

# November: window-dressing with statistics



## 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

- ▶ Key indicators of the real sector dynamics in September remained mixed. Although seasonally-adjusted monthly change in GDP finally turned positive (+0.2) after two consecutive months of decline in economic activity, the year-on-year figures are still distorted by the low base effect. We consider acceleration of industrial production (to +1.0%, SA) a positive sign, but data for at least two more months is required before we deem it sustainable. So far we observe stabilization of production and investment levels, but any further expansion is unlikely to happen without new drivers.
- ▶ Leading indicators so far indicate the absence of new drivers for acceleration of growth. Economic sentiment remains only weakly optimistic, with producers are still highly uncertain about future demand, despite positive trends in employment and incomes. Investment activity is starting to catch up, but is still not enough to spur longer-term economic growth.
- ▶ Although 69% of corporates continued to report an increased availability of credit in September, lending remains subdued, basically due to shy demand. The average ruble lending rates, according to CBR estimates, declined to 9.7% in September, but surveys indicate that the minimum lending rates range from 11.2% to 15.7%, depending on the borrower's category.

## Key indicators: November forecast

Indicator	November 2010F	MED*	2010F GPB Research
<b>Real sector</b>			
GDP, y-o-y	-	4.0%	4.1%
Industrial production, y-o-y	5.9%	7.6%	2.7%
Capital investments, y-o-y	9.7%	2.5%	2.5%
Retail sales, y-o-y	2.8%	5.2%	3.1%
<b>Private sector</b>			
Real income, y-o-y	2.2%	4.4%	4.4%
Accrued salary, RUB	-	20,838	19,710
<b>Foreign economy</b>			
Trade balance, \$ bln	10.0	137.2	138.5
Average oil price (Urals), \$/bbl.	79	75	75.5
<b>Stock market</b>			
RTS, points	1,600-1,650	-	1,650
<b>Exchange rate, inflation and rates levels</b>			
Inflation (CPI), y-o-y	8.0%	7.0-8.0%	8.1%
Refinancing rate	7.75%	-	7.75%
Bicurrency basket, RUB	35.0-36.5	34.5	36.3
Exchange rate, RUB/USD (avg.)	30.8	30.4	30.5
- no forecast available			

Source: MED, Gazprombank estimates

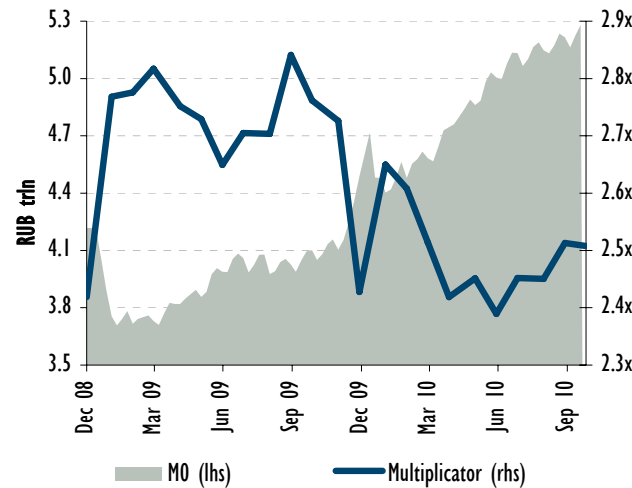
▶ Based on the current and perspective trends, we believe that:

- ◆ Retail sales dynamics are likely to remain positive, but the year-on-year figure would probably decelerate sharply due to diminishing low base effect. We also think that a slowdown in consumer prices in October signals somewhat less prominent dynamics of household demand. Although unemployment rate declined in September, there are factors that limit the positive effect on consumer sentiment. First, the seasonally-adjusted figure is still above 7.0% (7.3%), and second, unemployment rate tends to increase towards the yearend. Still, further deceleration of inflation is unlikely due to a rise in expectations, supported by monetary base growth. Thus, the November CPI figure might rise to 8.0% year-on-year. We, however, do not expect the CBR would lift the refinancing rate till the end of 2010.
- ◆ We share a positive view on the near-term commodity price levels, based on expectations of liquidity provision by the monetary authorities worldwide (and especially in the US). Under our case-case scenario, Urals price will average \$79/bbl. We do not anticipate the trade balance to fall below \$10.0 bn in November, as a sharp rise in imports due to investment demand observed in August it hardly sustainable under the current circumstances, when producers lack confidence in the future demand for their products.
- ◆ We believe that the risks of ruble depreciation have been overestimated,— the recent movements were mostly speculative in nature. Although fundamentals remain rather strong, we do not rule out persistent volatility of the exchange rate, especially after the CBR widened the range for bicurrency basket. As a result, we expect the average exchange rate of RUB 30.5-31.0 per USD in November, while the euro-dollar pair is likely to be more volatile. Therefore, we expect the bi-currency basket to remain within the 35.0-36.5 range over the coming month.

