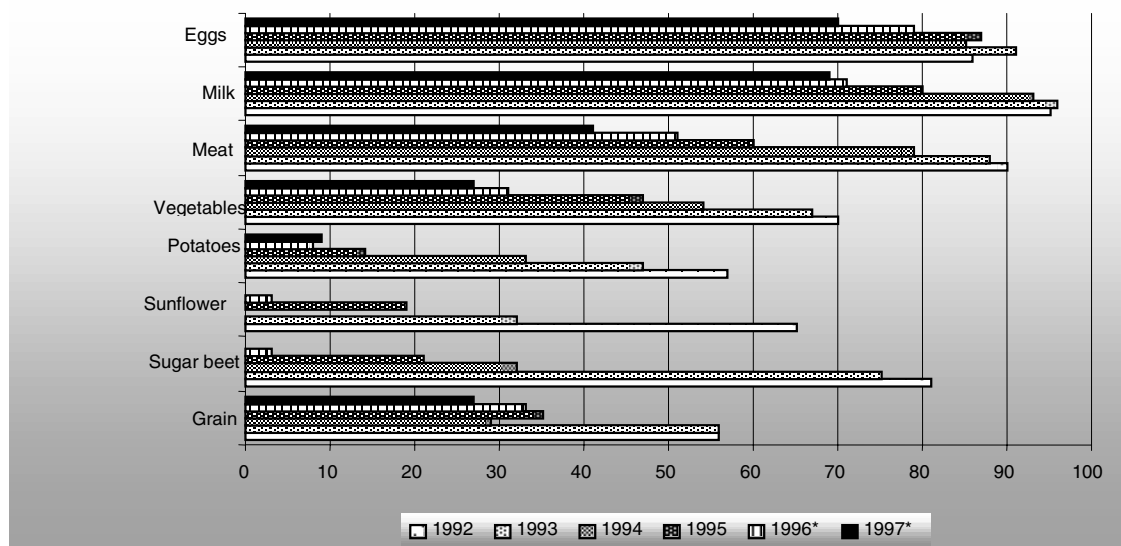
Even though recession in agriculture is continuing, adaptation tendencies are starting to develop due to overall social and economic reforms as well as changes specific to agricultural sector.

First of all, the agricultural sector is beginning to react to market signals. While during the Soviet period producers did not react to price variations, price liberalisation meant that resources started to be allocated in accordance with profitability and crops needed. Thus, in 1992 the shortage of buckwheat disappeared, and crops started to grow for the first time in many years. Estimates show that during seven years of reforms producers demonstrated a high positive correlation between the market situation and production behaviour in all major agricultural products (similar estimates for the 80s reveal a significantly negative correlation).

The behaviour of agricultural producers has changed significantly both in factor and products markets. Soviet collective farms operated under the conditions of planned supply of factors of production, and state distribution of products. All attempts made in the 80s to set up something similar to a market environment within the centrally planned economy were jeopardised, in particular

due to the fact that the management was not prepared to perform even small-scale marketing. Today new supply chains are available, agricultural farms have relatively diversified ties, a network of private dealers has been established, and organised markets are being set up. The share and role of state purchases have been radically reduced (Figure 6). The elimination of centralised supplies and party discipline, two major levers of farms' management in the Soviet economy, made it impossible to continue with compulsory supplies to the government. Currently state purchases are mainly ensured due to inaccessibility of credits. In order to get seasonal loans companies have to make commitments to supply products to state funds. Besides, statistics of state purchases by virtue of its specific nature slightly overestimates the share of real government purchases of meat and poultry products.

Figure 6: Share of state purchases in the total sales of major agricultural products.



**supplies to purchasing organisations which are not necessarily supplies to state funds.*

The relative rise in the price for inputs used in agricultural production has led to decapitalisation, significantly jeopardising the potential for growth. At the same time there has been a radical change in the efficiency of resource utilisation. It is well known that Russia, being a major manufacturer of tractors, used the majority of tractors produced (close to 100%) to replace redundant equipment rather than to expand the fleet. Even taking into account the low quality of this equipment, one should nevertheless recognise that farm machinery was used very inefficiently. While in the Soviet economy up to 40% of purchased fertilisers were estimated to be inefficiently used or simply lost, today's high prices of inputs ensure their sensible utilisation. Consumption of fuel and lubricants has dramatically decreased since the beginning of reforms. The agricultural sector for a long time enjoyed a concessionary price, but as the price of electric energy started to grow, energy intensive consumption dropped immediately. Today the cheapest elements of agricultural production are labour and land. They substitute for purchased resources in agriculture (Figure 7 and 8).

