

RUSSIA'S FINANCIAL MARKETS IN JULY 2014

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The MICEX Index, after having risen by 2% to 1,513 points over the first ten days of July, then dropped by 10% towards the month's end. By 28 July, MICEX Index stood at 1,361.9 points. The MICEX's capitalization by 28 July had amounted to Rb 21.8 trillion (or 32.0% of GDP). Russia's domestic corporate bond market displayed a surge of the weighted average effective yield on corporate bonds in face of a declining corporate bond portfolio duration index. Nevertheless, in July the market volume and the marker index, as well as investor primary and secondary bidding activity, were on the rise.

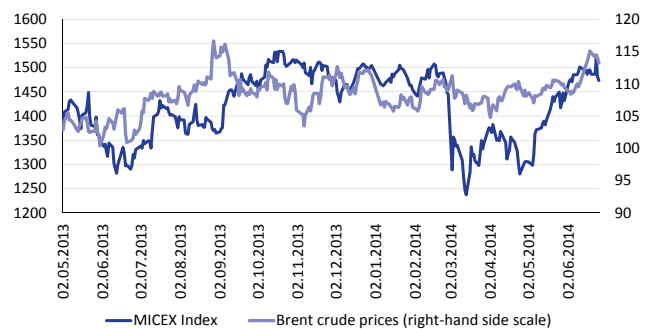
The Movement of the Russian Stock Market's Main Structural Indices

Due to the aggravating geopolitical situation in July, the MICEX Index was generally on decline. Over the first ten days of July, the MICEX Index increased by 2% to 1,513.4 points, and then plummeted to 8.5% over the period from 10 July through 21 July. In the last week of July, the negative background information continued to influence the stock market, with the result that the MICEX Index by 28 July had dropped to 1,361.9 points.

Over the first week of July, the highly liquid shares traded on the Moscow Exchange were moderately gaining at a rate of 1–3%. In the period from 10 July to 20 July, their value declined by a 6–9% on its index as of the month's beginning. By 28 July, the drop in value of privileged shares in *Sberbank* amounted to 15.9%, that of ordinary and privileged shares in *Sberbank* – to 13.3%, and that of shares in *Rosneft* – to 12.7%. Among the trends visible over that period, the most prominent one was the surge in value displayed by shares in *Norilsk Nickel*, which by 7 July had gained 7.6% since the month's beginning.

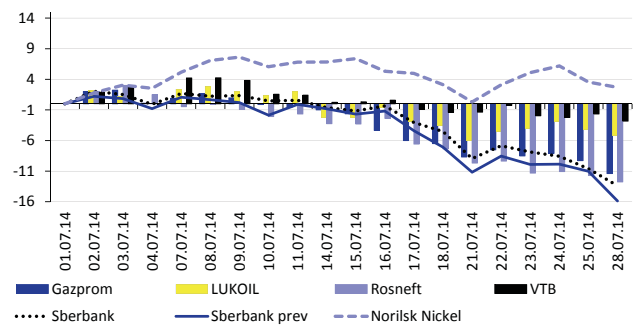
The annual yield on shares in *Sberbank* by 28 July 2014 had become negative: the annual loss since 29 July 2013 amounted to 22.8% for ordinary shares and to more than 21% for privileged shares. Shares in *VTB* were also loss-making – the annual loss (over the period from 29 July 2013 through 28 July 2014) was 15.2%. 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%. It should be noted that, during the same period, the price of shares in *Norilsk Nickel* increased significantly – by 53.7%, without taking in account dividend payments.

The movement of sectoral indices in July reflected the way the foreign economic sanctions were targeted: the indices in the machine-building, energy-production and oil and gas sectors over the period from 1 July



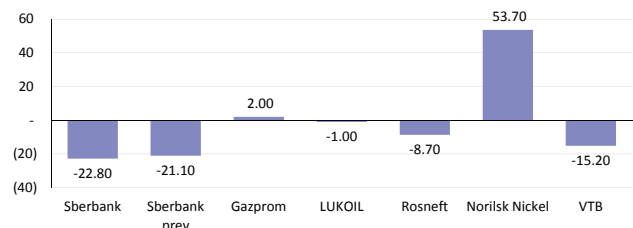
Source: Quote.rbc.ru.

