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TALKING TRENDS
Economy and markets

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CONTENTS

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Executive summary

Monthly summary

- Between February and March 2025, the Russian economy grew at an overall moderate pace. The period was marked by higher sectoral heterogeneity, with the consumer sector sustaining increased growth despite stagnation in retail lending. High-frequency data show that investment activity held on the high levels of 2024, but the export sector was confronted with difficulties. The gradual decrease in tightness of the labour market has so far failed to bring about the growth convergence of real wage and labour productivity. Alongside high inflation expectations, this is a significant driver of persistently high growth rates of consumer prices. Although price growth continued to slow relative to 2024 Q4, this occurred in part on the back of a strengthening in the ruble – and the steady nature of this trend needs further evidence.
  - In March, growth in consumer prices continued to slow. This was driven by the strengthening ruble and declining demand for a number of non-food products. As lending grew slower, expansion in monetary aggregates decelerated, which will add to the sustainability of disinflation processes in the future. Specifically, confidence strengthened that annual inflation is set to decline consistently in the coming quarters.
  - Overall, economic activity continued to expand in February-March, especially in the consumer segment. At the same time, a number of sectors recorded lower output because of plummeting external or domestic, previously overheated, demand. Once demand stabilises, this will help put the economy on a path of steadier growth moving forward.
  - The slump in global financial and commodity markets caused by higher uncertainty on the back of rising protectionism, as well as the unfulfilled expectations of market participants with regard to rapid geopolitical de-escalation, sent asset prices down in the Russian financial market.

In focus. Intense investment growth and potential GDP: analysing the relationship

- Recent years have seen intense growth in fixed investment. Mounting geopolitical pressure only temporarily worsened the investment sentiment of Russian companies in the first half of 2022. After that, capital expenditure swung to tangible growth as the Russian economy underwent structural transformation.
- Moderate labour productivity growth in industries undertaking extensive investment may suggest that investment have so far been to a greater extent aimed at substitution, making up for the disruption of production chains caused by fixed investment growth in recent years has helped upgrade the potential level of the Russian economy, neutralise the adverse consequences of sanctions and disruption of external economic relations

for economic potential. That said, the scale of its effects on the *pace of growth* in potential GDP in the future will only materialise with time.

- Business surveys show a likely investment growth slowdown in 2025, while the *achieved high levels of* investment will be kept up. That said, return on investment may gradually rise as the structural transformation of the economy and full-fledged establishment of new production chains have been completed.

1. Inflation

Seasonally adjusted consumer price growth slowed in March. Most of the stable price movement indicators also rose at a slower pace than earlier. They were driven by ruble strengthening and weakening of demand, although the effect of these factors varied across consumer segments. Without new strong proinflationary shocks, the annual inflation indicator will start declining in May due to both further gradual slowdown of the ongoing price growth and the departure from annual inflation calculation of rapid price rise acceleration in May–December 2024.

Non-food prices sharply slowed growth, declining in a number of durable goods, such as cars and televisions. Demand was subdued in this segment as buoyant expansion in unsecured consumer and auto loans had come to an end. In addition, the share of imports is high in this segment, especially that of components. This is evidenced by a more pronounced pass-through of ruble strengthening to prices. Whether the recent ruble strengthening will be sustainable is so far unclear in light of the situation with the prices of Russian exports amid the global economic turbulence and high geopolitical uncertainty.

Prevalent in the consumer services segment is the factor of strong domestic demand fuelled by income growth and mostly unrelated to credit. The effect of exchange rate pass-through to the prices of most services is also weaker and more lagged in time than in the segment of non-food goods. As a result, growth in the prices of market services is so far slowing less markedly, remaining fast. For its further steady slowdown real wage growth should follow the dynamics of labour productivity.

Overall, the food segment found itself between two other segments: price growth is rapidly slowing but remains fast. The pass-through of ruble strengthening is counteracted by a rise in import prices of some food items due to the conditions of global markets for agricultural produce, while demand in this segment is weakly price-elastic and is not directly related to lending.

Summing up, one can say that the restraining impact of monetary policy has started to make itself felt in consumer price movements. At the same time, the deceleration of annual inflation from its current high levels to 4% requires time and maintenance of a tight monetary stance. This is particularly relevant under high and unanchored household and business inflation expectations. The Bank of Russia will rely on macroeconomic data in determining whether the pace of inflation deceleration is adequate for bringing it back to 4% in 2026, as set forth in the forecast.

1.1. Price growth slowdown in Q1

- Inflationary pressure notably slowed in Q1 relative to late last year. This is, in particular, indicated by the majority of sustainable price growth indicators, with companies' price expectations and household inflation expectations going down.
- Price growth slowdown is in part driven by a tight monetary stance, with the cooling of lending and demand in some segments of non-food goods making itself felt. That said, a significant disinflationary effect came from ruble strengthening.
- Price growth remains elevated in the market services segment. For it to slow, the cooling of the labour market situation and wage growth in line with that of labour productivity are needed. This requires a tight monetary stance to be maintained for an extended period.

Consumer price rises slowed to 7.1% MoM SAAR in March from 7.5% MoM SAAR in February. The pace of price growth continued to slow in the non-food segment, remaining all but unchanged in food and slightly accelerating in services. Annual inflation edged up to 10.3% from 10.1% in February (Table 1).

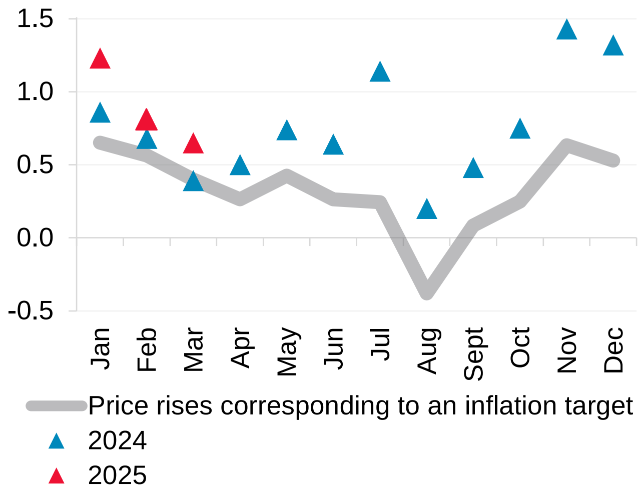
Inflationary pressure markedly declined in Q1 relative to late last year, with prices going up 8.3% QoQ SAAR in Q1 after 12.9% SAAR in Q4 2024, remaining, however, elevated. Meanwhile, adjusted for the impact of non-monetary components, price growth slowdown is so far little pronounced and unsustainable. Indeed, Q1 saw a significant disinflationary effect from ruble strengthening and a more modest impact from the cooling of demand. We estimate that, adjusted for the impact of the exchange rate, price growth in March and all of Q1 would have been close to 10% SAAR. The cooling of demand is seen in some segments of the consumer market (in, above all, durable non-food goods).

