RUSSIA
ECONOMIC DATA WATCH

15 January, 2015
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Raiffeisen Bank International

SUMMARY RUSSIA ECONOMIC DATA WATCH
Faced with deep recession and RUB weakness

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- **RUSSIA IN THE CEE CONTEXT (slides 4 to 9):** Economic underperformer (ex-Ukraine) amidst falling oil price, sanctions and weak policy response. High inflation in stark contrast to EA/CE/SEE where prices tend to stagnate.
- **FOCUS ON TURMOIL IN THE ROUBLE MARKET (slides 10 to 18):** FX crash in December could be arrested for the time being by first steps of coordinated actions by authorities. Rouble exchange rate still highly fragile as both fundamental and market pressures persist.
- **FOCUS ON GDP (slides 19 to 25):** growth has been slowing even before the crisis in Ukraine and the recent drop in oil, but remained slightly positive up to Q3 2014. Recent data points to contraction in Q4 and given the negative environment we cut our GDP growth forecast for 2015 from -1.5% to -4% with only a limited upside in 2016. Risks are clearly on the downside.
- **MONTHLY INDICATORS (slides 26 to 35):** High frequency indicators deteriorated in November with industrial production slipping into negative territory for the first time since early 2013 and other indicator remaining weak. Inflation reached 11.4% yoy for 2014 (Dec-to-Dec). Both exports and imports in steep decline; retail deposit growth slowing (Oct data).

SUMMARY RUSSIA ECONOMIC DATA WATCH
Key indicators history and recent (end of month)

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Russia	2011	2012	2013	Sep-14	Oct-14	Nov-14	Dec-14
Real GDP (% yoy)	4.3	3.4	1.3	1.1	0.5	-0.5	
Industry (% yoy)	4.7	2.6	0.3	2.8	2.9	-0.4	
CPI (eop, % yoy)	6.1	6.6	6.5	8.0	8.3	9.1	11.4
CPI (avg, % yoy)	8.5	5.1	6.8	7.0	7.2	7.4	7.6
Unemployment rate (%)	6.6	5.7	5.6	4.9	5.1	5.2	
General budget (% GDP)	1.6	0.4	-1.0	2.1*	1.9*	1.9*	
Current account (USD bn)	97	72	33	52**			
FX reserves (ex gold, USD bn)	454	487	473	409	383	374	
Ext. debt (gross, USD bn)	542	638	729	678***			
EUR/LCY (eop)	41.7	40.3	45.3	50.0	54.4	64.7	72.6
USD/LCY (eop)	32.1	30.5	32.9	39.7	43.6	51.9	60.0
RUB basket (eop)	36.4	34.9	38.4	44.3	48.5	57.7	65.7
Key interest rate (% avg)	5.3	5.4	5.5	8.0	8.0	9.5	17.0

Central (federal) government budget only; ** Q1-Q3 2014; * end-Q3 2014*
Source: National sources, Thomson Reuters, RBI/Raiffeisen RESEARCH

RUSSIA

IN THE CEE CONTEXT

CEE ECONOMIC ACTIVITY
Russia beginning to feel the pain in November

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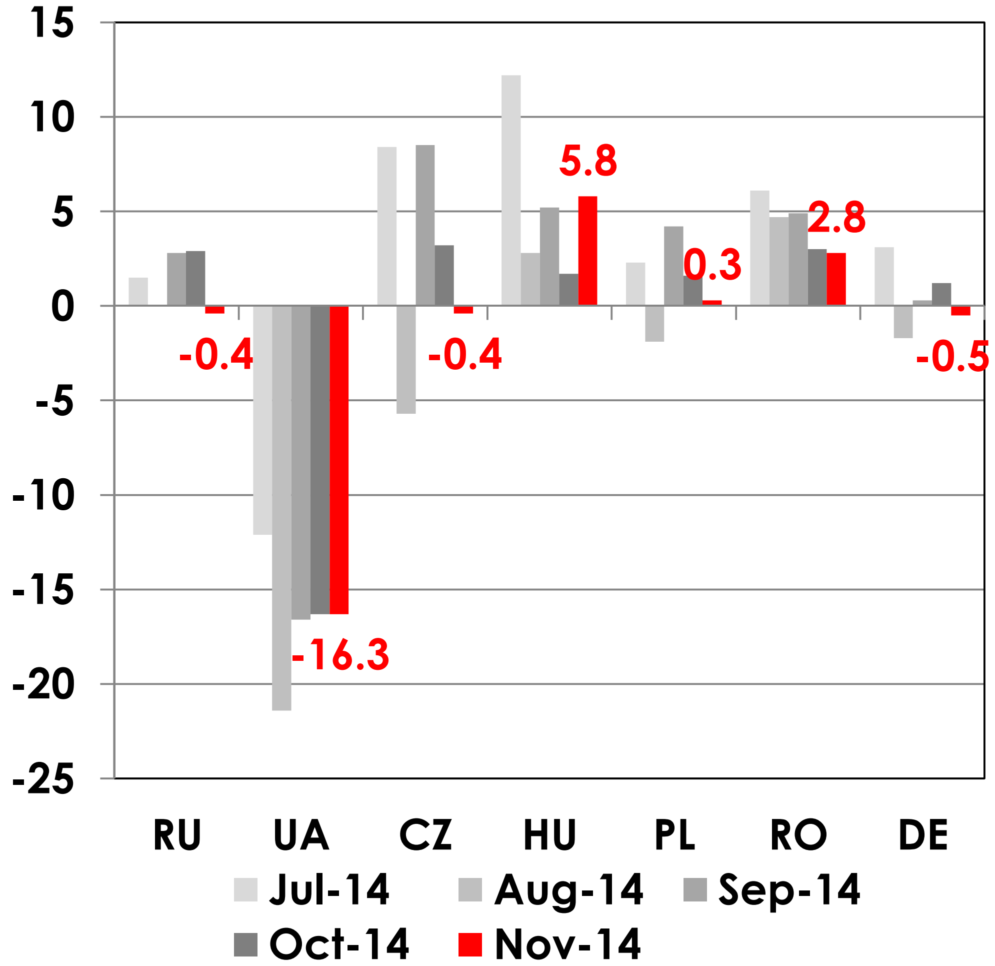
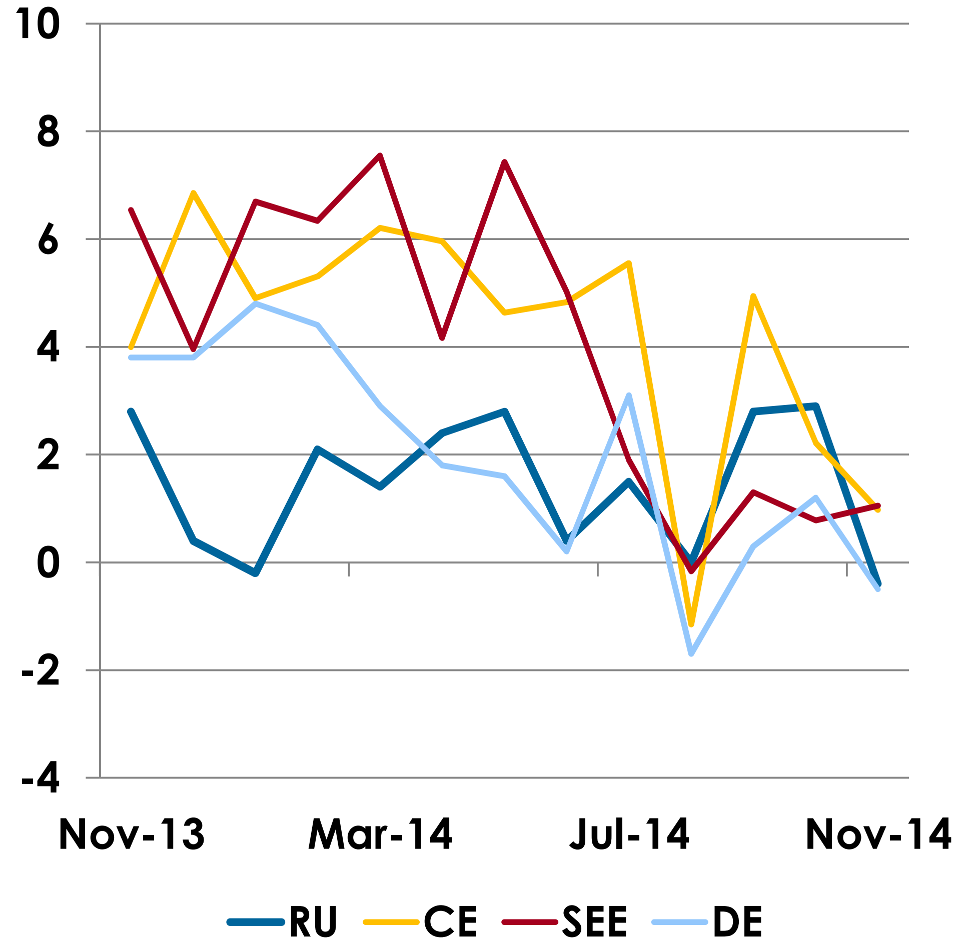
Industrial production (% yoy)



Source: Bloomberg, RBI/Raiffeisen RESEARCH

Industrial production: CEE aggregates (% yoy)



CE: CZ, HU, PL, SK, SI; SEE: BG, HR, RO, RS; DE: Germany
Aggregates are weighted with nominal GDP in EUR as of 2013
Source: Bloomberg, RBI/Raiffeisen RESEARCH

CEE ECONOMIC ACTIVITY
Russia below 2%, CE retail sales down as well

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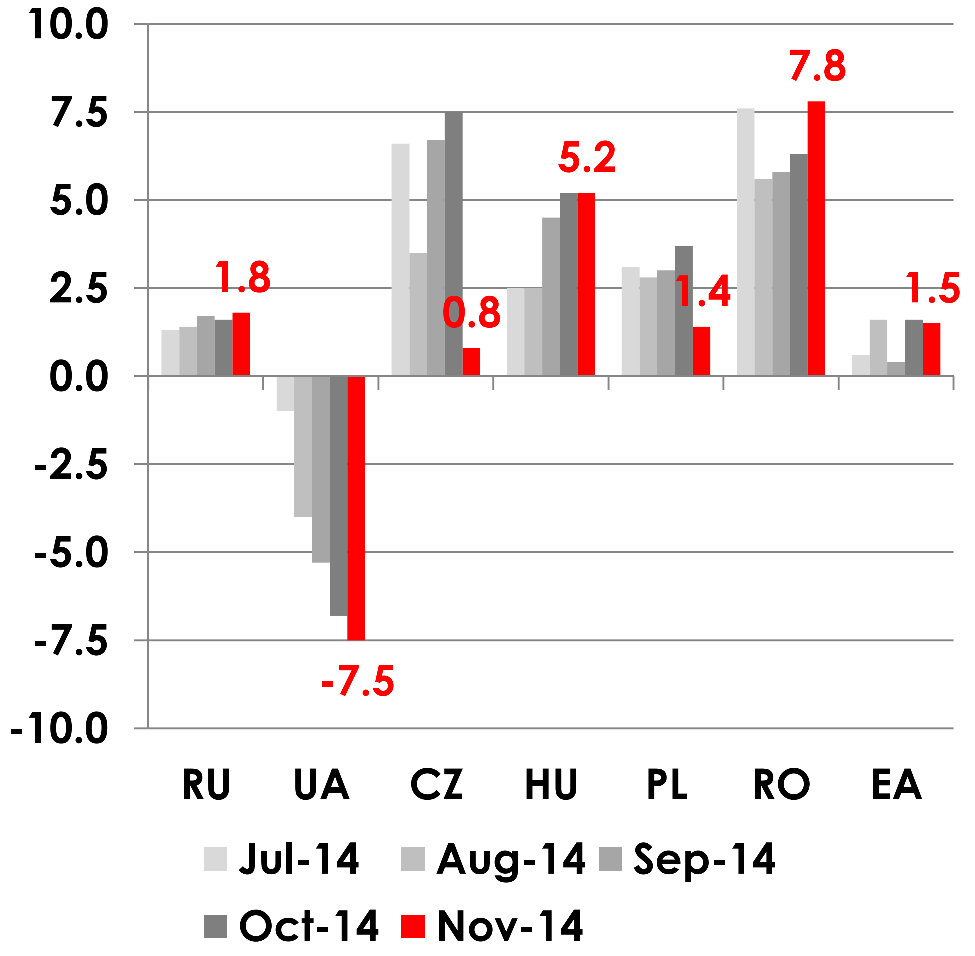
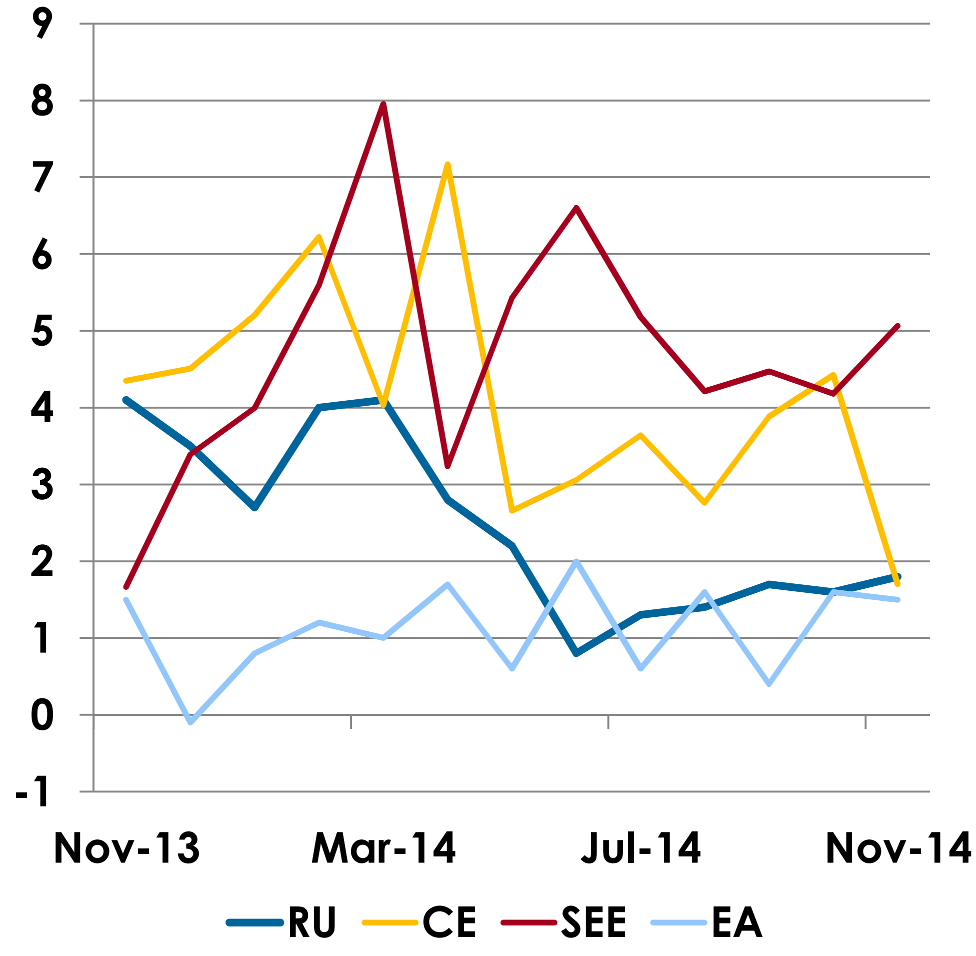
Retail sales (% yoy)



Source: Bloomberg, RBI/Raiffeisen RESEARCH

Retail sales: CEE aggregates (% yoy)



CE: CZ, HU, PL, SK, SI; SEE: BG, HR, RO, RS; EA: euro area
Aggregates are weighted with nominal GDP in EUR as of 2013
Source: Bloomberg, RBI/Raiffeisen RESEARCH

CEE INFLATION
Russia CPI far above CEE inflation (ex Ukraine)

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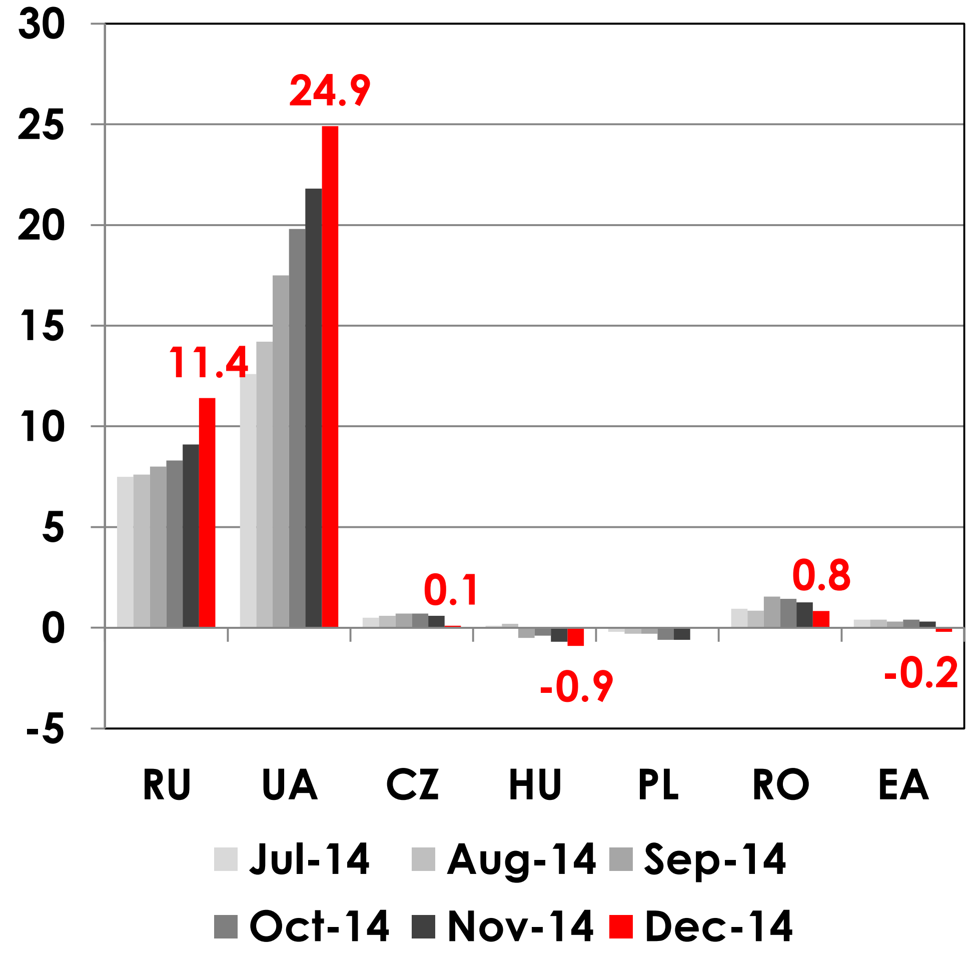
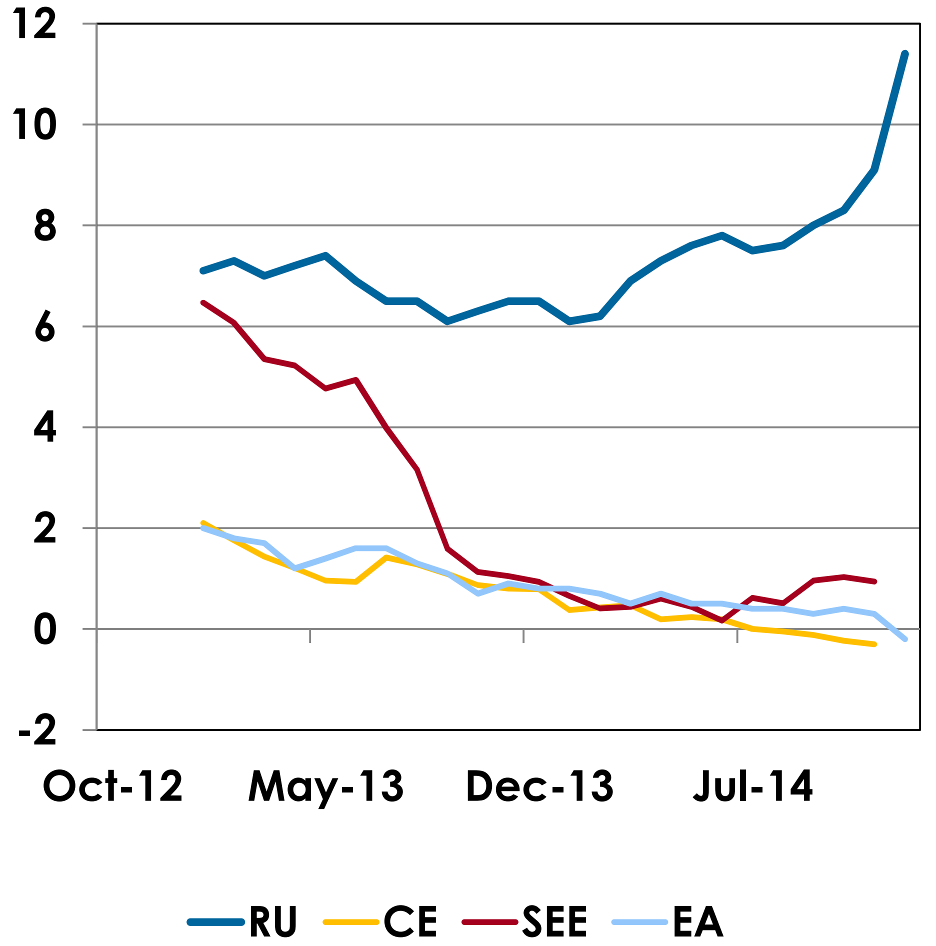
Inflation CPI (% yoy)



