



**NATIONAL
RATING
AGENCY**

Russia's Economy 3rd Quarter 2015 Review

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- In 3Q2015, Russia's GDP dynamics somewhat improved: it rose slightly in September from a plateau of July-August. Nevertheless, a 3Q2015 annual GDP growth was minus 3.8%. Russia's economic outlook weakens in the context of expected fall of the global economy growth rate to 3.1%. Consensus projections put global growth at 3.7 – 3.8% by the end of 2015.
- In 3Q2015, consumer good prices increased quicker than a year earlier, mostly as a result of the growing prices for nonfoods. At the same time, the growth rate for the industrial index of production reduced on the back of the falling prices in the mining sector.
- In 3Q2015, the dynamics of the industry-level real economy improved (demonstrating a 3.5% growth) owing to the mining and manufacturing sectors' better performance. The construction sector's performance weakened due to the falling effective demand and shrinking housing mortgage lending. The agricultural sector demonstrated a consistent growth on the back of seasonal strength. The transport sector rebounded slowly to the 2014 levels.
- In 3Q2015, the rate of reduction of capital asset investments slightly increased in the context of entities' weakening bottom-line results, lending reduction and rising delinquency rates in the loan sector.
- The retail and wholesale trade sectors are shrinking despite their growth in 3Q2015 by 5.2 and 2.3% respectively, fuelled by consumer crisis-period sentiment.
- The federal government's deficit hit 1.2% of GDP as a result of growing budget expenditures and falling oil export revenue (an overall quarterly reduction reached 13.6% in value terms). At the same time, Russia's domestic and external debt reduced by 0.9 and 2.1% respectively in 3Q2015.
- Russia's foreign trade performance weakened in 3Q2015, as exports contracted in value terms, while imports demonstrated a slight recovery. In January-September 2014, the gap with 2014 remained considerable, with exports down 32% and imports down 38.5% year on year.
- The ruble smooth depreciation was the FX market main trend in May-September. The tightening of the USA monetary policy is one of the key risk factors for Russia in 4Q2015.

In 3Q2015, Russia's economic dynamics somewhat improved: the growth pace increased by 0.3% in September compared with August due partially to the seasonal factor. By preliminary economic assessment, there were improvements in the fuel-and-energy, manufacturing, agricultural, transport sectors, and the construction sector performed better in terms of construction volume contraction. At the same time, retail trade and the sector of paid services demonstrated a negative dynamics. The result was a 3Q2015 annual GDP growth of minus 3.8% . Russia's 2015 economic growth forecast by different agencies and organizations was revised down to 3.2- 4.4% (see the table below).

Table Russia's 2015 Economic Forecasts

Central Bank of the Russian Federation (CBR)	-3,9%-4,4% ²
World Bank	-3,2%-4,3% ³
Ministry For Economic Development of the Russian Federation	-3,8%-3,9% ⁴
IMF	-3,8% ⁵
EEC	-3,3% ⁶
Consensus forecast	-3,7-3,8%

One should note that Russia's economic outlook weakens in the context of the IMF's global economy growth rate forecast revision to 3.1%, down 0.2p.p. from July, in the context of the Chinese economy continued contraction and the oil-exporting countries' economic recession caused by falling commodity prices⁷.

¹ Official website of Russia's Ministry of Economic Development: "On the current economic situation in Russia, January – September 2015, <http://economy.gov.ru/minec/activity/sections/macro/monitoring/>

² CBR's official website, CBR Chairman's statement made in the meeting of the CBR Board on Sep.11, 2015. http://www.cbr.ru/press/print.aspx?file=press_centre/Nabiullina_11092015.htm&pid=press&sid=ITM_29815

³ The World Bank's official website, Russia Economic Report №34, <http://www.worldbank.org/en/country/russia/publication/rer>

⁴ TASS (Russian news agency), statement by A.V.Ulyukaev, Russian Minister for Economic Development, made during the he Sochi-2015 International Investment Forum (Ulyukaev; reasons for lowering, the CBR key rate; <http://tass.ru/ekonomika/2310810>)

⁵ The IMF official website; Emerging Europe Sees Stronger Growth Ahead, but Faces New Risks, <http://www.imf.org/external/pubs/ft/survey/so/2015/car111315a.htm>

