

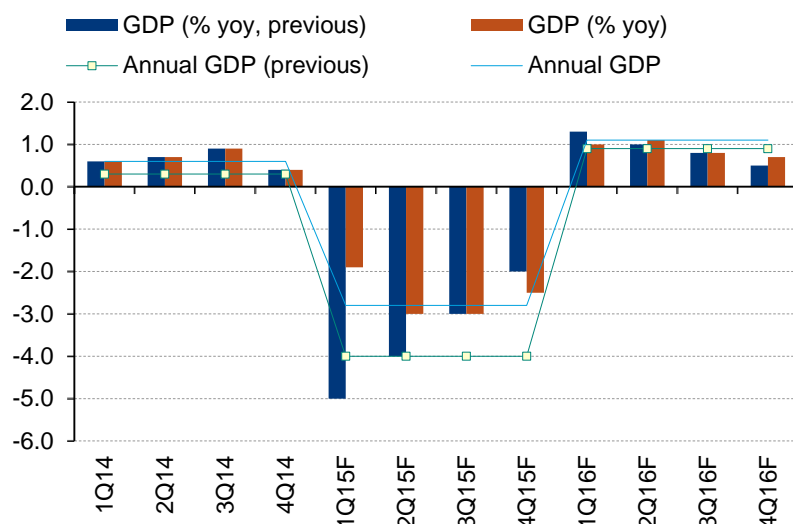
Russia: getting any better?

03 June 2015

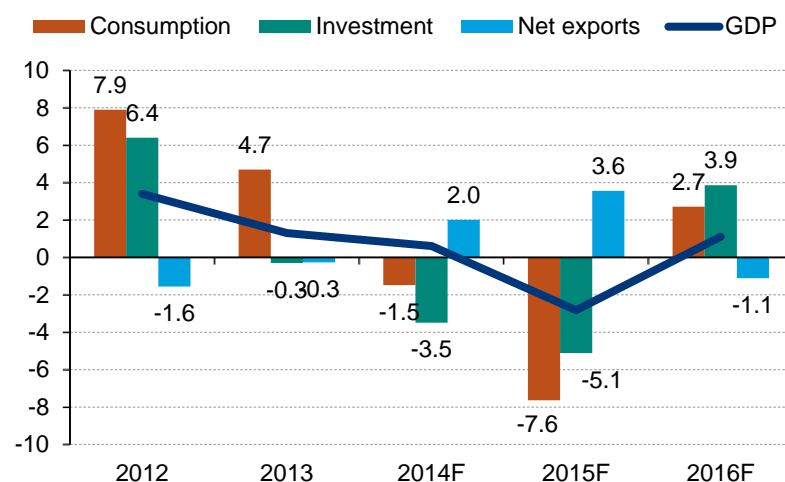
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Macro: not that bad after all

We hike 2015-2016 macro outlook on stronger than expected 1Q and hike in oil prices forecast



High inflation to undermine consumer and push economy into recession



We hike our expectations of real GDP to above consensus - 2.8% and +1.1% (up from -4.0% and +0.9%) in 2015-2016 , respectively. Oil price outlook revision as well as stronger than expected 1Q15 are the main triggers.

Despite strong 1Q15, economic decline should intensify later in the year to trough at around -3% yoy in 2Q15-3Q15.

- After 25% yoy jump in fiscal spending in 1Q15, government has 3% yoy less money to spend for the rest of the year, suggesting the reversal of the fiscal stimulus
- RUB is up nearly 30% since its Jan low, supporting imports

