AB-ICI: Depressed by Weak Deposits Growth

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Investment Summary

- The Alfa Bank Investor Confidence Index (AB-ICI) down 1.2% on weak deposits
- Despite weak funding, banks kept strong $17 bln corporate loans growth in January

The AB-ICI down another 1.2% last month

AB-ICI down 1.2%

The AB-ICI index declined another 1.2% last month, reflecting a sharp drop in economic confidence.

Economic confidence weak as retail deposits down $0.7 bln in January

- **The index's economic confidence indicator** was sharply down, even though capital outflow decelerated and the CBR reserves reestablished fast growth. The main bad news was the drop in retail deposits by around $0.7 bln in January, and also the increased share of currency-denominated deposits;

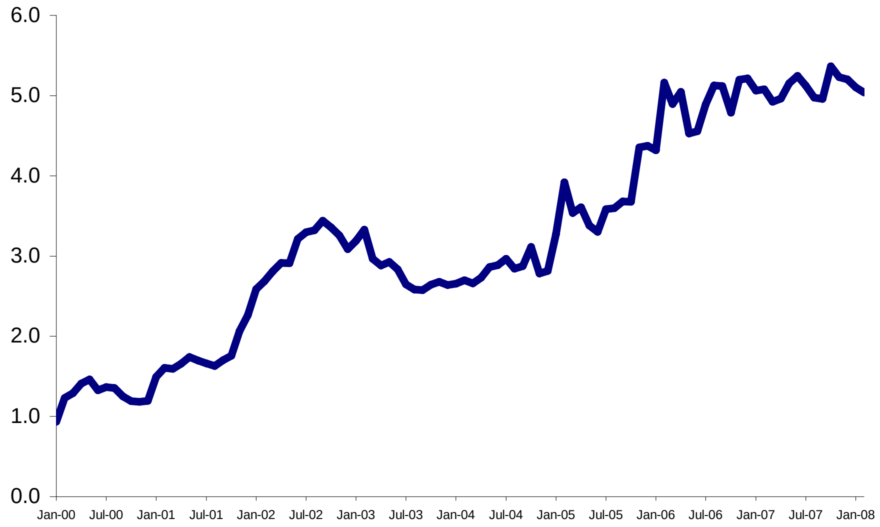
Foreign confidence flat

- **Foreign confidence** remained strong on unchanged 4Q07 figures;

Market confidence continues to decline

- **Market confidence** was down on weak RTS performance and a continuing increase in the share of large borrowers on the bonds markets. While international markets remain volatile, we believe that the Russian equity market is delivering a much weaker-than-expected dynamic. Despite strong macro-economic fundamentals, such poor performance is likely to reflect low confidence and the high uncertainty that is dominating the local landscape.

Figure 1: The AB-ICI down another 1.2% on drop in retail deposits



Source: Alfa Bank Research, New School of Economics

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Corporate loans up despite weak funding

Corporate and retail deposits were down in January, as they were in January 2007

In January, both retail and corporate funding declined m-o-m, which we attribute to seasonal weakness. This January, retail deposits were down $0.7 bln, an even smaller decline than the $1.2 bln drop last January. Corporate funding saw a $6 bln decline in January 2007 versus $4 bln in January 2008. Thus, we do not view the weak funding figures as particularly negative news.

Figure 2: Banking sector indicators, $ bln

	Dec-06	*Jan-07*	*Feb-07*	*Mar-07*	*Jun-07*	*Sep-07*	*Dec-07*	*Jan-07*
Assets	533	532	554	600	666	731	820	823
Retail deposits	144	143	150	154	168	185	210	209
Total corporate funding	178	172	178	201	218	235	272	267
Corporate loans	224	227	237	246	274	322	365	382

Source: CBR, Alfa Bank Research estimates

Corporate loans up $17 bln in January – very positive

We were positively surprised by the strong corporate lending growth, which totaled $17 bln in January. The corporate lending market reached $382 bln and now represents 46% of total assets, up from 43% in January 2007. We believe that positive economic statistics, especially the industrial output growth of 6% in 2M07, is positive news for banks, suggesting that there will likely be high demand for corporate loans.

Retail loans performed weakly in January

The retail lending market demonstrated seasonal weakness in January, increasing by only $1.7 bln. We believe that February and March are likely to witness a faster growth rate; however, we maintain our cautious attitude towards retail lending in the long run. The CBR has also changed its methodology, splitting retail loans into loans for individuals and loans for private entrepreneurs. In January 2008, the former portfolio totaled $118.8 bln for all Russian banks, while loans to private entrepreneurs added up to $10.8 bln, unchanged since the beginning of the year.

The placement of pension savings and state corporations' accounts as well as the VAT cut could boost banks' local funding

We believe that the Russian government is preparing to address the lack of long-term local funding. This is mainly confirmed by its proposal to place the pension savings accumulated in the State Pension Fund into deposits with Russian banks. The potential effect of this measure is currently estimated at $3.8 bln. As of the end of March, the State Pension Fund is expected to have another $3-4 bln, part of which can be distributed to Russian banks through VEB. Second, the $20 bln in state corporations' funds that is currently sitting in Central Bank accounts could be placed directly with Russian banks. Third, the Ministry of Economic Development and Trade's proposal to cut the VAT will free up $10 bln for the Russian economy beginning in 2009.

Interbank rate stable, market waiting for indication from CBR on how it will deal with April liquidity squeeze

In the meantime, banks' short-term ability to support strong lending growth is clearly the result of stability on the interbank market and of the liquidity situation. As a result, we believe that Rosneft's recent announcement that it had redeemed $2.6 bln of foreign debt and refinanced $3.0 bln is very good news. Clearly, the financial markets, in order to maintain stability in the coming weeks, are in need of an indication from the CBR as to how it will deal with the expected liquidity crunch in April. The Russian government's ability to overcome the liquidity problems in April should give strong support to the AB-ICI dynamic.

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