Figure 7: Utilisation of fertilisers as percentage of supplies to agriculture.

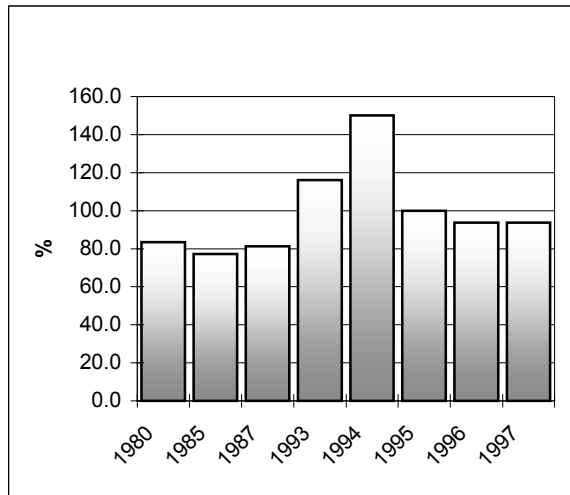
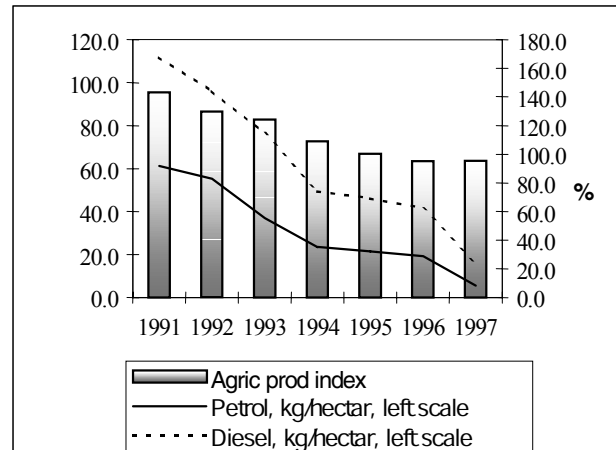


Figure 8: Variation of gross agricultural product (cumulative vs. 1991) and consumption of petrol and diesel fuel per hectare of crop areas.



* 1980-1987 - USSR in total

Source: Goskomstat and Ministry of Agriculture, data for corresponding years.

In 1997 the agricultural sector demonstrated some growth. Undoubtedly the foundation for this growth was favourable weather conditions that ensured a good grain harvest which to a great extent determines the total gross output volume in the industry. Nevertheless, in response to some signs of macroeconomic stabilisation agriculture began to show certain signs of increasing activity. The consumption of fertilisers started growing, the fall in the cattle stock slowed down, and poultry farming began to grow slightly. Official statistics poorly reflects the actual financial position of agricultural producers. At the same time, polls performed by the Institute for Transition Economics in 1997 indicated that the share of companies stating an improvement, or at least not a deterioration, in their financial position over the past year had dramatically increased, and exceeded half of respondents, while in previous years a majority of firms reported a deterioration of their financial position.

The positive development reported in 1997 was influenced by several factors. Throughout 1997 population's real income was growing together with the demand for livestock being highly elastic in terms of income under current Russian conditions. By 1997 protectionist measures against foreign agricultural imports had become much stronger, in particular with respect to poultry, sugar and some other products, which made it easier for domestic producers to enter the market.

Due to a good grain harvest in 1997 the price for grain forage is still at an extremely low level creating a basis for growth in poultry and pig farming. From May to October the interest rate on GKO's was relatively low thus investments were channeled into the real sector of the economy including the agro-industrial complex, and as a result, a normal agricultural credit system started to take shape.

One could continue listing favourable factors for the recovery of agricultural production. Many

positive trends were preserved, moreover a very tough 1998 witnessed new ones. Thus, in addition to poultry farming a certain level of growth was observed in pig farming. Preliminary 1998 data indicate that despite extreme weather conditions, unfavourable market situation and the economic crisis, total losses in agriculture have not increased. Such signs of stability can be explained only by the sector's actual adaptation to the new economic environment and agricultural reforms.

