



SBERBANK

Russia in 2013: **Macroeconomic Outlook and Risks**

Anton Stroutchenevski, Senior Economist

April 2013

INVESTMENT RESEARCH

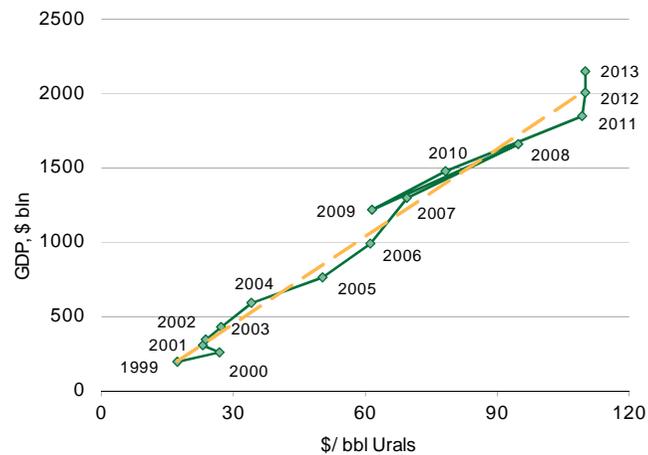
Russia's growth decelerated in 2H12 and will be slow in early 2013 with a chance to rebound later in the year

- **Base effects impact y-o-y dynamics.** Retail sales climbed 2.5% y-o-y in February. This is a very good result, given that 2012 was a leap year. Thus, average daily retail sales growth in February 2013 was a solid 6.2% y-o-y, pointing to steady expansion of overall household consumption. Investments grew 0.3% y-o-y. The same leap-year adjustment puts average daily growth in February this year at 3.9%. Overall, we reiterate our forecast of about 5.5% y-o-y growth in both household consumption and investments for 2013, and project GDP growth at 3.4%. Retail and investment growth will accelerate in 2H13, the former on the back of the slowdown in y-o-y inflation and the latter driven by the base effect.
- **CPI edges up 0.3% m-o-m in March.** This compares with 0.6% a year earlier, bringing y-o-y inflation down to 7.0% as of April 1, from 7.3% at end February. Weekly inflation has therefore normalized to 0.1% on average (though some short-term deviations in both directions are possible). In our base case, y-o-y inflation will remain close to 7% until June due to base effects, and then start slowing in summer.
- **Fiscal policy becomes more confusing.** The government seems to have finally realized that borrowing locally in order to transfer money to the State Reserve Fund has led to massive liquidity absorption. The Finance Ministry has declared that it intends to buy foreign currency for the State Reserve Fund directly from the forex market. This may neutralize its money market position but creates additional pressure on the ruble.

Nominal GDP correlates with the oil price – the former doubled since 1998 in real terms...

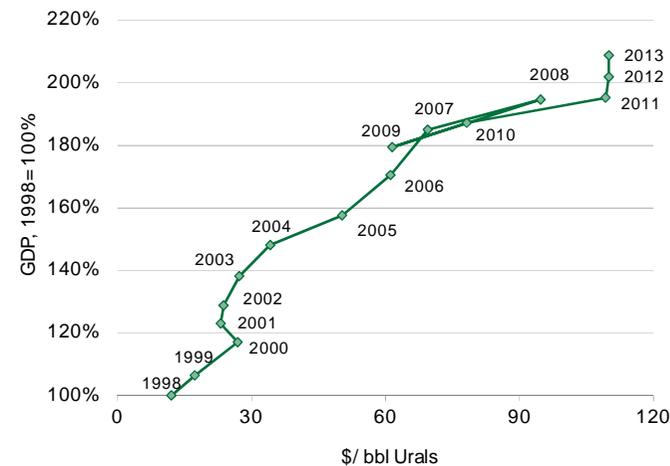
...while the latter rose even more in nominal terms

Nominal GDP



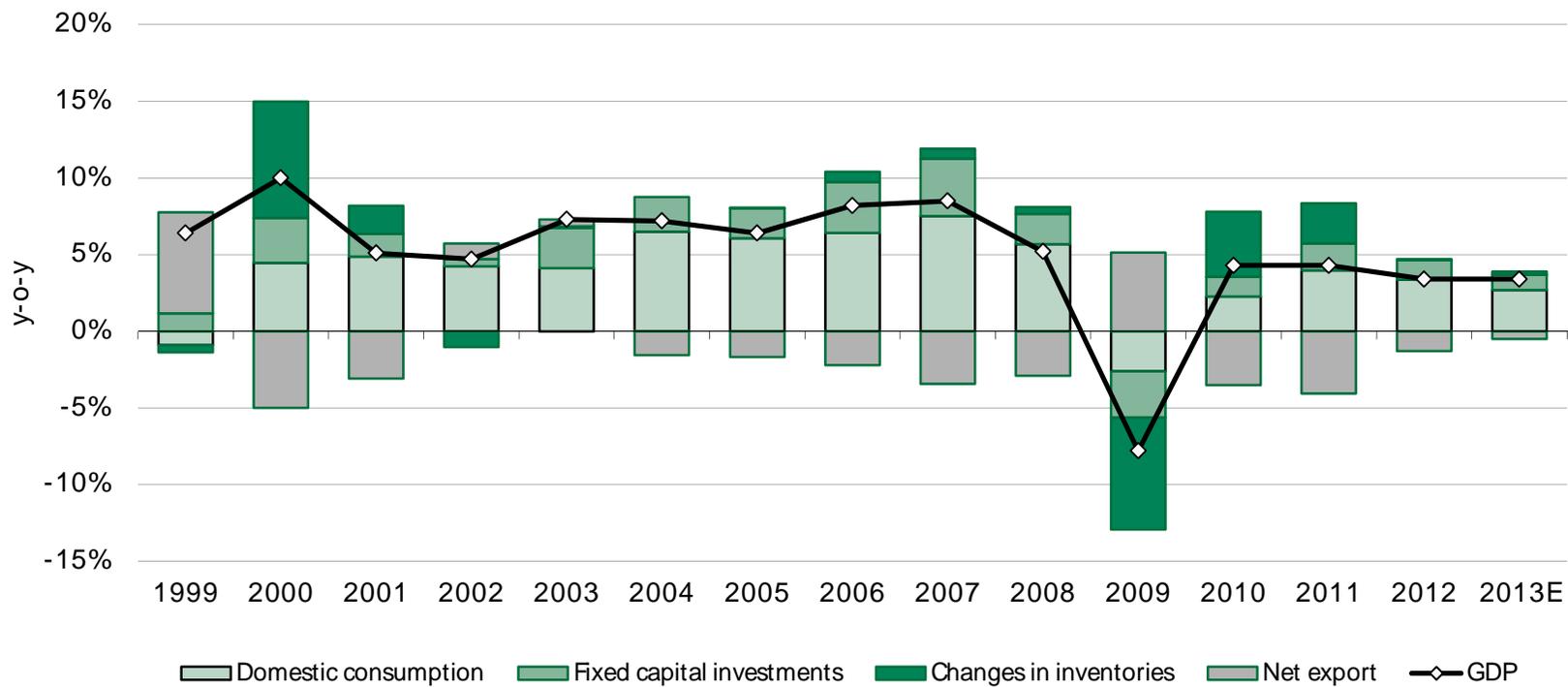
Source: State Statistics Service, Sberbank Investment Research

Real GDP



Source: State Statistics Service, Sberbank Investment Research

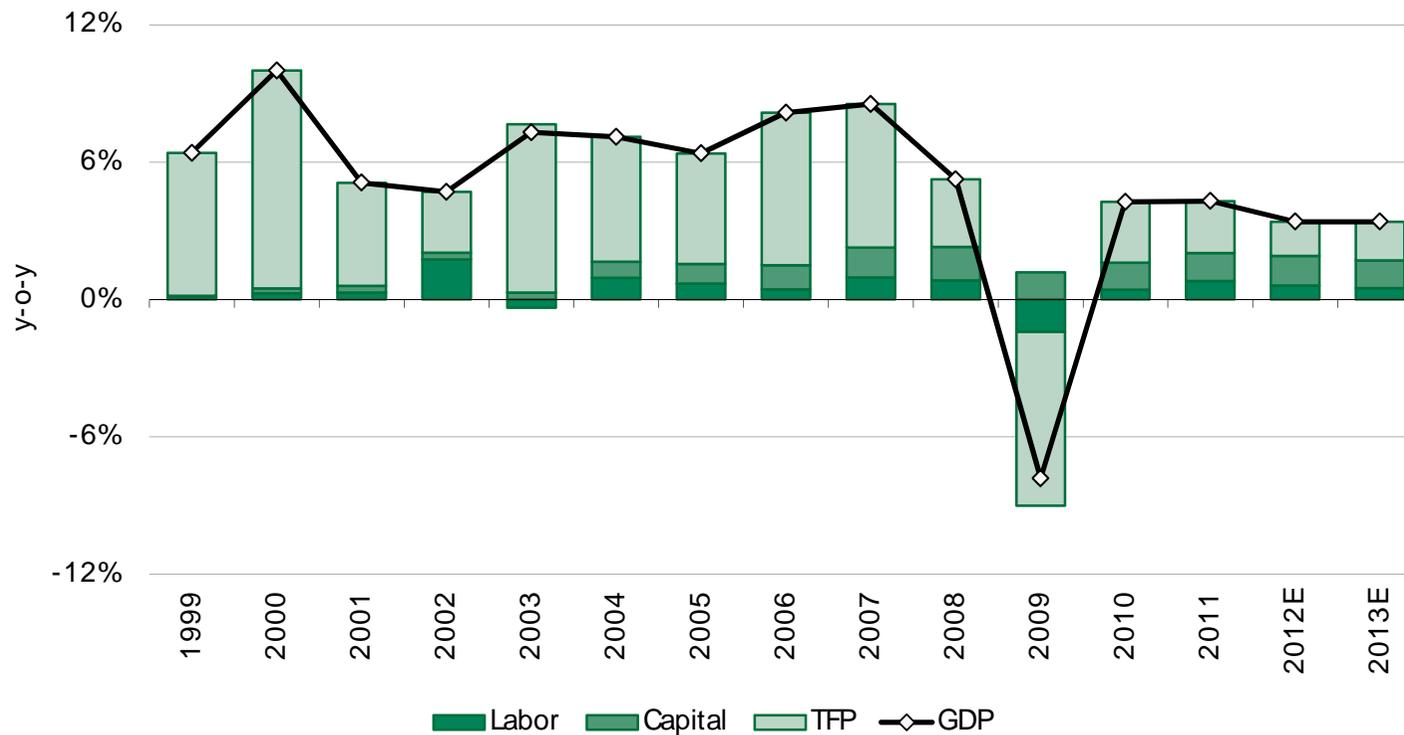
Domestic demand remains a key driver for economic growth



Source: State Statistics Service, Sberbank Investment Research

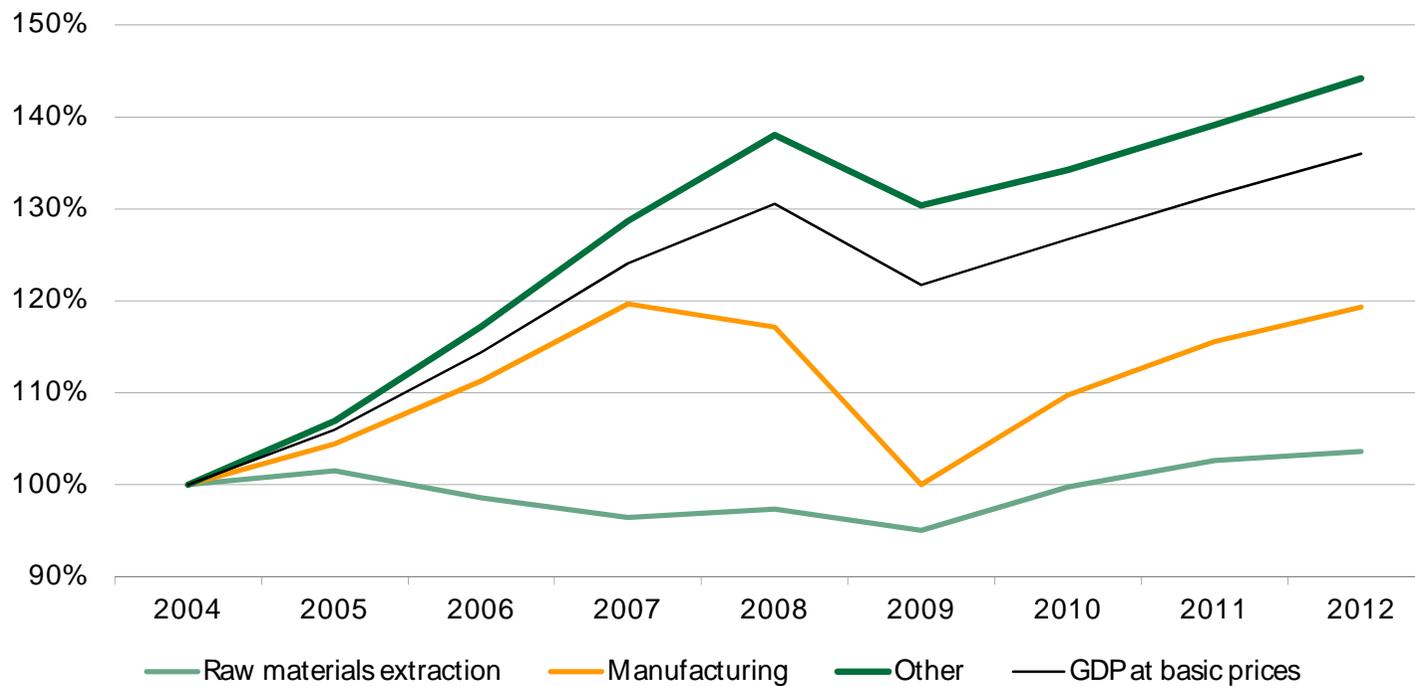
Since 1999, growth has largely been driven by rising total factor productivity (TFP)...

