Russia Economic Review

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Russia's central bank left its key interest rate unchanged at 9%, and further easing pace will depend on the inflation trend and geopolitical situation. The pace of economic growth is picking up.

- Russia's Central Bank (CBR) decided to leave its main interest rate at 9.0%, in line with the Bloomberg expectation. Decisions on further cuts will depend on the pace of the disinflationary trend, inflation expectations and short-term geopolitical risks.
- Industrial production in June increased by 3.5%Y/Y and retail sales growth accelerated to 1.2%Y/Y.
- Real wages continue to grow while the labour market is tightening. The unemployment rate in Moscow fell to 1.4% signalling the possibility of labour force shortage in the near future.
- The trade surplus in May, Q217 and during the first half of the year remained solid amid growing exports, while imports also show positive dynamics. On the other hand, the current account fell back into deficit in Q217 ($0.3bn) for the first time since 2013.

Russia's central bank left key interest rate unchanged at 9%

Russia's Central Bank (CBR) decided to leave its main interest rate at 9.0% at its regular board meeting on monetary policy on July 28.The decision was in line with Bloomberg expectations. And it appears to reflect greater uncertainty surrounding the inflation outlook, with unusually cold weather in April-May having impacted the disinflationary trend, while the new US sanctions against Russia might add further downward pressure on rouble. We believe additional monetary easing is still on the table for this year, but this decision will inevitably depend on domestic inflation and inflation expectations as well as geopolitical developments.

Indeed, despite renewed upward pressure on the oil price which has recently returned back above $50pbl, the latest developments in the FX market highlight currency vulnerability towards geopolitical risks. Having been passed with overwhelming majorities in both chambers and signed yesterday by President Trump the new legislation, which prevents the President changing the regime without the approval of Congress, means that they are likely to remain in place for a significant period and therefore will probably continue to weigh on the rouble and we think that further weakening (at least in short-term) to 62-65RUB/$ is possible.

On the other hand, the economic growth forecast for this year remains relatively bright. While the CBR expects GDP growth to be around 1.3%-1.8% in 2017, the Ministry for Economic Development (MED) is more optimistic. According to the MED, GDP growth has accelerated to 2.7%Y/Y in Q217 from 1.6%Y/Y in Q117 and the Minister Maxim Oreshkin believes that annualised growth for this year may exceed the Ministry's forecast of 2%.

Industrial production in June up by 3.5%Y/Y

Industrial production in June grew by 3.5%Y/Y – showing the best result for that month since 2011. Although on a monthly basis industrial output fell by 0.6%.But coming on the back of two strong increases earlier in the quarter, output was up by more than 2%Q/Q in Q2, to leave it up by 3.5%Y/Y (1.2%Y/Y in Q216). And in the first half of the year industrial production grew by 2.0%Y/Y compared to 1.4%Y/Y a year ago.

By the main three categories of industrial output, for the first six months of the year, mining increased by 3.1%Y/Y, compared to 2.9%Y/Y growth for the same period a year ago, manufacturing increased by 1.2%Y/Y (up by 0.7%Y/Y in same period of 2016) and output of electricity, gas and water grew by 2.5% Y/Y (down by 0.3%Y/Y in the first half of 2016), suggesting that the recovery is broad based.

Growing retail sales provide hope towards higher economic growth

June's retail sales growth came in at 1.2%Y/Y – a touch above the Bloomberg forecast and 0.5ppt higher compared to the previous month, following April and May's positive figures to leave Q217 growth at 0.7%Y/Y (was down by 1.6%Y/Y in Q117). And while retail sales growth for the first six months of 2017 was down by 0.5%Y/Y it was a far better result compared to 4.6%Y/Y decrease a year ago. On a monthly basis sales grew by 1.1%M/M which was 0.7ppt slower compared to the previous month but, at the same time, was a touch better that the Bloomberg consensus forecast of 0.9%Y/Y. So, at last, consumption has started to show signs of an upward trend providing cause for optimism with respect to future economic growth.

Within the detail, while food sales in June were down by 0.6%Y/Y and decreased by 0.6%Y/Y in Q217 to leave growth for the first six months at negative 1.8% compared to a year ago, non-food sales performed markedly better. Indeed, June's non-food sales were up 2.9%Y/Y and grew by 1.9%Y/Y in Q217 and by 0.8%Y/Y in the first half of the year.

Positive real wages dynamics, tightening labour market

While the rate of growth of real wages in May was revised down to 2.8%Y/Y (compared to the preliminary estimate of 3.7%Y/Y), the growth of wages in June was a touch higher at 2.9%Y/Y.

In nominal terms the average wage was 41,6430 RBL (equivalent of $680), up by 7.4%Y/Y in June and by 7.2%Y/Y during the first half of the year. Real wages were up by 2.9%Y/Y and 2.9%M/M (-4.5%Y/Y and 10.1%M/M in June 2016).

