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The Russian Securities Market: It's Development and Integration in the World Financial Architecture

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1. Economic and Financial Basis of the Stock Market Development: Comparing Russia to Competing Countries

The ***degree of maturity*** of the Russian stock market and its ***potential*** within the global financial system are best assessed in relation to other markets that have comparable features, such as: size, traditions, degree of maturity and regional location. These markets are ***direct competitors*** of the Russian stock market for international capital and trading activity. We are refering here to the markets of Brazil, China, Turkey and the three Eastern European countries: Czech Republic, Poland and Hungary. Data for the comparison are presented in **Table 1**.

Table 1*

Securities Market Development: Macroeconomic Environment

Indicators	Emerging Markets - Competitors				
	China: Mainland	Brazil	Russia	Turkey	Czech Republic + Poland + Hungary
Population, mln. (2001)*	1272	172	145	66	59
World Rankings (Population)*	1	5	6	15	20-22
Life expectancy, years (2001)	70.5	68.3	65.6	69.8	71.5 - 74.9
GDP 2003 Forecast, current prices, bln. USD**	1332	457	418	209	372
World Rankings (GDP, current prices, 2001)*	6	11	16	27	17 - 18
World Rankings (GDP PPP, 2001)*	2	9	10	21	15-17
GDP Per Capita, 2003 Forecast, USD	1047	2567	2883	3167	6305
Personal computers (per 1,000 people, 2001)*	19	63	50	41	85 - 146
Macroeconomic Dynamics					
Real GDP Annual Percent Changes Forecast, 2003, %	7.5	2.8	4.0	5.1	1.9 – 3.6

*The World Bank International Comparison Program (www.worldbank.org), PPP – Purchasing Power Parity
**IMF Economic Outlook Data Base (www.imf.org)

Table 1 demonstrates that ***Russia is positioned in a cluster of large emerging markets***. It is closely aligned to ***Brazil*** (having almost identical rankings) and to an extent to ***Turkey***. Having large growth potential (in terms of GDP and population size) Russia is a developing economy in terms of living standards (closest to Brazil in terms of life expectancy) and in terms of the level of economic development (GDP per capita and number of PCs per capita are used here as an indicator). Russia and Brazil are very similar by the population size (150 and 170 millions respectively) and in terms of live expectancy (66 and 68 years). They share 9th and 10^{th} place in the global price-adjusted GDP rankings (World Bank, 2001). 25% percent of the Russian population and 26% of the Brazilian population have incomes lower than 2 dollars a day (United Nations, 2002). Russia has fewer computers and phones per capita than Brazil and fewer Internet users, but there are more doctors and teachers in Russia (World Bank, United Nations, 2000). In both countries the share of high-tech products in the structure of exports is 9-12%. The dependency on raw materials and crudely processed goods exports is high.

Socio-political systems and national ideologies of the two countries have ***many similarities*** too. For example, "the special development path", "uniqueness", "national security predicating economic development", "protection of domestic producers" are familiar slogans in Russian political lexicon that are in equal measure applicable to "the Great Brazil". For many of it citizens Brazil is a make-belief superpower. Brazil strives for the permanent membership in the UN Security Council. Like Russia it has been searching for national identity and its place in the global politics for over 200 years now.

Both countries are structured as federations; both are run as presidential republics with a considerable input from influential governors and security services, both have significant land and natural resources located in several time zones. Both have strong paternalistic tradition. As Mr Cardoso, the president of Brazil, said in 2002: "Brazilians are proud of their soul that is tropical Russian".

Macro-financial environment, that the Russian capital market is functioning in, is typical for an emerging market (see **Table 2**). Financial depth level is low (that is the saturation of economy with financial resources, which in developed countries takes on the values in the range of 60%-100% and sometimes in excess of that). Inflation and interest rates are high. Government's share in domestic credit is large. For more than two years now, the dollar/rouble exchange rate is virtually fixed, which compounded with 10-20% inflation and high interest rates, makes the economy vulnerable to speculative attacks.

Interestingly enough, in terms of macro-financial environment Russia and Brazil are fairly close too. In both countries financial depth level is low, the business relies more on debt than equity financing, shareholder capital is controlled by large stakeholders and government dominates in the process of financial resources allocation.