Table 1. Inflation and its components

	Mar.	Mar.	Jan.	Feb.	Mar.
	2023	2024	2025		
% YoY					
All goods and services	**3.5**	**7.7**	**9.9**	**10.1**	**10.3**
Core inflation	**3.7**	**7.8**	**9.3**	**9.6**	**9.7**
Food	2.6	8.1	11.1	11.7	12.4
Non-food goods	0.1	6.7	6.1	6.1	5.9
Services	9.7	8.3	13.0	12.7	12.9
% MoM SAAR					
All goods and services	**3.3**	**3.9**	**10.3**	**7.5**	**7.1**
Core inflation	**2.8**	**5.7**	**10.3**	**9.2**	**7.4**
Food	1.2	2.0	7.4	10.2	10.5
– net of fruit and vegetables	**1.2**	**5.7**	**14.1**	**14.5**	**11.1**
Non-food goods	1.6	3.2	5.5	3.6	1.6
– net of refined petroleum products	**1.7**	**3.4**	**5.3**	**3.2**	**0.9**
Services	8.2	7.3	20.8	8.2	9.0
– net of housing and communal services	**9.7**	**7.3**	**18.7**	**10.3**	**11.9**

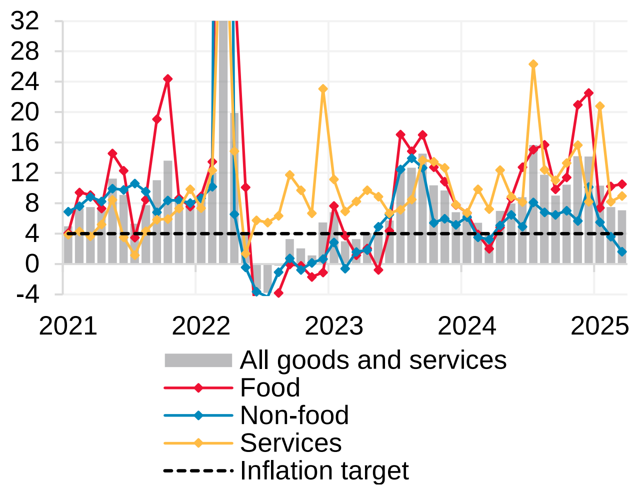
Sources: Rosstat, R&F Department estimates.

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



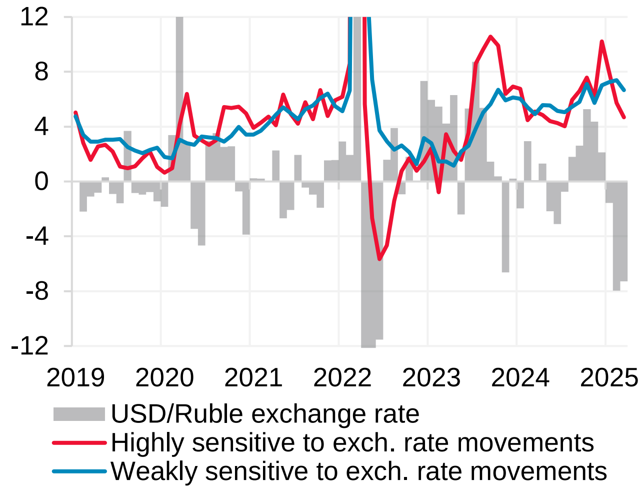
Sources: Rosstat, R&F Department estimates.

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.

Food prices rose 10.5% MoM SAAR in March, remaining close to the high levels of February (Figure 2). Fruit and vegetable price growth was steeper than usual at this time of year. The pace of price rises in other food products notably declined to 11.1% MoM SAAR after 14.5% MoM SAAR. The rate of price growth in food of animal origin continued to slow, remaining, however elevated.

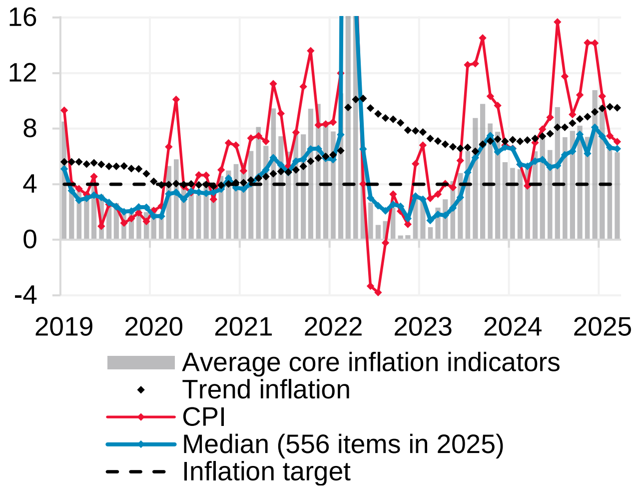
Price growth in the non-food segment slowed even more drastically to 1.6% MoM SAAR from 3.6% MoM SAAR in February. This segment sees the concurrent impacts of ruble appreciation and cooling of demand driven by a tight monetary stance and regulatory factors. The median of price rises in the goods highly sensitive to exchange rate movements fell dramatically (Figure 3). Prices of electronic goods and imported cars went down. The cooling of demand on the back of monetary tightening and depletion of deferred demand seen in recent years are also playing an important role. Q1 saw passenger car sales plunge 25.3% relative to last year. Retailers also report a steep drop in smartphone sales. Rosstat data also indicate a contraction in the sales of other electronic goods (Figure 6) which are often bought on credit.

In services, the rate of price growth rose to 9.0% MoM SAAR from 8.2% SAAR in February, driven chiefly by the prices of passenger transport services. Overall, price growth remains very fast in relatively less volatile services components at more than 10% in annualised terms. While services demand also reacts to monetary policy tightening, it remains strong, fuelled by wage growth. The easing of price pressure in the services sector will require labour market cooling and more balanced wage rises (Figure 8).

The majority of analytical indicators show gradual easing of persistent inflationary pressure, which still remains elevated level. The average of modified core inflation indicators declined. Median price growth also slowed (Figure 4), along with a total weight of items rising in price at an accelerated rate (Figure 5). The trend inflation estimate decreased. The decomposition of price growth[1] shows a marked decline in the contribution of demand-side factors to February's price rises, both reducing proinflationary and increasing disinflationary components of demand. However, this decomposition is simple to construct, while a more reliable identification of changes in the demand- and supply-side factors requires additional data corroborating changes which emerged in February. On top of that, a total contribution of supply-side factors to price growth in January–February remained very significant, substantially hampering a slowdown in inflation itself and a decrease in inflation expectations (Figure 8).

Nevertheless, a variety of polls also signal a possible price pressure decline. Indeed, the Bank of Russia survey showed a marked fall in companies' price expectations amid a slowdown in the rise of costs (Figure 7). Respondents of the S&P Global PMI poll report a drop in the pressure of costs and a slowdown in output price growth. Household inflation expectations slid in February–March for the first time since September 2024. That said, the consumer sentiment index continued to rise, with respondents' perceptions of their current financial position and expectations alike increasing. All indicators remain elevated. This change is largely a reaction to ruble strengthening, but recent monetary policy tightening (which is, among other things, a hefty factor of the ongoing exchange rate movements, working towards ruble strengthening, all other things being equal) is also playing an important role.

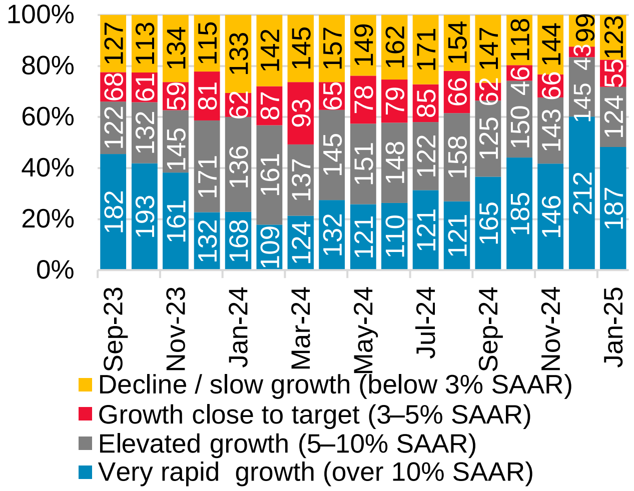
Figure 4. Modified core inflation indicators* (% in annualised terms) and trend inflation estimate (%YoY)



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

Sources: Rosstat, R&F Department estimates.

