

CIS: In Search of New Growth Drivers

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Major economies seem to have recovered from the 2008 crisis, but global economic growth remains slow, economic imbalances persist in many countries and risks are rising as policies remain unconventional

- Global economic growth after 2008 has largely been driven by government stimulus and higher debt, particularly in developed countries.
- Russia is largely immune from debt problems, but inconsistent economic policy is impeding growth.
- In China, economic stimulus has also helped to keep investments up and maintain strong economic growth. China's role as a global growth driver has increased and the impact of China on CIS developments will grow in importance.
- Over the past 25 years, China has doubled the volume of fixed capital formation as a percentage of GDP, indicating a steady decline in its effectiveness. Over the past three years, this ratio has fallen slightly, accompanied by decelerating growth. The search for a “new normal,” i.e. more efficient but most likely slower growth, is a new trend in Chinese economic policy. A new “Silk Road” is another long-term project.
- The sustained decline in the effectiveness of investment has built up financial imbalances, such as risks arising from dynamic imbalances between assets and liabilities in the financial sector (including shadow banking). Risks are manageable, and greater capital account transparency combined with the internalization of the Chinese currency is a step in the right direction.
- Given that developed country debt is much higher, these countries still greatly depend on stimulus such as the EU's QE and consistently low policy rates in the US. The IMF outlook for developed countries suggests relatively slow growth until 2020, which could mean that the reliance on stimulus will remain strong. Macroeconomic imbalances could persist, and the risk of destabilization could be high if money market rates start to rise unexpectedly.

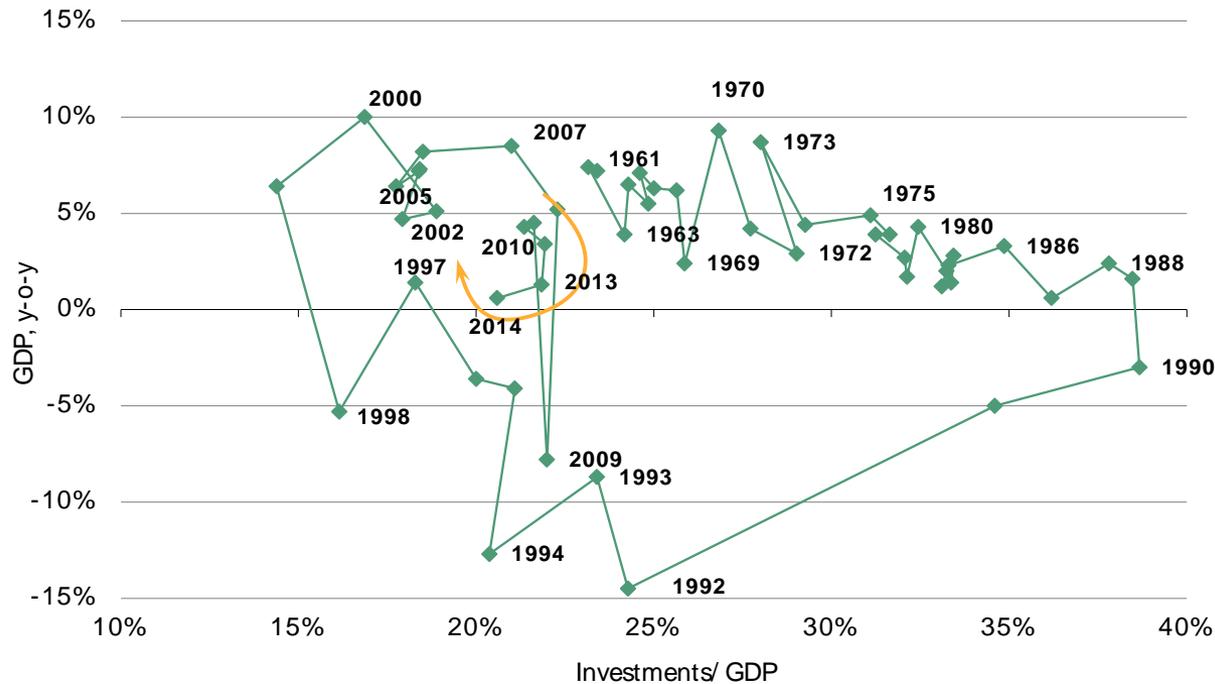
Russia's GDP grew just 0.6% in 2014, while the financial sector expanded 8.8%; GDP is likely to contract moderately in 2015

	2009	2010	2011	2012	2013	2014
Agriculture, hunting and forestry	1.5%	-12.1%	14.7%	-3.8%	3.0%	1.5%
Fishing	5.6%	-9.1%	4.1%	1.9%	3.7%	-4.1%
Mining and quarrying	-2.4%	6.6%	3.4%	1.6%	0.9%	0.7%
Manufacturing	-14.6%	8.6%	6.3%	2.8%	1.2%	2.5%
Electricity, gas and water supply	-4.7%	4.0%	0.0%	0.6%	-2.3%	-0.1%
Construction	-14.7%	4.4%	7.6%	2.6%	-2.4%	-5.1%
Wholesale and retail trade; repair of motor vehicles, motorcycles and personal and household goods	-5.8%	5.8%	3.2%	3.8%	1.1%	0.6%
Hotels and restaurants	-14.9%	6.5%	6.6%	3.7%	1.9%	-2.0%
Transport, storage and communications	-8.6%	5.5%	6.5%	3.9%	1.0%	0.3%
Financial intermediation	1.5%	0.3%	3.5%	18.2%	11.5%	8.8%
Real estate, renting and business activities	-4.5%	6.0%	2.2%	7.1%	2.0%	0.7%
Public administration and defence; compulsory social security	-0.1%	-0.3%	-3.2%	0.8%	1.2%	-0.3%
Education	-1.4%	-1.8%	-0.8%	0.3%	0.0%	-0.7%
Health and social work	-0.2%	0.3%	1.1%	3.0%	3.1%	1.0%
Other community, social and personal service activities	-20.0%	2.2%	-0.4%	-3.5%	-1.1%	-2.7%
Net taxes on goods	-14.0%	7.3%	7.0%	3.4%	1.0%	0.1%
GDP at basic prices	-6.7%	4.1%	3.8%	3.4%	1.4%	0.7%
GDP	-7.8%	4.5%	4.3%	3.4%	1.3%	0.6%

Source: State Statistics Service

Russia's economic slowdown may persist, which will have a negative impact on CIS economies: Russia's search for balanced growth will take time

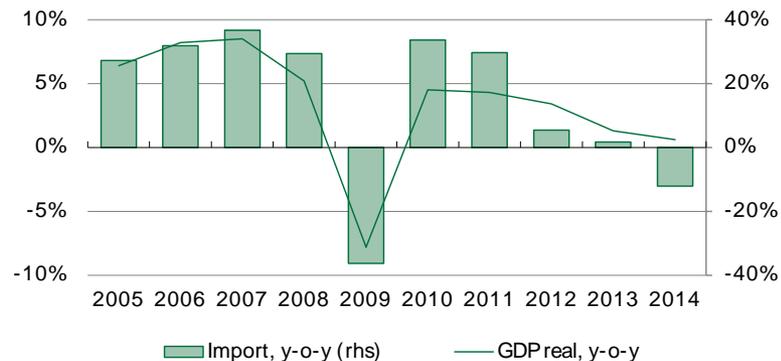
The quality of investments is more important than quantity: less is more



Source: State Statistics Service, Sberbank CIB Investment Research

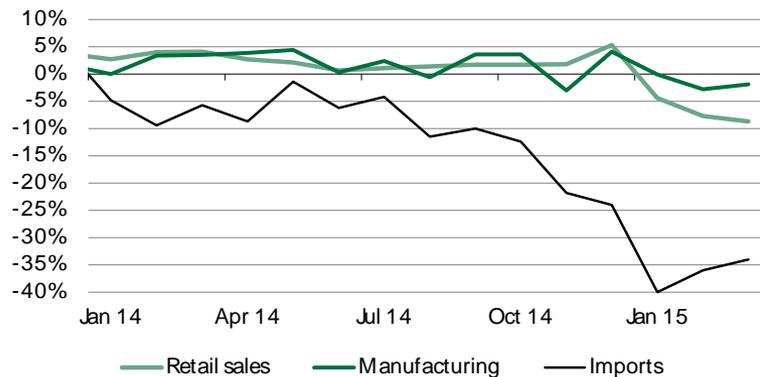
Economy still grew in 2014 as imports contracted

