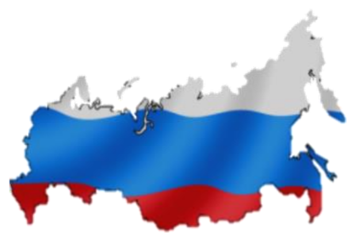
Russia Monthly Economic Developments

June 2019

Global growth continues to be dampened by weak industrial activity. The prices of most industrial commodities fell in May with the downward trend continuing into June. Oil prices fell sharply, the price of Brent crude oil fell from $72/bbl in mid-May to $60/bbl in early June. The ruble average exchange rate reached 64.8 against the U.S. dollar, weakening by 0.3 percent in May compared to the previous month. In the period January – May 2019, the current account surplus strengthened compared to the same period last year, due to the stronger trade balance and balance of services. Net private capital outflows increased, supported by the higher net foreign assets acquisition both by banking and non-banking sectors. Economic growth gained momentum in April, supported mainly by an increase in industrial production. Labor market dynamics were mixed in April. In May, the 12-month consumer price inflation dropped slightly to 5.1 percent, down from 5.2 percent in April. Inflation expectations remain elevated. On June 14, the Central Bank cut the policy rate by 25 bp to 7.5 percent in annual terms. On the back of stronger non-oil revenues, the federal budget surplus improved to 2.1 percent of GDP in the first four months of 2019, up from 0.9 percent of GDP in the same period last year.The trend towards growth in both retail and corporate segments credits continued in April. Further, key credit risk and performance indicators remained largely stable.

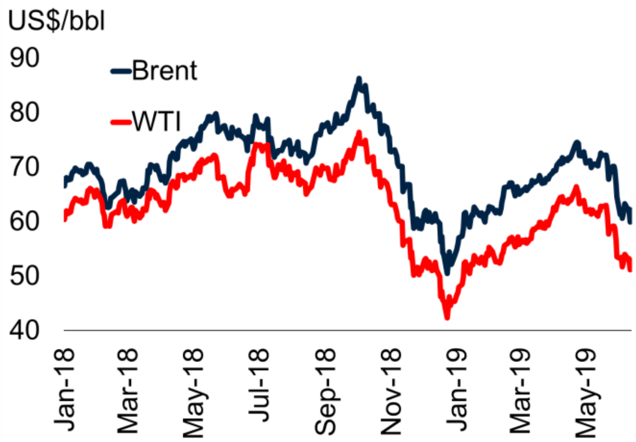


The Global Context

Global growth continues to be dampened by weak industrial activity. The slowdown has been broad-based. In nearly a quarter of countries, industrial production experienced a technical recession in the first three months of 2019—this is triple the number of countries compared to the start of 2018. Incoming data points to subdued growth in 19Q2, with the global manufacturing PMI falling in May to its lowest level in nearly seven years and below the threshold of expanding activity. There are continued signs of weakness in the growth of global goods trade, with new export orders contracting for the ninth consecutive month. Increased tariffs by the United States and retaliatory actions by China in May have affected close to $300 billion in bilateral trade flows and have significantly escalated trade tensions. On the back of subdued inflation and concerns of weak growth, major central banks have continued to signal accommodative policy stances. In early June, the U.S. yield curve inverted as 10-year yields on government bonds fell further, sliding to 2.1 percent. Global inflation remained subdued up to April, but an uptick in oil and food prices has begun exerting upward pressure, particularly in EMDEs. After falling sharply in May, global equity prices stabilized in early June as concerns about renewed trade tensions were offset by the positive impact of declining bond yields. International bond issuance and portfolio flows to EMDEs moderated in May but have also started to show tentative signs of stabilization in June.

