Russia Monthly Economic Developments

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THE WORLD BANK
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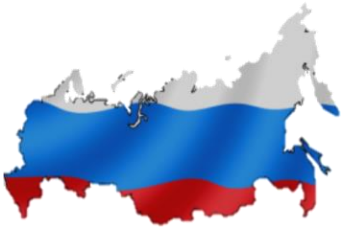
The global economy has continued to decelerate, growing by an estimated 2.3 percent in 18Q3 (q/q saar), down substantially from 3.3 percent in the previous quarter. This was driven by the slowdown in the Euro Area and Japan. Oil prices rose 4.9 percent (m/m) in January 2019, and they continued to rise, with the price of Brent crude oil reaching $64/bbl by mid-February. The ruble nominal exchange rate stayed flat in January compared to the previous month. Russia's current account surplus shrank in January, compared to the same period last year, on the back of lower oil prices. In 2018, supported by robust global growth, rising oil prices, one-off construction projects and the FIFA World Football Cup, GDP growth in Russia accelerated to 2.3 percent, up from 1.6 percent in 2017 (consensus: 1.7 percent). Labor market dynamics were stable in December 2018. In 2018, the federal budget surplus (on a cash basis) totaled 2.7 percent of GDP compared to a 1.4 percent of GDP deficit in 2017. Key credit risk and performance indicators remained largely stable in November. Reshaping of the banking sector continues due to the ongoing sector clean-up by the Central Bank of Russia and the evolving regulatory landscape.

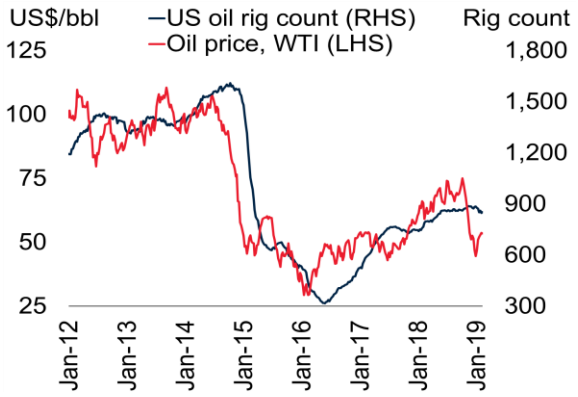
The Global Context



The global economy has continued to decelerate, growing by an estimated 2.3 percent in 18Q3 (q/q saar), down substantially from 3.3 percent in the previous quarter. This was driven by the slowdown in the Euro Area and Japan. The subdued momentum persisted in 18Q4 and will stretch into 19Q1, with the global manufacturing PMI registering 50.7—its lowest level in more than two years. Indicators suggest activity slowed in the United States in January as well as in the Euro Area, which saw a contraction in industrial production growth in November. China too witnessed a slowdown in 18Q4, bringing growth for 2018 to 6.6 percent, and this softening is expected to continue into 2019. Global trade has also stagnated, driven by sharp declines in the Euro Area, while trade tensions between major economies continue to weigh on confidence. Global financing conditions are anticipated to ease more than previously expected, driven by a slower tightening in the United States and the Euro Area.

In January 2019, oil prices rose 4.9 percent (m/m) and they continued to rise, with the price of Brent crude oil reaching $64/bbl by mid-February. This strengthening in prices was driven by a sharp reduction in the global oil supply; production is estimated to have fallen by 1.4 million barrels per day (mb/d) in January, following a reduction of almost 1 million barrels per day in December. This drop in output was primarily due to agreed-upon production cuts by OPEC and its non-OPEC partners although compliance was lower than required by the agreement. For example, production in Russia fell by 70 kb/d against a target of 230 kb/d. Saudi Arabia has indicated that it will continue to reduce production in the coming months by almost 0.5mb/d. Production was also curtailed in Canada by pipeline constraints. Oil prices were further supported by the announcement that the United States would impose sanctions on Venezuela's state-oil company, Petróleos de Venezuela. Venezuela currently produces 1.3 mb/d, just over 1 percent of the global supply. In contrast, production in the United States continued to increase, rising 90kb/d to 12 mb/d in January despite a reduction in the rig count over the month (Figure 1).

