Bank of Russia

TALKING TRENDS
Economy and markets

Research and Forecasting Department Bulletin

May 2023

CONTENTS

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The views and recommendations expressed in the bulletin do not necessarily reflect the official position of the Bank of Russia.
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Executive summary

Monthly summary

- The Russian economy continued to grow between April and early May. This growth is driven by demand from the public sector, coupled with a continued rebound in consumer demand, and by investment demand of the private sector – spurred by unfolding structural changes. Against this background, dynamic expansion is reported in lending including retail lending. The ongoing effects of a number of temporary disinflationary factors in the food segment and some non-food products are holding back consumer prices. At the same time, there are stronger resource constraints related to production factors (labour, production capacity, and technology). This leads to mounting price pressures, including due to the invariably elevated inflation expectations of households and businesses.
  - High-frequency and survey data point to continued economic growth in the spring months. Growth in consumer demand accelerated as real wages and incomes went up, overall labour shortages intensified and the savings rate declined in Q1, in part on the back of a dynamic rise in retail lending.
  - Consumer prices continued to rise at a moderate pace in April–May but the growth of sustainable price components, tilted to the downside, sped up. Concurrently, the production sector reported an increasingly pronounced outrunning growth of prices for consumer goods. This suggests that inflationary pressures are likely to mount and necessitate an increase in the key rate to deliver on the inflation target of close to 4% in 2024.
  - With muted growth in consumer prices and the Ministry of Finance having resumed the placement of floaters (OFZs with variable coupons), OFZ yields stabilised along the entire curve and chiefly on the long end. Having said this, concerns over a persistently high budget deficit and sizeable borrowings in the medium term remain the key factors behind the significant positive spread between long-term and short-term OFZ yields.

In focus: Is supply in the car market set to keep pace with recovering demand?

- Car market is gradually rebounding after the 2022 challenges, but car output and sales are still far below previous years' levels.
- Indirect evidence suggests that demand is recovering in line with the pace of economic growth, but supply expansion is falling somewhat behind.
- Subdued new car sales and a rise in used car imports result in further car fleet aging. The need to rejuvenate the car fleet may give more impetus to demand for new cars in the medium term.
- The response of supply to these medium-term trends will to a great extent depend on regulatory and economic measures, regarding, in particular, a tax regime, production localisation requirements, creation of conditions for investment, and so on.

1. Inflation

After hitting a low of 2.3% in April, annual inflation will, starting May, be rising until the end of the year even if consumer prices continue to climb at the current moderate pace. This trend will reflect gradual exit from inflation calculation of the low numbers of last year, when prices were declining or remained stable after a surge in the spring.

The current rate of price rises stays at about 4% in annualised terms. Price growth structure is, however, changing: rises in the prices of goods and services showing high volatility are slowing, while price rise acceleration is registered in goods and services known for a steadier and less volatile price growth. This is due to, among other things, gradual petering out of a disinflationary effect from last year's abundant harvest (in the food segment) and ruble strength in the middle of last year, which helped purchase durable consumer goods at low prices in ruble terms.

As consumer demand grows and the ruble weakens, pro-inflationary risks are increasing, which may prompt an acceleration in the current pace of consumer price rises and annual inflation. Should this development materialise, a tighter monetary policy may be required for the inflation target to be secured in 2024. This would call for factoring in long time lags, with which monetary policy decisions translate into the pace of inflation. This means that nominal interest rate increases would have to outpace price rise acceleration and its impact on an upturn in inflation expectations.

At the same time, a non-oil and gas budget deficit decline from the current level to the number approved in the budget law for this and subsequent years (i.e., a return to the fiscal rule parameters), should help restrain aggregate demand in the second half of 2023 and onwards, thus providing a disinflationary factor, reducing the need for tightening monetary policy.

1.1. Inflationary pressure gradually mounting

- Consumer price rises accelerated to 3.8% MoM SAAR in April, with annual inflation slowing to 2.3%. The pace of month-on-month price growth increased in the food and non-food segments, remaining, however, tempered. Services prices, meanwhile, continued to climb at a fast pace.
- The median and mean of the modified core inflation estimates remain notably below 4% in annualised terms. Ruble weakening has so far only made itself felt in a small number of categories.
- Survey-based and real-time indicators suggest growing demand and respondents' greater willingness to make major purchases as their financial situations improve. Against this background, an increasingly large number of businesses find it possible to hike prices. Coupled with the deferred impact of ruble weakening, this may boost price rises in the coming months.

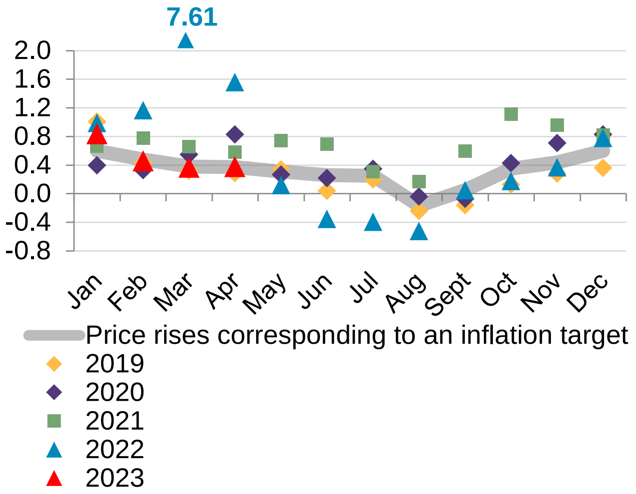
Annual inflation slowed to 2.3% in April from 3.5% in March (Table 1, Figure 1). The fast pace of price rises in the spring of 2022 has completed its exit from the calculation base. The annual inflation estimate was close to 2.3% as of 22 May, but annual inflation numbers are expected to gradually rise going forward if week-on-week price rises continue at the current rate.

Table 1. Inflation and its components

	Apr. 2021	Apr. 2022	Feb. 2023	Mar. 2023	Apr. 2023
% YoY					
All goods and services	**5.5**	**17.8**	**11.0**	**3.5**	**2.3**
Core inflation	**5.5**	**20.4**	**12.7**	**3.7**	**2.0**
Food	6.6	20.5	9.3	2.6	0.0
Non-food goods	6.2	20.2	11.2	0.1	-0.3
Services	3.3	10.9	13.0	9.7	9.4
% MoM SAAR					
All goods and services	**6.6**	**19.6**	**3.4**	**3.5**	**3.8**
Core inflation	**6.0**	**25.5**	**2.1**	**2.6**	**2.7**
Food	6.8	36.9	2.4	-0.2	1.1
– net of fruit and vegetables	**8.9**	**49.3**	**-0.5**	**1.0**	**1.0**
Non-food goods	8.4	6.7	-0.9	1.3	1.9
– net of refined petroleum products and tobacco	**7.8**	**8.2**	**-1.3**	**1.0**	**1.7**
Services	3.8	14.9	10.9	11.5	9.9
– Net of housing and communal services	**3.1**	**21.5**	**14.4**	**15.9**	**12.6**

Sources: Rosstat, R&F Department estimates.

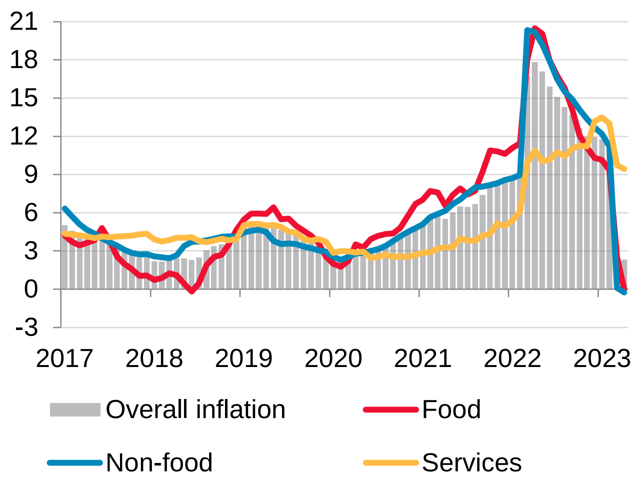
Figure 1. Price rises corresponding to an inflation rate of 4%, % MoM



Sources: Rosstat, R&F Department estimates.

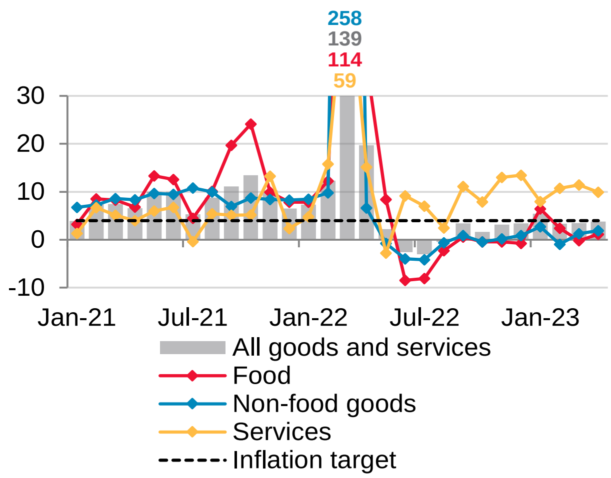
Seasonally adjusted consumer price growth accelerated to 3.8% MoM SAAR in April from 3.5% MoM SAAR in March (Figure 3). Price movements in individual segments remained similar to what we saw in previous months. The pace of price rises in food and non-food goods edged up but remained far below 4% in annualised terms. By contrast, price hikes slowed in services, remaining, however, fast.

Figure 2. Inflation and its components, % YoY



Sources: Rosstat.

Figure 3. Seasonally adjusted price growth, % MoM SAAR

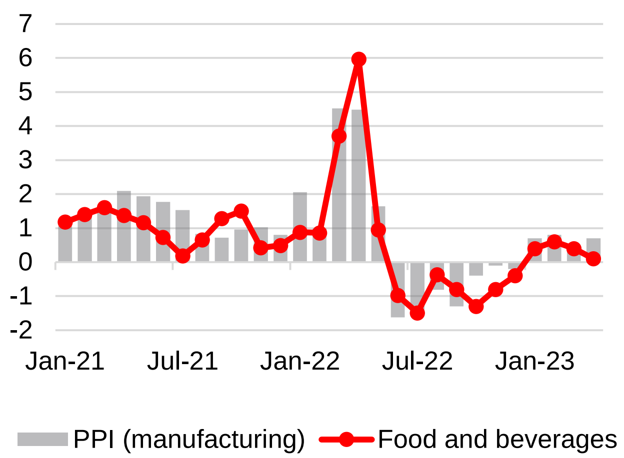


Sources: Rosstat, R&F Department estimates.