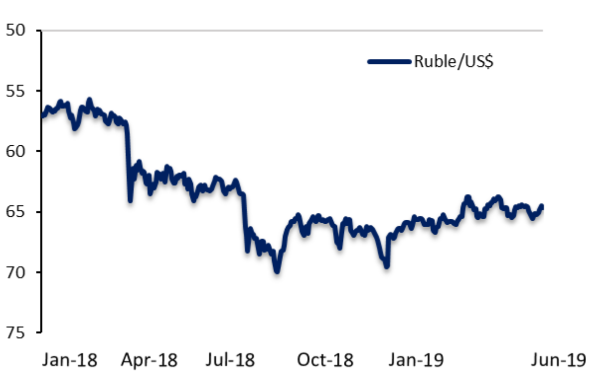
Oil prices fell on the back of demand-driven concerns. The prices of most industrial commodities fell in May with the downward trend continuing into June, reflecting demand concerns arising from the escalation in trade tensions between the United States and China. Oil prices, which had been stable throughout April and the first half of May, fell sharply in the second half of the month and into June. The price of Brent crude oil fell from $72/bbl in mid-May to $60/bbl in early June—a 17 percent decline. However, prices saw a small jump of $2/bbl in mid-June, reflecting geopolitical events. The broader fall in prices since May was driven by worries about slowing global demand, compounded by uncertainties regarding trade relations between major economies. The U.S. Energy Information Administration revised down its forecast for oil demand in 2019 by 0.2 million barrels per day (mb/d) to 1.2 mb/d, while OPEC revised their forecast down to 1.1 mb/d. Production among OPEC and its partners fell just below 30 mb/d in May, reflecting ongoing production cuts as well as a loss of production in Russia relating to contamination of the Drusbha oil pipeline. OPEC and its partners are due to meet in June to discuss whether to prolong the production cuts (Figure 1).

Figure 1: Oil prices fell sharply in the second half of May 2019



In May 2019, the Russian ruble weakened by 0.3 percent compared to the previous month, with the ruble average exchange rate reaching 64.8 against the U.S. dollar (Figure 2). Re-escalation of trade tensions between the US and China weighed on the ruble exchange rate in the first half of May. Yet, in the middle of the month, the ruble was supported by an increase in oil prices and investors interest to Russian bonds in view of the potential policy rate cut in June. The sharp drop in oil prices affected the ruble's exchange rate dynamics in the end of May.

Figure 2: The average ruble nominal exchange rate weakened in May 2019



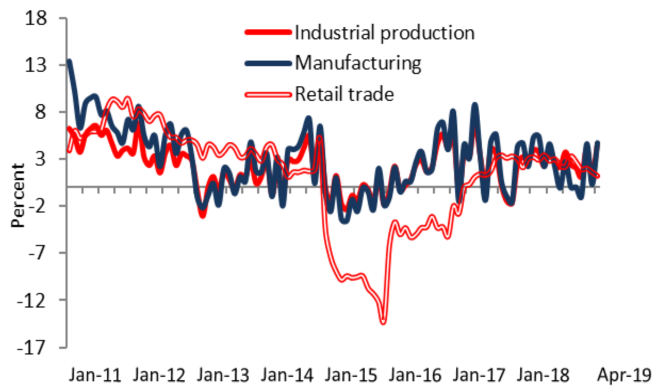
Source: CBR.

In the period January – May 2019, the current account surplus strengthened to US$48.7 billion compared to US$46.0 billion in the same period last year. According to the Central Bank, this improvement was due to the stronger trade balance and balance of services. Net private capital outflows increased to US$35.2 billion compared to US$18.9 billion in 2018, mainly due to higher net foreign assets acquisition both by banking and non-banking sectors. Russia's international reserves gained US$28 billion and reached US$495,2 billion, largely due to currency purchases in the fiscal rule framework.

In the first quarter of 2019, fixed capital investment growth slowed to 0.5 percent, y/y, according to high frequency statistics. While fixed capital investment grew robustly in agriculture, mineral resource extraction, manufacturing, construction, ICT, finance, and education, a sizable negative contribution from negative investment growth in real estate and transportation via pipelines weighed down on the overall investment growth. Geographically, fixed capital investment was concentrated in only two out of eight Federal Districts: Central (+16.4 percent, y/y) and Siberian (+13.1 percent, y/y).

