

# MONITORING OF RUSSIA'S ECONOMIC OUTLOOK:

## TRENDS AND CHALLENGES OF SOCIO-ECONOMIC DEVELOPMENT

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## Monitoring of Russia's Economic Outlook

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## TRENDS AND CHALLENGES OF SOCIO-ECONOMIC DEVELOPMENT

The almost concurrent deterioration of both the official and expert forecasts of Russia's economic growth in 2019 coincided with the deepening pessimism about the prospects for the world economy. As regards the former, analysts were disillusioned by the puny results of the year beginning, while as regards the latter, they became increasingly convinced that contradictions between the USA and China would intensify, no matter what the outcome of US-China trade talks might be.

The USA-China standoff was also one of the dominant factors pulling down crude oil prices, and these effects could not be sufficiently neutralized by the new sabotage attacks on oil tankers near the Strait of Hormuz. As a result, oil prices were more inclined to go down than up, thus making it impossible to detect any traceable trend. As far as Russia is concerned, the lack of clarity makes it even more difficult for this country to take a proper stand at the forthcoming OPRC+ meeting.

Russia is likely to face yet another hard choice – this time with regard to the 'above-plan' monies that are expected to replenish the National Welfare Fund in the near future. In principle, these monies could be so abundant as to make it more difficult for the government to explain the rise in VAT, excise taxes and other charges. However, the continuing focus on tax rises looks quite natural in view of the desire to replace stagnating private investments by public investment. The point of view that even ineffective expenditure is better than no expenditure at all will always be more popular than the opinion that escalation of such expenditure would inevitably predetermine not only current inefficiency, but also inefficiency in the long run. At the same time, the sustainability of allocations to the National Welfare Fund remains a burning issue, because the sources and factors determining the size of these allocations originate, in the main, somewhere outside of Russia's national borders, and so cannot be properly controlled.

Nevertheless, the areas where Russia's state policy seems to be satisfactorily efficient are quite apparent, in spite of the complicated political and economic situation.

Having analyzed the Bank of Russia's recent decision to cut the key rate, our experts note that such softening of Russian monetary policy looks perfectly justified against the backdrop of the ongoing decline in inflation, and the sluggish growth of GDP and personal income. They also agree with the RF Central Bank's forecast, according to which the annual inflation rate in 2020 will hover around 4%. Provided there are no shocks, the annual inflation rate can approach this target even in the course of the current year. However, any significant worsening of the geopolitical situation could immediately result in a capital outflow and in a downward pressure on the ruble, which would force the Bank of Russia to increase its interest rates.

Having analyzed the state of Russia's regional budgets over the course of the first four months of 2019, our authors point out that there was a continuation of last year's trend, characterized by a significant rise in revenues of the RF subjects that considerably outpaced expenditure growth. Over the course of the January-April period, the revenues of their consolidated budgets increased by 22.6% relative to the same period of 2018 (while their expenditures grew by 12.7%).

In the main, the rise in revenues was due to the receipts of profits tax, whose share in the general volume of tax receipts became greater than that of personal income tax (these two taxes accounted for 31.8% and 26.2%, respectively, of the RF subjects' budget revenues). It should be noted that the own revenue gap between the rich and poor regions continued to widen, thus following yet another trend that had emerged in 2017-2018.

The public debt of the RF subjects continued to shrink – in April 2019 it amounted to RUB 2.04 trillion, which represents a 7.2% drop on April 2018. Over the course of one year, from April 2018 to April 2019, 73 regions reduced their public debt, and only 12 regions increased it. The number of subjects heavily burdened with public debt significantly decreased. As of 1 May 2019, there were only two regions, Kostroma Oblast and Mordovia, whose public debt exceeded the volume of budget allocations. It should be noted that while Kostroma Oblast was close to reversing the unfavorable revenue-to-expenditure ratio, Mordovia just managed to arrest the growth of its debt burden.

Another expert overview of the state of the RF regions based on the results of the first three or four months of 2019 points to a decrease in the number of regions with negative industrial dynamics. Nevertheless, most of the North Caucasian territorial units and 50% of the regions of the Russian Far East belonged to zero or negative areas. As before, leadership in industrial growth was enjoyed by regions with resource or agglomeration advantages, or by federal subjects where the state defense order had been increased. Q1 2019 saw practically no growth in investment, with the exception of the city of Moscow and a number of Siberian regions, where investment was increasing at an impressive pace. A considerable decline in investment was observed in Krasnodar Krai and the Crimea, where it was caused by the completion of the motor road section of the Crimean Bridge and the highway approaches thereto.

The state of Russia's regional labor markets was approximately the same as during the past few (3-5) years. The number of vacant jobs remained stable, and it should be pointed out that one in five of such jobs was accounted for by the Moscow agglomeration, where these vacancies are not popular because of low pay. Unemployment remained high in the North Caucasus and Transbaikalia. Changes in real personal income were calculated by the Federal State Statistics Service (Rosstat) in accordance with its new methodology. A significant drop (by 4 or 5%) in real personal income was registered in St Petersburg and Leningrad Oblast, alongside a rather surprising drop demonstrated by that index in a number of the regions of the European part of Russia.

The May 2019 survey of directors of industrial enterprises conducted by the Gaidar Institute indicates that the demand for their products was quite satisfactory (65% of industrial enterprises were satisfied with their volume of sales). However, the dynamics of output in May, the month of numerous days off and festivities, was not mood uplifting, and output growth was only slightly above zero. According to the managers of industrial enterprises, their investment plans also hovered around zero, similarly to the situation in 2017 and 2018. In May, the respondent enterprises either had begun or were ready to begin cutting their selling prices. Our experts believe that this is the proof of the fact that the VAT rate increase pass-through effect has fully materialized.

