

Russia Economics

Time of volatility and a New Normal

December 8, 2011

Alexander Morozov

Chief Economist, Russia and CIS
OOO HSBC Bank (RR)

+7 495 783 8855

alexander.morozov@hsbc.com

View HSBC Global Research at: <http://www.research.hsbc.com>

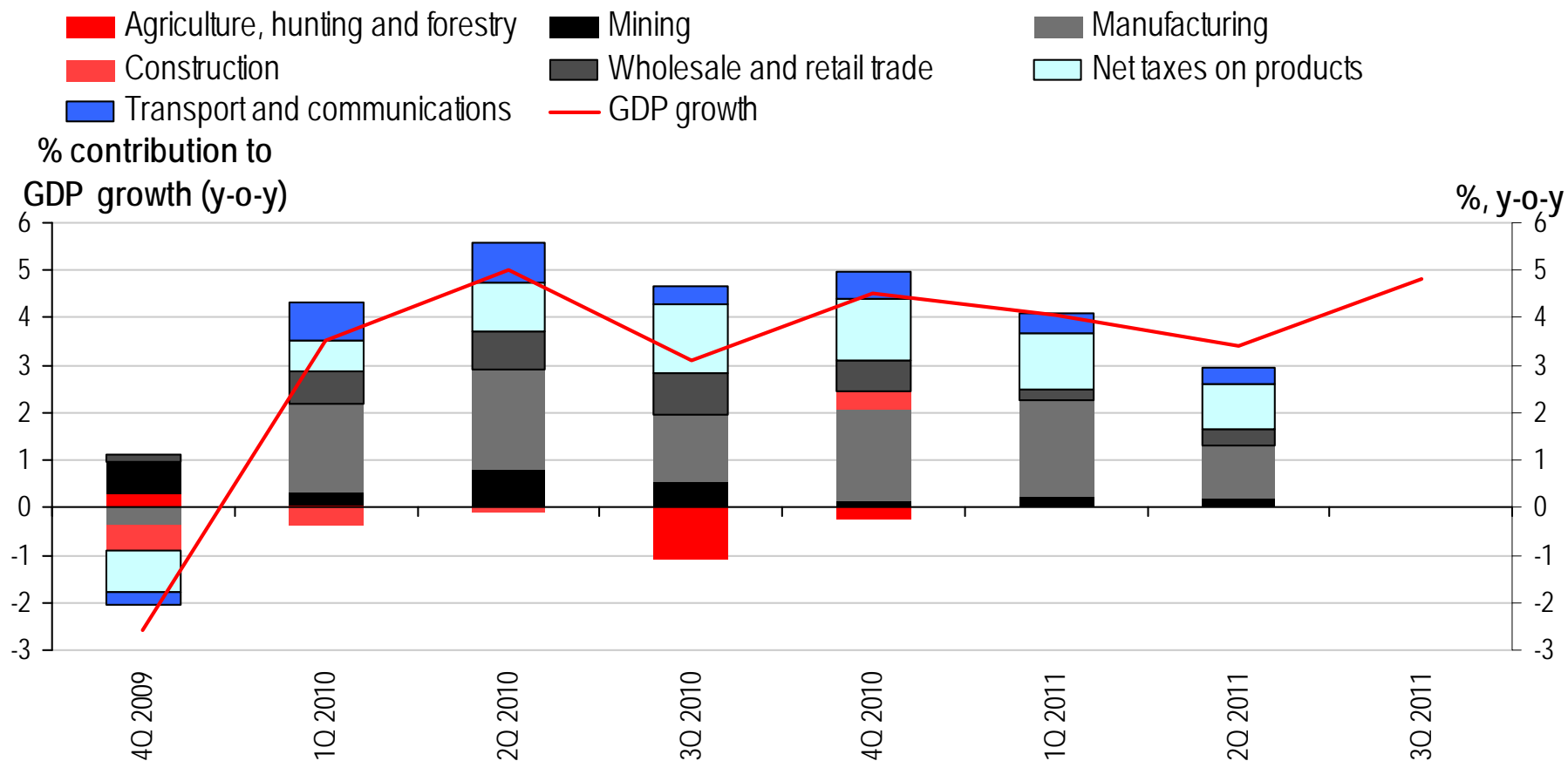
Disclosures and Disclaimer This report must be read with the disclosures and the analyst certifications in the Disclosure appendix, and with the Disclaimer, which forms part of it

HSBC 
The world's local bank

Content

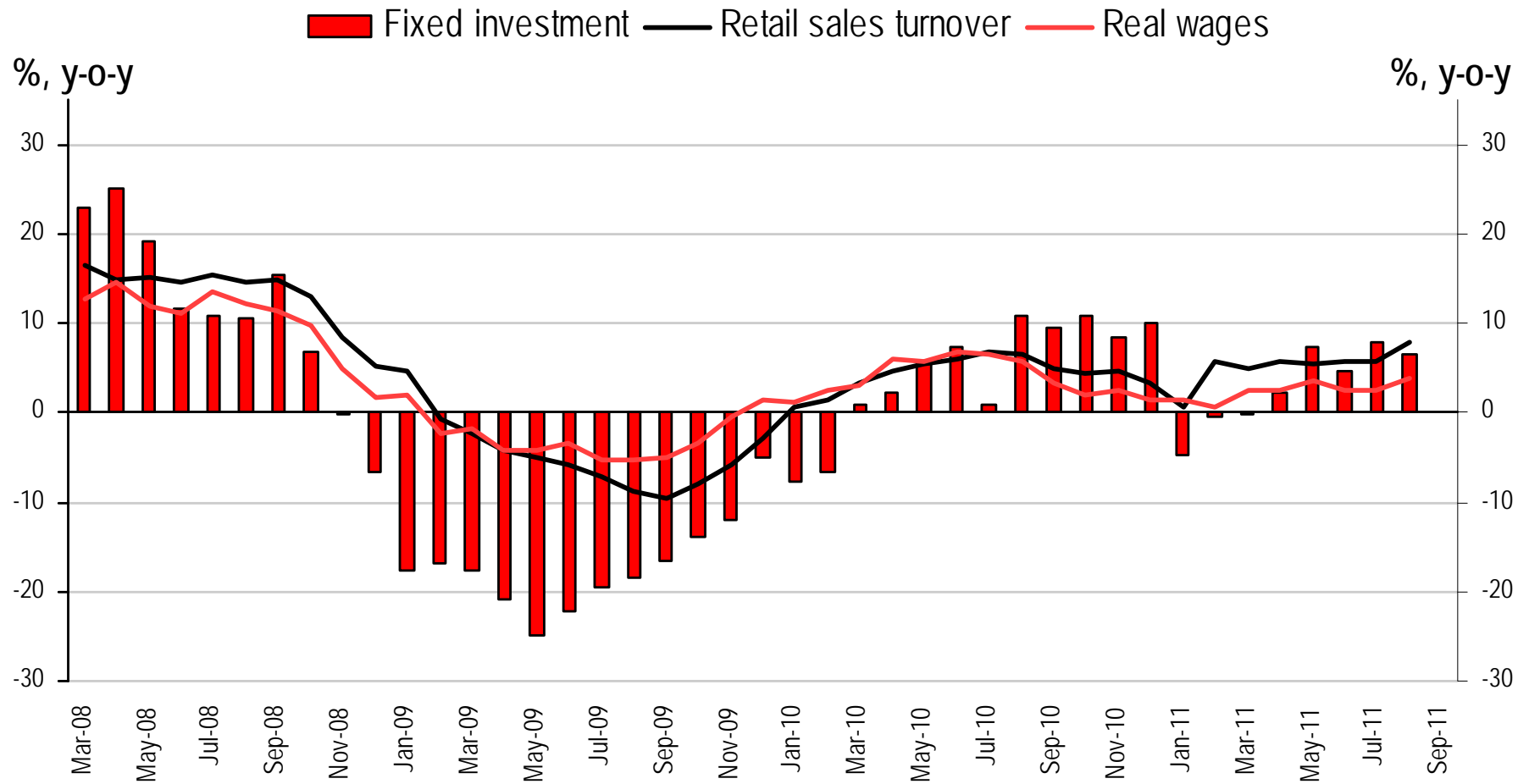
- **Economic growth**
- **Inflation**
- **Liquidity and interest rates**
- **The RUB**

