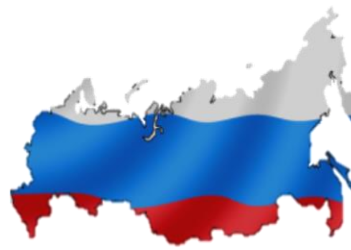
Russia Monthly Economic Developments

June 2017

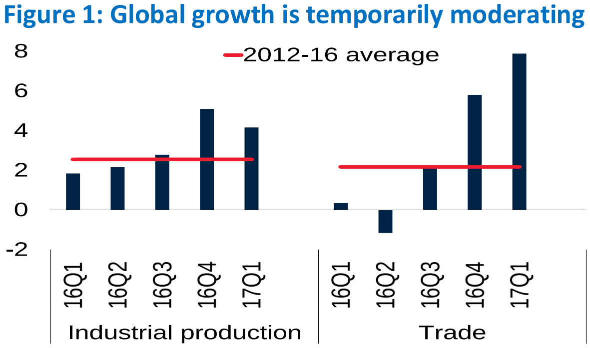
Global GDP growth moderated in the first quarter of 2017 as the temporary slowdown in U.S. consumption offset firm activities in other advanced economies and commodity exporting emerging market and developing economies (EMDEs). The oil price rebound, following the OPEC/non-OPEC extension of cuts, turned out to be short-lived. Oil prices dropped below the $50 mark in early June due to stubbornly high stocks and the responding supplies by the U.S. shale oil sector. Lower oil prices led to the ruble depreciating in May. Economic activity in Russia demonstrated robust growth in April, with high frequency indicators pointing to incipient recovery in consumer demand on the back of growing real wages and a pick-up in consumer credit. Labor market indicators also improved, and in May, inflation remained unchanged at 4.1 percent. In the first quarter of 2017, the federal budget primary deficit improved to 1 percent of GDP from 3.5 percent of GDP in the same period last year, largely due to higher oil prices.

The Global Context



In the first quarter of 2017, global growth moderated to around 2.5 percent (q/q saar) as the temporary slowdown in U.S. consumption offset firm activities in other major advanced economies and commodity exporting EMDEs (Figure 1). In May, the global manufacturing PMI edged down to 52.6 but remained above the long-run average of 51.4. In China, fixed asset investment and retail sales suggest that economic activity is expected to moderate in the second quarter of 2017. Financial markets in EMDEs remained buoyant in May; capital inflows remained robust, while bond spreads remained close to their lowest levels since September 2014 despite an uptick in second half of May. Bond issuance also continued at a fast clip in May, and corporate issuances continue to dominate bond market activity as EMDE companies take advantage of favorable borrowing costs to refinance existing debt.

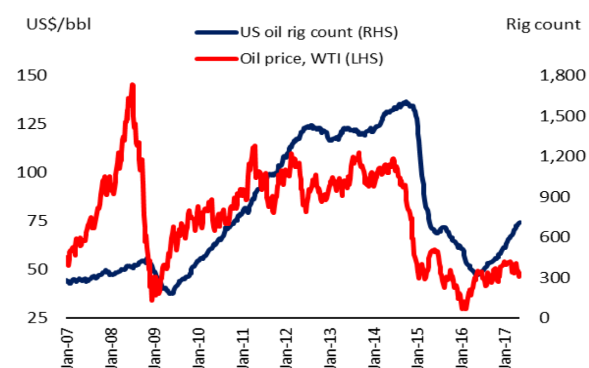
Figure 1: Global growth is temporarily moderating



Sources: Global Monthly, World Bank

In early June, oil prices pulled back after their post-May 25th gains. The oil price rebound, following the OPEC/non-OPEC extension of cuts by nine months, turned out to be short-lived. Oil prices dropped below the $50 mark in early June on the back of stubbornly high stocks and a quick response in supply by the U.S. shale oil sector (Figure 2). After bottoming out at 8.6 mb/d in September 2016 (down from a high of 9.6 mb/d in April 2015), U.S. crude oil production rose to 9.3 mb/d in April, and the U.S. oil rig count reached 733 in the first week of June, up from 316 a year ago. The Energy Information Administration expects U.S. crude production to reach 10.2 mb/d by the fourth quarter of 2018. The shale-driven rebound of U.S. crude oil production, coupled with weaker-than-expected OECD demand, has kept oil stocks in OECD countries at record highs. In the U.S. alone, which accounts for half of OECD crude stocks, oil stocks reached a record high of 542 million barrels in March 2017 (1.4 percent up from February and 6 percent higher than a year ago) according to the International Energy Agency.

