Bank of Russia

TALKING TRENDS
Economy and markets

Research and Forecasting Department Bulletin

MARCH 2024

CONTENTS

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Executive summary

Monthly summary

- Flash data suggest that the Russian economy continued to grow between January and February, driven by domestic demand and a certain rebound in non-oil and gas exports. For all the slowdown in retail lending and the increase in household savings in banks, consumer activity remained high. It was supported by ongoing growth in disposable incomes and strong consumer confidence given competition for workers. In this context, the monthly pace of growth in consumer prices remained elevated in the January to February period, after the autumn's decline from record highs. In the next few months, sustainably tight monetary conditions are expected to drive a further gradual slowdown in inflation processes as the economy returns to a balanced growth path.
    - The Russian economy is still confronted with severe labour (worker shortages across most sectors) and capital constraints (production capacity utilisation at a record high). Current economic expansion comes with a dynamic rise in demand. Growth is probably fuelled by prior investments and business optimisation efforts aiming to upgrade production facilities. However, the supply of goods and services is still behind the ongoing expansion of effective demand, and sustains increased inflationary pressures in the broader economy and the consumer sector alike.
    - Leading indicators point to a dip in inflationary pressures in the industrial sector, which feeds through to retail in a while. Among these indicators are producer prices for consumer goods and the indices of ex-factory prices in manufacturing. At the same time, the underlying components of inflation remain elevated, meaning that disinflationary processes are set to be more prolonged and inertial.
    - The OFZ yield curve remains inverted: in early March, a five-year OFZ yield was approximately one percentage point below that on two-year bonds. This form of the curve anticipates a gradual decline in the key rate as inflation processes slow in the economy. At the same time, implied average inflation through 2028 and beyond, which OFZ prices reflect, remains well above 4%.

1. Inflation

December 2023 – February 2024 saw month-on-month growth in consumer prices slow compared with its peak in the autumn. This reflects the impact of the tightening monetary stance, enhancing, above all, the attractiveness of savings. Still, the rate of inflation remains elevated. This implies that for a forecast inflation range of 4.0%–4.5% in December 2024 to be fulfilled, the disinflation process should intensify by Q3 or Q4 and month-on-month price growth should slow somewhat below 4% in annualised terms. This requires tight monetary policy to be maintained.

Meanwhile, real-time data for January–February suggest that consumer demand and expenditure growth continues to outpace household savings expansion, driven by fast real wage and income growth amid labour shortages in the economy. This means that heightened inflationary background may linger for some time, while the disinflation process may be more protracted in time, all other things being equal.

The leading indicators of disinflationary trends' strengthening in the economy at large and the consumer market in particular may come as a wide range of metrics, which need to be assessed in totality. For inflation, these are various indicators portraying the sustainability of the inflation trend (the core consumer price index as defined by the Bank of Russia, truncated and the least volatile inflation indicators, the median price growth, the producer price index in consumer industries, trend inflation, the exchange rate, etc.). For the labour market, these are primarily changes in the employment rate, vacancies, and nominal and real wages. For consumer demand, this is a variety of real-time and survey data, reflecting changes in the purchases of goods and services by households, household funds at banks, especially those held in time deposits, changes in businesses and households' inflation expectations.

1.1. Price growth past its local peak, road to 4% still ahead

- Consumer price growth slowed in the winter months relative to its autumn peaks, stabilising at an elevated level. Price rises remain far above 4% in annualised terms, including in the stable inflation components.
- Inflation deceleration was helped by the reversal of some factors' impact from pro-inflationary to disinflationary or neutral, meaning, in particular, exchange rate movements and the balance of demand and supply in some food markets. Consumer demand expansion somewhat slowed compared with the summer of 2023 but remained a key factor of the elevated rate of price growth.
- Inflationary pressure, including in the stable CPI components, remains elevated. Its decline, to be followed by meeting the inflation target in 2024, will require tight monetary stance to be maintained for a long time.

Consumer price growth edged up to 6.7% MoM SAAR in January from 6.3% MoM SAAR a month earlier. A slowdown in the food segment was offset by a slight acceleration in the non-food sector (driven by refined petroleum products) and the reversion to the elevated rate of services price rises, in, above all, the health resort segment. That said, recent months have seen average price growth notably slowing, to 6.5% MoM SAAR in December–January from 11.5% MoM SAAR in the autumn months.

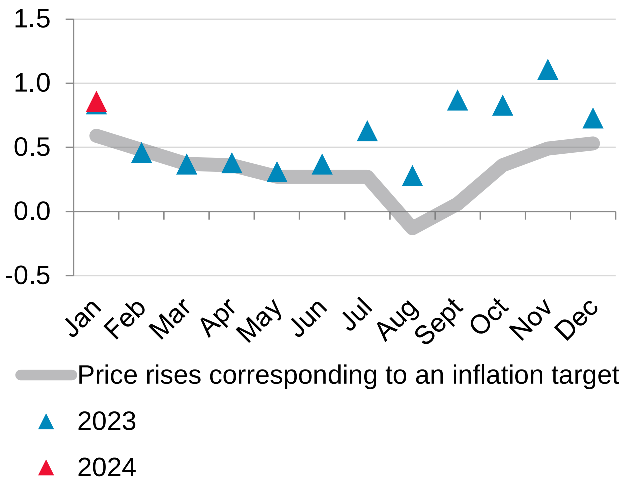
Annual inflation inched up in January to 7.44% from 7.42% in December (Table 1, Figure 2), rising to 7.6% as the slow price growth in February last year departed from the calculation base. If the elevated price growth rate persists in the coming months, annual inflation will continue rising until the middle of the year due to the low base effect.

Table 1. Inflation and its components

	Jan. 2022	Jan. 2023	Nov. 2023	Dec. 2023	Jan. 2024
% YoY					
All goods and services	**8.7**	**11.8**	**7.5**	**7.4**	**7.4**
Core inflation	**9.2**	**13.7**	**6.4**	**6.8**	**7.2**
Food	11.1	10.2	7.2	8.2	8.1
Non-food goods	8.7	12.2	5.6	6.0	6.2
Services	5.4	13.5	10.4	8.3	8.1
% MoM SAAR					
All goods and services	**8.4**	**6.6**	**10.3**	**6.3**	**6.7**
Core inflation	**9.1**	**2.7**	**10.0**	**7.2**	**6.7**
Food	8.4	6.8	12.7	8.9	5.7
– net of fruit and vegetables	**9.3**	**0.6**	**10.9**	**8.3**	**5.3**
Non-food goods	8.6	2.8	5.9	5.3	6.1
– net of refined petroleum products	**8.3**	**3.2**	**8.3**	**6.2**	**6.1**
Services	8.0	11.6	12.6	4.2	8.6
– net of housing and communal services	**11.0**	**10.4**	**13.8**	**4.2**	**12.4**

Sources: Rosstat, R&F Department calculations.

