

Sobriety After Hangover: Russia Macroeconomic Outlook

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Two topics and one summary

- **Contrasting macroeconomic environment:**
 - ✓ **1H 2010**
 - ✓ **2H 2010**
- **Sovereign credit risks vs. market risks for RUB bonds**
- **Summary. Implications for bonds**

Contrasting macroeconomic environment: 1H 2010

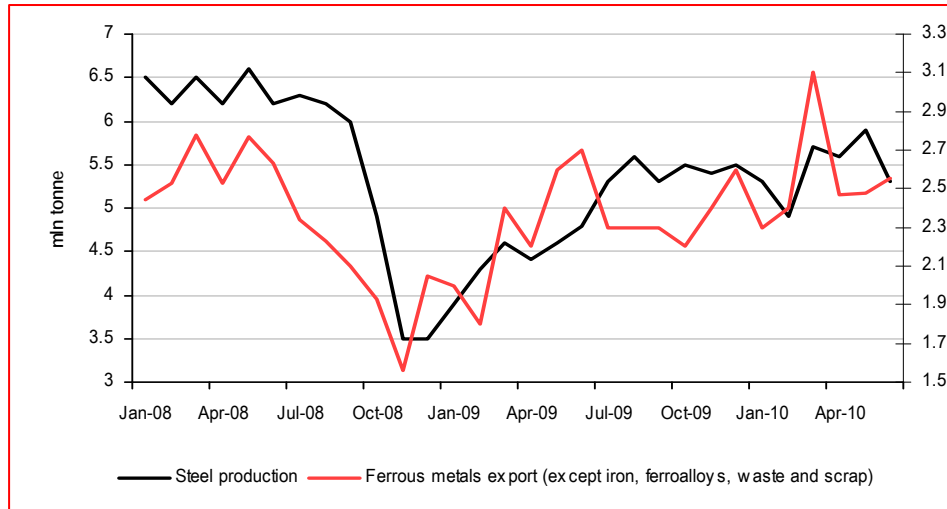
Benign Macroeconomic Environment in 1H 2010

- V-shaped economic recovery
- Inflation deceleration
- Improved current account and rising international reserves
- Falling rates and yields
- Firming currency

