

Russian & Global Capital Markets Weekly

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Last Week in Brief

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Global Markets

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This Week's Agenda

We continue to assume that inflation will, most probably, stand closer to 11% till the end of this year. According to the Deputy Economy Minister Andrey Belousov, inflation is estimated to grow by 1.1-1.6% in October 2007, driven by higher food and oil prices. The CBR plans to increase the **refinance rate** by this year-end as inflation is much higher than the target level.

The Tax Payment period spoiled the mood on the **Russian money market** last week. REPO volume exceeded RUB150bio on Friday ahead of the Income tax payment. The overnight rate closed the week at 7.47% and rose considerably last week compared to the previous week. MosPrime o/n rate grew from 5.29% on Monday to 7.46% on Friday last week. **International MM rates** fall the second week in a row.

RTS grew by 2.41% and closed the week at 2,194. **MICEX** and **MICEX COMP** indices closed the week at 3,382 (+2.89%) and 1,854 (+2.94%) respectively. All of RTS sector sub-indices closed positive last week. The Metal&Mining sector showed the largest advance and rose by 4.77% last week. High crude prices again supported the Russian market and "Russian oil stocks". The **Russian oil sector** added 1.81% last week.

The price of **UST10** stayed almost flat last Monday compared to last Friday. **Russia30** fell slightly from 112.94% to 112.81% last week. The **Russian Ruble bond market** continued an upward rebound last week.

Last week RUB continued to appreciate against USD, backed by depreciating USD on the world market. **USD/RUB** fell by 0.39% last week. **Russia's gold and foreign currency reserves** stood at \$440.1bio as of October 12, which is \$6.1bio or 1.41% higher than at the previous showing.

At the beginning of the last week **G7**, IMF and World Bank meetings were held which gave a "green light" to the selling of USD. Despite many talks about dangers of weakening USD for the global economy, G7 said that there is "nothing dramatic" in the current EUR/USD high rate. At the same time "big boys" worried about China's policy of not weakening Yuan. As a result EUR/USD closed last Friday at 1.4393. By not mentioning the depreciating USD, the G7 flagged its approval of the orderly USD depreciation, which argues in favour of more USD losses in the months to come.

Again we saw another round of catastrophically weak **US housing data**, which acknowledged that the speculation about a bigger cut will mount in the days ahead. Existing home sales and prices fall and inventories continue to soar. Builders will have to cut prices or reduce construction, or will probably do both.

Oil prices grew to new all-time maximum levels backed by intensifying Turkey/Iraq war, an inflow of speculative capital to oil markets, OPEC's forecasts for expected increasing oil demand for 2007 and 2008, and also the report from the US Department of Energy saying about a decline in oil storage, and, for sure, speculative hazard of traders technically looking to test a psychological level of \$100/bbl. Weaker USD also added to higher oil prices. Last week our **CEB composite OIL Index** grew from 83 to 87 which is again very sounding. Urals, WTI, Rebco grew by 4.58%, 3.56%, and 6.18%, respectively. Last week oil prices shot up and crossed a new level of \$92/bbl. AMEX oil index, Oil service index, and RTS O&G also grew considerably.

However, latest **CFTC** report showed that hedge-funds and traders cut long positions in crude oil contracts. So, it's evident that some start to fix profits if not sell yet. Furthermore, OPEC increased the supply of oil to the market.

Snapshot of Global Markets

Data taken at 16:27 MSK 27.10.2007

RUS EQUITY	Close	%Ch
RTSI	2 194,12	2,00
RTS Second-tier	2 346,59	1,06
Oil and Gas	268,75	2,64
Retail	346,76	0,26
Metals and Mining	365,38	1,48
Industry	352,27	0,73
Telecom	297,79	1,43

MICEX-10	Close	%Ch
MICEX Comp	1 854,47	2,07
MCX Start Cap	4 840,99	1,08
MCX Mid Cap	2 907,60	1,69
MCX Large Cap	3 068,73	2,18
MCX Oil&Gas	2 554,03	3,03
MCX Power	3 456,34	0,33
MCX Telecom	2 543,35	1,39

DEBT MARKET	Yield	bps ch	Price	bps ch
RUSSIA				
Russia 30Y	5,68	0,03	112,81	-0,25
Russia 28Y	5,96	0,02	180,00	-0,38
Russia 10Y	5,21	-0,05	104,06	0,06
USA				
UST 10Y	4,40	0,03	102,73	-0,28
UST 5Y	4,06	0,04	99,19	-1,86
UST 2Y	3,77	0,02	99,72	-0,03

EUROPE	Yield	bps ch	Price	bps ch
EU 10Y	4,17	0,01	100,57	-0,10
DE 10Y	4,17	0,01	100,57	-0,11
France 10Y	4,29	0,02	99,65	-0,14
Italy 10Y	4,44	0,03	97,04	-0,29
Belgium 10Y	4,30	0,01	97,69	-0,04
Other				
Japan 10Y	1,62	0,03	100,72	-0,30
Canada 10Y	4,29	-0,03	97,76	0,26
Australia 10Y	6,08	0,01	99,44	-0,13
New Zealand 10Y	6,42	0,04	96,97	-0,44

EMERGING MARKETS	Yield	bps ch	Price	bps ch
Brazil 40Y	5,53	0,00	134,25	0,00
Turkey 34Y	7,07	-0,02	111,06	0,19
Mexico 30Y	7,88	-0,05	124,14	1,10
Argentina 30Y	8,15	-0,24	140,00	4,50
Venezuela 34Y	8,59	-0,09	108,13	1,00
Malaysian 20Y	4,29	-0,01	89,60	0,10
Chili 13Y	4,96	-0,00	102,44	0,00
Taiwan 30Y	3,10	0,00	113,89	-0,00
India 30Y	8,32	0,00	100,09	-0,03
Peru 29Y	6,18	-0,04	105,00	0,50
Singapore 20Y	3,15	0,01	105,05	-0,15

BOND INDICES	Value	bps ch
RCBI	99,83	0,09

FX MARKET	Close	%Ch
RUSSIA		
USD/RUB TOM	24,7330	-0,23
EUR/RUB TOM	35,5705	0,11
MAJORS		
EUR/USD	1,4396	0,52
GBP/USD	2,0528	0,08
USD/CHF	1,1642	-0,13
USD/JPY	114,17	-0,01
EUR/GBP	0,7013	0,44

GLB COMP IDXs	Close	%Ch
GLB EQ GR IDX	10 979	1,10
GLB BND GR IDX	106,35	0,24

Credit Europe Bank		
Equity and Debt Indices		
Russia		
Equity	2 445	1,81
Bonds	132,29	-0,14
Europe		
Equity	9 807	0,72
Bonds	99,10	-0,14
Emerging		
Equity	15 116	1,91
Bonds	112,15	0,59

RUS MONEY MARKET	Close	Ch-Prev
Deposits in CBR	328,20	366,20
C/A Russia	456,50	433,50
C/A Moscow Regions	310,00	288,00
CBR's balance	161,10	35,60
Libor 1Y USD	4,63	0,01
Libor 1Y EUR	4,56	-0,01
Libor 1Y GBP	6,12	-0,01
MIBID	5,59	
MIBOR	6,92	
MosPrime O/N	7,46	0,42

CBR FIXINGS	Close	%Ch
USD RUB	24,8508	-0,16
EUR RUB	35,4497	0,14
GBP RUB	50,8596	-0,25

COMMODITIES	Close	%Ch
Gold	785,00	2,09
Silver	14,22	2,52
OIL PRICES (USD/barrel)		
Urals	84,8	2,79
Brent	84,25	-0,82
WTI	91,7	-0,42

WORLD INDICES	Close	%Ch
UNITED STATES		
DOW	13 806,70	0,99
S&P500	1 535,28	1,38
Nasdaq Composite	2 804,19	1,94
AMEX	2 486,02	1,72

EUROPE	Close	%Ch
EuroNext100	1 037,84	0,36
DAX	7 949,17	0,21
CAC40	5 794,87	0,60
Swiss Market Index	8 962,92	0,51
FTSE 100	6 661,30	1,29
IBEX 35	15 603,90	1,42
OMX Stockholm 30	1 171,53	0,06
MILAN MIB 30	40 535,00	0,55
Amsterdam Exchanges	547,16	0,22

JAPAN	Close	%Ch
Nikkei225	16 505,63	1,36
TOPIX	1 573,97	1,67

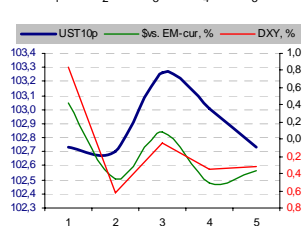
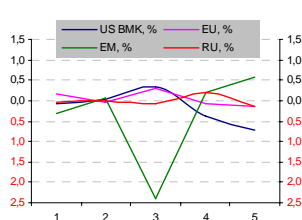
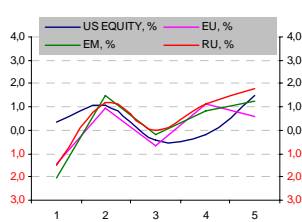
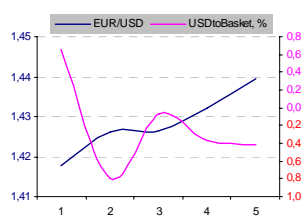
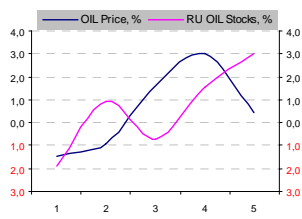
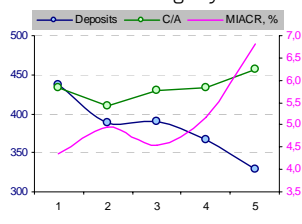
EMERGING	Close	%Ch
S&P/TSX	14 296,43	1,21
HANG SENG INDEX	30 405,22	1,84
Shanghai SE Comp	5 589,63	0,49
Thailand SET	894,57	0,13
Bombay SE 500 IDX	7 511,32	2,52
Straits Time Index	3 771,55	1,74
Taiwan SE Weighted	9 631,51	0,66

S&P/ASX	6 700,60	1,15
NZX ALL INDEX	1 144,76	-0,91
Jakarta Comp Index	2 624,43	1,07
KOSPI INDEX	2 028,06	2,60
Brasil Stock IDX	64 275,58	3,10
Kuala Lumpur Comp	1 398,35	1,46
Venesuela IBC	37 671,72	1,06
Karachi 100 Index	14 449,98	0,62

FX MARKET	Close	%Ch
OTHER		
AUD/USD	0,9183	1,11
USD/CAD	0,9615	-0,53
NZD/USD	0,7653	0,57
GBP/JPY	234,41	0,09

CARRY	Close	%Ch
AUD/JPY	104,85	0,01
NZD/JPY	87,38	0,53
GBP/CHF	2,39	-0,02

1-5 stand for the last 5 days, 5 is the latest trading day



Russian Markets

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Inflation Navigator

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According to the Deputy Economy Minister Andrey Belousov, inflation is estimated to grow by 1.1-1.6% in October 2007 and may exceed 10% in 2007, driven by higher food and oil prices..

Belousov again stressed hopes that the government would make their best to prevent inflation from rising above 10% in 2007. According to the First Deputy Chairman of the CBR Alexei Ulyukayev, Russia's inflation is expected to reach between 9.5% and 10% in 2007. But we assume that all "immediate" measures taken by the government, seems, will have an effect later than expected and will not help curb inflation by the end of 2007.

Remember that two weeks ago the government set import duties on milk and dairy products at 5% of their customs value, the duty on cottage cheese at EURO.3 per kilogram, and the duty on processed, powdered, blue and other cheeses at 5% of customs value. The duties will be effective for 6 months.

Last week large producers and sellers of food products agreed to stabilize prices for essential goods (bread, milk, oils, etc) "on their own initiative". It is rumored that an agreement took power from October 15, 2007 and will keep going till January 31, 2008. An interesting fact. But will it be as good as it sounds?

We assume that this measure will have only temporary effect and will lead to postponed inflation which we will meet rising again in 2008. Thus State's forecast about 7% inflation for 2008 appears to be doubtful.

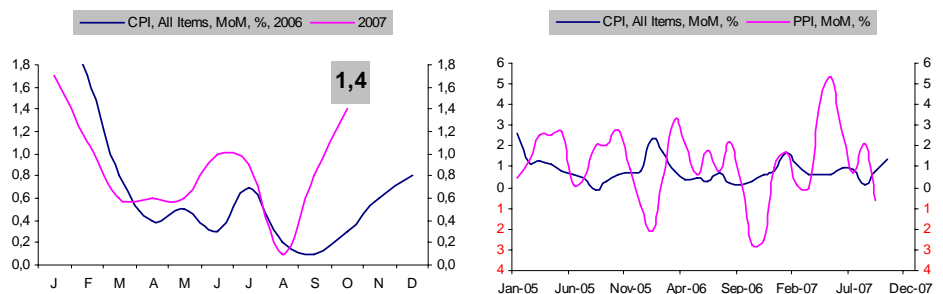
Fixings of prices on milk, oil & bread will lead to the shift in production lines – it will be more profitable for producers to produce cottage cheese, sour cream, macaroni but less milk, oils, and bread.