Fig. 1. The Movement of the MICEX Index and Brent Crude Oil Futures Prices in the Period from 1 June 2013 through 28 July 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 1 June 2013 through 28 July 2014)



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

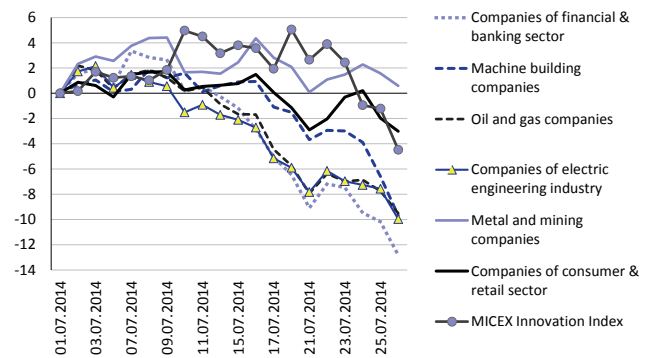
Fig. 3. Growth Rates of the Prices of Highly Liquid Shares Traded on Moscow Exchange Over the Period from 29 June 2013 through 28 July 2014

through 28 July declined on the average by 10%. The financial and banking sector's index declined by 12.8%. A positive change was demonstrated only by the metallurgical sector, where growth by 28 July amounted to 0.58% on the month's beginning. The decline of the consumer sector's index by 28 July amounted to 3% of its value as of 1 July.

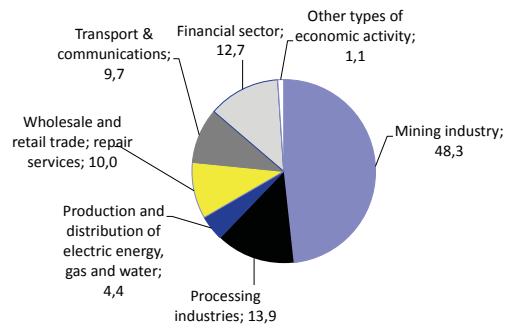
Over the course of the period from 1 July through 28 July 2014, the trading turnover of the Moscow Exchange amounted to Rb 645.9bn, which is by 0.6bn more than the same index for the corresponding period of June. The share of trading in ordinary and privileged shares in *Sberbank* in the Moscow Exchange's turnover in July amounted on the average to 28.4%. *Sberbank's* only serious rival on the MICEX was *Gazprom*, whose shares, however, accounted for no more than 19.7% of the Moscow Exchange's turnover. Thus, these two biggest companies together accounted for more than 47% 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 27.4% of its trading turnover. It is noteworthy that, in July, high trading turnover indexes were demonstrated by shares in *Uralkali* and *Novatek*. The 8 leaders in trading turnover on the share market accounted on the average for 75.6% of the monthly trading turnover of the Moscow Exchange, which differs only slightly from that index's value recorded in June.

According to *Emerging Portfolio Fund Research* (EPFR), over the period from 26 June through 23 July 2014, funds oriented to the Russian market experienced net outflows in the amount of \$ 354m. It should be noted that the rate of money outflow over the course of July was on the rise; thus, while in late June the weekly outflow volume amounted to \$ 34m, in the period from 17 July through 23 July it surged to \$ 172m. As of 28 July 2014, MICEX's total capitalization amounted to Rb 21.8 trillion (or 32.0% of GDP), having declined since 1 July by more than Rb 2.1 trillion, or 8.8%. As far as the stock market's capitalization structure by type of economic activity is concerned, in July the capitalization share of the mineral

