

# AB ICI: Down 14% in 2003 Despite Macro Stability

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## Investment Summary

- Despite an \$8 bln jump in CBR reserves in December, the AB-ICI fell, on slower deposit growth
- The AB-ICI declined 14% in 2003 as capital inflows were substantial but unstable
- 2003 figures suggest 70% of GDP growth was due to oil sector – structural changes still a puzzle

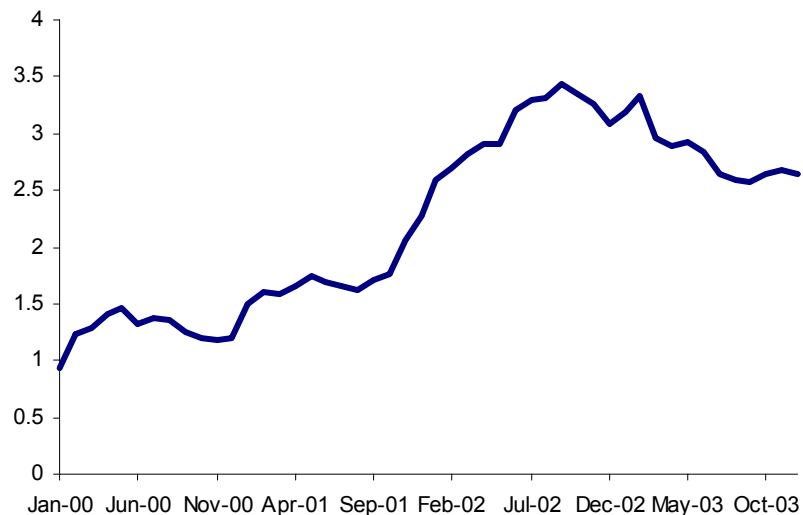
### **AB-ICI down 1.5% in December on slower growth in deposits**

Contrary to our expectations, the AB-ICI declined 1.5% in December. The reason behind this is the weakening of the economic component of the index, reflecting the substantial slowing in deposit growth from 3% to 1.7% over the last month used in the calculations. This slower deposit growth coincided with the sudden jump in average income in November 2003 due to the indexation of state salaries. As a result, the decline in the deposits/income ratio played negatively on the index.

### **\$8 bln increase in CBR reserves confirms substantial capital inflow in December**

It is important to mention that the weaker deposit growth sent down the economic component of the index, despite the still substantial capital inflow into Russia. During the last month of 2003, Russia continued to experience capital inflow, as was reflected in the unprecedented \$8 bln increase in CBR reserves, to a level of \$76.9 bln at year's end. Such an improvement was clearly due to the willingness of large Russian businesses to clear their tax obligations before year's end, to avoid claims from the tax authorities, hence the larger repatriation and borrowing from abroad.

**Figure 1. AB ICI: 14% decline in 2003 after having tripled in 2000-2002**



### **AB-ICI declined 14% in 2003 due to high volatility of capital inflow**

The performance of the AB-ICI for 2003 was, on the whole, not as good as we had initially expected. The Index declined 14% in response to the near 40% fall in its economic component. This reflects the high volatility of Russia's macro factors, such as capital inflows. While there was some improvement in terms of capital inflows in 1H03, in July-September a substantial outflow took place. The net capital inflow reemerged from October, but only helped to prevent the continuing drop of index (see Figure 1).



**70% of growth in 2003 was derived from oil prices and increased exports; new sources for growth have yet to be found**

Although CBR reserves are now among the highest in the world, and cover five years of foreign debt payments, they are still a function of volatile indicators, i.e. oil prices and the return of domestic capital. Some research suggests (see Figure 2) that above 70% of the 6.8% GDP growth in 2003 was due to high oil prices and increased export volume (mainly increase in crude oil exports). This dependence persists from 2002, when the contribution of other components to growth started to decline. Thus, Russia has yet to develop an alternative source of growth by, for example, increasing foreign investment.

**Figure 2. Contribution to growth by factors, 1999-2003**

	1999	2000	2001	2002	2003
GDP growth, including	6.4	10.0	5.0	4.3	6.8
Increase in oil prices	0.4	4.9	1.0	-0.7	1.5
Increase in volume of exports	0.1	2.8	1.5	3.6	3.8
Decline in imports of final goods	4.7	0.7	-1.2	-0.6	-1.0
Other factors	1.2	1.6	3.7	2.0	2.5

Source: Center of Macroeconomic Studies and Short-term Projections

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