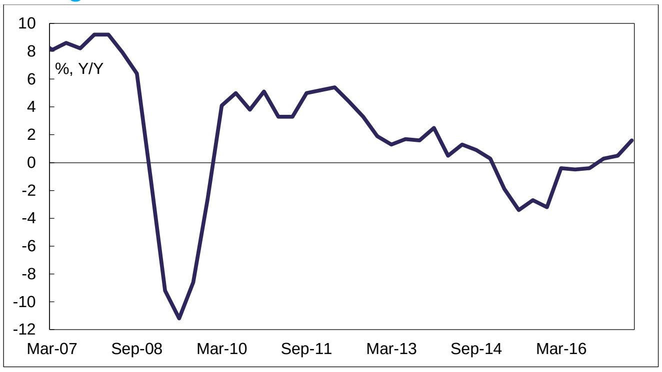
The unemployment rate in June declined further to 5.1% from 5.2% in May and was in line the Bloomberg consensus forecast. The labour market in Moscow has tightened further to 1.4%, compared to 1.8% a year ago and the unemployment rate of St Petersburg remains low at 1.6% (same as in June 2016). While demographically predictable, recent signs of shrinking of the working-age population may start to weigh on economic growth and, indeed, cause a problem for economic policymakers. Low productivity is the other side of the problem, as growing wages in times of tight labour market may lead to reinforcement of status quo of traditionally low productive labour and inevitably low competitiveness of Russian products.

Trade surplus remains solid while exports and imports grew

While Russian exports in May grew to $28.2bn, up by 27%Y/Y, imports increased at a faster pace, by 36%Y/Y to $19.7bn to leave the trade surplus at $8.5bn, which was below the Bloomberg forecast by $0.3bn, but still above the surplus this time last year.

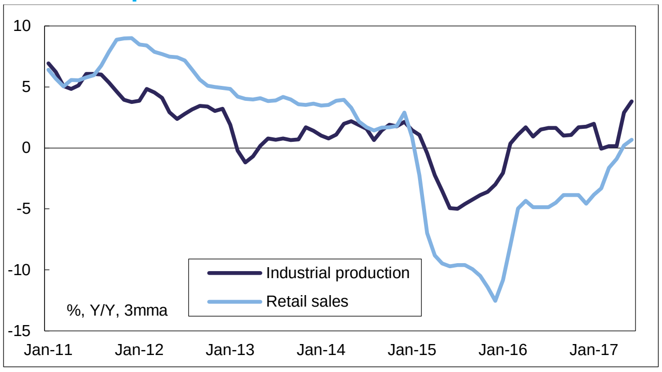
According to the MED, for the Q217 exports were up by 22.9%Y/Y and 29.2%Y/Y during the first six months of the year, while imports also showed positive growth and increased by 28.5%Y/Y in Q217 and by 27.4%Y/Y in the first half of the year. And while the trade surplus remained solid and grew by 24.8% in Q217 and by an impressive 59.2%Y/Y in January-June, the current account fell back into –deficit of $0.3bn in Q217, first time since third quarter 2013.

GDP growth



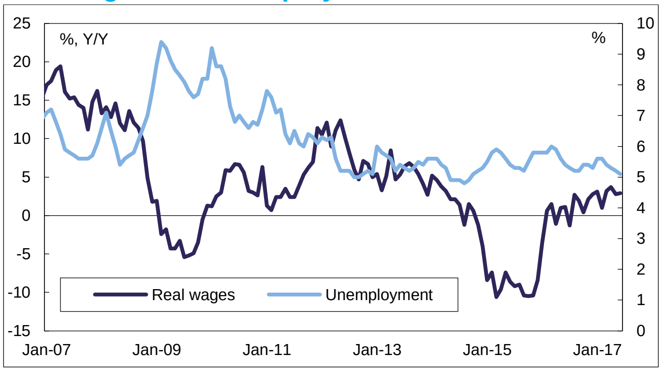
Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Industrial production and retail sales



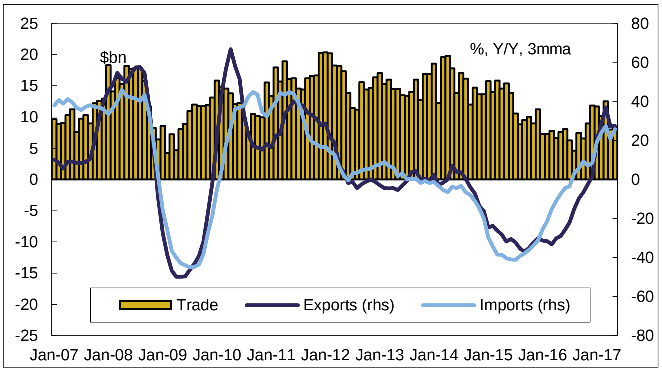
Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Real wages and unemployment rate



Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Trade



Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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