CIS MACRO OUTLOOK

Renaissance Group

Russia: Let's play leapfrog

Still pain in Ukraine

Kazakhstan: Readying for a milder boom

Sep 2013

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- 3 Key Cyclical Messages:

- Russia will see modest growth upside in 2H13 and 2014
  - Cyclical low reached in 2Q13 at 1.4% YoY GDP growth
  - GDP growth to accelerate from 1.5% YoY in 1H13 to 3.0% YoY in 2H13
  - GDP growth at 2.2% (2.3% consensus) in 2013 and 2.9% (3.0% consensus) in 2014

- Inflation will moderate on lower food prices
  - CPI peaked at 7.4% YoY in May 2013
  - Effects will gradually dissipate later in the year, with eop CPI at 5.8% in 2013 (6.6% in 2012)

- New fiscal framework preserves prudency, but enhances structural weaknesses
  - Headline deficits kept at below 1% of GDP by 2016
  - Non-oil deficit to moderate to 7.8% of GDP in 2016 from 13.9% in 2009 (10.3% in 2012)
  - Expenditure to shift from education and health to military

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- 3 Key Structural Messages:

- Russia to hit the middle income trap (MIT) in 2013/2014
  - Gerschenkron's advantages of backwardness fast slipping away
  - Fast-growing economies slow tend top slow down at per-capita PPP-based GDP of $16000
  - Russia to hit against this constraint in Q4 2013/Q12014

- The economics of the middle income trap has 3 political economy implications
  - MIT type of growth ensures no messy political transformation
  - MIT type of growth may, however, mean prolonged political and economic stasis
  - This could be counteracted by pursuing a borrow-and-spend policy a-la Greece

- Which model of economic development should Russia pursue?
  - Become like Canada/Australia
  - Become like Norway/Saudi Arabia
  - Become like China
  - Become like Greece
  - Reform

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CYCLICAL PICTURE

SOFT PATCH

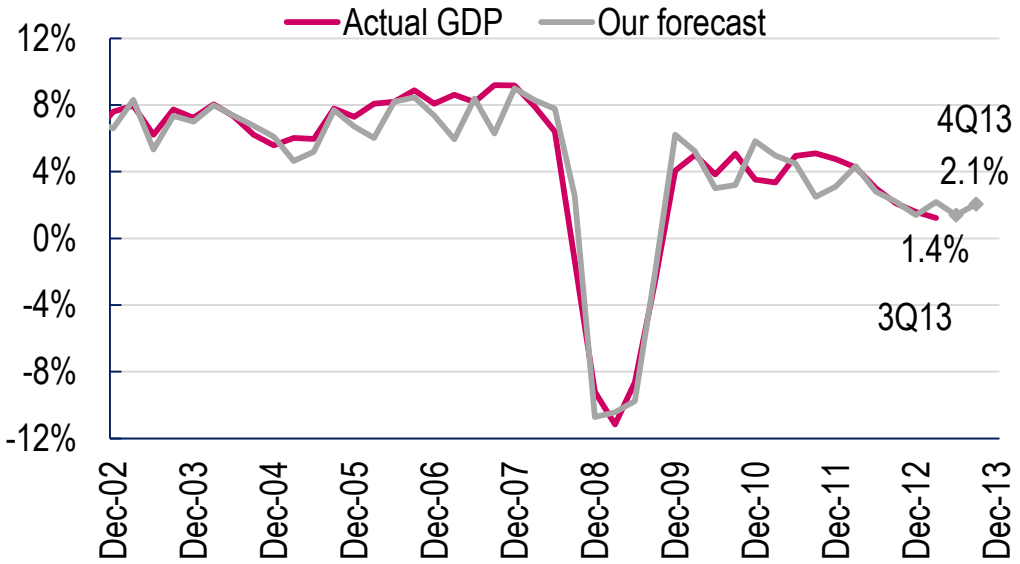
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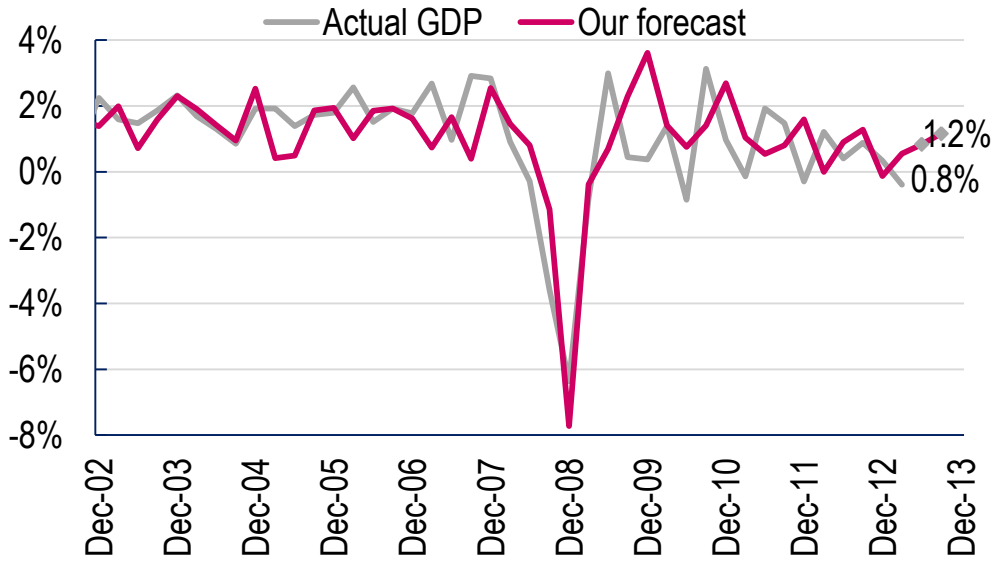
Slowdown across the board

Figure 10: Real economy

	Jul-13	Jun-13	YtD	2005-2008	2010	2011	2012
Industrial production, % YoY	-0.7	0.1	0.0	4.1	8.2	4.7	2.7
Fixed investment, % YoY	2.5	-3.7	-0.1	15.0	6.0	6.2	6.6
Retail sales, % YoY	4.3	3.5	3.8	13.7	4.4	7.2	6.0
Real wages, % YoY	6.6	5.3	5.6	14.2	4.6	4.1	8.2
Real disposable income, % YoY	4.2	2.2	4.3	10.6	4.3	0.7	3.9
Unemployment, %	5.3	5.4	5.6	6.9	7.2	6.3	5.3

RenCap-NES leading indicator points to mild recovery over next 2 quarters (YoY and QoQ)

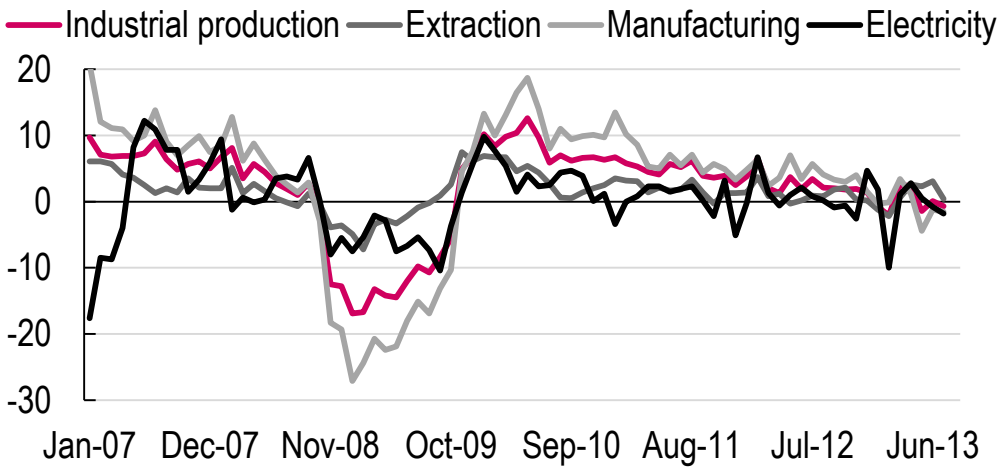




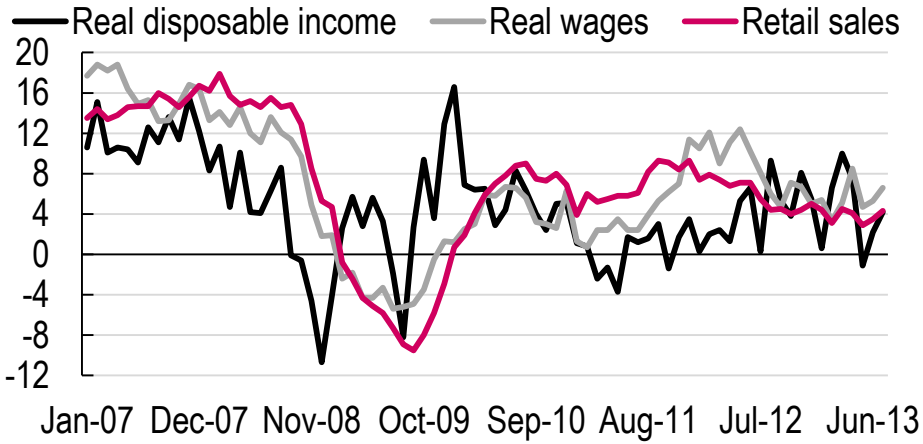
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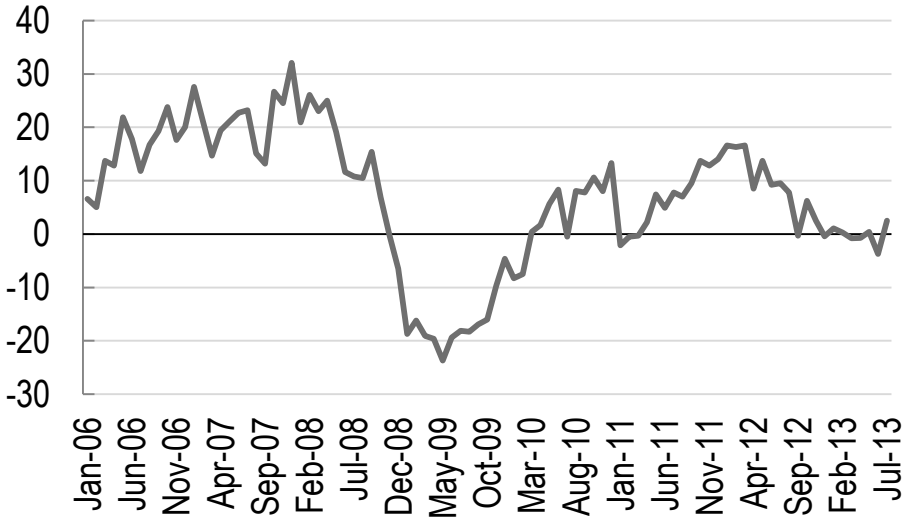
Industrial production is also softening, % YoY…



