Russia – Taking stock of 2015, looking forward to 2016

Challenging adaptation to a low energy price environment

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Russia – Challenging adaptation to low energy prices
Key views

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- For the **Russian economy**, the year 2015 was marked by the adjustment to a lower oil price environment. The external adjustment was successful and FX reserves stabilised during the year. The reaction of monetary and fiscal authorities has been adequate given the highly challenging situation.
- With a **significantly weaker rouble**, elevated inflation levels and real wage losses, the purchasing power of Russian consumers is in continuous decline. Industrial output is doing better as the decline is slowing down for the time being. Thus, signals from the economy are still mixed and the situation is fragile. Risks are increasingly tilted to the downside with a renewed slump in oil prices.
- We see the **Russian economy in 2016 in stagnation** after an almost 4% slump of GDP in 2015. We expect consumption and investment still to contract in 2016, though not as fast as in 2015. If the negative oil price trend reverses in coming months, the economic situation could improve in H2 2016 and the rouble could reverse some losses.
- One of the topics going forward will be the **budget deficit**, which is currently financed by the use of fiscal buffers (Reserve fund) – a policy which can be maintained only for another 1-2 years. Thus, something has to give in: either expenditures have to be slashed, tax revenues have to be increased or more (domestic/foreign) debt has to be issued.
- The **Russian banking sector keeps posting inferior readings**, which is broadly in line with our expectations. Although we see a certain macro-economic stabilisation at present, we remain very cautious in our expectations for the banking sector going forward. The system's ability to generate positive profits is fading away. RoE at 0.4%, RoA at 0% for 9m-2015 are the lowest readings since the start of 2008.

TAKING STOCK OF 2015
Key views review – what we got right/wrong

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WHERE WE WERE RIGHT

- Expecting the **Ukraine conflict** would not be resolved and Western sanctions would stay in place
- Assessing the **extent of the recession** with a drop in GDP by roughly 4%
- Properly observing the **vulnerability of consumers** and predicting substantial welfare losses
- Expecting high rouble volatility and forecasting a **weaker FX rate** by end-2015
- No large-scale fiscal or monetary stimulus like in 2008/2009 was implemented
- No substantial structural reform initiatives
- Right call, that Russia can at least **bridge 1-2 years with fiscal and FX reserves**

WHERE WE WERE WRONG

- **Oil price recovery in H2** did not materialize.
- We did not predict the **mid-year rally** in oil and rouble
- **Net capital flight diminished** more than expected and thus, **FX reserves** stabilised
- With the deep rouble plunge, **imports fell stronger** than expected

Russia in 2015
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Adaptation to lower oil price & sanctions

TRENDS IN 2015 – GDP (I)
Q1 to Q3 GDP contracts by 3.7% yoy; Q3 improvement

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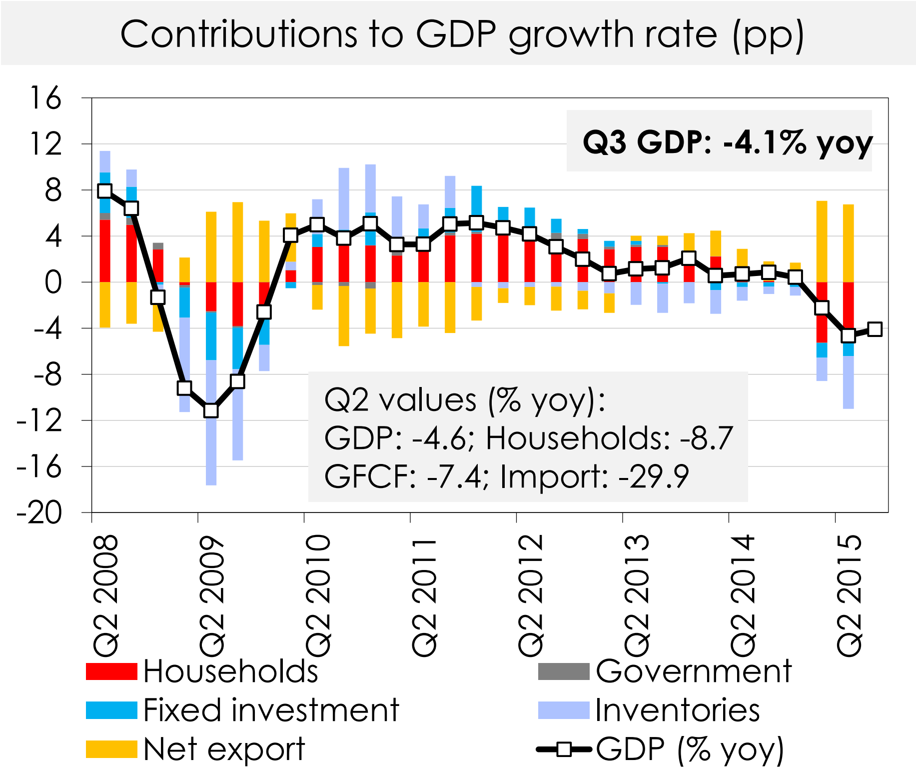
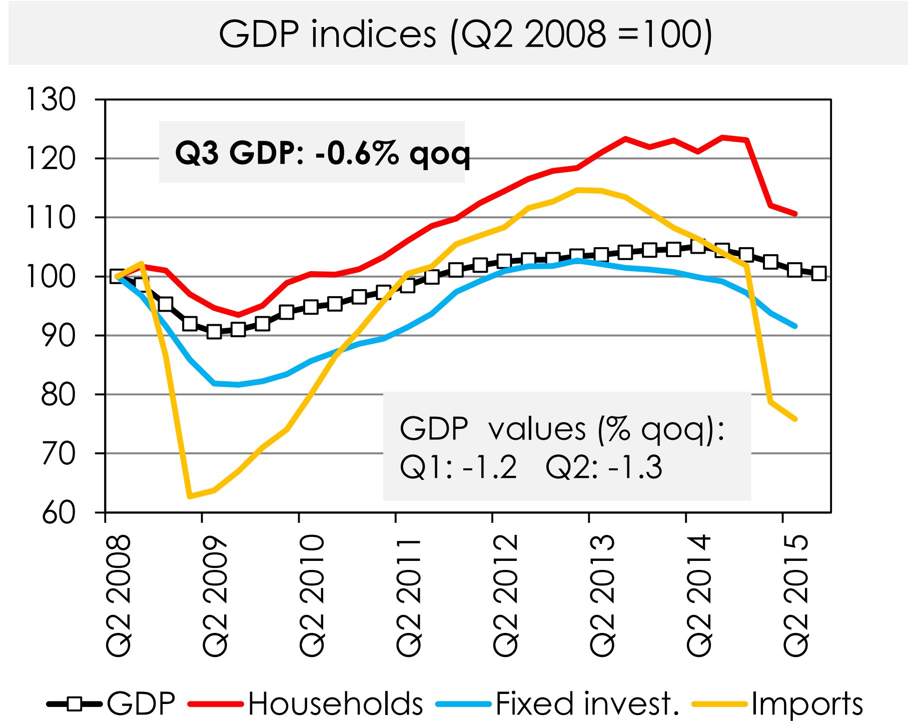


Breakdown of yearly growth rate into demand components; net exports = exports - imports
Source: Thomson Reuters, RBI/Raiffeisen RESEARCH



Indices of real GDP components; Q3 seasonal adjustment by RBI;
Source: Thomson Reuters, RBI/Raiffeisen RESEARCH

- Q3 GDP dropped by -4.1% yoy (-0.6% qoq), slightly less than the -4.6% yoy (-1.3% qoq) observed in Q2
- Contraction in private household demand stronger than in 2008/2009 crisis; RUB devaluation cuts into imports
- Investment has been flat in 2013 and shrinking since early 2014 – indicating prolonged growth weakness
- 2015 FC at ~3.7% yoy; stagnation in 2016 expected despite oil returning to USD 64 by year end-16

TRENDS IN 2015 – GDP (II)
Nominal GDP almost halves - sharply cuts market size

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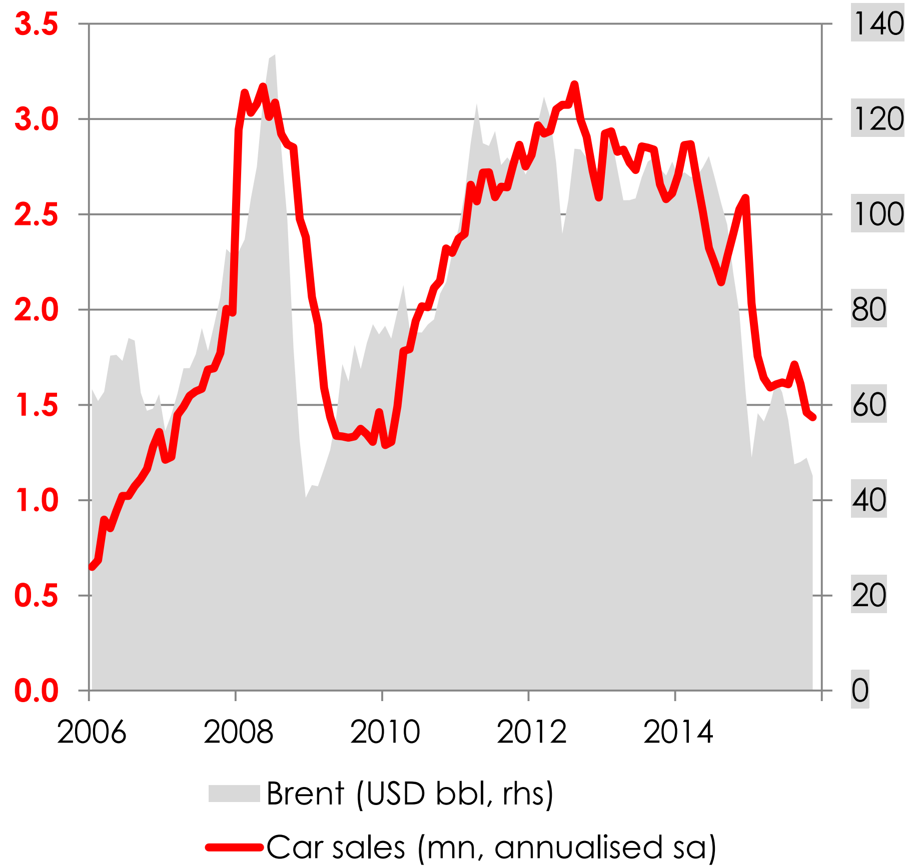
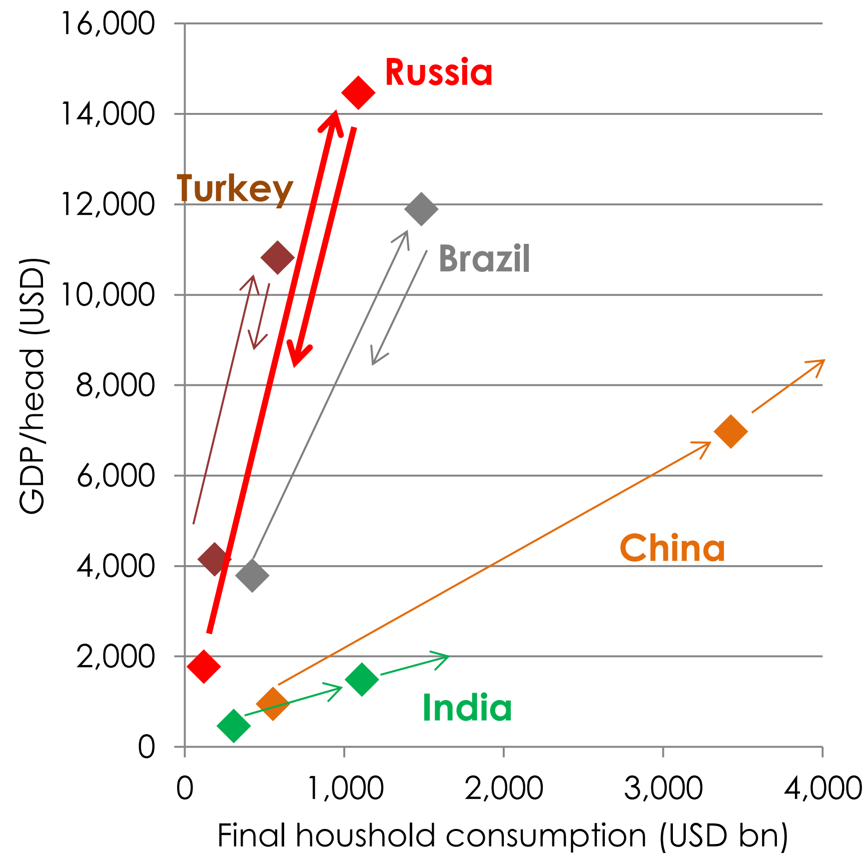
Car sales halved in 2015 as in 2008/2009



Source: Thomson Reuters, RBI/Raiffeisen RESEARCH

RU, BR and TR change into reverse gear



Levels in 2000 and 2013 and indication of IMF forecast 2016
Source: Thomson Reuters, RBI/Raiffeisen RESEARCH

TRENDS IN 2015 – INDUSTRIAL OUTPUT & RETAIL SALES
Industry at bottom for now, retail continues to shrink

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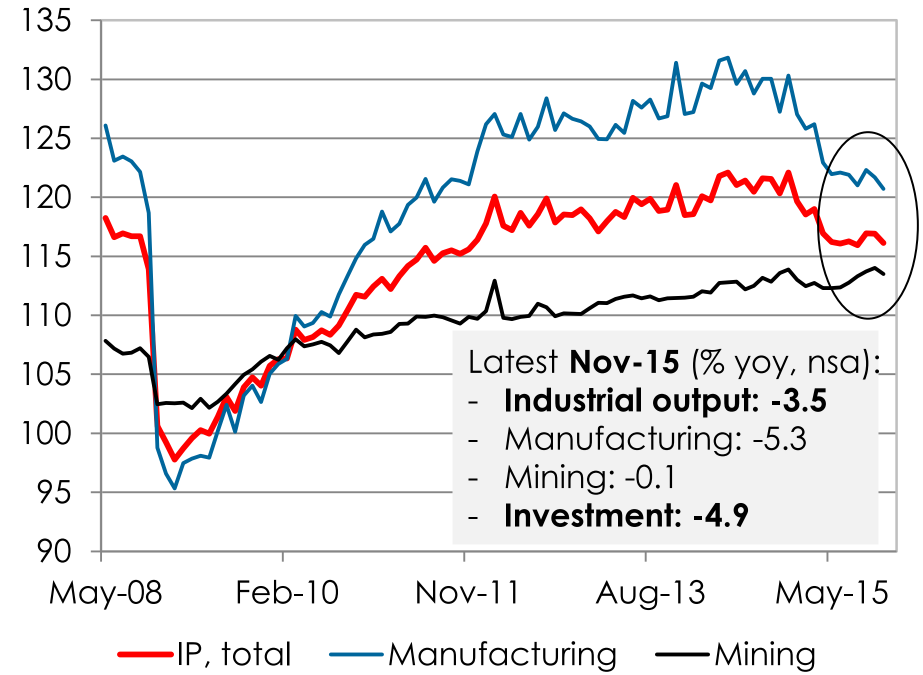
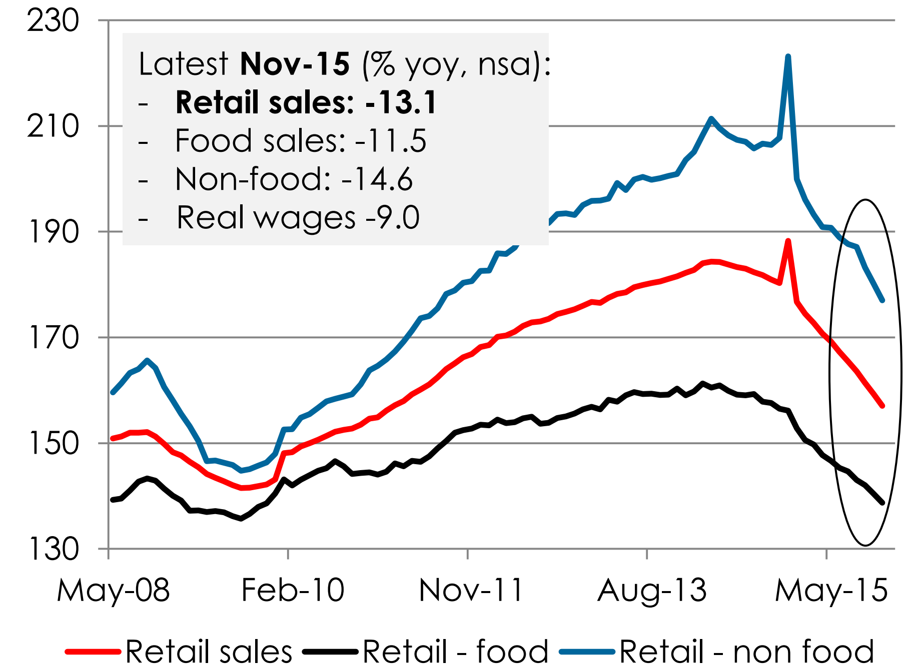
Industry: Bottoming out based on mining sector



