

AB-ICI: Weak ruble adds to negative trend

Natalia Orlova

(+7 495) 795-3677

NOrlova@alfabank.ru

February 28, 2014

www.alfa-bank.com

Moscow

Investment Summary

- AB-ICI index fell in January with all indicators signaling ensuing confidence deterioration
- Population and companies increased forex savings by \$14bn in January becoming a major source of net capital outflow
- Recent weak real economy data suggests further deterioration in ruble fundamentals

AB-ICI fell in January by 2.2% reflecting deterioration in all indicators

Companies and population aggressively accumulated forex savings in January

Global liquidity tightening pushed foreign confidence down

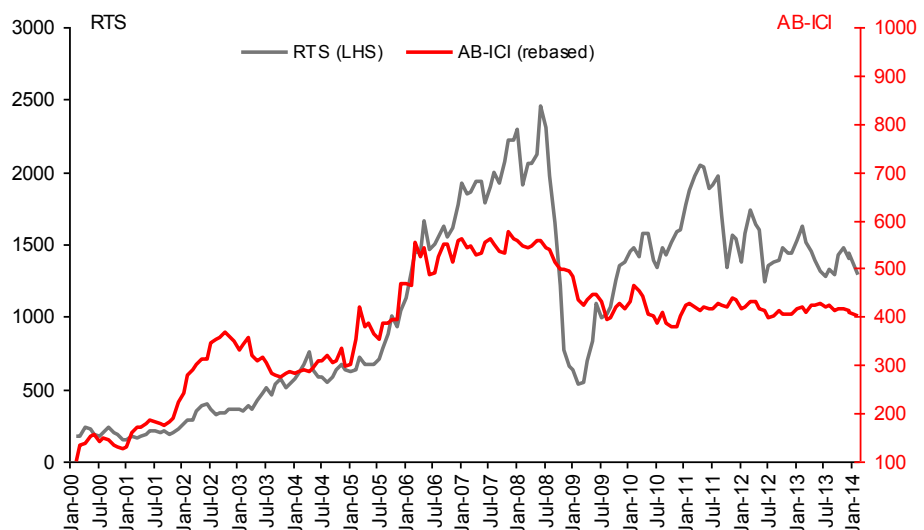
Poor real economy data signals no U-turn coming in the downward market confidence trend.

AB-ICI fell in January

The AB-ICI fell considerably in January by 2.2%. Sharp ruble depreciation added to deteriorating economic confidence as fx accumulation of savings turn out be a major source of net capital outflow. Global liquidity concerns in addition to license-revoking policy of CBR put pressure on foreign bank's presence in Russia. Fresh poor data on real economy signal that Russian economy is falling behind its peers what, accompanied by general EMs sell-off, creates risk of further fall in market confidence.

- **Economic confidence** fell sharply in January as forex market instability resulted in \$17bn net capital outflow. Fx savings of companies and population rose by \$14bn in January on increasing pessimism towards ruble. Despite the 10% YTD depreciation, the pressure on ruble is still in place as CBR's daily fx operations prevent quick adjustment to weakening fundamentals.
- **Foreign confidence** decreased in January. Downward trend in foreign banks' assets intensified as tightening of global liquidity conditions was accompanied by CBR's license-revoking policy. Ruble instability adds to the downbeat sentiment with foreign confidence likely to fall in the coming months.
- **Market confidence** fell in January with most factors performing poorly last month. Weak real economy data suggests that Russia is falling further behind its peers. With poor market sentiment towards all EMs, lagging Russian economy increases risks of country-specific market confidence deterioration.

Figure 1: AB-ICI fell in January



Source: New School of Economics, RTS, Alfa Research

AB-ICI: Ruble instability puts pressure on real growth

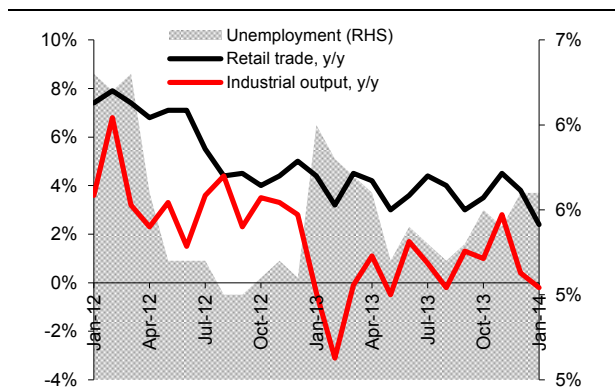
AB-ICI under pressure of 10% YTD ruble depreciation

Since the beginning of 2014 the key factor putting pressure on AB-ICI has been the foreign exchange rate instability, as YTD ruble depreciated by 10% to USD, being the worst performing currency among EM peers. The market tends to attribute ruble depreciation to the fact that while Russia's peers managed to raise key interest rates, CBR's room for maneuver is limited by the very weak GDP growth, which decelerated to 1.3% in 2013 and 0.7% y/y in January. The recent hawkish guidance provided by the CBR created hopes on the market that the interest rate policy might be tightened later this year. That said, we remain skeptical that this measure would be able to provide material support to ruble exchange rate, as we believe the ruble movement to be a reflection of the negative trends seen in the real sector.

