

February 2012: chill-out of economic activity



Table of contents:

Leading indicators	2
Current economic environment	3
Appendices:	
Economic situation abroad	5
Commodity markets	6
Money and fixed income markets	7
Stock markets	8

▶ 2011: a very modest success

Over the last year, Russian policy-makers succeeded in driving consumer inflation down to 6.1% - an absolute low in the modern history. However, on the reverse side of the medal, we observed very modest growth in the real sector. According to preliminary estimates of Rosstat, GDP in 2011 rose by 4.3%, almost trailing the original forecast made by the Ministry for Economic Development on December 17, 2010 (4.2%) - despite the average oil price topping the initial projection by almost 35%.

Moreover, as economic activity finally recovered to its pre-crisis levels by the end of the last year, productive capacity remained little changed as corporates were reluctant to execute capital investment in excess of amounts necessary to sustain existing capacity in working order. This fact leaves little room for any acceleration in GDP growth.

External conditions (aside of commodity prices) were unkind to Russia in 2011. Higher risk aversion and increased volatility spurred a massive outflow of capital from Russia: according to the CBR's estimates, financial account deficit amounted to \$75.3 bln, while private sector moved more than \$84 bln abroad, with almost 45% of that amount fleeing the country in 4Q11. As a result, Russian ruble lost 5.0% vs. USD and 3.5% against the CBR's dual-currency basket by the end of the year.

▶ 2012: setting the scenes

Financial markets across the globe rallied in January, and Russia has not become an exception. The slowdown of capital flight due to certain progress in euro crisis resolution and high commodity prices actually contributed to ruble appreciation against both US dollar (by 6.5%) and euro (by 5.1%). However, indicators of economic activity have remained mixed YTD: manufacturing seemed to slow down in January while economic activity in the services sector, on the contrary, accelerated.

▶ ST forecasts:

- External sector and exchange rates.** We anticipate no major shocks to the price of oil in the near future: Urals is expected to fluctuate in the range \$110–115. This, together with the seasonal slowdown in imports dynamics, is expected to contribute to positive trade balance of approximately \$19.7 bln in February. The direction of capital flows is subject to any progress in Greece's negotiations with creditors on the terms of debt restructuring, but at the moment, we do not anticipate an adverse scenario under which the parties would fail to agree on the bond swap conditions. Therefore, we expect ruble to average at ca. RUB 30.0 per USD, and actually anticipate some strengthening during the tax payment period (February 15–28).
- Real sector and price level.** Inflation risks over the next few months are likely to be subdued: tariffs of natural monopolies will only be hiked in July, postponing adverse effects on the general price level. Besides, the high base effect will contribute to further decline in YoY figures over 1H11. As we do not expect any surge in consumer demand, inflation in February can amount to 0.5–0.6%, pushing YoY value towards 4.0%. However, RDI dynamics at the beginning of the year is traditionally weak: we expect real incomes to add 2.0–2.5% YoY. However, retail sales may increase by as much as 6.0% as consumer confidence remains fairly strong and lending continues to grow. Capex and industrial production are expected to add 1.4% and 5.4% respectively.

Key indicators: February forecast

Indicator	February 2012E	2012E	
		MED	GPB Research
Real sector			
GDP, YoY	–	3.7%	3.5%
Industrial production, YoY	5.4%	3.4%	3.5%
Capital investments, YoY	1.4%	7.8%	6.5%
Retail sales, YoY	6.1%	5.5%	5.0%
Private sector			
Real income, YoY	2.3%	5.0%	4.5%
Accrued salary, RUB	–	–	25,274
External sector			
Trade balance, \$ bln	19.7	135.7	124.3
Average oil price (Brent), \$/bbl, av.	112	100	104
Exchange rate, inflation and rates levels			
Inflation (CPI), YoY	4.2%	5.0–6.0%	6.0%
Refinancing rate, eop	8.0%	–	–
Dual-currency basket, RUB (avg.)	34.1	–	35.9
Exchange rate, RUB/USD (avg.)	30.0	28.7	30.9
– no forecast available			

Source: MED, Gazprombank estimates

Leading indicators

▶ Money and credit

Monetary indicators in December were somewhat mixed. Despite a modest slowdown in corporate lending (+ 1.5% MoM), consumer credit rose by 4.0% MoM, indicating higher reliance of population on borrowed funds. At the same time, a seasonal hike in the monetary base by the end of the year was accompanied by slower rise in the money supply. Although bank multiplier effect could be impeded by ruble depreciation, we believe that calendar factors also affected the indicator's performance: notably, in December 2010 the multiplier exhibited a similar pattern.

▶ Industrial production

Latest data on energy consumption and industrial output exhibit a certain degree of discrepancy. However, we believe that the 1.6% decline in power consumption in December could be attributed to warmer weather, while in January industrial production may outpace the 0.1% increase in energy utilization - even if only due to calendar effects (more working days in January 2012).

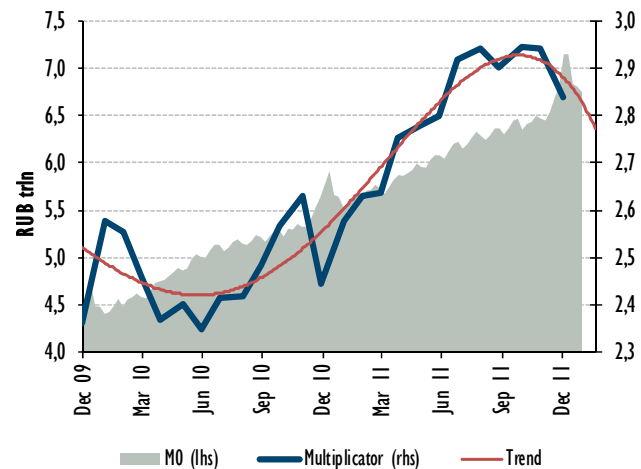
▶ Economic activity

Whereas new local orders continued to increase at a modest pace in January, export requests at the beginning of the year experienced the most severe drop since July, contributing to a marked slowdown in production. As a result, Russian manufacturing PMI declined to 50.8, but managed to stay above the 50-point threshold, indicating that optimism so far prevails among producers. Seasonally-adjusted trend, however, remained almost flat and is set to actually start falling.

