

## RUSSIA'S ECONOMY

### RUSSIA'S ECONOMY IN 2015

Aggravated geopolitical risks and the downgrade of the country's sovereign rating to speculative grade caused pessimistic investor sentiments in early 2015. In January 2015, Standard & Poor's downgraded Russia's rating to BB+; Moody's then downgraded it to Ba1 in February 2015.

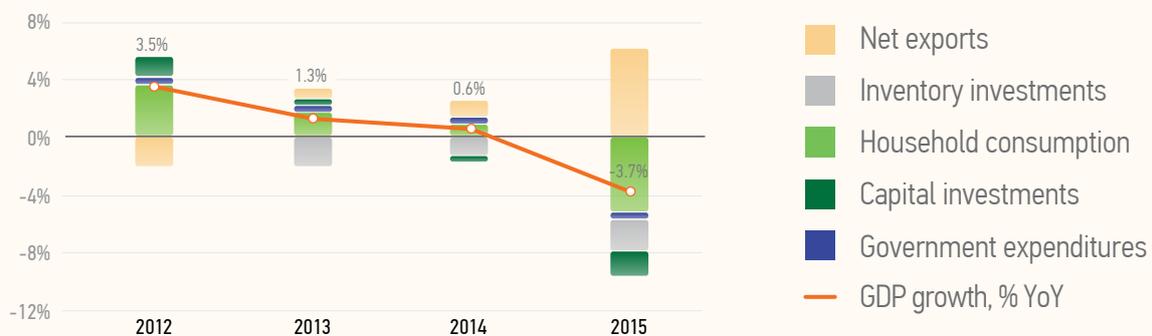
The situation improved upon compliance with the Minsk agreements reached in February 2015. This was followed by a rapid growth in oil prices to USD 60-65 per barrel. In May, the rouble strengthened to 50 RUB/USD, and Bank of Russia set about purchasing foreign currency to augment its reserves. The financial markets also showed upward trends. A substantial part of the unfavourable changes which occurred in late 2014 was recovered in the first half of 2015.

This improvement proved to be a temporary one. Oil prices resumed their downward slide in the second half of 2015 aggravated by an expected increase in Iran's oil supply, concerns about China's economic growth, and an expected increase in the Federal Reserve System (FRS) interest rate. In late 2015, the level of economic uncertainty remained high.

### RESULTS FOR THE YEAR

A substantial decline in oil prices and international sanctions resulted in a deep economic recession in Russia. The GDP declined by 3.7% in 2015. The current economic recession is the longest in the country's recent history. The recession has continued for six quarters in a row, and the economy has returned to its 2011 level in terms of the GDP. The main risk to macroeconomic stability now comes from the unfavourable oil market, which hampers Russia's recovery.

#### GDP BREAKDOWN BY COMPONENTS



Source: Federal State Statistics Service

The 2015 economic slump was not so deep as in 2009. Bank of Russia's policy and the shift to a floating exchange rate helped the economy adapt to external shocks. Weakening of the rouble after the transition to a floating exchange rate caused a slump in imports (by 25.6%), which statistically maintained GDP growth. The external sector is the only GDP component that made a positive contribution to 2015 economic growth.

Consumption bore the main brunt of the crisis. Retail sales went down by 10% in 2015. At the same time, retail turnover hit a 15-year minimum (-15.3%) in December. Consumer demand fell in a record short time due to falling real salaries (-9.5%) in the context of double-digit inflation (15.5% on average in 2015) and reduced retail lending (-6.3%). Consumption patterns were also negatively affected by strengthening savings sentiments and an increase in the share of income saved by individuals (14.1% in 2015 from 6.9% in 2014 and 10% in 2011–2013). The reduction in investments in fixed capital reached a substantial -7.6% after falling for the second year in a row.

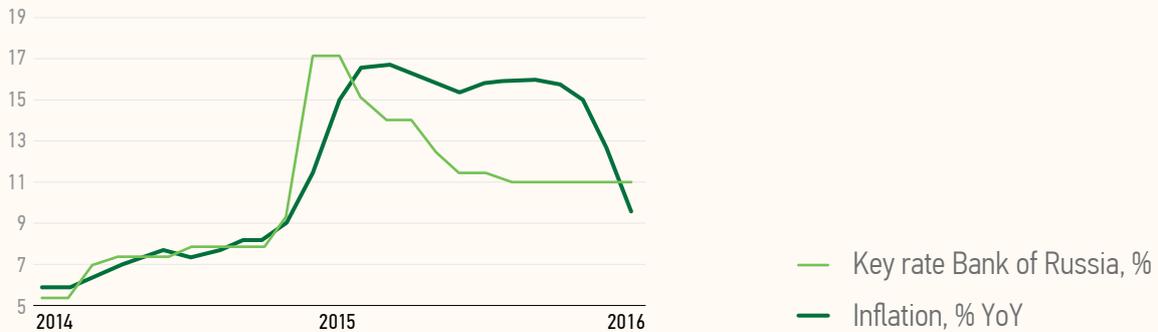
| THE WEAKENING OF THE ROUBLE RESUMED FOLLOWING THE DROP IN OIL PRICES



Source: Reuters

Inflation remained high throughout the year. It accelerated during the first quarter of 2015, reflecting the dramatic weakening of the rouble in late 2014 and food product shortages arising from the food embargo. Inflation peaked in March (16.9%), following which weak domestic demand and a strengthening rouble facilitated the deceleration of price growth. Indexation of utility rates and further weakening of the rouble interrupted the trend toward deceleration of inflation and the lowering of inflation expectations. Inflation came 12.9% in 2015, up from the 2014 figure.

## | BANK OF RUSSIA SUSPENDED THE DECREASE IN THE KEY RATE AS OF AUGUST 2015



Source: Rosstat, Bank of Russia

After a sharp increase in the key rate in December 2014, Bank of Russia lowered the key rate consistently throughout the first half of 2015. But the summer acceleration of inflation led to a rise in inflation expectations, prompting Bank of Russia to first reduce the increments at which the key rate was being lowered, and then to suspend the easing of the monetary policy altogether. As a result, the key rate has remained at 11% since August 2015.

The macroprudential policy of Bank of Russia, the provision of foreign currency repos to banks, and the decision of the Russian Government on the additional capitalisation of the banking system with Federal Loan Bonds (OFZs) suppressed the banking crisis at the beginning of 2015. However, most banks ended 2015 with a net loss. The total profit of the banking system proved to be three times less than the 2014 figures. The level of overdue retail debt is higher (8.1%) than during the 2009 crisis (7.9%).

Balance of payment statistics look favourable due to weakening of the rouble that partially set off the negative impacts of falling oil prices. In 2015, the current account balance was USD65.8 billion, up 12.6% from 2014. The trade balance surplus shrank to USD145.6 billion from USD189.7 in 2014. Oil and gas exports in dollar terms went down (-18%) along with oil export revenues (-38%). The main sources of the current account surplus were a decline in tourism and other service imports, migrant payroll and investment payments due to reduced foreign debt (-30% over 2014–2015). Capital outflow reached USD56.9 billion (USD50.2 billion adjusted for currency liquidity transactions of Bank of Russia) due to repayment of private foreign debt.