



Macroeconomic forecast for 2008

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- Given the deteriorating conditions and deepening crisis of confidence in global financial markets (whose impact is expected to continue to be felt until, at least, mid-2008), higher recession risks in the US – in addition to the concurrent threat of unmanageable inflation and the presidential elections – the Federal Reserve's monetary policy forecasts are becoming increasingly uncertain. We expect the Federal Reserve to again cut its benchmark rate in 1H08, which would result in further weakening of the dollar and increased commodity inflation (oil, gold, food, etc). Nevertheless, the deterioration in the financial sector and economy of the UK and EU imposes constraints on a weak US dollar policy against the euro and GBP. However, the potential for further dollar declines against the Asian currencies remains. By the end of 2008 we expect the EUR/\$ rate to climb to 1.40 and then further to 1.30 EUR/\$. At the same time, our mid-term forecast of the dollar exchange rate is quite vague: as it will be influenced by the slowdown of the US economy, the policy pursued by the global central banks with respect to interest rates and currency reserves, carry trade dynamics and demand by non-residents for depreciating US financial assets.
- We expect the rouble to continue strengthening against the US dollar in 2008 (up to 24 RUR/\$). However, the rising rouble trend may reverse in 2009 due to the anticipated strengthening of the dollar with respect to the euro, decrease in Russia's trade surplus, and diminishing capital inflows into Russia, caused by stricter terms and conditions for foreign borrowings and the need to repay earlier loans. In 2008, the most secure companies will be those that are focused on domestic demand, whilst securities pegged to commodity prices will be the most risky (yet, at the same time, the most attractive in case of a weakening dollar and growing inflation).
- In 2008, various conflicting factors will impact inflation. There are strong inflation expectations due to commodity inflation on global markets, rapid tariff growth of natural monopolies in Russia, soaring budget expenses and a continuation of the consumer boom. Whilst, at the same time, the exposure to monetary inflation will be lower due to a moderate decline in Russia's trade surplus and a contraction in the inflow of capital. We forecast inflation at 9% in 2008 vs. 12% in 2007.
- The Russian economy's demand for debt funding will stay high. Given the lower level of foreign debt available in 1H08, the Russian debt market will be significantly pressurised, and combined with rising inflation expectations should result in higher required returns on rouble bonds – this will be felt most of all by subprime borrowers. Later, as tensions on global financial markets subside and central banks continue with stimulating monetary policies, debt yields may fall again. Therefore, the expected high volatility in the stock market in 2008 may result in greater investor interest in the debt market.

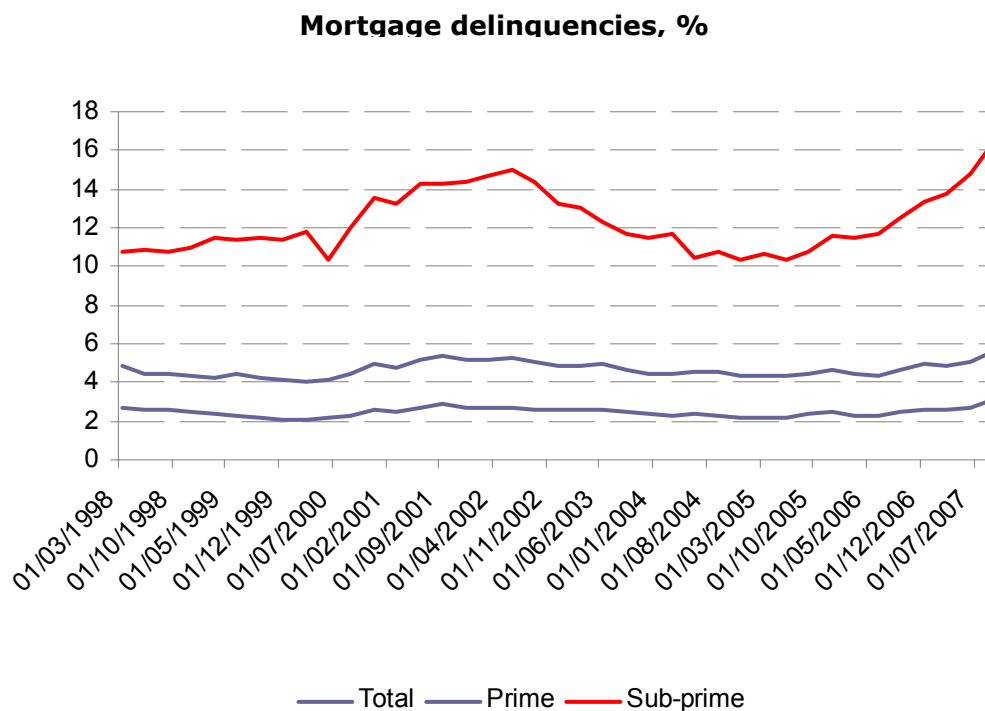


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Currency markets

In terms of regulating the monetary markets, conditions in the US economy are becoming increasingly uncertain and complex. The US housing market is facing its worst crisis for the past 16 years, with rampant mortgage bankruptcies, and there is a deepening crisis of confidence on the debt market. Write downs of banking assets due to the mortgage crisis and the panic prevalent on financial markets have already reached \$70-80 bn, with potential losses estimated at \$300-400 bn. Lehman Brothers expect 1 mn mortgage loan defaults next year against the current 300,000.

