

AB-ICI: FDI provides little support

Natalia Orlova

(+7 495) 795-3677

NOrlova@alfabank.ru

August 31, 2011

www.alfabank.com

Moscow

Investment Summary

- AB-ICI growth accelerated to 2.2% thanks to strong market performance in July.
- Decline in savings rate and modest FDI highlight limited local and foreign confidence.
- The global market instability started in August is likely to put pressure on AB-ICI going forward.

The AB-ICI increased 2.2% in July

AB-ICI accelerated to 2.2% from 0.6% a month before

Slowdown in retail deposits suggests lower savings rate

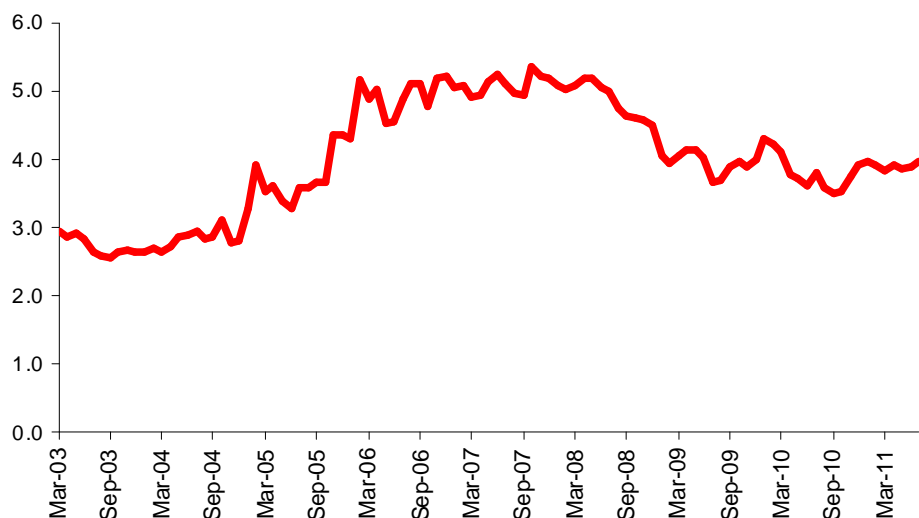
FDI slowed down to 12% y/y in 2Q11 vs. 48% y/y in 1Q11

Russian markets were strong in July, but August is key

Last month, our AB-ICI index managed to post a 2.2% m/m growth, suggesting acceleration vs. 0.6% in June. This improvement, however, was driven entirely by the strong performance of the markets in July. Local and foreign confidence, remained weak due to slowdown in retail deposit growth and weak FDI statistics. Weak AB-ICI growth structure suggests that August market instability can substantially affect index performance going forward.

- **Economic confidence** declined mainly due to the slowdown in retail deposits growth to 1% m/m in July which combined with acceleration of retail lending suggests lower savings rate. The support from capital account was also little, as according to our estimates the inflow dropped from \$2.9bn in June to \$1.5bn in July, and weak CBR reserve growth in August suggest the return of capital outflow is possible in the coming months.
- **Foreign confidence** fell as a result of FDI inflows slowing down from 48% y/y in 1Q11 to just 12% y/y in 2Q11. Also, in nominal terms, \$7bn FDI inflows for 1H11 is not enough to offset \$31bn capital outflows seen for the same period.
- **Market confidence** improved last month thanks to strong bond and equity markets in July. However, given that August global instability has hit Russian market substantially, and we will likely to see little support from this indicator going forward. Thus, the near future of AB-ICI will largely depend on Russia's ability to reignite investment growth and improve capital account.

Figure 1: AB-ICI increased by 2.2%



Source: New School of Economics, Alfa Research

RESEARCH DEPARTMENT research@alfabank.ru

The contents of this document have been prepared by Natalia Orlova of OJSC Alfa Bank ("Alfa Bank") as Investment Research within the meaning of Article 24 of Commission Directive 2006/73/EC implementing the Markets in Financial Instruments Directive (2004/39/EC). Please refer to the further important information in relation to this Document located on the last page.

1H11 FDI: too small to offset portfolio outflow

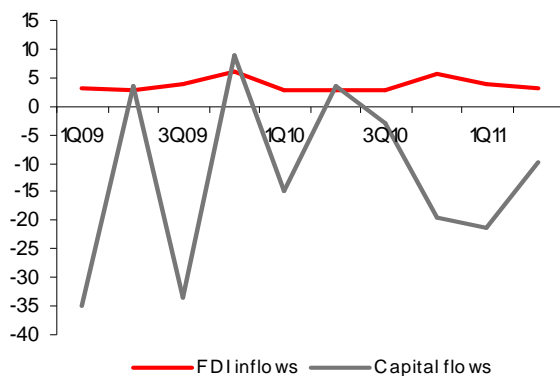
The laggard performance of foreign confidence calls to take a closer look at FDI situation

FDI inflow up 12% y/y in 2Q11 after 48% y/y; 40% of FDI still represented by oil and gas

The performance of the AB-ICI indicators suggests, that since 2000, economic and market confidence went up 6 and 10 times respectively, and foreign confidence increase by a mere 1.5 times. While this lagging behind can be seen as a potential for future catching up, the recent FDI statistics, which is the key contributor to this indicator, suggests that in the foreseeable future AB-ICI is unlikely to receive huge support from foreign direct investment inflows.

