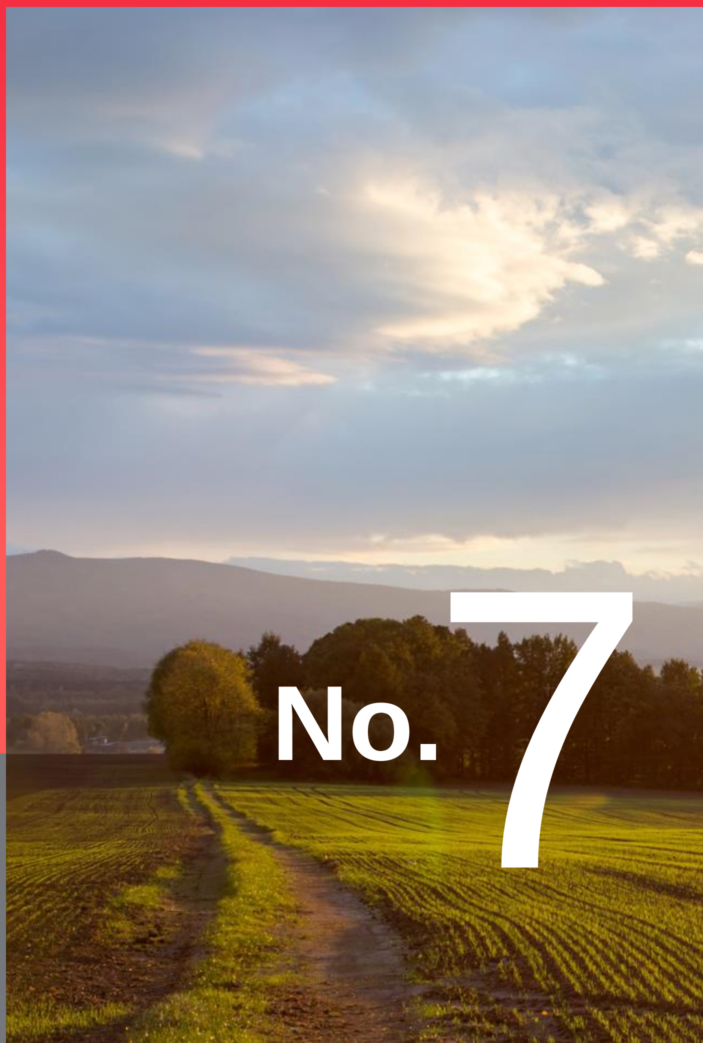
Bank of Russia



TALKING TRENDS
Economy and markets

Research and Forecasting Department Bulletin

OCTOBER 2024

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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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Bldg. V, 12 Neglinnaya Street, Moscow, 107016
Bank of Russia website: www.cbr.ru

Executive summary

Monthly summary

- The economy expanded slower in the third quarter as a result of both supply and demand factors. At the same time, demand in the economy and in particular consumer demand remained high overall – despite a certain decline in August. The entirety of these factors is still behind high inflationary pressures notwithstanding of the recent rise in interest rates, a slower expansion in retail lending and in the broader economy. Going forward, the current tight monetary policy is expected to ease labour shortages – a trend that seems to be emerging as employers show less appetite for hiring, explained by more moderate expectations for demand for their products and for investment. This is expected to combine with a consistently high saving ratio to cool down consumer demand and thereby movements in consumer prices.
    - Annual inflation was down in September; yet its further slowdown this year is likely to be small. Its subsequent deceleration may only gain a boost from a slide in underlying inflation, which requires a cooling in consumer demand to reduce it from mid-year levels. Given the marked increase in recycling fees for cars and in utility prices, the return of inflation to 4% in 2025 most likely requires a further tightening of monetary conditions.
    - Data and surveys for August and September for the most part signal slower growing economic activity with persistently high household consumption. This year's decline in crops on the back of adverse weather conditions will probably have adverse effects on Q3 and Q4 GDP. However, this year's larger than expected fiscal impulse is set to make a stronger contribution to domestic demand. Price stability in the coming quarters can only be maintained by moderating private demand. An appropriate degree of monetary policy tightness will be needed.
    - In September, the domestic financial market put in a mixed performance across its segments. Interest rates for various maturities were up under the influence of both the monetary policy stance and intense government borrowing. The ruble weakened as the balance of trade narrowed in the third quarter and the lags of foreign trade settlements persisted.

1. Inflation

Consumer price growth remains fast in both volatile and stable components. Strong demand in the economy at large and the consumer sector in particular is still spurring price rises as output expansion and consumer goods and services imports lag demand.

Supply-side constraints also send the cost of goods and services higher, due, above all, to the rising costs of purchasing raw materials and supplies, the wage bill, along with increasing logistics and payment costs. Strong demand and high inflation expectations allow much of cost expansion to be put through to output prices.

At the same time, annual inflation slid below 9% in September, with the process of its slow deceleration continuing. The pace of its deceleration is, however, an open question.

In this context, the development of the following macroeconomic relationships is worth watching:

- high interest rates restrain a rise in the private sector’s demand, including for credit (is already in evidence);

- businesses’ appetite for output expansion in expectation of fast growth in demand gets to normal (is already in evidence);

- businesses’ plans for hiring additional labour correct down, relieving accumulated labour market tightness (is already in evidence);

- the pace of wage growth gradually draws closer to that of a rise (the process is only just starting);

- the pace of household consumption growth slows in line with income expansion, with the savings ratio remaining high (the first signs of this are emerging);

- consumer price rises slow from the current levels (is yet to follow).

One can see that macroeconomic processes are unfolding in line with the logic set forth above.

Additional factors affecting demand and price should, however, be taken into consideration. The expansion of budget deficit this year, a dramatic rise in the car disposal fee, and the planned communal services price hikes in the coming years at a far faster pace than 4%, are all proinflationary factors of various kinds. But they all have an effect on the overall level of consumer prices. Amid unanchored and high inflation expectations, however, even one-off factors have a significant and upward effect on inflation expectations and consumer prices.

This effect is meant to be offset by monetary policy. This means that on the forecast horizon, the average level of the key interest rate should be higher than it would be without them, all other things being equal. This can be achieved by additional key rate raises at the closest key rate meetings or by maintaining a high rate longer, in the coming quarters, or a combination of both measures

1.1. Persistent inflationary pressure remains elevated

- Overall price rises were highly volatile in Q3. This was driven by, above all, one-off factors, such as a faster than earlier indexation of communal services prices and a change in the seasonal pattern of tourism and transport services. Persistent inflationary pressure remains elevated, with no clear downward trend in sight.
- Medium-term proinflationary risks are still high. For sustainable disinflationary trends to set in and inflation to return to target, a tight monetary stance will need to be maintained for a long time.
- Double-digit indexation of regulated services prices in the middle of 2025 and the car disposal fee hike are new one-off proinflationary factors, which are set to make an additional contribution to price growth. For monetary policy to address this problem, the secondary effects of this on inflation amid high and unanchored expectations should be forestalled.

