Global activity eased in the first quarter of 2018, particularly in advanced economies. After reaching multi-year highs in late May, oil prices fell following reports that Russia and Saudi Arabia were considering easing production cuts. In May, the ruble slightly depreciated with respect to the U.S. dollar, a result of increased investor risk aversion to emerging markets. In the first five months of 2018, supported by positive terms of trade and robust external demand, Russia’s current account surplus strengthened to USD$49.9 billion from USD$25.1 billion in the same period last year. Industrial production grew solidly in May, helped by robust growth in manufacturing. Labor market dynamics were mixed in April. In January - May 2018, aided by higher oil revenues and lower expenditures, the federal budget primary surplus strengthened to 2.0 percent of GDP from a 0.8 percent of GDP primary deficit in the same period last year. The government submitted its proposals on increasing the pension age, raising the VAT rate, and completing tax maneuvers in the oil sector to the Duma, to support infrastructure, digital economy and human capital development projects in the framework of the President’s decree of May 2018. In May, consumer inflation remained unchanged, helped by low food inflation. The Bank of Russia kept the key interest rate unchanged in June as inflation risk increased with an increase of the VAT rate from 18 percent to 20 percent suggested by the government. The banking sector’s statistics showed that lending activity continued to recover in April.

The Global Context
There was slower global growth in 2018Q1, relative to 2017Q4, especially in advanced economies. Growth in the United States and Euro Area decelerated, while growth contracted in Japan for the first time since 2015. Recent indicators of sentiment and industrial activity for emerging market and developing economies (EMDEs) suggest that these economies may have also slowed in the same period. In the financial markets, aggregate EMDE bond spreads jumped about 40 basis points in mid-May to their highest level in 16 months before slightly declining. Some EMDE currencies have fallen sharply against the U.S. dollar—notably the Argentine peso and the Turkish lira.

Oil prices fell in June 2018 (Figure 1). After reaching multi-year highs in late May, oil prices fell following reports that Russia and Saudi Arabia were considering easing production cuts. The price of Brent, the international benchmark, declined by $3 from its peak of $80/bbl in late May to $77/bbl in mid-June, while WTI, the U.S. oil price indicator, fell by $7 to $67/bbl over the same period. The possibility of a relaxation of the production cuts is a response to the ongoing collapse in oil production in Venezuela and the expected reduction in Iranian oil exports following the reimposition of sanctions by the United States. A decision on future production limits is likely to be announced at OPEC’s meeting on June 22nd, with the possibility of an increase in production of up to 1 mb/d. The International Energy Association estimates OPEC’s Middle East producers (excluding Iran) have a spare capacity of 1.1 mb/d, while a return of Russian production to pre-agreement levels would add a further 0.26 mb/d. U.S. oil production also continues to rise, with crude oil production increasing to 10.5 mb/d in March, up 1.3 mb/d from the previous year. The U.S. rig count has increased by 115 this year despite infrastructure and transport bottlenecks.

Russia’s Recent Developments
In May 2018, the ruble slightly depreciated with respect to the U.S. dollar on the back of investor risk aversion to
emerging markets (Figure 2). Despite oil prices increasing by 7 percent in May compared to the previous month, the ruble exchange rate with respect to the U.S. dollar depreciated by 2.4 percent a result of increased investor risk aversion to emerging markets. The ruble exchange rate remained almost flat with respect to the currency basket as it appreciated by 1.5 percent with respect to the euro, compared to April.

Figure 2: In May 2018, the ruble slightly depreciated with respect to the U.S. dollar

In the first five months of 2018, Russia’s current account surplus strengthened to USD$49.9 billion from USD$25.1 billion in the same period last year. The key factor behind this was the strengthening of the trade surplus due to positive terms of trade and robust external demand. Net capital outflows rose from USD$18.8 billion in January – May 2017 to USD$23.3 billion in January – May 2018 as net acquisition of financial assets by the non-banking sector increased. After a spike in net capital outflows in April (USD$7.6 billion) resulting from increased geopolitical uncertainty, net capital outflows narrowed to USD$2.3 billion in May. International reserves grew by USD$25.9 billion (compared to USD$16.9 billion in the same period last year), largely a result of currency purchases by the Ministry of Finance within the fiscal rule framework.

