



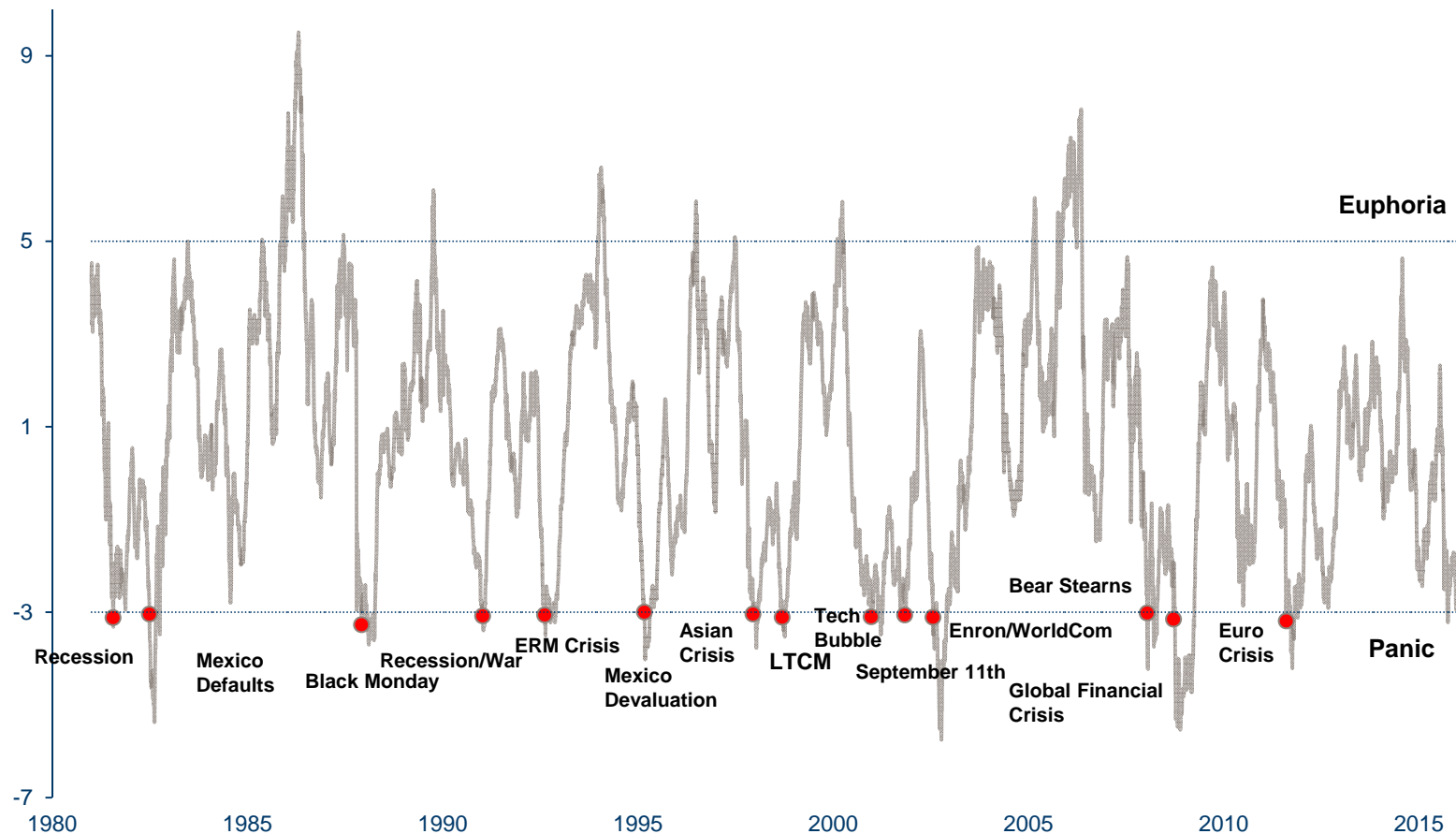
Russia's triumphs and traumas

21 March 2016

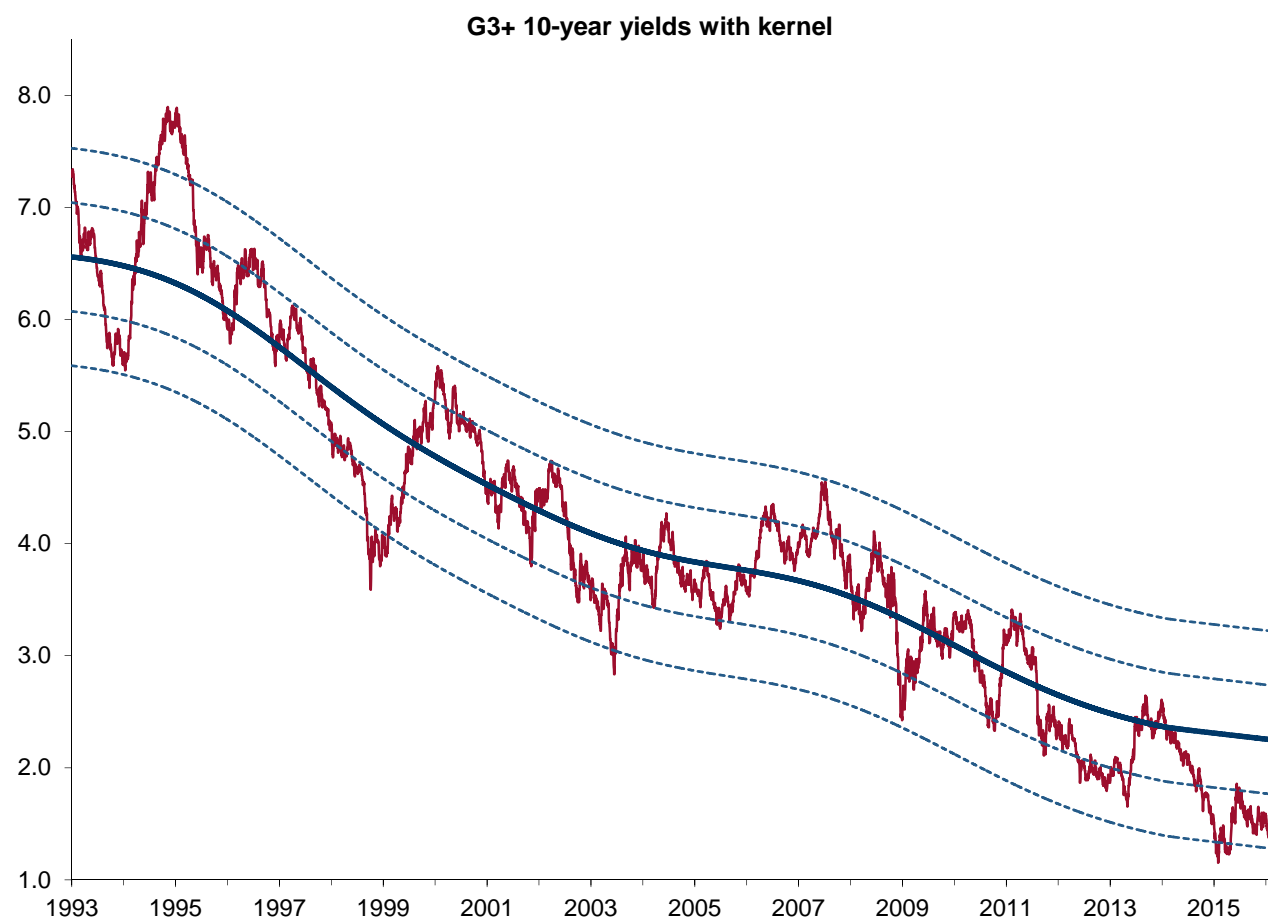
DISCLOSURE APPENDIX AT THE BACK OF THIS REPORT CONTAINS IMPORTANT DISCLOSURES AND ANALYST CERTIFICATIONS.



Global markets have been in Risk Appetite panic this year, a rare event that normally accompanies a major shock to the global economy...

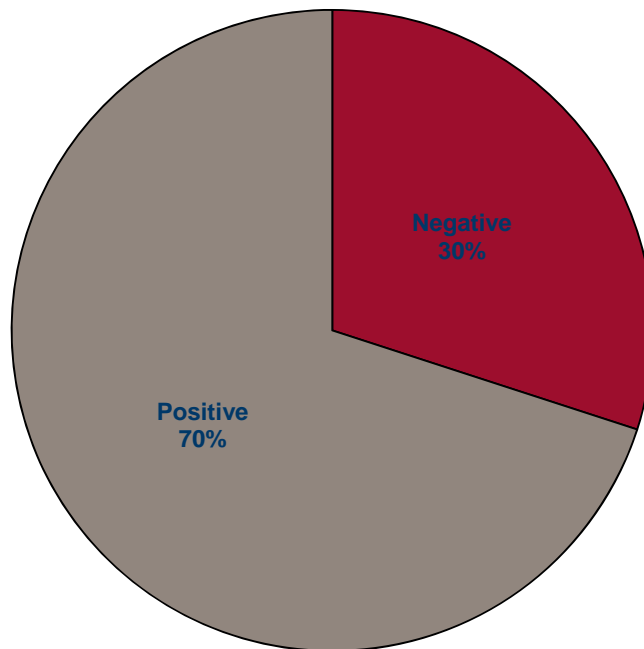


Long bond yields have fallen to historically low levels

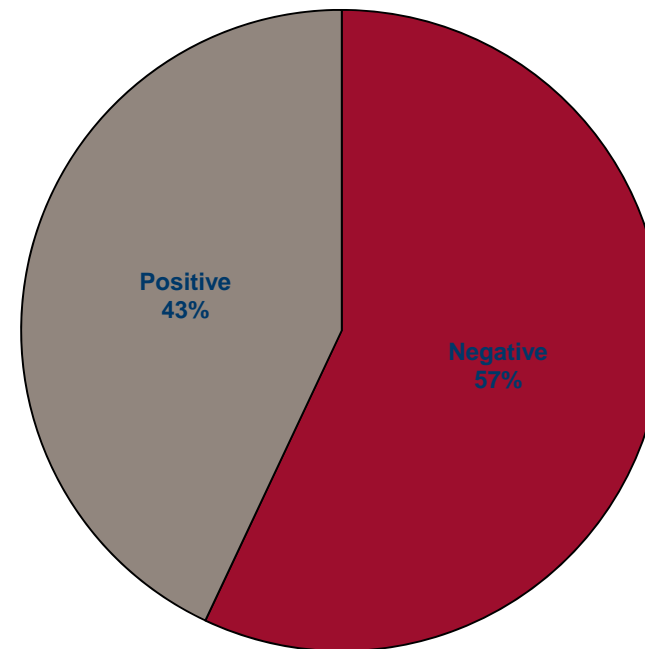


...as Japan joins the negative rates “experiment”

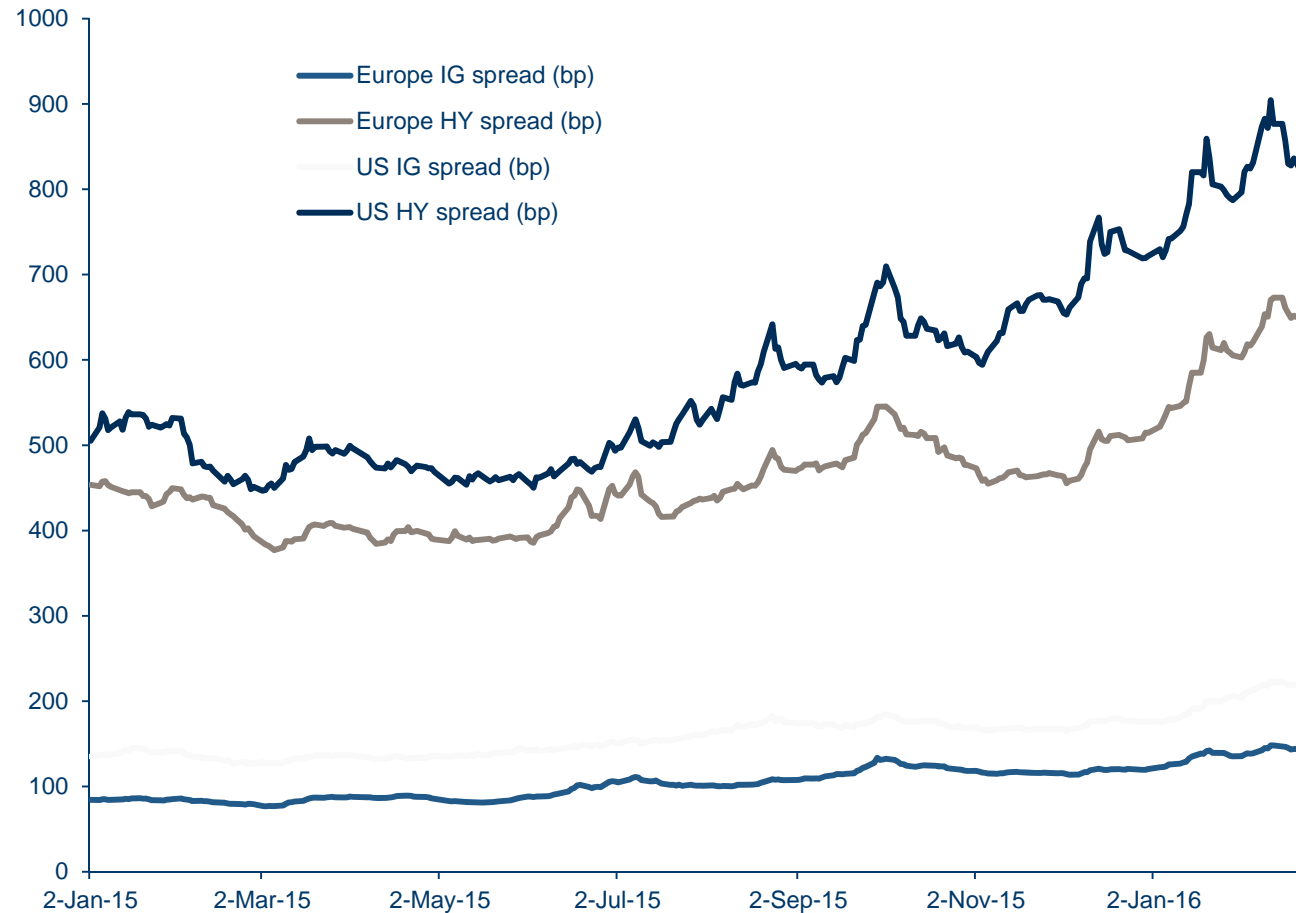
30% of G10 sovereign bonds trading at negative rates
(includes US, Japan, euro area, Australia, New Zealand, Switzerland, Sweden, Denmark)



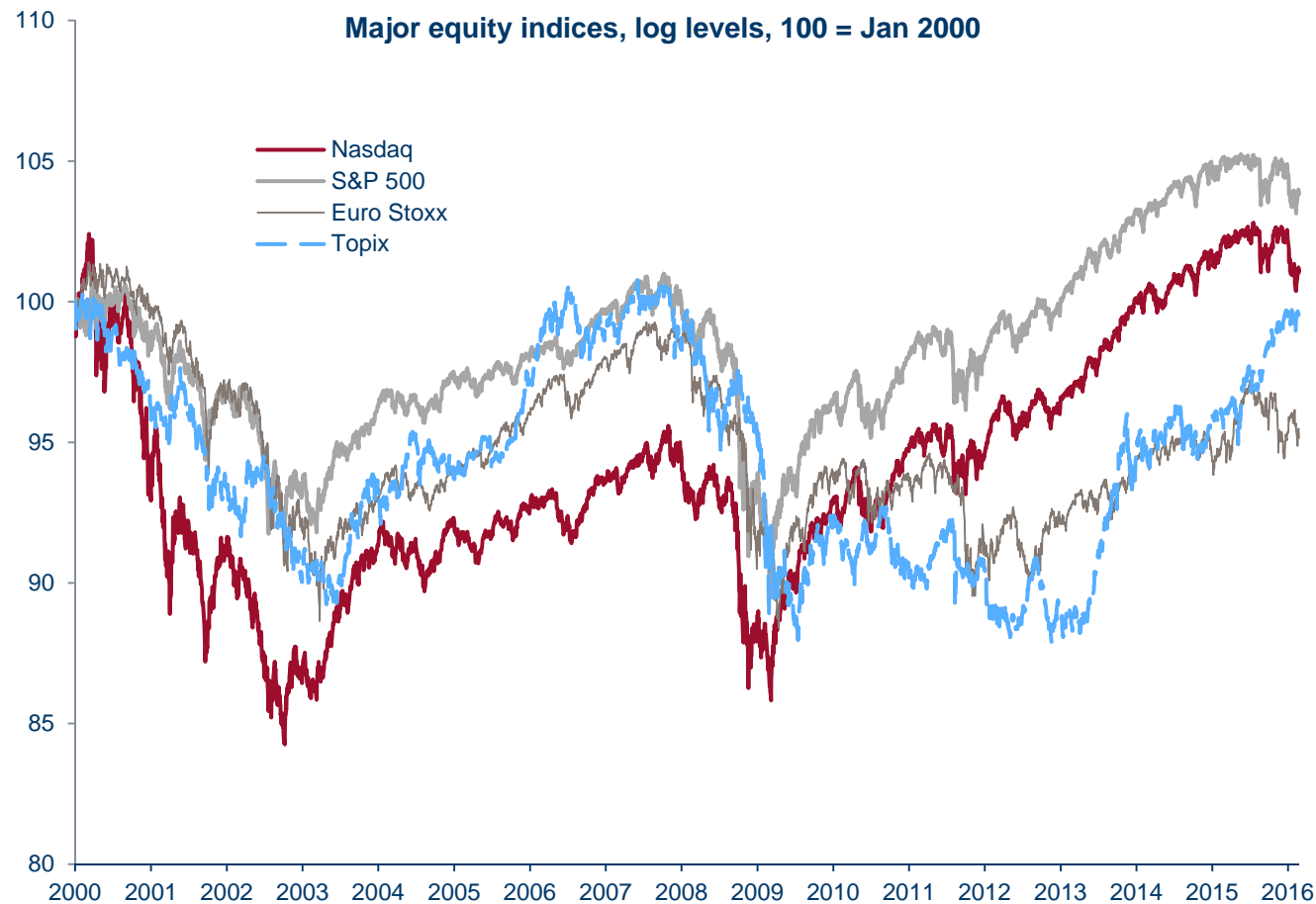
...including 57% of countries with negative policy rates
(includes Japan, euro area, Switzerland, Sweden, Denmark)



