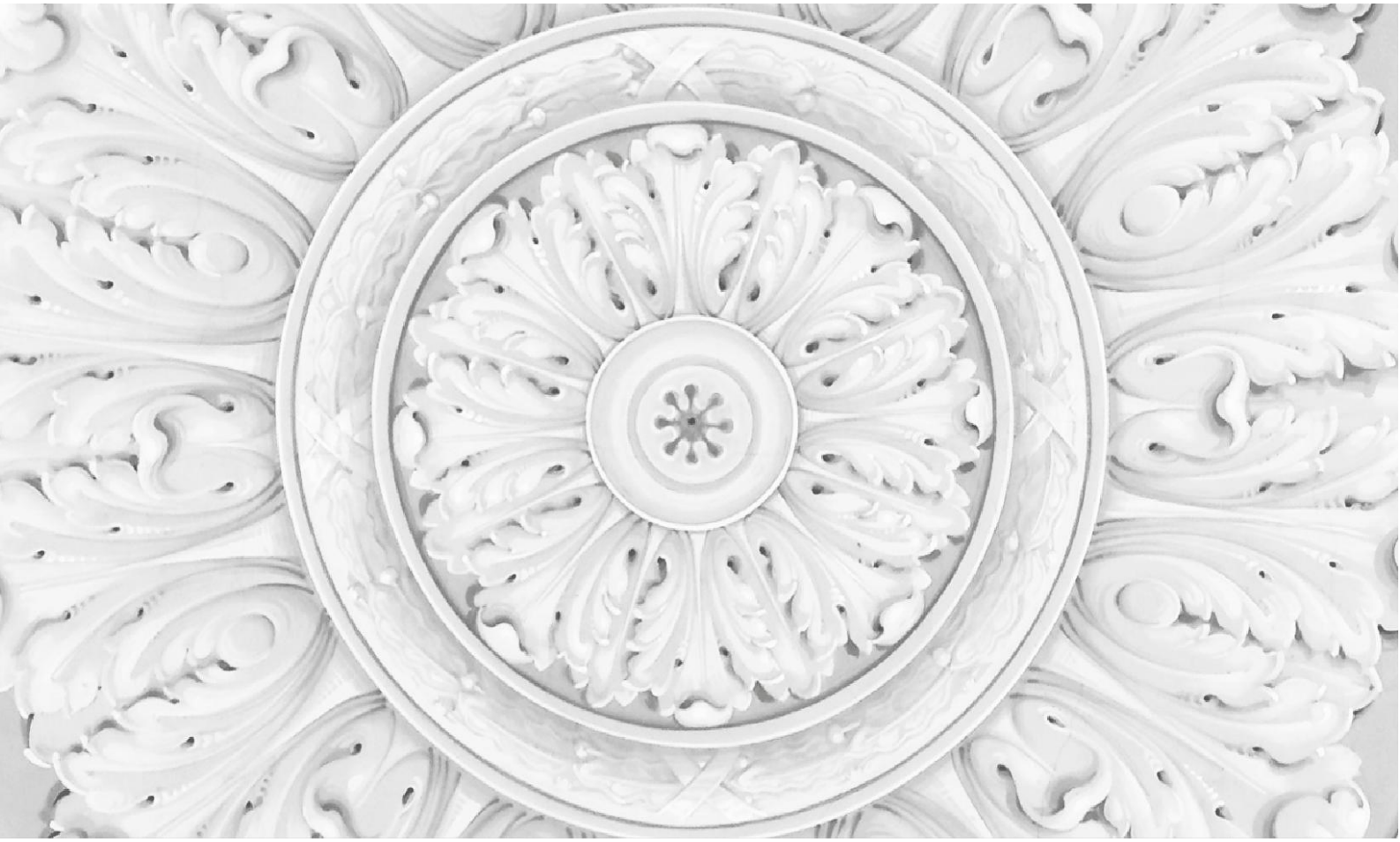
Bank of Russia

The Central Bank of the Russian Federation



TALKING TRENDS

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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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Executive summary

1. Monthly summary

- Inflation in November remained within the bounds of the Bank of Russia's baseline scenario as the foreign trade and financial environment was moderately favourable. Economic activity in October was overall positive, which suggests the economy is moving gradually to post slow economic growth.

  - Inflation settled at levels which are aligned with the Bank of Russia's official forecast for 2016 in the baseline scenario (5.5-6.0%), gradually approaching the target. However, inflationary pressure remains heightened. The stubbornly unsteady inflation expectations create significant risks that inflation may deviate from the target for 2017. Also, inflation risks remain, making the case for sustaining moderately tight monetary policy. We see stabilisation in analysts' expectations for price growth in 2017 at a point only slightly above the Bank of Russia's target of 4%, in a sign of growing credibility over the Bank of Russia's policy. Such credibility is set to help anchor inflation expectations at the appropriate level.

  - Economic activity shows tentative signs of qualitative improvement, despite the continued adjustment to low oil prices. A rebound finds its way in sectors focused on investment demand. Growth of real wages and investment imports is ongoing. The economy is moving towards a slow growth path.

  - Monetary conditions remain moderately tight. Russian markets showed a more subdued reaction to a strengthening in the dollar, triggered by growing expectations for policy normalisation by the Fed, as compared to emerging economies.

2. Outlook

- The current index GDP estimate suggests fragile positive growth in 2016 Q4.

- The US presidential election results made but minor impact on expectations for US business activity. The odds that the Fed will increase its interest rate in December are close to 100%.

3. In focus

The specifics of the labour market's adjustment to economic shocks in some Russian regions act to constrain the potential impact of monetary and fiscal policy tools aimed at lowering inflation.

1. Summary

1.1. Inflation

Inflation settled at levels within the bounds of the Bank of Russia's baseline scenario for 2016 (5.5–6.0%), gradually moving towards the target. However, inflationary pressure remains heightened. The current inflation expectations, stubbornly unsteady, create significant risks that inflation may deviate from the target for 2017. Food prices continue to post acceleration. Also, the current inflation trend and inflation risks remain, making the case for sustaining moderately tight monetary policy. We see stabilisation in analysts' expectations for price growth in 2017 at a point only slightly above the Bank of Russia's target of 4%, in a sign of growing credibility over the Bank of Russia's policy. Such credibility is set to become a factor anchoring inflation expectations at the appropriate level.

1.1.1. Inflation is moving slowly towards the target

- Price pressure is still elevated as measured against the Bank of Russia's target, which suggests risks that inflation may remain persistently high at 5%.
- In the next few weeks food prices may continue to grow at faster rates on the back of the recently resumed growth in prices of some food products in global markets.
- Annualised inflation in November was down to 5.8%, which is in line with seasonally adjusted inflation of 0.35-0.4% MoM, according to preliminary estimates.

Consumer prices grew 0.4% in November. According to our estimates, the increase in prices to the accuracy of two decimal places totalled 0.44%[1]. Tentative estimates show that this increase in prices for November corresponds to seasonally adjusted inflation of about 0.35-0.4% MoM. This implies a slightly decreased inflationary pressure in November against October[2], as it is close to a point corresponding to 4% annual inflation. Our preliminary analysis indicates that key drivers of seasonally adjusted inflation slowdown in November included food prices, especially those with continued effect from good crops (cereals, pulses, sugar, fruit and vegetables). They could set off the acceleration in prices on other food products, e.g. milk and dairy products.

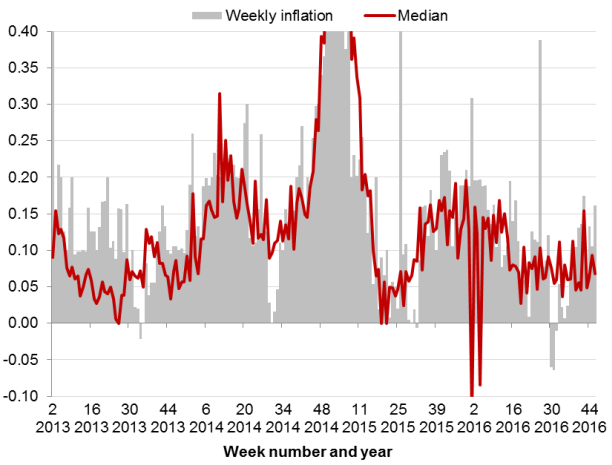
Increased growth paces are seen in milk and dairy products. This trend is driven by the continued growth in their global prices, trailed by the recommended minimum export prices for dairy products from Belarus, where the latest increase occurred on 4 November[3] (Figure 2). The Republic of Belarus is the key importer of dairy products for the Russian market; it saw its share growing from 33% in 2012 to 74% in 2015[4]. It is important to note that an upward movement in global prices translates into a domestic rise quickly enough, taking a month or two. The next weeks are therefore likely to post continued accelerated[5]

[1] Rosstat data on price growth are accurate to one decimal place. As inflation declines and approaches the target, estimates to the accuracy of second decimal places become more important.
[2] Seasonally adjusted growth in October was 0.45%.
[3] http://milknews.ru/analitika-rinka-moloka/rinok-moloka-v-mire/rinok-moloka-v-mire_7764.html.
[4] Calculations here are based on UN Comtrade Database data.
[5] Outside the bounds of normal seasonality.

growth in prices for milk and dairy products. Even so, their subsequent trend will be determined by global markets.

Having said that, we see no substantial rise in price pressures. The median growth in the weekly product basket is lower and invariably close to the 2013 levels (Figure 1), when seasonally adjusted inflation corresponded to annualised price growth of 5.0-5.5%.

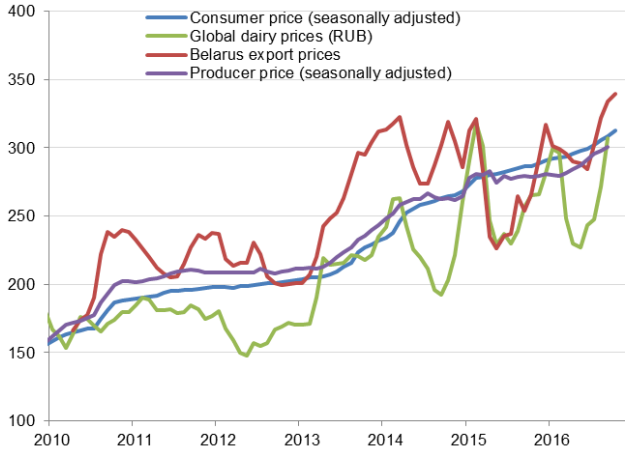
Figure 1. Weekly inflation and median product price growth*, %



** Excluding regulated service rates and prices of fruit and vegetables*

Sources: Rosstat, R&F Department calculations.

Figure 2. Dairy prices, %



** January 2010 = 100.*

Sources: Rosstat, FAO, Bloomberg Finance L.P., R&F calculations.

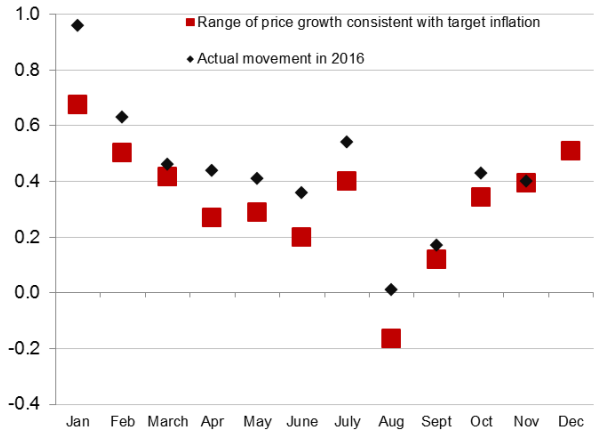
Sources: Rosstat, R&F Department calculations.

We calculated the approximate range of intra-year monthly price increase taking account of seasonality, which should correspond to the 4%[6] target rate of inflation. The graph obtained helps explain vividly how much the current inflation deviates from (or remains on) the path it should follow to reach the target level (Figure 3). For example, the actual inflation in 2016 remained in the specified range only in March and, according to preliminary data, in November. In this way, seasonally adjusted price growth was in March close to the target value, totalling a mere 0.37%. Throughout the rest of the months, seasonally adjusted inflation was above the range that is consistent with the target inflation, albeit overall aligned with the inflation reduction path as per the Bank of Russia's forecast.

According to our estimates, between September and November, seasonally adjusted monthly rates of price growth approached the range we calculated, which shows that inflationary pressure is receding in this period. A minor gap between monthly inflation and the target range consistent with 4% inflation appears likely to stay in the near future. Importantly, in the course of its movement towards the late 2017 target, inflation may deviate from the calculated target range of price growth in either direction in the forthcoming months. This deviation may come as a result of minor short-term shocks and the potential emergence of additional uncertainty in seasonally adjusted estimates for those inflation components which are unsteady.

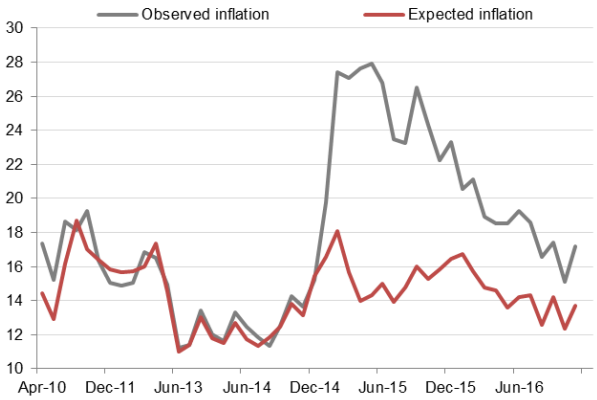
[6] Growth in the rates of regulated services is assumed to be 4%. This figure is important in correct calculation of July inflation.

Figure 3. Monthly growth rates of consumer prices, %



Sources: Rosstat, R&F Department calculations.

Figure 4. Direct estimates of observed and one year ahead inflation



Source: inFOM.

The risks that inflation target may fail to be delivered include the unsteadiness of household inflation expectations. According to inFOM's poll, the median value of inflation expected for the year ahead was up in November to 13.7% from 12.3% in October (Figure 4). Sharp fluctuations in this indicator in the second half, after the fairly rapid and uninterrupted decline, suggest that there are risks related to the potential anchoring of elevated inflation expectations.

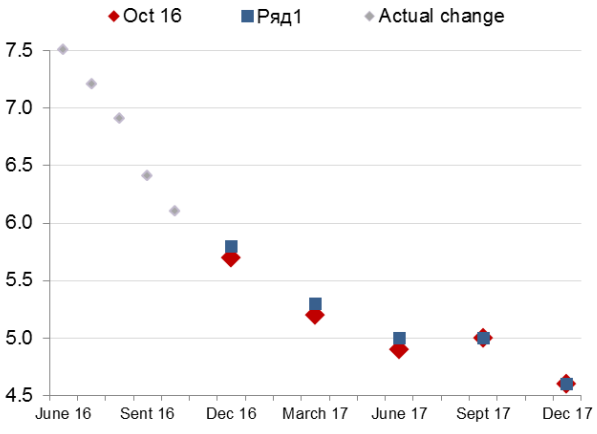
1.1.2. Financial analysts' expectations for inflation are slightly above the target

- The median of analysts' expectations for inflation in late 2017 was unchanged at 4.6%. One of the respondents in the poll spoke about expectations *below* the target level, for the first time.

- Expectations with regard to the key rate have not been changing for three consecutive months: a 0.5 bp quarterly reduction starting from 2017 Q1.

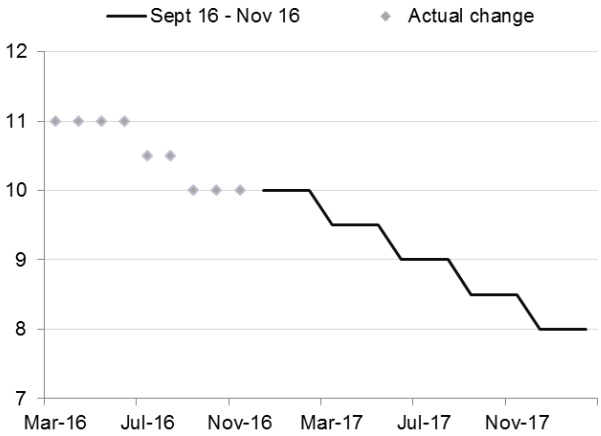
In November, there was a slight downgrade in financial analysts' expectations for inflation: the median values of expected increase in prices for the end of 2016 and the first half of 2017 increased by 0.1 pp against those in October (Figure 5). Expectations for inflation for late 2017 remained at the level of 4.6%. Inflation expectations by one respondent as regards the results of 2017 were, for the first time, *below* the target level at 3.8% YoY. The consensus forecast concerning the key rate was unchanged: as in the two preceding months, analysts expect a 0.5 pp quarterly reduction in the rate starting from 2017 Q1 (Figure 6).

