

AB-ICI: Strong Markets, but Outflow Continues

Natalia Orlova

(+7 495) 795-3677

NOrlova@alfabank.ru

November 30, 2010

www.alfabank.com

Moscow

Investment Summary

- The AB-ICI increased slightly by 0.7% last month thanks to Russian financial markets
- Capital outflow intensified due to corporate acquisitions abroad and foreign debt redemptions
- CBR forex interventions cause local rates to climb, highlighting risks of turnaround in interest rate trends

AB-ICI increased by 0.7% supported by strong markets

AB-ICI recovered 0.7% last month

Last month, the AB-ICI recovered a modest 0.7% after the 12.3% fall in January-September, as being an outsider to global capital inflows ahead of QE2, Russia remained immune to the debt crisis in the EU, which hit global emerging markets in end-October. Internal capital outflows however intensified, forcing the CBR to spend \$9bn reserves in the last month to support ruble.

Capital outflow intensified from \$2bn to \$6bn in the last two months

- **Economic confidence** declined despite the strong 3.9% y/y GDP growth in October due to intensified capital outflows caused by corporate acquisitions abroad and foreign debt redemptions. The \$8bn capital outflows in the last two months forced CBR to downgrade full-year capital outflow projections and spend \$9bn reserves in the last two months. The instability on the exchange rate market increased the dollarization of retail deposits underlining the risks of internal capital flight;

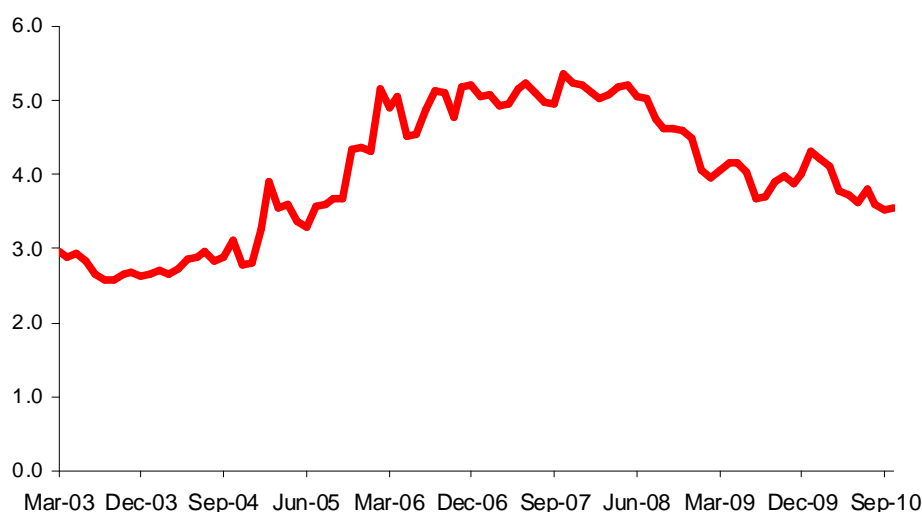
FDI inflows declined 18% y/y in 9M10

- **Foreign confidence** declined as Russia failed to increase FDI in 3Q10 resulting in the 18% y/y reduction in 9M10 after 41% drop in 2009, signaling low investment attractiveness of the real sector;

Russian market remains an outsider to the global capital flows

- **Market confidence** increased because of strong performance of Russian markets relative to its emerging market peers. If in September Russian market failed to join the global QE2 rally, last month it did not suffer from EU debt crisis highlighting Russia's role as an outsider to global capital flows.

Figure 1: AB-ICI increased 0.7% last month



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.

Internal capital flight is key risk for AB-ICI

3Q10 GDP growth reported at better than expected 2.7% y/y, in October growth accelerated to 3.9% y/y

Accelerated inflation has reduced consumption growth from 4.7% y/y in September to 4.3% y/y in October

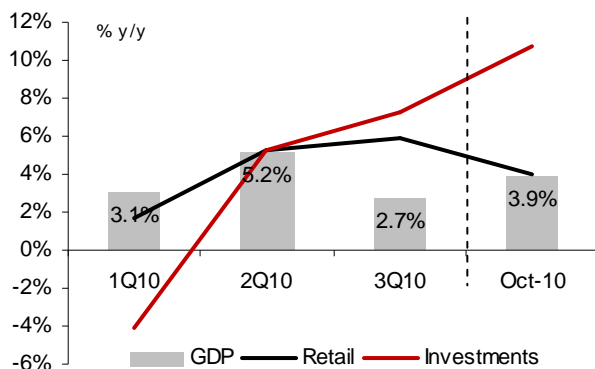
October loan growth was weak, at 0.5% m/m

Last month, the AB-ICI took a pause in the steady decline observed since the beginning of the year. Recent news brought some relief in terms of GDP growth. Rosstat's estimate of 3Q10 economic growth was 2.7% y/y versus the government's initial estimate of 2.3% y/y, suggesting that faster investment growth helped to offset the deterioration of net export. October's strong growth was mainly the result of an acceleration in industrial production growth from 6.2% y/y in September to 6.6% in October despite the unfavorable base effect. With October GDP growth accelerating to 3.9% y/y, putting the 10M10 figure at 3.7% y/y, our 3.6% y/y full-year forecast is realistic.

