

FINANCIAL MARKETS IN OCTOBER 2014

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In October 2014, the MICEX Index saw a downtrend caused by falling crude oil prices. The MICEX Index lost 1.4% in the period between October 1 thru October 24. The MICEX capitalization amounted to Rb 22,0 trillion as of October 24 (34.0% of GDP). The acceleration of the average weighted yield of bond issues (especially in the production sector) and the downtrend in the market index dynamics remained the major adverse effect in the Russian corporate bond market. At the same time, no deterioration in issuers' failure to discharge their obligations to bondholders was observed.

In October 2014, the list of sources having an adverse effect on the Russian economy, already including tense geopolitical situation and western sanctions, was updated by falling crude oil prices and Moody's Baa2k downgrade of sovereign credit rating for Russia. This has resulted in the revision of the forecasts of the key macroeconomic indicators such as GDP and inflation rate. In particular, the World Bank estimates GDP growth rate in Russia at 0.5%, which basically implies a stagnation, although the Ministry of Economic Development doesn't rule out that the Russian economy might grow at a faster rate. Furthermore, inflation is expected to be higher than 7.5%, the latest official forecast of the Ministry. The Central Bank of Russia shows similar projections for inflation¹. 2014 year-end inflation is therefore most likely to be higher than the key rate set by the financial regulator. Forecasts for 2015 are also being downgraded.

The worsening of the economic situation in the Russian Federation has resulted in that international ratings agencies have downgraded credit ratings for major corporate market players such as Russkiy Standart Bank, Vostochny Express Bank, Asian-Pacific Bank, Renaissance Credit Bank, Home Credit Bank, etc., while the long-term ratings forecast for the largest banks and manufacturers with state participation has been revised, with the outlook changed to negative. Nonetheless, some Russian companies hope that the geopolitical situation will improve and they have access to western markets. For example, OJSC Russian Railways prepares a Eurobond road show² in Europe and Asia³ in 2015.

1 Based on the information provided by Cbonds information agency.

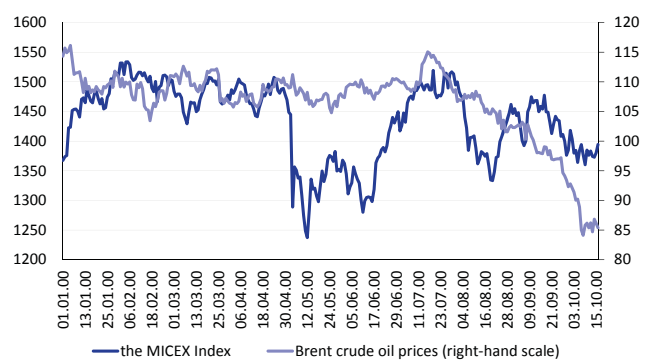
2 Road Show refers to the practical preparation of an issuer in issuing its securities (bonds, shares, etc.), including IPO.

3 Based on the information provided by Cbonds information agency.

Dynamics of the Russian stock market basic structural indices

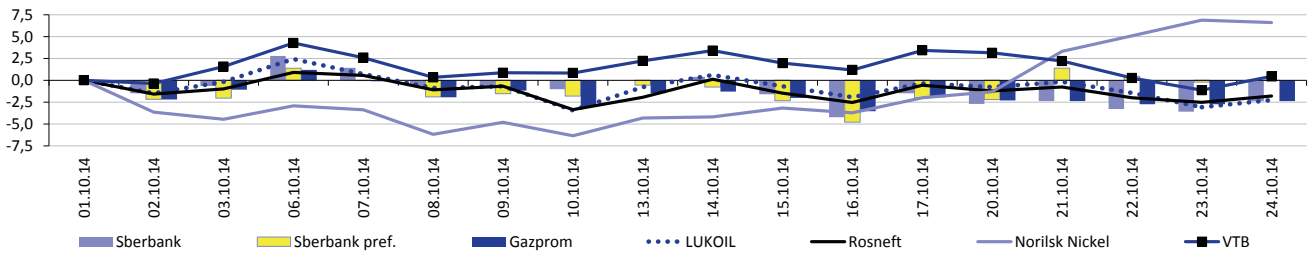
In October, the MICEX Index followed the downtrend in crude oil prices. The Index lost 1.4% in the period of October 1, 2014 thru October 24, 2014, reaching 1380.4 points by October 24. In the period between October 1 and October 24 the MICEX Index averaged at a level of 1383.2 points, hitting the lowest level of 1360.3 points on the 16th of October and the highest level of 1418,1 points on the 6th of October.