The same shift will be applied for the consumption – it will be more attractive for consumers to buy milk, bread etc at frozen prices.

And one more thing – finally freezing prices by large market players could sweep small players out of the market.

Our forecast:

We would wish to believe that prices will decelerate rising but there is not much time till the year-end and, seems, the State will not be able to keep inflation from rising above 10%. If we take the average from the State's forecast at 1.4% for October than Year-to-Date inflation will amount to 8.8% and hardly could the data post less than 1.2% for the remaining two months. Thus we could conclude that the inflation will, most probably, stand closer to 11% till the end of the year. We think that measures taken by the government aimed to curb inflation will have an effect on prices, but not in short-term perspective.



* In October CPI level is taken as an average between the State's forecast of 1.1-1.6%.

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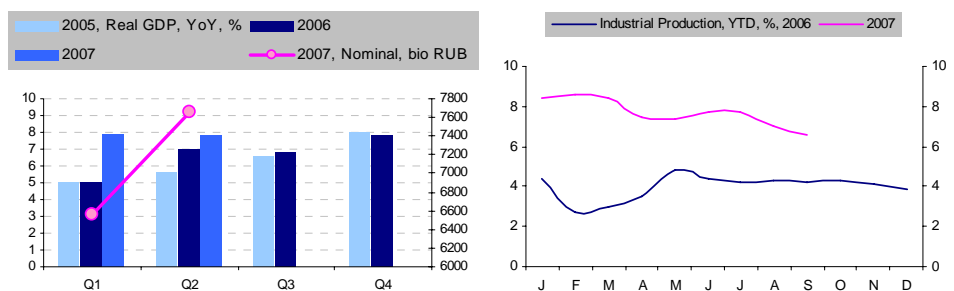
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Gross Domestic Product and Industrial Production

According to the Russian Economy Ministry, Russia's GDP grew by 7.4% in January-September 2007 compared to 6.6% for the same period a year earlier. GDP rose by 5.6% in September 2007 compared to 6.8% in September 2006. Russia's GDP is expected to grow by 7.7% in 2007. A rapid growth of the country together with the the growth of its gold and forex reserves and the stabilization fund ensures the stability of the country.

According to Russian Economy Minister Elvira Nabiullina, GDP is predicted to amount to \$1.2trio (+7.3%) in absolute terms by this year-end. Nabiullina also noted that the manufacturing sector was the biggest contributor to the industrial production (IP) growth. According to the head of the Economy Ministry's macroeconomic forecasting department, the industrial production output growth is expected to accelerate during October-December 2007 and IP can still meet its target of 7.4% by the end of the year (IP grew by 6.6% in January-September 2007).



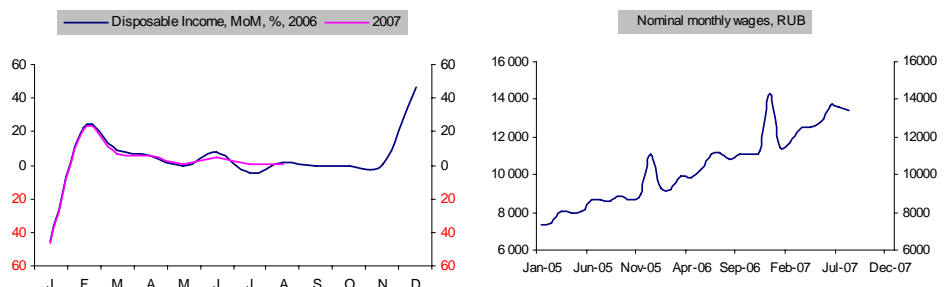
The CBR continues to support the Russian banking system

According to the CBR's First Deputy Chairman Alexei Ulyukayev, ~RUB400-450bio (\$16.12-18.14bio) from funds which are going to be used for Russia's Development Institutions could be temporarily allocated to support the liquidity of the banking system.

Officially population's incomes rise with rising inflation but the real picture is much worse

State officials try to ease the negative sentiment of the population after latest news that inflation in the country can exceed 10%. According to Rosstat, real disposable monetary incomes in Russia grew by 13.5% in September 2007 compared to September 2006, and rose by 0.8% compared to August 2007. So far, officially incomes rise faster than inflation.

The average nominal salary stood at \$555.4 last month, which is 24.7% higher compared to September 2006 and 4% higher compared to August 2007. In January-September 2007 the average nominal salary advanced 25.7%.



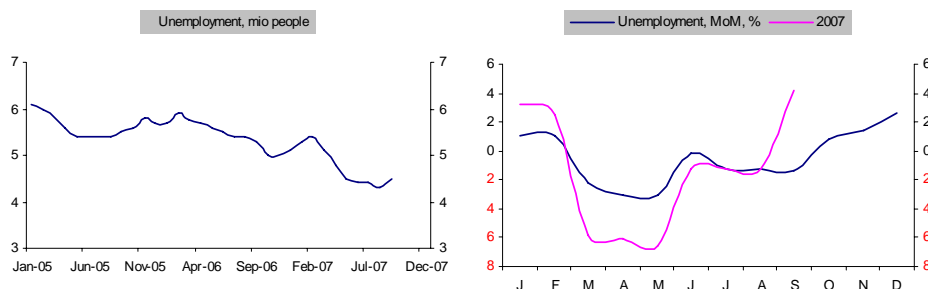
According to Alevtina Gulyugina, Deputy Chairman of the Center for Income Problems and Social Protection at the All-Russia Standard of Living Center, as a rule, personal incomes tend to rise towards the end of the year.

According to Russian Agriculture Minister Alexei Gordeyev, food prices stabilized in the country, but this, seems, not true, since almost nothing changed because less than a week passed since officials said about accelerated inflation.

According to the All-Russia Public Opinion Research Center, 16% of Russians spend more than three quarters of their monthly earnings on food products, while for 41% of respondents, food products account for 50-74% of their spending budget.

It is rumored that prices for natural monopoly services are expected to rise faster next year. Thus prices for housing and utilities services can rise by 18% per year in the average in 2008-2010, which is higher than the current 15%/year. It is necessary to take into account that payments for housing and utilities services is the second important spending category after food products.

Furthermore, pay attention that Rosstat gives average figures for the total population. However, low income people were hardest hit by the current inflation surge. Their incomes are rising more slowly than those of wealthier groups.



According to Rosstat, the total number of Russia's unemployed grew by 4.2% to 4.5mio in September compared to August 2007.

By the end of September, the number of Russia's economically active population stood at 75mio people (52% of the country's entire population).

Produced more Oil&Gas Condensate

According to the Russia's Energy and Industry Ministry, in January-September 2007 Russia produced 366mio tones of oil and gas condensate which is 2.4% higher than at the same period a year earlier. Rosneft, LUKoil, TNK-BP Holding, Surgutneftegas, and Gazprom Neft accounted for the bulk of the output. According to the Russia's Federal Customs Service, in January-September 2007 Russia exported 166mio tonnes of oil (+4.8% from the same period a year earlier) to countries outside the CIS, and 27.73mio tonnes (-2.4%) to the CIS.

Russia is going to redeem the remaining debt to the World Bank ahead of the schedule

The Russia's government is going to spend part of the Stabilization Fund to get rid of the debt to the World Bank. Remember that debts to IMF and Paris Club have already been redeemed. The servicing of the debt to the Paris Club was very expensive and getting rid of it had more financial aspect than political. It is necessary to mention that currently Russia's ForeignDebt/GDP ratio is the lowest in Europe. The debt to the World Bank accounts for 8% from the entire Russia's foreign debt, most of which corresponds to Eurobonds. 80% of the debt to the World Bank will take \$4bio to pay. But it is not clear now whether the World Bank will agree to accept the premature redemption.

Canceling of custom duties on the import of essential goods

Last week, the Head of Federal Tax Service Andrey Belyaninov offered to cancel custom duties on the import of essential goods. The Market skeptically looked at such an idea saying that this will sharply decrease the competitiveness of Russian producers and will not push prices down as fast as it could be expected. The Economy Minister Elvira Nabiullina said that there is no need to raise grain export duties after discussions about possible consequences with economists.

Pension money could be invested into foreign assets and local corporate papers

It is expected that Vnesheconombank, which manages pension money, could get rights to invest not only to Russian sovereign bonds but also into sovereign bonds of foreign states with high investment rating, and also to corporate bonds of the Russian first-tier corporate sector. According to VEB's head Dmitriev, the minimum rating for papers of foreign states could be set at not lower than AA investment grade. The idea is to diversify investments and to increase the return. But the conservative approach to funds management is expected, to be kept unchanged. It is possible that a part of the funds will be invested into papers backed by mortgage papers not guaranteed by the State since they are secured by the real estate. He also mentioned that the return of investments of pension funds will be lower than inflation in the country in 2007. Dmitriev said that if VEB's investment declaration is extended, then VEB will be able to keep return closer to 10% but not higher.

Related Economic Updates

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- ◊ Russian internet advertisement market is growing at a very fast pace (almost doubles each year). It is expected that the number of internet users will increase considerably by 2010 due to the fast development of broadband Internet in regions.
- ◊ According to the report of the Boston Consulting group, China will become the second market in the world in terms of the consumption volume. The demand for goods is unprecedentedly increasing in China, particularly for goods of higher quality. The growth rate exceeds 3-5 times the same figures for the developed countries. This is connected with the growth of welfare of Chinese people. It is expected that by 2010 Chinese market will take the third place after USA and Japan, and by 2015 they will outstrip Japan. According to Euromonitor, the volume of China's consumer market amounted to \$529bio in 2006 and will reach \$690bio in 2011. For Japan these figures are expected to be \$970bio (2006) and \$1trio (2011), for Germany \$558bio (2006) and \$585bio (2011).
- ◊ **Writing off old doubtful debts**
In Russia in 1998 many companies transferred taxes through banks which went bankrupt during that year's crisis. However, despite that, The Tax Service continued to pursue these companies and considered their debts as not paid back. The Finance Ministry will write off those debts from now.
- ◊ **Phone Tariffs for "Unlimited" tariff plan could be increased**
The Federal Tariff Service doesn't plan to increase average weighted level of tariffs for local telephone communications. It was mentioned that in Moscow and North-West Federal District local tariffs already reached the economically feasible level. However, it is expected that payments for the "Unlimited" tariff plan could be increased in some areas.
- ◊ **Possible VAT cut**
Seems that the State started to think seriously about VAT issue. The pressure from business community started to have an effect. Discussed was a possible decrease of VAT from 18% to 12%, and also replacing of VAT with sales tax (which could raise a lot of difficulties with new tax handling) But it was only a discussion yet. As many think, if VAT is decreased to 12%, it will be easier for companies to pay VAT than to use tax reduction schemes which should boost tax collection.
- ◊ Russia is going to speed up the development of Techoparks in the country.
- ◊ Russia is going to change its attitude to developing natural resources. Exploration and development of Eastern Siberia resources will be among coming priorities.
- ◊ Russia is going to continue talks with Saudi Arabia and Georgia (which are the only countries agreements with which are necessary to be signed to access WTO) on its accession to the World Trade Organization (WTO) in two or three weeks' time.

Russian Money Market

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MIACR: Last week the overnight rate lay in the band of 4.55–7.47%, for one week rubles could be found at 6.09-7.54%, and for one month at 7.00-8.87%. The overnight rate closed the week at 7.47% and rose considerably last week compared to the previous week.

Balances on C/A opened the week at RUB432.7bio and closed it at RUB456.5bio. Bank deposits with the CBR opened the week at RUB537.5bio and closed it at RUB328.2bio. Totally C/A + deposits fell by RUB85.5bio for the last week. MosPrime o/n rate grew from 5.29% on Monday to 7.46% on Friday last week. International MM rates fall the second week in a row.

And so – the tax payment period has come. VAT payments appeared to be solid. But rates stayed quite low – 5% on Monday on market open and 4% by the end of the same day. REPO/OFZ rates rose slightly from 5.1% to 5.5%, REPO/Corporate rate rose from 5.5% to 5.8%.

On Tuesday the MM o/n rate opened at 5% and stood for 3% by the end of the day. On Wednesday rates opened at 5-5.5% and grew to 7% due to Minerals Extraction Tax payments (~RUB120bio in total), later rates didn't fall on market close and remained at 7%. REPO volume stood for RUB60.7bio which appeared to be quite considerable amount.

On Thursday MM o/n rate opened at 7.5% and REPO/OFZ o/n rate at 6%. Such high rates pushed market participants to look at the CBR's side and REPO volume rose considerably to RUB154.6bio.

Ahead is the Income Tax payment on October 29. Last week the CBR reported a rise in gold and forex reserves by \$6.1bio to \$440.1bio, which confirmed recent interventions of the CBR on the currency market, about which we wrote in the previous report.

Recently the government introduced changes to the State Budget for 2007. According to the Ministry of Finance, revenues grew from RUB6.97trio to RUB7.44trio. High oil prices and extended debts of Yukos could be attributed to such an increase. However, the growth of expenditures appeared to be much higher. Budget expenditures grew from RUB5.46trio to RUB6.53trio. This rise includes RUB640bio which will be transferred to Development Institutions, also an increase of pensions and allowances for military servicemen. The Ministry of Finance forecasts that the surplus of the State budget in 2007 will amount to RUB912bio.