Import growth decelerates



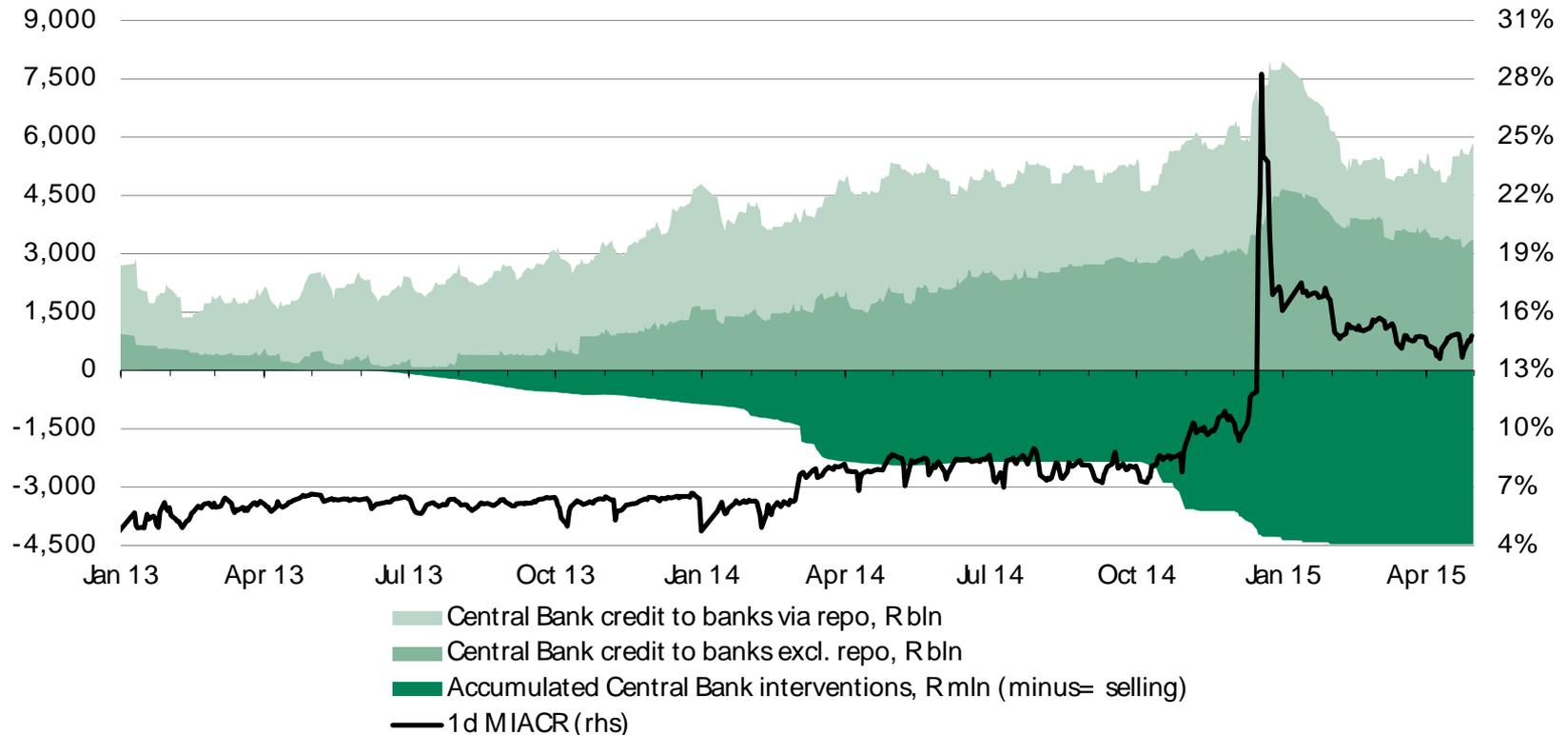
Source: State Statistics Service, CBR

Russians are buying more locally produced goods, y-o-y



Source: State Statistics Service, CBR

Since 1H13 the CBR has increased efforts to refinance banks but has at the same time been absorbing liquidity by buying FX; inflation has accelerated and rates have jumped as a result of the CBR key rate hike

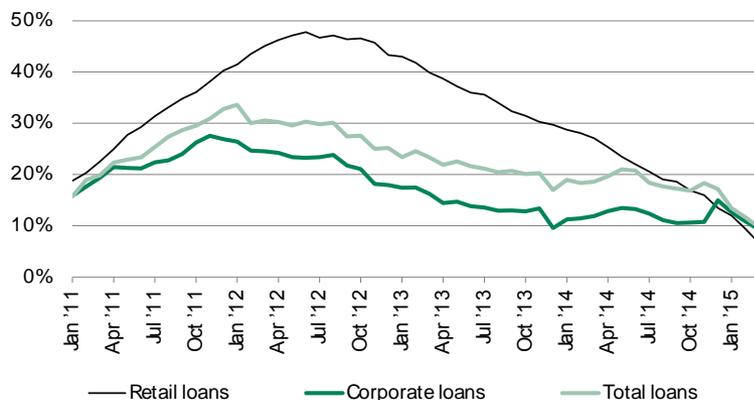


Note: CBR credit includes FX swaps.

Source: CBR, Sberbank CIB Investment Research

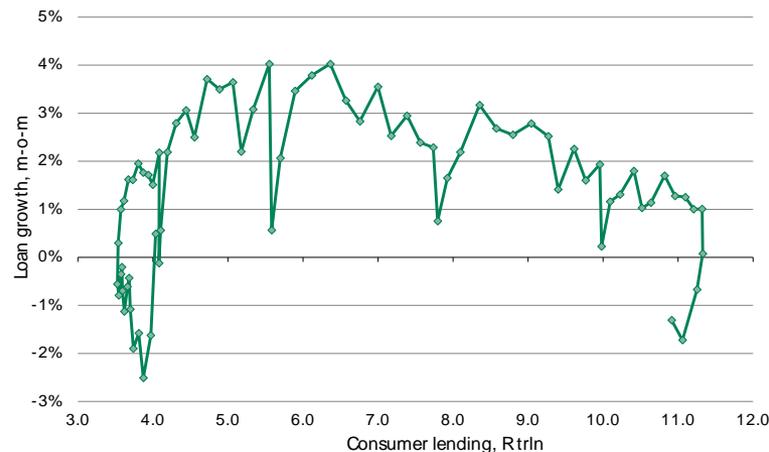
Consumer loan growth was too fast in 2011-12 and started to slow sharply in 2013; deleveraging will continue to suppress demand

Consumer lending expanded more than 40% in 2011-12, which also contributed to accelerating inflation, but is now slowing, y-o-y



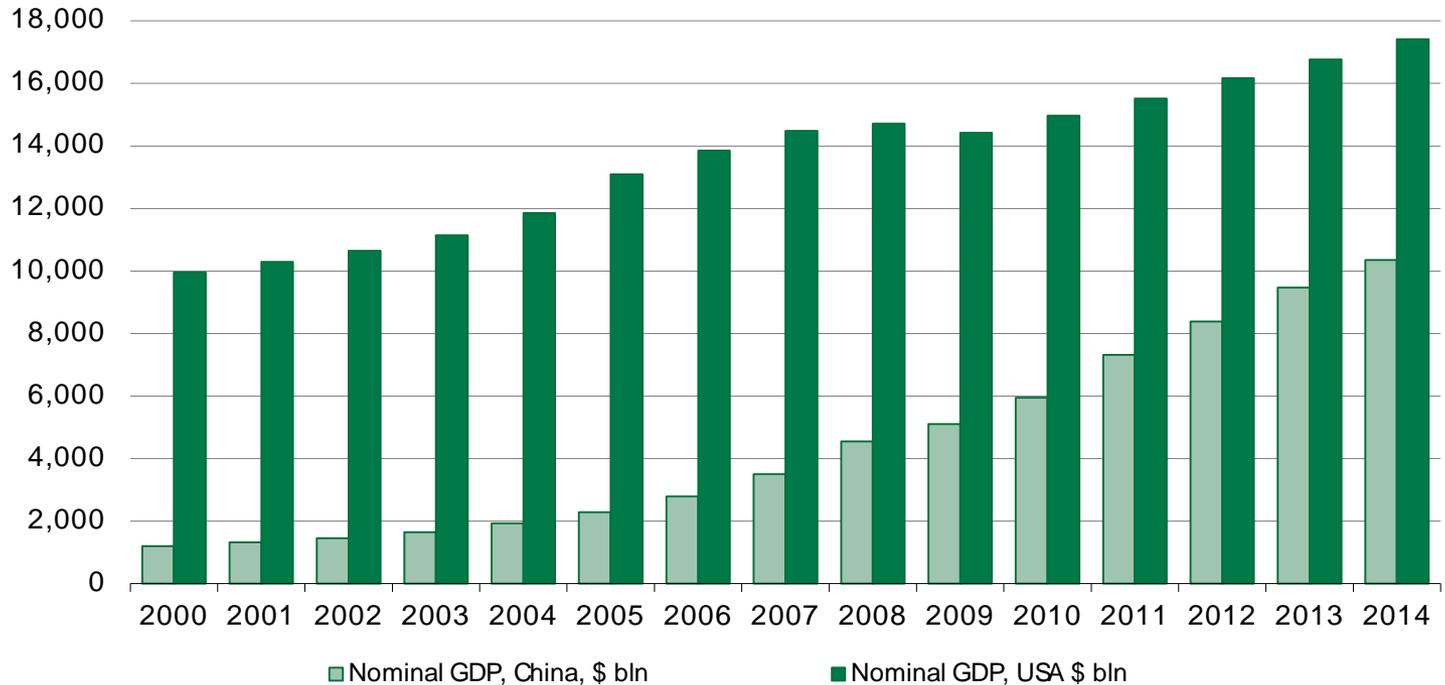
Note: Only ruble denominated credits are used, to exclude the revaluation effect.
Source: CBR

