CEEMEA Business Group

Russia Business News and Case Studies

Wrapping up the 2015 Business Year and 2016 Outlook

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About the author

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Danny Thorniley is President of DT-Global Business Consulting GmbH (an LLC company) which is Danny's own consultancy company based in Vienna through which he works with some 430 key clients on business strategy in CEEMEA, global and emerging markets especially Russia. These companies are part of the CEEMEA and Russia Business Group, which is an advisory and consultancy service. The services of the Group include written position papers, presentation slides and private client meetings as well as in-house presentations.

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

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

Danny has exceptional skill sets in global business strategy, business in emerging markets and CEEMEA and hands-operational knowledge of business operations, distribution, partnerships, investments and human resource issues.

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

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

He holds and has held a number of non-executive and advisory board memberships.

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

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

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

Executive summary

- Don't compare the end of this year with the end of last year!
- Generally most executives are not predicting a strong Christmas season.
- Most MDs of consumer companies remain pleasantly shocked at the resilience of the Russian consumer.
- Customers now want value and prefer to buy on promotions.
- Many companies are quite satisfied with how they have survived and expect more of the same in 2016.
- Watch out for some heavy discounting.
- "Stop using the word crisis. This is not a crisis. This is the new normal".
- "Being localised has saved our business in Russia".
- One industrial company plans a full ROI on its factory investment in 5 years.
- The crisis is good: it has made the owners of the company realise that Russia is not an endless goldmine.
- "We think and hope that the worst is over"!
- Generally business with the federal government is very tough as budgets are cut and the government is selective about supplier sourcing.
- One retail company engaged in 13 different scenarios of the 2016 budget.
- Other European markets are flat and boring and this helps the perception of your business in Russia.
- The traditional trade (kiosks) is continuing to shrink rapidly and this is changing the whole retail structure.
- <u>How can you keep profits reasonable if you can't keep raising prices?</u>
- Consumers are sticking to brands they know and respect and trust.
- <u>It will take 2-3 years until 2018 or 2019 until we can recoup our profit level of 2014.</u>
- Kazakhstan was the star CIS market and providing some compensation and good growth for a flagging Russia and collapsed Ukraine. But this has changed sharply.

It's been a roller-coaster year and executives are yearning for just a bit more stability: logically this ought to arrive but the oil price could still wobble (see below) and the rouble could be buffeted by rising US interest rates. We are witnessing this at the start of December.

How has business been generally in 2015?

This is almost impossible to answer as some Group members have reported sales increases of +15-25% in US dollars! (admittedly these companies are a minority) while some executives operating in the automotive sector or parts of the IT industry report sales down by -60% in dollars, again this is a minority of companies.

But "the average" sales growth in roubles for many companies especially those in pharmaceuticals and consumer goods has ranged from increases of 6-14% IN ROUBLES.

We note below in our tables the 2015 results and 2016 forecasts.

Will you have a happy Christmas?

Well, on a personal level I am sure your families will distract you and provide a wonderful Christmas! ☺ But from a business point of view, there is some scepticism at the start of December.

Don't compare this year with last year!

In many sectors though it will be almost impossible to compare end-2015 with end-2014 (and in fact the turn of the year as well) given that Russian consumers went on a spending spree from end- November to February. Executives of consumer goods companies will have to benchmark against several years' averages or against end-2013 or find some other formula. Equally in the B2B sector, it may also be tricky comparing the turn of this year with 12 months ago given that business slumped catastrophically at the start of 2015 for many firms and hopefully this year should prove marginally better.

Generally most executives are not predicting a strong Christmas season although several managing directors have reported that "Christmas sets" of products are selling well.

In addition a good number of executives expect that the end of this year, even comparing with a "normal" year, will be sluggish and that the start of next year (2016) is unlikely to be strong like for like.

One of the biggest questions of 2015 and 2016: **When will the Russian consumer stop spending?**

Most MDs of consumer companies remain pleasantly shocked at the resilience of the Russian consumer: certainly downtrading has taken place along with the search for value as consumers become more sophisticated and more clever in their purchasing. But most managers are pleased at the extent to which consumers have absorbed solid price increases over the last 18 months.

