

AB-ICI: Gap to RTS narrows

Natalia Orlova

(+7 495) 795-3677

NOrlova@alfabank.ru

July 10, 2017

www.alfa-bank.com

Moscow

Investment Summary

- The gap between the AB-ICI and RTS narrowed in May on the 5.5% m/m RTS decline
- Strong May headline promising for AB-ICI dynamics, implying further potential to narrow gap to RTS
- While approaching fundamental levels, RTS fluctuations will depend on global factors, such as FED moves

AB-ICI decreased by 1.8% in May

AB-ICI gap to RTS narrows in May

The gap between the AB-ICI and RTS indexes, which had been a concern of ours, contracted in May against the backdrop of an RTS index decline of 5.5% m/m vs. a more modest AB-ICI decrease of only 1.8% m/m, or 0.3% YTD. That said, the May statistics pointed to an improvement in the macro trends, which is a promising development for future AB-ICI performance:

Economic confidence on the decline

- **Economic confidence** decreased in May mostly due to the lack of retail deposit growth and net capital outflows from Russia, which reached \$27 bn in 5M17 vs. \$16 bn in 5M16. Moreover, the share of forex in overall retail deposits remained relatively high at 22.1% in May;

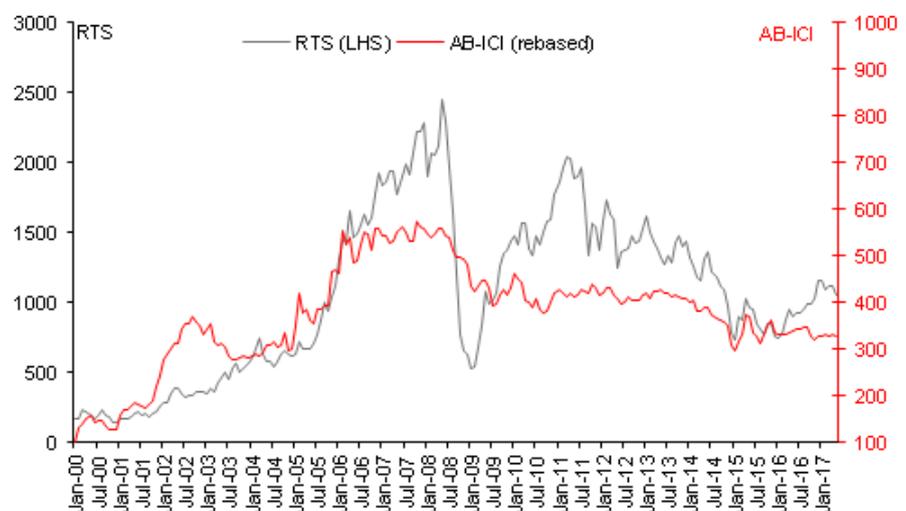
Market confidence decreases in May due to geopolitical concerns

- **Market confidence** also decreased in May as equities showed negative dynamics and Russian bond durations expanded (the April contraction proving to be a one-off). While Russian rates are generally still quite attractive for foreign investors (the spread between Russian and number of foreign bonds increased by nearly two-fold in May), the negative geopolitical backdrop forces investors to pursue cautious policies in relation to Russia;

Market share of foreign banks increases

- **Foreign confidence** showed positive dynamics in May as the presence of foreign banks on the Russian market increased from 7.4% in March-April to 7.5% in May.

Figure 1: AB-ICI and RTS Index: AB-ICI was down by 1.8% in May 2017



Source: RTS, Alfa Bank

AB-ICI: Gap to RTS narrows

RTS contraction of past two months does not surprise

The AB-ICI's narrowing gap to the RTS does not surprise us – the poor performance of AB-ICI since the beginning of this year has clearly suggested that the market's upside potential is limited. At the same time, despite the AB-ICI contraction last month the May macro statistics came strong, suggesting that the gap to the RTS will narrow going forward.

May macroeconomic statistics exceed expectations

The May macroeconomic data exceeded expectations: Retail trade grew 0.7% y/y in May versus the 0.6% y/y we had expected and the 0.5% y/y consensus forecast. Rosstat also improved the figure for April. The slow inflation rate, which has remained at 4.2% y/y in recent months (April-May), has translated into fast real salary growth – which has remained above 3.0% for the past three months – and is combined with a lower-than-expected unemployment rate of 5.2% y/y in May (versus 5.3% a month earlier). Industrial production was also very strong – it grew by 5.6% y/y in May and is up 1.7% y/y in 5M17: we attribute this to the unusually cold weather for the time of year playing in favor of strong growth.

The CBR kept cutting its policy rate in June which should provide additional support to the economy

The strong macroeconomic data including low inflation (4.2% y/y) allowed the CBR to cut the key rate by 25 bp to 9.0% in June. The regulator also expressed the view that 2H17 presents the possibility of further key rate cuts, which should be supportive for business sentiment. However, price growth unexpectedly accelerated significantly at the end of June: inflation rose to 0.4% for the week of 27 June-to-3 July and price growth reached 0.6% m/m in June (ahead of our 0.4% m/m forecast). This places annual inflation at 4.4% y/y for June – a figure which the CBR has called a shocking development. As a result, we believe that the CBR may take a pause in its rate cuts in July to address the inflationary shock.