Consumer credits volumes



Data: 2009-3m15
Source: CBR

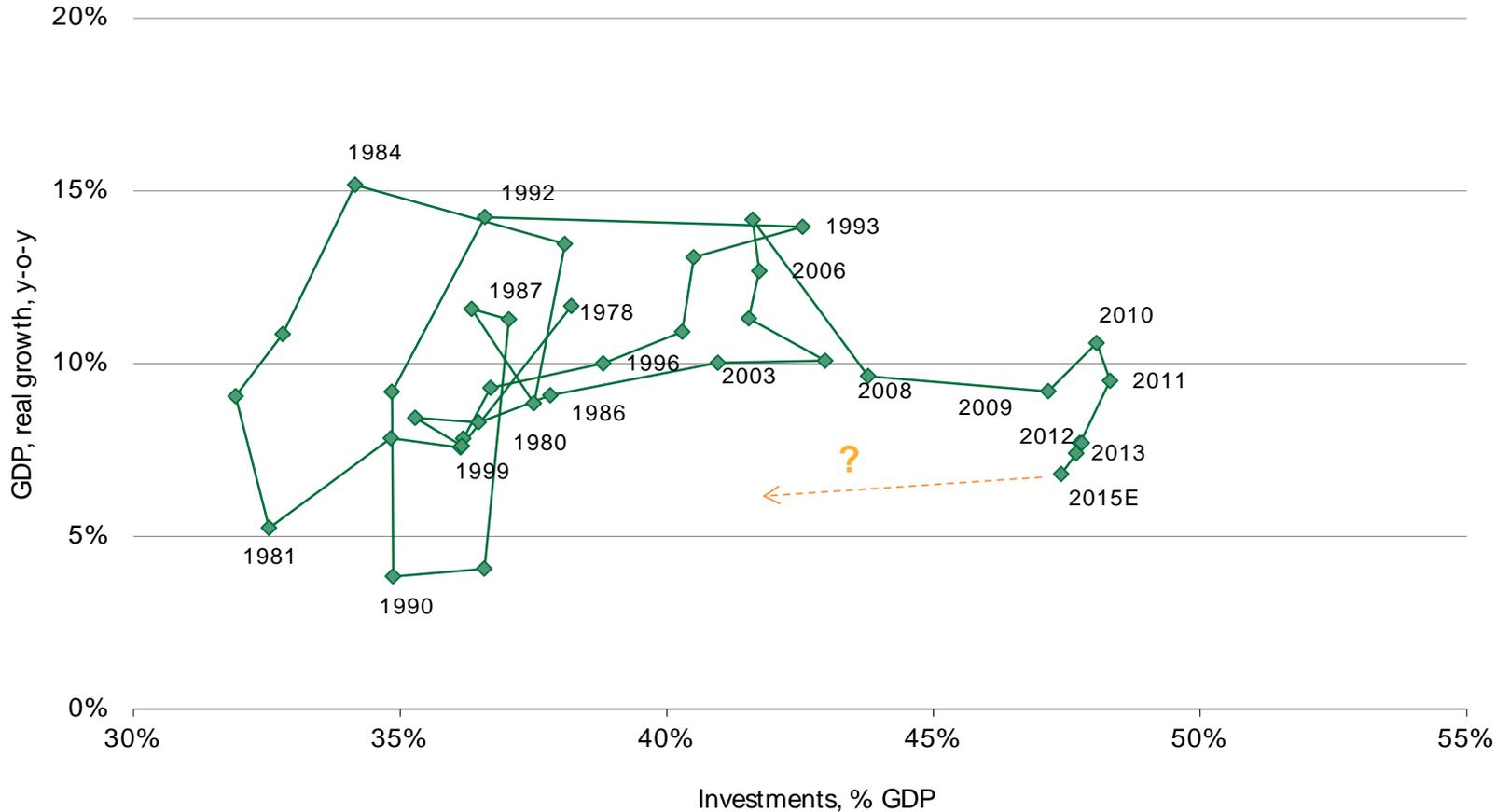
The Chinese economy is already more than half the size of the US economy and is expanding by up to \$1.0 trln per year



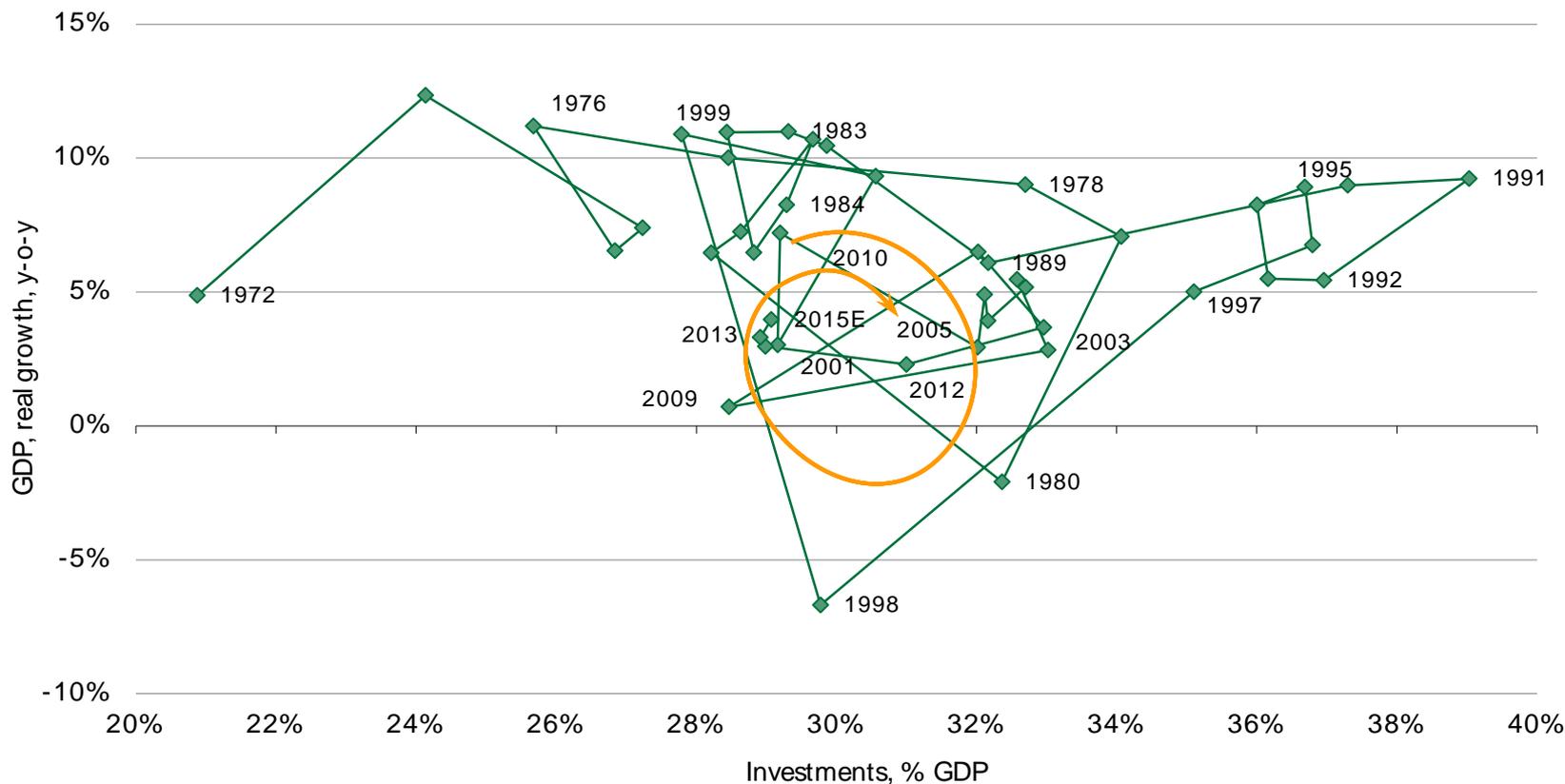
Source: IMF



China: same rapid growth in investments, buildup of financial problems (in particular, rapid growth of the shadow banking system) and critical importance of solving outstanding issues



South Korean example: doubling of investment as a percentage of GDP amid a buildup of financial imbalances, correction of 1997-98 and a period of more moderate economic trends



Source: IMF, Bank of Korea

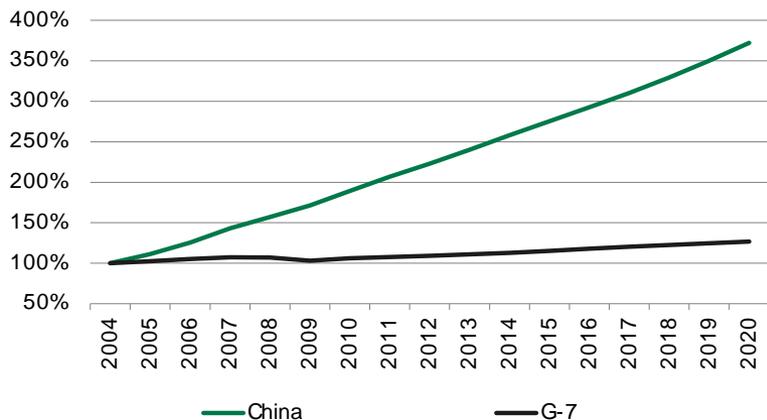
China's "contribution" to global "imbalances": its share in global GDP (2014) is much bigger than its IMF quota (as is the case for some other EM countries)...

	IMF quota	IMF votes	GDP, % of world (current prices)	GDP, % of world (PPP valuation)	External debt, % GDP	Central government gross debt, % GDP
China	4.0%	3.8%	13.4%	16.3%	8.6%	43.5%
G-7	45.4%	43.1%	46.1%	32.2%	124.1%	118.4%
Canada	2.7%	2.6%	2.3%	1.5%	82.9%	86.5%
France	4.5%	4.3%	3.7%	2.4%	189.3%	95.1%
Germany	6.1%	5.8%	5.0%	3.4%	145.1%	73.1%
Italy	3.3%	3.2%	2.8%	2.0%	114.7%	132.1%
Japan	6.6%	6.2%	6.0%	4.4%	59.2%	246.4%
United Kingdom	4.5%	4.3%	3.8%	2.4%	325.9%	89.5%
United States	17.7%	16.8%	22.5%	16.1%	97.3%	104.8%
Brazil	1.8%	1.7%	3.0%	3.0%	23.7%	65.2%
India	2.4%	2.3%	2.7%	6.8%	23.4%	65.0%
Russia	2.5%	2.4%	2.4%	3.3%	35.9%	17.9%
Indonesia	0.9%	0.9%	1.1%	2.5%	36.2%	25.0%
Netherlands	2.2%	2.1%	1.1%	0.7%	330.3%	68.3%

Source: IMF, Euromonitor

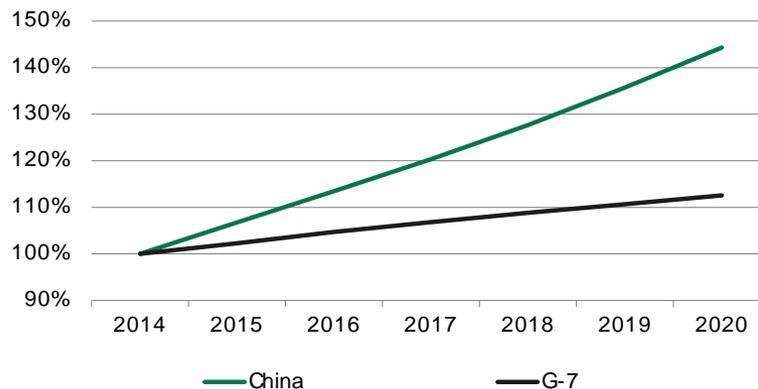
...and it is set to rise, which makes the attempt to develop alternative international financial institutions a natural decision; the latter will affect CIS countries

GDP projected growth, 2004 = 100%



Source: IMF

GDP projected growth, 2014 = 100%



Source: IMF

As opposed to the G7, China's growth has not been inflated much by internal imbalances...

