

In the second half of 2018, despite robust activity in the United States, there was a slowdown in global growth, which reached an almost three-year low of 2.4 percent (q/q saar) in 18Q3. The subdued momentum persisted in 18Q4 with the global manufacturing PMI ending the year at a 27-month low. After falling almost 20 percent in November 2018, oil prices declined by an additional 13 percent in December. The drop in prices was driven by ongoing concerns of oversupply as well as weakening prospects for global demand in 2019, particularly in China. While the oil price tumbled in December, the ruble nominal exchange rate depreciated moderately. On the back of turbulence in the emerging markets and elevated geopolitical tensions, net capital outflows in 2018 reached about 4.8 percent of GDP (USD 72.1 billion), the highest reading since 2014. In November 2018, there was a slowdown in growth momentum in Russia, with agricultural production dropping and growth in industry slowing. Labor market dynamics were stable in November. December readings of consumer inflation slightly exceeded expectations (3.8 – 4.2% interval according to the CBR forecast) and the 4 percent inflation target. The federal budget registered a surplus of 3.7 percent of GDP in the first eleven months of 2018.

The Global Context

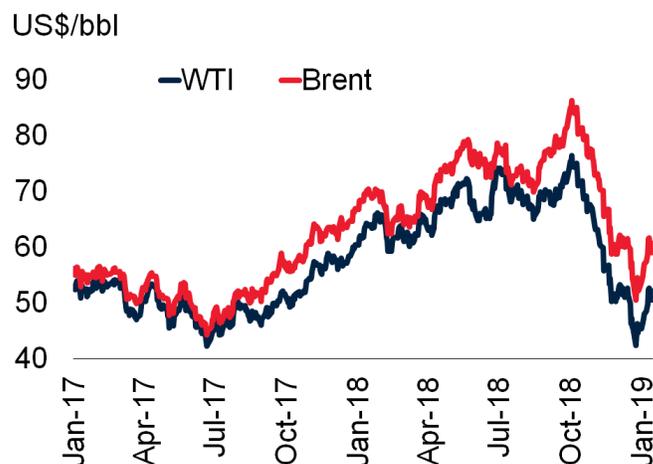
In the second half of 2018, despite robust activity in the United States, there was a slowdown in global growth, which reached an almost three-year low of 2.4 percent (q/q saar) in 18Q3. Survey data suggests that this subdued momentum persisted in 18Q4 with the global manufacturing PMI ending the year at a 27-month low. Growth was also more uneven during 2018, with activity decelerating in almost 80 percent of advanced economies and nearly half of EMDEs. In China, as industrial production and export growth decelerated, growth slowed to an estimated 6.5 percent in 2018. Incoming data confirms that the slowing momentum will continue into 2019. After reaching a six-year high of 5.4 percent in 2017, global trade growth slowed to an estimated 3.8 percent in 2018—the sharpest annual deceleration since 2012. Trade tensions between the United States and China continued to weigh on confidence. During 2018, many EMDEs were under financial pressure, fueled by a combination of the U.S. dollar’s strength, higher borrowing costs, and concerns about softening growth prospects.

After falling almost 20 percent in November 2018, oil prices declined by an additional 13 percent in December (Figure 1). The drop in prices was driven by ongoing concerns of oversupply as well as weakening prospects for global demand in 2019, particularly in China. However, prices rallied at the end of December and into January, with the price of Brent rising from a two-year low of \$50/bbl in December to around \$60/bbl in mid-January. This increase was driven by news that



OPEC had reduced production by 0.75 mb/d in December, ahead of its planned production cuts, in conjunction with non-OPEC partners, of 1.2 mb/d from January 2019. Iranian oil exports are estimated to have fallen to 1.1 mb/d in December, a decrease of almost 60 percent relative to their peak in April. Market sentiment was also boosted by the Saudi announcement that it intended to “stabilize the market” and would likely cut production by more than it had previously agreed.