Seasonally adjusted (sa) indices by RBI; 2005 =100
Source: Thomson Reuters, RBI/Raiffeisen RESEARCH

Retail sales adjusted sharply; continue to drop



Seasonally adjusted (sa) indices by RBI; 2005 =100
Source: Thomson Reuters, RBI/Raiffeisen RESEARCH

- The hit on industry has so far been much softer than in 2008/2009; while retail sales suffered much more
- Recent data in autumn points to some uptick in industry/manufacturing. However, we are cautious, that output can stabilize sustainable given state budget constraints and the continued slump of private demand
- Retail sales reflect almost one-to-one the decline in real wages; the decline seems to continue for now

TRENDS IN 2015 – MANUFACTURING
Drop in output accross entire spectrum of industries

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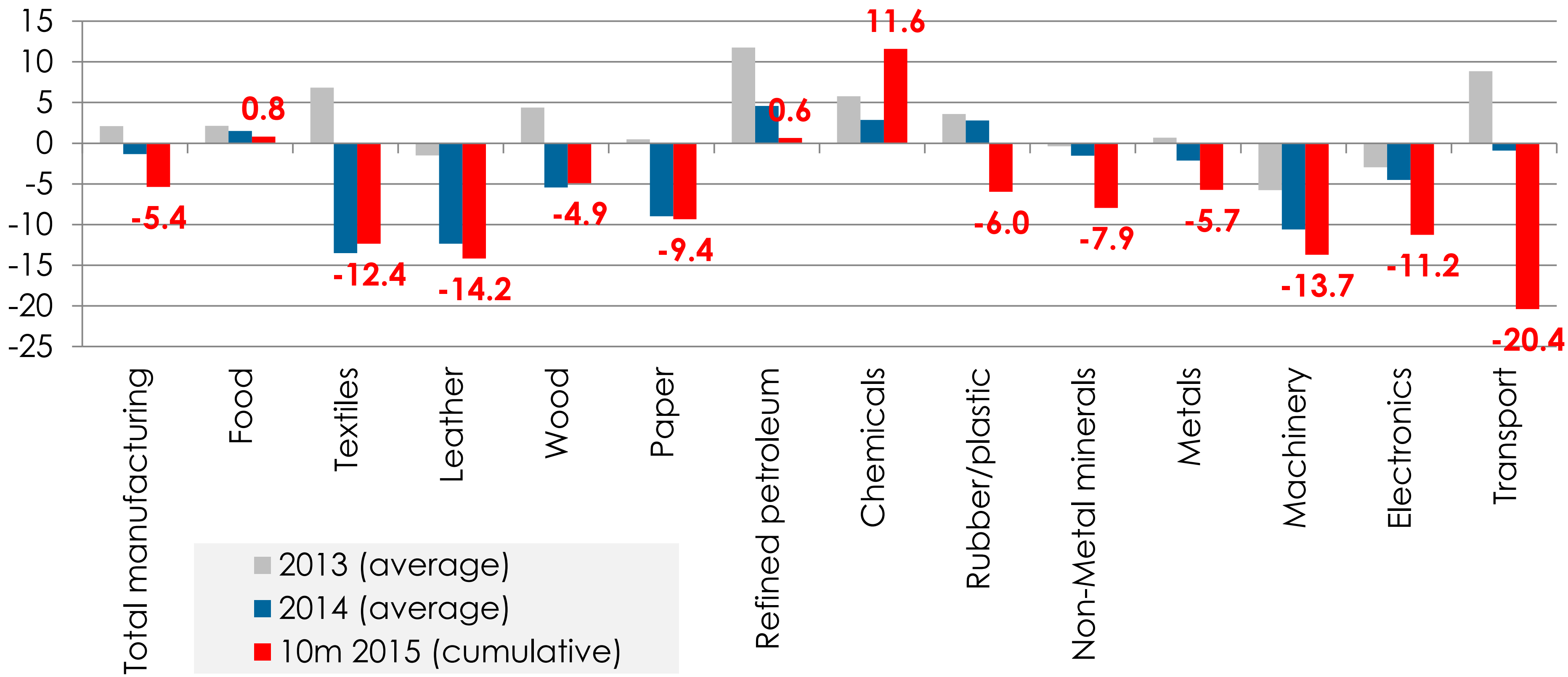

Cumulative growth rate: *Available months compared to same period in previous year*
Source: Thomson Reuters, RBI/Raiffeisen RESEARCH

- Light industries, machinery and transport equipment hit strongly, while chemical and food sectors do better
- Import substitution effects are largely overshadowed by the general drop in manufacturing
- Generally, we see the potential for import substitution very limited without an significant boost in investment

TRENDS IN 2015 – RETAIL SALES & WAGES
Nominal wages and retail sales far below inflation rate

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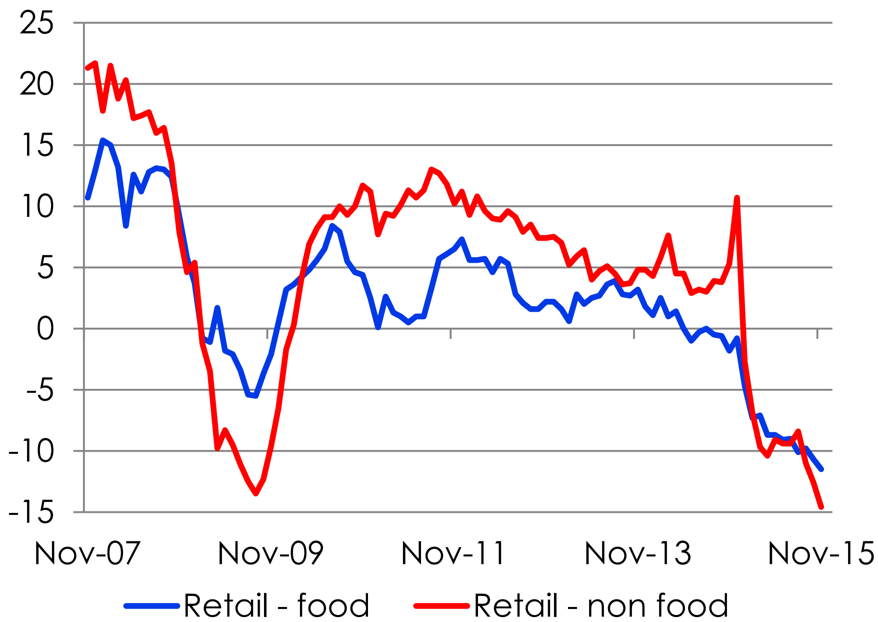
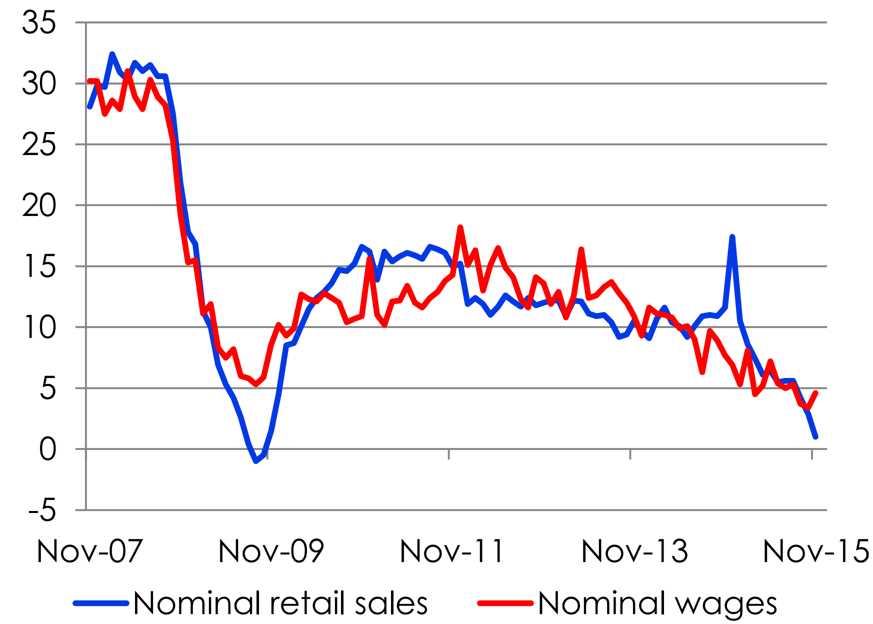
Retail sales (real, % yoy)



Source: Thomson Reuters, RBI/Raiffeisen RESEARCH

Nominal retail sales vs nominal wages (% yoy)



Source: Thomson Reuters, RBI/Raiffeisen RESEARCH

- Both food and non food segments of retail sales decline (after a period of increased purchases in late 2014)
- In nominal terms, retail sales and wage dynamics are still positive, but still in clear downward trend (with inflation around 15% yoy they are negative in real terms).
- The slump in retail sales is more pronounced than in 2008/2009.

TRENDS IN 2015 – INFLATION
Inflation still at around 15%, to decline in Q1'16

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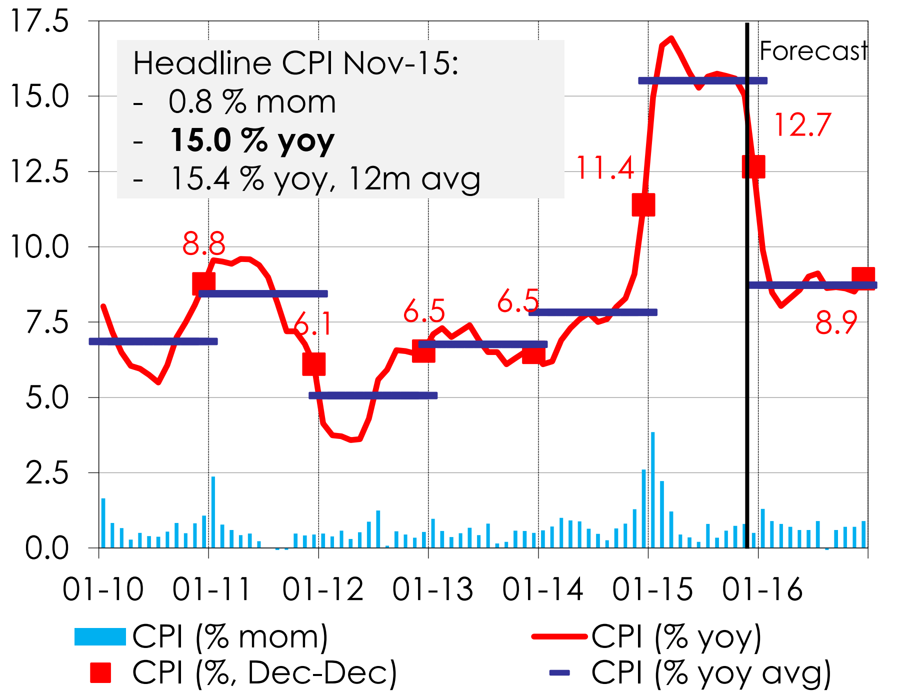
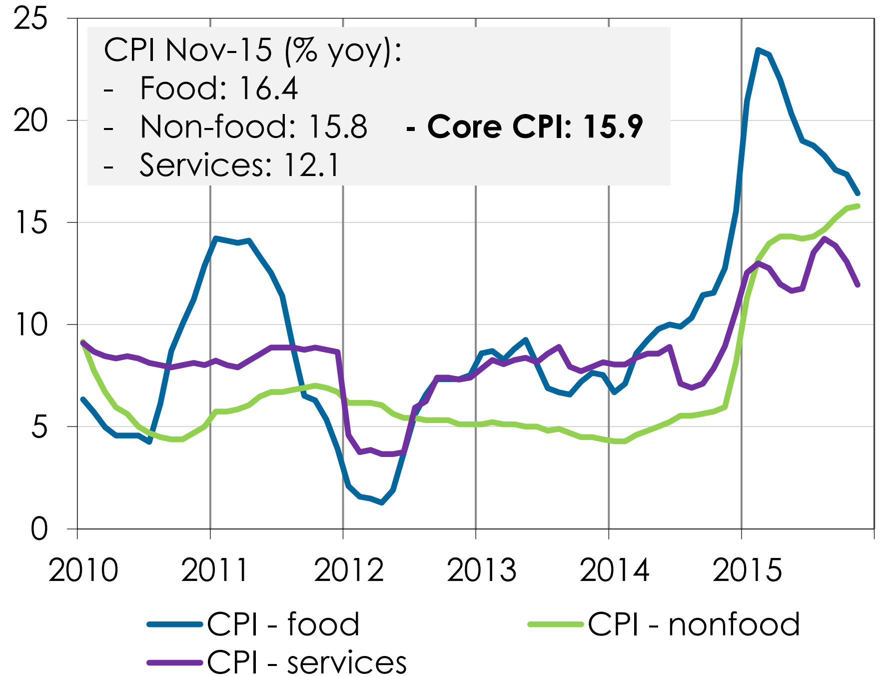
Consumer price index (CPI, %)



Source: Thomson Reuters, RBI/Raiffeisen RESEARCH

CPI breakdown(% yoy)



Source: Thomson Reuters, RBI/Raiffeisen RESEARCH

- Rouble depreciation and self imposed ban on food imports pushed CPI inflation to almost 17% yoy in March
- Inflation will decline to single digits in 2016, however inflation expectations still high, keeping CBR from cutting the key rate quickly and decisively – we expect only 100bp decrease in key rate in 2016
- Highly challenging CBR inflation target of 6.5% in Dec 2016 and 4% (+/- 1.5%) afterwards

TRENDS IN 2015 – ROUBLE & OIL PRICE (I)
In "free float" mode the RUB closely tracks oil

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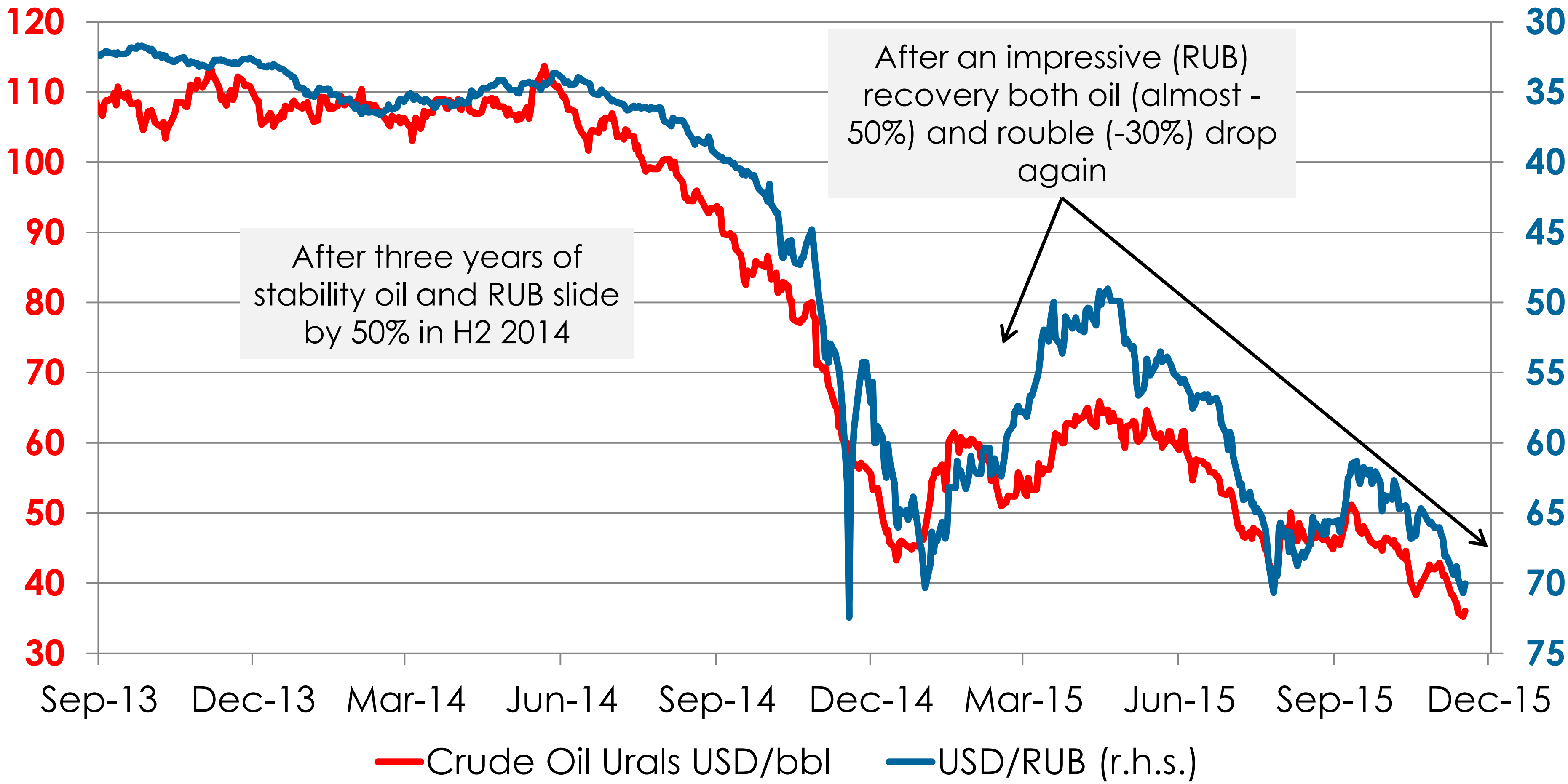

USD/RUB rate on inverse scale
Data as of 14 Dec 2015 17:00; USD/RUB 5y high: 72.5; 5y low: 27.3; Crude oil 5y high: 126.2; 5y low: 40.8
Source: Thomson Reuters, RBI/Raiffeisen RESEARCH

TRENDS IN 2015 – ROUBLE & OIL PRICE (II)
"Floating rouble" – Too much of a good thing?

