Russia Monthly Economic Developments

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THE WORLD BANK
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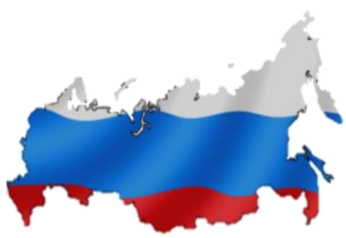
Global activity indicators suggest that growth remained weak in 19Q4, with global industrial production registering a tepid 0.9 percent (q/q saar). Oil prices fell sharply in mid-January 2020, remaining low in February following reports that the coronavirus outbreak had worsened. In January, the ruble continued strengthening, outperforming other EMDE currencies. Russia's current account surplus shrank in January compared to the same period in 2019, while the trade balance surplus remained almost unchanged. In annual terms, industrial production growth accelerated to 2.1 percent, y/y, in December 2019 compared to 0.3 percent, y/y, in November. In January 2020, annual inflation rate dropped to 2.4 percent, down from 3 percent in the previous month. On February 7, 2020, the Bank of Russia cut the key rate by 25 bp to 6 percent in annual terms on the back of continued consumer price index (CPI) deceleration. The unemployment rate stayed unchanged. In 2019, on the back of lower tax revenues, the federal budget registered a surplus of 1.8 percent of GDP (cash basis), down from 2.6 percent of GDP in 2018. Both retail and corporate sector lending slowed down, though unsecured consumer loans continued growing at double digit rates. Key credit risk and performance indicators remained stable. On February 11, 2020, the CBR agreed to sell its full stake (50 % +1 share) in Sberbank to the Government (Ministry of Finance) for a market price.

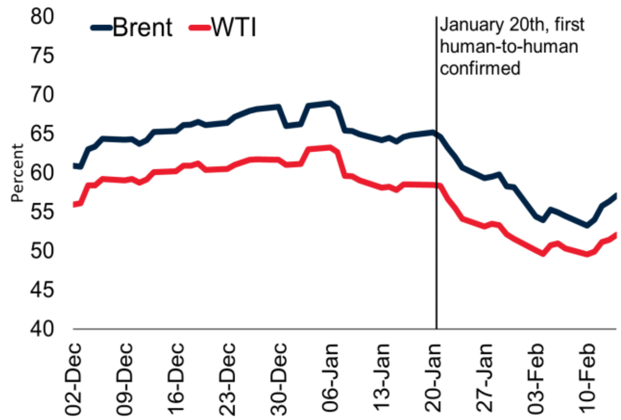
The Global Context

Global activity indicators suggest that growth remained weak in 19Q4, with global industrial production registering a tepid 0.6 percent (q/q saar). Survey data in January, however, pointed to a tentative recovery, with both the PMI manufacturing and new export orders rising on the back of improved trade relations between the United States and China. The outbreak of a novel coronavirus (COVID-19), which originated in Hubei Province in China, has infected over 80,000 people and killed over 2,500 globally. However, most cases have been on China's mainland. The outbreak could dampen global activity in 20Q1 as spillovers from China transmit through trade, financial, and commodities channels, with the latter reflecting China's large role in global commodity markets. In response to the weak external environment or the virus, many EMDE central banks have further eased monetary policy, with some governments also providing fiscal support. Despite the outbreak, equity prices in advanced economies rose in early February, but these gains have reversed somewhat following the spread of the virus outside of Asia.



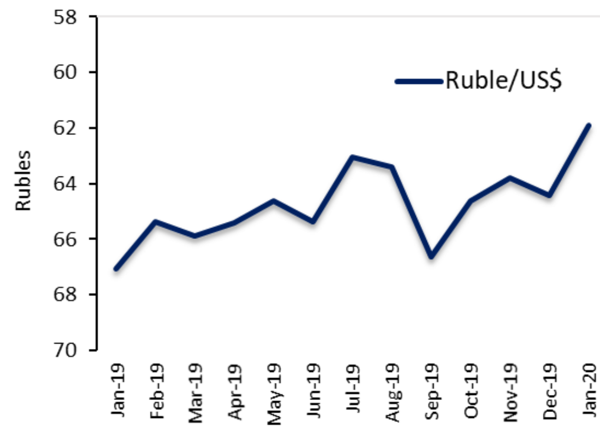
Oil prices fell sharply in mid-January and remained lower in February following reports that the coronavirus outbreak had worsened. Since January 20th (the date when Chinese authorites confirmed occurance of human-to-human transmission of the virus), the price of Brent crude oil has fallen 12 percent to US$57/bbl, while that of WTI is down 11 percent to US$52/bbl (Figure 1). The fall in prices reflects concerns that the virus will substantially reduce air travel and shipping, particularly in China, which is the world's largest importer and second largest consumer of oil. Forecasts for oil demand in 2020 have been revised down accordingly, with the International Energy Agency lowering its forecast by 365 thousand barrels per day (kb/d) to 825 kb/d, which would be the weakest increase since 2011. The U.S. Energy Information Administration reduced its forecasts by around 300 kb/d to 1 million barrels per day. As a result of the fall in prices, OPEC and its allies have indicated that they may cut production further, with OPEC's technical committee recommending a further reduction of 600 kb/d for the first half of 2020. Any decision will likely be formalized at the group's meeting in early March.

