

DAILY REPORT ON RUSSIA

AND THE FORMER SOVIET REPUBLICS

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RUSSIAN FEDERATION

Politics

Rebel Attacks Continue In The New Year

- The Russian military conducted three helicopter attacks on rebel positions on Tuesday destroying it, while rebels attacked Russian positions some 17 times the same day. Russia has claimed that it has taken control of the rebel republic, despite constant attack by rebels in Grozny. Rebels still maintain bases in the southern mountains. The Chechen rebel website reports that 12 Russian soldiers and two guerrillas were killed during a clash in the high hills of the Nozhai-yurt district on Tuesday. Both sides have regularly exaggerated each other's losses. The web site also reported clashes in Grozny and Chechnya's second largest town, Gudermes. Over the holiday weekend rebels killed 14 soldiers and wounded 23. Federal forces were on heightened alert Saturday in the capital, Grozny, in anticipation of possible rebel attacks in the shattered city. Civilians were leaving Grozny and Gudermes in response to rumors that fighting would intensify. More than 2,000 Russian troops have died in the 15-month campaign in Chechnya, but the failure to bring it completely under control has not dented President Vladimir PUTIN's rating in opinion polls. The President was voted man of the year for 2000, receiving 38 percent of the vote in a recent opinion poll.

Economy

Ruble = 28.52/\$1.00 (NY rate)
Ruble = 28.38/\$1.00 (CB rate)
Ruble = 26.87/1 euro (CB rate)

Russian PMI Slows

- Russia's manufacturing economy expanded further in December, but the pace of growth slowed to a 23-month low, according to *Moscow Narodny*

Bank Purchasing Managers' Index (PMI) data. The seasonally adjusted PMI, intended to give a snapshot of business conditions, registered 53.3 in December from 55.6 in November, with the slower rate of expansion largely reflecting a further slowing in the growth of export orders, the London-based bank said. "On the basis of this month's PMI, real GDP growth can be expected to ease significantly in 2001," *Moscow Narodny Group* economist Paul FORREST said. "Further easing of international competitiveness and weaker global commodity prices ensure that growth prospects are now heavily dependent on the government's ability to implement its economic programs," he said. PMI readings above 50 signal an increase in the manufacturing economy on the previous month, while readings below 50 signal a contraction. *Moscow Narodny* said the latest, albeit slower, expansion reflected further increases in output, new orders and employment.

Russia Not To Service Paris Club Debt

- Government sources today said that Russia will not service its debt to the Paris Club of country creditors in the first quarter of 2001. The Finance Ministry could not immediately confirm the reports by Itar-Tass, Interfax and RIA news agencies, which quoted sources close to the ministry. One ministry official told Reuters that Russia owed some \$1.5 billion to the Club in the first three months of this year. Russia, whose debt to the Paris Club amounts to \$48 billion, is seeking to restructure the debt. However, some Club mem-

bers, including Germany, Moscow's biggest creditor, are reluctant to offer debt relief, citing recent high prices for Russia's main exports. Germany Chancellor Gerhard SCHROEDER is coming to Moscow this weekend on a private visit during which he will meet President Vladimir PUTIN. Moscow owes \$3 billion in Paris Club payments this year, but the government has not included these funds in the 2001 budget, hoping for a restructuring deal.

December Inflation Accelerated

- Russian consumer prices rose at a faster pace in December than in November as people spent more ahead of the New Year celebrations. The State Statistics Committee said consumer prices rose 1.6 percent in December from November, after rising 1.5 percent in November from October. Prices rose 20.2 percent last month from December, 1999. Prices for food products rose 1.9 percent in December, compared with a 1.5 percent increase in November. Non-food prices rose 1.2 percent from 1.5 percent in November, the committee said. Russian inflation slowed in 2000, from 36.5 percent for the whole of 1999. The growing money supply has been the main factor influencing the rate of Russian consumer price growth in previous months, analysts said. Russian Deputy Prime Minister and Finance Minister Alexei KUDRIN Wednesday said that anti-inflation measures had been effective. He said the government, "has taken measures that work to ensure the control of inflation, the control of ruble rate and the control of money supply." KUDRIN confirmed that Russia's gross domestic product growth rate reached more than 7 percent and inflation was held at 20 percent in 2000. He predicts a minimum GDP growth rate for 2001 at 4 percent.