However, the history shows that the budget tends to spend less than planned. It will be not easy to spend such high amounts till the end of the year. According to the preliminary data about the federal budget execution, in January-September 2007 budget spending amounted to RUB3.48trio. But to match the forecasted RUB6.53trio for 2007, it's necessary to spend RUB3trio till the end of the year, then, it's necessary to spend ~RUB1trio per each remaining month (Oct, Nov, Dec). BUT the reality of the money market showed that we didn't see the rush in spending in October, thus the amounts which should be spent in November and December increased. The thing is that it is not easy to spend such high amounts for such short period of time, moreover it's necessary to do something real because spending is not just a transfer. Only money to the Development Institutions was promised to transfer now but they could be spent later, all other expenses must be real. Then, let us assume that we will see RUB700bio expenditures in October, then RUB2.3trio will remain for November and December, minus RUB640bio to the Development Institutions which could be just "a nominal transfer" and we get RUB1.66trio which must be spent on something till the end of this year. It's interesting on what.

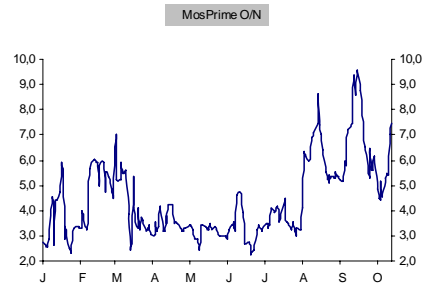
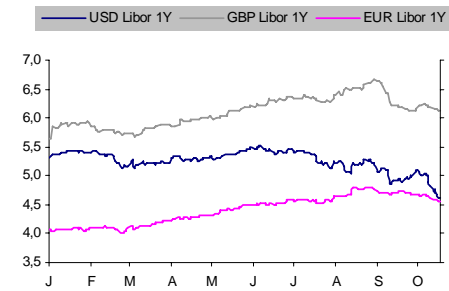
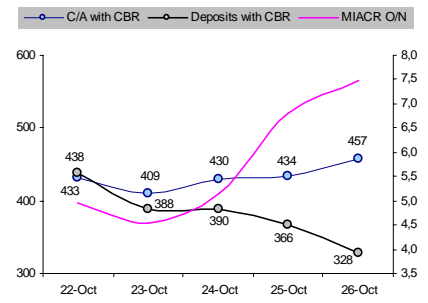
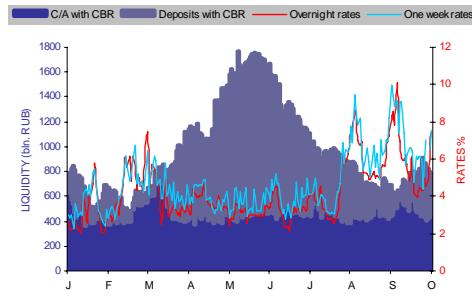
The CBR is going to revise the country's refinancing rate due to higher than expected current inflation and even higher forecasted figures.

Last week, some market reports again stressed possible liquidity problems of the Russian banking system. But let us give some credits to the CBR and the government because a lot was really done to improve the liquidity.

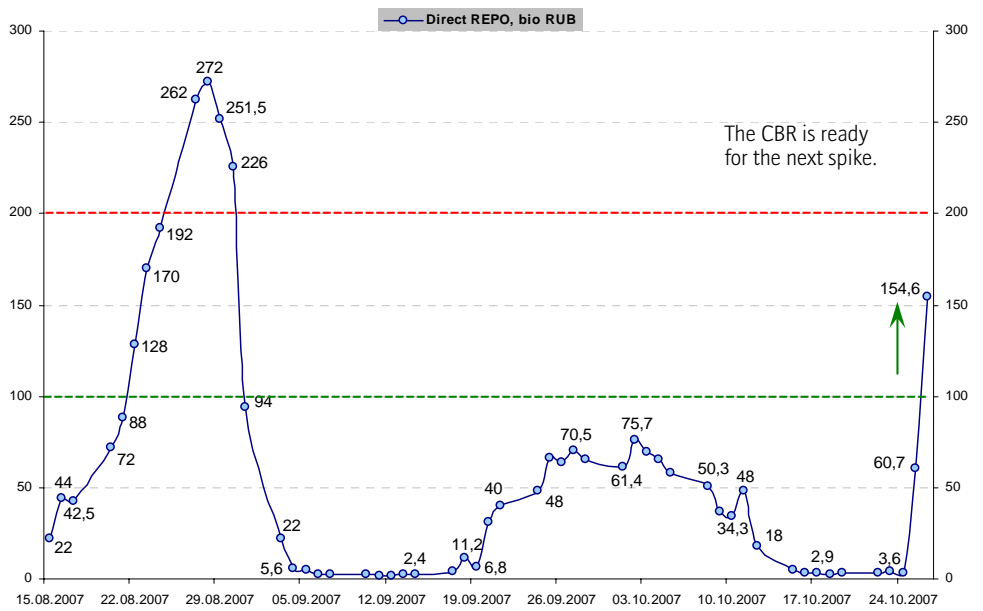
- (1) mandatory reserve requirements for lending institutions were decreased,
- (2) the ruble rate for swap operations with the CBR was decreased from 10% to 8%,
- (3) the market is waiting for higher budget expenditures which have to increase the liquidity,
- (4) Lombard/REPO list was extended and there are some bonds which satisfy the requirements of the CBR and will, most probably, soon be included in the list,
- (5) the revised forecast of the federal budget shows that expenditures will increase this year much faster than expected,
- (6) Economic statistics for 2007 is strong except for inflation which appeared to be higher than planned.
- (7) Accelerated inflation was mostly generated by rising oil and food prices on world markets. And not only Russia faced such high accelerated inflation figures, but the US and many other countries as well. However, even such high inflation (and we continue to assume that it will most probably reach 11% in 2007) corresponds to much higher than in many other countries growth rate of Russian economy.
- (8) The CBR is going to start accepting Eurobonds for collateral REPO from mid-November. Interest rates would be similar to REPO rates used for Ruble-denominated bonds with same rating. It is expected that this will extend refinancing capabilities to ~RUB250bio, which is the approximate volume of Eurobonds in banks' balances.

For sure no one can blame the CBR that they just sit and wait.

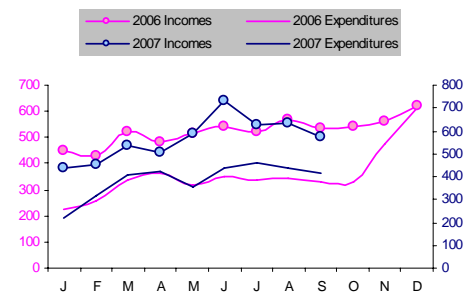
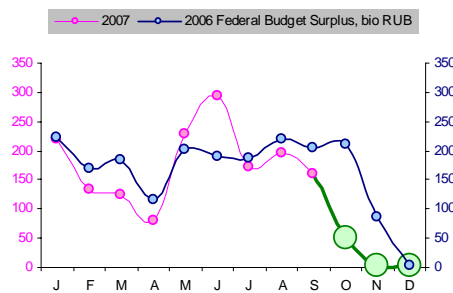
Rates and Liquidity Dynamics



Borrowing from the CBR



The Russian Federal Budget



Russian Stock Market

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Friday 19 – Monday 22:

As we expected after Friday 19 closed with a strong decline in almost all stock exchanges, on Monday Russian Stock Market showed a gap down. The developments on domestic trading floors were reflecting global fears of a possible US recession. The period was expected to be difficult as US housing data suffered heavy losses which led to massive stocks sell-offs, fueled by the threat of higher inflation. The decline swept through most market sectors. However, the level of 2,100 became the citadel where new long positions were taken waiting for the global situation to improve.

Another move up:

Already on Tuesday RTS started to grow. A lot of stocks still appeared to be undervalued. A correction from 2,174 to 2,100 appeared to be enough to form the base for further growth.

High crude prices again supported the Russian stock market and "Russian oil stocks". Russian oil sector advanced by 1.81% last week.

FOMC is coming and Russian Stock Market players wait for something good from it which resulted in 2% RTS growth on Friday 26 when the Index closed near its all-time maximum level.

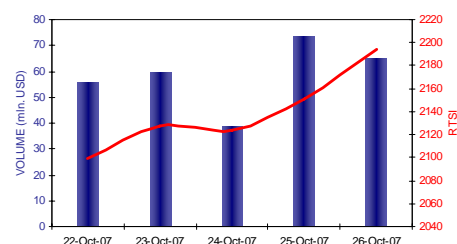
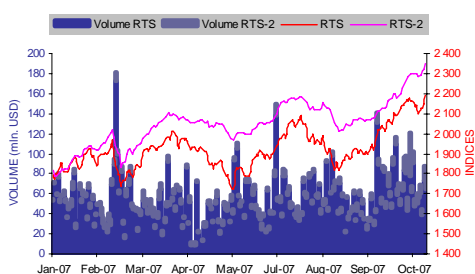
However it's necessary to remember that Russian indices have already reached levels, which were predicted for the end of this year. This could generate locking profits despite the support from commodity markets and crude prices in particular. However, this could be accelerated if oil prices will go down.

RTS grew by 2.41% and closed the week at 2,194. **MICEX** and **MICEX COMP** indices closed the week at 3,382 (+2.89%) and 1,854 (+2.94%) respectively.

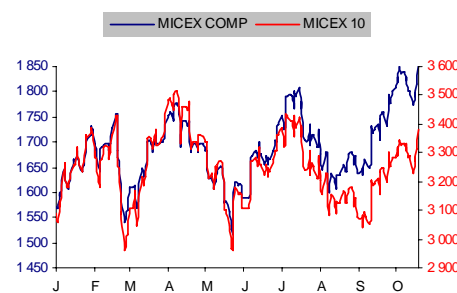
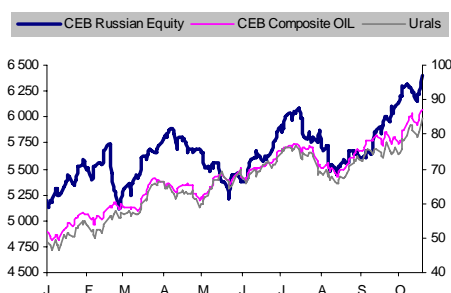
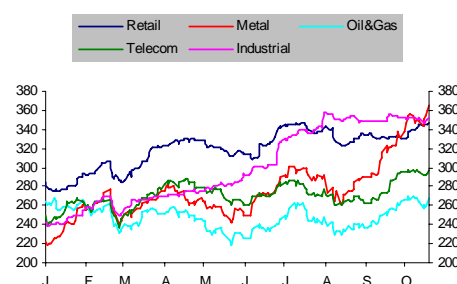
All of RTS sector indices closed positive last week. Metal&Mining sector showed the largest advance and rose by 4.77% last week.

We continue to believe that the Russian stock market has fundamentally well-defined upturn potential and will advance in the long-run above 2,200, for sure.

Russian Stock Market Dynamics



Type	Year To Day		Last Week	
	Index R-Ch	Index %Ch	Index R-Ch	Index %Ch
Oil&Gas	5,30	2,01	4,78	1,81
Telecom	48,36	19,39	2,80	0,95
Metal&mining	143,17	64,43	16,62	4,77
Industrial	110,09	45,46	0,52	0,15
Retail	61,72	21,65	2,42	0,70
RTS	395,49	21,99	51,70	2,41
RTS-2	526,40	28,92	45,76	1,99