Figure 1: Oil prices fell sharply in mid-January and remained lower in February



Source: Bloomberg.

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



Source: CBR.

Recent economic developments

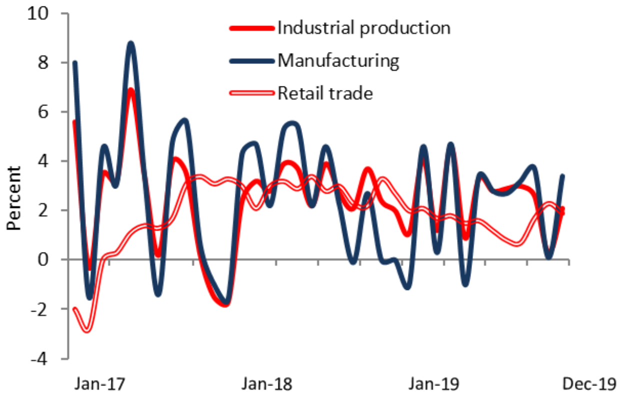
In January, the ruble continued strengthening, outperforming other EMDE currencies (Figure 2). It gained 2.4 percent with respect to the U.S. dollar compared to 2.0 percent in December 2019. This was on the back of sustained interest of foreign investors in Russia's assets and local tax payments. The official exchange rate initially strengthened from 61.9 Rub/USD as of January 1st to 61.8 Rub/USD on January 25th, after which it weakened, reaching 63 Rub/USD on January 31st. This is in part explained by oil price dynamics and reactions to the risks posed by the coronavirus outbreak in China. Meanwhile, negative dynamics were registered for other emerging market currencies as the MSCI International Emerging Market Currency Index declined by 1.1 percent in January following a 2.1 percent rise in the previous month, in part reflecting the expected slowdown triggered by the coronavirus outbreak. This decrease follows a sharp decline in commodity future prices as indicated by the Thomson Reuters/CoreCommodity CRB Commodity Index.

Russia's current account surplus weakened in January 2020 compared to the same period in the previous year, while the trade balance surplus remained almost unchanged. In January 2020, the current account surplus decreased to US$9.5 billion from US$10.2 billion in the same period last year. The trade balance surplus registered at US$14.6 billion compared to US$14.4 billion in January 2019. Net private capital outflows narrowed to US$7.3 billion compared to US$9.3 billion in the previous year. Net capital outflow stemmed mainly from the banking sector which ramped up net foreign assets and cut back on net foreign liabilities. Russia's international reserves gained US$7.1 billion in January compared to US$1.9 billion in the same period last year, largely due to foreign currency purchases in the domestic market, in line with the fiscal rule.

In annual terms, in December 2019, industrial production growth accelerated to 2.1 percent, y/y, compared to 0.3 percent, y/y, in November. Industrial production output growth strengthened in December (+0.2 percent, m/m, sa) in line with higher growth in manufacturing (3.4 percent, y/y, compared to 0.1 percent, y/y, in November). In particular, accelerated growth in production of food and metallurgical products contributed to the manufacturing growth. Meanwhile, growth in mineral resource extraction accelerated to 1.8 percent in December, y/y, from 1,4 percent, y/y, in

November. Construction growth moderately strengthened, registering 0.4 percent, y/y, in December compared to 0.3 percent, y/y, in November.