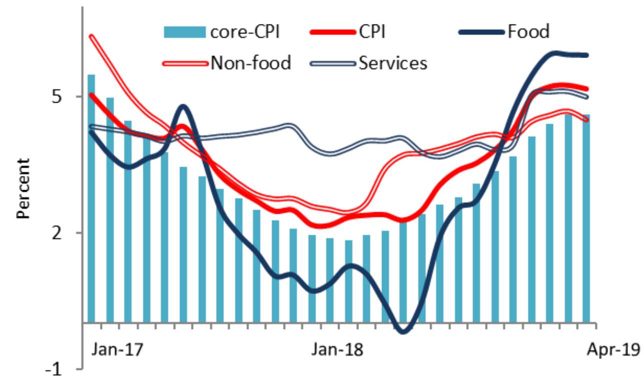
After weak dynamics in March, economic growth gained momentum in April, supported mainly by an increase in industrial production (Figure 3). In April, growth of output in five basic sectors firmed to 2.7 percent, y/y, from 0.2 percent, y/y, in March. This was largely the result of higher growth momentum in industrial production: 4.6 percent, y/y, and 1.2 percent, m/m, sa. Mineral resource extraction posted growth of 4.2 percent, y/y, compared to 4.3 percent, y/y in March. Meanwhile, growth in manufacturing firmed to 4.7 percent, y/y, from 0.3 percent, y/y, in March. Improvement in growth was broad-based among manufacturing subsectors, but the higher production of food products, fabricated metal products, and medical products contributed the most to growth acceleration in annual terms. April headline statistics on retail sales (+1.2 percent, y/y) and personal paid services (+0.6 percent, y/y) indicate continued subdued growth of consumer demand on the back of a rise in the VAT rate and a relatively tight monetary policy. Flat growth in construction signals weak growth of investment demand.

Figure 3: Industrial production increased in April 2019



Source: Rosstat, Haver Analytics, World Bank team.

Figure 4: Consumer inflation slowed down in May 2019



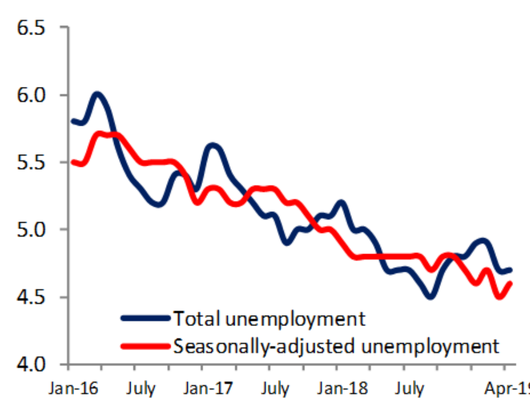
Source: Haver Analytics.

In May 2019, the 12-month consumer price inflation dropped slightly to 5.1 percent, down from 5.2 percent in April (Figure 4). While annual food inflation accelerated from a low base last year, inflation of non-food items eased, coupled with slower growth in gasoline prices. Though momentum in inflation strengthened slightly, as month-on-month inflation adjusted for seasonality increased, it remained close to the regulator's target in annualized terms. Subdued domestic demand growth helped the reugulator to keep inflation contained. Inflation expectations remain elevated. In May, household inflation expectations declined slightly to 9.3 percent from 9.4 percent in the previous month.

On June 14, the Central Bank cut the policy rate by 25 bp to 7.5 percent in annual terms. This decision was expected by the market and was driven by the following factors: continued slowdown of annual inflation, lower than expected economic growth in the first quarter of 2019, no drastic changes in inflaton expectations in May, and lower short-term pro-inflationary risks. The Central Bank stated the possibility of a further policy rate reduction and a transition to a neutral monetary policy until mid-2020. The Bank of Russia has lowered its end-of-year annual inflation forecast for 2019 from 4.7-5.2% to 4.2-4.7% and lowered its GDP growth forecast for 2019 from 1.2-1.7% to 1.0-1.5%.

Labor market dynamics were mixed in April 2019. The unemployment rate remained at the level of 4.7 percent. The seasonally adjusted rate increased marginally, by 0.1 percentage points, and reached 4.6 percent (Figure 5). Real wages increased by 1.6 percent in April compared to the same period in 2018. Pensions grew by 0.6 percent in real terms. Real disposable income dynamics, measured according to the new methodology, were negative in the first quarter of 2019 compared to the same period of 2018 (-2.3 percent).