Figure 5. Analysts' expectations for inflation, % YoY



Source: Bloomberg Finance L.P.

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



Source: Bloomberg Finance L.P.

1.2. Economic activity

There are tentative signs of a coming quality improvement in economic activity, despite the ongoing adjustment to low oil prices. Production is also showing signs of a rebound across a broader range of industries which are investment demand-oriented. Real wages are still growing, as are investment imports, while consumer activity stabilises. The economy is moving towards a slow sustainable growth path.

1.2.1. Industrial production: tentative signs of a rebound across investment demand-oriented sectors

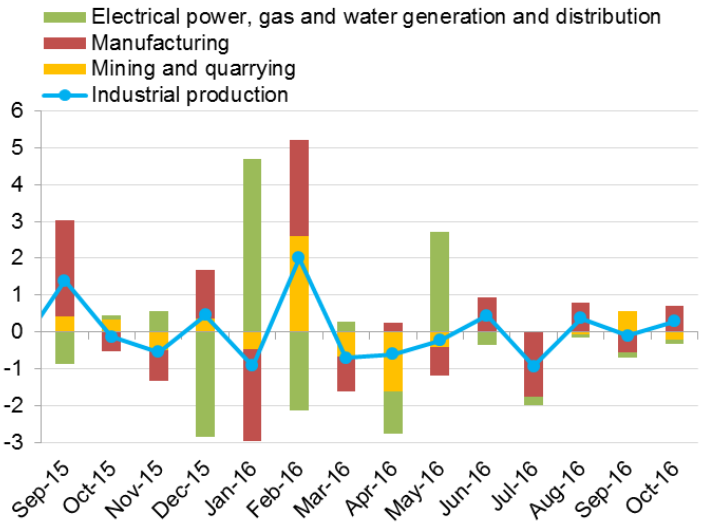
- In October, industrial production, in line with our seasonally adjusted estimates, was up 0.3% MoM.
- Key growth drivers originated from manufacturing.
- The expectations for PMI to stay above the 50 pp mark and the ongoing growth in investment demand suggest that industrial production is set to continue to grow moderately.

The behaviour pattern of the manufacturing sector remains very volatile. According to Rosstat data, industrial production in October was up 0.3% MoM, followed by a 0.3% MoM reduction seen the month before. Annualised contraction in the output was 0.2%, slightly above the consensus forecast (-0.4% YoY). The contribution of the calendar factor was far from minor: the working month of October 2016 was one day shorter than last year's.

Our estimates suggest a 0.3% MoM growth in industrial production in October, after -0.1% MoM seen in September. The key contributor to this indicator was the manufacturing industry (+0.7% MoM) (Figure 7). Judging by a product breakdown, the output was shored up by increased production of some food categories, oil products, vehicles, chemicals and metallurgical products.

Mining saw a 0.2% MoM contraction. Annualised output slowed down from 2.1% to 0.8% YoY. Slower growth rates in mining occur in non-fuel sector, the production of iron ore, rock excavation, etc. The average daily output of oil production in October increased to 11.23 million barrels, which was 1% higher than last month with its record data for the whole post-Soviet period.

Figure 7. Industrial contribution to monthly industrial growth, % MoM

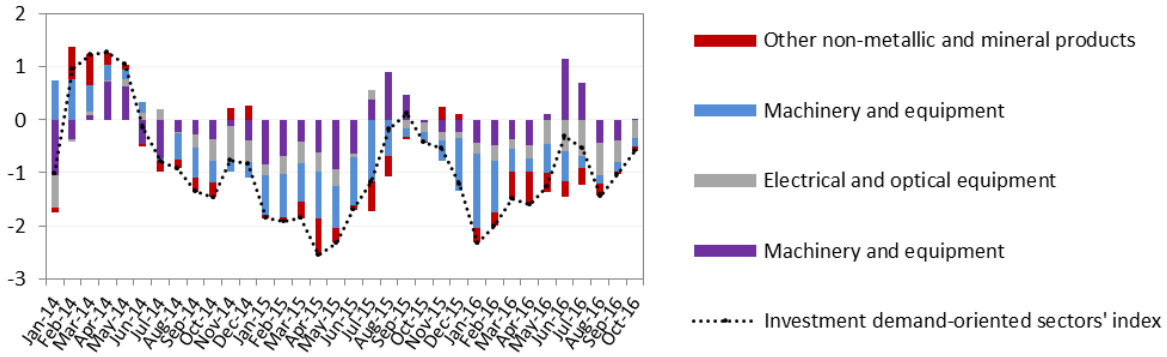


Sources: Rosstat, R&F Department calculations.

October 2016 saw production contraction slowing down in virtually all *investment demand-oriented industries* (Figure 8).

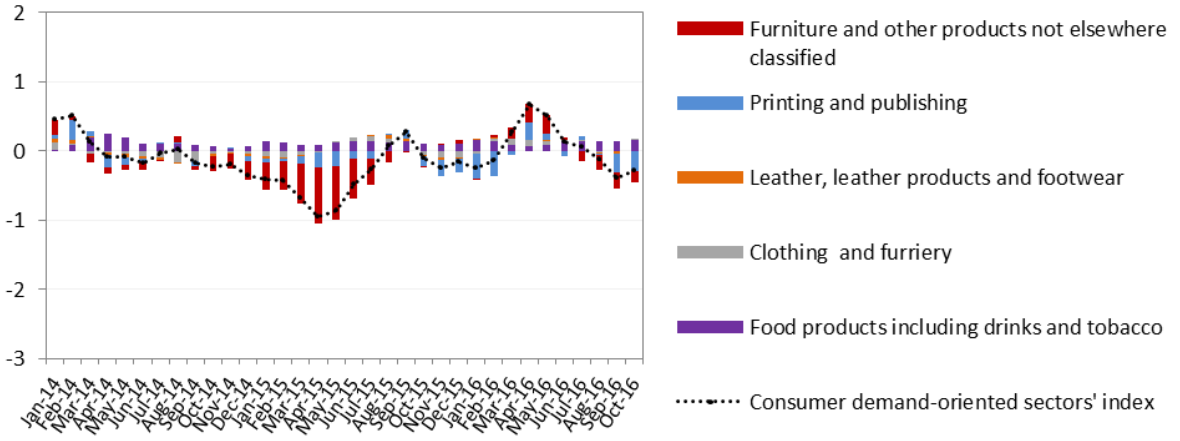
In the production of machinery and equipment, immaterial growth was observed. The most substantial positive contribution was made by agricultural machinery manufacturers, supported by increased exports. According to the Federal Customs Service, 2016 Q3 exports of agricultural machinery exceeded those in 2015 Q3 by 48%. Moving forward, positive dynamics of exports are expected to remain, thanks to the foray of Russian manufacturers into the Chinese market. Through the end of 2016, support to investment demand industries will be given by subsidies out of the federal budget for production and sale of pilot lots of this machinery.

Figure 8. Investment demand-oriented manufacturing sectors' production index (trend), MoM, %



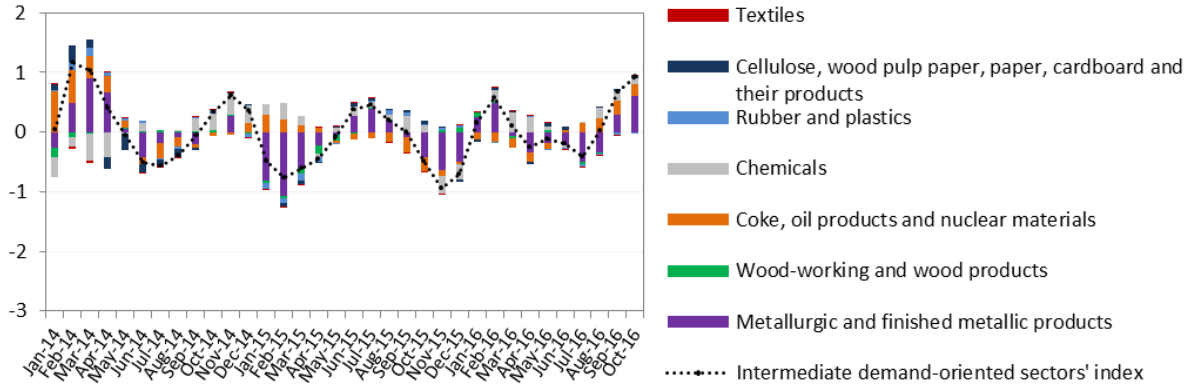
Sources: Rosstat, R&F Department calculations.

Figure 9. Consumer demand-oriented manufacturing sectors' production index (trend), MoM, %



Sources: Rosstat, R&F Department calculations.

Figure 10. Intermediate demand-oriented manufacturing sectors' production index (trend), MoM, %



Sources: Rosstat, R&F Department calculations.

Consumer demand-oriented sectors in October posted invariably negative developments in the production index as the output of durable products continued to decline (Figure 9). Even so, the rates of decline in the consolidated index were smaller than those in September.

Key negative contributors included printing and publishing, along with the production of furniture and other products. The apparel industry posted some minor growth. A strong rebound in the sector is held back by the problem of counterfeited products. As the population's purchasing power deteriorated, counterfeits were on the rise. As part of the government's efforts to shore up the industry, providers of leased machines may apply for subsidies[7]. The production trend in food products is still positive, maintaining the positions of the food industry.

As regards *intermediate demand-oriented industries*, the output edged up across virtually all components (Figure 10).

[7] Russian Government Decree No. 958, dated 23 September 2016.
http://government.ru/media/files/raSQ47mE2N590B4a64AHK8jq3l0o054J.pdf
The deadline for applications is 1 November, subsidies will cover contracts for new equipment, executed between 1 July 2016 and 1 December 2016; budget costs per this programme are 500 million rubles.

The most evident positive contribution was made by metallurgy, with its output growing both in September and October for the first time since February 2016. Despite the US anti-dumping duties for hot rolled products still in place, metallurgy output remained mainly unaffected. The Russian metallurgic companies went to court, requesting that European countries lift the anti-dumping duties for cold rolled products.

Chemicals were invariably expanding in October, albeit at more modest paces compared to the previous two months. Our understanding is that further growth in the chemical industry is set to be supported by rising outputs in the pharmaceutical industry with its ongoing extension of manufacturing capacities.

Consequently, the production trend remains very unsteady. Tentative signs of an anticipated economic rebound are gradually emerging here. More and more sectors are showing signs of recovery. Despite the mixed production data across industries that lingers, the October statistics suggest that investment demand is recovering. This conclusion is indirectly supported by growing investment imports (for more details, refer to 1.2.4. The ongoing recovery in imports beats expectations).

The consumer demand-oriented production remains the most problematic sector. However, with household income stabilising and in the absence of objective fundamental factors to cause a further decline in consumer demand, including for durable products, somewhat stronger data may come in the next few months.

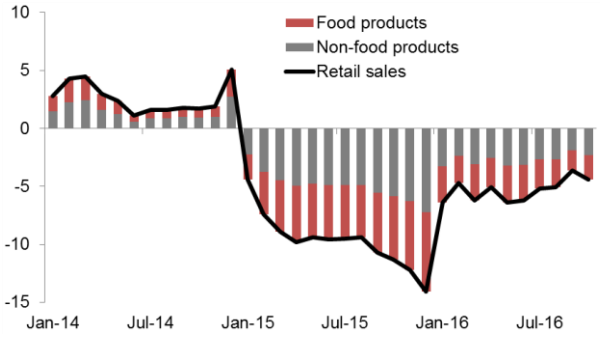
1.2.2. Shrinking consumer activity in October: change in seasonality or in the trend?

- In October, annualised contraction in retail sales totalled 4.4% YoY, which was worse than expected.
- Seasonally adjusted data indicate a 0.7% MoM contraction, after a rise of 0.1% MoM one month ago.
- Changed seasonality in retail sales may be behind the underestimated actual growth paces.

According to Rosstat, October's retail sales grew 0.7% MoM. According to R&F Department estimates, seasonally adjusted contraction totalled 0.7% MoM after a 0.1% MoM growth in September.

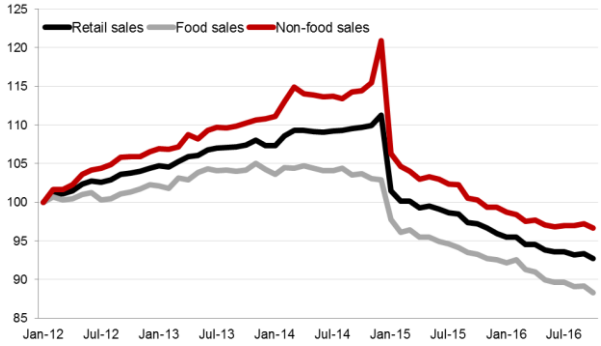
Annualised rates of decline in October accelerated to 4.4% YoY, after a 3.6% YoY decline seen one month ago. The decline against last year accelerated both in the food and non-food sectors. The latter, however, posted slower rates of decline of 3.4% YoY against 5.4% YoY (Figure 11). In such a way, the gap between food and non-food products was wider in October. Seasonally adjusted readings are also indicative of more moderate paces of decline in non-food products, suggesting a more dynamic recovery in the non-food sector (Figure 12).

Figure 11. Contribution of food and non-food products to retail sales, % YoY



Sources: Rosstat, R&F Department calculations.

Figure 12. Retail sales and their components (%, January 2012 = 100%, seasonally adjusted)

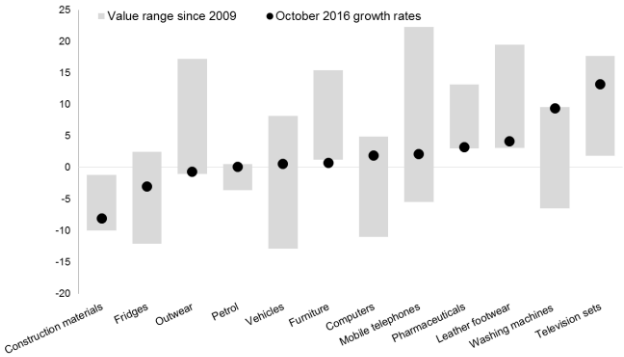


Sources: Rosstat, R&F Department calculations.

Having said that, some durable goods show very low paces of growth for October, possibly attributable to purchases having been made in previous months. Considering the ongoing improvement in consumer sentiment as regards major purchases, it is possible that partial demand for durable products will be met at a later stage.

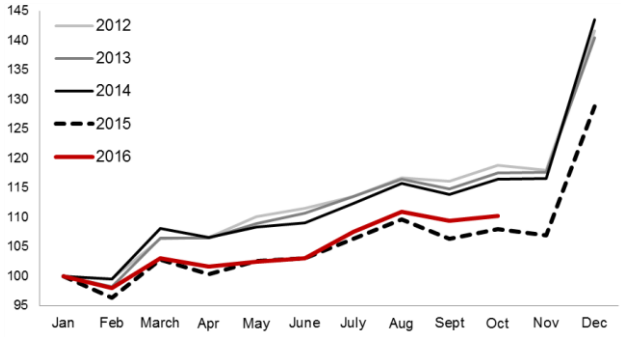
As follows from the analysis of immediately available data for October, individual non-food categories post a pace of growth higher than their lows for the period since 2009. The trend is observed in sales of refrigerators, cars, computers, washing machines and television sets. A certain change in seasonality is also seen. In this way, the rise in sales of construction materials, uncommon for September, gave way to contraction in October. Similar developments are seen in sales volumes of pharmaceuticals, leather footwear and outerwear (Figure 13)[8].

Figure 13. Retail growth and value range since 2009 (% MoM, seasonally adjusted)



Sources: Rosstat, R&F Department calculations.

