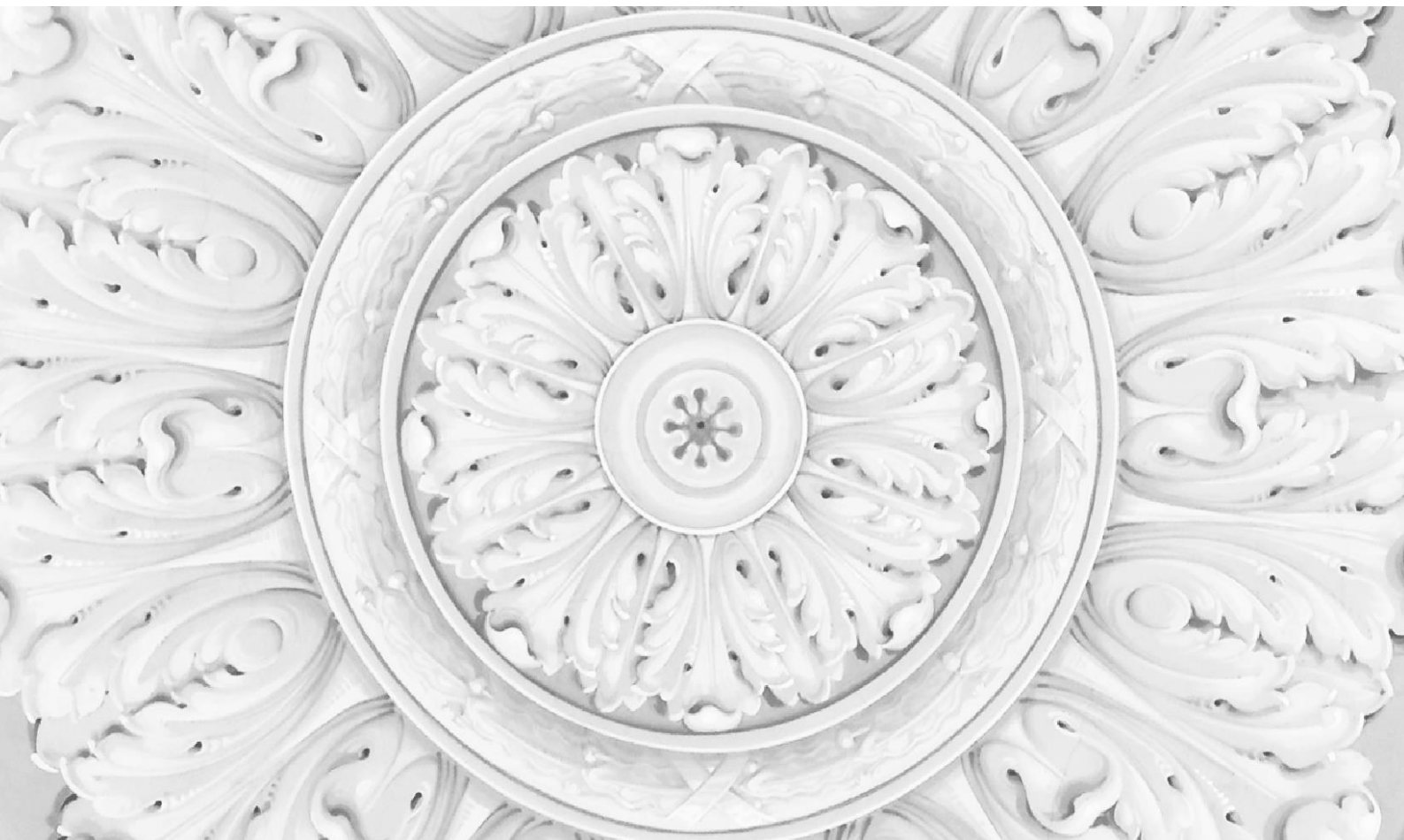




Bank of Russia

The Central Bank of the Russian Federation



Talking Trends

Macroeconomics and Markets

June 2017

**Research and
Forecasting**

Department Bulletin No. 5 (17)

The bulletin is based on data as of 05.07.17.

*The views expressed in the Bulletin
are solely those of the authors and do not necessarily reflect the official position of the Bank of Russia*

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Executive summary

1. Monthly summary

- Inflation in June accelerated, along with moving seasonality in fruit and vegetable products. Economic growth in 2017 Q2 most likely accelerated, along with rising consumption and investment activity. The current balance of risks suggests the need for moderately tight monetary conditions.
- Consumer inflation increased to 4.4% YoY in June and was mainly driven by prices on fruit and vegetable products. Nevertheless, the current path of CPI growth is in line with achieving the 4% target by the end of 2017. Moving seasonality explained by cold weather will probably allow for relatively higher CPI growth throughout most of 2017 Q3. Possible losses of harvest this year may also keep elevated inflationary pressures at the end of 2017 and at the beginning of 2018. Bank of Russia's policy lowers inflation risks and brings inflation back to the target level.
- Short-term indicators of economic activity along with survey data point to the fact that economic growth in 2017 Q2 has most likely accelerated. Recovery in domestic demand runs slightly faster than production, as the latter conclusion may be driven from data on expenditure-based GDP, as well as some leading indicators. Prospects for further production growth in the upcoming months remain quite positive. Slight slowdown in economic activity along with a short-term slump in oil prices will not keep the economy from maintaining moderate but sustainable growth.
- Risks to stability on financial markets remain moderate and do not create visible obstacles to achieving the inflation target for 2017. Russian markets managed to confidently withstand the short-run negative movements in oil prices and global markets, as well as speculations concerning new sanctions against Russia.

2. Outlook

- Analysts are convinced in the Bank of Russia's ability to bring inflation down to 4% by the end of 2017 and keep CPI growth close to that margin in the medium-term.
- The current GDP nowcast for Russia points to acceleration of growth in 2017 Q2, as GDP growth for 2017 could reach at least 1.5% if current external conditions remain in place.

1. Contents

1.1. Inflation

Inflation in June accelerated, along with moving seasonality in fruit and vegetable products. Cold weather in May and June provoked moving seasonality among some food components of the CPI, leading to acceleration of year-on-year growth rates by mid-2017. However, the latter factor does not create threats in terms of achieving the pronounced 4% inflation target by the end of the year. Current risks connected to rising inflationary pressures are perhaps associated with possible losses of harvest of selected vegetables and fruits due to cold spring and early summer, as well as low levels of stocks to be consumed next year. The latter factors may bring the year-on-year inflation consistently above 4% throughout the first half of 2018 and also cause second-round effects via rising inflation expectations.

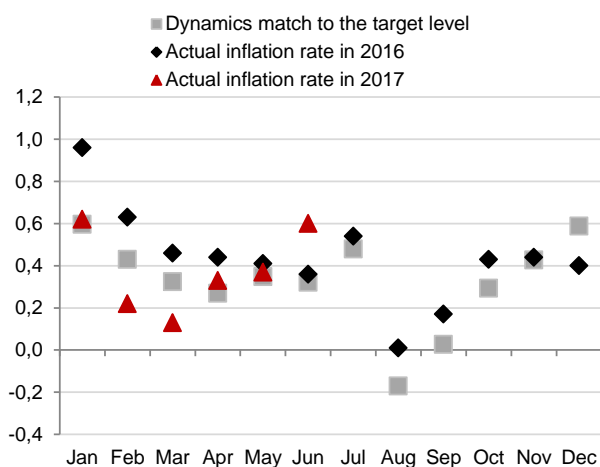
1.1.1. Inflation in June accelerated temporarily

- Inflation jumped to 4.4% YoY, mainly due to untypically high growth rates of fruit and vegetable prices.
- Despite this temporary spike in June, the current path of CPI growth is in line with achieving the 4% target by the end of 2017 thanks to the favourable factors of the beginning of the year.
- Moving seasonality caused by cold weather is likely to lift inflation above the 4% level up to September 2017 at least.

Inflation in June amounted to 0.6% MoM, according to Rosstat. Our preliminary estimates suggest that in seasonally adjusted and annualised terms this is noticeably above the 4.0% level (Figure 1). Inflation also grew to 4.4% in YoY terms after 4.1% in May.

Prices on fruit and vegetables grew by 8.3% (Figure 2). The cold spring led to the planting of potatoes, cucumbers, tomatoes, carrots, onions and beet having been postponed by 3 to 4 weeks, which automatically creates prospects for later harvest this year. According to the Ministry of Agriculture, the planting of potatoes and vegetables as a whole in May was 18% and 23% below normal anticipated levels respectively. The latter effect is untypical for early summer and served as the major source of the spike in YoY inflation in June. Therefore, the regular peak in seasonality corresponding to the lowest price growth on fruit and vegetables is likely to shift from August 2017 to September 2017 (Figure 3).

Figure 1. Actual monthly inflation and monthly 4% target bands, % MoM NSA

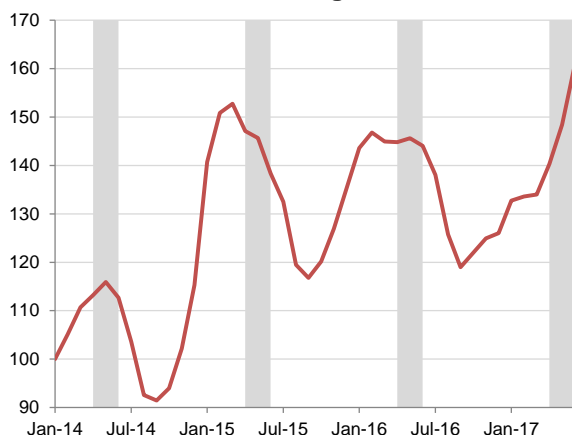


Sources: Rosstat, R&F Department calculations.

