

AB-ICI: Stabilizes after free-fall

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Investment Summary

- The AB-ICI index stabilized at the end-2010 level after the collapse in March
- Poor real economy performance in April reflects persistent deterioration of Russian fundamentals
- We expect such trends to persist in future as monetary tightening now joins structural weakness

AB-ICI was virtually flat last month, benefitting from capital outflow stabilization after the \$64bn spike in 1Q14

Economic confidence rose mostly due to capital outflow decelerating to \$4.6bn in April that is close to recent years' average

Foreign banks are still reducing their presence

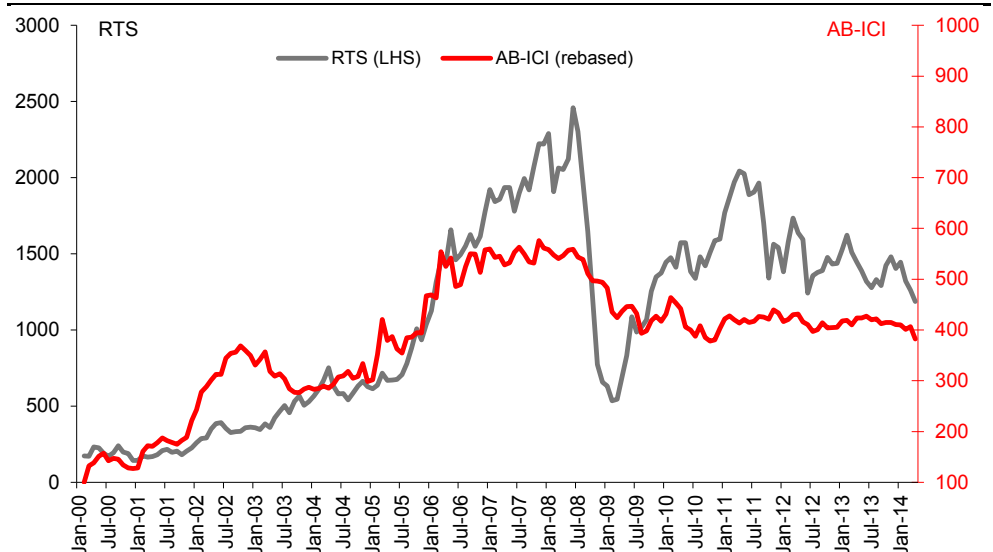
Market confidence stabilized, but is subject to pressure of a lagging real economy

AB-ICI was effectively flat in April

AB-ICI stabilized in April after the exacerbation of financial disarray in March. The index benefitted mostly from strong economic confidence, with its key driver being sharp capital outflow deceleration from the 1Q14 spike of \$64bn to \$4.6bn in April, the recent years' norm. Market confidence was effectively flat, while foreign confidence continued to fall on negative news flow and growing uncertainty. Although the easing of geopolitical tensions supported AB-ICI dynamics in April, the weak real economy is getting back in the game and puts additional pressure on future AB-ICI performance.

- **Economic confidence** increased, reflecting the economy's turn to its pre-March norm. Capital outflow is now close to the recent years' average at \$4.6bn in April after the \$64bn spike in 1Q14. The share of FX deposits also decreased slightly after the ruble stabilized on the positive news flow. That said, further economic confidence growth seems unlikely given recent news on a weak current account that poses concerns on future ruble dynamics.
- **Foreign confidence** decreased last month mostly on the weakening of the foreign banks' position in Russia. With the international sanctions issue still in place, a strong FDI inflows scenario seems unlikely, posing concerns on future foreign confidence performance.
- **Market confidence** was effectively flat after the negative news flow eased somewhat. That said, the spread between Russian and LatAm bonds has been widening since the beginning of this year, reflecting primarily the Russian economy lagging behind peers. With the economy trend remaining weak, risks of further market confidence deterioration are still in place.

