Forward and Futures Prices: Russia 1998[1]

1 The Situation

It was June 1, 1998, and something was happening in Russia that Julian Rigby had never seen before. As an international hedge fund manager with extensive experience speculating in risky emerging markets, Julian had seen plenty of high yield situations in sovereign debt. But the situation in Russia was different. It appeared to Julian that what was developing here was not merely another high-risk/high-reward play, but perhaps something close to a true arbitrage opportunity.

The basic facts were these: Russian T-bill rates had spiked up to 75%, the rouble was trading at about 6.2 to the dollar, and the forward exchange rate to the end of September was 7.4. Rigby Capital, Julian's hedge fund, had a cost of funds of 6% in dollars. So the fundamental equation of no-arbitrage in the forward market was not even close to holding:

$$7.4 = F \neq 6.2 \cdot \frac{1 + .75 \cdot \frac{4}{12}}{1 + .06 \cdot \frac{4}{12}} \doteq 7.6$$

In short, for every 100 million dollars the fund invested in Russian bills, it could clear around 2.7 million over its funding by simply hedging the FX risk in the forward market for a few months.[2]

Sure, the Russian government's finances were in chaos, and a default could occur at any time. But the T-bills here were *domestic* debt of the government – denominated in roubles. No matter how low its tax collections or foreign reserves, the government could always pay these off simply by ordering the central bank to print money, which it had never shown any hesitation to do in the past.

What else could go wrong?

[1] This case was prepared for class discussion at the London Business School.

[2] Buying 620 million roubles in the spot market, buying bonds and holding them to maturity yields 775 million. Selling this amount forward today turns it into 104.7 million dollars. Dollar interest charges for the period will be about 2 million, leaving 2.7 million in profit.

2 Background

Rigby Capital, like most hedge funds, conducted its non-U.S. trading through an omnibus account known as a "prime brokerage account" with an international bank in London. The bank (or "prime broker") had the capability of settling trades in nearly every organized capital market in the world through a network of correspondent banking relationships and clearing firms worldwide. The prime broker would also provide financing for its clients in every currency, making it possible for funds to transact in virtually any security in any country.

So, for example, Julian could call up any other big bank in Moscow, get a quote for a Russian treasury bill, and, if he wanted to buy it, simply give his prime brokerage account details to the counterparty and the trade would go through. He could then either procure the roubles needed to pay for the bills by engaging in a spot trade in the foreign exchange market, or do nothing in which case his prime broker would extend him rouble-denominated credit and charge him a spread over the interbank borrowing rate. Since interbank lending in roubles was relatively thin, the spreads here were quite high. So it would probably make more sense for Rigby to take the first approach and buy spot roubles himself. (If leverage was an issue, he could always borrow dollars for the spot trade at a competetive spread.) The spot rouble-dollar exchange rate was being actively managed in a fairly narrow band between 6.1 and 6.2 by the Russian central bank. Liquidity was good. The market was currently quoted 6.165-6.185.

In buying Russian bonds, the most liquid instruments were short-dated zero-coupon bills known as GKOs. The government had been sticking to a weekly financing calendar, issuing new GKOs of varying maturities through regular Wednesday auctions to refund maturing paper and finance government operations. An active aftermarket in GKOs also existed, driven by the trading of foreign investors as well as domestic banks. (The domestic government debt market is described in more detail in exhibit B. Exhibit A shows the time-series of GKO yields for six-month maturities.)

The most important step in the trade Rigby was contemplating was the FX hedge. Here there were a couple of alternatives.

1. Forward trading in Moscow was done primarily with over-the-counter cash-settled contracts called NDFs, for non-deliverable forward. Typical practice in the FX market for major currencies is to settle forward trades by actual exchange of the pre-agreed amounts of the respective currencies. NDFs worked more like financial futures, where the payoff of the contract at maturity was just computed as the net amount of dollars

one side owed the other, and then only that single dollar payment would be made. So if a forward price of 6.5 had been agreed for 100 million dollars notional, instead of swapping 650 million roubles at maturity for the dollars, the then-current value of the roubles in dollars would be computed and that amount netted against 100 million. For example, if on settlement day, the spot rate was 6.35 roubles/dollar, then the party who had "sold" the rouble at 6.5 would have a liability of 6.5/6.35=1.0236 times 100 million dollars. So he would pay his counterparty the net of 2.36 million dollars.