In the services sector, confidence was sufficiently higher as new businesses accelerated and unemployment declined. The sector's PMI reached a 6M high in January at 56.5, but this was not enough to make the long-term trend rise.

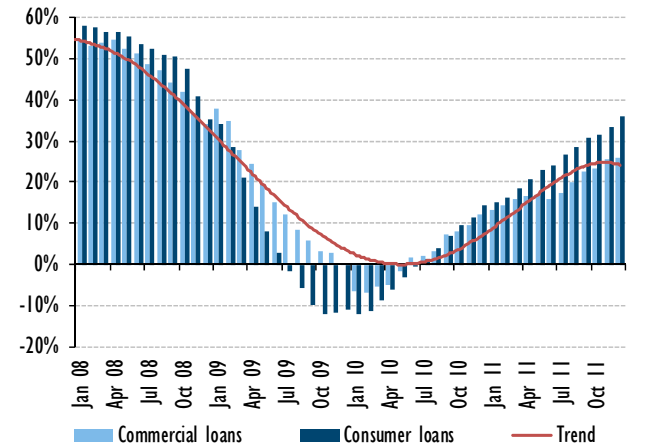
Shipping accelerated in December to 3.3% MoM due to seasonal hike in economic activity on the eve of public holidays, adding to the 3.4% overall growth of transportation in 2011. However, at the beginning of the year, economic activity traditionally tumbles (in part – due to calendar effects, such as lower number of working days), therefore we do not expect any surge in transportation and production volumes.

Monetary base and multiplier (M2/M0)



Source: CBR, Gazprom bank estimates

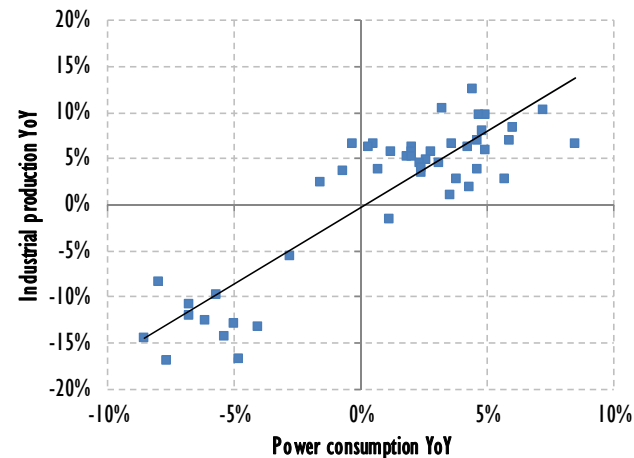
Lending volume*, % YoY



* Total loan portfolio increment over the last 12 months

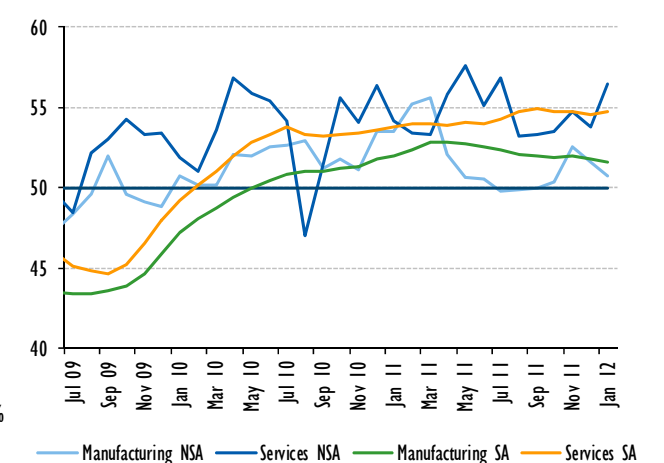
Source: CBR

Power consumption vs. industrial production, % YoY



Source: System Operator, Rosstat

Russia's PMI, points



Source: Bloomberg

Current economic environment

Production and output

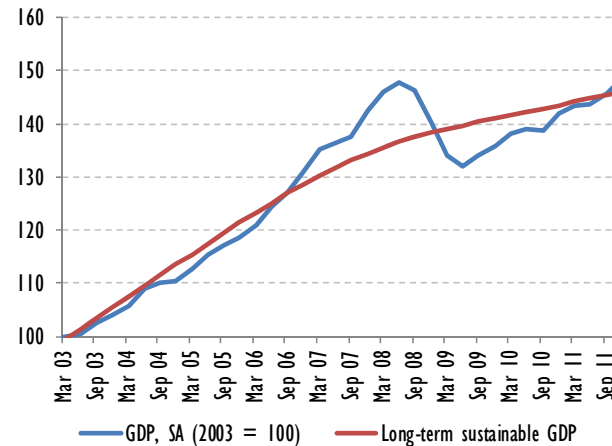
According to Rosstat's preliminary estimates, GDP in 2011 rose by 4.3%, almost trailing the original forecast made by the Ministry for Economic Development on December 17, 2010 (4.2%) – despite the average oil price topping the initial projection by almost 35%. Moreover, as economic activity finally recovered to its pre-crisis levels by the end of the last year (although quarterly data for 2009 and 2010 are still subject to revisions in March 2012), productive capacity remained little changed as corporates were reluctant to execute capital investment in excess of amounts necessary to sustain existing capacity in working order: capex in 2011 increased by 6.2% YoY while industrial output added 4.7%. This fact leaves little room for any acceleration in GDP growth in the long run, although deviations from LT equilibrium are possible in the short run due to accommodative fiscal and monetary policy.

