



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

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INVESTMENT RESEARCH

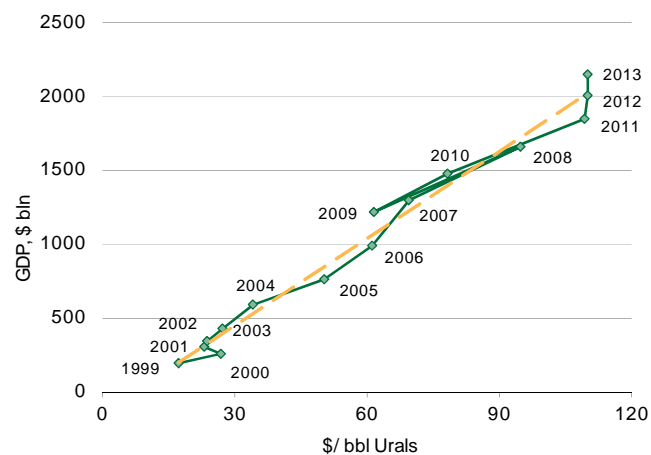
Russia's growth decelerated in 2H12 and will be slow in early 2013 with a chance to rebound later in the year

- **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...

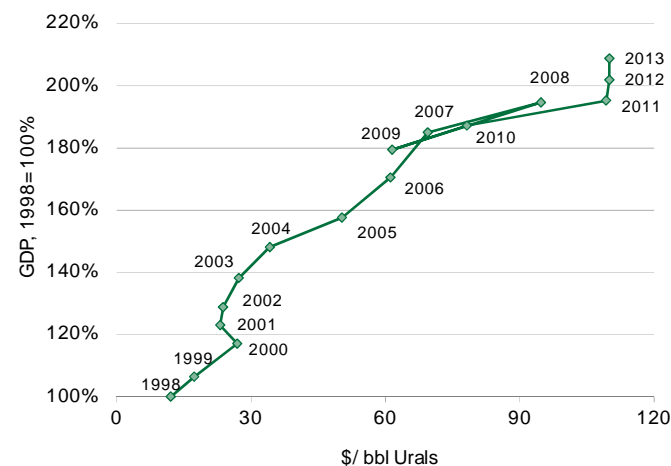
...while the latter rose even more in nominal terms

Nominal GDP



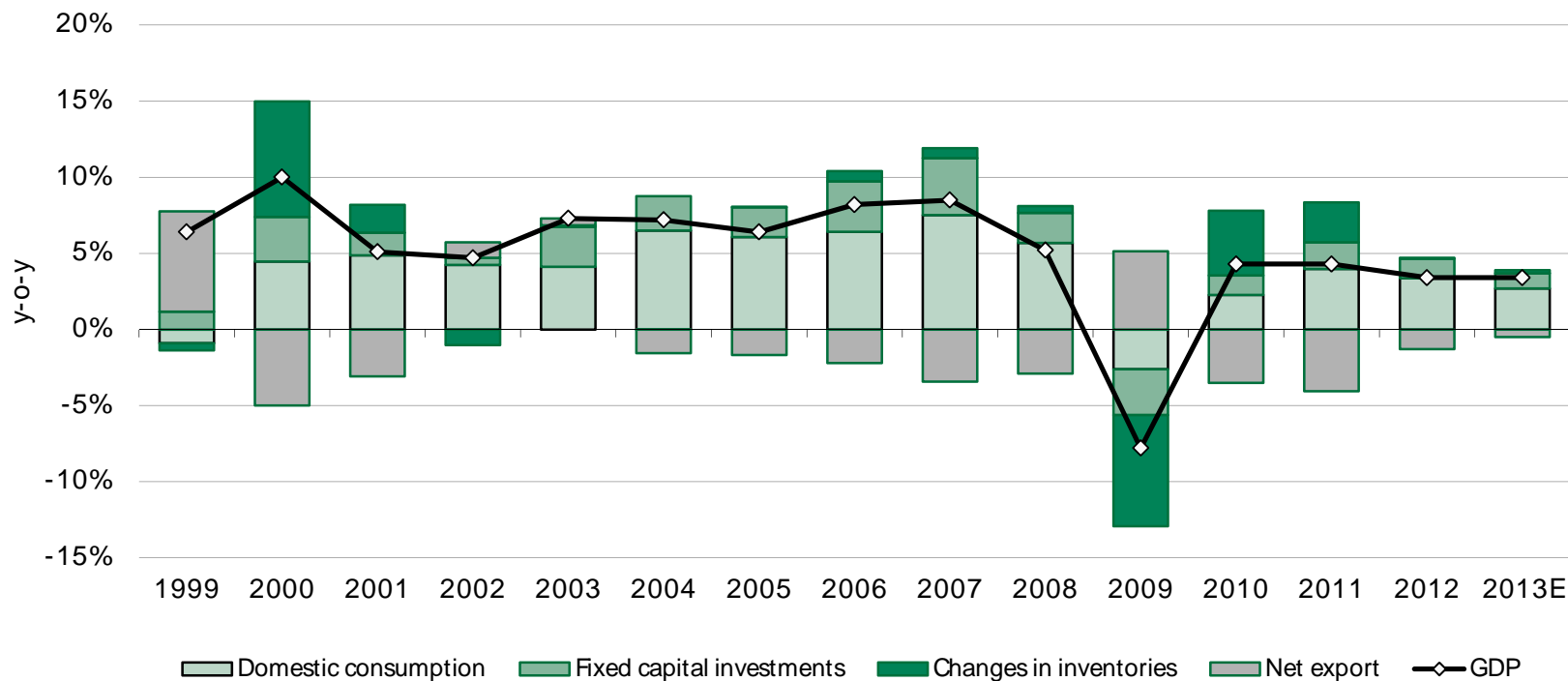
Source: State Statistics Service, Sberbank Investment Research

Real GDP



Source: State Statistics Service, Sberbank Investment Research

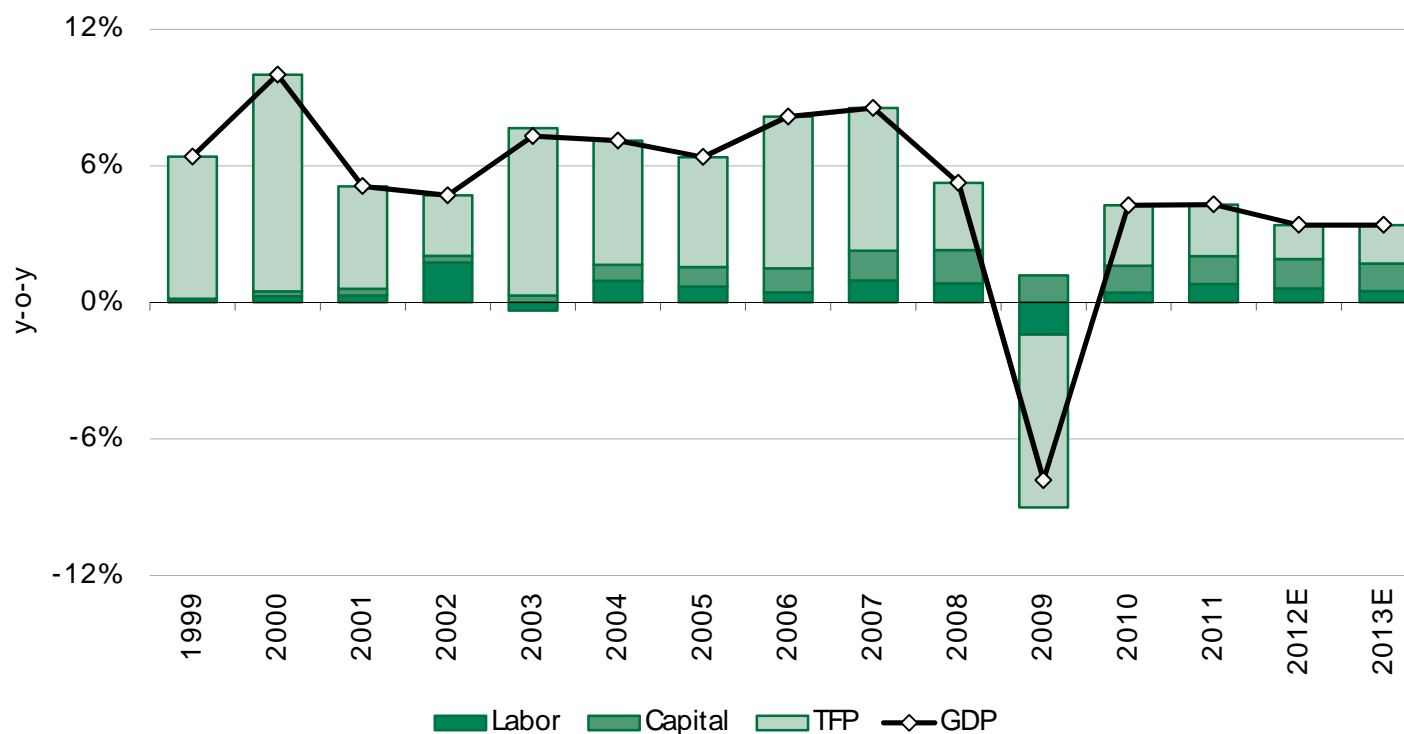
Domestic demand remains a key driver for economic growth



Source: State Statistics Service, Sberbank Investment Research

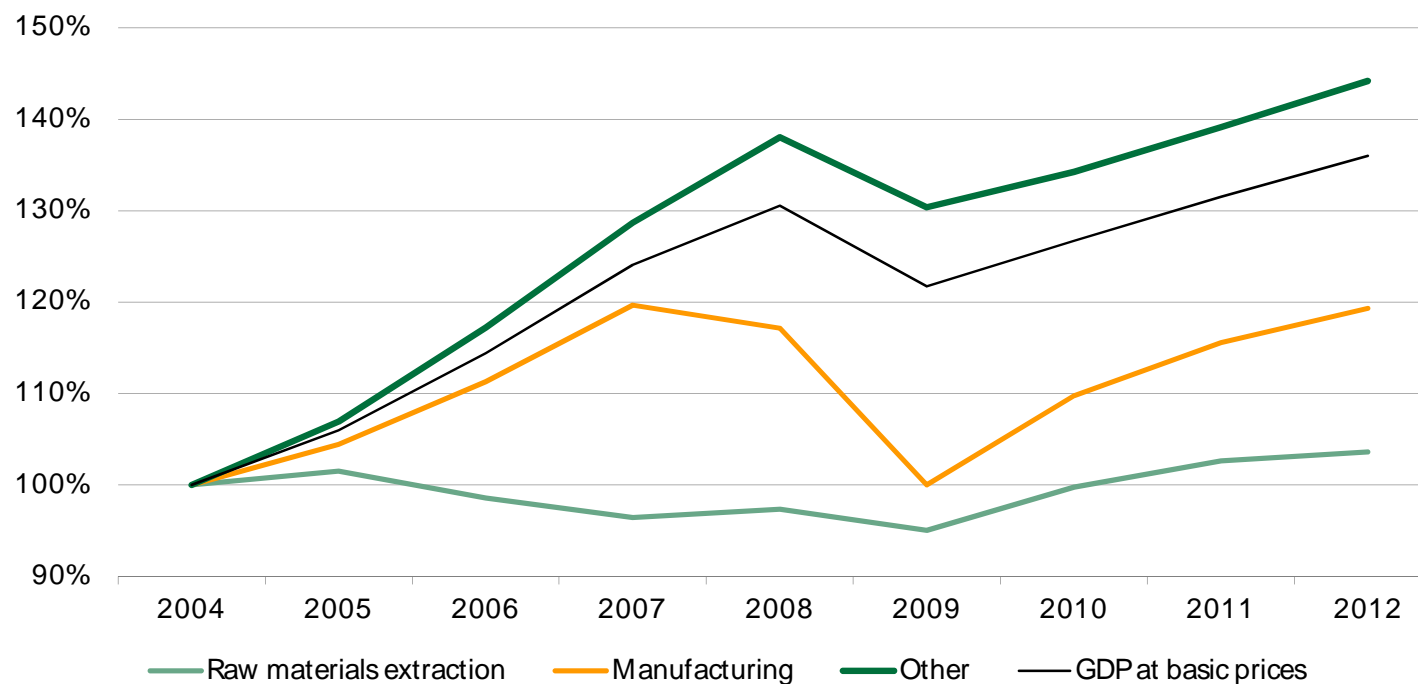
Since 1999, growth has largely been driven by rising total factor productivity (TFP)...