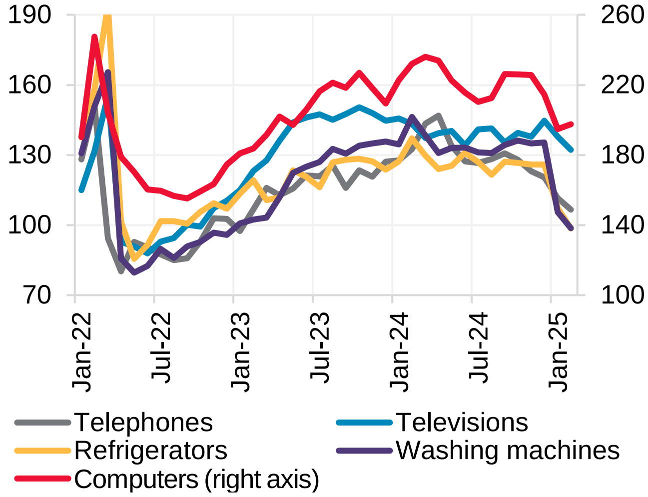
Figure 5. Total weight of goods and services* distributed based on seasonally adjusted price growth



** Net of fruit and vegetables, and regulated services.*
Note: Figures stand for the number of items.
Sources: Rosstat, R&F Department estimates.

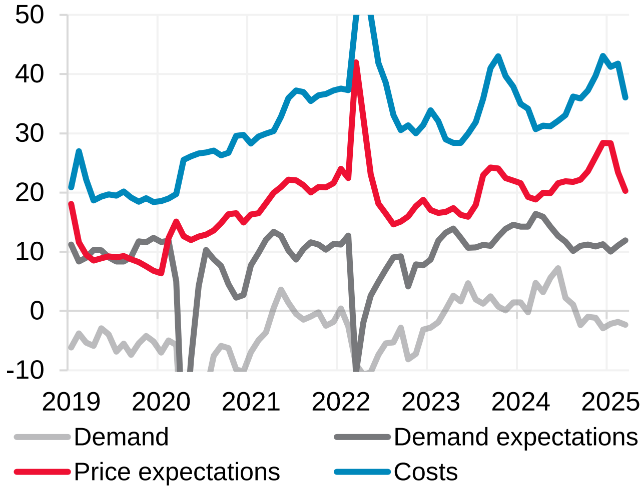
[1] Sheremirov V. (2022). Are the Demand and Supply Channels of Inflation Persistent? Evidence from a Novel Decomposition of PCE Inflation. Federal Reserve Bank of Boston Current Policy Perspectives. November 4, 2022.

Figure 6. Sales of some electronic goods items, SA, Dec.19 = 100



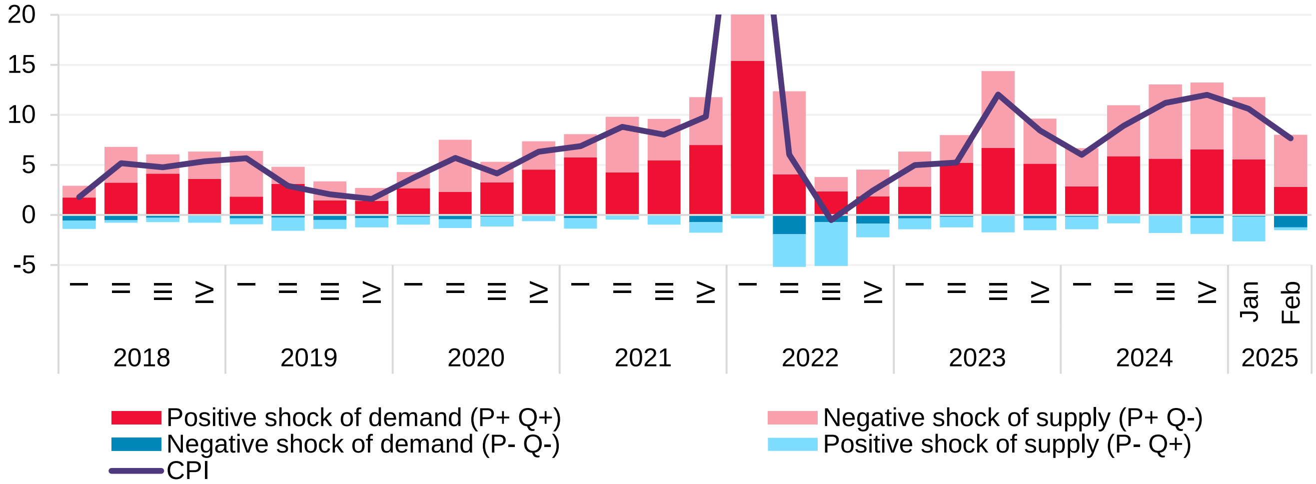
Sources: Rosstat, R&F Department estimates.

Figure 7. Business monitoring data for, points, SA



Source: Bank of Russia.

Figure 8. Price growth decomposition, % QoQ 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 the shift of the demand curve. Unlike the key method of the source paper, detrending is not conducted.*

Sources: Rosstat, R&F Department estimates.

2. Economic performance

According to published data, 2025 Q1 GDP growth (QoQ SA) relative to Q4 2024 will likely come out modest. The key reason behind this is solid December and overall Q4 2024 numbers, which were largely driven by strong output owing to government orders. At the same time, the January–February figures and survey data for February–March indicate continued economic activity growth, albeit slower than in previous quarters. 2025 Q1 GDP (SA) is bound to surpass the 3Q 2024 level.

Consumer goods producers remain growth leaders among industries. Exporting industries are increasingly falling behind due to adverse external economic and geopolitical factors. Given the reinstatement of the fiscal rule parameters expected this year, the performance of individual sectors of the economy is set to vary progressively wider. That said, the consumer goods sector will find itself in the most advantageous position, benefiting from growing household income amid the continuing labour market tightness.

The prospects of the investment goods sector are yet to be evaluated. On the one hand, the high loan and deposit rates make businesses put off implementing part of investment projects. On the other hand, the structural transformation of the economy, including partial import substitution, stimulates investment in both the establishment of new production facilities and the maintenance of those in operation. The resultant of these two opposite factors helped fixed investment grow by around 9% in 2024. 2025 Q1 saw growth acceleration in financing of investment goods industries, including the construction sector. This gives reason to expect that fixed investment will also grow in 2025, although less than last year.

Overall, the situation indicates the start of the Russian economy's gradual exit from a strong overheating phase, in which it found itself in 2024. In this phase, the supply of goods and services is trying to keep pace with demand, which grows at a faster rate. The problem is that as faster growth in demand continues, falling further behind production potential, this growth increasingly leads to prices growth rather than output expansion in physical terms (which grow progressively less because of limited production factors).

2.1. Gradual slowdown of economic growth

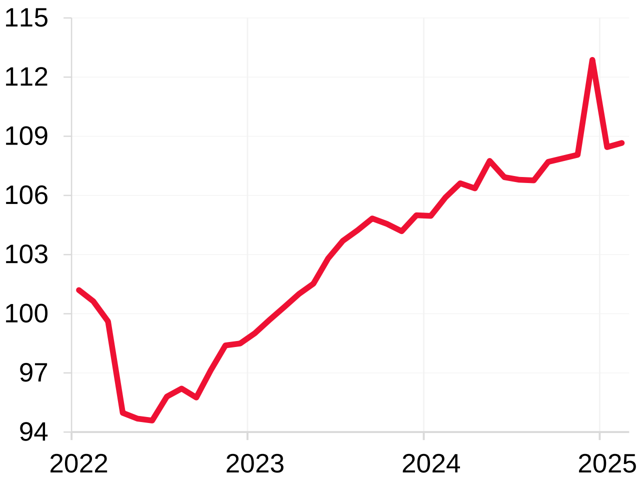
- Core industries' output returned to a moderate growth path in February, up 0.2% MoM SA, after sharp fluctuations in the previous 2 months (Figure 9). GDP growth seems to have dramatically slowed in Q1 compared with Q4, given a short-lived economic activity surge in December. As a result, the economy's overheating stopped to strengthen.
- The analysis of financial flows in the Bank of Russia's payment system and survey data (Figure 10) suggest a more modest pace of demand and output growth in Q1 along with moderate expectations for the future. In February, industrial output returned to a growth path, seen before a one-off output spike in December 2024 (up 0.4% MoM SA). Mining and quarrying continued on a downward path, driven by one-off factors[2] (Figure 11).

