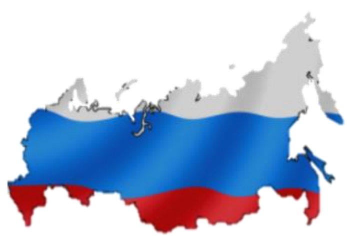
Russia Monthly Economic Developments

January 2020

Global growth held steady in 19Q3, with recent data pointing to a tentative stabilization of activity at low levels. Oil prices rose steadily through December amid rising optimism regarding a U.S.- China trade deal and stronger than expected demand momentum in some non-OECD countries. In December, the ruble continued strengthening, gaining 1.9 percent with respect to the U.S. dollar. In 2019, Russia's current account surplus narrowed to US$70.6 billion, down from US$113.5 billion in 2018, largely due to a lower trade balance. Industrial production output growth weakened in November (-0.6 percent, m/m, sa) in line with weaker oil production as well as lower growth in manufacturing. The 12-month consumer price inflation (CPI) dropped to 3 percent in December, remaining below the CBR target of 4 percent in annual terms. On 13th December 2019, the Bank of Russia decided to cut the key rate by 25 bp to 6.25 percent in annual terms. This decision was based on continued consumer price inflation slowdown and decreasing inflation expectations of households. In the first eleven months of 2019, the federal budget surplus dropped to 3.1 percent of GDP (cash basis) from 3.7 percent of GDP in the same period last year on the back of lower oil and gas revenues and higher non-interest spending. According to preliminary information from the Ministry of Finance, in 2019, average disbursement on National Projects totaled about 91 percent of the planned amount. In November, the banking sector was largely stable. Both retail and corporate sector lending growth slowed. On January 15, 2020, President Vladimir Putin delivered his annual speech to the Federal Assembly, outlining proposals for fixing the country's social, economic, and political problems. The President also proposed changes to the constitution, which would shift power between the executive, judicial, and legislative branches. After Prime Minister Medvedev resigned, a new government was appointed on January 21.

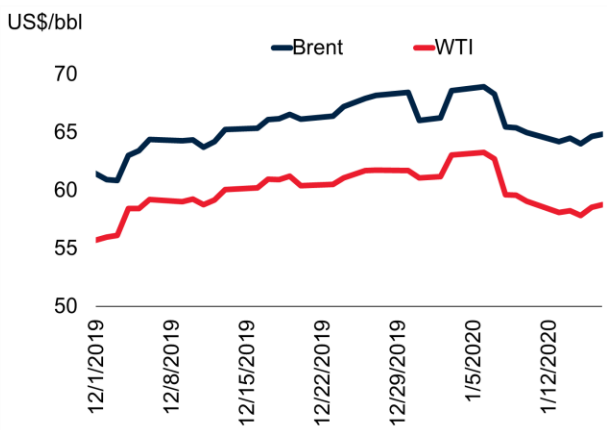
The Global Context



After contracting for most of the year, survey indicators of industrial activity ended 2019 in expansionary territory. Global growth held steady in 19Q3, with recent data pointing to a tentative stabilization of activity at low levels. Incoming data on global trade remained mixed, however, with November data pointing to a continued deterioration in container shipping and the production of capital goods and intermediates in G20 economies, while both manufacturing and services export orders improved further. During their December meetings, the U.S. Federal Reserve and the European Central Bank held monetary policy steady. However, a number of Emerging Market and Developing Economies (EMDEs) have continued to provide additional support such as the People's Bank of China, which cut bank reserve ratios in early January. Despite further policy support, GDP growth in China remained at a three-decade low of 6 percent (y/y) in 19Q4. Investor sentiment and global equity valuations continue to climb amid easing trade tensions as the United States and China signed a Phase One agreement on January 15th, as well as continued support from global monetary policy easing. After falling to a 3-year low in September, global inflation picked up gradually, partly reflecting marked food price-driven increases in China and India.

