# AB-ICI: Another Step in the Right Direction

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## Investment Summary

- The deceleration in the capital outflow supported the AB-ICI trend in February.
- The strong investment growth in recent months should favor future recovery, but…
- … the lack of additional improvement in the capital account is a risk factor.

## The AB-ICI increased 2.3% in February

**Market growth and slower capital outflow helped**

The AB-ICI continued its rise in February this year, mainly responding to the improvement of the balance of payments and market-focused indicators.

**Savings and dedollarization supported the economic index**

- **Economic confidence** increased, reflecting foreign investors' inflow to the local market. While Russian capital continues to exit the country, in February we observed an increase in foreign demand on the ruble bond market. The Russian public continued to reduce dollar holdings and also increased its savings, which all together provided strong support to the economic index;

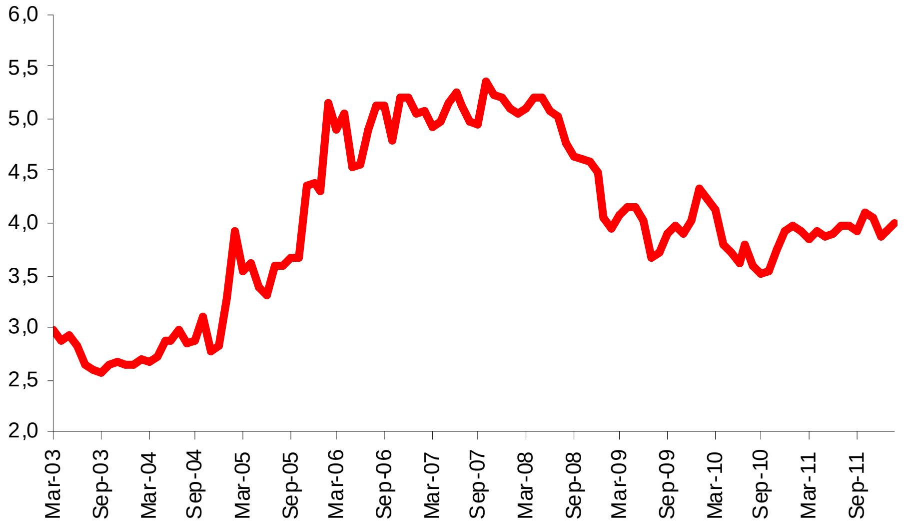
**No news on the foreign index**

- **Foreign confidence** was flat last month; however, we see few potential changes in the near future. The Russian market remains attractive but hard to penetrate for foreign players in both banking and non-banking fields.

**Market dynamics and structure improved last month**

- **Market confidence** increased, driven by both bond and equity market upward dynamics. After tight market liquidity in January, a number of issuers decided to come to the market, which helped to improve the structure and the dynamics of market growth. As March and April are traditionally more difficult months because of tax payments, we expect that the role of the market index in supporting the AB-ICI will be more modest in the near future.

**Figure 1: AB-ICI increased 2.3% last month**




*Source: New School of Economics, Alfa Research*

## Expecting improvement of capital flows

**Investment growth delivered a strong 15.4% y/y rate in February, but was not supported by construction**

Unlike the capital account trend, the real sector trend will continue to provide support for firm AB-ICI growth in coming months. Investment growth in February met our positive expectations, but it raised some issues that have to be clarified in the coming months. Investments delivered a high 15.4% y/y growth rate – in line with the 15.1% y/y increase in January – and seem to have been driven by corporate capex. Unfortunately, the construction sector failed to contribute strongly to the February figure. General construction output was up only 6.8% y/y after 11.7% y/y growth in January, while housing construction was up only 5.0% y/y after a 21.5% y/y increase the month before. In addition, the effect of the leap day in February suggests that if this factor is removed, investment growth was actually around 10% y/y.

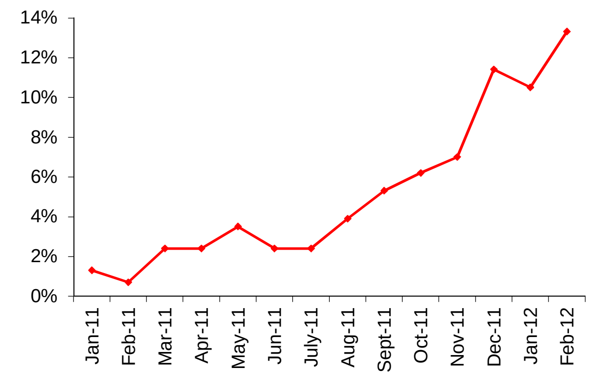
**Retail trade growth is not in line with the fast increase in real salaries and income**

We have more concerns over retail trade growth than investments. First, in February retail trade accelerated to 7.7% y/y after 6.8% y/y growth in January, but 2.5-3.0pp was due to the impact of the additional work day. Both figures are not as impressive as the 9.1% y/y retail trade growth in 4Q11. The slowdown in retail trade growth is particularly surprising given the acceleration in income growth, which began in December of last year. While disposable income growth stood at 2.6% in both 4Q11 and January-February 2012, the increase in real salaries jumped substantially from 6-7% in October-November to 11.4% y/y in December and 11.9% y/y in January-February. Given these numbers as well as continued retail loan growth, which accelerated to 39% y/y in February from 36% y/y in December, we would expect retail trade figures to be stronger.

**Figure 2: Construction and housing construction growth, y/y**


*Source: Rosstat, Alfa Research*

**Figure 3: Real salaries growth, y/y**




*Source: Rosstat, Alfa Research*

**Capital outflow and strong real sector trend are in conflict when affecting AB-ICI**

We will continue to focus on banking sector growth in the coming months. The fact that corporate loan growth has stayed at 23% y/y corresponds to our view that excessive budget spending is partially replacing borrowed funds. However, if our expectations for tight budget policy in the aftermath of the election come to pass, the CBR will have a hard time limiting loan growth. According to the CBR's preliminary statistics, in March Russia lost around $13bn in capital outflow, which will need to be offset and will create additional demand for local ruble-denominated loans. Thus, the strong real sector trend while the weak capital account appears to conflict in their impact on AB-ICI in the coming months.

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