[2] A fall from a high base of demand for gas and electricity to warm weather.

The manufacturing sector expanded output, fuelled by, above all, investment goods industries. The performance of other industries deteriorated. It was held back by constraints, primarily on the side of supply (shortage of personnel, logistics constraints, refinery breakdowns, weather conditions) (Figure 12). For instance, the output of food products has remained all but unchanged since mid-2024.

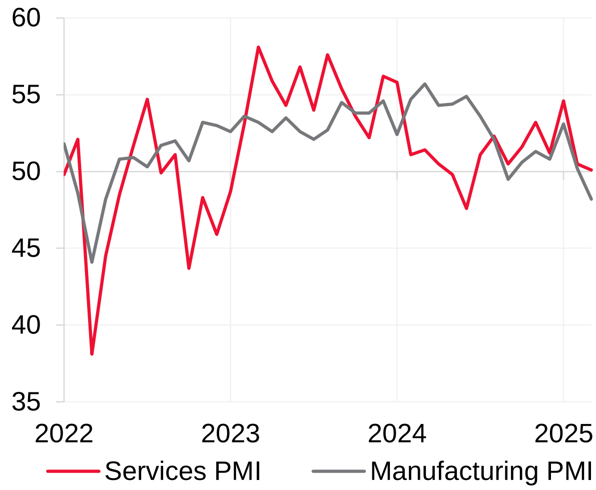
- At the same time, changes in household income are still stimulating consumer activity, contributing to income growth concurrently with savings accumulation (Figure 13, Figure 14). Wages continued to grow in January adjusted for seasonal factors and the effect of earlier than usual (in December) bonus payment. Together with the accelerated pace of pension indexation, this helped consumer confidence growth (Figure 17). At the same time, consumer demand started to cool in the face of a tight monetary stance and toughening of macroprudential requirements. This mainly materialises through changes in demand for non-food, especially durable, goods, which are often bought using debt (cars, major household and electronic appliances, computers, and smartphones). Nevertheless, in some segments, demand still exceeds production capabilities (in, above all, services and food), which hampers disinflationary processes.
- The easing of labour market tightness is occurring gradually. The unemployment rate stabilised at an all-time low of 2.3% SA (Figure 15), with the employment rate edging up 0.2% MoM SA to 61.4% SA (Figure 16). At the same time, a decline in companies' recruiting activity[3], leading to the contraction of vacancies overhang (Figure 18) and easing competition for personnel, may help narrow the gap between wage growth and a rise in productivity. Should the impact of a tight monetary stance on lending and fiscal policy normalisation continue, this is supposed to ensure the establishment of a sustainable disinflationary trend.

Figure 9. Core economic activities output, Q4 2021 = 100, SA



Sources: Rosstat, R&F Department estimates.

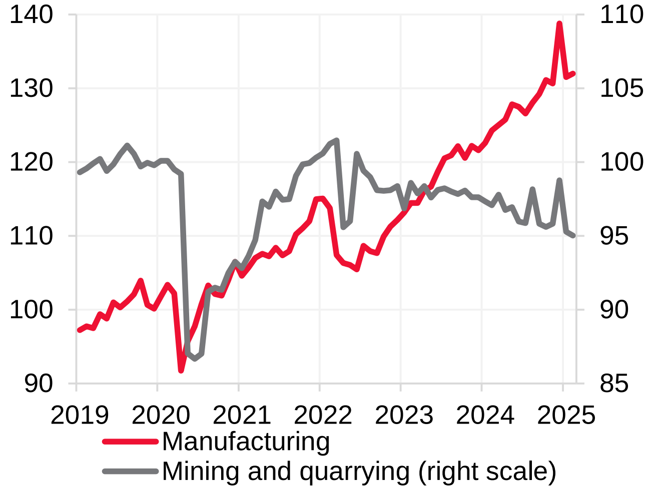
Figure 10. Russia's Manufacturing and Services PMI, points



Source: S&P Global.

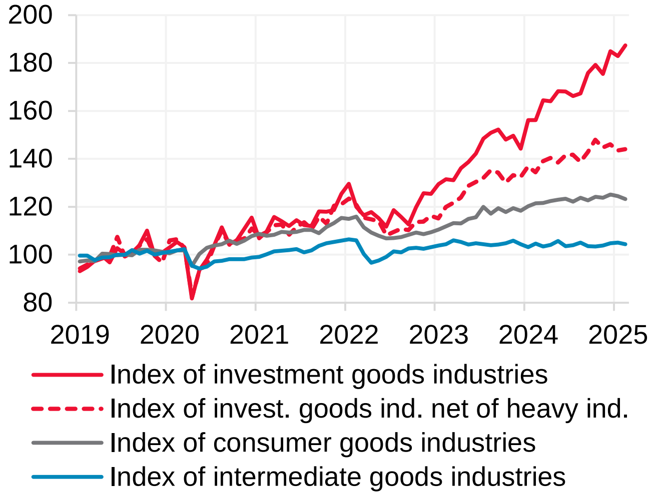
[3] According to a Bank of Russia survey, the share of firms suffering a personnel shortage has been stable for the second consecutive month. According to survey data from the Economic Forecasting Institute of the Russian Academy of Sciences, hiring plans have moved to negative territory, while the PMI has posted jobs contraction in services sector companies for the first time since July 2023.

Figure 11. Mining and quarrying and manufacturing indices (2019 = 100), SA



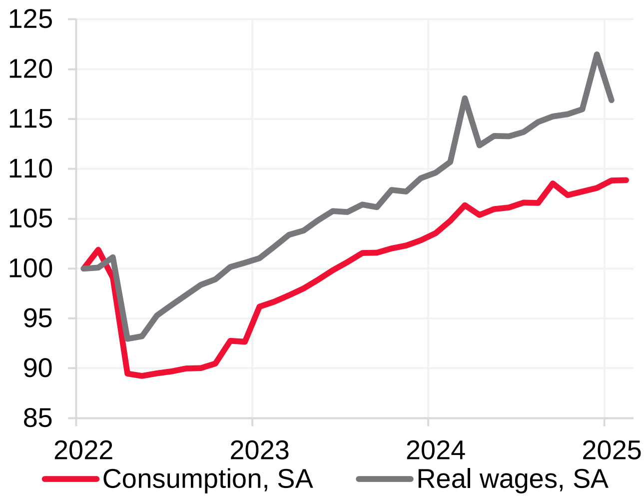
Sources: Rosstat, R&F Department estimates.

Figure 12. Output in groups of manufacturing industries, SA, 2019 = 100%[4], SA



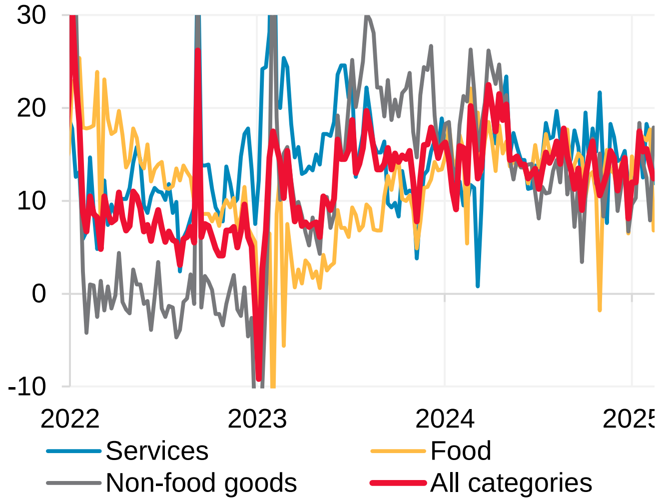
Sources: Rosstat, R&F Department estimates.