Figure 14. Annual retail sales (January = 100%)



Sources: Rosstat, R&F Department calculations.

A change in seasonality is seen in overall retail sales. The September contraction was less substantial than in previous years. Accordingly, the downward movement in the past month was somewhat better than analysts expected. At the same time, the impact from the base effect was reverse in October (the month is known for higher retail sales that tend to set off the September decline). This year, however, the September month-on-month drop was more moderate than usual, with the entailing softer-than-usual growth in

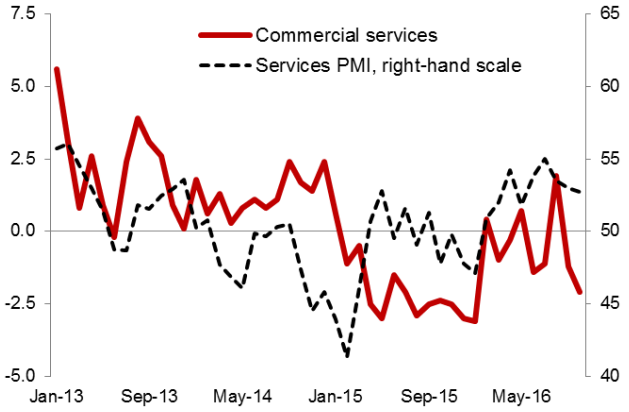
[8] The graph is based on physical output indices.

October. This effect may partially explain the acceleration in the decline of sales seen in October on last year. The observed change in seasonal fluctuations in retail sales is responsible for a drop in seasonally adjusted data sharper than that in actual data.

October saw a drop in the volumes of commercial services (tentative estimates put this contraction at -2.1% YoY). Back in late 2015, no surges of any significance were seen in the behaviour of this indicator, which is why we attribute some of the slowdown to the base effect. Contraction occurred amid a slight decline in PMI, which nevertheless showed expansion in commercial services (Figure 15).

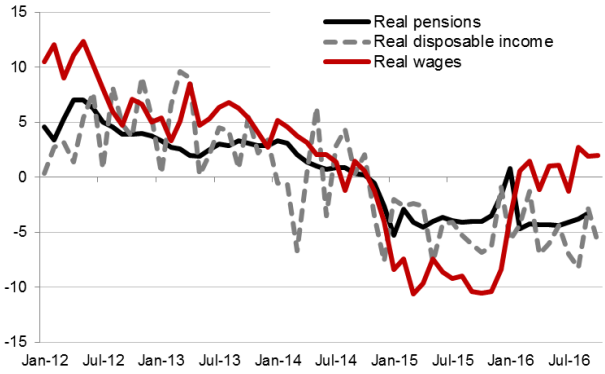
Weaker domestic demand came with growing real wages (which rose 2.0% YoY on 1.9% YoY growth seen a month ago) and the positive effect from consumer sentiment as regards the current and anticipated financial standing (Figure 16)[9].

Figure 15. Commercial services (% YoY) and services PMI



Sources: Bloomberg Finance L.P., Rosstat, R&F Department calculations.

Figure 16. Real household incomes (% YoY)



Sources: Rosstat, R&F Department calculations.

Polling data, coupled with the moderate advance in real wages of the recent months, give reason to expect that the October drop in sales may not be as sharp as official data suggest. More so, official statistics may well fail to fully reflect the substantial rise in online sales, thereby underestimating the actual purchasing power of the population[10].

For all these data, consumer demand is invariably weak; its recovery may occur at a pace slower than the still uneven recovery in incomes. This is suggested by the persistently high proportion of the population that has to economise. When it comes to additional income, the dominating share of the population prefers to save it up rather than spend on any major purchases[11].

1.2.3. Real wages are still growing

- Seasonally adjusted unemployment is unchanged at 5.5%.

[9] According to inFOM October polls.

[10] According to Assist, a pollster, the monetary amount of Internet payments in 2016 H1 against 2015 H2 was up 12%, while the number of transactions was up 27% despite the mixed trends across segments (calculations are based on 12 million online banking card payments).

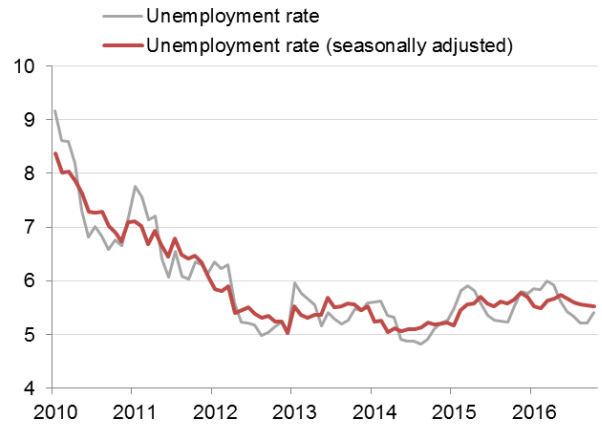
[11] According to inFOM, the proportion of respondents who had to economise over the last three months, stood at 58.6% for October and 66.4% for 2016 Q1. In October, 54% of respondents noted they would rather save up some available cash, while 33% would prefer to make major purchases.

- Nominal growth in wages across economic activities became more consistent.
- Annualised growth in wages stays in positive territory, with the offsetting drop in other types of household incomes.

The rate of unemployment in October was up to 5.4% from 5.2% seen in September. Rising unemployment is due to a contraction in seasonal labour, typical of autumn. Seasonally adjusted rate of unemployment is practically unchanged at 5.5% (Figure 17).

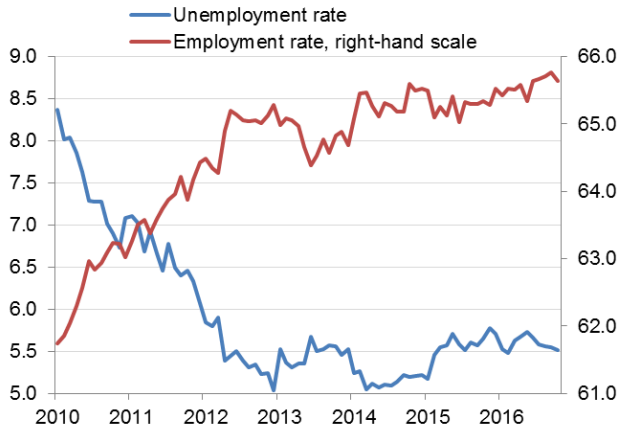
Seasonally adjusted employment level edged down in October (Figure 18). This was caused by the decline in those employed of 966 thousand people in the peak month of August, its highest seasonal change since 2012. The likely cause is the high numbers of seasonal workers hired, rather than the deteriorated economic situation. This is indirectly confirmed by the trends in the numbers of unemployed, which between August and October rose by a mere 85 thousand, which suggests that there is no trend towards contraction in permanent staff. Further details will be available from the labour force study ('Обследование рабочей силы'), a BoR statistical bulletin due late November, which will enable more insights into the subject.

Figure 17. Unemployment rate, %



Sources: Rosstat, R&F Department calculations.

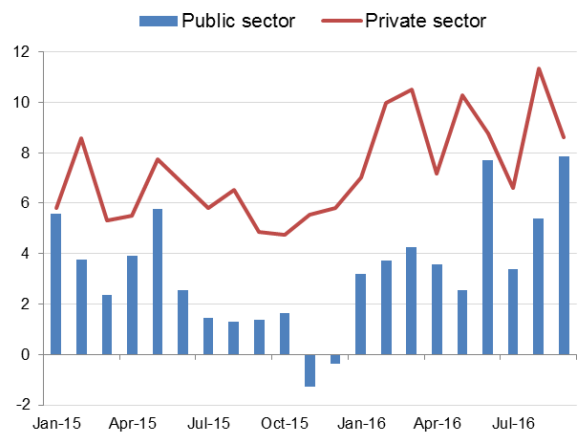
Figure 18. Unemployment and employment rate (seasonally adjusted), %



Sources: Rosstat, R&F Department calculations.

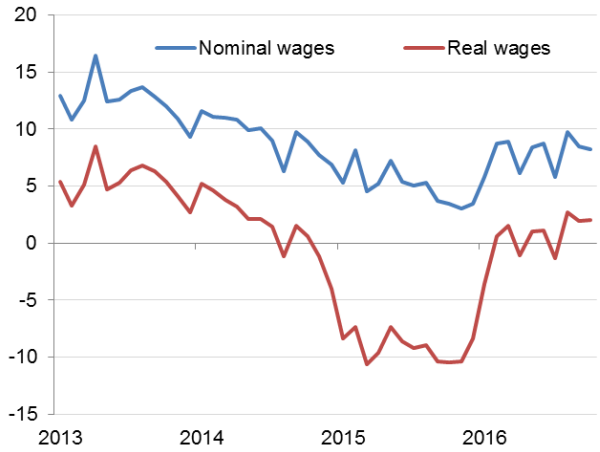
The pace of nominal wage growth in October was 8.2%, which is slightly down on the previous month (Figure 20). Rosstat revised the September paces of nominal wage growth downwards from 9.4% to 8.5% YoY and those of real wage growth from 2.8% to 1.9% YoY. In October, as inflation slowed down further, the rise in real wages edged up to 2.0% YoY. While the paces of real wage growth stabilised, the ongoing decline in households' other type of income is currently sufficient to set off inflation risks.

Figure 19. Wage index across sectors, % YoY



Sources: Rosstat, R&F Department calculations.

Figure 20. Wage dynamics, % YoY



Source: Rosstat

The sectoral wage data released in September suggest two conclusions. *First*, wage growth became more homogeneous, in a sign that the wage review, understood to be compensation for the sharp drop in real incomes in 2015, is gradually drawing to a close. *Second*, according to our estimates, the growth of public sector salaries[12] accelerated in September to 8.14% YoY (Figure 19). According to the economic classification of budget expenditures, as much as 293 billion rubles were spent on labour compensation in September this year, while this amount was 265 billion rubles for the previous year and 274 billion rubles for 2014. As compared to 2014, the growth in costs of labour compensation in September rose only 7%[13]. In general, the accrued growth in labour compensation in the budget system for the first 9 months of this year totalled 4% YoY. Annual growth in these costs is unlikely to exceed this figure, which is why the September acceleration is set to be temporary.

1.2.4. The ongoing recovery in imports beats expectations

- Imports are recovering strongly, on the back of rising investment imports…
- related to, majorly, procurement of mechanical equipment.
- This rise in imports has become steady and may suggest an improvement in investment demand.
- Exports turn in weaker data compared to previous months.
- In non-commodity exports, a rise is seen in food products, timber and construction materials.

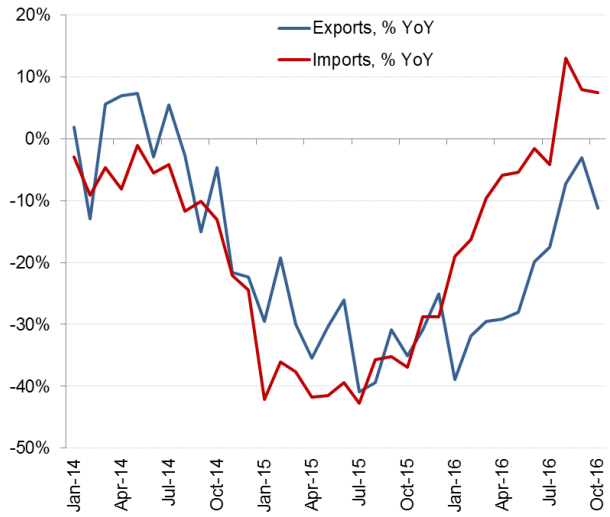
According to Bank of Russia data, imports continued to expand in October, while exports were underperforming. This puts pressure on trade balance surplus as its decline is ongoing.

[12] The public sector is understood to include public administration, military security, healthcare, social services and education.
[13] Cf. the decline of 2.3% in 2015 on 2014.

Of note, the advance of non-energy exports is only fragmentary. Of core non-energy products, expansion was seen in exports of food products, timber and construction materials. A substantial contribution to the exports is made by cereals, mainly on the back of the good crops.

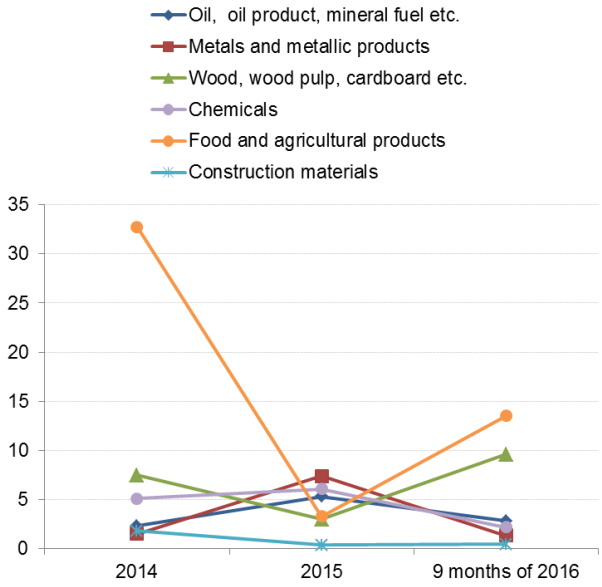
The pickup in imports is meanwhile strong enough. Imports for the first ten months of 2016 dropped only 2.8% YoY. In particular, the October growth in imports was ongoing, albeit at lower rates than those in the last two months. It slowed down to 7.5% YoY on 7.9% YoY in September and 13.0% YoY in August. MoM rates of import growth were also more modest. Seasonally adjusted statistical data also bear out this trend. Nevertheless, even taking into account this slowdown in its growth rates, the current recovery in imports beats initial estimates for it.

Figure 21. Export and import growth, USD, (% YoY)



Sources: Bank of Russia, R&F Department calculations.

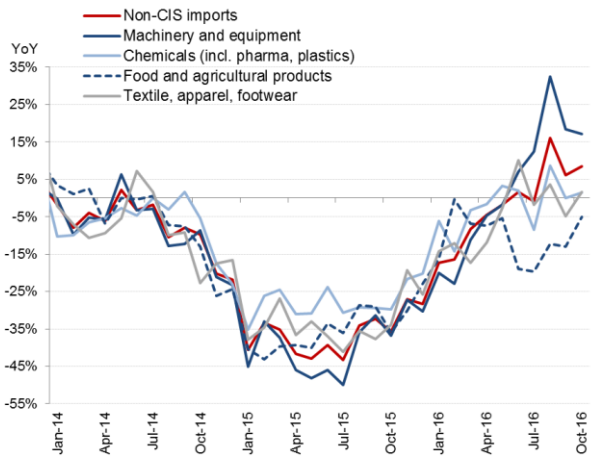
Figure 22. Core exports, physical volumes and growth rates (% YoY)



** For 2016, the values of growth paces are given for the first nine months of 2016 against the first nine months of 2015.*
Sources: Federal Customs Service, R&F Department calculations.

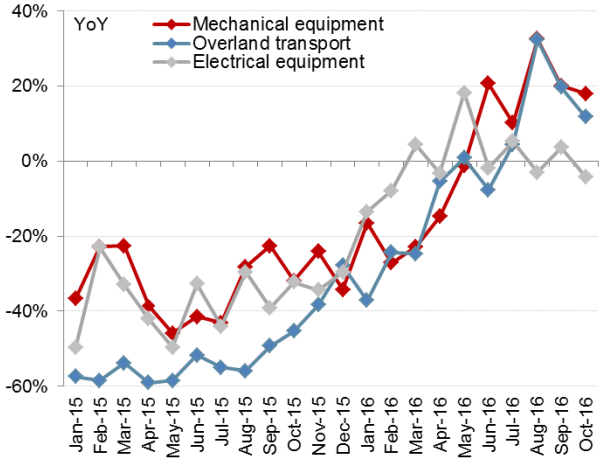
The overall positive trend in imports stems from fairly strong growth in imports of machinery and equipment, double-digit in YoY values since July 2016. Imports of other product categories, albeit in positive territory, still post weak growth. In individual investment import items, the strongest and most steady trend is observed in imports of mechanical equipment. It is important to note here that this is the core category of investment imports (approx. 50% of total amount).

