

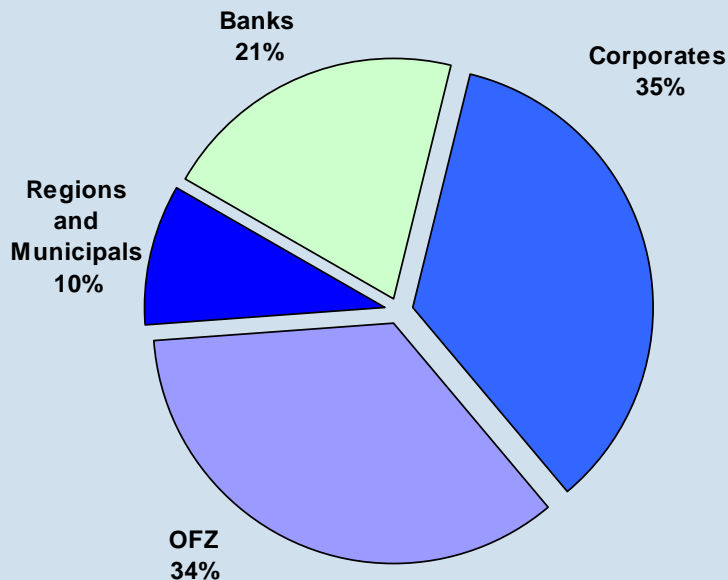
RUSSIAN ROUBLE BOND MARKET SURVIVING THE CRISIS

September 2008
Vladimir Bragin

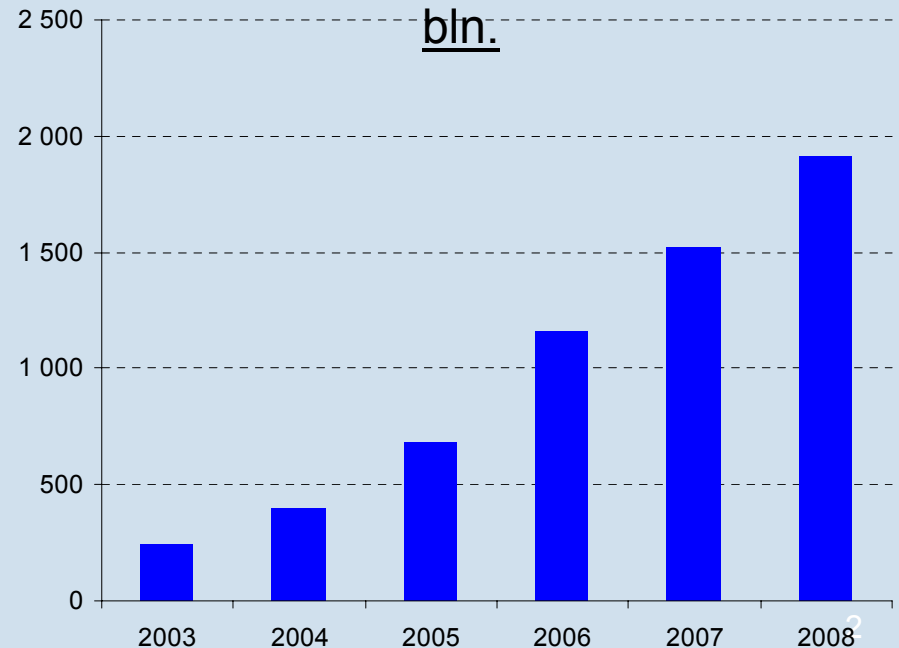
ROUBLE BOND MARKET TODAY

- ✓ Total market volume = RUR3,000 bln. (nominal terms)
- ✓ More than 500 issuers, total number of bond issues – about 750
- ✓ Government bonds: 26 issues aggregate volume RUR1,000 bln.
- ✓ Corporate, bank, sub-federal and municipal bonds are totalling RUR2,000 bln
- ✓ In fact corporate and bank bonds market due to high rate of PUT buyouts, especially in the 2nd and 3rd tiers

Rouble Bond Market Structure



Market Cap (ex-OFZ) in 2003-2008, RUR bln.



THE MARKET WAS CHANGING...