Figure 13. Proxy indicator for consumption (sum of retail, services and public food services sales) and real wages, 01.2022 = 100, SA, %



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

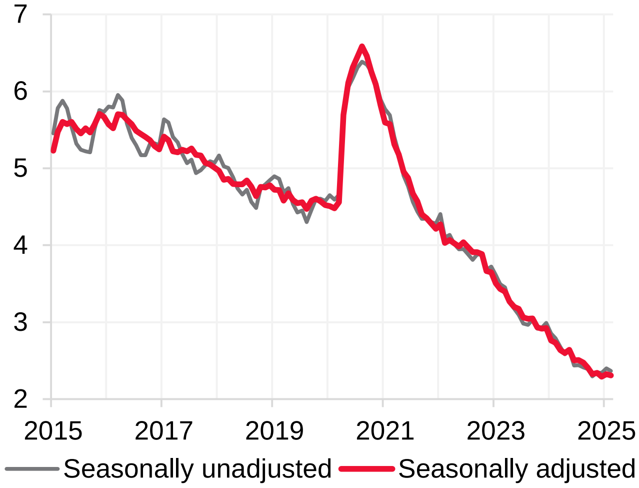
Figure 14. Nominal consumer expenditure growth by category, % YoY



Source: SberIndex.

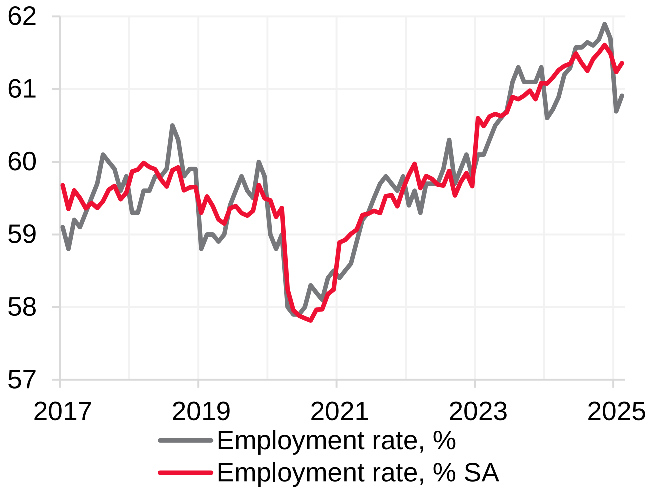
[4] For the index of investment goods industries net of heavy industries the production of "finished metal products other than machinery and equipment" and "other vehicles and equipment" are excluded.

Figure 15. Unemployment rate, %



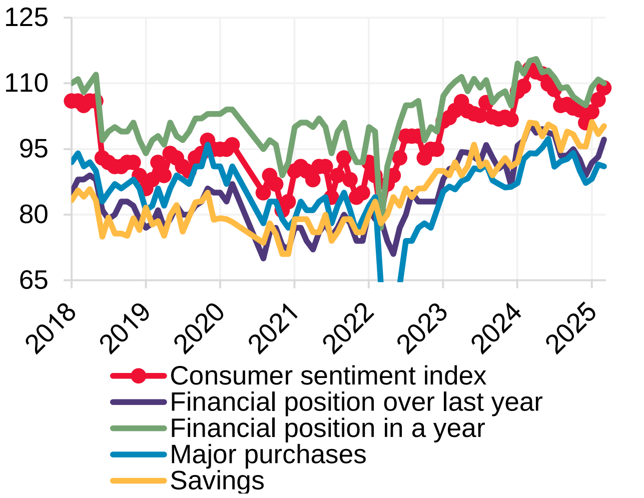
Sources: Rosstat, R&F Department estimates.

Figure 16. Employment rate, %



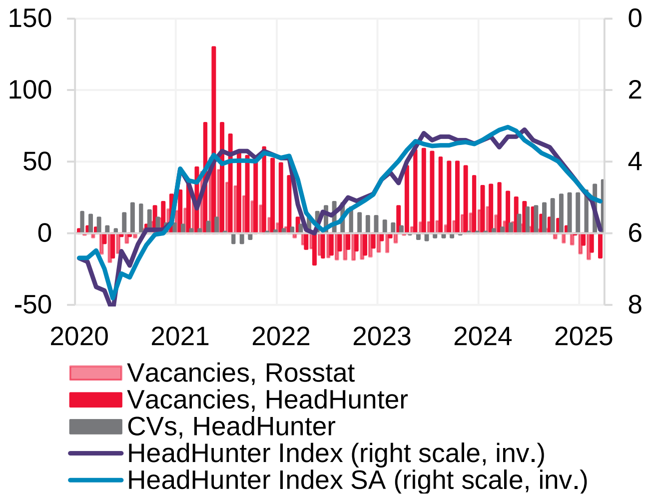
Sources: Rosstat, R&F Department estimates.

Figure 17. Consumer sentiment index and its sub-indices, points



Source: inFom.

Figure 18. CVs, vacancies (% YoY) and HeadHunter index (points)



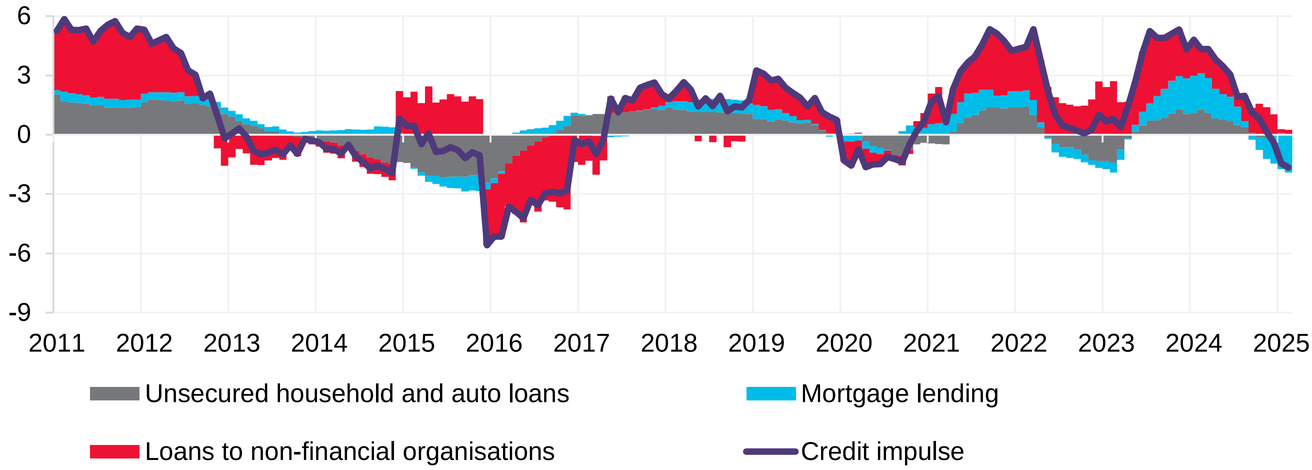
Sources: Rosstat, HeadHunter, R&F Department estimates.

2.2. Growth in lending and monetary aggregates loses momentum

- February saw lending slightly pick up in the corporate and retail segments alike. At the same time, lending growth remains far below the average 2024 Q1–Q3 levels. As a result, the credit impulse[5] continued to slide, reflecting the contracting input of lending to aggregate demand (Figure 19). The credit impulse is markedly negative and comparable with the 2020 numbers. Lending is cooling, driven by a tight monetary stance and toughening regulatory requirements. According to our estimate, the current moderate performance of lending in seasonally adjusted terms together with the zero structural deficit planned for 2025, are in accord with a forecast of a gradual inflation slowdown to 4%.

[5] The credit impulse is computed as a difference between a sum of the loan portfolio absolute rises (adjusted for foreign exchange revaluation) for a rolling year and a similar figure for the previous year relative to GDP for the previous rolling year. This reflects change in demand for the rolling year due to lending.

