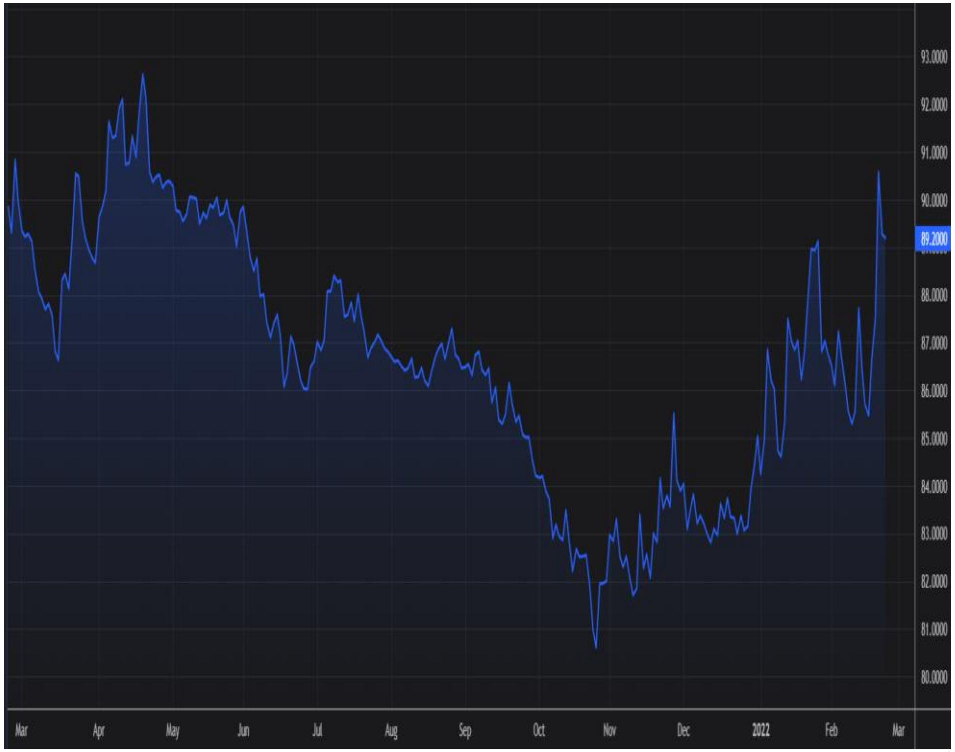
VERNY CAPITAL


# Russia’s Market Updates & Economic Dynamics

# The ruble hit past 80-level against the dollar on heightened Russia-Ukraine geopolitical tensions

**USDRUB Exchange Rate, 1-Year Trend, as at 22 Feb 2022**


**EURRUB Exchange Rate, 1-Year Trend, as at 22 Feb 2022**



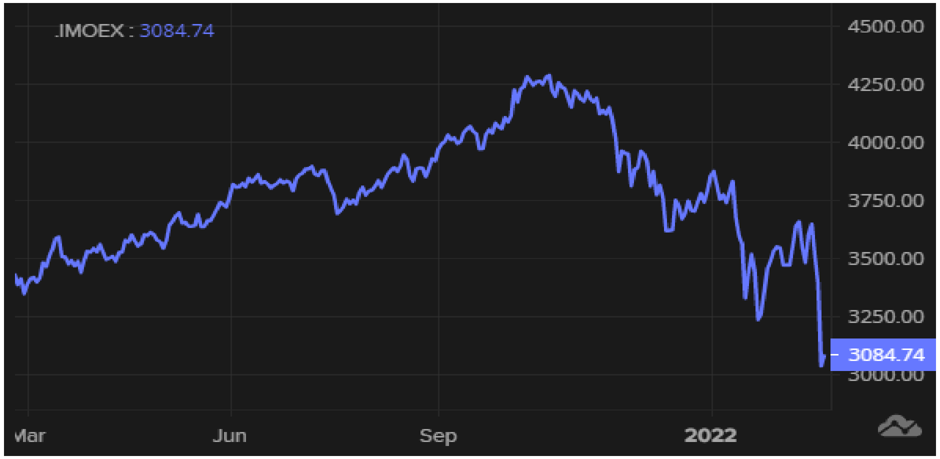

- The USDRUB exchange rate fell 3.1% on 21st February and slipped past the 80-level. It continues to weaken to a height of 80.9275 on 22nd February intraday trade, before closing at 78.7110. Year-to-date, the ruble has fallen 5.6% against USD (3rd January: 74.5508).

- Against the euro, the ruble lost 3.1% to 90.23 on 21st February after hitting 90.7850 on intraday trade, a level last seen in April 2021. The ruble touched a high of 91.4059/EUR on 22nd February intraday trade. Year-to-date, the ruble has weakened 5.9% against the euro (3rd January: 84.26).

*Source: Reuters*

# Impact of Russia-Ukraine tensions on Russia's financial markets and dollar assets

**1. MOEX Equity Index plunged 10.5% on 21st February, however it rebounded slightly by 1.6% to 3,084.74 points on 22nd February. Shares of Russia's key companies fell 13-20% over the 2-day period.**




**2. Ruble-denominated government bond prices plunged, 10-year OFZ yields closed higher at 10.51% on 21st February and 10.78% on 22nd February. Yields have widened by 241bps year-to-date**


**3. Russia 10-year USD CDS surged >30bps to 274.28 on 21st February, the highest since early 2016. Year-to-date, it has widened by 104.42bps**

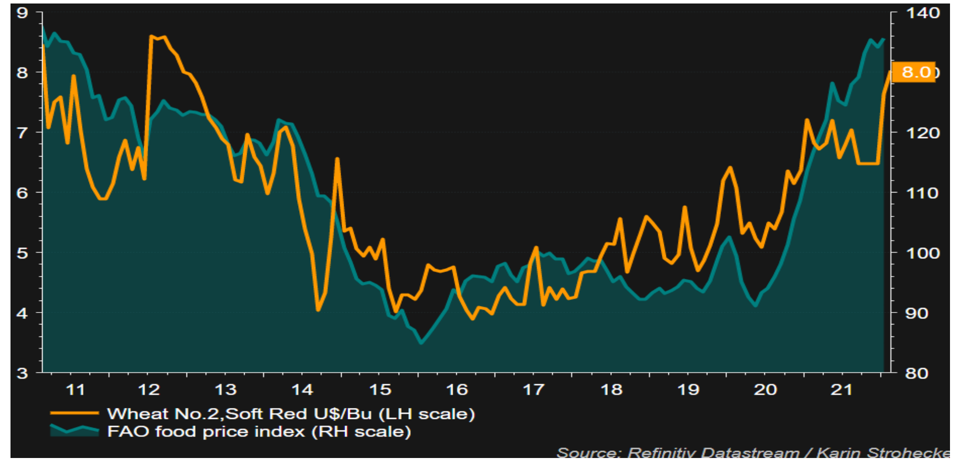

**4. Russia and Ukraine dollar bonds have underperformed their peers in recent months as investors trimmed exposure**


*Source: Reuters*

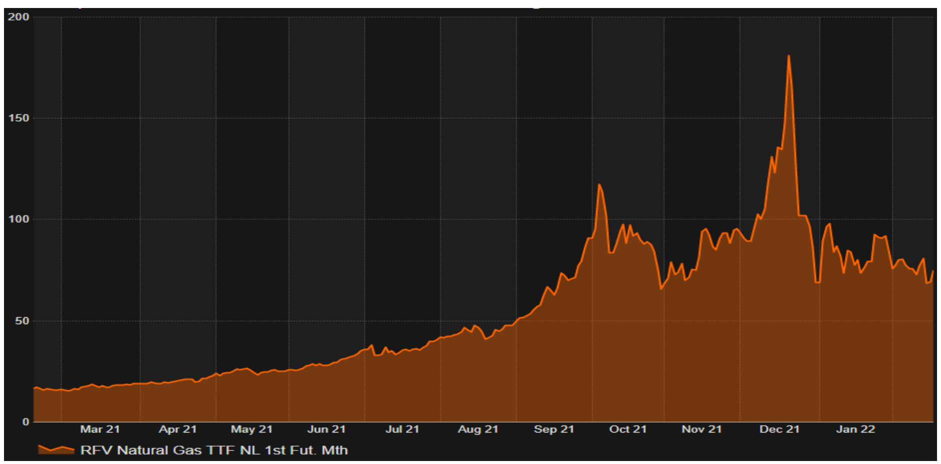
# Impact of Russia-Ukraine tensions on the global markets