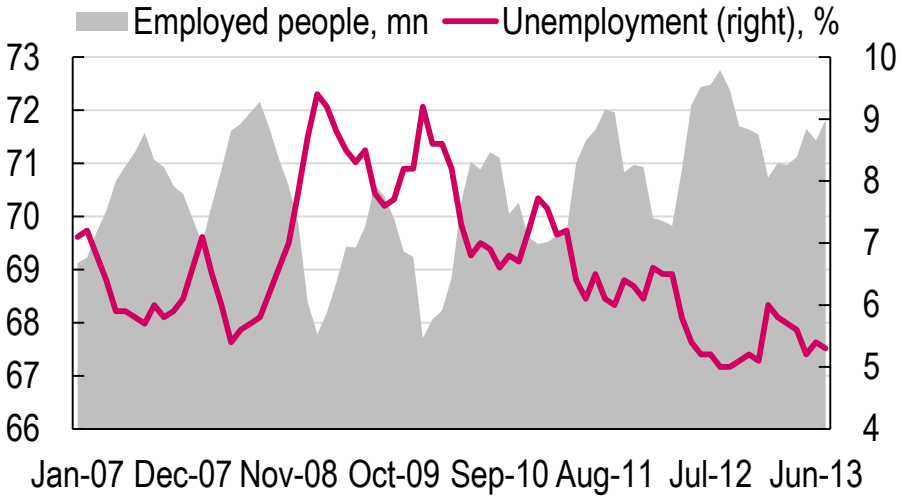
…as is consumption, % YoY…



…as is investment, % YoY…

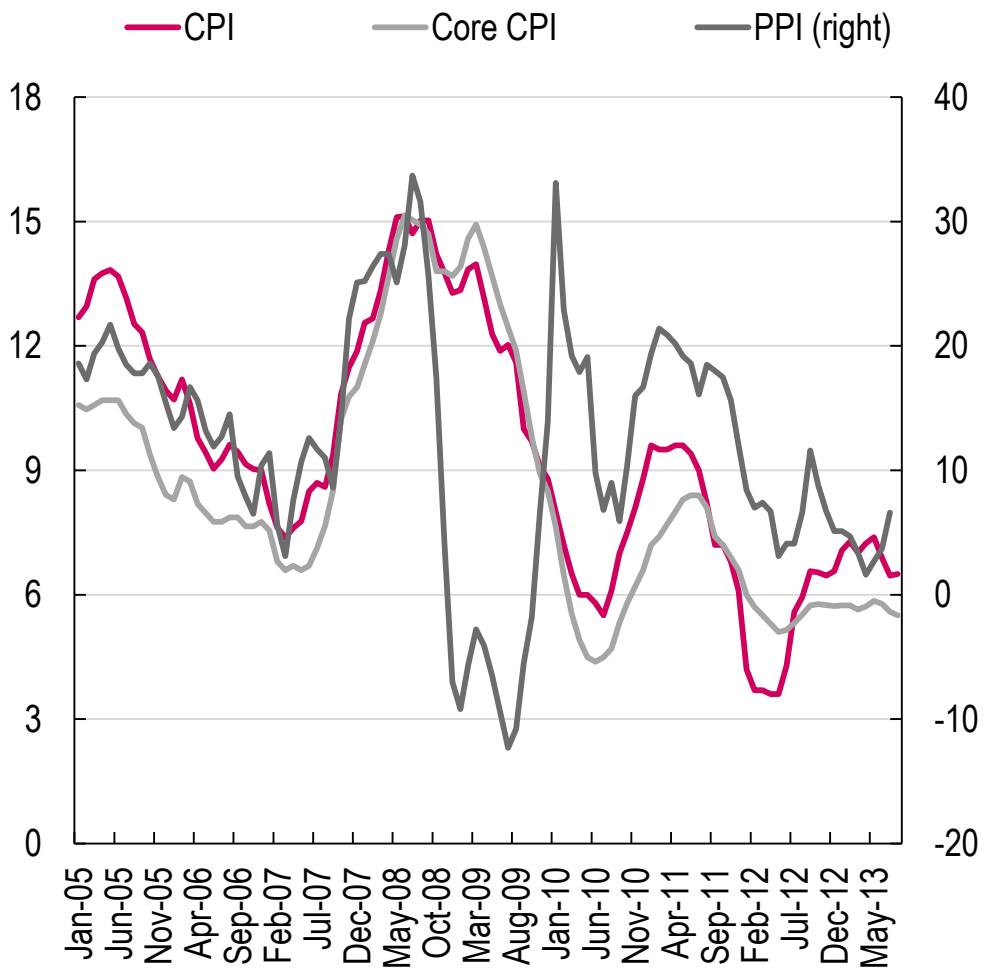


…despite tight labor market, % YoY

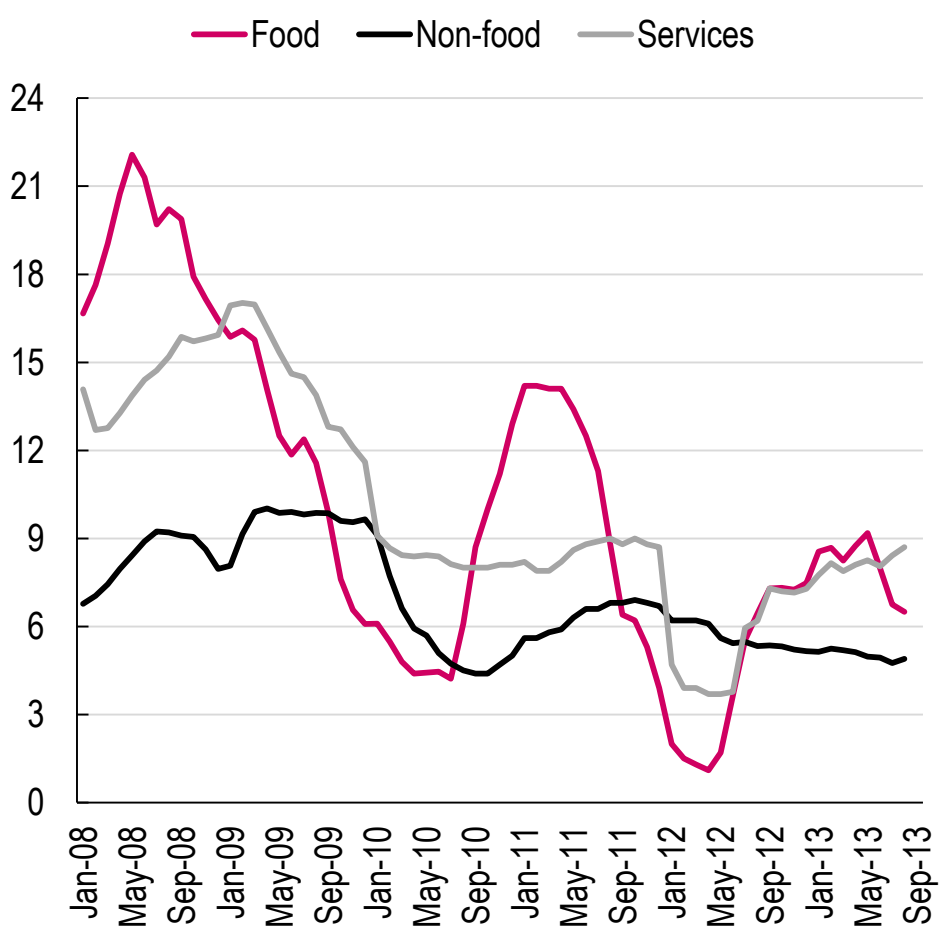


SOFT PATCH

Inflation has topped off, % YoY…

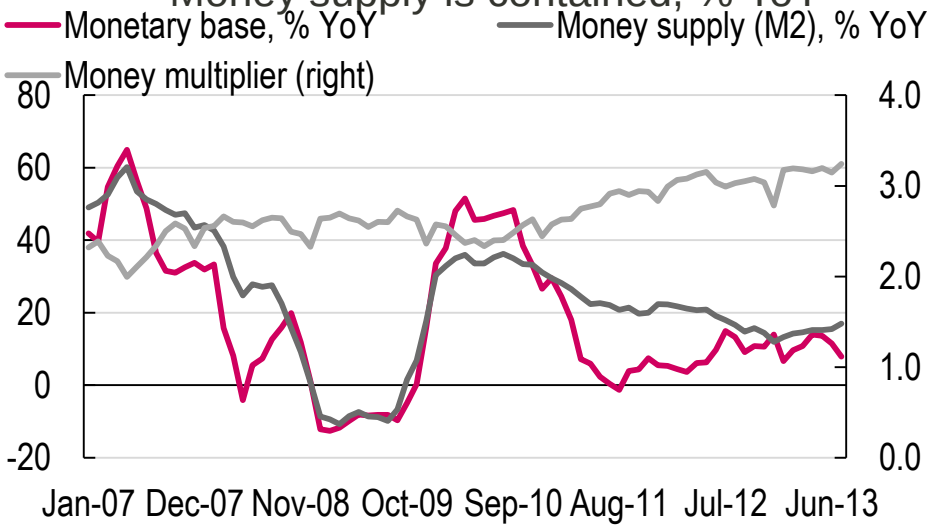


…driven by food , % YoY

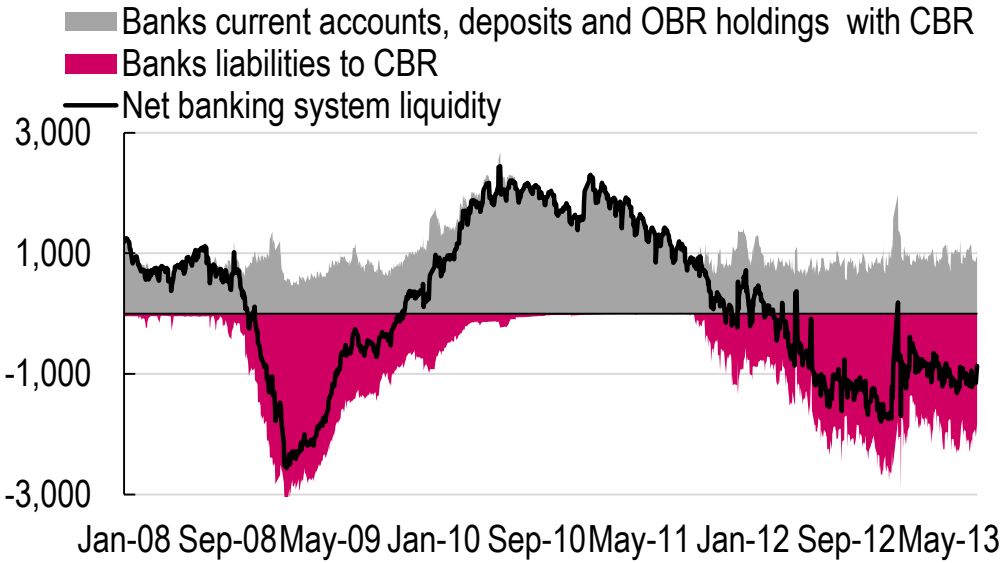


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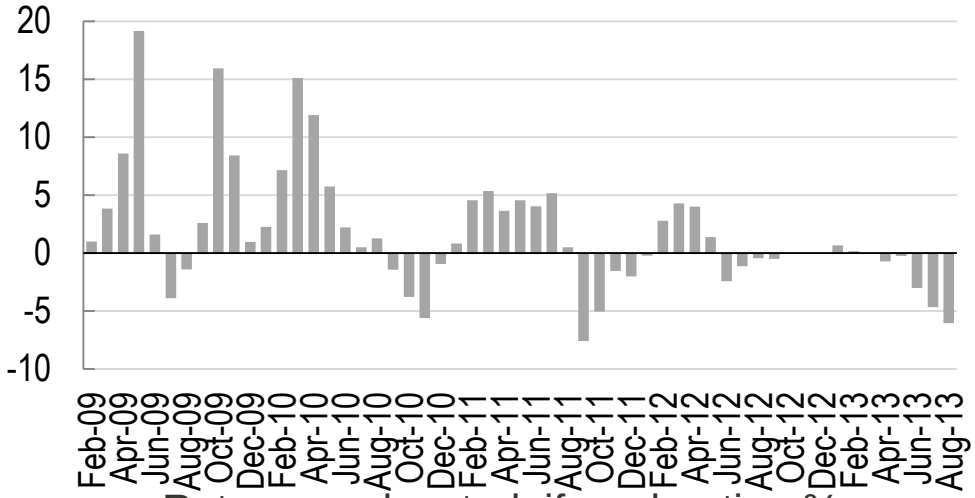
Money supply is contained, % YoY



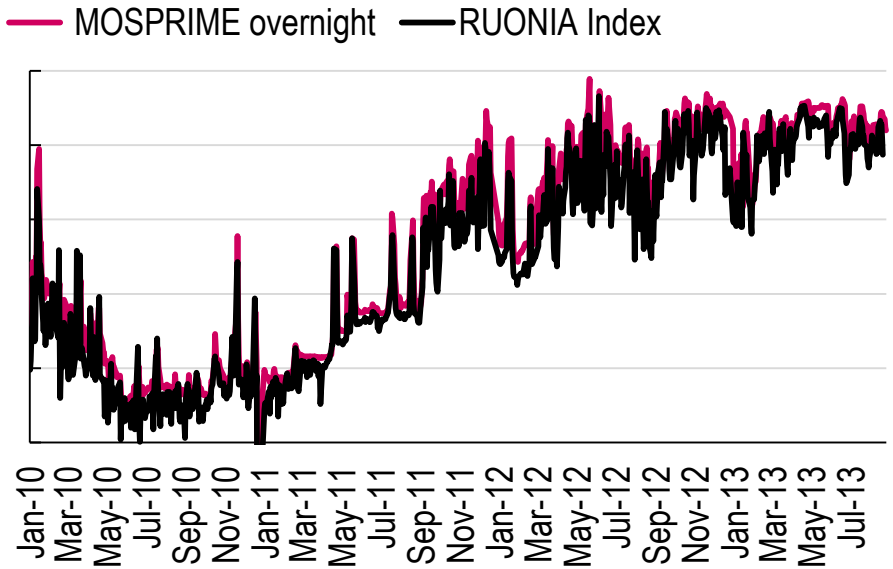
Liquidity is still tight, but improving RUBbn



