# Russia Monthly Economic Developments

October 2019

THE WORLD BANK
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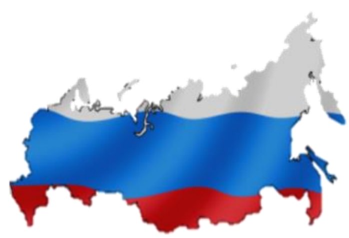
*Global economic growth continues to decelerate, falling to an estimated 2.3 percent, quarter-on-quarter, seasonally adjusted annualized rate (q/q saar), in 19Q2, amid weak industrial production and goods trade growth. Crude oil prices remained subdued in October, following a short-lived spike in September in the aftermath of the attack on oil facilities in Saudi Arabia. In September, the ruble outperformed most emerging market currencies supported by softer global conditions and the brief oil price spike. A lower trade balance narrowed Russia's current account surplus in the third quarter of 2019 to US$12.9 billion (2.9 percent of GDP) from US$27.4 billion (6.6 percent of GDP) in the same period last year. Economic activity growth was robust in September, as growth in agriculture accelerated after a good harvest, while growth in construction picked up slightly after a period of stagnation. Labor market dynamics were positive in August 2019. Consumer inflation continued its downward trend in September amidst weak consumer demand, reaching the target level of 4 percent. On 25 October 2019, in view of rapid consumer inflation slowdown and decreasing inflation expectations, the Bank of Russia decided to cut* the key rate *by 50 bp to 6.50 percent in annual terms. In January – September of 2019, the federal budget surplus improved to 3.8 percent of GDP (cash basis), up from 3.5 percent of GDP in the same period last year, supported by stronger non-oil and gas revenues and lower interest spending. The non-oil/gas federal budget primary deficit reached 3.1 percent of GDP, compared to a deficit of 4.2 percent of GDP in the same period last year, indicating a weaker fiscal impulse to the economy. In August, growth in both retail and corporate segments somewhat slowed. The Central Bank of Russia (CBR) continues to remove insolvent banks, albeit at a slower pace, indicating that the sector cleanup has largely been accomplished. Key credit risk and performance indicators remained stable.*

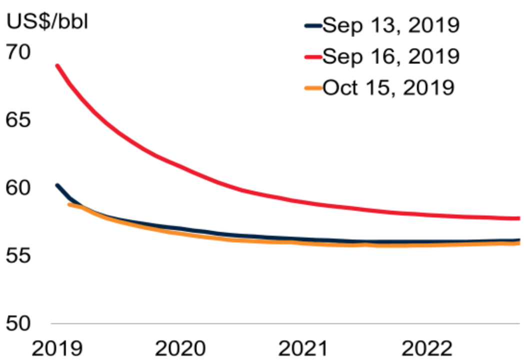
## The Global Context

**Global economic growth continues to decelerate, falling to an estimated 2.3 percent, q/q saar, in 19Q2, amid weak industrial production and goods trade growth.** Global manufacturing PMI continues to contract, albeit less severely, reflecting sustained weakness in the Euro Area, as well as in new export orders, particularly in Emerging Markets and Developing Economies. While much of the deterioration in activity had remained contained to the manufacturing sector, there are tentative signs that services activity is also slowing, with falling consumer confidence pointing to continued weakness in 19Q4. Global goods trade continued to contract in July amid elevated policy uncertainty, with manufacturing weakness spilling into services export orders, which registered a second consecutive month of contraction in September. Headline global inflation continued to moderate in 19Q3, reflecting subdued energy prices. Industrial activity remains anemic in the Euro Area and economic sentiment has fallen below 100 in Germany—the first time since the global financial crisis. In China, data are mixed, but generally point to slowing activity.



**Crude oil prices remained subdued in October, following their short-lived spike in September in the aftermath of attacks on oil facilities in Saudi Arabia.** The price of Brent crude oil peaked at US$69/bbl on September 16, the day after the attacks, but has since fallen steadily and averaged US$59/bbl over the first half of October. Production in Saudi Arabia was fully restored by the end of September, such that the fall in production over the month as a whole relative to August was 0.8 million barrels per day (mb/d), significantly smaller than the initial disruption of 5.7mb/d. The impact of the attack was also muted by high levels of oil inventories—OECD inventories are estimated at 4.5 billion barrels according to International Energy Agency, or about 45 days of global demand, and Saudi Arabia used its own inventories to meet existing orders. Despite the magnitude of the attack, long-term futures prices have not risen, indicating markets have not priced in an additional geopolitical risk premium (Figure 1). This may be because the geopolitical risk premium priced into oil futures prices is very small, and has not risen substantially. However, it may also be that other factors are dominating. New supply coming onstream (e.g. in Brazil, Norway, and the United States) together with worries about slowing oil demand growth, may be overshadowing any concerns of geopolitically-driven supply disruptions.