**1. Prices of key commodities & safe-haven assets have increased**

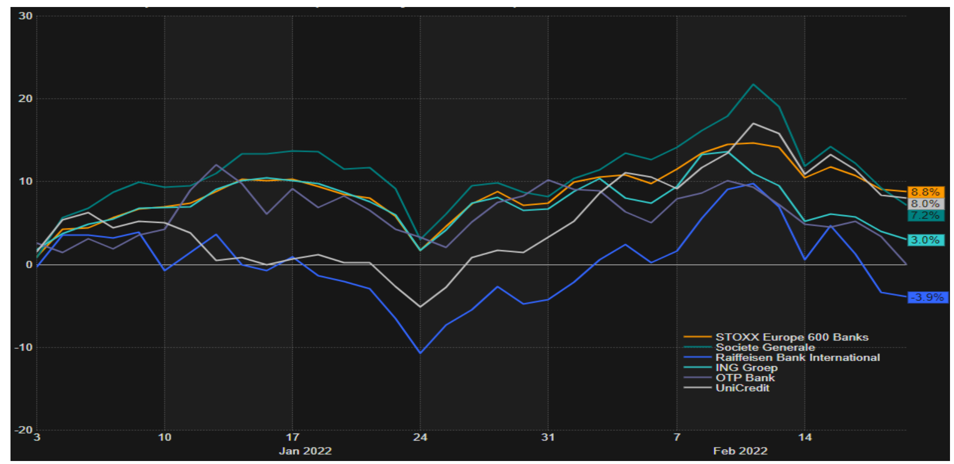

**2. Global food & wheat prices at decade highs, grains shipping from ports in the Black Sea could face disruptions from any military action or sanctions**




**3. Europe natural gas prices hit record highs in Dec 2021, Europe relies on Russia for 35% of its natural gas**



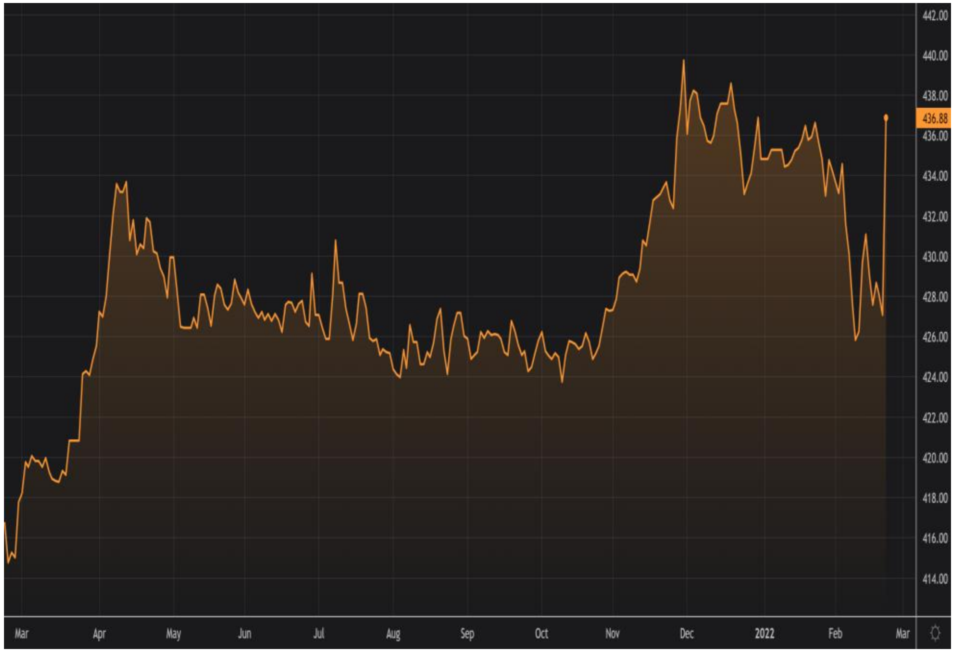

**4. French and Austrian banks have the largest loan exposure to Russia among Western lenders, followed by US, Japan, Germany**



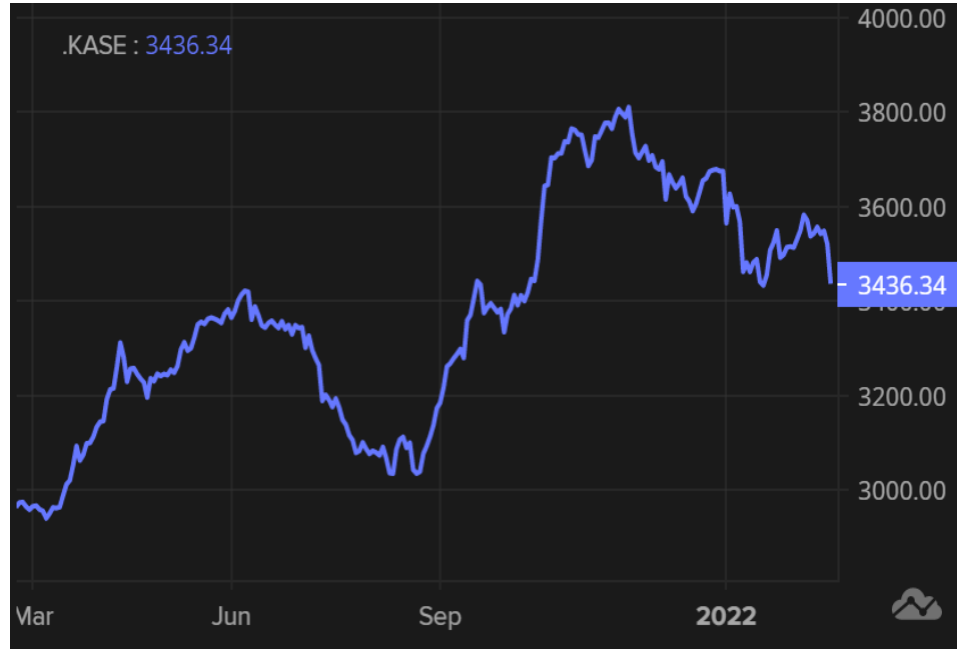

*Source: Reuters*

# Impact of Russia-Ukraine tensions on Kazakhstan's financial markets, expect market volatility in days to come

**USDKZT Exchange Rate, 1-Year Trend, as at 22 Feb 2022**




**KASE Index, 1-Year Trend, as at 22 Feb 2022**

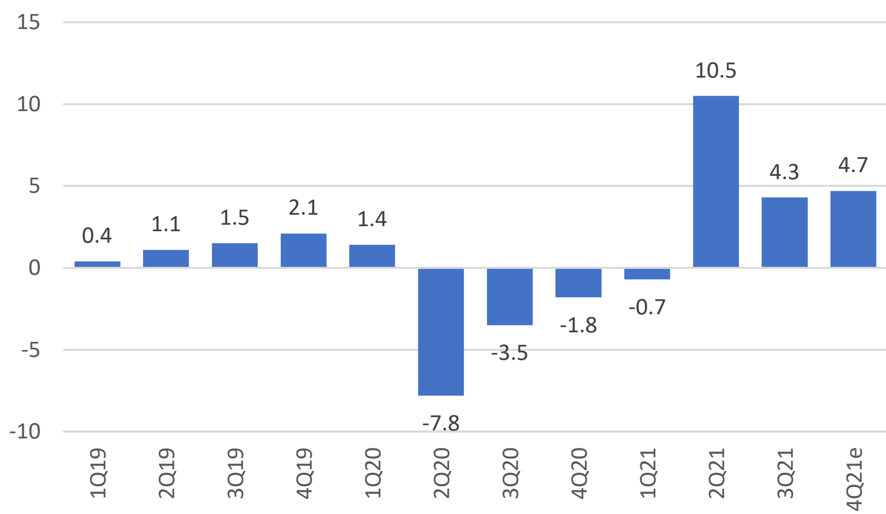



- The USDKZT exchange rate weakened by 2.3% on 22nd February, trading at an intraday high of 438.08, tracking the ruble trends. The tenge closed at 436.88/USD on Tuesday, weakened by 0.4% year-to-date.
- High oil prices and increased demand for tenge during the conversion for quarterly tax payments (on 25th February) however provided some support for the currency. The central bank has the capability to step in to support tenge in the event of need (NBK sold USD238.mln from its reserves on 12-13th Jan to support the tenge).
- The KASE index extended its losses by 2.4% on 22nd February, declining to an intraday low of 3,408.05 points, closing slightly higher at 3,436.34 points. The selloff of Kazakh blue chips reflects the escalation in Russia-Ukraine conflict and anticipation of new sanctions.