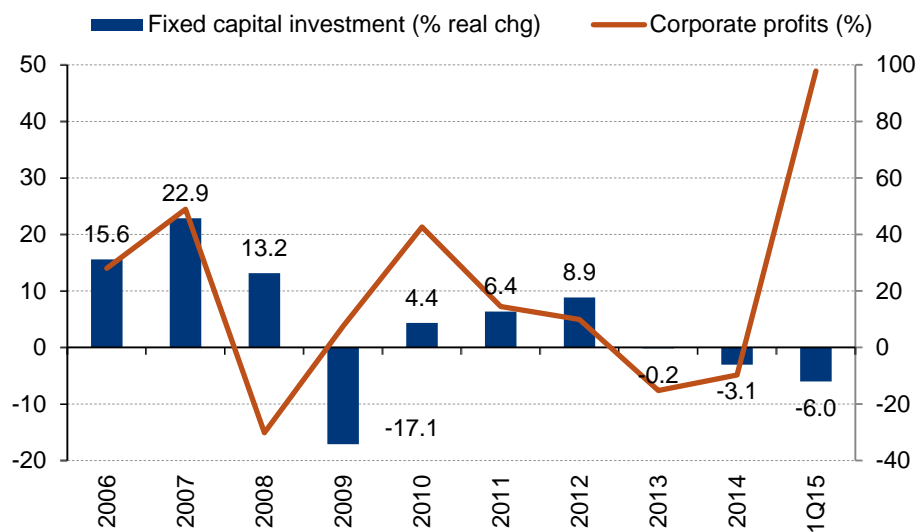
Nevertheless, stronger oil prices should provide some support to investment and pull stronger consumer recovery in 2016. We expect weaker 5.1% investment decline in 2015 (up from -7.9%) and +2.7% consumer recovery in 2016 (up from 1.7%)

RUB outlook is unchanged at RUB55/\$ in 2015 eop. FX strength faces headwinds from the likely tightening of CA surplus as well as CBR policy moves.

- CA should start to shrink from robust \$22bn surplus in 1Q15 due to stronger RUB and seasonality
- CBR does not like RUB below RUB50/\$ level and will likely further squeeze FX repo liquidity and intensify interventions

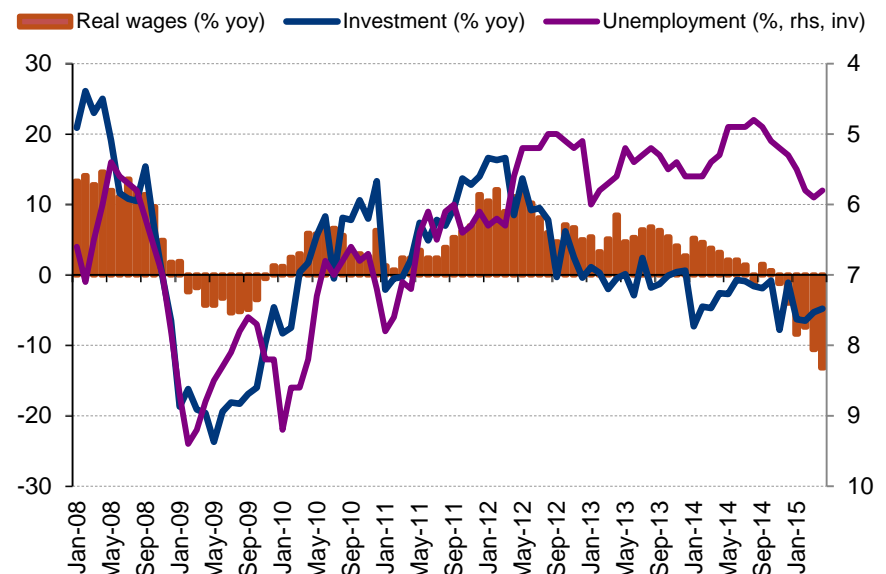
Profits as the main driver for the expected recovery

