Strategic Choice Advisory
Strategy and Transactions

Russia Macro Foresight

2018 Results: GDP Growth Edges Up on Industrial Construction, Profit Surges, but Consumption Still Weak, Prospects Unclear

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2018 results: GDP growth revised upward, perhaps rightfully so; IP growth picks up, but several key indices head south. At the same time, banking sector and corporate profit surprise positively

- **Real GDP growth picked up to 2.3% y/y in full-2018** vs. 1.6% in 2017 and only 0.3% in 2016, as Russia keeps recovering from the impact of Western sanctions (still intact, expanding) and low oil prices (now growing again)
- **The upsurge was actually "helped" by RosStat's sudden revision of growth in construction** to 5.3% y/y in full-2018. This was explained by the launch of the massive (USD 28bn) Yamal-LNG project, and the ensuing transfer of unfinished construction to finished status. The construction industry had been in dismal shape in previous years, and before the revision, growth until the final 1-2 months of 2018 also hovered around zero. The revision drew much ire and suspicion from various local experts and media
- However, we always felt that GDP growth and growth in construction, specifically, were understated, looking at strong growth in investment (to a large extent, industrial construction), and several other indices. **Therefore, the revision possibly serves justice to the economic recovery**
- Worth noting, **EconMin suggests that growth in recent years, including 2018, may be evened out due to the revision. Authorities still expect growth in 2019 to be notably weaker** at 1.3-1.6%, claiming the 2018 pent-up was a one-off event
- Meanwhile, **IP growth picked up to 2.9%, while cargo transport turnover slowed to 2.9%; and agriculture dipped 0.8%** (no major weather problems recorded), after strong growth in recent years *(see more details below)*

Indicator, % y/y	2016	2017	2018
Real GDP	0.3	1.6	2.3
Industrial production	1.3	2.1	2.9
Cargo transport turnover	1.8	5.5	2.9
Agriculture	4.8	3.1	-0.8
Fixed capital investment	-0.6	4.4	4.1*
Construction	-4.3	-1.2	5.3

- In a positive surprise with no strings attached, **banking sector profit surged 70.3%** in 2018. This follows a decline in 2017, after an upsurge in 2016
- Apparently, **both the sector purging, led by CBR, and the overall banking sector recovery, are to thank. Growth of most key indices improved markedly**, as can be seen from the table on the right
- Most noteworthy are the **acceleration in growth of loans to corporates (finally!), and an upsurge in corporate deposits (+21%!)**
- **Coupled with solid growth of real sector profit (33.2%)** after a slump in 2017, this shows that **overall profit is rising, and funds on bank accounts are piling up**
- We are a bit **concerned about rapid growth of retail lending, but overdue debt so far stays put** across all bank customer segments

Indicator, % y/y	2016	2017	2018
Corporate profit	**37.9**	**-8.5**	**33.2****
Banking sector profit	**4.8-fold**	**-15.1**	**70.3**
Banking sector assets	**-3.5**	**6.4**	**10.4**
Loans to individuals	1.1	12.7	22.4
Loans to corporates	-3.6	1.8	10.8
Total overdue debt	-5.1	3.5	0.2
Individual deposits	4.2	7.4	9.5
Corporate deposits	-13.8	9.2	21.0

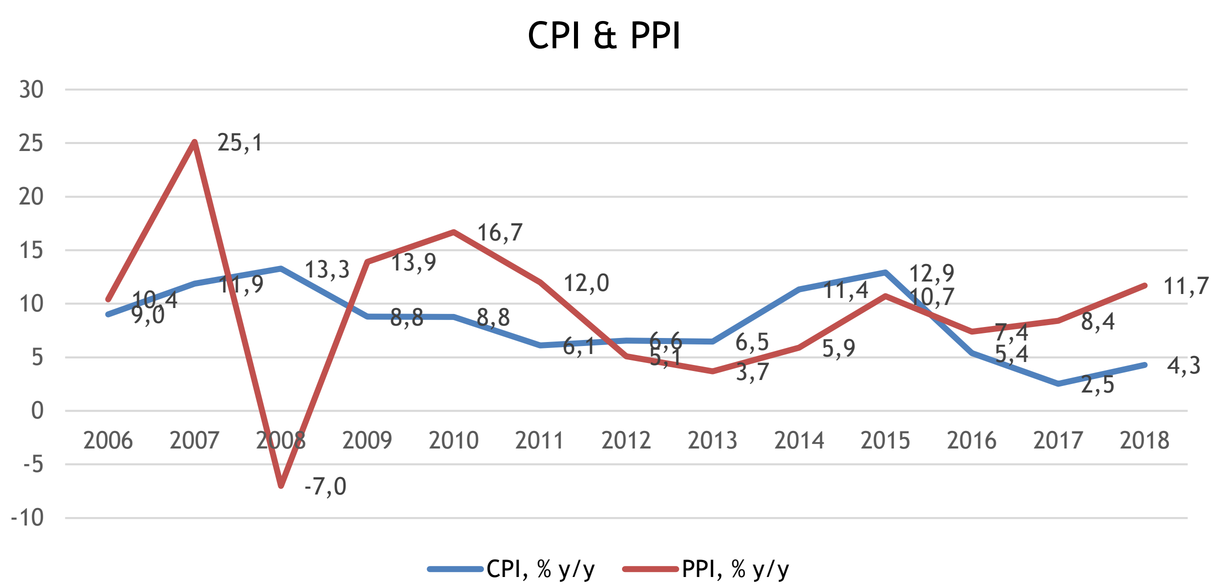
** - Jan-Sep 2018, % y/y*   *** - Jan-Nov 2018, % y/y*

Wages and employment on positive track, but overall income sluggish; retail trade growth picking up, but still weak. Both CPI and PPI inflation speeding up - this spells trouble!

