

# Russia: The Rouble and Economic Outlook

*Spring in Moscow?*



**by Dr. Daniel Thorniley**

President, DT-Global Business Consulting

[danielthorniley@dt-gbc.com](mailto:danielthorniley@dt-gbc.com)

17 May 2016

IN ASSOCIATION WITH:

BAKER & MCKENZIE

CUSHMAN &  
WAKEFIELD

**EY**  
Building a better  
working world

**Radius**  
GROUP

## Content

<b>About the author</b>	<b>2</b>
<b>Key economic summary</b>	<b>3</b>
Economic outlook	3
GDP outlook	4
The long mid-term outlook to 2025	4
The Big-5 factors influencing the Russian economy	4
<b>The rouble outlook</b>	<b>5</b>
Other factors affecting the rouble	6
<b>Inflation outlook</b>	<b>7</b>
<b>Industrial-investment indicators</b>	<b>7</b>
<b>Consumer indicators</b>	<b>8</b>
Economic scenarios and the rouble for 2016 at different oil prices	9
<b>The GDP outlook</b>	<b>9</b>
Central Scenario - 2016 economic outlook (oil averages \$40-47)	9
GDP and the Russian economy in 2015 and 2016	10
Macro-economic data 2009-2019	10
Key statistics by year and monthly	10
<b>The budget deficit</b>	<b>10</b>
<b>Appendix: the oil price drivers and consequences</b>	<b>12</b>

© 2016 CEEMEA Business Group, a joint venture between

DT-Global Business Consulting GmbH, Address: Keinergasse 8/33, 1030 Vienna, Austria,  
 Company registration: FN 331137t  
 and GSA Global Success Advisors GmbH, Hoffeldstraße 1, 2522 Oberwaltersdorf, Austria  
 Company registration: FN 331082k

Source: DT Global Business Consulting GmbH and CEEMEA Business Group research. This material is provided for information purposes only. It is not a recommendation or advice of any investment or commercial activity whatsoever. The CEEMEA Business Group accepts no liability for any commercial losses incurred by any party acting on information in these materials.

Contact: Dr Daniel Thorniley, President, DT Global Business Consulting GmbH  
 E: [danielthorniley@dt-gbc.com](mailto:danielthorniley@dt-gbc.com) / [www.ceemeabusinessgroup.com](http://www.ceemeabusinessgroup.com)

## About the author



### **Dr Daniel Thorniley**

danielthorniley@dt-gbc.com

Danny Thorniley is President of DT-Global Business Consulting GmbH (an LLC company) which is Danny's own consultancy company based in Vienna through which he works with some 330 key clients on business strategy in CEEMEA, global and emerging markets especially Russia. These companies are part of the CEEMEA and Russia Business Group, which is an advisory and consultancy service. The services of the Group include written position papers, presentation slides and private client meetings as well as in-house presentations.

Danny writes a well-received monthly position paper on the Russian market as well as quarterly presentation slides on other CIS markets. He visits Moscow on business every 2-3 weeks and hosts 8-9 private meetings of the Russia Business Group annually. The most recent one was attended by some 140 senior executives. He is also invited to make some 50 speeches/presentations each year by clients across the world on global business trends, business operations, emerging markets, corporate best practice. Many of these speeches are focused on Russia and the CIS and he has made some 60 "Russia presentations" to visiting western CEOs explaining the positives of the market without being naïve.

For 23 years (until the closure of the Vienna office) Danny was Senior Vice President and Senior Consultant at The Economist Group, Vienna on global corporate business trends, with specialisation in BRIC.

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.

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.

He has worked on a personal basis with companies operating in emerging markets for 26 years and has personal contacts with most senior western MNCs operating in the Russia and the CEEMEA region and beyond. He makes frequent presentations at CEO and Board level and has long-standing personal friendships with leading executives. He holds and has held a number of non-executive and advisory board memberships.

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.

His beloved daughter is called Natasha after he read Tolstoy's War and Peace when he was a young man. One of his other favourite books is Master and Margarita by Bulgakov.

