

AB-ICI 2005: Boosted by IPOs

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Investment Summary

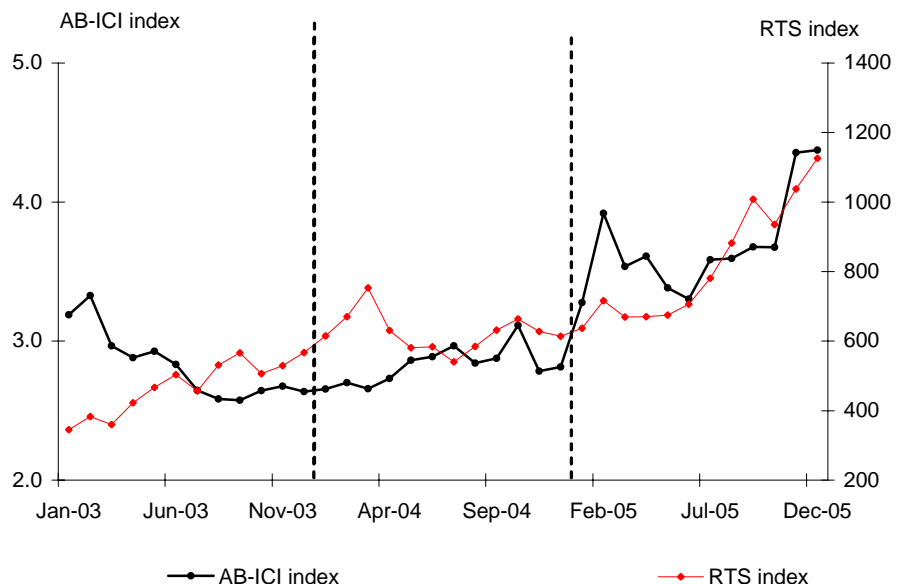
- IPO boom was the major factor behind 55% growth in the AB-ICI in 2005
- Liquidity outlook for 2006 is positive thanks to fiscal easing and capital inflows

IPO boom was the major catalyst in 2005

AB-ICI rose 55% in 2005, mainly due to 11 IPOs

The Alfa Bank Investor Confidence Index (AB-ICI) increased by 55% during 2005, the fastest growth rate since 2001. While the 90% jump of the Index in 2001 was mainly based on rapid recovery of economic confidence, such as capital and deposit growth, in 2005 the increase reflected the maturation of capital markets. Eleven companies launched IPOs in 2005, and the Russian market now offers ways to invest not limited to the oil and gas sectors.

Figure 1. AB-ICI: Up 55% in line with equity market growth



Sources: New School of Economics, Alfa Bank

Index growth could have been faster had monetary sterilization been less active

We also believe that the Index's recovery was constrained by excessive sterilization of the monetary mass by the Stabilization Fund, which reached 7.3% of GDP as of the end of 2005. Banking liquidity in 2005 did not improve compared to a year ago, which clearly prevented banks from increasing lending operations. As a result, the loans to GDP ratio remained unchanged at 24% of GDP.

Banks are leveraging GDP growth to a greater extent; retail loans remain at 4% of GDP

Like the equity market, banking activity is also diversifying. The share of the oil and gas segments is declining, while exposure to retail loans is up to 4% of GDP. Russian banks financed 40% of consumption growth in 2005 versus only 22% in 2004. The future performance of the AB-ICI seems strictly related to the degree to which banks leverage GDP growth.

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**Positive liquidity outlook for 2006**

We remain optimistic with regard to fundamental growth of the AB-ICI in 2006 for a couple of reasons.

Fiscal easing will help Index growth in 2006

As we mentioned in our 2005 notes, the federal budget is now accumulating the Stabilization Fund at a slower pace. Hence with more money available to finance growth, the financial markets will also benefit and are expected to show strong performance.

Strong ruble is boosting capital inflows

The ruble's current appreciation is another reason to be optimistic with regard to the Index dynamic. A strong ruble traditionally favors capital inflows to Russia, as it fuels the return on domestic markets. In 2005 Russia already recorded a very encouraging net capital inflow of \$0.3 bln, marking the first such annual inflow since the beginning of post-Soviet transition. In our view, the 2006 figure may be even higher.

The G-8 summit in St. Petersburg this summer will attract an international focus to Russia

We also expect the dynamic governing the AB-ICI as well as the financial markets in 2006 to strongly depend on Russia's international profile, which is now expanding. The G-8 summit in St. Petersburg this summer will attract an international focus to Russia and could result in deeper penetration of foreign companies to the Russian market should the Cabinet be prepared to improve the investment climate. On the other hand, if the Cabinet fails to respond to foreign interest, the market could become volatile and FDI remain poor.

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