Bank of Russia

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# TALKING TRENDS
# Economy and markets

Research and Forecasting Department Bulletin

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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

- In April–May, inflationary pressure remained elevated due to the effect of *persistent* factors. At the same time, the effect of *one-off* proinflationary factors somewhat weakened. Accommodative monetary policy continues to support economic growth and domestic demand, including through lending activity. The recovery of the global economy positively influences the dynamics of Russian exports and the related industries, and also leads to an increase in prices in global commodity markets. In this context, supply-side proinflationary risks are likely to remain in place until the end of the year. However, the effect of stable inflation factors will be weakening, albeit gradually, as the influence of the return to neutral monetary policy grows.
    - Annual inflation started to rise again in May. The increased level of stable components of price growth and the predominance of short-term proinflationary risks make it necessary to return to neutral monetary policy. Annual inflation is set to return to a persistent slowdown only in autumn, if short-term proinflationary and disinflationary factors are balanced.
    - Russian economy continued to grow in April, strengthening the positive results of the first quarter. Active corporate lending and investment imports growth indicates that economic growth will persist in the near future. Non-work days in early May might impact this month's results.
    - The Russian stock market was supported in May by the news pointing to a reduction of geopolitical risks. Global markets showed mixed dynamics.

## IN FOCUS. INFLUENCE OF THE PANDEMIC ON THE OPENING AND CLOSURE OF BUSINESSES

- During 2020, the intensity of business closures rose, which was caused by the economic consequences of the pandemic. The largest increase in the number of closed enterprises was observed in the most affected industries. Support measures helped mitigate the consequences of the coronacrisis, while not hindering the adjustment of the market to the new reality.
- In early 2021, the scale of closures decreased to pre-coronavirus levels. This could be supported by the economic recovery and the increased flexibility of companies' operations with their counterparties in the new environment.
- Companies with low labour productivity were closing at the highest pace. This is releasing economic resources for more efficient and productive companies.
- At the same time, the absence of signs of growth in the number of new companies amid the economic recovery as well as a more intensive closure of young companies that failed to achieve their potential due to the crisis, may offset the positive effect of this factor.

- In order to bring the Russian economy to a stable growth path, it is necessary to create conditions for the opening of new enterprises and support efficiently operating companies, especially young businesses with high growth potential. The creation of conditions for the growth in the number of efficient companies should be accompanied by establishing pre-requisites for the rapid development, expansion and improvement of the efficiency of new businesses.

# 1. Inflation

Seasonally adjusted weekly and monthly consumer price inflation remains dramatically elevated, although price rises has slowed in recent weeks. Inflation is decelerating as part of *short-term* pro-inflationary factors are petering out. At the same time, all the indicators of longer-term stable inflation components in large part associated with changes in demand remain elevated.

All this brought annual inflation to an ascending path in May after a temporary decline in April. A gradual emergence of the restraining effect on prices of the key interest rate raise will help a sustainable slowdown in annual inflation, which is poised to start in the autumn of this year. The high base of the end of 2020 will also play an important part in it.

Household and businesses' much higher inflation expectations than in the pre-coronavirus period make producers more willing to pass through a rise in output prices to consumers, who are thus more willing to accept price rises (i.e., price elasticity of demand decreases). The fast pace of output price rises in manufacturing indicates that the Russian economy, including the consumer sector, will see elevated inflationary pressure persist in the months to come.

Also, one has to bear in mind that the new round of rises in world food prices along with the prices of most other commodities in April-May has boosted short-term pro-inflationary risks, both globally and in Russia.

The prevalence of significant short-term supply-side pro-inflationary risks is also evidenced by logistics problems brought about by coronavirus-related restrictions and structural shifts in demand. Part of these problems will likely persist until 2022.

If short-term inflationary risks are realised, the overall consumer price inflation will likely continue to outpace the rise in stable inflation components. This will shape an even flatter inflation deceleration trajectory, hampering an extensive scaling down of inflation expectations.

## 1.1. Annual inflation slowdown in April gives place to its acceleration in May

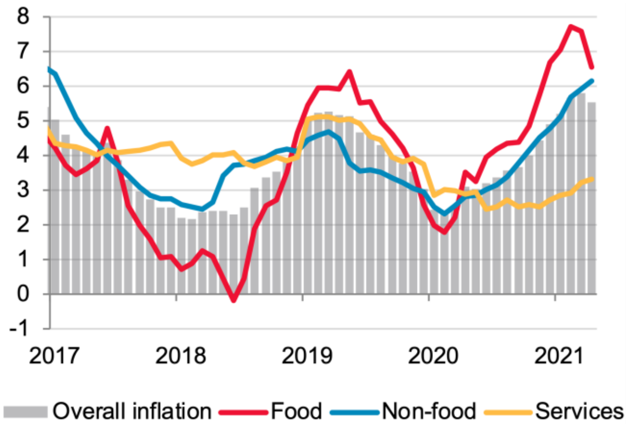
- Inflation temporarily slowed to 5.53% YoY in April, driven by the exit from calculation of the high base of April 2020, which saw a food price surge. The annual rate of price rises in non-food goods and services continued to accelerate.
- Despite some slowdown in April, month-on-month price growth stayed far above a level corresponding to 4% in annualised terms. As consumer demand continues to recover, the analytical indicators of price movements also suggest that inflationary pressure remains increased.
- The pace of month-on-month price hikes also remains elevated in May. Prices have gone up 0.48% since the start of the month. The annual inflation estimate rose to 5.8% as of 24 May, reflecting the exit from calculation of the low base of May 2020.

- Given the slow pace of price rises in 2020 and the remaining price inertia, inflation returned to an ascending path in May, which may continue into the autumn. With neutral monetary policy resumed, inflation will return to the 4% level in the middle of 2022, to subsequently stabilise close to the Bank of Russia target.

Consumer price inflation slowed in month-on-month and year-on-year terms in April (Figure 1, Figure 2) but remained elevated relative to 4%. Having reached a local peak of 5.79% in March, annual inflation slid to 5.53% in April. The annual inflation slowdown was expected, given the exit from the calculation base of the increased rate of food price rises in April 2020.

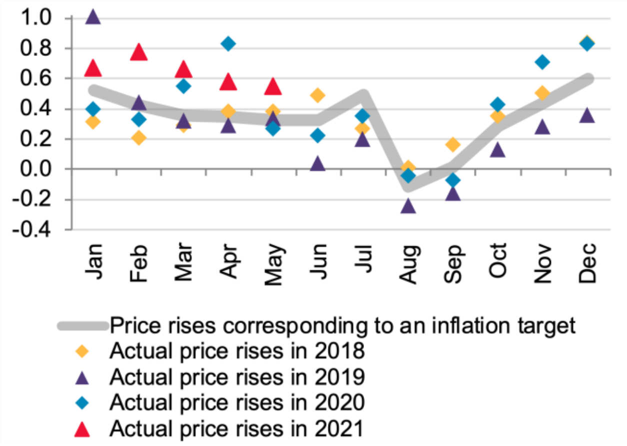
Annualised seasonally adjusted inflation stood at 6.30% MoM SAAR,[1] staying above the Bank of Russia target and reflecting continued inflationary pressure in the consumer market. At the same time, the slowdown in seasonally adjusted monthly price growth was observed to a greater extent in food products and services.

**Figure 1. Inflation and its components, % YoY**




*Source: Rosstat.*

**Figure 2. Price rises corresponding to an inflation rate of 4%, % MoM**



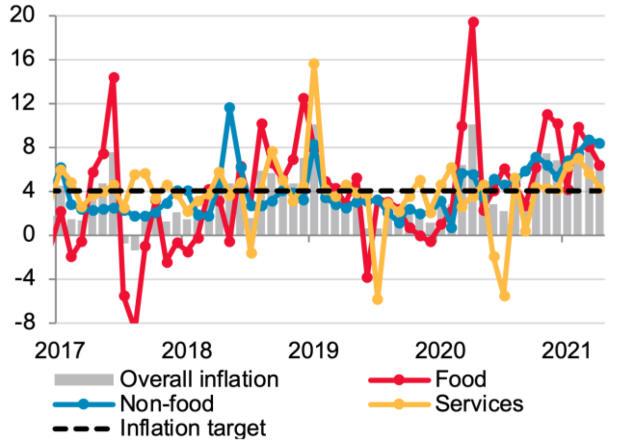

*Note. Preliminary estimate for May 2021.*

*Source: Rosstat, R&F Department estimates.*

Seasonally adjusted monthly consumer price inflation *in the food segment* slowed somewhat in April, staying notably above the 4% level (6.33% MoM SAAR (Figure 3). The price rise slowdown was in large part helped by poultry growers' agreement to fix the broiler carcass and egg output prices after their significant rises in the preceding months (Figure 4).

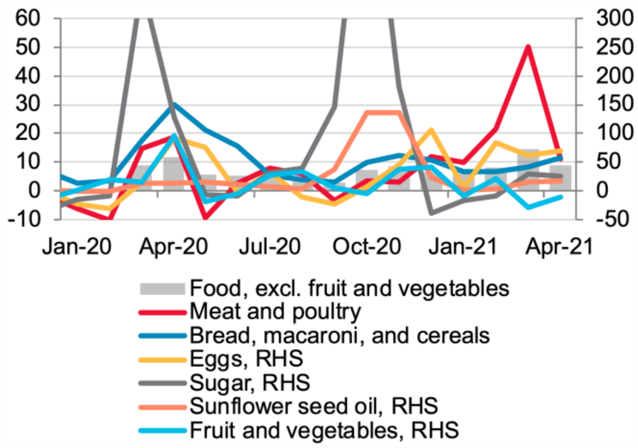
[1] SAAR – seasonally adjusted annualised rate.

**Figure 3. Seasonally adjusted inflation, % MoM SAAR**




*Source: Rosstat, R&F Department estimates.*

**Figure 4. Seasonally adjusted price rises for some food products, % MoM SAAR**




*Source: Rosstat, R&F Department estimates.*

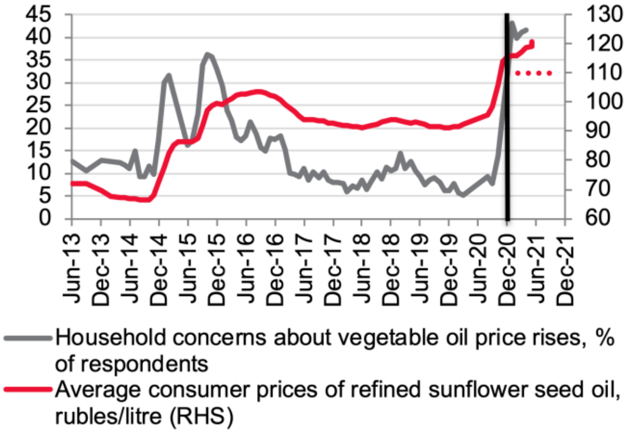
April's food price rises were boosted by the resumption of fruit and vegetable price hikes and the acceleration of month-on-month price growth in a variety of food products: bread and bakery products, groats (buckwheat) and legumes, butter, sunflower seed oil, and eggs. The pace of granulated sugar price hikes slowed somewhat but remained elevated.

