Bank of Russia

MARCH 2019

ECONOMY

Information and analytical commentary

Moscow
2019

Economy: facts, assessments and comments (March 2019)

In March 2019, economic activity continued to grow. The output of investment goods and durable consumer goods rose as investment activity stabilised and consumer demand expanded. The economy is close to the potential. Proinflationary risks from the labour market remained low. Estimates suggest that annual GDP growth will come in at 1.0-1.5% in 2019 Q1 and 1.2-1.7% as of the year-end.

CORE ECONOMIC INDICATORS *Table 1*
(year-on-year growth, %, unless indicated otherwise)

	2018 Q1	2018	January 2019	February 2019	March 2019	2019 Q1
Output of goods and services by key industry	2.9	2.9	0.4	2.1	...	...
Industrial output	2.8	2.9	1.1	4.1	1.2	2.1
Agricultural output	2.4	-0.6	0.7	1.0	1.5	1.1
Construction	5.2	5.3	0.1	0.3	0.2	0.2
Freight turnover	2.5	2.8	2.4	1.9	1.9	2.1
Retail sales	2.7	2.8	1.9	2.0	1.6	1.8
Unemployment rate / seasonally adjusted* (% of labour force)	5.1/4.8	4.8	4.9/4.7	4.9/4.6	4.7/4.5	4.8/4.5
Nominal wage	12.7	9.9	6.1	5.2	5.2	5.6
Real wage	10.2	6.8	1.1	0.0	0.0	0.4
Household real disposable money income	1.4	0.1	–	–	–	-2.3

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

Production activity

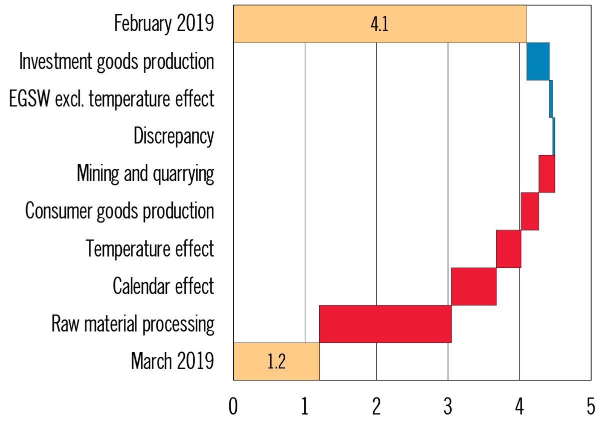
Annual growth of industrial production slowed in March 2019 to 1.2% from 4.1% in the previous month (Chart 1). In the first quarter, industrial output increased by 2.1% year on year (Table 1). The rise was somewhat lower than forecast in the *February issue of the commentary on the economy*, which predicted that annual growth of industrial production would hold near the previous quarter reading (2.5-3.0%). That said, the Q1 output growth structure remained virtually unchanged compared with the previous period with mining and quarrying being the main contributor and manufacturing contributing only intangibly (Chart 2).

Raw material production. In March 2019, raw material production preserved the trends registered in February: month-on-month output in mining and quarrying adjusted for seasonality and calendar effects (SA) continued to grow hitting a new all-time high. The indicator rose largely on the back of expanding production of natural gas in response to a rise in demand from manufacturing companies; the latter was associated with, among other things, the launch of Yamal SPG natural gas liquefaction facilities. That said, gas exports shrank considerably due to warm weather in Europe; this could make a significant negative contribution to wholesale trade dynamics. Coal production increased, while oil production continued to decline as caps under the OPEC+ deal were preserved.

Intermediate goods production. In March, intermediate goods production shrank month on month (SA). Output dropped the most considerably in metals and oil products, that is in the product groups which showed the most tangible growth in January-February 2019. That said, their output remains volatile and influenced by specific factors, which makes any speculations about the emergence of a downward trend premature.

