DT-Global Business Consulting GmbH, Address: Keinergasse 8/33, 1030 Vienna, Austria,
Company registration: FN 331137t

Contact: Dr Daniel Thorniley, President, DT Global Business Consulting GmbH, E: danielthorniley@dt-gbc.com

Curriculum Vitae of Dr Daniel Thorniley

Danny Thorniley is President of DT-Global Business Consulting GmbH (an LLC company) and co-founder of the CEEMEA Business Group which advises senior executives on global business trends. DT-Global Business Consulting is Danny's own consultancy company based in Vienna through which he works with some 330 key clients on business strategy in global, and markets and the CEEMEA region and Russia. The services he provides include written position papers, presentation slides and private client meetings as well as in-house presentations. He is also invited to make some 60 speeches/presentations by clients across the world on global business trends, business operations, emerging markets, corporate best practice.

Sir John Major, the former British Prime Minister has called Danny "The world's leading business expert on emerging markets"

For 23 years Danny was Senior VP at The Economist Group, Vienna on global corporate business trends.

Danny is regarded as a charismatic speaker who can present detailed business and economic analysis in an easily digestible fashion with a great deal of genuine humour. Danny is renowned for not using powerpoint presentation slides - never. Dr Thorniley has also given guest presentations at Executive MBA courses on behalf of Oxford University, the University of Chicago, IESE (Spain) and the Central European University in Budapest. The executive MBA students at Chicago rated him "best speaker" on 12 occasions out of 12 over 5 years. Danny has exceptional skill sets in global business strategy, business in emerging markets and CEEMEA and hands-operational knowledge of business operations, distribution, partnerships, investments and human resource issues.

He has worked on a personal basis with 330 companies operating in emerging markets for 27 years and has personal contacts with most senior western MNCs operating in the CEEMEA region and beyond. He makes frequent presentations at CEO and Board level (over 100). He has personal friendships with leading executives in Coca Cola, Procter & Gamble, Ernst & Young, Raiffeisen, Robert Bosch and many, many others.

He holds and has held a number of non-executive and advisory board memberships with major European and US corporations including the Global Advisory Board of the US company Aecom.

Dr Thorniley was educated at Oxford University. He holds a Bachelor of Arts degree, a diploma and a doctorate degree in Soviet political economy.

He has published three books, including one on Russia with Macmillan (UK/USA) and two with Profile books on Doing Business in Global Emerging Markets.

danielthorniley@dt-gbc.com

Executive summary

The economy is "doing sort of OK" from a low base last year with some indicators on the upside each month while others under-perform but monthly and quarterly GDP growth will return at the end of this year and 2017 will have mild positive GDP growth.

Companies are surviving in this environment and at our two recent executive events held in September and attended by some 300 senior managers the comments on business were frequently:

> "We're doing OK. We are performing better than expected. Things are not great but they are manageable. Business is slowly recovering. We are making money and profits. Business is going slowly in the right direction etc."

So the economy and business do seem to mirror each other to a large extent as "sort of not too bad".

> The economy is improving slowly but it's difficult to get traction in some sectors.

Key update items

- The rouble has been stable for 5 months (5 in 5 that is fluctuating in a range of 5% in the last 5 months) and even as oil ticks down, the rouble remains stable or even strengthens a little.
- Why? Because international portfolio investment is flowing into Russia (and other emerging markets) as investors/speculators search for yield (see text below).
- What could change this trend? Any rise in US interest rates or the arrival of President Trump!
- As capital flows into the country, capital flight leaving the country is decelerating quite sharply: at the start of September 2016 the outflow was a mere $10bn compared with a total for all 2015 of $59bn (and the 2015 figure was smaller than the 2014 number).
- Inflation is diminishing faster than expected (and the stable rouble explains that with other factors).
- The fact that the Russian Reserve Fund shrank form $50bn on 1 June to $32.2bn on 1 September was significant and negative news in the media for the Russian economy. We agree that it is not a positive trend and we do not belittle it and its consequences but there are several other positive compensatory factors as well such as the low levels of debt to exports and public debt as well as the rising level overall of FX reserves.
- The Central Bank cut the central rate as excepted to 10.0% in mid-September but then took a harder line by postponing more cuts until the first months of 2017.
- GDP is following the trend we expected and will turn positive at end of this year on a monthly basis but full year growth only returns in 2017.