Thanks to solid and consistent price rises, several major FMCGs have been able to keep sales up year-on-year at least until September/October by 13-18% in roubles. But others have reported slower rates of growth at 7-14% and many sense that the late autumn and run-in to Christmas will be softer.

One cosmetics company notes that the "quality of consumers has changed for the worse" meaning that customers now want value and prefer to buy on promotions which are becoming almost universal.

Some retailers report sluggish "foot-fall" (traffic) in stores and more executives wonder whether the Russian consumer can "keep on going".

One retailer also reports that:

> There are a few bright lights and some box sets are selling well but overall I think this Christmas could be disappointing. I also think that some retailers and FMCGs will have to start reducing headcount more in 2016 as the numbers set in more permanently.

This is a fair comment and some companies are making sober plans, but then again equally as we report in our consumer goods section below, many companies are quite satisfied with how they have survived and expect more of the same in 2016: many challenges but being able to survive and plan hopefully for a moderate recovery in the second half of 2016 and then moderate improvement in 2017-18.

As the MD of one European pharmaceutical company commented a few weeks ago in Moscow:

> The next 12-18 months will not be easy but I think if we stick it out, then there will be a moderately decent business model for us in 2017-18.

Watch out for some heavy discounting

In the run-up to Christmas in the last two years, manufacturers have complained about aggressive discounting and how much product was (and is) sold on promotion. Last year was such a crazy volatile year that discounts got swamped in the flurry of sales but even last year saw strong discounting and the end of 2013 certainly saw discounts of 20-30% running into Christmas which shocked some drinks and cosmetics companies. Our hunch is that discounting will re-occur this year and remain a feature in the consumer goods/retail sector as the consumer searches for value.

Of course executives are worried that the portfolio and brands can be permanently damaged if "everything is sold on promo all the time"!

This is not a crisis anymore; this is day to day reality!

One refrain from executives is: "Stop using the word crisis. This is not a crisis. This is the new normal". Put another way:

> Look at your business today with all its challenges

This is not a crisis scenario
This is your new normal existing business
It's probably the future as well.

Several executives have echoed this last point: many think that 2016 will see more of the same at slightly better levels than in 2015. The economy will not bounce back and neither will the business environment or business results.

The most quoted statement at a working dinner last week for managing directors of consumer good companies was: "We're doing well".

The MD of a major cosmetics company noted by telephone call last week that: "2015 has been the most successful year for us in Russia in the last 30 years". Presumably the success is based perhaps less on volumes rather than solid price rises combined with good cost management.

Interview with a managing director of an US industrial supplier

The MD of this company is reasonably upbeat and puts much of this optimism down to the fact that his company opened up a new factory in Russia in summer 2014.

Obviously this was an on-going investment but it wasn't stopped and thank God! Being localised has saved our business in Russia. We are seen as a local player and we can modify our product portfolio to offer affordable solutions to our industrial clients. This has made us hugely competitive. When you combine that with us changing our sourcing policy to Russian providers or cheaper Asian ones, it means we have captured good market share in the last 18 months. We can out-compete other western suppliers; we can even beat local Russian producers because we provide excellent quality; and we can even beat in-coming cheap Chinese competitors.

This Russian factory is the best-selling factory in the world in local currency for the company and it has the highest quality in the world! The company plans soon to supply the Middle East region from this Russian plant.

This company plans a full ROI on the investment over 5 years.

The MD of the Russian operations alluded to how important the Russian market is for his company in the European context as other European markets slumber or shrink.

The executive pointed out that the business is growing through 2015 at 25%+ in roubles and about -3% in dollars and Euros. Thanks to greater localisation they have been able to moderate price increases which means they have increased their market share.

The new normal has been good for the company locally because:

> It has made the owners of the company realise that Russia is not an endless goldmine. Expectations have been managed downwards and we can plan for a more regular business environment and consequent results.

The company also think that 2017 and 2018 will be boosted by investment from the football World Cup and that other development programs will start to kick in from 2020 when the current budget/planning cycle finishes. In closing the executive summed up:

> We think and hope that the worst is over!

Executive comments from the B2B sector

The European MD of a major US conglomerate also noted that business was holding up reasonably well and they may be helped by their conglomerate structure:

> We expected a very bad year in 2015 for Russia but it didn't quite turn out like that. I suppose when expectations have been managed downwards a lot, then any rally is welcome. But we have managed the business more tightly but also been able to keep some prices up and our brands are still working in some sectors. For example, agricultural sales area still doing very well and of course we offer some products which go into import substitution. Overall we grew about 25% in roubles which is still not great in dollars. But still, not that bad either.