	GDP index growth, 10y	Current account balance, % GDP, 5y average	Current account balance, % GDP, 2014	Budget balance, % GDP	Government securities yield*	Interest payments, % of budget revenues**
China	258.0%	2.5%	2.0%	-1.1%	3.5%	3.3%
G-7	112.7%	-0.9%	-0.8%	-4.6%	0.5%	-
Canada	120.6%	-2.9%	-2.2%	-1.8%	1.7%	7.9%
France	108.8%	-1.2%	-1.1%	-4.2%	0.7%	5.5%
Germany	113.8%	6.6%	7.5%	0.6%	0.5%	4.9%
Italy	95.2%	-0.8%	1.8%	-3.0%	1.5%	13.4%
Japan	106.0%	1.7%	0.5%	-7.7%	0.4%	15.6%
United Kingdom	112.6%	-3.6%	-5.5%	-5.7%	1.8%	7.6%
United States	116.8%	-2.7%	-2.4%	-5.3%	2.1%	13.5%
Brazil	139.5%	-2.7%	-3.9%	-6.2%	4.5%	21.7%
India	209.2%	-3.0%	-1.4%	-7.2%	-	24.9%
Russia	139.2%	3.6%	3.2%	0.9%	5.1%	1.8%
Indonesia	177.1%	-1.6%	-3.0%	-2.2%	3.9%	-
Netherlands	110.6%	9.0%	10.3%	-2.3%	0.6%	3.8%

* 10y generic government bonds are used

** 2012 or 2013 data

Source: IMF, Bloomberg, World Bank

The search for a “new normal” in developed countries is more challenging

- The yet-to-be-identified “new normal” in developed countries is being complicated by unconventional monetary policy, which contributes to increased market volatility, as recently seen on the oil and FX markets. The oil price has yet to find a new normal range.
- A mix of slow wage growth and with high indebtedness will restrain economic growth. Near zero inflation and sluggish growth will in turn complicate the deleveraging process. Debt problems are far from being solved in many countries, such as Greece and Italy.
- The exit strategy from unprecedented monetary easing orchestrated by major central banks remains unclear, which will keep markets nervous and volatile. Dependence on monetary stimulus may last longer than expected.
- Steps to decouple (to the extent possible) from potential new global shocks by gradually creating parallel financial institutions looks natural for less leveraged and faster growing emerging markets. Another reason to create parallel financial institutions is the lack of reforms at the existing entities.
- The AIIB can be seen as just one element of the mentioned evolution of the international financial system, which will help to support economic growth in the region.

In search of the “new normal”: China’s financial sector has problems, including bad debt, but they are surmountable. Inflation is significantly lower than economic growth, which provides a stark contrast to developed economies

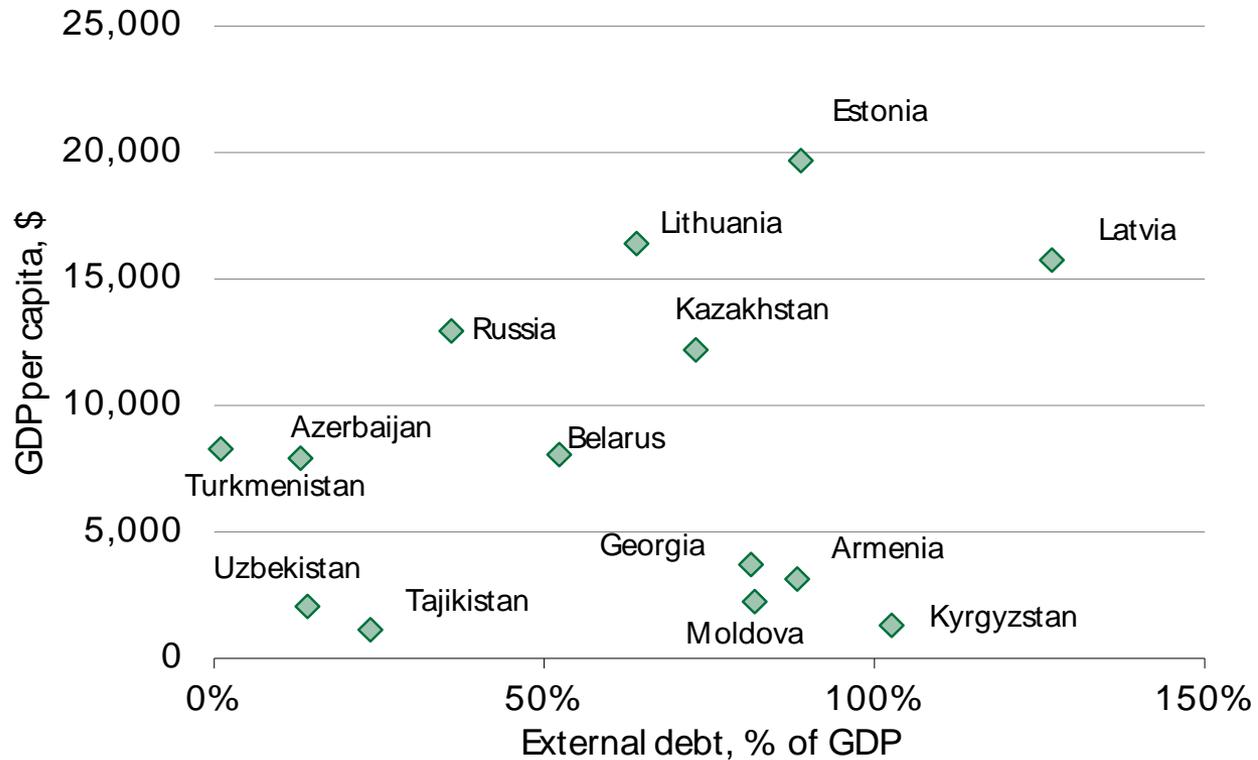
- China’s financial system is still relatively closed off and small compared with the US, so any potential worsening in China’s financial stability would be much more self-containable. Also, the yuan’s role in the global economy is not yet comparable with that of the dollar.
- GDP per capita is still relatively low in China, which helps the country to remain sufficiently competitive despite the fact that Chinese companies’ costs have clearly been rising faster than wages in recent years.
- China has been forced to significantly reduce investment growth, which has naturally applied the brakes to economic expansion. It would be no surprise to see the country’s economic growth in real terms coming in at around 5-6% per year for the next two to three years; even in this scenario, nominal GDP would expand by the “usual” \$1 trln annually.
- In two to three years, China’s economy will be more comparable in size with that of the US, though its financial system will remain much smaller. China’s debt market in particular is still relatively small and has huge development potential.
- The development of the bond market is necessary for market-based refinancing of banks and further liberalization of the capital account and globalization of the yuan.

CIS economics: divergent trends, as initial conditions, policies and challenges are different

- Economic trends continued to diverge in Belarus, Ukraine and Kazakhstan in 1Q15 (as well as in the other CIS countries). Some countries were more negatively affected by the Russian economic contraction, while others (such as Kazakhstan and Azerbaijan) were impacted by the oil price shock.
- Following the depreciation of the Russian ruble last year, the Belarusian authorities initiated a new exchange rate regime. Rather than allowing steady local currency depreciation, as in the past, the authorities opted for a one-off devaluation of around one third in January, after which greater flexibility was allowed. Since then, the Belarusian currency has generally followed its Russian counterpart. This has helped Belarus to support its balance of payments. However, the country is still dependent on external borrowing as its reserves shrank last year but debt repayments are biting.
- The Kazakh authorities have remained firm, keeping the nominal tenge relatively stable. The Ukrainian hryvnia, meanwhile, faced a rollercoaster ride at the beginning of the year, with drastic depreciation followed by a spike upward after the announcement of the IMF deal.

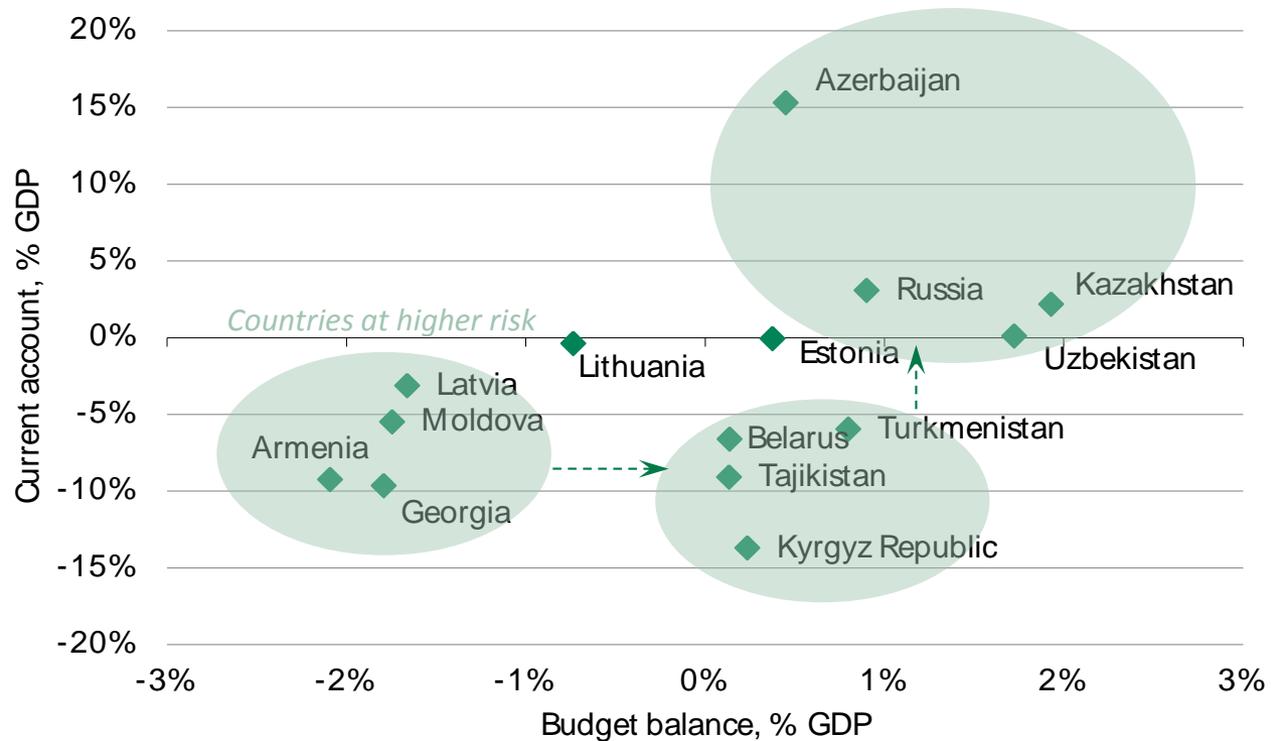
FSU GDP per capita and external borrowing, 2014