...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%



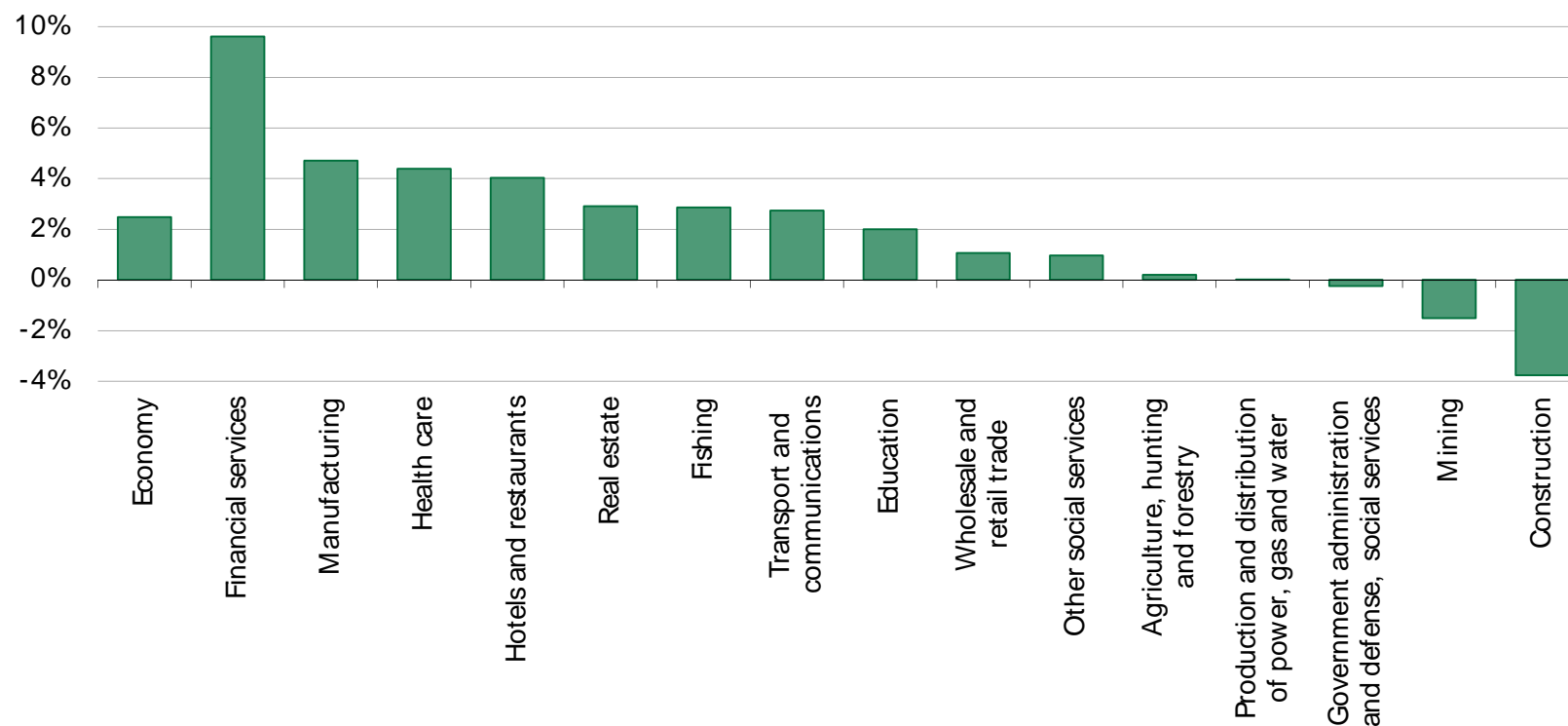
Source: State Statistics Service, Sberbank Investment Research

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%

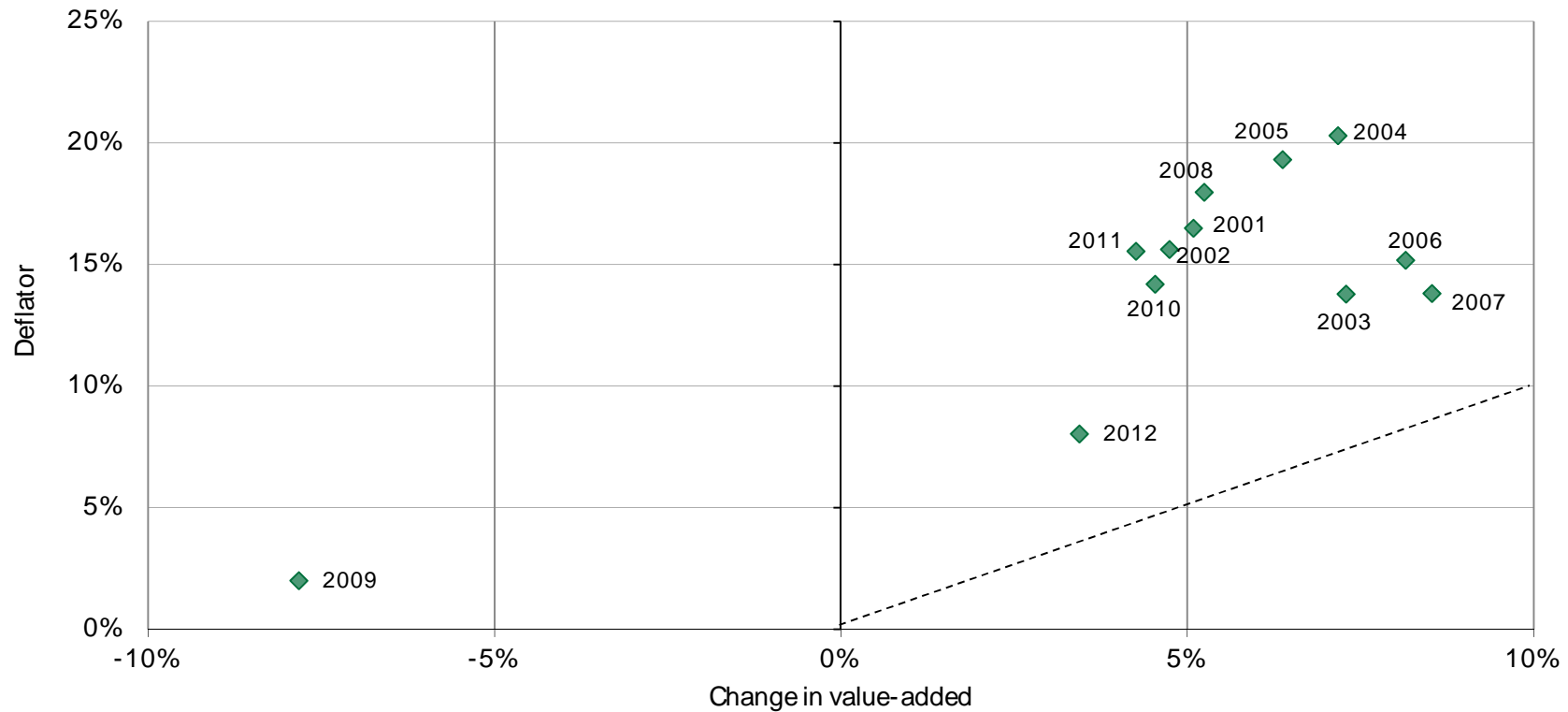
Source: State Statistics Service

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



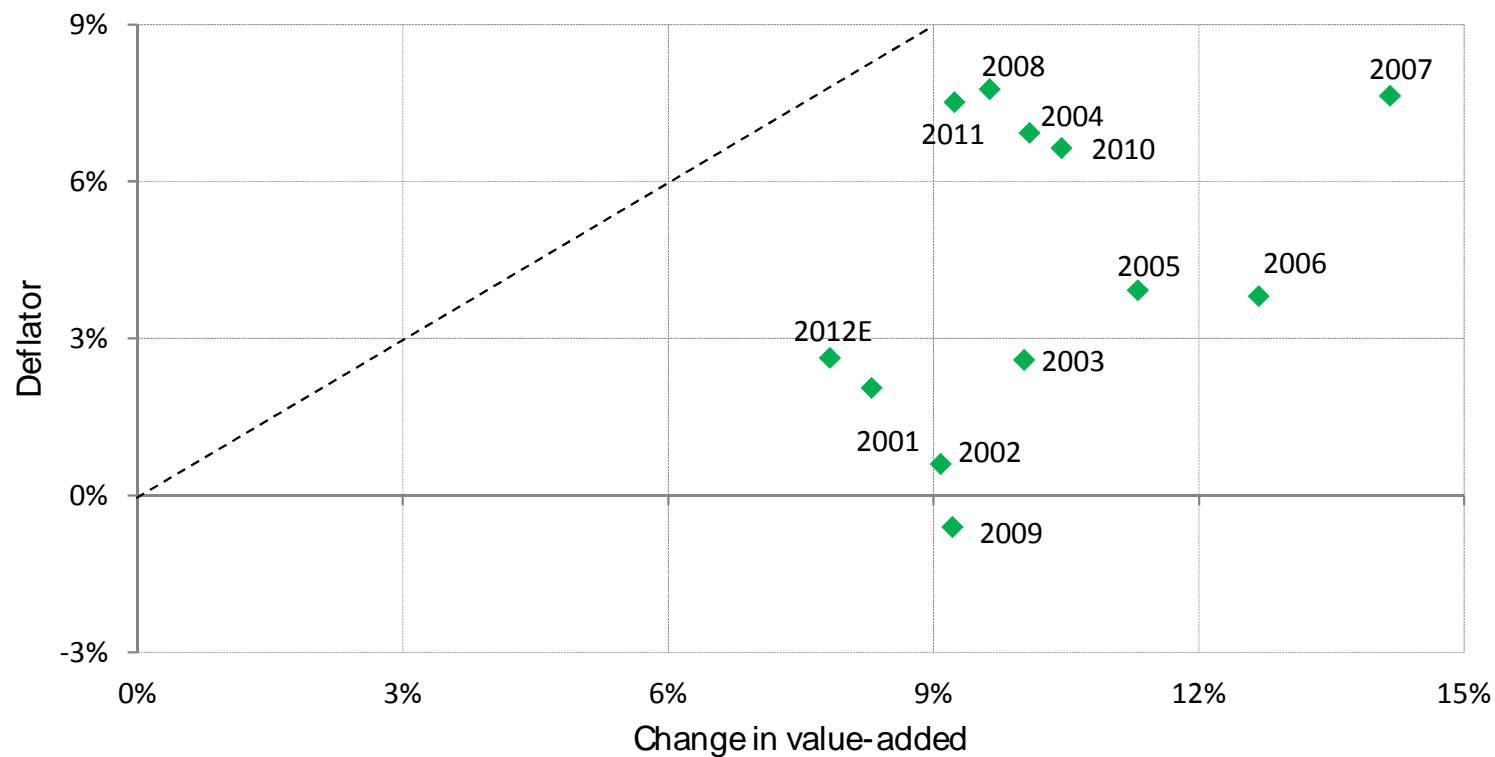
Source: State Statistics Service, Sberbank Investment Research