Despite all the noise, corporate profits are quite OK this year



Source: MinFin, BofA Merrill Lynch Global Research

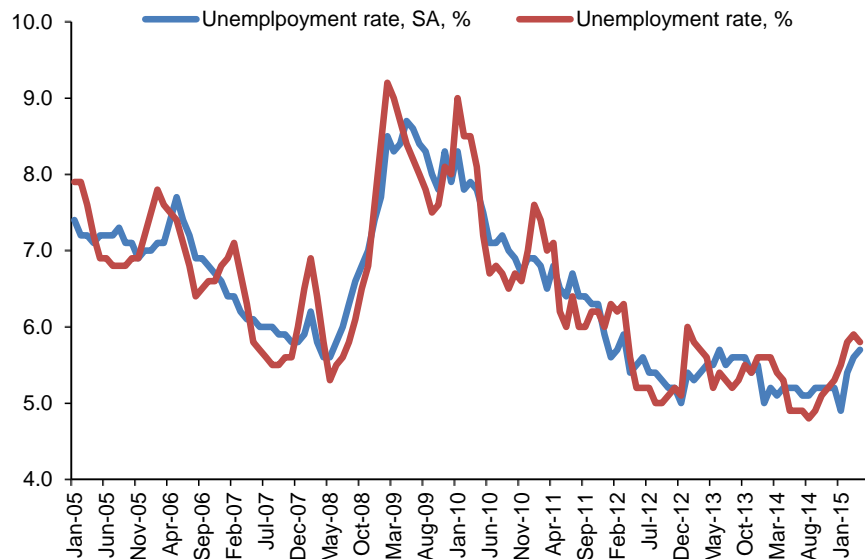
Stabilization of investment should pull consumer recovery as well



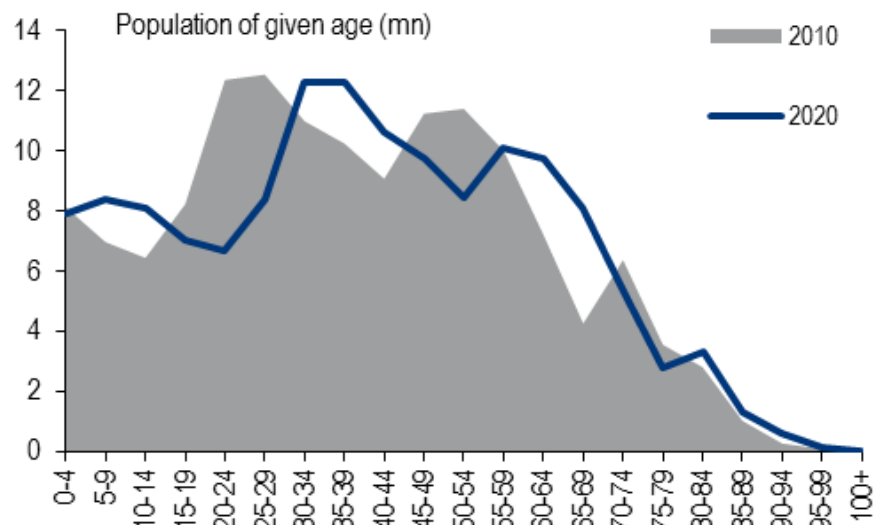
Source: Federal Statistical Service, Bloomberg, BofA Merrill Lynch Global Research

No major unemployment issues still

Unemployment is still close to historic lows despite recession



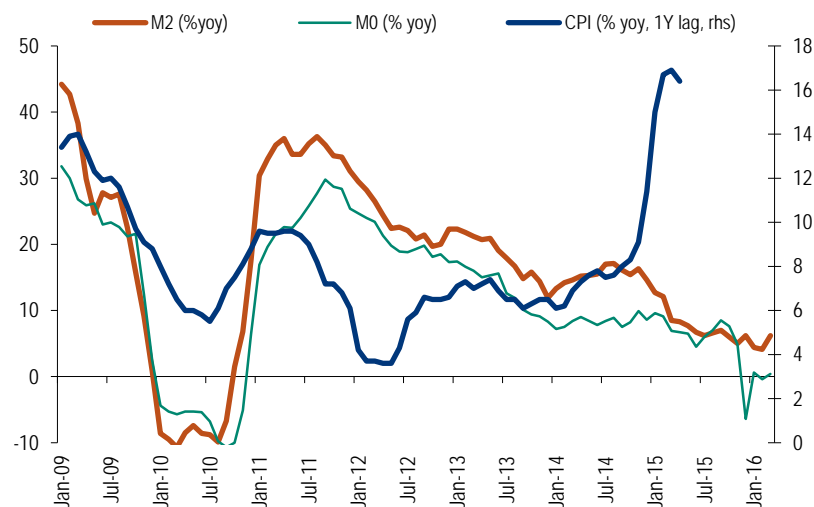
Demography to keep labor market tight in the next 10Y-15Y