FX interventions have resumed, $bn



Rates are elevated, if moderating %



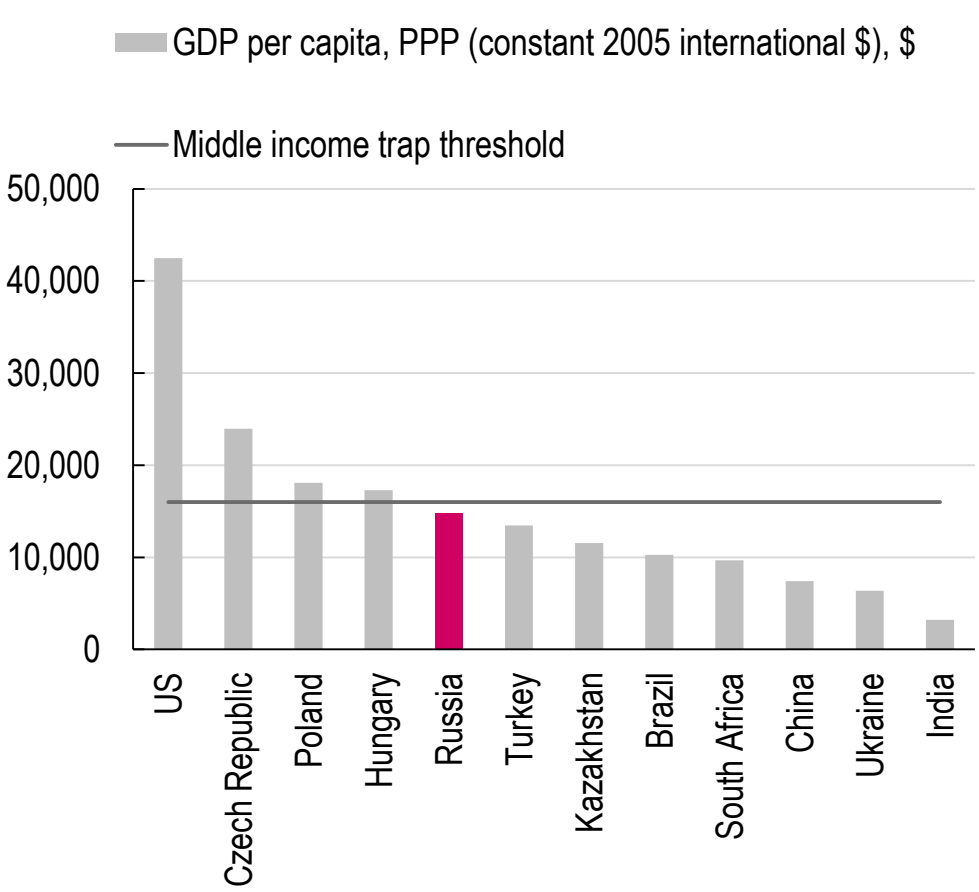
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STRUCTURAL PICTURE

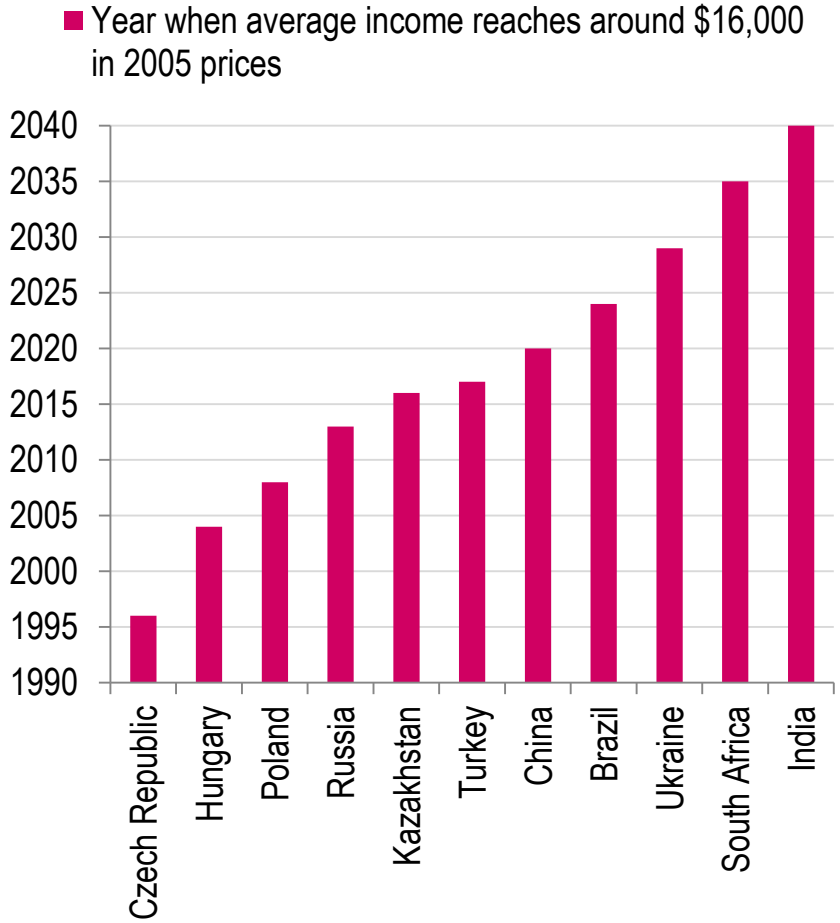
HITTING THE MIDDLE-INCOME TRAP

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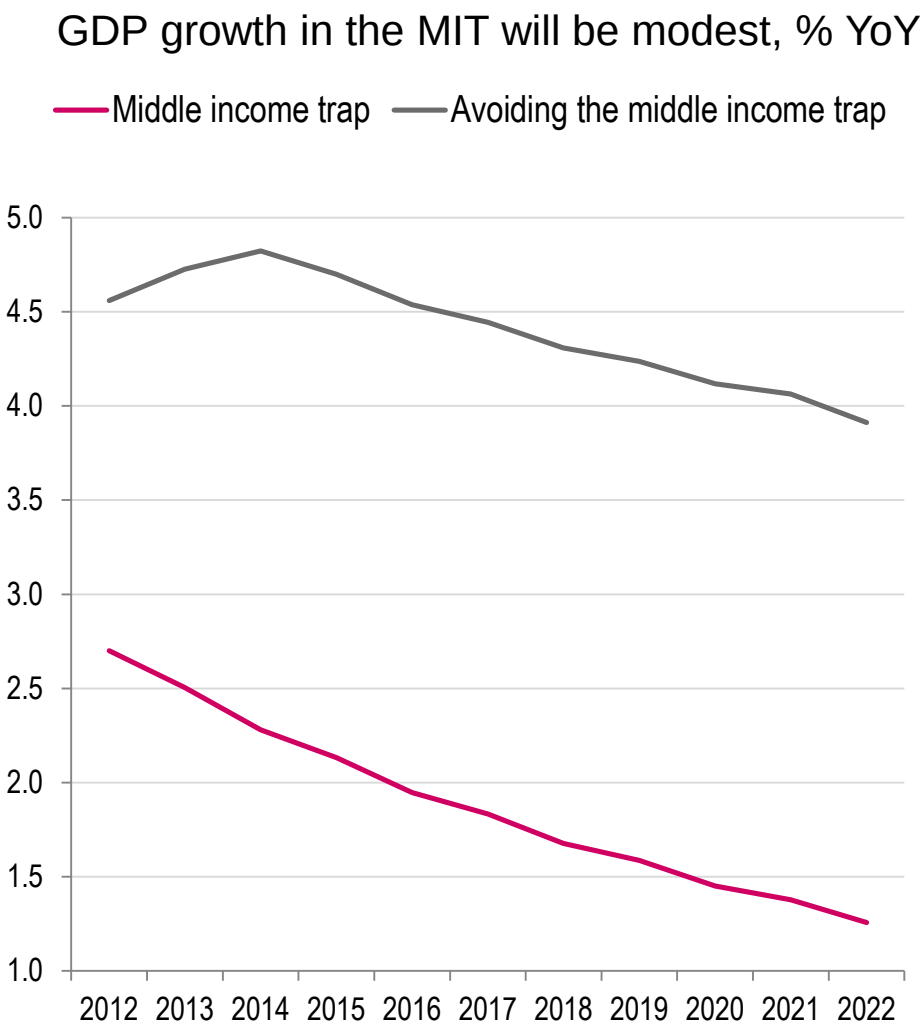
Russia is very close to the middle-income trap threshold...



