MONITORING OF RUSSIA'S ECONOMIC OUTLOOK:

TRENDS AND CHALLENGES OF SOCIO-ECONOMIC DEVELOPMENT

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Monitoring has been written by experts of Gaidar Institute for Economic Policy (Gaidar Institute) and Russian Presidential Academy of National Economy and Public Administration (RANEPA)

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MAIN TRENDS AND CONCLUSIONS

Having analyzed **the dynamics of inflation during the past year**, our experts put forth a number of assumptions regarding its rates in 2020. Having reached its local maximum of about 5.3% in March 2019, consumer price inflation steadily decreased to 3% in annual terms. The drop in inflation was facilitated by a slow rise in domestic demand, a strengthening of the ruble, a good harvest and a relatively stable situation in international financial markets. All these factors made it possible for the regulator to gradually reduce its key rate. On the whole, Russian inflation had remained close to the 4% target for three years in a row.

Our experts forecast that in early 2020 the annual inflation rate may even decrease below 2%, which will result in a further easing of the Bank of Russia's monetary policy. However, by the end of the year the growth rate of the Consumer Price Index will climb back to the range of 3.5-4%.

Having assessed **the RF balance of payments' final data for 2019**, the experts point out that the decrease in the current account balance to $ 70.6bn (which represents a 38% drop on 2018) can be explained, first of all, by the shrinkage of Russia's foreign trade surplus. Exports declined in absolute terms by $ 25bn (due to the drop in international prices for Russian main exports), whereas imports grew by $ 6bn. The trade deficit of services also increased.

At the same time, there was a profound drop in the net capital outflow from Russia's private sector (to $ 26.7bn vs $ 63bn in 2018). This shrinkage in capital outflows was observed both in the banking and non-banking sectors of the economy. Russia's **international reserves** considerably increased, to $ 554.4bn by the end of the year, which represents their record high for the whole post-global financial crisis period. These developments were determined, to large extent, by the RF Ministry of Finance's purchases of foreign exchange to the value of about RUB 3.5 trillion, in accordance with the budgetary rule (vs RUB 2.1 trillion in 2018). If the growth rate of the global economy and oil prices should decline, it can be expected that in 2020, Russia's current account surplus will continue to shrink. At the same time, any easing of their monetary policies by the developed countries will boost the attractiveness of Russian financial assets, thus improving the balance of Russia's net financial account.

Our preliminary analysis of **the dynamics of industrial production in Q4 2019** indicates that the manufacturing and extractive sectors returned to near-zero growth rates. There was a decline in the production of electricity, gas and water. It should be said that the decline in the growth rates in **the extractive sector** was related, inter alia, to the implementation of the OPEC+ deal and a notable drop in external demand for natural gas and coal. As far as **the manufacturing sector** is concerned, the food industry, chemical production, and metallurgy registered growth. Researchers have noted that positive dynamics were experienced by those branches that accounted for more than 70% of gross value added in Russia's manufacturing industries, although the result indicator of the manufacturing sector turned out to be close to zero. They believe that the Russian Federal State Statistics Service (Rosstat) should refine its flash statistics.

On the whole, the growth achieved by the manufacturing sector has so far failed to convince economists that this upward trend is going to persist, because it has taken place against the backdrop of quite modest investments in fixed assets. This means that producers tend to use their already existing facilities, while the current industrial growth taking place in conditions of weak demand is created by the ongoing stock replenishment.

Having analyzed the formation of **the banking sector's resources** over the course of the past year, our experts arrived at the conclusion that funding continued to be carried out in a sufficiently balanced way. Lending institutions were increasing their resource base through the use of traditional instruments such as the attraction of funds to the deposits held by legal entities and individuals. **Personal deposits** remain the largest source of funds, accounting for 31.6% of the total volume of bank liabilities. By the end of 2019, such deposits had grown to RUB 30.5 trillion, which represented a 2.1 trillion growth on the previous year. However, it should be admitted that their growth rate slightly declined. Another noteworthy factor was the continuing deforexation of major liability items. The level of deposit dollarization (all deposits in foreign currencies) decreased in ruble terms to 19.6% (from 21.5% in 2018). However, it should be said that the decline was caused to a considerable extent by the ruble's appreciation. The volume of borrowings in the interbank lending market, one of the most volatile sources of funding, also declined. The same was true of the attraction of funds from non-resident banks. By contrast, the volume of bonds issued by the banking sector increased (to RUB 1.9 trillion, from RUB 1.3 trillion in 2018).

Having examined the socioeconomic development of Russian regions (on the basis of data for January-November 2019, relative to the same period of 2018), our experts emphasize its low growth rates. The industrial **growth champions** include Yamal-Nenets Autonomous District, Yakutia, Buryatia, Moscow Oblast, and Primorski Krai. Having declined in the period 2016-2018, **residential construction resumed growth**. On the whole, the growth rate therein hovered around 8%, however growth in residential construction was not universal or similarly robust: the highest dynamics was observed in the Moscow agglomeration and Krasnodar Krai, while 26 regions experienced a continuation of decline in the commissioning of new housing. Most of the regional economies continued to be dependent on federal assistance; on the average, **the share of transfers** amounted to 17% of the revenue side of the regions' consolidated budgets, climbing, in some cases, to 70–80%. Within the structure of transfers, the share of subsidies allocated to regions increased to 42% over the course of the year, among other things due to the necessity of implementing Russia's national projects. On the whole, **the surplus of regional budgets** amounted to 7%, a situation that can be regarded as relatively satisfactory, although it should be noted that the examined data did not include those for December. This positive result was achieved, to a large extent, due to the input of the most developed regions with their huge budget surpluses.

1. INFLATION: THE RESULTS OF 2019

A. Bozhechkova, P. Trunin

In 2019, the significant inflation slowdown translated into a notable monetary policy easing. Over the course of the year, the Bank of Russia reduced its key rate 5 times (from 7.75 to 6.25% per annum), as a result of which, according to the Bank of Russia, it now stands near neutral level. Our experts forecast that in early 2020, the annual inflation rate may even plunge below 2%, and so the Bank of Russia may further ease its monetary policy. However, towards the year's end, the growth rate of the Consumer Price Index may climb back into the range of 3.5–4% due to increased budget expenditure and domestic demand recovery.

Having reached its local maximum in March 2019 (5.3%), over the period April-December 2019 consumer price inflation (relative to the previous 12 months) was in steady decline. In early 2019, the inflation-triggering factors were the raised VAT rate and the ruble's weakening in H2 2018. Nevertheless, the preventive measures deigned to toughen the monetary policy, which were introduced by the regulator in September and December 2018, made it possible to minimize the upward deviation of the inflation index from its target. Thereafter, the smooth **downward movement of inflation was facilitated by a slow rise in domestic demand, a strengthening of the ruble, a good harvest and a relatively stable situation in global financial markets.** The year-end inflation index for 2019 (relative to the previous 12 months) was 3% in annual terms (vs 4.3% at the end of the year 2018) (*Fig. 1*).

The growth rate of food prices rose from 4.7% in December 2018 to 6.4% in May 2019. Later on, in response to the slow rise of personal income, the ruble's strengthening and the good harvest, the growth rate of food prices declined. Thus, over June-September 2019, the food sector was demonstrating deflation (-0.5% in June, -0.3% in July, -1% in August, and -0.5% in September). It should be noted that such a **lengthy disinflation period was observed for the first time since 2011.** As a result, in December 2019, the growth rate of food prices in annual terms (relative to the previous 12 months) was 2.6% (vs 4.7% in December 2018).

