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(October 2018)

The Russian economy shows growth rates close to potential. After a moderate increase in 2018 Q3, production and investment activity indicators deteriorated somewhat in October. Seasonally adjusted month-on-month growth in industrial production and retail trade turnover came to halt. However, certain sectors showed positive trends (metallurgy, woodworking). These developments are overall in line with the Bank of Russia forecast that predicts 1.5-2% GDP growth in 2018.

Economy in October 2018 (year-on-year growth, %, unless indicated otherwise)

	2017	September 2018	2018 Q3	October 2018
Output of goods and services by key industry	2.4	0.6	1.5	...
Industrial output	2.1	2.1	2.9	3.7
Agricultural output	2.5	-6.0	-6.1	11.9
Construction	-1.4	0.1	-0.4	2.9
Freight turnover	5.5	2	2.9	-0.1
Retail trade turnover	1.3	2.2	2.6	1.9
Nominal wage	6.7	8.4	9.5	8.1
Real wage	2.9	4.9	6.3	4.4
Unemployment rate* / seasonally adjusted** (%)	5.2	4.5/4.7	4.6/4.8	4.7/4.7

* As % of labour force.

** Bank of Russia estimate.

Source: Rosstat.

Production activity

Preliminary estimates by Rosstat suggest that annualised 2018 Q3 GDP growth will come in at 1.3%, which is within the lower bound of the Bank of Russia forecast (1.3-1.7%) released in the August commentary.¹ In October 2018, production in annual terms continued to expand across many industries. The base effect associated with, among other things, delayed harvesting, brought about tangible annualised growth in agricultural output (11.9%) after a contraction in August-September 2018 (Chart 1). In October 2018, industrial production growth rate accelerated to 3.7% vs 2.1% in September (on the back of the calendar factor and the base effect).

Nevertheless, the current dynamics of production indicators in October proved somewhat below the Bank of Russia's expectations. This is associated in part with the effect of temporary factors and is no

reason for a forecast adjustment. According to the Bank of Russia's estimates, seasonally adjusted industrial output contracted.

Chart 1

Growth in agricultural output is attributed to the base effect associated with delayed harvesting

Growth as % on January 2014, seasonally adjusted



Sources: Rosstat, Bank of Russia calculations.

¹ Economy: facts, estimates and comments, No. 8, August 2018.

Slack production dynamics were registered in a number of industries. First, the output of investment goods in monthly terms (seasonally adjusted) shrank considerably. Significant contraction was registered in the output of agricultural machinery, on the back of lower demand from agricultural producers. Second, unstable dynamics were seen in raw material processing (bar woodworking and metallurgy; the latter posted sustainable growth for the first time in three months). Third, oil production slowed down after an acceleration in September. Furthermore, gas and coal production continued to shrink.

The production of certain consumer goods also continued a downward trend. In particular, the output of household appliances decreased, as it did in September, on the back of an increase in prices for imported components; the manufacture of textiles also posted a decline.

Investment activity

In 2018 Q3, investment activity was expectedly sufficiently high. The annual growth rate of fixed capital investment stood at 5.5% vs 2.8% in the previous period, which is partially attributed to the base effect. Given the above, the Bank of Russia continues to estimate the growth rate of gross fixed capital formation at 0.8-1.3% in the third quarter.

However, October's investment activity indicators deteriorated somewhat: investment imports contracted along with a decline in the output of investment goods. Construction works increased only inconsiderably.

Consumer demand

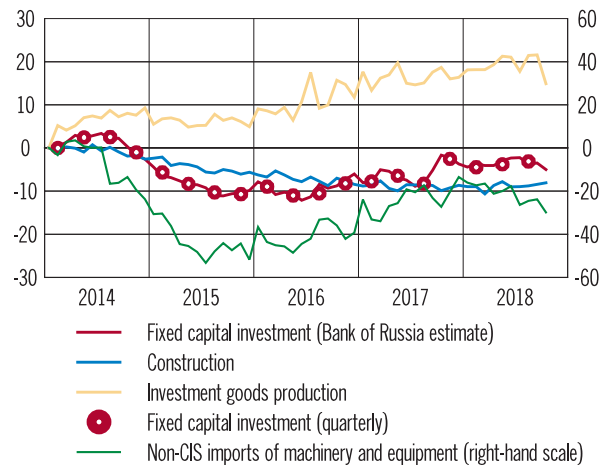
The growth rate of retail trade turnover continued to slow in October, coming in at 1.9% year on year (September 2018 – 2.2%). Month on month, the seasonally adjusted indicator remained at the previous month's level; however, growth in non-food sales, registered since June, ground to a halt. This may be associated with the fading of previously elevated demand, registered on the back of a rise in inflation expectations; the latter came as a result of the planned VAT rate hike, a weaker ruble, and slower wage growth.

Annual real wage growth continued to slow in September (to 4.4% from 4.9%) due to, among other things, inflation dynamics. At the same

Investment demand declined in October

Chart 2

Growth as % on January 2014, seasonally adjusted

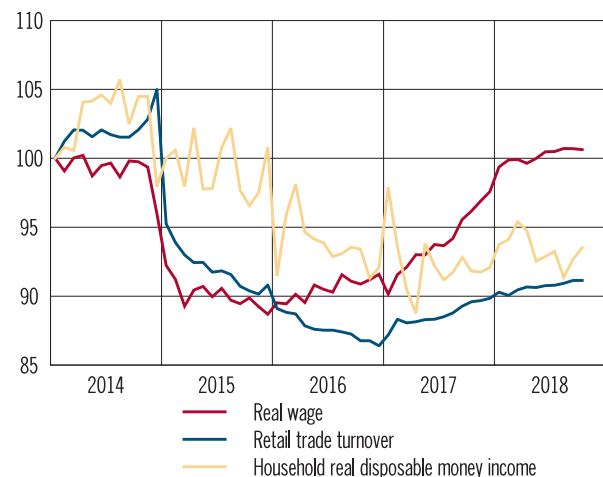


Sources: Rosstat, FCS, Bank of Russia calculations.

Real household income continued to grow in October

Chart 3

Growth as % on January 2014, seasonally adjusted



Sources: Rosstat, Bank of Russia calculations.

time, the increase in remuneration of social sector workers in 2018 Q3 continued to make a positive contribution to wage dynamics; this was associated with the implementation of the May presidential decrees. Estimates suggest that annual real wage growth will come in at 7-8% in 2018, in line with previous estimations.

At the same time, consumer demand is somewhat supported by non-labour incomes and social transfers. Their increase returned the annual growth rate of real disposable income in October 2018 to positive territory (1.4%). In monthly terms, the indicator increased for a second month in a row (Chart 3).

Forecast

The Russian economy shows growth rates close to potential. In October, the dynamics of economic activity indicators were in line with the Bank of

Russia forecast that predicts GDP growth of 1.5-2% in 2018, including growth in final consumption expenditure of households of 2.5-3% and gross fixed capital formation of 1.5-2%.

Cut-off date – 20 November 2018.

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

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