

FINANCIAL MARKETS IN MARCH 2014

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Foreign political events that took place in March 2014 had an extremely adverse impact on the Russian stock market. It took the MICEX Index just one day to tumble by 10.8% on March 3, 2014. Stock market capitalization lost Rb 1,72 trillion in March 2014, while total capitalization amounted to Rb 21,7 trillion (33.5% of GDP) as of March 26, 2014. The situation in the Russian corporate bond market kept worsening in March 2014 in response to mounting adverse trends in the Russian economy. The key market indicators, such as market volume and index, weighted average yield of issues, investment activity in the primary and secondary markets saw a downtrend during the month.

Dynamics of the Russian stock market basic structural indices

Mounting tensions in Ukraine had an extremely adverse impact on the Russian stock market. The MICEX Index dropped 1444,71 points at closing in the Moscow Exchange on February 28, 2014 to 1237,43 points by March 14, 2014.

VTB's shares dropped 24.62% by March 14, 2014 since February 27, 2014 while Sberbank's shares lost 20.4% of the value over the same period, and Gazprom's shares fell more than 15%. It is only Norilsk Nickel's shares that saw growth in March 2014, gaining a maximum of 6.76% in the period of February 27, 2014 thru March 7, 2014.

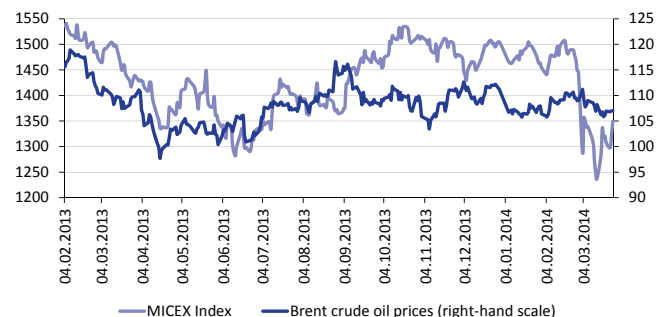
Sberbank's stock showed a negative yield by March 26, 2014, with annual loss reaching 15.0% since March 26, 2014 2013. However, VTB's shares lost most of its value among the most liquid Russian stocks in the period of 26.03.13 thru 26.03.14, reaching 25.6% in losses. Norilsk Nickel's shares saw an annual growth of 14.2%, whereas Gazprom's shares, LUKOIL's shares and Rosneft's shares lost 1 to 3%.

The dynamics of sector indices early in March 2014 showed the same downward response in external events, falling in the period of February 27, 2014 thru March 17, 2014 from 8.5% on the oil and gas sector index to 15.92% on the energy sector index. It is the machine building sector index that saw the deepest sinking, 25.92%, during the period.

Average daily trading turnover in the Moscow Exchange in March 2014 was Rb 64,5bn. Sberbank's stock contributed an average of 32.5% to the stock exchange turnover on a total of common and preferred stocks. It is only Gazprom, accounting for an average of 20.3% of the Moscow Exchange turnover in March 2014, that was able to compete with Sberbank. Therefore, the two major companies accounted for up to 50% of the trading turnover in the Moscow Exchange, whereas the next top-5 companies contributed 24.7%. It should

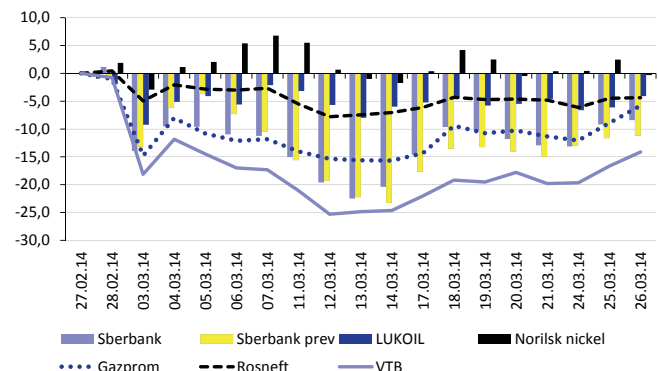
be noted that besides the foregoing most liquid Russian stocks, the top-5 most traded stocks also includes Magnit retail company. Besides, Mechel and Airflot used to fell into this group of companies from time to time. Overall, the eight most traded shares accounted for 70% to 80% of the Moscow Exchange daily trading turnover.