Fig. 1 – Overdue mortgages – the highest mortgage delinquency rates since 1986



Source: Mortgage Bankers' Association

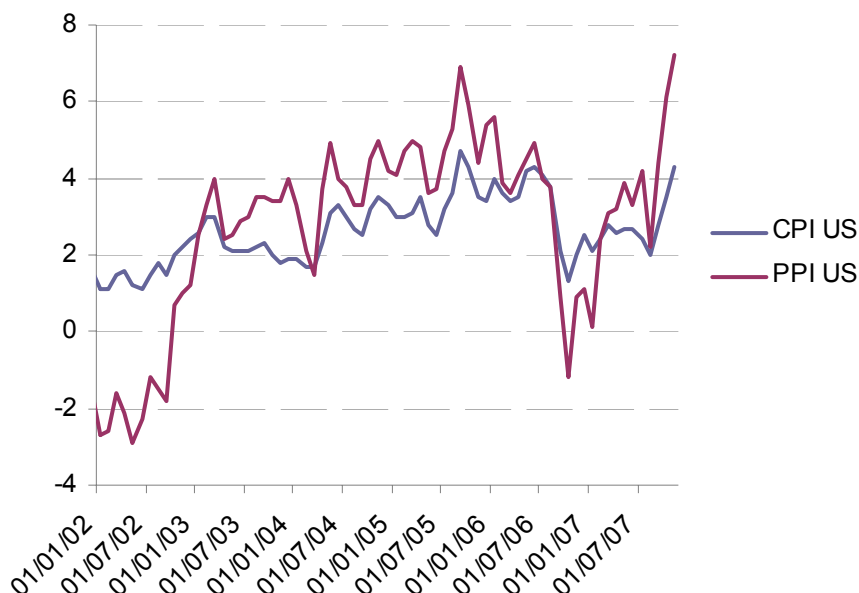
The glut of houses for sale combined with still conservative price adjustments (within a 10% range) has created the grounds for a significant decline in house prices next year – according to some estimates, they could decline by 15% to 40% from their peak levels). The difficulties of the financial sector impact the real economy through a reduction in the availability of bank loans, which is an extremely sensitive area for the highly leveraged US economy. The principal dangers relate to the abrupt decline in consumer spending, which accounts for about 70% of the GDP in the US. There is also a trend towards lower corporate profits, which is likely to negatively impact US employment levels and its stock markets – currently providing the last remaining level of support to American households. Recession forecasts are becoming increasingly downbeat. In response, the US administration is expected to make maximum efforts to avoid (or at least delay) an economic crisis occurring during the presidential elections in 2008. Already, the US government and the Federal Reserve have come up with extraordinary new initiatives – from freezing floating rate mortgage interest rates to the establishment of a superfund to buy out depreciated SIV assets and have coordinated measures undertaken together with four other central banks in order to sustain liquidity. It goes without saying that liquidity



support measures, per se, cannot tackle the critical mass of the bad debt crisis in the financial sector. However, freezing mortgage rates may partially reduce future bankruptcies and ease the pressure on the housing market.

At the same time, attempts by the Federal Reserve to ease the crisis through aggressive interest rate reductions by an aggregate 1 p.p. between August and December have already resulted in significantly higher inflation rates, which is likely to restrict the Federal Reserve in the pace and scale of further loosening its monetary policy. Thus, at the last session of the FOMC held on December 11, the federal funds rate was reduced by 0.25%, which disappointed most market participants who were expecting a 0.5% reduction. The session was followed by the publication of the PPI and CPI reports, which demonstrated much worse figures than expected. They demonstrated that the slowdown in the US economy has not been accompanied by declining inflation, which the FOMC had hoped for in its statements. **It now appears quite likely that stagflation will take hold, which would make it extremely difficult to relieve the crisis afflicting the economy, by the use of monetary policy measures.** So far, global central banks have been trying to replace or supplement benchmark rate cuts with short-term money interventions, in order to support liquidity. They hope that these measures will help ease the financial crisis and lower the level of interbank loan rates, and at the same will be less inflationary than additional reductions of the refinancing rate.

Fig. 2 – Inflation (CPI, PPI) in the USA, %



Source: US Ministry of Trade

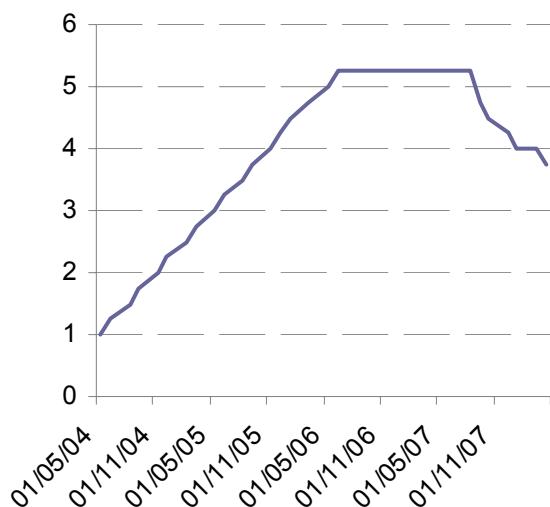
Table 1 – Expectations of the FED’s benchmark rate (based on futures prices)

Session date	Rate change	Current expectations, 18.12.2007	1 week ago	1 month ago
30.01.2008	Reduction to 4%	88%	94%	64%
	unchanged – 4.25%	12%	0%	36%
18.03.2008	Reduction to 4%	53%	39%	46%
	Reduction to 3.75%	41%	61%	41%

Source: Bloomberg



Fig. 3 – The Federal Reserve’s benchmark rate – actual (and implied by futures prices)



Source: Federal Reserve, Bloomberg

Increasing uncertainty in respect of the balance of risks facing the US economy and inflation growth rates, as well as the impact of the financial crisis on the EU and UK (which led to the Bank of England reducing its interest rate for the first time in two years, and the ECB offering an unprecedented level of liquidity (\$500 bn) for 1 day at rates, which were below market rates) resulted in the US dollar strengthening against the euro from 1.4850 at the end of November to 1.4350. It also strengthened against the yen and the pound.

Scenario 1 – Slowdown in the US economy which does not turn into a recession

If the slowdown in the economy next year corresponds with the Federal Reserve’s forecasts (1.5-2.5%), and the policy pursued by the Federal Reserve meets market expectations, the Federal Reserve will reduce interest rates to 3.75-4.0%, and at the same time print massive amounts of dollars in order to support liquidity in the banking sector. This is likely to further incite inflation expectations and weaken the dollar (to 1.5-1.55 EUR/USD). This will benefit commodities (oil, gold, non-ferrous metals, and food). This may indirectly boost prices for oil, gold mining and agricultural companies on the stock exchange. However, we advise caution with respect to the possible overvaluation of certain Russian commodity companies in comparison to their global peers.

