



Bank of Russia

No. 5 (49)



TALKING TRENDS

Economy and markets

Research and Forecasting Department Bulletin

JULY 2021

CONTENTS

| | |
|--|-----------|
| EXECUTIVE SUMMARY | 3 |
| 1. Inflation | 4 |
| 1.1. Inflationary pressure remains elevated | 5 |
| 1.2. Producer prices continue to rise at elevated pace | 9 |
| 1.3. PMI price indexes: pro-inflationary effect of costs is most pronounced in services sector | 11 |
| 2. Economic performance | 12 |
| 2.1. Real-time indicators in June: economy maintains growth | 12 |
| 2.2. Consumption growth slows in May | 14 |
| 2.3. Industrial output takes a break after three-month growth | 17 |
| 2.4. Further confident lending growth | 19 |
| 2.5. Global demand recovery will support exports | 23 |

The Research and Forecasting Department prepared this bulletin based on data as of 08.07.2021

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

- Inflationary pressure was still elevated in June, which was associated with the influence of *steady* demand- and supply-side factors. In this environment, households' and businesses' inflation expectations remain high, which is a factor that might exacerbate secondary proinflationary effects from price growth. Credit activity continues to expand quickly, further boosting the increase in domestic demand. As supply response to higher demand is not sufficiently fast, supply-side proinflationary risks persist. In such a situation, the impact of steady inflation factors will be weakening gradually.
 - In June, inflation rates and expectations were still elevated. Consequently, annual inflation exceeded 6%. As before, neither the consumer market, nor industrial sectors showed any signs of weakening inflationary pressure. Annual inflation will start to trend downwards steadily after the current monetary policy normalisation generates disinflationary effects, which will take time.
 - Russia's economy maintained an upward trend in May–June, including owing to a fast expansion of corporate and retail lending. As a result, the economy bounced back to its pre-pandemic level in Q2, whereas industries focused on consumer and investment demand reached pre-pandemic growth paces. Russian exports are supported by the recovery of the global economy and higher prices for commodities.
 - The Russian stock market continued to expand in June. Yields on both short- and medium-term bonds edged up. This is generally in line with trends in global financial markets and expectations of a further monetary policy normalisation in Russia. Contrastingly, yields on long-term bonds remained almost unchanged. This is evidence that financial market participants' long-term inflation expectations are anchored close to the inflation target.

1. Inflation

Seasonally adjusted consumer price rises remain substantially elevated and so far show no signs of slowing. As a result, annual inflation hit 6.5% in June. It does not seem to have reached its peak yet, given the inertia of inflation processes and their significantly lagged response to monetary policy coming back return to normal.

The key measures of *sustainable* inflationary processes are still indicating substantial inflationary pressure in the consumer sector. Indeed, median monthly price growth stood above 5% in May, with trend inflation indicators rising to 4.9%–5.1%. Nevertheless, indicators showing steadier performance are much lower than those of overall consumer price inflation.

This means that:

- 1) both non-monetary and monetary factors underlie elevated consumer price inflation;
- 2) the effect of non-monetary factors is somewhat more pronounced than that of monetary ones, but the latter's contribution to price rises is quite substantial;
- 3) the impact of non-monetary factors, such as some supply-side shocks, is long-lasting.

In an environment of rising costs and logistics constraints, the impact of rising consumer demand assumes a more pronounced pro-inflationary nature, hampering a price rise deceleration in the current monetary conditions.

On top of that, pro-inflationary risks are still prevailing over disinflationary ones, as suggested by a number of indicators which are leading in nature. For example, manufacturing and services sector companies alike continue to report the fast pace of input and output price rises, while the actual rate of rises in producer prices of consumer goods far outpaces retail price growth in these goods, setting the ceiling of their possible increase. The index of companies' expected price rises, calculated by the Bank of Russia has stayed at its peak since at least 2016, driven by the fast pace of world food price rises. Finally, the performance of monetary indicators "predicts" annual inflation stabilisation rather than its significant decline in the remaining part of the year.

Household inflation expectations and related secondary effects on consumer prices are likely to continue in this environment.

Therefore, any central bank fulfilling the mandate for maintaining price stability is required to increase the price of money in the economy via raising the key interest rate. Why will it produce a result, bringing down inflation?

First, the transmission mechanism of monetary policy is well-known and thoroughly studied, with the existence and effectiveness of monetary policy channels in Russia confirmed. In particular, Russia's banking system has recently seen a rise in household deposit rates in response to monetary policy measures adopted by now. In particular, an improvement in the attractiveness of deposits as a store of value and protection from inflation diminishes interest households' willingness to look for alternative sources of savings, bringing down demand,

including for durable goods. Rising loan rates make loans less appealing, which will slow lending growth somewhat, at the same time making it more sustainable and balanced in the medium term. Finally, the higher ruble interest rates positively affect the exchange rate, at least hampering national currency weakening. This also stabilises prices.

Second, the implementation of similar monetary policy decisions yielded results in other, both advanced and emerging, economies. Russia's experiences of inflation targeting in 2015–2020 bears this out.

It should be emphasized that slowing inflation down to the target through bringing monetary policy back to normal will be accompanied by maintaining economic growth at potential. Monetary policy is capable of curbing inflation, moreover, achieving this without incurring significant economic costs.

1.1. Inflationary pressure remains elevated

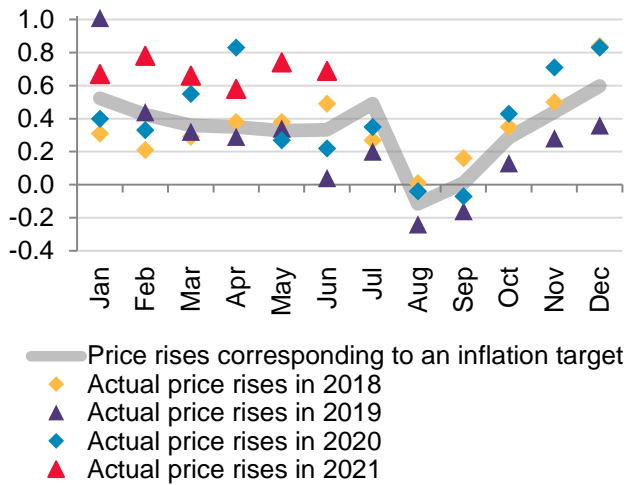
- Annual inflation accelerated to 6.50% in June from 6.02% in May. Further inflation acceleration is fuelled by elevated month-on-month price rises continuing across a wide range of categories in the consumer basket coupled with the low base of 2020.
- Analytical indicators of the most stable inflation components suggest the continuation of elevated inflationary pressure. This is prompted by continuing consumer activity expansion amid lingering supply-side constraints.
- Inflationary pressure is set to remain elevated in the coming months despite the impact of ruble strengthening and a more pronounced seasonal fruit and vegetable price decline than usual. In this environment, the return of inflation to the target will only come to pass as late as the second half of 2022.

Month-on-month price growth edged down to 0.69% in June from 0.74% in May but remained far above levels corresponding to an inflation rate of 4% (Figure 1). Given the low base of 2020, annual inflation continued to rise, reaching 6.50% in June (Figure 2). Inflation reached 4.19% over the period from the start of the year.

Seasonally adjusted consumer price inflation slowed somewhat to 8.86% MoM SAAR¹ in June (Figure 3). Meanwhile, the pace of price rises exceeding 4% in annualised terms was posted across a wide range of items (Figure 4).

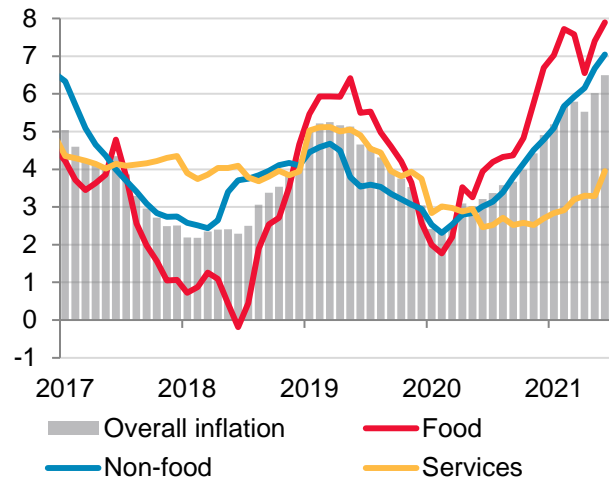
¹ SAAR – seasonally adjusted annualized rate.

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



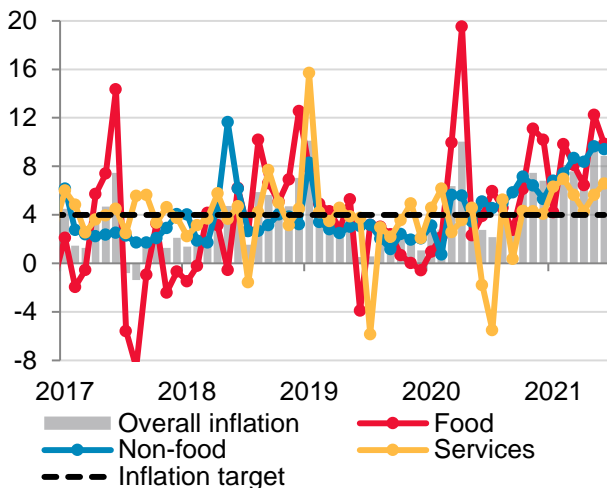
Source: Rosstat, R&F Department estimates.

