Russia Monthly Economic Developments

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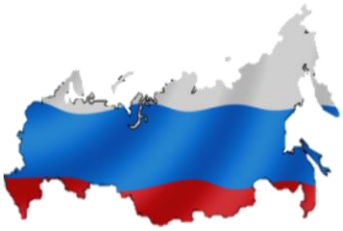
Global growth was solid in the third quarter of 2018, but it appears to be moderating. EMDEs have been under renewed financial pressure amid the strengthening of the U.S. dollar, higher borrowing costs, and concerns about softening growth prospects. Crude oil prices continued rising at the beginning of October, with the price of Brent exceeding US$86/bbl due to ongoing concerns about the impact of U.S. sanctions on Iranian oil exports. However, oil prices have since declined, with Brent dropping to around US$80/bbl on the back of both demand and supply news. The ruble exchange rate strengthened by the end of September, supported by the Central Bank's decision to raise the policy rate and to suspend currency interventions in the fiscal rule framework amidst relatively high oil prices. In the third quarter of 2018, net capital outflows from Russia's private sector increased as a result of elevated geopolitical tensions and turbulence in emerging markets. At the same time, net FDI inflows decreased, reflecting reduced interest of foreign investors in Russian assets as well as a possible restructuring of companies to shield themselves from the potential expansion of sanctions. The trend of rising consumer price inflation in Russia continued in September, though it remained below the target level of 4 percent in annual terms. In the first eight months of 2018, Russia's federal budget balance strengthened, aided by higher oil revenues and lower expenditures. In the beginning of October, the increase of the pension age was adopted as federal law. Key credit risk and performance indicators have been largely stable in September, and lending growth continues to both the retail and corporate segments.

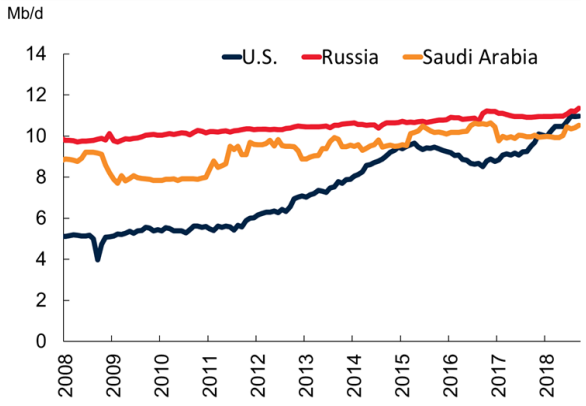
The Global Context



Global growth in the third quarter of 2018 was solid, but it appears to be decelerating and is likely to have moderated compared to the second quarter. The U.S. economy is expected to continue growing at a rapid pace, but signs of a slowdown are becoming more apparent in the Euro Area, China, and in many EMDEs. The latter have been under renewed financial pressure amid the strengthening of the U.S. dollar, higher borrowing costs, and concerns about softening growth prospects.

Increasing OPEC production: Crude oil prices rose 6 percent in September and continued rising at the start of October, with the price of Brent exceeding US$86 per barrel (bbl) on October 3rd and the price of WTI reaching US$76/bbl. The increase in prices have been spurred by ongoing fears about the impact of U.S. sanctions on Iranian oil exports, with exports falling to 1.6 million barrels per day (mb/d) in September from 2.4 mb/d in April. However, oil prices have since declined, with Brent dropping to around US$80/bbl on the back of both demand and supply news. OPEC and the International Energy Agency both revised down their forecasts for oil demand growth in 2018 and 2019, citing weaker economic outlook, uncertainty caused by trade tensions, and higher oil prices. In terms of supply, production among OPEC countries rose by 100 kb/d in September to a one-year high of 32.8 mb/d, while production in Russia rose to an all-time high, reaching 11.4 mb/d, an increase of 450kb/d relative to the same month in 2017 (Figure 1).