## Leading indicators

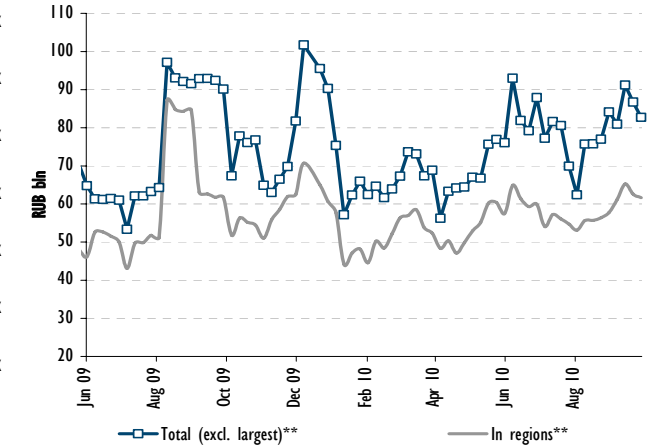
- ▶ Indicators of economic activity in September remained somewhat mixed. Manufacturing PMI fell by 1.7 p., but remained above the 50 p. threshold, which indicates that optimism among producers still prevails. Sentiment in the services industry recovered after a drop below 50 one month earlier. Yet, the survey by IET indicates that manufacturers still lack confidence in the future demand for their products. In fact, the number of respondents whose stocks of finished goods are 'below normal levels' in September reached a 7-year high, while the quantity of those who hold excessive stocks hit a record low.
- ▶ The availability of credit to corporate borrowers continued to improve in September. On the supply side, the level of minimum interest rates charged by banks fell to an average of 13.2% from 13.7% in August. Still, the demand for borrowed funds remains depressed due to cautious investment and production plans in the corporate sector. As a result, we do not anticipate any further acceleration of growth rates of the banks' loan portfolio (+3.3% m-on-m in August).
- ▶ The indicators of bank lending activity in September provide some evidence to support our view. Despite the steady increase in the monetary base in October (by 0.9% m/m), stabilization of the money multiplier at 2.5x indicates the reluctance of banks to lend. The only reason for the significant extension of lending by Sberbank was a loan to RUSAL (RUB 137.9 bln): after adjustment for single large-scale items the portfolio of loans of Russia's largest bank declined by 1.7%.
- ▶ Acceleration of power consumption growth during the first weeks of October might be interpreted as a good signal, given that industrial production exhibited a high correlation (above 90%) to it since the beginning of 2009. The average growth rate of 6.7% y-o-y seems even more plausible if we consider the diminished low-base effect and the absence of distortions associated with extreme weather conditions.

Monetary base and multiplier (M2/M0)