Some trends in IT

Generally business with the federal government is very tough as budgets are cut and the government is selective about supplier sourcing. Large project sales to Russian corporations are also under pressure due to financing and budget issues but there are definitely some positive exceptions here as well. Overall, any IT sales to consumers have done relatively well, but again purchasing power is not rising and so customers are buying fewer big-ticket IT items.

Many IT companies report negative sales in dollars in the range of -25% to -35% which means they are flat or slightly negative in roubles as well. These were certainly the numbers of one major US IT company, while another reported slightly better figures because "The market is immensely mixed and while we have some segments which are down brutally, a couple of others are sustaining us; but we are still very negative in dollars".

One or two companies are doing well thanks to large projects with major Russian companies. One US automation company reports that: "Our business in 2015 was saved thanks to large contracts with Rosneft". Another large US company reports that, "Our business in Russia is much better than expected and we are doing even quite well and this is thanks in large part to a project with Sberbank".

Interview with a European retailer (Do-It-Yourself sector)

The MD of this company has made interesting remarks at serval of your Moscow executive meetings. Last week he gave me a review of his 2015 business.

Like many others he noted: "All we need is a bit more stability: it doesn't matter at what level but relative stability would help the business hugely".

His company benefited from Russia consumers buying ahead of inflation at the turn of last year and with Russian consumers preferring to stay at home rather than holiday abroad.

> We had a good final quarter 2014, a fantastic first quarter 2015, a very good second quarter 2015 but in revenue terms a disappointing third quarter 2015.

His 2015 results will beat 2014 handsomely thanks to the powerful first half of the year but a super year has been eroded by a softer Q3 and doubts about Q4: "The market may dry up if disposable income and wages stay under severe pressure".

To achieve these results, he and his team spent more time on consumer research, looking at categories and also taking "a robust approach to creating value and looking at being very competitive.

This sentiment fits well with our remarks about affordable innovation and finding more price points.

> We are providing more value on price and promotions but we are also offering more: for example we offer free installation of bathroom and kitchen furniture/facilities. Anything to lock the customer in more.

As we noted above, this company too has immense problems benchmarking the business today and in Q1 of 2016 compared with 12 months before. This company also engaged in 13 different scenarios of the 2016 budget.

> We looked at oil at $120 per barrel (yes, please!) and oil at $20 per barrel. But our central scenario Danny is very close to yours: oil hovering around $46-54 and the rouble averaging about 5% less than in 2015 with small possibility of upside.

Regarding comparisons with last year, his company prefers to benchmark to January 2014. The MD though is thoughtful about the year ahead and especially the first half of 2016:

I don't see any favours coming our way in the next 6-7 months and we will have to hunker down.

As with many other companies, volumes have not been strong at all and so steady price increases have kept revenues and profits up. The company has protected profits with standard procedures:

- Managing sourcing and getting as local as possible or negotiating prices better
- Looking at reducing store/rental cost and related overheads with some success
- Being tighter in tender processes
- Looking at processes and procedures in the supply chain and our own deliveries
- Managing salaries reasonably well and of course at below inflation levels.

The good news is that regional European headquarters are appreciative of the achievements. This company is also not seeing much exciting growth in the whole of Europe perhaps with some exceptions in the CEE region. So overall, Russia doesn't look quite so terrible.

Other European markets are flat and boring and this applies to many other companies.

> Our company is still committed longer-term to this market and we will open 12 more new stores in the next 24 months and we are often one of the "anchor tenants". The pipeline may decelerate after that but this is due more to natural business trends.

Comments from a consumer goods executive dinner in Moscow (3 Dec 2015)

Last week I co-hosted a working dinner with 15 managing directors from the major consumer goods companies operating in Russia and here is a synopsis of their comments. As usual, and as a professional courtesy no names or companies are revealed.

The MD of a major US food investor

The MD of a major US food investor echoed the words of several senior managers when he said: "It's been a good year" and he went further:

> If you had offered me this position in January of this year, I would have bitten your hand off.