Source: Bloomberg, RBI/Raiffeisen RESEARCH

Inflation CPI: CEE aggregates (% yoy)



CE: CZ, HU, PL, SK, SI; SEE: BG, HR, RO, RS; EA: euro area
Aggregates are weighted with nominal GDP in EUR as of 2013
Source: Bloomberg, RBI/Raiffeisen RESEARCH

CEE ECONOMIC ACTIVITY
Q3 GDP growth in Russia lags behind CE/SEE

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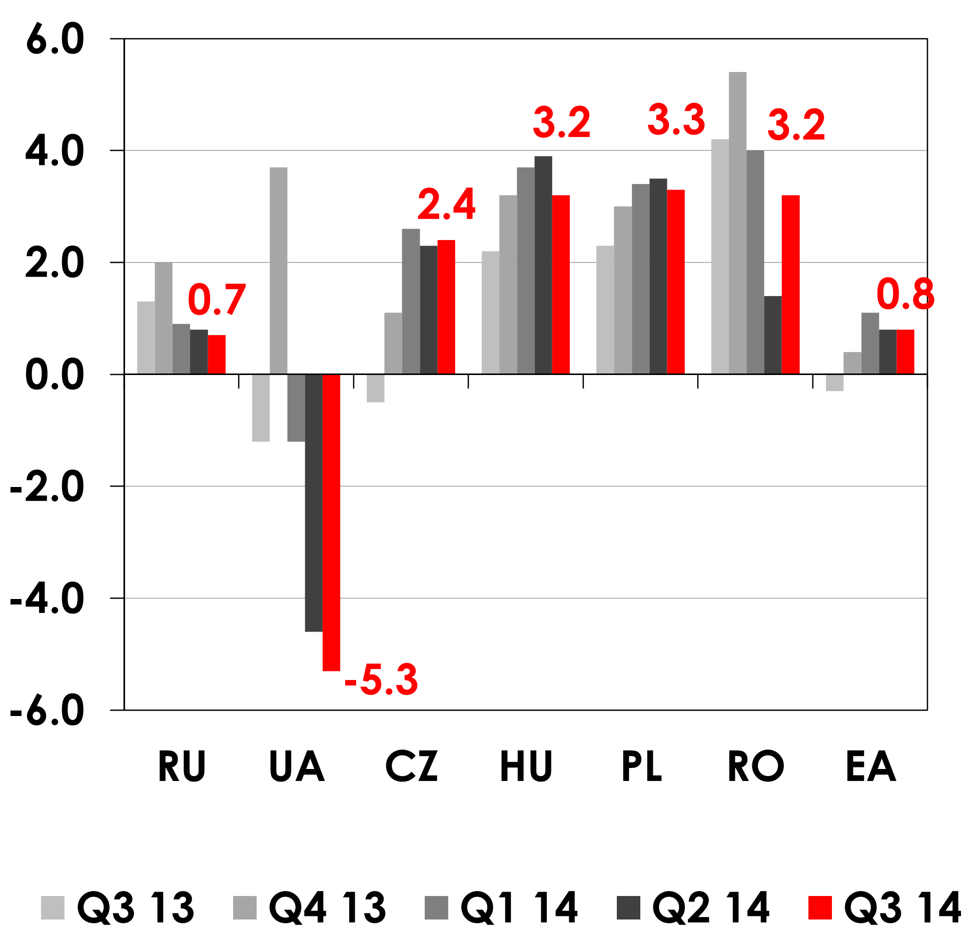
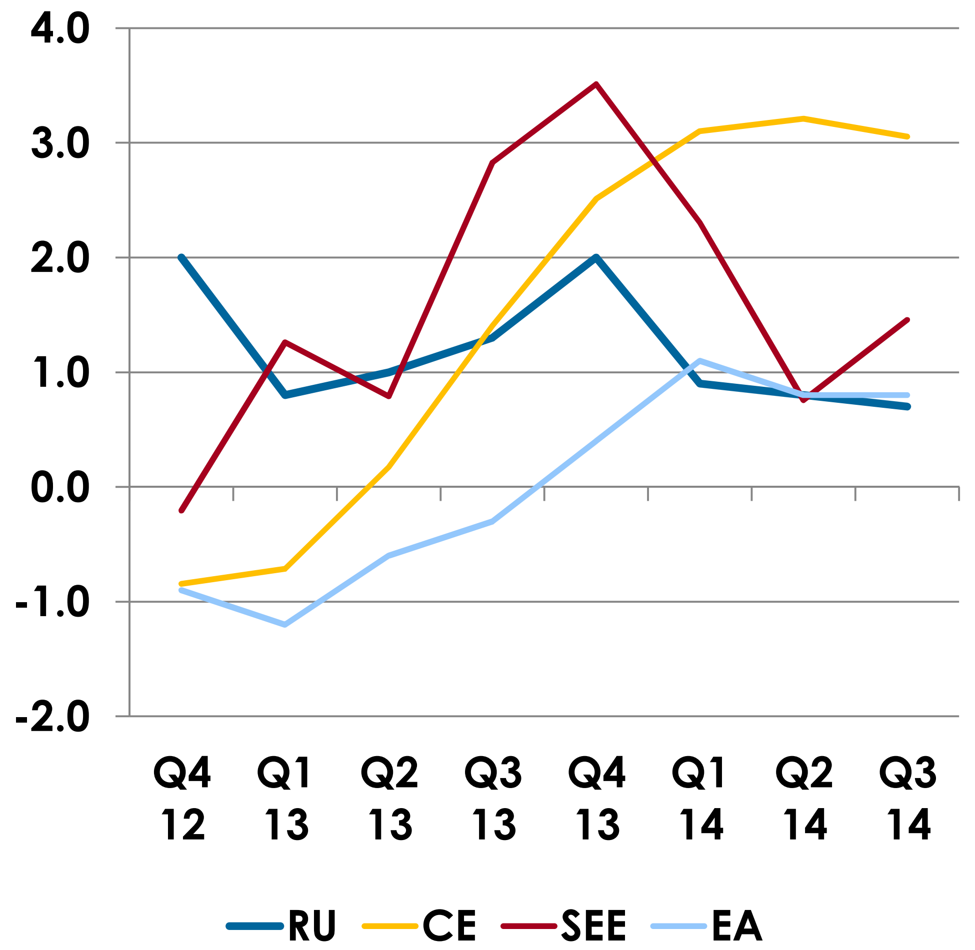
Real GDP (% yoy)



Source: Bloomberg, RBI/Raiffeisen RESEARCH

Real GDP: CEE aggregates (% yoy)



CE: CZ, HU, PL, SK, SI; SEE: BG, HR, RO, RS; EA: euro area
Aggregates are weighted with nominal GDP in EUR as of 2013
Source: Bloomberg, RBI/Raiffeisen RESEARCH

CEE EXCHANGE RATES
Rouble and Hryvnia weakest currencies in CEE

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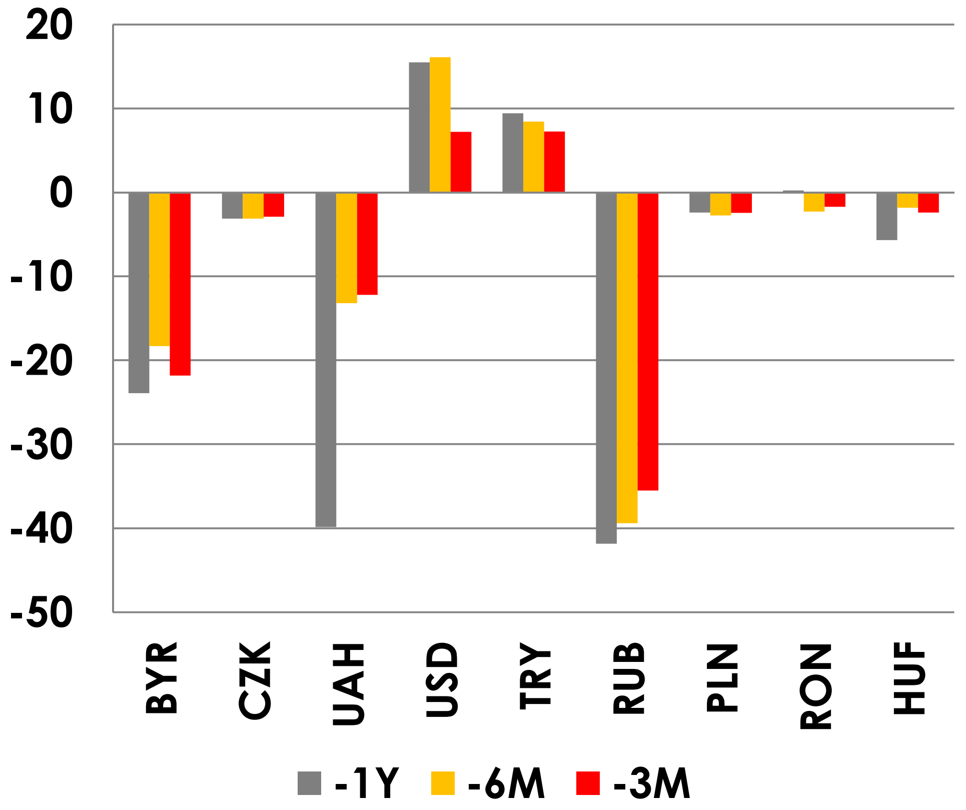
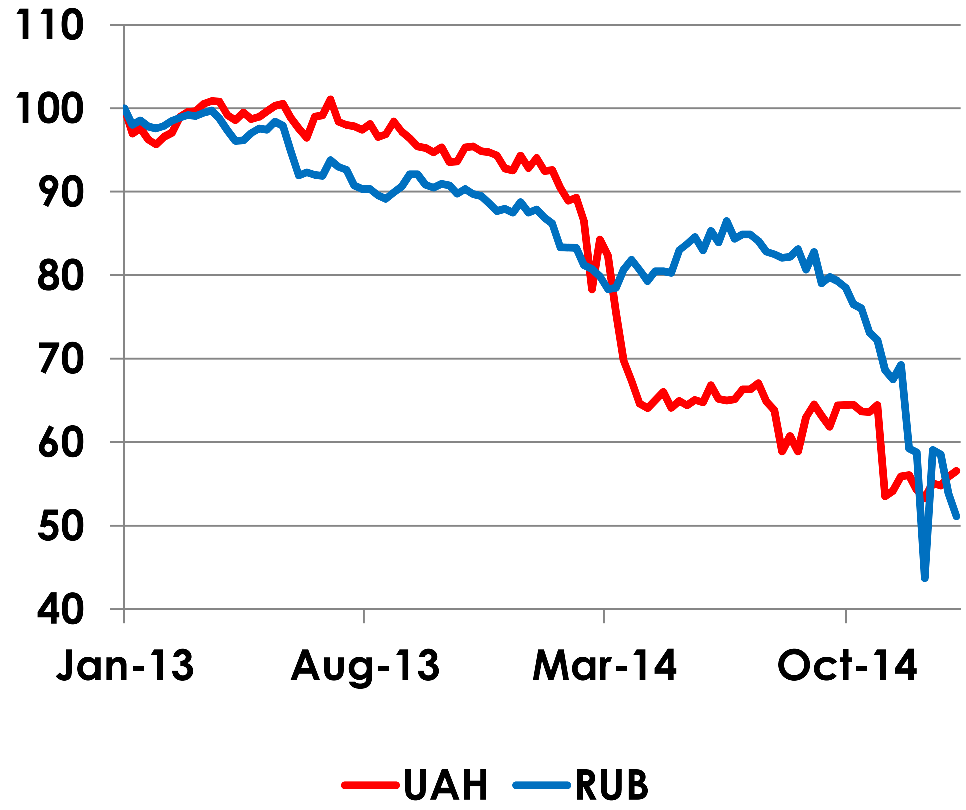
Cumulative change to EUR over last year (%)



Negative value: Depreciation of LCY to EUR; loss in purchasing power
Source: Thomson Reuters, RBI/Raiffeisen RESEARCH

Drop in UAH and RUB (%, index over last 2Y)



Decline: Depreciation of LCY to EUR; EUR/RUB: 5y high 85.0, 5y low 37.4; EUR/UAH 5y high 19.8, 5y low 9.5
Source: Thomson Reuters, RBI/Raiffeisen RESEARCH

- **In H1 2014 the UAH lost nearly 40%; the RUB lost "only" 20% then and even partly recovered in summer 2014**
- **RUB hit hard by sharp and unexpected drop in oil prices from above USD 100/bbl to close to USD 50/bbl**
- **Other CEE currencies relatively unaffected by Russia-Ukraine turmoil, given moderate integration with RU/UA**

RUSSIA

FOCUS:
TURMOIL ON THE RUBLE MARKET

RUSSIA: ROUBLE EXCHANGE RATE
Panic/overshooting late '14, pressure in early '15

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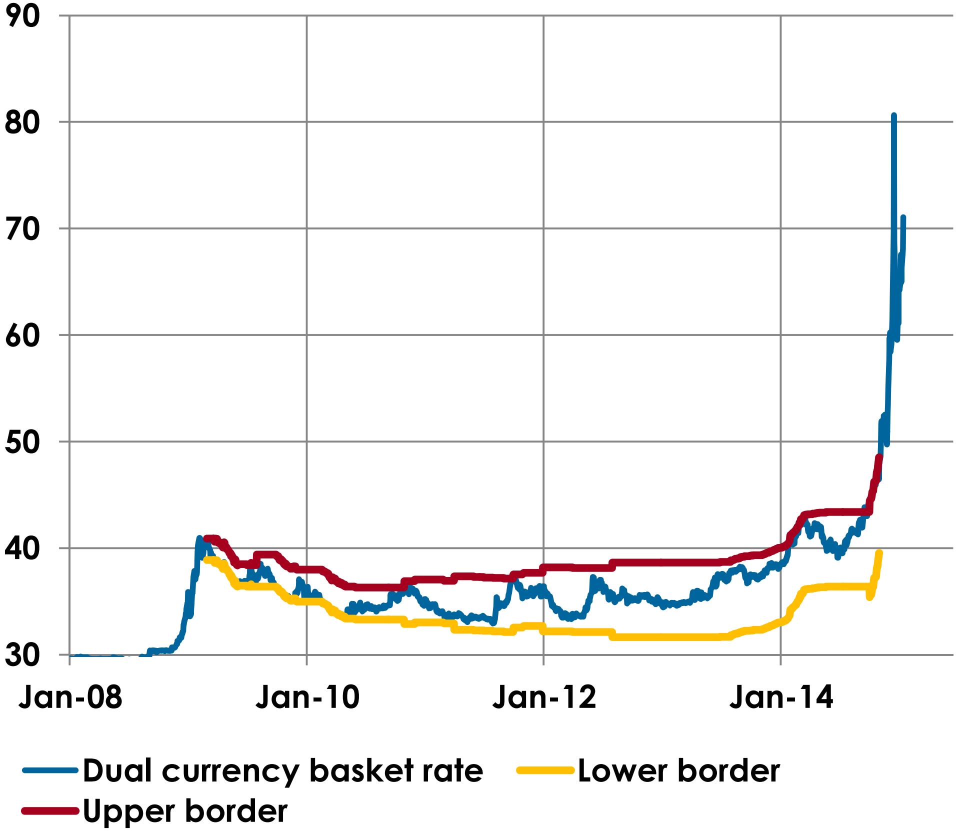
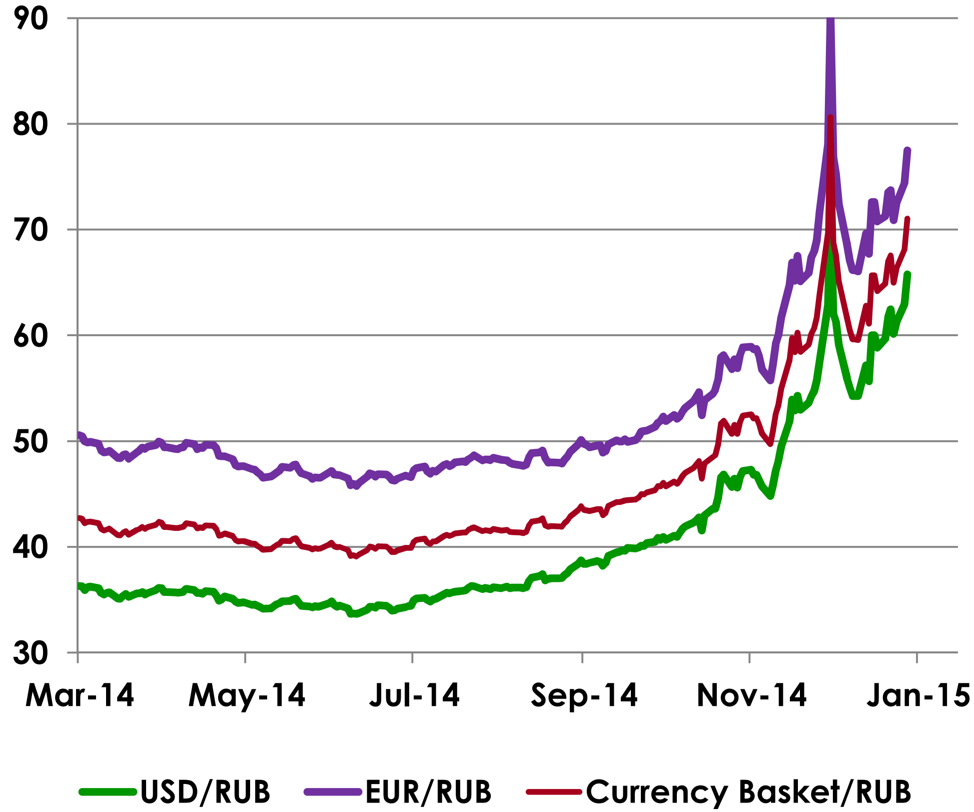
Rouble exchange rate to dual currency basket



Source: Thomson Reuters, RBI/Raiffeisen RESEARCH

Rouble exchange rate to USD and EUR



Basket/RUB: 5y high 78.6, 5y low 32.9; EUR/RUB: 5y high 85.0, 5y low 37.4; USD/RUB: 5y high 67.9, 5y low 27.3
Source: Thomson Reuters, RBI/Raiffeisen RESEARCH

- **From 2009 to late 2014 the CBR used a FX corridor based on a currency basket of 55% USD and 45% EUR**
- **After sideways movement in 2010-2012, the RUB depreciated by around 15% in 2013/H1 2014**
- **Strong rouble overshooting in Nov-Dec 2014 - after the abolishment of the basket on 10 Nov 2014**

