

# Economic Insight

## The meaning of the ruble's appreciation

The Russian ruble has rallied impressively recently. In April, it rose 12.0%, up more than one-third from this year's low seen at the end of January when the Ukraine-Russia military standoff in Donbas reached a deadly peak. Below is our attempt to formulate what the ruble's rise means to Ukraine's economy and the hryvnia.

**Market view: "Benign geopolitics".** Market perception (formed by foreign market players) towards Russian assets improved dramatically despite the ongoing sanctions regime. This perception stems from the view that Minsk II is a better version of a ceasefire than the previous one. The assumption is the EU's top leaders invested their political capital into Minsk II, and its successful implementation should be followed by the EU phasing out its sanctions on Russia. This view is partially naive, in our view. Our scepticism over Minsk II is explained [here](#).

**Market view: Eurozone QE.** In the wake of the ECB's recently launched QE of EUR60bn per month, the capital markets are fixated on yield. Russian assets, recovering from deep distress in 4Q14 and early this year, appear to have upside. In our view, the ruble's upside was grossly exhausted recently, meaning there is no significant remaining value now.

**Market view: "Crude oil price recovery".** Although quite modest compared to the appreciation of Russian assets over the past two months, our research shows that the strong correlation between the RUB FX rate and the crude oil price has been subsiding noticeably this year (Chart 1-Chart 3 on p.2). Hence, this factor has quite limited impact on the RUB's rally now.

**Russian authorities' view.** Being distressed by numerous problems, stemming from the deeply depressed RUB seen at the end of 4Q14 and early this year (which affected inflation, consumer confidence, banks and leveraged corporations) the authorities downplayed any previously considered benefits of having a weaker currency in real terms. To fight inflation and soften social discontent they welcome sharp nominal appreciation. However, such a RUB rise totally contradicts the authorities' policy of stimulating domestic production via increased competitiveness. The RUB's real appreciation (+31.4% YTD) is much more dramatic than in terms of market rates (+13.2% YTD). If the current RUB remains thinly undervalued despite the fast appreciation, it can become overvalued again later this year in a few months, threatening to become a burden to the industrial sector as occurred in the past. This is the main macroeconomic quandary arising from the ruble's recent rally; it is unsustainable and promises more volatility and weakness for the currency ahead.

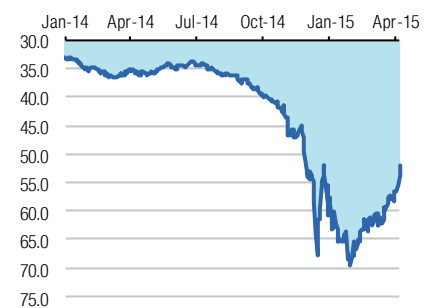
**Impact on Ukraine.** In general, the ruble's appreciation is positive for Ukraine's and the wider region's macro situation (albeit only if other things remain equal) as it reduces devaluation pressures on its neighbors' currencies, albeit for a short period of time. There is some breathing space for the UAH before the RUB enters a new wave of volatility in 2H15 when the US Fed begins its gradual increase of interest rates in June or September.

READ FIRST THE DISCLOSURES SECTION FOR IMPORTANT DISCLOSURES AND ANALYST CERTIFICATION

THURSDAY, 9 APRIL 2015

### USD/RUB spot market rate (inverted scale)

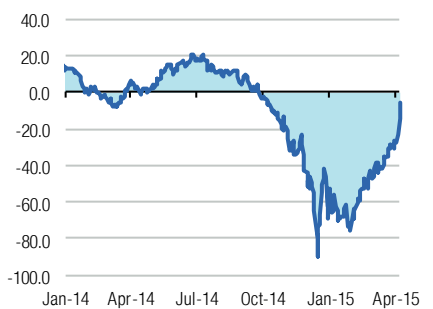
Daily history since 1 Jan 2014 through now



Source: Bloomberg.

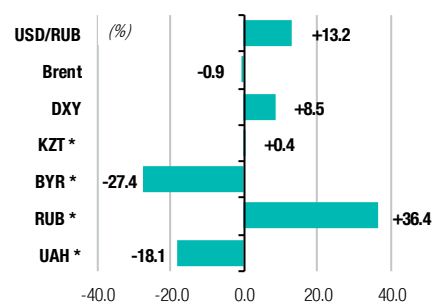
### RUB's misalignment by CPI-based real TWI

Daily history since 1 Jan 2014 through now



Source: ICU.