Oil prices were volatile following geopolitical events. Oil prices rose steadily through December amid rising optimism regarding a U.S.-China trade deal and stronger than expected demand momentum in some non-OECD countries. The price of Brent crude oil increased 5 percent (m/m) to US$66/bbl, and WTI rose to US$60/bbl. Oil prices spiked at the beginning of January, reaching US$72/bbl (the highest level since May 2019) following the escalation of tensions between the U.S. and Iran (Figure 1). However, worries about a further escalation quickly moderated and prices fell back to around US$65/bbl, below their December average. On the demand side, the IEA left global growth forecasts unchanged for 2019 and 2020 at 1 mb/d and 1.2 mb/d, respectively. Supplies may be tightening, however, due to the steeper OPEC+ cuts effective from January and Iranian oil exports nearing zero from around 1.5mb/d prior to the sanctions.

Figure 1: Crude oil prices rose steadily through December

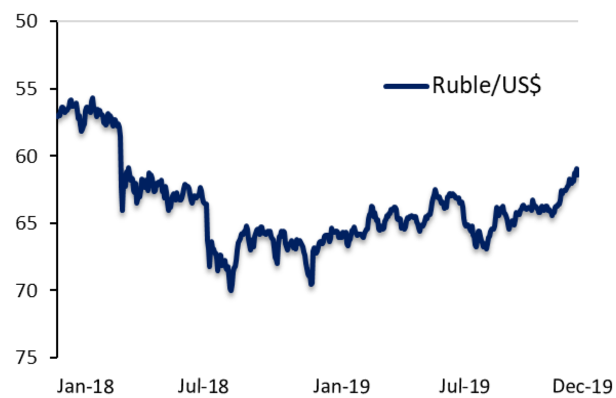


Source: Bloomberg.
Note: Last observation is January 17, 2020.

Recent economic developments

In December, the ruble continued strengthening, gaining 1.9 percent with respect to the U.S. dollar (Figure 2). Positive dynamics were registered for other emerging markets currencies: The MSCI International Emerging Market Currency Index rose 2.1 percent in December after falling by 0.5 percent in the previous month. Overall, in 19Q4, the ruble gained 1.3 percent with respect to the U.S. dollar. Continued purchases of public debt by non-residents supported the ruble. In 19Q4, net inflows to public debt increased to US$3.6 billion compared to US$1.3 billion in 19Q3 on the back of increased appetite for EMDE assets, relatively strong macro fundamentals in Russia, and the perception of reduced risk of sanctions. By the end of November 2019, the share of non-residents holding government bonds increased to about 32 percent from 24.4 percent in the beginning of 2019.

Figure 2: In December, the ruble continued to strengthen with respect to the U.S. dollar



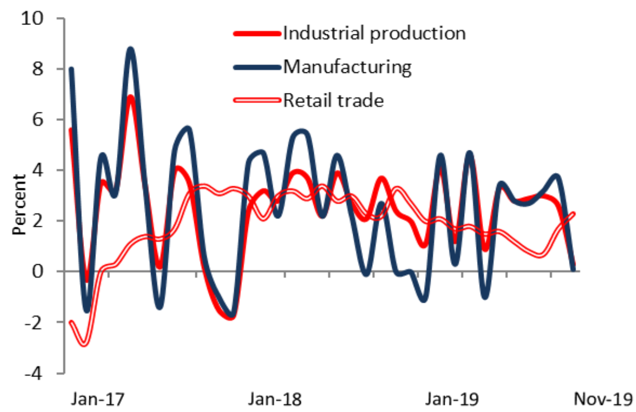
Source: CBR.

In 2019, Russia's current account surplus narrowed to US$70.6 billion, down from US$113.5 billion in 2018, largely due to a lower trade balance. The trade balance surplus dropped from US$194.4 billion in 2018 to an estimated US$163.1 billion in 2019 given lower energy commodity prices, Russia's participation in the OPEC+ agreement, and contracting international merchandise trade. Net private sector capital outflows declined to US$26.8 billion in 2019 compared to US$67.5 billion in 2018, largely due to FDI inflows to the non-banking sector. According to available statistics, in the first three quarters of 2019, about half of FDI inflows comprised of profit reinvestment. In the first six months of 2019, about 60 percent of incoming FDI originated in Cyprus and the Netherlands. International reserves increased by US$66.5 billion, up from US$38.2 billion in the previous year, mainly due to currency purchases in the fiscal rule framework. In 2019, the real effective exchange rate appreciated by 2.5 percent compared to 2018.

