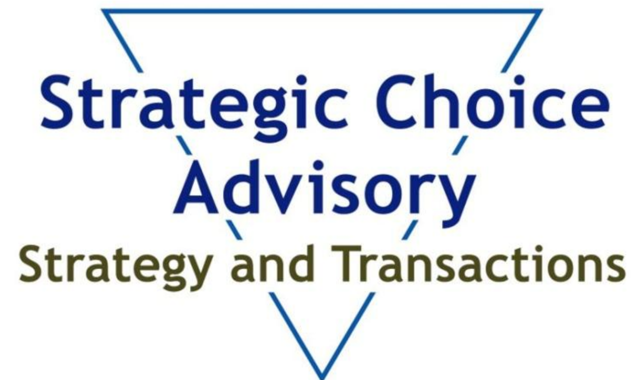


Russia Macro Foresight

Economic Growth Mixed but Generally Positive. Budget Deficit Shrinks, while CBR Struggles to Contain Consumption and Inflation

Real sector dynamics uneven as most sectors surge, a few others slump, while some recover. Overall, growth appears to be slowing, albeit still solid

- Economic growth stayed strong in H1/2024, as **real GDP gained 4.7% y/y vs. 3.6% in full-2023**, according to EconMin data. At that, the indicator came in lower than 5.3% y/y in H2/2023, as growth slowed from 5.4% y/y in Q1/2024 to 4% in Q2. More detailed Q2 breakdowns are as yet unavailable. **In Q1, final consumption jumped 6.7%, gross savings - 9.7%, while fixed capital investment skyrocketed 14.5% y/y.** CBR expects GDP growth to slow down to 3.2% in Q3 and make up 3.5-4% over the full-year
- In goods and services, May and especially June figures were mostly paltry. This is partially explained by quirks of the calendar, as Jun 2024 had two fewer workdays than Jun 2023. Thus we would not read too much into June data, but overall it seems growth is indeed slowing after last year's spurt. While in our previous report on full-2023 none of the sectors were colored red (marking sharp slowdown or contraction), quite a few turned red this time. Still, many key sectors saw welcome turnarounds, while even in sectors struggling on the whole, the dynamics was mixed, with evident bright spots. **Total corporate profit grew 13.6% in Jan-May** vs. -21.3% a year ago
- **Industrial output growth picked up further to 4.4%, as manufacturing surged 8%**, but extraction slid 0.3%. Total sales growth stayed robust at 21.9%, but surprising underperformers were warehousing & logistics (up just 11.8%), R&D (+3.2%), and healthcare (-2.6%)

Indicator, % y/y	2021	2022	2023	H1/ 2024
Industrial production	6.3	0.7	3.5	4.4
Cargo transp. turnover:	5.6	-2.3	-0.6	0.2
Railway	3.7	-0.1	0.0	-5.7
Automobile	5.0	5.8	22.1	7.7
Agriculture	-0.4	11.3	-0.3	0.9
Retail trade	7.8	-6.5	8.0	8.8
Paid services	16.7	5.0	6.9	3.8
Construction, o/w:	7.0	7.5	7.9	3.9
Housing	12.7	11.0	7.5	2.5
Fixed capital investment	7.7	6.7	9.8	14.5*

* - Q1/2024

Segment, % y/y	2022	2023	H1/ 2024	Segment, % y/y	2022	2023	H1/ 2024
Food products	1.1	5.9	6.9	Chemicals	-2.4	4.6	5.6
Beverages	6.7	1.4	9.7	Rubber & plastic products	0.2	9.2	4.2
Textiles	-3.8	0.6	8.4	Pharmaceuticals	9.3	1.9	8.3
Apparel	9.1	4.1	2.4	Coke & oil products	-0.6	2.6	-3.3
Metallurgy	-0.8	3.3	0.0	Machines & equipment	-0.7	4.5	-2.8
Wood products	-10.0	-0.2	6.0	Electrical equipment	1.1	19.0	8.6
Furniture	10.7	20.7	14.8	Automobiles	-44.2	13.6	27.4
Building materials	3.9	2.6	2.6	Computers & electronics	9.4	32.8	35.0

