

# Russia Economic Review

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## ***The Ministry of Finance has started to set aside some surplus oil revenues. The Central Bank left interest rates unchanged while GDP growth surprised on the upside.***

- Russia's Ministry of Finance (MinFin) announced that it will sell roubles related to surplus oil revenues (when oil prices climb above \$40pbl) to protect budget stability from medium-term currency volatility.
- The Central Bank held its benchmark interest rate at 10%, as the MinFin's operations in the forex market increased concerns over rising short-term inflationary risks. The next rate cut is likely to take place in June or July.
- Full-year GDP growth in 2016 came in at -0.2%Y/Y, surprising on the upside. While retail sales growth remains in negative territory (-3.6%Y/Y), manufacturing growth returned back to positive growth (1.4%Y/Y) and agricultural output was up by 3.5%Y/Y.

## **Ministry of Finance has started to sell Roubles**

Russia's Ministry of Finance (MinFin) announced that the Central Bank (CBR) would start to sell roubles on its behalf from 1<sup>st</sup> February. The decision was justified by the rise in oil prices, which reached \$55pbl after OPEC and non-OPEC countries agreed on production limits in December. While the three-year budget starting in 2017 was made under the assumption that oil prices would be stable at \$40pbl during the relevant period, recent developments, including the decrease in production and recent tougher stance on Iran undertaken by the new US administration, suggest that elevated prices might be sustained, at least for a while, bringing the Ministry additional revenues. Indeed, January's average price of Urals oil was \$53.2pbl, markedly higher compared to \$28.8pbl a year ago. The Ministry has decided to set aside those revenues to stabilise the currency, and, apparently, to prevent undesirable rouble appreciation.

Under current circumstances (oil prices around \$55pbl) it is expected that MinFin will sell around \$2-2.50bn equivalent of roubles monthly. Indeed, the MinFin announced that between 7<sup>th</sup> February and 6<sup>th</sup> March it plans to sell 113bn roubles (around \$2bn) with daily sales of 6.3bn Rub or around \$100mn. As the scale of intervention is modest, we don't expect steep rouble depreciation, although in the short term a downward trend might be seen.

## **Russia's Central Bank held key rate unchanged. Chances of rate cut in first half of 2017 diminished**

Despite the record low inflation rate of 5.4%Y/Y in 2016 and continuing disinflation trend (January's inflation came in at 5.0%Y/Y), the CBR is not in a hurry to restart monetary easing any time soon. Over the medium term, the effect of the MinFin "saving" additional roubles has been broadly viewed as a positive step in terms of supporting a stable exchange rate and diminishing its volatility related to fluctuations in oil prices. And there might eventually be additional advantages of a disinflationary effect from the removal of additional revenues from circulation. However, in the short term, the interventions might increase inflationary risks and the CBR has made it clear that the case for a rate cut in the first two quarters of the year is questionable. We therefore expect that the next rate cut would be announced around June or July.

Meanwhile, the disinflationary trend continues. In particular, January's inflation rate decreased to 5.0%Y/Y (0.6%M/M), with core inflation at 5.5%Y/Y (0.4%M/M). And while food prices fell to 4.2%Y/Y (0.9%M/M), non-food inflation came in at 6.3%Y/Y (0.5%M/M) and services inflation at 4.4%Y/Y (0.5%M/M).

## **GDP growth in 2016 came out at -0.2%Y/Y**

The full-year GDP growth rate for 2016 of -0.2%Y/Y represented an upside surprise compared to expectations of -0.6%Y/Y and followed an upwardly revised decline of 2.8%Y/Y the previous year. Among the sectors, agricultural output was the fastest growing and rose by 3.5%Y/Y (3.0%Y/Y in 2015), with mining output up by 0.2%Y/Y, a touch lower compared to a year earlier (0.4%Y/Y).

While the manufacturing sector also provided cause for optimism with positive growth of 1.4%Y/Y (-4.1%Y/Y in 2015), the growth of consumption remained weak. While the rate of negative growth moderated from the previous year (-8.1%Y/Y), retail sales growth remained in negative territory (-3.5%Y/Y).

In 2016, nominal GDP amounted to 85,880bn roubles or around \$1,500bn.