The downtrend in the MICEX Index in October can be explained by adverse dynamics of highly liquid stocks. In the period of October 1 thru October 24 common shares in Sberbank lost 2.38% and its preferred shares lost 4.79% from the beginning of the month till the 16th of October, but bounced back to the initial value by the 24th of October 24. It's worth noting that shares in Gazprom, Lukoil and Rosneft also lost 1.8–2.2% since the beginning of the month till October 24. The opposite dynamics in October 2014 was showed by shares in Norilsk Nickel, gaining 6.6% since the beginning of the month to the 24th of October. Shares in VTB gained 0.5% (with visible fluctuations within the interval) over the same period.



Source: RBK Quote.

Fig. 1. Dynamics of the MICEX Index and futures prices of Brent crude oil in the period between October 1, 2013 and October 24, 2014



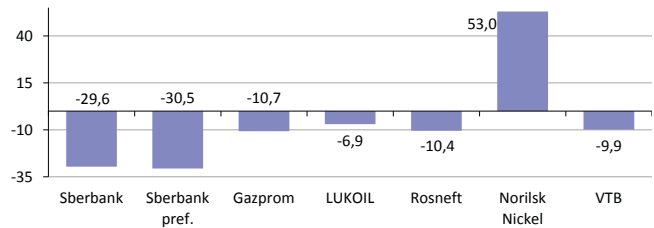
Source: RBK Quote, author's estimates.

Fig. 2. Growth rates of most highly liquid Russian stocks in the Moscow Exchange in October 2014 (in the period between October 1, 2014 and October 24, 2014)

The annual yield on corporate shares kept declining in October 2014. For example, in the period of October 25, 2013 to October 24, 2014 Sberbank lost 29.6%¹ on its common shares while preferred shares lost more than 30.5% during the same period. VTB, Rosneft, Lukoil and Gazprom also met with losses within a range of 6.9% and 10.7% on an annualized basis. It is Norilsk Nickel that saw a substantial growth earlier in 2014, as well as the growth in October 2014 resulted in an annual yield of 53.0%.

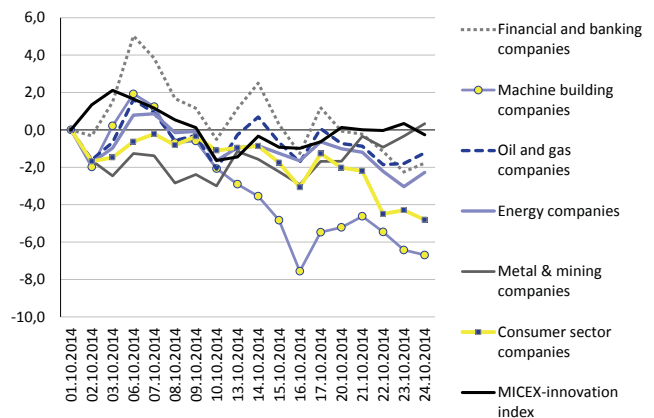
The machine-building sector index kept falling in October 2014 after a loss of more than 7% in September, and lost 6.7% by the 24th of October since the beginning of the month. Shares in Sollers Holding saw a fall during the month, losing 10.5% between October 1 and October 24, 2014. Furthermore, shares in GAZ and KAMAZ lost 10.3% and 9.7% respectively in October 2014. It is only the metallurgical industry index that saw no fall by the 24th of October since the beginning of the month. But the index gained only 0.34% in the period of October 1 to October 24.

Trading turnover in the Moscow Exchange in the period between October 1 and October 27, 2014 amounted to Rb 578,3bn, 9.3% below the same period in September. In October, Sberbank's total turnover on common and preferred shares contributed 32.6%



Source: RBK Quote, author's estimates.

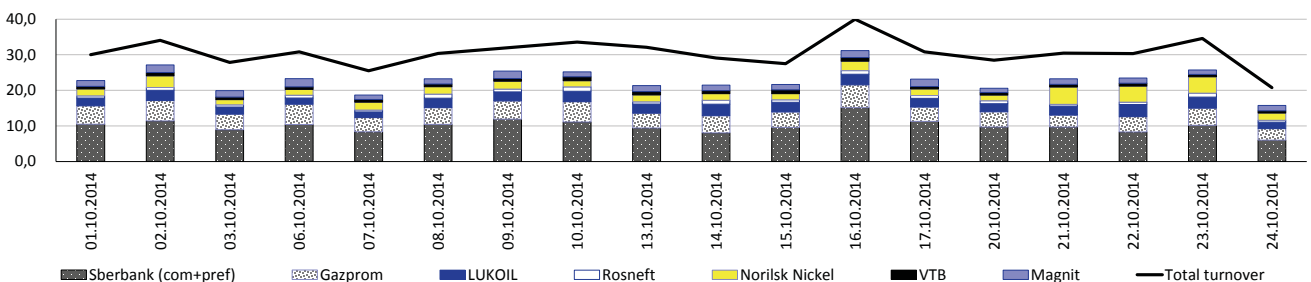
Fig. 3. Growth rates of most highly liquid Russian stocks in the Moscow Exchange in the period between October 25, 2013 and October 24, 2014



Source: RBK Quote, author's estimates.