→ ***Supportive for Russia financial markets despite global volatility***

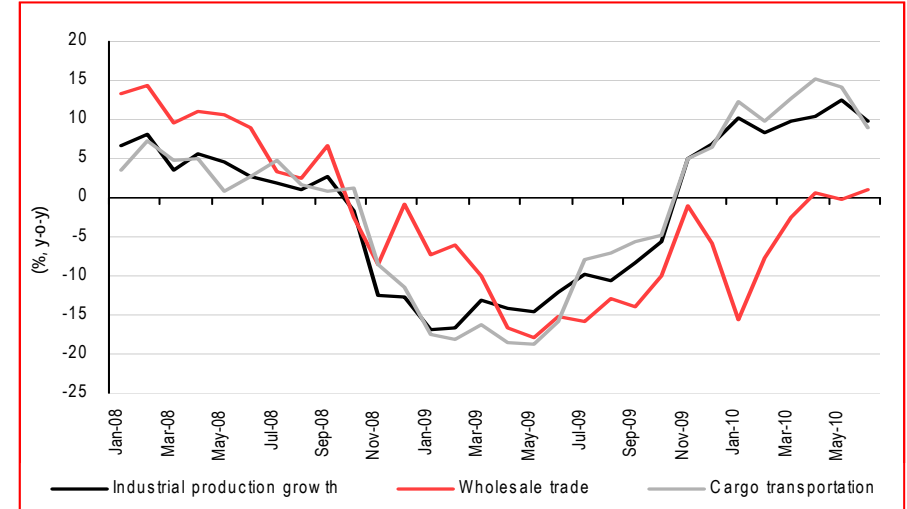
Export driven V-shaped recovery

Steel production and exports



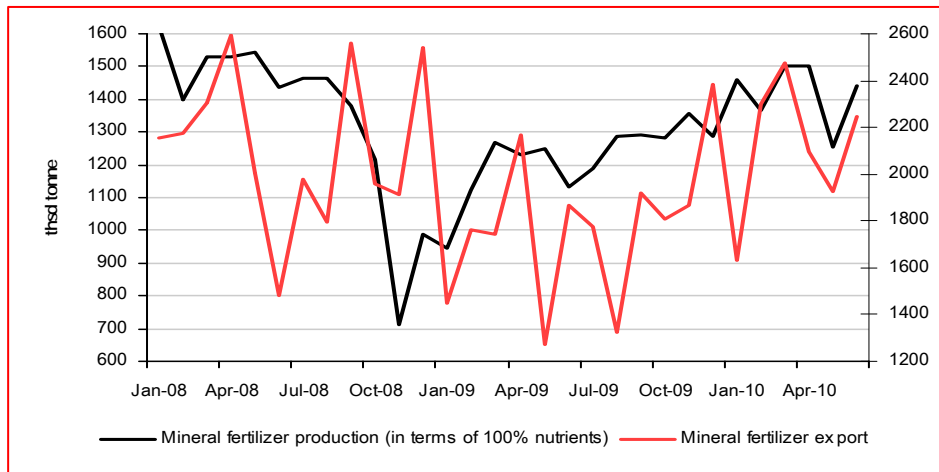
Source: Rosstat , FCS

IP, wholesale trade and freight cargo transportation



Source: Rosstat

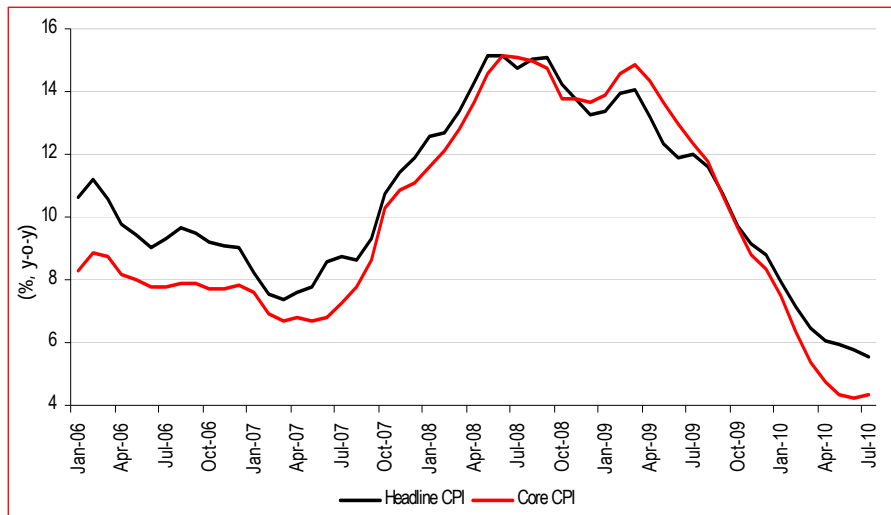
Fertilizer production and exports



Source: Rosstat , FCS

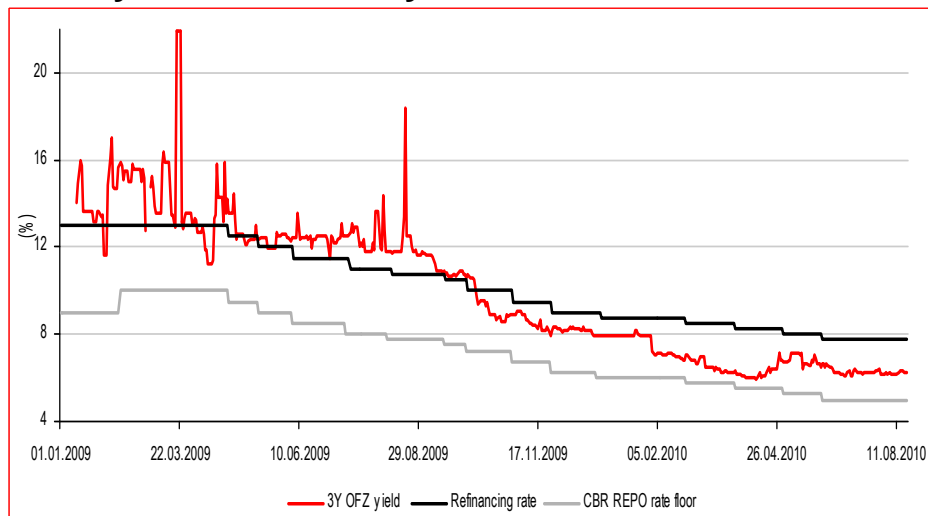
Lower inflation – lower rates

Headline and core inflation



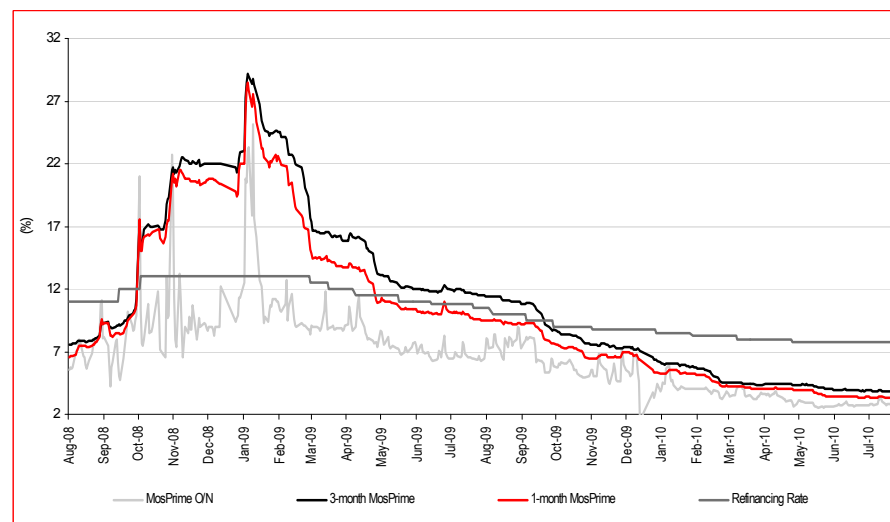
Source: Rosstat

Policy rates and OFZ yield



Source: Reuters, CBR

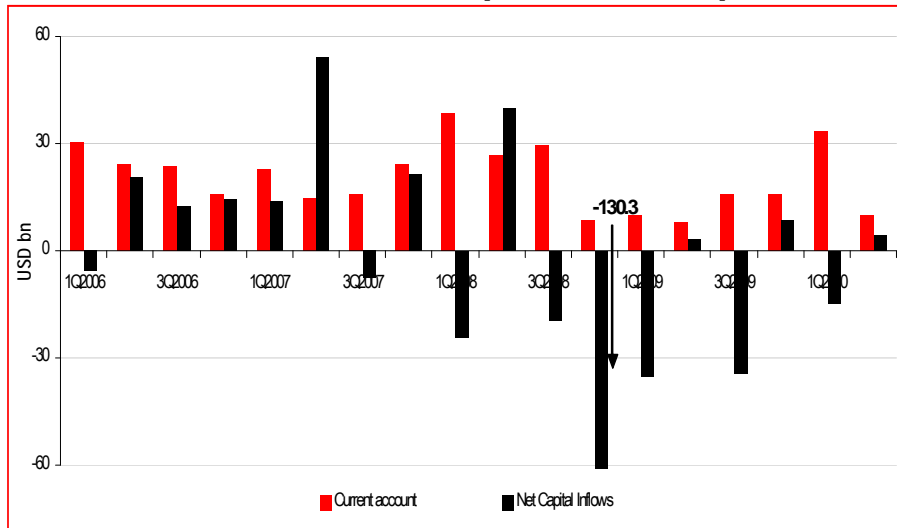