**Figure 1: Oil prices spiked in the beginning of September**

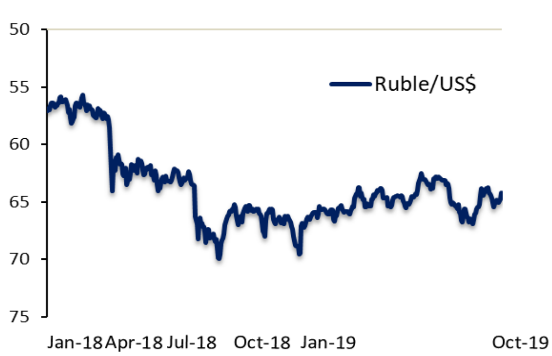



*Source:* Bloomberg.

## Recent economic developments

**In September, the ruble outperformed most emerging market currencies.** Softer global conditions were conducive to emerging market currencies, including the ruble. In addition, the ruble was supported by a brief spike in oil prices in the aftermath of the attack on oil facilities in Saudi Arabia. As a result, the ruble outperformed most emerging market currencies, rising 0.6 percent with respect to the US dollar (Figure 2). The MSCI International Emerging Market Currency Index rose 0.3 percent in September (on average), after having declined 3.3 percent in the previous month. Yet, the ruble overall lost 0.2 percent with respect to the US dollar in the first three quarters of 2019.

**Figure 2: In September, the ruble appreciated with respect to the US dollar**

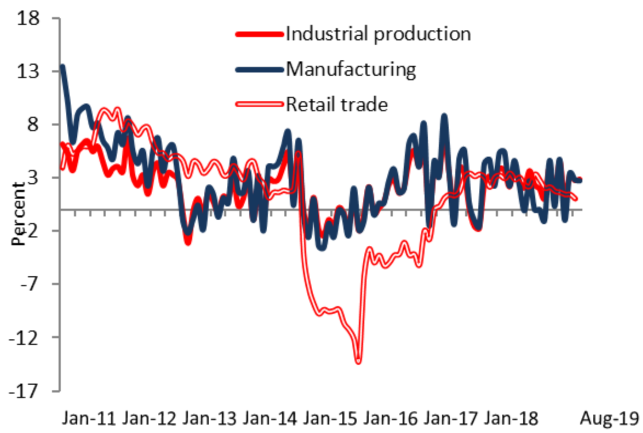



*Source:* CBR.

**A lower trade balance narrowed Russia's current account surplus in the third quarter of 2019 to US$12.9 billion from US$27.4 billion in the same period last year.** The trade balance surplus weakened as energy prices declined (oil prices fell 18.1 percent in 19Q3 compared to 18Q3) and global economic growth softened. Meanwhile, in volume terms, export of crude oil grew in August, after exports through the Druzhba pipeline, halted due to contamination, were resumed. After a drop in the first and second quarters, in the third quarter of 2019, non-oil/gas export value increased by 6.5 percent, y/y, supported by growth in export of machines and equipment, iron ore, and grains. The private sector registered a net capital outflow of US$1.3 billion, compared to US$19 billion in the same period last year, when geopolitical tensions and tightening in the advanced economies put pressure on Russia's capital outflows. Capital inflow in the state sector continued, although OFZ purchases in the secondary market slowed substantially in the third quarter, due to the easing of monetary conditions in Russia. International reserves rose by US$16 billion, mainly based on currency purchases in the fiscal rule framework. The current account surplus registered US$57.2 billion in the first three quarters of 2019, down from US$75.1 billion in the same period last year. From January – September, the real effective exchange rate appreciated by 1.3 percent compared to the same period last year.

**Economic activity growth was robust in September.** The agricultural sector expanded by 5.6 percent, y/y, after a good harvest. Industrial production grew by 3 percent, y/y (flat on m-o-m basis). Despite slightly negative growth of crude oil extraction (-0.1 percent, y/y), following the OPEC+ agreement, mineral resource extraction grew by 2.5 percent, y/y, supported by natural gas production and mineral resource extraction services. Manufacturing production rose by 3.2 percent, y/y, supported by manufacturing of computers and optical equipment, food products, chemicals, and metal products. Construction growth strengthened in September (0.8 percent, y/y, compared to 0.3 percent, y/y, in August). Consumer demand indicators remained subdued. Retail sales registered growth of 0.8 percent, y/y, compared to 0.7 percent, y/y, in August, with sales of goods in retail markets and fairs declining by 6.9 percent, y/y (Figure 3).