The number of persons employed in industry did not grow, and the respondent enterprises were not planning to increase wages in order to attract additional personnel. In 2019, only 15% of enterprises considered the level of remuneration of their employees to be 'below the norm'. This is the best result registered since 2007, when this index first began to be monitored by the Gaidar Institute. The worst result was registered in Q2 2009 (when 59% of enterprises considered their pay level to be insufficient). The worst result registered in 2015 was 30%. 

# 1. THE BANK OF RUSSIA SWITCHES OVER TO MONETARY POLICY EASING

A.Bozhechkova, P.Trunin

*At its June meeting, for the first time this year, the Bank of Russia Board of Directors decided to cut the key rate by 0.25 p.p.. to 7.5% per annum. Such a decision was motivated by the plunge of annual inflation in April-May 2019 to 5.1%, coupled with weakening inflation risks. The inflation forecast for 2019 has been revised, the target being reduced from 4.7–5.2% to 4.2–4.7%. The RF Central Bank expects that the annual inflation rate in 2020 will hover around 4%, and so it plans to roundup its transition to neutral monetary policy by the middle of the next year.*

The RF inflation index for May 2019 stood at 0.3% (vs. 0.4% in May 2018), and in annual terms (calculated for the previous twelve months) it rose to 5.1% (compared with 2.4% in 2018), thus surging 1.1 p.p.. above its target set by the RF Central Bank (Fig. 1). At the same time, consumer prices over the first ten days of June 2019 remained practically unchanged, although previously they had traditionally displayed growth during that period of each year. The acceleration of inflation that started in summer 2018 in response to the pass-through effect of the ruble's weakening against major world currencies, followed by that of the raised VAT rate, gave way to a slowdown in April 2019 (after having peaked at 5.3% in March). Now, in view of annual inflation having demonstrated a certain slowdown, on 14 June the Bank of Russia, for the first time since December 2018, decided to lower the key rate by 0.25 p.p.. to 7.5% per annum. The other reasons behind that decision were the lower rate of growth (relative to its forecast target) demonstrated by the Russian economy in Q1 2019 and the relatively stable situation on foreign markets.

It should be noted that the CPI growth rate began to gain on the previous month from September 2018 onwards (0.2%), peaking in January 2019 (at 1.0%). After a plunge in February to 0.4%, the CPI became stabilized in March through May at 0.3%. The monthly growth rate of food prices peaked in January 2019 (at 1.3%), thereafter declining, over the course of April-May, to 0.4%.

Prices for non-food products gained 0.2% in May 2019, while in January 2019 their growth rate was 0.6%, in February and March – 0.3%, and in April they jumped by only 0.2%. The prices of paid services rendered to the population, after their slowdown in February (0.2%) and March (0.1%), were once again on the rise: in April – by 0.2%, in May – by 0.4%. This movement pattern had to do with a seasonal surge of prices for resort and spa services, outbound tourism, and passenger transport tariffs.

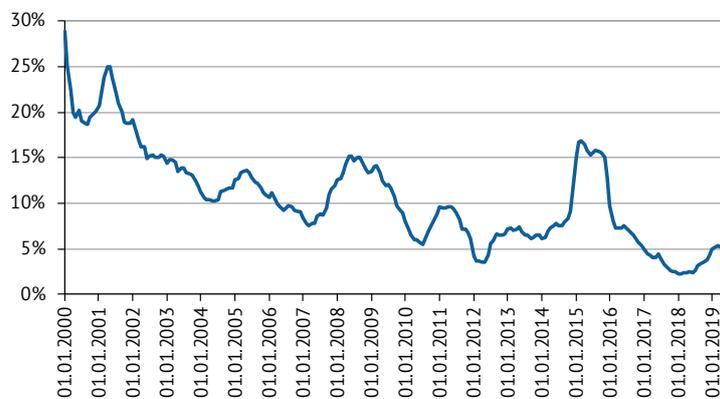


Fig. 1. Inflation (% , relative to the previous 12 months)

Source: Rosstat.

## Monitoring of Russia's Economic Outlook

The period-end core inflation (i.e., the change of prices other than those influenced by seasonal and administrative factors) for May 2019 rose to 4.7% (vs. 2.0% in 2018). It should be noted that it had been continuously on the rise since March 2018. Nevertheless, the index of core inflation relative to the previous month, after having peaked at 0.6% in January 2019, dropped in February to 0.4%, and then from April 2019 onwards stabilized at 0.3%.

The median inflation expectation for the year ahead, according to the INFOM survey results released by the Bank of Russia, was 9.3% in May, having lost 1.1 pp. relative to its year-beginning value (Fig. 2). It should be reminded that the surge in inflation expectations at the start of the year was caused in the main by the public concerns about the rising prices of certain foodstuffs, and also about the increased VAT rate. Meanwhile, not only the inflation expectations, but also the respondents' opinion of the current inflation movement have remained at a high level (10.4% in May 2019 vs. 9.2% in May 2018). According to the Bank of Russia's estimates, the qualitative indices reported by enterprises concerning their inflation expectations also demonstrate a certain decline, and this has to do with a weakening pass-through effect of the increased VAT rate.