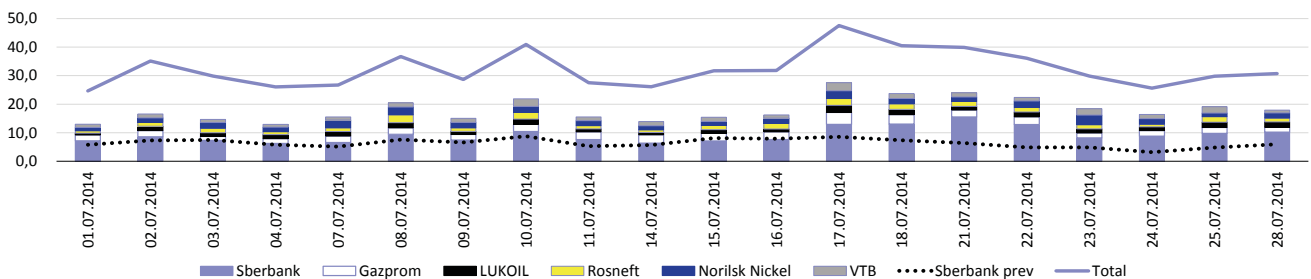
extraction sector shrank by more than 0.6%, to 48.3% of the MICEX total capitalization index. The capitalization share of financial companies also declined – by 0.7%, to 12.7%. The same is true for the capitalization share of companies belonging to the transport and communications sector – it declined by 0.3%, to 9.7%. As a result, due to the shrinking shares of companies belonging to the other sectors, the capitalization share of the processing sector's companies increased, while in fact, they demonstrated no actual capitalization growth in July.



Source: Quote rbc.com, the author's calculations.
 Fig. 4. Growth rates of Various Sectoral Indices on the Moscow Exchange (Over the Period from 1 July through 28 July 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



Source: Quote rbc.com, the author's calculations.
 Fig. 5. Structure of the Trading Turnover of the Moscow Exchange (Over the Period from 1 July through 28 July 2014)

The Corporate Bond Market

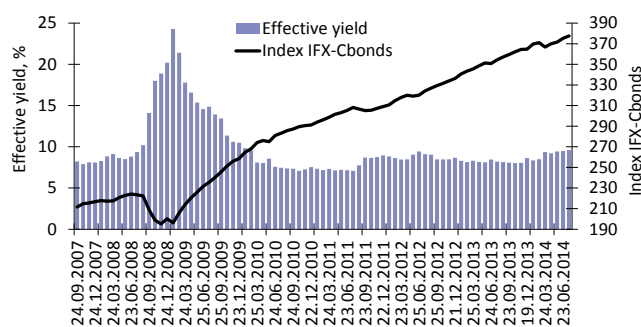
In July 2014, the volume of Russia's domestic corporate bond market (by the nominal value of ruble-denominated securities in circulation, including those issued by RF non-residents) continued to grow at a slow pace. By the end of July, the volume of that market had climbed to Rb 5,317.2 bn, which represents a 0.8% rise on late June¹. Over that period, the number of issued bond loans remained practically unchanged (1,031 ruble-denominated corporate bond issues against 1,030 in late June). At the same time, the number of emitters represented in the debt segment visibly increased (357 in July vs. 345 in June). The number of US dollar-denominated bond issues placed by Russian emitters on the MICEX remained unchanged – 17 issues (with an aggregate face value of above \$ 2.7 bn). As before, one yen-denominated bond issue placed by Russian emitters remained in circulation.

In July, investment activity on the secondary corporate bond market somewhat increased. Thus, in the period from 24 June through 24 July 2014, the combined volume of exchange transactions carried out on the Moscow Exchange amounted to Rb 127.1bn (for reference: over the period from 22 May through 23 June, the monthly trade turnover was about Rb 108.9bn), while the number of transactions carried out over the period under consideration surged to its local historic high – nearly 30 thousand (vs. 25.2 thousand in the previous period)².

The IFX-Cbonds index of the Russian corporate bond market continued to grow. By the end of July, it had increased by 2.4 points (or 0.6%) on late June. However, the weighted average effective yield on corporate bonds went up from 9.48% in late June to 9.61% as of the end of July (Fig. 7)³. The corporate bond portfolio duration index continued to decline: as of the end of July, that index amounted to 442 days, which represents a 30-day drop on late June.

The main factors influencing the movement of the bond market in July were the mounting geopolitical tension, the resulting capital outflow and the ruble's depreciation, as well as the fact that the RF Central Bank had raised its key interest rate.

The most liquid segment of the corporate bond market on the whole displayed increasing yields. The most significant yield increase (above 1 p.p.) was demonstrated by some of the issues of securities of companies belonging to the financial sector: *VTB Bank* (JSC), *Gazprombank* (JSC), *Gazprom Capital* (LLC), and *Zenit Bank*. Rising interest rates triggered more active trading – over the period under consideration, the volume



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

of sales and purchases of the majority of liquid securities issued by financial companies exceeded Rb 0.5bn. At the same time, the yields on securities issued by some manufacturing companies significantly dropped (for example, those issued by JSC *Novolipetskii Metallurgicheskii Kombinat* (NLMK) [Novolipetsk Metallurgic Combine] and *Russian Railways*). But on the whole, the manufacturing and energy sectors demonstrated some moderate yield growth (no more than by 0.2 p.p.). Yield growth was also noted with regard to securities issued by hi-tech companies⁴.