GDP

- We maintain our GDP upgrade for 2016 at -0.7% which close to the consensus of -0.6%.
- We also stick with our estimate for 2017 at +1.4%. but the Russian Central Bank is now more down-beat at a figure below 1%.
- Medium-term GDP growth will hover around 1.8% to 2.4% over the next 3-6 years.

The rouble

- Our prediction of recent months has proven correct: "The rouble is stable and we expect it to move sideways for the next few months presuming oil stays at $46-52 over the coming months".
- The rouble is doing a bit better than the oil price because of capital flows searching for yields.
- Some two-thirds of Russians are still willing to keep their deposits in roubles rather than FX.
- Capital flight is shrinking: down to $10bn in the first 8 months of 2016 compared with $60bn total in all of 2015.
- This is obviously supportive of the rouble.
- Total external debt has fallen by -30% in the last year and total debt exposure of $550bn is very manageable because total debt repayments in 2016 are about $70bn with much already paid off.

Inflation

- Inflation is also trending downwards and came in at 6.9% in August; we expect an average figure this year of 7.3% and year-end of 6.3% with continued moderation through 2017 averaging about 6.2% and ending 2017 as low as 5.5%.
- But achieving the Central Bank's target of 4.0% will prove sticky and probably be missed.

The consumer

- Retail and household spending will be negative this year by -3.5% and -2.6% respectively and then turn positive in 2017 by 2.0% and 1.8%.
- Consumer confidence improved a little in the second quarter as we predicted from minus -30 in Q1 to -26 in Q2.
- We guess that this could improve a little in Q3 thanks to a stronger rouble and falling prices.
- But recent monthly results in consumer and industrial indicators are mixed.
- Retail sales continue to disappoint at -5.1% in August and disposable income was down heavily by -8.3% but the latter indicator is unreliable as it includes citizens' currency activity.
- In July and August nominal wages at + 5.8% were at the lowest levels since January 2016.
- This meant in turn that real wages were still negative at -1.0% despite the improved inflation figure.

Industry/investment/agriculture

- Investment and industry remain weak as well as construction although the latter ticked up recently: investment will be down this year by -3.7% or worse and is trending at -4.3% in Q3.
- But industry did tick up in August by a small +0.7% and the manufacturing PMI rose to 50.8 but conversely business confidence declined to -5 from a level of -3 in the summer.
- The banking sector is stabilising but after being positive in the spring corporate credit fell -2.3% in July after a -1.1% decline in June while in recent months consumer credit has been negative by minus 7-8%.
- So a very mixed bag.
- Agricultural/grain output looks quite bumper this year and agriculture was growing at +6% in August which will help GDP but will also be very positive for inflation and is already playing a part.
- The budget deficit will come close to -4.0% this year and while commentators fear financial problems, we think there are enough available options to avoid crisis in the next 18 months providing oil stays over $40 per barrel.

Economic outlook

It has been tough.

> If we are correct and GDP turns positive in the third quarter of 2016, this will mean the economy was in negative territory for 7 quarters compared with only 5 quarters in the last crisis of 2008-09.
>
> Negative growth in 2015 and 2016 also means that Russia will report two consecutive years of negative growth for the first time since 1996.

The background was that the Russian economy started to weaken visibly in January 2013 (14 months before events in Crimea) and this was led by very poor results in investment and industry and it took another 15 months before consumer and retail figures were negatively affected.

But several factors are better for now:

- The oil price is hovering close to a range of $45-50 per barrel (and we did predict at the start of the year that $28-35 was too low).
- The rouble is bobbling at 71-72 to the Euro (close to levels recorded in February and September 2015).
- Inflation is down to 6.9% in August.
- Real wages therefore are much better than the start of the year but still negative/flat.

- The key interest rate was cut from 11.0% to 10.5% in June and again to 10.0% in September but the rate of future cuts is to be slowed and we now only expect 9.5% in spring-summer 2017.

The GDP outlook

Many indicators last December-January, especially for consumers, were among the worst in 20 years. Since then, the stronger rouble and softening inflation have helped bring back the numbers to just a weak or flat level (see below).

