Alfa-Bank

Macro Insights

AB-ICI: Year-End Risks Remain

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Investment Summary

- AB-ICI jumped 6% in September reflecting improvement in the FDI inflows
- Poor household income trend damages savings
- Market mood towards Russia has improved, but year-end risks remain

AB-ICI up 6% in September

AB-ICI recovered 6% m/m in September thanks to faster FDI inflows

The AB-ICI performance has become more volatile, suggesting that the overall trend is at inflection point. However, the further vector remains uncertain. AB-ICI was up 6% m/m in September, after 11% collapse in August, however, this recovery is assured primarily by the positive FDI statistics, which has proved to be unstable in the last couple of years. The local confidence indicators, concentrated in the Economic confidence segment are not giving much ground for optimism.

No recovery in household savings despite the consumption collapse is a troubling sign

- **Economic confidence** continued to decline, reflecting persisting pressure coming from the household side. Despite the sharp and deepening drop in consumption (retail trade is down 8.5% y/y in 9M15 and -10.4% y/y in September), the population is failing to accumulate savings. Retail deposits showed only modest 0.4% m/m growth in September, including $0.6bn in FX and RUB75bn in ruble savings. Lack of savings growth is putting both consumption and investment recovery under question.

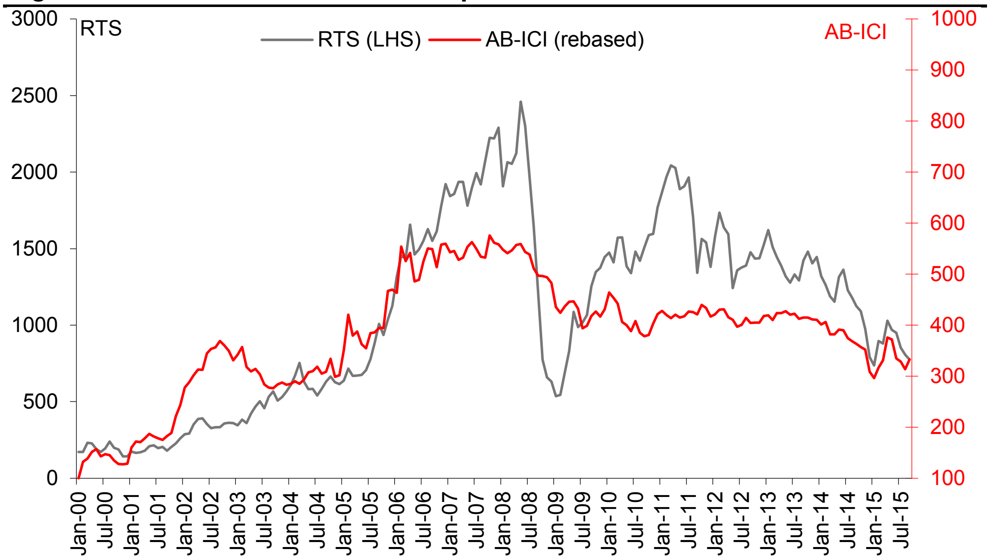
FDI inflows up 27% y/y in 2Q15, yet from a low base, dynamic unstable

- **Foreign confidence** increased, as the FDI posted 27% y/y growth to $9.5bn in 2Q15. This however represents a recovery from a low base of 2014, when FDI fell 50%, and the unstable quarter-on-quarter dynamic points at sporadic nature of these flows, rather than a stable trend.

Intrigue about December Fed rate hike remains

- **Market confidence** has been improving for the third month in a row, reflecting the return of interest to Russia following the cooling of Ukrainian tensions, as well as stabilization of global commodity prices and apparent Fed hesitation about the tightening. However, the most recent Fed commentary indicates high possibility of a hike in December, and the recent South China Sea tensions might spur a new round of overall nervousness for the global markets.

