

Russia – Reconnecting to the future

February 2008



Foreword

In 2008 Russia's two-stage election cycle is over. As the smoke lifts, it will be observed that the continuity of power has been secured in full compliance with the Russian constitution. The next likely president to be elected, Mr. Dmitry Medvedev, represents a new generation of politicians, with assumed deeper insights in the global economy, but also in the many problems of his country.

2007 was yet another year with strong growth. The double-digit wage growth paves now the way for consumption as the main driver in the economy, exercised by a middle class demanding new products and services. The improving investment climate contributes to the investment boom expanding opportunities for Nordic companies.

The current global financial turbulence has made also Russian banks suffer from strained liquidity – although this is a familiar phenomenon from previous years. On the positive side is the lack of a subprime market and only few secured debt obligations. The deregulated financial market offers new rouble-related derivatives instruments making funding and hedging easy.

In all, the banking sector has performed relatively well and international banking groups have continued to enter the scene. Nordea finalised the acquisition of JSB Orgresbank in early 2007, and is now positioned to service its Nordic customers better than ever.

We hope this report will be of value for you doing business in Russia. Nordea Bank is ready to assist you - don't hesitate to contact us. We wish you the best success in your business in Russia!

Mads G. Jakobsen, Managing Director,
Co-head of Markets, Capital Markets Products

Gone to press:

12 February 2008

Editor: Mika Erkkilä, Senior Analyst

mika.erkkila@nordea.com

Table of contents

Foreword	3
Country facts	4
Political update	5
Economy	6
Investment climate	9
Rouble outlook	11
Banking sector	13
Stock and bond markets	15
Nordea services	20
Nordea services in Russia	22
Contacts	25

Economic Research Nordea

Denmark:

Helge J. Pedersen, Head of Economic Research, Chief Economist
helge.pedersen@nordea.com, Tel +45 3333 3126

Johnny Bo Jakobsen, Chief Analyst (Areas of responsibility: US, UK)
johnny.jakobsen@nordea.com, Tel +45 3333 6178

Anders Matzen, Senior Analyst (Area of responsibility: Euro area)
anders.matzen@nordea.com, Tel +45 3333 3318

Anders Svendsen, Analyst (Area of responsibility: Emerging Markets)
anders.svendsen@nordea.com, Tel +45 3333 3951

Bjarke Roed-Frederiksen, Analyst (Area of responsibility: Emerging Markets),
bjarke.roed-frederiksen@nordea.com, Tel +45 3333 5607

Anette Skovgaard, Analyst (Area of responsibility: Euro area)
anette.skovgaard@nordea.com, Tel +45 3333 3171

Troels Theill Eriksen, Senior Analyst (Area of responsibility: Housing economist),
troels.theill.eriksen@nordea.com, Tel +45 3333 2448

Finland:

Leena Mörttinen, Chief Economist Finland
leena.morttinen@nordea.com, Tel +358 9 1655 9940

Reijo Heiskanen, Senior Analyst (Area of responsibility: Euro area)
reijo.heiskanen@nordea.com, Tel +358 9 1655 9942

Mika Erkkilä, Senior Analyst (Area of responsibility: Emerging Markets)
mika.erkkila@nordea.com, Tel +358 9 1655 9941

Norway:

Steinar Juel, Chief Economist Norway
steinar.juel@nordea.com, Tel +47 2248 6130

Erik Bruce, Senior Analyst (Area of responsibility: NO)
erik.bruce@nordea.com, Tel +47 2248 4449

Thina Margrethe Saltvedt, Analyst (Areas of responsibility: Oil, NO)
thina.margrethe.saltvedt@nordea.com, Tel +47 2248 7993

Sweden:

Jörgen Appelgren, Chief Economist Sweden
jorgen.appelgren@nordea.com, Tel +46 8614 9521

Torbjörn Isaksson, Senior Analyst (Area of responsibility: SE)
torbjorn.isaksson@nordea.com, Tel +46 8614 8859

Annika Winsth, Senior Analyst (Area of responsibility: SE)
annika.winsth@nordea.com, Tel +46 8614 8608

Bengt Roström, Senior Analyst (Areas of responsibility: SE)
bengt.rostrom@nordea.com, Tel +46 8614 8378

Political structure

Population and geography: 143 mn., av. life expectancy 66 yrs. (males 59 yrs., females 73 yrs.). Population growth rate -0.48%. Birth rate 10.92 births/1000 population, death rate 16.04 deaths/1000 population (est. 2006). Ethnic groups Russian 79.8%, Tatars 3.8%, Ukrainian 2%. Largest cities Moscow (8.7 mn.), St. Petersburg (4.8 mn.), Novosibirsk (1.4 mn.).

Territory: Divided into 84 constituent entities or federal administrative units, called "the subjects of the Federation": 47 oblasts (=regions), 21 republics, 5 autonomous okrugs (=districts/areas), 8 krais (=territories), 2 federal cities and 1 autonomous oblast. A decree was signed in 2000 putting the 89 federation subjects into seven administrative districts.

Constitution: Federal state. The constitution was adopted in December 1993. The president issues binding decrees and executive orders. They cannot contravene the constitution or federal laws. Decrees can be issued on matters, which should be regulated by laws, until the adoption of laws. In addition, every 89 federal administrative unit of the Russian Federation has its own constitution/charter and laws.

Head of state: President Vladimir Vladimirovich Putin, elected on 14 March 2004 for a four-year term. The president can be re-elected once, i.e. serve for two terms at the most. There is no vice-president. In case of permanent incapacity, the Prime Minister serves as acting president until a new one has been elected. Elections must be held within 3 months. There is also a presidential administration, which provides policy support to the President, drafts presidential decrees and co-ordinates policy among government agencies. A Security Council reports also directly to the President.

Government: The cabinet consists of the Prime Minister and his deputies, ministers and other agency heads. All are appointed by the President, the Prime Minister with the approval of the Duma. The federal centre has tightened its grips on the regions by e.g. establishing 7 Federal Super Regions, each administered by a Presidential plenipotentiary. The Regional Governor's power has also been curtailed, e.g. their right to automatically enter the Federation Council was abolished and candidates for the post of Regional Governor are nowadays nominated by the President.

Legislature: The bicameral Federal Assembly consists of the Federation Council and the State Duma. The upper house or the Federation Council has 168 seats and members serve four-year terms (2 members each appointed by the country's 89 federal administrative units). The lower house, the Duma, has 450 members (all 450 elected nowadays by proportional representation from party lists winning at least 7% of the vote). The Duma's members are elected for four-year terms. In addition, President Putin has created the Russian State Council, made up of the governors and leaders of 89 federal units. The Council works separately from the Federation Council and acts as an advisory body to the President. The Duma adopts draft laws by a simple majority or 226 votes, whereafter they shall be passed on to the upper house for approval (also simple majority) and signed by the President. If the Federation Council rejects the law, the draft law can still be passed provided the Duma votes for it by a 2/3 majority.

The 2007 Corruption Perceptions Index: Transparency International's annual Corruption Perception Index is the best known tool to measure corruption. The CPI ranks 180 countries by their perceived levels of corruption, as determined by expert assessments and opinion surveys. Russia ranks 146 out of 180 countries, between Togo and Angola.

Government:

Zubkov Viktor	Prime Minister
Medvedev Dimitriy	First Deputy PM
Ivanov Sergey	First Deputy PM
Zhukov Aleksandr	Deputy PM
Naryskin Sergey	Deputy PM
Kudrin Aleksey	Deputy PM, Min. of Finance
Lavrov Sergey	Min. of Foreign Affairs
Nabiullina Elvira	Min. of Economic Development & Trade
Nurgaliyev Rashid	Min. of Internal Affairs
Serdyukov Anatoly	Min. of Defense
Sobolev Valentin	Secretary of Security Council

Duma seats by party following the 2007 elections:

United Russia	315
Communists	57
Liberal Democrats	40
Just Russia	38

Economic structure

GDP (purchasing power, est. 2007): USD 2076 bn
GDP (current exchange rates, est. 2007): USD 1251 bn
GDP/capita (purchasing power): USD 14 600
GDP/capita (current exchange rates): USD 8 800

Exports/GDP: 31%, **net exports/GDP:** 9%

USD/RUB (av. 2007): 25.57

EUR/RUB (av. 2007): 35.01

FX reserves (January 2008): USD 470 bn

Gross external debt (September 2007): USD 431 bn

Exports (% of total):

Oil, fuel, gas 63%
 Metals 14%
 Chemicals 6%
 Machinery & equip. 5.5%

Imports (% of total):

Machinery & equipment 44%
 Food 17.5%
 Chemicals 16.5%
 Metals 7%

Share of GDP:

- agriculture 5%
 - industry 39%
 - services 56%

Yearly averages (2001-07):

GDP growth 6.9%
 FDI inflows USD 1.8 bn
 Inflation 13.3%
 Current account USD 57.8 bn and 9% of GDP

Thinking stability, hoping for change

The end of the Russian political year 2007 left many Western analysts with a self-evident sense of relief. When Vladimir Putin kept his promise to step down from the presidential post, even if most probably retaining the prime-ministerial position, it finally became clear that the continuity of power would be secured in full compliance with the Russian Constitution. Furthermore, Dmitry Medvedev, Putin's likely successor in the office, is viewed as the most liberal of all potential candidates.

To be true, Medvedev's liberalism is very relative. During his term as the head of the Presidential Staff in Moscow, Kremlin decided to replace the earlier elected governors with subordinate appointees, to repeal the parliamentary elections in the single-mandate districts, where the opposition had fair chances of success, and to tighten the legislation on political parties.

The good news comes from elsewhere. First, Medvedev represents the next generation, which has very little Soviet experience and, therefore, has less reasons to believe in the omnipotence of administrative methods. Second, his connection with *Gazprom*, an internationally-exposed Russian gas monopoly, where Medvedev represented the state, should have given him a deeper understanding of today's global economic trends as compared with, for example, people linked with "flagships" of the defense industry. But most importantly, being in charge of the so-called national projects and having traveled to many regions of Russia, Medvedev should have received the invaluable first-hand knowledge of the country's many problems.

In recent years, it has become a habit to talk about Putin's stability. It would be, perhaps, more accurate to call it stabilization, non-disputable *only* when compared with the previous decade and not necessarily becoming a self-sustained trend. The thing is that re-centralization of power in Russia had also a number of negative implications which heavily affected the system of governance.