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

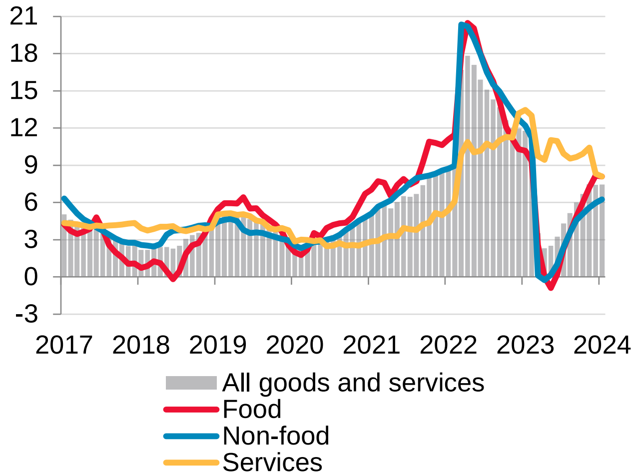


Sources: Rosstat, R&F Department calculations.

Food price rises slowed to 5.7% MoM SAAR, down from 8.9% MoM SAAR in December, as the components which made a significant contribution to price growth in the second half of 2023 came back to normal. The pace of seasonally adjusted fruit and vegetable price growth eased somewhat. Net of fruit and vegetables, food price increases softened to 5.3% MoM SAAR from 8.3% MoM SAAR. Price moves continued to be restrained by meat products: after an accelerated rate of their price growth in the summer – autumn of 2023, it sharply slowed starting December, in particular chicken meat prices decreased by 2.5%. Egg prices fell after their local peak in December.

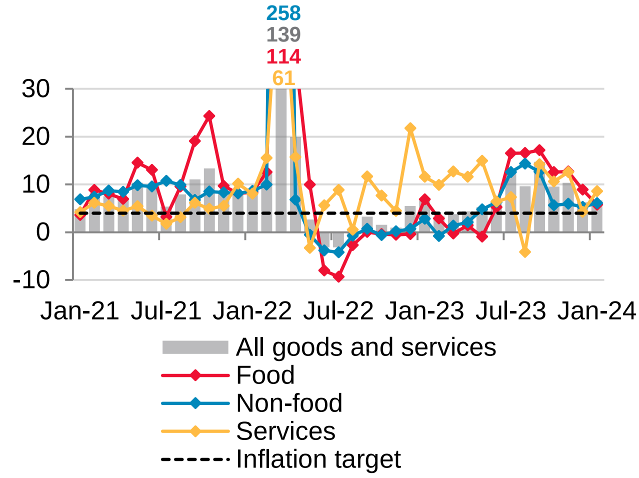
But pro-inflationary risks remain strong in this segment. Export growth and a substantial rise in domestic demand (Figure 4) are outstripping supply potential: poultry production even somewhat contracted in 2023. Extra demand from regions suffering from a hazardous epizootic situation heightens risks that a disinflationary effect of animal husbandry product prices will rapidly peter out. January also saw an acceleration in milk and dairy product price growth. Weekly estimates of price movements in February suggest that the disinflationary effect of animal husbandry product prices has started to abate.

Figure 2. Inflation and its components, % YoY



Sources: Rosstat.

Figure 3. Seasonally adjusted price growth, % MoM SAAR

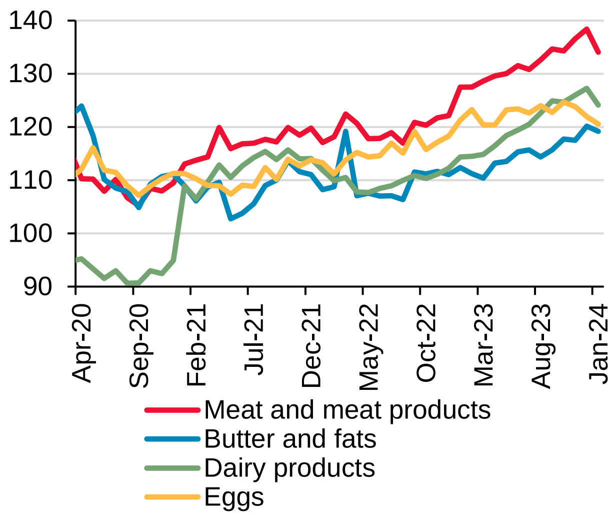


Sources: Rosstat, R&F Department calculations.

The non-food segment saw price growth accelerate to 6.1% MoM SAAR from 5.3% in December, with the heftiest contribution provided by refined petroleum product prices. Exchange (wholesale) prices were rising throughout January: market participants note a significant impact of a breakdown at a major refinery. The level of prices ensuring netback parity also rose in January. The petrol export caps imposed for half a year as of 1 March may contain fuel prices during the refinery repair and maintenance season. That said, the impact of these caps on the export of refined petroleum products will be minor, since it is diesel that accounts for the largest share of the export structure. No caps are imposed on diesel exports.

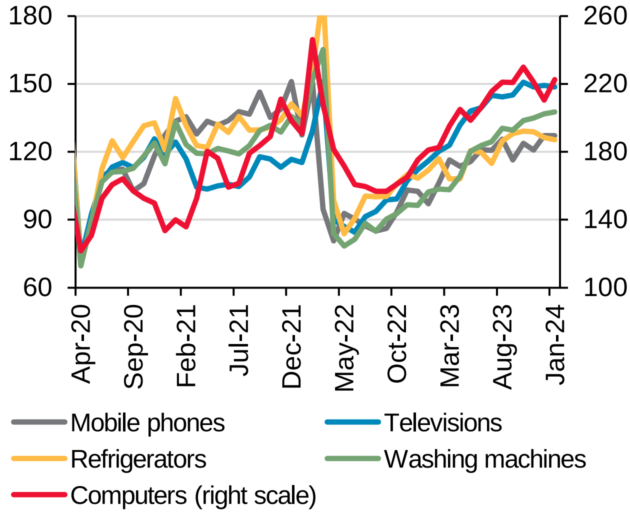
As regards other components of the non-food segment, the pattern of their price movements was mostly little changed. Price rises in electrical goods and household appliances somewhat accelerated, interrupting growth in their sales, but the latter remained strong (Figure 5).

Figure 4. Sales of some food goods, SA, December 2019 = 100



Sources: Rosstat, R&F Department calculations.

Figure 5. Sales of some electrical goods, SA, December 2019 = 100

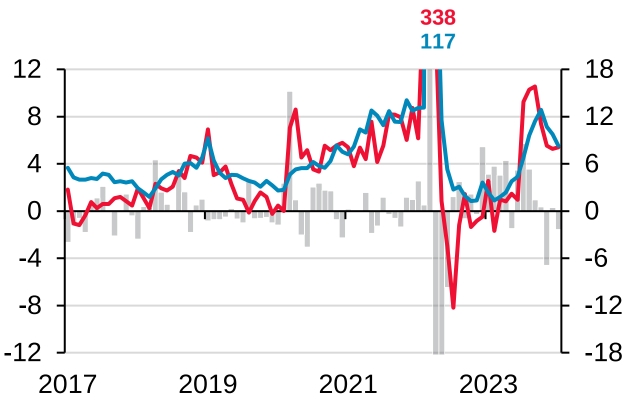


Sources: Rosstat, R&F Department calculations.