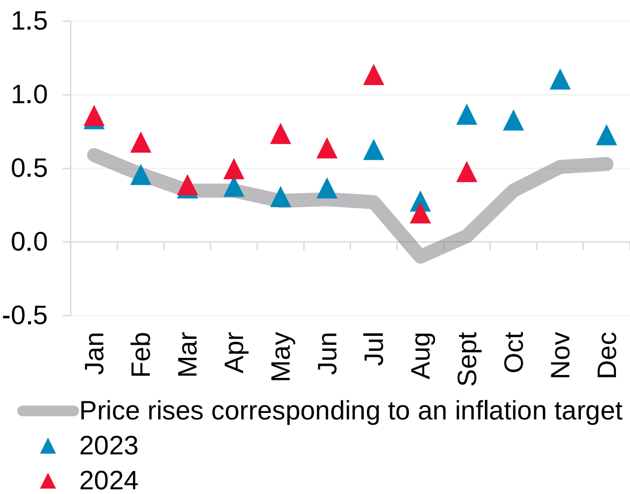
Consumer price growth accelerated to 9.8% MoM SAA in September from 7.5% MoM SAAR in August. The acceleration, relative to August, to a great extent resulted from a reversal of price moves in tourism and transport services on the back of a change in their seasonal pattern (movements in these prices temporarily pushed services prices down in August). Indicators of persistent inflationary pressure were little changed. They remain far above 4% SAAR, therefore it is so far too early to claim that there are clear signs of a disinflationary trend. Annual inflation slid to 8.6% from 9.1% due to a gradual departure from the calculation of very high inflation numbers in the autumn of 2023 (Table 1). Price growth accumulated over 9 months came in at 6.3% SA. Given significant inertia of price moves and a possible impact of additional proinflationary factors in Q4, price growth will likely exceed the Bank of Russia's current forecast interval for the full year 2024.

Table 1. Inflation and its components

	Sept.	Sept.	Jul.	Aug.	Sept.
	2022	2023	2024		
% YoY					
All goods and services	**13.7**	**6.0**	**9.1**	**9.1**	**8.6**
Core inflation	**17.1**	**4.6**	**8.6**	**8.4**	**8.3**
Food	14.2	4.9	9.7	9.7	9.2
Non-food goods	14.9	4.6	6.7	6.1	5.6
Services	11.0	9.7	11.4	11.7	11.6
% MoM SAAR					
All goods and services	**3.4**	**14.9**	**16.2**	**7.5**	**9.8**
Core inflation	**3.6**	**11.3**	**6.1**	**7.7**	**9.1**
Food	0.1	17.2	14.9	15.6	10.1
– net of fruit and vegetables	**0.1**	**11.4**	**7.1**	**8.0**	**11.5**
Non-food goods	0.7	12.7	8.2	6.9	6.5
– net of refined petroleum products	**0.5**	**9.7**	**4.4**	**5.3**	**5.4**
Services	11.8	14.5	28.5	-1.6	13.6
– net of housing and communal services	**16.8**	**18.4**	**9.9**	**-8.3**	**17.4**

Sources: Rosstat, R&F Department estimates.

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



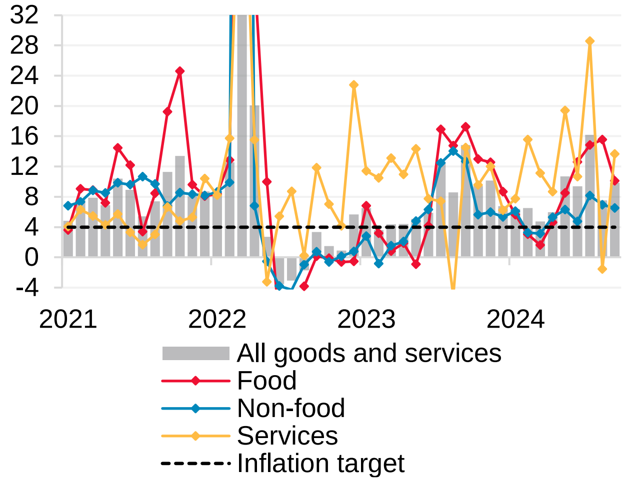
Sources: Rosstat, R&F Department estimates.

Food price rises slowed to 10.1% MoM SAAR from 15.6% MoM SAAR in August. The fruit and vegetables price decline came close to the usual seasonal pattern after notably lagging it in the summer, thereby pushing the overall seasonally adjusted food price growth significantly higher. At the same time, price hikes in other food products accelerated to 11.5% MoM SAAR from 8.0% MoM SAAR. The pace of price growth in oils and dairy products, bakery products, and meat gained momentum. Meat and milk producers note confident growth in demand and lagging capabilities of supply expansion, allowing costs to be put through to prices.

The risks of fast price growth in the food segment rose on the back of harvest contraction forecasts. In addition, quotas on duty-free chicken meat imports restraining prices (chicken meat prices dropped 4.6% since the start of the year) are expiring this year.

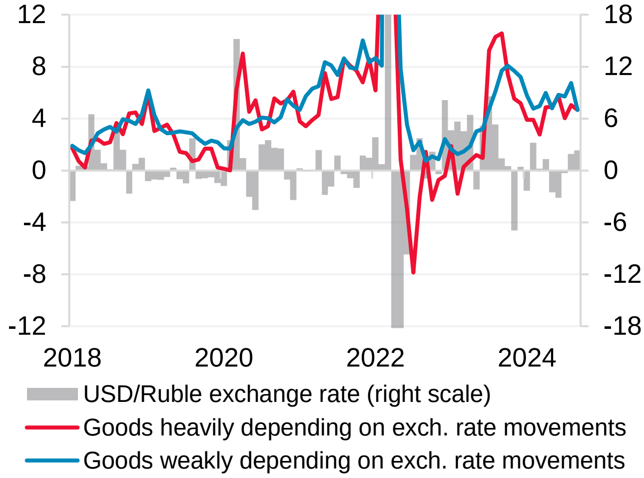
The pace of price growth in the non-food segment remained close to that a month earlier at 6.5% MoM SAAR after 6.9% MoM SAAR in August. Fuel price rises remain elevated, with the price of 98- and higher octane petrol climbing most of all. September's ruble weakening did not have a significant effect on price movements. The median of price hikes in the goods and services highly sensitive to changes in the ruble exchange rate did not show a notable correction in Q3 (Figure 3).

