Charlemagne Capital

Russian Market Update

19 September 2008

Trading on the Russian MICEX and RTS stockmarkets was suspended on Thursday, and had been temporarily suspended earlier in the week as well, in response to the marked falls seen in share prices. We detailed the reasons behind this sharp further weakness in Russian markets in our comment published on 18 September.

This suspension gave the Russian authorities breathing space to assemble a collection of measures aimed at restoring order to financial markets that, alongside the coordinated action undertaken by other countries, principally the US, to support their markets, allowed the Russian stockmarkets to re-open on Friday.

The measures announced by the Russian Ministry of Finance and Central Bank over the last couple of days can be summarised as follows:

- USD 40 billion injected into the banking system via short-term deposits and repurchase agreements
- A cut of 4% in reserve requirement ratios, equivalent to a cash injection of USD 12 billion
- The arranged rescue of KIT Finance, a local investment bank that had got into difficulties
- A reduction in the oil export duty, equivalent to a transfer of wealth of some USD 6 billion to the oil companies, which will ease the strain on the banking system as fourth quarter tax payments become due, with the promise of further reform of the oil tax regime to come
- USD 20 billion of government money earmarked to provide direct support to the stockmarkets

Such was the positive impact of these measures that the markets were once again forced to suspend trade temporarily, though on this occasion as a result of sharp share price rises rather than falls. The rouble-denominated MICEX market nevertheless closed with a gain of 25% on the day, whilst the US dollar-denominated RTS market closed up 23%.

There remains considerable uncertainty over the details of these announcements, which have yet to be published. The precise way in which the government will put USD 20 billion into the market is, in particular, awaited with keen interest. It seems plausible that it will be such state-owned companies as Gazprom, Rosneft, Sberbank and VTB that will benefit.

The events of recent days in Russia, the sharp falls seen in stockmarkets and the subsequent policy response, lead us to draw a number of conclusions:

- The authorities have succeeded in restoring confidence to the markets, at least in the short term (though parallel policy action in the US and EU also played its part). It is important to note that there were few domestic politics reasons for doing this (Russia is not, as yet, a nation of shareholders), rather there seems to be a realisation that healthy financial markets will be crucial in helping to raise the finances necessary to fund the massive infrastructure investment that is required to modernise the country.
- There will be a modest impact on the real economy, with growth likely to slow somewhat, as the availability of credit becomes subject to greater risk control. With the Russian economy tending to overheat however, this can be viewed as a positive, allaying fears on this score. Economic growth is still likely to remain strong.
- Although market volatility is likely to continue, and despite the rise in share prices seen on Friday, the Russian stockmarkets remain very cheap on both a relative and historical comparison.

If, at some stage in the future, we look back on September 2008, we will likely recognise that it was one of those rare outright buying opportunities that come along only once in a decade, we believe.

(This commentary draws upon the Conference Call given by Robert Procopé, from Charlemagne Capital's Russian team, on Friday afternoon.)

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