



Bank of Russia

No. 6 (42)



TALKING TRENDS

Economy and markets

Research and Forecasting Department Bulletin

OCTOBER 2020

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The Research and Forecasting Department prepared this bulletin based on data as of 09.10.2020.

The views and recommendations expressed in the bulletin do not necessarily reflect the official position of the Bank of Russia.

Please send your comments and suggestions to dip_bulletin@mail.cbr.ru

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EXECUTIVE SUMMARY

MONTHLY SUMMARY

- Inflationary pressure adjusted for temporary and one-off factors remains close to 4%. Accommodative monetary policy facilitates further recovery in economic and consumer activity. This will reduce disinflationary risks, as annual inflation is expected to reach 3.5–4.0% by the end of 2021.
 - In September, the growth of consumer prices significantly slowed down against August amid the intensified effects of one-off disinflationary factors. Inflationary pressure decreased in September primarily as a result of two circumstances, specifically a more substantial decline in fruit and vegetable prices than usual and the annual indexation of the cost of main educational services. Nonetheless, annual inflation rose slightly more, coming closer to 4%, due to low price growth rates recorded last autumn.
 - According to preliminary estimates, the recovery of economic activity in Russia slowed down even more after manufacturing firms and retailers completed the active stage of the restoration of their operations. The rebound of investment and export demand may take longer due to the persistent uncertainty about new coronavirus cases in Russia and abroad.
 - The financial market sentiment was predominantly negative in September following the decrease in global risk appetite amid the resurgence of the pandemic and higher geopolitical risks. In particular, this entailed the weakening of the ruble and the growth of the risk premium in prices for Russian financial assets. Despite a slight rise, risks associated with market volatility remained lower than over the previous periods of volatility spikes, including this year

IN FOCUS. Inflation in emerging market economies amid the pandemic

- Emerging market economies (EMEs) had very low inflation over the first months after the outbreak of the coronavirus-related crisis, although their national currencies weakened and markets were affected by one-off supply-side factors. This could be the result of both the effect of the anti-pandemic restrictions and the impact of low fuel prices. Owing to this inflation trend, EMEs were capable to promptly shift to the easing of their monetary policies, which had not been done over the earlier crisis periods. However, EMEs have been recently experiencing proinflationary supply-side factors and exchange rate pass-through effects. As a result, inflation turns out to be slightly higher than the regulators originally expected.
- Supply-side factors associated with the economic aftermath of the pandemic will probably have a longer-lasting and persistent proinflationary impact than it could have been expected at the earlier stages of the pandemic. This is explained by the high

uncertainty over how the epidemiological situation will evolve and affect economic activity.

- Since the beginning of 2020, the majority of EMEs have suffered a significant depreciation of their national currencies and a substantial rise in costs resulting from disturbances in supply chains and additional sanitary and epidemiological measures. Potential output is likely to contract. In addition, structural shifts in consumer behaviour models may considerably accelerate the recovery of demand in the markets for certain goods, which will have a proinflationary influence. This will partially offset the persistent disinflationary impact of generally *subdued demand*.
- Consequently, the future price growth rate may be slightly higher compared to the central banks' earlier forecasts underlying the monetary policy easing undertaken throughout 2020. This may be expected despite the exhausting effect of temporary proinflationary factors explaining the current price trends in EMEs.
- As for the monetary policy implications, central banks should act very prudently in the future and make robust decisions, considering the highly uncertain estimates of the impact of demand- and supply-side factors, further economic trends, and financial stability risks. Many central banks already emphasize these aspects in their official communication.

1. Inflation

Annual inflation edged up in September, continuing to approach 4%. The monthly seasonally adjusted rate of price rises, however, slowed drastically in September compared with August, driven largely by one-off disinflationary factors: a strong effect of the seasonal decline in the prices of fruit and vegetables and those of passenger transport services. Also, the seasonal indexation of education services prices was quite moderate. At the same time, the leading inflation indicators, including producer prices of consumer goods and business survey data, along with rouble weakening, suggest some intensification of cost-push inflationary pressure in the Russian economy.

The combination of supply-side (costs) and demand-side shocks brought about by coronavirus-related restrictions, produced opposite consumer price trends: the upward pressure on output prices driven by cost increases which were impossible to be fully passed through to consumers, given weak demand. As a result, consumer prices remain volatile compared with the usual seasonal pattern. That said, the full pass-through of the recent rouble weakening to prices will be lagged in time rather than instantaneous.

A strengthening of consumer demand as household income grows, will gradually reduce disinflationary risks arising from depressed consumer activity. We expect that as producers adapt to changing conditions, cost rises will also slow gradually unless new shocks emerge. All in all, this should bring consumer prices back to a less volatile trajectory, driven mainly by monetary factors. Therefore, by shoring up demand, the current loose monetary policy will reduce the related disinflationary risks at a faster pace.

This should see inflation in the 3.5%–4.0% range for 2021, allowing for time lags after monetary easing.

1.1. September's inflation easing driven by one-off factors

- Annual inflation accelerated to 3.67% in September from 3.58% in August as the reduced pace of last year's price rises exited the calculation base.
- Meanwhile, the seasonally adjusted monthly pace of consumer price inflation in September came in below a level corresponding to 4% in annualised terms. This indicator remains highly volatile. Indeed, the seasonally adjusted annualised rate of inflation slowed sharply to 3.01% SAAR from 4.67%% SAAR in August.
- Price movements continue to be affected by a large number of one-off factors producing a significant volatility and making it much more difficult to estimate the stable price rise components which monetary policy above all looks to. For example, the slowdown of services price rises to almost zero in September resulted from a minor – compared with last year – indexation of education services prices and price cuts in health resort services after their significant gain in the previous months.

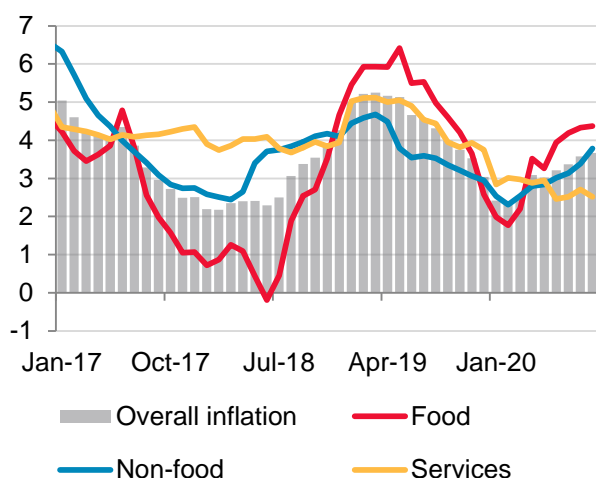
- The pro-inflationary effect of rouble weakening began to intensify in September. The pace of price rises in some goods depending on the rouble exchange rate gained momentum. Given that a full pass-through of exchange rate movements to consumer prices is lagged in time, we expect the upward pressure of exchange rate movements on prices can make itself felt for another one or two quarters if the rouble exchange rate stays close to its current levels.
- Over the period from 29 September to 5 October, consumer prices resumed their climb after stabilisation in the previous two weeks, although fruit and vegetable prices saw their largest drop for this week of the year. The sharp acceleration in the weekly price rises compared with the previous weeks was chiefly fuelled by the prices of the monitored basket of goods exclusive of fruit and vegetables and an adjustment for consumer basket components which are not monitored on a weekly basis.
- The combination of demand- and supply-side shocks caused prices of many goods and services to go up more slowly instead of declining even when the massive coronavirus-related restrictions were in place in the spring. The recovery of demand which started as restrictions were gradually lifted, allowed companies to partially pass through rising costs to prices, making prices of some goods and services go up at a faster pace than before the coronavirus period.
- Disinflationary risks remain. Short-term risks declined somewhat over recent months amid a gradual household income and consumer demand recovery. At the same time, the deterioration of the epidemiological situation and the potential reinstatement of restrictions may amplify disinflationary risks in the Russian economy.

A consumer price decline accelerated somewhat to 0.07% MoM NSA¹ in September after a 0.04% MoM NSA slide in August. Annual inflation continued to gain pace as the reduced rate of price rises last year exited the calculation base, reaching 3.67% in September after 3.58% in August (Figure 1). Annual consumer price inflation acceleration continued in both food and non-food goods. An annual inflation slowdown was recorded in the services segment.

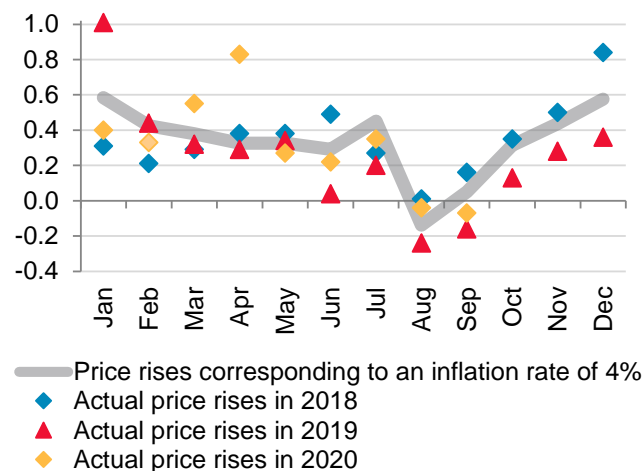
September saw price movements below a path corresponding to an annualised inflation rate of 4% (Figure 2): the seasonally adjusted annualised inflation rate slowed to 3.01% SAAR² after 4.67% SAAR in August, driven by the prices of food and some services categories (Figure 3).

¹ Non-Seasonally Adjusted.

² Seasonally Adjusted Annualised Rate.

Figure 1. Inflation and its components, % YoY

Source: Rosstat.

Figure 2. Price rises corresponding to an inflation rate of 4%, % MoM

Source: Rosstat, R&F Department estimates.

Food price inflation slowed to 2.28% SAAR in September (0.19% MoM SA) after 4.57% SAAR (0.37% MoM SA) in August. The pace of inflation was substantially restrained by a significant slowdown in fruit and vegetable price rises: to 0.2% MoM SA in September from 2.3% MoM SA in August. Gains in food prices exclusive of fruit and vegetables also lost momentum. Meanwhile, some product categories, such as sugar and sunflower-seed oil, saw a sharp price rise acceleration, which may have been fuelled by concerns over poor sugar-beet and sunflower-seed oil harvests.

Non-food prices went up more drastically by 5.84% SAAR (0.47% MoM SA) in September than in August (4.92% SAAR – 0.40% MoM SA). The impact of temporary pro-inflationary factors, in particular rouble weakening, gained strength.

We estimate that rises in the prices of some goods depending on the rouble exchange rate continued to accelerate. The formal estimation of the effect of the exchange rate pass-through to prices using the estimation of the relevant elasticity on retrospective data, suggests that the contribution of recent months' rouble weakening to price movements in September stands at 0.1 pp and increases to 0.15 pp in October–November, provided that the exchange rate stays on its current levels. At the same time, there is reason to believe that the full pass-through of exchange rate movements to prices may be lagged in time rather than instantaneous. Indeed, disruptions in global supply chains and significant inventories accumulated during the pandemic may lengthen the pass-through period. For example, wearing apparel and footwear price increases remain somewhat depressed because a part of retailers are now selling the spring collection which was purchased before the rouble weakening but remained unsold due to restrictions in place, instead of selling a new autumn collection.

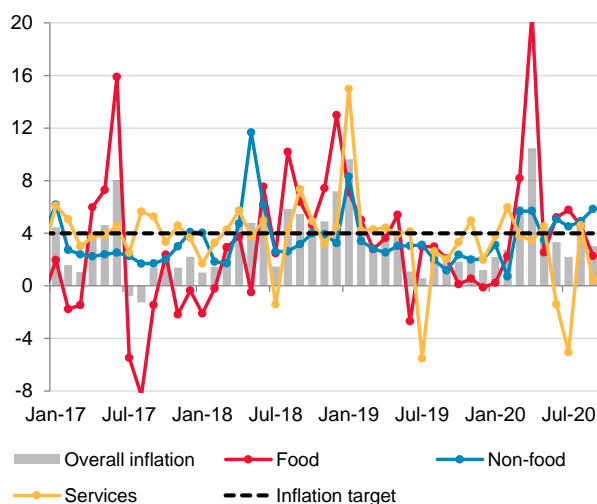
Services price rises slowed to 0.41% SAAR (0.03% MoM SA) in September after a 4.59% SAAR (0.37% MoM SA) climb in August. This segment's prices continue to be affected by various one-off factors which complicate the estimation of the stable component of price movements. For example, the services price cuts were strongly driven by a relatively

minor indexation of education services prices due to the remote work format, which brought down these prices in seasonally adjusted terms. The prices of health resort services suffering an elevated volatility in recent months (prices of these service rose 5.9% SA over July–August) were cut drastically by 3.8% MoM SA.

Also, the overall price trends are distorted by the formal stabilisation of foreign tourism prices: they have all but failed to be registered for half a year as travel was off limits. The reopening of borders with Turkey in August did not affect price changes, because travel in this country has not been included in the CPI since 2016. Meanwhile, travel companies show a rise in prices of travel to Turkey compared with last year³ after the reopening of the borders. Even with discounts offered by hotels, price increases exceeded the headline inflation level on the back of rouble weakening. One can therefore assume that if borders with countries travel to which is recorded in the CPI were to reopen, prices of foreign tourism services would go up for the same reason. All other things being equal, this would push inflation up 0.1–0.2 pp relative to the current level (as foreign tourism accounts for almost 2% of the CPI).

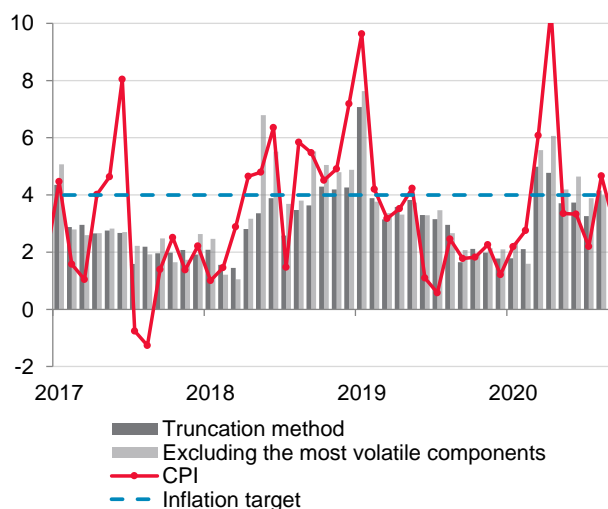
Price rises in personal and health services, which are less exposed to the impact of regulatory decisions or one-off factors, remain close to 4% in annual terms beginning from May, although activity remains subdued in many services sectors.

Figure 3. Seasonally adjusted inflation, % SAAR



Source: Rosstat, R&F Department estimates.

Figure 4. Modified core inflation indicators, % SAAR



Source: Rosstat, R&F Department estimates.

Modified core inflation indicators, which are less sensitive to the impact of one-off and temporary factors than headline inflation, showed a decline in inflationary pressure after its stabilisation close to 4% in the previous months (Figure 4). The average reading of the two modified inflation indicators fell to 3.2% SAAR in September.

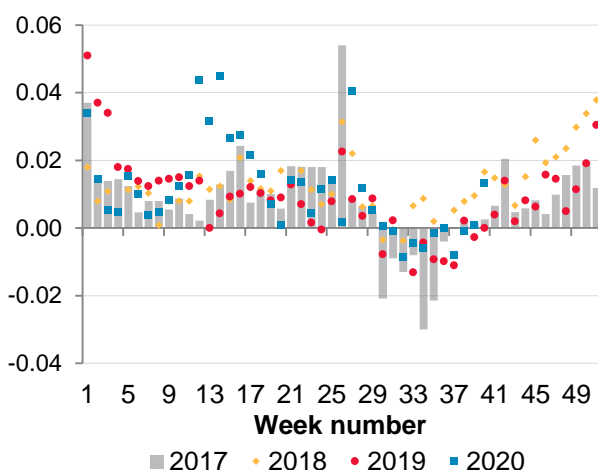
Consumer prices resumed their upward movement in the period from 29 September to 5 October, adding 0.1% over this week after their stabilisation in the previous two weeks. The

³ [All Inclusive at a 30% discount: how Russians spend their vacations in Turkey this year](#) / Forbes/ 10.09.2020.

average daily price increase was the largest from the start of July, rising far above the level of the same period last year (Figure 5). An estimate adjusted for the consumer basket components which are not monitored on a daily basis rose to 0.12 pp from 0.06 pp a week earlier. The annual inflation estimate continued to rise, reaching 3.76% as of 5 October.

