Russia Monthly Economic Developments

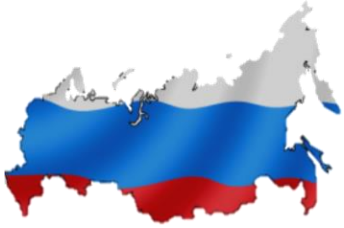
March 2019

THE WORLD BANK
IBRD • IDA

Incoming data confirms that global growth lost momentum in 2018, driven by a noticeable deceleration in both advanced economies and emerging market and developing economies (EMDEs). The loss of momentum was particularly pronounced in manufacturing amid signs of softening global investment and trade. The global manufacturing PMI suggests continued weakness in January and February 2019, with the index falling to its lowest level since mid-2016. After rising 8 percent in February, crude oil prices continued to increase in March this year: The price of Brent, the international marker, reached $68/bbl by the middle of the month, and WTI, the U.S. benchmark, increased to $58/bbl. In February, the Russian ruble gained 2.2 percent compared to the previous month, supported by the easing of global financing conditions, higher oil prices, and a relatively lower risk perception. Russia's economic growth was weak in January with output in five basic sectors[1] increasing by 0.2 percent, y/y, compared to a 1.9 percent growth, y/y, in December 2018. In February, annual consumer inflation accelerated to 5.2 percent, y/y, up from 5.0 percent, y/y, in January. Monthly inflation growth decelerated across all categories in February, sa, as January experienced the most intense VAT-pass-through effect. Labor market dynamics were stable in January, and real wages continued to grow but only increased by 0.2 percent compared to the same period in 2018. The federal budget balance improved in January compared to the same period last year on the back of stronger non-oil revenues. Credit expansion continued into 2019, but the fast-paced expansion in household credit could pose a risk to financial stability if the macroeconomic environment were to deteriorate. Key credit risk and performance indicators remained largely stable in early 2019.

Public Disclosure Authorized

The Global Context



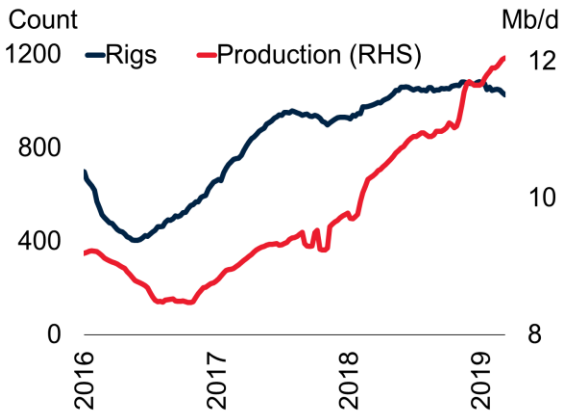
Incoming data confirms that global growth lost momentum in 2018, driven by a noticeable deceleration in both advanced economies and emerging market and developing economies (EMDEs). Growth in the Euro Area nearly halved in 2018, ending the year at 0.9 percent (q/q saar). Growth fell precipitously in EMDEs, down to 3.9 percent (q/q saar) after registering 5.4 percent (q/q saar) at the start of 2018. The slowdown coincided with the waning effect of stimulus measures in major economies, tighter financing conditions, financing stress in some EMDEs, and elevated policy uncertainty. The loss of momentum was particularly pronounced in manufacturing amid signs of softening global investment and trade. The global manufacturing PMI suggests continued weakness in January and February, with the index falling to its lowest level since mid-2016. Amid deterioration in global growth prospects, global financing conditions have eased, leading to generally more benign EMDE financing conditions and bond market stabilization.