RUSSIA: ROUBLE EXCHANGE RATE
Stronger FX move in '14 compared to '08/'09

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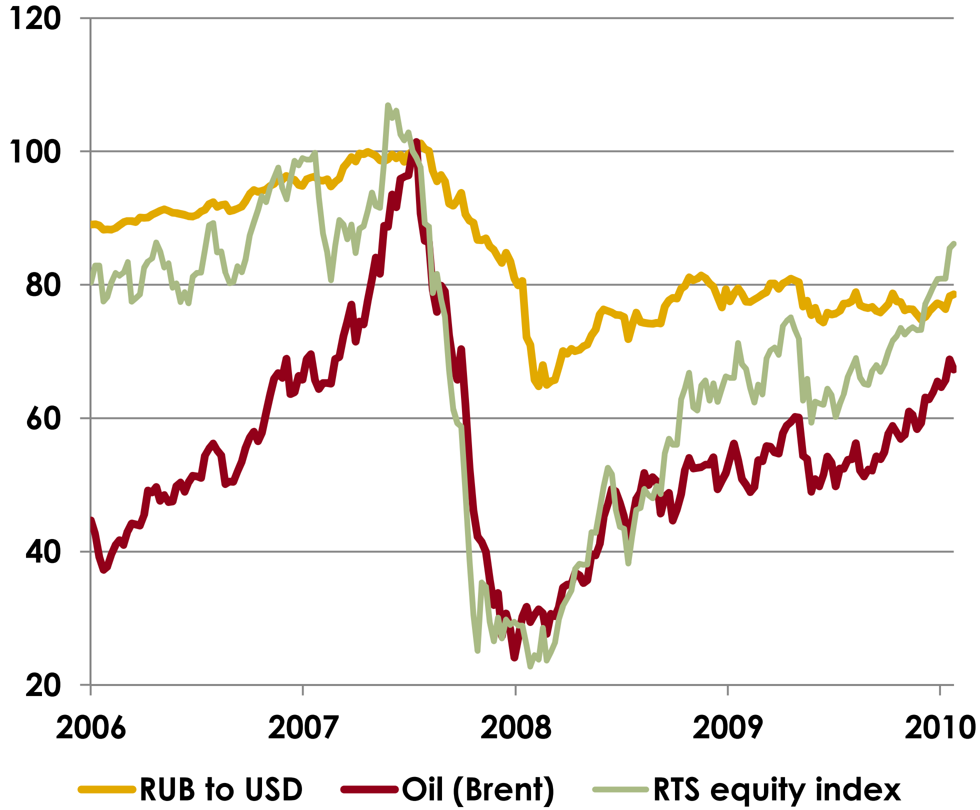
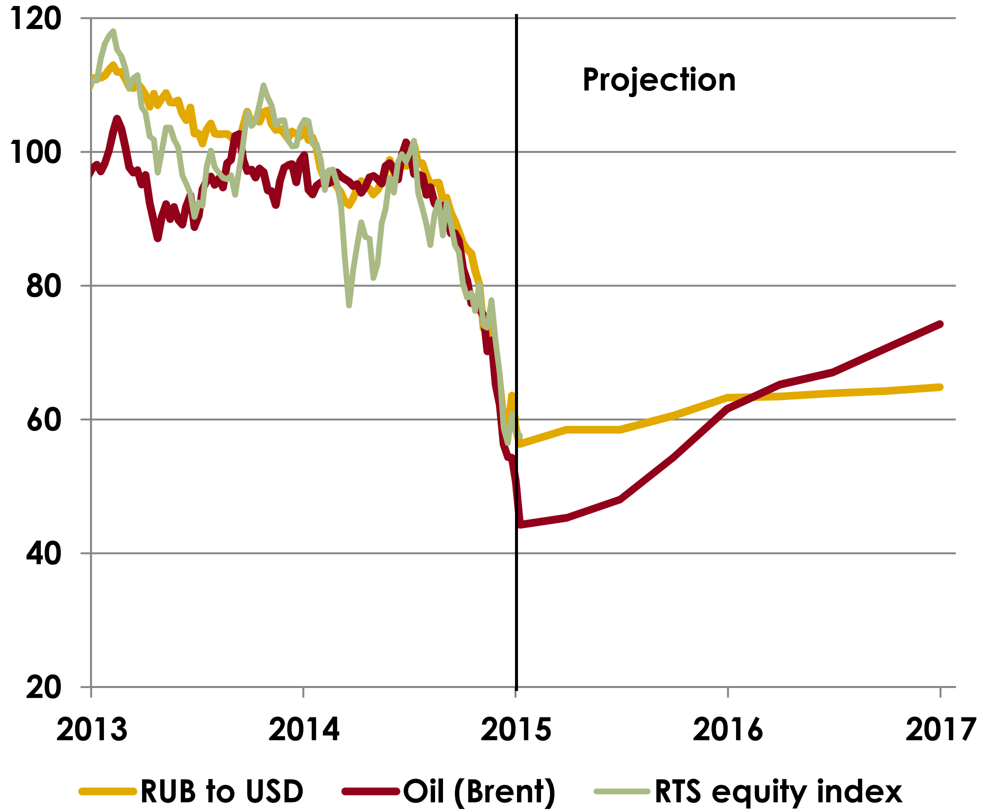
In 2008/2009: RUB falling less than oil (index)



Indexed at mid-2008 = 100%;
Source: Thomson Reuters, RBI/Raiffeisen RESEARCH

In 2014: RUB in parallel decline with oil (index)



Indexed at mid-2014 = 100%; *USD/RUB: 5y high 67.9, 5y low 27.3 Brent (USD/bbl): 5y high 111.6, 5y low 45.9; RTS: 5y high 2124, 5y low 629; Source: Thomson Reuters, RBI/Raiffeisen RESEARCH*

- **2008/2009: With strongly managed FX regime, the RUB lost a third in value; FX reserves fell by USD 200 bn**
- **2014: With much looser FX management, the RUB lost almost half in value ; USD 80 bn of FX reserves were sold**
- **We project a similar (relative) recovery in oil prices to 2009/2010, but RUB regains less value/sideways move**

RUSSIA: REAL EXCHANGE RATE VS OIL PRICE
With oil price dropping, real FX rate adjusting

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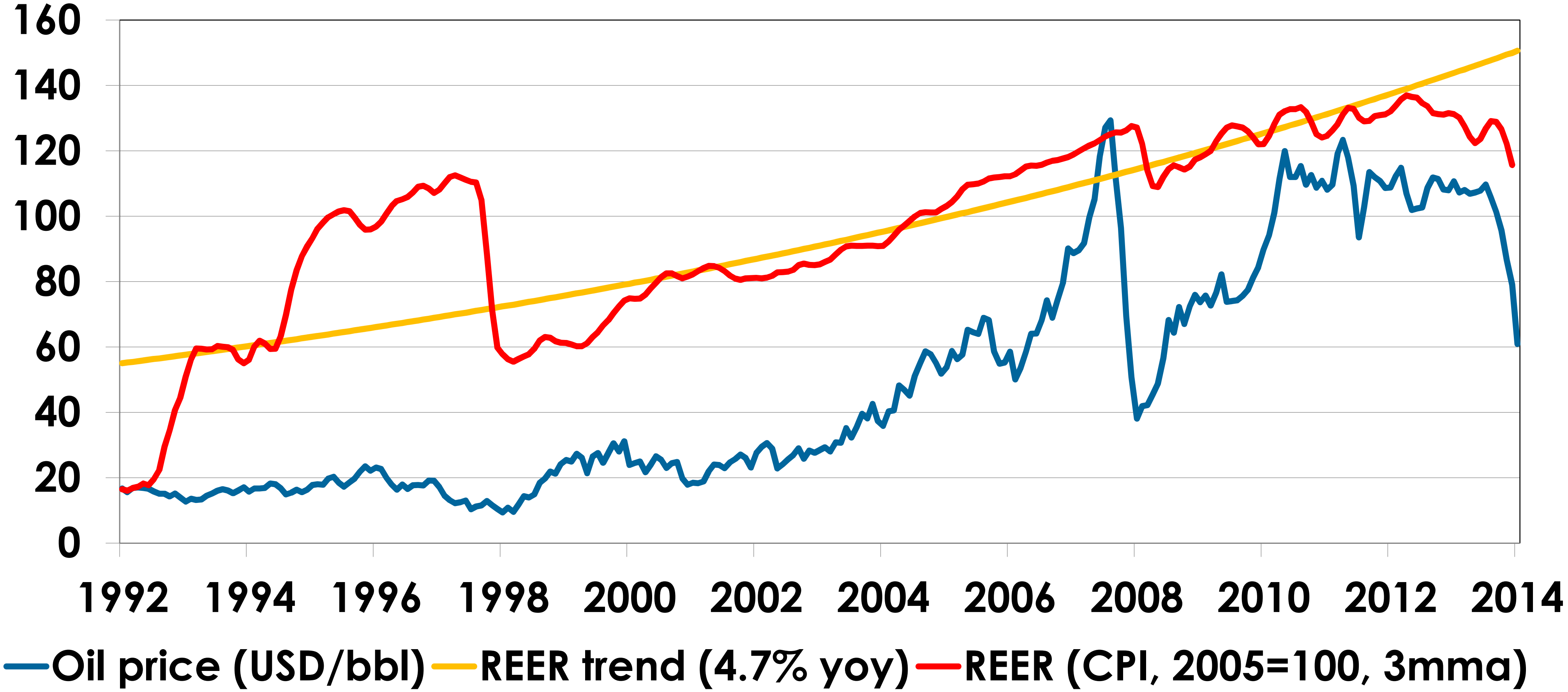

REER: Real Effective Exchange Rate based on Consumer Price Index
Source: Thomson Reuters, RBI/Raiffeisen RESEARCH

- **Russia appreciated strongly in real terms (nominal exchange rate plus inflation) over the recent decade**
- **This development was made possible by strong export revenues given rising and high oil prices**
- **With falling export revenues, an adjustment (i.e. decline) of the real exchange rate is justified**

RUSSIA: FX VALUATION USING RELATIVE PPP
Closed gap to long term fair value until Dec'14

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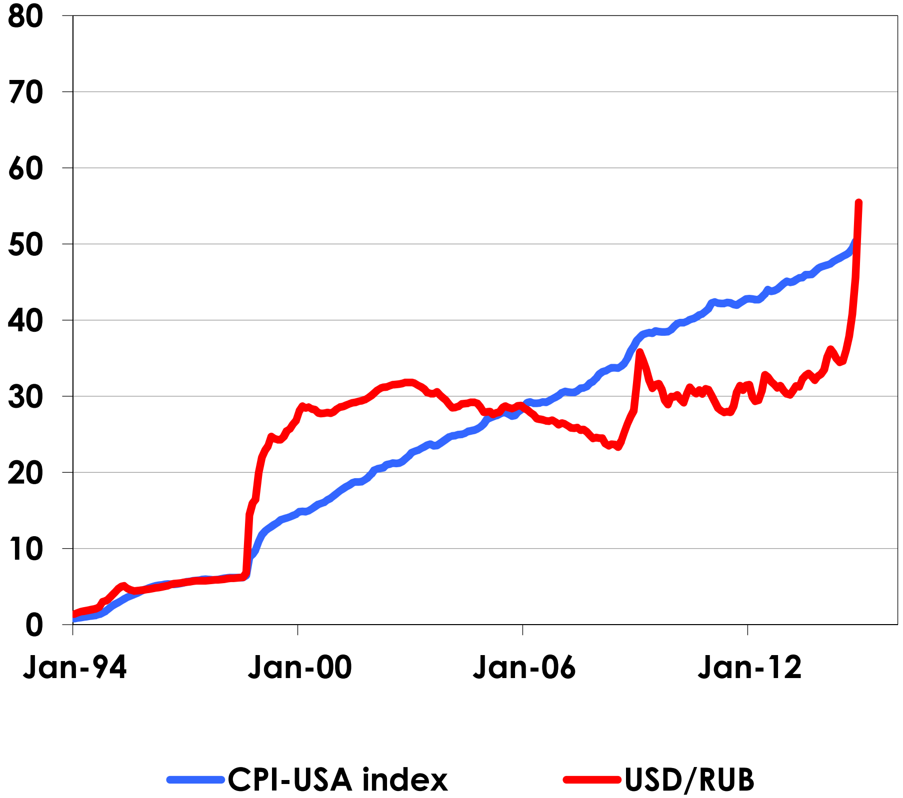
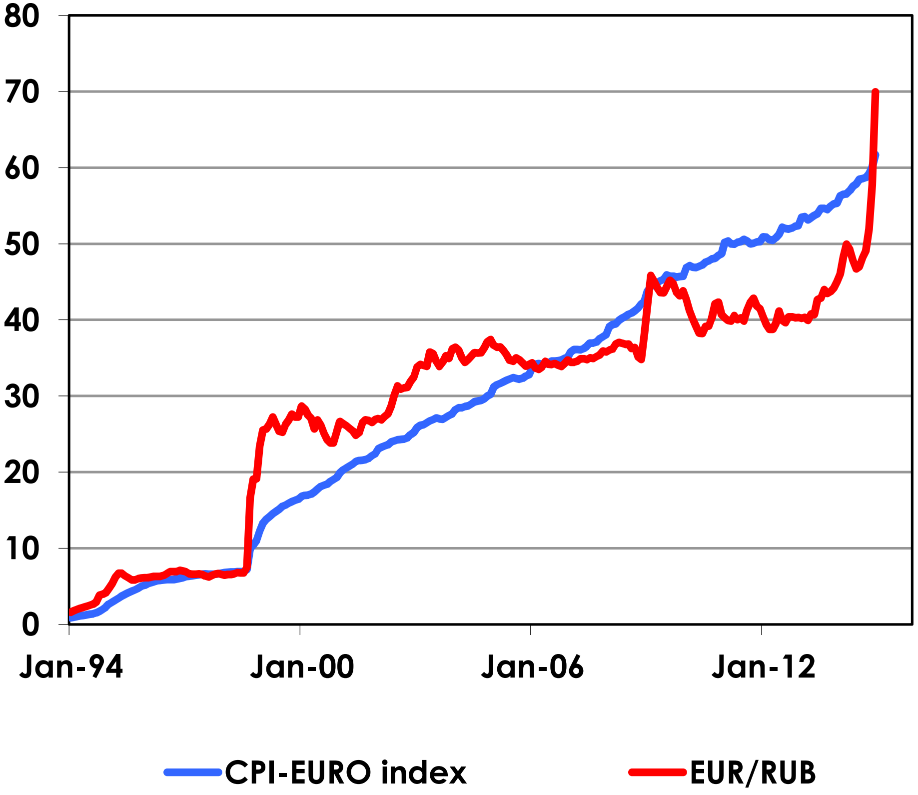
USD/RUB: Inflation vs FX rate



USD/RUB in comparison to index of price differential to the US, monthly avg, latest values as of Dec 2014; Source: Thomson Reuters, RBI/Raiffeisen RESEARCH

EUR/RUB: Inflation vs FX rate



EUR/RUB in comparison to index of price differential to the EA, monthly avg, latest values as of Dec 2014
Source: Thomson Reuters, RBI/Raiffeisen RESEARCH

- **Relative Purchasing Power Parity (PPP) assumes long term FX trends are connected to inflation dynamics**
- **According to relative PPP the rouble was undervalued between H2 1998 and 2005; overvalued later**
- **According to the metrics, values above USD/RUB 50 and EUR/RUB 60 represent overshooting at present**

RUSSIA: FX RESERVES AND EXTERNAL DEBT
FX reserves substantial, but under pressure

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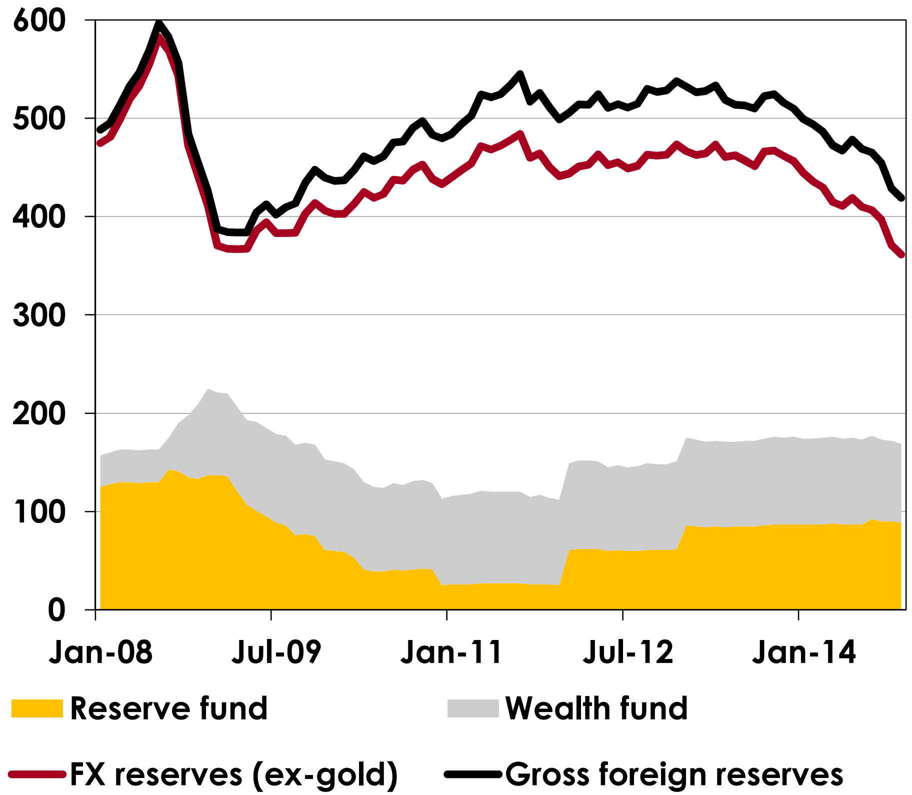
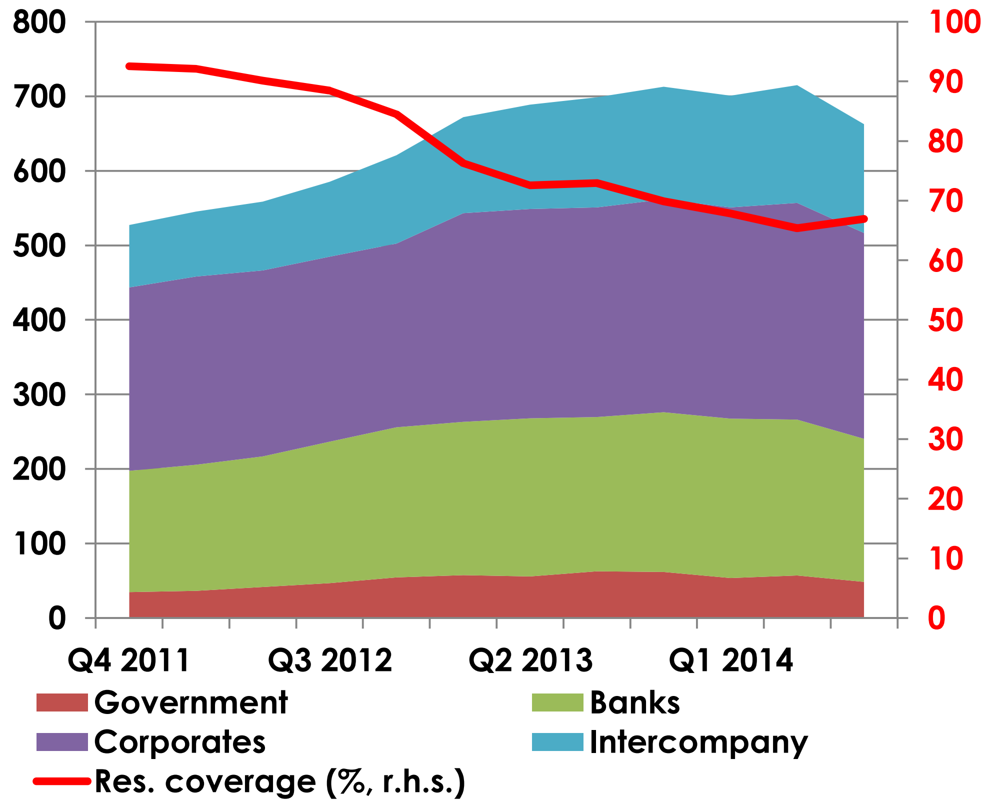
FX reserves and fiscal funds (USD bn)



FX reserves: Gross international reserves less monetary gold, SDR, and IMF position; latest data as of Nov 2014
Source: Thomson Reuters, RBI/Raiffeisen RESEARCH

External debt composition (USD bn)



Reserve coverage: Gross international reserves to gross external debt, latest data as of Q3 2014
Source: Thomson Reuters, RBI/Raiffeisen RESEARCH