Our estimates suggest that if prices of all other goods and services from the CPI basket continue to grow by 4% in seasonally adjusted annualised terms, moving seasonality may cause some further acceleration of headline inflation in YoY terms, as it would most likely peak in August. Partially this could be offset by a disinflationary effect from the exchange rate on non-food prices, which is, albeit fading, is most probably ongoing. Given a short-run pass-through to food prices, we also see additional inflationary effects from exchange rate depreciation in May-June 2017 to play a much less dominant but still a visible role. As long as the moving seasonality is quickly resolved, year-on-year inflation is likely to gradually drop, other things being equal. However, the probable losses of harvest due to persistently cold weather in the European part of Russia may have a more prolonged effect on CPI growth, which could last up to 2018 Q2.

Despite the temporary price growth, headline inflation evolves according to the path consistent with achieving the 4% target by the end of 2017. When conducting its monetary policy, the Bank of Russia cannot influence inflationary consequences resulting from cold weather, but must obviously take into account possible second-round effects related to permanent increase in inflation expectations.

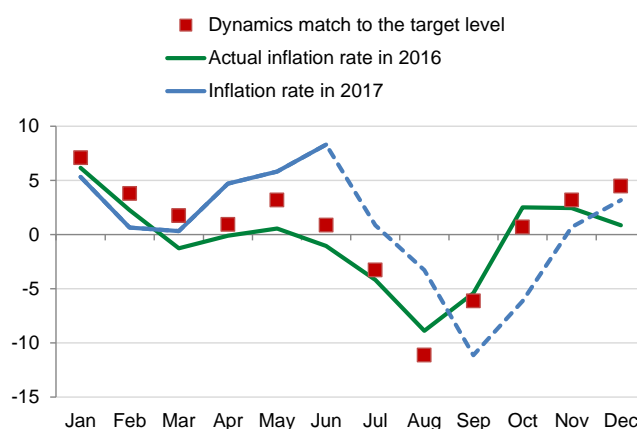
Figure 2. Weekly price growth for fruit and vegetables, %



Sources: Rosstat, R&F Department calculations

* Grey areas correspond to second quarters of each year.

Figure 3. Price growth for fruit and vegetables, % MoM



Sources: Rosstat, R&F Department calculations.

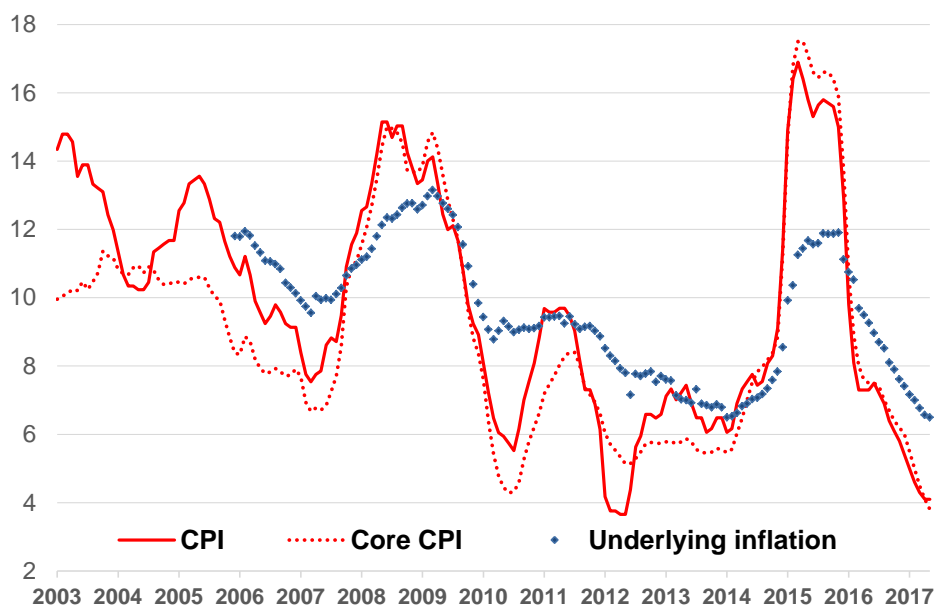
* January - June – actual dynamics, July - December – dynamics corresponding to 4% in seasonally adjusted annual terms with a one-month ahead shift.

According to inFOM, the decline in inflation expectations among the population has for the moment stopped. The current estimate of 10.3% YoY is still well above the 4% target.

1.1.2. Underlying inflation has hit historical lows but is still noticeably above the 4% margin

- Underlying inflation has declined from 6.6% YoY in April to 6.5% YoY in May (Figure 4).
- The current underlying inflation has reached historical lows, as a similar estimate was also observed in January 2014.
- The fact that underlying inflation is still noticeably above the 4% target level suggests that medium-term risks to inflation persist and must be further offset by moderately tight monetary policy.

Figure 4. CPI, core CPI and historical estimates for underlying inflation, % YoY



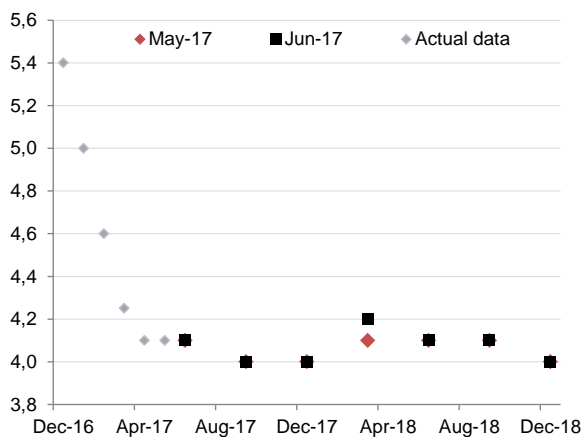
Sources: Rosstat, R&F Department calculations.

1.1.3. Bloomberg analysts expect headline inflation to hit target

- Analysts' inflation short- and medium-term expectations appear to be anchored to the Bank of Russia's target level.
- Analysts assume that the central bank will stick to moderately tight monetary policy at least up to the beginning of 2019.

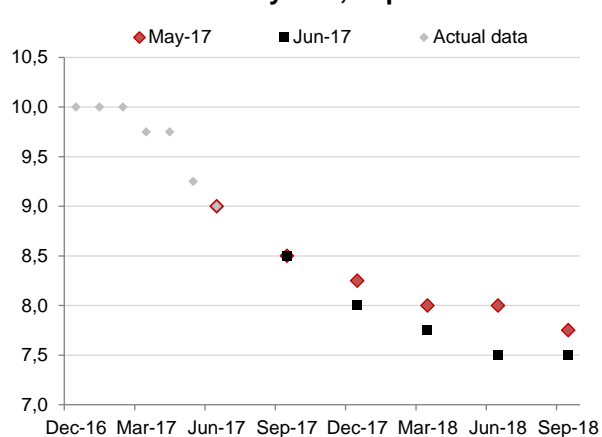
A monthly Bloomberg survey conducted in June showed practically no change in experts' consensus for inflation at the end of 2017. Most analysts believe that the 4.0% inflation target is likely to be reached by the end of 2017 Q3, as this level will further hold until the end of the year (Figure 5). In 2018 Q1 experts expect a slight acceleration of inflation to 4.2% YoY, the latter presumably being explained by the base effect. By the end of 2018, yearly CPI growth will gradually return to 4.0% YoY.

Figure 5. Analysts' inflation expectations, % YoY



Source: Bloomberg Finance L.P.

Figure 6. Analysts' expectations for the BoR key rate, % per annum



Source: Bloomberg Finance L.P.

Despite the fact that in June the Bank of Russia publicly stated its intent to stick to the moderately tight monetary policy, Bloomberg analysts slightly revised their expectations with respect to the key rate by the end of the year. The consensus forecast of the key rate declined from 8.25% p.a. in May to 8.0% p.a. by the end of June (Figure 6). The pooled forecast also assumes further reduction of the key rate to 7.50% p.a. by mid-2018 and its further flat trajectory in the second half of the year. That said, most experts predict gradual reduction of the real interest rate to its equilibrium level (officially stated by the Bank of Russia to be within the 2.5-3.0% band), as the gap is still likely to remain positive throughout 2018.

1.2. Economic performance

Short-term activity indicators and survey data point to the fact that, in all likelihood, economic growth accelerated in the second quarter. Industrial growth rates remained in positive territory. The increase in industrial production is characterised by increasingly sustainable data from both consumer- and investment demand-oriented industries. Domestic demand is recovering at a faster pace than industrial growth, which points to a positive outlook for industrial production in the next few months. It appears that the possible damage from a short-lived decline in oil prices in June did not prevent the economy from posting low but sustainable growth rates. Current economic developments suggest that the economy's gradual adjustment to the effects of negative external shocks is nearing completion. However, moving forward, the potential acceleration in growth is limited by a number of structural constraints including rigidities in the labour market.

1.2.1. Retail growth is gradually gaining momentum

- In May, the growth rate of retail turnover accelerated to 0.7% YoY following a rise of 0.1% YoY in April.
- When adjusted for seasonal and calendar effects, there was no change in retail sales in May compared to April.
- Retail trade dynamics in 2017 Q1, calculated using changes in the sales volume of certain categories of goods, turned out to be more favourable than Rosstat's estimate.
- Households demonstrated a slightly more positive attitude towards large purchases on the backdrop of continued growth in real wages.