Figure 5: The unemployment rate stayed flat in April 2019



Source: Rosstat, Haver Analytics, World Bank team

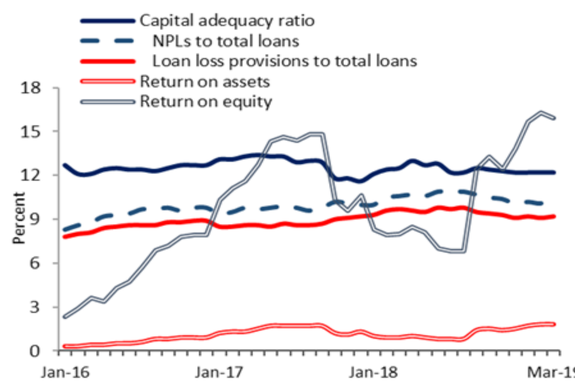
On the back of stronger non-oil revenues, the federal budget surplus improved to 2.1 percent of GDP in the first four months of 2019, up from 0.9 percent of GDP in the same period last year. Non-oil and gas revenues grew in January – April 2019 compared to the same period last year. This was largely the result of a VAT rate increase and a weaker ruble in the first four months of 2019 compared to the same period in 2018. A weaker ruble and higher energy goods production and exports compensated for lower prices, keeping oil and gas revenues at the same level (as a share of GDP) as in January – April 2018. Primary expenditures edged down by 0.1 pp. Spending on the national economy dropped by 0.2 percent of GDP and shrank in nominal terms. Lower primary expenditures and higher non-oil/gas revenues led to an improvement of the non-oil/gas federal budget primary deficit. In January—March 2019, the general government balance improved to 5.4 percent of GDP from 3.2 percent of GDP in the same period last year. This was largely the result of lower spending on social policy, national economy, and interest payments.

In April 2019, credit growth continued in both retail and corporate segments. Corporate demand for new loans strengthened as credit to the corporate sector grew by 5.5 percent, y/y, as of May 1, 2019 (after adjusting for FX changes). Lending to households in Rubles continues to grow in double digits – at 24 percent, y/y. The continued fast-paced expansion in household credit may pose a risk to financial stability in case of a deterioration in the macroeconomic environment. To limit the risks associated with the household over-indebtedness due to continuing growth in unsecured consumer lending, the CBR is introducing a mandatory calculation of a payment-to-income (PTI) ratio by banks and microfinance organizations (MFOs) on all loans above RUB 10,000. Effective October 1, 2019, CBR will further adjust risk weights on unsecured consumer loans to disincentivize lending to individuals with high PTI ratios and limit lending at higher interest rates.

Key credit risk and performance indicators remained largely stable (Figure 6). As of April 1, the system-wide capital adequacy ratio remained unchanged at 12.2 percent (against a regulatory minimum of 8 percent). The non-performing loan ratio slightly increased to 10.4 percent from 10.1 percent in the previous month. As of May 2019, the banking-sector's profits totaled RUB 750 billion (USD 11.4 billion), an increase, compared to RUB 537 billion (USD 9.3 billion) in the same period of 2018. Return on assets (ROA) and return on equity (ROE) have been growing steadily, reaching 1.8 percent and 15.9 percent respectively as of April 1, 2019.

The CBR continues to remove insolvent banks. The number of banks in Russia has fallen from 484 at the beginning of 2019 to 469 as of May 1, 2019.

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



Source: CBR.

