

FINANCIAL MARKETS IN AUGUST 2014

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In August 2014, the MICEX Index, after having risen to 1,460 points as of 21 August, over the next few days dropped by 4.1%, standing as of 29 August at 1,400.7 points. The MICEX's capitalization as of 29 August amounted to Rb 22.4 trillion (or 34.6% of GDP). In August, the main negative factor on Russia's domestic corporate bond market was the surge of the weighted average effective yield on corporate bond issues that triggered the downward movement of the corporate bond portfolio duration index and waning investor primary and secondary bidding activity. Nevertheless, August also saw some positive trends displayed by key market indicators, such as the market volume and the marker index, as well as issuer activity with regard to registration of new securities issues. Besides, bond issuers were better fulfilling their obligations to bondholders.

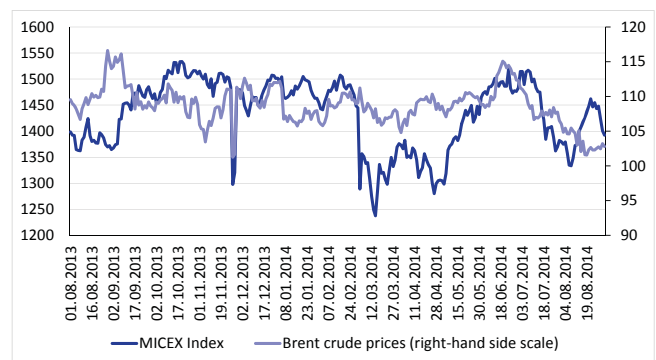
The Movement of the Russian Stock Market's Main Structural Indices

Over the period from 7 August through 21 August, the MICEX Index increased by 9.6%. That period saw no new sanctions against Russia being introduced by the European Union and the USA, and so the marker displayed growth. The fact that sanctions represent a relevant factor in the eyes of investors has been confirmed by the developments over the last ten days of August, when in response to the news of more impending sanctions against the RF the MICEX Index dropped by 4.1%, to 1,400 points.

Over the first week of August, the highly liquid shares traded on the Moscow Exchange were losing in value in response to a new package of sanctions directed in the main against Russia's major banks. The period from 10 August through 20 August saw the market's recovery to its level as of 1 August; later on, growth continued, and market quotations gained 5% on their values as of the month's beginning.

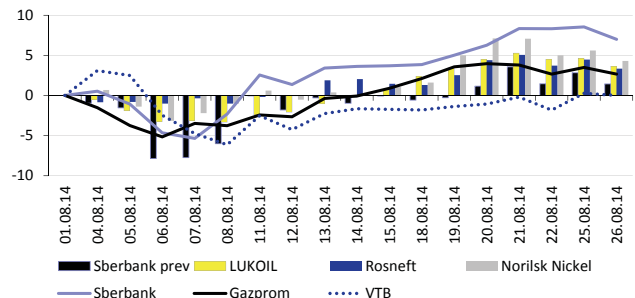
The annual yield on shares in *Sberbank* by 29 August 2014 had become negative: the annual loss had amounted to 17.0%¹ for ordinary shares and to more than 21.2% for privileged shares. Shares in *VTB* were also loss-making, the annual loss amounting to 15.2%. The annual yield on shares in *Norilsk Nickel* as of 29 August 2014 amounted to 65.4% as a result of a surge in their price early in 2014.

One noteworthy development was the decline of the MICEX Innovation Index in August. The cause of its impressive fall (by more than 15% since the month's beginning) was the price movement displayed by shares in *OJSK Armada (ARMD)* after the publication of its latest quarterly report. Negative expectations



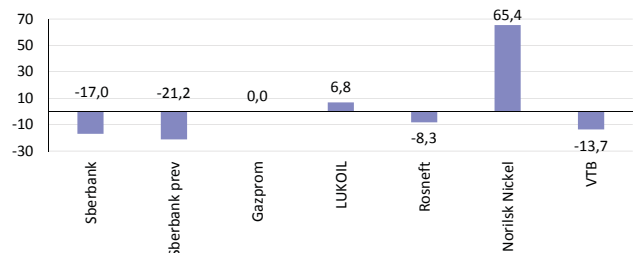
Source: Quote.rbc.ru.