According to the Emerging Portfolio Fund Research (EPFR), foundations investing in Russian shares saw a



Source: RBK Quote.

Fig. 1. Dynamics of the MICEX Index and futures prices of Brent crude oil in the period of February 4, 2013 thru March 26, 2014



Source: RBK Quote, author's estimates.

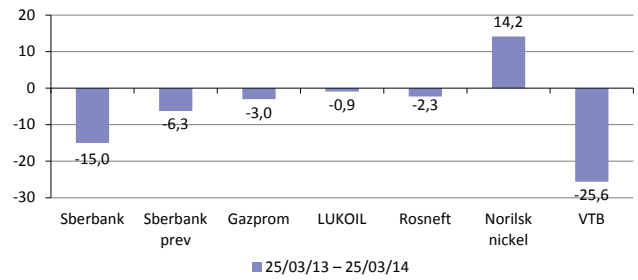
Fig. 2. Most liquid Russian stocks growth rates in the Moscow Exchange in August 2014 (within a period since February 27, 2014)

capital inflow in the period of February 27, 2014 thru March 26, 2014, for the first time since the beginning of year. The volume of capital inflow amounted to \$377m. The inflow was associated with the Russian stock market recovery after the failure of investors' expectations of western countries imposing strict sanctions on Russia. Moscow Interbank Currency Exchange (MICEX) capitalization totaled Rb 21,73 trillion (33.5% of GDP) as of March 26, 2014. The capitalization dropped more than Rb 1,72 trillion (-7.34%) since February 27, 2014. In March 2014, mineral production companies' increased by 0.8 p.p. to 48.8% while the share of manufacturing sector companies gained 0.5 p.p. to 12.8% in the MICEX capitalization structure. At the same time, the share of retail and wholesale trade companies, and financial sector companies shrank by 0.5 p.p. and 0.6 p.p. respectively.

Corporate bond market

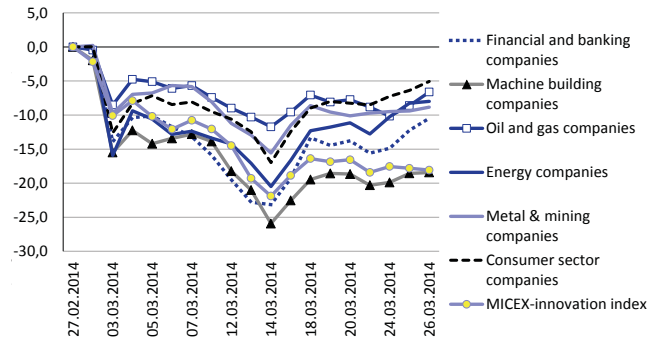
The Russian domestic corporate bond market volume (measured by the par value of outstanding securities denominated in the national currency, including those issued by non-residents) declined in March 2014 for the first time over the recent years. By the end of March 2014 the indicator amounted to Rb 5260,2bn, seeing a decline of 0.5% less against the value observed at end of February 2014¹. The indicator dropped in response to reduction in the number of issues (1044 corporate bond issues registered in the national currency against 1054 issues at the previous month end), whereas the number of issuers in the debt segment even inched up (360 issuers against 355 companies at the end of February 2014). At the same time, the number of USD-denominated bond issues of Russian issuers increased from 12 to 16 (a total of more than \$2,2bn). Additionally, there was an outstanding JPY-denominated bond issue. Investment activity in the secondary corporate bond market in March 2014

1 According to Rusbonds information agency.



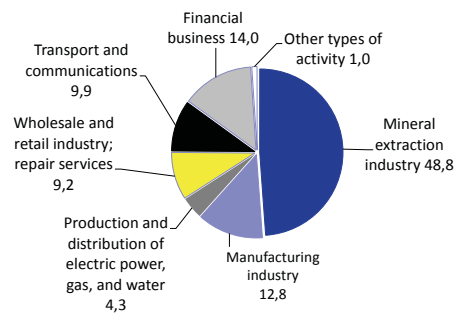
Source: RBK Quote, author's estimates.

