



Bank of Russia



JANUARY 2019

ECONOMY

Information and analytical commentary

Moscow
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Economy: facts, assessments and comments (January 2019)

2018 GDP growth came in at 2.3% outpacing the Bank of Russia's forecast. The discrepancy between the forecast and actual growth is attributable to temporary factors. In January 2019, industrial production held at the previous month's level, adjusted for seasonality and calendar effects. Its year-on-year growth slowed compared with December readings, largely due to the statistical high base effect. The January rise in investment demand was mainly covered by expanded imports. The expected weakening of consumer activity in January 2019, among other things, on the back of the VAT hike, slowed down annual growth in retail sales. That said, slowing sales growth primarily hit the non-food segment that peaked in late 2018. Overall, the Russian economy's response to the VAT increase has been moderate. Estimates suggest that annual GDP growth will stand at 1.0-1.5% in the first quarter.

CORE ECONOMIC INDICATORS

Table 1

(growth, % YoY, unless indicated otherwise)

	2017	December 2018	2018 Q4	2018	January 2019
Output of goods and services by key industry	2.4	1.9	2.5	2.9	...
Industrial output	2.1	2.0	2.7	2.9	1.1
Agricultural output	3.1	-0.1	4.1	-0.6	0.7
Construction	-1.2	2.6	4.1	5.3	0.1
Freight turnover	5.5	3.2	2.3	2.8	2.4
Retail sales	1.3	2.3	2.7	2.6	1.6
Unemployment rate / seasonally adjusted* (% of labour force)	5.2	4.8/4.7	4.8/4.8	4.8	4.9/4.7
Nominal wage	6.7	7.3	8.1	9.9	5.2
Real wage	2.9	2.9	4.1	6.8	0.2
Household real disposable money income	-1.6	0.1	-1.1	-0.2	-1.3

* Bank of Russia estimate.

Source: Rosstat.

Gross domestic product in 2018

According to the statistics released by Rosstat, physical GDP rose by 2.3% in 2018, outpacing the Bank of Russia's latest estimate of 1.5-2.0%.¹ Economic growth rates proved somewhat above the readings that, according to the Bank of Russia's estimates, are in line with the economy's long-term potential, given its structure. This is largely attributed to temporary factors.

The expansion of external demand (more considerable than in 2017) bolstered the mining and quarrying sector, and manufacturing output and freight turnover. The expansion in lending brought about growth in net interest income

of credit institutions, and boosted gross value added (GVA) in finance and insurance (Chart 1, Table 2).

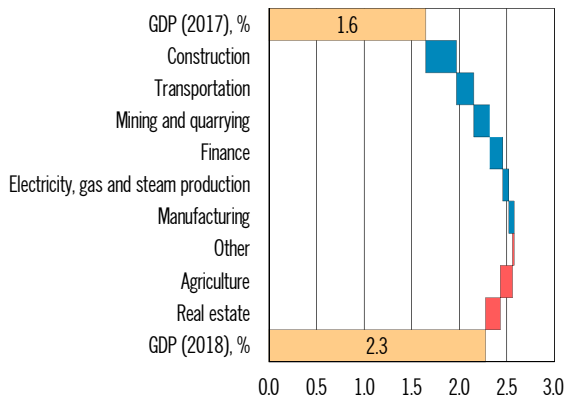
Construction output made a sizeable contribution to economic growth in 2018, as a number of large-scale projects, including state-controlled ones, were completed.

Agricultural output contracted on the back of a poorer grain crop in 2018 compared with the bumper harvest a year earlier. It was also negatively affected by slowing growth of livestock output (primarily poultry and eggs) caused mainly by the saturated domestic market and unfavourable epizootic developments in a number of regions. On the back of these factors, the contribution of agricultural GVA to GDP growth proved negative.

¹ The *previous issue of the Economy commentary* estimated that 2018 GDP growth would stand near the upper bound of the Bank of Russia's forecast range (1.5-2.0%).