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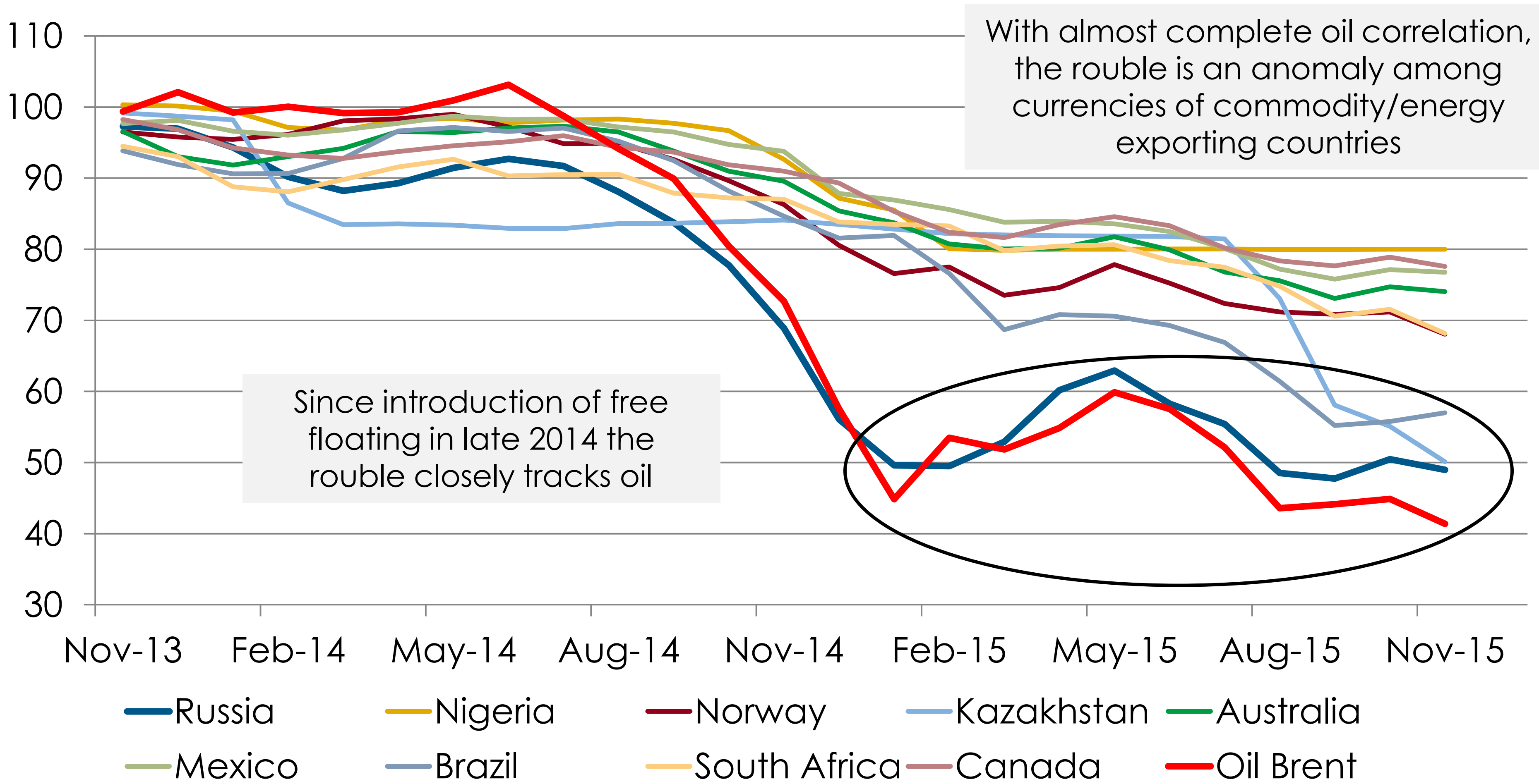

Indexed chart with average 2013 = 100: *monthly average nominal exchange rates of respective countries to USD and monthly average price of Brent in USD; down = weaker local currency to USD, lower oil price*
Source: Thomson Reuters, RBI/Raiffeisen RESEARCH

TRENDS IN 2015 – TRADE BALANCE
Stabilisation of trade balance short-lived, exports fall

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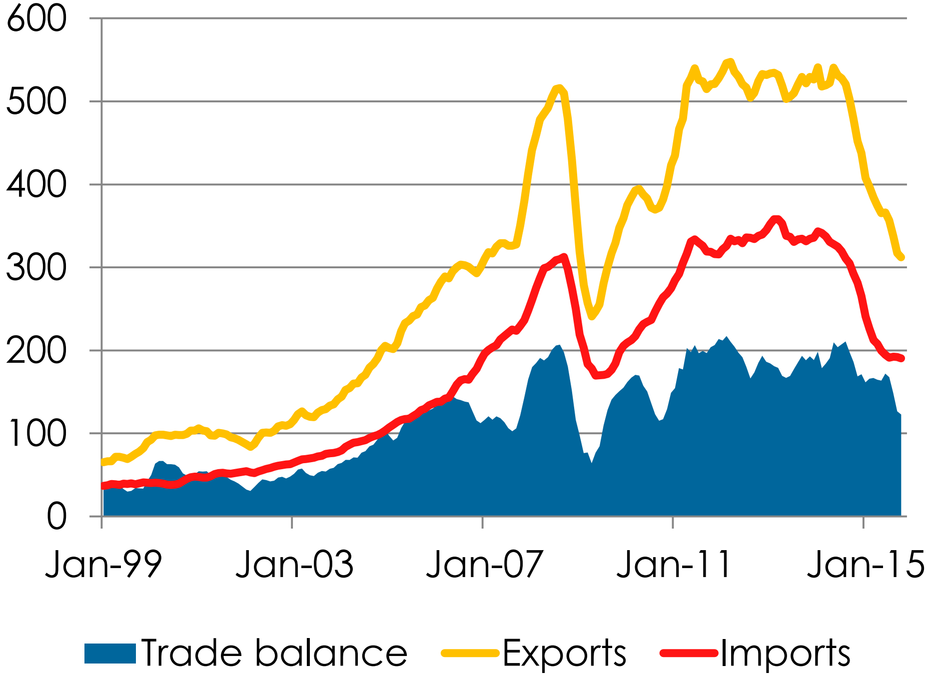
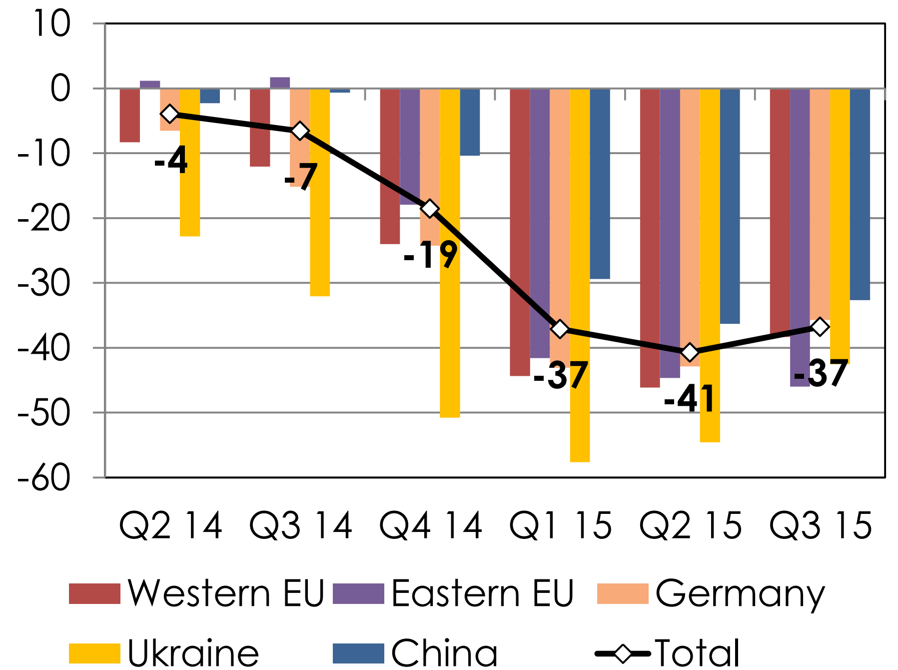
Merchandise trade balance (USD bn)*



Russian good imports (% yoy)



** 3 month average seasonally adjusted and annualised, last data Oct-2015*
Source: Thomson Reuters, RBI/Raiffeisen RESEARCH

USD based; three month period vs three month period a year earlier
Source: Thomson Reuters, RBI/Raiffeisen RESEARCH

- Sharp decline both in exports and imports (in USD) by ~45% since spring 2014 on weaker oil and rouble
- Stabilisation in imports after initial hit, but NOT in exports → deterioration in trade surplus in Q3 2015 by 33%
- In yoy terms, the decline has peaked, e.g. imports of -37% yoy in Q3 after -41% in Q2 2015

TRENDS IN 2015 – RESERVES AND DEBT
FX reserves stabilised, reserve fund covers deficit

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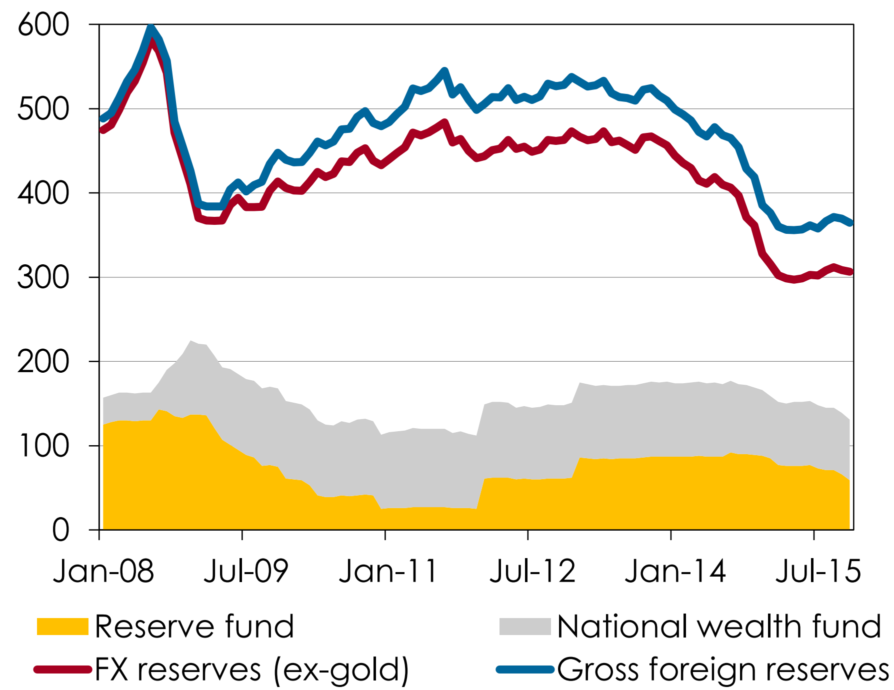
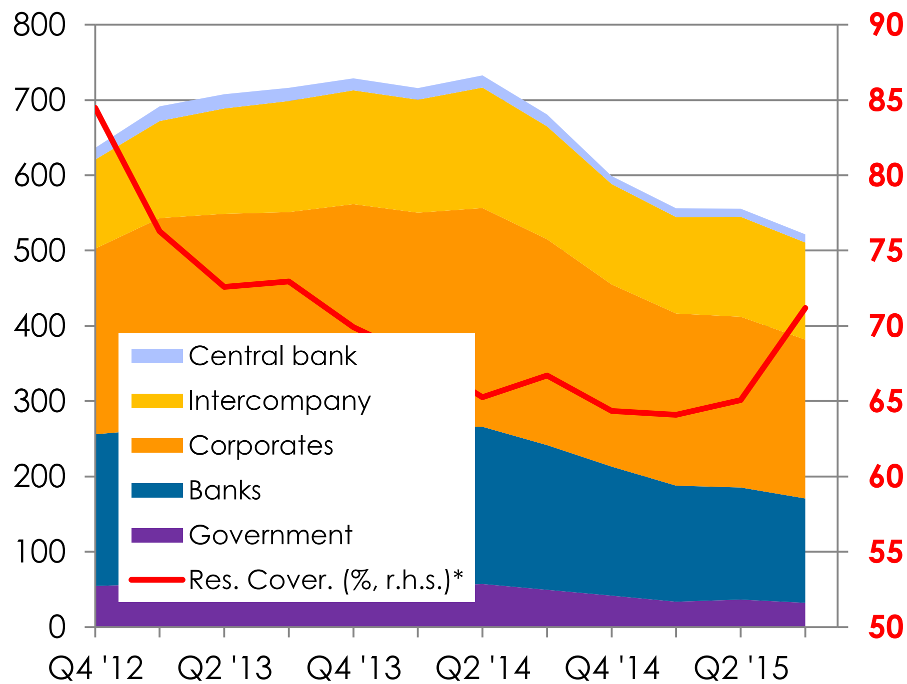
FX reserves and fiscal funds* (USD bn)



** FX reserve and national wealth fund are mostly part of CBR gross foreign reserves*
Source: Thomson Reuters, RBI/Raiffeisen RESEARCH

External debt (USD bn)



** Gross foreign reserves to total external debt ratio*
Source: Thomson Reuters, RBI/Raiffeisen RESEARCH

- The Res. Fund is tapped to cover budget deficits in 2015 and 2016 – which will deplete most of it
- End-Nov (in USD bn): Gross reserves: 364 (-5% ytd); **Reserve fund: 59 (-33% ytd)**, **Wealth fund: 72 (-8%)**
- External deleveraging continues in 2015 with total external debt down by USD 77 bn or 13% ytd

TRENDS IN 2015 – CAPITAL FLOWS
Diverging trends: Foreigners pull out - residents return