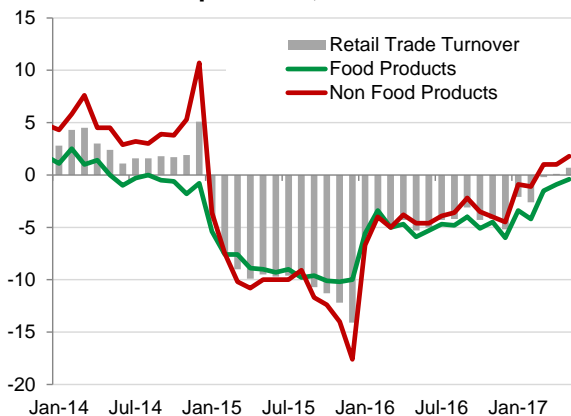
According to statistics from Rosstat, in May 2017 retail sales stood at 0.7% YoY. Data for January-April of the current year were revised following updates from respondents on their earlier provided responses. Thus, in April, retail sales increased by 0.1% YoY (having previously reported zero growth). Therefore, on an annualised basis, retail turnover has grown for the second consecutive month after 27 months of decline (Figure 7).

Growth was recorded again in the non-food segment: in May it stood at 1.8% YoY (1.0% YoY in April). Meanwhile, retail turnover of food products continues to decline. However, the rate of decline slowed to 0.4% YoY following 0.9% YoY recorded in April.

According to our estimates, when adjusted for seasonal and calendar effects, retail sales in May matched the level recorded in April (Figure 8). The 0.22% MoM decrease in sales of food products was offset by an 0.18% MoM increase in sales of non-food products.

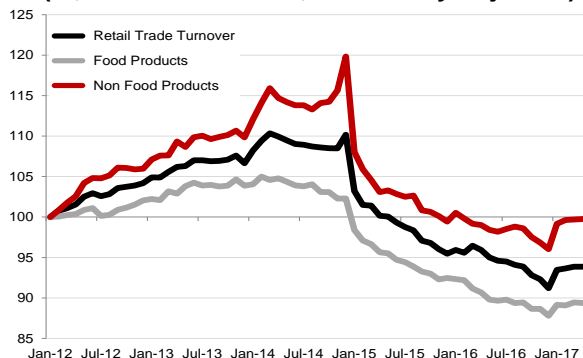
The increase in retail turnover was accompanied by continued growth in real wages: according to preliminary data, in May the growth rate of real wages remained consistent with the level recorded in April at 3.7% YoY (Figure 9).

Figure 7. Retail sales of food and non-food products, % YoY



Sources: Rosstat, R&F Department calculations.

Figure 8. Retail sales (% , Jan 2012 = 100%, seasonally adjusted)



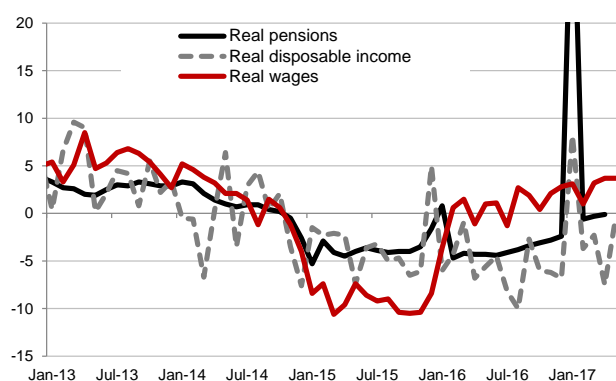
Sources: Rosstat, R&F Department calculations.

Rosstat revised the decrease in Q1 retail sales from 1.8% YoY to 1.6% YoY. Also, retail sales dynamics, calculated using changes in the sales volume of certain categories of goods, turned out to be more favourable¹. (Figure 10). Therefore, in 2017 Q1, there was no change in retail sales compared to the first quarter of the previous year. Sales of food products decreased by 0.6% YoY, while those of non-food products increased by 0.5% YoY. Rosstat estimates sales of both food and non-food products to have decreased by 3.0% YoY and 0.3% YoY respectively.

According to Romir Research Holding (a pollster)², in May, there was a decrease of almost 9% in real household spending in annual terms (Figure 11). However, this figure may be underestimated due to the fact that Romir only uses data about fast-moving consumer goods in its calculations. Therefore, large purchases are not included in the calculation. Their sales growth has significantly contributed to improved retail sales dynamics in recent months.

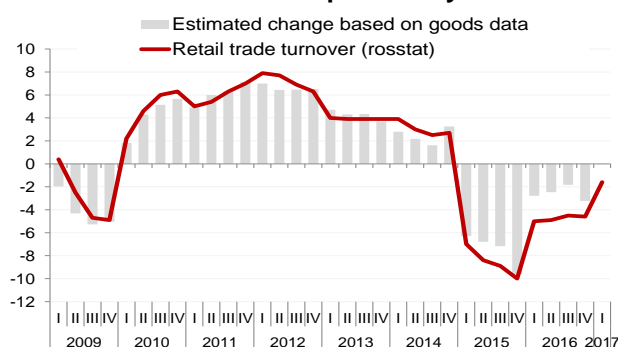
The positive trend in sales of non-food products is consistent with the survey data on consumer sentiment conducted by InFOM³. According to the survey, in May household attitudes towards large purchases slightly improved on the backdrop of growth in current wages and improved expectations about future wages (Figure 12).

Figure 9. Households' real wages, % YoY



Source: Rosstat, R&F Department calculations.

Figure 10. Retail sales dynamics, year to date, over same time previous year



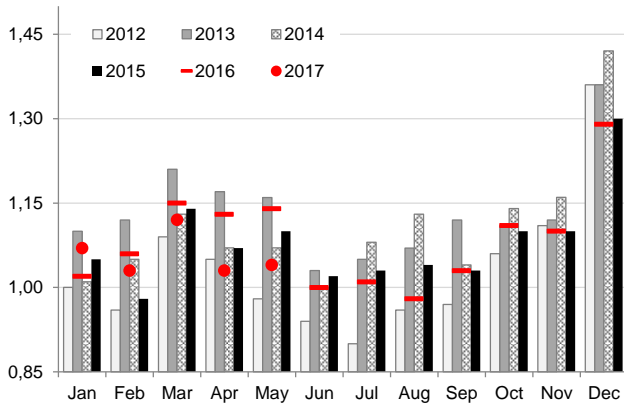
Source: Rosstat, R&F Department calculations.

¹ The index is the weighted average of key food and non-food product categories which jointly account for more than 71% of the total retail trade turnover. The commodity composition is borrowed from the pre-target year. For more details please refer to 'Talking Trends' No. 1, February 2017, Section 3. 'In Focus. Consumption: evidence for decline or growth'.

² Romir Research Holding. ["Groceries expenditures". 08.06.2017 Consumption: falling or growing? \(in Russian\)](#).

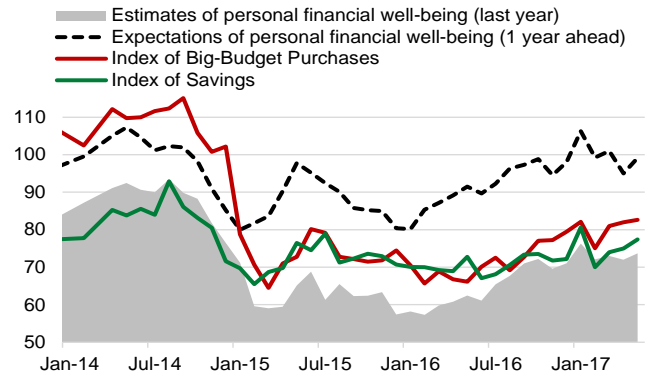
³ 'Inflation expectations and consumer expectations'. [No 5, May 2017](#).

Figure 11. Dynamics of real cost of living (% , January 2012 = 100%)



Source: Romir Scan Panel.

Figure 12. Dynamics of the consumer sentiment index and its components, pp

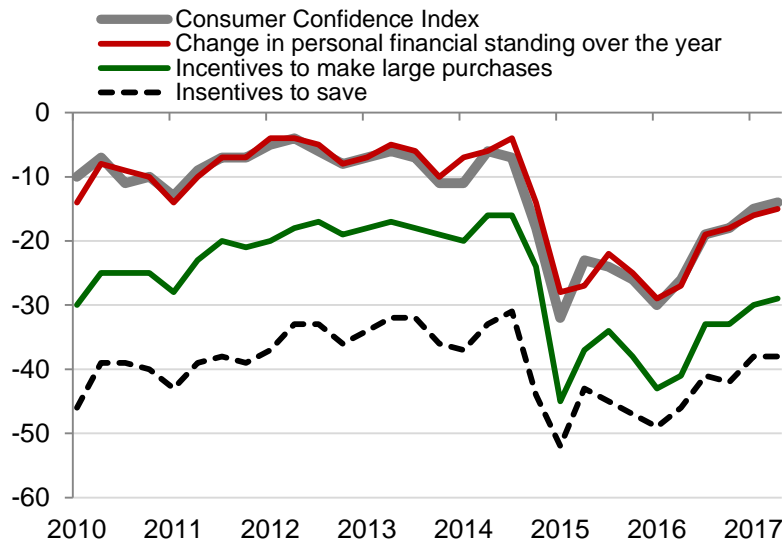


Source: InFOM LLC.

According to a sample survey conducted by Rosstat, consumer expectations continued to improve in 2017 Q2 (Figure 13). The consumer confidence index, reflecting aggregate household expectations, increased by 1 percentage point. There was an upgrade in estimates regarding potential changes to personal financial standing over the past year, as well as expectations about it for the future. This had a positive impact on household attitudes to large purchases. Compared to the first quarter, there was no change to the savings confidence index.

Given the improved consumer sentiment and the continued annual growth in real wages, it is expected that the annual rate of retail sales will stabilise in positive territory.