© Strategic Choice Advisory, 2024

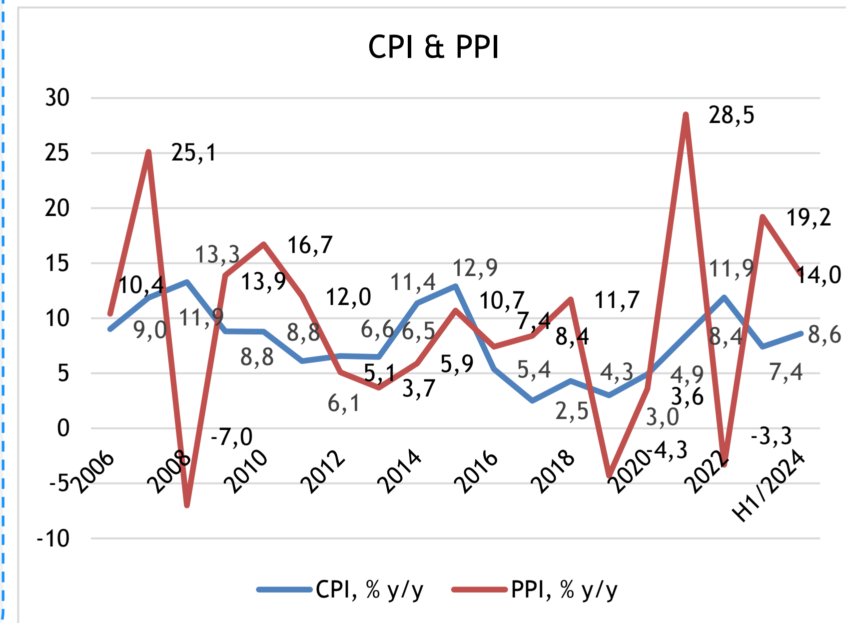
Real income growth accelerates further, driving consumption, even as CPI inflation picks up again. PPI inflation slows, but underlying input price pressure stays high

- Looking at income and wage data, it is no wonder consumption is soaring now. **Real disposable income (RDI) and real wage growth hit the highest levels since 2014**, when a major methodology review took place. Nominal wage growth reached an astonishing 18.7% y/y in H1. **The shortage of highly-skilled workers in a transforming economy** stays intact after the departure of dozens of foreign market majors, and the conscription campaign and resulting mass emigration of late 2022 – early 2023 (which has since been reversed, but the effects of which are still being felt)
- Positively, **employment continues to rebound**, as the number of full-time staff managed to grow 0.6% y/y, reversing a prolonged gradual decline. Part-time staff and contractors surged as well, as companies are actively hiring. Both unofficial and ILO-definition unemployment shrank further still, reaching a mere 1.9% and 0.5%, respectively, at end-June

Indicator, % y/y	2021	2022	2023	H1/ 2024
Real disposable income	3.2	4.5	5.6	8.1
Real wages	2.9	0.3	8.2	10.1*
Nominal wages	9.8	14.1	14.6	18.7*

** - Jan-May 2024*

- After slowing notably in 2023 to 7.4%, **CPI inflation sped up again, reaching 8.6% in June and 9.1% y/y in late July**. Food prices grew 9.2% y/y in June, with the same key culprits "outperforming" as in 2023, i.e. meat & poultry (16.3%), and fruits & vegetables (15.2%). Sharp price growth in eggs (49.7%; much higher earlier) caused quite the stir at some point, forcing Russia to revert to large-scale imports, anything but normal. In non-foods, building materials, gasoline, and medicines saw briskest price growth. Among services, inflation was strongest in passenger transport, and hotels and recreation services (11.6-15.6%), as these sectors are booming now. Healthcare service prices also rose strongly, by 8.8%
- **PPI inflation cooled to 14% y/y**, with prices rising just 3.8% ytd. Extraction prices grew 3.4% ytd, but are up 40% y/y, manufacturing - 4.6% ytd and 13.9% y/y. Biggest price hikes were seen in wood products, coke & oil products, metals, and … furniture (staggering twofold y/y price growth). Positively, **inflation in investment goods was marginal at 3.2% ytd**, despite robust investment and Western sanctions on equipment. Transport tariff inflation stayed in double-digits, as government banned price hikes in the busy railway sector