Figure 1: Oil prices declined by 13 percent in December



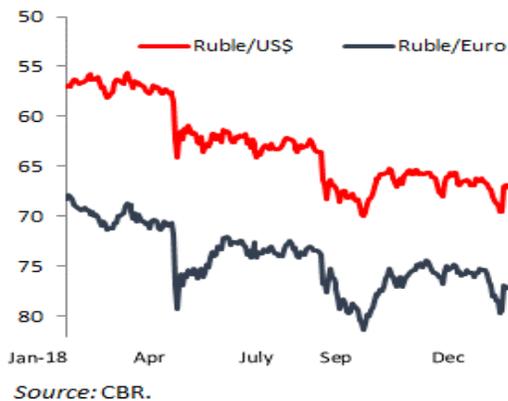
Source: Bloomberg

Russia’s Recent Developments

While the oil price tumbled in December, the ruble nominal exchange rate depreciated moderately (Figure 2). The oil price dropped by about 13 percent in December, m-o-m, and the ruble exchange rate with respect to the U.S. dollar

depreciated by 1.6 percent compared to November. The continued sell-off of OFZ government bonds and the anticipation of the resumption of the foreign currency interventions by the Ministry of Finance in January weighed on the ruble exchange rate. In 2018, the average price for Brent increased by about 31 percent while the ruble nominal exchange rate depreciated by 6.7 percent on the back of turbulence in emerging markets and elevated geopolitical tensions.

Figure 2: Tthe ruble nominal exchange rate depreciated moderately in December

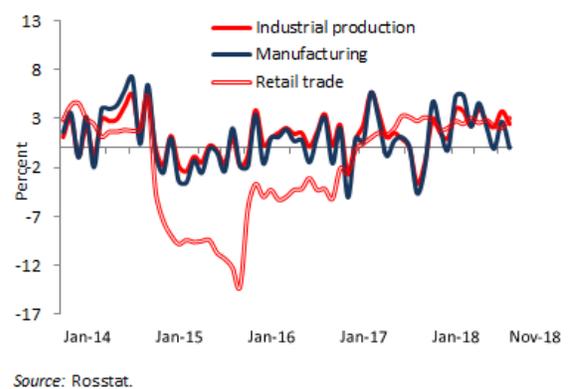


On the back of turbulence in emerging markets and elevated geopolitical tensions, net capital outflows reached about 4.8 percent of GDP (USD 72.1 billion) in 2018, the highest reading since 2014. In the government sector, net capital inflows (0.8 percent of GDP in 2017) turned into net capital outflows (0.4 percent of GDP in 2018), mainly through the selling-off of OFZ bonds. In 2018, net capital outflows in the private sector increased to 4.4 percent of GDP compared to 2.1 percent of GDP in the same period last year. Banks continued debt repayments in an environment of limited access to international financial markets. In the non-banking sector, net capital outflows increased: 1) net liabilities dropped, with a slump in incoming net FDI, reflecting reduced interest of foreign investors in Russian assets, and 2) net foreign assets grew. Supported mostly by rising oil prices, the current account surplus widened in 2018 to about 7.1 percent of GDP (USD114.9 billion), up from 2.1 percent of GDP (USD33.3 billion) in 2017. A stronger trade balance supported the

current account: both energy and non-energy exports increased. International reserves gained USD 33.7 billion in 2018 compared to an increase of USD 15.4 billion in 2017. This was largely due to foreign currency purchases in the fiscal rule framework conducted in the first three quarters of 2018 by the Central Bank on behalf of the Ministry of Finance. Foreign-currency purchases within the fiscal rule framework weakened the link between oil price fluctuations and the exchange rate, and despite growing oil prices, downward pressures on the exchange rate prevailed. The REER depreciated by 7.7 percent, y/y, in 2018.

In November 2018, there was a slowdown in growth momentum, with agricultural production dropping and growth in industry slowing. Growth in five basic sectors¹ slowed to 1.8 percent, y-o-y, from 3.5 percent, y-o-y, in October. In November, agriculture posted a negative growth rate of 3.9 percent, y-o-y, on the back of a lower harvest. Growth in industrial production slowed down to 2.4 percent, y-o-y, from 3.7 percent, y-o-y in October. While growth in mineral resource extraction remained robust (7.8 percent, y-o-y), manufacturing production was flat in annual terms (0 percent growth, y-o-y) due to a slump in manufacturing of other transportation and machinery, which was very uneven during the year. The construction sector grew by 4.3 percent, y-o-y, registering positive growth for the third consecutive month and showing signs of recovery.