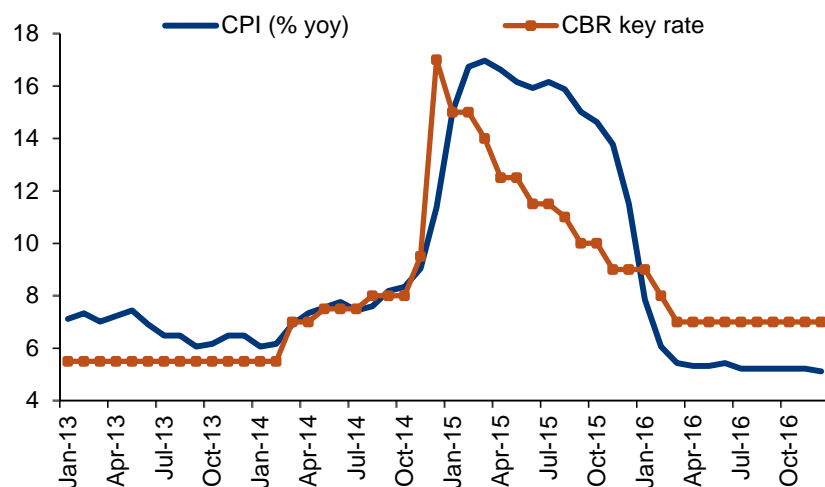
- Unemployment remains close to historical lows, partly due to structural labor force decline
- Labor market will remain tight largely regardless of macroeconomic trends
- Real wage will likely remain robust, relative to the economic growth

CBR easing - main investable theme

There are no fundamental reasons for inflation to stay high, apart from RUB meltdown in Dec-Feb



We see CBR key rate at 9% by 2015 eop and as low as 7% in 2016 eop



Sharp RUB weakness in the winter of 2014-2015 is the main and nearly the only reason for inflation to stay in double digits in 2015. Money supply dynamics argues for inflation to slow to low single digits within 1Y-2Y horizon

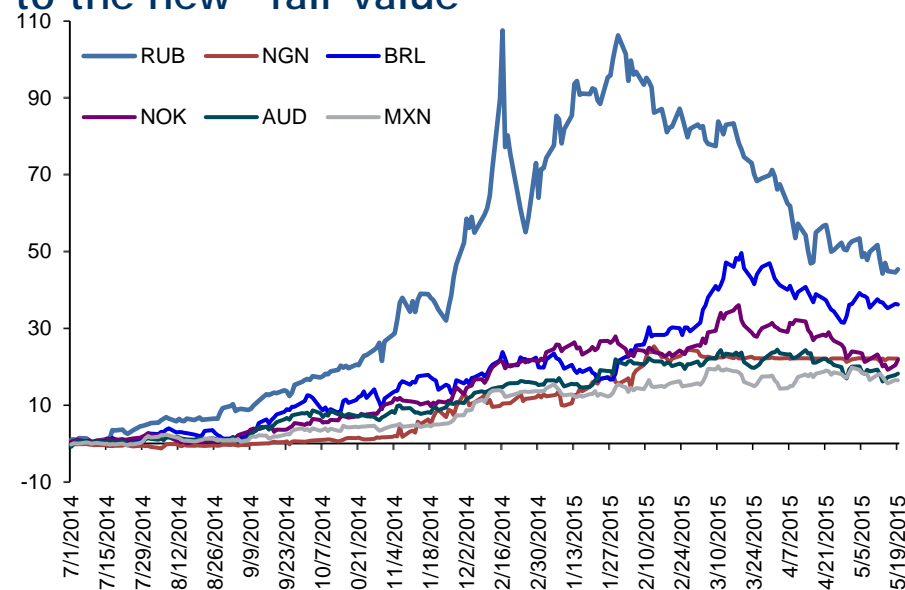
Inflation seems to have started to slow in April, weekly CPI data suggest that inflation slowdown intensified in May. We expect inflation to slow to 11.5% yoy in 2015 eop and all the way to 5.1% by 2016 eop.