Russian Stock Market Performance

Company Name	Last Price, \$	CHANGES, %			
		1 Day	1 Week	1 Month	1 Year
ENERGY					
Bashneft	16	2.2	2.6	19.0	1.6
Gazpromneft OAO	4.65	0.0	0.0	17.7	12.9
Gazprom OAO	12	2.8	3.3	9.6	10.6
LUKOIL	87.9	2.9	1.7	9.5	5.9
NovaTek OAO	5.5	1.9	1.9	11.9	1.9
Rosneft Oil Co	8.81	2.4	0.9	4.0	2.1
Surgutneftegaz	1.302	3.6	0.9	-4.4	0.2
Surgutneftegaz	P 0.67	1.5	-0.7	11.5	-28.0
Tatneft	5.9	5.0	3.7	8.5	24.2
Transneft	P 1825	3.4	3.1	3.1	-18.3
Ufaneftekhim	3.3	3.1	2.8	7.5	-5.7
BASIC MATERIALS					
Magnitogorsk Iron & Steel Works	1.26	3.7	4.1	9.1	62.1
Mechel	25	0.0	17.6	62.9	249.7
MMC Norilsk Nickel	290.8	2.0	8.5	12.7	105.5
Novolipetsk Steel	3.97	1.5	0.0	21.4	89.0
Polyus Gold Co	44.8	0.0	0.1	1.8	-6.7
Severstal	23.7	0.9	8.5	15.6	85.9
Uralkali	4.95	9.5	16.5	45.6	210.3
FINANCIAL					
Open Investments	275	-2.1	-4.5	-4.8	31.0
Sberbank	4.36	1.4	0.5	7.7	91.2
Sberbank	P 2.93	0.1	3.9	7.7	59.9
VTB Bank OJSC	0.0048	0.8	1.1	-2.7	#N/A N/A
COMMUNICATIONS					
Central Telecommunication Co	0.915	1.7	-4.4	0.5	53.8
Mobile Telesystems OJSC	13.3	3.5	8.6	16.7	75.0
North-West Telecom	1.825	0.0	2.5	26.7	65.9
RBC Information Systems	9.15	0.0	0.0	15.8	-14.1
Rostelecom	9.935	1.4	-0.9	-5.6	96.7
Rostelecom	P 2.55	0.0	0.0	0.0	25.6
Sibirtelecom	0.111	1.4	-0.9	16.2	25.4
Sistema JSFC	1470	2.1	8.5	11.4	14.8
Uralsvyazinform	0.065	2.4	1.6	13.4	65.8
VolgaTelecom	5.45	0.0	-4.7	16.0	37.8
UTILITIES					
Irkutskenergo OJSC	1.06	0.0	6.0	15.2	92.4
Mosenergo TGK-3 OAO	0.256	0.4	2.4	2.4	37.6
OGK-3 OJSC	0.155	0.0	0.0	15.7	86.7
OGK-5 OJSC	0.17	-0.3	3.7	10.0	88.9
Unified Energy System	1.237	0.3	3.7	0.9	68.2
Unified Energy System	P 1.115	1.4	8.3	5.7	65.2
INDUSTRIAL					
JSC Scientific Production Corp IRKUT	0.92	0.0	1.1	2.2	-23.3
TMK OAO	11.15	0.0	-1.8	19.9	#N/A N/A
Vsmpo-Avisma Corp	307.9	2.0	2.6	6.2	29.9
CONSUMER NON-CYCLICAL					
Baltika Brewery	48	0.0	0.0	2.1	21.5
Lebedyansky JSC	93.75	0.0	6.7	5.3	26.5
Wimm-Bill-Dann Foods OJSC	79.9	-0.3	-2.3	-2.0	99.8
CONSUMER CYCLICAL					
Seventh Continent	25.95	-0.4	0.4	3.4	-4.6
Aeroflot - Russian International Airlines	3.4	0.0	0.0	14.5	45.9
Magnit OAO	45.4	-0.8	-2.5	8.6	37.6
Severstal-Avto	49	2.1	4.3	0.5	104.2

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- ◊ **Aeroflot** (net profit grew by 18.8% in H1 2007 under RAS to \$160.8mio compared to the same period a year earlier).
- ◊ **Synergy** (net profit under IFRS went up by a factor of 2.14 to \$15.26mio in H1 2007 compared to the same period a year earlier).
- ◊ **Lafa Bank Group** (net profit after tax under IFRS grew by 0.7% to \$115.6mio in H1 2007 from \$114.8mio for the same period a year earlier).

Russian M&A, Issues, Intentions

◊ Perspectives of the Russia's M&A Market

Russia's M&A market is growing at a very fast pace. Not only did the number of M&A transactions grow, but also their value rose two times in January-June 2007. And that's actually a very good thing for the Russian Market, which is very young and has almost no history. Russia takes 2% of all the global acquisition volume, which is not bad. To compare, Europe takes 6%.

For sure, strong economic growth, fast developing infrastructure for capital markets, an inflow of foreign investors, and strengthening of government's role in the economy ensure a good background for the development of Russia's M&A. The consolidation allows Russian companies to compete effectively not only inside the country's borders already but on international markets as well. It is expected that the Russian M&A volume could reach \$100bio in 2007. Except for the desire to get more profits, Russian companies show the desire to be transparent and readiness to integrate to the world's business community, they start to think about stockholder's value. The recent liquidity squeeze prompted by the US mortgage crisis decelerated Russian M&A, but it will improve for sure as confidence on the market gets restored.

- ◊ **AutoVAZ** postponed borrowing of \$500mio syndicated credit due to changes in management of the company and changes in the market conjuncture.
- ◊ Last week **M.Video** announced a preliminary price range for its upcoming IPO at \$6-8 per share. The capitalization of the company is expected to be within \$1.08-1.44bio following the IPO, while free float is expected to reach 30%.
- ◊ **RAO UES** will soon export electricity to China. Export volume is expected to start from 3-4bio kilowatt-hours and reach 38bio kwt/hour later on. China is preparing for the import now.
- ◊ Last week **Aeroflot** said that for two weeks it will say about its official position about possible buying in Italian **Alitalia**. Aeroflot can buy Alitalia by raising EUR1bio loan to buy 49.9% stake in the loss-making Italian carrier. It is rumored that Italian company developed a survival strategy to keep the company afloat after strategic investor buys in.
- ◊ Last week **LUKoil** said that it doesn't intend to list on the New York Stock Exchange (NYSE). Presently, the Russian oil giant has OTC traded stocks on the NYSE and is listed on the LSE.
- ◊ **Bank Saint Petersburg** will place shares on RTS & MICEX (B-list) at \$4.35-\$5.65 per share and \$13.05-\$16.95 per GDR. GDRs will be composed of three common shares. The Bank is going to place 50.8mio additionally issued common shares as part of an IPO, thus the free float will account for 18%.
- ◊ **Evraz Group** exercised its call option to purchase a 25% stake minus one share in the Italian company **Palini e Bertoli** for EUR76mio. Thus, Evraz Group raised its stake in the Italian steel plant to 100%.
- ◊ **Holland Heineken** and **Danish Carlsberg** said that are going to form a consortium to take over **British Scottish & Newcastle (S&N)** and divide latest's assets. According to British Media, S&N doesn't want to be took over and is going to sell its 50% stake in **Baltic Beverages Holding (BBH)** (which is of Carlsberg's major interest in this hostile acquisition) so that forming of consortium of Heineken and Carlsberg appeared to be unattractive. If Carlsberg get control over S&N than it will become the only stockholder of "Baltika" which is the leader of the Russian beer market. BBH was previously formed to work in Western-Europe markets (Russia, Belorussia, Kazakstan, and Ukraine). Capitalization of Baltika, which is the main asset of BBH stands for ~\$8bio, while the capitalization of the entire BBH stands for ~\$14bio. It is rumored that Carlsberg wanted to get S&N's share in BBH, and also France and Greek's assets in the company, while Heineken wanted to get control over S&N's Britain assets and its assets in other European countries. Nevertheless, if S&N decides to sell its share in BBH, than again Carlsberg could be the buyer if it gives a good price, and it is most probable that S&N's stock holders could agree on such a sale. But there can appear a competition because many want to get such an attractive piece of a pie.

- ◊ **Lukoil** has a subsidiary in the US. The US forbids Russian company to invest more than \$20mio in Iran's economy. Last week Leonid Fedun said that Lukoil will do US based subsidiary's business within resident US rules. The thing is that Iran offered interesting projects to **Gazprom** and Lukoil, but due to restrictions from the US these projects could not be done, due to sanctions of the US against Iran. The similar situation is in Middle Africa, where Lukoil has interests, but where the US also put restrictions. Seems that the only country which can operate all these markets without any restrictions is China which feels free from US policy. Lukoil would not have any restrictions if the company did not have a US subsidiary (currently Lukoil has 1965 petrol stations in the US as of the beginning of 2007, which is greater than in Russia, Lukoil takes about 6% of petroproduct market in the US). Discussions about this led to some decrease in Lukoil stocks.
- ◊ Indian **ONGC Mittal Energy Ltd** acquired 30% stake in developing project of one of Caspian regions on Turkmen shelf (worth of a 30% stake was not disclosed). Indian company could compete with Lukoil over there. Lukoil together with **ConocoPhillips** is going to start developing 3 deposits there till the end of this year. These deposits contain oil and gas. But Lukoil could also cooperate with the Indian company, remember that Lukoil and ONGC possess a joint venture **Nelson Resources** on parity currently operating in Kazakhstan.
- ◊ Last week FAS rejected Norwegian **Aker Kvaerner** to get the control stake of "**Astrakhansky Korabel**" (56%), which is the largest shipbuilding company in Astrakhansky Region.
- ◊ **Vnesheconombank** postponed opening a \$100mio credit line to **Power Machines** till it becomes clear who is the actual owner of the company. It is rumored that this could be also caused by the news that "Indian contracts" for which lines were previously opened generated losses, and, from the other hand, also is rumored that Power Machines previously broke rules of \$60mio credit-contracts of Commerzbank and Donau Bank, but currently the company has not any overdue obligations. The control over the company is contested by Highstat Limited (Alexey Mordashov) and Stephens Capital Ventures S.A. (Oleg Deripasky). The selling of the RAO UES 25% scheduled on mid-November will decide.
- ◊ **X5 Retail Group** is currently in negotiations with OOO "Richfor" on acquisition of latter's chain stores "Marka" (12 stores in Moscow). It is rumored that the amount of the deal could stand for \$32-44mio, however the market perception is that the figure of greater than \$40mio is too high for this chain.
- ◊ **Basic Element** is going to purchase **RussNeft**. Basic Element applied to the Russian Federal Antimonopoly Service (FAS) for the permission to complete the deal. The date and the amount of the deal were not disclosed. According to Alexander Lukin, Deputy General Director and Financial Director of the Russian holding, the recent arrest of RussNeft's shares and the respective risks were all taken into consideration and would not influence Basic Element's decision on acquisition. It's competitor in this deal, Glencore, which is a part of **United Company RUSAL**, also submitted documents to FAS for the permission to purchase of RussNeft.
- ◊ It is rumored that **IES Holding** is going to launch an IPO in 2009. It is also rumored that the energy holding intends to consolidate its assets and obtain controlling stakes in **TGK-5, TGK-9, TGK-6** and **TGK-7** by raising its interest in the power generation companies (for some companies up to 100% stakes).
- ◊ It is rumored that **Russian Railways** is going to place some of its shares after 2010 to raise funds for the construction of new railroads.
- ◊ Russian agroindustrial holding, **Razgulay**, is going to make SPO, in the result of which its share capital will be increased by 11% from 106mio to 120mio shares. It is expected that the holding will use the proceeds to raise stakes in companies in which Razgulay owns small stakes. The company plans to complete the flotation before December 1, 2007.
- ◊ **Baltika** changed corporate mobile operator from MegaFon to **VimpelCom**. This was announced to be a sounding happening because currently **MegaFon** controls the lion's share of corporate clients at the North-West of Russia.
- ◊ It is rumored that **Gazprom-Media** is going to acquire 49% stake of **News Media** from UFG. **UFG** could sell the stake on the peak of News Media's development, while Gazprom-Media is going to strengthen its position on the Russian media market. Market participants estimate 100% of News Media at ~\$80-120mio. But Gazprom-Media is not the only one interested in UFG's stake. It was rumored that interested was also **Nafta Moscow**. It is expected that the growth rate of the press advertising market will amount to 28.8% in 2007 and 28.4% in 2008. UFG acquired 49% of News Media in April 2006 and according to some rumors did this expecting for the growth ahead of coming elections in the country and expects the decline after elections.
- ◊ Except for **Alitalia**, **Aeroflot** is interested in acquiring of Serbian **Jat Airways** also **Czech Airlines**. Czech Airlines, is rumored, got 175mio kronas net loss in H1 2007. **Air France-KLM** and **Korean Air** also showed their interest in acquiring czech assets. It is rumored that the market value of the company amounted to \$150mio.
- ◊ Igor Kostin, the deputy head of business planning department of **Severstal**, was appointed to the position of a Chief Director of **Power Machines**. Kostin is known as a good strategist who has a good record of strong achievements (ex.Izhorsky pipe plant, which he turned to the strongest in Russian factory producing large-diameter pipes).

- ◊ **TMK** is going to sign a ten year-agreement with Venezuela on supplying of gas pipelines. TMK is the largest pipeline producer in Russia – it controls 44% of the domestic market of steel pipes. TMK's expansion to foreign market was not high. Currently, it owns **Sinara Handel GmbH** which controls Romanian pipe plant **SC TMK-Artrom SA** and metallurgy plant **SC TMK-Resita SA**. Going to foreign markets will, for sure, increase the attractiveness of the company.
- ◊ **EKSMO**, the largest publishing house in Russia, can make an IPO in 2010. In the first half of 2008 the company plans to issue RUB1bio debt to start creating a credit history. The probability of selling a stake to a strategic investor to raise funds is also considered.
- ◊ **AFK Systema** will buy 41% of Indian **Shyam Telelink**, as a result the total stake in the company will grow to 51%. It is rumored that the amount of the deal will correspond to \$58.1mio. Also Systema has call options which will allow the company to raise its stake from 51% to 74%.
- ◊ Russian dollar-billionaire Gutseriev left Russia. It is rumored that he was accused of tax evasion. This is connected with **RussNeft** and a desire of the State to create the State oil company based on RussNeft. There appeared a high probability of international scandal if Great Britain repeat the situation with Berezovsky and will give a political asylum to Gutseriev. This could again spoil relations between Moscow and London.

Russian Debt Market

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Eurobonds

Monday was free from important economic statistics so investors looked at equity markets. The probability that the FED will cut the rate by higher than 25 basing points is very low. Indicators of US economic growth, employment and inflation are still high enough, thus there is no necessity to cut the rate higher than by 25 basing points. Moreover financial markets more or less calmed.

Eurobonds on Monday 22 almost didn't change compared to Friday 19. However, some cautious buying interest was observed for Sberbank-11 and -13 and Russian Standard Bank-09.