Table 3: Some indicators of livestock farming development in 1998

	September 1998 as % of September 1997
Meat produced:	
Cattle	94
Pigs	105
Poultry	114
Gross milk yield	96
Chicken eggs	105

Source: Goskomstat.

The window of opportunity for the agricultural sector in the 1998 crisis

Rouble devaluation in August 1998 has improved the price competitiveness of domestic food products on the national market and thus has created a window of opportunity for potential growth and structural reform in Russia's agricultural sector.

First, the devaluation of the rouble has turned into a natural and universal protection of the internal agricultural market. In other words, import substitution should enable domestic producers to increase their share of the Russian market. Secondly, unlike the similar situation of 1992-1994, development of the inflationary spiral that the Russian economy faces today does not present a risk of price disparity to the agricultural sector.

A positive consequence of the crisis could also be an increase in investors' interest in processing and food industries. Experts share the opinion that the financial crisis has led to a drastic curtailment of investments in the economy. Nevertheless, developments observed during the first weeks after the August 17 indicated a certain interest from investors in Russia's food retailing and processing of agricultural products. With the general reduction of investments in the economy one can expect structural changes in favour of agriculture.

At the same time the financial and economic crisis aggravated on-going problems of the agricultural complex. In particular, the banking crisis and inevitably higher inflation adversely affect the terms of lending to agriculture, thus limiting the possibilities for expansion in the domestic market. Devaluation of the national currency brings down population's real income, which reduces the overall demand for food. This is also restricting potential growth. Besides, under current conditions the attempts to block the markets in big cities will be resumed, making them dependent on food imports, which would also prevent the recovery of the agricultural sector.

Today's situation reiterates, to a certain extent, that of 1992-1994, whereby a price gap between domestic and imported agricultural products presented a chance to local producers to win over (or, more accurately, to keep) the domestic market. But in early 1990s it was clear that this opportunity

could not be seized because the sector was not prepared for competition, and there was severe lack of infrastructure for market development. Moreover, price liberalisation brought about a dramatic growth of price disparity, and contributed to the financial crisis in agriculture, which also affected the possibility of the sector's structural reorganisation. Currently the situation is different. Producers have more opportunities to take advantage of the current price gap as managers now understand the rules of a competitive market. The agricultural market infrastructure has been more or less established, and price parity has been maintained at the same level for a few years. There is no reason, therefore, to expect further deterioration in Russian agriculture.

This window of opportunity may not last long. Thus, the attempts to take advantage of the current situation should be highly focused and backed by government policy. The main risk in a financial crisis is that the government will focus on resolving social problems at the expense of agriculture and food industry, with further inevitable relapse of internal and external protectionism. In the coming years it will be important to keep a balance between a potentially dramatic reduction in food consumption by the population, and a growing domestic agricultural sector.

ECONOMIC UPDATE

Aggregate demand

In November seasonally adjusted real consumer expenditures on goods and services somewhat stabilised, remaining at October's level. Nevertheless real consumer expenditures were 10.1% lower than in November 1997. The reduction was mainly due to a substantial fall in expenditure on non-food items, which dropped by 20.2%. Real expenditure on food in November was only 3.6% lower than in November 1997. And that on services, prices for which rose relatively little in November, was 0.6% higher than a year ago. Seasonally adjusted real expenditures on new construction and equipment (a proxy for gross fixed investment) in November continued its rapid decline (-3.2% in a month) and were 15.3% lower than a year ago.

Output

The seasonally adjusted index of industrial production increased in November by 3.3% and was 8.2% higher the trough recorded in September. October–November growth was attributed to electricity production (+11.8% in two months), non-ferrous metals (+12.4%), machinery (+18.6%) and food processing (+9.3%). Nevertheless the volume of industrial production in November was still 9.1% lower than in November 1997.

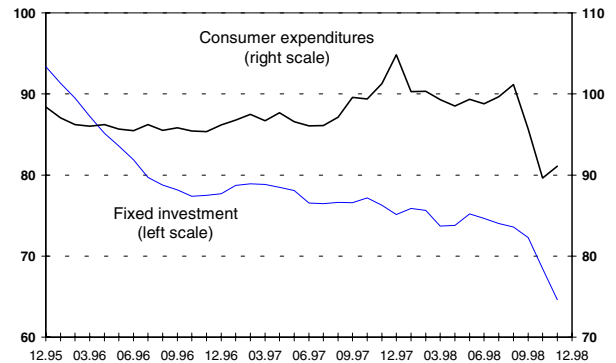
Agricultural output in the first 11 month of the year was 9% lower than in the same period of 1997, mainly because of the poor harvest. According to preliminary data, the grain harvest was 45.3% lower in 1998 at 48.5 mn tonnes (the smallest harvest in Russian Federation since 1953), harvest of sugarbeet was 21.1% lower than a year ago, and harvest of potatoes was 12.3% lower than in 1997.