Lack of inflationary risks open doors open for further rate cuts. We expect CBR to cut its key rate to 9% by 2015 eop and to 7% by the middle of 2016.

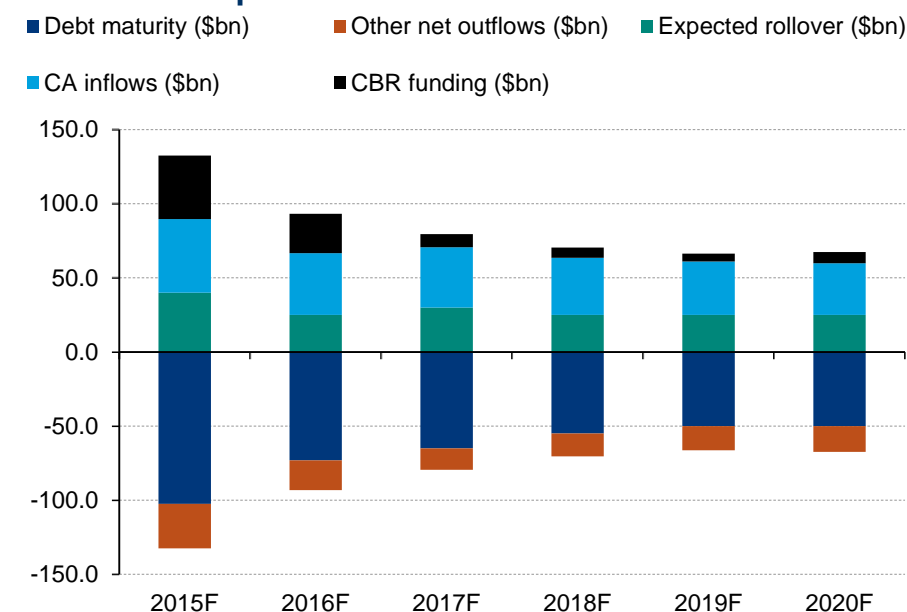
Falling rates boost valuations of Russian companies through lower borrowing costs as well as lower risk-free rate. We estimate that RFR at 7%-8% could boost company valuations by an average of 30%-40%

RUB still weak which help to resolve many problems

RUB is recovering from the selloff, is close to the new "fair value"



RUB keeps CA surplus, helping to refinance EXD redemptions

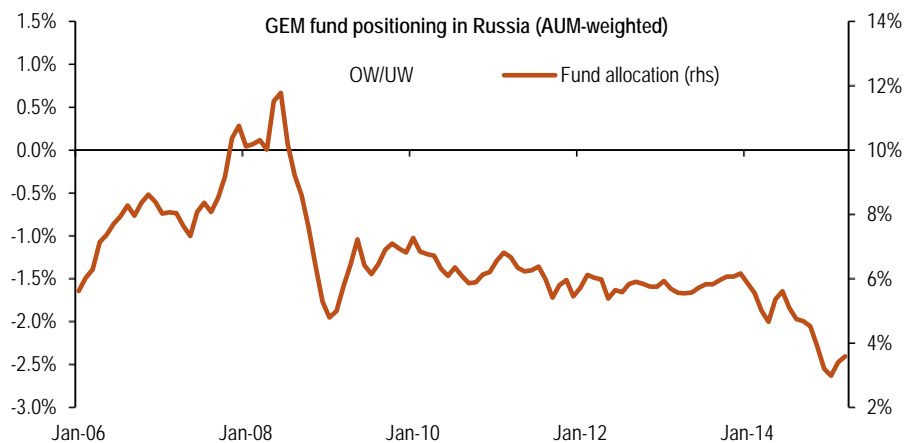


- RUB is recovering from earlier selloffs on de-dollarization. The trend can continue, but we think that it has already passed its new "fair value", which we estimate to be around RUB55-58/\$ level
- CBR does not seem to like RUB below RUB50/\$ level and might further squeeze FX repo provisions and intensify FX interventions to weaken the currency. We expect RUB55/\$ in 2015 eop
- Weak RUB addresses lot of macro issues:
 - CA to stay in robust \$67bn surplus despite lower oil prices, which should help to finance maturing EXD and boost CBR reserves despite sanctions pressure
 - Weaker RUB helps to balance the budget. Breakeven oil price falls from \$80/bbl at RUB58/\$ to \$60/bbl at RUB81/\$.