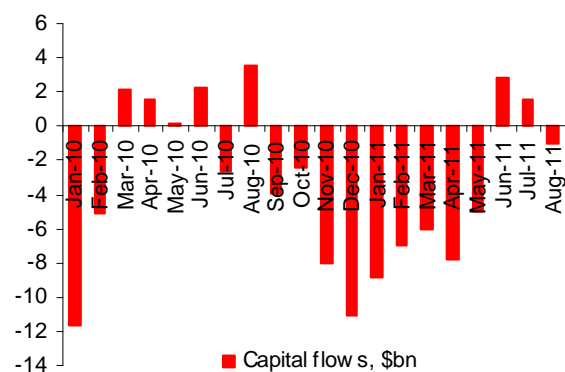
According to Rosstat, the FDI inflow accounted for \$7.0bn in 1H11, up 29% y/y. Even if this figure looks positive compared to last year's 13% y/y decline of FDI inflows, it masks a deceleration that occurred between 1Q and 2Q. After the 48% y/y FDI increase in 1Q11, in 2Q11 the increase was reported at only 12% y/y. The structure of the FDI confirms that, similar to Russian exports, the oil and gas sector remains an important area for FDI activity. In 1H11 it received 40% of total FDI inflows to Russia, and the slowdown in FDI growth from 1Q to 2Q this year appears to be directly linked to the 25% q/q drop in inflows to oil and gas.

Figure 2: FDI inflow vs. capital flows, \$ bn



Source: CBR, Alfa Research

Figure 3: Capital account, \$ bn



Source: CBR, Alfa Research

FDI is likely to remain at modest 1% GDP level in 2011

The 1H11 statistics suggest that even if this year's FDI inflows have a strong chance to exceed last year's \$13.8bn inflow by \$1-3bn, it is still not significant enough for the investment trend or capital account. FDI accounted for 0.9% of GDP last year and will stay around 1% of GDP in 2011, while the capital outflow last year accounted for 2.3% of GDP and jumped to 4% of GDP in 1H11. In nominal terms, the \$13.8bn in FDI inflows in 2010 and \$7.0bn in inflows in 1H11 are too small when compared to the \$34.0bn and \$31.2bn respective capital outflow figures, making the FDI inflow to Russia a weak tool in stabilizing the capital account.

Weak FDI statistics make AB-ICI vulnerable to market volatility

With little help from FDI, the recent market instability suggests that the improvement of the capital account starting in June may prove to be short-term. After the \$2.9bn in capital inflow to Russia in June, we anticipate Russia to report \$1-2bn in inflows in July as well, but the recent market instability raises questions over the capital account from August. Thus, the weak FDI trend has adverse consequence not only to the foreign confidence indicator of AB-ICI, but also economic confidence, which relies heavily on overall capital account. This means that going forward, at least in the near future, the index will largely depend on the market component, which proved to be highly volatile.

Contact Information

Alfa Bank (Moscow)

Head of Equities
Telephone

12 Akad. Sakharov Prospect, Moscow, Russia 107078
Michael Pijiolis
(+7 495) 795-3712

Research Department

Telephone
Head of Research
Oil & Gas
Macroeconomics
Financial Sector, Real Estate
Telecoms & Media, Transport, Industrials
Utilities
Metals & Mining
Consumer Goods, Retail, Pharmaceuticals
Agriculture, Fertilizers
Russian Product
Editorial
Translation
Production

(+7 495) 795-3676
Peter Szopo
Pavel Sorokin, Alexander Bespalov, Maria Yegikyan
Natalia Orlova, Ph.D., Dmitry Dolgin
Jason Hurwitz, Eldar Vagabov
Iouli Matevossov, CFA, CPA, Vladimir Dorogov, CFA
Alexander Kornilov, CFA, Elina Kulieva, Ph.D.
Barry Ehrlich, CFA, Andrey Lobazov
Alexandra Melnikova, Irina Prokopyeva
Alexandra Melnikova, Maria Bovykina
Angelika Henkel, Ph.D., Alan Kaziev
Cole Akeson, Heather Dean
Elena Elovskaya, Stanislava Ovcharenko
Aleksei Balashov

Equity Sales & Trading

Telephone
Facsimile
International
Domestic Institutional
Alfa-Direct Sales Team

(+7 495) 223-5500, 223-5522
(+7 495) 745-7897
Roland Glasfors, Victoria Duben, Michael Kotov, Dmitry Ryzhkov
Dmitry Soloviev, Dmitry Demchenko, Evgeny Tereschenko
(+7 495) 795-3680
Sergey Rybakov, Valeriy Kremnev, Evgeniy Batelman

Alfa Capital (Kiev)

Research Department

Telephone
Facsimile
Analysts

77-a Chervonoarmiyka St.(6th floor) Kiev, Ukraine 03150
(+380 44) 490-1600
(+380 44) 490-1601
Martin Masar, Oleh Yuzefovych