The regulation of sugar and sunflower seed oil prices, which the government has extended until 1 June and 1 October, respectively, in order to stabilise domestic prices, has, according to an inFOM poll, somewhat relieved household concerns about price hikes in these goods (Figure 5, Figure 6). This measure has, however, stimulated rises in the prices of goods which can be regarded as substitutes for products subject to regulation. These substitute goods are not included in the consumer basket monitored by Rosstat and, therefore, do not directly affect the CPI but can have an indirect effect on it via keeping household inflation expectations elevated. After price regulation has been eased, high inflation expectations can prompt significant increases in the prices of these items amid the continued world price hikes[2] (Figure 7). It is also noteworthy that in order to avoid a sugar price spike after the price fixation agreement has expired, Russia's Agriculture Ministry recommended that producers sell sugar at fixed prices until September. On top of that, a number of new measures to regulate prices in this market are being drafted.

Seasonally adjusted price rises in *non-food goods* stayed above the 8% MoM SAAR level in April, having slowed somewhat to 8.36% MoM SAAR as the rate of fuel price rises declined. (Figure 3). We note that the indicative petrol price in the damper mechanism formula was cut as of 1 May (Figure 8), which should help stabilise domestic prices within the inflation target, increasing the petrol stations' profit margins at the same time.

[2] Food prices continue to rise worldwide // Agroinvestor. 07.05.2021.

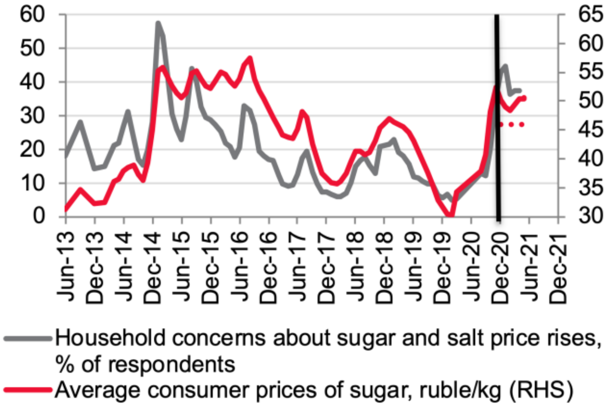
**Figure 5. Level of sunflower seed oil prices and household concerns about price rises**




*Note. Dotted lines represent the ceiling on refined sunflower seed oil prices imposed as of 16 December 2020 (110 rubles/litre).*

*Sources: inFOM, Rosstat.*

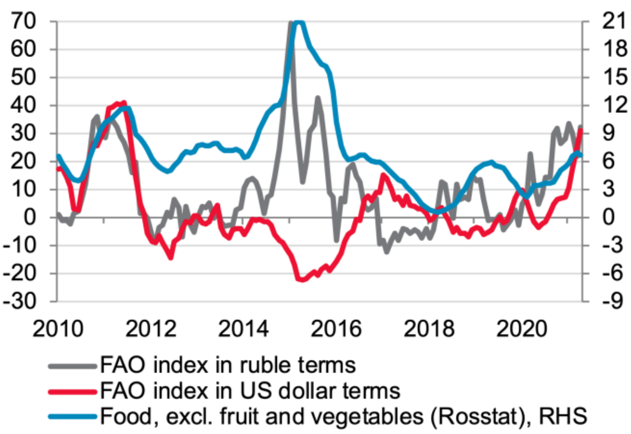
**Figure 6. Level of sugar prices and household concerns about price rises**




*Note. Dotted lines represent the ceiling on granulated sugar prices imposed as of 16 December 2020 (46 rubles/kg). Sources: inFOM, Rosstat.*

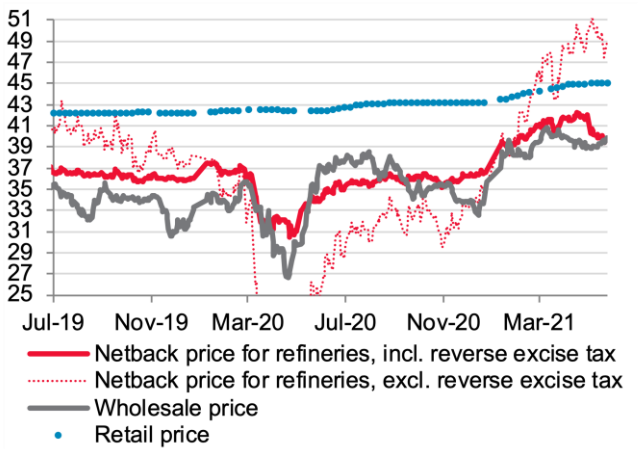
Acceleration of price rises in the sector of non-food goods (exclusive of refined petroleum products) continued. There was a notable price rise acceleration in tobacco, construction materials, tools and equipment. The fast pace of price rises continued in furniture, household chemical products, television and radio goods, and passenger cars. Extensive demand growth in the real estate market, disruptions in transborder deliveries, and shortages in the global market for automobile chips continue to exert upward pressure on the prices of non-food goods.

**Figure 7. World and domestic food prices, % YoY**




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

**Figure 8. AI-92 petrol price, rub/litre**



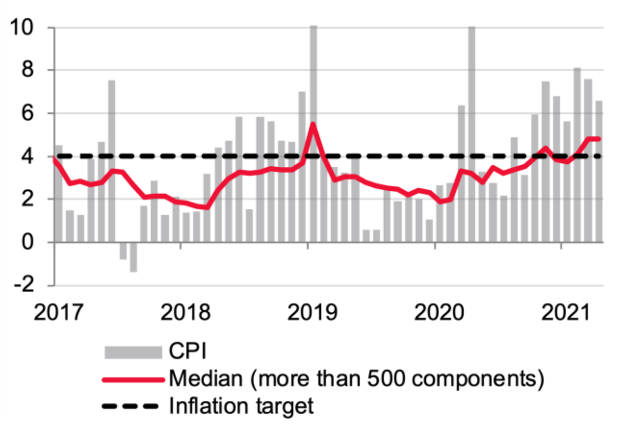

*Sources: St Petersburg International Commodity Exchange, Rosstat, R&F Department estimates.*

In the *services sector,* seasonally adjusted month-on-month price rises sharply slowed to 3.46% MoM SAAR in April, largely driven by a plunge in foreign tourism and air transport prices (Figure 3). Price movements in this category continue to significantly distort the overall inflation picture. The prices of travel to the United Arab Emirates fell notably as supply expanded and costs decreased on the back of the launch of a new lowcoster's flights (a one-off change in the price level). The prices of travel to other foreign tourist destinations are, however, not registered: Turkey became a case in point in April on the back of the border closure due to the worsening epidemic situation[3]. The closure of this destination gave an additional impetus to price moves in domestic tourism services.

Health care, education, and rail transport services price rises have also accelerated. The pace of price increases in personal services and those of arts and entertainment are staying above 4% in annualised terms, fuelled by demand recovery as the epidemic situation stabilises.

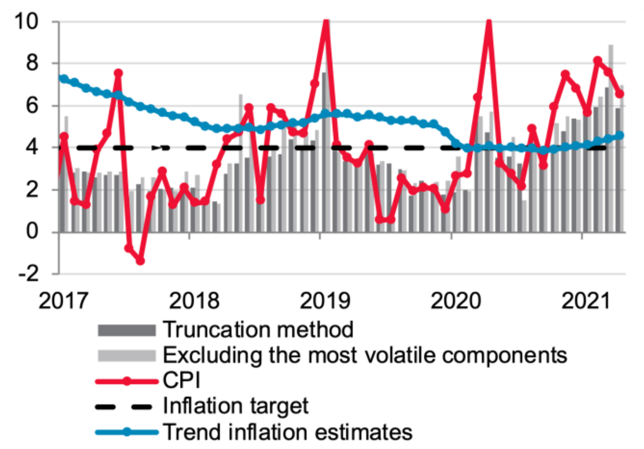
April saw the analytical indicators of price movements continue to suggest the persistence of elevated inflationary pressure adjusted for temporary and one-off factors. Indeed, the median distribution of monthly seasonally adjusted increases in maximally disaggregated CPI components[4] stayed above 4%, as in March (Figure 9). The mean modified core inflation indicator edged down to 6.4% MoM SAAR. Trend inflation, meanwhile, continued to rise to come in at 4.54%[5] in April (Figure 10).

**Figure 9. Median distribution estimated on disaggregated components, % MoM SAAR**




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

**Figure 10. Modified core inflation indicators and trend inflation estimates, % in annual terms**




*Source: Rosstat, R&F Department estimates.*

Prices have gone up 0.48%[6] since the start of May. Despite some slowdown in May's weekly price growth compared with the previous months (Figure 11), it remains above 4% in seasonally adjusted terms: distribution of price rises within the goods and services basket[7] monitored on a weekly basis has become more uniform, but median and weighted average price increases are staying above 4% in annualised terms (Figure 12). Given the low base of May 2020, an annual inflation estimate rose to 5.80% as of 24 May.

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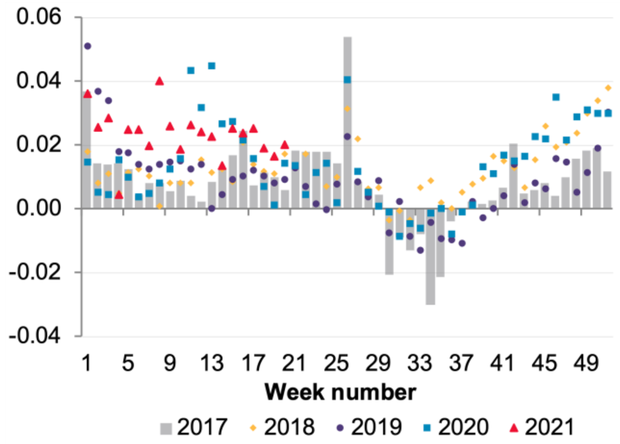
[3] The price of travel to Turkey increased 15.2% NSA over January–March 2021.
[4] 556 components in the 2021 basket.
[5] April 2021 trend inflation estimate // Bank of Russia. 14.05.2021.
[6] Rosstat will release the official May statistics on 7 June.
[7] Exclusive of fruit and vegetables and regulated services prices.