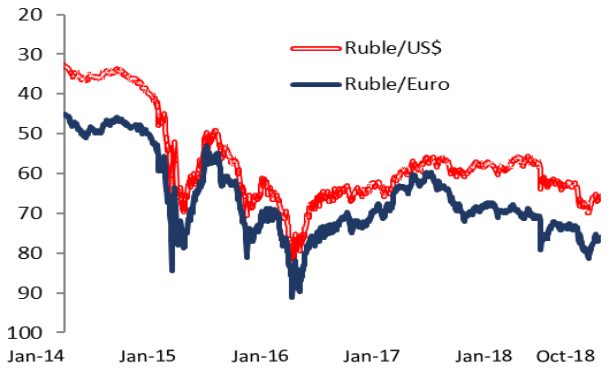
Figure 1: In September, Russian oil production rose to an all-time high



Russia's Recent Developments

The ruble exchange rate strengthened by the end of September, supported by the Central Bank's decision to raise the policy rate and suspend currency interventions in the fiscal rule framework amidst relatively high oil prices (Figure 2). By the end of September, the ruble exchange rate strengthened by 3.3 percent, compared to the end of August. Meanwhile, due to the ruble's depreciation in the beginning of the month, the average ruble exchange rate depreciated in September by 2.6 percent, m/m. In the beginning of October, Russia's five-year USD Credit Default Swaps fell to 143.16 basis points (bps) from 179.8 bps in the beginning of September.

Figure 2: By the end of September, the ruble appreciated with respect to the U.S. dollar

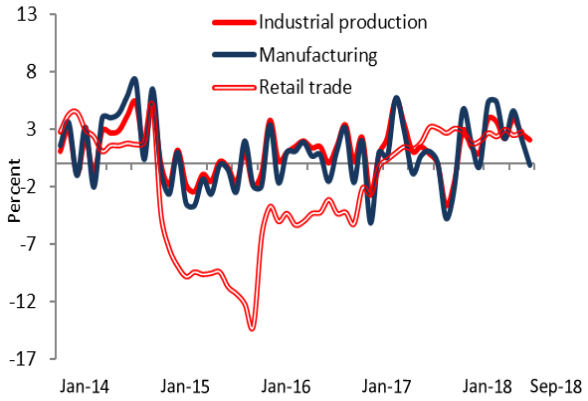


Source: CBR.

In the third quarter of 2018, Russia's current account surplus strengthened to US$26.4 billion, up from the US$3.2 billion deficit in the same period last year, due to higher oil prices, a weaker ruble, and sluggish domestic demand. The value of exports, mostly oil and gas, increased on the back of higher energy prices. The value of goods imported decreased by 1.3 percent, y/y, in the third quarter of 2018 compared to a robust growth of 13 percent, y/y in the first half of 2018. This was due to the weaker ruble and sluggish domestic demand. As a result, Russia's trade surplus increased by US$26 billion, supporting the current account. Due to elevated geopolitical tensions and turbulence in emerging markets, net capital outflows from the private sector surged to US$19.4 billion in the third quarter of 2018 compared to US$2.1 billion in the same period last year. Net FDI inflows in Russia decreased by US$6.1 billion (compared to an increase of US$8.3 billion in the same period last year), reflecting reduced interest of foreign investors in Russian assets as well as some possible restructuring of companies in order to shield themselves from the expansion of potential sanctions. In the period July – September 2018, international reserves rose by US$4.7 billion (compared to US$11.5 billion in the second quarter of 2018) as the Central Bank suspended FX currency interventions in the fiscal rule framework in August.

Industrial production growth softened in September with manufacturing growth registering a negative reading (Figure 3). In September, industrial production growth totaled 2.1 percent, y/y, compared to 2.7 percent, y/y, in August. Meanwhile, the level of industrial production output increased by 0.2 percent, sa, as compared to August. Mineral resource extraction (6.9 percent, y/y, in September, compared to 4.5 percent, y/y, in August) was driving industrial production growth. Oil production accelerated due to the easing of the agreed OPEC+ production cuts, and gas production continued to grow in September. Services in mineral resource extraction also supported this growth. In September, manufacturing output declined in annual terms (-0.8 percent, y/y), representing the first negative reading in 2018. This contraction was partly due to a base effect and fewer working days in September 2018 compared to September 2017. Detailed statistics are not yet available but data on production of major goods suggests a possible continued negative contribution from metallurgical production.