⁶ The European Economic Commission's official website, Forecast for 2015-2018 (based on 3Q2015 economic forecasts), posted on Sep.21,2015, http://www.eurasiancommission.org/ru/act/integr_i_makroec/dep_makroec_pol/economyPrognoz/Pages/Sred_prog.aspx

⁷ IMF, World Economic Outlook, October 15, <https://www.imf.org/external/pubs/ft/weo/2015/02/pdf/text.pdf>

Prices

During 3Q2015, the consumer price inflation growth rate was moderate. The overall growth was only 1.9 p.p. due to the seasonal factor and lower prices for fruit and vegetables in the summer and autumn months. This resulted in a negative dynamics of food prices in June-August. At the same time, the effect of the growing nonfood prices (among the factors causing the consumer price inflation) increased.

The total consumer price inflation in the nine months ended Sep.30, 2015 was 10.4% (or 11.2%, if October is included). The inflation rate was higher than a year earlier (in 3Q2014, prices grew by 1.5% and in the nine months ended Sep.30, 2014, by 6.3%⁸. Factors driving the inflation rate growth include risks associated with a more volatile exchange rate, combined with the expected tightening of the U.S.A. monetary policy (FRS will discuss its key rate in its next meeting, to be held on Dec.16, 2015).

Domestic industrial goods prices are also growing faster than the average national growth: in the period since the beginning of 2015 they rose by 12% compared with 5.2%⁹ in the same period 2014. However in quarterly terms, the industrial goods price growth slowed down (to 0.5% in 3Q2015 compared with 0.9% in 3Q2014) – due mostly to the downward price dynamics in the mining sector, where prices lowered by 12.6% in 3Q2015¹⁰. Meanwhile, the manufacturing industry and the utilities sector (electricity, gas and water generation and supply) demonstrate an above-average price growth.

Real economy

In 3Q2015, Russia's industrial output increased 3.5% compared with 2Q2015¹¹. However, it slowed down by 3.2% in January-September compared with the same period 2014¹². This reflected the contraction of the manufacturing industry and the utilities sector (by 6.4 and 1.4% year-on-year respectively). However, the 3Q2015 manufacturing industry output increased 5.4% compared with 2Q2015.

The slump in construction output intensified in 3Q2015. Over the nine months up to Sep.30, it was -8.3% in year-on-year terms¹³. In 3Q2015, the Business Confidence Index fell to 9%, that is, 3 p.p. below the previous quarter's and 3Q2014 level¹⁴. Factors driving the

⁸ Official website of the Russian Federal State Statistics Service (FSSS), http://www.gks.ru/bgd/free/BO4_03/IssWWW.exe/Stg/do6/202.htm

⁹ FSSS's official website, http://www.gks.ru/bgd/free/BO4_03/IssWWW.exe/Stg/do6/210.htm

¹⁰ FSSS's official website, http://www.gks.ru/bgd/free/BO4_03/IssWWW.exe/Stg/do6/142.htm, http://www.gks.ru/bgd/free/BO4_03/IssWWW.exe/Stg/do6/210.htm

¹¹ FSSS's official website, industrial output data, http://www.gks.ru/bgd/free/BO4_03/IssWWW.exe/Stg/do6/207.htm

¹² FSSS's official website, industrial output data, http://www.gks.ru/bgd/free/BO4_03/IssWWW.exe/Stg/do6/207.htm

¹³ FSSS's official website, http://www.gks.ru/free_doc/new_site/business/stroit/operativ2.xls

¹⁴ FSSS, http://www.gks.ru/free_doc/new_site/business/stroit/3-del-akt15.rar

construction output slump include the lower housing demand, falling real household income in Russia, as well as the high weighted average rate on ruble-denominated housing mortgage loans (13.15% for loans issued within a month, as of Oct.1), combined with a 62.3% housing lending contraction and mortgage delinquencies soared by 37.7% in January-September compared with the same period 2014¹⁵.

The agricultural sector expanded at a healthy pace in 3Q2015. Agricultural output increased 3x owing to the seasonal factor. At the same time, it grew 2.2% in 3Q2015 and 2.4% in January-September on year-on-year terms¹⁶.

The transport sector expanded at a healthy pace in 3Q2015. Its total turnover grew 2.6% compared with 2Q2015 and in 3Q2015 and 1.1% on year-on-year terms. Passenger traffic rise 27.8% in 3Q2015 compared with a quarter earlier, while the growth gap narrowed to -4.3%, suggesting that the seasonal factor was no longer valid (the month-over-month passenger traffic increase lowered in 3Q2015: 115,2% - 102,5% - 81,4 %).