Figure 2. Seasonally adjusted price growth, % MoM SAAR



Sources: Rosstat, R&F Department estimates.

Figure 3. Median CPI (% MoM SAAR) and US dollar to ruble exchange rate (%)

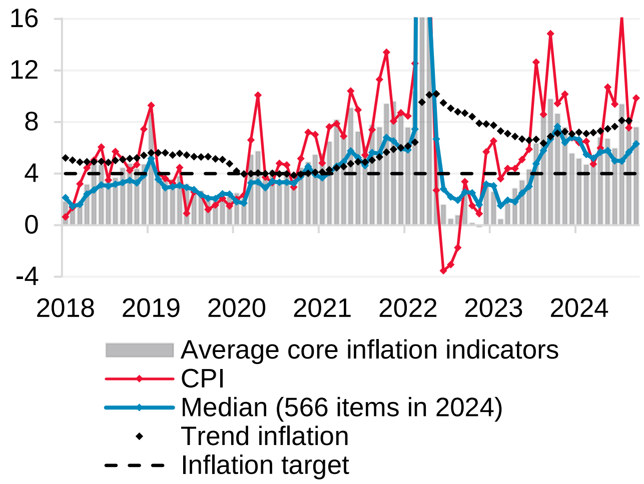


Sources: Bank of Russia, Rosstat, R&F Department estimates.

Services price moves which brought about high CPI volatility in Q3, changed to growth in September after a temporary slowdown in August (13.6% MoM SAAR after -1.6% MoM SAAR in August). The new seasonal pattern of changes in demand for and prices of transport and tourism services so far cannot be formally estimated by statistical methods, which introduces additional volatility to seasonally adjusted price indices. Net of tourism and transport, the pace of price growth slowed but remained fast – 10.6% MoM SAAR after 12.6% MoM SAAR in August. Stubbornly fast price rises in services (adjusted for one-off factors) suggest a significant proinflationary impact of demand in this segment, the most sensitive to rises in labour costs and, accordingly, to the continuing shortages in the labour market.

The analytical indicators of price movements so far do not suggest a sustainable disinflationary trend. The mean of modified core inflation estimates remained close to that a month earlier (Figure 4). The median of price growth distribution increased, the total weight of items going up in price at an accelerated pace was all but unchanged, with the share of items showing a very fast pace of price growth in its structure expanded (Figure 5). The trend inflation estimate rose in September.

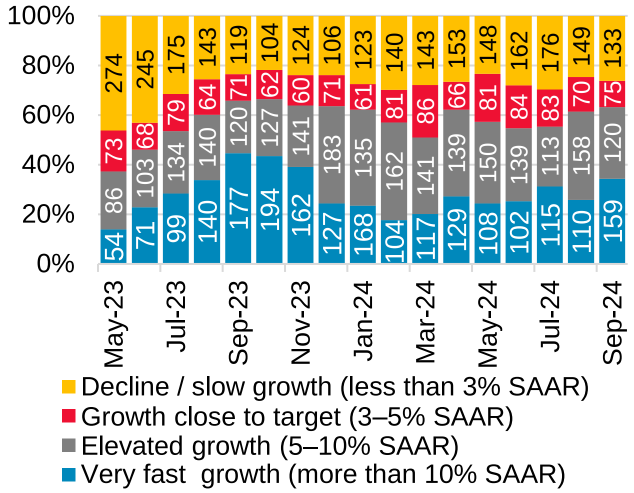
Figure 4. Modified core inflation indicators* (% in annualised terms) and trend inflation estimate (%YoY)



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

Sources: Rosstat, R&F Department estimates.

Figure 5. Aggregate weight of goods and services* distributed based on seasonally adjusted price growth



**Net of fruit and vegetables and regulated services.*

Note: The figures represent the number of items.

Sources: Rosstat, R&F Department estimates.

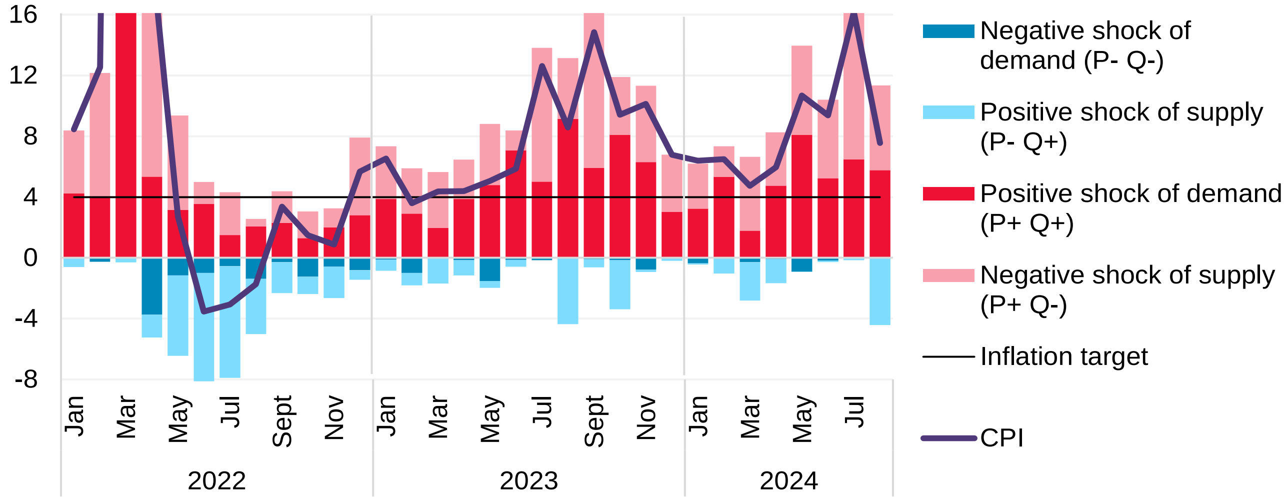
The decomposition of price growth based on the paper (Sheremirov, 2022[1]) indicates that the contribution of demand-side factors to the elevated rate of price rises remains significant and has in aggregate stubbornly stayed above 4% pp since April, despite consumer demand cooling in August (Figure 6). On average, a substantial proinflational effect on price changes in the last moving quarter also came from supply-side factors[2]: together with demand, they made an approximately equal contribution to the accelerated price growth.

Although household inflation expectations somewhat declined in September for the first time since April, and retail lending and household consumption growth is slowing, their high level still enables producers to put costs through to prices.

[1] Sheremirov V. (2022). Are the Demand and Supply Channels of Inflation Persistent? Evidence from a Novel Decomposition of PCE Inflation. Federal Reserve Bank of Boston Current Policy Perspectives. November 4, 2022.

