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Your Russia 2018 Budget

The Economic and Rouble Background

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Curriculum Vitae of Dr Daniel Thorniley

Danny Thorniley is President of DT-Global Business Consulting GmbH (a LLC company), Danny's own consultancy company based in Vienna through which he works with some 330 key clients on business strategy in global and emerging markets in the CEEMEA region and Russia. The services he provides include written position papers, presentation slides and private client meetings as well as in-house presentations. He is also invited to make some 60 speeches/presentations by clients across the world on global business trends, business operations, emerging markets, corporate best practice.

Sir John Major, the former British Prime Minister has called Danny "The world's leading business expert on emerging markets"

For 23 years Danny was Senior VP at The Economist Group, Vienna on global corporate business trends.

Danny is regarded as a charismatic speaker who can present detailed business and economic analysis in an easily digestible fashion with a great deal of genuine humour. Danny is renowned for not using powerpoint presentation slides - never. Dr Thorniley has also given guest presentations at Executive MBA courses on behalf of Oxford University, the University of Chicago, IESE (Spain) and the Central European University in Budapest. The executive MBA students at Chicago rated him "best speaker" on 12 occasions out of 12 over 5 years. Danny has exceptional skill sets in global business strategy, business in emerging markets and CEEMEA and hands-operational knowledge of business operations, distribution, partnerships, investments and human resource issues.

He has worked on a personal basis with 330 companies operating in emerging markets for 27 years and has personal contacts with most senior western MNCs operating in the CEEMEA region and beyond. He makes frequent presentations at CEO and Board level (over 100). He has personal friendships with leading executives in Coca Cola, Procter & Gamble, Ernst & Young, Raiffeisen, Robert Bosch and many, many others.

He holds and has held a number of non-executive and advisory board memberships with major European and US corporations including the Global Advisory Board of the US company Aecom.

Dr Thorniley was educated at Oxford University. He holds a Bachelor of Arts degree, a diploma and a doctorate degree in Soviet political economy.

He has published three books, including one on Russia with Macmillan (UK/USA) and two with Profile books on Doing Business in Global Emerging Markets.

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Key summary

The key drivers are still trending with the dynamic we predicted at the start of 2017:

- With global GDP improving marginally this year along with the EU and with China growing at about 6.7% this year, we predict that there will be enough demand for oil to keep the price in a range of $46 to $55. But US and shale production will prevent the average price rising above $65-70.

- Russian GDP turns positive this year after a 2-year recession. Second quarter 2017 GDP results were good and better than the first quarter: GDP year-on-year in the second quarter rose by 2.7% compared with just 0.5% in the previous quarter. We have tweaked upwards our estimate for annual GDP growth in 2017 by a small amount to 1.6% this year and 1.7% in 2018 with small upside risk. Indicators such as industrial output and investment also look better than they did 2-3 months ago.

- BUT the key fact is that without structural or institutional reforms on property rights, or without large social spending, then Russian GDP will fluctuate about 1.7% to a best figure of 2.2% over the next 3-5 years. This presumes the oil price in range of $46 to $55 per barrel.

There will be no big GDP boom or rally; this is what we have got.

- With the oil price at around $50, then the Russian economy can manage as can western and Russian business. Any price closer to $45 hurts a little while any price closer to $55 has small upside for the rouble and inflation.

- We analyse the rouble trends extensively below and argue that the rouble was very strong and is now actually reasonably solid. The only fact is that the Euro has risen against the dollar and therefore against the rouble. The consensus for the rouble over the next 18 months is to remain stable within 2-4 % of current levels presuming the oil price stays close to $50.

- Inflation has fallen recently and remains low. Prices popped up a bit in June to 4.4% (from 4.1% in May) due mainly to higher food prices. But they came down again to 3.9% in July. The largest threat to top-line inflation will be the harvest result and spring/early summer weather was poor or volatile. A bad harvest (after the good one last year) could pop prices back temporarily to 5%+ in the late autumn. But for now, this is not our central scenario:

	2017	2018	2019
Average annual inflation	4.1	4.2	4.3
Year-end inflation	4.2	4.3	4.4

- Lower inflation helps the Central Bank to reduce interest rates. The Bank decided not to cut interest rates at its last meeting (28 July) due to the imposition of new US sanctions. The Bank wanted to monitor any effects. These so far have been mild (as we predicted). We therefore imagine the Bank will continue its rate cutting soon by another 0.25% or even 0.5%. The Bank's medium-term aim is to get interest rates down to 6.5% to 6.75% in the next 24 months.