DECOMPOSITION OF GDP GROWTH RATES IN 2018 BY ECONOMIC ACTIVITY Chart 1

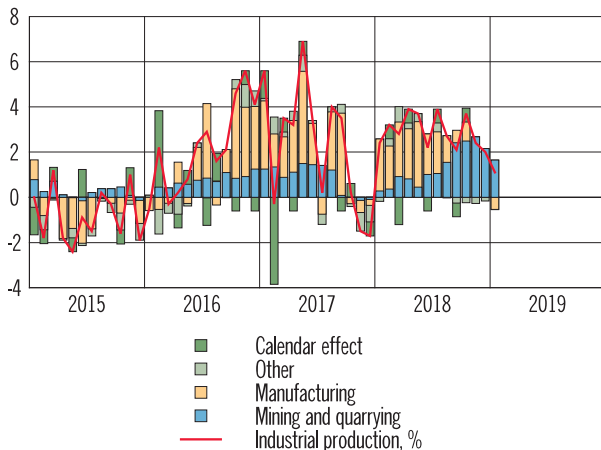
pp



Sources: Rosstat, Bank of Russia calculations.

INDUSTRIAL OUTPUT Chart 2

Contribution to annual growth, pp



Sources: Rosstat, Bank of Russia calculations.

GDP AND GVA BY KEY ECONOMIC ACTIVITY Table 2 (growth, % YoY)

	2017	2018
GDP	1.6	2.3
Agriculture	2.4	2.5
Mining and quarrying	2.4	3.8
Manufacturing	1.1	1.5
Construction	-1.2	4.7
Trade	2.5	2.2
Transportation	0.1	2.9
Finance	2.8	6.3
Real estate	2.2	0.5
Public administration	3.4	3.5
Net taxes	9.9	9.7

Source: Rosstat.

According to the Bank of Russia's estimates, GDP growth mainly accelerated in 2018 Q1, whereas seasonally adjusted (SA) quarter-on-quarter growth of economic activity slowed to 0.1-0.3% in the third and fourth quarters. This is suggested by the movements in key supply and demand indicators. Rosstat will release the updated quarterly GDP statistics on 1-2 April 2019.

Production activity

In January 2019, annual growth of industrial production slowed to 1.1%, largely due to the statistical high base effect of January 2018 (Chart 2). Industrial output (SA) held at the level registered in September-December 2018.

Both December 2018 and January 2019 saw mining and quarrying output drop (MoM, SA), largely on the back of lower oil production under the new OPEC+ deal. Gas production fell amid a slack demand in Europe and Turkey on the back of warm weather and rising competition with other gas suppliers, including Iran, Turkmenistan and the US.

Manufacturing output increased somewhat (MoM, SA) driven by the production of a wide range of intermediate goods. A rise in output was also registered in the woodworking and pulp-and-paper industry, as well as rubber and plastics. Furthermore, metallurgy recovered to the levels seen in October 2018 after a tangible contraction in December 2018, however, it remained highly volatile. Overall, the production of intermediate goods in January 2019 was at its all-time high.

A considerably negative contribution to industrial production growth in January 2019 came from investment goods production (MoM, SA). Estimates suggest that their output is at the lowest level since December 2016. The output of a wide range of engineering products contracted significantly, pointing to a highly volatile output of such products (Chart 3).

In January 2019, food output rose by 0.2% MoM (SA), which is in line with monthly average production growth in 2018 H2. However, the output of individual food products has remained volatile and exposed to specific factors.

The output of non-food goods also increased compared with December 2018 readings, mainly due to the expansion in furniture production seen in the past two years.

Production of other consumer goods, including household appliances and light vehicles, expectedly declined following the sinking consumer demand (see the *Consumer activity* section).

That said, the production of consumer goods holds overall close to its all-time highs (Chart 3).