1. Agriculture boosted GDP growth in 3Q...



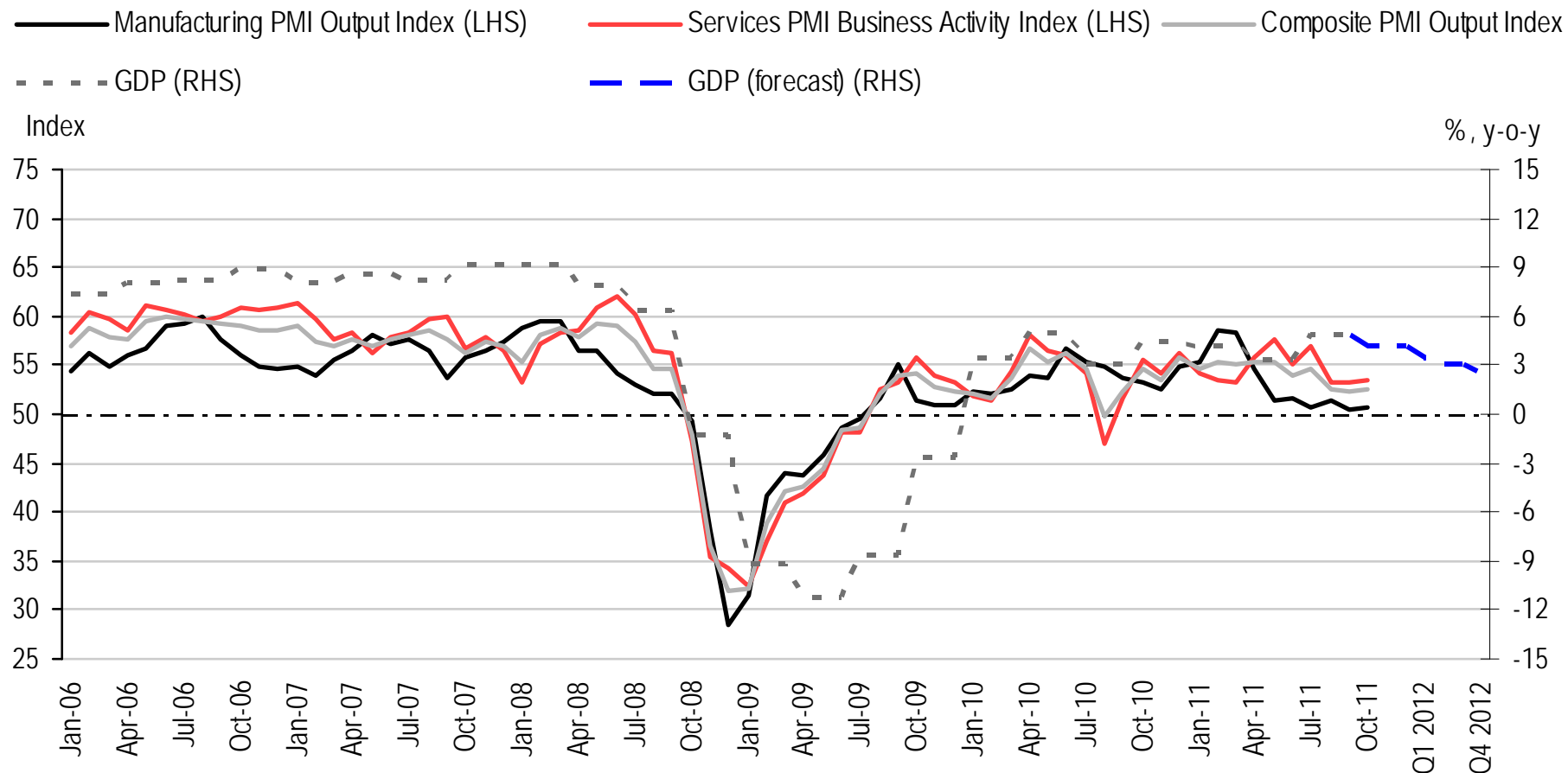
Source: Rosstat, HSBC

2. ...as well as stronger domestic demand



Source: Rosstat

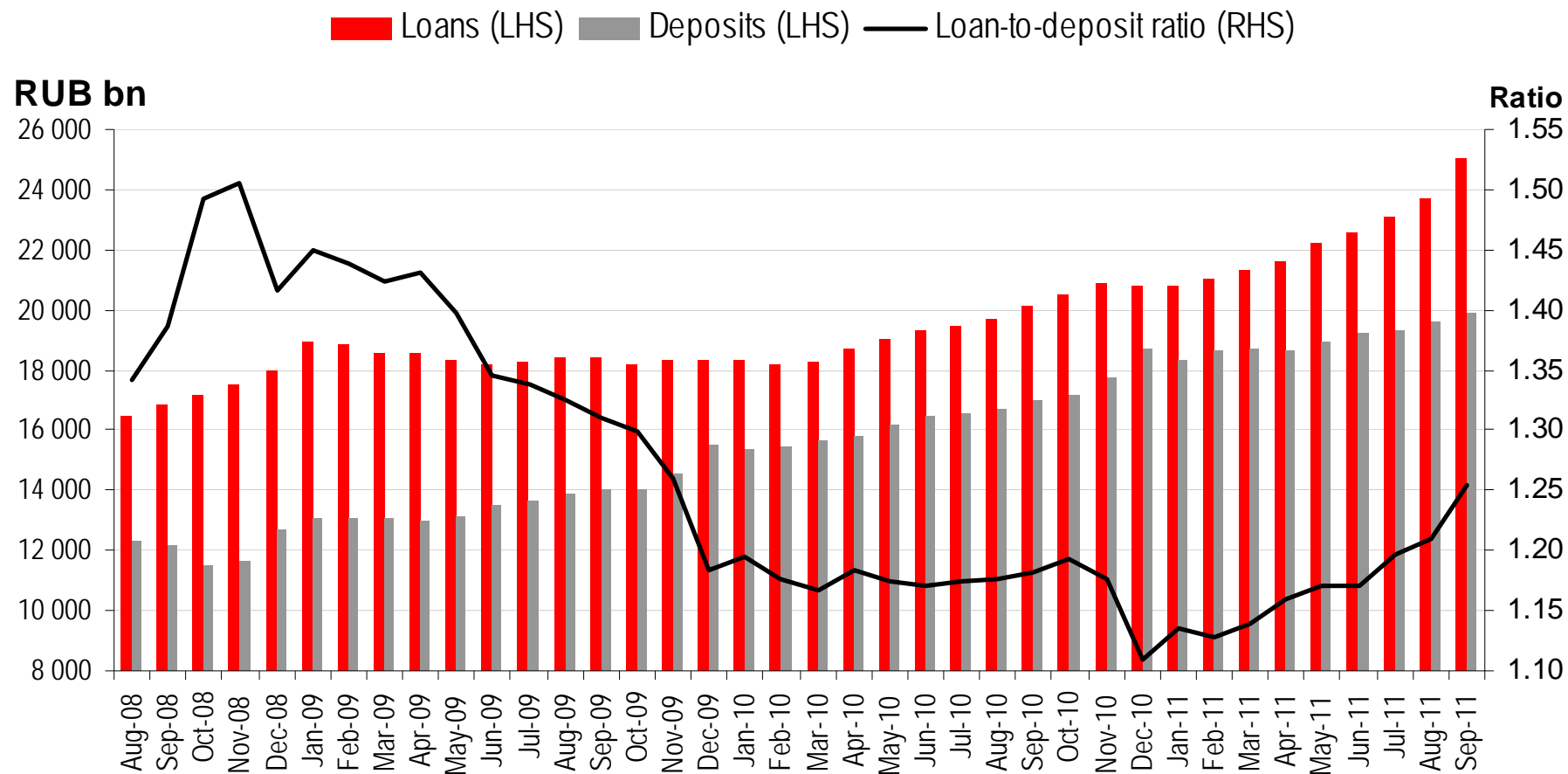
3. Yet, high downside risks are seen in the coming quarters



Source: Markit, HSBC

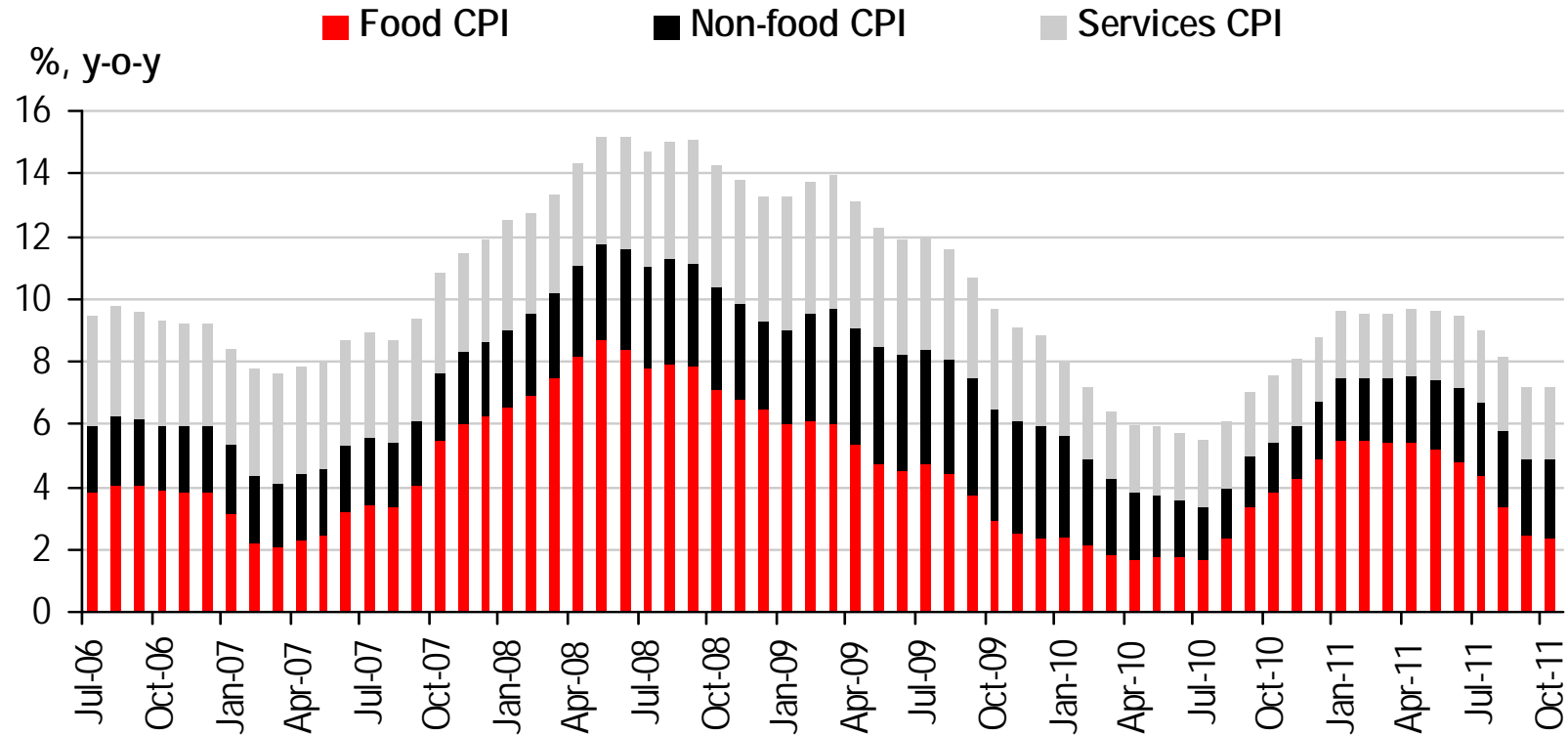
Note: 50.0 = no change on the previous month, above 50.0 = improvement, below 50.0 = deterioration