**Figure 3: Retail trade growth remained subdued in September**

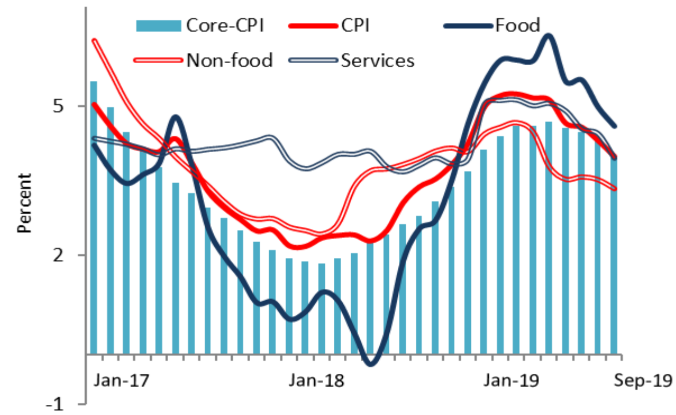



*Source:* Rosstat, Haver Analytics, World Bank team.

**Consumer inflation continued its downward trend in September amidst weak consumer demand.** The 12-month consumer price inflation dropped to 4 percent in September, down from 4.3 percent in August. The 12-month food inflation deceleration contributed the most to the decrease in headline consumer price inflation, along with a slowdown in the consumer price index for services as compared to August (Figure 4). Core consumer price inflation dropped to 4 percent in September, down from 4.3 percent in August. Current consumer inflation dynamics suggest that in December the consumer price index could reach below 4 percent in annual terms.

**On 25 October 2019, in view of rapid consumer inflation slowdown and decreasing inflation expectations, the Bank of Russia decided to cut the key rate by 50 basis points to 6.50 percent in annual terms.** The Bank of Russia lowered its annual inflation forecast to 3.2–3.7 percent from 4.0–4.5 percent in 2019 and to 3.5–4.0 percent in 2020. According to the Bank of Russia, disinflationary risks exceed pro-inflationary risks over the short-term horizon due to weak domestic and external demand. Yet, more pronounced global economic slowdown could lead to strengthened volatility in global commodity and financial markets, affecting exchange rate and inflation expectations. In the medium - term, pro-inflationary risks are posed by elevated and unanchored inflation expectations. Inflation dynamics may also be affected by fiscal policy parameters, including decisions on the investment of the liquid part of the National Wealth Fund in excess of the threshold level set at 7 percent of GDP.

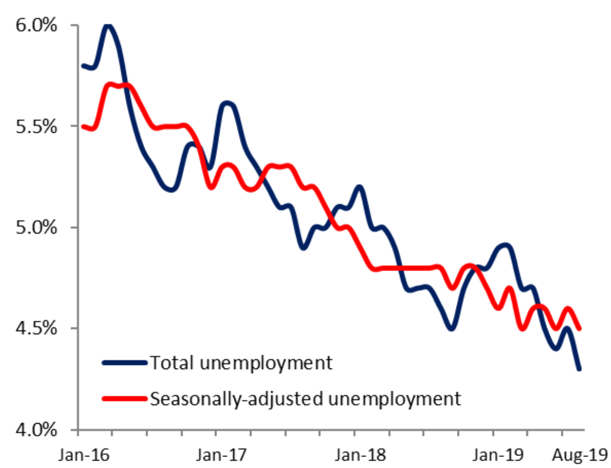
**Figure 4: Consumer price inflation slowed down in September and reached the target level**




*Source:* Haver Analytics.

**Labor market dynamics were positive in August 2019.** The unemployment rate decreased by 0.2 percentage points to 4.3 percent in August 2019. The seasonally adjusted rate decreased only by 0.1 percentage point and reached 4.5 percent (Figure 5). Real wages increased by 1.7 percent in August 2019, compared to August 2018, and by 0.6 percent, compared to July 2019, after seasonal adjustment. Pensions grew by 1.7 percent in real terms.