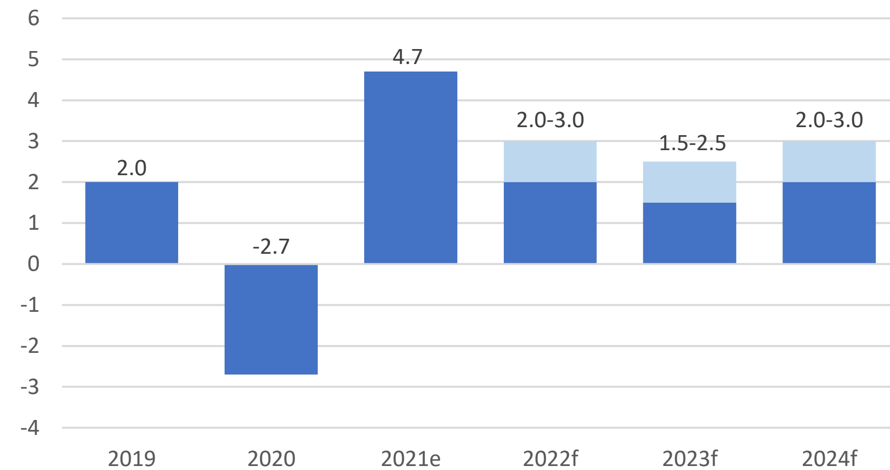
*Source: Reuters*

# Russia's GDP growth was resilient, estimated at 4.7% in 2021, a recovery from 2.7% contraction in 2020

**Russia's Quarterly GDP Growth, % YoY**




**Russia's Annual GDP Growth Forecasts, % YoY**

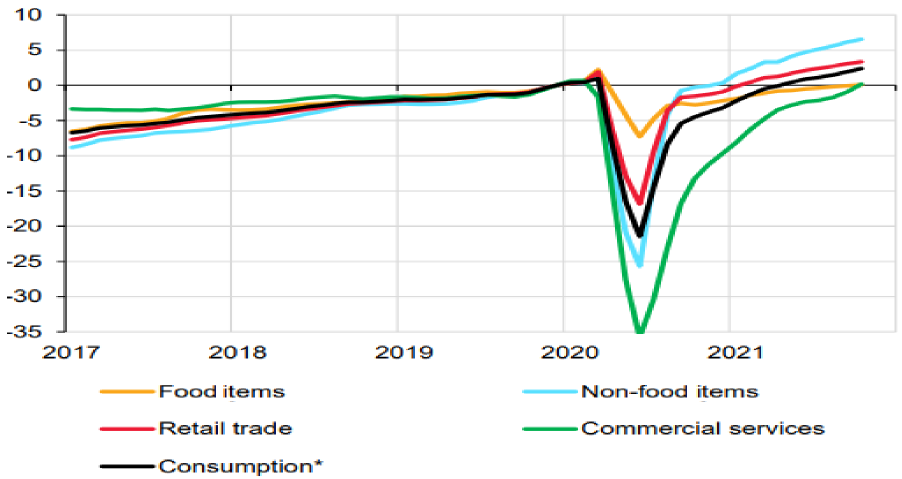



- According to the central bank's estimates, Russia's economic growth remained strong in 4Q21.
- Rapid growth in lending, rising real wages and households' moderate propensity to save, driven by high inflation expectations, supported expansion in consumer activity, especially in non-food markets. Meanwhile, growing domestic and external demand and high corporate profits shored up investment activity.
- Demand for labor force continues in many industries amidst labor shortages, and this is despite the inflow of foreign labor. Unemployment rate is at its record lows, while the number of openings was the highest on record.
- **A further increase in steady growth rates of Russia's economy will be conditional primarily on the growth paces of labor productivity**.
- **The central bank expects Russia's GDP growth of 2-3% in 2022** (2021e: 4.7%), returning to a balanced growth path of 1.5-2.5% in 2023 and 2-3% in 2024.

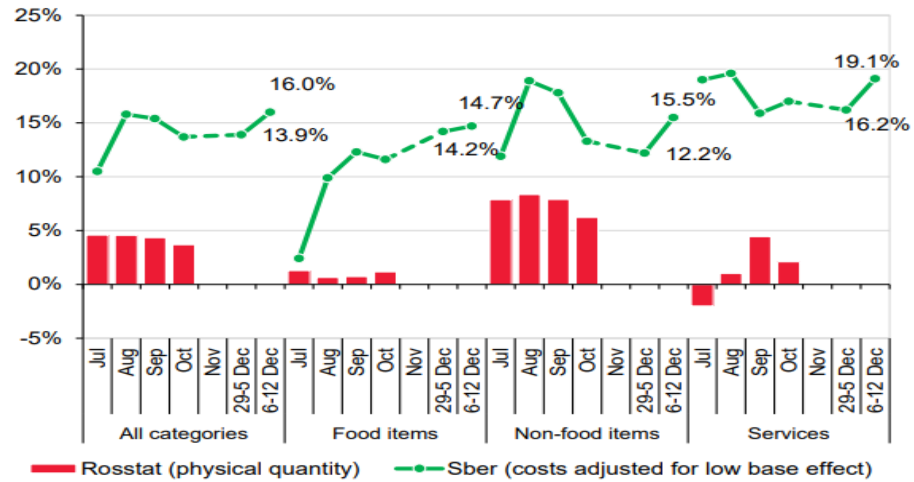
*Source: Central Bank of Russia, VC*

# Consumption of commercial services is now close to pre-pandemic level, growing domestic & external demand and high corporate profits shore up investment activity

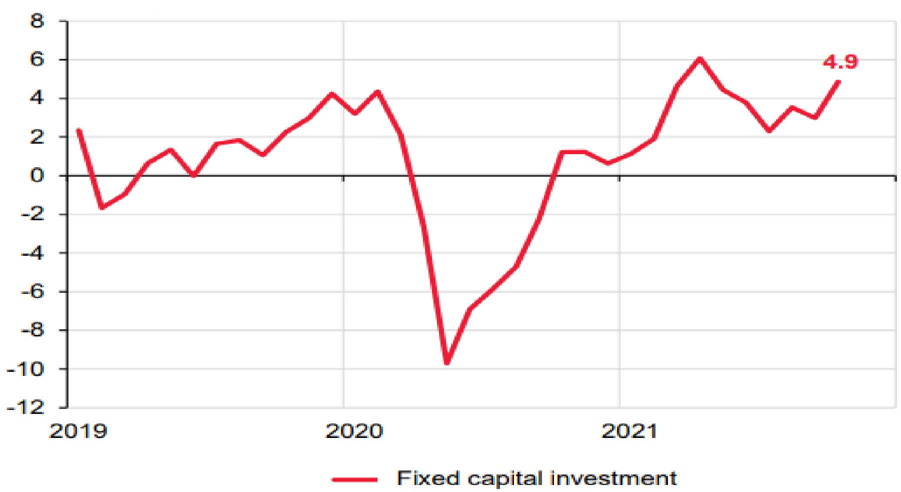
**Consumer Activity, % growth to Dec 2019**



