Bank of Russia

TALKING TRENDS
Economy and markets

Research and Forecasting Department Bulletin

MAY 2024

CONTENTS

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

Monthly summary

- Q1 GDP grew 5.4% on an annual basis; adjusted for one additional day in the leap February of 2024, growth was 4.5–4.8%. Q1 GDP growth was higher than in 2023 Q4. Flash readings and survey data for April, even though slightly less positive, indicate continued growth of the Russian economy both in terms of household consumption and investment activity. At the same time, the disinflationary trend of previous months came to a halt in April. This is evidenced by both the overall CPI and a wide range of performance indicators. It will take a further decline in the mismatch between aggregate demand and production capabilities for disinflation trends to resume. This can only occur on the back of demand growing at a more moderate pace than in previous quarters. Accordingly, to return inflation to target, tight monetary conditions need to be maintained for a long time. Moreover, unless current price growth and inflation expectations return to a downward path, a further tightening of monetary conditions may be required to restore price stability.
    - Current economic activity and demand trends are supported by high growth rates of income, and substantial growth in lending and public demand. To reinstate the balance between aggregate demand and potential output expansion, further cooling in credit activity is needed alongside more entrenched saving behaviour of households.
    - Between April and the first half of May, seasonally adjusted growth in consumer prices was up and back to its January–February readings. The acceleration is largely driven by the underlying components of inflation. Conversely, prices for volatile goods and services in April saw disinflationary changes. Household inflation expectations were also up slightly in May, while corporate expectations held steady. Failure of disinflation to resume in the coming months may well be a sign of insufficiently tight monetary conditions needed to return inflation to target.
- Fixed-rate bonds were under pressure from mounting inflation expectations, the expectations for the high rates to remain for a long time, and from expansionary borrowing. The Russian stock market grew between April and early May on the back of benign macroeconomic statistics and upcoming dividend payments by a number of major companies. Corporate demand for market financing remains high, with overall bond placement in January–April approaching the average volumes of 2023. The ruble strengthened slightly, thanks to support from exporters selling currency earnings for large March supplies, as well as on the back of lower demand from importers in the context of continued problems with cross-border payments.

1. Inflation

After a slowdown in March, seasonally adjusted month-on-month consumer price rises accelerated in April, driven, notably, by stable factors. As a result, the ongoing price growth returned to the elevated levels of the start of the year. Based on weekly data from Rosstat, April's increased pace of price rises continued in the first half of May.

Why has the disinflationary trend registered in March so far failed to take hold? The ongoing consumer price growth is, in effect, "a rear-view mirror" and annual inflation is even more the case. They show what comparative changes in demand and supply in the economy at large and the consumer segment in particular over recent several quarters have brought about. Price growth is the resultant factor of monetary policy' transmission mechanism operating via all of its channels.

Therefore, the sustainability and pace of disinflationary processes seen in the economy are not only determined by the current rate of price growth. These processes depend even more on the degree to which the current and expected change in demand is met by a rise in their supply from Russian producers and imports.

So far, there is a mismatch between them, giving rise to uncertainty regarding the subsequent development of disinflationary processes. Domestic demand, both private and government, continues to expand dynamically. Output is also growing, but less than demand. This situation objectively keeps the pace of price growth elevated.

The rising interest rates contain demand for market-based lending, but to a lesser degree and with a longer time-lag than in the pre-Covid period, when the economy was closer to equilibrium and fiscal policy was restraining in nature.

One cannot confidently claim that disinflationary processes have deepened and are sustainable unless there emerges a shift from rapid to more moderate growth in demand (including for loans), reflected in macroeconomic statistics and high-frequency data. This will take time. This time can be shortened through tightening monetary policy and bringing fiscal policy back to normal.

1.1. Easing of inflationary pressure comes to a halt in April

- Month-on-month price growth resumed acceleration in April after a slowdown in March. Easing of persistent inflationary pressure came to a halt. Weekly data suggest that the upward deviation from the 4% trajectory will likely widen in May.
- The risks of consumer price rise stabilisation on elevated levels remain significant. The restraining impact from producer prices seems to have petered out, while businesses' price expectations rose in April. Household inflation expectations climbed in May for the first time since the start of the year.