A key ingredient of any such cash-settled contract is the specification of how the correct spot rate would be determined at settlement date. The standard in the Russian market was to use the 11:00am closing price on the Moscow Interbank Currency Exchange (MICEX), the main electronic exchange used by Russian dealers and the central bank.

While nothing precluded Rigby from establishing relationships and trading directly with the Moscow banks, in practice it was more straightforward to deal with the major western banks, who would also quote active two-way markets for NDFs. Besides their superior creditworthiness, the western banks also offered the security of their reputational capital. It seemed safe to assume that they basically played by western rules. The same could not be said of potential Russian counterparties. One local institution had recently defaulted on its NDFs (along with all its other liabilities) and had successfully argued in court that its obligations were, in effect, gambling debts rather than commercial contracts, and hence unenforceable (See Exhibit C.)

2. A second option was to hedge FX risk with futures contracts traded on the Chicago Mercantile Exchange. These had been introduced in April, and seemed to offer even more security. (See Exhibit D.) Like all CME currency futures, these would be single-counterparty contracts, with the exchange's clearing-house guaranteeing both sides of each trade. In addition, every participant's position value was marked-to-market daily. So credit was even less of an issue. The downside was that there was not much liquidity yet in the futures contracts. Moreover, the contract settlement dates could not be chosen freely by two parties who wanted to trade with eachother. The only available settlement dates were September 16 1998, December 16 1998, and March 18 1999.

   Like the NDFs, the futures contract would settle in dollars on their final date. They too, would use the MICEX reference rate to determine the spot price at that time.

The table below shows the current prices of GKOs, and forwards and futures to different settlement dates. The bid/offer spreads represent where Rigby estimated he could actually

transact in reasonable size. (The GKO quotes are prices, not rates.)

Instrument	Last	Bid	Ask
GKO maturing 16-Sep-98	81.49	81.00	81.60
GKO maturing 30-Sep-98	79.89	79.20	79.90
GKO maturing 21-Oct-98	77.69	77.10	77.80
GKO maturing 09-Dec-98	74.45	73.70	74.70
GKO maturing 10-Mar-99	63.24	63.10	64.10
GKO maturing 07-Apr-99	61.68	61.00	62.00
NDF settling 16-Sep-98	-	7.25	7.30
NDF settling 30-Sep-98	-	7.38	7.45
NDF settling 21-Oct-98	-	7.52	7.60
NDF settling 09-Dec-98	-	7.82	7.90
NDF settling 10-Mar-99	-	8.95	9.05
NDF settling 07-Apr-99	-	9.20	9.35
Future settling 16-Sep-98	7.27	7.25	7.33
Future settling 16-Dec-98	7.87	7.85	7.95
Future settling 17-Mar-99	9.05	9.00	9.12

There were no significant stamp taxes, exchange fees or other transaction costs in these markets.[3] No, the key to putting on this trade was going to be liquidity. If Russia really did start to seriously come apart, Rigby knew all these spreads would widen dramatically, and the market would essentially grind to a halt. Of course this would also mean there would be no chance of unwinding this trade should it somehow go wrong. It would simply have to be held to the expiration of all the contracts.

Rigby didn't think that would be a problem. His fund had plenty of capital and could easily ride illiquid positions for six months or more. (As was the case with many hedge-funds, investors only had the right to withdraw funds every year, and even then had to give 90 days notice.) Besides, his prime broker would have custody of the long GKO position as well as any open forward or futures positions, and so would only demand additional capital in the event that the dollar value of the combined position lost value.

But that was the beauty of arbitrage trades. Even if there were a massive rouble devaluation, Rigby mused, the gain in the hedge would offset the decline in the dollar value of

[3]As always, the tax situation in Russia was murky. There was a recently-introduced 15% withholding tax on GKO capital gains. But foreign entities domiciled in a country which had a double taxation treaty with Russia – which Rigby was – had been exempted. Rigby's London custodian informed him that the tax had not been withheld on other clients' maturing GKOs during 1998.