The forthcoming presidential election in the US at the end of 2008 enhances the possibility of the US financial authorities aggressively supporting the economy and consumer spending during the pre-election campaign. A weak dollar will support exporters, which should reduce the US trade deficit. According to the Federal Reserve’s forecasts, the US economy should recover by 2009. Then, inflation will again be in focus, which may result in a tighter monetary policy and a stronger dollar. Accordingly, we expect the dollar to recoup some of its losses and reach 1.40 EUR/\$ by the end of 2008 and then gradual rise to 1.30.

Scenario 2 – US Recession

The likelihood of a recession is increasing with the continuation of the collapse in the housing market and the crisis in the financial sector. According to Goldman Sachs, the risk of a recession has increased from 30% to 40-45%. The consensus forecast of economists surveyed by the WSJ in early December estimates the likelihood of a recession at 38%, which is the highest rate for over 3 years. Analysts at Merrill Lynch believe that recession in corporate profits in the US has already started, with full-fledged recession to take place in 2008. The senior economist at Morgan Stanley, Stephen Roach has stated that the US economy is inevitably approaching a recessionary phase. The former Chairman of the Federal Reserve, Alan Greenspan has also confirmed recession risks. Although, by definition, for an economy to



be in recession, its GDP needs to decline for more than two consecutive quarters, we believe that a one percent slowdown of the US economy will be close – in terms of its consequences – to recession.

The deteriorating crisis on the financial markets and a significant decline in consumer spending will be major factors in this scenario. Although the threat of recession should trigger more aggressive rate cuts by the Federal Reserve, which would, in turn, lead to a weaker dollar – this could be compensated by a reduction in the carry trade and a flight to quality.

After a time lag, abrupt reduction of demand in the US should result in decelerating growth of the export-oriented economies of China, Japan and the EU. Central banks in these countries will be forced to loosen monetary policy, which will lead to a contraction of the interest rate differential and a weakening of their currencies against the dollar. This scenario envisages falling commodity prices, risk-averse investors, a reduction in the volume of carry trades and higher demand for Treasuries. A reduction of the US trade deficit as a result of lower levels of consumption and imports will also contribute to the dollar's recovery. The Federal Reserve will then have to concentrate its efforts on fighting the inflation provoked by the massive levels of liquidity (injected by its previous measures) in the financial system. This scenario implies a more drastic decline followed by a sharper reversal of the dollar than the previous one.

Scenario 3 – Slight decline in rates

If the US economy manages to avoid plummeting growth rates and the Federal Reserve does not continue cutting rates as expected by the market, the EUR/USD exchange rate is likely to stabilise within a range of 1.40-1.45. Nevertheless, as the problems related to excessive consumption backed by subprime loans in the US have still not been resolved, they may flare up later, which would force the Federal Reserve to significantly reduce rates in future.

Additional factors

1. The level of weakness of the US dollar will also depend on the policy followed by the key global central banks. **Firstly, it will depend on the ECB's (and the European economy's) pain threshold** with respect to the strengthening euro, which undermines the competitiveness of European exporters. It was primarily the euro, which strengthened against the weakening dollar over the past 5 years. Previously, industrial exporters had considered a EUR/\$ level of 1.40 as the maximum level to which the euro could strengthen, whereas it is currently approaching 1.50. Despite the threat of inflation, the excessive strengthening of the euro, combined with the increased volatility in the financial markets has prompted the ECB to discontinue raising rates (since September). It is possible that if a strong euro alongside diminishing consumer demand in the USA threatens the revenues of European exporters, increased political pressure will force the ECB to proceed with rate cuts – which may result in the dollar strengthening against the euro. Even without formal rate cuts, the ECB has already started to stimulate monetary policy by granting unprecedented levels of short-term loans to banks.

With respect to Asian currencies, the potential decline of the US dollar remains a likely possibility.

2. **Global central banks' measures (and declarations)** with respect to the US dollar as a reserve currency, whose attractiveness is rapidly declining, as US financial authorities try to rescue their economy and financial system through a weak dollar.

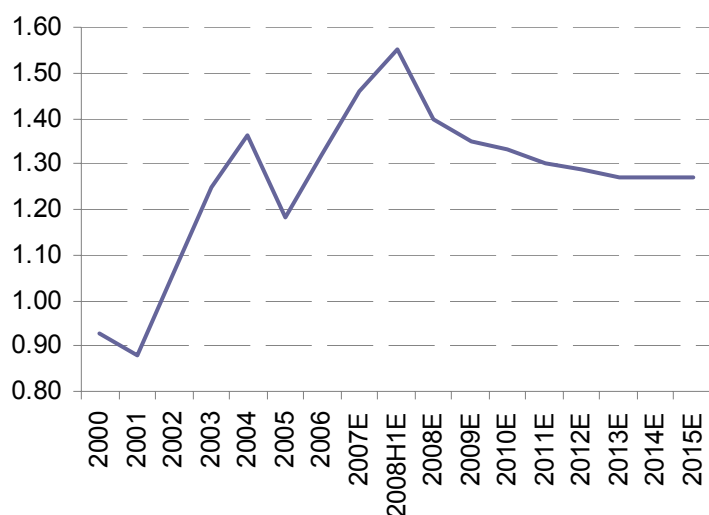
Both the measures undertaken and the statements declared by major holders of US treasuries (the central banks of China, Japan, and the Gulf states) with respect to their intention to reduce their dollar reserves, have an impact on global currency markets and threaten the further collapse of the dollar. In addition, the statements by some oil producing countries regarding the desirability of abandoning pegging the oil price to the dollar (Iran has already done so) have aggravated the instability of the dollar. In the long run, the unpegging of currency reserves and commodity prices from the US dollar, potentially constitutes the key risk factors for the dollar, since demand for the dollar as the primary settlement currency has provided the dollar its relative sustainability (so far) given the extraordinary level of the US trade deficit and foreign debt. Nevertheless, implementing these declarations will not be that simple – and despite the almost 70% drop of the dollar against the euro over the past 5 years, the dollar's influence on the global financial system has been falling at an extremely slow pace. Although the tendency towards increasing the role of alternative financial centres and the reallocation of cash flows in favour of the dynamically developing Asian countries is evident,



radical measures aimed at accelerating this trend may provoke a global economic crisis – and the resultant consequences are difficult to assess. All key market participants are aware of this danger.

