Alfa-Bank

Macro Insights

AB-ICI: Stabilizing on Better Market Sentiment

Natalia Orlova | **(+7 495) 795-3677** | **NOrlova@alfabank.ru**
Dmitry Dolgin | (+7 495) 780-4724 | DDolgin@alfabank.ru

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Investment Summary

- AB-ICI decline narrowed to 1% in January after 7% in the previous month thanks to more stable markets
- Macro data improved in January; however, it came at the expense of household savings
- Tight budget execution in January supports positive expectations for 2H16

AB-ICI declined 1% in January

AB-ICI decline slowed to 1% thanks to stabilization of market sentiment

AB-ICI narrowed its decline to 1% m/m in January after the 7% collapse in December, which mainly reflects the end of the most recent wave of global market turmoil. The internally-driven AB-ICI components remain under pressure from the tight budget policy, which forces households to spend savings. However, expectations of faster budget spending in 2H16 are likely to support sentiment from here.

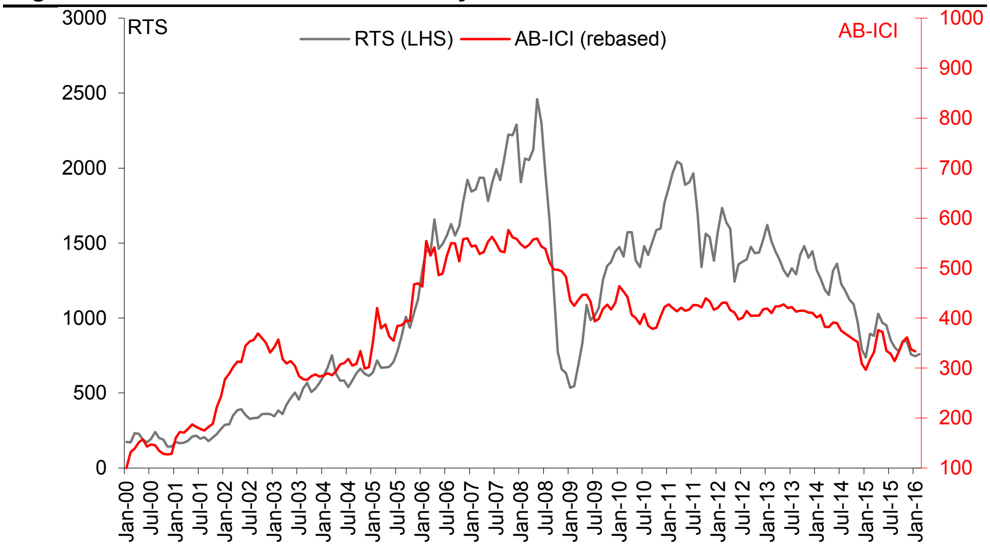
Household savings in FX dropped $4bn in January to finance local spending and possibly cross-border transfers to protect large deposits from bail-in

- **Economic confidence** fell, reflecting a drop in household savings. In January, Russian FX retail deposits dropped unexpectedly by $4bn, or 4%. This decline partially reflects a preference to finance extra spending, which helped to improve the retail trade drop to 7.3% y/y in January from 15.3% y/y in December. This might also partially reflect transfers to Belarus by high net worth individuals in response to recent initiative to make deposits of over RUB100mn subject to bail-in during bank failures.
- **Foreign confidence** declined, as foreign banks continued to reduce their presence in Russia. The contraction of the retail lending market and the US's renewed indication that international sanctions are unlikely to be lifted will probably put pressure on the foreign banks' activity in Russia.

A more dovish Fed stance, oil stabilizing at $30-35/bbl and Latin America woes supported market interest to Russia

- **Market confidence** increased, as global markets managed to stabilize toward the end of January thanks to the Fed's more dovish stance. With oil prices temporarily stabilizing at $30-35/bbl, Russia's attractiveness relative to its peers – especially in the Latin and South America (Brazil and Argentina) – has improved. That said, the sanction-driven refusal of global majors to participate in Russia's sovereign Eurobond placement suggests a low likelihood of large inflows to Russian bonds and equities.

Figure 1: AB-ICI down 1% in January



Source: New Economic School, RTS, Alfa Bank

AB-ICI: Stabilizing on Better Market Sentiment

Oil price stabilizes at $30-35/bbl, but downside risks remain – China the factor to watch

Since the end of January, AB-ICI has been benefitting from a more stable global environment. First, the financial markets saw some rebound following the Fed's indication that the upward movement in its key rate might be smoother than initially believed. Second, oil did not test new lows, remaining in the $30-35/bbl range. Finally, the recent negative news regarding the disappointing performance of Brazil and Argentina has improved Russia's relative attractiveness for global portfolio investors. That said, the key pillar of this stabilization, the oil price, remains shaky. While the upswings in the price are driven by news on the supply side, including the discussed commitment of some oil nations to freeze production, the demand side poses a longer-term threat to prices, in our view. The new round of declines on the Chinese stock market, which lost 10% of its capitalization in the last week of February, and PBoC's move to lower reserve requirements, serve as another indication of the pressures on the market and highlight risks to global demand.