Services price growth accelerated to 8.6% MoM SAAR in January. There was a rise in the prices of domestic tourism services, which had a restraining effect in December. Net of tourism and transport, the rate of services price rises remained close to that a month earlier, up 6.6% MoM SAAR after 6.1% MoM SAAR in December. Personal and health service prices continued to rise at the fastest pace, whereas regulated services had the key restraining impact.

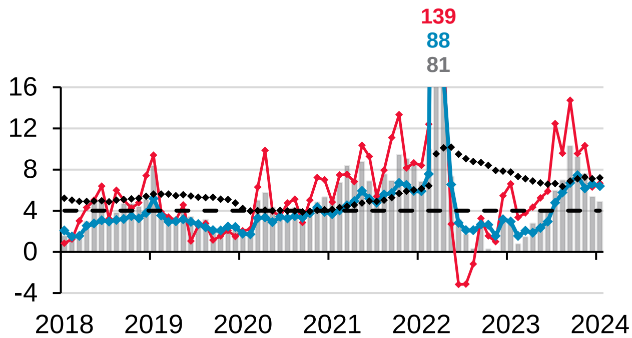
Change in the impact of exchange rate movements from pro-inflationary to neutral helped price growth to slow. The median of price growth in the group of goods highly sensitive to exchange rate movements became close to that of price rises in the group of goods weakly sensitive to exchange rate fluctuations. This indirectly indicates that the pass-through of ruble depreciation last year to retail prices is wearing off (Figure 6).

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



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

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



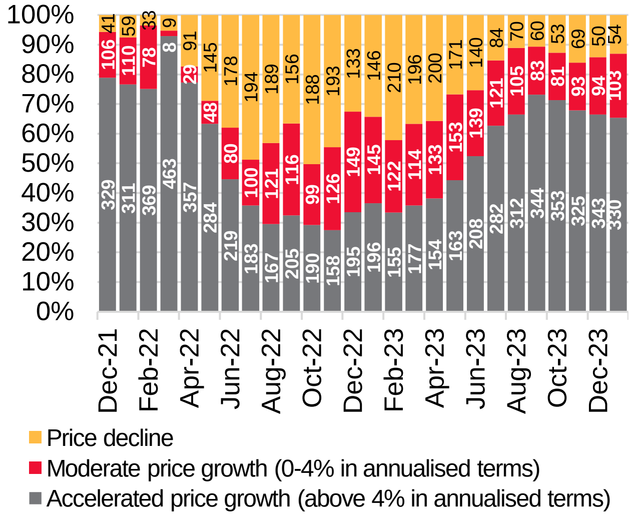
** Indicators are computed using the method of excluding the most volatile components and the truncation method.*

Sources: Rosstat, R&F Department calculations.

The analytical indicators of price moves continue to suggest that inflationary pressure remains elevated relative to the Bank of Russia target. The mean of modified core inflation indicators continues to slide but stays far above 4% in annualised terms (Figure 7). The median of price growth distribution decreased, driven by food prices (Figure 9). The weight of items going up in price at an accelerated pace is declining very slowly (Figure 8). That said, the trend inflation estimate rose to 7.19% from 7.08% in December. This yet again bears out the conclusion that the disinflation process is protracted in time, despite the historically high level of nominal interest rates.

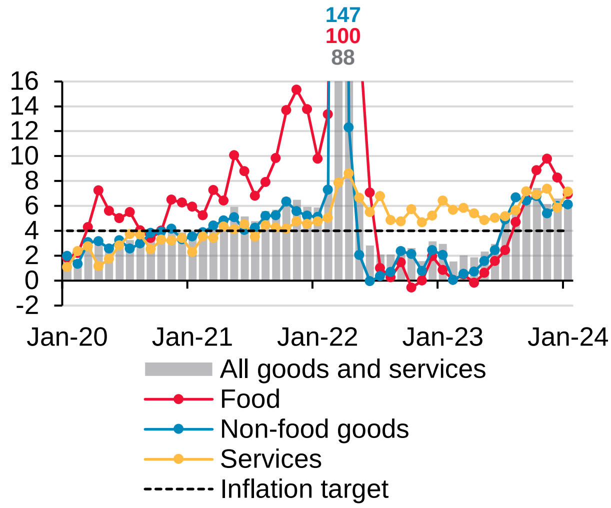
Price growth slowdown was concurrently driven by demand and supply factors. At the start of 2024, the balance of contribution to price movements relative to the trend of pro- and disinflationary supply factors went down to zero (Figure 10). In Q3–Q4 2023, the positive (pro-inflationary) balance of these factors was making a hefty contribution to inflation acceleration and the strengthening of the inflationary trend. The positive balance of pro- and disinflationary factors of demand also started to diminish towards end-2023, becoming weakly negative at the start of 2024.

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 calculations.

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

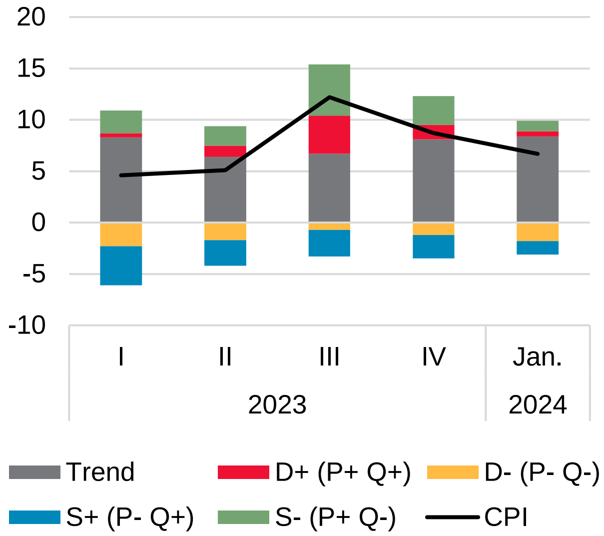


** 566 items in the 2024 basket*

Sources: Rosstat, R&F Department calculations.

But the trend component (sustainable, inertial) of price growth remains solid. Its decline can be driven by the expansion of the disinflationary contribution. Its decline can be driven by the strengthening of the disinflationary contribution of demand shocks, which, judging by the labour market situation, will occur in a gradual fashion.

Figure 10. Decomposition of average quarterly price growth in annualised terms (% SAAR) into demand and supply shocks (pp) by period

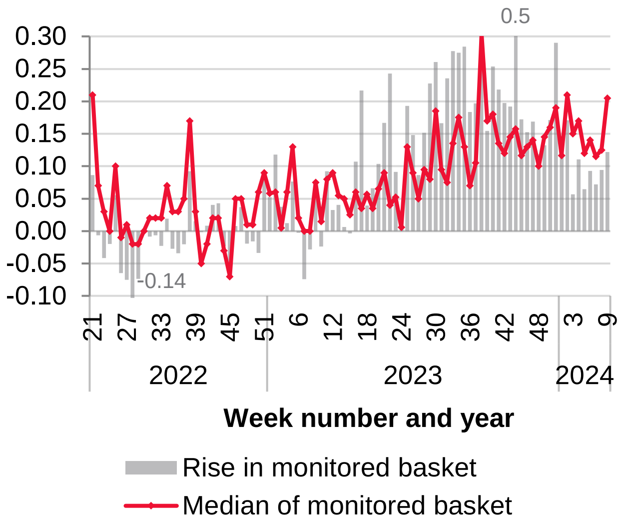


Sources: Rosstat, R&F Department calculations.

