Alfa-Bank

Macro Insights

AB-ICI: Further Downside Limited

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Investment Summary

- AB-ICI declined 4% in January 2015 after the 12% collapse in December 2014
- Lack of demand for new FX from the population suggests that further downside for the AB-ICI is limited
- Improvement in inflation trend is a prerequisite to ensure recovery in confidence

AB-ICI declined by 4% in January

AB-ICI declined 4% in January 2015 after December 2014's 12% collapse; further downside appears limited

In January, AB-ICI continued to show negative performance, declining 4% m/m, which however looks like stabilization after the 12% m/m fall seen a month earlier. The key positive sign is the lack of increase in the population's FX position, which may be a sign of expectations of stronger ruble going forward. Overall, since March 2014 our index dropped 23%, almost in line with the 25% index drop during the 2008-09 crisis episode, and we see limited downside to further decline in the confidence. However, a recovery from the current levels will be hampered by the deteriorating CPI trend.

Economic confidence continued to decline, but the decline in the FX deposits volume is a good sign

- **Economic confidence** continued to fall in January, reflecting persisting capital outflow and the spike in the dollarization of the retail deposits to 30% from 26% a month ago and 20% a year ago. However, unlike the case of 2008-09 crisis, when it reflected doubling in the volume of the retail FX accounts, this time it rather reflects the statistical revaluation effect of the stable FX accounts in the environment of no increase in the ruble savings. This means that following last year's sharp depreciation households consider flight to FX to be too risky. That said, the attractiveness of ruble savings is also little, and the current environment still favors consumption.

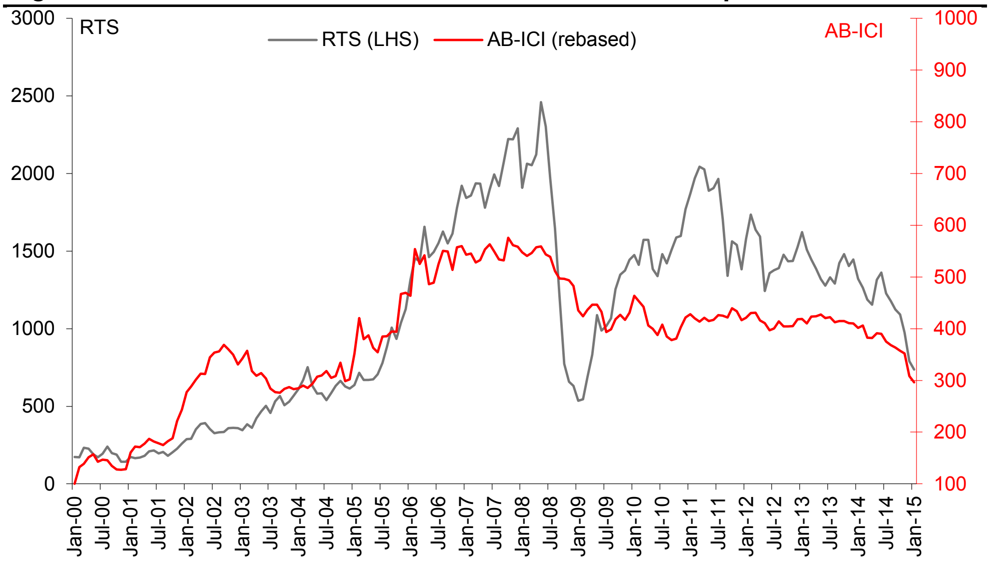
Increase in foreign bank's share is rather technical and one-off

- **Foreign confidence** increased reflecting a slight increase in the share of foreign banks assets in 4Q14, however as their assets are more FX-heavy (38% of assets vs. 33% for the entire banking system), the increase in the share reflects FX revaluation effect and therefore might be one-off.

The pressure on the markets in January was much lower than in December

- **Market confidence** declined, reflecting some pressure on the bond market due to Russia's loss of investment rating. However, the magnitude of the decline was high, indicating some stabilization in the local market mood following December's shock.

