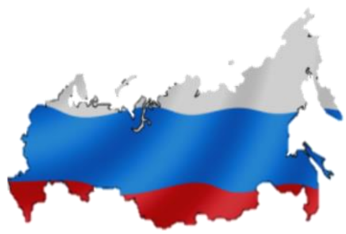
Russia Monthly Economic Developments

March 2018

Global growth continued to be solid in the fourth quarter of 2017, well above the estimated potential growth. Incoming data suggests robust growth is maintained in 2018. Growth in China slowed in the fourth quarter and high frequency data suggests continued moderation in the first quarter of 2018. Oil prices, which fell in the first half of February stabilized later in the month. The decline--which ended seven months of gains--reflects a modest recovery in oil inventories and further rises in U.S. oil production. Favorable external environment supported the current account in the first two months of 2018: export increase more than compensated for growing imports. Despite a drop in oil prices, in February 2018, the ruble stayed flat with respect to the US dollar. In January 2018, industrial production growth accelerated helped by robust growth in manufacturing. In February 2018, consumer inflation remained unchanged. Labor market indicators were relatively stable in January. In January 2018, the federal budget primary surplus strengthened, as drop in expenditures overcompensated for a decrease in revenues. The Central Bank continued its efforts to clean up the banking system, cutting the number of banks that are non-compliant with regulations and that conduct risky operations. On March 16, despite escalating geopolitical tensions, Russia placed US$4 billion of Eurobonds.

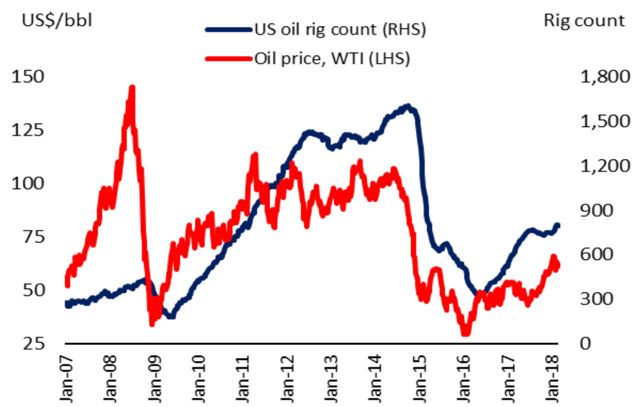


The Global Context

Continued strong global growth. Global growth continued to be solid in 2017Q4, at an estimated [3.0] percent (q/q saar), well above the estimated potential growth. Incoming data suggests robust growth is maintained in 2018. Growth in China slowed 6.3 percent in Q4 and high frequency data suggests continued moderation in 2018Q1. After weathering the February turbulence relatively well, EMDE financial markets remained stable in March. There is uncertainty on the outcome of ongoing trade negotiations, and the risk of escalating trade restrictions—as exemplified by the possibility of U.S. tariffs on steel and aluminum imports—has recently increased.

Oil prices down in February, ending seven months of gains (Figure 1). Oil prices, which fell in the first half of February stabilized later in the month to average US$63.5 per barrel in February--a 5 percent drop from January. The decline--which ended seven months of gains--reflects a modest recovery in oil inventories and further rises in U.S. oil production. Strong growth in the United States boost this year's non-OPEC oil production--the US is estimated to have reached a record oil production of 10.3 million bbl/d in February and is expected to become world's top oil producer. OPEC oil production, however, eased in February to 32.1 mb/d, mainly due to losses in Venezuela and the United Arab Emirates. OECD commercial stocks increased edged up in January for the first time in seven months to 2,871 million barrels. However, stocks in Cushing, Oklahoma reached their lowest level in three years.

Figure 1: Oil prices went down in February

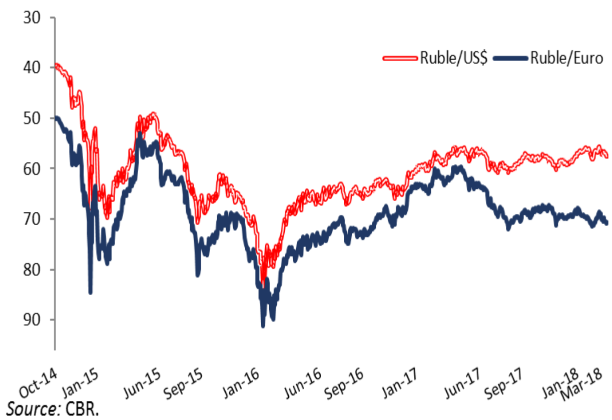


Source: Baker Hughes, Bloomberg.