The prices of food went up at an average pace of 1.1% MoM SAAR after their marginal drop in March, posted mainly in fruit and vegetables, whose price movements returned to their seasonal trajectory in April and dropped below it in the first half of May, offsetting a substantial rise at the start of the year (Figure 8).

Net of fruit and vegetables, the pace of food price rises remained unchanged from March, up 1.0% MoM SAAR. Meat product prices increased for the first time since May 2022 (up 0.3% after a decline of 0.3% MoM SA in March) in the wake of a rise in wholesale prices, which market participants put down to a rise in costs amid ruble weakening. Producer price hikes in the manufacture of food products has been seen since the start of the year, increasingly setting the stage for consumer food price growth (Figure 4). In addition, April saw dollar-denominated world food prices start rising for the first time since early 2022 (Figure 5), exceeding the level of export price parity and food import prices.

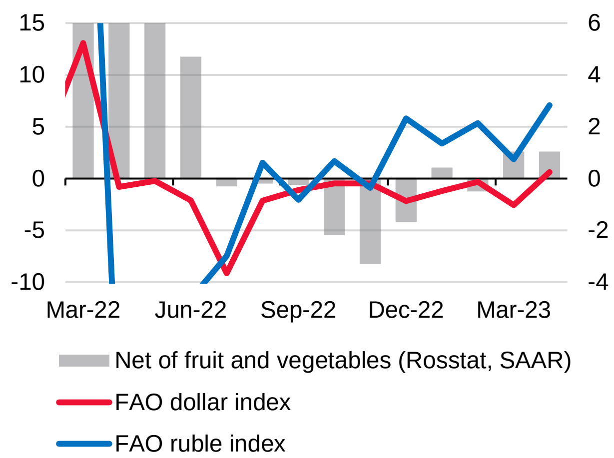
Figure 4. Producer price index of manufacturing industries *, MoM SA



** Net of manufacture of basic metals and manufacture of coke and refined petroleum products*

Sources: Rosstat, R&F Department estimates.

Figure 5. World and domestic food prices (in annualised terms), % MoM SA



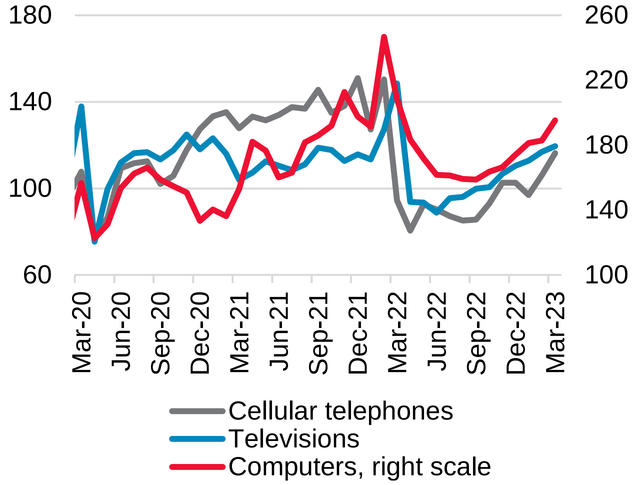
Sources: FAO, Rosstat, R&F Department estimates.

The non-food segment saw price rises accelerate to 1.9% from 1.3% MoM SAAR, with passenger car prices providing the largest contribution. Plans for hiking the prices on the back of ruble weakening were reported by both foreign and domestic car dealerships. Car price hikes continued in May, while the producers of domestic brands do not expect car prices to rise above the inflation level for the year. The key restraining effect on price rises comes from electronic and other durable goods. However, continued sales growth (Figure 6, Figure 7), ruble weakening and gradual depletion of stocks built up when the ruble was stronger, may gradually accelerate price hikes in these categories in the months to come.

Price increases in the services segment slowed to 9.9% MoM SAAR in April from 11.5% MoM SAAR in March, driven chiefly by tourist services. Net of the most volatile categories, such as tourism and air transport, services price growth, by contrast, accelerated to 7.7% MoM SAAR from 4.7% MoM SAAR in March. Personal services price growth accelerated to 8.2%

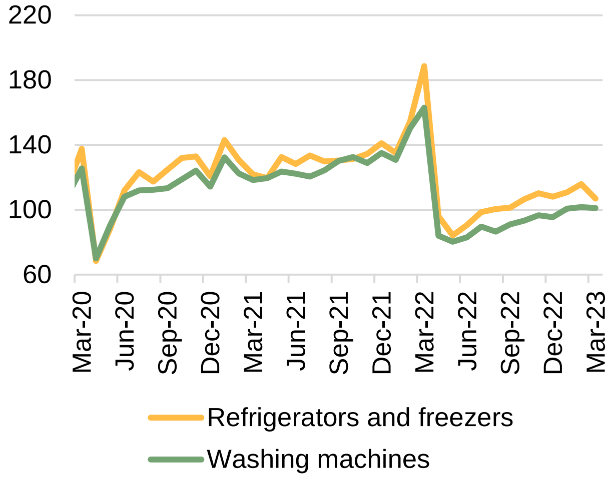
MoM SAAR – the highest level since May last year. This may indicate that the effect of demand-side pro-inflationary factors is gaining strength.

Figure 6. Sales of some non-food goods, SA, December 2019 = 100



Sources: Rosstat, R&F Department estimates.

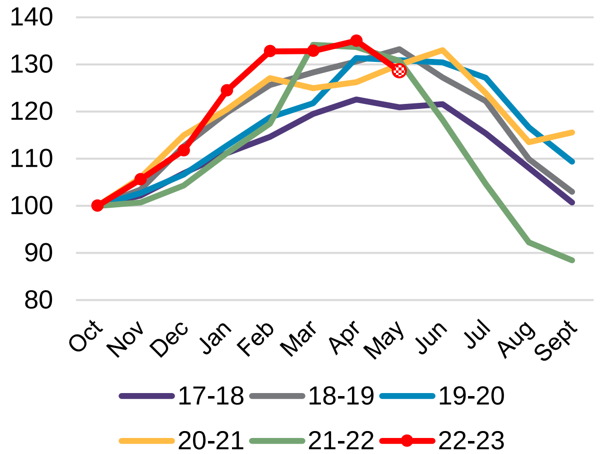
Figure 7. Sales of some non-food goods, SA December 2019 = 100



Sources: Rosstat, R&F Department estimates.

The elevated pace of services price hikes results from a catch-up rise in relative prices after their steep drop during the pandemic (Figure 9). This was fuelled by, among other things, a sustainable rise in services demand. The recovery to the pre-coronavirus levels has been practically completed, while further price movements in this segment will come as an important indicator of enduring inflationary pressure.

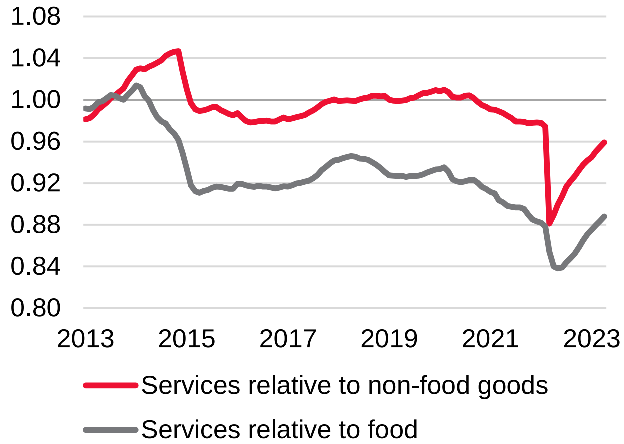
Figure 8. Fruit and vegetable price rises relative to October by year, % NSA



Note. The May number is an initial estimate based on weekly data.

Sources: Rosstat, R&F Department estimates.

Figure 9. Index of services prices relative to goods prices



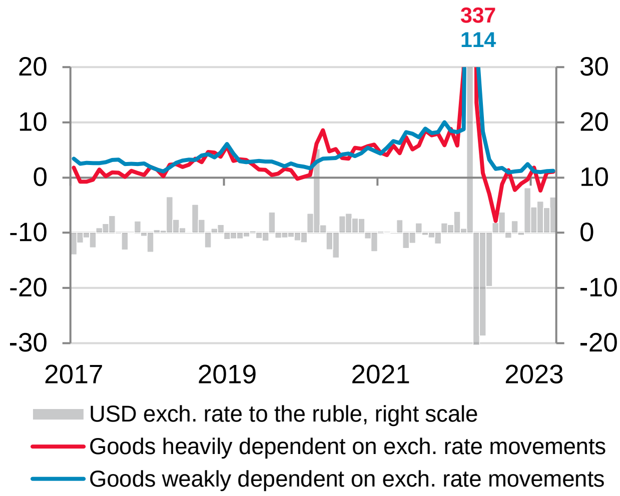
Sources: Rosstat, R&F Department estimates.

Also, the recovery of relative services prices, largely reflecting income recovery, suggests the absence of sustainable shifts between services and goods in the household consumption structure. That said, such shifts are certainly found within individual categories (food, non-food goods, and services), arising from the development of new operation forms and formats and consumer habits in the Covid and post-Covid periods (remote and hybrid work mode, provision of services in the digital mode) and from sanction-related restrictions and other shocks.

In particular, we note that the prices of consumer goods supplied under parallel import schemes have generally risen relative to early 2022, while the prices of goods supplied as part of alternative import operations (analogues and new brands purchased from other countries) have declined (per unit of the product range). With the prices and quantity of consumer goods imports goods recovering, this has enabled the household sector to maintain previous proportions of goods and services consumption.