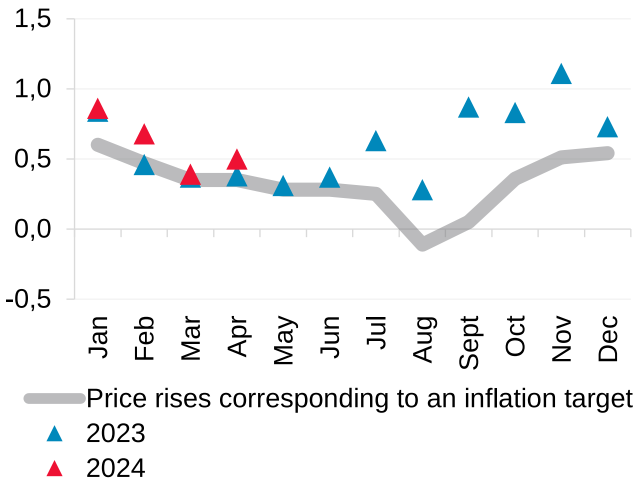
Consumer price rises accelerated in April to 5.8% MoM SAAR from 4.5% MoM SAAR in March (Figure 1). The stable indicators of price movements also rose in April. Annual inflation also edged up to 7.8%% from 7.7% in March (Table 1).

Table 1. Inflation and its components

	Apr. 2022	Apr. 2023	Feb. 2024	Mar. 2024	Apr. 2024
% YoY					
All goods and services	**17.8**	**2.3**	**7.7**	**7.7**	**7.8**
Core inflation	**20.4**	**2.0**	**7.6**	**7.8**	**8.3**
Food	20.5	0.0	8.1	8.1	8.3
Non-food goods	20.2	-0.3	6.6	6.7	7.0
Services	10.9	9.4	8.5	8.3	8.1
% MoM SAAR					
All goods and services	**20.0**	**4.2**	**6.3**	**4.5**	**5.8**
Core inflation	**26.4**	**3.9**	**7.3**	**7.1**	**8.3**
Food	37.3	1.6	2.8	1.2	4.3
– net of fruit and vegetables	**48.9**	**0.9**	**5.4**	**5.3**	**7.9**
Non-food goods	6.8	2.1	3.2	3.1	5.3
– net of refined petroleum products	**8.3**	**2.2**	**3.8**	**3.3**	**5.1**
Services	15.4	10.8	15.2	10.9	8.4
– net of housing and communal services	**23.0**	**14.4**	**20.3**	**13.1**	**9.7**

Sources: Rosstat, R&F Department estimates.

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



Sources: Rosstat, R&F Department estimates.

Food price growth accelerated to 4.3% MoM SAAR from 1.2% MoM SAAR in March. Fruit and vegetable price decline at a faster rate than seasonally normal[1] continued to contain overall food price increase. However, a decline in fruit and berries output in some regions on the back of May's frosts may reverse the so far favourable fruit and vegetable price trend.

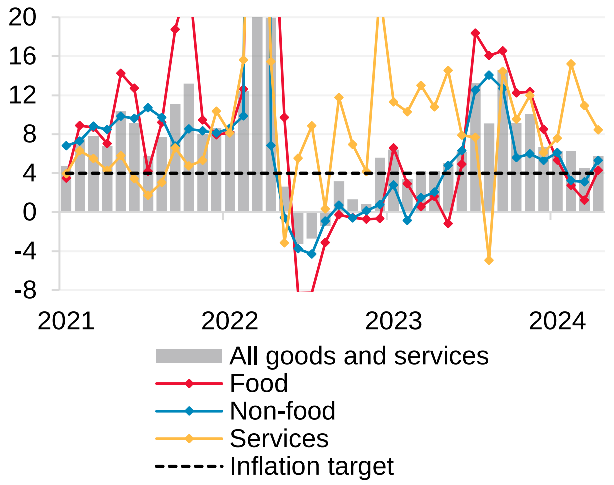
Net of fruit and vegetables, food prices climbed to 7.9% MoM SAAR after 5.3% MoM SAAR. The pace of price growth in dairy products, oils, baked goods and pastries notably accelerated. Meat product price rises marginally slowed, but the risks of the trend reversal remain high. In particular, mutton prices soared amid an acceleration in producer cost rises and increased external demand. Global market conditions continue to exert upward pressure on domestic prices in this segment. That said, supply-side pro-inflationary risks have mounted recently. Wheat output forecasts were downgraded after a spell of cold weather in May.

The non-food segment saw price growth accelerate to 5.3% MoM SAAR from 3.1% MoM SAAR. Fuel price rises gained pace somewhat. That said, the strong domestic market saturation, export restrictions and the damper mechanism significantly limit retail price growth potential. Construction materials price increases accelerated, which may stem from buoyant demand growth in the new housing market in 2023: housing is often commissioned without final finish for future home owners to do this on their own to suit their needs. Growth in the prices of other durable goods remained on average moderate. The impact of the exchange rate on the current price movements is generally neutral. The price growth median in the group of goods highly

[1] April's anomally warm weather in the European part of Russia must have enabled expenses for warming greenhouse crops, primarily cucumbers, to be cut, thus driving the prices of these vegetables down.