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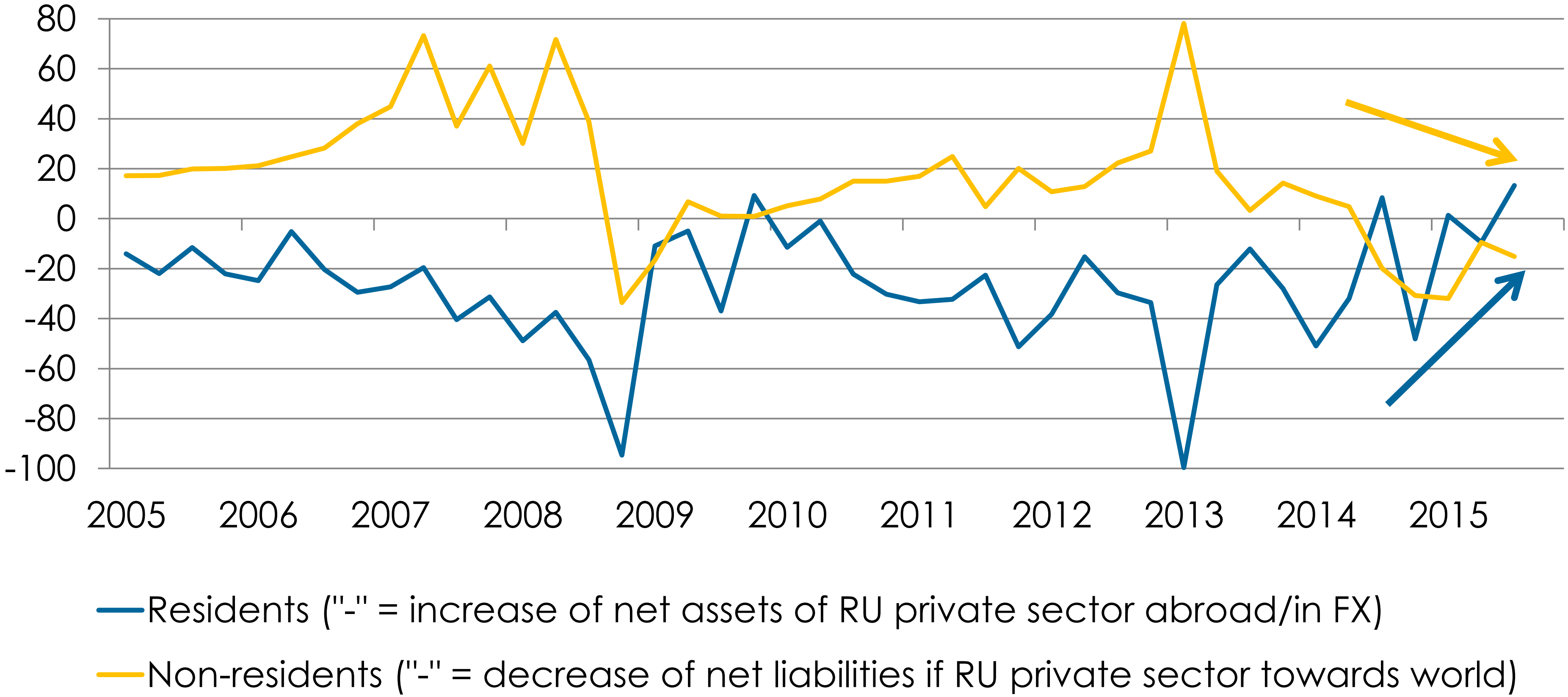
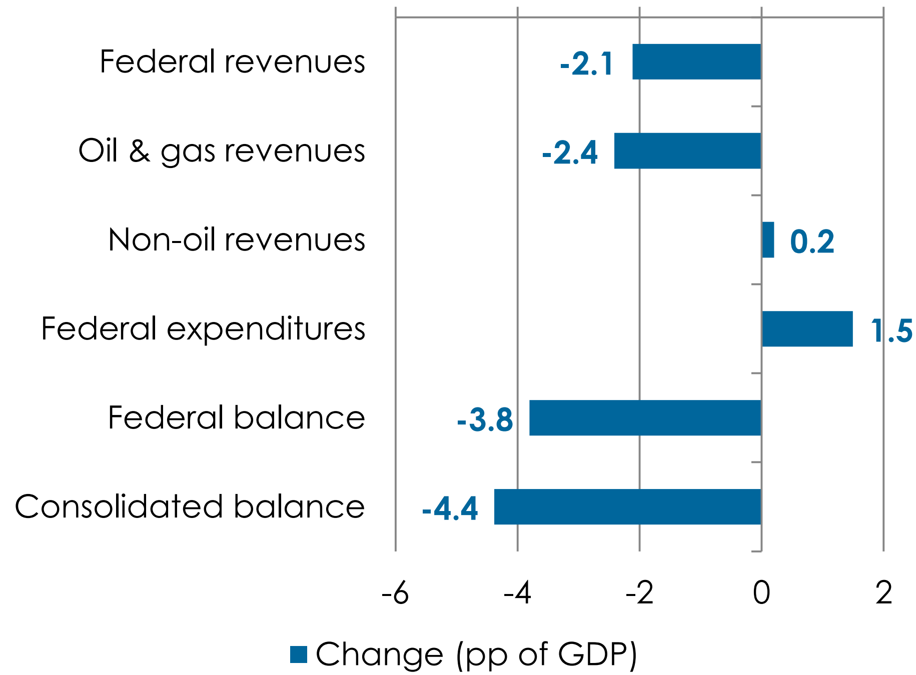


Source: Central Bank of Russia, RBI/Raiffeisen RESEARCH

- Russia usually shows a negative financial account, mainly driven by net private (= not state) capital outflows
- In Q3 2015, the first net capital inflow since 2010 has been registered;
- Though the exodus of foreign money continued (deleveraging since Q3 2014), Russian residents (banks + corporates) decreased assets abroad

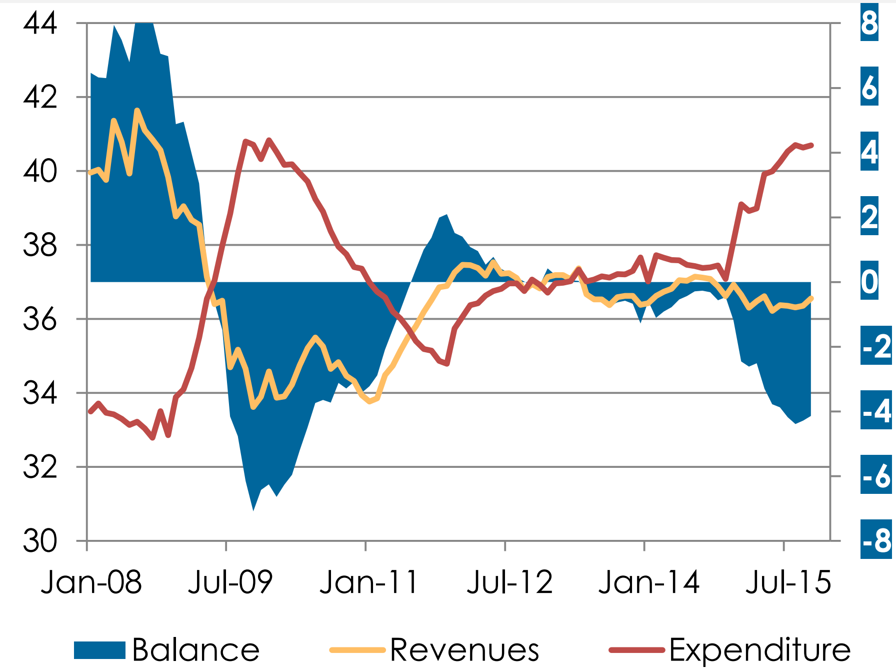
TRENDS IN 2015 – BUDGET
Federal budget deteriorates by 4% of GDP in 2015 ytd

Estimated budget deterioration '15 vs '14 (% of GDP)*



** Federal budget for 11m Jan-Nov, consolidated budget and revenue break-down 10m Jan-Oct; divided by GDP Q4-2014 to Q3 2015 adjusted for period length; Source: Thomson Reuters, RBI/Raiffeisen RESEARCH*

Consolidated budget* (% of GDP, 12 m rolling)



** Including expenditures of RUB 1 trn (1.4% of GDP) for bank support booked in Dec 2014; Source: Thomson Reuters, RBI/Raiffeisen RESEARCH*

- Looking at the first 11 month of the year and compared to the previous year, the **federal budget turned from a surplus of 2.7% of GDP to a deficit of ~1% of GDP** – but here are still major outlays upcoming in December
- Oil & gas revenues declines by 19%, other federal revenues increased by 10%, federal expenditures +14%
- Given additional expenditures to help banks in December 2014, the 12m rolling deficits are higher

TRENDS IN 2015 – RUSSIAN GOVERNMENT BONDS
Positive performance as risk premium strongly declined

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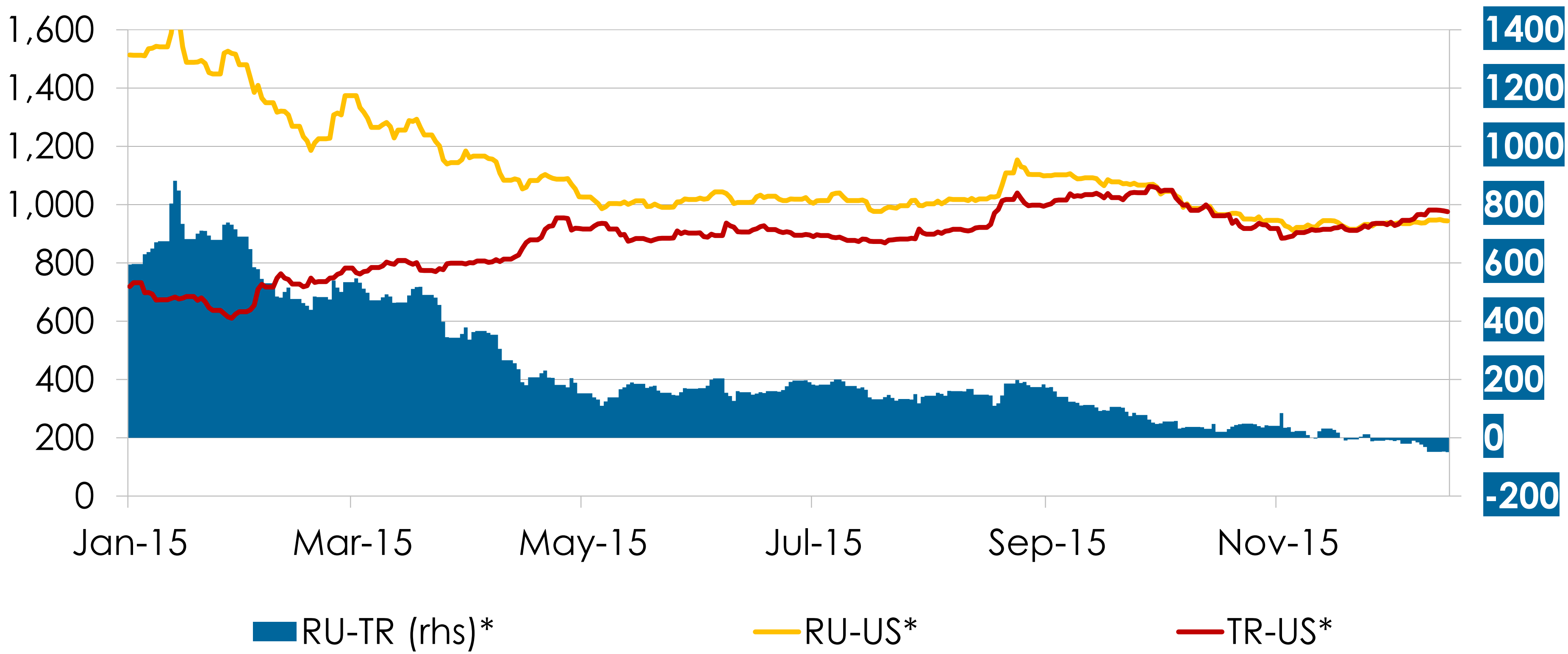

Source: Bloomberg, RBI/Raiffeisen RESEARCH

- Constructive sentiment towards RU, e.g. compared to TR, on the back of still high carry and strong easing expectations
- OFZ not too much impacted by RUB downside, risk of setbacks in OFZ

Weak outlook for Russia in 2016
–
Challenging H1, better H2 possible if oil prices (should) pick up

OUTLOOK 2016 – OIL AND ROUBLE
Hoping for an oil recovery in H2, else…

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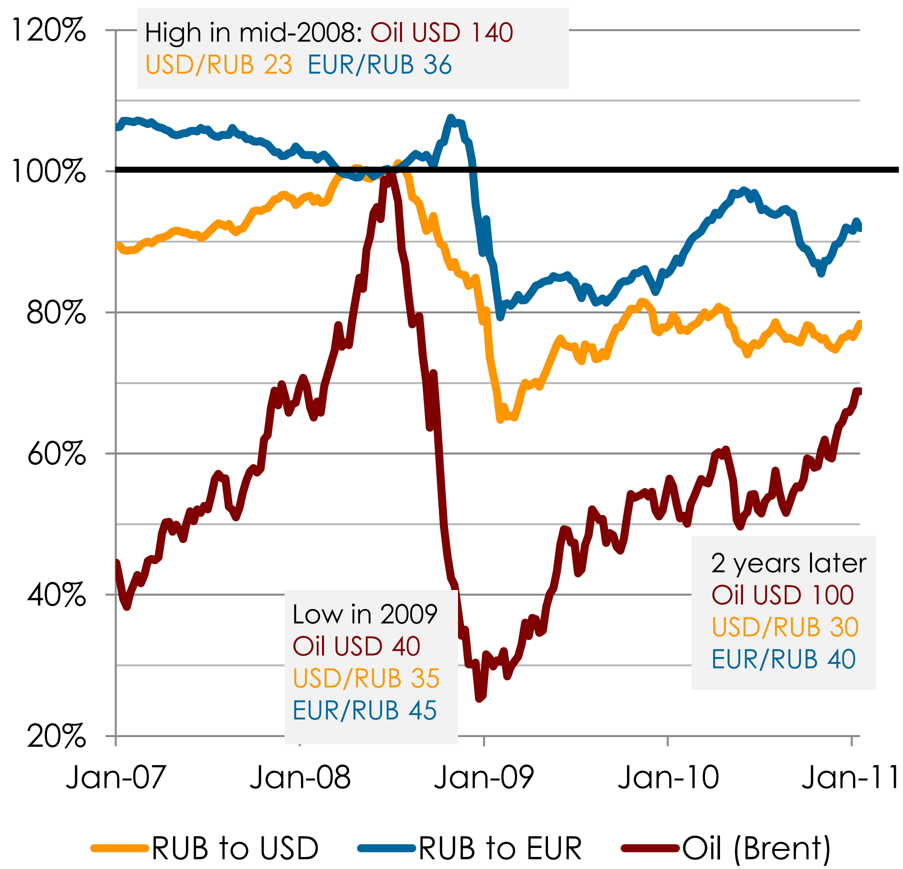
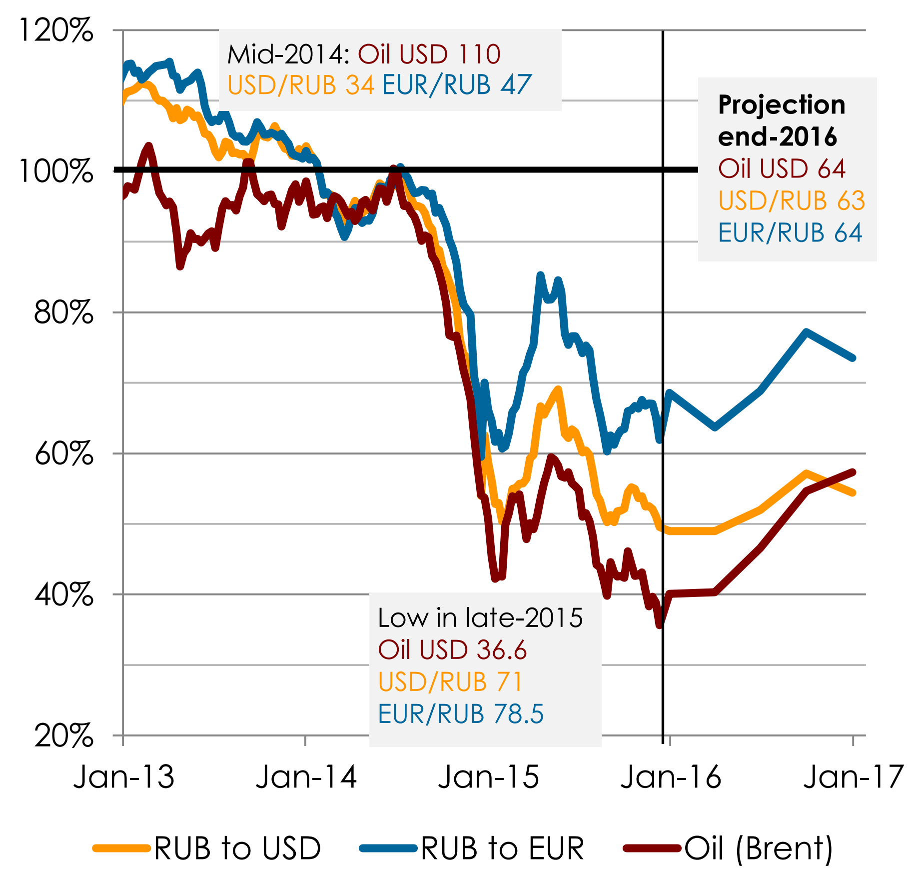
2008/2009: RUB rate moving less than oil