The growth rate of prices for non-food products peaked in March (4.8% relative to March 2018 r.), and then steadily declined to 3.0% in annual terms in December 2019 (vs 4.1% in December 2018). At the year end, the highest growth rates were demonstrated by prices for tobacco products (11.0%), pharmaceuticals (6.9%), and washing and cleaning products (4.9%).

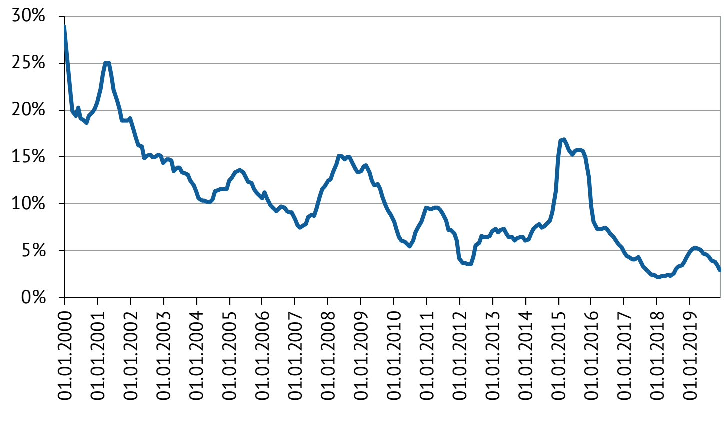


Fig. 1. Inflation relative to the previous 12 months, %

Source: Rosstat.

The marked slowdown in the growth rate of gasoline prices from 9.4% (in December 2018 relative to December 2017) to 1.9% in December 2019 (in annual terms) was caused by **the agreement between the RF government and several big oil companies, which was in effect until 1 July 2019.** It should be reminded that the upsurge of gasoline prices in April-June 2018 had to do with high oil quotes and the ruble's weakening in April in response to the toughening of economic sanctions.

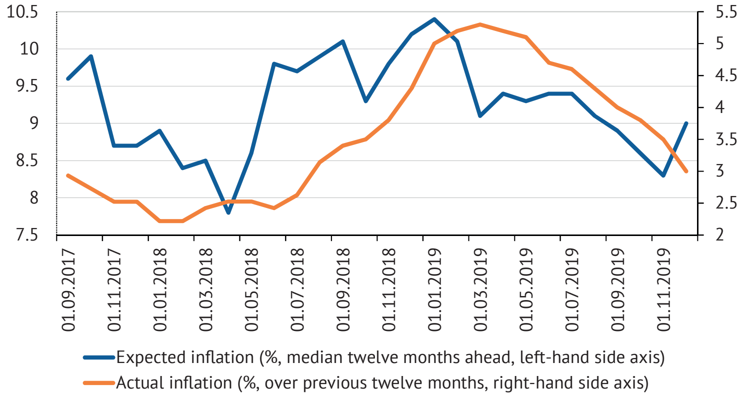


Fig. 2. Inflation and inflationary expectations

Source: Rosstat; Bank of Russia.

The prices of paid services rendered to the population as of the year end 2019 gained 3.8% (vs 3.9% in 2018). The leaders in growth were passenger transport fares (6.1%) and prices of education services (5.6%).

Core inflation (the change of prices other than those influenced by seasonal and administrative factors), after a protracted period of growth – throughout the year 2018 and the first 5 months of 2019 – began to decline in June, and so in December 2019 it stood at 3.1% per annum

Inflation slowdown went hand in hand with lowering inflation expectations. The median of inflationary expectations one year ahead, according to the InFOM survey results released by the Bank of Russia, stood at 8.3% in November, having lost 2.1 p.p. since the beginning of the year (*Fig. 2*). In December 2019, inflation expectations rose to 9%, but then as early as January, this index returned to 8.3%. On the whole, inflation expectations are staying at a sufficiently high level. However, given the adaptive nature of that index, the current inflation slowdown is creating appropriate conditions for its further downward slide.

The movement pattern of real personal income continues to be the factor that harnesses inflation. In 2019, real personal income climbed 1.5% compared with 1.1% in 2018. At the same time, it still stays below its 2014 level. The real wage growth rate over January-November 2019 relative to the corresponding period of 2018 was 2.5% (vs 7.4% over January-November 2018 relative to January-November 2017). Retail turnover has also been climbing at a lower rate: in 2019, it was 1.6% vs 2.8% in 2018.

The consumer price inflation slowdown has also been contributed to by the ruble climbing against the USD by 11% towards the year-end. The ruble's temporary weakening in August 2019 (by 4.9%), caused by declining oil quotes and capital outflows from the developing markets, produced no significant effect on the movement patterns of consumer prices (*Fig. 3*).

Thus, for **three years in a row, inflation in Russia has been either below or slightly above its target**, which can be viewed as an evidence of successful 'anchoring' of inflation expectations. The temporary monetary policy reversal in late 2018 towards its toughening helped minimize the inflation acceleration risks for 2019. Nevertheless, a protracted period of sustained positive real interest rate may be fraught with certain risks of economic growth slowdown.

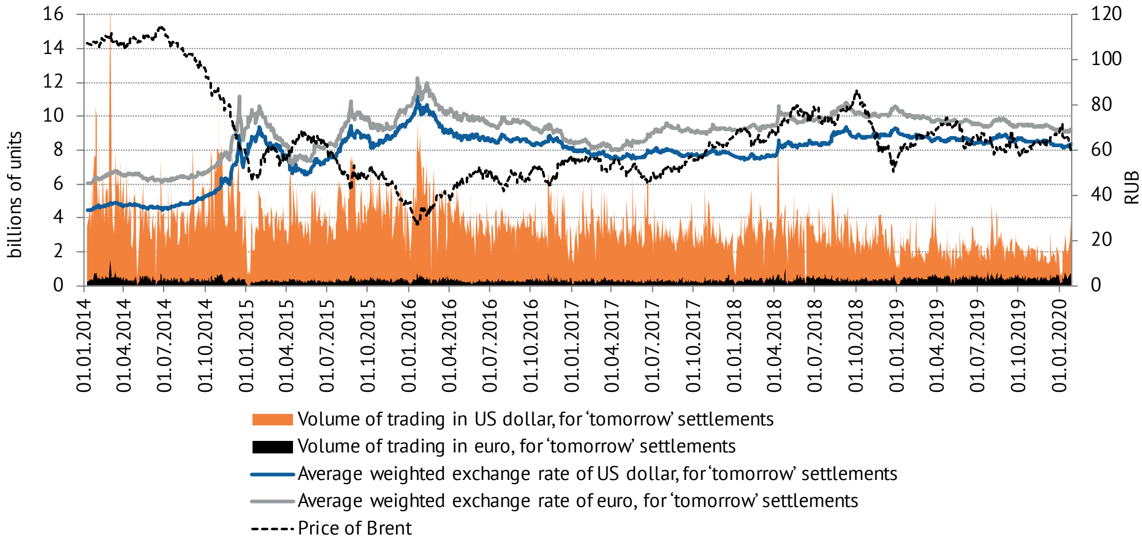


Fig. 3. The movement of the USD-to-ruble and euro-to-ruble exchange rates on the FX exchange; trading volume in the FX market; price of Brent

Source: RF Central Bank; Finam.

Our experts forecast that in 2020, inflation will by 3.5–4.0%, and later on it will hover around its target of 4%. If this prediction proves to be true, the Bank of Russia may continue to ease its monetary policy over H1 2020, which will be quite justified, considering the inflation index staying below its target, the modest business activity dynamics, and the slowdown in the global economic growth rate.