Foreign borrowing helps inflate GDP per capita, but to a certain limit



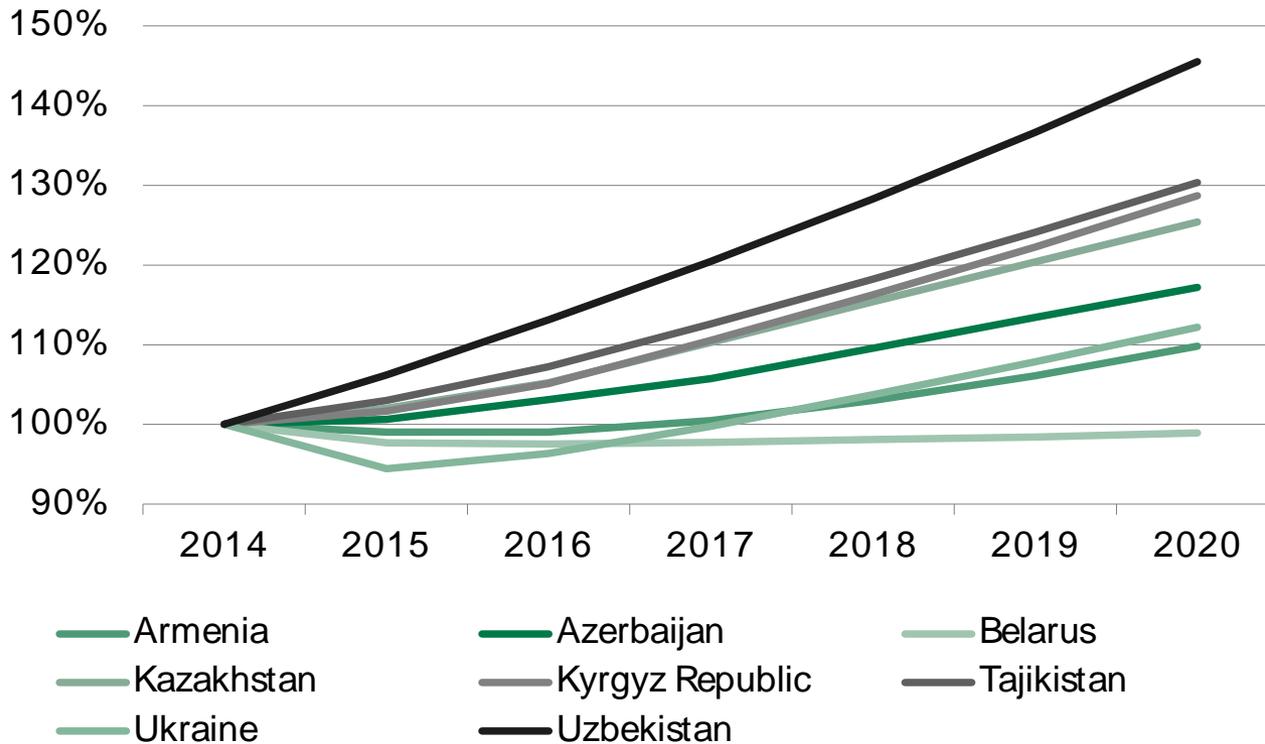
Source: IMF, Euromonitor, Reuters

Macroeconomic imbalances differ across the region



Source: IMF, Euromonitor, Reuters

Growth trajectories are set to diverge across the CIS



Source: IMF

Russia remained an important trade partner for some CIS countries in 2014

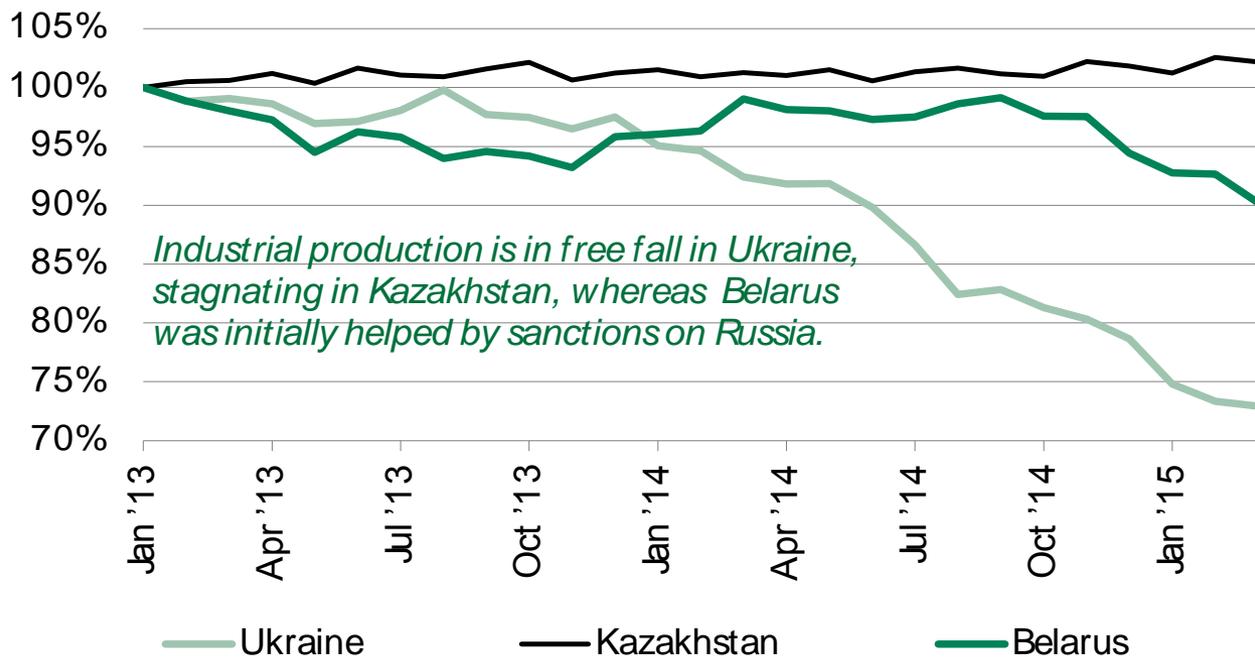
		Exports, \$ bln				
		Russia	Belarus	Kazakhstan	Ukraine	Other
Imports, \$ bln	Russia	–	11.8	5.2	9.8	259.2
	Belarus	19.7	–	0.3	1.6	16.7
	Kazakhstan	13.7	0.7	–	1.2	25.5
	Ukraine	17.1	4.0	1.7	–	31.6
	Other	446.4	19.3	71.1	41.3	–

	Trade turnover			
	Russia	Belarus	Kazakhstan	Ukraine
Russia	–	42.5%	15.8%	24.9%
Belarus	4.0%	–	0.9%	5.2%
Kazakhstan	2.4%	8.0%	–	2.7%
Ukraine	3.4%	7.5%	2.4%	–
Other	90.1%	41.9%	80.9%	67.3%

Source: State statistics agencies, Sberbank CIB Investment Research

Industrial growth diverged in Belarus, Ukraine and Kazakhstan...

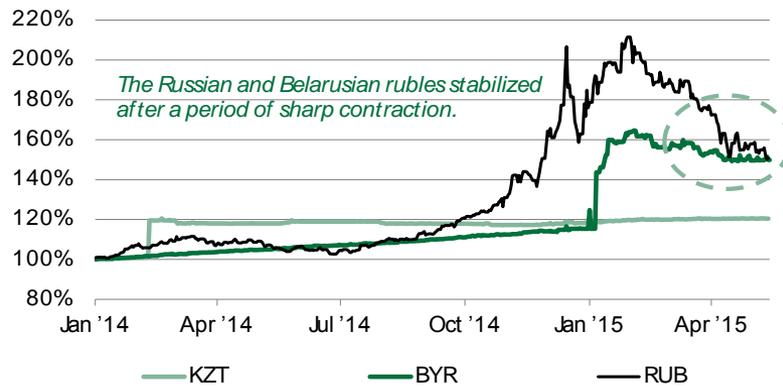
Seasonally adjusted industrial production, January 2013=100%



Source: State statistics agencies, Sberbank CIB Investment Research

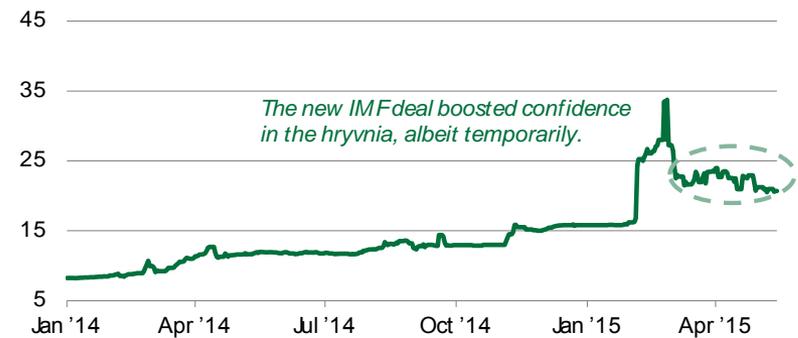
... as did exchange rates, which are not yet in equilibrium