- **Substantial FX reserves of slightly more than 20-25% of GDP - under pressure in 2008/09 and again in 2014**
- **FX reserves include also (most) of two government wealth funds, which are predominantly managed by CBR**
- **External debt (75% in FX) moderate at 33% GDP; but coverage ratio of external debt by FX reserves falling**

RUSSIA: EXTERNAL DEBT REDEMPTIONS
Principal repayment schedule next 2Y (USD mn)

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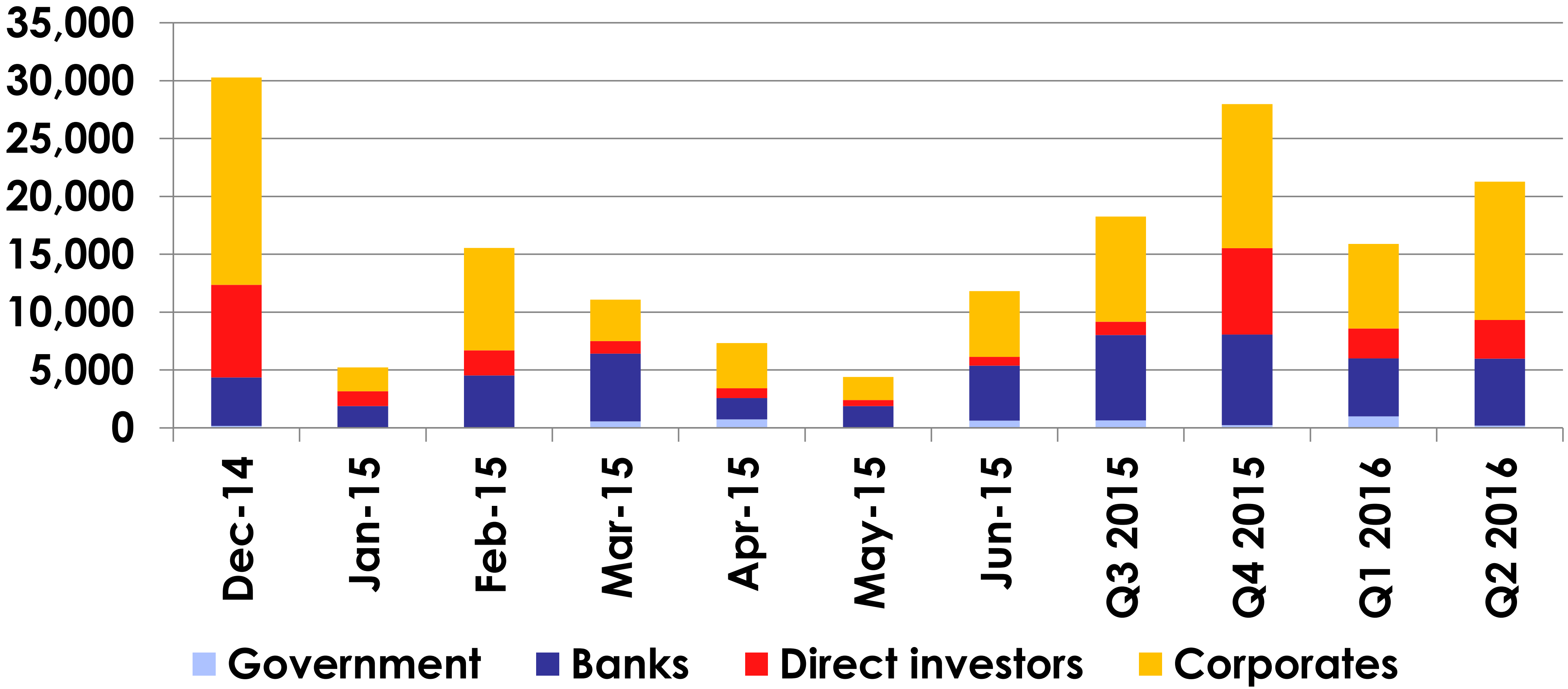

Principal payments; data as of end-Q2 2014; not shown is maturing debt from June 2014 to Nov 2014 of USD 118 bn; of longer maturity than two years and unknown maturity of USD 442 bn
Source: Central Bank of Russia, RBI/Raiffeisen RESEARCH

- **Russian gross external debt principal redemptions of around USD 100 bn in 2015, overwhelmingly private debt**
- **Share of banks in repayments around 1/3, corporates close to 50% and intercompany/direct investors 15%**
- **Estimated required market financing at USD 60-80 bn, i.e. lower than in schedule given offshoring practices**

RUSSIA: MONETARY POLICY
Central bank tightens policy since March

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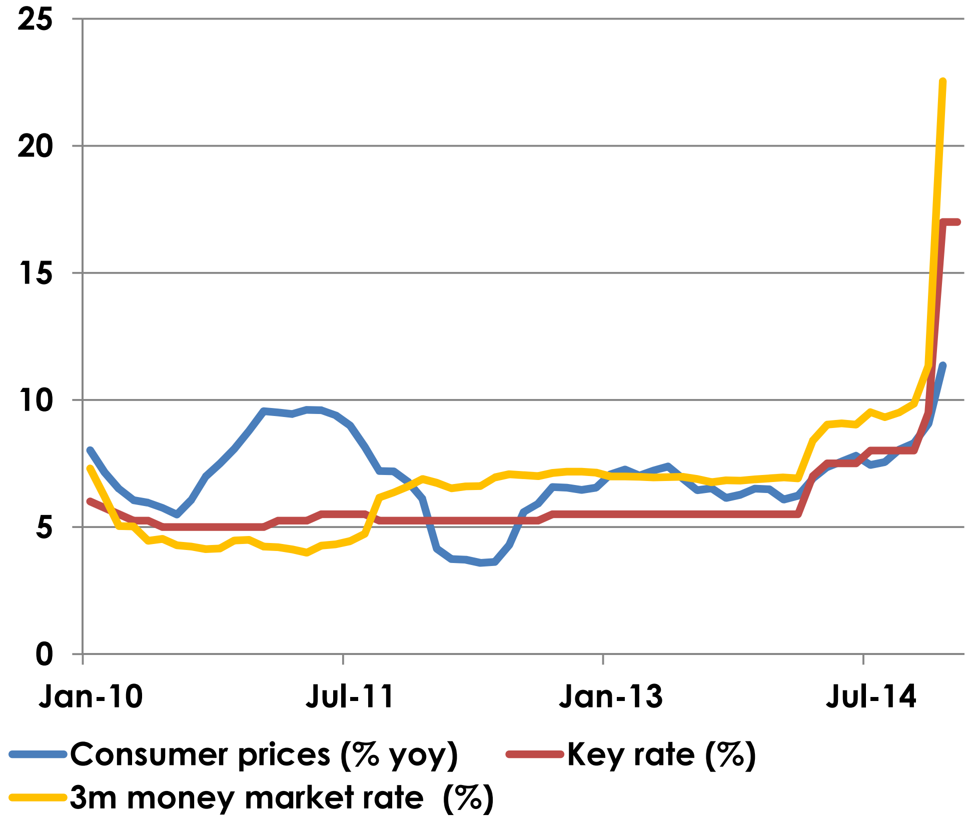
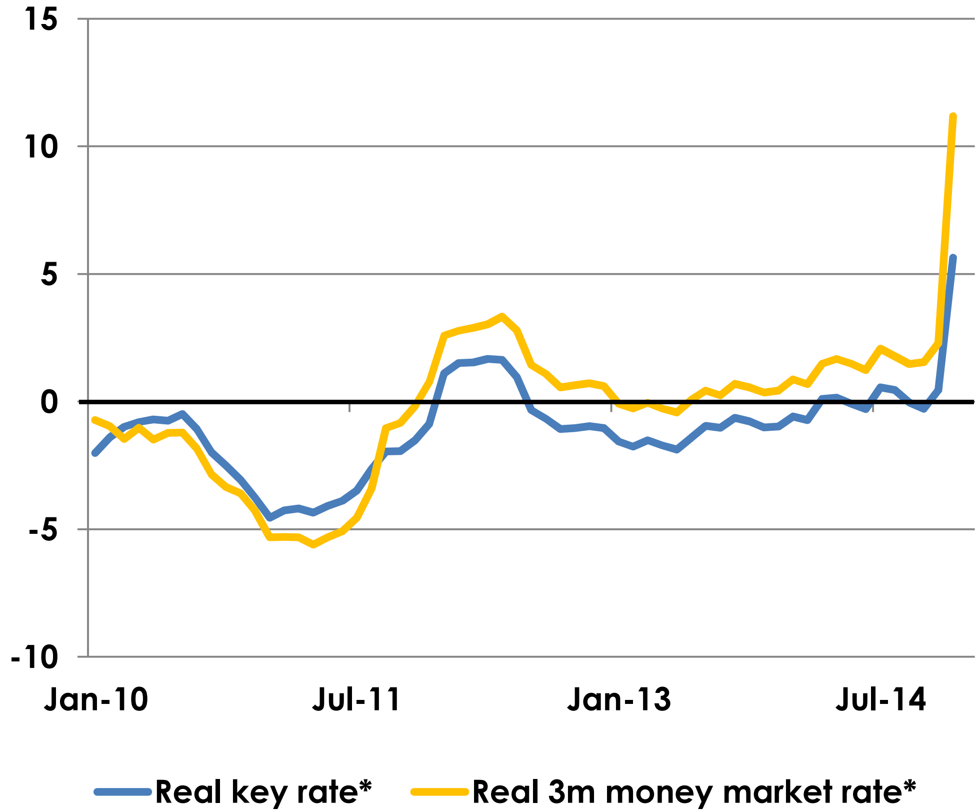
Nominal interest rates (%) vs inflation



Source: Thomson Reuters, RBI/Raiffeisen RESEARCH

Real interest rates (%)



Source: Thomson Reuters, RBI/Raiffeisen RESEARCH

- **Key interest rate hikes by 400bp until October; emergency hikes in Dec first by 100 bp then by 650bp to 17%**
- **After latest hikes, key rate exceeds CPI inflation level (% yoy, eop), resulting in a strongly positive real rate**
- **Inflation still to catch up given RUB devaluation making a strong cut in the key rate ahead of H2 2015 difficult**

RUSSIA: ROUBLE EXCHANGE RATE
For more information see

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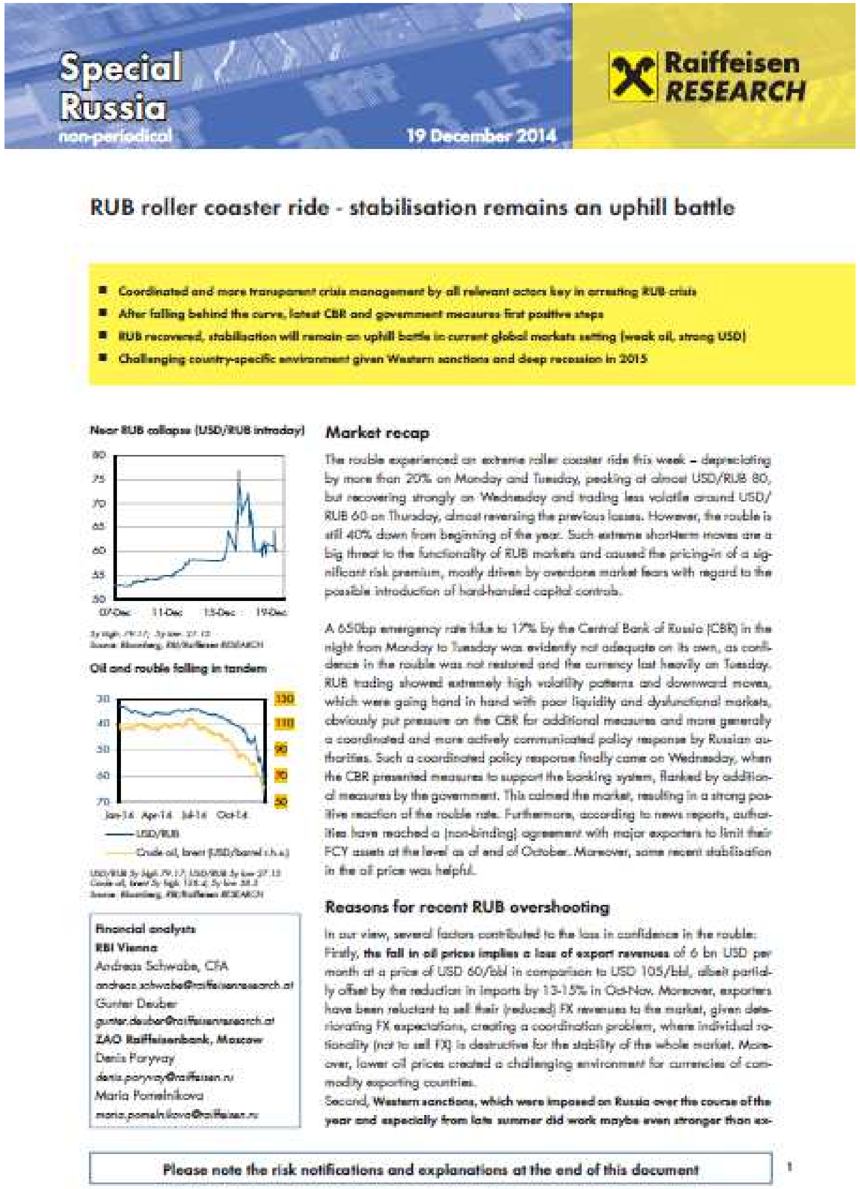
SPECIAL REPORT RUSSIA (19 Dec 2014) :

RUB roller coaster ride - stabilisation remains an uphill battle

- Coordinated and more transparent crisis management by all relevant actors key in arresting RUB crisis
- After falling behind the curve, latest CBR and government measures first positive steps
- RUB recovered, stabilisation will remain an uphill battle in current global markets setting (weak oil, strong USD)
- Challenging country-specific environment given Western sanctions and deep recession in 2015



Special Russia
non-periodical
19 December 2014
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RUB roller coaster ride - stabilisation remains an uphill battle

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Near RUB collapse (USD/RUB intraday)

Oil and rouble falling in tandem

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Market recap

The rouble experienced an extreme roller coaster ride this week – depreciating by more than 20% on Monday and Tuesday, peaking at almost USD/RUB 80, but recovering strongly on Wednesday and trading less volatile around USD/RUB 60 on Thursday, almost reversing the previous losses. However, the rouble is still 40% down from beginning of the year. Such extreme short-term moves are a big threat to the functionality of RUB markets and caused the pricing-in of a significant risk premium, mostly driven by overdone market fears with regard to the possible introduction of hard-handed capital controls.

A 650bp emergency rate hike to 17% by the Central Bank of Russia (CBR) in the night from Monday to Tuesday was evidently not adequate on its own, as confidence in the rouble was not restored and the currency lost heavily on Tuesday. RUB trading showed extremely high volatility patterns and downward moves, which were going hand in hand with poor liquidity and dysfunctional markets, obviously put pressure on the CBR for additional measures and more generally a coordinated and more actively communicated policy response by Russian authorities. Such a coordinated policy response finally came on Wednesday, when the CBR presented measures to support the banking system, flanked by additional measures by the government. This calmed the market, resulting in a strong positive reaction of the rouble rate. Furthermore, according to news reports, authorities have reached a (non-binding) agreement with major exporters to limit their FCY assets at the level as of end of October. Moreover, some recent stabilisation in the oil price was helpful.

Reasons for recent RUB overshooting

In our view, several factors contributed to the loss in confidence in the rouble: Firstly, **the fall in oil prices implies a loss of export revenues** of 6 bn USD per month at a price of USD 60/bbl in comparison to USD 105/bbl, albeit partially offset by the reduction in imports by 13-15% in Oct-Nov. Moreover, exporters have been reluctant to sell their (reduced) FX revenues to the market, given deteriorating FX expectations, creating a coordination problem, where individual rationality (not to sell FX) is destructive for the stability of the whole market. Moreover, lower oil prices created a challenging environment for currencies of commodity exporting countries.
Second, **Western sanctions, which were imposed on Russia over the course of the year and especially from late summer did work maybe even stronger than ex-**

Please note the risk notifications and explanations at the end of this document

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RUSSIA

FOCUS ON GDP

RUSSIA: GDP GROWTH
Slowing down BEFORE Ukraine crisis erupts

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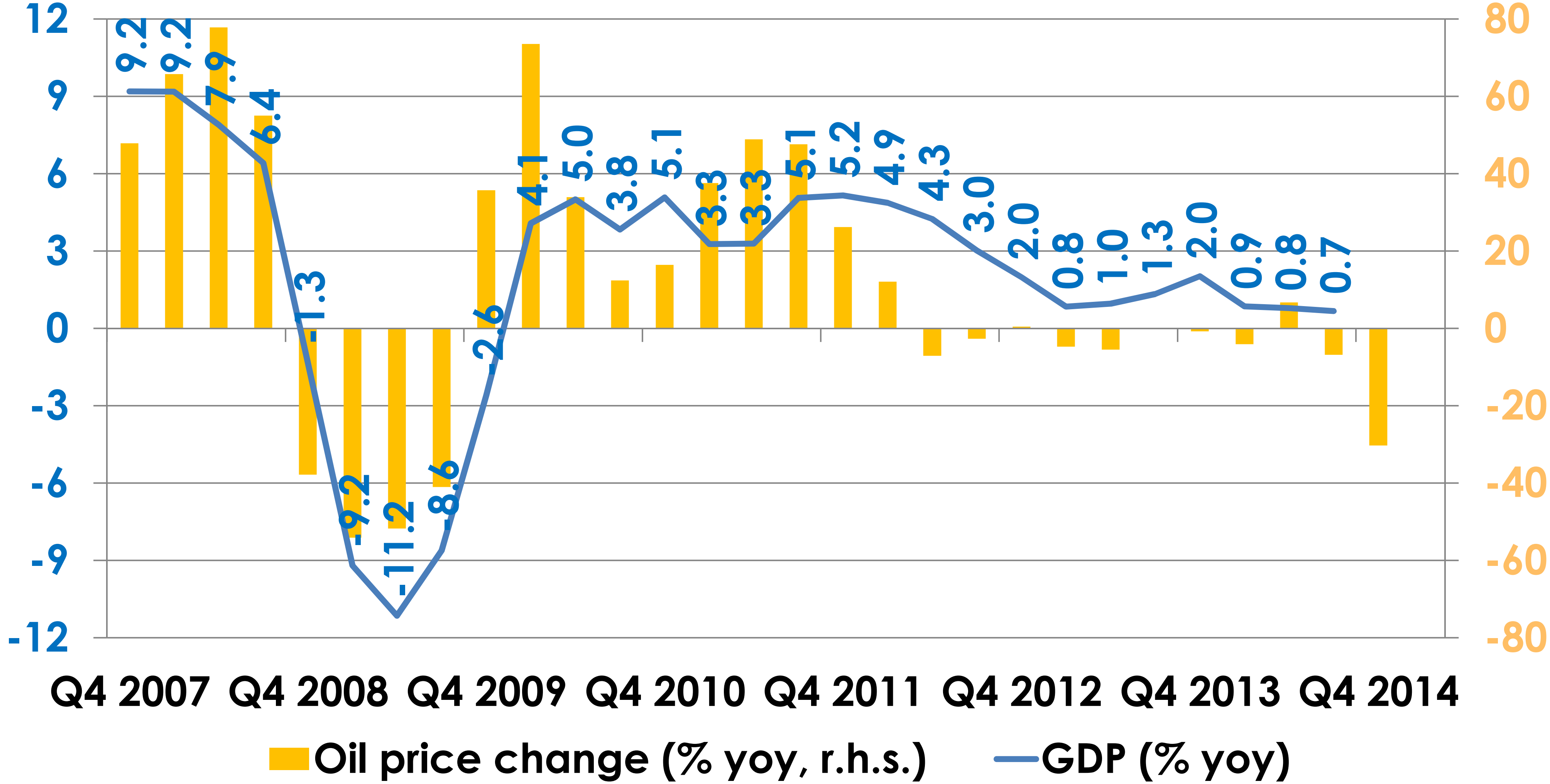

