

# AB-ICI: Following Market Sentiment

Natalia Orlova

(7 495) 795-3677

NOrlova@alfabank.ru

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www.alfabank.com

Moscow

## Investment Summary

- The Alfa Bank Investor Confidence Index (AB-ICI) rose 5% last month in response to the market rally
- The Russian economy, however, remained stagnant, which translated into a decline in the economic confidence index
- The low inflation of the past few months is a sign of weak consumption and low economic activity

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### The AB-ICI rose 5% last month

**The AB-ICI rose 5% last month...**

In October, the AB-ICI rose 5% after a posting a modest 1.2% increase in September. This impressive growth was driven by the strong performance of Russia's fixed-income and equity markets, which signaled an improvement in investor sentiment toward the country.

**...despite no sign of a decline in dollarization...**

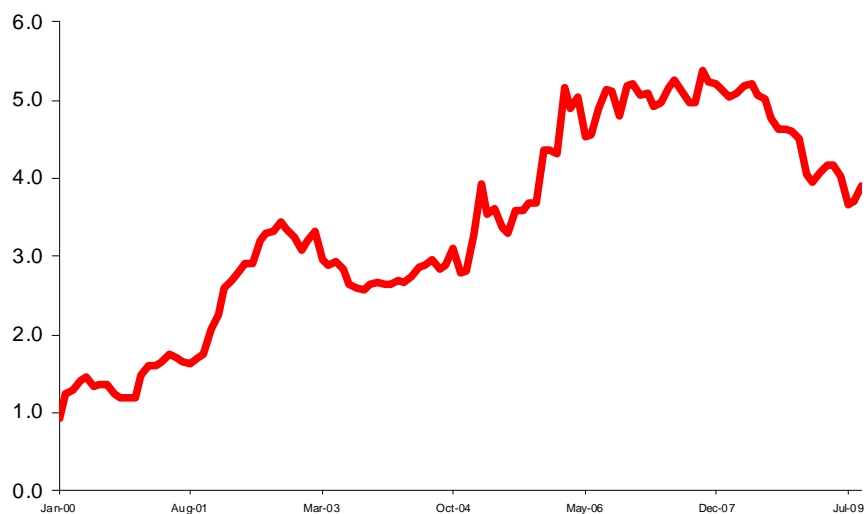
- The **economic confidence indicator** continued to decline, reflecting the lack of improvement in Russia's capital account. Though the dollar is weak on international markets, local confidence in the ruble is low, and retail and corporate deposits in foreign currency are not declining;
- **Foreign confidence** was unchanged owing to a lack of updated statistics;
- **Market confidence** improved considerably, reflecting a decline in the spread between Russia's sovereign bond yield and that of peers, as well as strong inflows to the country's equity markets. While the growth in financial markets was driven by liquidity, rising oil prices clearly increased investors' appetite for exposure to Russia.

**...thanks to continuing inflows of liquidity to bond and equity markets**

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**Figure 1: AB-ICI was up 5% last month**

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Source: New School of Economics, Alfa Research

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**RESEARCH DEPARTMENT** research@alfabank.ru

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## Russia's real sector was flat in October

**Confidence in the ruble is low, share of foreign-currency deposits remains high**

We believe the AB-ICI's performance will remain weak until the real economy shows signs of recovery. Last month's recovery in the index was driven by gains on financial markets that resulted from excess liquidity. However, our concern is that this optimism could dissipate as investors' attention shifts to the real sector.

**Retail indicators continue to deteriorate**

And Russia's economy is a long way from recovering. Retail indicators continue to deteriorate, with retail trade turnover dropping by 5.3% y-o-y in 9M09 vs. 4.7% y-o-y in 8M09, meaning the decline for September was 9.9% y-o-y. Even though unemployment declined to 7.6% in September from 8.1% in August, real disposable income fell 1.1% y-o-y in 9M09 vs. 0.7% y-o-y in 8M09.

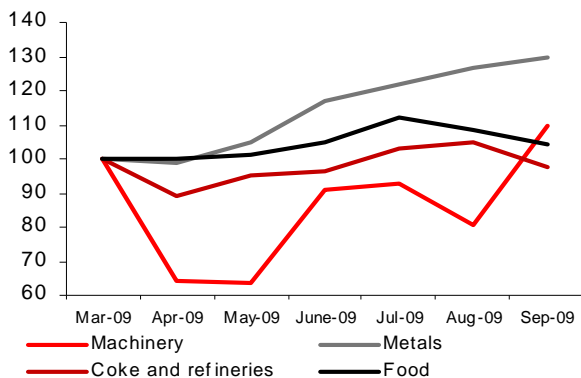
**Investment shrank by 18.9% y-o-y in 9M09**

The construction sector also shrank in September. Though the government ran a budget deficit of 4.7% of GDP in 9M09, the fiscal stimulus did not boost investment. Housing construction declined by 9.7% y-o-y in September, and overall investment shrank by 18.9% y-o-y in 9M09, the same as in 8M09.

