AB-ICI: Stagnant on Capital Outflow

Natalia Orlova (+7 495) 795-3677 NOrlova@alfabank.ru

May 31, 2011 www.alfabank.com Moscow

Investment Summary

- The AB-ICI added 1.7% last month, only partly offsetting the declines in the previous two months
- April's unexpected $8bn capital outflow worsens the outlook for the 2Q11 capital account
- The slowdown in GDP growth to 3.3% y/y in April underlines the weakness of underlying economic trends

AB-ICI grew 1.7% last month

AB-ICI stagnant since the beginning of the year on persistent capital outflow

Though the AB-ICI managed to post 1.7% growth last month on favorable market sentiment, this was only enough to compensate for the previous months' decline, resulting in a flat YTD performance. This stagnation is mainly explained by the fact that high oil prices, while making Russian financial markets more attractive, have been unable to prevent capital outflow, which has been $6-8bn per month YTD.

Capital outflow rose to $7.8bn in April, contrary to expectations

- **Economic confidence** remained virtually flat – while the general population continues to de-dollarize their savings, capital outflow from the Russian corporate sector unexpectedly intensified to $7.8bn in April after averaging $7bn a month in 1Q10. This sudden deterioration dashes our hopes for a positive 2Q11;

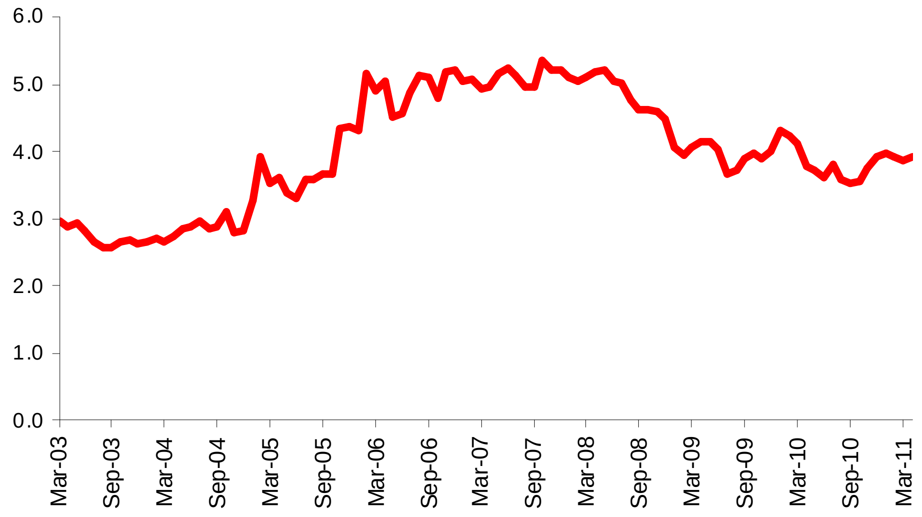
Quality of Russia's FDI inflows deteriorated

- **Foreign confidence** declined, as even though FDI inflows grew 48% y/y in 1Q11, this increase consisted entirely of investments in the commodity-extraction sectors and was financed by reinvested profits, not new capital;

Russia is holding IPOs again

- **Market confidence** was the only indicator to show an improvement. A number of IPOs in the agricultural (Ros Agro), banking (Nomos) and construction (Etalon) sectors rekindled foreign investors' interest in Russia. High oil prices supported asset prices on Russian markets, though their failure to translate into better economic trends remains a concern.

Figure 1: AB-ICI increased 1.7% last month



Source: New School of Economics, Alfa Research

RESEARCH DEPARTMENT research@alfabank.ru

Poor income growth, capital outflow continue to surprise

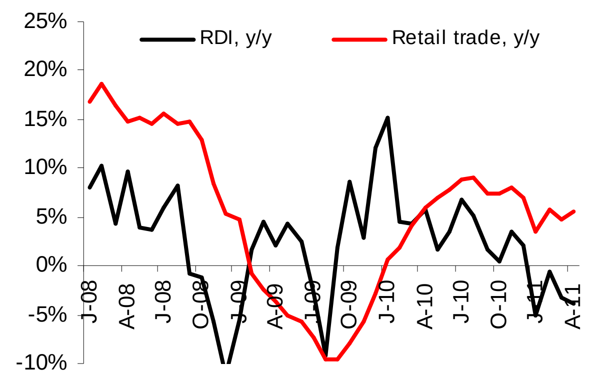
April statistics did not meet our expectations

April statistics did not fully meet our positive expectations for 2Q11, which we had formed based on higher oil prices, strong construction-materials growth and the 4.1% y/y GDP increase in 1Q11. The deceleration in GDP growth to 3.3% y/y in April and the recent deterioration in global market sentiment suggest that AB-ICI is likely to remain under pressure in the coming months.