Figure 13. Consumer confidence index and its components



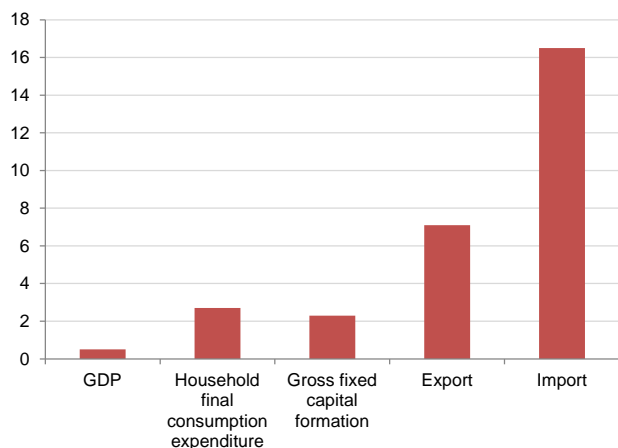
Sources: Rosstat, R&F Department calculations.

1.2.2. GDP: Q1 growth in domestic demand was met through imports

- The first quarter saw robust growth in household final consumption expenditure (+2.7% YoY) and gross fixed capital formation (+2.3% YoY).
- Growing domestic demand was satisfied through expanded imports and slower accumulating inventories.
- The difference between household final consumption expenditure and retail sales is partially attributed to the explosive growth in overseas banking card transactions, related to outbound travel and purchases made in foreign online stores.

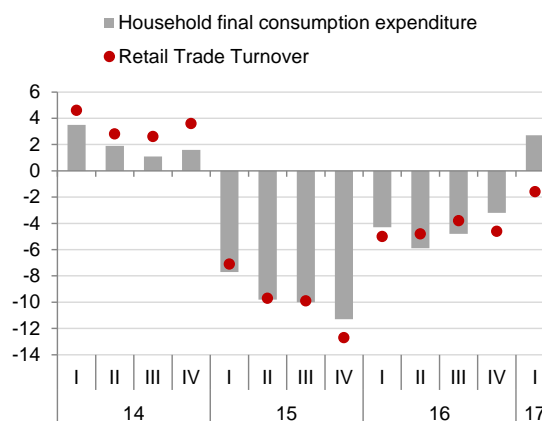
Rosstat recently released a preliminary estimate for 2017 Q1 expenditure-based GDP. GDP growth is estimated to have remained at 0.5% YoY (Figure 14). In a surprise development, households' final consumption posted a 2.7% YoY growth whereas Rosstat-estimated retail sales for the first quarter were down by 1.6% YoY and commercial services grew 0.2% YoY (Figure 15). This is further evidence backing our assumption that Rosstat's readings for retail sales in real terms may be underestimated due to the applicable methodology.

Figure 14. Q1 GDP components by disposition, % YoY



Source: Rosstat.

Figure 15. Household final consumption expenditure, % YoY



Source: Rosstat.

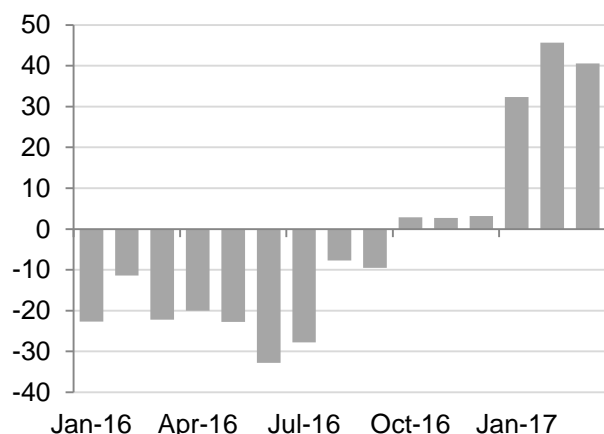
The gap in readings is partially down to the finalised data on final consumption expenditure of households - outbound travel and cross-border online sales are not included in retail sales statistics.

Data by Global Blue, a VAT refund service provider, help us understand the trends in Russian tourist spending overseas. According to Global Blue, Russian tourists' spending overseas saw a 41% YoY rise in March, a 46% YoY rise in February and a 32% YoY rise in January (Figure 16). The data also reveal strong growth in the volume of products coming in as purchases made in foreign online stores. According to the Russian

Association of Internet Trade Companies, the nominal turnover of cross-border retail operations increased 37% in 2016 (Figure 17). In all likelihood, this trend has continued into 2017. Furthermore, Russia Post's data corroborates this: Russia Post handled twice as many parcels in 2016 vers. 2015, with 2017 Q1 growth totalling 50% YoY vers. 2016 Q1.

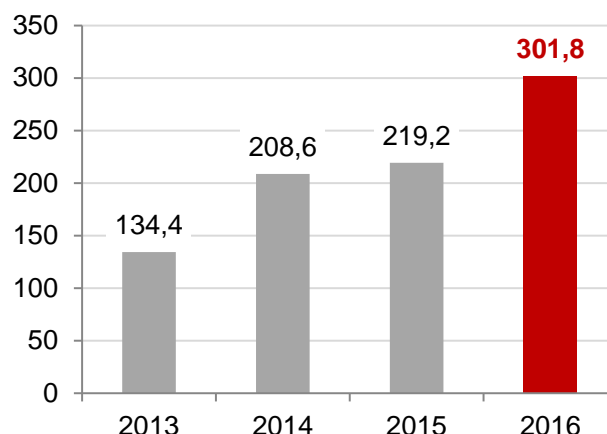
Based on household income use statistics for the first quarter, banking card transactions overseas accounted for 3.2% of total household spending on goods and services. We expected spending related to outbound travel and cross-border retail to grow nearly twofold vers. the first quarter last year – in order to account for the total difference between household end consumption expenditure and the combined turnover of retail sales and commercial services.

Figure 16. Russian tourists' spending abroad, % YoY



Source: Global Blue Intelligence.

Figure 17. Cross-border trade in Russia (imports), billion rubles



Source: The Russian Association of Internet Trade Companies.

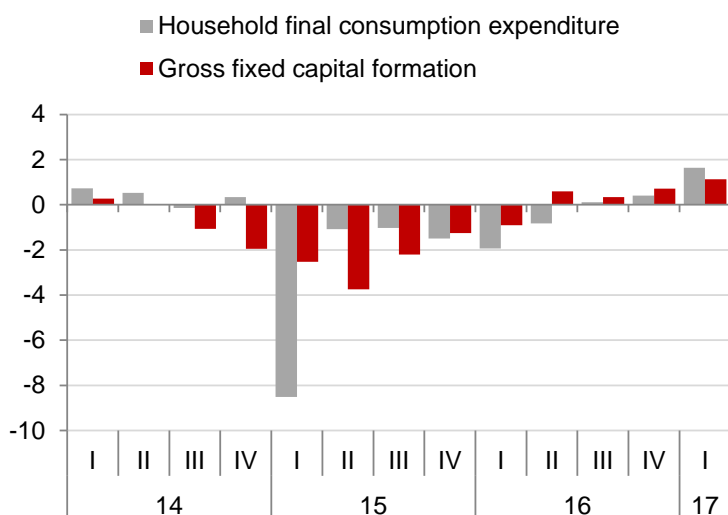
The volume indicator of gross fixed capital formation gained 2.3% YoY and was identical with Rosstat estimates for fixed capital investment data previously released. Meanwhile, gross formation adjusted for change in inventories was up by a mere 0.1% YoY. The change in inventories in nominal terms was +11.4 billion rubles compared to +73.9 billion rubles recorded one year ago.

The fairly strong performance of domestic demand was (Figure 18) was satisfied through imports. According to the Federal Customs Service's Q1 data, growth was primarily observed in imports of machinery and equipment, (+16.4% YoY), followed by clothing and footwear (+34.9% YoY).

As early as the first quarter, PMI data suggested that manufacturing outputs were lagging behind demand (considering that PMI indexes for inventories have been consistently lower than the 50.0 point since the start of the year), which is further supported by the GDP breakdown by disposition. Q2 PMIs suggest these trends continued. The backlogs of orders in the manufacturing sector grew between May and

June on the back of the outrunning growth in demand for consumer- and investment-oriented sector products. Finished goods inventories and raw material stock meanwhile continued to decline.

Figure 18. Household final consumption expenditure and gross fixed capital formation % QoQ, seasonally adjusted



Source: Rosstat.

1.2.3. May's output data came as a pleasant surprise

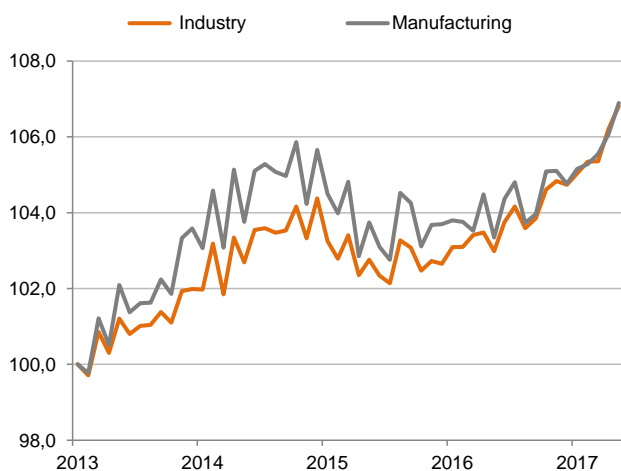
- The production sector grew 5.6% YoY, according to Rosstat, and 0.6% MoM, according to R&F Department estimates, seasonally and calendar effect adjusted.
- Mining and manufacturing were key industrial drivers where outputs were supported, among other things, by the cold weather and a strong ruble.
- Based on Manufacturing PMIs, it seems highly probable that industrial expansion will continue at a fast pace in the months to come.

