

AB-ICI: Rising on Foreign Banks' Penetration

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Investment Summary

- The Alfa Bank Investor Confidence Index (AB-ICI) is up on dedollarization, foreign banks penetration
- Reported FDI suggest repatriation of Russian capital, non-oil FDI as weak as 0.7% of GDP

The AB-ICI jumped 8% on banking sector results

AB-ICI up 8%

Economic confidence better on dedollarization, reserves growth

Foreign confidence up on active foreign banks penetration

Market confidence still weak, damaged by debt markets

Our AB-ICI index jumped 8% in October reflecting a significant increase in our foreign confidence indicator, completely offsetting weak market confidence.

- The index's **economic confidence** indicator increased, driven by growth in the CBR's reserves and continuing dedollarization pushed by a weak dollar;
- **Foreign confidence** increased dramatically, reflected by a sharp jump in the presence of foreign banks in the Russian banking sector. In our view this reflects the slow growth of Russian private banks, which have felt the lack of foreign funding. The FDI statistics released recently failed to provide support to the foreign confidence indicator, as the latter is focused on the fuel sector;
- **The market confidence** indicator was damaged by Russia's expansion into emerging markets and by a decline in the share of small and medium companies on the corporate bond market. In our view this indicates that the tough liquidity situation in the Russian banking markets has discouraged SMEs from borrowing through market instruments.

Figure 1: The AB-ICI is boosted by capital inflow, foreign banks faster penetration



Source: Alfa Bank Research, New School of Economics

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Foreign banks building presence, FDI weak

Organic growth allowed top-5 foreign banks to control 5.1% of Russian assets

Acquisition of Rosbank and consolidation of Impeksbank has put foreign banks share to 10.9% of total assets

The increase of foreign banks penetration in the Russian banking market is the combination of two trends. First, the organic growth of foreign banks has clearly accelerated in previous months. The share of top-5 foreign banks (see figure 2) accounted for 5.1% in total Russian banking assets versus 4.8% as of beginning of this year. Some banks, like Moscow International bank, are using the squeeze in local liquidity to increase their lending activity.

The second trend, which is more important, is the acquisition of Rosbank by Societe Generale and the consolidation of Impeksbank to Raiffeisen. Both banks were included to the list of foreign banks in 3Q07, boosting the share of foreign banks in total assets to 10.9% from June's figure of 8.7%.

Figure 2: Foreign banks in Russian banking sector, \$ mln

	Assets, Dec-06	Assets, March-07	% change, q-o-q	Assets, June-07	% change, q-o-q	Assets, Sept-07	% change, q-o-q
Raiffeisen	8,490	10,475	23%	11,005	5%	12,521	14%
MIB	9,184	10,197	11%	10,421	2%	12,506	20%
Citibank	4,824	5,011	4%	6,063	21%	5,592	-8%
ING	1,744	2,348	35%	1,935	-18%	3,222	67%
Deutsche Bank	1,475	1,538	4%	1,591	3%	3,185	100%
Top 5 foreign banks	25,719	29,570		31,014.5		37,027	
Total assets	533,422	599,731		666,228		730,994	
Share of top 5 foreign banks	4.8%	4.9%		4.7%		5.1%	

Source: Interfax, Alfa Bank Research

Cyprus and the Netherlands account for 70% of Russia's accumulated FDI

The penetration of foreign banks in the Russian banking sector is, however, not supported by general FDI trends. Firstly, the structure of accumulated FDI suggests that capital arrived from two countries – Netherlands and Cyprus – accounts for virtually 70% of the total accumulated FDI in Russia. As both countries in reality mask the repatriation of Russian capital, we believe that the role of foreign capital in the Russian economy is much lower than it seems to be through FDI statistics.

Figure 3: Breakdown of FDI inflows by country

	Accumulated FDI, \$ bln	Share, %
Total FDI, including	87801	100%
Netherlands	32230	37%
Cyprus	27362	31%
Germany	3830	4%
USA	3643	4%
UK	3192	4%

Source: Rosstat, Alfa Bank Research

With non-oil FDI as weak as 0.7% of GDP in 2007, FDI is not supportive of the AB-ICI dynamic

Secondly, FDI inflows are very much concentrated on the fuel sector. In 9M07 some \$12.6 bln of \$19.6 bln FDI inflow went to the fuel industry, or 64% of the total amount. This suggests that only \$7 bln went to non-oil activities, or around 0.7% of GDP. In 2006, the non-oil sectors attracted some 1% of GDP in the form of FDI. This figure indicates that the FDI dynamic is not yet playing a supporting role for the dynamic of our AB-ICI index.

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