

# ECONOMICS RUSSIA

Renaissance  
Capital

MACRO RESEARCH

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## *Economic developments in Russia in 2015*

January 2015

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# OIL PRICE SCENARIOS IN 2015

- We show our 2015E base case, which assumes that the Brent oil price averages \$60/bl in 2015
- The table also indicates how the base case would change in each of the scenarios listed to the left (higher oil prices) and right (lower oil prices)

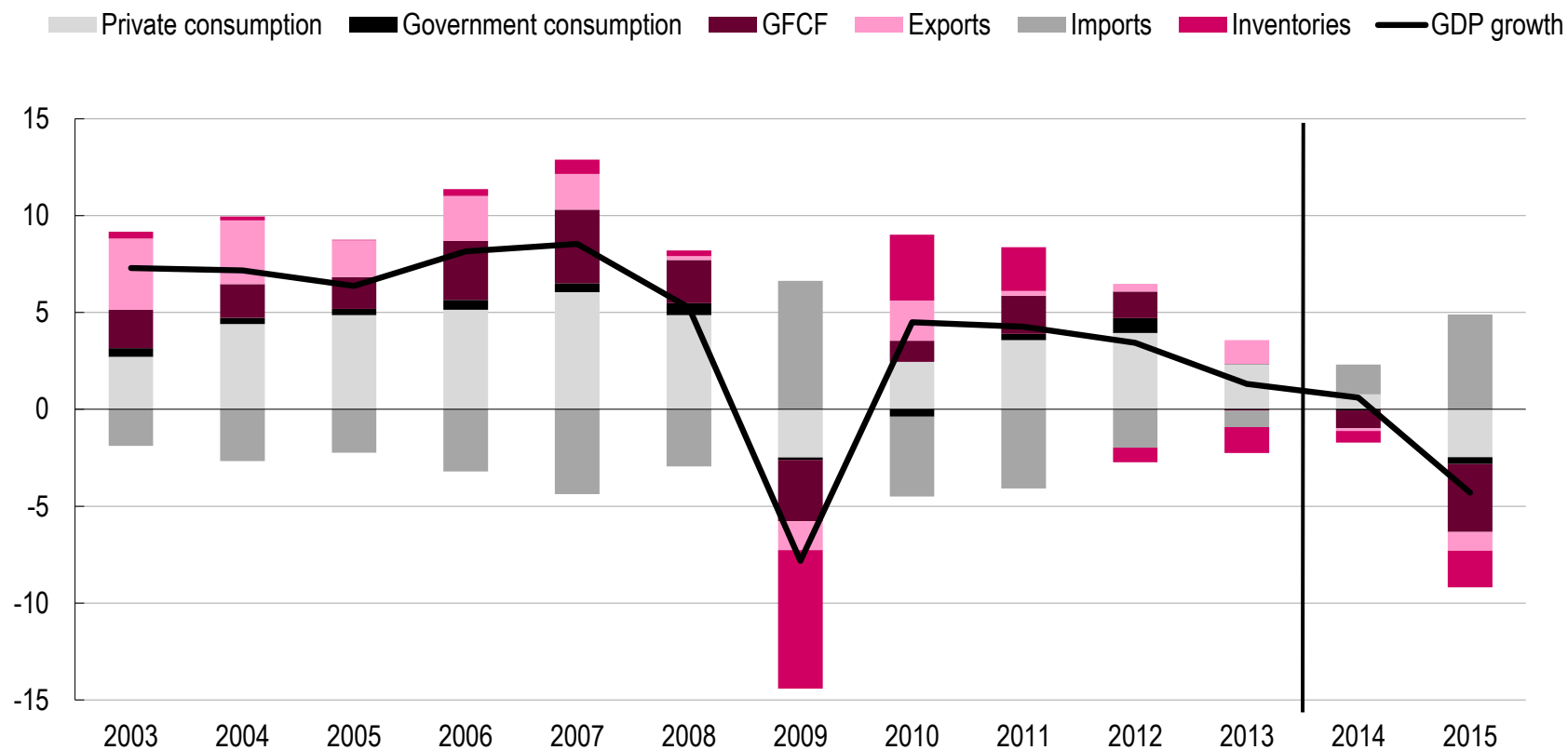
| Brent oil, \$/bl        | 100   | 90    | 80    | 70    | 60 Base case | 50    | 40    | 30    |
|-------------------------|-------|-------|-------|-------|--------------|-------|-------|-------|
| Real GDP growth         | 1.0%  | -0.4% | -1.7% | -3.1% | -4.3%        | -5.8% | -7.2% | -8.7% |
| RUB/\$1, annual avg     | 45.1  | 47.4  | 50.2  | 53.2  | 56.4         | 59.1  | 72.3  | 87.2  |
| Inflation, annual avg   | 9.8%  | 10.4% | 11.2% | 12.1% | 12.6%        | 12.0% | 13.0% | 13.5% |
| Current account, \$bn   | 83    | 75    | 68    | 60    | 53           | 46    | 70    | 85    |
| % of GDP                | 4.7%  | 4.5%  | 4.3%  | 4.1%  | 3.8%         | 3.6%  | 6.7%  | 9.9%  |
| External debt, \$bn     | 550   | 542   | 534   | 526   | 519          | 513   | 492   | 475   |
| % of GDP                | 31%   | 32%   | 34%   | 36%   | 38%          | 40%   | 47%   | 55%   |
| FX reserves, \$bn       | 365   | 360   | 355   | 350   | 345          | 340   | 330   | 320   |
| Months of imports cover | 15    | 15    | 16    | 17    | 18           | 19    | 22    | 26    |
| Budget, % of GDP *      | 1.1%  | 0.5%  | -0.7% | -1.8% | -3.2%*       | -4.5% | -5.2% | -6.6% |
| GDP, RUB tm             | 80.0  | 79.3  | 78.9  | 78.4  | 77.8         | 76.1  | 75.7  | 74.8  |
| GDP, \$bn               | 1,775 | 1,673 | 1,572 | 1,473 | 1,379        | 1,288 | 1,047 | 857   |

Note: These estimates imply no change in budget spending. In practice, we assume that the government cuts spending and the budget deficit would be capped by around 2% of GDP in any low oil price scenario.

Source: Renaissance Capital estimates

# ECONOMIC GROWTH

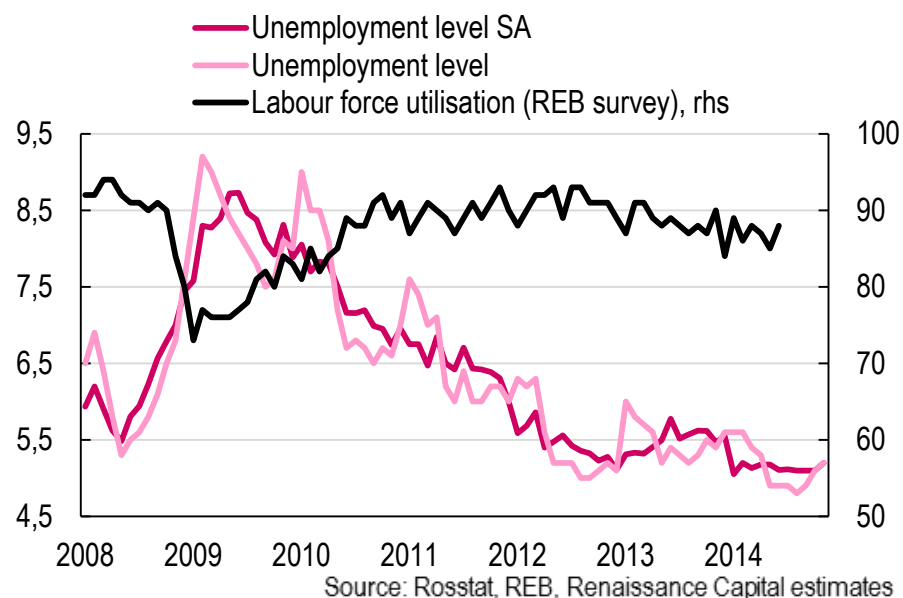
- Consumer demand is expected to fall by 4%, investment demand – by 16%
- Cuts in stocks might shave off no more than 2 % from Russian GDP growth this year, which compares with nearly 7 % in 2009.



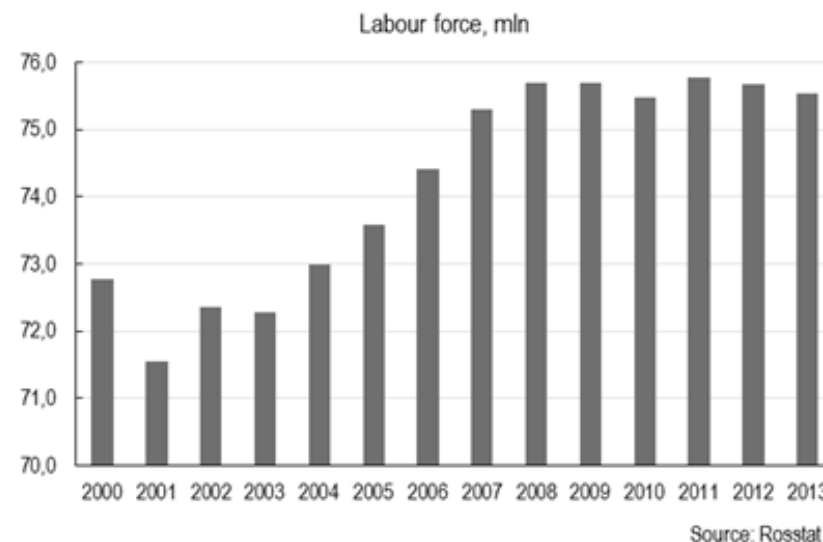
# LABOUR FORCE

- Labour market conditions remain supportive for domestic demand. However, the record-low unemployment figures are attributed to demographic factors
- Any huge pick-up in the unemployment rate from historically low levels is unlikely due to labour force dynamics – we pencil in its increase only to 6.5% in 2015

*Labour market indicators, %*



*Labour force*



# ROUBLE AND DOLLARISATION

- The 2008-2009 shock saw the level of dollarization rise from 15% to 20%. We suspect that this latest rouble crash, will, as in 2008-2009, push that level of dollarization higher again – perhaps up to the 25-30% level
- The underlying “fair value” for the rouble becomes weaker as there is a semi-permanent lower bid for the currency, due to this rise in demand for dollars.

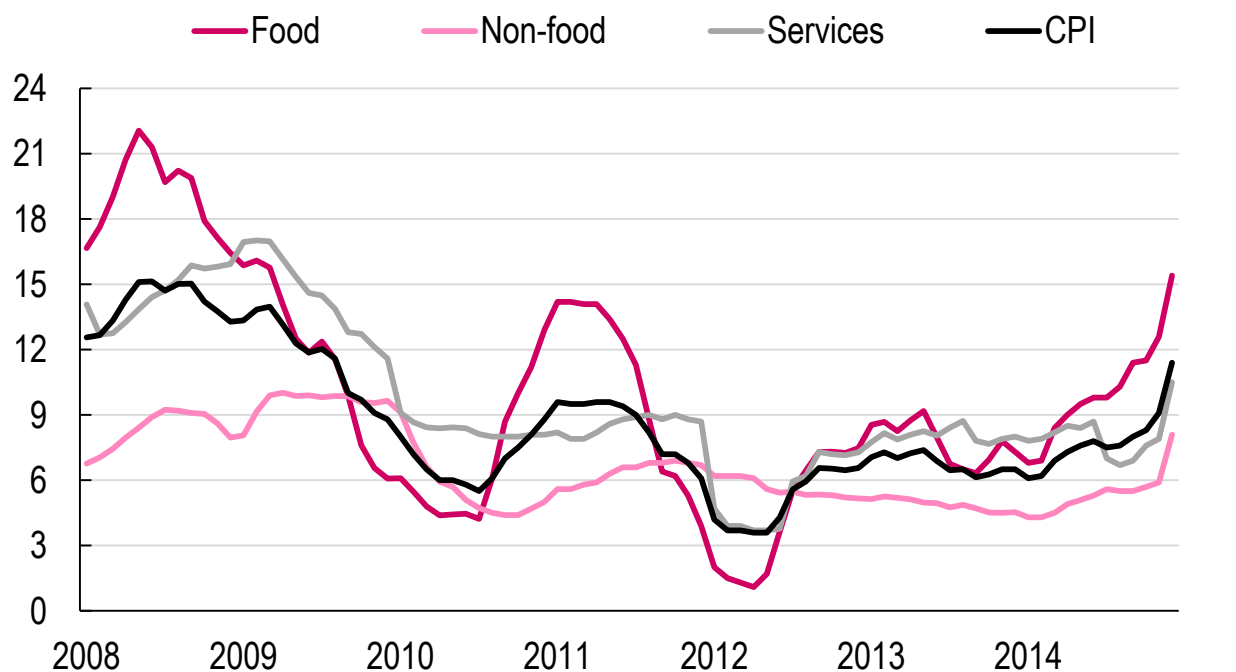
*Dollarisation of the Russian economy, %*



# INFLATION

- We see annual average consumer price inflation (CPI) hitting 12.6% at \$60/bl
- Price growth is expected to accelerate from 11.4% as of 1 January 2015 to 14.8% in March/April, boosted by the preceding rouble weakness. Next, it is likely to cool to around 10% by year-end as supply-side factors supporting price growth fade and the widening output gap takes its toll over price growth
- We see significant upside risks to our inflation forecasts, attributed to the possible heavy spike in inflation expectations resulting from unprecedented rouble volatility in December 2014

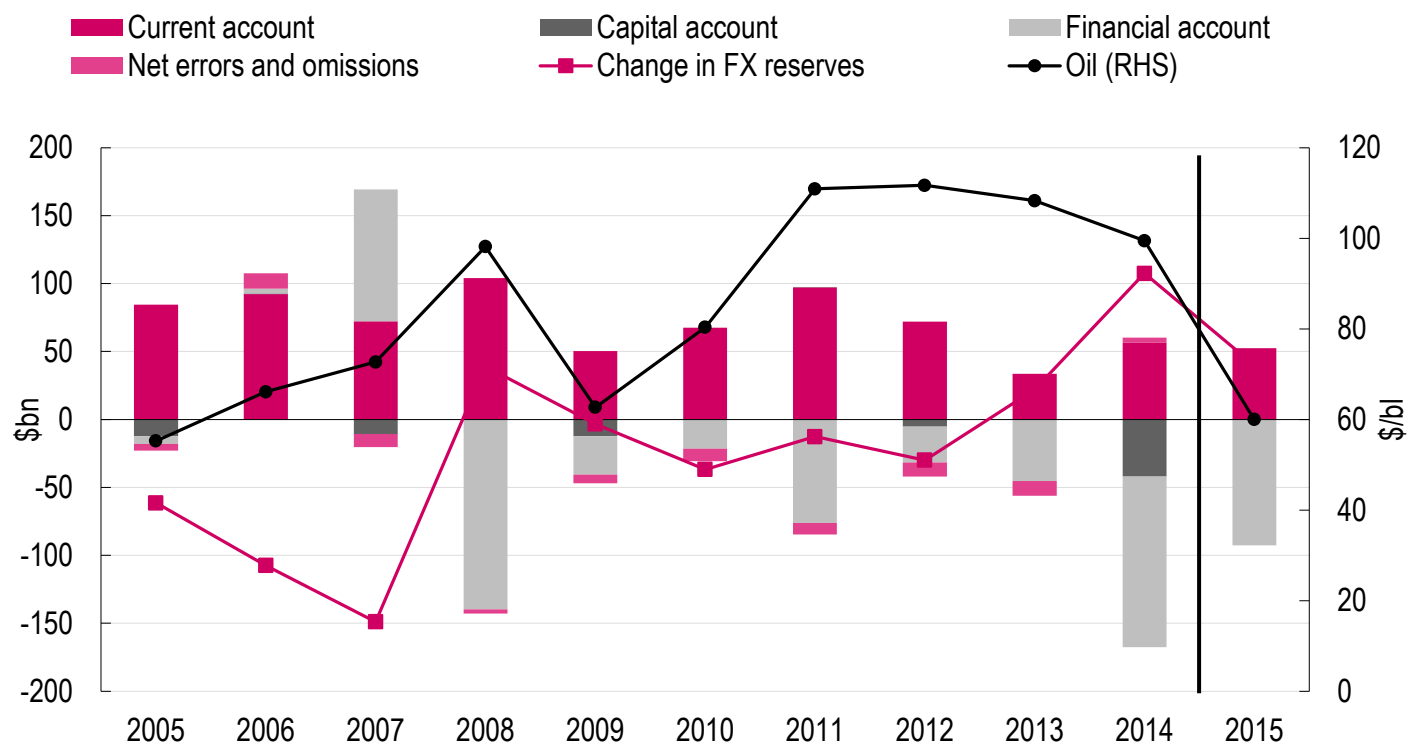
*CPI and its components, % YoY*



Source: Rosstat

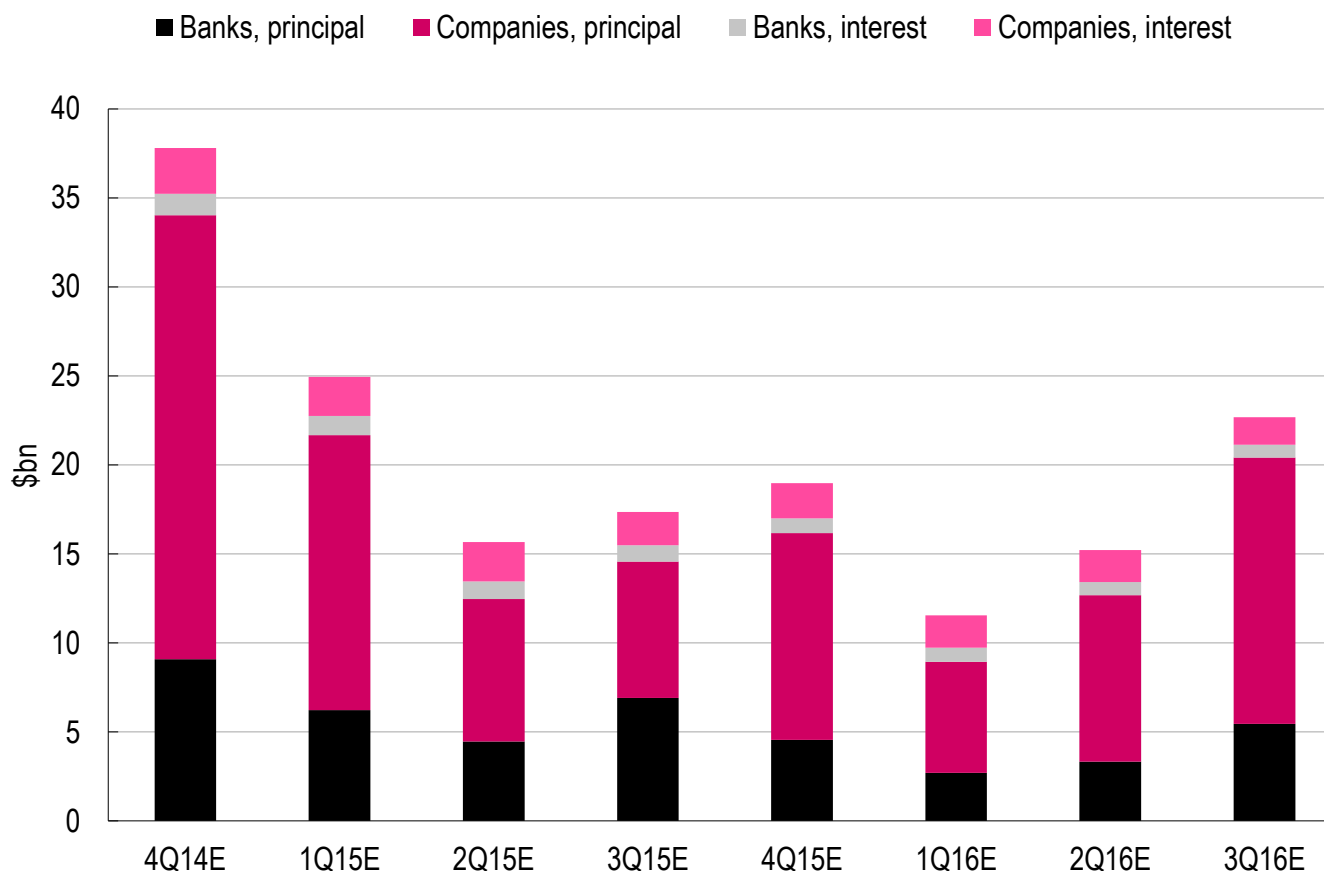
# BALANCE OF PAYMENTS

- C/A stays positive at any oil price, being an important source of FX inflows
- When the oil price falls, the rouble weakens and domestic consumer and investment demand contracts noticeably, thus taming imports growth and preventing a significant drop in the C/A surplus
- The C/A surplus amounts to 3.8% of GDP if the oil price averages \$60/bl (\$56.7bn, or 3.9% of GDP, in FY14)
- If the oil price improves, the C/A surplus also looks stronger, reaching \$67.9bn (4.3% of GDP) and \$60.3bn (4.1% of GDP) with oil averaging \$80/bl and \$70/bl, respectively. If the oil price goes to \$50/bl, the C/A surplus declines to \$45.8bn (3.6% of GDP)



