

## FINANCIAL MARKETS IN MAY 2014

N.Andrievsky. E.Khudko

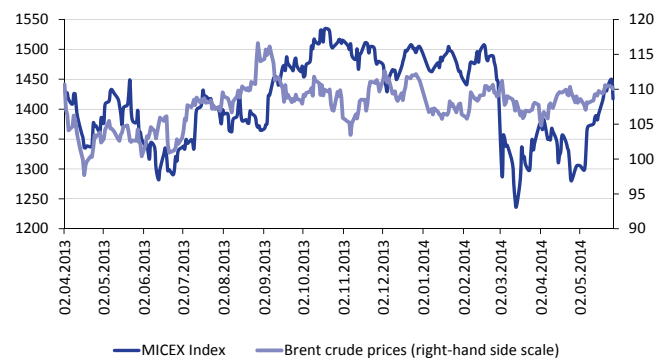
In May 2014, Russia's stock market continued its steady recovery. As of 26 May, the MICEX Index stood at 1,449.3 points, having grown since the beginning of that month by more than 11%. The growth leader among highly liquid shares were VTB Bank's securities – over the period from 2 May through 26 May they rose 24.25%. However, the highest annual yield on shares – more than 40% per annum – was shown by Norilsk Nickel. As of 26 May, the stock market's capitalization amounted to Rb 22.9 trillion (or 35.3% of GDP). The situation on the Russian domestic market of corporate bonds remained unfavorable (although without any signs of radical deterioration). Pushed down mainly by seasonal factors, investment activity and the weighted average effective yield on corporate bonds declined against April (especially in the financial market). At the same time, the Corporate Bond Market Index, the market's size and the activity of issuers displayed moderately positive trends. The growth rates of those indices were apparently slowed down by the emerging difficulties in attracting financing from international capital markets. Russia's bond issuers were able to meet their financial liabilities pertaining to the bonds.

### The Movement of the Russian Stock Market's Main Structural Indices

The movement of the MICEX Index in May 2014 reflected the Russian stock market's rapid recovery. That index's growth was especially robust in the first few days after the May Day holidays – for example, over the course of one day, 7 May, it went up by 3.41%. Over the period from 2 May through 27 May 2014, the MICEX Index stood at an average of 1,388.0 points.

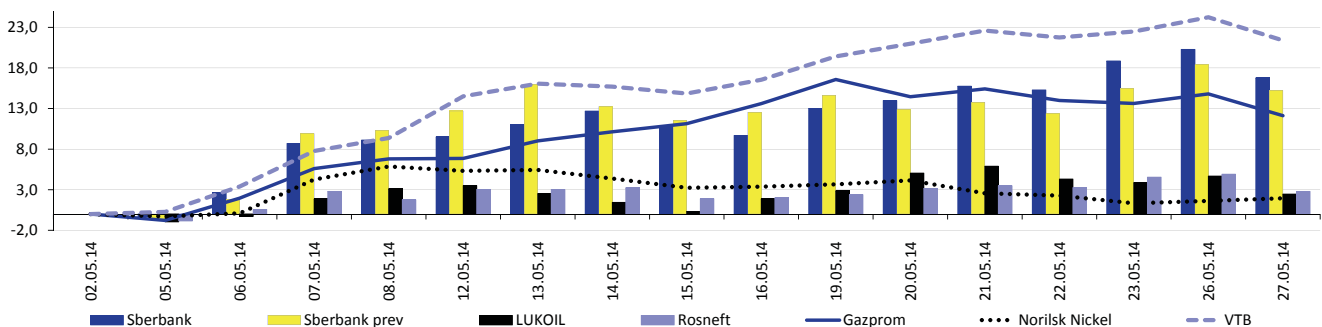
In May 2014, the highly liquid shares traded on the Moscow Exchange were gaining in value: over the period from 2 May through 26 May, shares in *Sberbank*, *VTB* and *Gazprom* went up by 20.29%, 24.5%, and 14.8% respectively. It should be noted that some of the blue chip stocks showed much lower growth rates. Thus, over the period from 2 May through 21 May, shares in *LUKOIL* went up by 5.89%. Having reached their peak value of Rb 6,784 per share on 8 May, shares in *Norilsk Nickel* had dropped by 3.69% by 27 May.

