Daiwa Capital Markets

Russia Economic Review

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In October the CBR, in line with expectations, cut interest rates by 25bp to 8.25%. Inflation persistently remains below the CBR's target of 4%. The economy continues to grow at a 2% pace.

- While the inflation rate was as low as 2.7%Y/Y in October, inflation expectations, according to the CBR, remain relatively high, preventing more aggressive monetary easing.
- Industrial production growth in September came in at 0.9%Y/Y, the strongest for this month since 2014. September's retail sales growth surprised to the upside at 3.1%Y.Y.
- Real wages continue to grow at 2.6%Y/Y while the unemployment rate stabilized at around 5% in September.
- Trade data were also encouraging, reflecting strong exports amid favourable commodity prices, while growing domestic demand was behind increased imports.

CBR cut interest rate further to 8.25%

Russia' central bank (CBR) cut its key interest rate by 25bps to 8.25% followed the scheduled board meeting on monetary policy on 27 October. While the inflation rate is persistently low compared to the CBR's target of 4% (inflation fell to 2.7%Y/Y in October and core inflation decreased to 2.5%Y/Y). While the acceleration in the disinflationary trend might partly be attributed to seasonal factors such as a good harvest, consumer inflation expectations, which are an important benchmark for the Central bank regarding its monetary policy, remain above the current inflation level and justify the CBR's cautious stance towards further monetary easing. At the end of the year the CBR expects inflation to be around 3%. We believe that under the circumstances the central bank will maintain a gradual easing path and expect a 25bp rate cut following the next scheduled board meeting on 15 December.

On the other hand, according to Ministry of Economic Development data, in September, in area accounting for 94% of Russian Federation citizens (which include republics, regions, cities of federal importance) the inflation rate was at or below the CBR's target (4%) compared to 86% a month ago and we expect that there will be a further rate cut of 25bps in December, to leave the key interest rate at 8% at the end of the year.

Meanwhile, despite relatively high real interest rates, the Russian economy continues to grow. Indeed, according to the Minister of Economic Development Maxim Oreshkin's comments during his working meeting with President Putin on 20 October, in September GDP growth accelerated to 2.4%Y/Y and the Ministry had expected economic growth to be around 2.2%Y/Y in 3Q17. The Minister has also mentioned that considering positive growth of wages, increasing lending and investments, the Ministry expects continuing positive growth in coming quarters. On 13 November the Russian Federal Service for State Statistics published its preliminary figure for economic growth in Q317, which came in at 1.8%Y/Y a bit lower compared to the Bloomberg forecast of 2.0%Y/Y, but nonetheless the best figure for the third quarter in five years.

Industrial production – strongest result for September since 2014

While industrial production growth in September was at first sight weaker than expected (0.9%Y/Y compared to 1.5%Y/Y in August), it was the strongest result for the same month since 2014. In January –September industrial production increased by 1.8%Y/Y compared to a year ago and in Q317 the growth rate came in at 1.4%Y/Y.

On the other hand while the mining industry's growth came in on the softer side and decreased marginally (-0.1%Y/Y) in September, growth in Q317 remained positive (2.3%Y/Y). The growth trajectory of manufacturing production remained positive in September (1.1%Y/Y) and in Q317 as well (0.4%Y/Y). Following the double-digit growth of car sales during last quarter, domestic production of light vehicles soared by 22%Y/Y in September and 21%Y/Y in Q317, providing cause for optimism for further growth.

While October's PMIs came in on the softer side, compared to the previous month they continue to be solidly above 50 points, underpinning prospects for further economic growth. Indeed the manufacturing sector PMI was 51.1, services – 53.9 to leave the composite index at 53.2.

September's retail sales' growth surprised to the upside

Retail sales growth in September surprised to the upside – accelerating to 3.1%Y/Y, the strongest figure since December 2014 and the best result for the same month in four years. In Q317 retail sales were up by 2.0%Y/Y. In September, the share of food in retail sales was 48% and non-food – 52%. Food sales showed strong dynamics, increasing by 3.7%Y/Y in September and by 1.9% in Q317. The car sales continued their double-digit growth (17%Y/Y in October).
Strong dynamics of retail sales coupled with improving dynamics of bank lending provides a cause for optimism about a further acceleration in GDP growth in the fourth quarter.

Real wages were up by 2.6%Y/Y while unemployment came in at 5%

Real wages in September showed positive growth for the fourteenth month in a row, underpinning upward consumption trend. Indeed, wages were up by 2.6%Y/Y and while this was below the Bloomberg consensus expectations (3.7%Y/Y the same level as in August), August's figure was revised lower from 3.7%Y/Y to 2.4%Y/Y and compared to the revised figure wages growth in September was in line with trend. Nominal average wage was 37,520 Rbl which is around $645.