The external - "democratic" - accountability of the regime has been essentially dismantled. Manipulation of the law, control of the broadcast media and use of administrative pressure created a situation in which changing an ineffective official through the expression of a popular discontent is very difficult. No wonder, sociological surveys reveal the overwhelming feeling of powerlessness among the average people. This, in turn, leads to apathy, lack of participation, the unwillingness of the public to scrutinize the actions of the authorities. The probability of a serious mistake thus increases manifold.

The internal accountability of the system is not able to compensate for this weakness. The national parliament was on the very top level declared "not a place for discussions". Political or administrative failures never end up with resonance resignations. The responsible figures are usually simply given another appointment - as otherwise the whole cadre policy of the "power vertical" may find itself in people's doubt. Discipline is low, as many times admitted by Russia's leaders themselves. On top, there comes ruinous corruption.

Meanwhile, the challenges that Russia is facing are only growing stronger. Its population is aging and struggles with a number of ills that undermine the national health. Its infrastructure and even energy generation are lagging behind the demands of the growing economy. Whereas Russia remains a raw material exporter, the growing Asia actively penetrates its own domestic markets with manufactured goods, let alone that it weakens Russia's economic positions worldwide.

Reforms are badly needed. But they were postponed - presumably, due to the decision not to rock the boat on the eve of presidential elections. Worse, if this happened because of the perceived lack of capacity.

To aim simply at "continuity" would hardly be an optimal scenario for Russia given the circumstances. Apparently, as his campaign pronouncements suggest, Vladimir Putin's designated successor realises that. The effectiveness of the governance could be much improved, if public checks and balances were re-introduced, the decision-making were made more transparent and the country could move away from manual control of the political space toward the development of democratic institutions. Russia would be much more secure in the face of globalization challenges, if it could place its political relations with the West in harmony with intensifying economic interaction and start again viewing Europe in particular as a source of the own further modernization, just as it was when Mr Putin himself came to power.

To conclude, somewhat paradoxically, Russian stability requires change, not continuity. Only then the economic opportunities, which Russia possesses and offers at the moment, would be placed on a solid and sustainable underpinning.

Arkady Moshes, Director, Programme on Russia in the Regional and Global Context, Finnish Institute of International Affairs

arkady.moshes@upi-fiia.fi

+358 206 111 750

Strong as ever

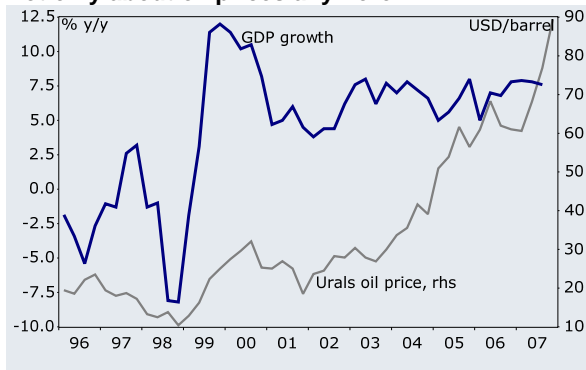
The economy is driven by strong consumption growth, underpinned by double-digit wage growth. In our view there are no serious risks which could derail growth in the short run. The economy's substantial buffers and improved balance sheets give a lot of leeway. However in the longer run risks increase.

Economic performance continues to impress

2007 was the 8th consecutive year with strong growth, which has averaged close to 7% annually since the recovery from the rouble crash and crisis 1998. Growth even accelerated again and 2007 was the strongest growth year since 2000.

On the demand side, domestic consumption has been the main driver of GDP growth. This trend has even become more pronounced in recent years as rising export windfalls have fed into domestic demand. Consumption has accounted for 85-90% of overall growth in recent years, along with double-digit real wage growth. Consumer credit has experienced explosive growth, which is expected to continue, given its relatively underdeveloped status.

Not only about oil prices anymore



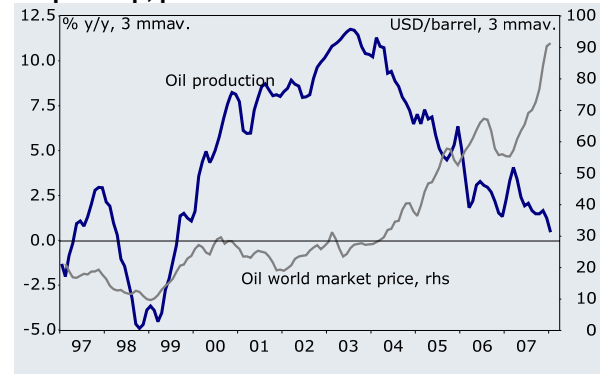
As a consequence, capacity constraints have emerged and led to high wage growth and demand growth going increasingly towards imports.

On the supply side, growth has increasingly been driven by the non-tradeables sector. Construction, trade, catering and real estate have all grown by 10% or more over the past year. Conversely, the contribution of tradeables to GDP growth has declined steadily

over the past years. Exports are feeling the pressure from an appreciating real exchange rate (the combination of a stronger RUB and higher inflation than in Russia's trade partners).

More than deteriorating competitiveness, the oil sector suffers from capacity constraints. The slow down in oil production has been dramatic compared to an annual average output expansion of over 8% in 2000-05. Actually growth came to a halt by the turn of the year 2007-08.

Oil price up, production down



These tendencies are probably explained by a combination of factors. As taxation of the oil sector is tied to the oil price, even dramatically higher prices do not encourage companies to invest. The benefit from high prices goes mainly to the state. At current oil prices the state takes some 90% of the marginal revenue from every one USD increase in the oil price (taxes, pipeline transport fees etc.), whereas just 10% accrues to the company. Secondly, the slowdown in oil production coincides with the increased presence of the state in the hydro carbons production.

Inflation becomes a political issue

Inflation has accelerated again. This is predominantly

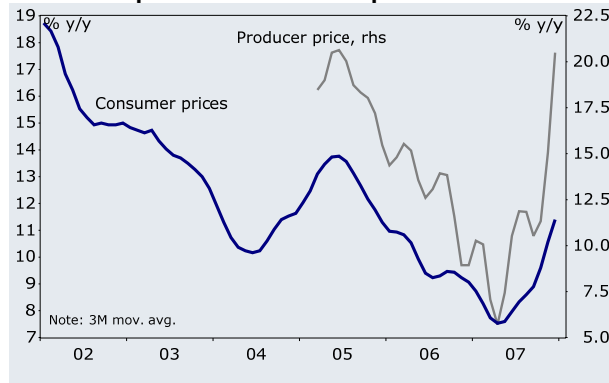
Russia: Macroeconomic indicators (% annual real changes unless otherwise noted)

	2004 (RUBbn)	2005	2006	2007E	2008E	2009E
Private consumption	8,406	12.8	11.2	11.8	10.0	7.0
Government consumption	2,847	2.2	4.2	4.5	5.0	4.0
Fixed investment	3,131	8.3	13.9	18.9	21.0	16.0
Stockbuilding*	428	0.4	0.4	0.6	0.4	0.2
Exports	5,860	6.2	7.2	4.7	4.0	3.0
Imports	3,774	16.9	21.7	25.6	16.0	12.0
GDP		6.4	6.7	7.5	7.0	6.2
Nominal GDP (RUBbn)	17,048	21,620	26,781	31,204	37,133	42,666
Unemployment rate, %		7.6	7.2	6.2	5.5	5.2
Consumer prices, % y/y		12.7	9.7	9.0	12.0	8.7
Current account, % of GDP		11.1	9.6	5.8	5.0	2.3
Central govt budget balance, % of GDP		7.4	7.5	4.5	2.5	1.0

* Contribution to GDP growth (% points)

due to higher food prices. It has become a political issue since Russia is in the midst of an election cycle. In response, the government resorted to price regulation last autumn. Some food retail chains have signed “voluntary” agreements to restrict price increases on some food staples. However as their share in the consumer basket is relatively minor and the agreement does not cover a large share of the food retailers, the desired effects have largely failed to materialise.

Inflation expected to continue up



Secondly, the extensive liquidity provision to the banking sector, in response to the global financial market turmoil and capital outflows, adds to inflationary pressure. The central bank prioritises stability of the bank sector over curbing inflation. If and when the situation normalises, we, however, expect the central bank to aim at price stability again. We expect inflation to continue upwards at least in H108 and to remain in double-digits throughout the year on the back of high food prices, reaccelerated money supply and increased fiscal spending.

Bright medium-term outlook

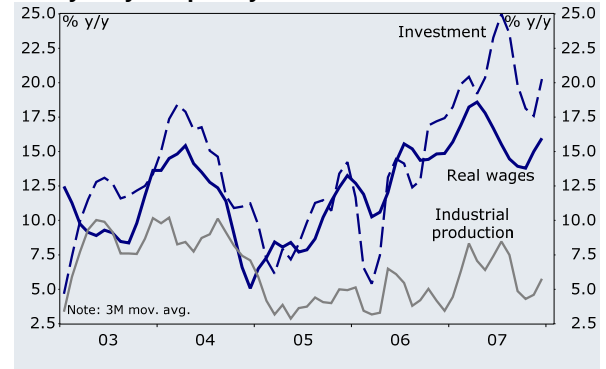
Despite these developments and certain risks, we remain optimistic on the growth outlook. The economy’s growth drivers have partly changed.

In the short-term, the global financial market turmoil will not go unnoticed in Russia. Real economic indicators such as industrial production, investment and retail trade weakened slightly during the autumn. This coincided with a period of capital outflows. However the central bank has repeatedly demonstrated its willingness to help. It reacted quickly to diminished liquidity and higher interest rates by increasing the money supply in order to support the stability of the financial system.

As we regard the economy to be fundamentally in good shape, we think the present weakness is more of a temporary nature than the beginning of a long period of slower growth. Russia has largely paid off its sovereign debt and improved its balance sheets. Although falling, both the budget and current account surpluses are still sizeable. There are a lot of buffers in terms of the oil

reserve fund, which could be used in case of a shock to economic growth and increase social spending for an extended period in the case of a downturn in commodities prices. At 470 bn USD in the beginning of 2008, the central bank’s FX reserves are also record-high and could be deployed in order to e.g. prevent a sudden currency devaluation.

Likely only temporary weakness



As regards demand conditions, we see consumption continuing as the main growth driver. Wage growth is expected to continue in double-digits and although expected higher inflation will eat into purchasing power, wage growth is unlikely to collapse. Pensions and public sector wages as part of a multi-year general public spending increase are also likely to continue rising.