DECOMPOSITION OF CHANGES IN INDUSTRIAL PRODUCTION — *Chart 1*

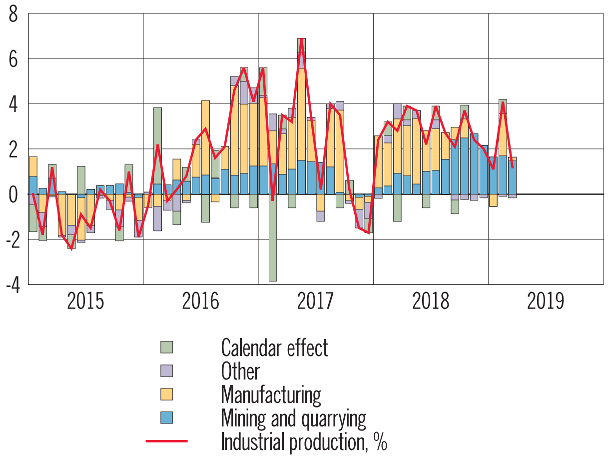
Contribution to annual growth, pp



** EGSW – electricity, gas, steam and water supply.*
Sources: Rosstat, Bank of Russia calculations.

INDUSTRIAL PRODUCTION — *Chart 2*

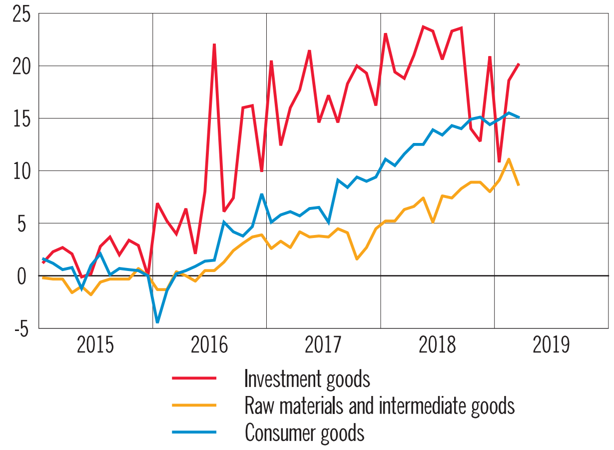
Contribution to annual growth, pp



Sources: Rosstat, Bank of Russia calculations.

INDUSTRIAL PRODUCTION BY PRODUCT GROUP — *Chart 3*

Growth on December 2015, % SA



Sources: Rosstat, Bank of Russia calculations.

Investment goods production. In March 2019, investment goods production recovered month on month (SA, Chart 3). Here, the production increase was registered both in construction materials and a wide range of engineering products.

Investment goods output is highly volatile. Medium-term trends point to a stagnant or shrinking output in key product groups. Thereby, the growth in production of electrical equipment and other vehicles registered in 2017 – early 2018 stopped as public orders for these products contracted and their output shrank. At the same time, other non-metallic mineral products (stone, fire-proof products, and certain construction materials) have been posting relatively strong growth since 2016; this was supported by a rising demand for these products from construction and manufacturing companies, as well as the external sector.[1]

Consumer goods production. In March 2019, consumer goods production shrank month on month due to the contracting output of a wide range of food products. As in February, the production of bakery and flour products shrank as costs rose on the back of 2018 grain price growth. Meat processing also registered a further decline which may be caused by short-term factors.

In contrast, the output of non-food consumer goods expanded month on month (SA). The output of pharmaceutical products and various durables, including light vehicles and furniture, continued to grow. The increase in production of non-food goods reflects the recovery of consumer demand after its slowdown in late 2018 – early 2019. At the same time, the output of textile products continued to shrink month on month (SA) dropping to the lowest reading since August 2017; this may point to low competitiveness, which includes in terms of prices, of these domestically produced goods compared with imports.

Transport. In 2019 Q1, freight turnover increased by 2.1% year on year reflecting the rise in production activity. The indicator rose across all transport categories (Chart 4). In

[1] See *Economy, information and analytical commentary, No. 7, July 2018*.

March 2019, railway freight turnover posted the most tangible growth. A seasonally adjusted increase was registered in transportation of coal and construction materials, where output had risen. At the same time, transportation of metals and grain shrank, while growth in pipeline transportation slowed down.

Business survey. Surveys among manufacturers gave ambiguous signals in March 2019. On the one hand, the PMI index of Russian manufacturing industries reached 52.8 points, which is the highest reading since January 2017. Respondents pointed to accelerated growth in production volumes and new orders on the back of expanding domestic demand; meanwhile new export orders contracted for the third month in a row.

On the other hand, Rosstat's survey and the Bank of Russia's monitoring of companies did not suggest any considerable improvement in businesses' sentiment. Respondents of the company monitoring continued to give unchanged estimates of the economic situation on average as demand for the companies' products held at the previous month level and the effect of exchange rate and lending condition drivers faded.