2. THE BALANCE OF PAYMENTS IN 2019

A. Bozhechkova, A. Knobel, P. Trunin

In 2019, Russia's trade surplus shrank significantly as result of a declining value volume of exports which, in its turn, was pushed down by sliding prices of oil and increasing imports. Meanwhile, net capital outflow that had been observed in 2018 gave way to net capital inflow, to the value of $ f 1.8bn, secured by an increase in the public sector's foreign liabilities and a slower-than-in-2018 rate of growth displayed by those of the private sector. International reserves by the year end surged above $ 554bn, thus hitting their record high of the entire period after the global financial crisis. Due to the application of the budgetary rule (which made the ruble less dependent on the oil price movement pattern) coupled with the financial account surplus, the ruble's exchange rate against foreign currencies became stronger.

According to the balance of payments preliminary estimates for 2019 released by the Bank of Russia, the **current account** was $ 70.6bn, which is 38% (or by $ 42.9bn) above the corresponding index for 2018.[1]

The balance of trade in goods amounted to $ 163.1bn**,** thus having lost 16% (or $ 31bn) compared with its 2018 level ($ 194.4bn) (*Fig. 1*). A decisive role in that decline was played by the **shrinking value volume of exports** (by 5.7%, or $ 25bn) – from $ 443.1bn in 2018 to $ 417.9bn in 2019**.** Such a plunge was caused primarily by the downward movement of mean annual export prices of oil, petroleum products, natural gas, and Russia's other main exports (*Table 1*) alongside the stable volumes of their supplies. One exception was liquefied

Table 1

Prices of Russia's main exports in 2019

Commodity group	Share in total exports, %	Mean export price, USD/tonne		Price change in 2019 relative to 2018
		January-November 2019	January-November 2018	
Crude oil	29.0	454	500	-9.2
Petroleum products	15.8	471	521	-9.6
Natural gas *	9.8	190	221	-14.0
Ferrous metals	4.4	449	505	-11.1
Bituminous coal	3.8	78	85	-7.8
Natural gas, liquefied**	2.0	124	142	-12.6
Mineral fertilizers	1.9	246	237	3.7
Wheat and meslin seed	1.5	201	190	5.8
Aluminum	1.1	1,691	1,721	-1.8
Timber	1.1	227	235	-3.1
Copper	1.0	5,900	6,352	-7.1
Fish, fresh and frozen	0.7	1,825	1,821	0.2
Vegetable oil	0.5	708	766	-7.6
Nickel	0.4	13,696	13,069	4.8

* USD per 1bn m^3
** USD per 1,000 m^3
Source: FTS; own calculations.

1 See Bozhechkova A., Knobel A., Trunin P. Russia's balance of payments 2018: current account balance hits its record high // Russian Economic Developments. 2019. V. 26. No. 2. P. 3–7.

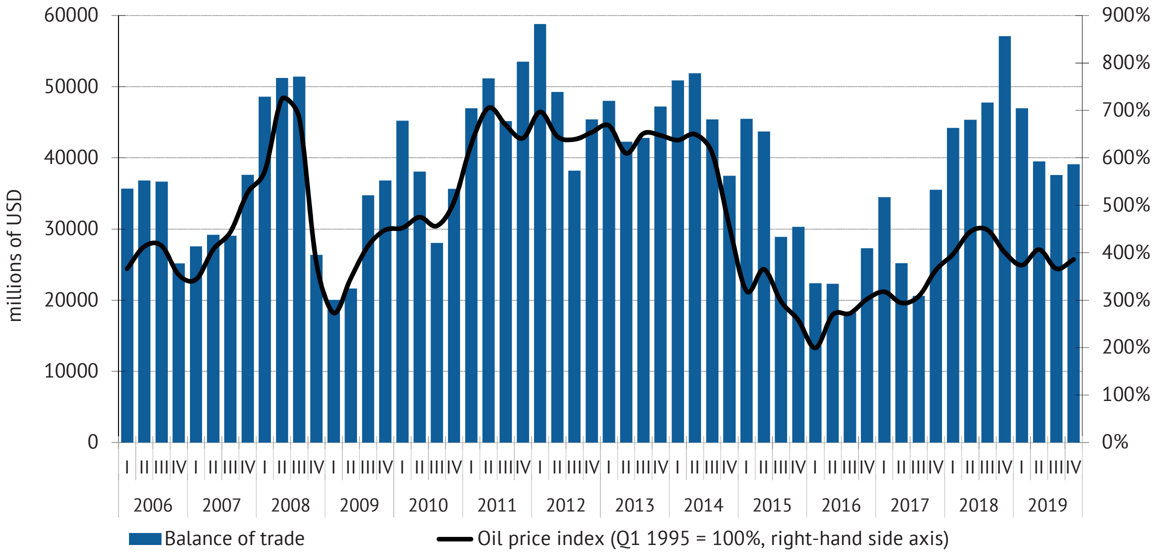


Fig. 1. The RF balance of trade and world oil quotes
Source: Bank of Russia; IMF.

natural gas; while its export price fell by more than 12%, its exports in terms of physical volume gained 75% thanks to supplies by Yamal LNG, thus increasing their value volume by 58%, from $ 5.3bn to $ 8.4bn.

The balance of trade decline was caused, beside the downward movement of export prices, also by the increase in imports **by 2.5%** (or by $ 6bn) from $ 248.7bn in в 2018 to $ 254.8bn in 2019. The upward movement of the value volume of imports can be explained by the ruble's strengthening: according to data released by the Bank of Russia, the real effective exchange rate of the ruble against major foreign currencies gained 2.5% in 2019 relative to 2018[1].

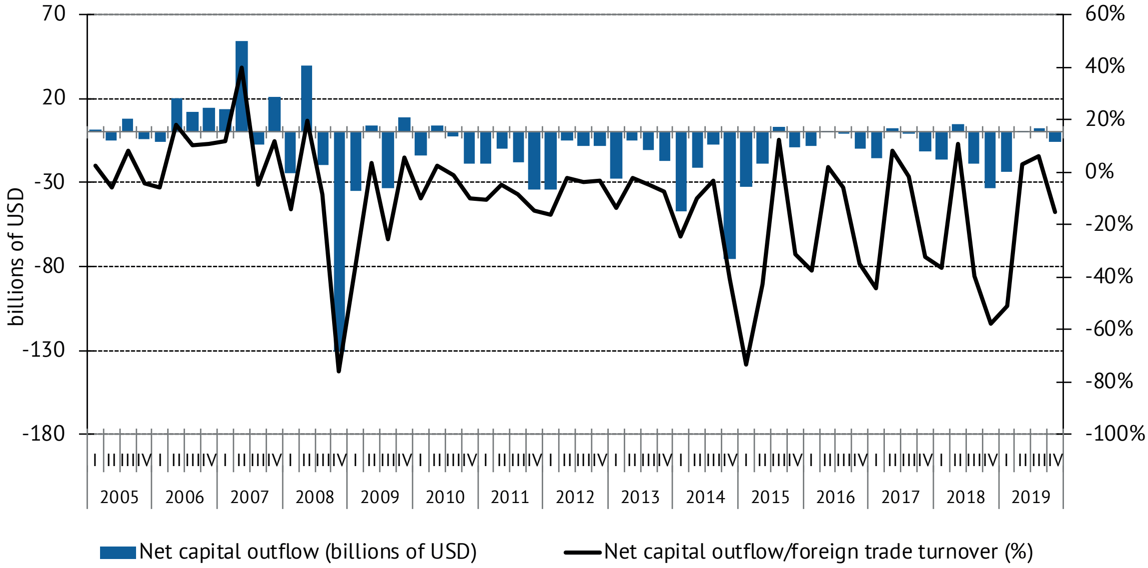
The **balance of trade in services** likewise declined, amounting in 2019 to $ -34.8bn compared with $ -29.9bn in 2018; i.e., negative balance gained 16.4% over the course of that year. Meanwhile, exports of services changed only negligibly – by 1.5% (or by $ 1bn in absolute terms, from $ 64.6bn to $ 63.6bn), but imports of services notably increased by 3.9%, from $ 94.6bn to $ 98.3bn.