Source: CBR, Gazprombank estimates

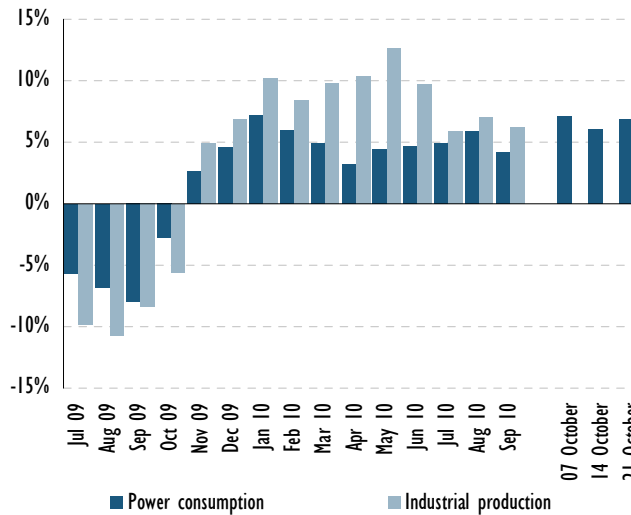
Sberbank's lending volume\*, RUB bln



\* weekly volumes  
\*\* 4-week average

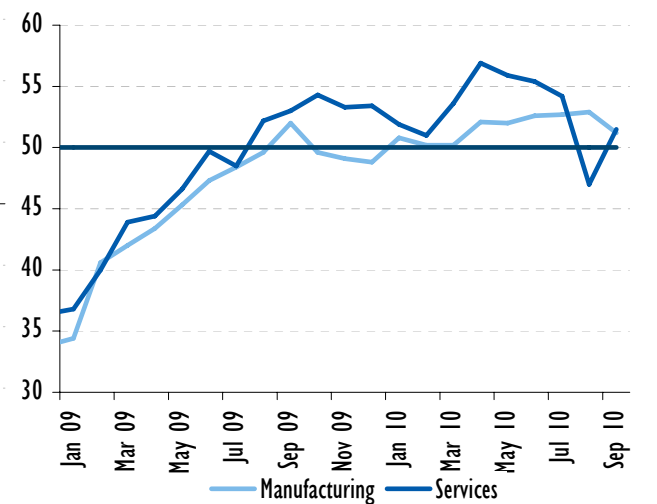
Source: CBR, Gazprombank estimates

Power consumption vs. industrial production, % y-o-y



Source: System Operator, Rosstat

Russia's PMI, points

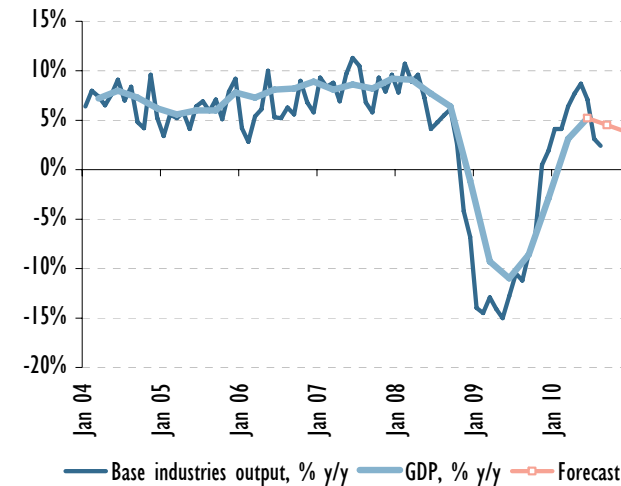


Source: Bloomberg

## Current economic environment

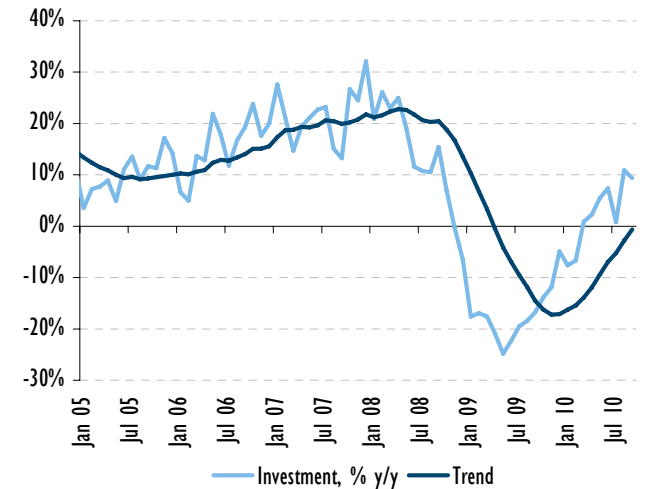
- ▶ Industrial production in September gained 6.2%, slowing down a bit from a surge by 7.0% in August. A seasonally adjusted growth of 1.0% m/m in September did not improve the combined 3Q result: total output produced in July-September was 0.3% lower than in the 2Q10. We do not expect to see any serious acceleration of production growth rates: leading indicators suggest little incentive to increase output on behalf of manufacturers, while the technical factors' influence (low base effect) continues to fall.
- ▶ Investment growth rate in September fell only a little short of the two-digit number (9.4% y-o-y), the seasonally-adjusted figure was quite modest: only 0.9% m/m after a rise by 4.3% a month earlier. Although in the short-run such a dynamics doesn't pose any significant threat to growth, underinvestment might negatively affect productive capacity in 2011.
- ▶ MED estimated that Russia's SA GDP growth turned positive (+0.2%) after two consecutive months of decline. Yet, a rebound in September was not enough to compensate for the previous losses. As a result, GDP in the 3Q dropped by 0.7%.
- ▶ MED estimated that Russia's trade balance improved in September to \$9.3 bln after an unexpected drop in August to \$8.3 bln: export gained 13.4% y-o-y (supported by stable oil prices) while import growth rate decelerated to 32.3% y-o-y. The preceding squeeze of trade balance can be attributed to a surge in the value of imported equipment, which is hardly sustainable given the weak investment demand.
- ▶ CBR during the first two weeks of October added \$9.3 bln to its foreign exchange reserves. Despite the fact that the CBR has widened the range of bi-currency values to RUB 32.9-36.9 effective October 14, we doubt that the value of FOREX interventions will decrease dramatically. On October 21, CBR shifted the boundaries upwards by 5 kopeks, which indicates that another \$650 mln were purchased.

Base industries output vs. Russia's GDP in 2004-2010



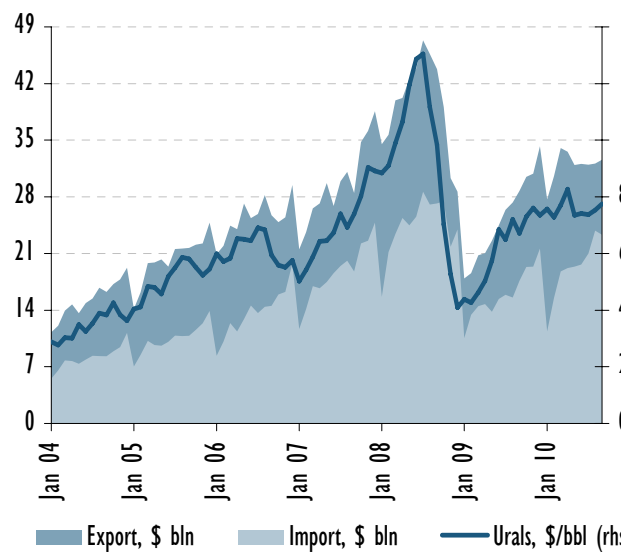
Source: Rosstat

Investment in working capital, % y-o-y



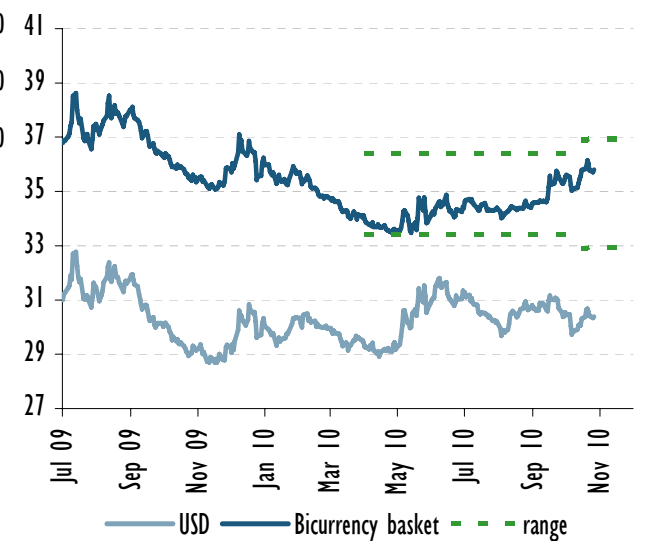
Source: Rosstat, Gazprombank calculations

