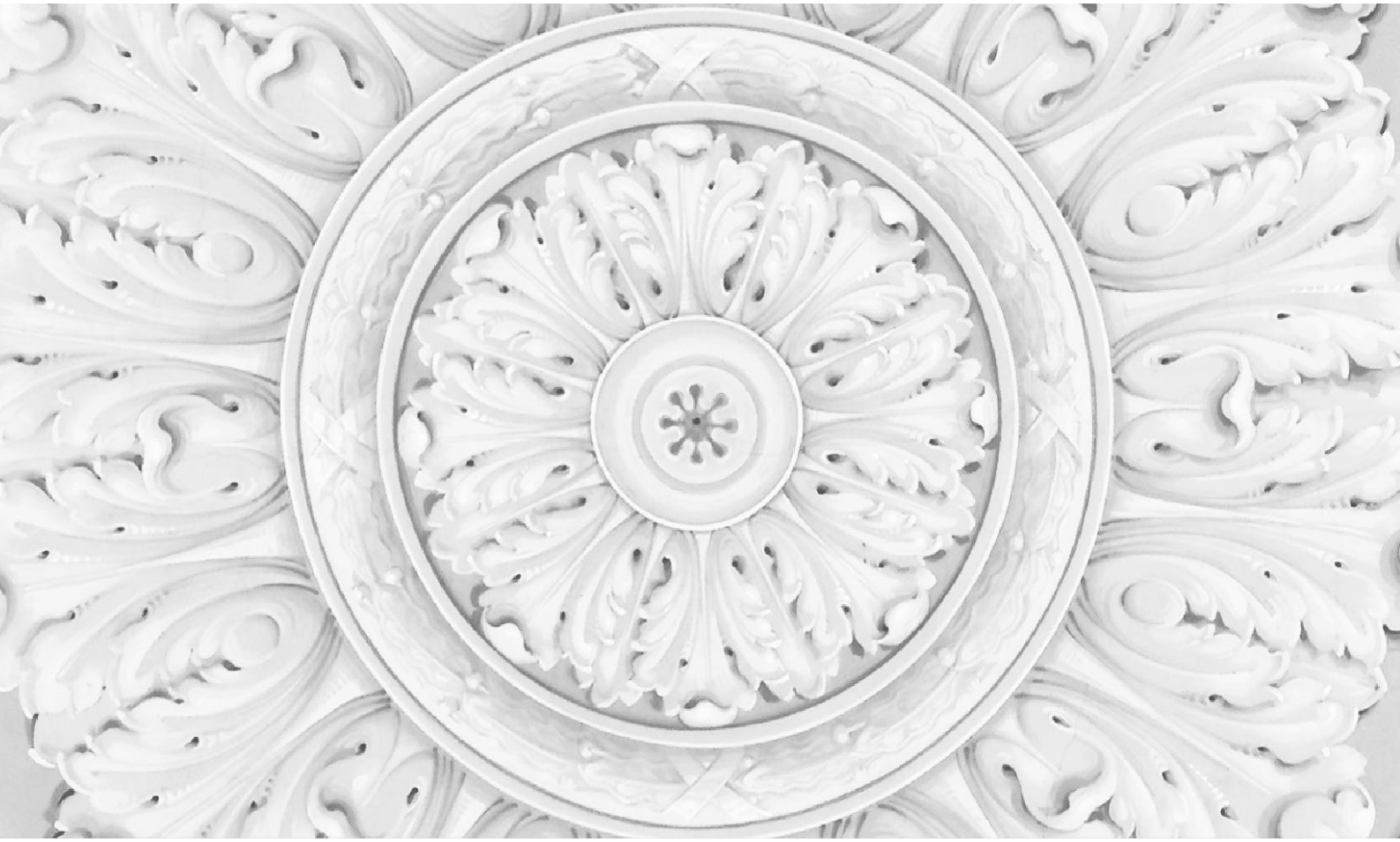
Bank of Russia
The Central Bank of the Russian Federation



TALKING TRENDS

Macroeconomics and Markets

January 2016

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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

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Executive summary

1. Monthly summary

- **The period between December 2015 and January 2016** saw further growth in inflation risks, including those related to financial markets, while financial stability risks exacerbated, and the probability of an ongoing economic recession became stronger.
  - **Inflationary pressure** strengthened and **inflation risks** grew.
  - In late 2015, the **Russian economy** renewed recession caused by the new slump in oil prices.
  - **Financial stability risks** in Russia increased on the back of dropping oil prices.

2. Outlook

- Leading business indicators suggest an ongoing **stabilisation in the advanced economies** and **a slowdown in economic growth in emerging markets**, causing a strong turbulence in financial markets.
- Leading business indicators in Russia have deteriorated triggered by both cheaper oil and a weaker ruble; **economic growth is not expected to resume before the second half of 2016.**

3. In focus: the balance of payments adjustment to be completed

- The Russian balance of payments for 2015 demonstrated a quick adjustment to a weaker ruble. The current account strengthened, while net capital outflow fell sharply against 2014. Although the new round of the ruble depreciation in late 2015 and early 2016 is likely to call for a further adjustment of the economy, primarily through contracting imports of goods and services, this adjustment scheme as such proved efficient.
- Given the new weakening of the ruble caused by lower oil prices, the current account surplus in 2016 is expected to remain high. The positive financial account trends which emerged in 2015 are set to gain a foothold and prompt a further reduction in net capital outflow to as much as $30–45 billion in 2016.

1. Monthly summary

1.1. Global economy, financial and commodity markets

1.1.1. Slower growth of emerging markets poses risk for the global economy and financial markets in 2016

Slower growth of the Chinese economy and other emerging markets jeopardises the global economy and financial markets in 2016. Another potential economic threat is the divergence of market expectations and the US Fed's intentions concerning monetary normalisation. The accommodative policy of the ECB, the Bank of Japan and the People's Bank of China might mitigate these risks.

USA

The US economic growth might decelerate in Q4 despite significant improvements in the labour market. The US Fed may surprise the markets by tightening its policy.

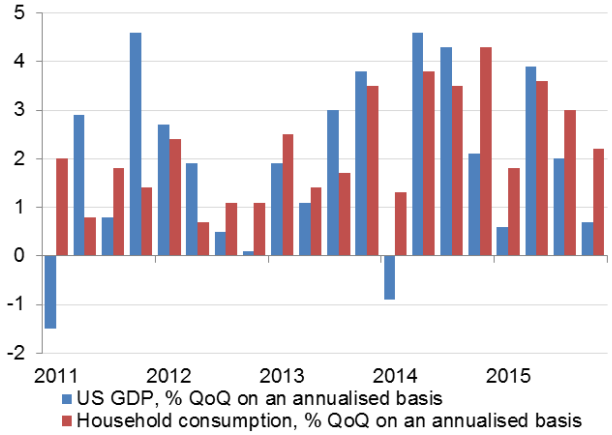
The Federal Reserve has adopted a wait-and-see attitude. In December the US Fed made the historic decision to raise interest rates up from the minimum level by 0.25 pp. The meeting that followed in January did not bring any unexpected outcomes, and the interest rates remained at 0.25%–0.5%. The contents of the press release published in the follow up of the January meeting were more interesting to market participants. Its general tone was neutral, and the US Fed gave special attention to the potential consequences of instability in the global financial markets. The Federal Reserve does not rule out another rate hike as early as March, and its general attitude towards the increment of the rate increase seems to be considerably tougher than markets expect. The latest US Fed's forecasts indicate an expected rate rise to 1.25%–1.5% before the year-end, meaning four increases in 2016. At present, market indicators (e.g., Fed Fund futures) account for only one or two rate hikes before the end of 2016.

Figure 1. Imputed probability of Fed rate rise from current 0.25%-0.5% following US Fed meeting in December 2016, %

Source: Bloomberg

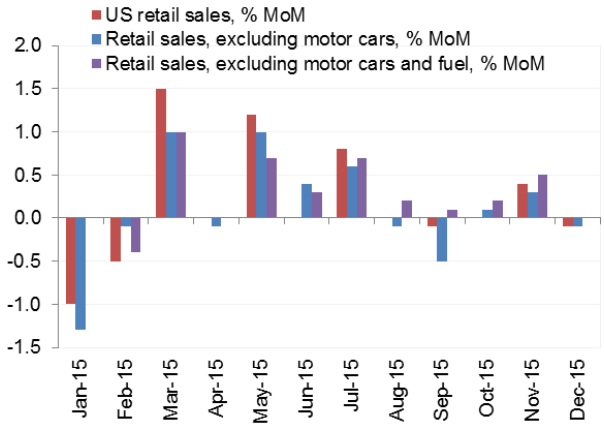
The first estimate of US GDP growth for 2015 Q4 was somewhat underwhelming. The QoQ growth amounted to 0.7% against the expected 0.8%. Consumption growth dropped from 3.0% to 2.2%. These figures might have been adversely affected by exports due to strong US dollar and a general slowdown of the global economic growth.

Figure 2. US GDP, % QoQ on an annualised basis



Source: Bloomberg

Figure 3. US retail sales, % MoM



Source: Bloomberg

Retail sales data were disappointing; consumer sentiment, however, remains positive. Retail sales declined in December by 0.1%. Sales excluding cars and petrol fell short of expectations (0.4% growth had been forecast) and remained unchanged in De-

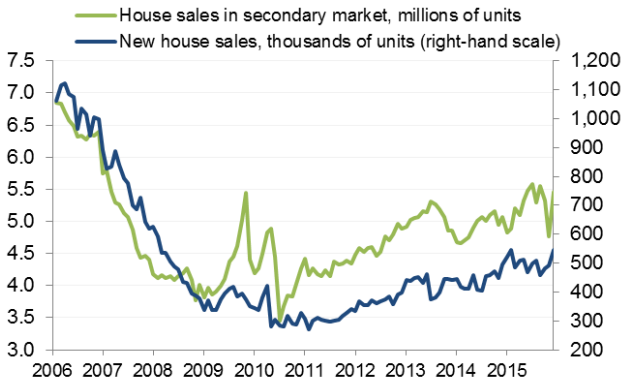
cember. A certain decrease in consumer estimates on the current situation is evident; their expectations, however, remain high, which might boost retail sales in the next few months.

The labour market might stabilise after a strong growth at the year-end. In December 2015, the economy (excluding agriculture) exceeded expectations by adding 292,000 jobs. The abnormally warm weather in December could have been the catalyst for better dynamics shifting the completion of seasonal work to a later date. January saw an increase in first-time claims for unemployment benefits. This indicator strongly correlates with the unemployment rate; therefore, January statistics might indicate a stabilisation in the labour market.

The industrial sector is likely to deteriorate in the next few months. In December, industrial output fell by 0.4% MoM after a 0.9% drop in November (seasonally adjusted). The preliminary estimate of the industrial PMI indicates a possible improvement of monthly dynamics in January. However, statistics on orders for durable goods demonstrates that the condition of the industrial sector might deteriorate in the future: the December decline amounted to 5.1% (against the expected 0.7%). Even net of the unstable component of orders for transportation (including airplanes), the decline was still 1.2%.

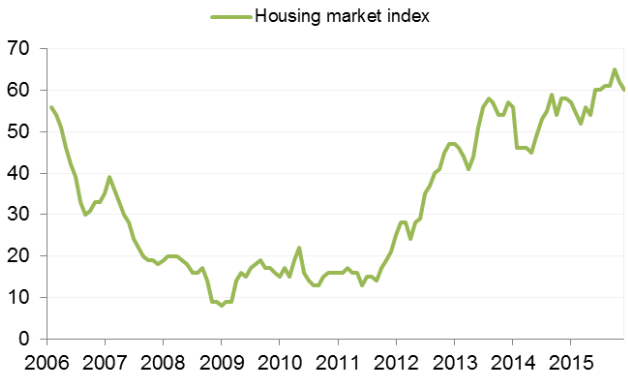
The housing sector statistics remain positive. The housing sales increased in both primary and secondary markets and approached the post-crisis maximum.

Figure 4. House sales



Source: Bloomberg

Figure 5. Housing market index



Source: Bloomberg

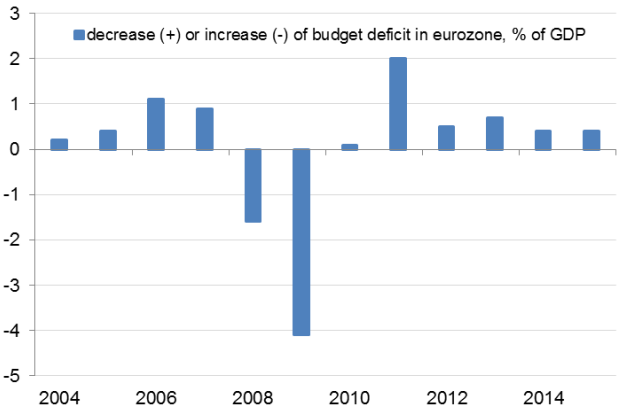
Eurozone

Unlike the US and Japanese economies, economic dynamics in the eurozone was influenced by many positive factors supported by the cheap euro due to the expected policy easing by the ECB and lower pressure on the economy exercised by the restrictive fiscal policy (see Figure 6).

Low inflation (0.4% YoY in January against 0.2% YoY in December, and 1.0% core inflation in January) is turning into a problem for the ECB as the bank is now troubled by

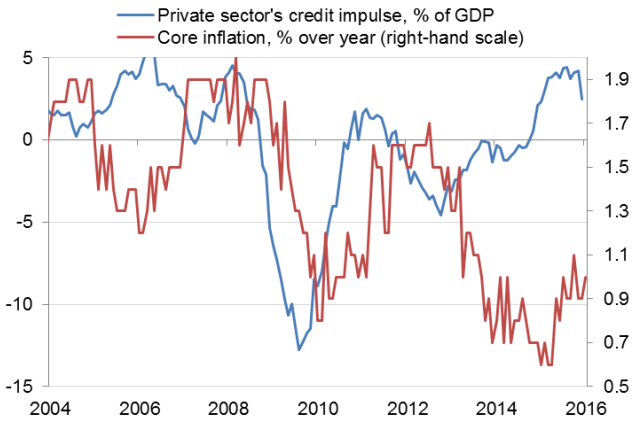
the adverse secondary effects of its persistently low rate. Falling oil prices continue to exert most influence on inflation. The dynamics of nominal wages (1.1% YoY increase in Q3 against earlier 1.6% YoY) does not offer much hope for any acceleration in inflation.

Figure 6. Eurozone budget deficit change, % of GDP



Source: Bloomberg

Figure 7. Eurozone's core inflation and private sector's credit impulse



Note. Credit impulse is understood to be an increment in lending increase/decline divided by nominal GDP.

Source: Bloomberg

It is worth mentioning that December statistics has shown a further deceleration of growth in M3 money supply (down to 4.7% YoY against 5.2% YoY in October), along with a drop in the credit impulse. The growth of private sector lending declined to 2.5% of GDP. Previously in the 2000s even such a low rate of generation of new, loan-backed demand would have been sufficient to move core inflation to about 1.7% (see Figure 6). In this connection, the ECB's apprehension of adverse secondary effects of low inflation seems well substantiated. These secondary effects are revealed not only in inflation anchoring at a low level, which justifies the policy easing, but also in financial stability risks, which conversely requires policy tightening.

However, while these risks remain minor, the ECB policy easing in March 2016 seems very probable. Such a decision would definitely support financial markets, including the Russian ruble. Markets expect a 0.5–1 pp cut in the ECB's deposit rate; the possible extension in the asset purchase programme is also being discussed, which would have a positive influence on investors' risk attitude.

China

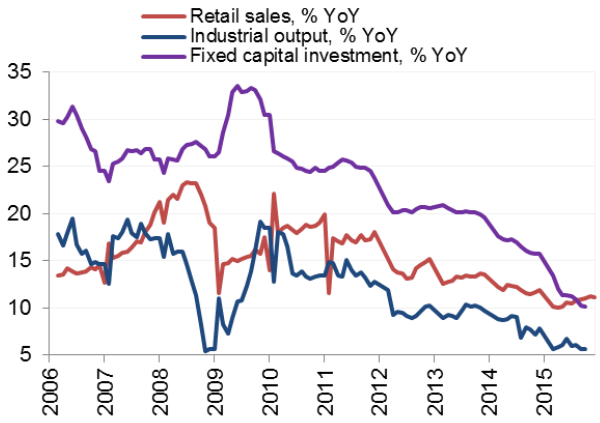
The Chinese economy remains one of the focal points of the global economy and financial markets for the two following reasons. First, the deceleration of the Chinese economic growth is accompanied by a transition to a new consumption-based growth model. This model is less resource and energy intensive, thereby increasing the adverse effect of slower Chinese economic growth for exporters of stock and materials, i.e. most developing countries. Second, the ongoing net capital outflow from China puts continuous

pressure on the renminbi exchange rate and the country's gold and currency reserves. High levels of uncertainty concerning the equilibrium level of the exchange rate and the path towards it invariably strain the financial markets and economies of other countries connected to China directly or indirectly.

The economic statistics published in the past two months indicate that China's economic growth is continuing to decelerate. The industrial output growth amounted to 5.9% as compared to the expected 6.0% and 6.2% in November. The cumulative growth of fixed capital investment in 2015 reached 10%, unable to live up to the expectations and outdo the November results (both at 10.2%). Such a decline of the growth indicator has been building up since early 2015 and might point to a significant slowdown of investment growth in monthly terms. Retail sales growth unexpectedly dropped from 11.2% in November to 11.1% (against the expected increase to 11.3%).

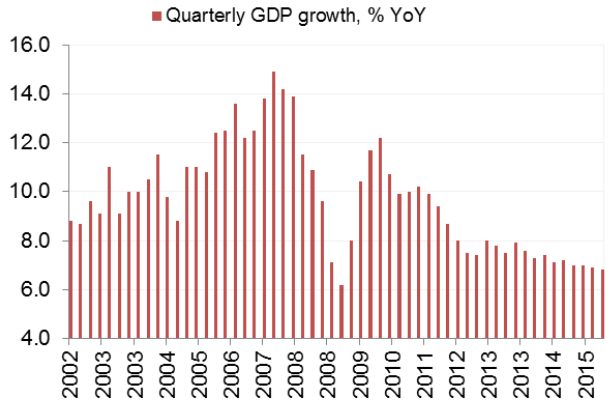
The YoY GDP growth in Q4 slowed down to 6.8% (against the expected 6.9%, with Q3 growth at 6.9%), making this indicator's performance the lowest since the financial crisis of 2008–2009. GDP growth in 2015 amounted to 6.9% almost reaching the official 7% target of the Chinese authorities.

Figure 8. Key economic indicators in China



Source: Bloomberg

Figure 9. GDP growth rates in China

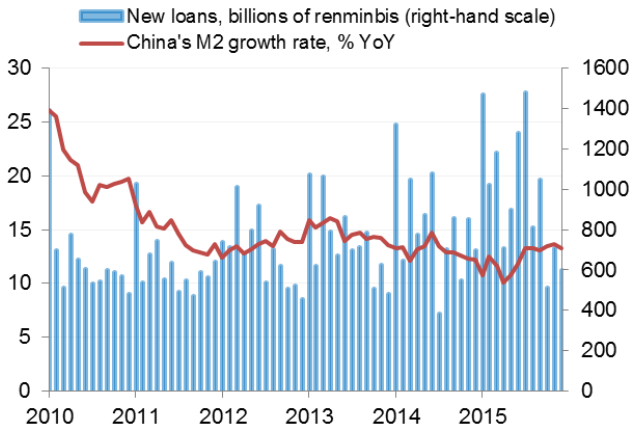


Source: Bloomberg

The growth of the money supply stopped after having accelerated in H1 following a significant reduction in lending. These monetary dynamics might point to insufficient demand growth despite the incentive measures which had been taken earlier. The high debt load of the Chinese economy impairs the monetary easing efforts and hampers the positive effects of lower interest rates.

The deviation of producer and consumer price dynamics exerts additional downward pressure on inflation. This decline in inflation might lead to adverse economic consequences unless the People's Bank of China responds with monetary policy easing, including the interest rate cuts. However, this might be easier said than done when countering capital outflow.

Figure 10. Money supply and lending in China



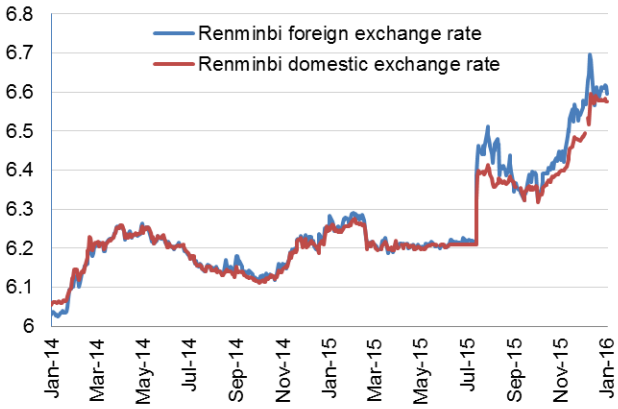
Source: Bloomberg

Figure 11. Prices in China

Source: Bloomberg

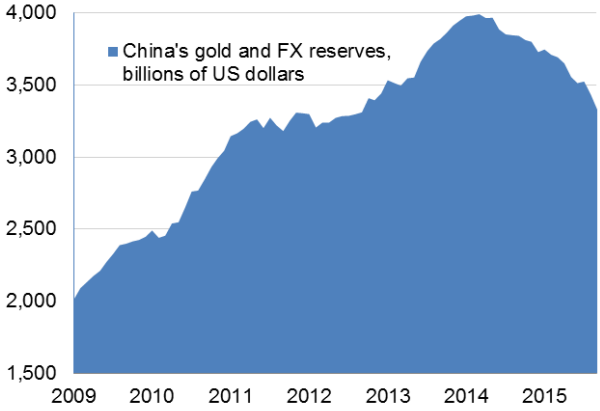
The unrelenting weakening of the Chinese renminbi has become one of the causes of increased volatility in the financial markets in early 2016. The growth of depreciation expectations amid the Chinese authorities' efforts to prevent the rapid weakening of the currency is forcing them to rely on international reserves in order to smooth the exchange rate dynamics.