We expect consumer prices to increase within the 0.4–0.6% MoM[8] range in May. This corresponds to a seasonally adjusted price rise within the 5.0–7.6% MoM SAAR range and annual inflation acceleration to 5.7%–5.9%. As the low inflation rate in May–July 2020 leaves the calculation base and price inertia continues, annual inflation will likely keep accelerating in the months to come.

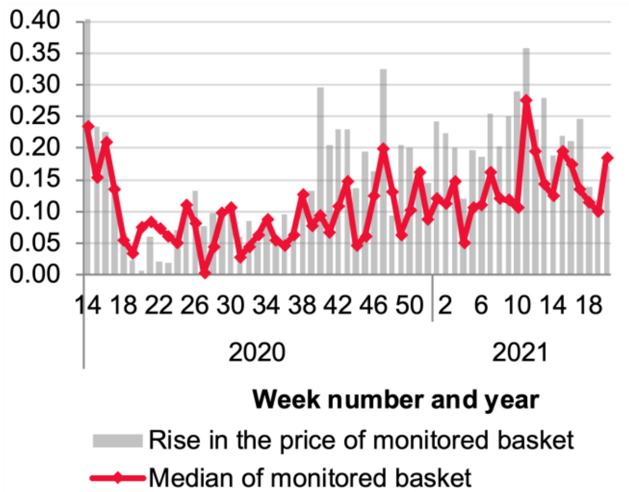
At the same time, as neutral monetary policy is resumed and the impact of transient pro-inflationary factors attenuates, seasonally adjusted month-on-month CPI increase is set to slow gradually. Annual inflation will start decelerating steadily in the autumn of 2020 to return to the 4% level in mid-2022 and subsequently stabilise at the Bank of Russia target.

**Figure 11. Average daily price rises, %**




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

**Figure 12. Pace of the basket price increase and median distribution of weekly price rises,[9] %**




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

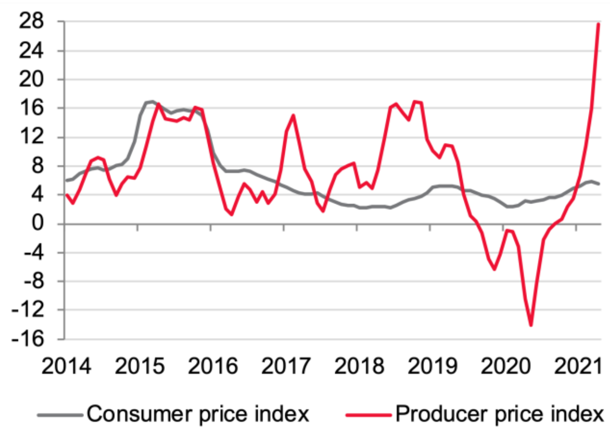
## 1.2. Faster producer price growth remains the source of consumer price rises

- An annual rise in produce prices of industrial goods sharply accelerated to 27.6% in April from 16.0% in March. Although this is to a great extent due to the low base of 2020 (Figure 13), month-on-month price increases were also steep at 2.7%. The key contribution to the annual price rise acceleration continued to come from energy industries with their heavy weight in the producer price index[10] (Figure 14).
- April's notable price rise acceleration to 39.0% YoY in the *intermediate goods* segment was owed to the low base of coke and refined petroleum product price growth (Figure 15).

[8] Rosstat will release the official May statistics on 7 June.
[9] The calculation is based on an enlarged list of goods and services (excluding fruit and vegetables and regulated services prices). Prior to that, Rosstat registered 64 items of goods and services on a weekly basis. As of April 2020, the list of items monitored on a daily basis was expanded to 100 categories, and to 106 categories as of January 2021.
[10] Extraction of crude oil and natural gas, and manufacture of coke and refined petroleum products account for 25.3% in the CPI basket of industrial goods in 2021.

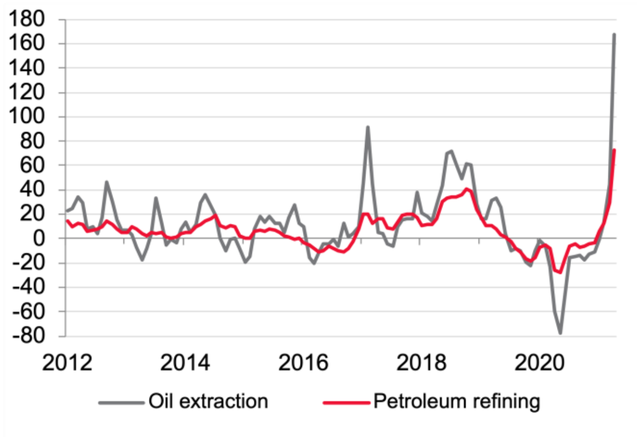
- A gradual investment recovery prompts price rise acceleration for many items in the segment of *investment demand* – to 5.8% YoY.
- In industries meeting *consumer demand,*[11] a PPI rise stayed on the elevated March level at 12.4% YoY, indicating the continuation of inflationary pressure from producer prices in the consumer market. Noteworthy is the acceleration of food and furniture price rises to 16.0% YoY and 11.9% YoY, respectively.
- Producer price rises calculated on the basket of some *consumer goods,*[12] weighted using the structure of household consumer expenditure for calculating the CPI accelerated to 11.9% YoY in April (Figure 16). Price rise acceleration was posted not only in some food products but also in many non-food goods. Amid the consumer demand recovery and rising inflation expectations, producers are to a great extent passing through their cost increases to consumers, with the increasingly steadier cost rises contributing to it.
- Historical data shows that producer price movements have the most significant effect on consumer prices within one quarter. Given producers' limited ability to reduce their profit margins and expenses on the transportation of goods from production sites to retail facilities, the current price movements may translate into the continuation of pressure on consumer prices at least until July.
- Therefore, short-term risks in the consumer market shift towards pro-inflationary factors. In this environment, it will likely take the weakening of sustainable pro-inflationary pressure longer to materialise. In particular, for consumer prices to steadily decrease, rises in producer prices of consumer goods need to pass their peak.

**Figure 13. Consumer and producer price movements, % YoY**




*Source: Rosstat.*

**Figure 14. Producer prices in oil extraction and manufacture of refined petroleum products, % YoY**




*Source: Rosstat.*

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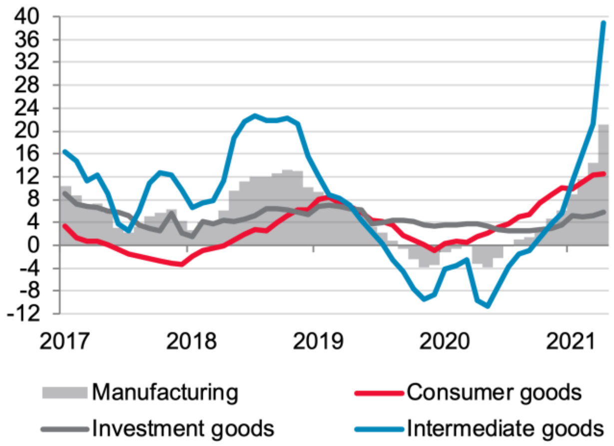
[11] The calculation of producer prices for groups of manufacturing industries producing consumer, investment and intermediate goods is carried out using the structure of weights for the calculation of the PPI of industrial goods in line with the Economic Activity Types under the OKVED 2 classification.

[12] Unlike the calculation above, instead of aggregation based on activity types, we used aggregation of comparable goods in the CPI and PPI structure, such as meat products, fish products, butter and fats, dairy products, pasta, sugar, coffee, wearing apparel, footwear, detergents and cleaning solutions, perfumery and cosmetic products, household electronic appliances, and furniture. They account for 30% of the consumer basket.

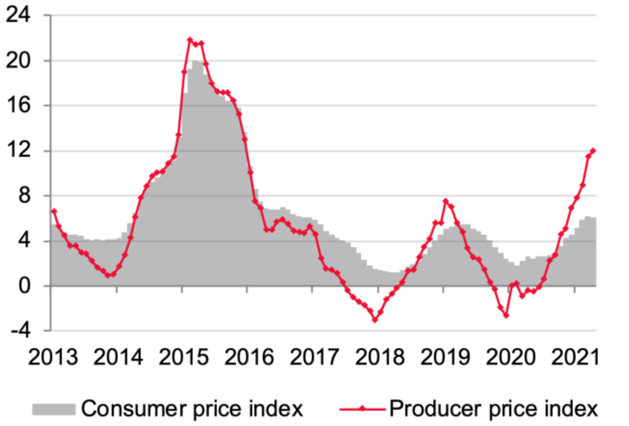
**Figure 15. Producer prices in groups of manufacturing industries, % YoY**




*Note. The weights of consumer, investment, and intermediate goods in the CPI of industrial goods for 2021 are 15.0, 19.2, and 33.2%, respectively.*

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

**Figure 16. Prices of some comparable goods in the CPI and PPI structure, % YoY**




*Note. Under the Rosstat methodology, Producer price movements are calculated net of VAT. Hence the impact of the VAT hike in January 2019 on producer prices is not factored in.*

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

## 2. Economic performance

It appears from real-time indicators that Russia's economic growth continued in the second quarter of 2021. GDP may reach the pre-coronavirus level as early as the middle of 2021.

As previously, economic growth varies across industries. Recent months have seen faster growth rates in exporting industries, industries manufacturing intermediate goods, as well consumer services industries hit the hardest during the pandemic. At the same time, consumer and investment goods industries continue growing at a more modest pace after their output has hit higher than pre-coronavirus levels.

Production constraints due to component supply disruptions tend to mount rather than ease. However, they have so far failed to substantially hurt the overall growth of the economy, which has shown a high degree of adaptivity in the face of constraints. This was helped by, among other things, accelerated digitalisation of business processes and online business expansion.

The increasing unevenness of economic performance coupled with production constraints results in a seemingly paradoxical combination of still elevated unemployment and a severe shortage of workforce in some industries and brings about an acceleration in nominal wage growth in the economy at large. On top of wage growth, consumer demand is also buoyed by an accelerating expansion of retail lending, including unsecure loans. A shift of consumer demand towards domestic consumption in the face of closed borders also continues. As a result, consumer demand remains an important factor of both economic growth and price rises.