Table 2*

Securities Market Development: Macro-Financial Environment

Indicators	Emerging Markets - Competitors				
	China: Mainland	Brazil	Russia	Turkey	Czech Republic + Poland + Hungary
Central Bank Prime Rates, %, June 2003	3 (2001)	27	16	45	1.5 – 8
Inflation (Consumer Prices), %, 2002	0.2 (2001)	10.2	15.1	29.7	1.8 – 5.5
Dynamics of Exchange Rate (USD Per National Currency), 2001 – June 2003, %	x	USD strengthened ↑20	USD strengthened ↑0.06	USD weakened ↓28	USD weakened ↓7 - 34
Financial Depth (Money +Quasi-Money / GDP), %, 2001*	159	30	23	59	47-74
Claims on Government / Domestic Credit, %, 2001	10	40	32	70	11-32
Government Finance, 2000 - 2002	Constant Deficit	Deficit	Constant Surplus	Constant Deficit	Constant Deficit
Current Account 1995 - 2001	Constantly Positive	Constantly Negative	Constantly Positive	Variable, Mostly Negative	Constantly Negative
Capital Flows 1995 - 2001	Constantly Capital Inflow	Constantly Capital Inflow	Constantly Capital Outflow (net = 131)	Variable	Constantly Capital Inflow
Foreign Direct Investments 1995 – 2001, bln. USD	285	152	21	8	79

*IMF International Financial Statistics (www.imf.org)

An exclusively ***Russian feature*** is the permanently ***positive current account*** coincident with ***low foreign direct investment*** and ***continuous capital outflow*** from the country. As the result, Russia constantly suffers from the deficit of financial resources that are needed to modernize the economy. This pattern began to emerge in the early 90s, that is immediately after the start of the liberal reform. The cause of the problem is political volatility, heavy tax burden, distrust of the authorities in the business community and the unfavourable view of Russia by the foreign investors, as of the country imposing too high risks and costs on a business. In this respect, Russia is quite similar to Turkey, which is too perceived as a risky territory with poor conditions for the conduct of business (see **Table 2**). As to Brazil, in the absence of high oil revenues (crude oil constitutes about 2-3% of the exports) and the decade-long trade balance deficit, Brazil compensates by foreign direct investment. Brazil attracts many times more foreign direct investment than in Russia (in the 90s among the developing countries Brazil was second only to China).

As a consequence, from an investors' point of view, ***Russia is an emerging market, similar to Brazil*** in terms of the extent of the development, the size of the economy and the macro-financial environment. Russian market is, however, more risky and less attractive – it is closer in this respect to Turkey (see **Table 3**). China and Eastern European countries are in a somewhat different league, they are more mature and competitive. All indicators produced by International Institute for Management Development, World Economic Forum, Heritage Foundation, Transparency International and international rating agencies point to the fact. The only exceptions are the Human Development Ranking, where Russia does well in comparison other emerging markets, reflecting a tradition of high literacy and compulsory education and the indicators of economic freedom and human development for China which are very low.

Table 3*

Estimated Russian Risk

Indicators	Emerging Markets - Competitors				
	China: Mainland	Brazil	Russia	Turkey	Czech Republic + Poland + Hungary
World Competitiveness Rankings 2003, International Institute for Management Development	12	21	26	25	21 - 23
Growth Competitiveness Rankings 2002, World Economic Forum	33	46	64	69	40, 51, 29
Microeconomic Competitiveness Rankings 2002, World Economic Forum	38	33	58	54	34, 46, 28
Index of Economic Freedom 2003 Rankings, Heritage Foundation	127	72	135	119	35, 66, 44
UN Human Development Report 2002 Rankings	96	73	60	85	33, 37, 35
Corruption Peceptions Index 2002, Transparency International Rankings	59	45	71	64	52, 45, 33
Standard & Poor's Sovereign Ratings, Foreign Currency, June 2003	BBB/ Positive/A-3	B+/ Stable/B	BB/ Stable/ B	B- /Stable/C	A-/Stable/A-2 (CZ) BBB+/Stable/A-2 (P) A-/Stable/A-2 (H

In Russia "the level of human development" is higher (60th place in the world, Brazil is in the 73rd place, UN), and the social stratification is lower (Gene coefficient 0.35-0.4 Russia vs. 0.6 Brazil). However, the competitive capacity of Russia is lower (64th and 46th places, World Economic Forum), there is less economic freedom (135th and 72nd places, "Wall Street Journal"), corruption is higher (71st and 45th places, Transparency International). But the Russian and Brazilian credit risk ratings are close after the Brazilian crisis in 2002 (S&P, March 2003).

