Daiwa Capital Markets

Russia Economic Review

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Russia's central bank left interest rates unchanged without committing to provide further monetary easing as market instability weighed on the rouble. GDP fell 3.7%Y/Y in 2015.

- Russia's central bank (CBR) maintained its key interest rate at 11% as plummeting oil prices and the weakening rouble posed upside risks to inflation. A less dovish tone from the CBR, notably lacking the "usual" promises for further monetary easing, revealed CBR concerns about recent market developments. But CPI fell to a single-digit rate in January thanks to a favourable base effect.
- Economic growth in 2015 (-3.7%Y/Y) was negative for the first time since 2009. Despite some signals that the economy is bottoming out, neutral or slightly positive GDP growth would be possible this year only if oil prices rebounded back towards $50pbl.
- We remain bearish on the outlook for near-term consumption amid a 10%Y/Y decrease in real wages and an unemployment rate near 6%.

CBR left key interest rate unchanged at 11%. No promises for monetary easing any time soon

The CBR left its key interest rate (one-week repo rate) unchanged at current 11% following its first board meeting on monetary policy for the year on 29 January. And while the decision was broadly expected considering market volatility, plummeting oil prices and the weaker rouble, the much less dovish tone – compared to previous statements in which CBR promised to re-launch monetary easing at the earliest opportunity – came as a surprise. The CBR pointed out growing market instability and the latest rouble depreciation as potential threats to financial stability. But we think that the possibility of a rate cut in Q216 exists if oil prices start to bottom out and stability returns to global markets.

The CBR expects inflation to decrease to 8-9%Y/Y in Q116 partly thanks to a favourable base effect. Inflation is expected subsequently to fall to 7% in January 2017 and to the 4% inflation target in 2018.

In January CPI fell to a single-digit rate for the first time in more than two years

Despite the highly volatile rouble exchange rate, CPI in January fell to 9.8%Y/Y (its first time below 10% since November 2014) and improved significantly from 12.9%Y/Y in December. While the inflation rate was in line with expectations, the main driver behind the improvement was a favourable base effect. Monthly CPI of 1.0%M/M represented an increase of 0.2ppt compared to the previous month. Core CPI of 10.7%Y/Y was in line with expectations, decreasing 3ppt from December.

GDP fell 3.7%Y/Y in 2015, the first full-year drop since 2009. Investment remains disappointing

GDP in 2015 fell 3.7%Y/Y, the first full-year drop since 2009 (-7.8%Y/Y) and only the second decline since the rouble crisis in 1998 (-5.3%Y/Y). But while 2015 was indeed a very difficult year for the Russian economy, and the CBR as recently as September last year expected the economy to shrink by 3.9-4.4%Y/Y, the result was in line with the CBR's more optimistic December outlook which had forecast a range of -3.7 to -3.9%Y/Y.

The CBR's outlook for economic growth in 2016, based on the brave assumption that the annual average oil price for this year will be $50pbl, is for a slight contraction in GDP of 0.5-1.0%Y/Y with a return to positive growth in 2017. Considering current low oil prices and uncertainties clouding the market, the chances that oil prices will return to levels close to $50pbl in coming months appear small and we expect the CBR to revise down its economic outlook for this year unless OPEC changes its current policy stance. The CBR's next updated outlook is expected to be published in the CBR's Monetary Policy Report in March.

In December, fixed investment fell 8.7%Y/Y – the steepest decline in 2015 – following a drop of 4.9%Y/Y in November and disappointing the Bloomberg consensus forecast of a decline of 5.5%Y/Y. The sluggish economy and unclear prospects of further cuts in interest rates are among the main factors influencing companies' investment decisions.

December retail sales and IP were broadly in line with market expectations

In line with the Bloomberg consensus, in December retail sales decreased by 15.3%Y/Y. And while this was the steepest decline in twenty years, we are not alarmed as the base effect from December 2014 "panic buying" was extremely unfavourable. Food sales dropped by 11.4%Y/Y, while non-food sales decreased by 18.5%Y/Y.

Meanwhile, in the same month, industrial production decreased by 4.5%Y/Y (Bloomberg consensus -4.2%Y/Y), down 1ppt from the previous month. While manufacturing production in 2015 shrank by 5.4%Y/Y, mining output increased marginally by 0.3%Y/Y.