Figure 23. Import component growth rates, non-CIS imports, USD (% YoY)



Sources: Federal Customs Service, R&F Department calculations.

Figure 24. Growth rates of investment import components, USD (% YoY)

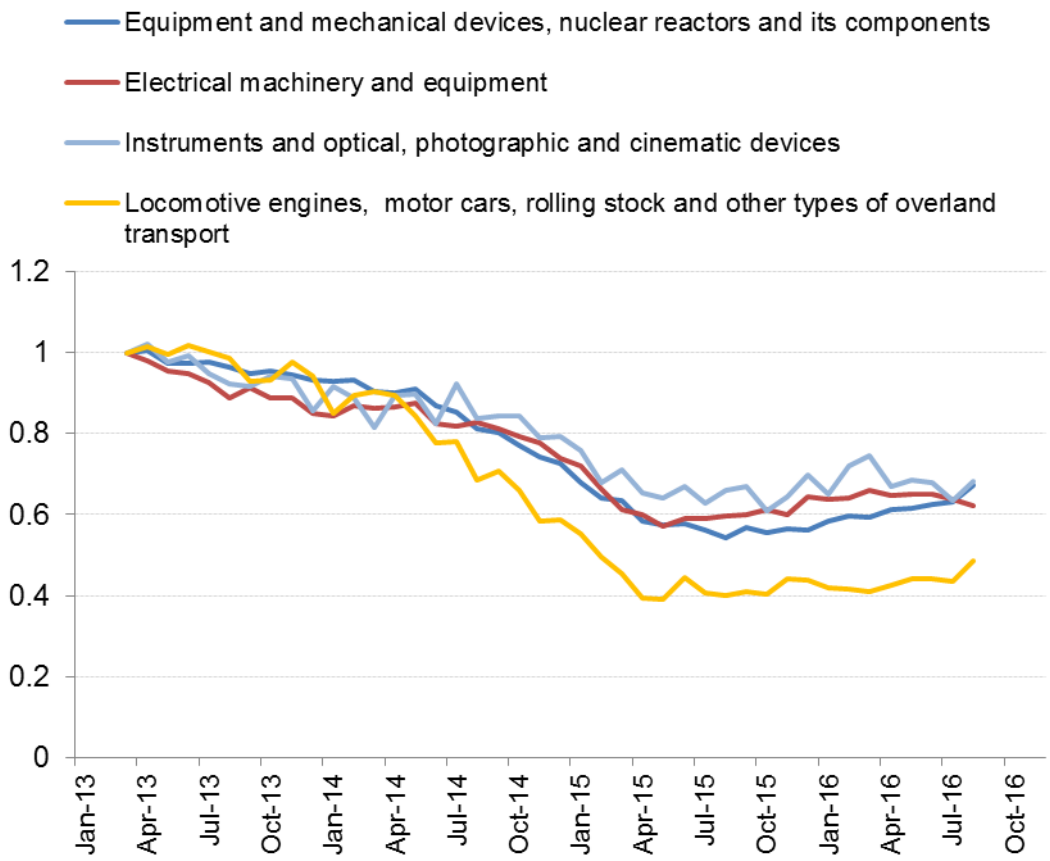


Sources: Federal Customs Service, R&F Department calculations.

Investment usually recovers once there is a rise in imports of mechanical equipment; a continued trend growth here suggests improved investment activity. Although the current recovery in investment imports has been quite sustainable, this trend has yet to become fully reflective in the overall investment indicator. It is also important to note that the rise in investment imports of the recent months has outpaced the expansion in consumer imports.

Consumer imports turn in positive data, as seen in food imports. A marked recovery finds its way in imports of fruit, meat and fish products. Non-food imports are meanwhile stagnating. No noticeable improvement is seen in either imports of fast moving consumer goods (detergents, cleaning products, cosmetics, etc.) or imports of clothes and footwear. This trend fails to support the assumption that consumer activity is on the rise.

Figure 25. Core components of imports of machinery and equipment, physical volumes, accrued, seasonally adjusted (pp)



Sources: Federal Customs Service, R&F Department calculations.

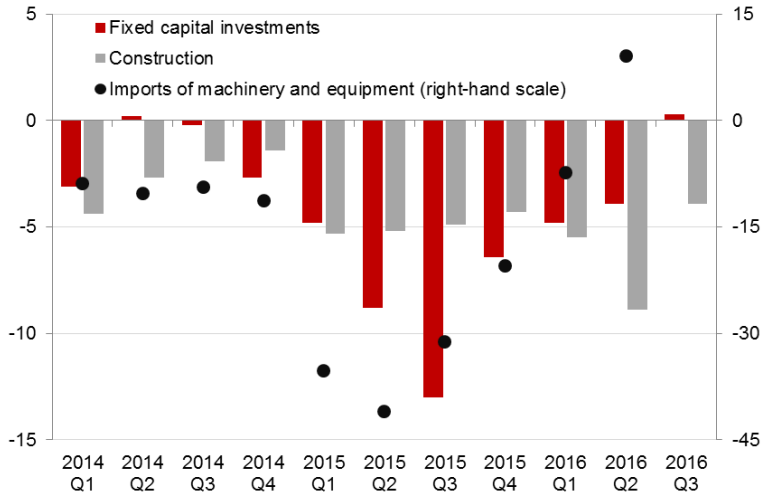
1.2.5. Investment is in positive territory, shored up by imports

- Q3 fixed capital investment rose 0.3% YoY on the back of recovering imports of machinery and equipment and 2015 Q3 low base effect.
- The sharp slowdown in the rates of decline in constriction in October suggests that investment is set to post positive data again in the fourth quarter.

Rosstat's preliminary data suggest that fixed capital investment for January to September 2016 was down 2.3% against the same period of 2015. YoY growth in 2016Q3 was 0.3% (Figure 26). This is the first time annualised investment rose in the period since 2014 Q2. Importantly, this was largely a technical rise driven by the low base effect of 2015 Q3.

Apparently, this growth was driven by investment in machinery and equipment. Q3 construction, which accounts for over 50% of investment, remained in negative territory, with growth seen in other components. Aggregated data for Q3 physical volumes of imports of machinery and equipment have yet to be released; however, the trend seen in some of their components points to some acceleration in annual growth. It appears that investment in machinery and equipment, mainly on the back of imports, was a key driver for improved investment in the third quarter.

Figure 26. Fixed capital investment, % YoY



** Aggregated data for Q3 physical volumes of exports of machinery and equipment are yet to be published.*

Sources: Rosstat, CEIC, R&F Department calculations.

Rosstat registered a sharp slowdown in the annual rates of decline in construction to 0.8% YoY from 6.8% YoY in September. Given that most construction falls on the fourth quarter, if the October trend[14] continues, fixed capital investment may post annualised growth for the second month in a row.

[14] Under our estimates. MoM growth, once seasonally adjusted, 1,1%.

1.3. Global economy, financial and commodity markets

1.3.1. The US Fed may speed up its monetary policy normalisation

- The ongoing improvements in the US economy have enhanced the likelihood of a Fed rate hike in December to 100%.
- Should the president-elect deliver on his campaign promises, inflation may accelerate and the US Fed will have to speed up the normalisation of its monetary policy in the forthcoming years.
- The ECB is expected to extend its quantitative easing programme. In addition, the regulator is insisting on fiscal policy easing.
- The Chinese authorities launched measures to counter overheating in the real estate market. It may have a negative impact on economic growth in the next quarters.

The ongoing growth of the US economy and the improved labour market conditions are sufficient factors for the US Fed to raise its policy rate in December. If the newly elected president delivers on his campaign promises, budget deficit may start growing. Given the nearly full employment in the US economy, it may accelerate inflation. In such case, the US Fed will have to speed up the normalisation of its monetary policy in the forthcoming years. The accelerated growth brought about by the stimulus measures adopted earlier this year gave way to suspension in the Chinese economic activity. Measures to counter overheating of the real estate market may have a negative impact on economic growth in the next quarters and ramp up capital outflow.

USA: the US Fed may speed up the normalisation of its monetary policy after Donald Trump has been elected president

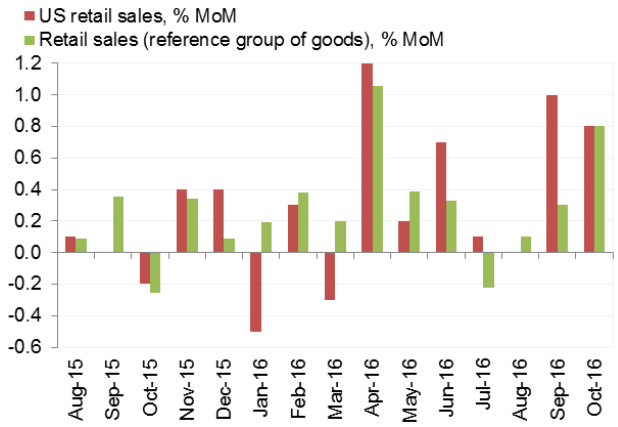
Donald Trump, a republican, won the US presidential elections on 8 November; it came as a surprise to experts. Hillary Clinton won the popular vote, but the indirect elections allowed Mr Trump to gain 290 votes of electors, overpassing the benchmark of 270 votes needed to win the elections. The president-elect is to be inaugurated on 20 January 2017. However, the uncertainty over specific steps and the scope of implementation of the new president's campaign promises will persist for at least several months afterwards.

The Trump administration is widely expected to considerably increase the budget deficit, given his campaign promises to cut corporate taxes, launch large-scale infrastructural projects and pump up military spending. The US economy is largely estimated to be already close to its potential level, and fiscal stimulus will expose both the United States and their trading partners to the risks of overheating and inflation

acceleration. Therefore, the normalisation of the US monetary policy may take a faster path than the market and the US Fed have expected.

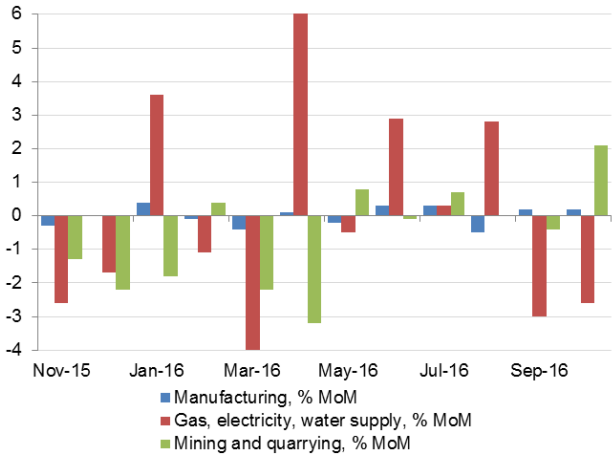
Nevertheless, Janet Yellen, the chair of the US Fed, made it clear in her speech to Congress that the Federal Reserve was not intending to take preventive measures and preferred to be guided by concrete steps president-elect Trump will make. Accordingly, the decision of the December session of the Federal Open Market Committee will be guided by the current estimates of the economic environment. The latest macrostatistics for retail sales (Figure 27), industrial production (Figure 28), durable goods orders and PMI have enhanced confidence that the US economy is doing well. In recent weeks the likelihood of the Fed's rate hike has stood at almost 100%[15].

Figure 27. US retail sales, % MoM (seasonally adjusted)



Source: Bloomberg Finance L.P.

Figure 28. US industrial production, % MoM (seasonally adjusted)



Source: Bloomberg Finance L.P.

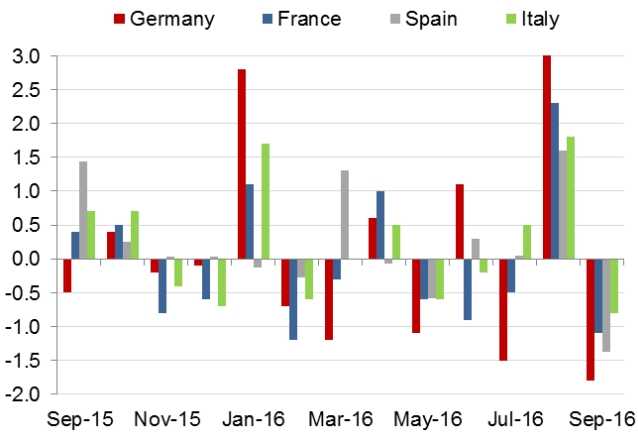
Eurozone: monetary policy is an engine for economic growth

The ECB meeting of 20 October dispelled doubts about the ECB's intention to wind up quantitative easing. In contrast, members of the Executive Board agreed that inflation pressure was yet to be built up and wage growth was sluggish. The statement by Mario Draghi buttressed the need to go on with stimulus measures. He said that the pace of economic growth in the eurozone is insufficient to build up inflation pressure. At the same time, economic growth is largely underpinned by monetary policy measures. Therefore, market participants expect that the ECB will expand its asset purchase programme into the next six months (until September 2017) at its December meeting.

The statistics published last week also points to unsustainable growth. Industrial production shrank by 0.8% MoM in September. The breakdown showed reduction in most countries and almost every sector. Germany saw a drop of 1.9% MoM while in Italy it stood at 0.8% MoM (Figure 29).

[15] According to futures dynamics.

Figure 29. Industrial production in the eurozone, % MoM (seasonally adjusted)



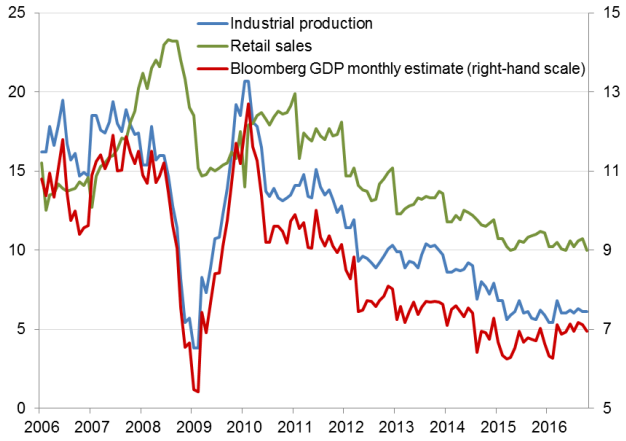
Source: Bloomberg Finance L.P.

China: the strong performance in October is still below expectations

Nearly all the October data on the Chinese economy failed to meet expectations. Industrial production remained at the September level of 6.1% YoY (Figure 30). Retail sales showed the year's lowest growth of 10.0% YoY (10.7% in September). The latter results from the high comparison base in October 2015, when sales of economy cars surged following a sales tax cut. Growth in fixed capital investments has slowed to 8.8% YoY (9.0% in September) and holds at this level only due to the ongoing intensive growth of private investments in real estate (Figure 31). In its turn, it is supported by sustainably high growth in lending (15.5% YoY), which has been preventing a slowdown in household demand for mortgage loans in recent months (Figure 32).

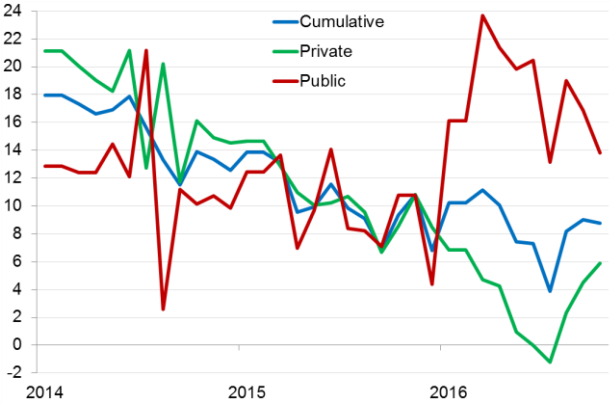
The Chinese authorities continue to impose restrictive measures in real estate to slow down its growth and weaken lending activity. The Financial Times reports that after having tightened the conditions of mortgage lending to households, the authorities began to impose restrictions on lending to developers wishing to purchase land plots for construction. Debt-laden developers often win tenders to buy land plots. The measures aimed at cooling the real estate market may slow down the growth rate of the Chinese economy and trigger the outflow of private capital, which had until then been invested in real estate.

Figure 30. GDP growth, industrial production and retail sales, % YoY



Source: Bloomberg Finance L.P.