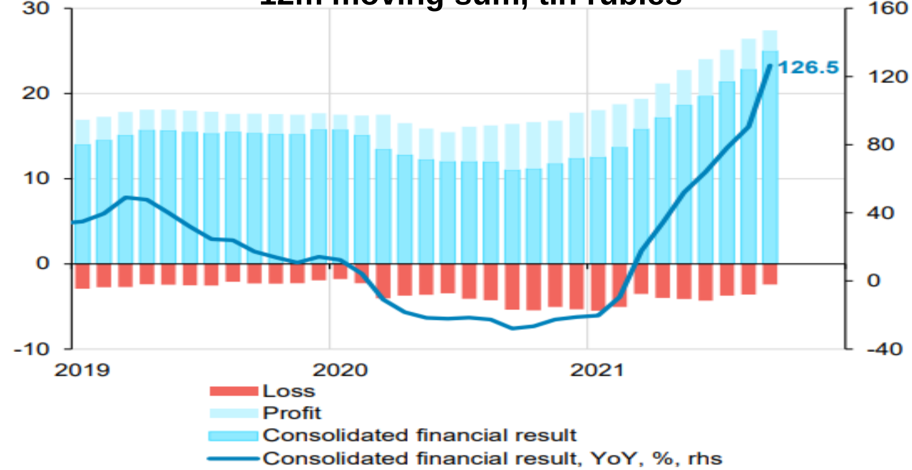

**Consumer Activity (Sberindex), % YoY**




**Investment Activity, % YoY**



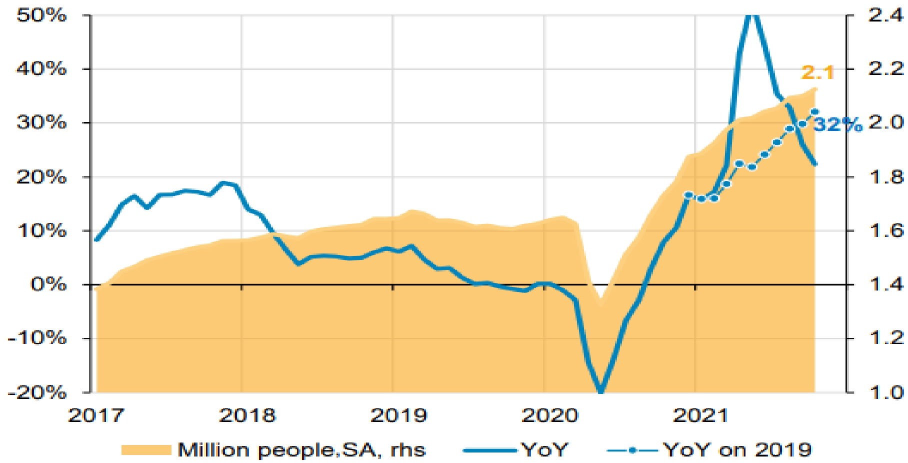

**Consolidated Financial Result of Organizations, 12m moving sum, tln rubles**



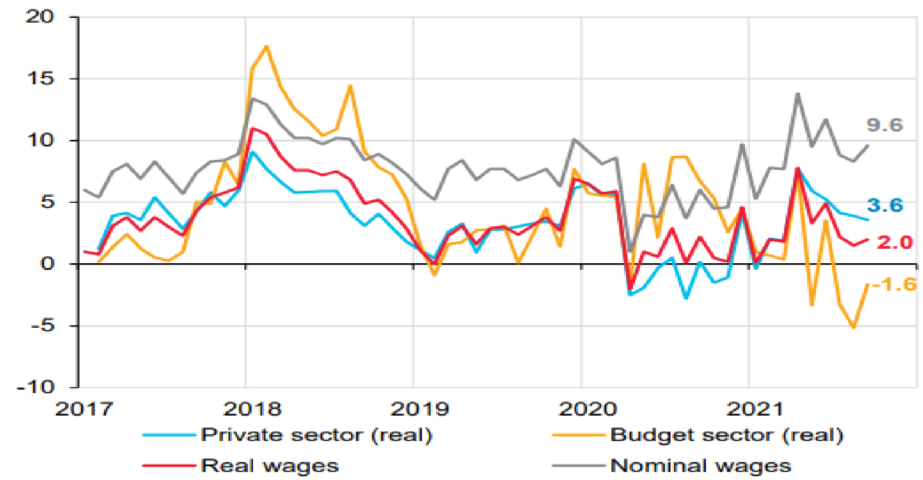

Source: Central Bank of Russia

# Russia’s unemployment rate has fallen to a record low, inflation pressure from the labor market has intensified due to labor shortages