According to Rosstat, in May industrial output grew 1.6% MoM and 5.6% YoY. Even once adjusted for an additional working day compared to May 2016⁴, the current pace of growth looks more than promising. R&F Department estimates find May's output, seasonal and calendar factor adjusted, to have grown +0.6%% MoM (+0.8% MoM in April) (Figure 19). However, given the very limited set of observations based on the new methodology, these estimates should be treated with caution mainly due to the wagging

⁴ Growth paces ~4% YoY.

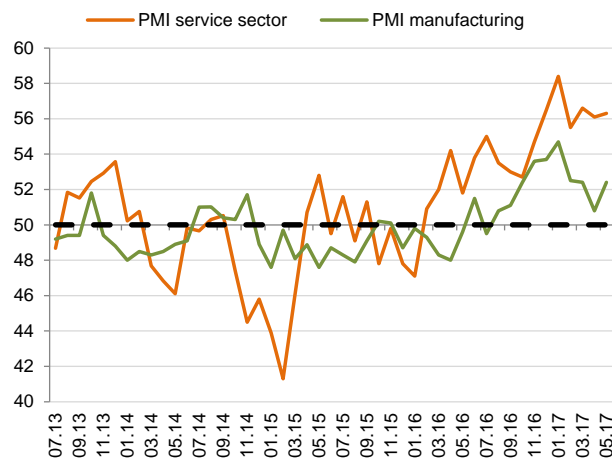
tail problem. As new data subsequently come in, these estimates are likely to change substantially. Also, the estimates leave out the effect of cold weather in May.

Figure 19. Industrial outputs* (January 2013 = 100)



Sources: Rosstat, Bank of Russia calculations.

Figure 20. PMIs, pp



Source: Bloomberg Finance L.P.

The sectoral breakdown signals robust growth rates in both mining (+0.8% MoM⁵, +5.6% YoY) and manufacturing (+0.8% MoM, +5.7% YoY). The former's expansion occurred on the back of rising gas production (+21.3% YoY), which accelerated markedly in comparison with the January-April data thanks to stronger domestic and external demand. Mounting gas withdrawals from underground storage facilities in the winter led to increased export demand from Central and Northern Europe, while the colder-than-usual spring in Russia spurred demand domestically. Solid growth rates were also observed in coal output (+8.4% YoY).

The product breakdown for the manufacturing sector suggests that growth is accelerating in the production of machinery and equipment, mainly that for agricultural use and some household appliances. The increase in their output is probably due to a stronger ruble with its positive effect on payments for imported components. The food, chemicals and rubber and plastics industries continue to enjoy moderate growth. Accordingly, signs of a robust recovery are finding their way into both investment-oriented and consumer demand-oriented industries.

Industrial output in May posted robust growth, consistent with the high PMI readings (Figure 20). The June decline in Manufacturing PMI to 50.3 pp is the only evidence for a halt in the acceleration of business activity, due to, among other things, a decline in oil prices. There are no grounds to expect the positive trend to reverse course – barring negative effects in the external environment, the manufacturing sector is likely to keep turning in robust growth rates.

⁵ Here and elsewhere, % MoM estimates by R&F Department are seasonally and calendar effect adjusted.

1.2.4 June PMI: Business activity growth slows down but remains substantial

- The composite PMI index decreased in June but was still above the long-term median of the period covered by the studies.
- The manufacturing sector accounted for most of the slowdown in business activity, as is evidenced by the PMI index hitting 2011-2012 lows – a time of moderate growth rates.
- Rising demand, together with accelerated growth in incomplete construction and improved respondents' expectations signal the likelihood of continued growth in manufacturing outputs in the months to come.
- At the same time, the slowdown in services is not a concern as their PMI is invariably higher than the long-term median of the period covered by the studies.

In June, the composite PMI index went down from 56 to 54.8 pp, which was also higher than the long-term median. In this way, despite the moderate slowdown against May, the private sector of the Russian economy kept posting solid business activity growth rates. This slowdown was observed in the service sector (PMI went down from 56.3 to 55.5) as well as in the manufacturing sector (PMI decreased from 52.4 to 50.3) (Figure 21). However, respondents in both sectors note strengthened demand and improved expectations for higher outputs. This supports the expectations for the market conditions to improve in the next few months.

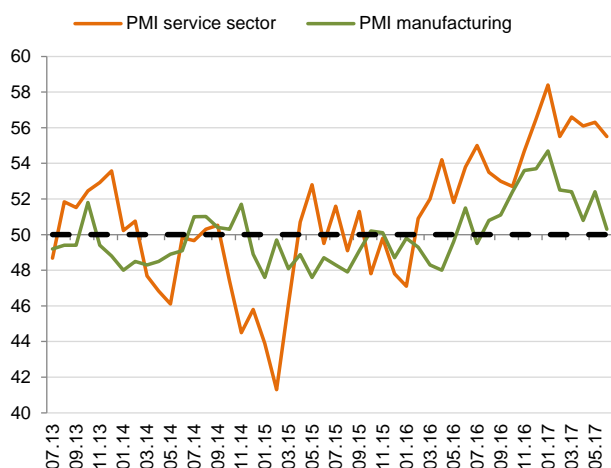
Although economic activity growth declined in manufacturing sectors in June as a result of dwindling oil prices, it remained in growth territory. That said, Manufacturing PMI in recent months has held close to its 2011-2012 readings, a time of moderate growth. Importantly, between late 2016 and early 2017, industrialists were ramping up production very cautiously over concerns about unsteady demand for their products. This stance was particularly typical of investment product manufacturers whose caution was coupled with the strategy of reducing inputs notwithstanding the increasing demand.

For all that, new orders PMI and output PMI are above the composite PMI reading, which suggests a stronger output potential in manufacturing in the near future than the composite index reading suggests (Figure 22). Moreover, accelerated growth in incomplete construction (for details please refer to para. 1.2.1 ('GDP: Q1 growth in domestic demand was satisfied through imports'), combined with a further improvement in expectations suggests a continued rise in manufacturing outputs in the next few months even if demand stabilises.

The decline in Services PMI in June suggests business activity in the sector was only slightly slower. The index remained notably above the long-term median of the period covered by the studies, while the average PMI value in the second quarter was only slightly lower than Q1 results. On top of that, as robust growth in new order intakes

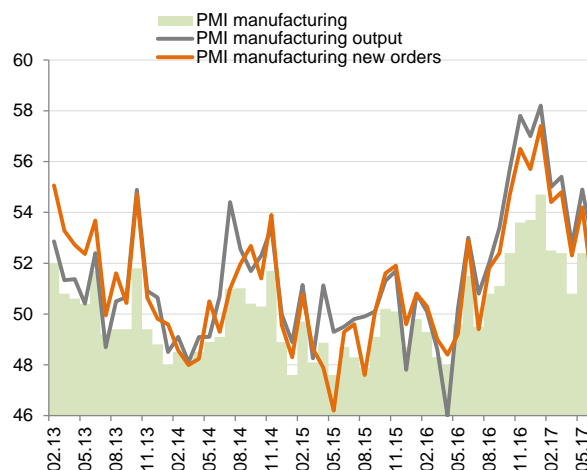
continues, coupled with new job creation and improved corporate sentiment, it seems highly probable that the sector will continue to post robust growth rates in the near future.

Figure 21. Manufacturing and Services PMIs, pp



Source: Bloomberg Finance L.P.

Figure 22. Manufacturing PMI, pp



Source: Bloomberg Finance L.P.

1.2.5. Business activity recovery slows down in the service sector

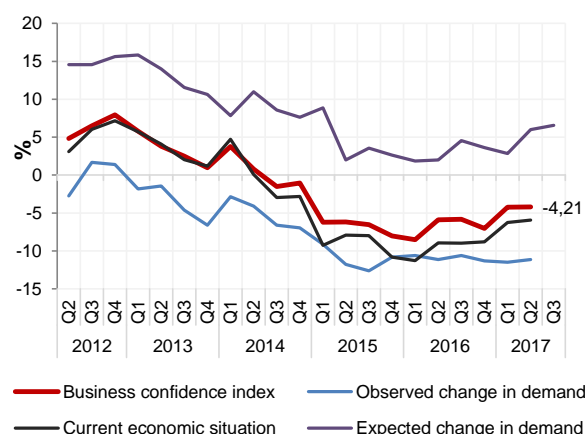
- According to Rosstat's data, in 2017 Q2, business activity recovery in the service sector demonstrated a slight slowdown compared to 2017 Q1.
- The limited improvement in respondents' estimates in the current period is primarily linked with a downgrade in the estimates for the volume of services.
- Given the renewed consumer demand, price indexes in the service sector may increase owing to the fact that companies will be increasingly shifting rising costs to consumers.

According to Rosstat's surveys, in 2017 Q2 the seasonally adjusted business confidence index (BCI) in the service sector revealed a slight improvement in the sector's business climate compared to the previous quarter, standing at -4.21% (Figure 23). Despite the renewed optimism among respondents, the index demonstrated a significant slowdown in growth on an annualised basis compared to the previous period (1.7 pp YoY vs 4.3 pp YoY in 2017 Q1).

The index displayed growth as a result of a slight improvement in estimates across all of its components: somewhat less negative estimates for current demand and the economic situation, as well as increased optimism among respondents about future demand (Figure 23). However, while the dynamics of key indicators in 2017 Q1 suggested that signs were emerging of the service sector's prolonged stagnation coming to a close, the results of the current survey suggest these positive trends will slow, moving forward.

