

AB-ICI: RTS still deviates from fundamentals

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Investment Summary

- RTS Index rose continuously, deviating from fundamentals, throughout 2016
- Despite the deceleration in inflation, the CBR failed to reduce dollarization in the economy
- Revision of GDP statistics raises concerns over Rosstat credibility, hurting the growth outlook

RTS – Deviation from fundamentals was the trend of 2016

RTS rose 52% in 2016 while the AB-ICI declined 4%

The AB-ICI declined 4% during 2016, while the RTS Index jumped by 52%. The market growth was driven by ruble appreciation and expectations of a thaw in geopolitical tension between Russia and the West – since end-2016, that thaw has manifested into expectations of sanctions being lifted. At the same time, these considerations did not affect fundamentals, which caused the AB-ICI index to stagnate:

Economic confidence was supported by the deceleration of net capital, but pressured by dollarization

- **Economic confidence** was very unstable but it did improve by end-2016, reflecting a gradual recovery in Russia's economy. This improvement partly reflected a deceleration in net capital, which declined from \$57bn in 2015 to only \$15bn in 2016. At the same time, there was little progress with the level of dollarization which had been expected to take place once the economic situation in Russia stabilized – however, the share of forex deposits in retail is still 24% and in the corporate segment it stands at 41%, as of end-2016;

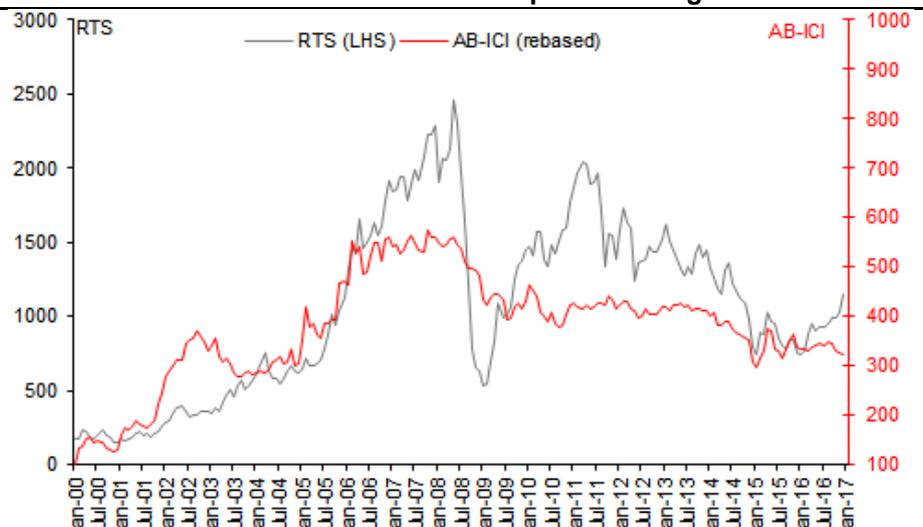
Market confidence was supportive

- **Market confidence** remains the pillar of the AB-ICI recovery, reflected by the high level of activity in local bond placements as well as the performance of the RTS;

Foreign confidence under pressure as reflected by the declining presence of foreign banks

- **Foreign confidence** was under significant pressure, reflected by the continuing decline in the presence of foreign banks on the Russian market (from 8.6% in 2015 to 7.6% at end-2016) – in fact, this trend went hand-in-hand with the reinforced role of state banks seen in 2016. The dynamics of this indicator dictated the trend in the whole AB-ICI index.

Figure 1: AB-ICI and RTS Index: Deviation keeps increasing



Source: New Economic School, RTS, Alfa Bank

AB-ICI: Locked in sideways trend

AB-ICI is moving sideways as the economy remains under pressure due to structural constraints

The AB-ICI closely tracked the trend in the economy, as Russian GDP stayed in recession for a second consecutive year. As we have stated a number of times before, the reasons behind the weak growth figures are deeply structural – a stagnant labor force supply and a highly uncertain environment reduce the incentive for investment and limit productivity growth. A program for structural reforms is expected to be presented by Alexei Kudrin by May 2017, but we are not sure that it will affect the growth outlook. The first concern is that the program will be watered down to address potential criticism and, thus, will lack a clear and straightforward direction. The second concern is that even if the proposed program is on the radical side, implementation will take time – most likely, the actual discussions will start only after the presidential election of March 2018, and the implementation could, thus, be delayed until 2019.

Rosstat revised up its 2015-16 growth figures: this now suggests that 2017 GDP upside is more limited than before

Over the past few months additional concerns have emerged with regards to future growth upside. Rosstat recently revised its 2015 GDP figures – instead of a 3.7% y/y GDP decline it now sees economic activity contracting by just 2.8% y/y. For 2016, the first economic growth estimate came in at only minus 0.2% y/y, versus the 0.8% y/y contraction we had expected and the 0.6% y/y decline provided by the Economy Ministry. These new figures raise two concerns: First, if the scale of the crisis is not as deep as previously assessed, this suggests the potential for catching up growth is now also very limited. As a result, we are now doubtful that 1.5% GDP growth for 2017 is feasible and advise to target a 0.5-1.0% y/y growth rate.

This also questions the credibility of the Rosstat figures, but we see the better figures as a reflection of the increased role of the defense sector

The secondly problem is related to the credibility of the Rosstat figures. A number of experts now consider the significant upward revision of the Rosstat data as a manipulation of the figures and that this revision casts doubts over the Russian statistics. We are neither surprised by the Rosstat revision nor shocked by the fact that despite the very weak consumption trend, Russia's GDP statistics were revised upwards. In our view, this reflects the growing role of defense and quasi-state sectors in the economy: the average consumer does not benefit from increased financing in these areas of the economy, however their activity should positively shape the GDP statistics.

Despite CBR efforts, both retail and corporate deposits keep a high share of forex savings, which is bad for investment

The prevailing cautious mood in the real sector is reflected in the high level of dollarization in deposits. As opposed to the 2009-10 crisis, when the dollarization level declined after the ruble depreciation, this time it has remained stably high. In retail deposits, the share of forex stood at 24% of total deposits as of end-2016. Worse still, is the high preference for forex savings also evident in the corporate area – companies keep around 41% of their deposits in forex, reflecting a low commitment to investment. Thus, despite the serious efforts made by the CBR to reduce inflation to 5.0% y/y by February 2017, the relatively high local rates are not convincing enough for retail and corporate clients.

Tight CBR and Minfin policies are likely to keep the AB-ICI in a sideways trend

The beginning of 2017 was marked by a reiteration from the CBR and Finance Ministry to maintain tight policy, which is likely to limit economic upside potential in the coming months. The agenda for structural reform is far from being finalized. As a result, we expect market confidence to remain the main driving force for the AB-ICI performance, but because other components will downplay the index, continued sideways movement is more likely than growth.

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