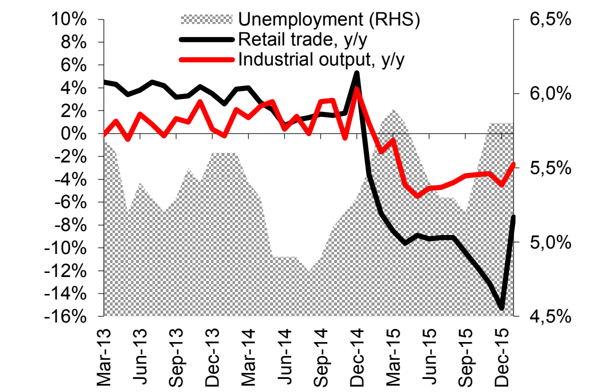
Russian consumer trend resilient to oil price decline, as ruble depreciation sparks panic buying and redirects household spending from foreign travel to local consumption

Recent macro data indicate that Russia is weathering the recent oil price drop. The key positive surprise was the sharp improvement in the retail trade dynamic from a 15.3% y/y contraction in December 2015 to 7.3% y/y drop in January. While most of this move was due to the base effect, the figure still exceeds expectations of a 8.5-10.0 decrease. As abovementioned, this move was partially financed by the decline in savings; however, on the positive side, we also note that the overall consumer confidence was supported by the stabilization of unemployment at 5.8% and the narrowing of the real salary drop from 8.4% y/y in December 2015 to 6.1% y/y in January 2016. Overall, we note that new sanctions against Turkey and Egypt, as well as ruble depreciation, create an opportunity for the reallocation of household budget from foreign travel to local spending, which could soften the blow of the oil price shock on local consumption.

Budget spending: risk for 1H16, opportunity for 2H16

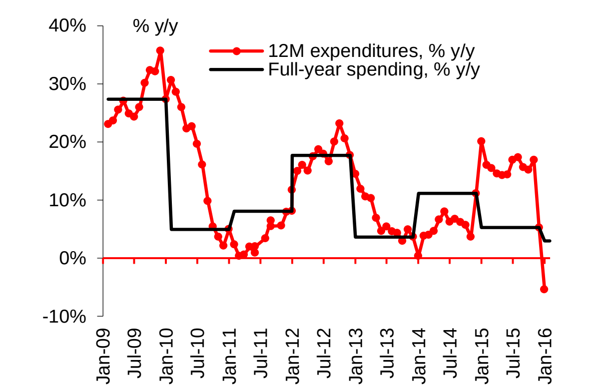
We believe that budget policy will be the key internal factor defining the sentiment in Russia in the coming months. Recent budget statistics have confirmed our view that the cabinet is targeting a very tight execution of budget spending at the beginning of the year: the January spending of RUB0.7tn was significantly below the average RUB0.8-1.0tn spending in previous Januarys; 12M spending showed a 5% y/y nominal decline for the first time since early 2000s. However, with the FY16 spending plan still implying zero-to-small-positive spending growth, this approach suggests that possible support could come in the electoral 2H16. The expectations of some budget easing should support sentiment in the corporate and the household sentiment – a positive guidance for AB-ICI in the coming months, provided downside oil price risks do not materialize.

Figure 2: Key Russian indicators, % and % y/y



Source: Rosstat, Alfa Bank

Figure 3: Budget spending, % y/y



Source: Finance Ministry, Alfa Bank

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IMPORTANT INFORMATION

Head of Equities
Michael Pijiolis
+7 (495) 795-3712

Alfa Bank
12, Akad. Sakharova Pr-t
Moscow, Russia 107078

Research Department +7 (495) 795-3676
research@alfabank.ru

Macroeconomics		
Natalia Orlova, Ph.D.	norlova@alfabank.ru	795-3677
Dmitry Dolgin	ddolgin@alfabank.ru	780-4724
Sergey Egiev	segiev@alfabank.ru	795-3612
Metals & Mining		
Dmitry Glushakov, CFA	dglushakov@alfabank.ru	+7 (499) 681-2918
Nikanor Khalin	nkhalin@alfabank.ru	+7 (495) 785-8266

Retail		
Alexandra Melnikova	amelnikova@alfabank.ru	795 3740
Alfa-Direct Research		
Geldy Soyunov	gsoyunov@alfabank.ru	641-3673
Alan Kaziev	akaziev@alfabank.ru	974-2515 (ext. 8568)
Editing and Production		
Andrew Mullinder	amullinder@alfabank.ru	795-3676 (ext. 8238)
Translation		
Anna Martynova	amartynova@alfabank.ru	795-3676

Equity Sales & Sales Trading (Moscow) +7 (495) 223-5500

International		
Maria Rodionova	mnrodionova@alfabank.ru	783 5106
Kirill Silvestrov	ksilvestrov@alfabank.ru	783 5133
Alexander Zorov	azorov@alfabank.ru	745-5621
Domestic Institutional		
Vladimir Aleksandrov	vkaleksandrov@alfabank.ru	783-5120

Alfa-Direct Sales +7 (495) 795-3680

Sergey Rybakov	srybakov@alfabank.ru	ext. 6399
Valeriy Kremnev	vkremnev@alfabank.ru	ext. 7083