Of course, inflation deceleration can also be helped by more significant positive shocks of supply (i.e., expansion in the supply of some goods, enabling their prices to decline). But the input of these shocks to price growth was smaller in January than in any quarter of 2023.

Based on weekly data, prices climbed 0.6% in February, which corresponds to 5.1% MoM SAAR.[1] A rise in the price of the basket monitored on a weekly basis and the distribution median for February on average were somewhat below January's numbers (Figure 11). Price movements were mixed across the components (Figure 12). Price hikes in animal husbandry products accelerated but remained moderate. The non-food segment saw price growth slow, driven by durable goods, possibly due to demand growth slowdown as unsecured consumer lending cooled. Monthly CPI estimates sometimes substantially deviate from weekly data (as in January 2024), therefore, an analysis on weekly data is preliminary, while final conclusions regarding price movements should only be based on monthly statistics.

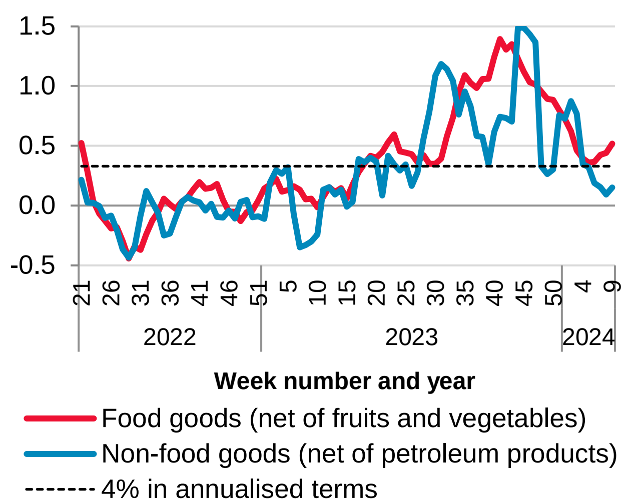
Figure 11. Price growth and median distribution of weekly price increases, %



Note: The calculation is based on an enlarged list of goods and services net of fruit and vegetables and regulated services.

Sources: Rosstat, R&F Department calculations.

Figure 12. 4-week moving price growth, %



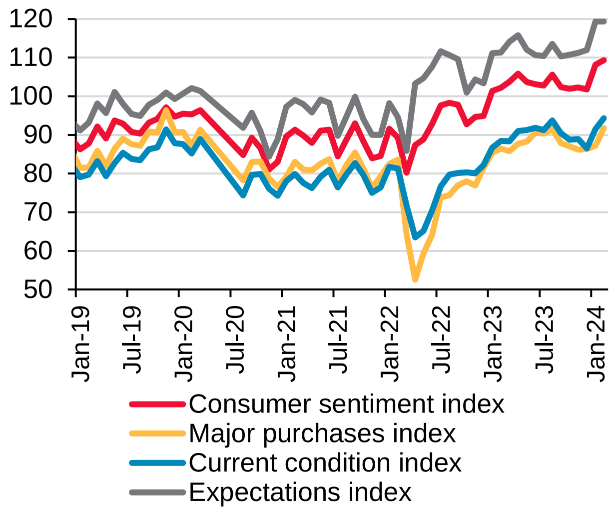
Sources: Rosstat, R&F Department calculations.

Monetary policy tightening is yet to have a full effect on changes in consumer demand. The consumer sentiment index again hit an all-time high in February (Figure 13). Real-time indicators of consumer activity also remain strong (SberIndex, Romir). Given that labour income continues to climb, while household inflation expectations are sensitive to food price hikes, pro-inflationary risks remain high. The estimates of households' perceived inflation and inflation expectations declined in January and February but are still below the 2023 average (Figure 14). Taken together, this means that for inflationary pressure to be sustainably relieved and the Bank of Russia's inflation target to be met this year, tight monetary stance will need to be maintained for a long time. We note that if inflation and inflation expectations steadily

[1] The consumer price index estimated on a weekly basis is measured on a shortened list of goods and services and may differ from the final reading. Services account for the smallest part of weekly data, which usually gives rise to the largest discrepancy.

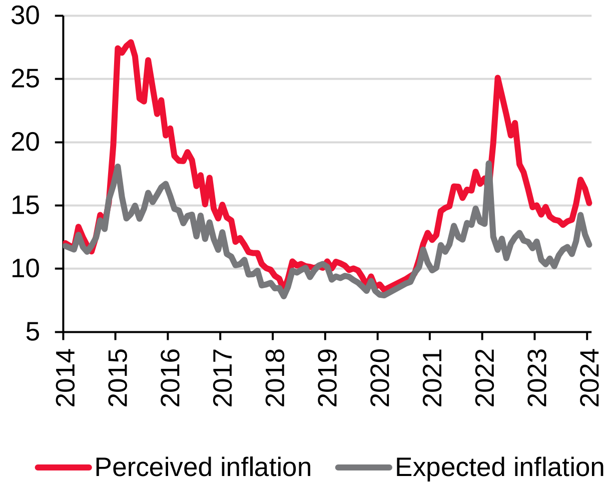
decline, a tight monetary stance achieved (i.e., unchanged real interest rates and credit activity ensured by these rates) may be maintained with the key rate being gradually reduced.

Figure 13. Consumer sentiment index and its sub-aggregates, p.



Source: inFOM.

Figure 14. Direct estimates of annual inflation: median values, % YoY



Source: inFOM.

2. Economic performance

Leading and real-time indicators point to the Russian economy's growth acceleration in January–February after some slowdown in November–December last year. But the recent slowdown owed to the high statistical base will likely result in formally slower seasonally adjusted GDP growth in Q1 relative to Q4 2023. Meanwhile, the upward dynamics in January–February build up conditions for GDP growth in Q2 relative to Q1.

This economic performance suggests the Russian economy's adaptation to high nominal interest rates, which was earlier only seen during the periods of high inflation. Possible factors behind this are economic agents' dramatically higher inflation expectations, which have only recently started to gradually decline. This makes economic agents less sensitive to the nominal level of interest rates. In addition, bearing in mind the continuing high quality of the loan portfolio, and borrowers' growing income, banks tend to buoyantly expand lending. In particular, non-price conditions of loan provision are eased. On top of that, one should note an important role of subsidised lending programmes and the maintenance of the positive fiscal impulse in stimulating demand in the economy.

There also emerges evidence of businesses' growing flexibility in response to numerous shocks and constraints encountered in recent years. In particular, the immediacy of the labour problem can be partially remedied by improving production efficiency through a better job and time management, including its intensification, etc. If sustainable, these changes enhance the potential level of Russia's GDP (all other things being equal).