## 2.1. Economic growth continues in second quarter

- GDP contraction slowdown to 1% YoY in the first quarter of 2021 indicates that quarterly economic growth gained momentum at the start of the year compared with the fourth quarter of 2020.
- A variety of real-time indicators suggests the continuation of economic growth in the second quarter as all the key components of demand, external and domestic, expand.
- Consumer demand growth is helped by a consistent improvement in the labour market situation, lending expansion, and spending of funds accumulated over the course of the pandemic.
- The coming quarters will see seasonally adjusted quarter-on-quarter economic growth gradually slow to the potential level. Given this growth performance, GDP may hit the pre-crisis level as early as the middle of 2021.

The recovery of the Russian economy is continuing in 2021. Based on a preliminary Rosstat estimate, GDP contracted 1.0% YoY in the first quarter of 2021 after a fall of 1.8% YoY in the fourth quarter of 2020. This corresponds to seasonally adjusted quarter-on-quarter economic growth acceleration to 1.6%[13] QoQ SA from 0.8% QoQ SA. Therefore, based on our estimate of seasonally adjusted rate of quarter-on-quarter GDP growth, economic activity may reach the pre-coronavirus level as early as the middle of this year.

A number of economic indicators and a small portion of economic statistics[14] suggest that economic growth will also continue in the second quarter of 2021 at a rate just above potential.

Financial flows point to April's notable business activity expansion relative to the first quarter in industries meeting external and intermediate demand. Consumer and investment goods industries posted the stabilisation of the payments close to the previous quarter's levels, suggesting a likely return of growth to a sustainable medium-term path in industries meeting domestic demand as the most extensive recovery phase comes to an end. Payments slumped at the start of May, in the "day-off" period, but expectedly rebounded after the second spell of the May holidays. The payments were driven mainly by industries meeting final and intermediate demand, with payments in investment goods industries lagging somewhat and those in exporting industries stabilising (Figure 17).

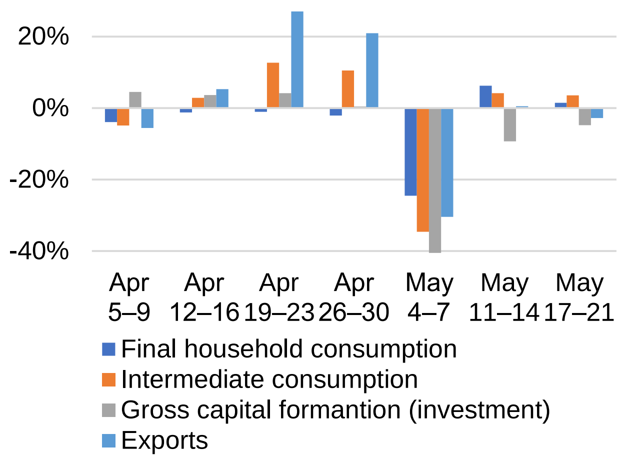
Industrial output continued to grow in April, inching up 0.3% MoM SA after a rise of 1.2% MoM SA in March. Mining and quarrying was a growth driver, up 1.8% MoM SA as oil production gradually increased in compliance with the OPEC+ deal and the extraction of other mineral resources expanded. Manufacturing output contracted slightly, down 0.7% MoM SA after two-months' growth (Figure 18). Some weakening of the sector's performance is indicated by April's PMI indexes. Institute for Economic Policy business survey data, however, gives reasons to expect industrial output and demand for the sector's products to continue expanding

[13] The estimate may change after the initial Q1 GDP will be released on 15 June with a more detailed breakdown by production method.

[14] Rosstat releases the estimate of a wide range of April indicators on 4 June.

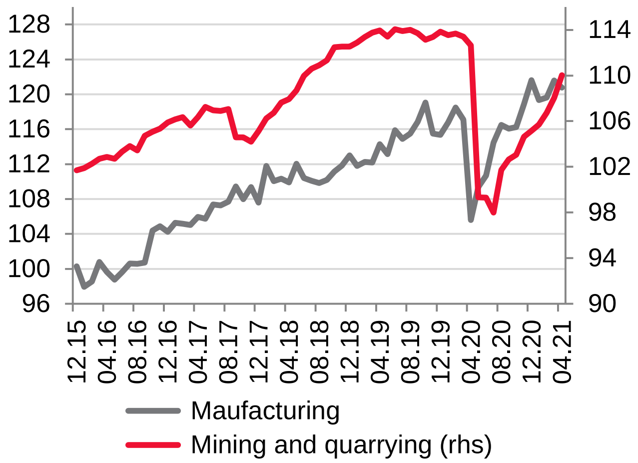
in May relative to April. Inventories of finished products are, at the same time, declining, suggesting that demand is now outstripping supply in this sector. Continued logistics disruptions seem to be preventing industry from stronger output growth.

**Figure 17. Incoming financial flows by industry, % of the Q1 2021 average level**




*Source: Bank of Russia, Monitoring of industry-specific financial flows.*

**Figure 18. Change in mining and quarrying and manufacturing indexes (2014 = 100)**



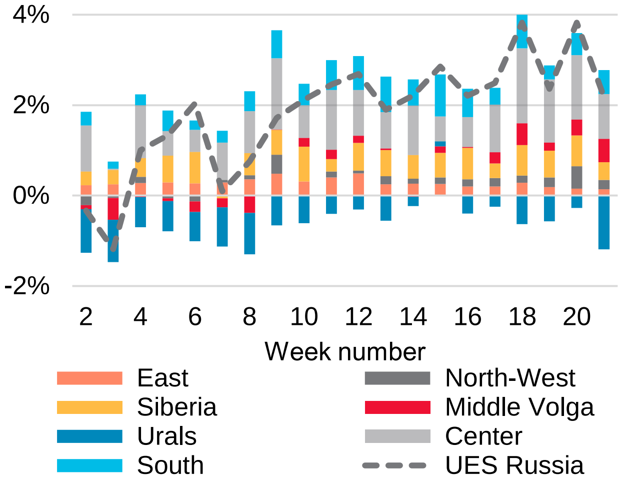

*Sources: Rosstat, R&F Department estimates.*

The stabilisation of power-intensive industries' output at higher than pre-coronavirus levels is indicated by electricity consumption (Figure 19). It has steadily held above the 2019 level in recent months, showing a slight upward trend.[15] This is also the case in all the power systems, except for that of the Urals, where the oil extraction infrastructure is concentrated (oil extraction is restrained in compliance with the OPEC+ deal). An important contribution is provided by electricity consumption growth in the South Integrated Power System, which benefits from domestic tourism expansion amid the closure of the key foreign tourist destinations.

Financial flows data indicates the return of consumer and investment demand to a sustainable growth path. Other real-time indicators also suggest growth continuation in these aggregate demand components. Indeed, consumer and investment imports continued their recovery, rising far above the 2019 level in April (see Subsection 2.3). Nominal everyday household expenditure is also holding above previous years' numbers (Figure 20). Consumer activity growth is helped by the labour market recovery (Figure 21) and continued confident expansion of consumer lending (see Subsection 2.2). One important factor is a declining savings rate. It is likely to have stayed depressed in the second quarter (Figure 22) as funds accumulated during the pandemic were spent, due to, among other things, a rise in inflation expectations. Indeed, the index of the perception of whether this is a good time for major purchases remains elevated.

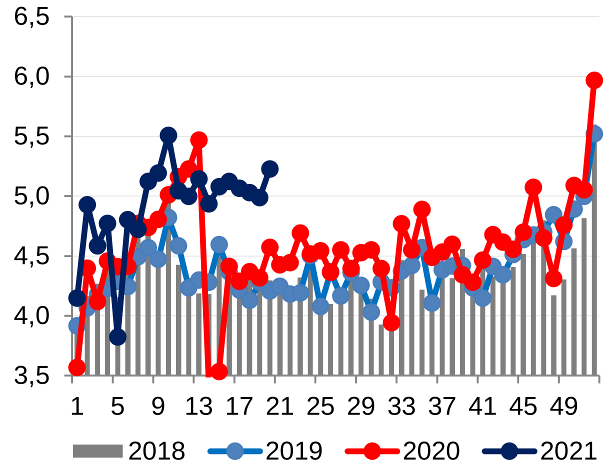
[15] Calculation was performed relative to 2019 in order to eliminate the effect of the low base of April–May 2020.

**Figure 19. Electricity consumption growth, as % of corresponding weeks of 2019**




*Source: Bank of Russia.*

**Figure 20. Nominal weekly household everyday expenditure, thousand rubles**

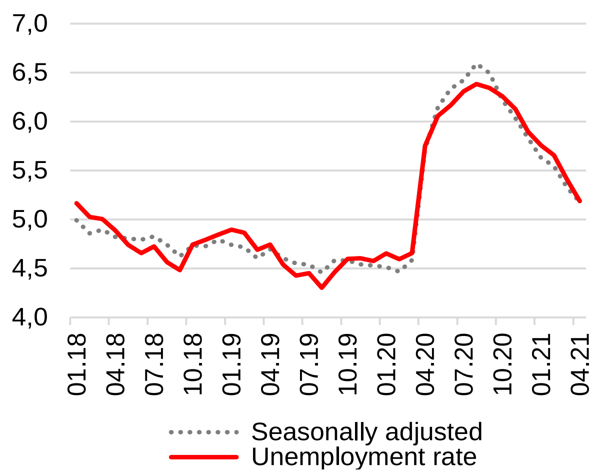



*Source: Romir.*

Investment demand growth is helped by businesses' expectations of a further rise in demand for their products. The indexes of output expectations based on various surveys indicate companies' high level of optimism.

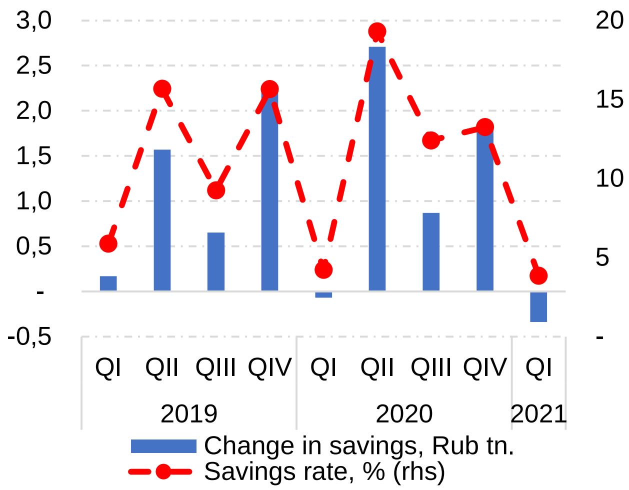
We note that the economy's post-pandemic recovery has already materialised. Growth will be gradually approaching potential in the quarters to come. The return of monetary policy to normal by the Bank of Russia will help maintain economic growth close to potential.