MM and policy rates



Source: Reuters, CBR

Stronger balance of payments – stronger currency

Current account and capital flows improved



Source: CBR

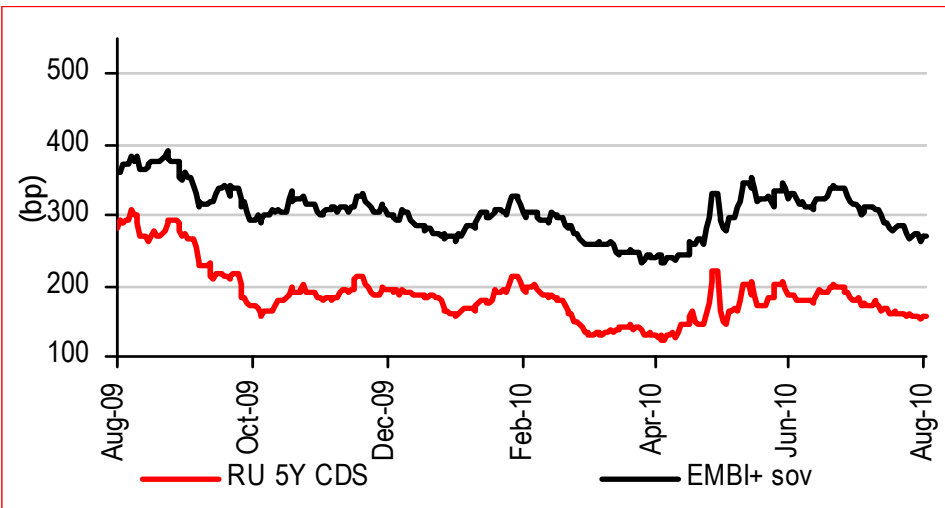
RUB firmed against USD and USD-EUR basket



Source: Reuters

Russia financial markets performed well

Russia sov spreads vs. EMBI+

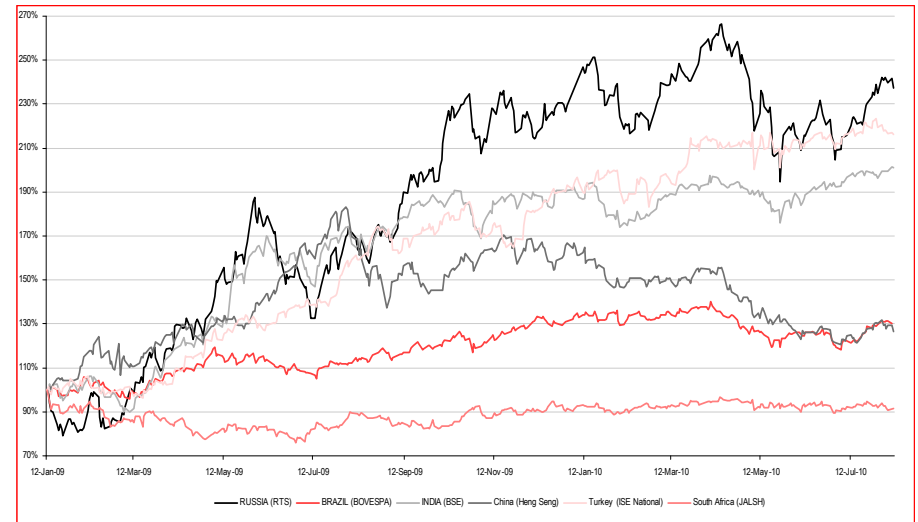


Source: Bloomberg

- Russian stocks outperformed other EM in 2009 and since July 2010

- Russia credit spreads have outperformed EM spreads

EM stock market indexes



Source: Reuters

Contrasting macroeconomic environment: 2H 2010

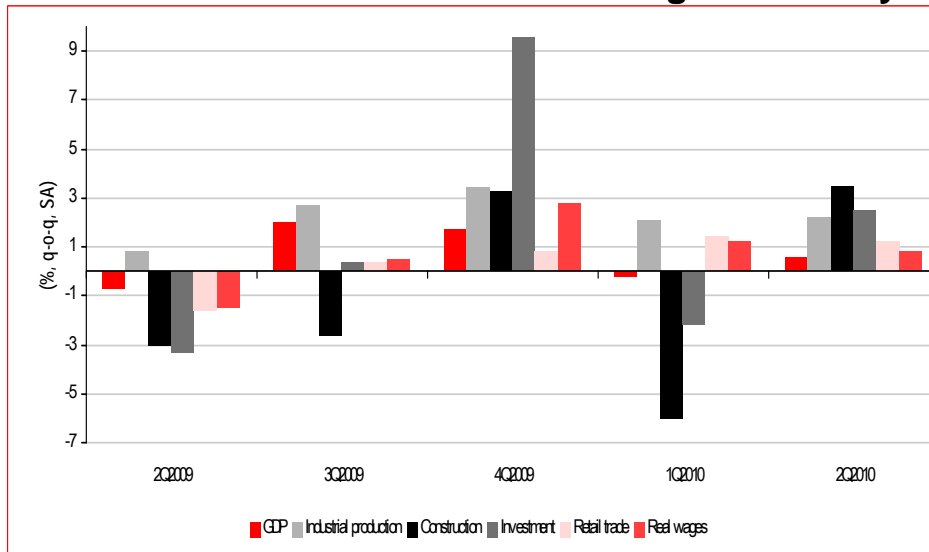
Weaker Macroeconomic Environment in 2H 2010