Figure 1: AB-ICI was flat in April



Source: New Economic School, RTS, Alfa Bank

Real Economy: Negative Trends Still in Place

The index stabilized on sharp capital outflow deceleration from \$ 64bn in 1Q14 to \$ 4.6bn in April

On the demand side, the real economy performed weakly, with retail trade decelerating to 2.4% in April after strong 4.0% in March

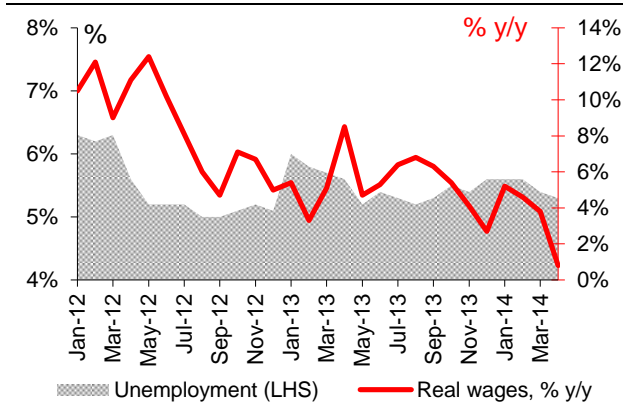
On the supply side, industrial production accelerated to 2.4% y/y last month, but mostly due to fast government spending growth that is likely to slow in 2H14

The AB-ICI index managed to stabilize in April after the March's turmoil on financial markets. Now that the index benefitted from sharp capital outflow deceleration from \$64bn in 1Q14 to \$4.6bn in April, underlying real economy trends are coming back into the spotlight. On this point, the recently released data package provides mixed-to-negative signals.

On the demand side, April data turned out to be quite weak. Retail trade growth decelerated materially from 4.0% y/y in March to 2.4% y/y in April. Partially, this was expected, as the strong performance in March was related to intensifying panic purchase behavior. Nevertheless, retail data remains disturbing, as consumption fundamentals also performed poorly. The key concern is real salary growth that was reported at only 0.8% y/y in April after 4.4% y/y in 1Q14. On the positive side, unemployment fell to 5.3%, but with the CBR staying in tightening cycle, the cost of retail loans is likely to put a cap on consumption trend in the coming months.

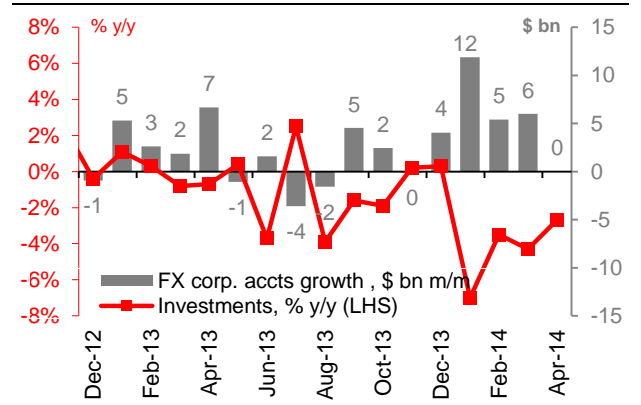
On the production side, April data demonstrated slightly better-than-expected dynamics. Industrial production accelerated to 2.4% y/y from 1.4% y/y in March, while investments fell by 2.7% y/y vs. the 5.0% y/y drop expected by the market. However, the proactive fiscal policy was the key driver of production growth in April and it is unlikely to last. Industry received a major boost from budget spending that accelerated from 6% y/y in 1Q14 to 19% y/y in April. The latest decision to keep the budget rule signals slowdown in budget expenditures growth in 2H14 with production trend likely to lose steam toward the end of the year.

Figure 2: Unemployment, % and Real wages growth, % y/y



Source: Rosstat, Alfa Bank

Figure 3: Investment growth, % y/y and FX corporate accounts growth, \$ bn m/m



Source: CBR, Rosstat, Alfa Bank

Now that monetary tightening joins structural weakness, GDP growth is likely to remain subdued, pressuring the AB-ICI index going forward

With such real economy trends, the recently released GDP estimate that suggests a modest 1.1% y/y growth figure in April after 0.9% y/y growth in 1Q14 is not surprising. However, considering the low-base of 1H13, it still looks fairly weak. Now that the Russian consumption story adds some concerns, the strong performance of economy does not seem like a likely scenario. With monetary policy tightened and with absence of a favorable low base effect, GDP growth could hardly resume to strong growth performance in 2H14. Thus, despite the easing of political tensions, new risks that emerge from previously stable sectors are likely to put considerable pressure on the AB-ICI index toward the end of the year.

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