Figure 2: Oil prices dropped below the $50 mark in early June

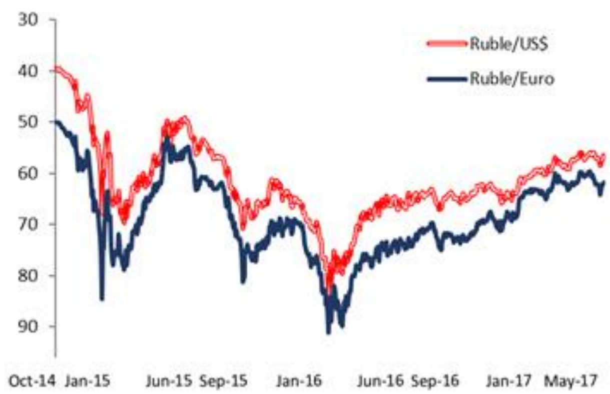


Source: Baker Hughes, Bloomberg.

Russia's Recent Developments

In May, lower oil prices resulted in the ruble depreciating (Figure 3). As oil prices decreased by 3.8 percent, the ruble depreciated by 1.1 percent with respect to the U.S. dollar to 56.95 Rub/USD.

Figure 3: The ruble depreciated in May

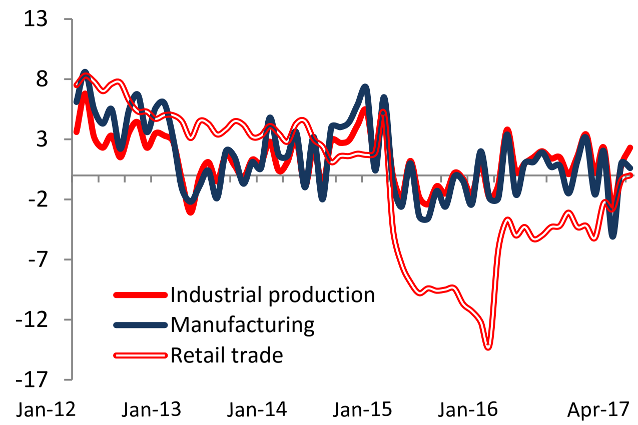


Source: CBR.

Fixed capital investment increased by 2.3 percent, y/y, in the first quarter of 2017, but it remained almost unchanged compared to the last quarter of 2016. According to data on large and medium enterprises, sectors such as transport, real estate, mineral resource extraction, and the financial sector contributed the most to fixed capital investment growth. Fixed capital investment in manufacturing continued contracting (-6.7 percent, y/y). Within manufacturing, fixed capital investment growth was uneven and expanded rapidly in some subsectors (textiles, clothing, wood products, and pharmaceuticals). After a low base in the first quarter of 2016, growth was registered in fixed capital investment of public sectors.

Economic activity in Russia demonstrated robust growth in April (Figure 4). The index of production in basic economic activities[1] grew by 3.1 percent, y/y, in the month of April compared to 1.3 percent in March. Out of six components, growth was registered in industrial production, transport, agriculture, and wholesale trade. In April, industrial production increased by 2.3 percent y/y, mainly supported by mineral resource extraction (+4.2 percent, y/y) and electricity and gas provisioning (+5.5 percent, y/y). Manufacturing recorded modest growth of 0.6 percent, y/y. The May PMI reading improved to 52.4 from a low of 50.8 in April, pointing to solid improvement of operating conditions in manufacturing.

Figure 4: Economic activity demonstrated robust growth in April



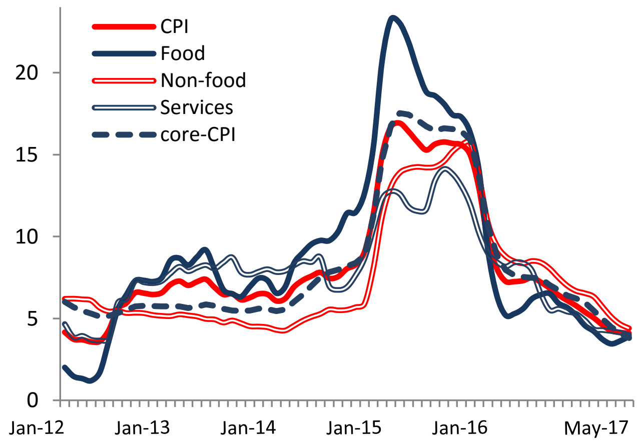
Source: Rosstat, Haver Analytics, World Bank team.

April's high frequency indicators indicate an incipient recovery in consumer demand. Retail trade stayed flat in April, and this represented the first non-negative reading since December 2014. Retail services declined by 1.3 percent in April compared to the same period a year ago, but they remained unchanged compared to March after seasonal adjustment.

Inflation stopped decelerating and remained unchanged in May, although food inflation picked up slightly (Figure 5). The 12-month Consumer Price Index (CPI) stayed at 4.1 percent in May, the same level as in April. While non-food and services inflation slightly decreased in annual terms compared to April, food inflation slightly accelerated. The The Core CPI index dropped from 4.1 percent, y/y, in April to 3.8 percent in May, indicating lower inflation pressures. On June 16, 2017, the Bank of Russia cut the key rate by 0.25 p.p. to 9 percent. The Central Bank noted that the slowdown of inflation has become more sustainable. Households inflation expectations touched a new record low in May. However, they stay elevated. The Central Bank named the external volatility, inertia of inflation expectations, possible fiscal policy revisions, fast consumption growth and labor shortages in some sectors as medium-term inflation risks. The next meeting of the Bank of Russia will be held on July 28, 2017.