- U- or L- type of economic growth
- Inflation acceleration
- Evaporating current account surplus
- Rising rates and yields
- Risks for the RUB – to the downside

→ ***Negative for Russia financial markets***

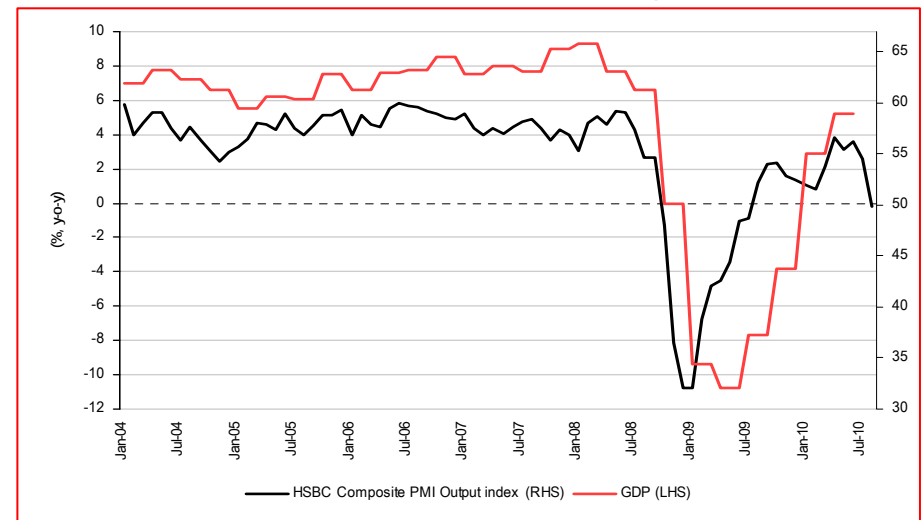
Economic growth moderates on weak domestic demand

Consumer and investment demand grows slowly



Source: MOED

HSBC PMI point to slower GDP growth



Source: Rosstat, Markit

Tightening fiscal policy to restrain medium-term growth...

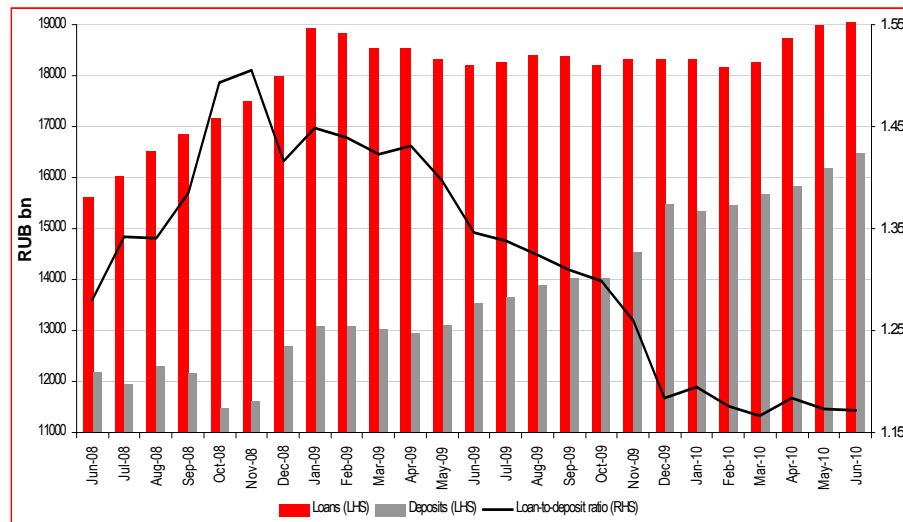
Official medium-term fiscal framework for 2010-2013

	2009	2010p	2011p	2012p	2013p
<i>RUBbn</i>					
Revenues	7337.8	7783.8	8617.8	9131.7	9983.9
Expenditures	9660.1	10212.4	10385.1	10844.6	11749.1
Deficit	2322.3	2428.6	1767.3	1712.9	1765.2
<i>% of GDP</i>					
Revenues	18.8	17.3	17.4	16.5	16.1
Expenditures	24.7	22.7	20.9	19.6	19
Deficit	5.9	5.4	3.6	3.1	2.9
Real expenditures growth (% , y-o-y)		-3.9	-4.5	-1.5	2.7