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



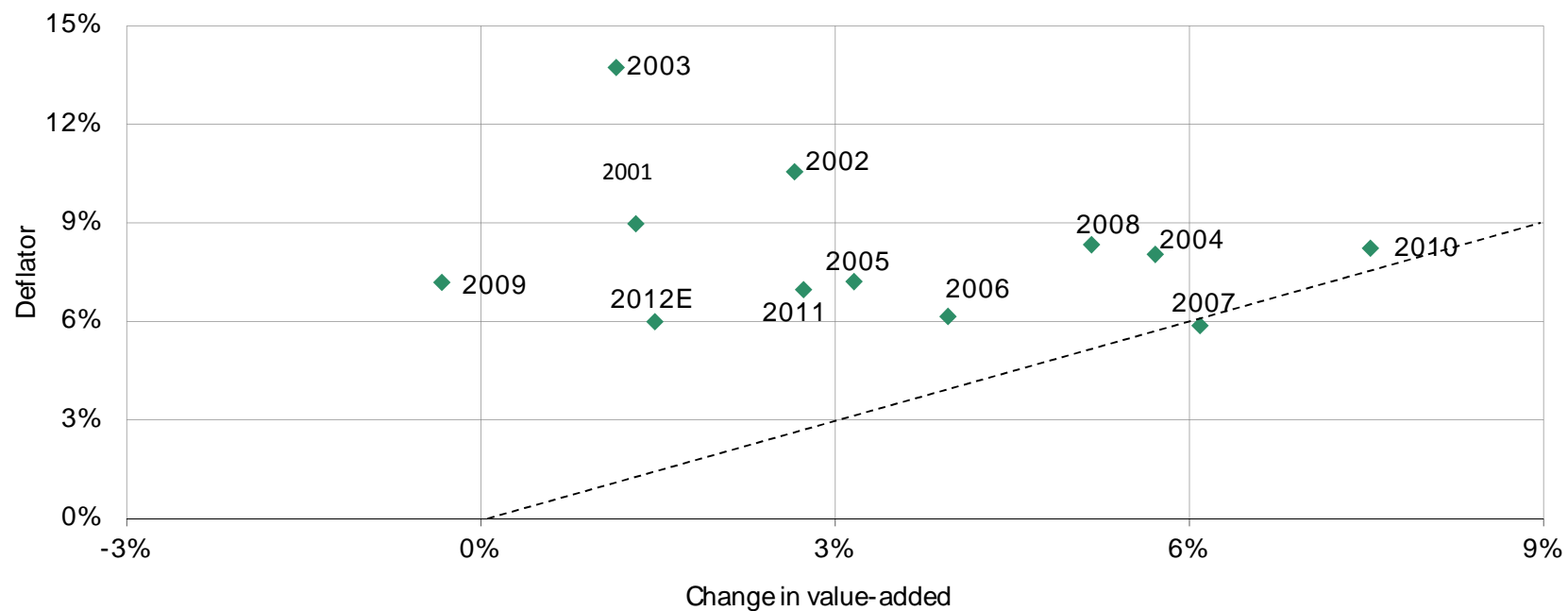
Source: State Statistics Service, Sberbank Investment Research

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



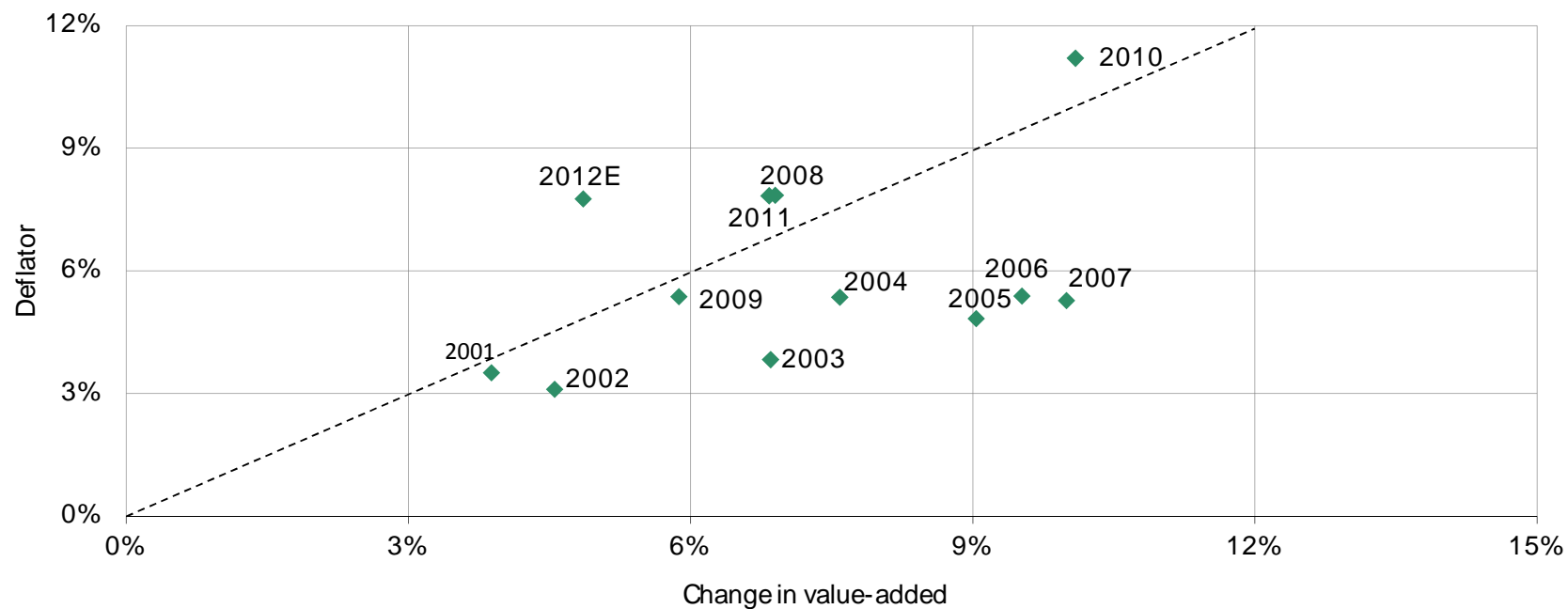
Source: IMF, Sberbank Investment Research

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



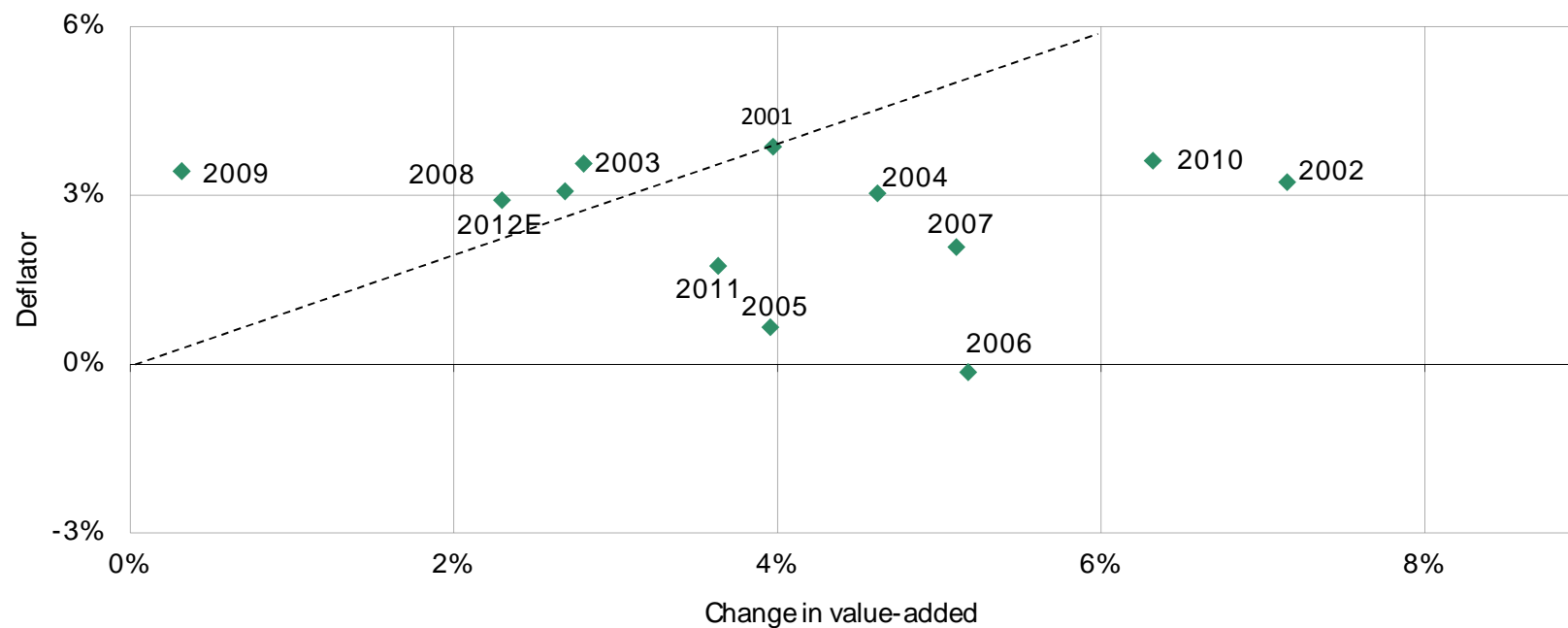
Source: IMF, Sberbank Investment Research