In 3Q2015, the rate of reduction of capital asset investments increased to 6.8% against 6.7% in 2Q2015. The reduction over January-September was 5.8%. The investment activity is affected by the continued weakening of the corporate sector's bottom-line results¹⁷ — to 142.6% for 1H2015 from 188.9% in 1Q2015 and 123.9% for January-August 2015 (latest data available) compared with the same periods 2014¹⁸. Delinquency rates on ruble-denominated loans issued to resident legal entities and self-employed persons increased by 0.1 p.p. relative to total non-performing loans in 3Q2015 and by 2.6 p.p. year-on-year. The amount of lending contracted compared with the nine months ended Sep.30, 2014 by 11.2% for ruble-denominated loans and by 16.7% for FX-denominated and precious metal loans¹⁹.

Trade

In 3Q2015, retail trade expanded 5.2%. This included a 3.7% growth in food trade (incl. beverages and tobacco) and a 6.7% growth in non-food trade. However, retail trade did not recover to the 2014 level in the nine months ended Sep.30 2015, and the gap increases each quarter (from -6.4% in 1Q2015 to grew to -8.5% for January-September 2015)²⁰. This negative dynamics was due to individuals' savings behaviour pattern²¹. The consumer crisis-period sentiment in 3Q2015 offset the fragmentary seasonal activity in the retail

¹⁵ CBR's official website, http://www.cbr.ru/statistics/UDStat.aspx?TblID=4-1&pid=ipoteka&sid=ITM_2357

¹⁶ FSSS's official website, http://www.gks.ru/bgd/regl/b15_01/IssWWW.exe/Stg/do9/2-1-5-1.doc

¹⁷ Bottom-line results (profit minus loss) of legal entities (excluding SMEs, banks, insurers and public sector entities), in actual prices

¹⁸ FSSS's official website, bottom-line financial results of legal entities in January-August 2015, http://www.gks.ru/bgd/free/b04_03/IssWWW.exe/Stg/do6/218.htm

¹⁹ Calculations based on CBR's data, http://www.cbr.ru/statistics/UDStat.aspx?TblID=302-09&pid=sors&sid=ITM_45484, http://www.cbr.ru/statistics/UDStat.aspx?TblID=302-05&pid=sors&sid=ITM_52941, http://www.cbr.ru/statistics/UDStat.aspx?TblID=302-01&pid=sors&sid=ITM_27910, http://www.cbr.ru/statistics/UDStat.aspx?TblID=302-02&pid=sors&sid=ITM_19292

²⁰ FSSS's official website: Retail trade in September 2015, http://www.gks.ru/bgd/regl/b15_01/IssWWW.exe/Stg/do9/2-2-1.doc

²¹ Russia's Ministry of Economic Development: "On the economic situation in the Russian Federation in January-September 2015" survey results

market in 1H2015, discounting any talk of the retail market operating environment stabilization. The Business Confidence Index²² has fallen to a marginal +1%²³. From July 1, 2015, retail trade businesses in Moscow, St-Petersburg and Sebastopol are exposed to greater administrative and fiscal burden due to the introduction of a trade levy²⁴.

There are similar trends in the wholesale trade sector, which expanded 2.3% in 3Q2015, but contracted 10.5% during the nine months ended Sep.30, 2015. The wholesale trade Business Confidence Index weakened in 3Q2015 to 2.6% compared to 5.8% a year earlier²⁵.

Public Finance

During the nine months ended Sep.30, 2015, the federal budget revenues decreased 5.2% compared with a year earlier and totalled RUR 10,794.3 billion. Therefore, the deficit increased to 1.2% GDP (+1.1 p.p. to 1Q2015) and totalled RUR648.9 billion²⁶.

Oil export duty rate was decreasing throughout 3Q2015 and reached US\$109.2 per ton in September²⁷. compared with US\$143 per ton in July 2015. Urals average price reached US\$54.4 in 3Q2015, down 6.2% from 1H2015. Ruble depreciated 2.8% against the US dollar to 59.3:1, and oil exports decreased 2.9% to 59.4 million tons, driving oil&gas revenues down by 13.6% in 3Q2015 compared with a quarter earlier²⁸.

