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Central Bank of the Russian Federation



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Information
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commentary

Economy

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Economy: facts, assessments and comments (August 2018)

According to Rosstat's revised estimate, GDP grew by 1.9% in the second quarter of 2018. Economic activities with the most pronounced contribution to GDP growth included industrial production, transportation, financial services and insurance, as well as wholesale and retail trade. Industrial production and investment indicators continued to show non-uniform dynamics in August. That said, company surveys point to an improving business sentiment, which may underpin production and investment activity in the future. In August 2018, consumer demand continued to moderately grow. The most sizeable increase was registered in non-food purchases; this is associated with a rise in household inflation expectations amid the weakening in the ruble and the forthcoming VAT hike. In July and August 2018, key economic indicators were overall in line with the Bank of Russia's Q3 forecast of annual GDP growth rate of 1.3–1.7%. As of the year-end, GDP is expected to increase by 1.5–2%.

Economy in August 2018 (year-on-year growth, %, unless indicated otherwise)

	2017	2018 Q1	2018 Q2	July 2018	August 2018
Output of goods and services by key industry	2.4	2.3	3.0	2.8	...
Industrial output	2.1	2.8	3.2	3.9	2.7
Agricultural output	2.4	2.6	1.9	0.9	-10.8
Freight turnover	5.5	2.4	3.4	4.1	2.5
Construction	-1.4	-4.0	0.9	-0.7	-0.8
Retail trade turnover	1.3	2.4	2.9	2.7	2.8
Unemployment rate* / seasonally adjusted**	5.2	5.1/4.8	4.8/4.8	4.7/4.8	4.6/4.8
Nominal wage	6.7	12.7	10.1	10.2	10.3
Real wage	2.9	10.2	7.6	7.5	7.0

* As % of labour force.

** Bank of Russia estimate.

Source: Rosstat.

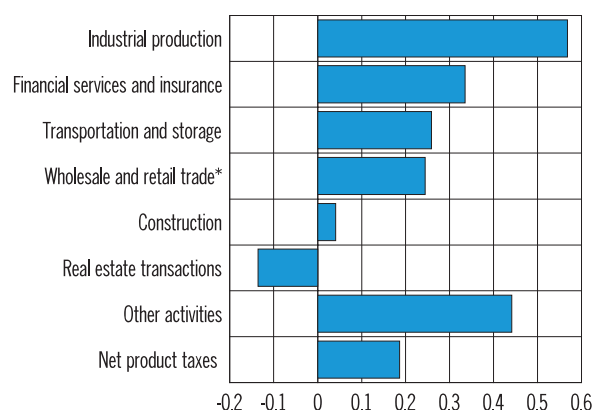
According to Rosstat's revised data, GDP grew by 1.9% in the second quarter of 2018 (preliminary estimate – 1.8%). A considerable contribution to the increase of output of goods and services came from industrial production (0.6 pp) and closely connected freight turnover (0.3 pp). Annual GDP growth was also supported by financial services and insurance (0.3 pp) as lending and banks' net interest income were on the rise. Wholesale and retail trade also made a tangible contribution (0.2 pp) as domestic and foreign demand expanded (Chart 1).

The August dynamics of key economic indicators was overall in line with the Bank of Russia's Q3 forecast of annual GDP growth rate of 1.3-1.7%. Having said that, certain economic

Chart 1

The rise in industrial production was the main contributor to annual GDP growth in 2018 Q2

Contribution to annual GDP growth, pp

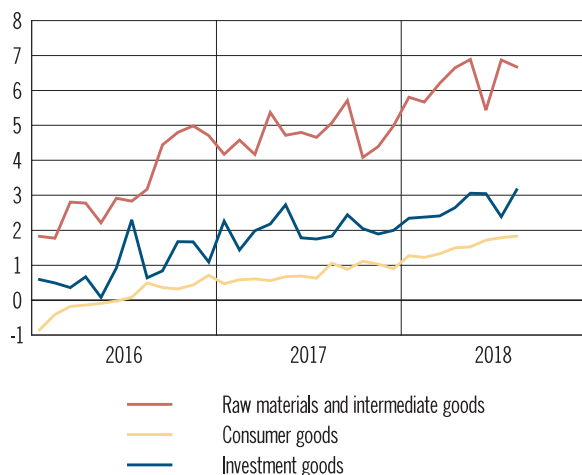


* Including motorcar and motorcycle repairs.
Sources: Rosstat, Bank of Russia calculations.

Chart 2

Output of investment goods rose in August to offset the July drop

Growth as % on 2013, seasonally adjusted



Sources: Rosstat, Bank of Russia calculations.

activity indicators continue to show non-uniform dynamics.