> **So, there has been a massive improvement since the start of the year BUT many numbers remain in absolute terms not so good.**

We expect the political and global environment to help the Russian economy a bit this year and in 2017 and we predict GDP will start quarter-on-quarter growth in the third quarter of this year as do most commentators and the Russian Central Bank. This means some GDP growth at the end of 2016 but not enough to compensate for the negative numbers in the first 8-9 months. But this does mean that 2017 will turn positive by about +1.3%.

But in its September analysis the Russian Central Bank made sharp downward revisions to 2017 GDP from a range of 1.0% to 1.4% to revised numbers of 0.5% to 1.0%. This is based on a quite conservative oil price projection of $40 for Urals oil. This oil price estimate explains why the Bank's estimate for 2017 is below the current western consensus.

We assess the industrial and consumer sectors below. Companies operating in the agricultural sector speak reasonably positively about business trends and receivables. A possible record grain harvest of 106-110mn tonnes could prop up GDP this year.

The long mid-term outlook to 2025

It is clear that (without any unexpected boom in the oil price to $65-75) there will be no quick bounce-back from this recession. GDP will increase about 1.3% in 2017 and then average around 1.8% to 2.3% during 2018 to 2022 depending on the oil price.

We do not anticipate much serious and quick structural economic reform over the next 3-5 years and so the dependency on the oil price and potential volatility remains in the foreground.

As many executives argue, "This is what we've got. This is not a crisis anymore, this is the new normal and the daily reality and we better get used to it".

The big 5 factors influencing the Russian economy

1. The oil price (currently positive for the Russian economy)
2. The rouble (The oil price is the rouble value, and again seems positive at the moment)
3. Eastern Ukraine (mixed impact but not trending worse)
4. Western sanctions (possible reduction (40% chance) of EU ones from December 2016)
5. China and the USA (moderate growth in both markets and good for Russia)

And the 3 big factors which help industrial output from being worse

Industrial output is helped in part by
1. Import substitution
2. Defence spending and
3. Trade and investment with China and Asia.

But we have underscored that none of these factors offer any golden solution to Russian industry and GDP.

Central scenario - 2017 economic outlook (oil averages $46-55)

GDP	1.3%
Inflation (year-end)	5.5%
Inflation (average)	6.2%
Consumer spending	1.6%
Investment	2.2%
Industrial output	1.7%
Rouble to US dollar average	63-69
Rouble to the Euro average	70-75

Economic scenarios and the rouble for 2017 at different oil prices

Average oil price 2016	GDP	Inflation average	Rouble/US$ Average	Rouble/€
$80-85	3.3%	5.5%	45-52	52-58
$70-80	2.8%	5.5%	52-57	58-64
$60-70	2.4%	5.8%	57-60	64-66
$55-60	1.8%	6.1%	60-63	66-69
$50-55	1.3%	6.4%	62-67	69-73
$45-50	0.3%	7.5%	64-69	72-77
$35-45	-1.3%	8.2%	68-74	74-82
$25-35	-2.5%	11.5%	74-80	83-92

The rouble outlook

The rouble is 22% stronger than it was at its recent low on 11 February (71.0 to the Euro on 26 September compared with almost 91 on 11 February).

We note that the rouble has been remarkably stable in the last 5 months fluctuating by only 5% in that period.

5 in 5.

When the oil price rose upwards to $50-52 per barrel in recent weeks/months, the rouble rose with it. BUT what is even better at the moment is that as the oil price drifts down to $45-48, then the rouble is not following it downward and remains stable or actually gets stronger.

The search for yield

In July and August 2016 investments in emerging market debt funds rose +$20bn after a collapse of -41bn in 2013-2015. Similarly, the EM equity index is up 30% from January this year.

> Certainly in terms of financials and short-term, portfolio investments the emerging markets have become attractive again

The Russian rouble (and other emerging market currencies) were performing relatively well in recent weeks and months because global investors and currency speculators are searching for yields and returns on portfolio/short-term investments.

The oil price has usually been the BIG influence on the Russian rouble and still plays a very important role. BUT in autumn 2016 it is global capital flows which support the rouble. When the oil price declined in July and August, the rouble did not go down with it.

Interest rates and return on investments into bonds and securities in Switzerland and Sweden are nominally negative while in the Eurozone they were flat but also turned negative in recent weeks. Yields on US dollar, British pounds and Japanese yen are also either zero or slightly negative.

Today in the developed world you pay to park your money.

In response global investors are running around the world look for yield i.e. better interest rates. Russia fits the bill along with other emerging markets. The key central rate in Russia was cut in September to 10.0% which is a lot higher than zero.