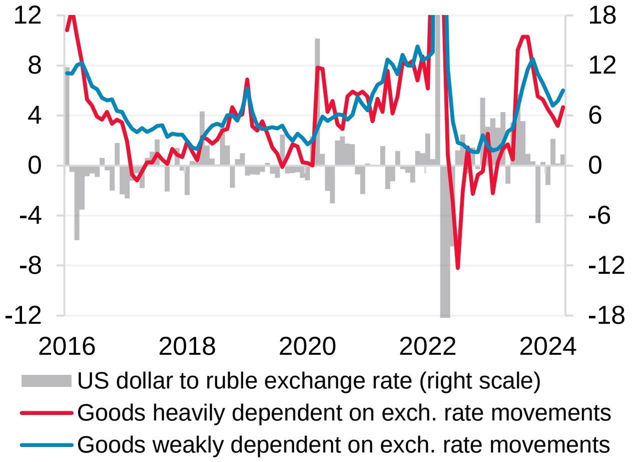
sensitive to the exchange rate is still somewhat below that for the group of goods showing low sensitivity to it (Figure 3).

Figure 2. Seasonally adjusted price growth, % MoM SAAR



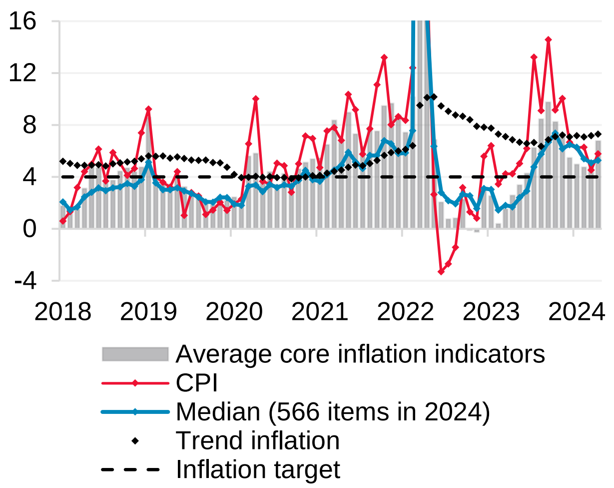
Sources: Rosstat, R&F Department estimates.

Figure 3. Median CPI (% MoM SAAR) and US dollar to ruble exchange rate (%)



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

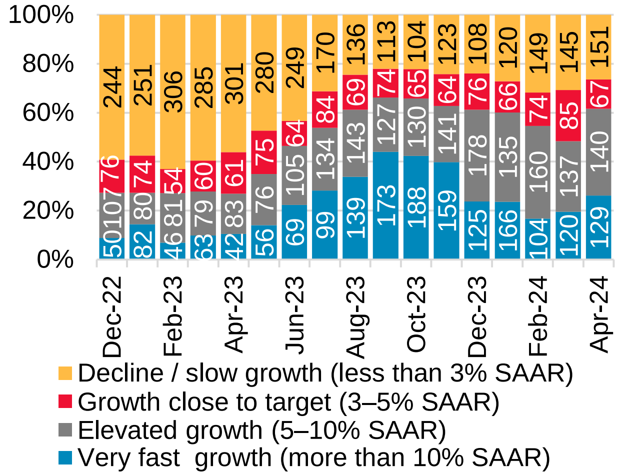
Figure 1. Modified core inflation indicators* (% in annualised terms) and trend inflation estimate (%YoY)



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

Sources: Rosstat, R&F Department estimates.

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



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

Note. The figures represent the number of items.

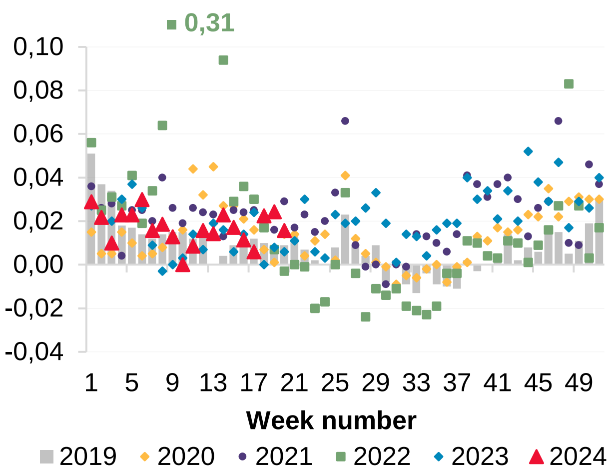
Sources: Rosstat, R&F Department calculations.

Price rises in services slowed to 8.4% MoM SAAR from 10.9% MoM SAAR in March, helped by a drop in the prices of air and rail transport services, as well as the prices of foreign tourism, very volatile in recent months. Prices charged for domestic tourist destinations continue to rise, but the pace of their increases has slowed. Net of the above components, services price rises notably accelerated to 12.6% MoM SAAR after 6.2% MoM SAAR, driven mainly by price increases in communications services due to rising costs.