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



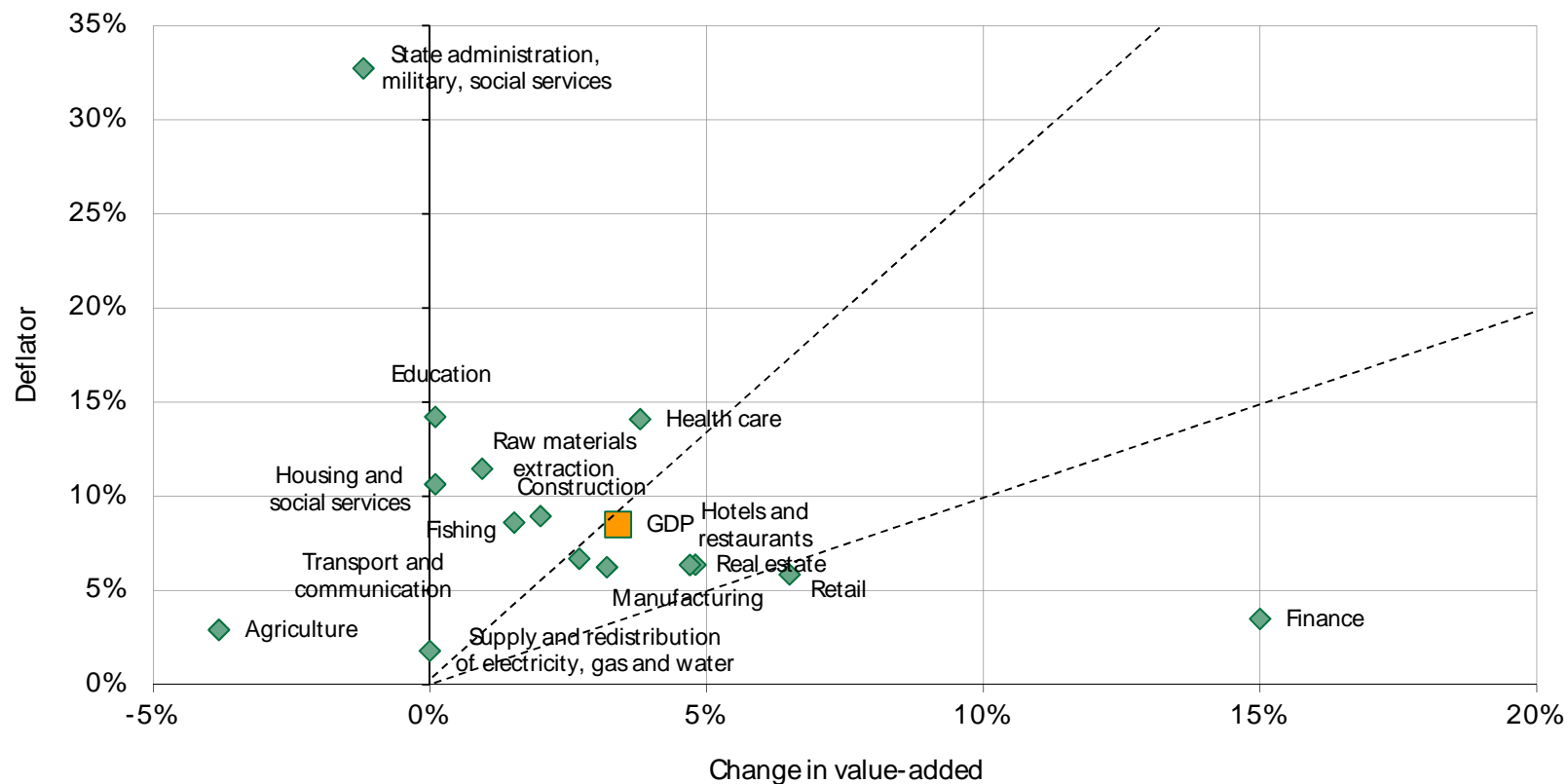
Source: IMF, Sberbank Investment Research

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

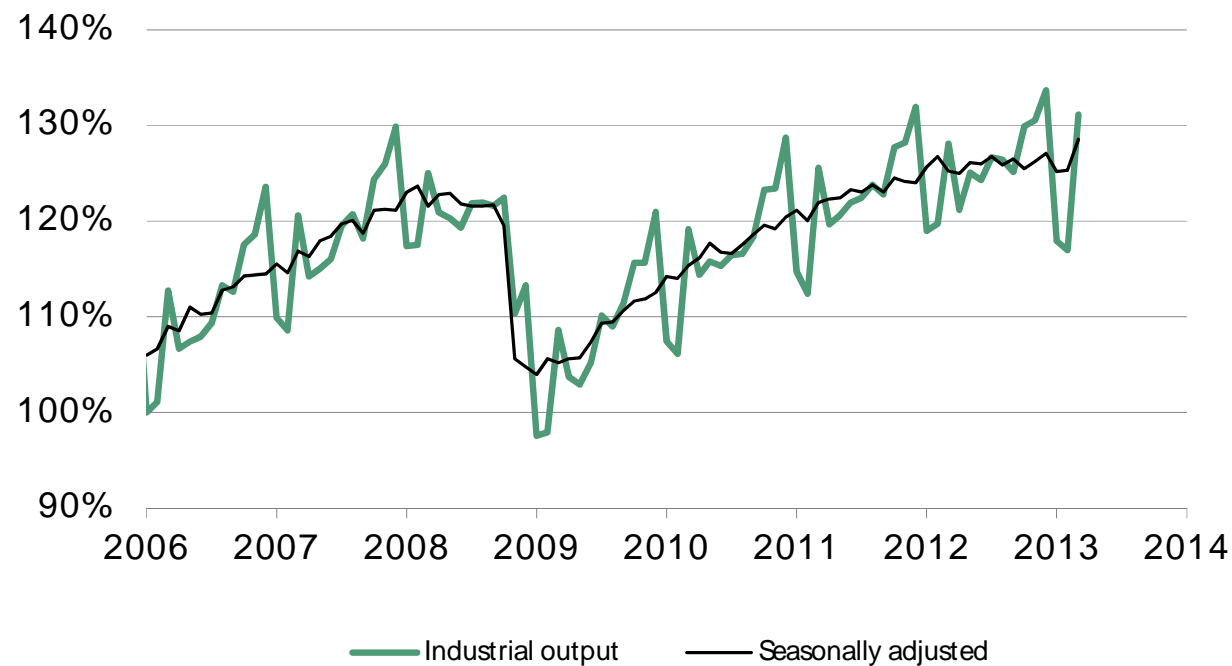
Breakdown of value-added growth and employment by industry, 2012

	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.

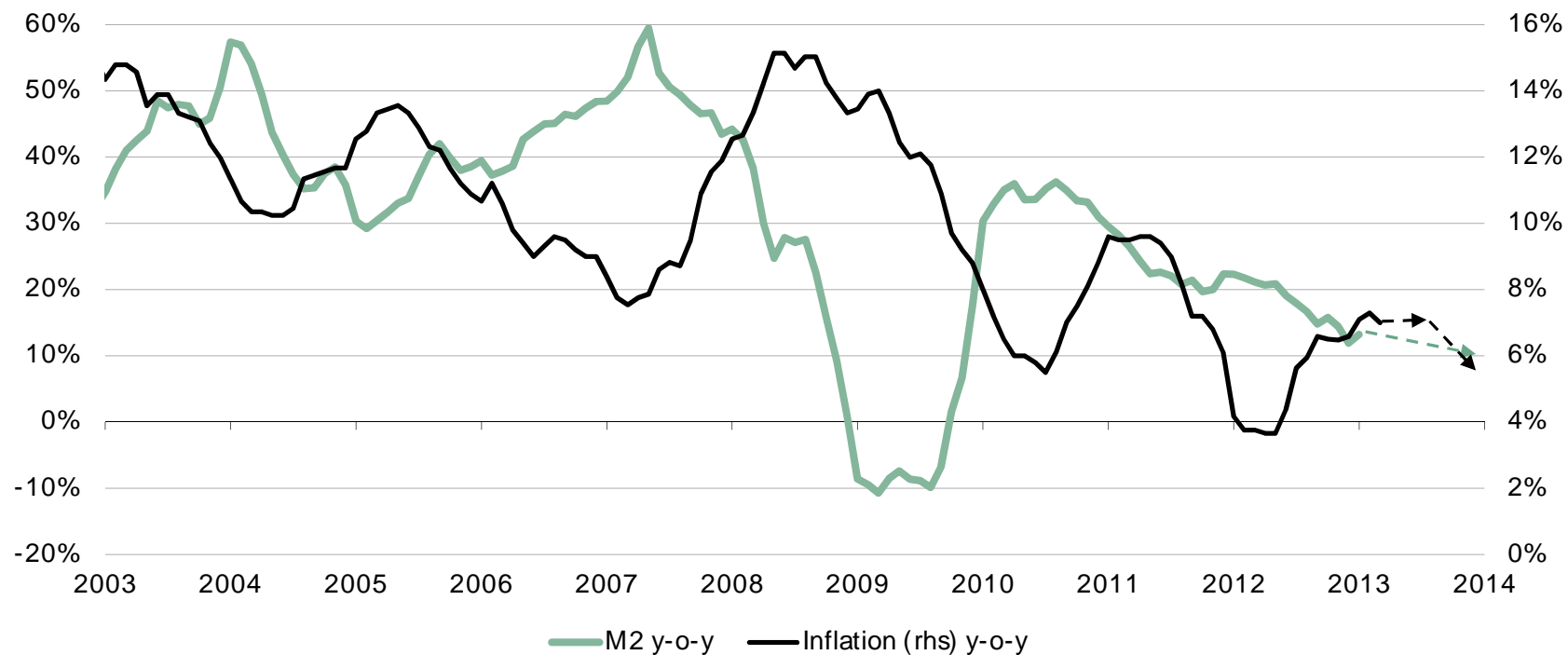
Source: State Statistics Service, Sberbank Investment Research

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



Source: State Statistics Service

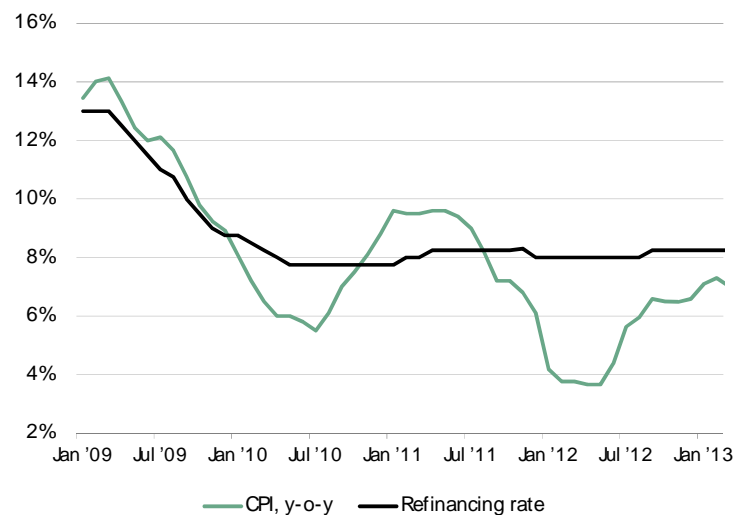
Inflation accelerated recently amid moderated money supply growth, but should once again decelerate next year



Source: Central Bank, State Statistics Service

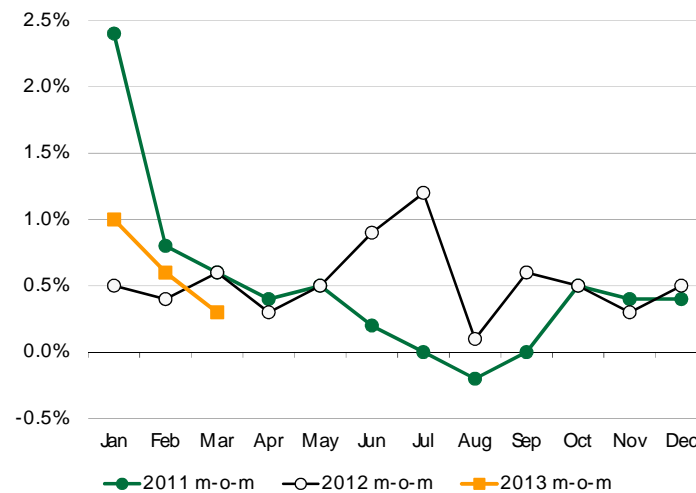
Annual inflation has been slowing since August 2011 due to base effects, while a weaker ruble, poor harvest and an amended refinancing policy contributed to its acceleration in recent months

