Alfa-Bank

Macro Insights

AB-ICI: Dedollarization a confidence measure

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July 1, 2019 **www.alfa-bank.com** **Moscow**

Investment Summary

- AB-ICI came up 0.3% in May as the share of foreign banks grew up and market sentiment was better
- Dedollarization talks of 2018 were a litmus test for the ruble: although the share of the dollar in CBR reserves dropped from 46% to 23%, it continues to service 67% of Russia's total exports and 36% of its imports
- Growing non-oil exports and increasing trade with the EAEU are key to allow the ruble gain more importance in foreign trade

AB-ICI up 0.3% in May

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The AB-ICI was up 0.3% in May as despite the modest economic activity the market and foreign confidence components delivered strong performance:

Economic confidence was not strong, as the share of dollarization was slightly up and growth in retail ruble-denominated deposits slowed

- **Economic confidence** did not improve in May after positive momentum in April. One important sign was the fact that after some acceleration in ruble-denominated deposit growth rates to 7.1% y/y in April, the market path returned to normal in May and growth in this segment reached 6.8% y/y, very close to this year's minimal rate of 6.6% y/y seen in March. The preference for forex savings remains firm, with $93.8bn kept in forex deposits, or 21.3% of total retail deposit funding.

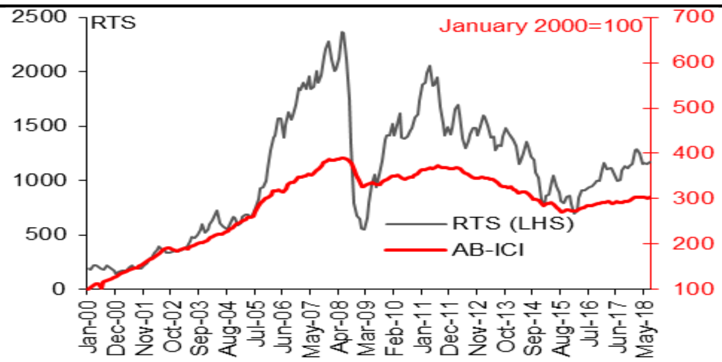
The growing expectations of a rate cut pushed bond durations lower but market sentiment is strong

- **Market confidence** was rather positive with the CDS posting a continuing decline and Headhunter IPO indicating increased market activity. Market sentiment remains strong responding to the general appetite of global capital towards EMs in general and Russian in particular. At the same time the duration of the corporate bond market stopped increasing – this might reflect increasing local expectations on a likely cut in the key policy rate, which pushed companies to reduce their appetite for long-term borrowing.

Foreign confidence increased as the share of foreign banks went up to 8.3% of total assets in Russia

- **Foreign confidence** delivered a good performance in May with the share of foreign banks going up to 8.3%. With the retail lending market growth showing some signs of stabilization and especially considering that the CBR is likely to make a new round of tightening in retail lending market regulation in order to cool its growth rate and take lending risk under control, we expect foreign banks will have a competitive advantage in keeping pace of their growth going forward.

Fig. 1: AB-ICI and RTS Index: AB-ICI up 0.3% in May



Source: RTS, Alfa Bank

AB-ICI: Dedollarization a confidence measure

Dedollarization is part of our confidence index however its agenda is much wider

The calculation of the AB-ICI incorporates the structure of local savings in order to take into account individual preferences for ruble deposits, which is an important sign of confidence to local economic policy. However, the dollarization agenda is much larger and was in focus in the past year.

In 2018, the CBR reduced the share of dollar instruments in its reserves from 46% to 23%; however, the dollar still services 67% of Russian exports and 36% of its total imports

Sanctions encouraged Russia to search for ways to dedollarize: during 2018, the CBR substantially changed the structure of its reserves, cutting the share of dollars from 46% to 23%, while boosting the share of the euro from 22% to 32% and the share of the Chinese yuan from 3% to 14%. However, at the level of trade flows, the change has been much slower and the dependency on the dollar remains strong. In 2013, the dollar was used to pay for 80% of the country's export revenue, by 2018 this figure had dropped to 67%, with the share of the euro rising from 9% to 17% during the same period and it now exceeds the share of the ruble in export transactions. On the import side, the situation was initially much more diverse, with the share of the dollar only 41% in 2013 versus the share of the euro at 30% and the share of the ruble at 28% and adjustments made since 2013 have also been extremely modest: the dollar still services 36% of total imports, while the share of the euro is unchanged at 30%. All in all, it would appear that (1) dedollarization is not going to take place as easily across the broader economy as it did at the state level; (2) the share of the dollar in Russian export flows remains high, reflecting the high share of commodities in total exports – 60% of fuel exports in 1Q19 and 59% in 2018; and (3) the decline in the share of the dollar does not necessarily boost the share of the ruble in global transactions.

One issue with regards to trade dedollarization is about timing: despite talks emerging in 2018, the dedollarization of trade flows mainly took place prior to 2017

There two important topics related to the dedollarization issue. The first is to understand what extent it gained momentum in the last year in response to mounting fears of sanctions. The EU and the Eurasia Economic Union (EAEU), Russia's two important trade partners, both posted a decline in the share of trade in dollar prior to 2017. In the case of the EU, the dollar was replaced by the euro, the share of which in export transactions jumped from 18% in 2013 to 34% in 2018, while at the import side it moved from 46% to just 48% over the same period. As for the EAEU, despite being a smaller market for Russia, the share of ruble transactions with this region was higher than average already in 2013, at 53% of exports and 61% of imports. In 2018, the figure was 70% and 77%, respectively; however, the main increases were also reported to have taken place in 2014 on the export side and prior to 2017 on the import side.

The second issue is about opportunities for dedollarization: it would come with stronger non-oil export growth and with larger EAEU trade, however in 2019 non-oil exports are stagnant and the share of the EAEU in Russian trade is below 10%

The second observation is related to opportunities for dedollarization going forward. It looks like the best way to achieve this would be to ensure the diversification of exports, which at the moment are still very dependent on fuel: however, the non-oil segment posted a very modest 0.5% y/y growth in 1Q19 after growing by 14% y/y in 2018, a sign that no improvement should be expected in 2019 from dedollarization efforts. Russia's growing trade flows with China are also likely to play in favor of keeping a constant share of dollars, as trade with China is more dollarized than other trade with the regions mentioned. To promote the role of the ruble in trade transactions, Russia needs to develop its trade with the EAEU where the share of the ruble is 72% of total transactions: however, this trade partner still accounts for less than 10% of Russia's total trade and trade volumes have been very stable over the last decade.

Low trust in the ruble as a currency of foreign trade transaction points to a ceiling for AB-ICI growth

All in all, it looks like despite external pressure coming from sanctions, the share of dollars in total economic transactions remains relatively high, coming in line with the persistently high share of forex retail deposits in the total funding structure of banks. In other words, while at the government level, the dedollarization decision is easy and fast to be taken, the entire economy just lacks an appropriate currency capable of replacing the dollar. The slow dedollarization pattern which is observed also shows that the ruble has little benefits from this process: thus, despite the fear of new sanctions are declining, trust in the ruble remains weak. We thus continue to believe that this points to a ceiling for AB-ICI growth.

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This document is published on a monthly basis.

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