## PMIs beat expectations again

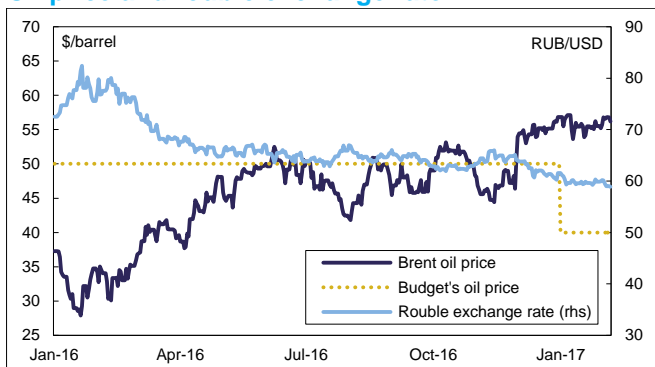
In January, the manufacturing PMI increased to 54.7 the highest level since March 2011, from 53.7 in December. The index rose amid growing demand from domestic clients, while export orders' growth remains modest. Nonetheless, the services PMI was also encouraging and came out at 58.4 (the highest level in more than eight years, from 56.5 in December) amid growing new orders, to leave the composite index at 58.3 (56.6 in the previous month). Increasing production and positive shifts in the labour market suggest that the upward trend may continue in coming months.

## Assets managed by two sovereign wealth funds increase slightly

Russia's MinFin published the balances of assets in the sovereign funds as at 1<sup>st</sup> February. The Reserve Fund came in at \$16.18bn equivalent with a portfolio of \$7.62bn, €6.71bn and £1,10bn. The Fund balance increased by \$0.2bn mostly due to exchange rate movements.

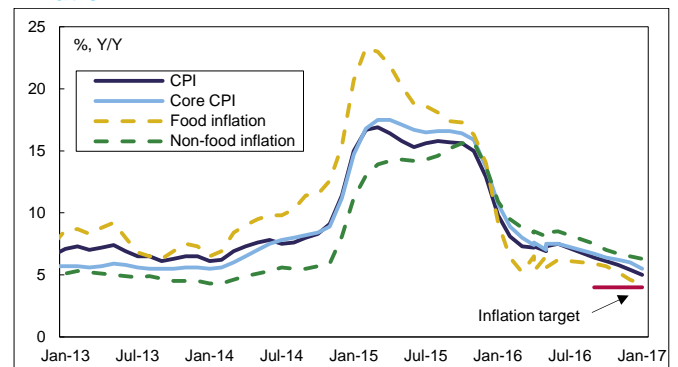
The Wellbeing Fund's balance was \$72.46bn (\$19.51bn, €20.76, £3.83 and deposits in Vnesheconombank (Bank for Development and Foreign Economic Affairs) of RUB 198.23bn and \$6.25bn). The balance of this Fund has also slightly increased from \$71.9bn in December amid the revaluation of currencies and investment revenues.

## Oil price and rouble exchange rate



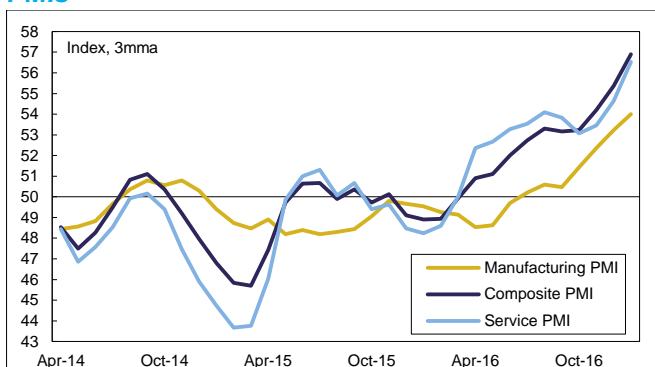
Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

## Inflation



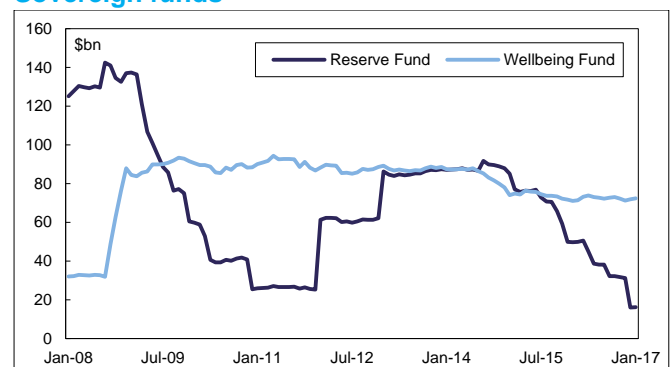
Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

## PMIs



Source: Markit and Daiwa Capital Markets Europe Ltd.

## Sovereign funds



Source: Bloomberg and Daiwa Capital Markets Europe Ltd.

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