Source: Federal Statistical Service, CBR, Bloomberg, BofA Merrill Lynch Global Research estimates

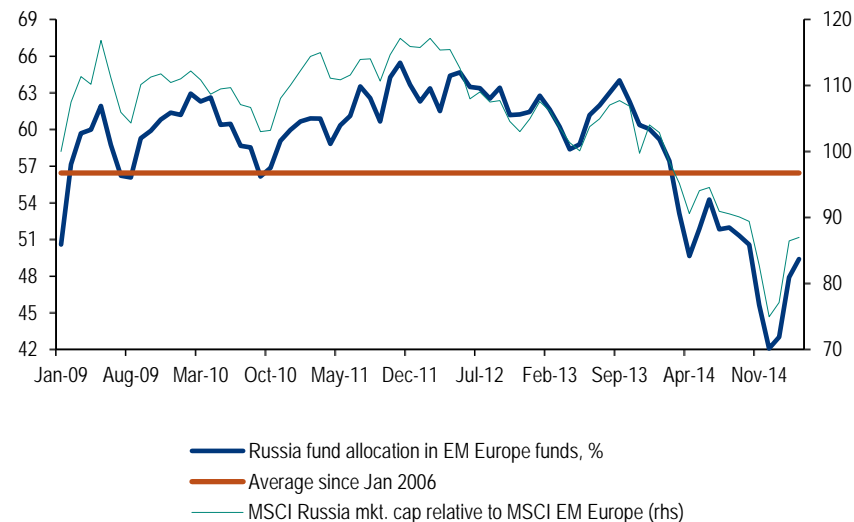
Valuations cheap as chips

GEM fund positioning in Russia (asset-weighted)



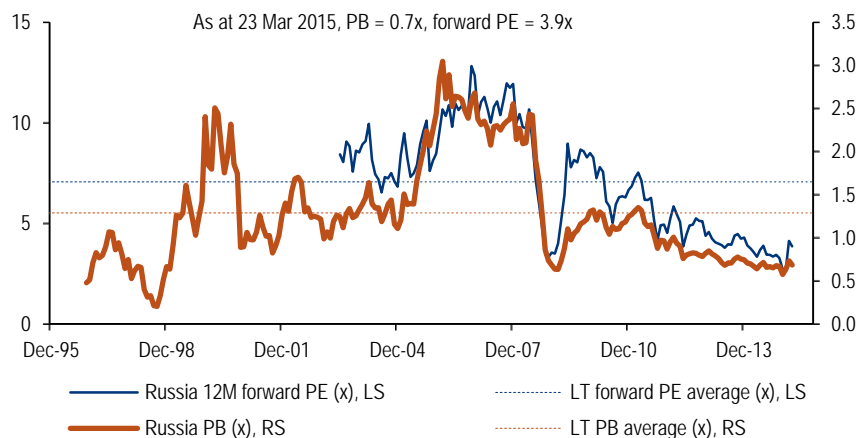
Source: EPFR, BofA Merrill Lynch Global Research, Datastream

EM Europe fund positioning in Russia (asset-weighted)



