CEEMEA Business Group

Russian Rouble Update

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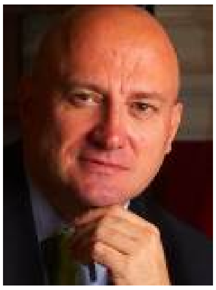
IN ASSOCIATION WITH: anaplan BAKER & McKENZIE EY Building a better working world Radius GROUP

About the author



Dr Daniel Thorniley

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Danny Thorniley is President of DT-Global Business Consulting GmbH (an LLC company) which is Danny's own consultancy company based in Vienna through which he works with some 330 key clients on business strategy in CEEMEA, global and emerging markets especially Russia. These companies are part of the CEEMEA and Russia Business Group, which is an advisory and consultancy service. The services of the Group include written position papers, presentation slides and private client meetings as well as in-house presentations.

Danny writes a well-received monthly position paper on the Russian market as well as quarterly presentation slides on other CIS markets. He visits Moscow on business every 2-3 weeks and hosts 8-9 private meetings of the Russia Business Group annually. The most recent one was attended by some 140 senior executives. He is also invited to make some 50 speeches/presentations each year by clients across the world on global business trends, business operations, emerging markets, corporate best practice. Many of these speeches are focused on Russia and the CIS and he has made some 60 “Russia presentations” to visiting western CEOs explaining the positives of the market without being naïve.

For 23 years (until the closure of the Vienna office) Danny was Senior Vice President and Senior Consultant at The Economist Group, Vienna on global corporate business trends, with specialisation in BRIC.

Danny has exceptional skill sets in global business strategy, business in emerging markets and CEEMEA and hands-operational knowledge of business operations, distribution, partnerships, investments and human resource issues.

Danny is regarded as a charismatic speaker who can present detailed business and economic analysis in an easily digestible fashion with a great deal of genuine humour. Danny is renowned for not using powerpoint presentation slides - never. Dr Thorniley has also given guest presentations at Executive MBA courses on behalf of Oxford University, the University of Chicago, IESE (Spain) and the Central European University in Budapest. The executive MBA students at Chicago rated him “best speaker” on 12 occasions out of 12 over 5 years.

He has worked on a personal basis with companies operating in emerging markets for 26 years and has personal contacts with most senior western MNCs operating in the Russia and the CEEMEA region and beyond. He makes frequent presentations at CEO and Board level and has long-standing personal friendships with leading executives.

He holds and has held a number of non-executive and advisory board memberships.

Dr Thorniley was educated at Oxford University. He holds a Bachelor of Arts degree, a diploma and a doctorate degree in Soviet political economy.

He has published three books, including one on Russia with Macmillan (UK/USA) and two with Profile books on Doing Business in Global Emerging Markets.

His beloved daughter is called Natasha after he read Tolstoy's War and Peace when he was a young man. One of his other favourite books is Master and Margarita by Bulgakov.

- The consensus for the oil price at over $60 per barrel probably needs to come down a bit.
- The Iranian sanctions deal, if ratified, will keep the oil price down and in the medium term shale energy is not going away; it is unlikely that energy prices will be strong again in the next few years.
- Now it's not Ukraine and sanctions that are hurting the rouble but the oil price and the timing of the rise in US interest rates.
- Global financial markets are currently feverish about upcoming US interest rate increases.
- Global financial markets are getting increasingly anti "Emerging Markets" and the rouble is getting sucked in along with others.
- It's not just the rouble: the Brazilian real is at a 12-year low versus the US dollar and most other emerging market currencies are at 5-year lows versus the dollar.
- The Russian Central Bank gave some mixed signals last week when it cut the central interest rate to 11.0% (weakening the rouble) but also suspended selling the rouble to buy FX, policy it commenced last May (thereby supporting the currency).
- The Bank is currently more worried about softening GDP growth and investment than inflation and the currency.
- But we also think that the Central Bank is also concerned about global swings impacting the rouble.
- After spending three months selling the rouble short, the Bank could need to get back into defensive mode

The recent fall in the rouble is cause for some concern. We noted in recent reports that in 2014 the Russian rouble was the second weakest currency in the world behind the Ukrainian hryvnia and that for 4-5 months of 2015 it became the strongest currency in the world. We did add that it might well remain the most volatile currency and this has proven to be correct given the current slump.

There are usually 3 big drivers behind the rouble. These are:

1) The global oil price.
2) The perceived situation in eastern Ukraine.
3) Whether western sanctions will be intensified.

Until 3-4 weeks ago, everything was reasonably manageable with these 3 factors. Then the oil price started to soften due very much to the announcement of the Iranian sanctions deal with the US (which still requires ratification by Congress by a specific majority) as well as on the back of weakening Chinese GDP and solid Saudi Arabian oil production.

It should also be remembered that the consensus for the oil price as recently as mid-July (just 2-3 weeks away) was $63 for the end of 2015 and $68 for the end of 2016. So there could still be some upside to the oil price and for the rouble in the weeks and months ahead. However, as we have often mentioned, shale gas is never going to go away; thus over the mid-term we tend to think that oil prices, presumably based on mild global growth and some slow re-introduction of Iranian oil into the markets, will fluctuate about $55 with some mild risk on either side.