Fig. 3. Most liquid Russian stocks growth rates in the Moscow Exchange in the period of March 26, 2013 thru March 26, 2014



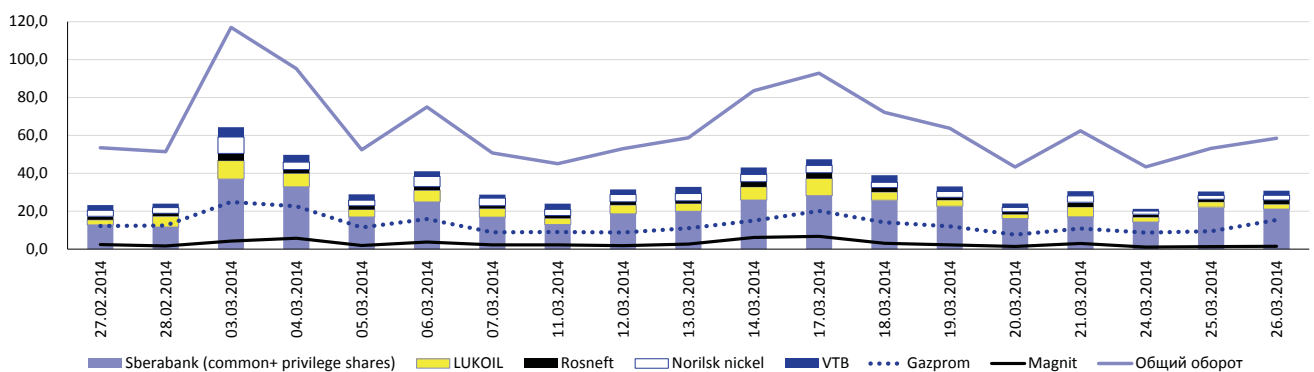
Source: RBK Quote, author's estimates.

Fig. 4. Growth rates in various sector stock indices in the Moscow Exchange (within a period since February 27, 2014)



Source: The Moscow Exchange's official website, authors' estimates.

Fig. 5. Stock market capitalization structure by type of economic activity



Source: RBK Quote, author's estimates.

Fig. 6. Trading turnover structure in the Moscow Exchange (in the period of February 27, 2014 thru March 26, 2014)

the period under review slightly decreased to 26,000, but remained at a high level (to compare, the number of transactions in the previous period amounted to 27,900)¹. This dynamics of trading shows that small investors were interested in trading securities.

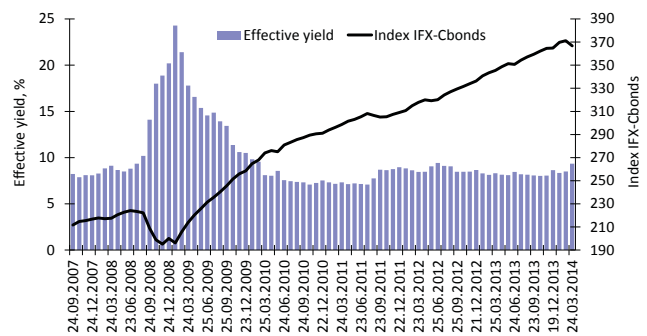
The Russian corporate bond market index IFX-Cbonds stopped growing. Its value declined by 4.4 points (or 1.2%) by the end of March 2014 against the value observed in the previous month. The corporate bond average weighted yield saw a sweeping growth, reaching the local high for the recent 1.5 years, and stood at 9.4% by the end of March 2014 against 8.5% late in February 2014 (Fig. 7)². Duration of the corporate bond portfolio kept falling, being 605 days as of the end of March 2014, 82 less than the value observed as of the end of previous month. Such a dynamics of duration resulted from mostly growth in interest rates in the market.

The worsening of the conditions in the Russian stock market was to a large extent triggered by political events, whereas statistics on the key macroeconomic metrics in the United States and Europe showed that the economy in these countries was recovering. First of all, a drastic increase of 1.5 p.p. of the key interest rate by the Bank of Russia's had an adverse impact on the dynamics of market rates. International rating agencies downgraded their projections for Russia and a few Russian issuers in the period of February thru March 2014, and rankings and forecasts for Russian companies are likely to be further adjusted in the months to come. This produced extra pressure upon the yield. Such Russian companies as MTS and Sistema JSFC whose projection was revised as positive were not affected by the trend.