Russia's Recent Developments

In February 2018, the ruble stayed flat with respect to the US dollar (Figure 2). Despite a drop in oil prices by 5.2 percent in February 2018, compared to the previous month, the ruble exchange rate with respect to the US dollar remained almost unchanged. The statement of the US Ministry of Finance which indicated the unlikeliness of sanctions on Russian sovereign debt supported the continued interest in Russian financial assets. Meanwhile, the ruble depreciated by 3.5 percent by March 21, compared to the end of February, largely on the back of increased geopolitical tensions and expectations of tightening of monetary policy in the US.

Figure 2: The ruble stayed flat with respect to the US dollar in February 2018

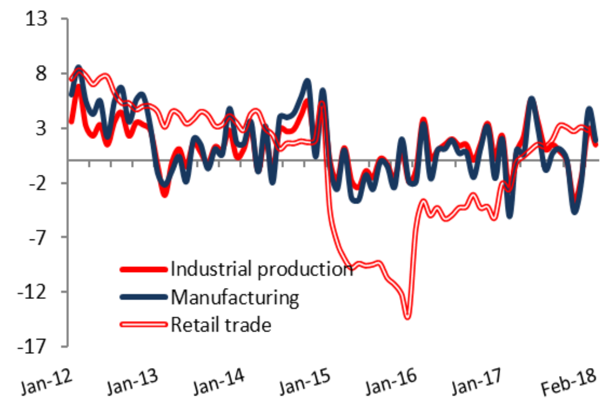


Source: CBR.

Stronger trade balance supported the current account in January - February 2018. In the first two months of 2018, the current account surplus increased to US$20.8 billion from US$14.5 billion in the same period last year. An increase in the trade surplus was the key factor behind the strengthening of the current account. Value of exports increased supported by higher energy prices and robust global growth. Value of imports increased (according to availbale statistics, in January 2018, imports of goods expanded by 20.7 percent in nominal terms, y/y), and this increase was less than the increase in exports. Net private capital outflows in the January-February 2018 reached US$9.8 billion compared to US$4.4 billion in the January-February 2017, largely due to an increase in foreign assets of the non-banking sector. The international reserves gained US$23.7 billion in January-February 2018 compared to an increase of US$15.4 billion in January-February 2017.

In January 2018, industrial production growth accelerated (Figure 3). Industrial production increased by 2.9 percent, y/y, in January 2018, and it increased by 2.4 percent, m/m, sa, after growth of 0.4 percent in December 2017. Compared to January 2017, manufacturing expanded by 4.7 percent, y/y, supported by growth in "other types of transport vehicles", metallurgy, and chemicals. Despite continued contraction in production of crude oil, mineral resource extraction grew by 1.1 percent y/y in January 2018, supported by strong growth in natural gas extraction, and increased volume of services related to mineral resource extraction.

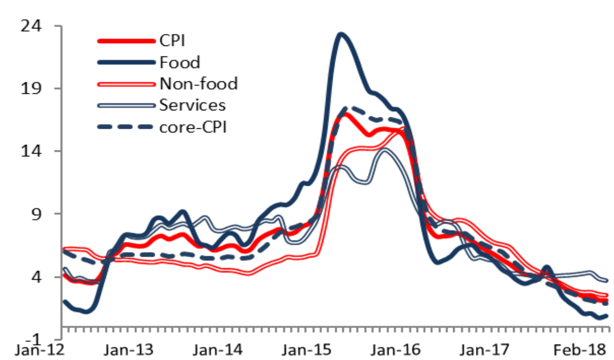
Figure 3: Industrial production growth accelerated in January



Source: Rosstat, Haver Analytics, World Bank team.

In February 2018, consumer inflation remained unchanged (Figure 4). The 12-month Consumer Price Index stayed at the level of 2.2 percent y/y, the same as in January 2018 and substantially below the inflation target of 4 percent. A slight increase in the growth of food prices was compensated by a slowdown in growth of prices for non-food items and services. Core inflation remained at about the same level as in January (1.9 percent y/y), indicating low inflation pressures. Inflation expectations continued to decrease in February. Low inflation and lower inflation expectations let the Central Bank to cut the policy rate by 25 bp to 7.25 percent in annual terms at the Board meeting on March 23. The Central Bank affirmed its intention to complete the transition to neutral monetary policy in 2018. Among inflation risks the Central Bank mentioned the dynamics of wages and unemployment, risks associated with global financial markets and increased protectionism in world trade.