Figure 12. Renminbi exchange rate



Source: Bloomberg

Figure 13. China's international reserves



Source: Bloomberg

Japan

Considerable slowdown in the economic growth and inflation forced the Bank of Japan to take new steps in monetary policy easing.

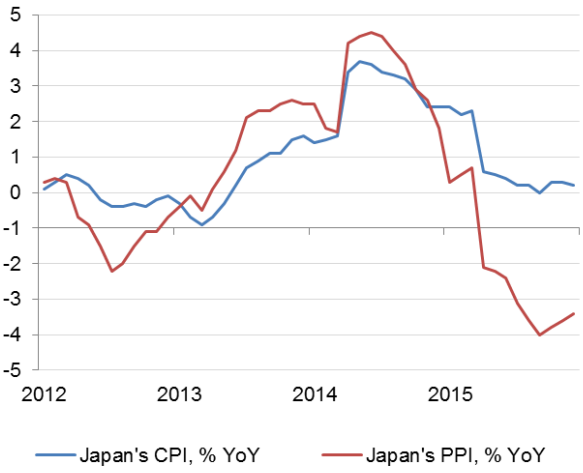
Economic indicators showed a downward trend in late 2015. In December, the industrial output declined by 1.6% YoY. Preliminary estimates for the industrial PMI failed to meet expectations (52.4 against 52.8), although remained in the growth territory (see Figure 16). Retail sales also fell below expectations.

Inflation is continuously wavering around zero following a strengthening of the yen and a drop in oil prices. The growth of the consumer price index in December amounted to 0.2%, while producer prices continue to go down despite the slower pace. A fair labour market climate has not yet impacted the growth of inflationary pressure.

The said developments have forced the Bank of Japan to announce the introduction of a negative interest rate (-0.1%) in order to drive bank lending. This rate will make a part of a three-tier system and will only be applied to excessive bank funds on correspondent accounts with the Bank of Japan. The parameters of the quantitative expansion programme have remained unchanged.

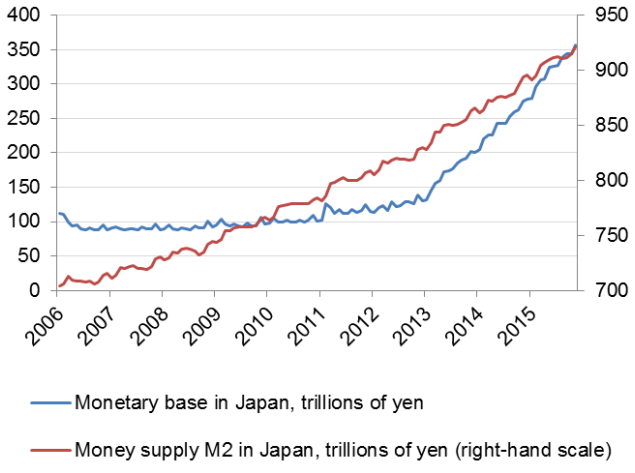
The Bank of Japan can be expected to take further steps as a part of the quantitative easing programme. The regulator's primary objective is to boost inflation expectations. This is particularly important in view of the spring wage negotiation between trade unions and employers.

Figure 14. Consumer and producer price inflation, % YoY



Source: Bloomberg

Figure 15. Monetary base in Japan



Source: Bloomberg

Leading indicator data: the problematic BRICS

Many emerging markets face a serious problem of a steady slowdown or a decline in business activity, which is demonstrated particularly well by PMI performance. In *every* BRICS country, PMI values are below 50, which separates a growth of the economic activity from its decline.

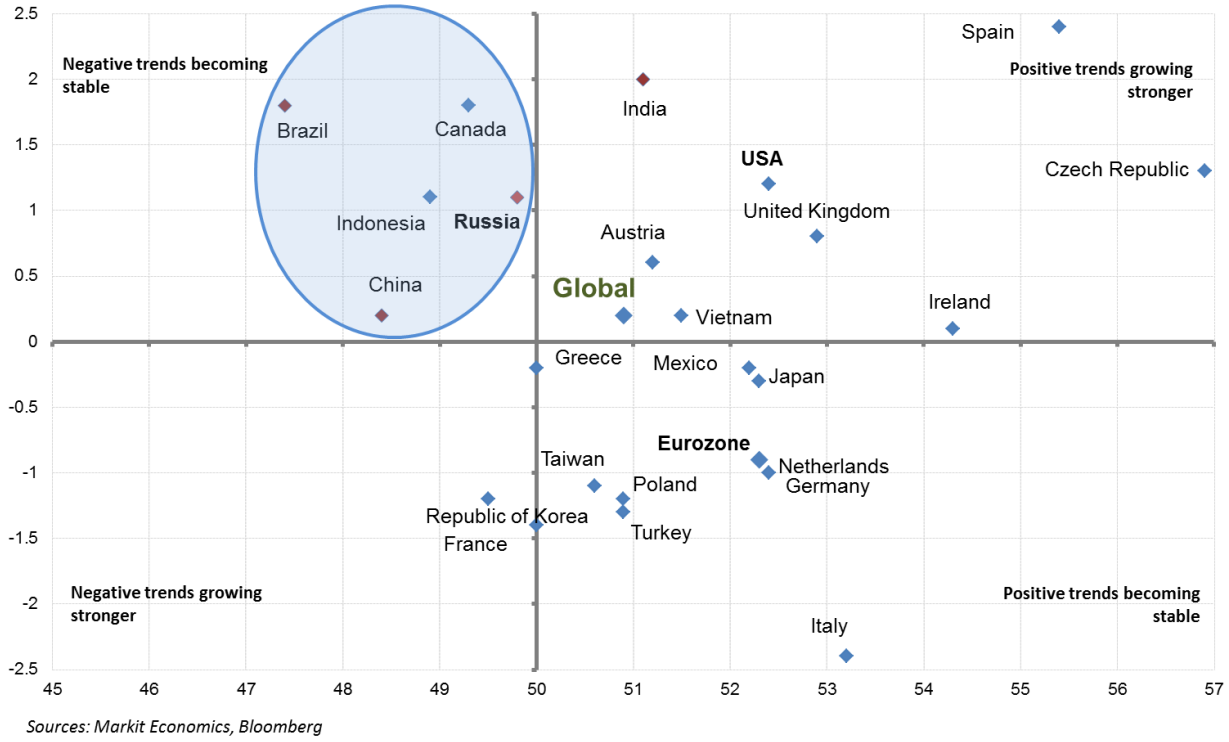
On the whole, many problems of emerging markets result from the excessive debt load of their corporate sector that has been accumulating since the 2008–2009 crisis, when the interest rates were ultra-low and the US Fed and the central banks of other developed countries pursued a quantitative easing policy. The rate take-off in the US drives a forced reduction of foreign debt of emerging market corporations, frequently accompa-

nied by a drop in the currency exchange rate, shocks, and a substantial impact on emerging market economies.

Preliminary estimates of the January PMI for the industrial sector have pointed to the persistence of positive trends in most developed countries. Industrial growth has somewhat slowed in the eurozone and accelerated in the USA.

The overall picture remains unchanged: advanced economies seem to be more stable than emerging ones.

Figure 16. PMI in manufacturing in January 2016 and increment on December 2015, points



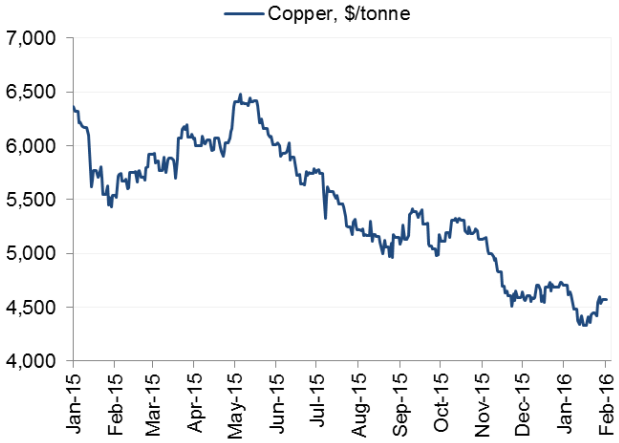
Sources: Markit Economics, Bloomberg

Sources: Markit Economics, Bloomberg

The dynamics of **copper prices**, as global industrial bellwether, was similar to that of other risk assets (see Figure 17). The December stabilisation was followed by a slump that reflected an increase in the risk of an economic slowdown. However, the generally mild attitudes of the central banks of advanced economies resulted in a partial recovery of prices.

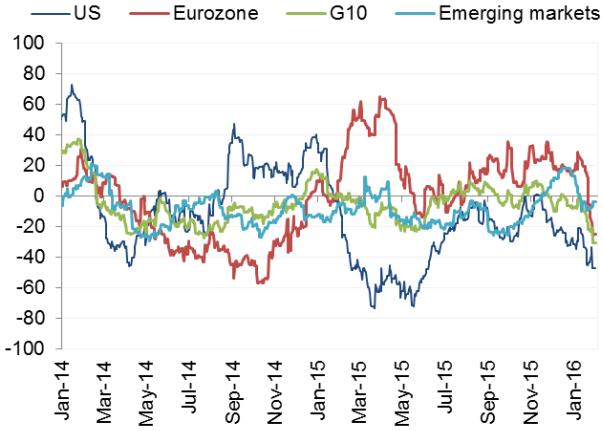
Summary surprise indicators of macrodata for advanced and emerging economies show, according to Citi, a negative trend. Growth in developing countries failed to meet the expectations and affected the performance of developed economies.

Figure 17. Copper price, $/tonne



Source: Bloomberg

Figure 18. Surprise indices in macrodata releases for US, eurozone and developed and emerging markets



Sources: Citi, Bloomberg

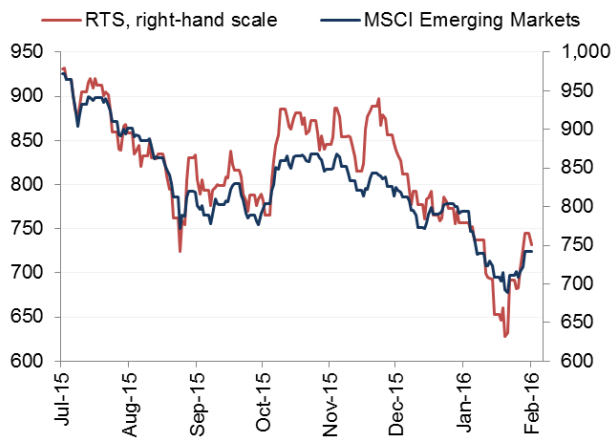
1.1.2. Financial markets: the year started with a slump amid the concerns over the Chinese economy

The beginning of the year proved quite negative. Risk avoidance resulted from an accelerated weakening of the renminbi exchange rate.

The positive market dynamics seen in late December gave way to a plunge in the first days of the new year. The accelerated weakening of the Chinese national currency gave rise to concerns over the state of the country's economy. The decline involved equity markets of both developed and developing countries with some of them formally entering the bearish zone (i.e., dropped by more than 20% from their peak values). This was accompanied by a burst of volatility, even though it was less severe than in August. The market weakening reflected the increased risks in the global economy and forced central banks to respond. The ECB's hint of a probable revision of its monetary policy parameters during the forthcoming meeting in March along with the Bank of Japan’s unexpected rate cut to a negative value supported the markets and resulted in the recovery of some of the lost positions in the second half of January.

The Russian market's response to the Bank of Russia’s decision to keep its key rate at 11% seems neutral to positive: the decision corresponded to the consensus. Even before the Bank of Russia Board of Directors announced its decision, market participants adjusted their expectations of the monetary policy stance. On the whole, the market anticipates a policy easing within the next 2-3 years. However, the mention of a probable rate hike has postponed the expected time of a rate cut to a later date. Certain analysts allow for the possibility of a key rate rise if oil prices remain low.

Figure 19. RTS and MSCI EM



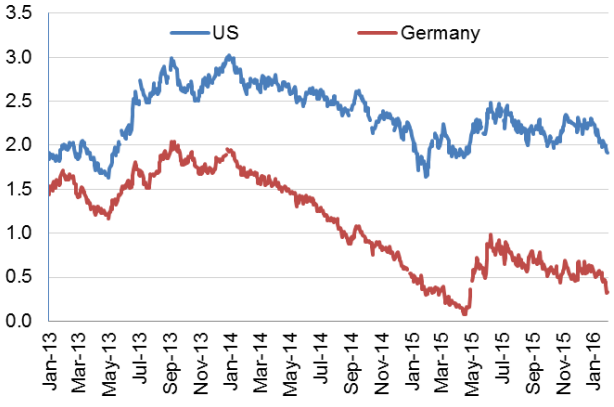
Source: Bloomberg

Figure 20. S&P500 and Eurostoxx50

Source: Bloomberg

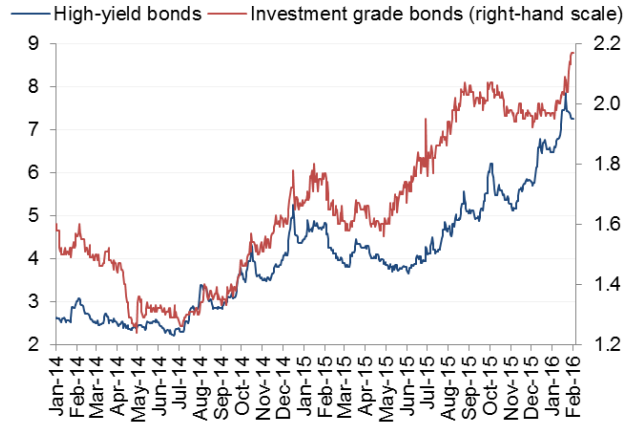
The yields on government bonds of advanced economies have dropped to their six-month low. Such movement resulted from a mild rhetoric of the major central banks, growing demand for risk-free assets, and a decline in inflation expectations. At the same time, the credit spread has continued to expand in both the investment-grade bonds and high-yield bonds segment. This trend has been observed since 2014 and has a negative impact on the financial market as a whole. The bond markets of emerging economies have been unable to avoid this common negative trend.

Figure 21. Yields on 10-year government bonds of developed countries



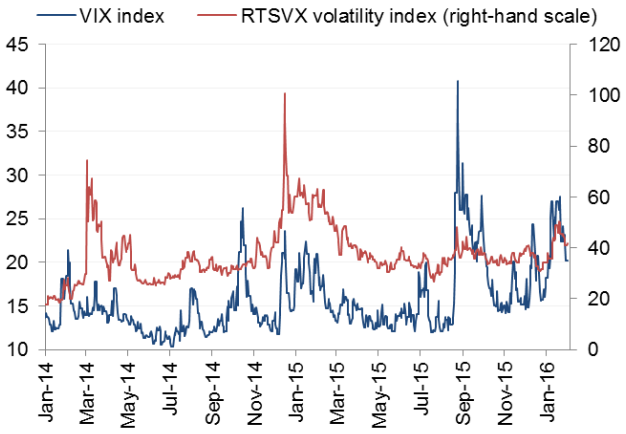
Source: Bloomberg

Figure 22. Credit spread of bonds of developed countries (%)



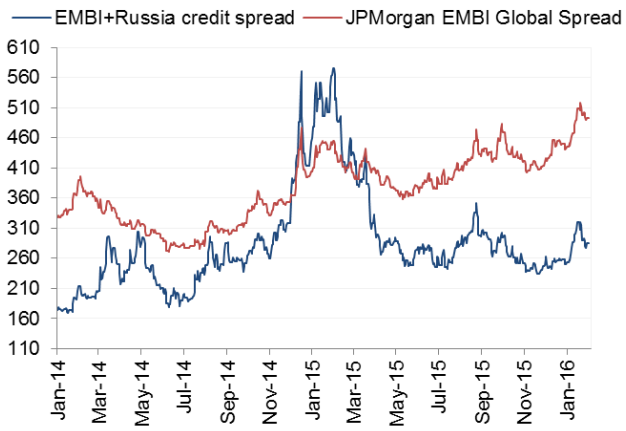
Source: Bloomberg

Figure 23. VIX index (S&P500) and RTS volatility index (RTSVX)



Source: Bloomberg

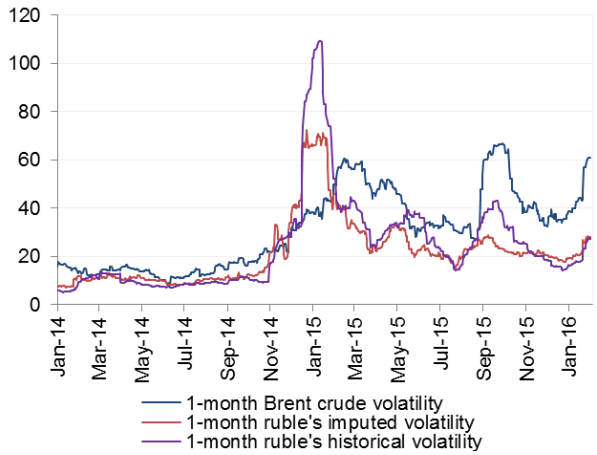
Figure 24. EMBI+Russia and JP Morgan EMBI Global spreads (bp)



Source: Bloomberg

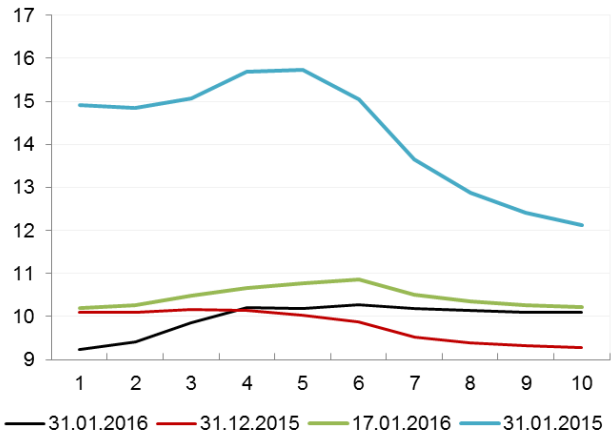
The Russian debt market has reacted strongly to the plunge of oil prices and the ruble depreciation. After having stabilised at 9.5% in December, the 10-year OFZ yield soared to almost 11% and later went back down to 10.1-10.2% to complete the January cycle by rising to 10.2-10.3% following the Bank of Russia's decision on the key rate.

Figure 25. Anticipated USD/RUB exchange rate volatility



Source: Bloomberg

Figure 26. GKO–OFZ yield curve, %

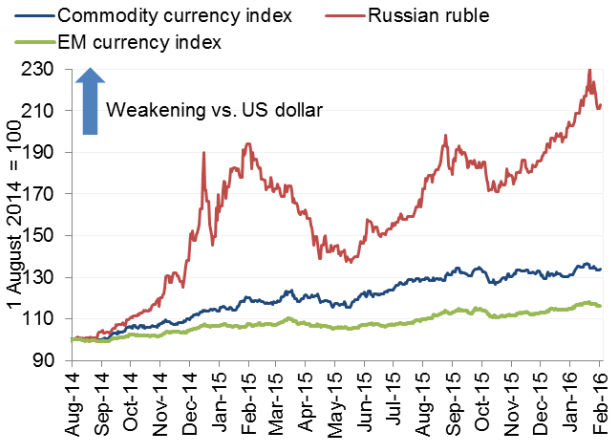


Source: Moscow Exchange

The volatility of the Russian FX market has increased. Plummeting oil prices followed by a quick rebound instigated an increase of fluctuations in the ruble exchange rate. The extra jumpiness came about after an important benchmark of 80 rubles per dollar was passed. The ruble volatility indicator has risen to its highest point since September 2015. Further developments of the ruble exchange rate will largely depend on the oil market climate.

The exchange rate of the US dollar to currencies of developed countries has proven rather stable, which is quite unusual for periods of increased volatility. For example, another possible easing of the monetary policy hinted at by the ECB failed to result in the euro depreciation.

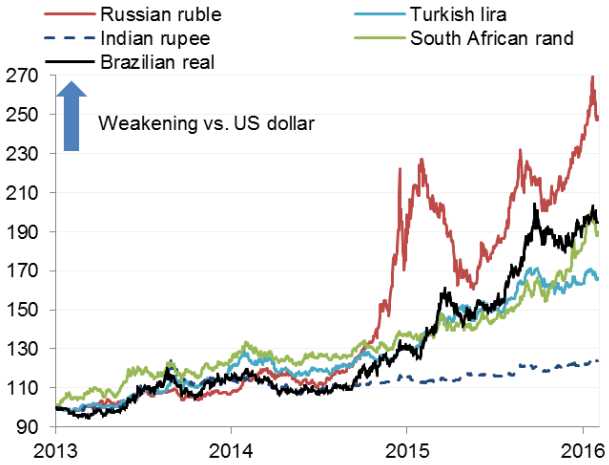
Figure 27. Exchange rates of emerging economies, commodity currencies (August 2014 = 100)



Note. Commodity currencies: New Zealand dollar, Norwegian krone, Australian dollar.