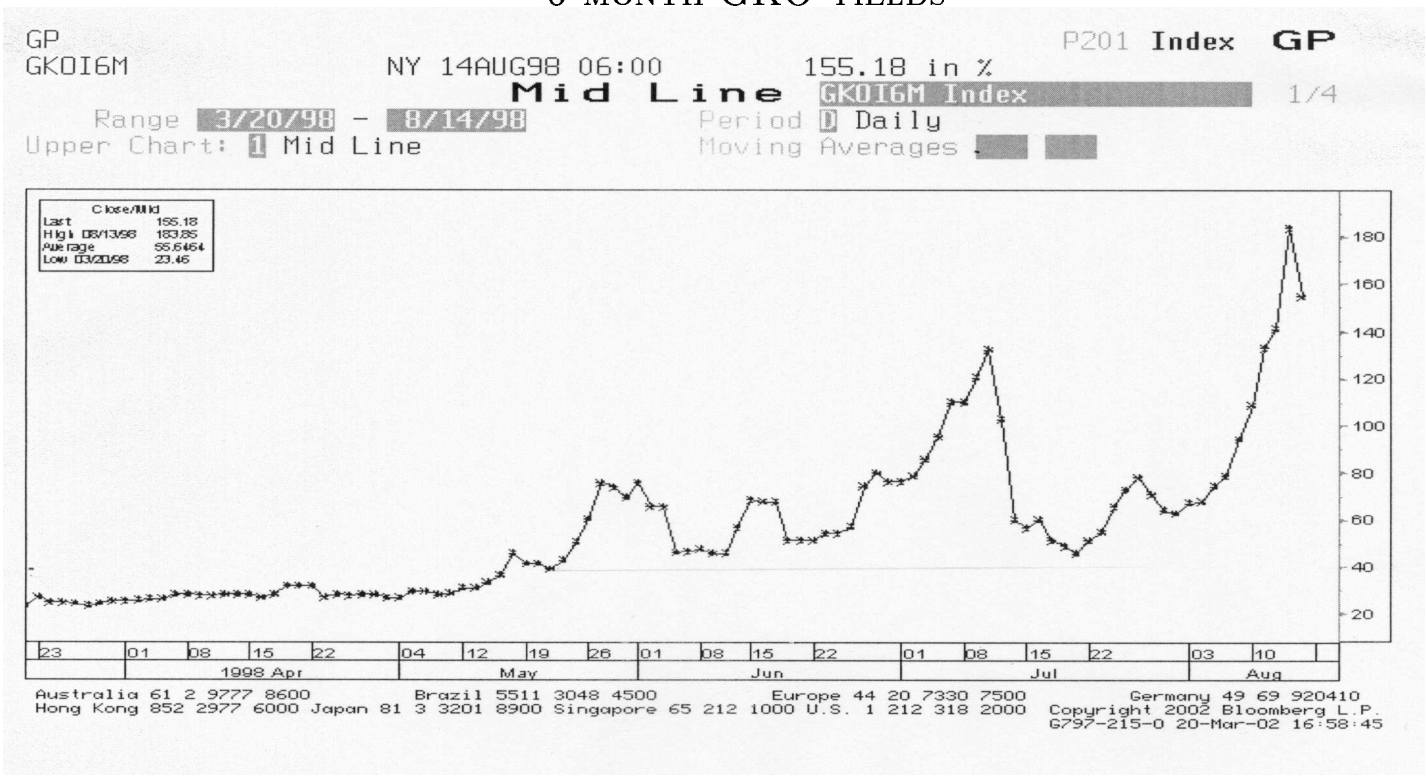
the bonds. He knew that in perfect markets there never were pure arbitrage trades. But these particular markets were anything but perfect. Theoretical relationships can and did get out of line from time to time. And the only thing that brought them back into line was the actual trading of quick, well-capitalized profesionals. Markets don't just naturally become efficient of their own accord. Somebody had to find it worth their while to make them efficient.

Well, right now that somebody might be me, Rigby thought.