[2] Among the key factors, July's price growth was owed to a regulated services price indexation, while August saw a rise in the contribution of food (mainly fruit and vegetables).

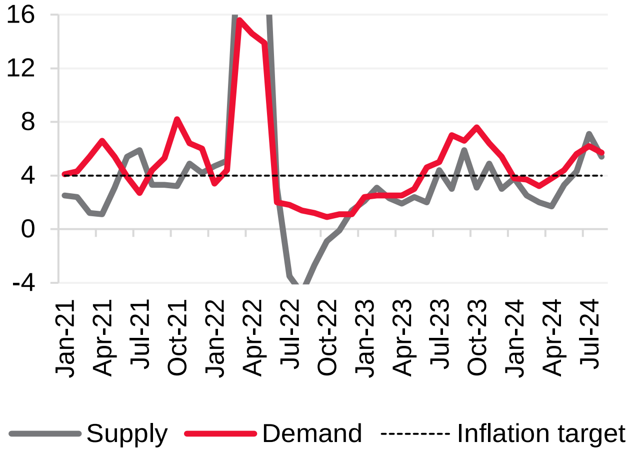
Figure 6. Price growth decomposition, % MoM SAAR



** The diagram uses Rosstat data on CPI and retail sales (in physical terms) for 45 categories of goods and services with a total weight of more than 80% of the consumer basket. The idea of the method is based on the baseline model of aggregate demand and supply: if changes in price (P) and volume of consumption (Q) are oppositely directed, then the cause of these changes is deemed to be a shift of the supply curve, if changes are codirectional, then the cause is assumed to be the shift of the demand curve. Unlike the key method of the source paper, trend removal is not conducted.*

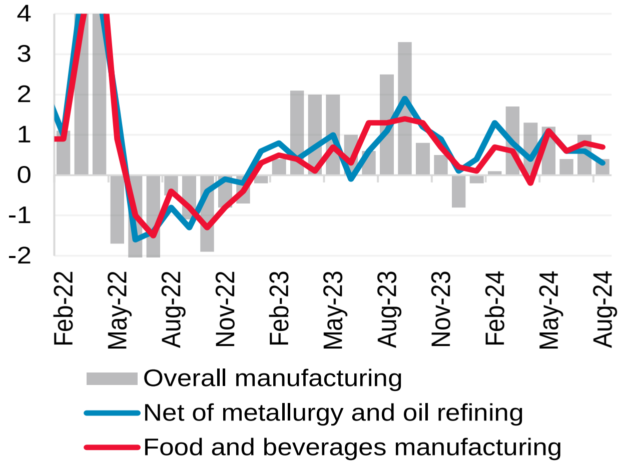
Sources: Rosstat, R&F Department estimates.

Figure 7. Contribution of demand and supply to price growth, pp 3MMA SAAR



Sources: Rosstat, R&F Department estimates.

Figure 8. Producer price index in manufacturing, % MoM



Sources: Rosstat, R&F Department estimates.

The balance of risks remains shifted towards proinflationary factors. In 2025, a significant additional, relative to expectations at the end of the summer, proinflationary input to price rises will be provided by temporary supply-side factors. Indeed, communal services price indexation as of 1 July 2025 will equal 11.9% rather than 5.7% planned earlier, adding 0.4 pp to the consumer price index in 2025. Another proinflationary contribution on the regulatory side will come from a sharp increase in the motor vehicle disposal fee as of 1 October 2024 (to be subsequently followed by a much faster rate of increase than 4% in 2025 and onwards). A car import surge ahead of 1 October has allowed dealers to build up car stocks under the previous car disposal fee regime, therefore, the new disposal fee will be put through to prices gradually. Nevertheless, we estimate that an accumulated effect of the car disposal fee hike may come in between 0.4 pp and 0.6 pp by the end of 2025.

These proinflationary factors are one-off in nature. They directly affect the overall level of consumer prices rather than the sustainable pace of price growth. But amid unanchored and high inflation expectations, these factors may exert tangible secondary effects on consumer prices. This requires a response from monetary policy: the average level of the key interest rate on a forecast horizon should, all other things being equal, be higher in order to curb these secondary effects. This can be achieved through further key rate raises at the closest key rate meetings or through an even longer maintenance of the high rate in the coming quarters, or through a combination of both measures.

2. Economic performance

Based on real-time indicators and business surveys, economic growth is continuing in Q3 at a more moderate pace than in the first half of the year. It is important to note that domestic demand growth is slowing. Indeed, lending demand (the number of loan applications) is gradually cooling in the retail and SME segments. At the same time, banks preserve a strong risk appetite. In particular, they are toughening non-price lending terms and conditions only because of the tightening macroprudential requirements.

As regards consumer demand, it received a further impulse after slackening in August. Despite the continuing robust household savings activity, income growth enables consumption to expand concurrently with savings. An ongoing increase in consumer goods imports along with an increase in their domestic production reflects growth in demand from households.

Government demand is set to be stronger than earlier expected. Given this development, for inflation to slow amid an almost full utilisation of the economy's output potential, demand growth in the private sector will need to be more moderate.

External demand (exports) remains generally stable. As a result, the slowing growth in aggregate demand, domestic and external alike, results in a lower labour market tightness, which, however, so far remains high.

Therefore, demand paves the way for a price growth slowdown, including in the consumer sector. Preconditions for this thus created will bear fruit provided that the economy's production potential does not encounter new constraints and (or) price shocks.

2.1. Economy's overheating gradually eases

- Real-time statistics suggest that economic activity growth continued in Q3, although at a slower pace than in Q2.[3] This is, in particular, evidenced by output performance in core industries (Figure 10) and is also indicated by financial flows (Figure 9), which show a slowdown in incoming payments expansion compared with the Q2 level. Business survey

[3] The Q2 GDP growth estimate was revised up, to 4.1% YoY. According to an R&F Department estimate, the updated Rosstat numbers suggest that seasonally adjusted growth stood at 1.0 and 0.6% QoQ in Q1 and Q2, respectively.

indicators also capture a gradual decline in the optimism of companies, which are lowering their forecasts for demand and parameters of production activity,[4] although most of business indices remain in activity expansion territory.