**Figure 21. Unemployment rate, %**




*Source: Rosstat, R&F Department estimates.*

**Figure 22. Savings and savings ratio change (factoring in lending), R&F estimates**




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

## 2.2. Lending growth acceleration in key segments

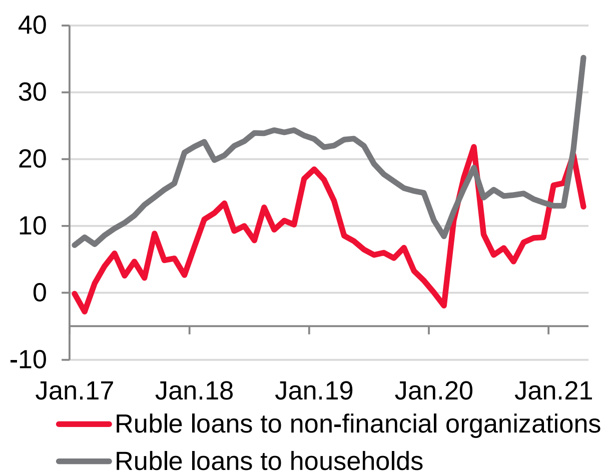
- The current monetary conditions are still supporting extensive bank lending growth in all the segments.

- Retail lending expansion accelerated further in April, most likely driven by temporary factors. The acceleration is, to a great extent, prompted, on the one hand, by rising demand in expectation of a further increase in lending interest rates following monetary policy normalisation, and on the other hand, by an expansion in the supply of unsecured consumer loans ahead of the return of add-ons to risk weights to the pre-coronavirus level.
- The pace of corporate lending growth, net of that to sole proprietorships, has also edged up. This comes on the back of business activity improvement, spurring demand for credit resources, including long-term loans.
- The share of non-performing loans is declining in all the segments, except for claims on financial institutions. This suggests continued stabilization of the quality of loan claims.
- The banking sector's financial result remains strong, helped by net fee and commission income and net interest income.

Growth in loans to both households and non-financial organizations accelerated in April.

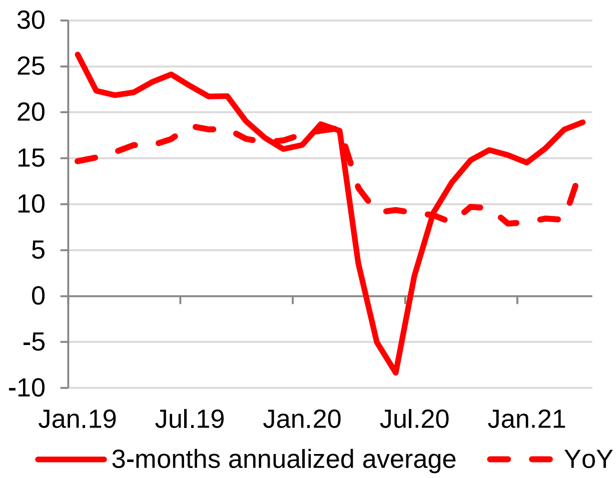
Ruble retail lending expansion hit a post-pandemic high in April, reaching 3.9% MoM SA after a 2.8% MoM SA rise in March (Figure 23). An elevated growth pace was recorded in all the segments. Bureau of Credit Histories data indicates a substantial loan issuance rise in April, along with an increased level of loan application approvals. Such strong retail lending expansion acceleration could be temporary. We may well be witnessing an effect of 1) a rise in household demand for loans in expectation of interest rate increases following Bank of Russia monetary policy normalisation, and 2) of an expansion in supply of unsecured loans by banks ahead of the return of add-ons to risk weights for this loan type to the pre-coronavirus level as of 1 July 2021. Seasonally adjusted growth in unsecured retail lending slowed somewhat in April compared with March, but three-month rolling average growth rate continues to rise, which will support further annual growth acceleration in this segment (Figure 24). Mortgage lending growth also continues to gain pace (Figure 25).

**Figure 23. Lending performance, 3-months annualized average, %**




*Source: Bank of Russia.*

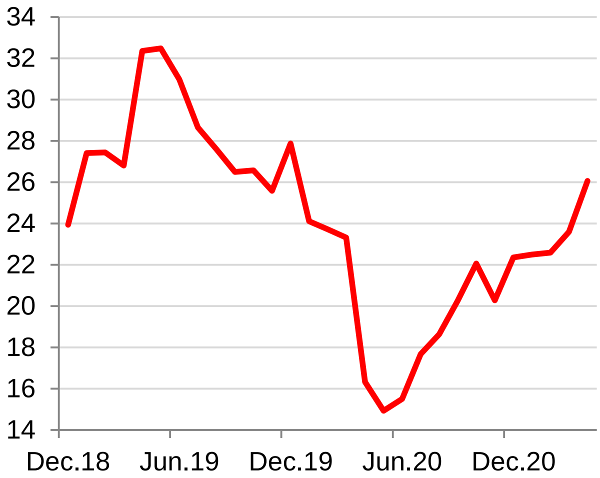
**Figure 24. Dynamics of unsecured consumer loans, %**




*Source: Bank of Russia.*

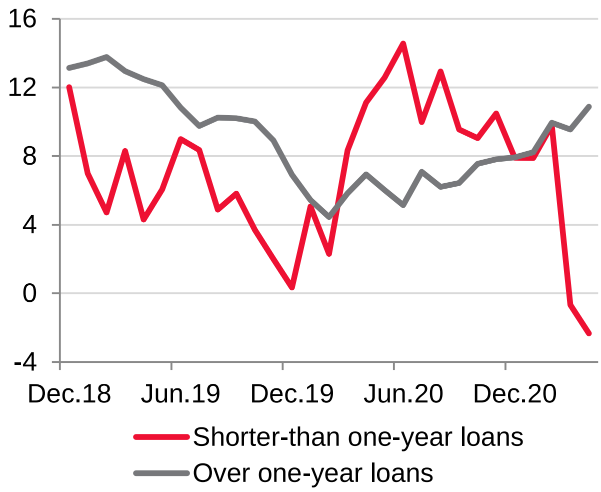
Corporate lending, net of that to sole proprietorships, also showed growth acceleration in April. Growth in ruble loans to non-financial organizations accelerated from 0.9% MoM SA to 1.3% MoM SA, lending to financial organizations expanded 2.8% MoM SA, up from 1.9% MoM SA a month earlier. Growth in the portfolio of loans to non-financial organizations was owed chiefly to long- and medium-term lending (Figure 26). This may be fueled by business activity expansion in industries meeting external and intermediate demand, as suggested by incoming financial flows. The PMI index performance shows increasing demand in the services sector. Productivity growth continues in manufacturing, with business expectations improving. Business activity expansion in turn provides incentives for raising long-term financial resources, including for investment. Also, increased demand for long-term bank loans may have been prompted by the low activity of bond issuers in the first quarter due to an elevated volatility in the debt market.

**Figure 25. Dynamics of mortgage loans, % YoY**




*Source: Bank of Russia.*

**Figure 26. Growth in ruble loans to non-financial organizations and sole proprietorships by maturity, % YoY**




*Source: Bank of Russia.*

Loans to sole proprietorships continue to contract. April saw contraction accelerate to -4.4% MoM SA from -2.0% MoM SA in March. This may have been driven by the expiration of some subsidized loan programmes.

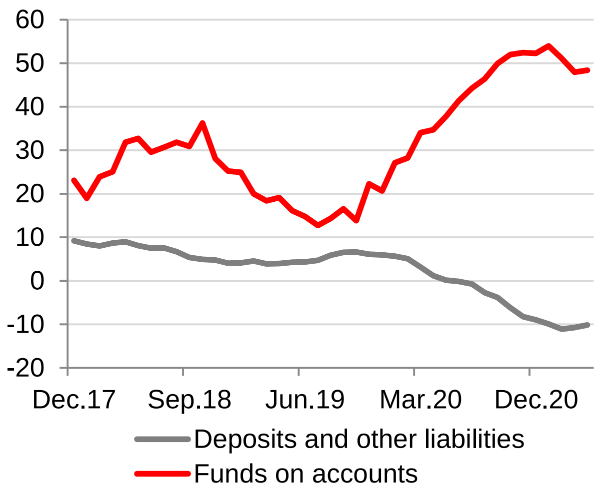
Household deposit expansion accelerated dramatically to 1.8% MoM SA in April from 0.3% MoM SA in March. In year-on-year terms, this growth was owed to an increase in funds on accounts, with deposits contracting. At the same time, annual growth in funds on accounts and contraction in deposits have slowed somewhat in recent months (Figure 27). An increase in interest rates on deposits triggered by a raise of the key interest rate gives reason to expect an expansion of total deposits and the share of long-term deposits in total household funds.

The share of overdue retail loans inched down to 4.5% from 4.6% and to 7.3% from 7.5% for loans to non-financial organizations and individual proprietorships. The share of non-performing loans to financial organizations edged up from 2.6% to 2.7% (Figure 28). A profit of

201 billion rubles[16] earned by the banking sector in April 2021 continues to provide favourable conditions for bank lending expansion.

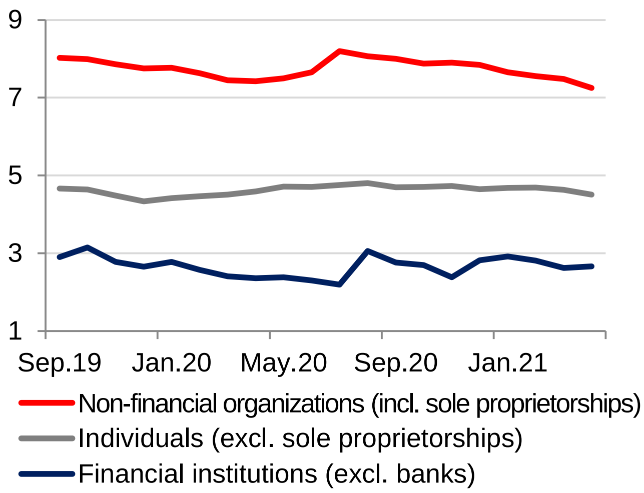
Thus, the current monetary conditions continue to help extensive bank lending growth.