- Real wages have been positive for almost one year and finally retail sales turned positive in May 2017. Real wages jumped further by 4.6% in July. But we have discussed in a Special Report on Consumer products why some/many consumer product companies are not witnessing a stronger business recovery (see below for short summary).

- A major reason that consumers are still cautious relates to government spending policies and budgets for 2017 to 2019. The years 2015-2017 have seen nominal and real spending cuts of -4% to -8% in government spending. The budget deficits on a rolling scale is falling and the government aims for a deficit this year of -2.1% from -3.6 last year. Few commentators or executives expect any massive social spending in the election year of 2018 but there may be some extra discretionary government spending at the margins.

The rouble

(updated summary from our July special report)

The first point, which we all recognise, is that the rouble hasn't really fallen in recent weeks, it's just that the Euro has strengthened.

Executives are a little concerned because the rouble has been for a long period since spring 2016 both relatively very strong and also stable. This is reflected in the following comment:

> "We budgeted Euro rouble in 2017 at 70/75/78 so we have benefited a lot for most of the year and we are still ok at this current level of 69."

Euro-Dollar

From November 2016 to May 2017 the Euro-dollar rate averaged 1.05 while in the last 2-3 months this has averaged 1.15 and thus the Euro has strengthened against the dollar by +8-9%.

Euro-Rouble

In autumn 2016 the Euro to rouble average was 72,
and then from November 2016 to June 2017 it averaged 62.
In June-July the average climbed to 67.

Compared with the Euro rate 9 months ago, the rouble is still stronger by 7-8%.
But compared with the recent strong level of 62, the rouble is down in recent weeks by -8%.

In recent weeks the Euro is up +8% versus the US dollar and the rouble is down against the Euro by -8%.

Given this is exactly the percentage rise by the Euro against the dollar, it seems that most of the rouble depreciation is due to the Euro rise.

Dollar-Rouble

The above comment is underscored by the facts that:

The dollar rouble averaged 63 in the last months of 2016
And then strengthened to an average of 58 in January-June 2017
And in recent weeks has averaged 59

The rouble is down against the dollar from recent highs by only 2-4%.

The oil price

In January-June 2017 the oil price averaged $54-55 but in June-July it averaged 47 and then climbed back to $50 in August 2017.

So, in recent weeks:

- The oil price (Brent) is down -10% to -14%.
- The rouble is down -8-9% against the Euro.
- The rouble is down 2-3% versus the dollar.

Given the weaker oil price and the strengthening Euro, the rouble is actually performing quite well/ok.

The rouble basket

Finally, the above is confirmed by the Rouble currency basket (55% dollar and 45% Euros based) which is a mix of dollar-Euro versus the rouble (a high number reflects weakness):

August 2015	75
January 2016	80-83

Rouble starts to recover early spring 2016

July 2016	67
December 2016	67
March 2017	59.5
April 2017	57.7
June	59.7

Rouble starts to weaken against the rising Euro

1 July	63.1
12 July	64.5
Mid-August	64.3

The rouble basket is still much stronger than the start of 2016 and stronger than December 2016.

FX reserves

As the authorities have sought to prevent rouble appreciation, they have sold roubles for dollars and FX and these dollars have been stored in the FX reserves which have therefore risen by $25bn in 2017:

Russian FX reserves (bn $)

January 2015	376
June 2015	356
January 2016	372
Sept 2016	395
Jan 2017	390
June 2017	414
August 2017	418

There are several reasons to explain rouble resilience

About 18 months ago on 11 February 2016, the rouble was at 91 to the Euro and was 78 to the dollar while in May 2017 the rouble touched 59 to the Euro and 57 to the dollar. So, over that 14 months period the rouble was up by about 33% versus the strong dollar and against the Euro.

> **This made the Russian rouble perhaps the strongest currency in the world through 2016 and the first quarter of 2017.**

Compared with its weak point in February 2016, the rouble in mid-July 2017 is still up by 25% versus the Euro and by 23% versus the US dollar.

The consensus outlook for the rouble is for relative stability while we have always predicted mild annual softening (see table below).

