

AB-ICI: Rebound after the turmoil in March

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Investment Summary

- AB-ICI increased for the first time after the March turmoil
- Slowdown in consumption growth reflects deterioration in the key factor behind Russia's growth
- With a deceleration in retail lending, a return to the fully-fledged consumer-oriented model is questionable

The AB-ICI index rebounded in May by a considerable 2.4% m/m

Economic confidence benefited from slower capital outflow

Foreign confidence remained flat; has vague prospects to improve

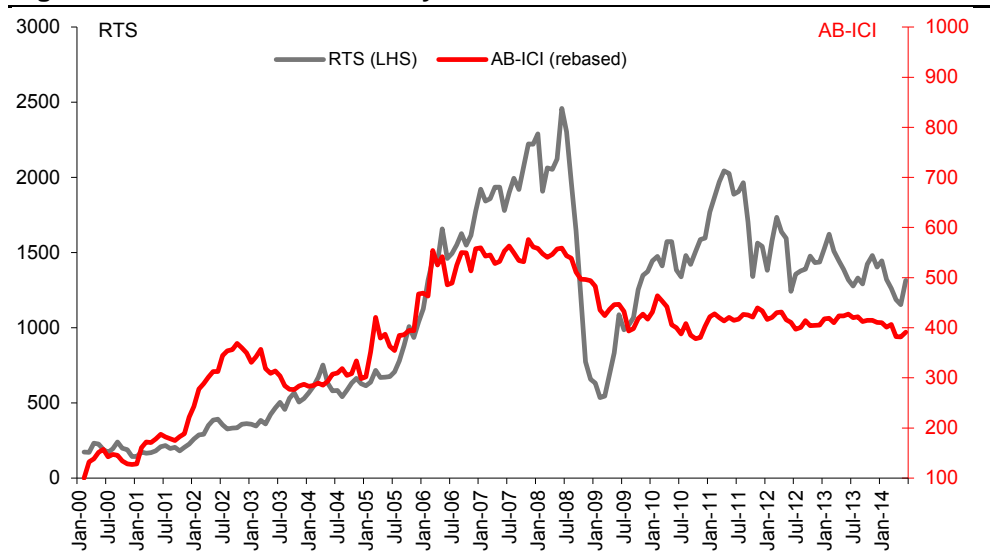
Market confidence benefitted from stabilization of geopolitical issues

AB-ICI increased in May

The AB-ICI index rebounded in May by a considerable 2.4% m/m. The index benefitted mostly from economic and market confidence indicators. First, slower capital outflow and a strong ruble environment supported the index. Second, stabilization of geopolitical issues slightly improved foreign markets' sentiment toward Russia. Still, despite overall improvement in sentiment, disturbing real economy trends have to come into the spotlight and pose additional concerns on Russia's growth story in the coming months.

- **Economic confidence** has increased mostly due to favorable capital outflow dynamics. The share of FX has also stabilized, benefitting from the strong ruble environment of the past month. Nevertheless, the upcoming current account data will be a litmus test that should show whether the current RUB/\$ levels are sustainable even in the short run.
- **Foreign confidence** was effectively flat last month. Taking into account the remaining geopolitical pressure, a scenario for strong FDI inflows does not look probable, thus undermining foreign confidence dynamics in the coming months.
- **Market confidence** increased last month, benefitting from the relative stabilization of foreign markets' sentiment toward Russia. RTS managed to grow, while spreads between Russian and LatAm bonds narrowed. That being said, Russia's growth story continues to lag its EM peers, calling into question market confidence in Russia in 2H14.

Figure 1: AB-ICI increased in May



Source: New Economic School, RTS, Alfa Bank

Real Economy: Consumption Underperforms

Index rebounded in May after stabilization in April

Producers' trend was rather strong in May, but mostly due to favorable fiscal policy

Consumption trend continues to underperform ...