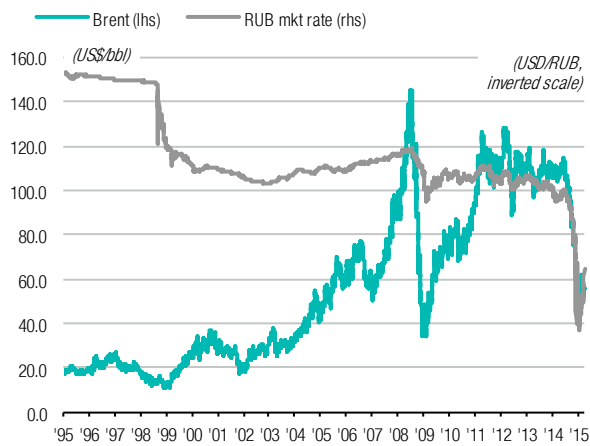
### 2015 YTD performance of CPI-based real TWIs of UAH, RUB, BYR, KZT vs. DXY, oil, RUB's FX rate (%)



Note: \* CPI-based real trade-weighted index.  
Source: Bloomberg, ICU.

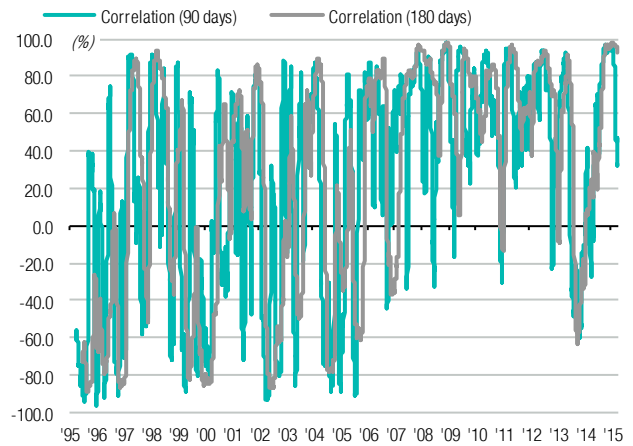
**Chart 1. RUB exchange rate and crude oil price (Brent) history from January 1995 through April 2015**

Market prices for USD/RUB FX rate and for Brent crude oil



Source: Bloomberg, ICU.

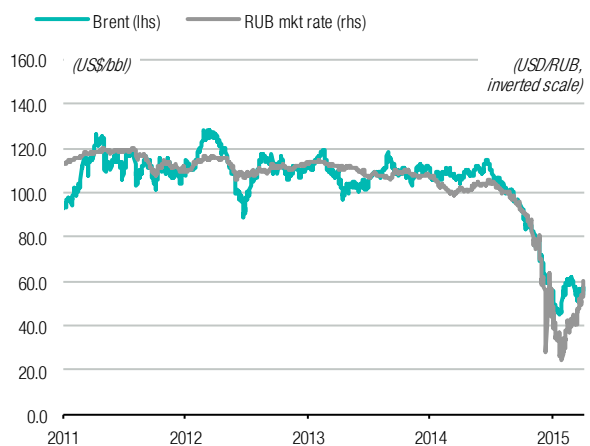
90- and 180-day correlation ratios between RUB and crude oil (Brent)



Source: Bloomberg, ICU.

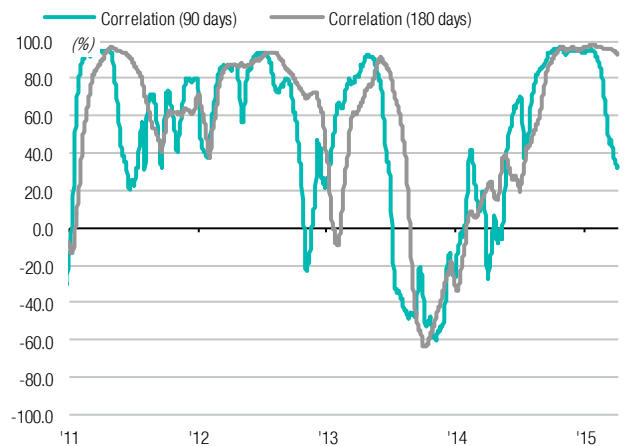
**Chart 2. RUB exchange rate and crude oil price (Brent) history from January 2011 through April 2015**

Market prices for USD/RUB FX rate and for Brent crude oil



Source: Bloomberg, ICU.