Furthermore, after many years of weakness, investment growth has taken off. It has accelerated considerably in the wake of the strong consumption and clearly exceeds GDP growth. Investment growth took off around the same time when GDP returned to the same level as before the multi-year deep slump in the first half of the 1990s. We consider the level (investments/GDP are only around 20%) still too low for investments currently to emerge in earnest as another growth driver. The ratio is usually around 30% or even more in fast-growing, emerging economies.

The start of a multi-year investment boom?



However providing continued political and financial stability, the investment boom could to larger degree support consumption as a growth driver. Although we

take a less rosy view on the chances for capacity expansion in the traditional raw materials production, the growing purchasing power of the middle class generates demand for new products and services.

Risks increase longer out

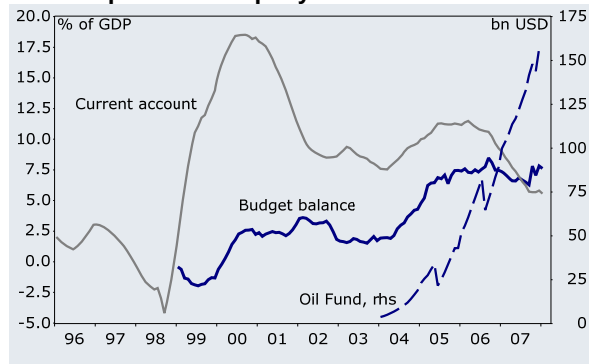
In our view there are no serious risks which could derail growth in the short run. However in the longer run we think that the risks to the outlook are two-fold. Firstly, the multi-year fiscal expansion could put macro stability at risk. Secondly, the challenge to sustain growth once the transitory and one-off factors, which have driven the recovery after the rouble collapse, wear off.

Authorities are planning an increase in public spending, which could lead to a deterioration in the fiscal balance by over 2% of GDP in the next few years. This comes on top of an already realised expansion starting in 2005. If implemented, this would happen in a situation with already strong growth, particularly consumption and the economy running at or close to full capacity utilisation.

The planned increase would allow most of the oil price and hence export revenues to be passed through to the economy, rather than saved. The challenge for fiscal policy is to try to withdraw the excess liquidity due to high export prices. Traditionally this has happened through a very low oil price on which the budget and spending is based. If the planned increase in the budgeted price will be implemented, spending will increase.

The outcome is additional inflationary pressure on top of the already existing one. In addition to higher inflation, this will put more pressure on the real exchange rate to appreciate and further deteriorate competitiveness. In this way economic growth will eventually slow down. The optimal policy response to sustained high export prices is a fiscal policy geared to saving these windfall revenues rather than consuming them.

Twin surpluses fall rapidly

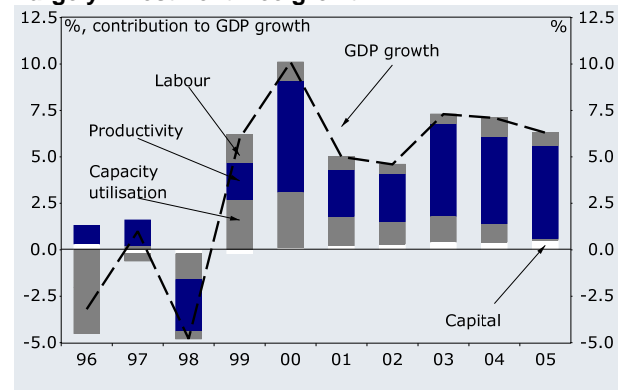


The second challenge is to make the economy embark on a capital-intensive and self-sustaining growth path. Part of the recent years' strong growth is due to catch-

up and productivity gains, as resources are re-allocated to more dynamic sectors. However at the same time we cannot neglect the importance of structural reform, particularly during President Putin's first 4-year term.

The strong recovery after the 1998 collapse owes to a depreciated rouble, which boosted competitiveness and exports. Depressed imports caused a dramatic improvement in the current account, the surplus was 18% of GDP at its highest. Secondly, the surge in oil prices led to a strong improvement in macroeconomic indicators. In the recovery phase, growth was to a large extent based on increasing capacity utilisation and productivity. Growth was largely investment-free, as capital and labour have accounted for less than half of GDP growth.

Largely investment-free growth



These temporary effects have largely or are about to peter out. The signs of an investment boom in the making are encouraging though. In our view, a healthy investment climate holds the key in securing the continuation of this. In this respect, the trend towards increased state ownership and interference is disturbing. It goes beyond natural resources. The Kremlin has supported the creation of national champions in a number of sectors, including civil aviation and ship building.

Thus far, the costs of state intervention have been concealed by the strong recovery of the economy's private sectors and a high oil price. However over time state ownership could divert resources from more productive areas of the economy. Additionally, the higher the oil price, the greater the probability of them stabilising or even falling. At the end of the day, there are no free lunches.

Mika Erkkilä

mika.erkkila@nordea.com

+ 358 9 1655 9941

Image and reality don't always match

Different studies conducted among foreign investors give shifting indications on which factors are a constraint or hindrance in doing business with or within Russia.

The results of a poll in 2007 among foreign investors, conducted on request from the Consulting Council on Foreign Investments at the government of the Russian Federation, pointed out the following reasons impeding the work of foreign investors in Russia (percentage of all respondents):

- corruption – 65%
- administrative barriers – 58%
- negative information on Russia - 57%

According to the poll, those investors who are already working in Russia have a much more positive approach:

- 56% are satisfied with the results of their work in Russia
- 52% assume that the income from investments on the Russian market on average is higher than in other countries

On the question “What attracts investments” the following answers were pointed out:

- growth of consumer activity – 75%
- steady economic growth – 67%
- qualified workforce – 53%

Thus the real problem seems to be the image of Russia in the eyes of western investors. The responsible Russian authorities have not confirmed any success stories in the fight against corruption.

What pulls down the assessment of Russia?

Factors limiting the positive assessment of Russia and thus the country rating are, e.g. according to rating agency Fitch, certain structural and political shortcomings. They increase its vulnerability in case of a sudden change of the situation, such as:

- dependence on the raw material / commodities prices
- relative weakness of the banking sector
- low quality of corporate management
- unfavourable business climate

Fitch makes a comparison of Russian indicators with average indicators of countries with the same investment sovereign credit rating (BBB) or close to it (A):

Indicator	Russia	Average rated BBB	Average rated A
Dependence on commodities 1)	79%	28%	23%
Banking sector risk 2)	D	D	C
Business climate 3)	96	58	32
Level of corruption 4)	143	66	42
Index of political rights 5)	6	2	1
Index of civil rights 5)	5	2.5	1

1) World Bank 2004

2) Fitch (A=minimum risk, E=maximum risk)

3) World Bank 2006 (1=highest, 179=lowest rating)

4) Transparency International “Corruption Perceptions Index” 2007 (1=min. level, 163=max. level)

5) Freedom House “Freedom in the World” 2007 (1=free, 7=not free)

Factors improving the picture

The current situation is not as gloomy as it might look: several facts speak for themselves and improve the picture: high commodity prices, quickly soaring foreign direct investments, relative stability in politics due to the smooth transitions of power both in the Duma and presidential elections.

Conditions for starting business (time required for opening of business, in days):

	2003	2004	2005	2006
Brazil	152	152	152	152
India	89	89	71	35
Mexico	58	58	58	27
China	48	48	48	35
Russia	42	36	33	28

Source: World Bank

Investment attractiveness surveys

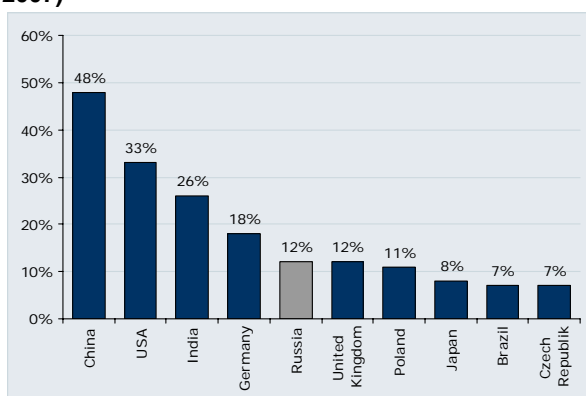
In a survey by Ernst & Young in 2007 among 809 managers of international companies regarding investment attractiveness Russia showed up for the first time. Russia scored a rating similar to e.g. the UK and Poland.

In a similar survey by A.T. Kearney in 2006 corporate managers ranked Russia sixth in terms of investment attractiveness, whereas in 2005 the ranking put Russia in 12th place.

The improvement is explained by high growth rates in the economy, vast foreign exchange reserves, and decrease of national debt. Foreign investors estimate the business profitability in Russia around 30% and higher.

The Minister of Finance, Mr Alexey Kudrin revealed in a recent speech preliminary figures for the Russian economy. Only the inflow of private capital into the Russian economy was an impressive 82.0 bn USD in 2007.

European Attractiveness Survey (Ernst & Young 2007)



Igor Bulantsev, First Deputy Chairman of the Management Board of Orgersbank

bulantsev@orgres.ru

+ 7 495 777 3477

National Projects

Currently Mr Dmitriy Medvedev is in charge of several national projects, covering education, health, housing and development of the agricultural sector. These projects are long-term state social and economic programmes, directed at raising the living standards of the population. The state has provided large scale financing of these projects to the tune of 17.6 bn USD. Russian and foreign investors and producers can participate in the implementation of these projects. This gives new opportunities for Nordic companies to compete for a share of the pie.

Budgets on National Projects 2006 - 2007 (bn RUB)

- health 222.5
- education 78.2
- affordable housing 134.3 (incl. 49.6 state guarantees)
- agriculture 47.3

Source: Internet site of national projects, www.rost.ru

Conclusions

In the short- and medium-term perspective the political and economic situation in Russia ought to remain stable. The course of government is also expected to stay predictable and a continuation of the same main priorities to develop the country.

The 2007-2008 elections will not cause a deterioration of the investment climate in Russia, we are instead likely to speak about an improvement in the situation and new perspectives for foreign investors. This is evidenced by the strong FDI inflows seen in recent quarters.

The expected accession of Russia to WTO will be an additional guarantee of transparency in the relations between the business community and the state, as well as the observance of equal opportunities for all market participants. Russia will continue to be a most attractive and dynamically developing market.