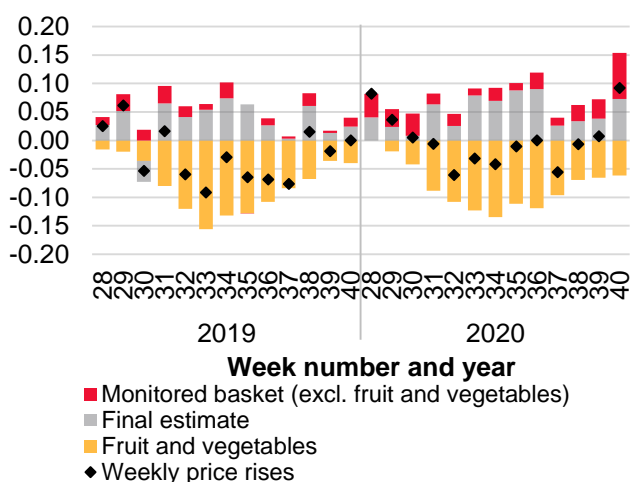
A sharp increase in weekly inflation at the start of October came on the back of a price rise acceleration for the basket of goods monitored on a daily basis (exclusive of fruit and vegetables). The average rise in the prices of goods and services monitored on a daily basis (net of fruit and vegetables) accelerated to 0.33%, with the distribution median declining slightly. This was largely owed to an increase in the prices of passenger cars of both foreign and domestic brands. The rest of non-food categories saw a moderate price gain (the exceptions include smartphones, up 0.6%, electric vacuum cleaners, a rise of 0.5%, and some medications). A seasonally normal slowdown in a fruit and vegetable price decline continues to be quite gradual (to 1.6% from 1.7% a week earlier).⁴ As a result, the pace of the seasonal fruit and vegetable price decline is still faster than in the previous years.

Figure 5. Average daily price rises, %



Source: Rosstat, R&F Department estimates.

Figure 6. Decomposition of weekly inflation rates



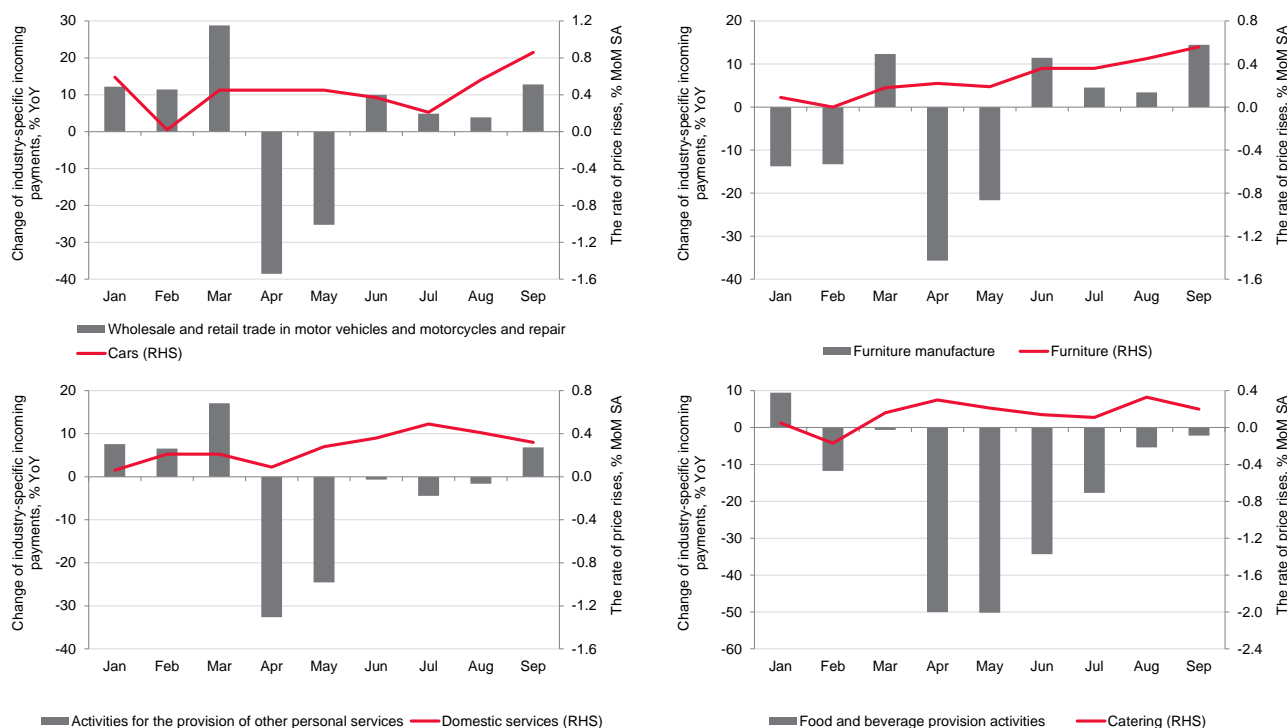
Source: Rosstat, R&F Department estimates.

The combination of supply- and demand-side shocks stemming from coronavirus-related restrictions gave rise to the following consumer price trends. When the most severe restrictions were in place, many groups of consumer goods and services which suffered a heavy fall in demand saw a price rise slowdown rather than a price decline. The subsequent recovery of consumer demand produced a price increase acceleration in the relevant goods and services (Figure 7). In some cases, the pace of price rises exceeded that at the start of this year. Amid a dramatic gain in costs in the face of rouble weakening and massive negative implications of the pandemic in general, producers enjoy the opportunity to pass through a significant portion of costs to consumer prices as soon as demand starts to recover. Consequently, given a gradual recovery of household income and rising demand, disinflationary pressure may prove to be smaller in scale than assumed earlier. But a

⁴ Estimates only cover the components whose prices are monitored on a weekly basis.

deterioration of the epidemiological situation may require a partial reinstatement of restrictions, which may scale up disinflationary risks in the economy.

Figure 7. Change of incoming payments in BR PS⁵, % YoY, and the rate of price rises, % MoM SA



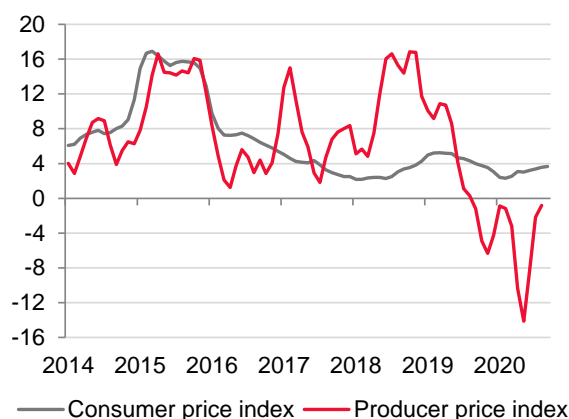
1.2. Producer price decline slowing

- A producer price decline slowed to 0.8% YoY in August from 2.2% YoY in July (Figure 8). The rebound of producer prices to last year's level is chiefly owed to a price decline slowdown in the oil extraction and petroleum refining sectors (Figure 9).
- Manufacturing producer prices moved to growth for the first time since August 2019, adding 1.1% YoY. Price rises were above all driven by industries manufacturing *consumer goods*, up 4.9% YoY (Figure 10). The manufacture of food products (up 2.9% pp), which may have been owed to, among other things, a rise in producer costs amid rouble weakening contributed the most to it.
- On top of the price rise acceleration in the manufacture of food products, price increases gained pace notably in other consumer goods segments: the manufacture of wearing apparel and other fabricated products. As consumption recovered, coming close to the "pre-coronavirus" level, producers enjoyed the opportunity to pass through a significant part of the cost increases to prices.

⁵ BR PS – the Bank of Russia Payment System. For details, see [Monitoring of industry-specific financial flows](#).

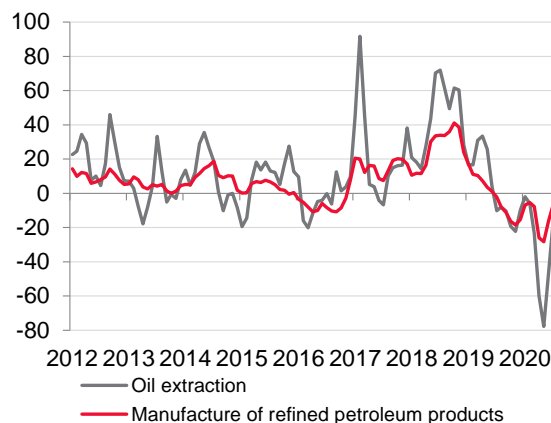
- Also noteworthy is that a rise in the producer prices of *investment goods* is slowing due to a more moderate recovery of investment demand than that of consumer demand. July–August saw prices decline in the manufacture of railway locomotives and rolling stock, which restrained an upward price movement in the investment goods segment. The key pro-inflationary impact has in the last few months come from the manufacture of motor vehicles, trailers and semi-trailers.⁶
- Movements in the producer prices of *intermediate goods* to a great extent depends on changes in the producer prices of coke and refined petroleum products, which are affected by price conditions in the oil market: the global oil price slump in March–April largely rebounded in August.
- The index of producer prices for similar categories of some consumer goods⁷ weighted using the structure of household consumer expenditure for CPI calculation accelerated its climb to 2.3% YoY in August from 0.6% YoY in July (Figure 11). The strengthening of the pro-inflationary impact of rouble weakening had a notable effect on producer prices in August. Nevertheless, bearing in mind the slow recovery of income to the “pre-coronavirus” levels, we believe that a further rebound of consumer activity to a more moderate trajectory after pent-up demand has been satisfied, will bring along moderate margins for producers. As a result, the upward pressure of producer prices on consumer prices will be generally more restrained.

Figure 8. Change in the producer price index and consumer price index, % YoY



Source: Rosstat.

Figure 9. Producer price index in oil extraction and petroleum refining, % YoY

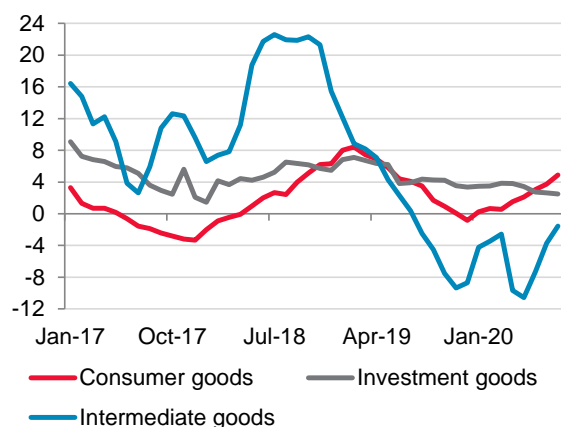


Source: Rosstat.

⁶ Rosstat does not publish weights for calculating the PPI for small categories of foreign economic activity, therefore the manufacture of some categories of consumer goods (for example, passenger cars and household appliances) is accounted for in broader aggregated components which are included in the segment of investment goods.

⁷ Unlike the previous calculation, instead of aggregation by activity type, we used aggregation by comparable goods in the CPI and PPI structure: meat products, fish products, butter and fats, dairy products, pasta, sugar, tea, coffee, wearing apparel, detergents and cleaning solutions, perfumery and cosmetic products, household electronic appliances, and furniture. They account for about 30% of the consumer basket.

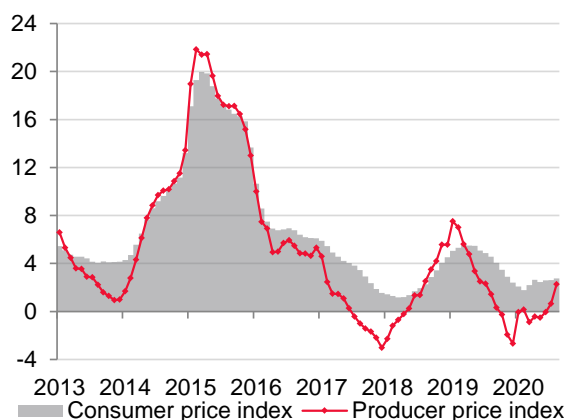
Figure 10. Change in producer prices by groups of industries in manufacturing, % r/r



Note: The weight of consumer, investment and intermediate goods account for 14.2%, 19.1% 30.5% respectively of the PPI.

Source: Rosstat, R&F Department estimates.

Figure 11. Change in prices of some comparable goods in the CPI and PPI structure, % YoY

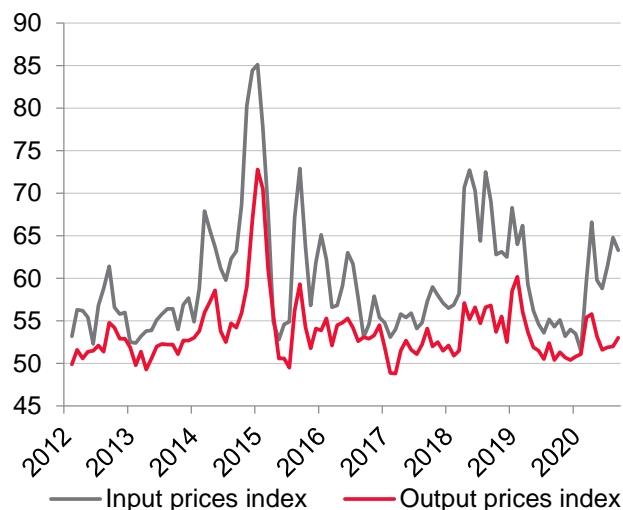


Note: Under Rosstat methodology, the calculation of the producer price indicator excludes VAT, and therefore, does not factor in the impact of the January 2019 VAT hike on producer prices

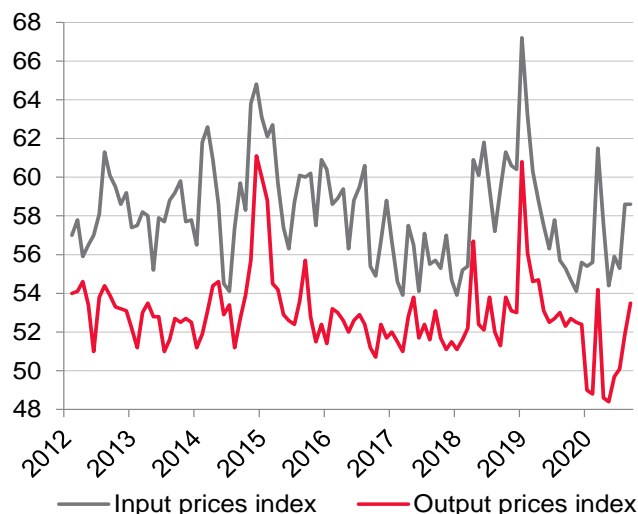
Source: Rosstat, R&F Department estimates.

1.3. PMI price indices in September: inflationary pressure mounting

- Inflationary pressure is mounting in the economy as economic activity recovers, allowing companies to pass through a part of cost rises to output prices. As the rouble weakened, PMI price indexes continued to go up in September, affecting manufacturing and services alike (Figure 12, Figure 13).
- The input price indexes remained elevated for the second consecutive month. The respondents cited price hikes by suppliers and rouble weakening as the key factors of cost increases.
- The output price indexes provide further evidence that the mounting of inflationary pressure on the back of supply-side shocks may occur even when the activity in many sectors is still below the “pre-coronavirus” level, i.e., in a situation of a negative output gap (see also Subsection 1.1, Figure 7).

Figure 12. Change in PMI manufacturing indexes, pp

Source: IHS Markit.

Figure 13. Change in PMI services indexes, pp

Source: IHS Markit.

2. Economic performance

It appears from real-time data that the Russian economy's recovery lost pace in September, largely owing to the completion of the active phase of demand recovery for consumer goods amid slow and uneven recovery in exporting and investment goods industries.

Borrowing activity has intensified in recent months in the corporate and retail segments alike, thanks to, among other things, loose monetary policy, regulatory easing, and government support measures. This has created additional demand in the economy, helping its faster recovery.

The negative output gap is gradually narrowing in the Russian economy. The fast recovery of consumer demand has allowed a faster output gap contraction in consumer industries, although a number of consumer services industries remain far below the "pre-coronavirus" level. However, the share of these services in consumption is small. As a result, the disinflationary impact of the output gap on the CPI may turn out to be weaker than in the case of an equally massive "uniform" downturn in the Russian economy.

This is indirectly borne out by the labour market: a relatively minor gain in unemployment (including hidden unemployment), an increase in the employment headcount and a fast resumption of real wage growth after a short decline. All in all, this restrains disinflationary risks arising from the economic downturn.

At the same time, the acceleration of the coronavirus spread in Russia and across the world, with pent-up consumer demand gradually running its course, may take a toll on external and domestic consumer demand, in particular, disrupting the recovery of the

consumer services sector. As a result, the impact of disinflationary factors may intensify somewhat.