**Figure 27. Household funds at banks, % YoY**




*Source: Bank of Russia.*

**Figure 28. Share of nonperforming loans in loan claims, %**




*Source: Bank of Russia.*

## 2.3. Confident merchandise export and import recovery

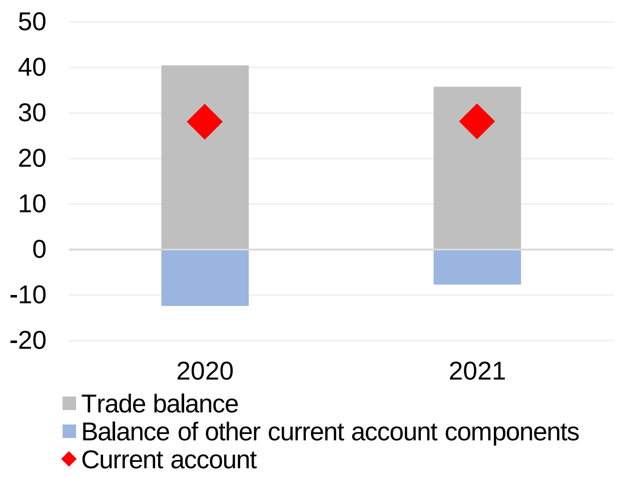
- A preliminary estimate puts the current account surplus in June–April 2021 at USD 28.1 billion, the same as a year earlier. The surplus structure, meanwhile, changed slightly, with the narrowing of the trade balance surplus offset by a reduction in the balance of services deficit.
- A reduction in the trade balance surplus stemmed from faster growth in imports than that in exports, with the latter receiving a significant boost from rising commodity prices and gradual recovery of oil extraction in compliance with the OPEC+ against a background of an overall rebound of external demand.
- April's acceleration of merchandise export growth embraced a wide spectrum of consumer and investment goods. Imports from non-CIS countries in March–April stood above the level of the pre-crisis 2019. We, however, expect consumer import growth to slow in the near future as demand is saturated in a number of categories and the pre-pandemic consumption structure gradually recovers, with the share of services rising.

[16] Profit before taxes.

Preliminary estimates put the current account surplus at USD 28.1 billion for January–April 2021, as a year earlier (Figure 29). The surplus structure, meanwhile, changed slightly. The trade balance surplus contracted to USD 35.8 billion from USD 40.5 billion, dragged down by faster growth in imports than that in exports. The services balance deficit narrowed, driven, above all, by the closure of key foreign tourist destinations, hampering the recovery of services imports.

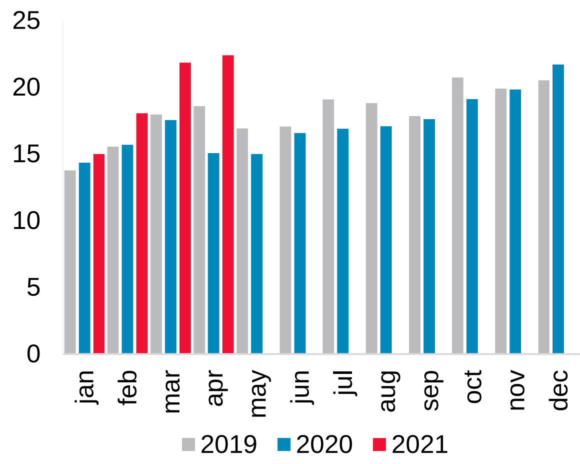
The export of goods is expanding as prices of commodities (oil,[17] metals, fertilisers, agricultural produce) rise, oil extraction is gradually increasing in compliance with the OPEC+ deal and key partner countries' economic activity rebounds as restrictions are lifted. Moreover, the import of goods has been rising since the beginning of the year reflecting consumer and investment demand expansion. Imports from non-CIS countries accounting for over 80% of total imports rose far above the 2019 and 2020 levels, with an increase over the pre-coronavirus year 2019 widened compared with March (Figure 31). Growth is posted across a wide spectrum of categories both in physical terms and by value (Figure 33, Figure 34).

**Figure 29. Key current account components in January–April, USD bn**




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

**Figure 30. Imports from non-CIS countries, USD bn**




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

*Investment import growth* at double digits relative to the pre-pandemic level (Figure 32) is posted in categories such as *construction machinery* on account of sustainable demand for housing construction; *long-haul trucks* reflecting online trade expansion and change in the conditions of road weight control, requiring lighter and more modern trucks.[18] Also, rising prices of agricultural produce and government support allow filling the shortage of agricultural machinery and upgrading available equipment.[19]

[17] Since oil and gas exports reflect world oil price growth with a one-two month lag, April's oil and gas component of exports is partially driven by a deferred effect of a steep price rise at the start of the first quarter.
[18] Amendments to the law on automobile weight and size took effect as of 17 January.
[19] https://iz.ru/1153629/2021-04-19/v-i-kvartale-2021-goda-prodazhi-selkhoztekhniki-vyrosli-na-53

*Consumer import* growth is buoyed by, above all, expanding purchases of non-food goods. This arises, on the one hand, from a partial return to the pre-coronavirus consumption model on the back of people's rising mobility and a gradual shift to work in the office, and, on the other hand, from an increase in the import of small and larger household appliances, likely because of the need to replenish the stock of goods, exhausted amid strong demand against a background of a massive shift to distance work. The closure of key foreign tourist destinations also helps a partial shift of consumer demand from the import of services to that of goods.

**Figure 31. Contribution of key items to growth in imports from non-CIS countries in Q1 2021, %***

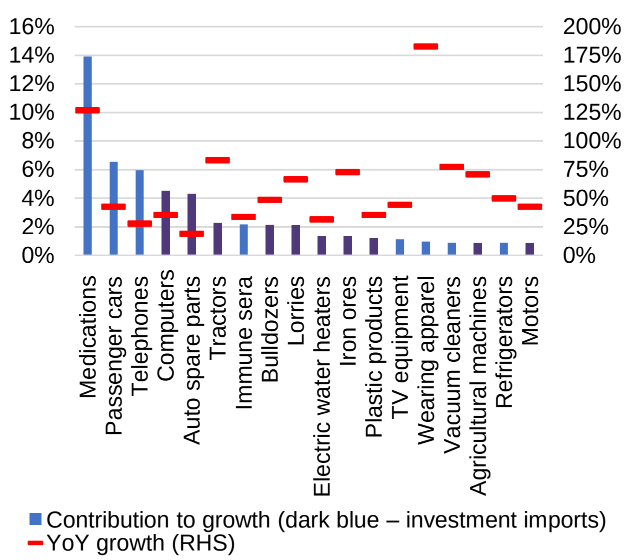
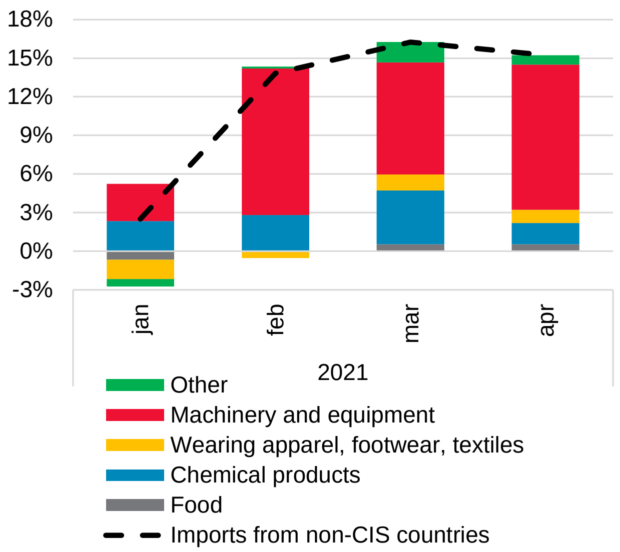



**Figure 32. Decomposition of growth in imports from non-CIS countries by large category, % of 2019***

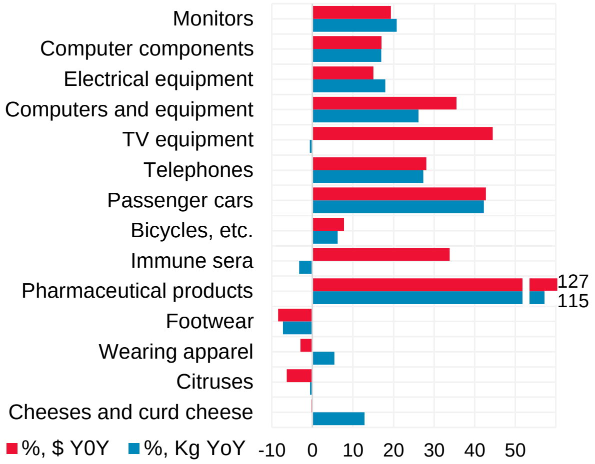



** Imports are adjusted for sea vessel deliveries under temporary import procedures. LNG sea carriers operating on the Arctic shelf under the temporary import procedure with subsequent re-export, account for 21.6% of overall import growth in the first quarter of 2021. Therefore, we adjust total imports for the value of these vessels.*

*Sources: Federal Customs Service, R&F Department estimates.*

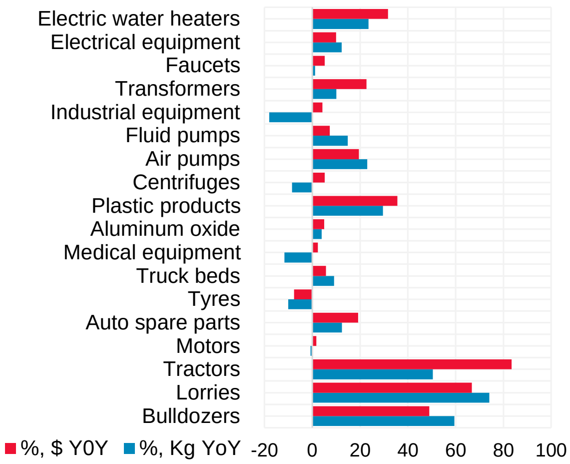
Further recovery of economic activity gives reason to expect long-term growth in *consumer* and, especially, *investment* imports. A record-high rate of merchandise import growth posted since the start of the year in part reflects structural changes in the economy brought about by the pandemic. They have so far supported import growth in categories such as computers and communication equipment, lorries and refrigerators, and pharmaceutical products. But this segment will likely reach saturation in the near future, while further growth will be driven by investment goods used in the construction, agricultural, and other industries which have received a positive impulse from the pandemic. Imports will be contained by the continuing logistics problems and gradual approach to the pre-pandemic consumption structure, with services consumption rising.