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

2014/2015: RUB rate more volatile



Indexed at mid-2014 = 100%
Source: Thomson Reuters, RBI/Raiffeisen RESEARCH

OUTLOOK 2016 – GDP GROWTH
Stagnation, investment & consumption still down

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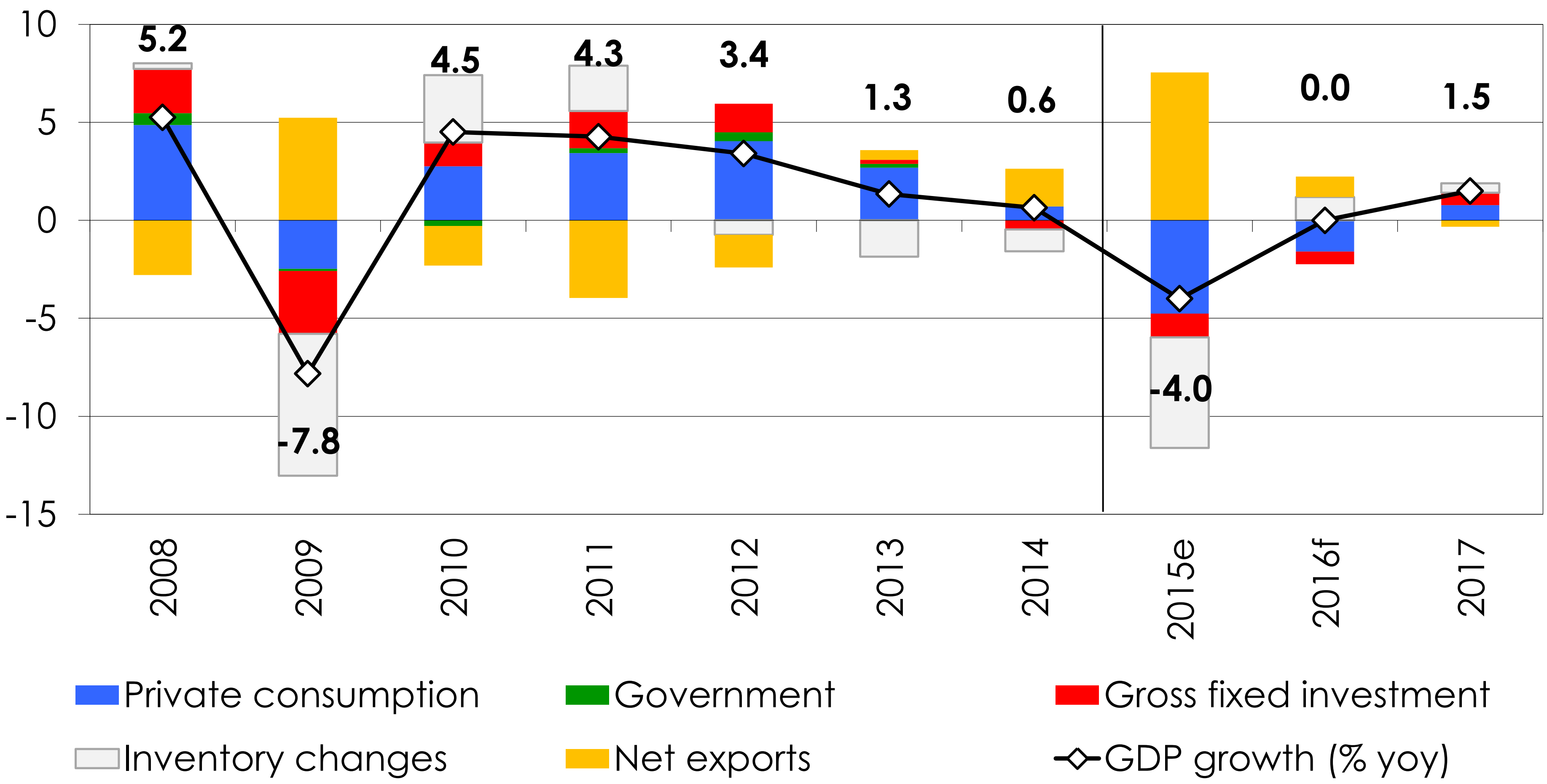
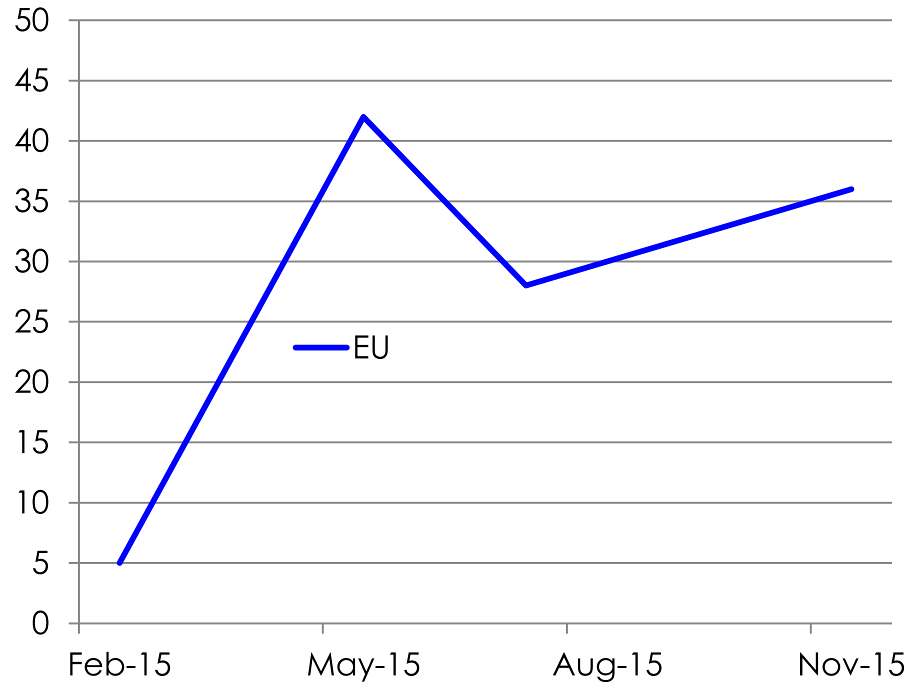


Source: Thomson Reuters, RBI/Raiffeisen RESEARCH

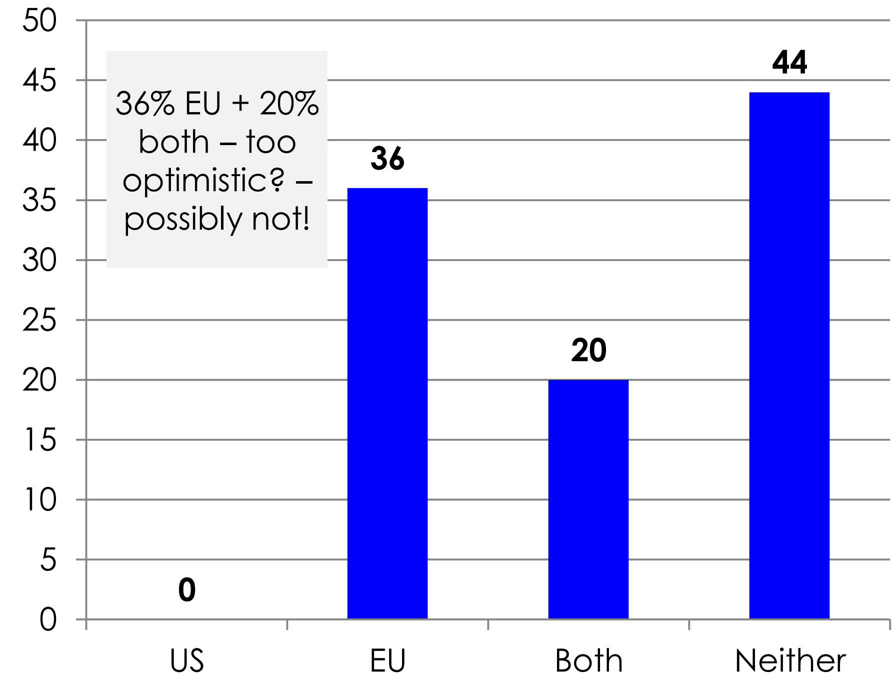
OUTLOOK 2016 – EU SANCTIONS OUTLOOK
Rapprochement of EU and Eurasian Economic Union?!

Easing of sanctions over next 12m? (% respondents)



Source: Bloomberg, RBI/Raiffeisen RESEARCH

Easing of sanctions over next 12 months?



Source: Bloomberg, RBI/Raiffeisen RESEARCH

- Baseline scenario sees no changes to EU sanctions in H1, and no substantial easing in H2
- However, there might be first signs of easing/modifications of sanction in H2
- A (EU) sanctions easing debate may also help to lift more "informal" bans on doing business with Russia by IFIs, also less compliance focus on RU related issues possible

OUTLOOK 2016 – OIL PRICE IN RUB TERMS FOR BUDGET
Rouble denominated oil price under pressure

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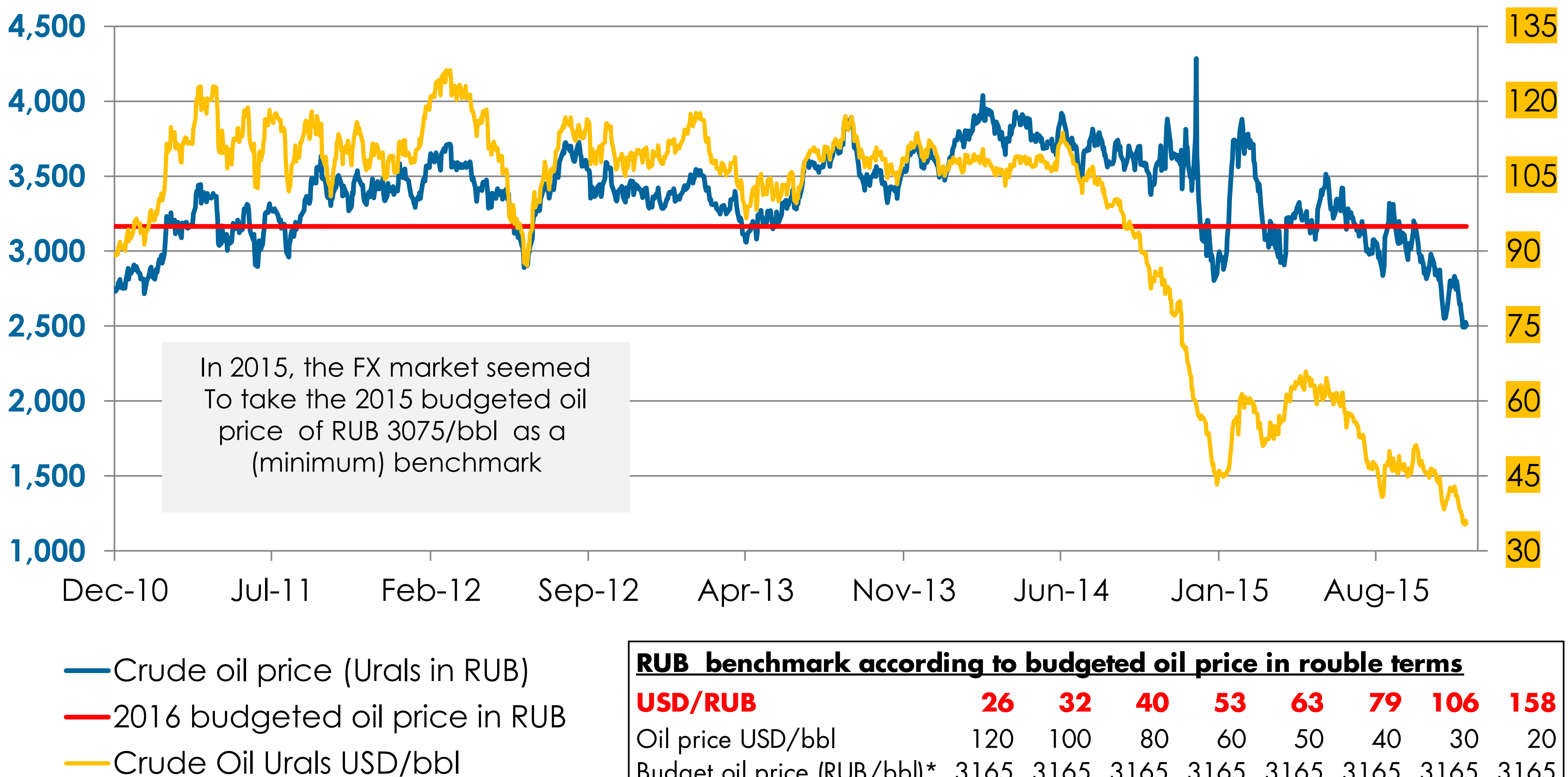

Data as of 16 Dec 2015 12:00; oil 5y high: USD 126.2; 5y low: 40.8; oil 5y high: RUB 4,285; 5y low: 2,352
Souce: Thomson Reuters, Minfin, RBI/Raiffeisen RESEARCH

RUB benchmark according to budgeted oil price in rouble terms

USD/RUB	**26**	**32**	**40**	**53**	**63**	**79**	**106**	**158**
Oil price USD/bbl	120	100	80	60	50	40	30	20
Budget oil price (RUB/bbl)*	3165	3165	3165	3165	3165	3165	3165	3165

* based on the parameters for 2016 budget of USD 50/bbl; USD/RUB 63.3
Source: RBI/Raiffeisen RESEARCH

OUTLOOK 2016 – BUDGET WILL BE KEY NEXT YEAR
Lower oil prices pose risks to budget performance

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Federal budget estimates	**2015**		**2016**				
	ytd	Budget law	**Budget law**	**RBI base**	RBI stress I	RBI stress II	Minfin stress
Urals (USD/bbl)	**52.2**	**50**	**50**	**54.5**	**40**	**30**	**40**
USD/RUB (avg)	60.8	61.5	**63.3**	**65.6**	75	80	72.6
Oil price in RUB	3,174	3,075	**3,165**	**3,575**	3,000	2,400	2,904
Fed. budget deficit (% of GDP)	**-1.3**	**-2.9**	**-3.0**	**-1.9**	**-4.2**	**-6.5**	**-5.2**
Fed. budget deficit (USD bn)	0.0	-35	**-37**	**-24**	-46	-67	-55
For reference:							
Nominal GDP (USD bn)	1,120	1,200	**1,240**	**1,270**	1,100	1,030	1,070

Notes: In RBI base and risk cases oil&gas revenues are proportionally changed to assumed RUB oil price change in comparison to budget plan; non-oil revenues in RBI base case are as budgeted, in risk I 90% of budget and in risk II case 80% of budget plan; budget expenditures are held constant at budgeted RUB values in RBI cases; Source: Ministry of Finance, author's calculation, RBI/Raiffeisen RESEARCH

- The 2016 budget plan foresees to cover the deficit of (equivalent) USD 37 bn mostly by the use of the **(a)** Reserve fund of now USD 59 bn
- If fiscal fund(s) would be depleted at some point, **(b)** domestic/international debt issuance, **(c)** a harsh fiscal consolidation course, **(d)** privatisations and/or **(e)** debt monetisation/money printing are the options

OUTLOOK 2016 & MACROECONOMIC FORECASTS
Difficult H1, improvement in H2 if oil picks up

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Baseline scenario:

- Recession in 2015 followed by stagnation in 2016, investment and consumption still to decline.
- The oil price trend could improve during H2, which would eases pressure on the rouble, the economy, and the banking sector
- Budget more strained than 2015, but major cuts likely still avoided as duma elections loom in late 2016
- Long term growth weakness and moderate rouble depreciation trend

Downside risks:

- Oil price low for protracted period, impacting growth, rouble, inflation, budget, fiscal and FX buffers
- Insufficient pick-up in investment
- Foreign policy engagements go bad
- Sanction remain in place for longer
- Rising social tensions in the elite and population
- Stagflation as long term scenario

Key macro projections baseline scenario

	2015e	2016f	2017f
Oil price Brent (avg, USD)	54	56	70
Real GDP (% yoy)	-4.0	0.0	1.5
Consumption (% yoy)	-8.5	-3.0	1.5
Investment (% yoy)	-5.5	-3.0	3.0
CPI (eop, % yoy)	12.8	9.0	8.0
CPI (avg, %yoy)	15.6	8.8	8.4
Key rate (year end, %)	11.0	10.0	9.0
USD/RUB (eop)		63	67
USD/RUB (avg)	61.6	66	65
General budget (% GDP)	-3.5	-3.5	-2.0
C/A (% GDP)	5.1	5.5	5.0
Gross FX res. (USD bn)	370	370	370

Source: National sources, Thomson Reuters, RBI/Raiffeisen RESEARCH

Stagnation: Bleak long term outlook
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Weak investments, growth and rouble depreciation (increasingly) realistic scenario

LONG TERM OUTLOOK – SIZE OF RUSSIAN GDP
“Stagnation” future

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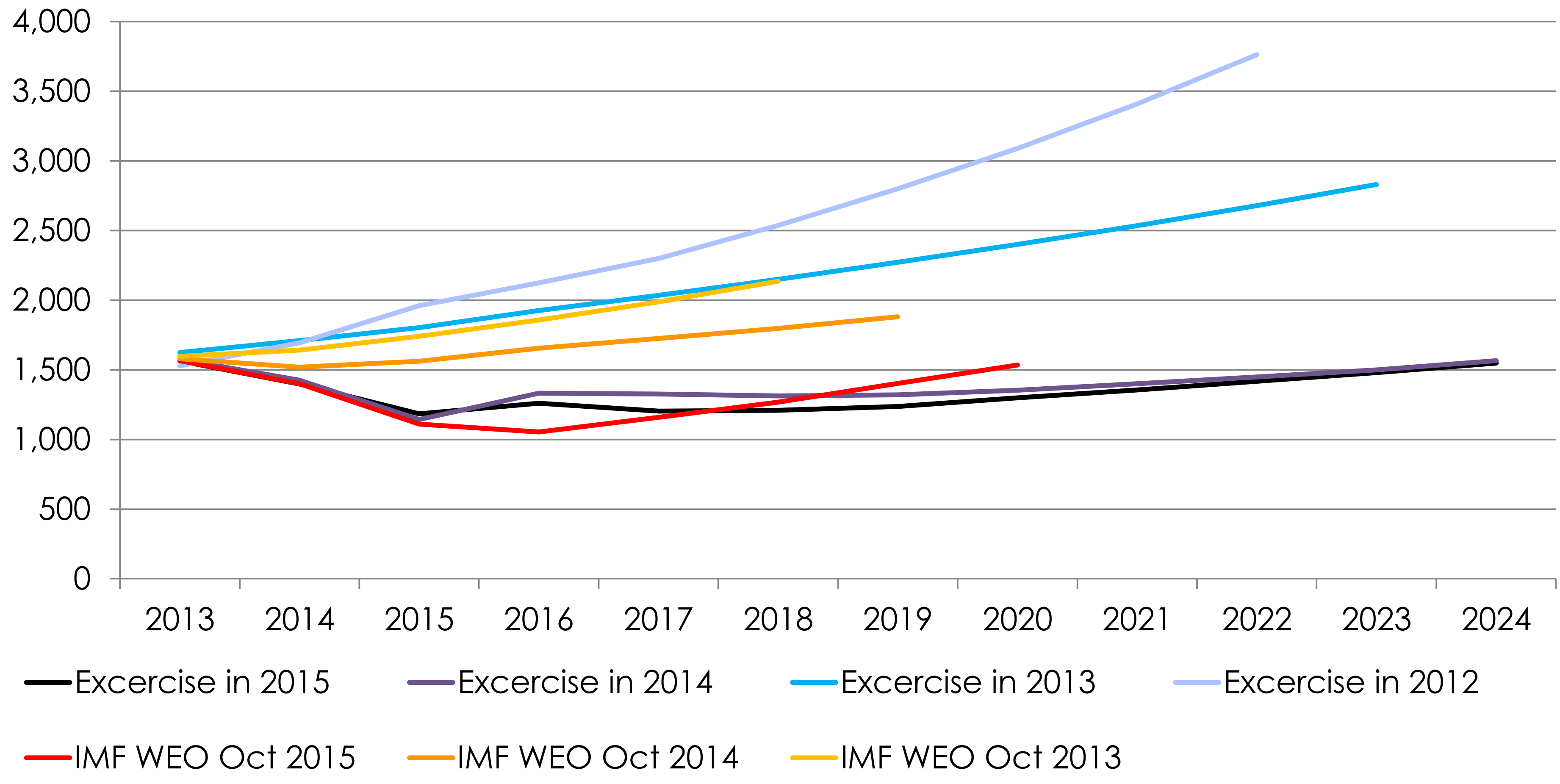

Source: IMF, Thomson Reuters, RBI/Raiffeisen RESEARCH

Russian Banking Sector

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Weathering Cyclical and Structural Weaknesses

BANKING SECTOR STANDING – LIQUIDITY & FUNDING
External funding scarce

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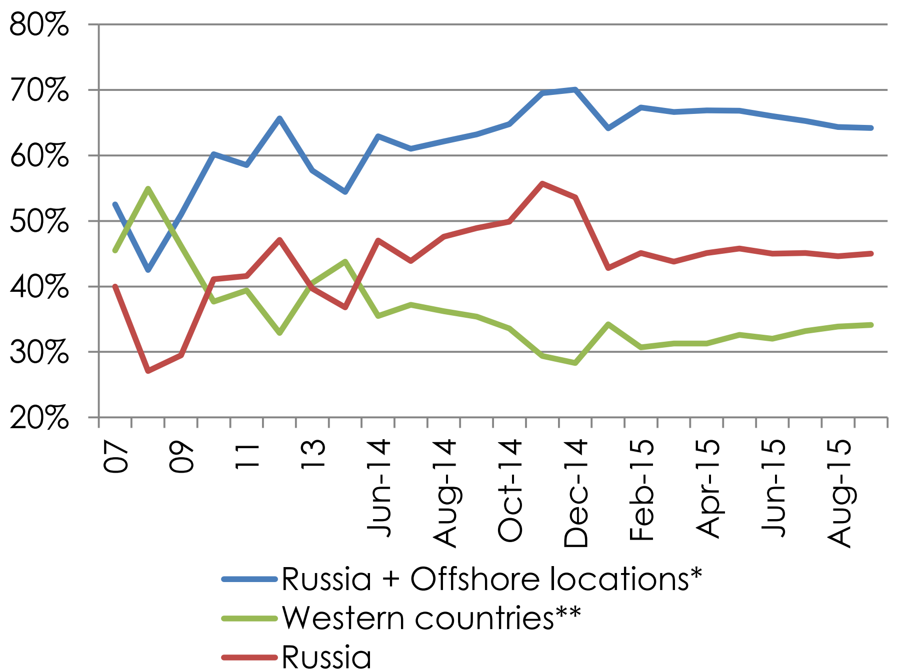
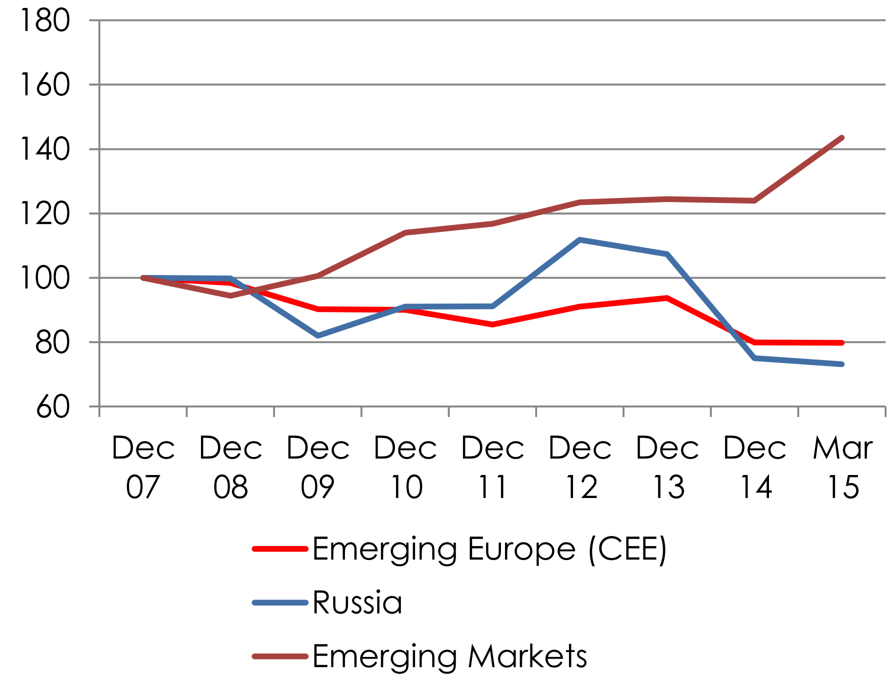
Interbank funding - geographical breakdown (% of total)



* RU + CY + 70% NL + 90% Others
** UK, US, DE, FR, IT, AT
Source: Central Bank of Russia, RBI/Raiffeisen RESEARCH

Cross-border claims of foreign banks (BIS-rep. banks)

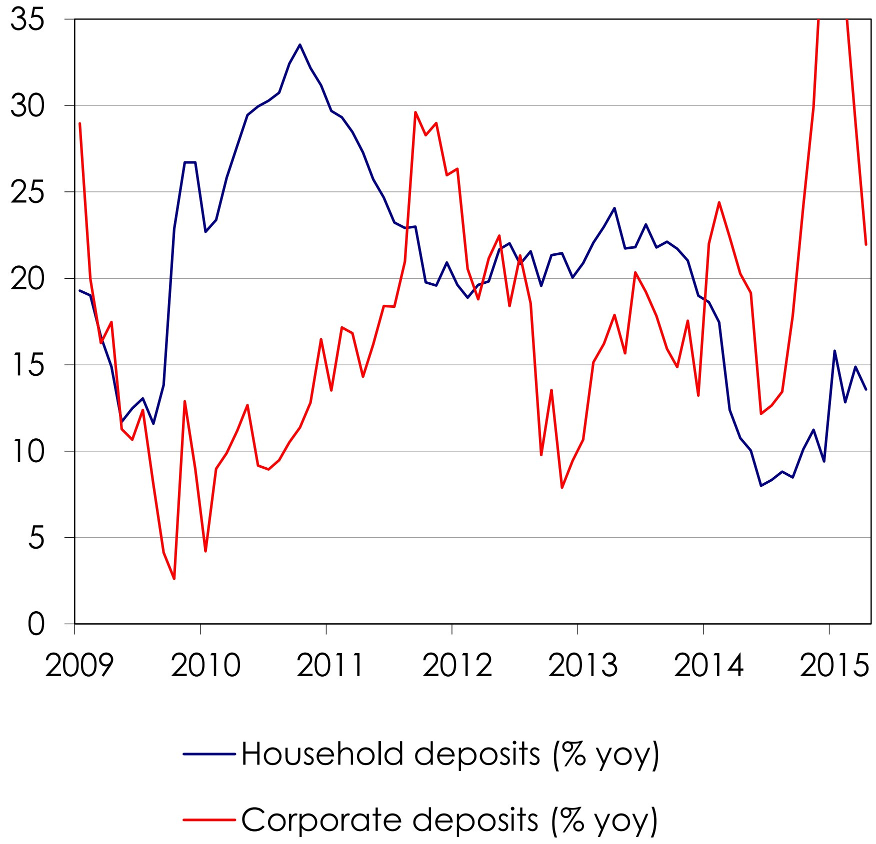


Source: BIS, RBI/Raiffeisen RESEARCH

- Sanctions
- Deteriorating external accounts
- More stringent European regulatory capital requirements

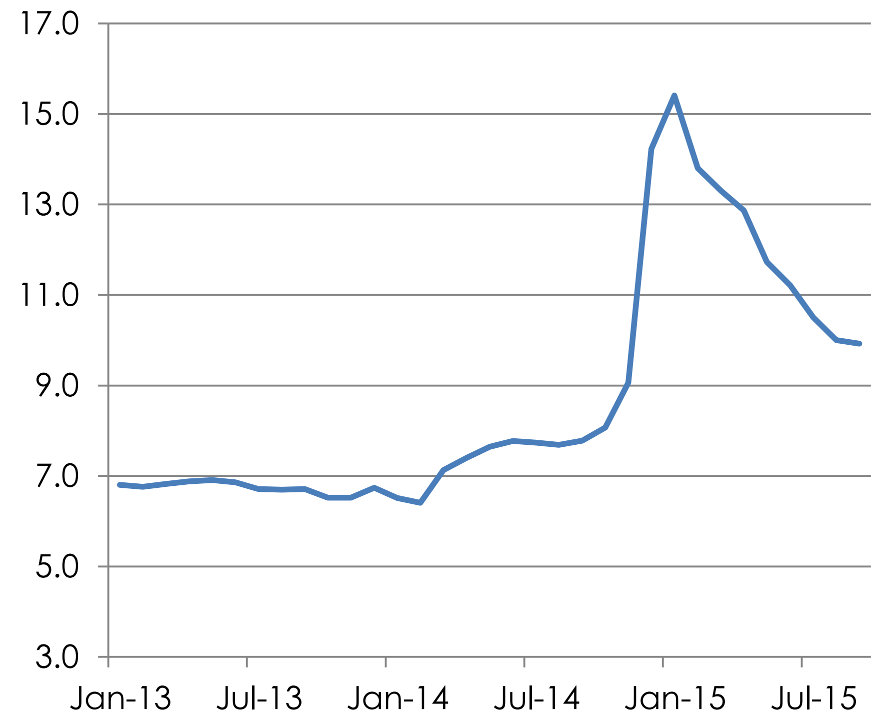
BANKING SECTOR STANDING – DEPOSITS
Funding costs very high

Private sector deposit dynamics (% yoy)



Source: Central Bank of Russia, RBI/Raiffeisen RESEARCH

Deposits - weighted average %* (% p.a., LCY)

