

Russian Banks Call for Change in System to End Volatility

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SOCHI, Russia -- Russian's government must change the country's banking system if it wants to avoid the sudden price falls that have paralyzed the country's stock exchanges, senior bankers and businessmen warned at the country's annual investment forum.

"The factors that were causing the market falls are still there," said Andrei Sharonov, the head of investment bank Troika Dialog. He was speaking at a forum being held in Russia's seaside resort of Sochi as a calamitous week of stock trading cast a shadow over the gathering of politicians and executives.

The forum is intended to showcase direct investment opportunities, but when it opened Friday the market capitalization of the country's largest companies had sunk by more than a fifth in two trading sessions, running down the funds of smaller banks and brokerages, before triggering the suspension of trading for most of Wednesday and Thursday.

"Russian companies are seriously undervalued," Prime Minister Vladimir Putin told investors at the conference's opening session Friday, moments after the RTS index surged 11% within minutes of opening. That move was a response to the state's emergency plans that involve freeing up as much as \$90 billion to resuscitate undercapitalized banks, slashing taxes for oil companies and using up to \$20 billion in state money to buy shares.

"We have no systemic problems in the Russian economy. All basic economic indicators are all right," said Putin.

Russian stocks have been falling since May, but many analysts have argued that this wouldn't significantly affect the economy's rapid growth, which is expected to be around 8% in 2008. Troika's Sharonov, however, was one of several prominent speakers at the conference who argued that conditions on the country's equity and credit markets now represent a threat to the country's growth.

"The shortage of liquidity will lead to the cancellation of projects. This will have an effect on the real economy, on wages, on employment and lots of other things...it's a Pandora's box that's already opened, and we need to find a serious, long-term solution to this unpleasant, nasty smelling affair," he said.

Sharonov said the country's banking systems was to blame for the liquidity shortage, during which interbank lending was virtually frozen as banks lost trust in their counterparts' ability to repay even short-term loans.

"I don't share in the optimistic view that the Russian government can allocate large sums to three banks and then everything will be normal," said Sharonov.

For much of the week, the central bank's liquidity injections failed to get far beyond the three major state-run banks, which scaled down lending and stopped passing liquidity onto smaller banks as they have done in the

past. Russian banks' reluctance to lend to one another was aggravated by news that local investment bank Kit Finance had failed to meet its debt obligations.

Sharonov said that some Russian banks still had overdue debt even after Thursday's emergency injection of liquidity.

The World Bank's head for Russia, Claus Roland, echoed Sharonov's concerns about the concentration of Russia's deposits in the country's largest banks.

"We shouldn't forget the longer-term structural issues that are at the heart of the matter," he said.

Economists have said that Russia's current growth rate could be halved next year, and now say that the country may draw down the funds that it saved up in export taxes on highly-priced oil in order to recapitalize the banking sector.

"You better think twice before you consider to release that money short term," said Roland, arguing that the country's pension system will need the \$32 billion held in the National Reserve Fund. He criticized business leaders calling for a reduction in the rate of value added tax, saying this would require the country to forsake overdue investment in infrastructure and education.

"You can't think that it's all over and it won't come back," said Alexander Shokhin, who speaks for Russia's richest businessmen as head of the country's Union of Industrialists and Entrepreneurs.

He said that bankers in his group had been due to meet Putin Friday to discuss the banking crisis, but that this meeting had been called off in favor of the conference.

"The finance ministry can't distribute funds to all the banks because some of these banks aren't using international accounting standards and their real financial position isn't clear; they may have a lot of loans on their balance sheet that could collapse at any moment," Shokhin told journalists.

"The global crisis isn't over and we need to get investors back," said Shokhin.

During last year's conference, Russian and foreign investors put their stamp on \$23.3 billion worth of projects, this year the total was 504 billion rubles (\$20.3 billion).

Executives with interests in the country's real estate sector said their businesses would suffer from the higher cost of borrowing, but delegates representing other sectors were less concerned.

"They (the Russians) are suffering this crisis like some others, maybe a little bit more, but at the same time, they will recover. In any case, in our business, the financial crisis has no impact," said the Christophe de Margerie, the chief executive of French oil major Total SA (TOT), which is partnering with OAO Gazprom (GAZP.RS) to develop the giant Shtokman gas project in the Russian Arctic.

Source: MarketWatch