Credit markets have seen substantial distress, with the pain in US high yield spilling over to Europe



Equity markets are threatening a “bear” market

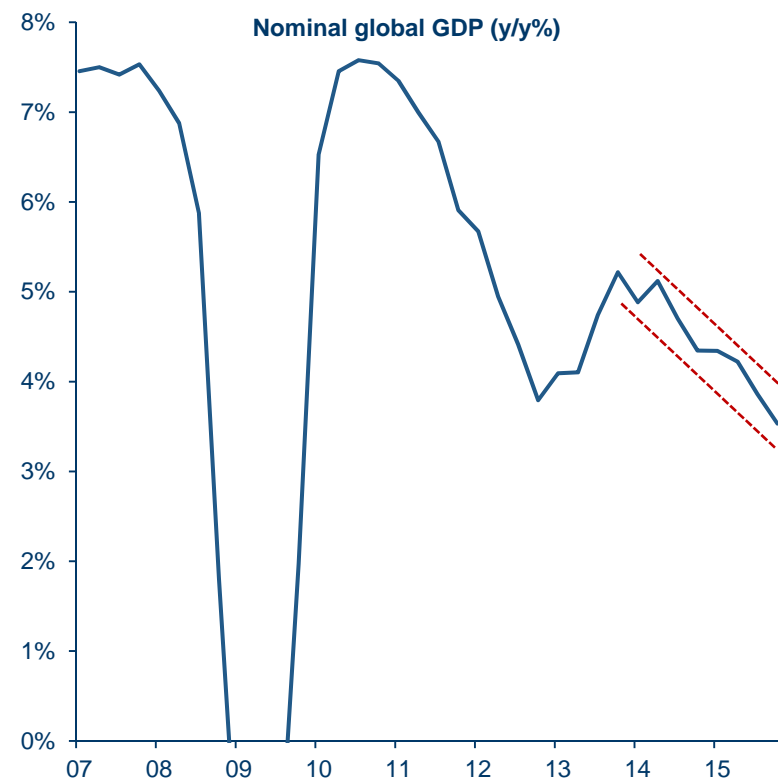
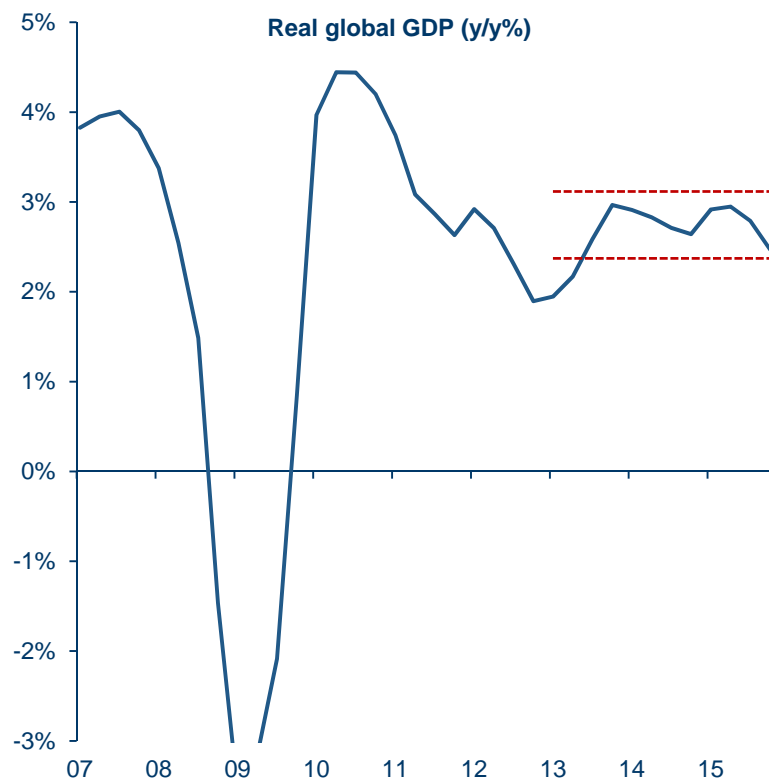


So what's going on?

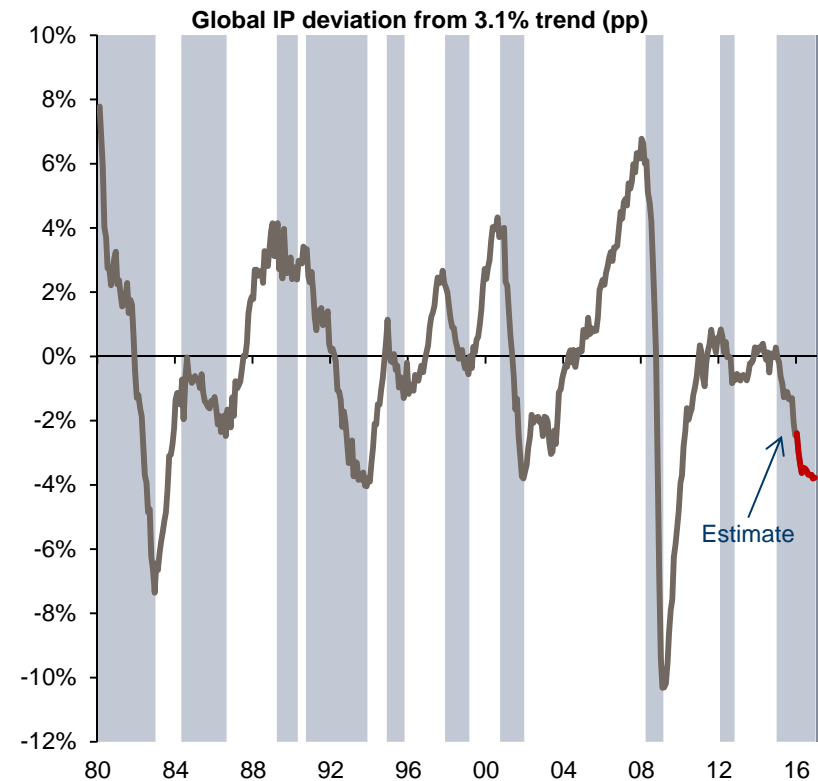
The list of concerns that we hear from clients is long:

- Weak and slowing global growth – with nominal much weaker than real
- Fear that the US will tip into recession
- Concerns about the capacity of central banks to continue to underpin the system
 - Chinese FX and equity market interventions kicked this off
 - The move by the BoJ to negative policy rates amplified the fears
 - The dramatic fall in yields has also hit sentiment regarding the health of the banking sector, particularly in Europe
- Continued policy divergence
- Weakness in China, and concern that policymakers are beginning to “lose control”
- Geopolitical risks, including the US election, the risk of Brexit, as well as on going instability in the Middle East, Russia etc.

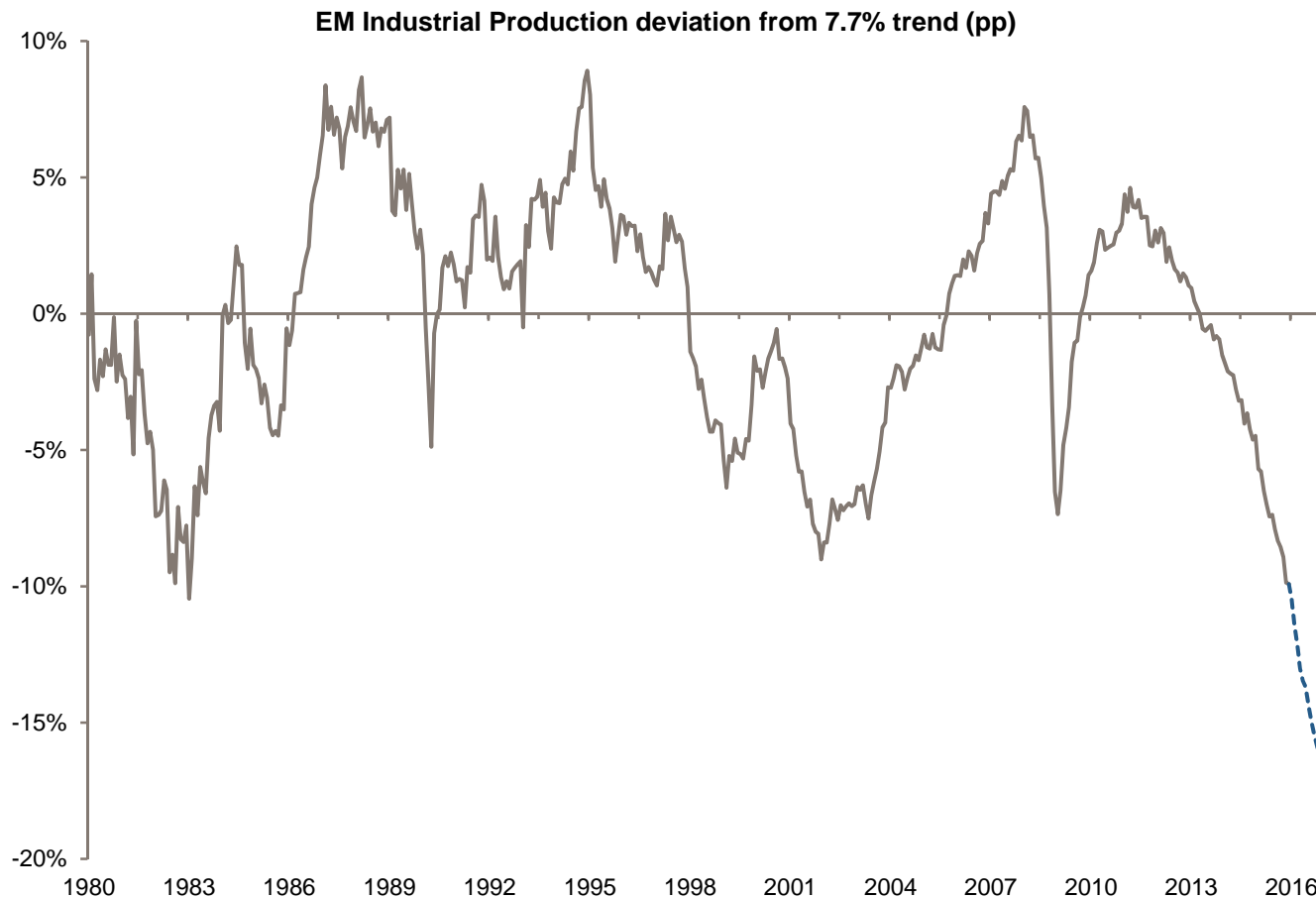
We think a key factor has been the weakness in the nominal economy....



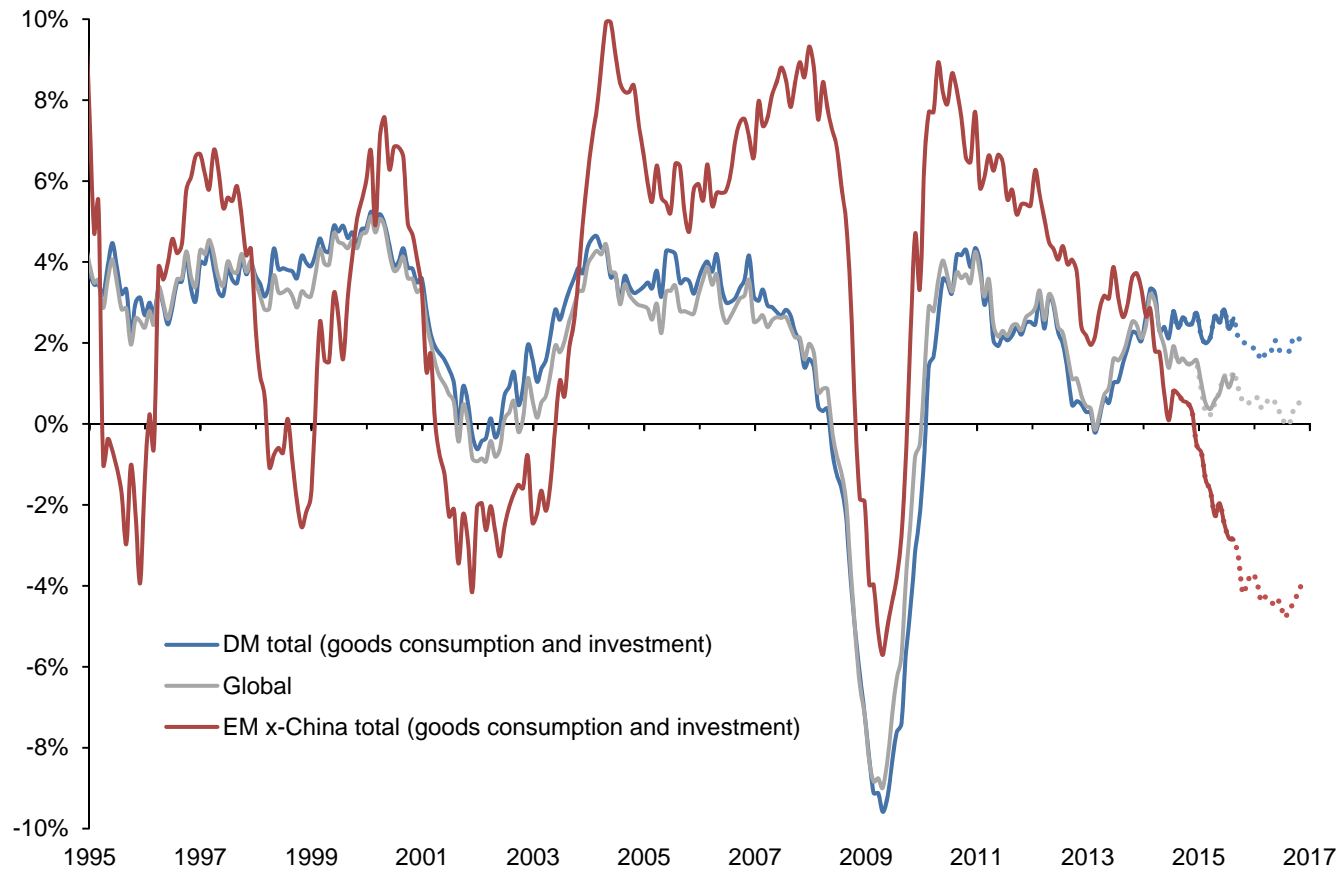
And while IP has remained positive, 18 months of sluggish growth has seen the level of activity fall well below trend



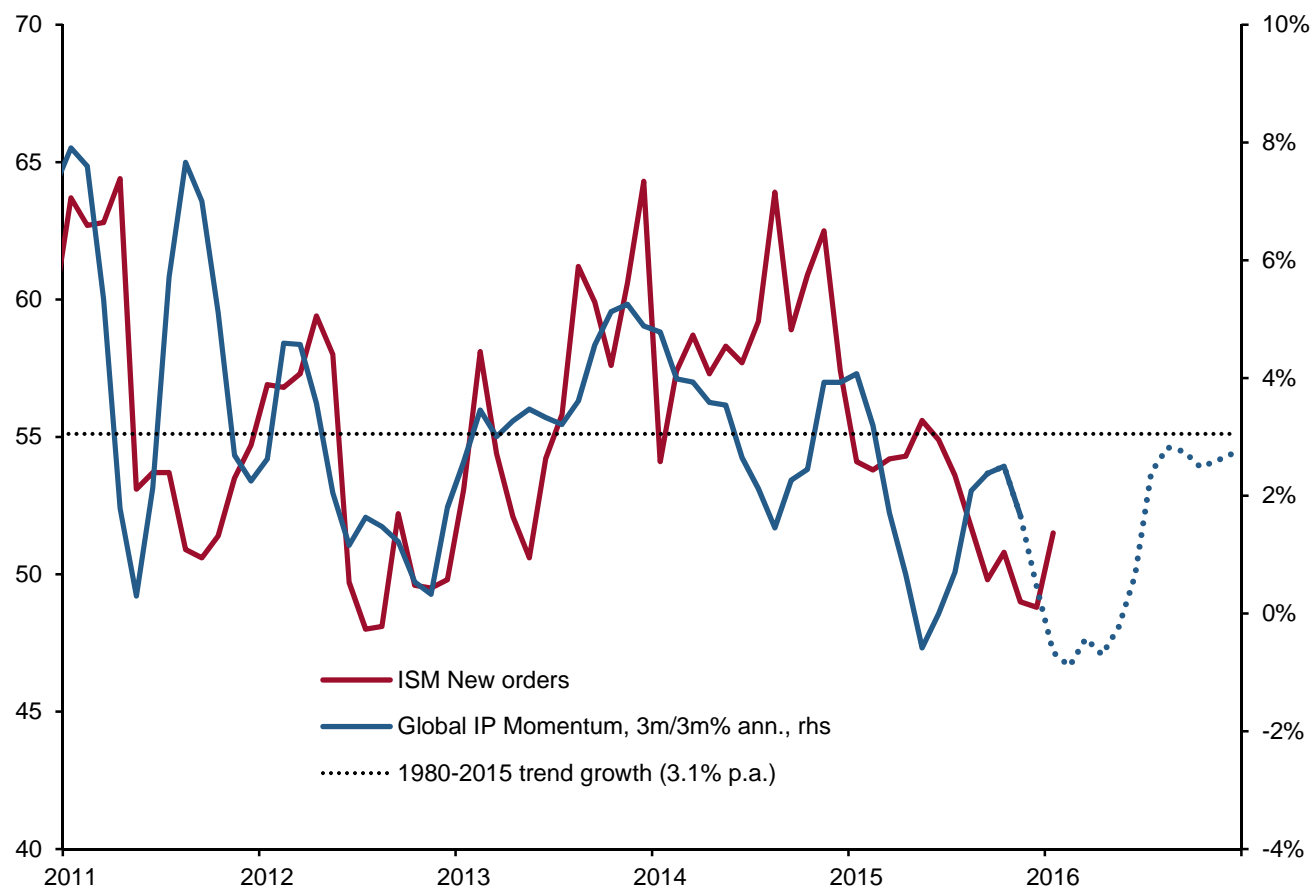
...with EM IP particularly weak relative to historical trends, as the “new normal” asserts itself in China