3 Exhibits

Exhibit A

6 month GKO yields



Spot Rouble-Dollar exchange rate

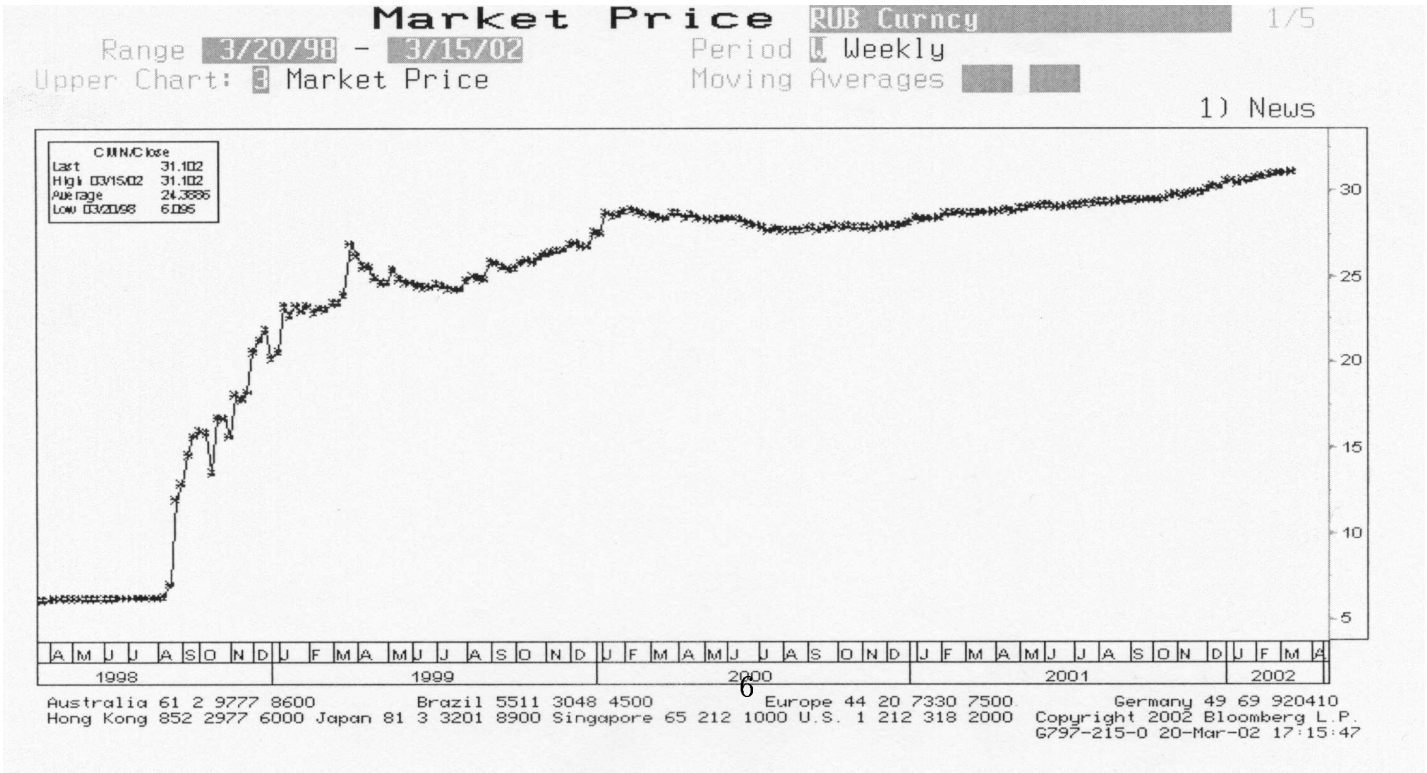


Exhibit B

GLOBAL INVESTOR
EMERGING EUROPEAN DEBT MARKETS SUPPLEMENT PG. 21-23
FEBRUARY 1998
RUSSIA'S GKO/OFZ MARKET

Overview

The most important developments in Russia in 1997 were the maturing of the securities market, the expansion of foreign investment, the country's accession to the Paris and London credit clubs as well as the upgrading of its international credit rating.

The GKO/OFZ market is the most developed and technologically advanced securities market in Russia, which was created in 1993. Over the past four years it has developed into one of the largest financial systems with more than 10 trading floors in Russia's most important regions. They include the Moscow Interbank Currency Exchange (Micex), the St. Petersburg Currency Exchange, the Rostov Interbank Currency Exchange, the Uralian Regional Currency Exchange, the Siberian Interbank Currency Exchange, the Asia-Pacific Interbank Currency Exchange, the Nizhni Novgorod Interbank Currency Exchange and the Samara Interbank Currency Exchange.

Market characteristics

One of the OSM's prime objectives is to finance Russia's domestic debt. This market is also used actively by the Central Bank of the Russian Federation (CBR) as a tool of monetary policy.

The instruments now trading on the OSM are GKOs (government short-term bonds, also known as Treasury bills) and OFZs (federal bonds).