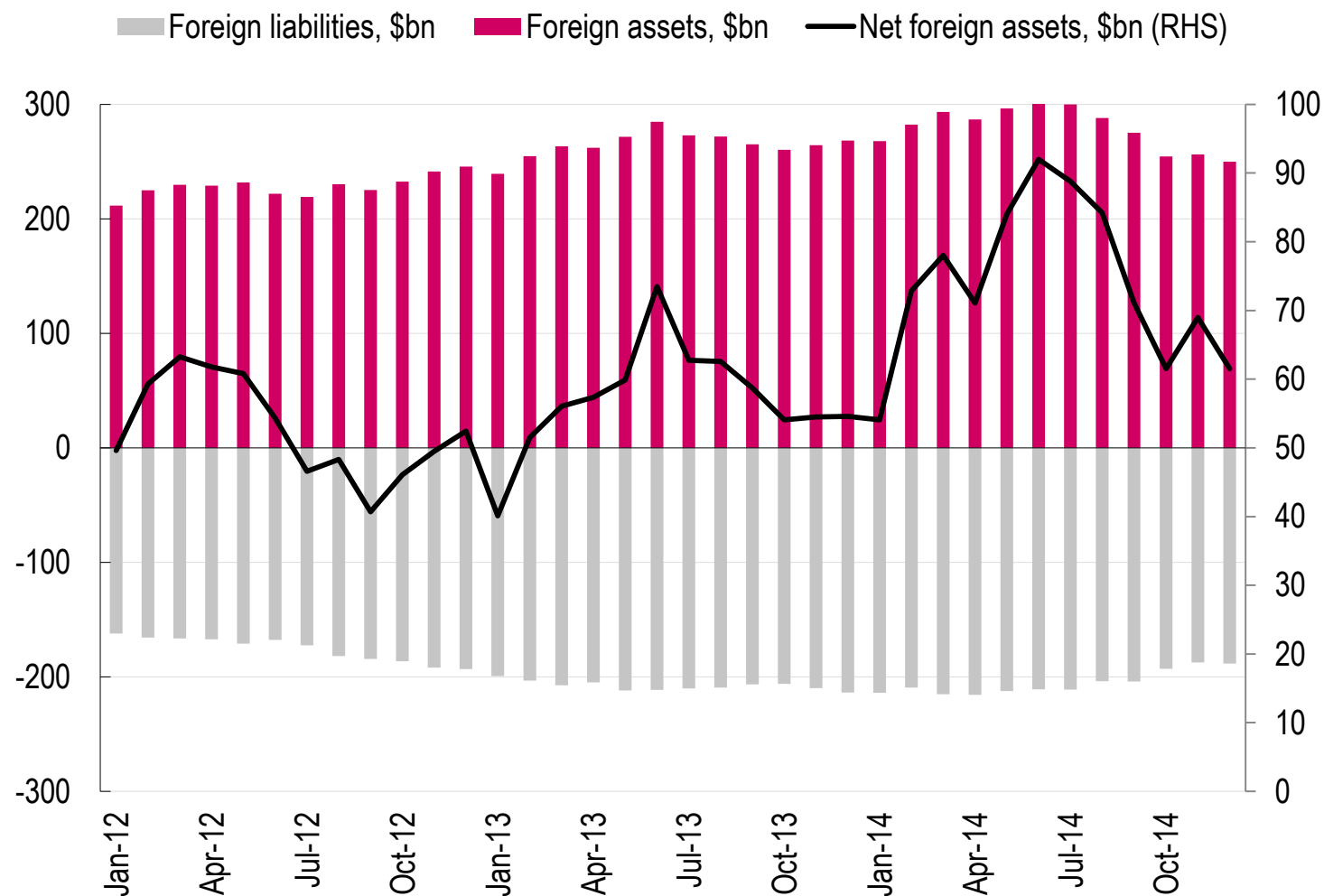
# EXTERNAL DEBT

- We estimate Russian banks and companies have to pay off \$77bn of external debt in 2015
- Official statistics tells \$128bn, but we maintain our view that these numbers could be overstated by at least 40%.
- They include low-risk transactions within multinationals or between parent companies and subsidiaries, and Russian financing done through offshore vehicles and trade loans to China which should not be repaid due to sanctions

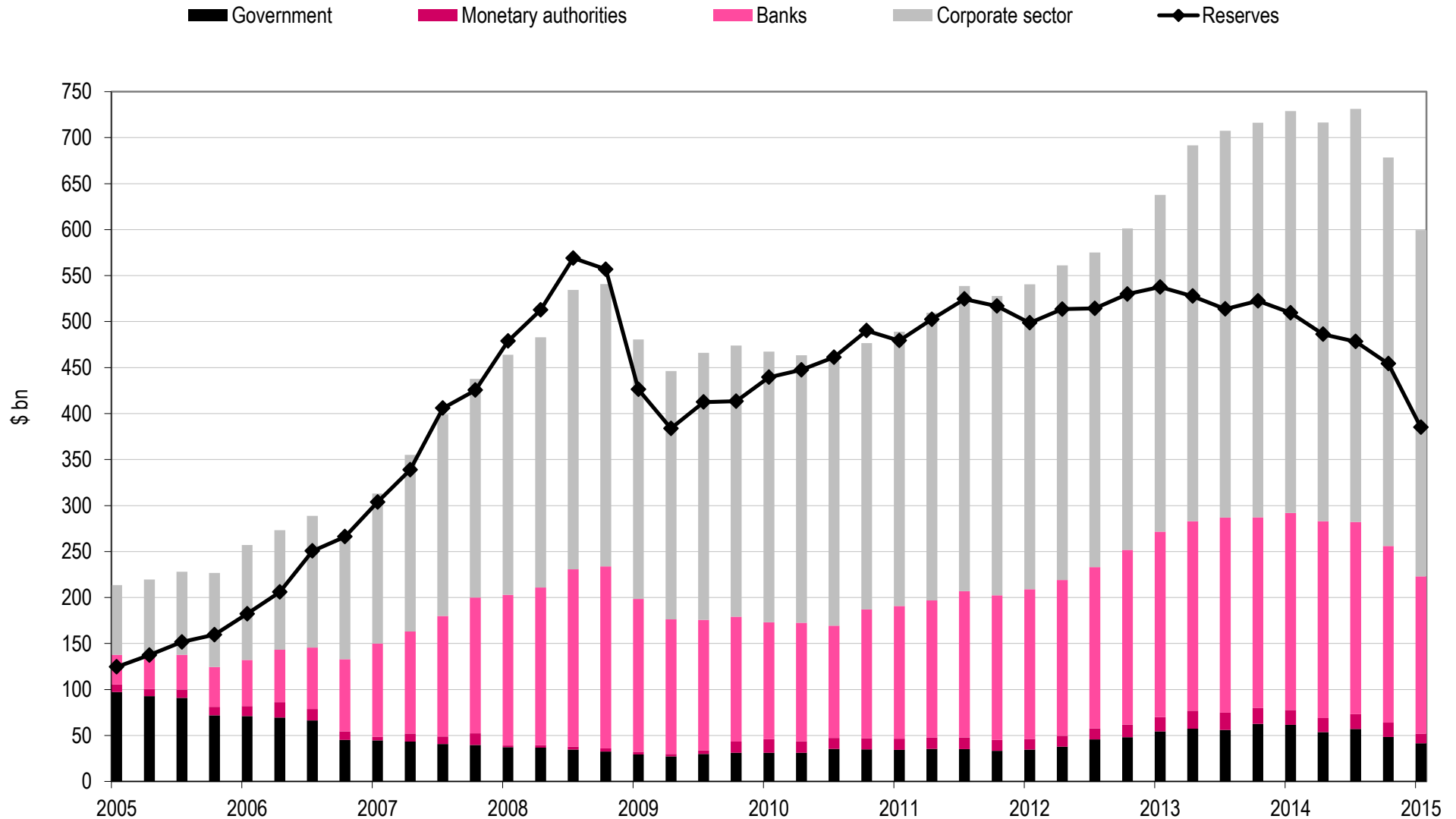


# BANKING SECTOR

- In contrast with 2008, banks are enjoying positive net foreign assets



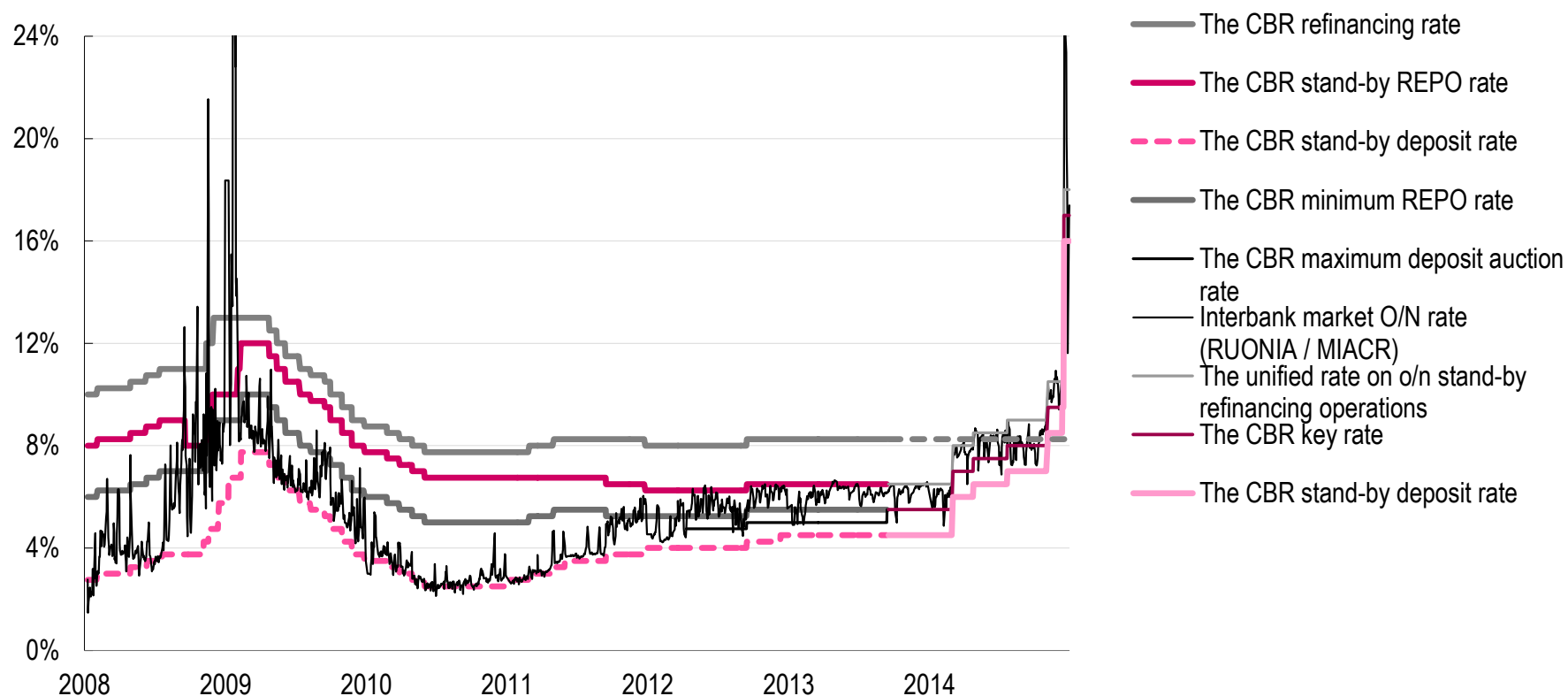
# EXTERNAL DEBT AND INTERNATIONAL RESERVES



Source: CBR

# CENTRAL BANK POLICY

- Current monetary policy stance is even tighter that in 2008 – 2009
- We expect the CBR to cut the key rate to 10% as of the end of 2015
- We think that the CBR will stay cautious and would not make a huge one-day move in the key rate, but would likely follow a gradual easing path through the year



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*Thank you!*

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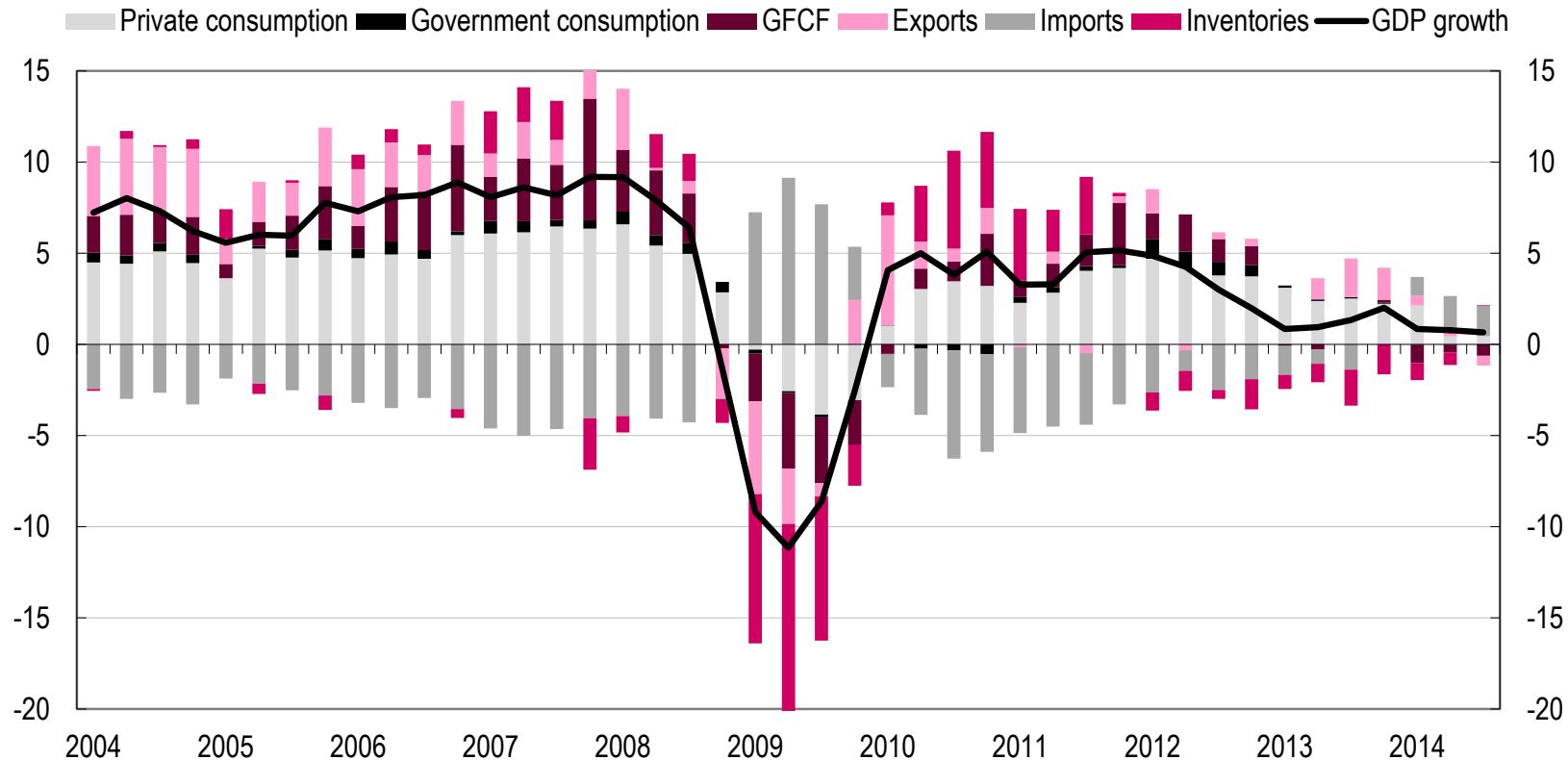
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# ECONOMIC GROWTH

- In 2013, the major drag on economic performance in Russia came from the inventory cycle. This primarily resulted from businesses adjusting inventories to the more-moderate pace of growth anticipated in the medium term
- This GDP-busting factor ended in 2014



Source: Rosstat, Renaissance Capital

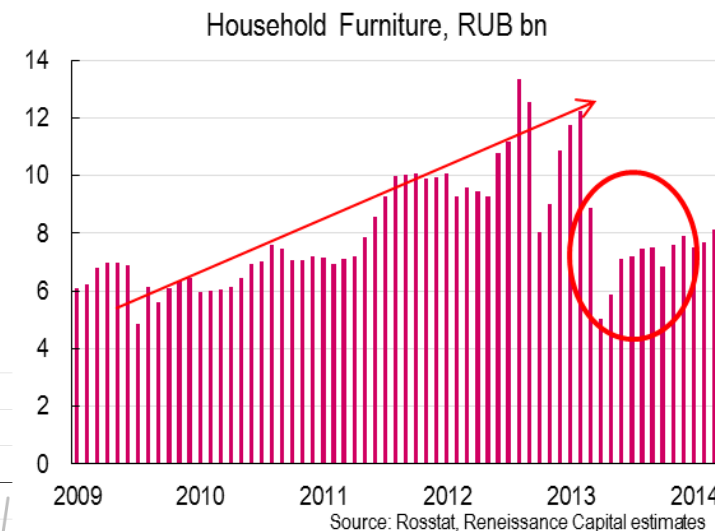
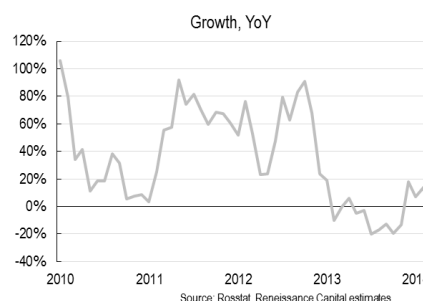
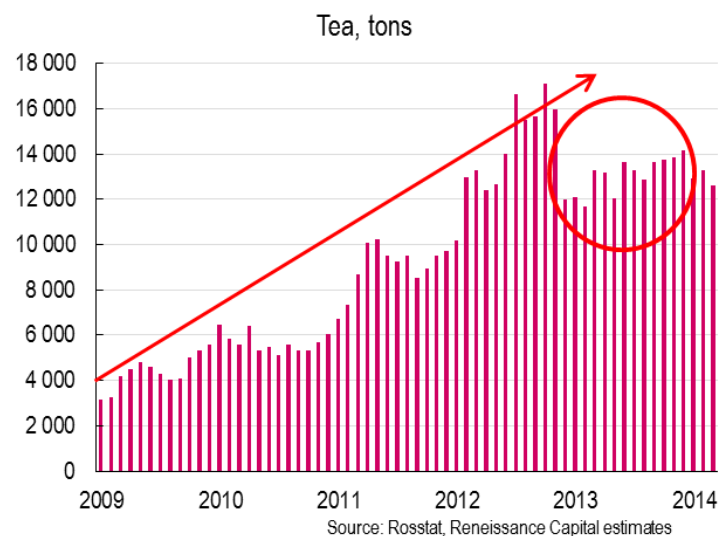
# ECONOMIC GROWTH

- In addition to the macro picture, certain microeconomic indicators support our view
- For instance, according to our estimates, in leading companies of the metals and mining industry, inventories and, in general, working capital amounts reduced noticeably through 2013, probably bottoming out