Investors also like countries which have a current account surplus and Russia is one of the few emerging markets which can make this claim. Despite falling in August the Russian current account still posted a surplus of $15bn and will come in at about +4% of GDP in 2016.

So speculation is doing well for the rouble and over the medium-term the consensus for oil ought to help as well.

Our central scenario is for oil to average around $42-$48 per barrel in 2016 and end the year at $50-52 range and then average $49-57 in 2017. This is close to the consensus.

Based on this oil scenario we now expect the rouble to fluctuate on average within 5% of either side of current (September) levels so about 73-77 to the Euro and 63-69 to the US dollar. We also expect the Euro-dollar to average around 1.08 during 2016.

These numbers for the exchange rate also reflect closely what most executives are putting into their 2017 budgets.

Other factors affecting the rouble:

1. Capital flows and hugely reduced capital flight is helping the rouble as well. In August net flows were +$1bn and the net outflow until 1 September were a mere $10bn compared with $60bn for the whole of 2015.
2. Russian banks are actually selling off some FX foreign assets because the funds are NOT needed to pay off FX debt which is diminishing.
3. But there will probably be some further outflows this autumn as this is the busy season when traditionally FX debt is serviced.
4. BUT "capital flight" will be down -60% to -75% this year.
5. As we note above, real interest rates are attractive in Russia with inflation at 6.9% in August and the central rate at 10.0% offering a premium of 3% and this can be even higher for short-term "in-and-out" flows.
6. External tourism will be considerably less this year, despite the removal of travel bans on Turkey. This means that there is less personal demand for dollars to travel abroad and perhaps more demand for "holiday roubles" as people go on holiday in Russia.
7. As the rouble strengthens, there is some self-perpetuation in the rise of the currency especially with individual citizens as they become more confident with the rouble and we note below that two-thirds of Russians are happy to hold their bank deposits in roubles rather than FX.

But a key factor dictating Bank policy is preventing any popular "run on the currency". If the Russian population panicked and a massive run on the currency happened, then the Bank would implement a full range of emergency measures to bolster the rouble. BUT we are far from this situation.

Russian citizens still have some faith in the rouble and 67% claim to prefer holding rouble savings rather than FX ones.

The strong current account surplus and the "quite tight" fiscal policy ought also to support some rouble strengthening: for other currencies such results and polices would ensure a strong currency but the rouble is more influenced by the oil price and global/Chinese growth factors.

The rouble: what can go wrong?

So our central scenario is for some more months of moderate stability and mild, manageable depreciation over the next 1-2 years. What can go wrong?

Mainly two things and both from the USA:

1) Rising US interest rates and
2) President Donald Trump.

If US interest rates rise at the end of 2016, then, as ever, the financial markets may over-react and over-sell their emerging market funds. A Donald Trump presidency would entail global economic turmoil for 2-3 months and markets and commodity prices would fall affecting Russia. The dollar could do one of two things: the panic could lead investors out of the dollar BUT conversely, as investors look for safety, they may “turn to mummy” and buy dollars even if the crisis emanates from the US (this did happen in the 2008-09 financial crisis).

We also note that (excluding a massive collapse) the Russian Central Bank will not support the rouble because it rightly thinks that trying to combat the markets is wasteful when they are in a selling mood and when the oil price is a factor outside the Bank’s control; the Bank’s wise view is best to “keep its powder dry” and wait on events. By September 2016 FX reserves at the Central Bank had actually risen to a recent high of $395bn (from $368bn on 1 January), which testifies that the Bank has little intention of protecting the rouble against the oil price.

Interest rates

The central rate was stuck at 11.0% for 10 months and then cut to 10.5% in June and with some economic stabilisation apparently taking place, with the rouble a bit stronger and most importantly, with inflation trending downwards, the Bank cut the rate again in mid-September to 10.0%. But the Bank then changed direction a bit by announcing that this was the last cut until Q1 and Q2 of 2017. Generally the Bank has been pro-growth in orientation and thus willing to cut rates whenever possible. Now it seems to be focusing slightly more on inflationary threats. The Bank wonders whether much of the recent fall in inflation has been due to the stronger rouble (the answer in part is yes) and thus if the rouble weakens on a lower oil price, then the inflation threat could return.