External sector

Import growth rates slowed down considerably by the end of 2011 as a result of sluggish consumption and investment demand, depressed further by ruble weakening in 2H11. External trade surplus traditionally widens in January-February due to seasonal influences (such as a decline in import volumes MoM), but this might not necessarily be the case in 2012. The recent survey of producer sentiment pointed to a decline in export orders (the sharpest since July 2011), which may result in more conservative exports value. However, the long-term structure of contracts, low susceptibility of commodities demand to shocks, and cold weather are likely to limit the potential adverse impact on the trade balance.

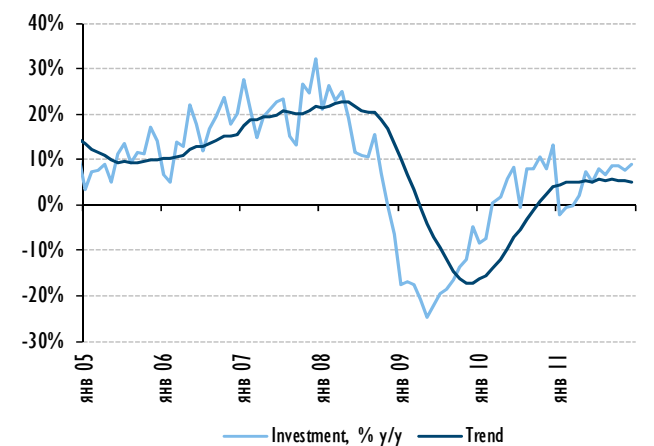
Ruble strengthened considerably in January: US dollar lost 5.6% of its value over the month, while euro ended up 5.1% cheaper than at the end of the last year. High demand for ruble came from two sources: local banks faced shortage of liquidity during the period of tax payments, and foreign players gradually increased their exposure to Russia as global risks eased a little.

Russian economy has reached full capacity level



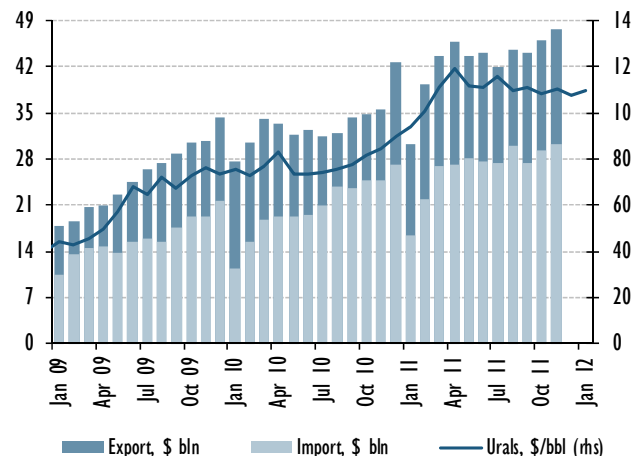
Source: Rosstat, MED, GPB calculations

Investment in working capital, % YoY: only slightly above trend



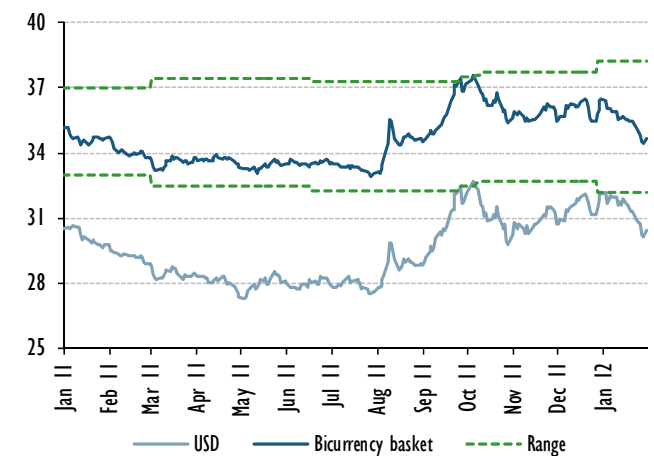
Source: Rosstat, Gazprombank calculations

Russia's trade balance vs. oil prices



Source: Bloomberg, CBR, MED

Ruble exchange rates



Source: Bloomberg, CBR

► Exchange rate

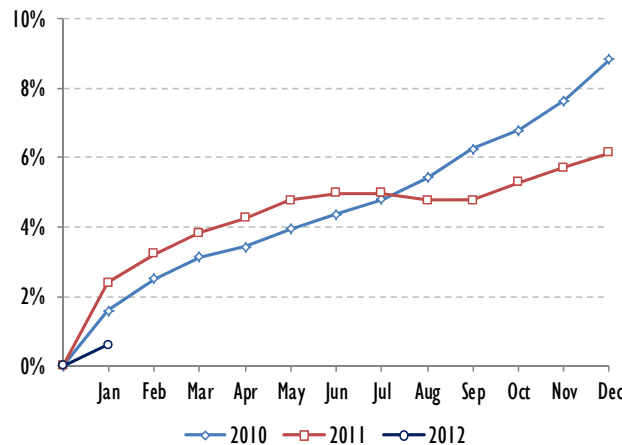
In 2011, the CBR undertook a number of steps towards inflation targeting, citing a shift in policy objectives away from control over the exchange rate. In particular, the range of acceptable dual-currency values was widened to 5, and then – to 6 RUB (at the moment, the upper and lower boundaries for the gauge are RUB 38.2 and RUB 32.2 respectively). The regulator has also diminished its interventions in the forex market. However, our indices of currency freedom continue to indicate limited flexibility of exchange rate determination: both the EMPR index (which measures the percentage change in ruble exchange rate against the value of currency bought/sold by the CBR) and ITIR (a similar index, adjusted for the impact of other monetary tools – such as interest rates – on exchange rate) continue to fluctuate beneath the 50-point threshold, whereas 100 points stands for free float while 0 is a rigid peg of domestic currency to a benchmark.