2.1. Domestic demand remains economy's growth driver

- Economic activity continues to rise in Q1 2024. That said, quarter-to-quarter growth is more moderate than in Q4 2023,[2] due to, among other things, the statistical effect of growth slowdown late last year. Domestic and government demand remain the key growth drivers, with external demand playing a moderate role.
- Overall financial flows declined relative to the Q4 level, while varying across enlarged industries. They may have been affected by more moderate price movements, including those of exports. Industries meeting investment and consumer demand continue to register growth.
- Business surveys also show mixed trends. The Bank of Russia's business climate indicator climbed 0.3 p. in January, chiefly on rising expectations. The industrial optimism index dropped in February, dragged down by the falling assessment of demand. The industrial forecasts index remained unchanged in February: improvements in the balance of demand and output expectations were offset by a decline in the balance of hiring plans. PMI surveys indicate a slowdown in business activity expansion, driven by the services sector, while the manufacturing sector continued to gain momentum thanks to domestic demand growth (Figure 17).
- January saw activity in construction, wholesale trade, and agriculture somewhat decline relative to December (Figure 16). Industrial production showed an opposite picture (Figure 18). Output in industries of the investment goods group, which account for a large share in the group's overall results and are known for their volatile performance, sharply rose again after a contraction late in the year. (Figure 19). The manufacturing sector's output hit an all-time high in January, helped by growth in the consumer goods segment. Meanwhile, some industries meeting investment[3] and intermediate demand[4] posted an output decline.
- The rapid income growth helps consumer demand expansion (Figure 20), even if the savings ratio concurrently increases (Figure 23). The key source of income growth is labour income expansion amid rising labour market rigidity (Figure 25). This was evidenced by a drop in both the HeadHunter index (Figure 21) and the unemployment rate (Figure 24), which saw a new all-time low at 2.8% SA in January. The fall in unemployment was driven by a buoyant rise in labour demand. Demand for workforce from employers grew 2.2% MoM SA in January.

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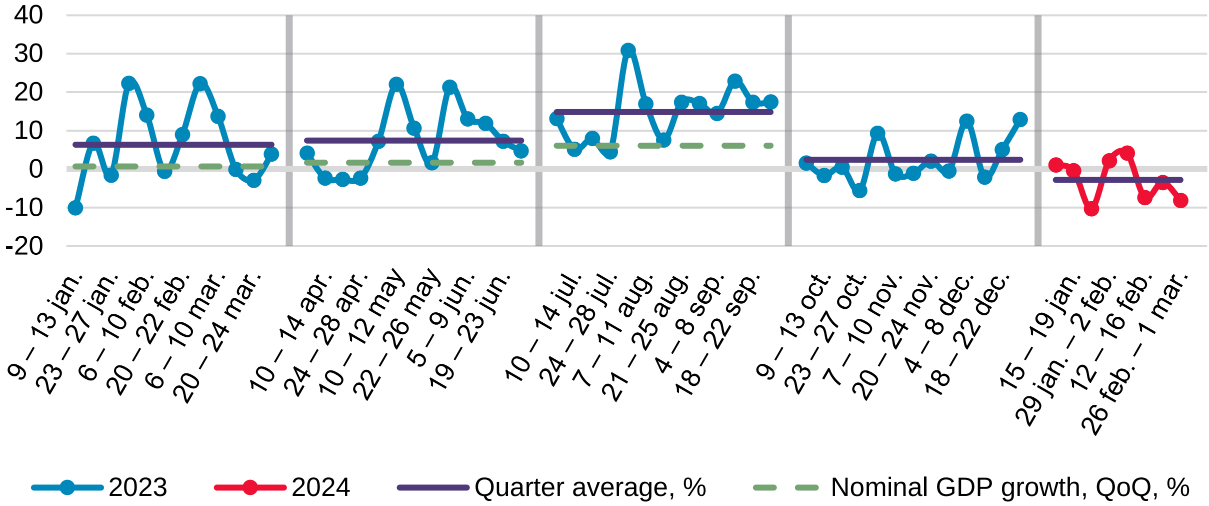
[2] Based on the first estimate of 2023 GDP released by Rosstat at the start of February and earlier Q1–Q3 data, Q4 economic growth stood at 1.2% QoQ SA (an R&F Department estimate). In April, when the second estimate of 2023 GDP becomes available and data for the first three quarters are updated, estimates of seasonally adjusted GDP performance within the year 2023 may change.
[3] Manufacture of other non-metallic products, primarily cement, as well as concrete products.
[4] Manufacture of basic metals and refined petroleum products.

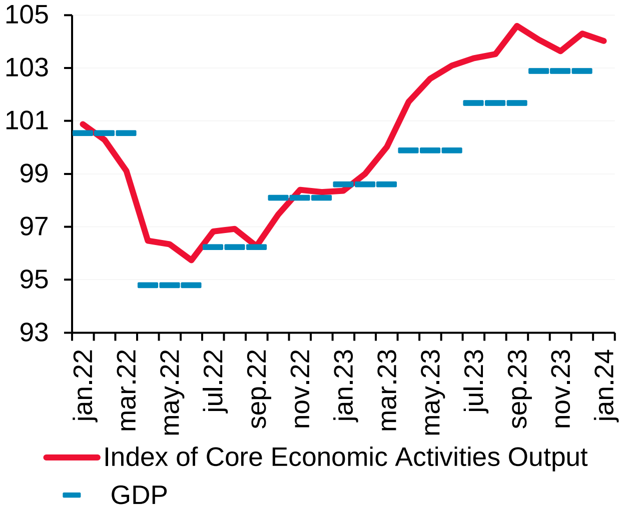
- The continuing personnel shortages, which, according to the surveys of industrial enterprises, hit an all-time high in January 2024, will buttress intensive competition for labour even amid a downward correction of hiring plans (business surveys). This may hamper bringing a rise in labour productivity into line with wage growth, thereby slowing the process of bridging the gap between supply potential and consumer demand. Under these circumstances, tight monetary policy will have to be maintained for a long time.

Figure 15. Incoming payments growth[5] relative to the previous quarter average weighted by industries' shares in gross value added, seasonally adjusted, %



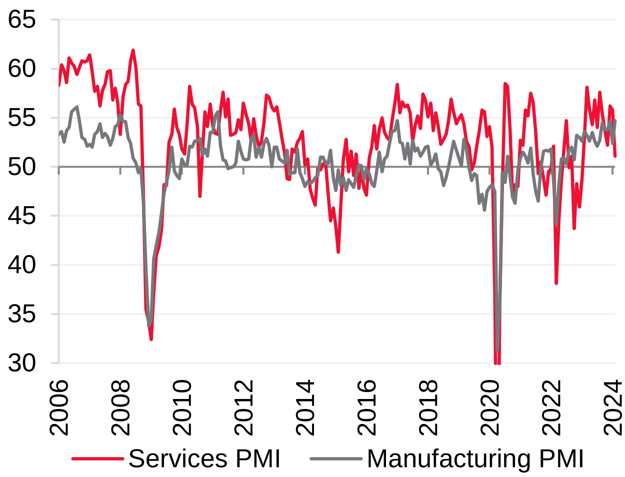
Sources: Bank of Russia, Monitoring of individual industries' financial flows.