3. Treatment of risks by investors and the dynamics of the **carry trade** transactions – In case of a recession, there is greater likelihood of a flight to quality and the outflow of funds from risky assets into US treasuries, which would contribute to the dollar strengthening.
4. The attractiveness of depreciated American financial assets for non-residents – Equity prices in the banking sector have declined by 20-40% since the beginning of the year. Citigroup, Morgan Stanley and UBS have responded to the loss of billions of dollars as a result of writing off assets by raising additional funds from Chinese and Middle Eastern investors. After the likely correction in major US equity markets, which are still close to historic highs, the prices of non-financial American companies may also become attractive for foreign investors, which would ensure inflows of capital into the US.

Fig. 4 – Forecast exchange rate (EUR/USD)



Source – Bloomberg, SOVLINK estimates

Rouble/US dollar – The rouble’s fair value?

Big Mac Index (Economist, February 2007)	15.20 RUR/\$
Clearing rate (money supply ex stabilisation fund/gold reserves)	18.70 RUR/\$
Money supply/gold reserves	9.90 RUR/\$
PPP (2004)	11.89 RUR/\$ (41% of the official rate over the period)

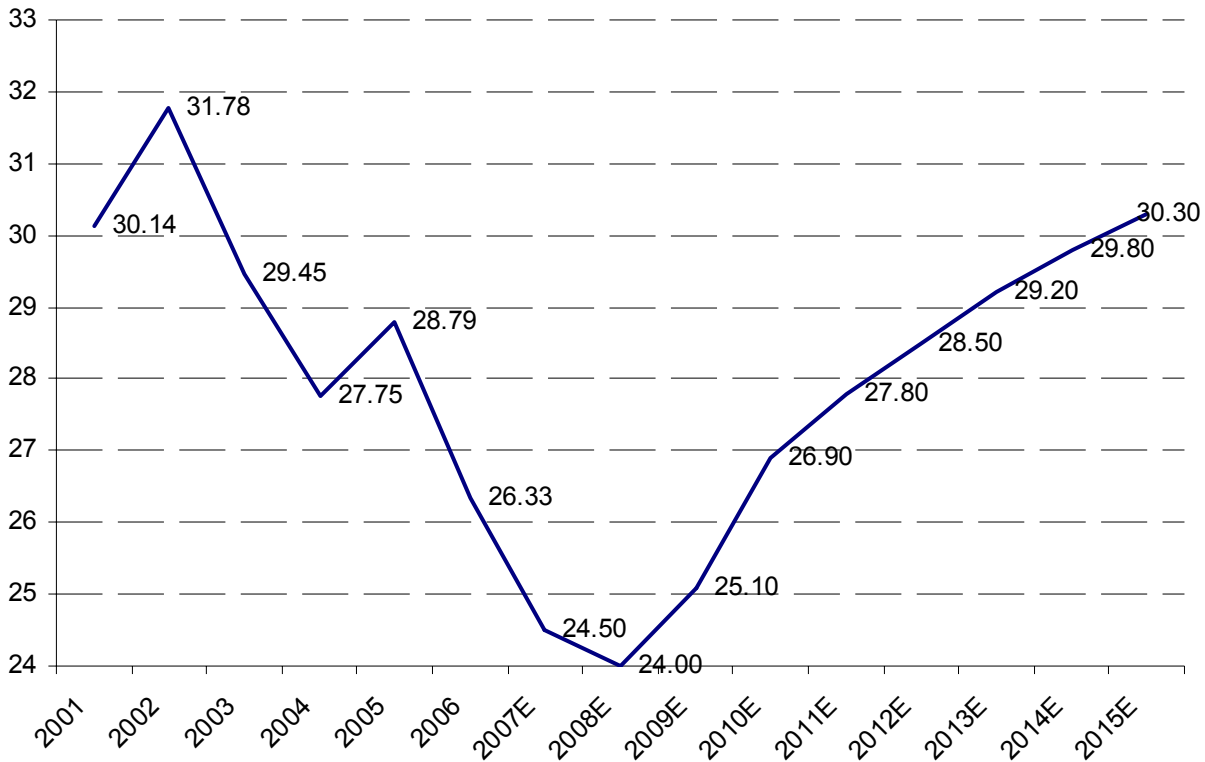
Although practically all indicators show that the rouble is significantly undervalued with respect to PPP, international comparisons indicate that this is usually the case for developing markets, whose national currency exchange rates are undervalued by 40-60% in comparison to parity rates (versus 70-100% in developed countries). This allows them to increase the competitiveness of their exports and substitute domestic products for imports.

As 60% of Russian exports is generated by revenues from the sale of oil, gas and oil products, the excessively high local currency rates is mainly due to higher raw material prices – particularly as the volume of energy resources exported, has grown only slightly. The trade balance surplus lays the foundations for a strengthening of the rouble, which helps to attract short-term “hot” money into Russia (mostly as foreign borrowings), and contributes to further growth of the rouble exchange rate. In 2008, the rouble may continue to strengthen, due to the continued weakening of the dollar and record high oil prices; however, the rouble will strengthen less than in recent years due to stricter borrowing terms



and US recession risks, which could exert pressure on the commodity markets. Meanwhile, in the mid-term, a series of factors will undermine sustainable growth of the rouble. Inflation rates in Russia are much higher than those in the US, which in theory should result in the weakening of the rouble. Stable or declining commodity prices are amongst the major risk factors. In this case, the growth of exports will visibly slowdown, and given faster growth of imports, the current account surplus will continue to fall – currently, it is 28% lower than last January-September – and turn into a deficit in several years' time. According to the Ministry for Economic Development and Trade, the trade balance may turn into a deficit as early as 2010-11. The possibility of substituting this source with an adequate inflow of capital is, in our opinion, questionable – especially, given the growing risks of instability in the global financial system. This could result in the growth of Russia's gold reserves coming to a halt. Simultaneously, the rapid growth of foreign debt – (+80% over the past 2.5 years), with repayments falling due over the next 3-5 years – will lead to the need to repay interest and principal amounts, if refinancing terms on foreign markets are not attractive. Although the stability margin is quite high now (with gold reserves amounting to about \$450 bn), the level of foreign debt (\$384.8 bn) is almost as high. A reduction of gold reserves constitutes a negative sign for currency speculators and may speed up the devaluation process. The strengthening of the dollar against global currencies and the outflow of capital from developing markets is also another risk factor. Given these assumptions, as of 2009, we expect a reversal of the current strengthening trend of the rouble, with the rouble trending down.