He did also comment that while some of the brands were coming under pressure due to the price increases on them, more affordable product were doing well in their portfolio and this is consistent trend in the Russian market. But there was more positive news:

> Our categories are up and we're very grateful for that and we're also up in volume because we have captured market share.

Another important theme reported was that the traditional trade (kiosks) is continuing to shrink rapidly and this is changing the whole retail structure.

> The big Russian retail boys are getting bigger and retail management takes up more time for the western MDs.

This point underlines how, while the Russian consumer is becoming more “normal and western” in behaviour, so too the retail outlook is experiencing “normalisation” which of course doesn’t entirely benefit western FMCGs who gained more profitability from the traditional trade.

This MD was, like so many others, shocked at the continued resilience of the Russian consumer, but like others, is very concerned about the moment when the Russian consumer “stops”!
The big rhetorical and practical question is:

> How can you keep profits reasonable if you can’t keep raising prices?

This is the biggest potential threat to the consumer product business outlook for 2016-17.

The MD of a major US FMCG company

This company with sales well over $1bn in Russia has also “had a very good year”. The MD notes that having investing heavily for 22 years in brands has paid off. The manager notes a theme repeated by others that:

> Consumers are sticking to brands they know and respect and trust.

This company has also spent much more time and money getting to know the consumer and focussing on consumer segments. A big point for this MD is that “finally the expectations from headquarters have gone down”.

The crisis has actually helped us to catch our breath and we are no longer automatically excepted to increase sales and profits by 15-20% in FX.

Once again, this manager is amazed at the resilience of the Russian consumer: “Very few categories are down; they are not increasing any more by +20% but they are growing 4-6%. This manager went on to confirm that 2016 though would only be moderate with no big bounce back:

> November was already a tough fight and 2016 will be tougher than 2015. You won’t be able to get as many price increases as everyone is looking at everyone else.

This company has cut back on staff but with some natural attrition and getting rid of low performers. The manager’s advice is:

> Don’t panic. Adopt a strategy and stick with it.

He has also been very pleased with how the Russian staff have responded pro-actively to the crisis:

> They say: “We have a problem, let’s solve it”. I appreciate this mentality.

But the MD of another major invested FMCG firm could not confirm the rise in categories.

Category volumes are down and margins are down because you can’t pass on the full devaluation impact to consumers.

The MD of an apparel company

This MD spoke of how upcoming tournaments would help his business. The company is growing 20%+ in roubles and the lower-end products are expanding by 50-60%+ as more Russians turn to sport and look for value. But volumes are almost flat and so growth stems from price increases and the company expects double-digit rouble growth again in 2016.

The MD made some insightful remarks about price increase absorption:

> In Moscow the consumer is able to absorb 100% of our price increases which is of course impressive while in the regions consumers mange to absorb about 60-70% of the price rises.

The MD added a final summation though on what this all means for profits:

> <u>It will take 2-3 years until 2018 or 2019 until we can recoup our profit level of 2014.</u>

We have frequently noted that many executives report that while profitability has diminished notably in the last 18 months, it remains at comparatively decent levels compared with other developed and even other emerging markets. Russia is not the glory profit market of the past, but it’s not bad either for most companies.

The MD of a European luxury goods company

This company also “reports a good year in roubles up +18% combined with good cost control”. As with other companies, volumes are flat or slightly down but compensated by price increases.

This MD reports:

> We have not seen much of a switch to cheaper brands and of course this is remarkably reassuring but there will be continued pressure from the value sector. Yes, retail continues to discount heavily. One interesting feature is that we are now seeing a lot of Chinese customers so some of the “consumer tourism” seems to be coming to Moscow.

The MD of a tobacco company

“Yes, we too are doing well”.

This is partly due to brands being still very important and holding their ground but there are pressures. Mid and low segment are very price sensitive and frankly the middle segment is “wobbly”, according to this manager.

This MD also notes positive changes in the business environment:

> Business is becoming more normal in a positive way. The consumer is becoming more rational and cost conscious like other consumers in Europe and the west. Staff are now more reasonable about salary levels and frankly in the past some were over-graded and over-paid.

On the down side, this manager feels, like many others, that the trends taking place in retail are not beneficial for western suppliers: “The growth of the modern trade is certainly not a good thing for the FMCGs like us”.

