In 2017, global GDP growth was estimated at 3.0 percent, up from 2.4 percent in 2016, registering its highest rate since the global financial crisis. Benign financial conditions, accommodative policies, and improved confidence contributed to this acceleration in growth. In 2018, oil prices continued to strengthen. In Russia, the ruble also strengthened on the back of higher oil prices and tax payments. A favorable external environment (recovering external demand and improved terms of trade) supported the current account in 2017: its surplus increased by about US$15 billion compared to 2016, to US$40.2 billion. In November, industrial production dropped, as all its components contracted, with manufacturing contributing the most. Meanwhile, the seasonally adjusted HSBC PMI manufacturing index increased to 52 in December from 51.5 in November, the highest reading since July, suggesting solid improvement in operating conditions of the manufacturing sector in December. Labor market indicators showed mixed dynamics in November. Annual average consumer inflation almost halved in 2017 compared to 2016, helped by the Central Bank’s relatively tight monetary policy and some temporary factors. The Central Bank continued the financial recovery process for banks bailed out under the new bail-out mechanism. In the January - November 2017 period, aided by higher oil prices, the federal budget primary balance registered a 0.1 percent of GDP surplus compared to a deficit of 1.5 percent of GDP in the same period last year.

The Global Context
There was a broad-based acceleration in 2017, with global GDP growth estimated at 3.0 percent, up from 2.4 percent in 2016, registering the highest reading since the global financial crisis. Benign financial conditions, accommodative policies, and improved confidence contributed to this acceleration in growth. The recovery was broad-based, with more than half of the world’s economy experiencing an increase in growth. Major advanced economies, including the United States, Euro Zone, and Japan, all accelerated in 2017. Growth in China, which slowed in 2016, accelerated to 6.9 percent from 6.7 percent in the previous year.

Oil prices averaged more than $61/barrel (bbl) in December, the sixth consecutive monthly increase. Prices continued to strengthen in 2018 with Brent—the international barometer—reaching almost $70/bbl in mid-January and WTI—the U.S. mid-continent price indicator—exceeding $60/bbl (Figure 1). The strength in oil prices has been supported by several factors. In November, OPEC crude supplies fell to 32.36 mb/d, down 1.3 mb/d from a year ago. This was in response to strong compliance with agreed-upon cuts, which rose to 115 percent in November, the highest during 2017. Output was lower in Saudi Arabia, Angola, and Venezuela. Stocks, on the other hand, have been dropping as well. OECD commercial stocks fell to their lowest level since July 2015. Likewise, in October, Chinese crude stocks likely fell for the first time in a year. On the consumption side, the International Energy Agency estimates that global demand growth will remain robust at 1.5 mb/d in 2017 (or 1.6 percent) and 1.3 mb/d in 2018 (or 1.3 percent), largely driven by improved global growth prospects. Oil prices are expected to average $58/bbl in 2018 and $59/bbl in 2019. In the long term (2025), they are expected to reach $65/bbl (based on January 2018 GEP forecasts).

Russia’s Recent Developments
In December, the ruble strengthened on the back of higher oil prices and tax payments. While the average oil price (Brent) increased by about 1.6 percent in December, the ruble appreciated by 0.6 percent with respect to the U.S. dollar (Figure 2). In addition to higher oil prices, the ruble received...
support from anticipated tax payments, while external debt payments exerted some depreciation pressures.

**Figure 2: The ruble appreciated in December**

![Chart showing the appreciation of the ruble against USD and Euro from October 2014 to January 2018. Source: CBR.]

A favorable external environment (recovering external demand and improved terms of trade) supported the current account in 2017: its surplus increased by about US$15 billion compared to 2016. According to preliminary information from the Bank of Russia, the current account surplus reached US$40.2 billion in 2017 on the back of a stronger trade balance. The higher current account surplus was mirrored by higher net capital outflows, which increased to US$38.5 billion in 2017 compared to US$29.9 billion in 2016. The banking sector, which continued its external debt repayments, was largely the source of net capital outflows; net capital outflows from the non-banking sector totaled about US$3 billion.

Private consumption, supported by growing real wages and pensions, and reviving credits to households, appeared to be the main engine of GDP growth in the third quarter of 2017. Rosstat published the first estimate of GDP demand side composition in the third quarter of 2017. As we expected, private consumption was the main engine of GDP growth in the third quarter, contributing 2.6 pp to annual GDP growth of 1.8 percent. The contribution of capital formation to growth fell to 1.3 pp from 3.2 pp in the second quarter: both fixed capital investment and change in reserves contributions to growth decreased. In the third quarter of 2017, fixed capital investment growth slowed down to 3.9 percent y/y from 6.3 percent y/y in the second quarter of 2017, largely due to a fall in investment in mineral resource extraction. In the third quarter of 2017, net export contribution to GDP growth was negative, as export growth (+4.5 percent, y/y) was more than compensated by growing imports (+16.3 percent, y/y). The slowdown of investment demand led to flat quarter on quarter growth: about 0.1 percent, q/q, sa, in the third quarter of 2017, compared to solid growth of 1 percent, q/q, sa, in the second quarter of 2017.