Source: Thomson Reuters, RBI/Raiffeisen RESEARCH

RUSSIA: GDP GROWTH
Real GDP driven by consumption in 2010-2013

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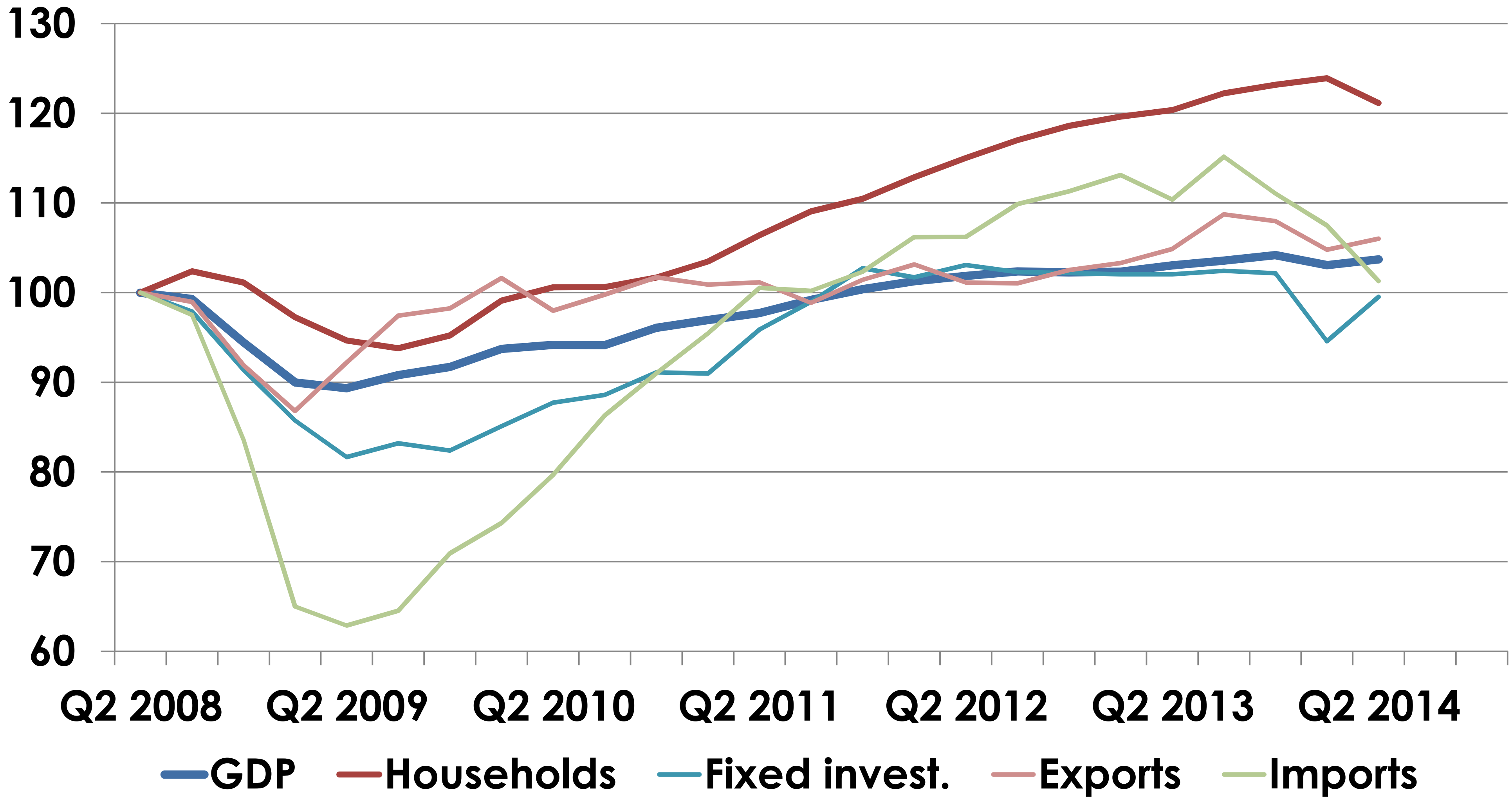

Source: Thomson Reuters, RBI/Raiffeisen RESEARCH

RUSSIA: GDP GROWTH
Domestic demand to turn negative, net exp. pos.

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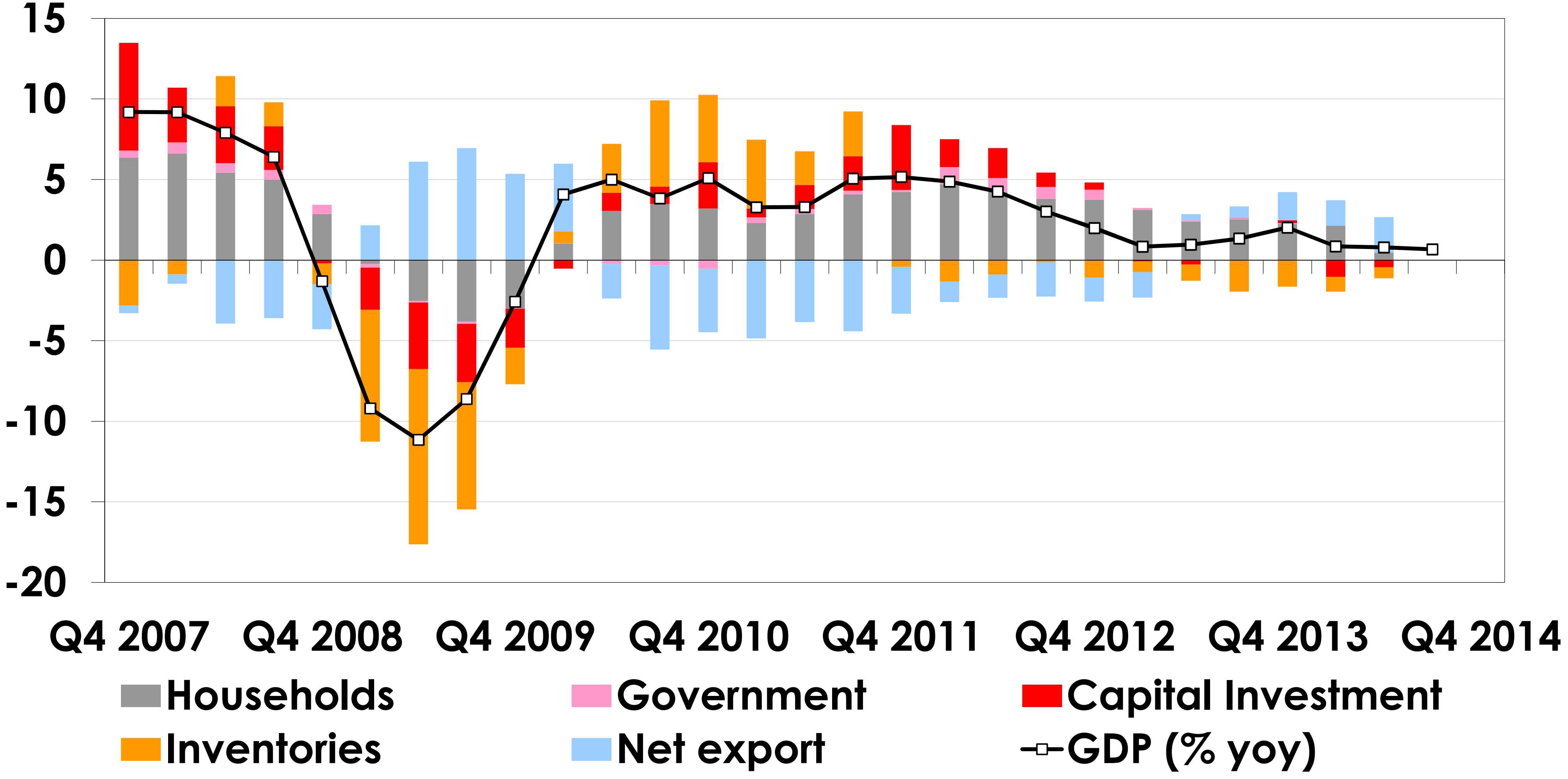

Source: Thomson Reuters, RBI/Raiffeisen RESEARCH

RUSSIA: GDP GROWTH
Growth dynamics susceptible to oil price shocks

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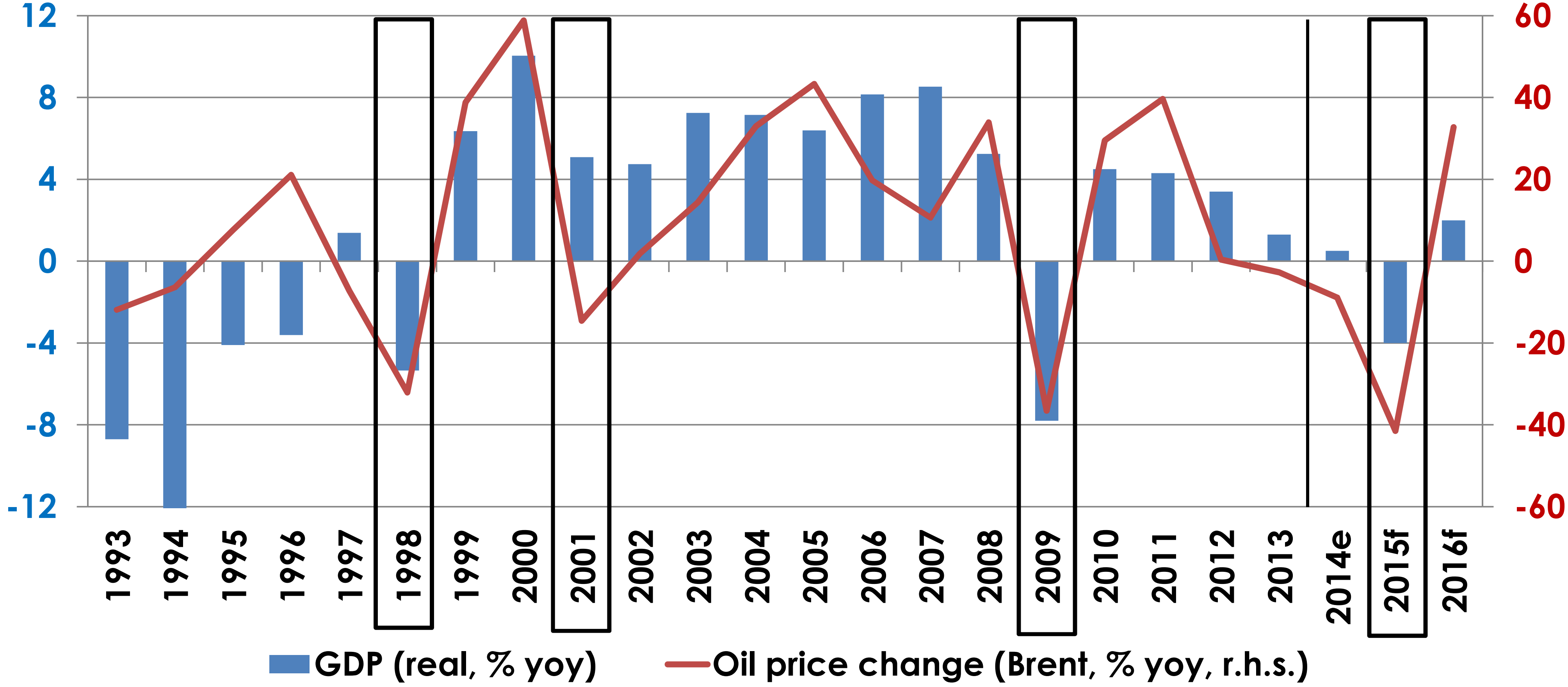

Source: Thomson Reuters, RBI/Raiffeisen RESEARCH

- **Looking at previous oil price shocks, Russian GDP in two of three cases sharply contracted, in 1998 (-5.3%) and in 2009 (-7.8%); only in 2001, a recession was avoided, despite a (moderately) falling oil price**
- **To be in line with the expected oil price of USD 58 avg, GDP could contract more than expected 4% in 2015**

RUSSIA: GDP GROWTH
Growth dynamics susceptible to oil price shocks

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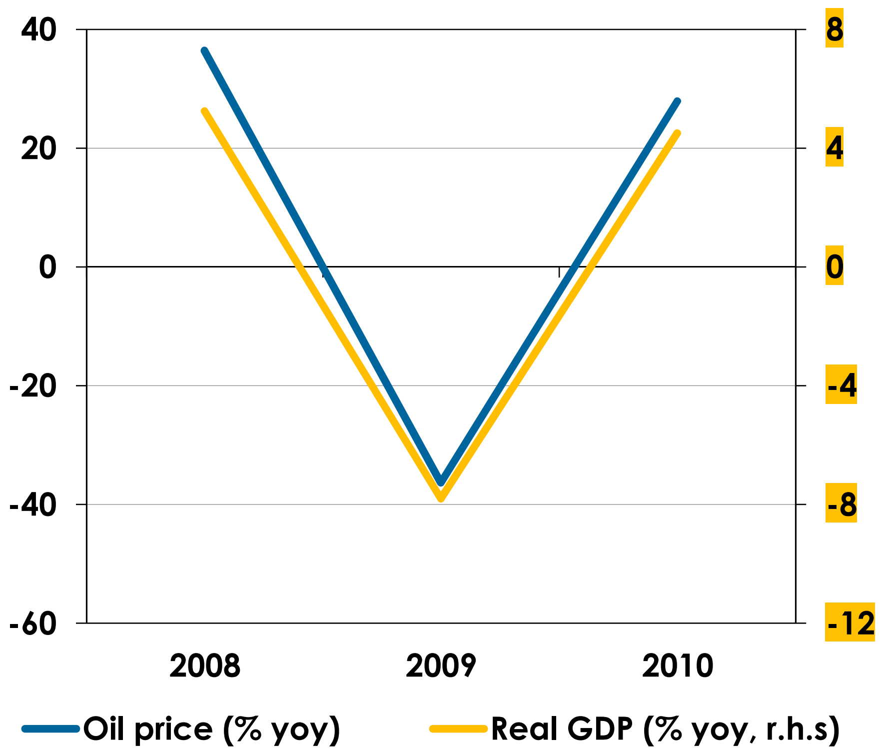
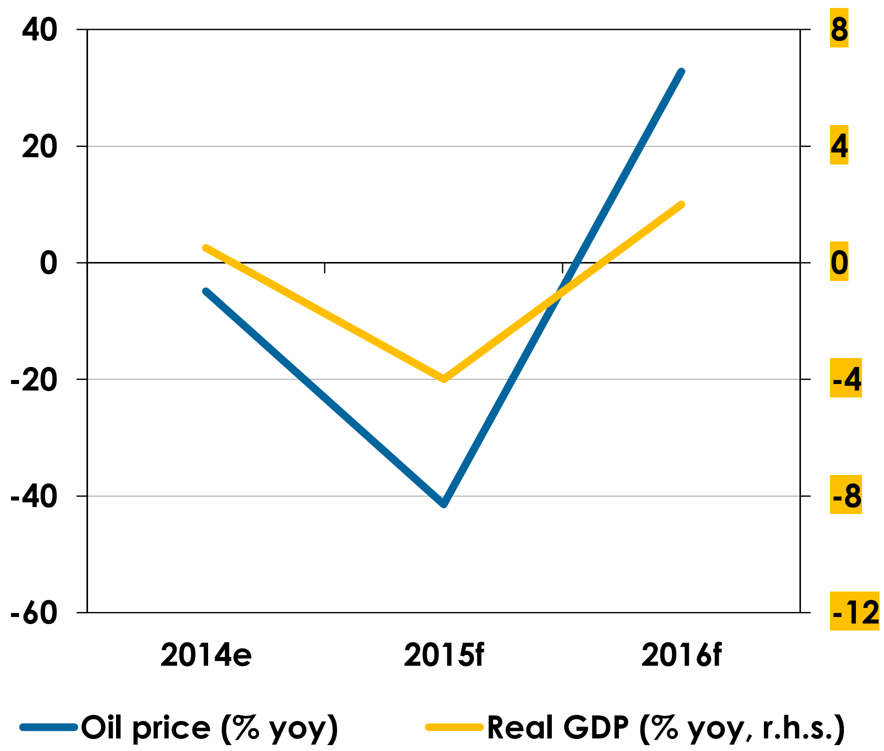
In 2008-2010: GDP and oil price



Source: National sources, Bloomberg, RBI/Raiffeisen RESEARCH

In 2014-2016: Expected GDP and oil price



Source: National sources, Bloomberg, RBI/Raiffeisen RESEARCH

- **GDP contraction by around 4% looks modest compared to the GDP slump seen in 2009 (-7.8)**
- **Mitigating factor: in 2008/09, Russia entered recession coming from overheating growth; this time, the economy has been in almost stagnation for two years before the oil price shock hit**

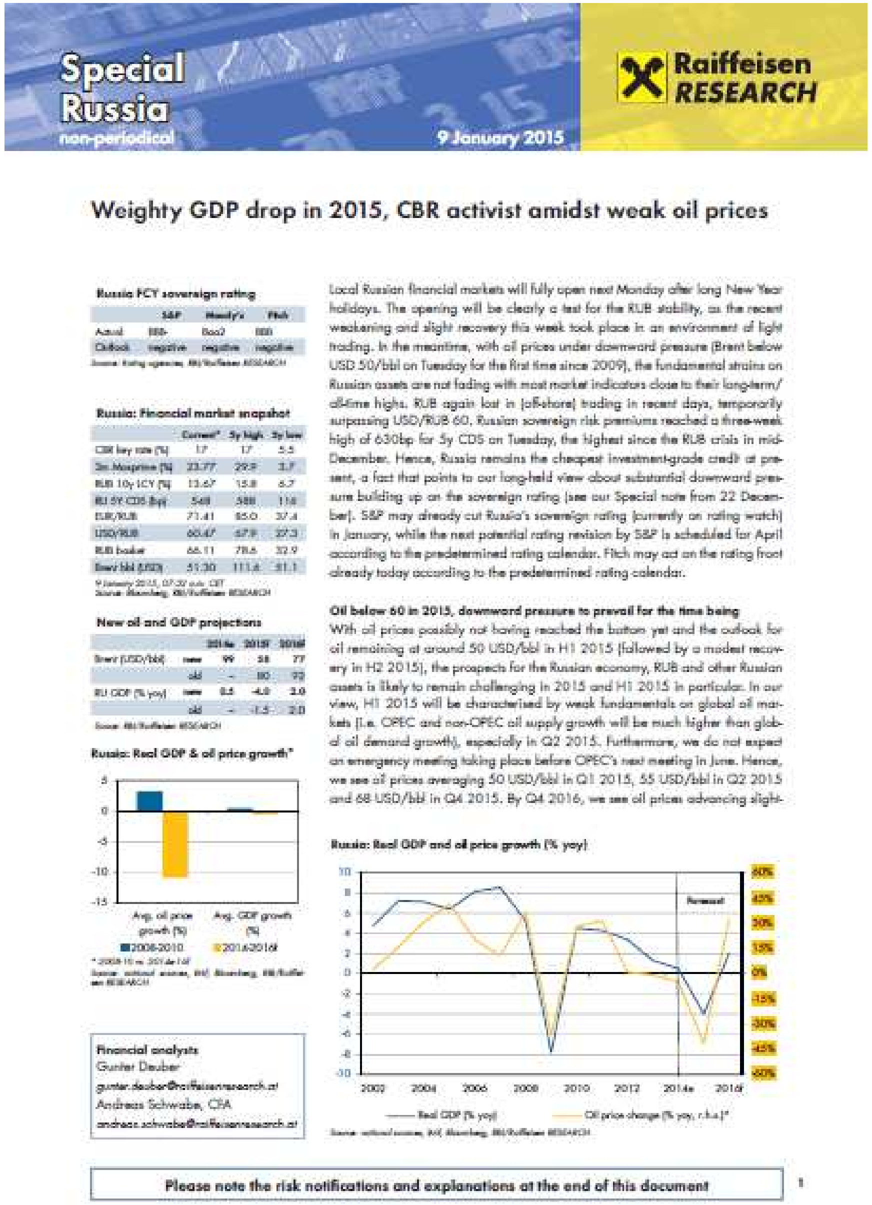
RUSSIA: GDP GROWTH
For more information see

Raiffeisen RESEARCH

SPECIAL REPORT RUSSIA (9 Jan 2015):

Weighty GDP drop in 2015, CBR more active amidst weak oil prices

- **With oil prices currently below USD 60/bbl and no political solution with the West clearly visible, fundamental pressures on Russian markets and Russian reserve assets will prevail for the time being.**
- **We substantially decreased our economic growth projection for Russia: our baseline scenario is now looking for a drop in GDP by 4% in 2015 (formerly -1.5%) and a feeble recovery in 2016.**
- **Given the large oil price drop in our baseline scenario of 40% in 2015 and the high historic volatility of Russian growth, a GDP drop by 4% yoy looks still modest and GDP contraction in 2015 could be easily higher.**


Special Russia non-periodical

9 January 2015

Raiffeisen RESEARCH

Weighty GDP drop in 2015, CBR activist amidst weak oil prices

Russia FCY sovereign rating

	S&P	Moody's	Fitch
Actual	BBB-	Baa2	BBB
Outlook	negative	negative	negative

Source: Rating agencies, RBI/Raiffeisen RESEARCH

Russia: Financial market snapshot

	Current*	5y high	5y low
CBR key rate (%)	17	17	5.5
3m Mosprime (%)	23.77	29.9	3.7
RUB 10y LCY (%)	13.67	15.8	6.7
RU 5Y CDS (bp)	548	588	116
EUR/RUB	71.41	85.0	37.4
USD/RUB	60.47	67.9	27.3
RUB basket	66.11	78.6	32.9
Brent bbl (USD)	51.30	111.6	51.1

* 9 January 2015, 07:30 a.m. CET
Source: Bloomberg, RBI/Raiffeisen RESEARCH

New oil and GDP projections

		2014e	2015f	2016f
Brent (USD/bbl)	new	99	58	77
	old	-	80	92
RU GDP (% yoy)	new	0.5	-4.0	3.0
	old	-	-1.5	2.0

Source: RBI/Raiffeisen RESEARCH

Russia: Real GDP & oil price growth*

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Local Russian financial markets will fully open next Monday after long New Year holidays. The opening will be clearly a test for the RUB stability, as the recent weakening and slight recovery this week took place in an environment of light trading. In the meantime, with oil prices under downward pressure (Brent below USD 50/bbl on Tuesday for the first time since 2009), the fundamental strains on Russian assets are not fading with most market indicators close to their long-term/all-time highs. RUB again lost in (off-shore) trading in recent days, temporarily surpassing USD/RUB 60. Russian sovereign risk premiums reached a three-week high of 630bp for 5y CDS on Tuesday, the highest since the RUB crisis in mid-December. Hence, Russia remains the cheapest investment-grade credit at present, a fact that points to our long-held view about substantial downward pressure building up on the sovereign rating (see our Special note from 22 December). S&P may already cut Russia's sovereign rating (currently on rating watch) in January, while the next potential rating revision by S&P is scheduled for April according to the predetermined rating calendar. Fitch may act on the rating front already today according to the predetermined rating calendar.