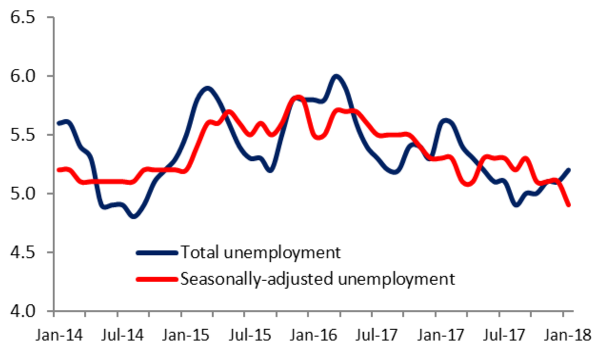
Figure 4: Consumer inflation remained unchanged in February 2018



Source: Rosstat, Haver Analytics, World Bank team.

Labor market indicators were relatively stable in January. Unemployment rate increased marginally in January 2018 to 5.2 percent compared to 5.1 percent in December 2017, but was much lower than in January 2017 (5.6 percent). The increase was due to seasonal factors. Thus, the seasonally adjusted rate declined by 0.2 percentage points to 4.9 percent (Figure 5). Real wages continued to grow and increased in January 2018 by 6.2 percent compared to the same period of last year, and by 1.8 percent compared to December 2017 after seasonal adjustment. Real disposable income contracted in January by 7 percent compared to the same period of 2017, unadjusted for the one-time payment in January 2017, and was at the level of January 2017, when adjusted for that payment. It also increased by 3.6 percent compared to December 2017 after seasonal adjustment. This indicator is volatile and to is largely driven by sources of income not registered by statistics. Pensions were indexed in the beginning of the year and the real growth was 2.6 percent compared to December 2017 after seasonal adjustment.

Figure 5: Labor market indicators were relatively stable in January



Source: Rosstat, Haver Analytics, World Bank team.

In 2017, the general government fiscal stance improved, aided by higher oil prices, a recovering economy, improved tax administration and lower expenditures. The general government budget primary deficit narrowed to 0.6 percent of GDP from 2.8 percent in 2016. General government primary expenditures decreased by 1.7 percent of GDP compared to 2016, mainly due to lower spending on defense and health.

In January 2018, the federal budget primary surplus strengthened to 4.5 percent of GDP from 1.4 percent of GDP in the same period last year, as drop in expenditures overcompensated for a decrease in revenues. While higher oil prices prompted for an increase in federal budget oil revenues from 7.6 percent of GDP in January 2017 to 9.6 percent of GDP in January 2018, non-oil revenues decreased from 12.2 percent of GDP to 9.3 percent of GDP. Such a drop in non-oil revenues is largely attributed to lower receipts of excise tax from a high base of last year. Federal budget primary expenditures decreased from 18.4 percent of GDP in January 2017 to 14.5 percent of GDP in January 2018. In January 2018, public spending on national defense (+ 0.5 percent of GDP) and state management (+0.5 percent of GDP) increased, compared to the same period last year. Meanwhile, in January 2018, spending on social policy appeared to be lower by 5.9 percent of GDP, compared to the same period last year, due to one-time pension payments in January 2017. Overall federal budget surplus improved from 0.6 percent of GDP in January 2017, to 3.5 percent of GDP in January 2018.

On March 16, despite escalating geopolitical tensions, Russia placed US$4 billion of Eurobonds. Investors' order book for the two bonds on offer placed US$7.5billion. The Ministry of Finance placed US$1.5 billion of Eurobonds maturing in 2029 (Russia-29) at a yield of 4.625 percent and $2.5 billion of Eurobonds maturing in 2047 (Russia-47) at a yield of 5.25 percent. The premium over the secondary market was about 10 base points for the Russia-29 and about 5 base points for the Russia-47. The bonds were purchased mainly by investors from the UK, US, and Russia. Five percent of the total amount was sold under a capital amnesty programme aimed at encouraging wealthy Russians holding assets abroad to transfer them back to Russia.

The Central Bank continued its efforts to clean up the banking system, cutting the number of banks that are non-compliant with regulations and that conduct risky operations: the number of banks in Russia has fallen from 561 at the beginning of 2018 to 558 as of February 1, 2018. In February, CBR published its financial technology strategy titled "Main Directions for Financial Technology Development in 2018-2020," along with a detailed roadmap to establish a regulatory framework for digital technologies and set up related financial infrastructure and regulation. The CBR outlined a number of high-priority innovative technologies that it encouraged the sector to develop: big data and smart data, mobile technologies, artificial intelligence, machine learning, biometry, blockchain and open application programming interface. The objective of the strategy is to promote competition in the financial market; increase accessibility, quality and the range of financial services; lower risks and reduce costs in in the financial sector and increase Russian technologies' competitiveness. Earlier CBR announced that it would be establishing a regulatory sandbox to test innovative financial technologies, products and services.

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