Figure 1: AB-ICI recovered 6% in September



Source: New Economic School, RTS, Alfa Bank

AB-ICI: Year-End Risks Remain

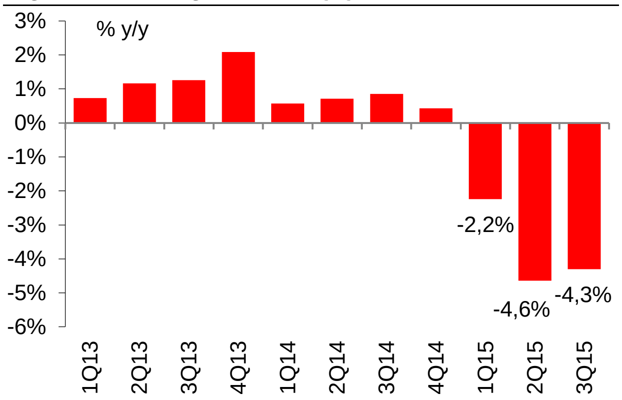
GDP drop stabilized at -4.3% y/y in 3Q15, future recovery remains under question

The recent volatility of the AB-ICI in the recent months is mirroring the uncertainties regarding the overall economic trend. The overall GDP drop seems to have stabilized in the recent months, with September showing only 3.8% y/y decline, and 3Q15 decline narrowing to -4.3% y/y after -4.6% y/y drop in 2Q15. However, the fact that the economy has reached its local low point does not clarify the timeframe for the future recovery. The possible drivers of the recovers are worth looking into.

Local consumption trend has no support from income, production is focused on state-sponsored projects

Consumption, accounting for 60-70% of the Russian GDP, and the primary source of local demand, is our key concern at the moment. As we mentioned on the front page of this report, the drop in the retail trade continues to deepen, and this is taking place in the environment of shrinking income grow: the historical low unemployment of 5.2% does not seem to prevent 9-10% y/y drop in the real salaries, as the companies are keeping the increase in the nominal salaries at minimal 4-5% y/y. The focus of the local growth has now shifted to producers, which are showing some moderation in the industrial output and investment decline (see the table below). The demand seems to be driven by the government, which is financing 27% y/y growth in the defense spending in 9M15, and the Syrian campaign suggests that the demand from the military is here to stay. However, the overall local mood remains depressed, and the recent budget discussion, which is guiding for a very tight 4% budget spending growth and 4% pensions indexation (both way below historical rates), offers little support to the local demand expectations.

Figure 2: GDP growth, % y/y



Source: Rosstat, Ministry of Economic Development, Alfa-Bank

Figure 3: Key macro indicators

	1Q15	1H15	9M15	3Q15
Retail trade, % y/y	-6,4%	-7,9%	-8,5%	-9,5%
Real salary, % y/y	-9,0%	-8,8%	-9,0%	-9,3%
Unemployment, % e.o.p.	5,9%	5,4%	5,2%	5,2%
Investments, % y/y	-3,6%	-5,4%	-5,8%	n/a
Construction, % y/y	-4,7%	-7,0%	-8,3%	-10,0%
H. construction, % y/y	32,2%	15,3%	7,0%	-6,2%
Industrial output, % y/y	-0,4%	-2,7%	-3,2%	-4,2%

Source: Rosstat, Alfa-Bank

Ability to use external demand is limited, non-oil exports is further down 25% y/y in 3Q15; BoP weakness is guiding for pressure on ruble

The external sector, unfortunately, offers little relief as well, as despite the recent ruble depreciation Russia, being focused on commodities exports, fails to boost export volumes: the 3Q15 current account surplus was at the 2-year low of $5bn, below expectations, despite the sharp 40% y/y drop in imports. The non-oil exports segment (40% of total) dropped 25% y/y (after 13% drop in 1H15) reflecting the negative trend in the global metals prices. The lack of ability to improve net exports has a twofold implication. First, it suggests that the GDP trend remains very vulnerable. Second, ruble depreciation remains the only tool to BoP readjustment. Both favor negative expectations on ruble and the overall local confidence. As a result, we remain cautious regarding AB-ICI performance in the coming months. The CBR stance will be an important catalyst: the October 30 decision to keep the key rate unchanged was very prudent, given the local inflationary and external capital flow and commodity prices risks; however, the near-term guidance was suspiciously dovish. Should the CBR proceed with the easing in December, it might increase the fragility of the capital flows.

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