Some weeks ago the info appeared that Evraz Holding could issue \$1.8bio Eurobonds as one of the variants to refinance debts taken to acquire Oregon Steel. Then seemed that everybody forgot about that but on Monday we saw increasing selling activity on Evraz-15. Seemed that Evraz really wanted to place Eurobonds. Raspadskaya-12 also went down.

On Tuesday the situation with EM was positive. EMBI+ didn't change almost and stood for 204bps. However, spreads are noticeably wider than a week ago. Situation around US housing and new losses of large US investment banks related to subprime sector still provoke investors' worries and limit the demand for risky assets.

On Tuesday long TNK and also Lukoil Eurobonds went up. We still observed buying interest for the new issue of Gazprom-18E, which was traded already at 101.375%. Rising oil prices again pushed some buying interest to the petrochemical sector – KazOS-11, Eurochem-12 and NKNH-15 were bought. The situation around Evtaz again got attention – Evraz-9 and Evraz-15 showed higher trading activity. Interest to the banking sector again came back – we wait that the demand for the Bank of Moscow, Alfa-Bank, Gazprombank will retain.

Taking into consideration that ~80% of Eurobond market participants are foreigners who look at our Eurobond market from the global point of view worrying about any kind of global crisis and do not get the real situation in Russia, which, compared to everything happening in the world, is much better. Still, those who buy – rule the market. And we can discuss a lot about what's happening domestically, but if 80% of market players sell because they think that global crisis will affect it would be wise to look at global crisis. Furthermore, we would concentrate your attention on those banking bonds who give yields higher than those of Sberbank and Gazprom, but can have government's support.

The market was expecting that the US housing data will continue to show negative statistics last week, so investors started to buy US Treasuries again, their yields correspondingly went lower.

On Wednesday the yield of UST10 continued to decline and spreads of Emerging debt continued to widen after Merrill Lynch reported about writing off losses of around \$7.9bio connected with low-quality mortgage. Last week Fitch agency decreased Merrill Lynch credit rating to A+. But hardly can such action damage to the giant's steadiness. Hardly this could damage to the Bank with assets of more than \$800bio and a capital of \$40bio.

The influence of the negative data from the US housing tend to decrease.

Thus after ML's report, most liquid Turkey and Brazil bonds kept their current levels and grew a little. A decline was observed in lower quality markets of Argentina, Venezuela and Equador.

By Friday UST10 fully priced in a 25bp cut in the US federal funds rate.

Weekly	Yield bps ch	Price bps ch	Weekly	Yield bps ch	Price bps ch
Russia30	0,04	-0,31	UST10	0,01	-0,05
Russia28	-0,01	0,06	UST5	0,02	-1,76
Russia10	0,02	-0,06	UST2	-0,02	-0,66
Brazil40	0,00	-0,06	EU10	-0,03	0,23
Turkey34	-0,08	1,00	EU2	-0,03	0,06

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Ruble Bonds

From the beginning of the week most liquid instruments went down. Investors fixed profit backed by uncertainty about coming FED's decision on the federal funds rate and anxiety about the tax payment period. But the decrease was smooth. Bonds of Gazprom-8,9, RZhD-5, and MosOblast-5 showed some slight decline. Russian Standard Bank-4 and URSA-3 declined, while URSA-7 grew.

Concerning FED, it's more probable that the rate will be cut by 25 basing points, and investors guess how will markets react to such a cut.

The key factor of the ruble debt is the liquidity – and we assume that the situation with liquidity will be better till the end of the year, which will be supported by currency interventions of the CBR from one side, and by promised by the State increasing budget spending from the other side.

Moreover the amount of non-residents on the ruble bond market decreased compared to two month ago thus potentially the influence of external factors will be limited to some extend.

Furthermore, liquidity perspectives look much better after latest statements of the government that Vnesheconombank will be able to invest pension savings of population (~RUB330bio) to foreign sovereign bonds of not lower than AA rating, also to some Russian issues of the first-tier (but specific criterias and companies were not mentioned yet) and also to mortgage bonds not guaranteed by the government of Russia (currently this refers to MIA-4, PIA AIZhK, and GPB-Ipoteka). According to market rumors, Vnesheconombank will get ~RUB130bio in 2008 as receipts of new pension funds, seems that the Bank will not sell considerable amount of OFZ and will invest to newly stated assets from additional receipts. Thus in mid-term perspective, structural changes of VEB's investments could lead to the shrinking of spread of the first-tier to the OFZ curve, and the scale of this change will depend on the amount of funds which will be permitted to invest in corporate ruble bonds.

Investors got the idea that the tax payment period was doing much better than at the corresponding previous period and on Tuesday we observed buying in ruble bonds, mostly in the first-tier segment (ex.Lukoil-3,4, MosOblast-6, RZhD-6). Banking papers, nevertheless, showed some decline – URSA-3,5, RussianStandard-4, KhFB-4 fell slightly.

Moreover we think that shrinking of spreads in corporate segment will be supported by further widening of Lombard/REPO list, the potential of which is not exhausted yet.

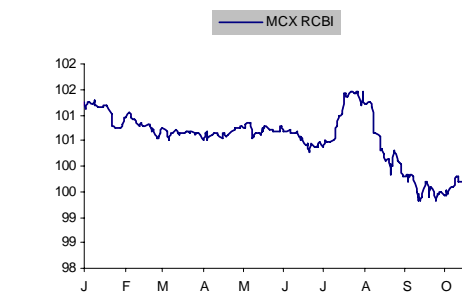
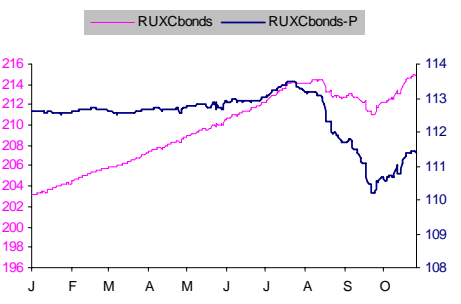
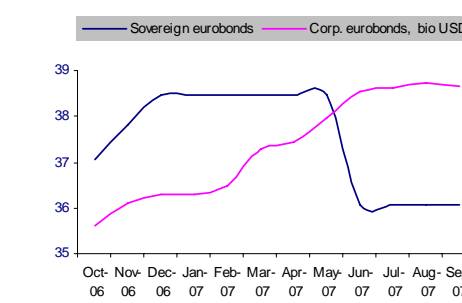
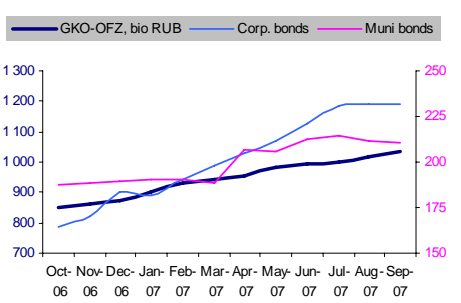
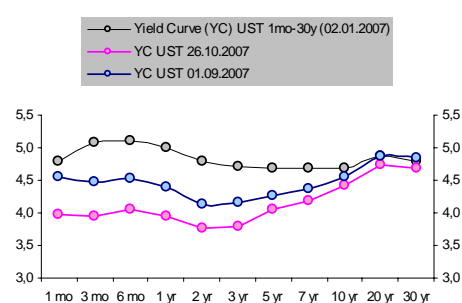
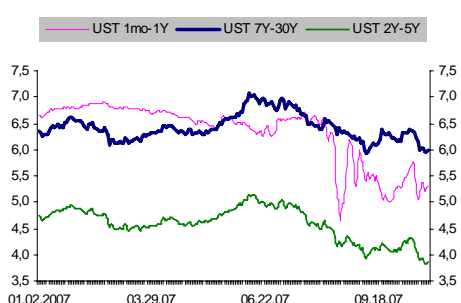
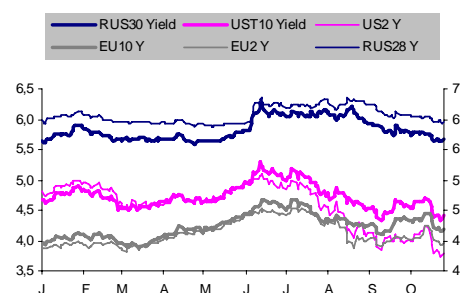
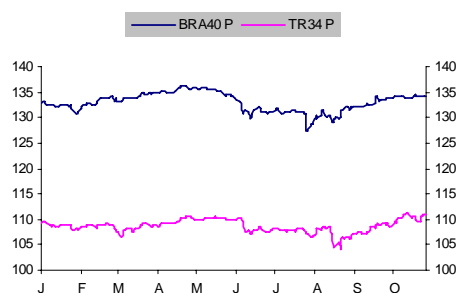
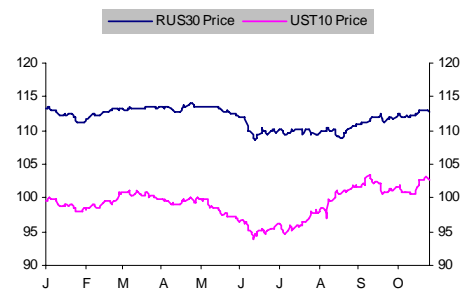
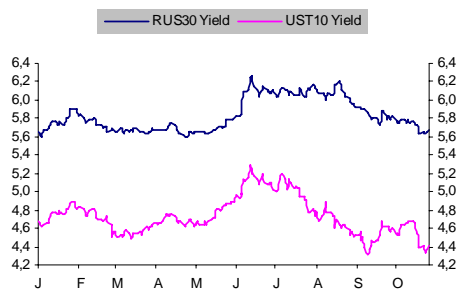
Later extraction tax was paid which led to the growth of rates on money market to 8% which did not assisted to ruble bonds buying. There were less buyers and we didn't notice aggressive selling as well. Buying interest to Yakutia-7 and Komi-8 appeared again (these papers are included in the PEPO list) and on Chuvashiya-5,6 which are not included in the list but match the CBR's requirements and will, most probably, be included in the REPO List soon.

Last week Tinkoff Credit Systems started the placement of its RUB1.5bio debut bond issue. In the first day of a placement, RUB272mio was borrowed. Not a good result, which shows low interest of investors in risky assets. Such low levels usually attribute to the third-tier issues. Deutsche Bank (the organizer of the issue) said that looks optimistic for the issue. Market thinks differently. Even 18% risk was not attractive and attributes more to venture investments. According to rumors, 18% stands for the high risk of the issuer (not enough information disclosure, new business model, absense of "history") and not for the general risk of the market. The Bond market as such likes something more clear about the future development of the company issueing the debt. Interesting was also the volume of deals –there was 17 deals of low volume, which really showed the situation on the market – investors do not want to invest in assets of such high risk.

Bonds of AFK "Systema" did not react to upgrade of its rating by Moody's to Ba3, which is now one step lower than rating of MTS.

Last week rumors floated that VTB will soon place USD-denominated Eurobonds, with same intentions marched off TransKreditBank and Bank of Kazakstan's Development. This would be a positive sign if placemnts will come successful.

Another perceptible moment of the last week – Moscow buys back its debts. Last week buy back auctions on Moscow-29, Moscow-36 and Moscow-43 were held, however, bought back was only RUB15mio of 29-issue. The total volume of debt stand for ~RUB1.5bio which was most probably bought by long-term investors which are satisfied with the quasi-sovereign quality of the debt and 10% coupon.



Russian FX Market

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Last week RUB continued to appreciate against USD. But now, seems, it was backed by depreciating of USD on the world market. USD/RUB fell by 0.39% last week.

The total trade volume on UTS TOM+TOD sessions fell last week by ~1.5bln compared to the previous week. But the allocation of trade volume was more or less even last week compared with the previous week.

USD/RUB chart was spoiled, the break below 25 RUB/USD now looks much evident, which could open further road down technically.

Gold and forex reserves and the stabilization fund are growing ensuring the stability of the Russian economy. Growing money supply adds to easing of liquidity difficulties.

Gold and foreign currency reserves

Russia's gold and foreign currency reserves stood at **\$440.1bln** as of October 12, which is **\$6.1bln or 1.41%** higher than at previous showing.

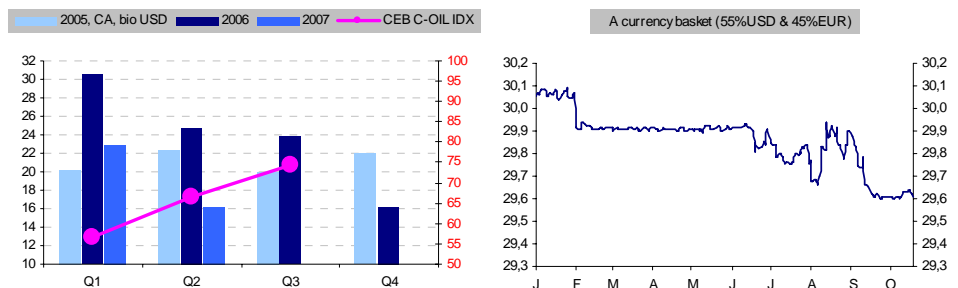
It is more probable that EUR/USD could touch 1.45 by the end of this year. G7 and following IMF and World Bank meetings said little negative about weak USD, which actually means a "green light" for further depreciating of USD.