4. Banks start seeing constraints on lending



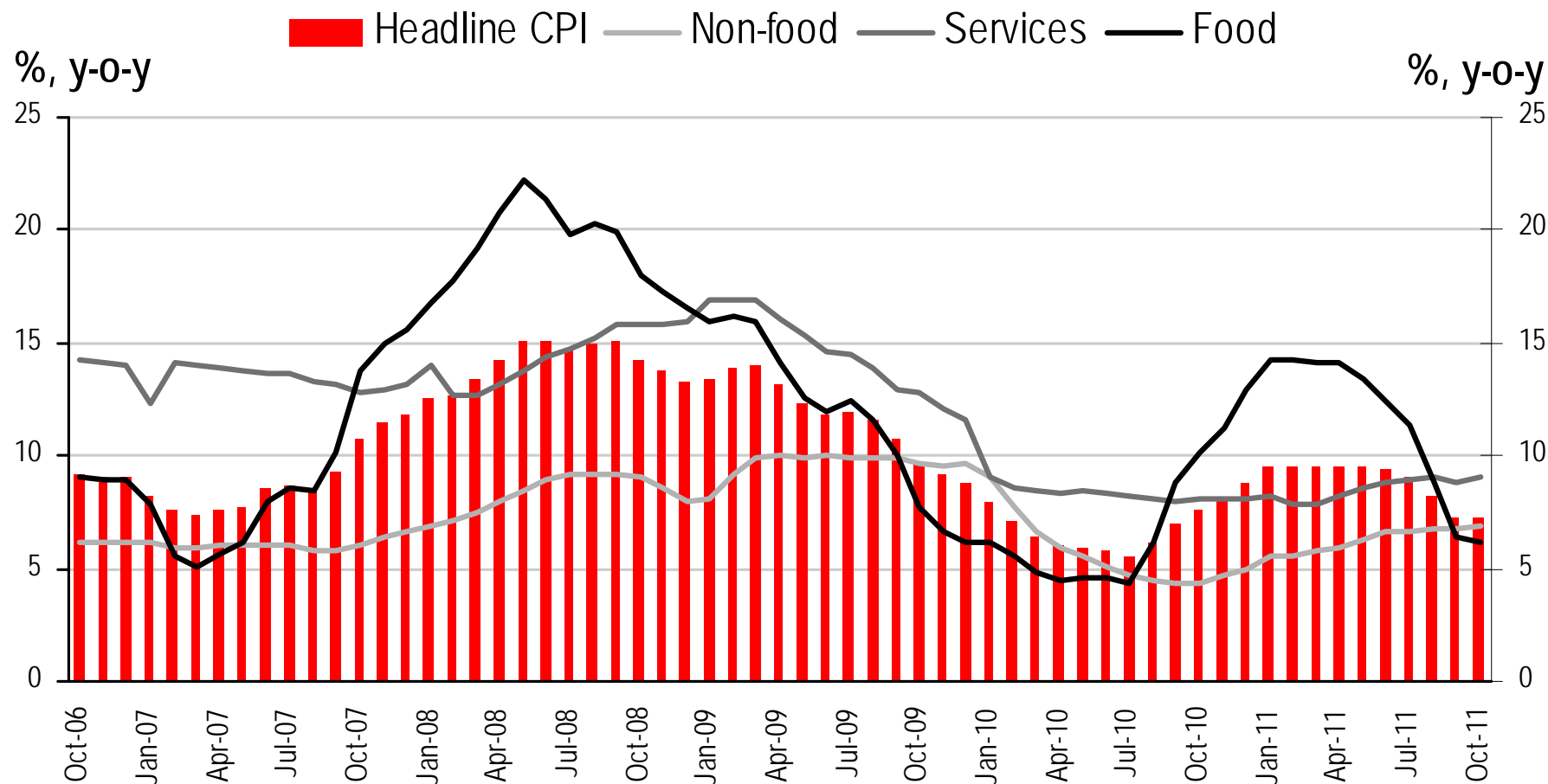
Source: CBR

5. Headline inflation has been declining...



Source: Rosstat

6. ...yet, non-food price growth remains elevated



Source: Rosstat

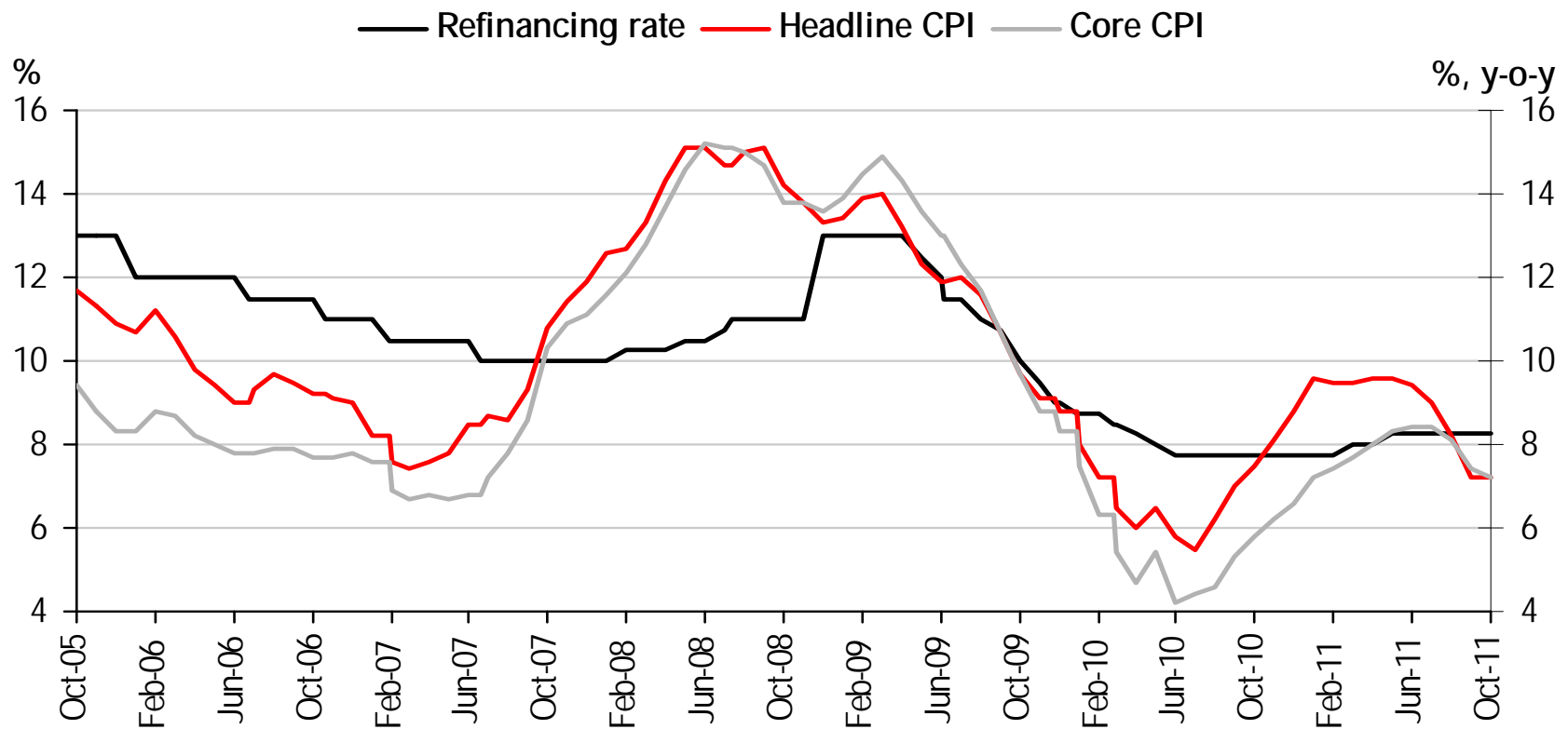
7. Budget is OK for now...as long as oil prices stay high

Official medium-term fiscal framework for 2011-2014

	2009	2010	2011p	2012p	2013p	2014p
<i>RUB bn</i>						
Revenues	7 338	8 304	11 008	11 779	12 729	14 116
oil&gas revenues	-	-	5 431	5 575	5 646	6 127
Expenditures	9 660	10 116	11 008	12 670	13 766	14 631
Surplus/Deficit (-)	-2 322	-1 812	0	-891	-1 037	-515
<i>% of GDP</i>						
Revenues	18.9	18.5	20.6	20.1	19.6	19.5
oil&gas revenues	-	-	10.2	9.5	8.7	8.5
Expenditures	24.9	22.5	20.6	21.6	21.2	20.2
Surplus/Deficit (-)	-6.0	-4.0	0.0	-1.5	-1.6	-0.7
<i>Oil prices assumptions Urals (USD/bbl)</i>						
Baseline scenario	-	78.0	108.0	100.0	97.0	101.0
To balance budget	-	-	118.3	116.2	114.4	107.8
<i>Real expenditures growth (% , y-o-y)</i>						
	-	-4.0	1.7	8.6	3.0	1.2