Nonetheless, we maintain our cautious stance on Russia's growth outlook, as the faster investment growth is coming hand in hand with a slowdown in consumption. After decelerating gradually from a peak of 6.7% y/y in July to 4.7% y/y in September, retail trade growth was reported at a mere 4.3% y/y in October owing to rising inflation. Price growth accelerated from 0.1% a week in October to 0.2% in November; as of the end of November, annual inflation had reached 7.8% y/y.

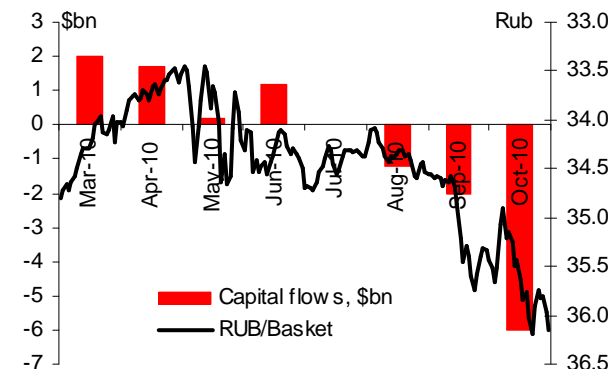
Though October's GDP recovery was strong, it was creditless. After the 4.6% q/q growth in corporate lending seen in 3Q10, including a 2.9% m/m increase in September, the loan book increased by only 0.5% in October. It therefore appears that companies are using the increase in final demand to deleverage. Moreover, September's pick-up in lending activity may have stemmed from the need to finance capital outflow.

Figure 2: Investments vs. retail trade



Source: Rosstat, Alfa Research

Figure 3: Ruble vs. capital outflows



Source: CBR, Alfa Research

CBR spent \$9bn in last two months

Better GDP growth, higher inflation and jump in local rates suggest refinancing rate should be increased soon

In October-November, the CBR spent \$9bn intervening on the FOREX market, causing domestic overnight rates to increase slightly from 2.5% to 3.5%. Given the expected current account surplus of \$2-3bn a month, this suggests that Russian companies continued to deleverage not only domestically, but also on international markets.

Three factors combined – (1) faster October GDP growth; (2) rising inflationary pressure; and (3) a higher domestic interest rate – make it very likely that the CBR will raise the refinancing rate in January-February. Nonetheless, we do not believe this step will have a positive impact on the ruble exchange rate, and we expect the currency to remain weak unless oil prices rise to above \$85-90/bbl. Therefore, the risks of capital outflows will weigh on AB-ICI in the coming months.

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
Utilities
Metals & Mining
Consumer Goods, Retail, Real Estate
Agriculture, Industrials, Logistics
Russian Product
Editorial
Translation
Production

(+7 495) 795-3676
Peter Szopo
Pavel Sorokin, Alexander Bespalov
Natalia Orlova, Ph.D., Dmitry Dolgin
Jason Hurwitz, Leyla Sharifullina
Alexander Kornilov, CFA, Elina Kulieva, Ph.D., Fedor Kornachev
Barry Ehrlich, CFA, Maxim Semenovykh, Sergei Krivokhizhin, Ph.D.
Irina Prokopyeva
Georgy Ivanin, Vladimir Dorogov, CFA
Angelika Henkel, Ph.D., Alan Kaziev
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
Roland Glasfors, Victoria Duben, Michael Kotov, Dmitry Ryzhkov
Dmitry Soloviev, Dmitry Demchenko, Mikhail Babaev,
Evgeny Tereschenko
(+7 495) 795-3680
Sergey Rybakov, Valeriy Kremnev, Evgeniy Batelman

Alfa Capital (Kiev)

Research Department

Telephone
Facsimile
Analysts

77-a Chervonoarmiyska St.(6th floor) Kiev, Ukraine 03150

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

Equity Sales & Trading

Sales & Trading
Telephone

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

Alfa Capital Markets (London)

Telephone
Facsimile
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 Szuccsich (+44 20) 7382-4174
Douglas Babic (+44 20) 7382-4178

Sales Trading

Alforma Capital Markets (New York)

Telephones
Facsimile
Sales

Sales Trading
Fixed Income 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
Jeffrey Weichsel (+1 212) 421-8563

Copyright Alfa Bank, 2010. 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 CIF 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, ACC, 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.**