The high volatility of the financial and commodity markets made the Russian government adjust its budgetary policy. This included the cancellation of the 2016-2018 three-year budget plan, temporary cancellation of the Fiscal Rule which aims to delink government spendings from market volatility by following long-term trends in oil prices²⁹. By the end of 3Q2015, general government debt decreased by 0.9% compared with end-1H2015 (to RUB 6,979.2 billion, including government guarantees)³⁰, and the external debt reduced by 2.1% (to US\$ 50,226.4 million, including government guarantees)³¹.

The Reserve Fund increased by 9.4% to RUR 4,670.5 billion, or 6.4% GDP (+0.6 p.p.). At the same time, it decreased in dollar terms by 8.2% compared with end-1H2015 due

²² In retail trade, the Business Confidence Index is the arithmetic mean of the balances of the following: estimated amount of goods in storage (with reversed sign), change in the entity's economic position in the current period compared with previous period and expected change in its economic position in the next period, in percent.

²³ Retail sector operating environment in 3Q 2015, the Higher School of Economics, Moscow, 2015. – 17 c, <http://opec.ru/1875858.html>

²⁴ Federal Law No.382 dated Nov.29, 2014, On the Introduction Of Changes in Parts One And Two Of Tye RF Tax Code

²⁵ FSSS's official website, http://www.gks.ru/bgd/regl/b15_01/IssWWW.exe/Stg/d09/2-2-4.doc

²⁶ Official website of the RF Treasury, <http://www.roskazna.ru/ispolnenie-byudzheto/federalnyj-byudzheto/188/>; Russia's Ministry of Economic Development's "On Russia's current economic situation based on economic performance in January-September" survey results

²⁷ Official website of St. Petersburg International Mercantile Exchange, http://spimex.com/upload/weekly-spbmbsb/weekly_spbmbsb_20151116_137_11091113.pdf

²⁸ Russia's Ministry of Economic Development: "On the economic situation in the Russian Federation in January-September 2015" and On the economic situation in the Russian Federation in the first half of 2015" survey results, official website of the Federal Customs Service, http://www.customs.ru/index.php?option=com_newsfts&view=category&id=52&Itemid=1978&limitstart=30; oil & gas revenues, by foreign-trade activity codes 2709, 2711210000.

²⁹ Federal Law No.273-FZ, dated Sep.30, 2015 "On the Preparation and Approval of Draft Budgets of the Russian Federation in 2016, Revision Of Some Laws of the Russian Federation and Invalidation Of Article 3 of Federal Law 'On the Suspension of Certain Provisions of the Russian Federation's Budget Code'"

³⁰ Official website of Russia's Ministry of Finance (MoF), http://www.minfin.ru/ru/performance/public_debt/internal/structure/total/

³¹ MoF's official website, http://www.minfin.ru/ru/performance/public_debt/external/structure/

to the ruble depreciation (devaluation). Russia's National Welfare Fund demonstrated a similar dynamics, increasing in ruble terms by 16.1% to RUR 4,878.8 billion (6.7% GDP) and contracting in dollar terms by 2.6% to US\$ 73,7 billion.

External Analysis

By preliminary estimates, Russia's goods exports (measured on the balance of payment basis) decreased in 3Q2015 by 13.8% compared with 2Q2015 and by 37.5% vs.2014 to US\$78.5 billion (according to the customs statistics, the decrease was more notable — by 13.1% and 36.9% respectively³²). The reduction over the nine months ended Sep 30, 2015 was 32% year-on-year.

Imports rose by 4.4% compared with 2Q2015 to US\$50.5 billion. However in year-on-year terms, imports decreased by 37.5% in 3Q2015 (according to the customs statistics, imports rose 5.8% on 2Q2015 and decreased 36.8% year-on-year). Over the nine months ended Sep 30, 2015, the decrease in imports was more notable than that in exports and totaled 38.5%³³. CBR's foreign currency reserves rose by 2.7% to US\$371,267 million during 3Q2015³⁴.

Monetary policy

Nation-wide money supply increased in 3Q2015 by 1.4% compared with 1H2015. , the external trade balance reduced by 34% to US\$28.2 billion, while the seasonally adjusted M2 money stock rose by 2.9% and by 2.3% in year-on-year terms³⁵. Retail deposits, which accounted for 45% of M2, rose by 2.1%, while the deposits of non-finance and finance entities (excepting banks), comprising 34% of M2, increased by 0.6%. The amount of cash in circulation rose by 1.3%³⁶.

