

# AB-ICI: Support from fundamentals needed

Natalia Orlova

(+7 495) 795-3677

[Norlova@alfabank.ru](mailto:Norlova@alfabank.ru)

July 4, 2015

[www.alfa-bank.com](http://www.alfa-bank.com)

Moscow

## Investment Summary

- AB-ICI recovered to its December 2015 level due to a strong saving trend and market growth
- At the moment, the RTS is outperforming the AB-ICI, which makes the market dynamic vulnerable
- Tight budget policy might limit the 2H16 growth trend and pressure the AB-ICI

### AB-ICI Recovers to December 2015 Level

**AB-ICI recovered to the level seen in December 2015**

After touching bottom in March 2016, the AB-ICI has recovered in recent months, and in May its value had reached the level of last December. As opposed to 2015, when the AB-ICI trend was strongly correlated with the RTS, in recent months the RTS has handily outperformed the AB-ICI. We believe that, in addition to the improvement of some macro trends, market growth was driven by expectations of a strong economic recovery, which is currently failing to materialize.

**Savings ratio up; share of FX deposits is declining**

- **Economic confidence's** improvement in recent months was driven by the recovery of the saving rate and rapid retail deposit growth. Retail deposit growth remains at 18% y/y, in line with the last year's growth rate; however, the share of FX deposits has gradually declined from 29% in the end of 2015 to current 26%.

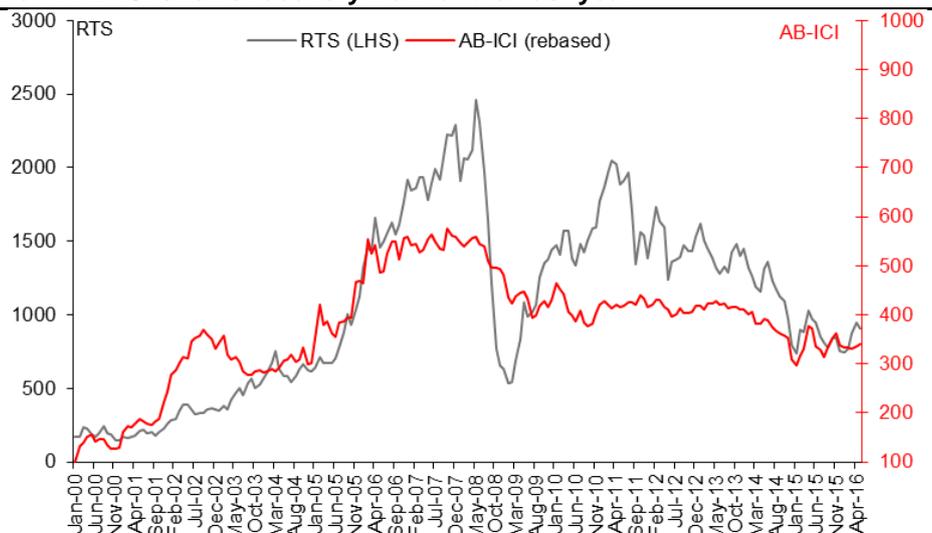
**Foreign banks still losing market share**

- **Foreign confidence** continues a gradual decline, mainly due to the poor FID inflows to Russia and the continuing decline of the share of foreign banks in the Russian banking sector.

**After volatile 2014-2015, investors were comfortable with Russian risk in 1H16, and the market index performed well**

- **Market confidence** was another factor driving up the AB-ICI index and reflecting the recovery of the Russian markets. While in 2015 investors were generally afraid of taking exposure to Russia, by 2016 the risk of additional sanctions looks low, while the market received support from the ruble exchange rate appreciation starting March 2016. This has helped Russian bond market to outperform its peers and RTS climb 20% YTD.

**Figure 1: AB-ICI shows recovery from end of last year**



Source: New Economic School, RTS, Alfa Bank

## AB-ICI: Support from fundamentals needed

**Poor macro statistics in May put in question the future RTS growth**

**May's 0.8% y/y GDP contraction suggests 2H16 recession risks stronger than before**

**Deleveraging is a problem**

**Reserve requirement increase, tight 2017-2019 budget draft hit sentiment**

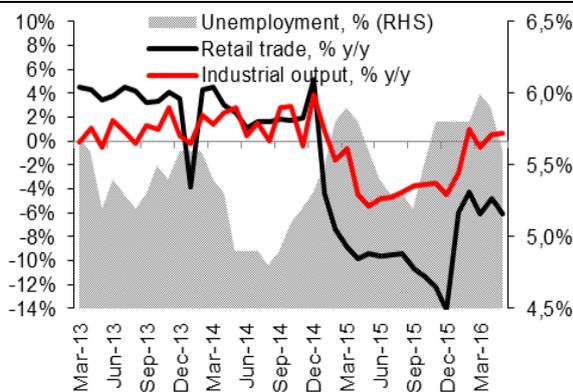
The pick up in the RTS, which looked sustainable in March, is increasingly questionable, given the macro statistics published recently. While at first we expected AB-ICI to join RTS's upward trend, it now appears that the RTS needs to gain stronger fundamental support.

