Alfa-Bank

AB-ICI: Slide Continues due to Market Forces

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April 29, 2011 www.alfabank.com Moscow

Investment Summary

- The AB-ICI fell by 1.5% last month due to the Russian market's underperformance relative to peers
- The outlook for capital inflow is unclear, as the investment climate remains poor
- The acceleration in retail lending growth is supporting consumption in 2Q11

AB-ICI fell 1.5% last month

AB-ICI continued to decline despite some improvement in economic trends

The AB-ICI retreated 1.5% last month, as the slight improvement in economic fundamentals was too fragile to compensate for the global market's jitters about Russia's growth trend.

Capital outflow slowed, but future prospects are cloudy

- **Economic confidence** increased slightly, as capital outflow slowed in March and April, allowing the ruble to appreciate to 2.5-year highs. The strong ruble increased the public's confidence in the national currency, and dollarized savings fell to below 19% of total retail deposits. However, the recent discussion of possible tax increases after 2012 makes the outlook for the capital account unclear;

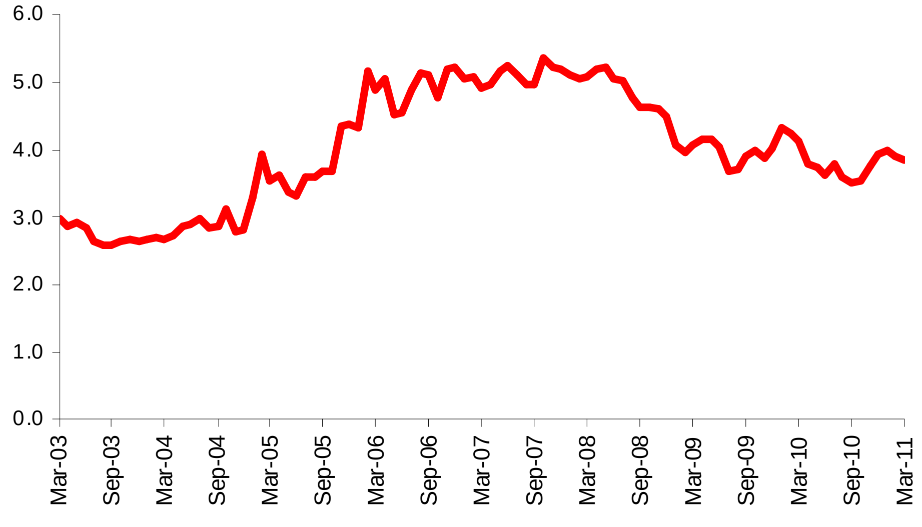
Foreign banks exiting Russian retail market

- **Foreign confidence** was flat, as no relevant statistics were released. However, HSBC's recent announcement that it was closing its retail business, which followed a similar decision by Barclays a couple of months earlier, signals a low level of interest in the Russian market among foreign players;

Russian markets lag peers despite strong oil prices

- **Market confidence** declined last month even though the commodities markets provided opportunity for gains. The weak domestic investment environment resulting from the payroll tax increase is making investors less interested in Russia compared with its emerging-market peers.

Figure 1: AB-ICI declined 1.8% last month



Source: New School of Economics, Alfa Research

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Consumption strong, investments to catch up

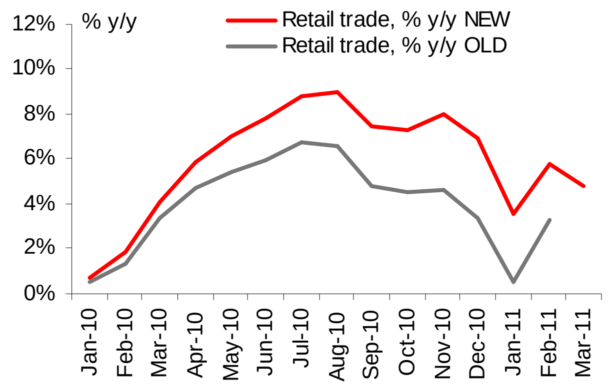
Retail trade growth reported at 4.7% y/y in 1Q11, justifying strong import growth

The latest consumer statistics turned out much better than earlier believed. Rosstat recently upgraded 2010 retail trade growth from 4.4% y/y to 6.3% y/y and revised the January and February 2011 figures upwards by 2-3pp. In addition, March growth was reported at 4.8% y/y, much higher than our and market projections. While we earlier estimated that 70% of 2010 GDP growth was restocking, the new retail figures suggest a better growth structure. Strong retail growth of 4.7% y/y in 1Q11 is in line with the rapid 41% y/y growth in imports.

Higher payroll tax pushed SMEs to pay more "gray" income

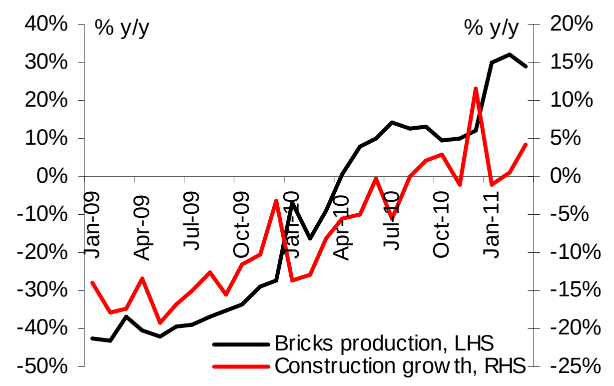
Surprisingly, real disposable income was reported weak, at -3.4% y/y in March and -2.9% y/y in 1Q11 after coming in positive in 2010, which would seem to call into question the sustainability of the observed consumption growth. However, we do not believe these figures should be taken at face value, as the increase in the payroll tax this year may have reduced entrepreneurial income and pushed a number of SMEs to pay a higher share of gray salaries in order to avoid additional financial pressure. The decline in unemployment from 7.4% as of YE10 to 7.1% in March underscores the strong consumer confidence.

Figure 2: Retail trade: New vs. old estimates



Source: Rosstat, Alfa Research

Figure 3: Construction and bricks production



Source: Rosstat, Alfa Research

Construction growth accelerated to 4.2% y/y, but investments have yet to recover

Construction growth accelerated in line with our expectation: March growth was 4.2% y/y overall and 13.5% y/y in the housing segment after two months of y/y declines. This improvement was backed by a strong and stable 30% y/y increase in bricks production, which leads us to expect a further improvement in construction volumes. The latter will hopefully support investment growth, which remained unspectacular in March, shrinking 0.3% y/y, suggesting companies are still behind on their CAPEX spending plans.

Retail lending increased by 2.6% in 1Q11; retail deposit growth slowed to 2.0%

Though 1Q11 GDP growth was initially estimated at 4.5% y/y, corporate lending for the period posted only a modest increase of 2.2% q/q, or 0.7% per month, vs. a 1.0% m/m average in 2010. Retail lending, on the other hand, posted stronger growth of 2.6% q/q in 1Q11, supporting consumption growth. The savings ratio also declined, as reflected in the slowdown in retail deposits growth from 4.2% in 1Q10 to 2.0% in 1Q11. We expect this trend to help stimulate consumption growth in 2Q11. However, in order to improve the quality of GDP growth and remove pressure on the AB-ICI, Russia requires an improved investment climate.

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