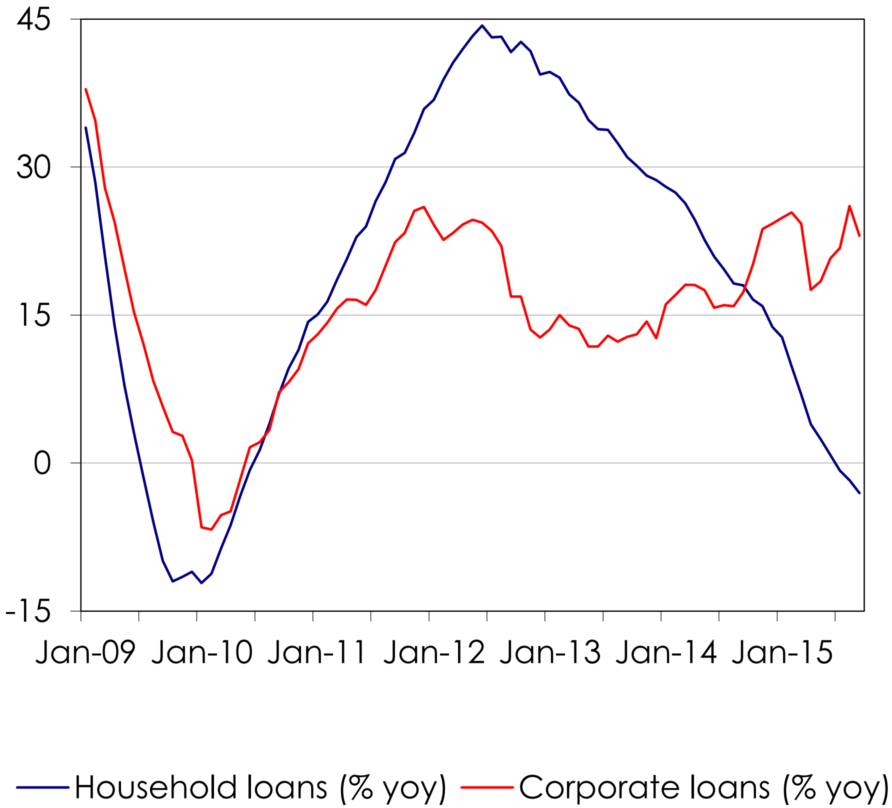


** corp and h/h, up to 1 yr, without Sberbank*
Source: Central Bank of Russia, RBI/Raiffeisen RESEARCH

BANKING SECTOR STANDING – LENDING
Lending activity dampened, credit risk up

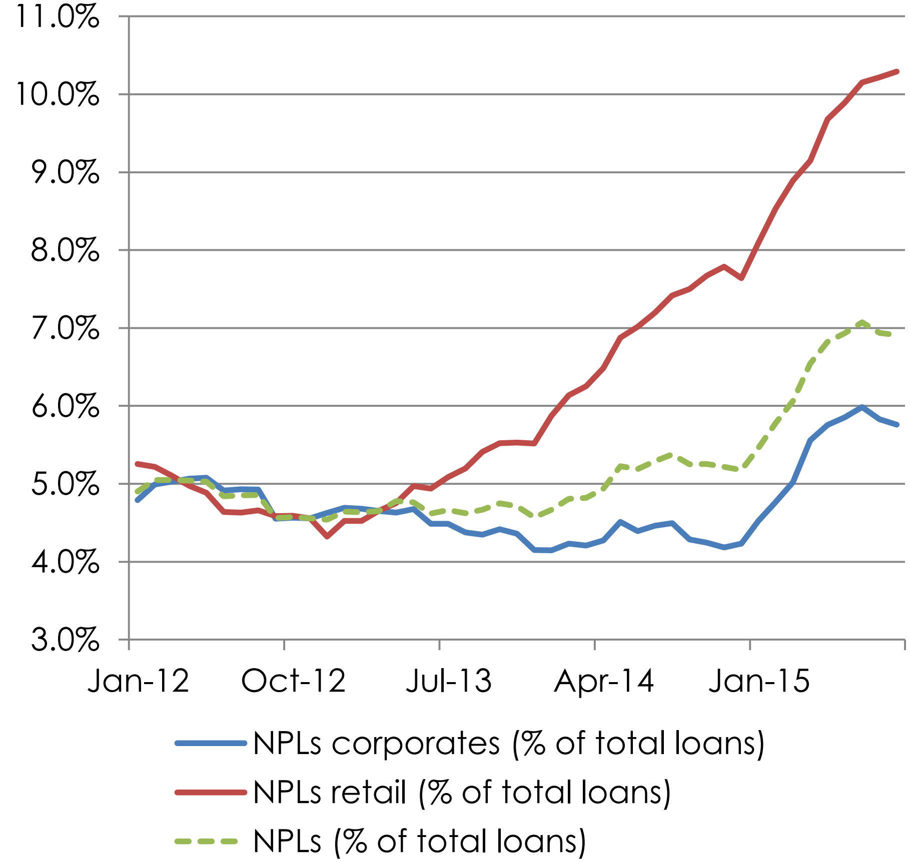
Raiffeisen RESEARCH

Banks' loans to private sector (% yoy)



Source: Central Bank of Russia, RBI/Raiffeisen RESEARCH

Non-performing loans dynamics (NPL ratio, %)

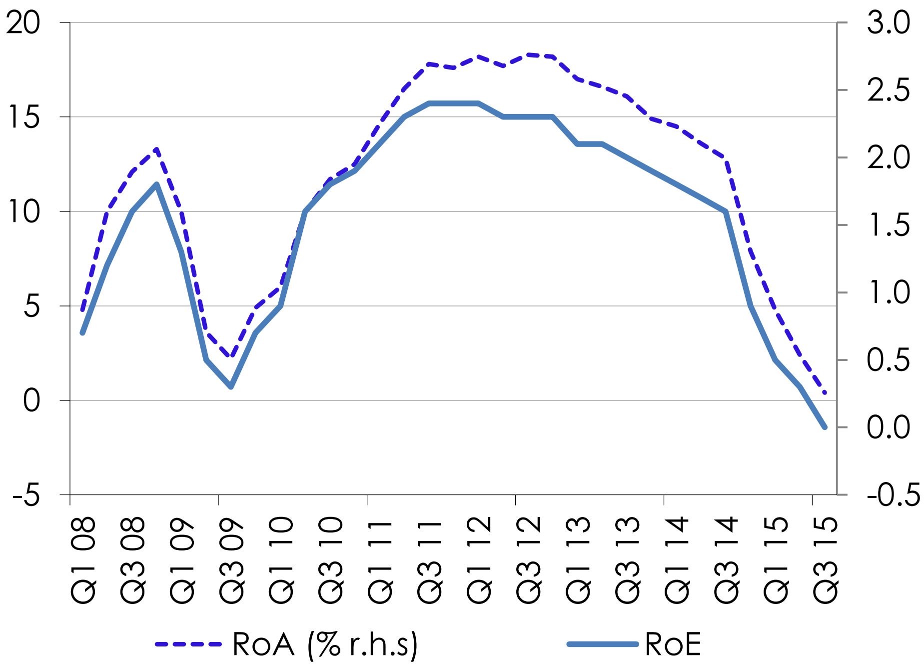


Source: Central Bank of Russia, RBI/Raiffeisen RESEARCH

BANKING SECTOR STANDING – Profitability
Sector averages low; individual differences stay big

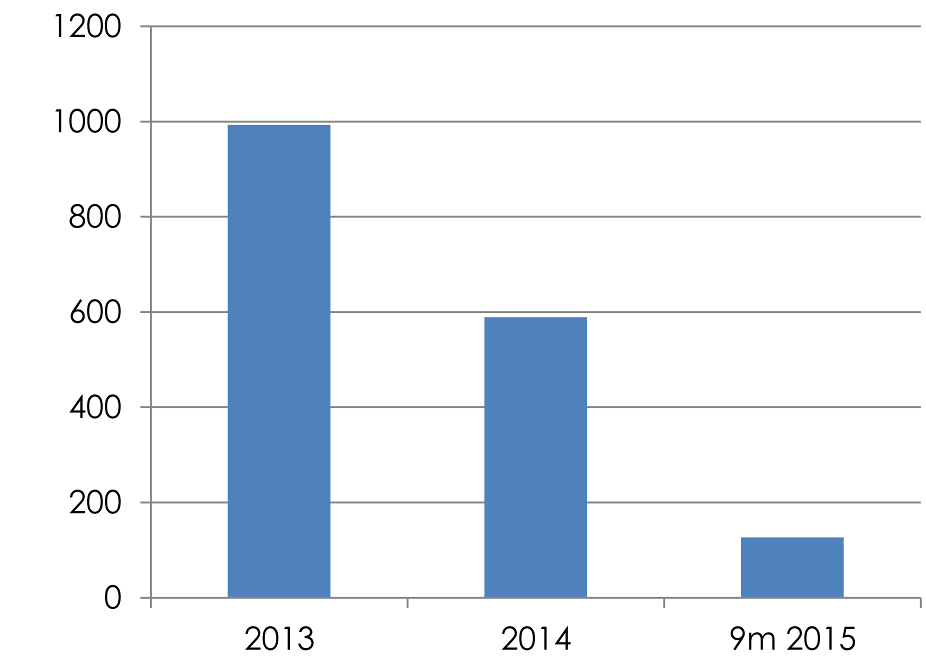
Raiffeisen RESEARCH

RU Banking sector profitability (%)



Source: Central Bank of Russia, RBI/Raiffeisen RESEARCH

Total profits of the RU banking sector, RAS (RUB bn)



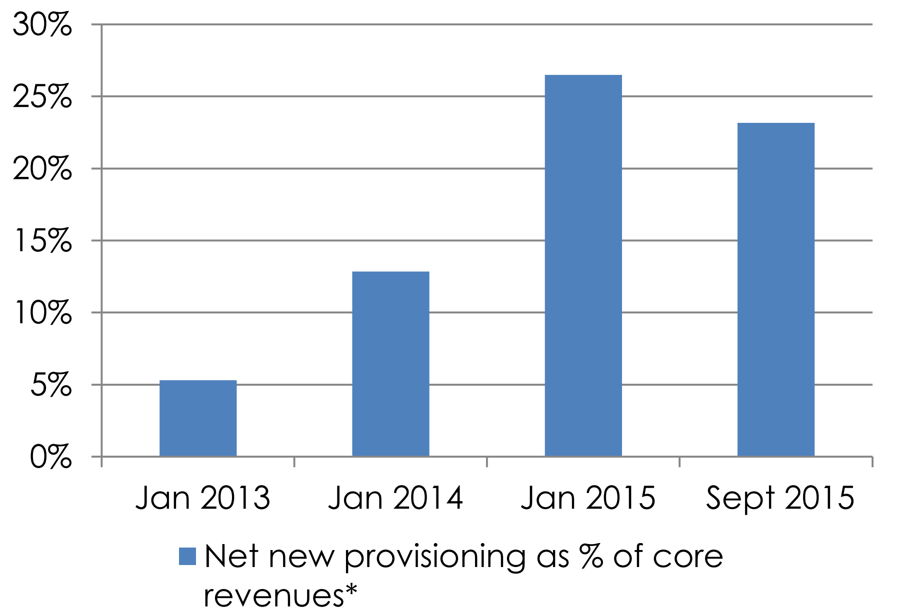
Source: CBR, RBI/Raiffeisen RESEARCH

- Scarcer lending possibilities; deteriorating franchise
- Costs of risks stay high
- Falling NIM
- Still, on the background of the low sector averages, there are significant differences among the individual banks' performance

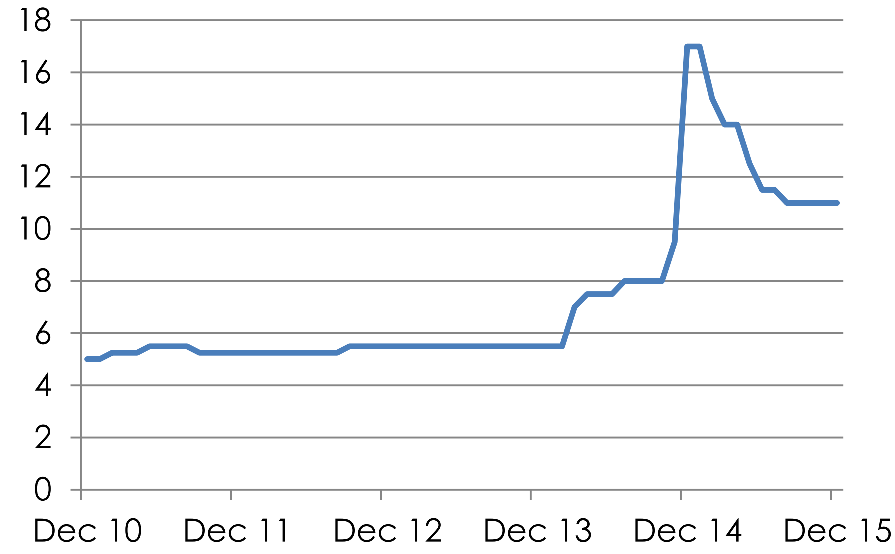
BANKING SECTOR – Risks resisted by regulatory support; more conservative business approach

Raiffeisen RESEARCH

"New" provisioning costs dynamics



CBR key rate (%)



Source: BIS, RBI/Raiffeisen RESEARCH

** Net new provisions: new provisions created minus restauration of former provisions on the revenue side*
Core revenues: interest income on loans and commission income
Source: Central Bank of Russia, RBI/Raiffeisen RESEARCH

- Macro-based risks for business environment escalate
- Credit risk trends are especially tough in retail banking; NPL reporting standards can mask the actual rusk status
- Funding risks pull out interest rate risks going forward, stemming from presumably large remaining maturity gaps
- The CBR is committed to improve solvency and clean-up the sector, and does this in a very neat and professional manner, so to avoid panic-driven crises or any other negative consequences of mopping away – now already quite large – insolvent players. Still, the regulatory forbearance phases out gradually.

BANKING SECTOR STANDING
Competitive landscape - massive changes in sight

Raiffeisen RESEARCH

- Increasing sector concentration
- Increasing grip of state-controlled and quasi-state-controlled ("state-overseen") groups (e.g. Otkritie)
- Foreign banks are likely to lower their market share on more cautious business stance; capital-related considerations
- Large private banks "of the past" are either falling now under the "state-overseen" cohort, or reduce their market weight notably, or fail
- Relatively small regional players remain niche-players

Distribution of profits and funding support

Number of banks in RU	
Jan-14	923
Jan-15	834
Sep-15	767

Profitability and CBR support across competitive cohorts, 9m 2015

	Banks' groups, ranked by asset size				
RUB mn	**1 - 5**	**6 - 20**	**21-50**	**51-200**	**total**
Profits	181 599	-47 716	-49 455	25 116	126 697
CBR support	3 889 668	1 021 342	451 066	325 247	5 757 642

Source: CBR, Interfax, RBI Raiffeisen RESEARCH

Systemically important banks in Russia

	Bank	**Market share in assets**
1	Sberbank	27.8%
2	VTB	16.0%
3	Gazprombank	6.0%
4	FC Otkritie	4.4%
5	Alfa Bank	2.4%
6	Russian Agricultural Bank	3.0%
7	UniCredit Bank	1.6%
8	Rosbank Group	1.4%
9	Promsviazbank	1.4%
10	Raiffeisenbank	1.1%
Market shares as of July 1, 2015		65.1%

Source: CBR, Interfax, RBI Raiffeisen RESEARCH

BANKING SECTOR STANDING – Competitive landscape Foreign–owned banks good resilience

Raiffeisen RESEARCH

- While the sector's averages are low, the more conservative risk-takers outperform the market now
- Foreign-owned banks continue to outperform the market in both NIM and RoE
- These banks traditionally have been more conservative in issuing loans at the high-yield – high risk side, and have been less involved into "rescue mission" at the peak of the crisis, than, for example, state-controlled rivals. The respective impact, with better asset quality and profitability ratios, is revealing now quite notably

Major patterns for FBs in Russia

- Contraction (up to leaving the market)
- Cost reduction
- Network restructuring
- Cherry-picking in lending

Source: RBI Raiffeisen RESEARCH

Major patterns for FBs in Russia

Aggregate Performance Parameters, Top-30 Russian banks

	2015e		**2014a**	
	NIM	**RoE**	**NIM**	**RoE**
Sberbank+VTB	3.5	4.3	4.7	9.8
State-controlled banks w/o Sber and VTB	1.8	-28.6	2.8	-11.3
Foreign-owned banks (Foreign subsidiaies)	4.1	2.8	5.1	6.9
RBI and UniCredit - weighted average, 9m	*3.9*	*17.3*	4.5	13.3
Consumer finance banks	7.3	-25.1	11.6	-22.1
Private banks w/o consumer finance banks	2.6	0.5	4.3	0.6
Top-30 in total	3.2	-0.9	4.5	4.2

Source: Standard & Poor's Rating Services, RBI Raiffeisen RESEARCH

Conclusion

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1. The Russian banking sector keeps posting inferior readings, broadly in line with our expectations.
2. Although we see a certain macroeconomic stabilisation in Russia at present, we remain very cautious in our expectations for the banking sector, going forward. Banking keeps feeling the pressure, and although the situation is generally stable in the sector now, it is weak and stable, so to say. It also largely leans on the state rescue measures and funding support.
3. Lending activity and profitability remain dampened by risks stemming from oil, geopolitical tensions and their negative spill-overs to the country's macroeconomic performance.
4. The asset side and profitability particularly reveal signs of strongly increasing pressure. Retail loan growth stays in negative territory, while solid corporate loan growth (LCY-expressed), is backed by state-induced support to systemic borrowers. Deterioration of asset quality goes on; with actual bad quality loans likely to exceed the reported ones (restructured loans, etc).
5. The system's ability to generate positive profits is fading away. RoE at 0.4%, RoA at 0% for 9m-2015 are the lowest readings since the start of 2008.
6. Foreign banks proved to be more resilient than the domestic peers, but the buffers are limited, and by large are contingent to the – possible – inferior economic development in the 12-18 months going forward.

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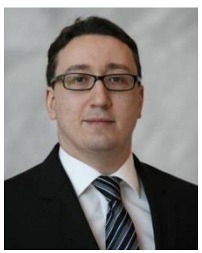

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See also our presentation on the Russian rouble - – Chronically ill or condemned to recover?