...but capital accumulation recently became an equally important driver



Source: State Statistics Service, Sberbank Investment Research

Real value-added growth in raw material extraction has been moderate, 2004=100%



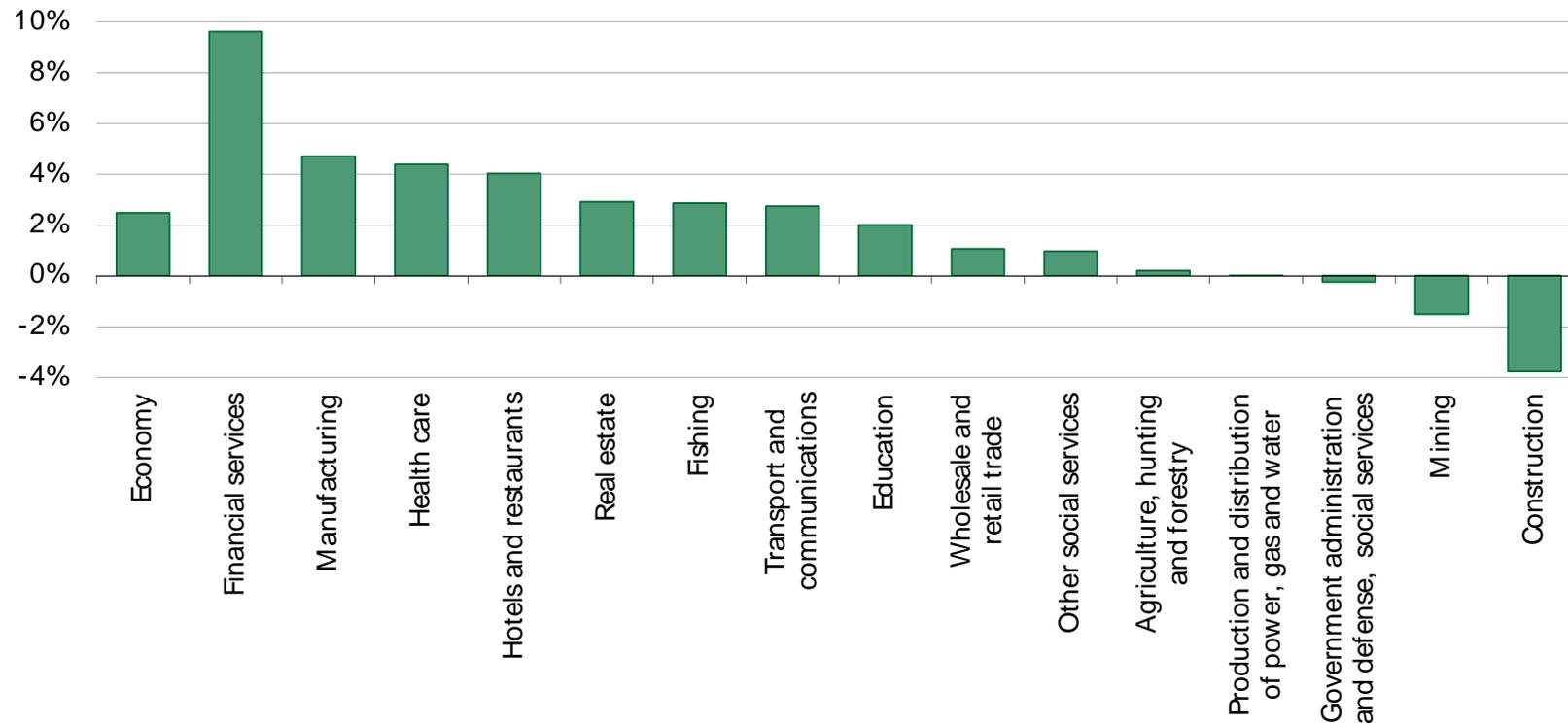
Source: State Statistics Service, Sberbank Investment Research

The import structure reflects changes in economic development

	Consumer goods	Intermediate goods	Investment goods
2006	46.2%	36.8%	17.0%
2007	44.4%	36.7%	18.9%
2008	41.8%	34.4%	23.8%
2009	44.3%	36.0%	19.7%
2010	40.4%	40.1%	19.5%
2011	36.7%	42.0%	21.3%

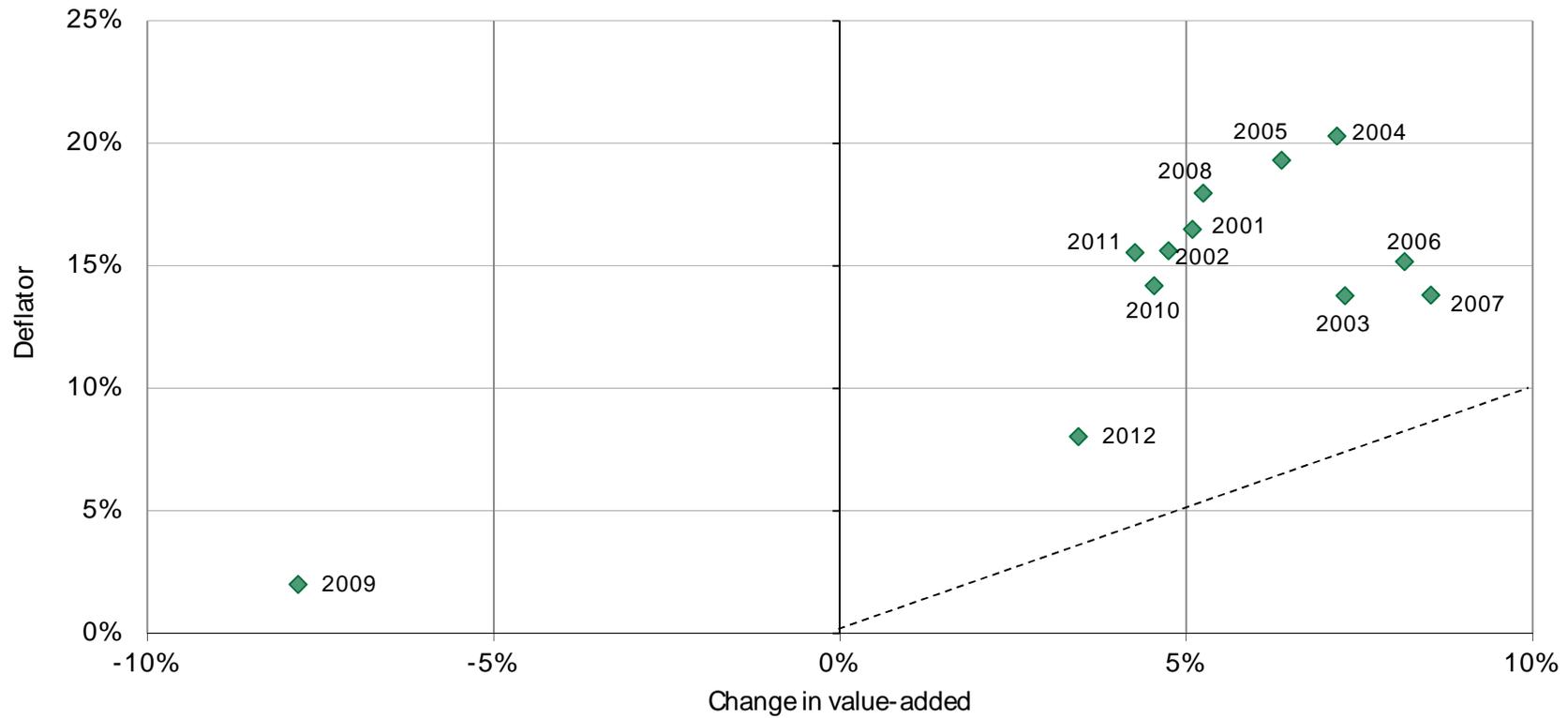
Source: State Statistics Service

The labor productivity dynamic differed in various industries, 2012, y-o-y



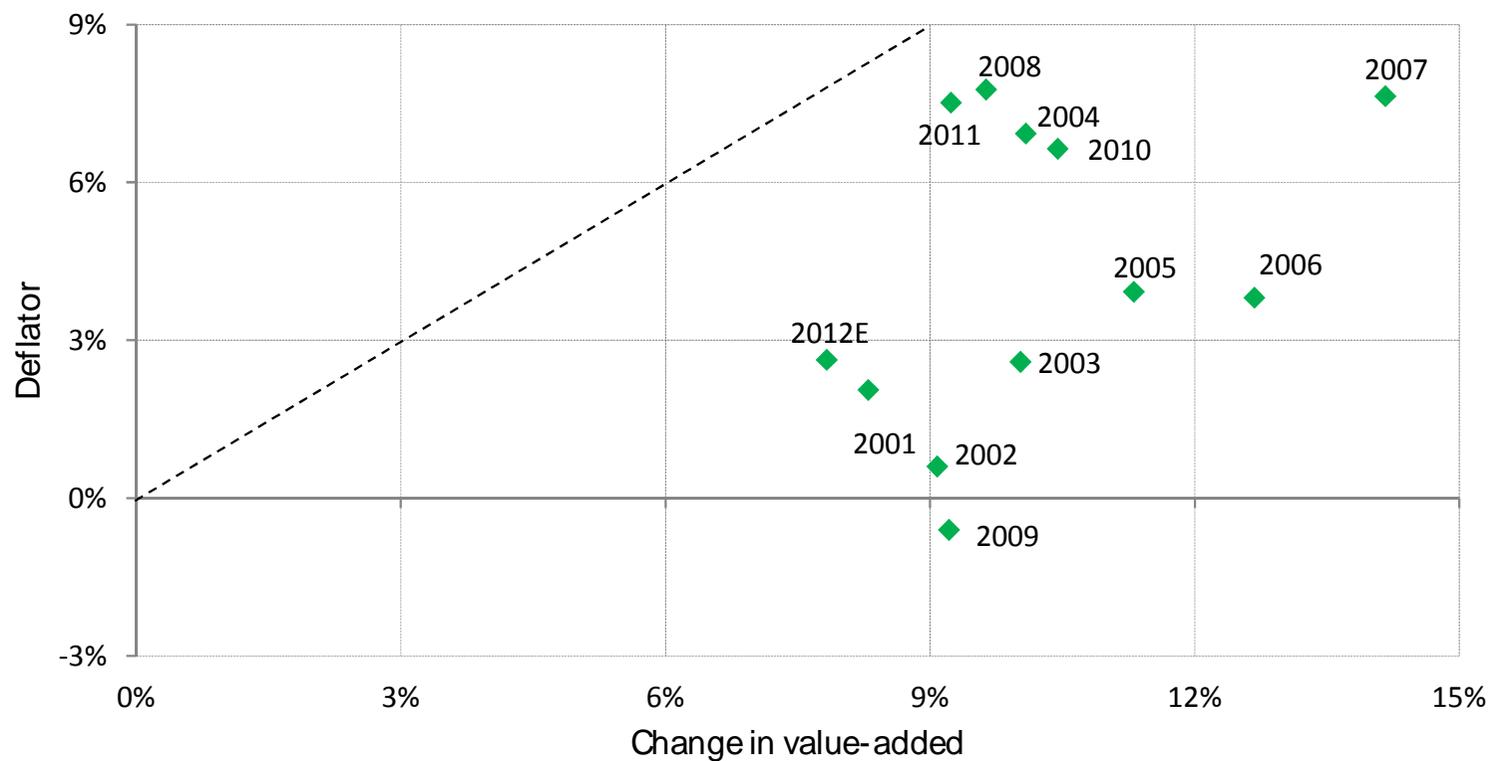
Source: State Statistics Service, Sberbank Investment Research