## Key economic summary

### Economic outlook

In each economic report this year we have noted how some economic indicators are improving and two of the most critical – the oil price and therefore rouble FX rate—are trending favorably compared with 4-6 months ago. A greater sense of corporate security has built up in recent weeks and months and a few executives have said referring to the weather, the economy and business that:

Spring is here in Moscow!

BUT no one is naively optimistic: “Things are not great, but they are better than they were and we know where we stand” sums up the mood of many.

External, international factors and shifts in global energy can quickly change things but, as you will see, we stick with our central scenario of recent weeks and months and actually tweak our numbers to a slightly better economic outlook. But as a reality check: GDP growth this year will still be negative about -1.3% and household spending and industry-investment will all be negative

A third important factor (after oil and the rouble) is that inflation is coming down a bit faster than anyone expected and this will be good news for consumer spending and confidence; and it will also help the Russian Central Bank to bring down key interest rates which ought slowly to help investment and industrial trends which are still weak. Lower inflation also means better real wages and we are seeing this.

Related to low inflation is the fact that significant things are happening with nominal and real wages: they are improving.

For much of 2015 nominal wages in Russia (paid by Russian companies and the civil service) hovered around 5%. BUT with inflation averaging 15% last year this meant that real wages (after inflation) were about -10% for many months of last year and that was close to the annual 2015 average. But in December and January nominal wages dipped for a couple of months to just 2-4%, one of their lowest levels in decades.

In recent months we saw inflation come down to 7% and nominal wages have popped back up to 7-8% (instead of 2-3% at the turn of last year).

What does this mean? Well real wages have turned positive in February and March for the first time in 15 months. And while for a couple of months (December-January) western companies (with nominal wage increases of 6-8%) were paying well above the norm in the rest of the economy, western companies are now back in sync with Russian nominal wages at 6-8%.

As inflation comes down, and we think it should average about 8.2% this year, consumers will feel better and employees will also feel more upbeat because that nominal pay increase of 7% will now not represent -8% in real terms but will be about zero or even slightly positive if inflation improves even more.

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. Until recent weeks nearly all indicators combined were doing very badly and consumer-related numbers were extremely poor at the end of 2015 and the first weeks of 2016.

But again several factors are better for now:

- The oil price is over \$45 per barrel (and we did predict \$28-35 was too low).
- The rouble is bobbling at 74-76 to the Euro (close to levels recorded in February and September 2015).
- Inflation is down to 7.3% in March and April.

- Real wages therefore have improved to slightly positive territory this spring.
- The key interest rate at 11.0% will probably be cut at the Bank's next meeting to 10.5% and we forecast further cuts bringing the rate to 9.25% to 9.0% by the end of 2016 or first quarter 2017.

## **GDP outlook**

Many indicators, after being the “worst in 15-20 years” in December 2015 (comparing that month with the same month in 2014), are now some of the best in 9-15 months. Once again we stress this does not make them absolutely good numbers but certainly in comparison with last year the numbers are better and trending in the right direction. For now we have marginally improved our GDP assessment for 2016 to -1.3% and there are fewer downside risks today than there were 3-6 months ago.

Our estimate for 2016 GDP is very close to the consensus figure, which has also been improving over the last three months. Some commentators suggest -2% to -3% for 2016 GDP: this currently looks excessive but much will depend on the oil price, rouble and inflation.

We expect the political and global environment to help the Russian economy a bit this year and in 2017 and we predict GDP 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%.

### **How deep the recession has been:**

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 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 1.9% to 2.3% during 2018 to 2025 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 background.

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**

We do confirm our long-standing assumption that with oil at about \$45-55 over the next 18 months and that any upside risk stems from less supply than is generally anticipated. The consensus view for the next 1-2 years is actually stronger than this at 55-60+ and Citi anticipate \$70 per barrel at end-2017. Of course any of these higher numbers would only benefit the Russian economy (see scenarios below).