2.1. Russia's Q2 GDP contracted less than in most other countries

- GDP contraction was more moderate than in most countries at 8% YoY in the second quarter.
- The deepest value added fall was expectedly posted in the services sector, hit the hardest by coronavirus-related restrictions. That said, a small size of consumer services industries limited their input to the overall GDP fall compared with many OECD countries.
- Among GDP components by end use, household consumption expectedly contributed the most to the decline, partially offset by a comparable contraction in imports, including those of consumer goods and services.

Rosstat has revised down its preliminary estimate of Russia's Q2 GDP contraction from -8.5% YoY to -8.0% YoY.⁸ This is in line with earlier Bank of Russia real-time estimates of GDP performance based on high-frequency indicators of business activity during the second quarter. A quarterly seasonally adjusted decline equalled -9.2% QoQ after a 0.4% QoQ rise in the first quarter. The first half of the year saw the Russian economy contract 3.4% YoY. Based on preliminary estimates, the Q2 GDP fall was less steep than in most countries (Figure 14).

The adjustment of GDP performance in the second quarter may stem from a less severe fall in the industries of the services sector than captured by the preliminary August estimate.⁹ That said, a value added fall of 9.3% YoY in industry, including mining and quarrying (down 12.8% YoY), amid a decline in global demand for energy resources, was deeper than output contraction.¹⁰

The second quarter's deepest value added plunge was expectedly posted in the services sector, which was hit the hardest by restrictions, in particular, in the hotel and restaurant business (down 56.9% YoY, culture and sports (a decline of 28.0% YoY), and other personal services (a 28.6% YoY fall). That said, because of a small size of Russia's consumer services sector, its contribution to GDP contraction was relatively modest at less than 2 percentage points. Real-time statistics indicate a significant recovery of the services sector's activity after most restrictions have been lifted.

Value added contraction was less significant in trade, down 12.7% YoY, whose input to Q2 GDP contraction stood at 1.9%. According to our estimate, output performance in

⁸ Companies' primary statistical reports were updated and additional data obtained from the Bank of Russia.

⁹ [Rosstat has released preliminary Q2 2020 GDP estimate](#) / Rosstat 11.08.2020.

¹⁰ Gross value added is calculated as the difference between goods and services output and intermediate consumption.

industries meeting consumer demand accounts for almost half of the year-on-year GDP contraction. GDP by end use bears this out. The largest negative contribution came from a 22.2% YoY fall in household consumption in the face of restrictions put in place. This was, however, partially offset by a sizable 22.2% YoY plunge in imports, including those of consumer goods and services.

Two industries which posted growth in the second quarter were the agricultural sector, where coronavirus-related restrictions had a notably less significant negative effect (up 0.4% YoY), and the financial sector, helped by continued lending expansion (up 6.1% YoY). Thanks to regulatory easing by the Bank of Russia along with a large-scale subsidised mortgage lending programme and the development of online banking services, the financial sector was able to maintain its positive growth rates, in contrast to the 2015 crisis, when the sector posted contraction at an average pace of 6.5% YoY throughout four quarters.

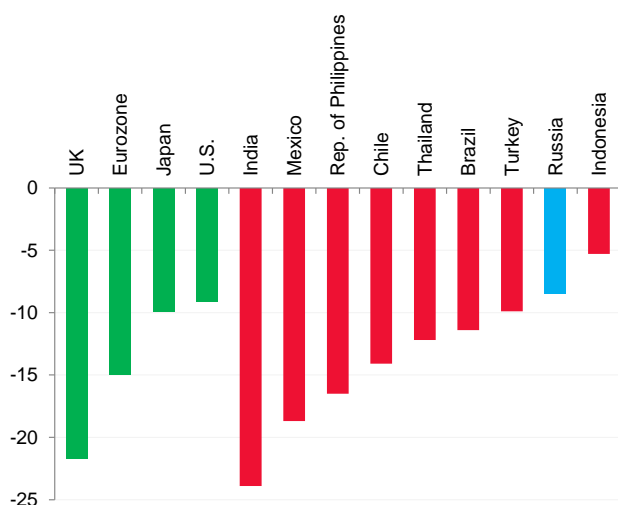
The performance of core industries' output (Core Industries Index, CII¹¹), which posted a 7.7% YoY fall in the second quarter was similar to that of overall economic activity. The recovery of core industries' output continued in August, but at a slower pace than in July, with production falling 4.6% YoY in August versus a drop of 4.8% YoY a month earlier (Figure 16). Core industries' overall output declined 4.7% YoY for July–August (Figure 18). Together with real-time indicators of economic activity for September (see Subsection 2.2.), this gives reason to expect a substantial quarter-on-quarter and year-on-year improvement in GDP performance in the third quarter.

According to estimates factoring in real-time Q3 indicators, economic growth may come in at about 4-5% QoQ in seasonally adjusted terms. Household consumption, buoyed by fiscal measures in place, the realisation of demand pent up as coronavirus-related restrictions were enforced, and the beginning gradual recovery of household income, will be the key drivers of recovery.

Overall, economic recovery was somewhat faster than expected in the third quarter, having received an additional short-term impetus in the first months after restrictions were lifted.

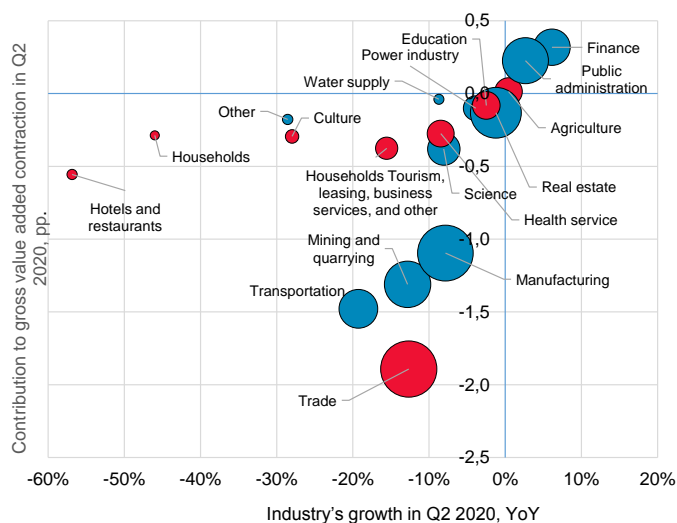
¹¹ The core industries index (CII) is calculated by aggregating seven industry-specific indexes (agricultural production; mining and quarrying output; manufacturing output; freight traffic; wholesale and retail sales, electricity, gas and water supply, with weights corresponding to the respective industry's share in Russia's gross value added in 2018. The composition of the core industries index calculated by the R&F Department is similar to that used by Rosstat in calculating the index of goods and services output in physical terms for core types of economic activity, with the exception of passenger transportation. Unlike the Rosstat index, the methodology of constructing the CII allows decomposition by economic activity type and enables the core industries index to be calculated on the level of Russian Federation subjects for real-time monitoring of the economic situation in individual regions.

Figure 14. Q2 2020 GDP in select countries, % YoY



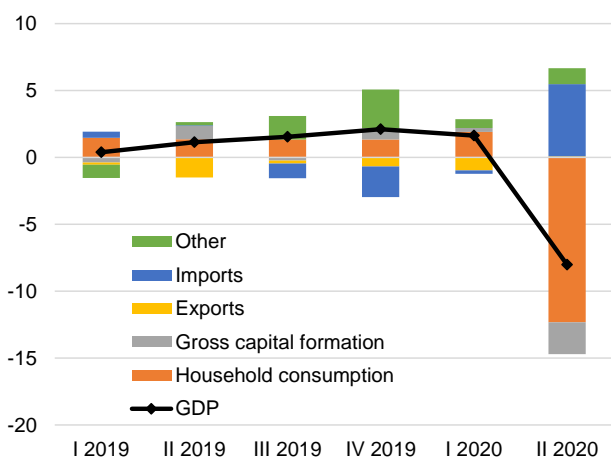
Source: Bloomberg Finance L.P.

Figure 15. Industries' performance and contribution to gross value added contraction in Q2 2020, %



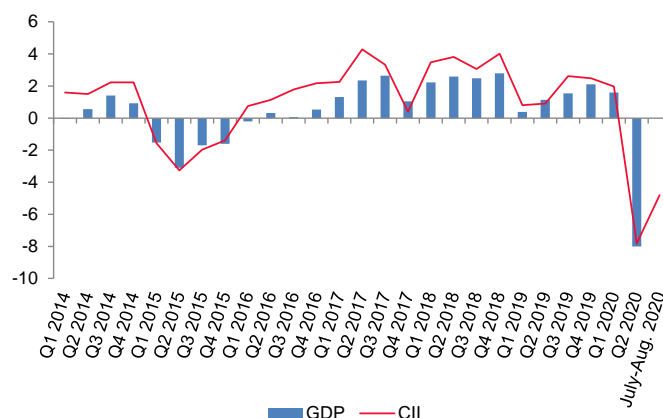
Source: Bloomberg Finance L.P.

Figure 16. Decomposition of GDP by end use, % YoY



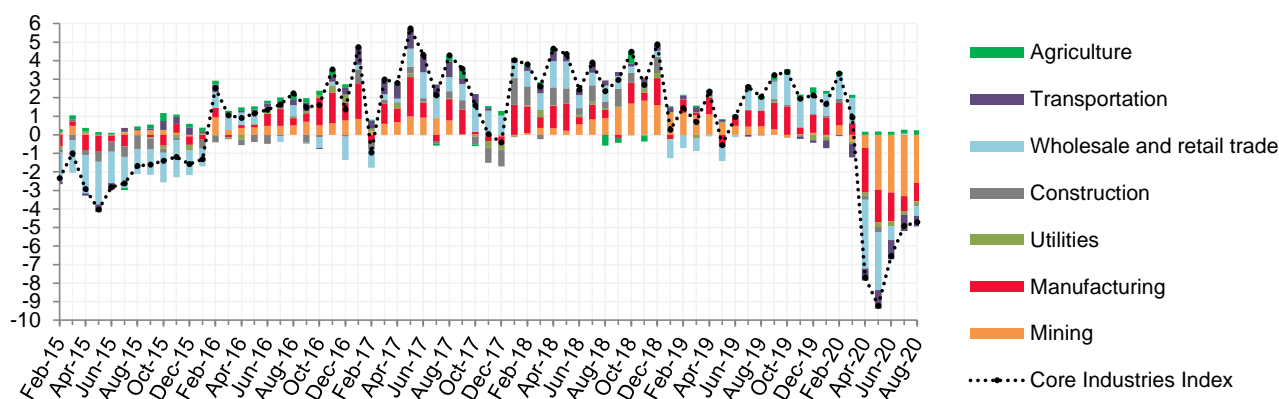
Source: Rosstat, R&F Department.

Figure 17. Quarterly index of GDP in physical terms and CII, % YoY



Source: Rosstat, R&F Department.

Figure 18. Contribution of industries to the CII in 2015–2020, % YoY



Source: Rosstat, R&F Department.

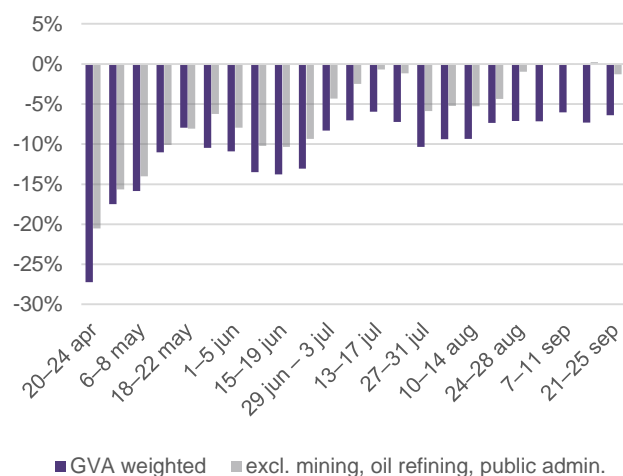
2.2. Economic activity stabilisation in September

- Real-time indicators show that economic activity generally stabilised on the August level in September, posting uneven results in individual sectors and industries. The four-week rolling average deviation of [incoming financial flows](#) from the “normal” level hovered around the -7% mark from the end of August through the end of September (Figure 19).
- September showed signs of a gradual consumer activity decline from the elevated levels of the summer months. The four-week rolling average deviation of incoming financial flows from the “normal” level in industries meeting consumer demand dropped from +6% at the end of August to 2.5% at end-September (Figure 20). This was driven mainly by a fall in demand for goods, whereas the indicator of activity in the consumer services market stabilised on the August level in September amid clear signs of business activity stabilisation in this market segment (Figure 22). Other real-time indicators of consumer activity show similar trends (Figure 21).
- A slight correction of the consumer demand trend in September was above all due to the gradual petering out of deferred demand and the effect of fiscal support measures. Moreover, despite a partial recovery of household income in the summer months, it was most probably still below the pre-coronavirus level.
- Indirect indicators of operating activities suggest that recovery continued in September but was uneven and mainly concentrated in mining and quarrying. Indeed, electricity consumption, an indicator of activity in power-intensive industries, stayed at the 97–99% of last year’s level in September versus 96–97% in July–August (Figure 23). The PMI output index for manufacturing declined to 53.6 in September from 54.6 in August, signalling a growth slowdown in the segment.
- Investment demand was recovering in September. The four-week rolling downward deviation of incoming financial flows from the “normal” level in industries meeting investment demand gradually decreased throughout September (Figure 20). That said,

September saw growth in the railway traffic of construction goods, which remained in positive territory as long as five months in succession. This indirectly indicates growth in the construction sector.

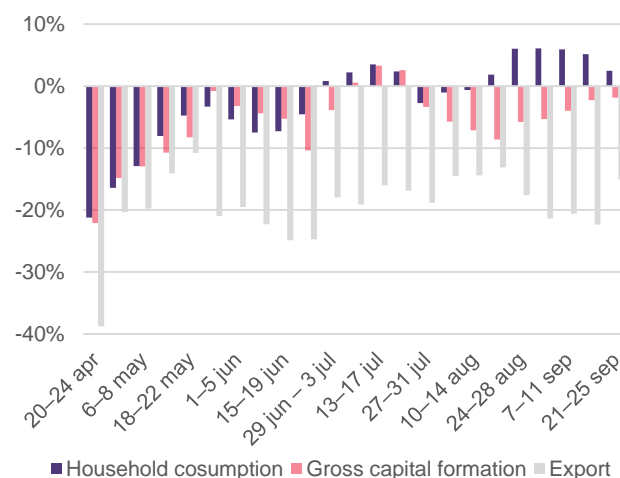
- The worsening of the epidemiological situation is a risk factor for further economic activity development. New coronavirus contagions have started to pick up rapidly in Russia and across the world. The prevention of the coronavirus spread may require a partial reinstatement of restrictions. But even if this kind of scenario materialises, these measures are expected to be less stringent than in the first wave of the pandemic, because the health care system has amassed the relevant experience and is generally better prepared for operation in the pandemic environment.
- Therefore, possible negative implications for the economy of the hypothetical new toughening of new restrictions seeking to combat the pandemic will be much milder than in April–May. Meanwhile, the continuing elevated uncertainty over the pandemic already acts as one factor restraining the Russian economy’s recovery after passing a trough of the downturn in the second quarter.

Figure 19. Four-week rolling average deviation of incoming payments from “normal” level



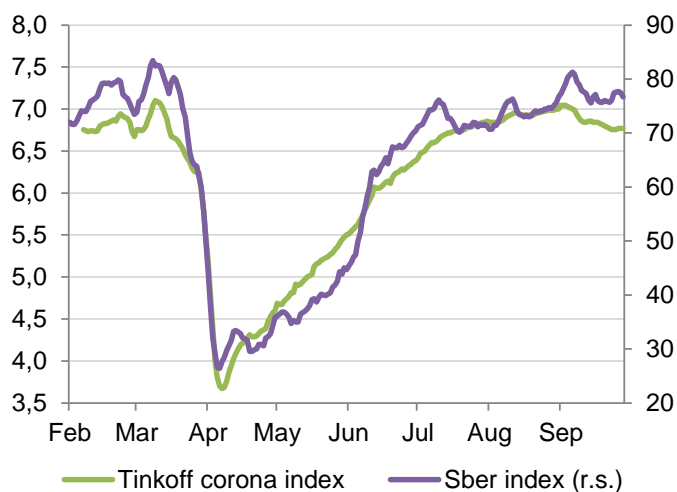
Source: Bank of Russia ([Monitoring of financial flows](#)).

