Bank of Russia

TALKING TRENDS
Economy and markets
Research and Forecasting Department Bulletin

October 2023

CONTENTS

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Executive summary

Monthly summary

- According to high-frequency indicators, the Russian economy gained momentum in September, helped in part by a rise in ruble-denominated export revenues. The dynamic expansion of corporate and retail lending is working to fuel demand. The past month marked a further strengthening in the growth of persistent components of inflation and overall consumer prices. Households' and businesses' inflation expectations remain high. The monetary policy decisions of July to September have yet to translate into the slowdown of price increases, on the back of inertia in economic processes and significant monetary policy lags. The past two months' data expose the strength of credit expansion and domestic demand the economy has reached by the middle of the year alongside the entailing pro-inflation momentum. The recently made monetary policy decisions are set to help gradually slow inflation processes over next few months and quarters. For inflation to return to target in the conditions of an accommodative fiscal policy in 2024, a further tightening in monetary policy may be needed.
    - PMI indices and financial flow data show invariably strong growth in business activity in September. The ongoing expansion in demand incentivises output and employment and fuels corporate optimism, enabling producers to faster pass on growing costs to output prices.
    - In September, seasonally adjusted consumer prices rose at the fastest pace since April 2022. Prices for goods and services that are normally fairly resilient were up again. According to surveys, September also saw a rise in producer costs and output prices in the manufacturing sector. It will take time for the tight monetary policy stance to put prices on a sustainable path to slowdown.
    - The inverse trend of the OFZ yield curve, which emerged after the September increase in the key rate, was more pronounced over the subsequent weeks. This suggests a meaningful tightening in price lending conditions. Moreover, market expectations are increasingly assuming the need to hold the key rate sustainably high.

1. Inflation

After a certain slowdown in August, consumer price growth hit double digits again in September in annualised seasonally adjusted terms. The input of the stable factors to price movements increased. That said, demand continued to rise, fuelled by, among other things, further lending expansion.

It would, however, be wrong to claim based on this that monetary policy measures fail to have an effect. The transmission mechanism of monetary policy is already acting to slow inflationary processes. Indeed, interest rates have risen (in particular on household time deposits and bank loans), household time deposit grow buoyantly. A gain in the attractiveness of ruble savings helps exchange rate stabilisation. If the key interest rate had remained unchanged, we would now be witnessing an increasingly intensive lending and domestic demand growth and an even stronger rise in inflationary pressure.

It does, however, take time for the transmission mechanism's action to slow demand growth to a more sustainable pace, commensurate with the economy's ability to meet demand through production expansion. It will take still longer for these processes to temper the pace of price movements, eventually bringing inflation down to the target.

The fast pace of price rises since the summer of this year reflects the response of prices to credit and fiscal impulse growth and ruble weakening accumulated in recent months.

The parameters of the draft 2024–2026 federal budget submitted to the State Duma provide for the maintenance in 2024 of the current fiscal impulse practically on the 2023 level, including through raising the cut-off price and the base level of oil and gas revenue in the fiscal rule, as well as of one-time non-oil and gas revenue. The draft budget also envisages an extensive borrowing programme. All other things being equal, for inflation to be brought down to its target in this situation, a commensurately lesser credit impulse is required than in conducting neutral fiscal policy. This increases the need for maintaining tight monetary policy in 2024 in order to keep up price stability, to prevent a further rise in inflation and ensure sustainable and balanced development of the Russian economy.

1.1. Inflationary pressure rises further

- Inflationary pressure remained significant in September, with all key categories showing an elevated pace of price growth. The stable indicators of price movements went up again staying above the 4% level.
- The fast pace of wage and lending growth along with elevated inflation expectations shore up a rapid consumer activity expansion, helping a pass-through of rising producer costs to end prices.
- The Bank of Russia's monetary policy decisions will facilitate gradual savings growth in such a way as to return a rise in demand to the pace corresponding to supply expansion potential. This will be a key factor of inflation slowdown in the quarters to come.

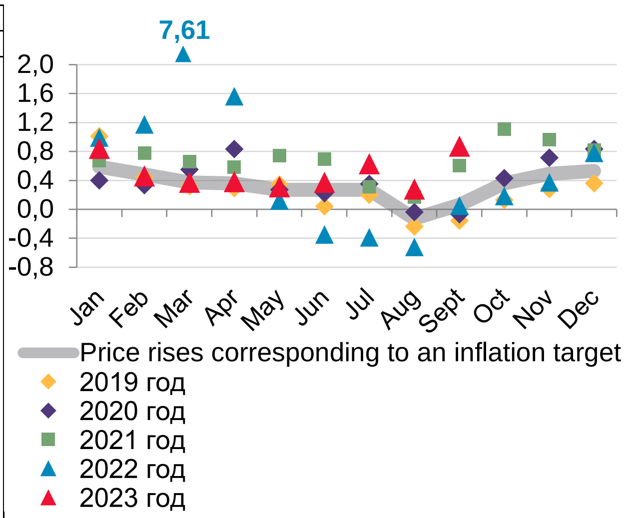
Consumer price inflation accelerated to 14.6% MoM SAAR in September from 9.4% MoM SAAR in August. Annual inflation rose to 6.0% from 5.2% a month earlier (Table 1, Figure 2). The annual inflation estimate went up to 6.3% as of 9 October. Recent weeks have seen inflation moving along a steep trajectory of 2021 (Figure 4). If monthly price increases continue on a track close to this trajectory until the end of the year, inflation may rise above the Bank of Russia's current forecast.

Table1. Inflation and its components

	Sept. 2021	Sept. 2022	July 2023	Aug. 2023	Sept. 2023
% YoY					
All goods and services	**7.4**	**13.7**	**4.3**	**5.2**	**6.0**
Core inflation	**7.6**	**17.1**	**3.2**	**4.0**	**4.6**
Food	9.2	14.2	2.2	3.6	4.9
Non-food goods	8.1	14.9	2.4	3.6	4.6
Services	4.2	11.0	10.0	9.5	9.7
% MoM SAAR					
All goods and services	**10.9**	**3.3**	**12.3**	**9.4**	**14.6**
Core inflation	**9.0**	**2.3**	**8.6**	**10.0**	**10.3**
Food	18.9	-0.1	16.4	16.4	16.9
– net of fruit and vegetables	**10.5**	**-0.2**	**5.4**	**10.8**	**11.2**
Non-food goods	6.8	0.8	12.5	14.3	12.7
– net of refined petroleum products and tobacco	**8.6**	**0.0**	**10.3**	**11.5**	**10.0**
Services	5.6	11.9	7.0	-4.6	13.8
– net of housing and communal services	**6.6**	**16.5**	**8.1**	**-11.8**	**16.8**

Sources: Rosstat, R&F Department estimates.