Source: MOF

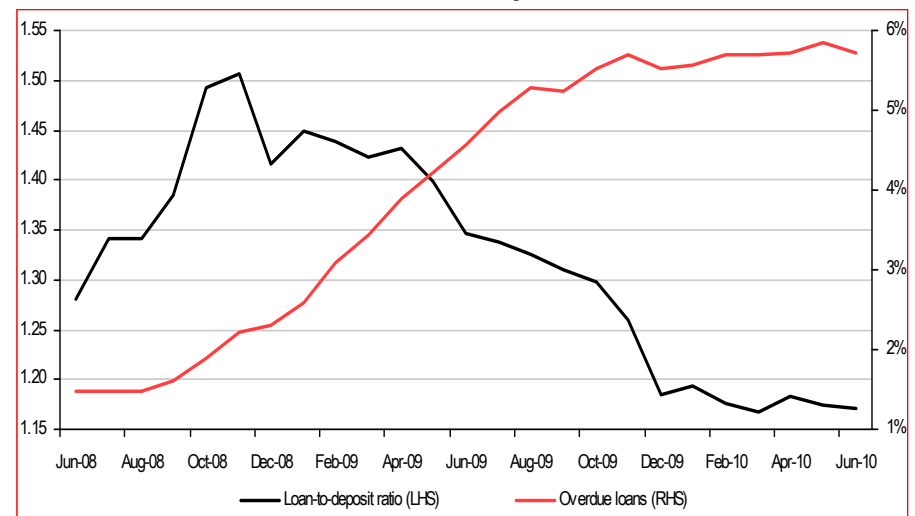
...so will much more modest credit growth

Loan, Deposits and Loan-to-deposit ratio



Source: CBR

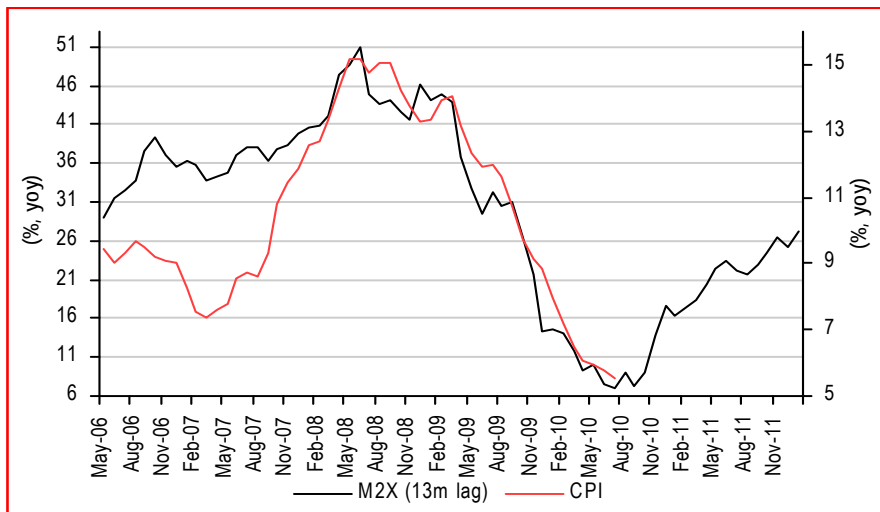
Overdue loans and Loan-to-deposit ratio



Source: CBR

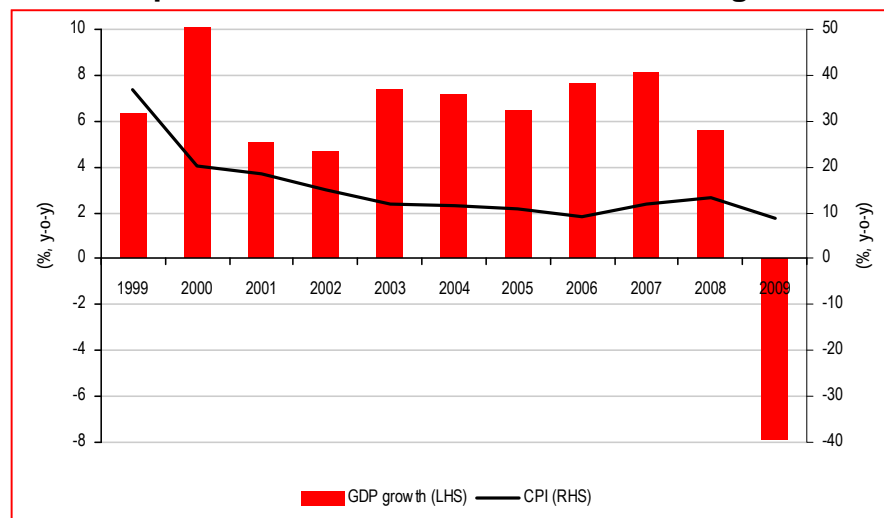
The near future promises higher inflation risks