**Figure 33. Imports of consumer goods[20] in Q1 2021**




*Sources: Federal Customs Service, R&F Department estimates.*

**Figure 34. Imports of investment goods in Q1 2021**




*Sources: Federal Customs Service, R&F Department estimates.*

[20] It is fairly difficult to separate consumer goods from investment goods in many components, such as monitors, telephones, computer equipment. Therefore, import growth may in this case reflect a rise in consumer demand or investment demand, or both.

# IN FOCUS. EFFECT OF PANDEMIC ON MARKET ENTRIES AND EXITS

- The rate of market exits rose in 2020, spurred by economic consequences of the pandemic. The most extensive rise in the number of business closures was posted in the hardest hit industries. Support measures helped alleviate the coronavirus implications without hampering market adjustment to new realities.
- The rate of market exits declined to pre-coronavirus levels at the start of 2021. This may have been helped by the recovery of economic activity and companies' improving flexibility in dealing with their counter-agents in the new environment.
- The group of companies showing the lowest labour productivity saw the highest rate of market exits, releasing economic resources for use by more efficient and productive companies.
- But a situation where the rate of new market entries shows no sign of rising as the economy recovers and young companies which have failed to realize their potential amid the crisis have scaled up their market exits, may bring to naught the above positive effect.
- For the Russian economy to move onto a sustainable growth path, conditions should be provided for establishing new companies along with support for efficient operating enterprises, especially young companies with a strong growth potential. Creation of conditions for increasing the number of high-productivity companies should be accompanied by establishing an environment conducive to new companies' rapid development, expansion, and efficiency enhancement.

The rates of market entries and exits may both reflect the current pace of economic activity and provide an indicator of structural changes and medium- and long-term implications of the coronavirus crisis, whose specifics are largely different from those of previous economic crises.[21]

As the most stringent restrictions were put in place to contain the spread of the new coronavirus infection in the spring of 2020, the number of liquidated companies was stable relative to the pre-coronavirus level of early 2020[22] (Figure 35). *On the one hand,* confronted with restrictions, many enterprises postponed the registration of their closure until later. *On the other hand,* government support measures could have kept part of companies, at least for a while, from deciding to close right then.

In July 2020, after most restrictions had been lifted, there was a surge of closures[23] adjourned in the second quarter. A significant impact of the deferred effect is borne out by the

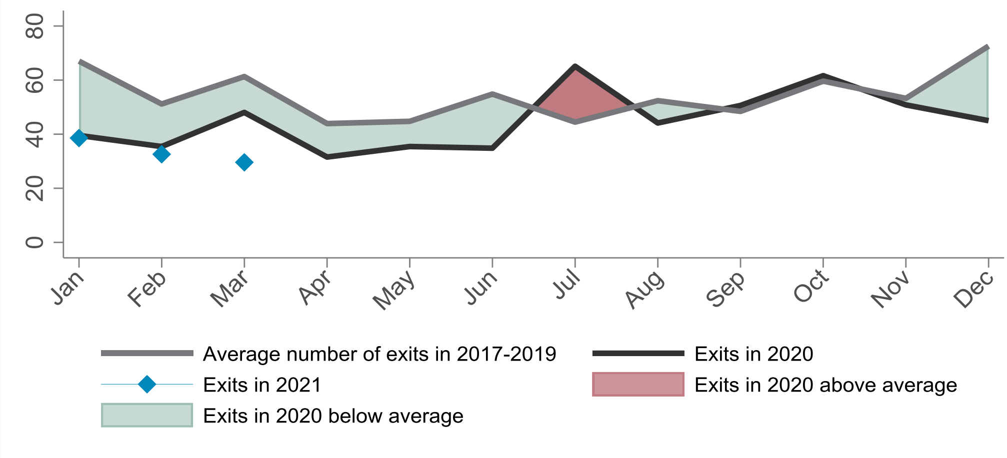
[21] For details, see the analytical note by E, Bessonova, S. Myakisheva, and A. Tsvetkova Market exits during the pandemic.

[22] At the start of 2020, the number of liquidations was below the average 2017–2019 level. This is owed to, among other things, the high base effect: in 2017, the Federal Tax Service started cleansing the register of small and medium-size enterprises from businesses that had long been out of operation but failed to be liquidated, hence the 2017–2019 number may have reflected actual exits of the previous years.

[23] The number of market exits stood 46% above the average 2017–2019 level.

fact that a surge of liquidations was seen not only in the hardest hit industries but also in other areas of activity. According to Unified State Register of Legal Entities (USRLE) data, July's rate of exits stood 57% above the average level for the same month of 2017–2019, but other industries also exceeded the average level by 42% (Figure 36).

**Figure 35. Number of liquidated enterprises, Rosstat data, thousand**




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

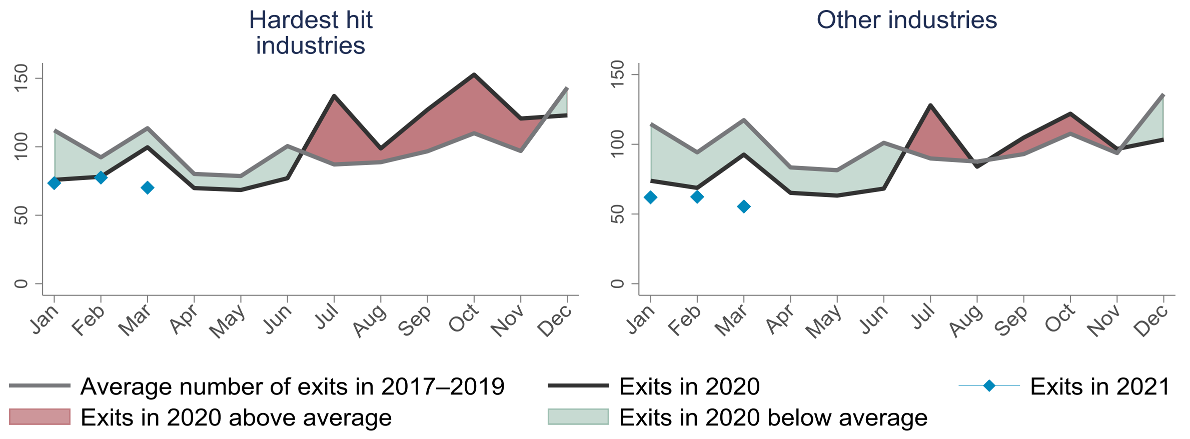
The number of exits was generally elevated in the second half of 2020.[24] But unlike July, it was not only due to the effect of decisions deferred while restrictions were in place. The elevated rate of market exits in the remaining part of the second half of the year stemmed from the economic consequences of the pandemic. This is suggested by the fact that the rate of exits in the autumn of 2020, which saw yet another spell of epidemic situation aggravation, was much higher in the hardest hit industries even as government support measures were provided. October's number of exits in the hardest hit industries stood 39% above the average level in the same month of 2017–2019 (Figure 36).

But as early as the first quarter of 2021, the number of liquidations returned to the "pre-pandemic" level, even lagging behind last year's figures in March.  We believe that against a background of the confident economic recovery this decline reflects the economy's fast adaptation to the pandemic's structural consequences, which required many companies to rethink their pre-crisis business models. Following the coronavirus shock, firms remaining in the market have to show greater flexibility and willingness to meet their counter-agents' needs than before the crisis.

It is worth noting that beginning from April 2020, liquidations reflect only market exits of companies' own accord, since a moratorium on creditor-initiated bankruptcies was imposed as of 6 April. Although the moratorium was lifted as of 7 January 2021, we will likely see the effect of this only as late as the middle of 2021, after the time needed to complete all the procedures of formal liquidation has elapsed.

[24] Comparing the gap with the average 2017–2019 level over the first three months of 2020 (roughly the pre-coronavirus level) and in the second half of the year.

**Figure 36. Number of liquidated companies by industry, USRLE data, 2017–2019 average = 100**




*Sources: Unified State Register of Legal Entities, R&F Department estimates.*

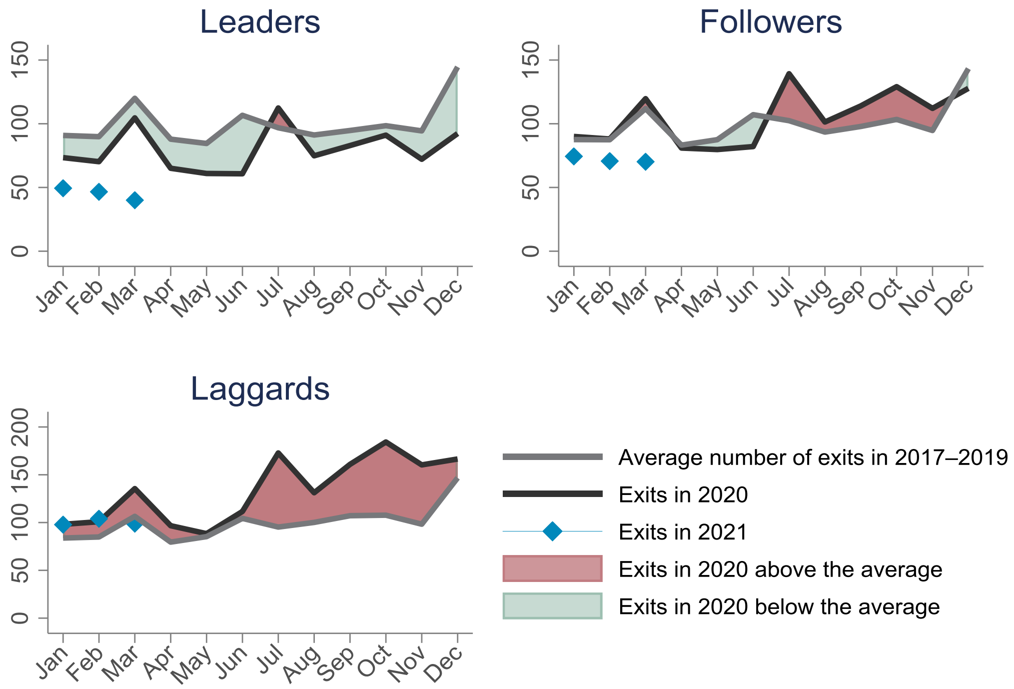
According to estimates based on SPARK data, the number of market exits in the group of productivity leaders stood 16% above the average 2017–2019 level in July 2020 and lagged 8% behind it[25] in October. The rate of exits was much higher in the group of laggards, standing 81% above the average level in July and 71% in October (Figure 37). The relative pattern of exits across the productivity groups remained similar at the start of 2021. The number of exits in the group of leaders was far below the pre-coronavirus level and roughly on the pre-coronavirus level in the group of laggards. This distribution of market exits by productivity may have a positive effect on labour productivity in the short and medium term, since the least productive firms leave the market, releasing labour force which could be used in higher-productivity companies.

