

AB-ICI: Reflecting Banking Growth

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September 25, 2006

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Moscow

Investment Summary

- AB-ICI increased by 5.0% last month on Russia's redemption of foreign debt, Fed pause
- Banking sector growth in 1H06 suggests increasing role of banks in economic growth

AB-ICI rose 5.0% on Paris Club redemption, Fed pause

The Alfa Bank Investor Confidence Index (AB-ICI) increased by 5.0% in August, mainly driven by market confidence:

AB-ICI was up...

...on flat economic confidence...

- The Index's **economic confidence** component remained flat. The share of currency-denominated deposits stagnated at around 20% of total savings, while the stagnation of CBR reserves weighed on Index growth;

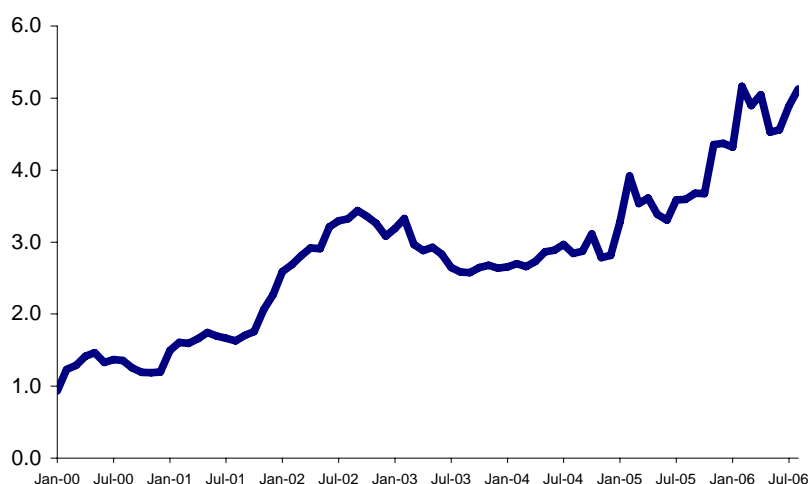
...stagnating foreign confidence...

- **Foreign confidence** was unchanged on the lack of fresh statistical data;

...and increasing market confidence driven by rating upgrade

- The **market confidence** indicator showed a positive trend driven by Russia's rating upgrade after repayment of Paris Club debt. Also, the country's fixed income and equity markets reacted positively to the pause in the Fed's rate hike campaign.

Figure 1. AB-ICI was up 5.0% last month driven by market confidence



Sources: Alfa Bank Research, New School of Economics

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Banking services growth is accelerating
Banking market growth dictates faster GDP growth

Recent banking data indicate accelerating growth in all banking markets, which is very positive news for the entire economy. While in previous years Russian banking sector assets were stagnating at 45% of GDP and retail deposits at 12% of GDP, this year we foresee a jump by both indicators to 48% and 14%, respectively. In terms of both deposits and lending, banking activity is delivering faster growth than in 1H05.

The key surprise comes from the retail lending market, which rose from \$41 bln to \$56 bln in the first half of the year. While in 2005 this market delivered 84% y-o-y growth, it is expected to post 95% growth for this year, putting the total volume of retail loans at \$80 bln, or 8.0% of GDP. This growth appears due to banks' penetration of the mortgage and auto lending markets, as well as the strong increase in consumer loans.

An interesting point about retail lending is that it shows no signs of further consolidation. The top 20 banks controlled 64% of this market in 2005, and their share remained unchanged in 1H06. The banks that were acquiring retail portfolios in 2005 decelerated their activity in 2006 due to slower organic growth. In the meantime, second-tier banks are rapidly catching up.

Retail deposits to reach 14% of GDP vs. 12% in previous years

On the deposit front, based on 1H06 results, year-end retail deposits are expected to amount to \$140 bln in 2006E, jumping to 14% of GDP after staying stable at 12% for the last five years. We attribute this acceleration to the increase in current deposits that started this summer, when a number of state employees began receiving their salaries in direct-deposit accounts as opposed to cash.

Figure 2: Corporate and Retail Markets in Russia, \$ bln

	2004	y-o-y change	2005	y-o-y change	1Q06	1H06	2006F	y-o-y change	2007F	y-o-y change
Private deposits	71.3	38%	95.7	34%	104.6	116.0	140.0	46%	190.4	36%
Corporate accounts	84.4	42%	112.0	33%	122.0	142.2	160.0	43%	220.0	38%
Corporate lending	114.9	47%	145.5	27%	158.8	179.0	210.0	44%	290.0	38%
Retail lending, including private entrepreneurs	22.3	119%	41.0	84%	46.5	56.4	80.0	95%	110.0	38%
Assets	257.2	35%	338.8	32%	376.2	425.7	480.0	42%	660.0	38%

Sources: CBR, Alfa Bank Research

Size of corporate lending market upgraded to \$210 bln by year's end

As for corporate markets, the growth rates for both liabilities and loans differed little from expectations. Based on 1H06 figures, we are upgrading our corporate lending projection to \$210 bln from a previous \$195 bln and corporate accounts forecast to \$160 bln from \$140 bln.

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