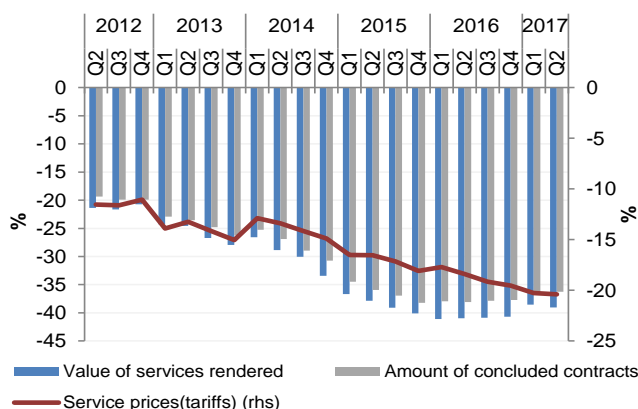
According to corporate estimates, the volume of services provided dropped in value terms to a greater extent in 2017 Q2 than in the previous period (Figure 24). Despite a slight decrease in customer outflow in the current period, business demonstrated increased optimism regarding the forecasted number of contracts to be concluded in 2017 Q3. This suggests that the slower pace of recovery currently observed in the sector may be temporary.

Figure 23. Business confidence and its components in the service sector, seasonally adjusted



Source: Rosstat, R&F Department calculations.

Figure 24. Estimated changes in the volume of services, in numerical and value terms, and prices for services, seasonally adjusted⁶



Source: Rosstat, R&F Department calculations.

In the current period, the majority of companies estimate their prices as below normal. Moreover, the share of those responding in this way remained roughly at the same level as the previous quarter (Figure 25). Nevertheless, companies are looking to the future with increased optimism and are predicting an improvement in prices, although these estimates are more conservative compared to the previous quarter. With renewed consumer demand, there is potential for price indexes in the service sector to increase due to the fact that companies will start transferring costs to consumers to a greater extent.

It can also be noted that renewed consumer demand is demonstrated by the reduced impact of insufficient demand, which limits business activity in the service sector and has been observed since 2016 (see Figure 26). As for other factors, it is worth noting a certain increase in the pressure of existing taxation for 35% of enterprises (up by 1 pp compared to 2016 Q2). The other factors (heavy regulatory loads, unfair competition, high interest rates on commercial borrowing, etc.) are less impactful⁷. In general, corporate estimates regarding key limiting factors corroborate the service sector's slower recovery.

⁶ (8) Taking into account data correction in 2015 Q4. Source: Centre for Business Tendencies Studies, ISSEK.

⁷ (9) Rosstat publishes estimates on only three key factors. For more detailed statistics, consult the information and analytical material of the Centre for Business Tendencies Studies of the Higher School of Economics entitled 'The business climate in the services sector'.

Figure 25. Estimated changes in prices (rates) for services, balances of responses, seasonally adjusted

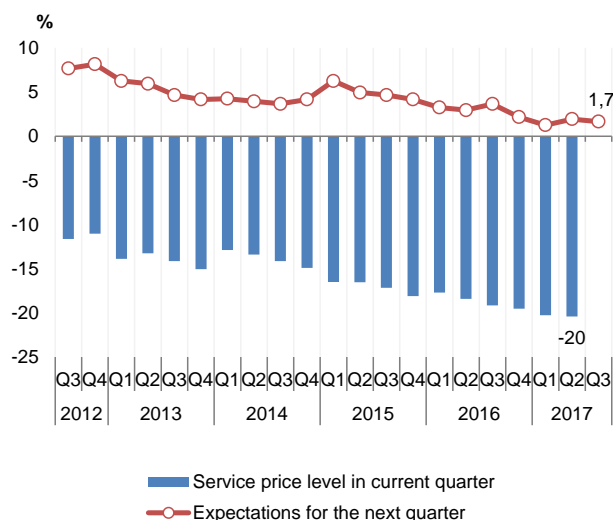
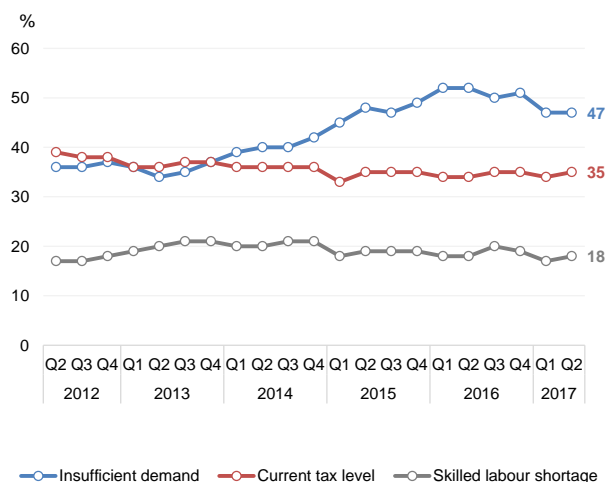


Figure 26. Movements in key business constraints in the service sector



Source: Rosstat, R&F Department calculations.

1.2.6. The upward trend in the new car market continued

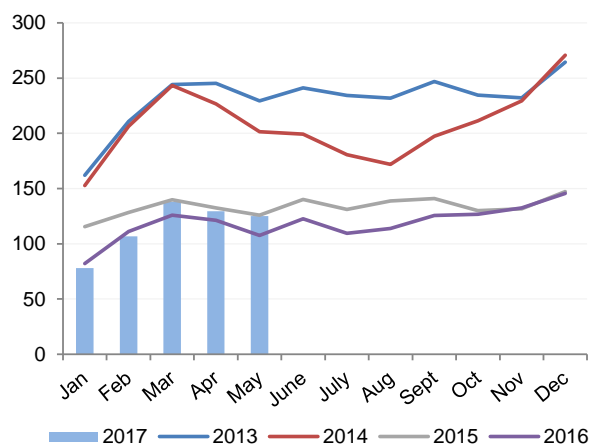
- In May, sales of new cars increased, continuing the dynamic pattern recorded in the previous two months (+ 0.3% MoM) and indicating the beginning of an upward trend this year.
- Increasing consumer prices for new cars (above the average for Russia) in the Central and Volga federal districts may be explained by the intensive recovery of consumer activity in these regions.
- This renewed increase in market activity does not currently give rise to significant risks of increased inflation.

According to the Association of European Businesses (AEB), in May 2017, sales of new cars and light commercial vehicles increased by 14.7% YoY (Figure 27). Moreover, when adjusted for seasonal and calendar effects, growth in May 2017 stood at +0.3% MoM (Figure 28). Thus, after significant growth in February-March, the following months saw car sales stabilised and followed the trajectory seen in 2015. This trend suggests a gradual recovery of consumer activity in the economy. Should the reasonably favourable external conditions continue in the coming months, its trajectory is likely to be consistent with the stable growth observed two years ago.

The growth in demand for new cars in the previous month was mainly determined by recovering sales in the mass market, which had previously reported a significant downturn during the crisis. In all likelihood, the market responded positively to the

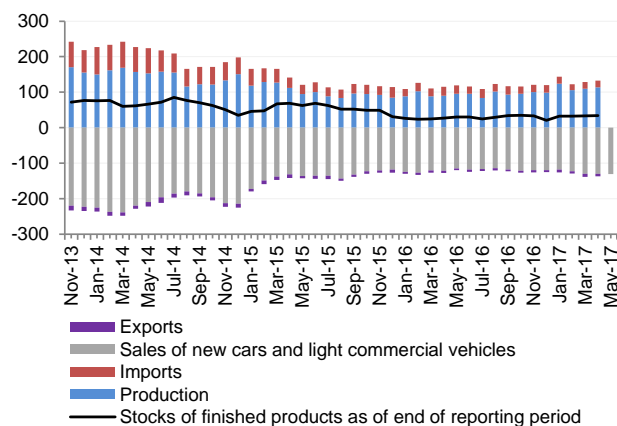
Ministry of Industry and Trade's decision to review the conditions of soft loan programmes in early May this year, with an effect on mass-market brands.

Figure 27. Sales of new cars and light commercial vehicles, thousands, pcs.



Source: AEB, R&F Department calculations.

Figure 28. Components of demand (-) and supply (+) on the car market in the Russian Federation, seasonally adjusted, thousands, pcs.



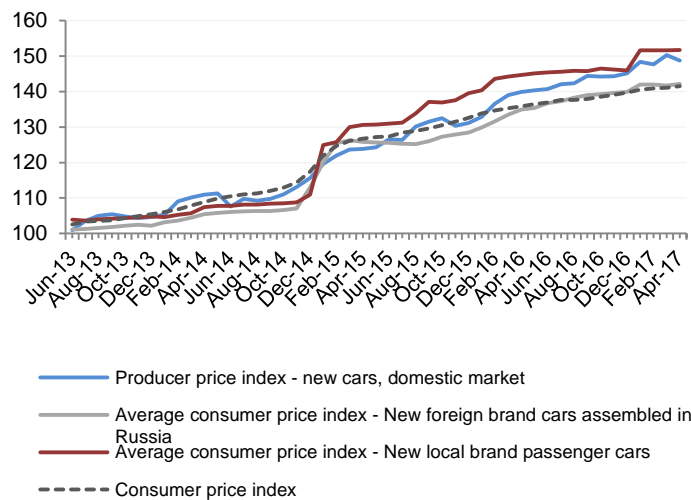
Source: AEB, R&F Department calculations.

The Ministry of Industry and Trade also announced that targeted support measures will come into force from July 2017. These include the programmes mentioned earlier such as 'First Car', 'Family Car', 'Russian Tractor', 'Russian Farmer' and 'Your Own Business'. These programmes will be allocated approximately 7.5 billion rubles throughout the year, which be a key factor for a further strengthening in this positive trend. This is especially important in the summer (July-August) when car sales are usually down owing to a change in consumer preferences.