Rouble strengthening comes to a halt

The global financial turmoil has also affected Russia and the rouble's strengthening trend vs the basket has come to a halt. The trend towards capital inflows turned and changed into outflows in some months and interest rates have also occasionally risen. Since September 2007, the central bank has prevented the rouble from appreciating. A stronger currency would represent additional tightening, which could hurt the bank system unduly in the current situation. Secondly, as the central bank views the recent acceleration in inflation to a large extent due non-monetary factors e.g. higher food prices, they maintain that a revaluation of the rouble will not bring down inflation.

Notwithstanding these problems, which we still regard temporary, Russia's external position is fundamentally strong. The current account surplus, although gradually diminishing on the back of strong imports, is still healthy and was about 77 bn USD (about 6% of GDP) in surplus on a 12M rolling base. FDI in 2007 was record-high and together with borrowing from abroad, capital inflows were much larger than the current account. As a result, FX reserves increased to 470 bn USD in the beginning of 2008.

There is a fundamental conflict between the authorities' aim to both lower inflation and prevent excessive strengthening of the exchange rate, which hurts exports. This conflict is further magnified in the face of these strong inflows. Furthermore, as actual policy involves making choices between inflation and the exchange rate, it leads to confusion on which target the central bank focuses on at any given time.

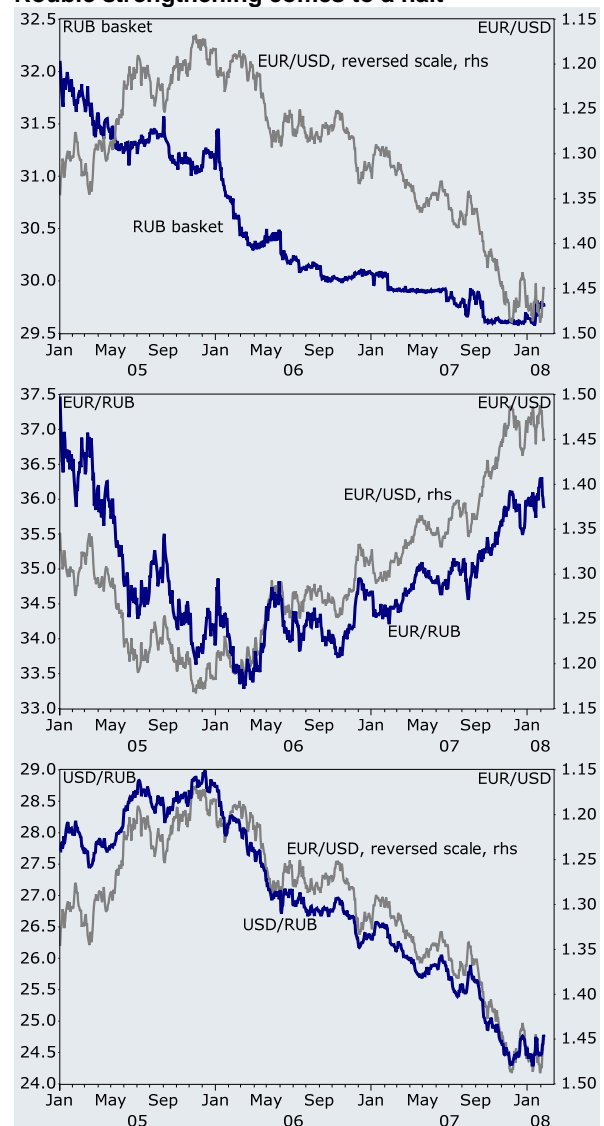
The end result of the large-scale interventions on the FX market (central bank buys incoming currency against roubles), whereby they prevent the excessive strengthening of the rouble, is that it is difficult to bring down the expansion in the money supply. This feeds into inflationary pressure, although the reason that inflation has not accelerated even more is that money demand has increased at the same time. As RUB has gradually strengthened, people have shifted away from currency deposits into roubles. The growth in foreign currency deposits are on multi-year downward trend, whereas RUB deposits have picked up.

If the central bank was earnest in bringing down inflation, it would have to let the nominal rouble rate appreciate whenever inflation deviates from the path consistent with the central bank's inflation target. The target is a quite optimistic 6-7% y/y in December 2008, which we believe that the central bank will have to revise upwards.

The burden of liquidity withdrawal falls thus on fiscal policy. This is done by depositing the windfall reve-

nues in the Oil Stabilisation Fund. However this has not been extensive enough, nor have budget surpluses been large enough to ease inflationary pressures. The only way to resolve the trade-off between both a stable exchange rate and lower inflation would be to step up fiscal sterilisation via the Oil Fund. Alternatively, if world commodities prices were to correct strongly downwards, that would take off appreciation pressure on the rouble. However in our baseline scenario, we expect the central bank to return to the policy of small, but frequent revaluations of the rouble vs the basket. This is necessary in order to contain inflation.

Rouble strengthening comes to a halt



Deregulations increase the use of RUB

A year and a half after the abolishment of the last currency control restrictions hampering cross border business, it is obvious that an increasing part of the growing foreign trade between the Nordic countries and

Russia is executed in roubles. Invoicing in roubles has proven to give e.g. exporting companies a competitive edge, as their Russian counterparts don't have to bother about foreign exchange risks.

The movements of the rouble against EUR and the Scandinavian currencies have been on a persistent weakening trend in both 2006 and 2007. As a result, we recommend companies with RUB exposure - receivables, equity or other open positions - to get familiar with the hedging opportunities available.

The financial markets in RUB have developed rapidly in 2007, both the number of instruments and liquidity. Most ordinary cross border solutions are now also permitted, though not always addressed by the local accounting or tax regulators, which calls for caution in the specific case. A watershed is the legal changes annulling the parts of Russian Civil Code Article 1062 equalling derivatives to betting and gambling, but also the ongoing process of creating a Russian ISDA as a platform what comes to standardised documentation between counterparts within Russia. The easing of red tape has been also reflected on the offshore markets, where the bulk of the liquidity in most instruments is found.

Hedging the FX risk

As the rouble has step by step become a normal tradable currency what comes to plain foreign exchange, Nordea Markets now also can offer a full set of hedging and funding instruments.

Ordinary FX forwards and swaps are available to 5 years and more. The pricing has gone hand in hand with the non-deliverable forwards, which is an alternative. An NDF is similar to an outright forward foreign exchange transaction. The net settlement is however carried out in USD, EUR or any Scandinavian currency. Instead of physical transfer of the principal amount, the customer either receives or pays the difference between the NDF and fixing rates. Amounts from under counter value of EUR 100.000 up to well over 50.0 MEUR can be obtained for both types of forwards.

New derivatives instruments to mitigate risks

After their introduction on the market cross currency and basis swaps have become excellent alternatives to hedging of long term currency and interest rate risk on favourable terms. It is now possible to turn the cash flows in e.g. internal loans from EUR to RUB, on both fixed and floating base. Locking both risks for a period of e.g. five years gives the company possibilities to calculate exact cash flows to a given FX rate level.

For the floating rate also MosPrime based solutions are possible. This daily quoted reference rate was introduced by EBRD (European Bank for Reconstruction

and Development) in 2005 and it seems now to gain credibility and use both locally and internationally.

As a novelty RUB options have been introduced recently. There are two types: ordinary and non-deliverable based (NDO's). This enables also the creation of option based strategies in RUB, like risk reversals and seagulls, if wished also at zero-cost.

Mika Erkkilä

mika.erkkila@nordea.com

+358 9 1655 9941

Henri Malvet, Emerging Markets Business Coordinator

henri.malvet@nordea.com

+358 9 369 50150

Growth continues and concentration is still high

The Russian banking sector is still on a growth trend. During 2007 total banking system assets increased around 35%, total loans grew by 56% and banks' own equity supported the growth with a 53% combined increase. The state-owned banks, like Sberbank (with roughly 25% of total assets), VTB (7%) and Gazprombank (4%) are still the dominating players and their market shares are even increasing. The table below shows the largest banks by assets and developments during 2007.

Major Russian banks

	Net assets (bn EUR)	
	Jan-07	Dec-07
Savings Bank of the Russian Federation (Sberbank)	100.0	132.0
Vneshtorgbank (VSB)	22.3	38.7
Gazprombank	20.5	23.1
Bank of Moscow	10.2	13.9
Russian Agricultural Bank	6.8	12.3
VTB 24	4.7	8.0
VTB North-West	4.2	5.8
Ak Bars	3.0	4.3
Bank of Khanty-Mansiysk	1.8	2.2
Main state banks (total) *	173.5	240.3
Total assets of banking system	404.9	526.3

* Excl. Vneshekonombank and small regional banks

Taken together the five largest banks (including privately-owned banks) account for more than 40% of total sector assets. The growth of the medium-sized banks, however, is significant and the importance of the banks ranking from 5 to 50 has increased in 2007. The growth among large and medium-sized banks has happened through organic growth but also by mergers and acquisitions of smaller banks – often in more distant regions with the purpose of expanding retail business. The concentration and fragmented nature of the banking system is illustrated in the table below

Concentration and fragmentation

Size grouping	% of assets
	Dec-07
1-5	43.0
6-20	21.0
21-50	13.0
51-200	15.0
201-1000	8.0
	100

Increased presence of foreign banks

International banking groups have also continued their expansion into Russia by purchasing Russian banks. The number of banks with majority foreign shareholding has grown from 65 to 83 during 2007. Among recent acquisitions are Absolut Bank by Belgian KBC, Impexbank by Raiffeisen, Extro-Bank by Santander and Orgresbank by Nordea (completed in March 2007). Some foreign banks also obtained their own bank licenses in 2007. The structural tendencies, like M&A's and increased foreign shareholding will most likely continue in the future on a high scale. Many Russian

banks have officially announced their interests in finding foreign partners.

Liquidity crisis

The general financial performance of the Russian banks has been good and improving over 2007. Driven by the international liquidity crisis during the autumn, however, the banks came under critical funding stress. In line with the general tightening of world liquidity, Russian banks suffered from funding constraints.

One of the main reasons for this stress is the fact that a significant part of Russian banks funding is from wholesale sources, such as interbank lending, international syndicated loans and other debt-market borrowing. Moreover, the Russian bank sector suffers from a relatively weak market for interbank lending and fragile confidence among depositors.