Raiffeisen RESEARCH

Market outlook:

- Higher external debt payments in December are a factor potentially weighting on RUB in Q4 2015, while the maturing of USD 20 bn of central bank FX repos during H1 2016 might as well add some uncertainty. However, market players and authorities are much better prepared in comparison to the rouble panic in Dec 2014.
- We see oil prices improving during 2016, which should support the rouble to some extent.

Fundamental (longer term) outlook:

- In coming years, we expect a smaller, but still positive current account, which will finance (remaining) structural capital outflows, while FX reserves do change only slowly. The most likely FX path would be slow depreciation, assuming a future of limited growth, limited inflation and political interest in a weaker currency.
- Risks to our "stagnation" scenario are renewed external shocks, entrenched inflation expectations and political risks, which would lead to faster depreciation. A return to pre-2014 levels looks unlikely.

See also our regional overview presentation - November 2015 edition

Raiffeisen RESEARCH

CEE Regional and Country Update – November 2015 edition

The general part of the presentation gives an overview over macro-economic trends in the Central and Eastern Europe (CEE) as well as our view on economic growth, inflation, exchange rates, central bank key rates and government bonds.

- **Economic growth**
- **Inflation**
- **Exchange rates**
- **Key rates**

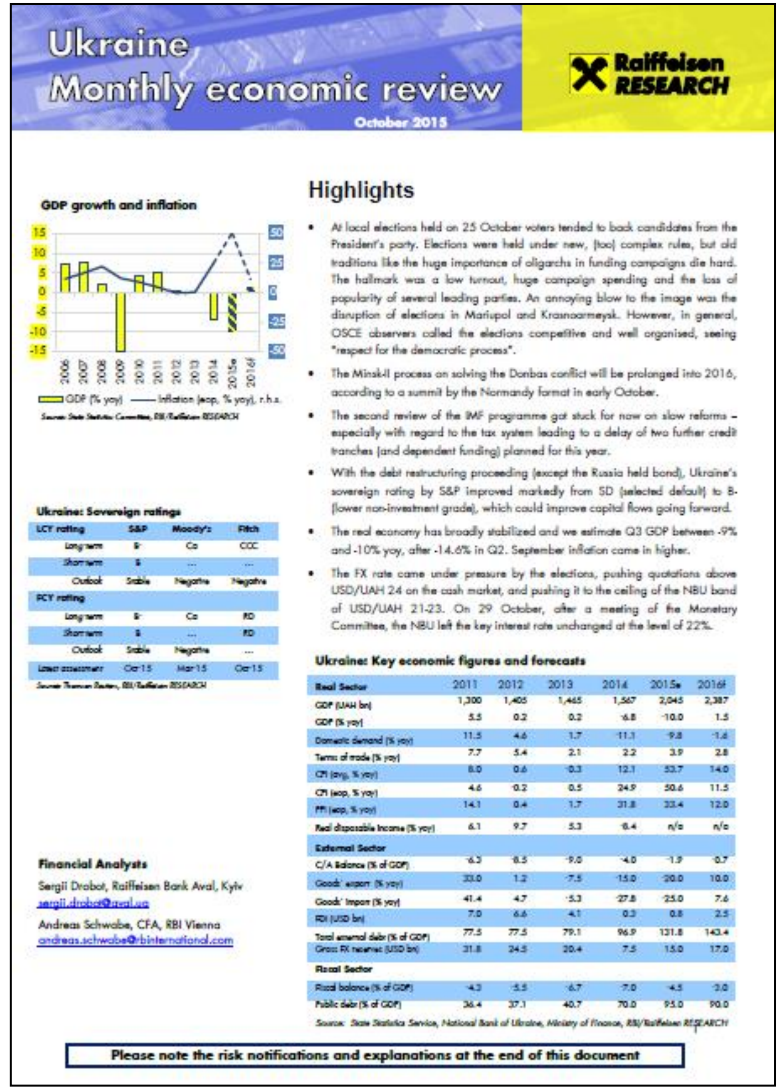
A second part consists of **country specific slides on 14 markets in the regions.**

See also our latest Research on Ukraine

Raiffeisen RESEARCH

CEE Economics: Ukraine Economic Review (Oct 2015)

- **At local elections on 25 October** voters tended to back the President
- **Minsk-II process** to be prolonged into ‘16
- **Second review of the IMF programme** got stuck for now on slow reforms
- **Agreed debt restructuring** (except the Russia held bond), Ukraine’s sovereign rating improved markedly
- **Real economy has broadly stabilized** and we estimate Q3 GDP between -9% and -10% yoy, after -14.6% in Q2. September inflation came in higher.
- **FX rate came under pressure** by the elections, pushing quotations above USD/UAH 24 on the cash market, and pushing it to the ceiling of the NBU band of USD/UAH 21-23.



Ukraine

Monthly economic review

October 2015

Raiffeisen RESEARCH

GDP growth and inflation

Source: State Statistics Committee, RBI/Raiffeisen RESEARCH

Highlights

- At local elections held on 25 October voters tended to back candidates from the President's party. Elections were held under new, (too) complex rules, but old traditions like the huge importance of oligarchs in funding campaigns die hard. The hallmark was a low turnout, huge campaign spending and the loss of popularity of several leading parties. An annoying blow to the image was the disruption of elections in Mariupol and Krasnoarmeysk. However, in general, OSCE observers called the elections competitive and well organised, seeing "respect for the democratic process".
- The Minsk-II process on solving the Donbas conflict will be prolonged into 2016, according to a summit by the Normandy format in early October.
- The second review of the IMF programme got stuck for now on slow reforms – especially with regard to the tax system leading to a delay of two further credit tranches (and dependent funding) planned for this year.
- With the debt restructuring proceeding (except the Russia held bond), Ukraine's sovereign rating by S&P improved markedly from SD (selected default) to B- (lower non-investment grade), which could improve capital flows going forward.
- The real economy has broadly stabilized and we estimate Q3 GDP between -9% and -10% yoy, after -14.6% in Q2. September inflation came in higher.
- The FX rate came under pressure by the elections, pushing quotations above USD/UAH 24 on the cash market, and pushing it to the ceiling of the NBU band of USD/UAH 21-23. On 29 October, after a meeting of the Monetary Committee, the NBU left the key interest rate unchanged at the level of 22%.

Ukraine: Sovereign ratings

LCY rating	S&P	Moody's	Fitch
Long-term	B-	Ca	CCC
Short-term	B	...	...
Outlook	Stable	Negative	Negative
FCY rating			
Long-term	B-	Ca	RD
Short-term	B	...	RD
Outlook	Stable	Negative	...
Latest assessment	Oct-15	Mar-15	Oct-15

Source: Thomson Reuters, RBI/Raiffeisen RESEARCH

Ukraine: Key economic figures and forecasts

Real Sector	2011	2012	2013	2014	2015e	2016f
GDP (UAH bn)	1,300	1,405	1,465	1,567	2,045	2,387
GDP (% yoy)	5.5	0.2	0.2	-6.8	-10.0	1.5
Domestic demand (% yoy)	11.5	4.6	1.7	-11.1	-9.8	-1.6
Terms of trade (% yoy)	7.7	5.4	2.1	2.2	3.9	2.8
CPI (avg, % yoy)	8.0	0.6	-0.3	12.1	53.7	14.0
CPI (eop, % yoy)	4.6	-0.2	0.5	24.9	50.6	11.5
PPI (eop, % yoy)	14.1	0.4	1.7	31.8	33.4	12.0
Real disposable income (% yoy)	6.1	9.7	5.3	-8.4	n/a	n/a
External Sector						
C/A Balance (% of GDP)	-6.3	-8.5	-9.0	-4.0	-1.9	-0.7
Goods' export (% yoy)	33.0	1.2	-7.5	-15.0	-20.0	10.0
Goods' import (% yoy)	41.4	4.7	-5.3	-27.8	-25.0	7.6
FDI (USD bn)	7.0	6.6	4.1	0.3	0.8	2.5
Total external debt (% of GDP)	77.5	77.5	79.1	96.9	131.8	143.4
Gross FX reserves (USD bn)	31.8	24.5	20.4	7.5	15.0	17.0
Fiscal Sector						
Fiscal balance (% of GDP)	-4.3	-5.5	-6.7	-7.0	-4.5	-3.0
Public debt (% of GDP)	36.4	37.1	40.7	70.0	95.0	90.0

Source: State Statistics Service, National Bank of Ukraine, Ministry of Finance, RBI/Raiffeisen RESEARCH

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

Recommendation history

Bonds

Financial instruments/Company	Date of the first publication
Eurobonds	01/01/2001
LCY bonds	01/01/1997

Recommendations history: Local currency government bonds (I: no change)*

Date of change	CZ			CZK	HU			HUF	PL			PLN	RO			RON	RU			RUB	TR			TRY
	2y	5y	10y		2y	5y	10y		2y	5y	10y		2y	5y	10y		2y	5y	10y		2y	5y	10y	
09/12/2014	Hold	Hold	Buy	Hold	Hold	Hold	Hold	Sell	Buy	Buy	Buy	Hold	Buy	Hold	Hold	Hold	Sell	Sell	Sell	Sell	Buy	Buy	Buy	Buy
09/02/2015	I	I	Hold	I	Buy	Buy	Buy	I	Hold	Hold	Hold	I	Buy	Buy	Buy	I	I	I	I	I	I	I	I	I
24/03/2015	I	I	I	I	I	Hold	Hold	I	I	I	I	Sell	I	I	I	I	Hold	I	I	I	I	Hold	Hold	Sell
28/04/2015	I	I	I	I	I	I	I	I	I	I	I	Hold	Hold	Hold	Hold	Hold	Buy	Hold	Hold	I	I	I	I	Hold
15/05/2015	I	Buy	Buy	I	I	I	I	I	I	I	I	I	I	I	I	I	I	I	I	I	I	I	I	I
02/06/2015	I	Hold	Hold	I	Hold	I	I	Hold	I	I	I	I	I	I	I	I	I	I	I	Hold	I	Buy	Buy	Buy
24/06/2015	I	I	Buy	I	I	I	Sell	I	I	I	Sell	I	I	I	Sell	I	I	Buy	Buy	I	Sell	Sell	Sell	Sell
06/08/2015	I	I	Hold	I	I	Sell	I	I	I	Sell	I	I	I	Sell	I	I	Hold	Hold	Hold	I	Hold	I	I	Hold
03/09/2015	I	I	I	I	I	I	I	I	I	I	I	I	I	I	I	I	I	I	I	Buy	I	I	I	Buy
22/09/2015	I	I	I	I	I	I	I	I	I	I	I	I	I	I	I	I	I	I	I	I	Sell	I	I	I
04/11/2015	I	I	I	I	Buy	Buy	Buy	I	I	Hold	Hold	I	I	Hold	Hold	I	I	I	I	Hold	Hold	Hold	Hold	Hold
17/12/2015	I	I	I	I	I	I	I	Buy	Buy	Buy	I	I	Buy	Buy	Buy	Buy	Buy	Buy	I	Buy	I	I	I	I

* *recommendations based on absolute expected performance in LCY; FX vs EUR; Source: RBI/Raiffeisen RESEARCH*

Recommendation history

Raiffeisen RESEARCH

Recommendations history: Sovereign Eurobonds (I: no change)*

	RU		RS		SK		SI		TR		UA		BY	
Date of change	**EUR**	**USD**	**EUR**	**USD**	**EUR**	**USD**	**EUR**	**USD**	**EUR**	**USD**	**EUR**	**USD**	**EUR**	**USD**
16/09/2014	Hold	Hold	–	Hold	–	–	–	–	Buy	Buy	Sell	Sell	–	Hold
09/12/2014	Sell	Sell	–	I	–	–	–	–	Hold	Hold	I	I	–	I
09/02/2015	I	I	–	Sell	–	–	–	–	I	I	I	I	–	Sell
05/03/2015	Hold	Hold	–	Hold	–	–	–	–	I	I	I	I	–	I
24/03/2015	Buy	Buy	–	Hold	–	–	–	–	I	I	I	I	–	Hold
17/04/2015	Hold	Hold	–	I	–	–	–	–	I	I	I	I	–	I
28/04/2015	I	I	–	I	Hold	–	Buy	–	Buy	Buy	Hold	Hold	–	Buy
02/06/2015	I	I	–	Sell	I	–	I	–	I	I	I	I	–	I
24/06/2015	I	I	–	I	I	–	I	–	I	Hold	I	I	–	I
06/08/2015	I	I	–	I	I	–	Hold	–	Hold	I	Sell	Sell	–	Sell
03/09/2015	I	I	–	I	I	–	I	–	I	I	Hold	Hold	–	I
22/09/2015	I	I	–	I	I	–	I	–	Sell	Sell	I	I	–	I
07/10/2015	I	I	–	I	I	–	I	–	I	I	I	I	–	I
04/11/2015	Buy	Buy	–	I	I	–	I	–	Hold	Hold	–	I	–	Hold
03/12/2015	Hold	Hold	–	I	I	–	I	–	I	I	–	Sell	–	I
17/12/2015	I	I	–	I	I	–	I	–	Buy	Hold	–	I	-	I

** recommendations based on absolute expected performance, i.e. expected spread change, under revision; Source: RBI/Raiffeisen RESEARCH*

EXCHANGE RATES AND KEY RATES
5y highs and lows

Raiffeisen RESEARCH

Country	EUR/LCY		USD/LCY		Key rate (%)	
	5y high	5y low	10y high	5y low	10y high	5y low
Poland	4.57	3.84	4.04	2.64	4.75	1.50
Hungary	322.62	262.27	294.34	177.61	7.00	1.35
Czech Rep.	28.37	23.99	26.01	16.24	0.75	0.05
Slovakia	-	-	0.95	0.67	1.50	0.05
Slovenia	-	-	0.95	0.67	1.50	0.05
Croatia	7.72	7.36	7.29	4.95	-	-
Bulgaria	1.96	1.95	1.86	1.31	0.22	0.01
Romania	4.64	4.07	4.23	2.75	6.25	1.75
Serbia	123.72	96.71	114.81	66.75	12.50	4.50
Bosnia and H.	1.96	1.96	1.87	1.31	-	-
Albania	143.02	136.15	133.82	95.81	-	-
Russia	84.96	38.43	70.95	27.28	17.00	5.50
Ukraine	37.78	9.74	33.75	7.89	30.00	6.50
Belarus	20,366.00	3,882.00	18,330.00	3,000.00	45.00	12.00
Turkey	3.46	2.02	3.06	1.51	10.00	4.50
Eurozone*	1.49	1.05	0.95	0.67	1.50	0.05

data as of 17 Dec-2015, 19:43 CET

* EUR/LCY is EUR/USD; Source: Bloomberg

LCY T-BOND YIELDS
5y highs and lows

Raiffeisen RESEARCH

Country	2y T-bond yields (%)*		10y T-bond yields (%)	
	5y high	5y low	10y high	5y low
Poland	5.13	1.47	6.37	1.98
Hungary	10.21	1.52	10.69	2.72
Czech Rep.	2.04	-0.40	4.36	0.36
Slovakia	-	-	4.88	0.36
Slovenia	-	-	6.80	0.79
Croatia	6.30	1.59	4.27	3.90
Bulgaria	4.09	0.34	5.65	2.11
Romania	7.32	1.21	7.64	2.62
Serbia	-	-	-	-
Bosnia and H.	-	-	-	-
Albania	-	-	-	-
Russia	17.50	5.48	15.79	6.69
Ukraine	-	-	-	-
Belarus	-	-	-	-
Turkey	11.30	4.90	11.05	6.01
Eurozone	1.91	-0.45	3.49	0.07
USA	1.00	0.16	3.74	1.39

data as of 17 Dec-2015, 19:43 CET

* HU 3y; Source: Bloomberg

Risk notifications and explanations

Raiffeisen RESEARCH

Kindly note that research is done and recommendations are given only in respect of financial instruments which are not affected by the sanctions under EU regulation no 833/2014 as amended, i.e. financial instruments which have been issued before 1 August 2014.

We may remind you that the acquisition of financial instruments with a term exceeding 30 days issued after 31 July 2014 is prohibited under EU regulation no 833/2014 as amended. No opinion is given with respect to such prohibited financial instruments.

Warnings

- Figures on performance refer to the past. Past performance is not a reliable indicator of the future results and development of a financial instrument, a financial index or a securities service. This is particularly true in cases when the financial instrument, financial index or securities service has been offered for less than 12 months. In particular, this very short comparison period is not a reliable indicator for future results.
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