Bank of Russia

No. 12

DECEMBER 2018

ECONOMY

Information and analytical commentary

Moscow
2019

Economy: facts, assessments and comments (December 2018)

Economic expansion saw a certain slowdown in December 2018. External demand for industrial products proved weaker than in prior months. Consumer demand sustained its expansion albeit at moderate paces. Investment activity in the final months of 2018 weakened, mainly driven by costlier imported equipment. The labour market held steady. 2018 GDP is on course to post growth between 1.5% and 2%, which is close to the upper bound of the Bank of Russia's forecast range. The estimate takes into account upwardly revised construction volumes.

Core economic indicators
(year-on-year growth, %, unless indicated otherwise)

	2017	November 2018	December 2018	2018 Q4	2018
Output of goods and services by key industry	2.4	1.8	...	...	...
Industrial output	2.1	2.4	2.0	2.7	2.9
Agricultural output	3.1	-3.9	...	...	...
Construction	-1.2	4.3	2.6	4.1	5.3
Freight turnover	5.5	3.0	3.2	2.6	2.9
Retail sales	1.3	3.0	2.3	2.7	2.6
Nominal wage	6.7	8.2	6.9	7.8	9.9
Real wage	2.9	4.2	2.5	3.8	6.8
Unemployment rate / seasonally adjusted*	5.2	4.8/4.8	4.7/4.8	4.8/4.8	4.8

* Bank of Russia estimate.
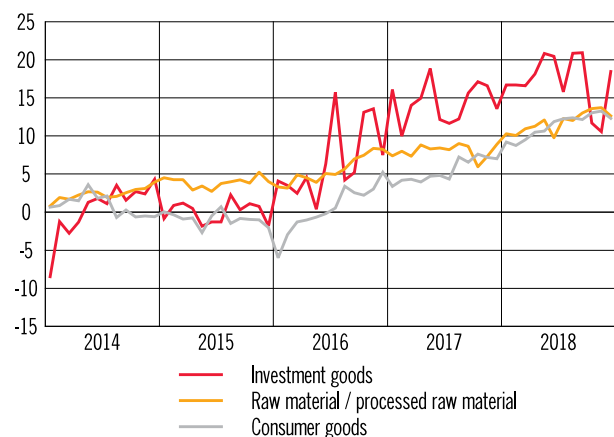*Source: Rosstat.*

Production activity

Annual growth in industrial production in December 2018 was slower at 2.0%. December's seasonally and calendar effect adjusted (further – SA) output was flat compared to the September-November 2018 period. Performance across industrial sectors proved mixed (Chart 1).

The period saw a slight drop in mining outputs (vs prior months' growth), mainly on the back of lower coal and metallic ores outputs, caused by their shrinking exports. The new OPEC+ cut deal restrictions had no implications for oil production in December, which grew and recorded fresh highs. The positive production developments stem from the technology-driven complexities of reducing outputs in wintertime. These developments helped sustain freight turnover (SA) at the prior month's point.

Outputs in the raw material processing sector slid in December on prior months (SA), to a great degree because of lower oil products outputs (primarily, fuel oil, which declined as producers were preparing for the launch of the tax manoeuvre) and ferrous metals volumes (on

Raw material and processed raw material outputs contracted as external demand declined   *Chart 1*

Growth in % to average 2013 reading, SA

- Investment goods
- Raw material / processed raw material
- Consumer goods

Sources: Rosstat, Bank of Russia calculations.

the back of declining exports amid lower global steel prices).

A decline was also registered in consumer goods outputs (SA). A short-lived rise in outputs of cars and household appliances in November (see the section 'Consumption and Savings') expectedly gave way to a contraction. December's outputs of food products on a

month-on-month basis (SA) also fell, driven in part by contracting amounts of processed grain cultures and sugar beet (in the backdrop of declining harvests) and, in individual regions, by adverse epizootic developments.

Conversely, investment demand goods outputs were up considerably in December (SA), revisiting their mid-2018 readings. Engineering posted the strongest growth rates. Outputs of construction materials also rose, e.g. steelwork and structural blocks. The rise in demand for these products is probably due to the railway bridge being constructed in Crimea, as well as the second Baikal tunnel being built as part of Baikal-Amur Mainline and Trans-Siberian Railway upgrades.