2. Life after the crisis of 1998: Steady Growth

The key indicators relating to the structure and dynamics of the Russian market in years 1995 to 2003 are presented in **Table 4** and **Table 5**.

Table 4*

Key Indicators of Russian Securities Industry Dynamics - I

Indicators*	1995 September	1997 September	1999 October	2000 October	2001 December	2002 December	2003 June
Market Performance							
Russian Trading System Index, 1.09.95 = 100	100	572	98	189	260	359	508 (3.07)
Financial Instruments							
Market Capitalization of Shares of Domectic Companies, bln. USD	n.a.	n.a.	n.a.	n.a.	39.7	74.8	100 - 105
Amounts Outstanding of Domestic Debt Securities, bln. USD	26.0 (December)	85.8 (December)	21.8 (December)	21.8	22.0	24-26	27 - 30
Amounts Outstanding of Promissory Notes, bln. USD	n.a.	17.4 (December)	7.8 (December)	11.9	15.2 (September)	20.5 (September)	26 - 27
Amounts Outstanding of International Debt Securities (Markets Outside Russia), bln. USD	1.2	9.6 (December)	19.3 (December)	17.7 (December)	17.3	20.8	23.3 (March)
Percentage of Russia in All Depositary Receipts Programs, 2002, %	≤ 1.0 (1995)	1.7 (1997)	3.0 (1999)	3.0 (1999)	3.0 (2001)	4.0 (2002)	4.0
Financial Intermediaries and Issuers							
Number of Companies with Shares Traded	70-80	260-300	350-400	300-350	370-400	370-400	420 - 460
▪ listed	x	100- 120	50 –60	30-35	30-35	30-35	50-60
▪ free market	x	160-180	310-350	280-320	340-370	340-370	370-400
Securities Firms	3176 (April)	5045 (April)	1628 (June)	924 (December)	618	600 - 700	600 -700
Universal Commercial Banks / Credit Institutions	2295 (December)	1764	1375	1320	1320 (October)	1329	1335
Major Stock Exchanges & Organized OTC Markets (>90% of market volume)	2 (Moscow)	2 (Moscow)	3 (Moscow)	3 (Moscow)	3 (Moscow)	3 (Moscow)	3 (Moscow)

*Bank for International Settlements, Bank of Russia, Federal Securities Market Commission, Moscow Interbank Currency Exchange, Russian Trading System, Moscow Stock Exchange, RF Ministry of Finance, Bank of New York Depositary Receipts Market Review

The following ***conclusions*** must be drawn:

- this market is extremely volatile (measuring the dynamics of more than 50 national markets shows that the Russian market is one of the most volatile in the world);
- it demonstrated steady growth, which is a trend that contradicts the dynamics of the global markets in years 2000 – 2002 (at the same time volatility inside any given year was high);
- Russian market encompasses the entire range of financial instruments common in the national and global markets (we shall note that this includes derivatives as well). Besides, it maintains a developed and stable infrastructure, including several hundred brokers/dealers, two national trading systems in Moscow, reliable depository, registration, clearing and settlements facilities covering the whole of the Russian territory;
- according to the forecasts turnover of the organised market in all financial instruments will exceed 100 billion dollars in 2003; we estimated that the Russian market will easily keep its position within top 30 markets of the world;
- and, finally, the most important conclusion is that the Russian market has stopped being an exotic frontier market. It has developed into a large emerging market, that is comparable by size, structure and risks to the major emerging markets of Latin America, Asia and Europe. International investor are accustomed to these markets and know them well.