- The industrial sector's performance in Q3 also varied across individual industries. August's growth in mining and quarrying and manufacturing compensated for output contraction in the previous two months (Figure 12). At the same time, there continued to be seen volatile growth in the investment goods industries[5] (Figure 13) and poor performance in mining and quarrying, dragged down by the cooling of external demand.[6] September's business survey indicated a business activity decline for the first time since the middle of 2022 (a PMI Index of 49.5, Figure 11). The slowdown of activity growth or its decline for a number of indicators were partially owed to supply-side constraints. For example, the respondents cited the worsening of suppliers' discipline on the back of import payments problems, as well as delays in deliveries by rail. An important role of supply-side factors is also indirectly indicated by continued high price pressure despite the weakening of growth.
- August also saw clearer signs of consumer demand cooling. We estimate that consumer demand did not rise relative to July. In September, however, some rebound of it was seen (Figure 15). Consumers' interest may have been in part spurred by a surge of car demand in expectation of price hikes ahead of a hike in the car disposal fee as of 1 October. Import expansion in August-September was partly driven by the same factor.
- Continuing growth in, above all, labour income (Figure 14), turns out to be sufficient for both savings growth and increased consumption. Households are showing a gradual shift to a more savings-oriented behaviour. Indeed, the indicator of households' propensity to save moved to further growth for the first time in four months, while the share of households preferring to spend money on major purchases declined (Figure 17).
- Gradual shift from consumption-oriented behaviour will help more moderate consumption growth and easing of inflationary pressure. At the same time, continuing fast income expansion amid a severe labour shortage will hamper its fast alleviation. The unemployment rate yet again hit an all-time low (Figure 18), with competition for personnel remaining strong (Figure 19). The labour market situation is a litmus test of whether the disinflation trend has set in and how strong it is. It is via a gradual normalisation of the labour market situation that a trend towards a gradual bridging of the gap between wages and productivity should be formed.
- An increase in demand can be driven by the government budget, which has provided a stronger stimulus than earlier assumed. The published budget projections raise the maximum

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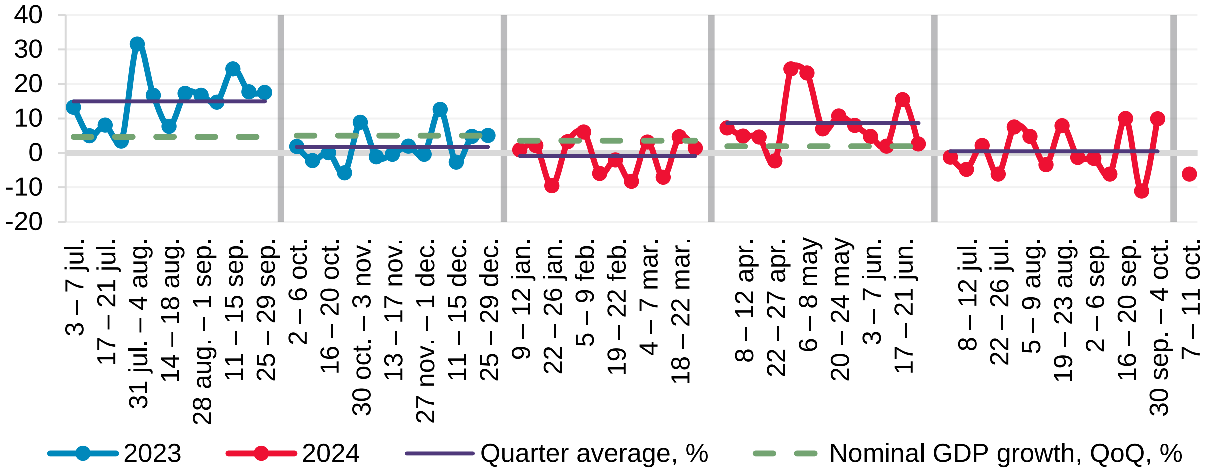
[4] Rosstat's Index of Business Confidence started falling in Q3, the Index of Industrial Forecasts from the Institute for Economic Forecasting of the Russian Academy of Sciences continued sliding in September, hitting a two-year low as the estimates of demand, production plans, and expected output prices corrected down, while the Bank of Russia's Business Climate Index dropped to the levels of early 2023.

[5] The correction of output up for the ***investment goods*** industries as a whole, showing 1,0% MoM SA growth after a fall of 1.9% MoM SA in July, was all but entirely owed to a rise in industries with the heaviest weight in the structure (net of them, the investment goods group's output fell 2.2% MoM SA in August).

[6] The recovery seems to have been all but entirely fuelled by a rise in daily natural gas extraction, while petroleum extraction is still contained by Russia's commitments under the OPEC+ agreement. Extraction of other mineral resources fails to show a growth trend amid stagnation of external demand for Russian coal and metals.

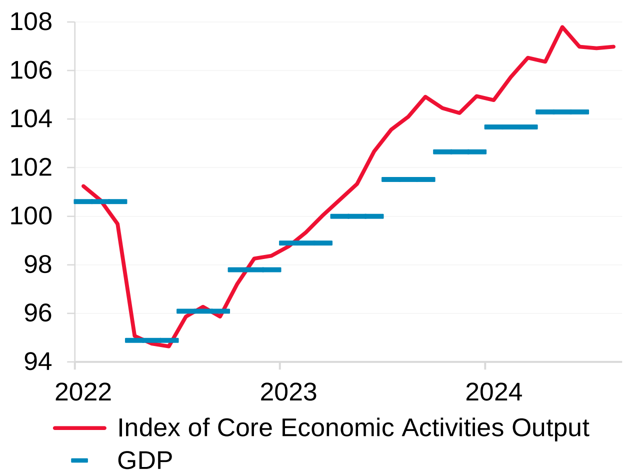
structural primary deficit of the 2024 federal budget from 1.6 trillion rubles to 2.0 trillion rubles. Moreover, they allow for its additional increase by another 1.1 trillion rubles. The additional expenditure seems to have already had an effect on aggregate demand and credit in the past months of the year, in particular, via a more dynamic lending to companies, counting on future budget outlays. However, the impact of a sizeable portion of the extra budget expenditure is translating into the economy in Q4. Given the limited potential for supply expansion, an additional (relative to earlier expectations) increase in government demand is a one-off proinflationary factor. All other things being equal, it means that monetary policy should in the coming quarters additionally cool private demand by maintaining a tighter monetary stance. At the same time, the budget projections assume a reinstatement of the fiscal rule for the forecast period of 2025–2027. Fiscal policy normalisation adhering to such budget parameters will help ease inflationary pressure in the economy.

Figure 9. Incoming payments growth[7] relative to the previous quarter average weighted by industries', shares in gross value added, seasonally adjusted, %



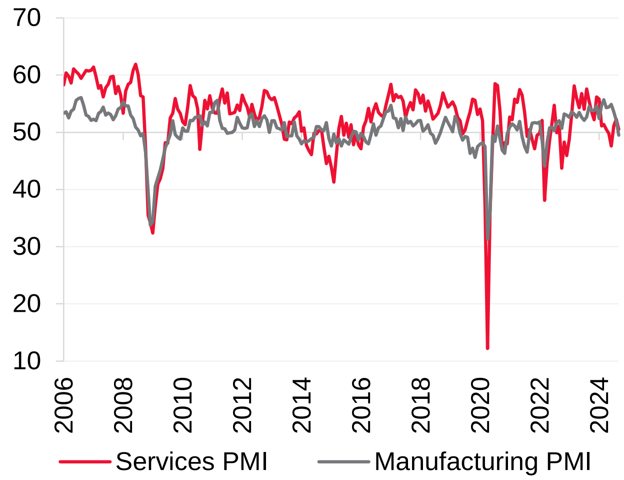
Sources: Bank of Russia, Monitoring of individual industries' financial flows.