- **The positive trends in economic growth, profit and bank deposits are offset by maintained weakness in population income and consumption**
- According to opinion polls, **investment and expansion by companies is held off by lack of confidence about economic prospects.** Various business confidence indices have reached multi-year lows, as the overall sentiment among businessmen we interact with stays gloomy
- Actually, **total unemployment continued to shrink, and both nominal and real wage growth accelerated,** the latter helped by recently slower inflation
- However, **real disposable income barely grew after several consecutive declines.** Besides wages, this indicator also includes income from property lease, etc., and accounts for mandatory payments (e.g. bank loans). This is why the growing debt burden on the population causes concern. Lower savings data shows people often borrow mostly to repay previously taken out loans…
- As we predicted, **retail trade growth is picking up, but at 2.6% in 2018 vs. 1.3% in 2017, it is still quite weak,** and does not offset the previous declines

Indicator, % y/y	2016	2017	2018
Retail trade	-4.6	1.3	2.6
Real disposable income	-5.8	-1.6	0.3
Real wages	0.8	2.9	6.8
Nominal wages	7.9	6.7	9.9
Total unemployment	-0.5	-6.5	-7.8

- After reaching a record low of 2.4% y/y in H1, **CPI inflation revved up to 4.3%** in full-2018, making up 1.7% in Q4 alone
- Similarly, **PPI inflation sped up to 11.7% from 8.7% in 2017 and 7.4% in 2016**
- We had predicted this CPI inflation pent-up in our previous report, pointing to historical correlations between PPI and CPI, and mounting PPI inflation
- Apart from input price pressure, **entities made full use of the marginal 2pp VAT increase, to justify much greater output price hikes.** We suspect's January's 1% m/m CPI inflation figure is seriously understated, due to methodology issues
- Going forward, **this spike-up can sag economic growth amid weak consumption**



Public, external sector balance posts further improvement, money supply keeps growing, but FDI inflows crash through the floor. Manufacturing generally positive, but B2B segment growth slows

EXTERNAL SECTOR

- **The trade surplus hit a record USD 194.4bn in 2018** vs. USD 115.4bn the previous year, thanks to both higher oil prices and the weak RUB boosting exports across the board
- While many would rush to point out Russia's maintained reliance on hydrocarbons, a closer look reveals that while oil and natural gas made up USD 178bn (only 40%), oil products and LNG brought in USD 84bn (19%), and non oil&gas exports reached USD 182bn (41%). Thus, **trade diversification is taking place, as oil&gas processing and other sectors gain ground.** Jan-Nov customs data shows food exports surged 23.8%, wood products grew 3.4%, chemicals – 4.2% (all in volume terms), among other non oil&gas products
- According to CBR data, service exports also outpaced imports at 13.2% vs. 7.5%, respectively, in full-2018
- Also positively, **government, central bank, corporate, and banking sector foreign debt continued to drop, albeit short-term government and corporate debt has risen lately,** possibly caused by funding difficulties amid Western sanctions
- Sadly, **inbound FDI made up a meagre USD 5.7bn in Jan-Sep 2018 vs. USD 28.6bn in full-2017 and USD 32.5bn in 2016**, as Russia's investment attractiveness continues to suffer…

PUBLIC SECTOR

- **The federal budget recorded its first surplus in several years, making up 2.7% of GDP in 2018.** This highlights Russian authorities' maintained prudence amid difficult economic and geopolitical conditions

MONETARY AGGREGATES

- **National-definition money supply grew another 11% in 2018,** after posting 10.7% and 9.2% gains in 2017 and 2016, respectively. Broad-definition monetary base also rose 9.3%. **This shows the overall liquidity situation keeps improving**

REAL SECTOR

- **Overall industrial production growth picked up to 2.9% in 2018 vs. 2.1% in 2017 and 1.3% in 2016. Manufacturing rose 2.6%, however, growth in Jan-Sep made up just 0.7% y/y**
- On the whole, **growth in manufacturing seems to have evened out** (vs. the strongly positive or negative readings recorded across segments in previous years). **For the most part, mildly positive rates are observed now across the board**
- **Robust growth in meat, fish, vegetable and dairy products still continues. This is despite an obvious slowdown in agriculture, which we attribute mainly to over-saturation in many segments,** as encouraged investors poured in en masse, and also retraction of certain government stimuli. It remains to be seen how this sector will develop, going forward, but we are cautiously optimistic
- Confectionery, sheet & film, ceramic tiles, paper & printing, stainless steel, aluminum, home appliances, cars & trucks, and medical equipment were especially buoyant. But growth slowed notably in previously robust overall chemicals, metal products, computers & electronics, textiles, and pre-fabricated steel structures. **Our impression is that growth in B2C goods now outpaces lukewarm B2B goods, which may signal a nearing slowdown. And unless consumption picks up, all the accumulated profits will not get invested!**

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