1st half of September 2008

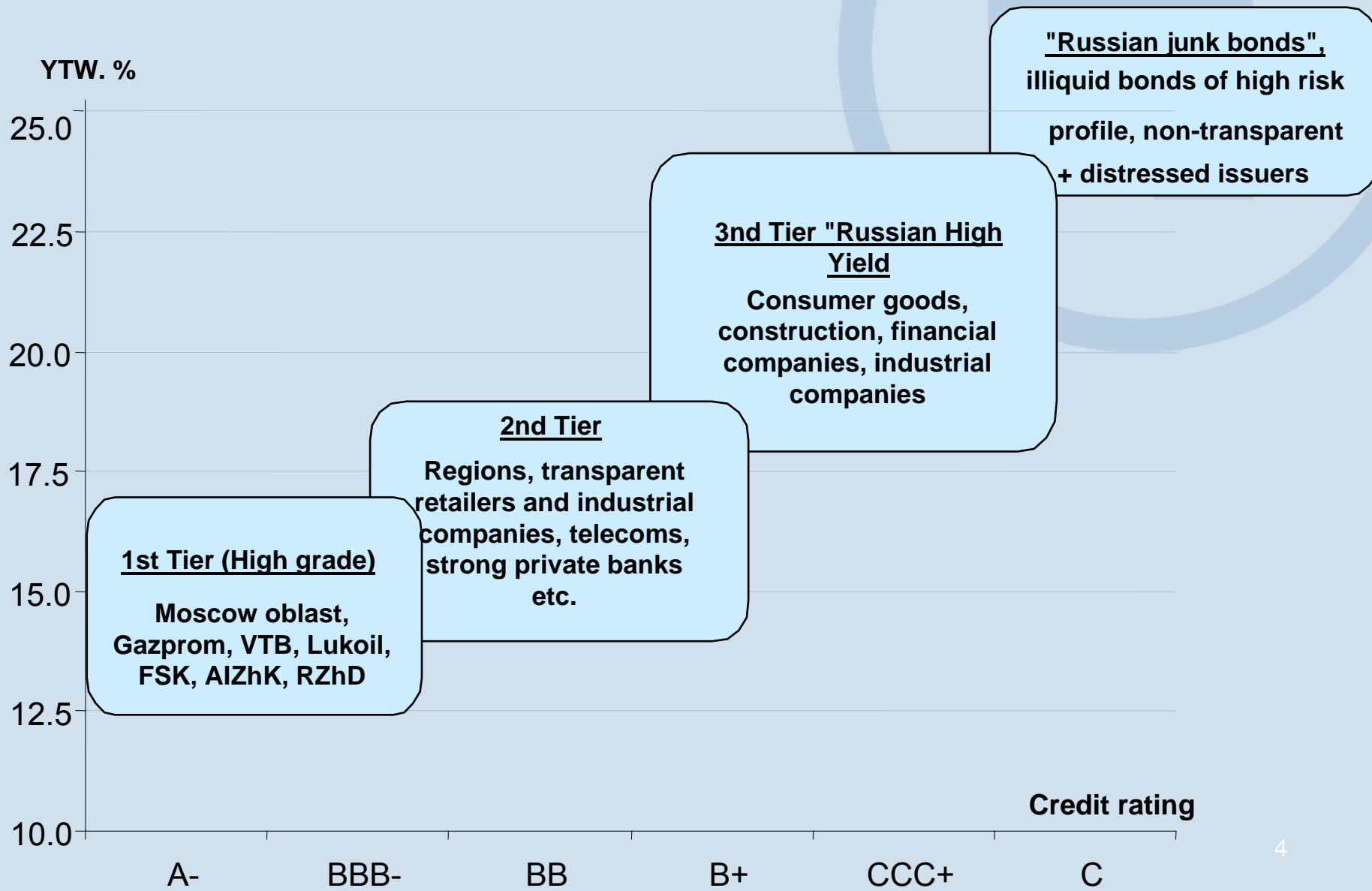
	Emission volume, bln.RUR	Number of issues	Avg. duration	YTW,%*	Avg. issue volume bln. RUR
1st Tier	559	57	2.00	9.71%	9.8
2nd Tier	819	268	1.21	10.41%	3.1
3rd Tier	395	391	0.68	16.61%	1.0