But medium-term we feel that a new inflow of Iranian oil supplies and the ability of US shale producers to pop back into the market when prices rise will act as a restraining factor on the oil price medium-term. Therefore: \$45-58 possible over the next 12-18 months and even \$55-62 over the next 3 years but any higher number sustainably does not look valid, unless of course the Saudi authorities decide to pump more oil and move away

to some extent from their “market share battle with Iran and the US shale producers”. If the Saudis do change policy or even announce that they will, this would boost the oil price by 5-20% and also the rouble valuation by at least +10%.

## 2. The rouble

The rouble’s future is inextricably linked to the oil price and the two numbers are moving in tandem more closely than at any time in the last 10 years.

### **The oil price is the rouble value.**

See below for more comments.

## 3. Eastern Ukraine

The important, cynical, fact here is “the perception” of what is happening. The official western view is that hostilities are calmer than they were and as anticipated, this has become a frozen conflict. Facts on the ground are probably worse than this assessment but we repeat that geo-politically the most important element is “the perception” of what is happening. For political risk, this then is good news. BUT the events on the ground are probably unlikely to stimulate much movement soon in western sanctions.

## 4. Western sanctions

Any diminishing of US sanctions looks extremely unlikely in the next 1-3 years. The new US President (whoever she may be ☺), will not fight the US Congress, which will certainly be republican, over reducing sanctions with Russia.

There is a small and slightly growing chance that European sanctions could be modified rather than eliminated over the next 18 months. German and US influence tend to ensure that European sanctions are kept in place.

But any change in “mood music” on sanctions could have quick positive effects pushing the rouble up +5% just on rumours or raising the rouble value by 8-15% if European sanctions were rescinded.

Two notes: 1) we do think that Hilary Clinton will be the next US president but it is not a gambling certainty and President Donald Trump is still a 40% possibility. 2) German commercial interests wish to rescind sanctions but the German political leadership has turned more against this eventuality without manifest changes on the ground in Ukraine.

## 5. China and the USA

Russia is dependent on Chinese growth: if Chinese GDP dips down, then global markets tumble and the oil price collapses taking the rouble with it. The US influence flows through interest rate policy: when the Federal Reserve plans several interest rate hikes, then all emerging markets and the rouble come under downward pressure.

Some of the relative currency stability today stems from the fact that the US Federal Reserve seems to be in a holding pattern on raising rates: in 2016 we now only anticipate 1-2 increases instead of a total of 3-4.

## **The rouble outlook**

The rouble is 18.6% stronger than it was at its recent low on 11 February (74.0 to the Euro on 15 May compared with almost 91 on 11 February).

On the back of a rising oil price, the rouble has strengthened by 15-20% in the last 2-3 months making it one of the strongest currencies in the world.....at least for a few weeks after being one of the weakest for many parts

of the last 15 months. Executives crave and yearn for rouble stability and while we certainly have some relative stability in March-May, it is too early to talk of currency stabilisation.

But everything depends on the oil price, which has followed the trend we expected. We argued that \$28-32 per barrel in recent months “felt low” and we predicted a rally given issues of more limited supplies to the market. Because the consensus for oil (\$45-48 in 2016 and \$50-60 in 2017) is close to the current price of \$47 today or above it, then there is some possible upside for the rouble. BUT every reader knows this is a volatile indicator with no guarantees: speculation and herd mentality drive the oil price as well as the rouble.

Our central scenario is for oil to average around \$42-\$46+ per barrel in 2016 and with some upside risk in 2017 to \$48-53.

Based on this oil scenario we now expect the rouble to fluctuate on average within 5% of either side of current (May) 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.

### **Other factors affecting the rouble**

Interest rates: the central rate is stuck at 11.0% and with some economic stabilisation apparently taking place, with the rouble a bit stronger and most importantly of all, with inflation trending downwards, it seems likely that the Russian Central Bank will take the central rate down to about 9.25% by the end of 2016. In a best case this could be down to 9.0% by the end of the year. Weaker interest rates ought to imply downward pressure on the currency but to be honest, interest rates (unless massive shifts) do not do much benefit or damage to the rouble when other factors (oil) drive the currency. But lower interest rates will have a positive effect on investment and output at least after some delay.

We do need to note though that the Central bank is not rushing to cut rates (and will wait until June) because it remains concerned that the current oil price rally at around \$45 is not sustainable.