Figure 2. Inflation and its components, % YoY



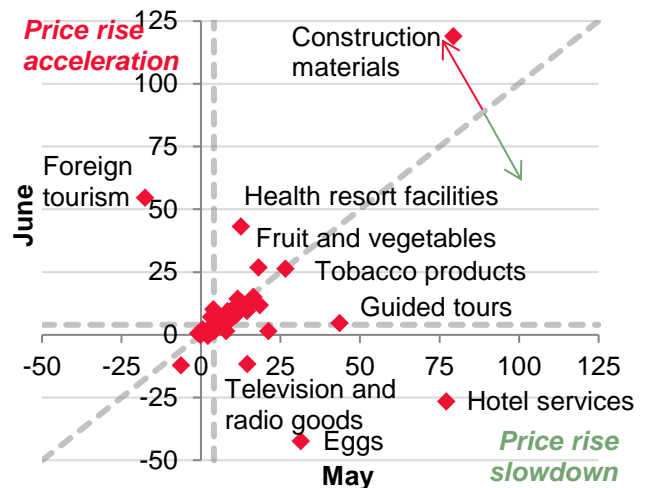
Source: Rosstat.

Figure 3. Seasonally adjusted inflation, % MoM SAAR



Source: Rosstat, R&F Department estimates.

Figure 4. Seasonally adjusted price rises in some goods and services, % MoM SAAR



Sources: Rosstat, R&F Department estimates.

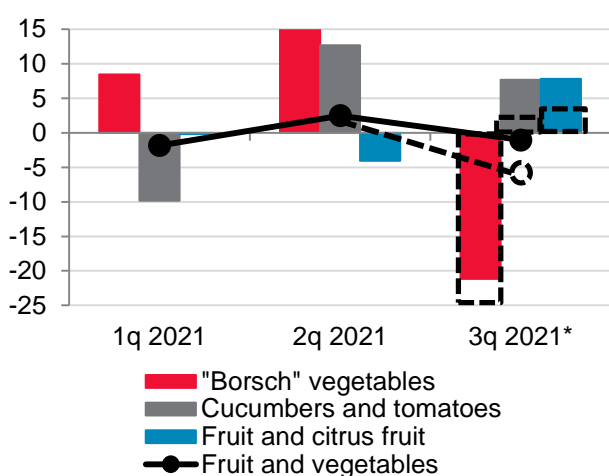
Seasonally adjusted consumer price rises in the food segment slowed to 9.85% MoM SAAR in June, remaining far above 4% in annualised terms (Figure 3). Notable upward pressure on prices came from seasonal fruit and vegetable price increases driven by the last year’s stocks coming to an end and a later than usual sowing time. With the advent of a new harvest, fruit and vegetable prices will see a steeper fall than usual. We do not, however, expect a greater effect of this on overall price growth. We estimate that this will take roughly 0.1–0.3 pp off the consumer basket price in seasonally adjusted terms (with the effect of declining “borsch component” prices accounting for up to 0.2 pp²) (Figure 5).

Food prices (net of fruit and vegetables) went up 7.58% MoM SAAR in June. Price rise slowdown compared with May was posted in many food items. The pace of price rises in some

² Vegetables, whose prices are monitored on a monthly basis are potatoes, white cabbages, onions, beets, and carrots.

foodstuffs remained elevated, however, while sugar price hikes, for instance, accelerated (driven by the expiration, as 1 June, of the official decree on imposing price caps, and risks that earlier announced subsidies³ will fail to materialise). We also note that June saw world food prices decline month-on-month for the first time since May 2020.⁴ This may represent the first signal of a possible price stabilisation in external markets after their over-25% increase from the pre-coronavirus levels of early 2020. Should this pattern of price movements continue in the months to come, the pressure of world prices on the domestic food market will attenuate gradually.

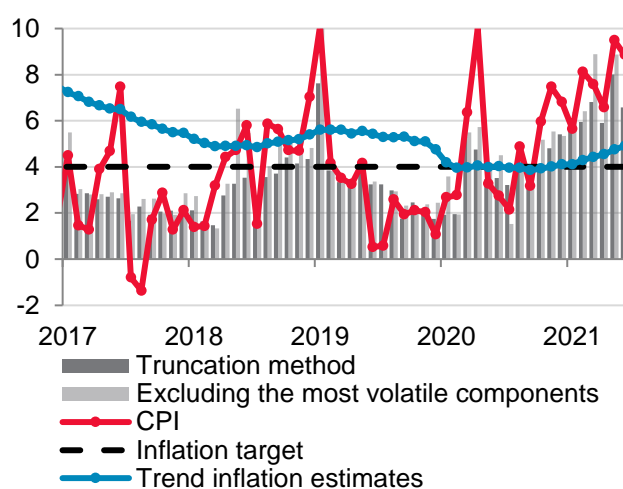
Figure 5. Seasonally adjusted price rises in fruit and vegetables, % QoQ, at the end of quarter



* Range of estimates for 3q 2021.

Source: Rosstat, R&F Department estimates.

Figure 6. Modified core inflation indicators and trend inflation estimates, % in annual terms



Source: Rosstat, R&F Department estimates.

Seasonally adjusted price rises in non-food goods came in at 9.41% MoM SAAR (Figure 3). Prices in this segment continue to be driven by negative price conditions in external markets (the shortage of microelectronic chips and timber), giving a boost to prices of some car and construction material components. The recovery of consumer demand, rising inflation expectations, and consumer lending expansion cause a further significant inflationary pressure increase in this segment.

The services sector has seen more moderate seasonally adjusted month-on-month price growth than that in the goods sector in recent months, but it accelerated notably in June compared with May, to come in at 6.59% MoM SAAR (Figure 3). Price hikes are still led by hotel, health resort and railway transport services. A further, likely temporary, impact on June's price rises was prompted by the opening of borders with Turkey, producing a jump of foreign tourism prices. With a number of mass foreign tourism destinations remaining closed, the

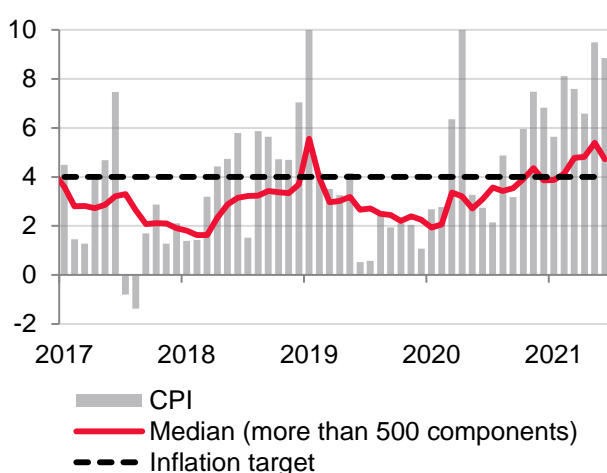
³ [Deliveries of inexpensive sugar in jeopardy](#) / Vedomosti / 10.06.2021.

⁴ According to FAO data, world food prices (in USD terms) dropped 2.5% MoM in June, with annual price rises slowing to 33.9%.

summer holiday season will likely maintain upward pressure on domestic tourism prices in the next few months.

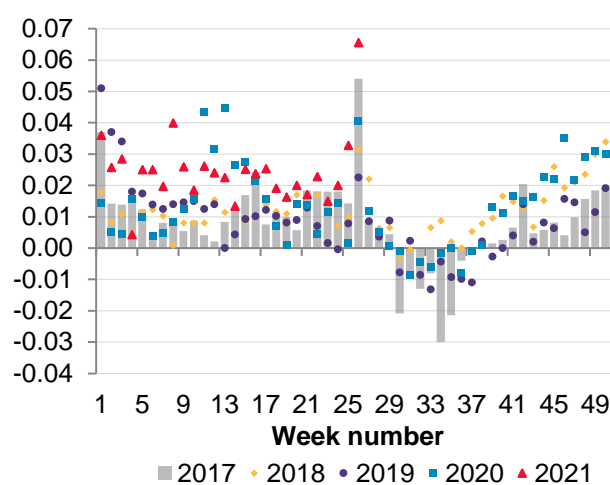
Analytical indicators of price movements continue to suggest the persistence of elevated inflationary pressure in June (Figure 6, Figure 7). It declined somewhat compared with May but remained increased relative to an inflation rate of 4%. The median distribution of monthly seasonally adjusted rates of price rises over maximally disaggregated CPI components⁵ and modified core inflation indicators declined somewhat but stayed above 5% MoM SAAR. Trend inflation⁶ continued to deviate from the 4% level, coming in at 4.9% in June.

Figure 7. Median distribution estimated on disaggregated components, % MoM SAAR



Source: Rosstat, R&F Department estimates.

Figure 8. Average daily price rises, %



Source: Rosstat, R&F Department estimates.

Real-time Rosstat data indicates that consumer prices rose 0.33% from 1 to 5 June (Figure 8). This is largely due to the indexation of housing and utilities services prices. Price rises were, however, further boosted by a jump in passenger car prices (which was not typical of the same period of previous years). The estimate of annual inflation rose to 6.6% as of 5 July.

Inflationary pressure is set to stay somewhat above the level corresponding to an inflation rate of 4% in the coming months. Price movements will continue to be affected by a mixed set of factors: on the one hand, by the worsening of price conditions in external markets and a pass-through of producer costs to consumer prices amid the continuing demand recovery, and on the other hand, by the recent ruble strengthening and seasonal arrival of fruit and vegetables to the market.

Bank of Russia interest rate decisions will help inflation come back to the 4% level in the second half of 2022, to subsequently stabilise close to the Bank of Russia's target.

⁵ 556 components in the 2021 basket.

⁶ The estimate is calculated on a 5-year rolling window.

Nominal rate amid elevated inflation expectations

What key rate level meets the definition of a neutral one in the current environment? When inflation stood close to 4%, the Bank of Russia looked to a nominal neutral interbank rate of 5-6%, based on a real neutral range of 1–2% at that time. With the current annual inflation above 6% and, most importantly, significantly higher inflation expectations, the same real rate of 1–2% should, under neutral monetary policy, correspond to a much higher range of the nominal key rate than 5–6%. Meanwhile, the range of estimates of a shift in the range of monetary policy neutrality is wide. The estimate largely depends on an opinion regarding the magnitude of an increase in inflation expectations in the economy at large and how long they will remain elevated.