The **balance of investment-generated revenues, similarly to the balance of wages**, demonstrated some significant changes over the course of the year 2019. The formed gained $ 5.9bn, jumping from $ -38.6bn to $ -44.5bn, due in the main to an increase, by $ 5.8bn, of payables (repatriation of investment income), alongside receivables staying at the same level; while the latter lost $ 0.3bn (plunging from $ -3.0bn to $ -3.3bn).

The impressive shrinkage of the current account balance was in part offset by the **financial account surplus**, which in 2019 amounted to $ 1.8bn compared with a deficit of $ 76.5bn in 2018. Net capital inflow was secured by growth of financial liabilities by $ 28.3bn over the course of the year 2019 (in 2018, financial liabilities plunged by $ 36.7bn) and an increase in financial assets by a lesser amount than in 2018 ($ 26.5bn in 2019 vs. $ 39.8bn in 2018).

Growth of foreign liabilities in 2019 occurred in the main due to the non-banking sector's operations ($ 25.7bn in 2019 vs. $ -4.2bn in 2018) and those of

1 For more details concerning the forex rate's pass-through effect, see Knobel A., Firanchuk A. Russia's Foreign Trade in January-August 2017 // Russian Economic Development. 2017 Vol. 24. No. 11. P. 12–18.



Source: Bank of Russia; Gaidar Institute estimations.

Fig. 2. Net capital outflow from the private sector in 2005–2019

federal administrative bodies1 ($ 22.0bn in 2019 vs. $ -5.5bn in 2018). At the same time, the **banking sector reduced its foreign liabilities:** from $ -20,1bn in 2019, and $ -25.0bn in 2018.

The **boost of financial assets of Russian residents abroad** resulted predominantly from the operations carried on by the non-banking sector. Thus, in 2019, the foreign assets held by the other sectors increased by $ 25.7bn (in 2018, their increase amounted to $ 30.8bn), while those held by banks – by $ 1.7bn (vs. $ 7.6bn in 2018). The foreign assets held by state bodies shrank by $ 0.9bn (vs. growth by $ 1.4bn in 2018).

The inflow of foreign direct investment in the non-banking sector in 2019 ($ 26.9bn vs. $ 5.9bn in 2018) was almost totally offset by its outflow ($ 26.3bn vs. $ 29.6bn in 2018). The **shrinkage of portfolio investment inflow in Russia's non-banking sector** in 2019 (by $ 3.2bn vs. $ 0.7bn in 2018) occurred alongside an increasing portfolio investment outflow (by $ 2.1bn vs. $ 1.4bn in 2018). The other liabilities of the non-banking sector increased by $ 1.9bn ($ 1.3bn in 2018), while the other assets gained $ 3.5bn ($10.1bn in 2018).

As a result, **net capital outflow from the private sector in 2019 demonstrates a sharp decline, to $ 26.7bn ($ 63.0bn in 2018)** (*Fig. 2*). Meanwhile, net capital outflow from the banking sector over the same year was $ 21.8bn ($ 32.6bn in 2018). The shrinkage of net capital outflow from the non-banking sector was much more pronounced – to $ 4.9bn ($ 30.4bn in 2018).

International reserve assets over the course of 2019 increased by $ 66.5bn ($ 38.2bn in 2018), and so as of the year end amounted to $ 554.4bn, thus **hitting their record high after the global financial crisis**. It should be reminded that the international reserves index stood at its historic high of $ 596.6bn in August 2008. The movement pattern of international reserves throughout the year 2019 was shaped primarily by foreign currency purchases by the RF Ministry of Finance, to the value of about RUB 3.5 trillion (compared with RUB 2.1 trillion in

1 The main factor behind the growth of foreign liabilities of federal administrative bodies were investments in OFZ by non-residents.

2018), in the domestic forex market in the framework of the budgetary rule. In 2019, the increased foreign currency purchases in the domestic forex market as dictated by the budgetary rule can be explained by planned purchases coupled with the postponed ones, as those purchases had been suspended over the period of August through December 2018.

Thanks to the budgetary rule, the ruble's exchange rate against foreign currencies became less dependent on oil quotes, and more dependent on capital flows. The improved situation with regard to capital inflow in Russia resulted, **in 2019, in the ruble rising 10.9% relative to the US dollar**, to RUB 61.9. Besides, capital inflow into Russia improved as a result of monetary policy easing by the US Federal Reserve and the European Central Bank (ECB), as well as the positive rhetoric of the trade negotiations going on since September 2019 between the US and China.

In 2020, we may see a further decline of the current account balance in response to a possible slowdown in the global economic growth rate and sliding oil prices. Meanwhile, monetary policy easing by the developed countries will conduce to a **higher attractiveness of Russian financial assets and an improved financial account balance.**

3. INDUSTRIAL PRODUCTION DYNAMICS IN Q4 2019

A. Kaukin, E. Miller

As seen by the period-end results of Q4 2019, the manufacturing and extractive sectors of the Russian economy once again displayed a near-zero growth, while production of electric energy, gas and water declined. Growth slowdown in the extractive sector occurred as a result of the implementation of the OPEC+ deal concerning daily oil production cuts, coupled with shrinking demand for Russia's natural gas and coal exports. Growth in the manufacturing sector was displayed by the food industry, chemical production, and metallurgy.

Q3 2019 saw[1] growth of the Industrial Production Index, which was sustained by the positive dynamics both in the extractive and manufacturing sectors of the Russian economy. Previously, we noted **lack of stability in the positive dynamics caused by a shrinking domestic demand and the short-lived character of factors responsible for growth** (these had to do mostly with the favorable situation in the world markets).

The Gaidar Institute's experts decomposed the time series and obtained the trend component2 of the industrial production indices for a number of industries on the basis of latest statistical data released by Rosstat. The results of processing the time series for the Industrial Production Index are shown in *Fig. 1*. It can be seen that in **Q4 2019, the trend component of the Index displayed a near-zero growth rate** – 99.75% relative to Q3 2019 in the extractive sector, and 99.01% relative to Q3 2019 in the manufacturing sector – the corresponding output movement patterns are shown in *Fig. 2*. The sector of electric energy, gas and water production over the same period experiences a decline – 97.41% relative to Q3 2019 (*Table 1*). Below, we present a more detailed analysis of the by-sector output movement patterns.