Russia: Value-added and GDP deflator dynamics, 2001-12



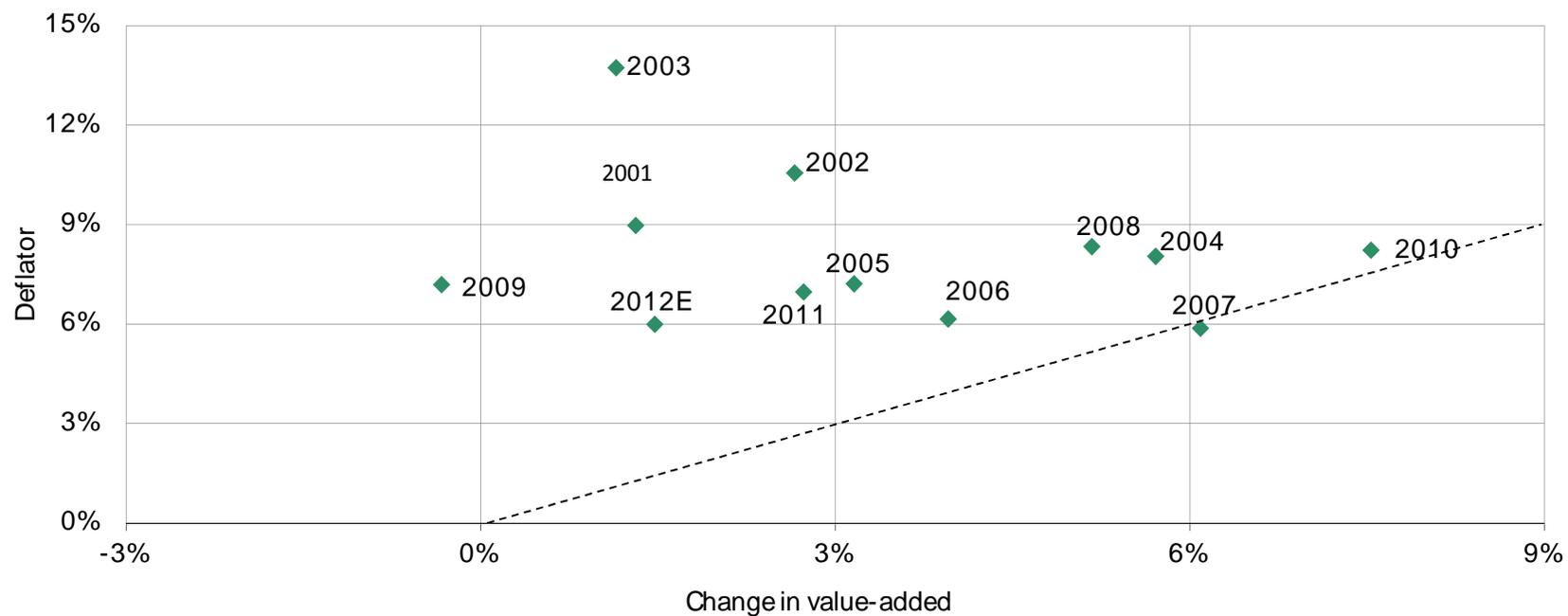
Source: State Statistics Service, Sberbank Investment Research

China: Value-added and GDP deflator dynamics, 2001-12E



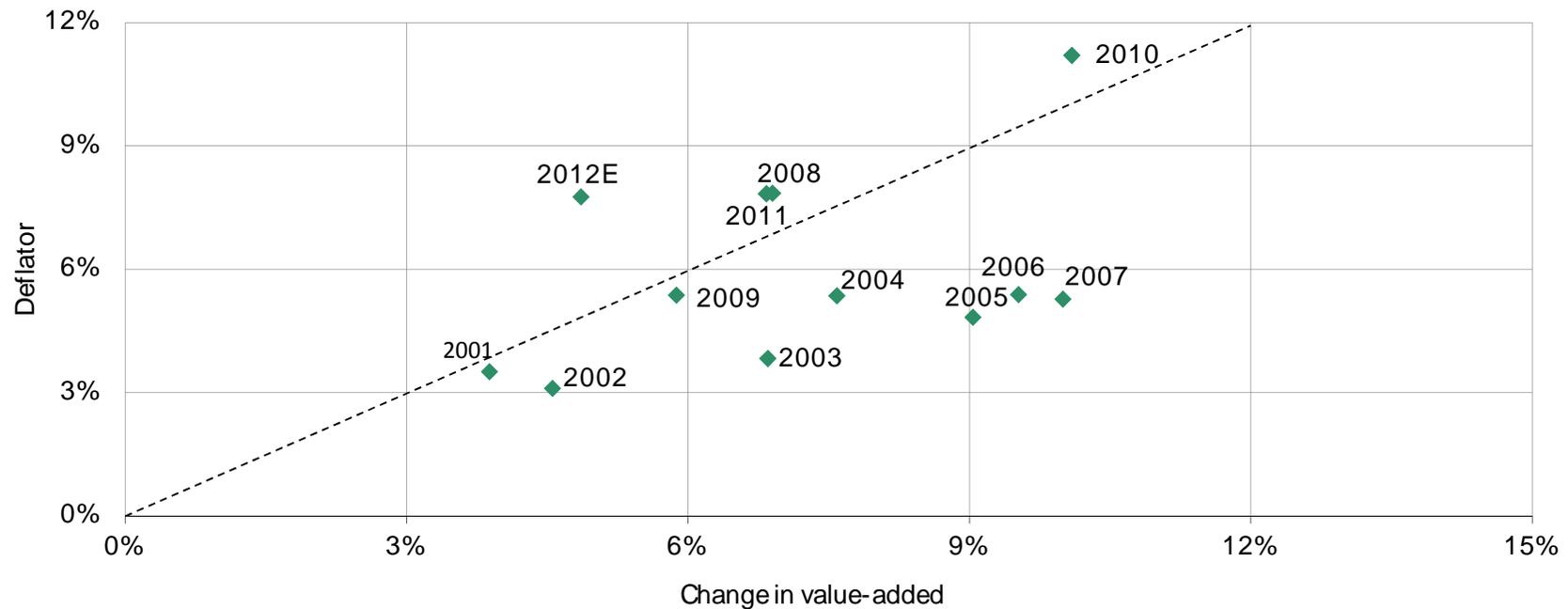
Source: IMF, Sberbank Investment Research

Brazil: Value-added and GDP deflator dynamics, 2001-12E



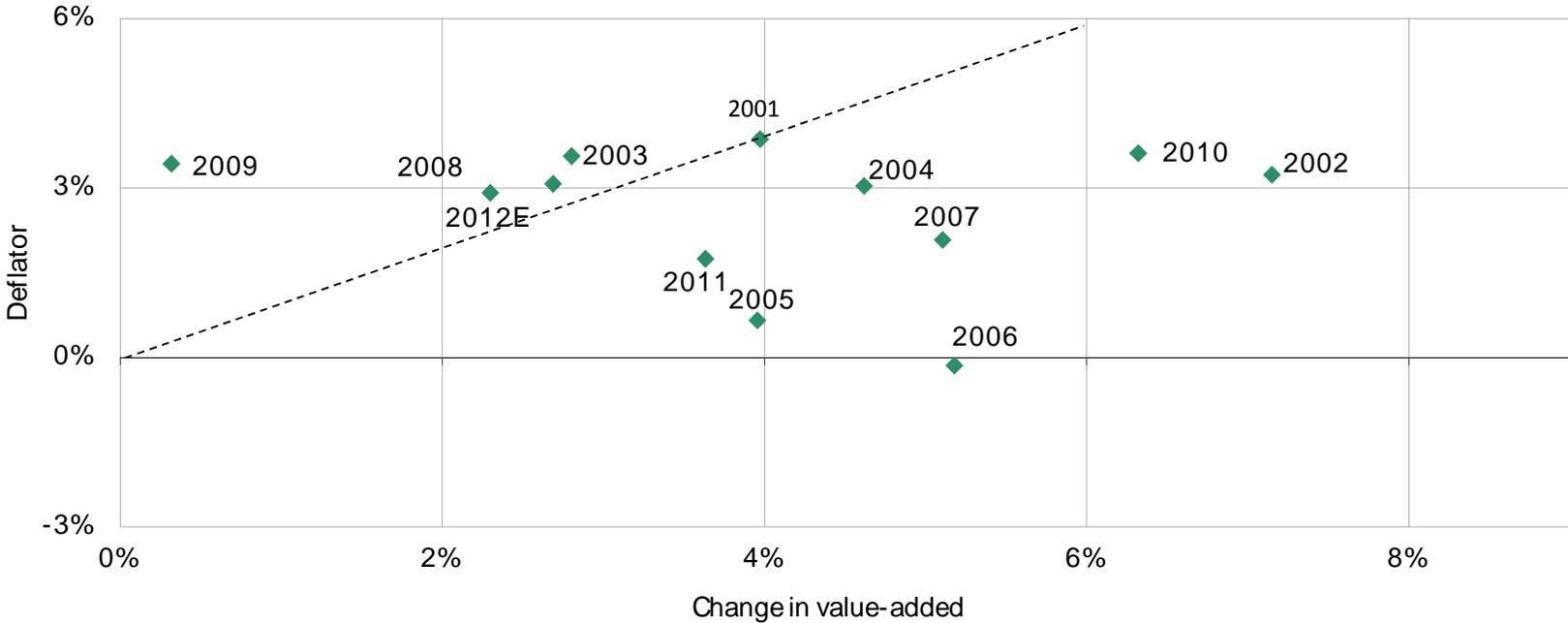
Source: IMF, Sberbank Investment Research

India: Value-added and GDP deflator dynamics, 2001-12E



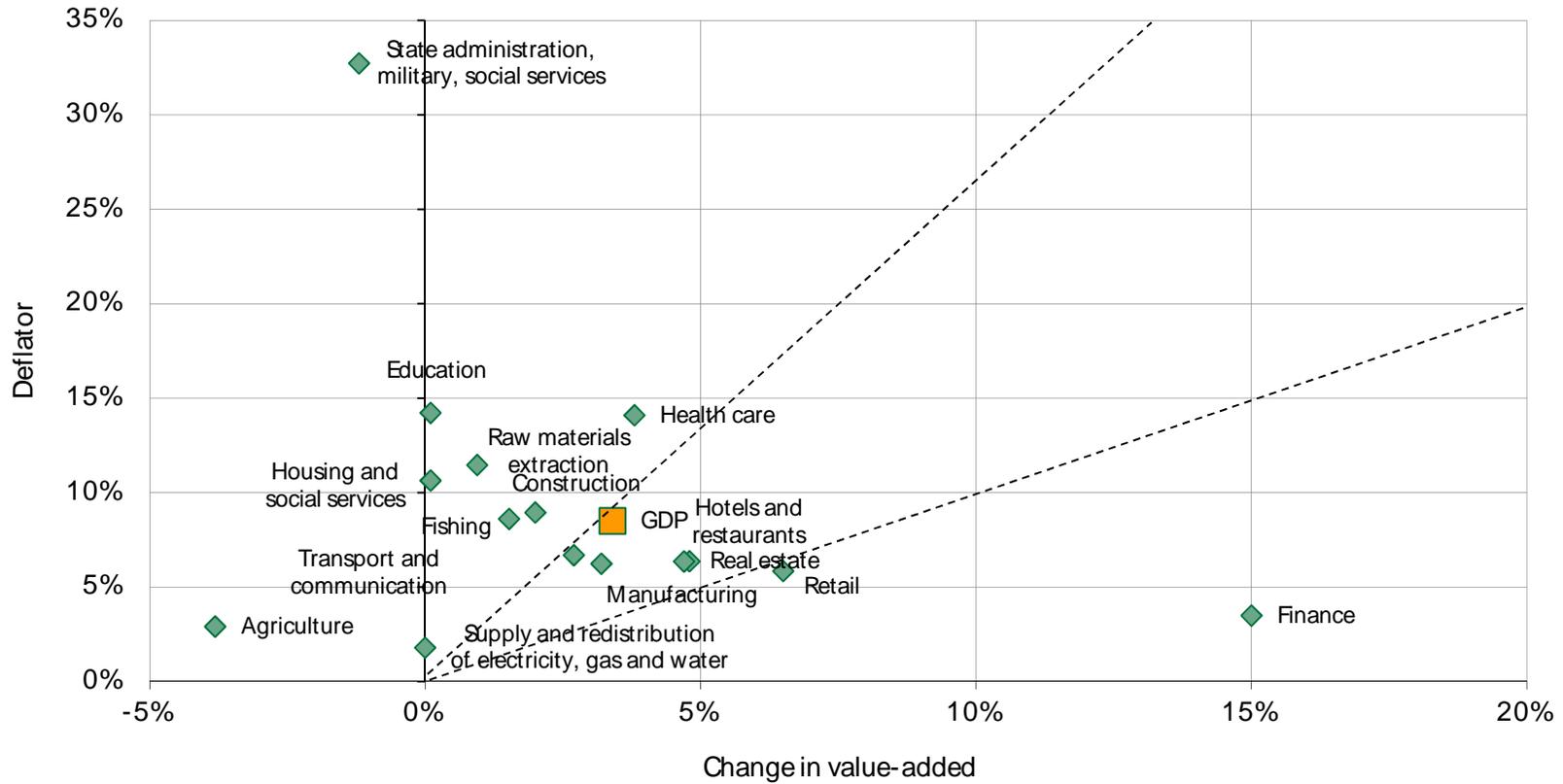
Source: IMF, Sberbank Investment Research