Equity Sales & Trading

Sales & Trading
Telephone

Sergey Grigorian, Denis Dolmatov, Yulia Grigoryan
(+380 44) 490-1600

Alfa Capital Markets (London)

Telephone (office)
Facsimile (office)
Telephone (Sales & Sales Trading)
Sales

1 Angel Court, 14th Floor, London, EC2R 7HJ
(+44 20) 7588-8500
(+44 20) 7382-4170
(+44 20) 7382-4175
Matthew Arnold (+44 20) 7382-4171
Victoria Filimonova (+44 20) 7382-4172
Robert Szucsich (+44 20) 7382-4174
Douglas Babic (+44 20) 7382-4178

Sales Trading

Alforma Capital Markets (New York)

Telephones
Facsimile
Sales

1270 Avenue of the Americas, New York, NY 10020
(+1 212) 421-7500
(+1 212) 421-8633
Isai Pochtar (+1 212) 421-8564
Michael Jordan (+1 212) 421-8560
Yan Gloukhovsky (+1 212) 421-8567

Copyright Alfa Bank, 2011. All rights reserved.

IMPORTANT INFORMATION

The contents of this document have been prepared by Open Joint Stock Company Alfa Bank ("Alfa Bank") as Investment Research within the meaning of Article 24 of Commission Directive 2006/73/EC implementing the Markets in Financial Instruments Directive 2004/39/EC ("MiFID"). Alfa Capital Markets ("ACM") is distributing this document to its clients in the EEA and accepts no responsibility towards any other classes of recipient. Alfa Bank and ACM have in place appropriate conflicts of interest policies and procedures aimed at ensuring the objectivity of the information contained in this document. Alfa Bank Group has financial interests in X5, VimpelCom and TNK-BP. X5 is listed on the LSE. VimpelCom is listed on the NYSE. TNK-BP is listed on the RTS Board. This research has been produced independently from all of the above relationships. Note that the recommendations contained in this document may differ materially from recommendations issued by Alfa Bank and distributed by Alfa Capital Markets in the 12 months preceding the publication of this document. The information contained in this document is provided for information purposes only and is not a marketing communication, investment advice or personal recommendation within the meaning of MiFID. The information must not be used or considered as an offer or solicitation of an offer to sell or to buy or subscribe for any securities or financial instruments. In the UK, this document does not constitute a Financial Promotion within the meaning of section 21 of the Financial Services and Markets Act 2000 (as amended). ACM is regulated by the Financial Services Authority ("FSA") with FSA registration number 416251, for the conduct of UK investment business and is the trading name of the UK branch of Alfa Capital Holdings (Cyprus) Limited ("ACC"), which is authorized by the Cyprus Securities and Exchange Commission under license number C1F 025/04. This document is not for distribution to retail clients as defined by MiFID and may not be communicated to such persons. This document is not for distribution or use by any person or entity in any jurisdiction where such distribution or use would be contrary to local law or regulation or which would subject Alfa Bank, ACC, ACM or any other group entity to authorization, licensing or other registration requirements under applicable laws. The information contained in this document is the exclusive property of Alfa Bank. Unauthorized duplication, replication or dissemination of this document, in whole or in part, without the express written consent of Alfa Bank is strictly prohibited. Although the information in this document has been obtained from, and is based on, sources Alfa Bank believes to be reliable, no representation or warranty, express or implied, is made by Alfa Bank, ACM or the authors. ACM and its officers and employees do not accept any responsibility as to the accurateness or completeness of any information herein or as to whether any material facts have been omitted. All information stated herein is subject to change without notice. ACM makes no warranty or representation that any securities referred to herein are suitable for all recipients and any recipients considering investment decisions should seek appropriate independent advice. Nothing in this document constitutes tax, legal or accounting advice. Alfa Bank, ACC and their associated companies, officers, directors or employees (excluding any financial analysts or other personnel involved in the production of research), from time to time, may deal in, hold or act as market makers or advisors, brokers or commercial and/or investment bankers in relation to the securities, financial instruments and companies mentioned in this email, or may have been, or may be represented on the board of such companies. If such circumstances arise, ACM, Alfa Bank, ACC and their associated companies have in place appropriate conflicts of interest policies and procedures to ensure that investment research remains independent and objective. A summary of ACC's conflicts of interests policy (which also covers ACM), containing details relevant to investment research, is available upon request from ACC or ACM. ACC and ACM have arranged for Alfa Bank and other relevant group entities involved in the production of research to implement equivalent policies. This document is distributed in the United States by Alforma Capital Markets, Inc., a subsidiary of Alfa Bank, which accepts responsibility for its contents. Alforma Capital Markets, Inc. did not contribute to the preparation of this report and the authors are neither employed by, nor are associated persons of, Alforma Capital Markets, Inc. The issuing entity and authors may not be subject to all of the disclosures and other US regulatory requirements to which Alforma Capital Markets, Inc. and its employees are subject. Any US person receiving this report who wishes to effect transactions in any securities referred to herein should contact Alforma Capital Markets, Inc., not its affiliates. **Alfa Bank is incorporated, focused and based in the Russian Federation and is not affiliated with US-based Alfa Insurance.**