On balance this decision will of course buttress and support the rouble with the prospect that real interest rates will remain in Russia slightly higher than was anticipated. This will mean the spread on rouble assets compared with western ones will be wider and make Russian assets bonds etc. more attractive

But in terms of growth and capital investment, this is less good news. Getting the central rate down to 8.5% will now take an extra 9-12 months or so.

What’s happening to the Reserve Fund?

Is Russia running out of money? Not really!

By 1 September the stock of the Reserve Fund was down to $32bn (from $60bn in January) and the Well-Being Fund was more stable at $73bn (actually up a little on the January figure of $71bn). Both of these funds each amounted to about $80bn some 15 months ago and the Reserve Fund has been drawn down to finance the budget deficit and to support economic sectors and to bail out some companies/banks stressed by the rouble devaluation.

But western commentators fear that the Reserve Fund will run out by the start of 2017 and that financing the growing budget deficit will become more difficult. This is true but we and others presume that the government will resort to more domestic debt issuance (bonds), more external borrowing, some privatisation revenue and tighter fiscal and monetary policy tweaking when necessary.

Overall FX reserves are not falling and the Central Bank is replenishing them as the rouble rises:

> Overall FX reserves were $368bn in January 2016 but were back up to $395bn in September.

Public debt has risen in recent years but from an extremely low base:

> Public debt was 8.5% in 2015, 13.5% in 2016 and will be 16.6% in 2017

But this compares with European levels ranging from 55% to 100%.

Of the country's total external debt of $515bn (down by -30% in the last year), only $90bn to $110bn is due in 2016 and $66bn in 2017. Such payments are manageable.

We wrote at length about the budget deficit in our July economic report and the summary here is that:

> The budget deficit in 2013 was a mere -0.5% in 2014 and then climbed to -3.6% last year and will hover around -4% this year. But this is still viable over the next 18 months. The point is that the starting point for this crisis was a good one: the authorities had some "fat to play with".

We do not belittle the deficit and financing situation BUT Russia has more ammunition than some western commentators realise.

Inflation outlook

Inflation has been better than expected for most of 2016.

There are a few reasons for this:

The so-called "base effect" (i.e. the high level 12 months ago means that any comparison with such numbers should entail downward movement this year) is having a deeper impact than anticipated and is also taking place as the rouble appreciates instead of falls. Also the flow-through impact from the rouble slump at the start of the year has been less sharp than anticipated and the rouble has rallied more quickly than expected.

These are the 3 key factors explaining the fall in inflation. One then adds on weaker demand and vibrant price competition, which also brings prices down and this was anticipated.

As we note, this is having some positive effect on real wages, which ought in time to benefit consumer spending and consumer confidence.

Employees will also be a bit more cheerful as they feel the rouble in their pocket go further while their real wages (after inflation) get stronger.

- The bumper summer harvest is also helping push food prices down and the August month-on-month figure was negative
- Core inflation (excluding food and energy) also decelerated from 9.1% in January to 7.0% in August.
- Prices for services also fell to 5.5% in August
- Inflation has come down since December reaching 9.8% in January and to 7.3% in the spring months and then fell again in July and dipped below 7% in August at 6.9%.
- IF the rouble continues its current stabilization while food prices remain under control, and GDP increases but only moderately, then it looks like inflation will fall further.

> We see inflation finishing the end of 2016 at 6.3% with average 2016 inflation at about 7.3%. We then see inflation averaging 6.2% in 2017 (with some upside risk) and ending 2017 at about 5.5%. Most risks are slightly to the upside.

- Interest rates are following inflation downward but they are still positive by about 3 percentage points and this will exert downward pressure on prices.
- Inflation is also ticking down of course due to weaker household spending and consumers are downtrading thanks to competitive retail prices, although western brands are raising their prices solidly.
- Lower energy prices also play a part as they do globally.

Industrial-investment indicators (updated)

Indicators related to industrial output and investment are still either mixed or remain at negative levels. There is some improvement but we are still some way from sustainable industrial/investment/economic recovery: it's a mixed picture. This means that companies in the B2B sector will still face pressures.