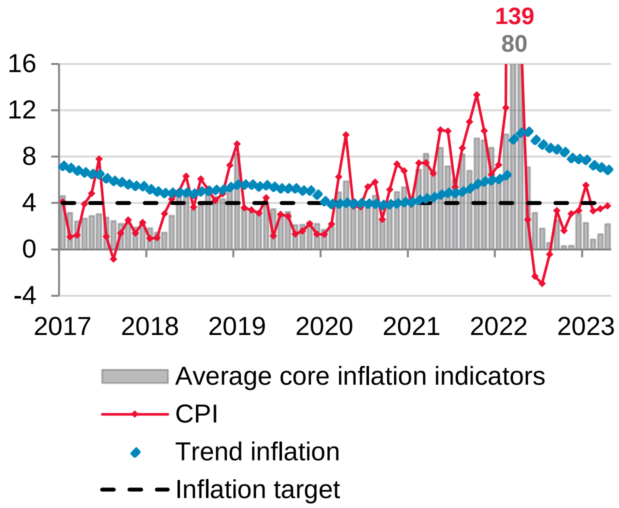
The indicators of stable price movements (the distribution median and the mean of modified core inflation indicators) so far remain notably below the 4% level (Figure 11). This is largely owed to the long-lasting effect of disinflationary supply-side factors in the goods segment. That said, the pass-through of ruble weakening to consumer prices (Figure 10) is now only found in isolated categories and is not general in nature. The pass-through may take longer than usual, given the stocks of imported goods and inventories of raw materials and components built-up/purchased in the period of ruble strength last year. Overall, the pro-inflationary effect of consumer activity recovery amid the continuing supply-side constraints may outweigh the impact of gradually attenuating disinflationary factors in the coming months.

Figure 10. USD exchange rate to the ruble (%) and median CPI (%, MoM SAAR)



Sources: Bank of Russia, Rosstat, R&F Department estimates.

Figure11. Modified core inflation indicators* (% in annual terms) and trend inflation estimate (%, YoY)



** The indicators are computed using the method of excluding the most volatile components and the truncation method.*

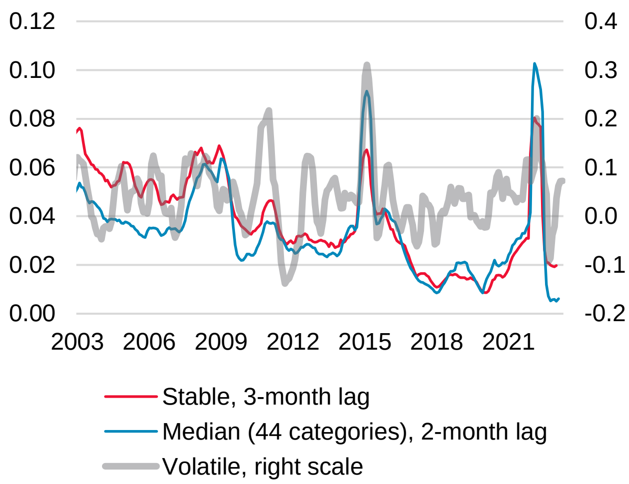
Sources: Rosstat, R&F Department estimates.

The mounting of enduring inflationary pressure has in the last 20 years been often preceded by a price rise acceleration in the most volatile components with a lag of around one quarter (Figure 12). Therefore, the intensification of the most volatile components' price rises in recent months may portend a subsequent acceleration of price rises in the least volatile CPI components.

This relationship may look paradoxical: goods and services known for the most volatile prices are, as a rule, the most affected by transient one-off factors. They often introduce noise to sustainable price trends and are thus often excluded from the calculation of variants of the core price index. But there is in fact no inconsistency here. Indeed, the periods of a rise in volatile prices may be followed by periods of their decline. But it is the elevated pace of a rise in the most volatile CPI components that the periods of a more enduring inflation surge often start with. This is likely owed to the high flexibility of these goods' prices.

How does then a rise in non-volatile prices usher in an increase in volatile prices? The most likely and obvious mechanism is the pass-through of the exchange rate and surges in demand to prices. Goods and services with volatile prices, such as fresh fruit and vegetables, as well as tourist services, usually rapidly respond to this because of the short turnover times and dynamic pricing (depending on demand). Compared with them, low-volatile prices (for example, those of non-food goods) are usually more inert and revised less frequently. But price impulses also make their way to them – only with a lag. Inflation expectations may also play a certain role: changing in response to fluctuations in volatile goods and services prices, they may change demand for and prices of low-volatile goods.

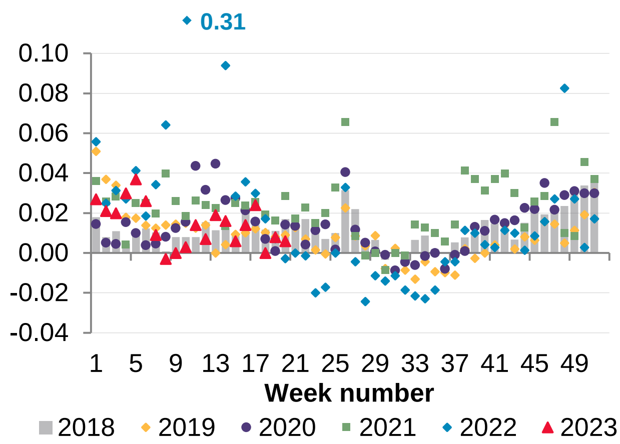
Figure 12. Natural logarithm of a price rise in the most volatile and stable consumer basket categories accumulated over 6 months, SA



Sources: Rosstat, R&F Department estimates.

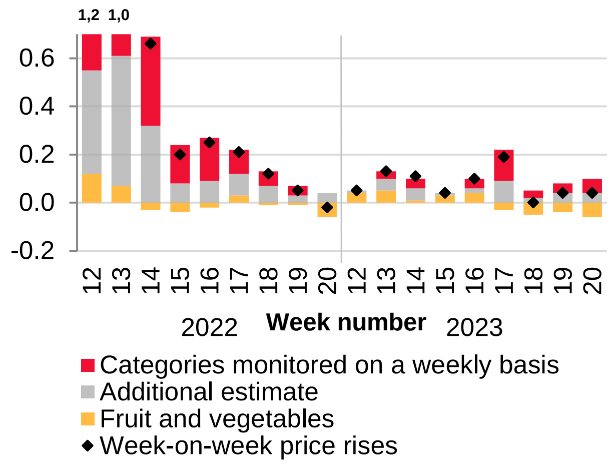
Week-on-week price growth was subdued over the first three weeks in May after an acceleration in late April (Figure 13). The key disinflationary effect came from a drop in fruit and vegetable prices (Figure 14). Meanwhile, the distribution median and the pace of price rises in the basket monitored on a weekly basis (net of fruit and vegetables and regulated services) increased somewhat relative to April and were estimated at 3.5% and 5.5%, respectively, in annualised terms as of 22 May. The share and weight of goods whose prices rise at an elevated pace also stood above the April level. This was due mainly to a price rise acceleration in some “heavy” categories with a large weight in the consumer basket: meat products, smartphones, cars, and fuel.

Figure 13. Average daily price growth, %



Sources: Rosstat, R&F Department estimates.

Figure 14. Decomposition of week-on-week price rises, pp



Sources: Rosstat, R&F Department estimates.

2. Economic activity

The Russian economy remains on a growth path, fuelled by rising demand from the government and households and by investment.

The rebound of consumer demand has become a notable trend, which has been gaining strength in recent months. It is driven by rising labour demand amid the shortage of supply, accelerating real wage growth, a consumer confidence improvement and diminishing anxiety, as well as savings put aside in previous quarters, which saw a high savings ratio.

Private sector investment is also on the rise, although this so far only appears from indirect and survey-based data. Thus, the elevated level of uncertainty has not resulted in a private investment drop this year. Why? Most probably because companies, just as they did in the course of adaptation to the coronavirus crisis, have reformatted their investment programmes to meet shorter-term needs.[1] This may be owed to the establishment of repair facilities, as well as capacities to produce critically important spare parts and components (where possible). At the same time, part of this investment may be associated with the implementation of government-subsidised import substitution programmes. This is, in particular, indicated by a rise in long-term lending at lower-than-market interest rates.

It should also be noted that a rise in the share of fixed investment in GDP relative to 2021 can be expected in medium term as the rate of capital depreciation increases along with a

[1] See N. Karlova, E. Puzanova. Change in business processes after the Covid-19 pandemic: business survey data (2022).

decline in its technological efficiency. Therefore, gross fixed capital formation and fixed investment expansion will likely outpace the growth of other domestic demand components in the structure of GDP.

Scaling up of production under government purchasing programmes as part of aggregate demand in the economy also boosts GDP. That said, this only has an indirect and lagged effect on total supply of goods and services produced for private consumption and investment – through the creation of new opportunities for businesses, arising, for example, from the completion of government infrastructure projects.

The development of the above trends is toughening competition for resources – labour, production, and financial. This is already indicated by an all-time low of unemployment, with employment headcount rising, record-high or close to it production capacity utilisation in many industries, and the fast pace of corporate lending expansion. This means that domestic demand growth outpaces a rise in domestic supply. Should this gap fail to be closed through import expansion, the economy will enter an overheating phase, where a further rise in demand will be met much more by prices than by output.

An important role in increased demand is played by a strong positive fiscal impulse resulting from countercyclical fiscal policy implementation last year. The return of the budget to its sustainable medium-term parameters governed by the fiscal rule would enable the developing overhang of demand to be at least partially contained.