Figure 19. Credit impulse, % of GDP



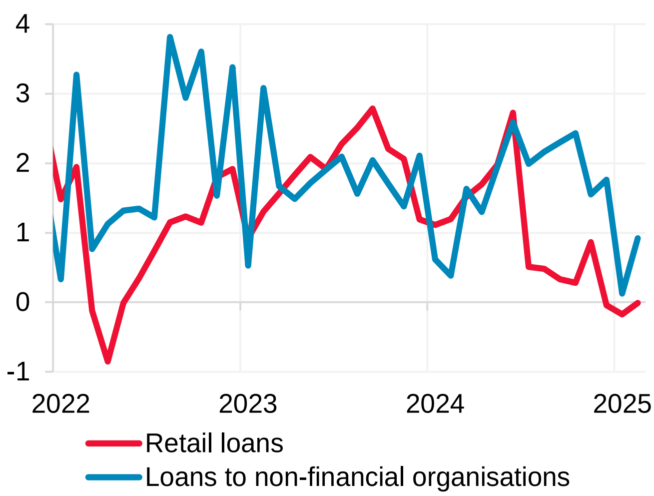
Sources: Bank of Russia, R&F Department estimates.

- The retail loan portfolio adjusted for securitisation was unchanged (SA) in February after contracting 0.2% MoM SA in January (Figure 20). The mortgage lending segment continued its moderate growth at 0.4% MoM SA after a rise of 0.6% MoM SA in January (Figure 21), buttressed by the Family Mortgage Lending programme[6] amid an increase in the reimbursement of commissions to banks by Russia's finance ministry.
- The other retail lending segments saw continued cooling in February. The unsecured consumer loan portfolio[7] shrank 0.9% MoM NSA after falling 0.3% MoM NSA. Credit cards account for a large share in the structure of loans, but a considerable proportion of this debt is repaid during an interest-free grace period (usually 100 days) and does not have a significant effect on change in the amount of loan debt. Growth in the auto loan portfolio slowed to 0.2% MoM SA from 1.2% MoM SA, reflecting a fall in demand in the car market after a surge last year: sales of both new and used cars since the start of 2025 are below the 2024 numbers.
- Ruble lending to non-financial organisations expanded 1.0% MoM SA after 0.1% MoM growth in January. This performance is largely owed to a drop in monthly budget expenditure after a surge in January on the back of advance payments for performing government contracts: the recipients of advance payments from the budget used part of these funds to repay earlier loans. We estimate that in the first two months of 2025 lending growth unadjusted for the effect of accelerated advance payment of budget funds would have stood at 1.4% rather than 1.1% SA. This pace of growth is far below the 2024 average and is a consequence of monetary policy tightening, as well as bank lending terms and conditions due to banks' capital contraction and planned departure from the policy of easing adds-on to capital adequacy ratios. That said, companies continued to extensively issue corporate bonds in January–March. Bonds partly substituted for standard bank loans but did not have a crucial effect on changes in companies' debt.

[6] A total of loans under the programme in February surpasses the levels of the same month of 2023 and 2024.
[7] According to data from Reporting Form 0409316.

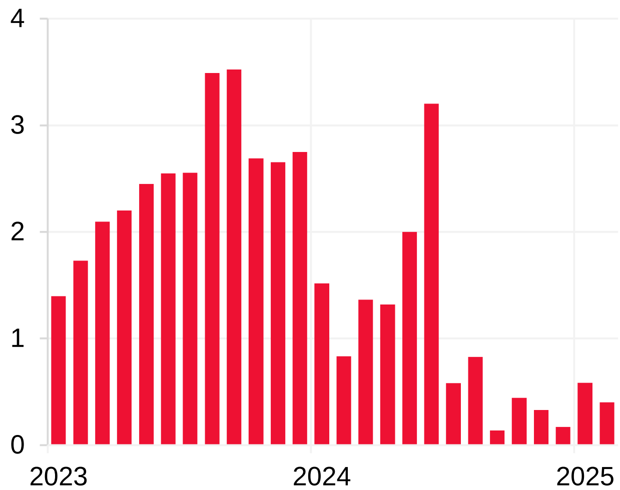
- Growth in customers' funds at banks slowed in February. The shift of annual bonus payments from early 2025 to late 2024 by some companies and cuts to deposit rates may have resulted in slower household deposit expansion: it slowed to 1.4% MoM SA from 2.4% MoM SA in January (Figure 22). Growth in corporate customers' funds slowed to 0.6% from 1.3% MoM SA.
- Broad money supply (net of foreign exchange revaluation) slowed to 1.0% MoM SA in February from 1.4% MoM SA in January (Figure 23). The reduction in the lending growth contribution to a rise in the expansion of broad money supply M2X was, to a large degree, offset by an increase in the contribution of the budget and net foreign assets. According to a preliminary estimate, a slowdown in monetary aggregates expansion continued in March. This will help gradual sustainable price growth slowdown within several quarters.

Figure 20. Ruble loans portfolio growth (adjusted for the securitization transactions), % MoM SA



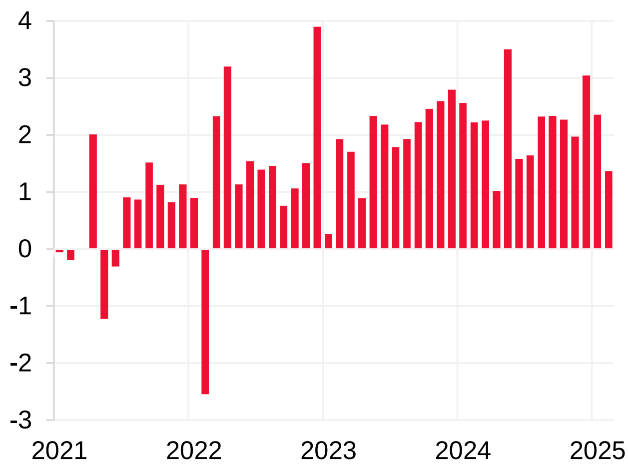
Sources: Bank of Russia, R&F Department estimates.

Figure 21. Ruble mortgage loan debt, adjusted for acquired rights of claim , % MoM SA



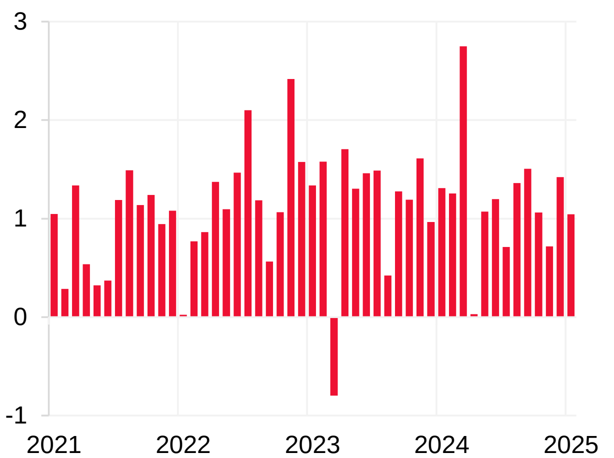
Source: Bank of Russia, R&F Department estimates.

Figure 22. Household funds with banks, % MoM SA



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

Figure 23. Broad money supply (net of foreign exchange revaluation) M2X growth, % MoM SA



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

In Focus. Intense investment growth and potential GDP: analysing the relationship

- Recent years have seen intense growth in fixed investment. Mounting geopolitical pressure only temporarily worsened the investment sentiment of Russian companies in the first half of 2022. After that, capital expenditure swung to tangible growth as the Russian economy underwent structural transformation.
- Moderate labour productivity growth in industries undertaking extensive investment may suggest that investment have so far been to a greater extent aimed at substitution, making up for the disruption of production chains caused by fixed investment growth in recent years has helped upgrade the potential level of the Russian economy, neutralise the adverse consequences of sanctions and disruption of external economic relations for economic potential. That said, the scale of its effects on the *pace of growth* in potential GDP in the future will only materialise with time.
- Business surveys show a likely investment growth slowdown in 2025, while the *achieved high levels of* investment will be kept up. That said, return on investment may gradually rise as the structural transformation of the economy and full-fledged establishment of new production chains have been completed.