The first issue of GKOs, worth Rb 1 billion (about $ 950,000 at the then exchange rate), was auctioned on May 18 1993. Since then, the Russian finance ministry has been constantly increasing the size of GKO issues. GKOs issued before October 28 1994 had a face value of Rb 100,000. Before the redenomination of the rouble at the beginning of 1998 their face value was Rb 1,000,000.

OFZs were issued later from June 1995. As these bonds are long term, they are less liquid than GKOs and therefore less popular with investors preferring short-term securities. Nevertheless, OFZs are attractive investments because of their quarterly coupon payments. Coupons may be fixed (OFZ-PD) or floating (OFZ-PK). These securities are also of interest to investors because, unlike GKOs and despite their long maturities, they do not carry the risk of changes in interest rates as yields on their quarterly coupons are linked to GKO yields.

There are some technical differences between GKOs and OFZs. But from the client's viewpoint these securities form a uniform structure as their yield, risk and liquidity depend solely on the terms to maturity of their different issues.

OSM participants fall into two categories: dealers and investors. OSM dealers are credit organizations and financial companies that have a brokerage licence from the CBR and a contract with the CBR allowing them to undertake transactions in government securities (GSs). Dealers may operate on the OSM on their behalf and at their expense and also perform the functions of a financial broker in concluding transactions in government securities on their behalf, but at the expense of and on instructions from investors.

There are two types of dealers: primary and secondary. Primary dealers quote 12 issues of government securities and have quotas for the purchase at primary auctions of at least 1% of the GS issue. They have other advantages over secondary dealers. For instance, they can present their quotations on the trading system, conduct repo transactions in GSs, and be authorized by the bank to handle non-residents' type S accounts. The primary dealer and authorized agent of the finance ministry on the OSM is the Central Bank of Russia. It is the holder of the main GKO and OFZ blocks and also performs supervisory functions, exerting influence on rouble liquidity and the circulation of money.

There are no restrictions on investors. They may be legal entities or retail investors, residents and non-residents of the Russian Federation. To participate in the market, the investor must enter a brokerage servicing agreement with the dealer. This agreement stipulates the procedure for acquisition, ownership and sale of bonds by the investor and also the rights, obligations and responsibilities of the parties in executing these transactions. Each dealer offers services to investors on its own conditions. No investors' transactions in GSs are allowed other than stipulated by the terms of the brokerage servicing agreement between the investor and the dealer.

Primary auctions of government securities take place every Wednesday from 11 am until 11:45am and from 2pm till 2:45pm at Micex. On the auction day, all the dealers are required to enter their bids and bids of their clients into the Micex Trading System. Bids may be of two types: competitive and noncompetitive. In competitive bids the dealer specifies the volume of securities desired at a specified price. The bond price is expressed in the percentage of the face value to an accuracy of hundredths of a percent. In non-competitive bids the dealer specifies the amount of money he is ready to spend to buy bonds at the auction weighted-average price.

The CBR may set a limit on non-competitive bids, usually not more than 30% of the total amount of bids. The value of this limit is announced together with other parameters

of the issue by the finance ministry when announcing the auction. However, the CBR may change the details. The central bank enrolls all the bids in a single list allocating them on a descending price basis. The list is submitted to the finance ministry which, proceeding from satisfied bids, determines the lowest bond selling price (reserve price) and the auction weighted-average price. Competitive bids are filled only if the bid price is not below the reserve price. Non-competitive bids are executed at the weighted-average price of competitive bids satisfied by the finance ministry in the course of the auction.

Secondary trading takes place only in the form of sale/purchase transactions through the Trading System. Trading takes place on the Micex on weekdays, except Wednesday, from lam till 1:30pm. About 40 issues of GKOs and 25 issues of OFZs are quoted during trading; the daily trading volume per trading session ranges from Rb2 trillion to Rb6 trillion ($ 300 million to $ 1 billion).

Dealers enter investors' orders for the sale or purchase of outstanding bonds into the Micex Trading System in the form of bids or offers on a real-time basis during the trading session. Each bid or offer should include the bond issue number, the type of transaction (purchase or sale), the code number of the investor on whose behalf the bid/offer has been submitted, the number of the trading account in the Micex depository, the number of bonds being bought or sold and the price (in percentage of the face value with an accuracy of hundredths of a percent) at which the dealer wishes to conclude the transaction. Otherwise this application (or part of it) is added to the list of active applications.

The momentary features of an individual issue during each trading session are: The highest bid price and the volume of active offers at this price (demand); The lowest offering price and the volume of bids at that price (supply);

The price of the last transaction; The total volume of transactions in roubles since the beginning of trading.