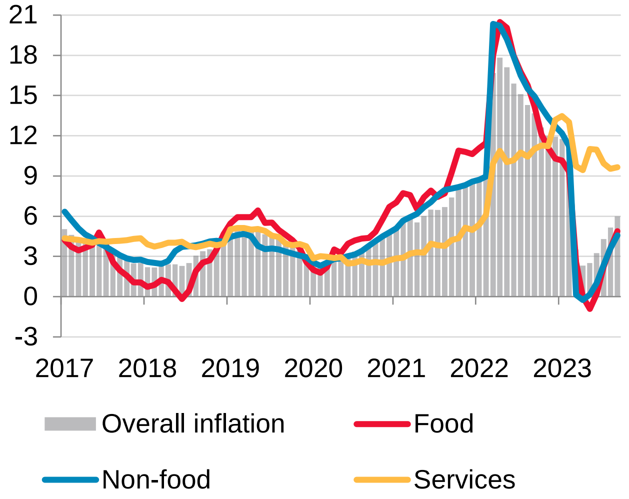
Figure 1. Price rises corresponding to an inflation rate of 4%, % MoM



Sources: Rosstat, R&F Department estimates.

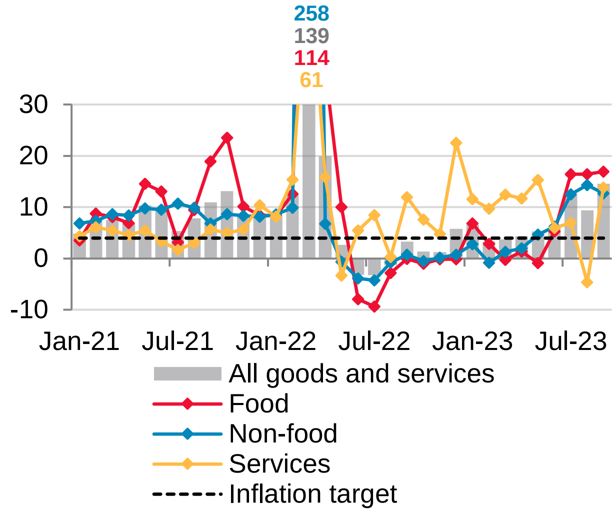
Food prices have continued to show double-digit growth in annualised terms for the third consecutive month. Their rises accelerated to 16.9% MoM SAAR from 16.4% MoM SAAR in August. Fruit and vegetables continue to provide a substantial input to this growth, driven chiefly by rising prices of imported fruit and citrus on the back of ruble weakening. Vegetable prices also started to rise. Producers refer to cost rises owed to fuel price hikes and fuel shortages in southern regions. Net of fruit and vegetables, food price rises did accelerate but on a smaller scale, to 11.2% MoM SAAR from 10.8% MoM SAAR, with continued price rises in meat products acting as a key driver. Producers attribute this to cost increases (fuelled, in particular, by labour shortages and significant wage growth associated with this). Price increases in eggs also notably accelerated on the back of strong demand. Further upward pressure on meat product prices may, in the immediate future, stem from rising demand for Russian pork after China's market opening and production disruptions due to the worsening of the epizootic situation.

Figure 2. Inflation and its components, % YoY



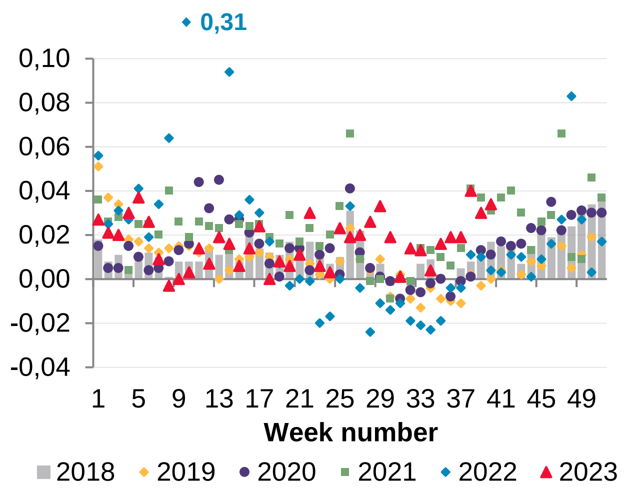
Sources: Rosstat.

Figure 3. Seasonally adjusted price growth, % MoM SAAR



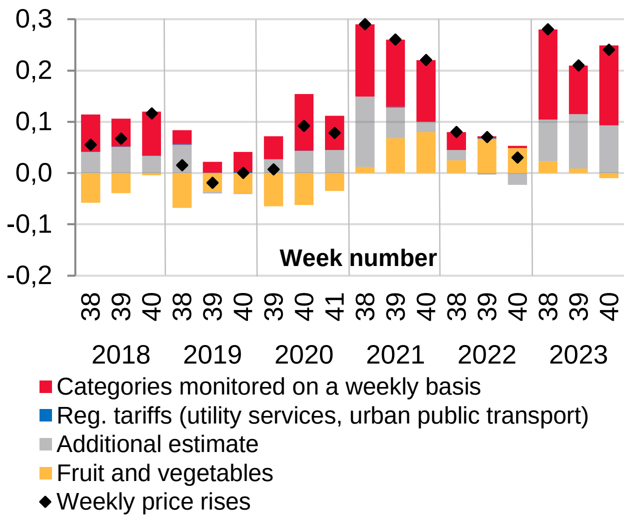
Sources: Rosstat, R&F Department estimates.

Figure 4. Average daily price growth, %



Sources: Rosstat, R&F Department estimates.

Figure 5. Decomposition of weekly price rises, pp



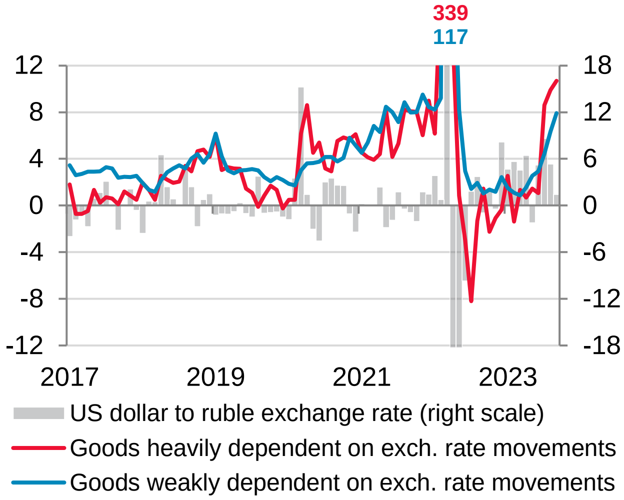
Sources: Rosstat, R&F Department estimates.

