
Russian economy's security cushion

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As a result of market reforms in the last 15 years, Russia became integrated into the world economy. Apart from obvious advantages, this achievement sometimes brings problems.

It has become clear that the world financial crisis has not bypassed Russia, and that the domestic stock market wholly depends on market conditions.

In turn, Russian banks strongly depend on Western credits. However, owing to super high oil prices, the Central Bank and the Finance Ministry have formed a huge "security cushion" for this rainy day, the International Reserves of the Russian Federation.

The Russian stock market was unstable in the last month and a half or two because of upheavals on the world arena of bears and bulls. But this week brought disaster. On Monday, Lehman Brothers, one of the biggest U.S. banks, declared bankruptcy, and late on Tuesday the U.S. Federal Reserve System (FRS) bailed out crumbling insurance giant, the American International Group (AIG), with an 85 billion emergency loan. As a result, the U.S. government will receive 80% of AIG's stock.

Financial investors tend to be particularly prone to speculation and at the same time very nervous. Having sensed trouble at home, Western investors fled from the Russian stock exchange in late July-early August. The events on last Monday and Tuesday plunged them into total panic. After the crash of the American, European, and Asian markets on Tuesday, September 16, Russian stock indexes went into a dive unseen since the 1998 default. The dollar-denominated RTS, the main index of domestic blue chips, fell by an astounding 11.5%, and the RTS suspended trade ahead of time. By that time, RTS slumped to 1,131 points although last May it climbed to almost 2,500.

Paradoxically, the leading Russian companies, the blue chips, have not become less attractive. For the most part, they represent the high-price raw material sector. In theory, it would be great to buy their shares at low prices, and then sell them when the situation improves but it is impossible to predict when major foreign investors return to the domestic stock exchange.

Needless to say, I'm very sorry for major Russian companies, which have lost so much of their value, and those who lost money on their shares. However, such are the laws of the stock exchange, or, to be more precise, the market of fictitious capital. Now it would be appropriate to call it the market of virtual capital.

Some stock market experts recently suggested propping up Russian shares with government money. But if this were done, this money would disappear in smoke, and do nothing for the market, as was the case in 1998 when foreign credits were pumped into the government bonds (GKO) pyramid and withered away.

The Russian CB was right to spend money on supporting the ruble. Foreign investors were selling Russian bonds at stock exchanges for rubles, and then buying dollars for rubles at the currency exchange to transfer them abroad.

Under the circumstances, the dollar, which had lost a lot of weight in the last three years, could have closely approached the ruble. This would make

everyone even more nervous. But the CB prevented the fall of the ruble against the dollar by injecting dollars from its reserves into the market. According to recent information, the CB spent almost nine billion dollars for this purpose in one week, from August 29 to September 5. The IRRF went down from \$582.5 billion to \$573.6 billion during this time. This trend may persist in the next couple of weeks, but this is not a disaster. In the last few years, the CB formed this security cushion to cope with such upheavals.

As a result, the ruble has now stabilized at 25.5 per dollar, which is important for stable foreign trade, that is, failsafe exports and imports. All Russian citizens should now feel better.

It is also very important to support the Russian banking system in this predicament. It is like the vascular system, and determines the healthy functioning of any normal economy. It is no secret that Russian banks took numerous loans abroad for themselves and Russian companies in the past few years to attract investment into the rapidly growing economy. In different estimates, in September alone, Russian banks and companies must pay about \$10 billion to their foreign creditors, and in the fourth quarter, \$45 billion or refinance loans at a higher interest. But the latter option is difficult because of the credit crisis in the West.

Nevertheless, the CB and the Finance Ministry are doing all they can to inject liquidity into the banking system, and resolve this problem. Officials maintain that for the time being it is not even necessary to take money from the IRRF.

The FM can issue loans from its Treasury, while the CB can take money from the mandatory reserves which the banks transfer to it themselves.

Now, the CB and the FM daily loan hundreds of billions of rubles to domestic banks. Moreover, the CB announced that it can bring its daily short-term loans to one trillion rubles.

For the time being, the Russian financial authorities are giving banks short-term credits: the CB, for one day, and the FM, for a period from one to five weeks. But towards the end of the year Russian banks will increasingly need long-term loans to refinance long foreign credits. However, this problem is not insoluble.

As the FM reported on September 17, the backbone banks, the Sberbank, the VTB and Gazprombank will be offered up to 1,126.6 trillion rubles from the federal budget for a term of three months or longer. The CB can give them another two trillion rubles for up to six months.

Russian Prime Minister Vladimir Putin said with good reason that the Russian economy is strong enough to overcome the global crisis.

Moreover, prices of oil, Russia's main asset, are again going up. On September 17, WTI went up by three dollars per barrel, reaching \$94.

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