> **Industrial output actually grew in February by +1.0% for the first time in 15 months and then recorded slight positive growth in the spring.**

This was followed by a bounce in June and positive growth in August (+0.7%).
This is an improvement but not really exciting and industrial output this year will turn positive at +0.2% and then pick up to 1.7% in 2017

- Business confidence averaged -4 through much of the year after a sluggish start and remained stable at this level through July and then declined in August to -5. This number is very seasonal (always weak at turn of the year) but the numbers do indicate a strong positive seasonal trend, which is being maintained so far (but with the August dip).
- Another indicator entitled the business sentiment indicator stands at a 3-year high in June-August.
- The PMI indicator improved to 49.8 in January (and a figure of 50.0 suggests growth) but then sank to a low of 48.0 in April. But since then the indictor has fluctuated around 50 and the August figure was 50.8.
- The services PMI also rose to average 53.5 in June-August, which is also at 3/4–year high so services are helping to buttress output.
- Car registrations were up by 114,000 in August compared for example with a high of 291,000 in April 2008. But the latest number reflects only a sluggish seasonal improvement and is close to a 5-year low level, which suggests that the automotive industry still has many months of struggle ahead.
- Car production in August was at a seasonal low of 74,000 which matches the low levels of 2010.
- Given that 5 out of 8 months this year have been positive for industrial production in 2016, we upgrade our annual 2016 industrial growth figure from -0.2% to +0.2% with some small upside.
- But the construction sector still struggles with a -9.0% figure in May but had rallied to +3.0% in July year-on-year.
- Banks' funding and liquidity profile continues to improve and the banking system is sufficiently capitalised with an aggregate capital adequacy ratio of 12.0%, which is above the regulatory minimum of 8.5%.
- Corporate bank deposits went negative in January by -3% for the first time since 2009 after generally increasing by 10-20% in recent years. Deposits did start to improve though in spring. On the other hand, corporate loans (in roubles) are diminishing finally: new corporate loans increased annually by 15-20% in 2013-14 and by around +6-8% last year and were growing by 4% to April 2016 but by July the trend was negative -2.3%.
- Non-performing loans have risen to 9.7% in the first half of 2016 which is still manageable.
- But before we get too carried away, investment numbers are still bad. Gross fixed investment was down by -7.6% in 2015 and we have downgraded slightly our estimate for this year to -3.7%. This is based on continued weak quarterly figures of -8.4% in Q1 and -4.8% in Q2 followed by -4.3% in Q3. Sanctions, finances, interest rates, foreign investment trends and weak confidence in the medium-term are all holding back the investment numbers.
- Other bad news is that exports denominated in dollars, after a traditional weak January at $17bn, have only averaged around $21bn monthly through June-August. Exports are running at about -18% in August (compared with August 2015) which is an improvement on the spring figure of -28%. Weak exports entail less demand for investment to produce exports and this then flows through into weaker industrial production.

We often state that 60% of Russia's economic problems stem from the oil price and 40% from western sanctions impacting financing and confidence. But we know that this ignores the fact that GDP growth started to trend downwards in January 2013, well before Crimea, and that it was industrial and investment figures which led the downward trend. Russia's economic problems pre-date the Ukraine crisis.

Consumer indicators

- Consumer indicators at the end of 2015 were very bleak and chalked up some of the worst figures in 15-25 years for nominal wages, real wages, retail sales and consumer confidence.
- The economic numbers were simply very bad.
- Retail sales slumped by -15.3% in December with the whole year figure for 2015 negative at minus -10.0%. The December 2015 retail sales figure was the worst monthly one in 25 years and the annual retail figure was the joint worst in 25 years along with 2009.
- The December 2015 nominal wage increase was the worst since 1993 which meant that real wages (after inflation) were close to 20-year lows at -10.0% in December and -9.5% for the whole of 2015.

Against that back-drop, as most executives will agree, the resilience of the Russian consumer was and is remarkable. With these economic numbers, Russians shouldn't be going into shops!

That's the recent backdrop and thankfully since then there has been some mild but not fundamental improvement. We still need to wait and see amid reports that the Russian consumer is finally showing signs of wear and tear.