The non-food segment saw price rises slowing to 12.7% MoM SAAR from 14.3% MoM SAAR, helped by price movements in durable goods. Indeed, price hikes in electronic goods slowed after their surge in August. Car price rises decelerated but their rate remains elevated. Car dealers put this down to the continued pass-through of costs owed to ruble weakening and a disposal charge increase amid increased demand. The pass-through of ruble weakening to prices is continuing (Figure 6), amplified by rising inflation expectations: retailers sold goods which they had earlier purchased at a stronger exchange rate (the stocks of household appliances and electronic goods remained considerable despite strong demand). The next stage of ruble weakening pass-through to prices will come when goods purchased after ruble weakening in the summer have made their way to the shelves of shops. This stage will likely be more tempered and drawn out in time.

An accelerated pace of fuel price rises continued in September. Weekly data, however, indicate that retail prices started to decline in late September – early October, driven by a drop in commodity exchange prices following the imposition of restrictions on commercial petrol and diesel exports. In addition, a decision to resume full payments under the damper mechanism for refined petroleum products will ease the sensitivity of domestic prices to global market changes, restraining their rise from the current levels.

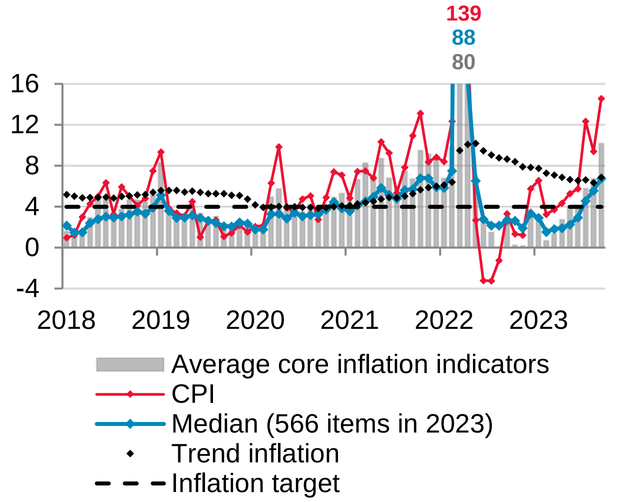
Services prices rose an average 13.8% MoM SAAR in September after a 4.6% MoM SAAR drop in August. That said, net of tourism, air and railway transport, the pace of services price growth remains fast at 13.6% MoM SAAR versus 8.6% MoM SAAR in August.

Figure 6. Median CPI (% MoM SAAR) and US dollar to ruble exchange rate (%)



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

Figure 7. Modified core inflation indicators* (% in annualised terms) and trend inflation estimate (%YoY)



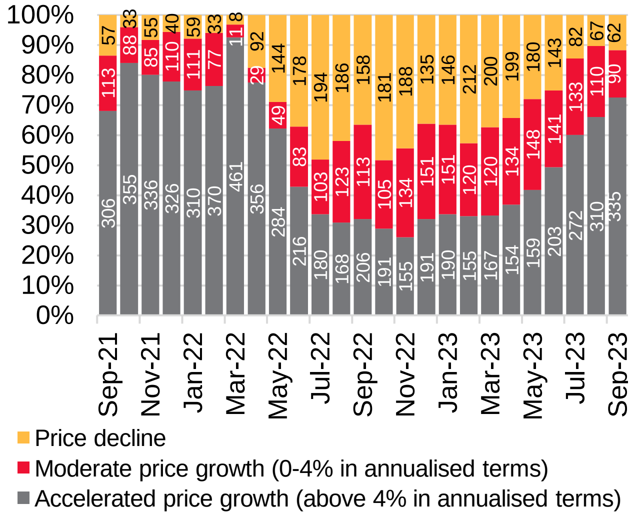
** Indicators are computed using the method of excluding the most volatile components and the truncation method.*

Sources: Rosstat, R&F Department estimates.

Stable indicators of price movements suggest the continuation of elevated inflationary pressure. Modified core inflation indicators increased in September, remaining far above 4% in annualised terms for the third consecutive month (Figure 7). The trend inflation estimate went up to 6.87% from 6.36% in August, suggesting the prevalence of pro-inflationary risks on a medium-term horizon. The weight of positions rising at an accelerated pace[1] continues to rise (Figure 8). The distribution median also increased, remaining above the inflation target for all enlarged categories (Figure 9).

[1] At a pace of above 4% MoM SAAR.

Figure 8. Aggregate weight of goods and services* distributed based on seasonally adjusted price growth

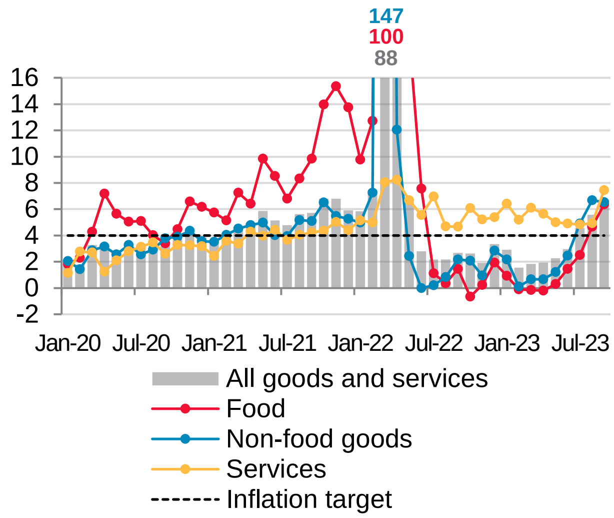


**Net of fruit and vegetables and regulated services.*

Note. The figures represent the number of items.

Sources: Rosstat, R&F Department estimates.

Figure 9. Distribution medians calculated on disaggregated components*, % MoM SAAR

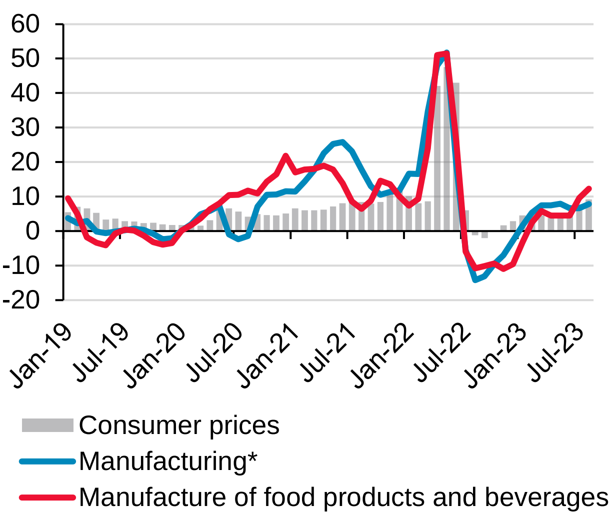


** 566 components in the 2023 basket*

Sources: Rosstat, R&F Department estimates.