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.**

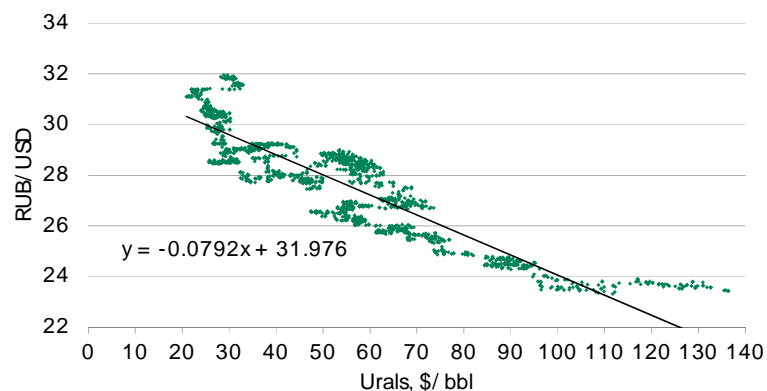
The Central Bank is unable to control the forex and money markets simultaneously



Source: Central Bank, State Statistics Service

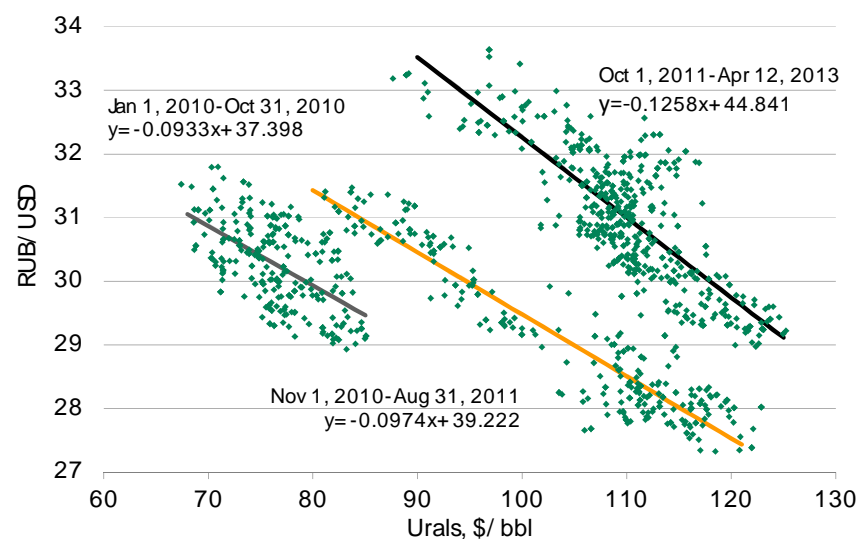
Historical exchange rate and oil price: new regime emerges as Central Bank reduces interventions

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

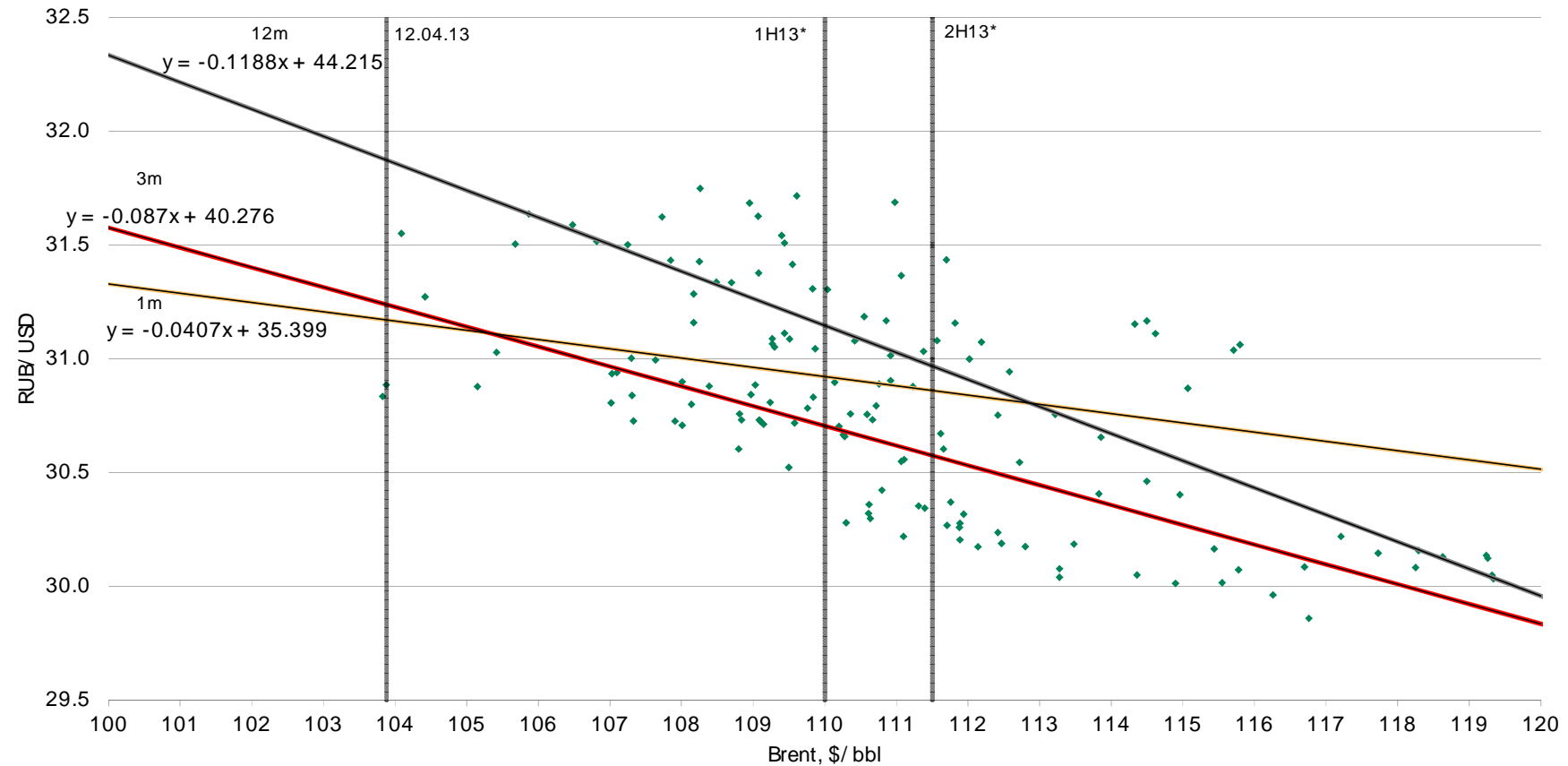


Source: Central Bank, Bloomberg, Sberbank Investment Research

...and after



The RUB/USD exchange rate versus the oil price

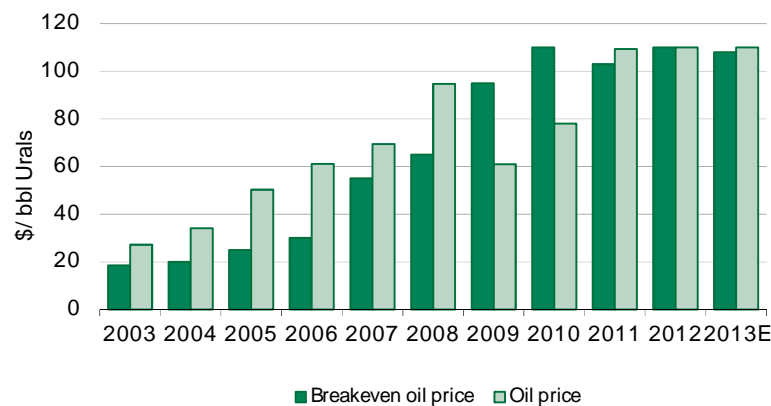


* - Bloomberg forecast consensus

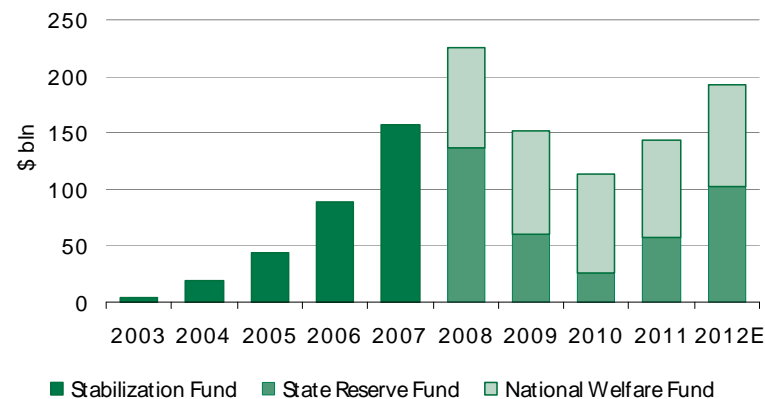
Source: Central Bank, Finance Ministry, Bloomberg, Sberbank Investment Research

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



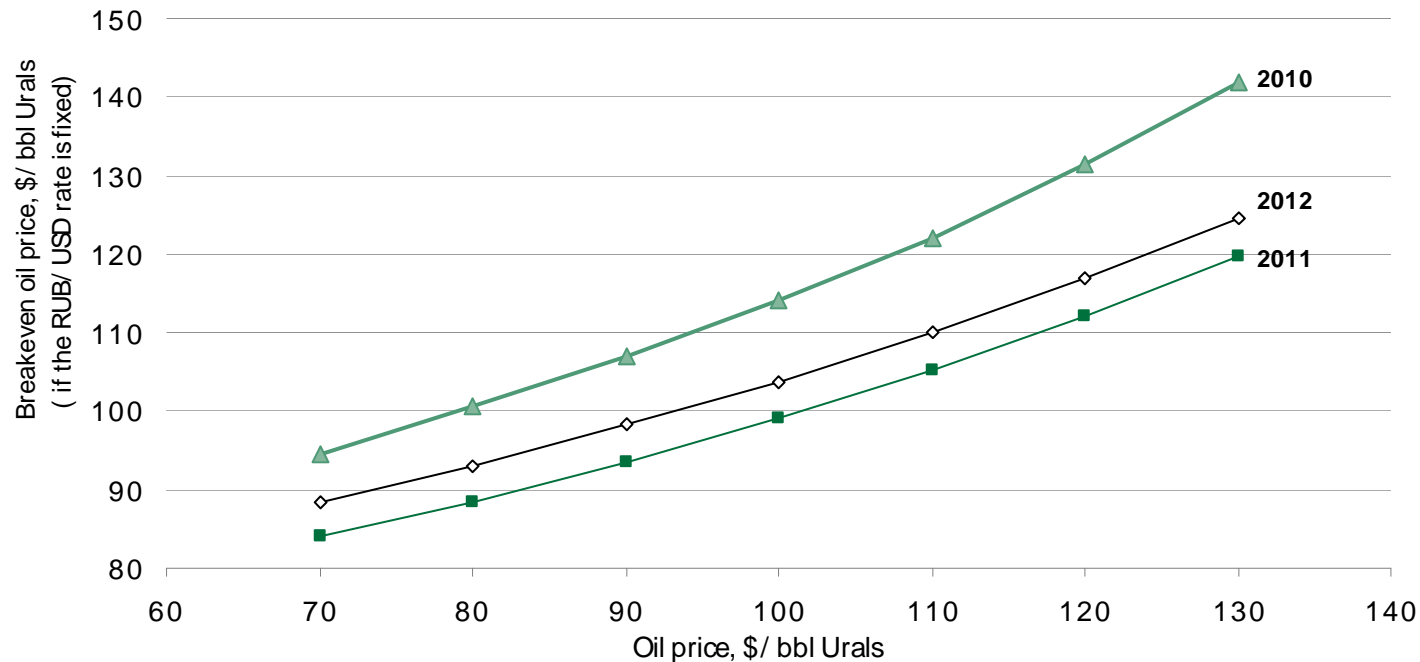
Source: Finance Ministry, Sberbank Investment Research