Korea: Value-added and GDP deflator dynamics, 2001-12E



Source: IMF, Sberbank Investment Research

Value-added and GDP deflator dynamics differed in various industries, 2012, y-o-y



Source: State Statistics Service, Sberbank Investment Research

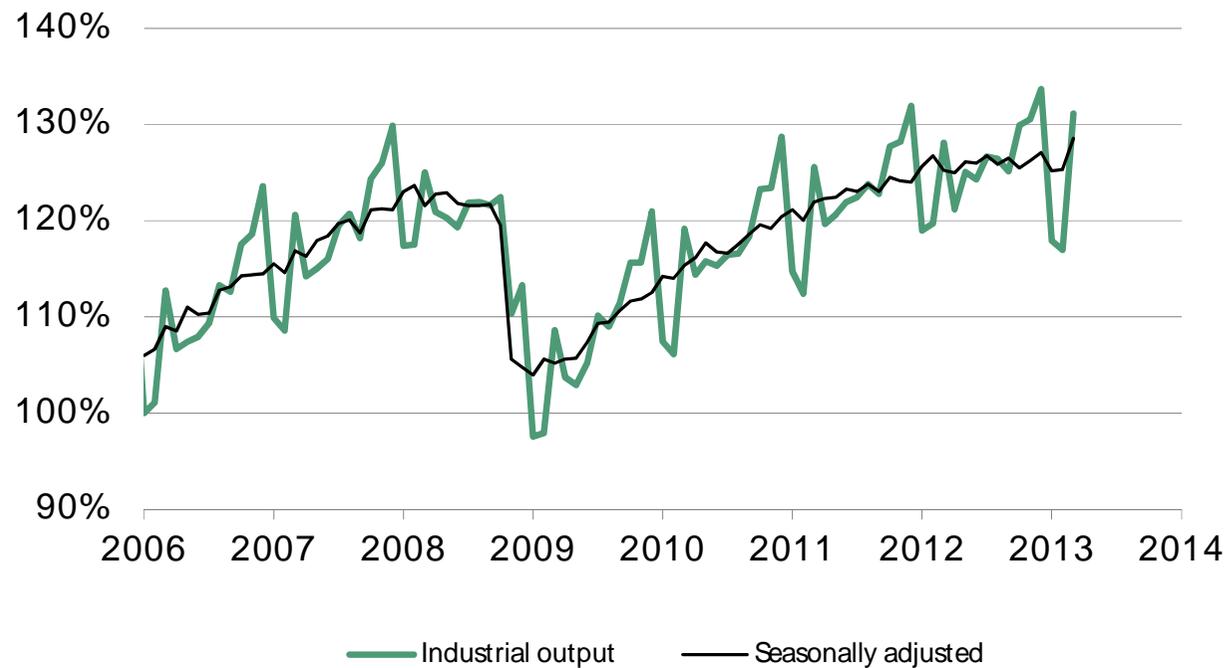
Breakdown of value-added growth and employment by industry, 2012

	Value-added* \$ bln	Employment mln	Value-added* per employee, \$ '000
Agriculture	59.9	6.1	9.8
Fishing	3.5	0.1	25.2
Raw materials extraction	186.6	1.1	169.7
Manufacturing	260.4	10.2	25.5
Supply and redistribution of electricity, gas and water	59.4	2.0	30.4
Construction	110.8	5.7	19.6
Wholesale and retail	338.2	13.0	26.1
Hotels and restaurants	16.6	1.2	13.4
Transport and communication	140.0	5.3	26.2
Finance	74.8	1.2	61.9
Real estate	202.2	5.6	36.4
State administration, military, social services	113.2	3.8	29.7
Education	51.6	5.7	9.1
Health care	66.6	4.6	14.6
Housing and social services	27.2	2.5	10.8
Total	1,713.9	71.3	24.0

Note: Value added is given at basic prices.

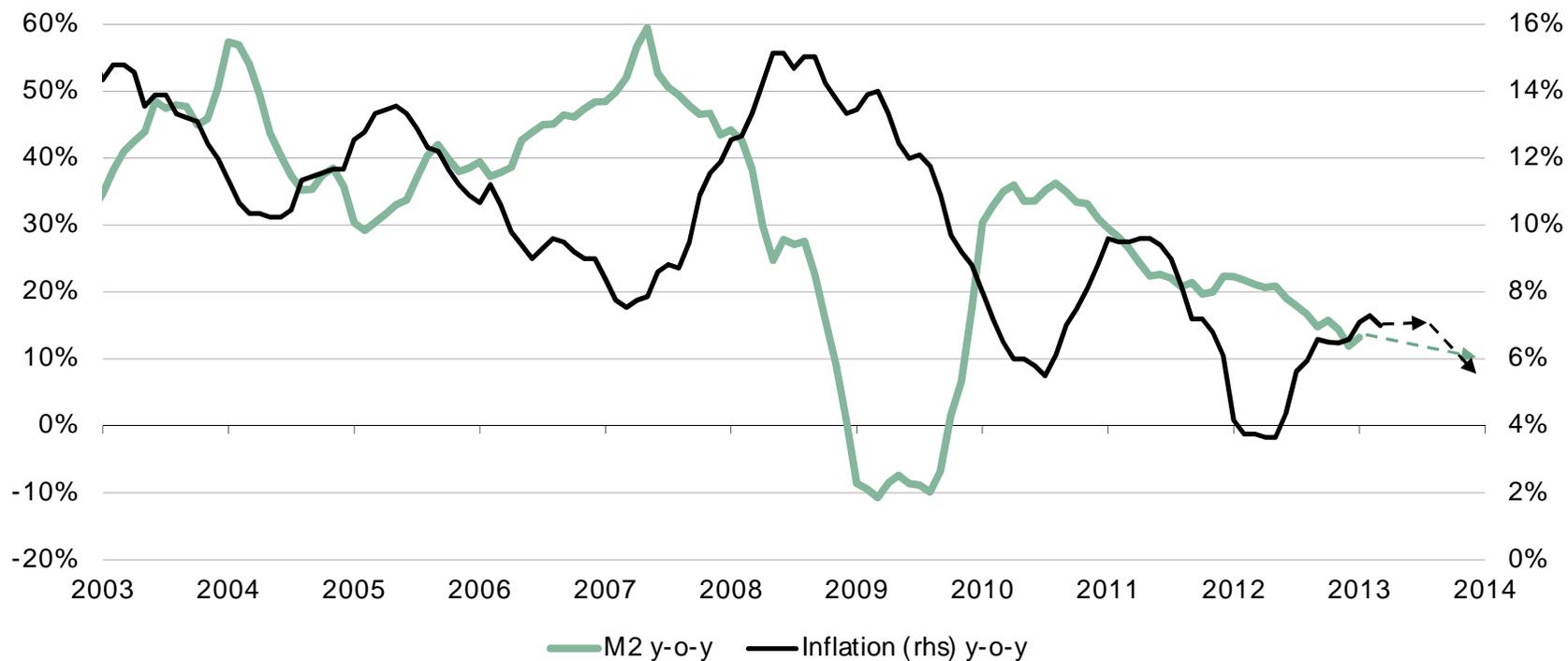
Source: State Statistics Service, Sberbank Investment Research

Industrial output growth decelerates (which was generally expected), Jan '06 = 100%



Source: State Statistics Service

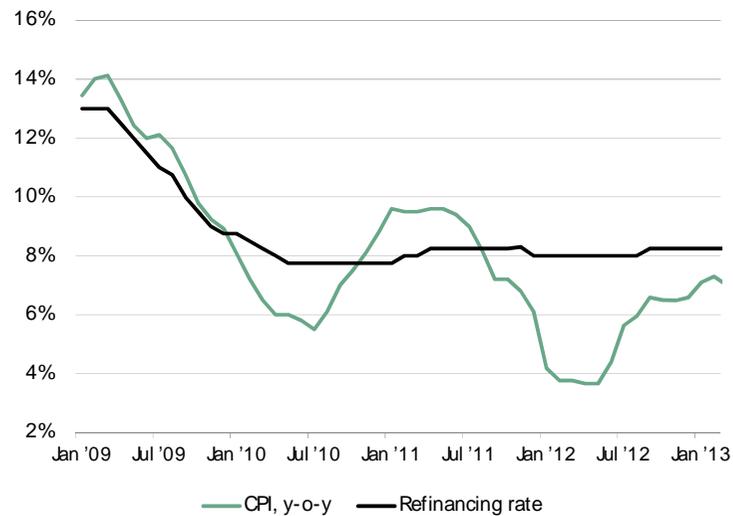
Inflation accelerated recently amid moderated money supply growth, but should once again decelerate next year



Source: Central Bank, State Statistics Service

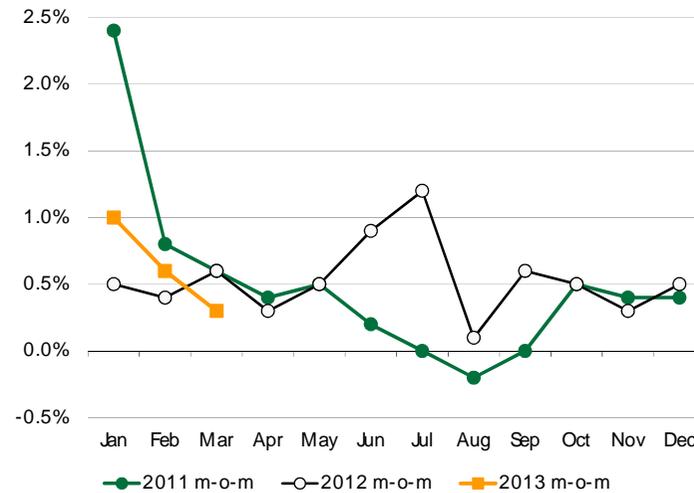
Annual inflation has been slowing since August 2011 due to base effects, while a weaker ruble, poor harvest and an amended refinancing policy contributed to its acceleration in recent months

Annual inflation vs refinancing rate



Source: State Statistics Service, Central Bank

Monthly inflation, m-o-m



Source: State Statistics Service, Central Bank

The budget will remain in good shape, but the fiscal rule being introduced is problematic

- **Russia's dependence on the oil price is no worse than the dependence of developed countries on printing money.**
- **The official breakeven oil price for 2011 was high but turned out to be around \$104-105/bbl, lower than the government expected. The breakeven price in 2012 was around \$110/bbl.** It is impossible to calculate the future breakeven price of oil accurately, as it depends not on budgetary expenditures alone but on revenues as well. The latter is a function of the exchange rate, which itself depends on the current oil price. Hence, the future breakeven price of oil is a function of the future price of oil, and hence modeling depends on statistically confounding, unpredictable variables. Meanwhile, the flexible exchange rate policy makes the budget more resilient to external shocks.
- **One of the risks associated with the idea of reintroducing the fiscal rule from 2013 and replenishing the reserve fund is that the government plans to continue to borrow on the local market even in the case of a budget surplus.** A “borrowed safety net” is costly and does not seem reasonable as it crowds out borrowers.
- **Rebuilding the State Reserve Fund to up to 7% of GDP by 2015 has become the real objective (albeit elusive) of state macroeconomic policy.**

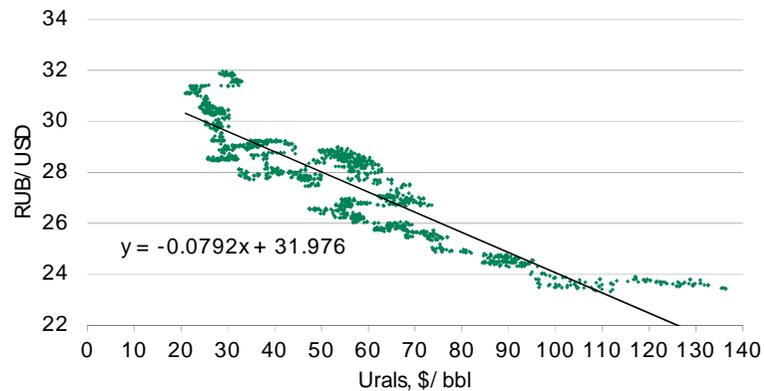
The Central Bank is unable to control the forex and money markets simultaneously



Source: Central Bank, State Statistics Service

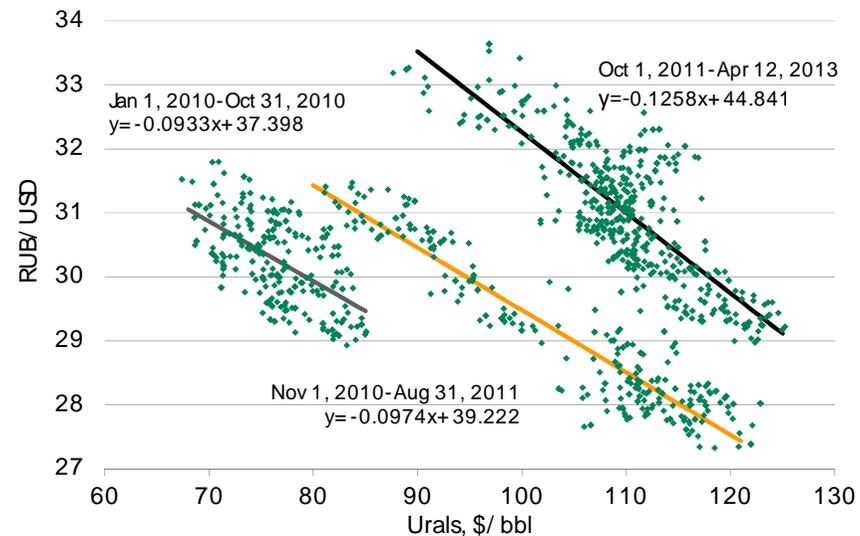
Historical exchange rate and oil price: new regime emerges as Central Bank reduces interventions

RUB\USD exchange rate and oil price before the crisis of 2008...