The possibility of the pass-through of rising producer costs to end-prices amid the continuing strong consumer activity keeps inflationary pressure elevated. Producer price rises accelerated in August. According to survey-based indicators, this trend continued in September. A PMI survey from S&P Global indicates record fast producer price growth since April 2022. Based on Bank of Russia monitoring data, companies' price expectations were rising for the third consecutive months, driven chiefly by the continued pass-through of ruble weakening and shortages in the labour market.

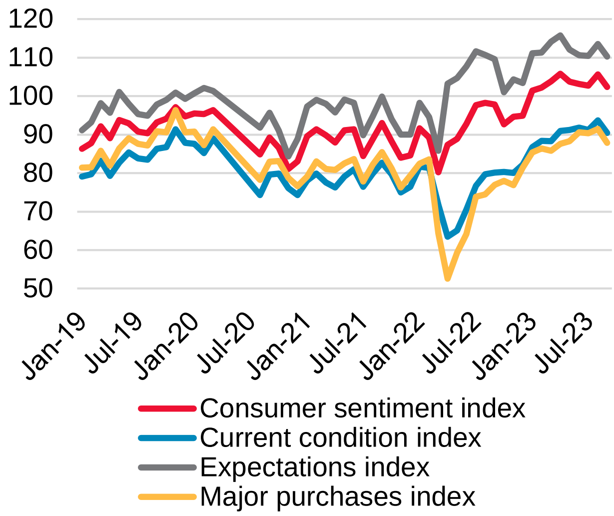
Figure 10. Producer and consumer prices, three-month rolling average, annualised, %



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

Sources: Rosstat, R&F Department estimates.

Figure 11. Consumer sentiment index and subindices, points



Source: inFOM.

More time is needed for the Bank of Russia's monetary policy decisions to result in savings expansion and cooling of demand, bringing it closer to output expansion potential, which is now objectively constrained by the low unemployment rate and the substantial lack of available labour resources. This would help gradually lower inflationary pressure in the coming quarters and return to an inflation rate of 4% in 2024.

2. Economic activity

Economic activity in Russia remains strong overall, catching up with confidently growing demand. Moreover, business surveys and most of September's real-time indicators suggest economic growth acceleration. Monetary stance tightening has not yet had a notable effect on key economic indicators, given substantial time lags owed to the inertia of economic processes.

It appears from real-time data that, adjusted for summer seasonality, import of goods started to contract by value and in physical terms. This reaction of imports is expected amid substantial ruble weakening since the start of the year and represents a key mechanism of the balance of payments' adaptation to a decline in the trade and current account surpluses. That said, continued growth in domestic demand is partly met by domestic production expansion and partly – by a possible contraction in accumulated stocks of goods (Russian and imported).

A gain in the fiscal sources of economic growth projected for 2024 will boost the development of industries associated with government purchases and financing. At the same time, the performance of industries depending on debt finance raised on a market basis will likely grow at a more moderate pace. Exporting industries' performance will depend on external conditions, as well as restrictions and domestic regulation.

2.1. Strong economic activity continuing

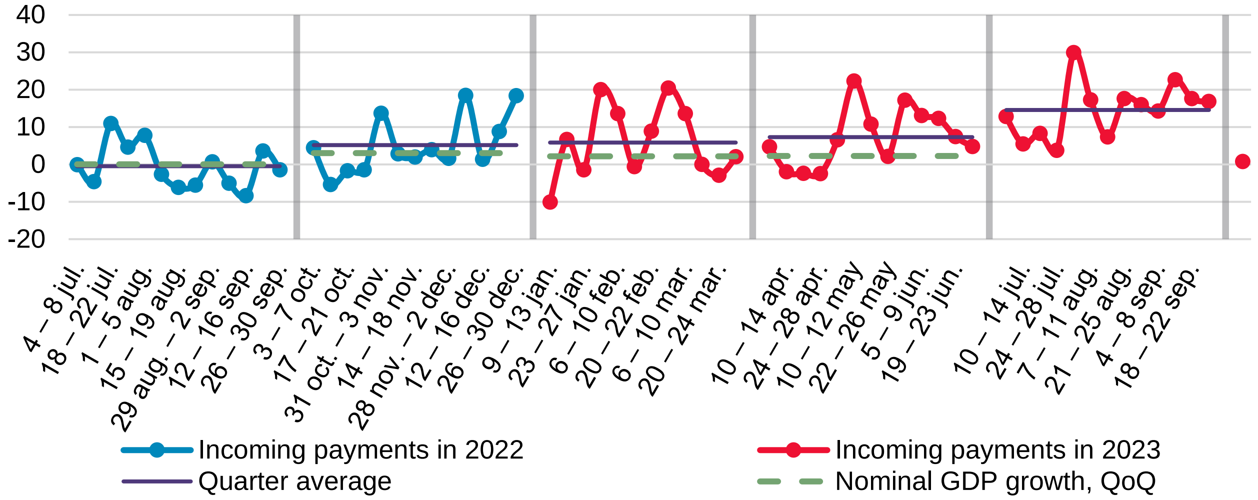
- Real-time metrics of core industries' performance and survey-based indicators suggest the continuation of confident GDP growth in Q3 2023 after the economy reached its potential level in Q2 (up 0.1% QoQ SA in Q2[2]). Output growth in core economic activities has slowed somewhat in June–August (Figure 13), while financial flows and PMI indices suggested a stronger economic activity in Q3. September's surveys showed companies lowering its estimates of current demand and output plans,[3] with the overall level of business optimism remaining elevated (Figure 14). In addition, businesses are trying to implement plans for stepping up personnel hiring in the face of labour shortages.

[2] The estimate is based on the first estimate of GDP dynamics by end use published by Rosstat. This estimate will be updated as subsequent GDP estimates by Rosstat are released, factoring in new data. Revised data often showed an annual GDP improvement in the past (see Database of Russia's macroeconomic indicator revisions).
[3] In September 2023, the Index of Russian Industry Forecasts from the Institute for Economic Policy posted the steepest decline after a March 2022 slump.