Figure 1: Oil prices began to rise in January 2019

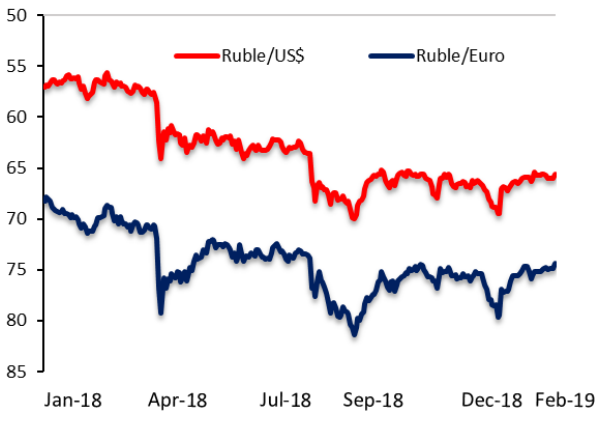


Russia's Recent Developments

Average ruble nominal exchange rate stayed flat in January 2019 compared to the previous month (Figure 2). The oil price

increased by about 4.5 percent in January, m-o-m, and the ruble average exchange rate with respect to the U.S. dollar stayed the same. In January, the Central Bank resumed its forex interventions on behalf of the Ministry of Finance in the fiscal rule framework. Meanwhile, the ruble exchange rate followed appreciation path within the month based on expectations of less tightening in advanced economies.

Figure 2: Average ruble nominal exchange rate stayed flat in January 2019 compared to the previous month

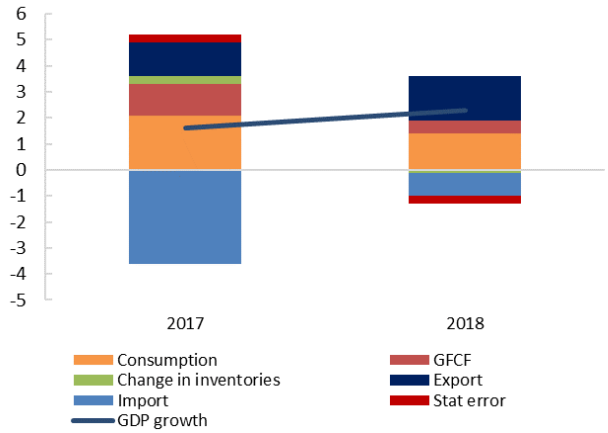


Source: CBR.

The current account surplus shrank in January, compared to the same period last year, on the back of lower oil prices. In January 2019, the current account surplus decreased to US$11.8 billion from US$12.9 billion in the same period last year. Lower exports, partly due to lower oil prices, led to a weaker trade surplus. Net private capital outflows in January reached US$10.4 billion compared to US$7.4 billion in 2018. The international reserves gained US$1.9 billion in January compared to US$11.7 billion in the same period last year.

Supported by robust global growth, rising oil prices, one-off construction projects and the FIFA World Football Cup, GDP growth in Russia accelerated to 2.3 percent in 2018 from 1.6 percent in 2017 (consensus: 1.7 percent). Relaxation of the OPEC+ agreement in June 2018 provided the impulse to mineral resource extraction growth as well as growth in related non-tradable sectors (transportation and storage) in the second half of 2018. In the first half of 2018, growth in tradable sectors was driven by manufacturing. Relatively low interest rates and deferred demand fueled consumer loans, and growth in the financial sector accelerated to 6.3 percent from 2.8 percent in 2017. Growth in construction accelerated to 4.7 percent from -1.2 percent in 2017,[1] mainly on the back of non-housing construction in the energy sector. While domestic demand was driving growth, contribution of net exports to GDP growth increased dramatically from -2.3 pp in 2017 to 0.8 pp in 2018. Contribution of domestic demand to GDP growth dropped from 3.6 pp in 2017 to 1.8 pp in 2018 (Figure 3). Thus, it was the higher contribution from net exports that led to growth acceleration on the demand side.

Figure 3: GDP growth in Russia accelerated to 2.3 percent in 2018 from 1.6 percent in 2017