The output in other economic activities overall increased month on month. Growth in freight turnover was largely driven by railway and motor transportation on the back of expanding output of intermediate goods. In annual terms, growth of the leading output index slowed (Chart 4) suggesting a slowdown in GDP growth (see the *Forecast* section).

January surveys of industrial companies gave mixed signals as regards the market conditions. The PMI index of Russia's manufacturing sectors suggests that new orders increased sustainably amid slowing growth of production volumes. Rosstat's Business Confidence Indices in both mining and quarrying and manufacturing demonstrated strong growth in January after a drop in the previous month. At the same time, the Bank of Russia-conducted monitoring of enterprises points to somewhat deteriorated economic conditions as production costs increased on the back of the VAT hike.

Investment activity

Investment demand rose in January 2019 (Chart 5), which translated into the increased imports of engineering products, in particular mechanical equipment and ships.

That said, investment activity indicators showed mixed dynamics. On the one hand, the production of investment goods contracted (see the *Production activity* section). On the other hand, construction continued to expand (MoM, SA).

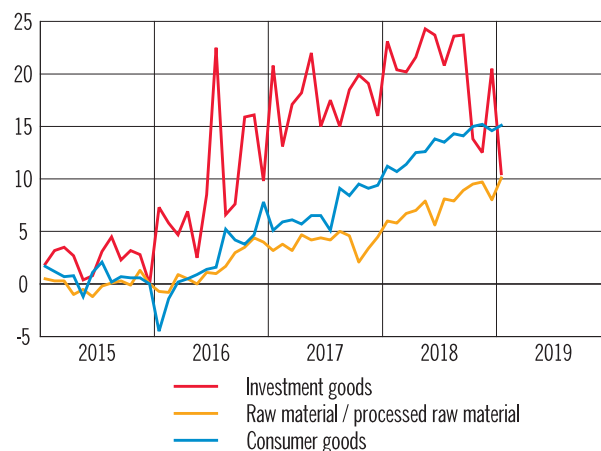
Consumer activity

In January 2019, annual growth of retail sales dropped to 1.6% from 2.3% seen in the previous

INDUSTRIAL PRODUCTION BY PRODUCT GROUP

Chart 3

Growth on December 2015, % SA

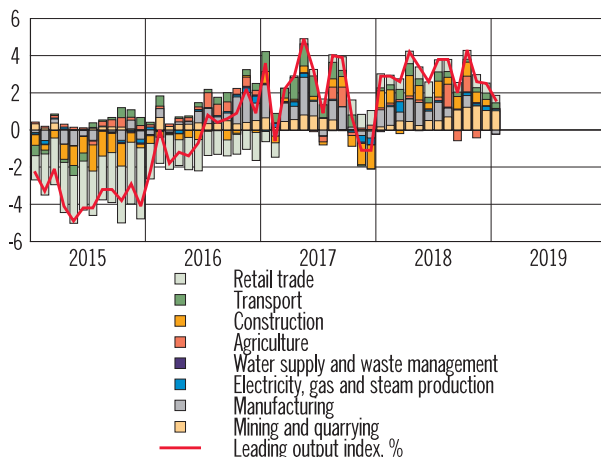


Sources: Rosstat, Bank of Russia calculations.

LEADING OUTPUT INDEX

Chart 4

Contribution to annual growth, pp

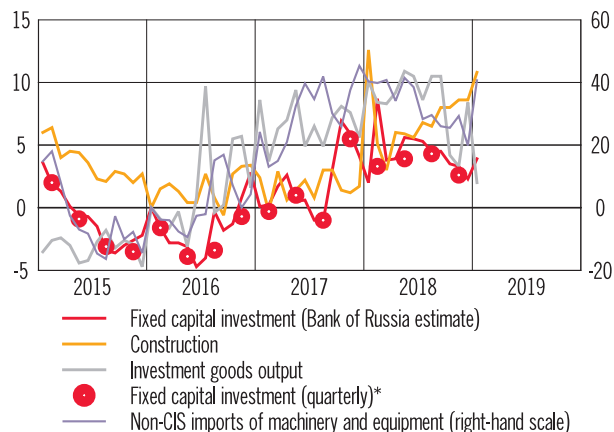


Sources: Rosstat, Bank of Russia calculations.