1. As long as the oil price stays in a range of $50-55 per barrel, then we will have rouble strength and/or stability. Even if oil dips to $47-48 range for a limited period, this ought not to hurt the rouble much and this was the case in early May 2017 and even in July 2017. The "fall" is due more to a Euro rise.

2. The key driver for rouble strength is the yield on Russian assets and currency: the central interest rate is 9.0% today and could fall to 8.0% by the end of the year. But with average inflation at about 4.1% to 4.3%, this means that the real yield (after inflation) will fluctuate at 3-4% which is one of the highest in the world.

3. This means that for now, when the oil price dips 5-10%, then the rouble does not automatically follow any more. BUT the oil price does remain a very important determining factor of the currency and the economy.

4. This is combined with the perception that Russian risk is decreasing and thus portfolio investment has rallied in the last 6-12 months and financing of IPOs has also improved markedly. The possible new US sanctions (summer 2017) appear not to have damaged this outlook much.

5. <u>As capital flows into the country, capital flight leaving the country is decelerating quite sharply: at the start of September 2016 the outflow was a mere $10bn compared with a total for all 2015 of $59bn (and the 2015 figure was smaller than the 2014 number). We expect capital flight to amount to about $25bn in 2017 compared with a trade balance of over $110bn and a current account surplus over $40bn.</u>

6. Some two-thirds of Russians are still willing to keep their deposits in roubles rather than FX.

7. Total external debt has fallen by -30% in the last year and total debt exposure of $550bn is very manageable because total debt repayments in 2016 are about $70bn with much already paid off.

8. Russia also benefits from the low levels of debt to exports as well as the rising/stable level overall of FX reserves ($412bn in July 2017).

9. Public debt is also extremely low at 16% of GDP in 2017 compared with EU levels of 80% to 110%

10. And finally, Russia benefits from a current account surplus which distinguishes it from most other emerging markets especially for example Turkey: the Russian surplus was a large 5.2% in 2015 and still solid at 2.0% last year and 2.8% in 2017.

So, pre-November 2016 the rouble was doing OK because of the search for yield by global speculators.

From November 2016 the rouble did fine because of Trump and the oil price, improved political risk perceptions AND the maintained good yield options.

> **Given the number of positives on the horizon, the rouble ought to stabilise at 58-64 to the US dollar in the next 18 months and presuming Euro-dollar average of 1.14, then the rouble will stabilise in 2017-18 at about 68-72 to the Euro.**

Presuming oil at around $48-55 per barrel for the next two years, which is the consensus view, then the FX rates and reserves ought to trend as in the tables below.

The economic outlook

Macro-economic data 2011-2022

GDP and output figures have been a bit confused and altered in recent months as the statistical office Rosstat changes it methodology but the major trends are rarely affected and the figures here are the most accurate currently.

	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
GDP	4,3	3,4	1,3	0.6	-2,8	-0,2	1,6	1,7	1,9	2,0	2,1	2,1
Retail sales	7,2	5,7	3,9	2,5	-9,8	-3,5	2,2	2,6	2,8	2,9	2,8	2,9
Household spending	6,8	7,9	4,7	1,8	-8,5	-2,6	1,8	2,6	2,6	2,8	2,7	2,8
Real wages	4,9	8,2	5,2	1,9	-9,5	1,5	2,9	2,7	2,9	3,2	3,0	3,0
Disposable income	2,8	3,7	3,3	2,1	-4,0	-5,2	0,2	2,2	2,4	2,5	2,4	2,4
Inflation (year-end)	6,1	6,6	6,5	11,4	12,9	5,4	4,2	4,3	4,4	4,8	4,7	4,8
Unemployment rate	6,5	5,3	5,5	5,3	5,4	5,8	5,3	5,5	5,4	5,2	5,1	5,3
Gross fixed investment	9,8	6,0	-0,3	-4,8	-7,6	-2,7	3,0	3,2	3,6	3,7	3,6	3,8
Industrial output	4,7	2,6	0,3	1,7	-3,4	1,1	1,8	2,3	3,1	3,3	3,0	2,9
FX reserves ($bn) year-end	510	528	509	385	370	377	422	428	435	442	448	457
Rouble/$ (year-end)	32,1	30,4	32,9	58,0	73,0	61,1	59,8	62,5	64,5	66,8	68,4	70,0
Rouble/Euro (year-end)	41,5	40,1	45,1	72,0	78,0	64.0	68.0	69.0	70,0	71,8	73,6	74,8
Budget balance (% of GDP)	-0,2	0,0	-0,5	-0,5	-3,5	-3,7	-2,6	-2,4	-2,2	-1,8	-2,3	-2,7
Current-account balance (% of GDP)	4,9	3,6	1,6	2,7	5,0	2,0	2,8	3,0	2,6	1,9	2,0	1,5