Prices

In December total CPI increased by 11.6% and yearly inflation rate reached 84.4%. Prices for food grew by 17.1% in the month, and for non-food goods at 6.3%, and while growth in prices for services was almost negligible at 1.8%. On a December-to-December level the CPI for food and non-food goods increased by 96.0% and 99.5%, respectively. The CPI for services grew by a modest 18.3% in 1997.

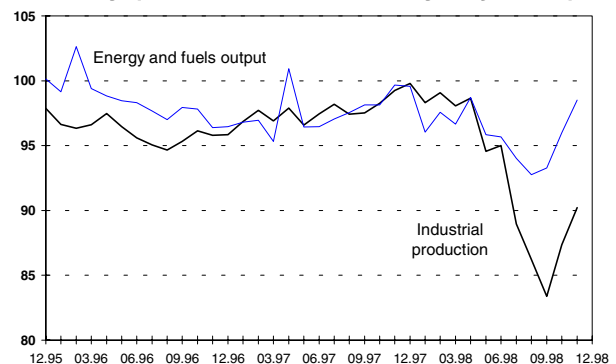
In November the composite PPI increased by 5.0% (4.4% in October) with the PPI in industry growing at 5.1% (5.9% in October) The highest

Components of aggregate demand (1995=100, seasonally adjusted)



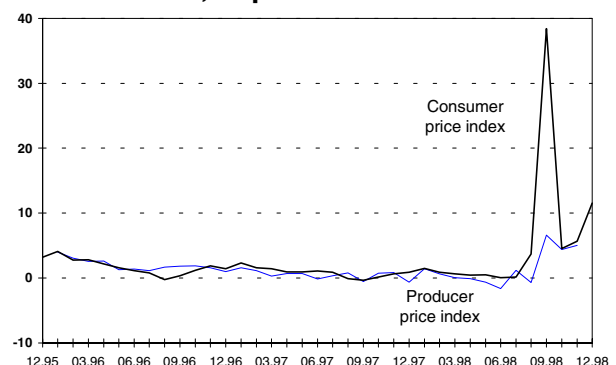
Source: Goskomstat.

Industry (1995=100, seasonally adjusted)



Source: Goskomstat.

Inflation rates, % per month



Source: Goskomstat.

rates of PPI growth were observed in consumer-oriented industries: for example, in November prices for textiles and footwear increased by 8.2%, for processed food by 8.6%, and for agricultural animal products by 13.8%. The same is true for export-oriented industries: in November the PPI for non-ferrous metals increased by 9.8%, for forest products by 8.3%, and prices for oil grew by 16.0%.

Labour

In November real wages continued to fall (by about 3% in the month) and were 33% lower than a year ago. Wage arrears from the budget increased by 1.2%, reaching R22.1 bn. These arrears remained the primary cause of the high level of strike activity among school teachers. In November 2,135 strikes (of which 98% were in education) with duration of at least one full working day were registered, four times more than a year ago. At the same time wage arrears of enterprises decreased for the second month in a row and dropping to R62.9 bn by end-November (compared to R67.2 bn at end-September). As a result the total stock of wage arrears declined slightly.

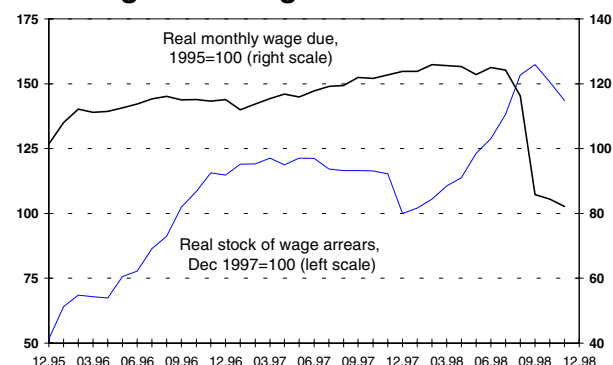
The civilian unemployment rate, according to VCIOM polls, continued to rise gradually, and in November reached 18.4% compared to 14.1% in March and 18.0% in November 1997. According to Goskomstat estimates, which are usually about 5 percentage points lower than that of VCIOM, in November 1998 unemployment rate was also only about 0.5 percentage points higher than a year ago.