Figure 20. Four-week rolling average of incoming payments from “normal” level by industry group



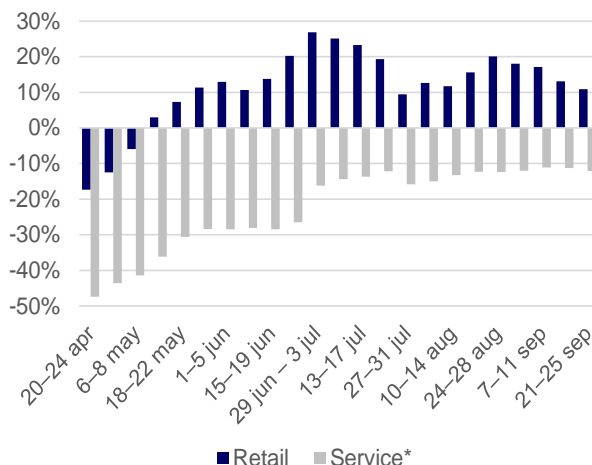
Source: Bank of Russia ([Monitoring of financial flows](#)).

Figure 21. Consumer activity Sberindex and Tinkoff Corona Index (7-days moving average)



Source: Sberbank, Tinkoff Bank.

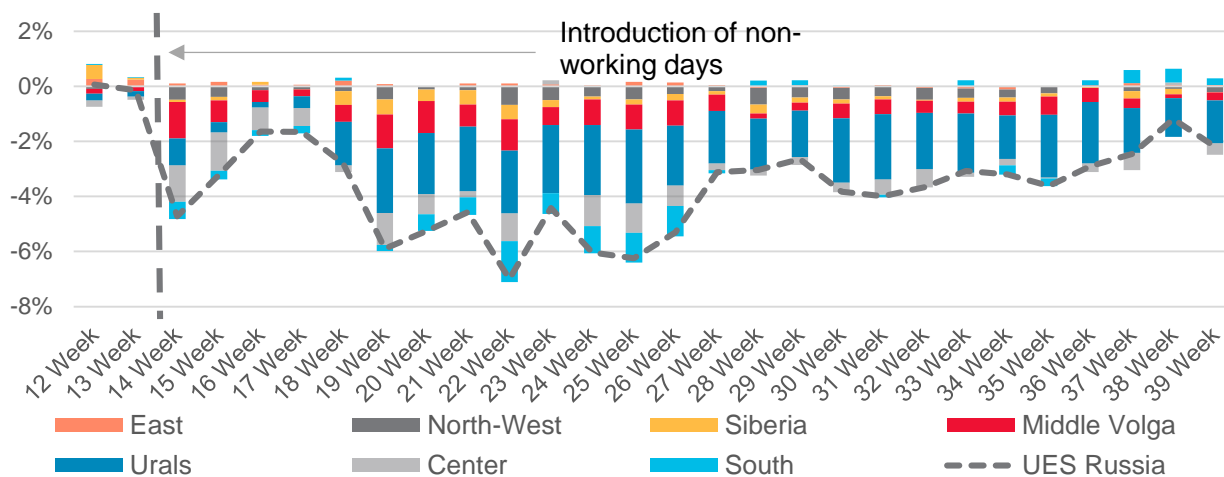
Figure 22. Four-week rolling average deviation of incoming payments from “normal” level by industry group



Average deviation for four activity types: Repair of computers and personal and household goods; Other personal service activities; Short-stay accommodation activities; Food and beverage service activities.

Source: Bank of Russia ([Monitoring of industry-specific financial flows](#)).

Figure 23. Contribution of regional energy systems to deviation of electricity consumption adjusted for temperature and calendar factors, % YoY



Source: System operator of United Energy System, R&F Department estimates.

2.3. Completion of recovery-induced growth phase in most of manufacturing industries in August

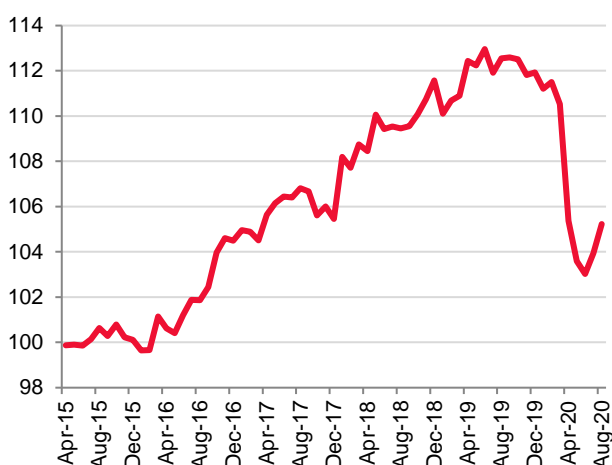
- Industrial output contraction slowed in August to -7.2% YoY from -8.0% YoY in July. Seasonally adjusted output continued to grow, but growth was uneven across groups of industries.

- Growth was driven by the recovery of mining, helped above all by an oil extraction gain owing to the planned raise of the production quota in compliance with the OPEC+ agreement.
- The manufacturing sector posted an output stabilisation in August thanks to the completion of the recovery-induced growth phase in most of the industries.
- The output of durable consumer goods was dragged down by a fall in the production of passenger cars as a result of planned vacation shutdowns of production facilities and postponed launch of new product lines. Investment goods enjoyed an output expansion.

A year-on-year decline in industrial output continued in August, with production falling 7.2% YoY after an 8% YoY contraction in July. Meanwhile, seasonally adjusted month-on-month growth accelerated to 1.2% MoM in August from 0.9% MoM in July (Figure 24), assuming that 24 June and 1 July were full-scale days off. If they are not regarded as such, the August estimate is upgraded to 1.5% MoM SA. A part of non-continuous cycle facilities probably kept working on those days but it is difficult to assess the percentage of those.

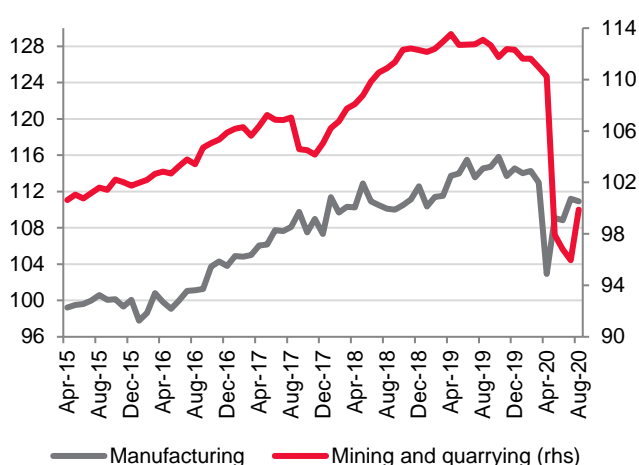
A year-on-year contraction expectedly slowed in mining and quarrying: its output fell 11.8% YoY in August versus a 15.1% YoY decline in July. Manufacturing output, by contrast, widened the gap with last year's level, contracting 4.1% YoY in August compared with a fall of 3.3% YoY in July. This decline can be attributed to a calendar effect. Net of the calendar factor, the decline estimate would have equalled 3.2% YoY.

Figure 24. Change in industrial production index (2014 = 100)



Source: Rosstat, R&F Department estimates.

Figure 25. Change in mining and quarrying and manufacturing indexes (2014 = 100)



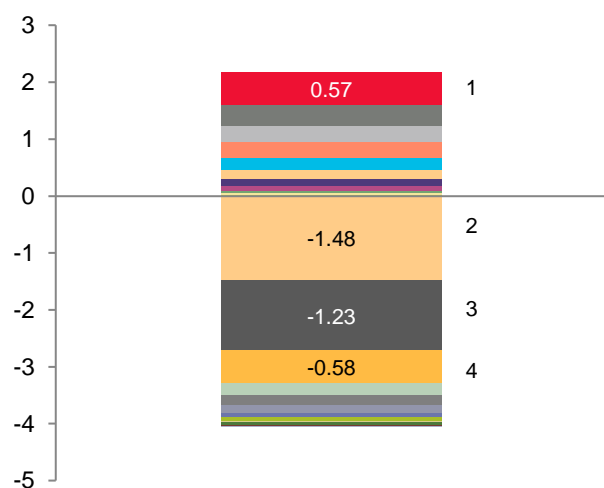
Source: Rosstat, R&F Department estimates.

The output expansion in August was above all fuelled by a 4.1% MoM SA extraction rise in mining and quarrying. This was expected: the extraction of oil and gas condensate expanded 8.7% MoM SA in August, driven by the planned easing of the terms and conditions of the OPEC+ agreement. Following a gain in extraction, the output of mining support service activities also started to increase, up 12.6% MoM SA (Figure 27). Nevertheless, mining and

quarrying output is still far below the “pre-coronavirus” level, as evidenced by electricity consumption in oil producing regions and still substantially reduced incoming financial flows in mining and quarrying.

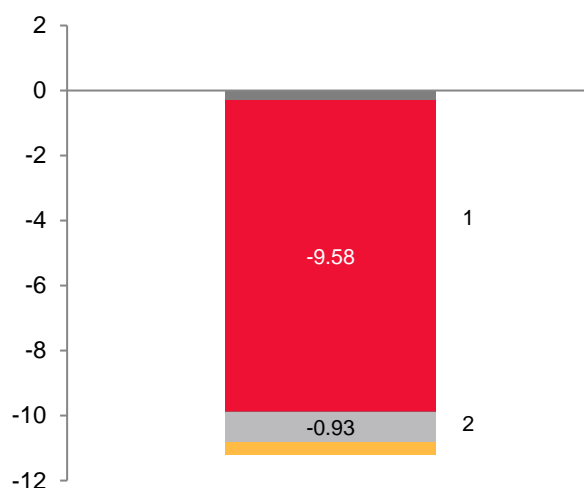
Manufacturing output stabilised at the July level in August,¹² providing evidence that the phase of recovery-generated growth is over in most industries. Output performance, however, varied across industries. The group of industries meeting *intermediate* demand weighed down on growth. After an output expansion in June–July, the manufacture of metals (Figure 26) suffered an output drop of 2.2% MoM SA, with the output of basic precious and other non-ferrous metals and nuclear fuel dropping 4.1% MoM SA. Another negative factor was the correction of output in the manufacture of wood and wood products, down 5.1% MoM SA, after July’s output far exceeded the level of the start of the year. Industries meeting intermediate demand were supported by the manufacture of refined petroleum products. After the recovery of oil extraction and domestic demand, the industry’s output continued to grow, but at a slower pace than in July, up 0.9% MoM SA.

Figure 26. Individual industries’ contribution to manufacturing growth, % YoY



- 1 – Food products
- 2 – Coke and refined petroleum products
- 3 – Basic metals
- 4 – Motor vehicles, trailers and semi-trailers

Figure 27. Individual industries’ contribution to mining and quarrying growth, % YoY



- 1 – Extraction of crude oil and natural gas
- 2 – Other mining and quarrying

Source: Rosstat, R&F Department estimates.

August saw the group of industries manufacturing *durable consumer goods* post a drop in the manufacture of motor vehicles. After output reached the February level in July, production contracted 7.1% MoM SA in August. The output of passenger cars fell 14.7% MoM SA in August after its growth in May–July, partly prompted by planned vacation shutdowns of production facilities. Another factor was the suspension of the planned launch of new car brands (Skoda, Nissan, Porsche). A number of other industries manufacturing durable consumer goods also suffered an output decline in August: the production of wearing

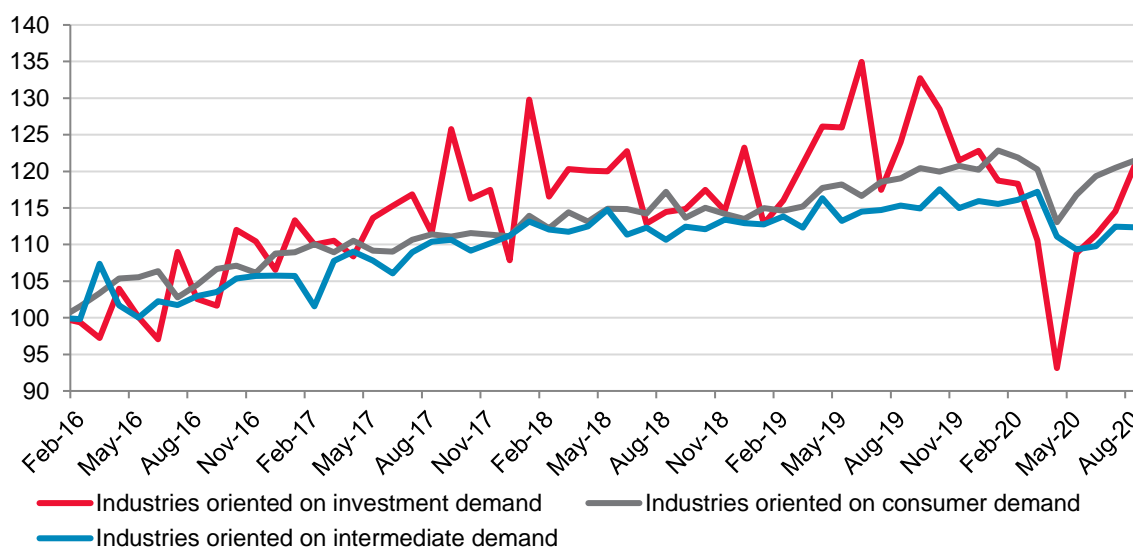
¹² Dropped 0.3% MoM SA, assuming that 24 June and 1 July were full-scale days off. If they are regarded as full-scale working days, manufacturing output rose 0.2% MoM SA.

apparel fell 4.8% MoM SA, the output of furniture contracted 2.8% MoM SA, the manufacture of leather saw an output decline of 0.5% MoM SA. The manufacture of domestic appliances maintained a positive trend, which helped exceed the “pre-coronavirus” production level in August.

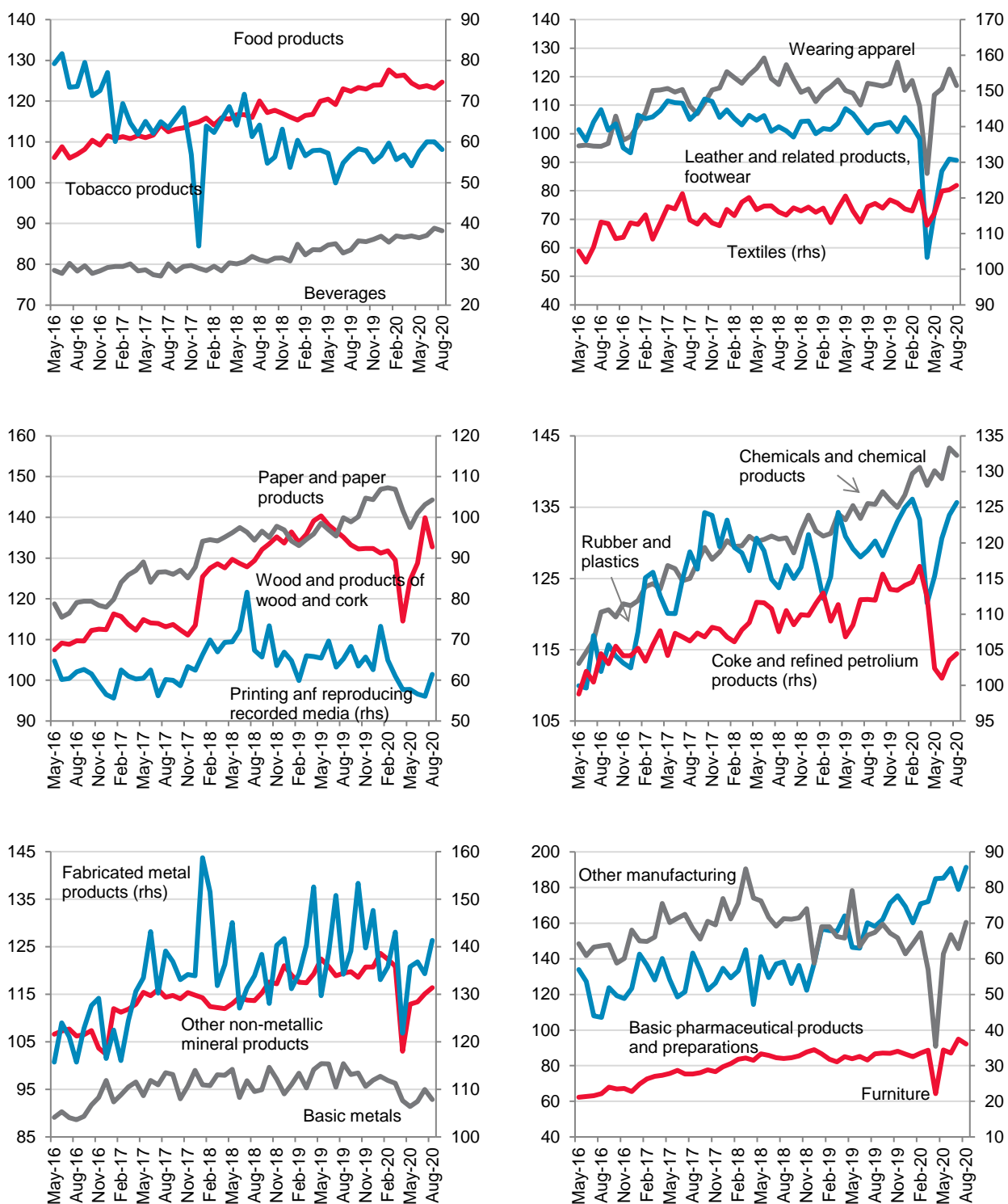
The manufacture of food products enjoyed an output expansion of 1.2% MoM SA in August after near-zero growth in the first half of the summer. This effect was partly achieved through an increase in the production of some product types after the sale in the first half of the summer of inventories built up earlier. Among growth leaders was the manufacture of cereals, up 3.2% MoM SA. The manufacture of meat products and dairy products, by contrast, posted a decline of 1.3% MoM SA and 2.3% MoM SA, respectively. Thanks to output growth in the manufacture of food products, the group of industries manufacturing *FMCG* made a positive contribution to manufacturing output in August. After a correction in July, the manufacture of pharmaceutical products again showed growth, up 7% MoM SA.