What makes the problem more difficult is that changes in inflation expectations have been different for different groups of economic agents. Based on polls, households' inflation expectations have risen several percentage points since the end of 2019. Businesses' inflation expectations have also increased substantially, but it is hard to estimate the exact magnitude of change. At the same time, the inflation expectations of financial market participants remained anchored at 4%. Changes in inflation expectations make themselves felt in a different way for each individual group: via consumer behaviour, pricing policy, demand for different kinds of financial assets, etc. Therefore, a key rate level balancing changes in the expectations of all groups of economic changes will likely be identified by trial and error rather than calculated in advance.

1.2. Producer prices continue to rise at elevated pace

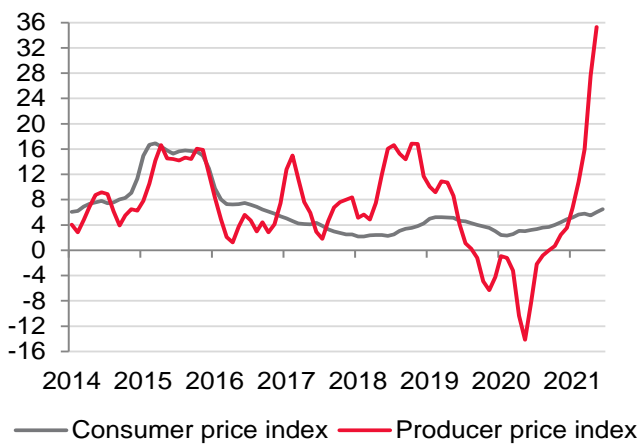
- Annual growth in producer prices of industrial goods accelerated to 35.3% in May from 27.6% in April, largely due to a low base (Figure 9). As a reminder, a year ago prices hit all-time lows in the mining and quarrying sector as world commodity prices plummeted. In addition to the low base of last year, producer prices are climbing as cost increases driven by disruptions in the supply of some components and an acceleration in nominal wage growth in the Russian economy are passed through to prices: April–May saw prices rising about 16% regarding to the corresponding months of 2019.
- From the perspective of industries, the main contribution to annual price growth again came from oil and gas extraction, the manufacture of coke and refined petroleum products (Figure 10). The manufacturing sector posted an acceleration of rises in the prices of intermediate goods to 49.1% YoY, driven by those in the manufacture of coke and refined petroleum products (Figure 11).
- Price rises are on average less steep in other segments but are also gaining pace. For example, industries meeting investment demand posted a price increase of 6.1% YoY. Industries meeting consumer demand⁷ saw price hikes accelerating to 12.6% YoY. The key

⁷ 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.

price growth drivers were food products, whose prices added 16.4% YoY, household appliances with a 14.5% YoY price increase, furniture and other fabricated products (11.4% YoY).

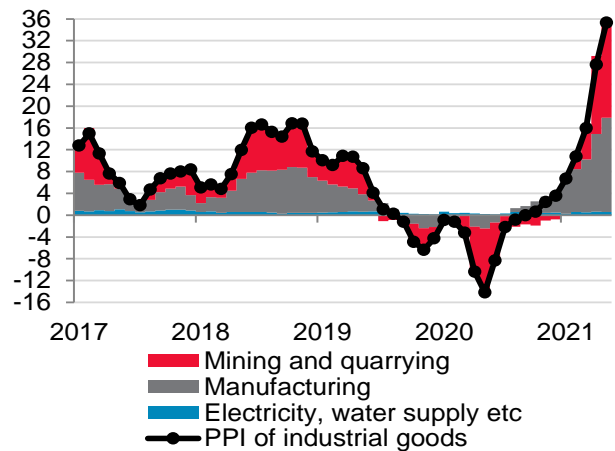
- Producer price inflation calculated on a basket of some consumer goods⁸ weighted using the structure of consumer expenditure for estimating the CPI, accelerated to 12.9% YoY in May (Figure 12). This indicates the persistence of significant pressure on retail prices from producer prices.
- In an environment of demand expansion and elevated inflation expectations, we may well see a further pass-through of producer costs to consumer prices going forward.

Figure 9. Consumer and producer price movements, % YoY



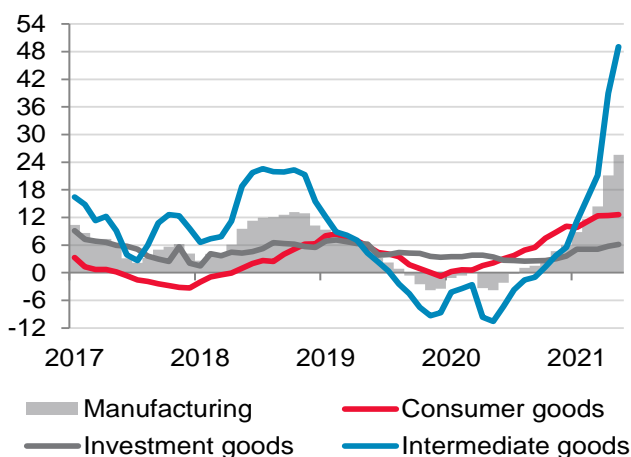
Source: Rosstat.

Figure 10. Input of main industries to a rise in producer prices, % YoY



Source: Rosstat, R&F Department estimates.

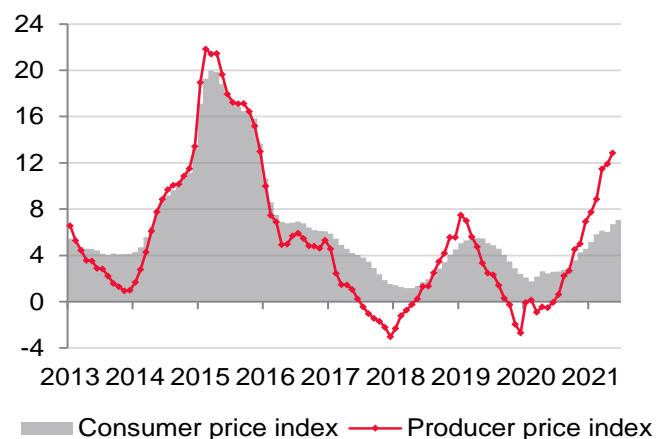
Figure 11. Producer prices in groups of manufacturing industries, % YoY



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.

Source: Rosstat, R&F Department estimates.

Figure 12. 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.

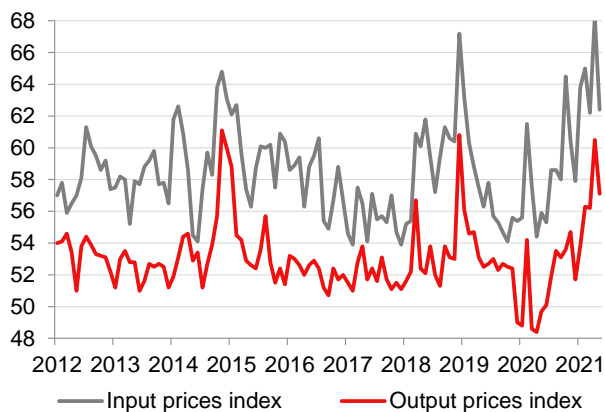
Source: Rosstat, R&F Department estimates.

⁸ Unlike the above calculation, 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.

1.3. PMI price indexes: pro-inflationary effect of costs is most pronounced in services sector

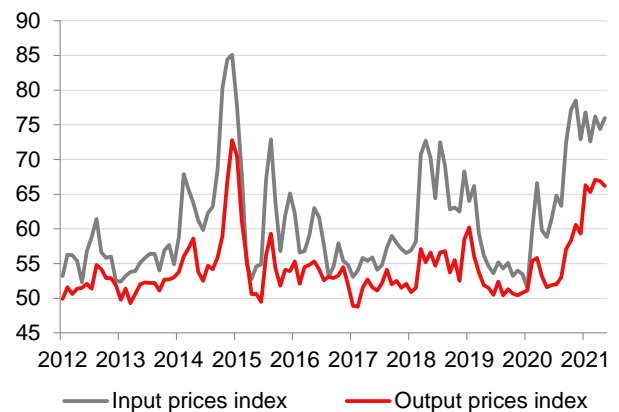
- PMI price indexes point to the continuation of elevated inflationary pressure in services and manufacturing alike.
- The services sector's indexes of input and output prices returned to the April levels after their sharp rise in May (Figure 13). The indexes still stay at high levels though, which in recent years have only been observed when temporary pro-inflationary factors were at their peak, i. e. at the start of 2019 and at the end of 2014 – the start of 2015.
- The continued confident recovery of activity and new orders in the services sector (see Section 2.1) allow companies to pass through a rise in costs to output prices, with companies citing wage indexation amid employment growth acceleration as one factor of cost increases.
- Price indexes remain elevated in manufacturing. Delivery problems exert upward pressure on costs and output prices. New orders, however, showed signs of contraction in June. The respondents directly attribute this to price rises, making their counter-parties scale down purchases. Producers may therefore be expected to pass through rising costs to output prices to a lesser extent in the months to come, which may slow their output price inflation.

Figure 13. Change in PMI services indexes, pp



Source: IHS Markit.

Figure 14. Change in PMI manufacturing



Source: IHS Markit.

2. Economic performance

Real-time and leading indicators of economic activity confirm that Russia's GDP hit the pre-coronavirus level in the second quarter of 2021, even surpassing it in many industries.

All three industry groups in manufacturing returned to the pre-coronavirus growth trajectory, with growth in the investment and consumer goods industries even outpacing it. In order to expand the supply of goods to meet growing demand, investment in production expansion is required in an increasingly large number of cases, which takes time to materialise. At the same time, there is still high uncertainty over future demand amid the difficult epidemic situation worldwide and over the sustainability of ongoing structural changes in demand. In this kind of situation, companies may postpone investment until uncertainty subsides.

Some consumer goods industries still see production expansion hampered by disruptions in transborder deliveries and a difficult epizootic situation. Consumer services, which faced the most severe downturn in the coronavirus period recovers at a fast pace, although the recent worsening of the epidemic situation is starting to hurt this sector again.

The acceleration of nominal wage growth supports the positive rates of real wage expansion despite higher inflation. Meanwhile, a dramatic wage growth acceleration is posted in industries which have exceeded the pre-coronavirus production level and in the construction sector which is facing a shortage of workers amid the industry's growing income.