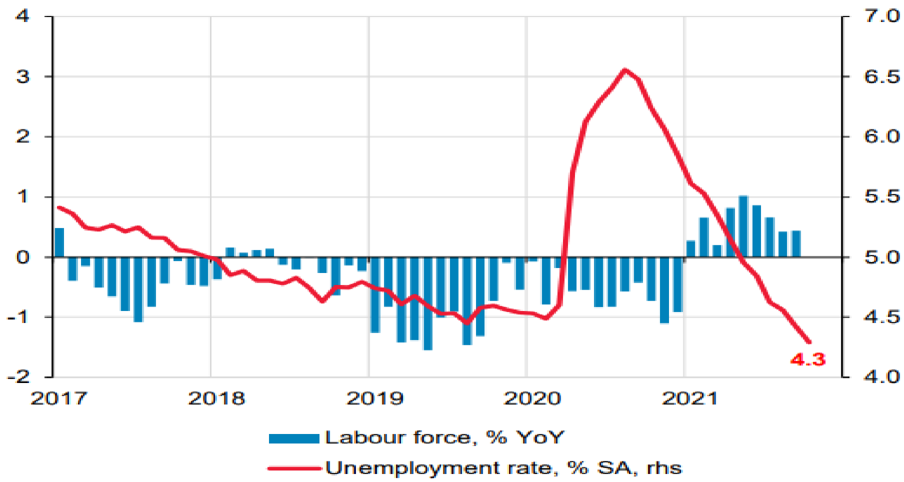
**Employers’ Demand For Labor, %**



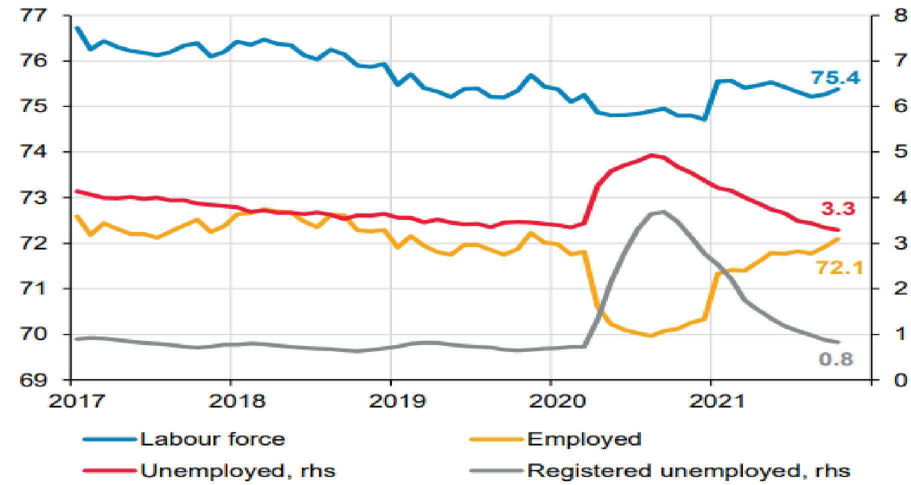

**Wages, % YoY**




**Unemployment & Labor Force, %**



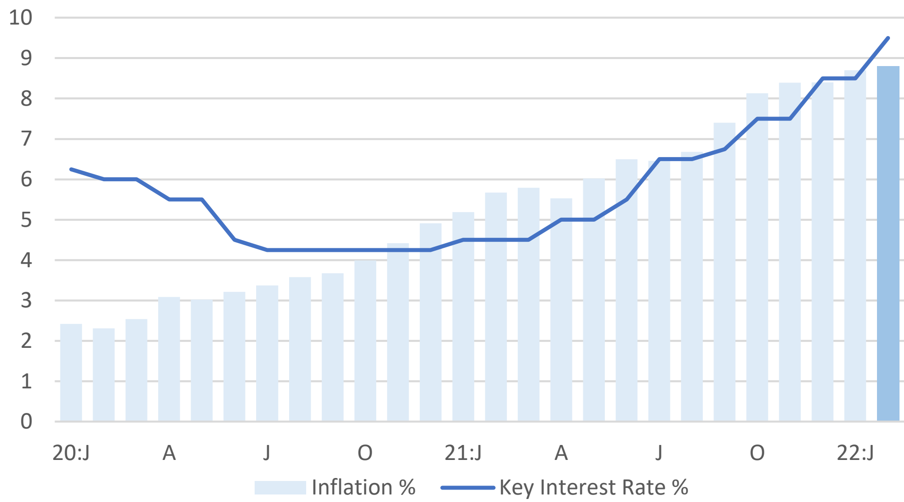

**Labor Force, mln people**



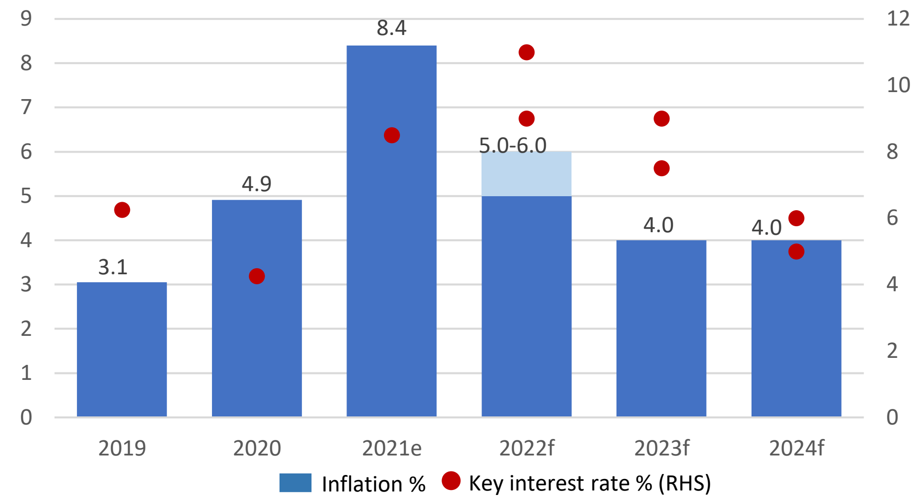

*Source: Central Bank of Russia*

# Russia's key rate was raised by 100bps to 9.5% as inflation climbed higher to 8.7% in January, monetary policy stance remains neutral

### Monthly Inflation vs. Key Interest Rate, % YoY




### Annual Inflation vs. Key Interest Rate Forecasts, %

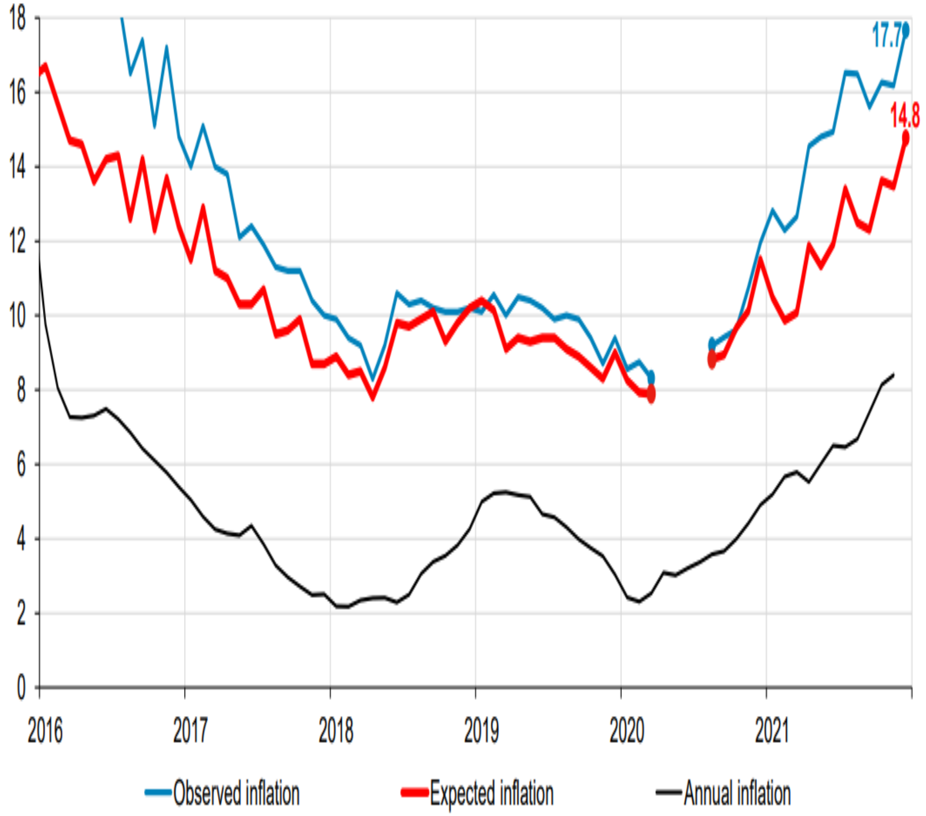



- Russia's **inflation picked up again at 8.7% in January 2022** (Dec 2021: 8.4%), and is estimated at 8.8% as at 4th February 2022.
- Higher inflation reflects that steady growth in domestic demand exceeds production expansion capacity in a wide range of sectors. In this context, businesses are able to pass on higher costs to consumers. In addition, further expansion in industrial output is limited by growing labor shortages.
- In January, households' inflation expectations abated slightly but remained close to six-year highs, while business price expectations are growing and reach new multi-year highs.
- On 11th February, the **central bank raised its key interest rate by 100bps to 9.5%**. As such, monetary conditions in Russia have changed from "accommodative" to "neutral".
- Given the monetary policy stance, Russia's **inflation is expected to decline to 5-6% in 2022, returning to official target of 4% in mid-2023**.