In October-November 2019, Russia's obligations concerning cuts on daily oil output by 228,000 barrels relative to the October 2018 level, imposed by the OPEC+ deal, were not fulfilled precisely (by 192,000 barrels per diem in October 2019, and 177,000 barrels per diem in

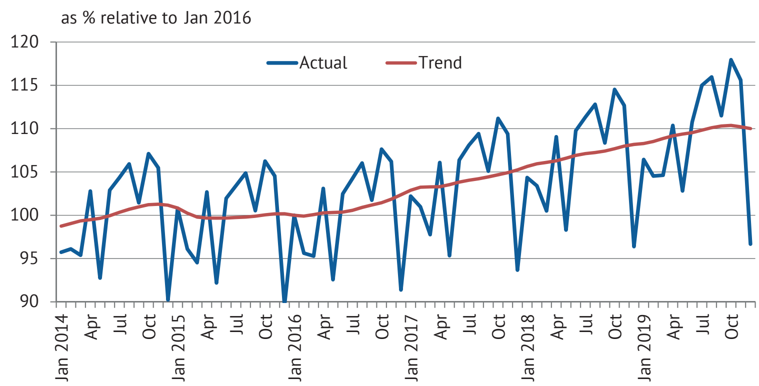


Fig. 1. The movement pattern of the industrial production index in 2014–2019 (actual data and trend components), as % relative to January 2016
Source: Rosstat; own calculations.

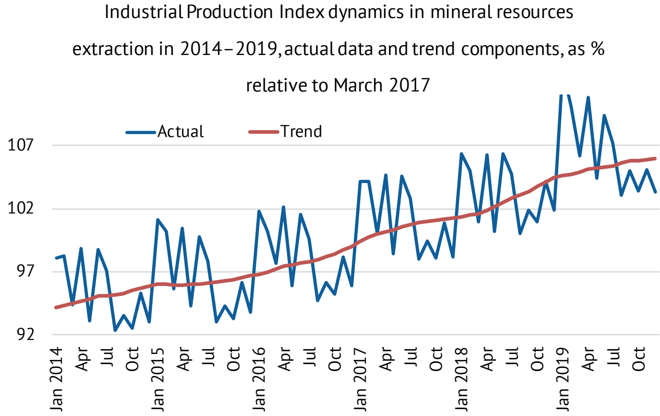
1 Kaukin A., Miller E. Industrial production dynamics in Q3 2019: market factors // Russian Economic Developments. 2019. V. 26. No. 11. P. 31–37.

2 In order to obtain a better-grounded view of the persistence or reversal of negative trends in each branch of industry, their output indices must be decomposed into the calendar, seasonal, irregular and trend components; the interpretation of the latter is interesting from the point of view of its content. The trend component was removed by using the Demetra software package based on X12-ARIMA.

November, due to the plummeting oil production in Saudi Arabia as a result of air raids that damaged its oil extraction infrastructure, as well as new natural gas fields deposits with large quantities of condensate having been put in operation). The restrictions imposed by the OPEC + deal have remained one of the main factors that **slow down the growth rate in the oil extraction sector**. In December, output was cut by 234,000 barrels per diem relative to October 2018 (with due regard for the OPEC+ panel initiative that **gas condensate** should be excluded from oil output figures), the OPEC + obligations being exceeded by 2.6%. 2019, edging up to 100.2% of that index in the previous quarter. However, any further weakening of external demand, particularly in European countries, may have a profound negative impact on the dynamics of this industry: thus, the sales of natural gas stored in Gazprom's European storage facilities to Gazprombank carried out in accordance with repurchase agreements[1], managed to increase natural gas exports only in October-November 2019, while in December Gazprom's European storages were once again overflowing. This state of affairs can be improved next year with the beginning of natural gas deliveries to China via the Power of Siberia pipeline launched on 2 December 2019 (over the course of that month, 328 MCM of natural gas was shipped via the pipeline).

The production of coke continued to be buoyed by the decrease in the tariff (the introduction of the reduction coefficient in the amount 0.9259 with regard to the existing tariffs contained in Section 2 of Price List No. 10-01) imposed on the export shipments of thermal coal in the direction of the maritime connections of the North Caucasus Railway on 16 July 2019, and also by the decrease in the tariff imposed on the export shipments from the stations in Kemerovo Oblast in the direction of the maritime connections of the October Railway, Northern Railway, and Kaliningrad Railway (from 1 November)[2]. The discount on export freight rates was applied until 31 December 2019.

Our analysis of the trend components of output in each individual branch of the manufacturing industry (*Table 1*), revealed **the following regularities**:



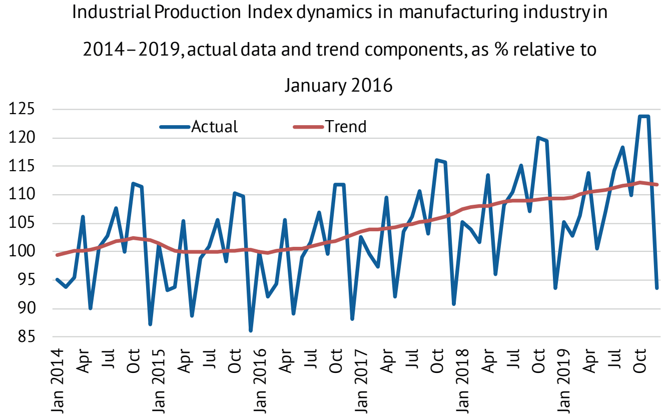


Fig. 2. The by-industry movement patterns of the industrial production index in 2014–2019, actual data and trend components
Source: Rosstat; own calculations.

1 Repo transactions are the means by which the Public Joint Stock Company Gazprom manages its working capital, making it possible to monetize its natural gas reserves during periods of low demand. Change of the de jure owner is considered as export, although, in fact, such a transaction represents the volume of shipments carried over to the next period.
2 The reduction coefficient was introduced in July as a response to the drop in demand in Western markets.

- the list of branches that registered output growth was the same as in Q3 2019. **The sources of growth were likewise the same: in the food industry**, this was the good harvest of grains, legumes, potatoes and vegetables, their output being much higher than in 2018; in **the chemical industry** – mostly thanks to pharmaceuticals (the increased demand for Russian generic drugs displayed by the CIS member countries); in **metallurgy** – owing to the inventory build-up carried out by metal-consuming industries. Although growth was registered by the branches accounting for more than 70% of the manufacturing industry's gross value added, the result indicator for the manufacturing sector turned out to be close to zero (the same discrepancy is also observed in Rosstat's primary statistics regarding production indices; therefore, apparently, for the sake of validity of the interpretation of the manufacturing sector's results, Rosstat should considerably refine its flash statistics);
- **a notable decline** was observed in **cellulose and paper production** (in December 2019 it dropped to 79% of the December 2018 level), which can be explained by the temporary pause caused by yje putting into operation of new industrial facilities and the ongoing modernization of existing ones[1];
- **timber and wood product processing stagnated** (as a result of the forest fires in Siberia and the Far East); the same was true for manufacturing of rubber and plastic products (the share of domestic producers in the tire market declined to 49%2); and manufacturing of the other non-metallic mineral products (the building construction branch, their main consumer, registered a close-to-zero growth rate).

Wholesale trade registered growth in Q4. The provision of **paid services** to the population registered close-to-zero growth rates due to the stagnation of real disposable personal income. The growth rate of **building construction** continued to be low (in December 2019, it amounted to 100.18% of that in December 2018). There was a continuation of the decline in **cargo turnover** (which dropped, in December 2019, to 99.23% of its December 2018 level).

On the whole, **the growth achieved by the manufacturing sector** has so far failed to convince economists that this upward trend is going to persist, because it has been taking place against the backdrop of quite modest investments in fixed assets. This means that producers tend to use their already existing facilities, while the current industrial growth taking place in conditions of weak demand is created by the ongoing stock replenishment**.** Bearing in mind the crucial importance of the fuel and energy sectors for the Russian economy, the OPEC+ decision to further cut oil production is giving rise to new concerns (during the period from 1 January to 31 March 2020,). Having already cut its daily oil production by 228.000 barrels in late 2019, Russia should further cut its per diem oil by output by 300,000 barrels, compared with 228,000 barrels per diem in late 2019.

