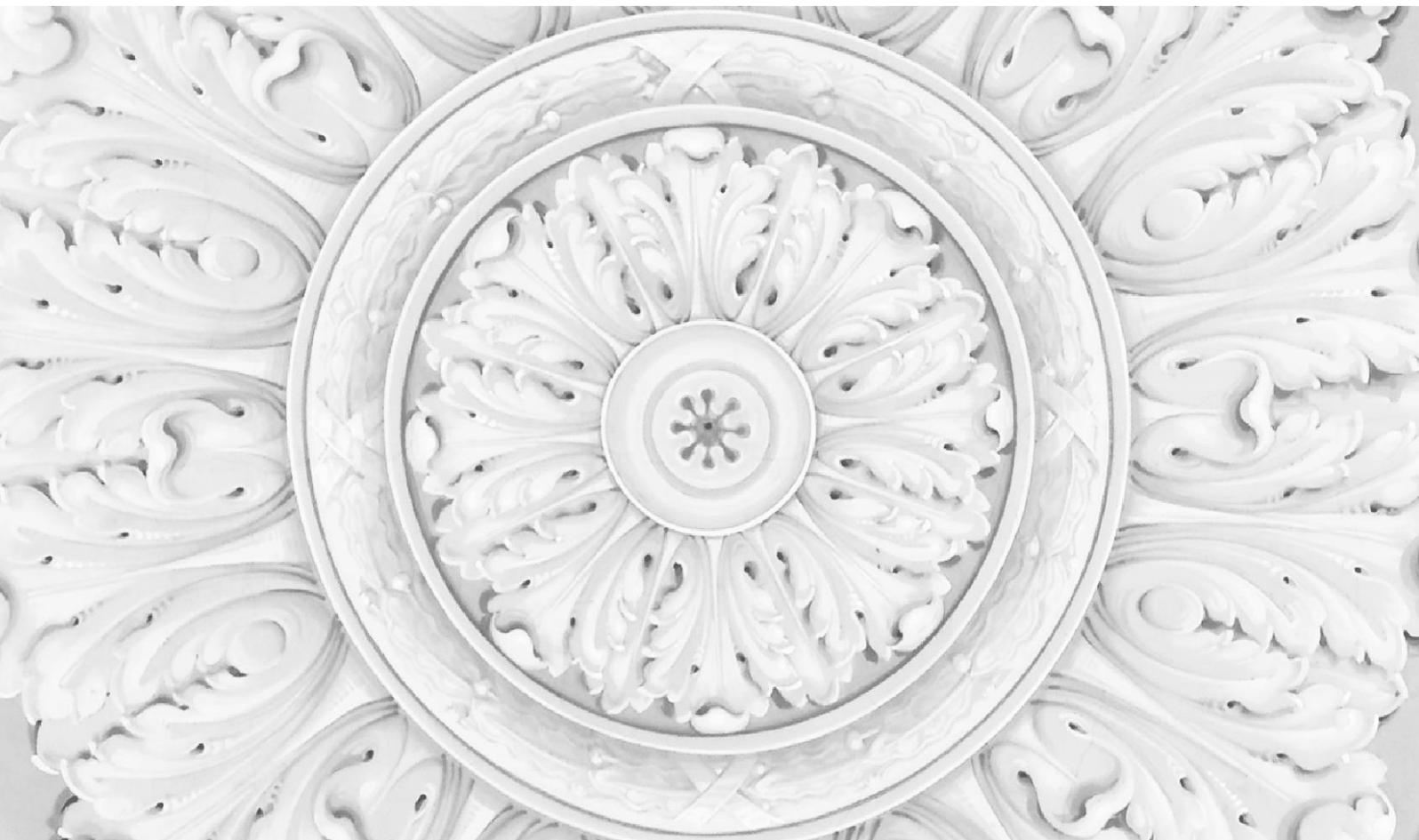




Bank of Russia

The Central Bank of the Russian Federation



Talking Trends

Macroeconomics and Markets

September 2017

**Research and
Forecasting**

Department Bulletin No. 6 (18)

The bulletin is based on data as of 01.09.17.

*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*

Please send your comments and suggestions to dip_bulletin@mail.cbr.ru

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1.1. Inflation

In July and August, inflation demonstrated a slowdown on the back of the harvest of fruit and vegetable products entering the market late this year. As a result, inflation was below the target level for the first time since inflation targeting began. In turn, this prompted reduced household inflation expectations. Barring significant negative surprises in December this year, inflation will not exceed 4%.

However, there is still the risk of inflation exceeding the target level in the medium term. Currently, the risks of increased inflationary pressures are linked with accelerated growth of consumer demand and a reduced supply of fruit and vegetable products going into next year. The latter may have a negative impact on the annual price growth rates in the first half of 2018, accelerating inflation to slightly above 4% during this period, and provoke higher inflation expectations, which may in turn have a secondary effect on inflation.

1.1.1. In August, inflation demonstrated a significant slowdown

- In August, prices decreased by 0.5%, while annual inflation slowed to 3.3%, reaching an all-time low.
- The change in consumer prices in August is in line with the seasonally adjusted price increase at 0.0% MoM, which is below the target level.
- The lower fruit and vegetable prices continue to greatly contribute to inflation slowdown. However, the fact that the 2017 fruit and vegetable harvest will be smaller compared with 2016 could accelerate inflation in 2018.

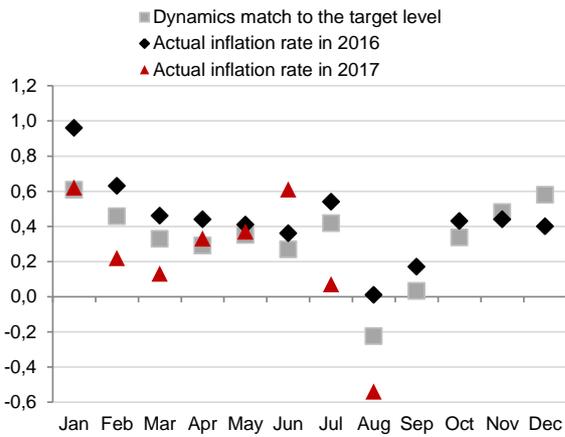
According to Rosstat, in August prices decreased by 0.5% MoM (Figure 1), which, according to seasonally-adjusted preliminary estimates, is a near-zero price increase. Meanwhile, the consumer price index decreased across all four weeks of August (Figure 2). Annual inflation hit its all-time lowest level at 3.3%.

In August, the seasonal decline in fruit and vegetable prices of 15.5% (8.9% in August last year, Figure 3) was a key factor behind the decline in the price index. As of 30 August¹, 26% of vegetable crops were harvested from the total cultivated area, so there will be a continued inflow of new crops, causing vegetable prices to decline in September and early October. This year the area of vegetable cultivation decreased by 4.5% on the previous year, and the latest data from the Ministry of Agriculture suggest yield has decreased by 3.6%².

¹ Information on the progress of harvesting from the Ministry of Agriculture of Russia

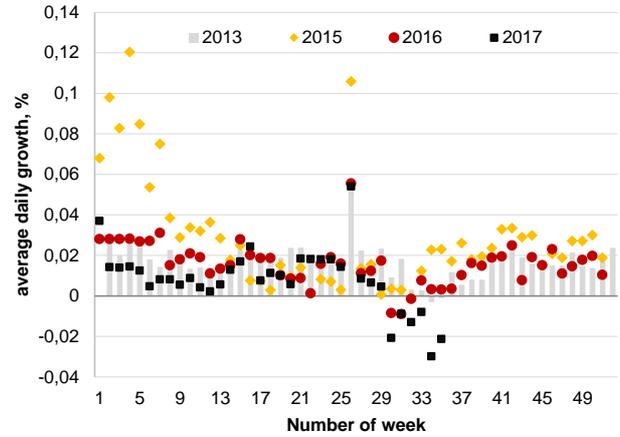
² As of 30 August.