Russians will be staying more at home this year or engaging in domestic tourism. There will be much less demand for FX to go on holidays to Egypt and Turkey and recent terrorism in western Europe ought to encourage people to stay in Russia. This ought to provide some seasonal support over the spring and summer to the currency.

We 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. In January FX reserves at the Central Bank actually rose to \$382bn, which testifies that the Bank has little intention of protecting the rouble against the oil price. By early May the Bank had even less need to protect the rouble and FX reserves had risen by mid-March to \$392bn.

In early March the stock of the Reserve Fund was down to \$49.9bn and the Well-Being Fund was more stable at \$71.3bn. Both 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 stressed by the rouble devaluation. These funds form much of the country's FX buttress against a weaker rouble. We can note that the Central Bank is seeking to protect them along with the rest of their FX reserves. This also helps explain the recent stabilisation in both funds in recent weeks.

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 policies would ensure a strong currency but the rouble is more influenced by the oil price and global/Chinese growth factors.

Capital flight is shrinking: down to \$7bn in the first quarter of 2016 compared with \$33bn in the first quarter of 2015.

Of a total external debt of \$515bn, only \$90bn to \$110bn is due in 2016 and \$66bn in 2017. Such payments are manageable.

## Inflation outlook

### **The inflation outlook has improved at the start of 2016 and is better than expected.**

Inflation is improving even better than we predicted. 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. These are the two 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 noted above this is having a palpable 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.**

- We expected the base effects (see above for explanation) to ensure that inflation would start to decline in early 2016 and this has come to happen. But the fall in inflation has been slightly quicker than expected.
- Inflation has come down since December reaching 9.8% in January and to 7.3% in both March and April. The decline was due in part to lower food prices (5.3% in April); durable goods slowed to 8.5% while services stabilized at 8.2%.

The consensus and the view of the Russian Central Bank is that inflation will pick up to 7.8% in the mid-summer months as the base effects run out of steam and then inflation will start to trend downwards again by year-end 2016 to 7.5%.

- IF the rouble stabilises at current levels and if the base effects turn out stronger than expected, then inflation in 2016 will average 8.0% and finish in December 2016 at about 7.5%. We then see inflation averaging 7.0% in 2017 and ending that year at 6.4%.
- Interest rates will follow inflation downwards and end 2016 at about 9.25% or at 9.0% around the turn of the year 2016-17.
- 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.
- It also seems that the trade restrictions with Ukraine and Turkey have not had much upward impact and we do not imagine there will be any strong future flow-through.
- Core inflation, excluding food and energy, also declined to 7.0% in April from 9.1% in January.

## Industrial-investment indicators

- The first quarter 2016 figures were better than expected. But indicators related to 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. 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.**

- This number could have been helped though by the extra day in the leap year and dipped back to -0.5% in March which was still better than expected.
- Business confidence improved again in April to -4 from -7 in January. 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 into spring.
- 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 offers any golden solution to Russian industry and GDP.
- The PMI indicator improved to 49.8 in January (and a figure of 50.0 suggests growth) but then sank in March to 48.3 and to a low of 48.0 in April.
- However, the services PMI did shoot up to 54.2 (the highest figure since March 2013). It seems some parts of the service sector are also buttressing output.
- Car registrations were up by 125,000 in March compared with 82,000 in a traditionally poor January. But the numbers reflect only a sluggish seasonal improvement, which suggests that the automotive industry still has many months of struggle ahead.
- We stick for now with our annual 2016 industrial growth figure of -0.5% with some small upside.
- Corporate bank deposits went negative in January by -3% for the first time since 2009 after generally increasing by 10-20% in recent years. On the other hand, corporate loans (in roubles) are still available: new corporate loans increased annually by 15-20% in 2013-14 and by around +6-8% last year and in 2016 year-to-date.
- But before we get too carried away, investment numbers are still bad. Gross fixed investment was down by -7.6% in 2015 and we revise downwards our estimate for this year to -3.2%. This is based on another weak figure of -8.4% in both February and March and close to the January figure. 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 in January were only worth \$17bn, which is the lowest figure since 2009 and climbed to just \$22bn in March. 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 worse in 25 years along with 2009.
- AND wages were bashed: nominal wages rose by only 1.6% in December after weak growth through the autumn of about 3%. The December 2015 nominal wage increase was the worst since 1993.
- This 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.