Fig. 1. The Movement of the MICEX Index and Brent Crude Oil Futures Prices in the Period from 1 August 2013 through 29 August 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 August)



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

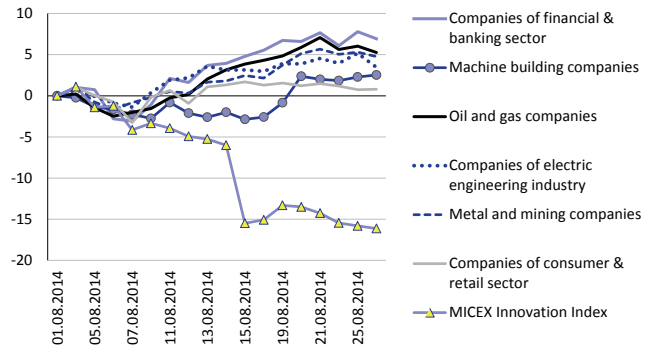
Fig. 3. Growth Rates of the Prices of Highly Liquid Shares Traded on Moscow Exchange Over the Period from 30 August 2013 through 29 August 2014

¹ The annual yield on shares is estimated on the basis of their price movement and does not reflect information on dividend payments to shareholders in accordance with the results of year-end shareholder meetings.

with regard to motor car sales volumes were influencing the machine-building index. The introduction of retaliatory sanctions by Russia and negative economic development expectations pushed down the growth rate of the index of consumer & retail sector companies, whose growth amounted to only 1.5% since the month's beginning.

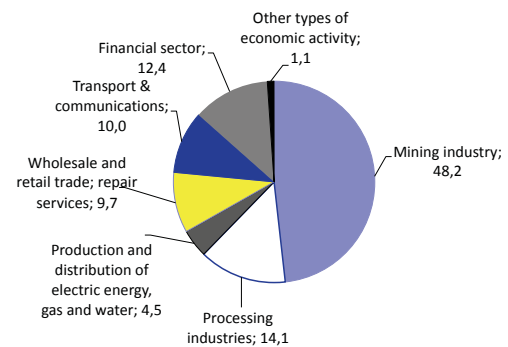
Over the course of the period from 1 August through 27 August 2014, the trading turnover of the Moscow Exchange amounted to Rb 641.7bn, which is 9.3% below its July level. Trading in ordinary and privileged shares in *Sberbank* accounted for 39.3% of the trading turnover of the Moscow Exchange, and on 25 August its share in the average daily trading turnover of the MICEX amounted to 57.0%. In August, the second-best performer on the MICEX was shares in *Gazprom*, which accounted for 17.4% of the average daily trading turnover of the Moscow Exchange. Thus, these two biggest companies together accounted for more than 57% 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 19.5% of the daily trading turnover of the Moscow Exchange, while top eight issuers of most tradable shares were responsible for more than 85.1% of its daily trading turnover.

According to *Emerging Portfolio Fund Research* (EPFR), over the period from 31 July through 27 July 2014, funds oriented to the Russian market experienced an inflow of assets in the amount of \$ 94.7m. As of 29 August 2014, MICEX's total capitalization amounted to Rb 22.4 trillion (or 34.6% of GDP), having increased since 1 August by more than Rb 262.1bn, or 1.1%. As far as the stock market's capitalization structure by type of economic activity is concerned, in August the capitalization share of the financial sector shrank by 0.67%, to 12.4% of the MICEX total capitalization index. Over the same period, the share of the



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 August 2014)



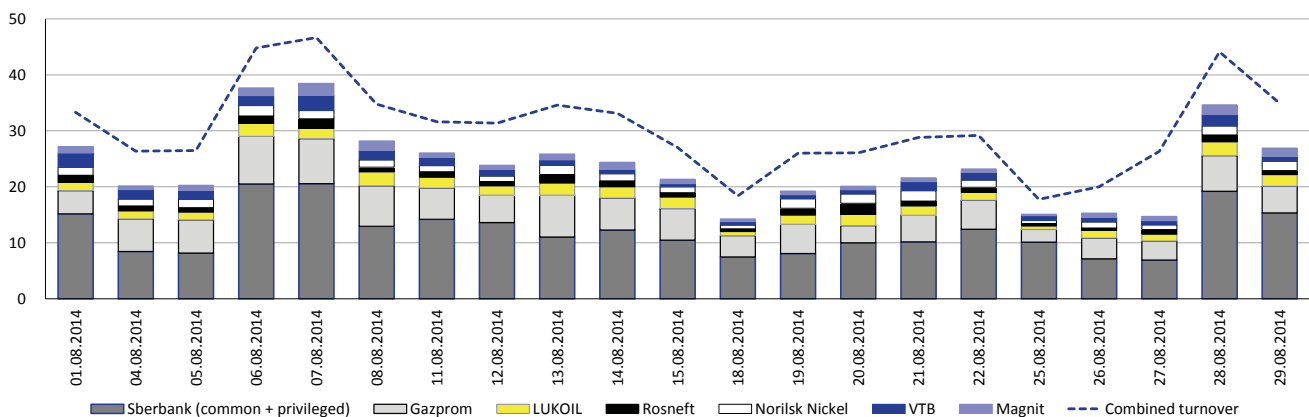
Source: the MICEX's official website; the authors' calculations.