Last couple of months brought negative news both on investment and consumption sides

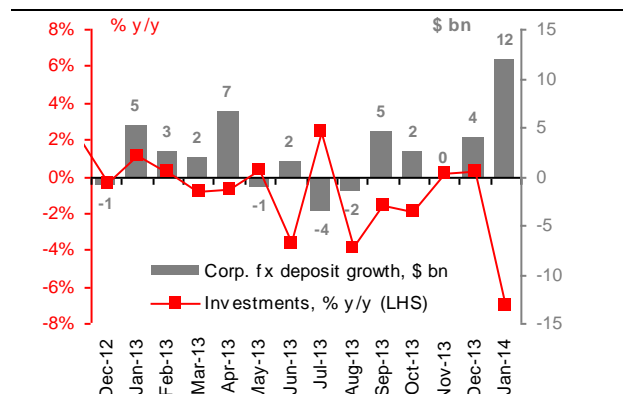
First, the production side of the economy continues to perform poorly. In January, investments dropped by 7.0% y/y after 0.3% y/y decline in 2013. It suggests that the tariff freeze imposed upon natural monopolies is indeed slashing this year's investment spending. Second, Russian consumption-oriented growth model is further losing steam. Despite January's strong retail loan growth of 28% y/y and low unemployment of 5.6% retail trade growth decelerated materially: to 2.4% y/y vs. 3.8% y/y in December. The deceleration of real wage growth to 2.5-2.7% y/y in the previous two months from the 4-6% y/y seen throughout 2013 is another worrying sign for consumption.

Figure 2: Producer and consumer trends



Source: Rosstat, Alfa-Bank

Figure 3: Investments and corporate fx deposits growth



Source: Rosstat, CBR, Alfa-Bank

FX savings increased \$14 bn in January, contributing to the huge \$17bn net capital outflow

Responding to the deteriorating prospects of local growth and global uncertainties the companies and population reacted by accumulating foreign currency savings. Corporate fx savings with banks rose by \$12bn this January compared with \$5bn in January 2013 reflecting willingness of the private sector to search for returns on the fx market rather than in real economy. Retail fx deposits grew by \$2bn in January, twice the sum seen in January 2013. This move was accompanied by the increased demand for cash currency outside the banking system, provoked by the CBR bank license revoking process. Altogether, accumulation of fx savings accounted for \$14bn, contributing to the \$17bn net capital outflow seen in January 2014.

With lack of new growth drivers, the risks of further capital outflow and pressure on AB-ICI remain

In order to reverse this trend some improvement in the growth rate is required, however the drivers of such growth remain uncertain. The market tends to believe that the ruble depreciation may be a positive factor for growth, however with Russia's high dependency on imports, high capacity utilization, and high share of oil exports the effect of nominal depreciation will be muted. We thus continue to see risks to economic confidence and AB-ICI for 2014 as high.

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 Open 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 Markets ("ACM") is distributing this document to its clients in the EEA and accepts no responsibility towards any other classes of recipient. Alfa Bank and ACM 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). ACM is regulated by the Financial Services Authority ("FSA") with FSA registration number 416251, for the conduct of UK investment business and is the trading name of the UK branch of Alfa Capital Holdings (Cyprus) Limited ("ACC"), which is authorized 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, ACM 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, ACM or the authors. ACM 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. ACM 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, ACM, 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 (which also covers ACM), containing details relevant to investment research, is available upon request from ACC or ACM. ACC and ACM have arranged for Alfa Bank and other relevant group entities involved in the production of research to implement equivalent policies. This document is distributed in the United States by Alforma Capital Markets, Inc., a subsidiary of Alfa Bank, which accepts responsibility for its contents. Alforma Capital Markets, Inc. did not contribute to the preparation of this report and the authors are neither employed by, nor are associated persons of, Alforma Capital Markets, Inc. The issuing entity and authors may not be subject to all of the disclosures and other US regulatory requirements to which Alforma Capital Markets, Inc. and its employees are subject. Any US person receiving this report who wishes to effect transactions in any securities referred to herein should contact Alforma Capital Markets, Inc., not its affiliates.

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	795-3677	
Dmitry Dolgin	ddolgin@alfabank.ru	780-4724	
Sergey Egiev	skegiev@alfabank.ru	795-3612	
Financial Sector			
Jason Hurwitz	jhurwitz@alfabank.ru	783-5005	
Marina Karapetyan	mkarapetyan@alfabank.ru	795-3740	
Oil & Gas			
Alexander Kornilov, CFA	akornilov@alfabank.ru	788-0334	
Ekaterina Malkova	emalkova@alfabank.ru	795-3725	
Metals & Mining			
Oleg Iuzefovych, CFA	olegiuzefovych@alfabank.kiev.ua	+380 (44) 239-9135	
Retail, Real Estate, Transportation			
Andrei Nikitin	ainikitin@alfabank.ru	795-3742	
Alexander Novikov	anovikov3@alfabank.ru	785-9568	
Alfa-Direct Research			
Geldy Soyunov	gsoyunov@alfabank.ru	641-3673	
Alan Kaziev	akaziev@alfabank.ru	974-2515	(ext. 8568)
Editorial & Production			
David Spencer	dspencer@alfabank.ru	745-7153	
Translation			
Anna Martynova	amartynova@alfabank.ru	795-3676	
Stanislava Ovcharenko	sovcharenko@alfabank.ru	783-5020	

Equity Sales & Sales Trading (Moscow)		+7 (495) 223-5500	
International		223-5500	
Michael Kotov	kotov@alfabank.ru		
Alfa-Direct Sales			
Sergey Rybakov	srybakov@alfabank.ru	+7 (495) 795-3680	ext. 6399
Valeriy Kremnev	vkremnev@alfabank.ru		ext. 7083
Alfa Capital Markets (London)		+44 (0) 20 7588-8500	
Sales		7382-4174	
Robert Szucsich	r.szucsich@alfa-cm.com		
Sales Trading			
Yan Gloukhovski	y.gloukhovski@alfa-cm.com	7382-4179	
Alforma Capital Markets (New York)		+1 (212) 421-7500	
Sales		421-8564	
Justin Landau	jlandau@alformacap.com		