The oil price is playing a major factor in the weakening of the rouble and this is seen in the fact that:

- Since 1 June the oil price has fallen from $63 per barrel to $51 - a fall of 19%, while
- Since 1 June the rouble has fallen versus the dollar from 53 to 61 --- a fall of 15%.

When oil was last time this close to $50 per barrel the rouble was 20-25% weaker and there has existed some sense of stabilisation in the Russian economy (at weak levels) and some sense of some financial stability. This latter point is underscored by:

1) The Russian Central Bank talking of building up FX reserves and they have in fact stabilised and actually climbed up to $360bn by the end of June.
2) The Central Bank also introduced in May a policy of selling FX to soften the rouble.
3) And as recently as 1 August, just this week, the Bank was relaxed enough to cut the central interest rate from 11.5% to 11.0%, seemingly unconcerned about any potential impact on inflation and the rouble.

But the market mood for the rouble and all emerging market currencies has been hugely affected in recent weeks as the global financial markets have again become obsessed with the timing of a rise in US interest rates which is now expected to take place this September or December. One might have expected this to have already been factored into the markets (many times over!) but it appears that the markets are uncontrolled when this comes into play. We did expect all emerging markets to suffer some wobble due to a forthcoming US rate rise (which will be small from a low level close to zero with future increases taking place at a measured pace).

It should also be noted that any rise in US interest rates will jack up the US dollar value which in turn will likely put more downward pressure on the oil price because the dollar and oil price move in inverse proportion to each other: a strong dollar means a weak oil price and vice versa.

The rouble fall in the last 2-3 weeks is probably 45% attributable to the weaker oil price but also 55% down to emerging market flutters.

It seems the rouble is being hit by a new one-two combination of punches: in the recent past it was a treble combination of oil price, Ukraine and western sanctions while now it is the oil price and US interest rates.

We did comment that when the rouble reached a recent high level in May this year of close to 50 to the dollar that we felt that at the then current oil price levels of about $60+, this exchange rate was too strong. Then through May-June the rouble depreciated mildly to about $55 to the dollar and 60 to the Euro which seemed and “felt” like a fair rate. Now the emerging market shake-down has brought the rouble further down in its wake.

This is the next big thing to note: while the rouble is certainly hurting, other emerging market currencies are under severe pressure and the Brazilian real for example is at a 12-year low versus the US dollar while nearly all other emerging market currencies are at a 5-year low to the dollar.

In our recent July Survey of Group members the consensus, with which we agreed, was as follows for the next year:

$-Rouble

- 65% of respondents predicted an average range of 55-60.
- 28% of respondents forecast 50-55.
- Just 7% predicted 65-70.

For the **€-Rouble**, the feedback as:

- 58% of respondents looked for 60-65.
- 30% forecast 65-70.
- Just 7% planned for 70-75.

At the moment we are on the negative edge of the better case scenario. We expect the US interest rate saga to continue for most of this year and forecast more oil volatility.

On current trends we move our estimate for the rouble average over the next 12 months from 57 to the dollar to 61.5 and versus the Euro from 64 to 68.

Exchange rate movements 1 January 2015 compared with 1 August 2015
(Local currency versus the US dollar except when Euro is specified)

	January 1	August 1	% change
Euro-dollar	1.21	1.1	-9.1%
$ - Russian rouble	60.9	62.3	-0.5%
Euro – Russian rouble*	72	68.3	5.1%
$ - Brazilian real	2.67	3.36	-25.8%
$- South African rand	11.6	12.6	-8.6%
$ - Turkish lira	2.31	2.76	-19.5%
Euro-Turkish lira	2.75	3.04	-11.0%
$ - Mexican peso	14.7	16.2	-10.2%
$ - Indian rupee	61.8	63.9	-3.5%
$ - Indonesian rupiah	12.44	13.4	-8.2%
$ - Polish zloty	3.55	3.75	-7.2%
$ - Romanian leu	36.9	40.1	-8.7%

*of course if one compares the rouble at 2 August 2015 with its mid-April 2015 level, then the rouble is down -24% versus the dollar and minus 23.8% against the Euro.

As ever, I hope you have found this short report useful and if you have any queries or comments do get in touch danielthorniley@dt-gbc.com.

4 August 2015

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PAUL HARTMANN AG was seeking to co-locate our first factory in Russia with a national distribution center. Also, the project had to meet stringent global quality standards and risk mitigation requirements, which made this project even more complex. With Radius Group, we found a responsible development partner who provided a comprehensive build-to-suit development and financing solution, and delivered a high-quality building on-time and on-budget.

Dr. Felix Fremery
Chief Process Officer, PAUL HARTMANN AG

We designed, implemented and financed a robust real-estate solution meeting Russian codes and German manufacturing best-practices, as well as PAUL HARTMANN AG's exacting requirements. Radius Group is proud to have fully realized PAUL HARTMANN AG's high expectations.

Chris Van Riet
Managing Director, Radius Group

DETAILS DELIVERED.

(1) High-powered ventilation & extraction system designed to German engineering standards maintain a dust-free manufacturing environment
(2) Co-location of manufacturing and distribution drives cost efficiencies and lowers lead times
(3) Information systems implementation provides seamless connectivity with PAUL HARTMANN AG operations worldwide
(4) Facility achieved BREEAM's highest rating for sustainable construction of any building in Russia in 2013

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