In November, industrial production dropped as a contraction was registered across its components, with manufacturing contributing the most. Industrial production shrank by 3.6 percent, y/y, and 1.4 percent, m/m, sa (Figure 3). Contraction deepened in mineral resource extraction (-1 percent, y/y) in November compared to -0.1 percent, y/y, in October. In November, crude oil extraction decreased compared to the same period last year due to the base effect and the OPEC+ agreement on production cuts. Natural gas production also fell, partly due to warm weather, and the water and electricity supply also dropped in November. Manufacturing production shrank the most, by 4.7 percent, y/y. This drag on manufacturing performance was largely due to slowing metallurgical production (in precious metals and other non-ferrous metals, nuclear fuel production), and production of other types of transport vehicles in November. Meanwhile, the seasonally adjusted HSBC PMI manufacturing index increased to 52 in December from 51.5 in November, the highest reading since July, signaling a solid improvement in operating conditions of the manufacturing sector in December.

**Figure 3: Industrial production dropped in November**

![Chart showing industrial production, manufacturing, and retail trade from January 2012 to November 2017. Source: Rosstat, Haver Analytics, World Bank team.]

Annual average consumer inflation almost halved in 2017 compared to 2016. The 12-month average Consumer Price Index stayed at the level of 2.5 percent in December (Figure 4). Therefore, the annual average consumer inflation reached 3.7

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1 Adjusted for currency swaps and correspondent accounts of resident banks in the Central Bank, and repayments of foreign currency loans by large banks to the Central Bank.
2 Source: Ministry of Economic Development.
percent in 2017 compared to 7.1 percent in 2016. The slowdown in the growth of prices for non-food and food items contributed the most to the inflationary abatement. A relatively tight monetary policy, helped by some temporary factors such as a stronger ruble and bumper harvest, helped the Bank of Russia to reach its end-year inflation target (4 percent in annual terms) in July. Onwards, the Central Bank intends to keep inflation close to the level of 4 percent. The current low inflation level suggests the potential for further monetary easing. The next Central Bank Board meeting will take place on February 9, 2018.

Figure 4: Annual average consumer inflation almost halved in 2017 compared to 2016

Labor market indicators showed mixed dynamics in November. Real wages continued to grow, supporting consumer demand. The unemployment rate in November was at the same level as the previous month, 5.1 percent. The seasonally adjusted rate slightly decreased from 5.2 percent in October to 5.1 percent in November (Figure 5). Real wages continued to grow and increased in November by 5.4 percent compared to the same period the previous year, and by 1.6 percent compared to October after seasonal adjustment. Real disposable incomes contracted by 0.3 percent in November compared to the same period in 2016, and they increased by 3.3 percent compared to the previous month after seasonal adjustment. This indicator is very volatile. The average contraction for the eleven months of 2017 was 1.1 percent compared to the same period in 2016. Pensions were indexed at the beginning of the year at the inflation rate, and with the deceleration of inflation, their real annual growth increased to 1.7 percent in November 2017.

Figure 5: The unemployment rate decreased in November

In the January - November 2017 period, aided by higher oil prices, the federal budget primary balance registered a 0.1 percent of GDP surplus compared to a deficit of 1.5 percent of GDP in the same period last year. In January – November 2017, the federal budget revenue stood at 16.3 percent of GDP, an increase of 1.2 percent of GDP compared to the same period last year, with oil revenues growing by 0.7 percent of GDP. Compared to the same period last year, primary expenditures decreased by 0.5 percent of GDP to 16.2 percent of GDP due to lower spending on defense (-0.3 percent of GDP), security (-0.2 percent of GDP), and health (-0.2 percent of GDP). Meanwhile, primary expenditures slightly increased in real terms. In January – November 2017, the non-oil primary deficit improved from 7.3 percent of GDP to 6.4 percent of GDP mainly due to an increase in non-oil federal budget revenues (corporate income tax, excise tax, and VAT). Overall, the federal budget deficit narrowed to 0.6 percent of GDP from 2.3 percent of GDP last year.

Economic recovery and declining interest rates supported further growth in consumer lending. In November, credit to households in rubles picked up, increasing by 12 percent, y/y, compared to 10.7 percent in October. Meanwhile, corporate lending has been stagnating - credit to the corporate sector in rubles grew only by 2.4 percent, y/y, compared to 3.2 percent in October. Sector non-performing loans were stable at around 10 percent. As of November 1, 2017, the sector’s capital adequacy stood at 11.8 percent (against a regulatory minimum of 8 percent).

The Bank of Russia continued the financial recovery process for banks bailed out under the new mechanism, by which banks are re-capitalized after writing off shareholder equity and subordinated debt. In December, the Bank of Russia announced the recapitalization of Otkritie to the amount of RUB 456.2 billion (approx. US$7.6 4 billion). The Bank of Russia also finalized the assessments of B&N and Promsvyazbank,
following which their capital has been written down to 1 ruble. The banks will be recapitalized and the Bank of Russia’s Banking Sector Consolidation Fund will become their shareholder, bringing all three rescued banks under the Bank of Russia’s ownership.

Proportionate regulation of the banking sector came into effect on January 1, 2018. Throughout 2018, those banks that are capitalized below RUB1 billion will have to opt for either increasing their capital or applying for a basic license, which will allow for a reduced scope of operations and less stringent regulatory requirements – over 200 banks are expected to be affected. All other banks will operate as banks with universal licenses.