Change in the analytical indicators of price movements suggests that persistent inflationary pressure mounted in April, surpassing the Q1 level. That said, it is still far above the inflation target. The mean of modified core inflation indicator estimates rose to 6.8% in annualised terms (Figure 4). The median of price growth distribution climbed, driven most of all by the food segment. The total weight of items rising in price at an accelerated pace significantly increased in April (Figure 5). The trend inflation estimate went up to 7.30% from 7.18% in March.

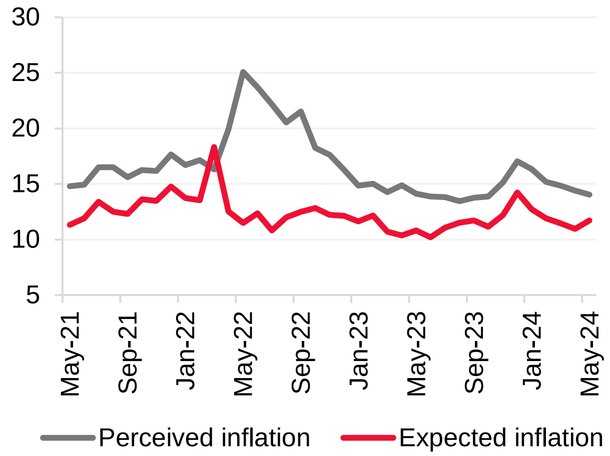
The week-on-week price rise accelerated in May relative to April, defying the normal seasonal pattern: prices climbed 0.38% from the start of the month to 20 May (Figure 6).

Figure 6. Average daily price growth, %



Sources: Rosstat, R&F Department estimates.

Figure 7. Household inflation perceptions: median readings, annual percentage change



Source: InFom

The risks of prices continuing to rise at an accelerated pace or going down to target too slowly remain substantial. Household inflation expectations rose in May for the first time since the start of the year (Figure 7). The acceleration of the current price rises may amplify this trend. The restraining impact of producer prices on consumer prices must have petered out for now. Producer price growth in manufacturing notably gained pace in March-April, with businesses' price expectations climbing in April as well.

2. Economic performance

Q1 GDP growth came in above most of the forecasts, surpassing the strong 2023 Q4 growth. One of the factors behind this performance was expansion in budget spending, which was, on top of this, carried out ahead of the usual seasonal schedule in Q1. Extra demand from the government also gave a boost to demand from the private sector, realised both in production chains involved in government purchases and through budget transfers and payments to households. The same processes spurred lending, due to, among other things, borrowers' improving financial position.

In April, the Russian economy showed some signs of growth slowdown, in, above all, the services segment. At the same time, the consumer goods sectors remained on a dynamic growth trajectory. The labour market tightness is increasing still further, creating conditions for further labour income growth at a fast pace. This income growth will buttress strong consumer demand even with the increased savings ratio, which, we note, somewhat declined in Q1.

It appears from the real-time data that the trade balance improved in Mach–April. This stemmed from both energy export expansion by value and the absence of a seasonal increase in imports. The latter apparently reflects problems with foreign trade settlements rather than cooling of domestic demand.

What macroeconomic consequences can this entail? Normally, foreign trade balance expansion unrelated to a change in external prices, ramps up net exports and GDP, helping also to strengthen the national currency. In a situation which we are now witnessing, consequences may be different because import quantities are determined by supply-side rather than demand-side restrictions.

If, as previously, the import payments problem were to be promptly resolved, imports would quickly recover, moreover, securing "an oversupply" to make up for the previous shortfall, because demand for imports is still very much there, to say the least. In this case, trade surplus would contract. Net exports would decline, but this is unlikely to have an effect on GDP. During the recovery period, imports, in addition to meeting domestic demand, would replenish contracted inventories of imported supplies and components. This would ramp up the GDP item "Inventories of material and technical means", while the overall effect would be close to zero.

Should the problems of import payments take longer to address, trade surplus may remain increased longer. This would support the ruble. Similar processes were seen in 2022 Q2. The complication of import supply and payment logistics would probably make imports more expensive in terms of foreign currency. In this respect, the situation would be different from that in 2022, which saw a dynamic shift from European to Asian goods, whose foreign currency price was lower than that of European goods. The effect on GDP would be insignificant: reduced imports and increased net exports would be offset by an inventories and stocks contraction.

2.1. Demand still exceeds supply

- April's real-time data suggest that the economy continues to expand after strong growth in Q1 (an initial Rosstat estimate of GDP growth in Q1 stands at 5.4% YoY and 1.7% QoQ SA,[2] Figure 9). But the adjustment of this indicator for an extra weekend day in February of the leap year 2024 produces an R&F Department estimate of GDP growth in Q1 at 4.5%–4.8% YoY. Data on financial flows in the Bank of Russia payment system (Figure 8) indicate growth for almost all groups of enlarged industries in recent months.