Fig. 5 – Forecast exchange rate Rub/USD



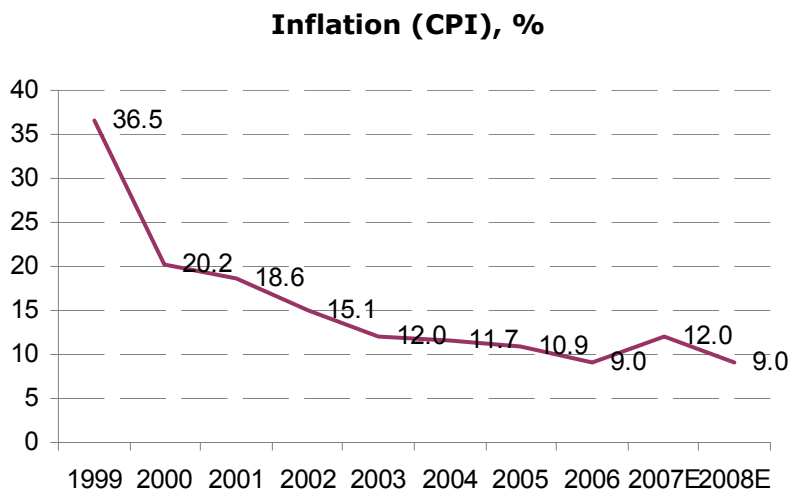
Source – CBR, SOVLINK estimates



Inflation forecast

It is now clear that 2007 will break the long-standing trend of optimistic statements by government officials predicting lower inflation. Whereas previously the accuracy of the inflation rate based on a basket of consumer goods estimated by the Federal State Statistics Service was treated sceptically by the market, now these official estimates themselves are shockingly high. Accumulated inflation from the beginning of the year to 11 December is estimated at 11.1%, whilst the recent annual forecast by the Ministry for Economic Development and Trade is 12% (versus the original forecast of 8% for 2007).

Fig. 6 – Inflation trends in Russia



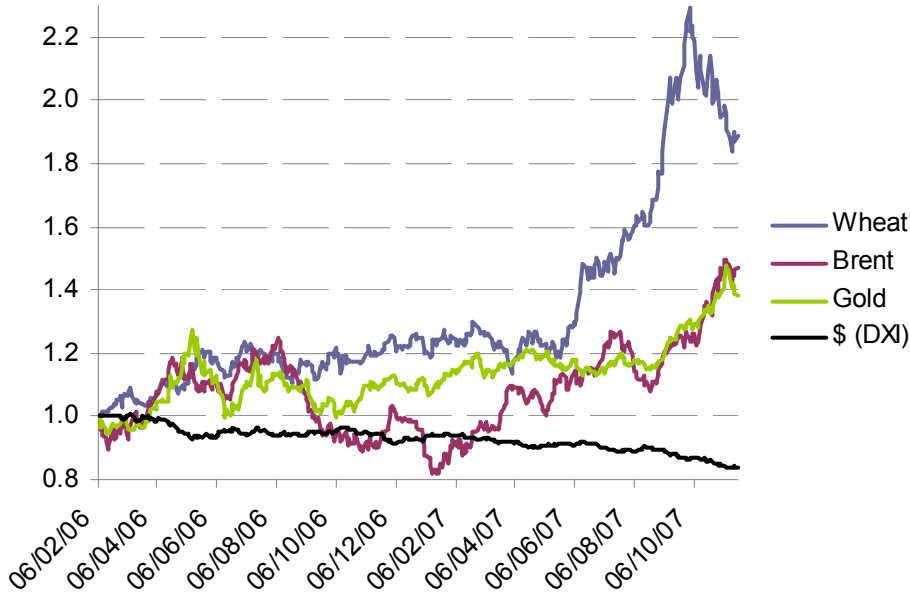
Source – State Statistics Service, forecasts by the Ministry for Economic Development and Trade, SOVLINK estimates

Inflation was at its highest in September-October when global CPI food prices grew by a total of 2.4% over 2 months (the highest for this period since 1999). Since then, inflation rates have fallen slightly, but are noticeably higher than last year's indicators.

In our review of October, 5 entitled "Inflation accelerates despite official forecast", we assumed that the principal factors influencing higher inflation were: the extraordinarily high monetary growth rates in Russia – during the first 5 months of 2007, the M2 money supply in Russia increased by 60% on an annual basis, which affected prices with a time lag of several months – and the significant speculative growth of world commodity (energy resources, metals, and food) prices, caused by massive rate reductions by the Federal Reserve and the subsequent decline of the dollar.