.....and we estimate that it will hit it in 2013



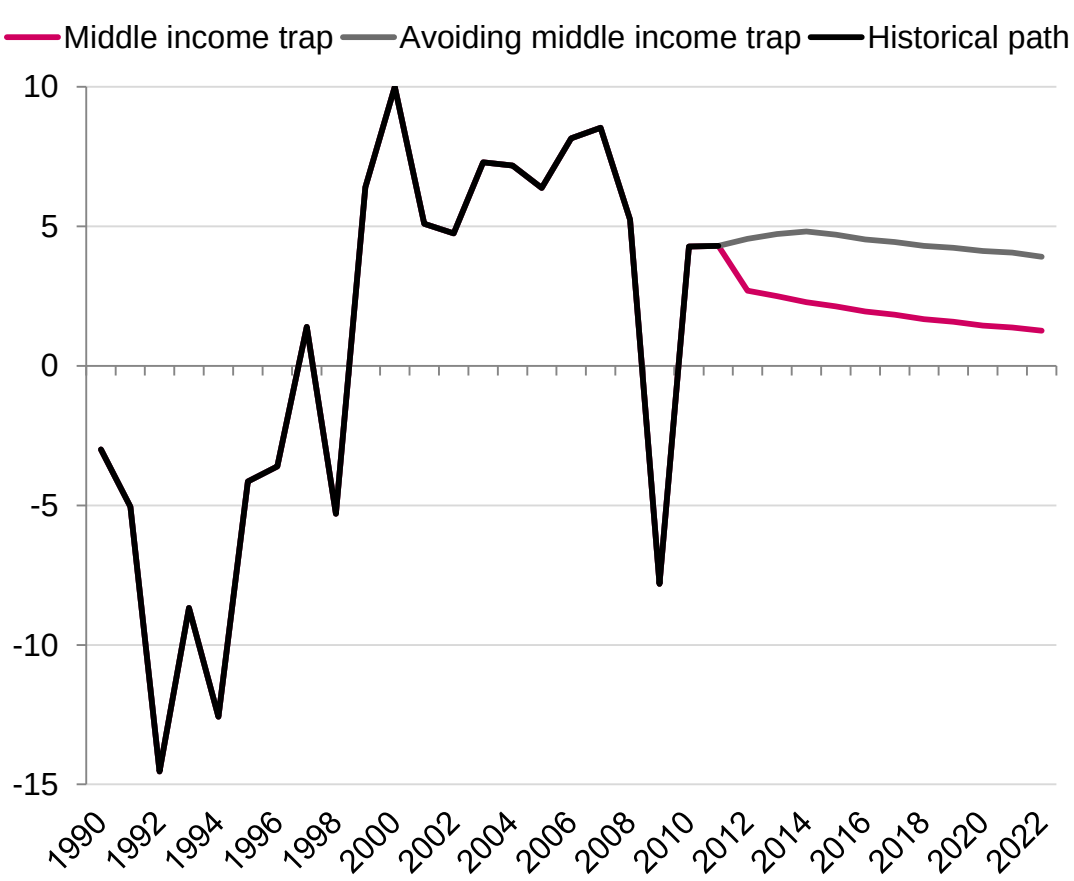
HITTING THE MIDDLE-INCOME TRAP



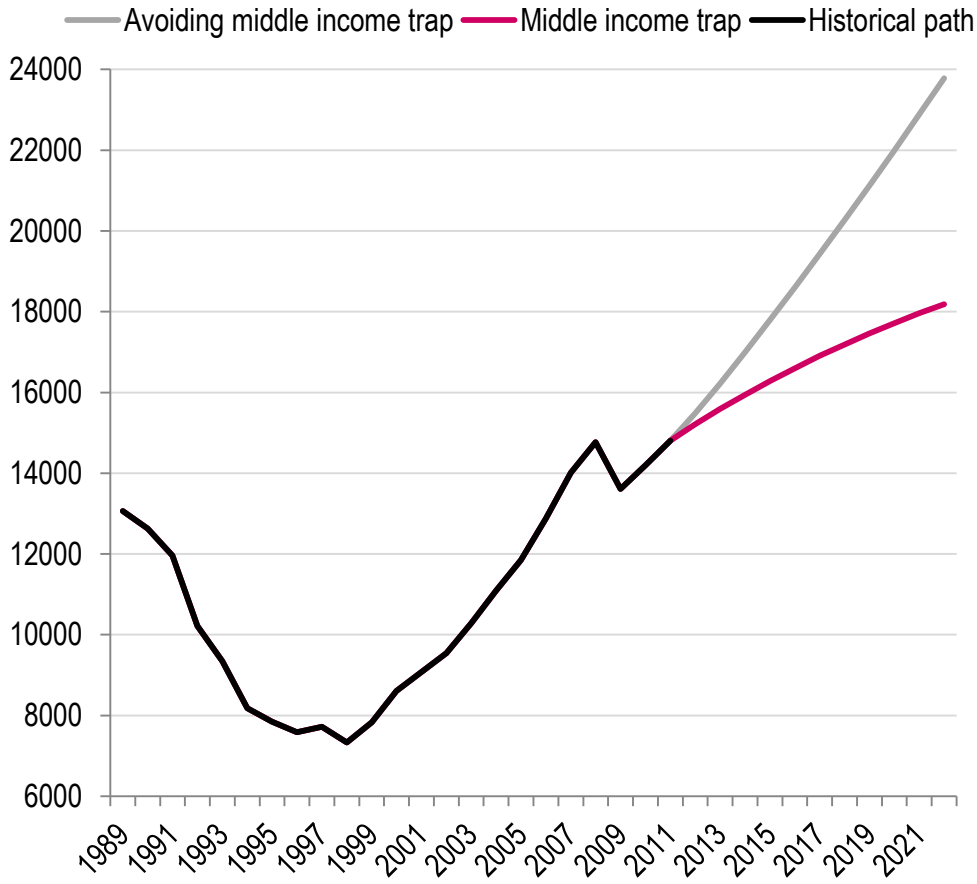
- Western economies lost steam in first half of 1970s, Japan suffered a similar fate in at the same income levels, SK in 1995, Singapore and HK in early 1980s, Taiwan in in late 1990s
- US hit MIT in 1963, UK in 1981
- CZ in 1997, Hungary in 2004, Poland in 2008, Russia in 2013, KAZ in 2016, Turkey in 2017, China in 2020, Brazil in 2024, Ukraine in 2029, SA in 2035 and India in 2040

HITTING THE MIDDLE-INCOME TRAP

PPP-based per-capita GDP differs significantly across scenarios, % YoY



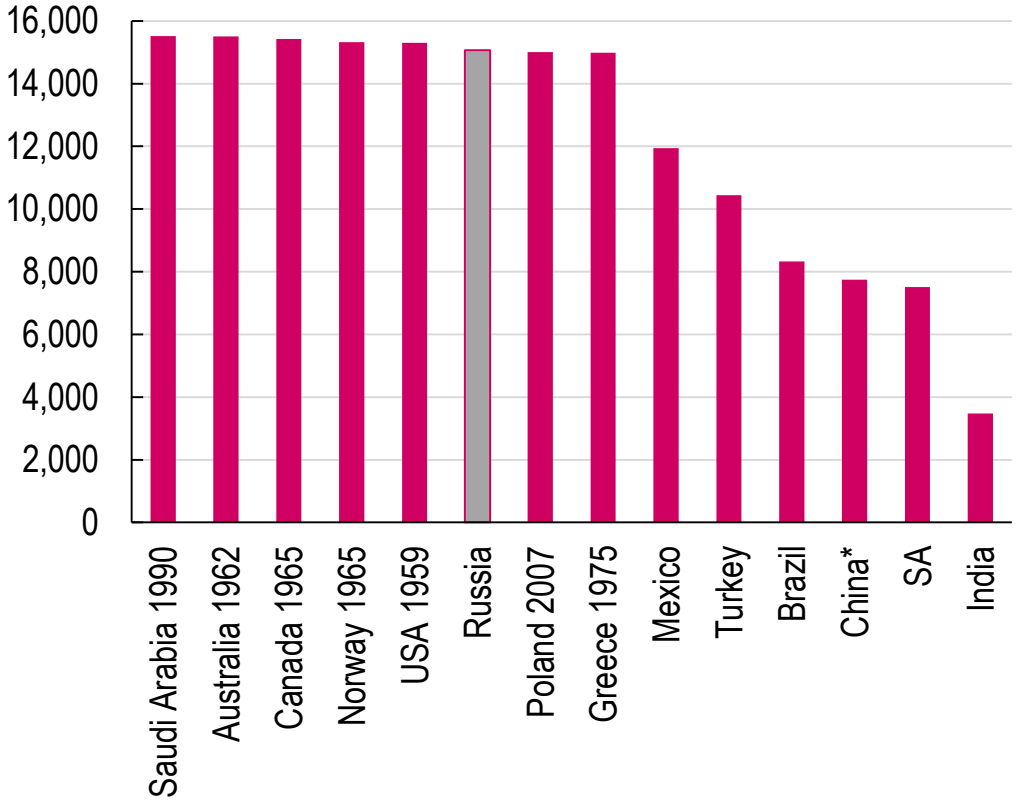
PPP-based per-capita GDP levels grows much faster if MIT is averted, 2005 US dollars



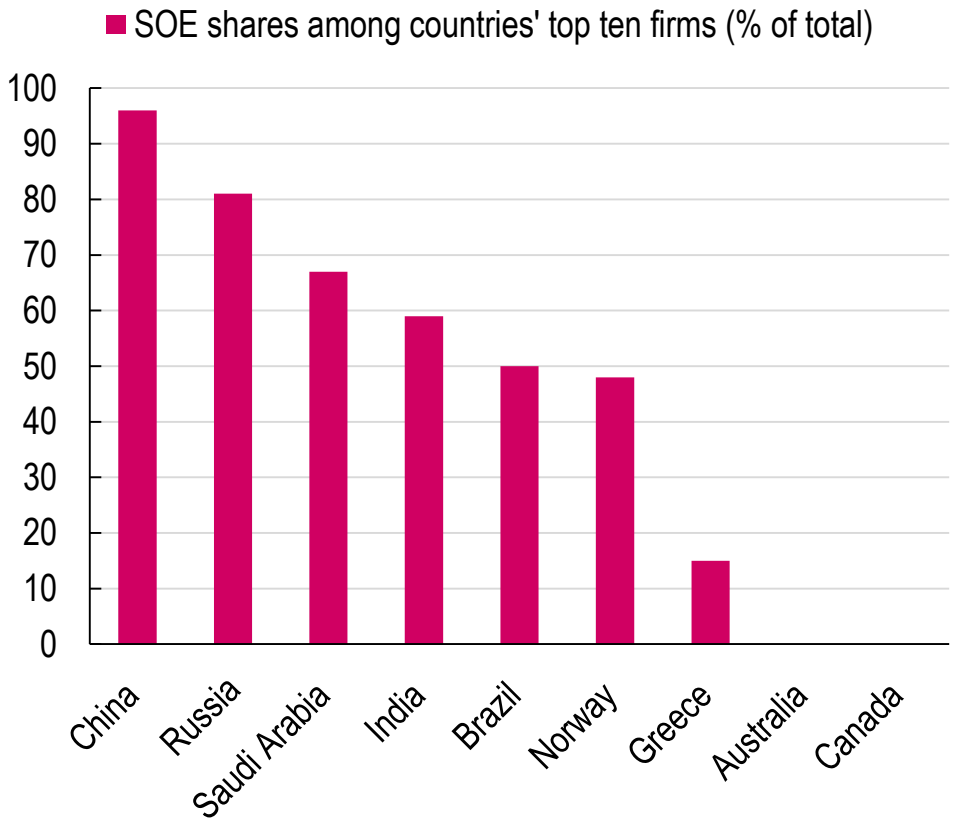
BECOME LIKE CANADA AND AUSTRALIA? NOT WITH THIS PRIVATISATION POLICY

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Per capita in 2010, unless otherwise stated, in 2005 constant PPP dollars



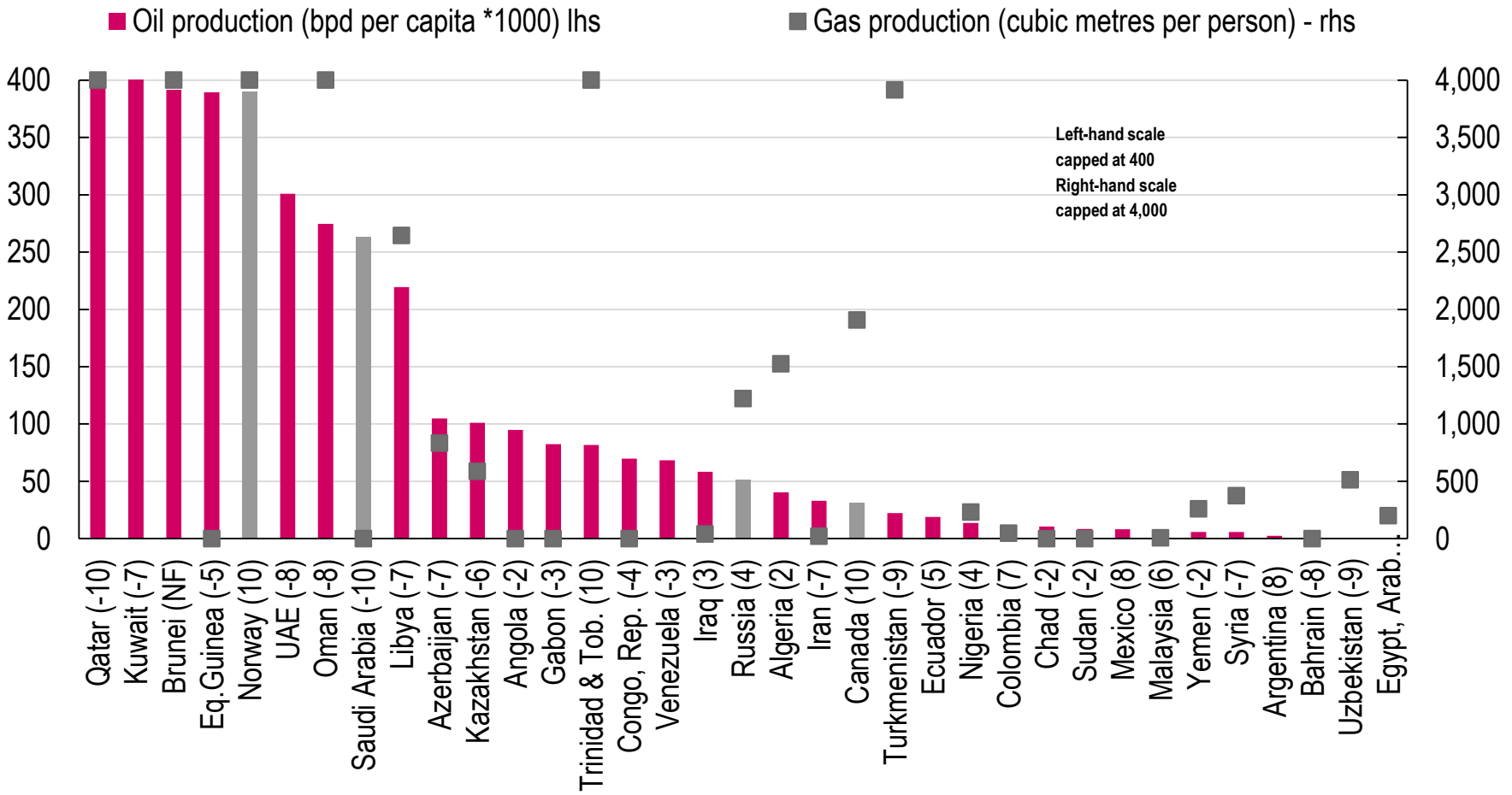
Share of state-owned enterprises (SOEs) among countries' top 10 firms (% of total), 2011 data



