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Macro Insights

AB-ICI: Cabinet promises strong growth to come

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Investment Summary

- AB-ICI contracted 0.1% m/m last month, the first decline since the beginning of the year
- Structural factors, like slow retail deposit growth and higher dollarization, were responsible for the AB-ICI decline
- Positive growth expectation of the cabinet, shared by the market, could be offset by tighter retail lending control

AB-ICI down 0.1% m/m in July, the first drop since last year

AB-ICI down 0.1%in July

The AB-ICI was down 0.1% m/m in July, driven by structural weakness in a number of areas:

Economic confidence under pressure as share of forex deposits rises to 21%

- **Economic confidence** was under pressure for two reasons. Ruble-denominated retail deposits grew by just 6.5% y/y in July, the weakest growth since the beginning of the year. At the same time, retail foreign-currency deposits remained at $96.5bn, representing 21% of total retail deposits. The increased volatility of the ruble exchange rate seen in August is likely to confirm this preference for foreign-currency savings.

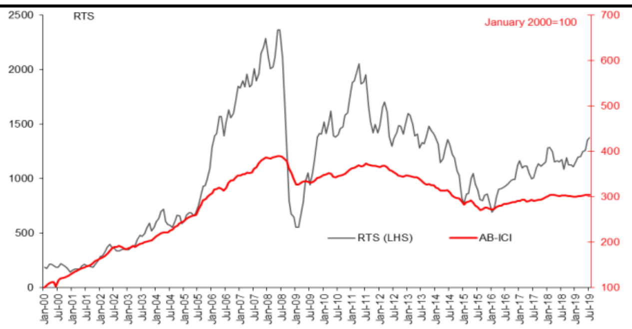
Global environment of low interest rates support the attractiveness of the Russian bond market

- **Market confidence** was positive in July, with a continued increase in bond durations, a decline in CDS and some growth in the RTS index. However, it is worth mentioning that the performance of equity market index is not as impressive as the improvement in bond market sentiment, particularly as seen through the decline in CDS. The global environment of lower interest rates has made the Russian bond market potentially attractive, this attraction was reinforced recently by Fitch's decision to assign Russia with an investment grade status.

Presence of foreign banks dropped below 8.0% again

- **Foreign confidence** was weaker than expected in July as the market share of foreign banks dropped again below 8%. We continue to believe that under the sanctions threat and given the poor levels of FDI flowing into Russia the foreign confidence indicator has little room to strengthen.

Fig. 1: AB-ICI and RTS Index: AB-ICI down 0.1% in July



Source: RTS, Alfa Bank

AB-ICI: Cabinet promises strong growth to come

Local agenda may support AB-ICI

In addition to the global environment which, again, may favors investors' interest to EM and Russia, the AB-ICI may also benefit from the expected improvement of the country's growth outlook.

Minister Oreshkin adjusted the 2019 forecast for the weak 1H19 results …

Last week, Minister Maxim Oreshkin unveiled an updated economic growth forecast for 2019-24. For this year, GDP growth was reiterated at 1.3% y/y, in line with the initial expectations, however the Ministry has cut its investment growth forecast to 2.0% y/y and real disposable income growth was downgraded from 1.0% y/y to 0.1% y/y only. Both adjustments seems to be due to the weak 1H19 figures and in a way are related to the need to incorporate the actual trend reported by Rosstat. As an example, investment growth was reported at just 0.5% y/y for 1Q19 and for the 2Q19 the estimate has not yet been provided by Rosstat. This came as a disappointment, given that the national projects were expected to boost investment activity already this year. The situation is even worst at the level of the gross capital formation which dropped 2.6% y/y and which may remain in negative territory for 2Q19 as well. The same applies for the performance of real disposable income: for 1H19 it was reported to be down by 1.3% y/y, including the 0.2% decline reported for 2Q19.

…but projects an acceleration in GDP growth to above 3.0% y/y from 2021 backed by 5.0%+ y/y investment growth

That said, the Ministry continues to keep positive guidance for 2020 and beyond. GDP growth is projected to accelerate to 1.7% y/y next year and to stay in a range of 3.1-3.3% for 2021-24. This optimistic view relies on an expected acceleration in the investment growth to 5.0% in 2020 (and projected to stay above 5.0% annually until 2024). A stronger growth environment will boost annual real disposable income growth to above 2.0% from 2021 which will allow to keep the annual retail trade growth at 2-3% y/y level until 2024.

Analysts' consensus expects GDP growth to accelerate from 1.1% y/y in 2019 to 1.7% y/y next year

At the moment the cabinet view is shared by the analysts' consensus. According to polls conducted by the HSE Development Center at the end of July, analysts expect GDP growth to accelerate from 1.1% this year to 1.7% in 2020. In other words, the more cautious view on this year growth implies that the market see even stronger than official guidance acceleration as a base scenario for next year. This confirms that the national projects are a powerful agenda dominating the growth outlook at the moment.

Should the CBR tighten retail lending regulations, slower retail lending growth will offset any positive effect of investment pick-up – we thus expect the market component of the AB-ICI to perform well but the foreign and economic confidence components of the index to stay weak

At the same time the positive expectations contrast the reality. Retail trade growth came surprisingly weak in July at just 1.0% y/y, this was the slowest monthly growth since the beginning of this year; it came below the 1.5% y/y retail trade growth reported for 2Q19 and 1.9% y/y reported for 1Q19. July's poor figure looks particularly negative given the upward revision of salary growth for June (nominal growth +7.7% y/y and real growth +2.9% y/y) and strong salary growth in July (nominal growth +8.2% y/y and real growth +3.5% y/y). The unemployment rate came at a very low level of 4.5%. One possible explanation could be that the weaker retail trade reflects a faster-than-expected deceleration in retail loan growth; in July the retail loan growth came 1.2% m/m only or 21.9% y/y. The biggest risk at the moment is thus that the CBR's efforts to tighten the retail lending market will neutralize the positive effect of the national projects pending on the economic growth rate: in this case, some acceleration in investment growth will be offset by the weakness in final consumption. All in all, we consider that the fact of the positive outlook for 2020, ruling the market now, will support the market component of the AB-ICI and provide some support to its performance, however both foreign and economic confidence components are expected to stay rather weak.

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%
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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.

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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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