AB-ICI: Capital Outflow Still a Risk

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Investment Summary

- AB-ICI drop deepened to 4.5% m/m last month on fast spending of savings by the population
- Negative newsflow from China continues to fuel capital outflow from EMs
- Ruble exchange rate and AB-ICI remain under threat in the coming months

AB-ICI down 4.5% in August

AB-ICI fall accelerated to 4.5% m/m last month on accelerated decline of savings amidst fast ruble depreciation

The AB-ICI drop accelerated to -4.5% m/m in August after -1.9% m/m in July, with pressure coming from both local economic and market confidence indicators. The latter was not a surprise, reflecting the general capital outflow from EM on the back of negative newsflow from China and anticipation of Fed tightening. However, the drop in local confidence was sharper than we expected and was due to both active spending of ruble savings and continued accumulation of FX position by the population in response to a new round of ruble volatility. We maintain a negative outlook on AB-ICI for the coming months as both external and local conditions favor continuing capital outflow.

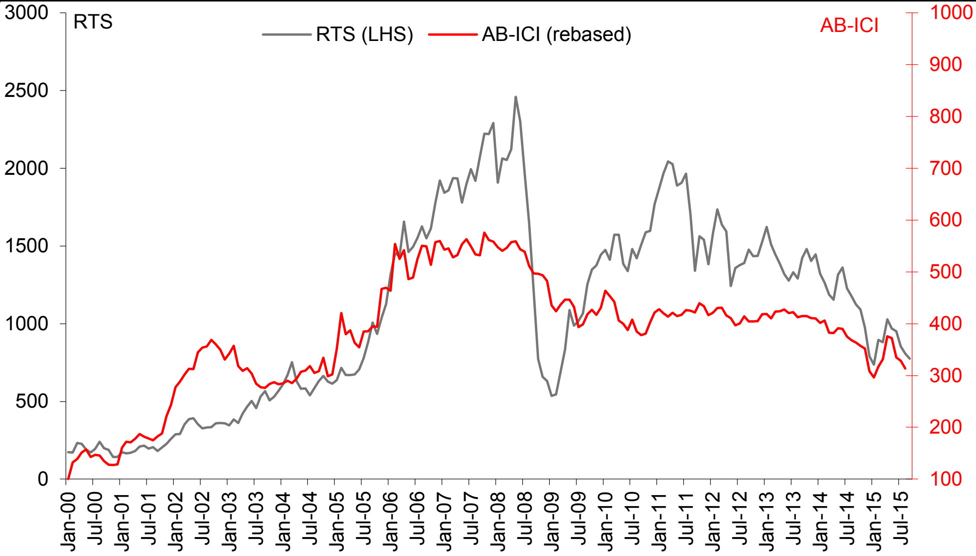
Ruble retail deposits showed no growth in August, dollarization spiked to 29%

- **Economic confidence** dropped significantly, reflecting declining trust to ruble as savings currency. In August, responding to the exchange rate instability, including ruble falling to RUB70/$ in the last week of August vs. RUB60/$ in the beginning of the month, the population ceased accumulating ruble deposits (vs. average monthly RUB180bn growth in 7M15) in order to partially finance consumer spending and also boost FX savings, pushing deposit dollarization to 29%, the highest level since January.
- **Foreign confidence** stood flat in the absence of new relevant data.

Fed rate hike seems to have been postponed but remains on the agenda; China remains a pressure factor

- **Market confidence** fell last month, confirming our take that concerns regarding the Chinese growth and expectations of Fed tightening would put pressure on the entire EM universe. Even though the Fed decided against the rate hike on September 17 meeting, 13 out of 17 directors still expect the step to be taken until this year-end, not helping to remove the nervousness on the markets.

Figure 1: AB-ICI down 4.5% m/m in August



Source: New Economic School, RTS, Alfa Bank

AB-ICI: Capital Outflow Still a Risk

The role of external pressure on AB-ICI should not be overestimated

The recent dynamic of the AB-ICI suggests that the role global market concerns in pressuring the Russian economic trends are not as strong as before, while internal challenges are gaining importance. True, not all the risks of further USD appreciation and decline in the oil price have fully played out, the decline in economic confidence indicators suggests that the local capital outflow is in the key focus at the moment, and addressing the low trust to ruble remains crucial to address this issue.

CBR expects $33bn net capital outflow till YE and only $22bn CA surplus, highlighting near-tem risks for ruble

The signals regarding the ruble exchange rate, however, remain negative. First, the near-term outlook suggests persisting pressure on the capital account side. The preliminary balance of payments estimates by the CBR suggest that the 16% ruble depreciation seen in July-August took place despite the $3.6bn current account surplus for this period, confirming that the capital account likely remained under pressure. The key concern however is that the full-year BoP forecast presented by the CBR included $73bn current account, but more importantly a $85bn net capital outflow, suggesting a $33bn net capital outflow to follow in September-December (which includes $15-20bn of net foreign debt redemption), exceeding the $22bn current account surplus expected for the period. This means that in the eyes of the CBR the sharp ruble depreciation already happened so far is not enough to stabilize the balance of payments, and additional pressure on ruble should be expected before the year-end. At the same time, the CBR dovish commentary to its September 11 key rate decision (the rate was left unchanged at 11%) suggest that the CBR is unwilling to use any tools to defend ruble, meaning that all potential negative external shocks would be reflected through the exchange rate depreciation.

The budget has little chance of limiting social spending growth until 2018, 4% pension indexation proposal is too tight to be realistic

Second, the budget discussion continues to favor inflation and ruble depreciation in a longer-term perspective. While the Finance Ministry has started the month with very tight proposals to limit pension indexation at 4% instead of 12% demanded by the law (equivalent of this year's inflation), in order to save RUB1tr in social spending and assure 7% y/y drop in the overall budget spending next year, this approach does not appear sustainable. First, the Cabinet has approved the extended freeze of defined contribution, which will provide RUB300-400bn in additional financial resources to fund state pension spending next year. Second, the discussion on addressing the budget deficit is increasingly leaning towards increase in taxation rather than cut in spending: even though the initial proposal to raise Mineral Extraction Tax did not go through, the new proposal on raising commodity export duty is on, with expected positive effect on budget revenues at RUB300bn annually. We therefore continue to doubt the viability of the 4% pension indexation proposals for the next year as well as the calls for a nominal decline in the overall budget spending for the next year. This should prevent further negative shocks for consumption next year, however it poses inflationary risks. In addition, those measures do not remove the uncertainties of the long-term framework of the budget policy, which is a standalone factor of accelerated capital outflow. We therefore continue to see AB-ICI under pressure both in the near-term and the long range.

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