Table 5*

Key Indicators of Russian Securities Industry Dynamics - II

Value of Trading (Main & Parallel Markets), bln. USD*	1995	1997	1999	2000	2001	2002	2003 (Forecast)
Shares	0.2 (Sept. – Dec.)	16.7 –17.0	5.7	23.5	29.0–29.3	47.6	60 – 70
ADRs & GDRs	-	-	17.1	29.5	23.2	40-45	-
Domestic Government Bonds	35.7	151.6	4.3	7.1	3.8	8.5	11 - 12
Domestic Corporate Bonds	-	0.2	0.03	0.2	0.7	3.9	7 - 8

* Main & Parallel Markets (Excluding Public Offerings & Repo Transactions). Moscow Interbank Currency Exchange, Russian Trading System, Moscow Stock Exchange, London Stock Exchange, Frankfurt Stock Exchange

The dynamics of the Russian stock market was very different from its competitors in years 2000-2002 (see **Table 6,** data by Morgan Stanley International). Against the backdrop of general market decline in the competing countries (maybe with exception of the Czech Republic) the Russian market has demonstrated the constant growth.

Table 6*

2000 – 2002: Strengthening of the Russian Securities Market, "Weakening" of the Competitors

MSCI Stock Indexes	1998	1999	2000	2001	2002	2003 26 June
Russia	64.41	222.98	155.23	237.76	270.74	381.86
China	30.36	33.38	22.63	16.74	14.03	16.15
Brazil	550.54	889.49	761.04	597.06	395.36	503.32
Turkey	133.59	460.03	247.66	164.12	93.7 September	-
Czech Republic	76.33	79.36	79.92	76.61	107.56	127.96
Poland	400.70	523.00	498.98	355.81	354.00	369.47
Hungary	291.4	322.89	233.59	209.14	269.55	266.4

*www.msci.com

As the result of the positive market dynamics in 1998-2003, the Russian market advanced on the competitor markets, which were falling throughout this period (**table 7**). Russian and Brazilian markets in shares and depository receipts came to virtually equal each other in 2002. The liquidity gap between Russia and other Eastern European countries has widened. It is only in the debt securities segment that Russia is considerably smaller than its competitors. This market has not been fully restored after the debt crisis in 1998.

Table 7*

Russian Securities Market : Catching Up With Competitors*

Indicators	Emerging Markets - Competitors				
	China: Mainland	Brazil	Russia	Turkey	Czech Republic + Poland + Hungary
GDP 2003 Forecast, current prices, bln. USD	1332	457	418	209	372
Market Capitalization of Shares of Domectic Companies, 2002, bln. USD	› 300	126.8	74.8	34.2	52.1
Total Value of Share Trading (Main & Parallel Markets), 2002, bln. USD	353	46.1	47.6	69.9	19.7
Amounts Outstanding of International Debt Securities, 2002, bln. USD	17.5	68.6	20.8	23.9	21.3 (Hungary + Poland)
Amounts Outstanding of Domestic Debt Securities, 2002, bln. USD	412.4	211.6	24-26	91.8	124.9
Percentage of Country in All Depositary Receipts Programs, 2002, %**	2.0	6.0	4.0	‹ 1.0	‹ 1.0

*IMF Economic Outlook Data Base (www.imf.org) , World Federation of Exchanges Annual Statistics, BIS, Bank of New York Depositary Receipts Market Review

Market Architecture

The market share of the ***two major Russian stock exchanges*** (Moscow Interbank Currency Exchange and Russian Trading System) constitutes more than 98% of the domestic volume of trading. Both exchanges are nationwide electronic markets, based on a continuous auction model and internet trading facilities in the MICEX's case, and on dealer market approach and quote – driven system in the case of Russian Trading System. The RTS has been modeled on NASDAQ. The stock exchanges operate in 8 time zones and attract several hundred professional market participants.

The ***key features*** of the Russian securities market architecture are:

-as a general rule, Russian companies are dominated by shareholders with controlling stakes in the company (or *stakeholders*). The ownership structure is not diversified. In this respect Russia is far from being unusual. Such ownership model is typical for all of the emerging markets, including Brazil, Turkey and East European countries;

-individual investors are very conservative in their attitudes (only 2-3% of the population name securities as their asset of choice). The general public is risk-averse due to historic and religious traditions of non-freedom and subservience to the state, several waves of emigration and wars, which have reduced the most active part of the population. As a consequence, institutional investors are rather small (their holdings do not exceed 5-10 billion dollars). As a general rule, the general public does not trust them and they can only exist in conjunction with the large industrial companies or the state;