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

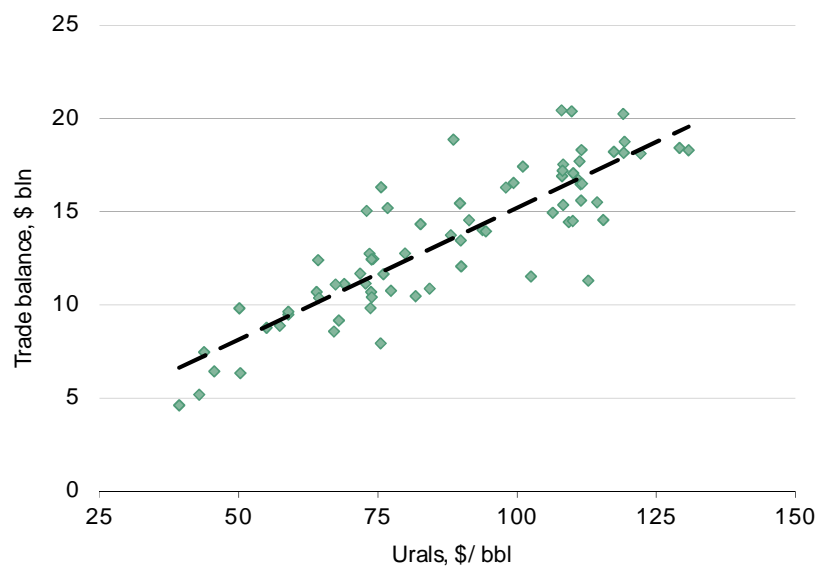
Source: Finance Ministry, Sberbank Investment Research

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



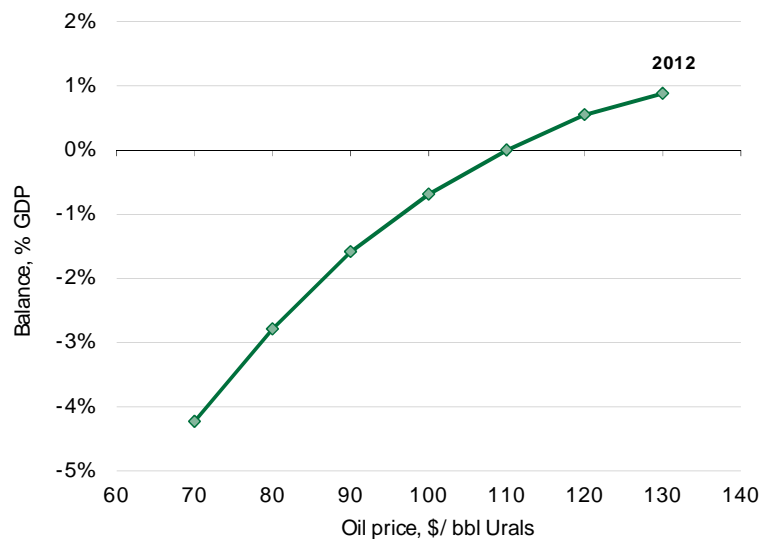
Source: Finance Ministry, Sberbank Investment Research

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



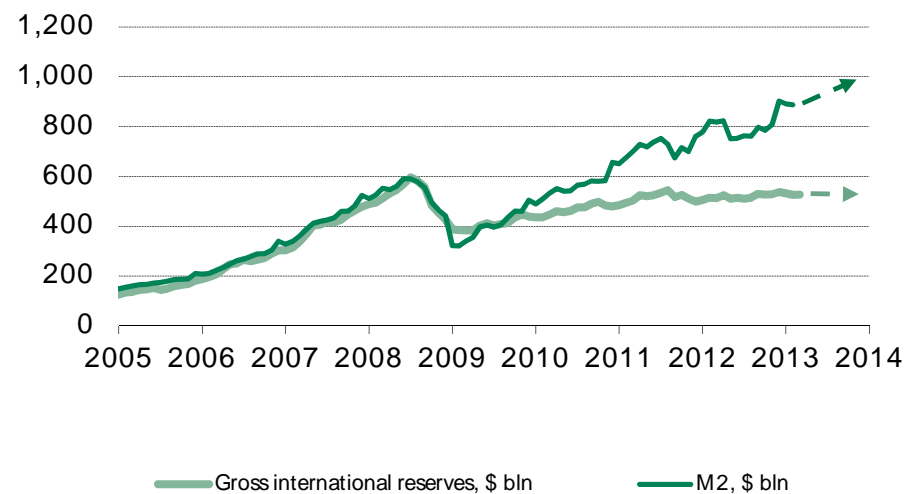
Note: Data from January 2007 to January 2013

Source: Central Bank, Finance Ministry, Sberbank Investment Research



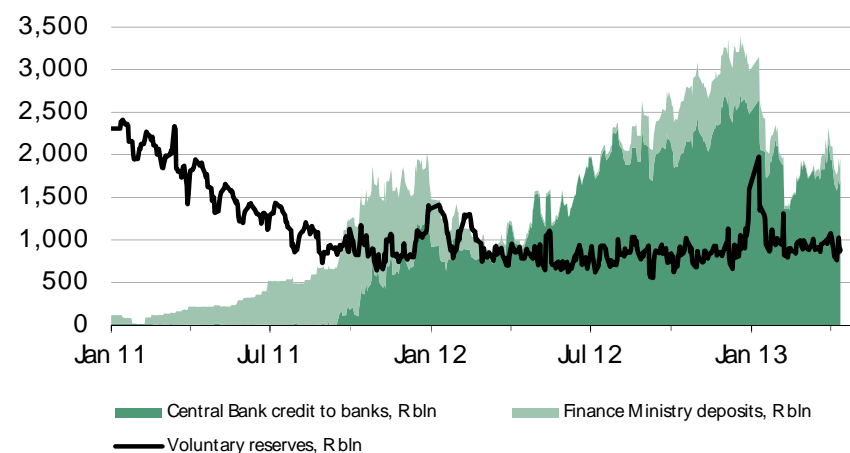
Source: Central Bank, Finance Ministry, Sberbank Investment Research