Inflation slowdown was also contributed to by the ruble's strengthening: over January-April 2019, the ruble climbed against the USD by 6.9%, to RUB 64.69. In May, the USD-to-ruble exchange rate lost 0.6%, plunging to RUB 65.06. On the whole, the ruble's strengthening has had to do with rising price of oil (it

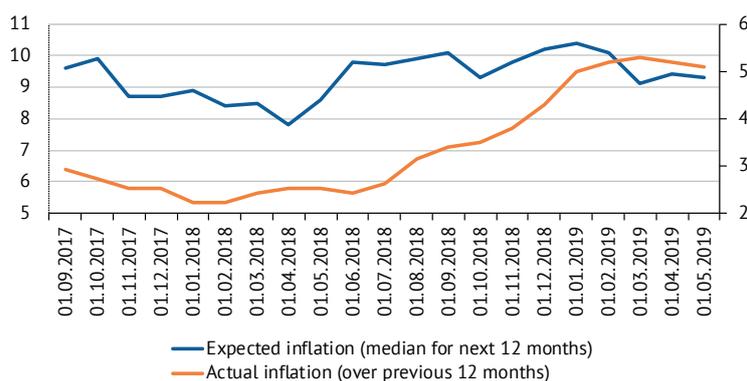


Fig. 2. Inflation and inflation expectations

Source: Rosstat; Bank of Russia.

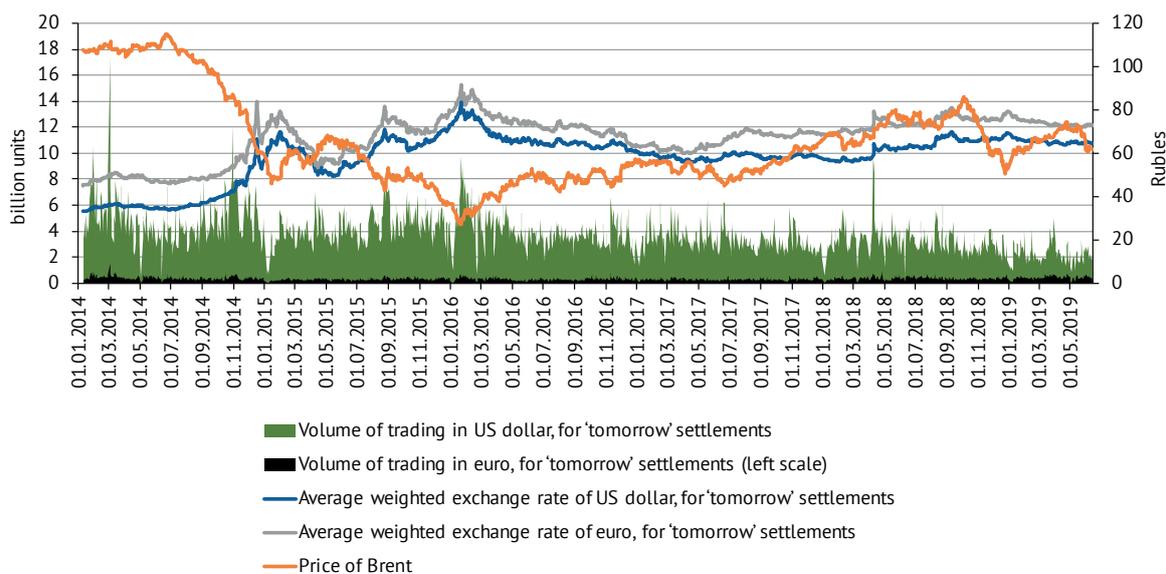


Fig. 3. The movement of the USD-to-ruble and euro-to-ruble exchange rates on the FX exchange; trading volume in the FX market; price of Brent

Source: RF Central Bank; Finam.

## 1. The Bank of Russia Switches Over to Monetary Policy Easing

jumped from \$ 60.6 per barrel in January 2019 to \$ 69.8 per barrel in May 2019) and its stabilization at a relatively high level (*Fig. 3*), and also with stability on the global financial markets. Nevertheless, there remain some risks of the ruble's weakening in response to the introduction of new economic sanctions on Russia.

The movement pattern of real personal income has remained one of the factors that suppress inflation, having been in negative zone for the past five years. According to data for Q1 2019, the growth of real personal money income relative to Q1 2018 was -2.3%<sup>1</sup>. The average annual growth rate (over the previous 12 months) of real wages over the period of January-April 2019 stayed at the relatively low level of 1% (vs. 9.4% on average in January-April 2018). The movement pattern of retail turnover was also very modest, its annual growth rate in January-April 2019 amounting to 1.7% vs. 2.8% in January-April 2018.

With due regard for the lowering pro-inflation risks, the Bank of Russia downgraded its annual inflation target from 4.7–5.2% to 4.2–4.7%, based on the year-end results of 2019. In 2020, according to the RF Central Bank's forecast, annual inflation will hover around 4%. Overall, this estimate can be considered to be acceptable, but in absence of any new shocks produced by the ruble's movement pattern in the forex market the inflation index may get close to 4% already before the end of this year. The Bank of Russia announced that, if the current domestic and foreign market trends remain unchanged, it plans to further reduce the key interest rate at one of its next Board of Directors meeting, and to switch over to neutral monetary policy (that is, a policy aimed neither at inflation slowdown nor at inflation speedup) before mid-year 2020. In all probability, this is an indication of a possible plunge of the key rate as early as July.

In our opinion, in conditions of slow growth rates of GDP and personal income coupled with inflation slowdown, monetary policy easing is quite justifiable. At the same time, any exacerbation of the geopolitical situation or a sharp deterioration of the situation in the global economy may at any moment trigger a massive capital outflow from Russia, create downward pressure on the ruble, and thus force the Bank of Russia to once again raise its interest rates. 

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1 Rosstat's new methodology based on the Methodological Provisions for Calculating the Indices of Money Incomes and Expenditures of the Population approved by Rosstat Order No 465 dated 2 July 2014 (as amended on 20 November 2018).