Given the structural shifts in the labour market and the continuing difficulties with hiring migrant workers, further return of unemployment to the pre-coronavirus level may trigger nominal wage growth acceleration, which will intensify inflationary pressure.

The continuing soft monetary stance is, through low interest rates, still stimulating loan demand and risk tolerance in taking investment decisions. Lending activity keeps rising confidently, showing an acceleration trend, which signals the expansion of lending's contribution to domestic demand growth in the Russian economy. Growth in ruble corporate lending accumulated since the start of the year has hit recent years' highs. Retail lending is also posting growth close to record high levels. A savings ratio decline thanks to, among other things, extensive borrowing, boosts consumer activity. The soft monetary stance also prompts a rise in demand for durable goods and real property and in large part account for the increased interest in stock market instruments as a store of value.

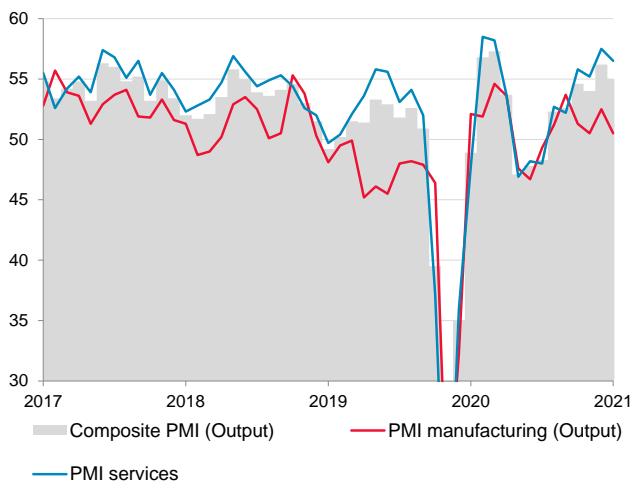
2.1. Real-time indicators in June: economy maintains growth

- In the middle of June, Rosstat released its first estimate of GDP performance in the first quarter of 2021, posting a 0.7% YoY decline⁹ after a fall of 1.8% YoY in the fourth quarter of 2020. We estimate that this corresponds to a marginal quarter-on-quarter growth slowdown to 0.7% QoQ SA from 0.8% QoQ SA in the fourth quarter.

⁹ A preliminary Rosstat estimate posted a 1.0% YoY decline.

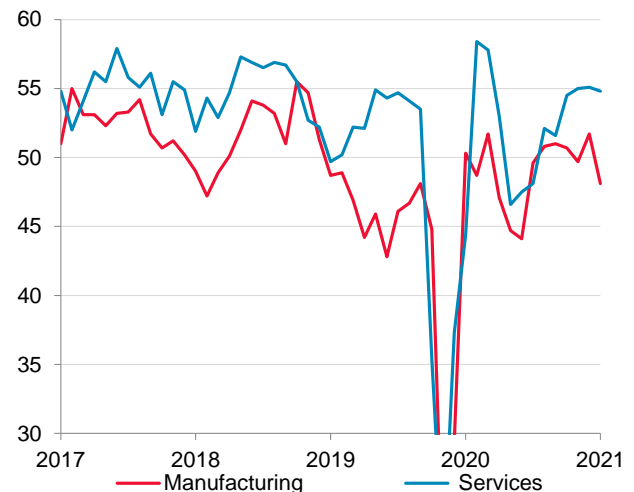
- The second quarter saw economic growth continue at a slower pace (in seasonally adjusted quarter-on-quarter terms) than in the first quarter. June's real-time indicators generally suggest growth stabilisation or a slight slowdown relative to the April–May levels. The tightening of restrictions provoked by the worsening of the epidemic situation took place closer to the end of the month and is so far fairly local, affecting mostly the consumer services sector.
- June's survey data indicates output growth slowdown in manufacturing, with new orders contracting. Indirect indicators (freight transportation, electricity consumption) also evidence continued gradual expansion in business operations.
- The services sector's activity growth also slowed, but remains at high level (Figure 13, Figure 14), because the services sector took a harder hit from the pandemic, and the recovery started from a lower base. The more moderate performance of manufacturing indicates the loss of recovery-induced growth potential in this sector of the economy, which reached the pre-coronavirus level as early as the end of 2020. This may well signal a change of the growth driver in the next few months.
- [Individual industries' financial flows](#) record continued economic activity growth in June compared with the average level of the first quarter and the start of the second quarter (Figure 17). Significant expansion was recorded in the incoming payments of industries meeting external demand, helped largely by favourable price conditions: the key growth drivers were the oil sector (petroleum extraction and refining) and manufacture of basic metals.
- The incoming payments of industries meeting consumer demand stayed above the average level of the first quarter: retail trade payments expanded while the services sector showed mixed results. Some change in the consumption structure is also evidenced by other real-time indicators (See Section 2.2). Investment goods industries' payments rose in June relative to May, but remained below the average level of the first quarter.

Figure 15. Russia PMI indices



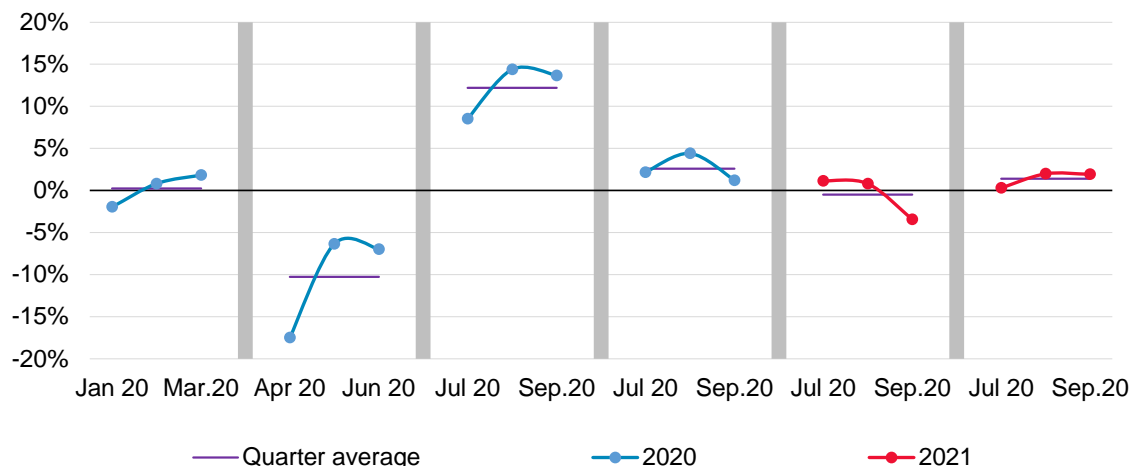
Source: IHS Markit.

Figure 16. New Orders PMI indices in Russia



Source: IHS Markit.

Figure 17. Incoming payments weighted by gross value added, exclusive of mining and quarrying, petroleum refining, and the government sector (% of the previous quarter's average level)



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

2.2. Consumption growth slows in May

- Consumer demand growth slowed down in May. The consumption structure, meanwhile, continued to deviate from the pre-coronavirus pattern, driven by expansion in non-food sales against a background of elevated inflation expectations and confident lending growth. This also resulted from a decline in services consumption, prompted by, among other things, the imposition of the “day-off” regime.
- The real-time estimates for June suggest a possible pause in consumer demand recovery in the next few months amid rising uncertainty over the epidemic situation. Inflation expectations and households’ further willingness to spend accumulated savings will continue to play an important role in consumption activity going forward.

Consumer activity growth slowed in May compared with April. This may have been driven by some slowdown of household labour income expansion after its surge in April.¹⁰

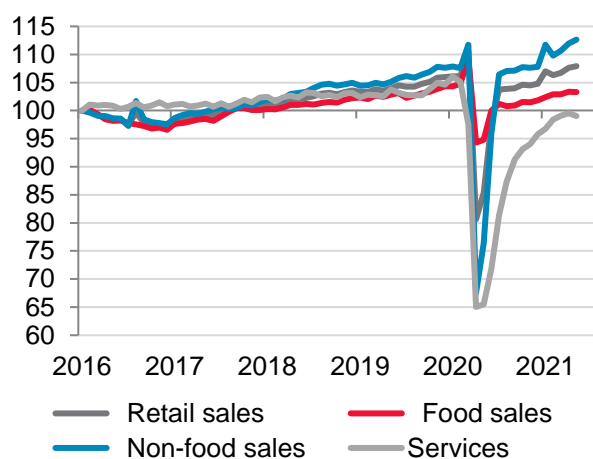
Retail sales growth slowed to 0.3% MoM SA in May from 0.8% MoM SA in April. The food segment posted sales stabilisation at -0.1 MoM SA after a rise of 0.5% MoM SA in April (Figure 18). A rise in the consumption of non-food goods slowed to 0.6% MoM SA after 1.2% MoM SA in April. At the same time, the consumption of personal services and public food service traffic contracted after consistent four-month growth, down 0.5% and 0.6% MoM SA, respectively, after a rise of 0.5% and 0.7% MoM SA in April. Long May holidays (including “days off”) may have contributed to that. That said, people’s social activity was high (according to mobility data from Google) in the other days of May amid a stable epidemic situation (a rise in coronavirus contagions started in June).

The consumption structure was gradually approaching that of the pre-coronavirus period at the end of 2020 – the start of 2021, but April saw a trend reversal, which continued into May

¹⁰ Real wages expanded dramatically in April by 7.8% YoY, in large part due to the transfer of part of payments from May.

