

AB-ICI 2009: The end of consumer-driven growth

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Investment Summary

- The Alfa Bank Investor Confidence Index (AB-ICI) declined 9.7%, reflecting 9% GDP in January.
- Since consumption is likely to decline in coming months, we are looking for continuing drop of the index

The AB-ICI showed a 9.7% decline

The AB-ICI declined 9.7% in February

Capital outflow was justified by 9% drop in GDP

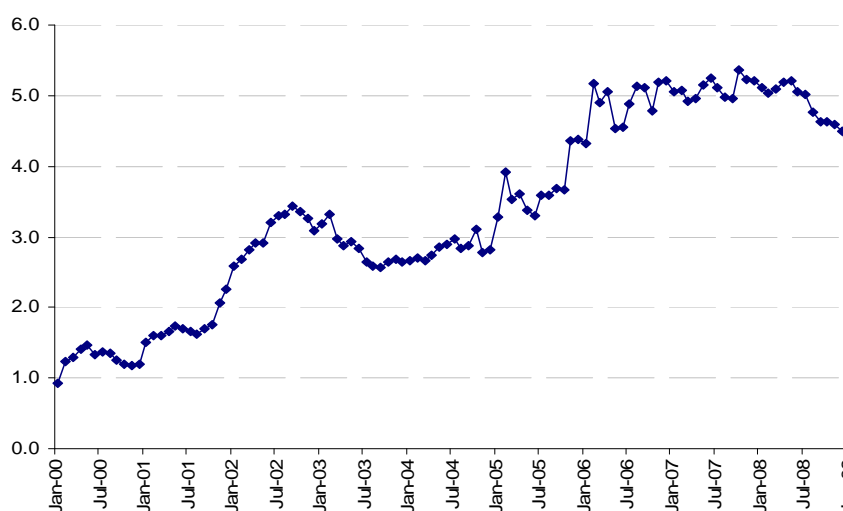
FDI was down y-o-y

Lower market confidence reflects increasing role of big companies

The AB-ICI declined by a substantial 9.7% last month reflecting the deterioration of all economic and financial markets trends.

- The index's **economic confidence** dropped by 28% last month, reflecting capital outflow and higher dollarization of retail deposits. With the strong 9% drop in GDP in January trust in the ruble is very weak and capital outflow is expected to continue;
- **Foreign confidence** also declined as the 2008 y-o-y FDI inflow registered a 2-3% decline. Despite the fact that the share of foreign debt increased slightly, it did not compensate for poor FDI figures;
- **The market confidence** indicator declined for both fixed-income and equity instruments since the market is becoming more focused on large companies and market diversification is gradually eroding.

Figure 1: AB-ICI dropped 9.7% last month



Source: Alfa Bank Research, New School of Economics

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No growth without consumers

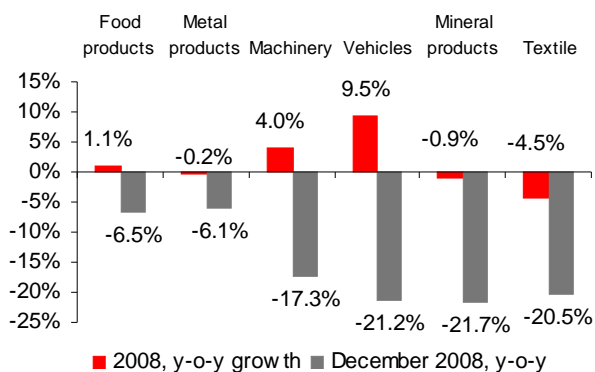
AB-ICI mirrors the decline in GDP, which became more focused on services in previous years

Industries contributed only 3% of last year's GDP growth

The decline in the AB-ICI mirrors the sharp contraction in GDP in the previous months. Despite the fact that the crisis was triggered abroad, the problems in the global markets have translated to a break in Russia's growth model. The evidence from economic statistics of recent years is that GDP growth became much more dependent on services starting in 2006. While before then the share of industry in GDP was close to 28%, in 2006 it dropped to 26.8% and to 24.4% in 2008. In 2002-2008, the share of three key non-industrial sectors – trade, construction and real estate services– rose from 39.2% to 47.6%. The main contributor to this growth was the trade sector, whose share grew by 5.6 ppts over the period. This change in the structure of the Russian economy suggests that its main foundation was household consumption, which relied on rapid salary increases and access to cheap loans.

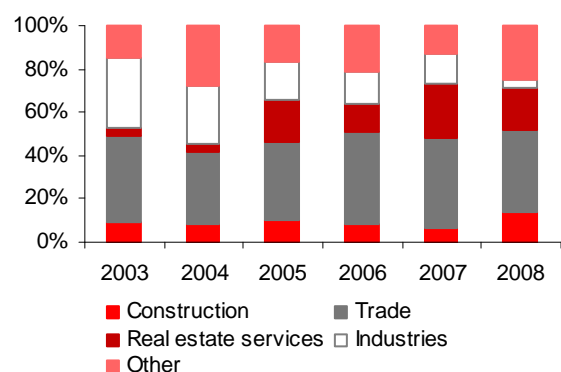
This GDP structure may explain why the Russian economy has proven so vulnerable to the decline in global demand and why its economy slowed so rapidly. The decline in global demand hit exporting industries, which reduced demand for manufacturing, which in turn cut output. This explains why a number of industries saw output fall by up to 20% y-o-y in December. Greater access to banking loans in 2007-2008 also appears to have made companies vulnerable to the liquidity crisis in 2H08. In 2008 industries contributed only 3% of real GDP growth, while the construction, trade and real estate service sectors accounted for 71% of GDP growth. In 2003, industries contributed around 30% of annual growth (see Figure 3).

Figure 2: Industrial growth by area



Source: Rosstat, Alfa Research

Figure 3: Sectors' contribution to GDP growth



Source: Rosstat, Alfa Research

We anticipate that consumption will start its decline in the coming months and will push AB-ICI to still lower levels

Our key concerns for 2009 are the pace and depth of the decline in consumption. Disposable income growth, which was 5.1% in September, dropped to -11.6% in December. Unemployment also jumped from 5.3% to 7.7% in three months. While people appear to be spending their savings, and in the coming months the slowdown in consumption may not be significant, it will inevitably decline starting in 2Q or 2H09. Given this forecast, we anticipate that the AB-ICI will continue its decline in the coming months.

Figure 4: Key household indicators

	2007	1H08	Jul-08	Aug-08	Sep-08	Oct-08	Nov-08	Dec-08
Real disposable incomes, y-o-y	10.7%	8.0%	5.7%	7.4%	5.1%	3.5%	-6.1%	-11.6%
Unemployment, %	6.1%	6.2%	5.3%	5.3%	5.3%	6.1%	6.6%	7.7%
Retail loans, \$ bln	128	161	168	167	167	161	154	143
Retail deposits, \$ bln	210	246	249	243	232	209	200	202

Source: Rosstat, Alfa Research

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