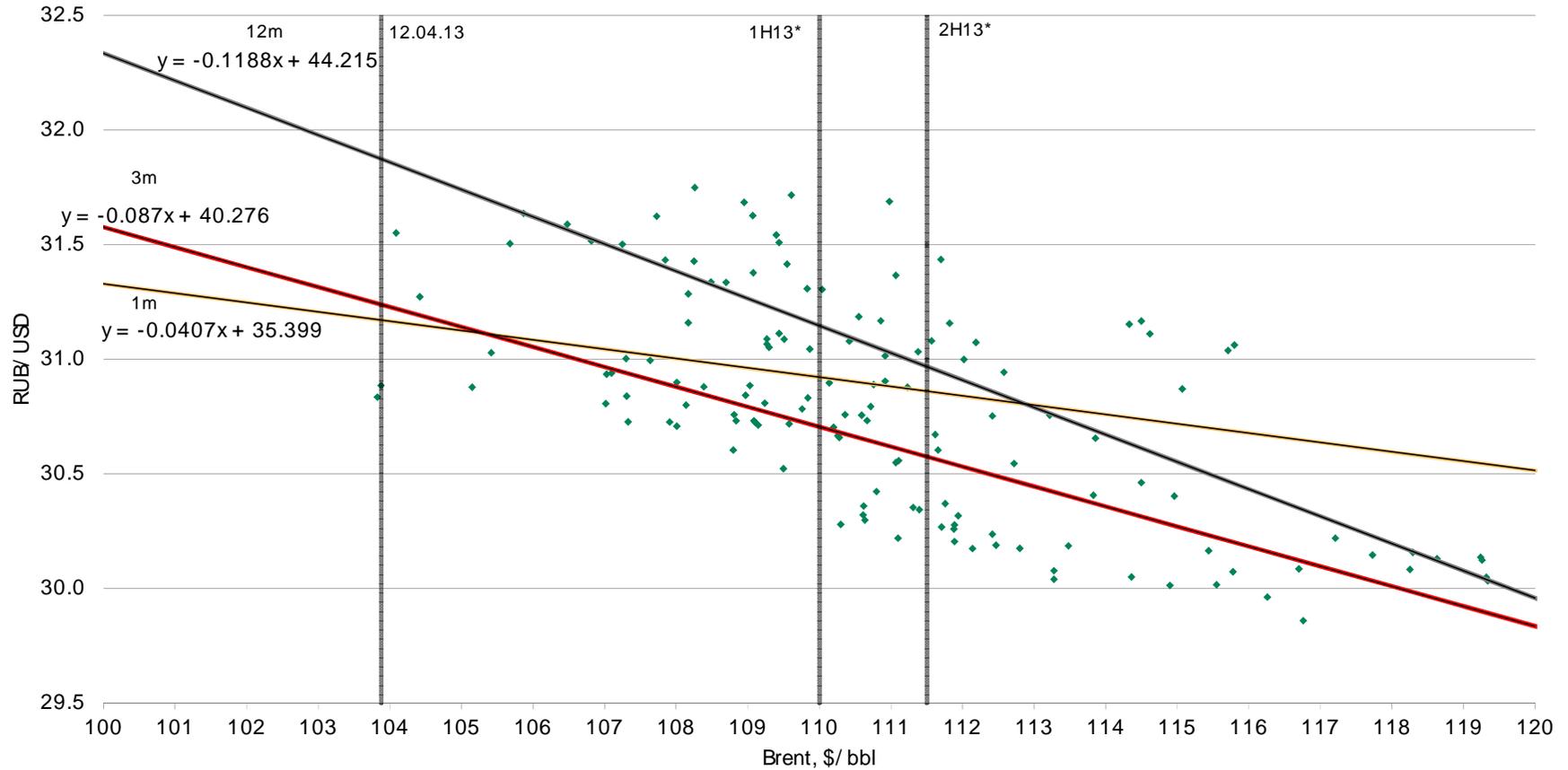


Source: Central Bank, Bloomberg, Sberbank Investment Research

...and after



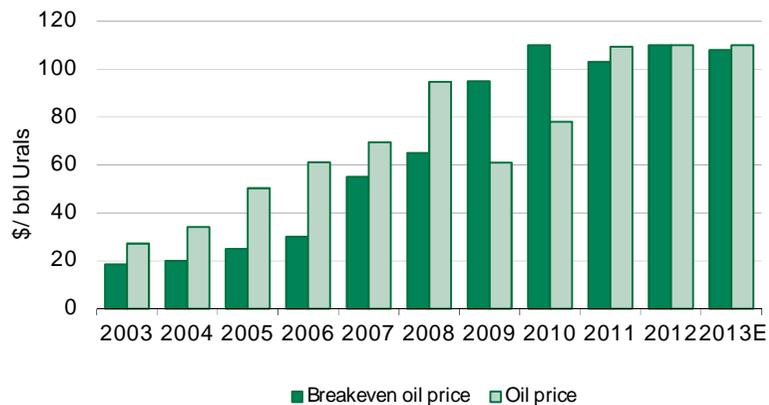
The RUB/USD exchange rate versus the oil price



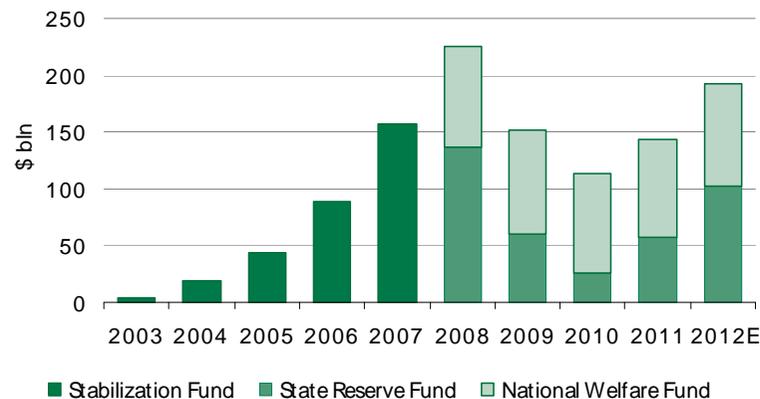
* - Bloomberg forecast consensus
 Source: Central Bank, Finance Ministry, Bloomberg, Sberbank Investment Research

Russia's breakeven oil price has grown substantially in recent years, but seems to have stabilized

Budgetary policy was generous and the State Reserve Fund shrank in 2009-10, as the budget was in the red (chart on right)



Source: Finance Ministry, Sberbank Investment Research



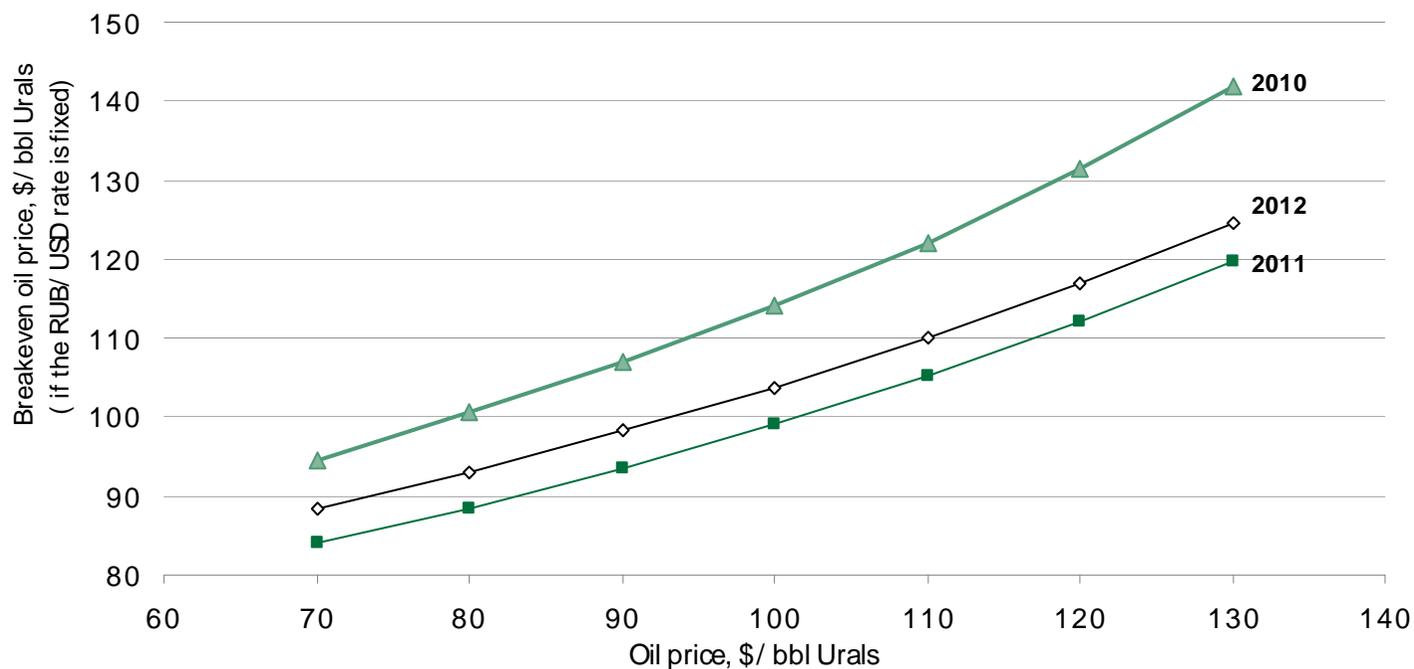
Source: Finance Ministry, Sberbank Investment Research

The Finance Ministry will have to borrow heavily due to the budget rule

	2012	2013E (Finance Ministry)	2013E(Sberbank Investment Research)
Revenues	12.9	12.9	13.4
Oil and gas revenues	6.5	5.9	6.4
Non-oil and gas revenues	6.4	6.9	7.0
Expenditures	12.9	13.4	13.4
Balance	0.0	-0.5	0.0
Net borrowing	0.5	0.6	0.8
Local	0.5	0.4	0.7
Foreign	0.0	0.2	0.2
Sovereign funds	-0.7	-0.4	-1.1
Privatization and other	0.2	0.3	0.3
Urals, \$/ bbl	110.3	97.0	110.0
RUB/ USD	30.1	32.4	30.9

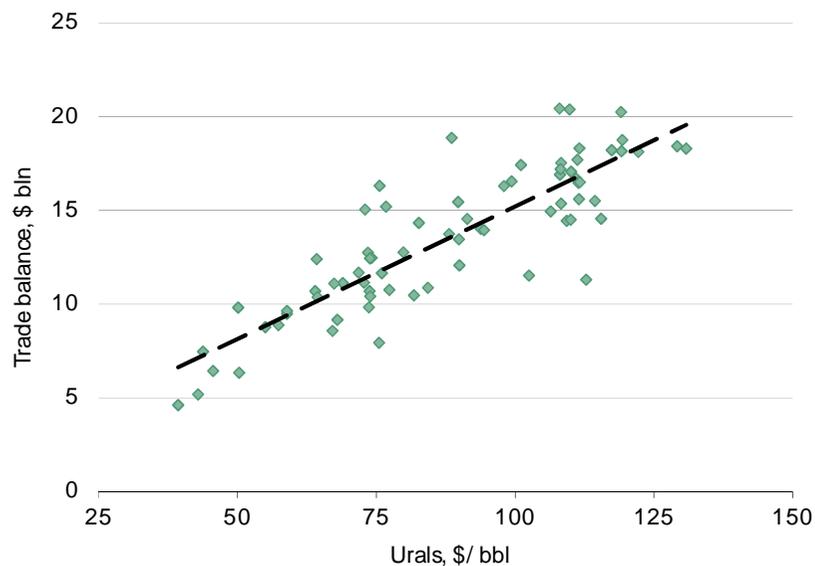
Source: Finance Ministry, Sberbank Investment Research