## 2. REGIONAL BUDGETS FOR FOUR MONTHS OF 2019: TRENDS RETAINED

A.Deryugin

*On the back of four months of 2019, the trend of high growth rates of revenues and lower growth rates of expenditures of regional consolidated budgets have been retained. This fact allows even the lowest-income regions to decrease fiscal burden and form reserves aimed at financing events in the framework of national projects.*

### Revenues

On the back of four months of 2019 compared to the same period of the previous year, revenues of the consolidated budgets of the subjects of the Russian Federation grew by 22.6% and exceeded the pace of inflation for the same period, as well as the overall revenue dynamics for 2018 as a whole (115.2%). It is too early to speak about the upward trend of the revenue growth rates in the context of the preliminary data of the regional budgets execution for May 2019 (at the period-end of five months of 2019 growth constituted 114.7%).

In 84 regions the consolidated budgets revenues over four months of 2019 exceeded the level seen during the same period of 2018. Only the Republic of Bashkortostan reported no growth of revenues (94.0% against the previous year), which is due to adjustment following unusually high revenue growth rates over 4 months of 2018 compared to the same period of 2017 (139.1%).

Therefore, it can be stated, that in early 2019 there were no regions in Russia that had trouble with revenue growth rates. Such conclusion is confirmed by preliminary data on realization of regional budgets execution over five months of 2019, that shows that only five regions demonstrated negative growth rates of budget revenues.

All principal revenue sources (with proportion of no less than 5% in the structure of consolidated budgets) showed positive dynamics in January-April 2019. Growth of the corporate profit tax constituted 146.6%, PIT – 110.1%, excises – 125.7%, tax on aggregate incomes – 116.4%, the corporate property tax – 109.4%, non-tax revenues – 111.5%, grants from the federal budget – 118.0%.

High growth rates of income tax returns were due to the April spike, when returns grew by over 3-fold compared to April of 2018 (Fig. 1).

Main sources of revenues in January-April 2019 were the corporate profit tax (31.8% of total revenues) and the personal income tax (26.2%). In case of maintaining the same pace of growth through the end of the year, proceeds from the profit tax into the regional consolidated budgets can exceed returns from the personal income tax.

Among federal districts, leaders in revenue growth rate over

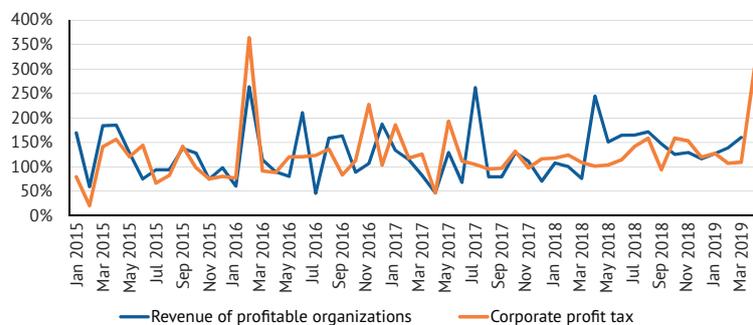


Fig. 1. Growth rates of proceeds from the corporate profit tax to consolidated budgets of RF subjects and income of profitable organizations, in % to the same period of the previous year

Sources: Calculations based on data released by the Federal Treasury and Rosstat.

## 2. Regional budgets for four months of 2019: trends retained

four months of 2019 were Far Eastern and Urals federal districts (131.4 and 128.7%, respectively). The lowest growth rates were posted by Volga (114.3%) and Southern (116.1%) federal districts.

One can note slight growth of revenues differentiation between wealthy and poor regions. Growth rates of high-income (13 subjects which didn't get grants in 2019 for levelling fiscal capacity), mid-income (41 subject), and low-income (31 subject) subjects over the first four months of 2019 compared to the same period of 2018 constituted 127.5, 118.2 and 118.8%, respectively. Data on growth rates of tax and non-tax revenues show 127.0, 119.2 and 114.6%, respectively. Growing divide in the level of the own revenues between the wealthy and poor regions at the beginning of 2019 continues the trend commenced in 2017–2018 and shows that the problem of fiscal inequality in Russia not only remains but is getting worse.

### Expenditures

Expenditure growth rate of consolidated budgets of RF subjects over first four months of 2019 constituted 112.7% compared to the same period of 2018 which is above the inflation rate.

Growing expenditures were observed in 75 regions, while in 64 of them they outpaced inflation for the same period. The lowest growth rates were registered in the North-Caucasus federal district (104.2%). Among federal districts with

Table 1

### Functional structure and dynamics of expenditures of the consolidated budgets of the RF subjects, %

	Expenditure structure			Gain	
	2017	2018	2019	2019/2017	2019/2018
General state issues	6.2	6.5	6.6	29.2	14.1
National security and law enforcement activities	1.0	1.0	1.0	26.5	14.1
National economy, including:	15.1	14.8	15.0	21.5	14.4
Agriculture and fisheries	2.6	2.2	1.9	-7.3	0.5
Transport	3.8	3.7	3.4	9.4	3.3
Public road system (road funds)	5.2	5.2	5.2	20.0	11.3
Other issues in the sphere of national economy	3.5	3.7	4.5	57.5	38.1
Housing and utility sector	8.4	7.8	8.9	29.7	27.9
Environmental conservation	0.3	0.3	0.2	12.3	-19.8
Education	28.7	28.0	27.5	16.9	10.7
Including :					
Pre-school education	8.0	7.8	7.6	15.7	10.8
Higher Education	14.1	13.5	13.5	16.4	12.8
Secondary vocational education	2.2	2.3	2.2	20.8	10.7
Other issues in education	4.2	4.5	4.1	18.8	4.0
Culture, cinematography	3.6	4.0	4.0	35.7	11.1
Healthcare	7.9	8.4	8.2	26.7	10.3
Social policy	24.5	25.0	24.7	23.2	11.7
Physical fitness and sports	2.3	2.4	2.3	22.2	7.7
Mass media	0.5	0.5	0.5	37.6	24.5
Servicing state and municipal debt	1.7	1.3	1.0	-24.6	-8.2
Expenditure, total	100.0	100.0	100.0	22.0	12.7

Sources: calculated from the Federal Treasury data.

the largest budgetary expenditures over the period under review, the Central federal district was on top (117.4%) with high values mainly due to Moscow's growing expenditures (119.9%).