Russia's trade balance vs. oil prices



Source: Bloomberg, CBR, MED

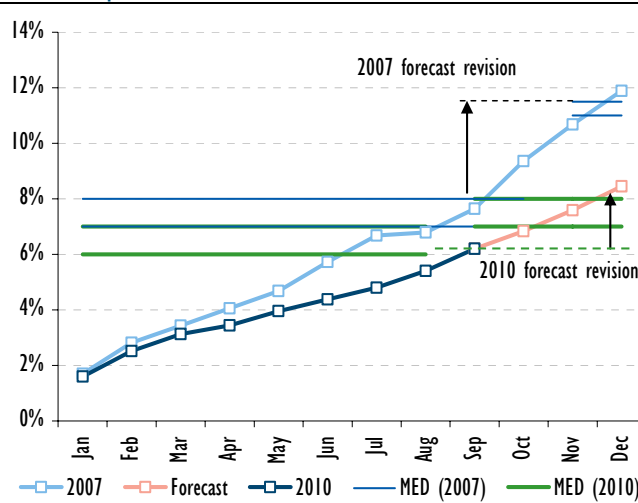
Ruble rate curves



Source: Bloomberg, CBR

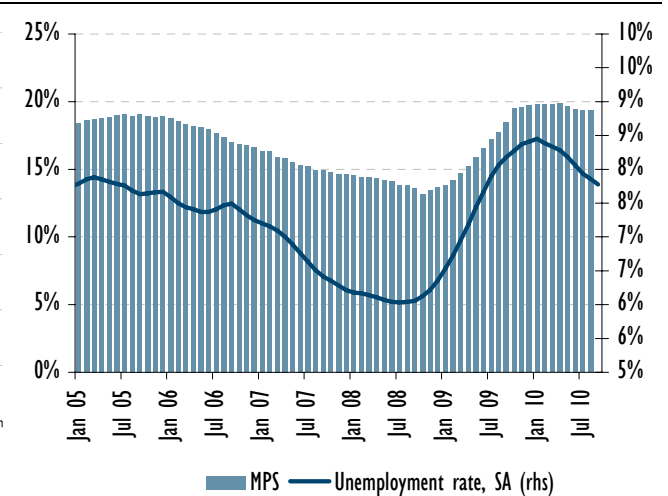
- ▶ We believe that the high volatility of the Russian ruble has speculative rather than fundamental reasons behind it. The depreciation mainly took place against the euro (-1.8%), while against the US dollar ruble gained almost 0.5% mtd, which is perfectly consistent with the two currencies' relative dynamics.
- ▶ Inflation slowed down a little in October: as of October 25, CPI added 0.5% mtd, with average weekly price growth of 0.1% during the last three weeks. That gives a glimpse of hope to the monetary authorities, who were very much looking forward to deceleration of inflation. Yet, we believe there's limited potential for the further slowdown, as the monetary (such as high growth rates of the money supply), as well as seasonal factors will be pushing the prices up.
- ▶ The indicators of consumer confidence exhibited further improvement, however, at a slower pace. The decline in unemployment rate to 6.6% in September from 6.9% a month earlier is likely to result in further increase in the marginal propensity to consume. Yet, a drop of 0.6% m/m (SA) of the real disposable income will be restraining demand recovery. Retail sales in September added 4.7% y-o-y, losing some of the momentum (August rise was 6.5% y-o-y).
- ▶ Fund inflows into the Russian stock market remained weak compared to the GEM: \$0.08 bln vs. \$7.1 bln in September, and \$0.238 bln vs. \$9.5 bln since the beginning of October. Yet, among the BRIC markets Russia was one of the best performing mtd: RTS gained 5.5%, second only to China (+12.7%).
- ▶ Corporate borrowers continued to take advantage of the favorable conditions in the Russian bond market due to abundance of liquidity: nominal corporate bond volume increased by more than RUB 115 bln. OFZ supply was also catching up: Ministry of Finance sold RUB 145.4.0 bln worth (at par) of government bonds in September and securities worth another RUB 84.9 bln since the beginning of October.

### Inflation: pessimistic scenario



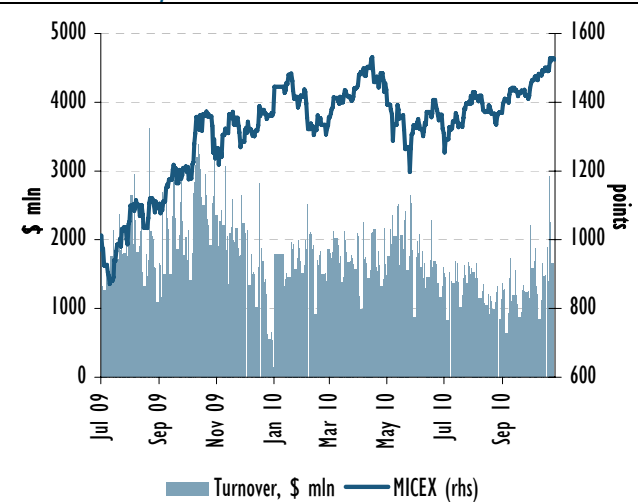
Source: Rosstat, MED, Gazprombank estimates