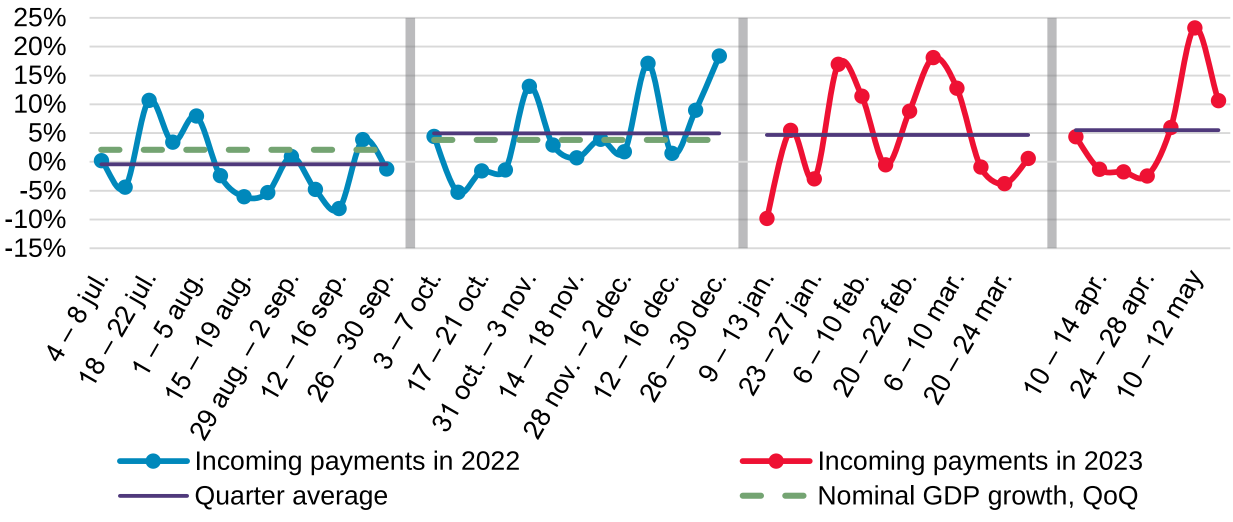
2.1. Domestic demand growing confidently

- According to an R&F Department estimate based on preliminary Rosstat data, GDP growth came in at 0.6% [2] QoQ SA for Q1. Real-time data suggests a similar rate of GDP growth in Q2 (Figure 15). Output expansion is still constrained by external demand, while on the side of domestic demand, the rebound of consumer activity goes along with continued elevated pace of investment coupled with fiscal stimulus.
- Activity expansion accelerated at the end of Q1 (Figure 16), driven chiefly by the recovery of wholesale sales,[3] which, judging by shipment numbers from Russian Rails, continued into April. An important contribution to activity recovery in recent quarters comes from manufacturing (Figure 18).
- While output numbers are mixed and vary across sub-industries, all of the three groups (consumer, intermediate, and investment goods industries) have expanded output since the start of the year on the aggregated level (Figure 19). Towards the end of Q1, consumer demand became the key output growth driver, whereas the growth of investment goods industries slowed after a two-month period of buoyant growth.

[2] Seasonally adjusted estimates were constructed by the R&F Department based on a preliminary Rosstat estimate of Q1 GDP, registering a 1.9% decline YoY.
[3] Due to expansion in wholesale diesel sales.

- The start of active growth in the group of consumer goods industries was consistent with the recovery of household demand[4] (Figure 23), with real wage growth accelerating and (Figure 20) households gradually abandoning their savings mode (Figure 22). Indeed, based on a Rosstat estimate, the share of household income spent on the purchases of goods and services in Q1 rose above the pre-pandemic levels of 2017–2019 (Figure 24), while the savings ratio started to gradually decline after its dramatic rise in 2022 (Figure 25). Real-time indicators suggest that the trend towards a gradual diminishment of pro-savings sentiment was taking hold at the start of Q2.
- Survey-based April–May indicators[5] for both large companies and the SME segment (Figure 17) signal the continuation of activity expansion, positive business sentiment and upbeat expectations for future output. Further reason for optimism may be provided by an export orders increase in manufacturing posted for the first time in the past 15 months. At the same time, limited capabilities of output expansion amid elevated labour demand (Figure 21) and insufficient production capacities[6] encourage companies to ramp up investment. This is, in particular, borne out by a rise in long-term corporate lending. If supply fails to timely meet demand expansion, the economy may enter a phase of overheating.

Figure 15. Incoming payments growth[7] relative to the previous quarter average weighted by industries' shares in gross value added, seasonally adjusted, %



Sources: Bank of Russia, Monitoring of individual industries' financial flows.

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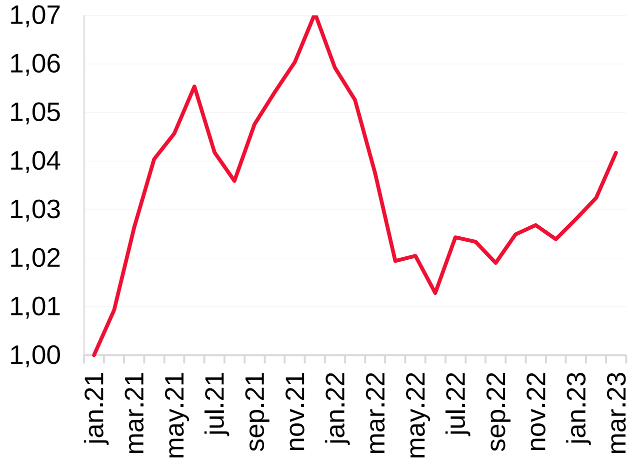
[4] Primarily for non-food goods.

[5] April's business climate indicators from the Bank of Russia and the Russian Industrialists and Entrepreneurs Union, as well as the industrial optimism index from the Institute for Economic Policy, posted growth, the PMI index declined but remained in positive territory. The Institute for Economic Policy index of industrial optimism for May hit the highest level over the past 15 months.

[6] Based on the April business survey from the Institute for Economic Policy, labour adequacy is at an all-time low, while a capacity shortage came close to the record-low levels of 2008.

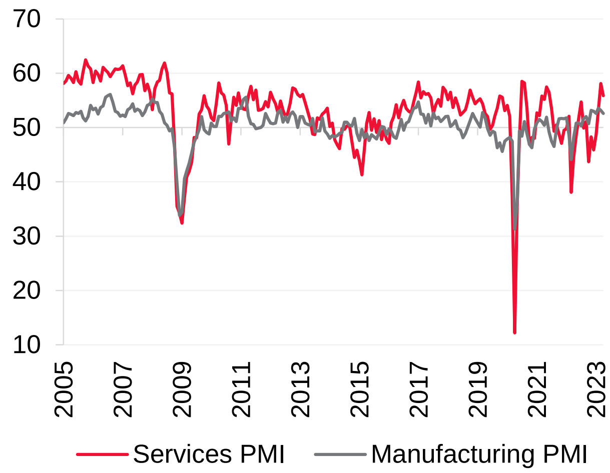
[7] Growth means a percentage change in the sought for value: $g = \frac{(x_1 - x_0)}{x_0} * 100$.

Figure 16. Output in core economic activities, jan.21 = 1



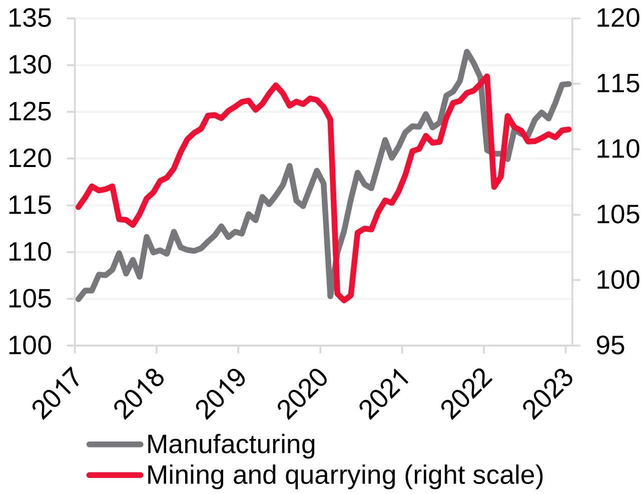
Sources: Rosstat, R&F Department estimates.

Figure 17. Russia's Manufacturing and Services PMI, points



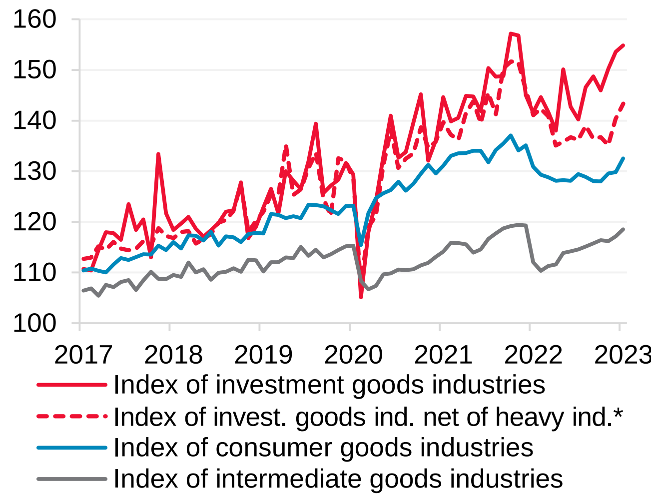
Source: S&P Global.

Figure 18. Mining and quarrying and manufacturing indices (2014 = 100)



Sources: Rosstat, R&F Department estimates.

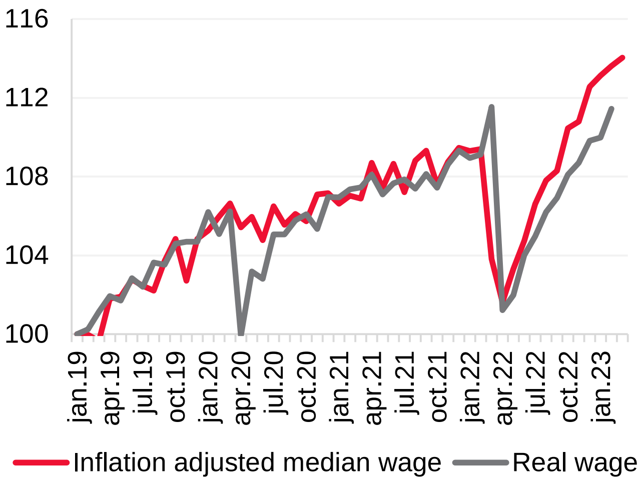
Figure 19. Output in groups of manufacturing industries, SA, 01.2016=100%



**The production of "finished metal products other than machinery and equipment" and "other vehicles and equipment" are excluded.*

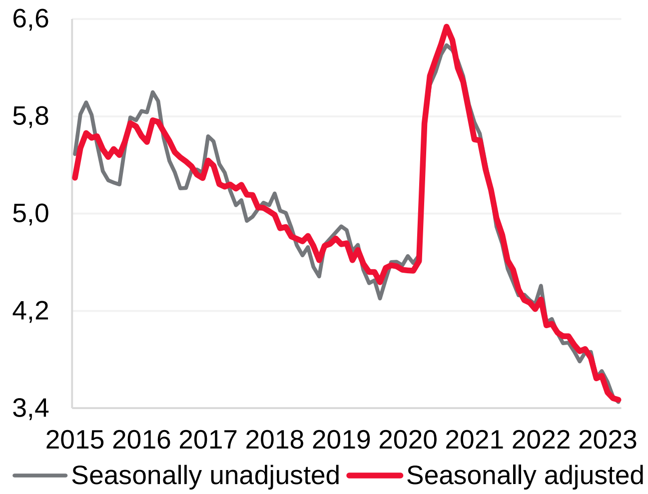
Sources: Rosstat, R&F Department estimates.