Fig. 4. Growth rates in various sector stock indices in the Moscow Exchange (in the period between October 1, 2014 and October 24, 2014)

1 Annual yield on shares is calculated on the basis of shares price movement and doesn't include dividends paid to shareholders following the results of the annual general meeting of shareholders



Source: RBK Quote, author's estimates.

Fig. 5. Trading turnover structure in the Moscow Exchange (in the period between October 1, 2014 and October 27, 2014)

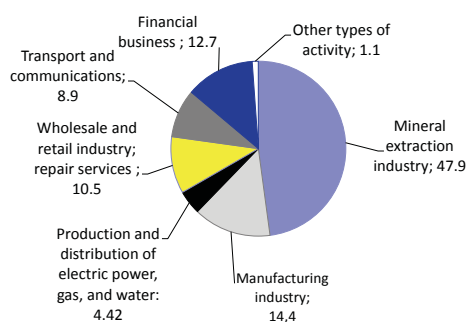
on average to the stock exchange trading turnover. It's worth noting that Sberbank contributed 3.6% less on the trading turnover on shares compared to September. On the contrary, Gazprom increased by 2.8% (up to 15.3%) its contribution to the turnover of the Moscow Exchange in October 2014. Therefore, the two most highly liquid shares accounted for more than 47.9% of the Moscow Exchange trading turnover. The other top-5 shares with the highest trade volume accounted for an average of 27.6% of the Moscow Exchange daily trading turnover, while the eight most traded shares accounted for up to 79.6% of the daily trading turnover.

According to the Emerging Portfolio Fund Research (EPFR), foundations investing in Russian shares saw \$96,3m of capital inflow in the period between September 28 and October 24. Moscow Interbank Currency Exchange (MICEX) total capitalization amounted to Rb 22,0 trillion (34.0% of GDP) as of October 24, 2014, losing Rb 454,2bn (2.0%) since the 1st of October. In October, the share of financial companies shrank by 0.56% to 12.2% in the MICEX capitalization structure. Furthermore, the share of the transport and communications sector shrank by 0.45% to 8.4% of total capitalization. The shrinking share of both sectors was set off by growth in the share of retail and wholesale companies and manufacturing industries.

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) remained basically unchanged in October 2014, like in the previous month. By the end of October the indicator amounted to Rb 5,633,2bn, only 0.8% higher than that observed as of the end of September¹. At the same time, the number of bond issues kept growing over the elapsed period (1041 corporate bond issues registered in the national currency against 1031 issues as of the end of September), whereas the number of issuers in the debt segment remained unchanged (345 issuers in September against 344 companies in the preceding month). There were 17 outstanding issues of USD-denominated bond issues of Russian issuers (a total of more than \$2,7bn) and an outstanding JPY-denominated bond issue.

Investment activity in the secondary corporate bond market in October 2014 increased substantially. For instance, the total volume of transactions in the Moscow Exchange amounted to Rb 102,3bn in the period between September 25 and October 24, 2014



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

Fig. 6. Stock market capitalization structure by type of economic activity

(to compare, trading volume amounted to Rb 97,0bn in the period between August 26 and September 24), which is the average annual value. The number of transactions in the period under review also increased a bit to 27,700 (26,400 transactions in the preceding month)².

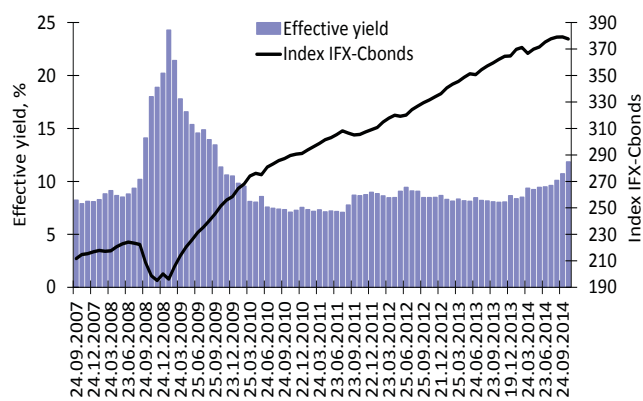
For a second time during the year the Russian corporate bond market index IFX-Cbonds saw a new trend (downtrend). By the end of October the index lost almost 1.5 points (or 0.4%) compared to the value observed as of the end of the preceding month. At the same time, the corporate bond average weighted yield showed a record growth rate up to 11.83% by the end of October from 10.72% earlier in September, the highest value since the end of the crisis-hit 2009 (Fig. 7)³. The corporate bond portfolio duration began to decline after a short period of growth: the duration was 428 days as of the end of October, 28 days less than the period observed as of the end of the preceding month. The decline can be easily explained by a substantial growth in interest rates in the bond market.