Business

UES Shifts ADS Program To Deutsche Bank

- *Unified Energy Systems (UES)* has announced that as a result of a December tender it will shift its American Depositary Shares (ADS) program from the *Bank of New York (BONY)* to *Deutsche Bank*. Under the ADS program Russian shares can be packaged together and traded by foreign investors on the New York Stock Exchange. Up to one-quarter of *UES* shares can legally be held by foreign investors through an ADS structure, the *Financial Times* reported. The utility company early

last year agreed to sell new ADSs in 2001 backed by about 4.8 percent of shares. *UES* spokesman Sergei PINCHUK said, "We were not satisfied with services provided by the *Bank of New York* during the several years of our mutual cooperation with the bank. There were some delays with information reaching our shareholders regarding the company's major transactions." *BONY*, for most of the 1990s, held a monopoly over ADS from Russian companies. Rivals have increased pressure on the bank following allegations of money laundering. Other Russian companies have strayed from the traditional choice of *BONY*. *MTS*, the mobile telephone operator opted for *JP Morgan* instead of *BONY* and *Aeroflot* is also on the verge of selecting *Deutsche Bank* to run its forthcoming Global Depositary Receipts program. *UES* spokesman added that the company expects the German bank will help attract new investors to the company, which requires as much as \$50 billion to modernize its equipment and utilities, PINCHUK said. *UES* shares have fallen about 65 percent since it unveiled its reorganization plan last March, Bloomberg News reported. Management has proposed splitting the company into transmission, generation and distribution companies. The transmission company would remain state-owned and dozens of generating companies would be sold. The Russian government, which owns 52 percent of *UES*, is expected to decide next month on the plan, after giving preliminary approval last month.

Russia To Close Independent Airlines

- Russia plans to close about two-thirds of the country's 299 independent airlines in an attempt to boost profit and improve safety at the remaining operators, Alexander NERADKO, director of the country's aviation authority, said. NERADKO said there are enough travelers to support as many as eight national carriers and about 95 regional operators. He did not reveal when, or how, the government planned to close the companies. The number of independent air companies operating in the former Soviet Union and Russia increased after *Aeroflot*, Russia's state airline, was broken up and lost its monopoly on domestic travel in 1991. *Aeroflot*, Russia's largest airline, was founded in 1923 and is 51 percent owned by the Russian government.

EUROPEAN REPUBLICS

Ukraine Seeks To Restructure Paris Club Debt

- Ukraine is preparing new talks on restructuring about \$500 million debt to the Paris Club of creditors to boost economic growth after the International Monetary Fund (IMF) resumed its \$2.6 billion lending program frozen over a year ago, Bloomberg News reported Wednesday. "The procedure for preparing for the talks could have begun only after the IMF resumed lending," said Vitaliy LISOVENKO, head of the Finance Ministry's foreign debt department. "Still, it may take Ukraine through the end of this year to complete an agreement because it must hold talks with each separate member of the Club," he added. He declined to comment on possible terms of the rescheduling, but said that the government could reach an agreement on terms within the next few weeks. Last year, Ukraine exchanged \$2.7 billion in foreign debt in 2000 and 2001 for new seven-year dollar- and euro-denominated bonds. Further rescheduling of the debt would help the Ukrainian economy, the government said. Ukraine's gross domestic product is expected to grow 4.2 percent this year from 2000.

Lithuanian GDP For 2000

- Lithuania's Statistics office on Friday said that the nation's gross domestic product (GDP) grew 3.1 percent year-on-year in the third quarter while the current account gap shrank 57.7 percent annually to 3.5 percent of GDP. Analysts said healthier transport and industrial sectors had led Lithuania's economy to higher than expected growth and weak domestic demand had trimmed the current account gap. In a Reuters poll, analysts expected annual third quarter GDP growth of 2.26 percent on average. The current account gap was expected to reach an average of 3.92 percent of GDP. "[This data] confirms the Lithuanian economy is recovering. The manufacturing and transport industries drove growth above expectations," *Hansabank Markets* analyst Maris LAURI said. Lithuanian GDP was flat in the second quarter of 2000 after a 6.7 percent fall in the third quarter of 1999. Nine-month GDP rose 2.3 percent, year-on-year, compared with a 4.1 percent contraction in the same period of 1999. Analysts said the growth was largely secured through an over 30 percent boom in exports over

January-September and recent euro appreciation against the dollar boded well for the economy with the litas pegged 4:1 to the US currency. Lithuania's GDP is officially forecast to rise some 2.1 percent in full year 2000 after the economy shrank 4.2 percent last year as the country reeled from the loss of its key export market in the wake of the August 1998 Russian financial crisis. Quarter-on-quarter, Lithuania's current account gap shrank to 420 million litas from 623 million litas—5.6 percent of gross domestic product (GDP)—in the second quarter of this year. "We can now say the current account deficit is no longer problem number one in Lithuania. Problem number one is now high unemployment and weak investment," said Gitanas NAUSEDA, an advisor to *Vilniaus Bank* chairman. Analysts said concerns about currency stability that shot up as the current account gap reached 11.2 percent in full-1999 will ease on the data. But they said Lithuania must pick up the pace with structural reforms if it is to consolidate its economic recovery and catch neighbors Estonia and Latvia that posted third quarter growth of 6.9 percent and 5.9 percent respectively.