Metals and mining companies' working capital, \$mln

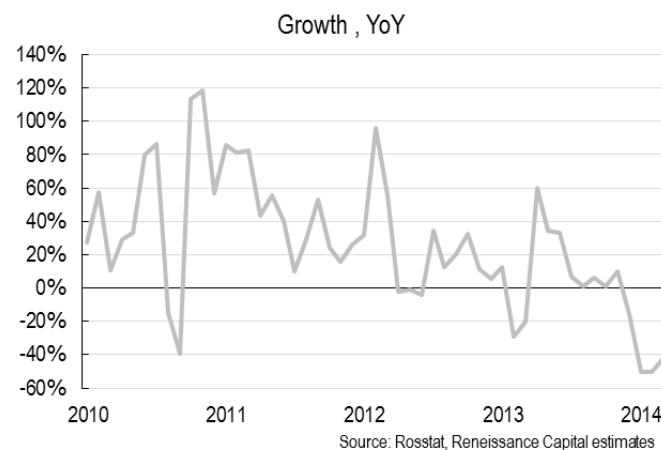
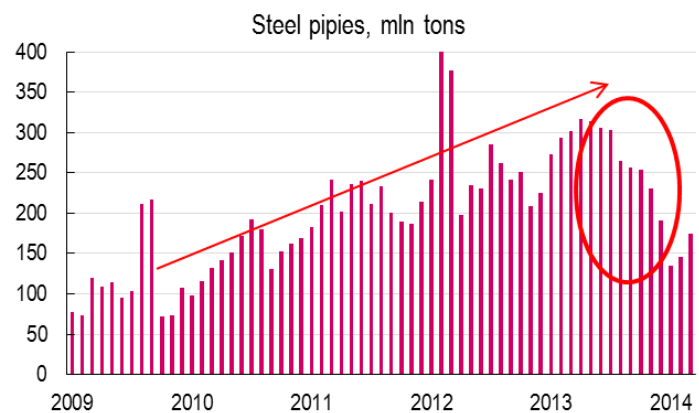
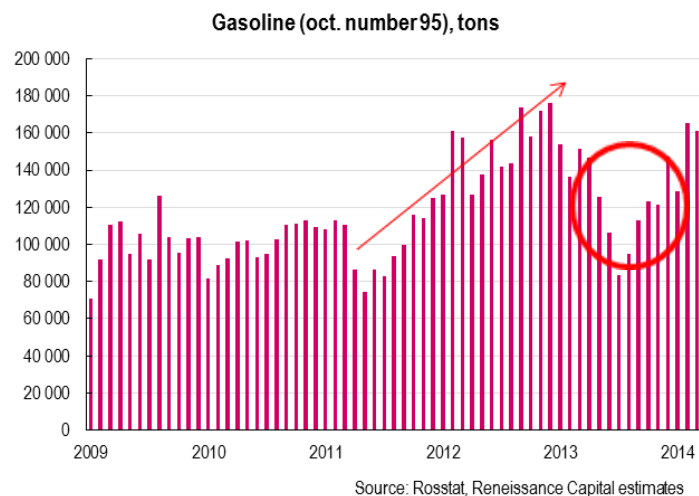
|                   | 2004  | 2005  | 2006  | 2007  | 2008  | 2009  | 2010  | 2011  | 2012  | 2013E |
|-------------------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|
| <b>MMK</b>        |       |       |       |       |       |       |       |       |       |       |
| Working capital   | 808   | 671   | 968   | 1222  | 666   | 869   | 1,056 | 1,199 | 1,109 | 372   |
| incl. inventories | 455   | 568   | 688   | 963   | 996   | 958   | 1236  | 1776  | 1674  | 102   |
| <b>Severstal</b>  |       |       |       |       |       |       |       |       |       |       |
| Working capital   | 1,344 | 1,109 | 2,482 | 3,226 | 4,677 | 3,064 | 2,477 | 1,068 | 2,315 | 2,219 |
| incl. inventories | 1,024 | 993   | 224   | 2,537 | 4,272 | 2,974 | 2,369 | 2,519 | 2,353 | 2,185 |

- Inventories in wholesale trade, consumer oriented



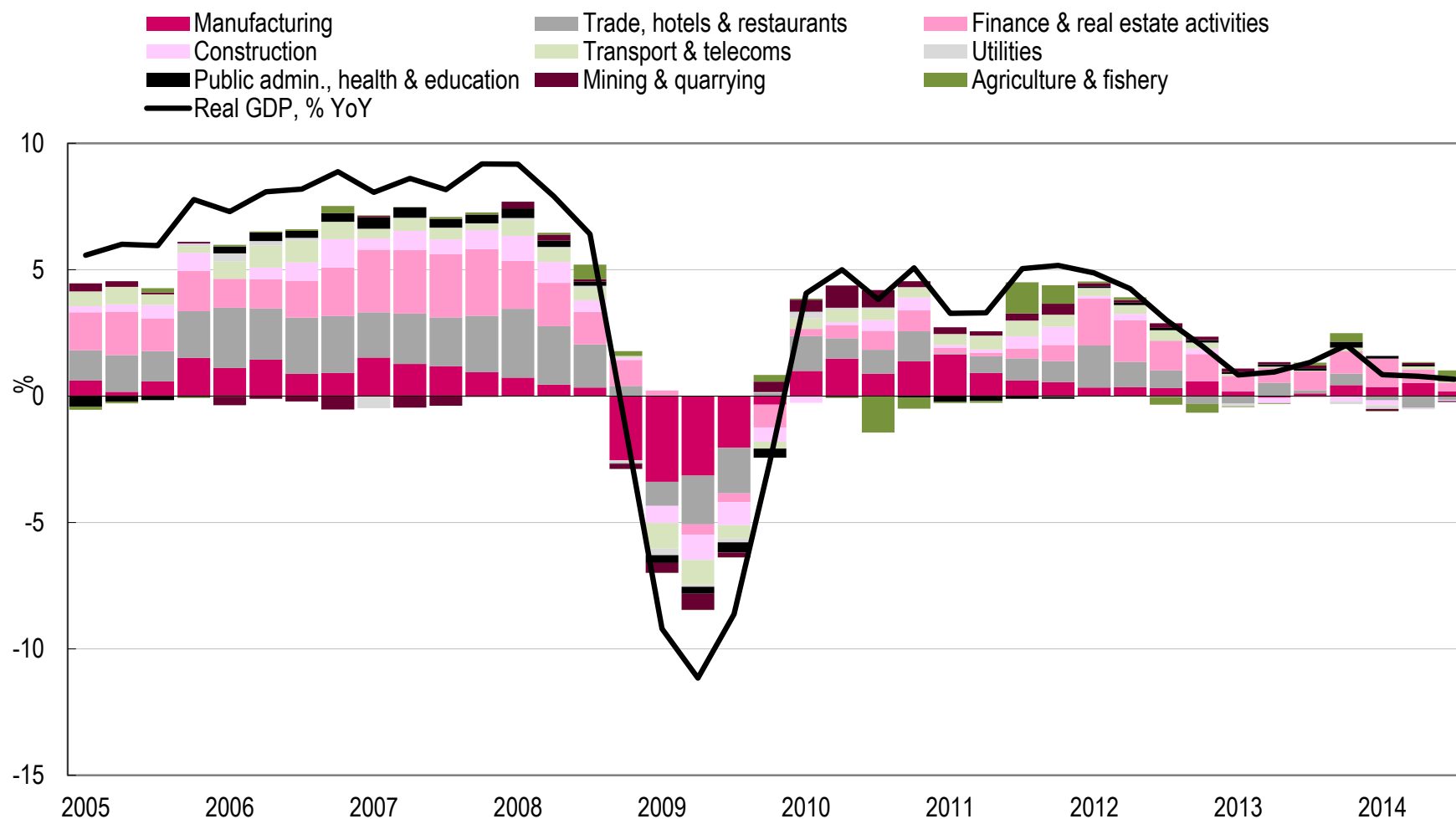
# ECONOMIC GROWTH

- Inventories in wholesale trade, business-oriented



# ECONOMIC GROWTH

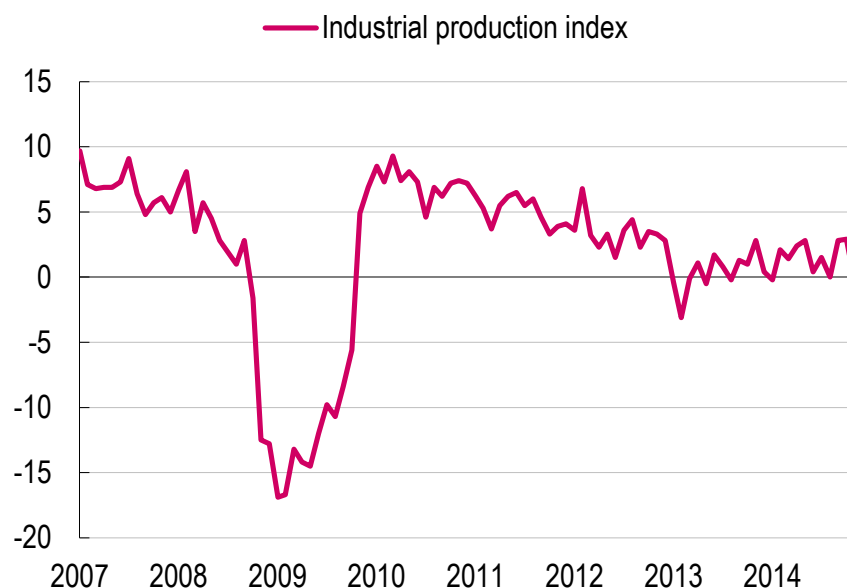
- Industry-wise, growth drivers in 3Q14 were dominated by finance and agriculture
- Though growth environment stayed quite fragile



# ECONOMIC GROWTH

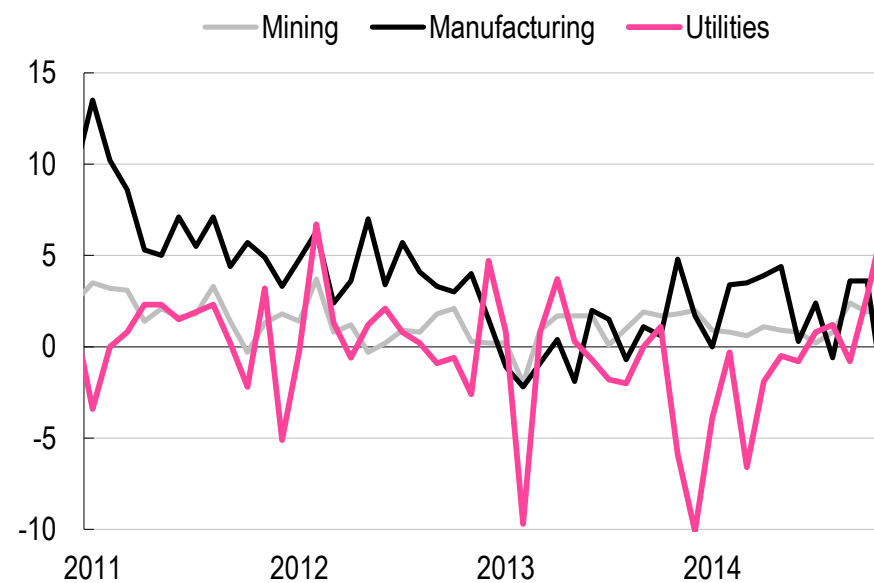
- Industrial production growth in 2014 surprised market on the upside to some extent
- Growth was driven by manufacturing, though utilities performance remained quite weak

*Industrial production growth, % YoY*



Source: Rosstat

*Industrial production components growth, % YoY*

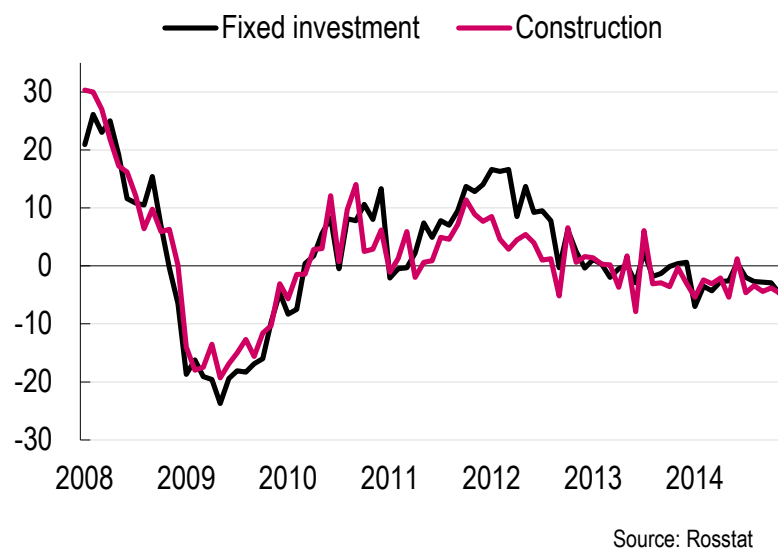


Source: Rosstat

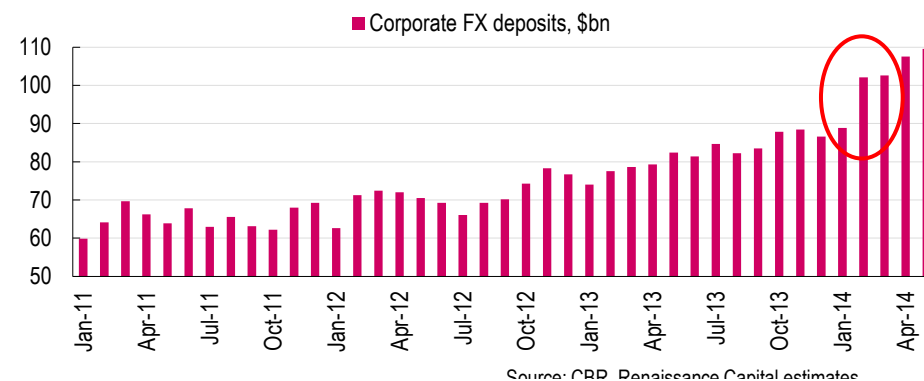
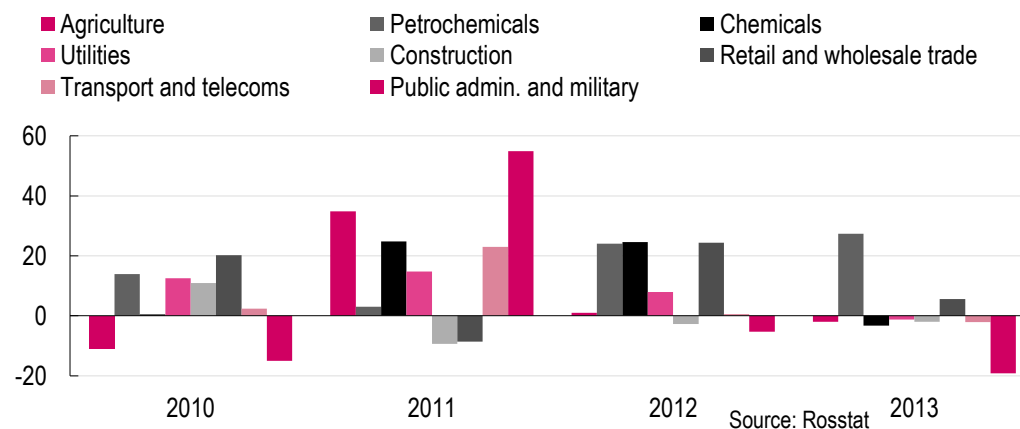
# CAPITAL EXPENDITURE

- Weak investment demand remains a significant drag on economic growth (capital expenditure is expected to drop by 3.8% in 2014)
- Elevated financial markets volatility, very difficult credit conditions and increased business uncertainty and due to Ukraine tensions put a drag on Russian domestic capex dynamics
- We expect that capital expenditure might fall by 16% in 2015, becoming the main negative drag on growth

Fixed investments growth, % YoY

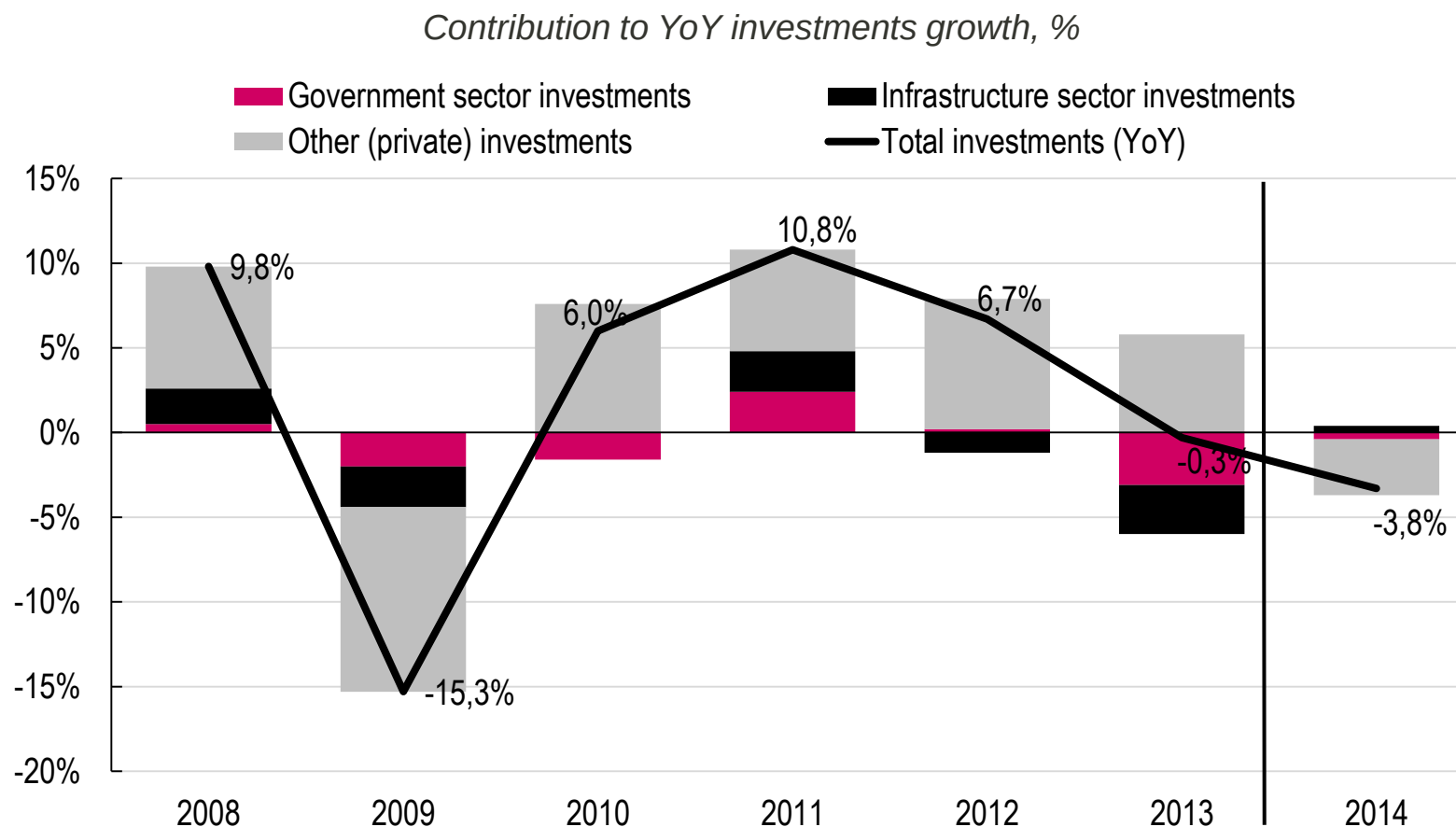


Fixed investments growth in certain industries, % YoY



# CAPITAL EXPENDITURE

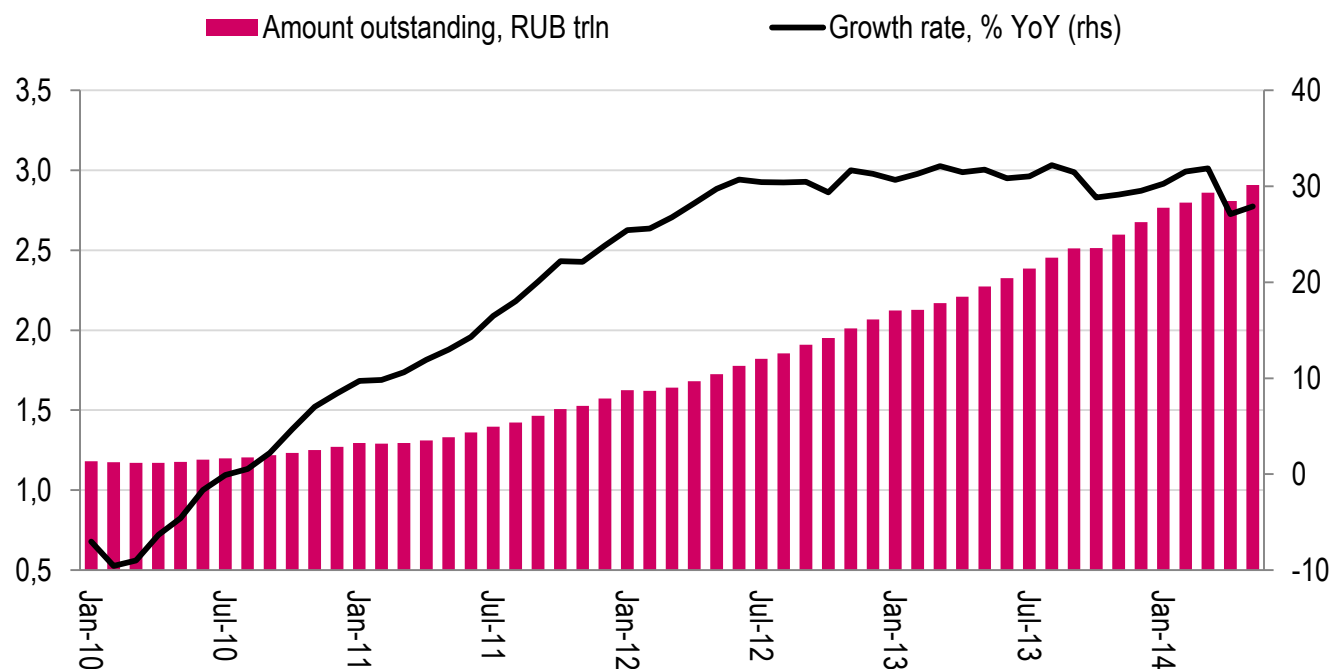
- In 2013 the stagnation in fixed investment growth was attributable to investment cuts in government and infrastructure sectors. The latter weighed heavily on still fairly robust private sector investment growth
- The cuts in businesses' capital expenditure in 2014 are primarily the result of elevated geopolitical uncertainty and increased cost of borrowing for Russian companies domestically and worldwide