Figure 20. Wage Indices SA, jan.19 = 100



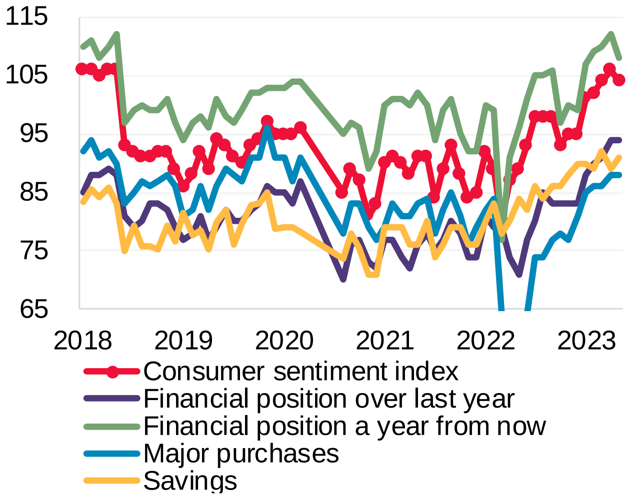
Sources: Rosstat, SberIndex, R&F Department estimates.

Figure 21. Unemployment rate, %



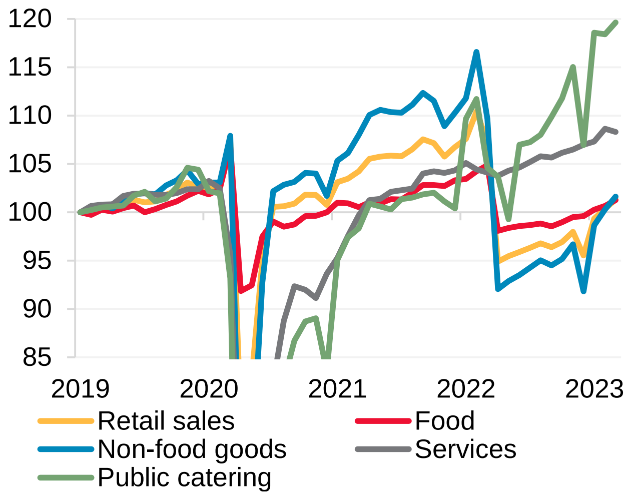
Sources: Rosstat, R&F Department estimates.

Figure 22. Consumer and financial sentiment indices, points



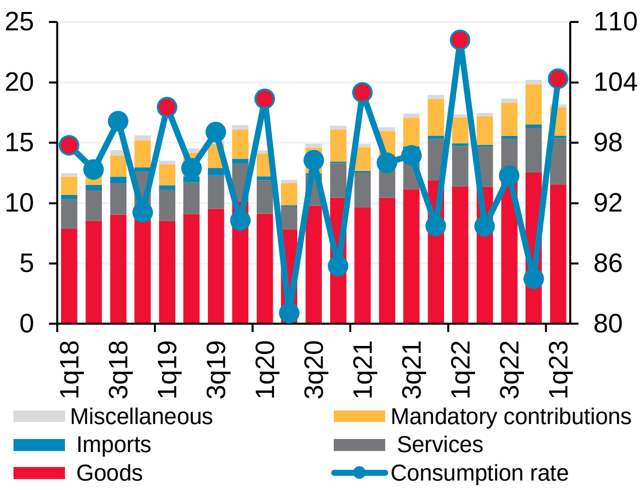
Source: inFOM.

Figure 23. Retail sales, sales in commercial and public food services, 1.2019=100%, SA



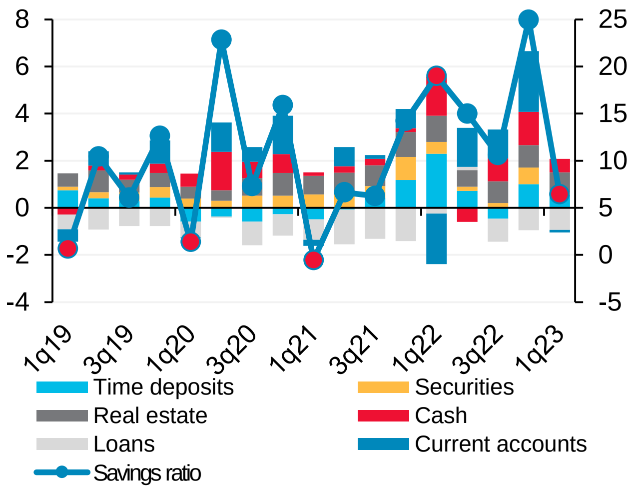
Sources: Bank of Russia, Rosstat, R&F Department estimates.

Figure 24. Key components of household spending (trillion rubles), and consumption rate (%, right scale)



Source: Rosstat.

Figure 25. Key components of household savings (trillion rubles) and savings ratio (%, right scale)

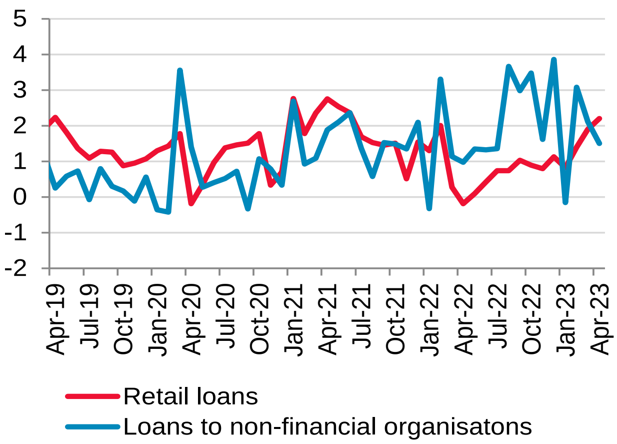


Source: Bank of Russia, Rosstat, R&F Department estimates.

2.2. Further retail lending acceleration

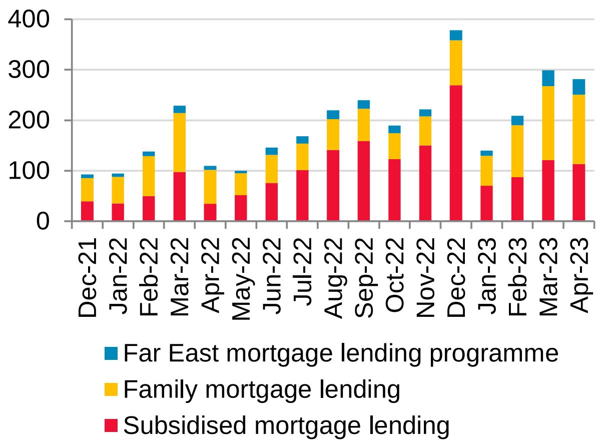
- Household ruble lending continues to expand in April, coming in at 2.2% MoM SA, up from 1.9% MoM SA[8] in March (Figure 26). As a month earlier, extensive portfolio growth was likely posted in all of the key segments. For example, the number of mortgage lending transactions increased (Figure 29), with a total of loans extended under subsidised lending programmes remaining significant (Figure 27). At the same time, this rise in activity may have been owed to the tightening of macroprudential policy as of May 1.
- The rebound of retail lending in, among other things, the unsecured consumer loan segment, is helped by banks' growing risk appetite amid household income growth and a rise in lending growth potential thanks to banks' strong profitability in previous months.
- Growth in ruble loans to non-financial organisations remains robust, despite a slowdown to 1.5% MoM SA from 2.1% MoM SA in March. In YoY terms, a dramatic slowdown was posted in the short-term loan segment, with long- and medium-term segments accelerating. Also, a number of companies are active in raising money through bond issuance.[9]
- Based on a preliminary estimate, annual growth in money supply M2 and broad money supply growth (unadjusted for foreign exchange revaluation) slowed in April. The key input to broad money supply[10] expansion in 2023 continues to be provided by lending growth. That said, acceleration in this monetary aggregate growth has, since the start of the year, been driven chiefly by a budget deficit increase and its financing through OFZ purchases by banks (Figure 30).
- The banking sector earned a total net profit of 224 billion rubles in April (1.1 trillion rubles since the start of the year), a dramatic increase on April 2021. This result was likely achieved through a rise in banks' net fees and commissions income and net interest income. The banking sector's robust profit growth will likely help buoyant lending expansion going forward.

Figure 1. Ruble loans portfolio growth, % MoM SA



Sources: Bank of Russia, R&F Department estimates

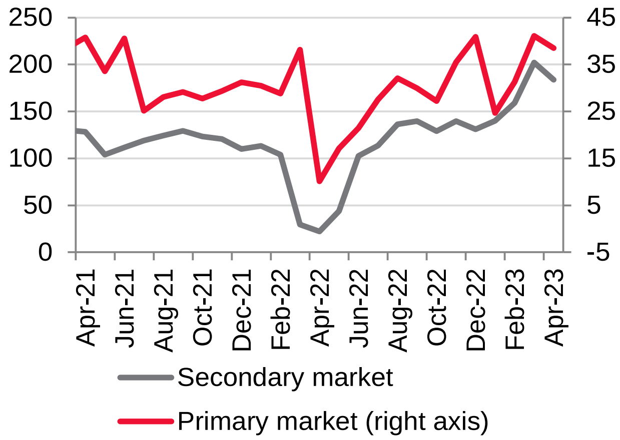
Figure 2. Loan issuance under subsidies mortgage loan programmes, billion rubles



Sources: DOM RF, R&F Department estimates.