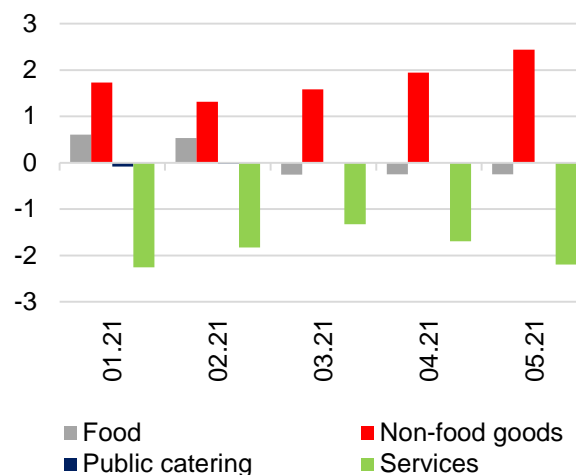
(Figure 19): the share of non-food goods in consumption went up, with that of paid services declining. This reversal may have been prompted by an acceleration of unsecured consumer lending expansion, which may shift a part of demand from services to the purchases of non-food goods. That said, the epidemic situation worsening at the start of June and the imposition of restrictions in various regions beginning from the middle – end of June, may amplify this trend in the structure of consumption in the months to come.

Figure 18. Retail and services sector's sales (January 2016 = 100%, seasonally adjusted), %



Source: Rosstat, R&F Department estimates.

Figure 19. Change in the share of expenditure, by key expenditure category, compared with 2019, ppt



Sources: Rosstat, R&F Department estimates.

On the one hand, a rise in uncertainty because of the epidemic situation worsening may increase the savings ratio and bring about a pause in consumption growth. According to Romir data, despite the still elevated pace of price rises, nominal everyday household expenditure has been returning to last year's levels since the start of June (Figure 20). On the other hand, consumer activity may be supported by the still diminished attractiveness of traditional savings instruments: real deposit rates are still negative, while a substantial rise in housing prices and the toughening of subsidised mortgage lending terms and conditions somewhat reduced the appeal for buying housing.

The household expenditure trends will, in the next few months, depend on how the epidemic situation unfolds and how successful is the vaccination campaign. Unless massive restrictions are imposed, consumer demand will keep close to the levels reached in the second quarter. This will be helped by a variety of factors, such as the recovery of household expenditure,¹¹ consumer confidence growth,¹² and inflation expectations which are still record high.¹³ Indeed, despite the imposition of the "day-off" regime and new restrictions in June, household perceptions of whether it was a good time for major purchases continued to improve

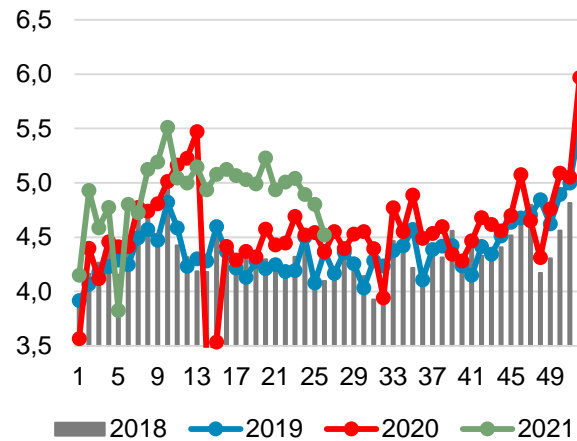
¹¹ [Wage recovery accelerated but covid-related losses still notable](#). / 28.06.2021 / SberIndex.

¹² Rosstat's consumer confidence index reflecting composite household expectations in the second quarter of 2021 compared with the first quarter of 2021 rose 3 ppt.

¹³ [Inflation expectations and consumer sentiment](#). / 25.06.2021 / Bank of Russia.

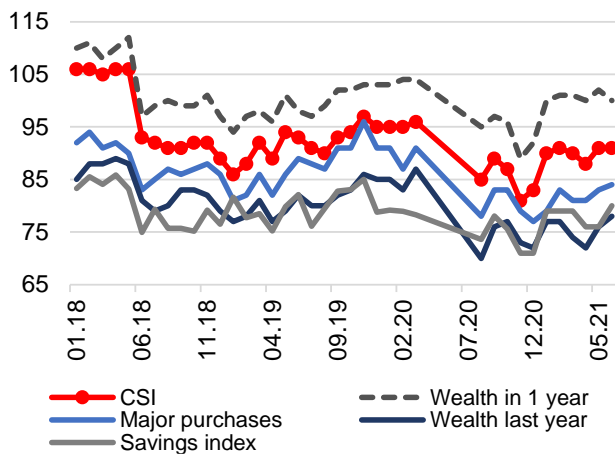
(Figure 21). Moreover, demand for consumer loans stayed at the elevated May levels, with durable goods remaining the leaders of consumer segment growth (Figure 22).

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



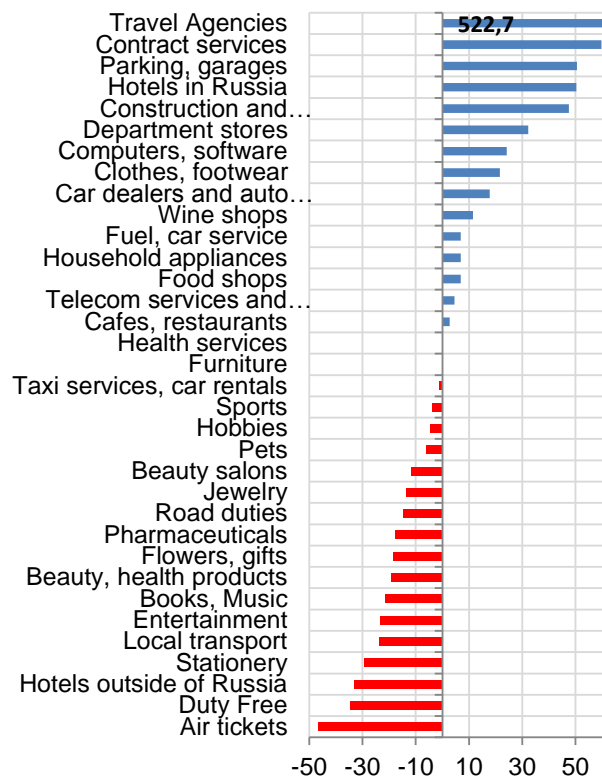
Source: Romir.

Figure 21. Household consumer sentiment index, p.



Source: Bank of Russia.

Figure 22. Change in nominal spending on goods and services in June, % relative to pre-coronavirus period¹⁴



Source: SberIndex.

¹⁴ Change relative to the 01.02–15.03.2020 period.

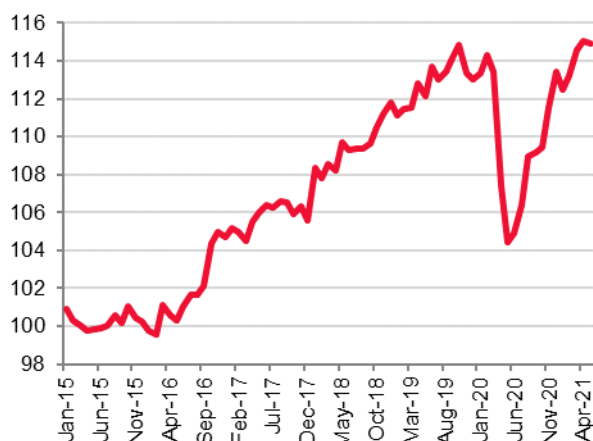
2.3. Industrial output takes a break after three-month growth

- In April–May, industrial output generally stayed above the start of the year and pre-coronavirus levels. That said, May's output edged down relative to April. Contraction in manufacturing outweighed slowed recovery in mining and quarrying.
- The manufacturing decline seems to be a temporary development. It was largely driven by one of the most volatile components: the manufacture of other transport equipment.
- May saw growth continue in many industries oriented to consumer and investment demand, suggesting continued recovery of production activity. Therefore, industrial output growth will likely resume in the summer.

Industrial production declined marginally in May 2021, down 0.1% MoM SA, after three months' growth¹⁵ (Figure 23). Overall, output stood above the pre-crisis level for three consecutive months: the May 2021 figure increased 0.5% SA compared with February 2020. The output results, however, vary across industry groups. Mining and quarrying is recovering extensively but is still below the pre-coronavirus level. Manufacturing output rose above the pre-crisis level at the end of 2020 – the start of 2021 and has since hovered around the level reached.

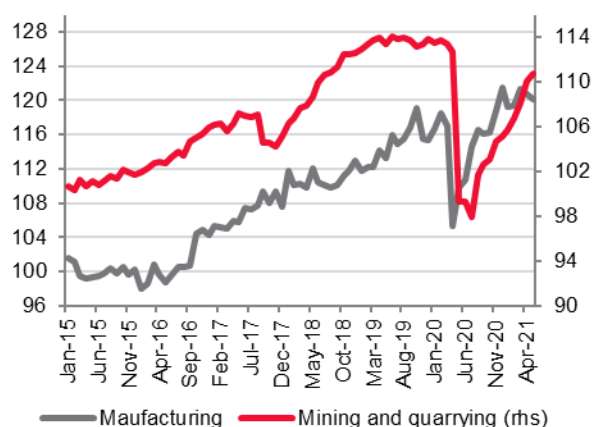
Mining and quarrying growth slowed to 0.6% MoM SA in May from 1.8% and 1.2% MoM SA in April and March, respectively (Figure 24). May's key growth driver was crude oil and gas extraction, up 0.8% MoM SA, which is gradually rebounding as demand rises. Output is still far below the pre-crisis level, because of the industry's compliance with the oil extraction caps under the OPEC+ agreement and varying pace of recovery across economies.

Figure 23. Change in industrial production index (2014 = 100)



Sources: Rosstat, R&F Department estimates.

Figure 24. Change in mining and quarrying and manufacturing indexes (2014 = 100)



Sources: Rosstat, R&F Department estimates.

¹⁵ In keeping with its monthly routine, Rosstat has revised its April 2021 industrial output data. The estimates were revised up slightly: the new industrial output estimate showed a rise of 0.4% MoM SA versus an increase of 0.3% MoM SA previously.

Manufacturing output contracted 0.5% MoM SA in May (Figure 25), dragged down chiefly by a fall in the manufacture of other transport equipment, down 15.5% MoM SA. This industry's output is among the most volatile,¹⁶ often introducing “noise” to the sector's overall performance due to its fairly large weight. It therefore appears that May's output contraction in manufacturing is a temporary development.