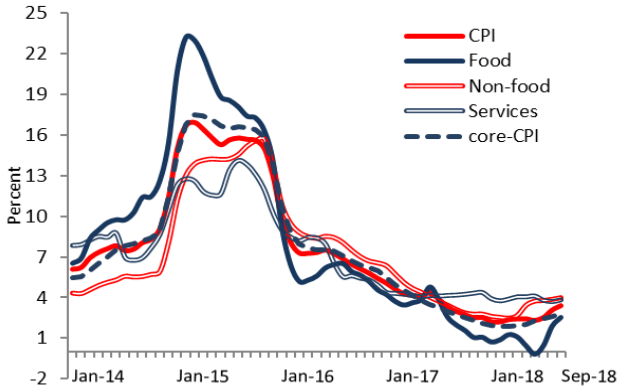
Figure 3: Industrial production growth softened in September



Source: Rosstat, Haver Analytics, World Bank team.

The trend of rising consumer price inflation continued in September though it stayed below the target level of 4 percent in annual terms. In September, the 12-month Consumer Price Index (CPI) increased to 3.4 percent, y/y, from 3.1 percent, y/y, in August (Figure 4). Consumer inflation in annual terms accelerated for all categories (food, non-food items, and services), with food inflation contributing the most to the acceleration. In the food category, prices for eggs, meat, and fish increased the most in annual terms. In terms of non-food items, the growth in prices for tobacco and gasoline was the largest. Meanwhile, lower excise taxes on gasoline (since June 1, 2018) helped to stabilize the growth in gasoline prices (0.1 percent, m/m). The 12-month core inflation rate increased from 2.6 percent, y/y, in August to 2.8 percent, y/y, in September. Households' annual consumer inflation expectations edged up to 10.1 percent in September from 9.9 percent in the previous month on the back of the ruble's depreciation and elevated uncertainty.

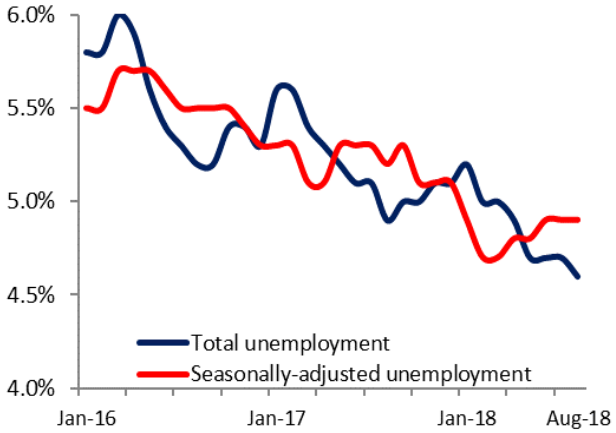
Figure 4: The rising trend of consumer price inflation continued in September



Source: Rosstat, Haver Analytics, World Bank team.

Labor market dynamics were stable in August 2018. The unemployment rate decreased marginally to 4.6 percent in August from 4.7 percent in the previous month. This decline was mostly driven by seasonal factors. The seasonally adjusted rate did not change and remained at the level of 4.9 percent (Figure 5). Real wages continued to grow, increasing in August by 7 percent compared to the same period in the previous year, and by 0.7 percent compared to July 2018 after seasonal adjustment. In August, real disposable incomes declined by 0.9 percent compared to the same period in 2017, but they increased by 1 percent compared to July 2018 after seasonal adjustment. This indicator is very volatile and is driven to a large extent by sources of income that are not registered by statistics. Pensions were indexed in the beginning of the year and they increased by 0.3 percent in August compared to the same period a year ago.