Figure 31. Fixed capital investments by property, % YoY



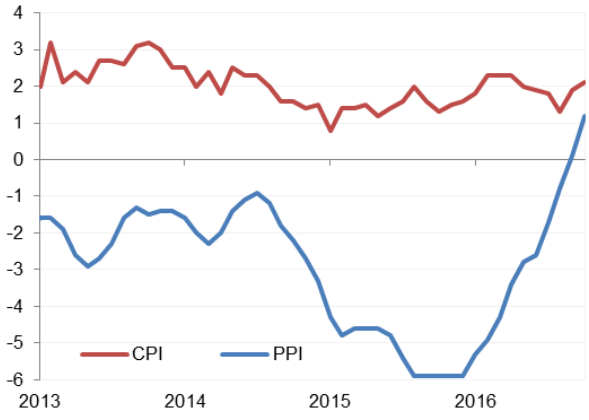
Sources: Bloomberg Finance L.P., R&F Department calculations.

Seasonally adjusted indicators of foreign trade perform sustainably. Imports are recovering following a rebound in prices for goods and metals. Exports are slowing down due to a slack external demand in transition economies resulting, among other things, from a shift in demand towards other Asian countries.

Figure 32. Debt financing, % YoY

Sources: Bloomberg Finance L.P., R&F Department calculations.

Figure 33. Producer and consumer price indices in China, % YoY



Sources: Bloomberg Finance L.P., R&F Department calculations.

Bloomberg estimates that GDP growth in China continued to slow down in October to 7.0% YoY against 7.1% and 7.2% YoY in September and August respectively (. Worsened dynamics of macroindicators come slightly against PMI growth observed for the second month in a row.

Producer price index kept recovering to 1.2% YoY in October (0.1% YoY in September) following goods and metal price growth (Figure 33). Consumer price index rose to 2.1% YoY in October (1.9% in September) as prices for vegetables grew faster and non-food inflation went up. Consumer prices may continue to grow in the months to come,

triggered by producer price dynamics. However, inflation acceleration will be tamed by relatively low growth in monetary aggregate M2 and an increase in production of food products, primarily pork.

1.3.2. The outcome of the US presidential elections determined global market performance in November

- Expectations of faster normalisation of the US Fed's monetary policy and its divergence from the policies of other major central banks resulted in higher yields on government loans and considerable appreciation of the US dollar.
- Significant growth of the dollar exchange rate against emerging market currencies and the resumed capital outflow may push central banks to tighten their monetary policies.
- After having plunged temporarily in early November, short-term money market rates have approximated the Bank of Russia key rate.

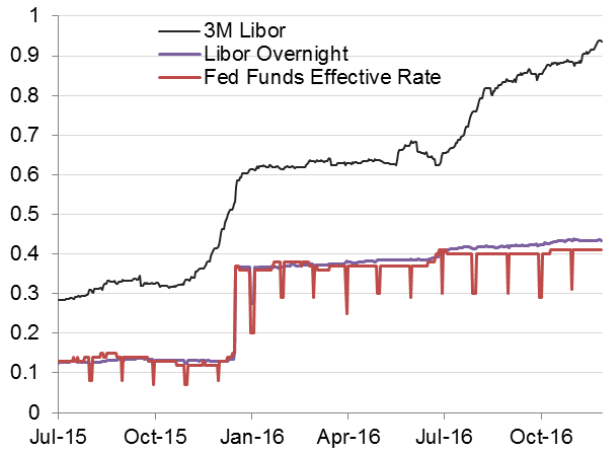
Global markets

The outcome of the US presidential elections became the key factor behind the performance of global financial markets in November. Market participants promptly revised their long-term expectations of inflation dynamics and the related rate path due to the highly probable implementation of the economic programme of the new president. US government bond yields soared in this environment, triggering a hike in yields on government bonds of other advanced economies (Figure 35). As a result, the spread between 10-year US and German bonds has reached its maximum level since 1989. On one hand, higher bond yields in Europe help the ECB tackle insufficiency of assets available for purchase. On the other hand, it undermines the policy's efficiency given there are no signs of inflation acceleration.

Investors downgraded the bond market from a top pick to an outsider in just a few days. Growth of the basic rate of return in advanced economies and possible negative implications of the new US president's policy for growth in emerging markets triggered a sell-out in all market segments. Yields on government bonds of developing countries grew in both local and foreign currency; the currencies of these states depreciated considerably against the US dollar.

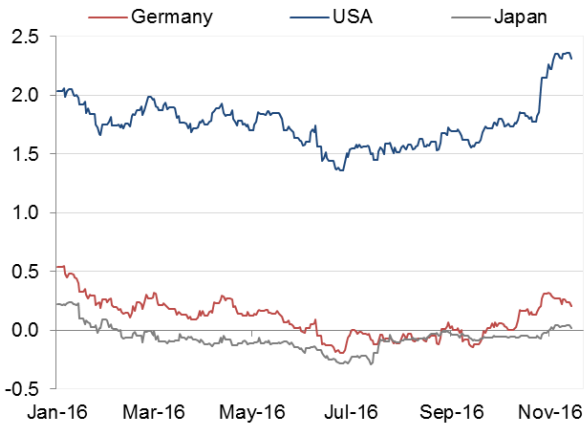
While the bond market dived, the equity market only profited from Mr Trump's plans and revisions of long-term expectations. The planned corporate profit tax cut will boost the disposable income of companies, while higher inflation expectations and long-term rates have already brought about growth in banking sector equities.

Figure 34. US dollar LIBOR, %



Source: Bloomberg Finance L.P.

Figure 35. 10-year bond yield, advanced economies, %

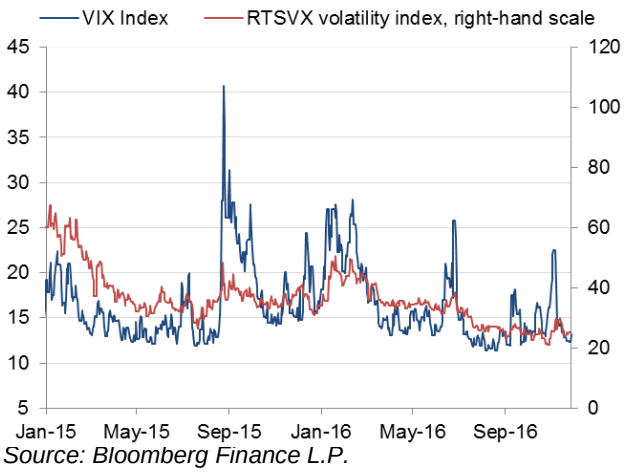


Source: Bloomberg Finance L.P.

Markets may currently overestimate the potential discrepancy between the US Fed's monetary policy and that of other central banks. First, fiscal policy easing in the US may be limited by the risk of the rapid growth of public debt. Debt accumulation along with a surge in yields may result in higher-than-anticipated growth in the cost of its servicing. That should limit either the appetite for fiscal policy easing or capabilities for tightening monetary policy. Second, the US Fed should consider the situation in the global economy, because a considerable rate hike may have unfavorable repercussions for both economic performance and financial stability, especially in emerging markets.

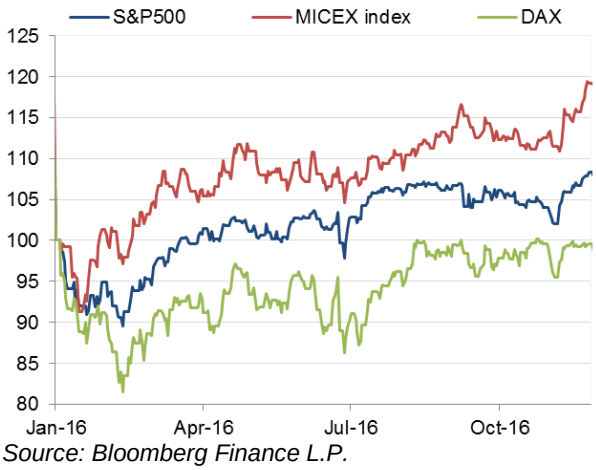
Depreciation of emerging markets currencies will bring most risks to the countries, which accumulated large foreign exchange debt during the period of low rates. In such case, national-currency-denominated debt burden goes up, which is particularly tangible for borrowers with a currency mismatch. Higher debt burden coupled with yield growth and capital outflow, which hamper refinancing, may trigger higher credit risks of borrowers. Currency depreciation triggered by higher import prices may also speed up inflation and exert permanent upward pressure on inflation expectations.

Figure 36. VIX index (S&P500) RTS volatility index (RTSVX)



Source: Bloomberg Finance L.P.

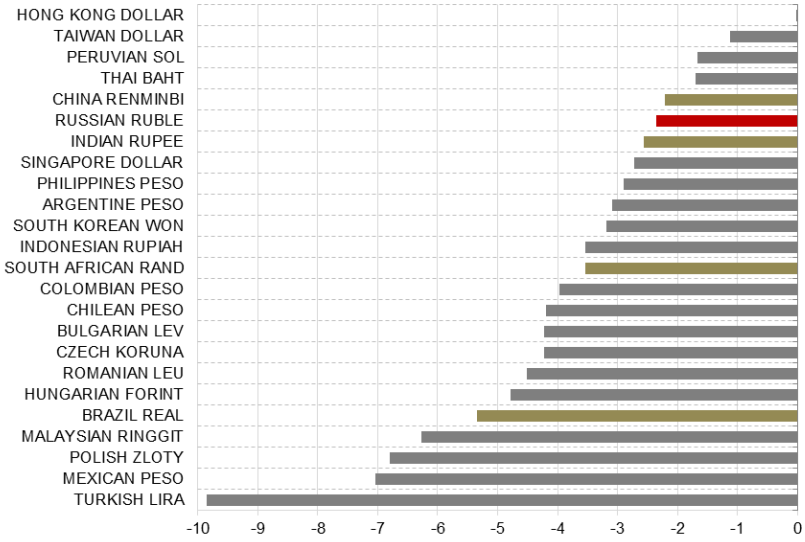
Figure 37. Local currency equity index, 1 January 2016 = 100



Source: Bloomberg Finance L.P.

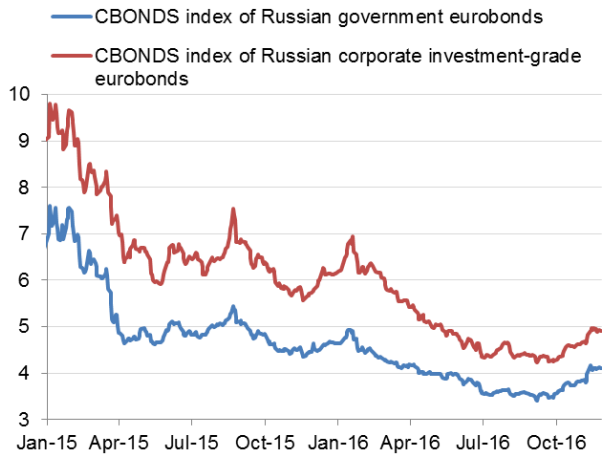
Central banks of certain developing countries may tighten their monetary policies if the above risks begin to grow. For instance, the Central Bank of the Republic of Turkey raised its policy rate by 50 bp to 8% in November, for the first time in three years, to check lira weakening. Many market participants expect other hikes to come. Turkey's gross external debt exceeds $420 billion[16], making the country particularly vulnerable to the depreciation of the national currency. The Bank of Mexico is also expected to raise its policy rate. The peso and the lira were the most depreciated emerging market currencies in November (Figure 38).

Figure 38. Exchange rate of emerging market currencies against the US dollar in 1-25 November, %



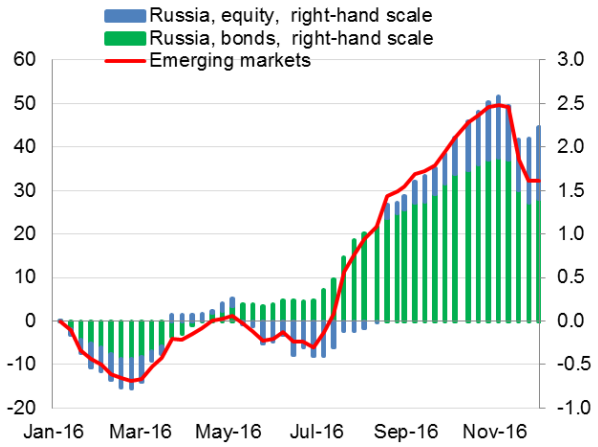
Source: Bloomberg Finance L.P.

Figure 39. Russian Eurobond yields, %



Source: Cbonds.

Figure 40. Cash inflows to emerging markets and Russia, $ billion, year-to-date



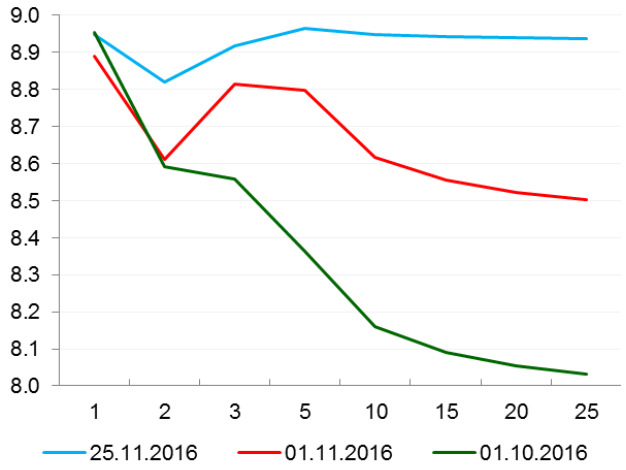
Source: EPFR.

[16] Given US dollar-denominated GDP of about $720 billion in 2015.

Russian markets

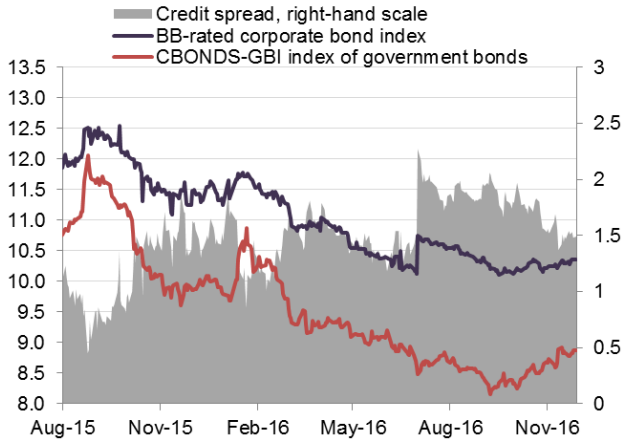
Global markets determined the dynamics of Russian financial markets. Russian assets performed better than the average emerging market data. That was partially explained by the oil price growth in the second half of the month in the run-up to the OPEC meeting. As a result, the ruble depreciated against the US dollar by less than 2.5% in 1-25 November to become one of the most stable emerging market currencies.

Figure 41. OFZ yield curve, %



Source: Moscow Exchange.

Figure 42. Ruble bond yield, %



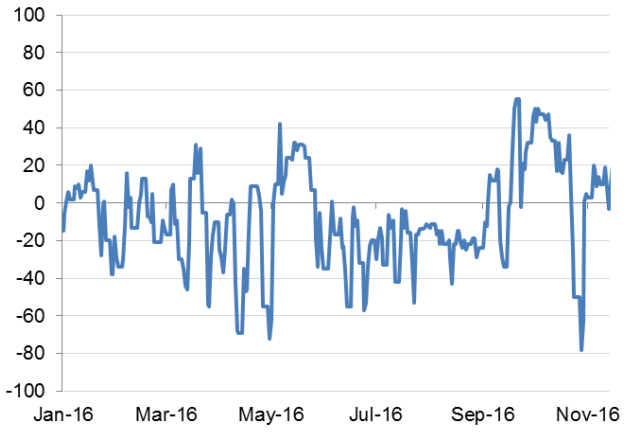
Source: Cbonds.

OFZ yields perform better than average government bonds of other emerging markets. OFZ yields grew predominantly at the long end of the curve; this allowed a slight upward slope for the first time since February (Figure 41). The shape of the curve changed considerably in the past two months, partially as a result of Bank of Russia Board meetings in September and October. However, long-term yields grew mostly due to the negative external dynamics.