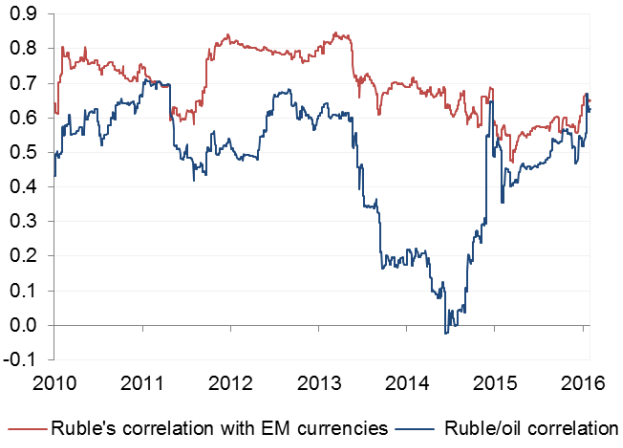
Source: Bloomberg

Figure 28. BRICS exchange rates (August 2014 = 100)



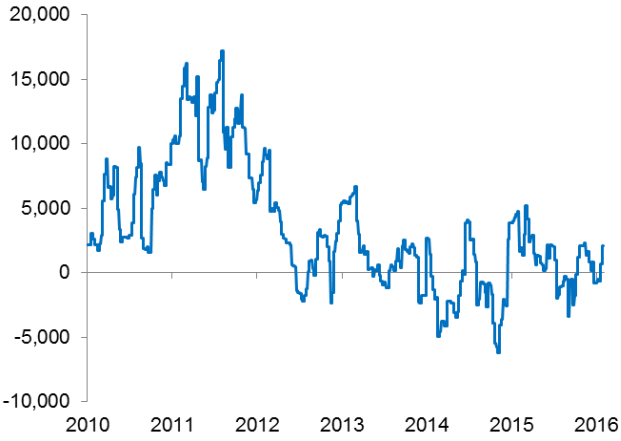
Source: Bloomberg

Figure 29. Ruble's 12-month correlation with emerging economies' currencies and oil



Source: Bloomberg

Figure 30. Net short position for ruble futures

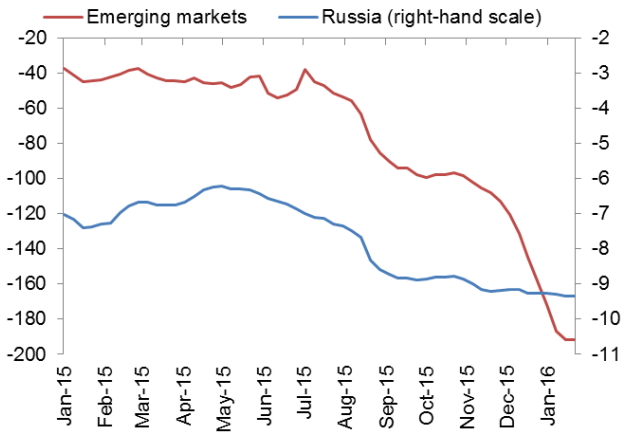


Sources: Bloomberg, Bank of Russia calculations

Cash outflow from funds focused on Russian bonds accelerated in the past two months. Russian Eurobonds headed the growth in all bond segments in 2015; therefore, the outflow acceleration at the end of the year might have been related to the investors' aspiration to secure their profits. Russian shares were more popular. On the whole, out-

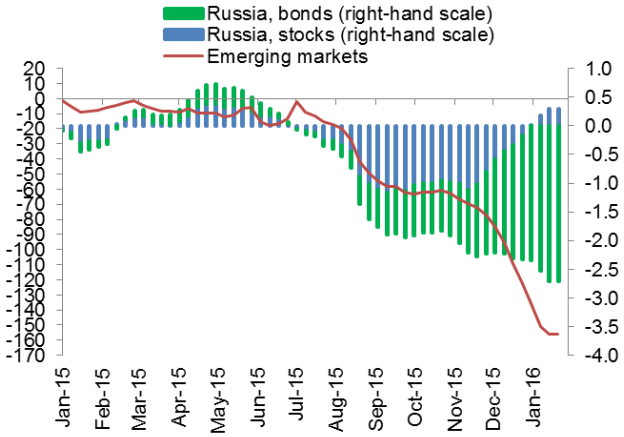
flows from funds focused on emerging markets continued, which is likely to result from reduced attractiveness of their assets following the deceleration of economic growth in these countries.

Figure 31. Cash flows into Russian and EM funds (accrued, '+' – inflow), billions of US dollars



Sources: EPFR Global, Bloomberg

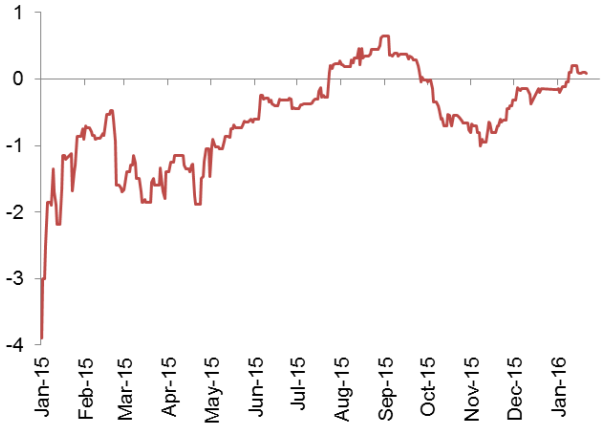
Figure 32. Cash flows into Russian and EM funds (accrued, '+' – inflow), billions of US dollars



Sources: EPFR Global, Bloomberg

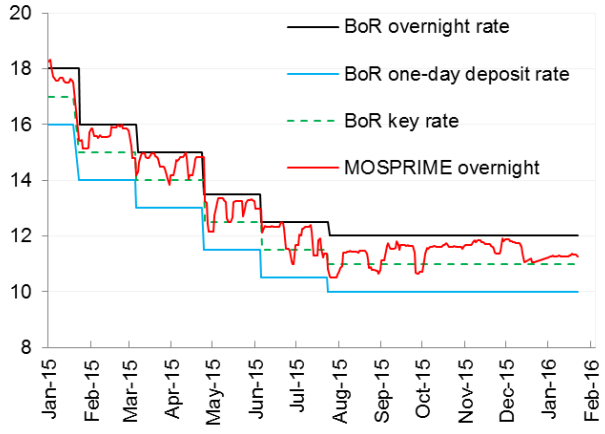
Expectations over risks related to liquidity and BoR monetary policy stabilised. In January, the FRA3x6 and 3M Mosprime spread entered the positive territory, which reflected the increase in the estimated probability of monetary policy tightening (Figure 33). In the past two months, short-term rates in the interbank lending market reached the middle of BoR interest corridor to reflect a seasonal improvement of the ruble liquidity (Figure 34).

Figure 33. FRA3X6 and 3M Mosprime spread, % p.a.



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

Figure 34. BoR interest rate corridor and short-term interbank lending rate



Sources: Bank of Russia, Bloomberg

1.1.3. Commodity markets: another price drop in January

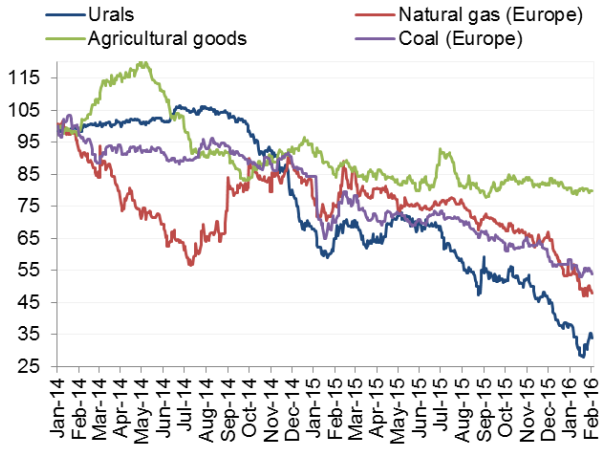
In January, many commodities and indices, including oil, plunged to their multi-year lows. Oil prices are likely to stay in the corridor of $20-40 per barrel for long. The demand for oil and oil derivatives in China and the ability of exporting countries to arrange a coordinated drop in production are the main factors capable of having a material effect on the oil prices dynamics.

In December 2015 and most of January 2016, prices for most commodities continued to decline. In December–January, the Bloomberg Commodity Index fell by 6% to reach its lowest level since February 1999 on 20 January. The Baltic Dry Index, which shows the demand for large-tonnage dry and liquid bulk shipping, also fell to the all-time low having sunk by 43% in two months in search of a bottom.

Oil prices headed the plummet caused by the glut and concerns over its further increase following the partial lifting of sanctions against Iran, as well as the emerging risks of economic slowdown in China. The prices rebounded in the last ten days of January following the statements made by Mario Draghi, President of the ECB, concerning the plans for additional measures to boost the eurozone's economy, as well as the information on a possible unscheduled meeting of representatives of the major oil producers, including Russia.

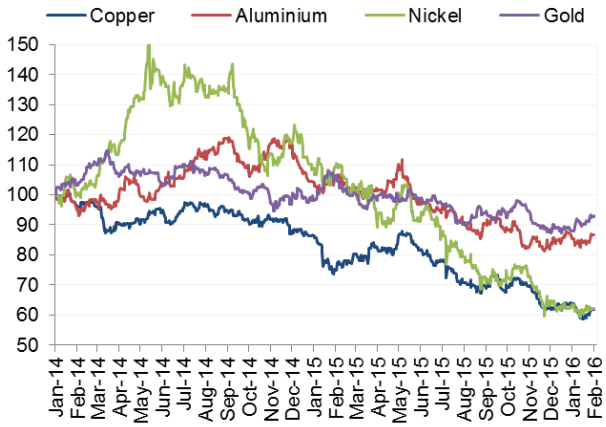
History knows the cases when the OPEC members and countries outside the cartel coordinated their efforts to restrict extraction to boost oil prices. According to RBC, they did so in early 1999 and in late 2001 when Mexico, Norway, Oman, and Russia joined the OPEC countries in limiting oil production. However, at this stage there is a small probability of such an arrangement. The latest OPEC meeting shows that reaching an internal accord within the cartel is highly unlikely given the strong disagreement between Saudi Arabia and Iran. As for the countries outside OPEC, Mexico has been hedging its oil price at $49 per barrel for the entire 2016 (according to the Financial Times) and has no incentive to cut production this year because of the difficulties with financing its budget deficit. Conversely, the Norwegian budget is relatively sound to be involved in such a campaign with a limited number of participants and take elevated obligations. In many other countries the oil industry is comprised of many private companies. This may result in discussing a bilateral agreement neither Saudi Arabia nor Russia are likely to benefit from. Monthly volatility of the Brent price, according to Bloomberg, increased in January to the level of October 2015, exceeding 60%.

Figure 35. Commodity prices (January 2014 = 100)



Source: Bloomberg

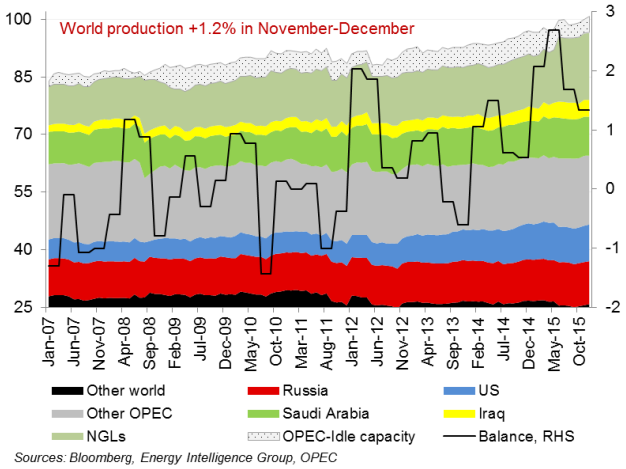
Figure 36. Metal prices (January 2014 = 100)



Source: Bloomberg

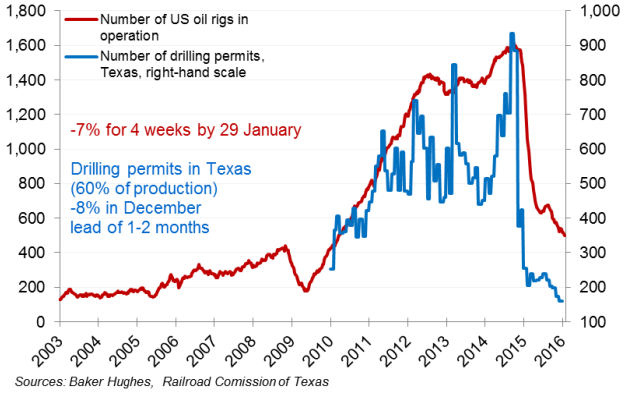
According to the Energy Intelligence Group, the global production of oil and liquid fuel rose by 1.2% in November–December (Figure 37). In January 2016, oil production in the OPEC countries continued to grow increasing by 0.1% MoM, and by 6.3% YoY. Iraq was the principal contributor to the increase in production (0.4 million barrels per day). In December, the country employed its idle capacities. On the whole, in 2015 idle capacities of the OPEC countries decreased by 1.6 million barrels per day. Apart from Saudi Arabia, only Libya still possesses significant idle capacities, but the country would be unable to put them into operation in the short term. Thereby, only Saudi Arabia and Iran are capable of substantially increasing oil output in the world, and the latter intends to increase oil supply to the global market after the sanctions are lifted. The US and Canada also experienced a production hike in November–December.

Figure 37. World liquid fuels production and market balance (mln barrels per day)



Sources: Bloomberg, Energy Intelligence Group, OPEC

Figure 38. Number of oil rigs in US and drilling permits in Texas

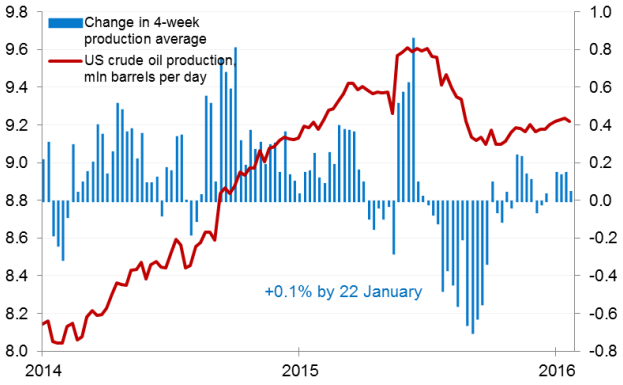


Sources: Baker Hughes, Railroad Comission of Texas

Hydrocarbon extraction in the US is persistently high and the reserves continue to expand. In December-January, the number of active oil rigs was still declining, while the

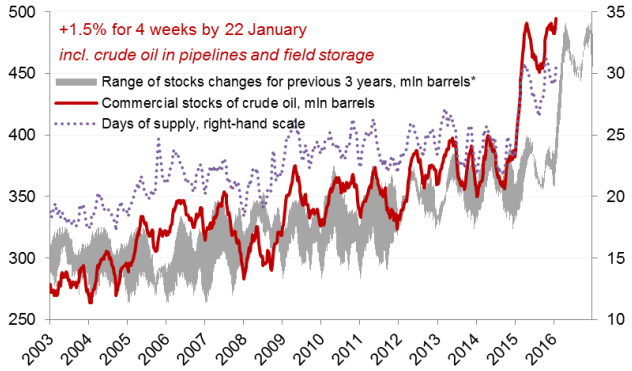
December data on the number of drilling permits issued in Texas allow expecting this trend to continue (Figure 38). However, price hedging by producers, a need to generate cash flow to repay the debts of companies with a precarious financial position, as well as sustainably growing efficiency of shale oil production resulted in the steady growth of oil production in the US in December-January (Figure 39). Commercial oil reserves continue to grow and, as of 22 January, are at the record high since the Great Depression (Figure 40).

Figure 39. US field crude oil production



Source: U.S. Energy Information Administration

Figure 40. US commercial stocks of crude oil

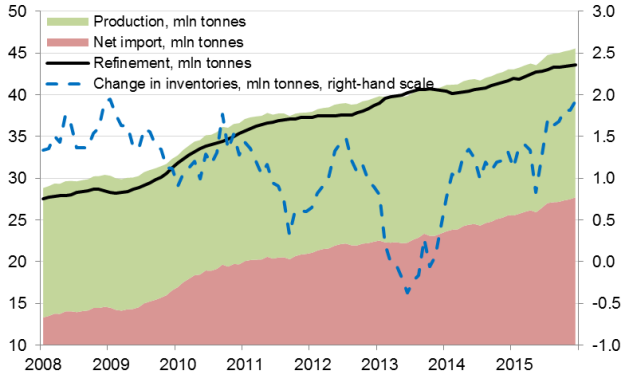


** For 2016 the upper bound is computed, the range is that for 2015.*
Source: U.S. Energy Information Administration

According to the Chinese Customs Service, an all-time high net oil import to China was recorded in December. The moving 12-month average of the indicator also continues to show steady growth (Figure 41). However, these numbers disguise the true picture of oil consumption in China. First, since late 2013, a gap has been developing between the demand for oil in China (production plus net import) and its processing (Figure 41). This indicates a consistent build-up of oil reserves, where the surplus is designated for the creation of strategic reserves, while, according to Bloomberg, the commercial oil inventories tended to decline in 2015. Even though China intends to increase its strategic oil reserves (expressed in days of consumption) from about 30 days at present to 90 days by 2020, their current growth is limited by the available storage capacities. According to Platts, in 2015 all the available ground facilities were full, and China started to actively use sea tankers to store oil. Given the average rate of reserve growth in 2015, capacities put into operation in 2016 would only last for 5–6 months. Therefore, if the number of sea tankers used to store oil is not increased, in 2016 China may halve the rate of its reserves generation (by 1 million barrels per day).

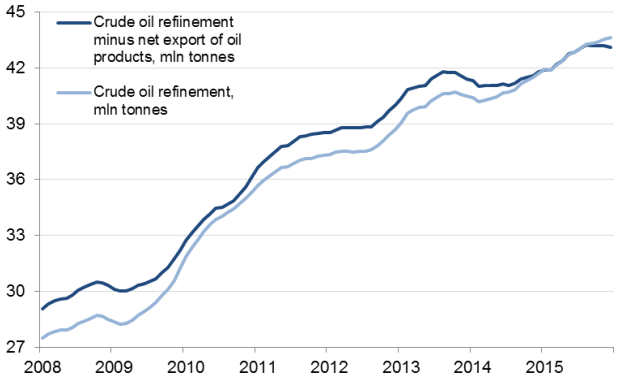
Second, higher demand for oil from oil refineries can be partly explained by the growth of export operations (China has been a net exporter of oil products since 2015 Q2), while satisfaction of internal consumption has tended to decline since August 2015 (Figure 42). Since oil product inventories in China demonstrate the usual seasonality (according to Bloomberg), such a situation points to a decline in the internal demand for oil products in the Chinese economy.

Figure 41. Balance components of crude oil market in China (12-month average)



Sources: National Bureau of Statistics of China, Customs General Administration PRC, Bloomberg

Figure 42. Crude oil refinement in China (12-month average)



Sources: National Bureau of Statistics of China, Customs General Administration PRC, Bloomberg

In early January, the US and EU partially lifted sanctions on Iran. Experts interviewed by Bloomberg are sceptical about Iran's oil exports due to the insufficient investments in the country's oil production sector for a number of years. The median forecast suggests +0.1 million barrels per day within a month after the sanctions are lifted, and +0.7 million barrels per day within a year[1]. Nevertheless, it would increase the oil glut in the market, which, according to Bloomberg, has already resulted in $2 per barrel increase in the Urals premium compared to Brent. In late 2015, Libya also announced its intention to substantially increase production; experts, however, are sceptical pointing out that the infrastructure suffered significant damage during the civil war.

The EIA, OPEC, and the World Bank have presented their January energy market forecasts. The EIA expects a steady growth in demand for oil in 2016–2017 (by 1.4 million barrels per day), a moderate increase of oil supply from the OPEC countries, primarily Iran, and a comparable production cut in other countries in 2016 (Figure 43). As a result supply and demand will be balanced by 2017 (Figure 44). The WTI crude is forecasted at $40 per barrel in 2016 and $50 per barrel in 2017. OPEC and the World Bank expect a more moderate growth of demand in 2016 (1.2 million barrels per day). The World Bank forecasts oil prices in 2016 and 2017 at $37 and $47 per barrel respectively, and expects the price recovery to be slower than during the previous slumps due to the extensive inventories.

[1] The Iranian government expected to increase exports by 0.5 million barrels per day immediately after the sanctions are lifted, and by another 0.5 million barrels per day within a year.