Figure 3: Growth lost momentum In November

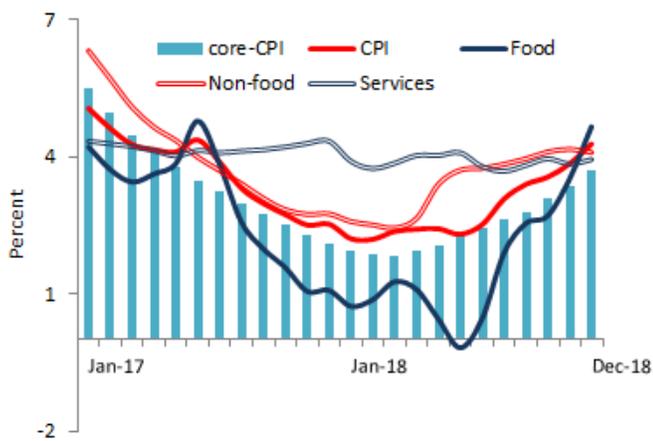


In December 2018, annual consumer inflation accelerated to 4.3 percent, up from 3.8 percent in November. December

¹ Output in five basic sectors is an aggregate indicator, which includes agriculture, industrial production, construction, transport, retail and wholesale trade.

readings of consumer inflation exceeded expectations (3.8 – 4.2 % interval according to the CBR forecast) and the 4 percent inflation target (Figure 4). This increase was mainly due to higher food inflation, which accelerated in December to 4.7 percent, y-o-y, from 3.5 percent in November due to a pass-through effect and a lower harvest. Prices for sugar and eggs grew in double digits in annual terms, the highest among food items. Prices for meat and poultry increased by 9.7 percent in December in annual terms. Core inflation increased from 3.4 percent in November to 3.7 percent in December. Household inflation expectations also increased in December, reaching 10.2 percent, up from 9.8 percent in November. According to the CBR, an increase in inflation expectations was partly due to the pricing in of the VAT rate increase by a larger share of respondents.

Figure 4: The consumer price index accelerated in December

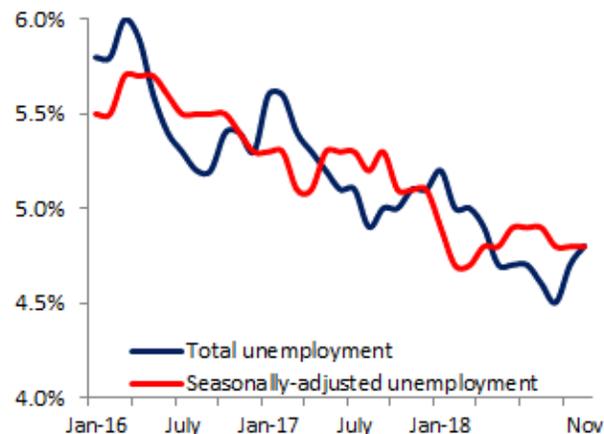


Source: Haver Analytics.

Labor market dynamics were stable in November 2018. The unemployment rate grew slightly to 4.8 percent in November, up from 4.7 percent in the previous month. This increase was mostly driven by seasonal factors. The seasonally adjusted rate did not change and remained at 4.8 percent (Figure 5). Real wages continued to grow and increased by 4.6 percent in November compared to the same period in 2017 and by 1.0 percent compared to October 2018 following seasonal adjustment. Real disposable incomes contracted by 2.9 percent in November compared to the same period in 2017. However, they increased by 1.0 percent compared to the previous month following seasonal adjustment. This indicator is very volatile, and is driven, to a large extent, by sources of income that are not registered by statistics. Pensions were indexed in the beginning of the year and in November 2018,

they decreased by 0.4 percent compared to the same period a year ago.