Foreign trade

It is clear that the collapse of the rouble have had the expected effect on trade. Imports remained at \$3 bn in October, unchanged from in September, but were about 60% lower than in October 1997. However, exports grew to \$6 bn, up from \$5.7 bn in September, and down 26% compared to October 1997, when they were \$8.1 bn. As a result the trade surplus increased to \$3 bn in October. Thus, the total trade surplus has made a rapid recovery since mid-1998, growing to a healthy \$7.3 bn for the first ten months of 1998, but still \$4.5 bn lower than in 1997.

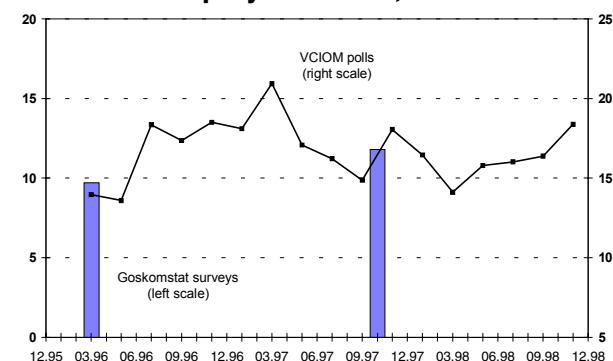
The government has introduced a 10% export tariff on scrap metal copper, nickel, zink, titanium, timber and some agricultural products.

Real wages and wage arrears



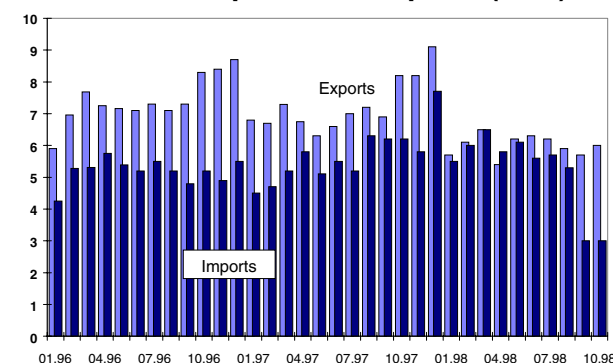
Source: Goskomstat.

Civilian unemployment rate, %



Source: Goskomstat, VCIOM.

Merchandise exports and imports (\$ bn)



Source: Goskomstat

Furthermore, a 5% tariff will be introduced on exports of gas, coal and oil products, fuel oil, and nickel. The tariffs are only related to trade with non-CIS countries and the tariffs are due to remain in place for just six months and so are in accordance with WTO regulations on temporary measures available for countries experiencing balance of payment problems. They therefore should not jeopardize Russia's negotiations with the WTO.

Enterprise finances and banking

Overdue trade credit and debts to the government continued to grow at a slow pace in October 1998 in all sectors.

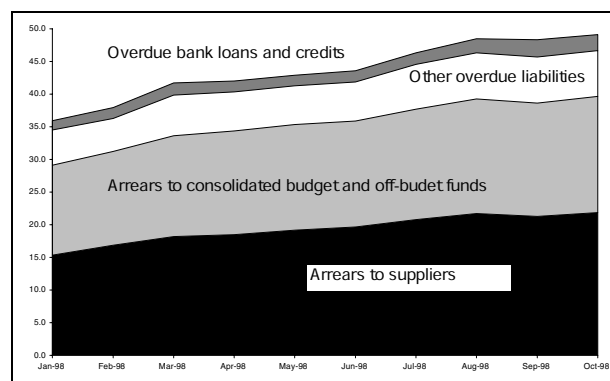
The largest privatization of 1998, the sale of 2.5% stake in Gazprom which took place just a few days before the year end, brought \$660 mn in revenues to the state budget, \$5 mn more than the starting price, and over 4 times higher than what has been collected in the first three quarters of the year. This puts total privatization revenues for 1998 at over R17 bn, compared to R23 bn collected in 1997. The Ministry of State Property prepared a list of major 1999 privatizations, and submitted it for the cabinet's approval. The list includes an auction of a further 2.5% stake in Gazprom, 25% of Svziainvest (postponed from 1998), 9% of LUKoil, etc.