* average for 1,09 - 16,09

Mid 2007

	Emission volume, bln.RUR	Number of issues	Avg. duration	YTW,%*	Avg. issue volume bln. RUR
1st Tier	285	38	2.61	6.33%	7.5
2nd Tier	525	240	1.94	7.50%	2.2
3rd Tier	410	321	1.02	10.43%	1.3

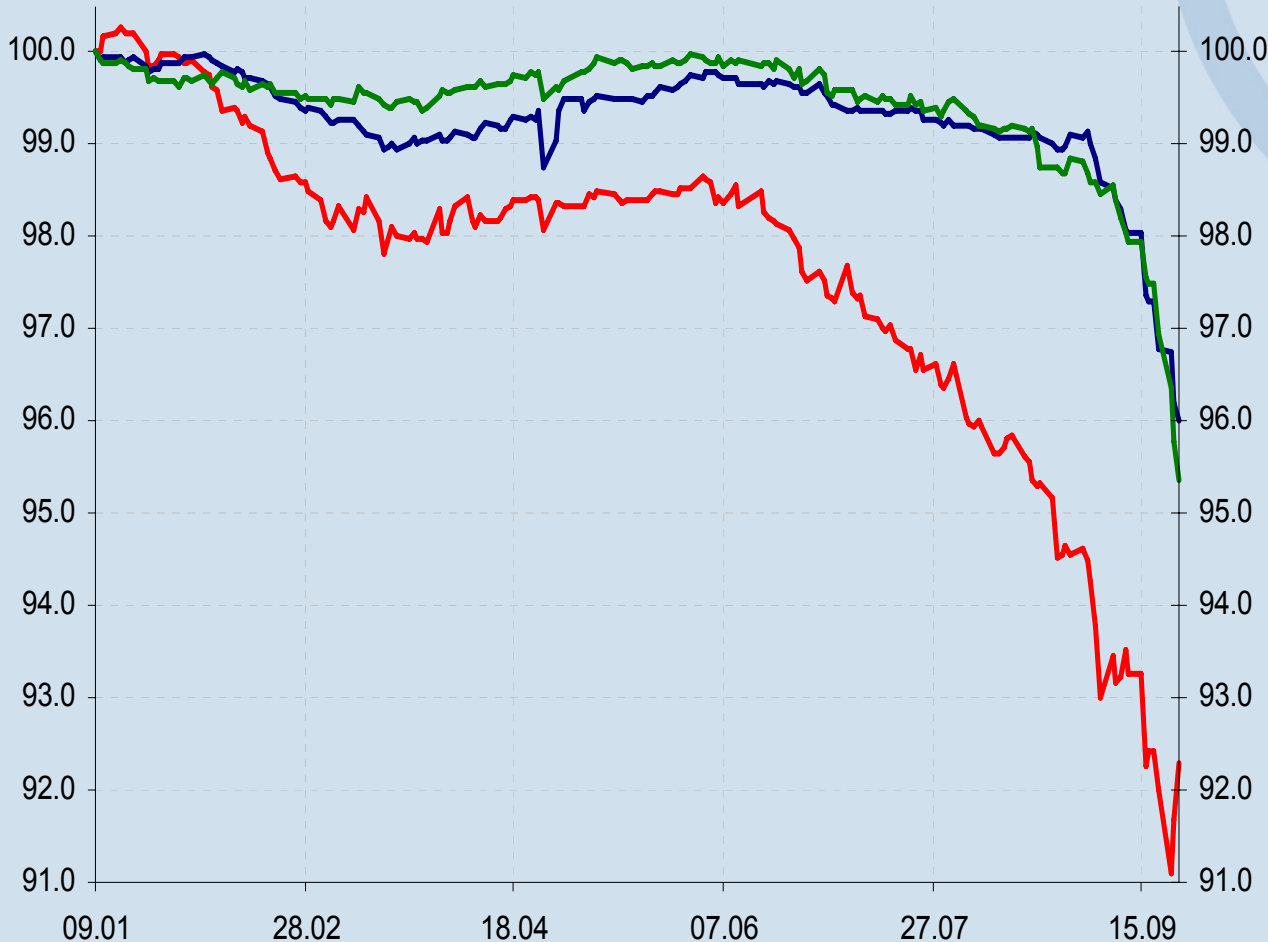
CATEGORIES OF ROUBLE BONDS (TIERS), AFTER THE RECENT FALL



MARKET PERFORMANCE, TRI

PRICE INDICES, TIERS

— TRI High Grade — TRI 2nd Tier — TRI 3d Tier



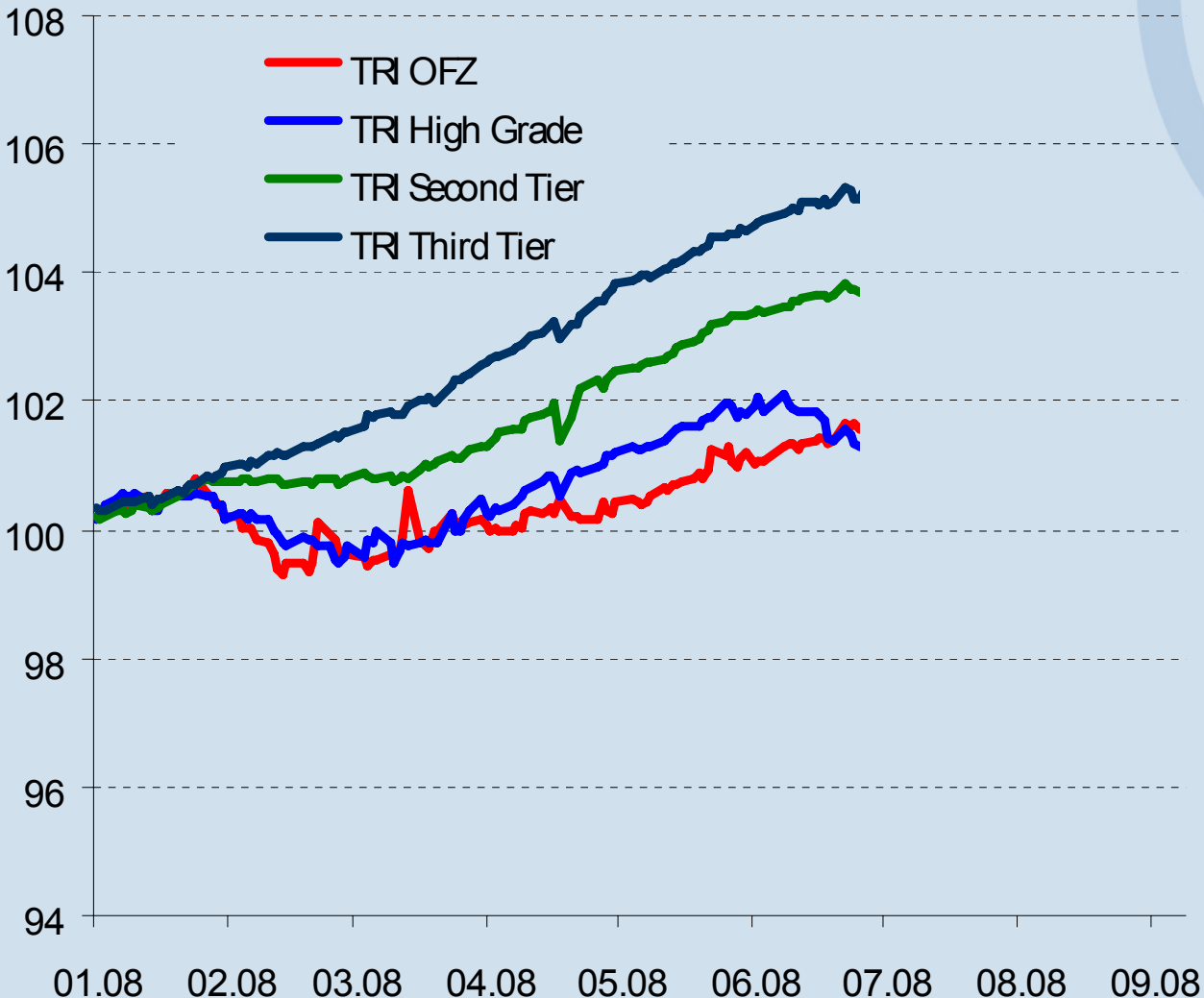
KEY TRI features:

- 45 Indices with hierarchical structure covering all segments of the rouble bond markets
- Broad base of underlying issues
- Indices can be easily replicated
- We provide full analytical and technical support of our indices

TRI Data is available:

- Bloomberg: TIBM
- Reuters: TRUSTBND
- Web-site: www.trust.ru

TOTAL RETURN, TIERS



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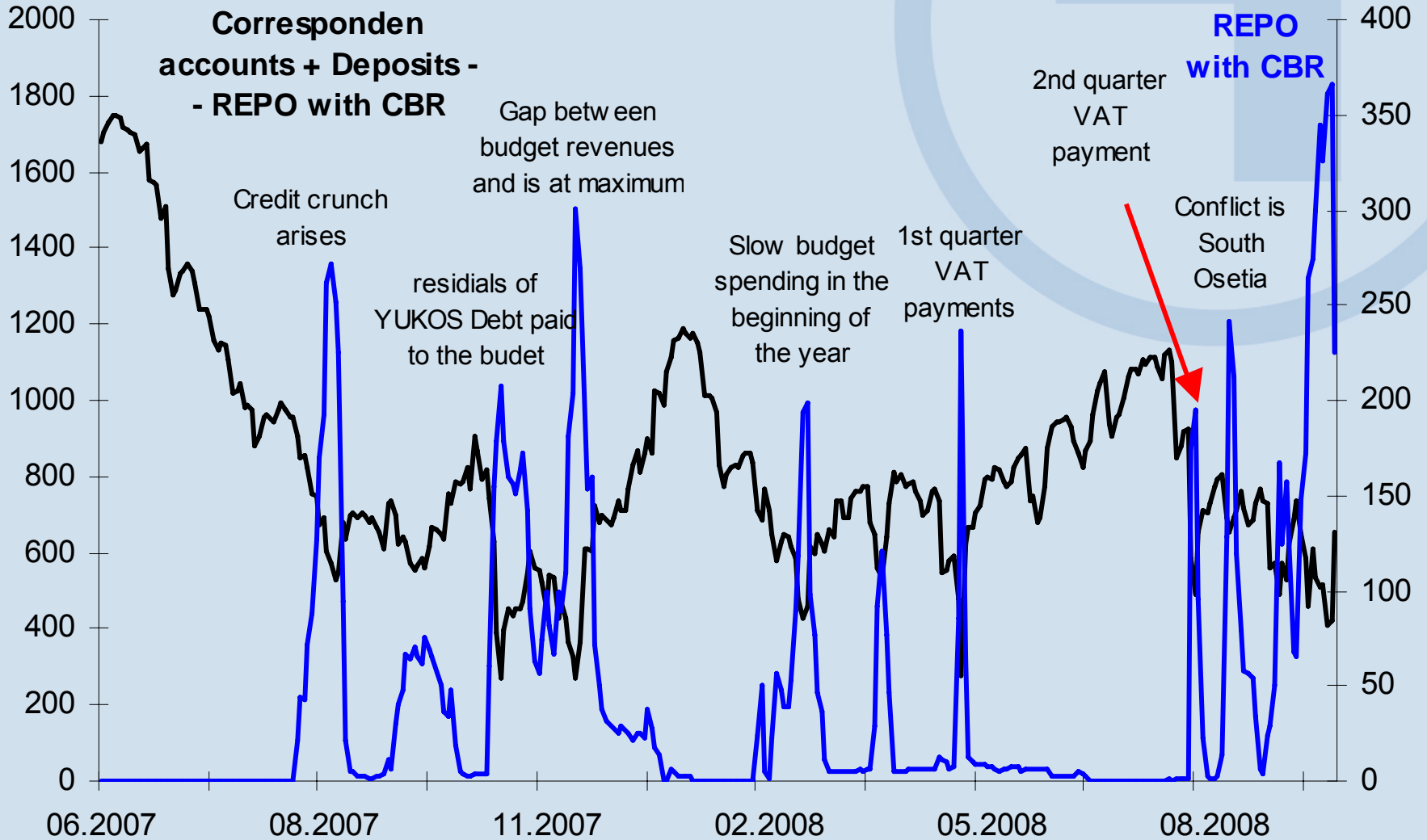
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KEY FEATURES OF THE ROUBLE BOND MARKET