The high growth rate shown by shares in *Sberbank* in May 2014 had no effect on the annual yield on these securities. It should be reminded that, on 23



Source: Quote.rbc.ru.

Fig.1. The Movement of the MICEX Index and Brent Crude Oil Futures Prices in the Period from 2 April 2013 through 27 May 2014



Source: Quote Rbc.ru, the author's calculations.

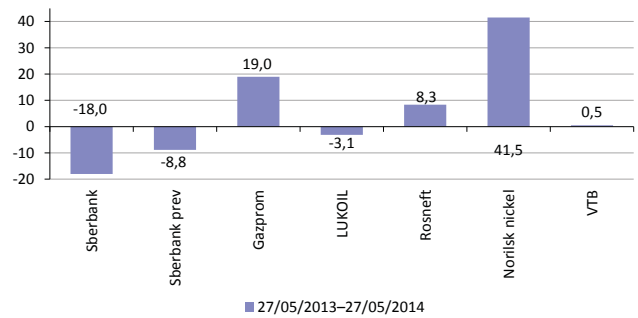
Fig. 2. Growth Rates of the Quotations of Highly Liquid Stocks on the Moscow Exchange (Over the Period from 2 May through 27 May 2014)

May 2013, shares in that bank went up to their historic high of Rb 110.7 per share. At the same time, over the course of 12 months (from 27 May 2013 through 27 May 2014), the annual percentage yield on *Sberbank's* ordinary shares amounted to 18%. During the same period, the price of shares in *Norilsk Nickel* increased by 41.5%. The annual percentage yield on shares in *Gazprom* was 19%, a very impressive result indeed. It should be said that the high growth rate shown by shares in *VTB* made it possible for them to return to their peak value registered on 27 May 2013.

As far as the sectoral indices are concerned, the highest growth rate was shown in May 2014 by the MICEX Financials Index, which went up 18.17% over the period from 1 May and 26 May. The MICEX Power Index grew by 12.67%. Over the course of May 2014, the other indices grew on average by 7.22%.

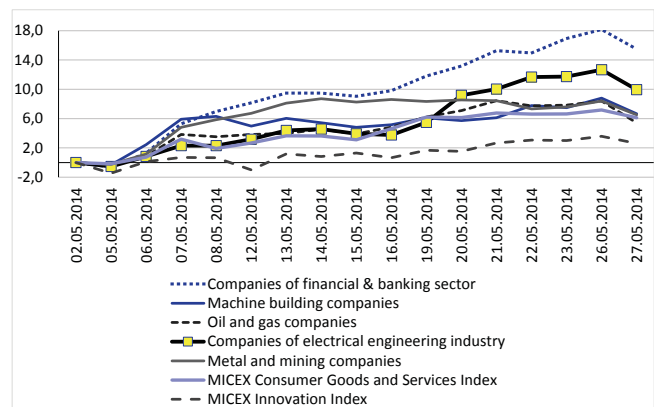
Over the course of the period from 1 May through 27 May 2014, the average daily trading turnover of the Moscow Exchange amounted to Rb 39.7bn. The most active trading days of that period were those between the May holidays 2014, when the daily trading turnover of the Moscow Exchange climbed to Rb 60.0bn, and some of the last ten days of May. Trading in ordinary and privileged shares in *Sberbank* accounted for 44.0% of the average daily trading turnover of the Moscow Exchange. In May, the second-best performer on the MICEX was shares in *Gazprom*, which accounted for 19.4% of the average daily trading turnover of the Moscow Exchange. On 21 May, their share of the daily trading turnover climbed to 35.5%. Thus, these two biggest companies accounted for more than 63% of the Moscow Exchange's trading turnover. Trailing behind them were five companies whose combined volume of trade in shares on the MICEX accounted, on average, for 24.1% of the daily trading turnover of the Moscow Exchange.