-as a consequence, debt financing dominates. The stakeholders are not interested in raising funds by public offerings and other equity financing methods. The general public is not interested in shares. The shares are targeted by 40-60 thousands of speculative internet traders and a small number of high-worth individuals. Just five shares, rooted in oil and gas industry, power generation and telecommunications, generate 80-90% of trading volume in the domestic market. Just one share, issued by the United Energy Systems accounts for 50-55% of general trading activity;

-this approach to raising capital will be there for years to come, so the traditional banking loans and debt securities will play a major role in covering the financial needs of businesses. There are no arguments to support the proposition that venture and small caps financing will be done on the equity, IPO or specialized New Markets basis. In the past five years there was only one IPO by a domestic high-tech company. We can hardly expect that the product structure will be as innovative and that the derivatives market will be as developed as in the markets based on the American model;

-financial resources available in the market do not exceed few tens of billions US dollars. The investment deficit to modernize the Russian economy is 60-70%. This predicates the small size of the domestic financial institutions and the dependency of the financial market on external portfolio-based and direct investment;

-the calculations demonstrate that the Russian capital market belongs to the group of the most volatile markets in the world. It depends, as does the Russian economy as a whole, on the price of oil, gas and raw materials exports and on the external investors with speculative strategies. Political risks are still high (the communist party is one of the two systemic parties in Russia);

-some serious distortions in the market architecture hamper its development. The cost of regulation is too high and tax incentives are insufficient for the investors. The domestic financial market is super-concentrated in Moscow (with more than 60% of the financial resources, 40-55% of the financial institutions, about 100% of the trading activity base in the capital). A significant part of the savings is held in foreign currency cash, amounting to several tens of billions of dollars and euro. These funds are hard to incorporate into the formal financial system. As it has been pointed out earlier, low financial depth is detrimental to the ability of the capital market to attract resources. On the other hand, according to the estimates 30-40% of assets are not capital and are extracted from the formal exchange of capital assets (first of all this relates to property, land and resources of informal economy). Most of the Russia's regions are left without financial resources, as they do not have sufficient financial infrastructure. The market is infested with oligopoly (four to five brokerage companies making 60-80% of the deals). The business success in the stock market depends on how closely a broker or a bank is aligned with the state and on whether there exists personal rapport between owners of a financial institution and civil servants. A significant number of deals is based on the insider information or geared towards manipulation of the market. The market is fragmented. The conflicts of interest between a client and a broker or between a trustee and a client are routinely resolved not in the client's favor. The absolute majority of brokerage firms and banks are small financial institutions exposed to very high risk. Approximately 40% of Russian banks have statutory capital totaling less than 1 million dollars, for more than 60% of brokers it is less than 0.5 million dollars. While the securities regulation is well developed on paper, the rule enforcement is poor. Real sanctions for dishonest practices in client/broker relationships are very rarely imposed.

All of the above are typical problems of an emerging market. There is nothing horrible about them if one sets them against the backdrop of the road traveled by the market since the early 90s. At that time, there were only 10-15 people in Russia who understood how the securities markets should be organized. These days the securities industry in Russia is a highly competitive business, with the established professional community. The market puts forward ever growing demands for the quality of technology, systems of risk management and staff. It has ten-year tradition of self-regulation. The Federal Securities Market Commission (modeled on the US SEC) has a meaningful role.

Links to International Markets

By the time of financial crisis in Russia capital account was fully open to international investors. The speculative flow of hot money from abroad directed towards stock market and government bond markets had its role in creating the crisis situation. Foreign investors made up 30% of the market in government securities and 60% of the market in shares. The volume of trading in depositary receipts has exceeded the size of the domestic share markets. The Eurobond segment has been expanding quickly catering for the federal government, local authorities and corporate borrowing.

During that period the Russian securities market was completely dominated by foreign speculative investors. It was most correlated with the securities markets of Brazil and markets of other Latin American countries. In years 1995- 2002 the correlation coefficient value was over 0.9 (at the time of crisis greater than 0.95). In one of the research papers by the International Monetary Fund this was explained by the fact that the investors view Russia and Brazil as substitute countries in the international market. In both countries the position of German investors from the banking sector are very strong. August 1998 has immediately caused termination of portfolio investment in Brazil, following conversion it into dollars. A large-scale capital flight has caused an acute crisis (collapse of the share market, devaluation of the national currency, depreciation of the Brazilian bonds –then following the Russian suit - slump in the national gold and currency reserves)

Operations of German banks represent a plausible linking mechanism. Having suffered losses in Russia, German banks have closed out positions in Brazil to restore liquidity.