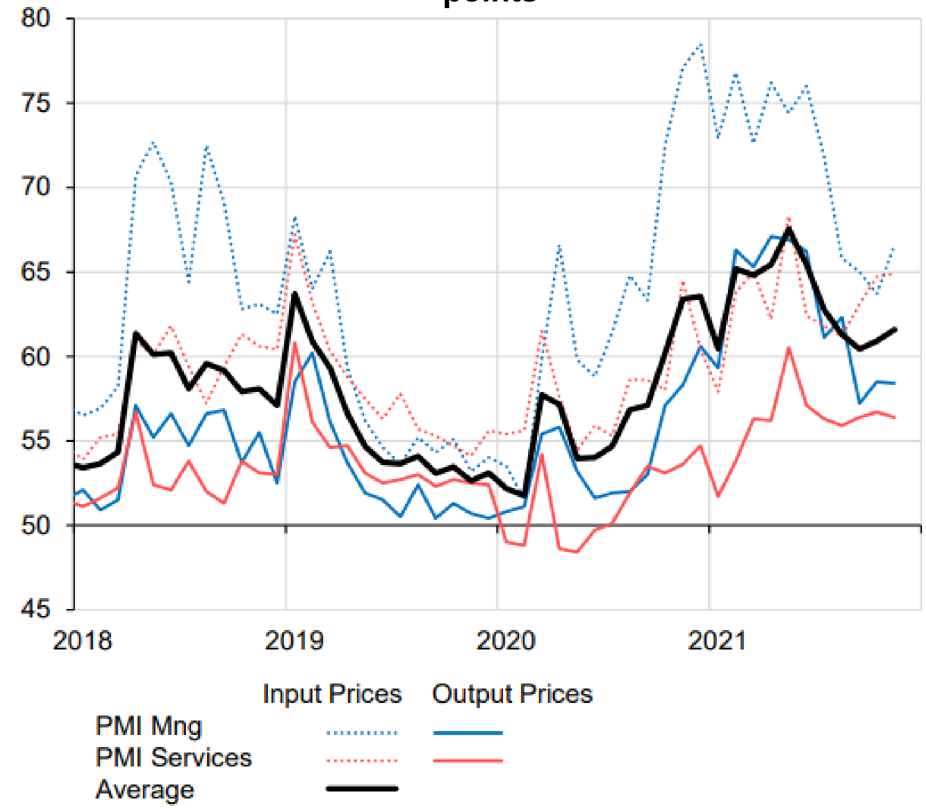
*Source: Central Bank of Russia, VC*

# Households and businesses inflation expectations reach multi-year highs and remain unanchored

**Inflation Observed & Expected by Households, %**




**PMI survey data for manufacturing & services, in points**

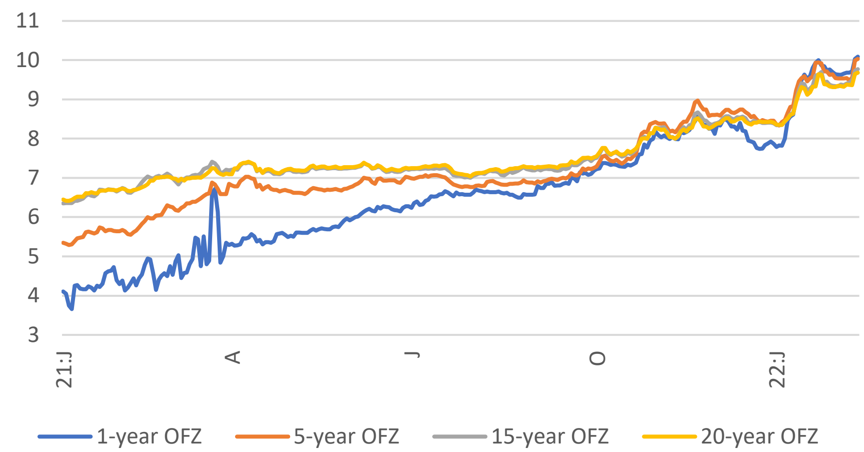



- The impact of one-off supply-side drivers of inflation translated into growing prices for a wider range of goods and services as inflation expectations of households and businesses remain high and unanchored.
- It is important for the central bank to keep inflation expectations anchored/in-check to avoid the inflation spiral effect.

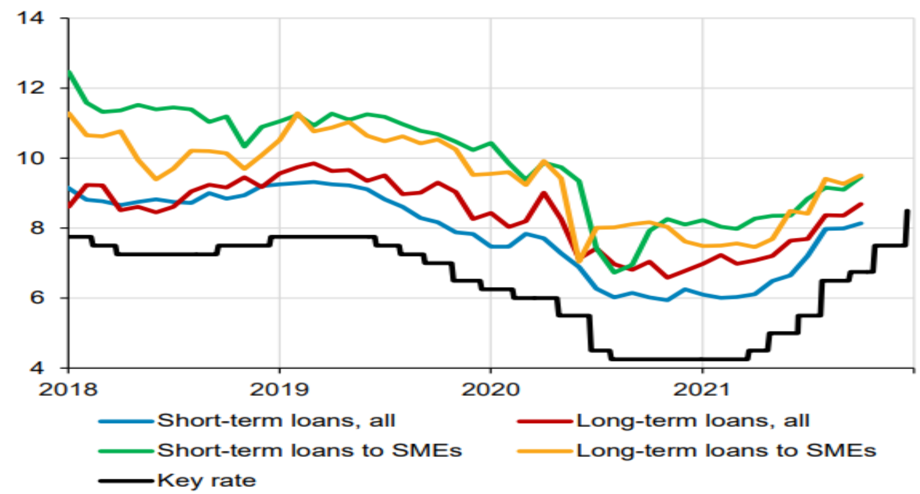
*Source: Central Bank of Russia*

# Yields on short-term OFZs rose reflecting market expectations for the key rate path. Yields on medium and long-term OFZs increased mainly due to elevated geopolitics