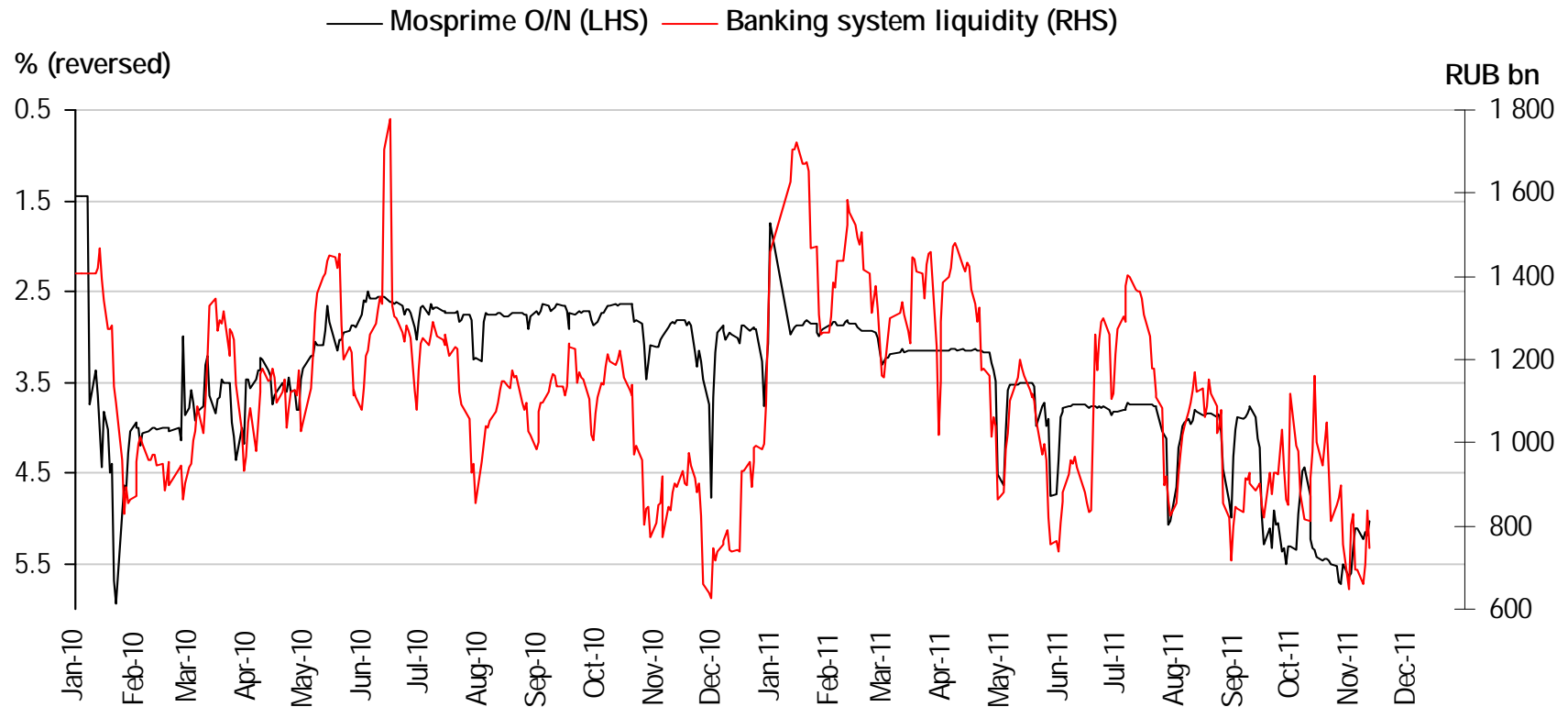
Source: MOF, HSBC

8. CBR prepares for policy easing



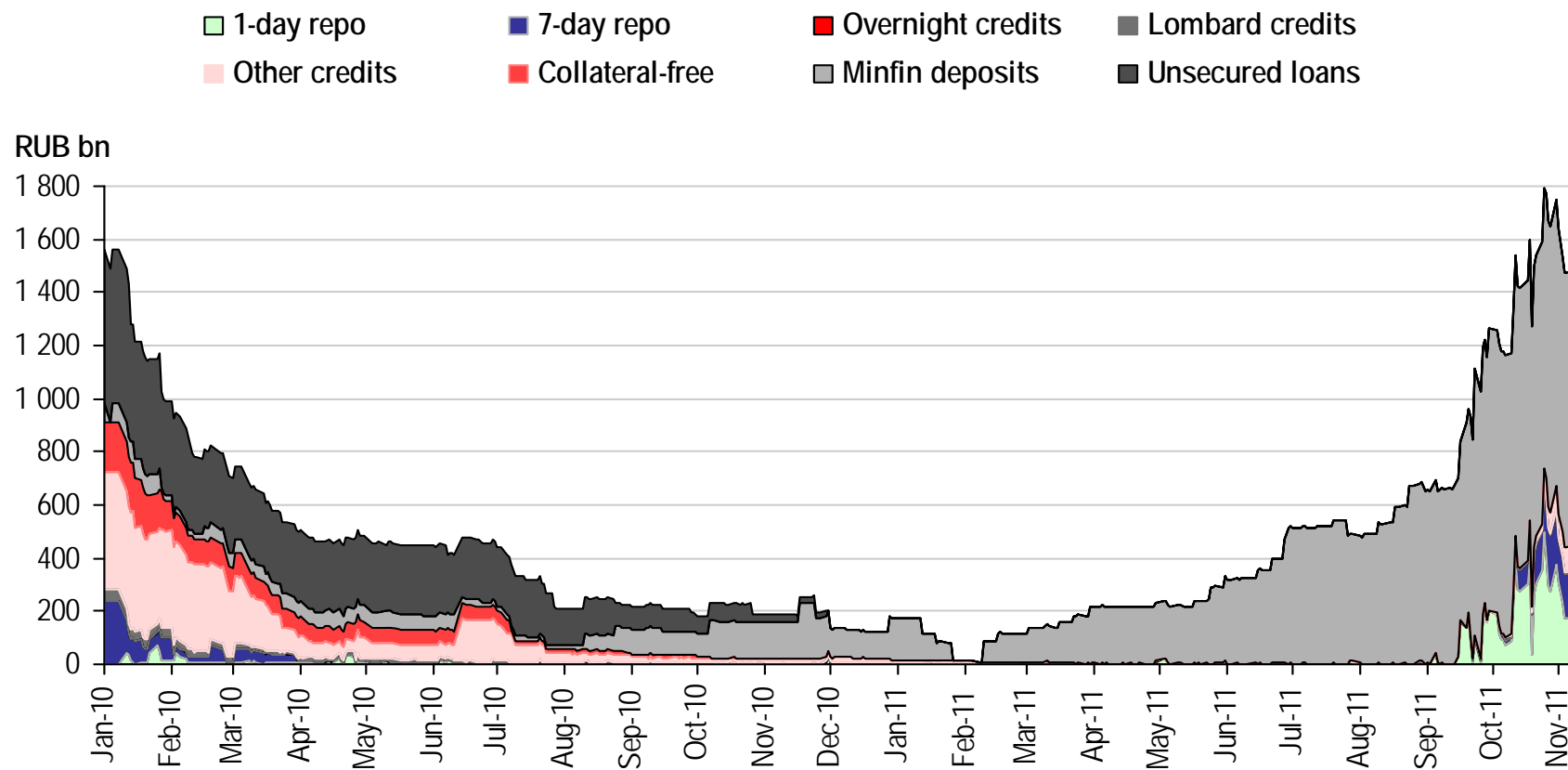
Source: CBR, Rosstat

9. Money market rates increased with the fallen liquidity



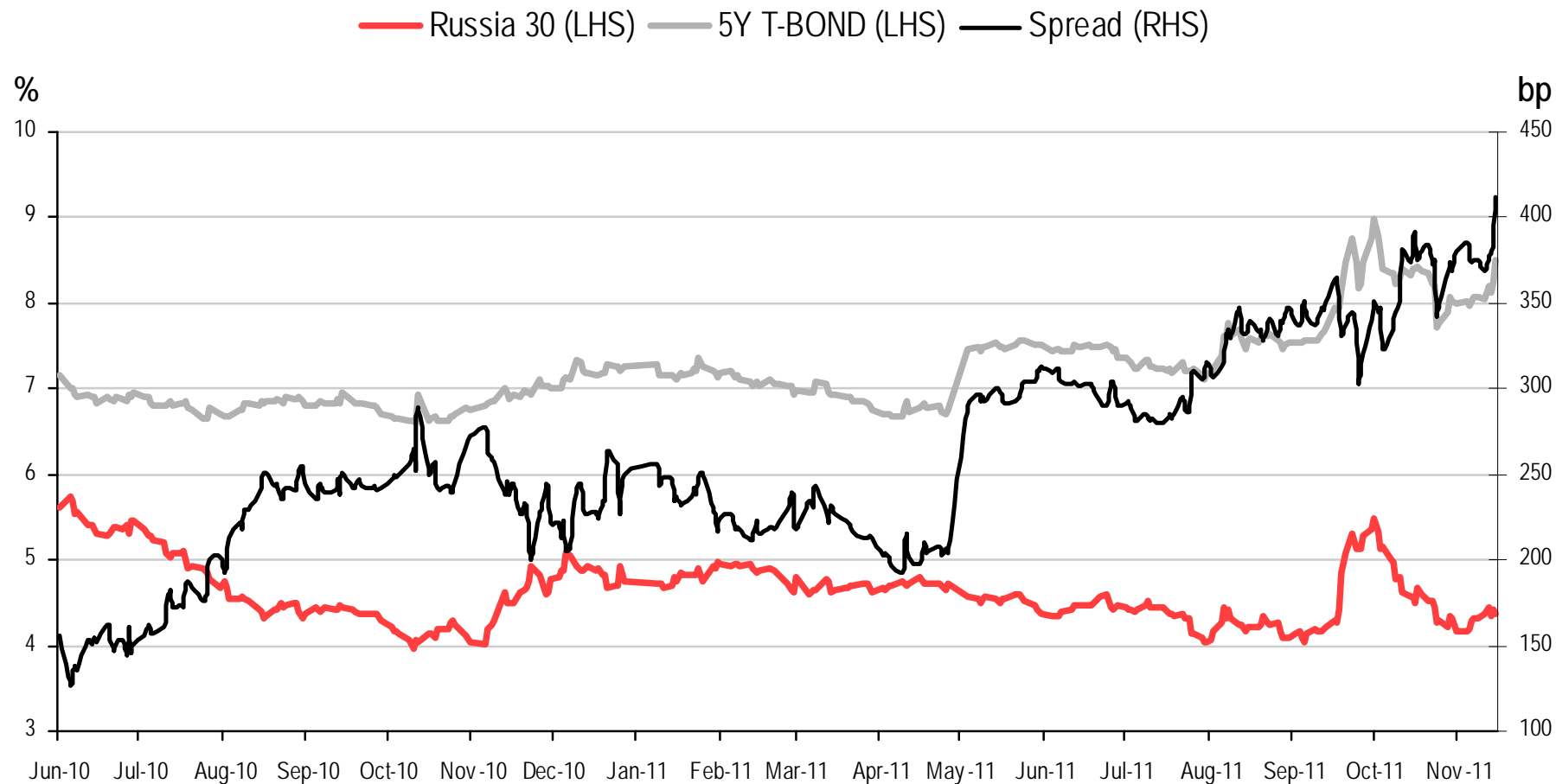
Source: Reuters

10. Refinancing of banks (CBR+MOF) reached RUB1.5 trn



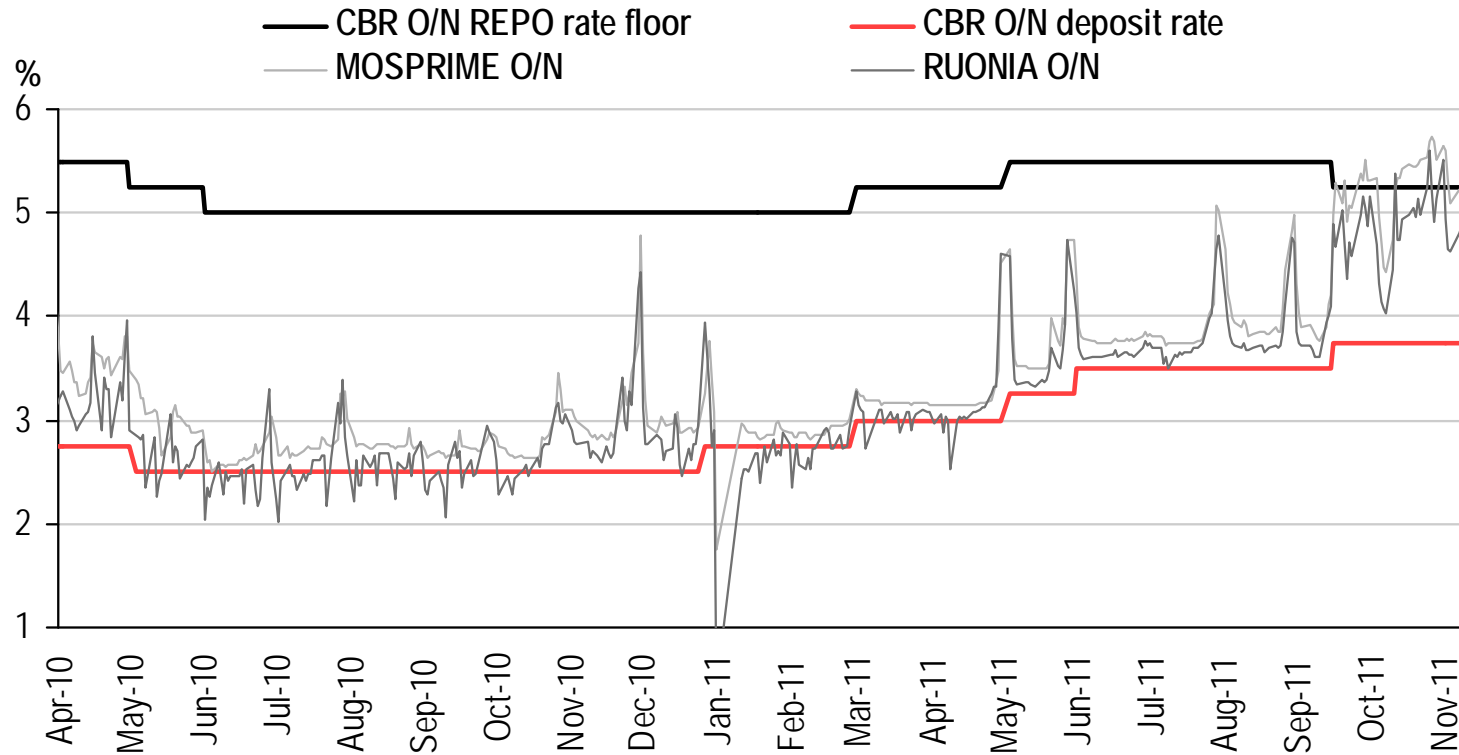
Source: MOF, CBR