- Retails sales in January were negative -7.3% compared with -15% in December. And improved again in February to -4.3% but then stumbled again to -5.8% in March with food sales down by -5% and non-food declining -6.5%. Based on this trend, retail sales will average about -2.5% in 2016 which will be close to the decline in household spending of -2.6%.
- As noted above, real wages improved in January to -6.1% and then turned positive for the first time in 16 months to +0.6% in February and +1.6% in March as both inflation came down and nominal wages rose from their recent slumped figures.
- It looks like most government and Russian corporate employees will receive average nominal pay increases of 5-6% and with inflation at 7.7% average this mean real wages will still be down -1.7% 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.
- Unemployment actually improved in March to 5.6% after some months of stabilisation at 5.8%, which is good news but we note that many workers receive shorter hours and less pay per hour.
- Disposable income was down -6.9% in February and then bounce up to just -1.8% in March 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 remain so at the start of 2016 by -5%. 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 worse 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 2016 was a roller-coaster and rouble volatility and international tensions (Syria/terrorism) helped keep the indicator down at -30 in the first quarter of 2016. But our “guesstimate” for the second quarter this year is that this indicator will pick up slightly.

#### Economic scenarios and the rouble for 2016 at different oil prices

Average oil price 2016	GDP	Inflation average	Rouble/US\$ Average	Rouble/€ Average
\$80-85	3.2%	5.8%	45-52	52-58
\$70-80	2.4%	6.0%	52-57	58-64
\$60-70	2.2%	6.4%	57-60	64-66
\$55-60	1.8%	6.6%	60-63	66-69
\$50-55	1.3%	7.0%	61-66	69-72
\$45-50	0.3%	7.7%	62-68	72-75
<b>\$35-45</b>	<b>-1.3%</b>	<b>8.2%</b>	<b>63-69</b>	<b>74-78</b>
\$25-35	-2.5%	11.5%	80-84	86-92

#### The GDP outlook

##### Central Scenario - 2016 economic outlook (oil averages \$40-47)

GDP	-1,3%
Inflation (year-end)	7.5%
Inflation (average)	8.2%
Consumer spending	-2.2%
Investment	-3.2%
Industrial output	-0.5%
Rouble to US dollar average	63-69
Rouble to the Euro average	73-78

## GDP and the Russian economy in 2015 and 2016

### Macro-economic data 2009-2019

	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	-3,7	-1,3	1,3	1,8	1,9	2,0
Retail sales	-5,5	6,3	7,2	5,7	3,9	2,5	-10,0	-0,5	2,0	2,3	2,4	2,4
Household spending	-7,6	5,5	6,8	7,9	4,7	1,8	-10,1	-2,6	1,5	2,2	2,5	2,5
Real wages	-2,8	4,4	4,9	8,2	5,2	1,9	-9,5	-1,7	1,7	2,6	3,0	3,02
Disposable income	1,0	3,7	2,8	3,7	3,3	2,1	-4,0	-1,0	1,7	2,2	2,4	2,5
Inflation (year-end)	8,8	8,7	6,1	6,6	6,5	11,4	12,9	7,5	6,4	6,3	6,1	6,0
Unemployment rate average	7,9	7,6	6,5	5,3	5,5	5,3	5,4	5,6	5,5	5,4	5,4	5,3
Gross fixed investment	-17,9	5,6	9,8	6,0	-0,3	-4,8	-7,6	-3,2	2,5	3,3	3,5	4,0
Industrial output	-10,8	8,3	4,7	2,6	0,3	1,1	-3,4	-0,5	1,7	2,3	3,0	3,1
FX reserves (\$bn) year-end	447	485	510	528	509	385	365	385	395	410	415	435
Rouble/\$ (year-end)	30,3	30,4	32,1	30,4	32,9	58,0	73,0	68,0	71,0	74,0	77,0	81,0
Rouble/Euro (year-end)	43,4	40,0	41,5	40,1	45,1	72,0	78,0	77,0	78,0	80,0	82,0	85,0
Budget balance (% of GDP)	-6,3	-3,5	-0,2	0,0	-0,5	-0,5	-2,8	-3,7	-2,7	-1,7	-1,3	-0,7
Current-account balance (% of GDP)	3,8	4,9	4,9	3,6	1,6	2,7	4,8	4,3	3,5	2,8	1,5	1,3