Sanctions and market saturation taking toll on some sectors, while others keep expanding unperturbed or have turned the corner (1/2)

- Among macro sectors, transportation continued to underperform, just barely eking out 0.2% turnover increase (vs. -2.1% a year ago and -0.6% in full-2023). Railway turnover dropped 5.7% y/y in H1, while growth in truck transport has eased, ringing in at 7.7%. But looking closer, while turnover (cargo load times distance) only inched up, cargo load actually rose notably, by 6.9% y/y. The dip in railways was only 3.1%, while truck load gained 9.9%. **This shows it was distance that decreased** (understandably amid sanctions), **while transport volumes are actually rising.** There was also rapid growth in marine transport turnover, while air cargo transport has overcome its pronounced drop and is now growing notably. Meanwhile, passenger transport surged 8.6%

- **Growth in construction has moderated** (even though we expected this to happen much earlier), in both housing (especially) and industrial (still going quite strong) segments. **Government's efforts to stop the housing boom are finally having an impact.** Despite the slowdown, **profit in construction is shooting through the roof** (RosStat Jan-May data), boosted by solid demand

- **Growth in agriculture stays minimal,** constrained by both export bans (aimed at tackling domestic inflation) and unfavorable weather conditions (long spell of snow and frost in early May, and a summer exceptionally hot in some regions, but cold and chilly in others). Retail price caps and CBR's monetary tightening are also limiting growth. Still, sales of key products like meat & poultry, milk, grain, etc. are up y/y. Significantly increased area under crops gives hope for a better harvest later in the year

- At the same time, **the food sector just keeps on going,** despite high consumer price inflation. In retail trade, foods notably outpaced non-foods, reversing the trend of 2022-2023. However, while profit in agriculture is starting to recover, a decrease was posted in food products. An especially troubled sector now is fish (even though fish processing is mostly growing). Growth has revved up again in alcoholic beverages, driven by better purchasing power and significant new investments in the sector, as local players work to replace sanctioned imports

- **Retail trade growth continues to accelerate,** reaching 8.8% in H1. At the same time, **previously red-hot HoReCa and paid services to the population saw growth cool** to 5.4% vs. 13.9% in full-2023, and to 3.8% vs. 6.9%, respectively. We suppose the high base may be responsible to a large extent, but would have to watch these sectors, going forward. Profit in hotels, tourism and recreation soared. Profit in retail and wholesale trade has declined (perhaps off a high base, plus due to risen transaction costs, especially in wholesale trade), but sector optimism (RosStat surveys) remains sky-high. **Total sales declined in healthcare,** despite improved welfare and seemingly high demand. Could it be due to more and more Russians choosing to lead a healthier lifestyle (which we touched upon in our previous report)? Still, significant price hikes helped healthcare sector profit to soar…

© Strategic Choice Advisory, 2024

Sanctions and market saturation taking toll on some sectors, while others keep expanding unperturbed or have turned the corner (2/2). Banking sector stays robust but risks overheating

- Among manufacturing segments, the ones we expressed concern about over the past year, specifically **chemicals, pharmaceuticals, and wood products, have all turned the corner and appear to be reviving.** Fertilizers, resins, detergents; and fuel pellets, plywood, chipboard and fiberboard are key growth drivers in the former and latter segments, respectively. Related paper products are also resurging now, with both paper (and publishing, further down the value chain) and cardboard (spurred by eCommerce expansion) leading the way. Growth in plastics has moderated, while tires are buoyed by the recovery and new growth in automobile production and sales
- Segments where output growth has slowed visibly or is failing to lift off are textiles & apparel, and leather products (outside military products), building materials (quite surprising amid an investment and construction boom), coke & oil products, metallurgy, telecoms; certain kinds of electronics and electrical equipment (but some products are thriving here), metal-working equipment, and agricultural machinery; medical equipment (following robust expansion), etc. Still, computers & electronics, woodworking equipment (helping the industry turnaround), cranes, oil&gas services, etc. are expanding actively, despite sanctions