Fast past money supply growth to push un prices



Source: CBR

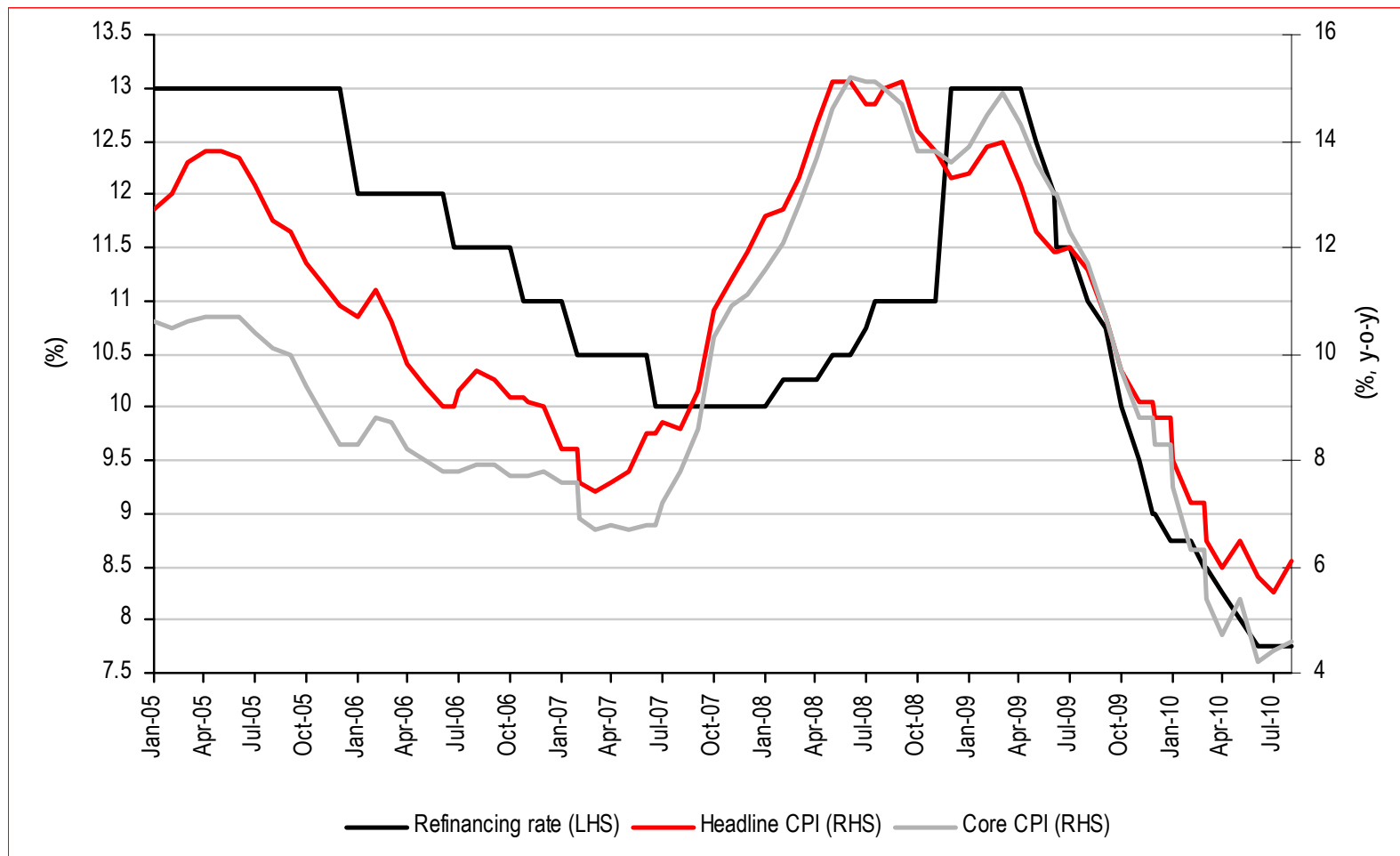
Russia past inflation track record is not strong



Source: Rosstat

To hike or not to hike? This is not the question

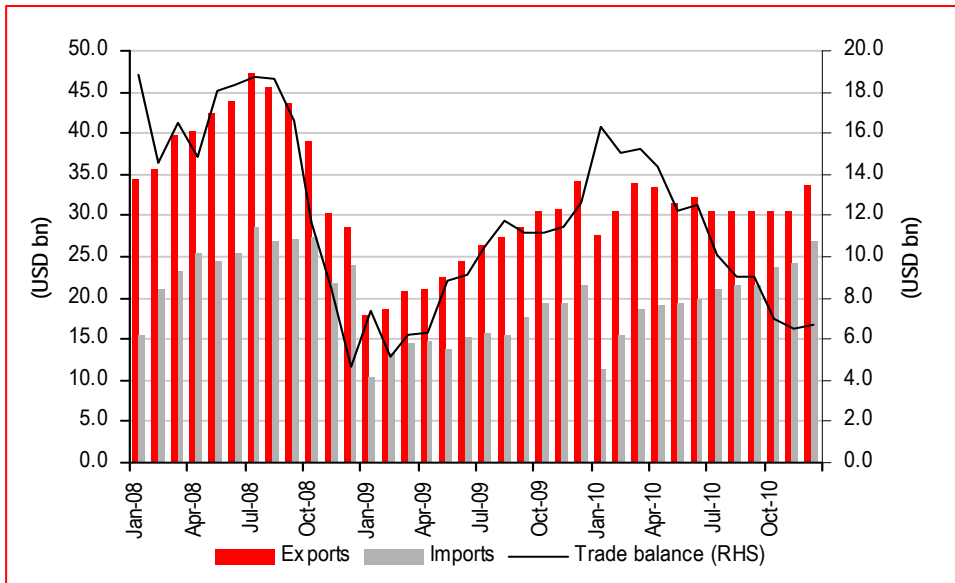
CBR has hiked rates in the past further to steady inflation acceleration