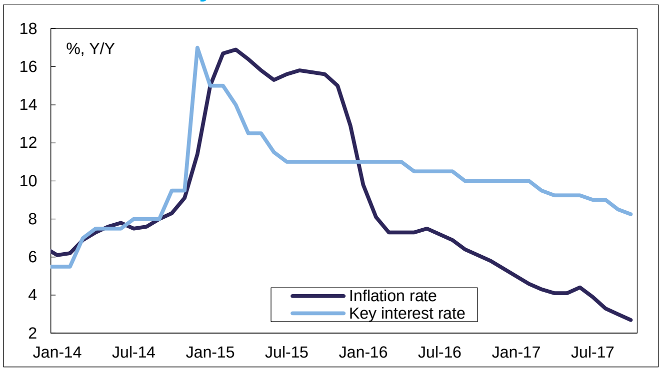
Stable positive dynamics of wage growth was observed in August in most sectors of the economy. While the financial sector remains one of the higher-paid jobs' areas in nominal terms, the rate of growth (in August) was quite low (0.8%Y/Y) compared to for example agriculture (8.5%Y/Y) and the food industry (9.6%Y/Y) among others. Higher growth rate of lower range wages provides cause for optimism for the broadening of consumers' base with a good perspective for the further growth of consumption.

The labour market is stable with an unemployment rate of 5% in September. Moscow and St Petersburg remain among the tightest labour markets in terms of potential labour shortage. Indeed, the unemployment rate in September in Moscow was 1.3% and 1.8% in St Petersburg.

September's trade surplus beats market expectations

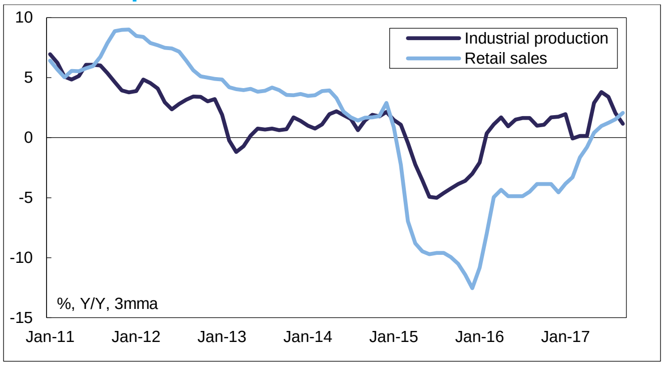
In September the trade surplus increased to $10.2bn from $6.6bn a month earlier and also came in at $1.4bn higher compared to the Bloomberg consensus forecast. Annualized growth of exports came in at 21%YY/Y and imports at 14%Y/Y, reflecting favourable energy prices and, at the same time, a gradual improvement of business conjuncture as growing imports show.

Inflation and key interest rate



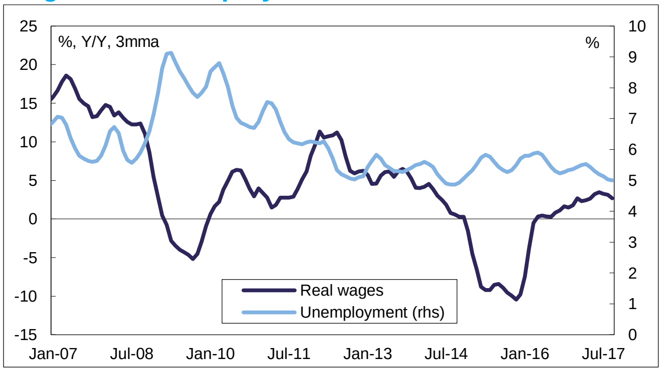
Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Industrial production and retail sales



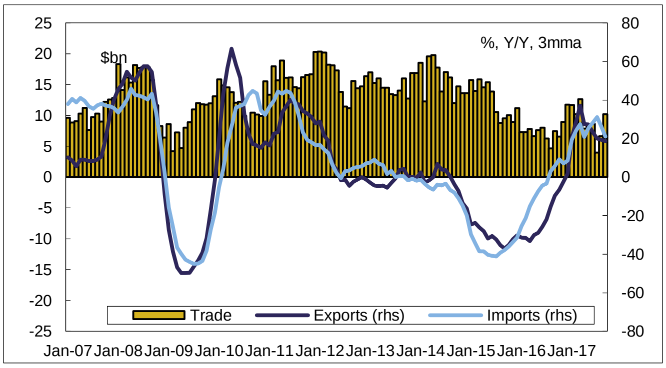
Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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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