

# Russian Economy Briefing

Navigating through the storm: scale of the challenge

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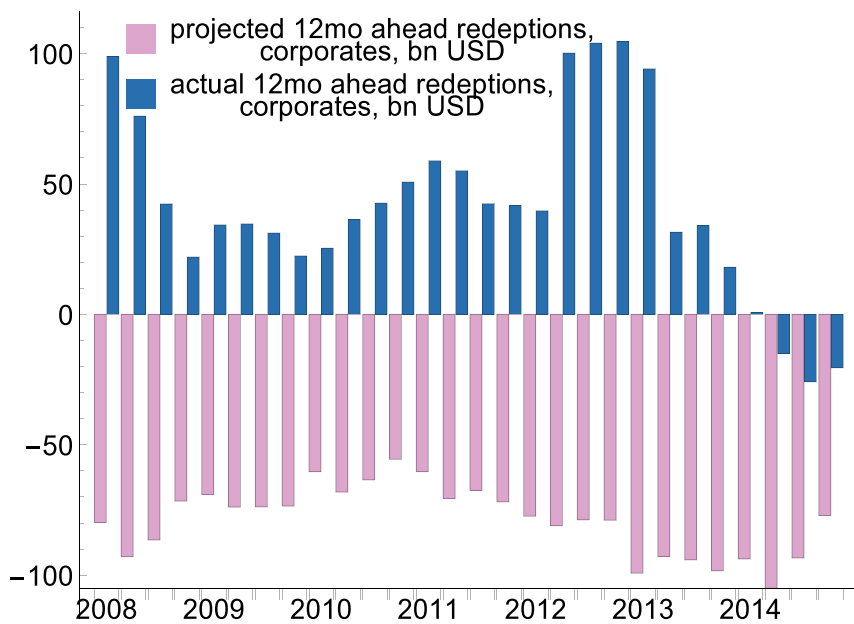


- I. Loss of access to external financial markets/financial stability risks
- II. Scale of economic activity has decline & current stage of adjustment
- III. Inflationary pressure and monetary policy stance
- IV. Impact on fiscal buffers and international reserves

# I. Dealing with a capital flow sudden stop: scale of the challenge

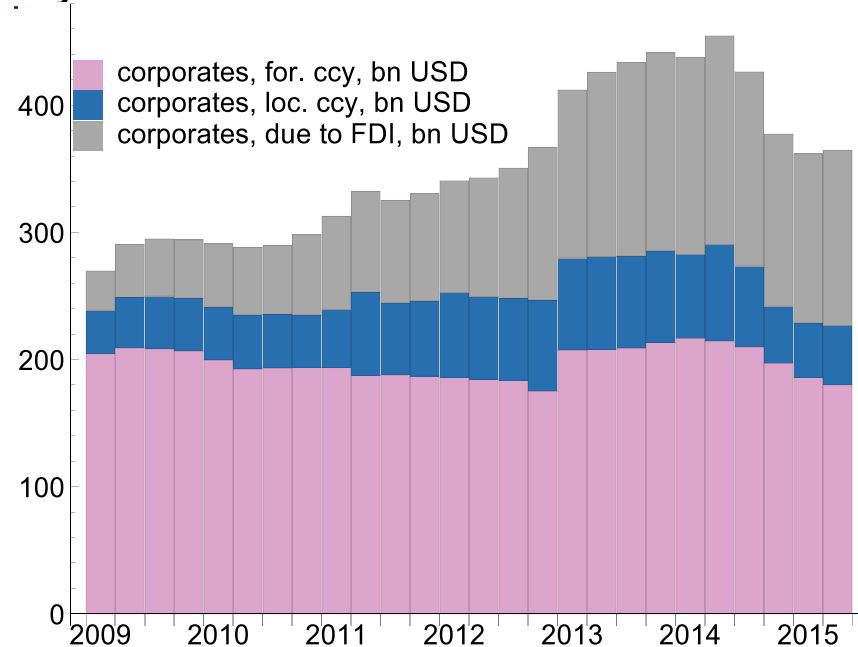
- Total foreign debt has come down from USD680.1bn to USD521.6bn in 1yr
- Headline estimates of debt are misleading: for corporates significant part of the debt is due to direct investors (“thin capitalization”), related parties
- CBR supports smoothening of debt redemptions by extending access to FX liquidity through repo, loans backed by credit to key exporters