Figure 1. Price growth, % MoM



Sources: Rosstat, R&F Department calculations.

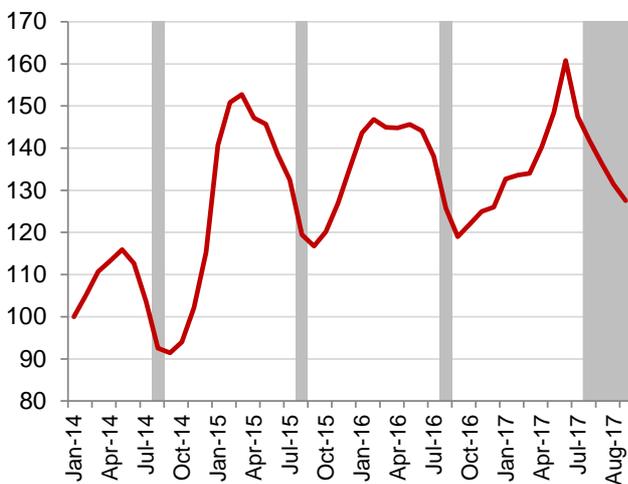
Figure 2. Average daily price increase, %



Sources: Rosstat, R&F Department calculations.

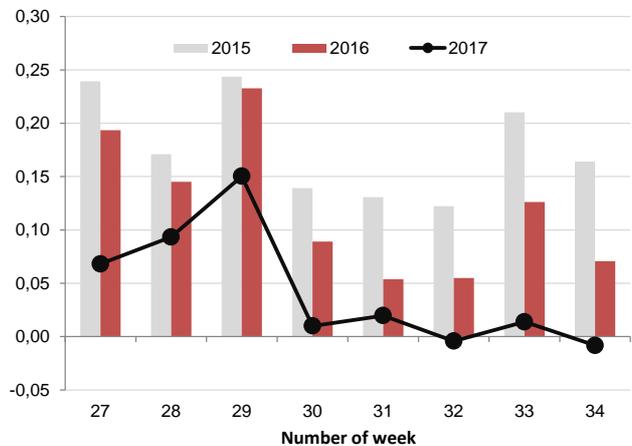
A smaller harvest yield compared to last year may provoke more significant seasonal price growth between the end of this year and early next year, accelerating annual inflation.

Figure 3. Trends in vegetable prices (January 2014 = 100)



Sources: Rosstat.

Figure 4. Price growth of a weekly basket of goods and services (excl. vegetables), %



Sources: Rosstat, R&F Department calculations.

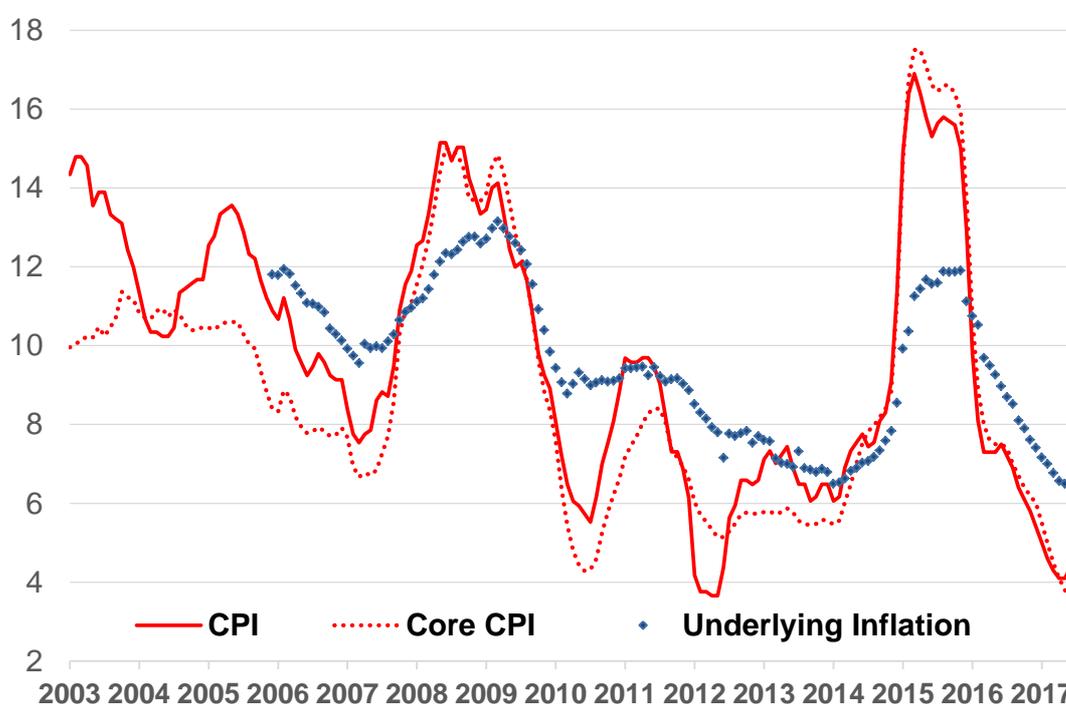
The low price growth rate in August cannot be fully explained by the decrease in fruit and vegetable prices alone. For five consecutive weeks, the rate of price growth of a weekly³ basket of goods and services remained around zero, which is much lower than the figures of previous years (Figure 4). This is an important factor that led to significant annual inflation slowdown in August.

³ Excluding fruit and vegetables.

1.1.2. Underlying inflation slowed down yet retained medium-term risks of exceeding the target level

- Estimates of the annual underlying inflation rate decreased to 6.2% in July 2017 from 6.4% in June (Figure 5).
- Underlying inflation reached its all-time low.
- The medium-term risks linked with inflation deviating from the target level are gradually easing but remain skewed upwards due to the rate of inflation above 4%. These risks are set to be mitigated by moderately tight monetary policy.

Figure 5. Trends in CPI, core CPI and historical estimates of underlying inflation, % YoY



Sources: Rosstat, R&F Department calculations.

- The current slowdown of underlying inflation is largely held back by the inertia of this indicator. To illustrate this, we calculated the current estimates of underlying inflation as though the pro-inflation shock that occurred at the end of 2014 into early 2015 had not fully materialised or not materialised at all⁴.
- Our findings show that if consumer inflation had remained at 7% YoY in that period, the underlying inflation estimate would have dropped to 5.5% by July 2017 (as opposed to its current 6.2%).

⁴ As alternative scenarios, we chose those with relatively lower local peaks of inflation in March 2015 (at 13 and 10% YoY respectively) as well as a scenario with constant annualised inflation (7% YoY, i.e. approximately the 2014 H1 level).

- It can therefore be concluded that current underlying inflation estimates are overrated. Nevertheless, the conclusion that there is an upward shift in medium-term inflation risks relative to the target level remains accurate.

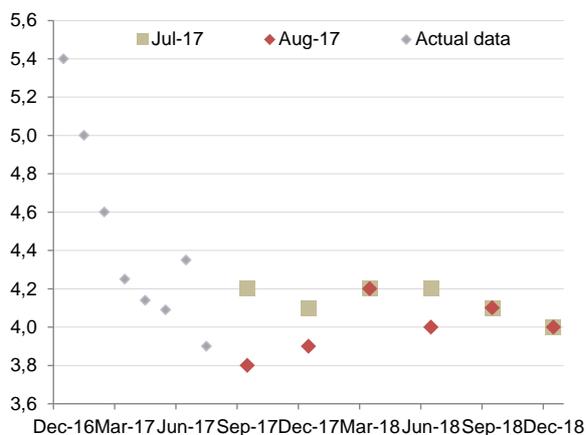
1.1.3. Analysts' consensus forecast just short of target level

- According to Bloomberg's consensus, analysts' inflation expectations for the end of 2017 decreased to 3.9%. Inflation in 2018 is invariably expected to hit the target level of 4%.
- According to experts, the Bank of Russia will continue to conduct moderately tight monetary policy and refrain from immediate reaction to the sharp slowdown in annual inflation in July and August.

