

AB-ICI: Demonstrating Expected Recovery

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Investment Summary

- The AB-ICI increased by 9% last month, ruble appreciation attracted capital inflows.
- We expect favourable market trend to remain supported by the banking market liberalization.

The AB-ICI increased by 9%

The AB-ICI went up by 9%...

...stronger ruble fuelled capital inflows, ruble deposits growth...

...and equity market recovery by the year-end

The Alfa Bank Investor Confidence Index (AB-ICI) went up by 9% due to improving liquidity and thus market sentiments:

- The index's **economic confidence** component improved substantially. The increase of the CBR reserves signal capital inflows and affected positively domestic liquidity. The ruble appreciation fuelled continuing decline in currency deposits which dropped to new low of 18.1% of total deposits.
- **Foreign confidence** increased based on higher FDI and increased foreign banks presence in Russia. The share of foreign banks in total capital increased to 8.2%
- **Market confidence** changed its trend and indicated serious improvement. Increase in number of IPOs and growth in RTS index both positively affected index dynamic.

Figure 1: The AB-ICI is up by 9% on capital inflow, market recovery



Source: Alfa Bank Research, New School of Economics

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Banking IPO's will boost market in 2007

Banking IPOs were announced, but never took place

Foreign investors currently need CBR permission

Duma is preparing amendments to liberalize the banking sector for foreign investors

Liberalization will help secondary trading, have a positive effect on IPOs

Russian Duma just passed in third reading the amendment to law on Banks and Banking regulation, allowing foreign investors to participate in the local banking shares market. The new regulation increase chances of state banks' IPO in 2007 and is very positive for entire Russian market.

Russian banking IPOs have been on the agenda for a couple of years. However, despite frequent announcements from Rosbank, VTB and Gazprombank, none of these share placements have materialized. Instead, the banks chose to sell stakes to strategic partners. Rosbank sold 20% to Société Générale and expects to offer another 30% by 2008, while Gazprombank received an injection from Gazfond, a Gazprom-owned entity.

The reason lies in Russia's complicated banking regulation, which is very unfriendly to foreign investors and restrictive for local investors. First, foreign buyers of banking stock need the CBR to give special permission, or "bless" the shares. Second, when injecting money into a bank's capital, both residents and non-residents must present CBR confirmation that their net assets correspond to the size of their investment in a bank's capital. The CBR introduced this rule to prevent banks from inflating their capital.

Ahead of the share placements of two state banks – the IPO of VTB and the additional placement by Sberbank – regulatory changes have been put on a fast track. Today, the Duma approved in third reading the Law on Banks and Banking Activity, which liberalizes foreign access to banking equities. The new regulation will unify rules for residents and non-residents, allowing both categories to buy up to 20% stakes in any bank without having to receive CBR permission. Should the Federation Council and President Putin approve the regulatory changes before year's end, the practice of blessing shares will be discontinued at the beginning of 2007.

These amendments will clearly facilitate secondary trading and be positive for all banking stocks traded in Russia. Even if participation in banking IPOs will still require proof of the financial soundness of potential buyers, facilitating secondary trading will still have a positive impact on the primary placement. We expect this new regulation will favourably affect AB-ICI dynamic in 2007.

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