The budget breakeven oil price is only a theoretical concept and is a function of the oil price itself, not expenditures alone

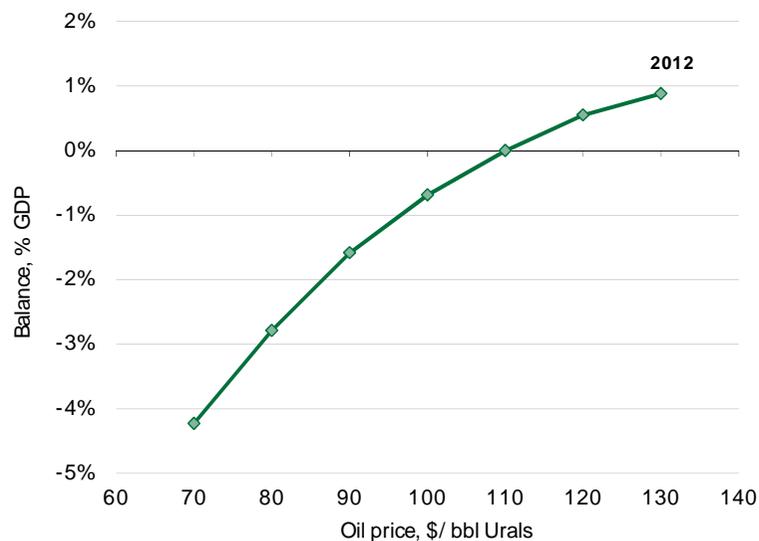


Source: Finance Ministry, Sberbank Investment Research

Case study: the trade balance would remain highly positive and the budget deficit would be limited if the oil price were to stay at \$80/bbl

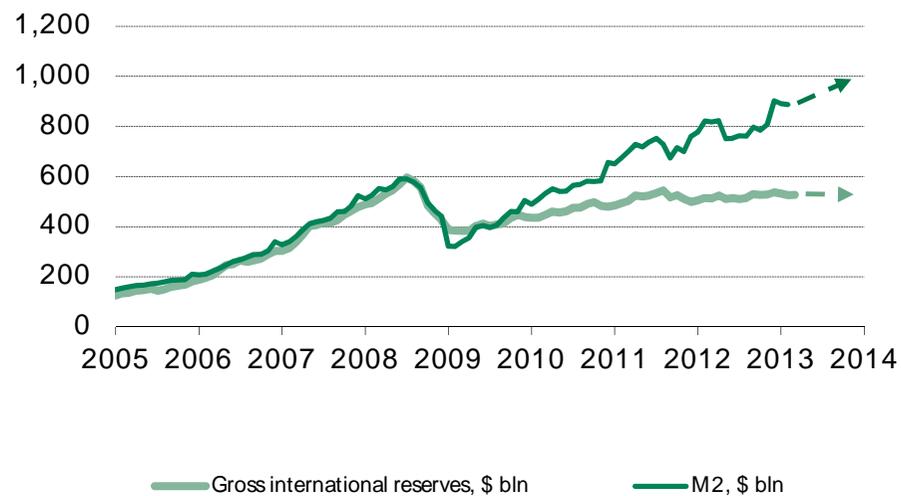


Note: Data from January 2007 to January 2013
Source: Central Bank, Finance Ministry, Sberbank Investment Research



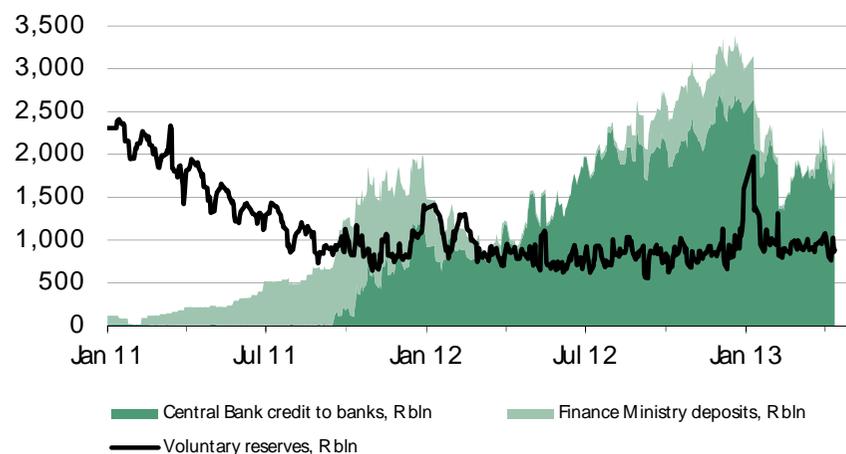
Source: Central Bank, Finance Ministry, Sberbank Investment Research

Russian M2 declined in nominal terms, but started to rise in February 2009, a sign that the economy is recovering (R bln); the sort of “currency board” regime is seemingly over: money is becoming endogenous

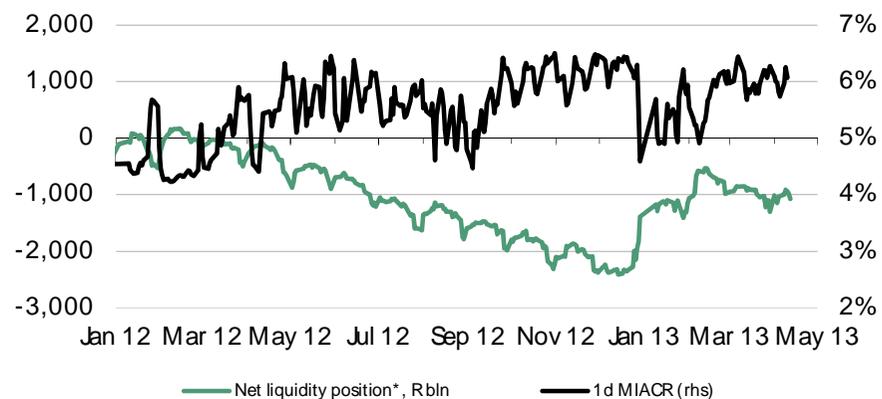


Source: Central Bank, Sberbank Investment Research

The role of the monetary authorities as lender of last resort grew substantially in late 2011

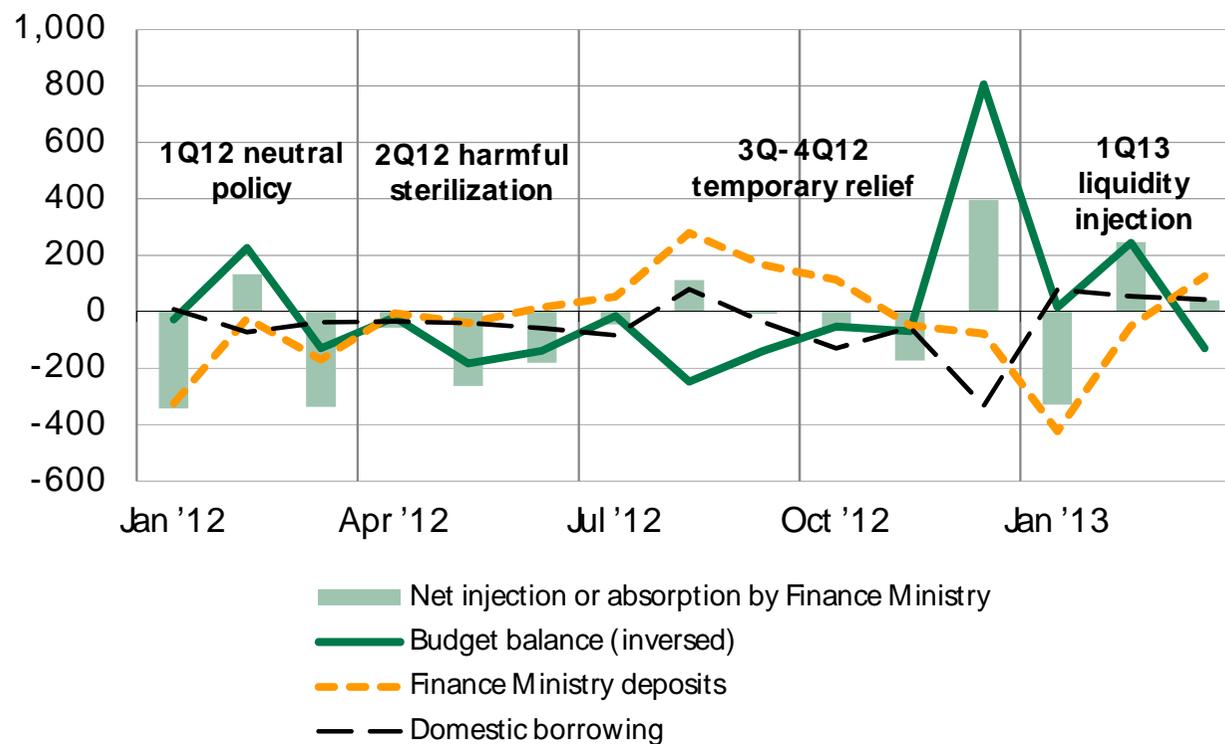


Source: Central Bank



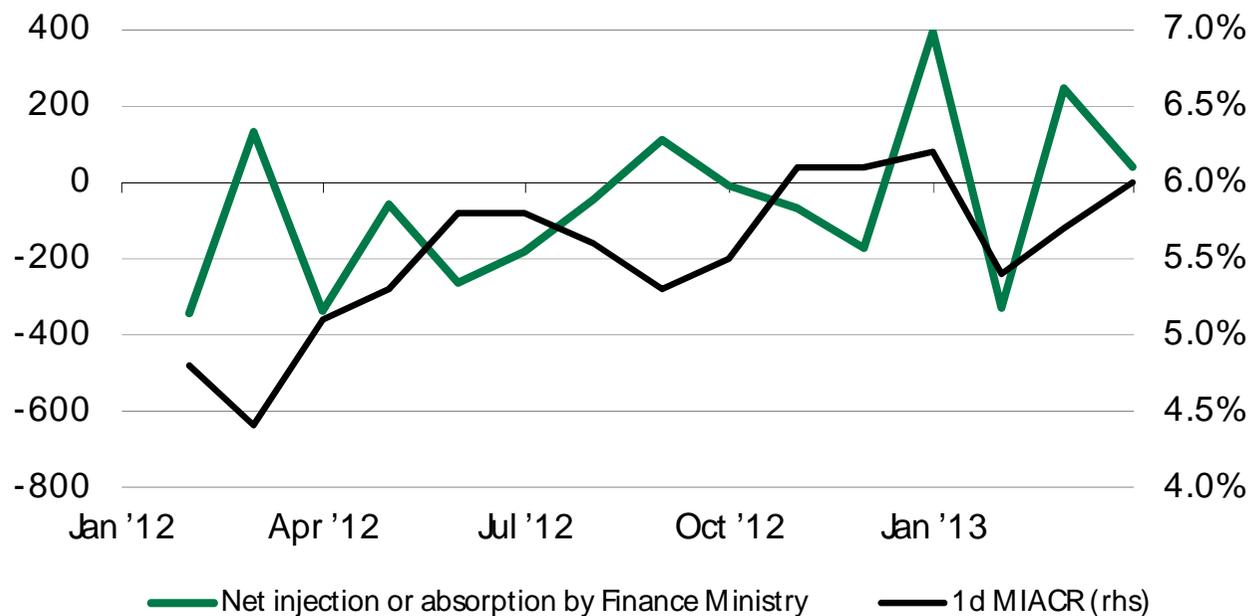
* calculated as the difference between banks' voluntary reserves and refinancing by the monetary and fiscal authorities
Source: Central Bank

Massive liquidity absorption by the Finance Ministry destabilized money markets in 2Q12, R bln



