

AB-ICI: Expected Stagnation

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March 4, 2013

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Moscow

Investment Summary

- The AB-ICI showed very modest 0.2% growth in January due to poor economic and market performance.
- Weakening economic growth increases pressure on CBR to ease monetary policy.
- The upcoming shift in CBR governance is creating nervousness on the market.

The AB-ICI increased 0.2% in January

AB-ICI was nearly flat in January

After strong 3% growth in December 2012, the AB-ICI slowed to just 0.2% in January 2013. The improvement of the foreign confidence indicator was a positive surprise, however, continuing capital outflow and the Russian market's underperformance compared to peers has almost entirely neutralized this effect on the AB-ICI.

Capital outflow continues in 2013

- **Economic confidence** dropped, reflecting continuing capital outflow, which was estimated at \$8-10bn by EcoMin in January vs. the average \$5bn monthly outflow in 2012. Adjusted for currency swap transactions, January's capital outflow was potentially as high as \$17-20bn. Moreover, banking statistics indicate a slight increase in the dollarization of retail deposits, confirming our expectation of a decline in trust of the local currency by the population.

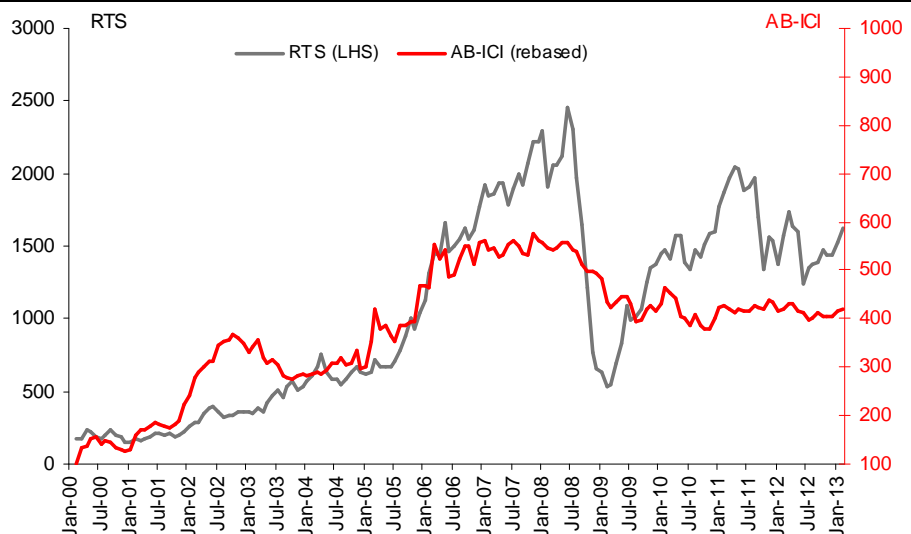
Foreign bank presence increased in 4Q12, FDI increased q/q

- **Foreign confidence** increased, reflecting an unexpected increase of foreign banks' presence on the Russian market in 4Q12 to 9.9% of total assets. FDI also brought a surprise by increasing to \$6.4bn in 4Q12 from \$4.7bn in 3Q12, providing a significant lift to the foreign confidence indicator.

Russian market is focused on the upcoming CBR management change

- **Market confidence** dropped in January. While the Russian market managed to grow in January, backed by positive news flow from the US and the euro area, it still underperformed peers. We attribute this weakness to uncertainties regarding the future head of the CBR, expected to be announced in March.

Figure 1: AB-ICI grew 0.2% in January



Source: New School of Economics, RTS, Alfa Research

CBR under pressure to ease policy

Retail trade growth in January was poor at 3.5% y/y...

The key factor determining AB-ICI performance is capital outflow, and unfortunately, the recent data suggest no improvement in the capital account trend, and the deceleration of economic growth provides no support. January's macro statistics came as a huge disappointment due to the consumption pattern. Retail trade growth decelerated to only 3.5% y/y after staying at 4.5% y/y in 4Q12 and 5.9% y/y in 2012. Moreover, the fundamentals behind January's figure were also weak: real disposable income growth was 0.7% y/y, the unemployment rate jumped to 6.0%, well above expectations, and retail loan growth was at 39.6% y/y, close to the 39.4% y/y in December last year.