Firms' investment is a foundation of production efficiency improvement. Capital thus created (plant and equipment, objects of intellectual property and so on), along with labour resources provide for ramping up the output of individual firms and the economy at large. Mounting of geopolitical tensions, decreasing access to part of imported materials and technology, as well as change in the geography of some external markets, have resulted in the structural transformation of the Russian economy. Stepped up investment has become one of its key features. Indeed, fixed investment rose 7.4% in 2024[8], expanding by more than a quarter (25.8%) in 2022–2024, outpacing GDP growth (Figure 24).

Most of the Russian economy's industries which had usually made a significant contribution to overall investment growth, submitted massive investment programmes by the start of 2022. These programmes largely relied on high prices of raw materials and stimuli of the post-Covid recovery. Change in trade and financial environment in 2022 made many companies revise their plans.

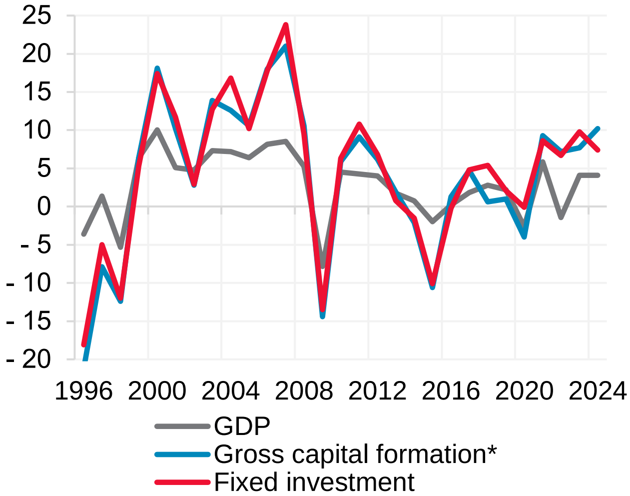
The nature of newly-emerged constraints, time spent on circumventing them or looking for new markets/suppliers varied across industries. Export-oriented companies revised the relevance of implementing the projects targeting markets, which became hard to access or completely closed to Russian products. Companies dependent on the import of machinery, equipment, or technologies were confronted with the need to look for alternative suppliers in friendly countries or within Russia. For projects implying a joint ownership of domestic

[8] For the entire range of business entities, exclusive of statistics from the Donetsk and Lugansk People's Republics, the Zaporozhye and Kherson Regions.

investors and those from unfriendly countries faced the need to look for new sources of finance. On top of that, an overall rise in uncertainty led to the adjournment of some plans.

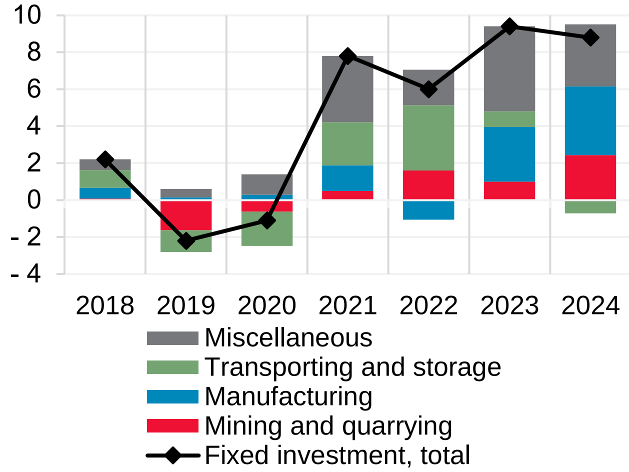
Some industries, however, overcame difficulties hampering the realisation of investment projects much faster than expected – as early as the middle of 2022. This was to a great degree helped by the measures put in place by the Russian government to support the economy, including import substitution, parallel imports, subsidised lending, and leasing programmes. As a result, fixed investment growth came in at 6.7% for 2022, even as GDP contracted. Growth drivers were chiefly mining and quarrying industries, as well as those engaged in transportation and storage – given the need for an urgent transformation of logistics (Figure 25). The new challenges were more painful to mining and quarrying, where investment slumped almost all across the board in 2022. Factors behind this were a drop in domestic demand and import restrictions.

Figure 24. Fixed investment and GDP, % YoY



* Including acquisition less disposables of valuables.
Source: Rosstat.

Figure 25. Industry-specific fixed investment, % YoY

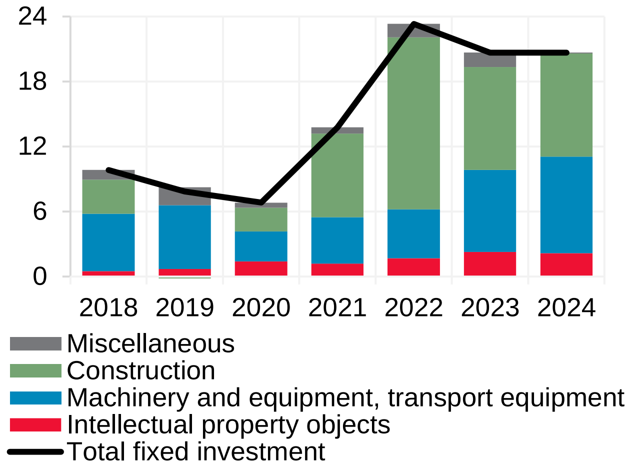


Sources: Rosstat, R&F Department estimates.

In 2023–2024, however, the impulse of fixed investment shifted from mining and quarrying to manufacturing. While the high level of uncertainty in the face of external restrictions hampered launching new projects in mining and quarrying, manufacturing enjoyed support from the rebound of domestic demand. Domestic firms benefitted from extra demand for their products as some niches emerged after the departure of foreign companies from the Russian market (import substitution). Similarly did the exporting companies, as new export destination were found. Additional investment incentives also came from the rising labour market tightness in sectors where technologies allow capital to substitute for labour. That said, neither the ruble depreciation periods nor difficulties regarding payments for imports arose as factors capable of cooling companies' investment. Most firms' investment surpassed the 2021 level in real terms.

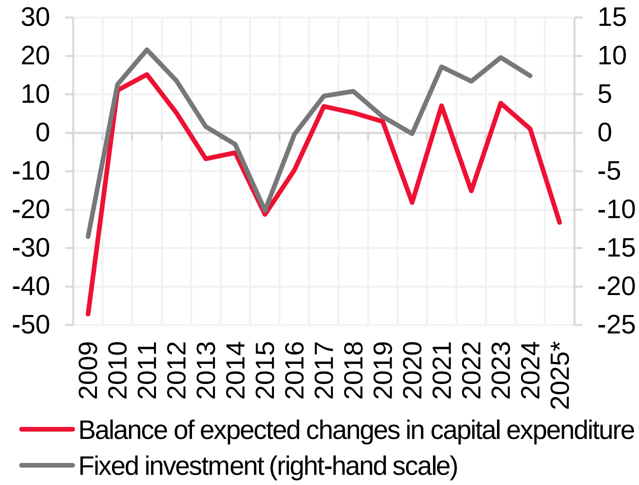
In addition to fixed investment breakdown by industry, there occurred notable changes in the asset structure of investment. As import substitution processes gained momentum, machinery and equipment were making an increasingly hefty contribution to investment growth. Given the need to replace foreign software with domestic products, the share of investment in intellectual property objects was progressively rising, hitting all-time highs. The contribution of industrial facilities and infrastructure construction was also solid. However, it will be gradually shrinking as subsidised mortgage lending programmes are wound down and major infrastructure projects are completed (Figure 26).

Figure 26. Contribution of asset types to nominal growth in fixed investment, pp.



Sources: Rosstat, R&F Department estimates.