► Consumption and price dynamics

Real disposable incomes in December rose at the fastest pace in more than a year, adding 6.3% YoY. However, the seasonal hike in the last month of the year couldn't mask the overall stall in personal earnings: the indicator rose by only 0.8% in 2011 despite the feasible slowdown of inflation. Yet, retail sales (+7.2% in 2011) were largely unaffected by stumbling incomes as declining unemployment and rising confidence prompted consumers to rely more heavily on lending when executing purchases of goods and services. This, however, did not prevent retail sales turnover from growing at an almost 2-digit pace: the indicator of consumer demand increased 9.2% YoY in September.

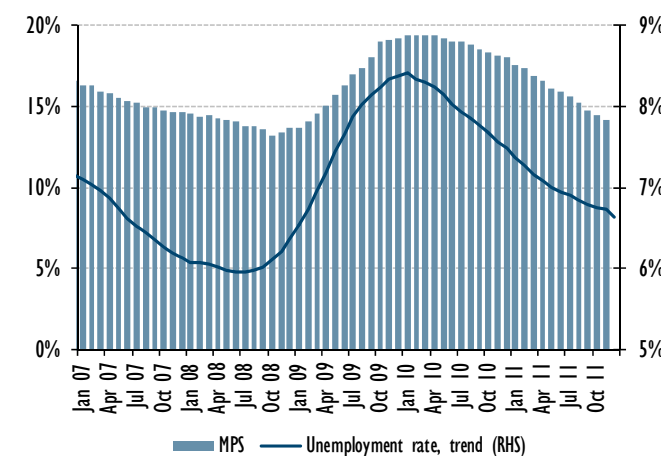
Consumer prices in January added ca. 0.6% (a year ago prices rose by 2.4% over the comparable period of time), mostly due to postponement of tariffs indexation until mid-summer and the high-base effect. The official estimates for 2011 range from 5.0% to 6.0%, but we believe that keeping inflation low is going to be a more challenging task than driving it down to 6.1% last year, unless economic growth slowdown is greater than we anticipate.

Comparative YTD inflation rates in 2010–12



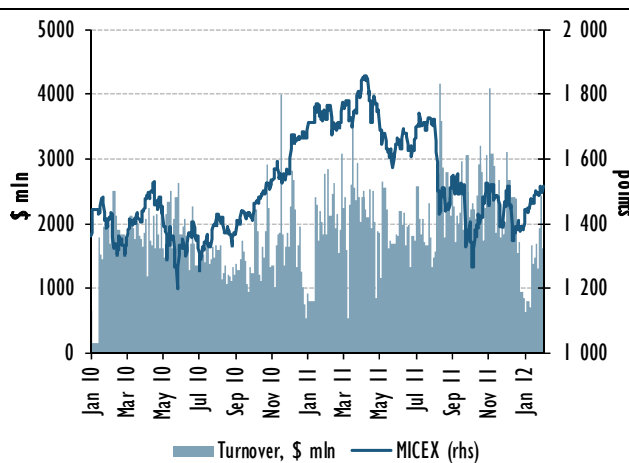
Source: Rosstat, Gazprombank estimates

Consumer confidence indicators



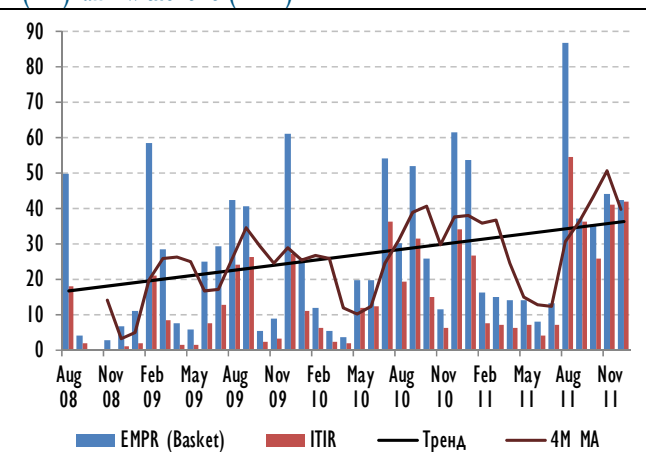
Source: Rosstat

Stock market dynamics



Source: Bloomberg

Index of exchange rate 'freedom': with adjustment for policy mix (ITIR) and without it (EMPR)



Source: CBR, GPB calculations

Appendices

1. Economic situation abroad

► Europe: still the major newsmaker

Although investors' attitude towards European problems improved materially in January, the situation in the region remains largely unstable. European leaders at the end of January agreed on accelerating the enactment of the permanent rescue fund (the European stability mechanism – ESM): under the new schedule, the facility (whose initial size is set at 500 bln euro) will start operating by mid-2012, ahead of the original plan to launch it in 2013. Moreover, European countries authorized new fiscal rules (which are now subject to parliamentary approval on national levels). However, the UK refused to join the pact, undermining the political integrity within the EU.