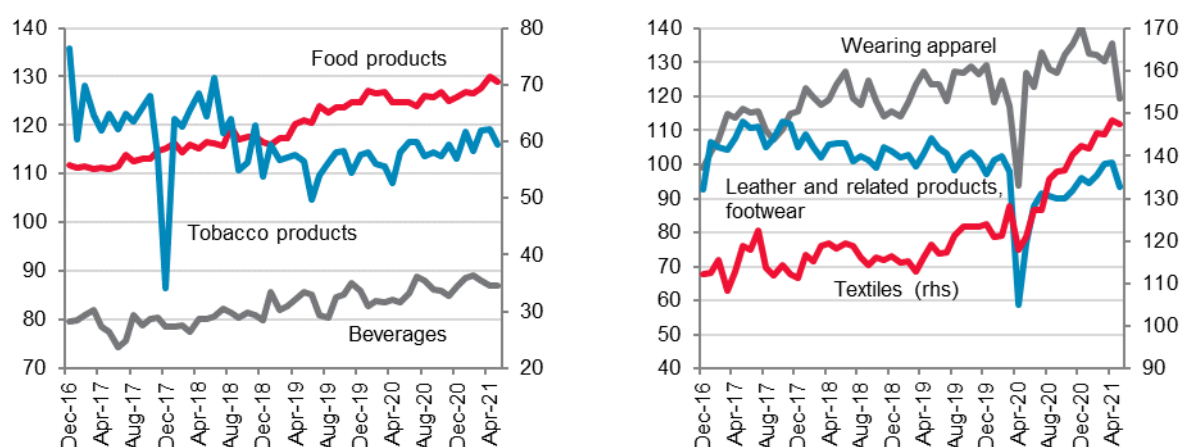
Manufacturing output rose above the February 2020 level for the seventh consecutive month (up 1.4% SA in May 2021 from February 2020). All of the three larger industry groups of the manufacturing sector (those producing investment, consumer, and intermediate goods) had already returned to the pre-coronavirus levels.

Net of the manufacture of other transport equipment, the investment goods industries posted 0.6% MoM SA growth, according to our estimate. The key drivers of this group of industries in May were the manufacture of fabricated metal products, except machinery and equipment, and the manufacture of non-metallic mineral products. This indicates expansion in demand for materials from the construction sector. The Centre for Macroeconomic Analysis and Short-term Forecasting, however, believes that output growth in the manufacture of fabricated metal products was driven by goods related to government defence procurement.

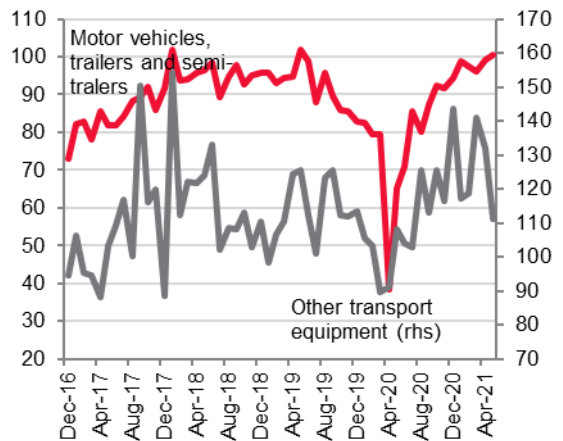
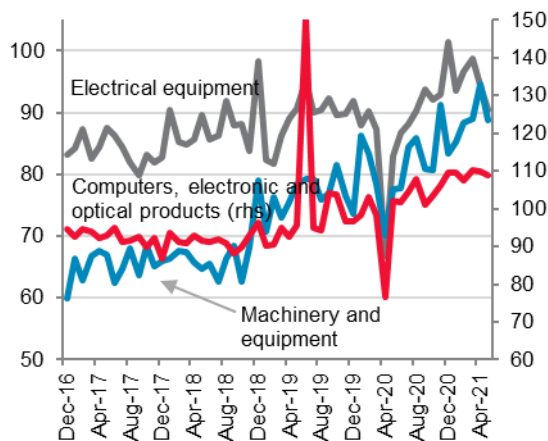
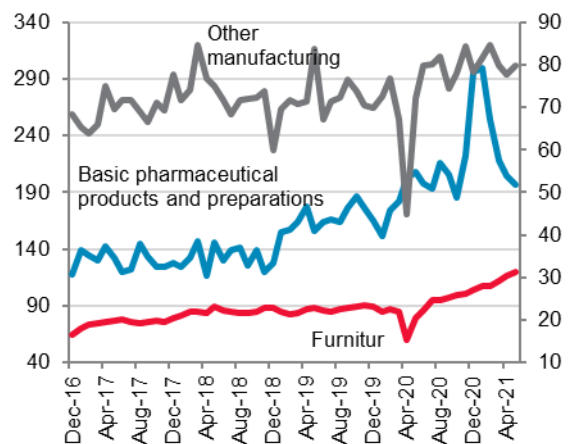
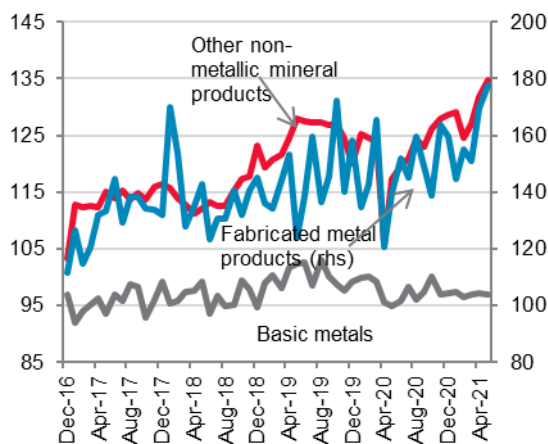
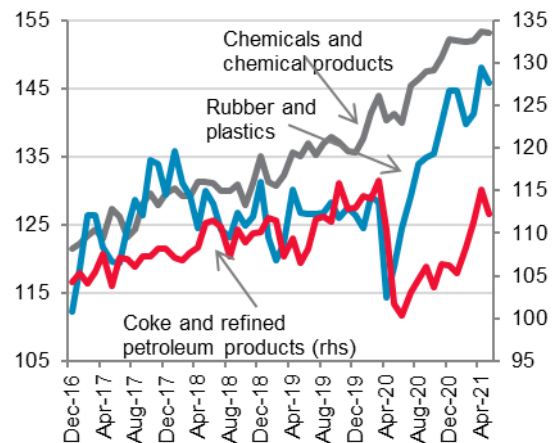
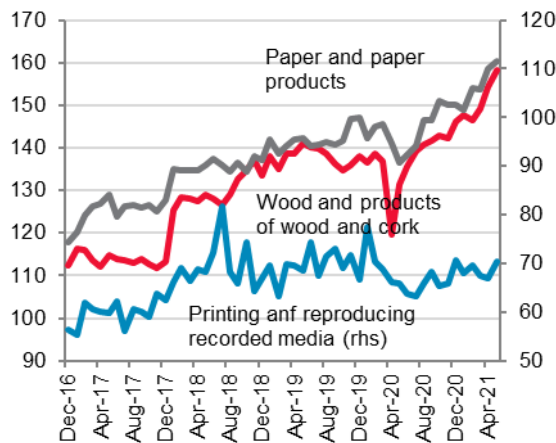
The group of industries manufacturing consumer goods maintains moderate output performance. May saw an output drop in the manufacture of food products, which has a large weight in this industry group. Its output, however, remained above the first quarter average. That said, the output of durable non-food goods, such as furniture, passenger cars, and household appliances) expanded.

Output contracted in industries manufacturing intermediate goods, dragged down by the manufacture of coke and refined petroleum products, which had, prior to that, been extensively recovering to reach the level of the start of 2020 by April 2021. This development is likely temporary because oil extraction continues to expand gradually.

Figure 25. Manufacturing industries' output, December 2012 = 100%, seasonally adjusted



¹⁶ Because large and one-off orders come in and are completed in an irregular fashion.



2.4. Further confident lending growth

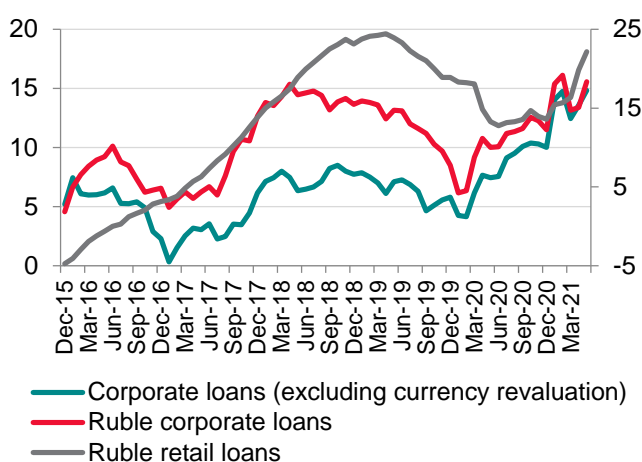
- Unsecured consumer lending expansion accelerated in May, buttressing consumer demand. The ongoing monetary policy tightening is gradually beginning to hurt other than subsidised mortgage lending.

- Corporate lending growth net of lending to financial institutions accelerated amid the continuing business activity recovery and the maintenance of impetus from subsidised lending.
- The banking sector's financial result remains strong, likely driven by net interest and fees and commission income. Meanwhile, the quality of loan claims is still stable, requiring no additional provisioning. This indicates potential for further bank lending expansion.
- Monetary policy tightening along with decisions related to macroprudential instruments will gradually slow lending expansion to levels ensuring its sustainable and balanced growth.

Lending expansion in the key market segments continues at a fast pace, buoying economic activity growth.