# CAPITAL EXPENDITURE

- Individual housing investment will probably maintain its robust expansion, supported by mortgage market developments
- Households' mortgage indebtedness remains one of the lowest among the EM peers, at around 4% of GDP as of the end of 2013
- A further increase is likely in the mid-term due to lowering interest rates and lengthening maturities in the economy, resulting primarily from the current CBR prime task of shifting to an inflation-targeting regime

## Mortgages dynamics



Source: CBR, Renaissance Capital estimates

# CONSUMER DEMAND

- Growth of consumption is still fairly robust, supported by tight labour market conditions
- In addition, in 4Q14 consumption was supported by consumers' will to purchase durable goods before its prices were influenced by a weaker currency, which probably acted like a short-term trigger
- Still due in lower nominal wages growth and higher inflation environment consumer demand is likely to drop by 3.9% in 2015

*Consumer demand indicators*

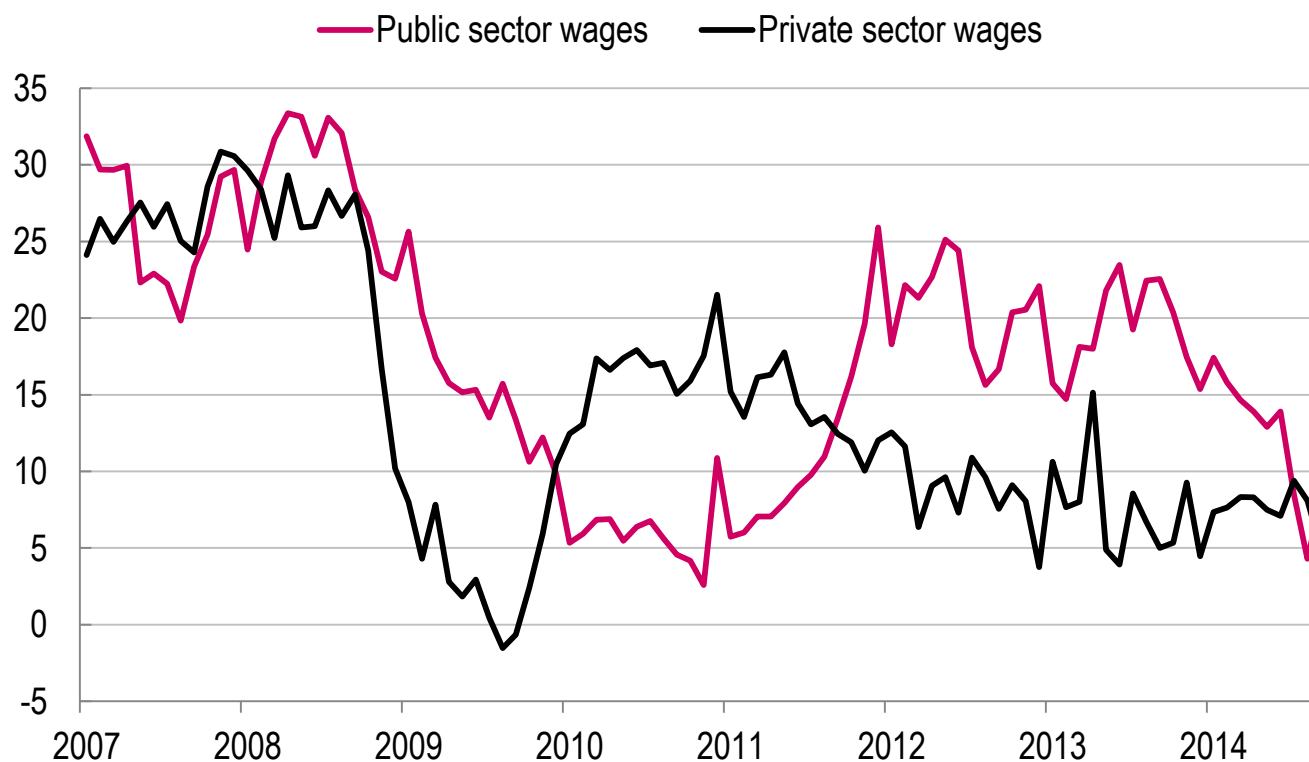


Source: Rosstat

# CONSUMER DEMAND

- Fairly robust wage growth was primarily driven by the public sector. The dynamics of public and private sector wages diverged significantly
- However, public wage growth is expected to slow down to 5% in 2015

*Growth of private and public sector wages, % YoY*



Source: Rosstat, Renaissance Capital estimates

# CONSUMER DEMAND

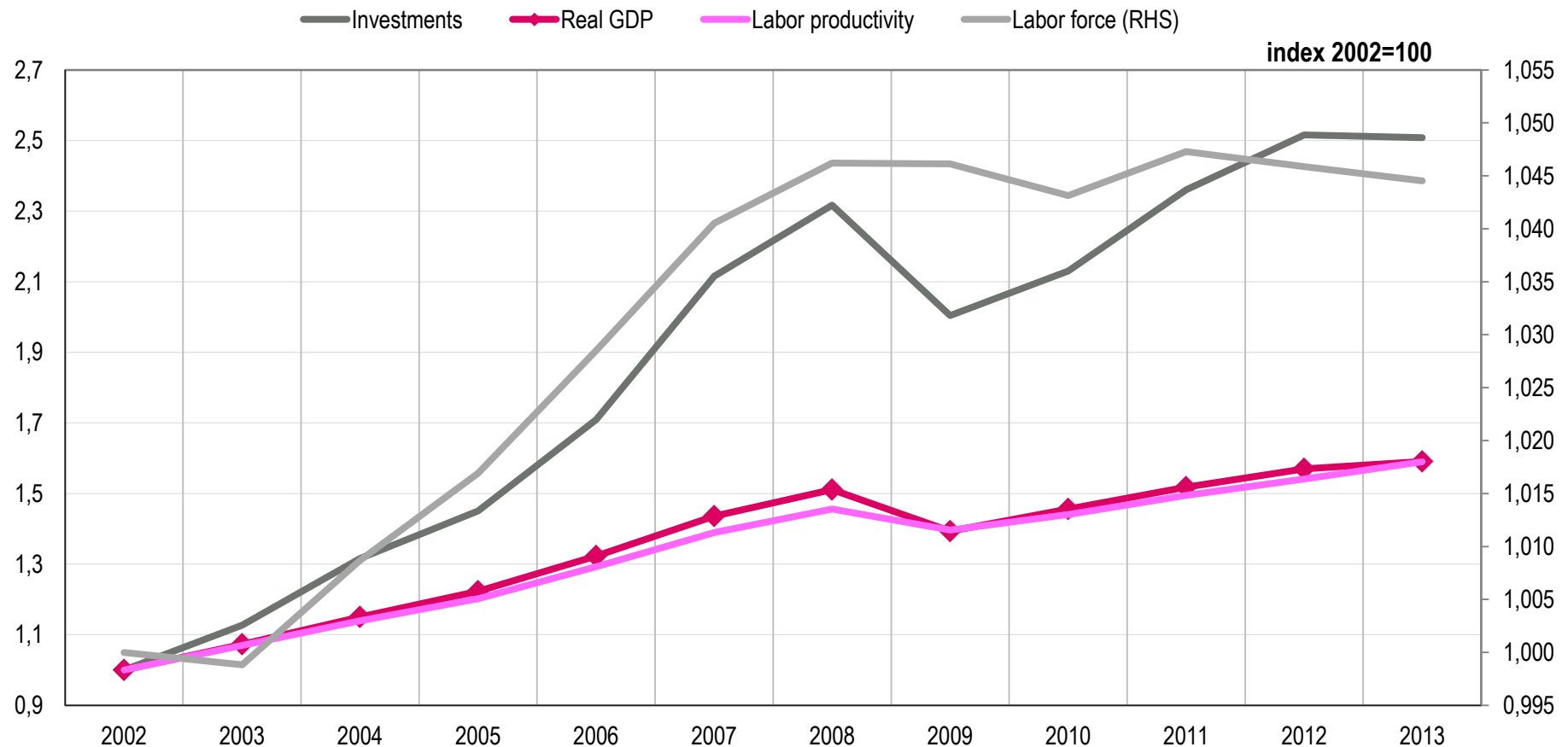
- Consumer confidence remains rather strong
- This is partly attributed to an improved assessment of the current political situation in Russia and, hence, the ability of Russian top officials to provide the necessary support to the economy and population. This belief offsets the negative news flow coming from events in Ukraine, in our view.
- This evidence is probably captured by the record-high poll ratings of Russia's President Vladimir Putin.

*Consumer confidence index by Levada Center (sa)*



# OUTPUT GROWTH AND RESOURCES

- Long-term factor for the slowdown of economic growth – stabilization of labour resources starting from 2008
- Medium-term factor – weak investment activity in 2013, primarily attributable to cuts in government-related capital expenditure



Source: Rosstat, Renaissance Capital estimates

# INFLATION

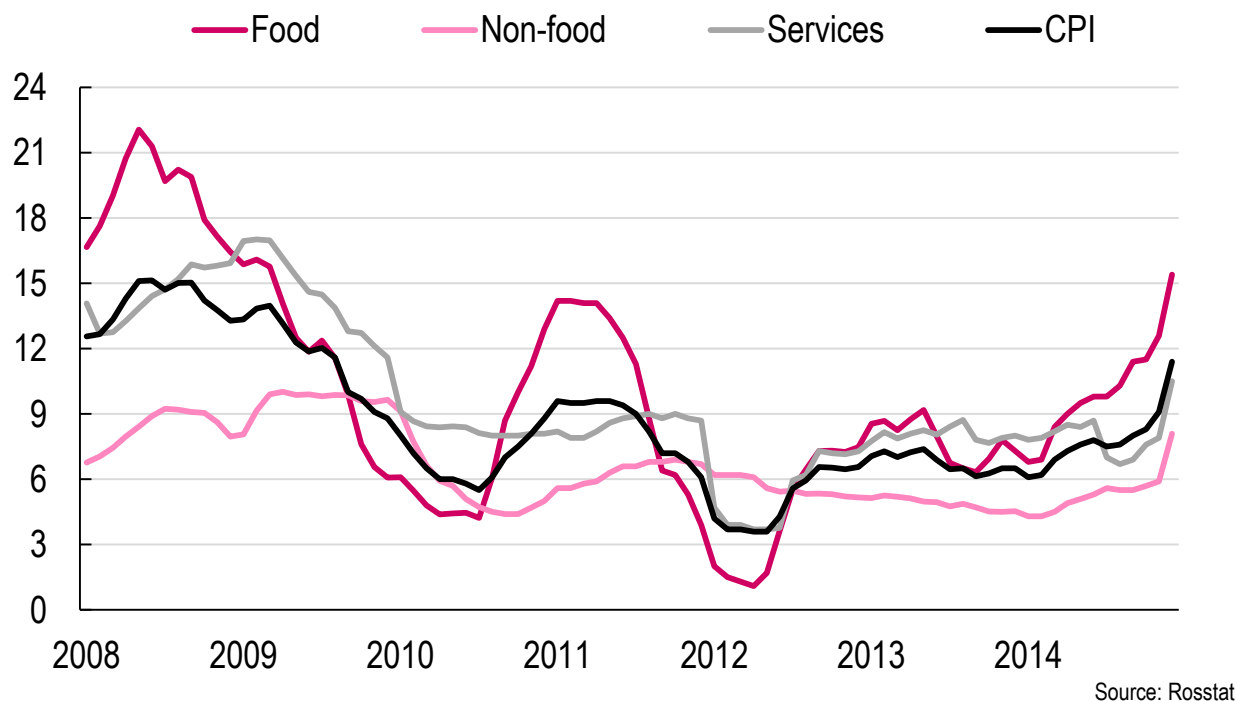
## ■ Main CPI factors

- Demand-side pressure (output gap)
- Inflation expectations
- Pass-through effect from exchange rate weakness
- Supply-side shocks (in particular, Russian food embargo)
- Regulated prices and tariffs

# INFLATION

- We see annual average consumer price inflation (CPI) hitting 12.6% at \$60/bl
- Price growth is expected to accelerate from 11.4% as of 1 January 2015 to 14.8% in March/April, boosted by the preceding rouble weakness. Next, it is likely to cool to around 10% by year-end as supply-side factors supporting price growth fade and the widening output gap takes its toll over price growth
- We see significant upside risks to our inflation forecasts, attributed to the possible heavy spike in inflation expectations resulting from unprecedented rouble volatility in December 2014

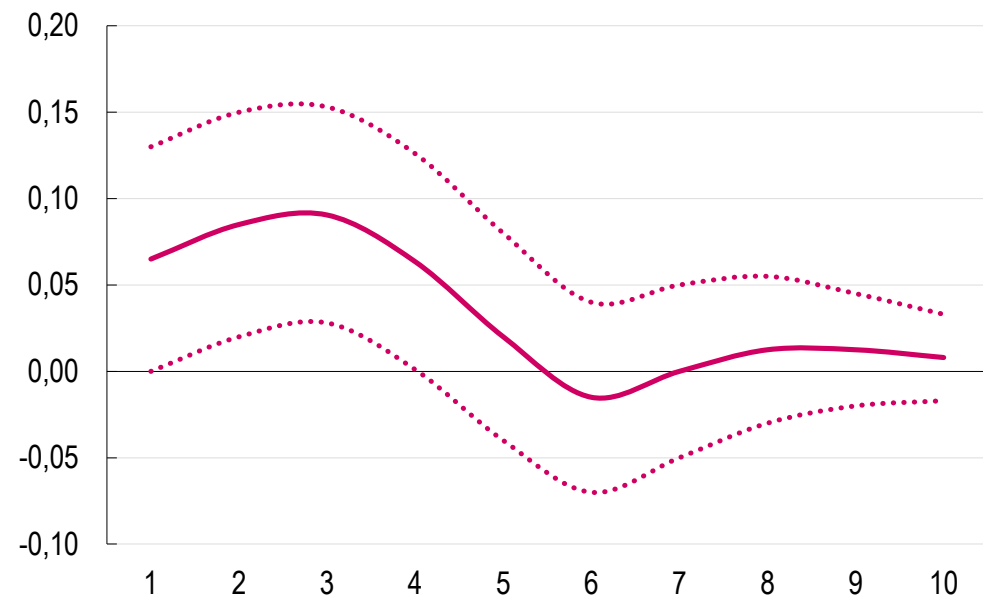
*CPI and its components, % YoY*



# INFLATION

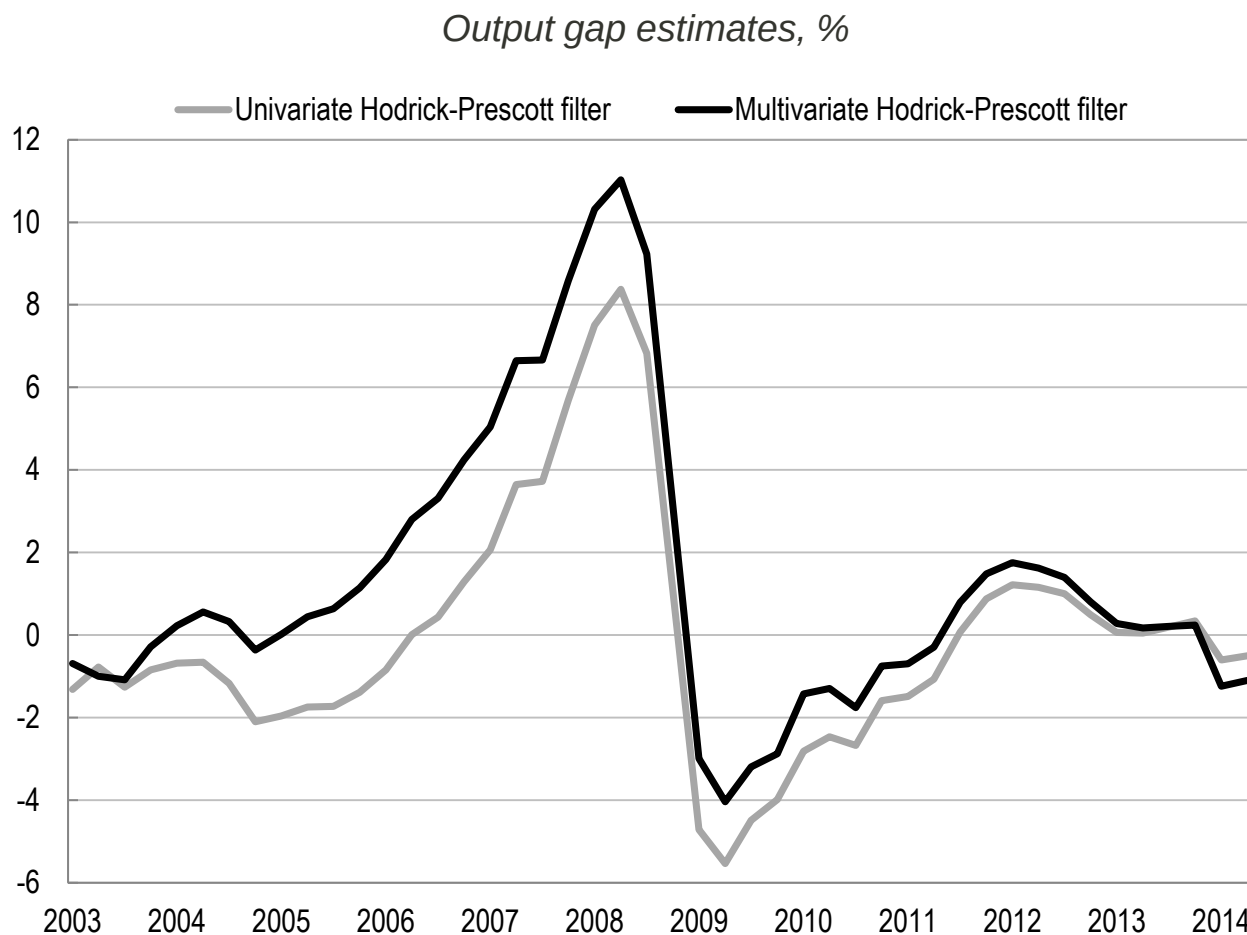
- According to our estimates, the exchange rate elasticity of headline inflation is about 12%
- The recent evidence does fully in line with our estimates of approximately 3 months' time needed for prices adjustment to exchange rate shocks
- But the reaction might to huge exchange rate movements might be less muted