Over the course of January-April 2017, imports decreased (-19.3% YoY). This is linked with a rise in localisation. These trends are likely to continue and grow stronger. In particular, the Ministry stated that the programmes aimed at supporting the car industry should include models that meet certain levels of localisation. Exports of new cars continue to grow: in the first four months of 2017, shipments abroad increased by 21.5% YoY.

The beginning of 2017 saw an increase in producer prices for new cars as producers sought to set off costs related to the 2016 weakening of the ruble (Figure 29). This increase was reflected in the average consumer prices for new cars assembled in the Russia. In this way, the greatest increase in consumer prices occurred early in the year. However, according to Rosstat, the average consumer price hike for new cars slowed in the last month. Therefore, since the beginning of this year consumer prices for domestic brands have increased by 4.0%, with foreign brands assembled in Russia going up by 1.6%.

Figure 29. Dynamics of consumer and producer prices for new cars, seasonally adjusted, Jan 2013 =100%



Sources: Rosstat, R&F Department calculations.

In terms of consumer spending in 2017, the share of new domestic and foreign cars assembled in Russia comprises 0.72% and 1.65% respectively. In aggregate, this is a relatively small contribution to CPI. Therefore, a slight increase in consumer prices in April 2017 should not generate risks of increased inflation across the whole country, moving forward.

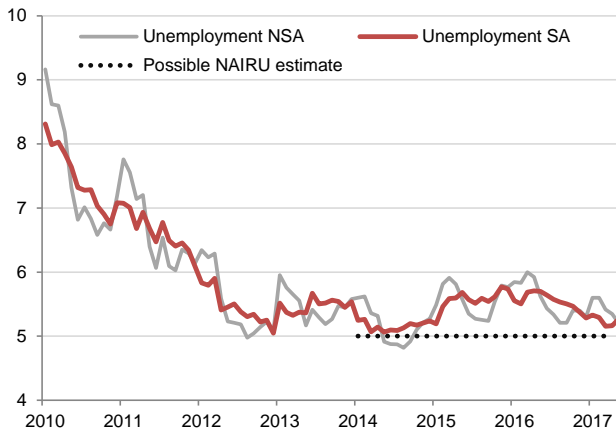
Nevertheless, in some constituent territories of the Russian Federation (Central and Volga Federal Districts), the growth rates of car prices exceed the average growth nationwide. These federal districts stand out as regions with the largest car sales per capita. In recent months, these regions have seen an increase in sales in absolute terms. The accelerated price increase may be caused by a recovery in consumer activity, which raises the risks of elevated inflation in these regions.

1.2.7 Cold weather in May was behind a temporary halt in unemployment decline

- Bad weather in May brought the downward movement in the unemployment rate to a halt as the weather conditions caused a delay in seasonal farming operations.
- Annual growth rates of real wages continued to recover on the back of slower inflation; however, this movement may stop in the next few months.

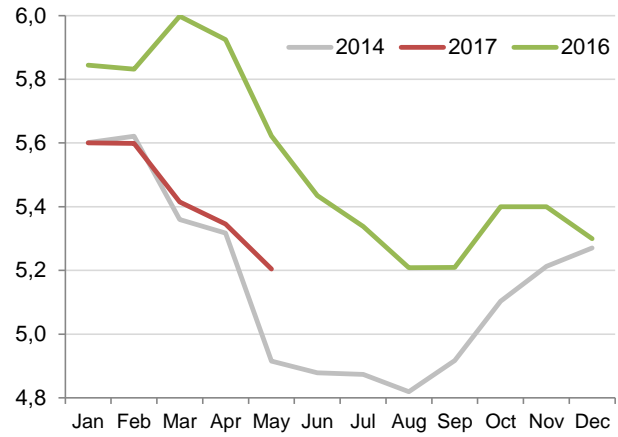
According to Rosstat, May's unemployment decreased vers. April from 5.35% to 5.2%. At the same time, seasonally adjusted unemployment rate went up to 5.27% from 5.14% recorded in the previous month (Figure 30). This decline in May (Figure 31), slower than would be expected from regular seasonal movements, may have been caused by cold weather leading to a delay in seasonal operations seen mainly in farming.

Figure 30. Unemployment, %



Sources: Rosstat, R&F Department calculations.

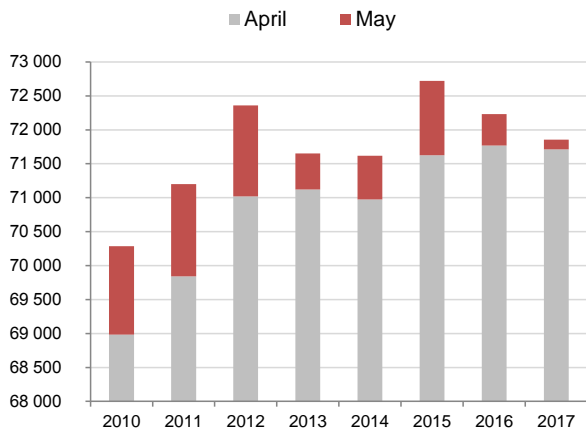
Figure 31. Intra-year unemployment (seasonally unadjusted)



Sources: Rosstat.

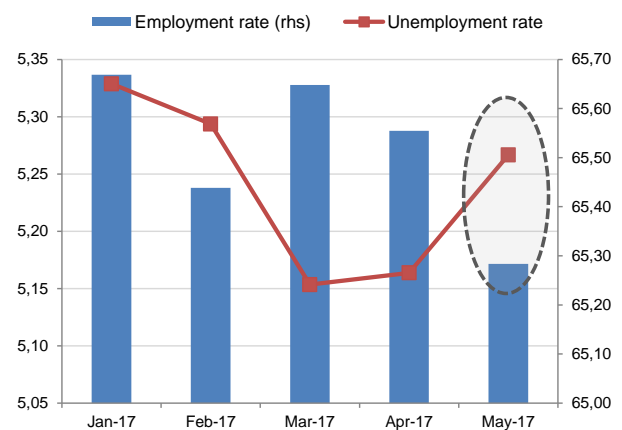
The delayed start in seasonal operations is further confirmed by the previous years' employment data. As a rule, there is a material rise in the numbers of those employed in May against April – with the average rise of 1 million people – due to the start of spring work (Figure 32). This year, this rise was a mere 142 thousand people, much below that of prior periods. This suggests that most workers failed to begin work in May.

Figure 32. Number of employed in April and May, thousands of people



Sources: Rosstat, R&F Department calculations.

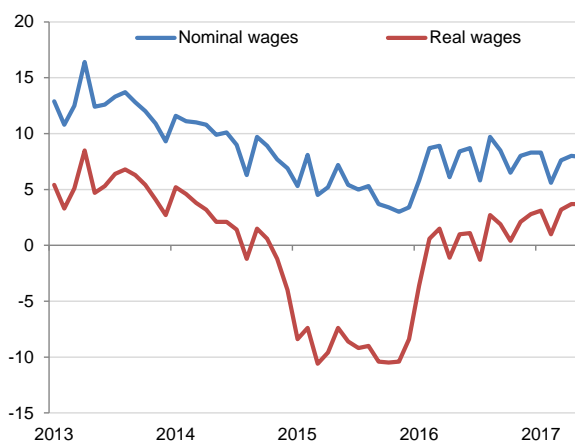
Figure 33. Employment and unemployment rates (seasonally adjusted) %



Sources: Rosstat, R&F Department calculations.

The bad weather conditions were also a reason why some seasonal workers were classed as unemployed. This number was reflected, among other indicators, in the employment rate, which went down from 65.6% to 65.3% (Figure 33). With the seasonal work cycle affected by this shift, we expect that a normalisation is due in the next reporting month.

Figure 34. Annualized nominal and real wage growth rates, %



Sources: Rosstat

In April, estimates for annual rates of growth in nominal and real wages were upgraded from 6.7% and 2.5% to 8.0% and 3.7% respectively. Preliminary May estimates suggest that nominal and real wages went up 7.9% and 3.7% YoY; the last time this rate of growth was registered was March 2014 (Figure 20). We can see the emergence of a sustainable trend towards growth in real wages, which is connected with inflation slowdown.

Nominal wages grew over the last year at an average rate of 8%. With a further slowdown in price growth looking unlikely in view of short-term inflation risks, in the ongoing absence of a clear trend towards accelerated growth in *nominal* wages, we expect no accelerated growth in *real* wages over the upcoming few months.

1.2.8. Labour underutilisation is waning

- Expanded unemployment indicators in the first quarter dropped more rapidly than the standard unemployment rate.
- The rapid decline in labour underutilisation suggests there is potential for accelerated wage growth.
- Employment in the formal sector continues to grow thanks to small enterprises and micro enterprises.

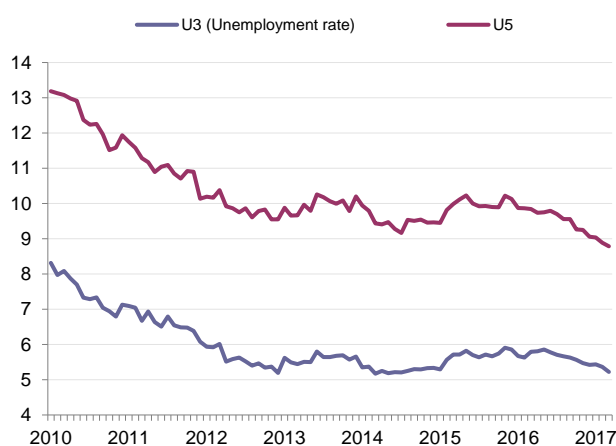
The Labour Force Survey for 2017 Q1 once again corroborated the significantly improved labour market conditions. The expanded U5 unemployment rate continued to decline at a faster rate than the standard figure (Figure 35)⁸ with the drop occurring thanks to a significant decrease in the number of economically inactive people who are not seeking employment but are available for immediate start. In general, while the

⁸ (10) The calculation of the indicators has been corrected due to a change in Rosstat's methodology (for more information, see the inset 'Changes to the methodology for calculating employment and unemployment indicators').

standard unemployment rate is tracking the 2014 trend (when it reached its all-time low) the expanded unemployment rate is even lower than the 2014 values (Figure 36).