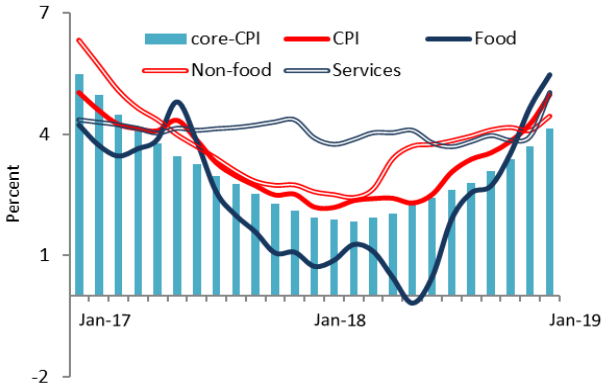


In January 2019, annual consumer inflation accelerated to 5.0 percent, up from 4.3 percent in December (Figure 4). This increase was mainly due to higher food inflation and higher inflation in services. While food products were mainly exempt from the VAT tax rate increase, inflation acceleration in this category could largely be due to the pass-through effect from the ruble's depreciation. Inflation in services increased mainly on the back of the VAT rate increase. Yet, the overall effect of this rate increase on inflation was moderate. Core inflation increased to 4.1 percent in January, up from 3.7 percent in December. Household inflation expectations also increased slightly in January, reaching 10.4 percent, up from 10.2 percent in December. Given that inflation in January was close to lower bound of the Bank of Russia expectations, the Bank of Russia

[1] *In January 2019, Rosstat published reviewed high frequency statistics data on construction. Growth in January – November of 0.5 percent, y-o-y, was changed to 5.3 percent in January – December. Changes were due to non-housing construction, mainly in the Yamalo-Nenetsk autonomous okrug. According to anecdotal evidence, Rosstat took into account the completion of a large construction site related to liquid gas production (Yamal SPG).*

Board of Directors decided to keep the key rate at 7.75% per annum on February 8.

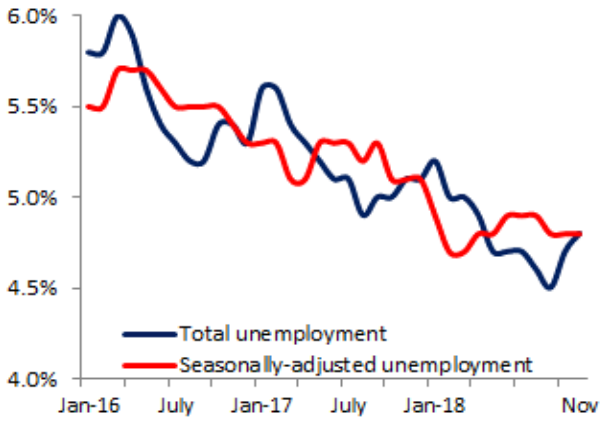
Figure 4: The consumer price index accelerated in January



Source: Haver Analytics.

Labor market dynamics were stable in December 2018. The unemployment rate (with and without seasonal adjustment) stayed at the level of 4.8 percent in December 2018 (Figure 5). Real wages continued to grow and increased in December by 2.5 percent compared to the same period of the previous year, but they contracted by 0.7 percent compared to November 2018 after seasonal adjustment. Real disposable incomes increased marginally in December (by 0.1 percent) compared to the same period in 2017. However, their growth compared to November 2018 following seasonal adjustment was much higher and reached 4.7 percent. This indicator is very volatile and is driven, to a large degree, by sources of income that are not registered by statistics. Pensions were indexed in the beginning of the year, and in December 2018 they decreased by 0.7 percent compared to the same period in 2017.

Figure 5: Labor market dynamics were stable in December



Source: Rosstat, Haver Analytics, World Bank team

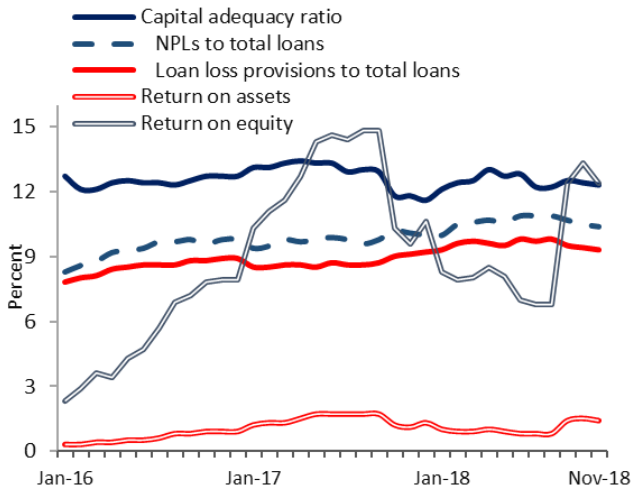
The fiscal balance improved in 2018. The federal budget surplus (on cash basis) totaled 2.7 percent of GDP in 2018 compared to a 1.4 percent GDP deficit in 2017. This improvement was due to higher oil prices combined with a weaker ruble, better tax administration, and a conservative fiscal policy. The non-oil/gas primary fiscal deficit improved to 5.6 percent of GDP in 2018 compared to 7.2 percent of GDP in 2017. This was mainly due to lower primary expenditures, which decreased from 17.1 percent of GDP in 2017 to 15.6 percent of GDP in 2018 (or about 2.6 percent in real terms, y-o-y), mainly on the back of lower expenditures on social policy, national economy and defense. The cut in social policy expenditures can be explained by the one-time payment made to pensioners in January 2017, which increased the base of 2017. Also, pensions are indexed by the CPI, and the GDP deflator is higher this year on the back of higher energy prices (the GDP deflator rose to 10 percent in 2018). Thus, as a percent of GDP, pensions would be expected to shrink. Domestic debt issuance and spending of the National Welfare Fund were the main sources of financing the "structural" deficit of about 1.4 percent of GDP in 2018. The structural deficit is calculated with oil and gas revenues at the oil price of US$40/bbl in 2017 prices. Oil and gas revenues exceeding the "structural" revenue will be saved in the National Welfare Fund. In 2018, the government issued domestic debt for 0.5 percent of GDP (net) and spent about 1.1 percent of GDP from the National Welfare Fund. By end December 2018, the federal government debt totaled 14.6 percent of GDP and National Welfare Fund – US$58.1 billion, 3.5 percent of GDP, (additional oil and gas revenues received during 2018 are not included). The general government surplus also improved to 5.0 percent of GDP in January – November 2018 compared to 0.5 percent in 2017.