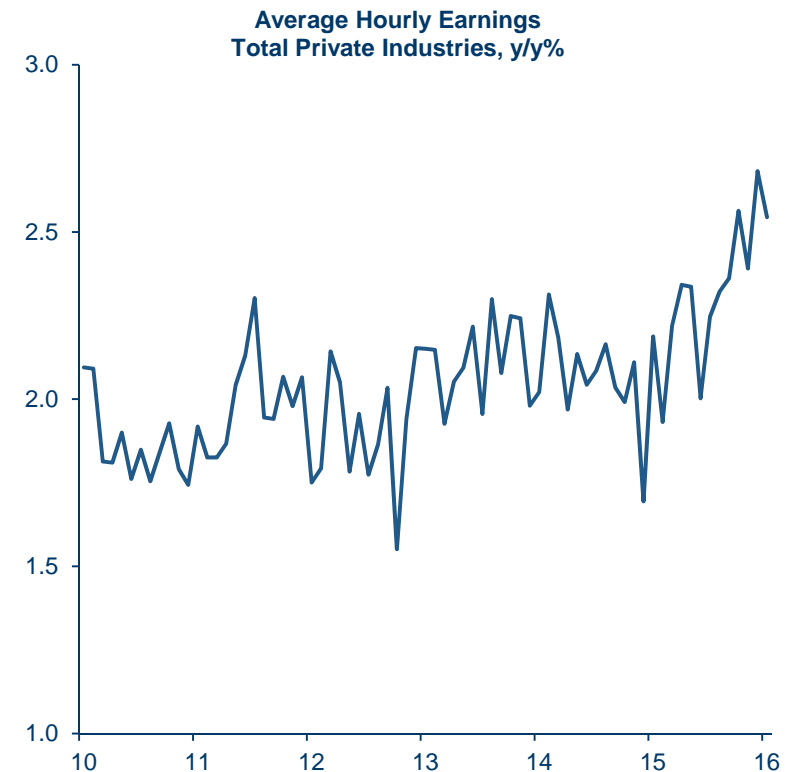
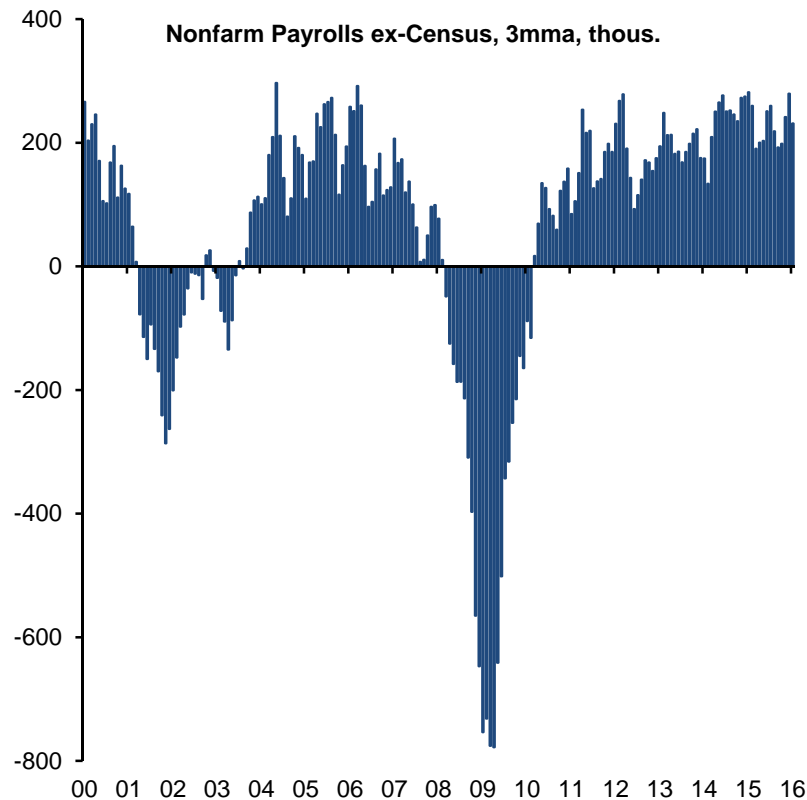
We think that the commodity bust is at the center of many of these issues, with EM demand much weaker than DM – which has actually been ok...



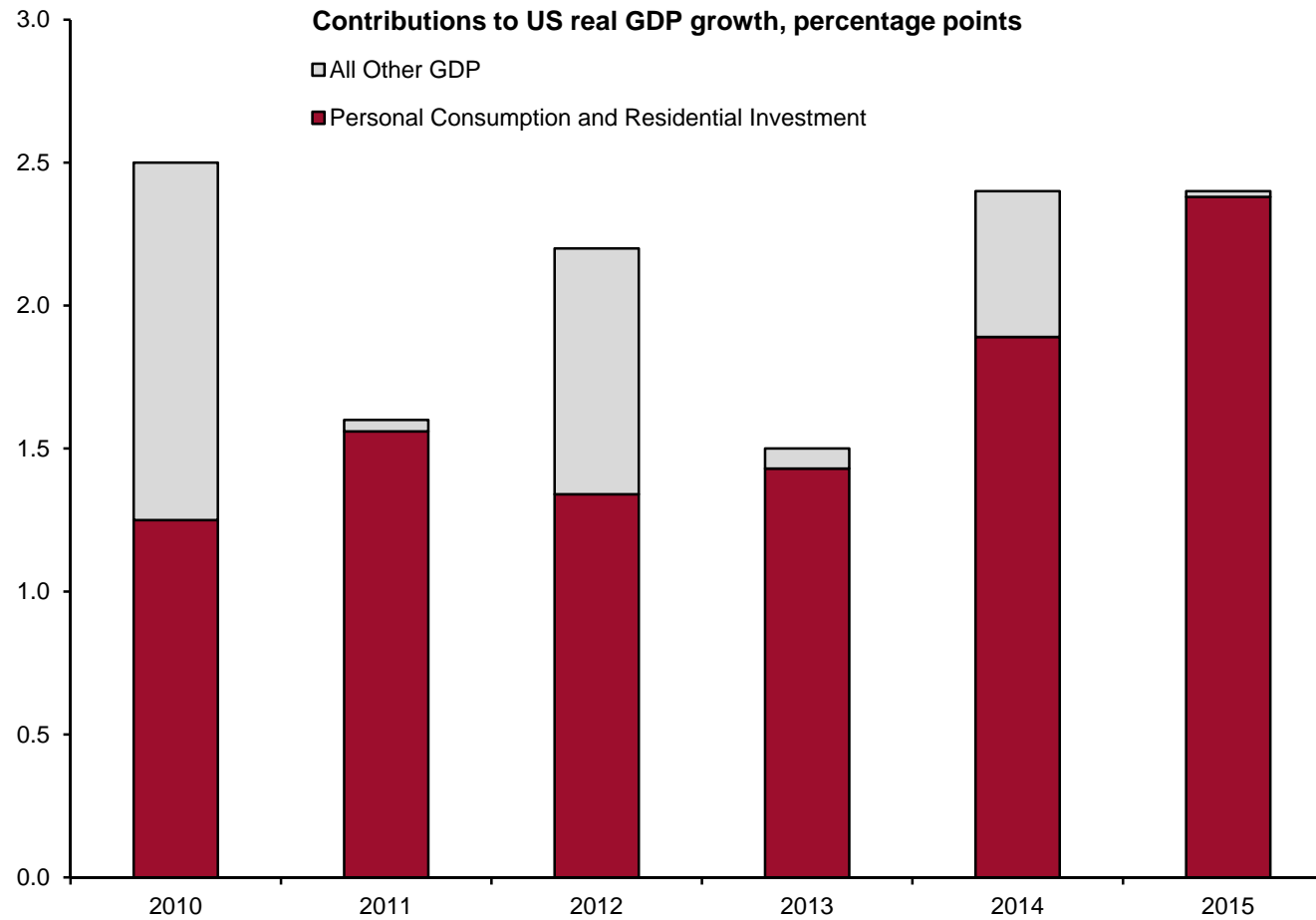
We also think that production at a global level will undershoot demand in coming months, suggesting that IP growth should rebound by-mid year



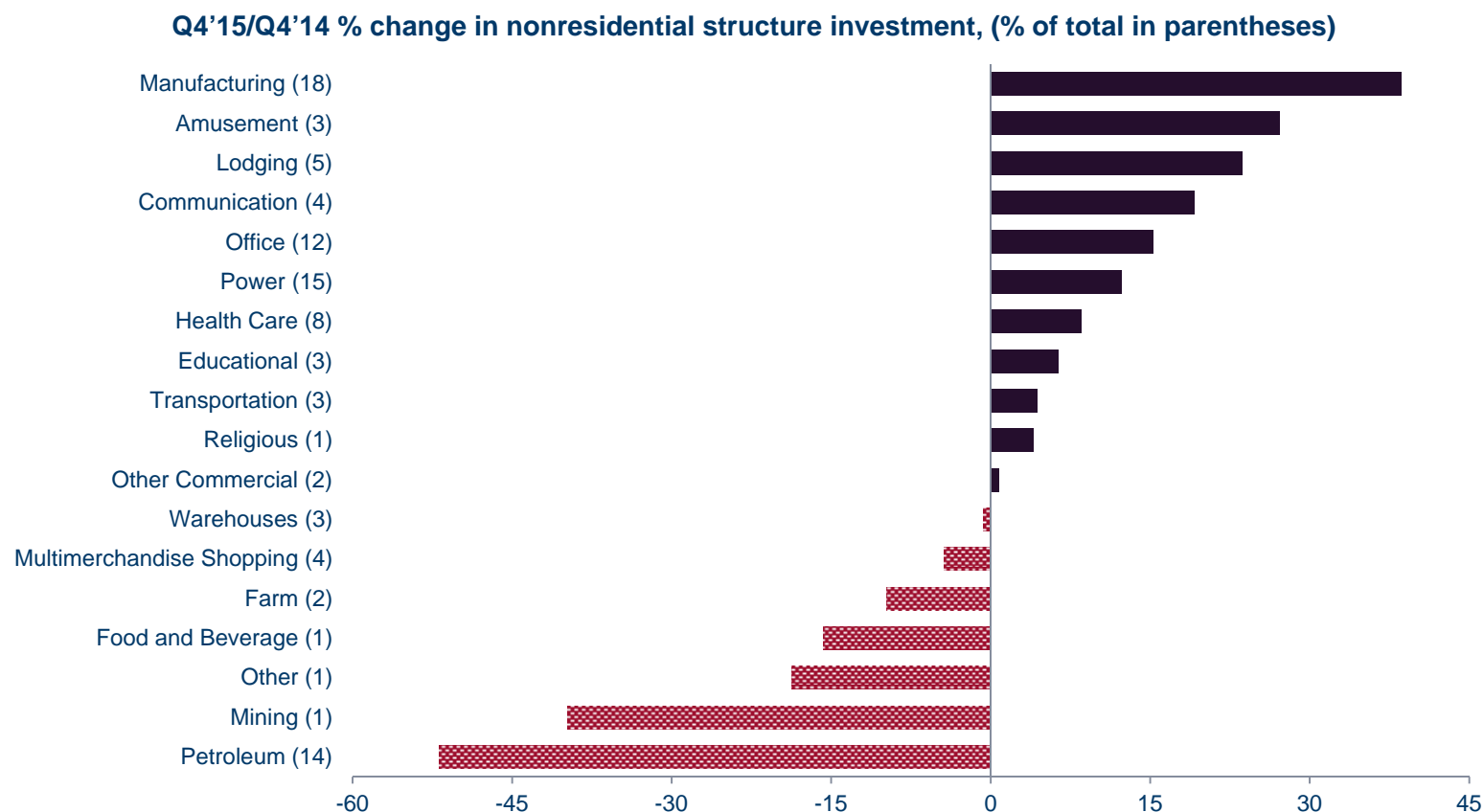
**While talk of a US recession has been very main steam,
we note that the core of the US is still robust...**



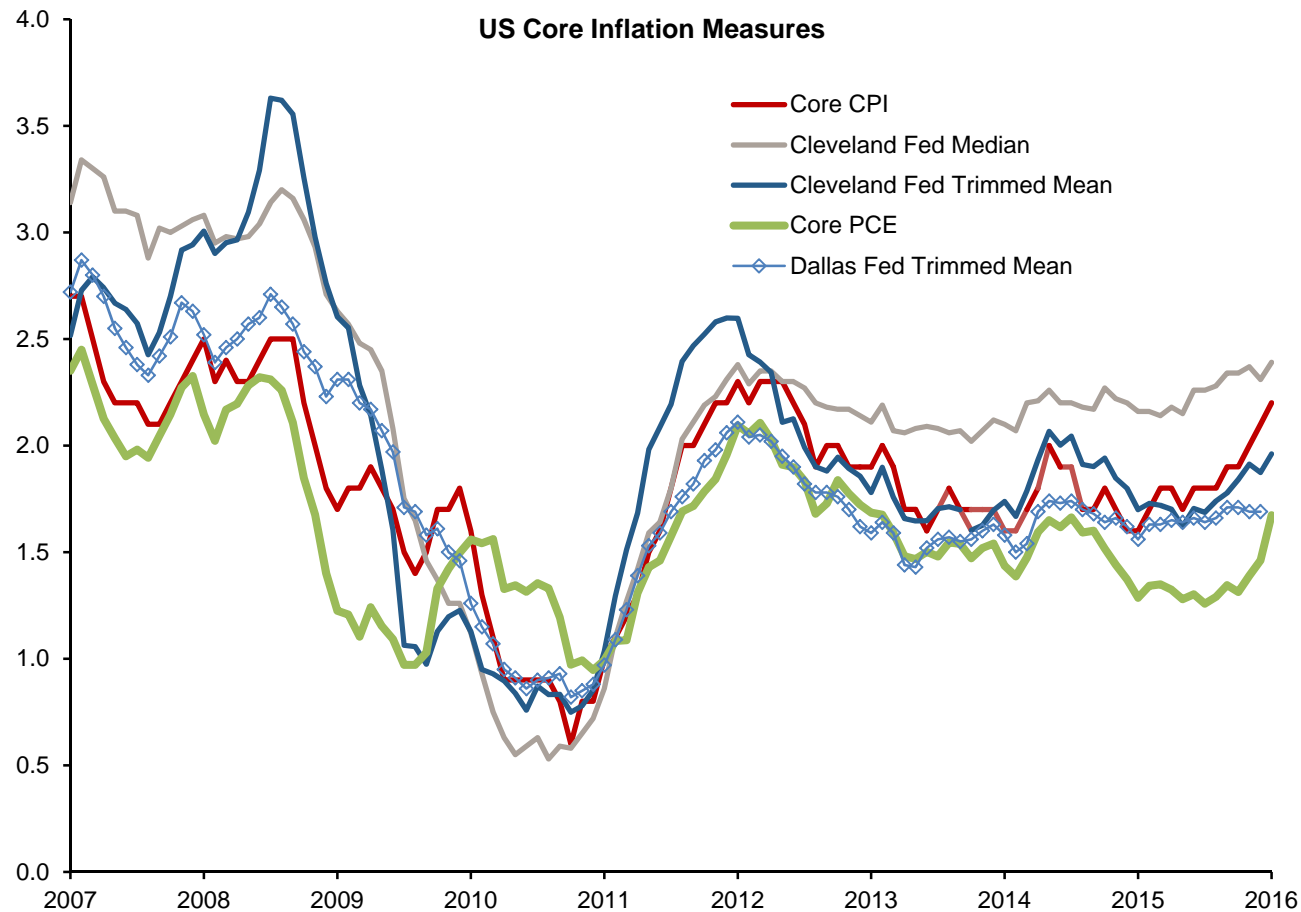
With household demand still rock solid...



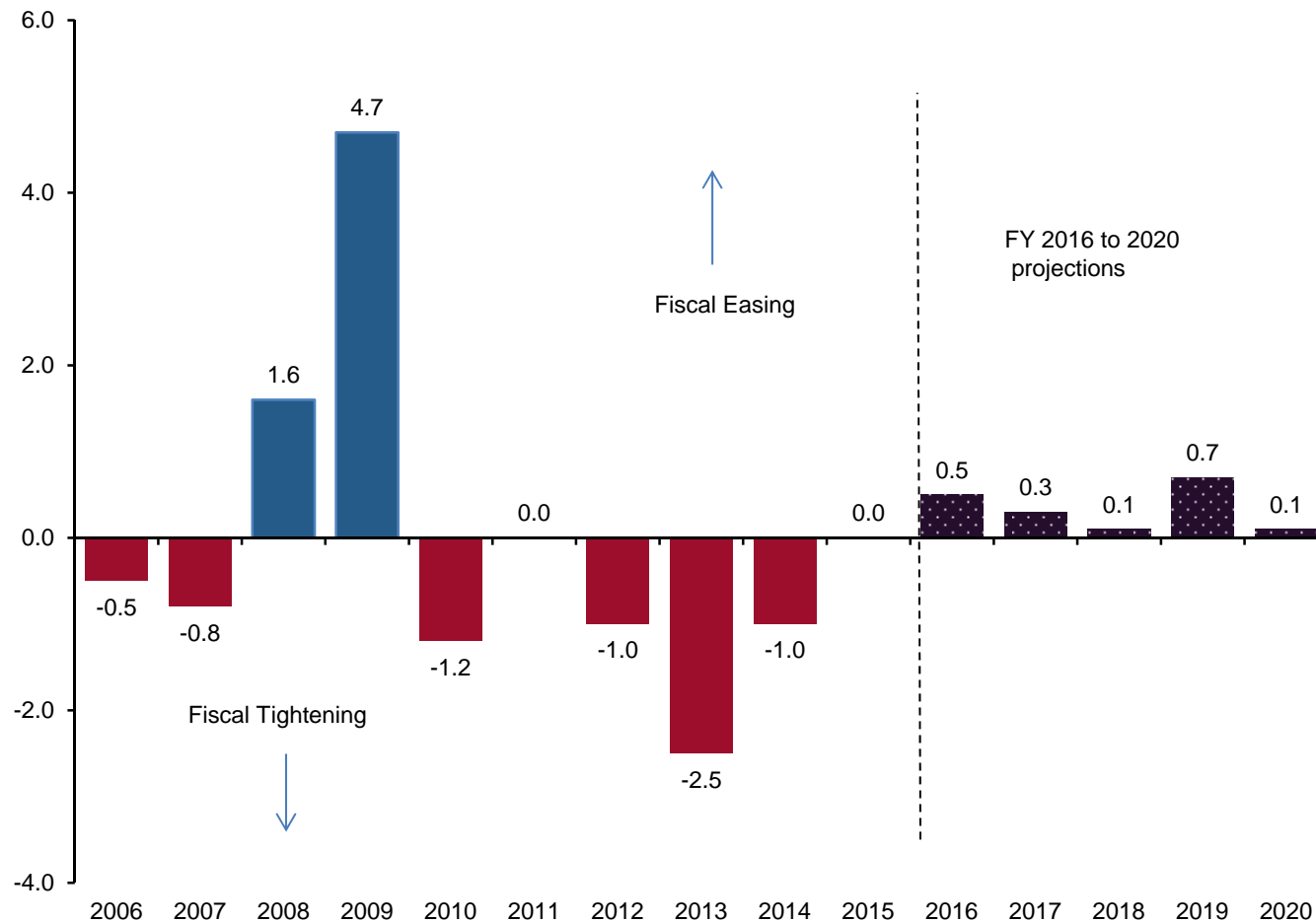
As with the global story, weakness in the US remains very much related to commodities and the industrial sector



And rather than deflation, it is now clear that US inflation has troughed... THE FED IS STILL IN PLAY...