In 3Q2015 (Aug. 3, 2015), CBR made a shift to a more relaxed monetary policy stance, reducing its key rate by 0.5 p.p. to 11%³⁷. When considering its key rate next time (on Oct. 30, 2015), CBR decided to leave it unchanged in view of the persisting inflationary risks³⁸.

The ruble nominal exchange rate that strengthened in the first months of 2015 and started to fall relative to the US dollar in May, weakened further in 3Q2015. The quarter average ruble-to-dollar exchange rate was 63.13:1 (+19.8% on 2Q2015). But in October, the ruble exchange rate strengthened by 5.3% to 63.25:1. The ruble-to-euro exchange rate followed a similar trend: during May-September, the ruble smoothly depreciated by 20.7% to 5.04:€1 due largely to the U.S. tightened monetary policy.

³² FCS's official website

³³ Calculated for 3Q2015 on the balance of payment basis; CBR's estimates; CBR's official website, <http://www.cbr.ru/statistics/?PrtId=svs>

³⁴ CBR's official website, http://www.cbr.ru/statistics/print.aspx?file=credit_statistics/iip_ira_15.htm&pid=svs&sid=mipzrRF

³⁵ Seasonally adjusted M2 money stock, according to CBR, conforming to Eurostat's international statistical recommendations on the seasonal adjustment of dynamic series of data (2009) and the IMF's Compilation Guide for Monetary and Financial Statistics (2008), using X-13-ARIMA/SEATS (US Census Bureau) to mitigate the time series excess smoothing risks and factor in the country's current economic situation.

³⁶ CBR's official website, <http://www.cbr.ru/statistics/?PrtId=ms>

³⁷ CBR's official website, http://www.cbr.ru/DKP/print.aspx?file=standart_system/rates_table_15.htm&pid=dkp&sid=ITM_49976

³⁸ CBR's official website, http://www.cbr.ru/press/pr.aspx?file=30102015_133001keyrate2015-10-30T13_17_50.htm

The Dynamics of Russia's Macroeconomic Fundamentals (2015 first three quarters compared with the same periods of 2013 and 2014)

Indicator	2013	2014	2015		
			1Q	2Q	3Q
GDP in current prices	6,5%	7,9%	7,2%	1,1%	0,5%
GDP in fixed (2008) prices.	1,3%	0,6%	-2,2%	-4,6%	-
Industrial output	3,4%	0,4%	-0,4%	-2,7%	-3,2%
<i>Mining industry</i>	1,0%	1,1%	0,7%	0,0%	0,3%
<i>Manufacturing industry</i>	5,1%	0,5%	-1,6%	-4,5%	-5,2%
<i>Electricity, water & gas generation and supply</i>	1,3%	-2,5%	0,0%	-0,1%	-0,6%
Investments in capital assets	-0,2%	-2,5%	-3,6%	-5,4%	-5,8%
Retail trade turnover (physical volume index)	3,9%	2,7%	-6,4%	-7,9%	-8,5%
Household real disposable income	4,0%	-0,7%	-1,3%	-3,0%	-3,3%
Consumer price inflation (CPI)	6,8%	7,8%	7,4%	8,5%	10,4%
Unemployment (monthly average rate)	5,5%	5,2%	5,7%	5,6%	5,3%
Goods exports (nominal, measured on the balance of payment basis)	-0,8%	-4,9%	-27,2%	-31,1%	-37,5%
Goods imports (nominal, measured on the balance of payment basis)	1,7%	-9,8%	-37,5%	-40,2%	-37,5%
Net external asset position	-5,1%	4,3%	-12,5%	-17,0%	-37,6%
Federal budget revenue	1,3%	11,3%	-2,4%	-7,0%	-5,2%
Federal budget expenditure	3,5%	11,1%	23,4%	15,9%	13,3%
Money stock (M2, measured according to national methodology)	14,6%	2,2%	6,3%	6,9%	7,5%
US\$ exchange rate (average nominal)	2,4%	19,3%	77,9%	50,4%	73,7%
Brent oil price (SPOT, Europe FOB)	-2,7%	-8,4%	-50,9%	-43,8%	-50,5%

Sources: Russia's Federal State Statistical Service, Russia's Ministry of Economic Development, MoF, Federal Treasury, CBR, International Energy Agency.



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