Figure 43. Crude oil and liquid fuels production growth by region

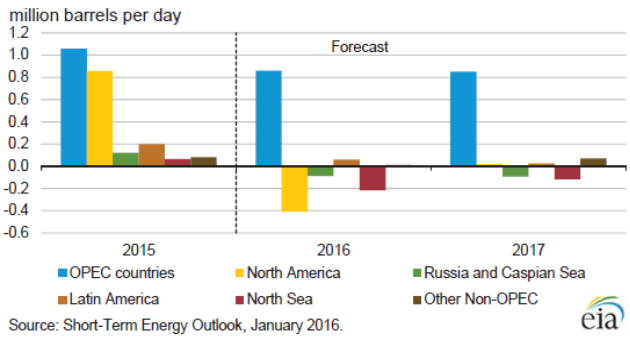
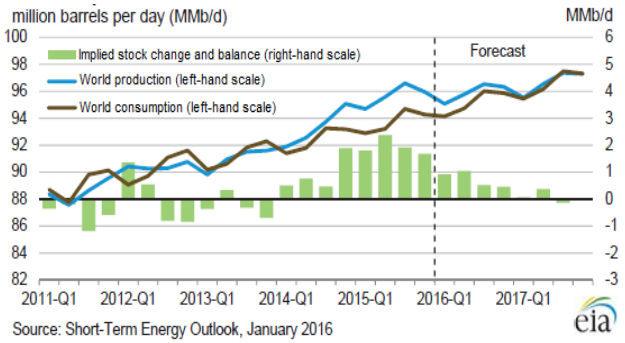
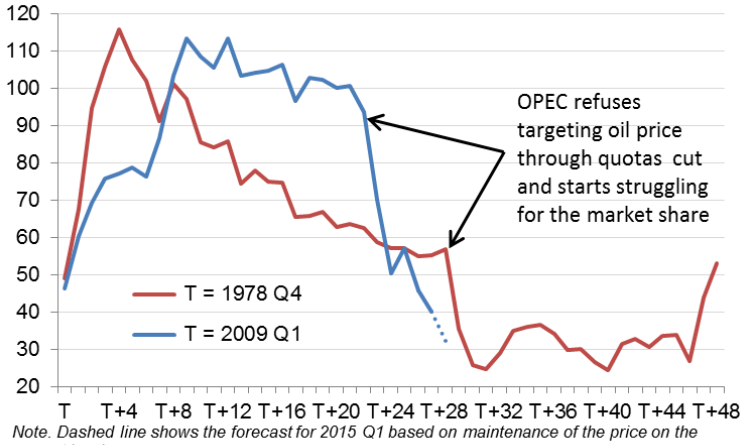


Figure 44. World liquid fuels production and consumption balance



The real oil price seen since 2009 is similar to the dynamics during the period of 1979-1986, which ended with a prolonged, almost five-year price stagnation at $25-35 per barrel in 2014 prices (Figure 45). The price drop had also been preceded by the increased extraction from non-OPEC producers[2], and the drop itself was prompted by OPEC abandoning price targeting through extraction reduction[3]. After the price drop, producers most dependent on the price level managed to maintain production for a year or two, while non-OPEC producers required a similar period to adjust and restore extraction operations. The OPEC countries actively built up their production levels to recapture the market share they lost during the price targeting period. Comparing the described episodes and keeping in mind the current demand- and supply-side risks, it is possible to expect oil prices stagnating close to the current level between 20$ and 40$ per barrel.

Figure 45. Brent crude real price in 1978-1990 and from 2009 onwards (2014 USD/bbl)



Note. Dashed line shows the forecast for 2015 Q1 based on maintenance of the price on the current level.
Sources: CEIC, R&F Department calculations

[2] Up to 1975, primarily in the USSR; subsequently, outside of its territory. More than three-fold increase in oil prices in early 1974 made the oil industry attractive for investments and technological developments. According to the World Bank's estimates, in 1974–1983 the increase of oil extraction in the North Sea and the Gulf of Mexico (the principal regions of growth) amounted to 6 million barrels per day (comparable to the increase in extraction from non-conventional sources in the past decade).

[3] In the 1980s, OPEC was more persistent, which helped increase the period of high prices by two years by almost halving the amount of cartel's oil export and reducing its share in the global supply from 46% to 28% (according to British Petroleum). At the same time, less prosperous countries constantly undermined the quota system.

1.2. Russian economy: the recession lingers

1.2.1. Industrial output in December: a continued decline?

Industrial output statistics for December points to the persistent overall output contraction in the principal economic activities. This justifies the anticipation of a more prolonged recession in the Russian economy than expected earlier. The main reason is the drop in oil prices over the past few months. At the same time, steep fluctuations of monthly indicators cause distrust in the data indicating slower industrial output contraction in December compared to November. The economy is likely to still be testing the bottom in the months to come.

In December 2015, industrial production declined by 0.2% MoM after Rosstat's seasonal adjustment (compared to a 0.6% MoM decrease in November 2015). The R&F estimates are a bit more optimistic and indicate that industrial output has remained unchanged since December (Figure 46). At the same time, our estimates demonstrate that the contribution of the output by types of economic activity has proven more diverse as compared to the previous months.

Figure 46. Industrial output, % MoM (seasonally adjusted)

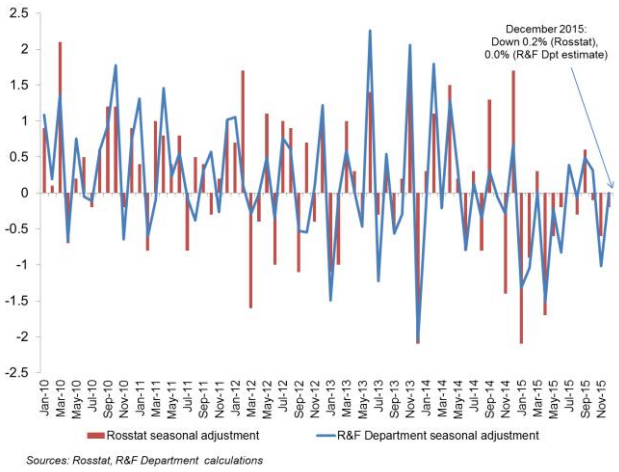
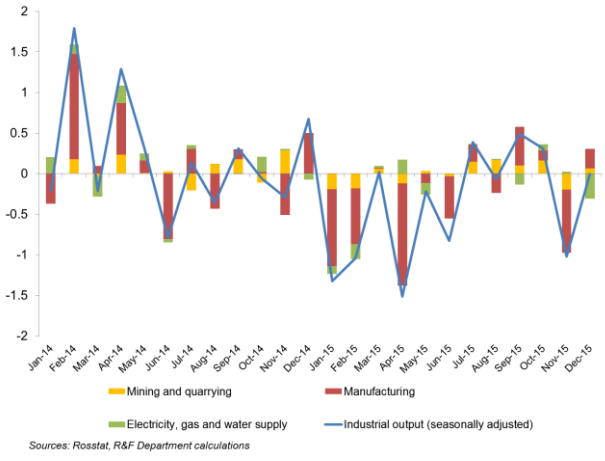


Figure 47. Contribution of individual components to industrial output index, % MoM (seasonally adjusted)

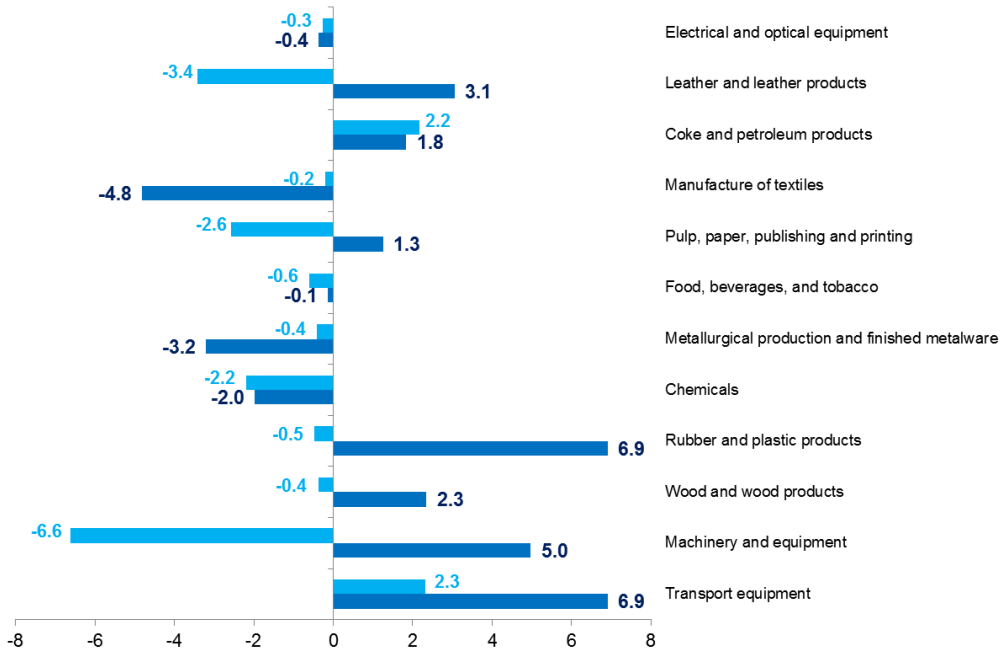


The minerals and the manufacturing sector showed stable dynamics in December. We estimate the seasonally adjusted output in mining and quarrying to range between 0.2% and 0.3% MoM, and in the manufacturing industry at 0.5% MoM. However, the extreme volatility of monthly data as well as the periodic outliers require cautious interpretation of such estimates.

In individual manufacturing industries, the output dynamics was multidirectional in December as compared to November. This concerns machinery and equipment, pulp and paper industry, leather and footwear production, and rubber and plastic products (Figure 48).

For the second month in a row, the metallurgical industry showed a marked decline in output, with the chemical industry following suit, although its general development in 2015 was quite favourable due to the introduction of new capacities and import substitution. So far, the present weak performance of the chemical industry is not related to any steady trends in its development. At the same time, the greatest hazard to chemical production is posed by a falling demand from consumer industries, and this risk is likely to materialise in 2016. The metallurgical production is strained by a falling external demand along with a prospective rise in competition from Chinese exports and tighter protective measures implemented by some advanced economies which consume Russian metallurgical products (for details see Section 1.2.3).

Figure 48. Growth rates in manufacturing (% MoM, seasonally adjusted)



Sources: Rosstat, R&F Department seasonal adjustment

The most positive component of manufacturing industries is the coke and petroleum products sector, which has experienced a steady growth of about 2.0% (seasonally adjusted) in the past two months. We believe that oil product manufacturing might be additionally backed by the modernisation connected with the transition of Russian refineries to manufacturing a higher quality fuel coupled with the ban to sell Euro-3 and probably also Euro-4 oil products.

Electricity, gas and water supply showed the most negative dynamics in December falling by 2.4% MoM. We do not see objective fundamental preconditions for such a plunge of this component of the industrial production index. The above mentioned drop might be explained by the specifics of the seasonal adjustment method used by the Research and Forecasting Department and the failure to fully account for the weather factor

(given the abnormally warm weather in December), as well as the abovementioned outliers of short-term data.

As long as oil prices remain low, we predict the uncertain dynamics in the industrial sector to continue during 2016 H1. The short-term model-based GDP forecast and the statistical estimates of the composite leading indicator based on a wide range of relevant short-term macro-indicators, signal that the recession is very likely to continue in Q1–Q2 if oil prices remain at the current lows (for details see Section 2.2.2. A decline in the composite leading business indicator: industrial recovery is put on hold until at least the second half of the year).

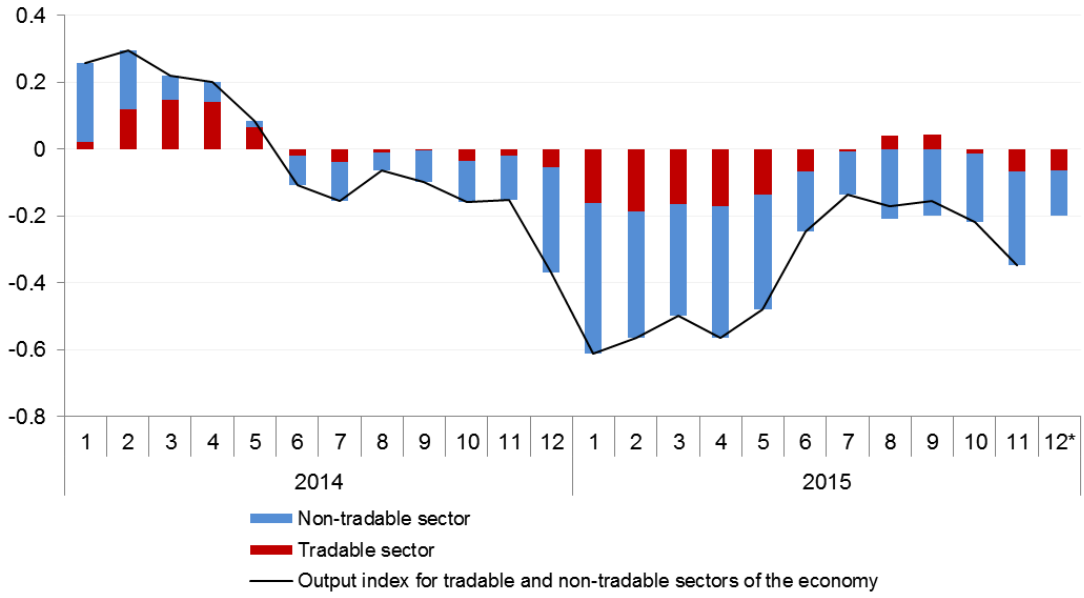
1.2.2. Downward output trend in the tradable and non-tradable sectors of the economy persists

In December 2015, the downward output trend in the tradable and non-tradable sectors of the economy remained, despite slowing. Retail trade and freight turnover were the main contributors to the negative trend dynamics in the non-tradable market services sector. In the tradable sector, the investment demand-oriented manufacturing industries are the principal factor mitigating its negative dynamics. The intermediate and consumer demand-centred industries have not yet demonstrated a sustainable trend towards output growth.

The non-tradable sector of the economy continued to determine the economic development (Figure 49). In December 2015, the downward output trend (with decelerating decline) in non-tradable market services remained in place due to the continued fall in retail turnover amid the lower consumer activity, and a drop in freight turnover. The latter results from the reduced road transportation volumes (which accounted for 68% of the entire freight turnover in tons per month) following a downturn in the principal freight-generating sectors, a reduction of export and import operations, and an introduction of charges from lorries for the damage they cause to motorways.

Figure 49. Output index for tradable and non-tradable sectors of the economy

Trend component growth rate, % MoM



Note. The December contribution of the trend component of non-tradable sectors excludes data on services provided to households due to the lack of respective statistics as of the reporting date.
Sources: Rosstat, R&F Department calculations

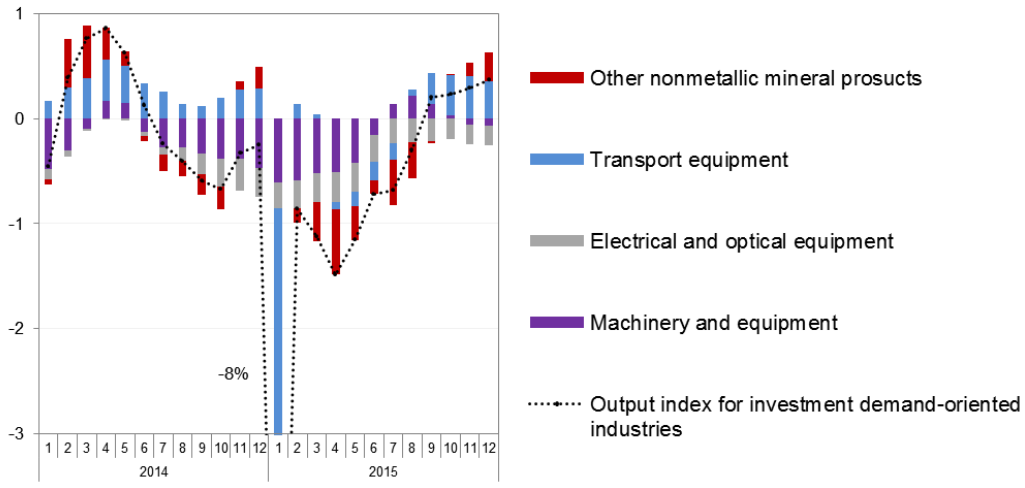
In the tradable sector, the downward trend in the output of goods and services also persists, even though December 2015 saw some growth of the overall output in manufacturing, mineral extraction, and agriculture as compared to the previous month (seasonally adjusted). However, in order to reverse this downward trend, further recovery of production capacities would be required.

In the manufacturing sector, all three industry groups – investment, consumer and intermediate demand-oriented industries – showed better trend dynamics.

In the group of investment demand-oriented industries (Figure 50), the principal factor contributing to the positive development was the output of motor vehicles and equipment (marine vessels and spacecraft). A prolonged decline was followed by an upsurge in the output of other non-metallic mineral products (construction materials). Despite the fluctuations of MoM volumes, production of machinery and equipment maintained its slightly negative trend. Electric equipment output again showed no signs of revival because the industry has no accumulated potential for import substitution. In the near future, investment demand-oriented manufacturing industries are likely to remain the key factor that mitigates the negative dynamics in the tradable sector of the economy.

Figure 50. Output index for investment demand-oriented manufacturing industries

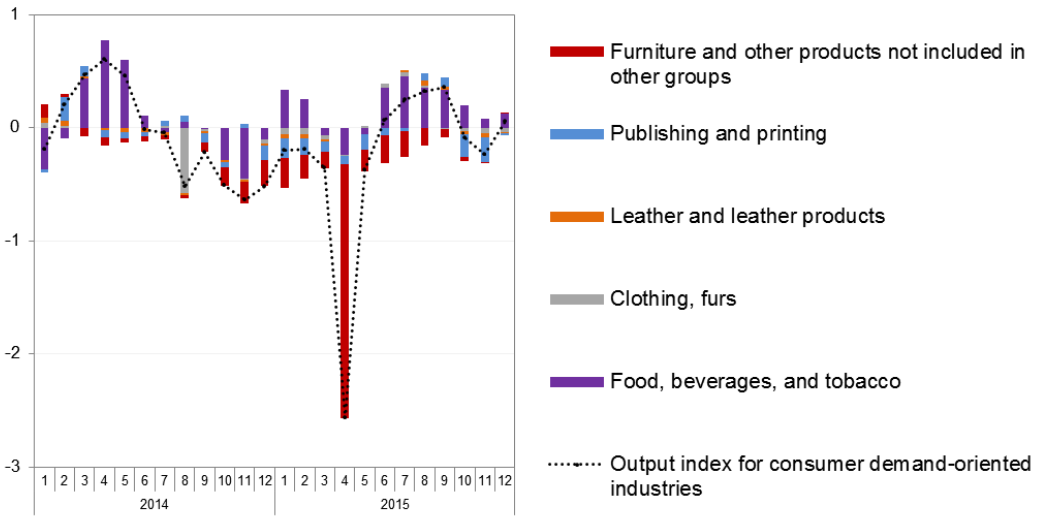
Trend component growth rate, % MoM



Sources: Rosstat, R&F Department calculations

Figure 51. Output index for consumer demand-oriented manufacturing industries

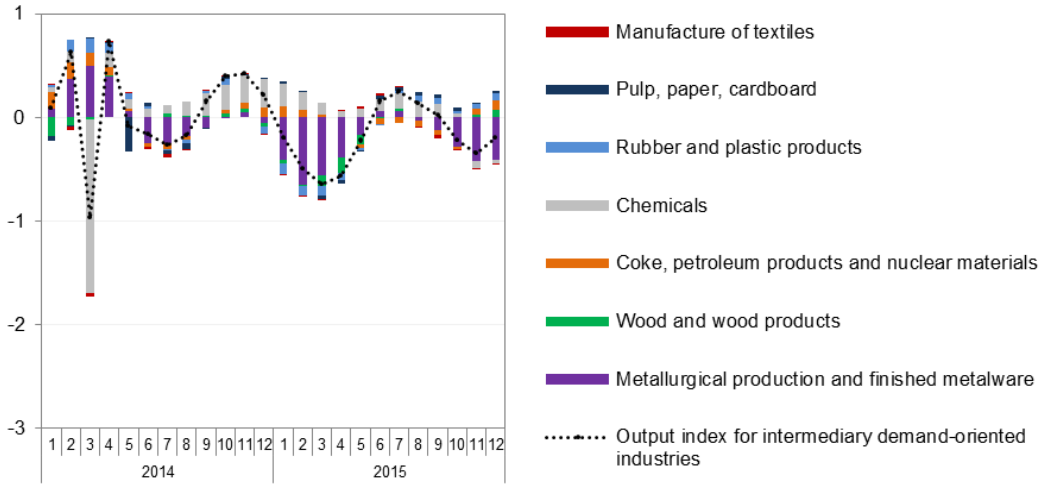
Trend component growth rate, % MoM



Sources: Rosstat, R&F Department calculations

Figure 52. Output index for intermediary demand-oriented manufacturing industries

Trend component growth rate, % MoM



Sources: Rosstat, R&F Department calculations

In consumer demand-oriented manufacturing industries, the trend reversed to reach slightly positive values after the two-month persistence in the negative territory (Figure 51). This group of industries remains under the influence of low consumer activity. While before October 2015 the output of food, including beverages and tobacco, had ensured positive dynamics in consumer demand-oriented industries, in the last months of 2015, the impact of this factor became immaterial despite its upward development amid the unrealised import substitution in the food industry. The growth in production of other consumer goods which could be classified as durables (furniture, clothing, footwear) is restricted by declining real household incomes. Since this dynamics is likely to persist in the next few months, the trend component in the group of consumer demand-oriented industries is unlikely to demonstrate any sustainable growth.