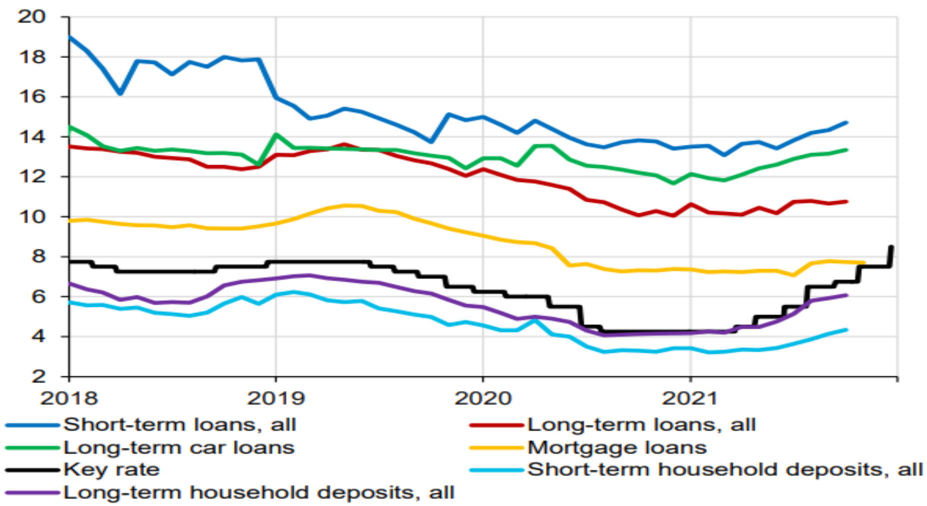
**OFZ Yields, %**




**Interest Rates on Corporate Loans in Rubles, %**



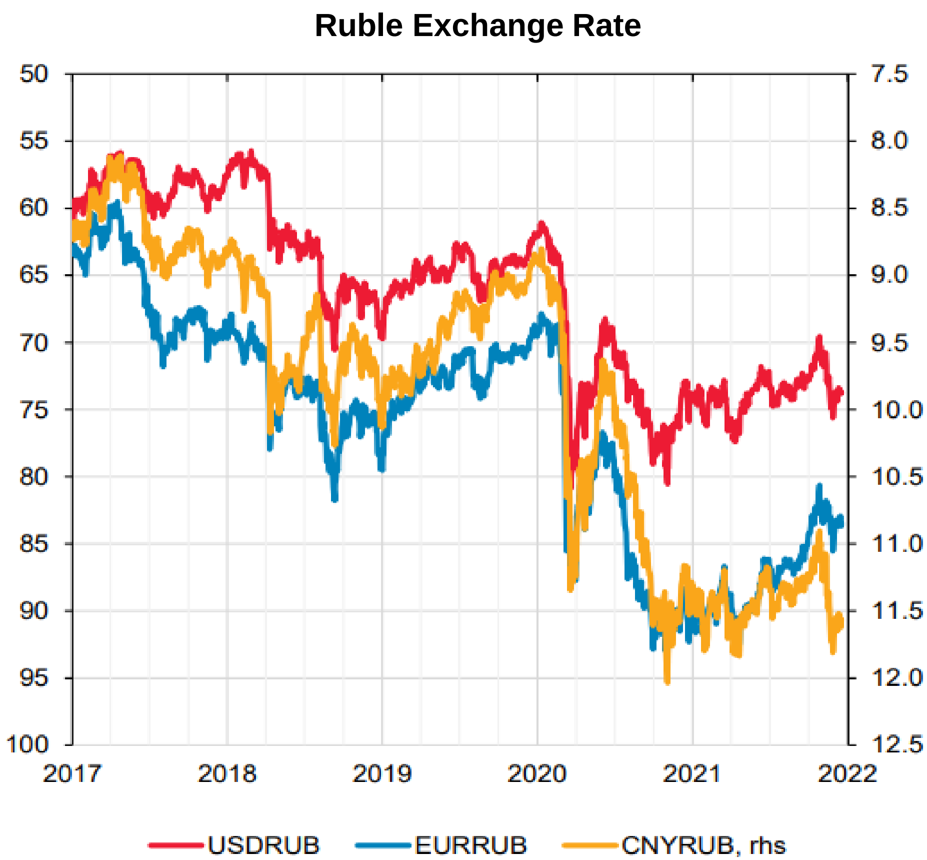

**Interest Rates on Retail & Household Deposits in Rubles, %**

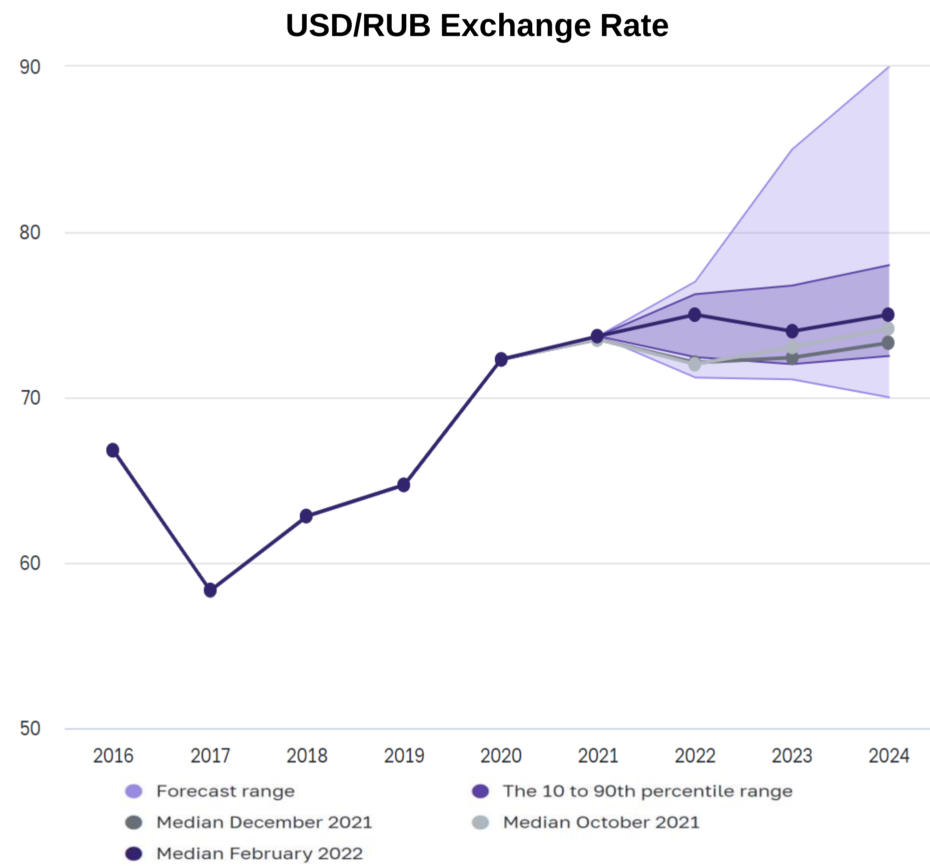



- Short-term OFZ yields rose, reflecting market expectations of the key interest rate path. Medium and long-term OFZ yields increased on geopolitical tensions.
- Credit and deposit rates continue to grow, mirroring the key interest rate.
- Rising nominal interest rates (amidst rising inflation expectations) has yet to ensure a sufficient increase in the propensity to save. The inflow of funds into fixed-term ruble deposits is moderate.
- Both retail and corporate lending markets maintain high activity, reflecting the neutral monetary policy stance.

*Source: Central Bank of Russia, Reuters, VC*

# Investments into high-yielding ruble assets are more attractive amidst higher interest rates, but geopolitics put downward pressure on ruble




- **The central bank macroeconomic survey in February 2022 shows that the USDRUB exchange rate is expected to range at 74.0-75.0 during 2022-2024**.
- Higher interest rates support the ruble by making investments into high-yielding ruble assets more attractive. However, geopolitical tensions put downward pressure on the ruble. Market players view that for the USDRUB to strengthen past the 70-level, inflation expectations need to lower substantially.

*Source: Central Bank of Russia, February 2022 macro survey results*

# Russia's BBB/stable sovereign rating is constrained by existing sanctions and prospect of additional sanctions from geopolitical tensions

- In a statement released on 8th February, Fitch stated that **Russia's 'BBB'/Stable sovereign rating is constrained by existing sanctions and the prospect of additional sanctions** weighing further on GDP growth, financing flexibility and prospects for structural improvements, which are credit weaknesses relative to peers.

- Tensions over Ukraine have increased the risk of conflict and more far-reaching sanctions, although Fitch's base case remains there is no full-scale invasion. Sanctions would likely be calibrated according to the extent of any Russian operations, which is highly uncertain.

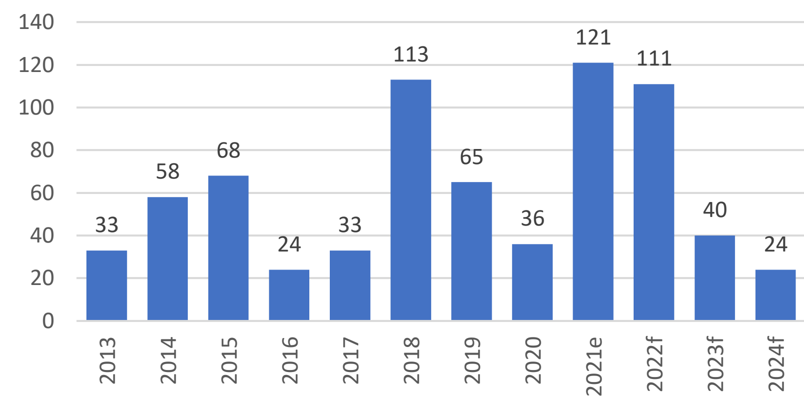
- Triggers could include contained military operations, or cyber-attacks. In the absence of conflict, more likely sanctions include preventing US investors transacting in secondary market sovereign debt, and additional sanctions on senior officials, government institutions and key individuals' wealth.

- US secondary market sovereign debt sanctions would further constrain Russia's fiscal financing flexibility and foreign investment, while capital outflows and a weaker Russian ruble could precipitate tighter policy. However, this would not significantly affect macro-stability or buffers, which include a **Federal Treasury cash reserve and National Wealth Fund assets totaling 16.5% of GDP, and the 'BBB' category's highest international reserves (17 months of imports)**.

- **Non-resident OFZ holdings have fallen to 20.5% of the total** (below 3% of GDP); Fitch expects Russia's **general government surpluses (average 1.3% of GDP in 2022-2023) and the banking sector to able to absorb more debt**. The Central Bank of Russia is able to provide additional liquidity and address market volatility through FX interventions.

**Russia's Foreign Exchange Reserves, USD mln**


**Russia's Current Account Balance, USD bln**




*Source: Fitch Ratings 8th February 2022, Central Bank of Russia, Trading Economics*

# Russian banks have large liquidity buffers to offset deposit outflows, foreign payment schedules are not onerous

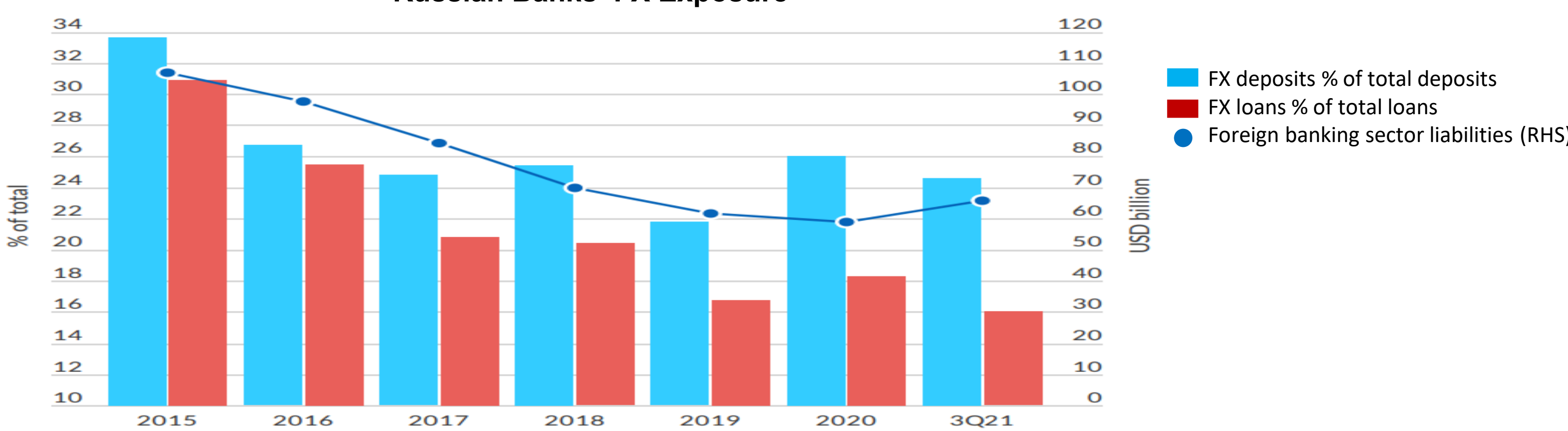
- Nevertheless, Fitch warned that heightened risks around Ukraine and the US draft Menendez Bill underline the **potential in a downside scenario for measures with a larger sovereign credit impact, such as preventing systemic banks and corporates from transacting in US dollars or accessing the international payments system**, or broad-based energy market sanctions disrupting exports.