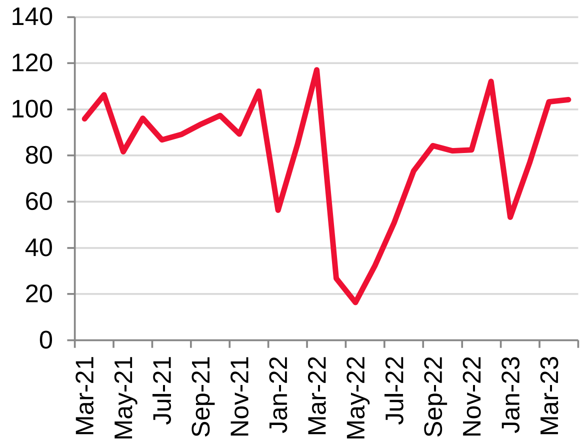
[8] According to an R&F Department estimate.
[9] This may be indicated by growth acceleration in the portfolio of other ruble debt liabilities.
[10] An estimate of April 1.

Figure 3. Mortgage loan applications, thousand



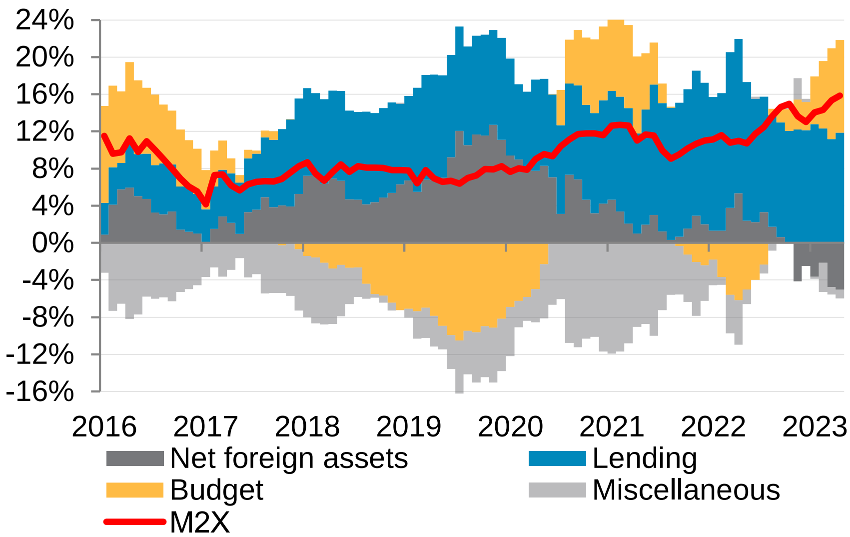
Sources: DomKlik, R&F Department estimates

Figure 29. Mortgage loan transactions, thousand



Sources: DomKlik, R&F Department estimates

Figure 4. Decomposition of broad money supply, % YoY



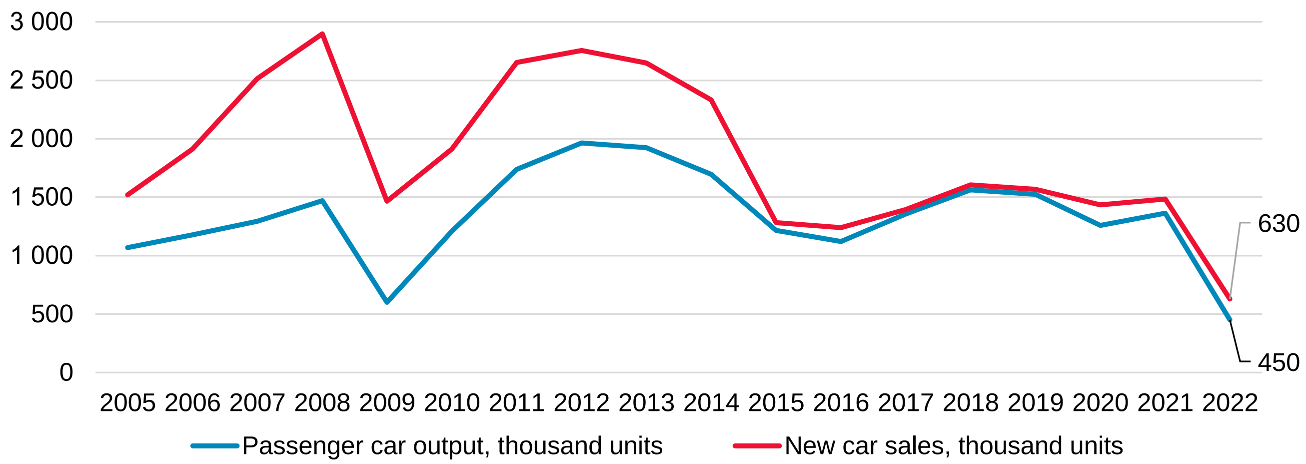
Sources: Bank of Russia, R&F Department estimates

In focus. Growing demand outstrips supply in car market

- Car market is gradually rebounding after the 2022 challenges, but car output and sales are still far below previous years' levels.
- Indirect evidence suggests that demand is recovering in line with the pace of economic growth, but supply expansion is falling somewhat behind.
- Subdued new car sales and a rise in used car imports result in further car fleet aging. The need to rejuvenate the car fleet may give more impetus to demand for new cars in the medium term.
- The response of supply to these medium-term trends will to a great extent depend on regulatory and economic measures, regarding, in particular, a tax regime, production localisation requirements, creation of conditions for investment, and so on.

Car output and sales have been volatile in the last two decades, being exposed to global and local economic and geopolitical factors bringing about substantial structural shifts (Figure 31). Among the segments of the Russian economy which were the most sensitive to the impact of sanctions in 2022 was the car market, which had not by then fully recovered from the coronavirus-related shocks of global supply chains. A contraction in deliveries caused a steep fall in domestic car output and imports, while rising uncertainty and soaring prices depressed demand.

Figure 31. Russian car market: new car output and sales (2005–2022), thousand units

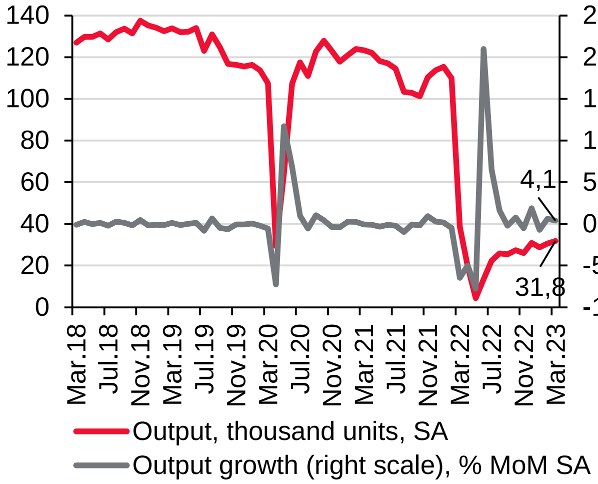


Sources: Rosstat, Unified Interagency Statistical System, OICA.

The car market is gradually recovering (Figure 32) after a fall in Q2 2022, but the car output is still three times lower than what we saw before this fall. It will take Russian car manufacturers more time to fully cope with the problem of replacing component suppliers. According to Rosstat data, car stocks are continuing to contract (Figure 33).

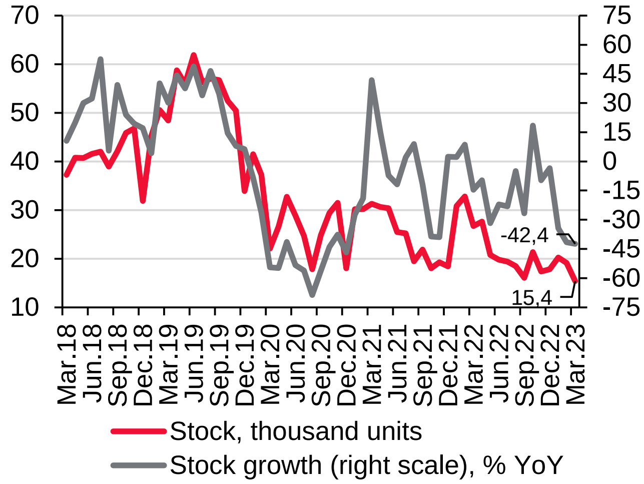
The financial position of key car market participants is reflected in financial flows of carmakers and car sales companies, i.e., firms in industries, such as manufacture of motor vehicles, trailers and semi-trailers (OKVED2 29) and wholesale and retail trade and repair of motor vehicles and motorcycles (OKVED2 45). Incoming financial flow contraction was in 2022 more pronounced in production (Figure 43) than in sales (Figure 45). The Q1 2023 financial flows in production bear out a gradual recovery trend, albeit still unsustainable. That said, a gain in outcoming financial payments in production may indirectly indicate a rise in costs due to the restructuring of supplier chains (Figure 44).

Figure 32. Passenger car output



Sources: Rosstat, R&F Department estimates.

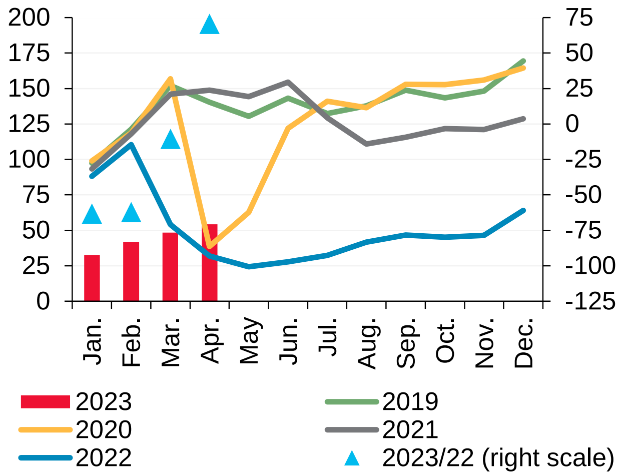
Figure 33. Passenger car stock



Sources: Rosstat, R&F Department estimates.