**Figure 5: The unemployment rate decreased in August**




*Source:* Rosstat, Haver Analytics, World Bank team

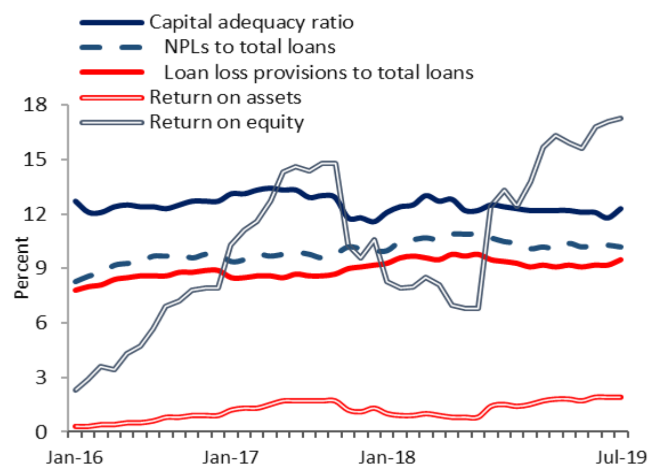
**In January – September 2019, the federal budget surplus improved to 3.8 percent of GDP (cash basis), up from 3.5 percent of GDP in the same period last year.** This came on the back of stronger non-oil and gas revenues and lower interest spending. Non-oil/gas revenues grew to 11.5 percent of GDP in the January – September 2019 period compared to 10.4 percent of GDP in the same period last year. This was largely the result of a VAT rate increase of 2 percentage points, higher non-tax receipts, and a weaker ruble. Oil and gas revenues dropped to 7.6 percent of GDP, from 8.5 percent of GDP in the same period last year, as the weaker ruble was unable to offset lower energy prices. Primary expenditures increased by 0.2 percent of GDP. Spending on defense, environment, housing services, and utilities each grew by 0.1 percent of GDP, while spending on social policy, national economy, and national security each declined by 0.1 percent of GDP. Higher non-oil/gas revenues led to an improved non-oil/gas federal budget primary deficit, which reached 3.1 percent of GDP, compared to deficit of 4.2 percent of GDP in the same period last year. In January - August 2019, the general government balance improved to 5.8 percent of GDP, up from 4.7 percent of GDP in the same period last year.

**In August, growth in both retail and corporate segments slowed slightly, yet the retail sector continued to grow at a high rate.** As of September 1, 2019, credit to households in rubles grew by 21.3 percent, y/y, compared to 22 percent in July. Credit to the corporate sector grew by 5 percent (after adjusting for FX changes) compared to 5.7 percent, y/y, in the previous month. To moderate growth in the retail sector, especially in its riskiest segments, the CBR introduced new macroprudential measures aimed at slowing down unsecured consumer lending. Effective as of October 1, 2019, all banks and microfinance organizations are obliged to calculate debt-to-income (DTI) ratio on all consumer loans above RUB 10,000 (US$150). The higher the DTI ratio and effective interest rate on a loan, the greater risk weight surcharge is to be applied to such loans.

**Key credit risk and performance indicators remained stable (Figure 6).** As of August 1, 2019, the capital adequacy ratio stood at 12.3 percent (against a regulatory minimum of 8 percent). The non-performing loan ratio slightly decreased to 10.2 percent from 10.3 percent in the previous month. In January - August 2019, the banking-sector's profit amounted to RUB 1354 billion (US$20.8 billion) compared to RUB 901 billion (US$14.9 billion) in the same period of 2018. Return on assets (ROA) and return on equity (ROE) have been growing. As of August 1, 2019, the ROA and the ROE reached 1.9 percent and 17.3 percent, respectively, compared to 1.5 percent and 13.8 percent, respectively, in the beginning of the year.

**The CBR continues to remove insolvent banks, albeit at a slower pace, indicating that the sector cleanup has largely been accomplished.** The number of banks in Russia has fallen from 484 at the beginning of 2019 to 455 as of September 1, 2019.

**Figure 6: Key credit risk and banking performance indicators remained stable in July**




Source: CBR.