Oil below 60 in 2015, downward pressure to prevail for the time being
With oil prices possibly not having reached the bottom yet and the outlook for oil remaining at around 50 USD/bbl in H1 2015 (followed by a modest recovery in H2 2015), the prospects for the Russian economy, RUB and other Russian assets is likely to remain challenging in 2015 and H1 2015 in particular. In our view, H1 2015 will be characterised by weak fundamentals on global oil markets (i.e. OPEC and non-OPEC oil supply growth will be much higher than global oil demand growth), especially in Q2 2015. Furthermore, we do not expect an emergency meeting taking place before OPEC's next meeting in June. Hence, we see oil prices averaging 50 USD/bbl in Q1 2015, 55 USD/bbl in Q2 2015 and 68 USD/bbl in Q4 2015. By Q4 2016, we see oil prices advancing slight-

Russia: Real GDP and oil price growth (% yoy)

Please note the risk notifications and explanations at the end of this document

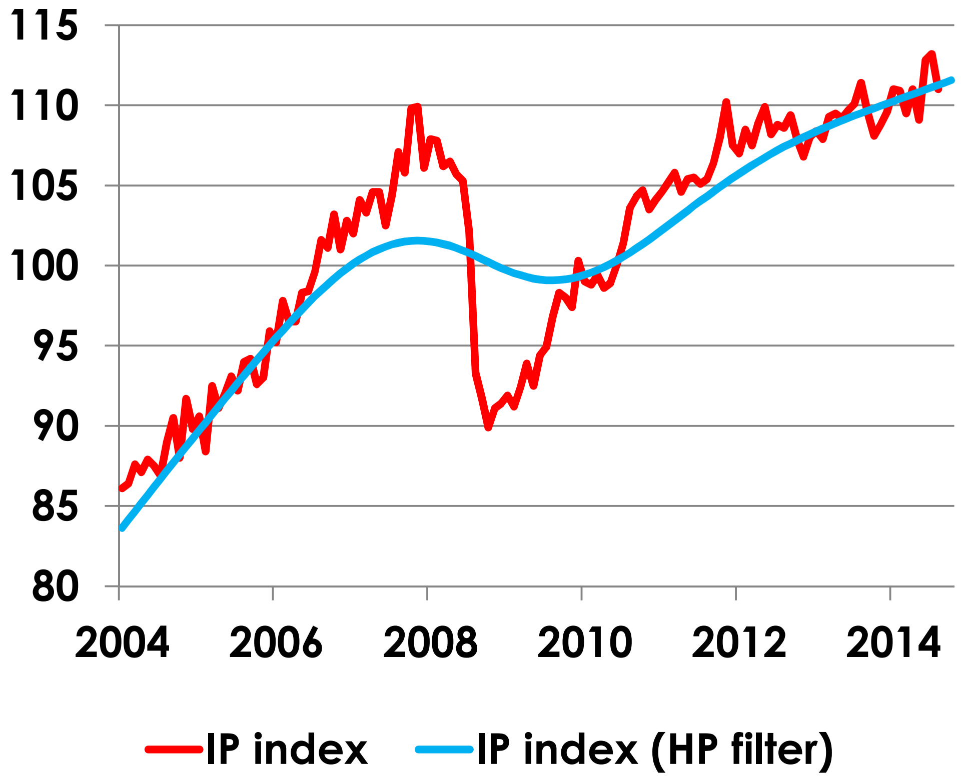
RUSSIA

MONTHLY INDICATORS

RUSSIA: REAL SECTOR – INDUSTRIAL PRODUCTION
Slower output growth as new normal

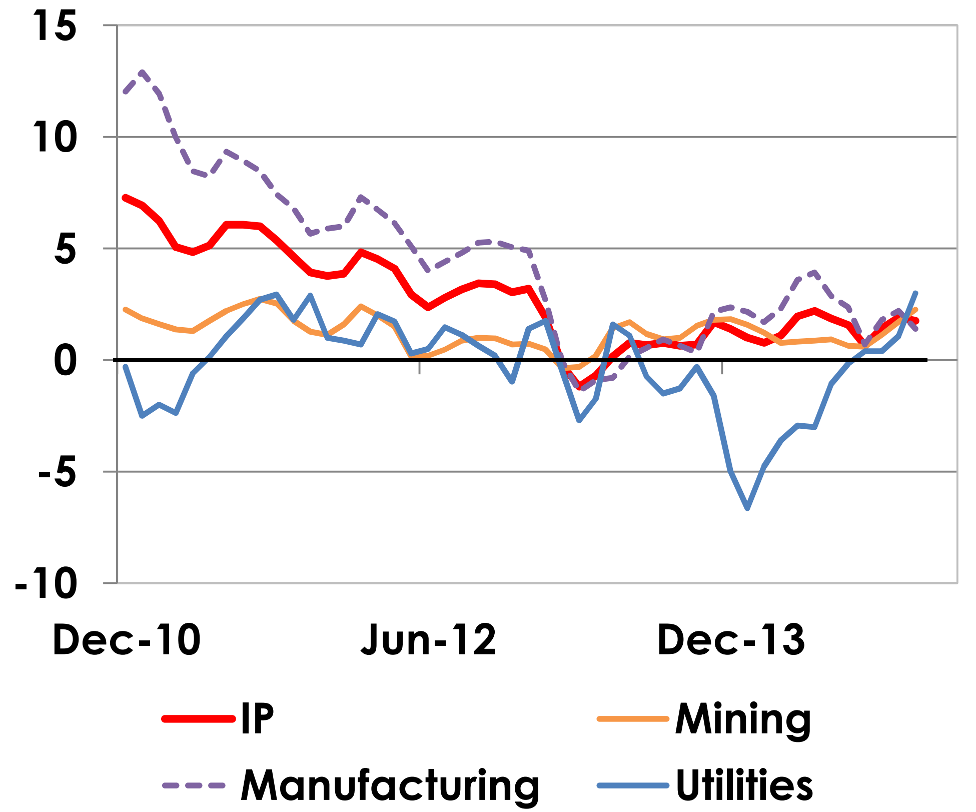
Raiffeisen RESEARCH

Industrial production (index*)



**seasonally adjusted*
Source: Thomson Reuters, RBI/Raiffeisen RESEARCH

Industrial production (% yoy, 3mma)



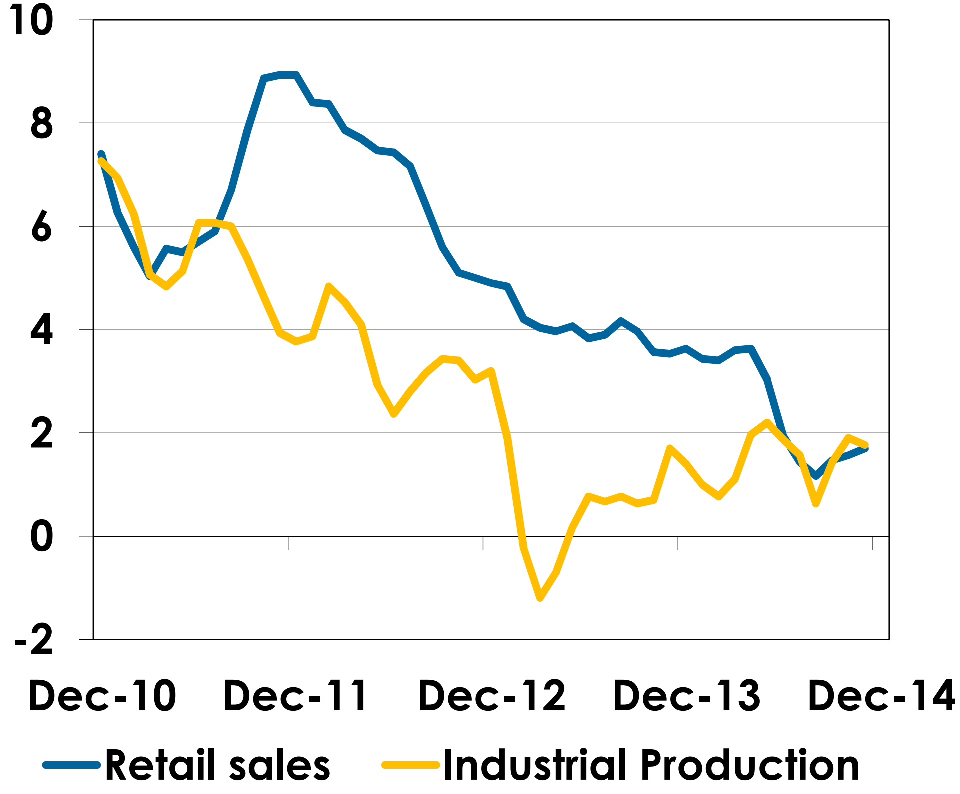
Source: Thomson Reuters, RBI/Raiffeisen RESEARCH

- **Substantial slowdown in industrial production growth since 2012-2013**
- **Decline of industrial production in early 2013; Nov 2014 drop to -0.5% yoy yet not visible in moving average**
- **Likely decline in 2015; mid-term „new normal“ of slow output growth between around 0-2% yoy**

RUSSIA: REAL SECTOR – INDICATOR COMPARISON
Key economic indicators show current weakness

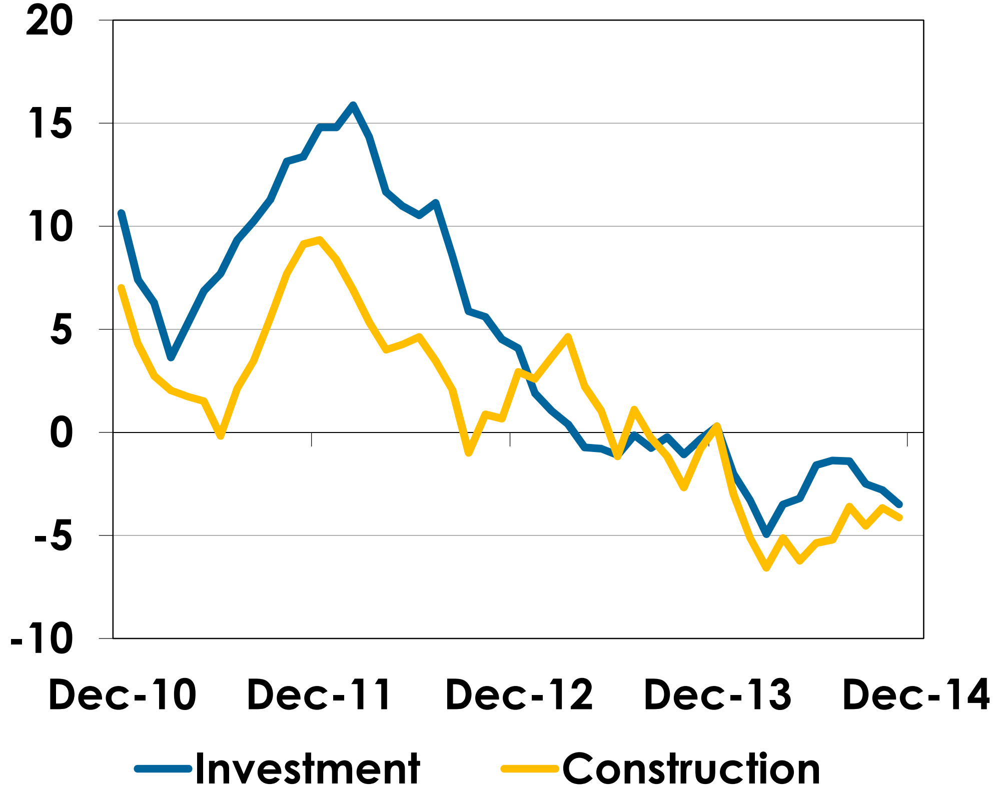
Raiffeisen RESEARCH

Retail sales vs industrial output (% yoy, 3mma)



Source: Thomson Reuters, RBI/Raiffeisen RESEARCH

Investment vs construction (% yoy, 3mma)



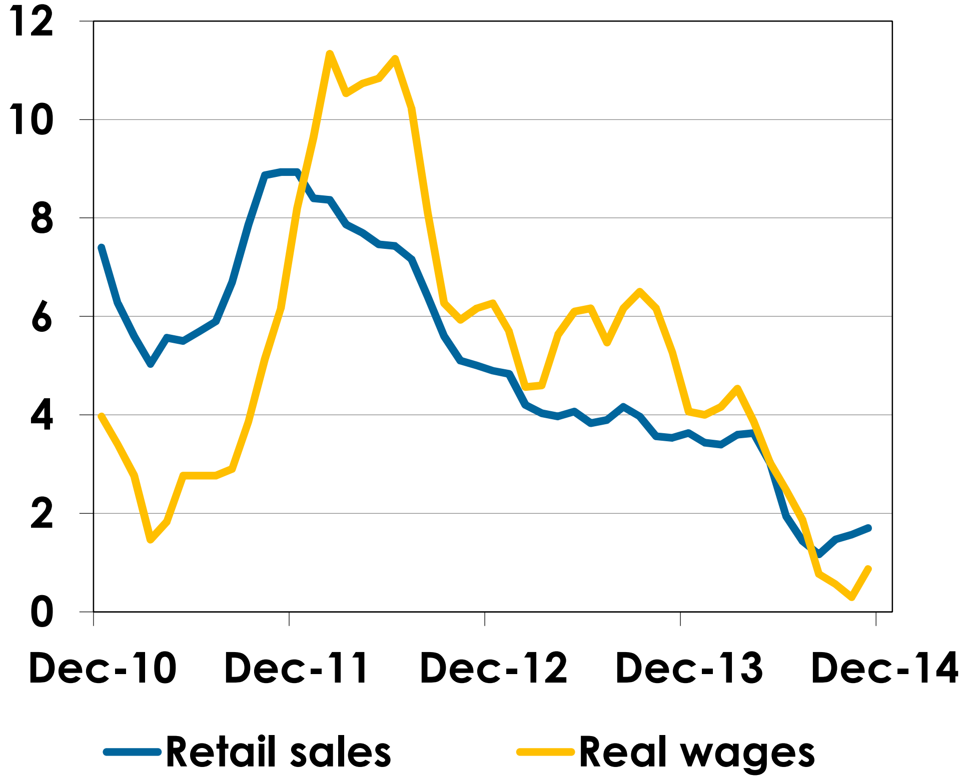
Source: Thomson Reuters, RBI/Raiffeisen RESEARCH

- **Retail sales is a proxy for household demand, which has been the main pillar for Russian growth**
- **Recent slowdown of retail sales growth below 2% - lower than the 4%**
- **Negative dynamics of investments and construction since early 2013 – so far, no signs of improvement**

RUSSIA: REAL SECTOR – RETAIL SALES AND WAGES
Real wage growth halts, unemploymnet low

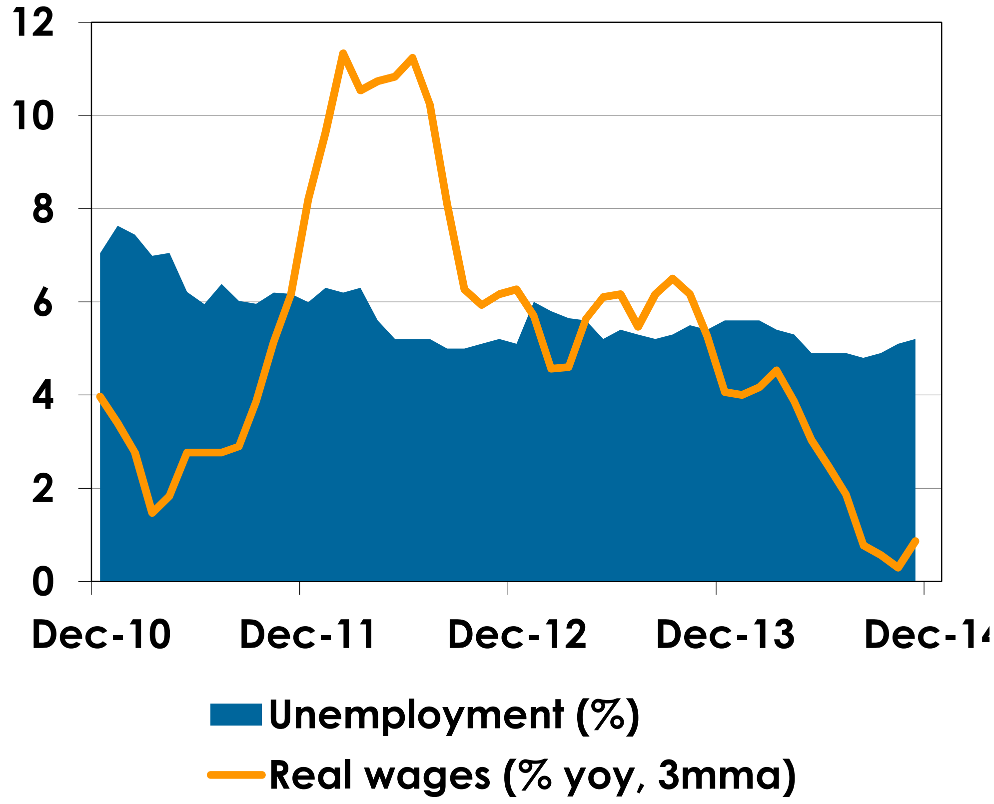
Raiffeisen RESEARCH

Retail sales vs real wages (% yoy, 3mma)