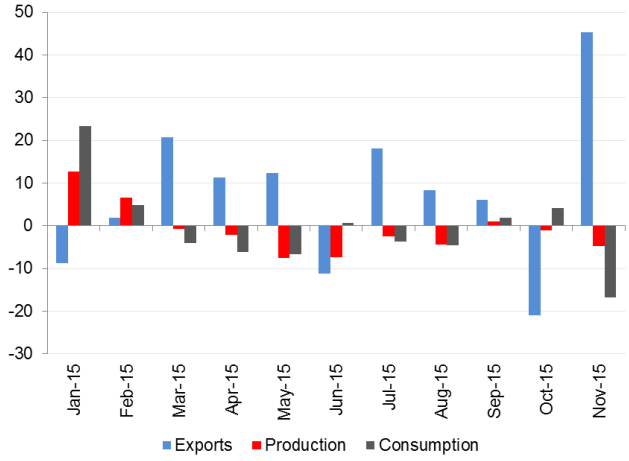
In December, the group of intermediate demand-oriented industries retained a negative MoM output growth, although the scale of the decline was somewhat smaller than in November (Figure 52). Metallurgy was once again the main contributor to the drop of production volumes in intermediate industries; this sector remained under the influence of dwindling internal demand for metal products of consumer industries and the increasing competition of export markets. At the same time, while at the beginning of the year the chemical sector was the main driver for the development of this group of industries (as a result of import substitution and export development), in November and December the MoM production volumes of this sector started falling due to certain products (primarily, paint materials) influenced by the low domestic demand. In the near future, both the demand of consumer sectors and the export supply capacities will determine the trends in intermediate demand-oriented industries.

1.2.3. Ferrous metallurgy: outlook dim

In 2015, development trends in the Russian ferrous metallurgy were determined by reduced domestic demand for rolled metal products, decreased world prices amid growing exports from China, and the ruble exchange rate dynamics. The situation in the industry will be complicated in the next two years: competition with Chinese manufacturers will continue to grow alongside increased protectionism for the export markets and a further decline in domestic demand. However, the weaker ruble will support Russian metallurgists and the expected contraction in the metallurgical production in the world will accelerate growth in metal prices.

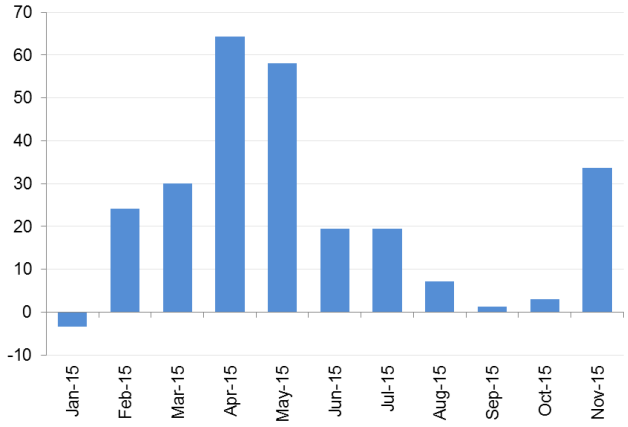
For the first 11 months of 2015, rolled steel production in Russia decreased by 1.2% as compared with the same period in 2014 (Figure 53). One of the main reasons for a decrease in metal production is a reduced consumption. According to market experts' estimates, the demand for steel in Russia decreased by 12% in 2015[4]. This trend was most visible in construction and mechanical engineering, while pipe manufacturers were seen to increase their steel consumption. The market saw an excess of supply over demand. Throughout 2015, metal product inventories at the distributors' warehouses were above the previous year's level (Figure 54).

Figure 53. Rolled steel production, exports, and consumption in Russia, % YoY



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

Figure 54. Rolled steel inventories at Russian enterprises' warehouses, % YoY



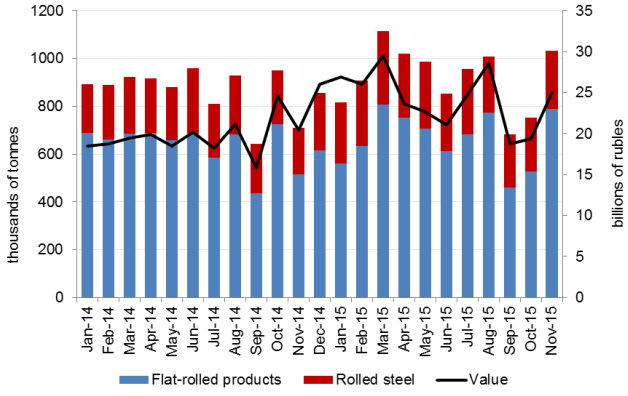
Source: Rosstat

Furthermore, Russian exports of rolled metal products grew by 2.8% in the first 10 months of 2015, but their dynamics were heterogeneous. From the beginning of autumn, the weak ruble stopped supporting exports, and export quantities fell sharply (Figure 55). On the back of excessive inventories at warehouses and high competition between suppliers, domestic quotations for rolled items went down. In spite of a decrease in global

[4] URL: http://metalinfo.ru.

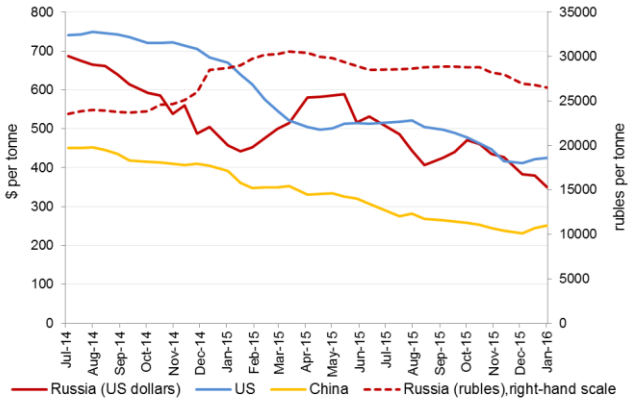
prices, the export quantities of metal products went up again in November, although they showed a considerable decline in terms of their value.

Figure 55. Russian metal-roll exports, quantity and value



Source: Federal Customs Service

Figure 56. Flat hot-rolled products: domestic prices



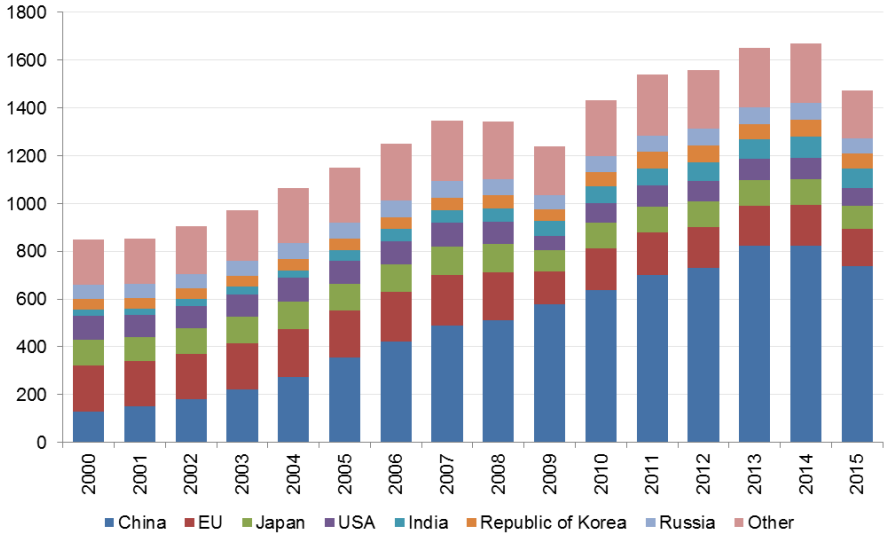
Sources: Metalinfo.ru, SteelBenchmarker

The main factors that affected global price behaviour in 2015 were the excessive manufacture of raw iron ore and, as a result, its low price in the global markets, and excessive metal production in China, which stimulated that country to increase its exports. In addition, a contraction in domestic demand for steel products was observed in many countries that are the largest steel manufacturers in the world.

As far as the prospects of the ferrous metal market were concerned, the main negative factor was increased competition from Chinese manufacturers. In order to balance supply and demand, China shut down some of its production capacities and reduced its output, which should stop, or at least slow down, the further landslide of domestic prices for metal products. As estimated by the Citigroup investment bank, steelmaking in China will decrease by 2.6% in 2016, but the demand for rolled products in China will continue to contract even quicker, resulting in increase in Chinese exports. The yuan depreciation might support Chinese exporters.

Growing protectionism in the export markets in the form of antidumping and countervailing duties imposed by Canada, the EU, and USA will retain its negative impact on the metallurgical industry in Russia.

Figure 57. Global steel production, millions of tonnes



Note. Production over 11 months in 2015.

Source: World Steel Association

The weaker ruble can support Russian metallurgists and enhance their competitiveness in the global market. In January 2016, another ruble depreciation increased the return on export sales once again. Furthermore, the prices for rolled metal products in the global market are getting close to the break-even point, so we should expect a further reduction in the manufacture of rolled products throughout the world, which should eventually lead to a gradual recovery in prices for ferrous metals.

Nevertheless, the metallurgical product market will continue suffering for the next year or two. A further decrease in demand for steel is expected in the Russian domestic market in the nearest future (up to 3%–10% in 2016, according to various estimates). The current conditions will require that Russian metallurgists should revise their development plans, manage the inventories competently, and also implement cost reduction programmes and programmes to maintain their competitive market positions. Many enterprises will obviously start working part-time and will have to take staff reduction measures. However, the full shutdown of metallurgical plants is unlikely.

1.2.4. Consumer and investment activity held back by ongoing uncertainty and weak demand

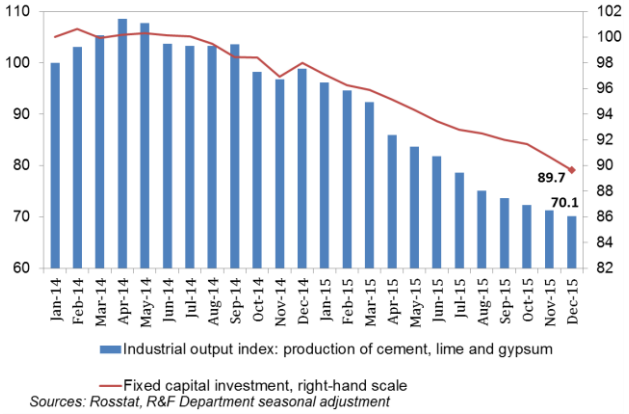
A variety of trends in the economic activity indicators of the construction market shows that the prospects of a quick investment activity recovery are still uncertain. Low demand continues to hinder consumer activity. In the event of a further decrease in oil prices, we expect that the negative situation in retail trade will continue in the near term.

The statistical data on fixed capital investment in December shows an even greater slump in capital investment dynamics at the end of 2015. As estimated by the Research

and Forecasting Department, the decrease in fixed capital investment in November and December 2015 exceeded 1.0% MoM seasonally adjusted. We believe that weak demand and uncertainty about the economic recovery outlook, which should have got more intense recently on the back of dropping oil prices, remain the most significant barrier for investment.

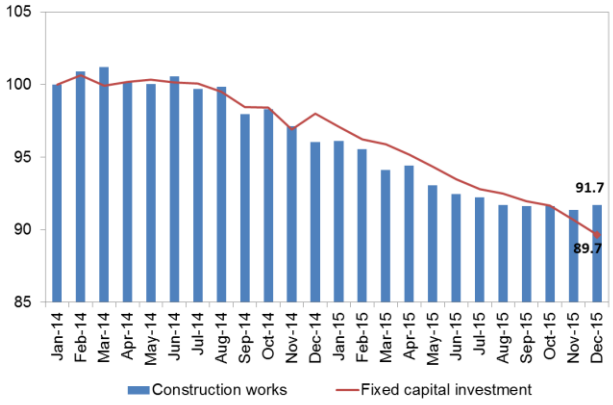
The recent months have also been characterised by a distinct trend towards decline in the cement production, which is one of the indicators traditionally considered to describe the ongoing and likely future investment activity (Figure 58). The dynamics of construction volume has stabilised after a decline in 2015 H1 (Figure 59). However, it is too early to affirm at present that we are witnessing the prerequisites for investment recovery: the monthly dynamics of this indicator were characterised at some points by noticeable volatility, and as a result the seasonally adjusted estimates for this indicator's short-term trends have recently been unstable. Due to negative trends in the economy that engender a high level of uncertainty, we predict that the decline in investment activity will be sustained and continue into 2016 H1.

Figure 58. Cement production and fixed capital investment (January 2014 = 100, seasonally adjusted)



Sources: Rosstat, R&F Department seasonal adjustment

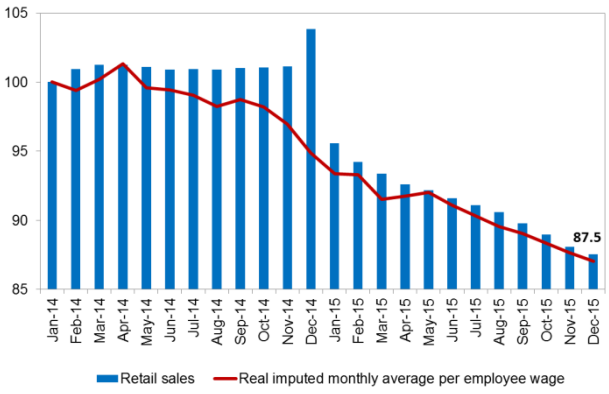
Figure 59. Construction works and fixed capital investment (January 2014 = 100, seasonally adjusted)



Sources: Rosstat, R&F Department seasonal adjustment

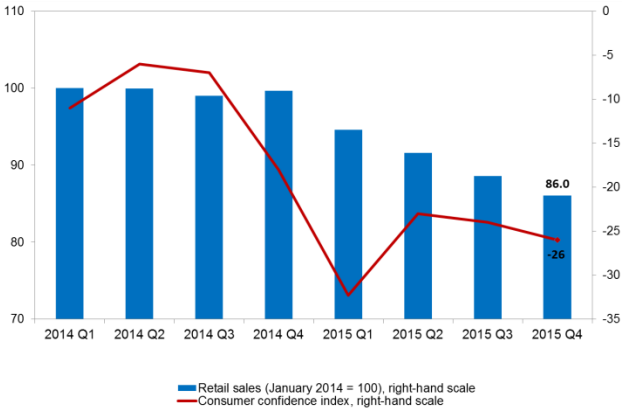
The downward trend in consumer activity continued in December. One of its key drivers remains the decline in real household incomes, which is very likely to continue into the upcoming months (Figure 60). According to Rosstat official estimate, the consumer confidence index in Q4 showed a moderate reduction of 2 pp (Figure 61). However, we believe it is too early to state that consumer confidence will not repeat its local minimum from the beginning of last year at any point in 2016. As we emphasised in the previous issues of Talking Trends, consumer sentiment has been governed to a large extent by the ruble fluctuations, which have recently intensified dramatically due to objective reasons. In the event of a further decrease in oil prices, the weakening of the ruble can invoke a drop in consumption.

Figure 60. Retail sales and real imputed wages (January 2014 = 100, seasonally adjusted)



Sources: Rosstat, R&F Department seasonal adjustment

Figure 61. Retail sales (January 2014 = 100) and Rosstat consumer confidence index



Sources: Rosstat, R&F Department seasonal adjustment

In our opinion, limited opportunities for raising external funds due to a persistently high debt burden in this sector make for an important factor on the supply side, which in combination with low demand will continue to stifle the retail turnover growth. According to estimates published in the Working Paper Series on the official Bank of Russia web-site,[5] the debt burden of the median Russian retail trade company notably exceeds both its microreasonable value and the analogous indicator for developing countries.

1.2.5. Economic activity in most federal districts declines amid persistent regional differences

In November 2015, the fall of the annualised key industry index accelerated. The decline in economic activity was observed even in the regions characterised by stable positive dynamics in the previous months.

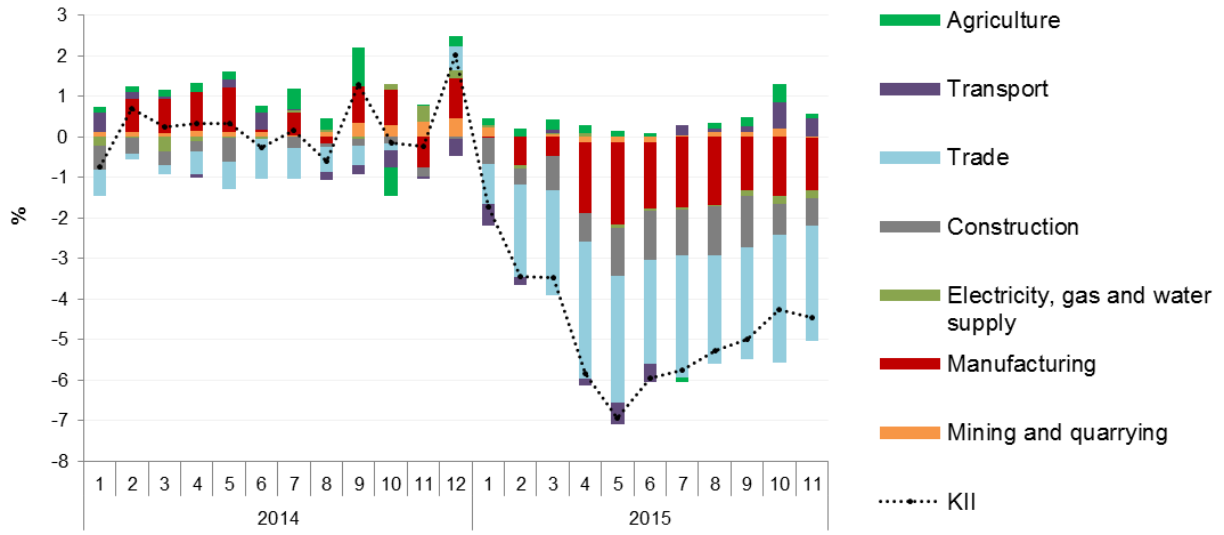
In November 2015, the key industry index (KII)[6] decreased by 4.4% YoY compared to a decrease of 4.3% a month earlier (Figure 62).

[5] For details see S. Donets, A. Ponomarenko. *Measuring Debt Burden // Bank of Russia Working Paper Series*. 2015. No. 5.

[6] KII is calculated as the aggregate of five industry indicators on a year-on-year basis (agricultural output; industrial output, volume of construction; volume of wholesale and retail sales, cargo turnover) with the weights corresponding to the industry's share in gross value added in the region in 2013.

Figure 62. Industrial components' contribution to KII behaviour in Russia

Growth rate, % YoY



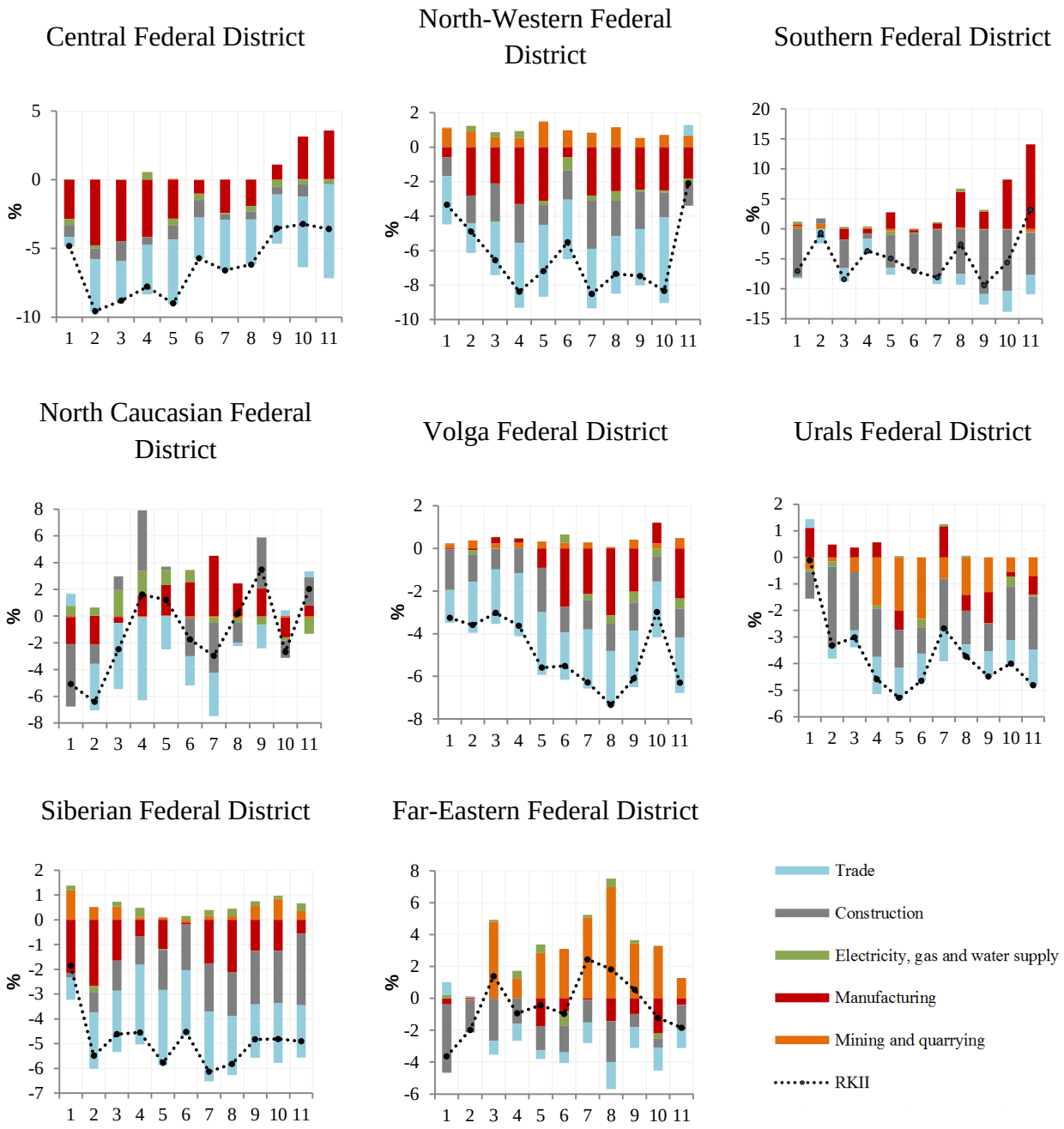
Sources: Rosstat, R&F Department estimate

The KII value in November was influenced by two varying trends broken down by industry. The first positive trend showed a reduced negative impact on the KII dynamics in trade, construction, production, electricity, gas and water supply, and manufacturing industries. However, this is not associated with the improved economic situation in the manufacturing and construction industries (production volumes in these areas fell in November compared with October); it has rather been determined by the influence of the calendar factor and the low base of November in the past year, when the manufacturing and construction industries suffered a decline. The negative influence of trade was mitigated by the slowdown of the YoY negative growth in wholesale turnover on the back of the intensified drop in retail trade, which contributes less to the KII dynamics. The second negative trend in the formation of the index was a reduction in the positive contribution of the following three sectors: mining and quarrying, transport equipment, and agriculture. The latter is associated with a reduction in mining and quarrying volumes, cargo turnover, and agricultural output in November compared with October.