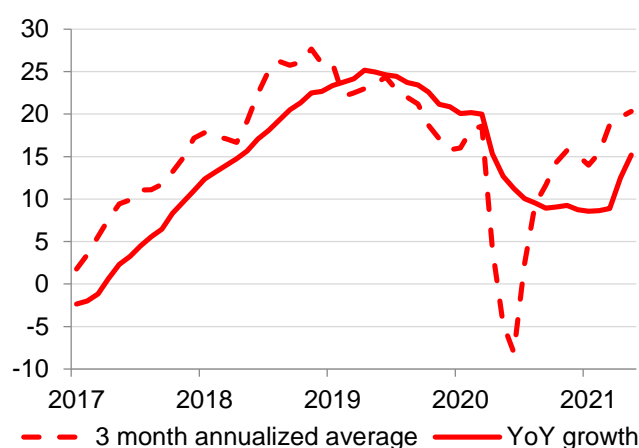
Retail lending growth accelerated to 2.4% MoM SA in May from 2.1% MoM SA in April.¹⁷ Unsecured consumer lending gained momentum to reach 1.7% MoM SA compared with 1.3% MoM SA a month earlier, supporting a consumer activity rise, which, among other things, underpins the elevated pace of consumer price hikes (for, above all, non-food goods). Nevertheless, according to National Bureau of Credit Histories data, the number of consumer loans issued decreased somewhat, which may also stem from gradual saturation of household demand for this type of loans. The continuation of this trend may bring down the pace of unsecured consumer loan portfolio growth going forward. Auto loan portfolio expansion of 1.8% MoM SA also remained strong but somewhat slowed compared with May, which may be due to a car market growth slowdown.

Figure 26. Banks' credit growth, % YoY



Source: Bank of Russia.

Figure 27. Unsecured consumer loans growth, %

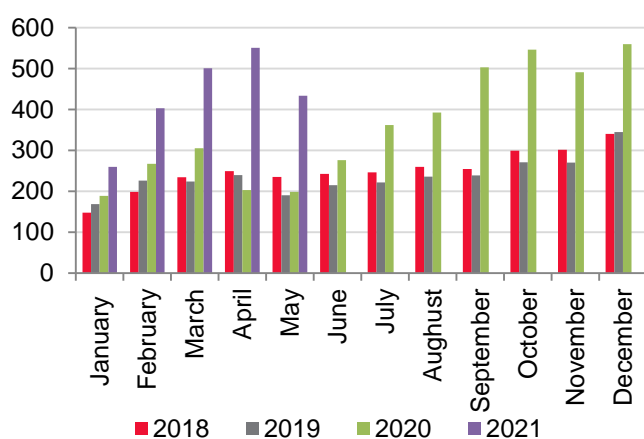


Source: Bank of Russia.

¹⁷ The specification of seasonal smoothing of time series was revised in June. The addition of April and May 2021 data showed that previous specifications were non-optimal because of their strong effect on the estimation of the 2020 seasonal factor.

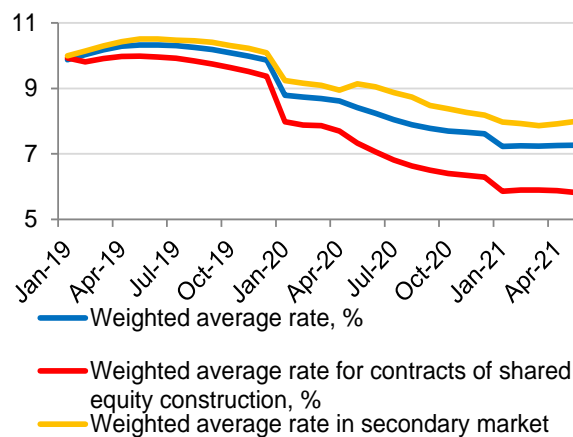
Extensive growth of mortgage loan portfolio continues but shows some slowdown: the rate of mortgage loan expansion, with mortgage-backed securities included, declined from 2.6% MoM NSA to 1.8% MoM NSA due to a notable contraction in new loan issuance. Seasonally adjusted growth of mortgage loan portfolio edged down from 2.6% MoM SA to 2.4% MoM SA. This may be owed to a decline in mortgage loan demand arising from both an increase in interest rates on other than subsidised mortgage loans in the wake of monetary tightening (Figure 29) and a rise in housing prices. A likely raise of non-subsidised mortgage loan rates, as well as the extension of the subsidised loan programme on less attractive terms and conditions (an interest rate rise, cuts to loan limits, especially for large cities) may bring the rate of mortgage lending growth back to more balanced levels in the coming months.

Figure 28. A total of new mortgage loans issued, billion rubles



Source: Bank of Russia.

Figure 29. Interest rates in the mortgage loan market, %



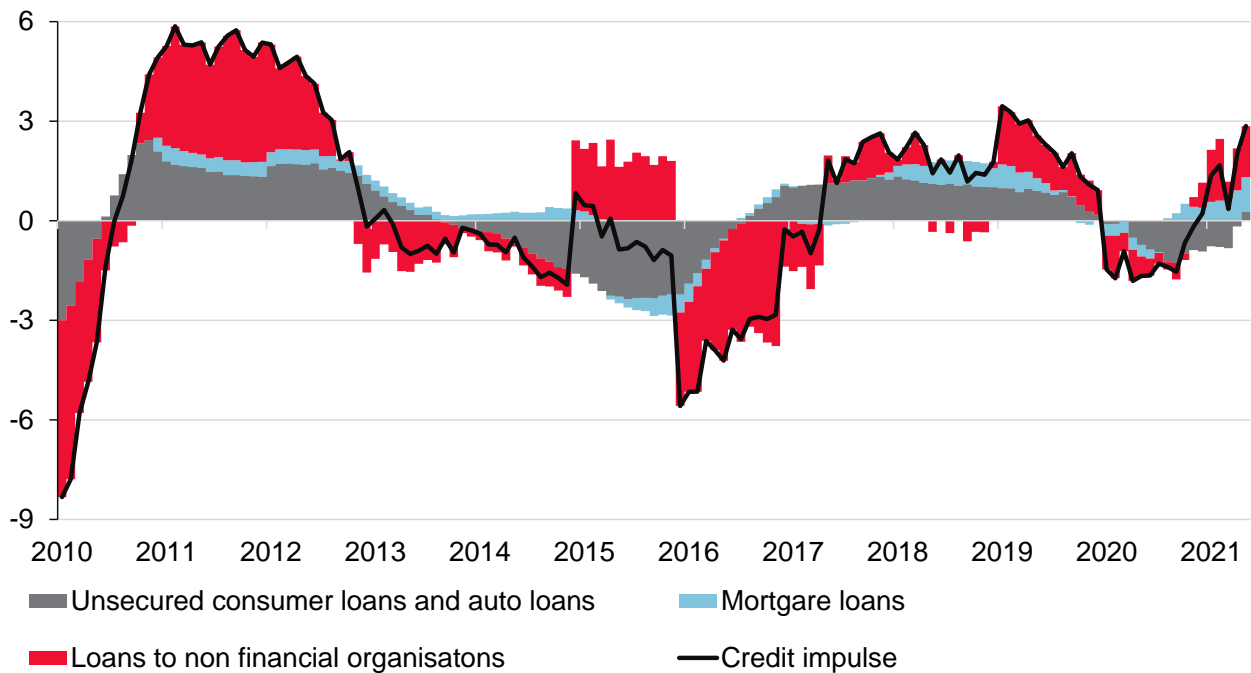
Source: Bank of Russia.

Corporate lending, exclusive of sole proprietorships, gained momentum in May. Growth in ruble loans to non-financial organisations accelerated from 1.6% MoM SA to 1.9% MoM SA. A rise in lending to financial institutions slid from 3.1% MoM SA to 2.5% MoM but remained strong. Lending to sole proprietorships changed from a decline to expansion, up 1.4% MoM SA, largely thanks to the launch of subsidised loan programme to provide finance for the recovery of business operations. The portfolio of loans to non-financial organisations and sole proprietorships expanded on short- (Figure 31), as well as medium- and long-term lending as investment demand rose.

The credit impulse¹⁸ remains positive and increases, driven by, above all, corporate and mortgage lending (Figure 30). The credit impulse for unsecured consumer loans has also stayed in positive territory in recent months, suggesting the strengthening effect of lending on growth in consumer demand and business activity.

¹⁸ 12-month rolling change in absolute lending growth in relation to 4-quarter rolling GDP.

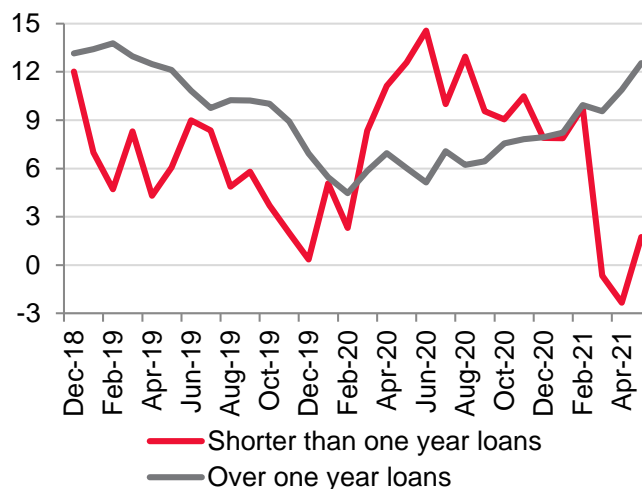
Figure 30. Credit impulse, % to GDP



Source: Bank of Russia.

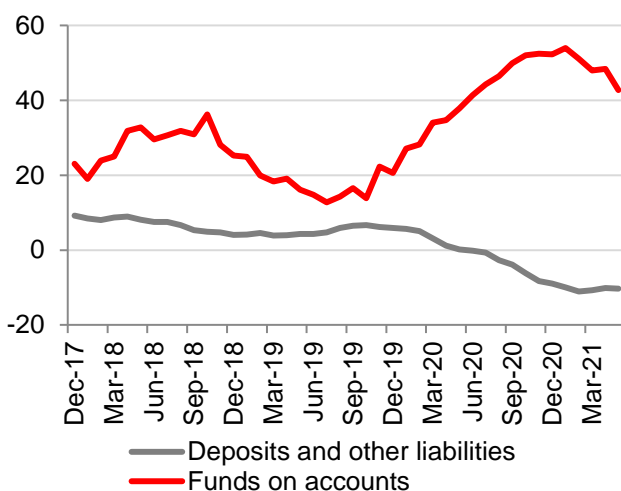
A total of household ruble funds slid 1.1% MoM SA in May after its 1.8% MoM SA growth in April. Annual growth in funds on accounts has slowed in recent months, while time deposits continued their year-on-year decline. This may partly stem from the leading effect of wage payment at the end of April ahead of the “days off”, as well as household spending driven by rising inflation expectations and the declining savings ratio. That said, household foreign currency deposits expanded 0.4% MoM SA.