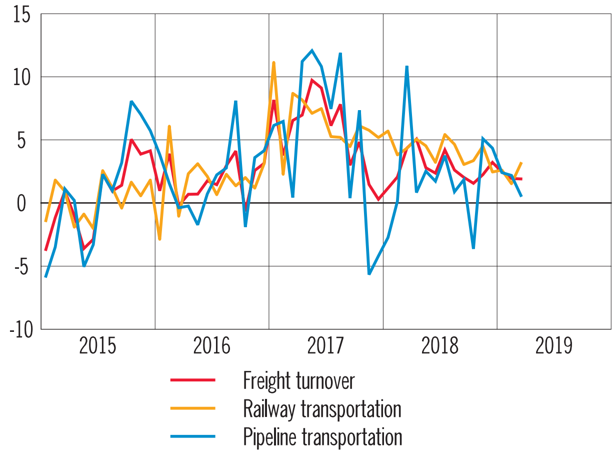
Investment activity

In March 2019, investment activity indicators suggested that it had stabilised. The output of engineering products and construction materials increased, while the annual contraction of imports of machinery and equipment slowed (Chart 5). In this environment, annual growth of fixed capital investment in 2019 Q1 is estimated at a near zero level.

Commissioned housing ceased to contract year on year for the first time since April 2018 (Chart 6). According to the Bank of Russia's estimates, this indicator will continue to post weak growth in the current year. At the same time, in the medium term housing construction will be supported by expanding mortgage lending and state support measures, including the Housing and Urban Environment National Project.

TRANSPORT *Chart 4*

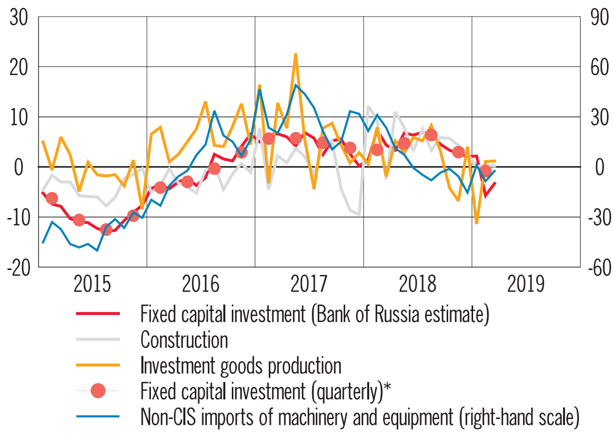
Percent change on corresponding month of previous year



Source: Rosstat.

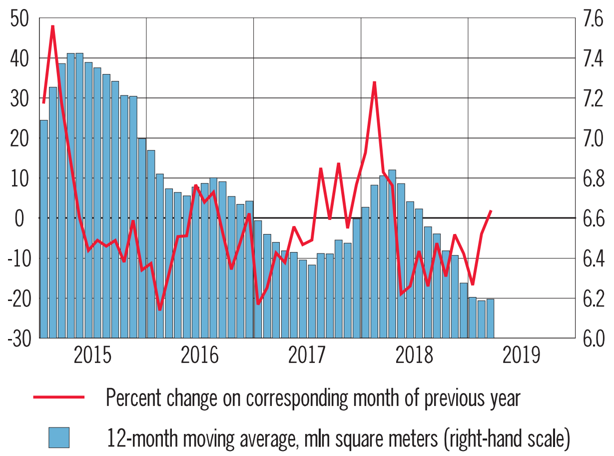
INVESTMENT ACTIVITY INDICATORS *Chart 5*

Percent change on corresponding period of previous year



** Fixed capital investment in 2019 Q1 – Bank of Russia estimate.*
Sources: Rosstat, FCS, Bank of Russia calculations.

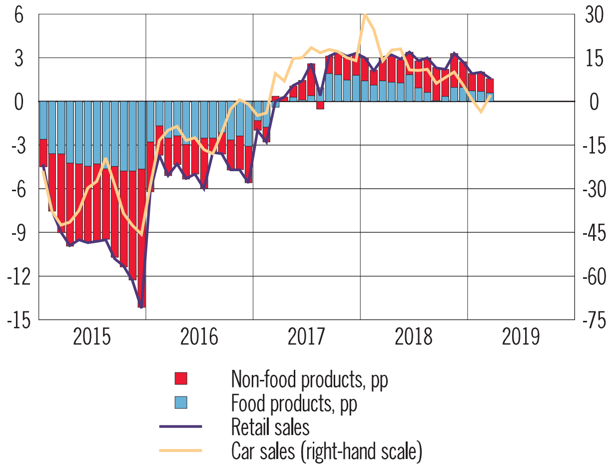
TOTAL HOUSING DELIVERED *Chart 6*



Sources: Rosstat, Bank of Russia calculations.

