

# AB-ICI: Threatened by Lower Capital Inflow

Natalia Orlova

(7 495) 795-3677

NOrlova@alfabank.ru

30 May, 2008

www.alfabank.com

Moscow

## Investment Summary

- The Alfa Bank Investor Confidence Index (AB-ICI) is up 2% on strong \$20 bln net capital inflow in April
- The CBR's willingness to limit capital inflow in order to curb inflation will damage the AB-ICI's performance
- The inflow of non-oil FDI, though it doubled y-o-y in 1Q08, is still too modest to be considered significant

### The AB-ICI is up 2% on strong net capital inflow

**AB-ICI up 2%, in line with expectations**

**Capital inflow was strong**

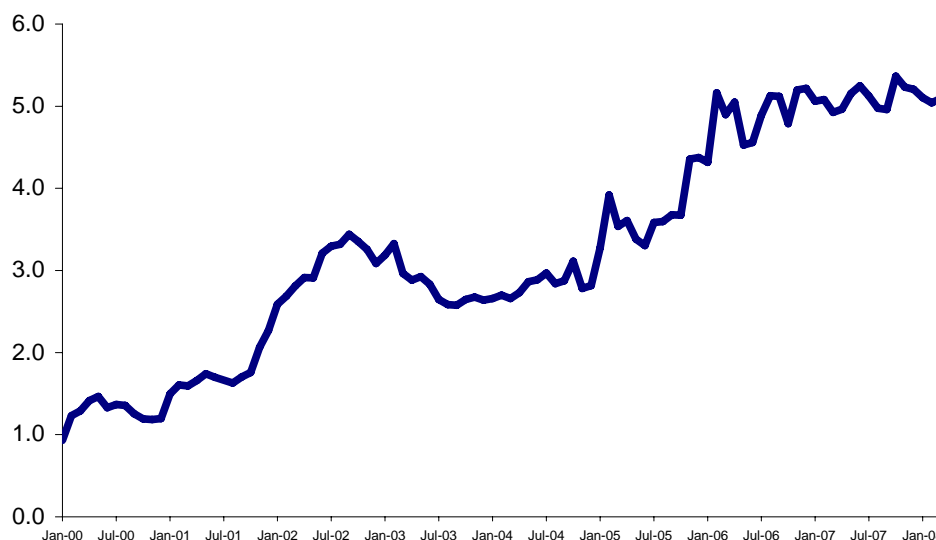
**Foreign banks' penetration up, but FDI weak**

**Market confidence mixed**

The AB-ICI index increased 2% last month on strong \$20 bln net capital inflow to Russia.

- **The index's economic confidence indicator** was up, backed by capital inflow and continuing growth in retail deposits;
- **Foreign confidence** did not improve. While foreign banks' market share exceeded 12% as of March 2008, FDI inflows dropped to \$5.6 bln in 1Q08 versus \$9.8 bln in 1Q07;
- **Market confidence** remained mixed on equity market volatility and less activity on the bond market.

**Figure 1: AB-ICI up 2% last month**



Source: Alfa Research, New School of Economics

**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 page 3.

## CBR wants to discourage capital flows

**The new exchange rate policy is a way to address growing uncertainty**

On May 14, the CBR announced a new exchange rate policy. Previously, the CBR's exchange market interventions had been primarily focused on maintaining the stability of the ruble exchange rate to the basket. Now, however, the CBR has indicated that it intends to take the local market into consideration along with the balance of payments when intervening. Deputy CBR Chairman Alexei Ulyukaev said that CBR interventions will be coordinated with fiscal policy and will be more intense during tax payment periods. We interpret these comments as: 1) a willingness to increase ruble flexibility in order to address increasing global and domestic uncertainties; and 2) confirmation that exchange rate intervention will remain the key mechanism of liquidity support.

**The huge net capital inflow of \$20 bln in April was the key reason for the new exchange rate policy, in our view**

We believe that the higher exchange-rate volatility reflects the CBR's willingness to cut short-term capital inflows to the country. The net capital inflow, which now contributes significantly to the CBR's reserves growth and therefore to the monetary supply, is becoming less predictable. While Russia had a strong \$9 bln net capital outflow in January, and \$23 bln in 1Q08, in April the country received a strong net capital inflow of \$20 bln. Capital inflow volatility is making the domestic monetary supply growth unpredictable, which obviously needs to be resolved.

**FDI was only \$5.6 bln in 1Q08, too small to replace speculative capital**

Clearly, the ideal scenario is that Russia will manage to cut speculative inflows while attracting more FDI. However, according to Rosstat, the inflow of foreign investment totaled \$17.3 bln in 1Q08, or down 30% y-o-y. FDI accounted for some \$5.6 bln of this, or a 27% y-o-y drop. Also according to Rosstat, Russian corporations attracted \$11 bln in new loans in 1Q08.