Therefore, there was a month-on-month decline of almost all indicators included in the KII. This indicates a high probability of negative GDP growth in November compared to October.

Figure 63. Industrial components' contribution to RKII growth in 2015

Growth rate, % YoY



Sources: Rosstat, R&F Department estimate

The regional picture of the crisis remains blurred. In the Central, Volga, and Siberian Federal Districts, where an increase of economic activity was observed for several months preceding November, the values of regional key industry indices (RKII)[7] showed

[7] A regional key industry index (RKII) has been developed for the purpose of prompt monitoring of the economic situation in different regions. As there is no official information on agricultural output and cargo turnover broken down by federal district, the RKII is estimated using three industry indicators: industrial output, construction, and wholesale and retail turnover.

negative dynamics once again (Figure 63). The further reduction in retail and wholesale turnover has become a determinative factor of such dynamics in the Central Federal District, the decline in manufacturing – in the Volga Federal District, and the intensified slump in construction and slower positive growth in mining and quarrying – in the Siberian Federal District.

Negative trends in the Far-Eastern Federal District intensified because of a further reduction in the positive contribution of mining and quarrying to the RKII change.

In November 2015, a growth in economic activity was observed in the North-Western, Southern, and North Caucasian Federal Districts. Furthermore, the key industry indices in the Southern and North Caucasian Federal Districts exceeded last year's values. This trend is likely to be unstable in the long run.

Against the backdrop of such a negative picture, growing manufacture indicators in the Southern and Central Federal Districts show a positive trend. Mechanical engineering turned out to be the key development driver for these regions, although the industry indices were declining countrywide. While investment demand remains low, the growth in mechanical engineering can be associated with support for companies in the Central and Southern Federal Districts under import substitution and defence procurement programmes.

In the Central Federal District the manufacturing industries have been showing positive year-on-year growth over the last three months thanks to a growing output of machines and equipment, electrical equipment, vehicles and equipment, coke, oil products, and nuclear materials.

In the Southern Federal District the growth in the indicators of most manufacturing industries has been observed over the recent months. The manufacture of transport equipment and of machinery and equipment showed the highest rates of growth year-on-year. The Rostov Region is home to the largest machine-building enterprises that are engaged in industrial defence procurement programmes, as well as Rostselmash Combine Plant LLC, which increased its supplies of agricultural machinery to the Russian domestic market by 20% in 2015.

1.2.6. Unemployment growth halted in December

The unemployment rate (seasonally adjusted) fell from 5.8% in November to 5.7% in December 2015. The new wave of lay-offs and growing unemployment stopped in December but is highly likely to resume in 2016. The labour market low mobility can hinder the economy's adjustment to low oil prices.

The current recession in the Russian economy is characterised by the moderate growth in unemployment and the lack of active lay-offs. As the structural factors prevail in the recession, the insignificant re-allocation of labour resources between enterprises, sectors, and regions impedes the active adjustment of the Russian economic structure to

the low energy prices. This can postpone the beginning of an active phase of economic growth, but it also contributes to maintaining social stability.

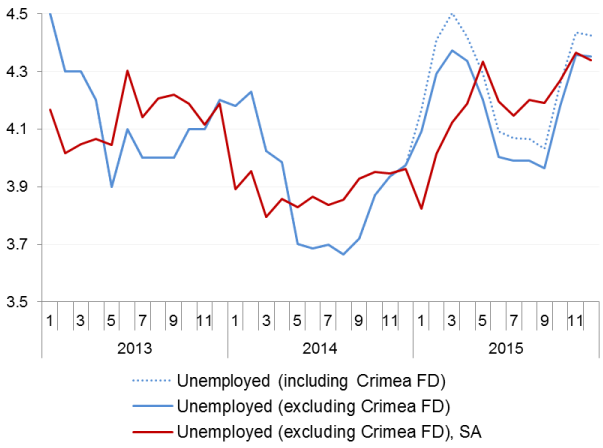
As reported by Rosstat, the unemployment rate in December 2015, taking into account data for the Crimea Federal District, remains the same as in November standing at 5.8%. The seasonally adjusted unemployment rate fell from 5.8% in November to 5.7% in December (Figure 64), and the number of unemployed, seasonally adjusted (excluding the Crimea Federal District) decreased by 0.6% compared with November (Figure 65).

The second wave of unemployment growth in December 2015 was held back from spreading out by the rather stable position of industrial output. In addition, industrial enterprises are still trying to avoid mass lay-offs by relegating employees to part-time work, when necessary. The rather small scale of lay-offs in this recession can also be explained by the fact that in these conditions Russian industry simply does not have the excessive number of employees that it used to have in past crisis years.

When companies try not to go forward with mass lay-offs, there is a considerable reduction in the number of vacant jobs. As the Ministry of Labour reported, employers' demand for employees shrank by a third in 2015 compared to last year. This slump in the demand for manpower will have an adverse impact on the unemployment rate in the near future. Growing uncertainty at companies about a quick economic recovery forces them to cut their production plans, which can also cause an increase of dismissals. Therefore, the probability of growing tension in the labour market continues into 2016.

Figure 64. Unemployment, including Crimea FD

Figure 65. Number of unemployed, millions



** Data for December 2015 are preliminary ones.*

Sources: Rosstat, R&F Department calculations

1.2.7. Underemployment remains high, especially in regions specialising in problem manufacturing industries

According to operating data from the Russian Ministry of Labour, the number of employees who had to work part-time was still high at the end of 2015. The highest underemployment was observed in certain regions of the Central, Urals, and Volga Federal Districts specialising in the machine-building and textile industries.

The growth of underemployment is traditional for the Russian labour market as it adjusts to crisis conditions. The most popular form of part-time employment is an unpaid leave at the employee's own request (i.e., voluntary part-time employment). The other forms of part-time employment are forced. They are either initiated by an employer or are formalised by a mutual agreement of the parties. Although these forms do not make major contributions to part-time employment, forced underemployment can be a signal that there are problems in the labour market.

Figure 66. Number of forced underemployed as of reporting date, people (outer date: 13 January 2016)

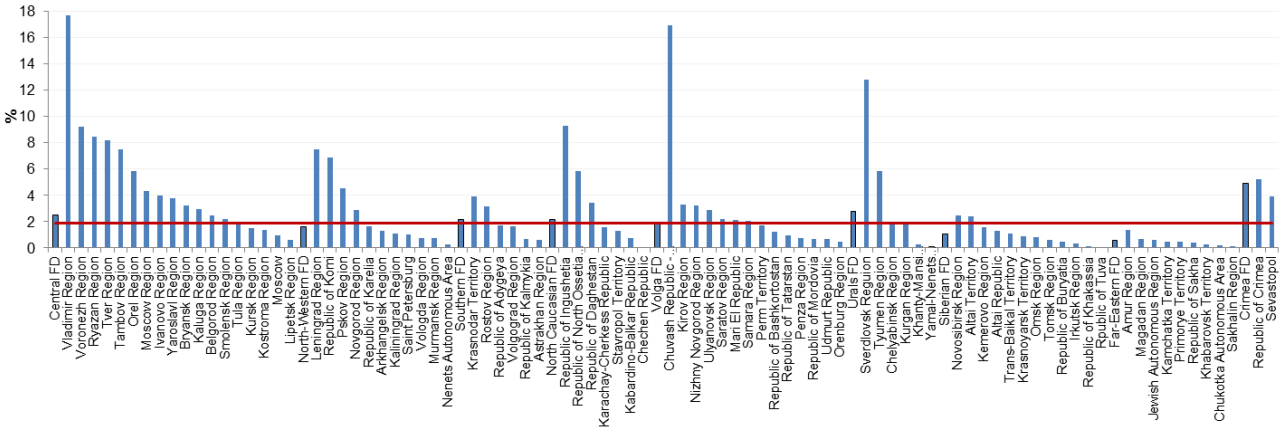
Sources: Monitoring of employee dismissal due to liquidation or staff reduction, as well as introduction of underemployment regimes, RF Ministry of Labour and Social Protection, R&F Department calculations

According to the most recent monitoring data from the Ministry of Labour of the Russian Federation on forced underemployment, as of the end of 2015 Q4 (23 December 2015), the number of employees standing idle or working part-time on the employer's initiative, as well as employees who have been sent into unpaid leaves through the mutual agreement of the parties amounted to 280,770, a decrease of 1.7% (excluding the Cri-

mea Federal District) compared to the end of Q3 (30 September 2015). Nevertheless, after large-scale growth in 2015 H1 (especially as a result of the increased number of employees working part-time on the employer's initiative), forced underemployment continues to remain at a rather high level compared to the beginning of the year (Figure 66) and is holding back unemployment growth. Besides, the trend towards increasing underemployment on the employer's initiative or through the agreement of both parties indicates declining labour market flexibility.

The share of partially employed in the average headcount of companies that have informed employment agencies about the dismissal of employees or the introduction of underemployment regime might be used as an indicator of tension in the regional labour market. According to the Ministry of Labour reported data as of 23 December 2015, the higher than average indicator was registered in the Central, Urals, and Crimea Federal Districts (Figure 67). A large number of persons working part-time can be seen in certain metallurgical and machine-building regions of Urals (Sverdlovsk and Tyumen Regions), machine-building regions of Volga (Chuvash Republic), and also central regions specialising in machine-building and textile industry (Vladimir, Voronezh, Tver Regions, and other).

Figure 67. Share of underemployed in the average headcount included in monitoring, by region as of 23 December 2015



Sources: Monitoring of employee dismissal due to liquidation or staff reduction, as well as introduction of underemployment regimes, RF Ministry of Labour and Social Protection, R&F Department calculations

The high risk zone covers regions that have enterprises operating as the major employers. Thus, the major employers in the Vladimir and Sverdlovsk Regions and in the Chuvash Republic made up to a half and more of the number of all persons working part-time in the respective region.

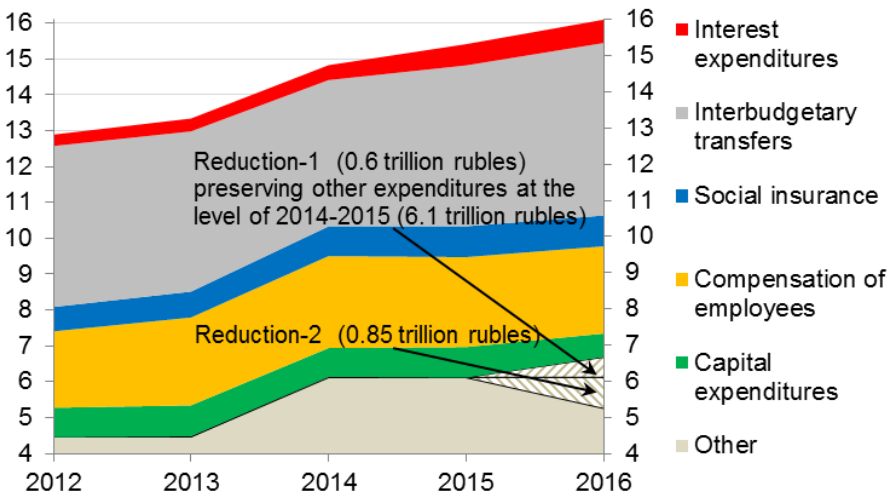
1.2.8. Fiscal policy procyclicality: a compulsory measure

Limited internal and external sources of public borrowing tightly bound the federal budget deficit and compel to conduct the policy of reducing expenditures amid the insufficient amount of the Reserve Fund. This makes the fiscal policy

procyclical during the economic recession and adversely impacts GDP growth estimated at 0.2–0.3 pp in 2016. A reduction in expenditures (excluding those protected) to 2014–2015 levels will save around 0.6 trillion rubles.

If the average price for Urals crude stays at $35/barrel, this will result in a fall of federal budget revenues of roughly 1.45 trillion rubles from the amount approved by law, thus increasing the deficit from 3.0% to 4.8% of GDP. Following the deficit target of 3% of GDP without increasing the tax burden causes a need to reduce expenditures respectively by almost 9% of the 16.1 trillion rubles approved by law.

Figure 68. Federal budget expenditure (trillions of rubles)



Sources: Russian Ministry of Finance, Russian Federal Treasury, R&F Department calculations

As a result of freezing the funded component of pensions, the share of the protected expenditures of the federal budget[8] decreased from about 60% in 2012–2013 to 55% in 2014–2016, according to our estimates. Excluding capital expenditures, the reduction of other federal budget expenditures to 2014–2015 levels in absolute terms will save 0.6 trillion rubles (Figure 68). The remaining reduction in expenditures (in the amount of 0.85 trillion rubles) will require a contraction of capital expenditures, which have already been reduced below the 2015 level, or a further reduction in other expenditures. An alternative option may be a more substantial utilisation of money from the Reserve Fund, the unspent budgetary funds from the previous year, and privatisation[9]. If the average annual oil price remains at a level below $35/barrel in 2016, this will require more sources to finance the deficit.

The need to reduce expenditures should be used to optimise them. The negative impact on economic growth from reducing expenditures by 0.6 trillion rubles (according to the ordinary structure of expenditures) can reach 0.2–0.3 pp. A worsening of the scenario

[8] These include interest expenditures, compensation of employees and social insurance expenditures, as well as interbudgetary transfers, including transfers to the regions considering their significant deficits.
[9] Increasing the net domestic debt in 2016 from the planned amount of 300 billion rubles will require the provision of considerable premiums to market interest rates.

macroeconomic conditions should also serve as a ground for the refusal of any additional pension indexation at the expense of the reserves.

1.3. Inflation stays high, inflation risks go up

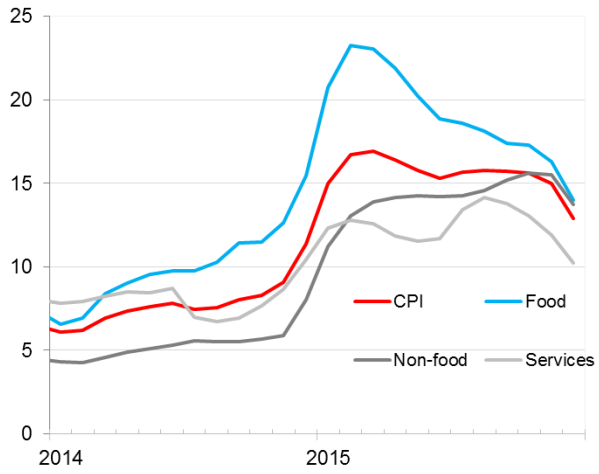
1.3.1. Ruble depreciation in December–January may add to 2016 inflation up to 1.3 pp in Q1

December inflation remained at the level of last month (0.8% MoM). The quickest acceleration of monthly CPI growth was observed in the food goods and services segment (Figure 69). Price growth for food goods remained at November 2015 levels and stood at 1.2% MoM (14.0% YoY), providing a 0.44 pp contribution of this group of goods to monthly inflation (Figure 70). The largest price increase was observed in the fruit and vegetables segment (over 20% of growth on certain components), which greatly influenced food inflation in December.

The prices for services in December 2015 grew by 0.7% MoM (10.2% YoY). The increase in prices for consumer services in December was mostly connected with the growing costs of passenger transport and tourism services. As a result of the slowdown in real household income, no considerable growth in prices for services is to be expected.

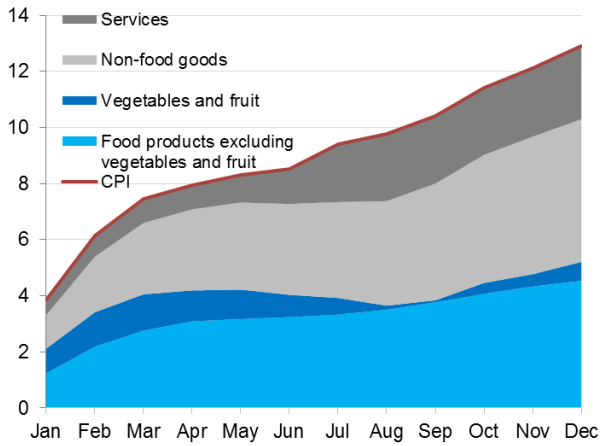
Price growth for non-food products slowed down from 0.7% MoM in November to 0.4% MoM (13.7% YoY) in December 2015. The contribution of non-food goods to inflation totalled 0.14 pp. The reduction in the contribution of non-food goods can be attributed to the mitigation of the exchange rate pass-through effect and a decline in consumer demand.

Figure 69. Prices in key segments of consumer market, % YoY



Sources: Rosstat, R&F Department calculations

Figure 70. Contribution of consumer goods and services to CPI, % MoM



Sources: Rosstat, R&F Department calculations

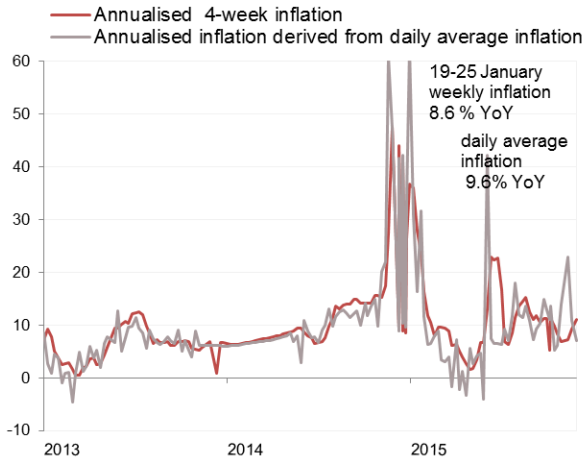
However, the pass-through effect of the weakening exchange rate observed in December 2015 through the first half of January 2016 might cause an additional growth in consumer prices up to 1.3 pp in 2016 Q1, all else equal.

Data on weekly inflation from 19 to 25 January 2016 show the shift in price growth from administered to non-regulated ones alongside the retention of the average daily price growth at the level of the previous week (0.028%). This might reflect the pass-through effect of the weakening ruble onto consumer prices.

Seasonally adjusted annualised inflation (inflation calculated a year ahead, proceeding from the average daily rate over the reporting week) was 10.5% YoY for the week of 19 to 25 January. Seasonally adjusted 4-week moving inflation went down to 9.1% (calculated a year ahead) and returned to 2014 levels (Figure 71).

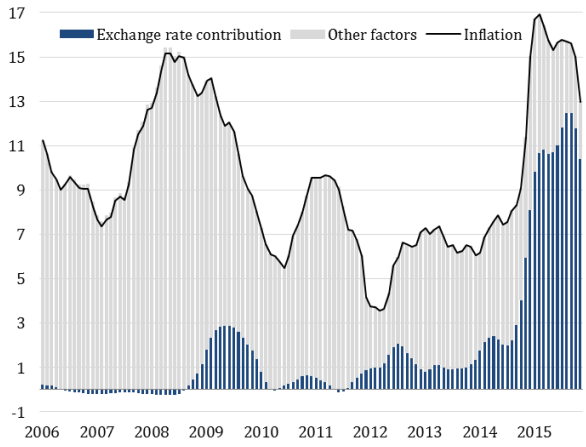
The possibility of new foreign currency shocks amid declining oil quotations remains the main source of inflation risks in 2016. Currently the pass-through effect of the weakening exchange rate that occurred in December through the first half of January 2016 is being held back by consumer demand shrinkage. However, the exchange rate weakening observed in January poses risks for inflation acceleration in average daily terms (Figure 72).