The Bloomberg's August survey revealed that analysts had lowered their inflation expectations for the end of 2017 to 3.9% (Figure 7). This is slightly below the target level set by the Bank of Russia. The main reason for the revision was a sharp slowdown in inflation in July and August, which changed the forecast reading for the end of the year. The forecast for the end of 2018 remained at 4%.

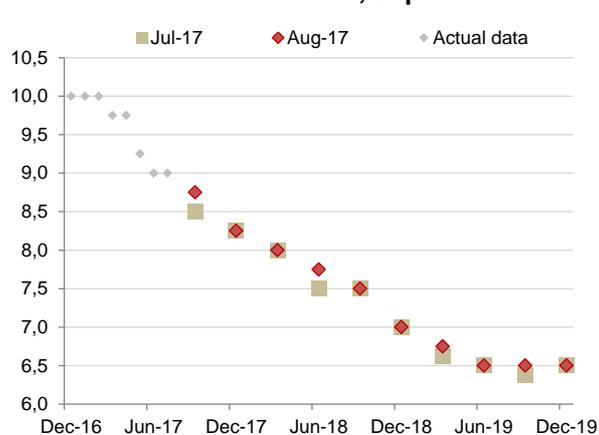
The expectations for key rate movements did not undergo significant change (Figure 8). Analysts still expect that a moderately tight monetary policy stance will hold and the key rate is set only to approach 6.5% by mid-2019. This lack of significant changes in the expectations for key rate movements indicates that analysts believe the current inflation slowdown to a level below target is temporary and they do not expect the Bank of Russia to take immediate action in response.

Figure 6. Analysts' inflation expectations, %, YoY



Source: Bloomberg Finance L.P.

Figure 7. Analysts' expectations of BoR key rate movements, % p. a.



Source: Bloomberg Finance L.P.

1.2. Economic performance

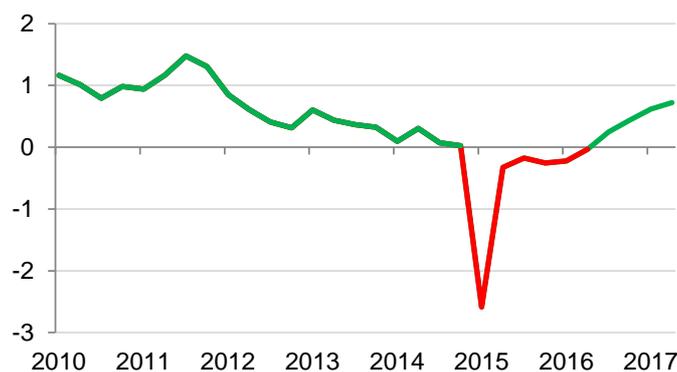
Short-term economic indicators and survey data indicate continued sustainable economic growth in the third quarter. The rise in production activity is characterised by increasing stability and is observed in both consumer and investment demand-oriented industries. Meanwhile, domestic demand is recovering at a faster pace than production growth rates. This means there is scope for positive short-term growth in production.

The current economic trends indicate that the economy has gradually completed the process of adapting to the consequences of negative external shocks and the economic cycle has entered a recovery phase after the recession. The potential for these registered growth rates to maintain is limited by structural factors including those on the labour market.

1.2.1. GDP growth hits its peak since 2013

- Preliminary estimates of GDP growth for the second quarter stood at 2.5% YoY. This is the highest annualised economic growth posted since 2013.
- Our estimates suggest that the seasonally adjusted quarterly growth rate of 0.7% in the second quarter 2017 is in line with the GDP growth rate (Figure 9).
- This is somewhat better than our previous estimate of seasonally adjusted GDP growth (0.5-0.6% QoQ SA).

Figure 8. Real GDP (seasonally adjusted), % QoQ



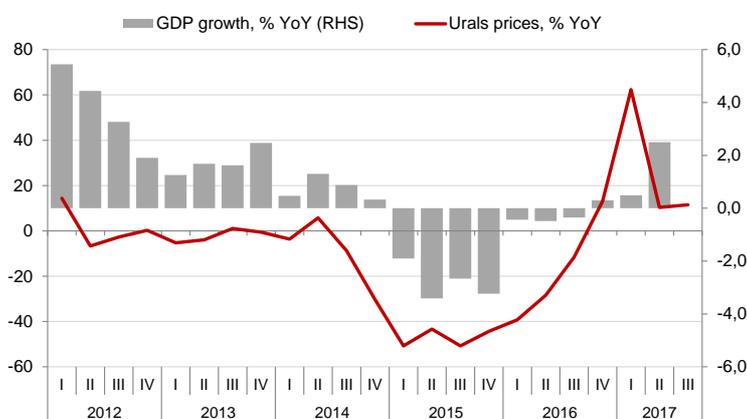
Sources: Rosstat, Bank of Russia calculations.

- It should be noted that estimates of seasonally adjusted GDP growth rates for previous periods have been revised by adding a new point. We thus increased the sea-

sonally adjusted GDP growth estimate for the first quarter of 2017 from 0.3 to 0.6% QoQ.⁵

- However, the revised estimates of seasonally adjusted GDP growth are still preliminary. Specifically, they are based on the fact that Rosstat did not retrospectively revise quarterly GDP dynamics when putting the final figure for the second quarter at 2.5% YoY.
- Despite the fact that the Russian economy has embarked on a trajectory of slow but steady growth thanks to the *new normal* conditions, the accelerated GDP growth rates in early 2017 can mainly be explained by the oil price growth in late 2016 into early 2017 having a deferred impact (Figure 10).

Figure 9. Oil price and real GDP*



Sources: Bloomberg Finance L.P., Rosstat, Bank of Russia calculations.

* For 2017 Q3, Urals is a preliminary estimate accounting for current dynamics

- If the economy retains its seasonally adjusted annualised growth rate of approximately 1.5% in the second half of 2017, 2017 Q3-4 GDP growth will not fall below 2.5% YoY – a point that has already been achieved. It should be noted, however, that this estimate is only valid barring Rosstat's upward revisions of GDP growth from late 2016 into early 2017.
- Under the conditions described above, GDP growth in 2017 should stand at approximately 2.0%⁶. Rough estimates suggest that 1.5 pp thereof will be due to potential growth, about 0.3 pp will be explained by oil price dynamics and the remaining 0.2 pp (or slightly higher) will be linked to a closing negative output gap (for more details, see insert *Deferred impact of oil prices on GDP and estimates for the contribution of various factors to the 2017 GDP forecast*).

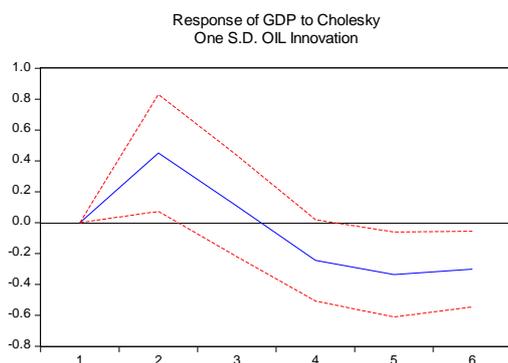
⁵ These revisions were also made to 2016 Q2-4: for the second quarter, seasonally adjusted growth was revised from 0.1% to 0.0% QoQ, for the third quarter - from 0.1% to 0.2% QoQ, for the fourth quarter - from 0.3 to 0.4% QoQ. As a result, quarterly GDP growth is now understood to have resumed in 2016 Q3.

⁶ Due to the qualifications above (linked in particular to seasonal trends in GDP, possible retrospective revisions and the uncertainty regarding future external conditions), this figure should be interpreted as a benchmark for our further evaluation of how various factors contribute to 2017 economic growth, not as a forecast.