Nominal exchange rate vs USD, January 2014= 100%



Note: increase denotes depreciation in nominal terms
Source: Bloomberg, Sberbank CIB Investment Research

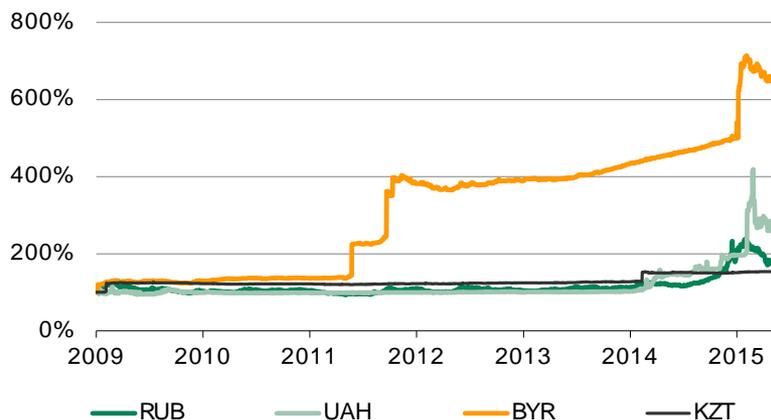
USD/UAH, nominal exchange rate



Source: Bloomberg, Sberbank CIB Investment Research

While nominal exchange rates diverged there was greater degree of convergence of real effective rates

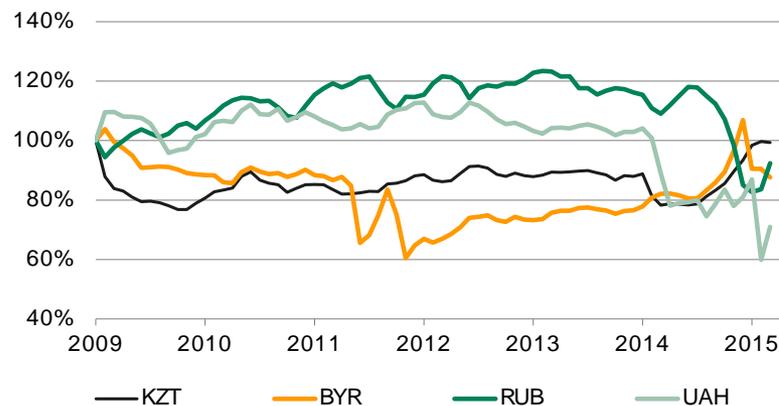
Nominal exchange rates, January 2009=100%



Note: increase denotes depreciation in nominal terms

Source: Bloomberg

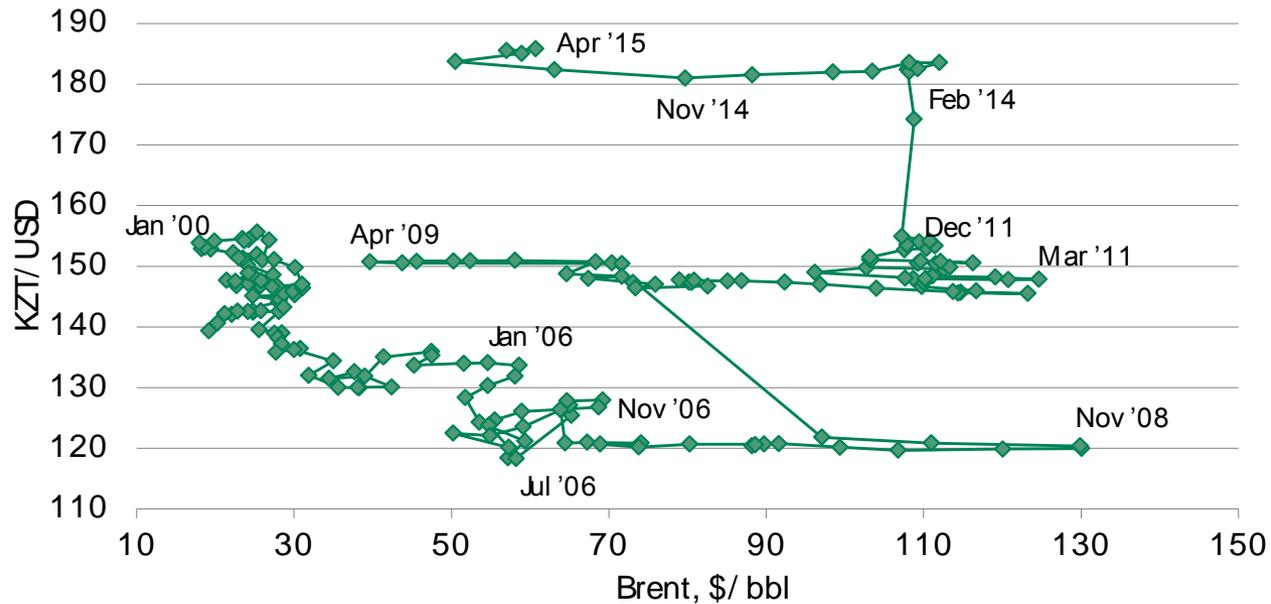
Real effective rates, January 2009 =100%



Note: increase denotes appreciation in real terms

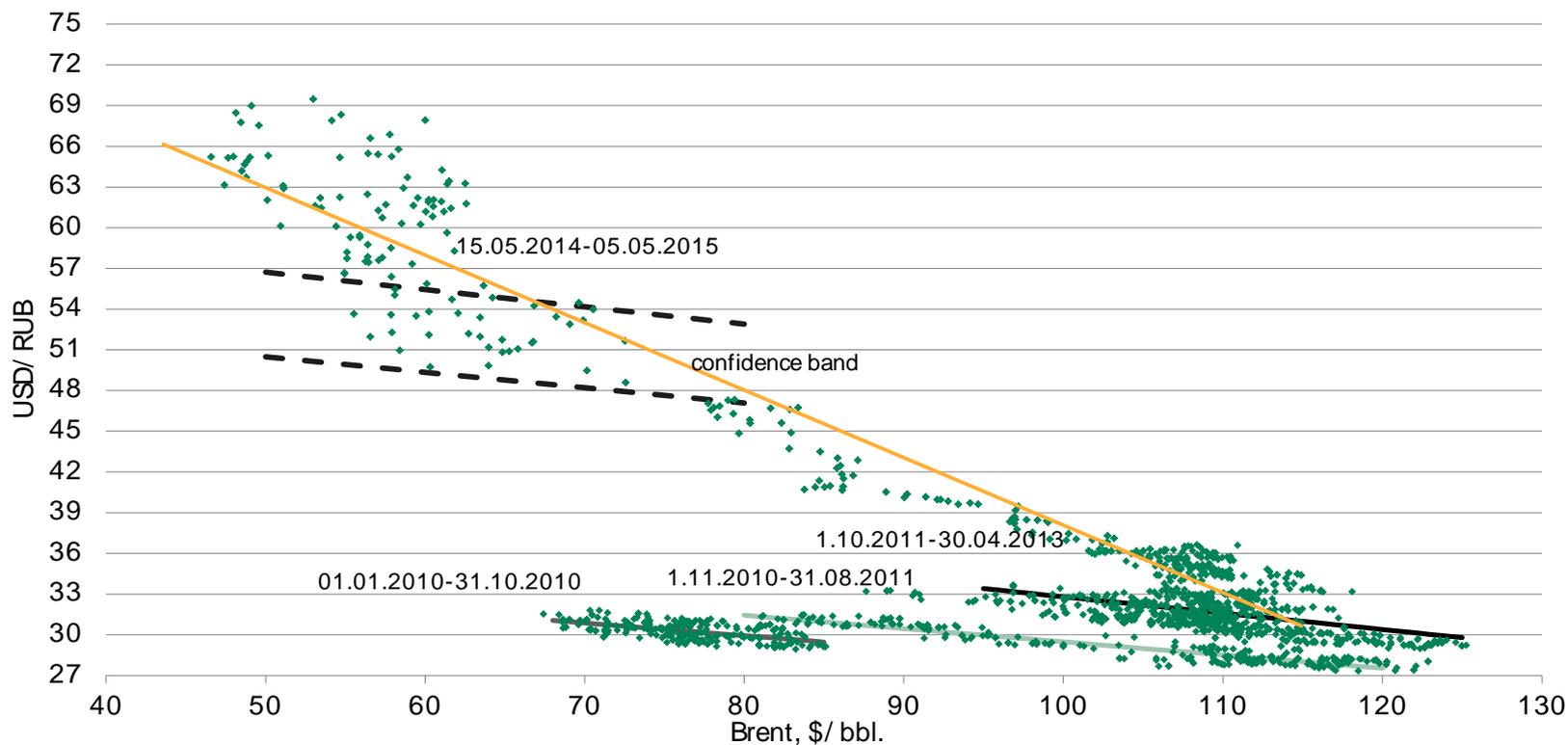
Source: Central banks, Sberbank CIB Investment Research