In July, after the record-high indices achieved in May and June, the emitter activity became significantly less prominent, which can be explained both by the unfavorable market situation and the seasonal factor. Thus, over the period from 24 June through 24 July 2014, 10 emitters registered 27 bond issues with a total face value of Rb 94.0bn (for reference: over May and June 2014, a total of 60–70 bond issues per month were registered, with a total face value of Rb 300bn–500bn). Big bond issues were registered by OJSC *Credit Bank of Moscow*, *Power Machines OJSC*, and OJSC *Detsky mir* [Children's World]⁵. More than two-thirds of the newly registered bond issues were exchange-traded bonds, although there were also some initial placements of bond issues.

Nevertheless, the situation on the primary market turned out to be more optimistic. The indices of primary placements were significantly higher than those of newly registered issues, and higher than the placement indices for the previous months. Thus, over the period from 24 June through 24 July 2014, 18 emitters placed 27 bond loans with a total nominal value of Rb 330.6bn, which represents a six-year record high (for reference: in the period from 22 May through 23 June 2014, a total of 24 bond series with a total nominal value of Rb 82.9bn were placed) (Fig. 8). The surge of

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.

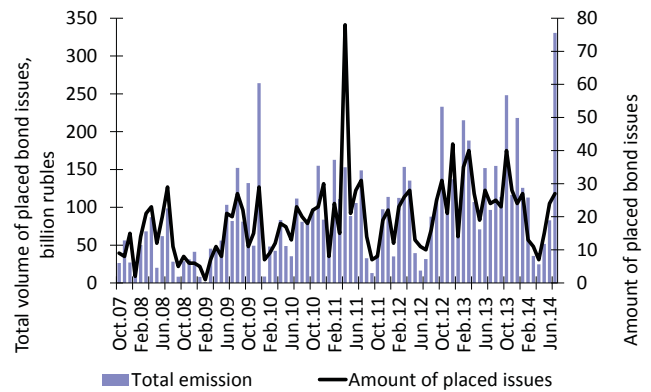
4 According to data released by the Finam investment company.

5 According to data released by the Rusbonds information agency.

the index of primary placements was caused by placement of a new bond issue by *Vneshekonombank* to the value of Rb 212.6bn; the first buyer was the RF Central Bank. Besides, big bond loans were placed by OJSC *Russian Railways* (a series of exchange-traded bonds to the value of Rb 25bn) and OJSC *Russian Agricultural Bank (Rosselkhozbank)* (two bond series to the total value of Rb 15bn)¹. Approximately half of the placed bond loans were exchange-traded bonds. Most of the placed bond loans were exchange-traded bonds. In spite of the persisting risks and capital outflow from the Russian securities market, *Russian Railways* and three housing mortgage agencies managed to attract finance in the form of 27-to-30-year loans, while another four issuers managed to attract it in the form of 10-year loans.

In June, the Bank of Russia annulled 3 bond issues of two second-echelon emitters due to their failure to place even a single security (for reference: over the previous months, on the average 7–8 bond issues per month had been annulled for that reason)².

Over the period from 24 June through 24 July 2014, 26 emitters were expected to redeem their bond issues with a total face value of Rb 96.9bn (for reference: in the previous period, one emitter was unable to redeem a bond issue in due time, and therefore



Source: According to data released by the Rusbonds company.

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

declared a technical default). In August 2014, the redemption of 14 issues of corporate bonds with a total face value of Rb 52.3bn is expected³.

Besides, over the period from 24 June through 24 July 2014, one real default on the payment of the coupons was declared (i.e., the emitter failed to make due payments on securities). At the same time, as before, that period saw no real defaults on the buyback offers to the current holders of securities before their maturity, and on the redemption of a whole bond loan⁴.

1 According to data released by the Rusbonds information agency.
2 According to data released by the Bank of Russia.

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4 According to data released by the Rusbonds information agency.