In late November, the MICEX index hit another record as the Brent crude price approached $50 a barrel at the beginning of the week. Cash inflow to Russian equity funds amid outflow from funds of other emerging markets boosted the equity market (Figure 40).

Money market rates fell to 9.5% early in the month, i.e. 50 bp below the Bank of Russia key rate. The spread between RUONIA and the key rate was last in negative territory in early October. After that, the situation normalised as the limits for the Bank of Russia's one-week deposit auctions went up and overnight deposit auctions came in handy to absorb liquidity under fine-tuning operations. The tax period falling on the end of the month pushed the rates slightly above the key rate. Nevertheless, that did not have any considerable impact on liquidity as banks' net liquidity position suggests (Figure 44). Banks' debt to the Bank of Russia has hardly changed over the past two months.

Figure 43. Spread between RUONIA and BoR key rate, bp



Sources: Bank of Russia, R&F Department calculations.

Figure 44. Banks' net liquid position to BoR, billion rubles

Sources: Bank of Russia, R&F Department calculations.

1.3.3. Commodity markets: OPEC member states have managed to reach an agreement

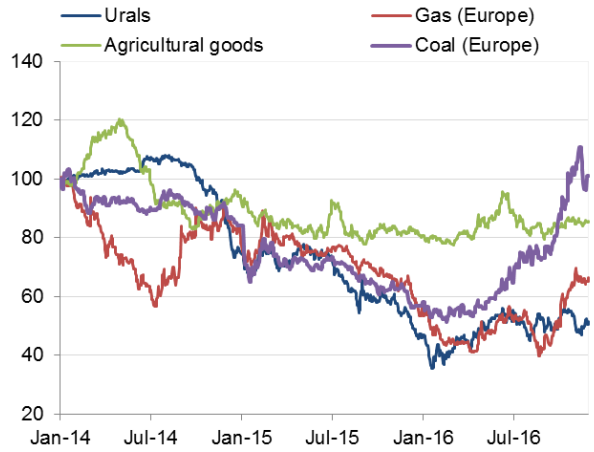
- OPEC member states have agreed on quotas for oil production cuts, which will allow market equilibrium.
- Nevertheless, uncertainty persists over their commitment to the agreement and the response in non-member countries, primarily US shale oil producers.

Prices for most commodities were slightly down in November. It may be attributed to the appreciation of the US dollar, after Donald Trump won presidency and expectations of accelerated rate hike by the US Fed gained ground (.

Prices for metals other than gold went up (some metals, like copper, showed a sizeable rise in prices) on the back of market participants' expectations of higher demand due to, among other things, Mr Trump's campaign promises to increase infrastructure spending (. The price growth was partially triggered by speculative motives. They forced the Shanghai Futures Exchange, the Dalian Commodity Exchange and the Guangzhou Commodity Exchange to toughen conditions of tender (to raise the commission and to introduce targeted limits for individual trading participants). Gold prices went down as China cut imports to tackle the capital outflow.

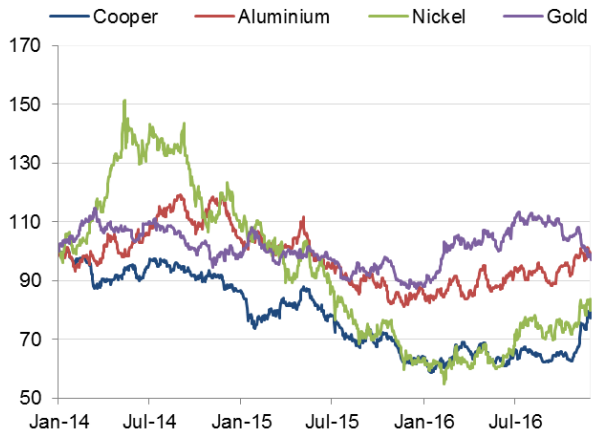
Oil prices were driven by the potential OPEC agreement on quotas for oil production cut. After a drop in mid-November, the prices grew by 5% as of the month-end. As a result, the Bloomberg Commodity Index added 1% in November.

Figure 45. Commodity prices (January 2014 = 100)



Sources: Bloomberg Finance L.P., R&F Department calculations.

Figure 46. Metal prices (January 2014 = 100)



Sources: Bloomberg Finance L.P., R&F Department calculations.

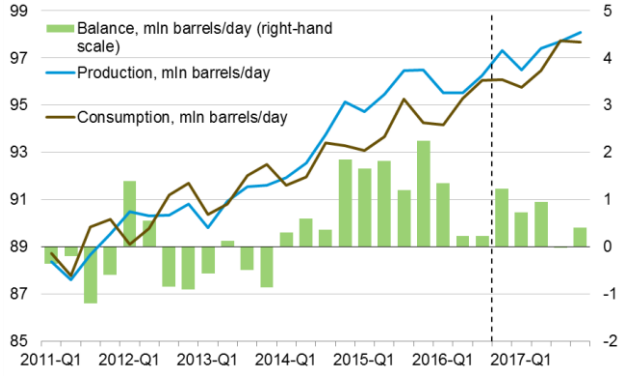
November was marked with the OPEC meeting which distributed production quotas between the member states. Some non-OPEC countries, including Russia, are also supposed to cut their production. Compliance with the production cut agreement should allow the oil market to find its equilibrium as early as the first half of 2017. In the absence of prerequisites for the agreement to be complied with, the International Energy Agency (IEA) and the US Energy Information Agency (EIA) expect that liquid fuel glut will persist throughout 2017, due to, among other things, the ongoing decline in interruptions of oil supply (Figure 48).

Should the agreement on production cut be implemented, shale oil producers are likely to become more active and increase their share of the oil market. WTI futures curve slopes downwards (backwardation[17]) in 2017 Q4 – 2018 Q3, pointing to the active hedging of shale oil producers. Share quotations of most such companies grew by 50% against the backdrop of the OPEC agreement. The Wall Street Journal points that bank lending, formerly one of the key constraints, is expected to become considerably more accessible. Goldman Sachs expects that production of shale oil will increase by 0.8 million barrels a day if the oil price stands at $55 a barrel. Price growth will presumably be checked by a lower growth rate of demand for oil.

In addition, the statistics show that production in OPEC countries often exceeds the established quotas. According to our estimates, between 1999 and 2015, production deviated from the quotas by the average of 1.1 million barrels a day or 4%. It is in line with the agreed-upon production cut. The related uncertainty may drag oil prices down.

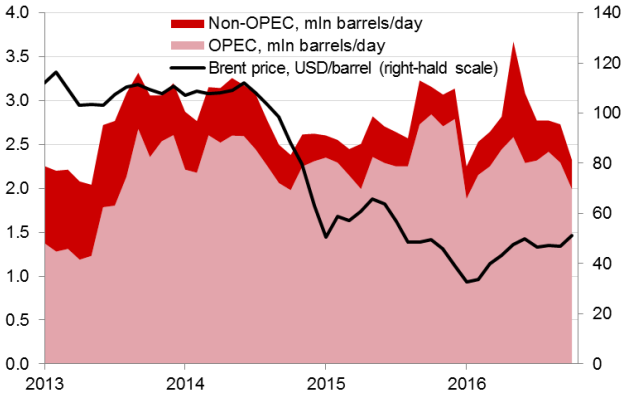
[17] The price of a futures contract is trading below the spot price.

Figure 47. EIA estimates for production, consumption and balance in the global fuel oil market



Source: EIA.

Figure 48. Interruptions in oil production and Brent crude price

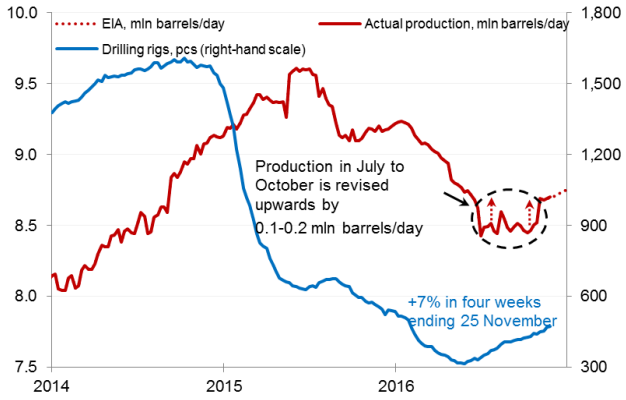


Sources: EIA, Bloomberg Finance L.P.

In November, the EIA expectedly revised its shale oil production forecast: both the forecast oil production and the reporting figures for the last months were revised upwards, while the forecast oil prices remained unchanged. Oil production in November is in line with the EIA forecast (Figure 47). In addition, EIA data show that the use of suspended wells ceased to back up oil production in October (Figure 48), i.e. the dynamics are determined by fundamental factors. Weighted average efficiency of oil production in October went down as drilling activity shifted from the highly productive region (Eagle Ford) to regions with lower productivity. However, drilling rigs are actively gaining in number (Figure 49).

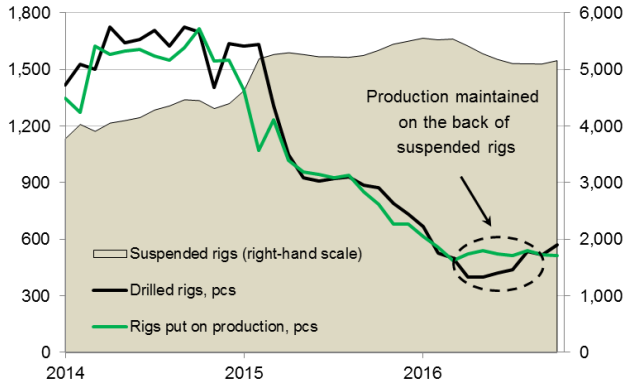
Estimated oil consumption in the US is also expectedly revised upwards: the United States have been the key demand driver in recent months. In November, year-on-year growth in demand for oil slowed down and failed to perform in line with the EIA expectations (Figure 50).

Figure 49. Oil production and active drilling rigs in the US



Sources: EIA, Baker Hughes, R&F Department calculations.

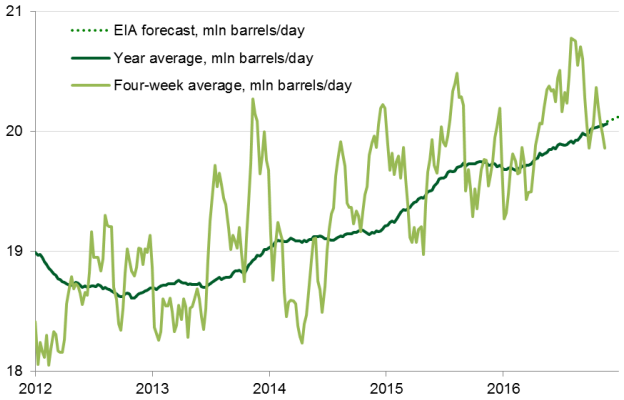
Figure 50. Operating shale rigs (on a monthly basis) and stacked rigs (for the month-end) in the US



Source: EIA.

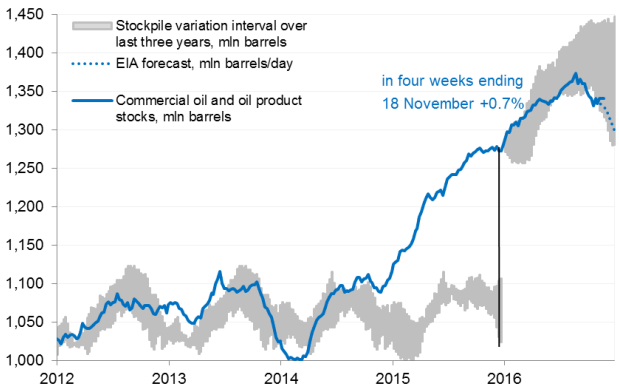
The EIA also pointed to the sub-standard dynamics of oil and oil product stocks: a decline in the US stocks against growing stocks in the OECD countries. Along with other factors (primarily the natural factor) it can be explained by different slopes in Brent and WTI futures curve: a flatter contango for Brent crude stimulates excess stocking outside the US. However, the US continued to accumulate stocks in November. That may be indicative of limited available capacities to store oil outside the US (Figure 52).

Figure 51. US oil consumption



Sources: EIA, R&F Department calculations.

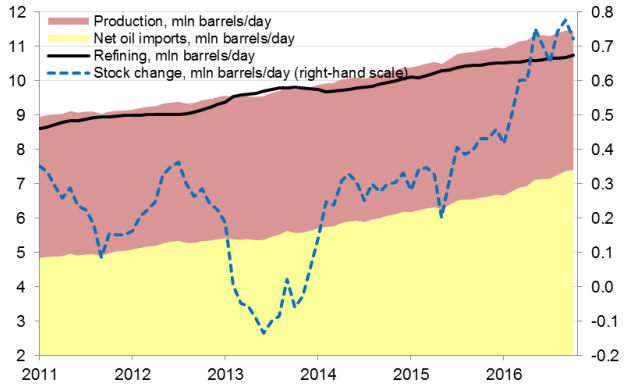
Figure 52. Total US commercial oil and oil product stocks



Sources: EIA, R&F Department calculations.

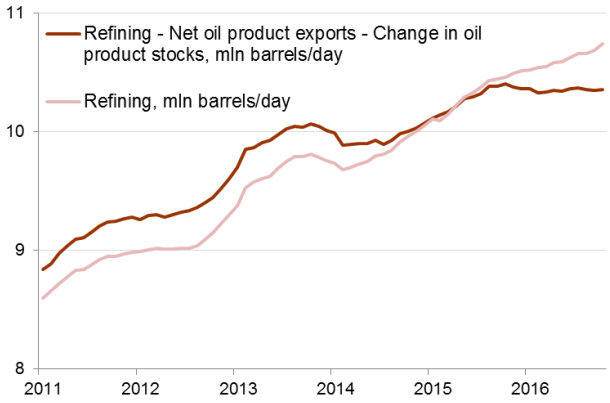
We believe that OPEC presented an optimistic forecast of trends in the liquid fuel market through 2040. OPEC expects oil prices to actively grow by $5 a barrel annually through 2021 and to $155 a barrel by 2040 ($92 a barrel in terms of 2015 prices). At the same time, non-OPEC countries are expected to show slack production dynamics. Shale oil is particularly expected to give a weak response to this price growth: slight growth in supply through 2020 (+0.3 million barrels a day in 2017-2020), moderate growth in the following years with a spike between 2025 and 2030, and the following reverse dynamics. The baseline scenario also provides for progressive growth in demand by approximately 1 million barrels a day annually on the whole forecast horizon. For comparison, the head of Royal Dutch Shell, an oil company, expects global demand for oil to spike in the next five to fifteen years.

Figure 53. Production, net imports, refining and changes in oil stocks in China, 12-month average



Sources: Bloomberg Finance L.P., R&F Department calculations.

Figure 54. Oil refining and consumption in China, 12-month average

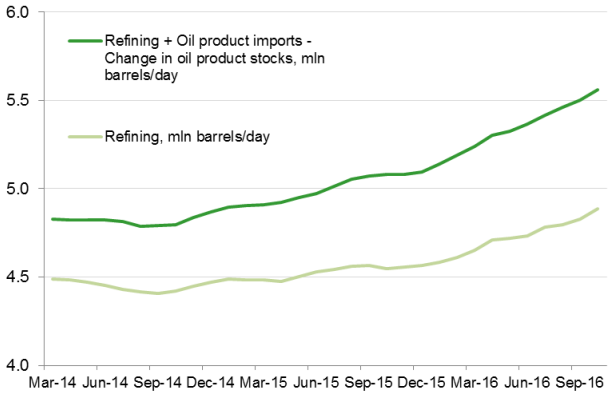


Sources: Bloomberg Finance L.P., Xinhua News Agency, R&F Department calculations.

In China, oil production dropped again (-11.3% YoY) in October. Consumption was higher than in any month of the third quarter and last October (+1.4% YoY). However, growth in net oil imports dropped considerably against the August and September data to stand at +4.3% YoY due to shrinkage in oil stocks, including strategic ones, for the first time since May 2015. Growth in net oil imports in China may continue to slow down before the year is out: SCI International Gao reports that teapot refineries have reached the ceiling in oil imports. It may exert additional pressure on oil prices.