For the sector as a whole, the main source of funding is corporate and retail deposits, while foreign liabilities account for a relatively moderate 20-25% of total funding and tenors on those international loans are mostly longer-term.

On average, therefore, short-term refinancing risks are seen as moderate. Together with the weak depositor confidence, the main worry is that some banks rely too heavily on the interbank market. Thus bank failures cannot be ruled out going forward. So far however banks have weathered the storm, and the Russian central bank has been very supportive via a range of measures to counteract the lack of liquidity. At the time of writing, the worst seemed to be over. However renewed stress cannot be ruled out.

Structural improvements, but still lagging behind international standards

The Russian authorities are constantly striving to improve transparency and the regulatory framework, but standards are still lagging significantly behind best practice and countries comparable to Russia. Among the recent improvements are the expanded use of international accounting standards (IFRS), a more open disclosure of bank's owners and beneficiaries and a more active role in counteracting money laundering. Also on individual bank level improvements are taking place. Banks are focusing more on risk management and control, and business focus is also gradually becoming more diversified into traditional retail and corporate banking services and less the "pocket"-bank business servicing mainly the banks owners. However having said that, transparency (especially in terms of ownership) and regulation are still weak.

In sum...

The banking sector in Russia is henceforth in a process of change and will be so also in the periods to come. Consolidation will take place through mergers, acquisitions and closure of small and/or weak banks, and foreign banks will most likely continue their large-scale entrance. Financially, the banks have been performing relatively well so far, but challenges have increased as highlighted by the liquidity crisis. Bank failures cannot be ruled out, and shareholders' willingness and capability to support banks in trouble is a big question mark. Financially, the banks also have to cope with the challenge of possibly weaker asset quality in the future as a result of the expansion into riskier retail banking. This puts pressure on capitalisation and loan loss provisions.

Per Bertram, Senior Manager, Group Credit, Financial Institutions Division, Country and Bank Analysis

per.bertram@nordea.com

+45 3333 1541

Overview of stock and bond markets

The Russian stock market

After the recent years' bull market in emerging countries the Russian stock market does not look as cheap as it was three-four years ago. Now stocks of major Russian companies are valued very closely to stocks of their foreign peers and sometimes even higher. Leaders in 2007 were stocks of metallurgical companies such as Norilsk Nickel, Severstal, Magnitogorsk Iron & Steel Works (MMK in Russian abbreviation), Mechel, Evraz Group, NLMK, TMK.

Contrary to metal stocks, traditional leaders of the Russian stock market – stocks of major Russian oil and gas companies – had a downward trend during most of the year except for recent months because galloping oil prices sparked new interest for oil stocks.

The tables show the key financial ratios of oil, metal and other most popular and liquid Russian stocks (all data on 12 December 2007).

Major oil and gas stocks

Issue	Market cap mn USD	P/E	P/S	P/BV
Gazprom	346 318	13.8	3.8	2.3
Gazprom neft	29 321	7.9	1.5	2.8
Lukoil	78 996	10.6	1.1	2.2
Novatek	23 007	34.1	9.8	7.1
Rosneft	103 736	10.3	2.7	4.6
Surgutneftegas	45 621	18.7	2.0	1.2
Tatneft	13 674	11.8	1.1	1.4
Average		15.3	3.1	3.1

Major metal stocks

Issue	Market cap mn USD	P/E	P/S	P/BV
VSMPO Avisma	3 683	21.0	3.3	3.9
Evraz Group GDR	28 693	14.8	2.7	5.7
Mechel ADR	13 296	14.2	2.2	4.0
Magnitogorsky Metal W	15 148	8.3	1.8	2.4
Novo-Lopetsky Metal W	25 232	12.4	3.5	3.1
Norilsk Nickel	51 878	6.7	3.3	3.0
Severstal	23 317	13.8	1.6	1.9
TMK	10 100	20.1	2.6	5.4
Average		13.9	2.6	3.7

Major telecommunications stocks

Issue	Market cap mn USD	P/E	P/S	P/BV
Golden Telecom	4 358	29.0	3.6	3.6
Volga Telecom	1 447	16.2	1.3	1.8
Vimpelcom ADR	39 527	30.2	5.9	7.9
Dalsvyaz	520	18.9	1.0	1.7
MGTS	2 615	20.9	3.3	2.9
Mobile Telesystems	30 654	16.0	3.9	6.0
Rostelecom	8 738	146.3	3.5	4.2
North-West Telecom	1 591	20.7	1.7	1.4
Sibir Telecom	1 480	28.2	1.1	1.9
Uralsvyazinform	2 152	39.4	1.4	2.5
Centr Telecom	1 438	12.0	1.1	3.1
Southern Telecom	610	20.2	0.8	1.4
Average		33.2	2.4	3.2

Major bank stocks

Issue	Market cap mn USD	P/E	P/BV
Bank of Moscow	7 667	23.1	4.4
Vozrojenie Bank	1 590	27.7	3.5
VTB	34 442	33.5	2.4
Rosbank	4 958	31.8	4.3
Sberbank of Russia	95 879	25.0	4.1
Average		28.2	3.7

Other major stocks (retailers, chemistry, mining, food, industry, transport, electricity)

Issue	Market cap mn USD	P/E	P/S	P/BV
Acron	2 041	17.6	1.8	3.1
Uralkali	12 474	57.5	11.3	14.3
UES RAO	55 300	16.2	1.5	1.9
Polymetal	2 272	32.2	6.3	10.3
Polus-Zoloto	8 346	261.1	10.2	2.5
Raspadskaya	4 431	29.6	7.5	4.9
Avtovaz	5 034	39.7	0.7	1.5
Kamaz	3 766	65.4	1.2	1.8
Wimm-Bill-Dann	3 722	27.6	1.6	5.9
Lebedyansky	1 824	22.0	2.1	6.0
Baltica	8 005	13.2	2.5	3.3
Aeroflot	4 007	14.8	1.3	4.8
NMTP	5 145	114.9	18.6	8.4
Sistema AFC	16 381	0.0	0.0	0.0
Magnit	3 527	47.4	1.1	10.1
X5 Retail Group ADR	7 238	58.1	1.4	2.4
Average		51.1	4.3	5.1

However the main intrigue in 2007 in the Russian stock market was the real beginning of the long-awaited restructuring of RAO UES (Unified Energy System of Russia) – the main electrical monopoly in Russia. As a result of the process of restructuring, the stocks of several tens of electrical companies will be spinned off in the coming months for shareholders of RAO UES. The holding company RAO UES will be split in tens of specific electric companies and will be closed in the summer of 2008. The idea is to build a competitive market in electric power and attract private investments in the industry. There are two types of specific companies whose stocks have been traded in the Russian stock market now: wholesale electrical generating companies (OGK in Russian abbreviation) and territorial generating companies (TGK in Russian abbreviation). Russian and foreign strategic investors have a big interest in these companies and have bought big stakes in them.

OGK's installed capacity and market cap./capacity

Issue	Market cap mn USD	Inst. capacity (MGWT)	Market cap/capacity (USD/KWT)
OGK 1	5 121	9531	537.3
OGK 2	3 763	8695	432.8
OGK 3	7 196	8497	846.9
OGK 4	6 549	8630	758.9
OGK 5	6 207	8672	715.8
OGK 6	3 481	9052	348.6
Average			612.7

TGK's installed capacity and market cap./capacity

Issue	Market cap mn USD	Inst. capacity (MGWT)	Market cap/capacity (USD/KWT)
TGK 1	3 661	6248	585.9
TGK 2	729.0	2424	300.5
TGK 3	7 130	10611	672
TGK 4	1 629	3324	490
TGK 5	870	2467	352.8
TGK 6	1 244	3140	396.1
TGK 7	2 822	6880	410.2
TGK 8	1 597	3602	443.4
TGK 9	1 444	3200	451.1
TGK 10	1 770	2773	638.5
TGK 12	1 706	4448	383.5
TGK 13	1 333	2458	542.3
TGK 14	273.0	646	422.3
Average			468.3

During 2007 the two biggest Russian government-controlled banks had IPOs. They are: Sberbank (the biggest bank in Russia with a market capitalization of about 95bn USD) and VTB bank (the second biggest bank in Russia with a market capitalization of about 35 bn USD). Their stocks are among the most liquid ones in the Russian stock market.

Looking forward we should say something about new big state-controlled companies in Russia. The Russian government manages the process of consolidation in the economy. They try to consolidate state assets in different industries to build big powerful, viable and competitive companies. Now several big companies are founded already: the Shipbuilding company, the Aircraft Building company, the Aircraft Engine Building company, RosAtom (nuclear assets), the Russian Railroad company, the Federal Grid company (federal electrical grid assets). There will be other companies and a part of their stocks will be offered to the public including foreign investors in coming years.

Currently there are two main organised marketplaces (exchanges) in Russia: the Russian Trading System (RTS: www.rts.ru/en/) and the Moscow Interbank Currency Exchange (MICEX: www.micex.com). Both are located in Moscow but their terminals can be used in different Russian cities. Other organised marketplaces have too small daily trading volumes. During recent years MICEX has become the absolute leader with an average daily stock trading volume 1.5 - 2.0 bn USD, while the volume on RTS is several million dollars only. Stock quotes and deals at MICEX are denominated in Russian roubles (RUR) but at RTS in USD mostly. The total market capitalisation of the most liquid stocks on MICEX is more than 1 300 bn USD now.

There are two major stock market indices in Russia. The first is the RTS index (RTSI) based on quotes in USD and the MICEX index (MICEXINDEXCF) based on quotes in Russian roubles (RUR). Both indices reflect the stock market adequately and give a clue to domestic and foreign investors how to measure the Russian stock market performance in different currencies and estimate the market risk.

Historical performance of RTS stock index (in USD, data 4 January 2003-12 December 2007)



The historical market risk (BETA) for RTS index (in USD) comparing with S&P 500 index is 0.8 (estimated for running 30 days intervals) and the correlation is equal to 28%.

More and more Russian companies become interested in attracting long-term investments and they sell stocks via IPOs and SPOs for domestic and foreign investors in Russia and abroad, including the London Stock Exchange, NYSE, NASDAQ and some European stock exchanges. As a result the Russian stock market has got more transparent and the Russian government improves market rules and laws to protect the rights of investors. Another good result is that more Russian companies compose their financial reports in IAS and US GAAP, which helps investors to value their stocks better. These companies usually also have web-sites.

