

AB-ICI: Consumption again under focus

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Investment Summary

- AB-ICI posts growth for a fourth consecutive month, up 3.7% YTD
- Russia's financial markets are surprisingly strong despite geopolitical tension
- Indexation of public-sector salaries focused attention on consumption and inflation trends

Fourth month of growth for AB-ICI index

Retail forex deposits dropped in February

The Russia market may lose its appeal, especially given the geopolitical tensions and narrowing spread between Russian and US rates

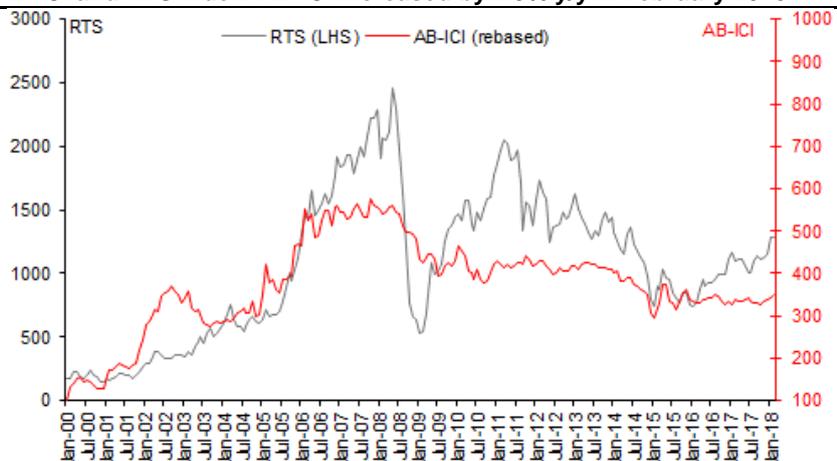
The further banking sector clean-up bodes well for foreign banks

AB-ICI – fourth straight month of growth

The AB-ICI index increased for fourth straight month in February, advancing 2.3% m/m and 3.7% YTD. That is a significant improvement on the previous year and likely reflects an improved consumption trend in Russia:

- **Economic confidence** recovered in February, which saw retail deposits increase by 1.2% m/m after a seasonal drop in January. The strength in the deposit trend can be seen through the contraction in dollar-denominated retail deposits, which dropped by \$2 bn in February after being flat at \$94 bn for around two years. That said, the declining dollarization of deposits did not prevent an acceleration of net capital outflows from Russia: outflows soared to \$9.8 bn in 2M18 vs. \$4.4 bn in 2M17;
- **Market confidence** remained strong, however the latest spate of geopolitical tensions began to neutralize the positive effect of Russia's recent sovereign rating upgrade. Moreover, the spread between Russian and US rates are narrowing: the US Fed recently raised its rate to 1.75% while the CBR decreased its key rate to 7.25%. The CBR also announced that it will move to a neutral monetary policy this year, which may reduce market appetite for Russian assets;
- **Foreign confidence** continues to grow due to the increasing share of foreign banks in the Russian market – 7.9% of banking sector assets in February were attributable to foreign banks, the highest share since August 2016. The CBR recently announced that it may revoke at least another 60 banking licenses this year, thus, the foreign banks may continue benefit from the sector's clean-up.

Fig. 1: AB-ICI and RTS Index: AB-ICI increased by 2.3% y/y in February 2018



Source: RTS, Alfa Bank

AB-ICI: Consumption again under focus

The beginning of 2018 was better than expected for Russia

Russia has performed quite well on the economic front since the beginning of 2018. The ratings upgrade by S&P came as a positive surprise and supported market sentiment, which had been eroded by sanctions risk. Economic growth was around 1.7% y/y in 2M18, according to Economy Ministry data. Vladimir Putin was elected as the president for a fourth term, with a record high 77% of the vote. The indexation of public-sector salaries may support the consumption trend this year.

Acceleration in public-sector salaries may support consumption and salaries this year

Consumer optimism due to higher salaries is gaining in importance. Recently Rosstat significantly upgraded salary-growth figures for 2018: nominal salary growth rose 12.9% y/y and real salaries increased 10.2% y/y in 2M18. Moreover, robust growth of 4.4% y/y was reported in real disposable incomes in February, the first positive figure since January 2017. We attribute the indexation of public-sector salaries for the substantial boost in salaries. For January, Rosstat reported 17.1% y/y average growth in the public sector salaries. Federal budget statistics confirm this: expenditure growth in healthcare, education and national economy increased by 47% y/y in 2M18. The strong acceleration in expenditure growth contradicts MinFin guidance of 1% y/y federal budget spending growth for full-year 2018; thus, there is a risk that after a couple of months, the authorities may try to limit the scale of salary growth. In the short run, public-sector salary growth is likely to persist, placing the emphasis on salaries growth in the overall economy and consumption patterns; that said it may lead to inflationary risks.

Consumption and industrial production growth in February was below expectations

At the same time, the improved income trend yet did not spread optimism across the whole economy. Macro statistics reflect that January's acceleration was temporary. GDP growth, according to Economy Ministry data, decelerated to 1.5% y/y in February after 1.9% y/y in January. Retail trade decelerated to 1.8% y/y in February, implying a slowdown from the 2.8% y/y growth recorded in January and around 3.0% y/y expansion in 4Q17. Industrial production also decelerated in February to 1.5% y/y from 2.9% y/y in January, despite the low base (-2.7% y/y in February 2017) and one more working day (19 days in February this year vs. 18 days in 2017). Moreover, several economic institutions have recently raised concerns over business investment activity, which has begun to show the signs of deceleration since March.

Increase in taxes on the agenda

After the presidential elections and Vladimir Putin's comfortable victory, with a record 77% of the vote, the government again returned to the forthcoming tax manoeuvre. The current proposals include a potential increase in personal income tax (from 13% to 15%), an increase in VAT, as well as the introduction of sales tax. All in all, it looks like the population will be the main focus of further tax increase; however, we do not believe that a final decision on the exact tax changes has yet been taken. We reiterate our view that the planned increase in the tax burden (whether it be through a tax rate increase or/and through improved tax collections) will impede economic growth; we reiterate our 1.0% GDP growth forecast for 2018.

The new round of geopolitical tensions against RTS

The overall backdrop looks in favor of continued modest AB-ICI index growth: strong salary growth and a potential subsequent acceleration in consumption; possible retail loan acceleration, as the non-mortgage market is still not overheated and high investor interest in the local market. As for the RTS index, the latest geopolitical tensions between Russia, the US and the EU may pressure it going forward.

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