Figure 31. Dynamics of loans for non-financial organization, % YoY



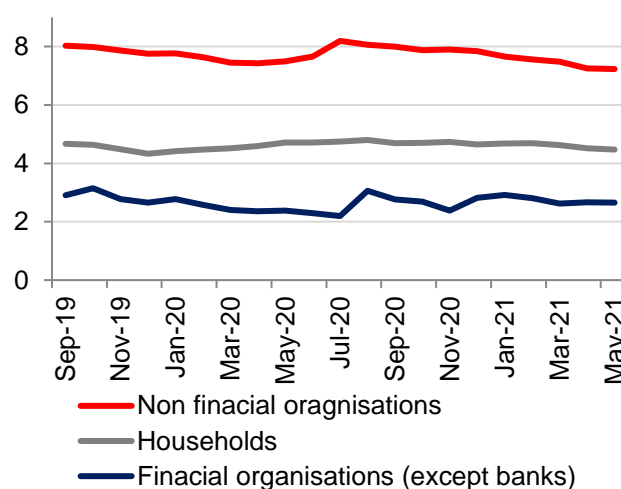
Source: Bank of Russia.

Figure 32. Household funds at banks, % YoY



Source: Bank of Russia.

Figure 33. Share of overdue loans, %



Source: Bank of Russia.

The recovery of business activity helps stabilise the quality of loan claims. The share of non-performing loans to households and financial organisations remained all but unchanged, inching down from 7.3% to 7.2% for loans to nonfinancial organisations and sole proprietorships (Figure 33). The share of problem and bad loans declined somewhat in the retail and corporate portfolios alike.

The banking sector's profit totalled 216 billion rubles in May 2021,¹⁹ exceeding the levels of the same months of 2020 and 2019. As in the previous months, it is likely supported by [net fees and commission and net interest income](#) amid general recovery of business activity and lending growth.

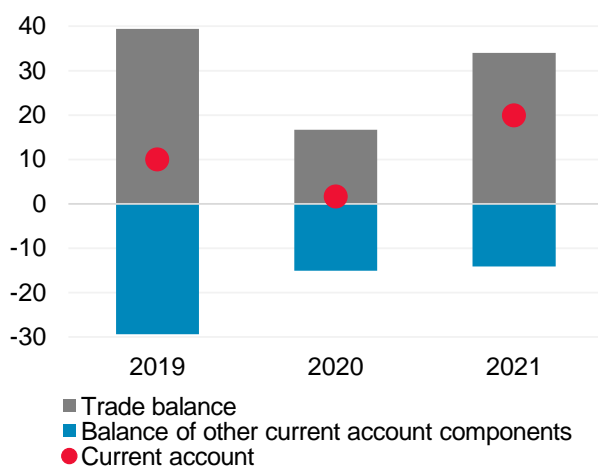
2.5. Global demand recovery will support exports

- The current account surplus expanded to USD19.9 billion in the second quarter of 2021 from USD1.6 billion a year earlier. The key factor behind the current account surplus growth was a trade surplus improvement thanks to a faster rate of merchandise exports amid the recovery of external demand accompanied by rises in the prices of goods. Oil and gas exports remain the only category making a negative contribution to export performance relative to the pre-pandemic levels. However, since caps on oil extraction imposed under the OPEC+ deal are expected to be relieved amid the recovery of global demand, the restraining effect of this factor is set to decrease.
- Extensive import growth, along with other macroeconomic indicators, suggests that domestic demand is rapidly rising in the Russian economy, driven by both fixed capital investment and household consumption.

¹⁹ Profit after tax.

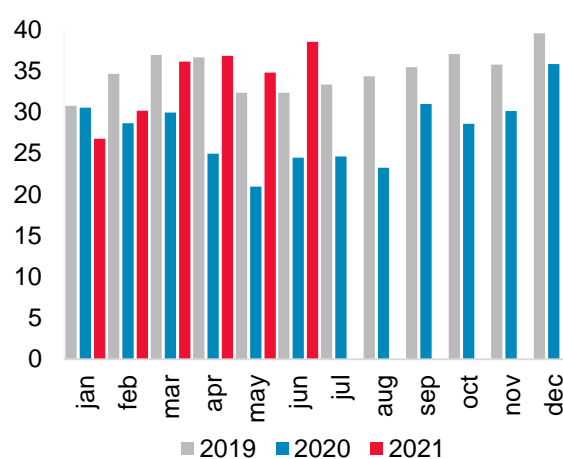
According to preliminary estimates, the current account surplus rose USD18.3 billion YoY in the second quarter to reach USD19.9 billion (Figure 34). This resulted primarily from the last year low base. The current account surplus expansion was, above all, fuelled by trade surplus growth to USD34.0 billion from USD16.7 billion a year earlier amid an energy and other merchandise export rise of 38.4% YoY by value. This is only partially offset by import recovery, up 41.6% YoY over January–May.

Figure 34. Key current account components, USD billion



Source: Bank of Russia, R&F Department estimates

Figure 35. Exports, USD billion



Source: Bank of Russia, R&F Department estimates

A rise in other than trade balance remains moderate, but an increase in personal transfers to foreign countries along with a decline in the wage surplus can be viewed as the first sign that migrant workers' inflow is rebounding. The services balance deficit remains stable, reflecting the continuing restrictions on transborder activity.

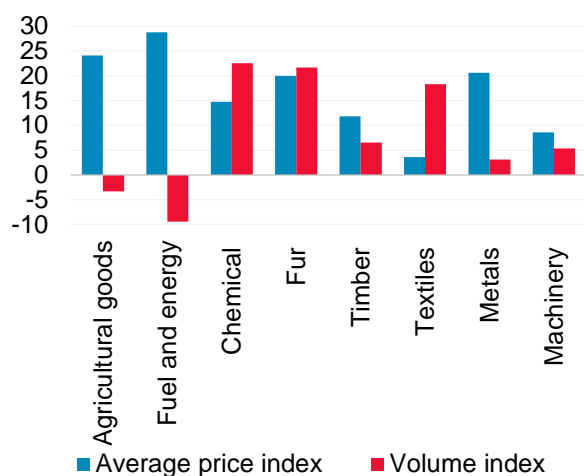
The recovery and acceleration of annual merchandise export growth (Figure 35) is posted across a wide range of categories. This reflects the recovery of external demand as restrictions are lifted but is primarily driven by price rises (Figure 36) resulting from the impact of restrictions on supply-side, which trails demand, and an overall rise in world prices of financial assets, including commodities. The pass-through of rising producer costs also affects export prices of goods.

According to Russia's Federal Trade Service statistics, an export decline in physical terms continues in categories such as agricultural goods and, especially, mineral products. Agricultural goods exports are restricted through various government measures seeking to curb domestic price hikes.²⁰ A gas and oil export fall in physical terms reflects still incomplete global consumption recovery with caps on extraction under the OPEC+ agreement still in place (the quotas are effective until March 2022). The export of the energy sector's products remains the only category making a negative contribution to exports relative to 2019 (Figure 37). That said, a price rally in global energy and food markets more than offsets a fall in the export of

²⁰ Imposition of export quotas and export duties on goods such as wheat, maize, oilseed rape, and sunflower seed oil.

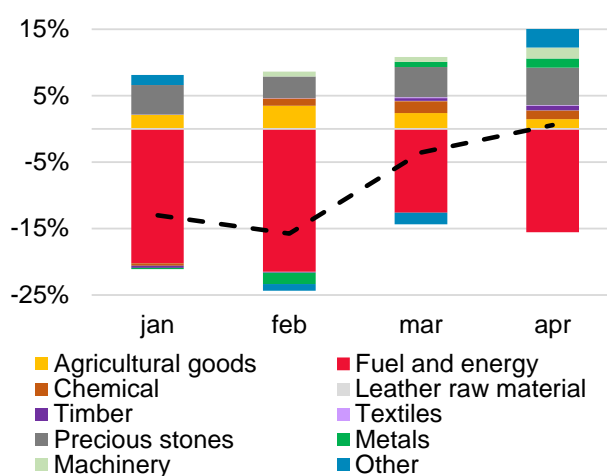
both categories in physical terms. The lifting of supply-side restrictions and the recovery of global demand are set to help further export growth and its contribution to economic activity at large.

Figure 36. Export of key groups of goods, deviation of monthly indexes from 100, January–April 2021 average, % YoY



Sources: Federal Trade Service, R&F Department estimates.

Figure 37. Decomposition of export growth by larger category, 2021, % of relevant month of 2019



Sources: Federal Trade Service, R&F Department estimates.

Export of other large categories of goods showed growth both by value and in physical terms. Metal²¹ and gold exports (19.6% of exports by value in April) exceeded the 2019 levels, with a rise in external demand helped by, among other things, extensive implementation of infrastructure projects in China. Growth in fertilizer and machinery/equipment exports (8.0% and 7.9%, respectively, of exports by value in April) also reflects the recovery of external demand and rising prices of goods.

The recovery of exports to pre-pandemic levels is accompanied by faster expansion in merchandise imports, up 22.5% from the same month of 2019. The key contribution to import growth comes from machinery and equipment imports, but the input of consumer and investment goods to import expansion was generally comparable. An extensive rise in imports, along with other macroeconomic indicators, suggests that domestic demand is rapidly expanding in the Russian economy, driven by fixed investment and household consumption.

²¹ Imposition of export duties on ferrous and non-ferrous metals as of 1 August 2021 may have an adverse effect on the competitiveness of Russian goods, bringing down exports.

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