Figure 10. Core economic activities output and GDP, Q4 2021 = 100, SA



Sources: Rosstat, R&F Department estimates.

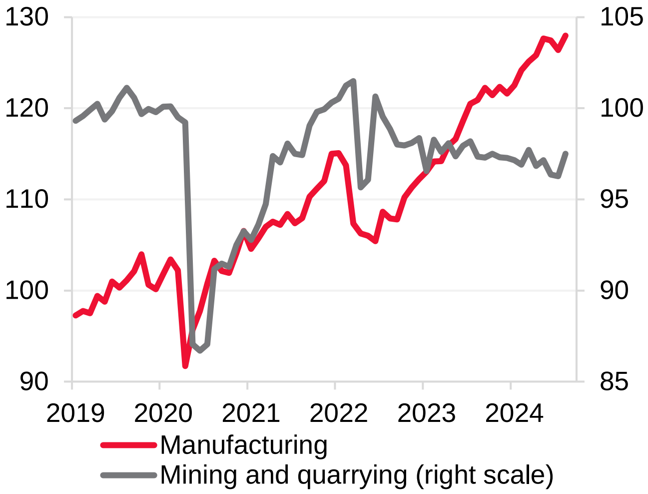
Figure 11. Russia's Manufacturing and Services PMI, points



Source: S&P Global.

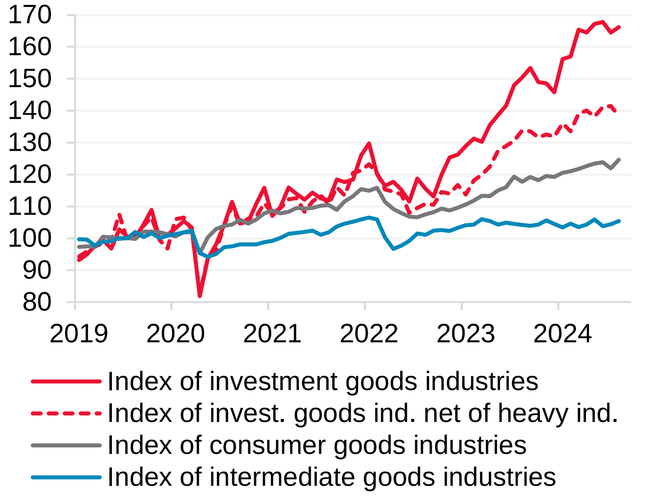
[7] Growth means a percentage change in the value: $g = \frac{(x_1 - x_0)}{x_0} * 100$.

Figure 12. Mining and quarrying and manufacturing indices (2019 = 100), SA



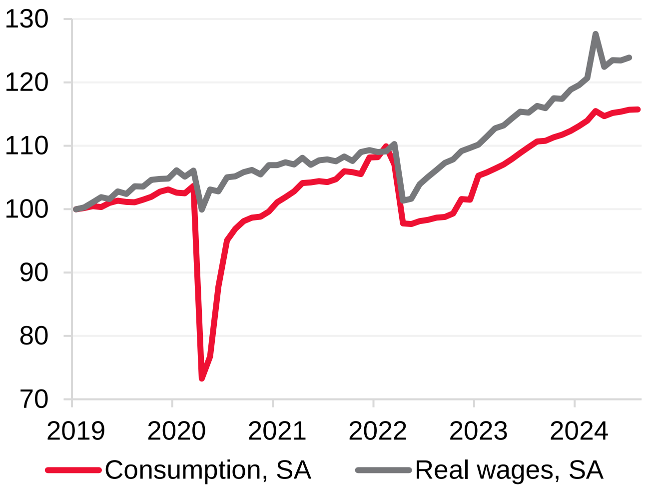
Sources: Rosstat, R&F Department estimates.

Figure 13. Output in groups of manufacturing industries, SA, 2019 = 100%



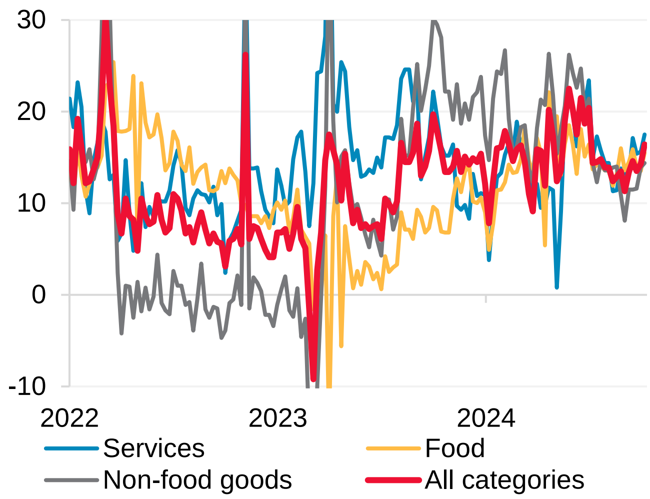
Sources: Rosstat, R&F Department estimates.

Figure 14. Proxy indicator for consumption (sum of retail, services and public food services sales) and real wages, 01.2019=100, SA, %



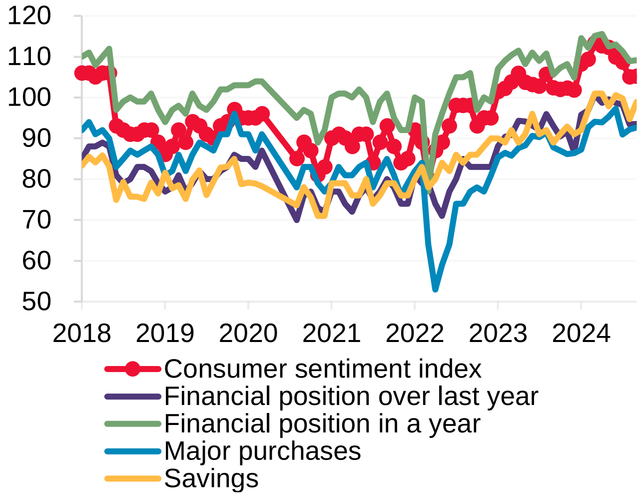
Sources: Rosstat, Bank of Russia, R&F Department estimates.