- Economic activity continues to vary across industries, with positive trends prevailing, as evidenced by statistics from the Bank of Russia's payment system. One can pinpoint leader industries, which have surpassed the pre-crisis output levels, and laggard ones, where the recovery trend is continuing. Thus, strong domestic demand ensures positive input to economic growth from trade (wholesale and retail) and manufacturing, with mining and quarrying playing restraining role (Figure 15). Industries meeting intermediate and consumer demand came as drivers of manufacturing output expansion in July and August (Figure 16). Mining and quarrying is showing output stabilisation against a backdrop of mixed performance in the oil and gas industry: restrictions on oil exports are offset by a gain in natural gas deliveries. The majority of subindustries in the crop-growing sector will fail to reach the record high output levels of 2022.
- A consumer demand surge in August, driven by the goods segment (Picture 17) as inflation expectations rose on the back of ruble weakening, had, judging by real-time data, petered out by September (Figure 18). So far, consumer spending has shown no signs of cooling, but the effect of monetary and macroprudential policy tightening is starting to gradually translate into loan provision slowdown in the unsecured consumer and auto lending segments. In addition, household funds continue to outflow from checking accounts to time deposits, interest rates on which were raised substantially. Nevertheless, it would be too early to claim that households' switch to the savings-oriented behaviour model is an accomplished fact. Indeed, despite some consumer sentiment correction (Figure 19), households' willingness to make major purchases remains at a historically elevated level, while the level of household funds raised by banks has not changed relative to August, judging by reporting from a major bank.
- The sustainability of consumer demand is helped by confident real wage growth (Figure 21), continuing amid elevated demand for labour and limited potential for meeting it (Figure 20, Figure 22), as well as active personnel hiring by companies.[4] Cost rises in turn boost businesses' price expectations.[5] As the pass-through of costs to prices remains possible, this implies that the easing of elevated inflationary pressure will be gradual. The impact of monetary policy tightening on demand has yet to materialise in full.

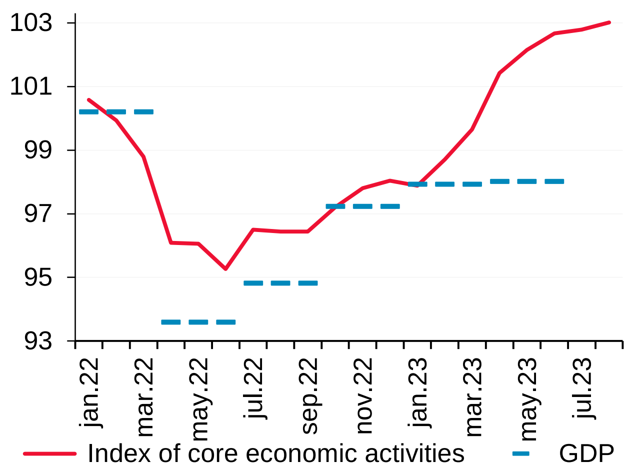
[4] According to PMI surveys, the rate of job creation hit a 20-year high.
[5] A PMI survey registered the highest subindex of producer output prices since April 2022.

Figure 12. Incoming payments growth[6] relative to the previous quarter average weighted by industries' shares in gross value added, seasonally adjusted, %



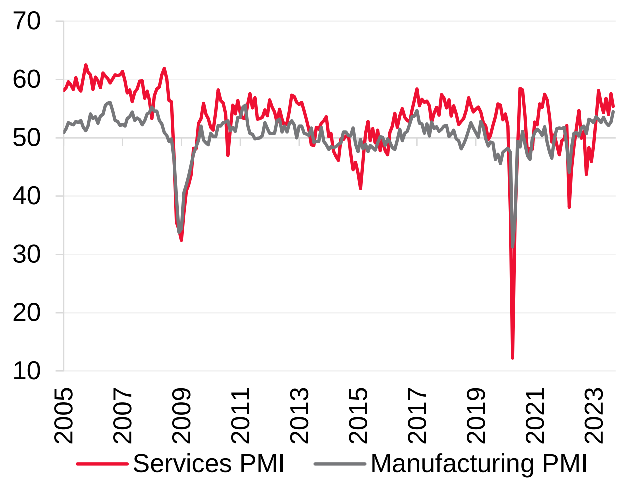
Sources: Bank of Russia, Monitoring of individual industries' financial flows.

Figure 13. Core economic activities' output and GDP, Q4 2021 = 100



Sources: Rosstat, R&F Department estimates.

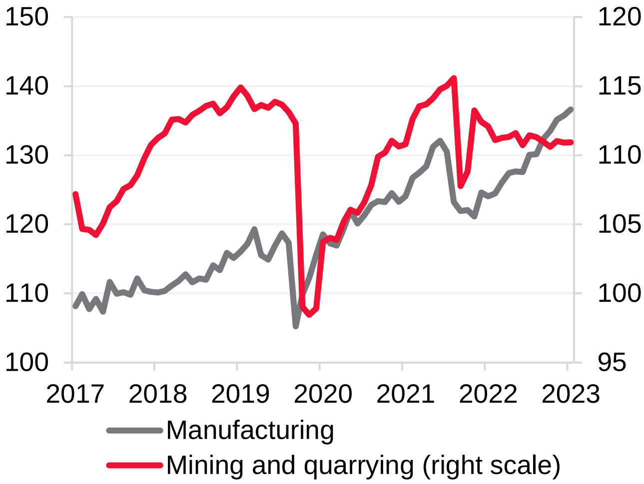
Figure 14. Russia's Manufacturing and Services PMI, points



Source: S&P Global.

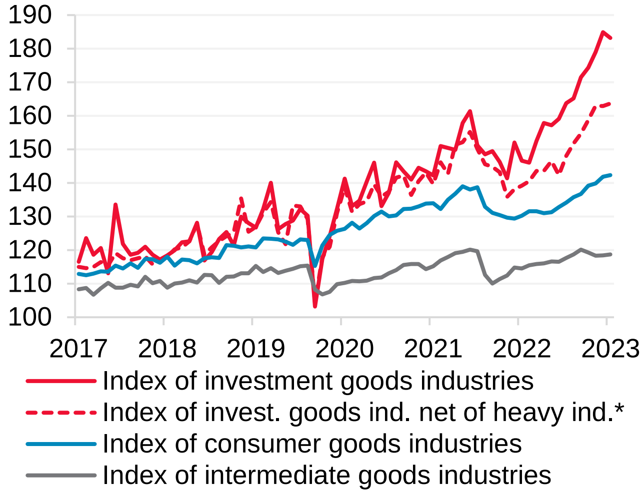
[6] The rate of growth is deemed to be a percentage change in the value $g = \frac{(x_1 - x_0)}{x_0} * 100$.

Figure 15. Mining and quarrying and manufacturing indices (2014 = 100)



Sources: Rosstat, R&F Department estimates.