Very little progress was made in implementing the banking reform program in December-January. The law on bankruptcy of credit institutions has returned to the Duma, after serious changes were introduced to it. In early January the Agency for the Restructuring of Credit Organizations (ARKO) was registered as a public company, but no evidence of its activity is yet available. The departure of Andrei Kozlov, the former first deputy chairman of the CBR who was heavily involved in the formation of the banking reform program, is likely to further delay its implementation.

The budget

In November, the revenues of the federal budget, in nominal terms, were up to R26.7bn, from R22 bn in October. Federal tax revenues amounted to R23.9 bn (equal to 89.5% of total revenues). Federal expenditures stood at R36.5bn, compared to R32.6 bn in the previous month. Interest expenditures were unusually high for the period (R8.9 bn); the majority being interest payments on Eurobonds. For January to November, the federal deficit comprised R103.8 bn.

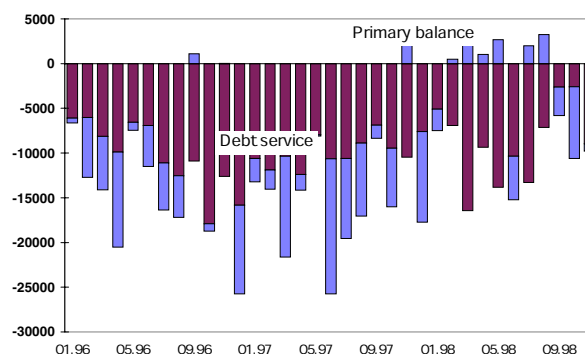
Arrears, % of GDP*



* Data is for 9 main sectors of the economy (see Table 7 statistical appendix for the list of sectors). September 1998 GDP data was used in calculating October arrears ratio.

Source: Goskomstat

Federal budget deficit, R bn



Source: Ministry of Finance

Regional and local governments in November ran a small budget surplus equal to R0.5 bn. Revenues and expenditures of regional and local budgets amounted to R40.3 bn, and R39.9 bn respectively.

The 1999 budget draft was passed by the Duma in the first reading in December. It is fixing revenues at R473.8 bn., expenditures at R 575.1 bn, i.e. a deficit at R101.3, or 2.5% GDP. The second reading is scheduled for January 19.

Financial markets

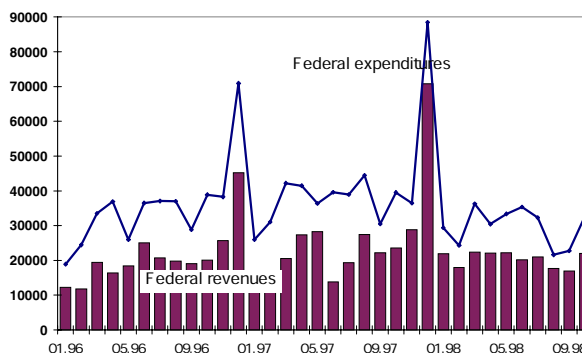
After a small uptick in October and November the Moscow Times dollar index fell 26% in December. The International Financial Corporation, who monitors 32 emerging stock markets, declared Russia the world's worst performing emerging stock market in 1998. The Moscow Times dollar index fell 87% during the course of 1998. Individual shares, such as Sberbank, MGTS, and Kubanenergo fell between 95-98%. With developments in Brazil and possible contagion of other Latin American countries, we can expect the low interest in Russian equity to continue for some time.

Money

The monetary base (currency in circulation (M0) and commercial bank's required reserves held at the CBR) grew to R203.4 bn on January 11th. Much of the increase appears due to the CBR printing money in order to enable the federal government to pay off wage arrears at the year end.

International reserves by the end of December stood at \$12.2 bn, down from \$12.8 bn a month earlier (in December 1997 international reserves stood at \$17.8 bn), and this despite benefiting from the successful sale of 2.5% of Gazprom to Germany's Ruhrgas, which added \$660 mn to the reserves. Reserves have shrunk mainly due to Russia's commitment to service their external obligations, especially Eurobonds which amounted to \$350 mn in December. However Russia failed to meet their payment on \$362 mn on London Club Soviet debt, but yet to be declared officially in default. Reserves fell to \$12 bn on January 8th.