Consequently, the probability that USD/RUB will come closer to somewhere 24.7 by this year-end increased. In the beginning of the next year the CBR could continue the policy of strengthening the ruble to show curbing with inflation and the new cabinet's success on this issue.

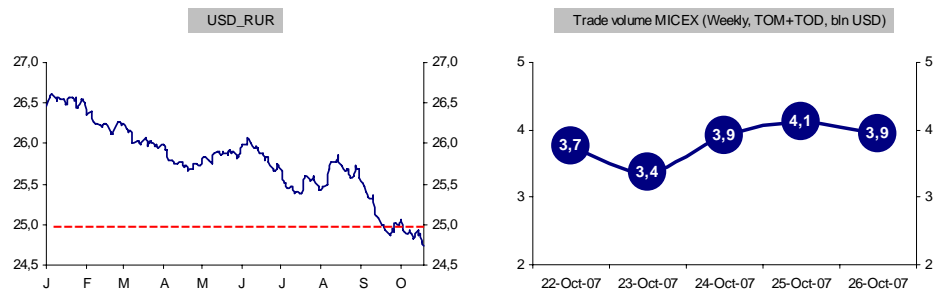
However, this is doubtful due to...

We already observe shrinking current account balance, which is quite considerable in 2007 compared to 2005 and 2006.

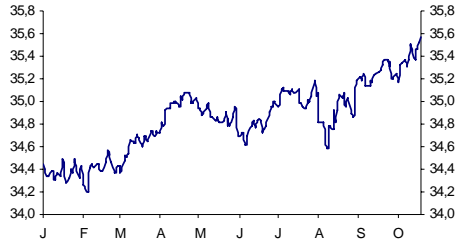
This is more remarkable while we have growing oil prices. This could be even the critical moment because if oil prices will go down then the balance will decrease even faster. Thus strengthening of the Ruble will only intensify decreasing current account due to an increase of the import growth rate. Moreover, the competitiveness of Russian producers on global markets will decrease with a stronger Ruble. From the other hand strong Ruble could be good for Russia in macro perspective because global financial turmoil will push investors to further diversify their assets by investing into something growing and Russian securities could be of interest for sure. Many of Russian companies appear to be undervalued which could boost buying into them. Furthermore, strengthening of the Ruble will positively influence services sector and negatively influence industrial sector. This trend could further continue.



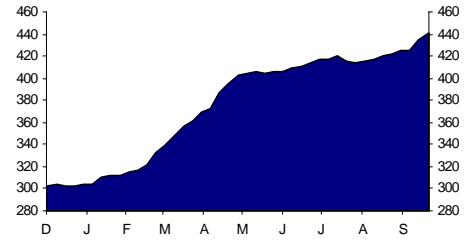
* CA=Current Account, CEB C-OIL IDX=Credit Europe Bank Composite Oil Index (taken quarter index value stands for the simple average of our index for the Quarter).



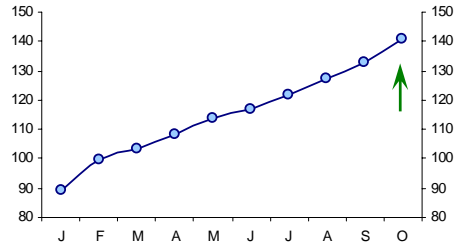
EUR_RUR



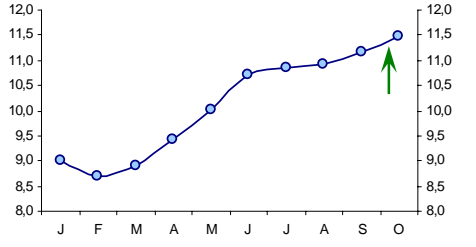
Gold and Forex Reserves, bn USD



Stabilization Fund of Russia, bn USD



Money Supply, trln rubles



Global Markets

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Major Currencies

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G7

At the beginning of the last week G7, IMF and World Bank meetings were held which gave "green light" to the selling of USD. Despite many talks about dangers of weakening USD for the global economy, G7 said that there is "nothing dramatic" in the current EUR/USD high rate. At the same time "big boys" worried about China's policy of not weakening Yuan. On Monday EUR/USD fell from 1.4340 to 1.4120 but as soon as market participants got that G7 didn't pay much attention to the weak dollar, EUR/USD started its rebound and by Friday USD fell to its all-time maximum against EUR posting 1.4373. [We think that till the end of the year EUR/USD will touch 1.45](#). Except for G7, main events of the week were housing data from UK and US, RBNZ meeting announcement. The G-7 ministers don't seem to be taking concerns about dollar weakness seriously.

By not mentioning the depreciating USD, the G7 flagged its approval of the orderly USD depreciation, which argues in favour of more USD losses in the months to come. Risk perception remained a dominant driver in the FX market last week. The risk aversion rose.

FOMC coming

The probability that the FED will decrease its federal funds rate by 25 basing points on October 31 meeting rose considerably. The US housing market continued its fast decline and posted new negative statistics last week.

The risk of financial market disruption spilling over into the real economic activity is too serious for the FED to ignore. Not easing runs the risk of a possible recession. The weakness in homes sales weighted on consumer confidence and will, most probably, lead to slower consumer spending this quarter. This is the predominant downside risk to the economy that the FOMC faces. Moreover, if the FOMC votes for not to move on October 31, it will have to understand that the markets will be surprised and disappointed. All these tips the balance towards a 25 basis point cut. The futures market fully priced in a 25bps cut for the Fed's coming meeting.

But we don't look for a US recession and expect global economic activity to remain solid with China and India continuing to grow rapidly.

Stronger Yuan

G7 finance ministers and central bankers blamed China for not allowing the CNY to appreciate faster. However, it remains questionable whether this will have any impact on China's FX policy. We assume that China will continue to intervene heavily in the FX market to limit the CNY appreciation against the USD. China's FX reserves will, most probably, sky-rocket further (\$1.434trio as of the end of September 2007).

Europe

Last week the ECB officials again stressed higher inflation risks in Eurozone. German Minister of Finance said that he expects 2007 annual inflation rate 2.2%. The German government is going to cut 2008 growth forecast from 2.4% to 2.0% and to increase 2007 growth forecast from 2.3% to 2.4%.

Last week, the ECB's Weber said that the ECB interrupted the rate hiking cycle only due to the financial market turmoil. However, he said that the ECB is ready to act after medium-term inflation risks.

UK

Following the comments by BoE's Barker who highlighted UK inflation risks, the chance of an early BoE rate cut declined. The details of the CBI survey showed that UK economy is not weak enough to warrant a rate cut right now, particularly after taking into account the fact that the BoE said that growth may recently have been stronger than suggested by the official data.

Investment Banks Reporting Losses

The sizable losses were recently reported by major investment banks and other financial institutions. Merrill Lynch's net loss in Q3 exceeded \$2.3bio and losses from bond sector exceeded \$7.9bio. **Deutsche Bank** and **Lehman Brothers** lost more than \$1bio each. **Citi** also wrote off several bio USD of losses in Q3. **Goldman Sachs** spent more than \$2bio of own money to save its two hedge-funds which invested hard in mortgage bonds and appeared to be one of few whose quarter report didn't show dramatic damages. **Bear Sterns** wasn't able to repeat Goldman's success and two of Bear's funds went to bankrupt. It is rumored that JP Morgan will write off \$1.5-2bio and the **Bank of America** ~\$1bio of losses. A good lesson for the whole financial world – it will, for sure, initiate reshuffles in personnel.

Economic Statistics

Again we saw another round of catastrophically weak housing data, which acknowledged that speculation about a bigger cut will mount in the days ahead. Existing home sales and prices fall, and inventories continue to soar. Builders will have to cut prices or reduce construction, or will probably do both.

Economic fundamentals justify for lower rates: **(1)** the decline in the housing market has worsened, **(2)** employment growth continues to trend lower, **(3)** the core inflation has moderate

Last week we saw the fall of existing home sales by more than 8% to a 9-year low of 5.04mio annualised in September 2007 from 5.47mio in August 2007. This suggests that there is a higher downward pressure on home prices, which already fell by 4.2% over the year to September 2007.

The advance of new home sales from 735k to 770k could obscure the real picture because an increase is actually due to the downward revise of the previous showing from 795k to 735k.

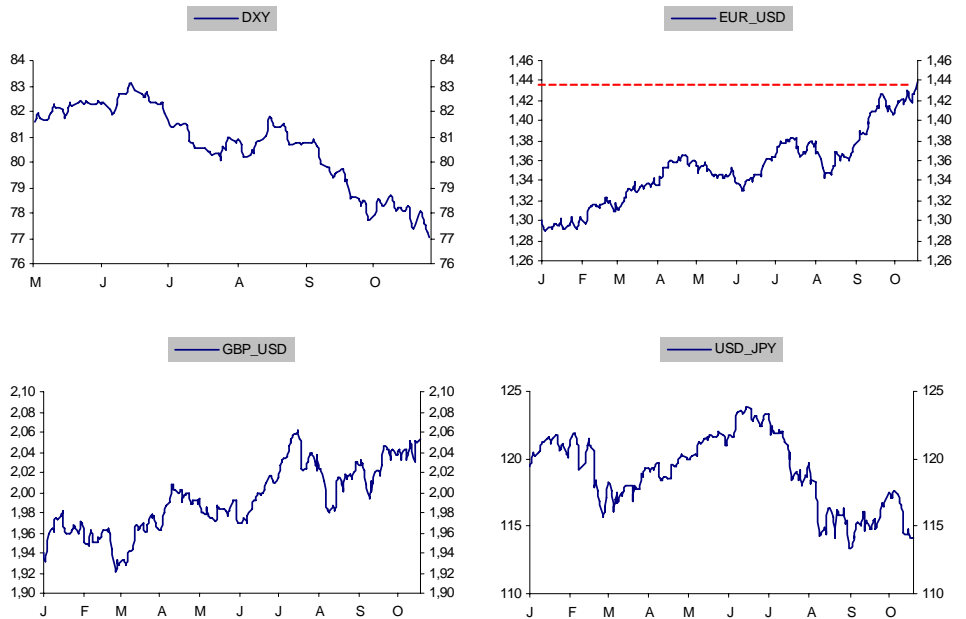
The 1.7% decline in US durable goods orders (GDO) in September may have come as a shock to the markets.

But pure DGO showed a good advance posting +0.7% vs. previous -5.9% excluding defence, and posting +0.3% vs. previous -1.8% excluding transportation.

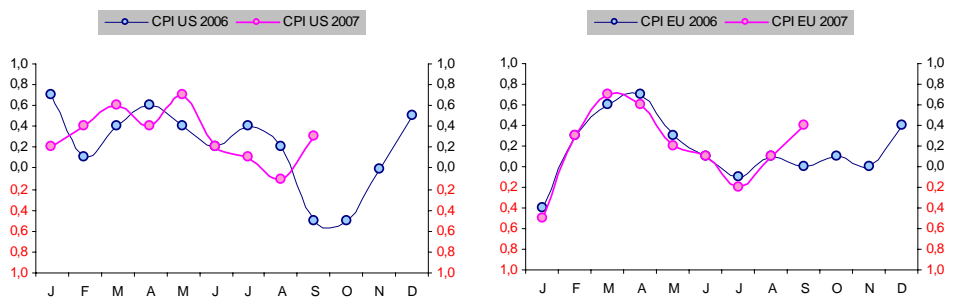
CARRY

There is no doubt that the carry trade is over for now. Investors are risk averse and the yen is being bought.

Currencies



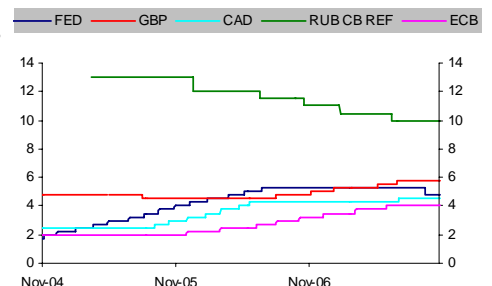
US vs. EU Inflation



Interest Rates

Last week the RBA said that inflation in this country is accelerating. We've seen a real pickup in inflation in the last six months and the Reserve Bank of Australia will have to respond with higher rates.

Russia	10.00%	Japan	0.50%
USA	4.75%	Canada	4.50%
UK	5.75%	Australia	6.50%
EU	4.00%	New Zealand	8.25%



Economies of Majors

USA			Europe		
	Current	Previous		Current	Previous
Existing home sales (September), mln	5.04	5.48	FR Consumer spending (September)	0,1%	0,7%
Durable goods orders excluding defence (September)	+0.7%	-5.9%	IT Consumer confidence (October) adjusted	107,3	107,3
Durable goods orders excluding transportation (September)	+0.3%	-1.8%	IT Retail sales (August)	0,2%	-0,2%
Durable goods orders (September)	-1.7%	-5.3%	IT Retail sales (August) Y/Y unadjusted	1,4%	0,1%
Jobless claims (week to 20.10)	331K	339K	EU13 Industrial orders (August) Y/Y	5,1%	-10.9%
New home sales (September)	770K	735K	EU13 Industrial orders (August)	0,3%	-4.0%
Sept Help Wanted index	24	23	EU13 Purchasing Manager Index Services	55.6	54.2
Michigan sentiment index (October) final	80.9	83.4	EU 13 Purchasing Manager Index	51.5	53.2
Existing home sales (September), mln	5.04	5.48	EU13 Current Account, bln	0.7	4.8
Durable goods orders excluding defence (September)	+0.7%	-5.9%	DE Import prices (September)	0.6%	-0.7%
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Durable goods orders (September)	-1.7%	-5.3%			
Jobless claims (week to 20.10)	331K	339K			
New home sales (September)	770K	735K			
Sept Help Wanted index	24	23			

Overseas M&A, Intentions, Trends

Turkey&Iraq

Last week Turkish army invaded into Iraq. The US decided not to intervene and let Turkey do their mission, thus the US lost the support of Iraq kurds which were the last ally of the US in Iraq, but strengthened its relations with its partner in NATO – Turkey. Seems that Turkey could get a long-lasting war because if they get deeper into the country, they will not be able to exit fast because with coming winter roads will be absolutely not appropriate for the transportation and Turkey army will have to keep staying there till spring, as a result Turkey army will constantly be attacked with Iraq rebels partisans and saboteurs.