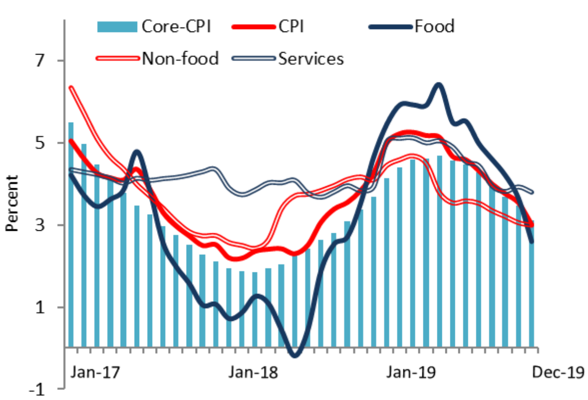
Figure 3: Industrial production output growth accelerated in December



Source: Rosstat, Haver Analytics, World Bank team.

In January 2020, annual inflation rate dropped to 2.4 percent, down from 3 percent in December (Figure 4). The decrease in headline CPI was largely due to the 12-month services CPI deceleration (2.8 percent, y/y, compared to 3.8 percent in December) and the continuous deceleration in the 12-month food inflation (2 percent, y/y, compared to 2.6 percent in December). Core CPI dropped to 2.7 percent in January, down from 3.1 percent in December. The slowdown happened from a high base of January 2019 which was pushed up by the VAT rate increase. Yet core inflation growth on a m-o-m basis did not show signs of increasing inflation pressures.

Figure 4: Consumer price inflation slowed down further at the early 2020

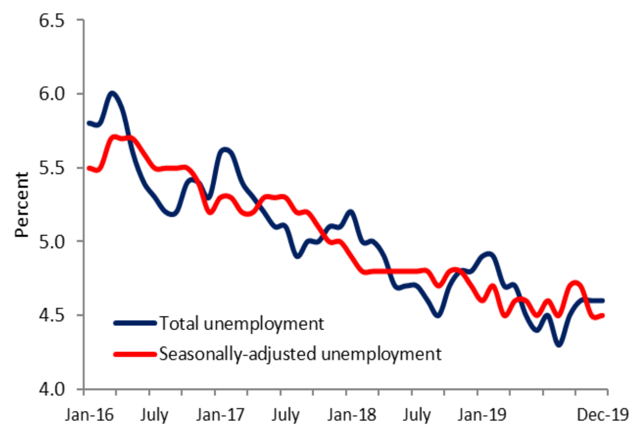


Source: Haver Analytics.

On February 7, 2020, the Bank of Russia cut the key rate by 25 bp to 6 percent in annual terms. The main reason for this decision was continued CPI deceleration and a decline in inflation expectations. In January 2020, households' inflation expectations decreased to 8.3 percent, down from 9 percent registered in December. However, inflation expectations remain elevated. Disinflationary risks still exceed pro-inflationary risks over the short-term horizon. The Central Bank noted possible further rate cuts at its upcoming meetings.

Labour market dynamics were stable in December 2019. The unemployment rate stayed at the level of 4.6 percent – the same as the previous month – and the seasonally adjusted rate also remained unchanged at 4.5 percent (Figure 5). Information on real wages is now being published with a one-month lag. In November 2019, this indicator increased by 2.7 percent compared to the same period in 2018.

Figure 5: In December 2019, the unemployment rate (sa) remained unchanged from the previous month



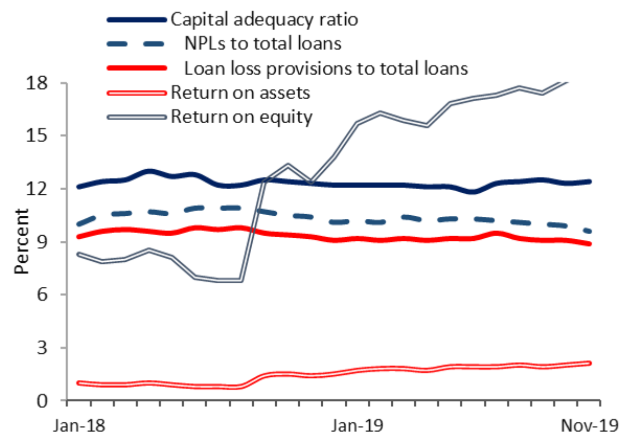
Source: Rosstat, Haver Analytics, World Bank team.