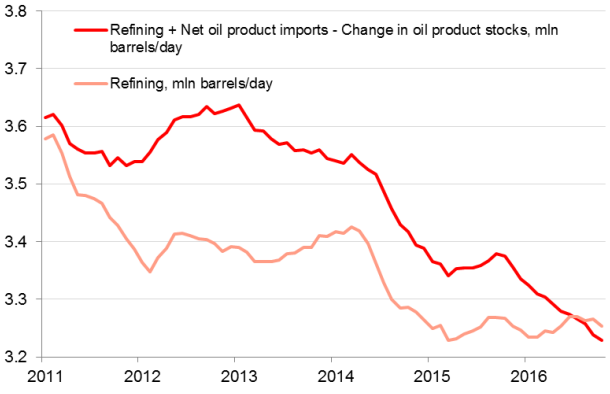
Oil product consumption in India has been growing slower in recent months than in the US. Having said that, India remains the key driver of growth in oil demand thanks to its performance in January-October. In Japan, oil product consumption keeps shrinking, and in September the country became a net oil exporter (Figure 56).

Figure 55. Oil refining and consumption in India, 12-month average



Sources: Bloomberg Finance L.P., R&F Department calculations.

Figure 56. Oil refining and consumption in Japan, 12-month average



Sources: Bloomberg Finance L.P., R&F Department calculations.

2. Outlook: leading indicators

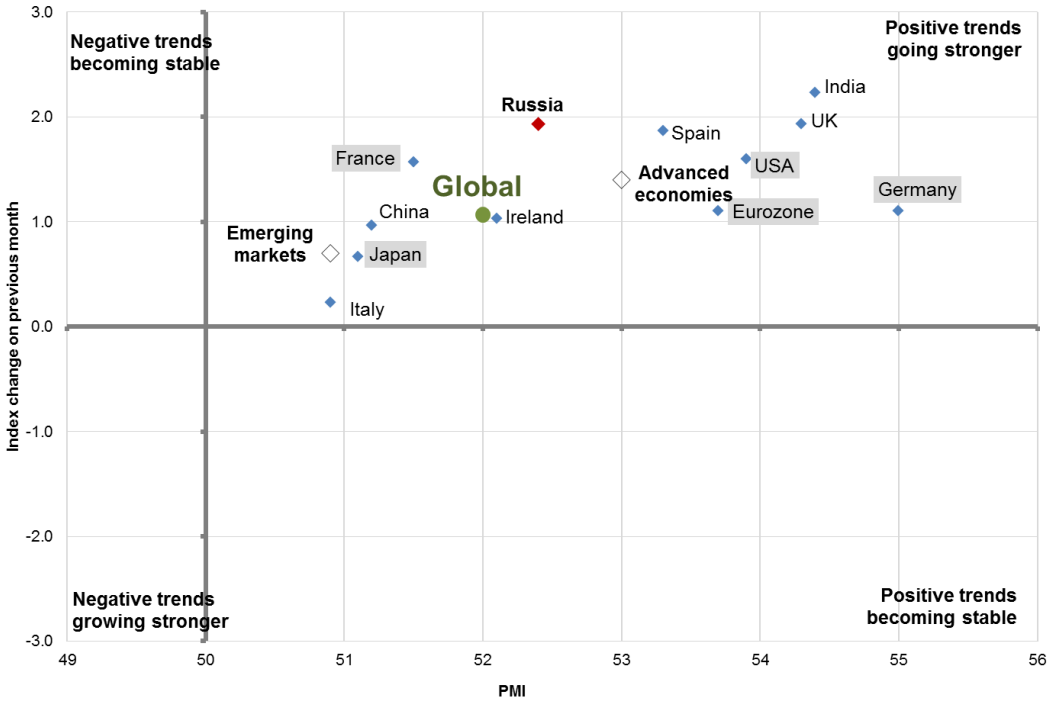
2.1. Global leading indicators

2.1.1. Preliminary PMI in the US and the eurozone signal growth acceleration

Preliminary PMI data in November (Figure 57, highlighted in grey) signal faster growth in business activity in manufacturing sectors both in the US and the eurozone.

The outcome of the US presidential elections did not have any negative impact on the sentiment in industrial production. On the contrary, growth in domestic orders in the US reached its 13-month high in November, and businesses more pronouncedly signalled that they were ready to scale up their activity, employment and procurement.

Figure 57. Manufacturing PMI in November and change against the August-October average



Sources: IHS Markit, Bloomberg Finance L.P.

Preliminary services PMI for the eurozone signals the ongoing improvement in the sector (growth from 52.8 to 54.1). As a result, composite PMI of the eurozone showed the highest growth in business activity in ten months. This is a positive signal, because growth rates, and specifically slower GDP growth in Germany (0.2% QoQ in the third quarter), rose questions regarding the eurozone growth prospects. PMI data and sustainable index growth in Germany promise faster growth in the fourth quarter.

2.2. What do Russian leading indicators suggest?

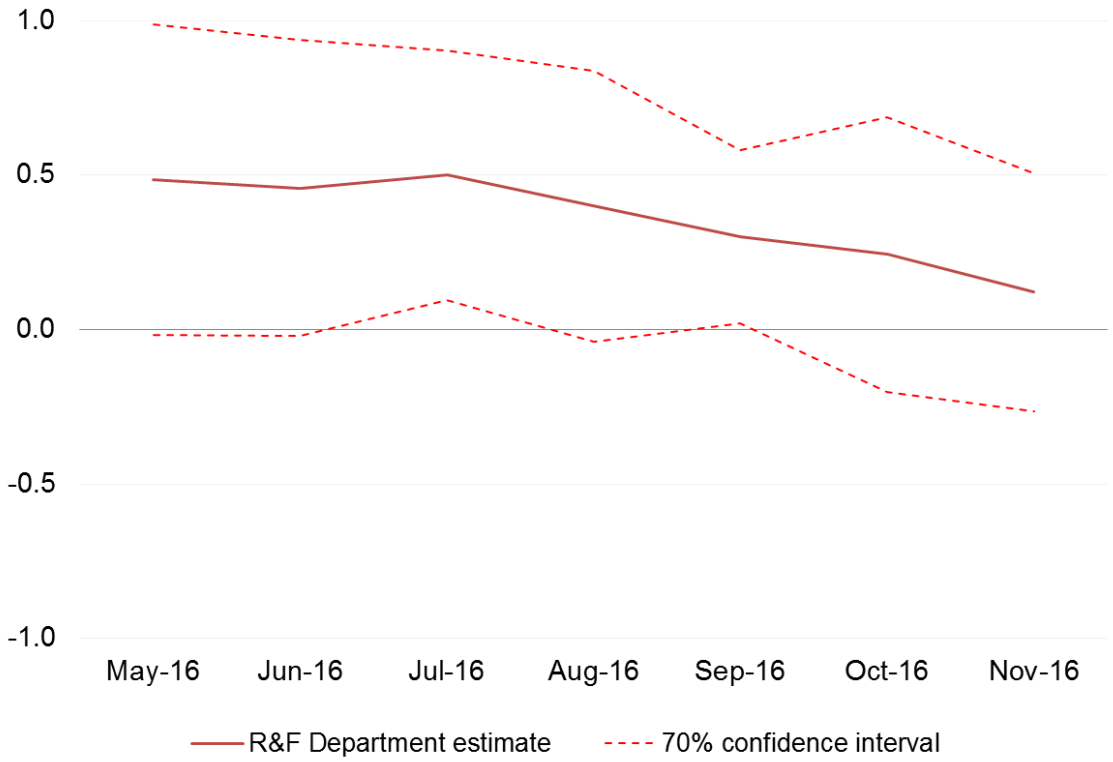
2.2.1. Index GDP estimate still implies growth

- Index GDP estimate for the fourth quarter implies a quarterly growth of 0.1% in October.
- Short-term macroeconomic statistics for September and October, published last week by Rosstat, called for a modest downward revision of index GDP estimate in the fourth quarter.
- Estimated Q4 GDP growth has been revised slightly downwards in the past six months.
- It means that the short-term statistics of recent months are a bit worse compared to the earlier model estimates. The summer data predicted growth of about 0.5% QoQ (seasonally adjusted) in the end of 2016 (Figure 58).

	November 2016	October 2016
	% QoQ	% QoQ
2016 Q4	**0.1**	**0.2-0.3**
2017 Q1	**0.2**	**0.3**
2017 Q2	**0.4**	**–**

- Estimates for the next two quarters suggest that positive GDP dynamics will continue and consolidate. Estimates stand at 0.2% QoQ for 2017 Q1 and 0.4% QoQ for 2017 Q2, seasonally adjusted.
- Our model estimate for 2017 Q2 points to GDP growth of 0.4% QoQ, seasonally adjusted.
- Index GDP estimate for the forthcoming quarters may change considerably as new short-term macroeconomic statistics are published.

Figure 58. Estimate of GDP growth in 2016 Q4, % QoQ



Sources: Rosstat, R&F Department calculations.

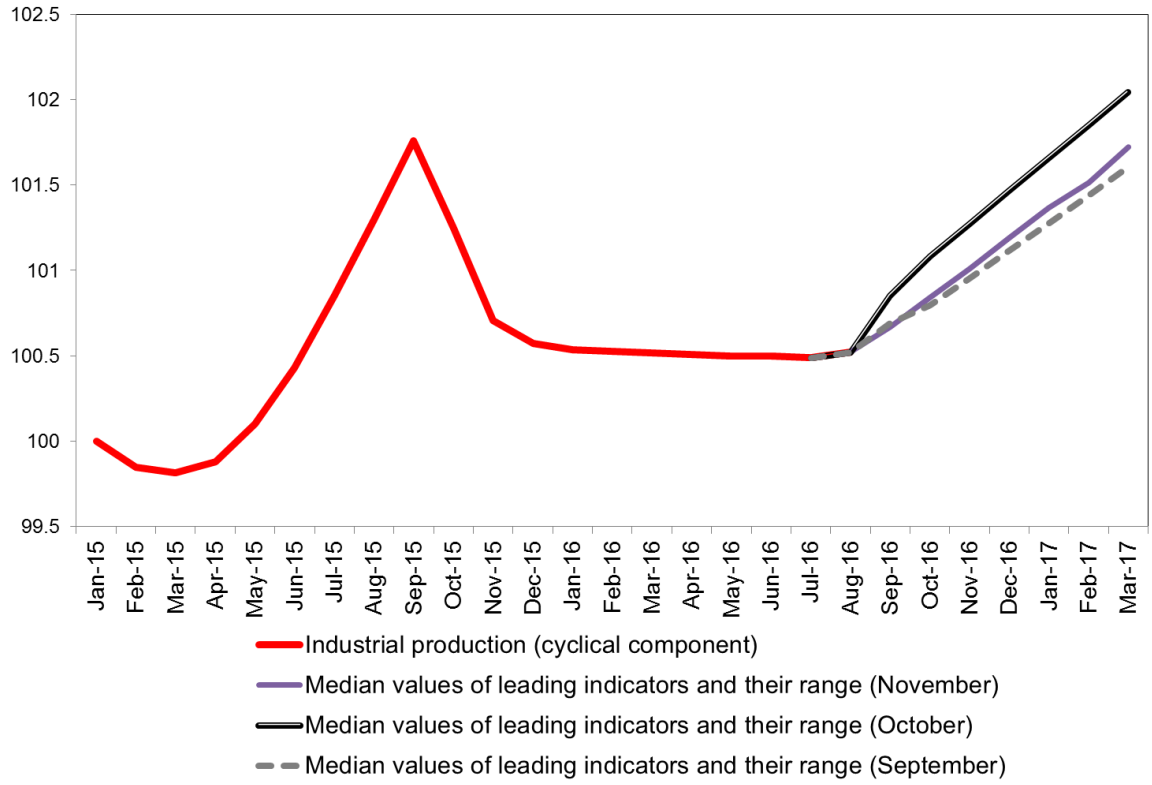
2.2.2. Composite leading business indicator: moderately positive outlook

- The November estimate of the composite leading business indicator, though having deteriorated slightly against the October data, still points to growth in business activity (Figure 59).

- High PMI indices, derived from market survey data, and oil price fluctuations are currently key determinants of the estimate of the cyclical component of industrial production. Therefore, the estimate remains unstable.

- Nevertheless, we still believe that industrial production is very likely to show moderate growth in the forthcoming months.

Figure 59. Cyclical component of industrial production (January 2015 = 100, seasonally adjusted) and leading business index



Sources: Rosstat, HSBC, Bloomberg Finance L.P., R&F Department calculations.

3. In focus. Structural analysis of unemployment in the regions

- Unemployment varies across regions largely due to industry specialisation and development of services in the region.
- It means that the structure of the regional labour market determines the region's response to economic shocks.
- Strong influence of region-specific factors in the labour markets of individual Russian regions constrains the potential impact of monetary and fiscal policy tools aimed at lowering inflation

Unemployment varies considerably across Russian regions. Quite a good national unemployment rate disguises high unemployment in some regions offset by unemployment considerably below the country level in the others. The structural analysis of unemployment would allow a deeper understanding of reasons behind regional disparity and measures to ease tension in the regional and national labour markets.

Agricultural, extractive and agro-industrial regions show the highest average unemployment rate (Figure 60). These regions do not enjoy highly developed market services. Their tertiary sector allows employment of diverse and often unskilled labour force. Average unemployment slightly differs from the national average rate in other regions, which are engaged in manufacturing and enjoy mixed specialisation.

Unemployment varies considerably across regions and shifts towards high values in some groups, predominantly those where market services are underdeveloped. Thus, outsiders posting unemployment that considerably exceeds the country's average, may be found among agrarian-industrial and industrial agricultural regions with underdeveloped tertiary sector, where the group's average unemployment approximates the national average. The group of agricultural regions also demonstrates patchy unemployment. Therefore, we assume that an advanced tertiary sector mitigates unemployment in the region. However, the geographic location and different demographic conditions stand behind such exceptions and turn a region into the outsider.

The borders of local labour markets do not coincide with regional borders. It can be seen on the region maps of overall unemployment and its distribution by type. They show areas of elevated tensions in the labour market in close or neighbouring regions. These areas indicate that the affected regions share similar features determined not only by their industrial specialisation, but also demographic conditions and location.

Regions to be attributed to labour markets with unemployment below the national average are as follows:

– Central and north-western financial and economic centres (Moscow, St Petersburg, the Moscow Region), and neighbouring territories with mixed specialisation;

– Volga regions with mostly mixed specialisation;

– Northern regions of the Urals Federal District focused on fossil fuel production and export (the Yamal-Nenets and the Khanty-Mansi Autonomous Area);

– Coastal regions of the Far East (the Chukotka Autonomous Area, Magadan Region, Kamchatka and the Khabarovsk Territory) focused on production or mixed specialisation.

Problematic regions with above average unemployment are as follows:

– agricultural and agrarian-industrial territories of the Southern and the North Caucasian Federal District;

– most regions of the North-Western Federal District with different specialisation;

– territories of the Siberian Federal District with different specialisation;

– Far Eastern regions (the production-focused Yakutia and the agrarian-industrial Amur Region and Primorye Territory).

In *the Central Federal District,* where most regions enjoy an advanced tertiary sector, both urban and youth unemployment is low. Exceptions are Moscow and the Moscow Region with high youth unemployment.

This is a consequence of polarisation, i.e. population influx to Moscow from neighbouring regions. The Russian capital attracts not only the most active and skilled labour force, but also the youth. Abounding with educational institutions, Moscow (and the neighbouring Moscow Region) records high youth unemployment. Active out-migration registered since early 1990s worsened the quantitative population structure in donor regions by triggering fast changes in the age pattern (demographic aging). It resulted in stagnant unemployment which may challenge individual regions with a loss of professional skills, labour force degradation and poverty concentration in certain social groups.

Some regions of the Central FD already register high unemployment among educated professionals. In the regions neighbouring with Moscow, it results from excessive labour supply driven by migrant workers. In the outermost regions of the Central FD (the Tula, Smolensk, Tver and the Kostroma Regions), low demand for skilled labour force is transforming into stagnant unemployment.