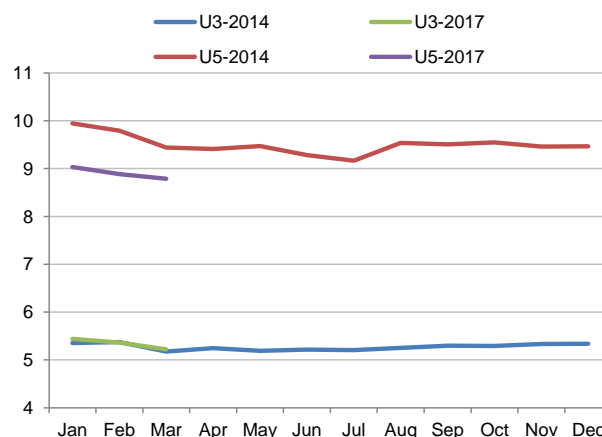
Decreased labour underutilisation suggests an increase in the demand for labour as economic activity recovers. The option to increase the number of working hours (amount of labour used) without hiring new employees could, to a certain extent, hamper wage growth. Should this option run its course, there would be increased competition for staff in the labour market which would, as a result, lead to accelerated wage growth.

Figure 35. Unemployment rate (seasonally adjusted), %



Sources: Rosstat, R&F Department calculations.

Figure 36. Unemployment rates in 2014 and 2017, %



Sources: Rosstat, R&F Department calculations.

It should be noted that further analysis of potential structural changes in the dynamics of Russia's economically active population is complicated by changes in Rosstat's methodology (see inset "Changes to the methodology for calculating employment and unemployment indicators").

Changes to the methodology for calculating employment and unemployment indicators

In 2017, the official statistical methodology for building the system of indicators for labour activity, employment and labour underutilisation (recommended by the 19th International Conference of Labour Statisticians) came in force.

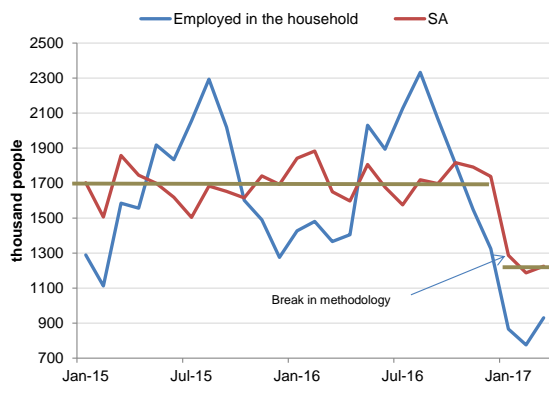
According to Resolution I (Paragraph 22), those employed in the production of goods and services for their own use (defined as all persons of the age surveyed, who, during the brief reporting period carried out any activity linked to the production of goods or provision of services for their own final consumption) were not categorised as employed. This primarily affected statistics regarding those employed in producing for their own households (Figure 37). While before 2017 all those employed in private households were included in the employed category, this category now only includes those who mainly produce goods and render services in exchange for money or to

make profit. Those who produce products primarily for their own consumption or consumption by family members were reclassified as economically inactive.

A further innovation saw the age group surveyed by Rosstat change from people aged 15-72 to 'over 15 years' (Figure 38). This led to an increase in the labour force of merely 0.2% as those over 72 comprise just 1-2% of the labour force. To calculate the standard unemployment rate, Rosstat continues to use the range of 15-72 years while moving to the new age range for all other indicators in the labour force survey.

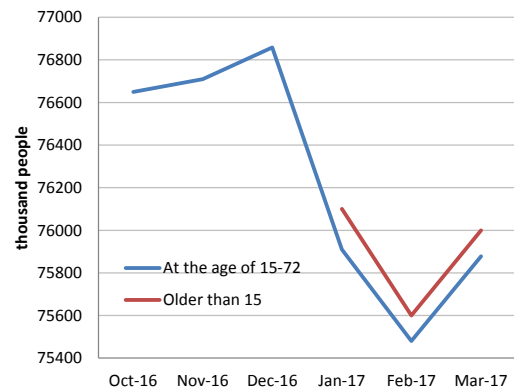
The change in methodology for recording employment in private households prevents us from directly comparing part of the 2017 statistics with previous periods. This is primarily relevant to the U6 expanded unemployment rate since a rather large proportion of those employed in private households are categorised as employed for less than 30 hours a week.

Figure 37. Number of those in primary employment



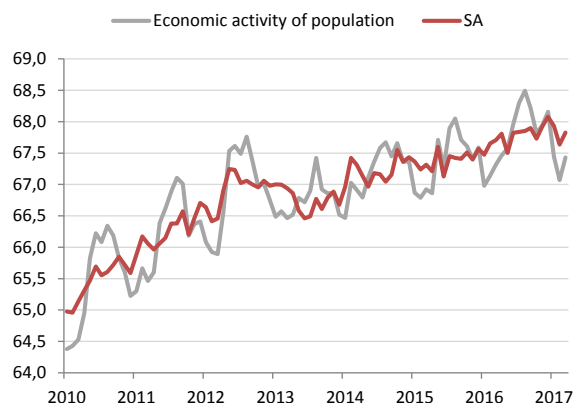
Sources: Rosstat, R&F Department calculations.

Figure 38. Number of the labour force

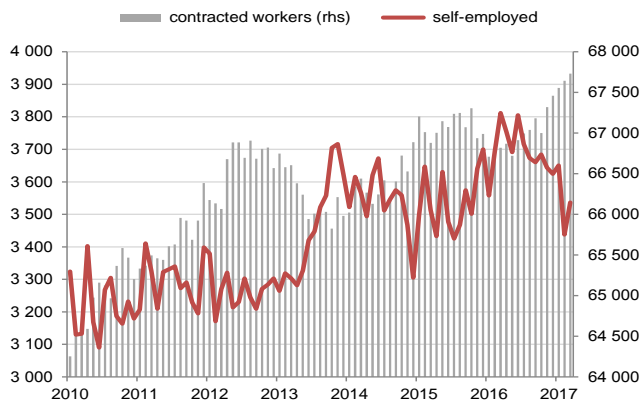


Sources: Rosstat, R&F Department calculations.

The following calculations of the indicators we review are adjusted for the number of those employed in private households (previously excluded from the entire time period). Comparing data from 2017 with previous periods allows us to conclude that there was no sharp drop in the level of household economic activity in the first quarter of this year compared to 2016 Q4. The seasonally adjusted indicator showed a slight decrease of only 0.1% and averaged 67.8% for the quarter (Figure 39).

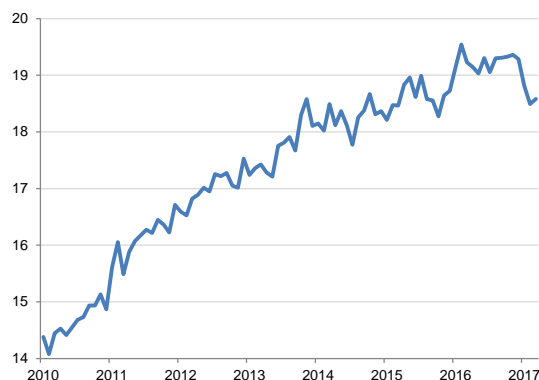
Figure 39. Labour force participation rate, %

Sources: Rosstat, R&F Department calculations.

Figure 40. Number of self-employed and hired labour, thousands people

Sources: Rosstat, R&F Department calculations

In 2017 Q1 there was a slight decrease in the number of those in employment. This is explained by the drop in the number of self-employed workers. Meanwhile, the level of hired labour increased dramatically (Figure 40). At the same time, the level of informal employment had dropped by more than 0.5 pp by March compared to the end of the previous year (Figure 41).

Figure 41. Informal employment (seasonally adjusted), %

Sources: Rosstat, R&F Department calculations.

Given that the informal sector is dominated by those working under employment contracts, it may be concluded that in Q1 the increase in hired labour was mainly observed in the formal sector. Meanwhile, monthly data demonstrate a decrease in the average number of those working under employment contracts in large and medium-sized enterprises. Therefore, the growth in the level of hired labour is mainly seen in small and micro enterprises and individual entrepreneurs.

2.2. What do Russian leading indicators suggest?

2.2.1. GDP nowcast shows further improvement

- Our June GDP nowcast for 2017 Q2 is 0.5-0.6% QoQ SA which is slightly better than the solid estimate for May.
- Strong estimates for 2017 Q2 are partly due to positive seasonally adjusted data for industrial production in May which could be slightly overestimated due to caveats in calendar and weather adjustments.
- Nevertheless, we believe that growth in 2017 Q2 has accelerated.
- Current estimates for 2017 Q3 and 2017 Q4 are 0.6% and 0.5-0.6% QoQ SA respectively.
- The latter estimates roughly imply Urals prices around 49 – 50 USD/barrel up to the end of 2017.
- These quarterly estimates suggest that GDP growth in 2017 may amount to 1.5 – 1.6%.

	June 2017	May 2017
	% QoQ SA	% QoQ SA
2017 Q2	0.5-0.6	0.5
2017Q3	0.6	0.5
2017Q4	0.5-0.6	0.4-0.5

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