Domestic demand (mainly household consumption and change in inventories) drove growth in the third quarter of 2019. Rosstat published the demand-side composition of GDP in the third quarter. Supported by real disposable income growth, monetary easing, and continued credit expansion, household consumption posted robust growth of 3.1 percent, y/y, compared to 2.8 percent, y/y, in the second quarter of 2019. Gross fixed capital investment growth remained soft (+0.7 percent, y/y). According to Rosstat high frequency statistics, the negative contribution from investment in mineral resource extraction and transportation and warehousing dragged down investment growth. Contribution of net exports to GDP growth was negative: export growth was subdued (-1.1 percent, y/y) on the back of slowing global growth and Russia supporting the OPEC+ agreement. Import growth accelerated to 4 percent, y/y, from 0.1 percent, y/y in the previous quarter as the ruble strengthened, conumption growth was robust, and inventories increased. The change in inventories contribution grew to 0.9 percent of GDP from 0.5 percent of GDP in the previous quarter.

In annual terms, in November 2019, industrial production growth slowed to 0.3 percent, y/y, compared to 2.6 percent, y/y, in October (Figure 3). Industrial production output growth weakened in November (-0.6 percent, m/m, sa) in line with weaker oil production as well as lower growth in manufacturing (0.1 percent, y/y, compared to 3.7 percent, y/y, in October). Production of leather and pharmaceutical products grew considerably while production of coke and petroleum products, chemicals, wood, and food contributed to the slowing in manufacturing growth. Meanwhile, growth in mineral resource extraction accelerated to 1.4 percent, y/y, from 0.9 percent, y/y, in October. Oil production registered negative growth in annual terms in line with Russia's participation in the OPEC+ agreement. In the beginning of December, OPEC announced a 0.5 mb/d cut in addition to the existing 1.2 mb/d effective until March 2020. Russia agreed to cut 0.07 mb/d from its current base of 11.75 mb/d (the second largest agreed cut after Saudi Arabia's -0.167 mb/d). Despite deeper cuts forecast until March 2020, oil production is expected to remain stable due to an exemption on gas condensates. Agricultural production growth was robust at 5.8 percent, y/y, while construction growth weakened, registering 0.2 percent, y/y, in November compared to 1 percent, y/y, in October.

Figure 3: Industrial production output growth slowed in November

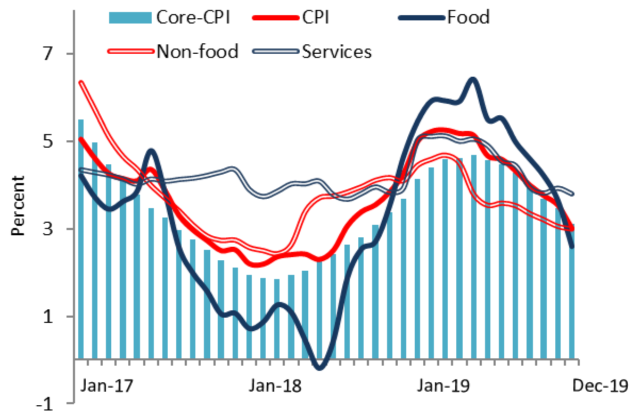


Source: Rosstat, Haver Analytics, World Bank team.

Consumer price inflation finished the year on a downward trend, remaining below the CBR target of 4 percent in annual terms (Figure 4). The 12-month consumer price inflation (CPI) dropped to 3 percent in December, down from 3.5 percent in November. The 12-month food inflation deceleration (2.6 percent, y/y, compared to 3.7 percent in November) contributed the most to the decrease in headline CPI, along with non-food goods inflation. Core CPI dropped to 3.1 percent in December, down from 3.5 percent in November. Inflation expectations have been fluctuating, with household inflation expectations increasing to 9 percent in December, up from 8.3 percent in November after having declined in the previous four months.