Key statistics by year and monthly

	2012	2013	2014	2015	2016												2017						
	year	year	year	year	Jan	Feb	Mar	Apr	May	June	July	Aug	Sept	Oct	Nov	Dec	Jan	Feb	Mar	April	May	June	July
Disposable income	3,7	3,3	2,1	-4,0	-6,3	-6,9	-1,2	-7,1	-5,7	-4,8	-7,0	-8,3	-2,8	-5,9	-5,6	-6,1	8,1	-4,1	-2,5	-7,6	-0,1	0,0	-0,9
Real wages	8,2	5,2	1,9	-9,5	-6,1	0,6	1,6	-1,7	-1,0	1,4	0,6	2,7	1,9	2,0	2,1	2,4	3,1	1,0	1,5	2,5	2,8	3,9	4,6
Real retail sales	5,7	3,9	2,5	-9,8	-7,3	-4,3	-5,8	-4,8	-6,1	-5,9	-5,0	-5,1	-3,6	-4,4	-4,1	-5,9	-2,3	-2,6	-0,4	0,0	0,7	1,2	1,0
Unemployment	5,3	5,5	5,3	5,4	5,8	5,8	6,0	5,9	5,6	5,4	5,3	5,2	5,2	5,4	5,4	5,3	5,6	5,6	5,4	5,3	5,2	5,1	5,1
Industrial output	2,6	0,3	1,1	-3,4	-2,7	1,0	-0,5	0,5	0,7	1,7	-0,3	0,7	-0,8	-0,2	2,7	0,2	2,3	-2,7	0,8	2,3	5,6	3,5	1,1
Fixed investment	6,0	-0,1	-4,8	-7,6	-8,4	-8,4	-8,4	-4,8	-4,8	-4,8	-4,3	-4,3	-4,3	-2,3	-2,3	-2,3	-0,9	-0,9	-0,9	2,3	2,3	2,3	4,8
Consumer prices	6,6	6,5	11,4	12,9	9,8	8,1	7,3	7,3	7,3	7,5	7,2	6,9	6,4	6,1	5,8	5,4	5,0	4,6	4,3	4,1	4,1	4,4	3,9
Budget deficit (running)	0,0	-0,5	-0,5	-3,5	-1,8	-1,9	-2,6	-1,4	-3,0	-3,2	-3,3	-3,3	-3,7	-3,4	-3,6	-2,4	-3,9	-3,5	-3,1	-2,8	-2,4	-2,3	-2,2

The GDP outlook

The three big obvious positives are:

1. The stabilisation and improvement in the oil price in a range of $50 to $55 with possible upside.
2. And the related solid strengthening in the rouble (the strongest currency in the world in 2016 after being one of the weakest in 2015).
3. Inflation is declining quickly: from an average of 15.6% in 2015 to 7.1% in 2016 and probably 4.0% in 2017.

So far the consensus and our views are working on the following assumptions:

- Oil will average $50-55 (we are just at the lower end now).
- Falling inflation to 3.9% last month will boost real wages, confidence and consumption.
- Retail sales to March and all last year were negative but the trend is an improving one and retail was up by 1.0% in July.
- The same applies to industry: 23 months of negative numbers in 2015-16 but in the last 8 months, 7 months have been positive and the trend is improving.
- Finally, in July and for Q3 fixed investment looks much stronger at 4.3% according to Flash Results published today in Russia. This follows negative figures every month of 2015 and 2016 until April 2017.
- Interest rates are creeping downwards and this should help expansion.
- We have so far been proven correct in that new sanctions have not had any appreciable impact on key indicators.
- If oil stays at $50 rather than $55 and if the government keeps its tight spending policy, then this will restrain growth.
- Tight spending is combined with relatively tight monetary policy even today although we now expect some further interest rate cuts. BUT real rates will still hover at about +4%.
- Such polices and the free-float of the rouble has meant that GDP did not slump as badly as in previous recessions given the collapse in the oil price combined with western sanctions.
- But we do not anticipate much serious and quick structural economic reform over the next 3-5 years and so the dependency on the oil price and potential volatility remains in the foreground.