According to *Emerging Portfolio Fund Research (EPFR)*, over the period from 24 April through 7 May 2014, funds oriented to the Russian market experienced net inflows in the amount of \$ 47m. As of 27 May, MICEX's total capitalization amounted to Rb 22.9 trillion (or 35.3% of GDP), having increased since 2 May by more than Rb 1.53 trillion, which represented a 7.2% rise on the beginning of that month. As far as the stock market's capitalization structure by type of economic activity is concerned, in May the capitalization share of financial companies increased by more than 0.76%, to 14.6%. The capitalization share of companies belonging to the consumer and retail sector grew by 0.32%. The capitalization shares of these sectors increased at the expense of the capitalization shares of the mineral extraction sector and processing industries which dropped in May by 0.66% and 0.45% respectively.



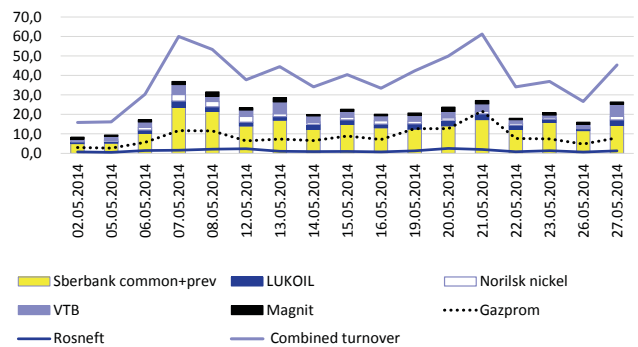
Source: Quote.rbc.ru, the author's calculations.

Fig. 3. Growth Rates of the Prices of Highly Liquid Shares Traded on Moscow Exchange Over the Period from 27 May 2013 through 27 May 2014



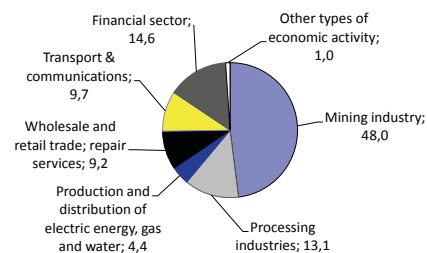
Source: Quote.rbc.ru, the author's calculations.

Fig. 4. Growth rates of Various Sectoral Indices on the Moscow Exchange (Over the Period from 2 May through 27 May 2014)



Source: Quote.rbc.ru, the author's calculations.

Fig. 5. Structure of the Trading Turnover of the Moscow Exchange (Over the Period from 2 May through 23 May 2014)



Source: the MICEX's official website; the authors' calculations.

Fig. 6. Structure of Capitalization of the MICEX Stock Market, by Type of Economic Activity

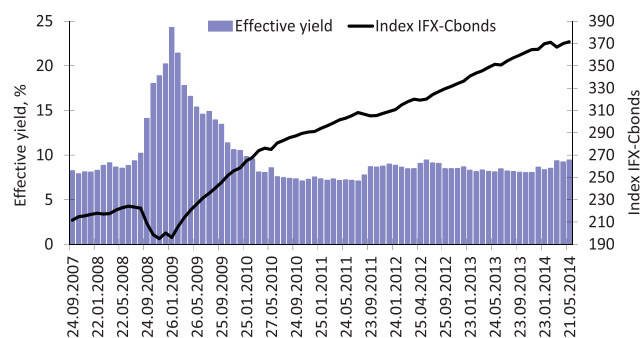
## The Corporate Bond Market

In May 2014, the decline in the volume of Russia's domestic corporate bond market (by the nominal value of ruble-denominated securities in circulation, including those issued by RF non-residents) stopped in its tracks. By the end of May, the volume of that market had climbed to Rb. 5,249.1bn, which represented a 0.2% rise on late April<sup>1</sup>. The achieved stabilization of the domestic corporate market's volume was caused by absence of any changes in the number of issued bond loans (1,034 ruble-denominated corporate bond issues). At the same time, the number of emitters represented in the debt segment slightly decreased (353 in May vs. 359 as of the end of April). The number of US dollar-denominated bond issues placed by Russian emitters on the MICEX and circulating thereon increased from 16 to 17 (with an aggregate face value of above \$ 2.2bn). As before, one yen-denominated bond issue placed by Russian emitters remained in circulation.

