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AB-ICI: Index Drop on Lower Savings

Natalia Orlova (7 095) 795-3677 NOrlova@alfa-bank.com

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Investment Summary

- **AB-ICI declined by 1% due to poor export revenue sales, hence lower CBR reserves growth**
- **Index is negatively reacting to decline of savings ratio, but lending helps consumption boom**

Long January holidays depressed the Index

AB-ICI declined 1% in January,…

The Alfa Bank Investor Confidence Index (AB-ICI) declined by 1% in January, reflecting that month's extended holiday period.

…reflecting poor export revenues,…

- The Index's **economic confidence** declined, reflecting the slow increase of CBR reserves. We attribute this to the poor trade balance figures resulting from the modest repatriation of export revenues in January, which is seasonal in nature.

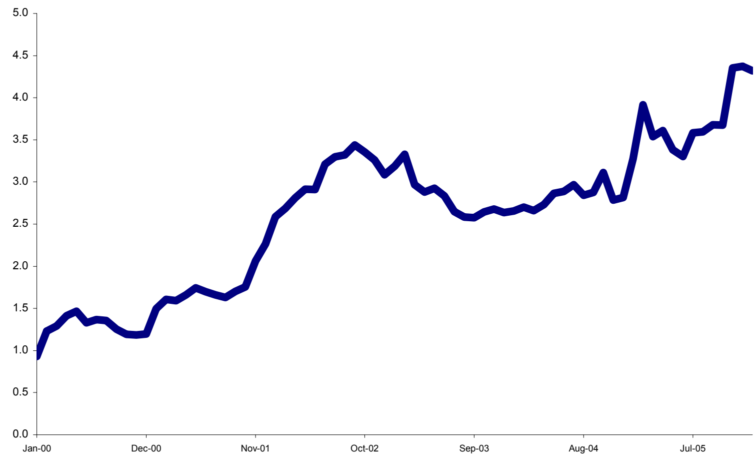
…flat foreign confidence…

- **Foreign confidence** indicators were unchanged.

…and a modest increase in market confidence

- **Market confidence** increased, as Russian assets continue to attract fund inflows despite market valuations no longer being cheap.

Figure 1. AB-ICI declined by 1% in January due to extended holiday period



Sources: New School of Economics, Alfa Bank

Only 32% of Russian population holds banking deposits

The most interesting finding was that Russia is entering a period of declining savings, which may have a negative impact on the economic component of the Index. Meantime, the financial markets are likely to benefit, as a lower savings ratio mirrors the consumption boom.

A recent poll conducted by the Deposit Insurance Agency (DIA) indicates that the public is becoming more informed about the deposit insurance law – 35% of respondents in 2005 were aware of it versus 30% in 2004. However, this had no effect on the share of the population holding accounts in the banking system – depositors represent the same 32% of the population as a year ago.

60% of Russian savings remain outside of the banking system and financial markets

One problem is that Russian households either invest outside of organized financial markets or keep their savings "under the mattress" (see Figure 2 below). Of the nearly $19 bln in annual savings regularly flowing outside of the banking system and staying in cash, some $10 bln in household savings could potentially be attracted to banking deposits, according to the DIA.

Figure 2. Structure of Household Savings

	Russia	Poland	Spain
Bank deposits	38%	60%	46%
Securities	1%	20%	16%
Investment funds	0.5%	10%	30%
Life Insurance	1.5%	10%	8%
Real estate	26%	-	-
Other instruments (gold etc)	1%	-	-
Cash	32%	-	-

Sources: CASE, ADI, Alfa Bank Research

Only 5% of depositors seek 3-year deposits; maturity remains very short-term

Another obstacle is the strong preference for short maturity of deposits. One fifth of depositors favor deposits with maturity of between nine months and one year, and only 5% prefer to save for more than three years. This implies that banks will have a hard time financing long-term loans needed by Russian companies to invest.

Sberbank still controls 55% of retail deposits as of end-2005

The third problem is that the market share of state banks is gradually declining. While Sberbank's share of deposit taking dropped from 59% a year ago to 55% by the end of 2005, the largest state-owned bank still controls more than half of the market. VTB has also been expanding its presence in the deposit market via organic growth and local acquisitions.

33% of the population received banking loans during the past three years

The poll also sheds some interesting light on lending preferences. Some 48% of respondents believe that now is not the time to increase savings, but rather to spend. Over the past three years some 33% of the population received banking loans, most of which were linked to consumer credit, as mortgage loans were taken by only 1% of the population.

In 2005 retail loans increased 80% y-o-y, while retail deposits grew only 30% y-o-y

We believe that the population's strong preference for lending vis á vis deposits is also confirmed by banking data. Annual growth in retail loans for 2005 is expected to reach some $18 bln, up more than 80% y-o-y, while the annual increase in retail deposits will total some $23 bln, a rise of 30% y-o-y. In 2006 households are likely to become net borrowers, i.e. contributing less to banks than they take to finance consumption.

Contact Information

Alfa Bank (Moscow)

Head of Equities	Dominic Gualtieri
Telephone Facsimile	(7 495) 795-3649 (7 495) 745-7897

Research Department

Telephone Facsimile	(7 495) 795-3676 (7 495) 745-7897
Head of Research, Telecoms	Andrei Bogdanov
Strategy	Chris Weafer; Erik DePoy
Oil & Gas	Nadia Kazakova CFA, Anisa Redman, Konstantin Batunin
Macroeconomics, Banking	Natalya Orlova, Svetlana Kovalskaya
Utilities	Alexander Kornilov
Telecoms	Andrei Bogdanov; Svetlana Sukhanova
Metals & Mining	Vladimir Zhukov, Natalya Sheveleva
Consumer Goods, Retail, Media	Svetlana Sukhanova; Elena Borodenko
Russian Product	Angelika Henkel; Vladimir Kravchuk
Fixed Income	Ekaterina Leonova; Marina Vlasenko, Denis Pryanichnikov
Technical Analysis	Vladimir Kravchuk
Editorial	Erik DePoy; Brendan Franich
Translation	Rinat Gainoulline
Production	Brendan Franich, Dmitry Taskin, Elina Kulieva

Equity Sales & Trading

Telephone Facsimile	(7 495) 795-3712 (7 495) 745-7897
International Sales	Kirill Surikov, Mikhail Shipitsin, Shani Kogan, Bryce Meeker
Domestic Sales	Oleg Martynenko; Alexander Nasonov; Konstantin Shapsharov; Dmitri Sadoviy
Address	12 Akad. Sakharov Prospect, Moscow, Russia 107078

Alfa Capital Markets (London)

Telephone Facsimile	(44 20) 7588-8500 (44 20) 7382-4170
Sales	Maxim Shashenkov; Mark Cowley
Sales Trading	Steve Downer
Address	City Tower, 40 Basinghall Street, London, EC2V 5DE

Alfa Capital Markets (New York)

Telephones Facsimile	(212) 421-8563 / (1 212) 421-7500 (212) 421-8633
Sales	Sabrina Ricci, Roman Kogan, Scott Licamele
Sales Trading	Harold Warren
Address	540 Madison Avenue, 30th Floor, New York, NY 10022