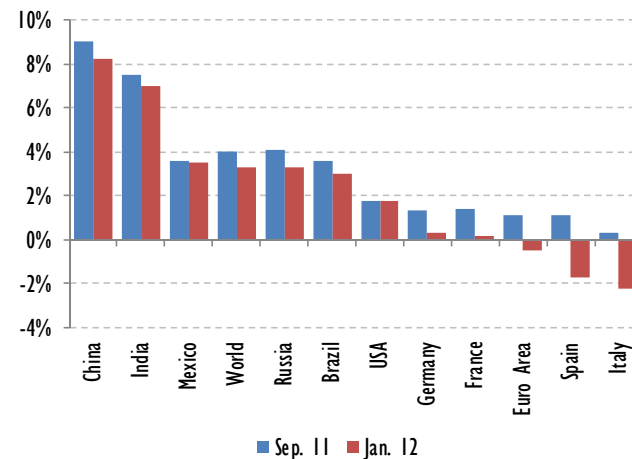
The key problem – namely, Greek debt restructuring deal – so far remains unresolved. Yet the time is running out: the final agreement between the country and its private creditors must be reached no later than February 13 to ensure the timely receipt of funds necessary to redeem as much as 14.5 bln euro on March 20.

► US: not as bad as it seemed

The latest macro data suggest that the US economy may be in a rather good shape: presumably, much better than many have expected. Non-farm payrolls rallied by 243K in January, sending the unemployment rate down to 8.3% (the lowest value since February 2009), while manufacturing activity in most of the federal districts has improved since the beginning of the year. Moreover, the US appeared to be virtually the single exception to the downward revision of GDP forecasts by the IMF: its economy is still expected to grow by 1.8% in 2012 while the eurozone is projected to face a recession (-0.5%, down from +1.1%) and the global output is anticipated to add only 3.3% (down from 4.0% expected back in September).

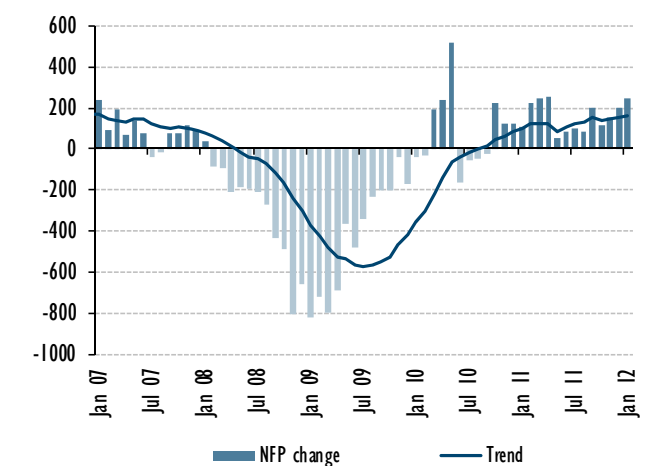
The Fed at its first scheduled meeting this year provided additional support to the markets by extending the period of exceptionally low interest rates until late 2014. Moreover, the FRS does not rule out new stimulus measures in case economic indicators provide signs of economic slowdown.

IMF forecasts of GDP across the key economies: a notable downgrade



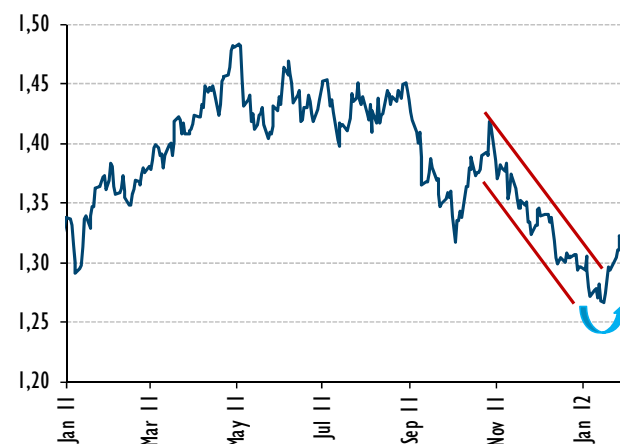
Source: Bloomberg

Change in non-farm payrolls, thousand



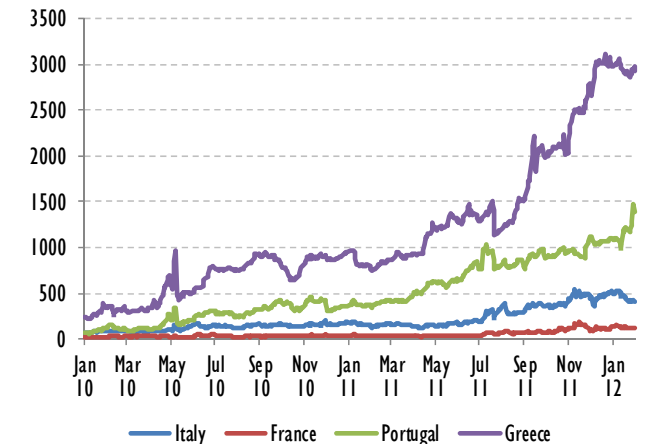
Source: Bloomberg, Gazprombank calculations

EUR/USD rate dynamics



Source: Bloomberg

European sovereign bond yield spreads dynamics (w.r.t. German Bunds of comparable maturity)



Source: Bloomberg, GPB calculations

2. Commodity markets

► Fundamentals

Oil price fundamentals remained somewhat mixed at the beginning of 2012. EU embargo on Iranian oil and political unrest in Nigeria threatened supplies of commodities, providing some support to oil prices. However, Saudi Arabia seems to possess enough reserve capacity to compensate for any disruptions with deliveries from Iran (who has threatened to cut shipments immediately in response to sanctions that would only become effective by mid-year). Therefore, the impact on crude prices was limited to short-term fluctuations.

China manufacturing activity topped estimates in January 2012: PMI unexpectedly exceeded the 50-point threshold, indicating a modest improvement in producers' sentiment. However, the positive influence of this data on prices was limited by the US reserve statistics: according to official DoE estimates, crude inventories rose to a 3-month high in early 2012.

