Emerging Europe: Rosy Russian Indicators Mask Delicate Situation --- Foreigners Are Buying Debt In Bid to Escape --- Factors Causing Economic Growth Are Ephemeral, Analysts Say

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MOSCOW -- Foreign investors flocking into Russia's stock market take note: Holders of the country's debt are paying the government to get out.

Two auctions of Treasury bills, or GKOs, over the last two months have been so heavily oversubscribed that yields on the debt were negative -- meaning that investors essentially are paying for the privilege of lending it money.

But it isn't enthusiasm for Russian markets that has drawn investors. Rather, it is a clause allowing investors to get their money out when the bonds mature.

More than 18 months after Russia defaulted on GKOs that then were valued at around $40 billion (41.17 billion euros), foreign holders of the bonds have been stuck with the money under central-bank rules requiring them to keep proceeds in the country for a year. The new bonds provide an exit route.

"These people are all captive," said Bruce Gardner, head of debt trading and advisory at Renaissance Capital in Moscow.

"They have no choice. No new money is coming in because people are trying to get their money out."

Even Russian investors -- who make up the bulk of the buyers of the recent GKO offerings -- aren't necessarily buying because of the desirability of the instruments. Instead, there is a lack of alternative short-term instruments in which to park surplus rubles.

This debt-market situation is in sharp contrast to the local equities market, where foreign inflows have fueled a 27% rally in Russia's benchmark index so far this year.

On the surface, the stock market looks rosy. With oil prices near 10-year highs, Russia's economy grew by more than 3% last year and government coffers continue to swell.

Many investors expect conditions to look even more promising after the March 26 presidential elections.

But analysts and bond traders caution that the conditions powering the country's economic growth -- high oil prices and the residual effects of the August 1998 ruble devaluation -- are ephemeral. Neither factor can sustain economic growth indefinitely, they say.

Russia also faces a host of structural problems, including a crippled banking system and a pervasive web of debt nonpayments. Consequently, the equilibrium remains precarious, as investors wait to see how the country's new leaders intend to govern.

"Russia is still a fairly marginal part of the investor universe," said Sergei Voloboyev, Eastern Europe economist at Credit Suisse First Boston in London. "It's still volatile, and the pain from the 1998 crisis still hurts."