### Consumer confidence indicators



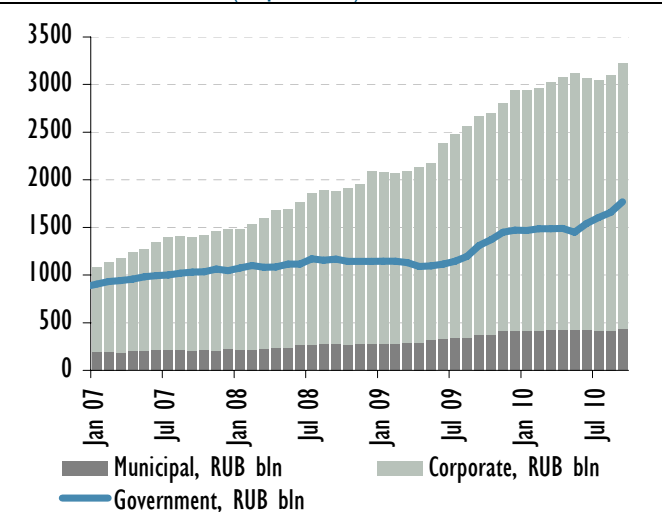
Source: Rosstat

### Stock market dynamics



Source: Bloomberg

### Bond market volume (at par value)



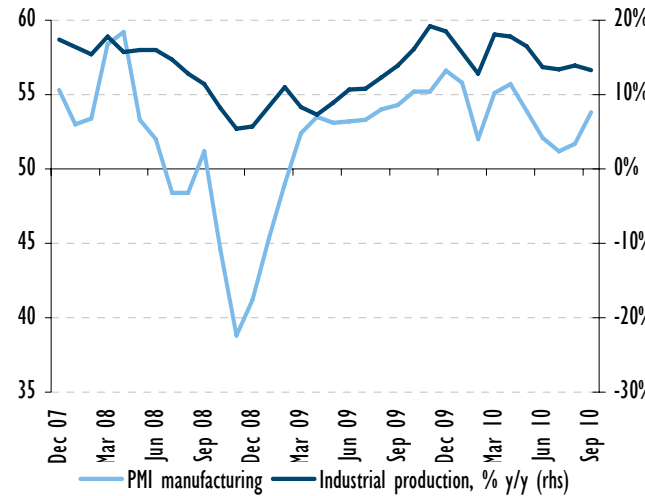
Source: Cbonds

## Appendices

### 1. Economic situation abroad

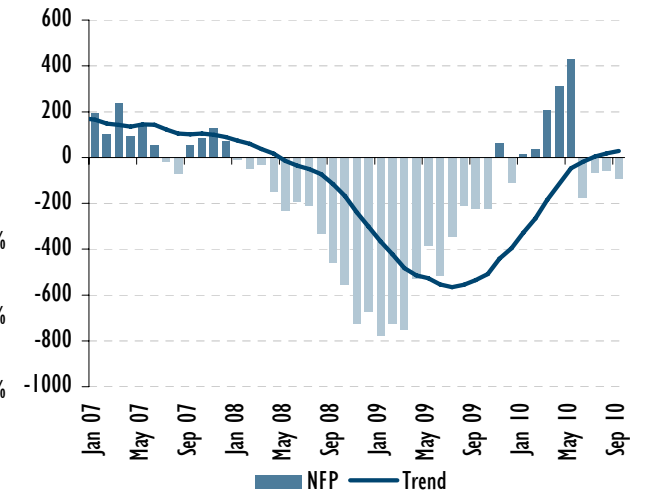
- ▶ Recently, the key concerns around the globe were the issues of competitive devaluation and deflation risks, as well as the potential policy responses.
- ▶ Although Finance ministers of the G-20 countries at their recent summit agreed to refrain from devaluing national currencies to spur economic growth, there is still no binding commitment. On the contrary, some countries are obviously taking advantage of their strong bargaining position – USA being one of the key beneficiaries.
- ▶ Markets are anticipating the Fed's announcement of further QE in the beginning of November. The estimates of a potential UST buyout differ, ranging from \$500 bln to \$2 trln, but dollar lost more than 10% against the euro since the beginning of September, and more than 18% since touching a local high at 1.192 (per unit of European currency) in June, obviously pricing in the high probability of action on behalf of the Fed. Given the limited flexibility of European policy-makers, further strengthening of the regional currency might negatively affect the prospects of economic recovery.
- ▶ Macroeconomic data in the US during the last two months was rather weak, fuelling the hopes for further stimuli from the FED. Additional source of concern comes from the low inflation rates in the US: CPI increment hasn't exceeded 1.2% y-o-y over the last four months. Yet, the risks of deflation seem limited at the moment.
- ▶ A hike in the reserve requirements for certain Chinese banks seemed to only have a short-term effect on investors' sentiment. The indicators of confidence in the manufacturing sector remained on the rise, and industrial production growth rates stabilized at above 13% y-o-y. Yet, Chinese foreign exchange policy remains an obstacle in the process of resolving global imbalances.

China's manufacturing indicators



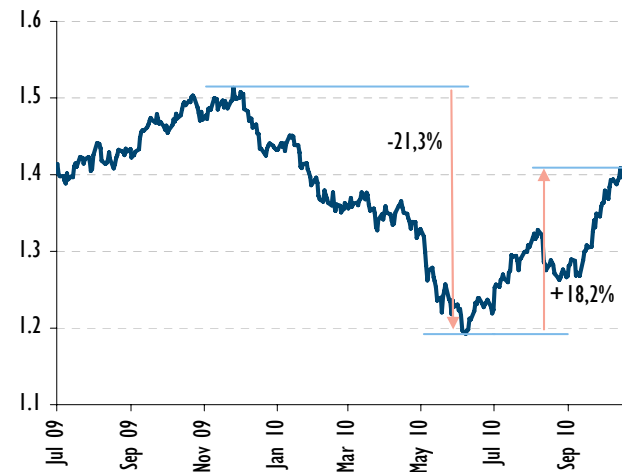
Source: Bloomberg

Change in non-farm payrolls, K



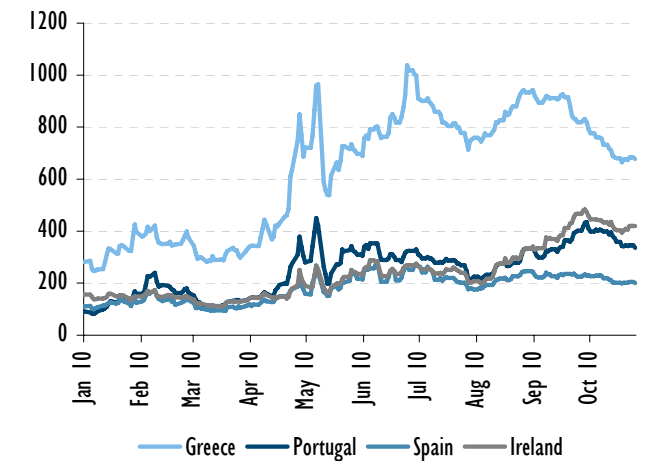
Source: Bloomberg, Gazprombank estimates