Figure 16. Core economic activities output and GDP, Q4 2021 = 100



Sources: Rosstat, R&F Department calculations.

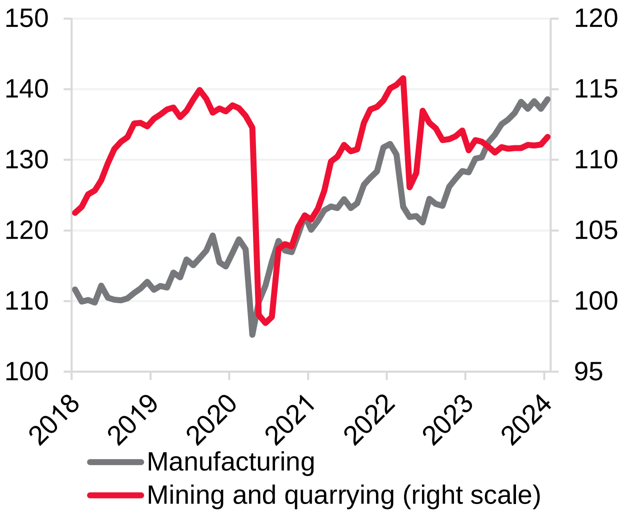
Figure 17. Russia's Manufacturing and Services PMI, points



Source: S&P Global.

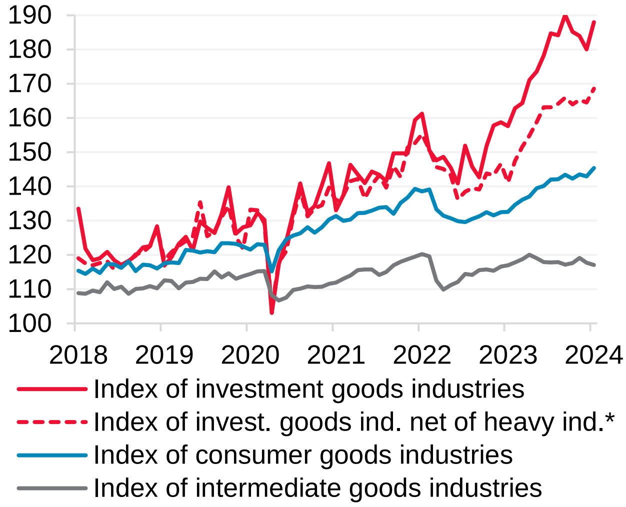
[5] Growth means a percentage change in the value: $g = \frac{(x_1 - x_0)}{x_0} * 100$.

Figure 18. Mining and quarrying and manufacturing indices (2014 = 100), SA



Sources: Rosstat, R&F Department calculations.

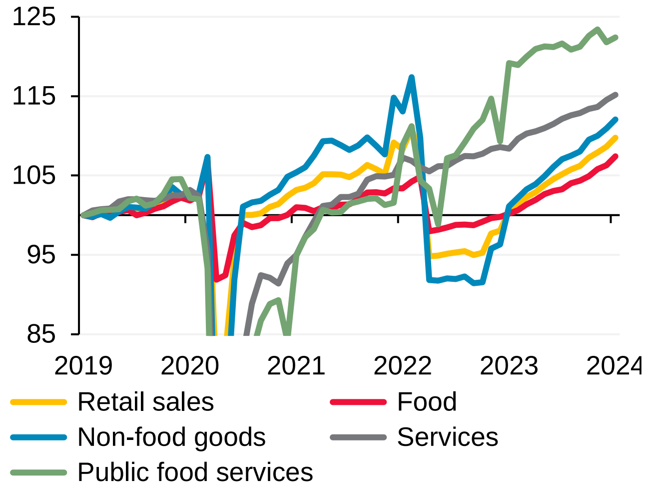
Figure 19. Output in groups of manufacturing industries, SA, 01.2016 = 100%



Sources: Rosstat, R&F Department calculations.

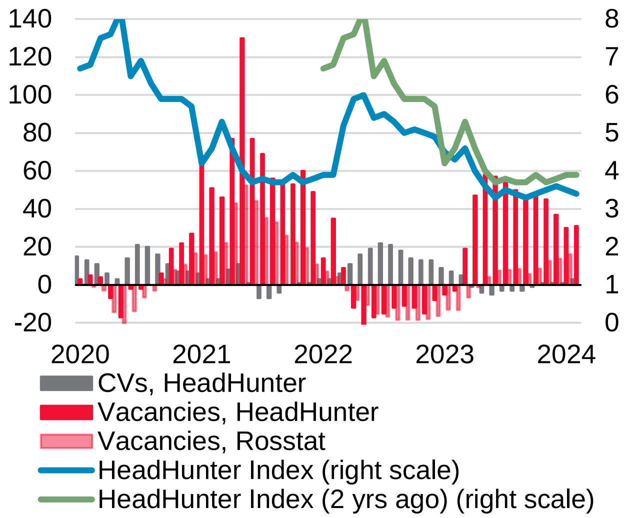
**The production of "finished metal products other than machinery and equipment" and "other vehicles and equipment" are excluded.*

Figure 20. Retail sales, sales of the paid services segment and public food services, 01.2019 = 100, SA, %



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

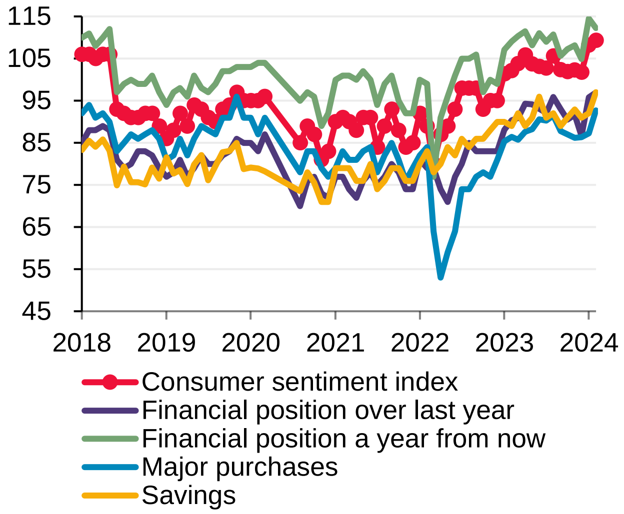
Figure 21. CVs, vacancies (% YoY) and HeadHunter index* (points)



** Ratio of active CVs to vacancies.*

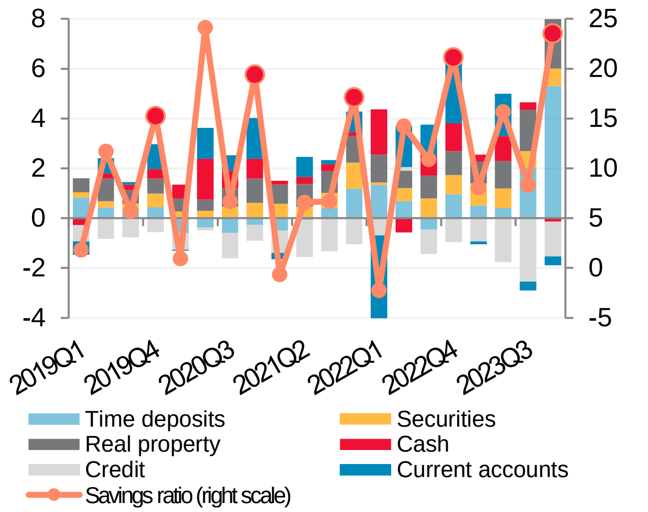
Sources: Rosstat, HeadHunter.