... with retail lending deceleration in May signaling further weakness

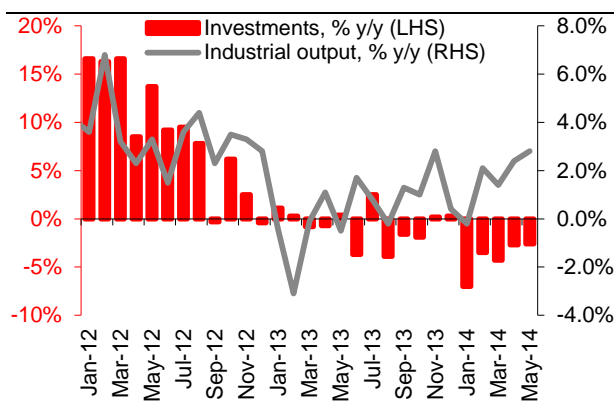
Now that the AB-ICI index has increased for the first time since February, it is time, as we've mentioned earlier, to study thoroughly real economy trends that determine the index's dynamics. Until now, the AB-ICI had actually benefited most from capital outflow deceleration and positive market dynamics, while consumption and production trends remained in the background.

The producers' trend did surprise on the positive side. Industrial output growth accelerated to 2.8% y/y in May and 1.7% y/y in 5M14. The investment slump has also decelerated slightly to 2.6% y/y from the 2.7% y/y drop a month earlier. However, recovery is mainly generated by the soft budget policy. Government expenditures remain the key driver behind strong production growth in 1H14, with current spending growth rates at 25% y/y in May and 10% y/y in 5M14. In such an easy environment, the government's ability to intensify its proactive stance is ambiguous.

The demand side, on the other hand, continues to underperform. While stronger industrial output growth pushed unemployment to an historical low of 4.9% in May, consumption was rather weak. In spite of recovering real wages that accelerated to 5.0% y/y from 3.2% y/y in April, retail trade decelerated to 2.1% y/y in May from an already mixed 2.7% y/y figure from a month earlier.

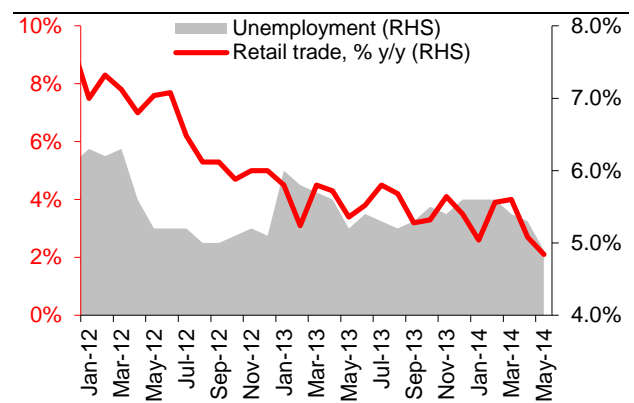
This is a particularly disturbing issue, as the trade slowdown coincided with an ensuing deposit outflow of 0.5% m/m in May after a sharp 2% m/m drop in March. Thus, deterioration in the consumption trend cannot be easily attributed to precautionary savings behavior. Rather, we consider the retail loan growth slowdown to be the key dragging factor. Deceleration of retail lending below 30% y/y to 29% y/y in 2013 and 23% y/y in May suggests, according to our estimates, that consumers are now paying interest out of their pockets rather than via refinancing activities. Thus, given the CBR's current hawkish policy stance, material strengthening of the consumption trend has rather vague prospects.

Figure 2: Industrial output and investments, % y/y



Source: Rosstat, Alfa Bank

Figure 3: Unemployment, % and retail trade growth, % y/y



Source: Rosstat, Alfa Bank

With consumption strength absent, prospects of strong AB-ICI recovery are vague

The deterioration of the retail trend is especially alarming, since consumption has been the most reliable driver behind Russia's economic growth in recent years. With the key factor of Russia's growth story demonstrating lackluster dynamics, it is hard to expect a strong performance from Russia's market value, hence the AB-ICI index's performance in the coming months.

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