- The **biggest impact on banking sector creditworthiness would be if sanctions impaired large state-owned banks' ability to execute foreign currency payments**, particularly through banning dollar transactions. Exclusion from SWIFT's messaging system would also cause sizeable near-term disruption, given alternative systems have limited international participation. **Fitch does not expect such measures in its base case, partly because they would impede repayment of foreign creditors, and consider sanctions on less systemically important banks more likely.**

- The rating impact on banks of such severe sanctions would depend on their formulation, especially how far payments to creditors could be channeled through alternative payment systems and other Russian banks, and exposures switched to other currencies or settled with Asian and European counterparties. **Bank ratings would likely be placed on Rating Watch Negative if such sanctions were imposed, and could be downgraded if greater uncertainty over the ability and willingness to service debt persisted**. If sanctions resulted in freezing banks' foreign currency assets, Viability Ratings would also come under pressure.

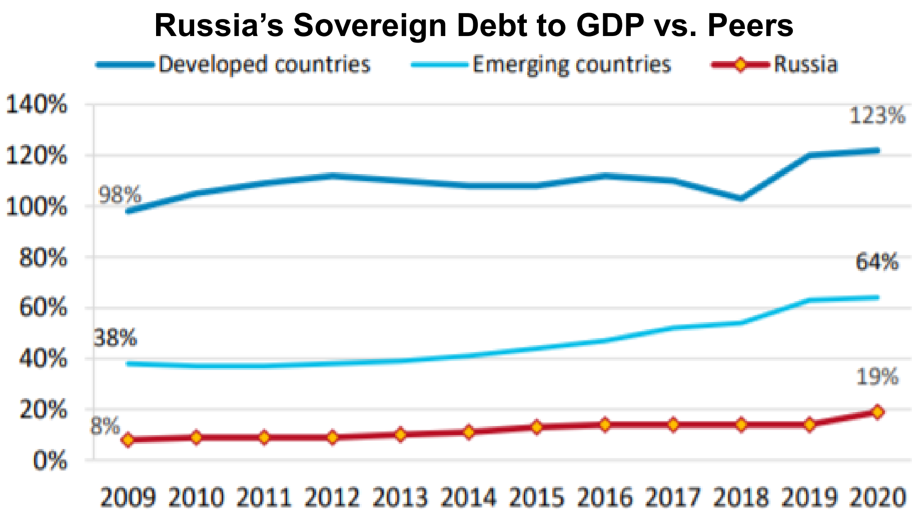
- The impact on financial metrics is unlikely to result in downgrades given banks have generally large liquidity buffers to offset deposit outflows, foreign payment schedules are not onerous (reflecting adjustment to earlier sanctions) and potential regulatory forbearance, if needed.

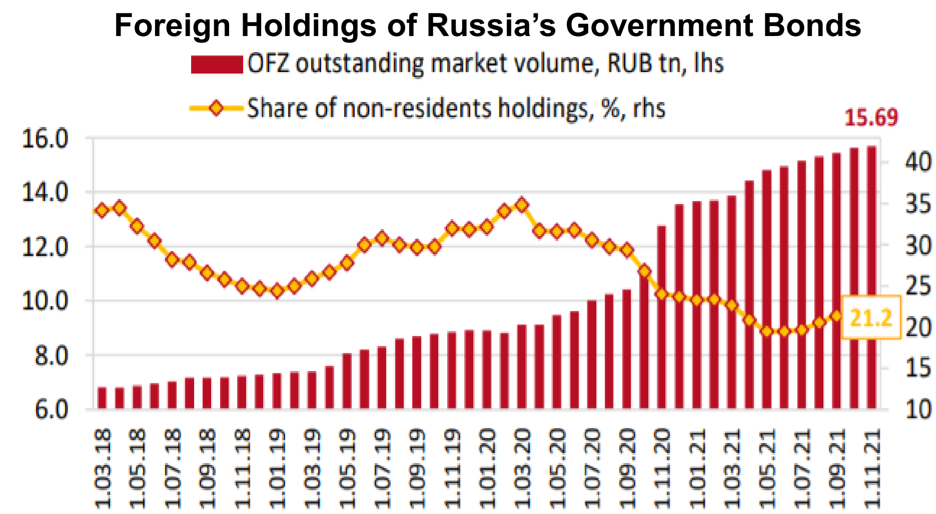
**Russian Banks' FX Exposure**

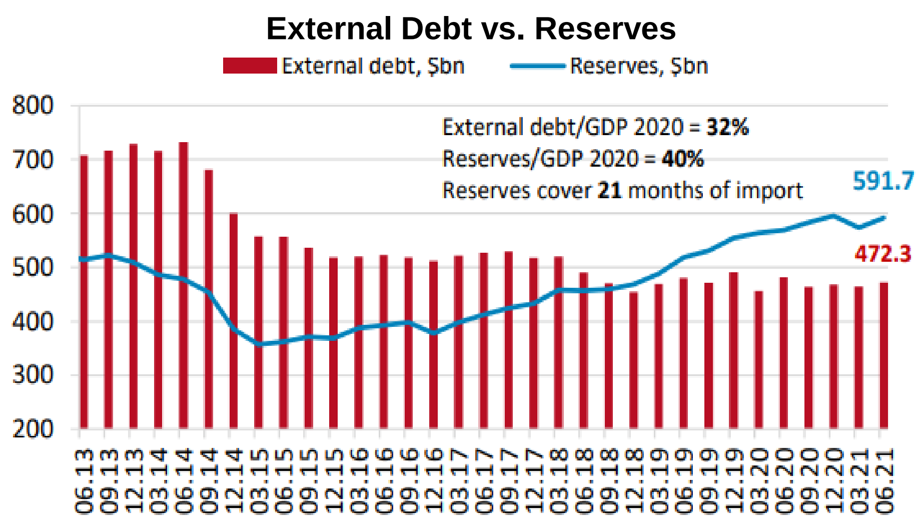


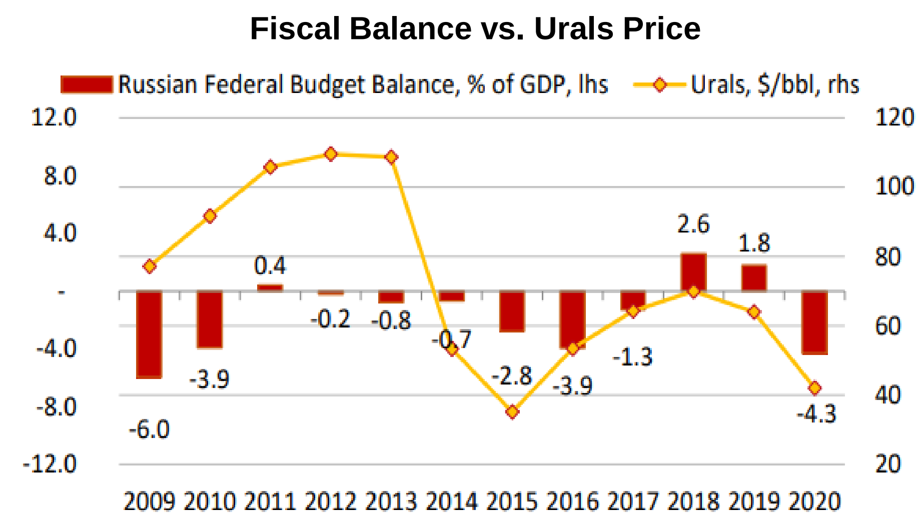

*Source: Fitch Ratings 8th February 2022*

# Russia strengthens macro-policy framework since 2015, build-up of large external & fiscal buffers and reduced external exposures have enhanced its resilience to external shocks




*Source: Central Bank of Russia*

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