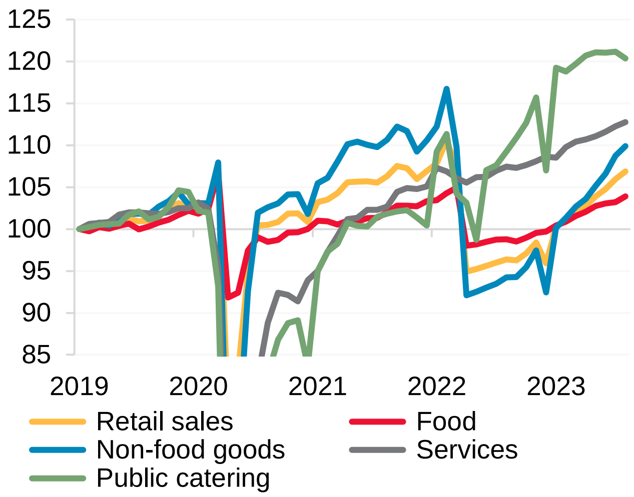
Figure 16. Output in groups of manufacturing industries, SA, 01.2016=100%



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

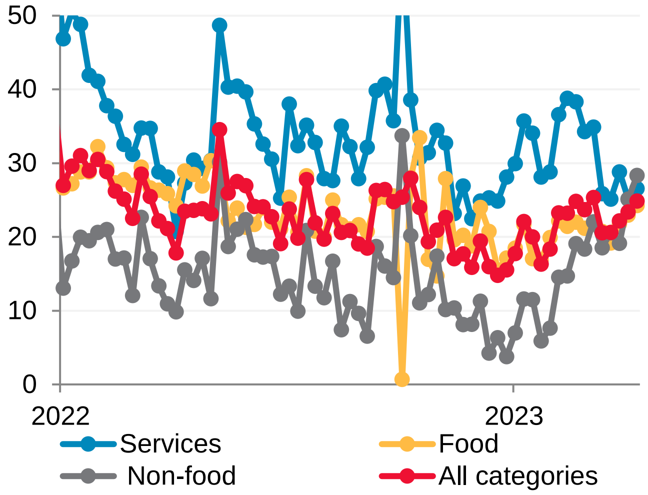
Sources: Rosstat, R&F Department estimates.

Figure 17. Retail, catering and services sector sales, 1.2019=100%, SA



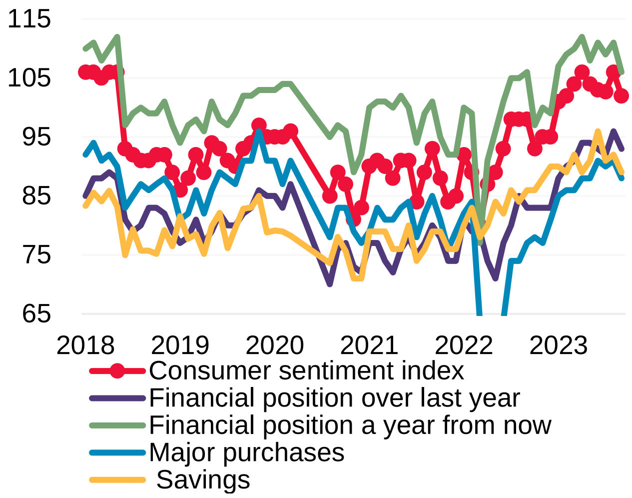
Sources: Rosstat, R&F Department estimates.

Figure 18. Nominal weekly household spending, relative to the same week two years earlier, %



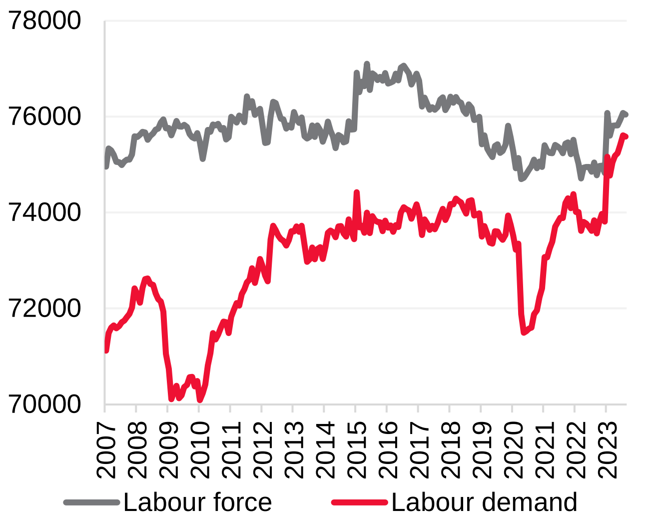
Source: SberIndex.

Figure 19. Consumer sentiment index and its subindices, points



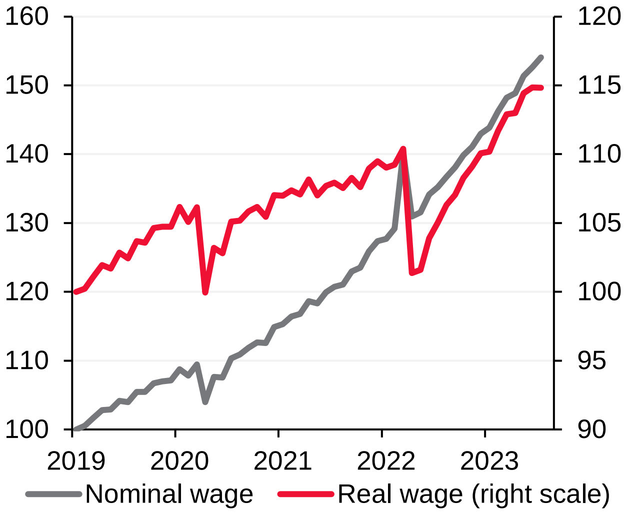
Source: inFom.

Figure 20. Labour demand (total employment headcount and vacancies) and labour force, thousand people, SA



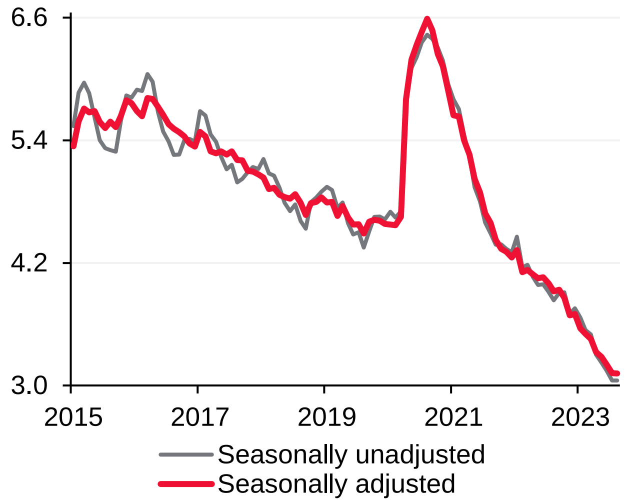
Sources: Rosstat, R&F Department indices.

Figure 21. Wage Indices SA, jan.19 = 100



Sources: Rosstat, R&F Department indices.

