

Russia Economic Review

Saori Sugeno

+44 20 7597 8336

Saori.Sugeno@uk.daiwacm.com

September's inflation data were in line with the CBR's baseline scenario providing hope that CPI will end the year around 5.5%. Improving consumer confidence suggests that domestic demand is picking up.

- The disinflation trend continued in September. CPI came in at 6.4%Y/Y, down 0.6ppt from August.
- While still negative, the overall consumer confidence index increased by 7% in Q316, suggesting that consumption is starting to pick up. The slower pace of decline in auto sales also provides a cause of cautious optimism.
- The manufacturing PMI rose to 51.1 in September to leave the composite index at 53.1 – well above the crucial 50.0 dividing line between expansion and contraction.
- Russia maintained a current surplus in Q316, albeit much smaller than in the previous years.

September's inflation was in line with the CBR's base scenario

While the Russian central bank's preliminary estimations show that economic growth has returned back to positive territory in Q316, the disinflationary trend continues. In particular, inflation declined in September to 6.4%Y/Y, 0.6ppt lower than the previous month. Core CPI came in at 6.7%Y/Y (7.0% in August). And according to the CBR's latest forecast, the possibility that annual inflation will fall to 5.5%Y/Y by year-end is fairly high as the favourable base effect will continue to support the disinflationary trend in coming months. Monthly inflation came in at 0.2%M/M (0.0% in August) and core inflation was 0.5%M/M (0.4% in August).

Within the detail, in September goods prices rose 6.7%Y/Y (0.2%M/M). Food prices rose 5.9%Y/Y (0.2%M/M), while prices of food excluding fruit and vegetables rose 6.4%Y/Y (0.4%M/M). Meanwhile, prices of non-food items rose 7.5%Y/Y (0.6%M/M) and services prices by 5.6% Y/Y (0.1% M/M). Prices of fruit and vegetable rose 1.9%Y/Y and decreased 5.4% compared to the previous month.

Consumer confidence shows signs of improvement

The latest data suggest that economic situation in Russia is stabilising and, as suggested by the Consumer Confidence Index for Q316, the Achilles Heel of the recovery process – consumption – has also likely started to pick up. While still in negative territory, the overall index score increased by 7% compared to the second quarter, coming in at -19%. The improvement in sentiment has been seen across all major measures, but most clearly in areas related to personal and general economic situation during the last 12 months and willingness to make major purchases. Indeed, the survey index related to assessments of the general economic situation increased by 11ppt from -37% to -26% while the index of expectations for the general economic situation rose by 5ppt to -8% compared to -13% in the second quarter. The major purchase index has increased by 8ppt and came out at -33% (-41% in the previous quarter). And the savings index of -41% was 5ppt higher compared to the previous term (Q216 was -46%).

Car sales data for September provide cause for cautious optimism

In September car sales decreased by 11%Y/Y compared to 18%Y/Y drop in the previous month, beating the Bloomberg consensus forecast by 2ppt. Over the first nine months of the year car sales shrank by 14%Y/Y. Among car brands showing positive growth in September, Toyota sales increased by 18%Y/Y (-6%Y/Y year-to-date) with sales of its luxurious Lexus cars up more than 50%Y/Y and by 14%Y/Y over the first nine months of the year compared to the same period of 2015. And while overall car sales continued to fall, the rate of decline has moderated providing cause for cautious optimism towards reviving domestic demand.

PMIs surprised on the upside

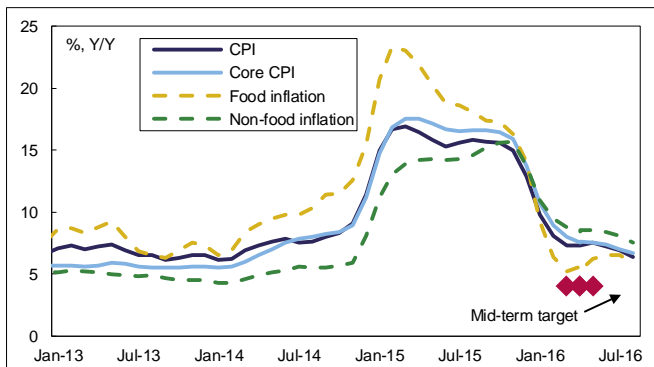
September's manufacturing PMI of 51.1 increased by 0.3pts compared to the previous month suggesting that the Russian industrial sector has started to pick up. Indeed, based on this survey, September also saw the highest growth of output in almost two years and firmer growth of new orders added to evidence that the consumption trend is reversing to the upside. And while the services PMI decreased by 0.5pts compared to August, at 53.0 it was still safely above the 50 points mark, and left the composite index at 53.1 suggesting steady progress towards full recovery in the real economy.



Current account is positive, albeit much smaller than a year ago

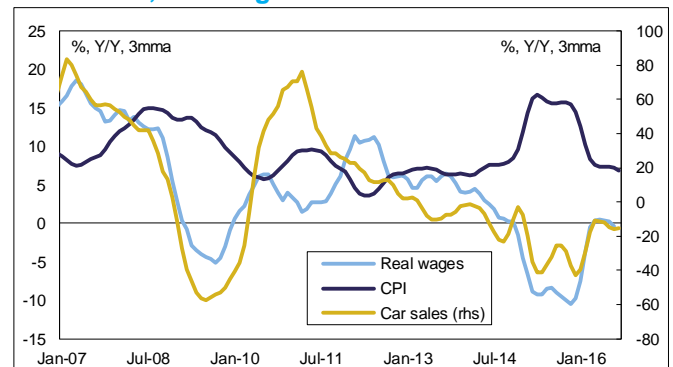
The current account in Q316 came in at \$1.9bn, down by 75% compared to a year ago, but up by 20% compared to the previous quarter. While the Russian current account remained positive over the first nine months of the year, it came in at \$15.6bn, markedly lower compared to the three quarters of the previous year (\$54.4bn). The main factors behind the shrinking current account surplus are the continuing slow growth of exports while the imports have started to pick up amid the stable rouble and improving domestic demand. The trade balance of \$4.9bn was 24% lower than in Q216. Exports came in at \$23.3bn, increasing by only 3.6%Q/Q, while imports rose 15%Q/Q over the same period.