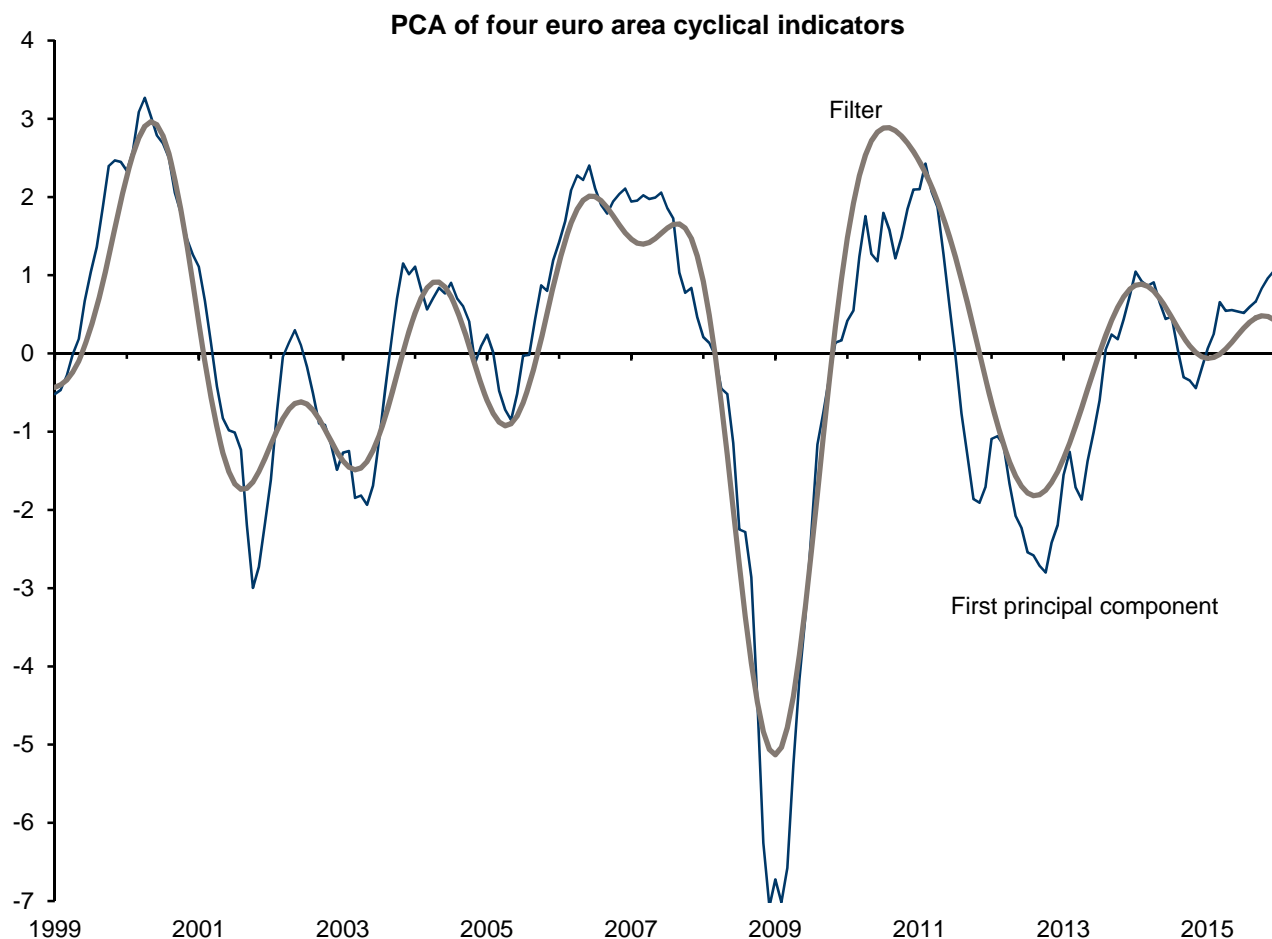
Importantly we see fiscal policy turning supportive for the first time since the crisis



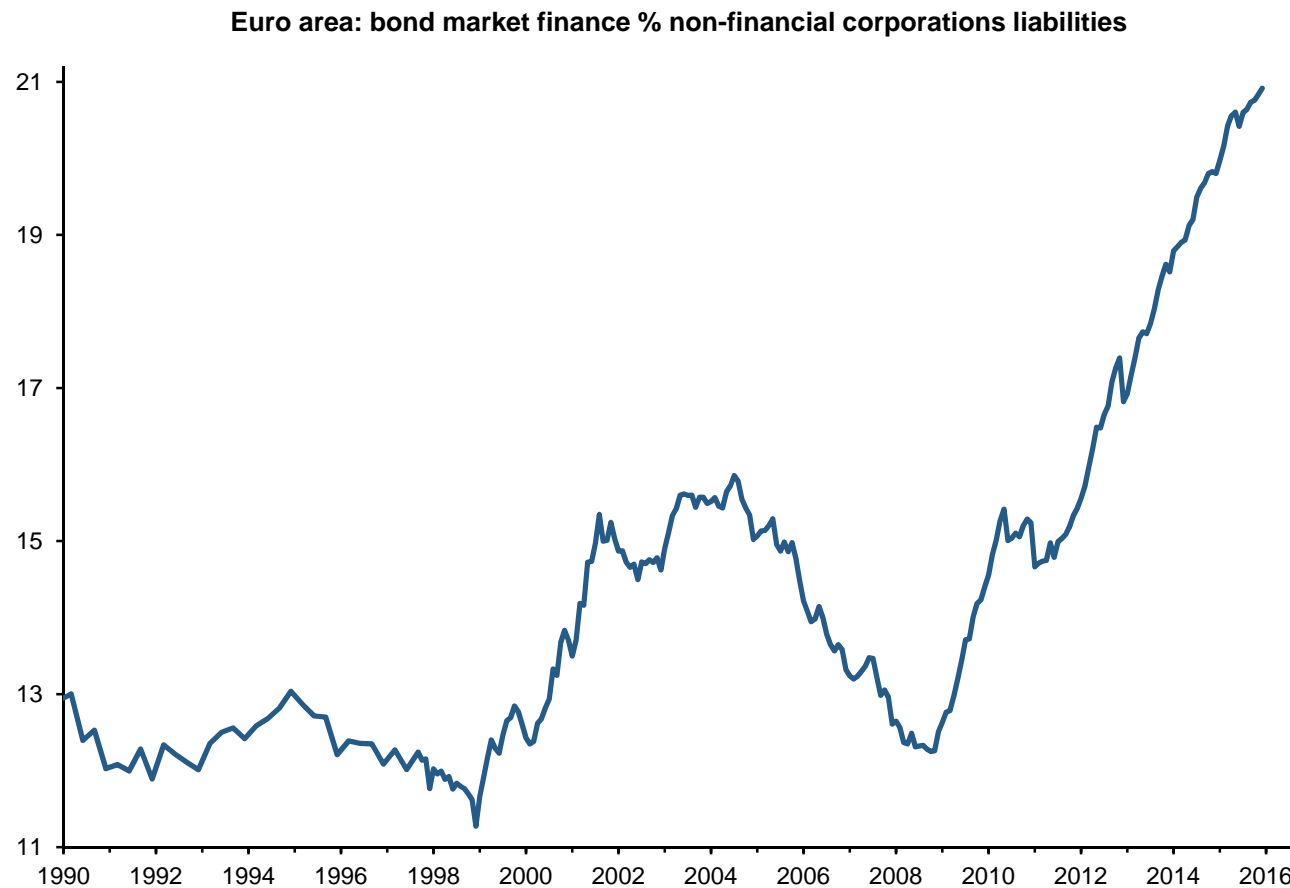
Notably consumer spending in Europe has also been recovering steadily



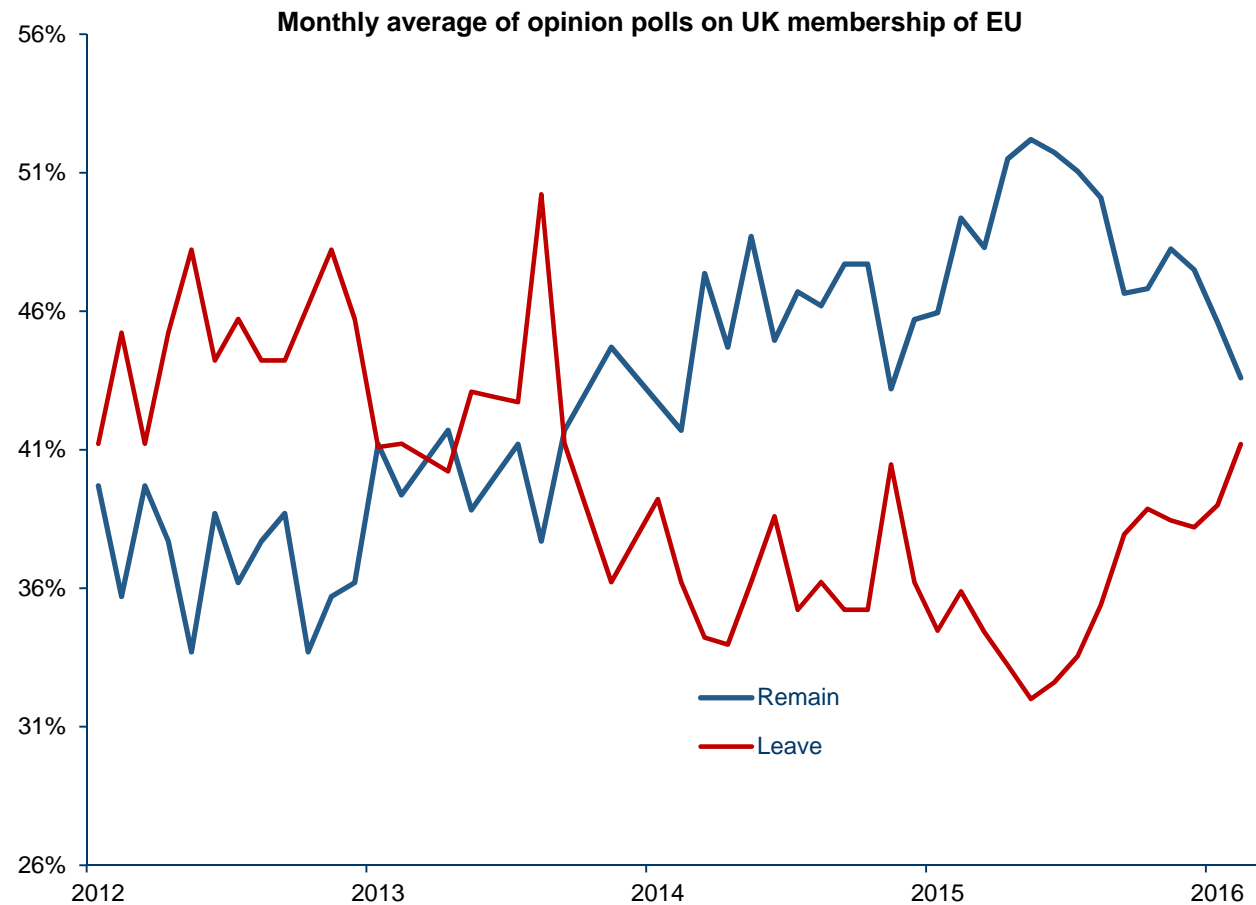
However, the higher frequency data suggest that near term growth has peaked...



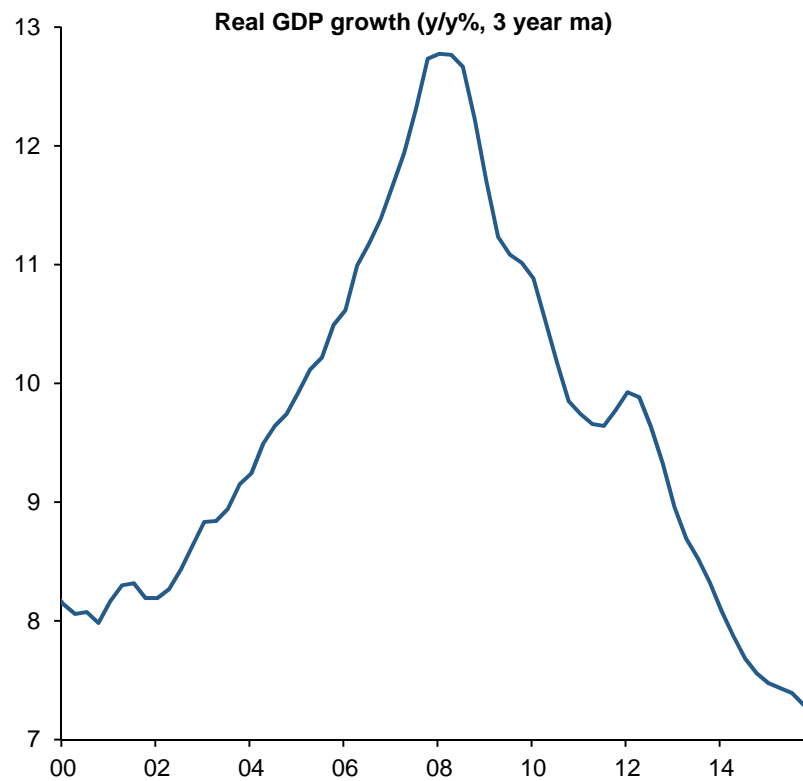
...making the case for more action from the ECB