The Russian stock market has acquired the independence of movement in years 1998-2003. While all the markets were in decline, it was constantly growing. Some of the causes are: high crude oil prices, positive trade balance, increase of the internal demand, creation of internet trading systems for the domestic investors, which account for in excess of 70% of the trading volume in stocks. On the other hand, despite the fact that the capital account regime for nonresidents turned less liberal in the aftermath of the 1998 crisis, all the sources of influence of the international investors on the Russian capital market remain in place. Sometimes the incessant upward movement of the stock indices looks like another manipulative bubble in the making, even more so because foreign investors still largely determine the price dynamics.

What are the links between the Russian and the external securities markets? In the domestic government bond market foreign investors take up about 10% slice (data provided by the Bank of Russia). As to the stock market, the Russian trading system (prior to 1998 it was the main stock market in Russia, now it has just 5-10% market share) was set up as a market for international investors form the very beginning. The market architecture is such that while the deals are made inside of Russia, the settlement (in US dollars) takes place abroad and in particular in off-shore centers. As the result this market is fully open to the movement of speculative capital.

The central market for the depository receipts on the Russian stocks (mainly oil companies) is the London Stock Exchange (Frankfurt and Berlin are several times smaller). In London the Russian securities constitute 45% of emerging market depositary receipts turnover and one third of total volume of trading in all classes of GDRs.

What is the proportion of Russian shares in portfolios of international investors? If the composition of Morgan Stanley Capital International indices is anything to go by (and international investors often use them as a benchmark for their portfolio make up) it is 4-5% (**table 8**). In the Central and Eastern Europe portfolios, which are largely formed on the basis of Russian securities, it is approximately 60%.

Table 8*

Structure of MSCI Emerging Markets Free Index

Countries	MSCI Emerging Markets Free Index Country Weghts (as of Marsch 31, 2003)
Russia	4.9
China: Mainland	7.0
Brazil	7.7
Turkey	1.1
Czech Republic	0.6
Poland	1.2
Hungary	1.3

*www.msci.com

3. Prospects for the Integration of the Russian Securities Market in the Global Financial Architecture

By extension of analogy, the ***future of Russia*** can be judged upon the past of Brazil. Indeed there are many similarities between the countries. As it has been pointed out already, portfolio investors often perceive Russian and Brazil as substitute countries in the international markets. Many considerations in support of this point of view are mentioned above.

For over 100 years now Brazil is a market economy that is struggling to reconcile stakeholder ownership with social protectionism and with semi-transparent state dominated economy, allegiance to the West with geopolitical ambitions of its own. Brazil is a model for anticipating the financial life in Russia, itself the country, which increasingly gravitates towards Latino-Americanization. In Brazil military coups in 1930 and 1964, the seizure of power by left-wing fractions in 1961 and 2002, a succession of presidents quitting their office prematurely, cyclical movement between outward-facing principles and nationalism, between authoritarianism and democracy, between the socialist idea and the market – all of these have resulted in the burst of economic growth replaced by hyperinflation, financial crises and monetary reforms. In years 1967, 1986, 1993 and 1994 the currency was denominated 1-2.7 thousand times. The burden of the foreign debt (that is up to 40% of the GDP), interest and maturity payments of 30-60 billion USD per year, dependency on the price of exports (in years1997-2002 the world price of coffee declined 4 times and the price of sugar decline 1.5 times), dependency on the international financial aid (in the summer 2002 a 30 billion credit from the IMF has forestalled the collapse of the Brazilian and international financial market) – these are the ordinary scenes of life and the threats to the long-term stability and growth of the Brazilian financial market.