[2] An R&F Department estimate.

At the same time, survey-based indicators show a growth slowdown (Figure 10), with businesses' optimism beginning to slightly cool.[3]

- Industrial output growth was more moderate in March than at the start of the year. The key growth driver was mining and quarrying, whose output picked up after a long period of stagnation (Figure 11).
- The group of industries meeting investment demand remains the key source of growth in the manufacturing sector (Figure 12), but posted some output expansion slowdown at the end of Q1. Its performance continued to be driven by a rise in private and government demand, with volatility still high and performance varying in some industries. Output expansion in consumer goods industries is buttressed by the manufacture of food products and a number of other industries. Industries meeting intermediate demand, on the other hand, showed output contraction on the back of a downward trend in the manufacture of basic and non-ferrous metals due to existing and newly-imposed export restrictions.
- Accelerated consumer demand expansion continues. A rise in household consumption[4] gained pace to reach 2.8% QoQ SA, the highest rate for the year. The key contribution came from the non-food segment, up 4.4% QoQ SA (Figure 13), with strong credit activity continuing throughout the quarter in the consumer segment (Figure 14).
- The strong consumer activity is accompanied by a slight savings ratio decline in Q1 (Figure 15). Coupled with real wage and disposable income growth, this ramps up the risks of a consumption rise outstripping supply expansion potential (Figure 16).
- One of the most significant output expansion constraints is the shortage of labour. The labour market tightness continued to increase. In particular, the unemployment rate hit a new low of 2.6% SA in March (Figure 17 – Figure 19).
- Employment growth is shifting towards labour-intensive activities (Figure 21). Within manufacturing, which leads employment growth and generally falls under capital-intensive activity, employment is also shifting towards labour-intensive industries (Figure 22). This shift of employment ramps up labour demand, creating additional labour market tightness. This leads to a more frequent wage indexing outpacing labour productivity growth.[5] Pro-inflationary risks inherent in this process may require a tighter monetary policy if realised.

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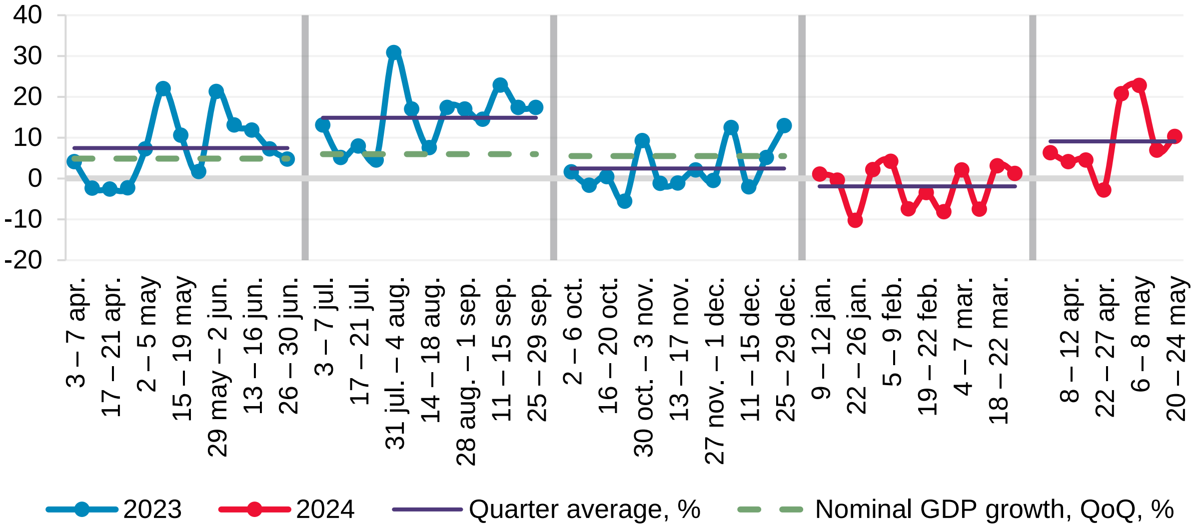
[3] Surveys by Sergey Tsukhlo (the Institute for Economic Forecasting of the Russian Academy of Sciences) and the Bank of Russia's Business Climate Index found a slight decline in the estimates of current conditions for doing business and companies' short-term expectations, but overall they are staying on historically high levels.

[4] An R&F Department estimate.