As a result, Brent futures curve at the moment remains inverted; however, no sharp decline in prices is envisaged by market participants. Moreover, the curve shifted up by \$3–4, depending on the contract maturity, as compared to the end of December terms.

► Other determinants

Dollar exchange rate against currencies of major trading partners of the USA was rather volatile in January, but the resulting appreciation appears to be modest (ca. 1.0%). As a result, its impact on commodity prices, in our opinion, remains weak, with fundamentals playing the key role in equilibrium price determination.

► Metals and other indicators

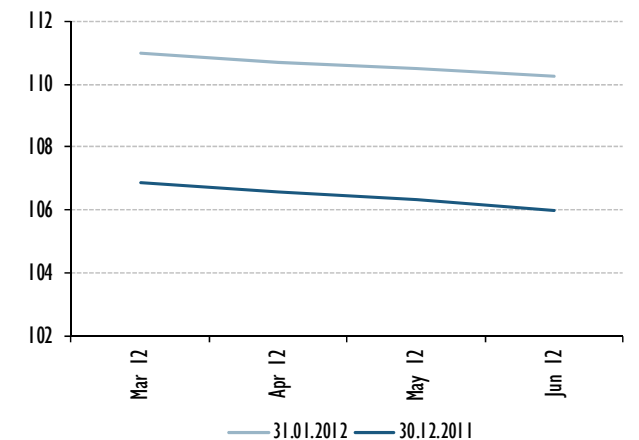
Baltic Dry Index lost 63% of its value YTD: the cost of freight is equivalent to fuel charges for the first time in 25 years. Although in January cargo shipments were impeded by declining demand for iron ore and coal from China ahead of New Year celebration (January 23–29), overcapacity in all vessel classes continues to weigh heavily on freight costs.

Urals price dynamics, USD/bbl.



Source: Bloomberg

Brent futures, USD/bbl.



Source: Bloomberg

Base metal price indices, points



Source: Bloomberg

Baltic Dry Index (shipping rates), points



Source: Bloomberg

3. Money and fixed income markets

▶ Money & FI markets abroad

Indicators of dollar liquidity were gradually improving throughout January, but are still far from the “normal” levels. TED-spread has narrowed to 50 bps – the level last observed in mid-November; 1-year interbank borrowing costs (LIBOR) declined to 1.1% (-3 bps).

In the eurozone, however, an improvement in the money markets was more evident. 12M LIBOR for loans denominated in euros fell sharply from 1.91% at the end of 2011 to 1.71% by early February (-20 bps YTD). A sizeable decline in the cost of borrowing in euros became attainable after the ECB provided European banks with long-term loans at the end of the last year, despite the fact that a significant share of these funds was deposited back with the ECB. In total, 523 banks received 489.2 bln euro, redeemable in 3 years.

Yields of 10-year UST remained below the 2.0% threshold YTD, indicating subdued appetite for risk. Yield spreads between troubled eurozone sovereigns’ debt and German Bunds exhibited mixed dynamics: successful Italian and Spanish bond auctions drove their YTM down while costs of borrowing for Portugal increased in comparison to the benchmark as investors feared that the country might follow suit of Greece.

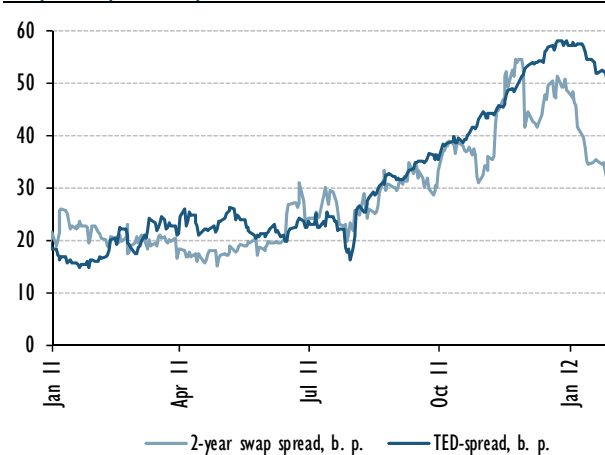
▶ Russian money & FI markets

The liquidity position of Russian banks improved at the very end of 2011 with the traditional inflow of funds from the federal budget. The NLP has occasionally returned to the positive territory, although during the tax period (January 15–28) it generally remained negative.

Despite the less than abundant ruble liquidity, banks filed a record amount of orders for long-term OZF auctioned on February 1. Total demand for the security with 9 years until maturity amounted to RUB 192 bln, exceeding the supply 5.5 times. Presumably, foreign investors bought a significant share of the issue as YTD ruble appreciation and easing global threats improved the attractiveness of liquid ruble-denominated assets.

Russian eurobonds also rallied in 2012: the spread between Russia 30 and 10-year UST shrunk by 35 bps in January – to 235 bps.