In October, the most highly liquid segment of the corporate bond market saw an accelerated growth in the yield of bond issues. Certain issues of manufacturers, namely OJSC ALROSA, LLC EvrazHolding Finance, OJSC Norilsk Nickel, once again saw the highest growth in rates (more than 2 p.p.), although no sellout of these securities was observed. A downtrend, insignificant though, was observed on certain bond issues of major financial issuers, namely Agency for Housing Mortgage Lending (AHML), Vnesheconombank, Gazprombank, and the overall yield of issues in the financial sector was growing in October 2014, with active sellouts of certain bond issues. The strongest growth in rates was observed in the production and energy segments of the market (by an average of 0.6–0.7 p.p.), while high-tech companies showed the lowest volatility, with the de-

1 According to the data reported by Rusbonds Information Agency.

2 According to the data reported by Finam Investment Company.

3 According to the data reported by Cbonds Information Agency.



Source: According to the data reported by Cbonds Information Agency .

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

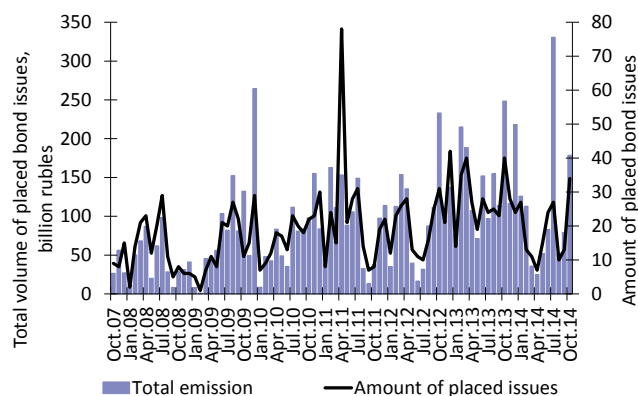
mand for these securities being very strong. Therefore, it was the production sector that came to be most vulnerable to adverse external developments¹.

The indicators of registration of new bond issues increased a bit in October upon the slackening of issuers' activity in new fundraising in September, but didn't reach the average annual level. For instance, 16 issuers registered 27 bond issues at an aggregate par value of Rb 88,6bn in the period between September 25 and October 24, 2014 (to compare, 29 bond issues at Rb 67,3bn were registered in the period between August 26 and September 24). Major bond issues were registered by CJSC Novikombank, LLC RGS Nedvizhimost, CJSC Sukhoi Civil Aircraft company². Exchange traded bonds accounted for more than 50% of the registered issues, however there were also a few debut issues among the registered bond issues.

The situation in the primary market again was found to be optimistic compared to the registration figures, and investment activity was substantially higher than the average annual value. For instance, in the period between September 25 and October 24, 2014 this year 22 issuers placed 34 bond issues at an aggregate par value of Rb 178,4bn (to compare, only 13 series of bonds at a par value of Rb 79,1bn were placed in the

1 According to the data reported by Finam Investment Company.

2 According to the data reported by Rusbonds Information Agency.



Source: According to the data reported by Rusbonds information agency.

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

period between August 26 and September 24) (Fig. 2). OJSC Russian Railways, Transneft, CJSC TPGK-Finance and OJSC Transfin-M placed the largest bond issues³. Exchange traded bonds accounted for more than 50% of the placed bond issues. In October 2014, unlike the preceding period, many issuers managed to raise for long-term.

Earlier in September–October the Bank of Russia declared void three corporate bond issues of a single issuer for non-placement of a single bond (no such cases were observed in the preceding period, although several bond issues were previously declared void on the same grounds every month)⁴.

All of the six issuers redeemed their bonds at an aggregate par value of Rb 33,8bn in the period between September 25, 2014 and October 24, 2014 (one issuer failed to honor its obligations and declared a technical default in the preceding period). Fourteen corporate bond issues at a total of Rb 58,6bn are to be redeemed in November 2014⁵.

No real defaults were observed in the bond market in the period between September 25 and October 24, 2014. ●

3 According to the data reported by Rusbonds Information Agency.

4 According to the data reported by the Bank of Russia.

5 According to the data reported by Rusbonds Information Agency.