In *the North Western Federal District* (except for St Petersburg, the Leningrad and the Novgorod Regions) unemployment has entrenched at the level above the Russian average. Regions of the North Western FD (other than St Petersburg) have rather mixed industrial specialisation and underdeveloped tertiary sector.

Unemployment is largely of structural nature and results from discrepancy between labour force qualities and industry demand. Unemployment has become stagnant in the Pskov, Novgorod and the Vologda Regions (situated between the two capitals), as well as the Kaliningrad Region and the Republic of Karelia. In the first group that resulted from labour force migration to Moscow and St Petersburg. It is a common problem for the country's two macroregions, the centre and the north. In the Kaliningrad Region, tensions in the labour market arise due to its exclave position. The Republic of Karelia focuses on

production of non-energy raw materials, dominated by woodworking and paper industry, and the labour market of its *monocities* does not offer any alternative jobs.

The North Caucasian Federal District traditionally registers high unemployment. However, actual unemployment may be lowed, because the population of these regions often works off the books. High structural urban unemployment and frictional youth unemployment are the key factors behind tensions in the labour market. High birth rate ensures constant inflow of youth to the labour market. The territory's agricultural focus restricts official job creation, given an underdeveloped tertiary sector (except for the Stavropol Territory).

Unemployment and low concentration of educational institutions result in extensive migration of youth and educated professionals to other Russian regions. Population outflow shifts the region's age pattern upwards and deprives it of a skilled labour force. The remaining population becomes engaged in private subsidiary farming, which prevents stagnant unemployment from spreading across the whole region. Such region-wide unemployment is registered only in individual regions (the Republic of Ingushetia and the Karachay-Cherkess Republic).

Unemployment in *the Southern Federal District* is still exceeding the Russian average rate, though posting better figures better than in the North Caucasian republics. All the regions usually focus on either agriculture or agriculture and industrial production, such profile determines unemployment among their working-age urban population. Some regions (the Republic of Kalmykia and the Krasnodar Territory) record youth unemployment above the Russian average. Unemployment has become stagnant in the Republic of Kalmykia and the Volgograd Region. However, extensive unemployment among vocational school graduates is the key challenge of the regional labour market. This may result from both the massive inflow of youth and skilled professionals from the North Caucasian FD and labour market-side pressure: a university graduate may hold a position which merely requires secondary vocational training.

The Volga Federal District acts as a demographic donor of other regions, notably the Central FD and the Urals FD. The district is represented by regions with mixed specialisations. Five of the 14 regions enjoy a more advanced tertiary sector. These regions border either the Central FD in the west or the Urals FD in the east. Unemployment below the Russian average level in most regions of the district (other than the Perm Territory and the Republic of Bashkortostan with above the average unemployment rate) comes amid serious challenges of the regional labour markets: high unemployment among youth and skilled professionals and stagnant unemployment in the areas bordering Kazakhstan.

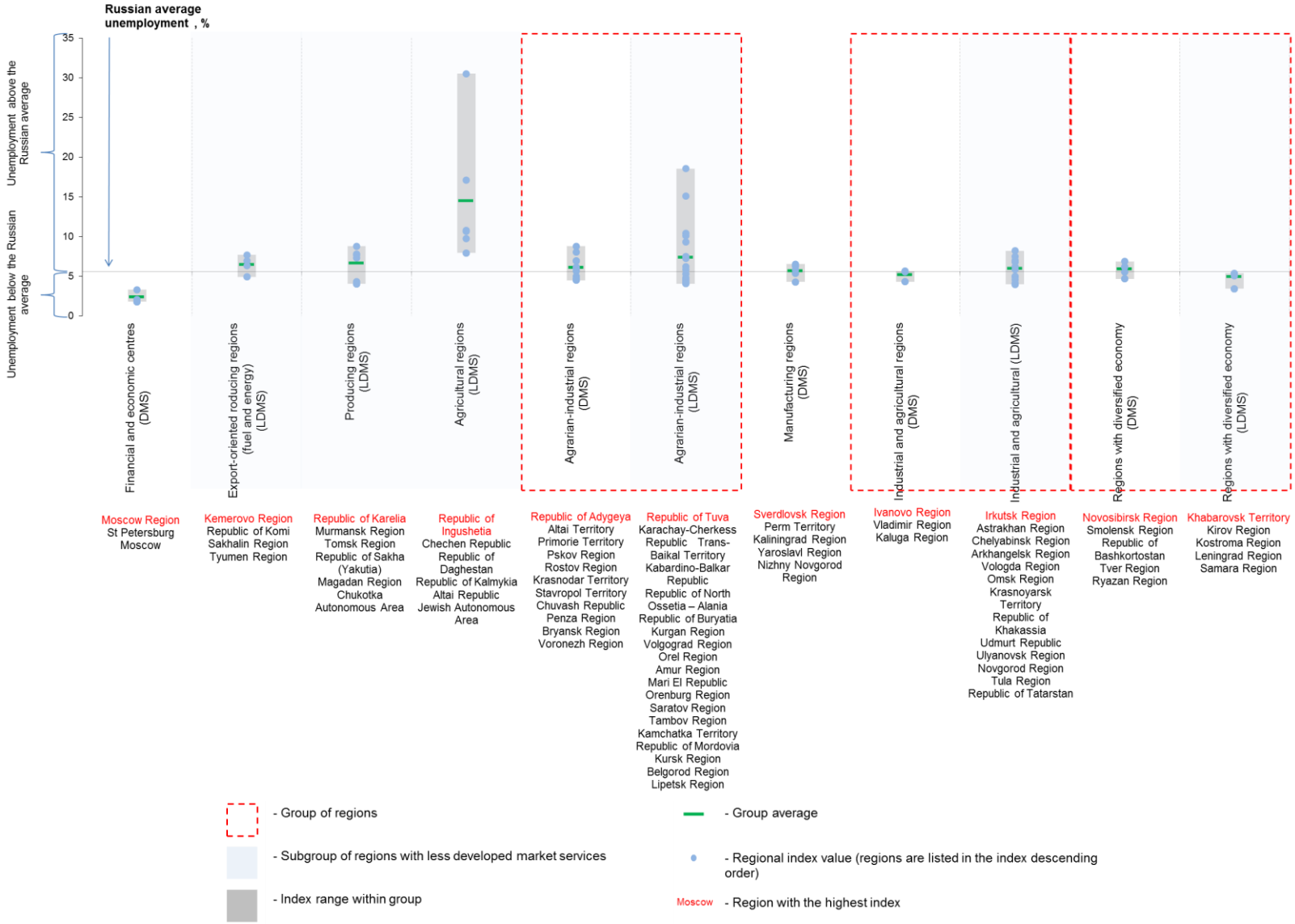
Oil and gas producing regions of *the Urals Federal District* (the Khanty-Mansi and the Yamal-Nenets Autonomous Area) enjoy low unemployment, while the district's southern regions (the Sverdlovsk, Tyumen, Kurgan and the Chelyabinsk Region) register a labour glut. Unemployment in the extractive regions is checked by the demographic factor: a decline in the labour force and its unwillingness to move from the south to the north.

Unemployment is a traditional problem in the Southern Urals (particularly, the Chelyabinsk Region) swamped with migrants from bordering countries and machine building factories, which have been experiencing a downturn in economic activity. High urban and youth unemployment has already become stagnant in some regions amid low demand for vocational school graduates.

The paradox of *the Siberian Federal District* and *the Far Eastern Federal District* is in the deficit of skilled labour force against the backdrop of high unemployment. Due to the narrow industrial focus of some regions of the Siberian FD and the Far Eastern FD, coupled with very low development of the tertiary sector, most of the employed are either field specialists or unskilled workers. In addition, East Siberia and the Far East do not enjoy intensive migration.

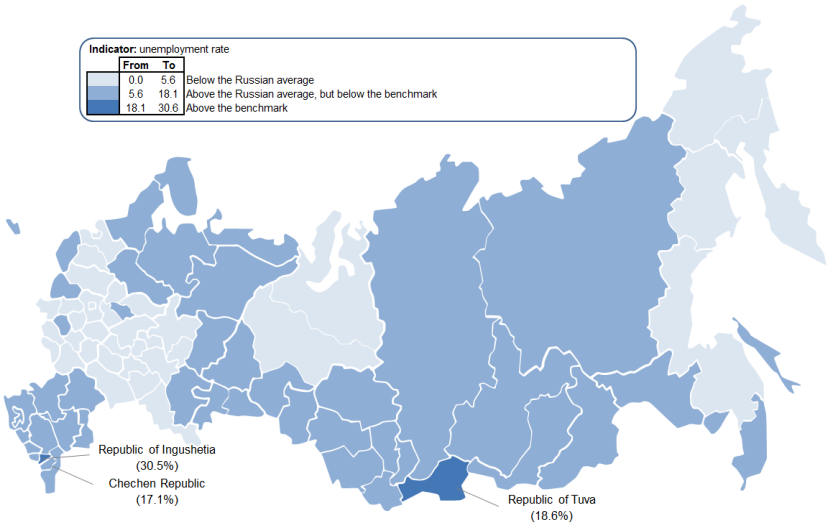
Strong influence of region-specific factors in the labour markets of individual Russian regions constrains the potential impact of monetary and fiscal policy tools aimed at lowering inflation.

Figure 60. Unemployment by group of regions



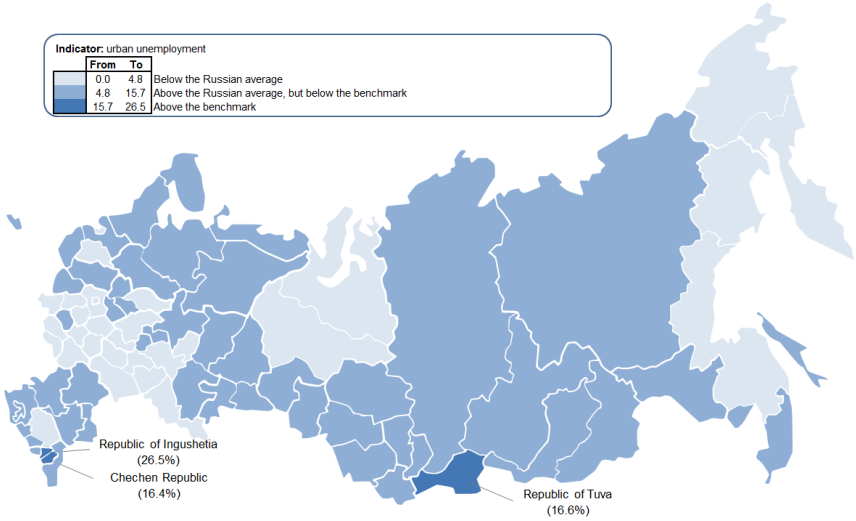
Sources: Rosstat, R&F Department calculation.

Figure 61. Unemployment rate



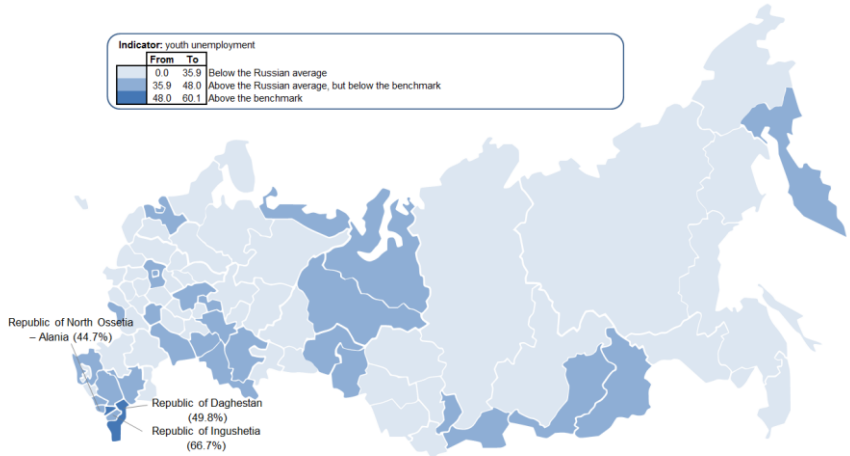
Sources: Rosstat, R&F Department calculation.

Figure 62. Structural unemployment



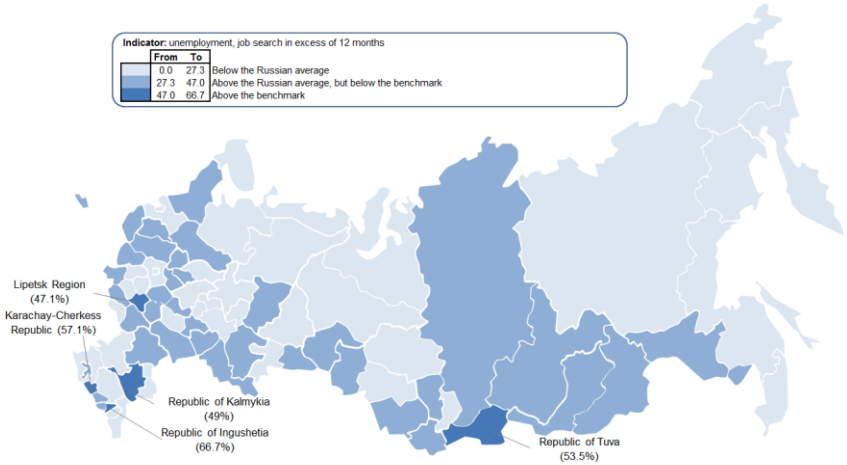
Sources: Rosstat, R&F Department calculation.

Figure 63. Frictional unemployment



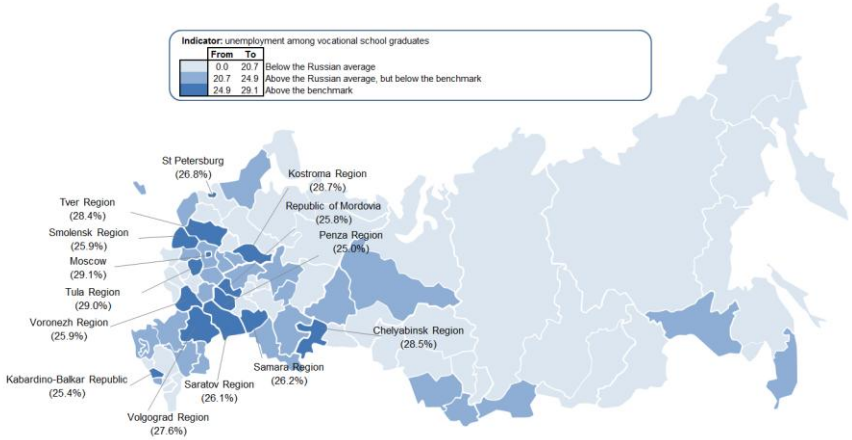
Sources: Rosstat, R&F Department calculation.

Figure 64. Stagnant unemployment



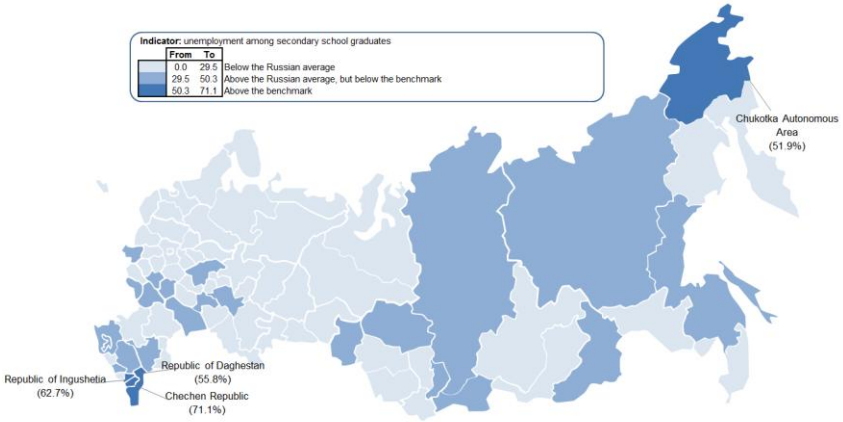
Sources: Rosstat, R&F Department calculation.

Figure 65. Unemployment among vocational school graduates



Sources: Rosstat, R&F Department calculation.

Figure 66. Unemployment among secondary school graduates



Sources: Rosstat, R&F Department calculation.

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