Economic growth and delayed consumer demand supported lending growth in both the retail and corporate segments in 2018. As of January 1st 2019, credit to the corporate sector grew by 12 percent, y/y, while loans to households grew by 22.6 percent, y/y. The household credit growth was predominantly driven by unsecured loans and mortgage loans. The decline in interest rates has also supported credit growth.

Key credit risk and performance indicators remained largely stable (Figure 6). As of December 1st 2018, the capital adequacy ratio stood at 12.3 percent (against a regulatory minimum of 8 percent). The non-performing loan ratio has slightly decreased, standing at 10.4 percent compared to 10.5 percent in the previous month. In 2018, the banking sector's profit amounted to 1,345 billion rubles (1.7 times higher than in 2017). The banking sector's profit still continues to be

affected by the performance of banks under the financial recovery process via the CBR's Banking Sector Consolidation Fund (BSCF). In December, the CBR announced that it would sell the Asian-Pacific Bank - one of the banks resolved by BSCF – in the open auction in March 2019. This will be the first attempt to return a bank that was resolved under a new resolution scheme to private investors. After the first eleven months of 2018, the return on assets (ROA) and the return on equity (ROE) increased since the beginning of the year to 1.4 percent and 12.4 percent, respectively, up from 1.0 percent and 8.3 percent, respectively.

Figure 6: Key credit risk and banking performance indicators continued to be stable in November



Source: CBR.

Reshaping the banking sector continues due to the ongoing sector clean-up by the Central Bank and the evolving regulatory landscape. The number of banks in Russia has decreased steadily since 2013. In 2018, 77 banks had their licenses revoked for failing to comply with regulations, bringing the total number of banks in Russia to 484 as of January 2019. The full transition to the propitiate regulation of banks since 2019 has resulted in 149 banks opting for a basic license. In 2017, the banking regulation was amended to divide banks by total capital into those with a universal license and those with a basic license (RUB 1 billion is a threshold, which determines the type of the banking license). The type of banking license determines a bank's regulatory burden. Banks with a basic license are subject to a simplified regulation. They will also be granted access to government support programs in some priority sectors such as lending to SMEs. This is a positive development for small regional banks as it will allow them to compete on more equal terms with the large public banks.

