

AB-ICI September: Up on Foreign Borrowing

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Investment Summary

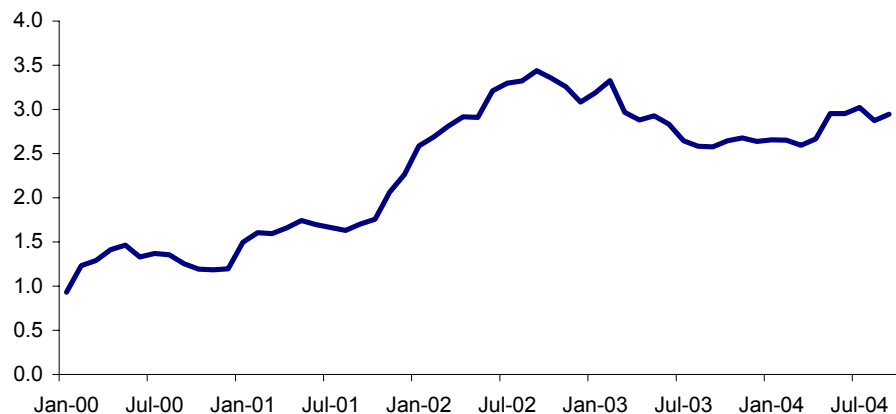
- AB-ICI shows recent high volatility on mixed signals, up 2.5% in September
- Index supported by \$4.8 bln increase in Russian corporate foreign debt, i.e. capital inflow
- Stagnant lending and squeezed corporate bond market remain chief risk-factors

AB-ICI's volatility is due to mixed economic signals

AB-ICI up 2.5% in September on Capital Inflow

Alfa Bank's Investor Confidence Index (AB-ICI) shows that volatility has increased over the past few months due to mixed signals. On the one hand, the current economic trend indicates a slowdown accompanied by squeezing opportunities to borrow money (i.e., deteriorating conditions on the corporate bond market) and a decline in depositor confidence. On the other hand, an increase in FDI and high oil prices are supporting both our index and investor interest in Russia.

Figure 1. Alfa Bank Investor Confidence Index: Up 2.5% on Capital Inflow



Sources: *New School of Economics, Alfa Bank*

Net capital inflow in September helped improve liquidity and supported the AB ICI

AB-ICI performance in September resulted from the same combination of confusing signals. The key positive factor that pushed the index up was the net capital inflow posted in September, the best figures seen since January 2004. The persistent poor liquidity plaguing the Russian banking sector drove a number of banks and companies to issue Eurobonds and to attract syndicated loans totaling \$2.0 bln and \$2.8 bln, respectively.

Figure 2. Eurobond Placements in September-October 2004

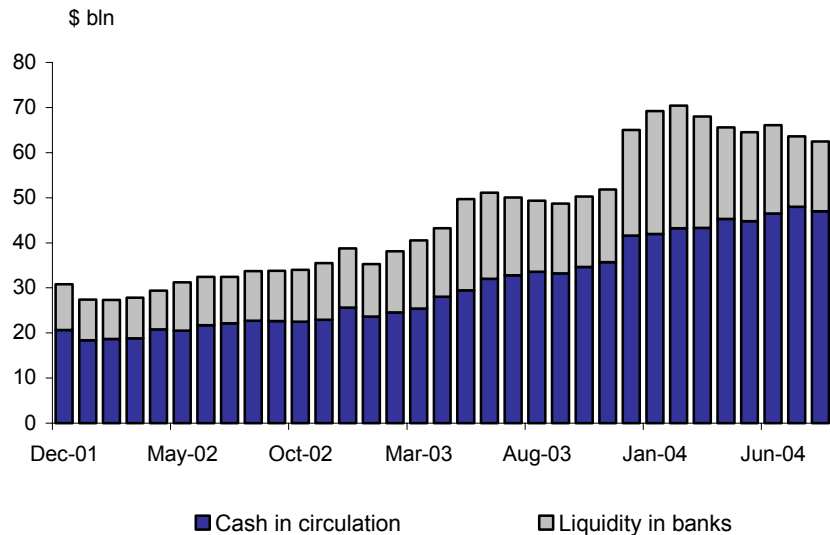
| | Volume | Currency | Maturity (yrs) | Placement Date |
|---------------------|--------|----------|----------------|----------------|
| MDM-bank | 200 | \$ | 2 | 10/09/2004 |
| Bank of Moscow | 250 | \$ | 5 | 14/09/2004 |
| Rusky Standard | 300 | \$ | 3 | 16/09/2004 |
| Norilsk Nickel | 500 | \$ | 5 | 19/09/2004 |
| Alfa Bank | 190 | \$ | 2 | 23/09/2004 |
| City of Moscow | 374 | € | 7 | 24/09/2004 |
| Moscow Narodny Bank | 200 | \$ | 3 | 28/09/2004 |
| VTB | 450 | \$ | 7 | 01/10/2004 |
| Vimpelcom | 300 | \$ | 7 | 14/10/2004 |

Source: *Reuters, Alfa Bank*

An increase in the CBR does not reveal much about liquidity as export revenues go to stabilization fund

This inflow of borrowed capital indicates an improved quality of growth in the CBR reserves. The reserves recently skyrocketed up \$100 bln, largely due to oil export revenues, but the monetary mass created as a counter party to reserves growth is flowing to Treasury accounts, and not into the banking system. This explains the fact that despite the increase in total monetary mass and reserves, Russia is experiencing liquidity issues in the banking sector. The net capital inflow is therefore a way to resolve this problem and provide the banking community with liquidity. We expect capital to continue to flow to Russian banks from abroad in October-November, thus supporting the AB-ICI

Figure 3. Cash and Banking Liquidity in Russia



Source: CBR, Alfa Bank calculations

Uncertain Market Mood May Hit Index Growth

The current key risk factors are linked to the market performance component and are included in the calculation of our index.

The first factor is the high volatility of equity market dynamics. The infamous 'Yukos Affair' is keeping the market nervous, and no one knows just how much longer volatility will reign on the RTS. Moreover, RTS dynamics at present cannot be perceived a movement of the market as a whole, but rather a combination of separate stories. For example, Mosenergo's skyrocketing prices and the deep drop in Yukos shares contributed to the index's rises and falls, but both stories are being driven by completely different catalysts. The Russian market is no longer moved by the consensus on country performance; instead, it represents a number of independent corporate trends.

Another point is that the poor liquidity in the banking sector may push down demand for financial instruments in general. In particular, it already seems to be hampering development in the corporate bond market. The boom in recent years in the equity, fixed income and real estate markets was directly linked to an increase in the monetary base. Therefore we are keeping a cautious approach towards assessing the full potential of AB-ICI growth until year's end.

Figure 4. Growth in Monetary Base vs. Increase in Asset Prices

| | 2002 | 2003 | 8M04 |
|--|------|------|------|
| Change in monetary base | 26% | 68% | -4% |
| Change in prices on OFZs (state bonds) | 5.6% | 9.6% | 0.2% |
| Change in equity market (RTS) | 38% | 58% | 8% |
| Change in real estate prices | 25% | 40% | 0% |

Sources: Alfa Bank, CBR

The RTS is not predictable, as a number of equity stories have completely different triggers

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