BANKING SECTOR

- **The banking sector remained piping hot, as growth of key asset and liability indices picked up further in H1**. Even the slowdown of corporate funds' growth has been reversed, despite CBR's monetary tightening. Both corporate and retail loan portfolios are growing rapidly, even with the sky-high interest rates and government phasing out mortgage loan programs. Growth of investment in securities slowed notably to 6.7% y/y as geopolitical instability increased, thereby boosting volatility and tempering risk appetites. Total banking system profit edged up 7.8% y/y to RUB 1.8tn, after a breakout RUB 3.3tn result in full-2023
- Luckily, loan quality so far stays manageable, as **corporate overdue debt declined 12.5% y/y**, sinking to 3.5% of the loan portfolio from 4.7% a year ago. Retail overdue debt rose 5% y/y, but its share of total retail loans made up 3.4% vs. 4% in H1/2023. The share of problem loans declined further to 5% of the corporate loan portfolio, and 7.7% of non-collateralized consumer loans (4.2% of the overall retail loan portfolio), respectively

Indicator, % y/y*	2021	2022	2023	H1/2024
Loans to individuals	25.1	9.5	26.5	27.1
Loans to corporates	10.6	14.3	20.1	20.9
Individuals' funds	3.1	6.9	19.7	26.0
Corporates' funds	16.7	20.6	14.7	15.6

** - Due to regular data revisions and methodology adjustments for data starting 2021 by CBR, annual y/y indices may not be directly comparable*

© Strategic Choice Advisory, 2024

Money supply growth constrained by CBR to fight inflation; external balance strengthens and budget deficit shrinks significantly even as foreign players continue to leave

MONETARY AGGREGATES

- **Growth of national-definition (RUB) money supply edged down to 18.7% y/y in H1** after slowing considerably in 2023. While cash in circulation slid 1.3%, deposits leapt 23.4%, as CBR hiking the key rate by more than 10pps to 18% drove up interest in RUB deposits. **Broad-definition monetary base (including FX funds) grew only 3.6%** due to Western sanctions against FX transactions with Russia, and the Russian economy's switch to RUB. Monetary authorities are now tightening liquidity to tackle high inflation

EXTERNAL SECTOR

- **FX & gold reserves finally moved above the** narrow USD 560-600bn range they had been fluctuating in for over a year, reaching USD 611.3bn as of Jul 19 (but have since edged down to USD 606.1bn as of Aug 2). We are wondering whether CBR is trying to stem RUB strengthening this way, in order to support budget revenues from commodity exports. The RUB is still down 11.6% y/y vs. the USD, 1.9% vs. EUR, 4.8% vs. CNY, and 8% vs. the foreign currency basket, but is up 3.7% 4%, 4.8%, and 5% respectively, year-to-date
- **The current account (CA) surplus made up USD 40.6bn in H1 vs. USD 50.1bn in full-2023.** The trade surplus stood at USD 67.8bn vs. USD 56.6bn a year ago. The service deficit barely moved y/y, making up USD 16.8bn. CBR has resumed publishing FDI data, but while little can be made out of the latest numbers due to covert cross-border capital flows, **the overall trend is now obvious - foreign investors are actively leaving Russia.** Accumulated FDI made up USD 268.6bn at the end of Q1/2024 vs. USD 304.2bn a year ago and USD 497.7bn at the end of 2021 (latest data before the outbreak of war with Ukraine). Debt to foreign shareholders dropped from USD 37.3bn to USD 22bn since the start of war
- **Total foreign debt rose USD 3.4bn q/q** to USD 306.1bn in Q2, dropping USD 10.7bn ytd and USD 34.7bn (10.2%) y/y. Government external debt inched up USD 0.5bn q/q (down USD 5.5bn y/y), while CBR debt jumped USD 7bn q/q (rising USD 4.8bn y/y). Possibly, Russian authorities feel it makes sense to borrow abroad at lower rates, viewing the country's high inflation and subsequent debt interest rates. Corporate foreign debt slipped another USD 4.2bn q/q, and has declined USD 34.9bn (16.5%) y/y