1 In 2018, capital investments in this branch grew by 20% relative to 2017; they were mainly directed toward technological modernization. See, for example, Golubkina, M., Lots of opportunities // The Russian Newspaper. 12 September 2019. [https://rg.ru/2019/09/12/reg-szfo/po-prognozu-moshchnosti-celliulozno-bumazhnoj-promyshlennosti-v-rf-vyrastut.html]

2 According to the marketing study 'The Tire Market in Russia: Examination and Forecast Until the Year 2023', prepared by the ROIF Expert marketing agency, the Russian tire market has changed its structure for the first time in its history. A retrospective analysis shows that traditionally, the largest share in that market was taken up by domestic producers.

3. Industrial Production Dynamics in Q4 2019

Table 1

By-industry movement of the industrial production index, %

Industry	Share in industrial production index, %	December 2019 on June 2019, %	December 2019 on December 2018, %	Changes over recent months
Industrial production index		100.43	101.69	stagnation
Extraction of mineral resources	34.54	100.64	101.48	stagnation
Manufacturing industries,	54.91	100.99	102.28	stagnation
including:				
production of foodstuffs, including beverages, and tobacco products	16.34	107.33	112.54	growth
textiles & textile products manufacturing	1.14	108.01	109.92	growth
leather production and leather products & footwear manufacturing	0.27	104.98	106.28	growth
timber & wood product processing	2.02	99.19	99.94	stagnation
cellulose & paper production	3.35	92.54	79.61	decline
production of coke & petroleum products	17.25	104.24	104.09	growth
chemical production	7.56	107.75	114.23	growth
manufacturing of rubber & plastic products	2.14	100.97	98.64	stagnation
manufacturing of other non-metallic mineral products	4.02	99.47	101.35	stagnation
metallurgical production & finished products	17.42	107.58	118.06	growth
machinery & equipment manufacturing	6.97	103.91	101.32	growth
electric, electronic & optical equipment manufacturing	6.27	101.31	100.44	stagnation
transportation equipment manufacturing	6.75	107.50	110.80	growth
other industries	2.42	83.79	78.28	decline
Electric energy, gas and water	13.51	98.74	97.68	slow decline
Wholesale trade		106.53	108.74	growth
Retail trade		101.39	102.06	slow growth
Cargo turnover		98.36	99.23	slow decline
Building construction		100.27	100.18	stagnation
Provision of paid services		101.61	104.04	stagnation

Source: Rosstat; own calculations.

4. BANKING SECTOR RESOURCES IN 2019

S. Zubov

The provision of assets by the banking sector in 2019 remained rather squared. Given the fact that economic subjects kept confidence in the banking sector, the lending institutions went on a resource base binge by using traditional tools—taking household and corporate funds on deposits. However, growth rates declined somewhat compared to the previous year.

Dynamics of the interest rates on retail deposits were mainly due to the inflation rate and the decisions on the monetary policy: after mid-year, a downward trend set up. Ruble appreciation and strengthening have contributed to the shrinkage of the currency liability entries in accounts which in its turn decreased exposure of the financial system against external shocks.

Among the most significant components of the banking sector resources remain as before retail deposits (31.6% of all bank liabilities), deposits of legal entities minus lending institutions (19.1%), organizations' current accounts (11.4%), and raised funds from banks including Bank of Russia (11.0%).

Retail deposits on ruble and currency bank accounts at 2019-end hit Rb 30.5 trillion, increase over past year amounted by Rb 2.1 trillion or 7.3% (in 2018, retail bank accounts grew by 8.9%). Slowdown of the retail bank accounts growth during last two years was due to the transition from the savings to consumption and investment models of behavior. Consumption growth rates amid real income stagnation were ensured by an increase of bank loan debt. Meanwhile, somewhat revival of interest of the population towards investments in real estate was observed on the stock market.

Bank deposits growth was ensured, first of all, by the increment of ruble deposits by 9.9% (in 2018 – by 7.6%).

Currency accounts volume in ruble denomination decreased during last year by 2.2% (the previous year demonstrated growth by 13.7%). However, taking into consideration USD exchange rate dynamics (ruble devaluation in 2018 and ruble appreciation in 2019) seen in last year, there was an increment of the dollar equivalent of currency accounts by 9.8%, meanwhile in 2018 the same indicator fell by 5.7%.

The level of deposits dollarization[1] of the population remains modest: over the year, the share of means on currency deposits in ruble equivalent in the overall deposits volume decreased from 21.5 to 19.6%, which is due to the ruble appreciation in the first place.

The level of retail accounts dollarization remains moderate: over a year the share of means of the currency deposits counted in ruble denomination in the overall volume of deposits decreased from 21.5% to 19.6%, which was due primarily to the ruble appreciation.

Another important component of the Russian banks' resource base are **corporate deposits**, which went up during 2019 by Rb 0.14 trillion or by 4.6% hitting Rb 18.5 trillion. Compared with the last year growth rates of such de-

1 Deposits in all currencies are taken into consideration.

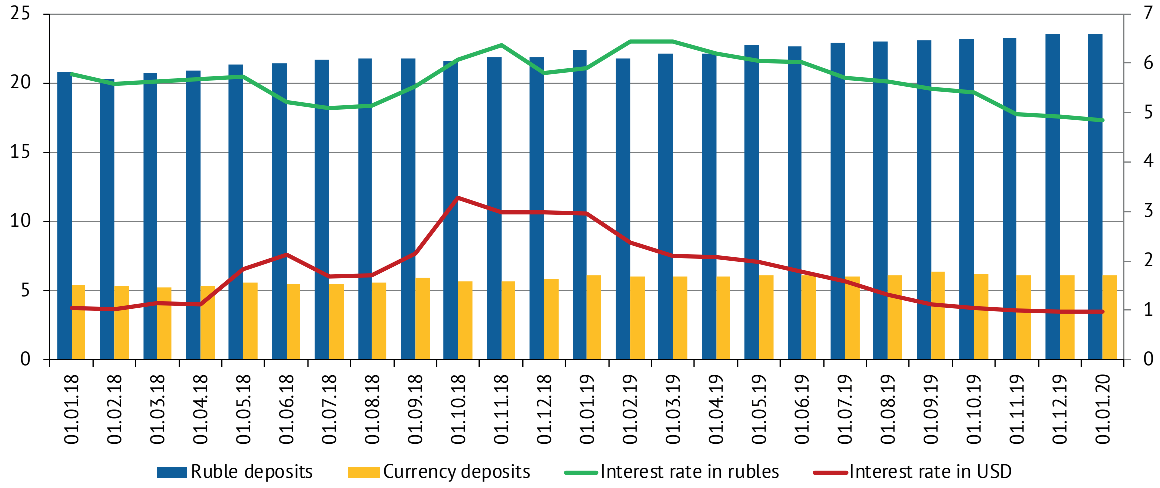


Fig.. 1. Volume of attracting funds to retail deposits (trillion rubles) and interest rates on deposit (%)

Source: Bank of Russia.