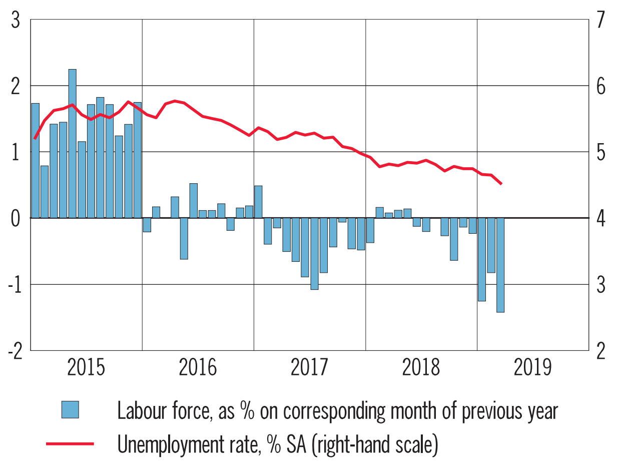
RETAIL SALES AND CAR SALES *Chart 7*

Percent change on corresponding month of previous year



Sources: Rosstat, Association of European Businesses, Bank of Russia calculations.

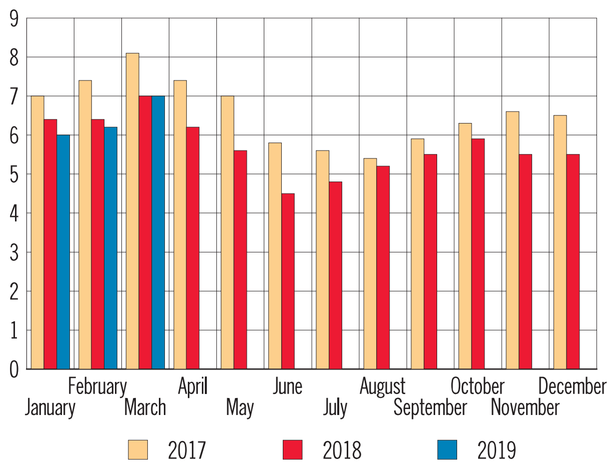
UNEMPLOYMENT AND LABOUR FORCE *Chart 8*



Sources: Rosstat, Bank of Russia calculations.

hh.INDEX *Chart 9*

Ratio between active CVs and job openings



Source: hh.ru.

Consumer activity

Annual growth of retail sales slowed to 1.6% in March 2019 (1.9-2.0% in previous months,[2] Chart 7) and came in at 1.8% in the first quarter, which is in line with the Bank of Russia forecast for this period (1.5-2.0%).[3] The volume of paid services to households increased by 1.1% largely due to transportation and telecommunication services (the launch of digital television). The moderate dynamics of consumer demand formed amid falling household incomes (see the *Labour market and incomes* section) and rising annual inflation.

The expansion of household demand was driven by the growing propensity to consume, which is suggested by a decline in household deposits and growth in retail lending. In March 2019, its monthly growth rates sped up to 2% from 0.8-1.4% seen in January-February 2019. In this environment, retail sales returned to month-on-month growth in March (+0.2% SA). Together with resumed growth in car sales, this may suggest that demand has completed its adjustment to prices after the VAT hike.

Labour market and incomes

In March 2019, the unemployment rate dropped to 4.5% (SA), an all-time low (Chart 8). This was caused both by structural and cyclical factors. On the one hand, unemployment contracted as labour supply shrank, among other things, due to demographic trends. On the other hand, companies' demand for labour continued to rise. The demand-to-supply ratio in the labour market (hh.index,[4] Chart 9) remained unchanged year on year in March.

We estimate proinflationary risks from the labour market as low. The year-on-year growth of real wage in February-March 2019 halted for the first time since 2016 (Chart 10). Its slowing growth was registered in both private and public sectors of the economy. The ongoing decline in annual growth of real labour remuneration

[2] *Rosstat revised the retail sales dynamics since 2016.*

[3] *Monetary Policy Report, No. 1 (25), March 2019 (the Report 1/19).*

[4] *The hh.index is the ratio between active CVs and job openings. It shows relative skill shortage. The lower the index, the lower competition between candidates.*

resulted from last year's high base effect (highest growth was registered in 2018 Q1 due to the implementation of May decrees) and a temporary inflation acceleration. According to the Bank of Russia's estimates, as annual inflation slows down in the second quarter, real wages will grow by 1.0-1.5%.