Different policies: Kazakh National Bank continues to target the tenge



Source: National Bank, Bloomberg

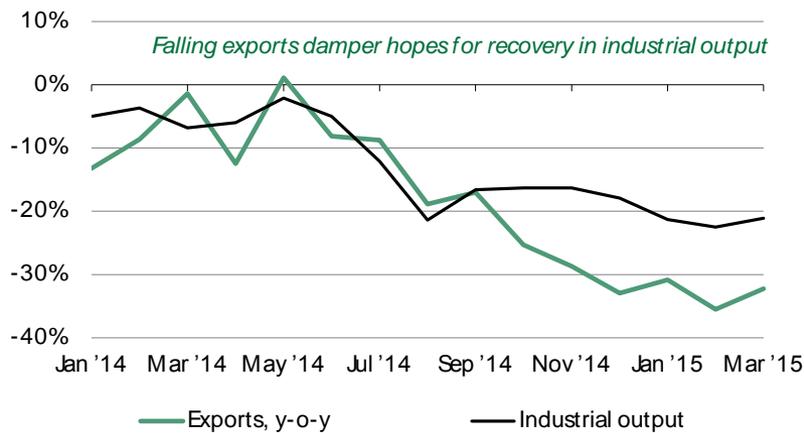
... while the CBR pretends to float the ruble: since mid-2013, the ruble has deviated far from equilibrium due to erratic interventions by the regulator



Source: CBR, Bloomberg, Sberbank CIB Investment Research

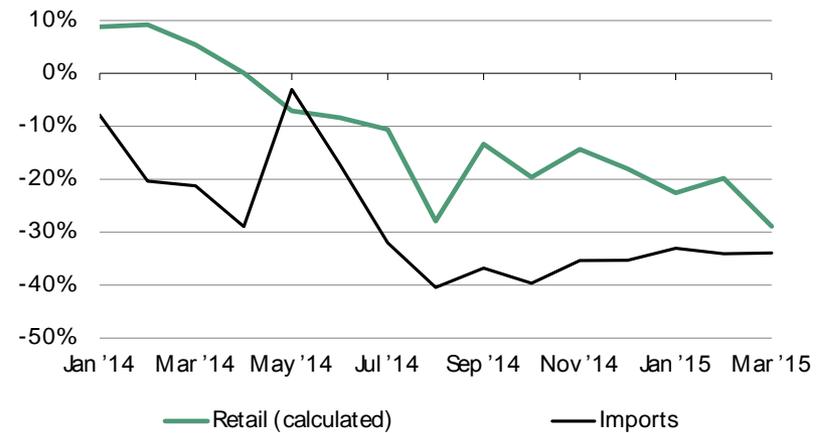
Ukrainian economy has tanked and is still in free fall

Exports, industrial output, y-o-y



Source: National Bank of Ukraine

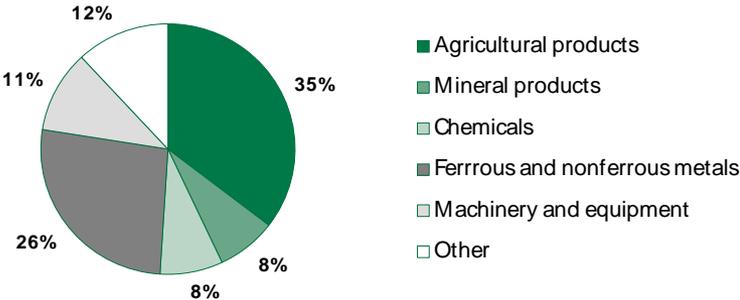
Retail, imports, y-o-y



Source: Ukrainian State Statistics Service, National Bank of Ukraine

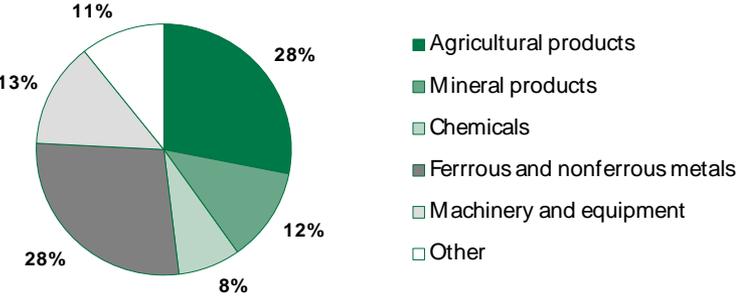
Agricultural exports accounted for 35% of total exports in 1Q15 in Ukraine...

Export structure, 1Q15



Source: National Bank of Ukraine

Export structure, 1Q14



Source: National Bank of Ukraine

... as agriculture was the only sector of the economy to expand
(on top of state administration)

GDP structure by production

	2011	2012	2013	2014	2014 real growth, y-o-y
GDP	100.0%	100.0%	100.0%	100.0%	-6.8%
Agriculture and fishing	8.3%	7.9%	9.1%	10.2%	2.9%
Raw materials extraction	6.7%	6.4%	5.7%	5.1%	-14.2%
Manufacturing	14.1%	12.8%	12.0%	11.4%	-12.0%
Supply and redistribution of electricity, gas and water	3.3%	3.6%	3.3%	2.9%	-8.1%
Construction	3.1%	2.7%	2.5%	2.2%	-19.9%
Wholesale and retail	15.4%	15.6%	15.7%	14.2%	-12.8%
Transport and communications	11.5%	10.1%	9.3%	7.0%	-6.6%
Finance	5.6%	4.4%	4.8%	4.5%	-4.5%
Real estate	8.3%	9.2%	0.1%	6.5%	-3.2%
State administration	4.2%	4.4%	4.6%	4.8%	2.6%
Social security, education, health care	8.1%	9.1%	9.3%	8.4%	-0.9%
Other	2.5%	2.6%	13.4%	9.7%	-11.3%
FISM	-4.0%	-2.8%	-2.6%	-	-
Net taxes	12.9%	14.0%	12.8%	13.1%	-6.3%

Source: Ukrainian State Statistics Service, National Bank of Ukraine

Ukrainian economic contraction will deepen in 2015 as growth turned more negative in 2H14 across the board

GDP structure by use

	2002	2009	2010	2011	2012	2013	2014	2014 real growth, y-o-y
GDP	100%	100%	100%	100%	100%	100%	100.0%	-6.8%
Final consumption	75.4%	84.7%	84.5%	85.5%	90.1%	90.7%	90.0%	-7.4%
Household	55.1%	63.7%	63.4%	66.5%	70.0%	71.5%	70.7%	-9.6%
State	18.4%	20.2%	20.3%	18.2%	19.4%	18.6%	18.6%	0.6%
Non-commercial organizations	1.9%	0.8%	0.8%	0.8%	0.7%	0.7%	0.7%	1.1%
Gross capital formation	19.2%	18.3%	18.1%	18.6%	18.8%	16.9%	14.0%	-29.2%
Fixed capital	18.1%	19.7%	17.7%	16.4%	19.4%	15.2%	13.9%	-23.0%
Changes in inventories	1.0%	-1.3%	0.3%	2.1%	-0.6%	1.6%	0.1%	-95.5%
Net exports	4.4%	-1.7%	-2.9%	-6.2%	-8.4%	-9.2%	-4.1%	-40.9%
Exports	55.1%	46.4%	50.8%	54.4%	50.9%	43.0%	49.2%	-14.5%
Imports	50.7%	48.1%	53.7%	60.6%	59.3%	52.2%	53.2%	-22.1%

Source: Ukrainian State Statistics Service, National Bank of Ukraine

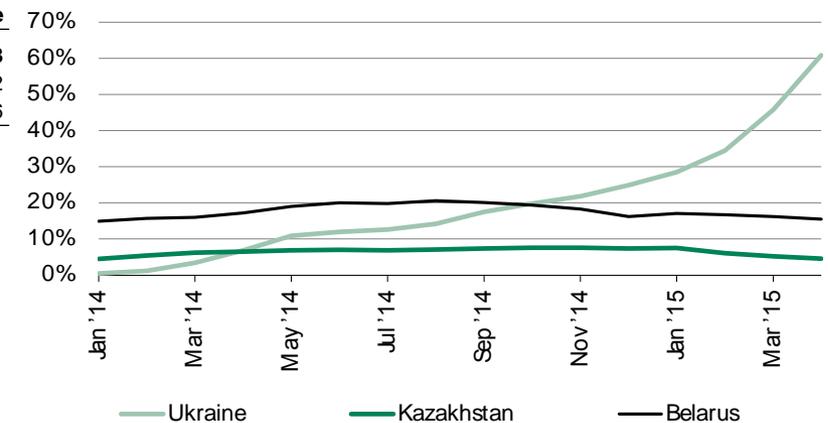
Belarusian trade balance turned positive in 1Q15 and inflation slowed

Belarusian foreign trade in 1Q15, \$ bln

	Export	y-o-y	Import	y-o-y	Trade balance
Total	7.6	-28.6%	6.8	-33.0%	0.8
Goods	6.1	-31.4%	6.0	-33.4%	0.2
Services	1.4	-13.4%	0.8	-30.1%	0.6