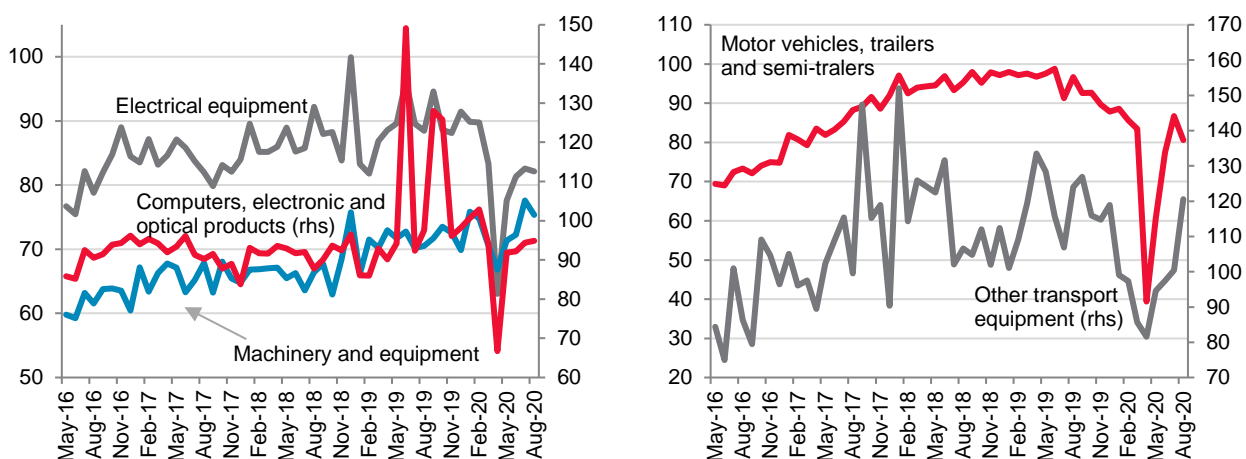
Industries producing *investment goods* contributed the most to manufacturing performance in August, driven by a rise in the output of other transport equipment, which expanded 20% MoM SA to reach the level of the end of last year. This industry, however, shows an elevated monthly volatility due to the effect of large one-off orders. In other machinery industries, extensive growth gave place to a stabilisation or marginal decline in output. Recovery continued in the manufacture of construction materials, up 1.1% MoM SA. Overall, adjusted for one-off effects, the pace of output recovery in industries meeting investment demand remains moderate. This is, in particular, borne out by real-time data on this group of industries’ incoming payments effected via the national payment system. The data is provided in the weekly [Monitoring of industry-specific financial flows](#).

Figure 28. Manufacturing output indexes, by industry group, January 2016=100%, seasonally adjusted



Source: Rosstat, R&F Department estimates.

Figure 29. Manufacturing industries' output, December 2012=100%, seasonally adjusted



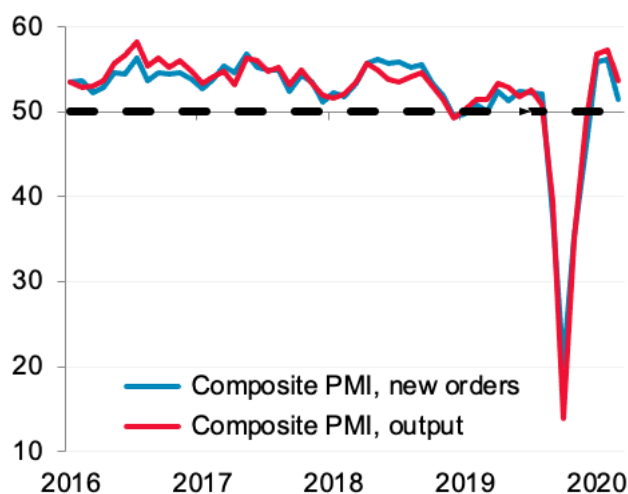
Source: Rosstat, R&F Department estimates.

2.4. PMI indexes in September: business activity recovery slowing

- The composite PMI index registered the weakening of economic activity recovery in September. Output growth slowed in services and manufacturing alike.
- New orders also showed signs of weakening, which is set to restrain output performance going forward. The relevant index shows a decline in new orders in manufacturing and a dramatic growth slowdown in services. Export orders continued to decline at a fast pace in both sectors at a fast pace.
- The availability of idle capacities coupled with the decline in new orders prompted a resumption of employment contraction at the respondent companies after its stabilisation in August.

The composite output PMI for September indicates a slowdown in the recovery of economic activity: growth weakened in both services and manufacturing. The composite index dropped to 53.7 from 57.3 (Figure 30).

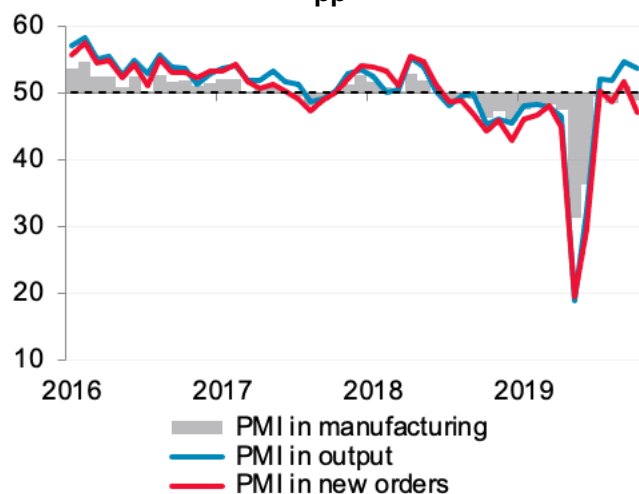
The manufacturing PMI fell from 51.1 to 48.9 in September, showing a minor business activity contraction (Figure 31).

Figure 30. Change in composite PMI indexes for Russia, pp

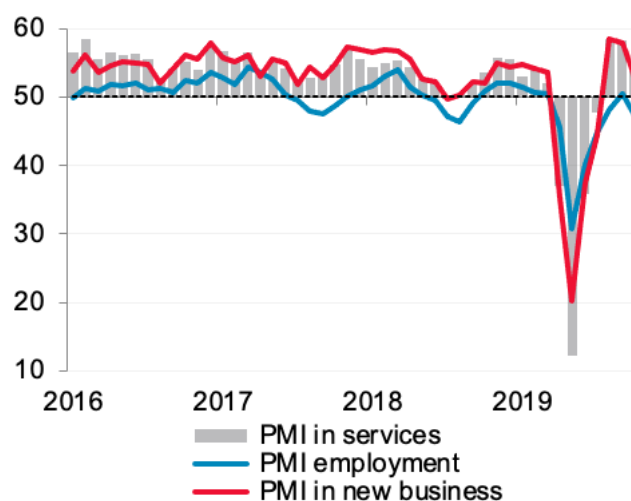
Source: IHS Markit.

September's business activity fall was driven by a notable contraction in new orders on the back of depressed demand and the loss of some customers (47.1 after 51.7 in August). External demand weakened at a faster pace: the new export orders index tumbled from 48.8 to 43.8.

Meanwhile, as a month earlier, the respondents reported an output rise in September, albeit slower than in August (54.6 versus 55.6). In manufacturers' view, the easing of coronavirus-related restrictions continues to have a positive effect on output performance. However, the contraction in new orders may contain further output recovery. Output growth failed to prevent an employment decline in manufacturing industries, which accelerated notably to 45.6 from 48.6 (Figure 33), with the new orders contraction and sufficient production capacity playing a role. The output expansion did not affect purchasing activities: companies were reducing inventories of raw materials and supplies built up earlier (43.3) and purchasing quantity (48.3). This may be owed to, among other things, difficulties in dealing with suppliers on the back of logistical problems and shortages of raw materials aggravated by the pandemic.

Figure 31. Change in PMI manufacturing indexes, pp

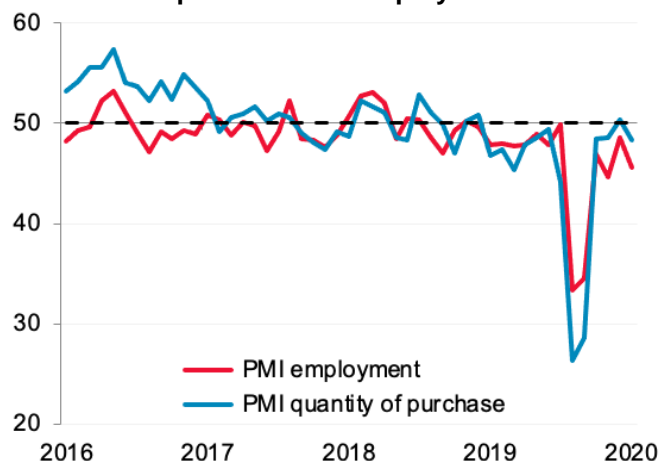
Source: IHS Markit.

Figure 32. Change in PMI services indexes, pp

Source: IHS Markit.

As in August, business expectations regarding future output worsened in September to 62.9 from 64.3. Formally, the level of optimism shown by the August surveys remains high, buoyed by expectations of the full-scale lifting of restrictions and the launch of new products. But the uncertainty over further development of the situation with the pandemic as well as contagion outbreaks in a number of Russia's large regions may have a negative effect on the relevant subindex in October.

The services PMI posted a slower business activity expansion in September, plunging from 58.2 to 53.7 (Figure 32), with the quarterly average staying on the highest level since the start of 2017. A new orders expansion slowed together with that in completed orders: the relevant index declined from 57.8 to 53. The rise in orders was buoyed by domestic demand, since export orders were falling for the seventh consecutive month (46.8), with the slide accelerating in September, just as in manufacturing.

Figure 33. Manufacturing PMI indexes for quantity of purchase and employment

Source: IHS Markit.

Figure 34. PMI for business expectations

Source: IHS Markit.

Employment in the services sector once again fell in September (47.4), dragged down by surplus capacities. Meanwhile, the number of uncompleted orders continued to decline in September (48 versus 48.2 in August). Business expectations worsened due to uncertainty regarding the duration of economic recovery.

2.5. Retail sales recovery came to a halt in August

- The active phase of realisation of pent-up household demand ran its course in August. A month-on-month gain in retail sales came to a stop, with a year-on-year sales decline accelerating to 2.7%.
- An increase in expenditure for goods posted during the self-isolation period and immediately afterwards, has weakened, with the expenditure structure showing signs of normalisation. That said, consumption continued to recover in non-food retail, down 1.2% YoY, while a decline in food expenditure accelerated to -4.2% YoY.
- The strongest improvement was recorded in the services sector, where a sales contraction slowed to 18.8% YoY.
- A rise in new coronavirus contagions is a factor of risk for consumer expenditure performance going forward. Should restrictions be partially reinstated, the consumer services sector, where activity is far below the pre-coronavirus level, will once again be hit the worst.

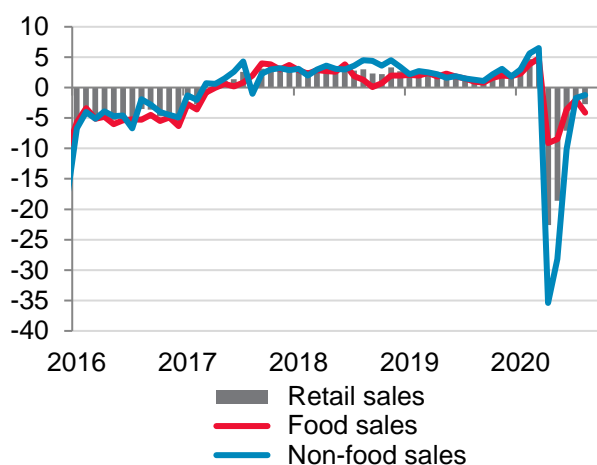
The active phase of deferred household demand realisation came to a stop in August, with the recovery of retail sales running its course – 0.0% MoM SA¹³ after a rise of 5.3% MoM SA in July and 14.7% MoM SA in June. A year-one-year decline in retail sales accelerated to -2.7% (Figure 35).

Based on quarterly surveys of small and medium-sized enterprises and organisations, as well as the respondents' revisions to data provided earlier, Rosstat has adjusted retrospective retail sales estimates for April–June. The rates of year-on-year decline in each of the above four months were downgraded by about 1 pp in the non-food category, with food retail sales remaining all but unchanged (a 0.1 pp improvement). As a result, the retail sales decline came in 0.6 pp smaller than the initial estimates for June–April and 0.7 pp less in July at -1.9% YoY (-2.6% YoY originally).

An increase in expenditure for goods posted during the self-isolation period and immediately afterwards, weakened, with the expenditure structure showing signs of normalisation. August saw consumption continue to recover in non-food retail, down 1.2% YoY, whereas food retail showed a decline acceleration to -4.2% YoY from -2.0% in July. That said, the share of food expenditure dropped from a peak of 57.3% in April to 46.4% in August, a typical August level in recent years.

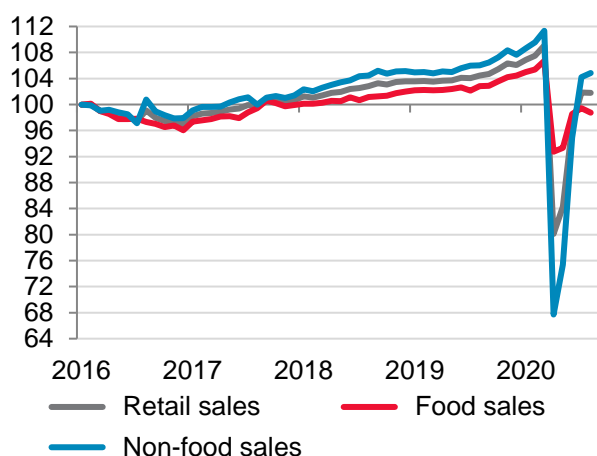
¹³ Here and further on, month-on-month growth rates are seasonally adjusted.

Figure 35. Change in retail sales of food and nonfood goods and retail sales turnover, % YoY



Source: Rosstat.

Figure 36. Retail sales (January 2016 = 100%, seasonally adjusted), %



Source: Rosstat, R&F Department estimates.

The sales of new passenger cars inched down 0.5% YoY in August on the back of logistical problems but returned to growth in September, rising 3.4% YoY.¹⁴ The faster demand recovery than that of output last summer brought down passenger car inventories: according to Rosstat data, output declined almost by a third YoY (-30.1% YoY) in August 2020, reducing car inventories by 68.7% YoY. As a result, some market participants pointed out that they faced local shortages of a number of brands whose production chains had not yet recovered. A sales improvement in September may have in part been driven by the realisation of demand pent up in August as the deliveries increased in the following month. An extensive car market recovery also continues in the used car segment of the car market. According to Russian Car Dealers Association data, used cars sales rose 10.5% YoY in August after a gain of 13.8% YoY in July. Despite demand improvement in recent months, market participants expect a dramatic decline in new car sales in the remaining months of the year: in the absence of serious constraints on economic activity, market participants forecast a 13.5% YoY sales contraction for the full-year 2020, with sales having declined 13.9% YoY in January–September.

August saw the strongest sales acceleration in the services sector, where the gap with last year's level narrowed to 18.8% YoY in August from 25.5% YoY in July, according to Rosstat data. Real-time data for September suggests that the services sector's activity may have stabilised at the August level in that month.