After rising 8 percent in February 2019, crude oil prices continued to increase in March, with the price of Brent, the international marker, reaching $68/bbl by the middle of the month, and WTI, the U.S. benchmark, increasing to $58/bbl. Global oil production continues to tighten, with output among OPEC countries falling to 220 thousand barrels per day (kb/d) in February. Total OPEC production is now 30.5 mb/d, down from 32.1 mb/d in the fourth quarter of 2018. Saudi Arabia continues to reduce supply and has announced that its oil output in March and April could be even lower than what was agreed upon in December. Production in Venezuela has also fallen further following recent power outages. Russia is expected to gradually reduce its output by the agreed 0.23 mb/d. These production declines have been balanced by ongoing output increases in the U.S., especially in the Permian basin; however, there are tentative signs that the pace of growth is slowing. The U.S. Energy Information

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

Administration revised down its forecast for U.S. production by 100kb/d in 2019 and 200 kb/d in 2020. U.S. oil inventories fell unexpectedly in mid-March, and growth in the rig count has slowed significantly, with the number of rigs down by 56 since the start of the year (Figure 1). In a surprise move, Norway announced that its oil fund would divest from oil and gas companies, a move that was interpreted as a signal of poor longer-term prospects in the oil industry.

Figure 1: In mid-March, growth in the rig count has slowed significantly

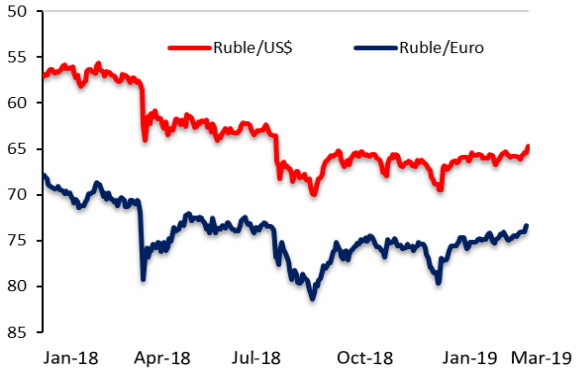


Source: U.S. Energy Information Administration.

Russia's Recent Developments

In February 2019, the Russian ruble gained 2.2 percent from the previous month, with the ruble average exchange rate strengthening to 65.9 against the U.S. dollar (Figure 2). A factor weighing down on the ruble exchange rate dynamic was the additional forex purchases by the Central Bank of Russia (these are delayed currency purchases from last year). However, supported by the easing of global financing conditions, higher oil prices, and a somewhat lower risk perception (CDS spreads slightly decreased in February), the ruble strengthened with respect to the U.S. dollar.

Figure 2: The average ruble nominal exchange rate gained 2.2 percent in February 2019



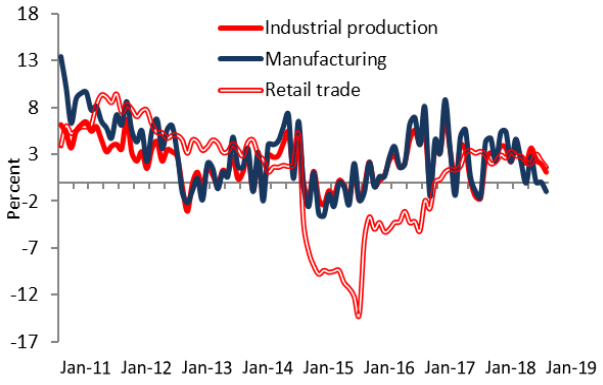
Source: CBR.

Despite lower oil prices in the first two months of 2019 compared to the same period last year, Russia's current account strengthened (albeit slightly) due to a higher trade balance surplus and stronger primary and secondary income balances. According to preliminary information, in January – February 2019, the current account surplus reached US$22.3 billion compared to US$20.6 billion in the same period last year. Net capital outflows from the private sector grew to US$18.6 billion from US$8.7 billion in the same period last year largely due to an increase in net foreign assets.