In August, as overall industrial production posted annual growth of 2.7%, output dynamics by key activity were mixed.

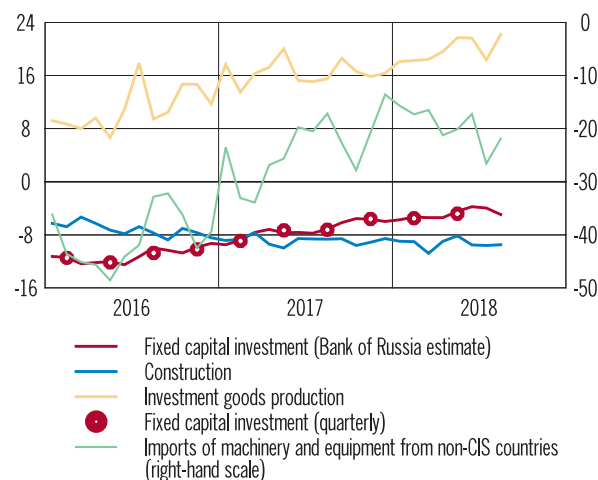
On the one hand, output of engineering products recovered after a significant drop a month before. The output was the most pronounced in the product groups which showed a decline earlier. This leads to the conclusion that the factors which influenced the July output in this sector were mainly short-lived. The increase in engineering production boosted the overall output of investment goods. Furthermore, production growth continued in mining and quarrying. The most significant increase was registered in coal mining amid a rising demand from Asia Pacific. This resulted in growing railway freight transportation of this fuel. The production of natural gas also remained sustainably high.

On the other hand, the output in ferrous and non-ferrous metallurgy continued to wobble, falling in August after having recovered in July. This may be associated, among other things, with the influence of geopolitical factors. The output of petrochemicals also contracted because of the temporary maintenance shutdown of a number of oil refineries. As the ruble weakened, this could be coupled with higher attractiveness of energy exports compared to energy product processing. Production dynamics in metallurgy and oil refining

Chart 3

Investment activity remains weak

Growth as % on January 2014, seasonally adjusted



Sources: Rosstat, Federal Customs Service of Russia, Bank of Russia calculations.

were the main contributor to the decline in raw material processing after its growth a month earlier.

Though production of investment goods recovered in August, investment activity remained overall weak. This is associated with stagnating construction coupled with a drop in production of construction materials and a shrinkage in their railway transportation. Furthermore, the depreciated ruble has a constraining effect on imports of machinery and equipment, which hold below the level seen in the first half of 2018 (Charts 2 and 3).

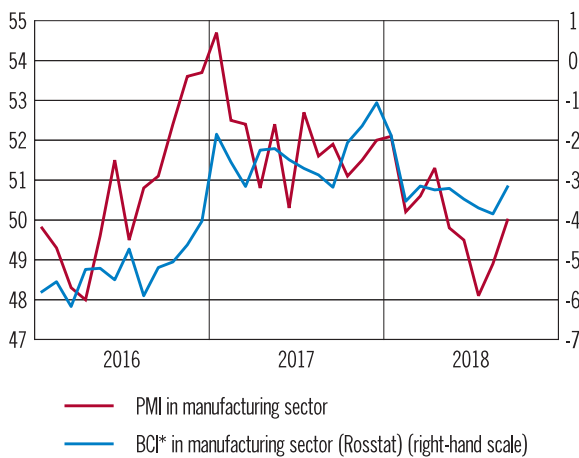
According to PMI¹ and Rosstat surveys, business sentiment improved somewhat; this may support production dynamics and investment activity. In particular, manufacturing PMI rose in September 2018 to 50 points, reflecting a temporary nature of the July drop in industrial production. Companies note an increase in new orders and expanding external demand.

August saw continued moderate growth in consumer demand. Non-food purchases posted the most pronounced increase. Annual growth of retail trade turnover stood at 2.8% in August, including a 4.1% rise in non-food sales. Annual increase in food sales was considerably lower (1.3%); however, in monthly terms sales remained at the level registered in June-July 2018 (Chart 5). The rise in demand for non-food products is largely associated with the expected increase in price growth

¹ IHS Markit.