And like all companies, this tobacco firm has managed costs well in the last 18 months. The manager told how, “In the past we may have spent costs merrily but now we are feeling the heat and so sweating the assets now!”

The MD of a chocolate company

He notes that consolidated brands are the ones which suffer less badly and this has been reported by several senior managers. However, he does comment that large-size packs are selling slower and these are “not flying off the shelves”.

This company imports much of its product but is trying to localise on packaging and on milk deliveries.

This MD also reports “business which is doing well” and again based on “same volumes as last year” but up in roubles thanks to price rises. In the run-up to Christmas he is seeing some drop in traffic and more demand for promotions.

The MD of a major US FMCG firm

The MD of this US FMCG company concurred with others about trends in distribution noting how distribution is being squeezed from all sides. The traditional sector is being pressurised and that hurts distribution because the big retailers play hard-ball with the supply chain and of course western companies are pressing for the best terms with their distributors. The advice of this manager is to make sure that you have the right partner who has the critical means to survive.

(This was confirmed by another MD who noted that: “The illiquidity crunch is painful for distributors and banks are not giving them much credit while we manufacturers also squeeze them. It can’t be fun! Some distributors are going bust).

He also agreed that much business is now “done on deals and promos” and the danger here is that this drives the categories down but does not build up a sustainable market share. The positive side of things is that: “You can still drive penetration in different segments: premium, middle and especially low”.

This manager also noted that non-food companies are able to drive prices upwards (at least to date) but food companies are having a tougher time of things. Regulatory uncertainty and bans on imports from EU, Ukraine and Turkey also complicated operational planning.

A few words about Ukraine and Kazakhstan

In recent meetings with executives managing these markets several comments support the analysis we have been providing in our quarterly reports on these markets.

Regarding Ukraine, most companies are still struggling badly and think that 2016 will also remain very difficult. As the MD of one major FMCG company noted last week:

> Ukraine is dead for the this year and next year.

However, about 10-15% of companies have survived the last 18 months reasonably well and some others now see the early start of a slow recovery:

> We have lost 50% of our business in the last two years, reports one MD of a western food company. But we are seeing some stabilisation in the market in recent weeks. The Ukrainian consumer is starting to buy again and I think Ukraine has reached bottom and just got passed it.

The MD of a luxury goods company also notes that: “Ukraine is recovering surprisingly well and even with distribution destroyed in parts of eastern Ukraine we are holding up in volume and units. This is a pleasant surprise”.

However, news coming out of Kazakhstan is generally very bad and probably due to expectations being changed quite rapidly: one year ago, Kazakhstan was the star CIS market and providing some compensation and good growth for a flagging Russia and collapsed Ukraine. But this has changed sharply with the oil price collapse, shrinking GDP growth and of course the devaluations.

One consumer product manager noted last week:

> Kazakhstan was such a sweet market for us and now it is collapsing with business being cancelled or postponed.

Other managers were quoted as stating:

> Kazakhstan is a nightmare
> Kazakhstan is slumping sharply and categories are falling

Kazakhstan is at a different stage of the cycle compared with Ukraine: Ukraine has started to recovery slowly while Kazakhstan is at the early stage of slumping.

Business results for 2015 and budget plans for 2016 by business sector

Organic sales growth in Roubles, 2015 and 2016

(second preliminary budget for 2016, % change)

	All companies		Consumer products		Pharma/health		B2B/industrial	
	2015	2016	2015	2016	2015	2016	2015	2016
20%+	13	16	19	12	9	16	0	0
10%+	21	31	30	46	21	37	6	6
5-10%	22	30	19	25	29	26	28	24
1-5%	17	8	20	5	26	10	11	24
Flat/zero	10	9	3	4	6	5	28	47
Minus 1-10%	8	5	3	8	3	5	12	0
Minus 10%+	8	1	6	0	6	0	17	0

In recent weeks more companies have upgraded their forecast for rouble sales growth in 2016: before the majority were clustered in high single digits while now more are clustered in low double digits.