- Retail sales were -15% last December and by April had improved to -4.8%. But since then retail sales have been stuck at -5% until and including August. We expect the annual 2016 figure to be no better than -3.5%. Non-food sales are performing relatively worse than food ones.
- Real wages were also bleak at -10.2% last December but actually trend positive in March by 1.6% but July and August both were in negative figures for real wages: this means that if inflation is 7% in August and real wages are -1.0% then nominal wage increases in August were 6.0%.
- It looks like most government and Russian corporate employees will receive average nominal pay increases of 5-7% in 2016 and with inflation at 7.3% average this means real wages will still be down -1.7% on average this year. BUT this is a huge improvement on last year.
- Still nominal wages will not be strong and it appears that pensions will rise below inflation as well.
- The retirement age for government employees will gradually rise to 65 for men and 63 for women. Starting in 2017, the retirement age for all government employees will rise by 6 months each.
- We have noted in another report recent executive comments that the "Russian consumer is finally getting tired". It is too early to say when the improvement in real wages will transfer into sales in the shops and the consumer may be adopting a wait and see approach. The mild economic recovery may come "just in time" to save any consumer collapse.
- Unemployment actually improved in August to 5.2% after reaching 6.0% in the spring which is good news but we note that many workers receive shorter hours and less pay per hour.
- Disposable income was poor again in August at -8.3%. BUT we argue that this indicator is of little value as it includes FX sales and purchases by citizens, and the first quarter figures were probably warped by the rouble fluctuations.
- Consumer credit was exploding by +35-40% annually in 2012-2013 and then decelerated to 20% growth in 2014. New consumer credits (in roubles) were still rising at the start of 2015 by about 10% but by the end of last year they had turned negative and remained so through the first half of 2016 at an average of -6% to -8%. The July figure was -7.8%. Of course less available credit will hold back household spending and is a major reason we keep our spending estimate in negative territory this year, combined of course with the effect of negative real wages.
- Consumer confidence at the start of 2015 was the second worst figure in 25 years (excluding 2009) at -32 and then improved by Q3 to -24 but slipped back in Q4 to -26. The first quarter of 2016 was a roller-coaster and rouble volatility and international tensions (Syria/terrorism) helped keep the indicator down at -30. Our "guesstimate" for the second quarter proved correct with a mild recovery to -26. We expect this indicator to continue improving on the back of a stronger rouble and sinking inflation which will bring real wages back into positive territory on a monthly basis by the end of the year.

GDP and the Russian economy in 2015 and 2016

Macro-economic data 2009-2020

	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
GDP	-7,9	4,3	4,3	3,4	1,3	0.6	-3,8	-0,7	1,3	1,8	1,9	2,0
Retail sales	-5,5	6,3	7,2	5,7	3,9	2,5	-8,8	-3,5	2,1	2,7	2,8	2,9
Household spending	-7,6	5,5	6,8	7,9	4,7	1,8	-8,5	-2,8	1,8	2,6	2,6	2,8
Real wages	-2,8	4,4	4,9	8,2	5,2	1,9	-9,2	-2,8	2,2	2,7	2,9	3,2
Disposable income	1,0	3,7	2,8	3,7	3,3	2,1	-4,0	-3,0	1,8	2,2	2,6	2,7
Inflation (year-end)	8,8	8,7	6,1	6,6	6,5	11,4	12,9	6,3	5,5	5,3	5,2	5,0
Unemployment rate	7,9	7,6	6,5	5,3	5,5	5,3	5,4	5,7	5,6	5,5	5,4	5,3
Gross fixed investment	-17,9	5,6	9,8	6,0	-0,3	-4,8	-7,6	-3,7	2,4	3,5	3,9	4,0
Industrial output	-10,8	8,3	4,7	2,6	0,3	1,1	-3,4	0,2	1,7	2,5	3,1	3,3
FX reserves ($bn) year-end	447	485	510	528	509	385	365	410	390	400	415,0	420,0
Rouble/$ (year-end)	30,3	30,4	32,1	30,4	32,9	58,0	73,0	68,0	71,0	76,0	78,0	79,0
Rouble/Euro (year-end)	43,4	40,0	41,5	40,1	45,1	72,0	78,0	74,0	77,0	82,0	84,0	84,0
Budget balance (% of GDP)	-6,3	-3,5	-0,2	0,0	-0,5	-0,5	-3,6	-4,1	-3,2	-2,6	-2,2	-1,8
Current-account balance (% of GDP)	3,8	4,9	4,9	3,6	1,6	2,7	4,3	3,8	3,3	3,2	2,5	1,9