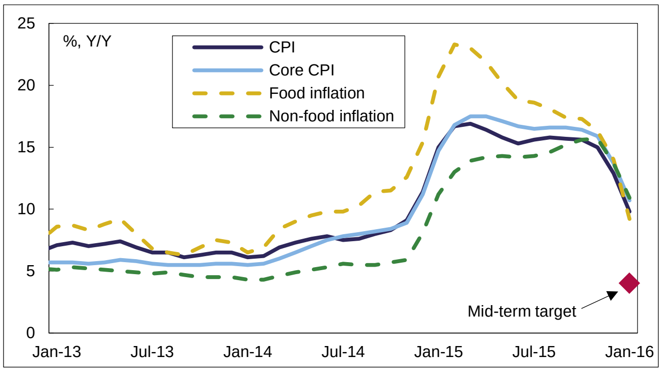
January manufacturing PMI improved, but service sector indices disappointed

On the other hand, January's PMIs were a mixed bag. Indeed, the manufacturing PMI increased more than 1ppt compared to the previous month to 49.8 – only a touch below the 50-point level indicating expansion. Although export-related new orders decreased and the employment situation worsened, domestic output, new orders and input purchases (for the first time in over a year) grew, providing cause for optimism. But January's service sector PMI of 47.1, while a touch above the Bloomberg consensus, decreased by 0.6pts compared to the previous month, as output and new orders fell. Increased tariffs put pressure on prices, affecting demand. As a result, January's composite PMI increased by 0.6pts compared to December to 48.4, still short of expansion territory.

In December unemployment rose while real wages dropped by 10%Y/Y

In December the unemployment rate of 5.8% was the same as in November and below the Bloomberg forecast of 5.9%. On the other hand, in the major cities the unemployment rate remains very low indeed, just 1.7% in Moscow and 1.9% in St Petersburg. Meanwhile, the same month real wages decreased by 10%Y/Y, only a touch better than the previous month's decline of 10.4%Y/Y (revised).

Inflation



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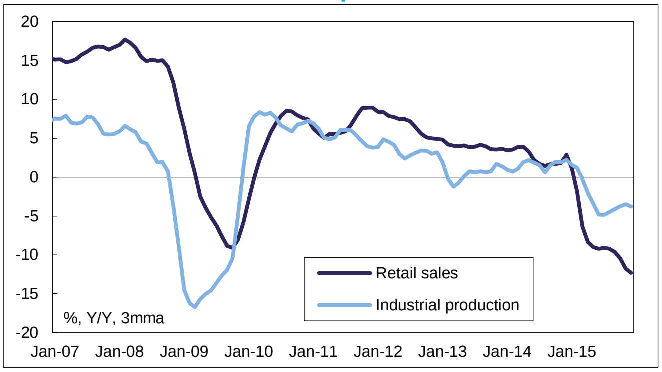
Retail sales and industrial production



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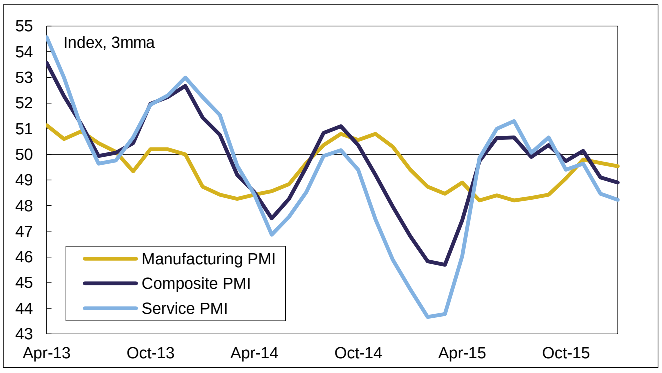
PMIs



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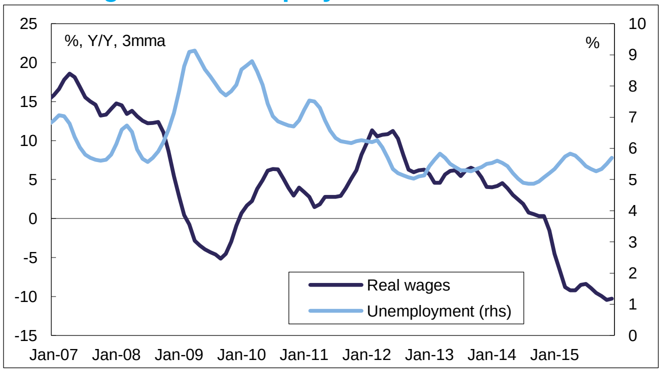
Real wages and unemployment



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