Debt market overview

Various funding options are available on Russian debt and capital market. The choice of debt instrument is determined by the projected cash flow of the issuer / borrower. If the amount to be raised is substantial, a bond issue could be considered. But if the funds needed are more modest, an ordinary credit from your bank is more economic. Promissory Notes market ("veksel" in Russian) may be tapped for short-term funding only (up to 1 year), while lower transaction costs compensate for higher yields (on average 50-100 bp wider than bond yields).

In a nutshell

- either public issue or private placement
- must be registered with the Federal Financial Markets Office, FFMO
- preparation of the issue is time consuming, the procedure takes around 3 months
- low registration fee, maximum RUB 101 000 (~ USD 3 500)
- some costs paid in advance on the planned issue; if issue fails no payback

- additional costs (arrangement and underwriting fees, documentation and infrastructure costs etc) amount to 0.2-1.2% of the issue and are higher for small-size issues
- a private placement issue reduces some costs, but prevents liquidity on secondary market increasing the yield required by the investor.

- third tier – bonds of companies with middle credit quality, small-size and non-liquid issues (Amtel, Volga, APPM, Nidan foods).

Current market structure

Russian bonds:

Government bonds

- the government bond market is currently represented by a number Ministry of Finance (OFZs) and Central Banks' (OBRs) bonds of 40 bn USD total. There are 286 dealers and more than 7 000 investors in the market. These instruments offer various maturity (from 1 to 30 years) and income (fixed or float).
- we do not expect the government bond market to grow in next years rapidly because of stable Russia's budget surplus and high oil prices.
- the largest OFZ issues are the most liquid on Russian debt market.
- several years ago due to low liquidity of OFZ market, most investors used City of Moscow yield curve as a benchmark for other corporate and municipal bonds. Now OFZ yield curve became a generally accepted benchmark.

Municipal bonds: 50 regions with total issues volume of 10 bn USD. The main characteristic of the municipal bond market:

- regional diversification
- favourable taxation
- the most liquid sector of municipal debt market is Moscow region bonds which replaced previous leader – City of Moscow bonds. There are 4 issues with maturities from 1.5 to 6.5 years and average amount of 12.4 bn RUR.

Corporate bonds: more than 650 issues and 490 issuers; current volume – more than 60 bn USD. The main characteristics of Russian corporate bond market:

- the most dynamic segment of Russian debt market
- high diversification by industry and issuers
- developed infrastructure and growing liquidity

Traditionally the corporate bond market is segmented by:

- first tier (“blue chips”) – the most liquid securities of first-class issuers (Gazprom, TNK, Alrosa, Vneshtorgbank, RAO UES, FSK UES, RZD)
- second tier – liquid bonds of high credit quality issuers – regional and industry leaders (Russian Aluminum, regional telecommunication companies, Sun Interbrew, Mechel, Novatek, Avtovaz etc.)

Market environment

The market grew slower and increased in volume only 32% comparing to average 65% in years 2005-2006. A vast number of issues were postponed due to the 2007 liquidity crunch. Total postponed issues volume is according to our estimates about 17 bn USD. If these issues were distributed timely, the market would grow this year 65% once again.

Typical loan size is 1 bn RUR (approx. 40 mn USD). Nevertheless there are many issues of 5 bn RUR (200 mn USD) outstanding. The biggest corporate bond issues were two of Gazprombank (each 20 bn RUR – approx. 1.6 bn USD) distributed to the market in autumn 2007.

The highest-quality issues have yields around 6-6.5% - for example OFZ and Moscow bonds. BBB-graded issuers have yields approximately from 6.5% to 8.5%. An example here is AIZHK (Baa2, government mortgage agency), or Gazprom and Lukoil. Lower graded issues have higher yields, for example Mirax Group (tough Russian developer) with S&P B rating has yields around 10.5%.

For companies of lower credit rating or without rating it is considered to be usual to have yield from 10% to 15%. The highest yield at initial placement this year was TKS Bank (no rating, only several months after it was created) with 18% bonds.

Risks

There were no noticeable defaults on the bond market since it emerged in 1998 and the volume has grown from nothing to 120 bn USD. There were several small banks' technical defaults which were mostly concerned with problems with the regulator. In 2004 Credittrust and Sodbisnes banks failed to meet their obligations in time because Central Bank of Russia withdrew their licenses.

The most efficient Central Bank's weapon against liquidity crisis is a repo list. It is a list of issues that can be deposited to borrow money from Central Bank via direct repo operations. The list was expanded in September 2007 by including a number of corporate issues. This action allowed banks to extend their borrowing operations and increased demand of the issues included in the list. The main criteria for issues to be included in the list is “B1/B+” or higher company rating from Moody's or S&P/Fitch, respectively. Only company rating is taken into account currently, the issue's rating does not affect the decision whether to include the issue on the list. That's why no issue distributed by SPV can be included into repo list. This situation might be reviewed next year by the Central Bank.

Sector	% of issuers on Repo list
Industry	3
Consumer goods production	5
Metallurgy	11
Energy and utility	13
Oil and gas	33
Government and municipal issuers	35
Banks, insurance and others	54
Hightech	67

Source: Central Bank of Russia, Cbonds, Micex, Orgresbank

The table above shows the shares of companies in the respective sectors whose issues are included on the repo list. They are mostly government and municipal bonds and oil, but also telecom and financial companies' bonds.

It is very positive news that some issues are to be included on the repo list, because increasing demand raises its price.

Mortgage risks are not relevant for Russian debt market since there is no subprime market at all and there is a little number of secured debt obligations issued. Most bonds are plain, fixed-rate and not secured. Most bonds have embedded put options at the dates arranged beforehand to lower the holder's interest rate risks.

Main Russian bond market risks are:

- short market and issuers' credit history
- issuers' low transparency and weak IR
- long money shortage in economy

These problems are a sort of common problems of emerging market. We believe that this year's liquidity crisis will lead to a re-evaluation of risks and promote issuers to higher transparency. High-quality issues yields won't be harmed while lower-quality lenders will face a necessity to pay more for new borrowings. We consider this year's events will make the market healthier.

Prospects for 2008

Key factors that define the market prospects are rouble exchange rate, international bond market and internal political and economic environment. Their short-term influence could be defined as follows:

Negative	Positive
Global credit and liquidity crisis still not resolved. There is a lot of uncertainty concerning the influence on the world economy and investors' risk appetite	Russia's liquidity is supported by the central bank and high export revenues. Central bank actively supplies money through several vehicles, eg. daily rep auctions, cross-currency swaps, medium-term (up to 6 mths) loans to banks backed by banks' loan portfolios etc.
Weak corporate culture. A lot of third tier issuers placed their bonds without disclosing audited consolidated financial statements	Russian financial institutions have low exposure to high risk mortgage debt Markets expect that Fed will lower key rates in 2008 and world central banks consolidated efforts will alleviate liquidity disruptions
High export revenues and high rouble liquidity fuel inflation	Current risk aversion environment will punish non-transparent issuers. To be able to borrow on bond market issuers will be forced to disclose audited financial statements Central bank will focus on fighting inflation and will pay less attention to smoothing RUR exchange rate. It will cause RUR to appreciate vs USD-EUR basket. Thus unhedged positions in rouble debt instruments will benefit from FX gains

Documentation, registration process

The issuance of securities in Russia is supervised by the Federal Financial Markets Office, FFMO, which also stipulates the procedure and required documentations. The main steps of the process are as follows:

- 1) A Lead Manager is selected by the issuing company. They agree on the terms and conditions of the issue. Lead manager gives recommendations to the issuer concerning the choice of Underwriter and Payment Agent for the issue (services of Financial Consultants are no more obligatory). Usually all functions are provided by lead manager.
- 2) The Underwriter prepares the Information Memorandum, organizes marketing campaign, forms the underwriting syndicate and guarantees the placement of the whole amount. Nowadays "best efforts basis" is rarely applied as the Underwriter has to guarantee that the entire issue will be sold within several days.
- 3) The Payment Agent provides payments of coupons and redemption of securities at maturity.

The preparatory work with the documentation takes 4-5 weeks, after that the registration with FFMO takes another 4 weeks. After obtaining a registration number from FFMO the sales promotion can start. The placement can be done in two weeks after obligatory disclosure of information on issue in printed media (usually business newspapers).

An arrangement with MICEX about listing and a custody registration in the NDC, National Depository Central

must be done by the lead manager. A material Global Certificate is deposited with the NDC, but in practice all dealing with bonds is in dematerialised form.

Approximate costs of the issuer (in % of the face value of the total amount) are as follows:

- tax on issue – 0.2% (maximum RUR 100 000)
- lead manager and Underwriter fee – up to 1%
- payment Agent commission – 0.05%
- custody services (NDC) – 0.05%
- exchange services (MICEX) – 0.04%
- costs of information disclosure, road-show, marketing etc – 0.1%

The placements are done through a Dutch-style auction procedure, where auctioneers bid either for the price or coupon rate. Since the issuer has to pay profit tax if the price of the placement is above par and pay an issue tax on the nominal value of the issue, it is more convenient to make auctions for the rate of the coupons.

Artem Dziura, Head of Securities Department,
Treasury, Orgresbank

artem@orgres.ru

+7 495 777 34 77 1194

Nordea Services from the Head Office

Nordea has over 30 years' experience in banking in Russia. We have been the pioneer foreign bank in Russia, with one of the first foreign Representative Offices in Moscow and being participant in the first joint venture bank with Western ownership in Russia. Since 1996 Nordea has been the pioneer bank of cross-border rouble payments. Today we are building an even stronger presence in Russia through a majority stake in JSB Orgresbank.

Rouble Payments

Nordea's customers can freely make payments in roubles. In July 2006 several restrictions related to rouble payments were abolished. However, the remitter is required to provide more extensive information and specific codification than in ordinary payment orders.

The following rouble payments are possible:

- services and foreign trade transactions
- expenses of representative offices in Russia
- taxes and similar charges
- share capital, inter-company loans and interest payments
- other payments mentioned in the payment code list (VO-codes)

Russian banks are under the obligation to monitor that payments are made in accordance with the instructions and exchange regulations issued by the Central Bank of Russia.

Advantages of accepting roubles for payments

- The Nordic exporter accepting payment in roubles may get a competitive edge in trade negotiations, when the Russian partner has no foreign currency account or otherwise lacks access to currency, like cities or municipalities
- The Russian partner avoids paying commissions for currency conversion
- Payments in currency from Russia are usually more expensive than rouble payments

It generally takes four banking days for a rouble payment to arrive at Nordea if sent from Moscow, and usually a few days more if sent from other locations. If the remitter's bank is JSB Orgresbank the payment normally reaches Nordea in two banking days.