| Main Economic Indicators | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | 2018 | 2019 | | | | | | | | |
| Output Indicators | | Jan | Feb | Mar | Apr | May | Jun | Jul | Aug | Sep |
| GDP, % change, y-o-y | **2.3** | - | - | 0.5 | - | - | 0.9 | - | - | |
| Basic sectors, % change, y-o-y | **2.9** | 0.3 | 2.3 | 0.2 | 2.9 | -0.3 | 2.0 | 2.5 | 2.2 | |
| Industrial production, % change, y-o-y | **2.9** | 1.1 | 4.1 | 1.2 | 4.6 | 0.9 | 3.3 | 2.8 | 2.9 | 3.0 |
| Manufacturing, % change, y-o-y | **2.6** | -1.0 | 4.6 | 0.3 | 4.7 | -1.0 | 3.4 | 2.8 | 2.7 | 3.2 |
| Retail trade | **2.6** | 2.0 | 2.1 | 1.7 | 1.6 | 1.4 | 1.4 | 1.0 | 0.7 | 0.8 |
| Extraction of mineral resources, % change, y-o-y | **4.1** | 4.8 | 5.1 | 4.3 | 4.2 | 2.8 | 2.8 | 3.0 | 3.1 | 2.5 |
| Construction, % change,y-o-y | **5.3** | 0.1 | 0.3 | 0.2 | 0.0 | 0.2 | 0.1 | 0.2 | 0.3 | 0.8 |
| Fiscal and Monetary Indicators | | | | | | | | | | |
| Federal government balance, % GDP | **2.6** | 4.8 | 2.0 | 2.2 | 2.1 | 2.7 | 3.1 | 3.4 | 3.7 | 3.8 |
| Inflation (CPI), %, y-o-y | **2.9** | 5.0 | 5.2 | 5.3 | 5.2 | 5.1 | 4.7 | 4.6 | 4.3 | 4.0 |
| Inflation expectations, %, y-o-y | **10.2** | 10.4 | 10.1 | 9.1 | 9.4 | 9.3 | 9.4 | 9.4 | 9.1 | 8.9 |
| Balance of Payment Indicators | | | | | | | | | | |
| Trade Balance, billion $ (monthly) | **194.5** | 14.4 | 16.5 | 16.0 | 14.6 | 12.3 | 12.7 | 11.2 | 11.2 | |
| Current Account, billion $, ytd | **113.8** | 10.3 | 22.7 | 33.7 | 45.5 | 48.7 | 45.8 | 51.4 | | 57.2 |
| Export of goods, billion $ | **443.4** | 30.8 | 34.7 | 37.0 | 36.7 | 32.2 | 32.8 | 33.4 | 33.4 | |
| Import of goods, billion $ | **249.0** | 16.4 | 18.2 | 21.0 | 22.1 | 20 | 20 | 22.2 | 22.2 | |
| Financial Market Indicators | | | | | | | | | | |
| CBR policy rate, %, end-o-p | **7.75** | 7.75 | 7.75 | 7.75 | 7.75 | 7.75 | 7.5 | 7.25 | 7.25 | 7.0 |
| Credit to households in Rub, % change, y-o-y | **22.6** | 23.2 | 23.6 | 23.7 | 24.0 | 23.5 | 23.0 | 22.0 | 21.3 | |
| Credit to the corporate sector in Rub, % change, y-o-y | **12.0** | 12.3 | 12.1 | 12.3 | 11.4 | 11.8 | 11.6 | 10.7 | 10.2 | |
| Capital adequacy ratio | **12.2** | 12.2 | 12.2 | 12.2 | 12.1 | 12.1 | 11.8 | 12.3 | 12.4 | |
| NPLs to total loans | **10.1** | 10.2 | 10.1 | 10.4 | 10.2 | 10.3 | 10.3 | 10.2 | 10.1 | |
| Loan loss provisions to total loans | **9.1** | 9.2 | 9.1 | 9.2 | 9.1 | 9.2 | 9.2 | 9.2 | 9.2 | |
| Return on assets (ROA) | **1.5** | 1.7 | 1.8 | 1.8 | 1.7 | 1.9 | 1.9 | 1.9 | 2 | |
| Return on equity (ROE) | **13.8** | 15.7 | 16.3 | 15.9 | 15.6 | 16.8 | 17.1 | 17.3 | 17.7 | |
| Income, Poverty and Labor Market | | | | | | | | | | |
| Real wages, % change, y-o-y | **7.0** | 1.1 | 0.0 | 2.3 | 3.1 | 1.6 | 2.9 | 3 | 3 | |
| Unemployment (%, ILO definition) | **4.8** | 4.9 | 4.9 | 4.7 | 4.7 | 4.5 | 4.4 | 4.5 | 4.3 | |
| Exchange rate | | | | | | | | | | |
| USD/ RUB, average | **62.5** | 67.3 | 65.86 | 65.14 | 64.62 | 64.82 | 64.22 | 63.2 | 65.53 | 64.98 |
| Euro/ RUB, average | **73.9** | 76.9 | 75.78 | 73.75 | 72.61 | 72.51 | 72.43 | 70.99 | 72.88 | 71.61 |
| Oil price | | | | | | | | | | |
| Brent, $/ bbl | **71.1** | 59.3 | 64.1 | 66.4 | 71.2 | 70.5 | 63.3 | 64.0 | 59.3 | 62.3 |
| *Source: Rosstat, CBR, EEG.* | | | | | | | | | | |

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