**More-diverse FDI is good news**

The good news, however, is that the share of fuel-driven FDI is declining. In 1Q07, some \$7.4 bln was invested in mineral extraction, reflecting the internal corporate transfer of Russian oil and gas majors. Non-oil FDI inflow in 1Q08 accounted for \$4.3 bln, well above the \$2.1 bln reported in 1Q07. In particular, some \$1.6 bln was invested into generation companies, which signifies that FDI flows are currently better diversified.

**Figure 1: Quarterly FDI inflow by sectors, \$ mln**

|                    | 1Q07  | %   | 2Q07  | %   | 3Q07  | %   | 4Q07  | %   | 1Q08  | %   |
|--------------------|-------|-----|-------|-----|-------|-----|-------|-----|-------|-----|
| Mineral extraction | 7,663 | 79% | 3,511 | 58% | 1,427 | 37% | 1,332 | 16% | 1,260 | 23% |
| Manufacturing      | 688   | 7%  | 1,062 | 17% | 620   | 16% | 1,731 | 21% | 732   | 13% |
| Financial sector   | 505   | 5%  | 132   | 2%  | (195) | -5% | 681   | 8%  | 74    | 1%  |
| Trade              | 301   | 3%  | 344   | 6%  | 726   | 19% | 1,885 | 23% | 449   | 8%  |
| Construction       | 49    | 1%  | 405   | 7%  | 124   | 3%  | 313   | 4%  | 297   | 5%  |
| Real Estate        | 453   | 5%  | 368   | 6%  | 827   | 22% | 1,625 | 20% | 666   | 12% |
| Other              | 97    | 1%  | 259   | 4%  | 278   | 7%  | 586   | 7%  | 2,107 | 38% |
| Total              | 9,756 |     | 6,081 |     | 3,807 |     | 8,153 |     | 5,585 |     |

Source: Rosstat, Alfa Research

## Contact Information

### Alfa Bank (Moscow)

Head of Equities  
Telephone  
Facsimile

Dominic Gualtieri  
(+7 495) 795-3649  
(+7 495) 745-7897

### Research Department

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

(+7 495) 795-3676  
(+7 495) 745-7897  
Ronald P. Smith  
Ronald P. Smith, Erik DePoy  
Chirvani Abdoullaev, CFA, Konstantin Batunin  
Natalia Orlova, Olga Naydenova  
Ivan Shuvalov, Konstantin Beletskiy  
Alexander Kornilov, Elina Kulieva  
Robert Mantse, Maxim Semenovykh  
Vitaly Kupeev  
Alexey Kryuchkov  
Roydel Stewart, Andrei Fedorov  
Rinat Gainoulline  
Ekaterina Leonova  
Vladimir Kravchuk, Ph.D.  
Angelika Henkel, Ph.D., Vladimir Dorogov, Vladimir Kravchuk, Ph.D.  
David Spencer, Heather Dean  
Anna Sholomitskaya, Dmitry Dolgin  
Aleksei Balashov

### Equity Sales & Trading

Telephone  
Facsimile  
Head of Equity Product  
International Sales  
Domestic Sales

(+7 495) 795-3672, 795-3662  
(+7 495) 745-7897  
Michael S. Boboshko  
Kirill Surikov, Mikhail Shipitsin, Michael McAtavey  
Alexey Primak, Alexander Nasonov, Konstantin Shapsharov,  
Vsevolod Topolyansky, Diana Nuriakhmetova  
12 Akad. Sakharov Prospect, Moscow, Russia 107078

Address

### Alfa Capital (Kiev)

#### Research Department

Telephone  
Strategy, Macroeconomics, Fixed Income  
Metals & Mining  
Engineering, Chemicals  
Utilities  
Consumer Goods  
Banking  
Real Estate, Small-Cap Strategy  
Editorial

(+380 44) 490-1600  
Sergiy Kulpinsky, Ph.D.  
Oleh Yuzefovych  
Denis Shauruk  
Maksym Nikulyak, Kateryna Ruskykh  
Tetyana Orlova  
Andrey Zaripov  
Andriy Gubachov  
Danylo Spolsky

#### Equity Sales

Sales  
Telephone

Sergey Grigorian, Ivan Shehvtsov, Anfisa Anikushina  
(+380 44) 490-1600

### Alfa Capital Markets (London)

Telephone  
Facsimile  
Sales  
Sales Trading  
Address

(+44 20) 7588-8500  
(+44 20) 7382-4170  
Maxim Shashenkov, Mark Cowley, Taissia Chinina  
Douglas Babic  
City Tower, 40 Basinghall Street, London, EC2V 5DE

### Alforma Capital Markets, Inc.

Telephones  
Facsimile  
Sales  
Sales Trading  
Address

(+1 212) 421-8563 / (+1 212) 421-7500  
(+1 212) 421-8633  
Robert Kaplan, Roman Kogan  
Roman Kogan  
540 Madison Avenue, 30<sup>th</sup> Floor, New York, NY 10022

Copyright Alfa Bank, 2008. 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. ACC 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, ACC, 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.