Key statistics by year and monthly

	2012	2013	2014													2016			
	year	year	year	Q1	Q2	July	Aug	Sept	Oct	Nov	Dec	Jan	Feb	March	April	May	June	July	Aug
Disposable income	3,7	3,3	2,1	-1,4	-2,3	-2,0	-4,9	-4,3	-5,6	-6,5	-0,7	-6,3	-6,9	-1,2	-7,1	-5,7	-4,8	-7,0	-8,3
Real wages	8,2	5,2	1,9	-8,6	-9,2	-9,2	-9,8	-10,4	-10,9	-10,4	-10,2	-6,1	0,6	1,6	-1,7	-1,0	1,4	-1,3	-1,0
Real retail sales	5,7	3,9	2,5	-6,7	-9,4	-9,1	-9,1	-10,4	-11,7	-13,1	-15,3	-7,3	-4,3	-5,8	-4,8	-6,1	-5,9	-5,0	-5,1
Unemployment	5,3	5,5	5,3	5,7	5,6	5,3	5,3	5,2	5,5	5,8	5,8	5,8	5,8	6,0	5,9	5,6	5,4	5,3	5,2
Industrial output	2,6	0,3	1,1	-0,4	-4,9	-4,3	-4,3	-3,7	-3,6	-3,5	-4,5	-2,7	1,0	-0,5	0,5	0,7	1,7	-0,3	0,7
Fixed investment	6,0	-0,1	-4,8	-6,0	-6,5	-6,8	-6,8	-5,6	-5,2	-4,9	-8,7	-8,4	-8,4	-8,4	-4,8	-4,8	-4,8	-4,3	-4,3
Consumer prices	6,6	6,5	11,4	16,2	15,8	15,8	15,8	15,7	15,6	15,0	12,9	9,8	8,1	7,3	7,3	7,3	7,5	7,2	6,9
Budget deficit (running)	0,0	-0,5	-0,5	-1,7	-2,3	-2,9	-3,1	-3,0	-3,0	-3,3	-2,6	-1,8	-1,9	-2,6	-1,4	-3,0	-3,2	-3,3	n/a

As ever, I hope you have enjoyed this report and found it useful. If you have any queries, do get in touch at **danielthorniley@dt-gbc.com**

28 September 2016

Appendix: the oil price drivers and consequences

Some interesting figures

- The USA has become the largest global energy producer.
- US oil output is 70% up on its 2008 figure.
- China has taken over from the USA as the largest global energy consumer.
- Currently US energy imports are the lowest since 1960.
- A 10% drop in the oil price adds about 0.15% to global GDP so the current 45% decline could increase global GDP by about 0.3% in 2016 after a 0.7% stimulus. BUT other factors are holding back global growth so we do not see or anticipate such upward swings
- A 20% drop in the oil price results in $70bn of extra disposable income for US consumers but so far US consumers and global ones are not splurging this money.
- Total oil exports in 2013 were worth about $1.1 trillion and a 40% drop in the oil prices entails losses of about $400bn for energy producers.

Why has the oil price collapsed?

- Shale/energy production is accelerating quicker than anticipated against a weak demand back-drop
- Global demand is stagnating as China slows down and the US buys from itself.
- We are entering "the age of the dollar"; several trends dictate that the US dollar ought to be relatively stronger in the coming years. The oil price and dollar value move in inverse proportion to each other so this ought to impart downward pressure on oil.
- The US is also supplying more to the world and buying less energy from it.
- Speculation and shorting account for at least 20% of the price movements.
- Saudi Arabia decided in November 2014 not to support the oil price and thereby broke the OPEC oil cartel.
- Global stock markets started getting spooked at the low oil price fearing it was more an indicator of weak demand and not just low supply.
- Saudi Arabia was fed up with acting as the oil supporter of last resort.
- The Saudis felt that other suppliers would not stick to agreed limitations and thus they would lose market share.
- The Saudis wanted to retain market share to the relatively lucrative Asian market where GDP growth remains comparatively strong for now.
- It is assumed that the Saudis are also engaging in some economic warfare with Iran whose budget is only balanced at an oil price of $140.
- It is also thought that the Saudis are playing a sort of "game of chicken" with the US shale producers who are only profitable with an oil price in a range of $55-70.
- But US shale producers are proving efficient and productive: the number of wells has dropped markedly this year but overall production has not fallen much
- It is estimated that Saudi Arabia's own break-even point for a balanced budget is around $75-80 per barrel and thus current prices are also hurting Saudi Arabia.