11. Tight liquidity triggered Russian bonds' yields diversion



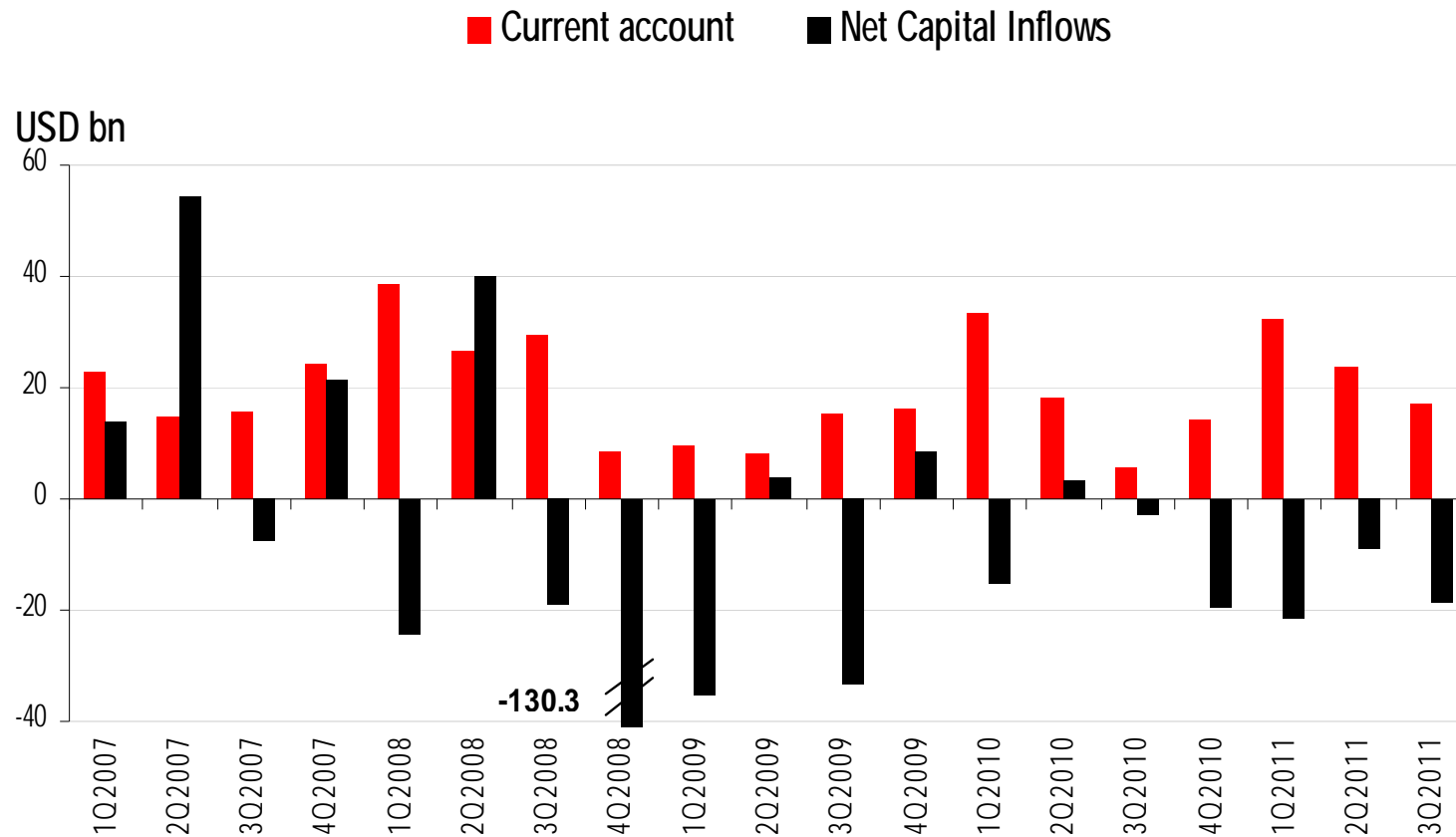
Source: Reuters

12. Money market rates trend around CBR repo rate – a New Normal



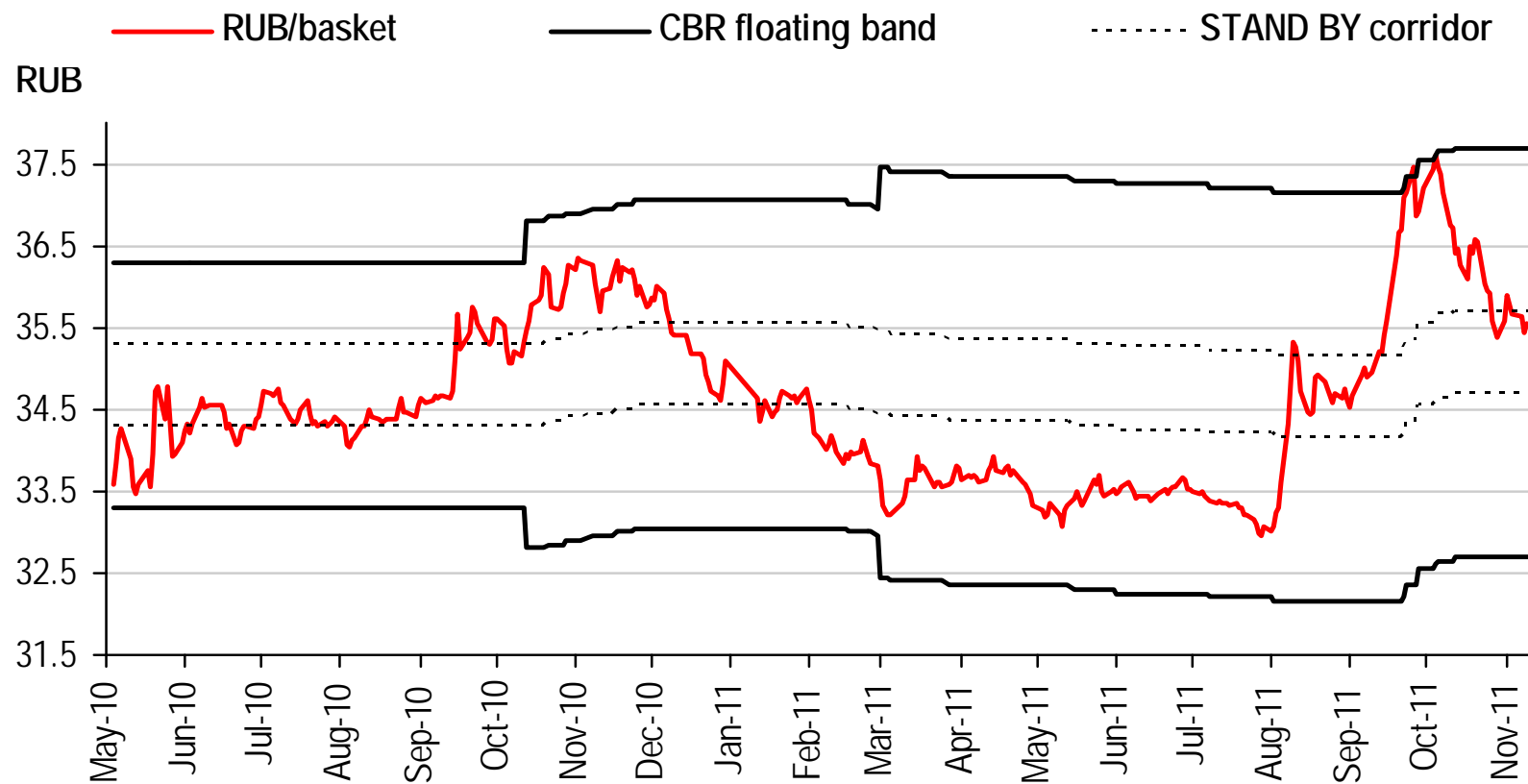
Source: CBR

13. Sustained capital outflows weaken the RUB...



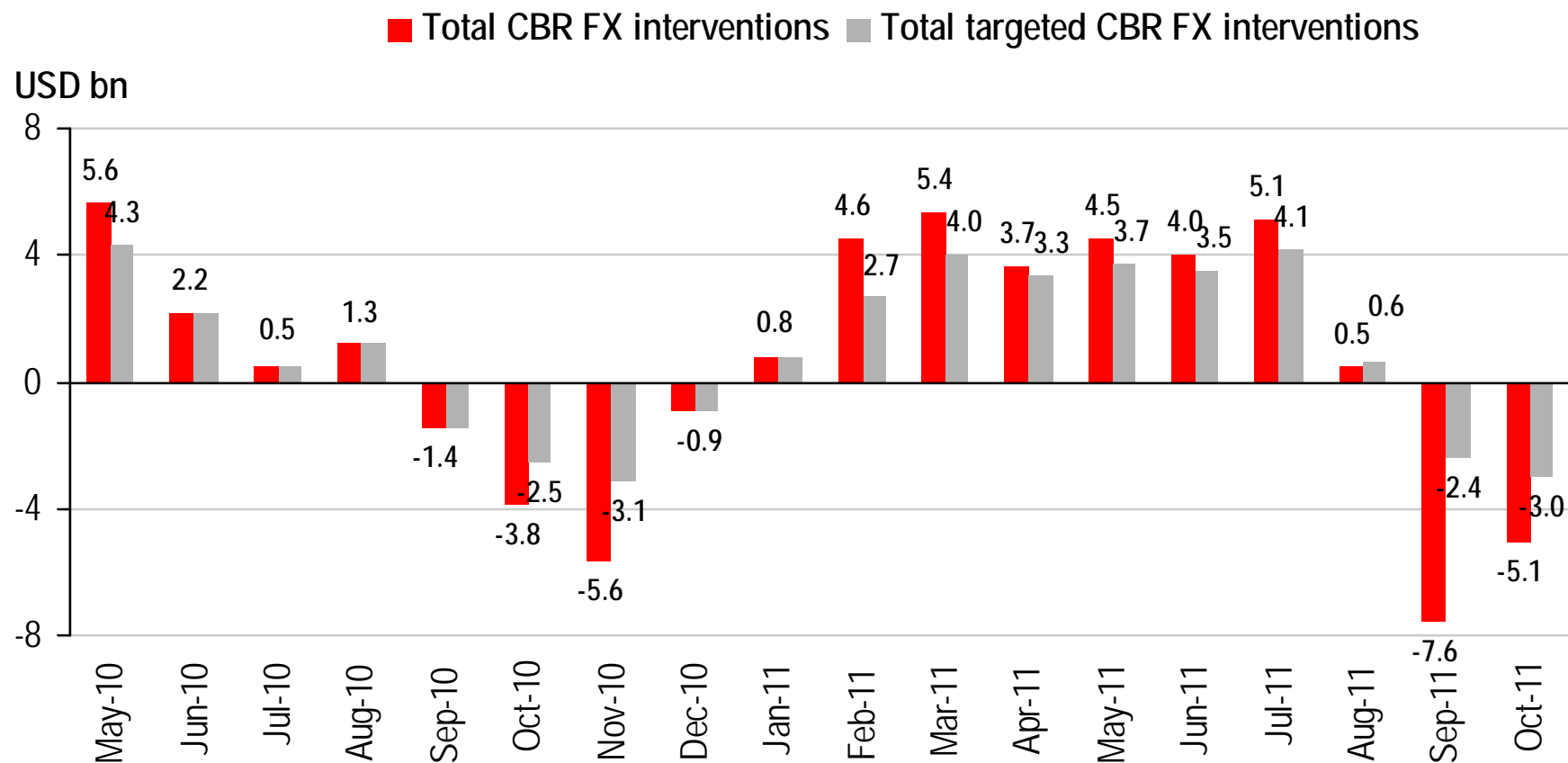
Source: CBR

14. ...prompting the CBR to sell FX above RUB/basket35.70



Source: Reuters, CBR, HSBC

15. CBR's FX sales squeeze RUB liquidity



Source: CBR, HSBC

16. RUB is exposed to seasonality

RUB HEATMAP

Monthly current account surplus (USD bn)

	CA 10	CA 11	CA 12
January	12.4	9.7	8
February	10.9	12.6	9.5
March	10.3	10.1	9.5
April	9.7	12.9	9
May	6.9	9.6	6
June	2	1.3	-1
July	3.1	8	4.5
August	-0.5	3	1
September	2.9	6	3
October	3	4	2
November	3.3	4.5	3.5
December	6.4	4	2