- ✓ Still young, market emerged in 2001-2002
- ✓ No experience of public defaults
- ✓ **Inadequate money market regulation (e.g. absence of some king of key rate)**
- ✓ **High volatility of money market rates, “fragile” liquidity**
- ✓ Dominance of big players
- ✓ Weak connection to the world markets
- ✓ **Weak market infrastructure**

LIQUIDITY SHOCKS



COINCIDENCE OF SEVERAL INTER-DEPENDENT FORCES

External forces:

- New wave of the world credit crisis
- Falling oil prices

Internal reasons:

- Conflict in South Osetia
- Tightening monetary policy over 2008
- Slow budget spending
- Tax payments
- **Inadequate estimates of REPO collateral which is accepted by CBR and available to market**

RECENT CRISIS STEP-BY-STEP

1. Outflow of capital, enforced by the conflict in Osetia and officials rhetoric
2. Decrease in oil prices and export revenues
3. CBR interventions supporting rouble, but taking away rouble liquidity
4. Weak budget spending discipline, widening gap between revenues and spending
5. Last straw: beginning of tax payment period
- 6. CBR failed to provide enough refinance**
7. Financial institutions cut limits on, questioning credibility of each other
8. Forced sales of securities, panic
9. Trading was halted

COLLATERAL DOES MATTER!

- Not so long before the crisis CBR officials declared that they are able to provide up to RUR1000 bln. via REPO.

THIS SUM WAS ENOUGH TO PREVENT THE CRISIS, BUT:

- Although total emission volume of bonds included in the REPO list even bigger, the use of them as the collateral is limited:
 - *Before a bond is being used as a collateral it is transferred to Government securities section, which limits other operations with it*
 - *Biggest portion of potential collateral is OFZ significant part of which is held by entities which does not need any refinance (e.g. Pension Fund Managing Company)*
 - *Bond prices was significantly lower, e.g. AlZhK bonds prices was around 65-70% of face value*

MAXIMUM REPO VOLUME IS ESTIMATED AROUND RUR 360-370 bln. AND THE MAJOR RESTRICTION IS COLLATERAL!

- Other forms of refinance are not so convenient and give no more than RUR 60-70 bln.

TOO LATE BUT VERY MUCH...

It took 1.5 days to the CBR and government to adopt emergency measures to cover liquidity deficit:

- Decrease in reserve requirements below the level of beginning of 2008 (according to the CBR estimates it would release RUR300 bln from reserves)
- Decrease in rates on CBR refinance instruments, smaller discounts attached to collateral.
- Increase maximum amounts of deposits of budget funds to commercial banks (during one week Minfin deposited more than RUR650 bln)

REPO with CBR recently went below RUR70 bln. which is not even close to critical level

THE AFTERMATH...

- Liquidity will not be available to all market participants, credibility crunch is not over
- Primary market is away till the end of 2008
- Debt markets are closed for big number of issuers, and together with big number of forthcoming PUT options this means higher chance of new defaults
- Buyers market! Huge upside potential, but slow to realize as the number of market participants having long funding available is very limited
- Maybe CBR and the government learn this lesson...

LIQUIDITY...

- Budget funds are available not to everybody
- VAT tax payments are approaching
- Gap between budget revenues and spending has not reached its maximum (usually it happens in November)
- Plenty of liquidity coming from budget spending in December will be compensated by withdrawal of budget funds from deposits with commercial banks