Deferred impact of oil prices on GDP and estimates for the contribution of various factors to the 2017 GDP forecast

Based on simple econometric estimates, the Granger causality test indicates that oil prices will have a significant deferred impact on Russia's GDP for a period of one to two quarters on average. The VAR model also indicates that GDP will demonstrate a statistically significant positive response to the price of Urals within two quarters following the occurrence of the shocks (Figure 11). At the same time, a simple pair regression of GDP growth rates on the back of oil prices with a lag of one quarter suggests a relatively stable estimated linear correlation coefficient of 0.01 (Figure 11, Figure 12). This means that, all other things being equal, the 10% annual growth rate of oil prices in the previous quarter will lead to annual GDP growth increasing by approximately 0.1 pp in the next quarter.

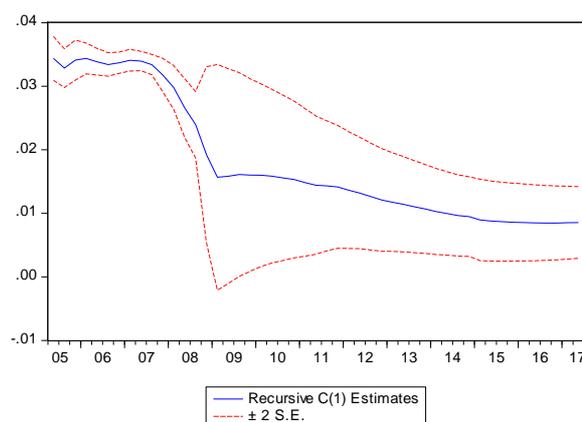
Figure 10. GDP response to the oil price shock in the standard VAR model adjusted for Russia*



Sources: R&F Department calculations.

*The model was calculated based on a sample for the period between 2005 Q1 and 2017 Q2.

Figure 11. Recursive estimations of the linear correlation coefficient of slowed GDP growth rates on the back of increased oil prices with a lag of one quarter



Source: R&F Department calculations.

If oil prices remain at the current level until the end of 2017, in line with the Bank of Russia's baseline scenario, annual GDP growth rates should not dip below 2.5% YoY on average during 2017 Q3-4. Above, we estimated GDP growth in 2016 Q3 at +0.2% QoQ SA, which is in annualised terms lower than adjusted annualised growth potential (1.5%).

Thus, should potential growth rates and stable oil prices remain, YoY GDP increase in 2017 Q3 will occur thanks to the low base effect of 2016. Annualised GDP growth in 2016 Q4 (0.4% SA) is close to 1.5%, so, other things being equal, the base effect is set to be immaterial. Moreover, our estimates suggest that, given these figures, the risks of potential harvest loss due to cold weather appear relatively moderate – their negative impact is expected to be within 0.1-

0.15 pp, which is comparable to the positive impact that the low base effect in 2016 Q3 had on annual growth. Therefore, under these conditions and assuming that Rosstat does not subsequently revise GDP upwards in 2016 H2, overall GDP growth in 2017 should be about 2.0%:

$$2.0 = \frac{0.5+2.5+2.5+2.5}{4}$$

Therefore, out of the GDP growth of a possible 2.0% or greater in 2017, **1.5** pp will account for potential growth. With account for oil price elasticity at **0.01** and the deferred oil impact on GDP over a quarter's horizon, the contribution of oil prices can be roughly estimated as:

*Estimates of annual Urals growth rates,
for the period between 2016 Q4 and
2017 Q3*

$$\frac{0.01 \times (13 + 62 + 10 + 12)}{4} = \sim \mathbf{0.3 \text{ pp.}}$$

Accordingly, the remainder (0.2 pp or slightly higher) will be attributed to the closure of slightly negative output gap, which emerged after 2014.

1.2.2. Industrial production in July dropped in the run-up to growth expected in the months ahead

- In July, industrial production fell by 1.1% MoM according to Rosstat estimates and by 0.6% MoM according to R&F Department estimates when adjusted for seasonal effects.
- The most significant decrease in output was observed in the manufacturing industry, which posted negative annual growth rates.
- These are due to the continuing decline in the production of construction materials and the cessation of government programmes supporting machinery and equipment production.
- The PMI index for the manufacturing industries suggests a high probability that industrial growth is set to resume in the coming months.

Industrial production took a downturn in July, which will probably be temporary. According to Rosstat's estimates, when adjusted for seasonal and calendar effects, industrial output decreased by 1.1% MoM. Moreover, annual growth rates have slowed from 3.5 to 1.1% YoY.

Research and Forecasting Department estimates suggest a more moderate decline: -0.6% MoM⁷. It should be highlighted that the decrease in output occurred across all industrial sectors but it had the most significant impact on the manufacturing industry. Its output declined by -0.7% MoM and -0.8% YoY. Alongside the negative impact of the decline in the production of construction materials (brick, cement, breeze blocks) over the previous year, the manufacturing industry was negatively affected by the cessation of public procurement that had been supporting the industry in 2017 Q2, and a general decline in the production of vehicles, computers and electrical equipment. For example, July's output of buses decreased by 39% YoY and that of lorries by 10% YoY. However, there was a significant increase in sunflower oil production (+43% YoY) and cereals (+51% YoY). Despite the fact that by the beginning of August the progress of the harvest was significantly lagging behind the previous year (in terms of the volume of harvested areas), the increased yield partially compensated for this. In terms of sunflower production, the significant increase in cultivated areas played a significant role and in 2017 its harvest may have set a record for the entire post-Soviet period. The weakening of the ruble increased the export competitiveness of agricultural producers.

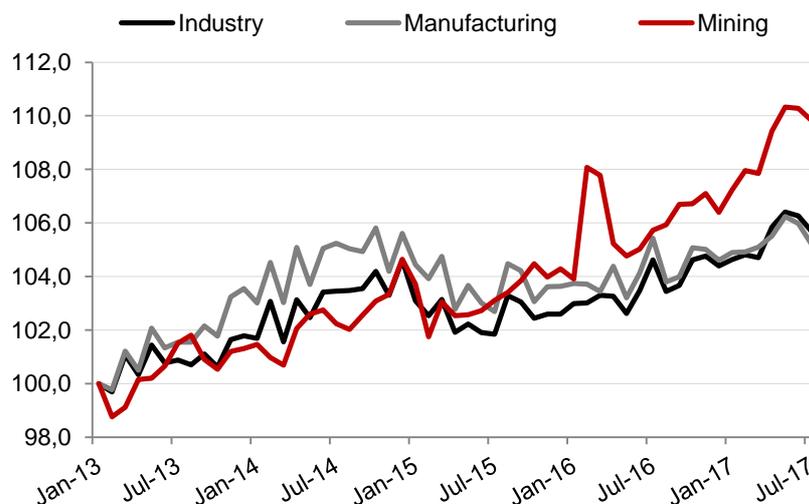
The decline in natural resource extraction was less sizable at -0.4% MoM. The slowdown in the growth of oil output (+2.9% YoY in May, +2% YoY in June and +1.6% YoY in July) was offset by the continued high growth rates of gas output (+18.2% YoY) on the back of strong external demand, as well as coal output (+7.8% YoY). Mining has in recent years has been performing much better than the overall production sector (Figure 30).

Growth rates for output of electricity, gas, steam and water supply also declined by 0.3-0.4% MoM.

On the whole, the industrial production statistics for July and part of June seem to be the expected correction following the strong statistics in April-May, which proved significantly better than the burgeoning upward trend then suggested (Figure 30). In addition, the decline in industrial output in July and the emerging negative growth in manufacturing were not in line with manufacturing PMIs (for more details see Subsection 1.2.3 Composite PMI: "normalisation" of economic growth). A moderate increase in production volumes, alongside a reduced goods inventory and an increased goods-in-process inventory, created a buffer of potential production in the manufacturing sector. This trend promises a turnaround towards growth in the coming months.