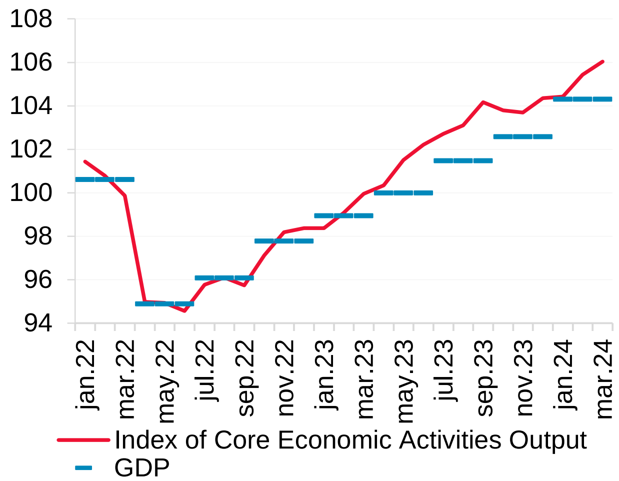
[5] According to surveys by Sergey Tsukhlo, just 7% of industrial enterprises expected wage changes outpacing labour productivity growth in 2021, while 15% of companies planned wage growth based on a faster rise in labour productivity. In 2024, 21% of enterprises are expecting a faster rise in wages than that of productivity.

Figure 8. Incoming payments growth[6] relative to the previous quarter average weighted by industries' shares in gross value added, seasonally adjusted, %



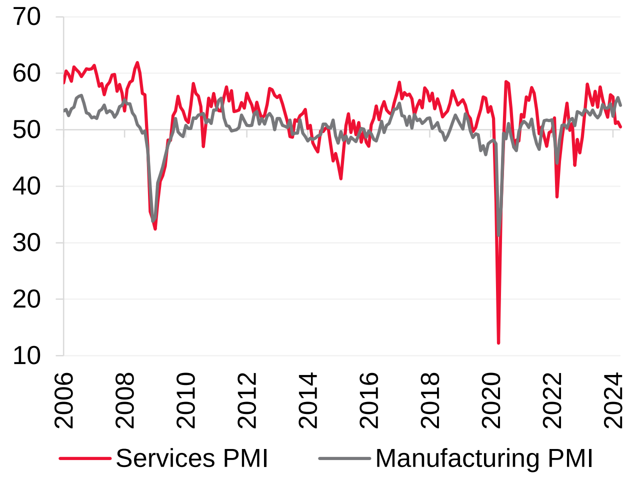
Sources: Bank of Russia, Monitoring of individual industries' financial flows.

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



Sources: Rosstat, R&F Department calculations.

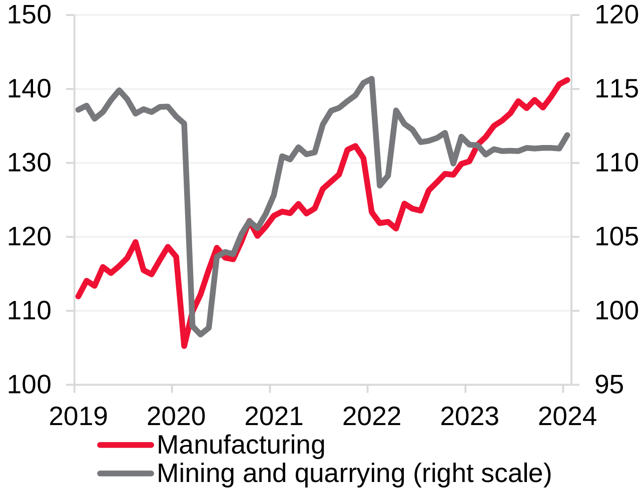
Figure 10. Russia's Manufacturing and Services PMI, points



Source: S&P Global.

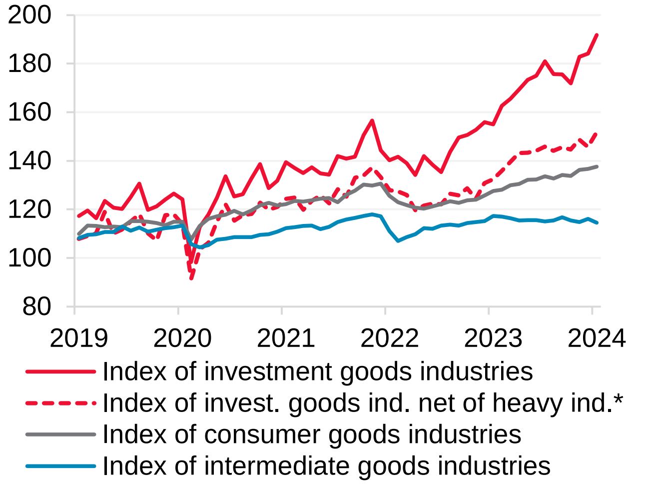
[6] Growth means a percentage change in the value: $g = \frac{(x_1 - x_0)}{x_0} * 100$.

Figure 2. Mining and quarrying and manufacturing indices (2014 = 100), SA



Sources: Rosstat, R&F Department calculations.