EUR/USD rate dynamics



Source: Bloomberg

5-year CDS spreads dynamics (eurozone)



Source: Bloomberg

## 2. Commodity markets

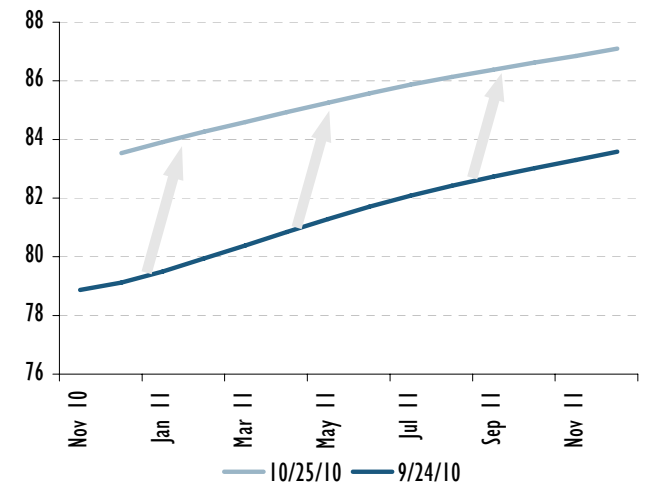
- Commodity markets were ruled by speculative demand as high volatility in the FOREX made them more attractive for investment. Dollar weakness was the key supporting factor, as the fundamentals remained mixed (high crude stockpiles advocated the idea of unstable future demand, while strong results in the corporate sector indicated the possibility of a recovery) and weighed on the value of the commodities.
- Prices of Urals oil in October fluctuated in the range of \$78.6-83.4/bbl, and although there was a general downward trend since the beginning of the month, it is not inconsistent with the dynamics that prevailed since June. Base metals have generally grown during October: the price index added 5.8% from the beginning of the month. Metals futures demonstrated a slightly smaller rise, but still trade almost 2.0% above the base asset value, which indicates a positive outlook.
- Brent futures suggest that the market participants share rather optimistic views on oil price dynamics. Contract curve is (1) upward-sloping, which indicates expectations of a price rise on the horizon of 1-12 months and (2) shifted upwards by as much as \$4.5 (for certain delivery dates) as compared to the previous month's curve. Although the size of the Fed stimulus package may miss the investors' estimates, which may result in a temporary rebound of the US dollar, our longer-term view on commodities remains positive.
- Baltic Dry Index – an indicator of shipping costs – rose by 12% mtd, losing only slightly after touching a local max on October 14. Increase in the costs of freight of capesize vessels (+22% in the first week of October), which are used for the shipment of iron ore and coal.

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

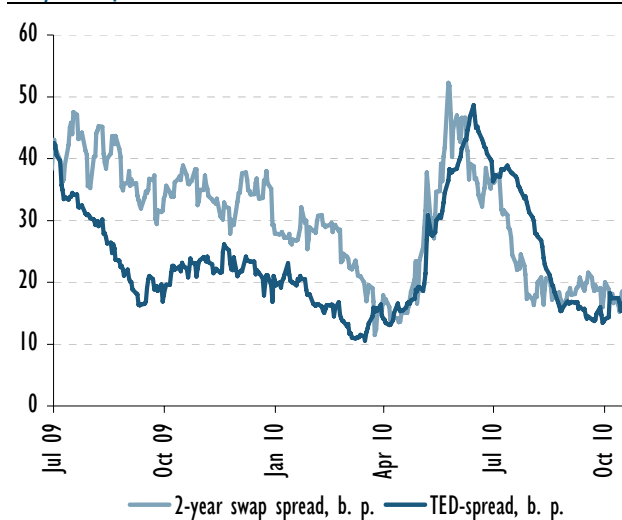


Source: Bloomberg

### 3. Money and fixed income markets

- ▶ We see no risks to liquidity on the horizon of at least 12 months: not with the commitment of the monetary authorities to supply the funds necessary to sustain recovery. This is especially true for the US money market: the short-term borrowing costs (LIBOR) are near historical lows, and longer-term rates are under pressure from potential Fed demand on the UST. One-year USD LIBOR might be falling below 0.75% in the near future if no reassessment of risk occurs, while the 10-year Treasury yields fluctuate around 2.5%. Key money market spreads indicate no risks (whether credit or liquidity): TED-spread stabilized close to only 16 b. p., converging with the 2-year swap spreads.
- ▶ The perception of EM credit risks is rather favorable, too. Spread offered by EM bonds over the USD tended downwards, targeting the level of 250 b. p. (measured by EMBI+ spread). YTM on Russia-30 touched 4% in mid-October, down by 37 b. p. from the beginning of the month, which indicates the persistence of demand for debt instruments with good credit quality. The latter is indicated by the narrowing of the CDS spread on Russia to below 140 b. p.
- ▶ Russian money market was affected by the tax payment season, but the withdrawal of liquidity only had a marginal effect on interbank rates. O/n borrowing costs for banks with the top credit quality reached 3.5% in the end of October, but the spike didn't last for long. 3m NDF rates remain in the 3.0-3.5% range, but given the high volatility of exchange rates, such a situation doesn't indicate any liquidity deficit. Accumulated volume of liquid assets on the banks' balance sheets by almost RUB 300 bln, but still amounts to more than RUB 1.5 trln, and serves as good insurance to banks against the liquidity shocks.