Figure 71. Weekly inflation based on prices for 64 goods and services, % YoY



Sources: Rosstat, R&F Department calculations

Figure 72. Inflation decomposition, % YoY



Sources: Rosstat, R&F Department calculations

1.3.2. Inflation expectations continue growing in January

Despite the quick annual inflation reduction in November 2015–January 2016, household inflation expectations grew during this period, thus creating material inflation risks. Most likely, these expectations were affected by the slump in oil prices and the ruble depreciation. Anyway, the increased inflation expectations considerably complicated the slowing of inflation down to the target for 2017.

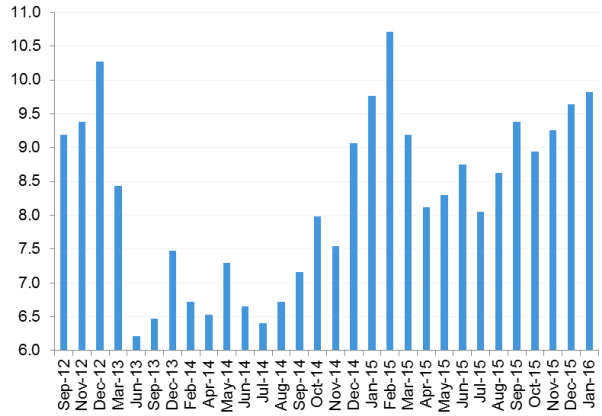
According to the survey data of inFOM LLC, household inflation expectations a year ahead are still at a high level in January (Figure 73). The Research and Forecasting Department's estimates show that inflation expectations continued to grow in January compared to December: January estimates were 9.7% against 9.6% in December. These estimates consider the Research and Forecasting Department adjustment for the systematic overrating of expected inflation by survey respondents (see '***inFOM LLC surveys: adjustment for systematic overrating of inflation by respondents'*** below). Diffuse indices also indicate that in light of recent fluctuations in oil prices and the ruble exchange rate, the respondents interviewed by inFOM LLC are also disposed to expect an acceleration of price growth (Figure 74).

inFOM LLC surveys: adjustment for systematic overrating of inflation by respondents

In addition to the relevant survey data from inFOM LLC, we adjusted the regular overrating by respondents of survey data on inflation expectations. According to estimates, inflation expectations grew to 9.7% in January compared to 9.6% in the previous month. These calculations were based on the econometric assessment of the linear factor from the paired regression of actual consumer inflation in 12 months (as % of the respective period of the previous year) to the values of survey indicators at each moment of time.

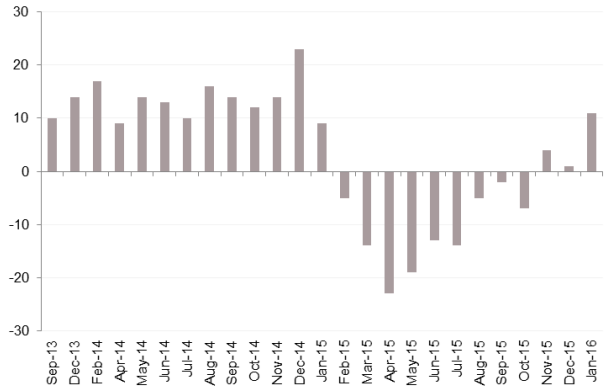
Retrospective estimates showed that the resilience of actual future inflation based on household expectations is statistically far below 1. From the informative point of view, this result will not suffer any changes even if we exclude the upper quantile from the sample which corresponds to respondents who have provided the highest rates of expected inflation. This allows us to talk about the trend towards persistent overrating of inflation by respondents in their interviews.

Figure 73. Direct inflation expectation estimates by inFOM LLC adjusted for their regular overrating, % YoY over a calendar year



Sources: Rosstat, inFOM LLC, R&F Department calculations

Figure 74. Diffuse index of replies 'will grow quicker than now' and 'will grow slower than now' to the FOM question: 'How will prices change over the next 12 months, in your opinion?', % YoY



Source: inFOM LLC

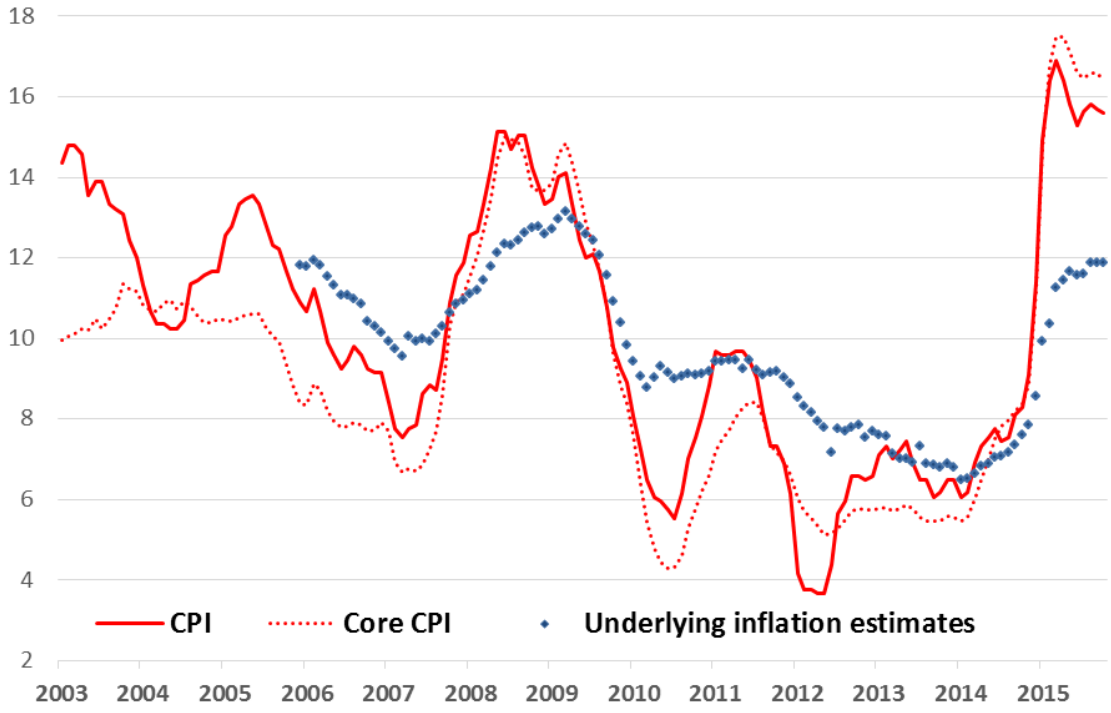
1.3.3. Underlying inflation continues to be high

In December, the annual rate of underlying inflation decreased to an estimated 11.1%[10]. The technical factors (in particular, considerable fluctuations of the seasonal component's estimates in the basic data used for calculations) were instrumental for the underlying inflation review. However, despite this decrease the underlying inflation estimate continues to be high.

If the current trends in price and monetary aggregates dynamics persist, we expect that underlying inflation estimates should go down gradually. However, if the increased inflation risks materialise, the underlying inflation slowdown will be much slower, retaining inflation at a higher level than it is required for reaching the inflation target of 4% in 2017.

[10] The underlying inflation level is calculated as a median value of three estimates obtained from singling out the unobserved common component from a set of price indicators through dynamic factor models. The method for evaluating underlying inflation is described in the Bank of Russia research paper: E. Deryugina, A. Ponomarenko, A. Sinyakov, K. Sorokin. Evaluating the Underlying Inflation Measures for Russia // Bank of Russia Working Paper Series. March. 2015. No. 4.

Figure 75. CPI, core CPI and Bank of Russia historical estimates of underlying inflation, % YoY



Sources: Rosstat, R&F Department calculations

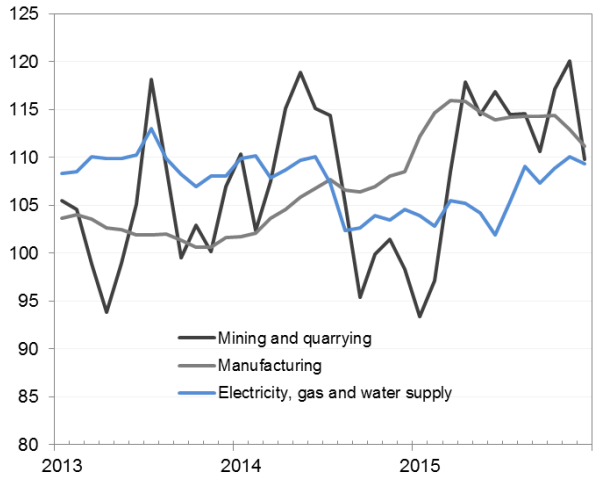
1.3.4. Slowdown in producer price growth determines annual inflation decrease in early 2016

The downward price trend in the consumer goods sector forms the basis for a further slowdown in the annual growth of producer price index and food inflation in early 2016, but this basis is not strong enough yet for a sustained inflation deceleration throughout the year.

In December, the producer price index continued its downturn by 2.2% MoM (in November 2015, it declined by 0.7% MoM). Annual producer price growth slowed from 13.9% YoY in November to 10.7% YoY in December 2015. The overall price growth in the mining and quarrying industry was 9.8% YoY; in the manufacturing industry, 11.2% YoY; in the electricity, gas, and water supply, 9.3% YoY (Figure 76).

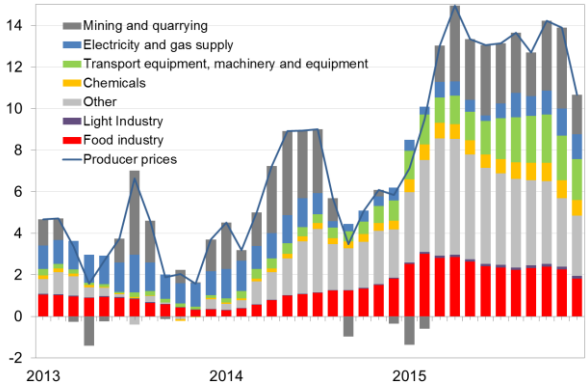
The contribution of the manufacturing industry to the annual producer price index over the said period was 7.6 pp (8.7 pp in November), the mining and quarrying contribution was 1.9 pp (3.9 pp in November), and that of the electricity, gas, and water supply was 1.1 pp (1.3 pp in November). As a result, the contribution of all the components to the annual producer inflation decreased considerably compared to the previous month (Figure 77).

Figure 76. Producer prices in individual industries, % YoY



Sources: Rosstat, R&F Department calculations

Figure 77. Contribution of individual industries to producer prices, % YoY



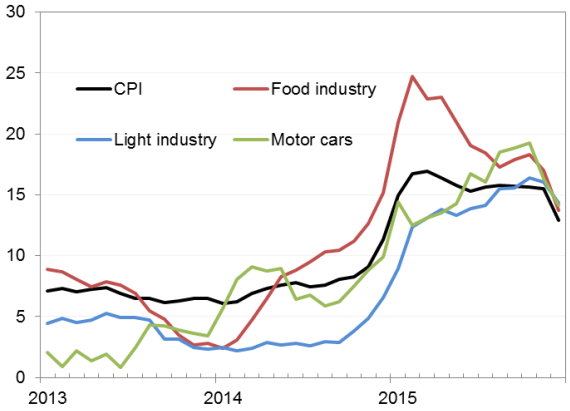
Sources: Rosstat, R&F Department calculations

In December 2015, producer prices in the mining and quarrying industry decreased by 7.1% MoM compared to November 2015, thereby determining the industry's significant contribution to the slowdown of inflation. The analysis of certain components of domestic producer prices shows that in December 2015 the sharpest decline in prices was registered in the fuel and energy sector, mainly through the price decrease in crude production of 8.0% MoM (increase of 9.5% YoY) and in iron-ore concentration of 7.1% MoM (increase of 13.9% YoY). The commodity price dynamics was the key driver of the deceleration of prices in the specified sectors.

The dynamics of manufacturing producer prices slowed by 1.3% MoM largely due to natural resources processing (up to 7.2% MoM in the production of petroleum products).

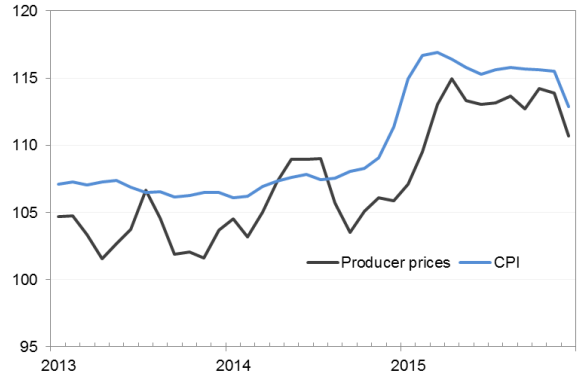
However, the maximum price growth was shown by the food industry, which determines consumer price growth for food products to a large extent (0.6% MoM). Although the annual growth of food industry prices declined from 17.0% YoY in November to 13.7% YoY in December, the monthly growth of prices still exceeds the level required for reducing inflation to the forecast level of 2016 (6.5%).

Figure 78. Consumer goods producer prices and consumer prices, % YoY



Sources: Rosstat, R&F Department calculations

Figure 79. Consumer and producer price indices, % YoY



Sources: Rosstat, R&F Department calculations

2. Outlook: leading indicators and forecasts

2.2.1. GDP nowcast: higher risks of ongoing recession in the first half of the year

The macrostatistics for the past month confirm our December assumption that the recession is likely to persist in 2016 H1. The December data on the leading, financial and non-financial indicators of the real sector signal the ongoing economic downturn. Our estimates of the GDP growth in the two-quarter horizon have been revised downwards against the calculations last month.

The GDP index estimate[11] for 2015 Q4 was revised downwards to -0.8% QoQ in December compared to -0.6% QoQ in December (seasonally adjusted).

The key factors triggering the downward revision of the GDP nowcast compared to the previous month were PMI in manufacturing, fixed capital investment, and retail trade turnover (Figure 80). In December, the dynamics of these indicators were worse than we expected in the previous month.

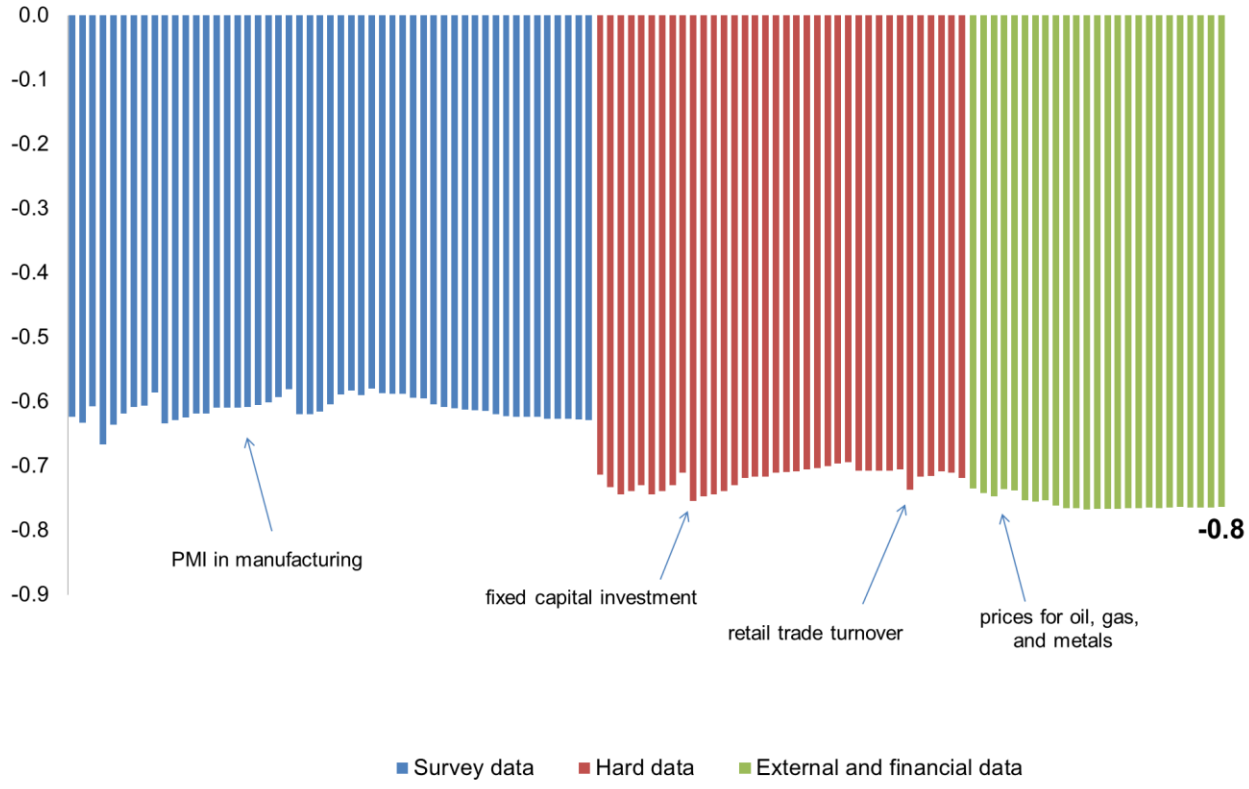
The negative input of the drop in oil prices can be observed, as this indicator is included in the model and deteriorates the GDP nowcasts for Q4, albeit by a relatively small value (less than 0.1 pp). It should be noted that the contribution the drop in oil prices has on the GDP estimate is reflected implicitly in the aggregate with the indicators used in the GDP nowcast index estimate model. The development of the index estimate, after the oil price index is included in the model (Figure 80), can be interpreted to a greater extent as the contribution of oil price dynamics not sufficiently taken into account and which is still not reflected in the broad spectrum of indicators used in the model.

Given the December statistics, we have revised downwards our estimates of the GDP growth in 2016 Q1 to -0.7 QoQ (the R&F model estimate for December was -0.3% QoQ, seasonally adjusted). In 2016 Q2, we estimate the decrease in the seasonally adjusted GDP to stand at -0.3% QoQ (in December the model forecast near-zero dynamics). However, these values might change considerably in future as new short-term statistics becomes available.

[11] GDP index estimate is based on Rosstat's data on social and economic situation in Russia in the corresponding month and other statistical, leading and financial data as of the calculation date, and results from simulation of a dynamic factor model. These Research and Forecasting Department forecasts are based on model calculations and their results do not represent the official Bank of Russia's forecast. The data set used for GDP index estimate includes 110 different time series divided into three groups: 1) survey data, 2) hard data, 3) external and financial data. The detailed methodology for the GDP index estimate is described in the Bank of Russia's Working Paper Series: A. Porshakov, E. Deryugina, A. Ponomarenko, A. Sinyakov. // Nowcasting and Short-term Forecasting of Russian GDP with a Dynamic Factor Model // Working Paper Series. March 2015. No. 2.

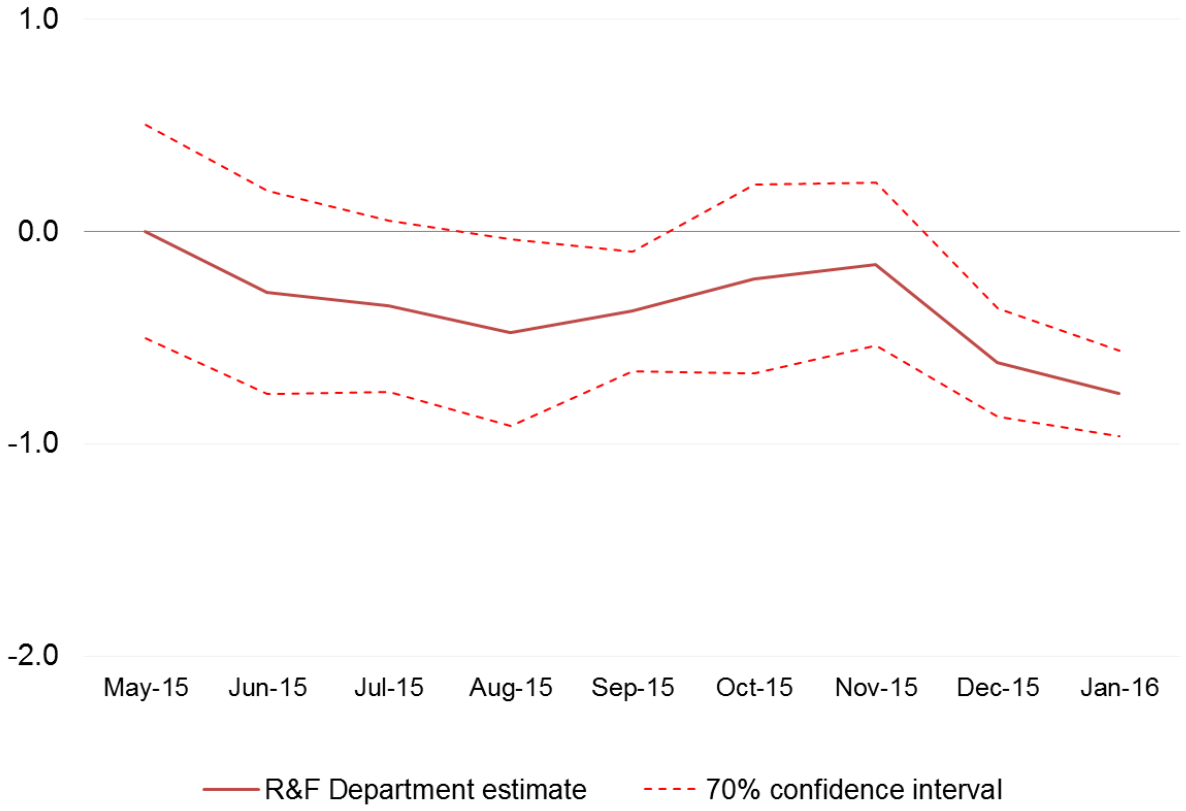
	January 2016	December 2015
	% QoQ	% QoQ
2015 Q4	**-0.8**	-0.6
2016 Q1	**-0.7**	-0.3
2016 Q2	**-0.3**	0.0

Figure 80. Evolution of DFM-based GDP nowcast for 2015 Q4 (performed in January 2015), pp



Sources: Rosstat, R&F Department calculations (seasonally adjusted)

Figure 81. Estimate of annualised GDP growth in 2015 Q4, % QoQ



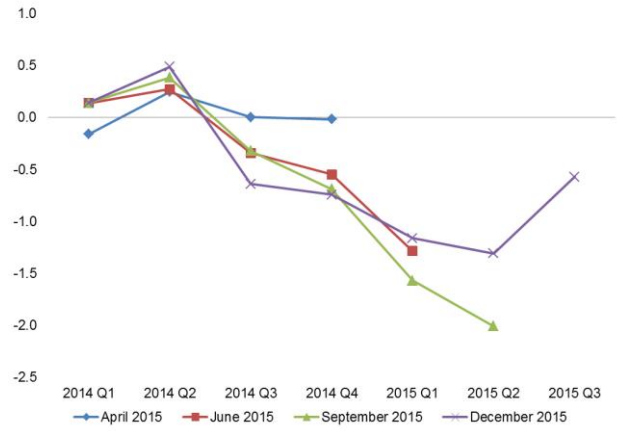
Source: R&F Department calculations

On the Rosstat methodology for calculation and revision of the GDP data and the specifics of the R&F short-term model estimate

In late January, Rosstat published the first estimate of the GDP growth in 2015, it stood at -3.7%. This figure exceeded expectations of many analysts and, particularly, that of the R&F December model estimate of -3.9%. Provided that the dynamics of the GDP seasonal component for 2015 is not further reviewed, according to the R&F calculations, the published annual estimate assumes that no continuing GDP fall was observed in Q4, seasonally adjusted.