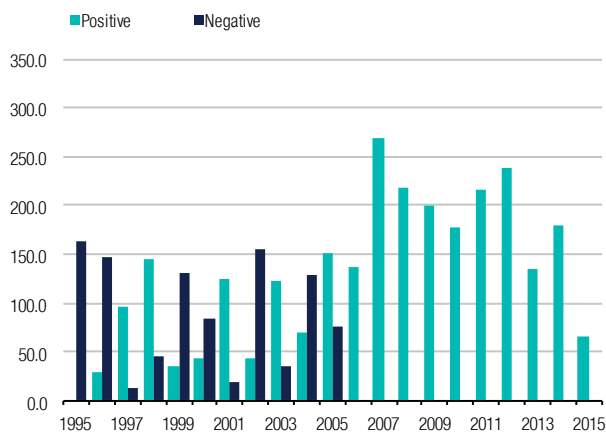
90- and 180-day correlation ratios between RUB and crude oil (Brent)



Source: Bloomberg, ICU.

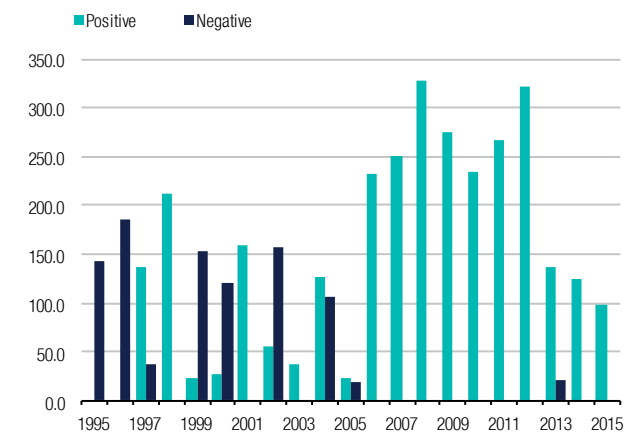
**Chart 3. Number of days per year when correlation ratio between RUB FX rate and crude oil price (Brent) exceeded 60% threshold**

Using the data on 90-day correlation ratios



Source: Bloomberg, ICU.

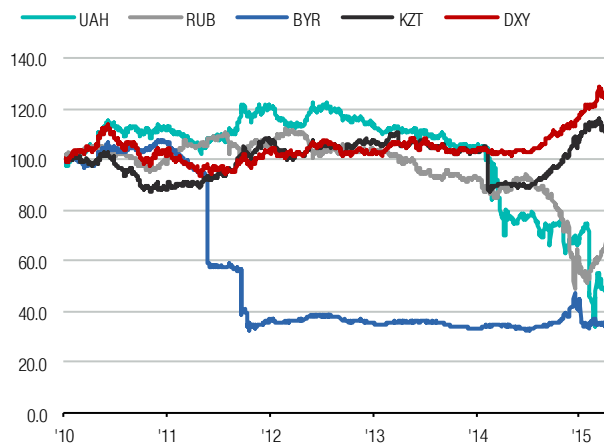
Using the data on 180-day correlation ratios



Source: Bloomberg, ICU.

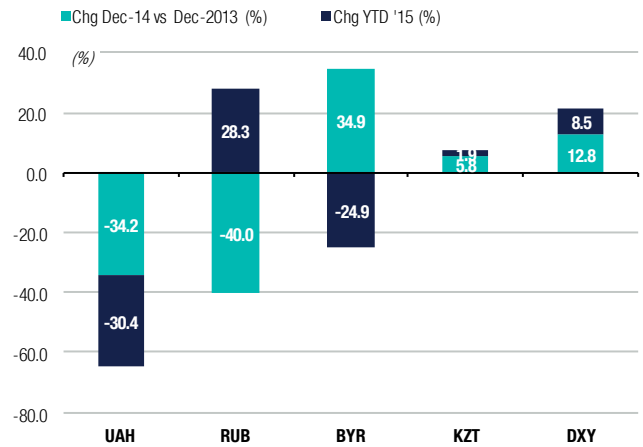
**Chart 4. Nominal trade-weighted indices: UAH, RUB, BYR, KZT and DXY (US dollar)**

Rebased at 100 points as of 1 Jan 2010, history through 9 Apr 2015



Source: Bloomberg, ICU.