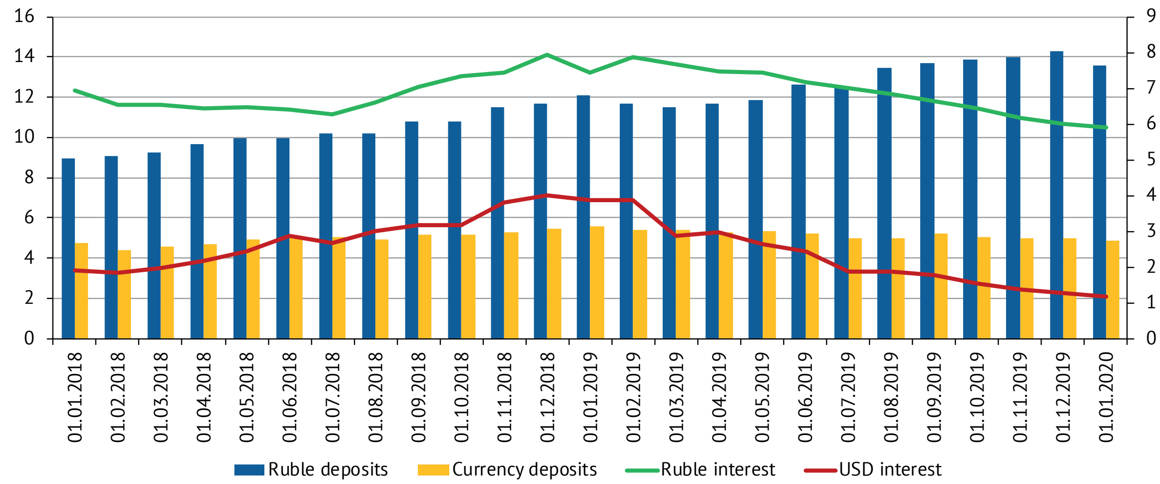


Fig. 2. Volumes of funds raised on deposits of legal entities (trillion rubles) and interests on deposits (%)

Source: Bank of Russia.

posits contracted (in 2018 growth amounted to 29.3%). This is primarily linked with the contraction of currency deposits. However, taking into account dollar exchange rate decline of dollar equivalent of currency deposits slowed down by 1.2% in 2019 against 5.8% seen in 2018.

Interest rates on ruble deposits declined by 15.8% (in 2018 up 7.1%), contraction on dollar deposits was much more significant – 64.7%, meanwhile in 2018, growth hit 102.1%. At year-end many banks terminated accepting euros on deposits of legal entities due to the fact that interest rates on deposits in the EU were in the red.

Transaction interest-free deposits[1] demonstrated last year a sustainable growth: total amount of such accounts during last year went up by 5.7% (for 2018 by 7.9%) hitting Rb 11 trillion.

1 Funds of legal entities and retail operating and current accounts, resources in settlements, factoring and forfaiting transactions.

Debt commitments of the banks remain not too attractive financial instruments for the clients: compared to interest-bearing deposits their emission volume is insignificant. Total volume of bonds at 2019-end hit Rb 1.9 trillion (in 2018 – Rb 1.3 trillion) up 41.1% during the year (up 9.7% over past year). Volume of debt securities and savings certificates contracted by 75.8% (down 61.0% during 2018) and stays at a low level – Rb 0.04 trillion.

Decrease of **borrowing on the interbank market** demonstrates a reduction of dependence from the most volatile sources of funding. During the year, the volume of received loans and deposits from the resident banks down 8.3% (down 3.3% in 2018).

Alongside this, the volume of moneys raised from non-resident banks continued a downward trend, over the year it decreased by 32.3% in the ruble equivalent (up 20.7% in 2018).

As far as borrowings from the Bank of Russia they decreased over the past year by 6.0%, meanwhile in 2018 a significant growth was observed – by 29.3%. Taking into consideration the short term of borrowings, one can draw a conclusion on the **improvement of the bank liquidity.**

The level of the bank resources concentration remains high. The share of five major banks as for the size of assets of lending institutions account for 65.5% of retail deposits (in 2018, this indicator stayed at 65.1%), and 59.2% of corporate deposits. The share of raised funds by way of credits from the Bank of Russia decreased somewhat – by 24.7% (in 2018 – 32.9%).

Last two-year trend is projected to stay in 2020: low inflation and stabilization of inflation rates **make ruble accounts and deposits more attractive than the currency ones**, which will ensure sustainable and moderate growth of bank liabilities.

5. DEVELOPMENT OF REGIONS IN JANUARY-NOVEMBER 2019: INERTIA RETAINS

N. Zubarevich

The regions over January-November 2019 demonstrated stunted social and economic development. Except renewal in the residential construction sector following the recession the fastest rate of development was posted in the largest Moscow agglomeration. Amid the weak wage growth seen in the vast majority of the regions the low level of unemployment retains. The budgetary situation is favorable, however the revenues growth of the budgets of many regions in large measure is secured by the growth of transfers. The need to implement President's Executive Orders was reflected in the outstripping growth of budgetary expenditure on national economy and provision of public amenities.

January-November 2019 data demonstrate retention of late trends. Moderate economic growth kept up[1]. **The industrial growth champions** (minus less developed regions with small industrial production volume) include Yamal-Nenets AD (17%) and Yakutia (12%) due to production of gas and crude oil, Briansk (15%) and Moscow (13%) regions, Republic of Buryatia (23%) and Primorsky Krai (12%) mainly owing to the state defense order and food industry.

Significant **economic growth seen in the capital agglomeration ensured the outstripping dynamics for the entire Central Federal District** (over 8%), the industrial sector of the Far Eastern FD demonstrated a robust growth. Due to an industrial recession posted in Stavropol Krai, North Ossetia and especially in Dagestan (-25%) **the North Caucasus FD demonstrated negative dynamics (-3%)**. The number of regions posting an industrial recession decreased to 12, and in the most industrially developed ones (Yaroslavl, Irkutsk regions, Nenets AD, and Khabarovsk Krai) the recession is small – 1–3%. Close to zero dynamics retains the principal crude oil extraction region – Khanty-Mansi AD, the same situation exists in Sverdlovsk region.

The construction sector in January-November 2019 was barely growing (0.4%), among the largest regions the heaviest recession was observed in St. Petersburg (-22%). **However, commissioning of new housing was recovering** (up 8%) following a significant decrease seen in 2016–2018. Growth in residential construction was not across-the-board, in 26 regions the commissioning of the new housing was shrinking in January-November, the recession was the heaviest (15–30%) in the outland northern and eastern regions (Republics of Komi, Buryatia, Yamal-Nenets AD, and Kamchatka Krai) and in depressed territories (Ivanovo, Kirov regions, Altai Krai, etc.).

The residential construction reflects continued concentration of the population in two largest agglomerations and stable attractiveness of the south. The Moscow agglomeration concentrate over 18% of the total volume of the commissioning of the new housing, St. Petersburg with the Leningrad region account for over 6%, followed by the Krasnodar Krai (around 6%). Despite robust growth of the residential construction in the capital (up 74%) mainly due to the new areas and decline in the commissioning of new housing in Moscow (-3%) and

1 See paper by A. Kaukin and E. Miller in this issue.

Leningrad (-12%) regions, outer zones of the two major agglomerations outstrip the federal cities by the volume of the residential commissioning, especially the Moscow regions, which is 1.7-fold larger than Moscow.

Growth of the retail commerce remains slow (1.6% in January-November) but is nearly widespread. Solely 9 regions registered contraction of the retail trade within statistical discrepancy (1%). Minus less developed republics with low credibility of statistical data the retail trade were growing at a faster pace in Moscow, Leningrad, Tver regions, Primorsky Krai and Yakutia (up 4–5%). **Exceptional concentration of retail trade remains in the largest agglomerations of the country** owing to high wages and incomes of the population: Moscow and the Moscow region account for around 23% of the retail trade turnover, and the St. Petersburg agglomeration accounts for less than 6%.