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

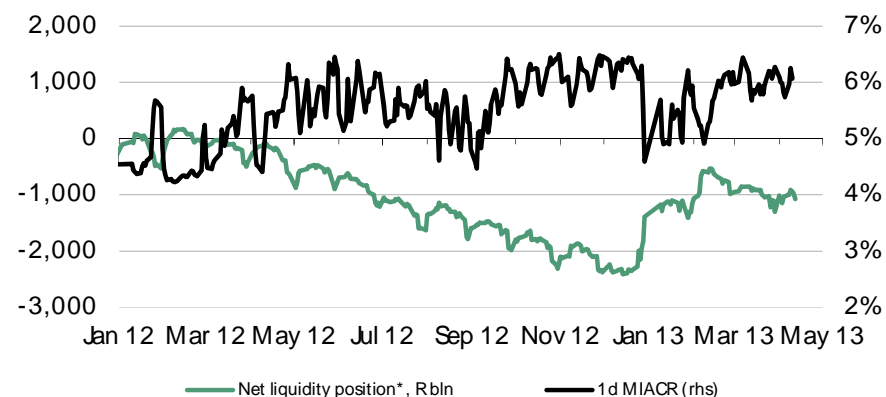


Source: Central Bank, Sberbank Investment Research

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

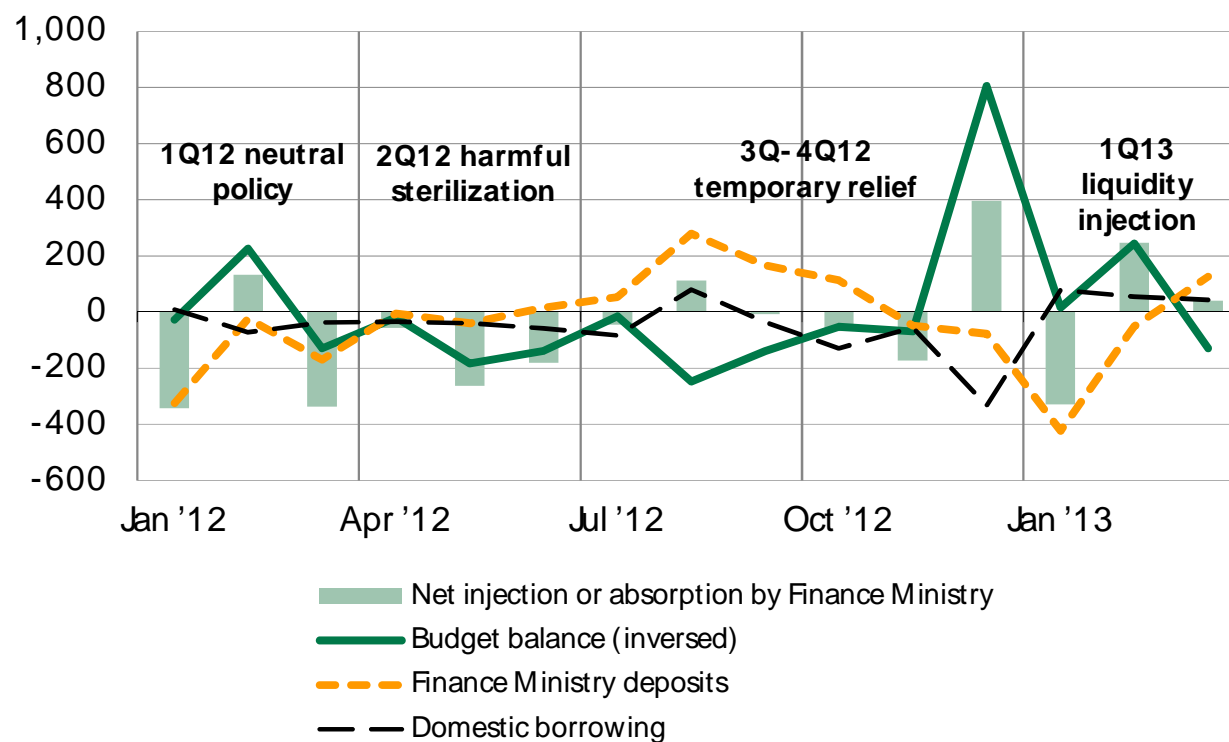


Source: Central Bank



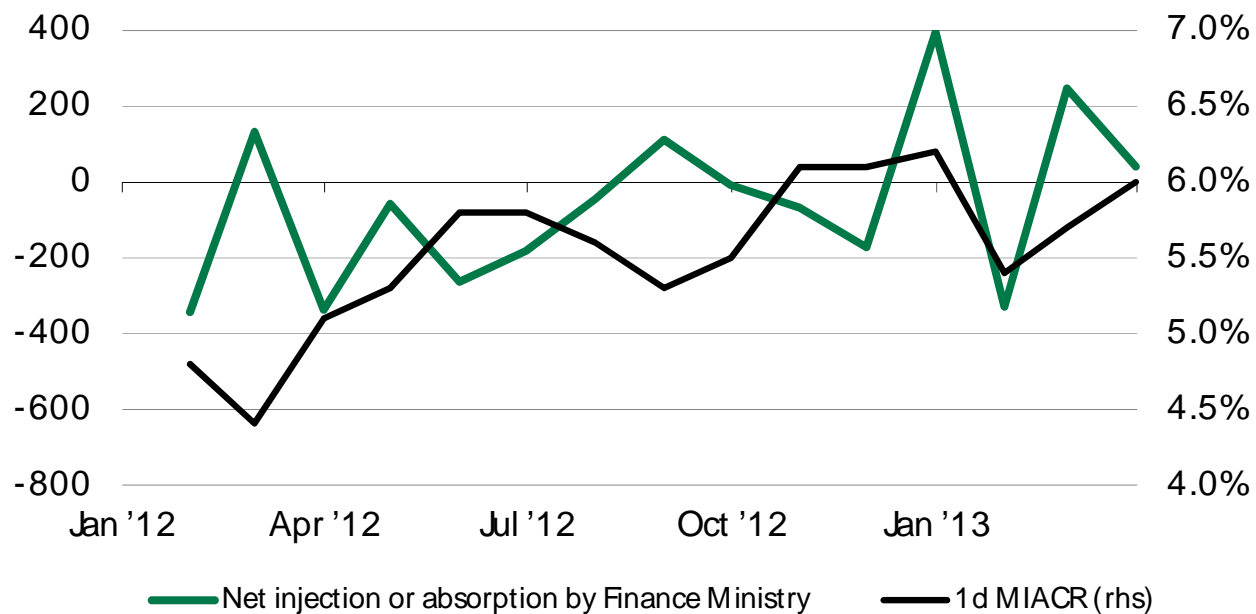
* calculated as the difference between banks' voluntary reserves and refinancing by the monetary and fiscal authorities
Source: Central Bank

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



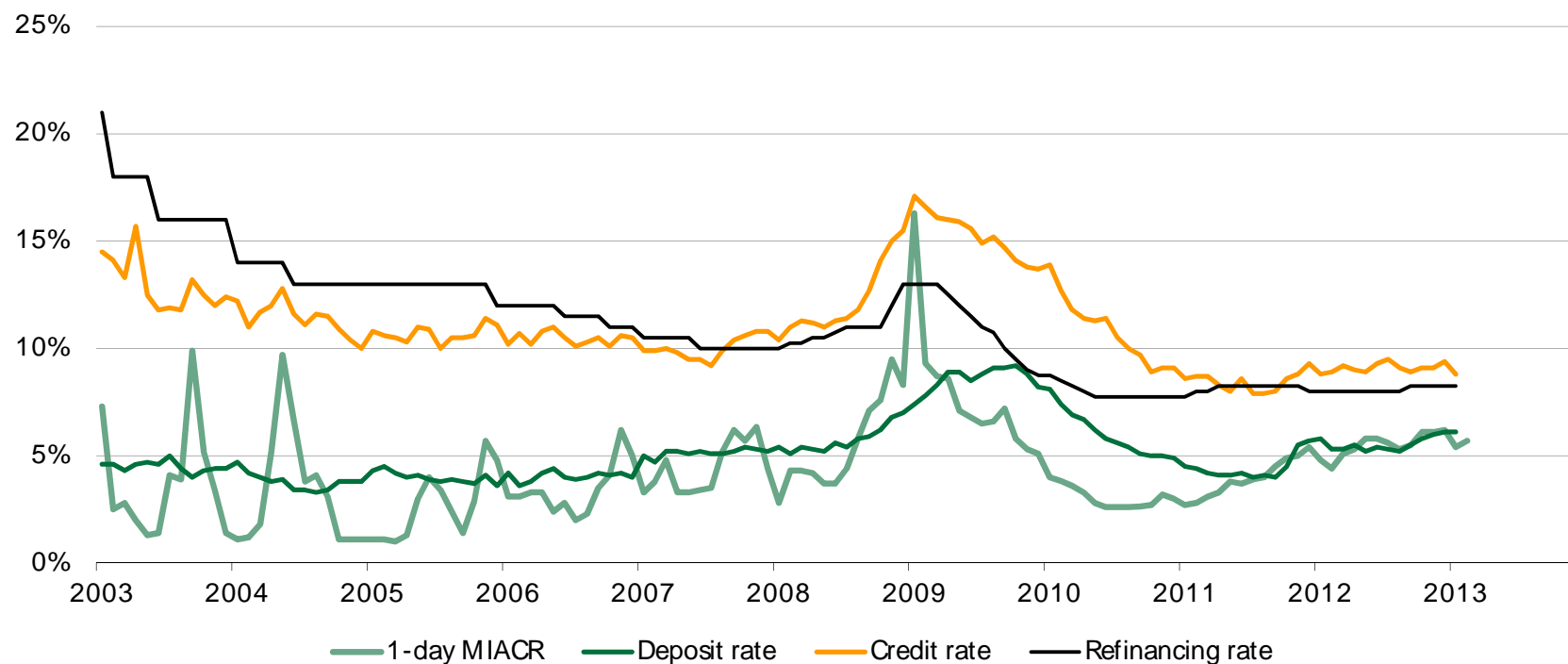
Note: Injection of liquidity (+), absorption of liquidity (-)
Source: Finance Ministry, Central Bank, Sberbank Investment Research

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



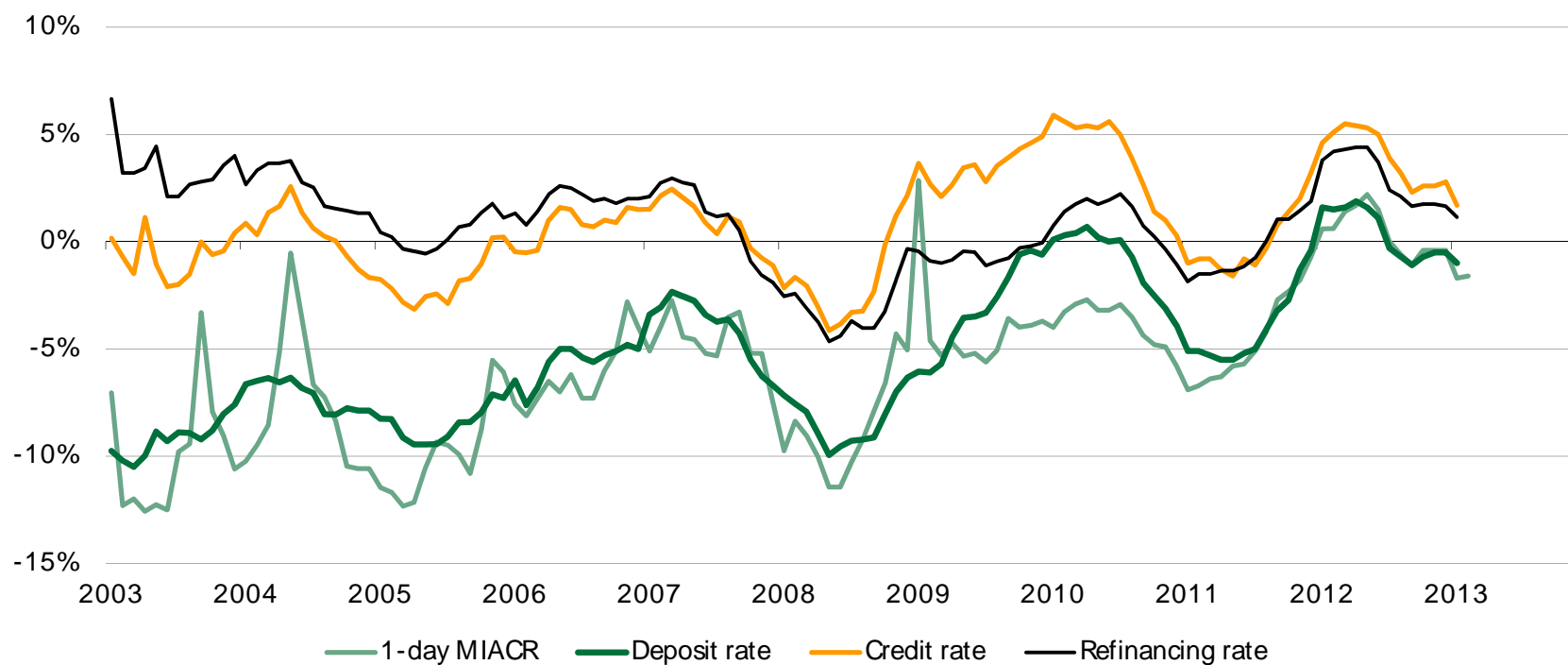
Source: Central Bank, Finance Ministry, Sberbank Investment Research