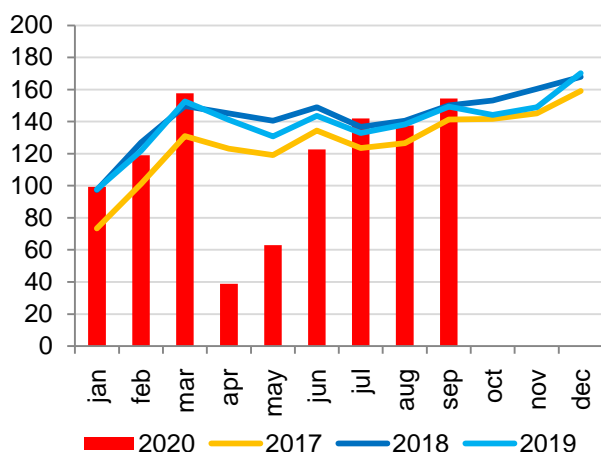
In addition to the deferred demand realisation and the effect of fiscal measures, strong consumption numbers in July–August stemmed from household income expansion as economic activity recovered. Personal income tax revenue swiftly changed from a decline to a year-on-year expansion in July–August. Survey data also indicates a gradual return of consumer and credit confidence to the January–February level.¹⁵ VTsIOM's September

¹⁴ [New car sales rose 3.4% in September 2020](#) / AEB 06.10.2020.

¹⁵ [Consumer and credit confidence indicators gradually returning to pre-crisis levels](#) / VTsIOM 14.09.2020.

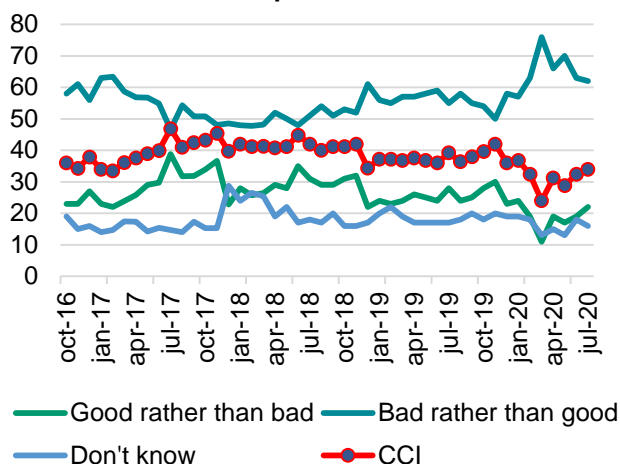
survey indicated that the share of households which believed it was a good time for major purchases increased 5 pp compared with June to 22% (Figure 38).

Figure 37. Sales of new passenger cars and light commercial vehicles, thousand units



Source: Association of European Businesses, R&F Department estimates.

Figure 38. Consumer confidence index “Is it a good time for major purchases?”, % of respondents



Source: VTsIOM.

The development of the epidemiological situation will be the key factor of risk for consumption performance. The prevention of new coronavirus contagions may require a partial reinstatement of restrictions. In this situation, the services sector, where activity remains far below the “pre-coronavirus” level, may bear the brunt of economic and consumer activity contraction.

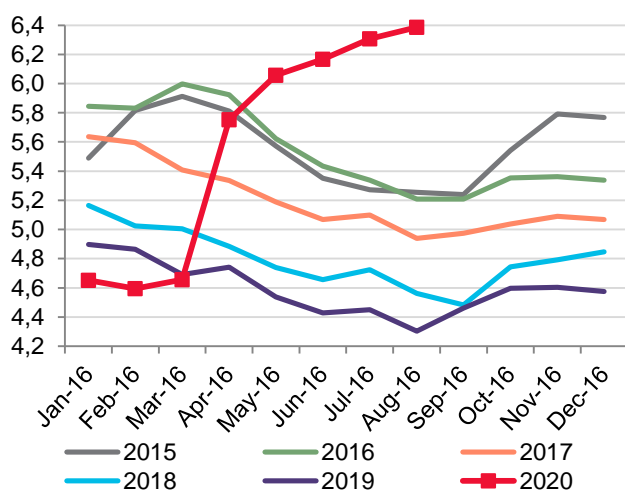
2.6. Labour market situation stabilizes gradually

- The unemployment rate rose to 6.4% (4.8 million people) in August, up almost 2 pp from the “pre-coronavirus” level, less than in most other countries.
- The pace of an increase in the number officially registered unemployed persons is slowing. A peak of this gain is expected to be passed in September, concurrently with the expiration of the unemployment benefits for families with underaged children.
- Broader measures of unemployment did not increase much more than the standard unemployment rate did. This suggests a moderate rise in hidden unemployment.
- Nominal and real wage growth accelerated to 5.7% YoY and 2.3% YoY, respectively, in July. Wage growth is posted primarily in the public sector.
- The current statistics suggest the absence of significant disinflationary risks from the labour market.

The unemployment rate rose to 6.4% in August from 6.3% in July and to 6.45% from 6.3% in seasonally adjusted terms (Figure 39, Figure 40). As a result, the unemployment rate increased almost 2 pp from the “pre-coronavirus” level, less than in most other countries. Meanwhile, the employment rate declined slightly less by about 1.5 pp, while real-time indicators point to a resumption of employment growth in September.

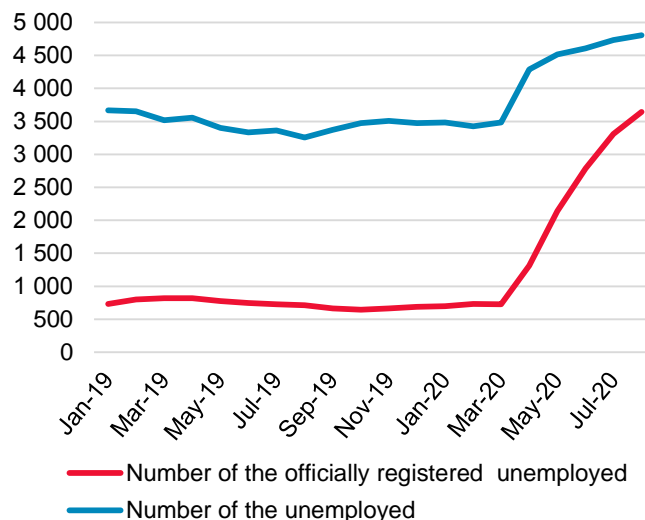
A rise in the number of registered unemployed persons is slowing: the unemployment headcount stood at 333 thousand in August, down from 524 thousand in July and 644 thousand in June. At the same time, a gain in registered unemployment so far continues to outpace that under the ILO definition (Figure 40). This indicates an increase in the number of people who did not have an official source of labour income at the time when the acute phase of the pandemic started and restrictions were imposed, only registering as unemployed in order to get hold of social benefits. According to RF Labour Ministry forecast, the number of officially registered unemployed people will hit a high in September, after the programme for the payment of benefits to households with underaged children (3 thousand roubles) has expired.

Figure 39. Unemployment rate, %



Source: Rosstat.

Figure 40. Number of the unemployed, thousand people



Source: Rosstat.

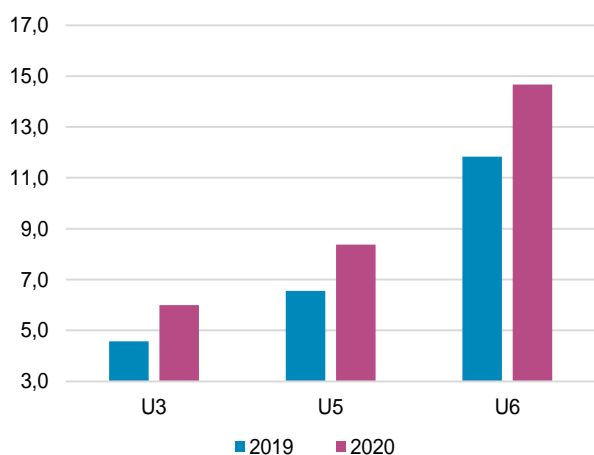
The second quarter accounted for the greater part of the rise in unemployment under the ILO definition. The broader measures of unemployment, U5 and U6,¹⁶ increased at an even faster rate in this period. This means that part of those who lost jobs, have stopped seeking employment and are no longer classified as part of economically active population, and part of them started working less than 30 hours a week. The number of people who are not looking for employment but are ready to start working, was rising during the second quarter. At the same time, the number of people working shorter hours reached a peak in April, when the “day-off” regime was in place (5.54 million people), declining subsequently (to

¹⁶ In addition to unemployed people, the unemployment measure U5 includes those who are not actively seeking employment but are ready to start working. U6 also includes employed people working shorter hours (less than 30 hours a week).

3.96 million people in June). As a result, the U5 measure went up 2.1 pp in June 2020 compared with June 2019, while the U6 indicator climbed 2.6 pp year-on-year (Figure 41).

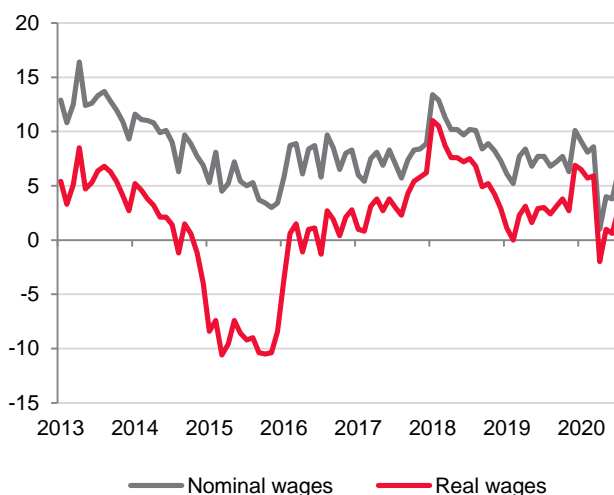
Nominal and real wage growth accelerated to 5.7% YoY and 2.3% YoY, respectively, in July (3.8% YoY and 0.6% YoY, respectively, in June) (Figure 42), providing a substantial support to the recovery of household income and consumer activity in the summer months. Meanwhile, wage growth is above all recorded in the public sector. The leading indicators suggest a continued acceleration in nominal wage growth in August–September: a rise in the revenue from personal income tax, whose key tax base is labour income, accelerated to 13–14% YoY (Figure 43). The current trend in wage and income at large therefore suggests the absence of significant disinflationary risks.

Figure 41. Unemployment rate U3 (ILO methodology), U5¹⁷ and U6¹⁸ in Q2 2020, %



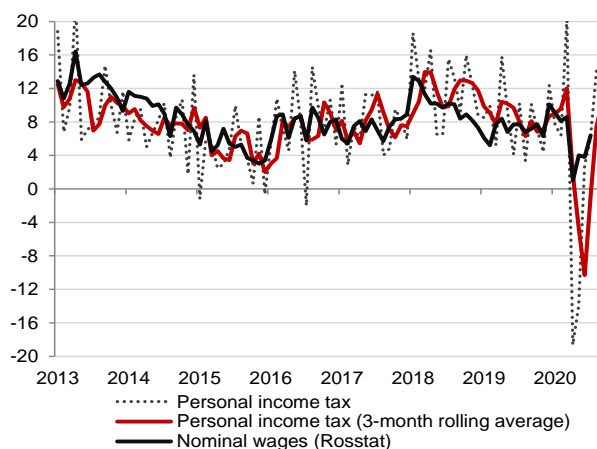
Source: Rosstat, R&F Department estimates.

Figure 42. Wage growth rate, % YoY



Source: Rosstat.

Figure 43. Nominal wage growth and personal income tax, % YoY



Source: Rosstat, RF Treasury, R&F Department estimates.

¹⁷ Includes unemployed population, potential labour force.

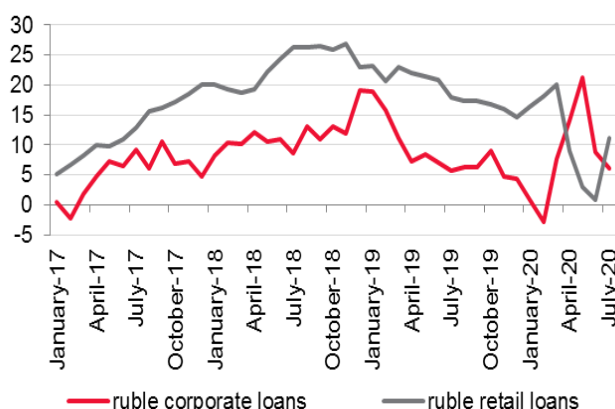
¹⁸ Includes unemployed population, potential labour force, and willing to work but not seeking employment and not prepared to start working, as well as those working less than 30 hours a week.

2.7. Banking sector in August: lending's positive response to monetary and fiscal stimuli

- The total amount of mortgage loans hit the highest level in the entire history of observations; their strong annual growth is set to continue in the coming months. An unsecured consumer lending expansion is gaining momentum, but a number of segments, in particular, auto lending, shows signs of weakening.
- A corporate lending¹⁹ rise continued to gain pace for both short-term and long-term loans, possibly signalling the recovery of investment demand.
- The quality of servicing unsecured consumer loans and auto loans worsened somewhat, while the mortgage lending segment enjoyed a stable situation, with no worsening posted in corporate loans.
- A total of additional provisions set aside by banks declined relative to previous months, along with restructuring requests. This may suggest that the period of identifying troubled loans will soon be over. Still, as regulatory easing is wound down, banks can be expected to build up additional provisions.
- Growth in various lending segments suggests the market's positive response to monetary and fiscal stimuli, which, in particular, helped avoid a lending downturn.

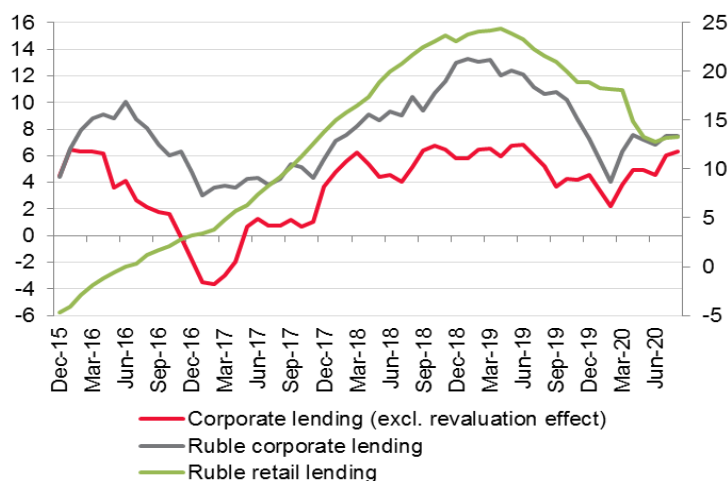
Retail lending growth accelerated in August from 1.3% MoM SA to 1.5% MoM SA, three-month annualized growth increased to 16.1% (Figure 44), the portfolio also continued to expand year on year (Figure 45).

Figure 44. Credit dynamics, three-month annualized average, %



Source: Bank of Russia.

Figure 45. Credit portfolio growth, % YoY

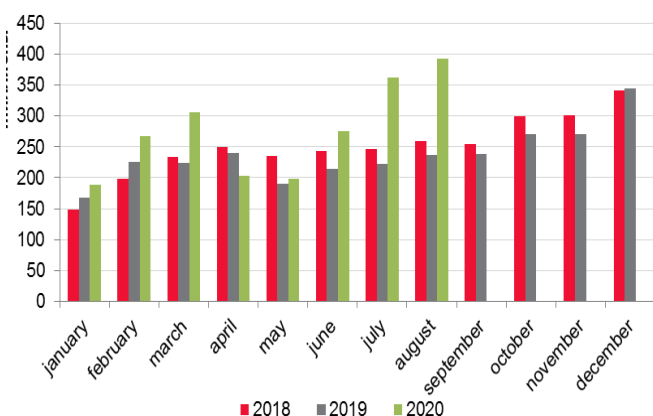


Source: Bank of Russia.

¹⁹ Loans to nonfinancial organisations and sole proprietorships.