Figure 5: Labor market dynamics were stable in August



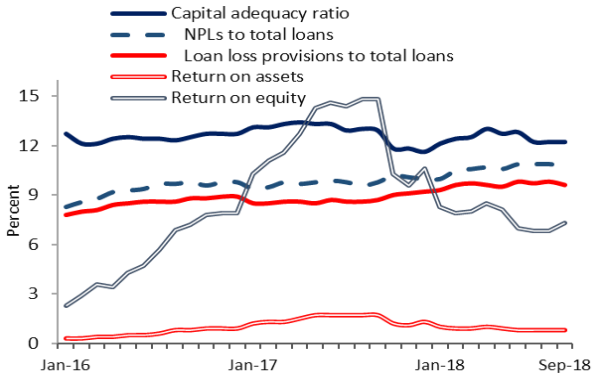
Source: Rosstat, Haver Analytics, World Bank team

From January – August 2018, aided by higher oil revenues and lower expenditures, the federal budget primary surplus strengthened to 4 percent of GDP, up from a 0.2 percent GDP primary surplus in the same period last year.[1] While higher oil prices and the ruble's depreciation prompted an increase in federal budget oil revenues, from 6.6 percent of GDP in January – August 2017 to 8.6 percent of GDP in January – August 2018, non-oil revenues increased by 0.3 pp to 10.5 percent of GDP. Federal budget primary expenditures decreased from 16.5 percent of GDP in January – August 2017 to 16.2 percent of GDP in January – August 2018, and this was mainly due to lower spending on social policy (resulting from the one-off pension payments in January 2017) and lower spending on the national economy. The overall federal budget stance improved from a 0.6 percent GDP deficit in January — August 2017 to a 3.1 percent GDP surplus in the January — August 2018 period. The general government budget stance strengthened from a 0.7 percent GDP deficit in January – July 2017 to a 2.6 percent GDP surplus in January – July 2018. In the beginning of October, the federal law on the increase in the pension age was adopted. As a result, the retirement age would gradually increase by five years – to 65 years for men and to 60 years for women—starting in 2019 and ending in 2027/2028. Additionally, the law suggests an increase in the eligibility age for social pensions (though this excludes indigenous groups from the Far North), survivor's pensions, and mandatory length of service for selected categories of workers qualified for early retirement. In the medium to long term, this reform will increase the average retirement age and increase the potential growth rate of the economy. In addition, it would reduce transfers from the federal budget to the Pension Fund.

Key credit risk and performance indicators have been largely stable in September (Figure 6). As of September 1st, the capital adequacy ratio stood at 12.2 percent (against a regulatory minimum of 8 percent). The non-performing loan ratio has slightly decreased, standing at 10.8 percent compared to 10.9 percent in the previous month. For the first nine months of 2018, the banking sector's profit amounted to 1,068 billion rubles, significantly exceeding the result of the same period last year, which amounted to 675 billion rubles. 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). The return on assets (ROA) has stabilized at the level of 0.8 percent while the return on equity (ROE) increased to 7.3 percent in August compared to 6.8 percent in the previous month.

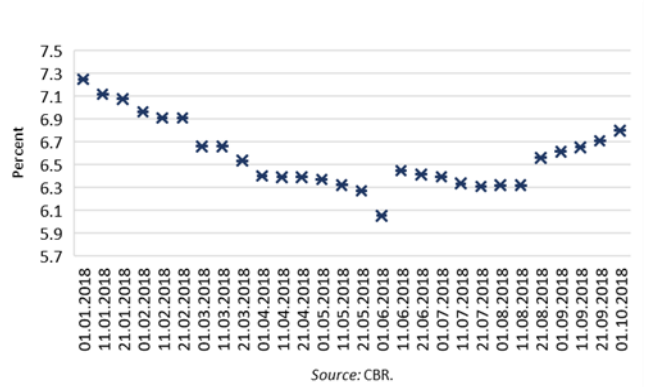
[1] *On a cash basis.*

Figure 6: Key credit risk and performance indicators remained largely stable in September



Source: CBR.