Exceeding revenue growth rates over expenditures ones extend the 2018 trend. Regions are not in a hurry to spend additional financial resources gained from growing profits. They maintain a tight budgetary policy and continue to repay state debt. Maybe, some of additional revenues will be spent on the realization of national projects. However, since they are to a significant extent of investment nature such spending will take place towards the end of the year.

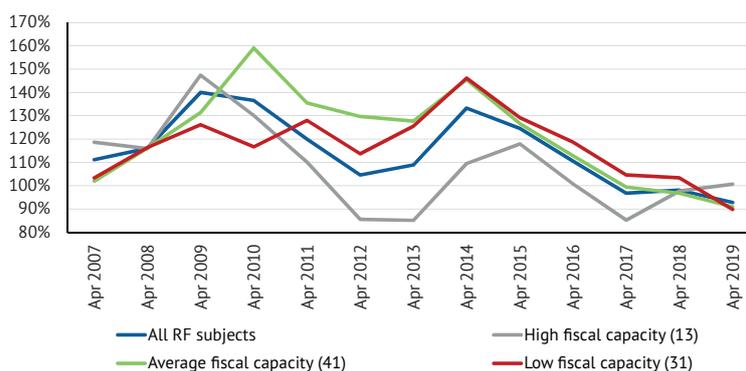
Outpacing dynamics of budget revenues are reflected on the government and municipal debt spending. Their share in the structure of expenditures kept declining and constituted 1.0% at the end of four months of 2019. This is minimum value over the corresponding period for the last six years. Environmental expenses have also declined (81.2% from the previous year). Other expenses across main sections of budgetary classification have grown (*Table 1*). The highest growth rates were demonstrated by housing and utilities (127.9%), mass media (124.5%) and assistance to economy (114.4%).

### Budget balance and state debt

At the beginning of 2019, the state debt of the subjects of the Russian Federation kept shrinking, and by the end of April 2019 declined by 7.3% compared to the beginning of the year. When compared to April 2018<sup>1</sup> declined by 7.2%, down to Rb 2.04 trillion. As in 2018, this was due to revenues growth as well as Finance Ministry's policies aimed at encouraging regional authorities to adopt a tight fiscal policy. From April 2018 to April 2019, 73 RF subjects reduced their state debt, while it grew in 12 subjects. The following subjects are leaders in cutting the state debt: Krasnodar region (Rb -19.9bn), Voronezh region (Rb -12.1bn), and Arkhangelsk region (Rb -9.4bn). Leaders in growth are – Moscow region (Rb 28.9bn), Khabarovsk region (Rb 7.3bn), and Sverdlovsk region (Rb 4.5bn). The following regions showed highest contraction of the state debt: Voronezh region (-45.5%), Nenets (-35.5%) and Yamal-Nenets (-35.5%) autonomous districts, while the following regions had strongest growth rates – Tyumen region (159.0%), Moscow region, and Khabarovsk region (16.1%).

As to the differences in the state debt dynamic between wealthy and low-income regions, the debt growth rates in low-income regions turned out to be the lowest (*Fig. 2*), which contributed to the reduction of debt burden of that group of Russian regions (*Fig. 3*).

According to preliminary estimates, the ratio of regional state debt as of 1<sup>st</sup> May 2019 compared to 1<sup>st</sup> May 2018 to theirs tax and



*Fig. 2. Growth rate of the state debt of the RF subjects with various levels of fiscal capacity, % to the same period of the previous year*

Sources: own calculation on the basis of data released by the RF Finance Ministry and Federal Treasury

<sup>1</sup> Because of substantial influence of seasonality on dynamic of regional state debt, it is better to analyze it's changes over last 12 months, rather than comparison with the beginning of the current financial year.

## 2. Regional budgets for four months of 2019: trends retained

non-tax revenues declined from 25.3 to 21.8% (Fig. 3), which is the lowest value over the last 10 years.

### Ratio of state debt to tax and non-tax revenues, %

The number of regions with high debt burden declined. As of 1<sup>st</sup> May 2019, there were only two regions where state debt ratio to overall volume of budget tax and non-tax revenues exceeded 100%: Kostroma region (104.7%), and Republic of Mordovia (224.3%) (as of 1<sup>st</sup> May 2018 there were three). If Kostroma region was close to leaving the group, Republic of Mordovia is only able to stop debt growth, but not to reduce it.

