

# AB ICI: Market Up, Index Flat

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## Investment Summary

- **Alfa Bank Investor Confidence Index was flat last month, but is down 10% since May 2003**
- **Market component reflects foreign investors' optimism, which drove the Index higher**
- **Stagnant CBR reserves reflects the increase in capital outflows, which constrained the Index**

### *AB ICI was flat last month*

The latest Alfa Bank Investor Confidence Index remained flat compared to the previous month, which indicates substantial stabilization compared to the previous 7% drop generated by the state investigations of Yukos. However, the Index has now declined to the level of the beginning of 2002 after steady erosion of the value added by expectations of faster WTO negotiations.

### *Net capital outflow is keeping CBR reserves flat, pushing the Index down*

The main factor pushing the Index down was deterioration of the capital account, as reflected in the CBR reserves dynamic. Since August the CBR has been unable to increase the level of reserves, which remain "frozen" at around \$62 bln. While initially the drop stemmed from debt payments to the Paris Club, in September the CBR began to intervene on the market to prevent the ruble exchange rate from experiencing a sharper fall. The R/\$ rate finally stabilized at a level of R30.5-30.6/\$ after having approached the R30/\$ level in July-August.

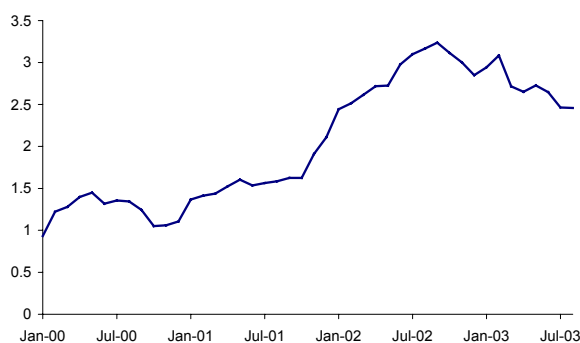
### *Slow growth in deposits was due to the vacation season*

The slowdown in deposit growth was another constraining factor for the Index performance. We attribute this to the vacation season and expect the trend to reverse in October-November due to higher social payments on the eve of the Duma and presidential elections.

### *Russia receives foreign lending, but is not attractive enough for FDI*

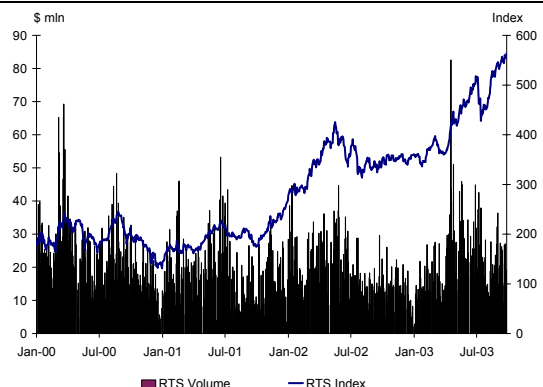
While the Index is partly based on the latest FDI numbers from the first half of 2003, there has been no sign that direct capital inflows have been increasing substantially in the second half. Russia is apparently seen as a good borrower, but strategic foreign investors are in no rush to increase direct exposure to the country. The upcoming elections are clearly an important catalyst that could change this perception of Russia.

**Figure 1. AB ICI has declined this year...**



Sources: Russian Economic School, Alfa Bank

**Figure 2. ...while the RTS Index is up over 60% YTD**



Source: RTS

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***Market has been booming on an inflow of liquidity***

The market component of the Index, however, drove it higher. In particular, the equity market has performed exceedingly well this year, reflecting the inflow of new money from non-residents. Foreign fund managers have been seeing continued interest in Russia on the part of clients, and this has triggered an inflow of cash. The liquidity component of the market's growth seems increasingly important and is reflected in the diverging trends of the AB ICI and the Russian equity market.

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