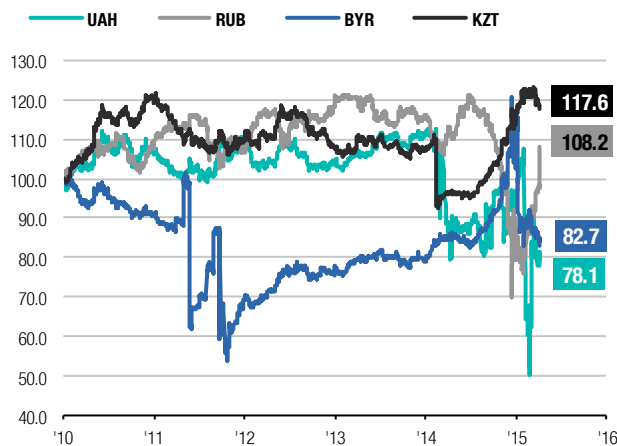
Cumulative percentage change from year-end 2013 through 8 Apr 2015 in breakdown of two periods: 1) over 2014, and 2) 2015 year-to-date



Source: Bloomberg, ICU.

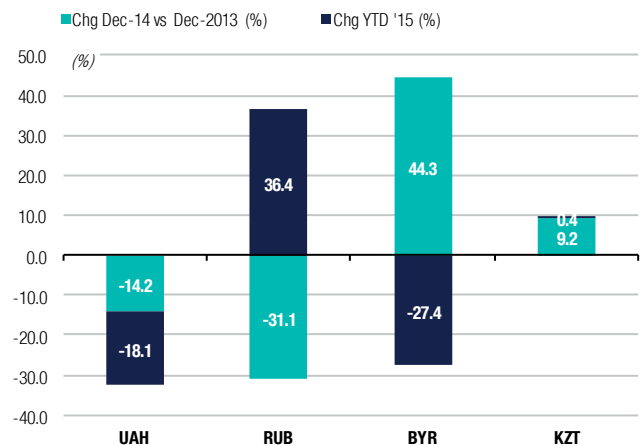
**Chart 5. CPI-based real trade-weighted indices: UAH, RUB, BYR, KZT**

Rebased at 100 points as of 1 Jan 2010, history through 9 Apr 2015



Source: Bloomberg, ICU.

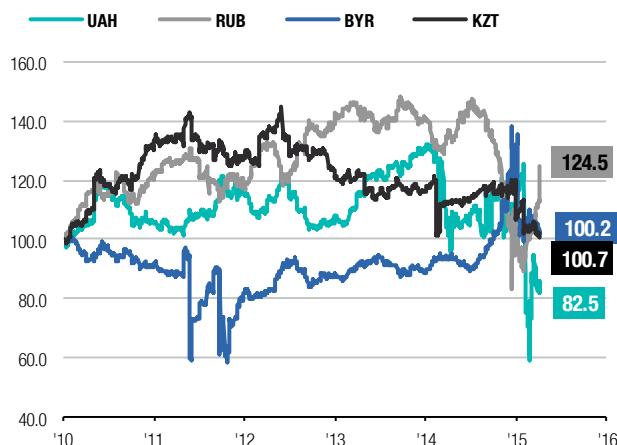
Cumulative percentage change from year-end 2013 through 8 Apr 2015 in breakdown of two periods: 1) over 2014, and 2) 2015 year-to-date



Source: Bloomberg, ICU.

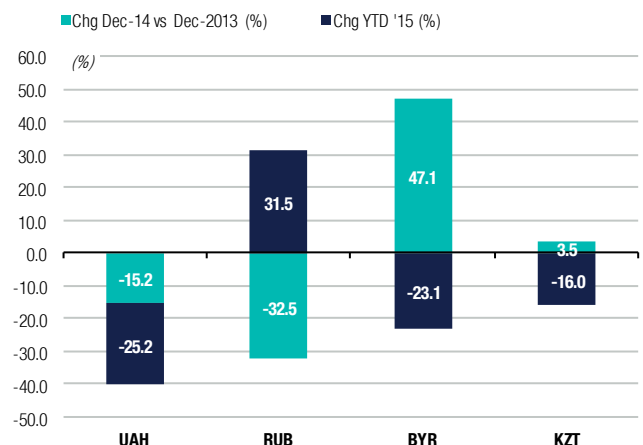
**Chart 6. PPI-based real trade-weighted indices: UAH, RUB, BYR, KZT**

Rebased at 100 points as of 1 Jan 2010, history through 9 Apr 2015



Source: Bloomberg, ICU.

Cumulative percentage change from year-end 2013 through 8 Apr 2015 in breakdown of two periods: 1) over 2014, and 2) 2015 year-to-date



Source: Bloomberg, ICU.

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**Buy:** Forecasted 12-month total return greater than 20%

**Hold:** Forecasted 12-month total return 0% to 20%

**Sell:** Forecasted 12-month total return less than 0%

Note: total return is share price appreciation to a target price in relative terms plus forecasted dividend yield.

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**Buy:** Forecasted 12-month total return significantly greater than that of relevant benchmark

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