INVESTMENT ACTIVITY INDICATORS

Chart 5

Growth on December 2015, % SA



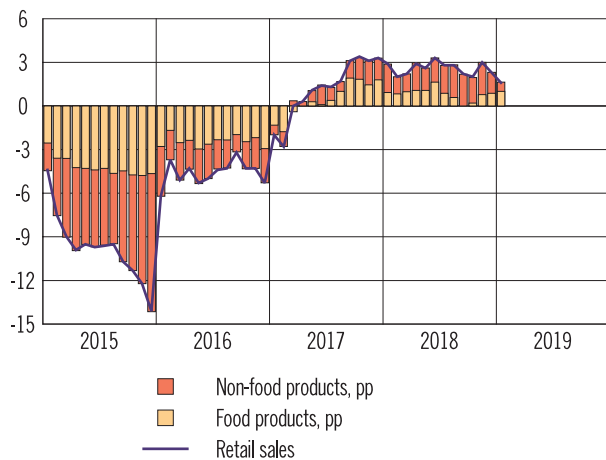
* 2018 Q4 - Bank of Russia estimate.

Sources: Rosstat, FCS, Bank of Russia calculations.

RETAIL SALES

Chart 6

Per cent change on corresponding month of previous year



Sources: Rosstat, Bank of Russia calculations.

LIGHT AND COMMERCIAL VEHICLE SALES

Chart 7

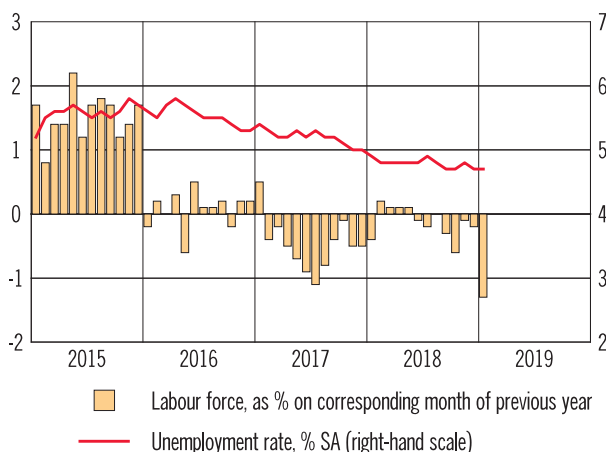
Per cent change on corresponding month of previous year



Source: Association of European Businesses.

UNEMPLOYMENT AND LABOUR FORCE

Chart 8



Sources: Rosstat, Bank of Russia calculations.

month (Chart 6). That said, sales slowed in the non-food segment (to 1.2% YoY vs 2.8% in December and 4.3% in November 2018), and the segment of light and commercial vehicles (Chart 7). Consumers might have already satisfied their demand in September-November 2018, as they expected prices to rise early in the year on the back of the VAT hike. Consumer demand was contained by household income (see the *Labour market and incomes* section).

Polls among households also point to a weakening consumer activity. According to the inFOM survey,² in January 2019, the consumer activity index was at its two-year low, whereas the share of respondents whose financial standing deteriorated in the past 12 months continued to expand.

At the same time, retail trade turnover continued to grow month on month (SA) in January 2019 backed by food sales.

Labour market and incomes

According to the Bank of Russia's estimate, the labour market was close to the equilibrium in January 2019. Unemployment held at 4.7% SA (Chart 8), which is close to an inflation-neutral level.

