

AB-ICI: Struggling with a Liquidity Overhang

Natalia Orlova

(+7 495) 795-3677

NOrlova@alfabank.ru

March 31, 2010

www.alfabank.com

Moscow

Investment Summary

- In February, the AB-ICI declined on a weak balance of payments and unstable retail deposits trend
- The excessive liquidity in the banking sector is failing to translate into lending growth, which is negative for the AB-ICI
- The CBR's attempts to sterilize excess liquidity indicate that it remains concerned about the quality of loans

AB-ICI down 2.3% last month on unstable capital flows

2.3% m-o-m decline in AB-ICI reflects poor quality of current account...

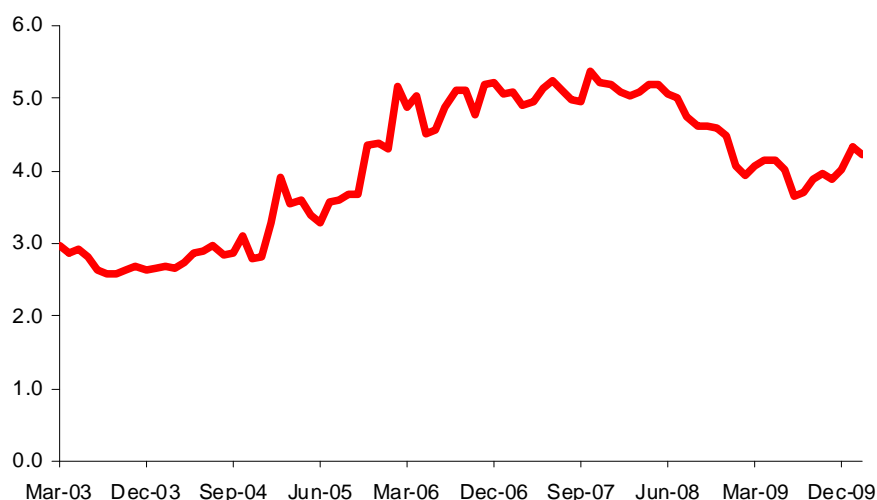
...weak prospects for foreign confidence index...

...and declining attractiveness of Russian financial assets

The AB-ICI's recent winning streak came to a halt last month, reflecting the deterioration of both the economic and market confidence indicators.

- **The economic confidence** indicator was down, reflecting a lack of capital inflows and an unstable retail deposits trend. The CBR posted no YTD growth in reserves until mid-March, suggesting that Russia is not a very attractive destination for foreign capital. Retail deposit growth was highly unstable, rising from 0.2% m-o-m in January to 2.3% in February;
- **The foreign confidence** indicator was flat, as no relevant FDI data were released over the period. However, given KBC and Raiffeisen's recent indications of their intention to scale back their presence on the Russian market, we do not expect this index component to be strong going forward;
- **The market confidence** indicator fell in response to lower average Russian stock market levels and an increase in the yield spread between Russian bonds and those of EM peers. The decline in stock and bond markets underlines the risks faced by the Russian economy.

Figure 1: AB-ICI was down 2.3% last month



Source: New School of Economics, Alfa Research

RESEARCH DEPARTMENT research@alfabank.ru

The contents of this document have been prepared by Natalia Orlova of OJSC Alfa Bank ("Alfa Bank") as Investment Research within the meaning of Article 24 of Commission Directive 2006/73/EC implementing the Markets in Financial Instruments Directive (2004/39/EC). Please refer to the further important information in relation to this Document located on the last page.

No support expected from lending

In our view, the unstable recovery of the AB-ICI is fully in line with the low visibility on Russia's growth pattern. We continue to look at lending as a good proxy for the overall recovery of the economy and the AB-ICI.

Budget deficit is creating a liquidity overhang

Russian banks remain awash in liquidity. The key reason for the considerable inflow of liquidity is the country's higher-than-expected budget deficit: in 2M10, the government ran a deficit of RUB194 bln compared with a RUB132 bln surplus in 2M09.

Banks have dispensed with CBR support

The liquidity inflows have primarily been used by banks to cut their exposure to the CBR. By November 2009, the largest Russian banks had redeemed virtually all of their exposure to uncollateralized CBR loans. The central bank's position in total banking liabilities declined from RUB3.5 trln at the beginning of 2009 to RUB1.1 trln at the beginning of February 2010; most of the latter amount is subordinated loans to the largest state banks.

Corporate loan book fell 1.1% YTD

Despite the liquidity overhang, both corporate and retail loans continue to decline. The corporate loan book decreased for the third month in a row, and the pace of the decrease accelerated m-o-m. In February, it shrank by 0.7% m-o-m vs. the 0.3% m-o-m decrease reported for January. Retail loans declined for the 13th month in a row, dropping by 0.6% m-o-m. The quality of retail loans also worsened, with NPLs reaching 7.3% vs. 7.1% in the previous month.