The logistic market is on the way up

According to the Federal Logistics Union of Germany, logistic field volume amounted in 2006 to EUR180bio in Germany (is expected to reach EUR200bio in 2007 and EUR220bio in 2008), EUR106bio in Great Britain, EUR97.1bio in France, EUR72.6bio in Italy, EUR71.9bio in Spain. Among largest logistics companies are German Deutsche Post and its subsidiaries DHL Logistics and DHL Express, Danish Reederei Maersk, and also Deutsche Bahn c Schenker. For Europe, in 2006 logistics business volume amounted to EUR836bio and is expected to reach EUR900bio in 2007 and EUR950bio in 2008.

Microsoft is going to buy 20 companies annually at a price from \$50mio to \$1bio. Now the corporation has \$23bio of free funds. Thus the corporation will intensify acquisition of small companies rather than big companies in the coming future. Earlier, it was supposed that Microsoft could acquire Yahoo to compete in the sphere of Search on the US market. But Microsoft said that it will pay attention on small companies. Currently, according to comScore, Windows Live (Microsoft Searcher) takes only 10.3% of the US search market, Google 57%, Yahoo 23.7%.

It is expected that technologies and equipment that will help save energy will be profitable business in the future.

The largest Chinese investment company **Citic Securities Co.** and **Bear Stearns** will exchange assets of \$1bio worth. Citic will get 6% of Bear's shares (which could be further extended to 9.9%), intern, Bear will get ~7% of Citic. Parties will also form a joint venture in Hong Kong to provide their services there together. The deal will help Citic to strengthen in the US, and it will help Bear Stearns to strengthen in Asia. Remember, this year Bear lost ~\$1bio due to mortgage crisis in the US and had to close two of its funds. The Bank's shares depreciated by 37%. The market value of Citic is estimated to amount \$46.8bio. Citic Securities Co. is controlled by Citic Group which is under China's government control. China's companies invest overseas actively, especially into banking sector. Thus in May this year **China Investment Corp.** acquired ~10% stake of US hedge-fund **Blackstone Group LP**, and in July **China Development Bank** agreed about a purchase of 6.7% of **Barclays Plc.** Interesting is that the deal of Citic & Bear must be approved by the States of US & China. China will approve, for sure, but there could appear some difficulties with the US side since it is known that the US do not like the fact of penetration of China into it.

Russia&Balkans

Russia strengthened its positions on the Balkans. The country invested in Serbia more than \$2bio for the latest two years and is going to continue this trend. Russia is interested in strong neighbours as in economic as in political point of view. However, the US strategists dislike this for sure.

Last week, **Microsoft** took a \$240mio stake in Facebook, the online social network.

OIL PRICES

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Crude oil prices ended an extraordinary week by rising. Persistent worries about tight supplies ahead of the winter peak season helped to push prices higher.

Oil prices grew to new all-time maximum levels backed by intensifying Turkey/Iraq war, an inflow of speculative capital to oil markets, OPEC's forecasts for expected increasing oil demand for 2007 and 2008, and also the report from the US Department of Energy saying about a decline in oil storage, and, for sure, speculative hazard of traders technically looking to test a psychological level of \$100/bbl. Weaker USD also added to higher oil prices.

Oil futures set records on concern that supplies from Northern Iraq may be disrupted if Turkey intensifies military action against Kurdish rebel bases in the region.

Last week our **CEB composite OIL Index** grew from 83 to 87 which is again very sounding. Urals, WTI, Rebo grew by 4.58%, 3.56%, and 6.18%, respectively. Last week oil prices shot up and crossed a new level of \$92/bbl. AMEX oil index, Oil service index, and RTS O&G also grew considerably.

US EIA: US commercial crude oil inventories for October 19 (excluding those in the Strategic Petroleum Reserve) fell by 5.3mio barrels last week and reached 316.6mio barrels.

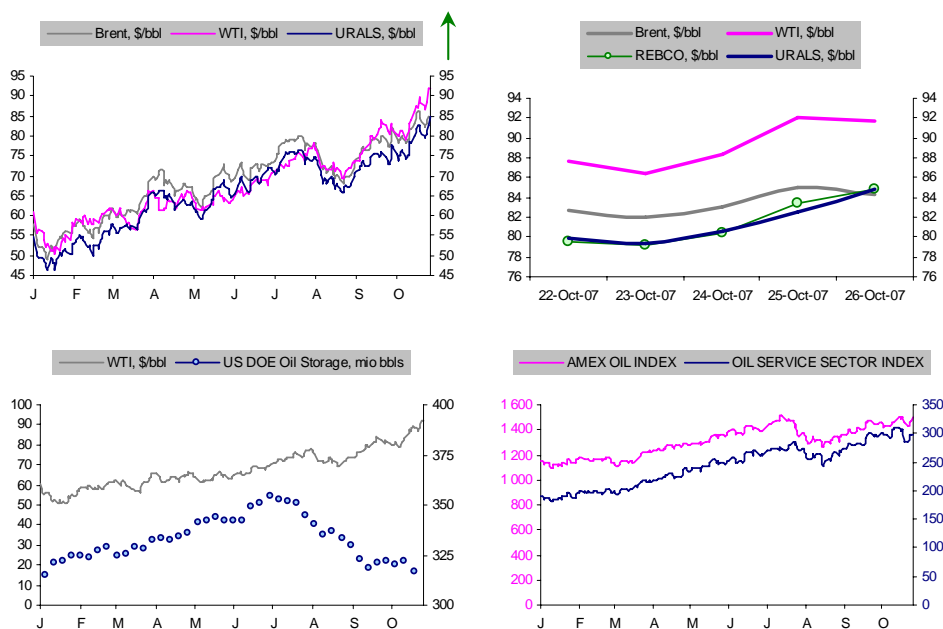
Moreover it is expected that this winter will be cold and there will be shortages in supplies in winter period. Furthermore, general perception that the US weathers out the financial crisis led to the inflow of speculative capital to crude oil trading which also pushed oil prices up.

We continue to assume that taking into consideration all happened recently, **\$100/bbl** is possible for crude oil but it will be the bubble for sure. Price of \$100/bbl is an extremely psychological and technical level. **Hazard of traders** could technically push crude oil prices to approach it.

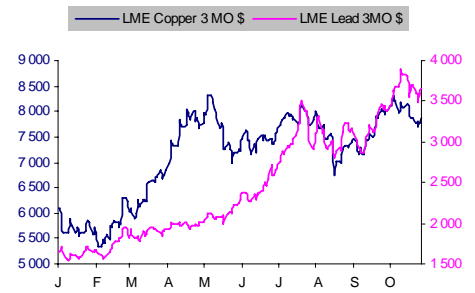
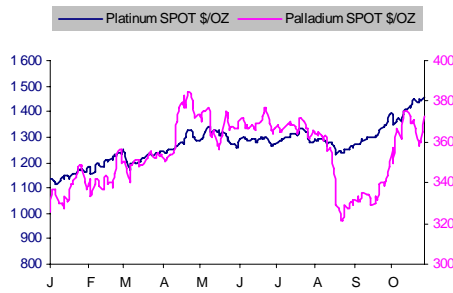
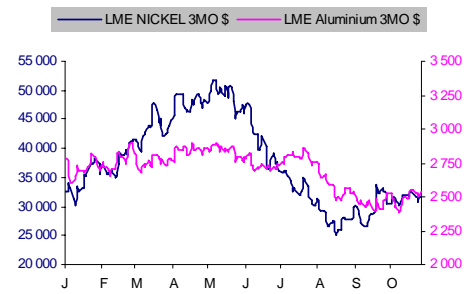
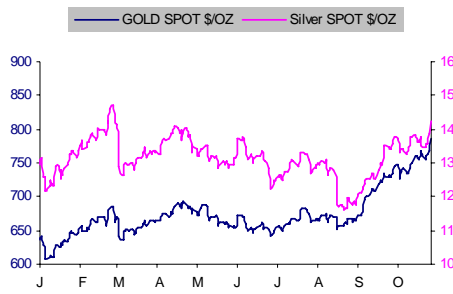
However...

OPEC increased the supply of oil to the market due to latest record rise in oil prices and pessimistic look on the development of the global economy. It is expected that the extraction volume of OPEC in total will increase by 500.000bbl/day to 31.4mio bbl/day in October. Russia declared that its extraction volume increased by 2.6% this year compared to the same period a year earlier.

However, latest **CFTC** report showed that hedge-funds and traders cut long positions in crude oil contracts. So, it's evident that some start to fix profits if not sell yet.



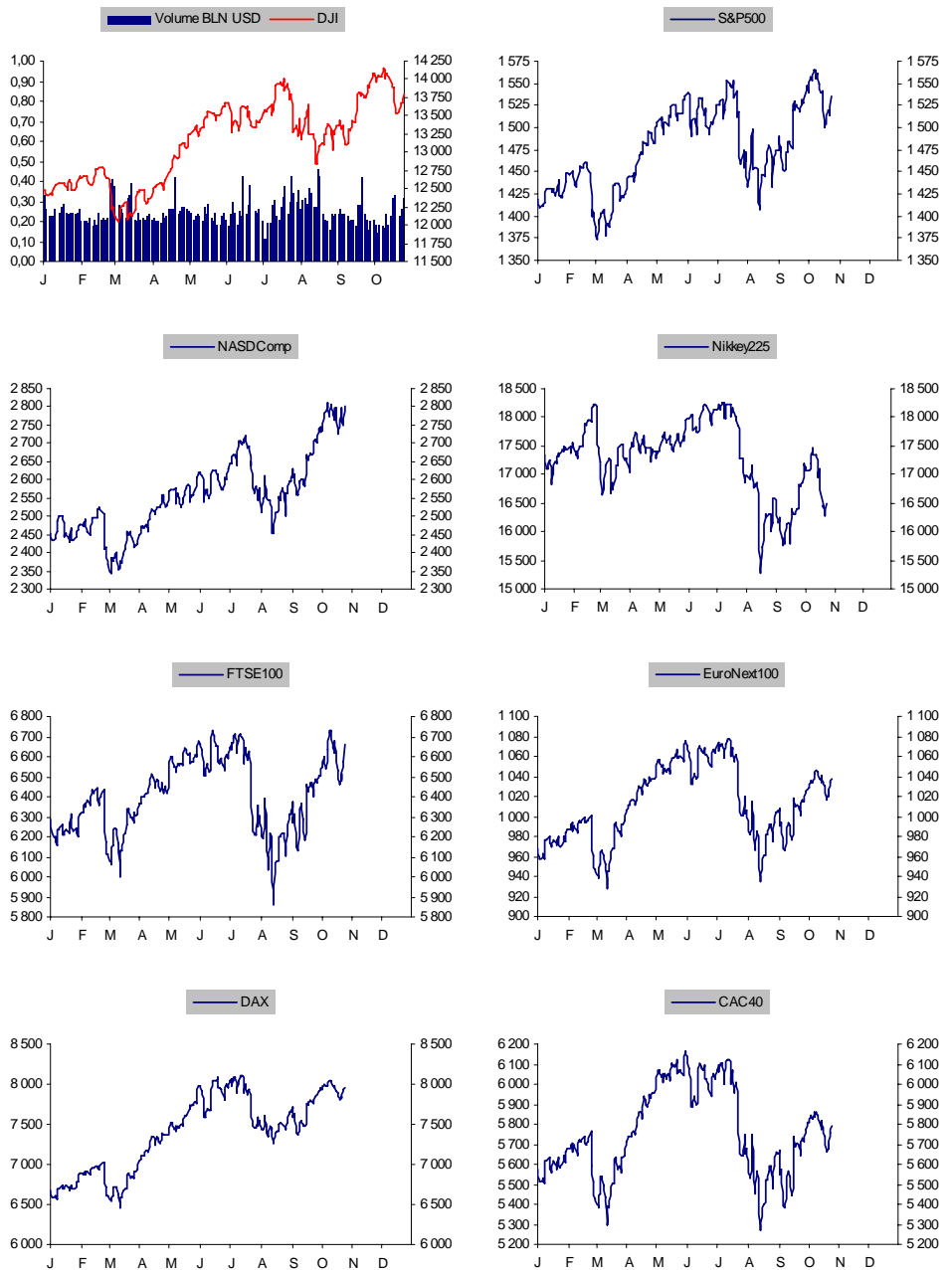
METALS



The threat that the oil price rally can trigger an inflationary spike on top of the weakness of the dollar pushed the gold price to a fresh high of \$785/OZ while platinum rose to a record high of \$1,458/OZ. Thus we see an increasing appeal of the precious metal as a hedge against inflation.