In May, investment activity on the secondary corporate bond market significantly declined, having been pushed down in the main by seasonal factors. Thus, in the period from 22 April through 21 May 2014, the combined volume of exchange transactions carried out on the Moscow Exchange amounted to just Rb 76.3bn (for reference: over the period from 24 February through 24 March, the monthly trade turnover was about Rb 109bn), while the number of transactions carried out over the period under consideration dropped to 23.8 thousand (vs. 28.4 thousand in the previous period)<sup>2</sup>.

Having dwindled in March, later on the IFX-Cbonds index of the Russian corporate bond market began to grow. By the end of May it had increased by 1.6 points (or 0.4%) on late April. Having experienced a slight drop in early May, the weighted average effective yield on corporate bonds nevertheless went up from 9.22% in late April to 9.43% as of the end of May (Fig. 7)<sup>3</sup>. The corporate bond portfolio duration index continues to display a negative trend. As of the end of May, that index amounted to 554 days, which represented a 26-day drop on late April. This negative trend was caused not only by the aforesaid decrease in the duration of bond circulation, but also by the rise in the effective yield on corporate bonds.

For a third month in a row, Russia's financial market had been under negative pressure caused by an unfortunate sequence of economic and political events, which resulted in the emergence of unfavorable market trends.



Source: According to data released by the Cbonds company.

Fig. 7. Behavior of the IFX-Cbonds Index of the Russian Corporate Bond Market and the Dynamics of Its Weighted Average Effective Yield

Firstly, investor behavior on Russia's domestic bond market was to a certain extent influenced by this country's sovereign debt rating being downgraded by the Standard & Poor's credit ratings agency (from BBB to BBB- with a negative outlook). That fact, in its turn, made it more difficult for companies to attract foreign financing and increased capital outflows from Russia<sup>4</sup>. Secondly, high inflation expectations significantly boosted the inflation rate. In order to control inflation, the RF Central Bank unexpectedly raised its key interest rate from 7.0% to 7.5%, thus pushing up the interest rate on bonds circulating on Russia's domestic bond market. Thirdly, in late April and May 2014, the RF CB withdrew licenses from many banks (OJ-SC *National Business Development Bank*, the commercial bank *Mestny Kredit*, *Atlas Bank*, *First Republican Bank*, the bank *Navigator*, and the bank *Moscow Lights*).

Moreover, there were plenty of disconcerting statistics pointing to the poor performance of Russian companies during the spring 2014. Thus, their profits significantly declined on the same period of last year<sup>5</sup>.

The most liquid corporate bonds continued to display a variety of trends with regard to their yields. Some individual bond issues of companies belonging to the manufacturing sector had the highest upward and downward volatility (in April, the highest volatility was displayed by some bond issues of financial companies). Thus, the most significant yield increase (above 1 pp.) was demonstrated by the securities of OJ-SC *Joint-Stock Oil Company Bashneft*, while the most significant yield loss (by more than 1 pp.) was displayed by the securities of OJ-SC *Joint-Stock Oil Company Rosneft* and OJ-SC *Holding Company Metalloinvest*. Also, a substantial yield increase was demonstrated by the bonds issued by OJ-SC *Gazprombank*. At the same time, it should be noted that the sales and purchases of the aforesaid securities on the secondary corporate