*Response of headline inflation to exchange rate shock*



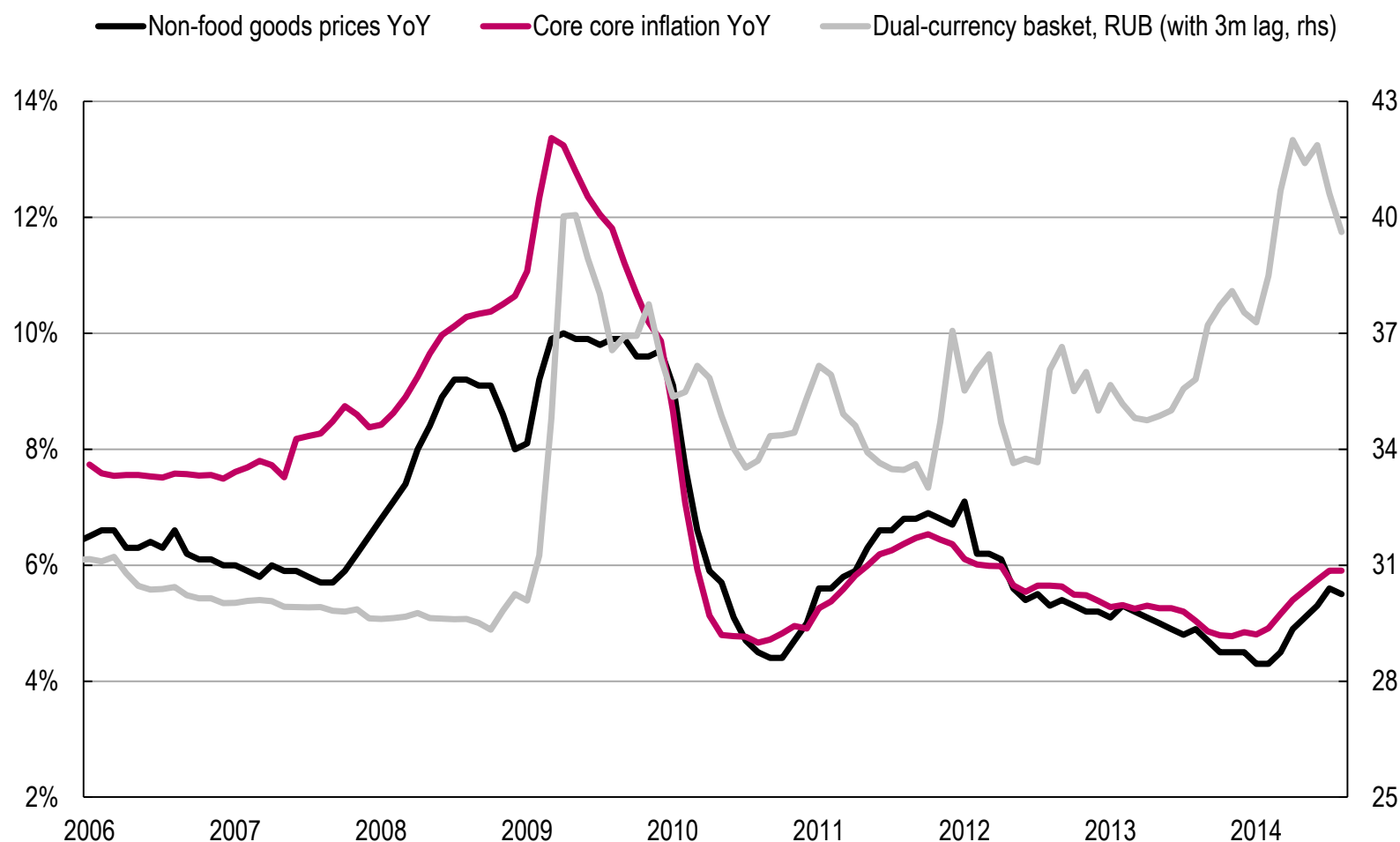
# INFLATION

- According to various filtering techniques, the output gap remains negative, thus indicating the absence of significant demand-side inflationary pressure
- Still “potential growth” is usually overestimate when counties are doing well and underestimated when growth weakens, i.e. last points output gap estimates are generally subject to huge revisions



# INFLATION

- The main source of inflation acceleration in 1H14 was pass-through effect from weaker currency
- Still the exchange rate pass-through has weakened significantly during recent years (from an estimated 25-30% prior to 2009 to 10-12% currently)

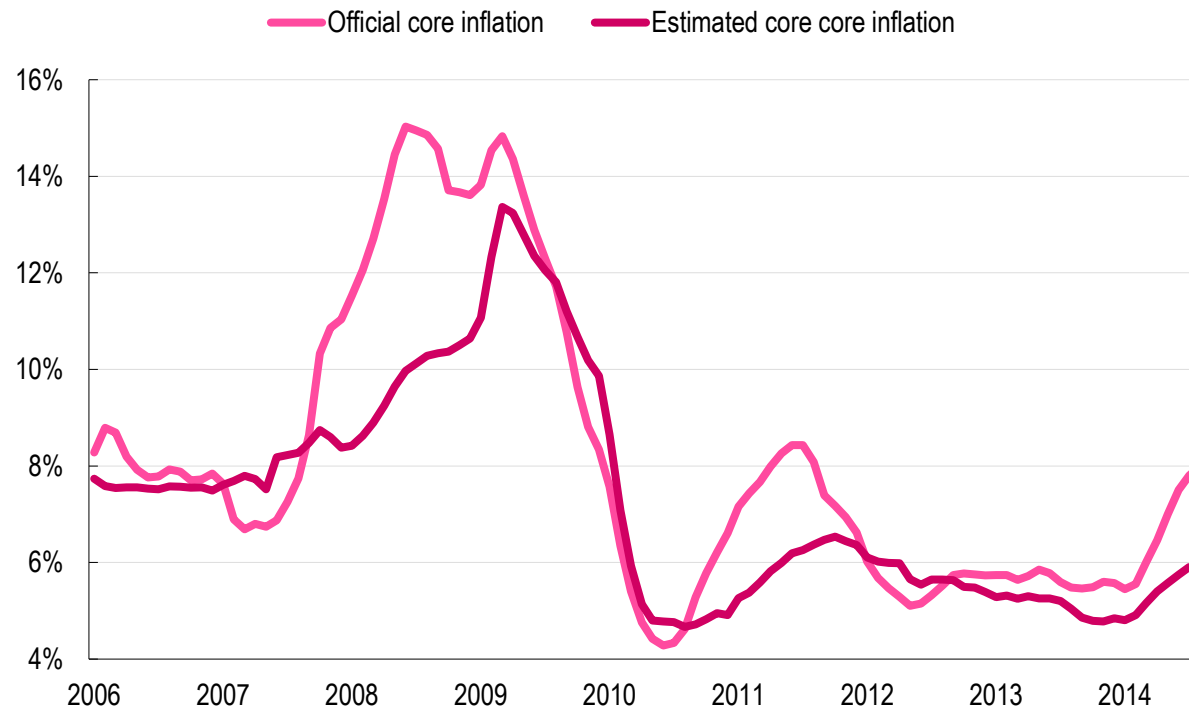


Source: Rosstat, Renaissance Capital estimates

# INFLATION

- Food embargo is likely to contribute to Russian CPI around 1.3% in the mid-term.

*Core inflation indicators, YoY*



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# *Monetary policy in Russia*

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# MONETARY POLICY FRAMEWORK

## ■ Goals of monetary policy

- Reducing inflation (5.0% in 2014, 4.5% in 2015 and 4.0% in the mid-term)
- Smoothing exchange rate fluctuations

## ■ Medium-term monetary policy principles

- Introducing inflation-targeting regime by 2015
- Developing monetary policy framework to take better control over interest rates in the economy
- Switching to floating exchange rate by 2015

# INTEREST RATE POLICY FRAMEWORK

- **The CBR interest rate policy system is based on a unified policy rate (the key rate) and the interest rate corridor**
- **The key rate as the main element of the interest rate corridor**
  - Unified interest rate on one-week liquidity provision and absorption open market operations (currently 17.0%)
- **The borders of the interest rates corridor**
  - One-day liquidity provision and absorption standing facilities (currently 18.0% and 16.0%) symmetric relative to the key rate
- **Additional instruments**
  - Auctions for the provision of 3m loans, secured by non-market assets, with floating interest rate linked to the CBR key rate (aimed at the decrease in market collateral held by the CBR, thereby improving the efficiency of the interbank market)
  - Fine-tuning operations from one to six days
- **The refinancing rate will have a minor role until it is set equal to the key rate, by 1 Jan 2016**

# INTEREST RATE POLICY

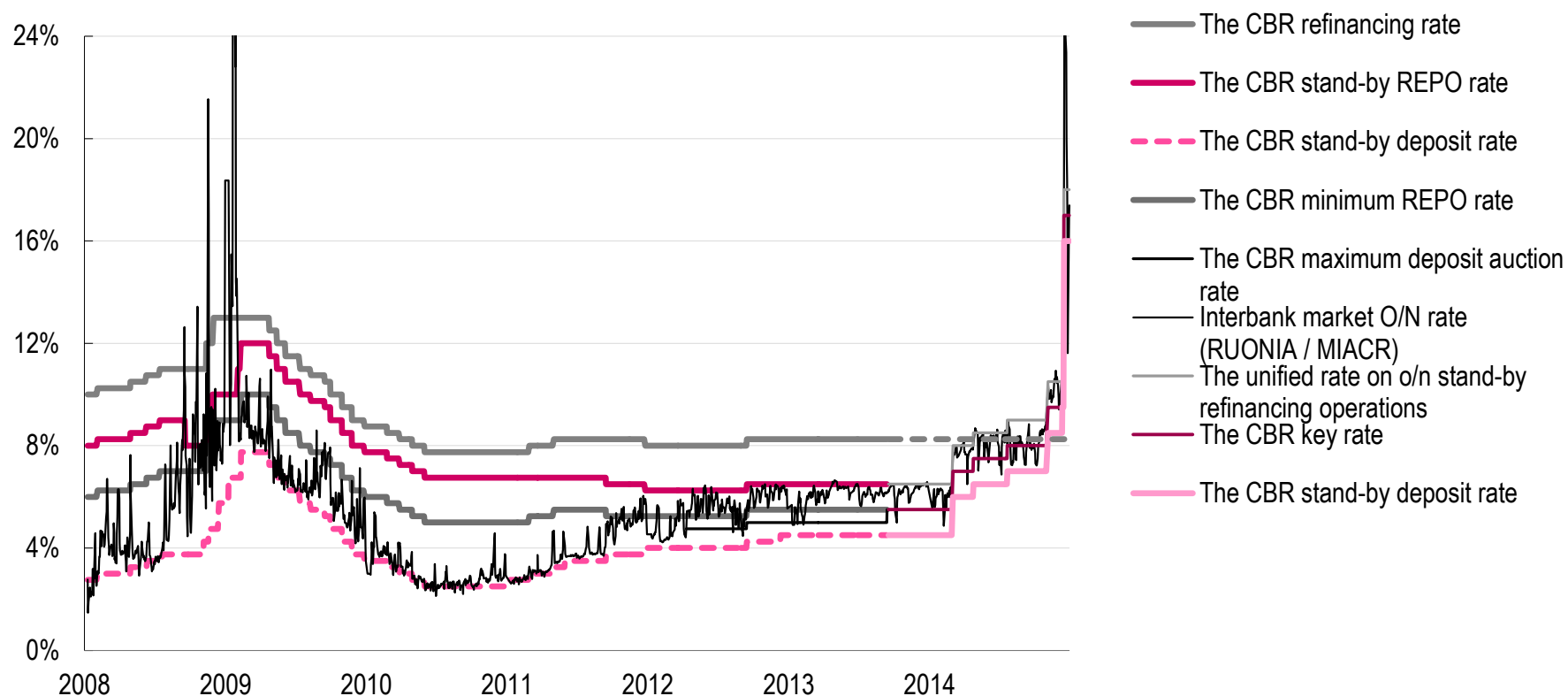
- The CBR hiked the key rate from 11.5% to 17% on 15 December 2014, trying to tame rouble weakness and anchor inflation expectations

| Purpose              | Type of instrument                         | Instrument                                                        | Term                                     | Rate since 03.02.14 | Rate since 12.12.14 | Rate since 16.12.14 |
|----------------------|--------------------------------------------|-------------------------------------------------------------------|------------------------------------------|---------------------|---------------------|---------------------|
| Liquidity provision  | Standing facilities (fixed interest rates) | Overnight loans; FX swaps (rouble leg); Lombard loans; REPO       | 1 day                                    | 6.50                | 11.50               | 18.00               |
|                      |                                            | Loans secured by gold <sup>1</sup>                                | 1 day                                    | 6.50                | 11.50               | 18.00               |
|                      |                                            |                                                                   | from 2 to 549 days <sup>2</sup>          | 7.00                | 12.00               | 18.50               |
|                      |                                            | Loans secured by non-marketable assets or guarantees <sup>1</sup> | 1 day                                    | 6.50                | 11.50               | 18.00               |
|                      |                                            |                                                                   | from 2 to 549 days <sup>2</sup>          | 7.25                | 12.25               | 18.75               |
|                      | Open market operations (minimum rates)     | Loans secured by non-marketable assets, auctions <sup>3</sup>     | 3 months, 18 months <sup>4,5</sup>       | 5.75                | 10.75               | 17.25               |
|                      |                                            | Lombard credit auctions <sup>3,4</sup>                            | 36 months                                |                     | 10.75               | 17.25               |
| Liquidity absorption | Open market operations (maximum rates)     | Deposit auctions                                                  | from 1 to 6 days <sup>6,7</sup> , 1 week | 5.50 (key rate)     | 10.50 (key rate)    | 17.00 (key rate)    |
|                      | Standing facilities (fixed interest rates) | Deposit operations                                                | 1 day, call                              | 4.50                | 9.50                | 16.00               |
| Memo item:           |                                            |                                                                   |                                          |                     |                     |                     |
| Refinancing rate     |                                            |                                                                   |                                          | 8.25                | 8.25                | 8.25                |

3 Floating interest rate linked to the CBR key rate

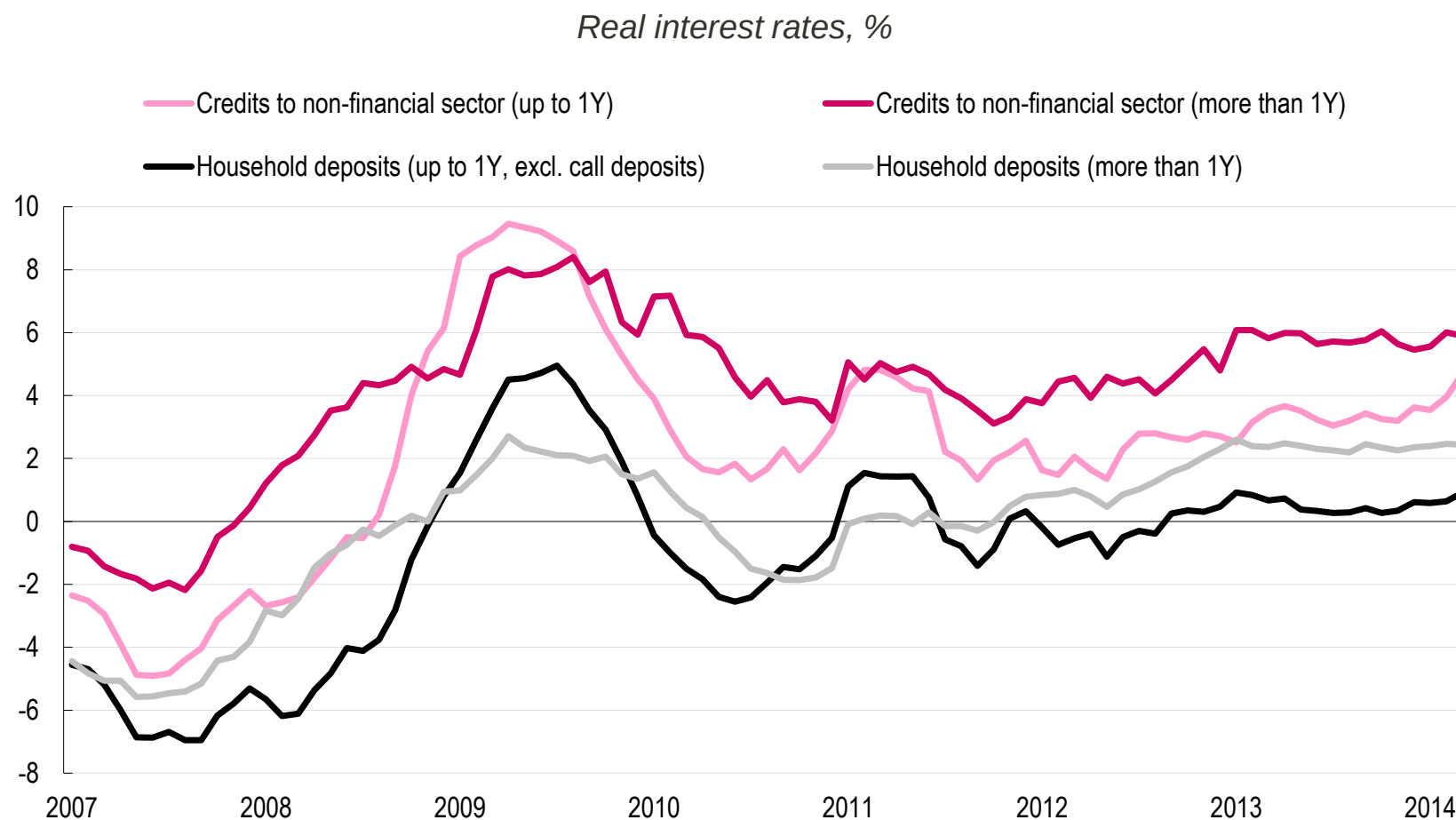
# INTEREST RATE CORRIDOR

- Current monetary policy stance is even tighter than in 2008 – 2009
- We expect the CBR to cut the key rate to 10% as of the end of 2015
- We think that the CBR will stay cautious and would not make a huge one-day move in the key rate, taking it to the previous level, but would likely follow a gradual easing path through the year



# INTEREST RATES

- After the recent hikes, monetary policy conditions would be extremely difficult



Source: CBR, Renaissance Capital estimates

# EXCHANGE RATE POLICY FRAMEWORK

- **The CBR moved to a floating exchange rate regime in November 2014**
- **However, the CBR, in theory, stays on FX market**
  - To contain exchange rate volatility imposing financial stability risks
- **The authorities are becoming very cautious on reserve spending**
  - After selling \$124bn during 2014
- **Dual-currency basket (0.55 USD, 0.45 EUR) as the operational indicator of exchange rate policy**

# PREVIOUS EXCHANGE RATE POLICY MECHANISM

- **Floating operational band**

- Boundaries are automatically shifted by 0.05 RUB upwards (downwards) when the cumulative volume of FX purchases (sales) exceeds the threshold amount (currently – \$350mln)
- In addition to interventions aimed at smoothing exchange rate fluctuations, the CBR may conduct interventions related to accumulation or expenditure of the Reserve Fund

- **On 18 August 2014 the CBR announced further steps aimed at the increase of exchange rate flexibility**

- Widened the floating band from 7 to 9 roubles
- Decreased the amount of cumulative intervention threshold, which lead to the shift of the floating band by 5 kopecks, from \$1.0bn to \$0.35bn (this parameter was hiked on March, 3rd from \$0.35bn to \$1.5bn as an emergency measure in response to financial market turmoil).
- Abandoned “planned” interventions within the floating band

# PREVIOUS EXCHANGE RATE POLICY MECHANISM

- In October 2013 the CBR disclosed the parameters of the FX policy mechanism in details

Figure 3. The parameters of the Bank of Russia FX policy mechanism  
(as of the 7 October 2013)

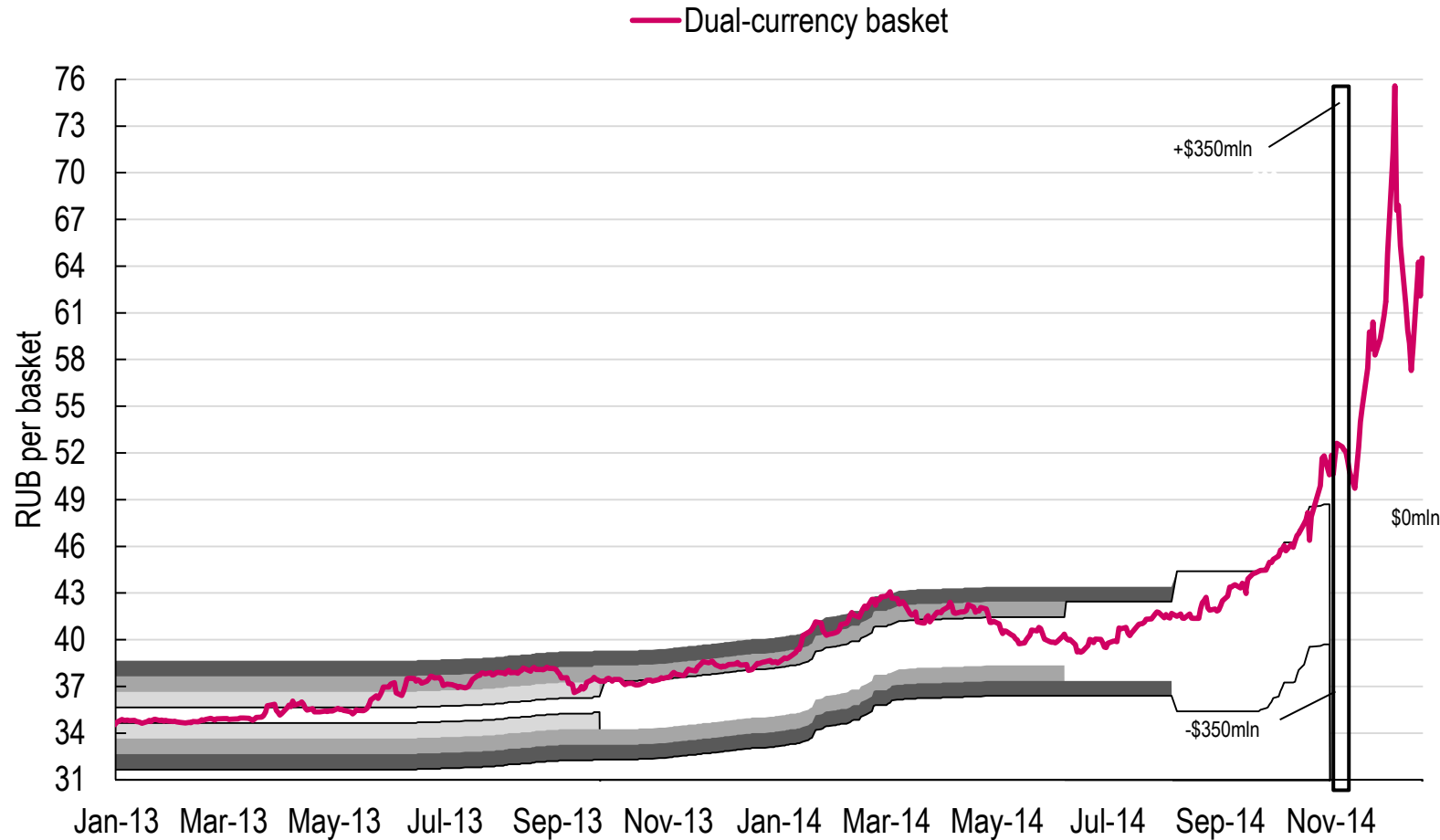
| The volume of interventions,<br>aimed at smoothing the volatility<br>of the rouble exchange rate*,<br>million USD per day |                                   |                                   | The volume of operations,<br>related to the<br>accumulation<br>(expenditure) of the<br>sovereign funds*, million<br>USD per day   |  |
|---------------------------------------------------------------------------------------------------------------------------|-----------------------------------|-----------------------------------|-----------------------------------------------------------------------------------------------------------------------------------|--|
| 39.30 RUB                                                                                                                 | The width                         | Upper boundary of<br>the corridor | +<br><br>Determined on the basis of<br>the amounts of the Federal<br>TreasuryFX purchases<br>(sales) with the Bank of<br>Russia** |  |
|                                                                                                                           | 0.95 RUB                          | -400                              |                                                                                                                                   |  |
| “technical” range                                                                                                         | 1 RUB                             | -200                              |                                                                                                                                   |  |
|                                                                                                                           | 0.1 RUB                           | 0                                 |                                                                                                                                   |  |
| “neutral” range                                                                                                           | 3 RUB                             | 0                                 |                                                                                                                                   |  |
|                                                                                                                           | 1 RUB                             | 200                               |                                                                                                                                   |  |
|                                                                                                                           | 0.95 RUB                          | 400                               |                                                                                                                                   |  |
| 32.30 RUB                                                                                                                 | Lower boundary of<br>the corridor |                                   |                                                                                                                                   |  |

Determined on the basis of  
the amounts of the Federal  
Treasury FX purchases  
(sales) with the Bank of  
Russia\*\*

\* «+» – the Bank of Russia FX purchases, «-» – the Bank of Russia FX sales

\*\* The volume of these operations does not depend on the location of the dual-currency basket value inside the floating operational band with the exception of the “technical” range, inside which the Bank of Russia does not implement FX operations.