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



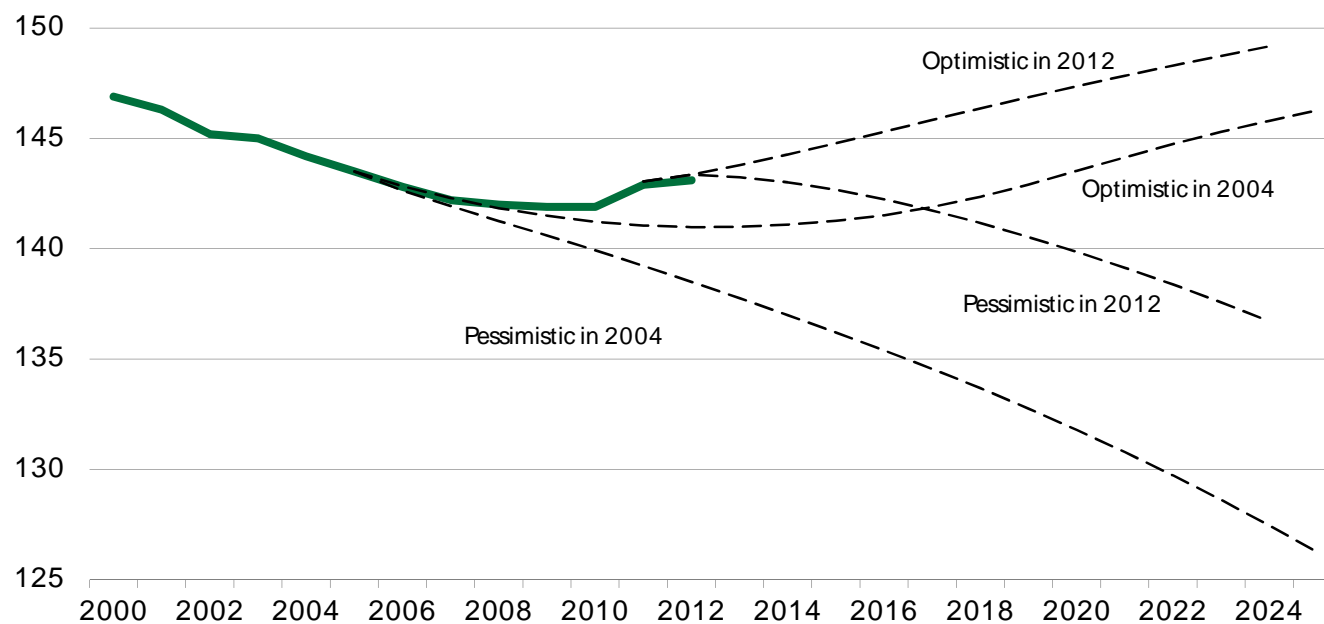
Source: Central Bank

Real interest rates are turning positive



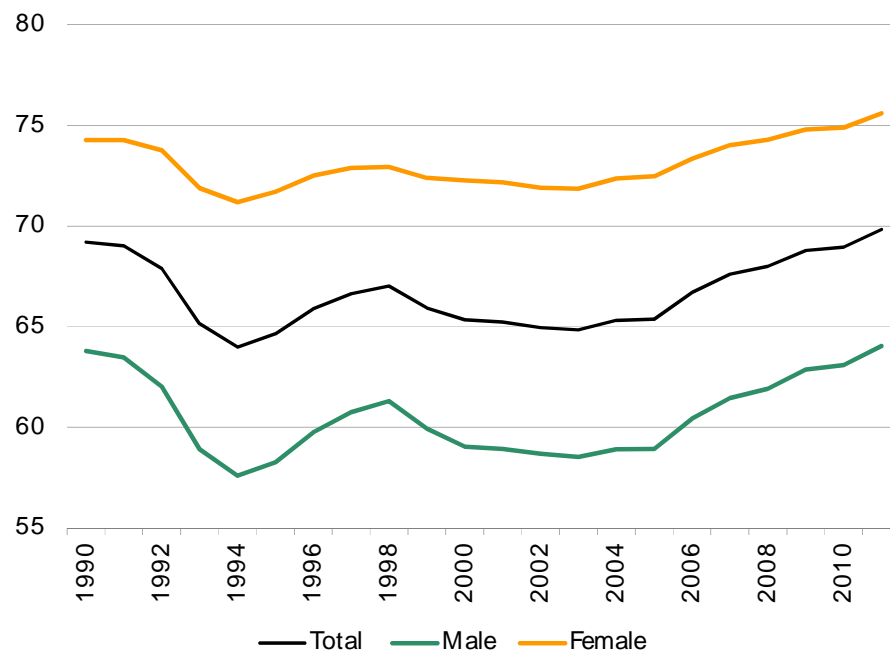
Source: Central Bank, State Statistics Service, Sberbank Investment Research

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

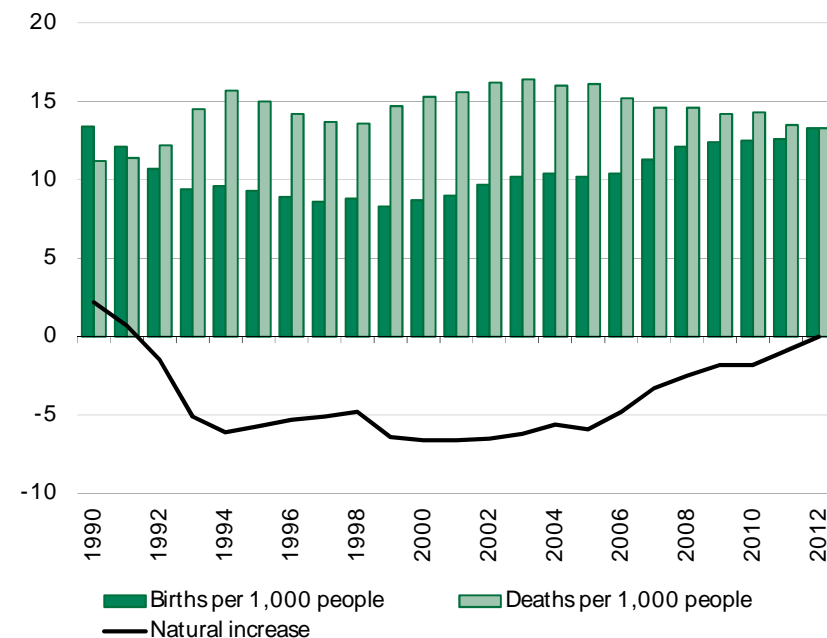


Source: State Statistics Service

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



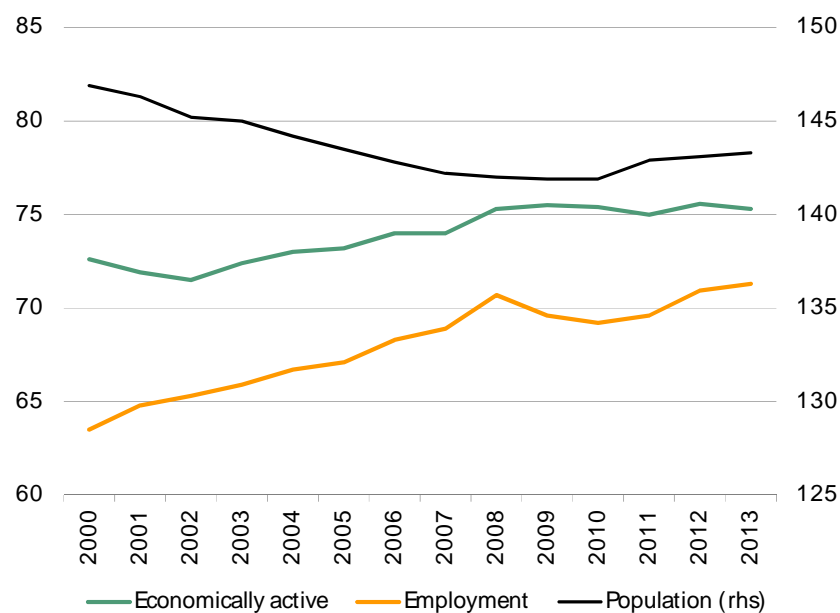
Source: State Statistics Service



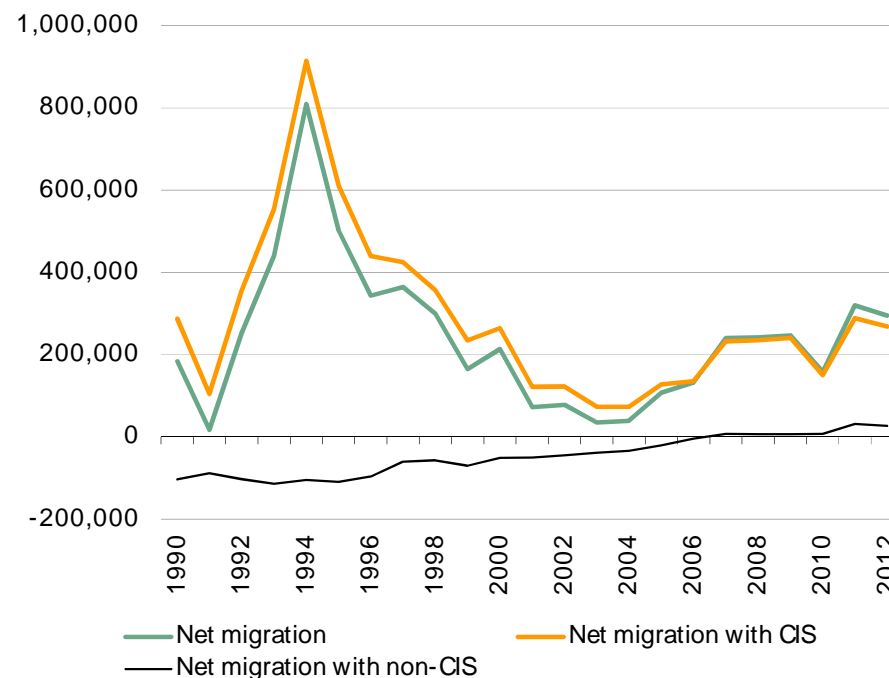
Source: State Statistics Service

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



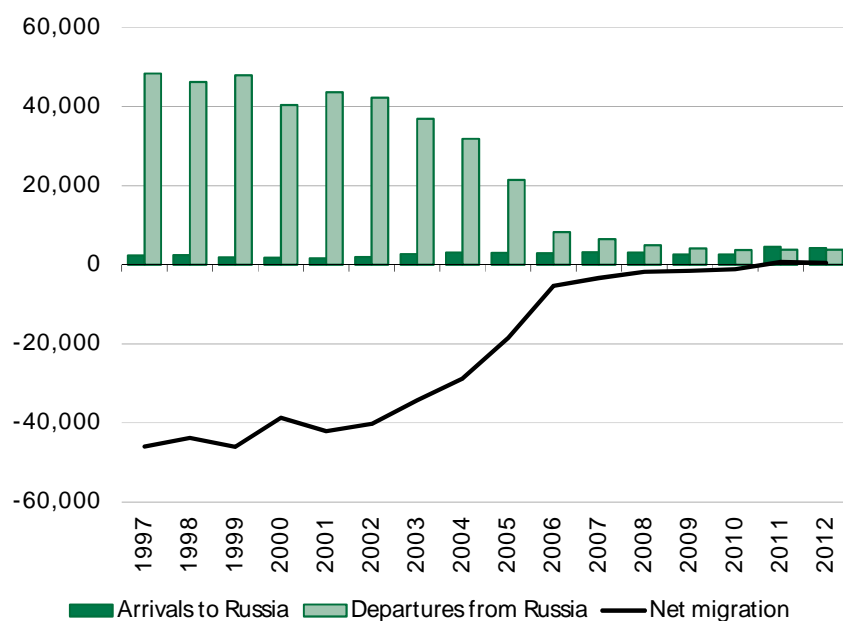
Source: State Statistics Service



Source: State Statistics Service

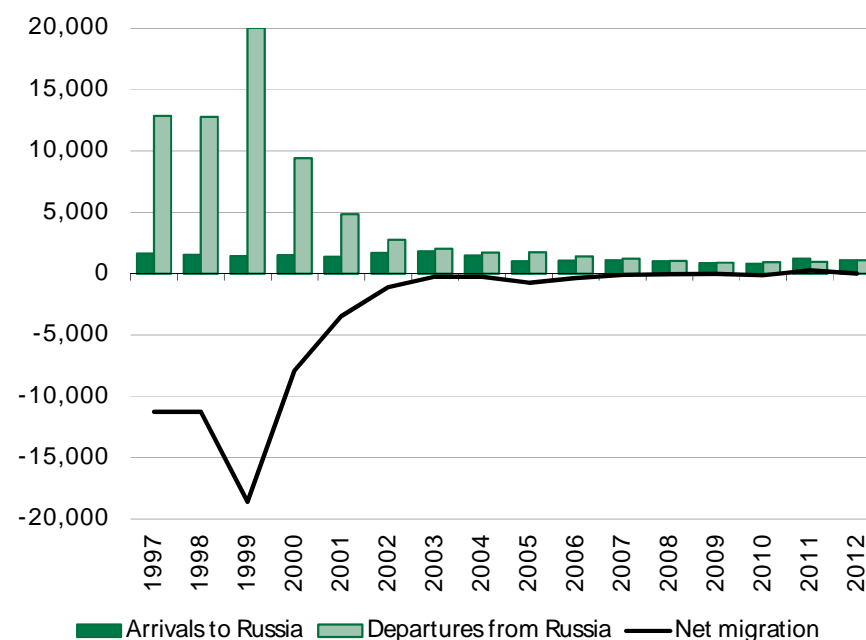
Examples of net migration between Russia and select non-CIS countries

Germany



Source: State Statistics Service

Israel



Source: State Statistics Service

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