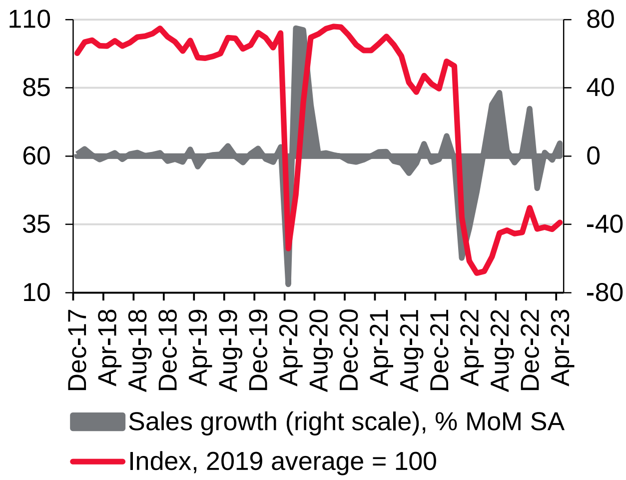
New car sales have also been slowly recovering this year (Figure 34, Figure 35), while their gap with numbers posted before the plunge in 2002 is slightly narrower than that in output. This indicates a faster rebound of new passenger car imports, notably, more intensive in physical terms than by value. This may evidence a contraction in the share of premium cars, with imports being reoriented towards new lower horse-power cars. This generally reflects a structural change in car imports: car brands from unfriendly countries accounted for just 6% of imports in Q1, while the share of Chinese car sales rose dramatically (Figure 36).

Figure 34. Sales of new passenger cars and light commercial vehicles, thousand units and % YoY



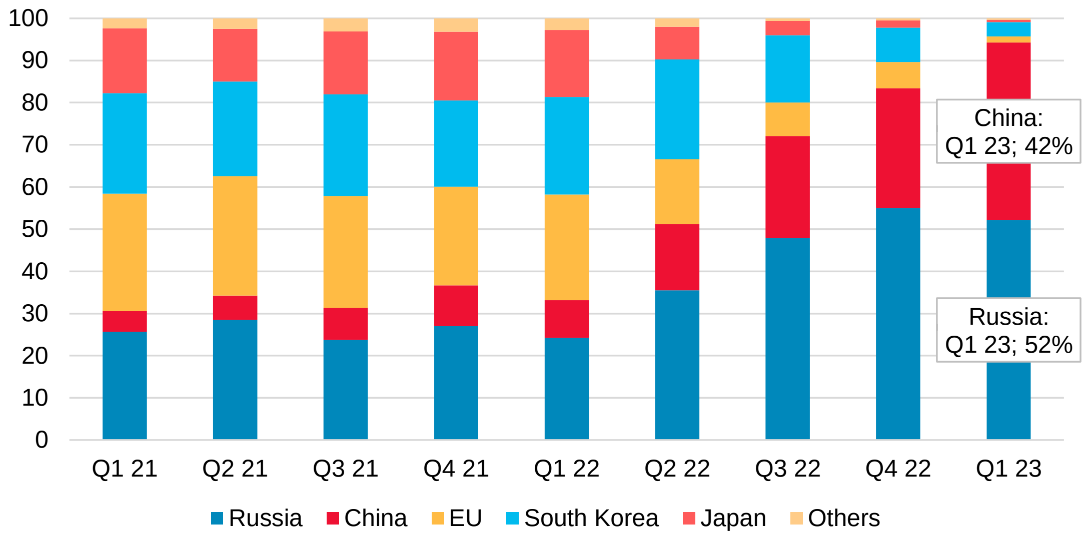
Sources: AEB, R&F Department estimates.

Figure 35. Level (index) and growth in sales of new passenger cars and light commercial vehicles



Sources: AEB, R&F Department estimates.

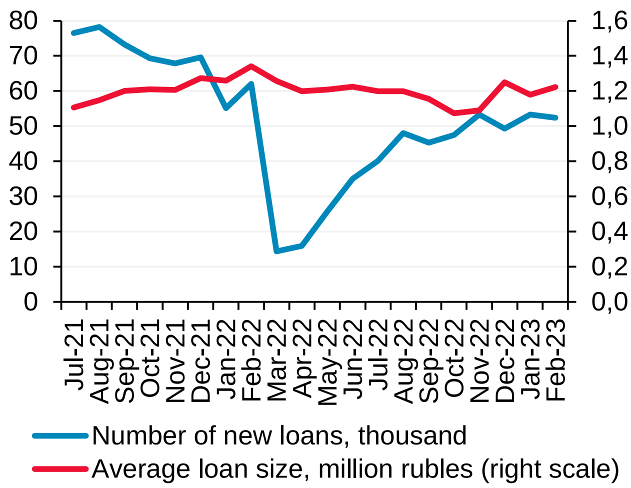
Figure 36. Share of countries in sales of new passenger car brands in Q1, %



Sources AEB, Autostat.

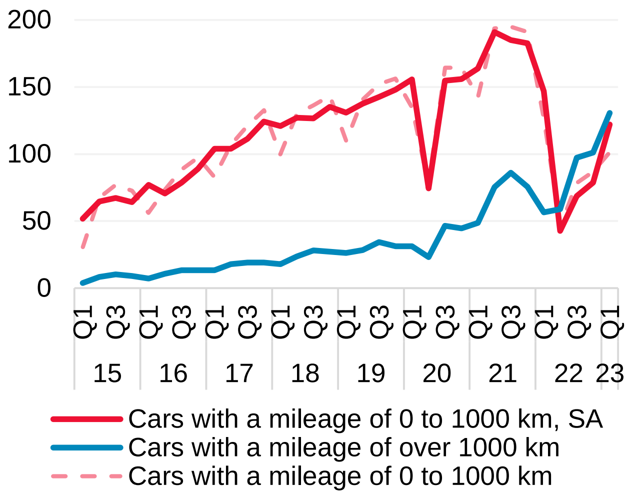
After a steep drop in the total number of new loans going towards car purchases in the period from March to August 2022, auto loans have partially recovered and stabilised in recent months but are still below the early 2022 level (Figure 37). That said, lending to finance used car purchases has sharply expanded, exceeding a total of loans going to the new car market (Figure 38), whereas in previous years lending in the used car segment was many times lower than in the new car segment. A rise in demand for used cars is also indicated by their import expansion. According to Avtostat data, used car imports totalled 259.7 thousand units in 2022, 35% more than new car imports last year. A total of 141 thousand used cars were imported between January and April last year, 17% more than new car imports. These changes have largely resulted from the inadequate supply of new cars, which is falling behind a rise in demand.

Figure 37. Number of new auto loans and average auto loan size



Sources: Bank of Russia, R&F Department estimates.

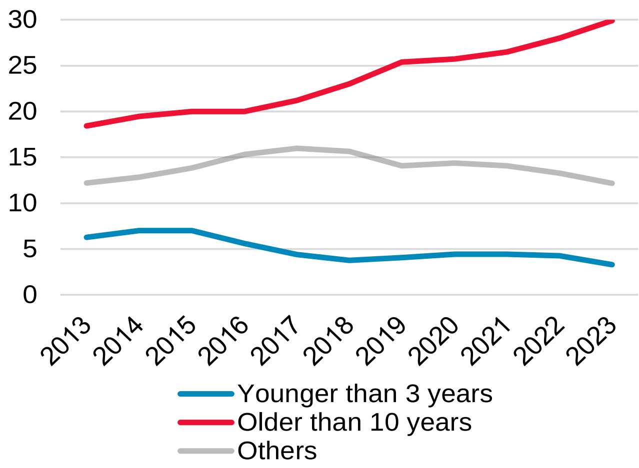
Figure 38. Quarterly total of loans, billion rubles



Source: Bank of Russia.

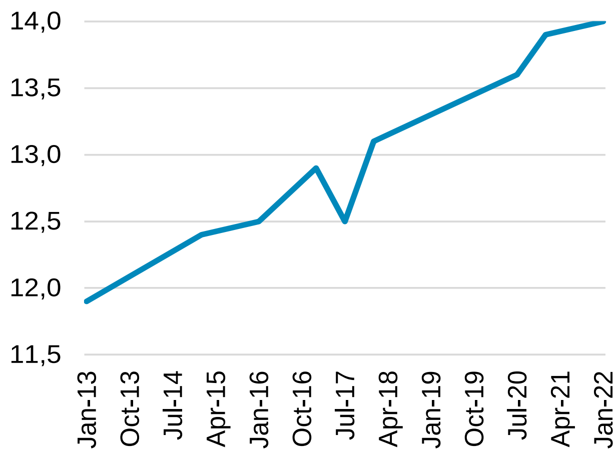
Subdued supply of new cars and an increase in used car imports from foreign countries in place of new cars may cause further car fleet ageing. In previous years, the average car fleet age gradually rose[11] even as new car sales were much superior to those seen after a sales plunge in 2022 (Figure 40). For example, the share of cars aged 7–10 and 11–15 years was far larger in 2021 than in 2011, whereas the share of cars aged less than 6 years contracted (Figure 39, Figure 41). That said, car ownership stood at 328 cars per 1,000 population in 2021, 35% more than in 2011 (Figure 42). This car ownership ratio is far below the average level in advanced countries but is comparable with that in emerging market economies.

Figure 39. Car fleet size, million units



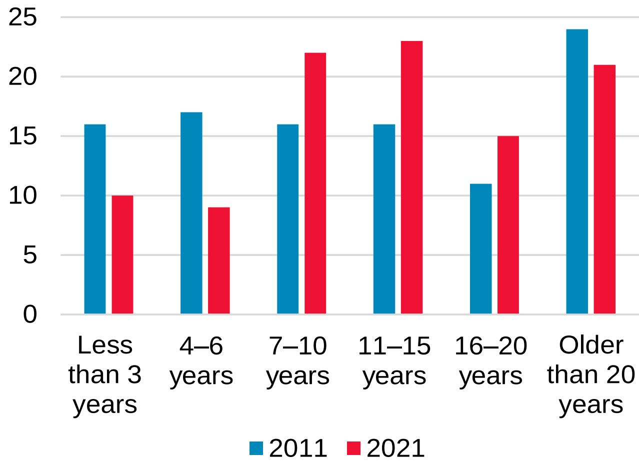
Sources: Autostat, R&F Department estimates.

Figure 40. Average age of Russia's passenger car fleet, years



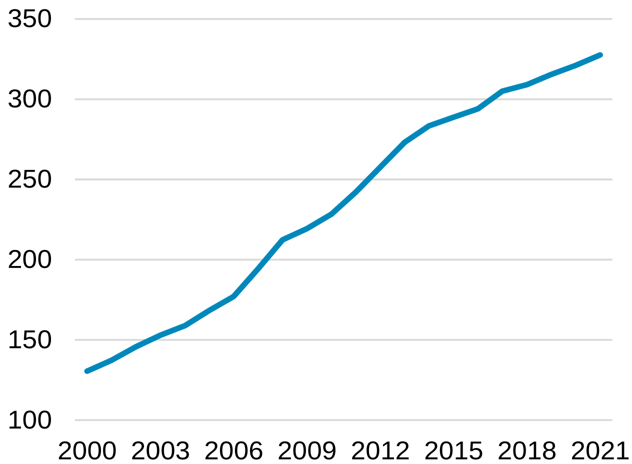
Sources: Autostat, R&F Department estimates.