The 1.2% and 0.7% y/y GDP contraction in 1Q16 and in April, respectively, fuelled positive expectations for 2H16 growth. However, in May, the economic trend suddenly deteriorated. Construction dropped 9% y/y and retail trade fell 6.1% y/y in May – both well below our and consensus expectations. For 5M16, Russian GDP fell 1% y/y and the risks of recession in 2H16 look higher than we had initially forecast, based on 1Q16 results.

One area that could cast light on the poor May results is the deleveraging that has started since April. Corporate loan growth, which stood at 5-6% (cleaned of the depreciation effect) in 2015, decelerated to 1.7% y/y in May: we estimate ruble-denominated loans were flat YTD, but that the corporate FX loan book contracted 7% YTD. It looks as though companies used the improvement of the growth trend to reduce debt instead of increasing investment. Retail lending was equally poor, still showing a 2% y/y contraction. While in nominal terms markets had stopped contracting since March, in fact this was due to the recovery of mortgage lending (dominated by state banks), while non-mortgage lending still did not find a bottom. Overall, economic growth is thus credit-less, which limits the speed of recovery compared with the 2010 experience.

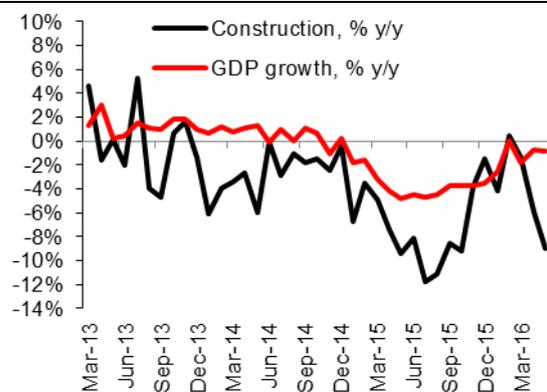
The problem we see is that the recent newsflow is not supportive of business sentiment. First, the CBR policy rate cut on June 10, from 11% to 10.5% was neutralized by the monetary authority's decision to increase the reserve requirement by 0.75pp from August 1. This step would allow the sterilization of RUB100bn to the fund of obligatory reserves, but would also require banks to increase their average holdings on their correspondent accounts by another RUB200bn. This step will prevent a continuing decline in interest rates. Second, the preliminary version of the next three-year budget draft implies a freeze in nominal expenditures at 3% below this year spending plan. Given that this tight budget policy has not been combined with the implementation of a reform agenda, it would simply cause a deceleration of the growth, and is thus negative for the outlook. If the freeze of budget expenditures is confirmed in the coming month, we would cut our 2017 GDP growth forecast from current 2.5% to 0.5% y/y. This could translate into a poor AB-ICI dynamic in coming months.

**Figure 2: Russia's key macro indicators**



Source: Rosstat, Alfa Bank

**Figure 3: Russia's key macro indicators**



Source: Rosstat, Alfa Bank

#### 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:

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

<b>Restricted (R):</b>	A rating, target price or financial forecasts are not disclosed owing to compliance or other regulatory considerations.
<b>Under Review (U/R):</b>	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.
<b>Coverage in Transition (I/T)</b>	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.
<b>Not Rated (N/R)</b>	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.**

**Head of Equities Alfa Bank**  
 Michael Pijiolis 12, Akad. Sakharova Pr-t  
 +7 (495) 795-3712 Moscow, Russia 107078

---

**Research Department**
**+7 (495) 795-3676**

research@alfabank.ru

**Macroeconomics**

 Natalia Orlova, Ph.D. norlova@alfabank.ru  
 Sergey Egiev segiev@alfabank.ru

795-3677

795-3612

**Alfa-Direct Research**

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

**Metals & Mining**

 Dmitry Glushakov, CFA dglushakov@alfabank.ru  
 Nikanor Khalin nkhalin@alfabank.ru

+7 (499) 681-2918

+7 (495) 785-8266

**Editing and Production**

 Andrew Mullinder amullinder@alfabank.ru 795-3676  
 (ext. 8238)

**Retail**

 Alexandra Melnikova a.melnikova@alfabank.ru  
 Evgeniy Kipnis ekipnis@alfabank.ru

795 3740

795 3713

**Translation**

Anna Martynova amartynova@alfabank.ru 795-3676

**Financials**

Leonid Slipchenko lslipchenko@alfabank.ru +7 (495) 788-0334

---

**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

**Alfa-Direct Sales**

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

**+7 (495) 795-3680**
**Domestic Institutional**

Vladimir Aleksandrov vkaleksandrov@alfabank.ru 783-5120