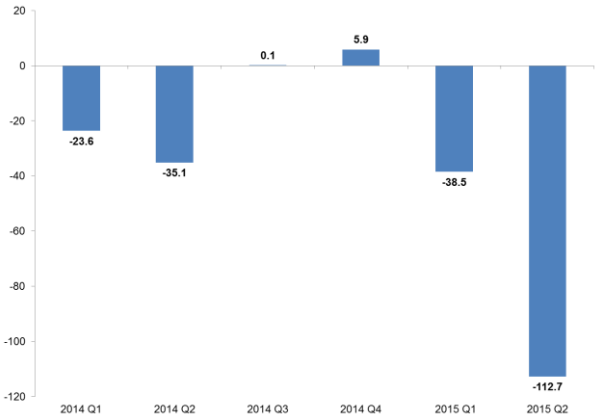
However, based on our short-term model estimates, we believe that the GDP dynamics in 2015 Q4 still pointed to a continuing recession in the economy. A relatively more optimistic Rosstat's estimate compared to market expectations is likely to be related to its positive revision of the seasonally adjusted quarterly GDP growth for the first nine months of 2015, its outcome has not yet been officially published. A similar situation was seen when Rosstat improved the estimates of seasonally adjusted quarterly GDP growth in 2015 H1 in December (Figure 82).

Figure 82. GDP in 2008 prices (% QoQ, Rosstat seasonal adjustment)



Source: Rosstat

Figure 83. Rosstat December revision of GDP seasonal component in 2008 constant prices ('–' means decrease), billions of rubles



Sources: Rosstat, R&F Department calculations

It should be noted that a considerable divergence in the R&F model estimate of the annual GDP growth for Q3 (-5.0% YoY against Rosstat's data -4.1% YoY) largely resulted from the use in the R&F calculations of the previous quarterly GDP growth in 2015 H1, which was not revised upwards[12]. A December review by Rosstat showed that the 4.1% annual GDP fall, which was below the analysts' expectations, occurred in Q3 on the back of the continuing recession in 2015 Q3 in line with R&F forecasts.

Given the above, when assessing the accuracy of the GDP nowcast, **we focus, first of all, on their conformity with the actual seasonally adjusted quarterly GDP dynamics,** since this indicator is assessed through the short-term macroeconomic statistics used for modelling. At the same time, the estimate of the annual GDP growth rate may be associated with a certain inaccuracy due to a volatile and sometimes seriously revised seasonal component. The forecast of the seasonal component exceeds the primary objectives of traditional dynamic factor models.

Given another expected revision of the seasonal component in the GDP data, we continue to base our estimate for Q4 not on Rosstat's first official estimate for 2015 as a whole but on the model calculations with regard to a wide range of short-term macroeconomic indicators which signal that the recession is continuing.

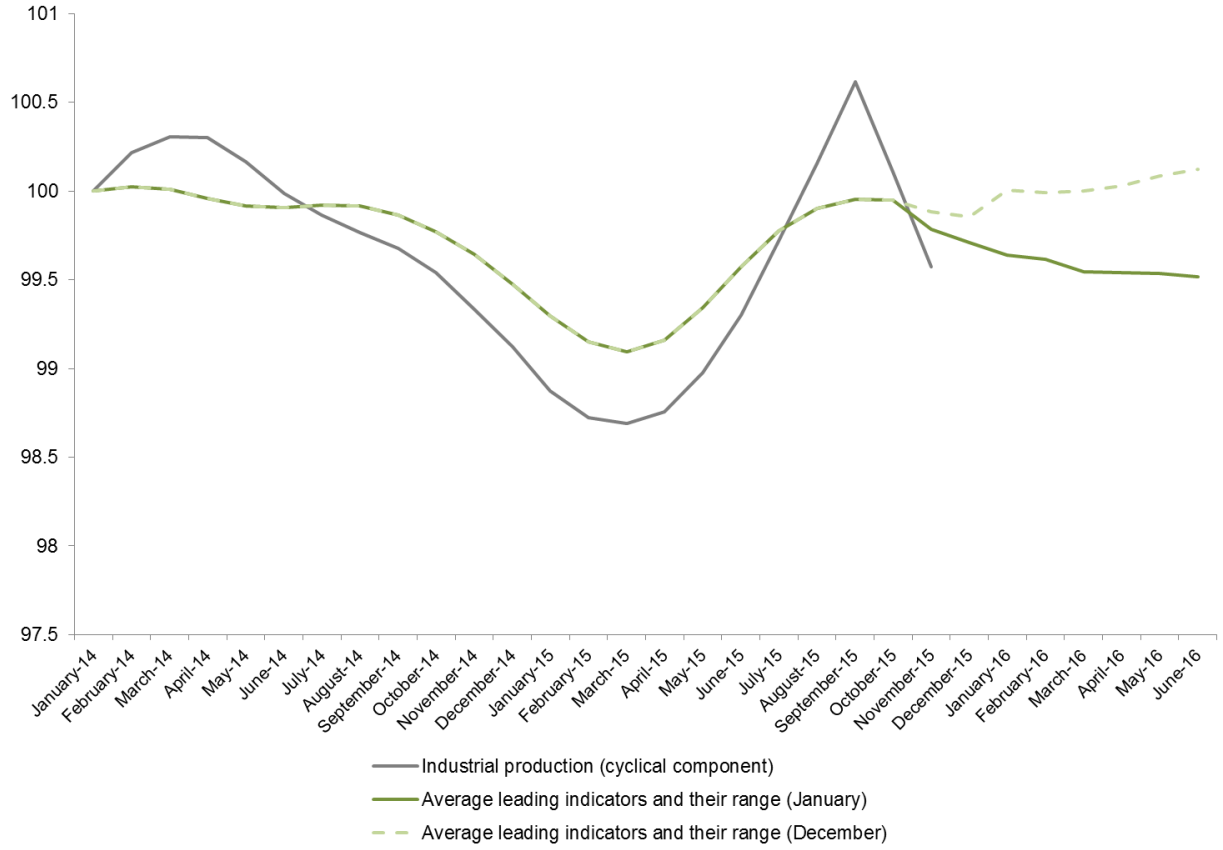
The GDP dynamics for 2015 broken down by quarters and covering Q4 is expected to be published early in April.

[12] For details *see* Talking Trends No. 1. October, 2015. Section 2.1.1 GDP nowcast and forecast: macro-indicators in line with expectations.

2.2.2. A decline in the composite leading business indicator: industrial recovery is put on hold until at least the second half of the year

The composite leading business indicator[13] continues to show no signals to resume the industrial growth in 2016 H1 (Figure 84). We expect the cyclical component of industrial production to show a slightly negative dynamics in the coming months. The scenario of a further output contraction in Q1 and Q2 is estimated to be much more probable than the growth scenario.

Figure 84. Cyclical component of industrial production (January 2014 = 100, seasonally adjusted) and leading business index



Sources: Rosstat, HSBC, Russian Economic Barometer, R&F Department calculations

The current index estimate was largely shaped under the impact of PMI for Russia, which prevail in the list of indicators showing most leading properties we selected through our statistical methodology. In addition, the ongoing decline in oil prices pushes the cur-

[13] Calculated by the Research and Forecasting Department on the basis of HSBC methodology for a wide range of short-term economic indicators (over 100 variables) through the turning point method. For details see *Fenn D., Nerbrand F., Kasem S., Selvakumar Y. 2015. "HSBC Leading Indicators." HSBC Global Research*.

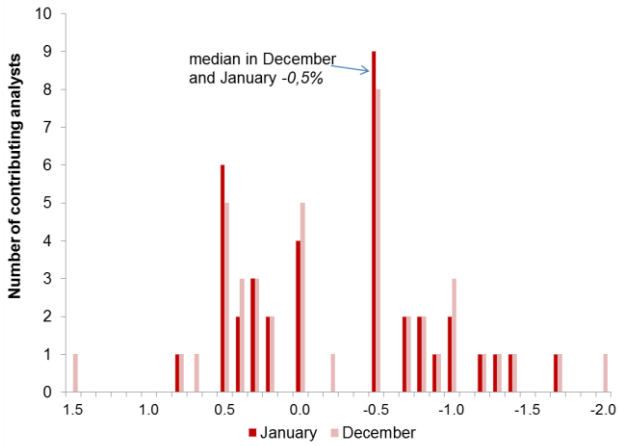
rent estimates for the composite leading business indicator down. We expect the January statistics to facilitate further downward revision of the composite leading business indicator's estimates.

2.2.3. Current forecasts by financial analysts and market participants: persistent inflation risks will require smoother monetary easing in 2016

1) **GDP**

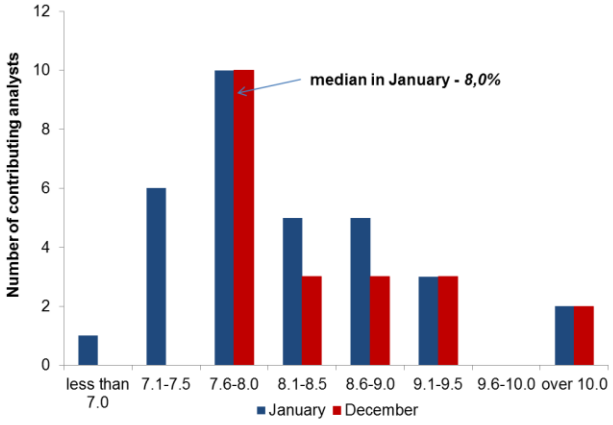
Bloomberg consensus forecast as of 28 January 2016 shows that experts expect that the drop in Russia's GDP in 2016 will not exceed 1.7%. The median estimate remained at -0.5%, same as in the previous month. We believe that the analysts have not revised their forecast for oil prices in 2016 significantly downwards since the previous survey, and consider their January fluctuations as temporary and fundamentally unsound.

Figure 85. GDP growth forecasts by external analysts in 2016



Sources: Bloomberg, R&F Department calculations

Figure 86. Consumer inflation forecasts by external analysts in 2016



Sources: Bloomberg, R&F Department calculations

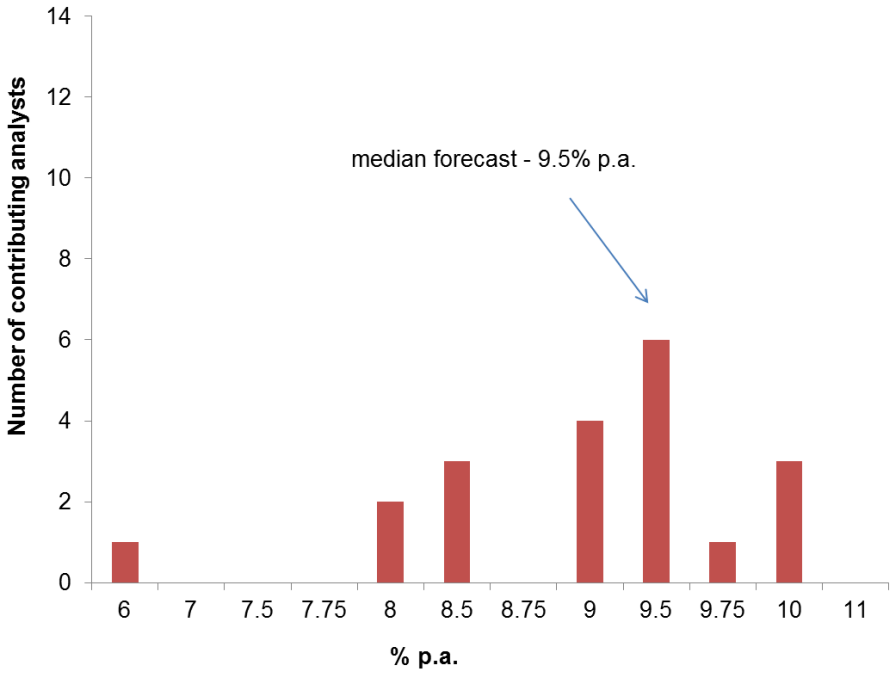
2) **Inflation**

As of 28 January 2016, the median consumer inflation forecast for the end of 2016 is 8.0%, which is in line with the consensus forecast by analysts from December 2015 (Figure 86). Most experts are very likely to believe that oil prices have already tested the bottom, and will be followed with a rebound and stabilisation of the ruble exchange rate in the coming months. However, unfavourable fluctuations in the foreign economic environment and the ruble exchange rate may boost inflation expectations in the economy for a longer period of time. In its turn, it will force the Bank of Russia to pursue a tighter than forecast monetary policy in 2016.

3) **Bank of Russia monetary policy**

As of 28 January 2016, Bloomberg analysts expect the key rate to stand at 9.5% at the end of 2016 (Figure 87). Compared to December, the median estimate of the key rate has gained 75 bp. Provided that there are no negative external shocks, the annual consumer inflation will slow due to the 'base effect', although the Bank of Russia will reduce its rates more moderately throughout the year than forecast by analysts in December 2015 following the additional inflation risks which manifested themeselves during the past month.

Figure 87. Bank of Russia key rate forecasts by external analysts as of end 2016



Sources: Bloomberg, R&F Department calculations

3. In focus

Balance of payments: further adjustment to a weaker ruble and rapid deceleration of net capital outflow

The Russian balance of payments for 2015 showed a quick adjustment to a weaker ruble. The current account strengthened, while net capital outflow fell sharply against 2014. Although the new wave of the ruble depreciation in late 2015 and early 2016 is likely to require a further adjustment of the economy, primarily through lower imports of goods and services, this adjustment scheme as such proved efficient. Given the ongoing ruble depreciation triggered by the oil price drop, the current account surplus can be expected to remain high in 2016. The positive trends which manifested themselves in the financial account in 2015 should be entrenched. They can be expected to result in a further considerable decline in net capital outflow in absolute terms to about $30-45 billion in 2016.

In 2015, Russia's balance of payments underwent considerable qualitative and quantitative changes under the influence of foreign trade shocks and FX rate. The major changes are as follows:

- A considerable decline in the Russian visible exports following lower export prices
- A considerable decline in the Russian goods and services imports following lower physical volumes
- A substantial decrease in the negative balance of net investment incomes
- Growing current account surplus
- Deteriorating foreign direct investment balance
- A drop in net capital outflow

The first estimate of the balance of payments for 2015 published by the Bank of Russia last week demonstrates that the current account has grown to $65.8 billion against $58.4 billion in 2014, despite falling energy prices in H2. In the relative terms, the current account rose considerably to 5.5% of GDP in 2015, up from 3.3% in 2014, following a decline in GDP in US dollar terms.

The current account balance improved on the back of the trade flow adjustment to the ruble depreciation (Figure 88). In 2015, the balance of trade fell by $44.1 billion compared to 2014, to $145.6 billion. However, the weakening of the national currency in 2015 driven by the drop in oil prices dampened further deterioration in the balance of trade. Thereby, the weaker ruble became the key factor behind the decline in visible imports as well as import of services in 2015 compared to 2014 (Figure 89). The contraction of service imports improved the balance of services by $18.2 billion compared to 2014.

A considerable improvement in the investment income balance along with the balance of services triggered growth of the current account surplus. This was mainly determined by a decrease in external liabilities of Russian banks and companies throughout the

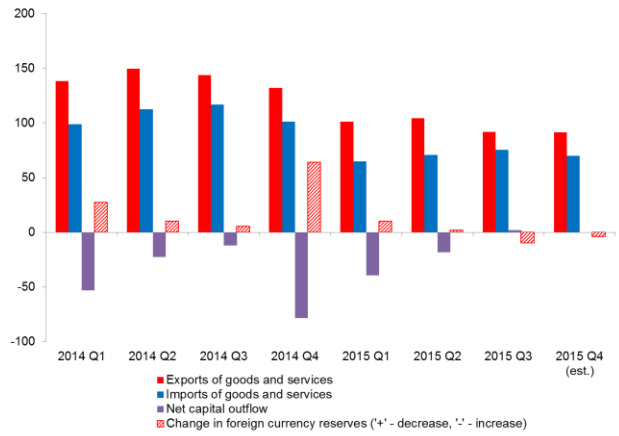
past year following both the repayment of debts and the dollar revaluation decreasing the number of liabilities (and related payments) denominated in other currencies. In 2015, the investment income balance improved by $25.9 billion and the incomes payable reached $34.0 billion.

Given the new wave of the ruble depreciation following the drop in oil prices, the current account surplus is expected to remain high in 2016.

Figure 88. Balance of payments major components, billions of US dollars

Sources: Bank of Russia, R&F Department calculations

Figure 89. Trade balance and capital outflow indicators, billions of US dollars



Sources: Bank of Russia, R&F Department calculations

In 2015, the financial account balance stood at $57.1 billion, far below the 2015 forecast. For most of 2015, the capital outflow was driven by a contraction in external liabilities (primarily in the banking sector) amid financial sanctions, while previously capital outflow resulted from the accumulation of foreign assets by residents. Last year, the exchange rate swings failed to entail any feverish speculative demand for foreign currency or dollarisation growth similar to those of late 2014. We expect that external debt repayments will remain a predominant factor of capital outflow dynamics in 2016.

In addition, a decline in the value of exports following the drop in commodity prices, the GDP fall and the income contraction in dollar terms associated with the weakening of the Russian currency objectively reduce the potential for the capital outflow from Russian residents. Other things being equal, this should result in a lower capital outflow in absolute terms (in relative terms, the outflow may even increase).

As regards the analysis of capital outflow, a considerable decrease in such items as ‘Dubious transactions’ and ‘Net errors and omissions’ is prominent. Over the past two years, these items shrank about ten-fold, from $40 billion to $4 billion. On the one hand, this may result from the tighter supervision policy of the Bank of Russia. On the other hand, the current capital exports in 2015 can be slightly underestimated, among other things, due to statistical reasons, one of which is allegedly related to the representation of capital outflow in other items of the balance of payments. From this perspective, one of

the problems that have repeatedly fallen within the Bank of Russia's focus is fictitious import schemes, particularly as part of trade agreements with the CIS countries. This assumption is implicitly supported by the fact that the growth in visible imports in 2015 forecast by the Research and Forecasting Department last December in recognition of the statistics for the first 11 months ended up being $5 billion below the actual data published last week. In addition, during the last several quarters our forecasts for goods and services imports based on historical import elasticity also tented to have a systemic downward deviation.

In any event, the trends which manifested themselves in the financial account of the balance of payments in 2015 should be entrenched in 2016. This should lead to a further considerable drop in net capital outflow in absolute terms to about $30-45 billion in 2016. Besides, net capital outflow in the risk scenario might be lower than in the baseline scenario.

It should be noted that the recently increased oil price fluctuations coupled with the ongoing uncertainty have broadened our estimates for the fundamental level of the exchange rate that ensures equilibrium in the balance of payments. This results from the fact that calculations of the equilibrium exchange rate are based, among other things, on historical estimates of oil price elasticity of exchange rate, which may change over time due to objective reasons. One such reason is a recent contraction in the share of commodities in Russia's total visible exports following the oil price fall that cannot be duly reflected in current econometric estimates based on historical time series.

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