At the end of April 2019, budget loans were still part of structure of regional state debt, which share constituted 48.1%. Proportion of loans issued by credit organizations from 1<sup>st</sup> April 2018 through April 2019 practically did not change and constituted 21.6%, while the share of bonds kept growing and reached 26.6% of the total regional state debt. ▀

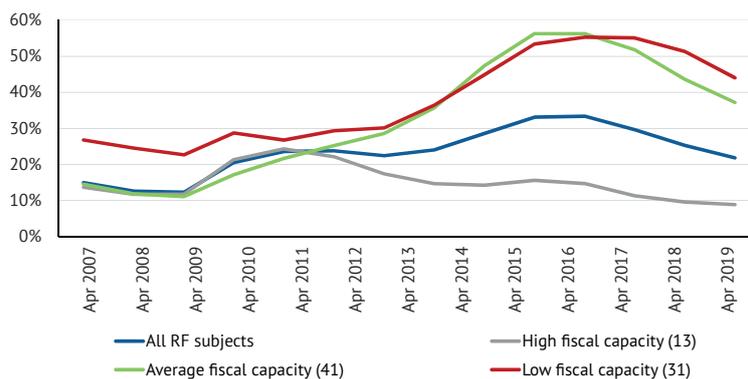


Fig. 3. Dynamics of the debt burden of the RF subjects to tax and non-tax revenues, % to the same period of the previous year

Source: own calculations based on the data released by the RF Finance Ministry and Federal Treasury.

### 3. WEALTHY REGIONS HAVE BECOME STILL RICHER

N.Zubarevich

*Results of the first three-four months of 2019 are contradictory: amid somewhat industrial output growth investments remains stale, however their concentration increased in regions with agglomeration and resource advantages. The majority of the Federal Districts reported continued contraction of housing commissioning. Regional budgets improved owing to proceeds growth from the profits tax and transfers, however polarization grows, the wealthiest regions boast of more budget money.*

The industrial growth rates registered in January-April 2019 moved up compared to 2018 dynamics for the same period (2.8 and 1.8%, respectively). The number of regions with declining output decreased (from 20 to 18). The majority of regions of North Caucasus and half of regions of the Far East, depressed Ivanovo, and Amur regions posted negative or near zero dynamics. For a second year running are falling indicators posted by oil producing Nenets AD, the principal oil-producing region Khanty-Mansi AD is stagnating together with Tatarstan. More significant industrial output was registered in Arkhangelsk (-18%) and Rostov (-6%) regions which was due to high base effect of the previous year.

The industrial growth leaders are divided into three groups: with sustainable dynamics owing to resource and agglomeration competitive advantages (Yamal-Nenets AD, Astrakhan region, Yakutia, city of Moscow and Moscow region); with recovery growth which followed after the recession owing to increased state defense order or improved economic environment in the automobile market (Tula region, Udmurtia, and Kaluga region); with undeveloped industry which creates low base effect (Crimea, Sebastopol, Chechnya, Tyva, etc.). Sometimes these factors go together: fast industrial growth seen in Buryatia in January-April 2018 and 2019 (by 28 and 17%, respectively) is due both to low base effect and increased state defense order and exports of helicopters.

The manufacturing sector posts weaker growth than industry as a whole, -2.2%, and there are more regions with recession – 24. The most notable recession took place in the North Caucasus FO (-7.4%), nearly all regions posted recession, and in Dagestan manufacturing output contracted by a third due to problems with the state defense order experienced by enterprises of Kaspiysk. Among the regions with more developed manufacturing sector the negative dynamics were posted by Primorsky and Khabarovsk krai, Irkutsk, Chelyabinsk, Orenburg, Saratov, Rostov, Arkhangelsk, Ryazan, and Ivanovo regions, Republic of Karelia.

Investment growth in Q1 2019 was negligible (+0.5%). Data for this period across regions is not representative. Aggregated dynamics across Federal Okrugs are more informative. Only two federal okrugs boasted of investment growth: Central FO – by 16% mainly due to growth in Moscow by around 26% (the capital accounts for more than a half of the total investment in CFO), and in Siberian – by 13% where main contribution was made by Irkutsk, Kemerovo and Omsk regions. All other federal okrugs registered declining investment.

### 3. Wealthy regions have become still richer

The highest recession was posted in Southern FO (by 20%), negative dynamics is seen in nearly all of its subjects except Adygea and Sebastopol. Significant decrease of investment was registered in Krasnodar krai (by 30%) and Republic of Crimea (by 20%) due to completion of construction of the Crimean motorway bridge and approaches to it. Volga FO, Northwestern FO, and North Caucasus FO saw investments to decrease by 3–5%, Far East – by 6% and decrease was seen in the majority of its regions. Recession in the Urals FO (-8%) was also due to the negative dynamics posted in all large regions except Yamal-Nenets AD (+10%) where second stage of the gas liquefaction complex is being built. Oil-producing Khanty-Mansi AD saw investments to fall by 10% but its share in the total investments of UFO remains at the peak – 41%.

Downward trend continued in the housing construction complex (-3% in January-April 2019). However, regional dynamics during the first months of the year is not representative; the differences are great regarding both regions and federal okrugs. The most significant growth was noted in the Central FO (up 12%) owing to the Moscow “thrust” (up 4/6-fold) and in the Southern FO (up 9%) – mainly due to Krasnodar krai and Rostov region. Volga FO posted relatively small growth – up 4%. All other federal okrugs posted downward trend; the worst performance was noted in the Northwestern FO – down by one thirds owing to strong decline of housing commissioning seen at the beginning of the year in St. Petersburg (down 60%). Decrease of new housing supply contracted by 12–15% in Siberian and Urals FO. Downward trend in these three federal okrugs was due to high effect base of early 2018 (due to construction delaying in 2017 new housing supply was put off to Q1 of the next year). Far East and North Caucasus posted moderate recession (-4%), but they account for merely 3–4% of the new housing supply in the country.

The retail trade turnover growth posted in January-March 2019 slowed down to 1.7% (the same period of 2018 – 2.2%). Regional dynamics is barely different and stay in the range of -2 to 4–5%; it is close to average across country in the majority of regions. Downward trend in 9 regions is small and stay within the limits of statistical discrepancy. The trade growth was maintained in Q1 by consumer lending.