Figure 5: Labor market dynamics were stable in November

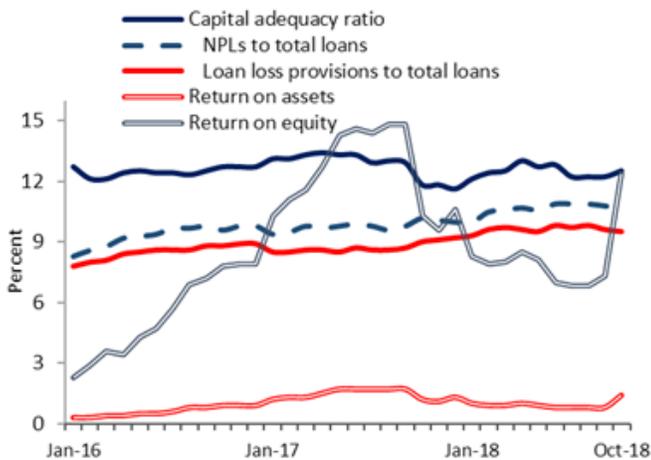


Source: Rosstat, Haver Analytics, World Bank team

The fiscal balance improved in November. The federal budget deficit of 2017 (0.6 percent of GDP) turned into a surplus of 3.7 percent of GDP in the first eleven months of 2018. This improvement was due to higher oil prices combined with a weaker ruble, better tax administration, and a conservative fiscal policy. The non-oil/gas primary fiscal deficit improved to 4.4 percent of GDP in the first eleven months of 2018 compared to 6.3 percent of GDP in the same period last year, mainly due to the conservative fiscal policy. Federal budget primary expenditures decreased from 16.2 percent of GDP to 14.5 percent of GDP (+0.7 percent in nominal terms, y-o-y) on the back of lower social policy expenditures. The cut in social policy expenditures can be explained by the one-time payment made to pensioners in January 2017, which increased the base of 2017. Also, pensions are indexed by the CPI, and the GDP deflator is higher this year on the back of higher energy prices (the GDP deflator averaged 9.5 percent in the first three quarters of 2018). Thus, as a percent of GDP, pensions would be expected to shrink. Domestic debt issuance and spending of the National Welfare Fund are the main sources of financing the “structural” deficit of about 1.4 percent of GDP in 2018. (Structural deficit is calculated with oil and gas revenues at the oil price of US\$40/bbl in 2017 prices. Oil and gas revenues exceeding “structural” revenue will be saved in the National Welfare Fund). In January – November 2018, the government issued domestic debt for 0.5 percent of GDP (net) and spent about 0.5 percent of GDP from the National Welfare Fund (in November). The general government surplus also improved to 5.3 percent of GDP January – October 2018 compared to 0.9 percent in the same period last year.

Key credit risk and banking performance indicators were mainly stable in October (Figure 6). As of November 1st, the capital adequacy ratio stood at 12.4 percent (against a regulatory minimum of 8 percent). The non-performing loan ratio has modestly decreased to 10.5 percent compared to 10.7 percent in the previous month. The return on assets (ROA) and the return on equity (ROE) have been steadily increasing since mi-year – as of November 1st, 2018 ROA and ROE stood at 1.5 percent and 13.3 percent respectively.

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



Source: CBR.

The CBR continues cleaning-up of the banking sector by removing insolvent banks. Since the beginning of the year 71 banks had their licenses revoked for failing to comply with regulations. On January 22nd CBR bailed out Moscow Industrial Bank (ranked #33 by assets) through its Banking Sector Consolidation Fund and provided liquidity support. The bank’s problems were mainly caused by providing loans to non-performing projects in construction, industry and real estate sectors.

Proportionate regulation came into full effect since January 1, 2019. By the end of 2018, 146 banks (30% of the Russian banks) opted for receiving a basic license. Banks with a basic license can conduct a limited number of activities compared to the banks with a general license. In return, there are a number of exceptions to the general requirements for credit institutions provided for banks with a basic license.