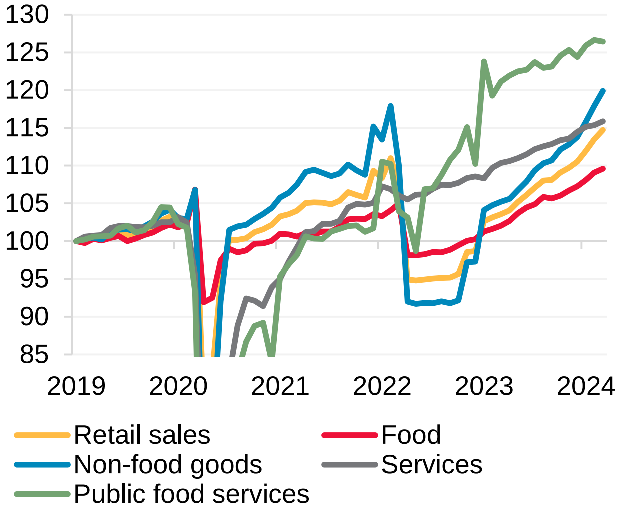
Figure 12. Output in groups of manufacturing industries, SA, 01.2016 = 100%*



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

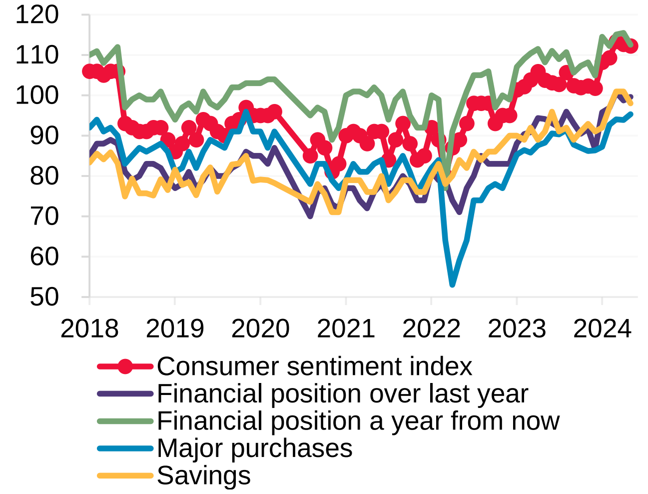
Sources: Rosstat, R&F Department calculations.

Figure 13. Retail sales, sales of the paid services segment and public food services, 01.2019 = 100, SA, %



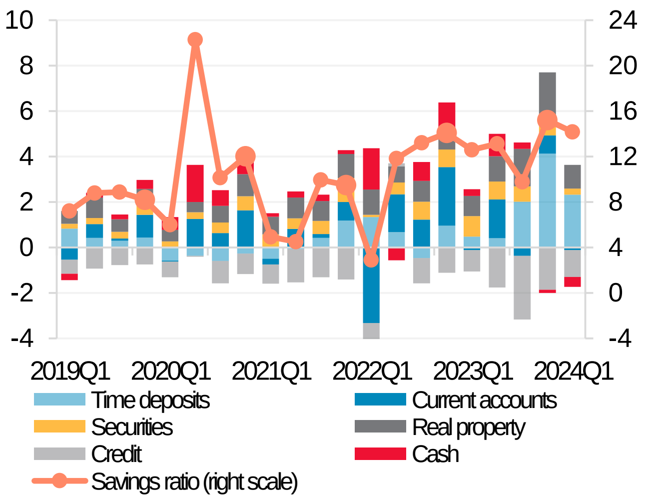
Sources: Bank of Russia, Rosstat, R&F Department calculations.

Figure 14. Consumer sentiment index and its sub-indices, points



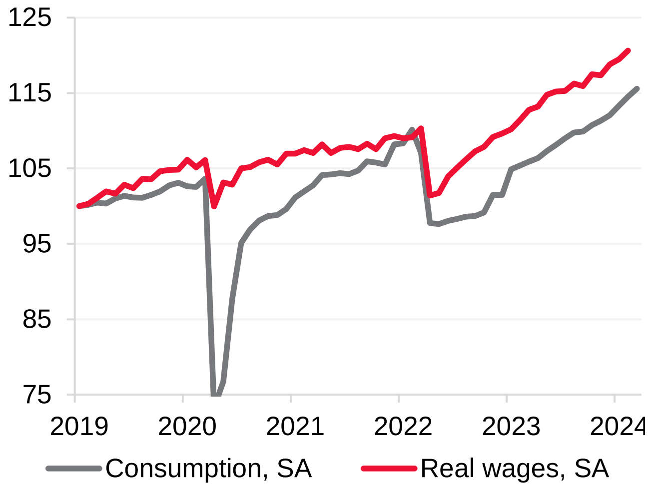
Source: inFom.