Construction growth turned negative in April, and output of construction materials decelerated sharply

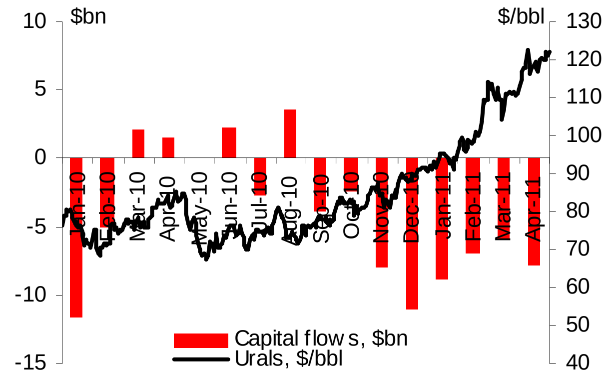
Our first concern is that construction did not improve as we had hoped. While investments were up 2.2% y/y in April, they were primarily driven by corporate CAPEX spending. Contrary to our expectations, construction shrank 1.9% y/y after growing 4.2% y/y in March driven by a significant 2.5% y/y decline in housing construction. Our key concern here is that the lack of a continuous recovery in construction coincided with a significant deceleration in production of construction materials: while in 1Q11, this segment grew 30% y/y, in April growth slowed to 19% y/y. This poor figure is in line with the weakness in domestic steel production and suggests there is a risk the construction recovery will end before it even got going.

Figure 2: Retail trade and income growth



Source: Rosstat, Alfa Research

Figure 3: Capital outflow



Source: Rosstat, Alfa Research

Higher retail trade growth of 5.6% y/y is not supported by 3.8% y/y drop in real income

Our second concern is that retail trade growth continues to accelerate even though real disposable income growth is negative. Despite the 10% increase in pensions, income dropped 3.8% y/y in April, or 3.1% y/y in 1Q11. Though, as we noted before, we rely more on retail trade figures, as the increase in gray salaries may reduce official income growth statistics, the widening gap between retail trade and income calls into question the sustainability of the trade growth.

April capital outflow of $7.8bn the biggest disappointment; we forecast a $15bn outflow in 2Q11

Finally, the biggest disappointment in April was the $7.8bn capital outflow. The CBR also downgraded the March capital outflow from $4bn to $6bn, pulling the rug out from under our positive capital outlook. The poor capital account in April also suggests that high oil prices failed to have a positive effect on capital inflows to Russia. The lack of visibility on the government's tax plans for next year will likely keep pressure on the capital account. Given the recent decline in oil prices, we now expect a $15bn capital outflow in 2Q11 and see downside risk to our RUB29/$ year-end forecast.

Contact Information

Alfa Bank (Moscow)	12 Akad. Sakharov Prospect, Moscow, Russia 107078
Head of Equities	Michael Pijiolis
Telephone	(+7 495) 795-3712
Research Department	
Telephone	(+7 495) 795-3676
Head of Research	Peter Szopo
Oil & Gas	Pavel Sorokin, Alexander Bespalov
Macroeconomics	Natalia Orlova, Ph.D., Dmitry Dolgin
Financial Sector, Real Estate	Jason Hurwitz, Eldar Vagabov
Telecoms & Media, Transport, Industrials	Iouli Matevossov, CFA, CPA, Vladimir Dorogov, CFA
Utilities	Alexander Kornilov, CFA, Elina Kulieva, Ph.D.
Metals & Mining	Barry Ehrlich, CFA, Maxim Semenovykh, Andrey Lobazov
Retail, Pharma, Agriculture, Fertilizers	Alexandra Melnikova, Irina Prokopyeva
Russian Product	Angelika Henkel, Ph.D., Alan Kaziev
Editorial	David Spencer, Heather Dean
Translation	Elena Elovskaya, Stanislava Ovcharenko
Production	Aleksei Balashov
Equity Sales & Trading	
Telephone	(+7 495) 223-5500, 223-5522
Facsimile	(+7 495) 745-7897
International	Roland Glasfors, Victoria Duben, Michael Kotov, Dmitry Ryzhkov
Domestic Institutional	Dmitry Soloviev, Dmitry Demchenko, Evgeny Tereschenko
Alfa-Direct Sales Team	(+7 495) 795-3680
	Sergey Rybakov, Valeriy Kremnev, Evgeniy Batelman
Alfa Capital (Kiev)	77-a Chervonoarmiyska St.(6th floor) Kiev, Ukraine 03150
Research Department	
Telephone	(+380 44) 490-1600
Facsimile	(+380 44) 490-1601
Analysts	Oleh Yuzefovych
Equity Sales & Trading	
Sales & Trading	Sergey Grigorian, Denis Dolmatov, Yulia Grigoryan
Telephone	(+380 44) 490-1600
Alfa Capital Markets (London)	1 Angel Court, 14th Floor, London, EC2R 7HJ
Telephone (office)	(+44 20) 7588-8500
Facsimile (office)	(+44 20) 7382-4170
Telephone (Sales & Sales Trading)	(+44 20) 7382-4175
Sales	Matthew Arnold (+44 20) 7382-4171
	Victoria Filimonova (+44 20) 7382-4172
	Robert Szucsich (+44 20) 7382-4174
Sales Trading	Douglas Babic (+44 20) 7382-4178
Alforma Capital Markets (New York)	1270 Avenue of the Americas, New York, NY 10020
Telephones	(+1 212) 421-7500
Facsimile	(+1 212) 421-8633
Sales	Isai Pochtar (+1 212) 421-8564
	Michael Jordan (+1 212) 421-8560
Sales Trading	Yan Gloukhovsky (+1 212) 421-8567