The state of the regional labor markets in 2019 practically did not differ from that of the 2017–2018 period. The employment issues are rock bottom as well as wage arrears; regional indexes have not changed compared to late 2018 except its notable growth in Murmansk and Ivanovo regions. The number of job vacancies remains stable – around a million, and Moscow accounts for over one fifth of them where these vacancies are not in demand due to uncompetitive wages.

The unemployment level measured by the World Labor Organization methodology averaged at the minimum of around 5% across the country in recent years and in February-April constituted 4.8%. Regional differences are negligible and practically remain unchanged. The worst indexes have been posted by Ingushetia – 27%, Chechnya, Dagestan, Karachaevo-Cherkassia, and Tyva – 13–14% each; Transbaikal regions post unemployment level twice as high as the average one. The lowest unemployment level (a bit over 1%) is observed in two largest federal cities boasting a huge labor market and in the outside zone of the capital agglomeration – Moscow region (below 3%) as well as in leading oil-producing regions—Khanty-Mansi AD and Yamal Nenets AD (25 each) and they are most of all left in the event of the job loss.

Growth of nominal wages seen in March 2019 came to 7% against March 2018; the majority of the regions boasted of similar indexes. Exceptions are two

leading oil and gas producing regions: in Khanty-Mansi Adnominal wages was not growing and in Yamal-Nenets AD even decreased somewhat (-1%), which can be explained by the lack of indexation or stagnation of the bonus (variable) part of salary paid by companies. As in the previous years, wages and salaries in Sebastopol (15%) and Republic of Crimea grew at priority rates; Moscow also excelled regarding wages and salaries growth rates (11%).

Dynamics of real cash income of the regional population over Q1 2019 calculated by Rosstat according to new methodology but without adjusted data series for the previous periods. Methodology change has not improved indexes: in the country as a whole income downward trend continued (-2% in Q1 2019). All federal okrugs reported negative dynamics the difference was solely in rates – from recession by 1% seen in Central FO (owing to income growth of the Moscow population by around 2%), Urals and Far Eastern FO to 4% in Northwestern FO (incomes of the St. Petersburg population and Leningrad region contracted by 4–5%). Weak growth within the scope of count accuracy was noted in 14 regions and higher growth rates were noted in Tver region and Zabaikalsky krai. Very heavy decline seen in neighboring Buryatia, in Arkhangelsk, Belgorod, Yaroslavl, Ivanovo, and Kostroma regions is hard to explain (Fig. 1).

Correlation of wages and salaries growth and decline of real cash income of the population always provokes questions. The highest spread exists between rapidly growing nominal wages (9–15%) and heavy decline of real cash income of the population (-7–8%) registered in Crimea and Sebastopol. Partly this can be explained by high proportion of informal income, which are unstable and are not subject to indexation unlike wages of public servants. On the whole, methodology

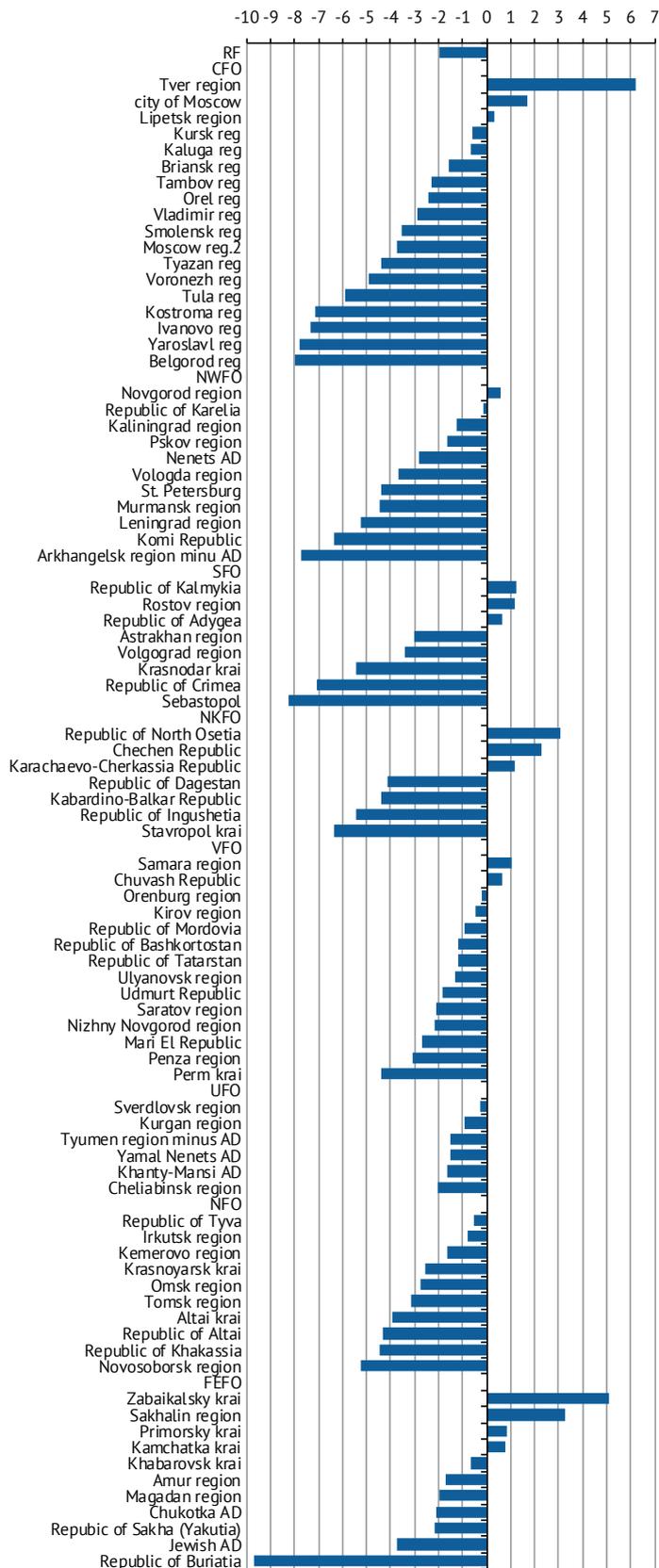


Fig. 1. Dynamics of real cash income of the population in Q1 2019, in % to the same period of 2018

Source: Rosstat calculation on the basis of new methodology.