Industrial survey data in December 2018 were overall a reflection of the current situation. Russia's Manufacturing PMI showed slower improvements in market conditions, with the Rosstat Business Confidence Index edging lower. According to a Bank of Russia business survey, overall economic conditions, both countrywide and across most federal districts, were somewhat lower than the neutral level. Business sentiment in manufacturing, for all its slight improvement, was still at the lows of early 2018.

Total industrial output in 2018 rose 2.9%, with the strongest growth (4.1%) being recorded in the mining sector. The acceleration in oil, gas, coal and ore outputs was driven by external demand, chiefly from Europe and Asia Pacific.
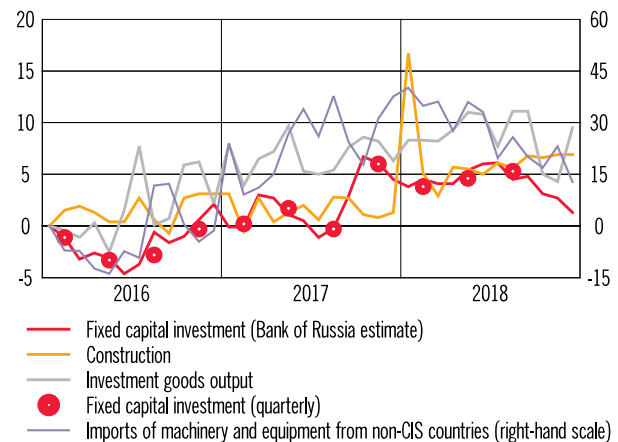
Investment activity

Investment activity in November-December 2018 is estimated to estimated to have slowed, in part due to costlier imported equipment (Chart 2). At the same time, December's contraction in investment imports was partly offset by rising outputs of domestic investment goods.

Gross fixed capital formation in 2018 proved somewhat higher than the Bank of Russia forecast (1.5-2.0%).[1] This owes its existence to Rosstat's upwardly revised construction volumes for recent years (in 2018 growth totalled 5.3%). The updated statistics are more consistent with

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[1] *Monetary Policy Report, No. 4 (24), December 2018.*

Investment activity was slower in the final months   *Chart 2*
of the year

Growth on January 2016, % SA

- Fixed capital investment (Bank of Russia estimate)
- Construction
- Investment goods output
- Fixed capital investment (quarterly)
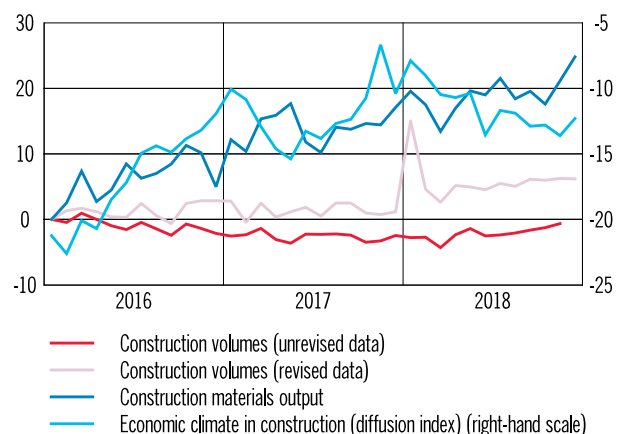- Imports of machinery and equipment from non-CIS countries (right-hand scale)

Sources: Rosstat, FCS, Bank of Russia calculations.

Revised construction data are more aligned   *Chart 3*
with indirect indicators

Growth on January 2016, % SA

- Construction volumes (unrevised data)
- Construction volumes (revised data)
- Construction materials output
- Economic climate in construction (diffusion index) (right-hand scale)

Sources: Rosstat, Bank of Russia calculations.

construction volume dynamics and construction companies' sentiment[2] (Chart 3).