Figure 15. Nominal consumer expenditure growth by category, % YoY



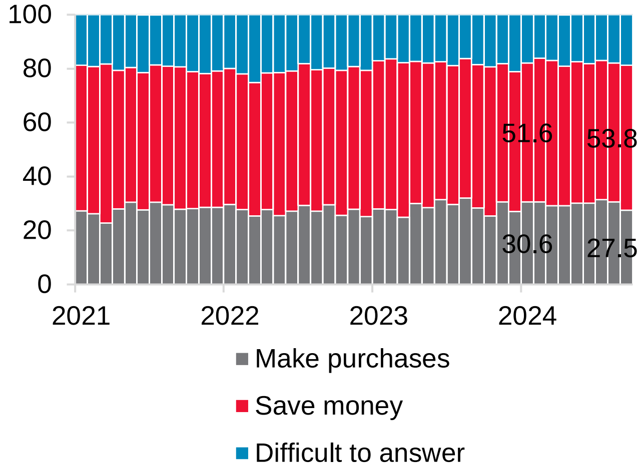
Source: SberIndex.

Figure 16. Consumer sentiment index and its sub-indices, points



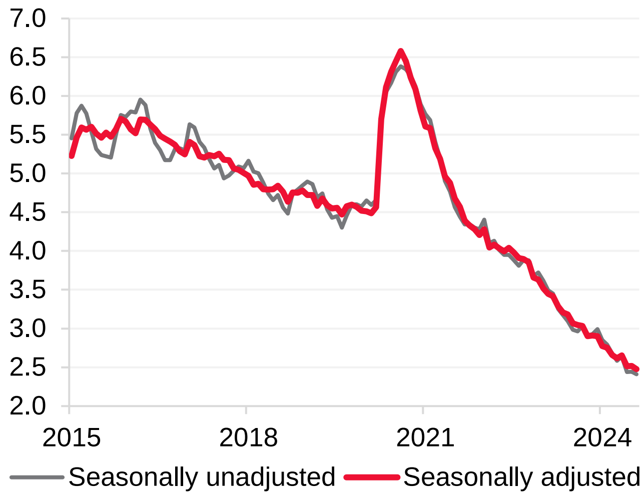
Source: inFom.

Figure 17. What is the best way to manage your spare money at the moment? (%)



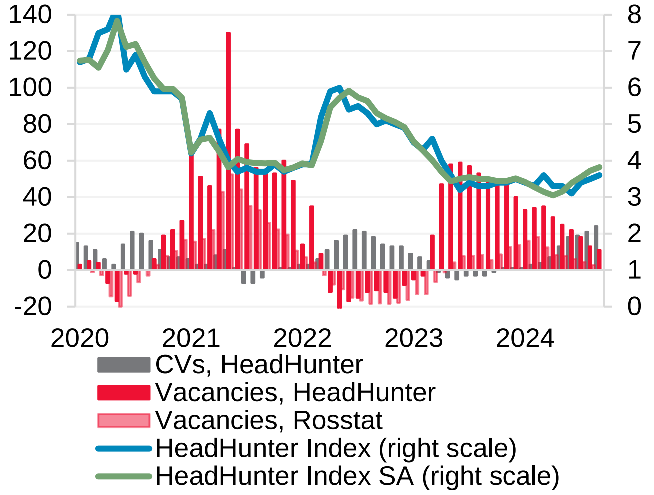
Source: inFom.

Figure 18. Unemployment rate, %



Sources: Rosstat, R&F Department estimates.

Figure 19. CVs, vacancies (% YoY) and HeadHunter index (points)



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

2.2. Retail lending is cooling, corporate lending growth is steadily strong

- Lending growth remains far above the rate allowing inflation to slow to 4%. The cooling of lending expansion is so far only seen in the retail segment, with the pace of expansion in lending to non-financial organisations remaining elevated. Against this background, the credit impulse[8] in the retail segment dropped to the lowest level since the middle of 2023 (dragged down mostly by mortgage lending, Figure 20). The credit impulse in the corporate segment is also weakening but not so fast. That said, the overall level of the credit impulse

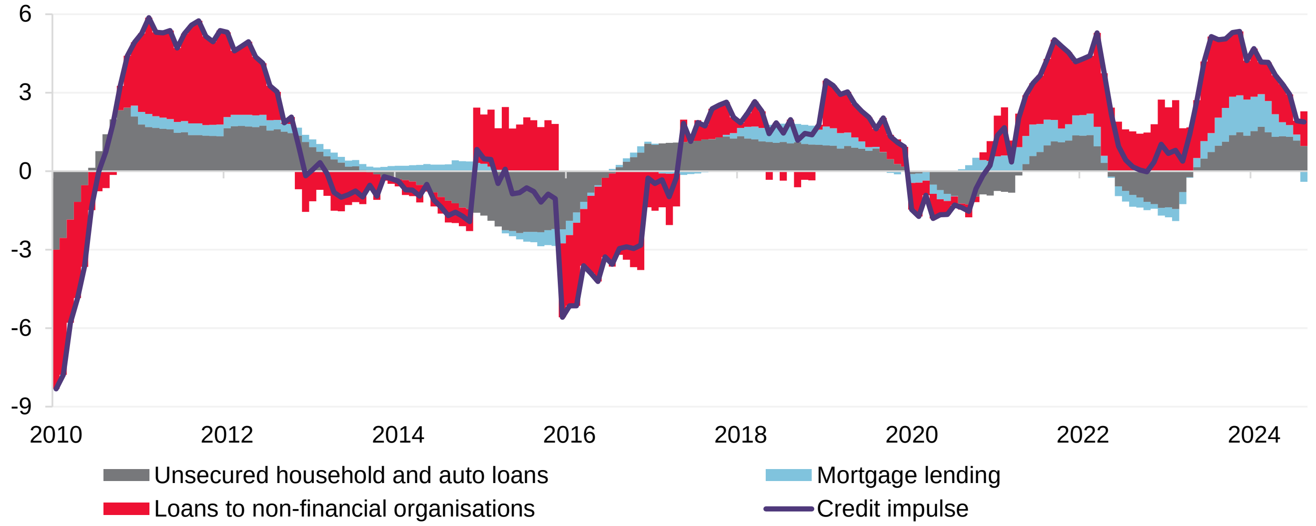
[8] Difference between credit growth over the past moving 12 months and the previous moving 12 months. It reflects the contribution of credit to demand growth in the economy.

is now far below its mid-2023 peaks. Overall, this means that the direct input of lending to aggregate demand remains significant this year (lending growth), but its contribution to economic growth (the credit impulse) has, after all, contracted.