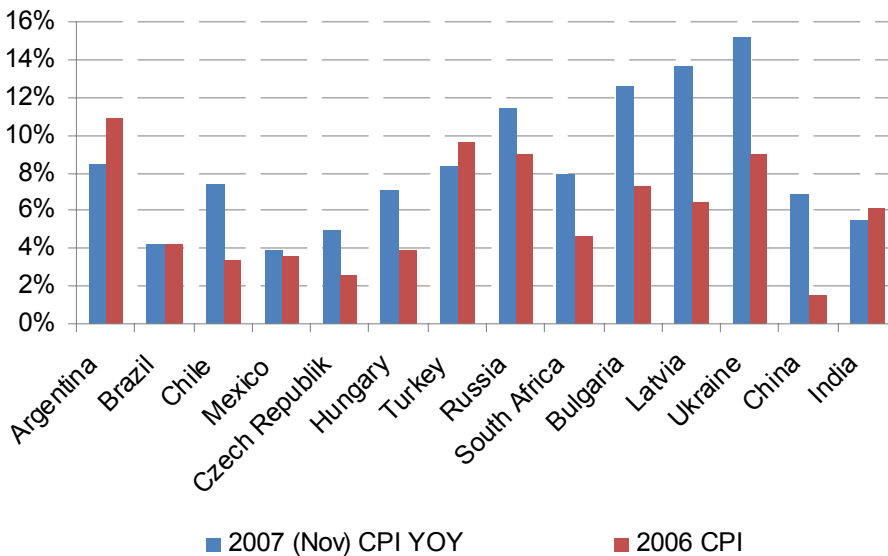


Fig. 7 – Cheap dollar – expensive commodities



Source – Bloomberg, SOVLINK estimates

Fig. 8 – Inflation (CPI) in emerging markets



Source: Bloomberg, IMF

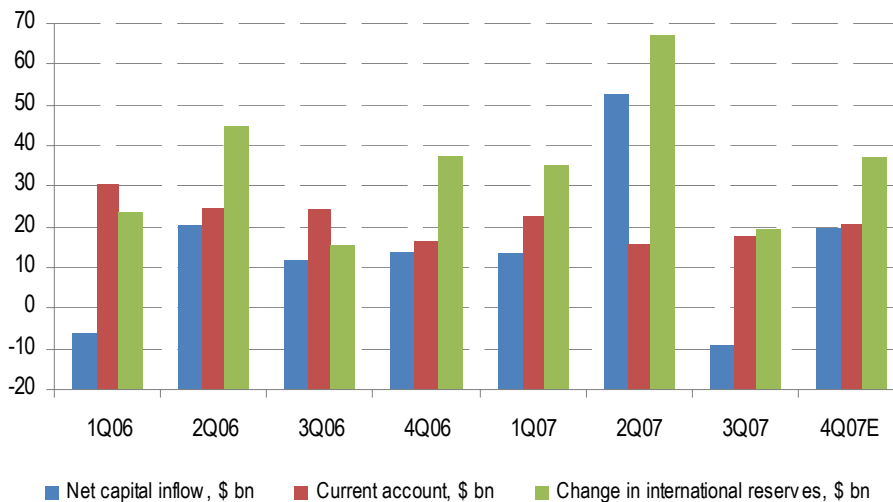
Significant growth of budget expenses is another factor, which has influenced inflation – 20.4% of GDP in 2007 vs. 16% of GDP in 2006. The government has already started spending the stabilisation fund (by allocating RUR 300 bn out of the total RUR 640 bn to institutes for development purposes). However, we believe that the inflationary effects of this measure will be limited, since funds granted to institutes for development should be spent over a period of 3-4 years.



Measures taken by the government to limit inflation (rebates on import duties for dairy products and higher export duties for grain), as well as the imposition of price freezes for 6 major food items by the largest producers and retail chains until the end of January (David Yakobashvili, chairman of the board at Wimm-Bill-Dann, has proposed extending the freeze until the end of March) have had little effect on stabilising prices. Moreover, we expect further rises in food prices, once the period for which prices have been frozen expires.

We expect that the complex set of factors influencing inflation will continue in 2008. Inflation expectations are already high (not only for Russia – see Fig. 8). Commodity inflation (growth of global prices for energy resources and food) poses the greatest risks. Cost push inflation will also continue – in particular, gas price growth of 25% vs. 15% in 2007, as a result of future price rises approved by the Federal Tariffs Service. The rapid growth rates of consumer loans and the rejection of traditional saving patterns by Russian households have contributed in unbalancing the supply and demand for goods and services and also in increasing inflation rates. For the same period next year, we expect lower monetary inflation than in 2007, due to constraints on foreign financing and a moderate decline in Russia's trade surplus.

Fig. 9 – BoP – main items

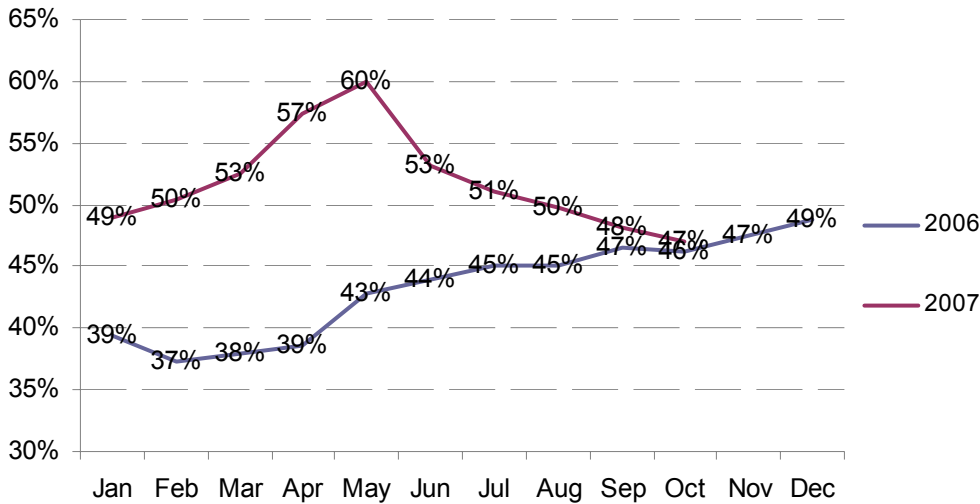


Source – CBR, SOVLINK estimates

In 2008, according to our estimates, the inflow of foreign investment capital will continue due to the attractive position of the Russian financial market against a background of an anticipated real rouble exchange rate, but will be less than this year, because of the significant deterioration in the positions of the largest Western financial institutions and the restricted availability of foreign borrowings to Russian companies and banks.