Source: National Bank of Belarus

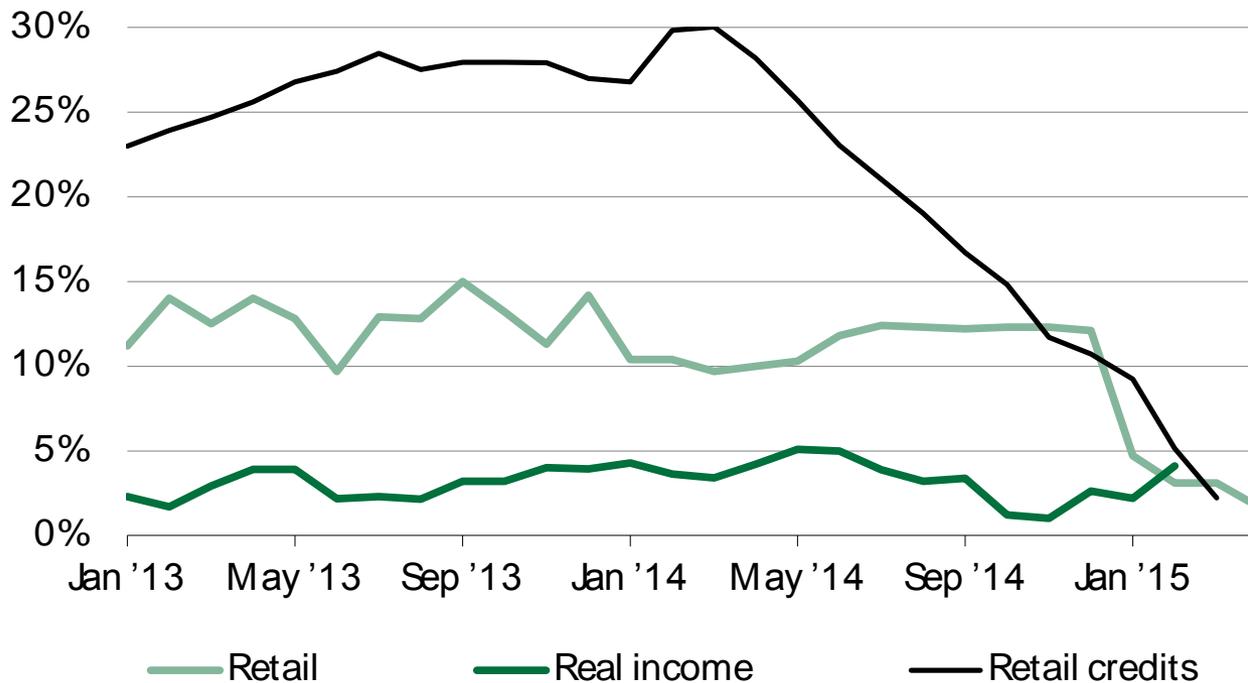
CPI, y-o-y



Source: National statistics committees

Domestic demand in Kazakhstan is cooling as households deleverage

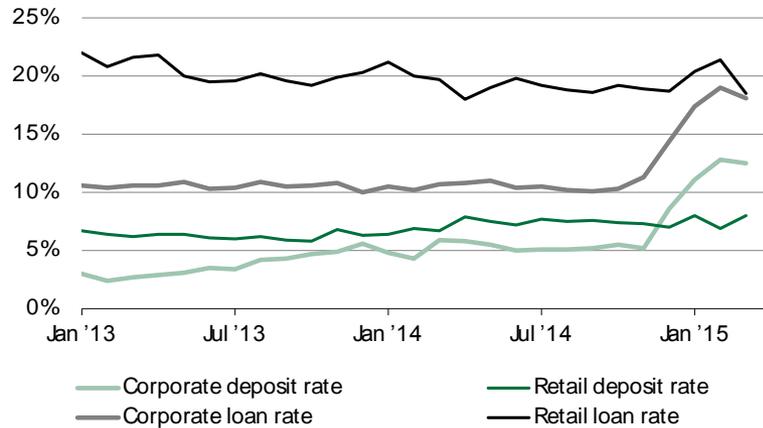
Retail, real incomes and retail loans y-o-y



Source: National Bank of Kazakhstan

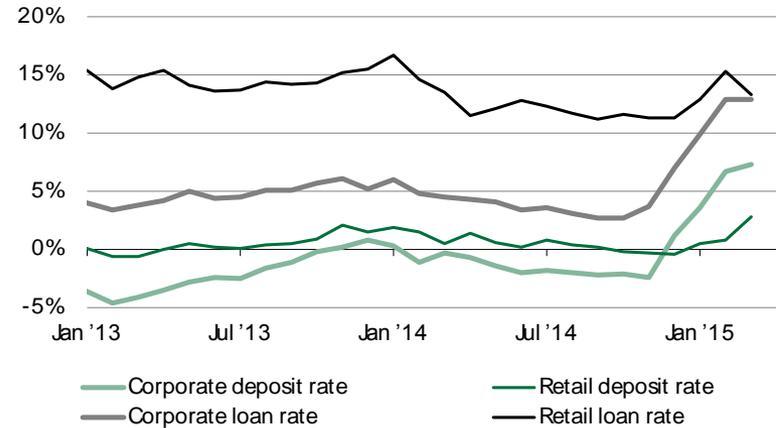
Nominal and real rates started to rise in Kazakhstan, which could hamper growth...

Interest rates, nominal



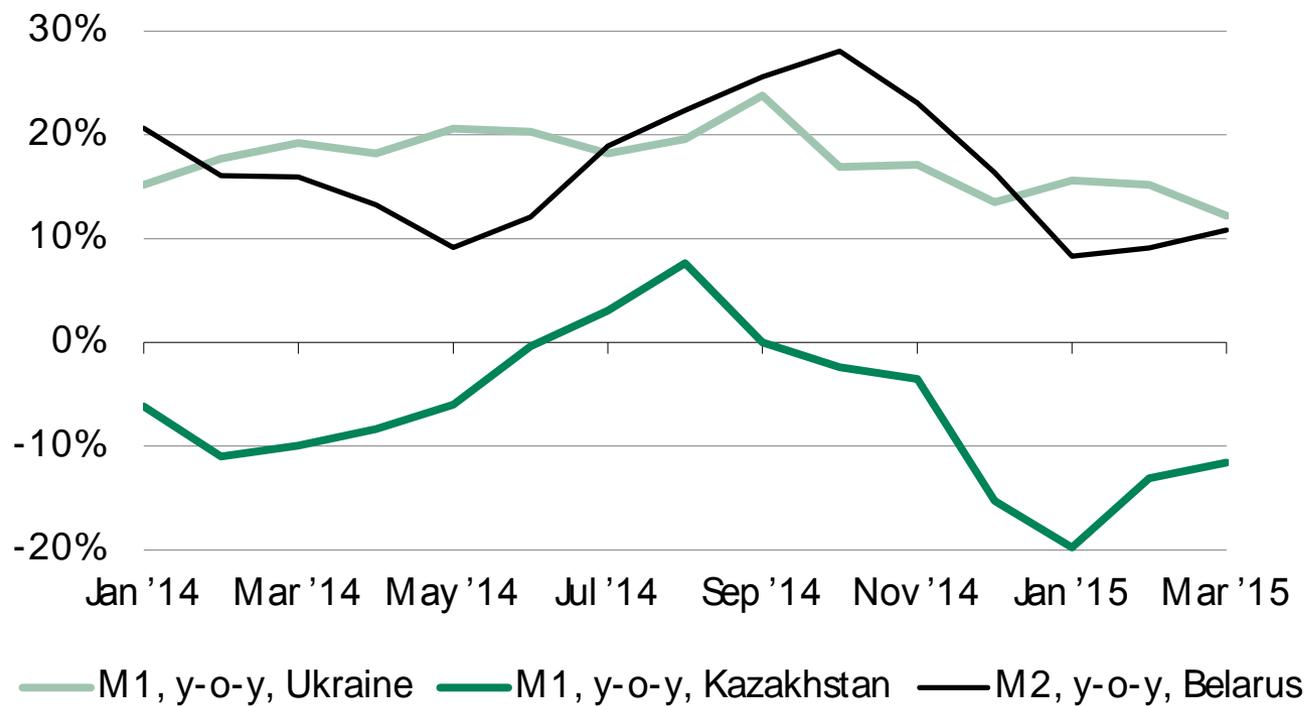
Source: National Bank of Kazakhstan

Interest rates, real



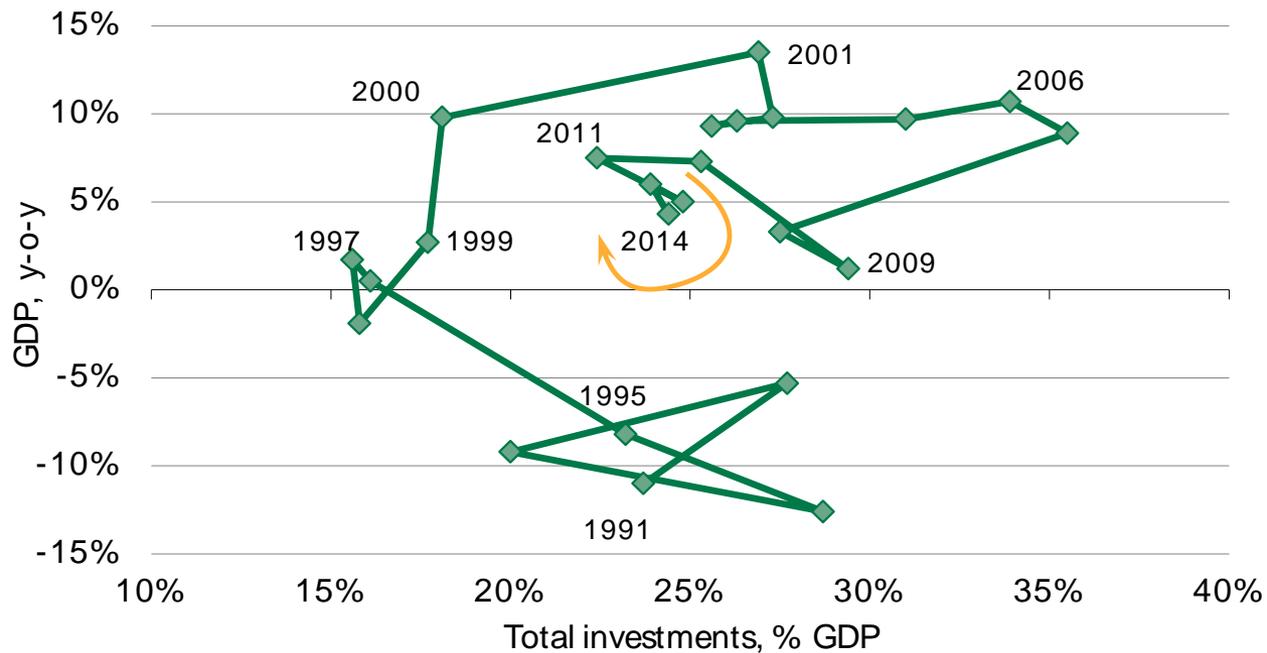
Source: National Bank of Kazakhstan

... as the money supply contracts



Source: National banks

Kazakhstan overcoming overheating as growth slows



Source: State Statistics Agency, Sberbank CIB Investment Research

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