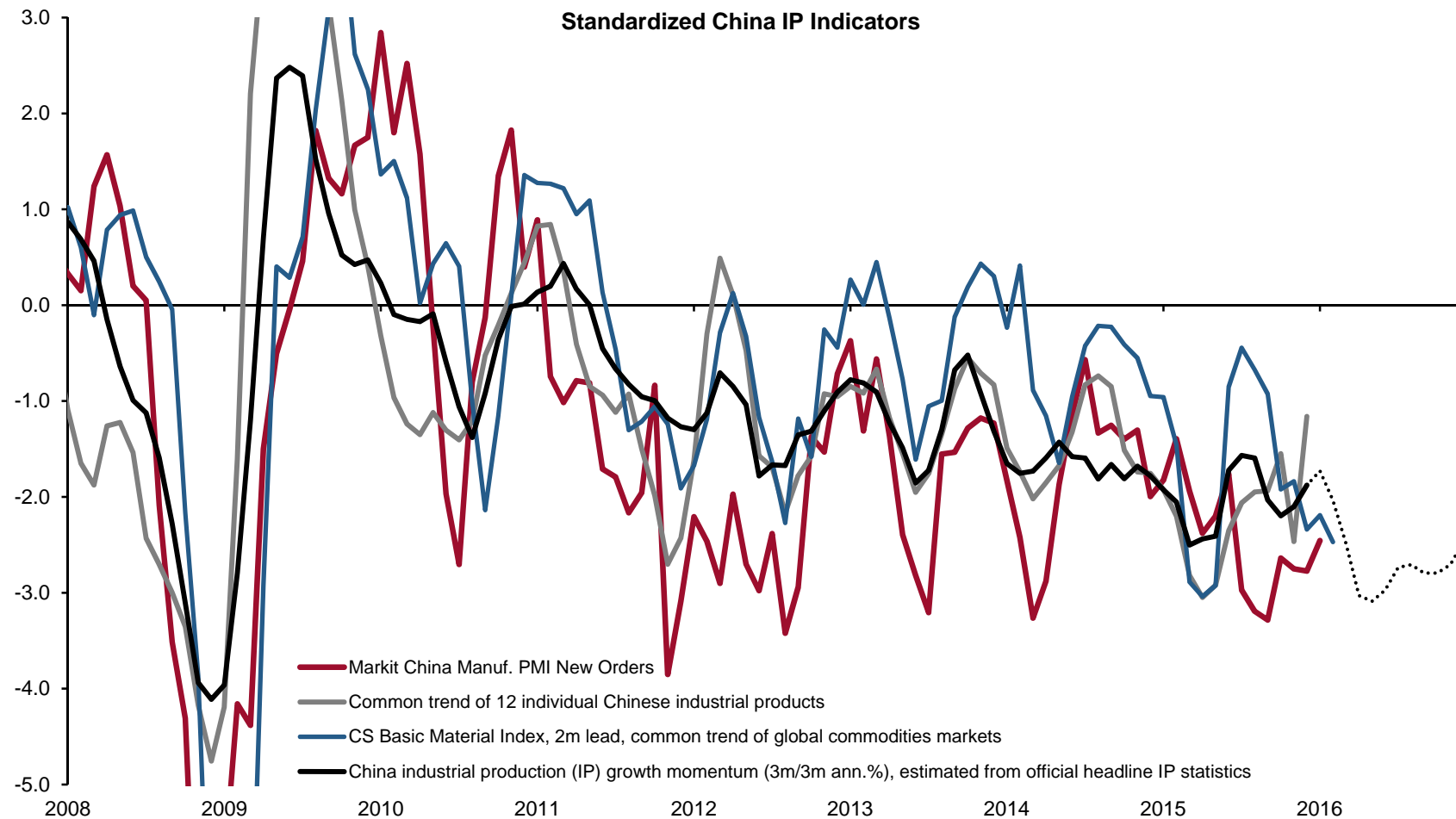
UK: Brexit – likely to be close run



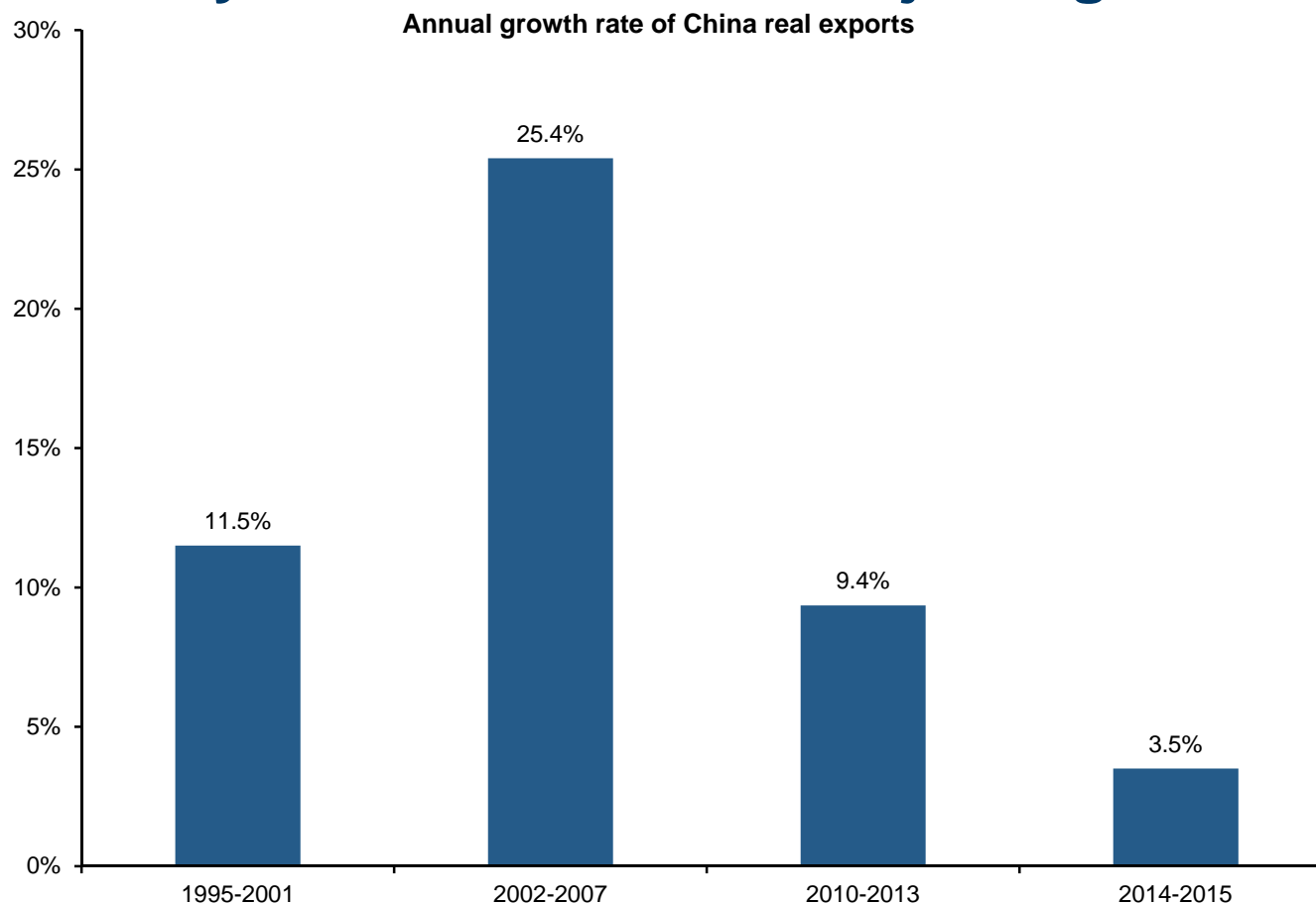
The key question in China is whether the slowdown has further to run? We think it has only just begun...



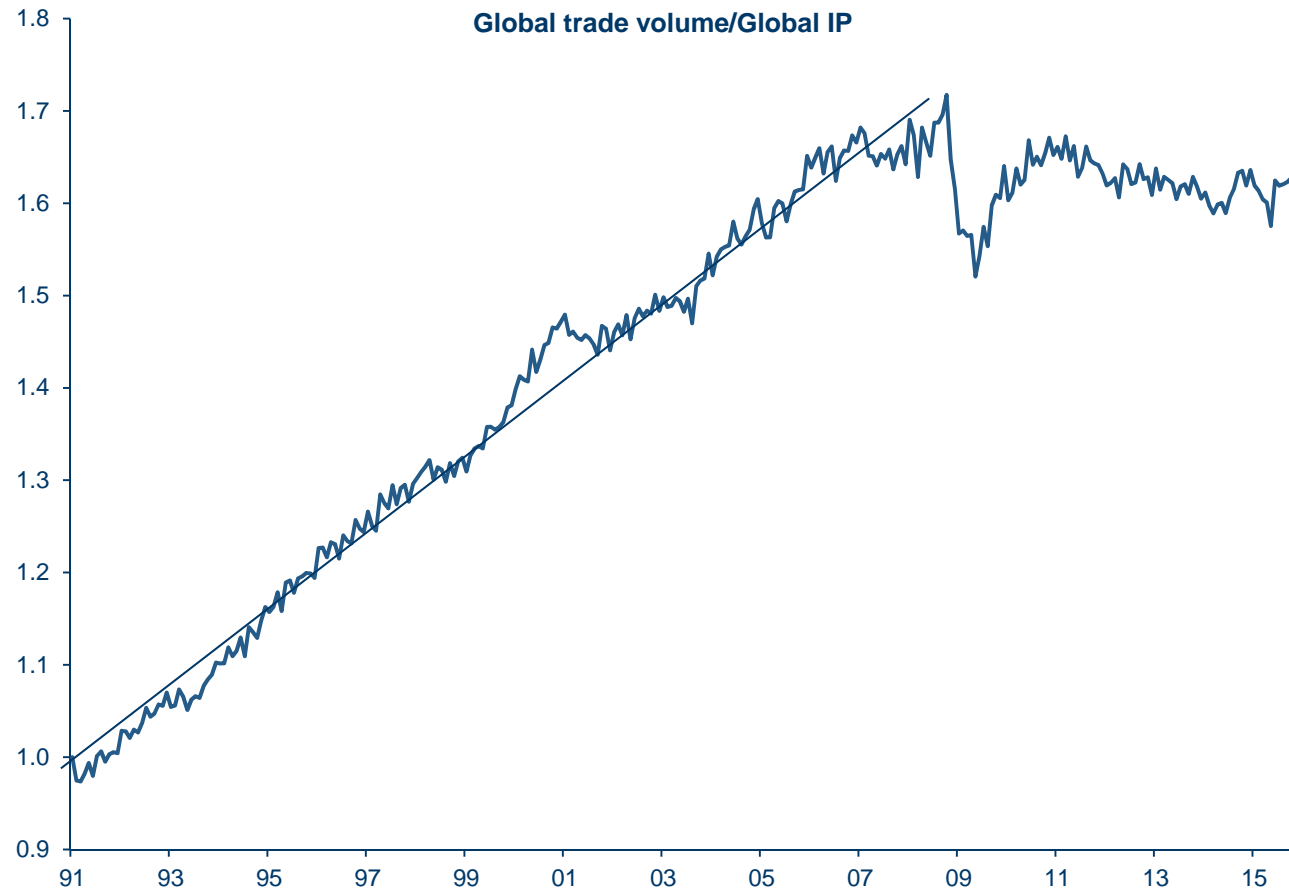
**In the near term, IP growth is trying to stabilize,
but the respite will be temporary, with a substantial
further slowing likely...**



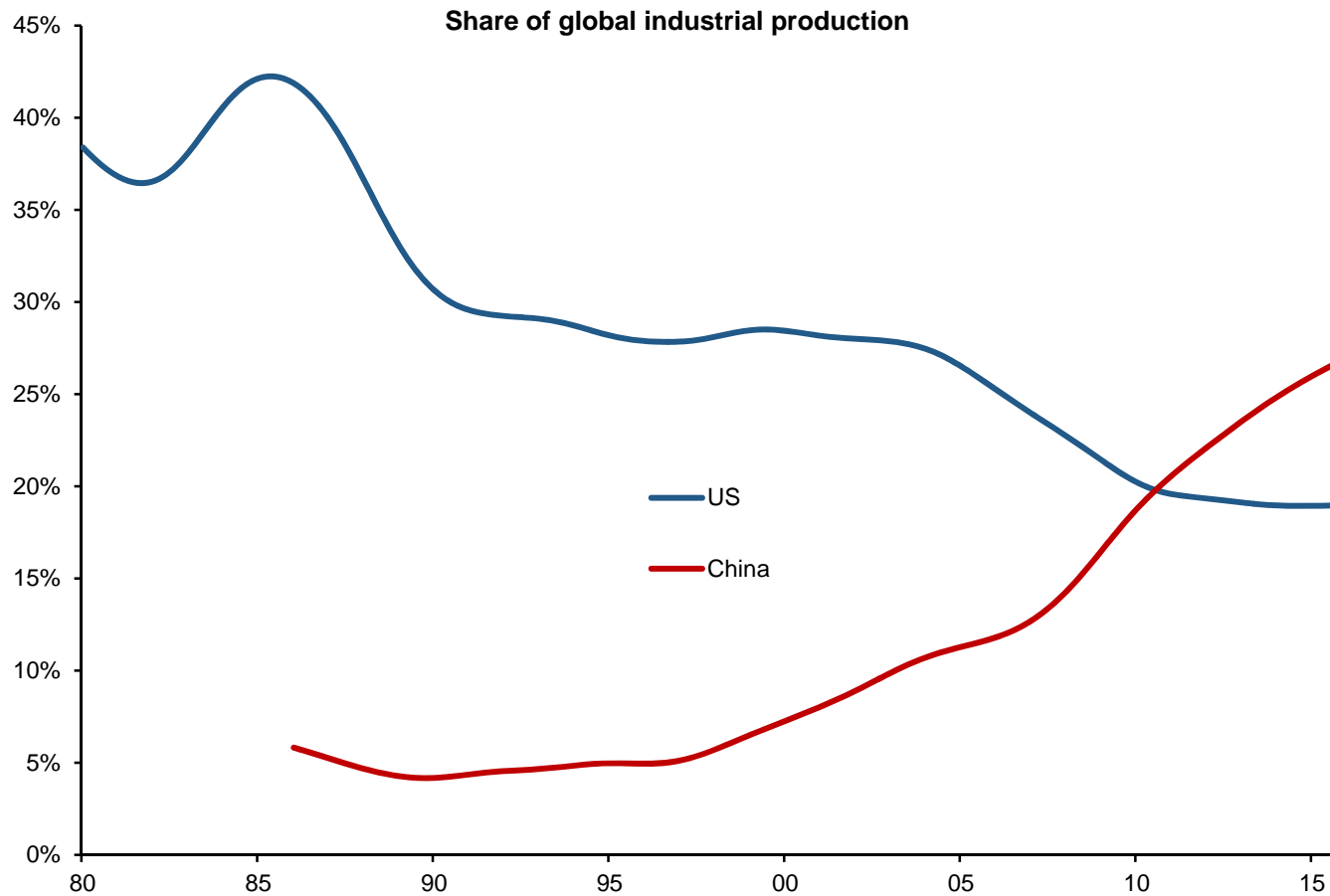
But beyond the near term the issues are mainly structural. Much of the “hockey stick” in the 2000s was driven by a one-off boost from joining the WTO



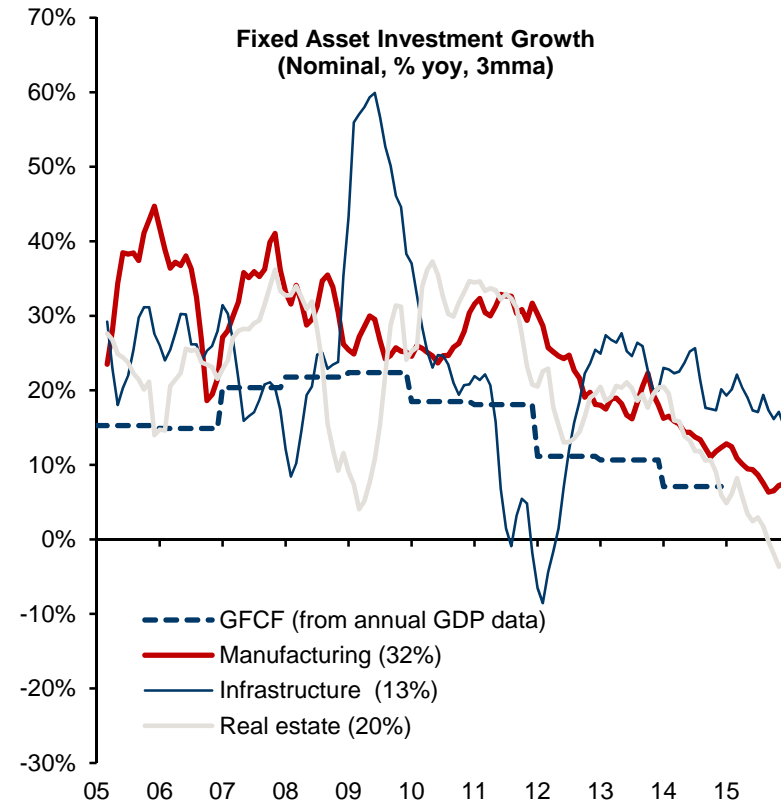
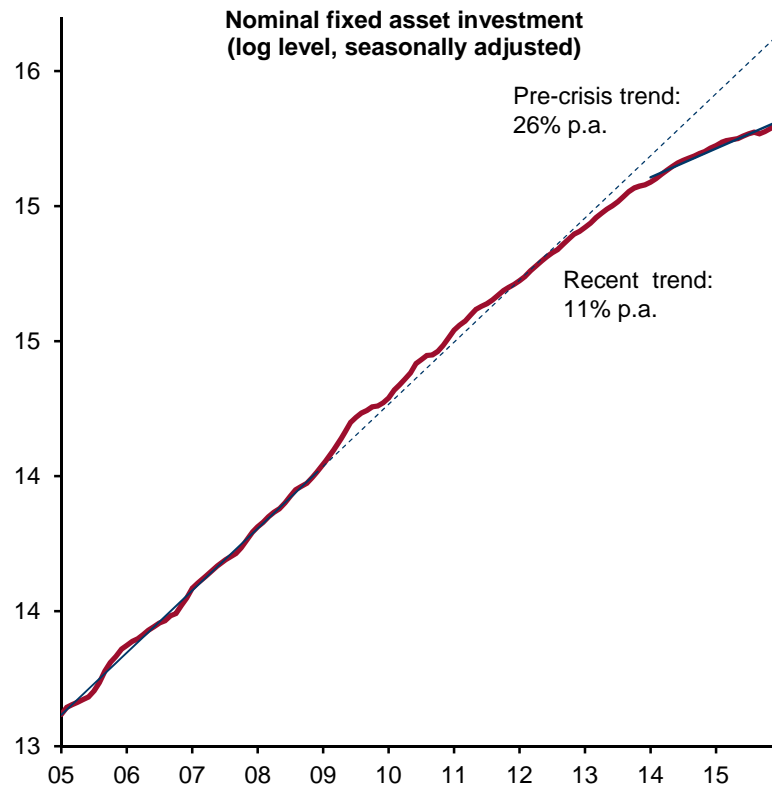
A structural shift post Lehman in the relationship between growth and trade is not helping



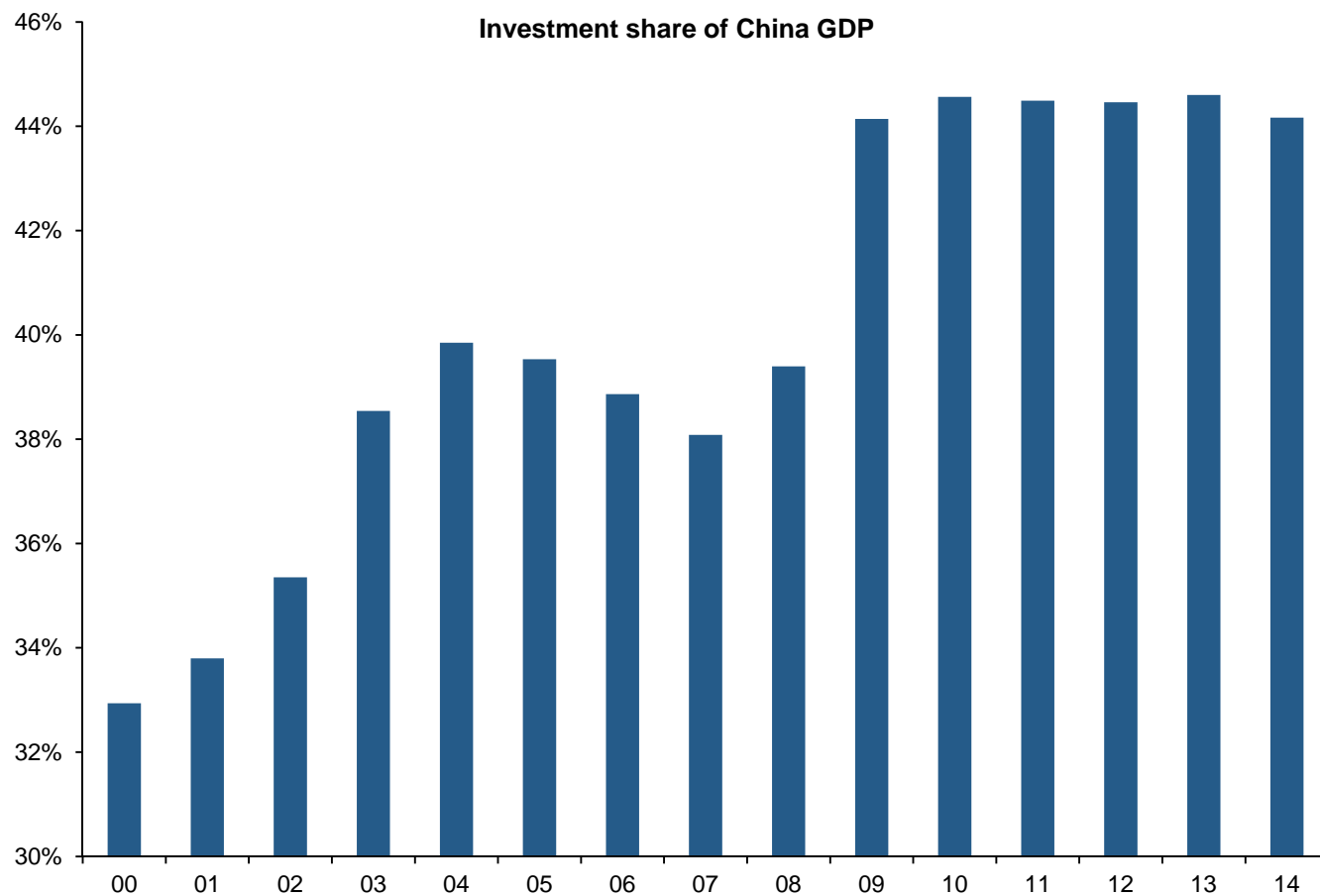
Weak exports also reflect the fact that China is now so big, making further market share gains harder