Major Equity Indices



Last week world market equity indices closed mixed but mostly positive. Top upside movers were: NASDComp (+2.90%) and S&P500 (+2.31%).

However, Nikkey225 fell by 1.84%.

Index	Close	%Ch
DOW	13807	2,11
S&P500	1535	2,31
NASDComp	2804	2,90
Nikkei225	16506	-1,84
FTSE100	6661	2,04
EuroNext100	1038	0,69
CAC40	5795	0,95
DAX	7949	0,83
SWISS	8963	0,29

IMM CoT Analysis

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ABOUT CFTC

Congress created the Commodity Futures Trading Commission (CFTC) in 1974 as an independent agency with the mandate to regulate commodity futures and option markets in the United States.

Today, the CFTC assures the economic utility of the futures markets by encouraging their competitiveness and efficiency, protecting market participants against fraud, manipulation, and abusive trading practices, and by ensuring the financial integrity of the clearing process. Through effective oversight, the CFTC enables the futures markets to serve the important function of providing a means for price discovery and offsetting price risk.

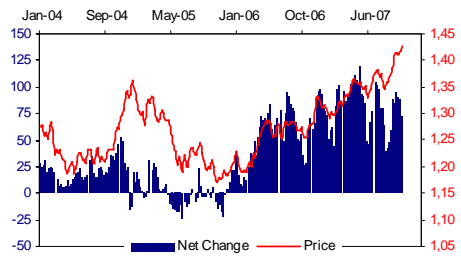
INTERPRETING THE DATA

The Commitments of Traders (COT) reports provide a breakdown of each Tuesday's open interest for market reports in which 20 or more traders hold positions equal to or above the reporting levels established by the CFTC.

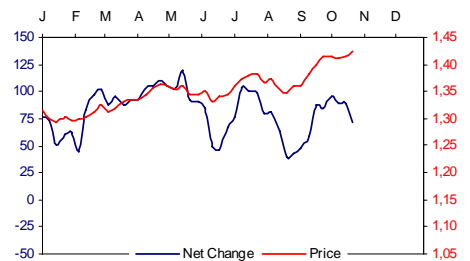
First of all we pay attention to whether the position figure is positive or negative. Positive figure means that long positions exceed short ones on the financial instrument.

Secondly, we are interested in the dynamics – thus, increasing net position figure shows that traders turn to long side and interest changes to "buy" on the financial instrument.

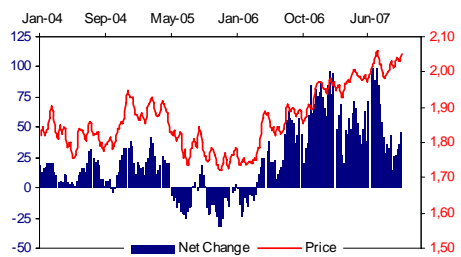
EURO Historical



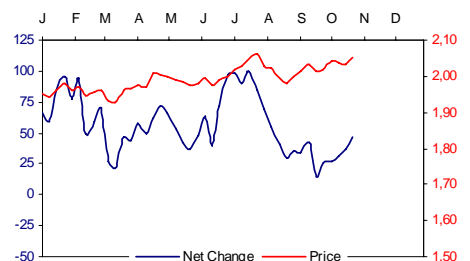
EURO This Year



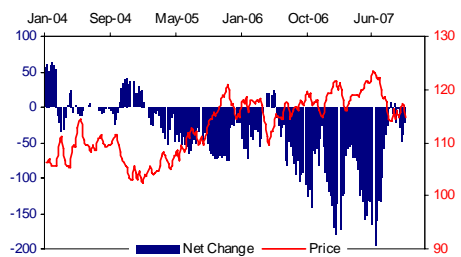
GBP Historical



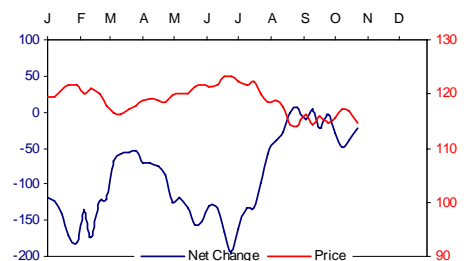
GBP This Year



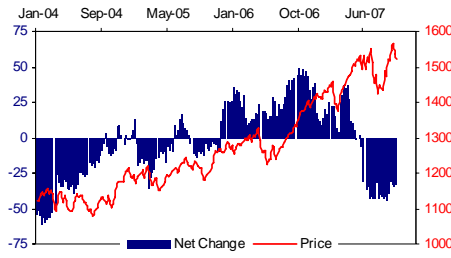
JPY Historical



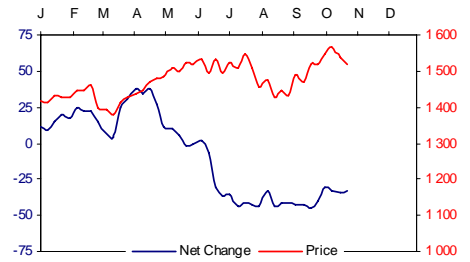
JPY This Year



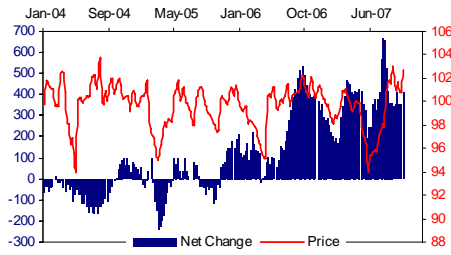
S&P500 Stock Index Historical



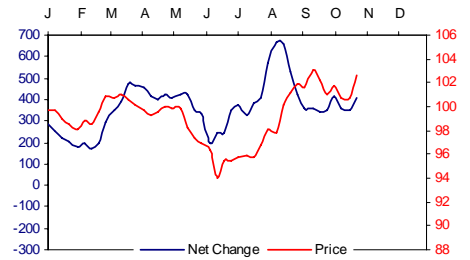
S&P500 This Year



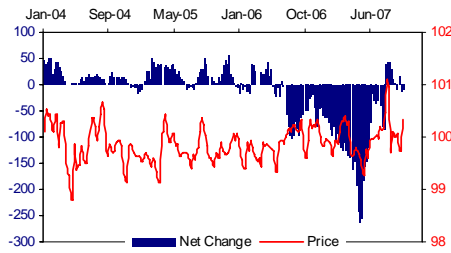
UST10 Historical



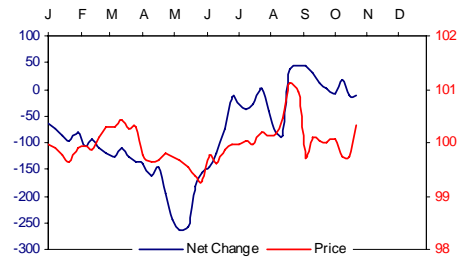
UST10 This Year



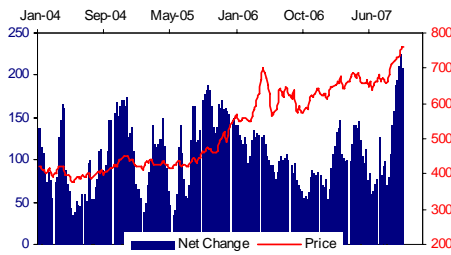
UST2 Historical



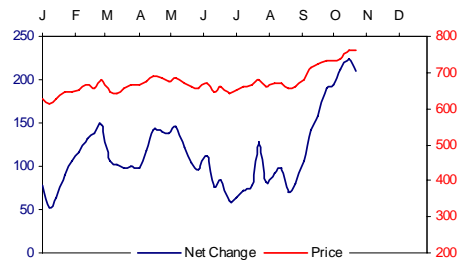
UST2 This Year



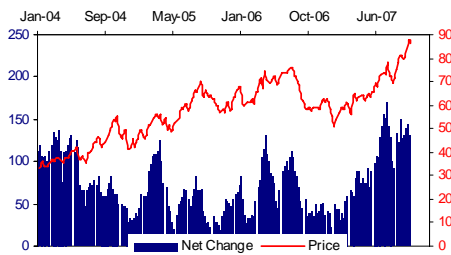
GOLD Historical



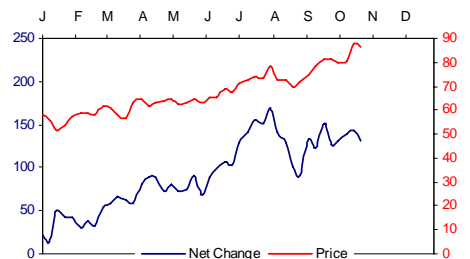
GOLD This Year



WTI Historical



WTI This Year



This Week's Agenda

	Event	Survey	Actual	Prior
30.10.2007 5:00	EU Bloomberg Eurozone Retail PMI	OCT	--	50,5
30.10.2007 9:00	US S&P/CS Composite-20 YoY	AUG	-4,20%	-3,90%
30.10.2007 9:00	US S&P/CaseShiller Home Price Ind	AUG	--	198,4
30.10.2007 10:00	US Consumer Confidence	OCT	99,4	99,8
30.10.2007 17:00	US ABC Consumer Confidence	28-Oct	--	-17
31.10.2007 5:00	EU Euro-Zone Consumer Confidence	OCT	-5	-5
31.10.2007 5:00	EU Euro-Zone Indust. Confidence	OCT	2	3
31.10.2007 6:00	EU Euro-Zone Unemployment Rate	SEP	6,90%	6,90%
31.10.2007 6:00	EU Business Climate Indicator	OCT	1,03	1,09
31.10.2007 6:00	EU Euro-Zone CPI Estimate (YoY)	OCT	2,30%	2,10%
31.10.2007 6:00	EU Euro-Zone Economic Confidence	OCT	106,5	107,1
31.10.2007 6:00	EU Euro-Zone Services Confidence	OCT	19	18
31.10.2007 7:00	US MBA Mortgage Applications	26-Oct	--	0,00%
31.10.2007 8:15	US ADP Employment Change	OCT	60K	58K
31.10.2007 8:30	US GDP Annualized	3Q A	3,10%	3,80%
31.10.2007 8:30	US Personal Consumption	3Q A	3,10%	1,40%
31.10.2007 8:30	US GDP Price Index	3Q A	2,00%	2,60%
31.10.2007 8:30	US Core PCE QoQ	3Q A	1,60%	1,40%
31.10.2007 8:30	US Employment Cost Index	3Q	0,90%	0,90%
31.10.2007 9:45	US Chicago Purchasing Manager	OCT	53	54,2
31.10.2007 10:00	US Construction Spending MoM	SEP	-0,50%	0,20%
31.10.2007 10:00	US NAPM-Milwaukee	OCT	--	70
31.10.2007 14:15	US FOMC Rate Decision Expected	31-Oct	4,50%	4,75%
01.11.2007 1:30	RU Russia October Manufacturing PMI			
01.11.2007 0:00	RU Gold & Forex Reserve USD	26-Oct	--	440.1B
01.11.2007 0:00	RU Russia Stabilization Fund	OCT	--	3519.1B
01.11.2007 7:30	US Challenger Job Cuts YoY	OCT	--	-28,50%
01.11.2007 8:30	US Personal Income	SEP	0,40%	0,30%
01.11.2007 8:30	US Personal Spending	SEP	0,40%	0,60%
01.11.2007 8:30	US PCE Deflator (YoY)	SEP	--	1,80%
01.11.2007 8:30	US PCE Core (MoM)	SEP	0,20%	0,10%
01.11.2007 8:30	US PCE Core (YoY)	SEP	1,80%	1,80%
01.11.2007 8:30	US Initial Jobless Claims	27-Oct	325K	331K
01.11.2007 8:30	US Continuing Claims	20-Oct	--	2530K
01.11.2007 10:00	US ISM Manufacturing	OCT	51,5	52
01.11.2007 10:00	US ISM Prices Paid	OCT	63	59
01.11.2007 0:00	US Total Vehicle Sales	OCT	16.0M	16.2M
01.11.2007 0:00	US Domestic Vehicle Sales	OCT	12.2M	12.5M
02.11.2007 0:00	RU Money Supply Narrow Def.RUB	29-Oct	--	3764.6B
02.11.2007 5:00	EU PMI Manufacturing	OCT	51,5	51,5
02.11.2007 8:30	US Change in Nonfarm Payrolls	OCT	85k	110k
02.11.2007 8:30	US Unemployment Rate	OCT	4,70%	4,70%
02.11.2007 8:30	US Change in Manufact. Payrolls	OCT	-10K	-18K
02.11.2007 8:30	US Average Hourly Earnings MoM	OCT	0,30%	0,40%
02.11.2007 8:30	US Average Hourly Earnings YoY	OCT	--	4,10%
02.11.2007 8:30	US Average Weekly Hours	OCT	33,8	33,8
02.11.2007 10:00	US Factory Orders	SEP	-0,40%	-3,30%

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