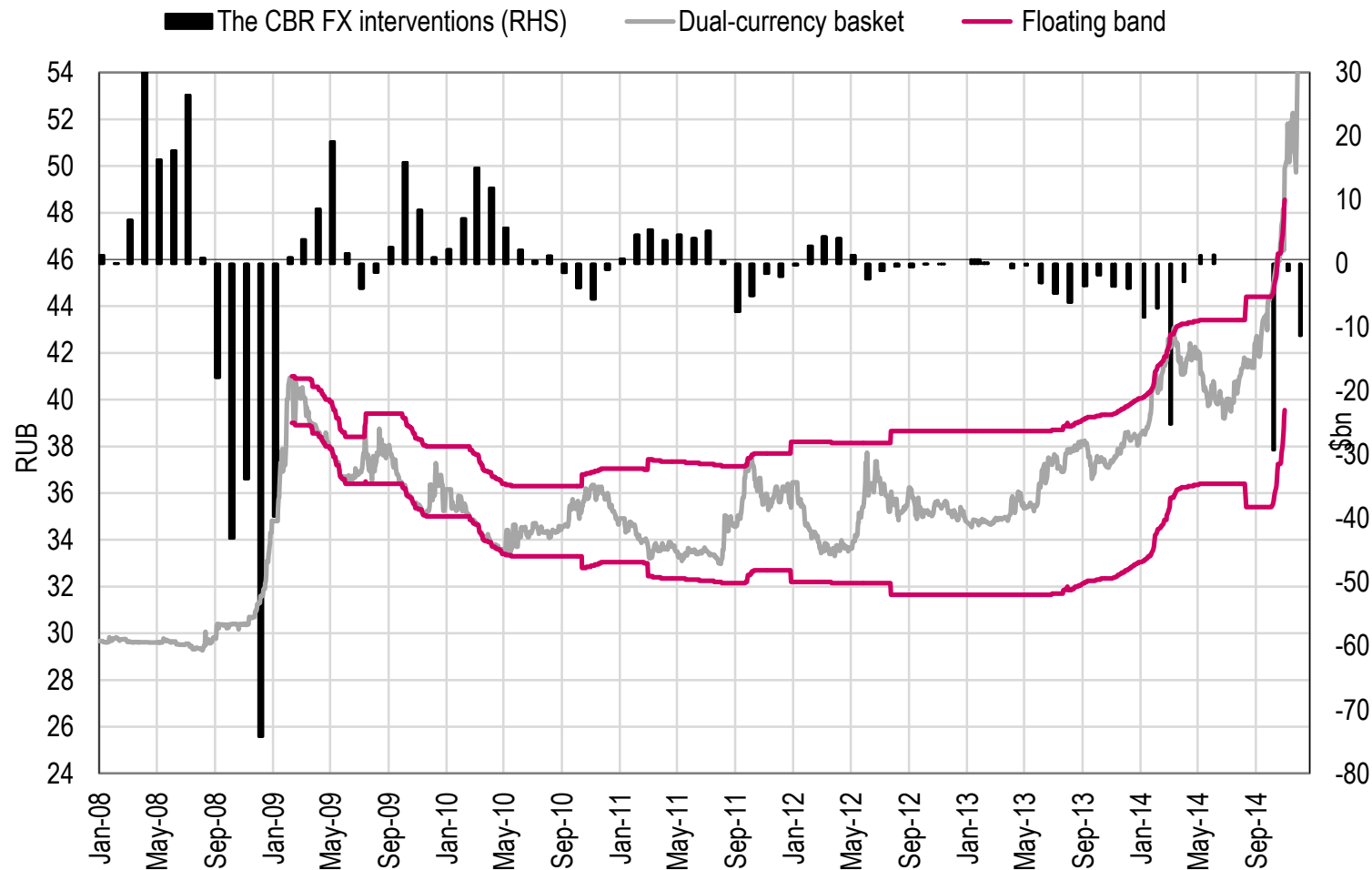
# RUB EXCHANGE RATE AND CBR INTERVENTIONS



Source: CBR, Bloomberg, Renaissance Capital estimates

\*\* "+" means FX sales by the CBR, "-" means FX purchases by the CBR

# RUB EXCHANGE RATE AND CBR INTERVENTIONS



\*Prior to Feb. '09 the CBR had a tightly managed band

Source: CBR, Bloomberg, Renaissance Capital

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# *External balances and rouble*

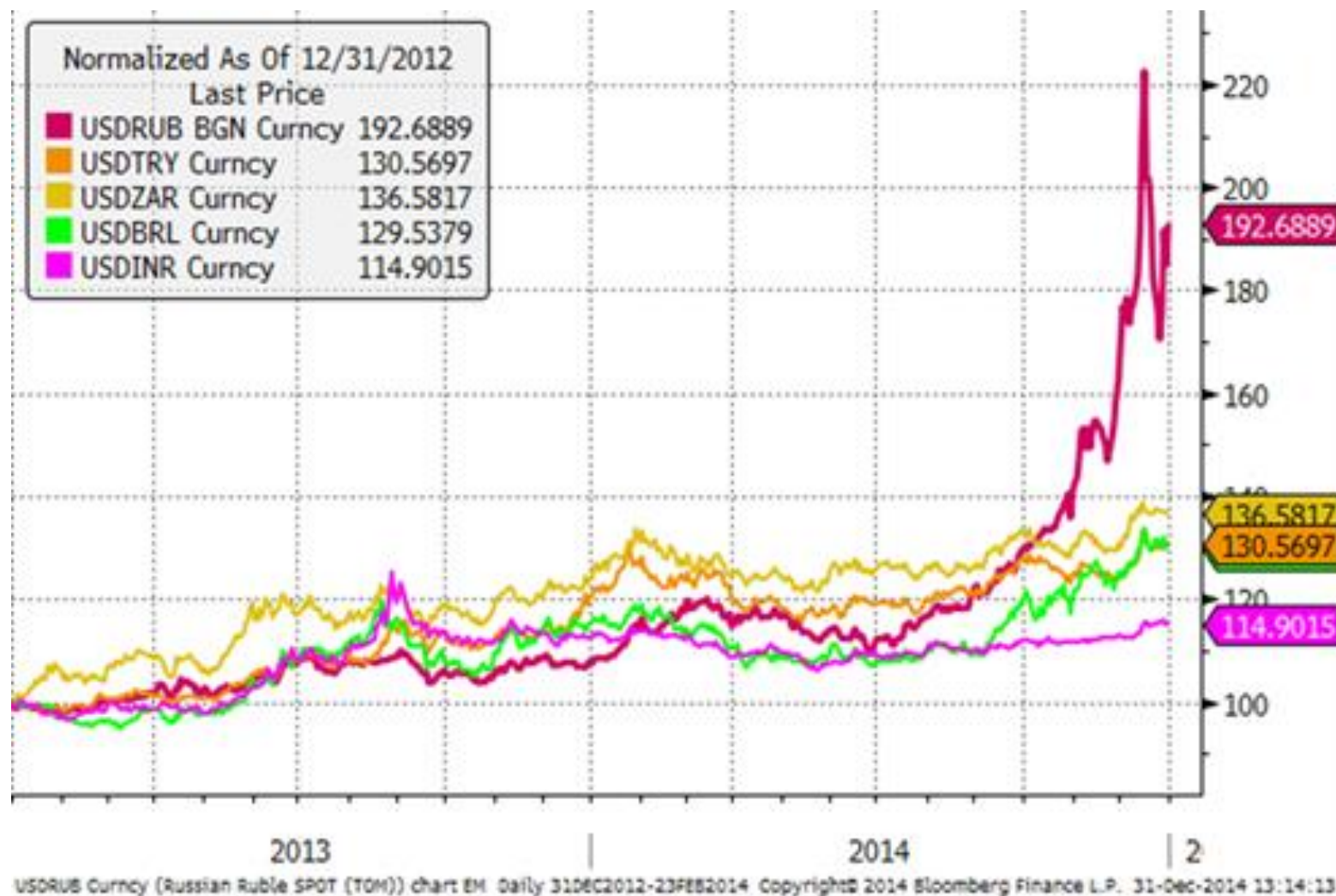
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# EXCHANGE RATE

- **Main rouble exchange rate drivers**
  - Oil prices and current account surpluses
  - Capital flows
  - Redemption of FX corporate and banking sector debt
  - Households' savings structure

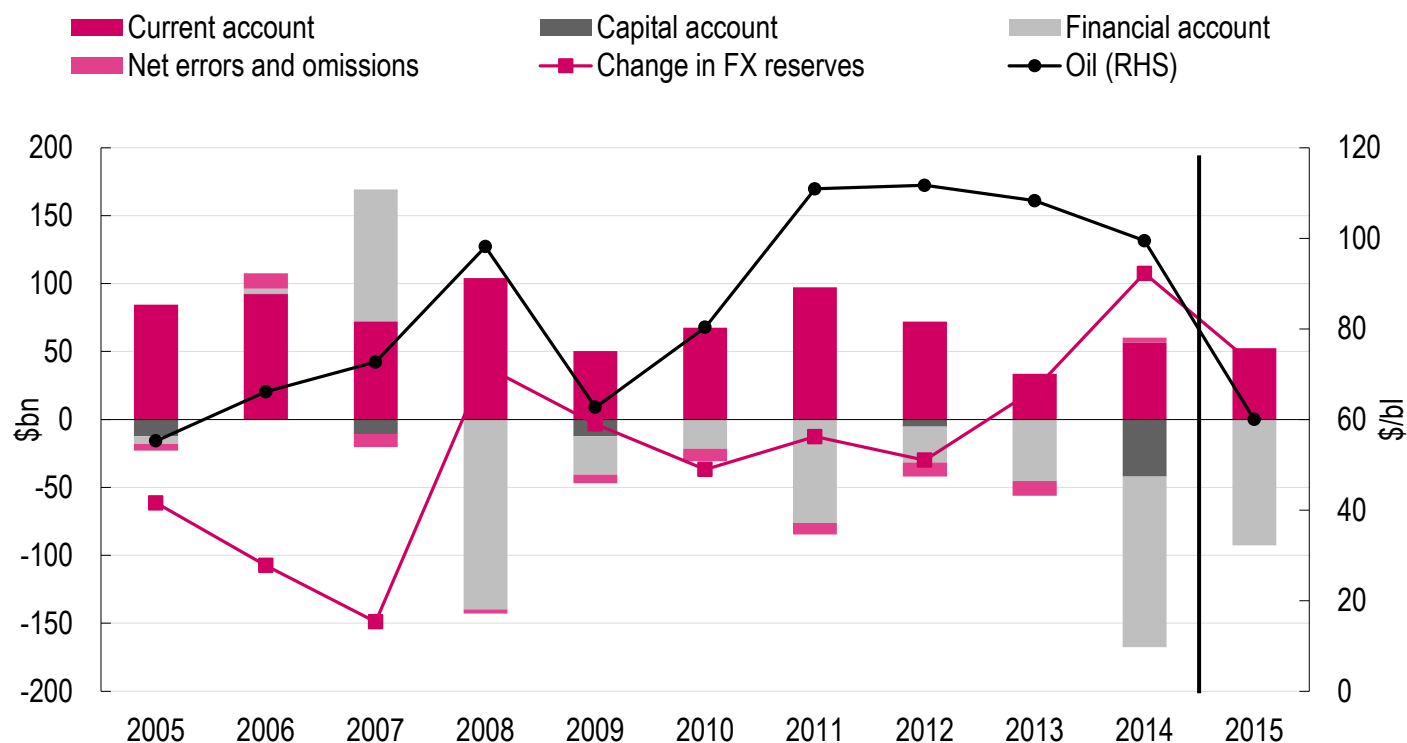
# RUB DYNAMICS

- Ruble exchange rate moved far away from its peers in 2014, hit by weaker oil prices and debt redemptions



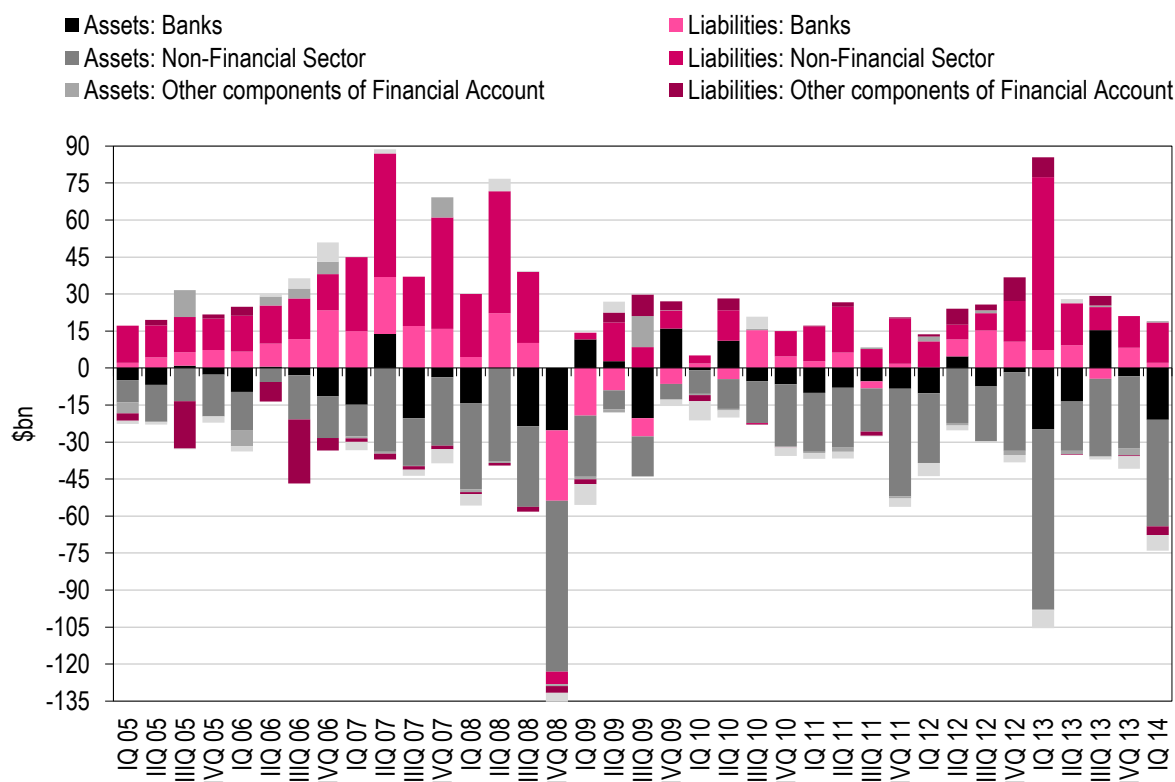
# RUB DRIVERS

- C/A stays positive at any oil price, being an important source of FX inflows
- When the oil price falls, the rouble weakens and domestic consumer and investment demand contracts noticeably, thus taming imports growth and preventing a significant drop in the C/A surplus
- The C/A surplus amounts to 3.8% of GDP if the oil price averages \$60/bl (\$56.7bn, or 3.9% of GDP, in FY14)
- If the oil price improves, the C/A surplus also looks stronger, reaching \$67.9bn (4.3% of GDP) and \$60.3bn (4.1% of GDP) with oil averaging \$80/bl and \$70/bl, respectively. If the oil price goes to \$50/bl, the C/A surplus declines to \$45.8bn (3.6% of GDP)



# RUB DRIVERS

- The traditional link between Russian current account and capital flight broke down in 2013
- Businesses capital outflows did ease in 2013 (by \$18bn), which was in line with the decline in the goods trade balance (\$15bn), but not the drop in the whole current account (\$39bn).
- Banks made a swing from bringing \$10bn into Russia in 2012 to moving \$6bn out of Russia in 2013. Broadly speaking, the reason is that in 2013 banks still had funds but also had fewer opportunities to place them domestically amid softer economic activity.