But a clear message is that GDP turns positive this year after two years of recession but that the recovery is patchy and staccato and there will be no boom this year or during the next 3-5 years based on the middle scenario.

As many executives argue, “This is what we’ve got. This is not a crisis anymore, this is the new normal and the daily reality and we better get used to it”.

We often state that 60% of Russia’s economic problems stem from the oil price and 40% from western sanctions impacting financing and confidence. But we know that this ignores the fact that GDP growth started to trend downwards in January 2013, well before Crimea, and that it was industrial and investment figures which led the downward trend. Russia’s economic problems pre-date the Ukraine crisis.

Central scenario - 2017 economic outlook (oil averages $48-55)

GDP	1.6%
Inflation (year-end)	4.3%
Inflation (average)	4.0%
Consumer spending	1.8%

Investment	3.0%
Industrial output	1.8%
Rouble to US dollar average	56-62
Rouble to the Euro average	68-71

Economic scenarios and the rouble for 2017-2018 at different oil prices

(Presuming Euro-$ exchange rate of about 1.15/1.17)

Average oil price 2016	GDP	Inflation average	Rouble/US$ (avg)	Rouble/€ (avg)
$80-85	3.7%	7.5%	43-48	48-52
$70-80	3.0%	6.0%	47-52	52-54
$60-70	2.4%	5.6%	52-56	55-59
$55-60	1.8%	4.5%	56-59	59-63
$50-55	1.6%	4.1%	58-61	63-68
$45-50	0.8%	5.5%	63-66	68-73
$35-45	-1.3%	8.8%	66-75	74-82
$25-35	-2.8%	12.5%	75-85	83-92

Inflation outlook

	2017	2018	2019
Average annual inflation	4.1	4.2	4.3
Year-end inflation	4.2	4.3	4.4

Inflation is falling faster than most expected and is now very close to the Bank's target of 4.0% range. After averaging 15.5% in 2015 and 7.0% in 2016, the average figure for the first 7 months of 2017 is just 4.3%.

Inflation decelerated again in July to 3.9% (after a jump to 4.4% in June) and the July number was below market expectations of 4.3 percent. Inflation fell below the Central Bank's 4% target for the first time since the Bank switched to an inflation targeting policy in late 2014, to hit the lowest level since May 2012. Prices increased at a slower pace for food (3.8% from 4.9% in June) and non-food products (3.7% from 4%). Month-on-month inflation slowed in July to just 0.1% from 0.6% in June.

The current inflation figure is the lowest in 25 years.

Prices will probably fall further through the summer and could fall below 3.5% in August-September. But the consensus is then that top-line inflation will tick up again at the end of this year to about 4.0% or 4.2% as the flow though of low food prices leaves the inflation data: the 2016 harvest was very good and low food prices from that are still flowing through current figures.

> **However, if the 2017 harvest is another good one, then there is a possibility that prices would stabilise at 3.5% or trend even lower and a bumper harvest could see the inflation rate fall even to 3.0% for some months. This is not our central scenario.**
>
> **But the point is that on a central scenario, inflation will range about 3.8% to 4.4% in the next 18 months with risk divided equally slightly above or below this range depending on the harvest.**

Interest rates

Lower inflation should surely allow the Bank to make further and faster rate cuts. The Bank has remained conservative and kept real rates high to squeeze inflation out of the system. That goal seems to have been achieved for now and thus why more rate cuts are expected. At the start of the year the consensus was that the key interest rate would be reduced to 8.25% by the end of 2017. If inflation stabilises around 4.0%, then the key rate will come down to this level or even touch 8.0%.