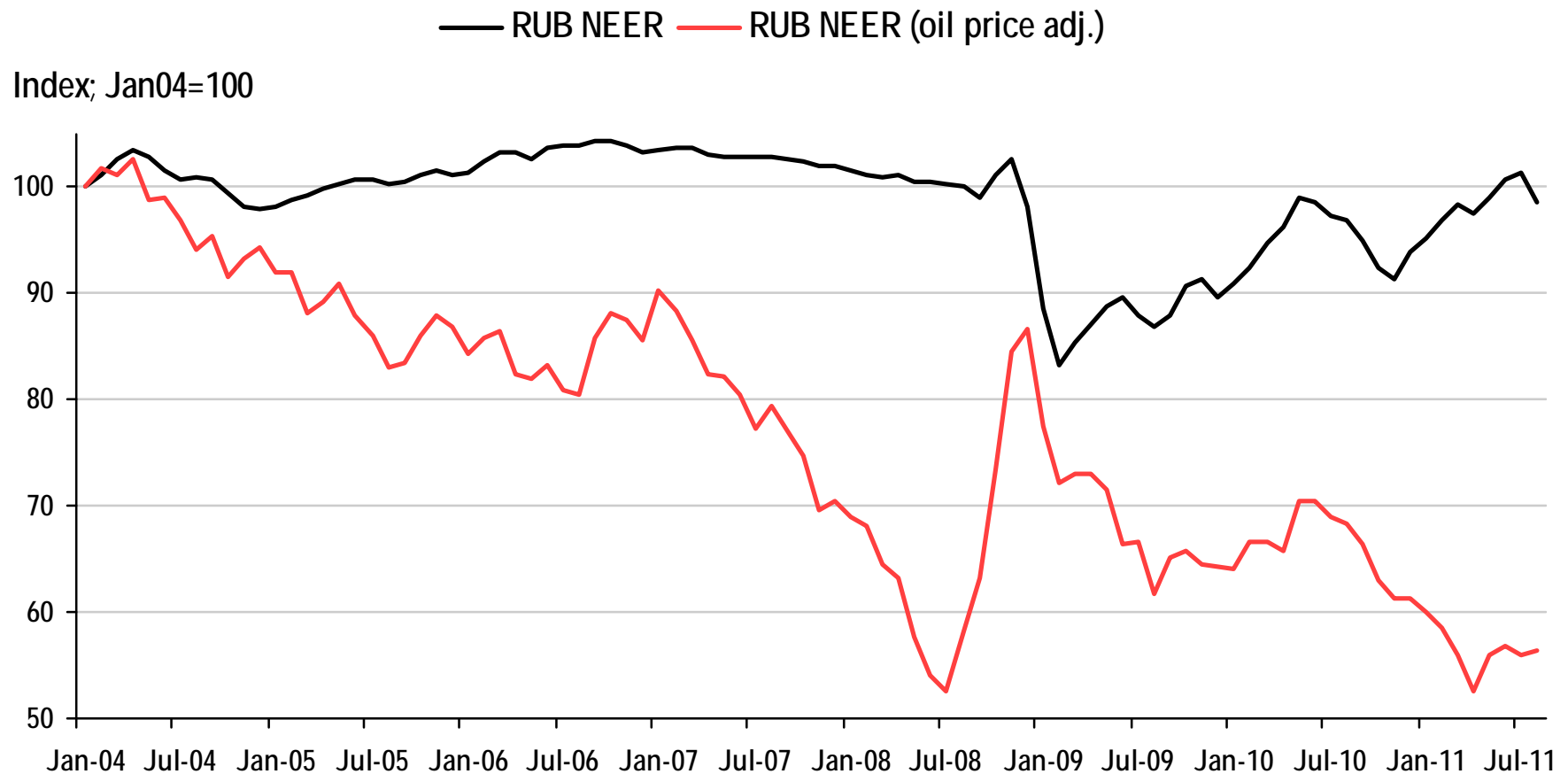
RUB positive

RUB neutral

RUB negative

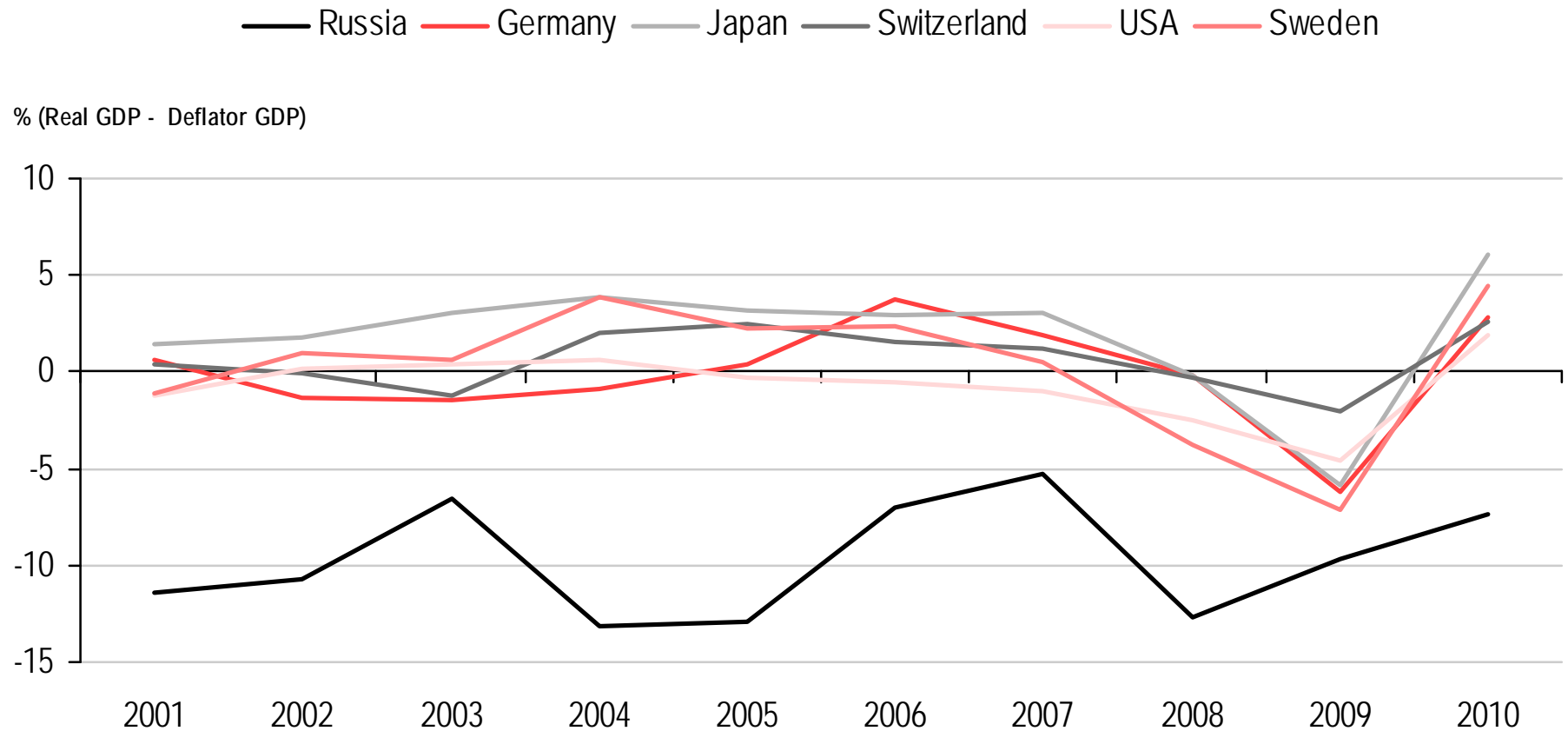
Source: CBR, HSBC

17. Note: With flat oil prices, RUB would have depreciated...



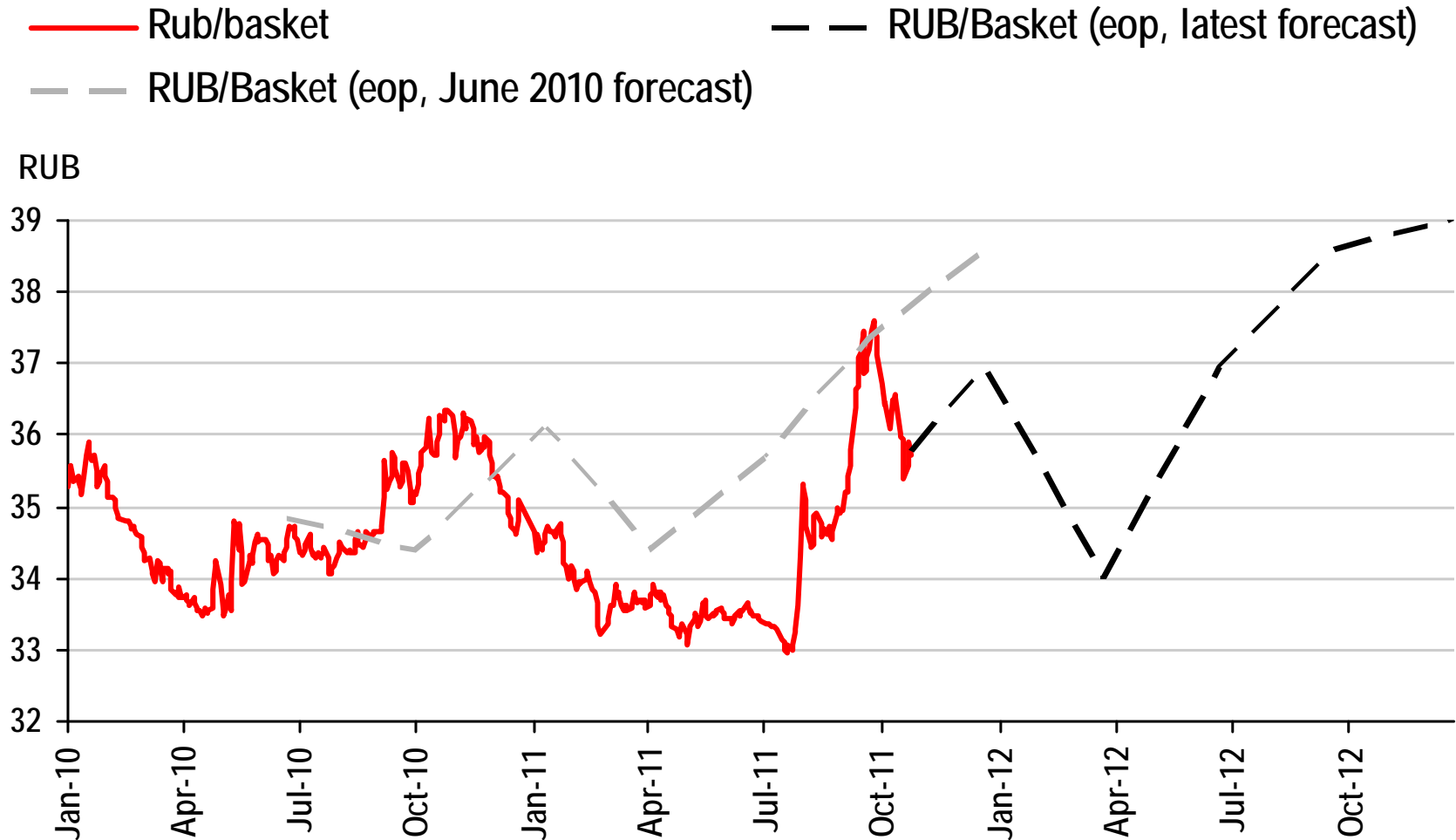
Source: CBR, HSBC

18. ...since Russian economic growth persistently lags behind inflation



Source: IMF, HSBC

19. HSBC has strong track record on the RUB



Source: Reuters, HSBC

Summary

- Volatile growth: Recent acceleration of **economic growth** in Russia appears to be temporary
- Volatile inflation: **Inflation** to decline to below 6% in 1Q 2012, yet to increase again in 2H 2012
- Good days for **liquidity** are over: CBR's repo rate – a New Normal for MM rates
- Volatile RUB: **RUB** to see some sunny days in 1H 2012 before depreciating to new lows

Disclosure appendix

Analyst Certification

The following analyst(s), economist(s), and/or strategist(s) who is(are) primarily responsible for this report, certifies(y) that the opinion(s) on the subject security(ies) or issuer(s) and/or any other views or forecasts expressed herein accurately reflect their personal view(s) and that no part of their compensation was, is or will be directly or indirectly related to the specific recommendation(s) or views contained in this research report: Alexander Morozov

Important Disclosures

This document has been prepared and is being distributed by the Research Department of HSBC and is intended solely for the clients of HSBC and is not for publication to other persons, whether through the press or by other means.

This document is for information purposes only and it should not be regarded as an offer to sell or as a solicitation of an offer to buy the securities or other investment products mentioned in it and/or to participate in any trading strategy. Advice in this document is general and should not be construed as personal advice, given it has been prepared without taking account of the objectives, financial situation or needs of any particular investor. Accordingly, investors should, before acting on the advice, consider the appropriateness of the advice, having regard to their objectives, financial situation and needs. If necessary, seek professional investment and tax advice.

Certain investment products mentioned in this document may not be eligible for sale in some states or countries, and they may not be suitable for all types of investors. Investors should consult with their HSBC representative regarding the suitability of the investment products mentioned in this document and take into account their specific investment objectives, financial situation or particular needs before making a commitment to purchase investment products.

The value of and the income produced by the investment products mentioned in this document may fluctuate, so that an investor may get back less than originally invested. Certain high-volatility investments can be subject to sudden and large falls in value that could equal or exceed the amount invested. Value and income from investment products may be adversely affected by exchange rates, interest rates, or other factors. Past performance of a particular investment product is not indicative of future results.

Analysts, economists, and strategists are paid in part by reference to the profitability of HSBC which includes investment banking revenues.

For disclosures in respect of any company mentioned in this report, please see the most recently published report on that company available at www.hsbcnet.com/research.

** HSBC Legal Entities are listed in the Disclaimer below.*

Additional disclosures

- 1 This report is dated as at 10 November 2011.
- 2 All market data included in this report are dated as at close 10 November 2011, unless otherwise indicated in the report.
- 3 HSBC has procedures in place to identify and manage any potential conflicts of interest that arise in connection with its Research business. HSBC's analysts and its other staff who are involved in the preparation and dissemination of Research operate and have a management reporting line independent of HSBC's Investment Banking business. Information Barrier procedures are in place between the Investment Banking and Research businesses to ensure that any confidential and/or price sensitive information is handled in an appropriate manner.

Disclaimer