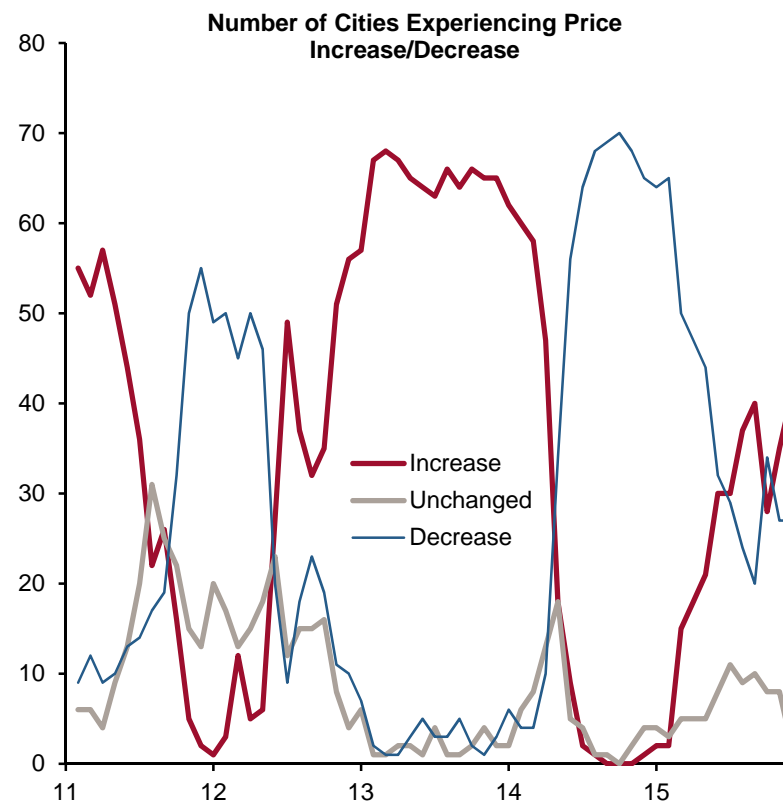
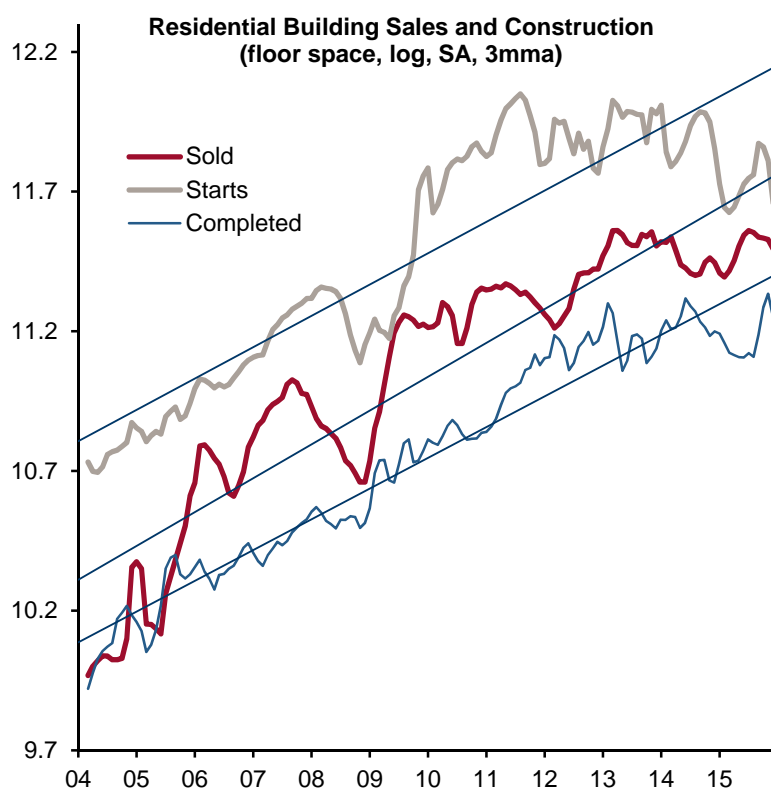
Investment growth has slowed noticeably



However the investment share of output has yet to fall meaningfully



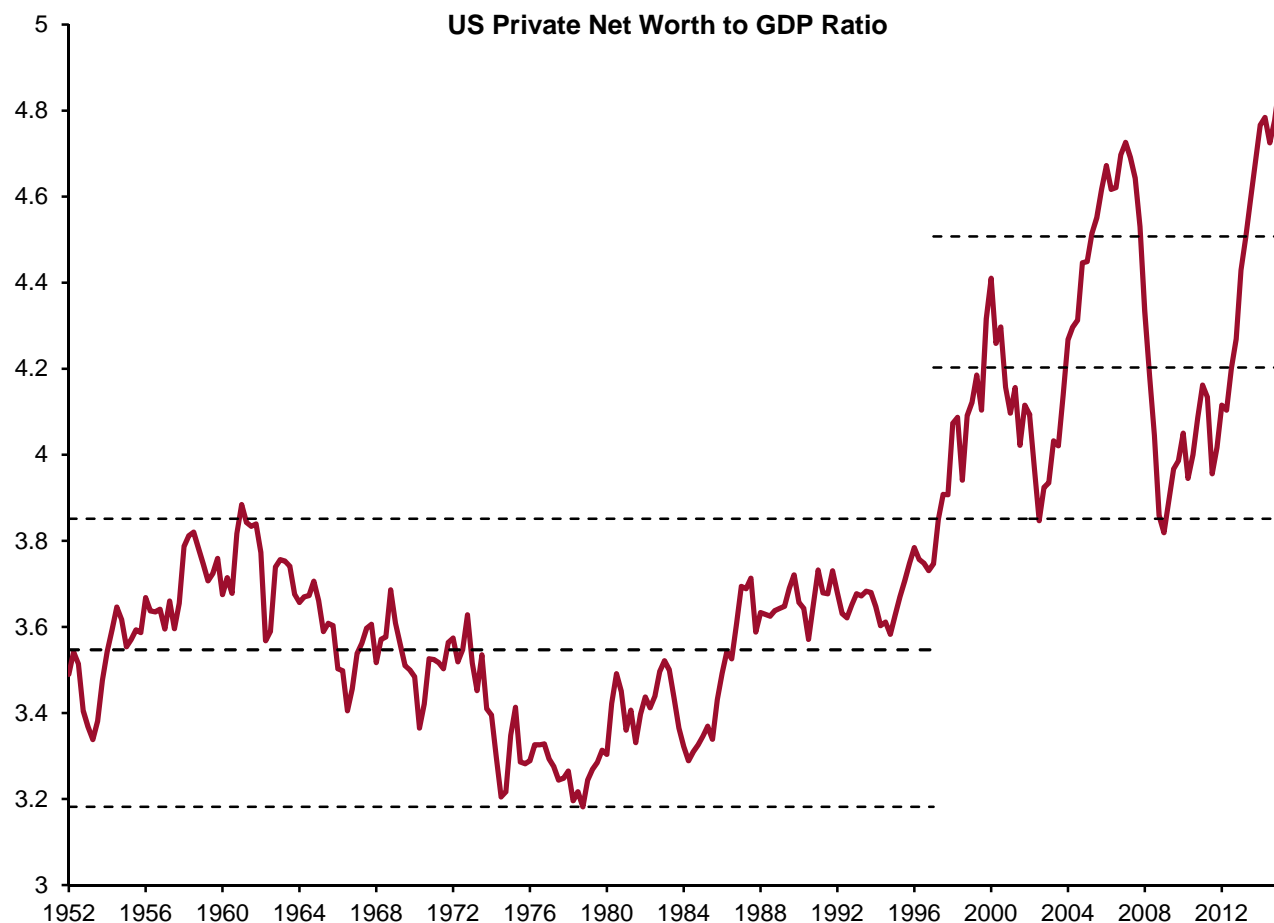
Housing investment has probably peaked in level terms, although prices have recovered in recent months as the stimulus hits



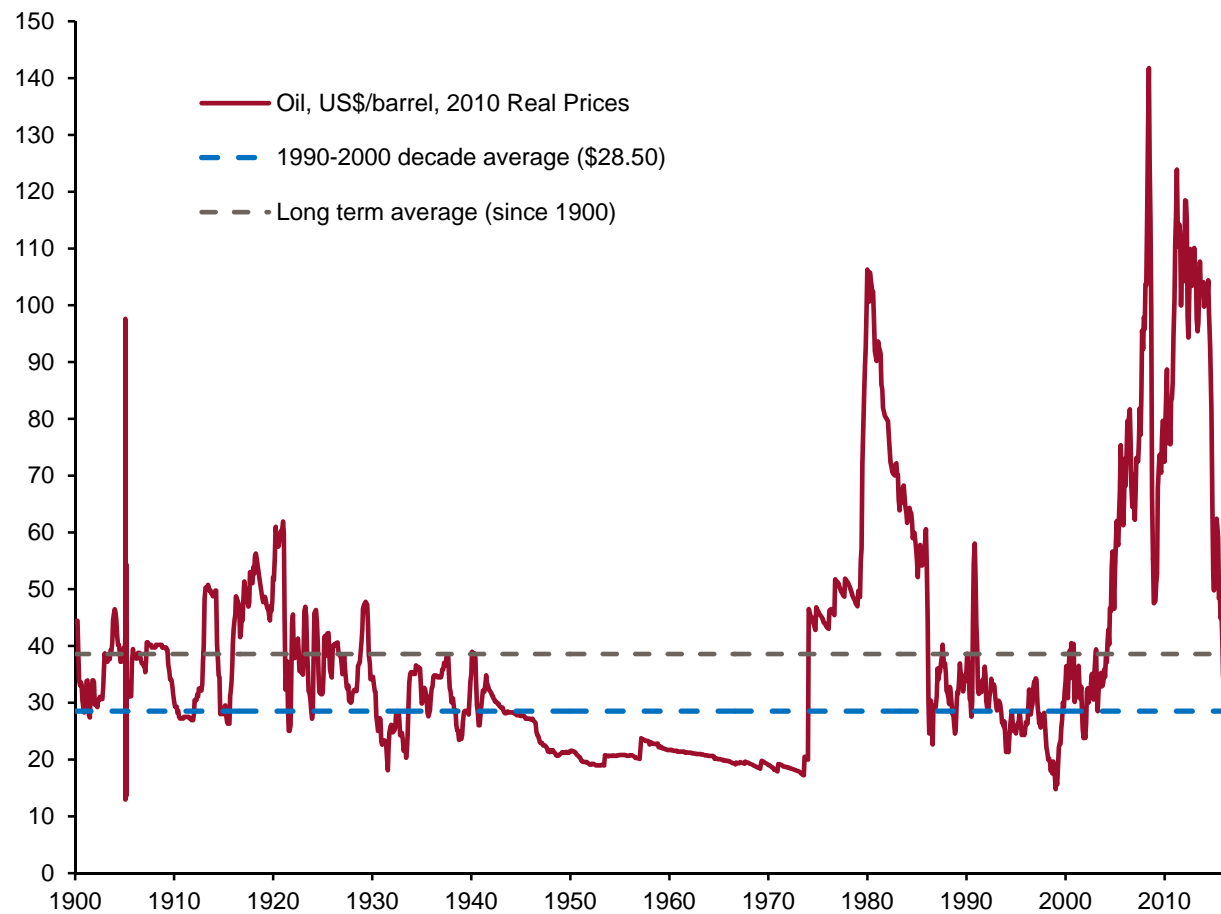
The fall in FX reserves has many nervous



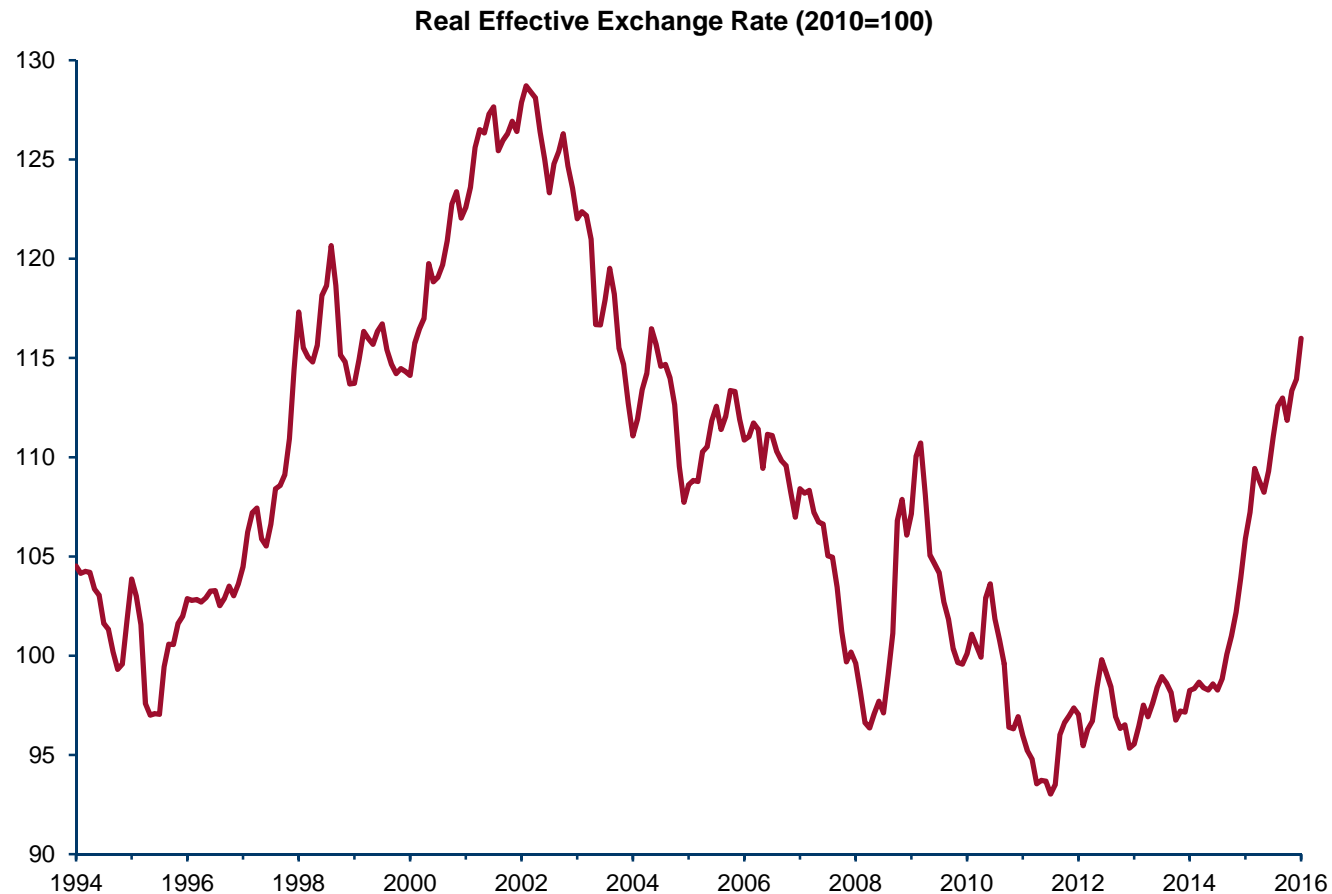
Moving Back To Markets, QE had the desired impact on wealth; but with the Fed in play, risks are building