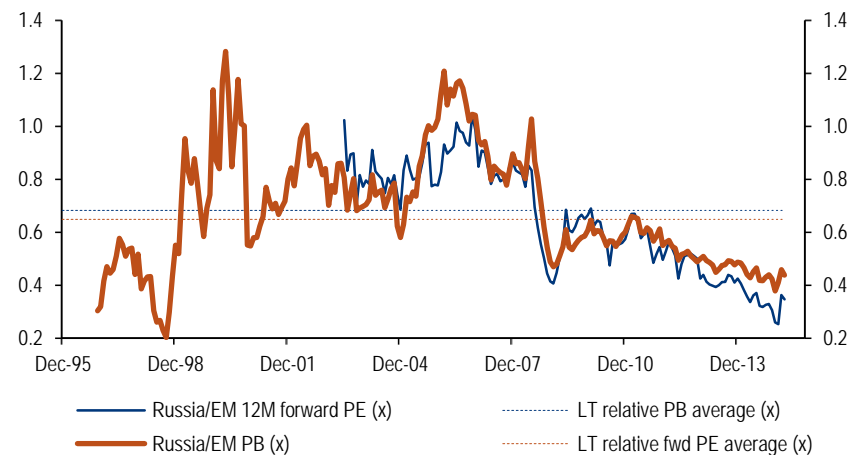
Source: EPFR, BofA Merrill Lynch Global Research, Datastream

Russian equities appear substantially undervalued relative to their own history



Source: BofA Merrill Lynch Global Research, Factset, MSCI

Russian equities seem exceptionally cheap relative to other emerging markets



Source: BofA Merrill Lynch Global Research, Factset, MSCI

RUB helps to address most of fiscal problems

Weaker RUB helps to balance the budget by keeping breakeven oil price lower

	\$80/bbl	\$75/bbl	\$70/bbl	\$65/bbl	\$60/bbl	\$55/bbl	\$50/bbl	\$45/bbl	\$40/bbl
RUB58/\$	0	-0.8	-1.5	-2.2	-2.9	-3.7	-4.5	-5.4	-6.3
RUB63/\$	0.6	0	-0.7	-1.5	-2.2	-3	-3.9	-4.8	-5.7
RUB68/\$	1.4	0.7	0	-0.8	-1.6	-2.4	-3.3	-4.2	-5.2
RUB74/\$	2.2	1.5	0.8	0	-0.8	-1.7	-2.6	-3.5	-4.5
RUB81/\$		2.4	1.6	0.8	0	-0.9	-1.8	-2.8	-3.9
RUB90/\$			2.6	1.5	0.9	0	-0.9	-1.9	-3.0
RUB100/\$				2.8	1.9	1.0	0	-1.1	-2.2
RUB114/\$					3.1	2.2	1.1	0	-1.1
RUB131/\$						3.4	2.4	1.2	0

Source: MinFin, BofA Merrill Lynch Global Research

Forecast summary

	2012	2013	2014	2015F	2016F
Nominal GDP (\$bn)	1917	2072	1845	1257	1405
GDP per capita (\$)	13492	14580	12981	8843	9882
Real GDP (% yoy)	3.5	1.3	0.6	-2.8	1.1
Investment (%)	5.3	-0.3	-3.5	-5.1	3.9
Private consumption (%)	5.2	4.7	-1.5	-7.6	2.7
Public consumption (%)	1.2	-0.1	0.7	-0.3	0.3
Export (%)	-0.8	3.8	0.9	0.9	0.6
Import (%)	11.0	5.9	-8.3	-18.3	6.6
Unemployment (%)	5.5	5.5	5.4	5.8	5.7
Nominal wage growth (%)	9.5	10.0	8.0	7.0	7.0
Real wage growth (%)	4.4	3.3	0.2	-8.3	1.5
CBR policy rate (% eop)	5.5	5.5	17.0	9.0	7.0
CPI (% yoy, eop)	6.6	6.4	11.4	11.5	5.1
CPI (average)	5.1	6.7	7.8	15.3	5.5
CBR policy rate (% eop)	5.5	5.5	17.0	9.0	7.0
RUBUSD, eop	30.5	33.0	60.7	55.0	55.0
RUBUSD, avg	31.1	32.2	38.7	58.2	55.0
Budget balance (% GDP)	0.0	-0.5	-0.4	-3.6	-3.3
CA balance (% GDP)	4.2	1.6	3.7	5.3	3.3
CA balance (\$bn)	81	34	68	67	47
Trade balance (\$bn)	195	182	183	111	101

Source: Federal Statistical Service, CBR, Finance Ministry, BofA Merrill Lynch Global Research

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