Net capital outflow from Russia, \$bn

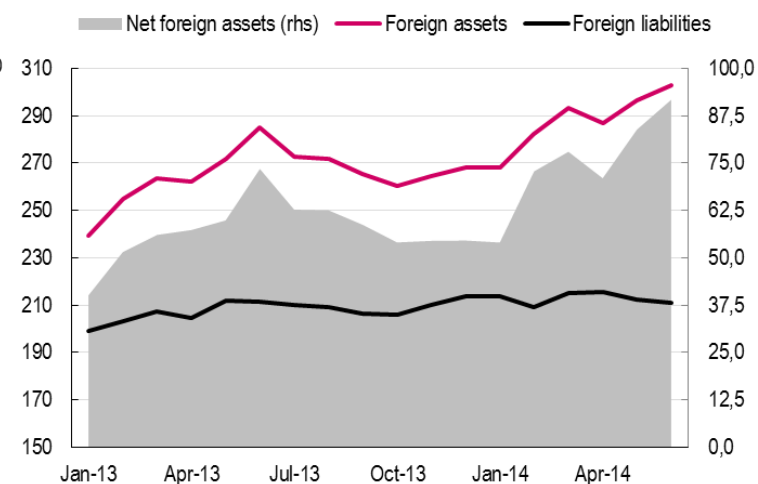
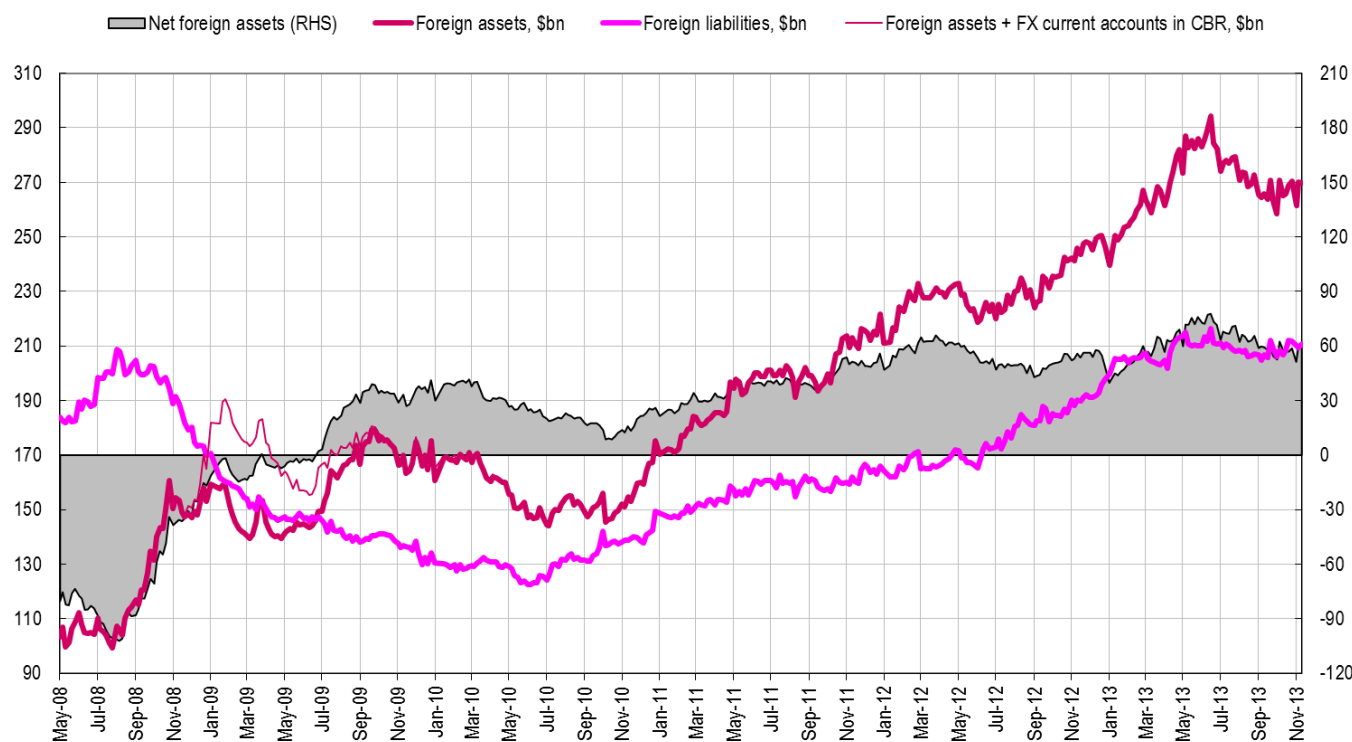
| Sector                                 | 9M14 | 3Q14  | 2Q14 | 1Q14 | 2013 | 2012 |
|----------------------------------------|------|-------|------|------|------|------|
| Businesses*                            | 56,3 | 26,1  | 10,4 | 19,8 | 40,2 | 62   |
| Banks (adjusted for FX swaps with CBR) | 8,3  | -28,1 | 2,1  | 34,3 | 7,3  | -9,7 |
| Grey capital flight                    | 13   | 7,7   | -2,3 | 7,6  | 11,9 | 10,4 |
| Total                                  | 77,6 | 5,7   | 10,2 | 61,7 | 59,4 | 62,7 |

\* partly attributes to individuals

Source: CBR

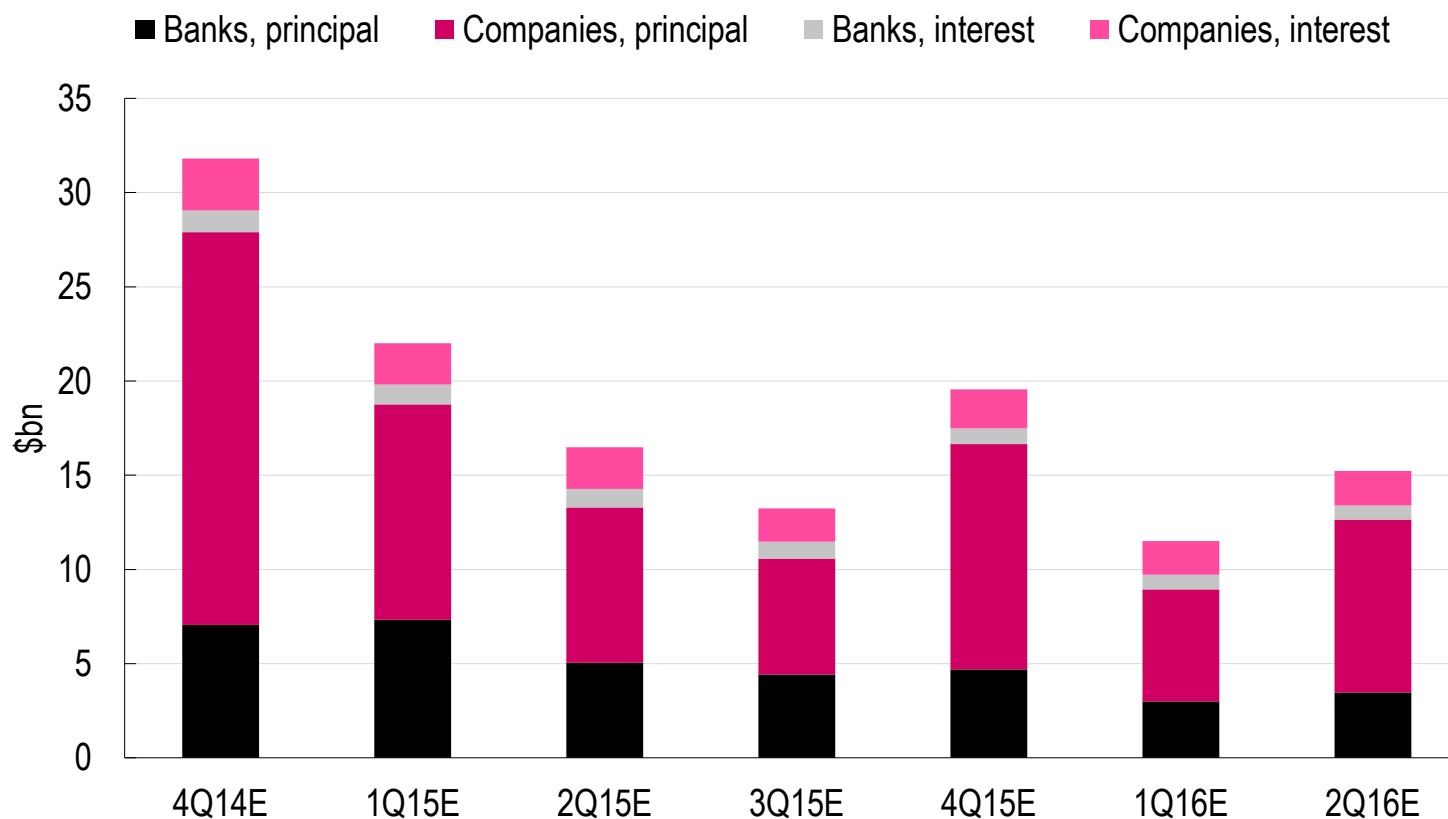
# RUB DRIVERS

## Foreign assets and liabilities of the banking sector (\$bn)



# RUB DRIVERS

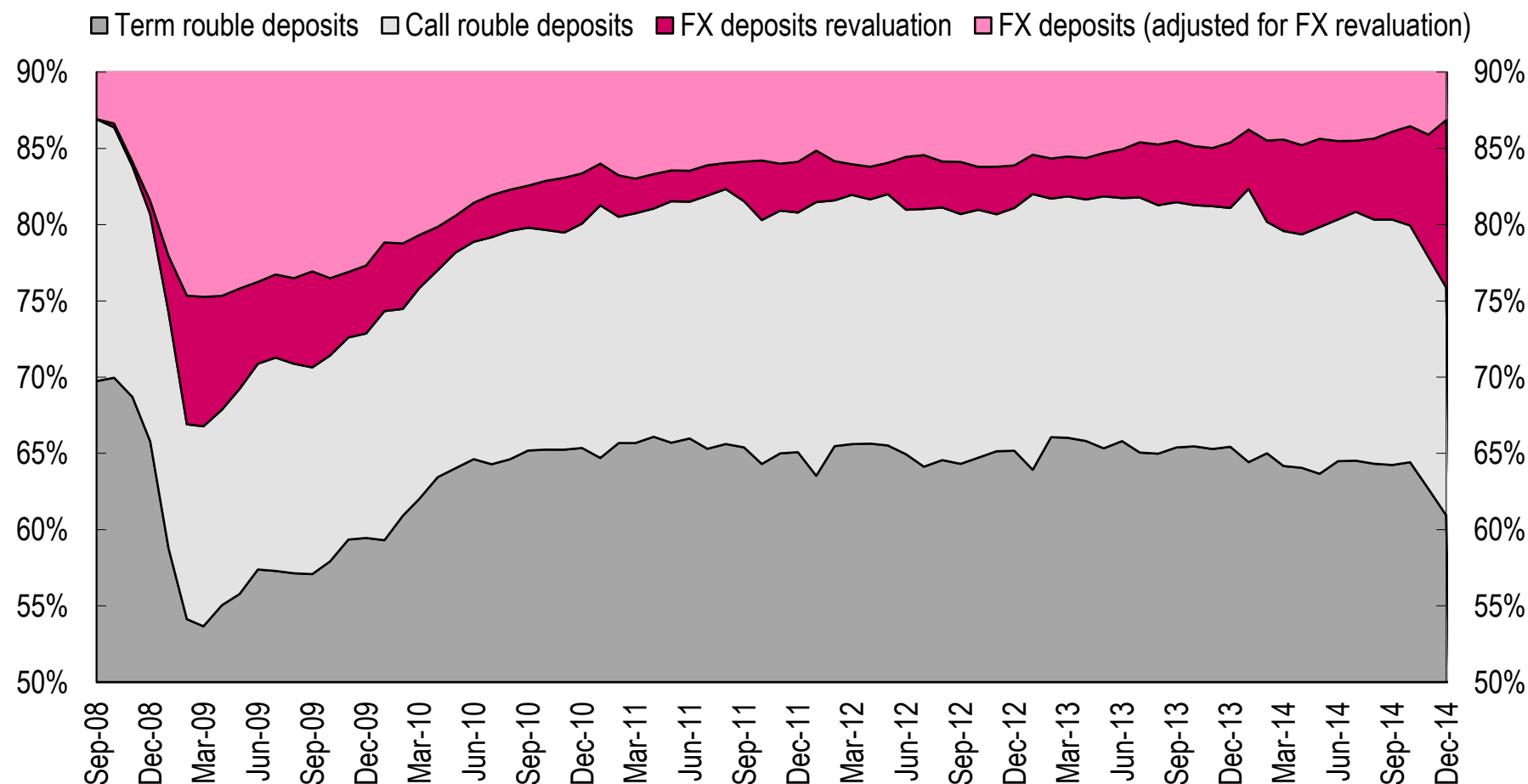
- We estimate Russian banks and companies have to pay off \$72bn of external debt in 2015
- Official statistics tells \$120bn, but we maintain our view that these numbers could be overstated by at least 40%.
- They include low-risk transactions within multinationals or between parent companies and subsidiaries, and Russian financing done through offshore vehicles and trade loans to China which should not be repaid due to sanctions



# RUB DRIVERS

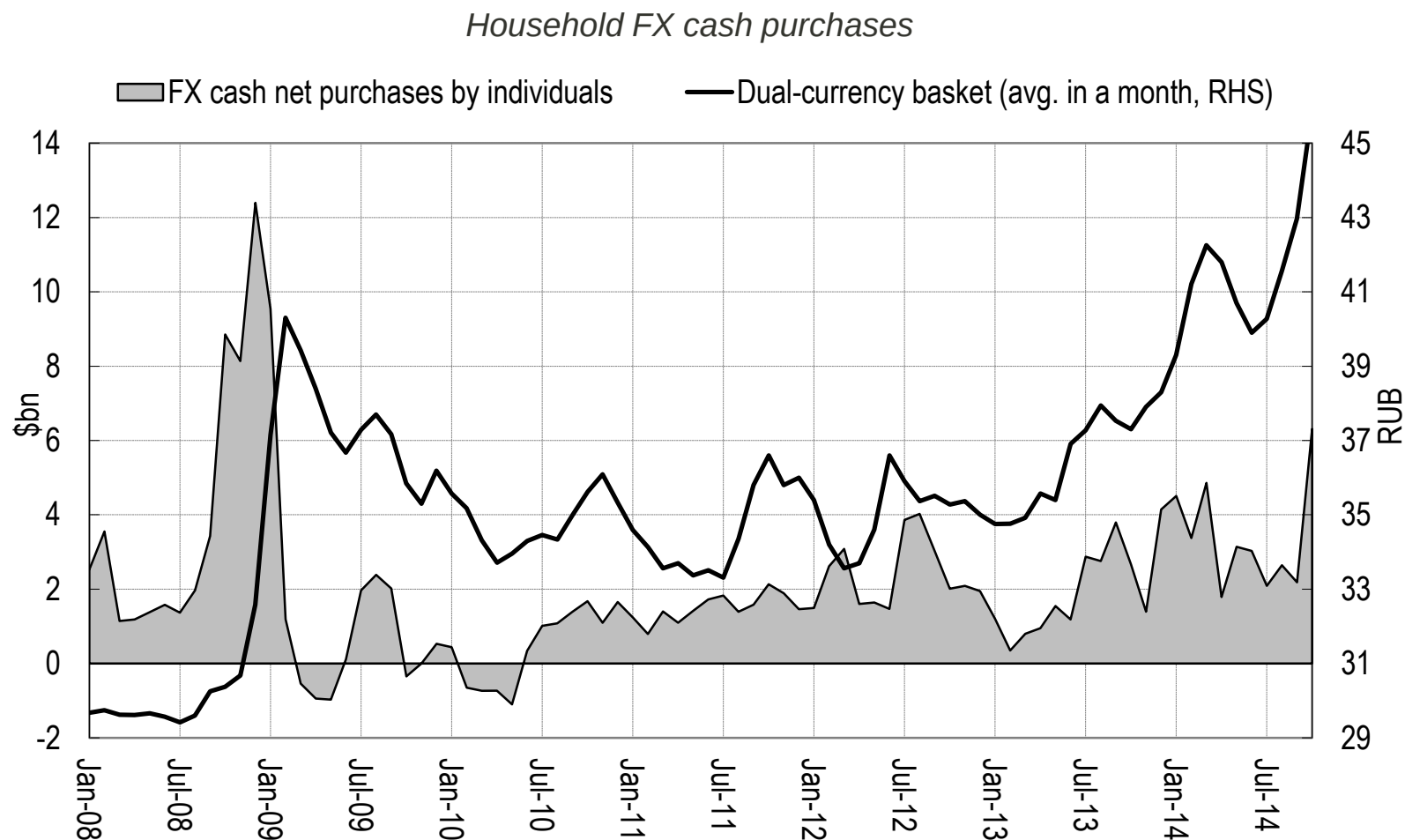
- In contrast to the devaluation of 2008-2009, under the managed floating exchange rate regime there was no significant pressure on the FX market from households

*Household deposit structure*



# RUB DRIVERS

- In contrast to the devaluation of 2008-2009, under the managed floating exchange rate regime generally there was no significant pressure on the FX market from households – until recently



# RUB DRIVERS

- The 2008-2009 shock saw the level of dollarization rise from 15% to 20%. We suspect that this latest rouble crash, will, as in 2008-2009, push that level of dollarization higher again – perhaps up to the 25-30% level
- The underlying “fair value” for the rouble becomes weaker as there is a semi-permanent lower bid for the currency, due to this rise in demand for dollars.

*Dollarisation of the Russian economy, %*



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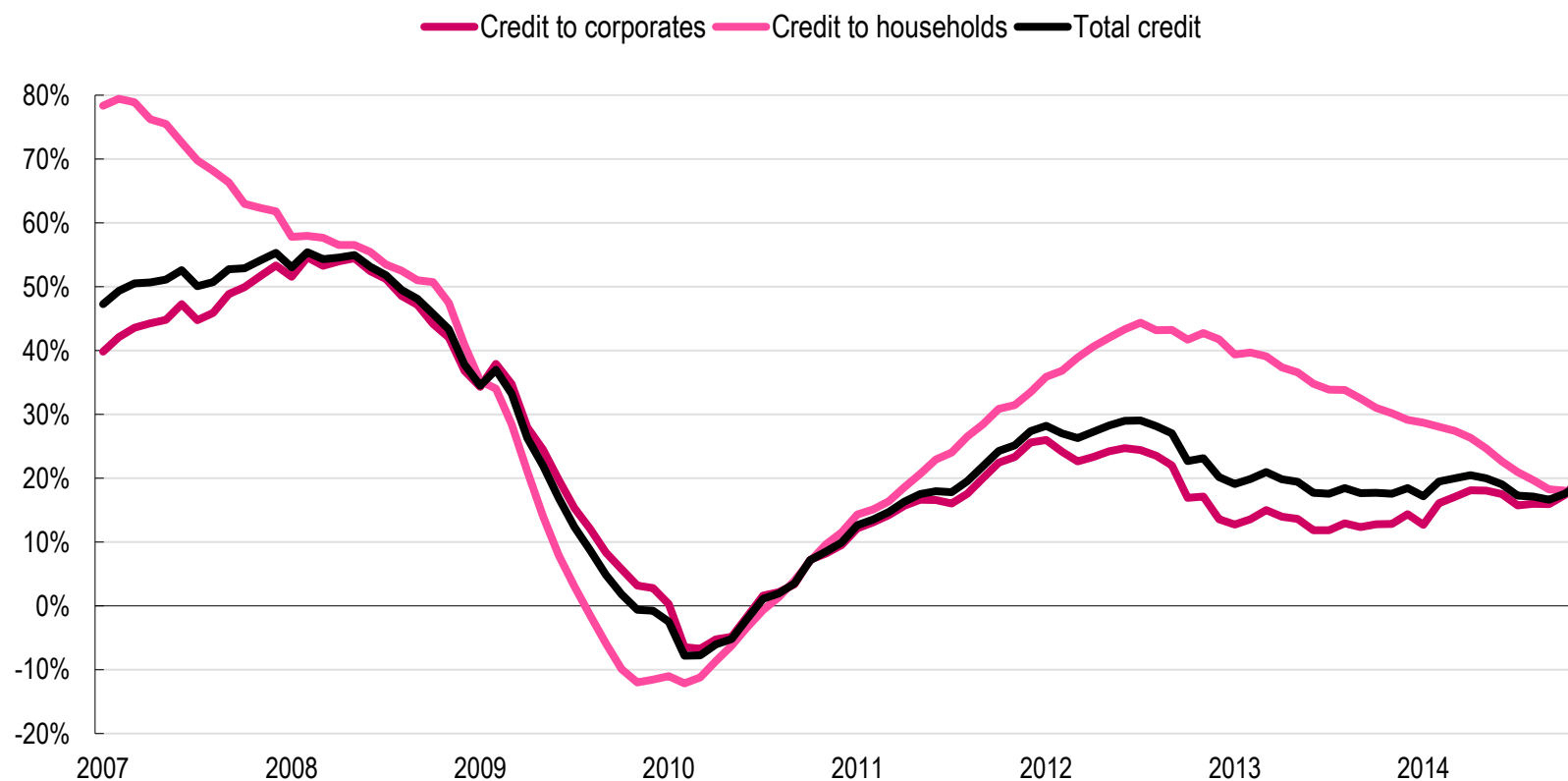
# *Banking sector*