The structure of growth is still a concern: investment growth is mainly driven by government regulation rather than by the stronger demand

At the same time, strong macro data over the last month does not necessarily mean that the structure of growth is good. Bets that Russia's economic growth will accelerate are strongly connected to the expectation of a recovery in investments; however, despite 2.4% y/y investment growth in 1Q17, its structure is an issue: the observable sectors (representing nearly 80% of total investment) demonstrated only a 0.4% y/y increase, while the SME area generated roughly 10% y/y investment growth. We attribute this to the new online reporting law in the retail trade segments, which, however, does not imply an improvement in Russia's investment structure. Moreover, sectors that should benefit from import substitution are performing quite dismally: in the agriculture segment, investment dropped by 6.9% y/y in 1Q17 and in the tourism segment, investment growth decelerated substantially to 7.9% y/y in 1Q17 (vs. 18.1% y/y in 1Q16).

RTS upside potential dependent on global factors

All in all, in May the RTS performance was quite weak while the AB-ICI remained relatively stable. The strong headline figures of the Russian economy, even if they mask a weak growth structure, should still play in favor of a market recovery going forward. Russia's main macro risk indicators – the debt load and credit growth – look much better than other countries; and that may trigger some capital inflows to the Russian market over the coming months. Clearly, future FED moves will be key as to what extent Russia can benefit from its' macro fundamentals; thus, market dynamics will remain dictated by global factors over the short term.

RATING DEFINITIONS

Alfa Bank applies a three-tier rating system for stocks under coverage. These ratings are based on the expected total stock return, which is the sum of the return to the target price and the expected dividend yield.

The ratings are:

Overweight (O/W):	Expected total stock return > 15%
Equal Weight (E/W):	Expected total stock return < 15% and > 0%
Underweight (U/W):	Expected total stock return < 0%

Owing to price volatility and our policy of not changing our ratings in response to frequent, short-term misalignments with expected returns, our ratings may sometimes not conform with the ranges indicated above.

In addition to the ratings above, we may occasionally assign the following classifications to stocks covered:

Restricted (R):	A rating, target price or financial forecasts are not disclosed owing to compliance or other regulatory considerations.
Under Review (U/R):	In response to recent or pending news flow requiring a significant overhaul or amendment of a company's financial model, the previous rating and/or target price is temporarily not disclosed.
Coverage in Transition (I/T)	Due to changes in the research team, the disclosure of a stock's rating and/or any other stock-specific information is temporarily suspended. The stock stays in Alfa Bank's coverage universe and usual disclosures will be resumed in due course.
Not Rated (N/R)	The stock is not in Alfa Bank's coverage universe at the time the research product referring to it is published.

IMPORTANT INFORMATION

The contents of this document have been prepared by 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 Holdings (Cyprus) Limited ("ACC") is distributing this document to its clients in the EEA and accepts no responsibility towards any other classes of recipient. Alfa Bank and ACC have in place appropriate conflicts of interest policies and procedures aimed at ensuring the objectivity of the information contained in 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). ACC is regulated 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 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, ACC or the authors. ACC 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. ACC 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, 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, containing details relevant to investment research, is available upon request from ACC. ACC has arranged for Alfa Bank and other relevant group entities involved in the production of research to implement equivalent policies.

Alfa Bank is incorporated, focused and based in the Russian Federation and is not affiliated with US-based Alfa Insurance.

Alfa Bank Equities

12, Akad. Sakharova prospect Moscow, Russia 107078
 +7 (495) 795-3712

Research Department
+7 (495) 795-3676

research@alfabank.ru

Macroeconomics

Natalia Orlova, Ph.D. norlova@alfabank.ru 795-3677
 Valeriya Volgareva vvolgareva@alfabank.ru 780-4724

Consumer, IT & Media

Alexandra Melnikova a.melnikova@alfabank.ru 795-3740
 Evgeniy Kipnis ekipnis@alfabank.ru 795-3713

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

Alexander Zorov azorov@alfabank.ru 745-5621

Alfa-Direct Research

Geldy Soyunov gsoyunov@alfabank.ru 641-3673
 Alan Kaziev akaziev@alfabank.ru 974-2515
 (ext. 8568)

Editing and Production

John Walsh jwalsh@alfabank.ru 795-3676
 (ext. 8238)

Translation

Anna Martynova amartynova@alfabank.ru 795-3676

Head of Alfa-Direct
+7 (495) 795-3680

Sergey Rybakov srybakov@alfabank.ru ext. 6399

Alfa-Direct Sales

Valeriy Kremnev vkremnev@alfabank.ru ext. 7083
 Olga Babina obabina@alfabank.ru ext. 4092