Figure 7: The top ten credit institutions attracting the largest amount of household deposits[2] showed upward dynamics of the maximum interest rate (ruble deposits)



Source: CBR.

Lending growth continued to both the retail and corporate segments. In September, credit to households in rubles grew by 22 percent, y/y. The growth was predominantly driven by unsecured loans and mortgage loans. Credit to the corporate sector in rubles also increased, by 8.4 percent, y/y. Retail deposits have been moderately decreasing since August 2018 - by 0.6 percent, m/m, and 0.8 percent, m/m, in August and September, respectively. Banks began increasing the retail deposit rates in anticipation and following a recent 25 bps increase in the CBR key policy rate (Figure 7). This may indicate a reversal of a prior trend of declining deposit rates and a likelihood that banks' funding costs will increase through the remainder of 2018. In August – September, corporate deposits in rubles increased by 0.5 percent, m/m, and 1.6 percent, m/m, respectively. This could be due to a conversion of some USD-denominated deposits into rubles.

The CBR continues its clean-up of the banking sector by removing insolvent banks. From January – October 1, 2018, 53 banks had their licenses revoked for failing to comply with regulations.

[2] *Sberbank, VTB, Rosagrobank, Alfa-Bank, Gazprombank, Otkritie, B&N, Raiffeisen, Credit Bank of Moscow, and Sovcombank.*

Main Economic Indicators

Output Indicators	2017	2018								
		Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sept
GDP, % change, y-o-y	**1.5**	-	-	1.3	-	-	1.9	-	-	-
Basic sectors, % change, y-o-y	**2.4**	2.3	2.7	1.9	3.7	3.7	1.5	2.8	1.1	-
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
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
Retail trade	**1.3**	2.9	2.0	2.2	2.9	2.6	3.3	2.7	2.8	2.2
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
Construction, % change,y-o-y	**-1.4**	0.2	-0.2	-9.7	1.4	5.6	-1.3	-0.7	-0.8	0.1
Fiscal and Monetary Indicators										
Federal government balance, % GDP	**-0.6**	2.8	1.6	1.8	0.9	1.4	2.0	2.6	-	-
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
Inflation expectations, %, y-o-y	**10.3**	8.9	8.4	8.5	7.8	8.6	9.8	9.7	9.9	-
Balance of Payment Indicators										
Trade Balance, billion $ (monthly)	**115.4**	17.0	12.2	15.0	15.3	15.1	15.6	13.4	-	-
Current Account, billion $	**35.4**	12.8	20.8	28.8	41.0	49.9	53.2	60.7	69.0	-
Export of goods, billion $	**353.5**	33.4	31.2	36.9	36.2	36.5	36.6	34.4	-	-
Import of goods, billion $	**238.1**	16.4	19.0	21.9	20.9	21.4	21.0	21.0	-	-
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
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
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
Capital adequacy ratio	**11.6**	12.1	12.4	12.5	13.0	12.7	12.8	12.2	12.2	12.2
NPLs to total loans	**10.0**	10.0	10.5	10.6	10.7	10.6	10.9	10.9	10.9	10.8
Loan loss provisions to total loans	**9.2**	9.3	9.6	9.7	9.6	9.5	9.8	9.7	9.8	9.6
Return on assets (ROA)	**1.3**	1.0	0.9	0.9	1.0	0.9	0.8	0.8	0.8	0.8
Return on equity (ROE)	**10.6**	8.3	7.9	8.0	8.5	8.1	7.0	6.8	6.8	7.3
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	8.0	7.0	-
Unemployment (%, ILO definition)	**5.1**	5.2	5.0	5.0	4.9	4.7	4.7	4.7	4.6	-
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
Euro/ RUB, average	**65.8**	69.0	70.3	70.4	74.2	73.7	73.2	73.4	76.2	79.0
Oil price										
Brent, $/ bbl	**54.4**	69.0	65.4	66.5	71.6	76.7	75.2	74.4	73.1	78.9

Source: Rosstat, CBR, EEG, IMF, WB staff estimates.

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