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## Capital and Investment Markets 2007 outlook for Russia, Ukraine and Kazakhstan

### Russia

(Source: Russian Federal Service for State Statistics, Renaissance Capital)

Foreign investors are actively coming to Russia. In the first quarter of 2007, foreign investment in Russia amounted to \$24 USD billion, according to the Federal State Statistics Service, almost three times more than the same period in 2006 ( \$8.8 billion), which in turn, was twice the level for the same period in 2005. This trend should be expected to strengthen further. Still, there is no reason for euphoria. First, less than half of all capital which came in 2006 into the country (43%) was direct foreign investment - that is to say, investment in new production facilities and services. Most of the capital inflow were loans to domestic businesses that will eventually have to be paid. Second, experts say that up to 40 percent of foreign capital inflow is Russian money that was earlier taken out of the country and invested in offshore zones. In the coming year the market expects as many as 35 Russian IPOs which will raise up to \$25 USD bln. Meanwhile residential and commercial construction is booming and consumption rates may continue growing 25-30 percent annually in dollar terms. Liberalisation of capital controls in July this year will bring more portfolio money into Russia, catalysing the development of the derivative markets. Investors in listed companies will increasingly need to look for efficiency, reduced cost and improved margins as they become more selective about which shares to invest in. Political risk will move up on the list of key factors for investors throughout 2007 and early 2008 as every election leads to market uncertainties.

### Ukraine

(Source: PricewaterhouseCoopers)

There has been a significant level of international investment in the banking and insurance sectors. Local currency (hryvnia) is pegged to the US dollar (5.05 since 2004). Consumer credit facilities are expanding rapidly. A full range of traditional banking services are available in Ukraine, although intermediation costs remain high. In November 2006, Parliament passed a law that will permit foreign banks to operate branch offices in Ukraine once Ukraine joins the WTO (expected in 2007). There are no requirements to convert foreign currency export proceeds into hryvnia. Leasing and factoring are possible, but these markets are in the early stages of development. The Ukrainian equity market has grown rapidly in the past few years. There are more than 250 traded companies, although the ten largest companies account for more than half of the market capitalisation. Despite its rapid growth, the equity market is highly fragmented, lacks price transparency, and is illiquid. It is estimated that around 90% of securities transactions occur outside the organized market. Ownership of many privatized companies is concentrated in the hands of Ukraine's six major financial groups, so the number of shares available for trading remains low. There are several stock exchanges in Ukraine. However, almost all trading is now effected through the PFTS Stock Trading System ([www.pfts.com/eng](http://www.pfts.com/eng)), which went electronic in 2005 and was finally afforded stock exchange status in June 2006. Shares, domestic and external government bonds, municipal bonds, corporate bonds, Ukrainian treasury bills, savings certificates, investment certificates and other types of securities are traded through PFTS.

### Kazakhstan

(Source: Asian Development Bank, International Monetary Fund)

High prices for hydrocarbons, ambitious structural changes, foreign investment, and political stability have spurred the economy and improved living standards in recent years. The challenge ahead is to maintain the trend and ensure equitable development. To do this, the economy needs to increase its resilience to adverse external factors and to find sources of growth beyond oil and gas. Expanding non-oil manufacturing, raising productivity in agriculture, and extending the reach of small and medium enterprises offer potential for this. One warning light is flashing though: rising inflation and rapid real exchange rate appreciation have tracked recent robust growth, and sound economic management is needed to prevent overheating and to foment private investment in non-oil activities. Intensified structural reforms will help sustain strong economic performance over the medium term. Early WTO accession, customs administration reform, and further progress in enhancing regional trade will help secure productivity gains. Many institutional investors welcome the program underway to privatize state enterprises that are presently run by various ministries. This should facilitate enterprise restructuring and enhance competition policy, areas where Kazakhstan's ranking in international structural reform indicators is relatively weak. The formation of Samruk and Kazyna, with the aim of streamlining operations and enhancing commercialization of large state enterprises and development institutions, should also help in this regard. Plans to boost the development of the securities market, which should also result in enhanced corporate transparency and governance, are commendable and the recent pickup in initial public offerings by Kazakhstani corporates—both domestically and abroad—is encouraging. However, increased availability of financing through development institutions could reduce the corporate sector's demand for funding through the issuance of equity and debt securities, thereby impeding the development of the capital market.