Annual growth of nominal wages continued to slow down (Chart 9) to reach 5.2%, meaning labour remuneration of social sector and cultural workers neared the target values.³ Thus, the effect of May decrees on wage growth eased. This coupled with inflation acceleration to influence real wages where annual growth slowed to 0.2%, the lowest reading since mid-2016. Real household disposable money income stopped growing and dropped by 1.3% YoY in January 2019.

Estimates suggest that the contribution of other components to household incomes will remain negative, as in 2018. First, real property incomes continued to shrink (in 2018, they dropped by 8.1%). Second, growth was registered

² See the *summary of the Inflation Expectations and Consumer Sentiment review, No. 1 (25), January 2019.*

³ The target level here is the wage level of social sector and cultural workers, which should increase in accordance with the Presidential May decrees. A specific level is established for each category of workers and usually equals the average wage in the region.

in mandatory payments and contributions, the negative contribution of which came in at 1.2 pp (Chart 10). This resulted from the rise in interest payments amid expanding consumer lending, and growth of tax payments as their collectability improved and the tax base increased.

Forecast

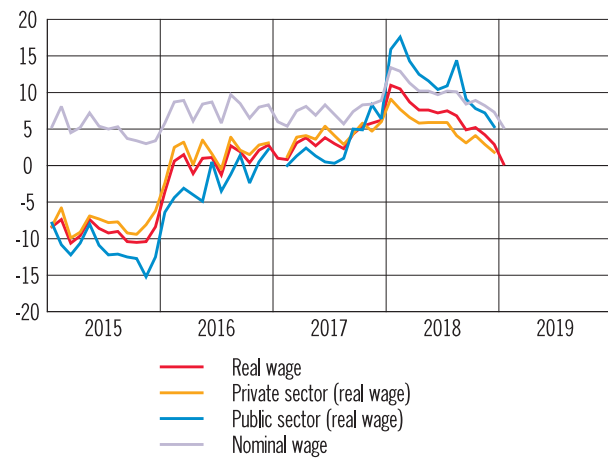
Economic activity indicators in January 2019 were overall in line with the Bank of Russia's expectations. Estimates suggest that quarterly GDP growth (SA) will hold in 2019 Q1 at the previous quarter level of 0.1-0.3%, which is overall in line with the previous forecast.

Given the base effect and the constraining effect of the VAT hike on economic activity, growth of annual GDP, households final consumption expenditure and gross fixed capital formation is set to slow to 1-1.5% in 2019 Q1.

WAGES

Chart 9

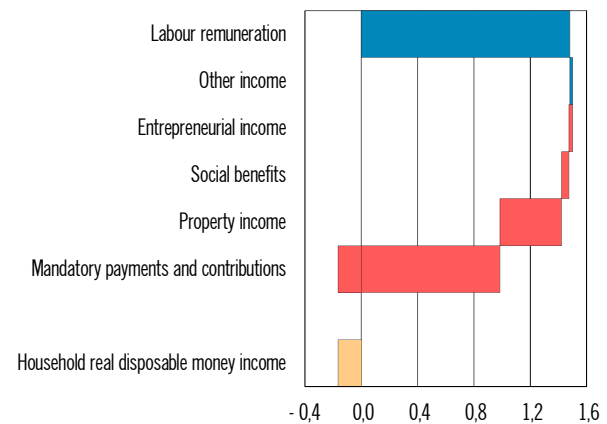
Per cent change on corresponding month of previous year



Sources: Rosstat, Bank of Russia calculations.

DECOMPOSITION OF GROWTH IN REAL HOUSEHOLD DISPOSABLE MONEY INCOME IN 2018

Contribution to annual growth, pp



Sources: Rosstat, Bank of Russia calculations.

Cut-off date – 22 February 2019.

A soft copy of the information and analytical commentary is available on the Bank of Russia website (<http://www.cbr.ru/DKP/>).

Please send your comments and suggestions to svc_analysis@cbr.ru.

This commentary is prepared by the Monetary Policy Department.

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