Fig. 10 – Growth of the money supply (M2) y-o-y



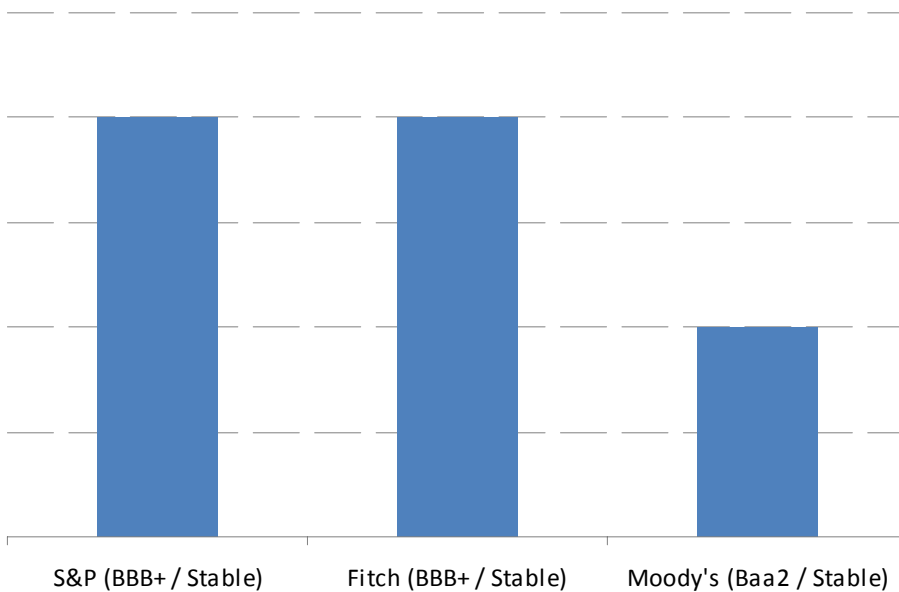
Source: CBR

Due to lower capital inflows, the growth of money supply y-o-y slowed from 60% in May to 47% in October. In 2008, we expect money supply to grow at 30-45% (depending on conditions on the global commodity and financial markets). Next year, we expect inflation to drop to 9% vs. 12% in 2007.

Should Russia expect an upgrade of its sovereign credit rating?

As of today, the leading 3 rating agencies have upgraded Russia’s sovereign credit rating to investment grade (Fig.11).

Fig. 11 – Russia’s sovereign credit ratings



Source: Rating agencies’ data



According to S&P and Fitch, Russia's foreign currency debt rating is one grade lower than the highest credit rating (level A) available. In 2006, both agencies upgraded Russia's sovereign credit rating following early repayment of debt to the Paris Club group of creditors, and reiterated their rating in August 2007. At the same time, Moody's has set Russia's rating one grade lower and has not reviewed its rating since October 2005. This is surprising, since Moody's is considered the least conservative agency amongst the top 3 and relies on formal credit rating indicators (budget surplus and stabilisation fund, ratio of foreign debt to GDP, volume of accumulated gold reserves, growth of GDP and investments). According to the crediting agencies, based on these measures, Russia should have been upgraded to level A.

In late November, Frank Gill, director for sovereign ratings at S&P said that he was considering the possibility of upgrading Russia's sovereign rating.

Almost all the rating agencies mention the upcoming presidential elections as a restraining factor on Russia's ratings. Nevertheless, in early December, Moody's released a report, which asserted that the results of the parliamentary and future presidential elections are likely to reduce political risks and imply that the economic policy pursued under president Putin will be continued which, in turn, will support Russia's credit ratings.

Thus, we expect an upgrade of Russia's sovereign rating following the presidential elections. Furthermore, Moody's may upgrade Russia's rating by two grades (in one step) to level A. Currently, Moody's sovereign credit rating of Russia at level A2, means that bond issues by the biggest state-run companies can receive ratings, which are higher than Russia's sovereign rating.

The market has already valued Russia's debt higher than debts of countries with higher ratings:

Country	Moody's	S&P	Fitch	10Y YTM, %
Russia	Baa2	BBB+	BBB+	5.60
Hungary	A2	BBB+	BBB+	7.00
Poland	A2	A-	A-	5.91
Korea	A2	A	A+	5.79
Chile	A2	A	A	4.70
Czech Rep	A1	A	AA-	4.76
Greece	A1	A	A	4.61
China	A1	A	A+	4.40

Source: Bloomberg, data from rating agencies, SOVLINK estimates

At the same time, if the rating of Russian state bonds is upgraded to A, there will be a growing demand for such securities from institutional investors that impose more rigid requirements on the quality of assets that can be included in their portfolio, and this could result in a decline of their yield. Furthermore, an upgrade of Russia's sovereign rating could lead to an upgrade of its corporate ratings, which could reduce their borrowing costs – as, given the credit crisis prevalent on global markets, higher credit ratings are valued by investors. However, the current instability of global financial markets has affected the availability of debt. Hence, an upgrade of Russia's sovereign rating to A would have a positive impact on the market; however, in our opinion, the effect would be limited due to the current high market value of Russia's debt and the weakening risk appetite of investors.

Forecast interest rates on the domestic market

We analysed changes in the yields of rouble bonds as of early July (before the crisis on the global credit markets). In our analysis, we considered the following classes of issuers:

- 1st tier (companies and banks with state interest, issuers with investment credit ratings, and leading international companies).
- 2nd tier (leading Russian companies with credit ratings ranging from BB- to BB+).



3. Banks (top-30 with liquid bonds), excluding the largest state banks.

Results of our analysis

	Average yield to maturity, 19.11.2007	Average changes in maturity in comparison to 02.07.2007
1 st tier	7.1%	0.55 p.p.
2 nd tier non-financial companies	7.9%	0.95 p.p.
Banks	10.1%	2.2 p.p.