Source: Thomson Reuters, RBI/Raiffeisen RESEARCH

Unemployment and real wages



Source: Thomson Reuters, RBI/Raiffeisen RESEARCH

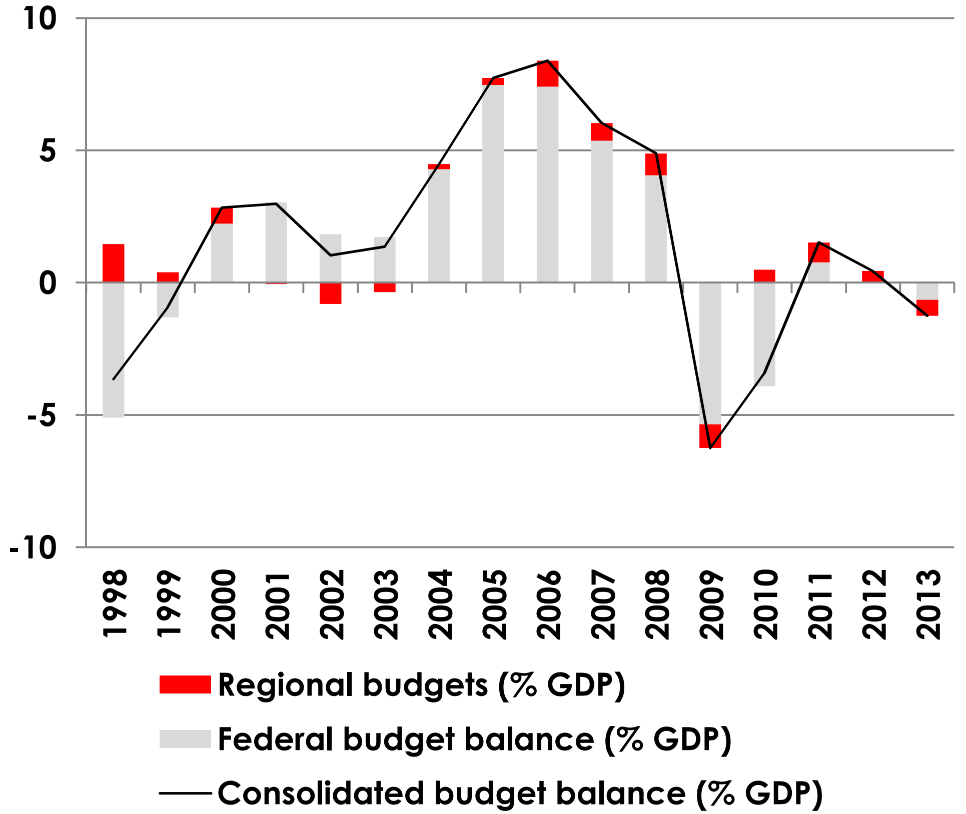
- **Slower retail sales growth partly caused by deceleration of wage growth – which has come to a halt**
- **Before, wages have been strongly pushed up by rising public wages since 2011/2012 and record low unemployment around 5%**

Please note the risk notifications and explanations at the end of this document

RUSSIA: FISCAL POLICY
Headline deficit low, but structural deficit looms

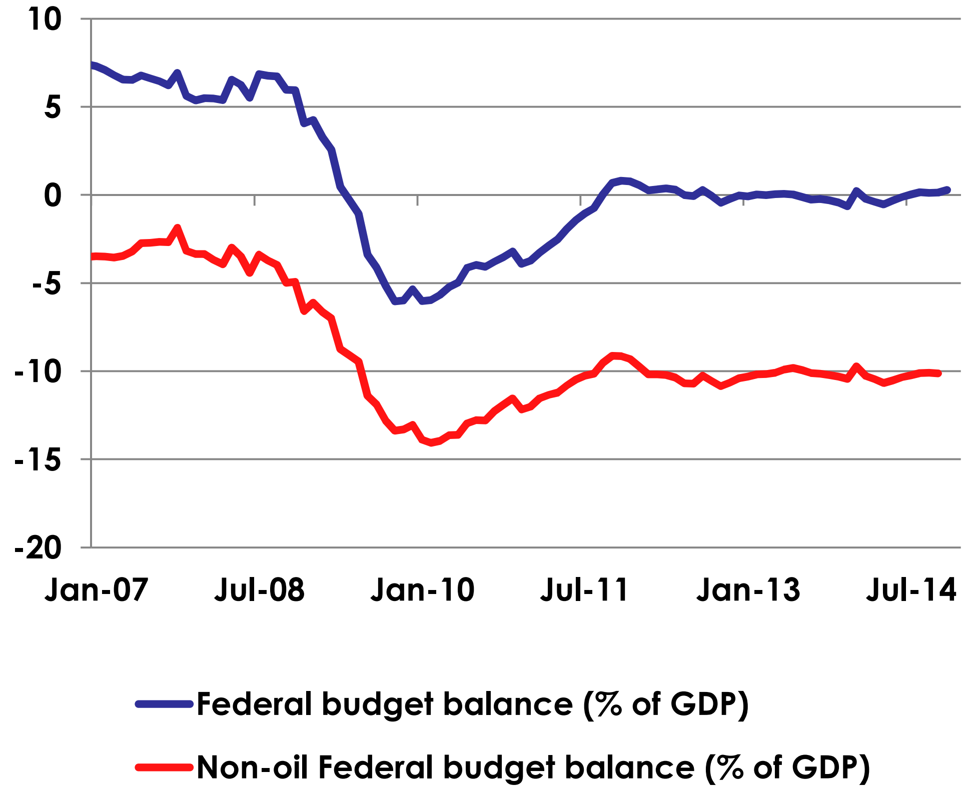
Raiffeisen RESEARCH

Yearly general budget balance (% of GDP)



Source: Thomson Reuters, RBI/Raiffeisen RESEARCH

Federal budget vs non-oil deficit (% of GDP)



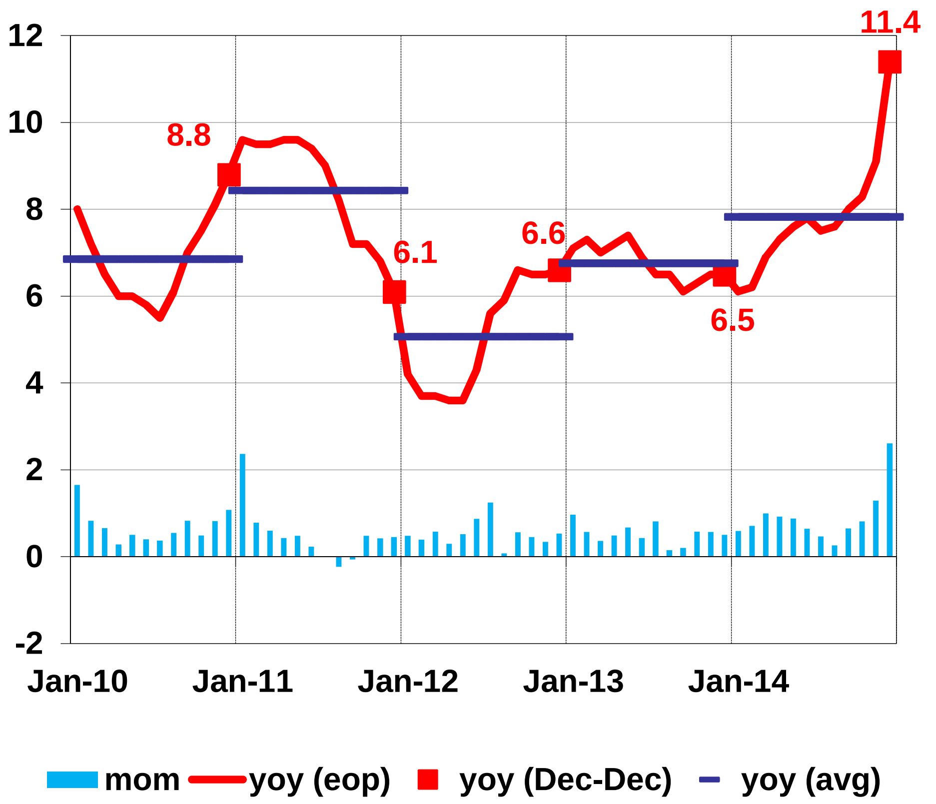
Source: Thomson Reuters, RBI/Raiffeisen RESEARCH

- **The government budget has been rather balanced in 2011-2013, in 2014 so far in surplus given weak RUB**
- **Structural weakness of non-oil central government budget deficit of around 10% of GDP (i.e. 10% of GDP oil related revenues; 50% of central government revenues); regional budgets turned negative in 2013**

RUSSIA: CONSUMER PRICES
Food ban and weak rouble push inflation up

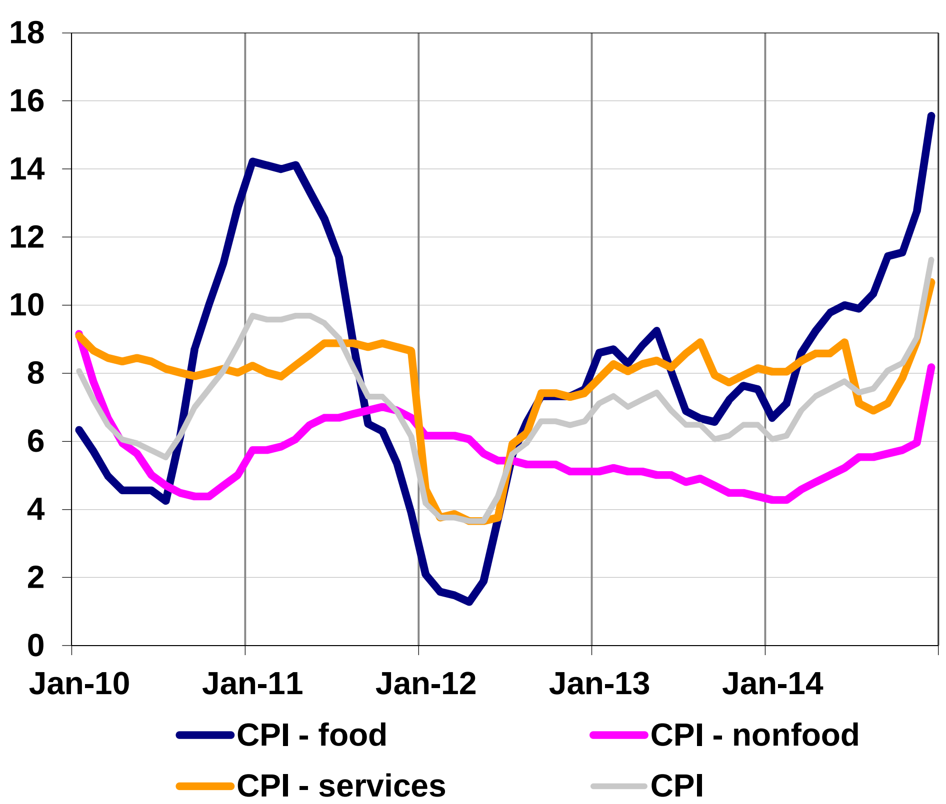
Raiffeisen RESEARCH

Consumer price index (CPI, %)



Source: Thomson Reuters, RBI/Raiffeisen RESEARCH

Subindices: Food, non-food & services (% yoy)



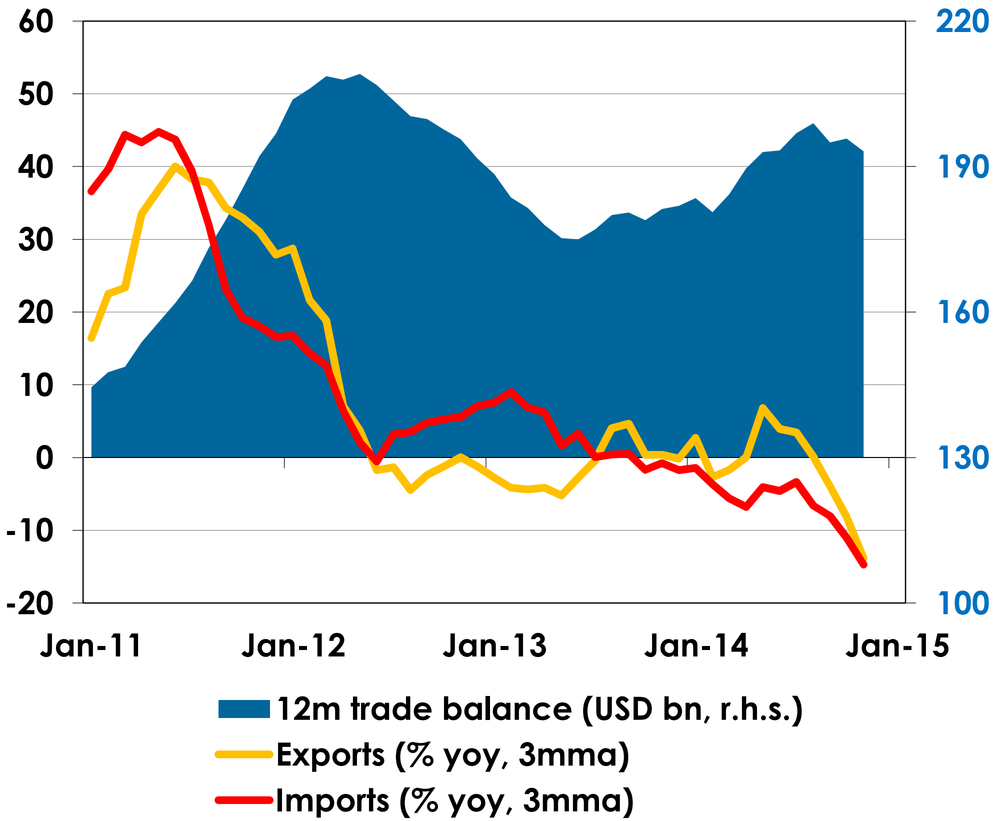
Source: Thomson Reuters, RBI/Raiffeisen RESEARCH

- **Self imposed ban on food imports from the West pushes food price inflation into double digits**
- **Headline inflation rising on higher food prices and weakening RUB, elevated inflation in H1 2015 at least**
- **Challenging inflation target by the central bank of 4.5% (+/- 1.5%) in 2015-2016 and 4% (+/- 1.5%) afterwards**

RUSSIA: TRADE BALANCE
Trade balance surplus up, given import decline

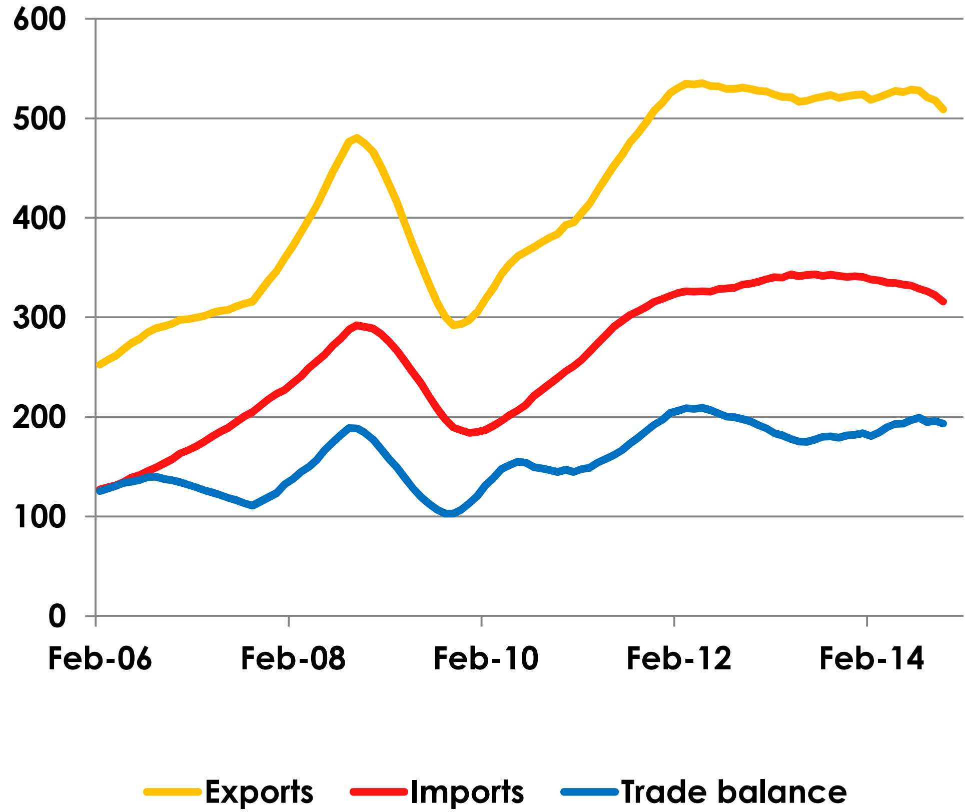
Raiffeisen RESEARCH

Merchandise trade balance dynamics (USD)



Source: Thomson Reuters, RBI/Raiffeisen RESEARCH

Merchandise trade balance (USD bn)*



** 12 month rolling sum*
Source: Thomson Reuters, RBI/Raiffeisen RESEARCH

- **Resurge in oil prices after the financial crisis to above USD 100/bbl Brent led to export and import boom**
- **Sharp drop in trade dynamics in 2011/2012; since then subdued growth on historically high absolute levels**
- **Import contraction led to rise in trade balance since mid-2013; recent export drop decreases balance again**

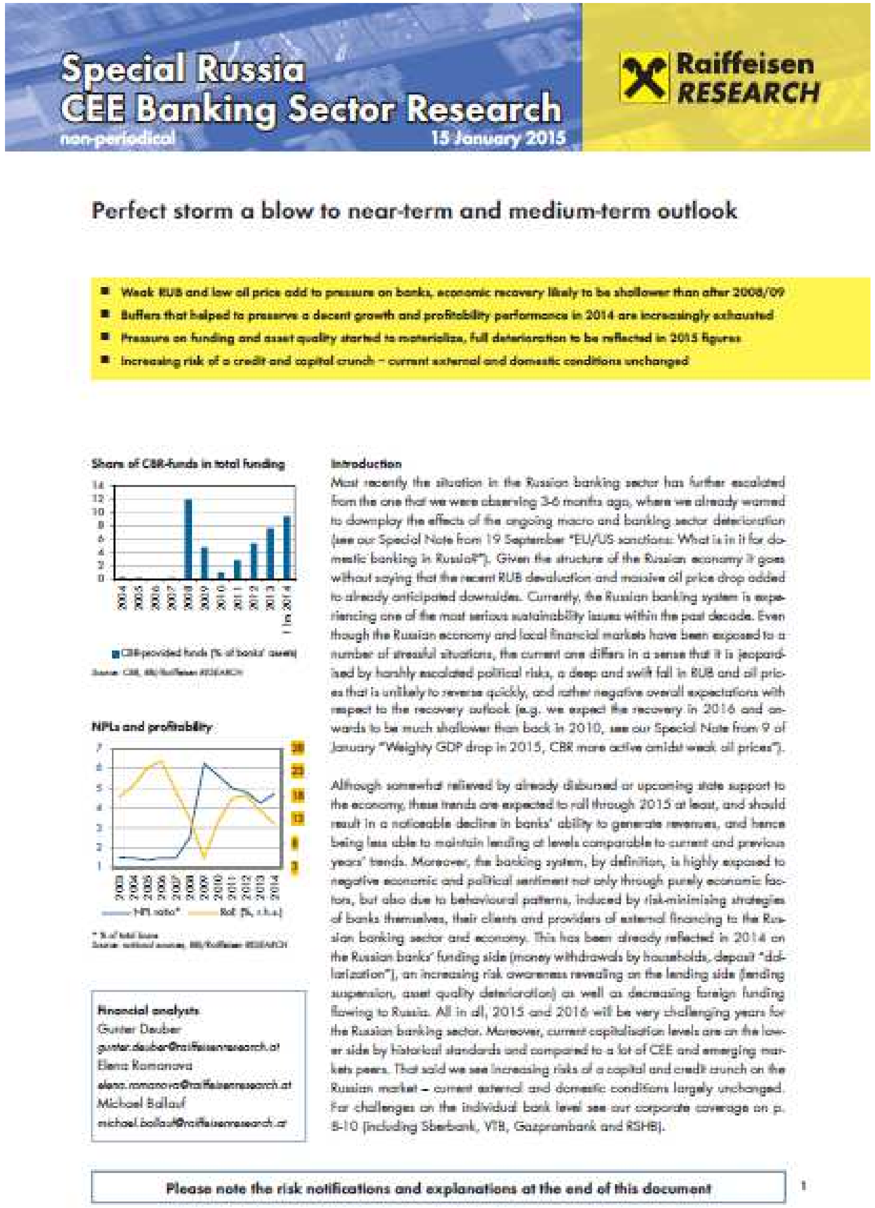
RUSSIA: BANKING SECTOR
For more information see

Raiffeisen RESEARCH

SPECIAL REPORT RUSSIA (15 Jan 2015):

Perfect storm a blow to near-term and medium-term outlook

- **Weak RUB and low oil price add to pressure on banks, economic recovery likely to be shallower than after 2008/09.**
- **Buffers that helped to preserve a decent growth and profitability performance in 2014 are increasingly exhausted.**
- **Pressure on funding and asset quality started to materialize, full deterioration to be reflected in 2015 figures.**
- **Increasing risk of a credit and capital crunch – current external and domestic conditions unchanged.**



Special Russia
CEE Banking Sector Research
non-periodical
15 January 2015
Raiffeisen RESEARCH

Perfect storm a blow to near-term and medium-term outlook

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- Pressure on funding and asset quality started to materialize, full deterioration to be reflected in 2015 figures
- Increasing risk of a credit and capital crunch – current external and domestic conditions unchanged

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Introduction

Most recently the situation in the Russian banking sector has further escalated from the one that we were observing 3-6 months ago, where we already warned to downplay the effects of the ongoing macro and banking sector deterioration (see our Special Note from 19 September "EU/US sanctions: What is in it for domestic banking in Russia?"). Given the structure of the Russian economy it goes without saying that the recent RUB devaluation and massive oil price drop added to already anticipated downsides. Currently, the Russian banking system is experiencing one of the most serious sustainability issues within the past decade. Even though the Russian economy and local financial markets have been exposed to a number of stressful situations, the current one differs in a sense that it is jeopardised by harshly escalated political risks, a deep and swift fall in RUB and oil prices that is unlikely to reverse quickly, and rather negative overall expectations with respect to the recovery outlook (e.g. we expect the recovery in 2016 and onwards to be much shallower than back in 2010, see our Special Note from 9 of January "Weighty GDP drop in 2015, CBR more active amidst weak oil prices").