In 2019, on the back of lower tax revenues, the federal budget registered a surplus of 1.8 percent of GDP (cash basis), down from 2.6 percent of GDP in 2018. In 2019, oil/gas revenues dropped by 1.4 percent of GDP to 7.3 percent of GDP due to lower oil prices and tax manoeuvre in the oil sector. Non-oil/gas revenues grew by 1.2 percent of GDP, reaching 11.2 percent of GDP; this was supported by an increase of the VAT tax rate and a weaker ruble in the first half of 2019, which positively affected corporate income tax, VAT, and import duties receipts. Non-tax revenues increased by 0.3 percent of GDP compared to 2018, partly due to higher dividends from Gazprom, Rosneft, and Transnet. Non-interest federal budget expenditures grew by 0.7 percent of GDP mainly on the back of higher spending under categories including national economy (+0.3 percent of GDP), health (+0.2 percent of GDP), housing and communal services (+0.2 percent of GDP), and education (+0.1 percent of GDP). Supported by higher non-oil/gas revenues, the non-oil/gas primary federal budget deficit shrank to 4.8 percent of GDP, down from 5.3 percent of GDP last year. In 2019, federal government debt grew to 12.4 percent of GDP, up from 11.8 percent of GDP, of which external debt increased by 1 percent of GDP to 3.9 percent. This was spurred by non-residents purchasing government bonds. As of January 1, 2020, the National Welfare Fund (NWF) stood at US$125.6 billion (7.1 percent of GDP) compared to US$58.1 billion at the beginning of 2019.

In 2019, both retail and corporate sector lending slowed down although unsecured consumer loans continued growing at double digit rates. Credit to households in rubles grew by 18.6 percent in 2019 compared to 22.8 percent in 2018. The unsecured consumer lending (UCL) slightly moderated as the CBR's regulatory measures started taking effect. In the first eleven months of 2019, the UCL grew by 20.1 percent versus 21.8 percent in the same period of 2018. Credit to the corporate sector, after adjusting for foreign currency (FX) changes, grew at a weaker rate in 2019 than the previous year (4.5 percent in 2019 versus 5.8 percent in 2018). This weak growth reflects soft corporate demand for credit, constrained by low economic growth.

Key credit risk and performance indicators remained stable (Figure 6). As of December 1, 2019, the capital adequacy ratio increased to 12.4 percent from 12.3 percent a month prior (against a regulatory minimum of 8 percent). Non-performing loans slightly declined, reaching 9.6 percent. In 2019, the banking sector's profit amounted to RUB 2 trillion (US$31.5 billion) compared to RUB 1.3 trillion (US$21.5 billion) in 2018. As of December 1st, Return on assets (ROA) and return on equity (ROE) reached 2.1 percent and 18.8 percent, respectively, compared to 1.5 percent and 13.8 percent, respectively, in the beginning of the year.

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



Source: CBR.

The CBR continues to remove insolvent banks. As of January 1, 2020, there were 442 banks compared to 484 at the beginning of 2019.

On February 11, 2020, the CBR agreed to sell its full stake (50 % +1 share) in Sberbank to the Government (Ministry of Finance) for a market price. According to preliminary information, the actual sale price will be determined based on the weighted average price of Sberbank shares for the six months preceding the first day of sale. Currently, the market value of the CBR shares is about RUB2.7 trillion (US$43.6 billion). CBR equity stake at Sberbank is not marked at market price. As of 2018, its booked value stood at just RUB72.9 billion on the CBR's balance sheet.Thus, the CBR stands to make a profit from this sale (of about RUB2 trillion). This sale will resolve the regulator–owner conflict of interest of the CBR holding a majority stake in Russia's biggest bank. The proceeds from this sale would be transferred to the federal budget as CBR's profit (75 percent per law) and will finance additional social support programs announced by the President in January. Currently, additional social spending is estimated at 4 trillion rubles; about US$63 billion (or 3.5% of GDP) in 2020 – 2024. The sale will be conducted in instalments, to be completed by 2021. To finance the purchase, the Ministry of Finance will tap into the liquid part of the National Welfare Fund in an amount exceeding 7 percent of GDP. The CBR is to sell FX currency from the NWF so that the government will invest in rubles in Sberbank shares. The CBR plans to gradually sell FX currency in the market over 3 to 7 years; thus, the effect on the exchange rate will be limited. Meanwhile, the fact that US$43.6 billion of the NWF will be invested in domestic assets goes against its savings and stabilization objective. Also, a large part of additional social expenditures is recurrent and is likely to require more sustainable ways of being funded (such as through tax increases or efficiency savings rather than via this one-off arrangement).

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