AB-ICI: Suffering from Capital Outflow

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

28 September, 2007 **www.alfabank.com** **Moscow**

Investment Summary

- The Alfa Bank Investor Confidence Index (AB-ICI) dropped another 2.8% last month on capital outflow
- The slowdown in the growth of banking assets to 20% in 2008 may seriously affect the AB-ICI's performance

The AB-ICI was down another 2.8% last month

AB-ICI dropped 2.8% in August

Our AB-ICI index slid 2.8% in August, continuing to suffer from the uncertainty on the global markets.

Economic confidence has been damaged by capital outflow

- The index's **economic confidence** indicator went down, driven by capital outflow. While the CBR's reserves are still at around the $420 bln level, they have stopped growing, resulting in a tense liquidity situation.

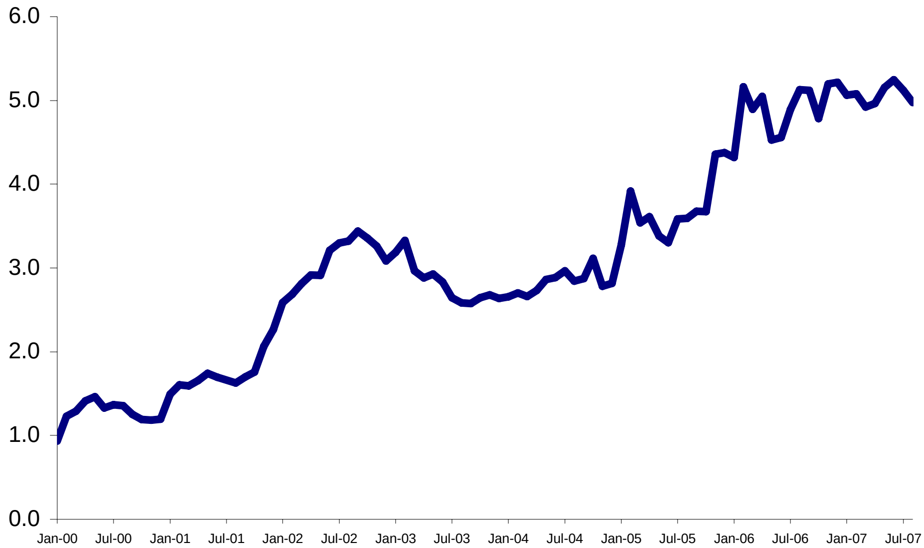
Market turmoil may slow the growth of investment by foreign banks in the Russian banking sector

- **Foreign confidence** was unchanged last month, though it may be damaged in the near future. From one side, the current market instability suggests uncertainty over the value of assets and will slow the growth of investment by foreign banks in the Russian banking sector. We also believe that foreign investment remains highly concentrated on the commodity segment.

Corporate spreads have increased

- **Market confidence** deteriorated last month, reflecting the increase in corporate spreads, lack of new IPOs and general uncertainty on the market.

Figure 1: The AB-ICI dropped 2.8% in August on increasing spreads, capital outflow



Source: Alfa Bank Research, New School of Economics

RESEARCH DEPARTMENT research@alfabank.ru

Alfa-Bank

We cut our banking sector forecast for 2008

Frozen international markets call for adjustments in forecasts

The most important question is how substantially the current liquidity problem will affect the banking sector's growth rate. If international markets stay frozen for at least the next six months, forecasts for 2007-2008 will need to be adjusted.

The banking sector grew fast in 1H07, driven by IPOs and corporate borrowing

The banking sector's assets went up by 25% YTD in 1H07, driven by fast growth in retail and, mainly, corporate accounts (see figure 4). We believe that the latter is a direct result of corporations' tremendous IPO activity and borrowing on the bond market. As a result of the global turmoil, we do not anticipate a significant inflow of corporate accounts in 2H07. Retail deposits are likely to deliver solid growth, as households will be compelled to take money out of the real estate market and switch to bank deposits. As a result, instead of upgrading the banking sector's growth rate based on strong 1H07 results, we will be looking for a 39% y-o-y increase in assets for all of 2007 because of the liquidity squeeze.