Industrial production demonstrated solid growth in May 2018, helped by robust growth in manufacturing (Figure 3). Industrial production expanded by 3.7 percent, y/y, and 0.5 percent, m/m sa, in May. Growth was mainly driven by manufacturing, which rose by 5.4 percent, y/y. In May, growth in mineral resource extraction stood at 1.3 percent, y/y, driven by coal and gas production, while oil production remained more or less flat in the framework of the OPEC+ agreement. Rosstat conducted a revision of high frequency statistics for industrial production in 2017 - 2018, which is based on a wider range of available data (revised data are submitted by enterprises during the year). In addition, some changes in 2016 statistics arose due to the adjustment of enterprises to the new classification of types of economic activities, which Rosstat began to use in 2017. As a result, industrial production growth totaled 2.1 percent, y/y, in 2017 and 2.8 percent, y/y, in the first quarter of 2018 compared to 1 percent, y/y, in 2017 and 1.9 percent, y/y, in the first quarter of 2018, as previously published. The upward revision was mainly due to revisions in manufacturing. Manufacturing expanded by 2.5 percent, y/y, in 2017 and 3.7 percent, y/y, in the first quarter of 2018 compared to 0.2 percent, y/y, in 2017 and 2.2 percent, y/y, in the first quarter of 2018 as previously released.

Figure 3: Industrial production demonstrated solid growth in May 2018

In May 2018, consumer inflation remained unchanged, helped by low food inflation (Figure 4). The 12-month Consumer Price Index (CPI) stayed at the level of 2.4 percent, y/y, the same as in April. Growing prices for services contributed the most to the increase in consumer prices in annual terms in May, yet their contribution to the CPI index remained unchanged compared to April. Meanwhile, the contribution of non-food items to consumer inflation increased, mainly due to growing gasoline prices and the nominal depreciation of the ruble with respect to the U.S. dollar. Food inflation in annual terms was at a historical minimum in May, thus compensating for higher inflation in non-food goods. In the same month, core inflation increased to 2 percent, y/y, from 1.9 percent, y/y, in April, indicating higher inflationary pressures. In May, inflation expectations increased to 8.6 percent in annual terms from 7.8 percent in April on the back of the ruble’s depreciation.

In June 2018, the Bank of Russia left the key interest rate unchanged. The regulator noted elevated inflation risks (estimated increase of consumer inflation by 1 pp) due to the VAT rate increase proposed by the government. The regulator noted that the current monetary policy stance is close to

In June 2018, the Bank of Russia left the key interest rate unchanged. The regulator noted elevated inflation risks (estimated increase of consumer inflation by 1 pp) due to the VAT rate increase proposed by the government. The regulator noted that the current monetary policy stance is close to
neutral as it almost does not restrain growth of credits and domestic demand growth. Yet, according to the Bank of Russia, some tightness is required given the new fiscal measures suggested by the government and their potential effects on inflation expectations and inflation.

**Figure 4: Consumer inflation remained unchanged in May 2018**

![Figure 4: Consumer inflation remained unchanged in May 2018](image)

**Labor market dynamics were mixed in April 2018.** The unemployment rate decreased marginally by 0.1 percentage points to the level of 4.9 percent. However, this decrease was driven by seasonal factors as the seasonally adjusted rate increased slightly and reached 4.8 percent (Figure 5). Real wages continued to grow and increased in April 2018 by 7.8 percent compared to the same period in the previous year and by 0.8 percent compared to March 2018 after seasonal adjustment. Continuing their increasing trend since February, real disposable incomes increased in April by 5.7 percent compared to the same period of 2017. They also increased by 1 percent compared to March 2018 after seasonal adjustment. This indicator is volatile, and is, to a large extent, driven by sources of income that are not registered by statistics. Pensions were indexed in the beginning of the year and their real growth was 0.8 percent compared to April 2017.