On December 13, 2019, the Bank of Russia decided to cut the key rate by 25 bp to 6.25 percent in annual terms. This decision was based on continued consumer price inflation slowdown above expectations. Households' inflation expectations continued to decrease as well. The Central Bank noted possible further rate cuts in the first half of 2020.

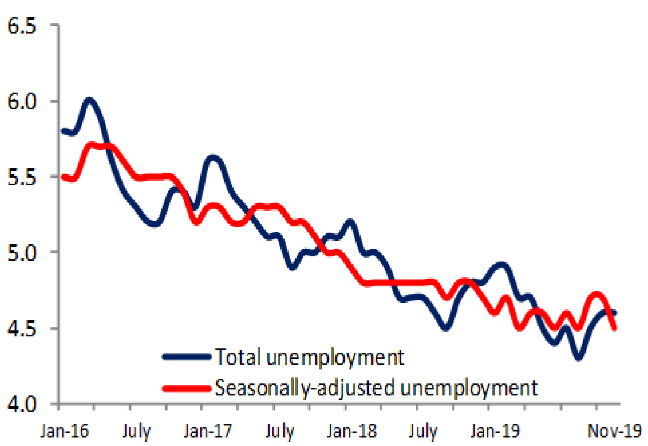
Figure 4: Consumer price inflation finished the year below the CBR target of 4 percent in annual terms



Source: Haver Analytics.

Labor market dynamics were neutral in November. The unemployment rate remained at 4.6 percent – the same as the previous month. However, the seasonally adjusted rate decreased by 0.2 percentage points (pp) to the level of 4.5 percent (Figure 5). Information on real wages is now being published with a one-month lag. In October, this indicator increased by 3.8 percent compared to the same period of 2018.

Figure 5: The unemployment rate (sa) decreased in November (Percent)



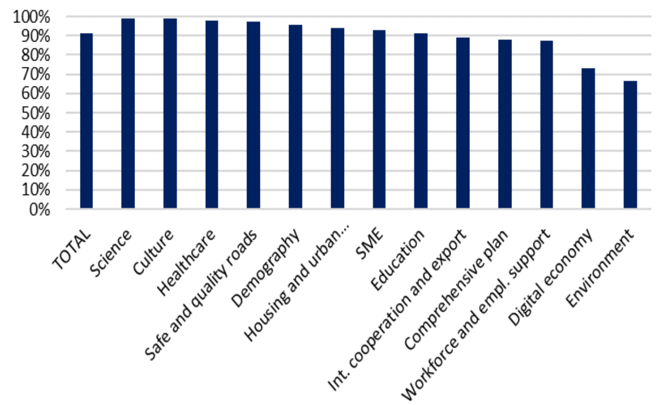
Source: Rosstat, Haver Analytics, World Bank team

In the first eleven months of 2019, the federal budget surplus dropped to 3.1 percent of GDP (cash basis) from 3.7 percent of GDP in the same period last year. This came on the back of lower oil and gas revenues and higher non-interest spending. Non-oil/gas revenues grew to 11 percent of GDP in the January-November 2019 period compared to 10.1 percent of GDP in the same period last year. This was largely the result of a VAT rate increase of 2 pp, higher non-tax receipts, and a weaker ruble with respect to the U.S. dollar on an annual basis. Oil and gas revenues dropped to 7.4 percent of GDP, down from 8.9 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 environment, housing services, utilities, and health each grew by 0.1 percent of GDP, while spending on social policy 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 3.6 percent of GDP compared to a deficit of 4.4 percent of GDP in the same period last year.

In the first 10 months of 2019, Russia's general government fiscal surplus decreased slightly on the back of higher expenditures (5.0 percent of GDP vs. 5.3 percent of GDP). In January - October 2019, general government expenditures increased to 31.3 percent of GDP from 30.9 percent of GDP in the same period last year. Primary expenditures increased mainly at the regional and federal levels, mostly due to spending within the National Projects framework. Despite shrinking oil/gas revenues following lower oil prices, general government revenues increased by 0.1 percent of GDP in the first ten months of 2019 compared to the same period last year. A VAT rate increase, a weaker ruble, and higher non-tax revenues supported revenues at the federal level. At the regional level, the increase in revenue stemmed mainly from higher receipts from the corporate income tax.