BECOME LIKE NORWAY OR SAUDI? NOT WITH LOW ENERGY PRODUCTION PER CAPITA

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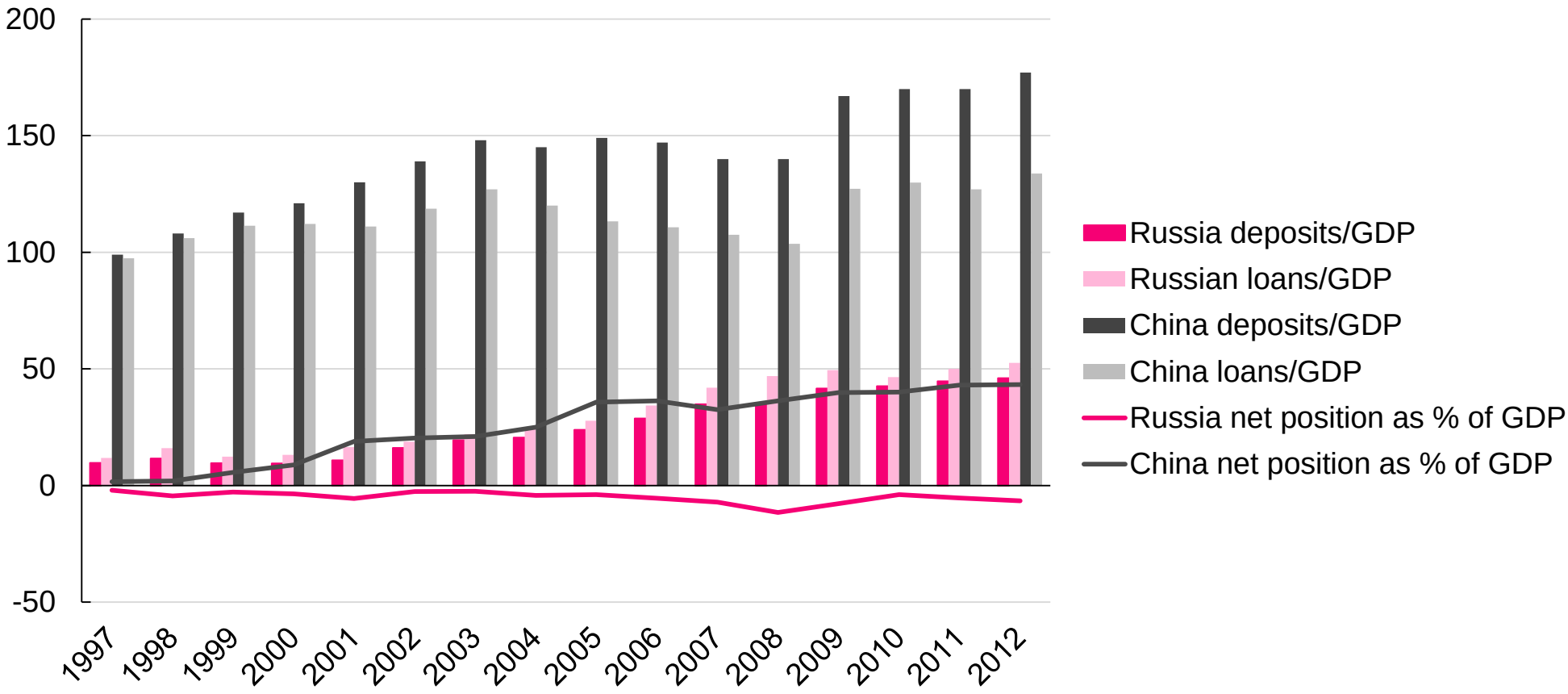
Oil (lhs) and gas (rhs) production per capita, with Norway, Saudi Arabia, Canada and Russia highlighted (Polity IV scores in brackets)



BECOME LIKE CHINA? NOT WITH RUSSIA'S LOW SAVINGS

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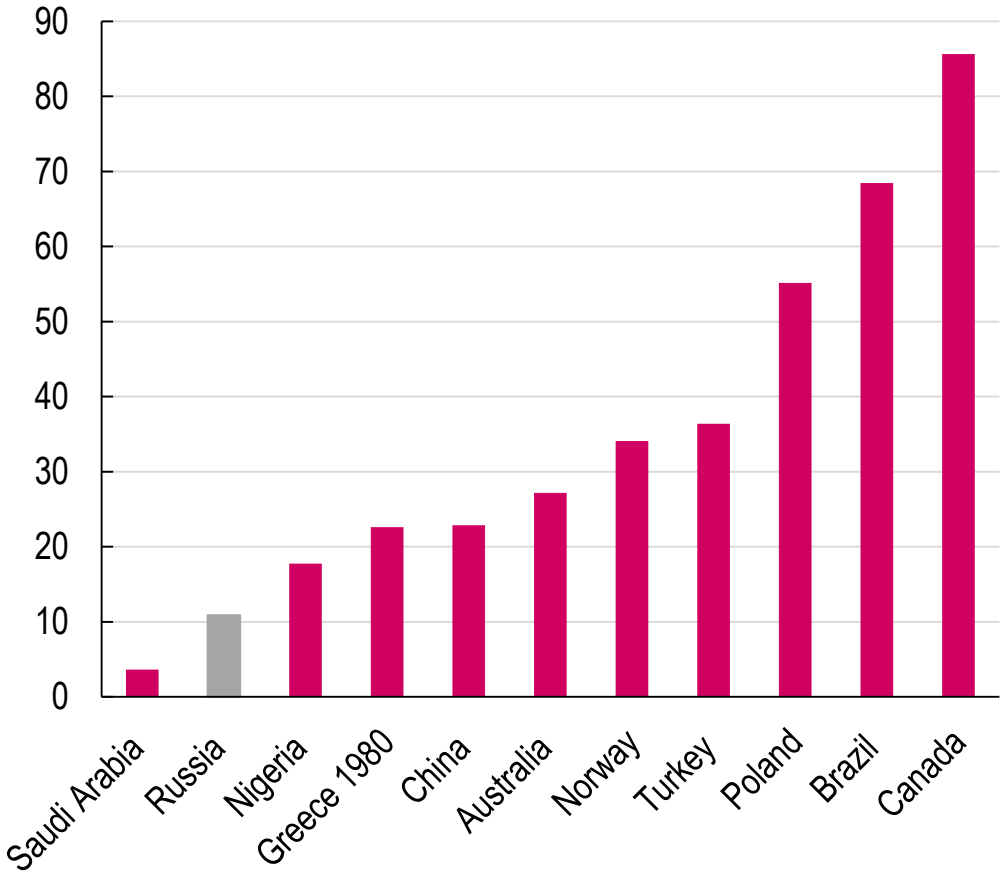
Loans, deposits and the net position as % of GDP - China's deposit surplus vs Russia's deficit helps explain interest rate differentials



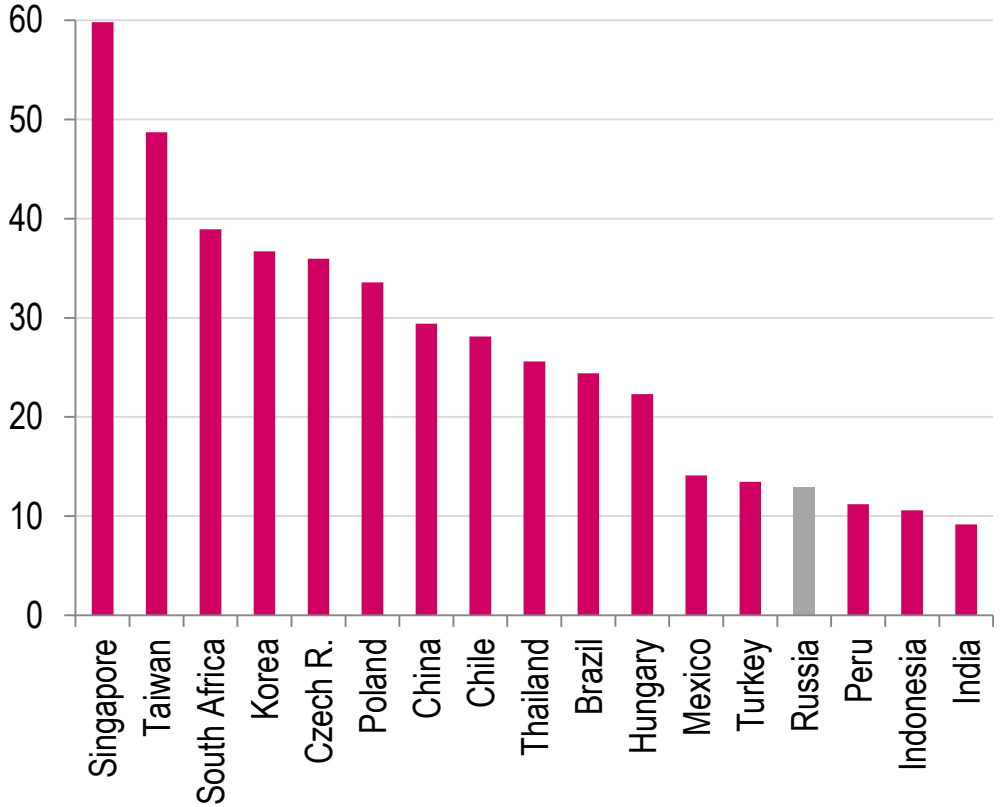
BECOME LIKE GREECE? NOW WE ARE TALKING!

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Public debt in 2012 as % of GDP (Greece in 1980)