**Figure 5: Labor market dynamics were mixed in April 2018**

![Figure 5: Labor market dynamics were mixed in April 2018](image)

From January – May 2018, aided by higher oil revenues and lower expenditures, the federal budget primary surplus strengthened to 2.0 percent of GDP from a 0.8 percent GDP primary deficit in the same period last year. While higher oil prices and the ruble’s depreciation prompted an increase in federal budget oil revenues, from 7.1 percent of GDP in January – May 2017 to 8.3 percent of GDP in January – May 2018, non-oil revenues remained flat at 9.8 percent of GDP. Federal budget primary expenditures decreased from 17.7 percent of GDP in January – May 2017 to 16.1 percent of GDP in January – May 2018 mainly due to lower spending on social policy due to the one-off pension payments in January 2017. The overall federal budget stance improved from a 1.6 percent GDP deficit in January-May 2017 to a 1.2 percent GDP surplus in January-May 2018. The general government budget surplus improved from 0 percent of GDP in January – April 2017 to 2.6 percent of GDP in January - April 2018.

The government submitted its proposals on increasing the pension age, raising the VAT rate, and completing tax maneuvers in the oil sector to the Duma. Starting 2019, the government suggests raising the pension age by a year annually, until it reaches 65 for men (compared to 60 currently) and 63 for women (compared to 55 currently). This measure could ease pressures on the budget and help Russia fend off demographic pressures: Russia’s labor force is projected to decline in the medium term. In addition, the government plans to raise the VAT rate from 18 percent to 20 percent and complete tax maneuvers in the oil industry (abolishing export duties on oil and oil products while increasing the mineral resource extraction tax). According to government estimates, tax changes could increase federal budget revenues by about 0.9 percent of GDP annually. The government needs additional fiscal resources to conduct projects in infrastructure, digital economy and human capital development in line with the President’s decree signed in May 2018.

In April 2018, the banking sector’s statistics showed that lending activity continued to recover. Retail lending continued to grow at double-digit rates. In April, credit to households in rubles accelerated to 17.1 percent, y/y, compared to 16.1 percent in March. Credit to the corporate sector in rubles grew by 7.5 percent, y/y, compared to 6.3 percent in March. The sector’s aggregate capital adequacy ratio increased to 13 percent as of April 1, 2018, compared to 12.5 percent a month before (above the regulatory minimum stipulated in Basel III which is 8 percent). The non-performing loan ratio has slightly increased, standing at 10.7 percent as of
April 1, 2018, compared to 10.6 percent in the previous month (Figure 6). Banks’ financial performances have been largely stable with the return on assets at 1 percent and the return on equity at 8.5 percent as of April 1, 2018. Consolidation in the banking sector continued - the number of banks in Russia has fallen from 561 at the beginning of 2018 to 534 as of May 1, 2018, mainly due to the Central Bank’s ongoing efforts to clean up the sector and close weak and noncompliant banks.

On June 1, 2018, the Central Bank of Russia (CBR) published its guidelines for the development of the Russian financial markets in the period 2019-21, along with a detailed roadmap. The CBR maintained its key priorities for the development of the financial markets as per the guidelines for 2016-18, which include: raising the living standards and quality of life of the Russian population through the use of financial market instruments; facilitating economic growth through competitive access of Russian economic agents to debt and equity financing and risk hedging instruments; and creating conditions for financial sector growth. To achieve the above goals, the CBR has outlined the following several measures: creation of a trusted environment; promotion of competition in financial markets; maintaining financial stability; and increasing the accessibility of financial services.

Figure 6: The non-performing loan ratio has slightly increased