Alfa-Bank

Macro Insights

AB-ICI: Rally Hits the Wall

Natalia Orlova **(+7 495) 795-3677** **NOrlova@alfabank.ru**
Dmitry Dolgin (+7 495) 780-4724 DDolgin@alfabank.ru

July 1, 2015 www.alfa-bank.com Moscow

Investment Summary

- AB-ICI retreated 1% in May following the 13% spike in April
- CBR's return to the FX market put an end to the ruble rally and the growth in economic confidence
- Potential improvement in the 2H15 GDP growth trend is limiting the downside to AB-ICI this year

AB-ICI down 1% in May

AB-ICI down 1% in May on CBR FX reserve accumulation and deterioration of global EM market mood

The strong increase in confidence indicators seen in February-April stopped in May, with the AB-ICI declining 1% m/m after the 13% spike in April. The pivotal point was the CBR's mid-May decision to reinstate FX interventions, which lowered the attractiveness of the ruble in the eyes of households and financial market participants. In addition, the deterioration in the global market mood, including the tightening of Fed rhetoric and Greece-related woes, put pressure on emerging markets, and was an additional drag on the local market performance.

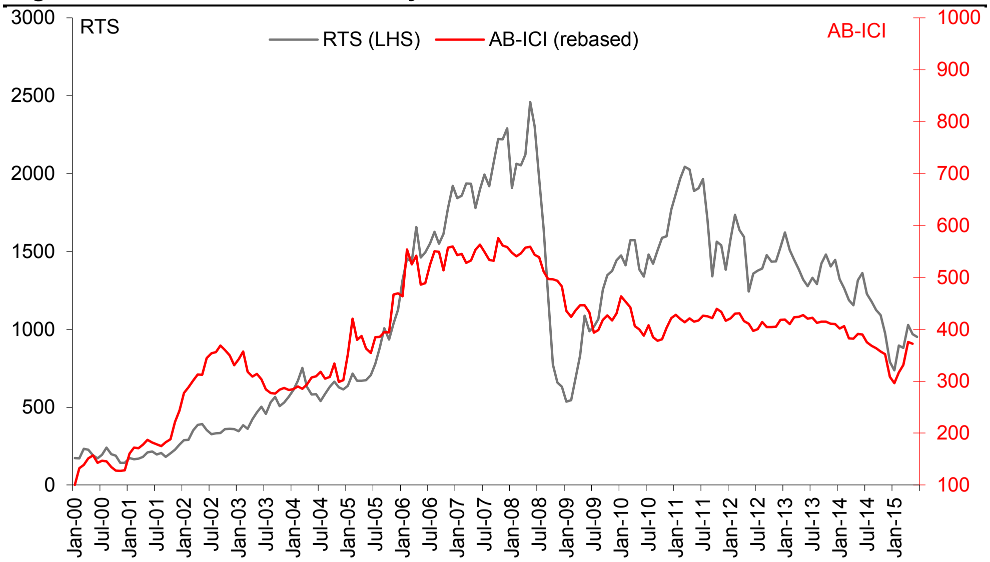
CBR's plan to accumulate $500bn in reserves put pressure on ruble expectations, preventing growth in economic confidence

- **Economic confidence** declined, reflecting a more cautious household approach to the ruble: in May, the inflow of ruble deposits was only RUB70bn vs. the RUB300bn monthly average in Feb-Apr, causing the share of FX deposits to increase to 24.8% after three consecutive months of declines. We believe it represents a reaction to the CBR's May decision to reinstate FX interventions. The plan to accumulate $500bn in foreign reserves (vs. $360bn currently) minimizes expectations of further ruble appreciation.
- **Foreign confidence** remained unchanged, as no new relevant data was released.

Russian market also fell victim of the global risk-off mode ahead of Fed tightening and uncertainties around Greece

- **Market confidence** dropped in May, reflecting the pressure on the Russian market coming from changed CBR communications regarding FX and the deterioration of the global mood. The latter is a consequence of the increased concern regarding the lack of success in the Greek debt negotiations, as well as the realization that the Fed tightening, which had already been postponed from June 2015, is still likely to take place before the end of this year.

Figure 1: AB-ICI down 1% in May



Source: New Economic School, RTS, Alfa Bank

AB-ICI: Rally Hit the Wall

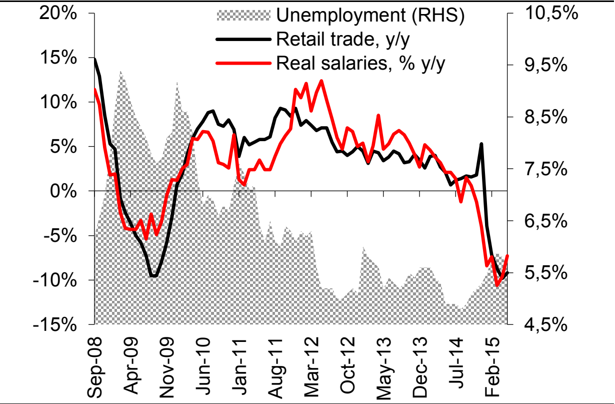
CBR puts an end to ruble and AB-ICI rally in May by reinstating $200m daily interventions and announcing a plan to buy $140bn