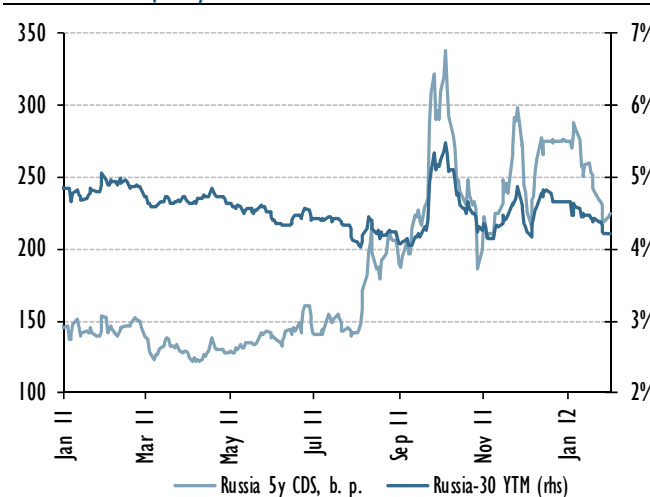
Key MM spreads, bps



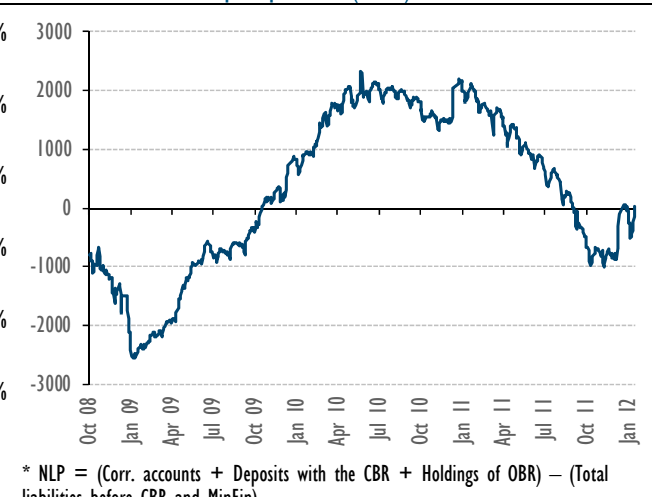
1y LIBOR and 10y US Treasuries yield



Russia credit quality indicators



Russian banks' net liquid position (NLP*), RUB bln



* NLP = (Corr. accounts + Deposits with the CBR + Holdings of OBR) – (Total liabilities before CBR and MinFin)

4. Stock markets

The start of the year was rather successful for most of the stock markets worldwide as negative sentiment eased a bit and exceptionally low fundamental valuations made equities attractive for investors. DM indices added 2.0-10% in January, while EM gauges rose by 1.0-11.0%.

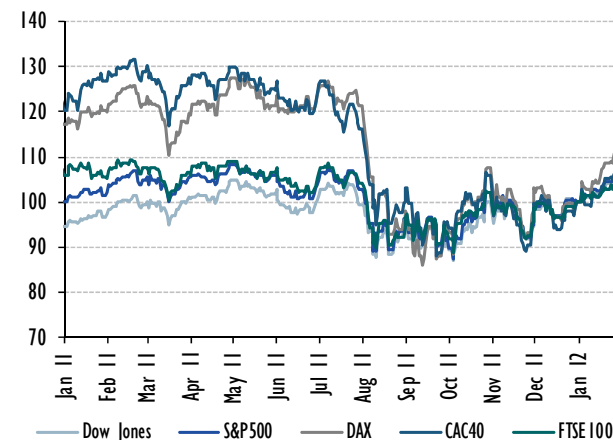
However, selective statistics were not that supportive. US GDP in 4Q11 missed estimates: the gauge increased 2.8% QoQ while consumption rose by only 2.0%. The reporting period, although generally provided a positive surprise (financials of approximately 2/3 of the companies who have already presented their 4Q11 results beat analysts' estimates and the average surprise amounted to 2.9%), EPS growth last quarter was probably limited to 3.3% – the slowest pace in more than 2 years of record.

Implied volatility in markets subsided gradually throughout January, although at a slower pace than in 4Q11, as indicated by the VIX index in the US and VSTOXX index in Europe. However, most of the indicators point at fragile appetite for risk (although there has been a temporary decline in demand for UST after the EU summit, 10-year UST remain at levels below 2.0%).

The dead end in negotiations between Greek officials and private creditors so far remains the major obstacle to a full-scale rally in financial markets. The time is obviously running out: in order to secure the transfer of funds to Hellenic Republic, which has to redeem EUR 14.5 bln of bonds on March 20, the terms of debt restructuring must be tailored no later than February 13. People familiar with the matter have said that a tentative agreement includes the exchange of maturing bonds for new debt instruments with 20–30 years till maturity and an average coupon rate of 3.6%. This implies a haircut of approximately 70% in present value terms.

Russian stock market, being severely oversold by the end of 2011, has been one of the best performers among the EMs. MICEX added 7.9% in January while RTS rose by 14.2%, supported by ruble appreciation against dollar of approximately 6.5%. However, the gauge may face some resistance when it reaches the 1600-point threshold.

DM stock markets dynamics, January 2010=100



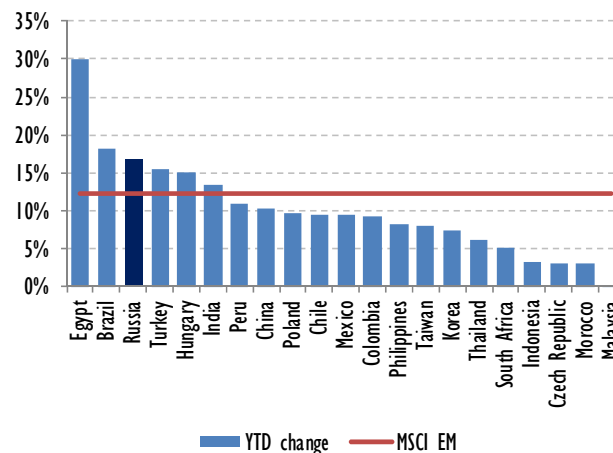
Source: Bloomberg

EM stock markets dynamics, January 2010=100



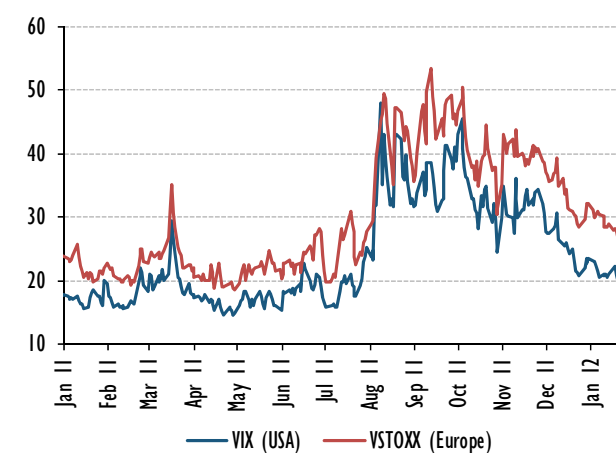
Source: Bloomberg, Gazprombank estimates

EM YTD dynamics comparison



Source: MSCI

VIX (implied volatility index)



Source: Bloomberg

Gazprombank

HQ: 16/1 Nametkina St., Moscow 117420, Russia
(Office: 63 Novochemushkinskaya St.)