Main Economic Indicators

Output Indicators	2017	2018 Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sept	Oct	Nov	Dec	2018	2019 Jan
GDP, % change, y-o-y	**1.6**	-	-	1.3	-	-	1.9	-	-	1.5	-	-	-	**2.3***	
Basic sectors, % change, y-o-y	**2.5**	2.3	2.7	1.9	3.7	3.7	1.6	2.8	1.2	0.7	3.6	1.8	1.9	**2.9**	
Industrial production, % change, y-o-y	**2.1**	2.4	3.2	2.8	3.9	3.7	2.2	3.9	2.7	2.1	3.7	2.4	2.0	**2.9**	
Manufacturing, % change, y-o-y	**2.5**	4.3	4.7	2.2	5.3	5.4	2.2	4.6	2.2	-0.1	2.7	0.0	0.0	**2.6**	
Retail trade	**1.3**	2.9	2.0	2.2	2.9	2.6	3.3	2.7	2.8	2.2	2.0	3.0	2.3	**2.6**	
Extraction of mineral resources, % change, y-o-y	**2.1**	0.8	1.2	2.4	2.5	1.3	2.8	3.2	4.5	6.9	7.4	7.8	6.3	**4.1**	
Construction, % change,y-o-y	**-1.2**	12.2	9.4	-2.5	11.0	7.9	3.1	-0.7	3.3	5.9	5.7	4.3	2.6	**4.7**	
Fiscal and Monetary Indicators															
Federal government balance, % GDP	**-1.4**	2.8	1.6	1.8	0.9	1.4	1.9	2.5	3.1	3.5	3.6	3.7	2.7	**2.7**	
Inflation (CPI), %, y-o-y	**3.7**	2.2	2.2	2.4	2.4	2.4	2.3	2.5	3.1	3.4	3.5	3.8	4.3	**2.9**	5.0
Inflation expectations, %, y-o-y	**10.3**	8.9	8.4	8.5	7.8	8.6	9.8	9.7	9.9	10.1	9.3	9.8	10.2	**10.2**	10.4
Balance of Payment Indicators															
Trade Balance, billion $ (monthly)	**115.4**	16.9	12.2	15.0	15.0	15.2	15.2	13.2	15.9	18.9	19.7	19.0	18.9	**194.4**	
Current Account, billion $, ytd	**35.4**	12.9	20.6	30.0	39.5	47.2	48.4	57.5	65.5	76.0	-	-	114.9	**114.9**	11.8
Export of goods, billion $	**353.5**	33.4	31.2	36.9	36.2	36.5	36.6	34.4	37.4	38.7	41.3	40.5	41.4	**443.4**	
Import of goods, billion $	**238.1**	16.4	19.0	21.9	20.9	21.4	21.0	21.0	21.6	19.8	21.6	21.5	22.5	**249.0**	
Financial Market Indicators															
CBR policy rate, %, end-o-p	**7.75**	7.50	7.50	7.25	7.25	7.25	7.25	7.25	7.25	7.50	7.50	7.5	7.75	**7.75**	
Credit to households in Rub, % change, y-o-y	**7.4**	14.5	15.2	16.1	17.1	18.5	19.4	20.3	21.1	22	22.5	23.1	22.6	**22.6**	
Credit to the corporate sector in Rub, % change, y-o-y	**2.0**	5.1	5.5	6.3	7.5	6.9	7.4	8.1	9.5	8.4	9.7	10.6	12.0	**12.0**	
Capital adequacy ratio	**11.6**	12.1	12.4	12.5	13.0	12.7	12.8	12.2	12.2	12.5	12.4	12.3	-	**-**	
NPLs to total loans	**10.0**	10.0	10.5	10.6	10.7	10.6	10.9	10.9	10.9	10.7	10.5	10.4	-	**-**	
Loan loss provisions to total loans	**9.2**	9.3	9.6	9.7	9.6	9.5	9.8	9.7	9.8	9.5	9.4	9.3	-	**-**	
Return on assets (ROA)	**1.3**	1.0	0.9	0.9	1.0	0.9	0.8	0.8	0.8	1.4	1.5	1.4	-	**-**	
Return on equity (ROE)	**10.6**	8.3	7.9	8.0	8.5	8.1	7.0	6.8	6.8	12.4	13.3	12.4	-	**-**	
Income, Poverty and Labor Market															
Real wages, % change, y-o-y	**6.2**	11.0	10.5	8.7	7.6	7.6	7.2	7.5	6.8	4.9	5.2	4.2	2.5	**6.8**	
Unemployment (%, ILO definition)	**5.1**	5.2	5.0	5.0	4.9	4.7	4.7	4.7	4.6	4.5	4.7	4.8	4.8	**4.8**	
Exchange rate															
USD/ RUB, average	**58.3**	56.8	56.8	57.0	60.4	62.2	62.7	62.8	66.1	67.7	65.8	66.2	67.3	**62.5**	67.3
Euro/ RUB, average	**65.8**	69.0	70.3	70.4	74.2	73.7	73.2	73.4	76.2	79.0	75.7	75.3	76.6	**73.9**	76.9
Oil price															
Brent, $/ bbl	**54.4**	69.0	65.4	66.5	71.6	76.7	75.2	74.4	73.1	78.9	80.5	65.2	56.5	**71.1**	59.3

Quarterly data are not consistent with the annual number.

Source: Rosstat, CBR, EEG.

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