Therefore, after July's correction, the industry is likely to return to a slow growth trajectory.

⁷ Here and hereinafter, estimates of % MoM are R&F Department estimates adjusted for seasonal and calendar effects

Figure12. Industrial production*, % (January 2013 = 100%)

* Adjusted for seasonal and calendar effects

Sources: Rosstat, Bank of Russia calculations.

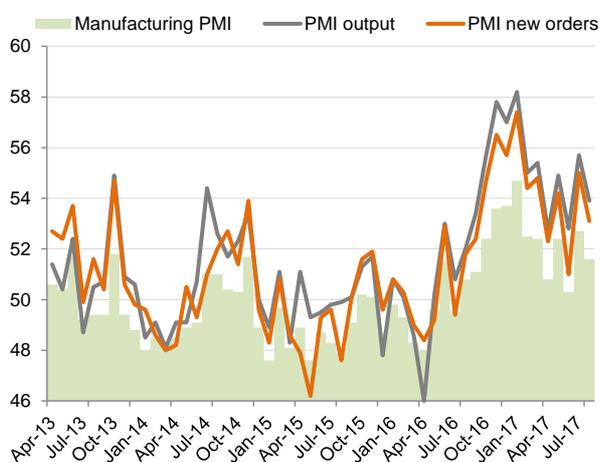
1.2.3. Composite PMI: "normalisation" of economic growth

- As expected, overall economic growth slowed to an apparently "normal", stable level.
- In August, the PMI index in the manufacturing sector fell to 51.6 pp on the back of slow recovery in consumer demand.
- Increased production activity in the face of continuing decline in employment suggests an emerging increase in labour productivity, at least in individual processing sectors.
- Cautious expectations given by respondents about future production and demand are seen as constraints on economic activity and, at the same time, add stability to its indicators.
- Growth in services demonstrated a slowdown to mid-2016 levels, remaining relatively stable.

In August, the PMI index of the manufacturing industry fell from 52.7 to 51.6 pp indicating a stable but slower increase in business activity in the sector (Figure 14). It is of note that the current reading of the main PMI index matches its average level on record. Most PMI indexes of business activity are also in keeping with their long-standing average readings (except for goods-in-process, raw materials and procurement). Everything seems to point to the sector's growth rates returning to "normal", which, barring new shocks, should foster continued sustainable and moderate growth in manufacturing.

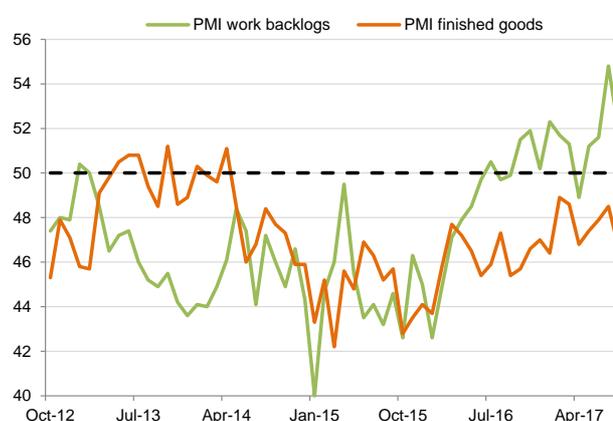
In the recent months of improved business activity, companies pursued a cautious strategy of raising production volumes due to the volatile demand for their products. In August, their optimism about prospective output growth hit an all-time low since January 2016 on the back of slowly recovering consumer demand. The last time a similar low level (even lower) was recorded when Urals dropped to \$30 a barrel, for a short time. It appears that the surveyed companies were concerned about the uncertainty about future production and demand due to the negative impact caused by the prolongation and tightening of US sanctions against Russia. In its releases, IHS Markit often points out that respondents cite the political situation inside Russia and foreign policy developments as primary factors of uncertainty.

Figure 13. PMI indexes in manufacturing industries, points



Source: Bloomberg Finance L.P.

Figure 14. PMI indexes in manufacturing industries, points



Source: Bloomberg Finance L.P.

Having drastically reduced inventories (46.7 pp vs 48.5 pp) and posted slower output growth (53.9 pp vs 55.7 pp), manufacturing companies continued to create a buffer for potential growth in the future, as the volumes of goods-in-process continued to expand (52 pp vs 54.8 pp) (Figure 15). The growth rates of the latter were lower than in July but above average in terms of the current business expansion in the sector. Thus, even if demand weakens, growth in production will continue for some time. This adds stability to production growth.

Alongside the slowdown in production growth, new orders and purchasing, companies reported a more significant drop in employment compared to July (48.9 pp vs 49.3 pp). Combined with increased output, this indicates an increase in labour productivity, at least in terms of short-term data in individual sectors. This may mitigate potential inflation consequences associated with tougher competition among companies for labour, given the persisting rigidity in the labour market.

The stabilisation of export orders is of particular note: the PMI index closed in on the point that separates decline from growth, standing at 49.4 pp in August and 49.7 pp in July. Stabilisation of exports might be linked to the weakening of the ruble in recent

months. However, it is too soon to talk about conditions for a qualitative turning point in the medium-term trend (since the end of 2013) towards reduced levels of new export orders.

In July⁸, the manufacturing industry's performance was misaligned with the movements of PMI, which has remained above 50 pp for 13 consecutive months, the point which separates growth in business activity from decline. It is possible that July's negative trend was temporary and caused by contraction in outputs of some companies reliant on state procurement programmes. Besides, public companies are outside the remit of IHS Markit's survey. Nevertheless, the PMI index in July and August points to a return to moderate, "normal" growth rates in the sector due in the coming months. Moreover, if demand continues to rebound at a more stable pace in the future, both PMI and the manufacturing industry could turn in better data.

As for the service sector, business activity growth slowed to a 13-month low in July (composite PMI fell to 52.6 points in July from 55.5 points in June) but is still close to the survey's long-term average. Although employment and new orders were still posting moderate growth, volatile expectations for future demand brought about a decline in business confidence to its lowest levels in 2017. Nevertheless, the aforementioned slowdown in business activity growth should be largely viewed as correction following the local peaks achieved earlier. It is also in line with the slow but steady rise in services. This conclusion is further backed by increased goods-in-process in the sector, which indicates that the current level of production in tertiary industries is insufficient to meet demand.

1.2.4. Real wages growth is the highest since 2014

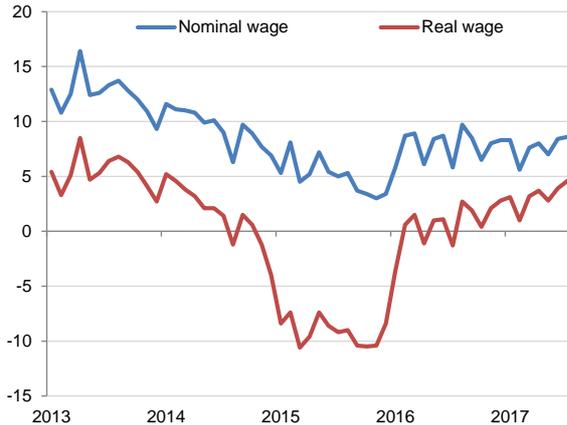
- Accelerated growth of nominal wages in the summer months alongside the decrease in inflation meant annual growth in real wages hit its maximum since February 2014.
- However, this may come with inflation risks, which have not yet made themselves apparent.
- Accelerated nominal wage growth is mainly occurring in the private sector, while wages in the public sector are growing at a moderate pace.
- In July, seasonally adjusted unemployment rate remained at 5.3%, indicating that equilibrium in the labour market had almost been achieved.

In July 2017, according to Rosstat's preliminary data, nominal accrued wages growth accelerated to 8.6 from 8.4% YoY in June. Real wage growth accelerated from 3.9 to 4.6% YoY, reaching its highest point since February 2014 (Figure 16). The significant growth in real wages in July is largely thanks to inflation slowdown. The accelerated nominal wage growth also had a mild impact on the growth of real wages.