Research Department

Andrei Bogdanov

Vice President - Head of Research

+7 (495) 988 23 44

Andrei.Bogdanov@gazprombank.ru

Equity Research

Equity Strategy

Andrei Bogdanov

Anna Bogdyukovich

+7 (495) 983 18 00 ext. 540 85

Metals & Mining

Natalia Sheveleva

+7 (495) 983 18 00, ext. 21448

Sergei Kanin

+7 (495) 988 24 06

Chemicals

Alexei Astapov

+7 (495) 428 49 33

Market and equity technical analysis

Vladimir Kravchuk

+7 (495) 983 18 00 ext. 21479

Banking

Andrey Klapko

+7 (495) 983 18 00 ext. 21401

Macroeconomics

Anna Bogdyukovich

+7 (495) 983 18 00 ext. 54085

Utilities

Dmitry Kotlyarov

+7 (495) 913 78 26

Oil & Gas

Ivan Khromushin

+7 (495) 980 43 89

Alexander Nazarov

+7 (495) 980 43 81

Transport & Industrial

Alexei Astapov

+7 (495) 428 49 33

Telecoms, Media & IT

Anna Kurbatova

+7 (495) 913 78 85

Andrei Bogdanov

+7 (495) 988 23 44

Fixed Income Research

Alexey Demkin, CFA

Head of FI

+7 (495) 980 43 10

Alexey.Demkin@gazprombank.ru

Strategy

Alexey Mikhailov

+7 (495) 983 18 00 ext. 2 90 14

Credit research

Yakov Yakovlev

+7 (495) 988 24 92

Yury Tulinov

+7 (495) 983 18 00 ext. 2 14 17

Production team

Mike Sidelev

+7 (495) 983 18 00, ext. 54084

Tatyana Andrievskaya

+7 (495) 287 62 78

Equity product department

Konstantin Shapsharov

Managing Director, Head of Department

+7 (495) 983 18 11

Konstantin.Shapsharov@gazprombank.ru

Debt product department

Pavel Isaev

Head of DPD

+7 (495) 980 41 34

Pavel.Isaev@gazprombank.ru

Equity Sales & Trading

Sales

Maria Bratchikova

+7 (495) 988 24 03

Artyom Spasskiy

+7 (495) 989 91 20

Svetlana Golodinkina

+7 (495) 988 23 75

Trading

Alexander Pitaleff,

Head of equity trading

+7 (495) 988 24 10

Denis Voynikonis

+7 (495) 983 74 19

Anton Zhukov

+7 (495) 988 24 11

Debt capital markets

Igor Eshkov

Head of DCM, ED

+7 (495) 913 74 44

Fixed Income Sales & Trading

Andrei Mironov

Head of FI S&T, ED

+7 (495) 428 23 66

Equity Capital Markets

Alex Semenov, CFA

Head of ECM

+7 (495) 989 91 34

Sales

Ilya Remizov

+7 (495) 983 18 80

Dmitry Kuznetsov

+7 (495) 428 49 80

Vera Yaryshkina

+7 (495) 980 41 82

Sebastien de Prinsac

+7 (495) 989 91 28

Roberto Pezzimenti

+7 (495) 989 91 27

Trading

Elena Kapitsa

+7 (495) 988 23 73

Dmitriy Ryabchuk

+7 (495) 719 17 74

Electronic trading department

Maxim Maletin

Head of Electronic trading

+7 (495) 983 18 59

broker@gazprombank.ru

Sales

Alexandr Lezhnin

+7 (495) 988 23 74

Anna Nifanova

+7 (495) 983 18 00 ext. 21455

Dmitry Lapin

+7 (495) 428 50 74

Alexander Pogodin

+7 (495) 989 91 35

Trading +7 (800) 200 70 88

Denis Philippov

+7 (495) 428 49 64

Damir Terentev

+7 (495) 983 18 89

Timur Zubairae, CFA

+7 (495) 913 78 57

Vladimir Krasov

+7 (495) 719 19 20

Copyright © 2003-2011. Gazprombank (Open Joint Stock Company). All rights reserved

This report has been prepared by the analysts of Gazprombank (Open Joint — stock Company) (hereinafter — GPB (OJSC)) and is based on information obtained from public sources believed to be reliable, but is not guaranteed as being accurate. With exception of information directly pertaining to GPB (OJSC), the latter accepts no liability for accuracy and completeness of information herein. All opinions and judgments herein represent analysts' personal opinion regarding events and situations described and analyzed in this report. They should not be regarded as the GPB (OJSC) position and are subject to change without notice, also in connection with new corporate or market events appearing. GPB (OJSC) is not under any obligation to update, amend this report or notify anyone on it. Financial instruments mentioned herein may be unsuitable for certain categories of investors. The report shall not be the only basis for investment decision. Investors shall make investment decisions at their own discretion, inviting independent consultants, if necessary, for their specific interests and objectives. Authors accept no liability whatsoever for any actions arising out of the use of this report.

Information contained herein or in appendices hereto is not to be construed as solicitation, or an offer to buy or sell any securities or advertisement, unless otherwise directly stated herein or in appendices hereto.