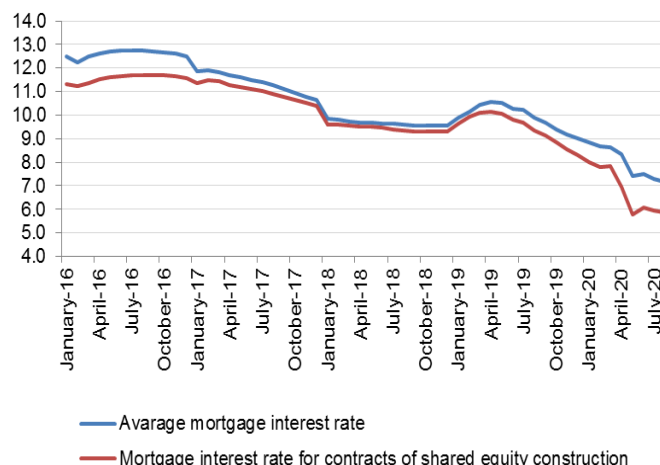
Retail lending was still buoyed by mortgage loans – a total of new loans rose by almost two thirds relative to August 2019. Loan debt expansion accelerated to 16.7% YoY (a rise of 15.8% YoY in July) and to 16.9% YoY with MBS²⁰ debt included (16.1% YoY in July). The key growth factor was the subsidised mortgage lending programme, which accounted for over 90% of loans in the new housing market. Also about 40% of new loans are those collateralised by claims on shared-equity construction contracts, whose total doubled relative to last year. The cuts of bank lending rates are another factor of mortgage lending growth. A sizable mortgage lending expansion does not, in our view, create significant risks for banks. The share of overdue loans is stable, which may be due to borrowers' fairly [high DSR²¹](#). Also, subsidised mortgage loans require a sizable down payment, thus reducing bank risks, while given the low interest rates do not increase borrowers' debt burden significantly.

Figure 46. Dynamics of new mortgage loans, billion rubles.



Source: Bank of Russia.

Figure 47. Mortgage interest rates, percentage points



Source: Bank of Russia.

Retail lending is also supported by the restoration of consumer sentiment: as of the end of August, [incoming financial flows climbed above the “normal” level](#) in industries meeting consumer demand. As a result, growth in unsecured consumer lending accelerated to 0.9% MoM SA from 0.5% MoM SA in July, three-month annualised growth reached 6.8%, with an increase on August 2019 coming to 9.5% YoY. According to [National Bureau of Credit Histories](#) data, loan demand is also supported by interest rate cuts and banks' marketing policies. Growth rates vary across segments: *on the one hand*, based on [United Credit Bureau](#) data, August saw an extensive recovery of general-purpose consumer loans in the cash loan segment, *on the other hand*, the recovery of [credit card](#) and [POS loan](#) issuance is weakening. The quality of servicing unsecured consumer loans has worsened somewhat in recent months: the share of loans overdue 90 days and more stood at 9.3% as of end-August (8.9% at the end of July, and 7.5% at the start of 2020).

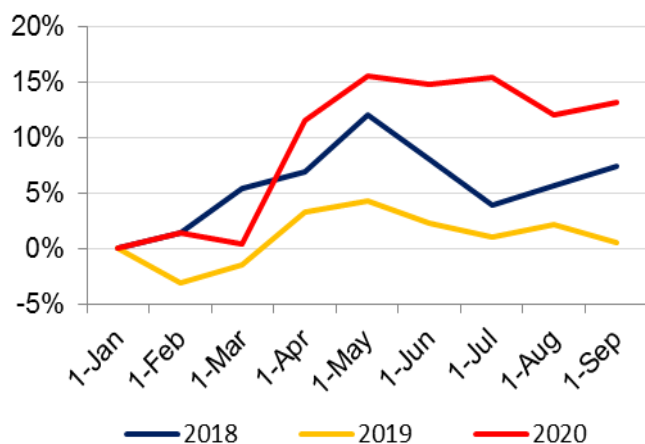
²⁰ Mortgage-backed securities.

²¹ Here and further on – a borrower's debt service ratio.

Auto loan slowed to 0.9% MoM SA, with three-month annualised growth standing at 17.03% and expansion relative to August 2019 at 9.2% YoY (9.5% YoY in July). [The loan issuance decline](#) may in part be due to the petering out of deferred demand for car brands whose production cycle was less disrupted by the pandemic.²² The share of auto loans overdue 90 days or more climbed to 7% (6.9% as of the start of August, 5.7% at the start of 2020). Nevertheless, borrowers' average DSR has risen in recent months, according to [National Bureau of Credit Histories](#) data.

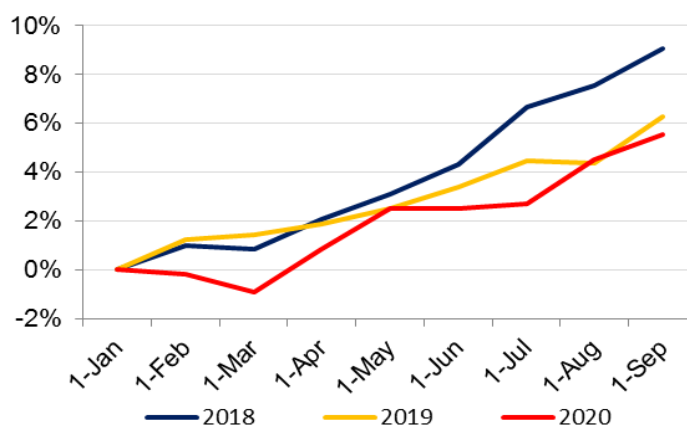
Corporate lending growth accelerated to 0.9% MoM SA in August from 0.7% MoM SA in July. Three-month annualised growth came in at 7.9%, in line with the PMI index posting the recovery of business activity. We saw growth in shorter-than-one-year loans (Figure 48), driven in part by lending under government programmes, as well as a rise in long- and medium-term loans (Figure 49). This gives reason to expect the recovery of investment demand, which is borne out by an improvement in [the relevant industries' incoming financial flows](#). A total of loans to financial and nonfinancial organisations expanded 9.4% YoY. The quality of servicing corporate loans remained generally stable in August: the share of nonperforming loans dropped to 8.1% from 8.2% in August, with the share of loans of the 4th–5th quality categories inching down to 10.9% from 11.0%.

Figure 48. Shorter than one-year loans to nonfinancial organizations, in rubles, % to the start of the year



Source: Bank of Russia.

Figure 49. Over-one-year-loans to nonfinancial organizations, in rubles, % to the start of the year



Source: Bank of Russia.

Growth in household rouble deposits slowed to 0.7% MoM SA in August (0.9% MoM SA in July). Growth was to a great extent supported by escrow accounts and shorter-than-30-day demand deposits, while long- and medium-term deposits dwindled. This trend continues due to remaining uncertainty and the cuts of deposit rates, leading customers to look for alternative investment opportunities.

²² According to United Credit Bureau and Autostat data, car dealers faced a shortage of the quickest-selling car brands at the end of the summer, caused by a disruption in logistic chains on the back of the pandemic and the sales boom in June–July.

Loan-loss provisions rose 99 billion roubles²³ in August 2020, over one and a half times less than in July and June. Note that, given regulatory easing, loan-loss changes may fail to fully reflect the banking sector's risks, and one can expect provisions to expand.

The banking sector earned a profit of 178 billion roubles, somewhat less than 187 billion roubles in July but up from the May and June numbers. Profit after taxes totalled 172 billion roubles.

Part of the trends posted in July, therefore, continued in August. Lending activity continues to recover in most of the segments, thanks to, among other things, government and Bank of Russia support measures. The banking sector's financial result also recovered to the pre-coronavirus level.

Still, a number of segments showed signs of lending slowdown, driven by the petering out of deferred demand and households' reduced ability to pay. Risks arising from increased uncertainty and the unsustainability of economic recovery also continue. On top of that, the coming months may see a gradual winding down of regulatory easing implemented at the start of the pandemic. In particular, it is recommended that banks set aside provisions at full scale, which may take a toll on lending growth.

At the same time, the Bank of Russia at the start of August officially announced cuts of adds-on to risk weights for unsecured consumer loans issued beginning from 1 September 2020. This measure will support consumer lending going forward without creating more risks to financial stability.

3. IN FOCUS. Inflation in emerging market economies during pandemic

- The specific feature of the “coronavirus” crisis in emerging market economies (EMEs) is that inflation was very low in the first months after the onset of the crisis, despite the weakening of these countries' national currencies and one-off supply-side factors. This may have stemmed from the impact of coronavirus-related restrictions, as well as that of low fuel prices. This inflation performance enabled emerging markets to promptly embark on monetary easing, which they never did in the previous crises. Recently, however, pro-inflationary supply-side factors and the effect of the exchange rate pass-through have started to emerge. As a result, inflation shows to be somewhat higher than the regulators initially expected.
- The effect of pro-inflationary supply-side factors arising from the economic implications of the pandemic will likely be more protracted and persistent than could have been assumed at earlier stages of the pandemic. This results from high uncertainty over further development of the epidemiological situation and its impact on economic activity.

²³ Adjusted loan loss reserves.

- The weakening of national currencies and a rise in costs driven by disruptions in supply chains and further sanitary and epidemiological measures taken since the start of 2020 were quite substantial in most emerging markets. What we view as a likely development is a partial loss of potential output, to be accompanied by a faster “pro-inflationary” demand recovery in markets for some goods, involving structural changes in the consumer behaviour model. This will partially offset the continuing disinflationary effect of weak demand.
- As a consequence, further price rises may take a somewhat higher trajectory than previously assumed by central banks’ forecasts, which were the basis of the stage-by-stage monetary easing undertaken this year. This may occur despite the petering out of temporary pro-inflationary factors which are evident in emerging markets’ current price movements.
- From the monetary policy perspective, central banks’ further decisions should be totally balanced and robust (resistant to changes in the situation), given the high uncertainty regarding the estimates of the effect of demand and supply factors, further economic performance, and risks to financial stability. These aspects are already rightly reflected in the official rhetoric of most regulators.

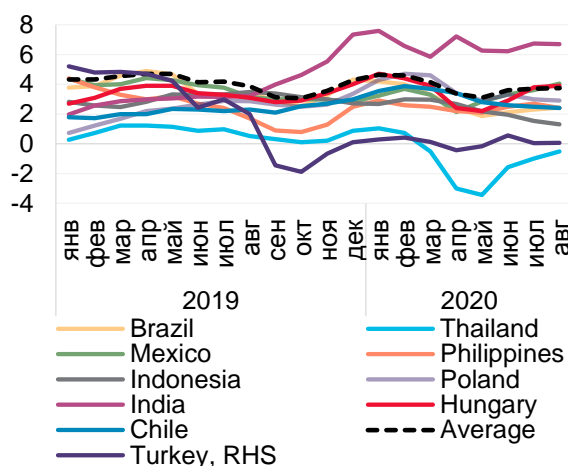
The reaction of emerging markets’ central banks to the crisis triggered by the coronavirus epidemic was largely unprecedented in economic crises. In a situation of national currency weakening and an escalation of risks to financial stability reflecting crisis developments, monetary authorities often have to conduct pro-cyclical monetary policy, resorting to its tightening.

But in the current crisis, the majority of central banks have loosened monetary policy drastically, cutting key interest rates to all-time lows. Risks to financial stability, which sharply escalated as the acute phase of the pandemic unfolded in the first half of 2020, made the regulators less concerned about whether it was right to embark on monetary easing than about what was the right time to do so. Given the significant restraining effect on business activity of unprecedented restrictions seeking to combat the pandemic, accompanied by an income fall and depressed demand, the regulators’ decisions proceeded from the expected substantial shift of the balance of medium-term risks towards disinflationary factors. Indeed, at the initial stage of the interest rate cuts, the forecasted disinflationary effect of depressed demand notably exceeded the assumed pro-inflationary effect of demand, brought about by a decline in emerging markets’ exchange rates against the key reserve currencies, disruptions in supply chains, and a rise in producer costs. Monetary easing, along with fiscal stimulus, provided an important additional impulse for the global economy to move to recovery after passing a downturn trough in the second quarter of 2020.

Inflation in many EMEs indeed slowed notably in the first half of 2020 (Figure 50). But further on, it started to accelerate in most emerging markets. Moreover, as early as the end of the first half of the year, as economic activity recovered after the lifting of restrictions, price movements started to be increasingly driven by a broad spectrum of oppositely directed

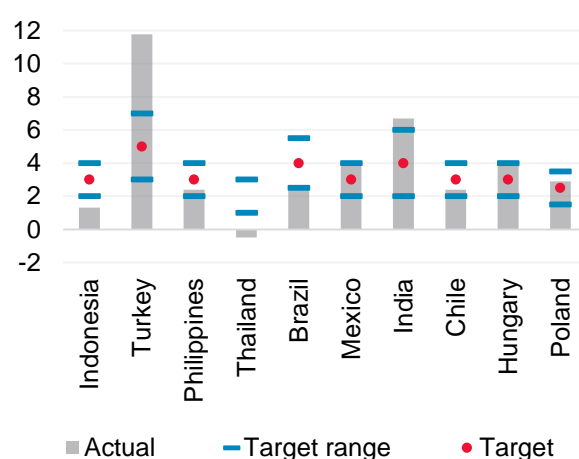
disinflationary as well as pro-inflationary factors. Their combination is now truly complicating the assessment of fundamental inflationary pressure in the economy, which is of primary importance in designing monetary policy.

Figure 50. Headline inflation in selected countries and sample average, % YoY



Source: Bloomberg Finance L.P.

Figure 51. Headline inflation, target ranges, and targets (August 2020), % YoY



Source: Bloomberg Finance L.P.

We believe, however, that if medium-term risks of downward inflation deviation from the target continue, conditions may arise already now for a gradual shift of the balance of factors from disinflationary to pro-inflationary ones. *On the one hand*, the emerging recovery of business activity is accompanied by sustainable changes in demand structure and consumer preferences in general. This, as we earlier showed by a specific example from the Russian economy (see Subsection 1.1, Figure 7), can be reflected in a faster demand recovery and an increased pace of rises in the prices of some goods, as a result of which pro-inflationary pressure *in some consumer segments* may emerge even if a negative output gap continues in the economy *at large*. *On the other hand*, the realisation of a scenario involving a loss of potential amid persistent upward pressure on costs and the emergence of logistics problems is an additional factor which, on top of loose monetary policy, may significantly accelerate the upward movement of inflation back to the target.

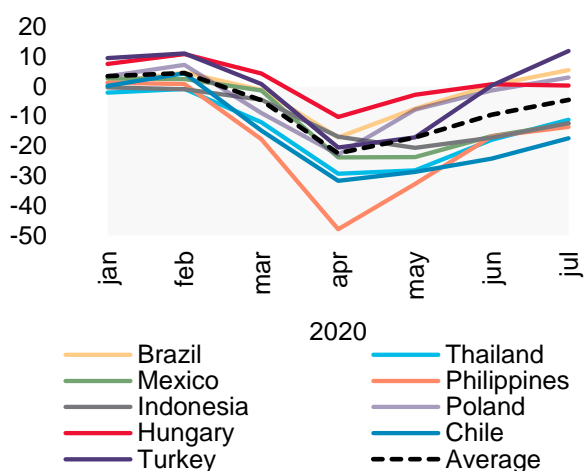
Inflation stayed within the target range in most of major EMEs under consideration in August,²⁴ with some of them posting both upward and downward deviation from the target (Figure 51). The key disinflationary factor in the first half of the year was a drop in demand on the back of stringent restrictions on businesses' operations and social mobility put in place to contain the coronavirus spread. The use of retail sales as a proxy for changes in consumer demand shows a steeper inflation decline in countries with a deeper fall in retail sales (Figure 52).

As businesses resume their operations and restrictions on people's mobility are eased, consumption gradually recovers. The cases of countries which we consider suggest that the

²⁴ Brazil, Hungary, India, Indonesia, Mexico, Poland, Turkey, Philippines, and Chile. The countries were chosen thanks to the availability of short-term time series for a wide range of indicators.

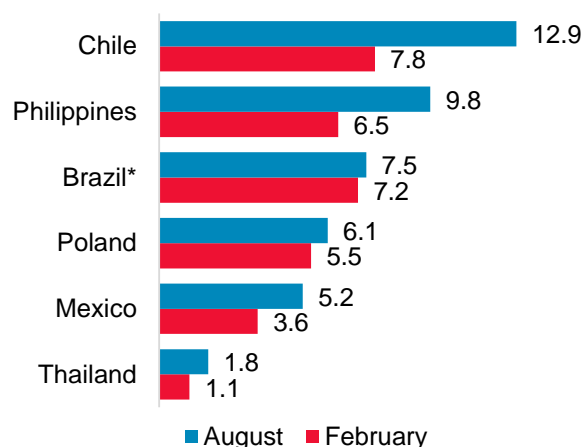
July retail sales²⁵ rose above last year's in Hungary, Poland, Turkey, and Brazil (Figure 52). This can be explained by a combination of factors such as relatively high budget support with a relatively small increase in unemployment (in the rest of the sample countries, unemployment in August exceeded the pre-crisis level by 45-65%, whereas the countries in question showed a several times smaller unemployment rise (Figure 53), the realisation of deferred demand along with an additional short-term impulse from a stage-by-stage lifting of restrictions.