\*Our estimate for rouble exchange rate here is close to current (end May 2016 levels). We base these estimates on the assumption that the oil price ought to improve somewhat during 2016, which would mean some mild strengthening. But we think that other non-oil factors could mean some counter-balancing depreciation. Hence why in net terms we don't see much fluctuation. FX rates will vary of course depending on the oil price and see our scenarios table above.

### Key statistics by year and monthly

	2012	2013	2014	2015								2016						
	year	year	year	Jan	Feb	Mar	Apr	May	June	July	Aug	Sept	Oct	Nov	Dec	Jan	Feb	Mar
Disposable income	3,7	3,3	2,1	-0,8	-1,6	-1,8	-4,0	-6,4	3,5	-2,0	-4,9	-4,3	-5,6	-6,5	-0,7	-6,3	-6,9	-1,8
Real wages	8,2	5,2	1,9	-8,0	-7,4	-10,6	-13,2	-7,3	-7,2	-9,2	-9,8	-10,4	-10,9	-10,4	-10,2	-6,1	0,6	1,6
Real retail sales	5,7	3,9	2,5	-4,4	-7,2	-8,7	-9,6	-9,2	-9,4	-9,1	-9,1	-10,4	-11,7	-13,1	-15,3	-7,3	-4,3	-5,8
Unemployment	5,3	5,5	5,3	5,5	5,8	5,9	5,8	5,6	5,4	5,3	5,3	5,2	5,5	5,8	5,8	5,8	5,8	5,6
Industrial output	2,6	0,3	1,1	0,9	-1,6	-0,6	-4,5	-5,5	-4,8	-4,3	-4,3	-3,7	-3,6	-3,5	-4,5	-2,7	1,0	-0,5
Fixed investment	6,0	-0,1	-4,8	-6,3	-6,5	-5,3	-4,8	-7,6	-7,1	-6,8	-6,8	-5,6	-5,2	-4,9	-8,7	-8,4	-8,4	-8,4
Consumer prices	6,6	6,5		15,0	16,7	16,9	16,4	15,8	15,3	15,8	15,8	15,7	15,6	15,0	12,9	9,8	8,1	7,3
Budget deficit (running)	0,0	-0,5	-0,5	-1,6	-1,8	-1,8	-2,1	-2,5	-2,3	-2,9	-3,1	-3,0	-3,0	-3,3	-2,6	-1,8	-1,9	-2,6

### The budget deficit

And the budget deficit improved in January narrowing to -1.8% from -2.6% in December 2015, which was reasonably stable in February at -1.9% and then widened to -2.6% in March. The widening in February-March was due to a slight pick-up in expenditure that rose from 15% of GDP in January (always a slow month) to 18% of GDP in February. This figure is still lower than average expenditure of 19-20% of GDP as recently as 2015.

The good news is that the Russian government arrived at this crisis with some fat: the budget deficit in 2014 was a mere -0.5% and deteriorated to -2.8% last year. Current numbers suggest that the full-year deficit 2016 will be about -3.7% to -4.0% and the government has adequate external and internal borrowing options to finance such levels for 18-24 months.

In February the Ministry of Economic Development estimated the 2016 deficit at -4.1% with oil averaging \$40 per barrel.

Discretionary spending by the government was down by -8% to -10% in 2015 and we expect similar numbers in 2016. This will make selling to the federal and local authorities continuingly difficult.

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\*\*](mailto:danielthorniley@dt-gbc.com)

17 May 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 numbers 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.