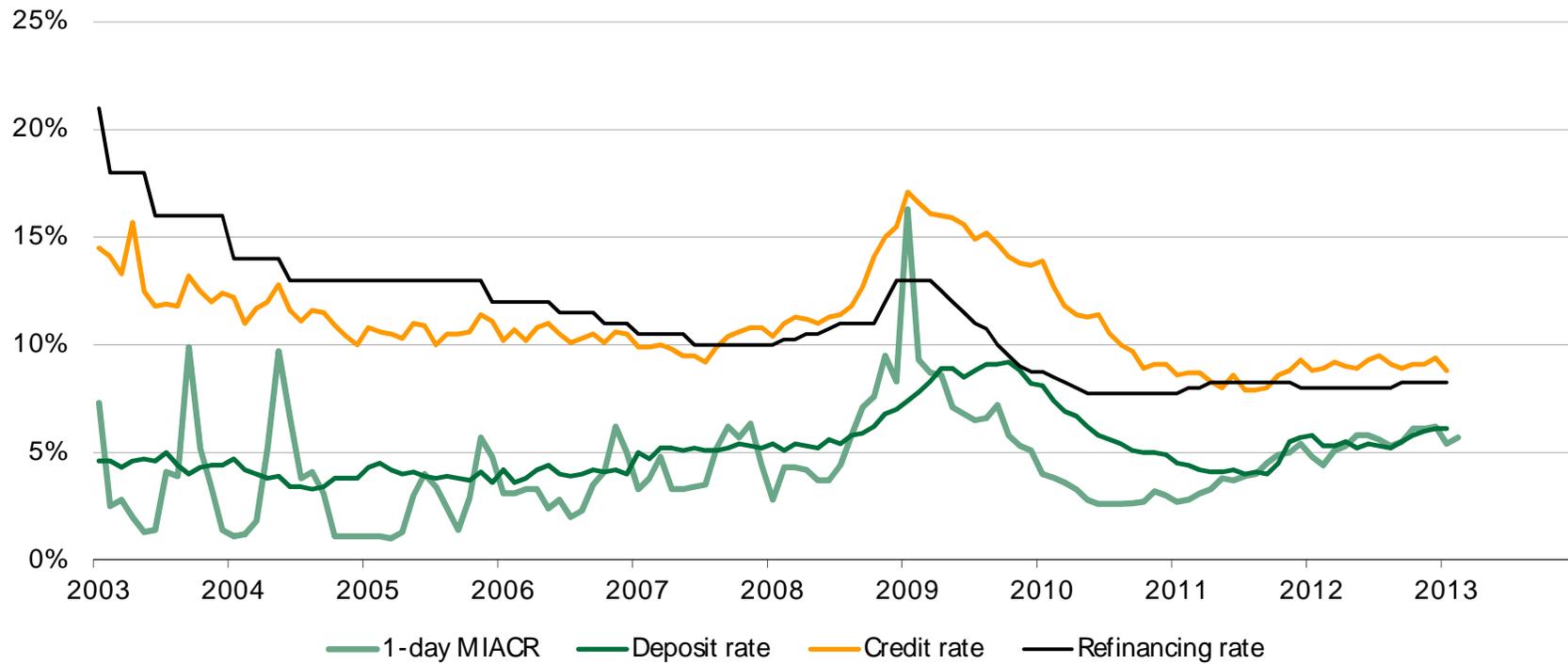
Note: Injection of liquidity (+), absorption of liquidity (-)
 Source: Finance Ministry, Central Bank, Sberbank Investment Research

Liquidity absorption has been costly: overnight rates have risen, R bln



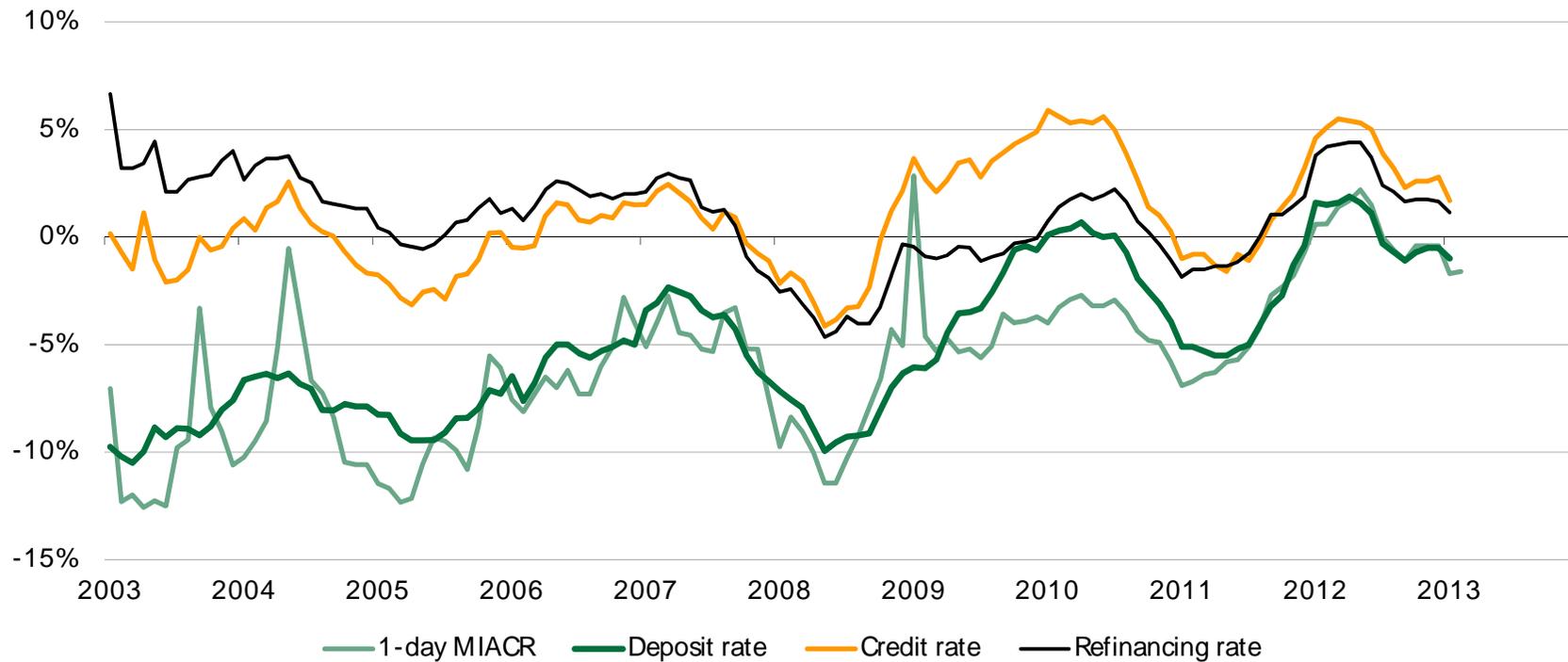
Source: Central Bank, Finance Ministry, Sberbank Investment Research

The margin between banks' lending rates and their borrowing costs narrowed amid disinflation



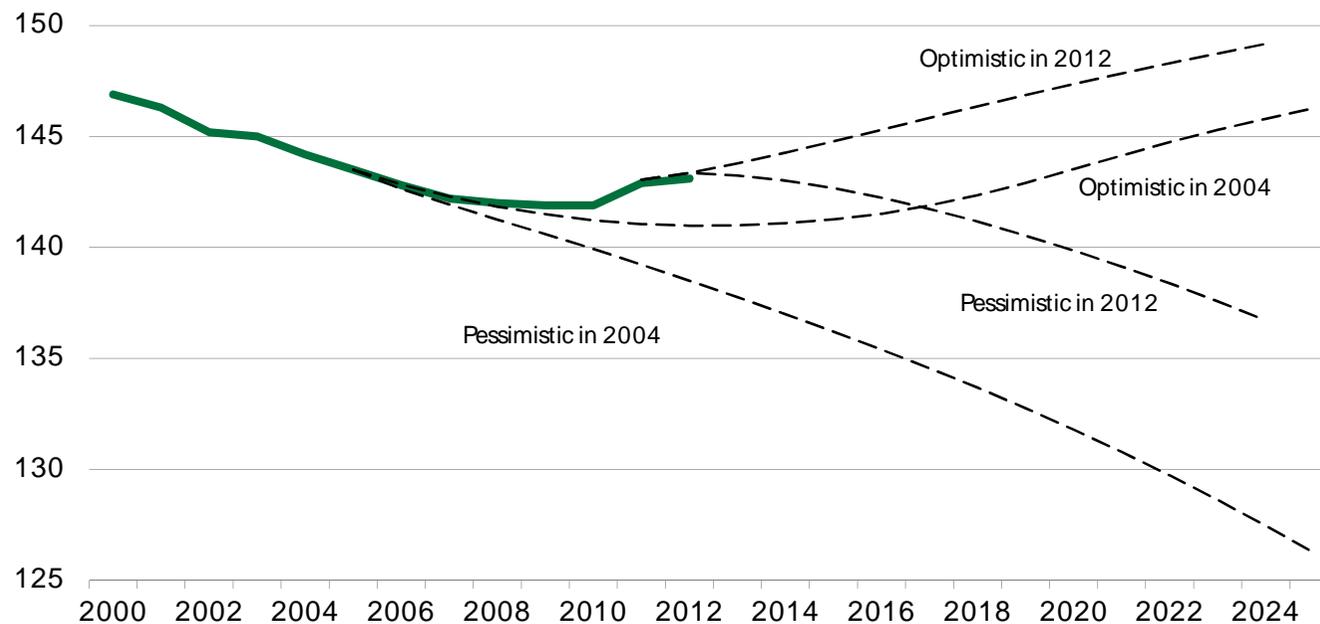
Source: Central Bank

Real interest rates are turning positive



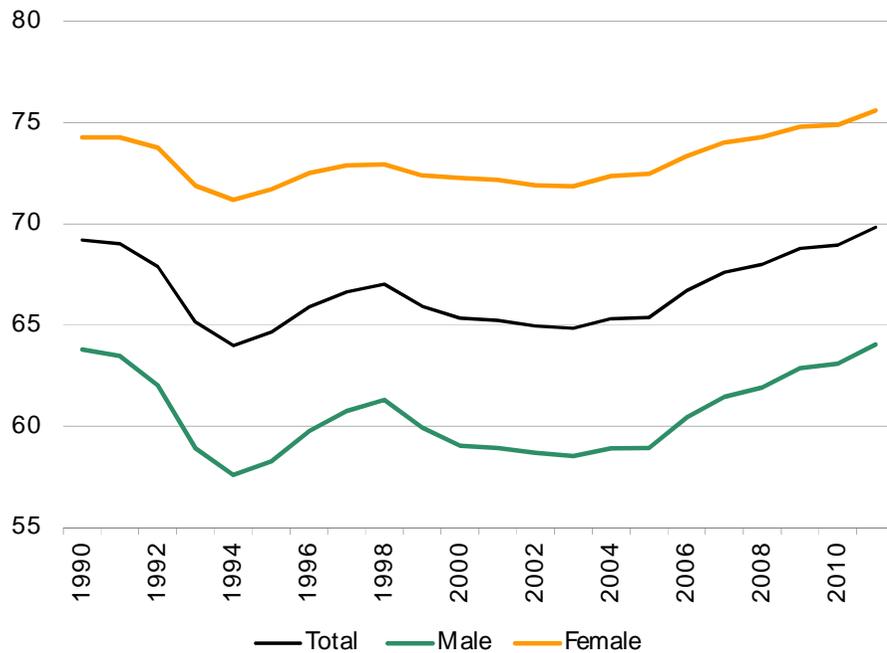
Source: Central Bank, State Statistics Service, Sberbank Investment Research

Population dynamics are outstripping even the most optimistic scenario, mln people

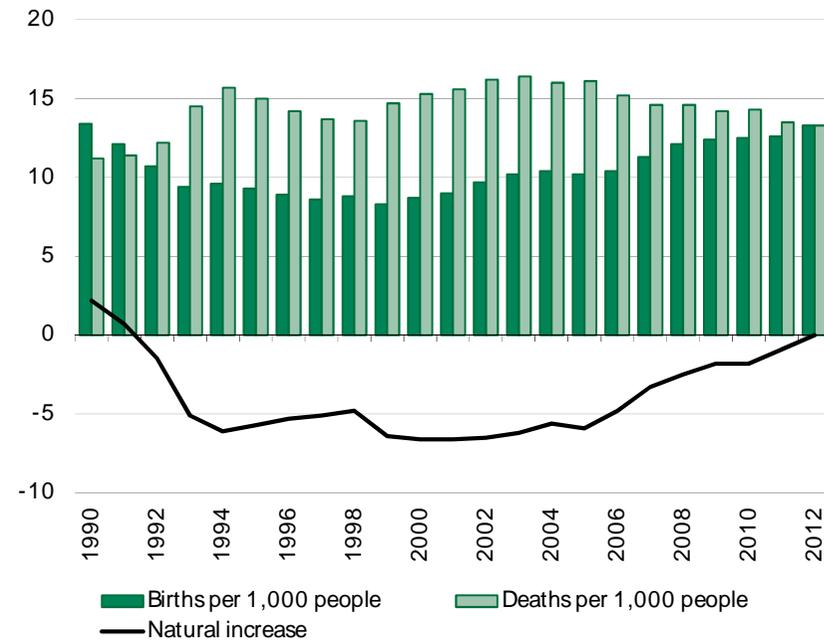


Source: State Statistics Service

Life expectancy is growing (years), while the natural increase in the population moves toward positive