Young companies showed a high rate of exits, just as the least productive ones (Figure 38). This group is often one of the most vulnerable in crises. *First,* during their first years, companies do not yet operate at full capacity, thus failing to take advantage of the economy of scale to the full. *Second*, establishment of strong ties with suppliers as well as a pool of loyal consumers/customers may take time. Therefore, young companies' productivity is usually lower than that of well-established firms. On top of that, young enterprises often bear a heavier burden of debt raised for their establishment.

As a result, many young firms may encounter relatively high-amplitude cost and demand shocks in the periods of supply disruptions and a fall in demand, despite their possible relatively strong potential for productivity growth. Therefore, the exit of young companies may have an adverse effect on labour productivity in the economy at large, since companies have to exit the market without realizing their potential.

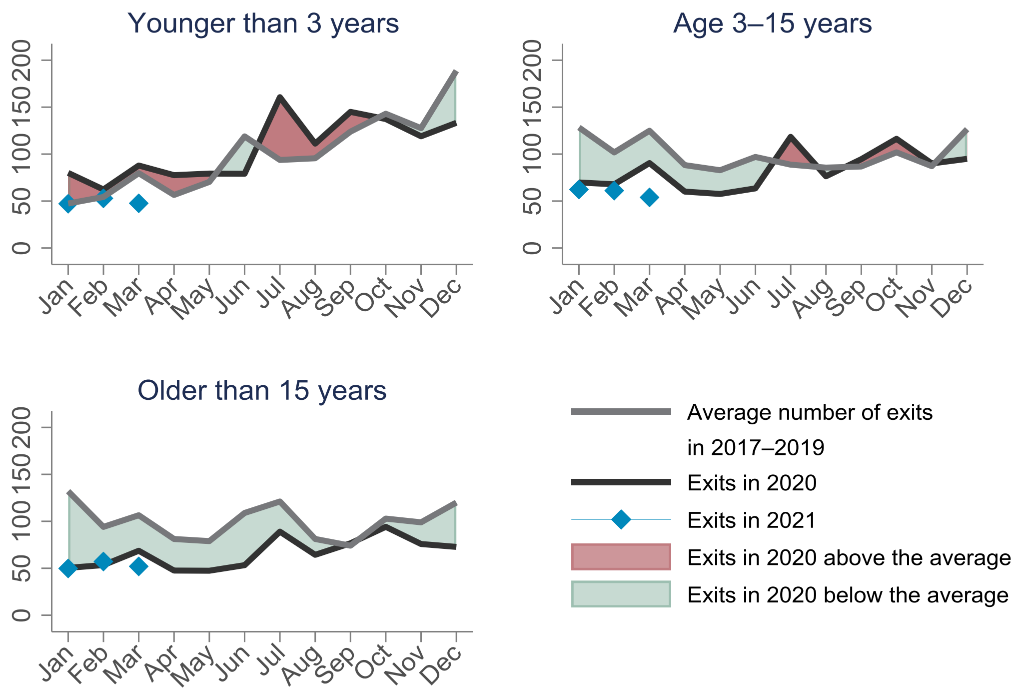
[25] Firms were grouped according to their labour productivity levels as follows. Using data from 2011–2018 financial reporting of firms employing more than 10 personnel from the RUSLANA database, the sample was split into 290 industries under the OKVED2 code, with 20% of highest-productivity companies in individual industries identified as leaders. Enterprises whose productivity is below that of leaders but above median in each industry were assigned to the group of followers. Companies with productivity below median in individual industries were assigned to the group of laggards. Information about enterprises dates of exit was obtained from the SPARK database.
For details of productivity assessment methodology, see: Bessonova E. Firms' Efficiency, Exits and Government procurement contracts / Bank of Russia Working Paper Series wps49. 2019; Bessonova E., Tsvetkova A. Productivity convergence trends within Russian industries: firm-level evidence / Bank of Russia Working Paper Series wps51. 2019.

**Figure 37. Number of liquidated companies by productivity level, sample data, 2017–2019 average = 100**




*Sources: SPARK, R&F Department estimates.*

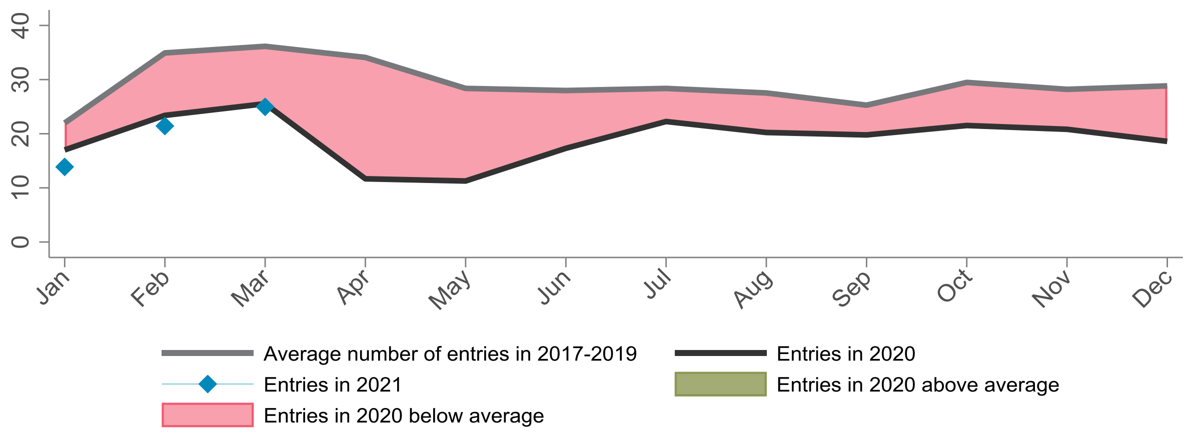
**Figure 38. Number of liquidated companies by age group, USRLE data, 2017–2019 average = 100**




*Sources: Unified State Register of Legal Entities, R&F Department estimates.*

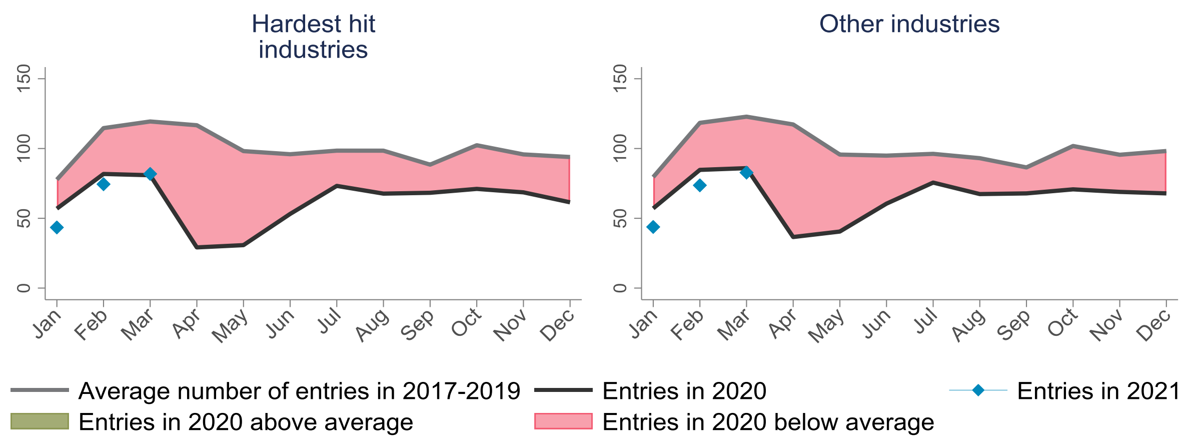
In the medium and long run, change in the rate of market entries has an effect on labour productivity, and hence on the potential of economic growth in the medium and long run. The number of entries sharply declined when restrictions were in effect in April–May 2020 (Figure 39). Then it rebounded to roughly pre-pandemic levels of the first quarter of 2020, remaining below the 2017–2019 average. Moreover, unlike exits, the rates of entries in the hardest hit industries were roughly equal to those in other industries (Figure 40).

**Figure 39. Number of newly registered enterprises, Rosstat data, thousand**




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

**Figure 40. Number of registered companies by industry, USRLE data, 2017–2019 average = 100**




*Sources: Unified State Register of Legal Entities, R&F Department estimates.*

Market entries and exits in 2020 and the start of 2021 generally allows formulating several assumptions regarding medium- and long-term coronacrisis implications for economic activity.

Beneficial implications from the perspective of future productivity trends include a rise in the rate of exits of the lowest-productivity enterprises, which releases economic resources for use by higher-productivity companies. The higher rate of exits by companies from the hardest hit sectors indicates the economy’s adjustment to structural changes brought about by the pandemic.

One possible negative implication is that the lowest-productivity companies which have had to leave the market because of the economic downturn may have included a number of young companies which will not get a chance to realise their potential in the future. Moreover, the number of new market entries shows no sign of rising, which does not help the replacement of companies exiting the market by new enterprises with a strong growth potential. Hence, the beneficial effect of the crisis, i.e., the exit of the least productive companies comes to naught as there is no evidence of a replacement effect, implying the advent of new enterprises which could use resources thus released with greater productivity. It is difficult right now to assess the scale of these oppositely directed effects and their eventual impact on medium- and long-term productivity growth prospects. This requires an analysis over a longer horizon, studying, among other things, the impact of the lifting of the bankruptcy moratorium, which will likely start affecting the rate of exits beginning from the middle of 2021.

Thus, for the Russian economy to move onto a sustainable growth path, conditions should be provided for establishing new companies along with support for efficient operating enterprises, especially young companies with a strong growth potential. Creation of conditions for increasing the number of high-productivity companies should be accompanied by establishing an environment conducive to new companies’ rapid development, expansion, and efficiency enhancement.

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