Alfa-Bank

Macro Insights

AB-ICI: Market optimism may not be enough

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April 3, 2019 www.alfa-bank.com Moscow

Investment Summary

- AB-ICI appeared in line with our expectations, increasing by 0.2% on strong market and foreign sentiments
- Market performance is the main support for the AB-ICI, especially that oil prices are strong and sanctions fears lower
- Preference for savings under pressure and economic confidence depressed, limiting AB-ICI performance

AB-ICI up 0.2% in February

AB-ICI increased by 0.2% in February due to improved market and foreign sentiments

The AB-ICI grew 0.2% m/m in February and this recovery relied on the recovery of market and foreign confidence, which came in line with our expectations. Economic confidence, by contrast, remains rather weak.

Economic confidence did not see any improvements in February as ruble-denominated deposit growth decelerated to 7.6%

- **Economic confidence** indicated a poor performance in February, which stemmed from a controversial situation in retail deposit growth: (1) the ruble-denominated segment was weak, decelerating to 7.6% y/y in February vs 7.9% in January, but (2) forex-denominated deposits increased by $1.7bn in February, as a result, their share to total retail deposits accounted for 21.5%. This relatively high level of dollarization implied that the local population remained more skewed to forex-denominated deposits as a means of saving. All in all, the divergence in ruble- and forex deposit growth led to a 9.4% y/y increase in total retail deposits. Although, this situation did not give any certainty regarding future development of the market and economic sentiment remained subdued.

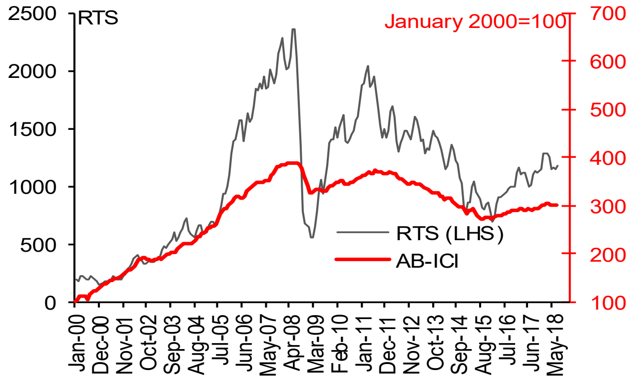
Market confidence was strong on foreign inflows to the OFZ market

- **Market confidence** remained positive in February as a result of declining sovereign CDS, implying a reduction in financial risks. In addition, the market indicated some improvement in foreign investor sentiment to local state bonds - in February, the share of non-resident holdings of OFZ increased to 25.5% vs 23.6% in December. However, the declining duration of corporate bonds, weak RTS and reluctance of companies to issue new bonds placed a ceiling on market confidence.

Foreign confidence slightly improved as the share of foreign banks increased to 8%

- **Foreign confidence** indicated some signs of improvements due to the increasing share of foreign banks in the Russian market – 8% of banking sector assets in February were attributable to foreign banks, the highest share since September 2018

Fig. 1: AB-ICI and RTS Index: AB-ICI up 0.2% in February



Source: RTS, Alfa Bank

AB-ICI: Market optimism may not be enough

Support is more likely to come from the market component

Based on the macro results of 2M18 and global developments, it looks like the AB-ICI should receive more support from the market performance as opposed to the improvement of the economic confidence.

External environment is favorable: 54% of Russians expect de-escalation on sanction in the short-run, oil price is up 8% in February

The external environment was primarily favorable in February-March. The fear of sanctions has eased after the so-called Mueller report was presented on 24 March. According to the announced summary, the Mueller investigation has found no evidence of collusion between US President Donald Trump's campaign and Russia in the 2016 election. This positive news provided at least temporary relief to the Russian market, and probably influenced growing positive sentiment in Russia. In fact, a recent poll by the Levada Center found that there are more Russians, who believe that the West will lift sanctions on Russia in the short-run and relations will recover – the share of positive-minded Russians increased from 46% in 2018 to 54% in 2019, which is the highest level since 2014. Another threat, which might arrive from the revised DASKA bill is also seen as limited – a large number of foreign investors consider that DASKA 2.0 presented to Congress on 13 February has little chance of being implemented. As fears of sanctions ease, Russia's economy is encouraged by the favourable environment of global commodity markets: oil prices increased by 8% in February to $64.5/bbl and new sanctions on Iran could boost it even further. The Russian market also received some support from a move by the Federal Reserve towards a more accomodative stance on monetary policy - in a way, it plays in favor of more flexible CBR policy.

A combination of the stable exchange rate and a flat key policy rate seems comfortable for Russia's market

Low fear of sanctions push the market to pay more attention to the economic agenda, in particular to monetary policy issues. There is also good news on this front as additional rate hike do not look necessary, given the inflationary pattern. Inflation may reach 5.3-5.5% in March, which is much better versus initial CBR expectations of 5.5-6.0% y/y pick level. In addition, inflationary expectations started to ease and, according to the CBR, they dropped to 9.1% in March vs 10.1% in February. All together, this implies that the CBR may consider a rate cut option later this year, which is expected to build a positive case for the local bond market.

New 2018 figures point that consumption was up 2.6% in 4Q18, pointing a risk for saving ratio

At the same time, the local picture is mixed. Retail trade growth reached a strong 2.0% y/y in February, beating the 1.5% y/y consensus and our 1.0% y/y expectation, accelerating from the 1.6% y/y growth posted in January. The main reason for the better-than-expected performance seems to be the stronger income trend. Rosstat revised up the nominal and, thus, real salary growth: the latter was upgraded from 0.1% y/y growth to 1.1% y/y for January and, in February, it thus grew by 0.7% y/y. The strong preference for consumption is also confirmed by the recently revised Rosstat data for 2018 – it looks now that household consumption has accelerated to 2.6% y/y in 4Q18 and was the main driving force for GDP growth at the end of 2018. However, this tendency raises some concerns with regard to investment growth this year and also seem to reflect that households have cut their saving preferences in order to maintain the scale of consumption.

In the short-run, external environment is favorable, but there are a number of factors, which could damage foreign confidence

Another point of concern is that despite favorable market sentiment, in the real sector the situation is far from immune from the negative scenario. There were a number of signals in the recent months that the direct presence of foreign business in Russia is likely to decline going forward. In the real sector a strong negative signal was Ford's decision to close its plants in Russia, which was the first foreign automobile plant opened here in 2002. In the banking sector, a number of foreign banks are experienced pressure form global markets because of a risk of engagement in money laundering scandal, discussed in the Guardian on March 5 – as a result of that publication, Raiffesen Bank International led declines in European banking shares - dropping up to 15% in one day. All in all, there are a number of factors, which could damage foreign confidence even if the sanctions agenda will be quiet.

The AB-ICI is expected to continue its modest growth in the coming months

The overall backdrop for the coming months looks mixed for AB-ICI index growth however it looks that external market forces are likely to prevail and thus a continuing modest growth is very likely.

RATING DEFINITIONS

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The ratings are:

Overweight (O/W):	Expected total stock return > 15%
Equal Weight (E/W):	Expected total stock return < 15% and > 0%
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Target Prices

The Target Price reflects the research analyst's informed opinion on the price which is likely to be attained by the stock within 12 months, subsequent to the date of the Target Price determination.

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