**Debt redemptions manageable, set to decline**



Source: CBR, VTB Capital Research

**Less than 50% of external corp debt is foreign. ccy denominated debt to non-direct investors**



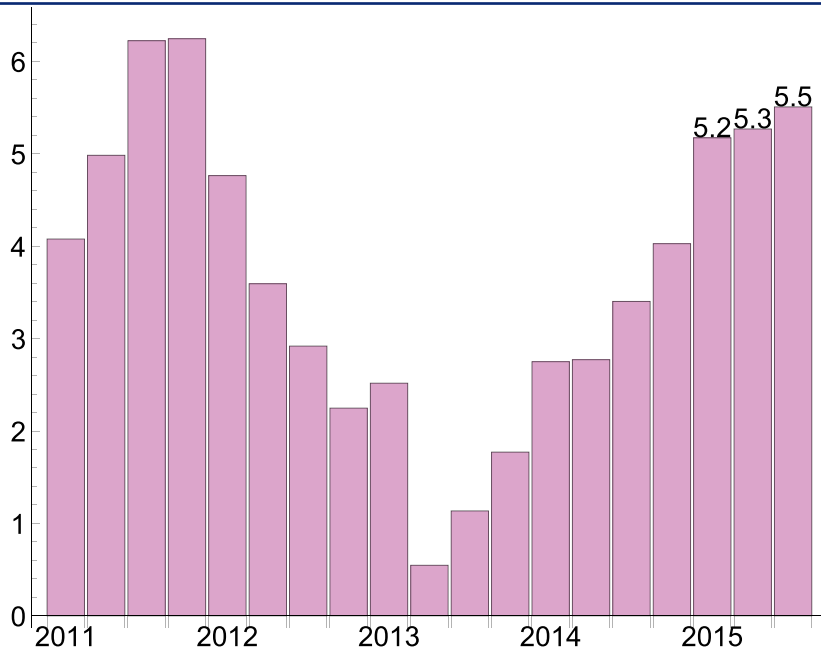
Source: CBR, VTB Capital Research

# I. Dealing with a capital flow sudden stop: rapid external adjustment



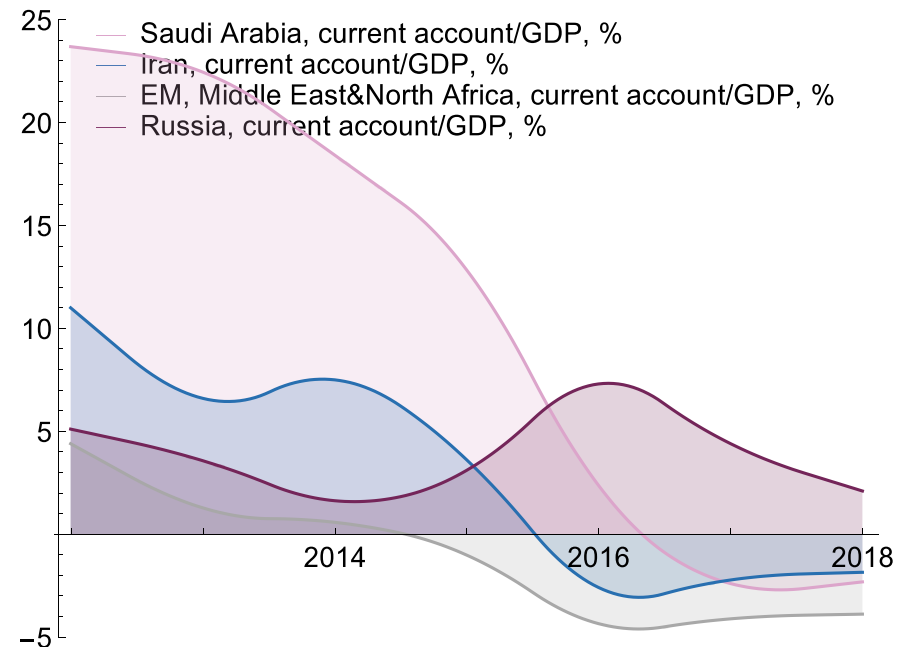
- External adjustment comes primarily through imports contraction, down 40-50% YoY with approximately equal fall in both consumption and investment goods
- Total current account is expected to reach USD62-65bn in 2015 or >5% GDP
- Share of non-oil&gas exports to remain 30-40%