PRIMARY MARKET TAKES LONG VACATIONS

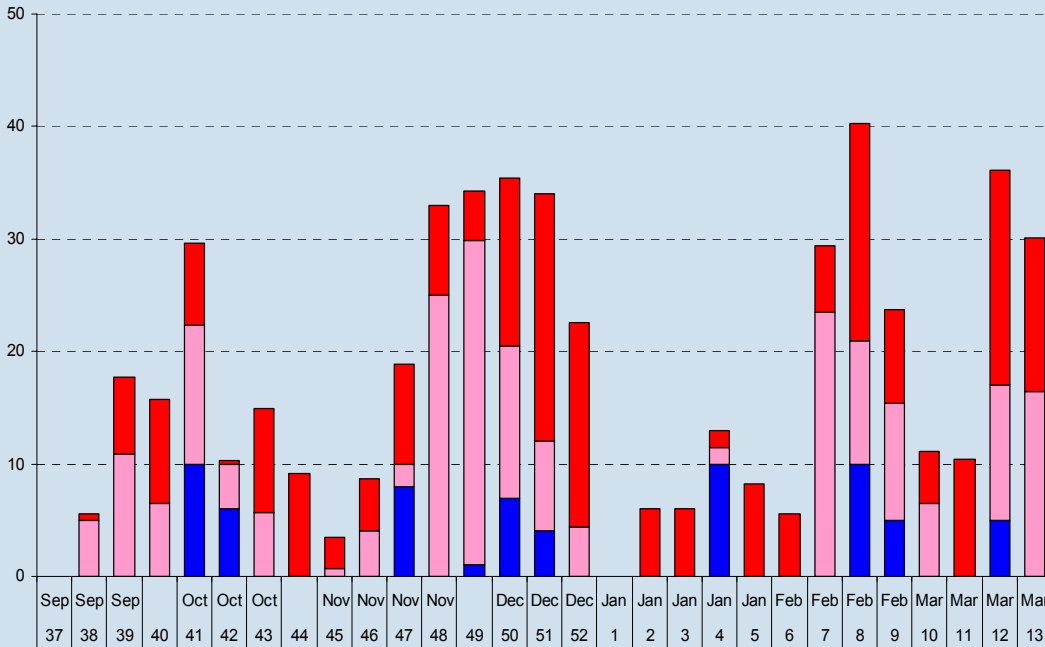
- The schedule for primary placements is empty. We do not think that in current circumstances any significant placement at a reasonable coupon is even possible. Exception is so-called “technical issues”
- New placement are expected only after yield are down to the levels of the beginning of September
- Liquidity constrains are not going to soften till the end of 2008

HIGH CHANCE OF NEW DEFAULTS

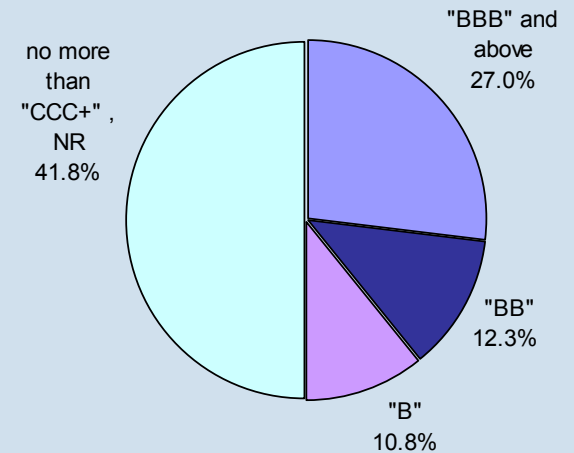
- Risk zone – 3rd tier. For big number of issuers the market was already closed in 2007.
- More than RUR290 is to redeem till the end of this year (around 17% of total emission volume of banks and corporates). More than 40% are 3rd tier bonds
- In 2008 «hidden» defaults became real: more than 10 technical defaults
- No practice of public bankruptcies. Lack of alternative ways to solve insolvency problems

Buyout schedule (up to March 2009)

■ 1st tier ■ 2nd tier ■ 3rd tier



Ratings of bonds to be redeemed in 2008



HUGE GROWTH POTENTIAL

- Yield of YTW 14-18% for REPO-list bonds is not rare
- Some high-grade bonds are traded at 70-80% of their face value
- Plenty of opportunity to buy high-grade bonds with couple-months duration and yielding YTW 12-13%

BUT:

- The potential is slow to realize, massive demand for bonds is not likely to revive soon
- Once the secondary market normalizes, new primary placements are expected

IMPROVEMENTS IN GOVERNMENT AND CBR INSTRUMENTS

- This crisis made it clear that refinance mechanisms need improvements:
 - Granting access to budget funds for bigger number of market participants
 - Enlarging REPO list, otherwise increasing REPO volume is impossible
 - Higher budget discipline



THANK YOU FOR YOUR ATTENTION!