**Recent economic statistics give the impression of a horizontal growth trend rather than a recovery**

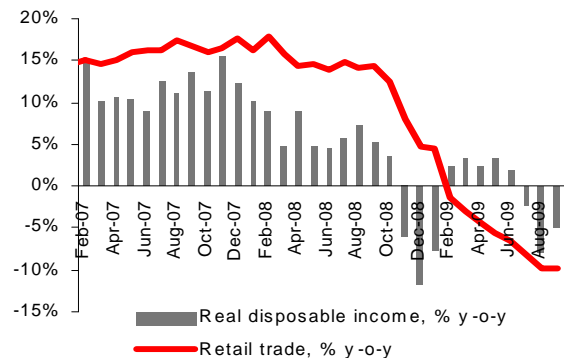
Despite the weak retail and investment trends, Russian officials believe the economy has emerged from recession. The government reported that seasonally adjusted GDP grew 0.6% q-o-q in 3Q09, and the economy is expected to grow by 3-4% q-o-q in 4Q09. However, according to Vladimir Sokolin, the former head of Rosstat, recent economic statistics give the impression of a horizontal growth trend rather than a recovery. We believe the upturn in some sectors – such as metal production, where output has increased by 30% since March – reflects strong external demand. Moreover, the growth in the metals sector has already resulted in close to full capacity utilization, so there looks to be little room for further expansion. We doubt that Russia's GDP will start growing again unless exports continue to rise. Until the lack of investment in the country is addressed, we believe there is a high risk that output will remain stagnant.

**Figure 2: Sector growth rate, March 2009=100**



Source: Rosstat, Alfa Bank

**Figure 3: Disposable income and retail trade**



Source: Rosstat, Alfa Bank

**The ongoing contraction in banks' loan books is a clear sign of stagnation**

The ongoing contraction in banks' loan books is a clear sign of stagnation. According to recent comments by the CBR, the loan portfolio of Russian banks has declined by 2.5% since the beginning of September. Banks continue to use available liquidity to cut their exposure to CBR funding rather than make loans.

## Contact Information

### Alfa Bank (Moscow)

Head of Equities  
Telephone

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

### Research Department

Telephone  
Head of Research  
Oil & Gas  
Macroeconomics  
Banking  
Telecoms, Technology, Internet, Media  
Utilities  
Metals & Mining  
Consumer Goods, Retail, Real Estate  
Transportation, Fertilizers, Machine-Building  
Russian Product  
Editorial  
Translation  
Production

(+7 495) 795-3676  
Ronald P. Smith  
Chirvani Abdoullaev, CFA, Alexander Bespalov  
Natalia Orlova, Ph.D.  
Natalia Orlova, Ph.D., Leyla Sharifullina  
Elena Mills, Ekaterina Balykina  
Alexander Kornilov, Ph.D., Elina Kulieva  
Barry Ehrlich, CFA, Maxim Semenovych, Sergei Krivokhizhin, Ph.D.  
Elena Mills, Vitaly Kupeeov  
Georgy Ivanin  
Angelika Henkel, Ph.D., Vladimir Dorogov  
David Spencer, Heather Dean  
Anna Sholomitskaya, Elena Elovskaya  
Alekssei Balashov

### Equity Sales & Trading

Telephone  
Facsimile  
International  
Domestic Institutional  
Alfa-Direct Sales Team

(+7 495) 223-5500, 223-5522  
(+7 495) 745-7897  
Isai Pochtar, Michael Kotov, Roland Glasfors  
Dmitry Soloviev, Dmitry Demchenko, Mikhail Babaev  
(+7 495) 795-3680  
Sergey Rybakov, Valeriy Kremnev, Evgeniy Batelman

### Alfa Capital (Kiev)

#### Research Department

Telephone  
Facsimile  
Analysts

77-a Chervonoarmiyska St.(6<sup>th</sup> floor) Kiev, Ukraine 03150

(+380 44) 490-1600  
(+380 44) 490-1601  
Denis Shauruk, Oleh Yuzefovych

#### Equity Sales & Trading

Sales Trading  
Telephone

Sergey Grigorian, Ivan Shehavitsov, Denis Dolmatov  
(+380 44) 490-1600

### Alfa Capital Markets (London)

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

City Tower, 40 Basinghall Street, London, EC2V 5DE  
(+44 20) 7588-8500  
(+44 20) 7382-4170  
(+44 20) 7382-4175  
Julia Dawson (+44 20) 7382-4174  
Douglas Babic (+44 20) 7382-4178  
Mark McCracken (+44 20) 7382-4172

### Alforma Capital Markets (New York)

Telephones  
Facsimile  
Sales  
Sales Trading  
Fixed Income Sales

540 Madison Avenue, 30<sup>th</sup> Floor, New York, NY 10022  
(+1 212) 421-7500  
(+1 212) 421-8633  
Robert Kaplan, George Kogan  
Roman Kogan  
Jeffrey Weichsel

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