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# LENDING GROWTH

- Lending growth is gradually slowing

*Banking sector credit growth, % YoY*

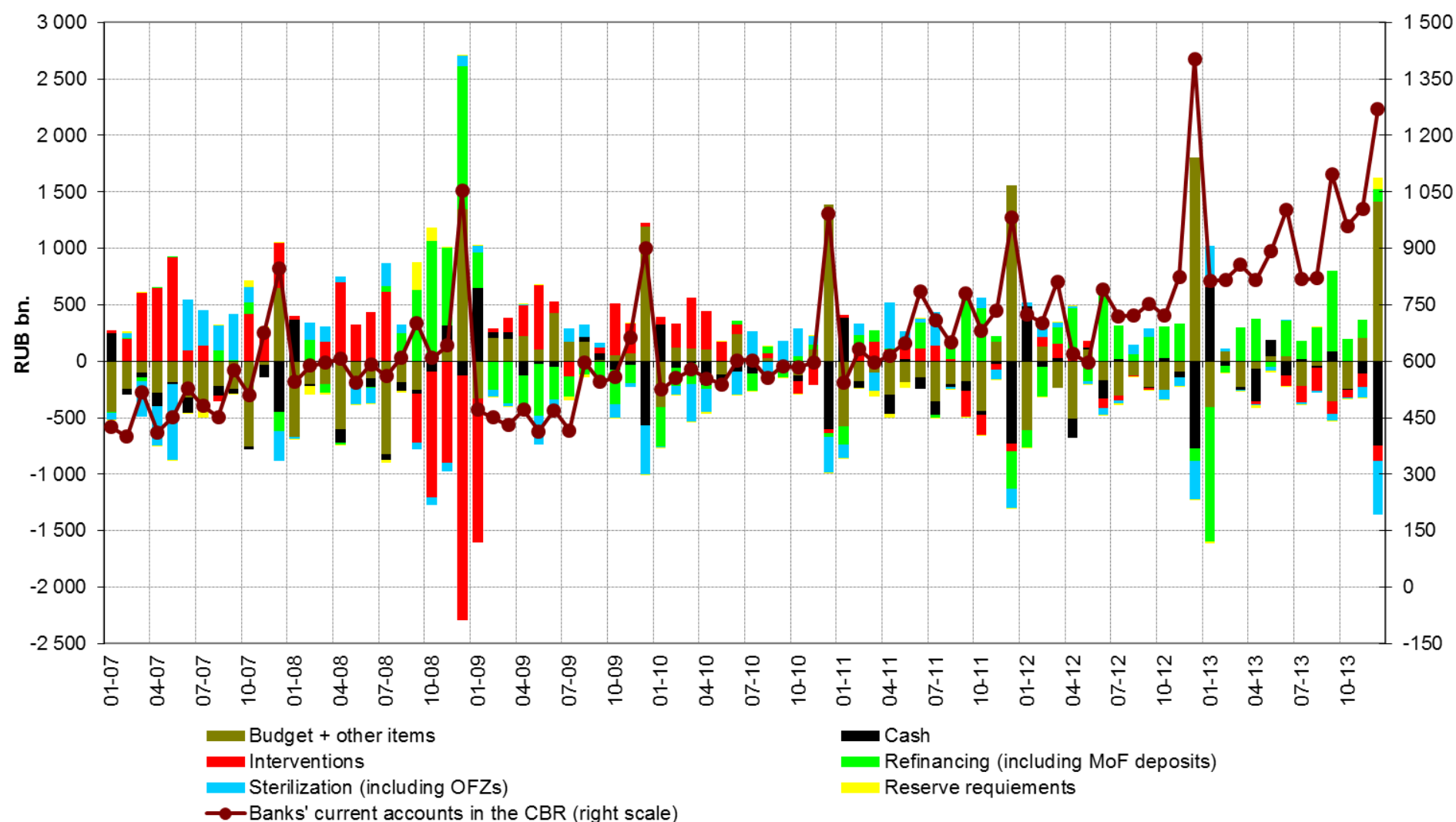


# BANKING SECTOR LIQUIDITY

- **Traditionally the banking sector used to operate in a surplus of liquidity**
  - Before the 2008 crisis this was mainly due to FX purchases by the CBR
  - In 2009-2010, the CBR's FX interventions and large budget deficit financing with resources from the Reserve Fund boosted banking sector liquidity
- **Since September 2011 the system switched to what is perceived to be a structural liquidity shortage**
  - The amount of the CBR's FX purchases decreased with the greater flexibility of the rouble
  - Cash in circulation continued to increase steadily, in line with nominal GDP growth trends, withdrawing liquidity from the banking sector
- **The scale of the structural liquidity shortage will possibly increase in the medium term**
- **The CBR's set of refinancing instruments is ready to meet growing demand for liquidity, although money market conditions are expected to stay tight due to market limitations**

# BANKING SECTOR LIQUIDITY

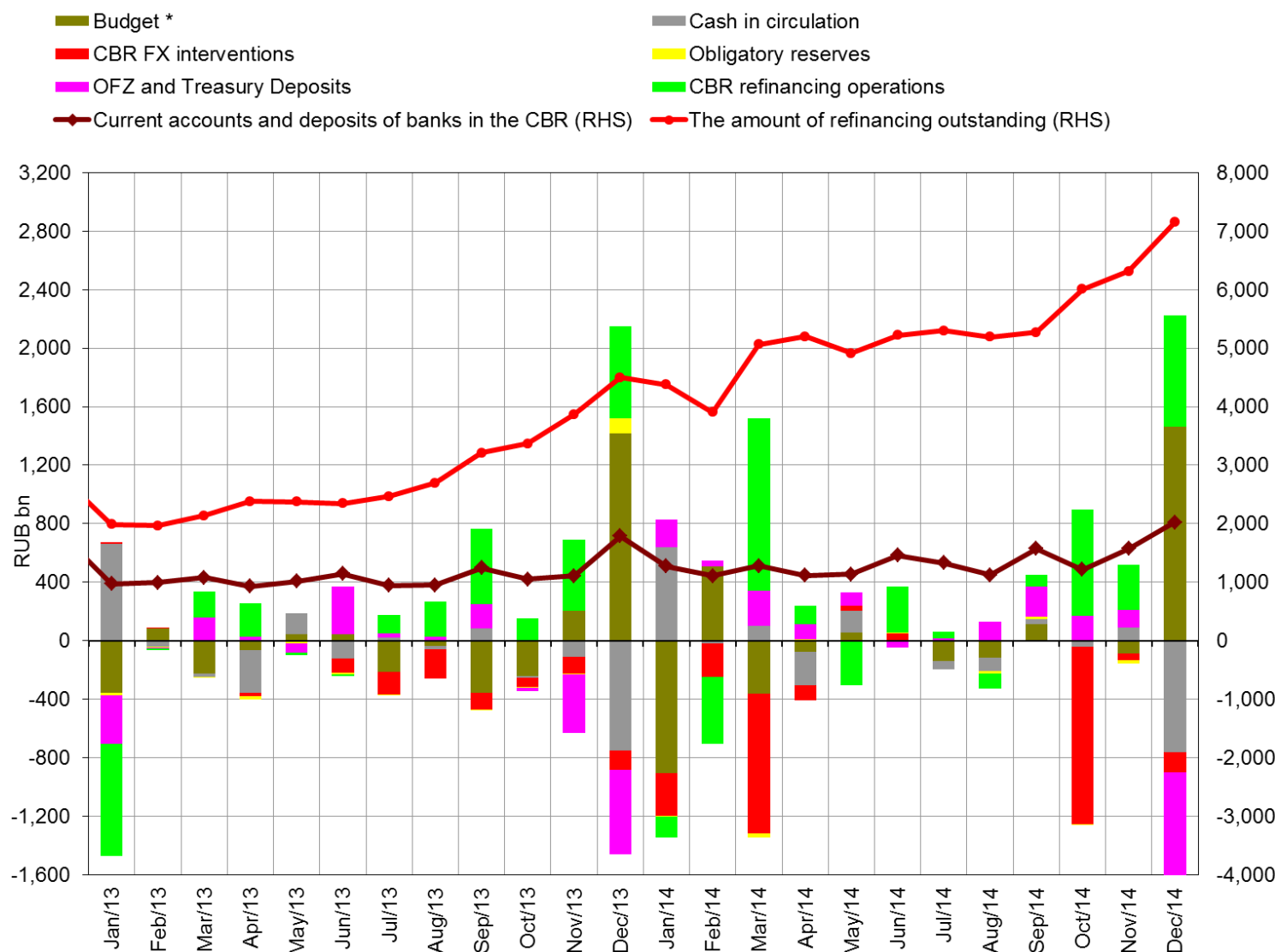
## Factors affecting banking sector liquidity\*



\* “+” – liquidity provision, “-” – liquidity absorption

# BANKING SECTOR LIQUIDITY

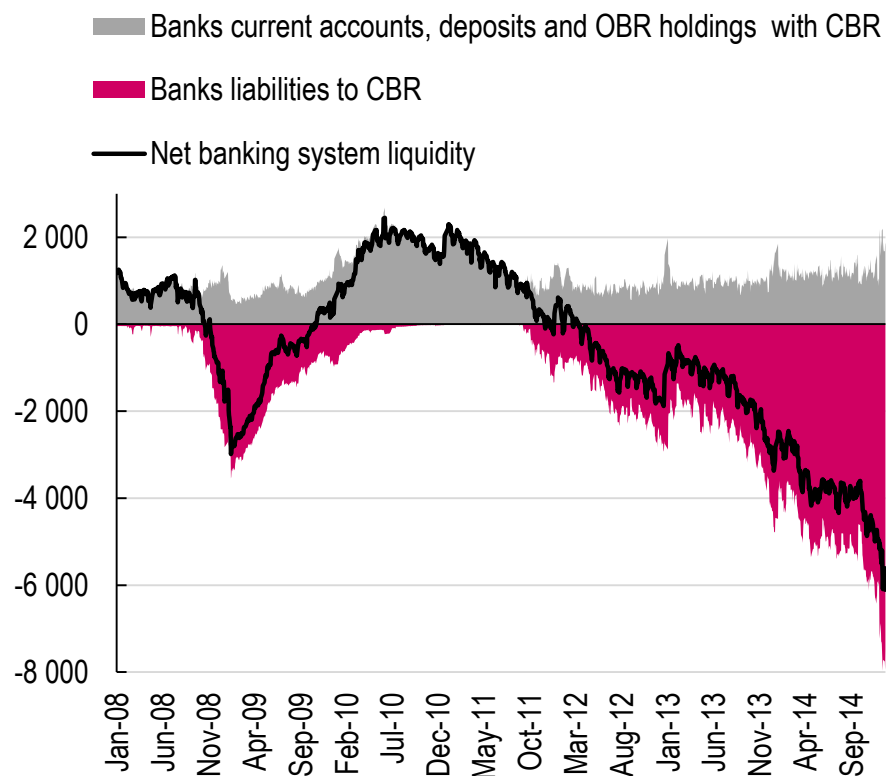
## Factors affecting banking sector liquidity



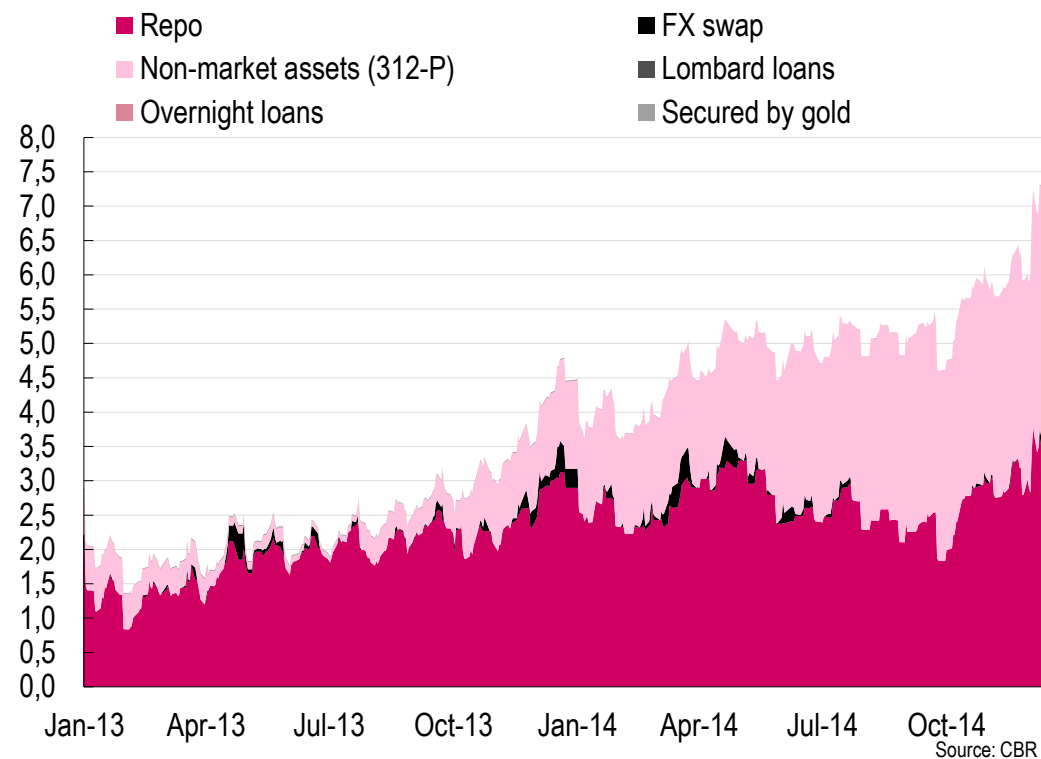
# BANKING SECTOR LIQUIDITY

- The CBR stays the net provider of liquidity

*Net banking sector liquidity, RUB bn*



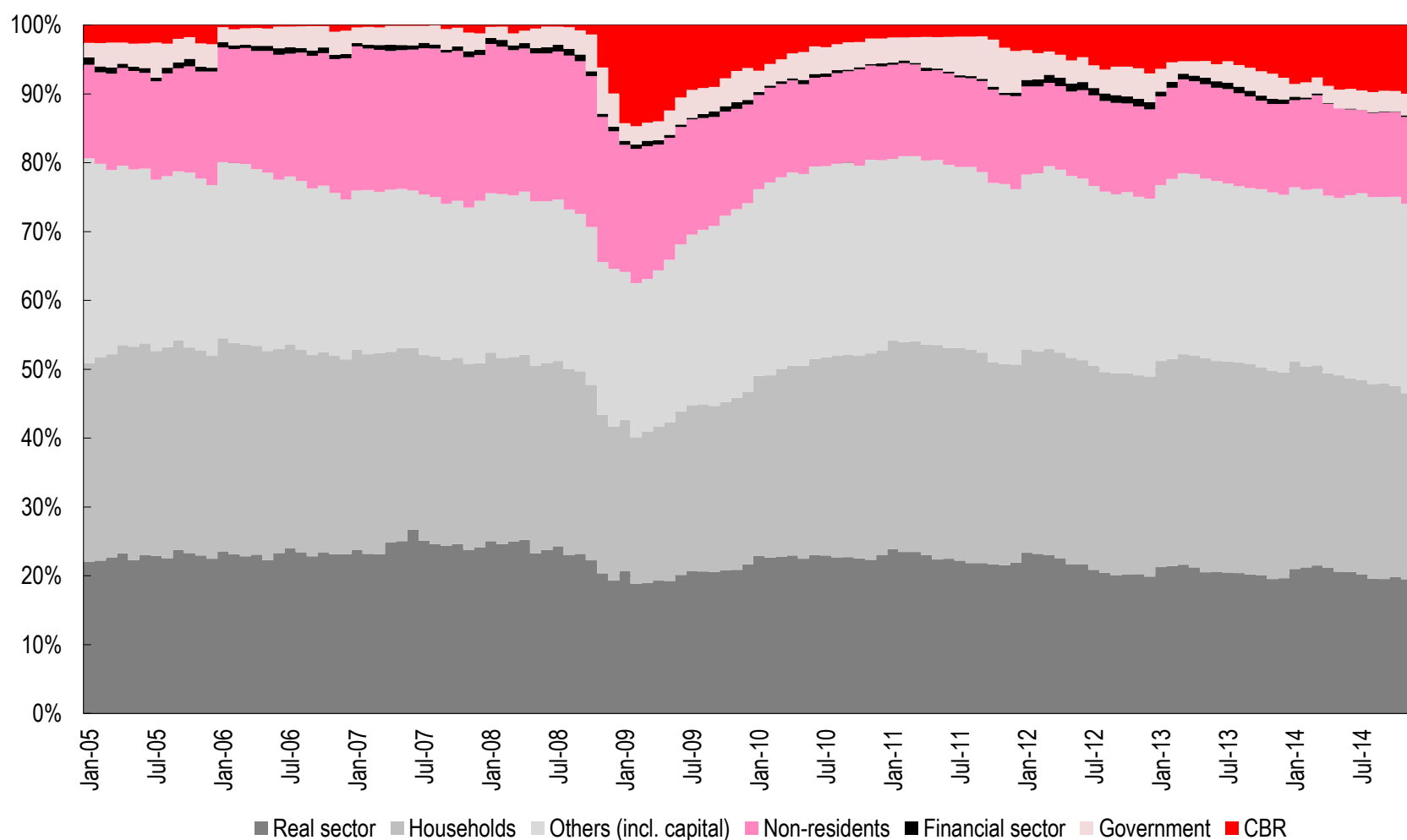
*The amount of the CBR refinancing operations, RUB bn*



Source: CBR

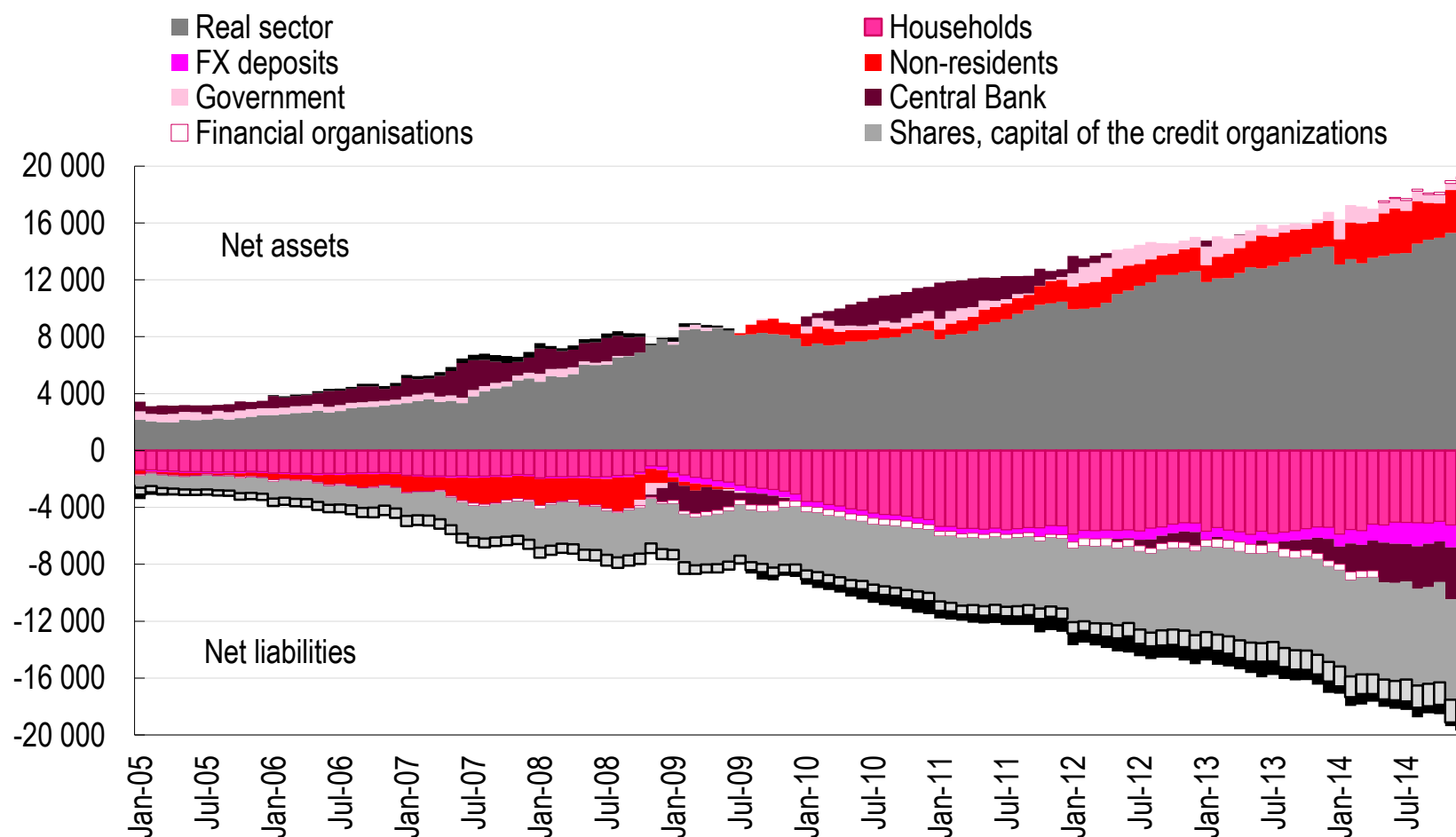
# BANKING SECTOR

- The structure of banking sector liabilities remains broadly stable, with a growing share of CBR funding



# BANKING SECTOR

- The balance of the banking sector



# ECONOMIC GROWTH

- In 2014 GDP growth slid further below potential (0.6%)
- In 2015, Russia is facing a new and challenging environment given the drop in oil prices and Western sanctions
- With oil at \$60/bl, we expect Russian GDP growth to fall by 4.3%
  - With low oil revenues, external deleveraging, very tight domestic credit conditions, and elevated business uncertainty, domestic demand is likely to drop while we do not expect to see significant government and central bank policy support for growth
  - Low unemployment, a lower level of de-stocking and gains from a weaker currency limit the downside
- Growth estimates depend heavily on oil price dynamics
  - If oil prices go to \$70/bl or \$80/bl, Russian GDP growth could contract less sharply, by 3.1% or 1.7%, respectively.
  - Looking at the more severe scenarios, we see growth turning more negative, with growth of -5.8% at \$50/bl oil and -7.2% at \$40/bl
- What else could make the picture look different?
  - On the downside, the risks include a further escalation of political tension regarding Ukraine
  - On the upside, the risks include higher gains from import substitution and some government support, including infrastructure projects financed from sovereign funds