Survey data suggest improvement in business sentiment

Chart 4

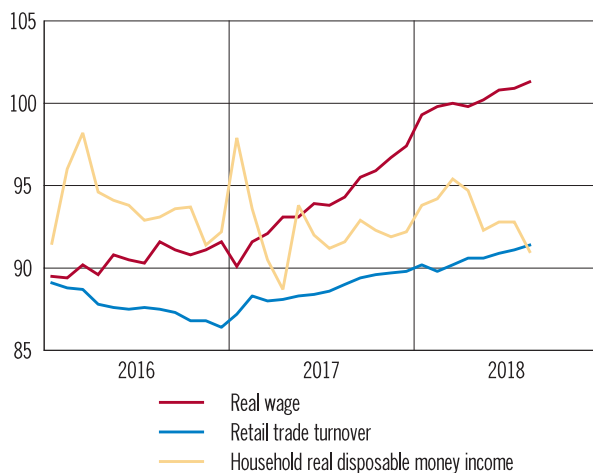


* Business Confidence Index.
Sources: Rosstat, IHS Markit.

Slack dynamics of real disposable income may contain consumer activity

Chart 6

Growth as % on January 2014, seasonally adjusted

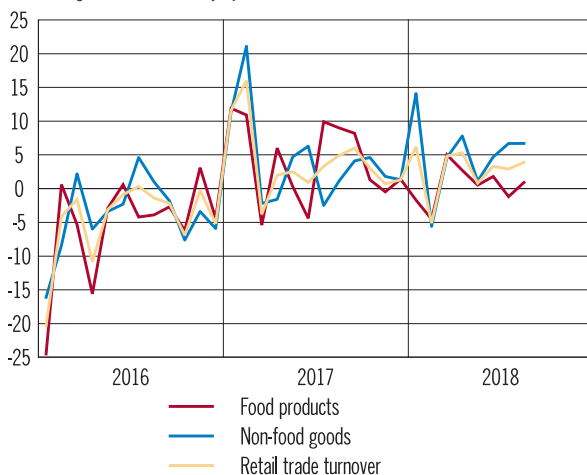


Sources: Rosstat, Bank of Russia calculations.

Sales of non-food goods showed the most pronounced growth in August

Chart 5

Annualised growth, % MoM, seasonally adjusted

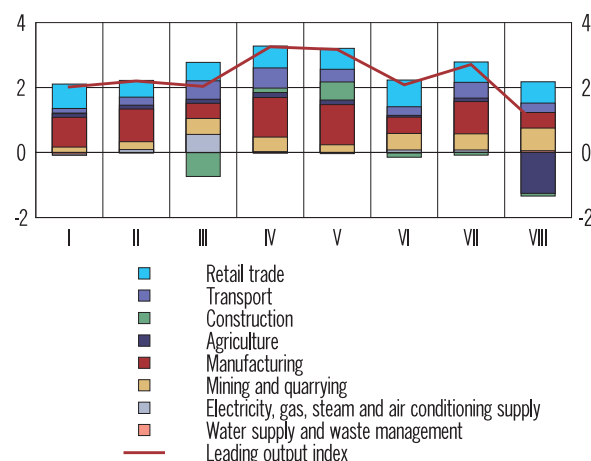


Sources: Rosstat, Bank of Russia calculations.

Leading output index dynamics point to slowing annual GDP growth in 2018 Q3

Chart 7

Contribution to growth of the annual leading output index by sector, pp



Sources: Rosstat, Bank of Russia calculations.

rates on the back of the weakening in the ruble and the forthcoming VAT hike. This is also confirmed by the September inFOM survey which suggests that respondents' expectations of the ruble depreciation were on the rise in August and September, while the exchange rate dynamics and VAT were more frequently mentioned among inflation expectation driving factors pointing to proinflationary risks. In this environment, respondents consider the current period of time as the most suitable for large purchases. The expansion of lending underpins consumer demand, whereas slack dynamics of real disposable income, despite growing real

wages, may only contain growth in household final consumption expenditure (Chart 6).

As households' demand rises, the output of main consumer goods continues to increase steadily. In August 2018, non-food goods which demonstrated the highest production growth rates included knitwear, clothing, footwear and bags. Food production expanded in large part on the back of meat convenience food, vegetable and fish product output. The rise in fish processing is associated with an all-time large catch of salmon fishes, in particular humpback. At the same time, a decline in the grain harvest in 2018 against the last

year bumper crop translates into negative annual growth rates of agricultural output and may have a constraining effect on food production.

Given the movements of economic indicators in July and August, the Bank of Russia forecasts that in the third quarter annual final consumption expenditure growth rates will stand at 3-3.5% and

gross fixed capital formation at 1.5-2.5%, which corresponds to 1.3-1.7% annual GDP growth. The forecast also factors in slower growth of leading output index of goods and services by economic activity (Chart 7). As of the end of 2018, GDP is still expected to increase by 1.5-2%, which is in line with the potential growth rates of the Russian economy.

Cut-off date – 1 October 2018.

A soft copy of the information and analytical material is published on the Bank of Russia website (<http://www.cbr.ru/DKP/>).

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