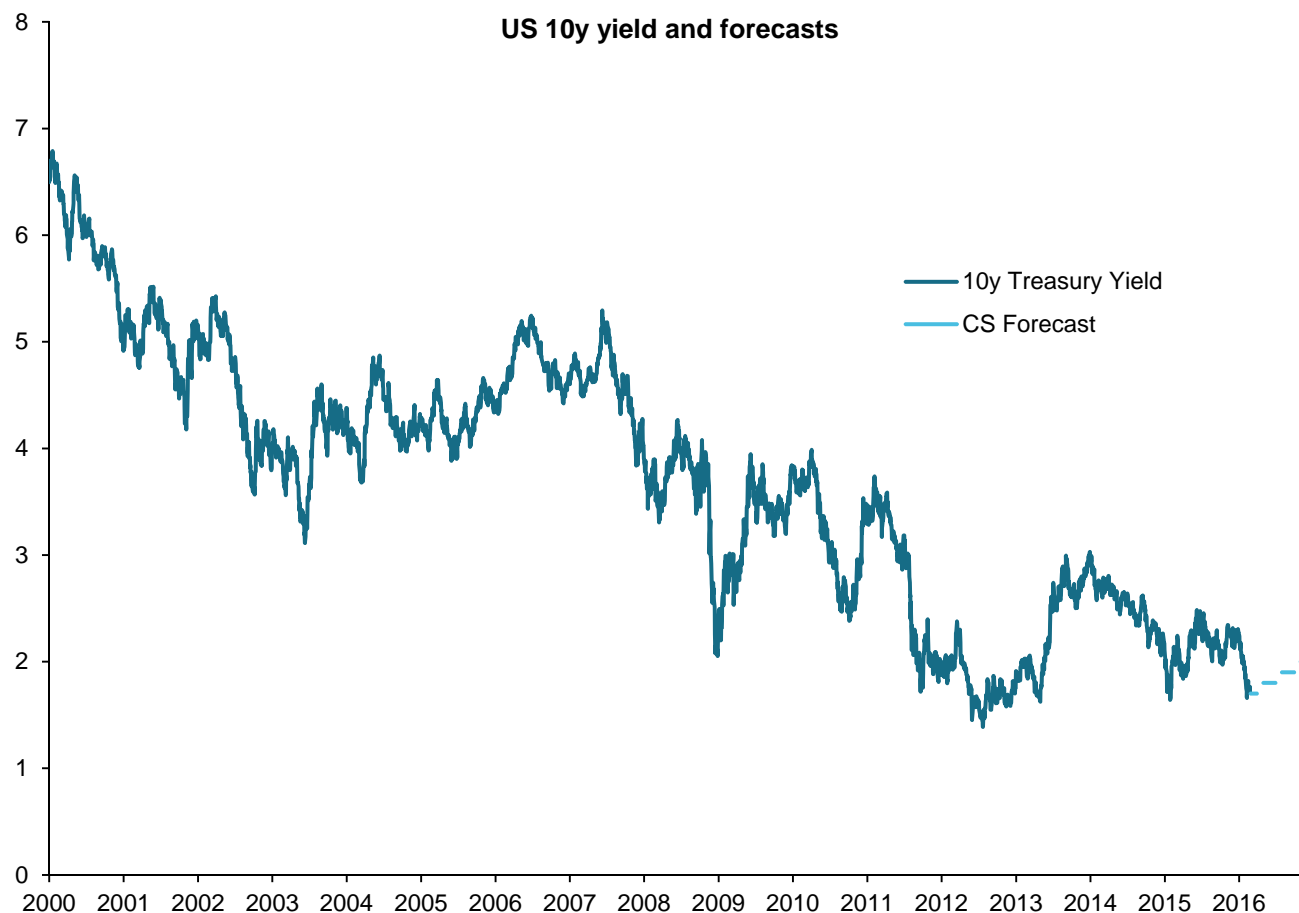
Oil looks to be approaching a bottom, but don't expect a big bounce



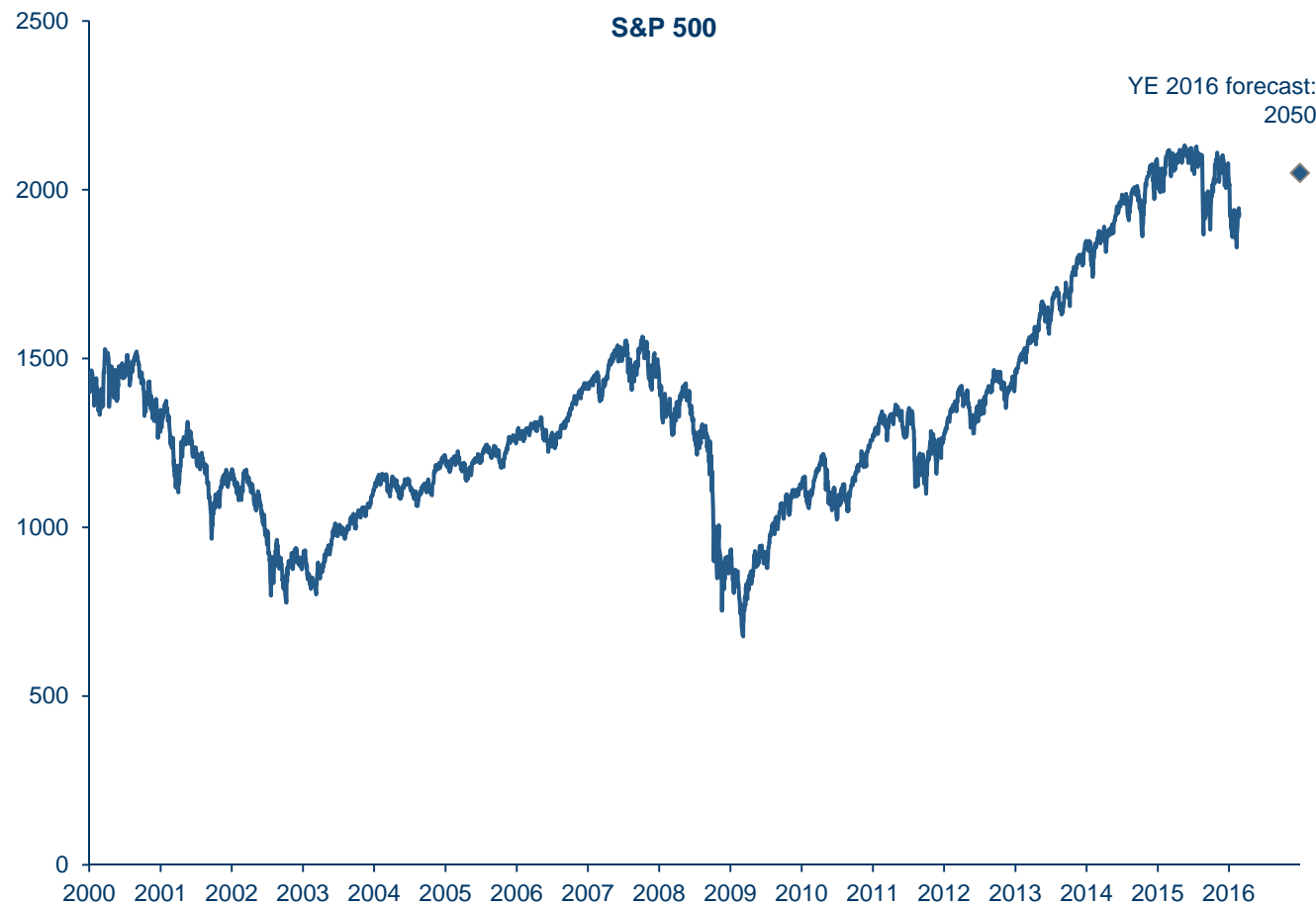
While the dollar may pause in the near term, the bull market has further to run



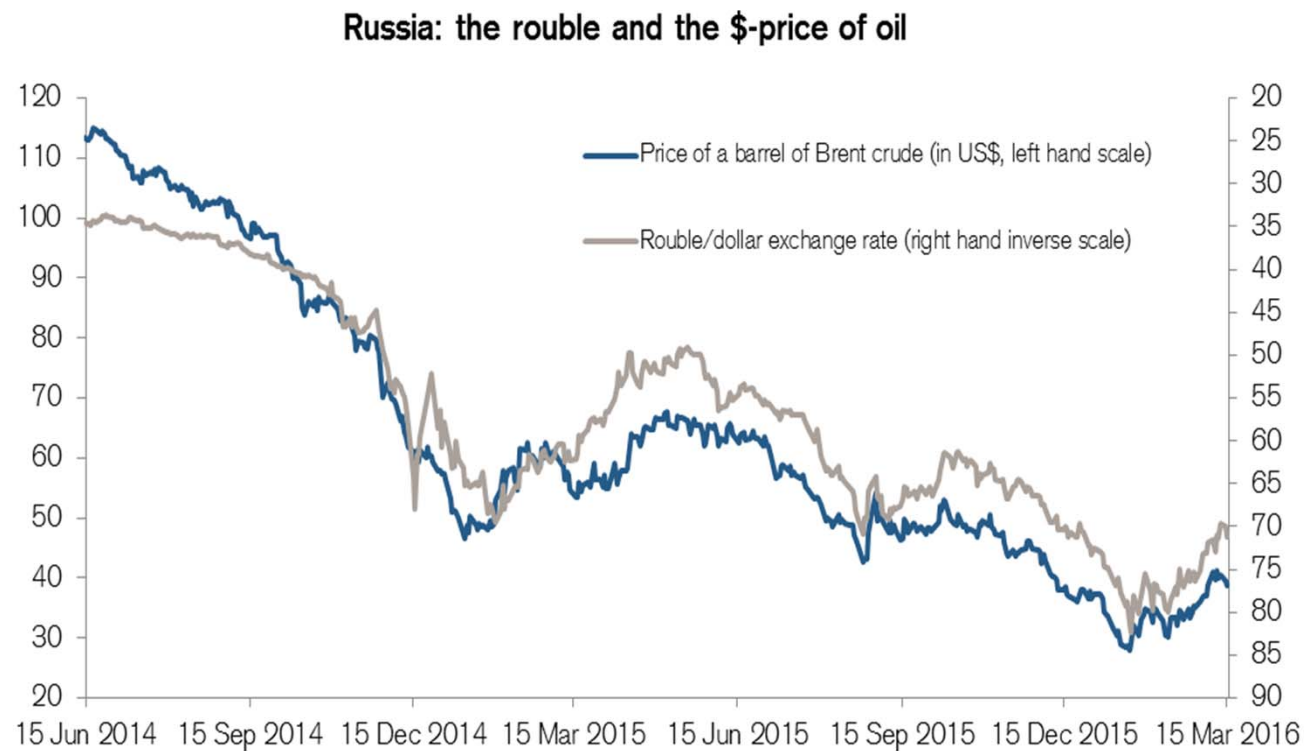
We expect US yields to move a little higher, but China and Europe will keep the long end contained



Our Equity Strategist does not expect the US stock market to continue to fall, with the S&P likely to finish the year a little higher

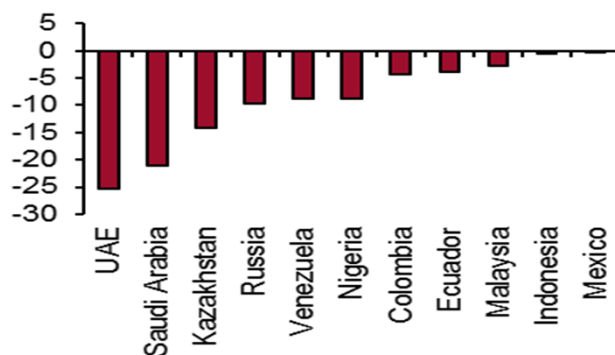


The rouble/US\$ exchange rate: still tracking oil prices

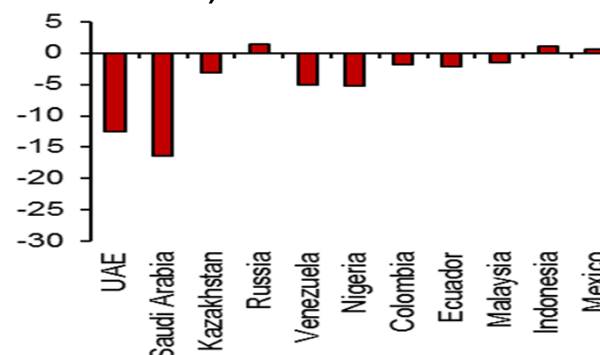


Most oil-exporting nations have seen a large current account deterioration since 2013 -- Russia stands out among them with its current account improvement

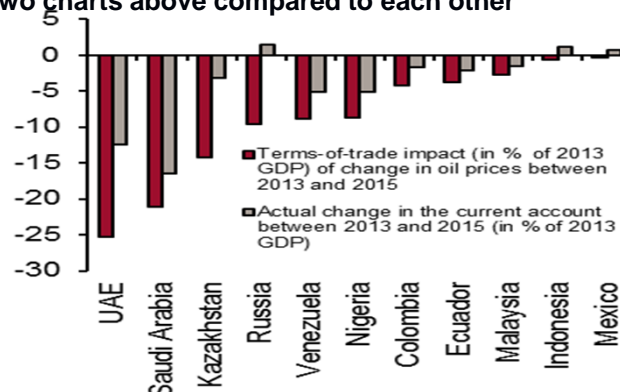
Terms-of-trade effect: Real-income-consequence (in % of 2013 GDP) of the fall in global oil prices that took place between 2013 and 2015



Actual change in the current account of the balance of payments between 2013 and 2015 (in % of 2013 GDP)

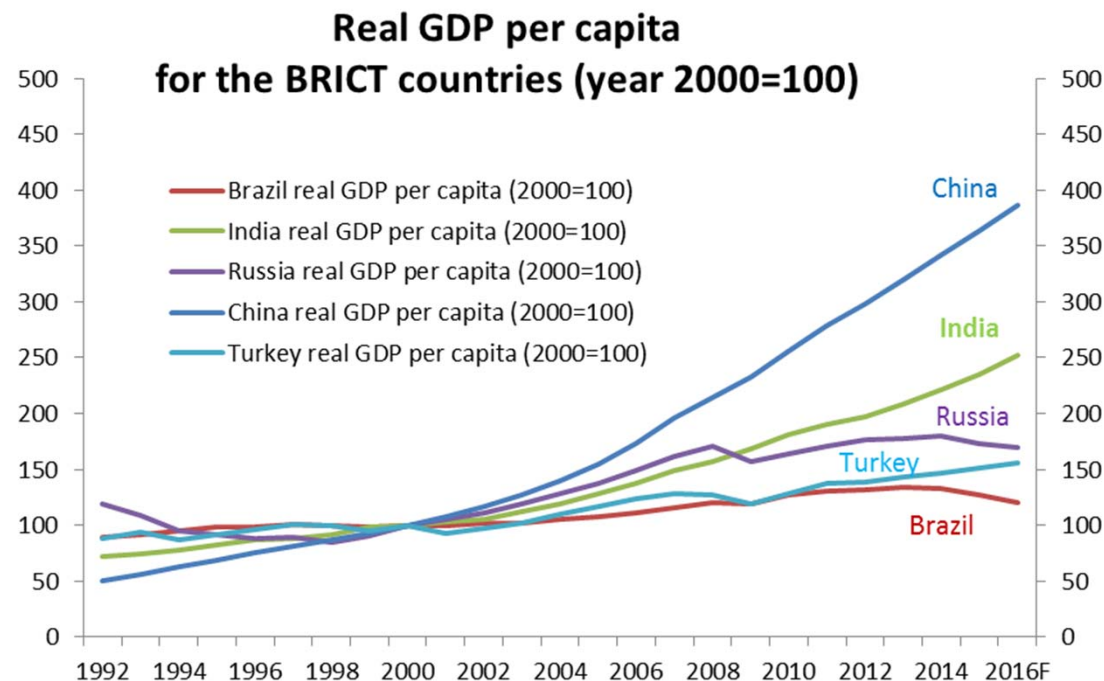


The two charts above compared to each other



Sources: The BLOOMBERG PROFESSIONAL™ service, the UN's commodity trade database, the IMF's country reports, and Credit Suisse; the 2015 estimates reflect the outcome for the first three quarters of that year, rather than the full year.

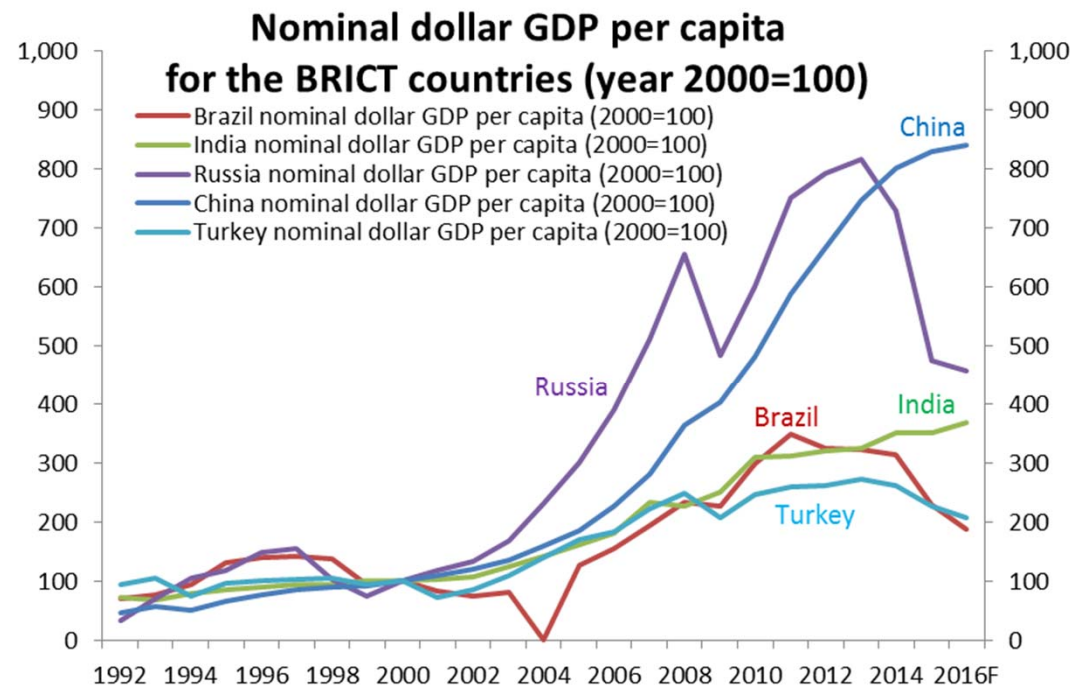
Russia's real GDP per capita is now same as in 2008; by comparison it doubled between 1998 and 2008



Source: IMF's WEO database from October 2015, and Credit Suisse's EM Economics Quarterly from 10 March 2016

Comment: The growth differentials between the BRIC countries are to a large extent a function of their ratios of fixed investment to GDP, which in 2014 amounted to 48% in China, 35% in India, 19% in Russia and 17% in Brazil. Other factors that impede growth in Russia and Brazil include curbs on domestic competition, direct government involvement in many production sectors, poor legal title protection, bureaucratic hurdles preventing start-ups, shrinking slack in the labour market, and declining scope (on account of balance of payments constraints and high inflation) for propping up growth through rapid credit expansion through the banking system.