The most liquid corporate bond market segment saw, unlike the previous period, a strongly pronounced uptrend in the yield of bond issues (except a few 2-tier companies which saw a decline in their bond yield). Financial issuers, namely Vnesheconombank, OAO Russian Agricultural Bank, OAO Gazprombank, as well as OAO Bashneft saw the highest growth in the yield (more than 2 p.p.). It should be noted that financial sector companies' securities saw a substantial overall growth in the yield (an average of more 1 p.p. for liquid bond issues), which was the case either during large-scale sale of securities, or, otherwise, an extremely low investment activity. Securities of producing and hi-tech companies saw less pronounced growth in the yield on bonds, about 0.8 p.p. and 0.5 p.p. respectively. However, there was high demand for the securities of such issuers as MTS and Sistema JSFC.

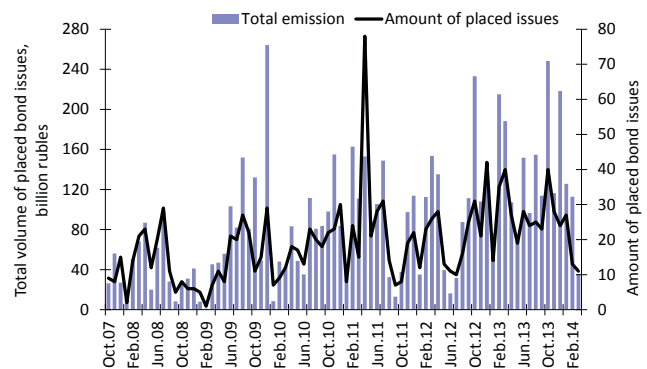
1 According to Finam Investment Company.

2 According to Cbonds Information Agency.



Source: According to Cbonds Information Agency.

Fig. 7. Dynamics of the Russian corporate bond market index and average weighted yield



Source: According to Rusbonds information agency.

Fig. 8. Dynamics of initial public offerings of corporate bonds denominated in the national currency

In March 2014, Russian bond issuers' activity regarding registration of new bond issues declined after hitting a record in February 2014, however it was maintained at a high level as compared to previous months. For example, 17 issuers registered 35 bond issues at an aggregate par value of Rb 140,5bn in the period of February 22, 2014 thru March 24, 2014 (to compare, 61 bond issues at Rb 398,6bn were registered in the period of January 24, 2014 thru February 21, 2014).

The worsening of market conditions had an adverse effect on the primary market whose trading figures dropped lowest since the middle of 2012. For example, 9 issuers placed 11 bond issues at an aggregate par value of Rb 35,7bn in the period of February 22, 2014 thru March 24, 2014 (to compare, 13 ruble-denominated and four foreign currency bond issues at a par value of Rb 112,8bn and \$400m respectively were placed in the period of January 24, 2014 thru February 21, 2014) (Fig. 8). Exchange-traded securities accounted for almost half of the bond issues placed. However, ZAO Ipoteknyy Agent Petrocommerce-1, a mortgage agent, managed to borrow for a period of almost 33 years while another two issues for 10 years

despite low investment activity and adverse projections for the Russian market.

In March 2014, two bond issues were declared void and cancelled for registration by the Bank of Russia for non-placement of a single bond (no bond issues were declared void by the Bank of Russia Financial Markets Service for non-placement of a single bond in February 2014)¹.

In the period of February 22, 2014 thru March 24, 2014, all 19 issuers redeemed their bond issues at an aggregate value of Rb 82,8bn on the date of maturity (all of the issuers honored their obligations and no technical default was announced in the previous months). This is a positive factor in the market

under the circumstances. Twenty two corporate bond issues at a total of Rb 61,3bn are to be redeemed in April 2014².

Additionally, no real default(s) (e.g., when the issuer has failed to repay to bondholders even within a grace period) on coupon yield payment and early redemption(s) of securities on the put date and full repayment were reported in the market in the period of February 22, 2014, like in the previous months³. At the same time, it should be noted that one issuer declared a technical default on the coupon yield during the period under review. ●

1 According to the Bank of Russia.

2 According to Rusbonds company.

3 According to Rusbonds company.