Usually the price is accompanied by its derivative - the yield to maturity. During one trading session prices may move substantially: usually fluctuations amount to about 0.5% but sometimes they have been as high as 4%. Once the trading is over, a weighted-average price is calculated. The price of the last transaction during the trading session is called the closing price. The characteristics of each trading session are the highest and lowest transaction prices, the highestbid price and lowest offering price of the trading session and the closingprice.

As a rule, bonds are repaid on the auction day at their face value. Before repayment, each dealer enters the required amount of bids for GSs into the trading system. After presentation of the whole volume of bonds to be repaid, the central bank enters into the trading system

a bid for the purchase of the whole volume of bonds at face value.

GKOs and OFZs

GKOs are zero coupon bonds issued by the Russian ministry of finance. At primary auctions they are priced at a discount to par. On maturity, they are repaid at their face value. The general trend in secondary trading is that they rise towards face value as the redemption date approaches. But while the bonds are being traded, their prices may fluctuate substantially depending on market forces.

Unlike GKOs, OFZs carry coupons - which may be fixed or floating. They have maturities of more than one year and coupon payments are principally made every three months. For OFZ-PDs the coupon interest rate is fixed and equals approximately 10% to 20% of their face value. OFZ-PK have floating coupons determined from GKO yields: usually the finance ministry announces the interest rate of the next coupon seven days before the coupon payment date.

The sources of proceeds for investors on the OSM are discounts (GKOs and OFZs) and the accrued coupon payments (OFZs). Additional proceeds can be derived on the OSM from managing the portfolio of GSs that have already been purchased. Yields on government securities having different maturities as a rule trend identically but the speed of changes in prices differs. The main point in management is to sell portfolio bonds with lesser yields as soon as the proceeds from a transaction begin to exceed costs and to channel the money for buying bonds with higher yields. This allows some investors to profit from short-term speculative transactions in GSs.

The OSM is characterized by high liquidity and great depth. This means that, due to a stable effective demand for government securities, it is not hard to sell large volumes of GSs on the secondary market. One of the main reason that many investors are attracted to the bond market is because they have the opportunity to sell bonds they have bought.

The OSM, being a domestic debt servicing instrument, now produces the bulk of revenues for the state. The finance ministry is ac.tively trying to restructure its domestic debt in favour of issues with longer maturities.

The OSM is closely linked with the interbank rouble credit market (MBK) and the Rb/US$ foreign exchange market. Once the level of liquidity and reliability of these markets lowers, the money is transferred to the OSM as the most reliable and liquid market. This causes GS prices to rise and GS yields to drop. The outflow of money from the MBK and the currency market is, in its turn, conducive to a rise in the interest rate. The OSM expansion also exerts upward pressure on the interest rate as some transactions in the market are credit-based.

The features of the GKO market mentioned above have fostered its vigorous development and attracted many investors. Investors are interested in the OSM because it offers them absolutely reliable placement of their assets and provides returns above the average yields on deposits (with regard to tax exemptions). It also provides complete liquidity as they may be repaid in cash within a few weekdays, if necessary.

The OSM has been accessible to non-resident investors since February 1996. At first, they were admitted to the GS primary market only as long as they agreed to invest for a term of not less than six months. Restrictions on the volume and term of investment were lifted in August 1996. Then non-residents were allowed to participate directly in both primary auctions and secondary trading through special accounts of the "S" type opened at an authorized Russian bank appointed by the CBR to carry out transactions for non-residents. After purchasing roubles the investor is free to trade their GKO portfolio actively in the same way as domestic investors. The investor can sell GKOs against roubles re-invest and switch into GKO paper of different maturities, provided that all rouble sales proceeds are credited to an S-account.

The most significant restrictions under the S-account imposed by the central bank relate to the repatriation of redemptions or sales proceeds. A minimum investment tenor is established by requiring that a dollar forward be in place for at least the last two months of the investment. The CBR set the forward rate using a formula to fix the investor's dollar return at a maximum rate of 9% per annum, down from 13% per annum initially. Overall, the forward rate received by the investor results from the combination of the 35% executed at the offcial CBR rate and the 75% executed at the market rate, the latter of which generally reflects a higher dollar yield. From January 1998, such compensating transactions are not necessary.