Figure 22. Consumer sentiment index and its subindices, points



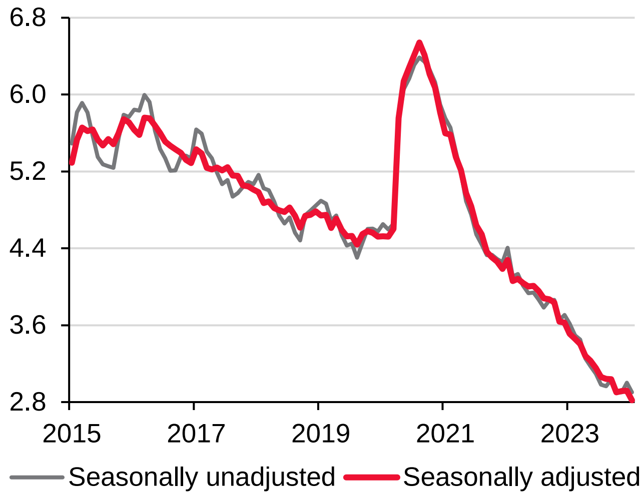
Source: inFom.

Figure 23. Components (trillion rubles) and savings ratio (%, right scale)



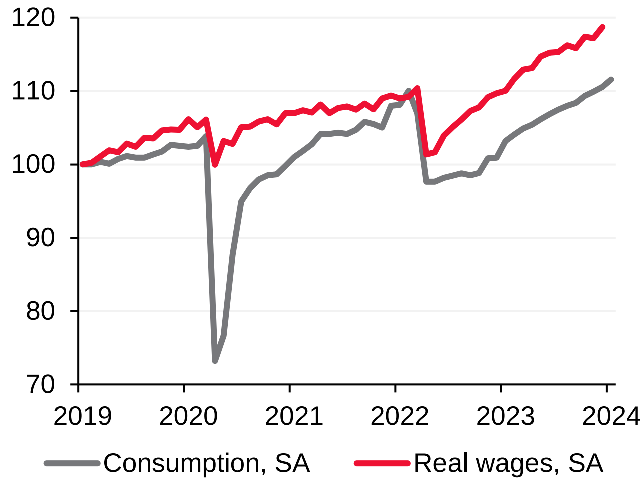
Sources: Bank of Russia, Rosstat, R&F Department calculations.

Figure 24. Unemployment rate, %



Sources: Rosstat, R&F Department calculations.

Figure 25. Proxy indicator of consumption (sum of retail, services and public food service' sales) and real wages, 01.2019 = 100, SA, %



Sources: Rosstat, R&F Department calculations.

2.2. Lending expansion slows at the start of the year

- Lending growth (seasonally adjusted) at the start of the year was slower than in the summer–autumn of 2023. This stemmed from interest rate hikes, tightening of conditions under subsidised programmes and the impact of the macroprudential limits and risk weight adds-on. Still, it would be premature to claim that a sustainable trend towards a slowdown and stabilisation of lending growth at a moderate level consistent with bringing inflation down to the target has been formed.

- Household loan growth in January was comparable with that in December at 1.1% MoM SA[6] (Figure 26). Its structure, however, changed. We estimate that growth in unsecured consumer lending accelerated to 1.3% MoM SA from 0.8% м/м SA[7] in December (Figure 29), which is close to the average levels of H1 2023 (1.2% MoM SA). Notably, this growth accelerated amid further loan rate increases (Figure 29). This may reflect, on the one hand, banks' adaptation to tightening macroprudential requirements, and, on the other hand, continuing strong demand for loans amid confident household income growth and elevated inflation expectations.
- Auto loan expansion remains strong amid the continued recovery of new passenger car sales. Demand is further buttressed by the subsidised auto lending programme even after its terms and conditions were toughened.
- That said, compared with the feverish demand in H2 2023, the mortgage lending segment saw a tangible cooling after the terms and conditions of the subsidised mortgage loan programme[8] were toughened. The number of loans extended under the subsidised loan programme tumbled at the start of the year but remained larger than in the same periods of previous years (Figure 27). The decrease in the number of mortgage loan transactions and approved mortgage loan applications (Figure 28) gives reason to expect a slower mortgage lending growth than in 2023.
- Expansion in ruble loans to non-financial organisations slowed to 1.3% MoM SA from 1.7% MoM SA in December.[9] This is owed to both monetary stance tightening and a possible move of a part of payments under government contracts from the end to the beginning of the year, which somewhat reduced demand for working capital.
- High deposit rates boost savings attractiveness. Given the growing household income, this supports rapid household deposit growth, up 2.6% MoM SA in January and 2.8% MoM SA in December (Figure 31). Growth in corporate funds slowed to 1.3% MoM SA in January from 2.0% MoM SA a month earlier.
- Money supply expansion has generally stabilised at an elevated level in recent months. Meanwhile the budget's contribution substantially contracted in recent months, giving way to lending as the key source of money supply growth. Based on budget projections for 2024, the budget's input to monetary aggregate expansion will likely grow. Therefore, the key contribution to money supply expansion slowdown in 2024 to a more moderate level is expected to come from lending growth.

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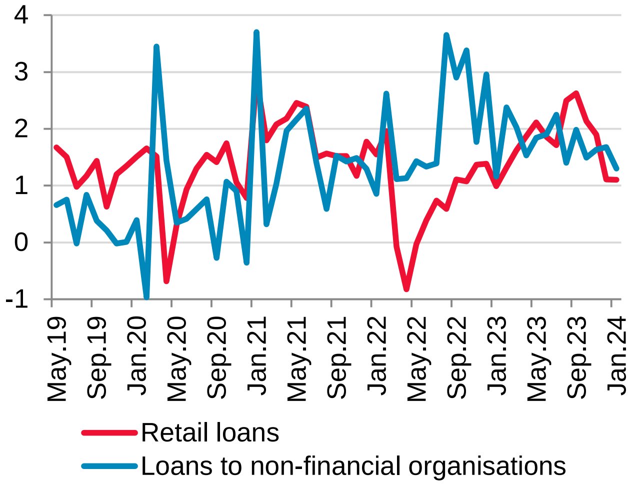
[6] Growth in December adjusted for a loan securitisation write-off.

[7] Growth in December adjusted for a loan securitisation write-off. MoM NSA growth in December and January at -0,1 и 0,9%, respectively.