## Current account/GDP is expected to exceed 5% in 2015



Source: CBR, Rosstat, VTB Capital Research

## World Bank expects Russia to sustain robust CA in the medium term

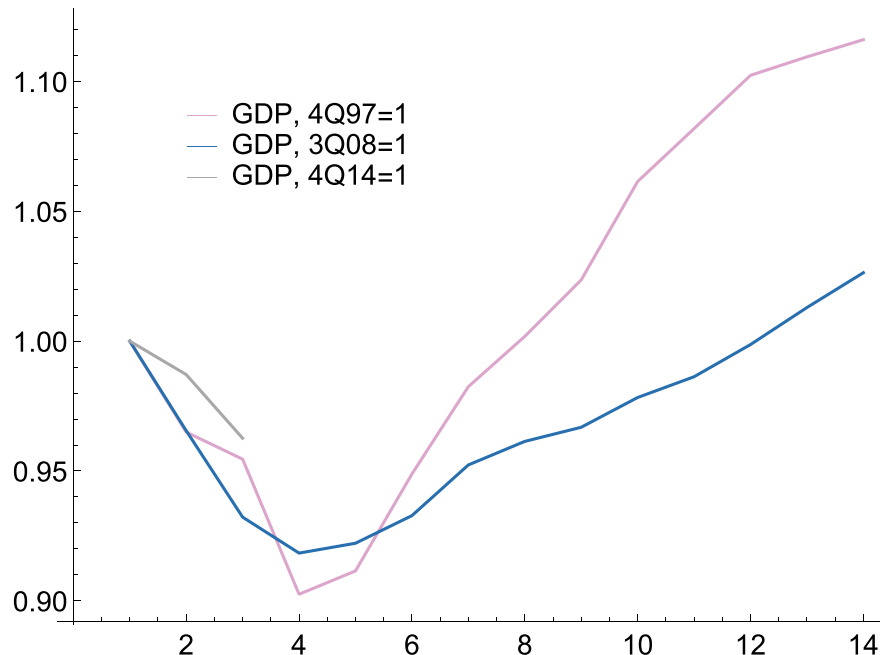


Source: World Bank, VTB Capital Research

## II. Floating exchange rate cushions the blow from commodity prices decline

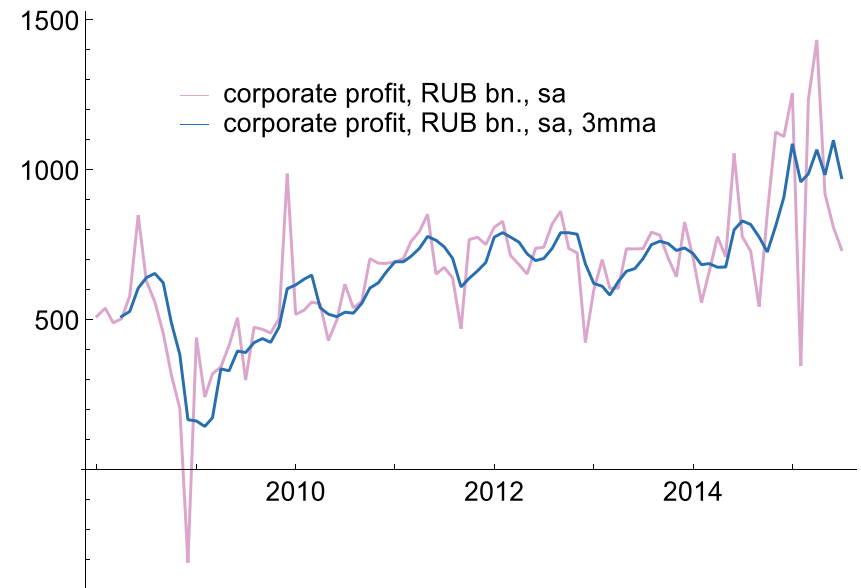
- Real exchange rate depreciation that was brought about by the transition to floating exchange rate decreases stress on real economy: output and employment
- Main gauges of economic activity are relatively stable comparing to the previous slowdown episodes: IP bottomed out at -5.5% in March recovering to -3.7% YoY in September, GDP passed the lowest point in the mid-3Q15 recovering to -3.8% YoY in September

