

# Citibank Sees Ongoing Challenges to Economic Stability Ahead

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Citibank's chief economist in Russia said decision-makers in the Kremlin will be "constrained from all sides" in eliminating the Russian economy's dependency on commodity prices.

Russia will confront a persistent protest movement and a steady decline in oil revenues over the coming years, Citibank said Wednesday.

Despite the efforts of bureaucrats and politicians, the country's stock exchanges, the valuations of its major companies, its budget and its currency still move closely in line with commodity prices.

And the government will be "constrained from all sides" in tackling this dependency by delicate issues including pension reform, military expenditure and the implementation of President Putin's pre-election spending promises, said Elina Rybakova, chief economist at Citibank in Russia.

"There are no easy decisions left," she told reporters. "Only very complicated decisions remain, and they will not be made until we have our backs against the wall."

Russia's break-even oil price — the point at which the budget will balance — is currently about \$120 a barrel. Citibank's five-year forecast for Brent crude is \$85 a barrel.

The international banking giant is bearish on oil because of the emerging boom in shale oil production in the United States. Gas prices in the United States dropped dramatically as a result of the exploitation of shale gas reserves, and shale oil could follow its example, said Seth Kleinman, head of Citibank's European energy research. This is likely to result in a "supply side revolution."

A \$1 increase in the price of Urals crude, the Russian benchmark, adds about \$55 billion rubles (\$1.8 billion) to the budget, Finance Minister Anton Siluanov said last year.

Citibank has calculated that, on average, the ruble appreciates or depreciates against the euro-dollar basket by 1 percent for every 15 percent change in the oil price.

Given the expectation of declining oil prices, Russia's dependency on energy exports makes many of its stocks unattractive, said Kingsmill Bond, Citibank's chief Russia strategist.

An exception is the "fabulous story" of companies benefiting from consumer growth, including Sberbank, VTB and Internet provider Yandex, Bond added. But their equities are illiquid and only account for about a quarter of the market.

The shadow of political risk also hangs over the economic outlook, said Citibank, which has been consistent in its view that the urban protest movement that erupted after Dec. 4 Duma elections last year is not an ephemeral phenomenon.

A demonstration in Moscow on May 6 was attended by about 50,000 people and resulted in violent clashes in the center of the city.

There was an expectation that the official return of Vladimir Putin to the presidency in March would calm the situation and usher in another 12 years of political stability, Rybakova said.

"But, from the point of view of the market, what did we learn from the [presidential] election that we didn't know three months ago?"

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