[1] Agriculture, industrial production, construction, transport, retail and wholesale trade.

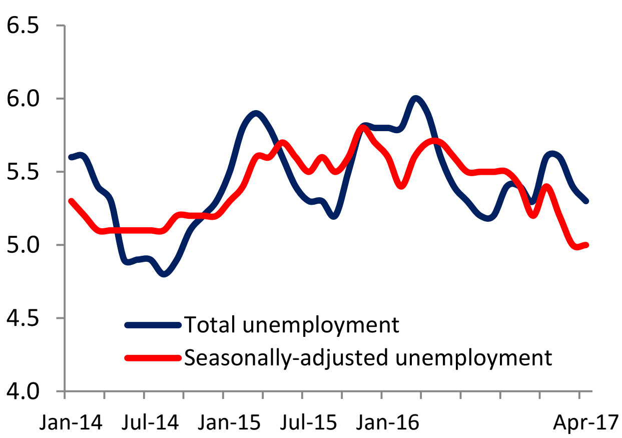
Figure 5: Consumer inflation remained slightly above the end-year target



Source: Rosstat, Haver Analytics, World Bank team.

Labor market indicators improved in April. The unemployment rate declined by 0.1 percentage points in April, reaching 5.3 percent, while the seasonally adjusted rate remained unchanged at 5 percent (Figure 6). Real wages continued to rise and increased by 2.5 percent in April compared to the same period in the previous year. Unexpectedly, real disposable incomes contracted by 7.6 percent in April compared to the same period in 2016, which could be partly attributed to the volatility of this indicator. Average contraction in real disposable incomes for the first four months of 2017 totaled 2.2 percent compared to the same period in 2016. Pensions were indexed in the beginning of February at the inflation rate, meaning that the real growth of pensions was close to zero.

Figure 6: The unemployment level remained unchanged in April



Source: Rosstat, Haver Analytics, World Bank team.

In the first four months of 2017, the federal budget primary deficit improved to 1 percent of GDP from 3.5 percent of GDP in the same period last year, benefitting from higher oil prices. In January – April 2017, the federal budget revenue stood at 17.6 percent of GDP, an increase of 2.5 percent of GDP compared to the same period last year, with oil revenues growing by 2.2 percent of GDP. Compared to the same period last year, primary expenditures increased marginally by 0.1 percent of GDP to 18.6 percent of GDP. While expenditures for social policy (+0.8 percent of GDP), national economy (+0.2 percent of GDP), and state management (+0.1 percent of GDP) increased, this was almost compensated for by a decrease in national defense (-0.7 percent of GDP), national security (-0.1 percent of GDP), and health (-0.2 percent of GDP). The non-oil primary deficit improved from 8.5 percent of GDP to 8.3 percent of GDP due to an increase in non-oil federal budget revenues (VAT and corporate income tax). Overall, the federal budget deficit narrowed to 1.9 percent of GDP from 4.4 percent of GDP last year.

The government submitted amendments to the 2017 federal budget law to the State Duma: these stipulate an increase in expenditures balanced by an increase in non-oil revenues, which is in line with the budget consolidation. If the State Duma approves these amendments, the budget will be based on slightly higher oil prices (US$45.6/bbl compared to US$40/bbl) and a higher growth rate of the economy (2 percent compared to 0.6 percent) than is stipulated in the current law. Budget revenues are projected to increase by Rub 1.2 trillion (1.3 percent of GDP), of which Rub 720 billion (0.8 percent of GDP) account for higher oil revenues. Expenditures would increase by Rub 362 billion (0.4 percent of GDP), which is slightly less than an increase in non-oil revenues. As a result, in 2017, the federal budget non-oil primary deficit would improve to 7.6 percent of GDP compared to 8.4 percent of GDP in 2016 and 7.7 percent of GDP as per the current law. The federal budget deficit would narrow to 2.1 percent of GDP compared to 3.4 percent of GDP in 2016 and 3 percent of GDP as per the current budget law. Adhering to budget consolidation is important for the government in the new norm of low oil prices (including with the changed response in structural oil supply in the global market, given the presence of the shale oil producers), and in light of its intention to introduce the new fiscal rule in the medium term.

Credit to households in rubles slightly picked up in April, providing support to consumer demand. Growth of lending in rubles to households accelerated to 5 percent in April, y/y, compared to 4 percent in March. Credit to firms in rubles remained subdued, having expanded in April by a marginal 1.3 percent, y/y, about the same rate as the previous month. Credit to firms in foreign currency decreased by 10 percent in April, y/y, compared to a reduction by 13.7 percent, y/y, in March.

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