According to preliminary information from the Ministry of Finance, in 2019, average disbursement on National Projects totaled about 91 percent of the planned amount (about Rub 150 billion or US$2.4 billion were not spent) (Figure 6). The highest spending rate was registered for the Science Project with spending of about 99 percent of the planned amount. The lowest spending rate was registered for the Environment National Project – 66 percent of the planned amount.

Figure 6: In 2019, average disbursement on National Projects totaled about 91 percent of the planned amount



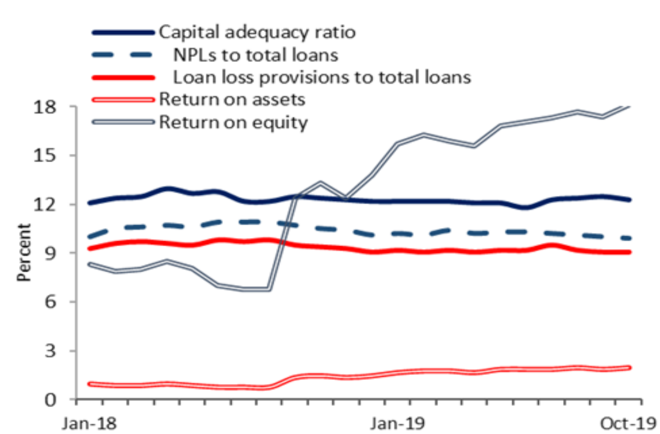
Source: Ministry of Finance.

On January 15, 2020, President Vladimir Putin delivered his annual speech to the Federal Assembly, outlining proposals for fixing the country's social, economic, and political problems. Among the key social issues highlighted by the President were measures aimed at improving demographics and poverty reduction. President Putin set a goal of raising the birthrate to 1.7 children per woman by 2024, up from 1.5 last year. The maternity capital program has been extended until 2026 at least and indexed in terms of the amount of the payment. The President also announced additional subsidies for children under 3 years and for children aged 3-7 for families in which the per person income is below the cost of living. President Putin announced additional payments for teachers as well as an increase in budget scholarship places in universities across the country. According to the Ministry of Finance, additional social expenditures could cost up to Rub 4 trillion rubles in the period 2020 - 2024. The President has pointed out that Russia should achieve a higher GDP growth rate than the world average in 2021 (currently forecasted at 2.6 percent). Annual investment growth needs to be at least 5 percent and its share in the country's GDP should be increased from the current 21 percent to 25 percent in 2024. The President also proposed changes to the constitution, which would shift power between the executive, judicial, and legislative branches. Following Prime Minister Medvedev's resignation, a new government was appointed on January 21.

Both retail and corporate sector lending growth slowed, but retail lending continued to lead growth. In November, credit to households in rubles grew by 18.7 percent, y/y, compared to 19.8 percent in the previous month and 23.2 in the beginning of 2019. Some slowdown in retail lending could be attributed to the CBR's regulatory measures to curb households' excessive debt burden. After adjusting for foreign currency (FX) changes, credit to the corporate sector grew by 4 percent, y/y, compared to 5.1 percent in the beginning of the year. As of December 1st, the share of FX-denominated corporate loans also declined from 28.8 percent in the beginning of 2019 to 24.6 percent.

Key credit risk and performance indicators remained stable (Figure 7). As of November 1, 2019, the capital adequacy ratio stood at 12.3 percent (against a regulatory minimum of 8 percent). Non-performing loans continue to stay high, at around 10 percent, but are adequately provisioned. In the first eleven months of 2019, the banking sector's profit amounted to RUB 1.9 trillion (US$28.8 billion) compared to RUB 1.3 trillion (US$20.6 billion) in the same period of 2018. Return on assets (ROA) and return on equity (ROE) reached 2.0 percent and 18.1 percent, respectively, compared to 1.5 percent and 13.8 percent, respectively, in the beginning of the year.

Figure 7: Key credit risk and banking performance indicators remained stable in October



Source: CBR.

The CBR continues to remove insolvent banks. In November, the number of banks decreased by 10, and as of December 1, 2019, there were 444 banks compared to 484 at the beginning of the year.

