Alfa-Bank

Macro Insights

AB-ICI: Key policy rate under focus

Natalia Orlova (+7 495) 795-3677 NOrlova@alfabank.ru
Natalia Lavrova (+7 495) 795-6336 NLavrova@alfabank.ru

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Investment Summary

- AB-ICI maintained its growth trajectory in April, adding 0.5%, which implies 1% YTD in 4M19
- April was the first month when all three components: economic, market and foreign confidence had an almost equally positive influence on the AB-ICI
- The fragility of the market confidence component may place a ceiling on the performance of the AB-ICI

AB-ICI up 0.5% in April

AB-ICI increased by 0.5% in April or 1% YTD

The AB-ICI indicated 0.5% growth in April driven by a strong performance from all three components: although the market component has been the main pillar of AB-ICI growth since the beginning of the year, April was the first month (since June 2018), when economic confidence also surprised by modest growth. Foreign confidence, reflecting the growing interest of foreign investors to the Russian market, also demonstrated sustainable growth in April.

Improved ruble-denominated deposit growth (to 7.1% y/y) in April strengthened economic confidence

- **Economic confidence** finally turned to growth following a long period of decline. The first positive news came from an increase in ruble-denominated deposits – in April, they increased by 7.1% y/y vs 6.6% y/y in March and an average of 11% y/y over the last year. Second, interest in forex-denominated deposits stabilized – as a result, due to ruble appreciation, their share of total deposits contracted from 21.4% in March to 21% in April. However, some drawbacks remain, primarily related to the acceleration in retail loan growth, which has not led to a significant improvement in consumer financial positions.

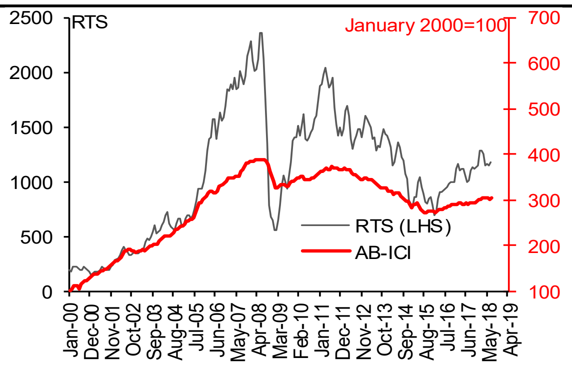
Market confidence improved under an increased share of non-resident holdings of OFZ to 27.1% in April vs 26.2% in March

- **Market confidence** continued to strengthen in April driven by two months of consecutive increase in the duration of corporate bonds and a sustainable sovereign CDS, which has a tendency to decline. The improved market confidence was also reflected in the growing interest of foreign investors in Russia – in April, they invested around RUB404 bn in the OFZ market and increased their share of non-resident holdings of OFZ from 26.2% in March to 27.1% in April.

Foreign confidence remained relatively strong – the presence of foreign banks increased to 8.1% in Russia

- **Foreign confidence** demonstrated some improvement in April, as reflected by the increased share of foreign banks in the Russian banking system – rising to 8.1% in April - it accounted for 8.0% in March. Thus, foreign banks continue to capture additional market share as sanctions risk eased.

Fig. 1: AB-ICI and RTS Index: AB-ICI up 0.5% in April



Source: RTS, Alfa Bank

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Growing inflows from foreign investors - accounting for 42% of the OFZ placements in April - push the market to focus more on the CBR's actions

The market confidence component has become the main pillar of AB-ICI growth in 2019, reflecting growing interest in the Russian market. Over April, the foreign investors bought 42% of the OFZs placements and increased their presence on the OFZs market to the level of July 2018. These growing inflows from foreign investors - due to an easing of sanctions risk - pushed the market to pay more attention to monetary policy issues and CBR actions.

Current economic environment became a challenge for the CBR

While the overall market environment seems to be favorable there are still some uncertainties related to weak macroeconomic indicators, which may become a serious challenge for the CBR in setting key rate policy. In fact, there are a number of factors, which are both in favor of a rate cut and against it.

Low 0.5% economic growth compel the CBR to cut the policy rate…

(1) The main incentive to cut the key policy rate stems from economic growth, which in 1Q19 was lower than initially assessed by the CBR and consensus forecasts. According to Rosstat, the first estimate of GDP growth came in at just 0.5% y/y, which is even below our very cautious 0.6% y/y forecast. The new breakdown of Russian quarterly GDP growth implies that fixed investment growth dropped to 0.2% y/y in 4Q18, i.e. evaporated once the big infrastructural projects like Kerch Bridge and World Cup infrastructure-related construction projects were completed.

… which is also supported by 2.6% m/m increase in ruble-denominated deposits

Another factor behind a possible rate cut may be an acceleration in retail deposit growth. Ruble-denominated retail deposits increased by 2.6% m/m after being up by just 0.3% m/m in March, reaching 7.1% y/y annual terms. As the level of forex deposits apparently remained unchanged at around $93bn, such a substantial inflow of retail deposits set a foundation for a possible rate cut.