Figure 41. Share of segments in the age structure of passenger car fleet, %



Source: Autostat.

Figure 42. Car ownership per 1,000 population, units



Source: Rosstat.

[11] The average age of passenger cars of domestic brands is five years older than those of foreign brands, standing at 16.6 years as of January 1, 2018 versus 10.9 years for foreign brands. The car fleet age varies across Russian regions. According to Avtostat data, Moscow boasts the youngest car fleet, whose average age is 10.4 years. The oldest passenger cars are found in Kamchatka (24.4 years). The average old age may in part be owed to a situation where old cars which are no longer used fail to be deregistered and are thus included in statistics.

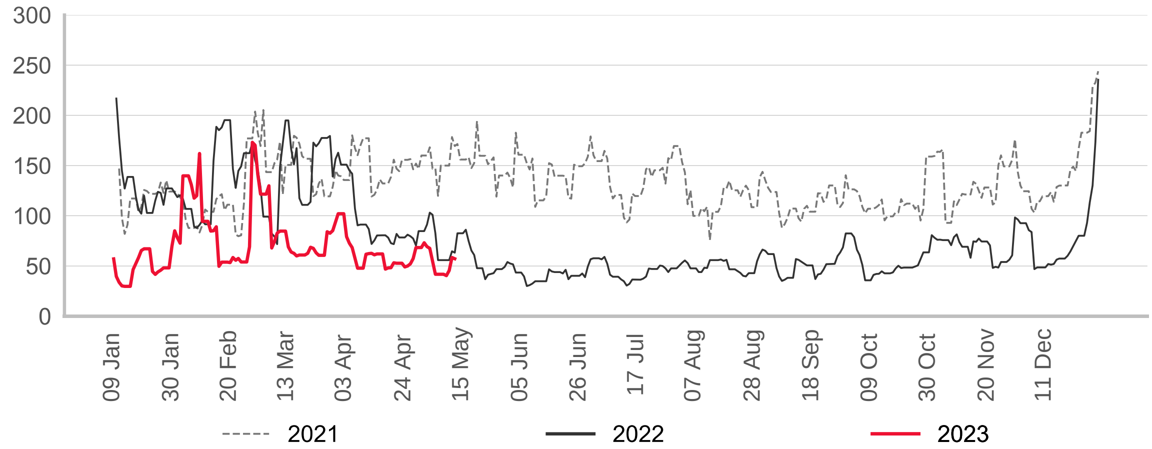
As the Russian economy adapts to the changed external conditions, its further recovery will buttress a rise in consumer demand, including for motor vehicles. Additional car demand makes the need to upgrade the ageing car fleet increasingly relevant. In this environment, we see three main roadforks for the car market, depending on the response of supply:

1. **Expanding production at existing facilities of Russian and foreign manufacturers.** This would require addressing the problem of supplying components for Russian carmakers and creating incentives for foreign producers from friendly countries to enter idle production facilities.
2. **Scaling up imports (of both new cars from friendly countries and used ones).** Should domestic production expansion be insufficient, demand could be met by expanding cars imports from abroad. The Russian car market already widely relied on a similar model in the period between the 2000s and mid-2010s.
3. **Maintaining the existing car fleet.** Should car supply expansion via the above two channels fails to fully meet demand, consumers will have to use the existing car fleet longer. This may boost demand for major car overhaul services and spare parts.

A further, separate, roadfork we see is extensive development of the car sharing market. This would make it possible to partially meet demand for independent car travel without owning a car amid limited supply of new motor vehicles.

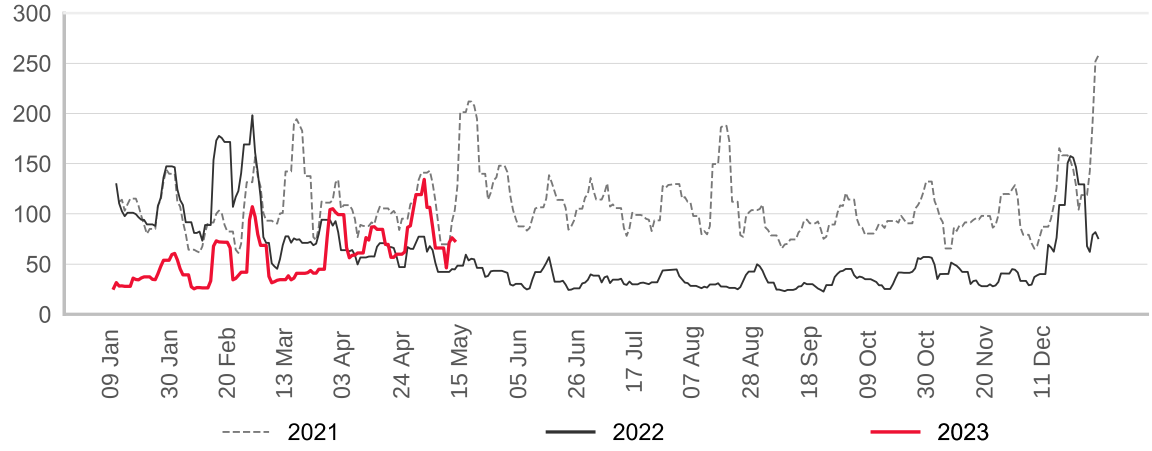
Uncertainty about the future outcome of car market restructuring is so far high. All of the three roadforks will likely materialise to a greater or lesser extent. That said, a certain fine-tuning of a new equilibrium using economic measures (import duties on new cars and components, localisation requirements, a tax regime) is quite possible but requires understanding a balance of risks and benefits from decisions made in this context.

Figure 43. Seven-day rolling average of daily incoming payments flow in manufacture of motor vehicles, trailers and semi-trailers (OKVED2 29), index (100 = 2019 average)



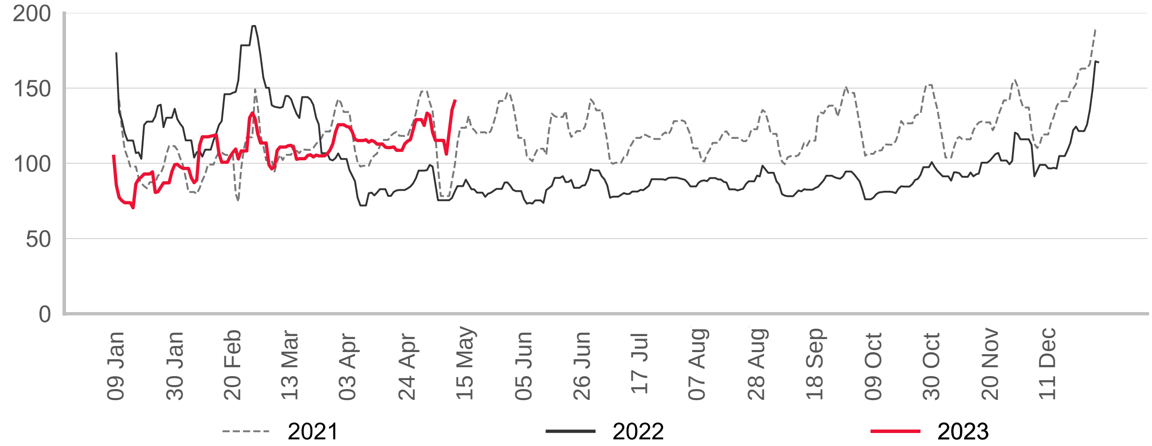
Source: Bank of Russia.

Figure 44. Seven-day rolling average of daily outcoming payments flow in manufacture of motor vehicles, trailers and semi-trailers (OKVED2 29), index (100 = 2019 average)



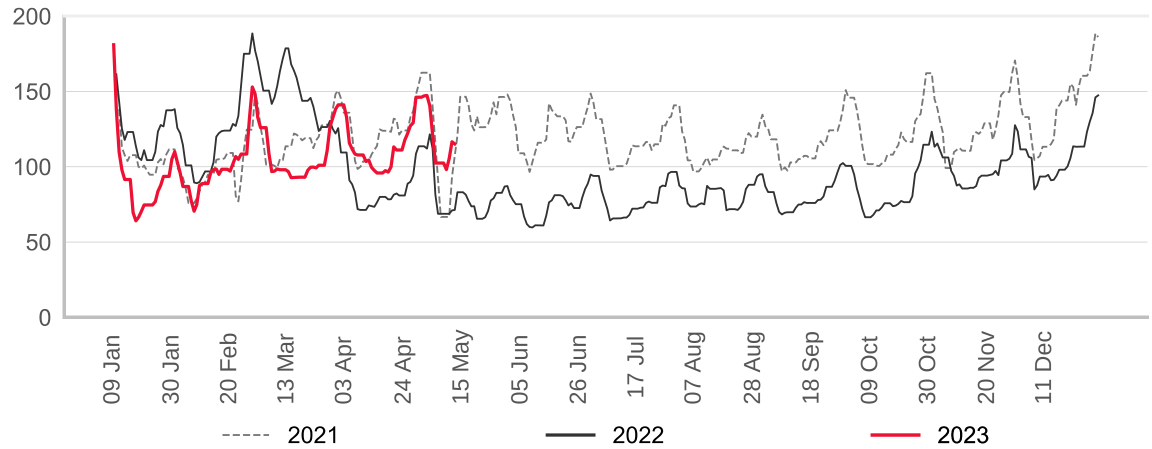
Source: Bank of Russia.

Figure 45. Seven-day rolling average of daily incoming payments flow in wholesale and retail trade and repair of motor vehicles and motorcycles (OKVED2 45), index (100 = 2019 average)



Source: Bank of Russia.

Figure 46. Seven-day rolling average of daily outcoming payments flow in wholesale and retail trade and repair of motor vehicles and motorcycles (OKVED2 45), index (100 = 2019 average)



Source: Bank of Russia.

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