SOUTH CAUCASUS & CENTRAL ASIA

Itera Resumes Gas Supplies To Georgia

- Russia has resumed gas supplies to Georgia today, after cutting the nation off on January 1st in the middle of a cold winter. Energy blackouts in the past strategically timed to coincide with bilateral negotiations, most recently in October and December, 2000, have sparked violent protests in the streets. Georgian President Eduard SHEVARDNADZE sent a letter on Wednesday to Russian President Vladimir PUTIN and Prime Minister Mikhail KASYANOV, requesting to help in resuming gas supplies to Georgia. On an instruction from the Georgian leadership, Fuel and Energy Minister David MIRTSKHULAVA on Wednesday flew to Moscow and held talks with appropriate Russian structures and departments, particularly with *Itera*, a gas trading company with close links to *Gazprom*. Prior to the negotiations, MIRTSKHULAVA said with regret, "At this moment, I have no alternative but to negotiate with *Itera*." *Itera* press service reported Georgia was acutely in need of increased gas deliveries after a number of suppliers cut off gas supplies to the ninth and tenth power-generating sets of the Tbilisi hydro-power

station which threatened not only with the stoppage of the Tbilisi power station but also with upsetting the operation of Georgia's entire power grid.

On Monday, Russia stopped its gas supply to AES' power units, irrespective of AES' advanced payments for the entire month of January. Russia's *Ineftgazstroi*, an independent gas reseller, said it will return the advanced payment. *Ineftgazstroi* said it was acting on a request from the Russian Economics Ministry, which told them they would not be supplied with gas unless they cut supplies to Georgia. According to a Georgian Foreign Affairs Ministry statement, "such circumstances directly endanger the whole energy-supply system in the country, particularly the sites of prior security importance.

Vice president of AES in Georgia Michael SCHOLEY said, "Our gas supply has been turned off on a pretext. The subtext is geopolitics," the *Financial Times* reported. Russia is using its oil and gas reserves, on which Georgia is entirely dependent, as leverage in negotiations over the withdrawal of Russian bases in Georgia, alleged Georgian support for Chechen rebels, and disputes over energy and other debts.

Socar Oil Production Increased Slightly In 2000

- The *State Oil Company of Azerbaijan (Socar)* said oil production rose by 0.2 percent last year compared with output in 1999, as increasing investment in the nation's oil industry started to take effect. *Socar* produced 9 million tons of oil (66 million barrels) last year, up from 8.99 million tons in 1999. The company's offshore fields produced 7.5 million tons of oil. *Socar* said gas production fell by 5.7 percent to 5.7 billion cubic meters last year, from 6 billion cubic meters in 1999. "*Socar* is constructing new platforms at the fields to increase oil production," said Akif NARIMAMOV, chief geologist of *Socar's* offshore oil and gas production unit. The company operates partnerships with international oil companies such as *Exxon Mobil Corp.*, *Royal*

Dutch/Shell Group, and *BPA moco* to explore Azerbaijan's sector of the Caspian Sea.

Armenia Stresses Importance Of Section 907

- Armenian Foreign Minister Vardan OSKANYAN on December 26th stressed the importance of continuing the section 907 amendment to the Freedom Support Act by the US Congress, Armenia's Snark news agency reported. The amendment bans direct US government aid, including in the military sphere, to Azerbaijan because of Baku's blockade of Armenia and Nagorno-Karabakh. OSKANYAN said that the continuation of the Section 907 has a higher priority for Armenia than cooperation with the US on issues of security. The waving or lacking of rules surrounding Section 907 could be interpreted by Azerbaijan wrongly and could play a negative role in the settlement of the Nagorno-Karabakh conflict. US Defense Secretary William COHEN in a July meeting with his Armenian counterpart Serzh SARKISYAN said that Section 907 hinders the development of military cooperation between the US and both Armenia and Azerbaijan. The US is a member of the Organization for Security and Cooperation in Europe's (OSCE) Minsk Group, which plays an advisory role in the settlement process.

Niyazov Committed To Increasing Production

- Turkmen President Saparmurat NIYAZOV said on Monday that the main task for the Turkmen leadership is to bring the amount of production per capita to \$12,000 by the year 2010. "That means that salaries will be high, people's life will improve, and there will be a lot of goods on the domestic market," NIYAZOV said in the New Year address to the nation. "Powerful economy and well-developed agriculture will ensure that," he added. The President stressed that, "GDP should grow by at least 14 to 15 percent by the end of 2001 as compared with the last year." He said oil production should reach 10 million tons, while gas production - up to 75 billion cubic meters. "We shall undoubtedly carry out

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