Figure 2: Banking statistics

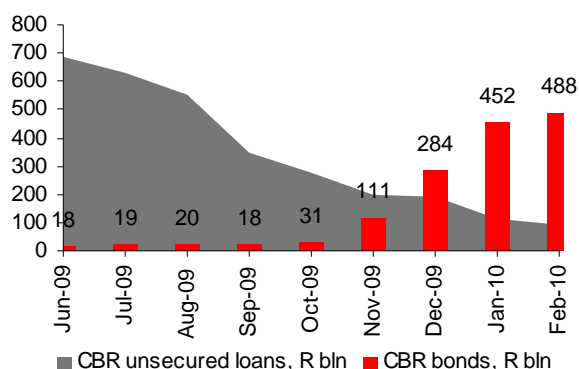
	Sep-09	Oct-09	Nov-09	Dec-09	Jan-10	Feb-10
Growth rates, m-o-m						
Retail loans	-1.1%	-0.7%	-0.2%	-0.3%	-0.8%	-0.6%
Corporate loans	-0.7%	-0.5%	0.3%	-1.2%	-0.3%	-0.7%
Retail accounts	0.5%	1.4%	2.9%	6.9%	0.2%	2.3%
Corporate accounts	1.8%	-2.2%	2.6%	2.0%	-1.4%	-0.9%
Quality of loans, % of loan book						
Corporate NPLs	5.6%	5.9%	6.2%	6.1%	6.1%	6.2%
Retail NPLs	6.4%	6.6%	6.8%	6.8%	7.1%	7.3%

Source: CBR

CBR is preventing rates from declining; we do not expect lending to recover in the coming months

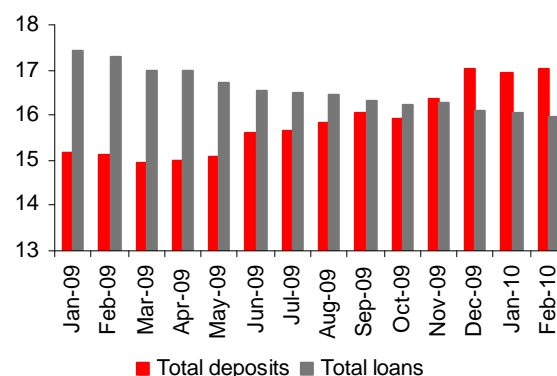
The Russian monetary authorities's ability to boost lending is limited, mainly owing to the low quality of borrowers. Starting in November 2009, the CBR expanded its range of sterilization tools and is now selling bonds to state banks, primarily Sberbank. This strategy helps prevent a sharp drop in interest rates and keeps banks from taking on more credit risk. However, the rapid sterilization also suggests that the CBR sees little room for lending growth. We believe the AB-ICI will continue to lack support from local sources of growth and that its recovery will be driven by inflows of capital attracted by a strong ruble.

Figure 3: CBR loans vs. bonds, RUB bln



Source: CBR, Alfa Bank

Figure 4: Deposits vs. loans, RUB trln



Source: CBR, Alfa Bank

Contact Information

Alfa Bank (Moscow)

Head of Equities
Telephone

12 Akad. Sakharov Prospect, Moscow, Russia 107078
Michael Pijolis
(+7 495) 795-3712

Research Department

Telephone
Head of Research
Oil & Gas
Macroeconomics
Banking
Telecoms, Technology, Internet, Media
Utilities
Metals & Mining
Consumer Goods, Retail, Real Estate
Transportation, Fertilizers, Machine-Building
Russian Product
Editorial
Translation
Production

(+7 495) 795-3676
Peter Szopo
Chirvani Abdoullaev, CFA, Alexander Bespalov
Natalia Orlova, Ph.D., Dmitry Dolgin
Natalia Orlova, Ph.D., Leyla Sharifullina
Elena Mills, Ekaterina Balykina
Alexander Kornilov, Ph.D., Elina Kulieva, Ph.D., Fedor Kornachev
Barry Ehrlich, CFA, Maxim Semenovykh, Sergei Krivokhizhin, Ph.D.
Elena Mills, Vitaly Kupeeov
Georgy Ivanin
Angelika Henkel, Ph.D., Vladimir Dorogov, CFA
David Spencer, Heather Dean
Anna Sholomitskaya, Elena Elovskaya
Alekssei Balashov