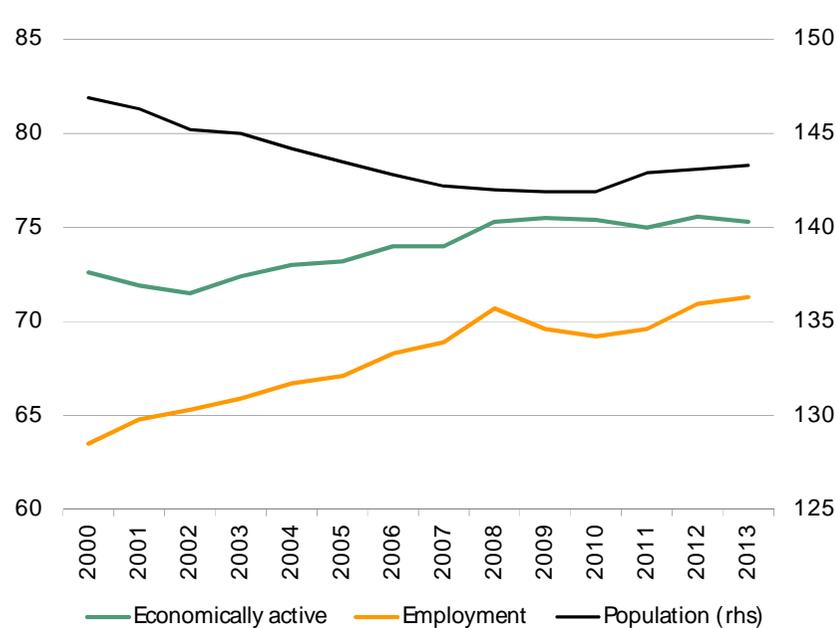
Source: State Statistics Service



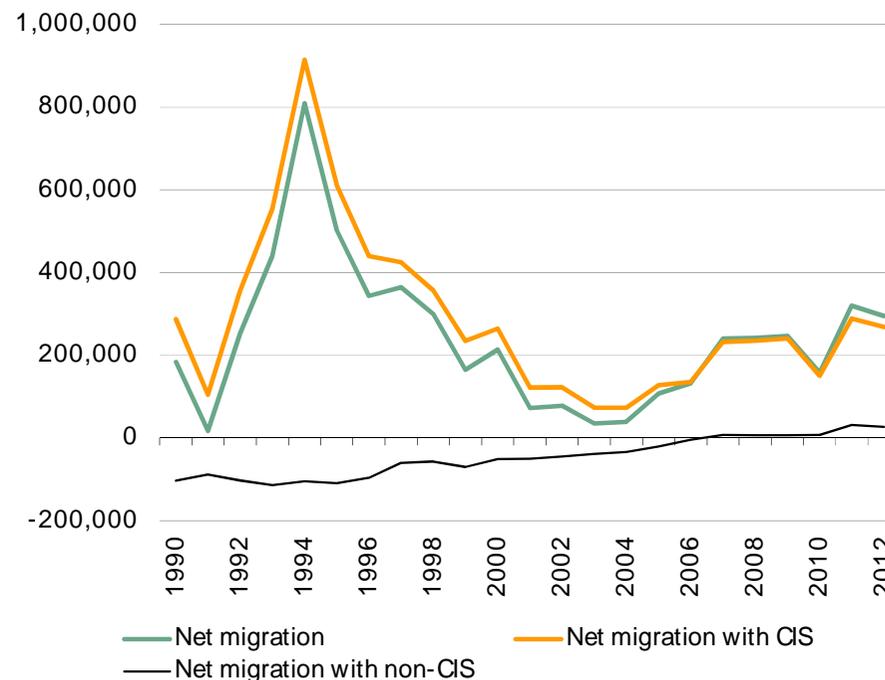
Source: State Statistics Service

Despite earlier fears, the economically active population stabilized, as has employment (mln people as of January 1)...

... while net migration with non-CIS countries is already positive



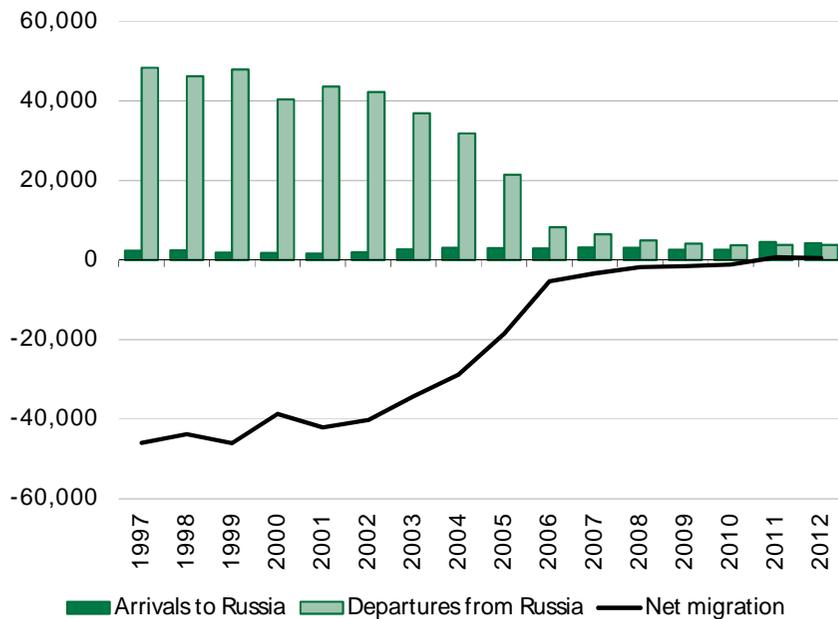
Source: State Statistics Service



Source: State Statistics Service

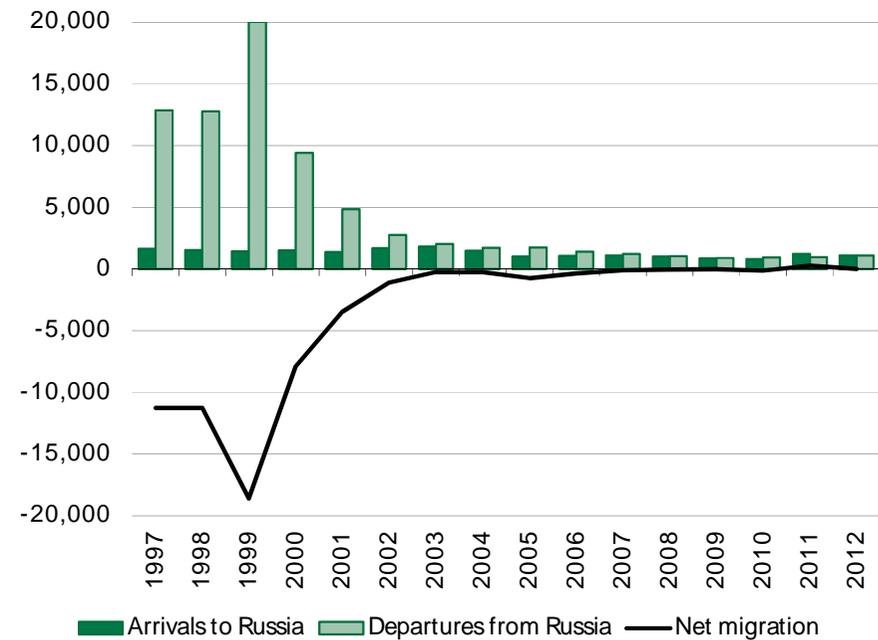
Examples of net migration between Russia and select non-CIS countries

Germany



Source: State Statistics Service

Israel



Source: State Statistics Service

Senior Management

Co-Head of Sberbank CIB

Ruben Vardanian, Alexander Bazarov

Chief Economist, Managing Director

Evgeny Gavrilenko

Research Department

+7 (495) 258 0511

Head of Research Paolo Zaniboni +7 (495) 787 2381

Head of Equity Research Andy Smith +7 (495) 787 2381

Head of FI Research Alexander Kudrin +7 (495) 933 9847

Strategy

Chief Strategist Chris Weafer +7 (495) 933 9886

Strategist Ovanes Oganisyan +7 (495) 933 9868

Strategist Iskander Abdullaev +7 (495) 258 0511

Oil and Gas

Senior Analyst Oleg Maximov +7 (495) 933 9830

Senior Analyst Alex Fak +7 (495) 933 9829

Analyst Valery Nesterov +7 (495) 933 9832

Utilities

Senior Analyst Alexander Kotikov +7 (495) 933 9841

Analyst Andrey Trufanov +7 (495) 933 9831

Telecoms, Media and IT

Senior Analyst Anna Lepetukhina +7 (495) 933 9835

Assistant Analyst Yana Kuznetsova +7 (495) 933 9834

Metals and Mining, Chemicals

Senior Analyst Mikhail Stiskin +7 (495) 933 9839

Analyst Irina Lapshina +7 (495) 933 9852

Analyst Zaurbek Zhunisov +7 (495) 787 2302

Analyst Anton Rummyantsev +7 (495) 933 9840

Assistant Analyst Alexander Levinskiy +7 (495) 258 0511

Manufacturing, Small and Mid Cap

Senior Analyst Mikhail Ganelin +7 (495) 933 9851

Senior Analyst Igor Vasilyev +7 (495) 933 9842

Assistant Analyst Ivan Belyaev +7 (495) 933 9853

Financials

Senior Analyst Andrew Keeley +44 (20) 7936 0439

Assistant Analyst Andrey Pavlov-Rusinov +7 (495) 258 0511

Real Estate

Senior Analyst Julia Gordeyeva, CFA +7 (495) 933 9846

Consumer

Senior Analyst Mikhail Krasnoperov +7 (495) 933 9838

Senior Analyst Konstantin Fastovets +7 (495) 933 9858

Assistant Analyst Artur Galimov +7 (495) 933 9833

Assistant Analyst Maria Sukhanova +7 (495) 933 9856

Transport

Senior Analyst Mikhail Ganelin +7 (495) 933 9851

Senior Analyst Igor Vasilyev +7 (495) 933 9842

Assistant Analyst Ivan Belyaev +7 (495) 933 9853

Economy

Senior Economist Anton Stroutchenevski +7 (495) 933 9843

Junior Economist Sergei Konygin +7 (495) 933 9848

Fixed Income

Head of FI Research Alexander Kudrin +7 (495) 933 9847

Senior Analyst Alexey Bulgakov +7 (495) 933 9866

Senior Analyst Dmitry Poliakov, CFA +7 (495) 933 9849

Analyst Sergey Goncharov +7 (495) 933 9854

Assistant Analyst Nikolay Minko +7 (495) 933 9857

In accordance with US SEC Regulation AC, US regulatory disclosures and analyst certification can be found at <http://www.troika.ru/eng/research/disclosure.wbp>.

This research report is prepared by Sberbank CIB or its affiliate named herein and provides general information only. Neither the information nor any opinion expressed constitutes a recommendation, an offer or an invitation to make an offer, to buy or sell any securities or other investment or any options, futures or derivatives related to such securities or investments. It is not intended to provide personal investment advice and it does not take into account the specific investment objectives, financial situation and the particular needs of any specific person who may receive this report. Investors should seek financial advice regarding the appropriateness of investing in any securities, other investment or investment strategies discussed or recommended in this report and should understand that statements regarding future prospects may not be realized.

Investors should note that income from such securities or other investments, if any, may fluctuate and that price or value of such securities and investments may rise or fall. Accordingly, investors may receive back less than originally invested. Past performance is not necessarily a guide to future performance.

Any information relating to the tax status of financial instruments discussed herein is not intended to provide tax advice or to be used by anyone to provide tax advice. Investors are urged to seek tax advice based on their particular circumstances from an independent tax professional.

Foreign currency rates of exchange may adversely affect the value, price or income of any security or related investment mentioned in this report. In addition, investors in securities such as ADRs or GDRs, whose values are influenced by the currency of the underlying security, effectively assume currency risk.

The information contained herein has been obtained from, and any opinions herein are based upon, sources believed to be reliable, but no representation is made that it is accurate or complete and it should not be relied upon as such. All such information and opinions are subject to change without notice.

From time to time, Sberbank CIB or its affiliates or the principals or employees of its affiliates may have or have had positions or derivative positions in the securities or other instruments referred to herein or make or have made a market or otherwise act or have acted as principal in transactions in any of these securities or instruments or may provide or have provided investment banking or consulting services to or serve or have served as a director or a supervisory board member of a company being reported on herein.

Sberbank CIB maintains strict internal policies, which are designed to manage any actual or potential conflicts of interest from harming the interests of investors.

Further information on the securities referred to herein may be obtained from Sberbank CIB upon request.

This report may not be reproduced, copied nor extracts taken from it, without the express written consent of Sberbank CIB.

For residents of the United States: This research report is being distributed in the United States by SBERBANK CIB USA, INC., which accepts responsibility for the contents hereof. Any U.S. person receiving this report who wishes to effect transactions in any securities referred to herein should contact SBERBANK CIB USA, INC., not its affiliate. Further information on the securities referred to herein may be obtained from SBERBANK CIB USA, INC. upon request.

For residents of the United Kingdom and rest of Europe: Except as may be otherwise specified herein, this research report is communicated to persons who are qualified as eligible counterparties or professional clients (as defined in the FSA Rules) and is made available to such persons only. The information contained herein is not intended for, and should not be relied upon by, retail clients (as defined in the FSA Rules).