Economic growth was weak in January (Figure 3). Output in five basic sectors increased by 0.2 percent, y/y, compared to a 1.9 percent growth, y/y, in December 2018. Growth in industrial production (1.1 percent, y/y, +0.1 percent, m/m, sa) was driven by firm mineral resource extraction growth (4.8 percent, y/y, following a low base of 2018). Yet, compared to December 2018, growth in mineral resource extraction was negative following seasonal adjustment as Russia joined the OPEC+ agreement. Manufacturing output dropped by 1 percent, y/y, prompted by a dip in production of non-auto vehicles (partly related to military production). As expected, retail sales growth decelerated in January to 1.6 percent, y/y, compared to 2.3 percent, y/y, in December 2018. This was due to a VAT rate increase, low real wages growth (+0.2 percent, y/y), and declining real incomes (-1.3 percent, y/y). Continued rapid growth of retail credits and a preferential VAT rate for a large part of food produce supported retail trade. Wholesale trade

dropped by 6.2 percent, y/y, weighing down on the growth in five basic sectors (energy goods sales constitute about half of wholesale trade).

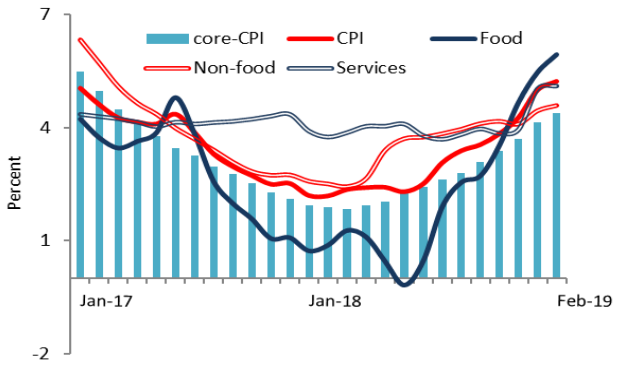
Figure 3: Economic growth was weak in January



Source: Rosstat, Haver Analytics, World Bank team.

In February 2019, annual consumer inflation accelerated to 5.2 percent, y/y, up from 5.0 percent, y/y, in January 2019 (Figure 4). Prompted by a higher contribution of food inflation (0.2 pp), the 12-month consumer inflation accelerated in February. In the same month, monthly inflation growth decelerated across all categories, sa, as January experienced the most intense VAT-pass-through effect. Core inflation increased to 4.4 percent, y/y, in February 2019, up from 4.1 percent, y/y, in January. Household inflation expectations remain elevated although they eased to 10.1 percent in February, down from 10.4 percent in January.

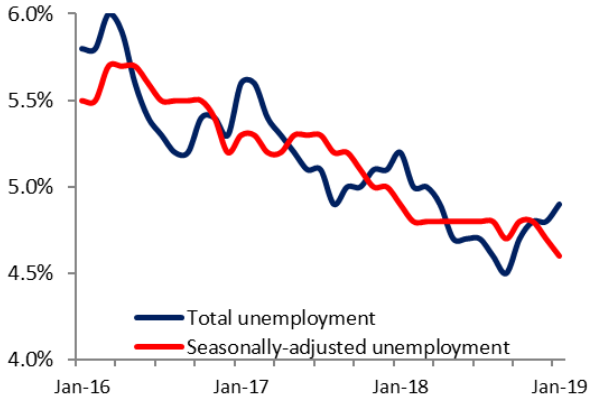
Figure 4: The consumer price index accelerated in February 2019



Source: Haver Analytics.

Labor market dynamics were stable in January 2019. The unemployment rate grew slightly to 4.9 percent in January from 4.8 percent in the previous month. This increase was mostly driven by seasonal factors. The seasonally adjusted rate decreased by 0.1 percentage points in the same period (Figure 5). Real wages continued to grow but increased by only 0.2 percent in January compared to the same period in 2018, and contracted by 0.4 percent compared to December 2018 following seasonal adjustment. In January, real disposable incomes decreased by 1.3 percent compared to the same period in 2018. However, they increased by 3.2 percent compared to December 2018 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 2019 and grew by 0.8 percent (adjusted for inflation) in January compared to the same period a year ago.