In March 2019, Rosstat announced a transition to a new methodology for calculating money income and household spending. Newly released data for 2018-2019 are more in line with wage movements (Chart 11). The difference between income and wages from 2017 Q2 resulted from the shrinkage of other earnings, including undisclosed ones (Chart 12). In 2019 Q1, other monetary earnings continued to decline. Together with terminated wage growth, this led to a 2.3% contraction of real household disposable money income.

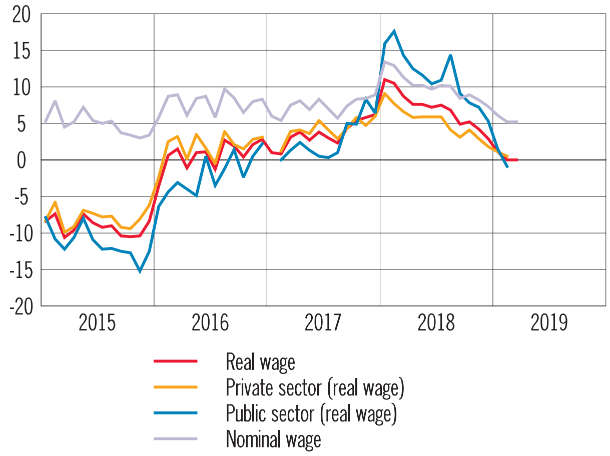
Forecast

Economic activity in March 2019 was overall in line with the Bank of Russia's expectations. According to the Bank of Russia's estimates, which factor in 2015-2018 GDP revision, the economy held close to the potential in late 2018 – early 2019. Annual GDP growth estimate for 2019 Q1 remained overall unchanged at 1.0-1.5%. In 2019, GDP growth is still forecast at 1.2-1.7%.

Moreover, the Q1 estimate of GDP expenditure was updated following the revision of historical data. Thus, the annual increase in household final consumption expenditure in 2019 Q1 was estimated at 1.7-2.2% (Report 1/19 forecast 1.0-1.5% growth), with that of gross fixed capital formation at 0.0-0.5% (1.0-1.5%).

WAGES — *Chart 10*

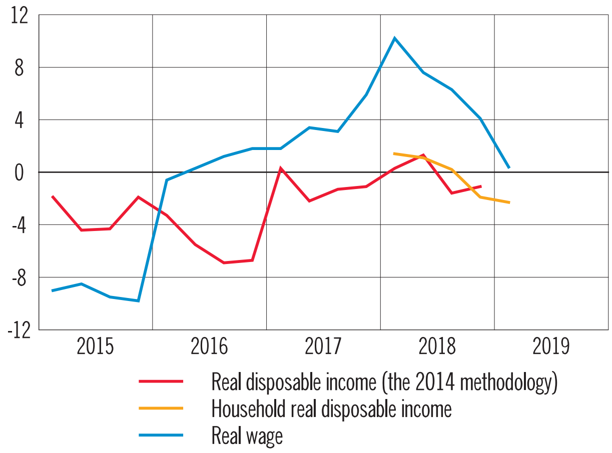
Percent change on corresponding month of previous year



Sources: Rosstat, Bank of Russia calculations.

DISPOSABLE INCOME AND REAL WAGE — *Chart 11*

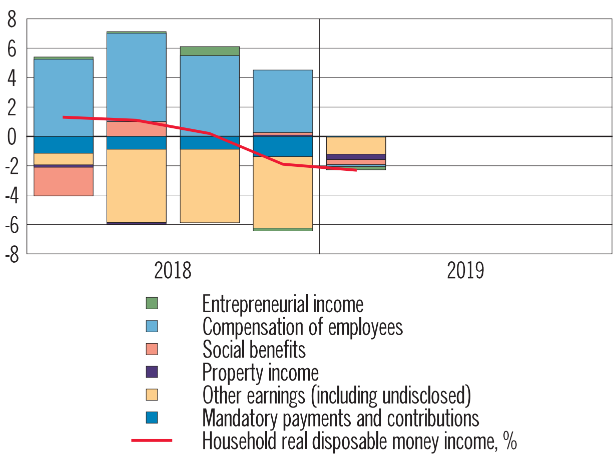
Percent change on corresponding quarter of previous year



Sources: Rosstat, Bank of Russia calculations.

HOUSEHOLD REAL DISPOSABLE MONEY INCOME — *Chart 12*

Contribution to annual growth, pp



Sources: Rosstat, Bank of Russia calculations.

Cut-off date – 23 April 2019.

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

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

This commentary is prepared by the Monetary Policy Department.

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12 Neglinnaya Street, Moscow 107016
Bank of Russia website: www.cbr.ru