Source: Rosstat, CBR

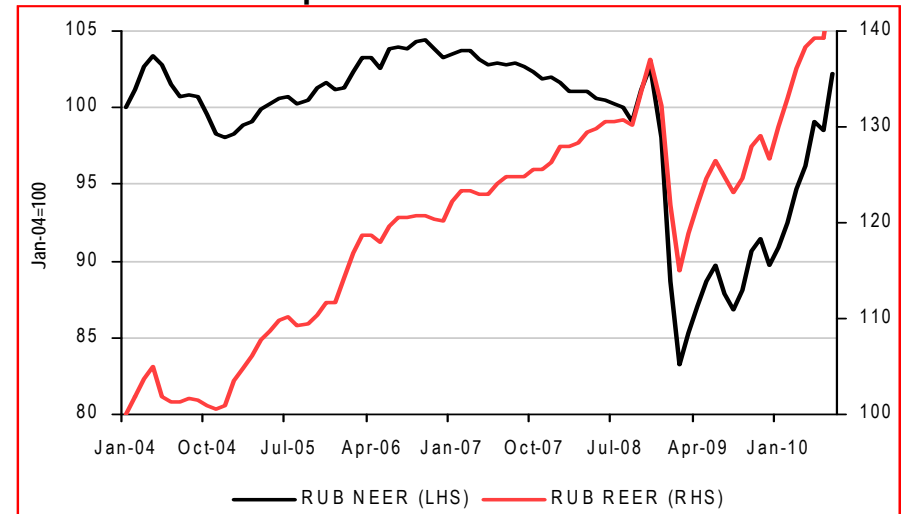
CA surplus falls quickly with fast imports growth

Exports, Imports and trade balance



Source: CBR, HSBC

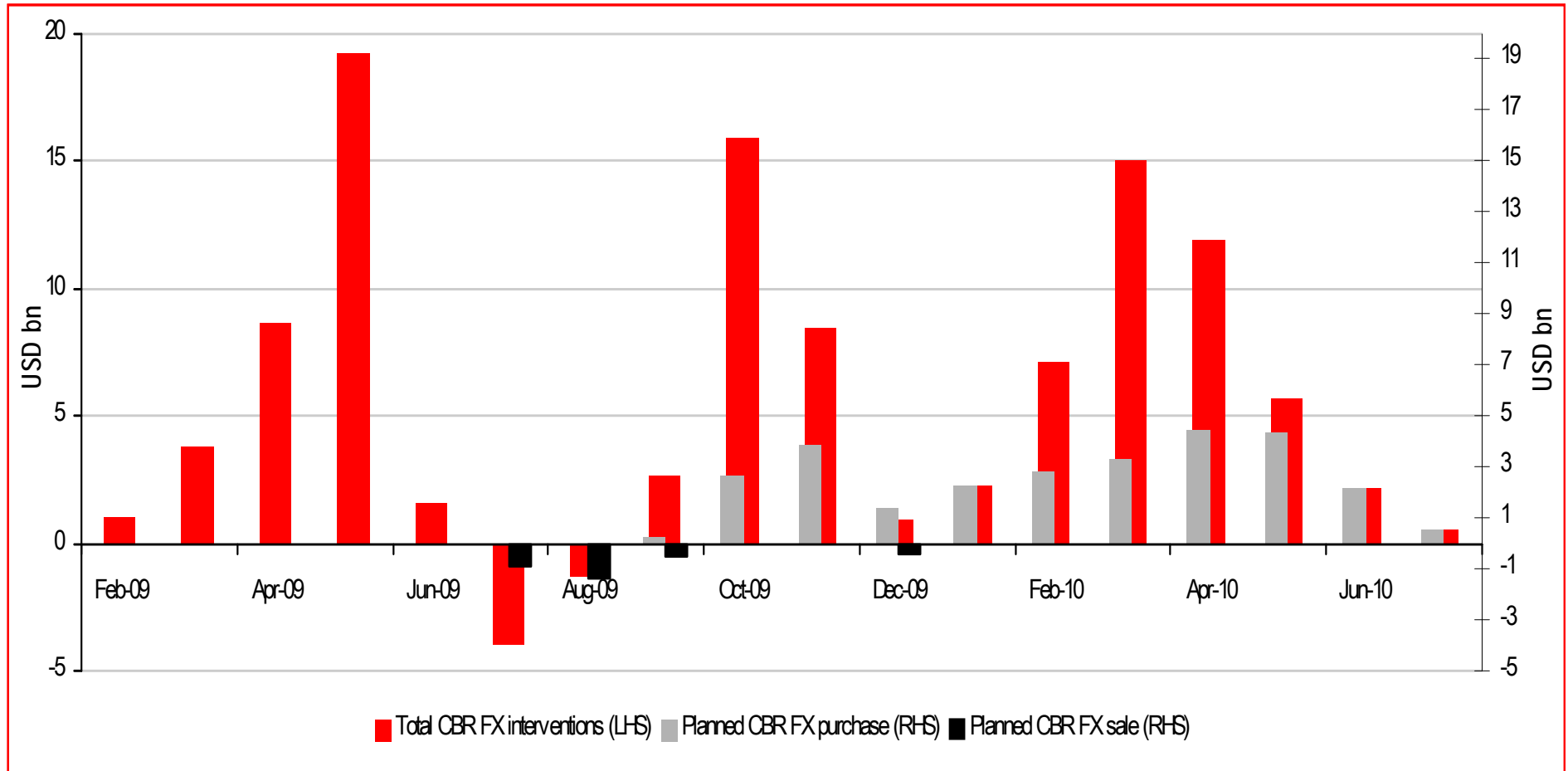
RUB is more expensive in real terms than in 2008



Source: CBR

Modified CBR FX policy favours weaker RUB

Targeted CBR FX interventions match current account surplus



Source: CBR, HSBC

Sovereign credit risks vs. market risks for RUB bonds

Russia sovereign credit metrics are very strong

Russia debt and reserves numbers are stronger than in AAA-countries!