Figure 1: AB-ICI declined 4% in Jan. 2015 after 12% collapse in Dec. 2014



Source: New Economic School, RTS, Alfa Bank

Fast Inflation: a Threat to AB-ICI Recovery

Introduction of ruble free-float reduced population's demand for FX

Despite the continuing decline in the AB-ICI and its' key economic indicator, January brought positive results as well. We are particularly pleased to see that if during the 2008-09 crisis episode the population doubled its FX savings from $27bn to $54bn in a year, in 2014 the volume of FX bank savings actually declined from $90bn to $86bn and continued to decline to $84bn last month. This was achieved thanks to the introduction of ruble free-float regime, which allowed a very sharp ruble depreciation in December last year, not giving enough time for a flight to FX. At the moment, the $/RUB exchange rate is considered too risky to convert, which will certainly help to limit the households' demand for FX this year.

The key rate hike helped to prevent further deterioration in ruble savings

The second positive development was that the CBR's key rate hike to 17% in December managed to at least prevent further decline in the preference for ruble savings. If in the previous years January saw 2% m/m outflow of retail deposits, in January 2015 the decline was limited to 1% m/m. However, the overall low attractiveness of the ruble savings remains an issue. If prior to 2014 retail ruble deposits were showing 19-20% y/y growth, as of January 2015 the growth was only 1% y/y.

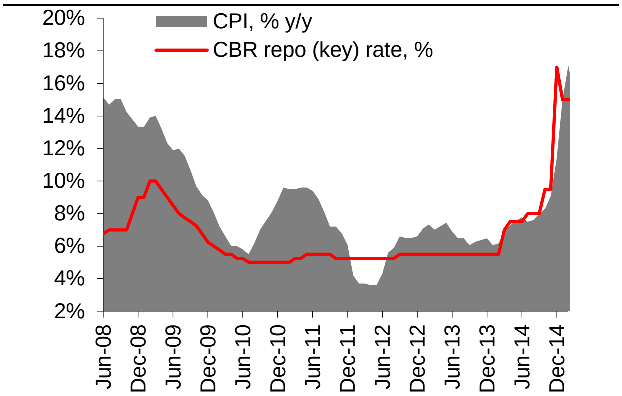
Accelerating inflation and premature interest rate policy easing pose threat to the savings rate recovery going forward…

The negative surprise however is that the forward-looking signals for the savings rate do not appear supportive. First, inflation seems to be accelerating materially: from 6.5% in 2013 to 11.4% in 2014 and 15.0% y/y as of January 2015. Being the consequence of food import ban and several waves of ruble depreciation in 2014, inflation is set to accelerate further in the coming months, negatively affecting expectations, and stimulating above-expected consumption instead of savings: in January, despite the 8.0% y/y collapse in real salaries, retail trade showed only 4.4% y/y decline. Second, January's cut in the key rate to 15% y/y, which we always considered premature is likely to put real interest rate further into the negative territory, putting further pressure on the savings rate going forward.

…and may fuel high net capital outflow, preventing a recovery in the AB-ICI

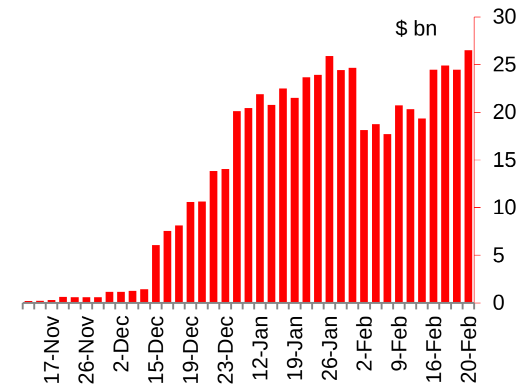
Our concern is that the faster inflation in the environment of declining GDP may keep ruble expectations under pressure and therefore maintain a high preference for net capital outflow. We note that despite the strong current account (suggested by the 41% y/y drop in imports) ruble failed to appreciate in January, while some appreciation in February took place in the environment of banks' higher demand for CBR FX repo, which is an instrument similiar to CBR FX interventions seen in the previous FX management regime. Therefore, while we do not expect further sharp drops in the AB-ICI in the foreseeable future, any recovery from the current levels also seems unliekly

Figure 2: CBR key rate and CPI growth, % y/y



Source: Rosstat, CBR, Alfa Bank

Figure 3: CBR FX repo lending to banks, $ bn



Source: CBR, Alfa Bank

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