Key MM spreads



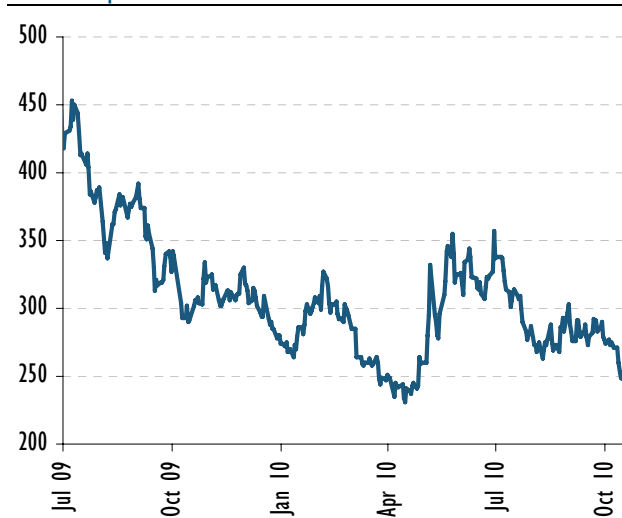
Source: Bloomberg

1y LIBOR and 10y US Treasuries yield



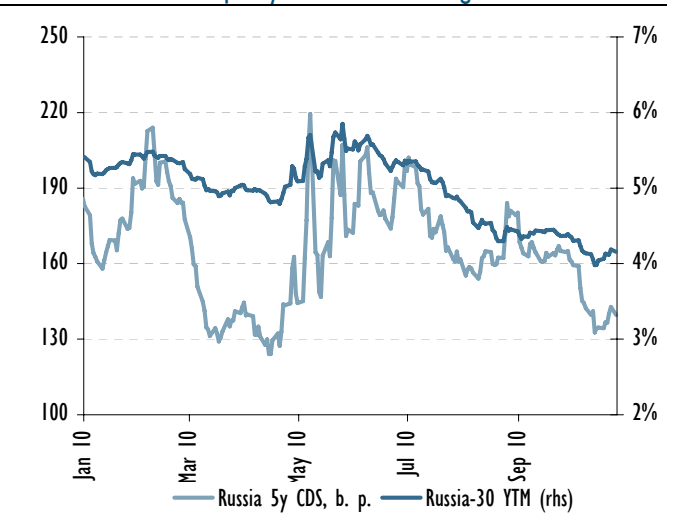
Source: Bloomberg

EMBI+ spread



Source: Reuters

Indicators of credit quality of Russia's sovereign debt

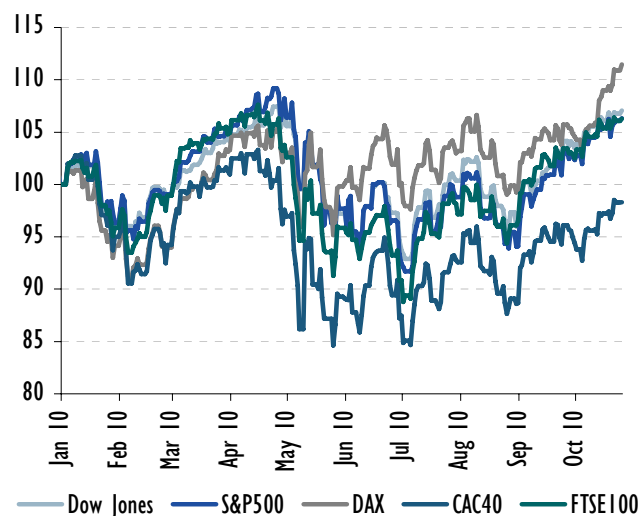


Source: Bloomberg

## 4. Stock markets

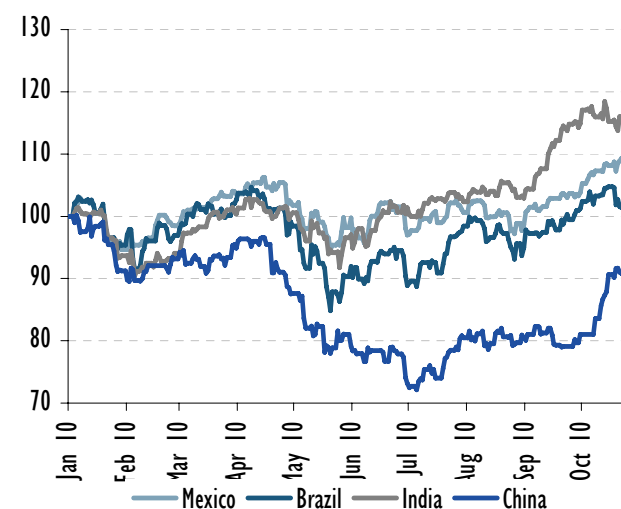
- ▶ Despite the fears that this year may provide more proof to historical findings stating that September was the worst month for US equities, stock markets exhibited positive dynamics, gaining 7-9%. Other developed markets showed a similar surge. October dynamics was more reserved: Germany was the top performer with a score of +6.6% mtd (DAX index). In the US the rise in stock prices was largely attributed to strong financial results in the corporate sector. Net income of 297 companies (out of the 500 comprising S&P500) who released their 3Q results exceeded expectations by 3.5-20.0%, depending on the sector.
- ▶ Among the BRIC, Shanghai Comp. (+12.7%) was the best performer, trying to catch up for a prolonged slump. Most of the other EMs has risen, as well, but the cap change was 5.8% mtd (Mexican index).
- ▶ Despite being the best-performing sector (according to 3Q financial statements) financial stocks continued to underperform other sector shares in October. Banks in US and Europe added 1.4% mtd. The key issue in the sector was the proposed tightening of banking regulation: Fed chairman Ben Bernanke announced an investigation of the mortgage foreclosure practices at banks (preliminary results are expected to be released in November). Summit of G-20 leaders scheduled to take place in Seoul on November 11-12 will host the discussion of new Basel capital accord, as well as coordination of other actions by the monetary authorities.
- ▶ Uncertainty over the direction of the US stock markets in October contracted further: VIX index (which indicates implied volatility) fell below 20 points, nearing its pre-crisis level.