### GDP declines -4.6% YoY in 2Q15 vs -11.2% YoY in 2Q09



Source: Rosstat, VTB Capital Research

### Profit rates were supported by ruble weakness reaching 38% YoY in 1H15

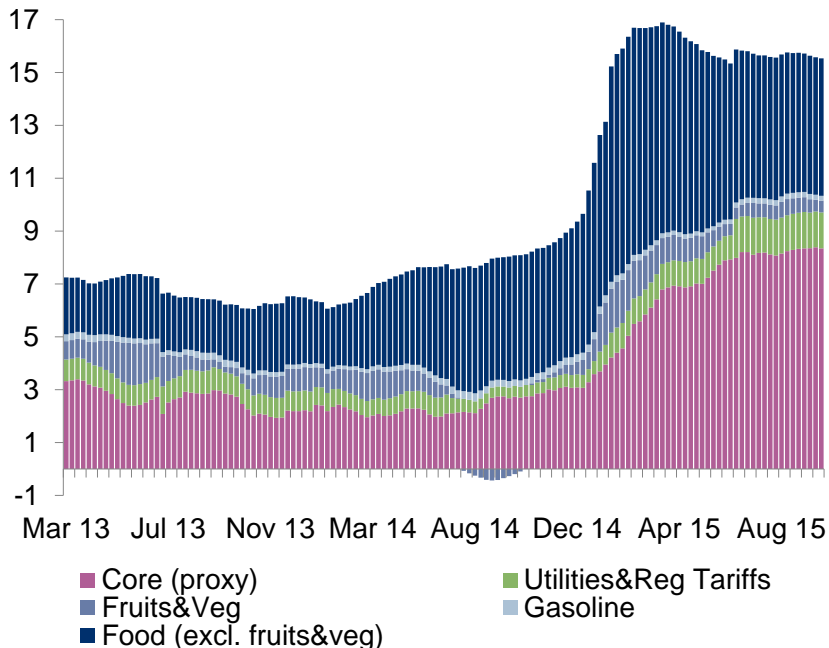


Source: Rosstat, VTB Capital Research

### III. Exchange rate pass-through to prices has run its course and weak household demand pushes inflation lower

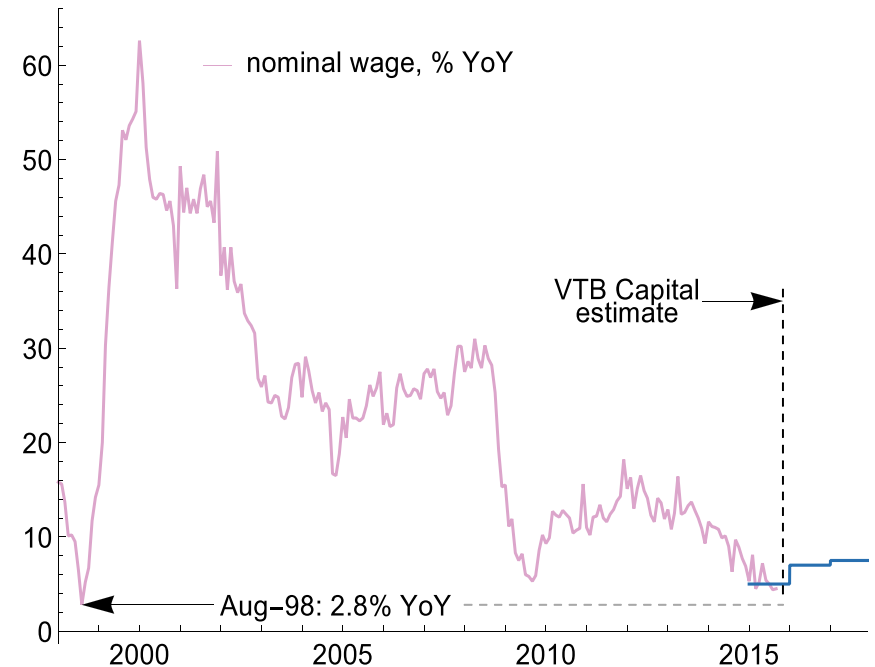
- Inflation has peaked at 16.9% in March and since then has been on a downward trend
- Modest pace of disinflation is mostly optical as most of the current inflation has been accumulated during late 2014 – early 2015 thus a rapid decline of the headline inflation is expected on the back of the high base effect
- Other factors weigh on price growth: public sector wage indexation freeze , declining real income