FX sales outlook in 2015 – 2016, all companies

	2015	2016	
		1st draft	2nd draft
+10%	7	9	16
5-10%	3	11	19
1-5%	10	24	13
Flat/zero	13	27	22
Minus 1-10%	20	20	21
Minus 10+	45	10	9

FX sales outlook 2015 and 2016 by sectors

	2016		
	Consumer products	Pharma/ Health	B2B/ Industrials
10%	18	5	0
5-10%	13	31	11
1-5%	18	5	32
Flat/zero	19	15	37
Minus 1-10%	26	26	15
Minus 10%+	5	16	5

Where can you get business growth in Russia?

1. New product portfolio: can you diversify your offering to customers/clients?
2. Downward affordable innovation and aiming at more consumer segments: slice and dice your consumer segments more intensely
3. Upward innovation: can you still sell to the “high-rollers”?

4. Offering solutions: i.e. provide the equipment and technology around a single product; offer after-sales servicing; offer upgrading
5. Offer innovatory financing techniques: can you make it easier for people to buy from you?
6. Go to more Russian regions (no golden solution)
7. Go to more CIS markets (no golden solution now)
8. Are there rising local champions, regional operations which can perhaps be competitors but also customers?
9. Import-substitution: does this open business opportunities to western equipment suppliers selling to Russian customers who want to buy the equipment which will make them self-reliant?
10. Is Russia feasible as an export market? More than 90-95% of investors have focussed until recently on Russia as a growing domestic market. Now more are debating whether there is an export model to develop. Admittedly questions of trade/transport costs and requisite product quality will arise. But several pharmaceutical companies have recently invested in Russia with the aim of exporting to European, US and Asian markets.

A quick word on HR and talent in the Russian economy

Our Survey does a very accurate job of outlining what western companies are doing.

- Generally in western companies the average increase for average white collar workers is about 5-9% averaging round 7%.
- Companies do plan a minor tick up for 2016.
- In both years 2015-16 average salaries will be below inflation of 15% in 2015 and about 9% in 2016.
- ”Lower roles” in western companies tend if anything to get slightly lower increases at about 4-7% average but others also offer the white collar average.
- We know that all companies (western AND Russian) and the Russian government and authorities are offering about the same i.e. nominal wages increases of about 5-6% because this is what Rosstat reports.
- This means that all Russian wages are averaging about 5-7% which with inflation at 15% explains why real wages are down -10% (i.e. 15%inflation minus - 5% nominal wages = minus -10% real wages. The point is that western companies are matching very much what Russian ones are doing and this is an overall thing in the Russian economy.
- However, salaries for top talent are still above these “normal averages”; top talent is not obtaining quite the massive increases of the past; but western companies note that top talent is on the move and will change jobs for a premium of 20-30% whereas this was a smaller amount in the past.
- Finally, as you know, while companies are tending not to fire many people, they are demanding that workers (blue and white collar) work fewer hours, less days or take “reduced compensation packages”. This is a much bigger feature of the economy compared with previous years.

There is an interesting insight from one MD of a European engineering company:

> Companies have worked hard at building up capital and financial strength. They are tending not to spend this on capital equipment and still postponing projects. BUT they are willing to spend some of his money on talent and aim to build up their HR strength for now and the future.

The Economic Outlook

Macro-economic data 2009-2019

	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
GDP	-7.9	4.3	4.3	3.4	1.3	0.6	-3.8	0.2	1.7	2.0	2.7
Retail sales	-5.5	6.3	7.2	5.7	3.9	2.5	-8.8	1	2.4	2.8	2.9
Household spending	-7.6	5.5	6.8	7.9	4.7	1.8	-6.3	1.0	2.1	2.8	3.0
Real wages	-2.8	4.4	4.9	8.2	5.2	1.9	-8.9	0.0	2.8	3.0	3.3
Disposable income	1.0	3.7	2.8	3.7	3.3	2.1	-3.3	1.0	2.4	2.9	3.1
Inflation (year-end)	8.8	8.7	6.1	6.6	6.5	11.4	13.0	7.7	6.6	6.3	5.9
Unemployment rate	7.9	7.6	6.5	5.3	5.5	5.3	5.7	5.7	5.7	5.5	5.4
Gross fixed investment	-17.9	5.6	9.8	6.0	-0.3	-4.8	-8.8	-1.2	3.2	4.2	3.9
Industrial output	-10.8	8.3	4.7	2.6	0.3	1.1	-3.3	0.5	2.4	3.0	3.1
FX reserves ($bn) year-end	447	485	510	528	509	385	365	360	370	375	380
Rouble/$ (year-end)	30.3	30.4	32.1	30.4	32.9	58.0	64.8	68.0	71.0	75.0	78.0
Rouble/Euro (year-end)	43.4	40.0	41.5	40.1	45.1	72.0	71.8	72.5	75.2	78.7	84.8
Budget balance (% of GDP)	-6.3	-3.5	-0.2	0.0	-0.5	-0.5	-3.2	-1.9	-1.0	-0.5	-0.2
Current-account balance (% of GDP)	3.8	4.9	4.9	3.6	1.6	2.7	3.1	2.8	2.5	2.2	1.0