Russia's dollar-GDP grew faster than China's between 2000 and 2013...but since then falling export prices and sharp rouble depreciation have killed Russia's \$-GDP



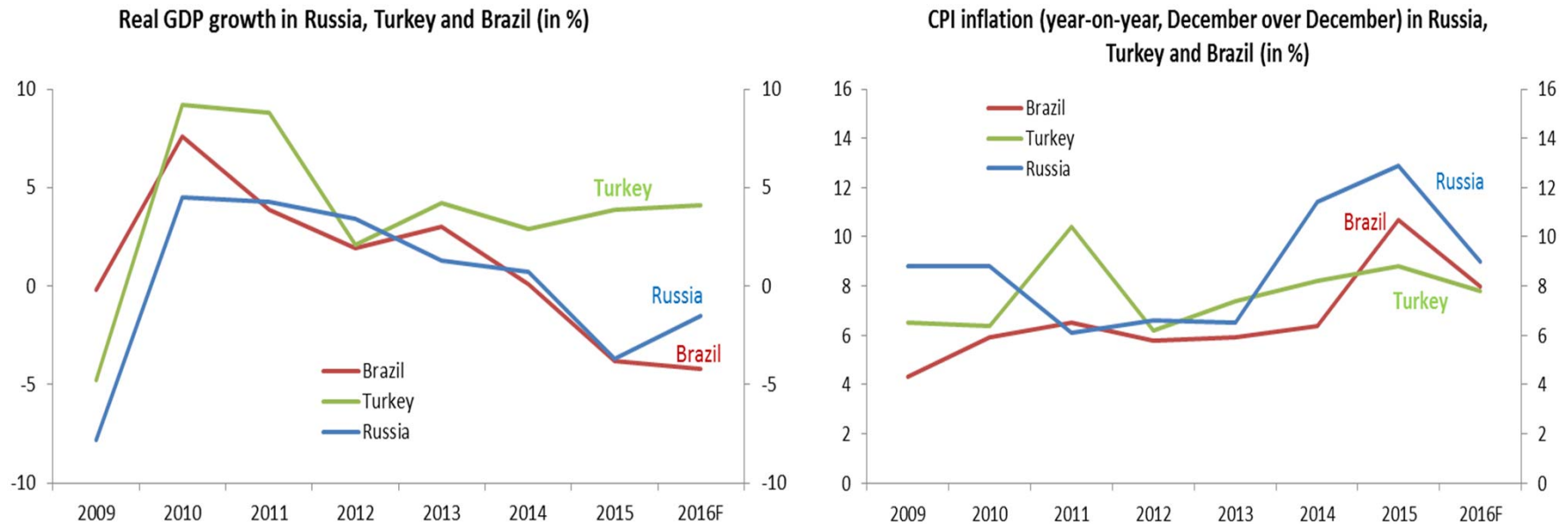
Source: IMF's WEO database from October 2015, updated with data from Credit Suisse's EM Economics Quarterly , 10 March 2016

As recently as in 2014, Russia's per capita income was high by BRIC standards (and by Turkey's), but it now similar to China's, Brazil's and Turkey's

Income, population, ratings for the BRIC countries and Turkey					
	China	India	Brazil	Russia	Turkey
Annual compound growth in real GDP per capita 2000-2015 (in %)	9.0	5.9	1.6	3.7	2.8
Annual GDP per capita at current prices 2014 (in US dollars)	7,547	1,623	11,915	12,948	10,876
Annual GDP per capita at current prices, forecast, 2016 (in US dollars)	7,906	1,701	7,143	8,118	8,640
Annual GDP per capita at purchasing power parity exchange rates 2014 (in US dollars)	12,880	5,855	16,096	24,805	20,188
Population end-2016 (in millions, forecast)	1,383	1,297	206	144	74
Cumulative population growth 2010-2015 (in %)	2.6	6.3	4.6	0.6	2.8
Sovereign credit rating (S&P/Moody's)	AA-/Aa3	BBB-/Baa3	BB/Ba2	BB+/Ba1	BB+/Baa3
5-year sovereign CDS spread, bps, 14 March 2016	114	142	390	286	255

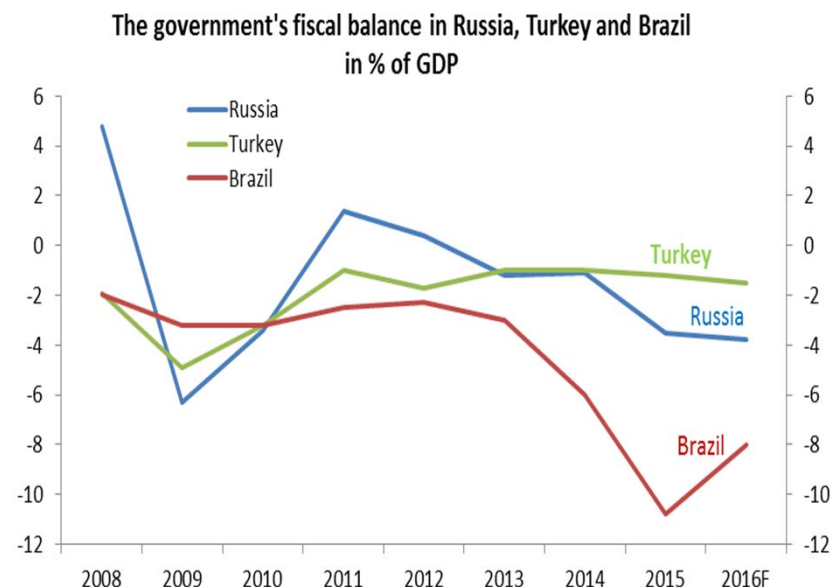
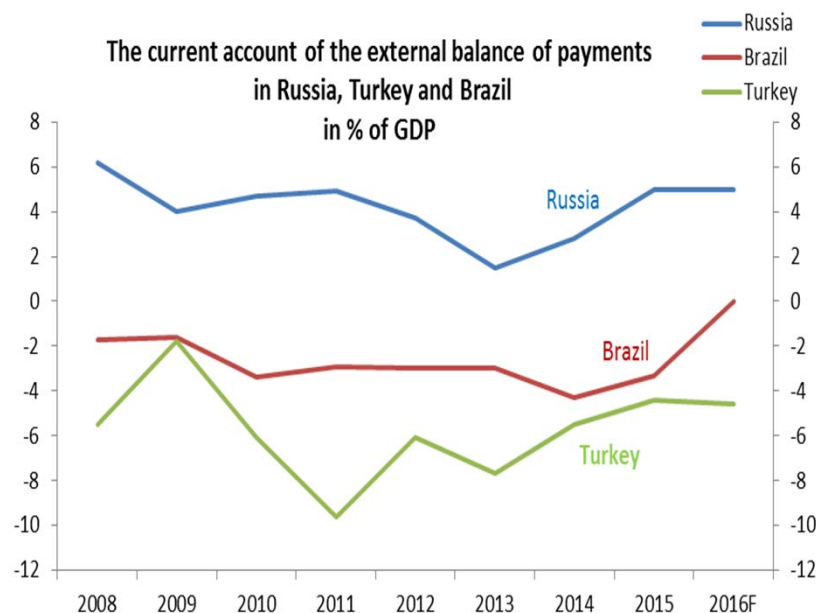
Sources: IMF's WEO database from October 2015, Credit Suisse's EM Economics Quarterly from 10 March 2016 and The BLOOMBERG PROFESIONAL™ service. Quoted forecasts are from Credit Suisse's Research Team. Quoted ratings and spreads are up-to-date as of 14 March 2016.

Miserable 2015 growth and inflation stats for Russia and Brazil; less miserable data for Turkey



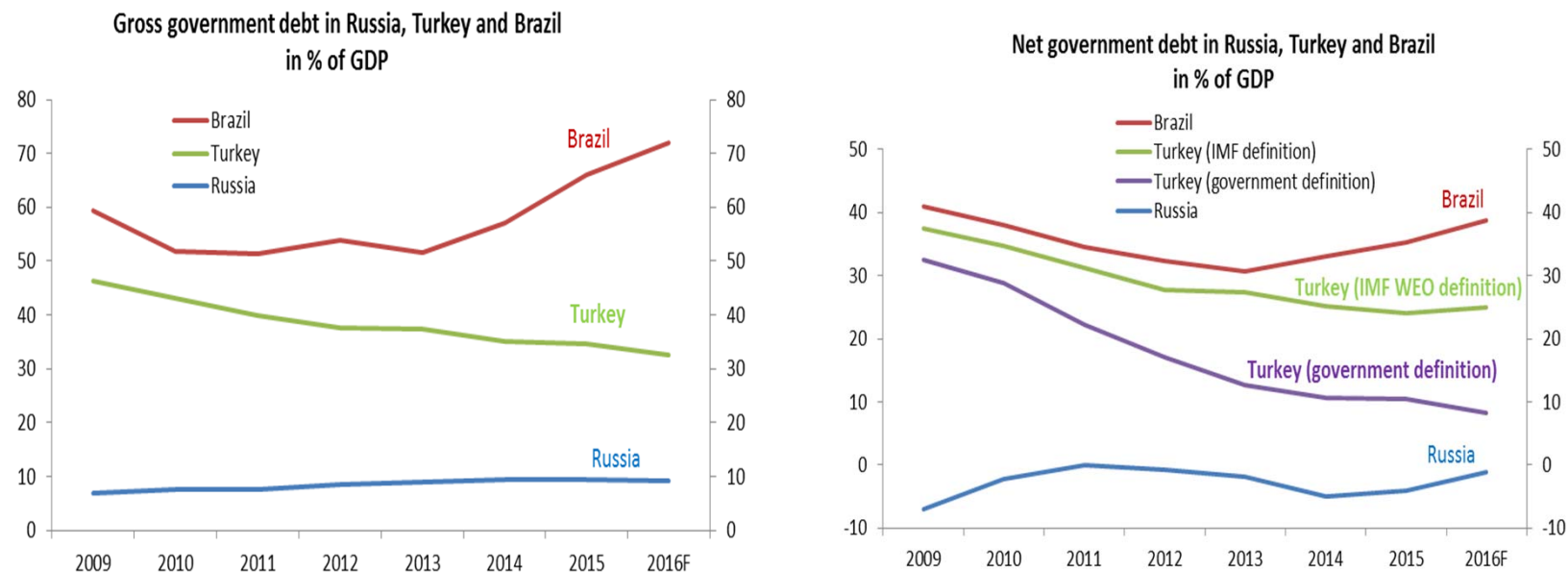
Sources: IMF's WEO database from October 2015, Credit Suisse's EM Economics Quarterly from 10 March 2016. Quoted forecasts are from Credit Suisse's Research Team.

Collapsing domestic demand has led to current account improvement (but fiscal balance deterioration) in Russia and Brazil – Russia can afford this better than Brazil



Sources: IMF's WEO database from October 2015, Credit Suisse's EM Economics Quarterly from 10 March 2016. Quoted forecasts are from Credit Suisse's Research Team.

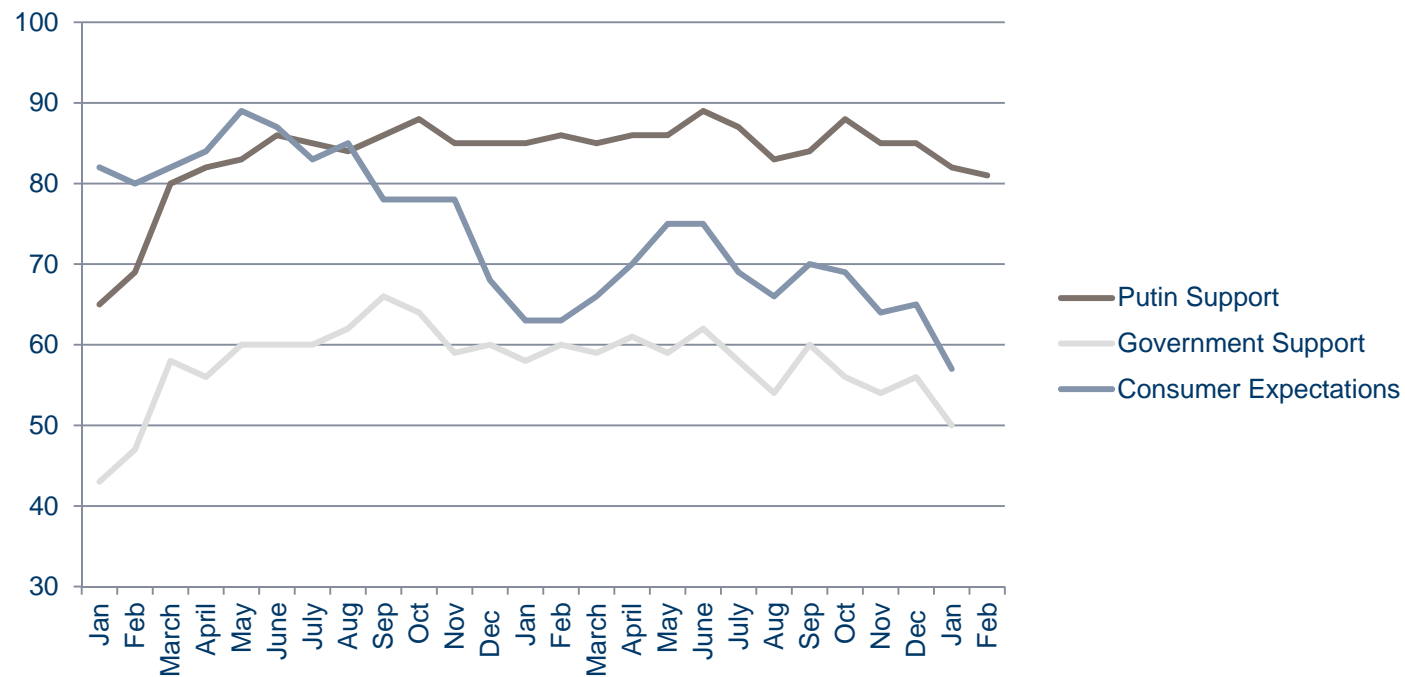
The Russian government's low level of indebtedness is a stand-out credit-positive factor, one that mitigates harm done by the widening fiscal deficit



Sources: Gross debt numbers are from Credit Suisse's EM Economics Quarterly from 10 March 2016, with an added line for the numbers for Turkey from IMF's WEO database from October 2015. Quoted forecasts are from Credit Suisse's Research Team, except in the case of Turkey (the figure for Turkey is an IMF forecast).

Putin's largely immune to worsening economic situation, but the government is not

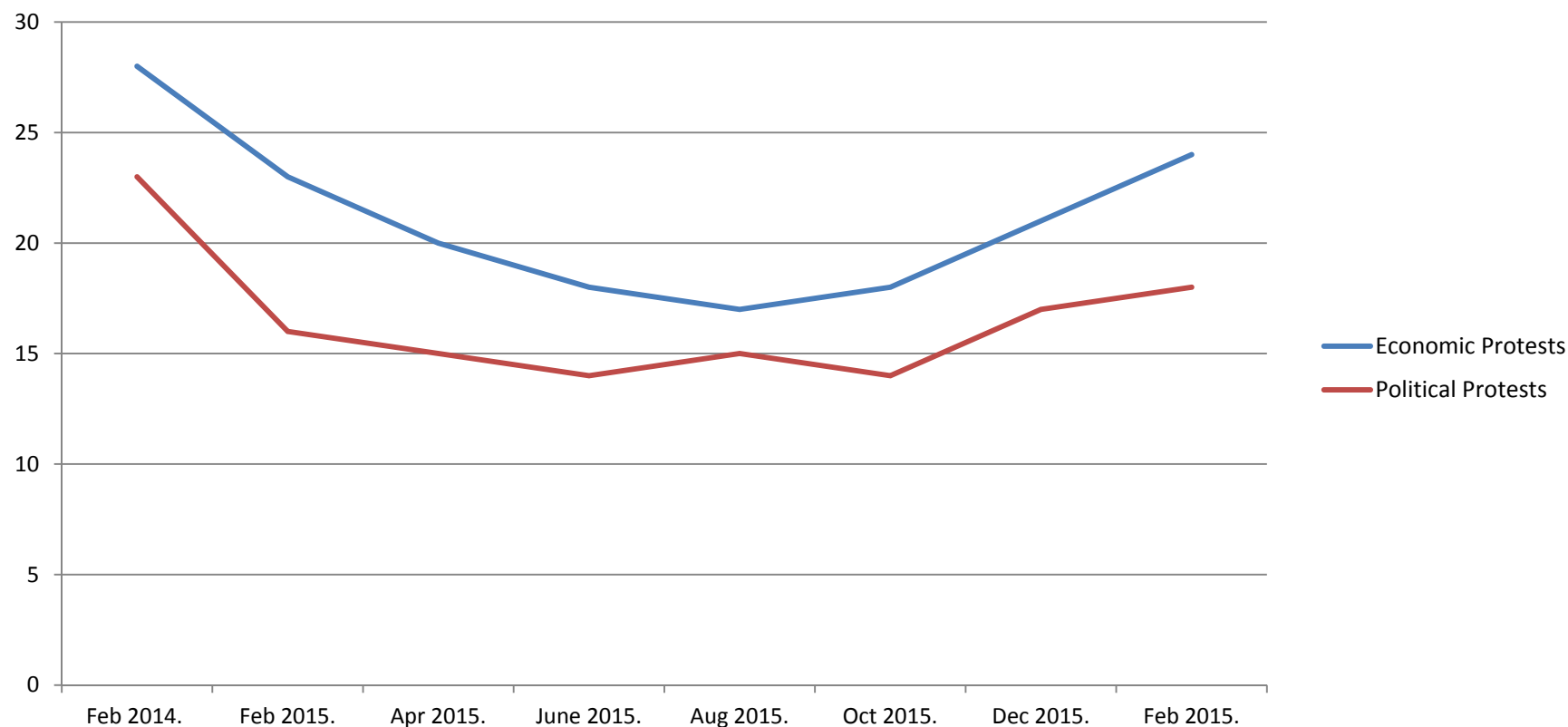
Consumer Confidence vs Support of Government, Putin



Source: Levada

Appetite for Protest's Low, but Rising

Do you expect protests in your region?



Disclosure Appendix

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