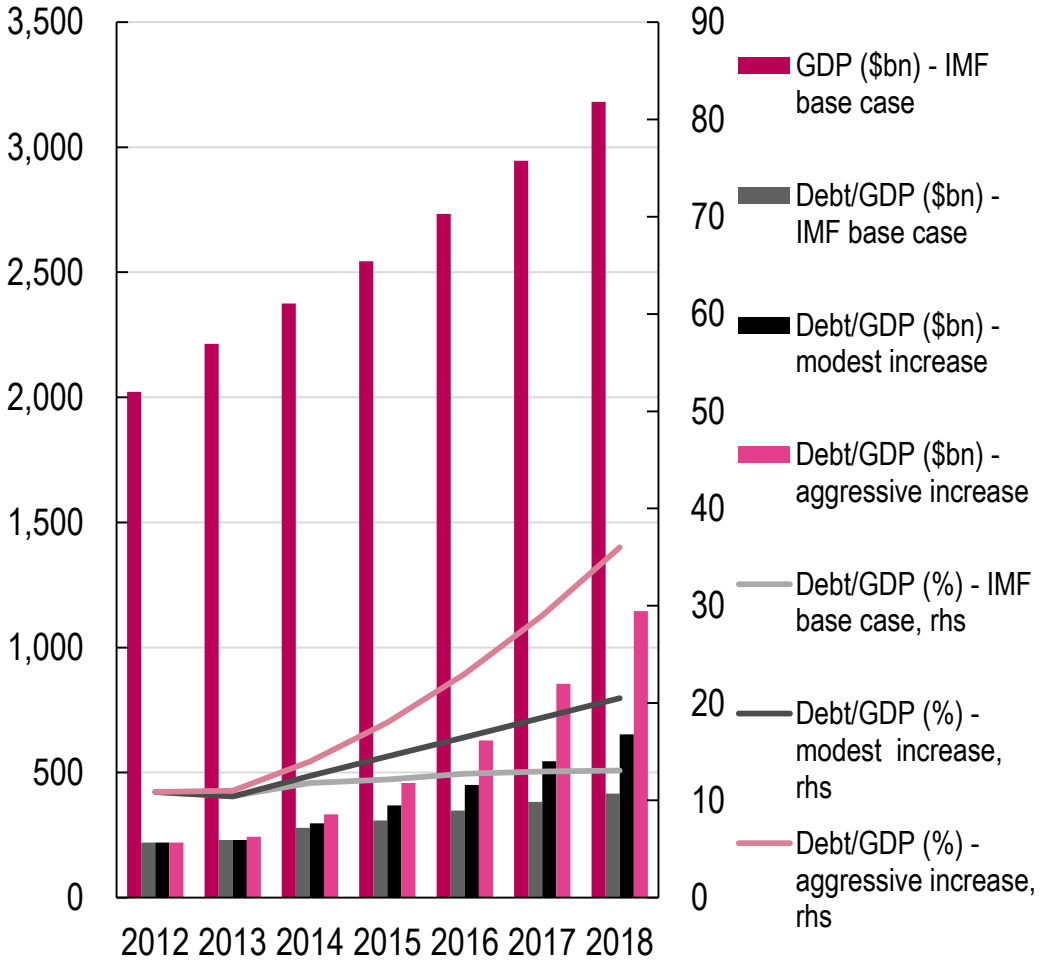
Retails loans, % GDP, 2012



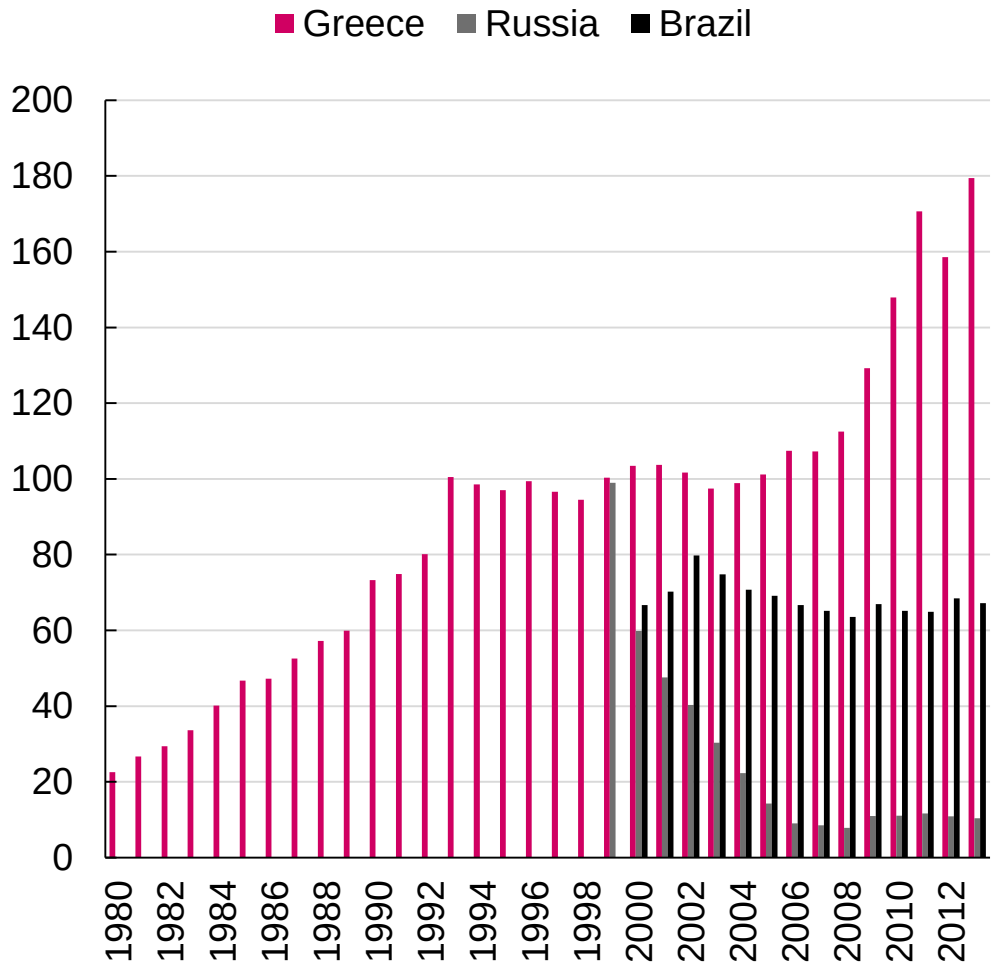
BECOME LIKE GREECE? NOW WE ARE TALKING!

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Potential public debt scenarios, GDP and public debt ($bn on lhs, % of GDP rhs)

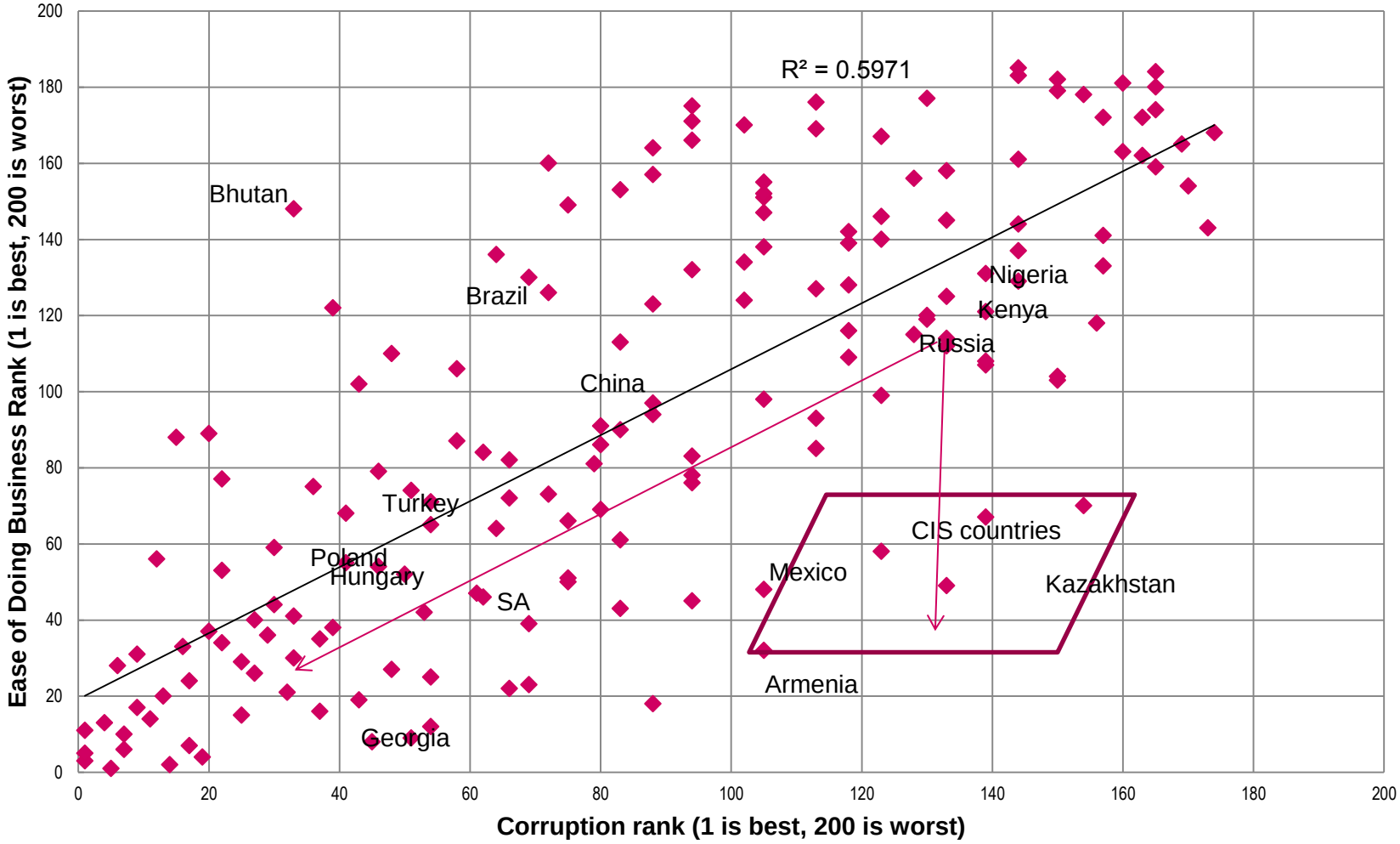


Public debt ratios since 1980 – Brazil, Russia and Greece



OR JUST IMPLEMENT REFORMS

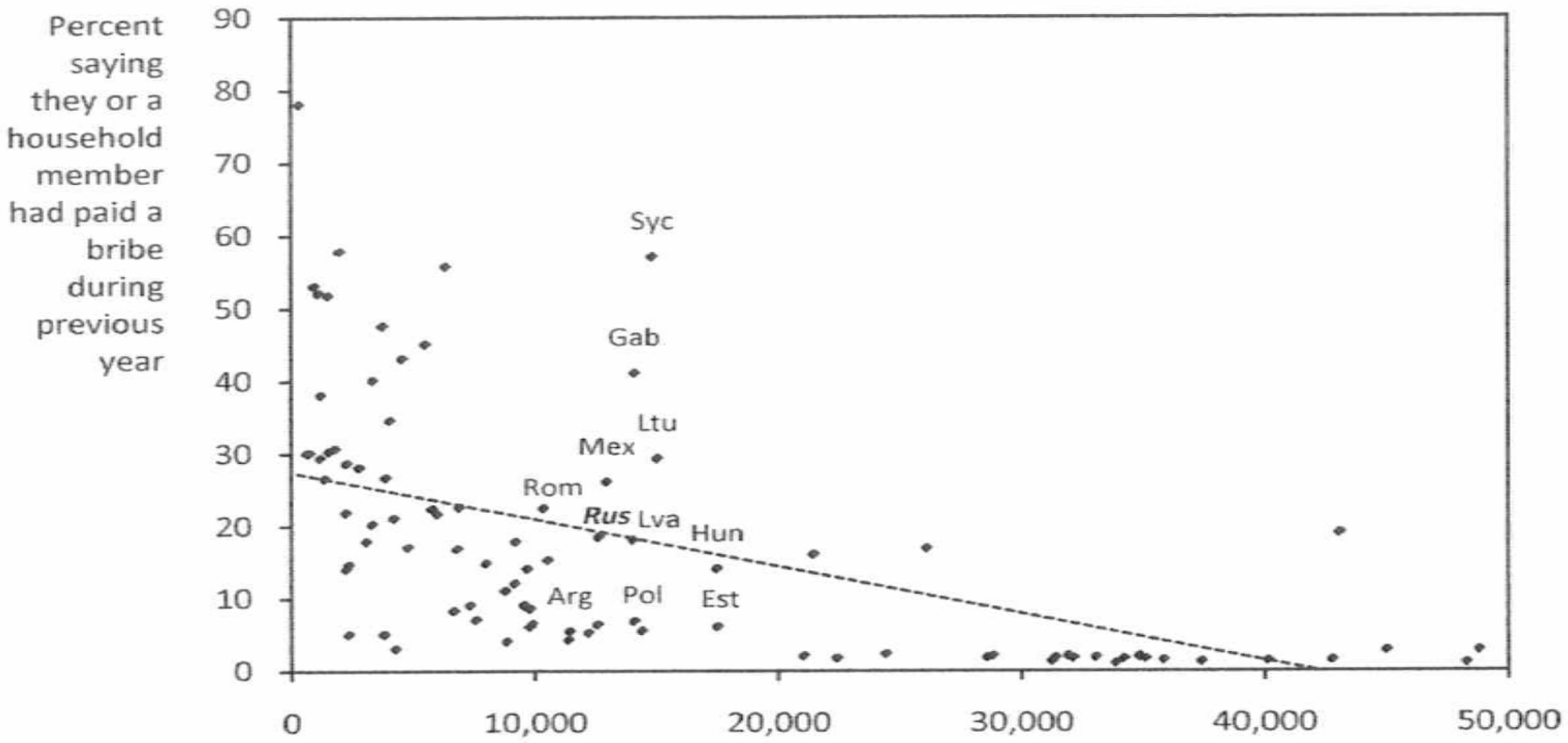
Ease of doing business ranking (2013) vs ranking in Corruption Perceptions Index (2012) by Transparency International



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HOW CORRUPT IS RUSSIA?

Figure 10.1 Frequency of bribery around the world, 2004-2009

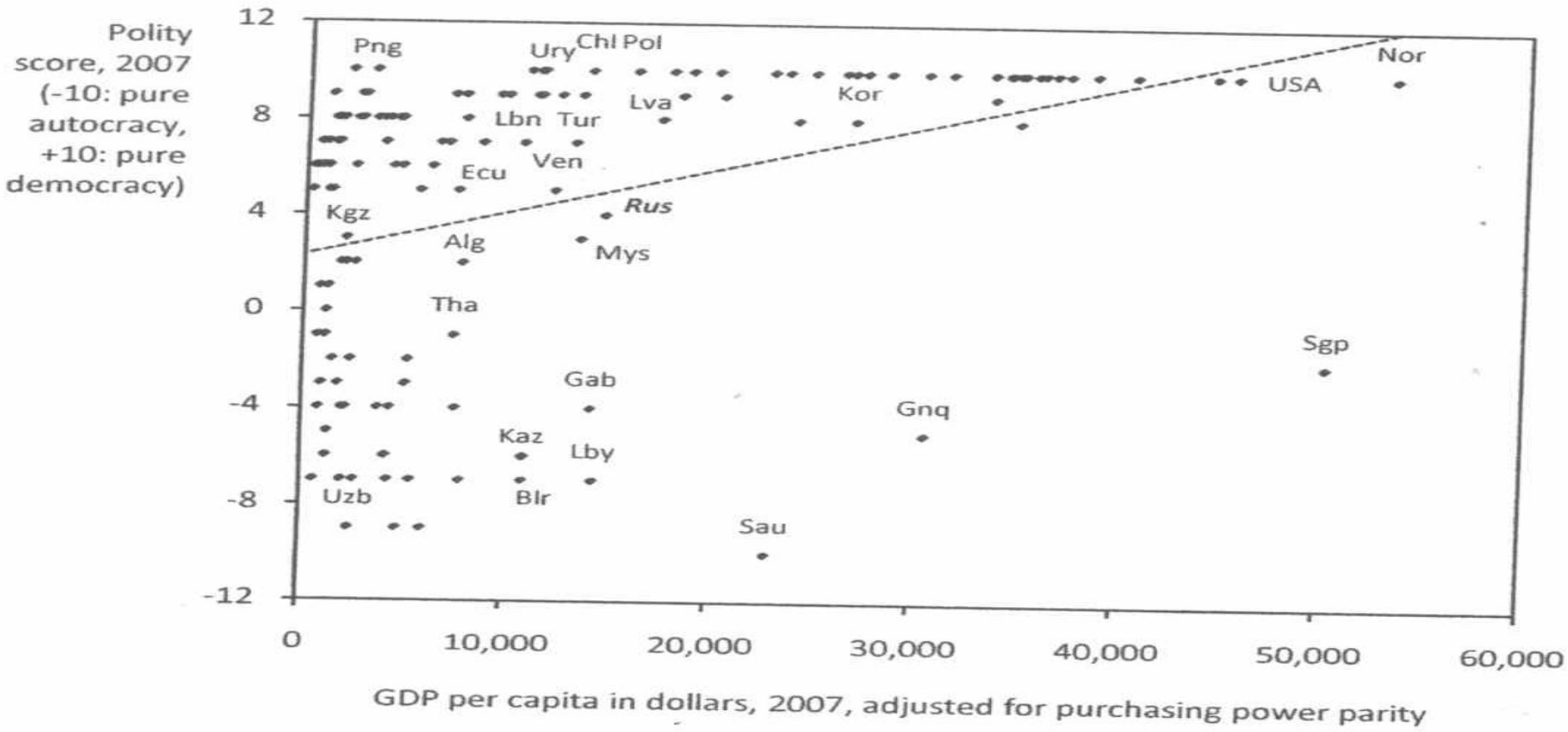


Sources: Transparency International, *Global Corruption Barometer* surveys, averaged for 2004-2009; World Bank, *World Development Indicators*.