DM stock markets dynamics, January 2010=100



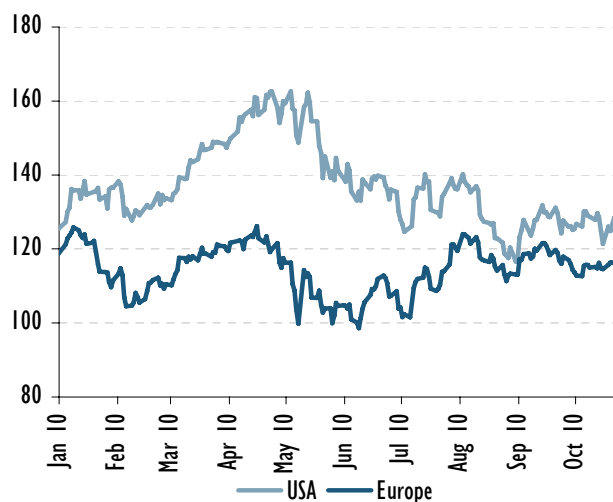
Source: Bloomberg

EM stock markets dynamics, January 2010=100



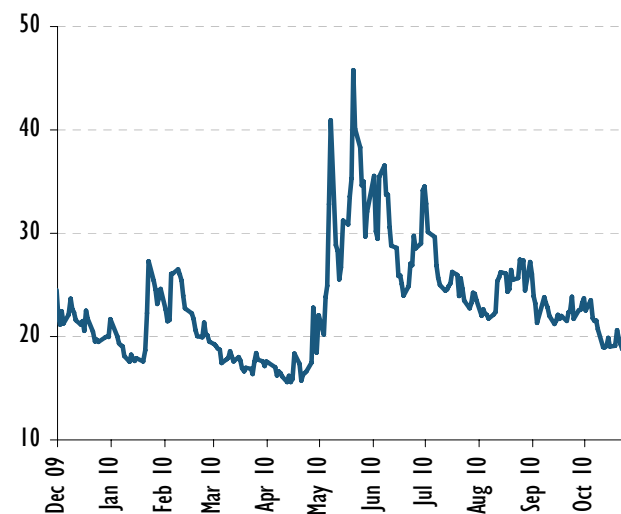
Source: Bloomberg, Gazprombank estimates

Banking stock dynamics, December 2008=100



Source: Bloomberg, Gazprombank estimates

VIX (implied volatility index)



Source: Bloomberg

## Gazprombank

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

### Research Department

**Andrei Bogdanov**

Head of Research

+7 (495) 988 23 44

[Andrei.Bogdanov@gazprombank.ru](mailto:Andrei.Bogdanov@gazprombank.ru)

#### Equity Strategy

**Andrei Bogdanov**

+7 (495) 988 23 44

**Anna Bogdyukevich**

+7 (495) 983 18 00 ext. 54085

#### Fixed Income

**Alexey Demkin, CFA**

+7 (495) 980 43 10

**Yakov Yakovlev**

+7 (495) 988 24 92

**Yury Tulinov**

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

**Pavel Pikulev**

+7 (495) 983 18 00 ext. 2 14 26

#### Banking

**Andrey Klapko**

+7 (495) 983 18 00 ext. 21401

#### Macroeconomics

**Anna Bogdyukevich**

+7 (495) 983 18 00 ext. 54085

#### Telecoms & Media

**Andrei Bogdanov**

+7 (495) 988 23 44

**Anna Kurbatova**

+7 (495) 913 78 85

#### Transport & Industrial

**Alexei Astapov**

+7 (495) 428 49 33

#### Oil & Gas

**Ivan Khromushin**

+7 (495) 980 43 89

#### FMCG & Retail

**Rustam Shikhakhmedov**

+7 (495) 428 50 69

#### Metals & Mining

**Sergei Kanin**

+7 (495) 988 24 06

#### Utilities

**Dmitry Kotyarov**

+7 (495) 913 78 26

#### Chemicals

**Alexei Astapov**

+7 (495) 428 49 33

#### Production Team

**Tatiana Kurnosenko**

+7 (495) 983 18 00 ext. 54084

**Julia Melnikova**

+7 (495) 980 43 81

### Debt Product Department

**Pavel Isaev**

Head of DPD

+ 7 (495) 980 41 34

[Pavel.Isaev@gazprombank.ru](mailto:Pavel.Isaev@gazprombank.ru)

#### Debt Capital Markets

**Igor Eshkov**

Head of DCM

Executive Director

+ 7 (495) 913 74 44

#### Fixed Income Sales & Trading

**Andrei Mironov**

Head of FI S&T

Executive Director

+7 (495) 428 23 66

#### 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

### Equity Product Department

**Konstantin Shapsharov**

Director

+7 (495) 988 23 24

[Konstantin.Shapsharov@gazprombank.ru](mailto:Konstantin.Shapsharov@gazprombank.ru)

#### Equity Sales & Trading

##### Sales

**Maria Bratchikova**

+7 (495) 988 24 03

**Artyom Spasskiy**

+7 (495) 988 91 20

**Svetlana Golodinkina**

+7 (495) 988 23 75

#### Equity Capital Markets

**Vitaly Zarkhin**

Director

+7 (495) 988 24 48

#### Online Brokerage

**Maxim Maletin**

Head of Online Brokerage

+7 (495) 983 18 59

#### Trading

**Valeriy Levit**

Director

+7 (495) 988 24 11

Copyright © 2003-2010. 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.