Figure 27. Balance of expected changes in capital expenditure (annual average, pp.) and fixed investment (% YoY)



** January–March 2025 data.*

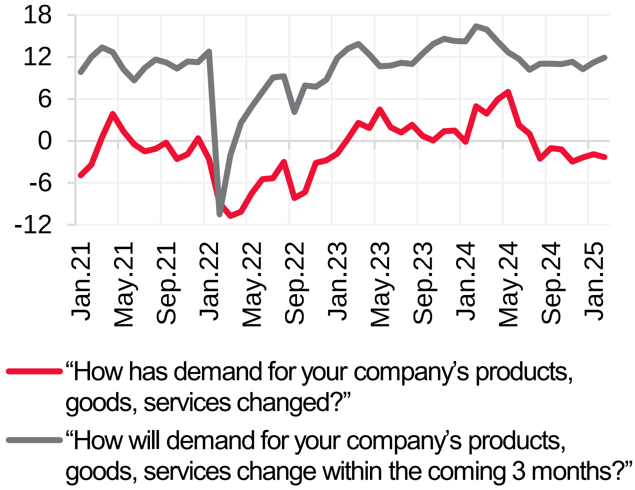
Sources: Institute for Economic Policy, Institute for Economic Forecasting of Russian Academy of Sciences, Rosstat, R&F Department estimates.

Companies' publicly available investment plans for 2025, along with business survey data, suggest a likely slowdown of fixed investment growth in the coming quarters, with high levels of investment maintained (Figure 27). What may play an important role in gradual cooling of investment plans is a decline from local peaks of respondents' optimism regarding the current and future demand for companies' products (Figure 28). The worsening of expectations is a consequence of monetary stance tightening and the return of the budget to the fiscal rule parameters in 2025. That said, a rise in the cost of debt in the wake of the key interest rate increases is not per se the key factor in taking investment decisions for many companies, given a traditionally small share of loans and a large proportion of own funds as sources of finance (Figure 29).

Although strong capital expenditure growth in recent years has become one of the medium-term economic growth drivers, it is important to know what the effectiveness of this investment is. To asses this, we compare change in labour productivity (output per worker) in a group of industries with the strongest investment growth and in other industries in 2022–2024. All industries[9] in each of these years are split into two equal groups: those that have experienced investment growth relative to 2021 above and below median (Figure 30). The diagram shows real output growth per worker relative to 2021 in each group.

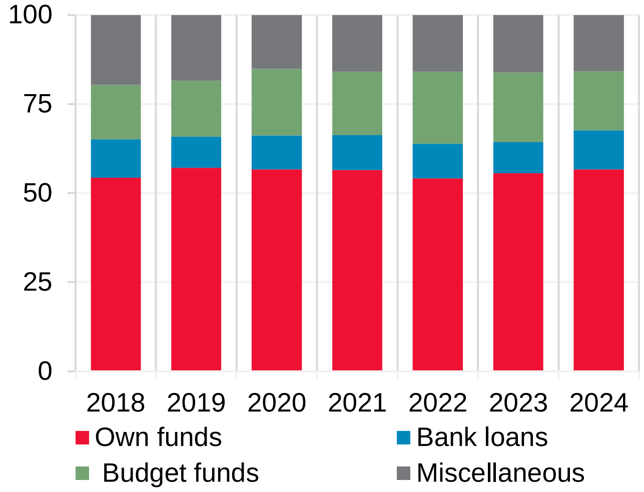
[9] 88 industries, the precision of business activity classification (OKVED) is three digits.

Figure 28. Balance of companies answers to the question about changes in demand, pp., SA



Source: Bank of Russia.

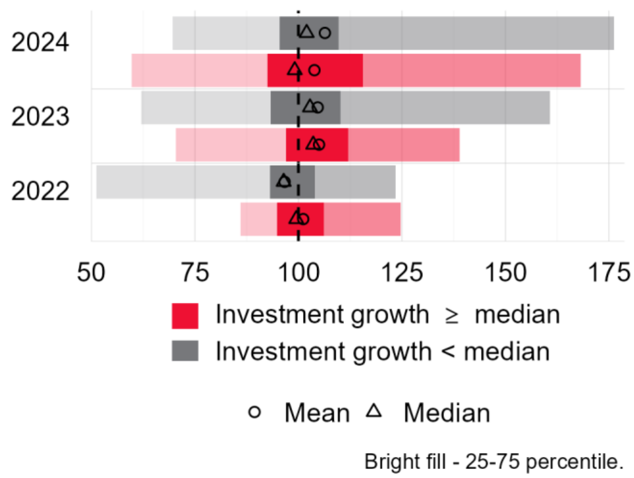
Figure 29. Sources of finance for fixed investment, %



Sources: Rosstat, R&F Department estimates.

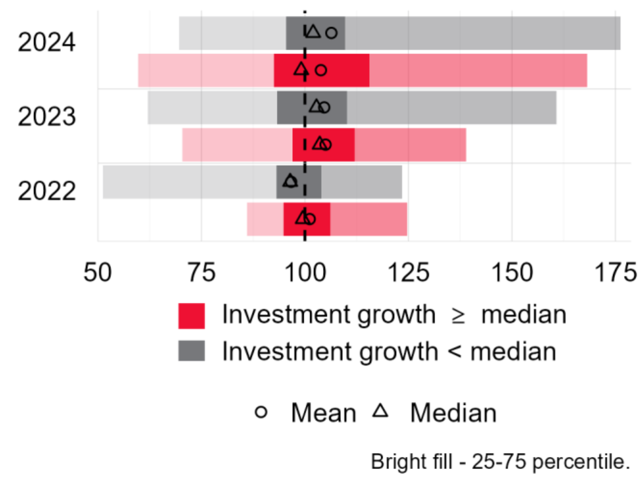
The estimates do not show visible differences between the groups of the more and less investing industries. If the focus is only on investment in machinery and equipment, which should, to a relatively greater degree, have an effect on labour productivity, the results do not change perceptibly (Figure 31). This indirectly shows that extensive investment in 2022–2024 so far have a moderate effect on labour productivity growth because of the investment cycle length. That said, part of this investment may have aimed to achieve substitution rather than to substantially upgrade the level of technology.

Figure 30. Output per worker in groups of industries by growth in total fixed investment (% to 2021 in real terms)



Sources: Rosstat, R&F Department estimates.

Figure 31. Output per worker in groups of industries by growth in fixed investment to machinery and equipment (% to 2021 in real terms)



Sources: Rosstat, R&F Department estimates.

On the one hand, the majority of Russian firms were confronted in 2022 with the need for massive capital expenditure and prompt decisions seeking to restructure production chains in the face of the circumstances. On the other hand, the choice of suppliers, dramatically narrowed, bringing about a rise in competition for investment goods and their prices. Alternative options, such as purchasing investment goods within Russia or friendly countries, were, as a rule, also available to companies previously, but were regarded as suboptimal, probably for the price-quality considerations. For example, some companies which started to purchase equipment from alternative suppliers, have reported a rise in the number of breakdowns and a shorter operational life of equipment or higher prices of analogues comparable in quality. In this event, a larger amount of profit needs to go towards investment in order to maintain the pre-sanction pace of output growth.

The above conditions in fact correspond to a situation of a shift towards the elevated rate of capital formation, with return on it declining. The resultant effect of the two oppositely directed changes for potential economic growth is not evident. Overall, our analysis finds that intense fixed income expansion in recent years may, so far, have failed to produce a marked increase in the pace of potential economic growth. That said, potential seems to have already shifted upwards (at least in the part of the economy which is not oriented to exports). On top of that, it shows that fixed investment needs to be stepped up in order to maintain the level of output (the share of investment in GDP is structurally higher), neutralising the adverse consequences of sanctions and disruption of external economic relations.

Factors which have a restraining impact on investment effectiveness can be gradually curbed in the medium term as the structural transformation of the economy is completed and new production chains are fully established. Indeed, improvements in the profitability of domestic industries producing machinery and equipment may stimulate long-term investment in, among other things, research and development, which could ensure the competitiveness of domestic machinery and equipment compared with what was regarded as optimal from the perspective of price-quality ratio prior to 2022. Although the current effectiveness of investment may have failed to change, the emerging stimuli may ensure its improvement in the medium and long term.