** Legal entities as at 31 January 2010*

'UAE' HSBC Bank Middle East Limited, Dubai; 'HK' The Hongkong and Shanghai Banking Corporation Limited, Hong Kong; 'TW' HSBC Securities (Taiwan) Corporation Limited; 'CA' HSBC Securities (Canada) Inc, Toronto; HSBC Bank, Paris branch; HSBC France; 'DE' HSBC Trinkaus & Burkhardt AG, Dusseldorf; 000 HSBC Bank (RR), Moscow; 'IN' HSBC Securities and Capital Markets (India) Private Limited, Mumbai; 'JP' HSBC Securities (Japan) Limited, Tokyo; 'EG' HSBC Securities Egypt S.A.E., Cairo; 'CN' HSBC Investment Bank Asia Limited, Beijing Representative Office; The Hongkong and Shanghai Banking Corporation Limited, Singapore branch; The Hongkong and Shanghai Banking Corporation Limited, Seoul Securities Branch; The Hongkong and Shanghai Banking Corporation Limited, Seoul Branch; HSBC Securities (South Africa) (Pty) Ltd, Johannesburg; 'GR' HSBC Pantelakis Securities S.A., Athens; HSBC Bank plc, London, Madrid, Milan, Stockholm, Tel Aviv, 'US' HSBC Securities (USA) Inc, New York; HSBC Yatirim Menkul Degerler A.S., Istanbul; HSBC México, S.A., Institución de Banca Múltiple, Grupo Financiero HSBC, HSBC Bank Brasil S.A. - Banco Múltiplo, HSBC Bank Australia Limited, HSBC Bank Argentina S.A., HSBC Saudi Arabia Limited., The Hongkong and Shanghai Banking Corporation Limited, New Zealand Branch.

Issuer of report

HSBC Bank (RR) (Limited Liability Company)

2 Paveletskaya Square, Building 2

Moscow 115054,

Russian Federation

Telephone: +7 495 721 1515

Fax: 7 495 258 3154

Website: www.research.hsbc.com

This document has been issued and distributed by HSBC Bank (RR) (Limited Liability Company) for the information of its institutional and professional customers; it is not intended for and should not be issued and distributed to retail customers. HSBC Bank (RR) (Limited Liability Company) makes no representations that the products or services mentioned in this document are available to persons in Russian Federation or are necessarily suitable for any particular person or appropriate in accordance with Russian law. All inquiries by such recipients must be directed to HSBC Bank (RR) (Limited Liability Company). HSBC Bank (RR) (Limited Liability Company) shall not be responsible or liable for any consequences, losses or damages incurred as a result of any purchase, investment or other transaction or activity made or conducted on the basis of the information contained in this document.

This document is not and should not be construed as an offer to sell or the solicitation of an offer to purchase or subscribe for any investment or transaction. HSBC Bank (RR) (Limited Liability Company) has based this document on information obtained from sources it believes to be reliable but which it has not independently verified; HSBC Bank (RR) (Limited Liability Company) makes no guarantee, representation or warranty and accepts no responsibility or liability as to its accuracy or completeness. The opinions contained within the report are based upon publicly available information at the time of publication and are subject to change without notice.

In Australia, this publication has been distributed by The Hongkong and Shanghai Banking Corporation Limited (ABN 65 117 925 970, AFSL 301737) for the general information of its "wholesale" customers (as defined in the Corporations Act 2001). Where distributed to retail customers, this research is distributed by HSBC Bank Australia Limited (AFSL No. 232595). These respective entities make no representations that the products or services mentioned in this document are available to persons in Australia or are necessarily suitable for any particular person or appropriate in accordance with local law. No consideration has been given to the particular investment objectives, financial situation or particular needs of any recipient. In Korea, this publication is distributed by either The Hongkong and Shanghai Banking Corporation Limited, Seoul Securities Branch ("HBAP SLS") or The Hongkong and Shanghai Banking Corporation Limited, Seoul Branch ("HBAP SEL") for the general information of professional investors specified in Article 9 of the Financial Investment Services and Capital Markets Act ("FSCMA"). This publication is not a prospectus as defined in the FSCMA. It may not be further distributed in whole or in part for any purpose. Both HBAP SLS and HBAP SEL are regulated by the Financial Services Commission and the Financial Supervisory Service of Korea. This publication is distributed in New Zealand by The Hongkong and Shanghai Banking Corporation Limited, New Zealand Branch.

© Copyright. HSBC Bank (RR) (Limited Liability Company) 2011, ALL RIGHTS RESERVED. HSBC Bank (RR) (Limited Liability Company) retains all rights (including copyrights, trademarks, patents as well as any other intellectual property right) in relation to all information provided on or via this document (including all texts, graphics and logos). You do not receive any license in relation to such information. No part of this publication may be reproduced, copied, published, distributed, stored in a retrieval system, or transmitted, in any form or by any means, electronic, mechanical, photocopying, recording, or otherwise, without the prior written permission of HSBC Bank (RR) (Limited Liability Company). MICA (P) 142/06/2010 and MICA (P) 193/04/2010