Negative dynamics of paid services provision retails (-0.9%), recession runs on in more than half of regions, the most significant one is observed in Khabarovsk Krai, Buryatia, Ingushetia and Sebastopol (5–10%). The households continue saving on services, preferring to buy goods including on consumer credits (their growth went on growing rapidly).

Nominal wages in January-November went up 7%, taking into account inflation the real growth came to around 3%. Regional dynamics barely differ. A **more notable growth of the nominal wage (by 11%) was registered in Sebastopol and the Republic of Crimea** due to significant transfers, in Sakhalin region which posted rapid growth of budget revenues owing to an increase of corporate income tax receipts, which allowed to increase wages in the budgetary sector as well as in Kostroma region.

Regional labor markets are stable. Unemployment level estimated according to the WLO methodology in September-November remains very low (4.6%), and regional differences are stable[1]. Slight increase of unemployment compared to the same period of 2018 was registered in Republics of Dagestan and Altai (from 10–11 to 12–13% in 2019) as well as in Yaroslavl and Orel regions (from 4–5% to 6%). **Russia's traditional way to balance the labor market by way of part-time employment remains** – the number of part-time employees in Q3 2019 amounted to 1 million persons and scarcely differed from the same period of 2018 and the number of those on unpaid holidays persistently stay at 3 million persons. A more acute issues of part-time employment estimated by a ratio of the number of underemployed to the total number of employed in large and medium-sized enterprises and organizations are observed solely in Briansk and Novosibirsk regions, Republics of Karelia and Crimea, city of Sebastopol and Perm Krai (4–6% in Q3 2019). Amid the contraction of the number of able-bodied population and economic stagnation, unemployment does not grow, the labor market compensates by the scale of underemployment.

The Federal treasury data for January-November 2019 demonstrate **slowdown in revenues growth of the consolidated regional budgets** 10% in nominal terms), in January-September 2019 income grew at a faster pace (12%). Three components ensure the revenues growth: corporate tax (+9%), excises (+20%) and, most of all, transfers (+24%) (*Table 1*).

The following regions demonstrated robust growth of consolidated budgets: Chukotka AD (up 71%), which received twice as many transfers, Sakhalin (36%) and Murmansk (28%) regions due to corporate income tax increase by

1 Zubarevich N.V. Russian Regions in January-July 2019: combination of growth, stagnation and recession // Russian Economic Development. 2019. Vol. 26. No. 10. P. 58–61.

1.6–1.9-fold as well as Amur region, Baikal Krai, Jewish AD, and Republic of Mari El (22–28%) mainly due to transfers growth by 1.5–2-fold. Budget revenues growth of Chechnya by 22% was due to the transfers increase by 24%.

Only six regions (Kaluga and Kemerovo regions, Republics of Bashkortostan, Khakassia, Yakutia, and Khanty-Mansi AD) reported budget revenues contraction compared to the same period of 2018, the majority of them register small decrease (down 1–4%), which is mainly due to a shrinkage of the corporate income tax receipts. Only Khakassia reported steep decline of the budget revenues (down 12%) due to receiving fewer transfers (down 5%) and above all else, owing to PIT tax proceeds slide by 40%, which is hard to explain. Moreover, property tax receipts by the Republic's budget contracted (down 12%) because of excluding personal tax from the tax base. **Dependence of the majority of regions on the federal assistance was still significant in 2019.** The share of transfers hit 17% of the total amount of the revenue side of the regions' consolidated budgets, it was minimal for the underdeveloped republics' budgets (Ingushetia – 83%, Chechnya – 81%, Tyva – 75%, Altai – 70%, Karachaevo-Cherkassia – 69%, Dagestan – 67%, and Crimes – 67%.

The system of transfers' distribution in January-November 2020 became less transparent due to a change in the assistance structure to regions. The proportion of equalization grants, which is calculated by a formula amounts to only 30% of all transfers. There is a positive trend: the volume of other transferred has fallen by 25% including "registered" (for budget balancing) subsidies to Crimea (decrease by 12%), city of Sebastopol (by 36%) and Chechnya (by 13%).

Simultaneously, **the share of subsidies allocated to regions increased to 42%**, among other things due to the necessity of implementing Russia's national projects. The proportion of subsidies hit 20% of the total amount of transfers, and in the Republic of Crimea it stood at 59%, the city of Sebastopol – 44%, in other words assistance to these regions was channeled differently. Above all else, there was a 2-fold growth of the so called "other Interbudgetary transfers" which are subject to distribution along least transparent criteria. Their share hit 21% of the overall volume of regional assistance and exceeded the volume of subventions by 20%. Most of the funds through this channel received Kaliningrad region on the support of the residents of special zone (Rb 58bn), large sums were channeled to the Moscow region (Rb 35bn), St Petersburg (Rb 12bn), Khanty-Mansi AD, Chukotka AD, and Irkutsk region (Rb 17–18bn each), as well as to Sakhalin (Rb 12bn), and Briansk region (Rb 9bn). The decision taken regarding Irkutsk region is obvious – assistance in flood relief.

In January-November 2019 regional budgets expenditure went up by 15%, they outstripped revenues 1.5-fold. Growth champions were Chukotka AD (70%) and Sakhalin region (38%), as well as Irkutsk and Vologda regions, Primorski Krai, Sebastopol, and Chechnya (24–28%). Republics of Mordovia and Khakassia contracted their expenditures by -10% and -8% respectively in order to reduce their huge debt burden and falling budget revenues.

Expenditure growth on the national economy was a priority for regional budgets because regions must implement national projects (*Table 1*). Chukotka boasted of 3-fold growth of this type of expenditure and in Sebastopol they increased by two third owing to significant federal assistance. **Second priority is urban development, expenditure on which went up by 31%. Mainly, this growth was due to Moscow (40%)**, other regions posted notably lower growth (20%), meanwhile budget spending on urban development remains small – 1-3%, sharply differing from the capital (14%). **Third priority – budget spending on**

healthcare system (18%), significant growth was observed in all regions minus Republics of Mordovia, Khakassia, Yakutia, and Kamchatka Krai. Dynamics of expenditure on education (10%), culture (9%) and social policy (11%) fails to keep pace with dynamics of overall expenditures.

The fact that a significant portion of budget expenditures fall on the last month of the year, data for January-November does not allow to assess the sustainability of budget policy. Regarding all regions the situation is rather positive, **budget surplus hit 7% of revenues** mainly due to large surplus registered by the Moscow budget (RB 257bn) and large surplus posted by the budgets of Yamal-Nenets (RB 62bn) and Khanty-Mansi (Rb 48bn) AD, Krasnoyarsk Krai (Rb 47bn) and St Petersburg (Rb 32bn). **However, 12 regions at 11 months-end posted significant deficit**, particularly, Orel and Ulyanovsk regions posted deficit 3% of revenues, Republics of Kalmykia, Tuva, and Jewish autonomous district 2%.

Table 1

Dynamic and share of revenues and expenditures of the consolidated budgets of the regions in January-November 2019, in % to the same period of 2018

Revenues			Expenditures		
	dynamic	share		dynamic	share
Total	10	100	Total	15	100
Corporate tax	9	26	National economy	21	20
PIT	8	28	Housing and utilities	26	10
Excises	20	6	Urban development	31	4
Gross income tax	14	5	Education	10	25
Property tax	-4	11	Health care	18	8
Transfers	24	17	Social policy	11	21

Source: Rosstat.

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