⁸ -0.7% MoM and -0.8% YoY in July.

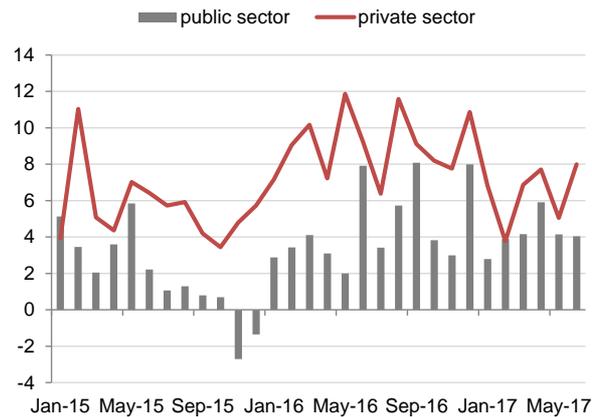
In June, nominal wage growth was led by the private sector. According to our estimates, the private sector demonstrated annual salary growth rates that were twice as high as those in the public sector: 8% vs 4% (Figure 17). Given the significantly more modest growth in output of goods and services, the growth rates of wages in the private sector signal increased inflation risks.

Figure 15. Growth rates of nominal and real wages, %YoY



Source: Rosstat.

Figure 16. Growth rates of nominal and real wages in the private and public sectors, % YoY

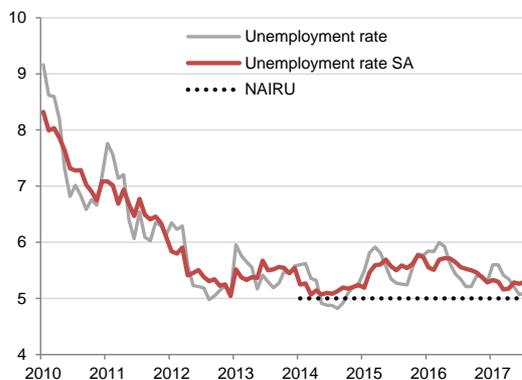


FTEs were taken as weight standards; since 2017, calculations have been based on new weight standards (due to changes to the classification of foreign trade activities), which may have an effect on the results presented.

Sources: Rosstat, R&F Department calculations.

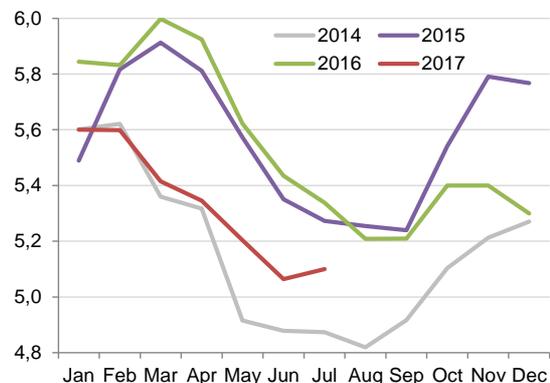
In July 2017, when adjusted for seasonal effects, the number of employed increased by 22 thousand, reaching almost 72 million people. Unemployment increased by 38 thousand people. In July, the unemployment rate remained at 5.3% SA (Figure 18), indicating that equilibrium in the labour market had almost been achieved. Given the favourable weather conditions for agriculture in August, a decline in the unemployment rate can be expected.

Figure 17. Unemployment, %.



Sources: Rosstat, R&F Department calculations.

Figure 18. Unemployment, NSA broken down over 2014-2017, %



Source: Rosstat.

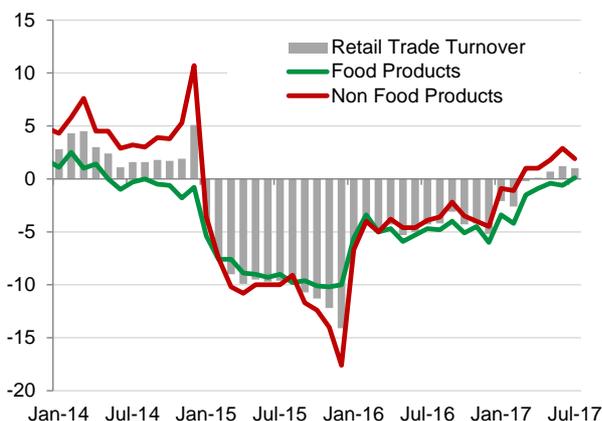
1.2.5. Consumer activity continues to recover

- In July, retail sales went up by 1.0% YoY after printing 1.2% YoY in June.
- When adjusted for seasonal and calendar effects, retail sales in July remained flat compared to June.
- Survey findings suggest continued recovery in consumer activity on the back of the rise in real wages.

According to Rosstat, growth in retail sales in July stood at 1.0% YoY, slowing from 1.2% YoY in June (Figure 20). The decline in retail sales of food products that had been ongoing since June 2014 came to a close: it increased by 0.1% YoY. In the non-food segment, growth was reported for the fifth month in a row but its rate slowed to 1.9% YoY (vs 2.9% YoY in June). The continuing recovery of turnover in YoY terms was accompanied by accelerated growth of real wages - to 4.6 from 3.9% YoY in June (revised from 2.9% YoY) (Figure 22).

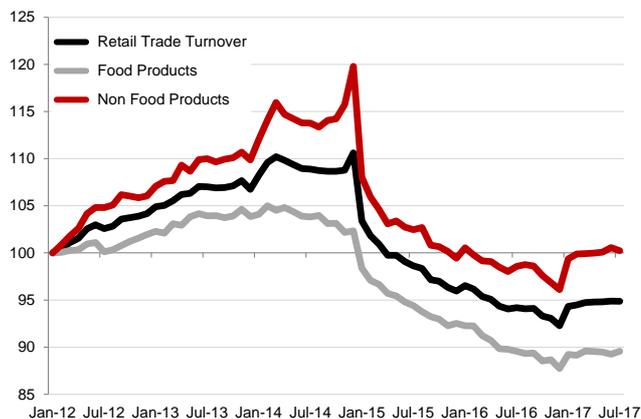
When adjusted for seasonal and calendar effects, according to our estimates, retail sales in July matched those of the previous month (Figure 21). The 0.34% MoM increase in sales of food products was balanced out by a 0.31% MoM decrease in sales of non-food products.

Figure 19. Food, non-food and total retail sales, %, YoY



Sources: Rosstat, R&F Department calculations.

Figure20. Retail sales (% , January 2012 = 100%, seasonally adjusted)



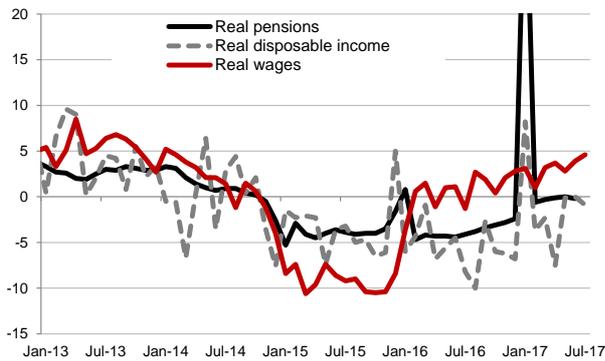
Sources: Rosstat, R&F Department calculations.

According to the research conducted by Romir Research Holding⁹, real household expenditure on everyday goods in July exceeded the figures posted in the previous two years, but remained lower than 2013 and 2014 data. The annual growth in real household consumption expenditure was 4.2% (Figure 23).