The fact that AB-ICI growth stopped abruptly in May did not come as a surprise to us. In the previous issue of AB-ICI, we wrote that the CBR decision to return to the FX market was confusing in terms of communication with the market and was likely to halt the strong ruble appreciation taking place at the time. In early June, the CBR went on to specify the target level for international reserves at $500bn, which implied accumulation of as much as $140bn, fortifying the negative signal to the ruble exchange rate. As the confidence local households and companies have in the ruble is pivotal in determining their savings and investment strategies, the prospects for sustainable AB-ICI growth are now substantially leaner. That said, the possibility of a serious deterioration from the current levels is not evident and requires a closer look.

Tighter CBR approach to dispersing ruble liquidity is a positive surprise

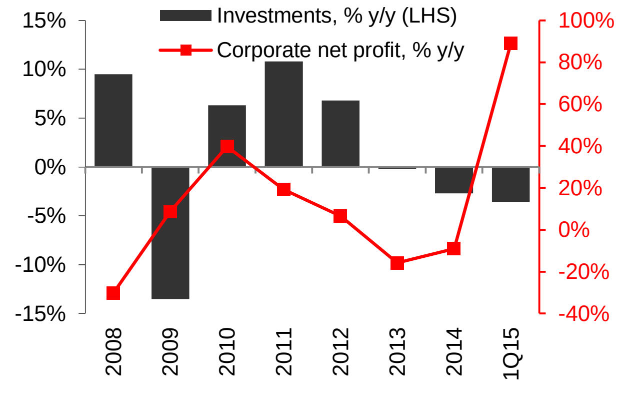
The events that followed the CBR's $500bn reserves plan allow us to take a less negative view on the ruble's prospects, at least in the near term. First, it appears that the reintroduction of FX interventions in mid-May ($7bn has been bought so far) was accompanied with some quantitative tightening in the CBR's approach to disbursing ruble liquidity. This can been seen in the apparent lowering of the limits on the ruble repo auctions (40% of banks' ruble exposure to the CBR) to levels below demand in the second half of May, and the daily CBR data that indicate that this approach persisted in June. Second, while the CBR continued to cut the key rate, lowering it to 11.5% in mid-June, it indicated that the interest rate easing cycle is coming to an end. The two facts explain the relative stability of the ruble exchange rate in the 53-55/$ range, which is likely to support local confidence.

Figure 2: Key consumer trends



Source: CBR, Alfa-Bank

Figure 3: Fixed investments and corporate net profit, % y/y



Source: Rosstat, Alfa-Bank

After declining 3.2% y/y in 5M15, Russian GDP is likely to recover in 2H15 on both better consumer and producer activity, which would limit the downside to AB-ICI

Another consideration that prevents us from taking too negative a view on the ruble and overall economic confidence in 2H15 is the expectation of improvement in the GDP growth trend by YE15. The May macro statistics, which included an unemployment decline to 5.6%, stable nominal salary growth at 7-8% y/y and some improvement in the retail lending trend, suggest that the consumption drop is nearing its bottom. The corporate investment trend is so far posting continued deterioration; however, the surge in corporate profits in 1Q15 following the ruble depreciation combined with the limitations on boosting FX position set ground for some recovery in investment for 2H15, as well. As a result, even if there is little chance for sustainable AB-ICI growth in the long-term, especially given the very limited economic growth potential, the upcoming months might turn out to be much less negative than the market expects.

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

Head of Equities
Michael Pijiolis
+7 (495) 795-3712

Alfa Bank
12, Akad. Sakharova Pr-t
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	segiev@alfabank.ru	795-3612

Financial Sector, Internet

Marina Karapetyan	mkarapetyan@alfabank.ru	795-3740

Oil & Gas

Alexander Kornilov, CFA	akornilov@alfabank.ru	788-0334

Metals & Mining

Dmitry Glushakov, CFA	dglushakov@alfabank.ru	+7 (499) 681-2918

Retail, Real Estate

Andrei Nikitin	ainikitin@alfabank.ru	795-3742

Alfa-Direct Research

Geldy Soyunov	gsoyunov@alfabank.ru	641-3673
Alan Kaziev	akaziev@alfabank.ru	974-2515 (ext. 8568)

Translation

Anna Martynova	amartynova@alfabank.ru	795-3676

Equity Sales & Sales Trading (Moscow) **+7 (495) 223-5500** **223-5522**

International

Dmitry Matyukhin	dmatyukhin@alfabank.ru	745-5621

Domestic Institutional

Vladimir Aleksandrov	vkaleksandrov@alfabank.ru	783-5120

Alfa-Direct Sales **+7 (495) 795-3680**

Sergey Rybakov	srybakov@alfabank.ru	ext. 6399
Valeriy Kremnev	vkremnev@alfabank.ru	ext. 7083