Figure 52. Retail sales in selected countries and sample average, % YoY



Source: Bloomberg Finance L.P.

Figure 53. Unemployment rate in selected EMEs, %



* Brazil data is given for July 2020.

Source: CEIC.

Against this background, a rapid consumption recovery contributed to inflation acceleration. Despite a wide range of temporary factors affecting price rises, it is noteworthy that in Hungary and Poland, for instance, inflation came in above the middle of the target range in August (Figure 51). Noteworthy is an upward deviation of inflation from central banks' targets in Mexico and India. While not meaning to question the impact of temporary pro-inflationary factors on price movements in some EMEs, we believe that even with further demand recovery being gradual, the petering out of their impact may slow price rises not as much as could be expected. Likewise, many EMEs, where inflation so far remains reduced, may see a faster return to the target than could be assumed given the current loose monetary policy. This is largely due to:

- **first**, a faster demand recovery in markets for some goods, driven by changes in the consumer behaviour model and possible underestimation against this background of supply-side price pressure triggered by the pandemic's implications;
- **second**, the emergence of secondary effects realised through an increase in inflation expectations resulting from a dramatic weakening of emerging market currencies in 2020;

²⁵ The most recent data available for all countries.

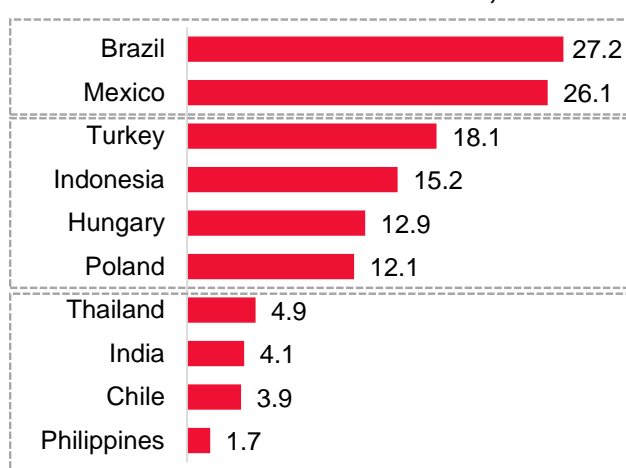
- **third**, difficulties of fine-tuning the current loose monetary policy amid shrinking room for further interest rate cuts in most EMEs and issues concerned with the appropriateness of additional fiscal measures and the time of future transition to fiscal consolidation in a situation of high uncertainty regarding further spread of the pandemic.

Further on, we will analyse each of the above causes separately, having considered, using the example of selected EMEs, the influence of the main factors, which, in addition to the dynamics of demand, most significantly affect inflation in the current environment. We split these factors into the following four groups: 1) *the exchange rate of the national currency*, 2) *producer costs*, 3) *changes in the volatile components of the consumer basket* (food and energy prices), 4) *additional fiscal policy changes and other idiosyncratic factors* (changes in legislation and tax burden, etc.).

1) Exchange rate of the national currency

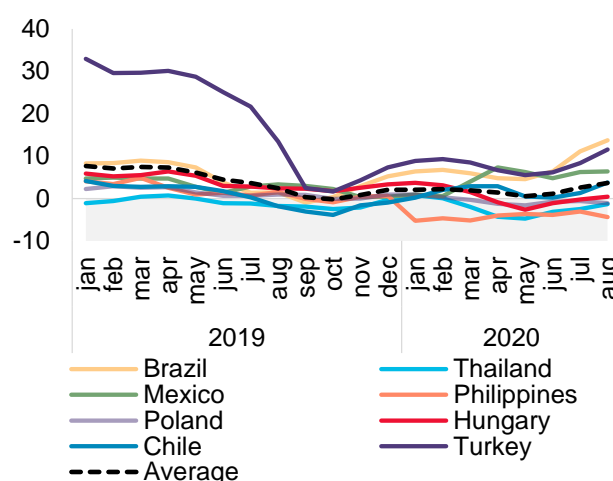
With the onset of the crisis, emerging market currencies weakened dramatically against the US dollar and other major currencies. Oil exporting countries suffered the steepest exchange rate fall, driven by the oil price slump. The deepest exchange rate plunge in the first weeks of the crisis (regarding March 6 as the reference point) was posted by the Brazilian real and the Mexican peso, which lost a quarter of their value against the US dollar (Figure 54), followed by Turkey and Indonesia, which went through internal crises. Philippines, Chile, India, and Thailand suffered a less massive depreciation of their national currencies against the US dollar.

Figure 54. Deviation of the maximum value of the exchange rate of the national currency to USD from the 06.03.2020 level, %



Source: Bloomberg Finance L.P., R&F Department estimates.

Figure 55. Producer price indices, % YoY



Source: CEIC.

Exchange rate movements have an effect on the overall level of domestic prices via the prices of imports, including those of commodities and intermediate goods. Meanwhile, the full pass-through of exchange rate movements to inflation is, as a rule, lagged, and its scale can vary not only from the perspective of the effect on some goods and services in the consumer basket but also depending on the specifics of macroeconomic shocks determining exchange rate fluctuations. Apart from this, in EMEs, where economic agents' expectations are not fully anchored to the targets, a temporary pro-inflationary effect of national currency weakening can translate into an increase in inflation expectations, which, all other things being equal, creates risks of inflation's persistent climb above the target, requiring a response through monetary policy measures.

Therefore, *on the one hand*, one can claim that the pass-through effect has become one of important factors of inflation acceleration since the end of Q2 2020, given the scale of emerging market currencies depreciation. *On the other hand*, the above-mentioned features of the pass-through effect themselves are sources of high uncertainty in the real-time estimates of price dynamics adjusted for the exchange rate factor.

2) **Producer costs**

The pandemic's implications have increased producer costs dramatically. As mentioned above, this increase in large part stems from an exchange rate decline via the import channel. The movements of the producer price index in selected emerging markets show that an accelerated rise in producer costs was recorded in countries which suffered the largest weakening of their national currencies (Brazil, Mexico, Turkey) (Figure 54, Figure 55).

But factors, such as disruptions in supply chains for components and final goods, downtime, and extra costs for ensuring labor safety in the context of tightening sanitary and epidemiological standards also had an important impact on the growth of producers' costs. For example, disruptions in supplies from the US had a substantial impact on the growth of producers' costs in Mexico. Extra costs for ensuring labor safety are presumably the largest in European countries and Thailand.

The specifics of the above factors of growth of producers' costs amid the pandemic indicates that, on the one hand, their pass-through to prices has not yet fully completed, and on the other hand, that, given the high uncertainty in the economy, along with a variety of institutional problems, there are high risks of continued upward pressure on producers' costs and, accordingly, consumer prices in the future. This will continue to exert upward pressure on consumer prices at least for the next several months.

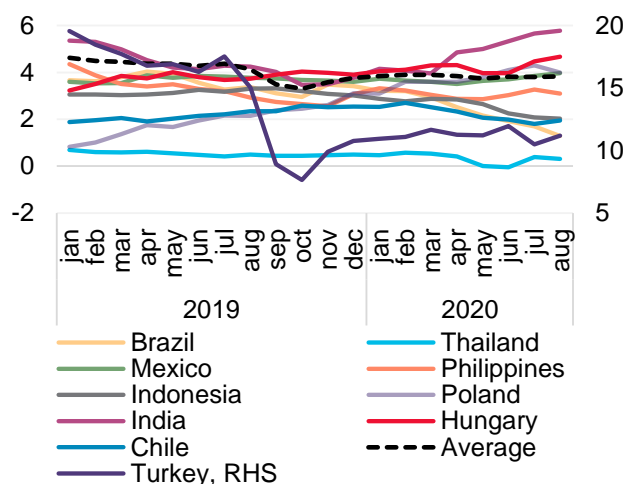
In addition, the current crisis may have produced significant changes in both *the level* of economies' potential output and its *growth rates*. Many firms, facing rising costs, may have exited the market or cut down on their investment plans due to the high level of uncertainty.

3) Changes in volatile consumer basket components (food and energy prices)

An important influence on inflation is exerted by the dynamics of prices for a group of goods included in the CPI, but traditionally excluded from the core inflation indicator: food and energy resources.

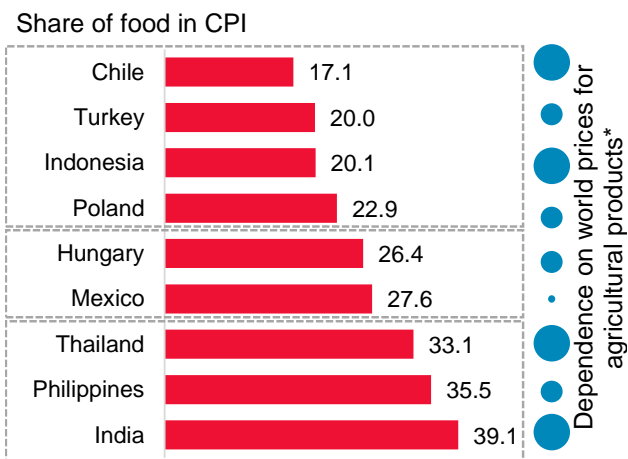
The impact of food and energy prices on the general price level varies across the countries under consideration. The magnitude of this impact depends on the share of a category of goods in the consumer basket, as well as the sensitivity of domestic prices to world price changes. The share of food in the consumer basket is largely determined by the share of the rural population in the country and the general level of economic development and household income. The largest share of food in the CPI among the countries under consideration is recorded in India, Philippines, and Thailand (Figure 57). Meanwhile, it should be noted that the dynamics of food prices may currently become a pro-inflationary factor, owing to both the growth in world food price observed since May and likely additional growth in price in local currencies if they weaken.

Figure 56. Core inflation in selected countries and sample average, % YoY



Source: Bloomberg L.P.

Figure 57. Share of food in CPI and the sensitivity of local food prices to the dynamics of world prices, %

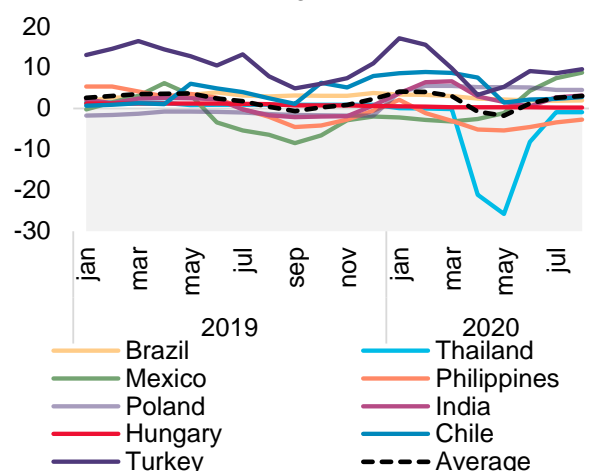


Note. Dependence on world prices of agricultural products is estimated as a correlation between the dynamics of domestic prices for food and world prices for agricultural products.

Source: CEIC, Bloomberg Finance L.P., R&F Department estimates.

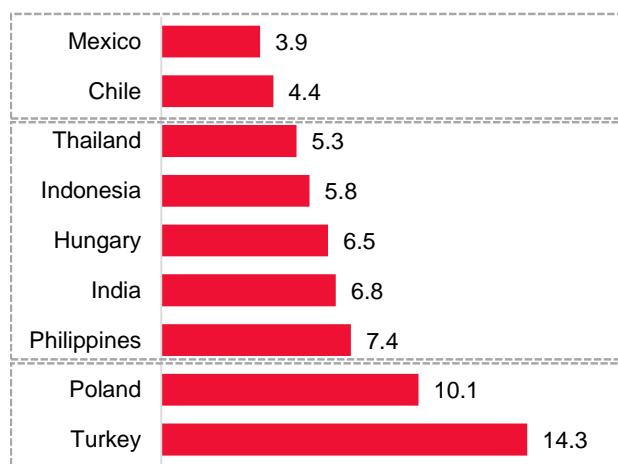
The share of energy resources in the consumer basket also depends on factors such as the level of a country's economic development and household income. The strongest dependence of inflation on energy prices can be observed in Turkey and Poland, which are characterized by the highest annual growth rates of prices for this category of goods in 2020 (9.8% and 4.9%, respectively – Figure 56) with the largest share of energy resources in the consumer basket (Figure 59).

Figure 58 Domestic prices for energy resources in selected countries and sample average, % YoY



Source: CEIC.

Figure 59. Share of energy resources in CPI, %



Source: CEIC.

4) Fiscal policy changes and other idiosyncratic factors

According to regulators and analysts, various idiosyncratic factors will have an additional multidirectional influence on the dynamics of inflation in the EMEs in the coming quarters (Table 3). In the context of the exhaustion of emergency packages of measures to support the economy and the population some EMEs still need to stimulate the recovery of consumer demand. With this in view, Hungary and Brazil expanded their special programmes (Széchenyi Recreation Card and Income-Transfer Program).

Changes in some taxes and customs duties should also have an important additional effect on inflation. For instance, Poland and Hungary, are planning to increase the excise tax on tobacco products in 2020–2021, which, according to regulators' estimates, will add 0.4 and 0.5 pp to inflation, respectively, all other things being equal.

In general, the adjustment of monetary policy for possible new fiscal stimulus measures and the anticipated shift to fiscal consolidation in the future will pose an important challenge for central banks. The degree of independence and credibility of a central bank plays a significant role in building confidence in the policy pursued by the regulator. Reduced independence of the central bank could lead to higher inflation expectations and increased pressure on the national currency.²⁶

All other things being equal, the influence of the considered idiosyncratic factors, in our opinion, will affect the price dynamics over the next quarters, fully or partially compensating for the disinflationary pressure.

²⁶ IMF *The Impact of COVID-19 on Inflation: Potential Drivers and Dynamics*, September 2020.

Table 3. Fiscal policy changes and other idiosyncratic factors in selected emerging markets

Poland	<ul style="list-style-type: none"> • Change in indirect taxes on tobacco (EU) (stage-by-stage implementation: January 2020, July 2020, January 2021): will raise inflation by 0.4 pp in 2020–2021.
Hungary	<ul style="list-style-type: none"> • Change in indirect taxes (stage-by-stage implementation (January 2020, July 2020, January 2021), will raise inflation by 0.5 pp. • Increased allowances for the Széchenyi Recreation Card.
Brazil	<ul style="list-style-type: none"> • Partial extension of the income-transfer program for households until December. • Cancellation of taxes on some import categories of goods until end-2020.
Philippines	<ul style="list-style-type: none"> • Temporary increase in import duties on crude oil and refined petroleum products.
Indonesia	<ul style="list-style-type: none"> • Drafting of amendments to central bank charter (increased emphasis on economic growth and the leading role of the country's government in the monetary council).
Turkey	<ul style="list-style-type: none"> • VAT reduction for some categories (from 8% to 1% – on accommodation and food services, entertainment, organisation of weddings, housing servicing and repair, dry cleaning and retailer services. • Increase in special consumer tax on cars of medium and premium class from September 1 (+1 pp to inflation for the year).
Mexico	<ul style="list-style-type: none"> • Cuts of some local taxes.

Thus, the recovery of economic activity that began after the lifting of restrictions, the effect of fiscal stimulus, including those that supported household income, and loose monetary policy largely dampened the disinflationary effect of the episode of a drop in economic activity and consumption during the period of restrictions.

Since the impact of certain factors on price dynamics may vary, the balance of the influence of pro-inflationary and disinflationary factors is unique to each country (Table 4). In conditions when the assessment of unobservable variables (the output gap, neutral interest rate, etc.) becomes even more complicated and imprecise than in the pre-crisis period, it is reasonable to proceed from the current changes in observable indicators in decision-making. After the simultaneous monetary easing in EMEs, further steps should become more balanced, taking into account changes in both demand-side and supply-side shocks.

Table 4. Assessment of the impact of pro-inflationary and disinflationary factors²⁷

	Consumer demand	Food prices	Oil price	National currency depreciation	Producer costs	Idiosyncratic factors
Effect	Disinflationary	Both ways	Both ways	Pro-inflationary	Pro-inflationary	Both ways
Poland	+	+	+++	++	+	++
Hungary	+	++	++	++	+	++
Brazil	+	++		+++	+++	++
Philippines	++	+++	++		++	+
India		+++	++	+		
Indonesia	+++	++	++	++		+
Chile	++	+	+	+	++	
Turkey	+	++	+++	++	+	++
Thailand	++	+++	+	+	+++	
Mexico	++	++	+	+++	+++	+

Source: R&F Department estimates.

²⁷ +++ – strong, ++ – moderate, + – weak.

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