Consumer-related statistics: by year and monthly

	2012	2013	2014												2015									
	year	year	Jan	Feb	Mar	Apr	May	June	July	Aug	Sept	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May	June	July	Aug	Sep	Oct
Disposable income	3.7	3.3	-1.5	1.0	-6.8	1.9	5.8	-2.9	2.3	3.4	0.6	2.1	-4.7	-7.3	-0.8	-1.6	-1.8	-4.0	-6.4	3.5	-2.0	-4.9	-4.3	-5.6
Real wages	8.2	5.2	5.2	4.6	3.1	3.2	5.0	2.1	1.4	-1.2	1.5	0.3	0.5	-4.7	-8.0	-7.4	-10.6	-13.2	-7.3	-7.2	-9.2	-9.8	-10.4	-10.9
Real retail sales	5.7	3.9	2.4	4.1	4.0	2.6	2.1	0.9	1.2	1.4	1.7	1.7	1.8	5.3	-4.4	-7.2	-8.7	-9.6	-9.2	-9.4	-9.1	-9.1	-10.4	-11.7
Unemployment	5.3	5.5	5.7	5.6	5.4	5.3	4.9	4.9	4.9	4.8	4.9	5.1	5.2	5.3	5.5	5.8	5.9	5.8	5.6	5.4	5.3	5.3	5.2	5.5
Industrial output	2.6	0.3	-0.2	2.1	1.4	2.4	2.8	0.4	1.5	0.0	2.8	2.9	-0.4	3.9	0.9	-1.6	-0.6	-4.5	-5.5	-4.8	-4.3	-4.3	-3.7	-3.6
Fixed investment	6.0	-0.1	-7.0	-3.5	-4.3	-2.7	-2.6	0.5	-2.0	-2.7	-2.8	-2.9	-4.8	-2.4	-6.3	-6.5	-5.3	-4.8	-7.6	-7.1	-6.8	-6.8	-5.6	-5.2
Consumer prices	6.6	6.5	6.1	6.2	6.9	7.3	7.6	7.8	7.5	7.7	8.0	8.3	9.1	11.4	15.0	16.7	16.9	16.4	15.8	15.3	15.8	15.8	15.7	15.6
Budget deficit (running)	0.0	-0.5	0.4	0.3	1.4	-0.4	-0.1	-0.1	-0.1	-0.2	-0.4	-0.5	-0.6	-0.6	-1.6	-1.8	-1.8	-2.1	-2.5	-2.3	-2.9	-3.1	-3.0	-3.0

Rouble more stable? Yes, but…..

We provide a brief economic update below but just an early word on the rouble. Executives are forecasting for a more stable oil price and rouble in 2016 than in 2015 and as a central scenario among several others, there is nothing extreme about this given the extreme volatility in 2015.

But just one note of warning: while the cosnensus suggest that oil will average $55-56 per barrel this year and act as a support for the rouble, we do think that further volatility can stem from the oil price and also from the global market reactions to small increases in US interest rates and we have seen some of this in the last week as the rouble declined from just below 69 to the dollar to 74 to the Euro. The US dollar looks like being strong for the next couple of years at least and all currencies, including the rouble, could still wobble against the dollar.

Our central forecast is for the rouble to average 69-74 to the euro in 2016 and at 63-68 to the US dollar with oil averaging $52 in 2016.

BUT we do feel that any likely shift from this scenario is likely to be a negative one due to oil trends and more rises in US interest rates in 2016.

There is one plus side and that could stem from improved political risk: with a western-Russian coalition in Syria and no further worsening with Turkey. We saw all too briefly in mid-November the oil price going down but the rouble staying strong thanks to the hope that relations between US and Russia were improving: political risk was getting better for two weeks!