Thus, bonds issued by banks came under the most pressure amongst prime borrowers. Whereas the yield to maturity (7-8%) of the most liquid bonds in the non-financial sector is still significantly lower than inflation, the yield of securities issued by companies such as Alfa Bank, MDM Bank, etc amounts to about 10%. Securities of 2nd tier banks with a high proportion of foreign debts and retail loans (Kit Finance, Ursa Bank, Russian Standard, HCF, etc) are already offering returns that are close to the forecast 2007 inflation rate – as these borrowers are treated as more risky by the market. Nevertheless, bonds issued by these companies are listed by the CBR as collateral for bank refinancing, which implies a fairly positive valuation of their credit status by the Russian regulatory authorities. It is unlikely that these securities will default, and their return to maturity based on the offer price is already quite attractive. However, the reassessment of risks has not yet been completed, and risk premiums are likely to rise further.

Fig. 12 – Weighted average yield of corporate rouble bonds (actual), %



Source: Cbonds

We expect borrowing costs to continue growing in 2008 – at least, in the 1st half-year. Our expectations are based on the declining risk appetite of global investors, limited access of Russian companies and banks to foreign markets and the deterioration of domestic liquidity levels. Nevertheless, we anticipate high demand for credit resources in the Russian economy. Leading Russian companies have announced large placements on the domestic debt market scheduled for next year. Even if the actual volumes offered are lower than the declared levels (as it is possible to raise some of the borrowings on foreign markets), the domestic placement level will be very high for the local market, which will result in a higher yield (by 1-1.5 p.p. on average, according to our estimates) and a growing difference in the costs of borrowings, depending on the quality of the issuer and liquidity of the issue. In future, as tensions on the global financial markets subside and the global central banks persevere with stimulating monetary policies, the yields may again decline.



Table 2 - Largest announced offerings:

Issuer	Amount	Period	Notes
Rosneft	RUR 45 bn	2008	Approved by the board of directors. The volume offered might be lower since there was news in late December that the company would offer Eurobonds amounting to \$2-4 bn in 2008, which the company had originally planned for July 2007. The 1 st tranche of rouble bonds totalling 15 bn RUR should have been offered in November 2007; instead, according to Mr. Bogdanchikov, the company will issue the bonds early next year.
Gazprom MTS	RUR 35 bn (5 series) RUR 30 bn (3 issues)	2007-08	Information as of early August 2007 Approved by the board of directors in early October.
Bank of Moscow	RUR 30 bn (3 issues)		Approved by the board of directors. The volume of the offering might be lower due to the successful raising of a syndicated loan amounting to \$600 mn in November (vs. the scheduled \$400 mn).
AIGK VTB 24 Vimpelcom-Invest Gazprombank	RUR 16 bn, 2 issues RUR 16 bn, 2 series RUR 15 bn, 2 series RUR 10 bn	December 2007 February 2008 1H08 2008	Approved by the supervisory board. Issues were registered by the CBR. Issues were registered by the CBR. In November, Gazprom offered 2 bond tranches, totalling RUR 40 bn (from a total scheduled offering of RUR 50 bn), with the remaining issue of RUR 10 bn postponed until next year.
Petrokommerz Kit-Finance KAMAZ AFK Sistema Vozrozhdenie Bank Zenit Bank	RUR 8 bn (2 issues) RUR 8 bn (2 issues) RUR 6.5 bn RUR 6 bn RUR 5 bn RUR 5 bn	2008 Early 2008	Approved by the board of directors. Approved by the board of directors. Offering postponed from 2007 until 2008. Approved by the board of directors. Offering postponed from 2007 until 2008. Approved by the board of directors.

Source: Company data, Cbonds

Conclusion

- Given the deteriorating conditions and deepening crisis of confidence in global financial markets (whose impact is expected to continue to be felt until, at least, mid-2008), higher recession risks in the US – in addition to the concurrent threat of unmanageable inflation and the presidential elections – the Federal Reserve’s monetary policy forecasts are becoming increasingly uncertain. We expect the Federal Reserve to again cut its benchmark rate in 1H08, which would result in further weakening of the dollar and increased commodity inflation (oil, gold, food, etc). Nevertheless, the deterioration in the financial sector and economy of the UK and EU imposes constraints on a weak US dollar policy against the euro and GBP. However, the potential for further dollar declines against the Asian currencies remains. By the end of 2008 we expect the EUR/\$ rate to climb to 1.40 and then further to 1.30 EUR/\$. At the same time, our mid-term forecast of the dollar exchange rate is quite vague: as it will be influenced by the slowdown of the US economy, the policy pursued by the global central banks with respect to interest rates and currency reserves, carry trade dynamics and demand by non-residents for depreciating US financial assets.
- We expect the rouble to continue strengthening against the US dollar in 2008 (up to 24 RUR/\$). However, the rising rouble trend may reverse in 2009 due to the anticipated strengthening of the dollar with respect to the euro, decrease in Russia’s trade surplus, and diminishing capital inflows into Russia, caused by stricter terms and conditions for foreign borrowings and the need to repay earlier loans.



3. In 2008, various conflicting factors will impact inflation. There are strong inflation expectations due to commodity inflation on global markets, rapid tariff growth of natural monopolies in Russia, soaring budget expenses and a continuation of the consumer boom. Whilst, at the same time, the exposure to monetary inflation will be lower due to a moderate decline in Russia's trade surplus and a contraction in the inflow of capital. We forecast inflation at 9% in 2008 vs. 12% in 2007.
4. The Russian economy's demand for debt funding will stay high. Given the lower level of foreign debt available in 1H08, the Russian debt market will be significantly pressurised, and combined with rising inflation expectations should result in higher required returns on rouble bonds – this will be felt most of all by subprime borrowers. Later, as tensions on global financial markets subside and central banks continue with stimulating monetary policies, debt yields may fall again. Therefore, the expected high volatility in the stock market in 2008 may result in greater investor interest in the debt market.



STOCK RATING POLICY

STRONG BUY:	Upside over 25%; confidence level – high / upside over 100%; confidence level - low
BUY:	Upside between 15 and 25%; confidence level – high / upside between 25% and 100%; confidence level – low
HOLD:	Upside of less than 15%; confidence level – high / upside of less than 25%; confidence level – low
SELL:	Target price at or below current price levels

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