Main Economic Indicators	2018												2018	2019					
Output Indicators	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sept	Oct	Nov	Dec		Jan	Feb	Mar	Apr	May	Jun
GDP, % change, y-o-y	-	-	1.9	-	-	2.2	-	-	2.2	-	-	2.7	**2.3**	-	-	0.5	-	-	
Basic sectors, % change, y-o-y	2.3	2.7	1.9	3.7	3.7	1.6	2.8	1.2	0.7	3.6	1.8	2.1	**2.9**	0.2	2.2	0.2	2.7		
Industrial production, % change, y-o-y	2.4	3.2	2.8	3.9	3.7	2.2	3.9	2.7	2.1	3.7	2.4	2.0	**2.9**	1.1	4.1	1.2	4.6		
Manufacturing, % change, y-o-y	4.3	4.7	2.2	5.3	5.4	2.2	4.6	2.2	-0.1	2.7	0.0	0.0	**2.6**	-1.0	4.6	0.3	4.7		
Retail trade	2.9	2.0	2.2	2.9	2.6	3.3	2.7	2.8	2.2	2.0	3.0	2.3	**2.6**	1.6	2.0	1.6	1.2		
Extraction of mineral resources, % change, y-o-y	0.8	1.2	2.4	2.5	1.3	2.8	3.2	4.5	6.9	7.4	7.8	6.3	**4.1**	4.8	5.1	4.3	4.2		
Construction, % change,y-o-y	12.2	9.4	-2.5	11.0	7.9	3.1	-0.7	3.3	5.9	5.7	4.3	2.6	**5.3**	0.1	0.3	0.2	0.0		
Fiscal and Monetary Indicators																			
Federal government balance, % GDP	2.8	1.6	1.8	0.9	1.4	1.9	2.5	3.1	3.5	3.6	3.7	2.6	**2.6**	4.8	2.0	2.2	2.1		
Inflation (CPI), %, y-o-y	2.2	2.2	2.4	2.4	2.4	2.3	2.5	3.1	3.4	3.5	3.8	4.3	**2.9**	5.0	5.2	5.3	5.2	5.1	
Inflation expectations, %, y-o-y	8.9	8.4	8.5	7.8	8.6	9.8	9.7	9.9	10.1	9.3	9.8	10.2	**10.2**	10.4	10.1	9.1	9.4	9.3	
Balance of Payment Indicators																			
Trade Balance, billion $ (monthly)	17.0	12.2	15.0	15.0	15.2	15.2	13.1	15.8	18.8	19.9	19.0	18.2	**194.5**	14.3	16.4	15.5	13.7		
Current Account, billion $, ytd	12.9	20.7	30.0	39.3	46.9	47.9	56.7	64.5	75.4	89	102.7	113.8	**113.8**			32.8	45.5	48.7	
Export of goods, billion $	33.4	31.2	36.9	36.2	36.5	36.6	34.4	37.4	38.7	41.3	40.5	41.4	**443.4**	30.7	34.7	36.5	35.7		
Import of goods, billion $	16.4	19.0	21.9	20.9	21.4	21.0	21.0	21.6	19.8	21.6	21.5	22.5	**249.0**	16.4	18.3	21.0	22.0		
Financial Market Indicators																			
CBR policy rate, %, end-o-p	7.50	7.50	7.25	7.25	7.25	7.25	7.25	7.25	7.50	7.50	7.5	7.75	**7.75**	7.75	7.75	7.75	7.75	7.75	7.5
Credit to households in Rub, % change, y-o-y	14.5	15.2	16.1	17.1	18.5	19.4	20.3	21.1	22	22.5	23.1	22.6	**22.6**	23.2	23.6	23.7	24		
Credit to the corporate sector in Rub, % change, y-o-y	5.1	5.5	6.3	7.5	6.9	7.4	8.1	9.5	8.4	9.7	10.6	12.0	**12.0**	12.3	12.1	12.3	11.4		
Capital adequacy ratio	12.1	12.4	12.5	13.0	12.7	12.8	12.2	12.2	12.5	12.4	12.3	12.2	**12.2**	12.2	12.2	12.2			
NPLs to total loans	10.0	10.5	10.6	10.7	10.6	10.9	10.9	10.9	10.7	10.5	10.4	10.1	**10.1**	10.2	10.1	10.4			
Loan loss provisions to total loans	9.3	9.6	9.7	9.6	9.5	9.8	9.7	9.8	9.5	9.4	9.3	9.1	**9.1**	9.2	9.1	9.2			
Return on assets (ROA)	1.0	0.9	0.9	1.0	0.9	0.8	0.8	0.8	1.4	1.5	1.4	1.5	**1.5**	1.7	1.8	1.8			
Return on equity (ROE)	8.3	7.9	8.0	8.5	8.1	7.0	6.8	6.8	12.4	13.3	12.4	13.8	**13.8**	15.7	16.3	15.9			
Income, Poverty and Labor Market																			
Real wages, % change, y-o-y	11.0	10.5	8.7	7.6	7.6	7.2	7.5	6.8	4.9	5.2	4.2	2.9	**7.0**	1.1	0.7	0.7	1.6		
Unemployment (%, ILO definition)	5.2	5.0	5.0	4.9	4.7	4.7	4.7	4.6	4.5	4.7	4.8	4.8	**4.8**	4.9	4.9	4.7	4.7		
Exchange rate																			
USD/ RUB, average	56.8	56.8	57.0	60.4	62.2	62.7	62.8	66.1	67.7	65.8	66.2	67.3	**62.5**	67.3	65.86	65.14	64.62	64.82	
Euro/ RUB, average	69.0	70.3	70.4	74.2	73.7	73.2	73.4	76.2	79.0	75.7	75.3	76.6	**73.9**	76.9	75.78	73.75	72.61	72.51	
Oil price																			
Brent, $/ bbl	69.0	65.4	66.5	71.6	76.7	75.2	74.4	73.1	78.9	80.5	65.2	56.5	**71.1**	59.3	64.1	66.4	71.2	70.5	

Source: Rosstat, CBR, EEG.

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