PUBLIC SECTOR

- **The state budget deficit shrank unexpectedly by over 60% y/y to RUB 0.9tn (0.5% of GDP)**, after making up RUB 3.35tn (2.3%) in 2022 and RUB 3.24tn (1.9%) in 2023. Revenues jumped 38% y/y, while spending grew a much slower 22.3%. Interestingly, import duties rose just 11.9%. National Welfare Fund has been practically flat over the past year, now standing at RUB 12.7tn
- Contrary to many analysts' expectations, **post-election spending has only increased**, and the government upped the full-2024 budget deficit forecast by RUB 0.5tn to RUB 2.12tn (1.1% of GDP) to accommodate President Putin's various promises
- A FinMin source we spoke to attributes improved budget execution mainly to departure of foreign players (who had been channeling profits outside Russia), and growth of domestic investment, boosting budget revenues. While previously it was extremely difficult to boost market share, now "the air has cleared" and investors are frantically trying to make the best of new opportunities. This boosts business volumes and, consequently, helps fill state budget coffers. Tax administration has also been toughened recently

© Strategic Choice Advisory, 2024

Summary

- Again and again, in yet another report, we say that the Russian economy stays in pretty good shape. Overall economic growth remains solid, import substitution and domestic tourism keep driving economic development, while rapid wage growth amid a deficit of skilled workers also fuels consumption
- However, it appears that widened secondary sanctions are catching up with a number of sectors, as increased transaction and logistic costs and delays make life more difficult for companies across the board. Growth is slowing in many segments, partly being attributed to the high base effect. At that, we already have seen a number of key sectors overcome the nuisances since the start of war and resume brisk growth. Will the sectors that are now slumping or seeing growth slow follow suit, and will domestic investors rush in to help out, sensing new opportunities? Remains to be seen over the course of the next year or so
- The extra liquidity inflows owed to capital repatriation, new investment spree, and higher commodity prices in a period of global military tensions, add to that robust wage growth due to a labor shortage, result in much higher inflation. CBR is frantically trying to curtail consumption and inflation, but judging from banking sector dynamics, it is just barely managing to do so. PPI inflation has slowed slightly after last year's leap, but cost pressures stay strong
- Here we would like to quote a conversation with a furniture sector expert we spoke to while writing this report. The dynamics of key sector indices seemed to be contradicting each other, as output growth cooled but stayed high at 14.8% y/y, output prices soared 97% (!), but profit dropped 18.7% - in Jan-May or H1 (period provided, depending on data source and availability). We were wondering about the causes and consequences, what came first and what came later ("the chicken and egg")
- The response we got was hilariously funny, and at the same time eye-opening. He said: as is widely known, consumers rushed in to buy furniture they needed or thought they would need at some point, due to the announced departure of major foreign manufacturers, plus some of the importers and retailers. Then this craze subsided. Of course, at first local producers and stores avoided sharp price increases to stay competitive, then at some point had to boost prices. But now that wages are growing so strongly, purchasing power is so robust, if you used to sell, say, 10 tables a month at X price, now you sell 10 tables a week at the same X price, *why bother* increasing production (and/or sales force, store area, supply chain, etc.), if you can just make the price 2X, and sell your usual 10 tables a month for twice the revenue?! Indeed, why bother?.. *Growth* itself is not the point for many people, and the example is reflective of the current situation in many other sectors
- So, looking at growth slowing in some sectors, *should we bother*, i.e. become worried? Or, should we just look at the be all and end all of business, the bottom line? It appears that even as war is raging, and sanctions are flaring, there is a renewed sense of normalcy in the economy. Competition, market saturation, demand, input vs. output price inflation, - these are all market factors that are determining dynamics in respective sectors, more than the actual war and sanctions themselves, which have become but another factor, another parameter/variable in the equation. We are sure that market forces will balance themselves out eventually, and are only reminded to stay buckled up for the ride

© Strategic Choice Advisory, 2024

Contact details

For additional information, please contact:

Andrew Afanasiev

Managing Partner, CEO

Mob. +7 (903) 745 7330
E-mail: aafanasiev@strategicchoice.org

Strategic Choice Advisory

20A Bronnaya M. str.,
Moscow, 123104, Russia

Tel.: +7 (495) 135 2830

https://www.strategicchoice.org

© Strategic Choice Advisory, 2024