[8] The first installment has been raised to 30% from 20%, while the maximum loan sum has been equalized across regions.

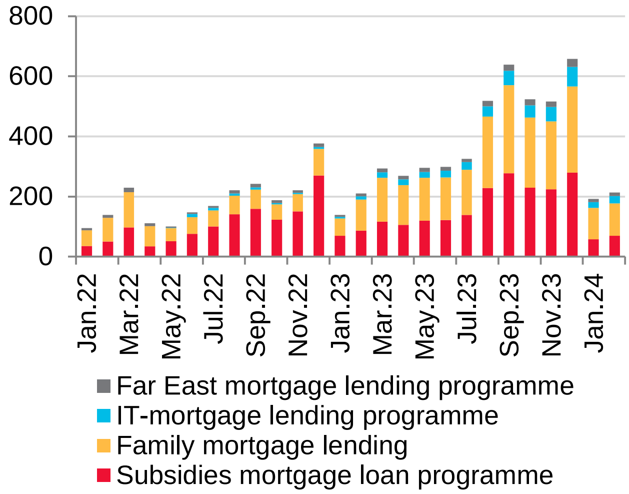
[9] Growth in the portfolio of sole proprietor loans slowed to 1.5% MoM SA from 2.2% MoM SA.

Figure 26. Ruble loans portfolio growth, % MoM SA



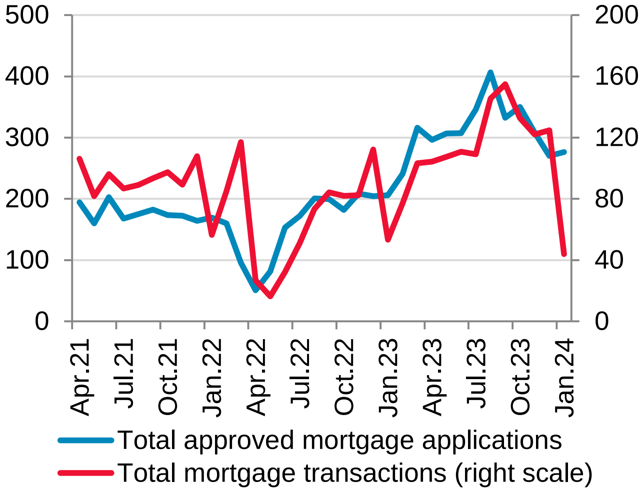
Sources: Bank of Russia, R&F Department calculations.

Figure 27. Loan issuance under subsidies mortgage loan programmes, billion rubles



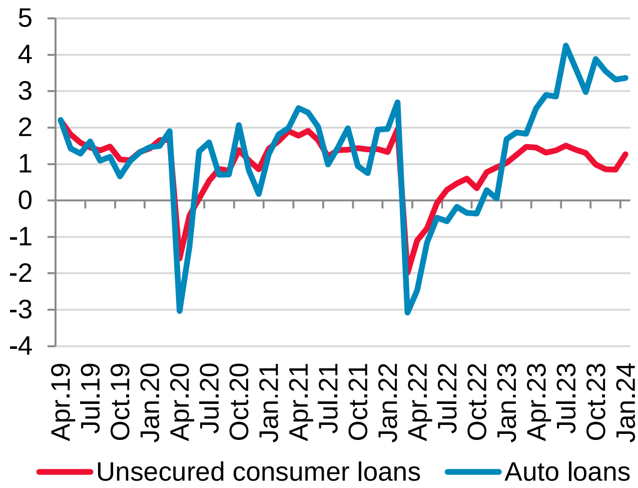
Sources: DOM RF, R&F Department calculations.

Figure 28. Approved mortgage loan applications and transactions, thousand



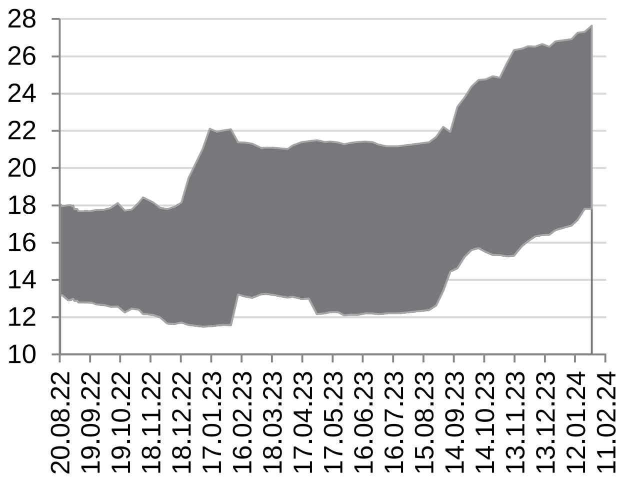
Sources: DOM RF, R&F Department calculations.

Figure 29. Ruble loans portfolio growth, % MoM SA



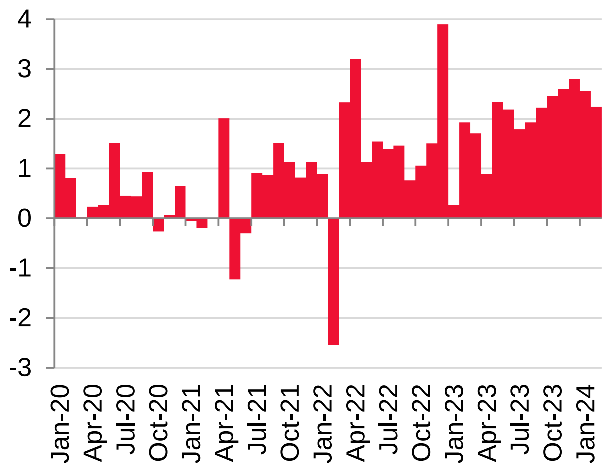
Sources: Bank of Russia, R&F Department calculations.

Figure 30. The range of average offered rates on consumer loans, %



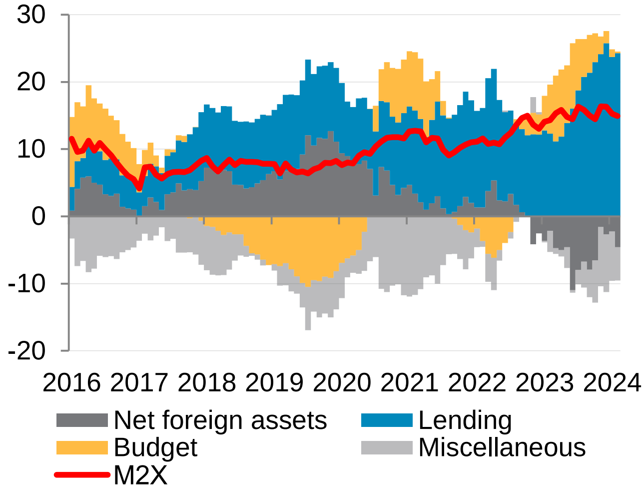
Sources: banki.ru, R&F Department calculations.

Figure 31. Household funds with banks, % MoM SA



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

Figure 32. Key drivers of annual growth in broad money supply on the asset side, %



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