Figure 22. Unemployment rate, %



Sources: Rosstat, R&F Department indices.

2.2. Temporary retail lending acceleration in August

- Lending growth remained strong in August despite substantial hikes in market rates on loans in the wake of the key interest rate increase.
- The key factors behind the dynamic retail lending expansion were the outflow of demand to the subsidised market segments, where the rates remained unchanged, and a surge in demand amid a rise in inflation expectations. In the corporate segment, companies were able to draw down funds under credit lines approved earlier in anticipation of loan terms and conditions revision by banks.

- Preliminary data suggest that growth in non-subsidised retail lending segments may have slowed down while demand for subsidised loans continued to rise. Further on, interest rate hikes and putting in place more stringent restrictions will result in a lending growth slowdown.

Retail lending growth accelerated to 2.5% MoM SA in August from 1.8% MoM SA in July (Figure 23), driven chiefly by mortgage lending. Lending continues to provide the heftiest input to broad money supply expansion (Figure 30).

Mortgage lending growth accelerated to 3.7% MoM from 2.8% MoM. The number of loans provided to finance housing acquisition in the secondary market increased 17.7% MoM, the number of loans extended under shared equity agreements rose 48% MoM. The key driver of loan provisions in the new housing market was subsidised mortgage lending, accounting for 60% of all mortgage loan provisions (Figure 24). Demand for subsidised mortgage loans was fuelled by hikes in interest rates on non-subsidised loans and fears that the subsidisation programme in pace would be soon wound down or terms of conditions of lending under it would be substantially toughened. Demand may have been additionally spurred by rising inflation expectations. In such an environment, households tend to regard real property as a protective asset in the face of price rises and exchange rate fluctuations. September saw loan provisions under subsidised programmes hit the highest level over the entire history of their existence, even though supply was limited by a raise of the minimum down payment from 15% to 20%.

Demand in the secondary market trailed far behind that in the new housing market. Demand is likely formed by borrowers with a large enough down payment, for whom the interest rate hike was less critical than for those paying the minimum sum. Meanwhile, the number of mortgage loan applications in August suggests that a slowdown in the non-subsidised mortgage loan portfolio growth may be moderate in September–October[7] (Figure 25). Going forward, as interest rates rise and add-ons to risk weights for a number of mortgage loans[8] are increased, mortgage lending cooling may become more pronounced, including in the subsidised segment.

Unsecured loan growth remained strong at 1.5% MoM SA in August (Figure 26), despite interest rate hikes (Figure 27). This was driven by a rise in household propensity to consume on the back of rising inflation expectations. Further on, unsecured loan portfolio expansion may slow as interest rates go up, with macroprudential limits lowered and add-ons to risk weights raised. Indeed, based on Frank RG data, September saw a steep fall in unsecured consumer loan provisions after their surge in August.

Meanwhile, borrowers' personal credit ratings have increased since the start of 2023. With respect to consumer loans, this may stem from banks' declining risk appetite and a more scrupulous selection of borrowers in light of Bank of Russia policy. This helps more moderate credit risk accumulation by banks.

As interest rates were raised in August, growth in ruble loans to non-financial organisations slowed to 1.5% MoM SA from 2.1% MoM SA a month earlier. The pace of growth,

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[7] A lag between turning in a mortgage loan application and a loan provision may come to 1–2 months.

[8] http://www.cbr.ru/press/pr/?file=638125158978042557FINSTAB.htm, http://www.cbr.ru/press/pr/?file=638261611512660659FINSTAB.htm

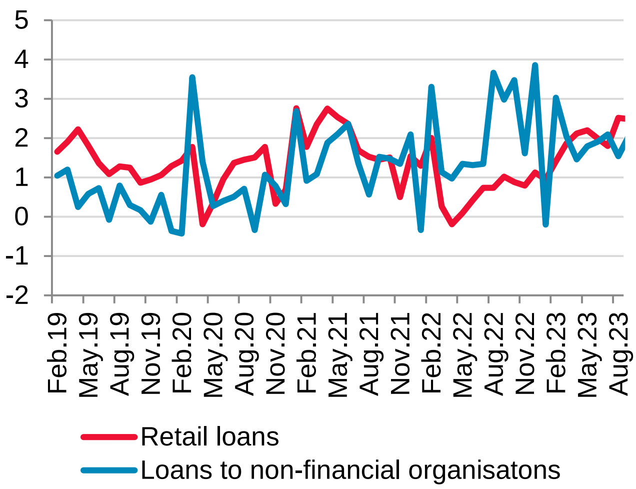
however, remained elevated, possibly helped by companies' drawing down the balances of credit lines in anticipation of a hike in interest rates on them. Expansion in the portfolio of loans to sole proprietorships also slowed to 3.3% MoM SA in August from 3.7% MoM SA.

Businesses' price expectations have risen sharply in recent months – close to the highest levels since 2013 (exclusive of the expectations surge early in 2022). Against this background, a hike in nominal rates on loans may not necessarily be accompanied by a proportionate tightening of monetary terms and conditions for borrowers, and, accordingly, restrain demand for debt finance.

Growth in household ruble deposits accelerated to 1.8% MoM SA in August from 1.6% MoM SA, which is attributable to increases in deposit rates (Figure 29) following the key rate hike. A rise in the attractiveness of savings resulted in a massive outflow of funds from demand deposit accounts to time deposits. Household foreign currency accounts started to contract more rapidly.

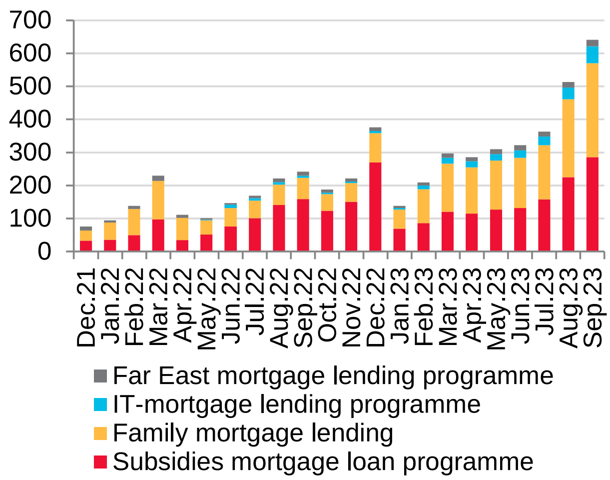
Corporate ruble deposits accelerated their growth to 2.1% MoM SA from 1.5% MoM SA. At the same time, for 8 months of 2023 deposits remain within the bounds of average monthly growth.