As ever, I hope you have enjoyed this report and found it useful. If you have any questions or comments, do let me know at danielthorniley@dt-gbc.com and I wish you and your family and loved ones a restful Christmas and new year.

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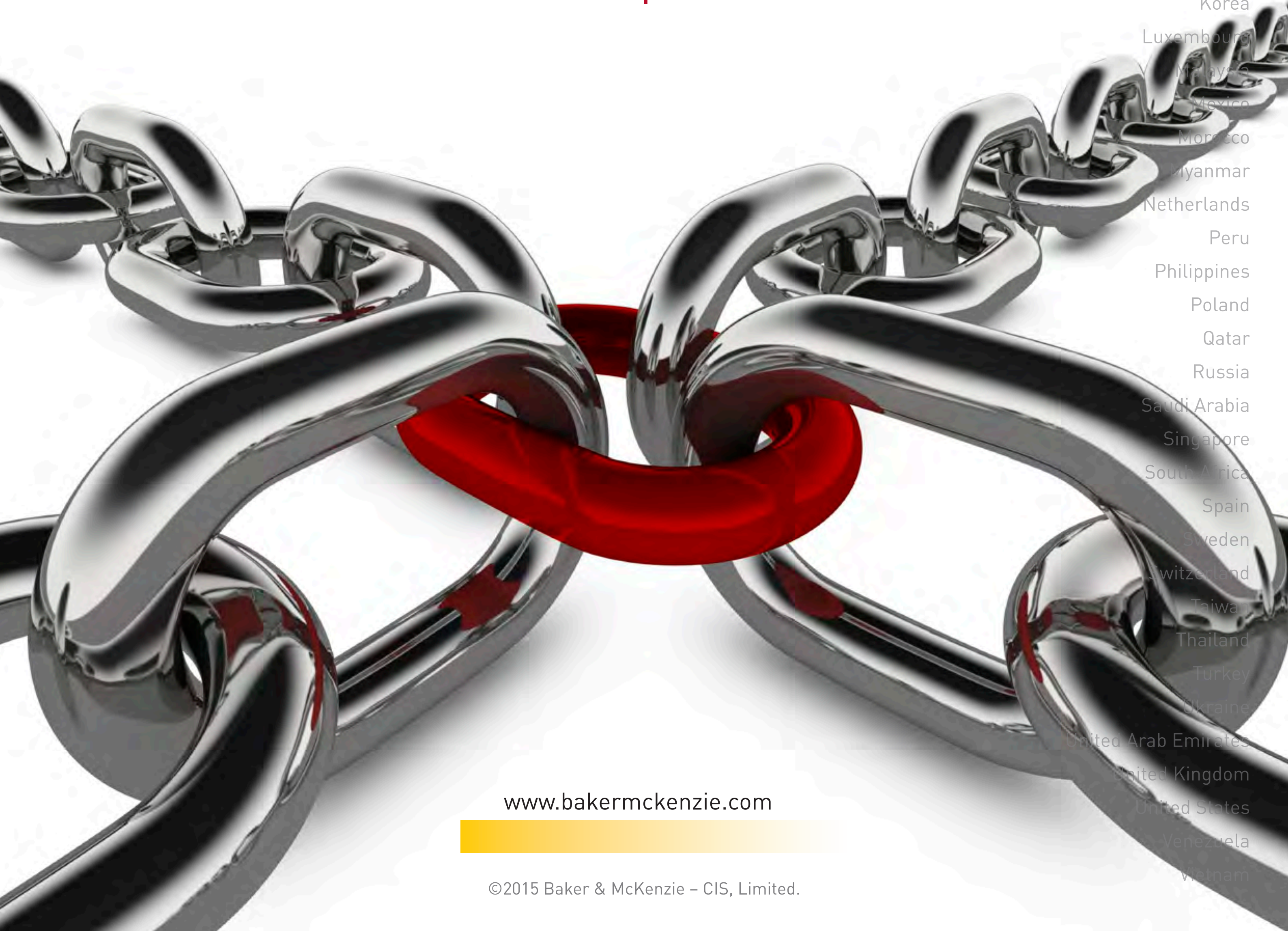

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