⁹ Исследовательский холдинг «Ромир», [«Кошелёк нараспашку» 08.08.2017.](#)

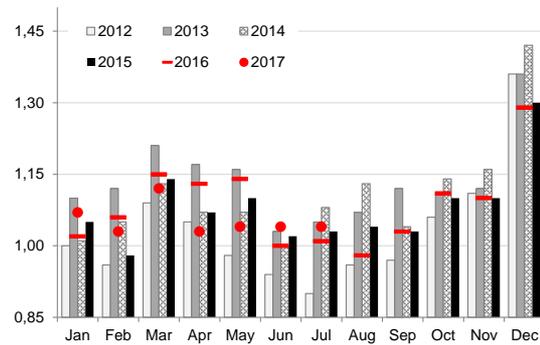
The rebounding consumer demand is also confirmed by the Nielsen consumer confidence index¹⁰, which reflects the sentiment of "online consumers" and their expectations for the future. In 2017 Q2, the index increased by 7 pp, demonstrating a trend towards recovery after falling to an all-time low in 2016 (Figure 24). In the second quarter, all three indicators demonstrated improvement. Of the three indicators, the most significant positive trend over the last year was seen in households' attitudes to spending: the share of respondents who deem the current time a favourable period for purchases increased by 7 pp. vs 2016 Q4¹¹ (Figure 24).

Figure 21. Real household income, % YoY



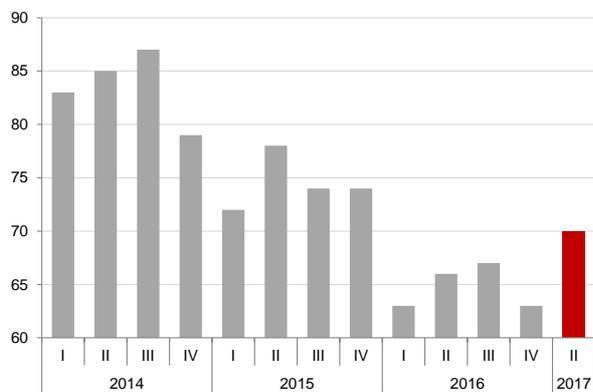
Sources: Rosstat, R&F Department calculations.

Figure 22. Real daily household expenditure (%), January 2012 = 100%



Source: Romir Scan Panel.

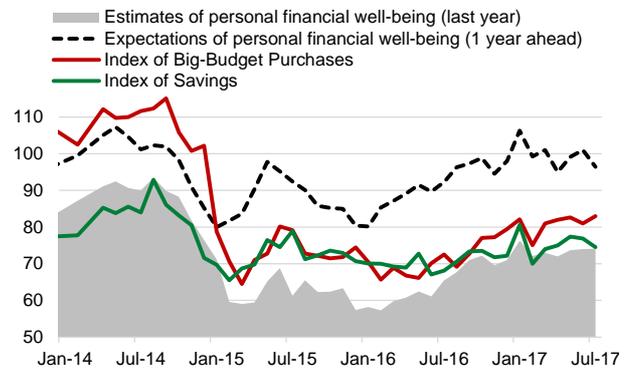
Figure 23. Consumer confidence index *



Source: Nielsen.

* A reading above 100 pp conveys the prevalence of optimists, that below 100 pp - pessimists, and a reading of 100 pp stands for balanced optimistic and pessimistic expectations of the future.

Figure 24. Consumer sentiment index and its components, points



Source: InFOM

¹⁰ Nielsen [«Первые признаки восстановления уверенности российских потребителей» 17.08.2017.](#) The index is composed of three indicators: consumer assessment of labour market prospects for the next 12 months, financial standing in the next 12 months and the current propensity to spend.

¹¹ The study was not conducted in 2017 Q1. The share of respondents expressing positive expectations for labour market prospects grew by 6 p.p. and the share of respondents who assess their financial standing over the coming year as "good" or "excellent" rose by 4 pp.

Consumer demand may have been bolstered by continued improvement in household estimates of the current economic situation and consumer expectations. For example, according to *Monitoring of Russia's Economic Outlook, a study* conducted by RANEPА, the Russian Presidential Academy of National Economy and Public Administration, in June, the number of people who stated that the economic situation in Russia had improved exceeded 10% for the first time since the survey's inception (i.e. since 2015)¹². This share rose from 5.8% in May to 10.7% in June thanks to a decrease in the number of people who mentioned a slight worsening and a slight decrease in the number of people who mentioned a noticeable deterioration in the economic situation¹³.

According to the survey of consumer sentiment conducted by inFOM¹⁴, household attitudes to large purchases have improved along with worsening attitudes towards savings (Figure 25). The recovery in consumer activity is also demonstrated by the increased share of those who would prefer to spend their disposable income on expensive goods alongside the reduced share of those who would prefer to save. However, the share of the latter remains larger (34% vs. 54%). This observation is consistent with the conclusion that retail sales have made a faster recovery in regions with relatively higher per capita incomes (for more details, see subsection 1.2.6. *High-income regions behind recovering retail sales*).

Accelerated real wage growth rates leads to expected further growth in consumer activity in the coming months.

1.2.6. High-income regions behind recovering retail sales

- About half of all retail sales in Russia are generated by 11 regions. The leaders include Moscow, the Moscow Region, St. Petersburg, the Krasnodar Territory and the Sverdlovsk Region.
- As a rule, these regions have a high per capita income and a better developed retail infrastructure.
- Since 2016 H2, retail sales in these regions have seen a faster recovery than in low-income regions.
- This is due in part to the fact that the consumption rate in high-income regions "plummeted" in the crisis and we are seeing the first signs of its recovery potential beginning to materialise.

About half of retail sales in Russia are generated by 11 regions alone. The leaders include Moscow, the Moscow Region, St. Petersburg, the Krasnodar Territory and the

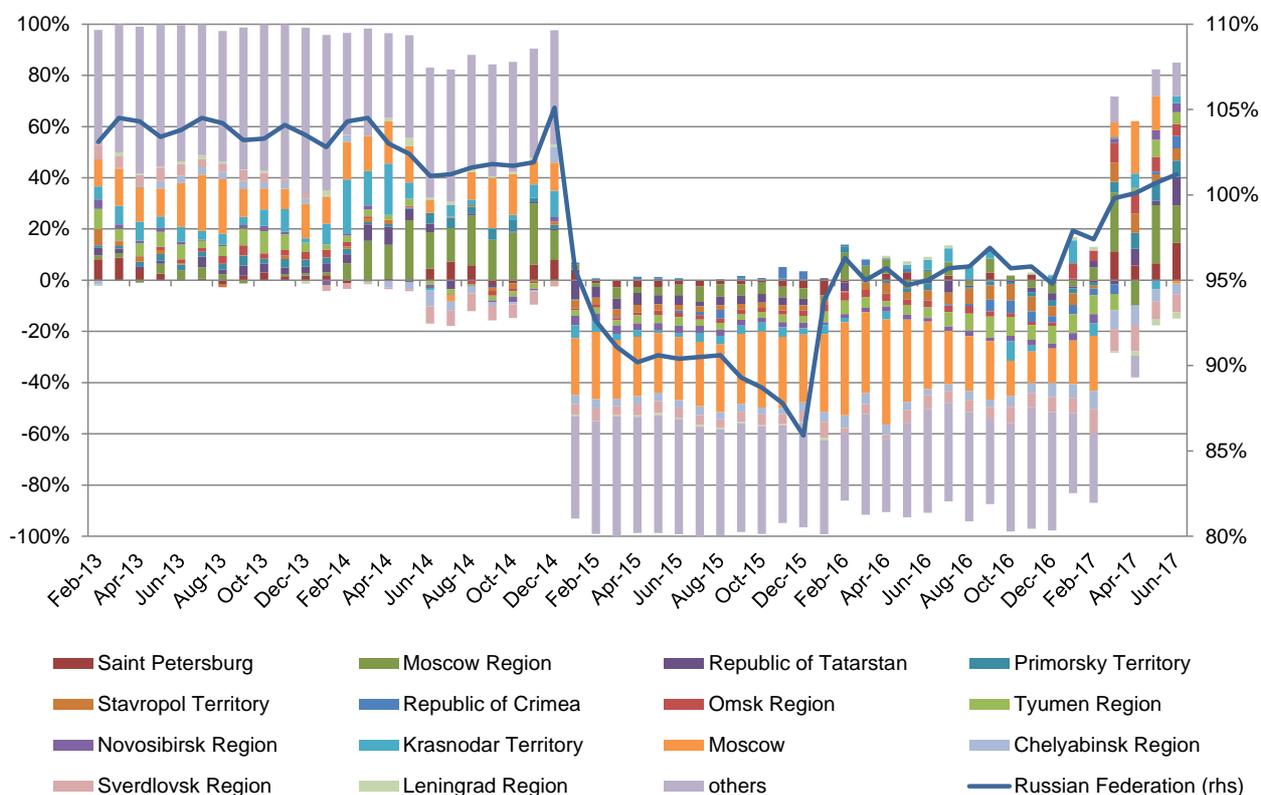
¹² РАНХиГС, [ежемесячный бюллетень «Мониторинг социально-экономического положения и самочувствия населения», август 2017 года \(Monitoring of Russia's Economic Outlook, a monthly bulletin\)](#)