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

mineral extraction sector and processing industries notably increased.

The Corporate Bond Market

In August 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 its rapid growth. By the end of August, the volume of that mar-



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

Fig. 6. Structure of the Trading Turnover of the Moscow Exchange

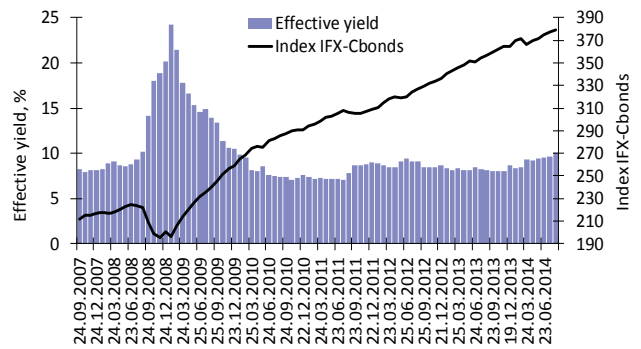
ket had climbed to Rb 5,531.4bn, which represented a 0.4% rise on late July¹. At the same time, that period saw both a decline in the number of issued bond loans (1,026 ruble-denominated corporate bond issues vs. 1,031 in late July) and in the number of emitters represented in the debt segment (346 in August vs. 357 in July). This fact points to an increase of the average volume of each issue. As before, a total of 17 US dollar-denominated bond issues (with an aggregate face value of above \$ 2.7bn) and one yen-denominated bond issue placed by Russian emitters are circulating on the MICEX.

In August, investment activity on the secondary corporate bond market somewhat declined after having been displaying a moderate growth rate for several months in a row; sales prevailed over purchases. Thus, in the period from 25 July through 25 August 2014, the combined volume of exchange transactions carried out on the Moscow Exchange amounted to Rb 91.5bn (for reference: over the period from 24 June through 24 June, the monthly trade turnover amounted to Rb 127.1bn), and the number of transactions carried out over the period under consideration dropped to 27.6 thousand (vs. nearly 30 thousand in the previous period), whilst still remaining near its annual average level².

The IFX-Cbonds index of the Russian corporate bond market slightly increased. By the end of August it had increased by 1.3 points (or 0.3%) on late July. At the same time, the weighted average effective yield on corporate bonds once again surged from 9.61% in late July to 10.09% as of the end of August, which represents its record high for the period since late 2009 – the crisis year (Fig. 7)³. The corporate bond portfolio duration index continues to display a negative trend. As of the end of August, that index amounted to 410 days, which represented a 32-day drop on late July.

The yields on the debt market were pushed up by the increased key interest rate of the RF Central Bank, the aggravating political risks and lower availability of loans on the external markets. The short-term prospects of restricted access to external borrowings will motivate Russian bond issuers to borrow on a larger scale in the domestic market – a factor which, due to that market's limited investment potential and persistently high risks, will not conduce to lower yields.

The most significant yield increase (above 1 p.p.) was demonstrated by some of the issues of securities of the following companies: OJSC *Russian Railways* (series 30), *VTB Bank (JSC)* (series BO-22), OJSC *Mobile TeleSystems* (series 07), and OJSC *Russian Agricultural*



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

Bank (Rosselkhozbank) (series 16). However, the yields on other securities issued by the same manufacturing companies significantly dropped (even by comparison with the overall downward trend displayed by the market). Thus, the yields on series 14 issued by OJSC *Russian Railways* and series BO-06 and BO-21 issued by *VTB Bank* dropped by more than 1 p.p. Rapid yield growth was noted with regard to securities issued by telecommunications companies (by nearly 0.6 pp. over the period under consideration), which cannot be said about companies belonging to the financial, manufacturing and energy sectors (where average yield growth did not exceed 0.2 p.p.). Thus, so far the market indicators have been displaying only a moderate response to the sanctions introduced against financial and energy companies, although big companies operating in these two sectors experienced a boost in bidding for their securities – the volume of trading in bonds issued by the majority of such issuers exceeded Rb 1bn over the period under consideration⁴.