So, as to Russia, we can expect ***volatility*** in social, political, economic and financial terms multiplied by the craving for a social experiment (manifesting itself in the 20th century) and by the financial strain, inevitable if Brazil and Russia attempt reaching out for new horizons. In the next 5 on 10 years (on the upward sloping part of the new cycle) financial markets of these countries may grow in parallel, subject to the new inflow of funds and coordinated strategies of foreign investors. Fast growth may take turns with new financial crises (volatility of global prices, political risks, economic misadventures of authorities). Value of Brazilian shares increased by 700 times in between 1990 and 1999, followed by a 50% slump by September 2002. From 1995 to 1997 Russian stocks have appreciated by the factor of 5.5, to experience a 90% fall by October 1998.

Is it possible to say that political and economic system taking shape in Russia has many Latin-American features? To reach a solid conclusion this proposition must be examined further. But in relation to the securities market the similarities (if current trends are extrapolated) will manifest themselves in the following:

-Russia will develop a large emerging market open to international investors. The international investors will get used to it as they got used to the markets of Latin America and Asia; Russian securities will not be exotic anymore;

-stakeholder capitalism as the basis of the Russian economy renders it impossible for the accessible and popular retail American-style stock market to take root;

-the debt approach to financing will perpetuate itself. Debt securities will prevail over shares. The role of bank credit will remain significant. Venture financing will be largely undertaken through debt rather then equity arrangements;

-institutional and retail investors segment in ownership structure and in capital market will remain insignificant. Investor conservatism will have a full impact on the preferences for financial products;

-product structure will remain more simple than in the equity-dominated markets; prospects of derivatives markets are not impressive;

-as as consequence, the mixed securities market model will be sustained (universal banks and non-bank brokers/dealers can access the corporate securities market on even terms);

-limitations to the development of the domestic capital market will be: dependency of the financial condition of the country on raw material export prices, low financial depth, large investment deficit, wide share of the government in the domestic credit (if the oil price falls), high regulatory costs and distortions of market architecture;

-international investors will continue to hold the competitiveness of the country in the low regard.. This will result in the limitation of the direct and long-term portfolio investments from abroad;

-high market risk and high future volatility are unavoidable (this is due to the dependency on the raw material exports, speculative strategies of foreign investors, shocks coming from other emerging markets);

The largest Russian companies have already taken to looking towards the Western markets for really meaningful money. For them the domestic market is important only for getting price and credit history purposes. This is similar to the Latin-American model. The trading volume in ADRs in the US and Great Britain was in excess of 60% of the domestic Brazilian market. This indicator was 110% in Mexico and in Russia it was excess of 80%.

At the same time Russian is an exporter of capital in the long-run. Cashflows and capital of the biggest companies are often transferred to off-shore zones, leaving behind just processing and manufacturing facilities.

Therefore the scenario forecast of the integration of Russia in the global financial architecture is:

- property, cashflows, capital and trading activity in the assets of the Russian origin will continue to be transferred abroad; this will coincide with the rise of the domestic securities market and further liberalization of capital account system. Russian companies raise the biggest amounts of money abroad. The asset management centers of the Russian origin will continue to be created abroad too;

-the international segment of Russian Eurobonds, ADRs and such will be at least as important, as the market in assets originating from Brazilian and other major emerging markets;

-in the domestic market local investors will retain a significant role, especially if the oil and gas prices are falling. As in years 1995 to 1998 international investors will largely drive the price dynamics;

-foreign debt will continue to exceed foreign direct investment. This will continue to keep the Russian economy apart from the global economy. The excess of debt over FDI will point to the high financial risks and the mistrust (unlike Chinese, Latin American and Eastern European economies);

-poor capacity of the Russian financial system to protect itself against speculative attacks and market shocks, implies that Russia will have chances periodically to become the source of global financial instability (like many other emerging markets). Debt crises and as well as crises caused by speculation in share and derivative markets could occur;

-significant potential for the continuation of the Russian stock market rally remains in the mid-term. This will result in the increase of market capitalization and improvement of market performance, which will attract attention of the international investors.

These are the trends that provide framework for extrapolating of the current market model. At the same, extrapolation rarely gives correct results. Stress scenarios are: a) transition of power to the left-wing factions. The communists are the most populated Russian party, their programme includes the restoration of Stalin model of socialism while adopting nationalistic agenda, b) Europeization of Russia, demolition of new walls and barriers erected by the European Union in the process of eastward expansion.

These are extreme and opposite scenarios implying two completely different answers to the question about the integration of Russia in the global financial architecture.