Alfa-Bank

AB-ICI: Weak Capital Flows Put Growth on Hold

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Investment Summary

- Acceleration of capital outflows in March and lack of catalysts for financial markets kept AB-ICI flat
- The economic confidence component may continue to suffer from high private capital outflow
- The market confidence component will depend on interest rate dynamics and new Cabinet composition

The AB-ICI stood unchanged in March

No improvement in confidence after the elections has kept the AB-ICI flat

As expectations of further improvement of the capital flows in March failed to materialize, our AB-ICI remained flat after two consecutive months of growth. Despite positive expectations that after the elections all confidence components will improve, in reality the capital outflow and cautious market investor attitude have prevented a better index dynamic.

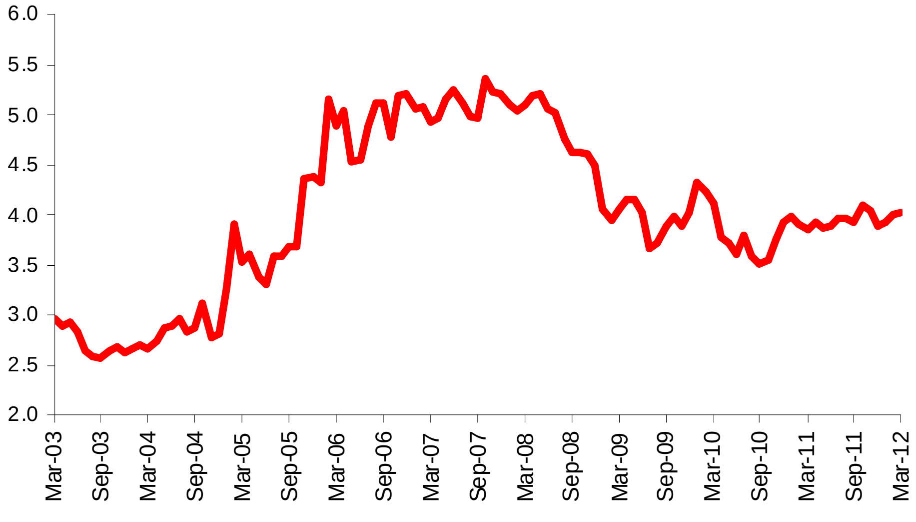
Strong $13bn capital outflow in March disappointed

- **Economic confidence** stood flat, as the continuing increase of household savings, supported by strong wage growth, was offset by the poor capital account. Contrary to expectations, capital outflow accelerated to $13bn in March, putting the 1Q12 figure at $35bn, in line with the previous quarter. According to the CBR, the wide part of this capital outflow may reflect the lack of individual confidence: last year some 35% of total capital outflow was due to private individual transactions, including around $12bn invested in foreign real estate.
- **Foreign confidence** was flat last month as no relevant data were released.

Market confidence is unchanged due to lack of catalysts

- **Market confidence** remained unchanged. While the external environment was favorable until very recently, the market players remained cautious due to the concerns regarding future growth trends. The current discussion in the government on potential changes in taxation is taking longer than expected, adding nervousness to the market. The market lacks catalysts to deliver strong performance.

Figure 1: AB-ICI stood flat last month



Source: New School of Economics, Alfa Research

Investments Are the Key Concern

March investment growth figures were disappointing…

AB-ICI may continue to suffer from mixed real sector signals. March macro statistics were not as strong as expected. Investment growth failed to remain steady, last month decelerating to 4.9% y/y after bringing 15.4% y/y growth in 2M12. This deceleration reflected weaker activity in construction with both broad construction and housing construction figures dropping into negative territory in March. Slower investment growth caused a deceleration of GDP growth to 3.2% y/y and led to modest industrial output growth at 2.0% y/y. The consumption trend, however, remained rather strong, putting retail trade growth at 7.3% y/y and supported by the 12.6% y/y increase in real salaries.

…but the 1Q12 statistic is still stronger as opposed to 1Q11

Despite rather modest March figures, we believe that the 1Q12 results look rather good compared to 1Q11. First, GDP growth did not decelerate and remains steady at 4.0% y/y. Secondly, the income trend has improved materially, causing an acceleration in retail trade but also deceleration in import growth from 42% y/y in 1Q11 to only 13% y/y in 1Q12. Investment growth was 11.2% y/y, delivering a 0.8% y/y decline a year ago. That said, strong investments and consumption were obviously offset by destocking, which is smoothing the impact on growth. Industrial output, as example, has decelerated from 5.9% y/y in 1Q11 to 4.0% y/y in 1Q12.

Figure 2: Key macro indicators, 1Q12 vs. 1Q11

	1Q11	1Q12
GDP growth, % y/y	4.0%	4.0%
Unemployment, %	7.1%	6.5%
Disposable income, % y/y	0.0%	2.6%
Real wage, % y/y	1.6%	11.7%
Retail trade, % y/y	5.0%	7.5%
Investments, % y/y	-0.8%	11.2%
Construction, % y/y	1.6%	5.2%
…housing, % y/y	-2.2%	5.7%
Industrial output, % y/y	5.9%	4.0%
Import growth, % y/y	42.4%	12.9%

Source: Rosstat, CBR, Ministry of Economic Development, Alfa Research

Capital outflow of $35bn in 1Q12 is a concern and may limit AB-ICI growth going forward

Capital outflow remains a big issue on the agenda that may limit AC-ICI growth going forward. In 1Q12, capital outflow totaled $35bn and was unchanged from the 4Q11 level. The outflow is as high as 7% of GDP and withdrew more than 80% of Russia's current account surplus. Given that around one-third of the capital outflow is from private individuals, who invested $12bn into foreign real estate last year, we continue to believe that the capital outflow is very likely to persist until the end of the year.

Market confidence may suffer from the high interest rates

Russia's inability to benefit from the higher oil prices environment is keeping its local interest rate rather high. The overnight rates did not decline far below the 5-6% level reached in the end of last year. The 3M interest rates are also staying high at 7%. It is worth mentioning that this level of interest rates are maintained with large direct support coming from both the Finance Ministry and the CBR. State authorities provide funding for around 5% of total banking sector assets and increased this position in March in order to prevent rate acceleration. De facto, the state is increasing its role in supporting economic growth while private capital is more cautious. This landscape may affect financial market dynamics and will be a risk factor for the AB-ICI in coming months. A possible positive surprise might come from the nomination of a new government; however, the market presently lacks clarity on the new Cabinet's future economic agenda.

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