### 3. Wealthy regions have become still richer

change did not result in notable improvement of the quality of income accounting on the regional level except Moscow.

Early 2019 was favorable for regional consolidated budgets: revenues for January-April 2019 went up by 23% against the same period of 2018. Revenues contracted solely in the Republic of Bashkortostan (down 6%) due to the fall of proceeds from the profits tax. Main reasons for improved budget revenues – growth of proceeds from the profits tax by half and transfers by 21% (*Table 1*). The profits tax in Moscow over January-April 2019 moved up by 48% bringing additionally Rb 124bn of revenues. Over this period, the capital accounted for 27% of all proceeds from the profits tax in regional consolidated budgets. Regions registering high growth rates of the profits tax were Tyumen region with autonomous districts, Sakhalin and Republic of Tatarstan. Wealthy regions have become still richer<sup>1</sup>.

High rates of transfers growth seen in January-April 2019 nearly coincide with their dynamics for the whole of 2018 (22%). Apparently, the federal authorities have replaced the policy of “optimization” of assistance to regions (in 2014–2016 transfers stayed put and it was not restricted by voter important 2018).

Regional budgets expenditures grew at a slower pace and approximately the same rates both as a whole and across main expenditure items. Rapid growth of budget revenues and execution of wage decrees allowed the territories to manage without budget resources maneuver common for the previous years.

*Table 1*

#### Dynamics of revenues and expenditures of regional consolidated budgets in January-April 2019, in % to corresponding period of 2018

Revenues, total	23	Expenditures, total	13
Profits tax	47	National economy	14
VAT	10	Education	13
Property tax	9	Healthcare	10
Transfers	21	Social policy	12

Source: calculation made on data released by Federal Treasury. 

<sup>1</sup> On dynamics of regional revenues and expenditures also see Alexander Deryugin “Regional budgets over four months of 2019: trends remain” in this issue of Monitoring.

## 4. RUSSIAN INDUSTRIAL SECTOR IN MAY 2019: OUT OF STAGNATION

S.Tsukhlo

*In May, according to industrial enterprises estimates, output, and employment held steady. Moreover, industry indicated its readiness to cut prices thus showing the termination of the VAT new rate pass-through into producers' prices. Business forecasts retain high level of optimism maintained by the growth of finished goods inventories.*

May business surveys data on dynamics of sales registered demand growth rate unchanged at the April level – far from the best one for the current year but exceeding the worst values seen in 2018. This being said, enterprises estimates of the current demand demonstrate growing satisfaction with sales to 65%. Demand forecasts have reached such level of optimism, which was not registered from early 2018. The industrial sector demonstrates even higher inclination to overcome stagnation commenced in 2012.

Estimates of finished products inventories have become more optimistic. In May, balance of this indicator hit +7 points, which was its 17-months peak. In 2018, balance usually stayed in the range of -2...+2 points, which is indicative for minimal hopes of enterprises for sustainable demand growth.

However, data regarding real output dynamics for May abounded with weekends and public holidays do not inspire former optimism. According to enterprises estimates output growth rate remains somewhat above zero.

This being said, the level of optimism regarding enterprises output plans is still rather high (highest since late 2017). To note, this level of optimism is not only high but is surprisingly stable for last years. Although it is still far from the levels registered by surveys conducted in 2010–2011 and much less than in 2007–2008.

In May, industry proceeded with reduction of prices thus signaling termination of the VAT new rate pass-through into producers' prices. Nevertheless, the real rate of price growth in early 2019 was significantly lower forecasts of late 2018. The December forecasts promised price hike from registered in that month balance of -1 point up to +31 points in January. However, in reality balance increased in January to moderate +18 points. Approximately the same balance (+16) was registered during relatively calm for Russia's monetary policy in January 2018.

Enterprises price forecasts for the first five months of 2019 decreased by 36 points and hit now -6 points. That is to say, enterprises are ready to reduce prices already in the coming months of 2019. Such strong decline of prices was not predicted by Russian industry since December 2008.

Industrial sector in May failed to increase the number of workers although in April planned to do it. The same plans were registered in May. Thus, for a second month running balance of real employment fluctuations remains zero amid still high intentions of enterprises to increase the ranks of their workers.

At the same time, the resolution of staffing problem at the expense of wage growth is not planned by businesses. In 2019, solely 15% of enterprises estimated the compensation rate of their workers as “below norm.” This is the

#### 4. Russian industrial sector in May 2019: out of stagnation

minimum (i.e. the best value) for the entire period of this indicator monitoring (2007–2019). The maximum was registered during the critical for the industry Q2 2009 and constituted 59%. In 2015, the worst value of the indicator came to anything but “critical” 30%.

The investment plans of the industrial sector lost by April all optimism of the start of the year dropping from +15 to -2 points. In May, indicator’s downward trend terminated and some sort of growth was registered, which possibly indicates around zero state, which was observed in the investment plans of 2017–2018 following optimism demonstrated at the start of a calendar year. 

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