Main Economic Indicators												
	2019											
Output Indicators	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
GDP, % change, y-o-y	-	-	0.5	-	-	0.9	-	-	1.7	-	-	
Basic sectors, % change, y-o-y	0.3	2.3	0.2	3.1	0.0	2.1	2.5	2.4	3.1	3.1		
Industrial production, % change, y-o-y	1.1	4.1	1.2	4.6	0.9	3.3	2.8	2.9	3.0	2.6	0.3	
Manufacturing, % change, y-o-y	-1.0	4.6	0.3	4.7	-1.0	3.4	2.8	2.7	3.2	2.6	0.1	
Retail trade	2.0	2.1	1.7	1.8	1.5	1.6	1.2	0.8	0.7	2.6	2.3	
Extraction of mineral resources, % change, y-o-y	4.8	5.1	4.3	4.2	2.8	2.8	3.0	3.1	2.5	2.6	1.4	
Construction, % change,y-o-y	0.1	0.3	0.2	0.0	0.2	0.1	0.2	0.3	0.8	2.6	0.2	
Fiscal and Monetary Indicators												
Federal government balance, % GDP	4.8	2.0	2.2	2.1	2.7	3.1	3.4	3.7	3.8			
Inflation (CPI), %, y-o-y	5.0	5.2	5.3	5.2	5.1	4.7	4.6	4.3	4	3.75	3.53	3.0
Inflation expectations, %, y-o-y	10.4	10.1	9.1	9.4	9.3	9.4	9.4	9.1	8.9	8.6	8.3	9
Balance of Payment Indicators												
Trade Balance, billion $ (monthly)	14.4	16.5	16.0	14.6	12.3	12.7	11.2	11.2				
Current Account, billion $, ytd	10.3	22.7	33.7	45.5	48.7	45.8	51.4		57.2			70.6
Export of goods, billion $	30.8	34.7	37.0	36.7	32.2	32.8	33	33.8	35	36.1		
Import of goods, billion $	16.4	18.2	21.0	22.1	20	20	22.3	21.8	20.9	23.7		
Financial Market Indicators												
CBR policy rate, %, end-o-p	7.75	7.75	7.75	7.75	7.75	7.5	7.25	7.25	7.0	7.0	6.5	6.25
Credit to households in Rub, % change, y-o-y	23.2	23.6	23.7	24.0	23.5	23.0	22.0	21.3	20.8	19.8	18.7	
Credit to the corporate sector in Rub, % change, y-o-y	12.3	12.1	12.3	11.4	11.8	11.6	10.7	10.2	10.4	9.8	8.4	
Capital adequacy ratio	12.2	12.2	12.2	12.1	12.1	11.8	12.3	12.4	12.5	12.3		
NPLs to total loans	10.2	10.1	10.4	10.2	10.3	10.3	10.2	10.1	10	9.9		
Loan loss provisions to total loans	9.2	9.1	9.2	9.1	9.2	9.2	9.2	9.2	9.1	9.1		
Return on assets (ROA)	1.7	1.8	1.8	1.7	1.9	1.9	1.9	2	1.9	2		
Return on equity (ROE)	15.7	16.3	15.9	15.6	16.8	17.1	17.3	17.7	17.4	18.1		
Income, Poverty and Labor Market												
Real wages, % change, y-o-y	1.1	0.0	2.3	3.1	1.6	2.9	2.9	3	2.4	3.1	3.8	
Unemployment (%, ILO definition)	4.9	4.9	4.7	4.7	4.5	4.4	4.5	4.3	4.5	4.6	4.6	
Exchange rate												
USD/ RUB, average	67.3	65.86	65.14	64.62	64.82	64.22	63.2	65.53	64.98	64.35	63.87	62.94
Euro/ RUB, average	76.9	75.78	73.75	72.61	72.51	72.43	70.99	72.88	71.61	71.06	70.66	69.90
Oil price												
Brent, $/ bbl	59.3	64.1	66.4	71.2	70.5	63.3	64.0	59.3	62.3	59.4	62.7	65.9

Source: Rosstat, CBR, EEG.

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