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HOW (UN)DEMOCRATIC IS RUSSIA?

Figure 10.3 Economic development and democracy, 2007



Sources: Polity IV (after September 2009 revision), and World Bank, *World Development Indicators*, 2009.

WHAT DO RUSSIANS WANT?

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Roots of discontent

What causes frustration or anxiety in your life?	May 2011, %
Unreasonably high cost of living	67
Low quality of medical services	53
Widespread corruption among public servants	49
High level of crime	48
Influx of migrants	41
Deplorable state of education system	39
Moral decay of society	39
Weak protection of property	36
Limited career opportunities	35
State of pension system	35
Increasing intolerance in society	27
Absence of an independent judiciary	26
Growth of Russian nationalism, xenophobia	16
Authoritarian regime	15
Restriction of media freedom	14

Source: The Economist, Levada Centre, Novaya Gazeta

Does Russia need democracy?, % of respondents

	Jun-05	Dec-06	Dec-07	Jun-08	Jun-09	Dec-09	Jun-10	Jul-11	Oct-11	Jul-12
Yes, Russia needs a democracy	66	56	67	62	57	57	60	55	61	63
No, democratic government is not for Russia	21	27	16	20	26	23	24	32	25	24
No answer	13	17	17	18	17	20	16	13	14	13

Source: Levada Center

What type of democracy does Russia need?, % of respondents

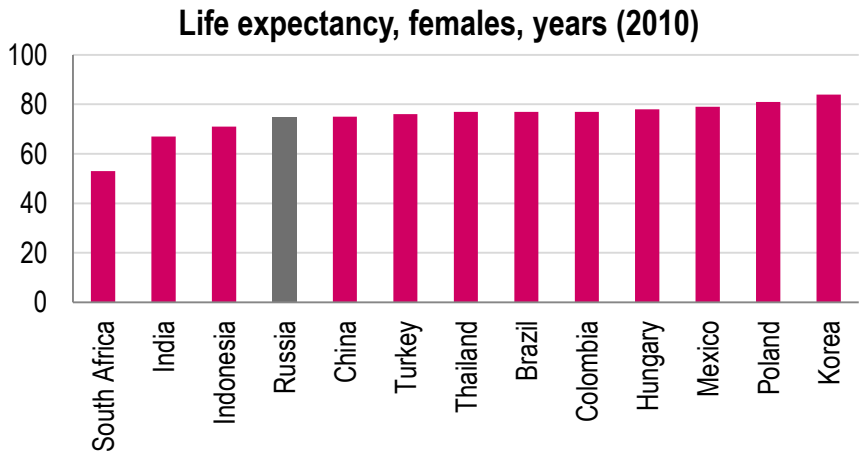
	Jun-05	Dec-06	Dec-07	Jun-08	Jun-09	Dec-09	Jun-10	Jul-11	Oct-11	Jul-12
Like in developed countries in Europe and America	24	18	22	20	20	23	23	23	19	27
Like in the Soviet Union	16	13	10	13	18	14	17	16	14	20
A special type, in accordance with Russian national traditions and peculiarities	45	48	47	45	39	43	44	45	49	38
Russia does not need democracy	6	10	7	8	10	7	7	7	7	3
No answer	9	11	14	15	14	13	10	10	11	12

Source: Levada Center

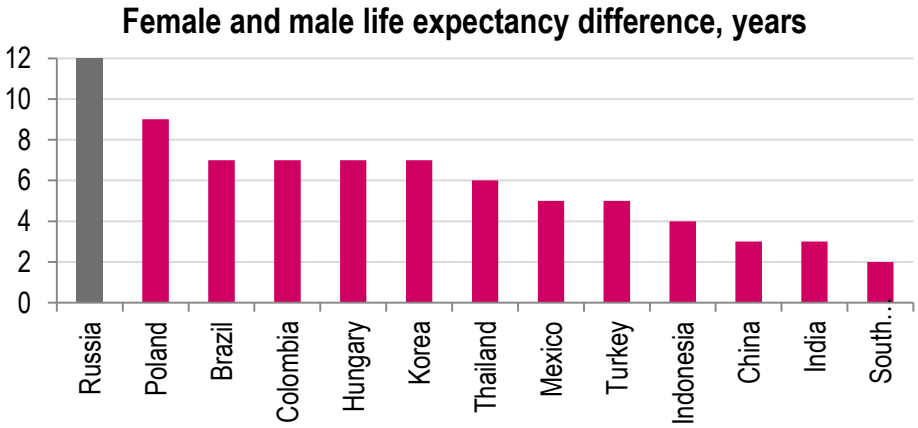
DEMOGRAPHIC REVIVAL?

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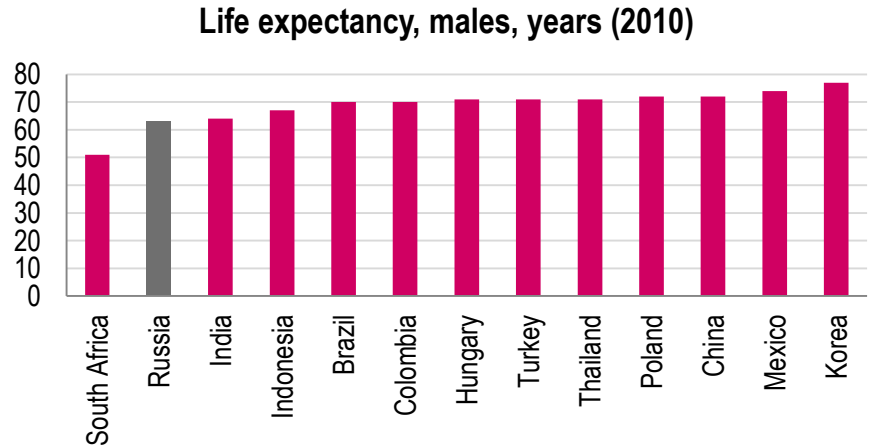
Female life expectancy in line with that of other EMs



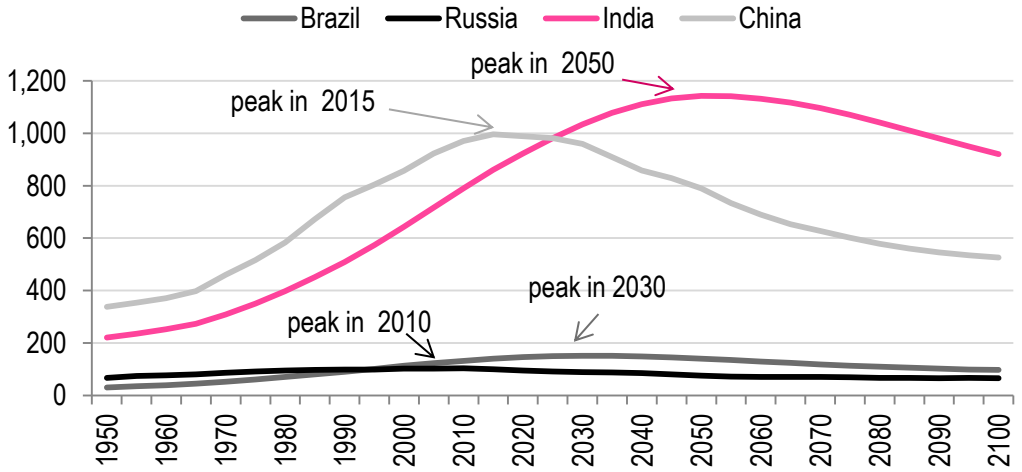
The difference in male/female life expectancy is largest in Russia



Male life expectancy is less so



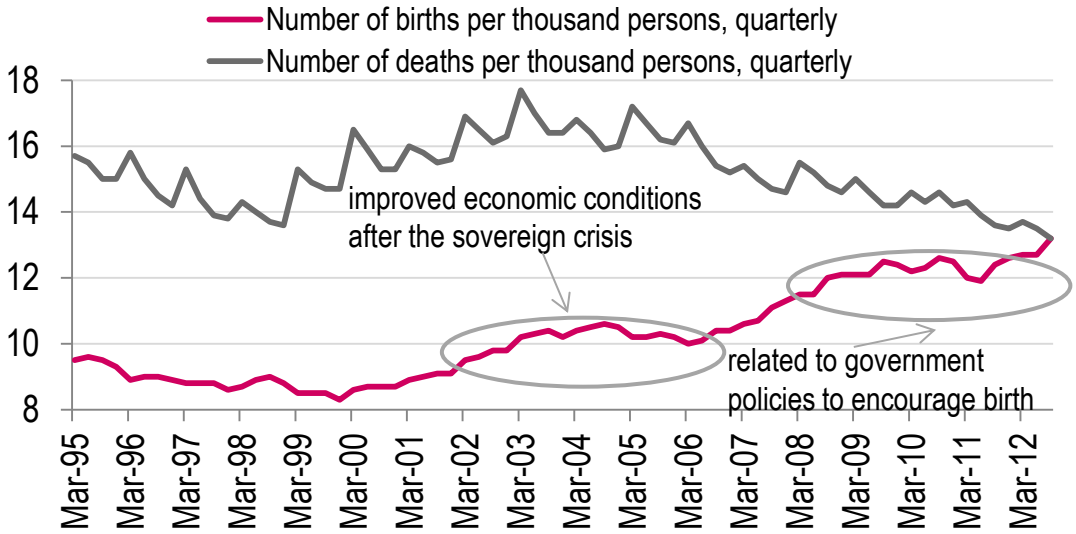
Population peaked in 1995



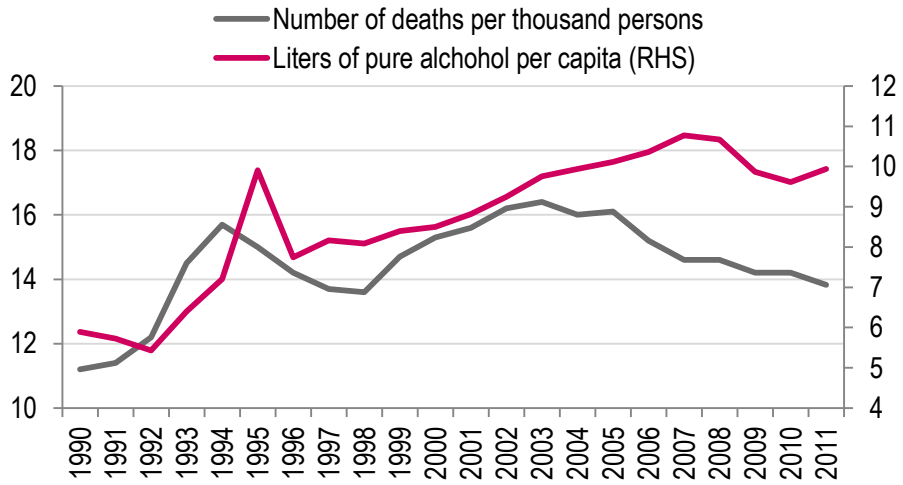
DEMOGRAPHIC REVIVAL?