The restricted access to international capital markets also pushed up issuer activity with regard to registration of new issues, although this growth has occurred in the main due to the already circulating bond issue volumes being increased by big emitters. Thus, over the period from 25 July through 25 August, 10 emitters placed 25 bond loans with a total nominal value of Rb 163.7bn (for reference: in the period from 24 June through 24 July 2014, a total of 27 bond series with a total nominal value of Rb 94.0bn were placed). Big issues were placed by JSC *Atomenergoprom* (full name — Joint Stock Company Atomic Energy Power Corporation, short name — *AEP*) (8 series of exchange-traded bonds to the value of Rb 100bn), CJSC *BFA* (Baltic Financial Agency) (4 series of exchange-traded bonds to the value of Rb 10bn), and Joint Stock Commercial Bank *Peresvet* (4 series of exchange-trad-

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.

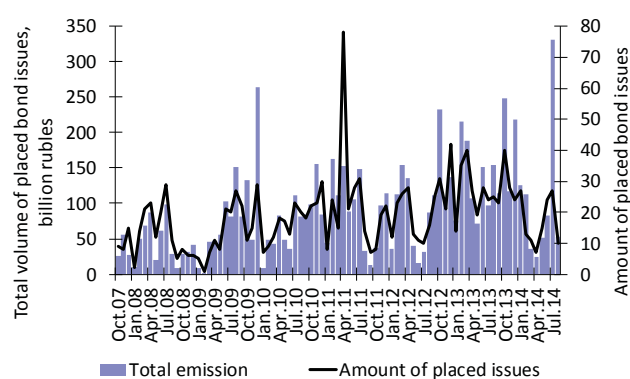
4 According to data released by the Finam investment company.

ed bonds to the value of Rb 10bn)¹. More than 2/3 of the placed bond loans were exchange-traded bonds, although there were also several initial placements of bond issues. Besides, one of the placed bond issues was denominated in US dollars.

However, the indices of initial placements of bond issues demonstrated a significant investor activity decline in August. Thus, over the period from 25 July through 25 August, only 8 emitters managed to place a total of 10 bond issues with a total nominal value of Rb 52.6bn (for reference: in the period from 24 June through 24 July 2014, a total of 27 bond series with a total record-high nominal value of Rb 330.6bn were placed) (Fig. 8). The biggest bond issues were placed by OJSC *VTB Leasing* (2 series of exchange-traded bonds to the value of Rb 15bn), Moscow Mortgage Agency (1 series of exchange-traded bonds to the value of Rb 12bn), CJSC *Horus-Finance* (2 series of exchange-traded bonds to the value of Rb 10bn), and CJSC *UniCredit Bank* (1 series of exchange-traded bonds to the value of Rb 10bn)². More than half of the placed bond loans were exchange-traded bonds.

In August, in contrast to the situation over previous months, bond emitters managed to attract finance only in the form of medium-term loans (mostly for periods no longer than 5 years), with the exception of one mortgage agency which placed a 14-year bond loan.

In August, the Bank of Russia annulled 9 bond issues of two emitters due to their failure to place even a single security (for reference: in July, 3 bond issues had been annulled for that reason)³. This happened in the main due to the altered plans of these companies with regard to attracting external funds, because they are big emitters with a very good standing on the debt



Source: According to data released by the Rusbonds company.

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

market – *Vneshekonombank* and *Power Machines OJSC* (*ZTL, LMZ, Elektrosila, Energomashexport*).

Over the period from 25 July through 25 August 2014, all 12 emitters redeemed their bond issues with a total face value of Rb 55.2bn (for reference: in the previous period, 2 emitters had been unable to redeem their bond issues in due time, and therefore declared a technical default). In September 2014, the redemption of 4 issues of corporate bonds with a total face value of Rb 4.8bn is expected⁴.

Besides, over the period from 25 July through 25 August 2014, 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 loan⁵ were declared (in the previous period, one emitter had declared a default on the payment of the coupons)⁶.

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

4 According to data released by the Rusbonds information agency.

5 That is, when the emitter fails to make due payments on securities even during the payment grace period.

6 According to data released by the Rusbonds information agency.