Rouble payments to and from Russia

For a rouble payment to be routed via the payment system of the Central Bank of Russia, the remitter is required to provide more extensive information than in ordinary payment orders. Also here the reason for the payment and VO code must be added.

The Nordic receiver of a RUB payment should ask the Russian payee to pay all rouble invoices in accordance with the standard requirements of the Central Bank of Russia, as Russian Payment Order forms differ from international practice.

A more detailed brochure of rouble payments is available on Nordea's Internet pages www.nordea.com (Corporate & Institutional / International Network and Services / Publications / Other publications). It also includes the most common VO payment codes and a model payment order from Russia to a customer of Nordea.

Types of rouble accounts

Non-residents may open an unlimited number of accounts in one or several authorised banks in Russia.

A RUB Current Account (general purpose account) can be used for commercial transactions, taxes, maintenance payments, etc.

Accounts may be opened for:

- Non-resident representative offices of foreign companies in Russia
- Non-resident foreign legal entities, including correspondent banks
- Non-resident private persons
- Non-resident entrepreneurs

Outside Russia, both corporate and individual customers of Nordea Bank can open RUB accounts in any Nordea branch office. The only account type is avista / on-demand and non-interest bearing.

Hedging the RUB exchange rate risk

In recent years the deregulations within Russia have enhanced the development of a functioning market not only in deliverable foreign exchange forwards but also in other derivatives, both inside and outside Russia.

This gives Nordea's customers possibilities to hedge against both rouble currency and interest rate fluctuations in new ways, thus extending the opportunity to use roubles for different commercial transactions.

Information about the current market rates and further guidance can be obtained from your local Nordea Markets Sales office.

Further information:

Nordea / International Payment Services

In Denmark tel. +45 33 33 53 01

In Finland tel. +358 9 165 55392

In Norway tel. +47 22 48 55 33

In Sweden tel. +46 8 614 7400

Orgresbank

Julia Rybalkina, Head of Financial Institutions (coordinating part), tel. +7 495 777 3477 (ext.1280), rybalkina@orgres.ru

Elena Bondarenko, Head of Intl Payments (SWIFT, euro-payments), tel. +7 495 777 3477 (ext. 1045), bondarenko@orgres.ru

Julia Moguzova, Head of correspondent banks division (RUB payments), tel. +7 495 777 3477 (ext.1030), moguzova@orgres.ru

Trade Finance

Trade finance is available using documentary credits, guarantees etc. We have a large and growing number of co-operation banks in Russia. More information of banks for trade finance is available e.g. from our Trade Finance Advisors and from Nordea Emerging Markets, Central and Eastern Europe department.

Documentary Credit

Documentary credit (D/C), or alternatively letter of credit (L/C), is a method of payment in which the buyer's bank undertakes to effect payments for the underlying goods subject to due performance of the terms and conditions specified in the instrument. If the exporter wishes to exclude any risk associated with the Russian Country Risk or buyer's willingness to pay, he should opt for a confirmed documentary credit. Nordea is in a good position to offer confirmations of L/C's at competitive rates. Buyers are more and more requesting financing. We offer short or medium term financing under a deferred payment L/C with discounting to the exporter. Today discounting on applicant's cost is a widely used method of medium time financing in Russia.

Guarantees

Nordea is prepared to issue guarantees on behalf of its customers to Russian buyers, e.g. as collateral for advance payments. Guarantees are granted to Nordic exporters against a counter – guarantee issued by a Russian bank. Currently we are selectively dealing with over 50 top banks in Russian. The transactions are to be agreed with our Trade Finance Department.

Region Central & Eastern Europe, Russia & CIS

cee@nordea.com

+358 9 1655 4365

Export and Project Finance

Nordea offers short and medium term export finance solutions. Export finance helps the exporter to remove short or medium term receivables from their balance sheet, thereby reducing both credit and currency risks,

improving liquidity and simultaneously providing the buyer with desired payment terms. As global competition intensifies, importers often request exporters to provide deferred payment terms or direct financing. The majority of our products do not involve any element of recourse to the exporter.

Nordea can arrange complex project financing and guarantee packages for large-scale projects, for example power plants, pulp mills, or telecommunication networks. Project financing is normally arranged to a special purpose vehicle project company with limited recourse to project sponsors. A project finance package usually includes financing from a variety of sources, different types of collateral arrangements, guarantees, escrow accounts, and project sponsor commitments etc. Development banks, such as EBRD and IFC often play an important role in co-financing large-scale projects.

Nordea can act as an arranger, agent and financial advisor. In regard to large-scale financing structures, Nordea has substantial experience of syndication arrangements and club deals worldwide including Russia, and we co-operate with an extensive and well-established network of international banks.

Aila Aho, Nordea Bank Finland Plc, Export and Project Finance

aila.aho@nordea.com

+358 9 1655 6583

Magne Schreiner, Nordea Bank Norge ASA, Export and Project Finance

magne.schreiner@nordea.com

+47 22 48 58 13

Niclas Ringblom, Nordea Bank AB (publ), Trade and Project Finance Sweden

niclas.ringblom@nordea.com

+46 8 534 915 92

Orgresbank – the subsidiary of Nordea

Introduction

JSB Orgresbank (OJSC) – a subsidiary bank of Nordea Bank AB. Nordea owns 75.01% of “Orgresbank” stake, the bank’s other shareholders are European Bank for Reconstruction and Development and the top management of the Bank.

Orgresbank has been operating on the market of banking services since 1994. Featuring vast business expertise on financial markets the bank is aware of its customers’ requirements and successfully renders a wide range of services to its individual, corporate and institutional clients.

Orgresbank ranks among the top-50 Russian banks by assets and among the top-60 Russian banks by stockholders' equity. High ratings assigned to Orgresbank by influential international agencies confirm the efficiency of its activities.

Fitch Ratings, an international rating agency, upgraded Orgresbank’s ratings on 30.03.2007 to the following:

- Issuer default rating (IDR) - A (from level B)
- Short-term rating – F2 (from B)
- Support rating – 1 (from 5)
- Individual rating - D
- Long-term national rating – AAA (rus) (from BB+(rus)).
- Forecast IDR and short-term national ratings – Stable.

Orgresbank appeared to be the second bank in Russia to receive such high ratings from Fitch Ratings International Agency.

Cooperation with corporate customers is a priority segment of Orgresbank. The bank improves its servicing technologies and high-quality product lines on an ongoing basis and serves about 6 500 corporate customers. The Corporate Banking International Division was specifically created for servicing international corporate clientele.

Under a multiple-purpose financial institution strategy the bank also continuously expands its product lines to individuals, offering hot lending products, payments, deposits, bank cards and other products on the terms and conditions that are advantageous to customers.

Regional growth is a priority for the bank. Currently the bank’s sales network comprises 34 full-service branches and mini-offices in 7 regions of Russia. In 2008 the Bank intends to:

- at the beginning of the year establish 6 regional offices in new areas

- develop a network of additional branches in the regions of the Bank’s presence
- set up credit and cash offices in the new regions.

Corporate accounts

Large corporates with a well-developed branch network and foreign companies engaged in business activities in Russia require technology-intensive financial products and services. Among promising services it is worthwhile highlighting such services as zero balancing – zero balance maintenance on the settlement account of the customer branch organizations and cash pooling – daily transfer of available monetary funds into the account indicated by the customer for their further allocation.

In Orgresbank accounts can be opened both for local and foreign companies and their subsidiaries in the local currency – roubles – as well as in all major currencies.

At present these accounts can be opened only as single accounts, the connection of accounts to a cash pool is partly limited by the Russian legislation. One of the highest priorities in Orgresbank is to develop cash management services.

All documents needed for opening an account in Orgresbank for legal entities are available both in Russian and in English. The bank has the opportunity to advise client local or international law companies which could support the process of getting registered in the Federal Tax Service, opening accounts, outsourcing specialists in accounting and so on.

Payments

The Russian payments system is regulated and supervised by the Central Bank of the Russian Federation (the CB). According to CB documentation, the payments in roubles are subject to strict rules concerning the forms of payment documents. These payments are usually transmitted via the CB clearing system, which processes payments 5 times a day, or directly between the banks through correspondent accounts.

Foreign currency and rouble payments to/from non-residents in most cases are executed within the purview of the currency control regulations. It implies providing the bank with the documents as the base of the deal prior to making the payment. However, foreign currency payments between non-residents do not have any legal limitations.

In general the incoming and outgoing payments are executed on the same-day value basis, provided that the instructions are received by the stated cut-off time. However, one should also take into consideration the cut-off time of the beneficiary’s bank and the time difference

between the distanced territories of Russia – the country covers eleven time zones.

Orgresbank offers their customers a wide range of payment types: domestic payments – payment orders, direct debit, salary payments, standing orders for private customers – and international payment services.

Orgresbank provides the facilities for remote on-line and off-line account operations and control via Bank-client System.

Cash operations

Orgresbank has its own security service for collecting cash, which gives the client the opportunity to choose the most convenient time and route (for the client). The service also includes counting of cash, crediting to the account (possible with the same value date), delivery of valuables to the appointed destination, preparing banknotes or coins of the desired face-value.

Orgresbank offers a convenient way of handling cash by opening a cash desk at the client's premises. The bank's cashier accepts cash payments from private persons in favour of the client, provides currency exchange services, processes private payments, operates bank cards and etc. Moreover Orgresbank can also install cash machines in a client's office.

E-Services

Orgresbank's electronic banking software, or a so called Bank-client System, provides a wide range of functionality that helps to operate with the company's bank accounts on a daily basis. The system is accessible from the office or from any point in the world via Internet.

Bank-client System contains following functionality:

- a multi-level data protection and payment confirmation
- a convenient and user-friendly interface
- high system operation speed
- payment import/export
- prompt support from the bank's IT-experts
- access to main banking services
 - Domestic and International payments
 - Balance reporting
 - Salary payments

Orgresbank offers two versions of E-Banking systems: PC based (Bank-Client/Windows) and Web based (Bank-Client/Internet). Service is available in Russian and English.

Lending

Russian banking market of business (companies) financing keeps growing rapidly. One of the market trends is the increase in the demand for long-term credit facilities and credits in the national currency.