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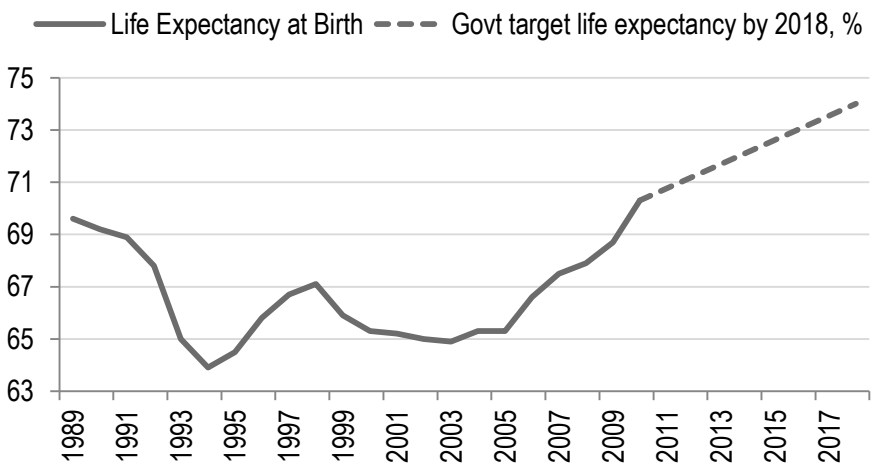
Births are rising and deaths are falling



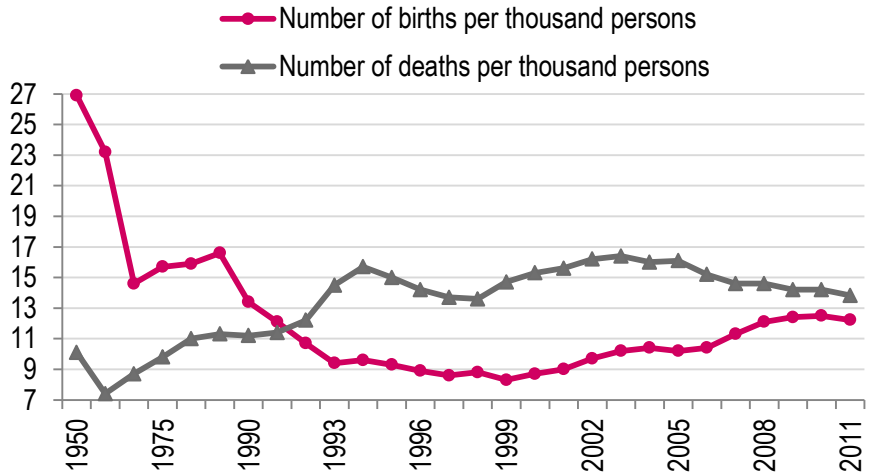
Deaths are correlated with alcohol consumpiton



Life expectancy has been on the rise



Gap btw births and deaths is closing



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Still pain in Ukraine

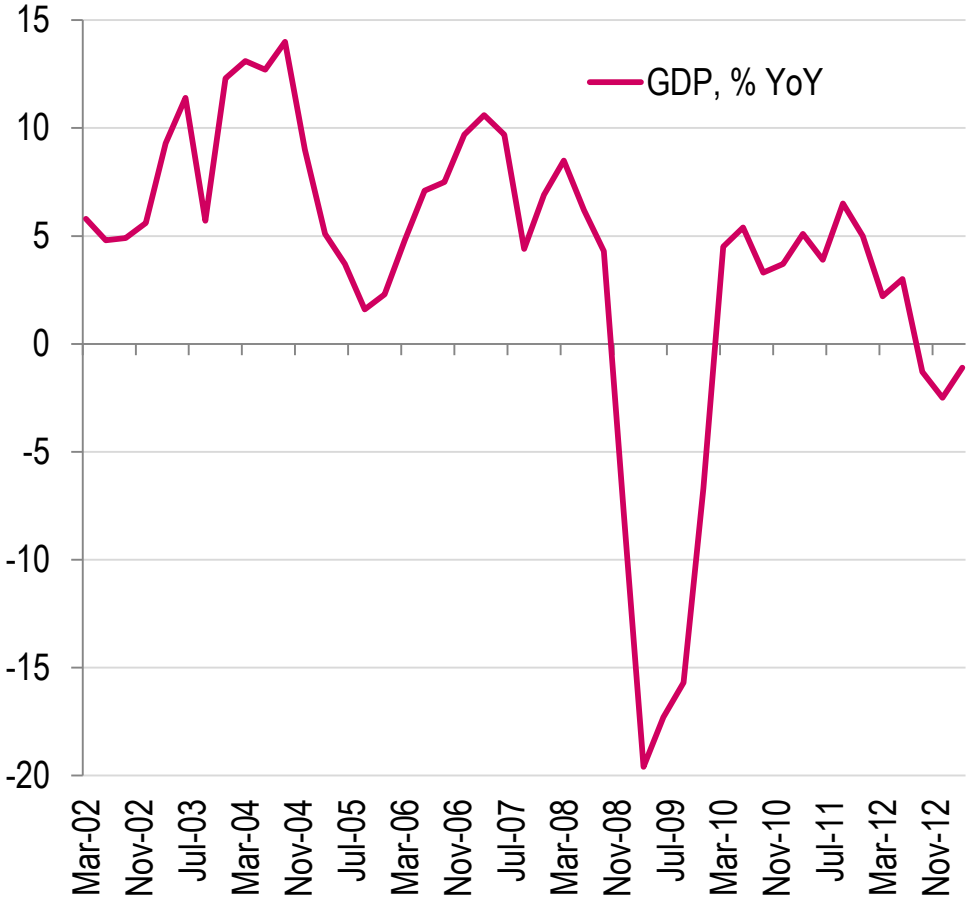
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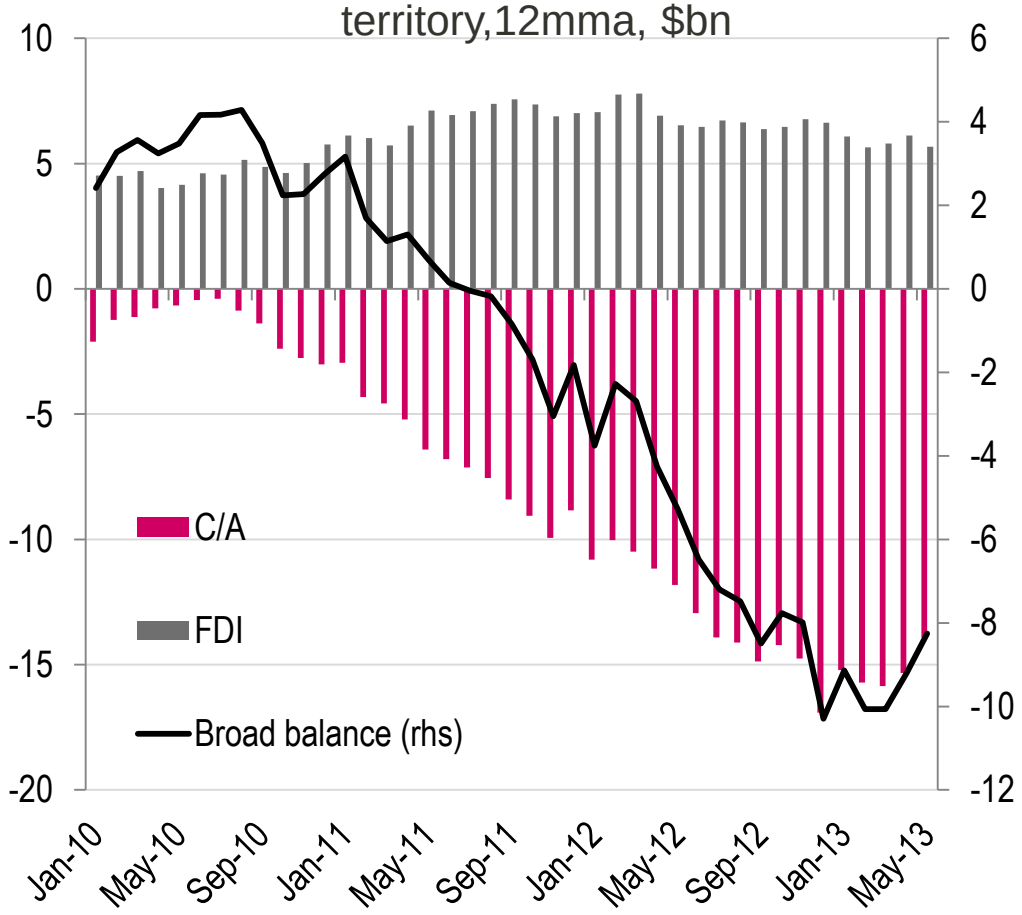
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STILL PAIN IN UKRAINE

GDP falls for three consecutive quarters



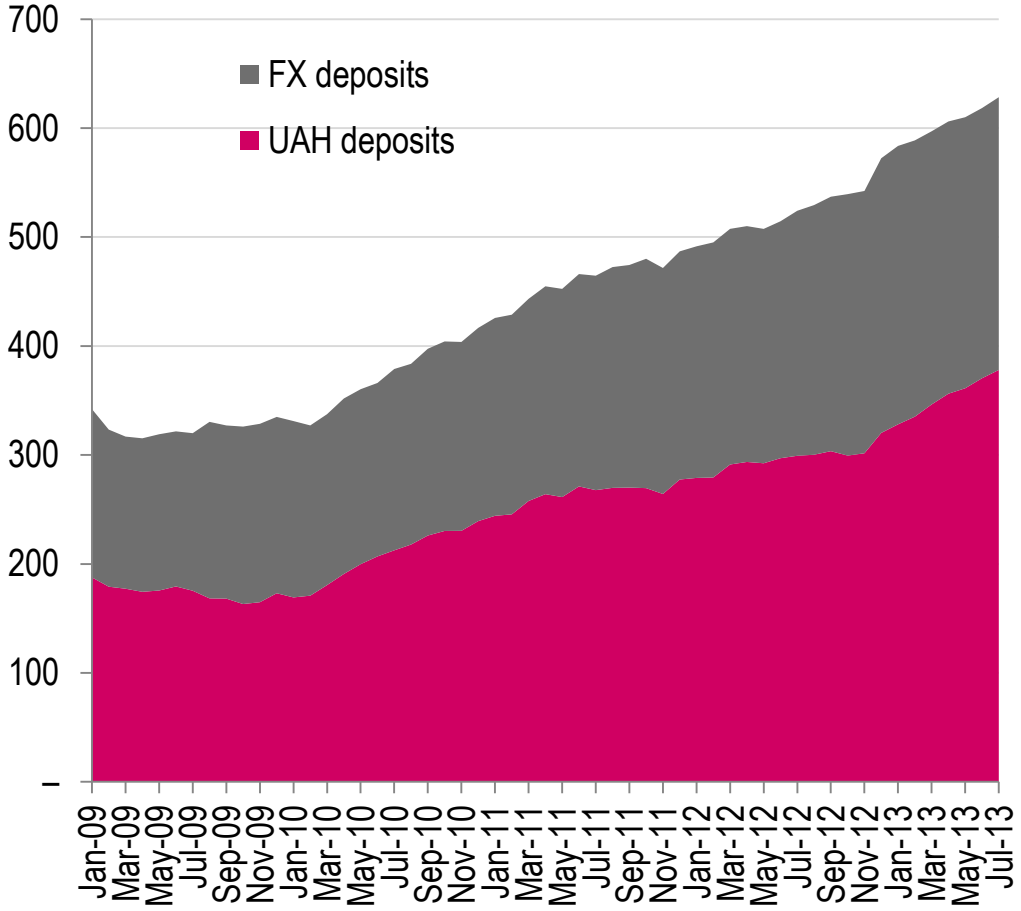
Broad balance is still deep in negative territory,12mma, $bn



STILL PAIN IN UKRAINE

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Deposits are still stable, UAHbn



FX share of deposit are falling



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Kazakhstan: Readying for a milder boom

Sep 2013

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READYING FOR A MILDER BOOM

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- Until 2007, KAZ was booming like the Baltics, the US or periphery Europe, with double- or triple-digit bank lending and property price rises
- When bust came, KAZ banks defaulted on the bonds that fuelled that boom
- KAZ being the fastest-growing among MSCI Frontier Markets
- Total debt levels today are again very low and real estate market is returning to life, so that there is plenty of room for a milder re-run of the boom along with
- Energy production per capita enough to secure political stability
- Business friendly reforms have put KAZ into 49th place globally according to WB Ease of Doing Business 2012 rankings
- KAZ is not an imminent boom story, we think this is a country with good prospects for asset price growth
- However, rapid growth in credit and asset prices will only follow more success in cleaning up NPLs in the banking system, and when there is growth in deposits to fund further lending

READYING FOR A MILDER BOOM

Oil (lhs) and gas (rhs) production per capita, with Norway, Saudi Arabia, Canada and Russia highlighted (Polity IV scores in brackets)

