

AB-ICI: Trends unchanged

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Investment Summary

- The AB-ICI index increased by 1.6% m/m in August, however the economic fundamentals behind it showed no improvements
- Stronger equity market trend could be neutralized by the continuing decline in the presence of foreign banks
- The gap between the AB-ICI and RTS index has stopped narrowing and runs the risk of widening again

AB-ICI: trends unchanged

AB-ICI increased by just 1.6% m/m in August

In August, the gap between the AB-ICI and RTS indexes widened, as the AB-ICI index posted modest growth vs. the strong performance of the RTS. The AB-ICI index grew only 1.6% m/m (-0.4% YTD) due to the supportive market component, but that was offset by weak economic fundamentals:

Economic confidence show no change

- **Economic confidence** remained flat in August, still pressured by flat retail deposit dynamics and high levels of dollarization (22.2% in August vs. a pre- crisis level of 18.0% in 2013).

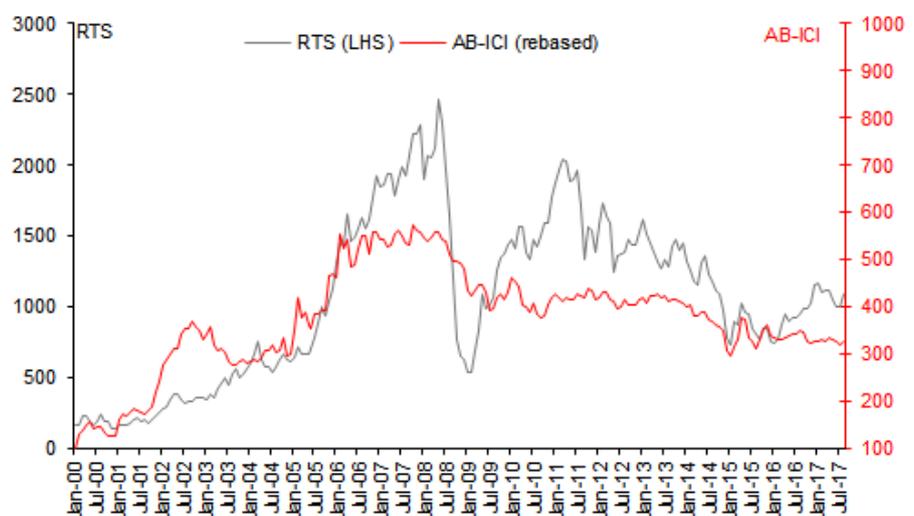
Announcement of Obuv Rossia IPO is positive

- **Market confidence** strengthened in August, as we expected last month, due to the continued appetite of foreign investors for risk assets and the quite attractive Russian rates. Recently, Obuv Rossii announced plans for an IPO, which we expect to be a supportive factor of future market confidence.

If Nordea Bank is sold, the share of foreign banks in Russia may decrease to 7.0%

- **Foreign confidence** came under significant pressure in August: the share of foreign banks on the Russian market dropped below 7.4% in August 2017 – the lowest level since at least 2007. Moreover, this share is likely to decline even further, as Swedish group, Nordea, plans to sell its Russian asset, Nordea Bank, or at least the loan portfolio. Thus, the share of foreign banks may decrease to 7.0-7.1%. After the CBR’s decision to provide support to Otkritie and B&N Bank, the share of private banks is now equally under pressure.

Figure 1: AB-ICI and RTS Index: AB-ICI gained 1.6% m/m in August 2017



Source: RTS, Alfa Bank

AB-ICI: Unchanged trends

Conflicting trends driving AB-ICI: improved market sentiment (which however look unstable) and weak fundamentals

Instability in the banking sector also adds to concerns and may negatively impact AB-ICI dynamics

August growth figures do not allow to expect economic growth to return to 2.5% y/y reported in 2Q17

Banking sector troubles inconsistent with economic recovery; AB-ICI potential is limited

We do not believe that the AB-ICI's substantial growth last month is sustainable, but rather it was a one-off effect from the strong appetite of foreign investors for riskier assets, i.e., the market component of the AB-ICI index was again the main driver of growth, as it was in July. Going forward, the change in sentiment could represent a risk for AB-ICI dynamics. For example, in September, market sentiment already took a turn for the worse: A) global investor appetite for risk decelerated due to positive news from the US regarding President Trump's tax reform plans; and B) market confidence is under pressure from concerns about Russia's banking sector, and investors are showing aversion to bonds of banks.

Since the end of August, Russia's banking sector has come under significant pressure: the CBR announced the rescue of two large private banks – Otkritie and B&N Bank (8th and 12th by assets, respectively) – on 29 August and 21 September, correspondingly. A quite significant run on Otkritie's deposits was one of the reason why the CBR decided to enter its equity capital. During July-August, Otkritie saw retail and corporate deposit outflows of nearly RUB0.7 tn. What concerns the market about the rescue of these banks is a statement from the CBR that it could write-off all the subordinated debt of Otkritie – nearly RUB123 bn, including three subordinated Eurobonds totaling \$1 bn (nearly RUB60 bn). At the economic level, there is a fear that the scale of the CBR's rescue, which is yet not very clear, could trigger inflation growth or create a risk for inflationary expectations.

August's macro statistics did not alleviate concerns over the scale of the GDP recovery. After a strong 3.8% y/y pick-up in 2Q17, industrial production growth in August coincided with our conservative expectations of 1.5% y/y. Retail trade increased by 1.9% y/y in August, however we do not believe this is convincing enough, as the acceleration in retail trade was mirrored with strong 0.5% m/m deflation in August; and the continuing decline in unemployment (4.9% in August) has coincided with a deceleration in nominal salary growth to 7.1% y/y in July-August. As for economic growth, only three sectors demonstrated improvements (commodity extraction, trade and transportation), while the rest showed flat-to-negative growth dynamics. The strong import growth, which was above expectations (28% y/y in July vs. 25% y/y expectations), is also putting a ceiling on domestic growth. On the positive side, household consumption grew at 4.3% y/y in 2Q17 after 2.7% y/y growth in 1Q17, which reflected an upturn in the consumption trend. Business sentiment improved slightly in September, but remains significantly worse than in 1H17: The IHS Markit composite PMI index increased to 54.8 in September from 54.2 in August, but compared to the 56-57 levels posted in 1H17, it remains low.

Our main concern with the recent developments in the banking sector are linked to Russia's economic growth story. The acceleration of economic activity usually coincides with a gradual improvement in loan quality and provides support to those banks, which experienced trouble during crisis years. However, at the moment, this is not the case for Russia: the level of NPLs continued to grow from 2007 in nominal terms and even in percentage terms is higher than the previous peak of 2009. We consider this as a confirmation of our cautious GDP growth outlook which could limit AB-ICI index upside potential.

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