1 According to data released by the Rusbonds information agency.

2 According to data released by the Finam investment company.

3 According to data released by the Cbonds information agency.

4 According to data released by the Cbonds information agency.

5 According to data released by the Cbonds information agency.

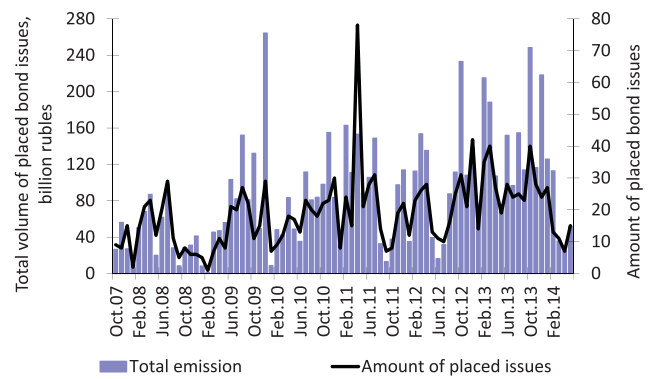
bond market were not happening at a hectic pace, which characterized the sales and purchases of securities issued by financial companies (for example, over the course of the period under consideration, the aggregate volume of transactions with some of the bond issues of *Vneshekonombank*, *Zenit Bank* and the *Agency for Housing Mortgage Lending* amounted to more than Rb 1bn). However, on the average, neither companies belonging to the manufacturing sector nor hi-tech companies had high interest rate volatility. At the same time, an upward trend in yields on bonds was demonstrated by bonds issued by companies belonging to the financial sector (above 0.3 pp.). Corporate bonds issued by companies belonging to the energy sector displayed opposite trends. It should be noted that demand for such securities was very low<sup>1</sup>.

In spite of the unfavorable market situation and the traditional decline in the activity of market participants in the first half of May, the indices of registration of new bond issues hit a three-month high. Thus, over the period from 22 April through 21 May 2014, 12 emitters registered 61 bond issues with a total face value of Rb 304.4bn (for reference: over the period from 25 March through 21 April 2014, a total of 25 bond issues were registered, with a total face value of Rb 58.6bn). One of the causes of this surge in issuer activity was a sharp decrease in the availability of foreign financing. Big bond issues were registered by CJ-SC *UniCredit Bank* (with a total face value of Rb 110bn), OJ-SC *Russian Grids* (with a total face value of Rb 100bn), and OJ-SC *NOMOS-BANK* (with a total face value of Rb 22bn)<sup>2</sup>. Almost all newly registered bond issues were exchange-traded bonds.

The activity on the primary market also became more robust in comparison with the previous period, when trade indices hit their two-year low. Nevertheless, the indices of activity on the primary market remain very low. Thus, over the period from 22 April through 21 May 2014, 10 emitters placed 15 bond loans with a total nominal value of Rb 513.85bn (for reference: in the period from 25 March through 21 April 2014, a total of only 7 bond loans with a total nominal value of Rb 24.6bn were placed) (Fig. 8).

1 According to data released by the Finam investment company.

2 According to data released by the Rusbonds information agency.



Source: According to data released by the Rusbonds company.

Fig. 8. Dynamics of the Primary Placements of Issues of Ruble-Denominated Corporate Bonds

Most of the placed bond loans were exchange-traded bonds. In spite of the adverse market situation, OJ-SC *AIZhK* managed to attract finance in the form of 15- to 19-year loans, while another four issuers managed to attract it in the form of 10-year loans.

In May, the Bank of Russia annulled 8 bond issues due to failure to place even a single security (for reference: in April 2014, not a single bond issue was annulled for that reason)<sup>3</sup>. As a result, two big emitters, *Gazprom Neft* and *RESO-Garantia*, revised their plans to borrow on the bond market.

Over the period from 22 April through 21 May 2014, all 18 emitters redeemed their bond issues with a total face value of Rb 66.2bn in due time (for reference: in the previous period, one emitter was unable to meet his obligations under the bonds, and therefore declared a technical default). In June 2014, the redemption of 23 issues of corporate bonds with a total face value of Rb 56.8bn is expected<sup>4</sup>.

It should be noted that the period from 22 April through 21 May 2014 saw no real defaults on the payment of the coupons, on the buyback offers to the current holders of securities before their maturity, and on the redemption of a whole bond loan<sup>5</sup>. In this respect, the situation remained unchanged from the previous few months.

3 According to data released by the Bank of Russia.

4 According to data released by the Rusbonds information agency.

5 According to data released by the Rusbonds information agency.