Inflation rate



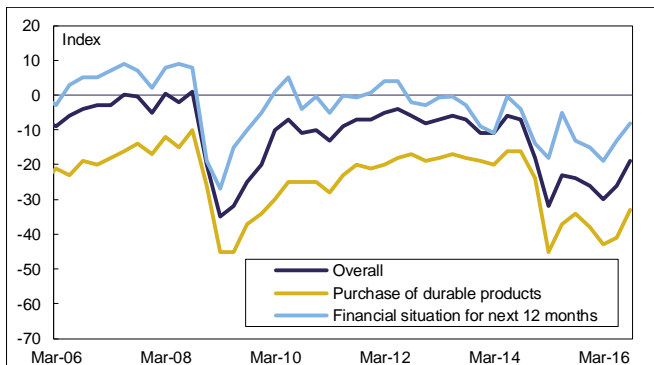
Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Cars sales, real wages and CPI



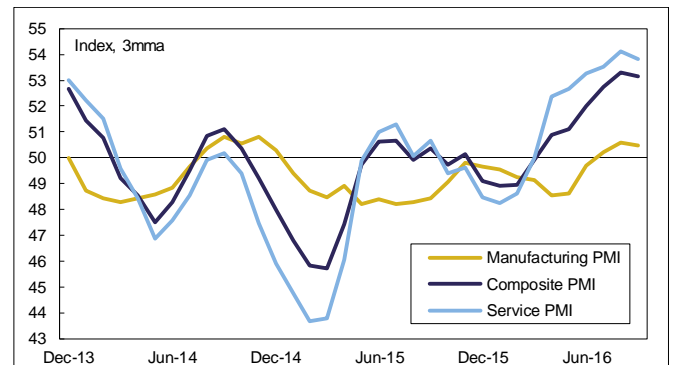
Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Consumer confidence



Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

PMIs



Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

Economic Research

Key contacts

London

Head of Research	<i>Grant Lewis</i>	+44 20 7597 8334
Head of Economic Research	<i>Chris Scicluna</i>	+44 20 7597 8326
Emerging Markets Economist	<i>Saori Sugeno</i>	+44 20 7597 8336
Economist	<i>Emily Nicol</i>	+44 20 7597 8331
Associate Economist	<i>Mantas Vanagas</i>	+44 20 7597 8318
Research Assistant	<i>Danielle Pettet</i>	+44 20 7597 8332

New York

Chief Economist	<i>Mike Moran</i>	+1 212 612 6392
Junior Economist	<i>Lawrence Werther</i>	+1 212 612 6393

Hong Kong

Economist	<i>Kevin Lai</i>	+852 2848 4926
Research Associate	<i>Christie Chien</i>	+852 2848 4482
Economic Assistant	<i>Junjie Tang</i>	+862 2773 8736

London Translation

Head of Translation, Economic and Credit	<i>Mariko Humphris</i>	+44 20 7597 8327
--	------------------------	------------------

DAIR <GO>

All of the research published by the London and New York research teams is available on our Bloomberg page at DAIR <GO>. If you are unable to access the research on this page, please contact Danielle Pettet on +44 207 597 8332.

Access our research blog at:

www.uk.daiwacm.com/blog



Follow us
[@DaiwaEurope](https://twitter.com/DaiwaEurope)

This research report is produced by Daiwa Securities Capital Markets Co., Ltd and/or its affiliates and is distributed by Daiwa Capital Markets Europe Limited in the European Union, Iceland, Liechtenstein, Norway and Switzerland. Daiwa Capital Markets Europe Limited is authorised and regulated by The Financial Services Authority and is a member of the London Stock Exchange, Eurex and NYSE Liffe. Daiwa Capital Markets Europe Limited and its affiliates may, from time to time, to the extent permitted by law, participate or invest in other financing transactions with the issuers of the securities referred to herein (the "Securities"), perform services for or solicit business from such issuers, and/or have a position or effect transactions in the Securities or options thereof and/or may have acted as an underwriter during the past twelve months for the issuer of such securities. In addition, employees of Daiwa Capital Markets Europe Limited and its affiliates may have positions and effect transactions in such securities or options and may serve as Directors of such issuers. Daiwa Capital Markets Europe Limited may, to the extent permitted by applicable UK law and other applicable law or regulation, effect transactions in the Securities before this material is published to recipients.

This publication is intended for investors who are not Retail Clients in the United Kingdom within the meaning of the Rules of the FSA and should not therefore be distributed to such Retail Clients in the United Kingdom. Should you enter into investment business with Daiwa Capital Markets Europe's affiliates outside the United Kingdom, we are obliged to advise that the protection afforded by the United Kingdom regulatory system may not apply; in particular, the benefits of the Financial Services Compensation Scheme may not be available.

Daiwa Capital Markets Europe Limited has in place organisational arrangements for the prevention and avoidance of conflicts of interest. Our conflict management policy is available at <http://www.uk.daiwacm.com/about-us/corporate-governance-and-regulatory>. Regulatory disclosures of investment banking relationships are available at <https://daiwa3.bluematrix.com/sellside/Disclosures.action>.