Figure 4: The Russian banking sector in figures, $ bln, 1H07

	1H06		2006		1H07		2007		2008	
	$ bln	YTD	$ bln	Y-o-Y	$ bln	YTD	$ bln	Y-o-Y	$ bln	Y-o-Y
Assets	426	26%	533	57%	667	25%	740	39%	888	20%
Retail deposits	116	21%	144	50%	168	17%	210	46%	270	29%
Corporate deposits	142	27%	178	59%	218	22%	240	35%	286	19%
Retail lending	56	37%	78	91%	98	26%	105	35%	140	33%
Corporate lending	179	23%	220	51%	271	23%	300	36%	350	17%

Sources: CBR, Alfa Bank Research

We cut our forecast for banking asset growth to 20% in 2008

A significant gap between the demand for loans and the supply of resources will materialize in 2008. On the one hand, we initially expected Russian companies to borrow $60 bln abroad, but the tough international market conditions are likely to increase local demand for loans. However, the very same factor suggests that the growth of corporate deposits will slow in 2008. We anticipate that Russian banks will not be able to satisfy the increasing local demand for loans and thus cut the corporate market growth projections to 17% for 2008.

The share of local funding will increase from 60% of assets to 63%; mortgage growth will slow

As a result, we cut our growth forecast for Russian banking assets to 20% y-o-y in 2008. The share of local funding (corporate and deposits) will increase from 60% of total assets in 2006 to 63% in 2008. We also cut the annual target for retail lending from $178 bln as of the end of 2008 to $140 bln, implying growth of only 33%. The mortgage market seems to be the most vulnerable to this slowdown, as lack of access to long-term funding will significantly reduce banks' ability to develop these products.

Contact Information

Alfa Bank (Moscow)

Head of Equities	Dominic Gualtieri
Telephone	(+7 495) 795-3649
Facsimile	(+7 495) 745-7897
Research Department	
Telephone	(+7 495) 795-3676
Facsimile	(+7 495) 745-7897
Head of Research	Ronald P. Smith
Strategy	Ronald P. Smith, Erik DePoy
Oil & Gas	Dmitry Loukashov, CFA, Konstantin Batunin
Macroeconomics, Banking	Natalia Orlova, Olga Naydenova
Telecoms, Technology, Internet	Ivan Shuvalov, Vitaly Kupeev
Utilities	Alexander Kornilov, Elina Kulieva
Metals & Mining	Valentina Bogomolova
Consumer Goods, Retail, Media	Brady Martin
Transportation, Fertilizers, Machine-Building	Roydel Stewart, Andrei Fedorov
Kazakh Product	Dmitry Loukashov, CFA, Rinat Gainoulline
Fixed Income	Ekaterina Leonova, Pavel Simonenko
Technical Analysis	Vladimir Kravchuk, Ph.D.
Russian Product	Angelika Henkel, Ph.D., Vladimir Dorogov, Vladimir Kravchuk, Ph.D.
Editorial	Michael McAtavey, Cole Akeson
Translation	Anna Sholomitskaya
Production	Aleksei Balashov
Equity Sales & Trading	
Telephone	(+7 495) 795-3712
Facsimile	(+7 495) 745-7897
International Sales	Kirill Surikov, Mikhail Shipitsin, Shani Kogan, David Johnson
Domestic Sales	Alexander Nasonov, Konstantin Shapsharov, Dmitri Sadoviy
Address	12 Akad. Sakharov Prospect, Moscow, Russia 107078

Alfa Capital (Kiev)

Research Department	
Telephone	(+380 44) 490-1600
Strategy, Macroeconomics, Fixed Income	Sergiy Kulpinsky, Ph.D.
Metals & Mining	Oleh Yuzefovych
Engineering, Chemicals	Denis Shauruk
Utilities	Maksym Nikulyak, Kateryna Ruskykh
Consumer Goods	Tetyana Orlova
Editorial	Orysia M. Kulick
Equity Sales	
Head of Sales	Sergey Grigorian
Institutional Sales	Ivan Shehavtsov
Senior Sales	Anfisa Anikushina
Telephone	(+380 44) 490-1600

Alfa Capital Markets (London)

Telephone	(+44 20) 7588-8500
Facsimile	(+44 20) 7382-4170
Sales	Maxim Shashenkov, Mark Cowley
Sales Trading	Ross Hassett, Douglas Babic
Address	City Tower, 40 Basinghall Street, London, EC2V 5DE

Alfa Capital Markets (New York)

Telephones	(+1 212) 421-8563 / (+1 212) 421-7500
Facsimile	(+1 212) 421-8633
Sales	Sabrina Ricci, Roman Kogan
Sales Trading	Roman Kogan
Address	540 Madison Avenue, 30th Floor, New York, NY 10022