Federal revenues and expenditures, R bn



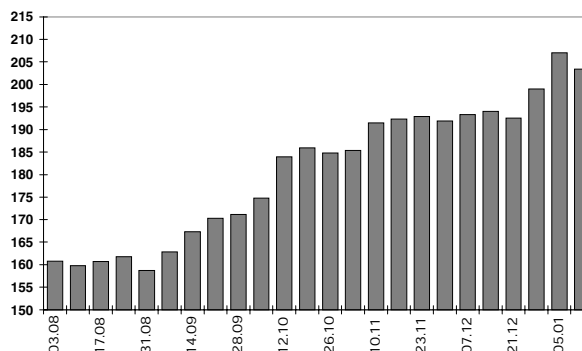
Source: Ministry of Finance

Moscow Times \$ Index (The Russian bubble)

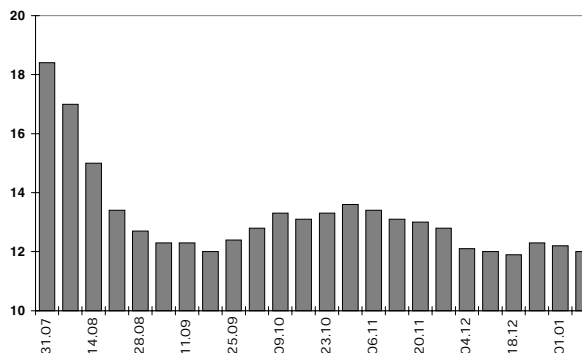


Source: Moscow Times

Monetary base (weekly data, R bn)



Gross reserves (weekly data, \$ bn)



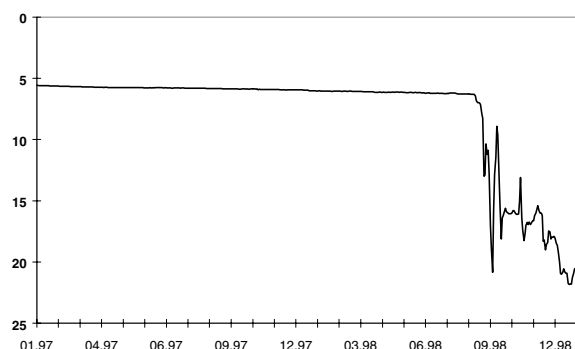
Source: CBR

The exchange rate

The rouble continued to depreciate. In December the official exchange rate went from R18.3 to R20.7 per \$, representing a weakening of the rouble of 12%. For 1998 as a whole it means that the exchange rate weakened 71%, with an exchange rate just below R6 per dollar in the beginning of January 1998. On MICEX the exchange rate exceeded R21.5 per \$, the average exchange rate for 1999 assumed in the 1999 budget, on several occasions in both morning and afternoon sessions.

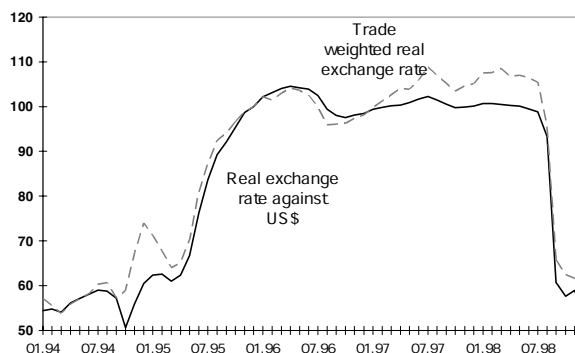
The government has continued to defend the budget's assumption of R21.5 per \$. The CBR, in order to influence the exchange rate, has banned some banks from the afternoon trading session. Furthermore from January 11, exporters are forced to sell 75% of their export revenues on the market. This should have a positive impact on international reserves, and therefore the CBR's ability to further influence the rouble. However, this is likely to be a temporary measure as exporters find ways of circumventing these regulations, as was the case when the 50% sale requirement was introduced in October, and we expect the rouble to fall further in the near future.

The rouble exchange rate (R/\$)*



* MICEX exchange rate till 17th August. CBR rate from then on. Source: CBR

The real exchange rate



Source: Moscow Times, Goskomstat, Financial Times