> **The point is that there is now more positive for lower interest rates which could, at the margins, stimulate more investment, financing and growth.**

The Russian consumer

The economy is picking up but for some/many business is not matching this. Why? There are several reasons:

1. Once again as the rouble strengthens, more Russians are taking holidays abroad which means they have less money to spend at home.
2. With the rouble stronger, you have fewer tourists traveling to Russia to enjoy cheapy shopping.
3. The consumer and retail trade are now much more resistant to price rises.
4. There is a string of regular business trends: rising competition, own label, me-commerce disruption, a challenging Russian retail.
5. But as with the global economy, the economic pick-up is not too strong, the economy is not going to boom and Russians are wise enough to know that.
6. Thus, the economic situation is more "chronic".

7. Related to all this, the Russian consumer has faced a hard slog in the last 3 years just when things had stabilised in 2010-12. The Russian consumer, like western executive staff, is tired.
8. In addition, the process of the “normalisation” of the Russian consumer continues: the Russian consumer has shown tremendous resilience since 2009 But she/he has also changed a lot looking for more value, discounts and promotions.
9. The pension outlook, as in other markets, also gives the Russian consumer especially middle-aged ones food for thought. The retirement age for government employees will gradually rise to 65 for men and 63 for women. Starting in 2017, the retirement age for all government employees will rise by 6 months each year.
10. The consumer may also be wary about future tax changes: VAT seems set to rise and there are rumours about personal income tax.
11. Consumer credit was exploding by +35-40% annually in 2012-2013 and then decelerated to 20% growth in 2014. New consumer credit (in roubles) increased by about 10% in 2015 but on a sharply decreasing trend and was negative by -6% to -8% in 2016. Of course, less available credit will hold back household spending and is a major reason we keep our spending estimates at moderate levels. Consumer credit did turn positive at the start of 2017 by some 2% and by 5% in spring this year.
12. Government spending policy is having a large impact. After the 1998 and 2008-09 crises, the Russian government stepped in with social spending and income support and subsidies for car purchases etc. This has been absent in recent years. Moreover, spending on education and health has been worse hit and these sectors are seeing spending as a proportion of GDP actually decline.
13. Interest rates have been and are high in real terms.
14. In other words, the Russian state has been implementing strong austerity measures which are coming out of fashion in the West.
15. The consequence of all this is that many Russian consumers are taking the view that: “I will have to finance myself with more spending on out-of-pocket health care and also on my children’s education. For this reason, they are probably spending less and being more discerning in their consumer spending on food, detergents, cosmetics, drinks etc.

On the plus side, we think that economic improvement especially with wages, will eventually buttress consumer demand and this may be the case as consumer confidence continues to improve a little bit. This indicator for the quarters one and two crept up a little bit as we predicted last month.

> **We repeat our argument that thankfully the economy is recovering (slowly) but just in time to prevent any deterioration in consumer behaviour. The Russian consumer is finally very tired after 2-3 years of wear and tear. The recuperation process will be slow but it is underway**.

As we have long argued, the Russian consumer needs more time to reflect on her/his financial situation before splurging on consumer spending. Logically it seems inevitable that falling inflation, a strong rouble and rising/stable nominal and real wages ought to translate into a pick-up of consumer spending.

That is happening but slowly: retail sales were negative in 2015 at -9.8% and also in 2016 at -3.5%. Monthly figures in 2017 were negative until April and in June they rose 1.2%, one of the best monthly figure in two years.

Disposable incomes were also disappointing in 2016 at -5.9% (We point out again that disposable income is not a good indicator as it includes FX purchases and the volatility in this indicator is shown in the January 2017 leap by +8.1% followed by the -7.6% slump in April). The more important indicators are household consumption and real wages.

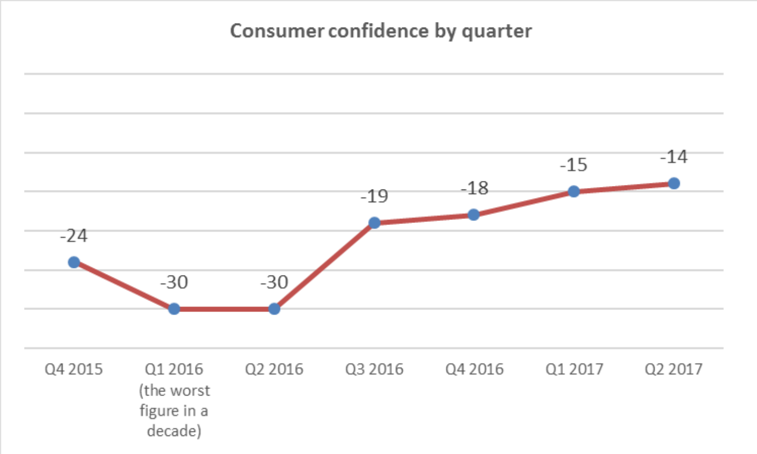
Real wages have been positive for 12 months and the last 3-month period has been one of the best at an average of 2.7% growth. Nominal wage growth in April was 6.7%, 7.9% in May and 7.4% in June.