Main Economic Indicators													
	2017	2018											
		Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sept	Oct	Nov	Dec
Output Indicators													
GDP, % change, y-o-y	1.6	-	-	1.3	-	-	1.9	-	-	1.5	-	-	-
Basic sectors, % change, y-o-y	2.5	2.3	2.7	1.9	3.7	3.7	1.6	2.8	1.2	0.7	3.6	1.8	-
Industrial production, % change, y-o-y	2.1	2.4	3.2	2.8	3.9	3.7	2.2	3.9	2.7	2.1	3.7	2.4	-
Manufacturing, % change, y-o-y	2.5	4.3	4.7	2.2	5.3	5.4	2.2	4.6	2.2	-0.1	2.7	0.0	-
Retail trade	1.3	2.9	2.0	2.2	2.9	2.6	3.3	2.7	2.8	2.2	2.0	3.0	-
Extraction of mineral resources, % change, y-o-y	2.1	0.8	1.2	2.4	2.5	1.3	2.8	3.2	4.5	6.9	7.4	7.8	-
Construction, % change, y-o-y	-1.4	0.2	-0.2	-9.7	1.4	5.6	-1.3	-0.7	-0.8	0.1	2.9	4.3	-
Fiscal and Monetary Indicators													
Federal government balance, % GDP	-0.6	2.8	1.6	1.8	0.9	1.4	1.9	2.5	3.1	3.5	3.6	3.7	-
Inflation (CPI), %, y-o-y	3.7	2.2	2.2	2.4	2.4	2.4	2.3	2.5	3.1	3.4	3.5	3.8	4.3
Inflation expectations, %, y-o-y	10.3	8.9	8.4	8.5	7.8	8.6	9.8	9.7	9.9	10.1	9.3	9.8	10.2
Balance of Payment Indicators													
Trade Balance, billion \$ (monthly)	115.4	17.0	12.2	15.0	15.3	15.1	15.3	13.4	15.8	18.9	19.7	19.0	-
Current Account, billion \$, ytd	35.4	12.9	20.6	30.0	39.5	47.2	48.4	57.5	65.5	76.0	-	-	114.9
Export of goods, billion \$	353.5	33.4	31.2	36.9	36.2	36.5	36.6	34.4	37.4	38.7	41.3	40.5	-
Import of goods, billion \$	238.1	16.4	19.0	21.9	20.9	21.4	21.0	21.0	21.6	19.8	21.6	21.5	-
Financial Market Indicators													
CBR policy rate, %, end-o-p	7.75	7.50	7.50	7.25	7.25	7.25	7.25	7.25	7.25	7.50	7.50	7.5	7.75
Credit to households in Rub, % change, y-o-y	7.4	13.9	14.6	15.7	16.6	18.1	18.9	19.7	20.7	21.5	22.1	22.7	-
Credit to the corporate sector in Rub, % change, y-o-y	2.0	5.1	5.5	6.3	7.5	6.9	7.4	8.1	9.5	8.4	9.8	9.6	-
Capital adequacy ratio	11.6	12.4	12.5	13.0	12.7	12.8	12.2	12.2	12.2	12.5	12.4	-	-
NPLs to total loans	10.0	10.5	10.6	10.7	10.6	10.9	10.9	10.9	10.8	10.7	10.5	-	-
Loan loss provisions to total loans	9.2	9.6	9.7	9.6	9.5	9.8	9.7	9.8	9.6	9.5	9.5	9.4	-
Return on assets (ROA)	1.3	0.9	0.9	1.0	0.9	0.8	0.8	0.8	0.8	1.4	1.4	4.5	-
Return on equity (ROE)	10.6	7.9	8.0	8.5	8.1	7.0	6.8	6.8	7.3	12.4	12.4	13.3	-
Income, Poverty and Labor Market													
Real wages, % change, y-o-y	6.2	11.0	10.5	8.7	7.6	7.6	7.2	7.5	6.8	4.9	5.2	4.6	-
Unemployment (% , ILO definition)	5.1	5.2	5.0	5.0	4.9	4.7	4.7	4.7	4.6	4.5	4.7	4.8	-
Exchange rate													
USD/ RUB, average	58.3	56.8	56.8	57.0	60.4	62.2	62.7	62.8	66.1	67.7	65.8	66.2	67.3
Euro/ RUB, average	65.8	69.0	70.3	70.4	74.2	73.7	73.2	73.4	76.2	79.0	75.7	75.3	76.6
Oil price													
Brent, \$/ bbl	54.4	69.0	65.4	66.5	71.6	76.7	75.2	74.4	73.1	78.9	80.5	65.2	57.4

Source: Rosstat, CBR, EEG.

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In its analytical work, the World Bank uses official statistics of the Russian Federation.

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