External environment mirrored in Fed's possible rate cut - which is expected by 80% of experts - also makes it comfortable for the CBR to set dovish monetary policy

The external environment seems to remain favorable for a cut in the CBR's policy rate. In fact, the Federal Reserve halted its policy rate hike cycle and now the question is only when it will move to a rate cut. While Richard Clarida, the Fed's Vice Chairman believes that the current rate level is appropriate, he also assumes that the rate can be cut if economic growth worsens. Considering the growing tensions between China and the US and decelerating PMI, this situation looks possible. Our view is supported by the fact that 80% of experts now expect the Fed to cut its rate by the end of this year, which represents an additional argument in favor of this CBR step.

A rapid 23.8% y/y retail lending growth together with inflationary risks makes a loose monetary policy less possible

(2) On the opposite side, the situation for the CBR is considered to be more complicated and may compel the CBR to maintain the current level of the policy rate. One of the problems is related to retail lending growth, which has continued to accelerate. In April, it reached 2.0% m/m, exceeding the 1.7% m/m increase seen in March, and representing 23.8% y/y growth. This implies that the consumer financial position has remained unstable, and macroprudential measures, implemented by the CBR and focused on curbing retail loan growth are still unsuccessful. In combination with still high inflationary risks - as during the period of 15 April–15 May wholesale gasoline prices were up 20%, raising concerns over retail gasoline price dynamic in July, once the freeze of local prices ends - the decision to turn to a loose monetary policy tends to be uneasy for the CBR.

A monetary policy situation remains uncertain, which is an additional argument in favor of modest expectations for the AB-ICO performance

Considering the above-mentioned factors, in the coming months, the main watch factor is the key policy rate. On 14 June, the policy rate meeting, the CBR can be enforced by the market to move towards a more accommodative stance on monetary policy, although future steps, given the rapid retail loan growth, can be restricted, and the CBR is expected to take pause rather than continue to cut the key policy rate. This pause is seen as a factor of uncertainty, which is an additional argument in favor of modest expectations for the AB-ICI performance.

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:

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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.

Alfa Bank Equities

12, Akad. Sakharova prospect Moscow, Russia 107078
+7 (495) 795-3712

Head of Equities Konstantin Shapsharov
+7 (495) 228 8828 kshapsharov@alfabank.ru

Research Department **+7 (495) 795-3676**

Head of Research
Boris Krasnozhenov bkrasnozhenov@alfabank.ru +7 (495) 795-3612

Macroeconomics
Natalia Orlova, Ph.D. norlova@alfabank.ru + 7 (495) 795-3677
Valeriya Volgareva vvolgareva@alfabank.ru +7 (495) 780-4724
Natalia Lavrova nlavrova@alfabank.ru +7 (499) 923 6697 (ext. 6336)

Equity Strategy
John Walsh jwalsh@alfabank.ru +7 (499) 923 6697 (ext. 8238)

Metals & Mining
Boris Krasnozhenov bkrasnozhenov@alfabank.ru +7 (495) 795-3612
Yulia Tolstykh yatolstykh@alfabank.ru +7 (499) 923 6697 (ext. 8681)

Consumer
Evgeniy Kipnis ekipnis@alfabank.ru +7 (495) 795-3713
Olesya Vorobyeva oovorobyeva@alfabank.ru +7 (499) 681-3075

Banking
Evgeniy Kipnis ekipnis@alfabank.ru +7 (495) 795-3713

TMT & Agriculture
Anna Kurbatova akurbatova@alfabank.ru +7 (495) 795-3740
Olesya Vorobyeva oovorobyeva@alfabank.ru +7 (499) 681-3075

Translation
Anna Martynova amartynova@alfabank.ru +7 (495) 795-3676

Data Specialist / Analyst
Denis Dorofeev didorofeev@alfabank.ru 7 (499) 923-6697 (ext. 8086

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

International Sales
Alexander Zorov azorov@alfabank.ru 745-5621
Svetlana Golodinkina sgolodinkina@alfabank.ru 785-7416
Artem Belobrov abelobrov@alfabank.ru + 7 (495) 785-7414

Equity Financing
Viacheslav Savitskiy vsavitskiy@alfabank.ru
Oleg Morozov omorozov@alfabank.ru +7 (495) 783 5101

Alfa Direct (Domestic retail brokerage)

Head of Alfa-Direct **+7 (495) 795-3680**
Sergey Rybakov srybakov@alfabank.ru 795-3680 ext. 6399

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

Alfa-Direct Sales
Valeriy Kremnev vkremnev@alfabank.ru ext. 7083
Olga Babina obabina@alfabank.ru ext. 4092