In the largest corporate segment, floating rates (Libor, Euribor, in RUR - Mosprime) are applied more and more when providing credit facilities as well as unsecured lending upon presentation of international reporting and assessment of the company-borrower future development.

Orgresbank offers loans to companies and institutions of the different types of ownership to finance current liquidity gaps, working capital increases, vehicles purchases, production lines and separate equipment items acquire, repair and renovate premises, foreign trade finance and for other purposes.

The bank's borrowers include both large- and medium-sized entities meeting the bank's requirements for borrowers.

The partnership with major foreign financial institutions allows the bank to offer its customers the range and cost of financial resources complying with the international standards.

The Bank's credit facilities:

- overdraft
- term loan
- revolving and non-revolving credit facilities
- acceptance lending
- documentary lending

Trade and Project Finance

The main reason for the high demand by Russian companies for trade and project finance is the high equipment depreciation and the necessity to update, replace and purchase new equipment. The main trend on the trade and project finance market is the visible stagnation in export deals and sharp increase in import deal amounts that can be explained by the situation in Russian foreign trade.

The bank has started developing its trade and project finance business since the end of 2004. The position of the bank as a daughter bank of Nordea Bank AB helps to provide TPF products to clients at a new quality level.

The trade and project finance department of Orgresbank offers to its clients a wide range of services related to the trade operations financing (import, export or local transactions), as well as to the leasing and financing of any projects (plants or warehouses constructions, network development, etc.).

Leasing

The demand for leasing services from Russian companies is growing constantly. The main reasons are obsolete equipment that needs to be replaced and convenience for the lessee in leasing scheme, tax preferences and the deficiency in presentation of additional security.

Main trends on the Russian leasing market in the nearest future are as follows:

- tough competition and appearance of international leasing companies on the Russian leasing market
- the development of leasing in the regions
- in the short-term the main market potential can be observed in construction, road-building, agricultural equipment, food, engineering, technological, woodworking, pulp and paper and timber cutting equipment
- in the medium-term large growth potential has real estate financial leasing, industrial complex and electricity-generating equipment

Orgresleasing LLC, a subsidiary of Orgresbank offers legal entities services on leasing purchase deals for a large range of fixed assets, including:

- equipment for different industries
- cars and trucks - automotive equipment
- railroad rolling stock
- real estate

Retail banking

The retail market is one of the recently developed markets, notwithstanding one of the most fast growing and promising financial markets in Russia. Market perspective is confirmed by the fact that almost all large credit institutions provide retail services; there is a noticeable interest in the market from foreign banks.

Nevertheless there is a large growth potential. According to the All-Russia Public Opinion Research Centre only 58% of Russians use banking services; among the most popular services are bills payment, credit products, currency exchange and bank cards (mostly salary cards).

The main trends of the retail market are:

- improvement in the financial knowledge of the population
- high demand on credit products, real estate loans and car purchase loans
- increase in demand for financial and asset management

Services designed to individuals are an Orgresbank business segment developing intensively. The bank offers its customers:

- various types of lending
- bank card transactions
- clearing transactions
- e-services
- money depositing services

A priority business line of Orgresbank is integrated services to corporate customers' employees. In this case financial products and services are provided on special

and beneficial terms and conditions: overdraft on card account, consumer loan, mortgage lending and car loans.

The bank also offers VIP-standard services within the Private Banking segment to company executives: plastic cards Visa and MasterCard of Gold class at special rates, Diners Club cards, placement of redundant funds, including capital trust, broker services at financial markets.

Facts JSB Orgresbank (OJSC)

Founded: Moscow 1994

Owners: Nordea Bank AB 75.008%, EBRD 12.496%, top management of the Bank 12.496%

Employees: 1427

Branch offices: Moscow, St. Petersburg, Samara, Penza, Saratov, Novosibirsk and Stary Oskol.

As of January 1, 2008:

Assets - 72 961.63 million rubles,

Equity capital - 5 173.29 million rubles.

Loans to customers: 49 846.21 million rubles.

Fitch Ratings:

Foreign Currency:

- Long-Term IDR: "A-"
- Short-term: "F2"
- Outlook: Stable

National:

- Long Term: AAA (Rus)
- Outlook: Stable

Individual D

Support 1

Esa Teräväinen, General Manager, Corporate Banking, International Division, Orgresbank

teravainen@orgres.ru

+7 495 777 3477 1480

Contacts

Nordea Bank Finland Plc.

Aleksis Kiven katu 9, Helsinki
 FIN-00020 NORDEA
Markets / Research Emerging Markets
 Mika Erkkilä +358 9 1655 9941
Senior Relationship Manager, Head of Region Central & Eastern Europe
 Sami Loukkola +358 9 165 52804
Markets / Emerging Markets Sales
 Mari Nopanen +358 9 369 50800
Markets / Emerging Markets Business Co-ordination
 Henri Malvet +358 9 369 50150

Nordea Bank Danmark A/S

Christiansbro, Strandgade 3
 P.O. Box 850, 0900 Copenhagen
Markets / Emerging Markets Sales
 Jana Poulsenova +45 3333 1617
 Anna Salkova +45 3333 1815
Markets / Research Emerging Markets
 Anders Svendsen +45 3333 3951

Nordea Bank Norge ASA

Middelthunsgt. 17, P.O. Box 1166 Sentrum
 N-0107 Oslo
Markets / Emerging Markets Sales
 Morten Aarvik +45 3333 1460

Nordea Bank Sverige Abp

Hamngatan 10, SE-105 71 Stockholm
Markets / Emerging Markets Sales
 Erik Åkesson +45 3333 1618

Nordea e-mail addresses in the Nordic countries:
 name.familyname@nordea.com

Nordea contacts in the Baltic Sea region Estonia Branch

Hobujaama 4, EE-10151 Tallinn
 Telephone +372 6 283 200
 Telefax +372 6 283 201
General Manager
 Vahur Kraft
Head of Nordic and International Desk
 Andreas Laane

Latvia Branch

Kalku Street 15, Riga, LV-1050
 Telephone +371 7096 200
 Telefax +371 782 0325
General Manager
 Valdis Siksnis
Head of Nordic and International Desk
 Guna Riekstina-Cika

Lithuania Branch

Didzioji g. 18/2, LT-2001 Vilnius
 Telephone +370 5 2361 361
 Telefax +370 5 2361 362
General Manager
 Inga Skisaker-Kinduriene
Head of Nordic and International Desk
 Jurate Jazukeviciene

Nordea Bank Polska SA

Atrium Tower, 6th floor, Al. Jana Pawla II 25,
 PL-00-854 Warsaw
 Telephone + 48 22 581 3300
General Manager
 Wlodzimierz Kicinski
Head of Nordic Corporate Banking
 Egil Rindorf

Subsidiary in Russia

JSC Orgresbank

Moscow Head Office
 19 3-ya Ulitsa Yamskogo Polya, Building 1, 125040
 Moscow, Russia
Head of Corporate Banking International
 Esa Teräväinen
 Telephone: +7 (495) 777-3477 (ext.1480)
E-mail: Teravainen@orgres.ru

St Petersburg Branch

Ulitsa Kirochnaya 12, 191028; St Petersburg, Russia
Head of Corporate Banking International
 Natalya Ogorodnikova
 Telephone: +7 (812) 635-70-85, 635-70-86 (ext.333)
E-mail: NOgorodnikova@orgres.spb.ru

Regional Orgresbank offices

Samara Branch

Ulitsa Chapayevskaya 138 A, Samara, 443010 Russia
 Telephone: +7 (846) 333-13-33

Penza Branch

Prospekt 30-letiya Pobedy 8, Zarechny, Penza Region,
 442960 Russia
 Telephone: +7 (8412) 61-67-30

Saratov Branch

Ulitsa Kiselyova 65, Saratov, 410012 Russia
 Telephone: +7 (8452) 73-50-74, 73-50-81

Novosibirsk Branch

Ulitsa Sovetskaya 15, Novosibirsk, 630007 Russia
 Telephone: +7 (383) 325-11-77

YUM 033 02.08

Nordea Markets is the name of the Markets departments of Nordea Bank Norge ASA, Nordea Bank AB (publ), Nordea Bank Finland Plc and Nordea Bank Danmark A/S.

Copyright Nordea Markets, 2006. Not approved for publication in the United States. Nordea Markets is part of the Nordea Group. This document has been issued for the information of Nordea Markets Non-Private Customers and Market Counterparties only, it is not intended for and must not be distributed to Private Customers. This document may not be reproduced, distributed or published for any purpose without the prior written permission of Nordea Markets. Nordea Group and any person connected with them may provide investment banking services to an issuer of any of the securities or any other company mentioned in this document either directly or indirectly and may have done so during the twelve months prior to publication of this document. Nordea Group and persons connected with it may from time to time have long or short positions in the securities mentioned in this document and as agent or market maker, may buy, sell or hold such securities. All the information and opinions contained in this document have been prepared or arrived at from publicly available sources which are believed to be reliable and given in good faith. We do not represent that such information is accurate or complete and it should not be relied upon as such, nor is it a substitute for the judgment of the recipient. All opinions and estimates contained herein constitute Nordea Markets' judgment as of the date of this document and are subject to change without notice. The information in this document is not, and should not be construed as an offer to sell or solicitation of an offer to buy any securities, options or futures contracts. Nordea Markets does not accept any liability whatsoever for any direct, indirect or consequential loss arising from any use of information in this document. Nordea Bank Finland Plc, London Branch, is regulated for the conduct of investment business in the U.K. by the Securities and Futures Authority and is a member of the London Stock Exchange and as regards the activities of Nordea Bank Finland Plc, London Branch, in the United Kingdom. Nordea Bank Finland Plc, London Branch, does not seek to restrict or exclude any duty or liability to its customers which it may have under the Financial Services Act 1986 or regulations implemented pursuant thereto.

Nordea, Markets Division

Nordea Bank Norge ASA
17 Middelthuns gt.
PO Box 1166 Sentrum, N-0107 Oslo
+47 2248 5000

Nordea Bank AB (publ)
10 Hamngatan
SE-105 71 Stockholm
+46 8 614 7000

Nordea Bank Finland Plc
27A Fleminginkatu, Helsinki
FIN-00020 Nordea-Merita
+358 9 1651

Nordea Bank Danmark A/S
3 Strandgade
PO Box 850, DK-0900 Copenhagen C
+45 3333 3333