- Retail lending growth in August was comparable with that in July at 0.5% MoM SA[9] (Figure 21). The mortgage lending segment showed cooling: portfolio expansion adjusted for securitisation slowed to 0.2% MoM SA from 0.5% MoM SA.[10] This resulted primarily from a steep fall in the number of loans extended under mortgage lending programmes (Figure 22). That said, a significant part of demand moved to the market segment, but its scale is small, given the high interest rates on mortgage loans.
- Unsecured consumer lending growth slowed to 0.5% MoM SA from 0.8% MoM SA (Figure 23). Factors behind this are the tightening of both monetary and macroprudential policies. Moreover, the latter may now provide a heftier input to the slowdown. Q3 saw cuts to macroprudential limits for loans with borrowers' debt-to-income ratio of more than 50%, while adds-on to risk weights for consumer loans with high total value were raised as of July. These measures, along with their additional tightening late in Q3 – early Q4, aim to diminish banks' willingness to extend consumer loans in the most risky segments. On top of that, the credit card segment is showing signs of cooling.
- The pace of auto loan portfolio growth slowed to 3.8% MoM SA from 4.1% MoM SA but remained fast (Figure 23). Strong demand for auto loans is buoyed by special offers, discounts from distributors, subsidised interest rates from producers, as well as expectations of price hikes after a car disposal fee increase as of 1 October. We may, however, see cooling in this lending segment after a surge of car demand in Q3 on expectations of the price hikes.
- Growth in lending to non-financial organisations accelerated to 2.2% MoM in August from 2.0% MoM SA in July. This means that the loan demand elasticity so far remains low. The key reasons behind this are businesses' upbeat expectations regarding further demand expansion and activity along with a strong financial result, improving their creditworthiness. However, the increasingly clear signs of the economy's cooling may result in a gradual revision of expectations down. Judging by business surveys, this process may have already started in some segments of the economy.
- Growth in household funds at banks notably accelerated to 2.3% MoM SA from 1.6% MoM SA (Figure 24). This performance, comparable with that at the start of the year, was buttressed by rising interest rates on deposit products, with steady growth in disposable money income continuing.

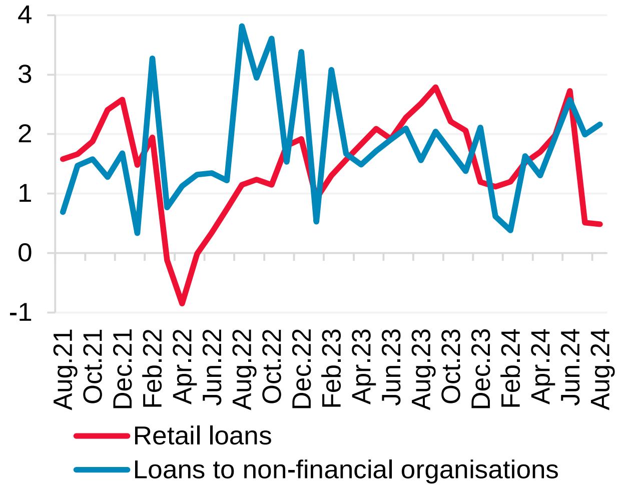
[9] Adjusted for securitisation.
[10] Average 2024 Q1 growth stood at 1.2% MOM SA.

Figure 20. Credit impulse over moving 12 months, % GDP



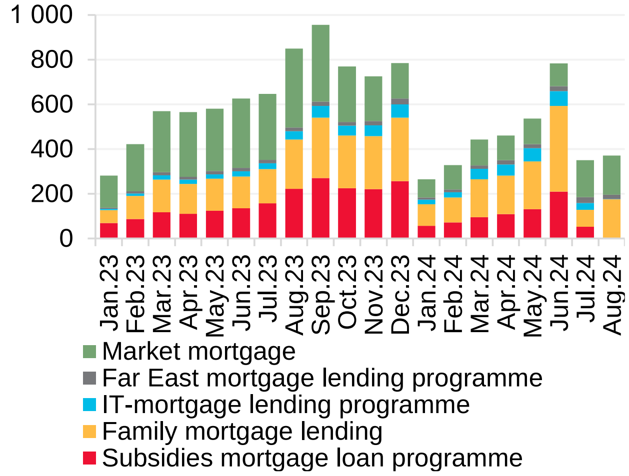
Sources: Bank of Russia, R&F Department estimates.

Figure 21. Ruble lending (adjusted for securitisation), % MoM SA



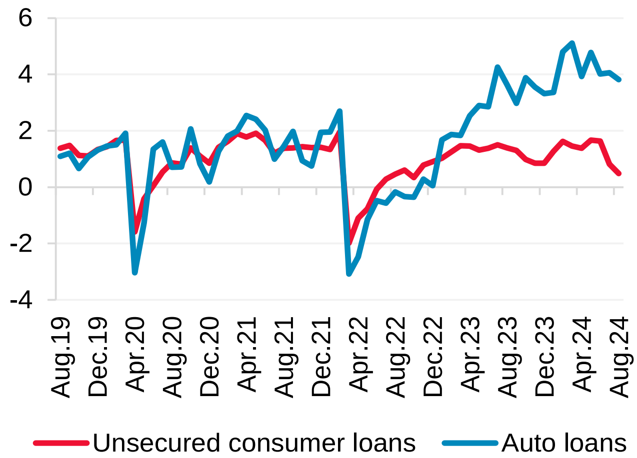
Sources: Bank of Russia, R&F Department estimates.

Figure 22. Loan issuance under subsidies mortgage loan programmes and market morgage, billion rubles



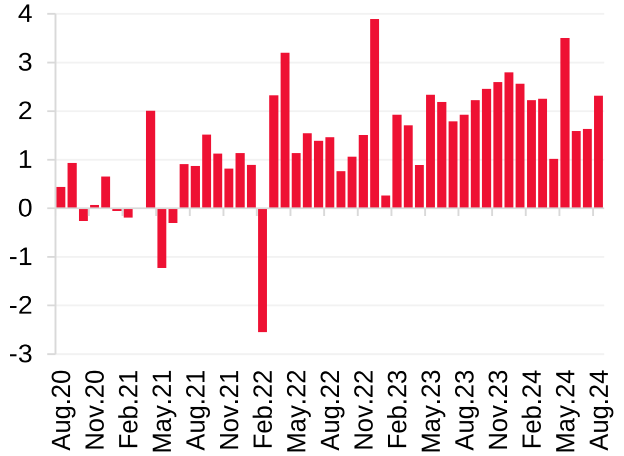
Sources: DOM.RF, Bank of Russia, R&F Department estimates.

Figure 23. Retail loans portfolio growth, % MoM SA



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

Figure 24. Household funds at banks, % MoM SA



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