- Russia public gross debt is 8.5% of GDP (median AAA is 59.5% of GDP)
- Russia public sector is a net lender to the rest of the world (median AAA gross public sector debt is 53.5% of GDP)
- Russia interest on public debt is 0.5% of GDP (median AAA is 1.8% of GDP)
- Russia net borrowing-to-current account receipts ratio is -14.5% vs. median AAA of 1.8%
- Russia reserves-to-current account payments ratio is 11.8 months vs. median AAA of 1.7 months

Source: S&P

Yet macroeconomic risks drive up RUB bond spread

Russia 30 vs 5Y OFZ



Source: Reuters, HSBC

Smaller deficit monetization is inflation positive...

...yet not until 2H 2011

Deficit monetization	2009	2010	2011
RUB bn	2197	1419	242
% of GDP	5.7	3.2	0.4

Source: MOF

Summary

Summary

- 2H 2010: a flow of negative news on:
 - economic growth
 - inflation
 - balance of payments
 - rates and the currency...
- ...giving a rise to market risks...
- ...despite that sovereign credit metrics remain strong
- Such the environment appears negative for the RUB bonds that will have to wait for better times (in 2H 2011?)
- Yet, sovereign and quasi-sov eurobonds should be well supported

Appendix

Appendix. Russia and CIS Sovereign Risk Indicators

	Net Debt (% of GDP)					Gross Debt (% of GDP)					Interest (% of GDP)				
	2008	2009	2010e	2011e	2012e	2008	2009	2010e	2011e	2012e	2008	2009	2010e	2011e	2012e
Median AAA	42.0	42.6	53.5	52.5	53.5	46.9	44.6	59.5	57.2	55.7	1.5	1.9	1.8	1.6	1.7
Median AA	14.2	21.1	24.1	28.3	31.4	21.2	28.1	29.1	32.4	35.4	1.1	1.2	1.2	1.3	1.5
Median A	24.1	29.3	35.7	38.1	39.0	30.0	35.8	39.1	42.2	42.9	1.7	1.6	1.8	2.2	2.1
Russia (BBB)	-14.1	-7.5	-3.5	-3.3	-5.6	6.5	6.5	8.5	9.6	10.6	0.4	0.6	0.5	0.6	0.7
Kazakhstan (BBB-)	-15.2	-13.4	-11.3	-10.3	-10.6	6.1	9.4	12.2	14.7	15.6	0.4	0.0	0.0	0.0	0.0
Median BBB	20.7	35.7	33.4	35.5	35.3	28.3	37.3	36.6	38.9	39.5	1.6	2.2	2.1	2.1	2.2
Median BB	27.1	30.6	32.8	32.2	33.5	32.5	37.5	41.7	39.6	37.8	2.0	2.0	2.0	2.0	2.2
Ukraine (B-)	15.7	42.5	40.3	37.6	35.2	17.6	42.8	40.6	37.8	35.3	0.6	1.6	3.2	3.0	2.8
Median B	26.0	34.1	36.6	37.5	35.2	32.5	41.1	41.6	40.8	40.4	0.9	1.1	1.4	1.3	1.3

Source: S&P

	Net borrowing/CAR (%)					Reserves/CAP (months)				
	2008	2009	2010e	2011e	2012e	2008	2009	2010e	2011e	2012e
Median AAA	3.1	-5.0	1.8	2.7	2.8	2.1	2.1	1.7	3.1	2.8
Median AA	-5.4	-4.9	-9.6	-13.2	-11.7	3.7	5.6	3.9	3.8	3.8
Median A	-5.6	-8.9	-8.3	-6.9	-7.9	3.2	5.4	6.2	5.9	5.4
Russia (BBB)	-18.2	-11.5	-14.5	-8.7	-1.4	11.5	12.6	11.8	12.0	11.8
Kazakhstan (BBB-)	-21.0	-16.7	-16.9	-17.4	-17.9	2.9	3.8	3.5	3.8	4.7
Median BBB	4.5	-2.5	-1.9	-3.3	-3.5	3.0	4.4	5.0	4.8	4.7
Median BB	0.8	-2.2	-1.6	-1.4	-0.4	4.0	4.1	4.3	4.0	4.3
Ukraine (B-)	3.0	5.9	5.4	-1.7	-4.3	3.6	6.3	3.1	2.3	2.8
Median B	10.3	4.9	5.0	1.7	2.0	2.7	2.8	3.1	3.0	2.8

Source: S&P

Net borrowing/CAR (%)

The current account deficit (surplus) minus net inflows from foreign direct investment and portfolio equity investments, as a percent of CAR. A negative number indicates net external debt repayment.

Usable reserves/current account payments (months)

Official foreign exchange reserves (including gold at market price) minus items not readily available for foreign exchange operations and repayment of external debt (such as: (1) reserves pledged as security; (2) mark-to market losses on reserves sold forward; (3) reserves deposited with offshore branches of domestic financial institutions; and (4) the monetary base for sovereigns with a currency board or longstanding fixed peg), divided by monthly imports of goods and services, plus factor income earned by nonresidents from residents, plus transfers to nonresidents.

Net debt/GDP (%)

Gross debt minus general government financial assets (cash, deposits, arms-length loans, and minority holdings of traded equities), as a percent of GDP.

Gross debt/GDP (%)

Debt incurred by national, regional, and local governments, either for governmental purposes or for on-lending to a government-owned or private sector entity, as a percent of GDP. Internal holdings, including social security and pension fund investments in government debt, are netted out.

Interest/GDP (%)

Interest payments on general government debt, as a percent of GDP.

Disclaimer

* Legal entities as at 28 October 2008

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