Figure 5: Labor market dynamics were stable in January



Source: Rosstat, Haver Analytics, World Bank team

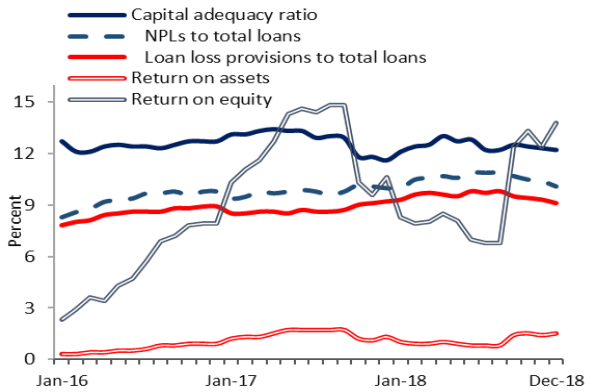
On the back of stronger non-oil revenues, the federal budget balance improved in January 2019 compared to the same period last year. Despite lower oil prices, federal budget revenues increased to 19.4 percent of GDP in January, up from 19.1 percent in the same period last year. This was the result of a 0.9 pp increase in non-oil revenues with non-oil federal budget revenues reaching 10.5 percent of GDP on the back of the VAT rate increase and improvement in tax administration. In January 2019, the VAT tax increase largely affected tax receipts from VAT levied on imported goods and services. The new VAT rate levied on goods and services produced domestically will be reflected in tax receipts starting in the second quarter of 2019. Oil/gas revenues

decreased to 8.9 percent of GDP from 9.7 percent of GDP due to lower oil prices. Federal budget expenditures rose to 15.7 percent of GDP, up from 15.5 percent of GDP last year due to higher spending on national defense (+0.6 percent of GDP), education (+0.3 percent of GDP), and social policy (+0.2 percent of GDP). The increase in primary expenditures was outweighed by non-oil/gas revenue increases, which led to an improvement of the non-oil/gas federal budget primary deficit to 4.6 percent of GDP compared to 5.2 percent of GDP in the same period last year.

Credit expansion continued into 2019. Credit to the corporate sector in rubles grew by 12.3 percent in January, y/y, while loans to households rose by 23.2 percent, y/y, driven mainly by unsecured loans and mortgage loans. The recent fast-paced expansion in household credit could pose a risk to financial stability if the macroeconomic environment were to deteriorate. Lending growth has been outpacing wage growth (22.6 percent vs 9.9 percent in 2018 respectively) and if this trend persists, debt service costs may become an excessive burden, especially for lower-income households which are seeing a rapid increase in their leverage. Moreover, the rapid expansion in unsecured household credit leaves the sector more vulnerable to a deterioration in the economic outlook and could lead to a build-up of non-performing assets if growth slows substantially. To address the risks posed by accelerated growth in consumer lending, the CBR adjusted risk weights on unsecured retail loans three times in 2018 (the latest increase to become effective April 1, 2019) and will require banks and microfinance organizations to calculate DTI (debt-to-income) ratio beginning in the fourth quarter of 2019.

Key credit risk and performance indicators remained largely stable (Figure 6). As of January 1st, the capital adequacy ratio stood at 12.2 percent (against a regulatory minimum of 8 percent). The non-performing loan ratio has been fluctuating around 10 percent, standing at 10.1 percent in January compared to 10.4 percent in the previous month. The banking sector's profit in January 2019 amounted to 264 billion rubles compared to 71 billion rubles in January 2018 although this growth was, in part, affected by a change in reporting methods. At the end of 2018, the return on assets (ROA) and the return on equity (ROE) increased to 1.5 percent and 13.8 percent, respectively, up from from 1.0 percent and 8.3 percent, respectively, at the beginning of the year.

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



Source: CBR.

On March 11, 2019, Evrofinance Mosnarbank (ranked #83 by assets) was placed on the U.S. sanctions list for supporting Venezuela's state-owned oil company PDVSA, which has been on the U.S. sanctions list since January. Under the sanctions, U.S. individuals or entities are prohibited from doing business with Evrofinance bank. The bank was founded in 2011 as a binational bank to fund joint Russia-Venezuela oil and infrastructure projects. Venezuela's development bank owns 50 percent of the bank, with the rest split between Russia's state-controlled Gazprombank and VTB Group.