Equity Sales & Trading

Telephone
Facsimile
International
Domestic Institutional

Alfa-Direct Sales Team

(+7 495) 223-5500, 223-5522
(+7 495) 745-7897
Isai Pochtar, Michael Kotov, Roland Glasfors, Dmitry Ryzhkov
Dmitry Soloviev, Dmitry Demchenko, Mikhail Babaev,
Alexander Balayan, Ivan Shehavgtsov,
(+7 495) 795-3680
Sergey Rybakov, Valeriy Kremnev, Evgeniy Batelman

Alfa Capital (Kiev)

Research Department

Telephone
Facsimile
Analysts

77-a Chervonoarmiyska St.(6th floor) Kiev, Ukraine 03150

(+380 44) 490-1600
(+380 44) 490-1601
Denis Shauruk, Oleh Yuzefovych

Equity Sales & Trading

Sales Trading
Telephone

Sergey Grigorian, Denis Dolmatov
(+380 44) 490-1600

Alfa Capital Markets (London)

Telephone (office)
Facsimile (office)
Telephone (Sales & Sales Trading)
Sales
Sales Trading

1 Angel Court, 14th Floor, London, EC2R 7HJ
(+44 20) 7588-8500
(+44 20) 7382-4170
(+44 20) 7382-4175
Julia Dawson (+44 20) 7382-4174
Douglas Babic (+44 20) 7382-4178
Mark McCracken (+44 20) 7382-4172

Alforma Capital Markets (New York)

Telephones
Facsimile
Sales
Sales Trading
Fixed Income Sales

540 Madison Avenue, 30th Floor, New York, NY 10022
(+1 212) 421-7500
(+1 212) 421-8633
Robert Kaplan, George Kogan
Roman Kogan
Jeffrey Weichsel

Copyright Alfa Bank, 2010. All rights reserved.

IMPORTANT INFORMATION

The contents of this document have been prepared by Natalia Orlova, Chief Economist at Open Joint Stock Company Alfa Bank ("Alfa Bank"), as Investment Research within the meaning of Article 24 of Commission Directive 2006/73/EC implementing the Markets in Financial Instruments Directive 2004/39/EC ("MiFID"). Alfa Capital Markets ("ACM") is distributing this document to its clients in the EEA and accepts no responsibility towards any other classes of recipient. Alfa Bank and ACM have in place appropriate conflicts of interest policies and procedures aimed at ensuring the objectivity of the information contained in this document. The information contained in this document is provided for information purposes only and is not a marketing communication, investment advice or personal recommendation within the meaning of MiFID. The information must not be used or considered as an offer or solicitation of an offer to sell or to buy or subscribe for any securities or financial instruments. In the UK, this document does not constitute a Financial Promotion within the meaning of section 21 of the Financial Services and Markets Act 2000 (as amended). ACM is regulated by the Financial Services Authority ("FSA") with FSA registration number 416251, for the conduct of UK investment business and is the trading name of the UK branch of Alfa Capital Holdings (Cyprus) Limited ("ACC"), which is authorized by the Cyprus Securities and Exchange Commission under license number CIF 025/04. This document is not for distribution to retail clients as defined by MiFID and may not be communicated to such persons. This document is not for distribution or use by any person or entity in any jurisdiction where such distribution or use would be contrary to local law or regulation or which would subject Alfa Bank, ACC, ACM or any other group entity to authorization, licensing or other registration requirements under applicable laws. The information contained in this document is the exclusive property of Alfa Bank. Unauthorized duplication, replication or dissemination of this document, in whole or in part, without the express written consent of Alfa Bank is strictly prohibited. Although the information in this document has been obtained from, and is based on, sources Alfa Bank believes to be reliable, no representation or warranty, express or implied, is made by Alfa Bank, ACM or the authors. ACM and its officers and employees do not accept any responsibility as to the accurateness or completeness of any information herein or as to whether any material facts have been omitted. All information stated herein is subject to change without notice. ACM makes no warranty or representation that any securities referred to herein are suitable for all recipients and any recipients considering investment decisions should seek appropriate independent advice. Nothing in this document constitutes tax, legal or accounting advice. Alfa Bank, ACC and their associated companies, officers, directors or employees (excluding any financial analysts or other personnel involved in the production of research), from time to time, may deal in, hold or act as market makers or advisors, brokers or commercial and/or investment bankers in relation to the securities, financial instruments and companies mentioned in this email, or may have been, or may be represented on the board of such companies. If such circumstances arise, ACM, Alfa Bank, ACC and their associated companies have in place appropriate conflicts of interest policies and procedures to ensure that investment research remains independent and objective. A summary of ACC's conflicts of interests policy (which also covers ACM), containing details relevant to investment research, is available upon request from ACC or ACM. ACC and ACM have arranged for Alfa Bank and other relevant group entities involved in the production of research to implement equivalent policies. **Alfa Bank is incorporated, focused and based in the Russian Federation and is not affiliated with US-based Alfa Insurance.**