¹³ The number of respondents who replied that the economic situation in Russia has not changed increased from 45.8% in May to 46.7% in June.

¹⁴ Household inflation expectations and consumer sentiment, [No. 7, July 2017](#).

Sverdlovsk Region (Figure 26). Therefore, retail sales data in these constituent territories determine the all-Russian retail sales index. These regions are characterised by high average per capita household monetary income, in excess of the median value¹⁵ (Figure 27).

Figure 25. Regions' contribution to retail sales, % YoY

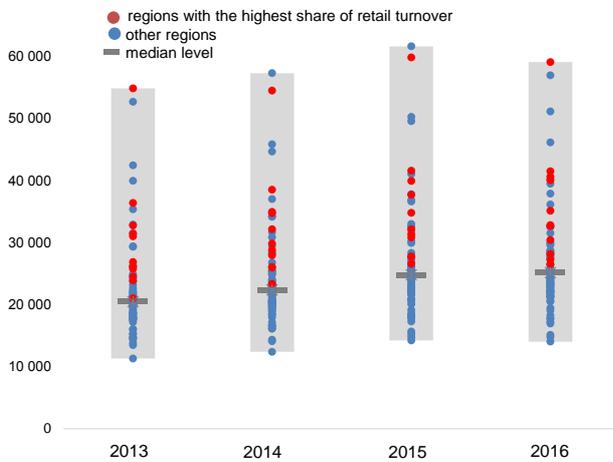


Sources: Rosstat, R&F Department calculations.

During the decline in retail sales in 2015-2016, the drop in sales in high-income regions was more significant in regions with a less developed retail infrastructure (Figure 28). It is posited that households in high-income regions reduced consumption of all non-essential goods. However, households in low-income regions, on the contrary, continued to spend a significant part of their monetary income on consumption of essential goods, which saw more moderate contraction during the crisis. The strongest impact on total retail sales during the economic downturn was made by the drop of sales in Moscow. Since the second half of 2016, regions with higher per capita incomes have delivered faster consumption recovery rates.

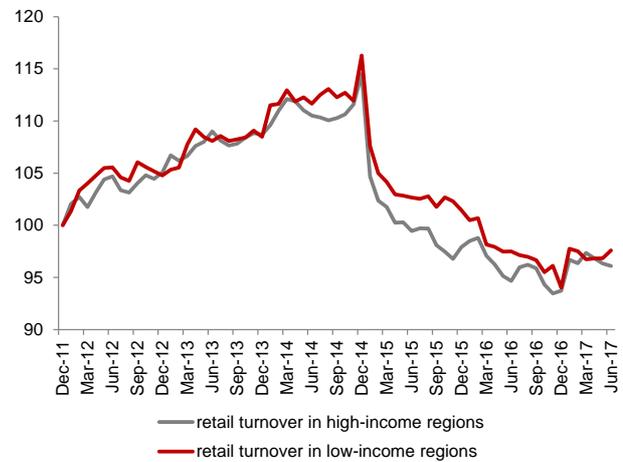
¹⁵ High-income regions are regions with an average per capita income above the median, low-income - with per capita income below the median for the period from 2013 to 2016.

Figure 26. Breakdown of regions by per capita household monetary income, rubles



Sources: Rosstat, R&F Department calculations.

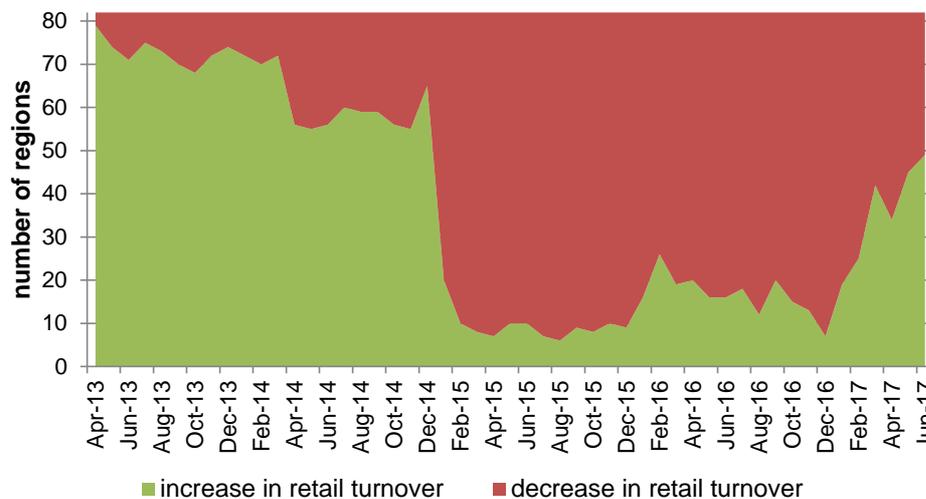
Figure 27. Retail sales in high-income and low-income regions,%, December 2011 = 100% (seasonally adjusted)



Sources: Rosstat, R&F Department calculations.

In January sales growth was observed in 19 regions, with their number going up to 49 in June (Figure 29). Increasing retail sales in St. Petersburg, the Moscow Region and the Republic of Tatarstan made the most significant positive contribution to June's sales (Figure 26). The Moscow Region has a large number of retail outlets, including hypermarkets and marketplaces, serving a multitude of residents including those living in the capital. As a result, the region occupies a leading position. In St. Petersburg, growth in sales is fostered by its developed port infrastructure and growing tourist inflow. In the Republic of Tatarstan, alongside recovering consumer activity in the non-food sector, demand for food products is on the rise (by 5.2% YoY). Furthermore, these regions' leading indicators in June gained a boost from Confederations Cup matches being held in Kazan.

Figure 28. The breakdown of regions with decreased or increased retail sales



Sources: Rosstat, R&F Department calculations.

2.2 What do Russian leading indicators suggest?

2.2.1. GDP growth slows down to potential level

- GDP nowcast for 2017 Q3 was adjusted downwards to 0.4-0.5% from 0.6% QoQ SA in July.
- The main reason for this downward revision was the latest Rosstat data on industrial output. Solid PMI data, in turn, continue to make a noticeable positive contribution to GDP nowcast.
- Estimate for 2017 Q4 was also reduced to +0.4% QoQ SA, the current estimate for 2018 Q1 is +0.4% QoQ SA. These readings, in annualised terms, are close to our estimate for the potential GDP growth (1.5% YoY). This indirectly suggests that the Russian economy is following the path of sustainable, though not very high growth.
- The latter estimates may be considerably adjusted after the release of new short-term statistics by Rosstat.

	August 2017	July 2017
	% QoQ SA	% QoQ SA
2017 Q3	0.4-0.5	0.6
2017 Q4	0.4	0.6
2018 Q1	0.4	–

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