The Central Bank continued its efforts to clean up the banking system, honing in on banks that are non-compliant with regulations and conducting risky operations. The number of banks in Russia has fallen from 484 at the beginning of 2019 to 479 as of February 1, 2019. As of March 2019, the transfer of non-performing assets from failed banks to Trust Bank, which was set up as a "bad bank" in 2018, was completed. Total assets transferred amount to RUB2 trillion (USD$30.45 billion). The CBR recently reduced the amount expected to be recovered from Trust Bank to only 20 percent of the assets transferred, down from previous estimates of 40-60 percent.

Main Economic Indicators

Output Indicators	2017	2018 Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sept	Oct	Nov	Dec	2018	2019 Jan	Feb
GDP, % change, y-o-y	**1.6**	-	-	1.3	-	-	1.9	-	-	1.5	-	-	-	**2.3***	-	
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	1.9	**2.9**	0.2	
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	2.0	**2.9**	1.1	
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	0.0	**2.6**	-1.0	
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	2.3	**2.6**	1.6	
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	6.3	**4.1**	4.8	
Construction, % change,y-o-y	**-1.2**	12.2	9.4	-2.5	11.0	7.9	3.1	-0.7	3.3	5.9	5.7	4.3	2.6	**5.3**	0.1	
Fiscal and Monetary Indicators																
Federal government balance, % GDP	**-1.4**	2.8	1.6	1.8	0.9	1.4	1.9	2.5	3.1	3.5	3.6	3.7	2.7	**2.7**	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	**2.9**	5.0	5.2
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	**10.2**	10.4	10.1
Balance of Payment Indicators																
Trade Balance, billion $ (monthly)	**115.4**	16.9	12.2	15.0	15.0	15.2	15.2	13.2	15.9	18.9	19.7	19.0	18.9	**194.4**	13.4	
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	**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	41.4	**443.4**		
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	22.5	**249.0**		
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	**7.75**	7.75	7.75
Credit to households in Rub, % change, y-o-y	**7.4**	14.5	15.2	16.1	17.1	18.5	19.4	20.3	21.1	22	22.5	23.1	22.6	**22.6**	23.2	
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	9.7	10.6	12.0	**12.0**	12.3	
Capital adequacy ratio	**11.6**	12.1	12.4	12.5	13.0	12.7	12.8	12.2	12.2	12.5	12.4	12.3	12.2	**12.2**		
NPLs to total loans	**10.0**	10.0	10.5	10.6	10.7	10.6	10.9	10.9	10.9	10.7	10.5	10.4	10.1	**10.1**		
Loan loss provisions to total loans	**9.2**	9.3	9.6	9.7	9.6	9.5	9.8	9.7	9.8	9.5	9.4	9.3	9.1	**9.1**		
Return on assets (ROA)	**1.3**	1.0	0.9	0.9	1.0	0.9	0.8	0.8	0.8	1.4	1.5	1.4	1.5	**1.5**		
Return on equity (ROE)	**10.6**	8.3	7.9	8.0	8.5	8.1	7.0	6.8	6.8	12.4	13.3	12.4	13.8	**13.8**		
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	4.2	2.9	**6.8**	0.2	
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	4.8	**4.8**	4.9	
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	**62.5**	67.3	65.86
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	**73.9**	76.9	75.78
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	56.5	**71.1**	59.3	64.1

**Quarterly data are not consistent with the annual number.*

Source: Rosstat, CBR, EEG.

Please contact Apurva Sanghi: asanghi@worldbank.org

Prepared by a World Bank team under the guidance of Apurva Sanghi, consisting of John Baffes, Peter Nagle, Yoki Okawa, Olga Emelyanova, Katerina Levitanskaya, Mikhail Matytsin and Irina Rostovtseva.