While unemployment is stable around 5.1% in July, some 10% of the population have seen their wages reduced per hour as well as the hours worked and 12% report delays in payment of wages.

As a result, consumer confidence has improved as we anticipated:

> **The above factors and figures ought to support the mild economic and consumption recovery in the third quarter 2017 and through into 2018.**

Consumer confidence indicators by quarter



Regarding this indicator: please note when consumer confidence is booming this number runs at about -5 to -6.

Industry/investment/agriculture

- Industry and investment have been the weak links in the last 3-4 years and are a cause for concern regarding the fundamentals of the Russian economy.
- But thankfully industry and investment are coming back: industrial output in the first quarter was up a bare +0.4% but then jumped in the second quarter by 3.8%.
- The stronger rouble and import substitution are helping and industry will grow by 1.8% this year and by 2.0% on a better case.
- Investment declined by -2.3% in 2016 and was still negative in Q1 this year but finally turned positive in Q2 by +2.3% after a 4-year investment recession. Delayed projects are finally coming out of moth-balls and as interest rates decline a bit (but remain high in real terms). The big Flash News from today is that the Russian Statistical Service reckons that fixed investment rose 4.3% in July and that this is the indicator for Q3 this year.
- The rising oil price is helping trade figures and this eventually should flow through into industrial output.
- Manufacturing PMI was posting very strong figures and rose to 54.7 in January 2017 (one of best figures in 10 years) but since then it has fluctuated about a bit more at 50.8 in April but rose back to 52.7 in July. So, this is good but not fully sustainable yet.
- The services PMI also rose to a 58.4 in January and was also close to a 10-year record before softening a little to 56.1 in April. This indicator has averaged close to 55 this year but slumped to 52 in July and we will have to see if that is a one-off.
- Business confidence has returned after some bumpy months last year: recent levels of -1 to +1 put the indicator back to 2012 levels.
- Car registrations experienced their usual start of year dip and were at a seasonal low of 107,000 in February which matches the trends in 2015 and 2016 and then rallied to 140,000 in March and 130,000 in June. All this compares with a high of 291,000 in April 2008. The trend is one of stabilisation but at the new low levels which started early 2015.
- The trend in car production is similar but slightly better: in June the number rose by 120,000 after a December low of 98,000. This matches seasonal trends and is in fact a little better than last year but remains at depressed levels compared with 2010-12 period when comparable monthly production was 175,000.
- The construction sector slumped by around -9% in 2015 and the sector was still negative last year on a rising trend. At the start of 2017 construction overall was still only at 85% of its January 2014 level. Given low base figures in previous years, the sector could turn positive this year in a range of 2-6%.
- Agricultural/grain output was quite bumper in 2016 and the sector grew by an impressive 4.8%. This helped GDP but was also very positive for inflation. However, executives comment that the bulk/size of the harvest is good but the quality is less so. Also, quality product is being exported leaving poor quality in the domestic market and thus domestic prices are even rising despite the “bumper harvest”.

- Agricultural output was broadly flat in the first months of 2017 and actually declined in June by -1.3%. Much will depend on the weather which was generally poor through the spring.
- Banks funding and liquidity profiles continue to improve and the banking system is sufficiently capitalised with an aggregate capital adequacy ratio of 12.0%, which is above the regulatory minimum of 8.5%.
- The trend in new loans continues: to private individuals they are rising by +5% while to corporates they are were declining by -2% at the start of the year but rouble loans to companies were positive in April by 1.5% and by 10% in FX.

As ever, I hope you have enjoyed this report and found it useful. If you have any queries or comments, then do get in touch with me danielthorniley@dt-gbc.com.

18 August 2017

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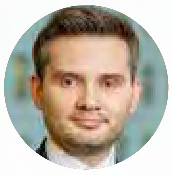

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