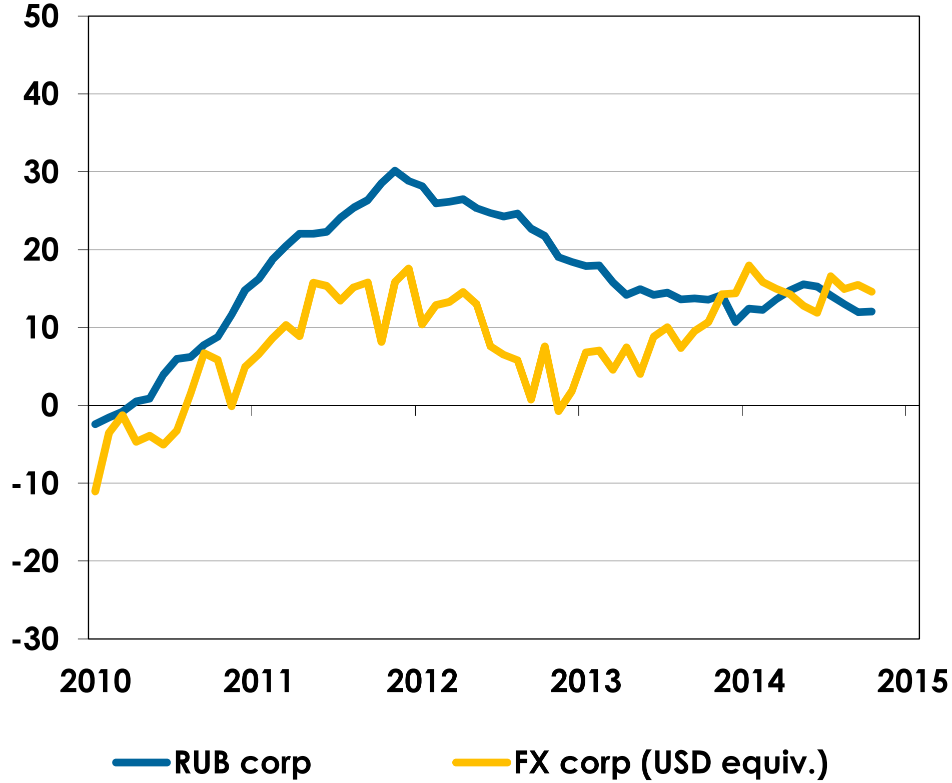
Although somewhat relieved by already disbursed or upcoming state support to the economy, these trends are expected to roll through 2015 at least, and should result in a noticeable decline in banks' ability to generate revenues, and hence being less able to maintain lending at levels comparable to current and previous years' trends. Moreover, the banking system, by definition, is highly exposed to negative economic and political sentiment not only through purely economic factors, but also due to behavioural patterns, induced by risk-minimising strategies of banks themselves, their clients and providers of external financing to the Russian banking sector and economy. This has been already reflected in 2014 on the Russian banks' funding side (money withdrawals by households, deposit "dollarization"), an increasing risk awareness revealing on the lending side (lending suspension, asset quality deterioration) as well as decreasing foreign funding flowing to Russia. All in all, 2015 and 2016 will be very challenging years for the Russian banking sector. Moreover, current capitalisation levels are on the lower side by historical standards and compared to a lot of CEE and emerging markets peers. That said we see increasing risks of a capital and credit crunch on the Russian market – current external and domestic conditions largely unchanged. For challenges on the individual bank level see our corporate coverage on p. 8-10 (including Sberbank, VTB, Gazprombank and RSHB).

Please note the risk notifications and explanations at the end of this document 1

RUSSIA: BANKING SECTOR - LENDING
Strong retail lending boom over

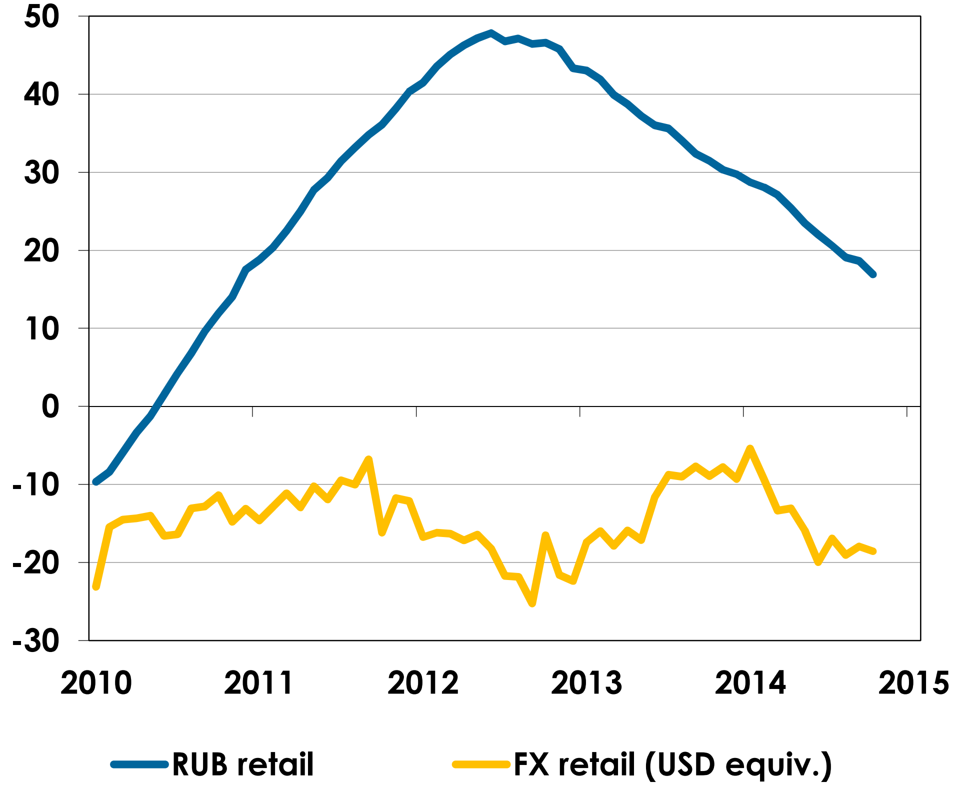
Raiffeisen RESEARCH

Corporate lending (nominal, % yoy)



USD equivalent values based on RUB denominated statistics of FX converted at market rates to USD; latest data as of Oct 2014
Source: Thomson Reuters, RBI/Raiffeisen RESEARCH

Retail lending (nominal, % yoy)



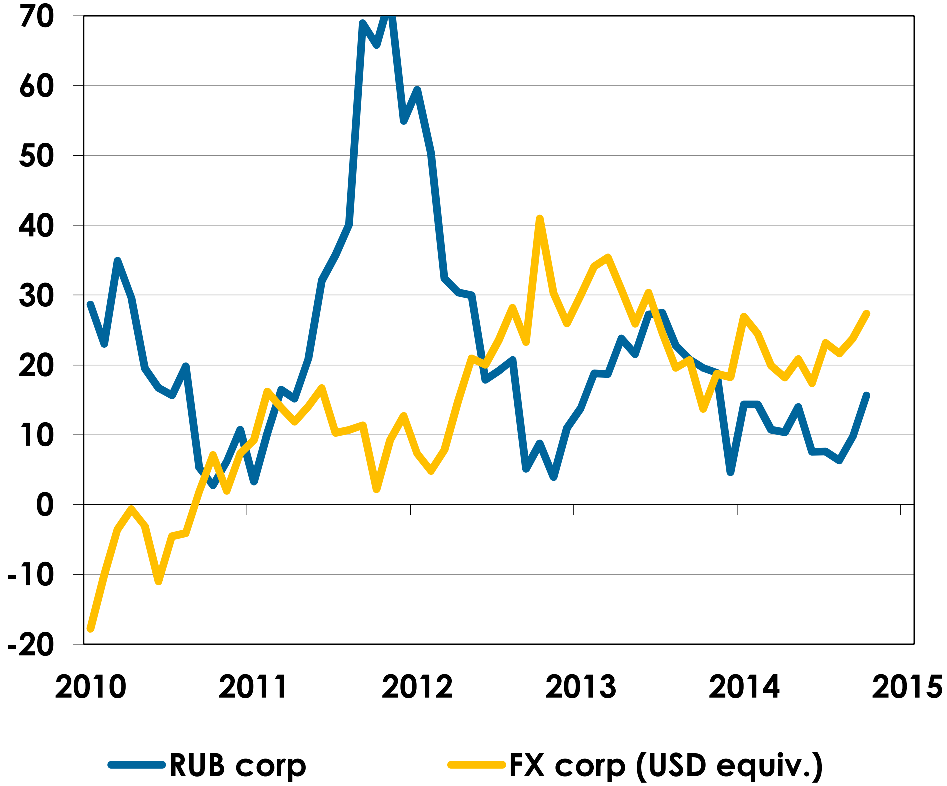
USD equivalent values based on RUB denominated statistics of FX converted at market rates to USD; latest data as of Oct 2014
Source: Thomson Reuters, RBI/Raiffeisen RESEARCH

- **FX lending segment small in corporate (around a quarter of loans) and miniscule in retail (below 3%)**
- **Corporate sector: FX lending picking up in 2014 (to 15% yoy in USD terms), exceeding RUB lending dynamics**
- **Retail lending: boom of recent years coming to an end with nominal lending growth below 20%**

RUSSIA: BANKING SECTOR – DEPOSIT TAKING
Corporates increase deposits; stagnation in retail

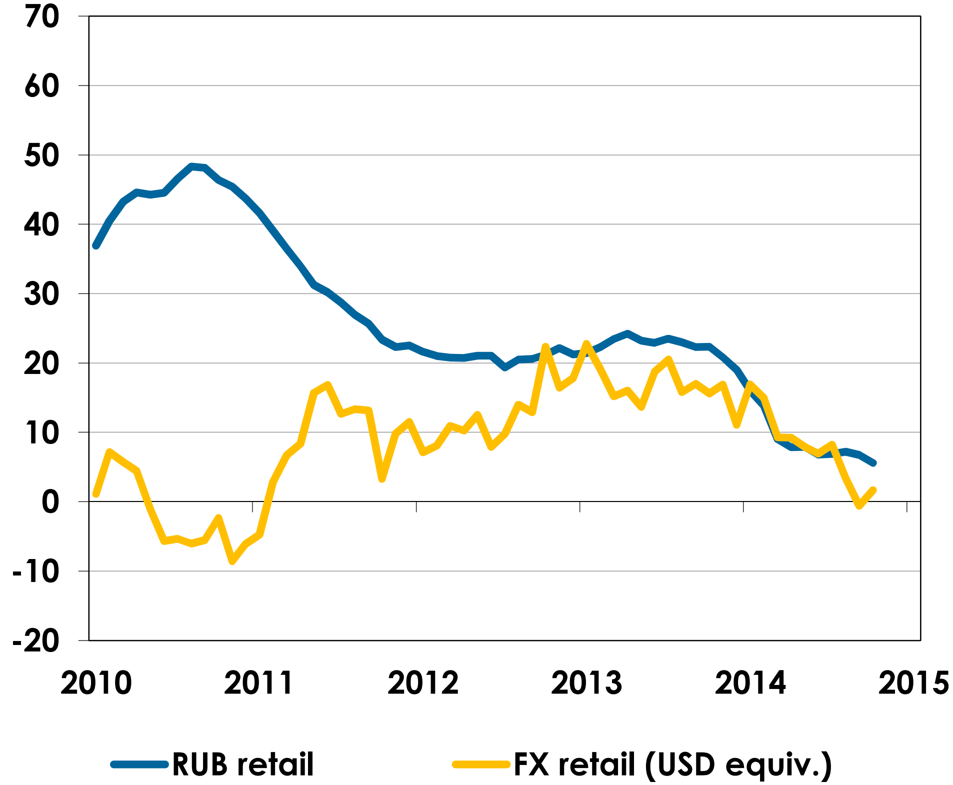
Raiffeisen RESEARCH

Corporate deposits (nominal, % yoy)



USD equivalent values based on RUB denominated statistics of FX converted at market rates to USD; latest data of Oct 2014
Source: Thomson Reuters, RBI/Raiffeisen RESEARCH

Retail deposits (nominal, % yoy)



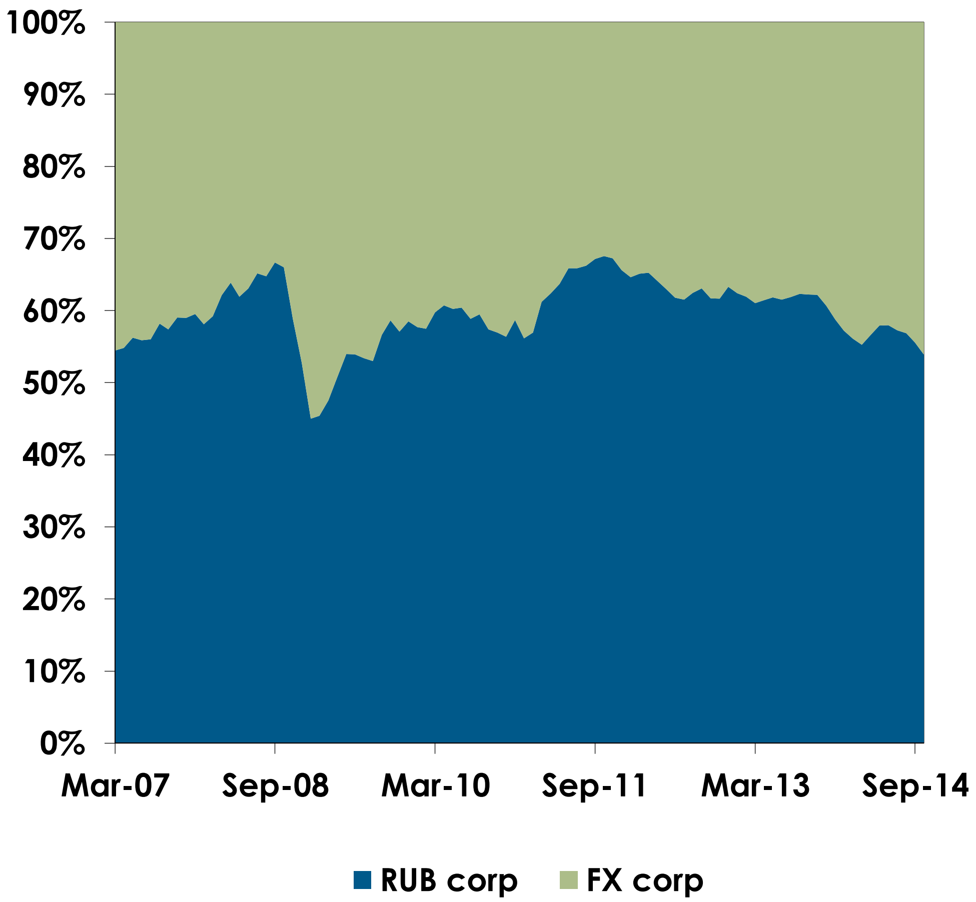
USD equivalent values based on RUB denominated statistics of FX converted at market rates to USD; latest data of Oct 2014
Source: Thomson Reuters, RBI/Raiffeisen RESEARCH

- **FX deposit segment sizeable in corporate (around a 40-45%), but smaller in retail (20% of retail deposits)**
- **Corporate sector: deposit growth both in RUB and in FX segments; FX stronger in 2014, recent acceleration**
- **Retail lending: slowdown both in RUB and FX segments; recent stagnation in nominal terms ("real" decline)**

RUSSIA: BANKING SECTOR – DEPOSIT TAKING
No drastic shift into FX deposits until October '14

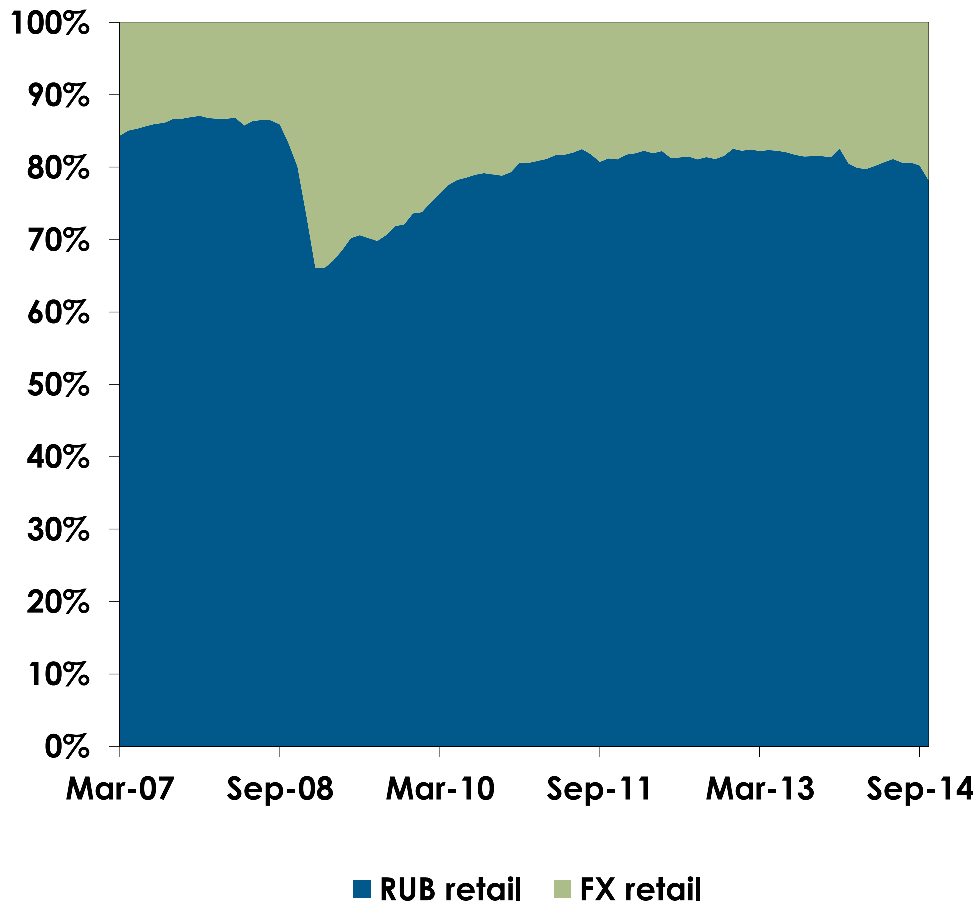
Raiffeisen RESEARCH

Shares of RUB and FX in corporate deposits (%)



Latest data as of Oct 2014, based on RUB denominated values
Source: Thomson Reuters, RBI/Raiffeisen RESEARCH

Shares of RUB and FX in retail deposits (%)



Latest data as of Oct 2014, based on RUB denominated values
Source: Thomson Reuters, RBI/Raiffeisen RESEARCH

Risk notifications and explanations

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