#### The bulk of inflation shock has been incurred during late 4Q14 –1Q15, normalizing since then



Source: Rosstat, VTB Capital Research

#### Nominal wages growth converge to inflation target providing for sustainable disinflation



Source: Rosstat, VTB Capital Research

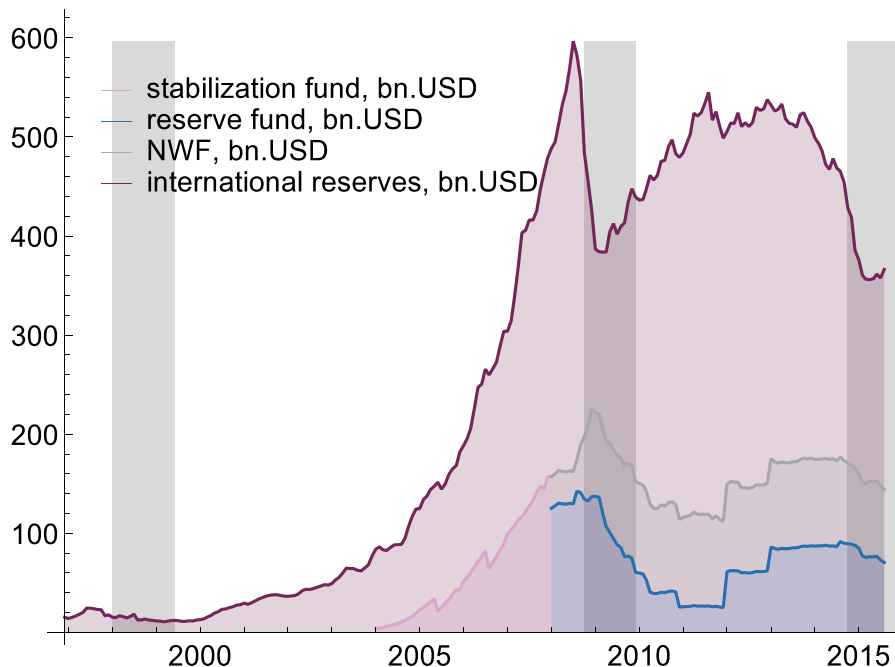


# IV. Fiscal policy outlook and reserve fund mechanics



- The fiscal policy stance remains tight: federal deficit/GDP at 3% for 2017 and declining
- The bulk of the deficit is financed from the sovereign funds, local net issuance is expected at RUB390bn (USD6.3bn).
- Fiscal consolidation on many fronts: civil employees wages frozen for 2<sup>nd</sup> year in a row, pension indexation at the level of inflation target materially below actual inflation rate
- Pension system reform on the agenda: means-tested payments, adjusting pension age

## Sovereign funds and international reserves



Source: CBR, Rosstat, VTB Capital Research

## Sovereign funds spending does not affect volume of int. reserves ...

CBR's assets	CBR's liabilities
...	...
international reserves	sovereign funds ↓
	MinFin's RUB account ↓

...it changes ccy composition of CBR's liabilities

Source: World Bank, VTB Capital Research



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Sell	44	25%
Restricted	1	1%
Not Rated	0	0%
Under Review	4	2%
	<b>174</b>	

Source: VTB Capital Research as at 30 September 2015

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Sell	3	20%
Restricted	1	7%
Not Rated	0	0%
Under Review	1	7%
	<b>15</b>	

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