Special consideration should be given to the taxation of non-residents. Taxes on proceeds from sales of GKOs amount for non-residents to 15% of the whole difference between the price at which the given GKOs were bought and the price at which they were sold. The proceeds from sales of OFZs are mainly taxed at a rate of 15%. But the difference in exchange is taxed at a rate of 20%.

Foreign investors displayed enhanced interest and confidence in the OSM in 1997. Foreign investments in government securities account now for 25%. Non-residents will continue trading on the OSM which ensures for investors both high yields and sufficient reliability.

GS prices had been continuously rising since the Russian presidential election in July 1996. In mid-March 1996, yields in the GKOOFZ market reached 120% per annum. By November they had fallen to 40%. In April 1997 they ranged from 30% to 35% and in June

the yields were less than 20% annualized.

During 1997 the market value of outstanding bonds rose from Rb221 trillion to Rb330 trillion. From July until late October 1997, the rates on the OSM stood steadily at 16.5% for short-term securities and at up to 18% for very long ones (with maturities from two to three years and fixed interest).

The crisis that hit the Hong Kong and New York stock exchanges had hurt all financial markets worldwide. The OSM was no exception. Prices fell as a result of the sale of large portfolios of GKOs and OFZs by non-residents and payment of margin calls by Russian banks on Eurobonds and external debts of the Russian Federation. There was a surge in the weighted-average yields on GSs between November 1 1997 and December 1 1997. They rose from 18% to 36% annualized, reaching even 45refinancing rate was raised from 21% to 28% and the Lombard rate from 28% to 36%.

In December 1997, the government securities market began to steady, implying that the market is emerging from the crisis. An almost month-long continuous rise in yields on the secondary market came to an end and the trend reversed. In the last week of 1997 the yields were moving either way but there were no abnormal ups or downs. This suggests that the market is calming down.

The particular number of the GKO or OFZ issue is of no great importance at present as it is always possible either to hold it until maturity or to play on the market. In the first case an investor's income is known in advance and guaranteed by the state (investment income) and in the second case the income may be higher or lower depending on the dealer's experience (speculative income). Market professionals always derive higher incomes than the market average at the expense of less experienced participants and investors' unconditional bids and offers. That is why in estimating the OSM investment yield, one should never forget the possibility of deriving speculative incomes by entrusting a professional market operator with the management of your portfolio. You can always appraise the efficiency of such management by comparing the derived income with the market average yield.

The OSM will remain in perspective the most active sector of the financial market and the largest by the sizes of investments and yields. The emergence of new instruments, such as repo transactions, Lombard credits, GKO futures contracts and opening of the OSM stock section will open up new vistas for the development of business in this market sector.

A special report by Natalia Shinakova, Dealer, Inkombank

Exhibit C

FINANCIAL TIMES (LONDON)
JULY 6, 1998, MONDAY

RUSSIA SEEKS TO DEMYSTIFY DERIVATIVES

Investors in Russia who have seen share prices rise 105 per cent in 1997 and drop 64 per cent so far this year may regard the market as little more than a casino. The Russian courts have been inclined to agree.

In April a Moscow court ruled that some forward contracts were best viewed as gambling contracts under chapter 58 of the Russian civil code, and were therefore not enforceable under local law. The court appeared to fear that Russia's new capitalists would turn into crazed Dostoevskian dissolutes who would wreck their lives betting on imponderables.

Russian lawyers are not alone in questioning the complexities of derivatives trades. It was not so long ago in the UK that Hammersmith and Fulham council's foray into the swaps market was deemed ultra vires. But the Moscow court's decision has caused something of a headache for foreign investors anxious to hedge their rouble assets, and has deterred much-needed capital inflows.

To help clarify the situation the central bank has stepped in to demystify capitalism for Russia's lawyers.

It has written to the supreme arbitration court explaining why forward contracts are a legitimate part of the banking system.

The bank has also instructed its branches to react to breaches of forward contracts as seriously as they would to non-fulfilment of any other contract. Offences could lead to on-site inspections and, in extreme cases, the revocation of banking licences.

"We are demonstrating that we regard this market as a very important and integral part of the Russian financial system," said Denis Kisilyev, deputy chairman of the central bank. "I think as soon as we have got a proper ruling from the court it will improve the quality of the market itself and restore the confidence of investors that they can hedge rouble assets."

Bruce Bean, a partner at the Moscow office of the Clifford Chance law firm, said the court's original decision related to "non-deliverable" forward contracts, which do not lead to any exchange of an underlying asset.