Consumption and savings

Retail sales slowed down in December 2018, following a short-lived rise in November 2018. At the time, acceleration was recorded in the non-food segment on expectations for price growth in part due to the VAT rise.[3] Retail sales posted both annualised and month-on-month
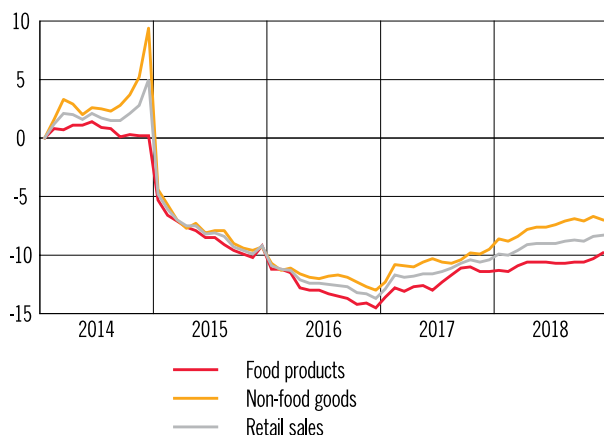
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[2] *Change in economic conditions in construction (balance of responses). Based on the Bank of Russia's 1-11 December business survey. The survey covered 11,668 enterprises.*

[3] *See Economy, No. 11 (35), November 2018.*

Consumer demand continued
to expand in December   *Chart 4*
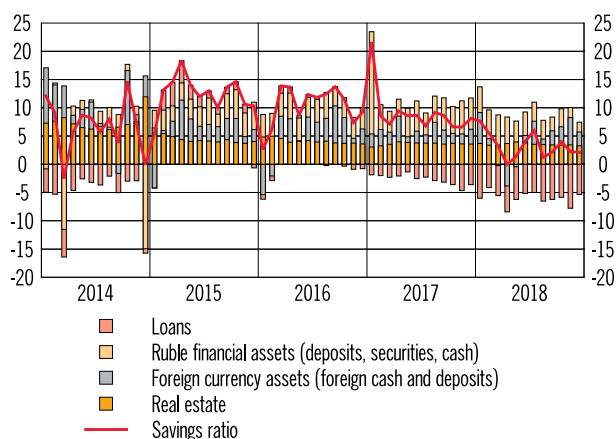
Growth on January 2014, % SA

— Food products
— Non-food goods
— Retail sales

Sources: Rosstat, Bank of Russia calculations.

Savings ratio sustained
at steady levels   *Chart 5*

Contribution in percentage points, SA

☐ Loans
☐ Ruble financial assets (deposits, securities, cash)
☐ Foreign currency assets (foreign cash and deposits)
☐ Real estate
— Savings ratio

Sources: Rosstat, Bank of Russia calculations.

growth (SA), approaching the mid-2015 reading (Chart 4).

Households' final consumption expenditure in 2018 is estimated to be close to the lower bound of the Bank of Russia's forecast range (2.5-3%).

Bank of Russia estimates show that consumer activity expansion in the first months of 2019 is set to be pressured by temporarily accelerated inflation driven by the VAT rise.

The savings ratio was steady[4] after a considerable decline in November; it is however invariably low compared to the 2015-2017 period

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[4] *The savings ratio estimate includes mortgage portfolio securitisation transactions; for further details refer to 'Russian Banking Sector Developments', December 2018.*

(Chart 5). This decline in the savings ratio comes as a result of strongly accelerated household lending and, to a lesser extent, slower rising deposits.

Labour market and incomes

Unemployment in December 2018 remained close to its natural level (4.8% SA). Its 4.8% annual average value is an all-tome low. This movement was helped by rising labour demand. In this way, the number of openings posted on hh.ru in December 2018 rose 43% on the same month last year (Chart 6).

Preliminary Rosstat data show that the annual pace of real wage growth slowed in December to 2.5%. This was driven by the high base effect of the previous year in the first place (December 2017 was the time remuneration was revised in the social and cultural sector in accordance with the Russian President's May decrees). Accelerated inflation made a further contribution to the slowdown in the annual indicator.

Real wages in 2018 are estimated to gain 6.8% – which is close to the Bank of Russia forecast (7-8%) as per the Report. Adjusted for the effect of the Russian President's May decrees, real wages are estimated to post 4.6% growth.