Figure 23. Ruble loans portfolio growth, % MoM SA



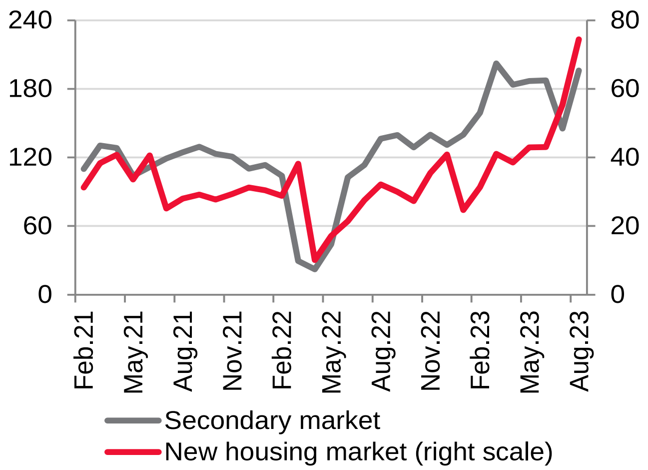
Sources: Bank of Russia, R&F Department estimates

Figure 24. Loan issuance under subsidies mortgage loan programmes, billion rubles



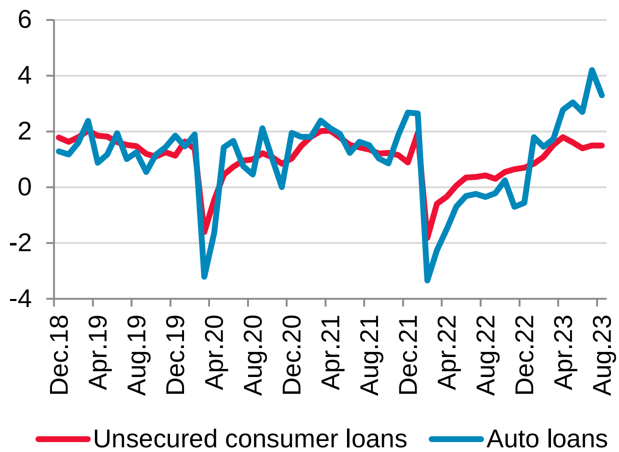
Sources: DOM RF, R&F Department estimates.

Figure 25. Mortgage loan applications, thousand



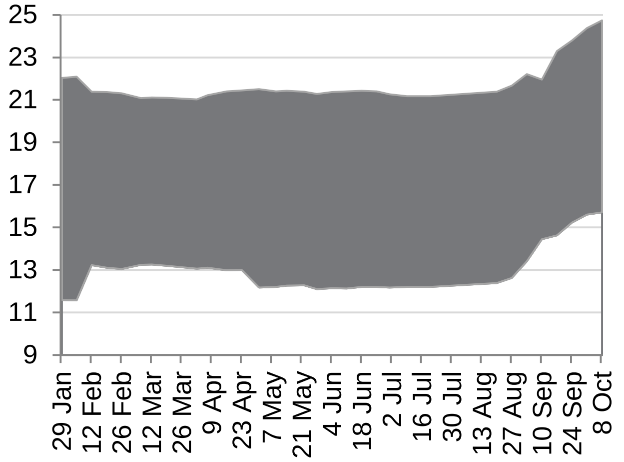
Sources: Domklik, R&F Department estimates.

Figure 26. Ruble loans portfolio growth, % MoM SA



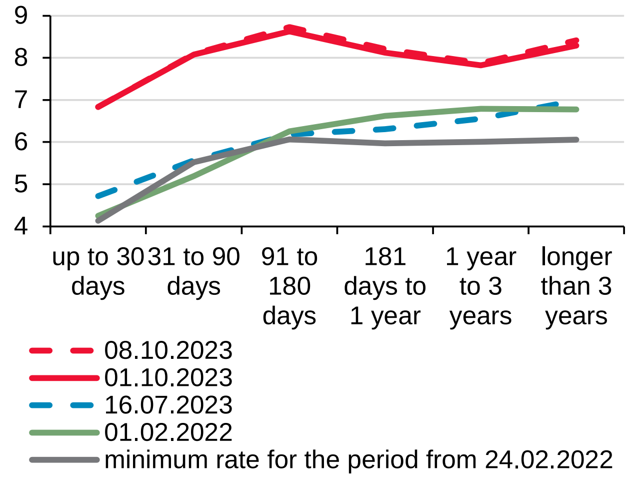
Sources: Bank of Russia, R&F Department estimates

Figure 27. Rates on unsecured consumer loans, %



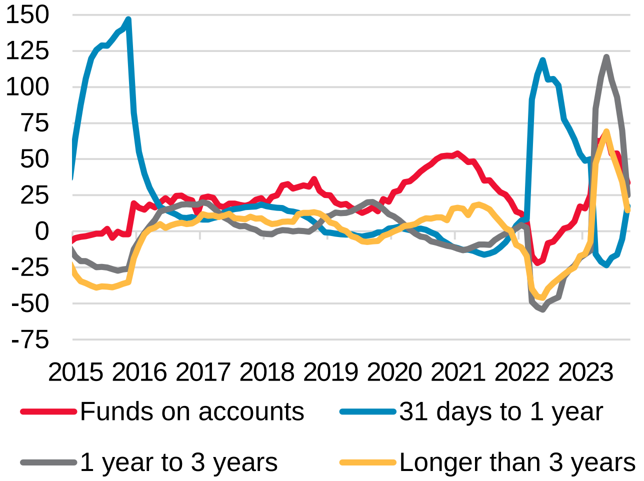
Sources: banki.ru, R&F Department estimates.

Figure 28. Average deposit rates depending on maturity, %[9]



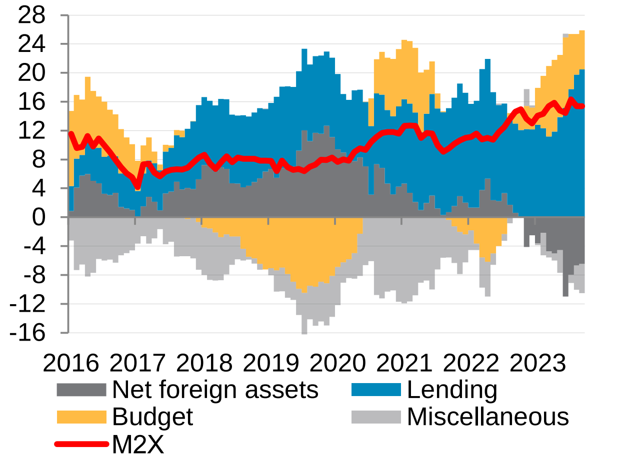
Sources: banki.ru, R&F Department estimates.

Figure 29. Household ruble funds with banks, % YoY



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

Figure 30. Key drivers of annual growth in broad money supply on the asset side, %



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

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[9] Data as of 8 October.