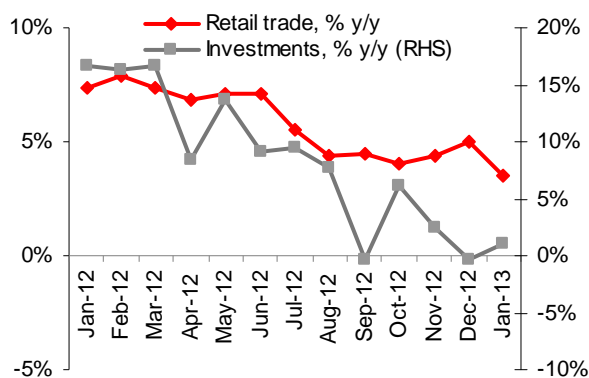
...adding to weak industrial output, which was down 0.8% y/y, the first decline since 2009

Producer sentiment also deteriorated in January, with industrial output growth dropping 0.8% y/y, the first decline since 2009. Investment growth, although exceeding expectations, was at 1.1% y/y and thus is unlikely to change the overall growth outlook. Investments account for only 23% of GDP and this item's growth rate is very unstable due to the significant role the state budget plays in its financing. The weaker-than-expected retail trade figure points to a risk of continuing deceleration in economic growth in the coming months.

CBR and MinFin cut their exposure to banks from 8.3% of assets in November to 5.6% in January

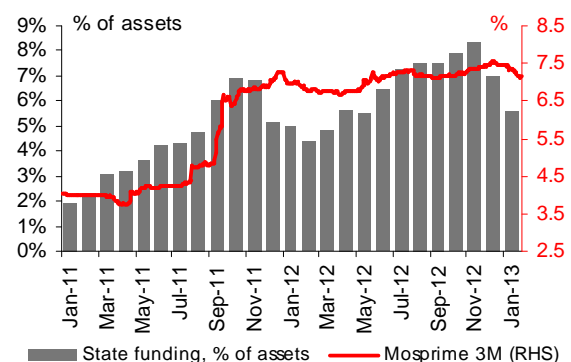
Banking statistics mirrored the poor economic trend, with corporate loan growth of only 13.5% y/y, unchanged from the poor 4Q12 results. Due to the weakness in demand for loans, the CBR and MinFin withdrew RUB750bn from the banking system, cutting their support to banks from 8.3% of assets in November 2012 to only 5.6% in January. Market interest rates remain stable and continuing weakness in the growth trend may limit the increases that we expect to take place in March-April.

Figure 2: Retail trade and investments



Source: Rosstat, Alfa Research

Figure 3: State funding, % of assets and interest rates



Source: CBR, Bloomberg, Alfa Research

Accelerated inflation, combined with historically low unemployment, prevented a rate cut

The poor growth rate did not help reduce inflationary pressure. After reaching 6.6% y/y in December 2012, above the 6.1% y/y as of end-2011, inflation continued to accelerate to 7.1% y/y in January and is expected to reach 7.3-7.4% y/y in February. As a result, the CBR kept the interest rate unchanged, pointing to historically low unemployment and accelerated inflation as the key arguments against a rate cut.

The market will be looking closely at the appointment of new CBR chairman

That said, the obvious deceleration of economic growth is putting significant pressure on the CBR to ease interest rate policy, and we believe the new CBR chairman, who is expected to be named in March and formally appointed in June, will have to respond to the Cabinet's demands. The key question, however, is to what extent the new CBR management will be active in cutting rates. Should the new chairman be very proactive in following the Cabinet's agenda, this may create additional nervousness on the market, which would clearly not help to keep capital outflow in check.

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