"You and I can bet about what time Yeltsin comes out of the Kremlin. That is not deliverable. That is a bet," he said.

"You can see the court's argument that forward contracts are a similar gamble. But they are done all over the world and they should be done in Russia. The central bank is absolutely right."

How much the bank's actions will help salvage Russia's battered financial markets is another matter.

Denis Smyslov, Russia investment director at Global Fund Management, said: "I do not think this will have a major impact on the markets, which are still afraid of a devaluation. But at least it shows the central bank is eager to develop the necessary infrastructure."

John Thornhill in Moscow.

Exhibit D

Financial News

April 20, 1998

Custody & Settlement: CME helps rouble onto world stage

The Chicago Mercantile Exchange will start trading the first derivative contracts on the rouble outside Russia this week when it launches futures and options on the currency, writes Nick Hasell.

The rouble is expected to emerge as one of the world's most traded currencies over the next few years following the disappearance of European currencies into EMU and the increasing stability and growth of the Russian economy.

Both futures and options contracts will be traded almost continuously around the clock, from 7.20am to 2.00pm Chicago time on the CME trading floor, and between 2.30pm and 7.05pm on the exchange's Globex electronic after-hours system.

The contracts are quoted as US dollars per rouble with the settlement price fixed against the rouble/dollar rate on Micex, the Moscow Interbank Currency Exchange.

Richard Deitz, managing director of fixed income at Renaissance Capital in Moscow, said that although there is already an active market in rouble derivatives in Russia - in the form of non-deliverable forwards (NDFs) - its development had been held back by counterparty credit concerns and the lack of price transparency.

Deitz described the easing of counterparty concerns through use of the CME as "the single strongest argument" for the introduction of the new contracts.

But some derivatives traders have expressed concern at the potential manipulation of the Micex, based on its current erratic movements on days when rouble NDF contracts expire.

The launch is part of the CME's continuing strategy to list a range of products on emerging market currencies.

It already lists contracts on the Mexican peso and Brazilian real.

M2 PRESSWIRE

JUNE 2, 1998

CME'S RUSSIAN RUBLE FUTURES TRADING ACTIVE, SETS RECORD IN OPEN INTEREST

Open interest in the Chicago Mercantile Exchange's (CME) Russian ruble futures contract broke new records and neared the critical 5,000 contract open interest level on Friday following less than six weeks of trading.

During the past week, open interest in ruble futures increased nearly 50 percent, growing from 3,351 contracts at the close of business May 22 to 4,952 contracts at the close of trading May 29.

"We are excited about the enthusiastic reception that our Russian ruble contract has generated during the first month and a half of trading," said CME Chairman Scott Gordon. "From the outset, we expected that growing international involvement in the Russian economy would translate into strong demand among the financial community for this type of risk management tool."

CME President and Chief Executive Officer Rick Kilcollin said, "There is obviously a great deal of need at this time to hedge exposure in Russian financial markets. The 5,000 contract open interest level is often the key liquidity threshold for larger institutional investors to enter a market. We're very pleased by this strong, early showing."

Thus far, ruble futures have had the fastest growing open interest of all currently traded CME currency contracts - surpassing even the popular Mexican peso contract.

During the past week, as volatility in Russian financial markets increased, average daily trading volume in the ruble increased nearly threefold from about 250 contracts per day to 767 per day. The highest single day of trading in ruble futures occurred May 28, when 981 contracts changed hands.

Trading volume in the contract also recently set a trading record on the CME's GLOBEX electronic trading system.

Gordon noted that on many days electronic trading of ruble futures on has accounted for one quarter to one third of all trading, and that on one recent day the majority of ruble trading was on GLOBEX. Time in Moscow is typically nine hours ahead of Chicago.

The Russian ruble contract is sized at 500,000 rubles, which at present day exchange rates is equivalent to $81,000.

Trading on Russian ruble futures and options on futures started at the CME on April 21, 1998, when Alexander Potemkin, Deputy Chairman of the Central Bank of the Russian Federation, rang the bell on the opening of trading. The products were the first ruble futures

and options contracts available on an exchange outside of Russia.

The CME's ruble futures contract cash settles to the reciprocal of the Moscow Interbank Currency Exchange's (MICEX) Russian ruble per U.S. dollar spot market rate on the 15th calendar day of the contract month.