After a significant drop in the previous month, in December 2018, real household disposable money income rose in both annual terms and

Labour demand
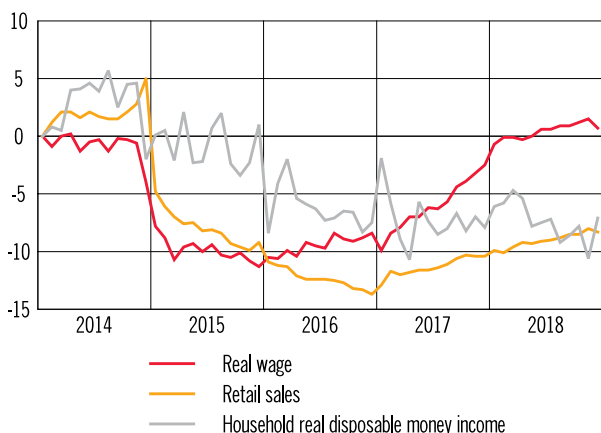recovered   *Chart 6*

Per cent change on corresponding month of previous year

☐ Number of openings
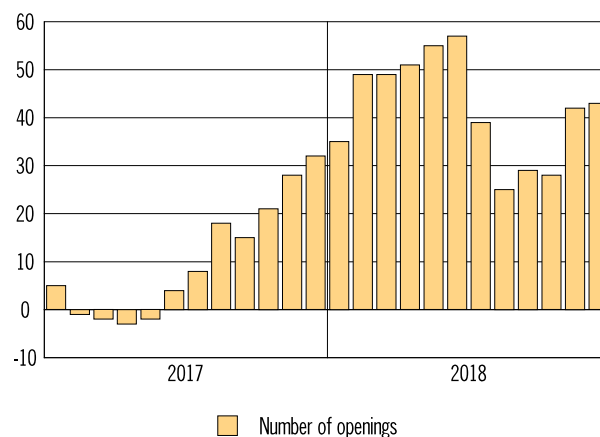
Source: hh.ru.

Real income of households
was unsteady   *Chart 7*

Growth on January 2014, % SA

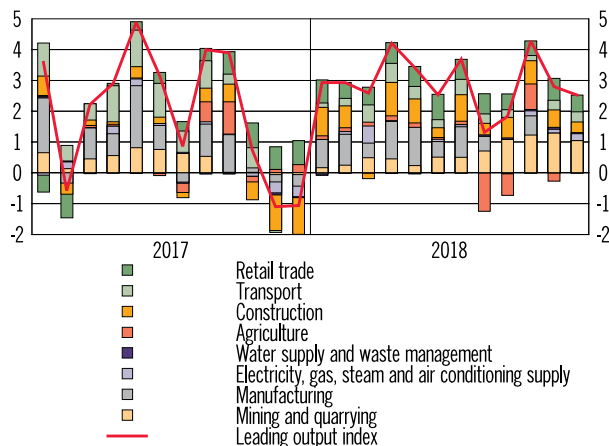*Sources: Rosstat, Bank of Russia calculations.*

Annual growth in the leading output index slowed
down in December 2018   *Chart 8*

Contribution to annual growth in the leading output indicator, pp

Sources: Rosstat, Bank of Russia calculations.

month-on-month (SA, Chart 7). That said, this growth is hardly suggestive of a sustainable trend. This blip must have been a result of rising other incomes which are more volatile. 2018 saw real disposable money income drop 0.2%, according to Rosstat.

Gross domestic product

The slack economic performance in the final months of 2018 may be suggestive of slower quarterly growth in 2018 Q4 than previously assumed. The annual growth of the leading

indicator continued to slow in December 2018 – despite the base effect (Chart 8). Given the trends in place, 2019 Q1 may well post weaker than expected performance.

Despite the slowdown in core measures for economic activity in November-December 2018, 2018 GDP may well hit a point close to the upper bound of the Bank of Russia forecast range[5] (1.5-2%). This is linked with revised construction volumes, most of which fell on early 2018.

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[5] In *December's Monetary Policy Report and in in the previous issue of the commentary*.