Figure 15. Savings components (trillion rubles) and savings ratio (%, SA, right scale)



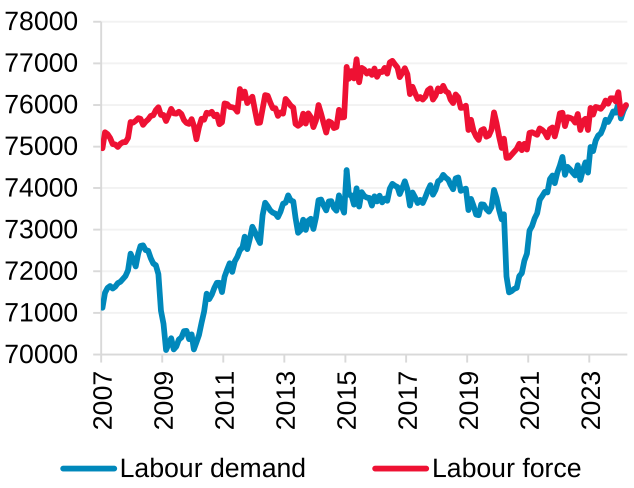
Sources: Bank of Russia, Rosstat, R&F Department calculations.

Figure 16. Proxy indicator for consumption (sum of retail, services and public food services sales) and real wages, 01.2019=100, SA, %



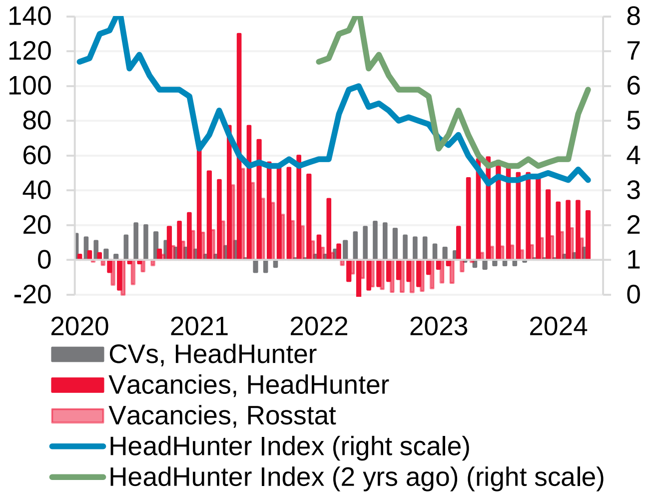
Sources: Rosstat, R&F Department calculations.

Figure 17. Labour force and labour demand, thousand people, SA



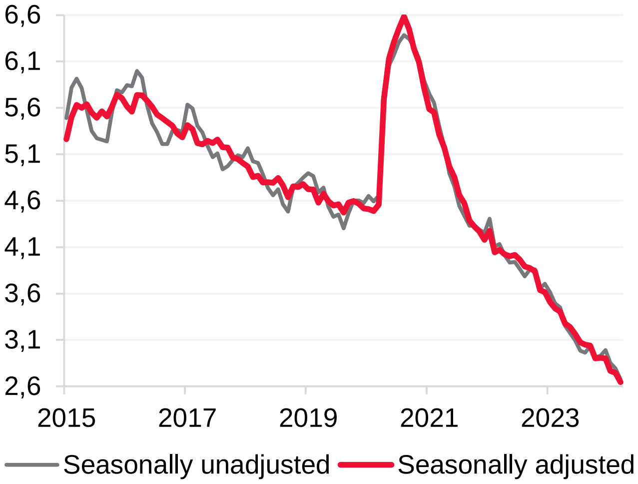
Sources: Rosstat, R&F Department calculations.

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



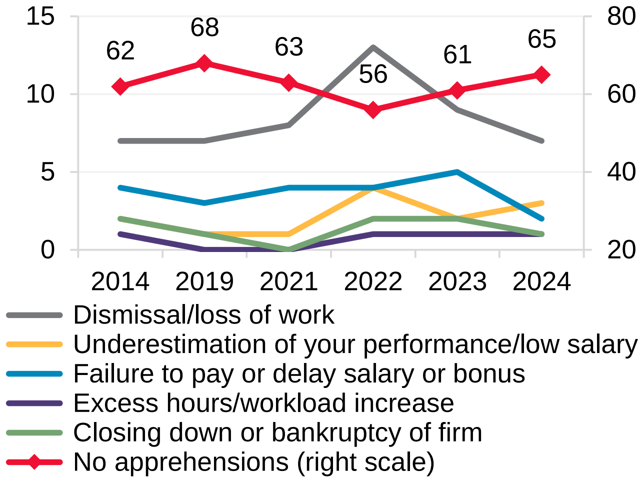
Sources: Rosstat, HeadHunter.

Figure 19. Unemployment rate, %



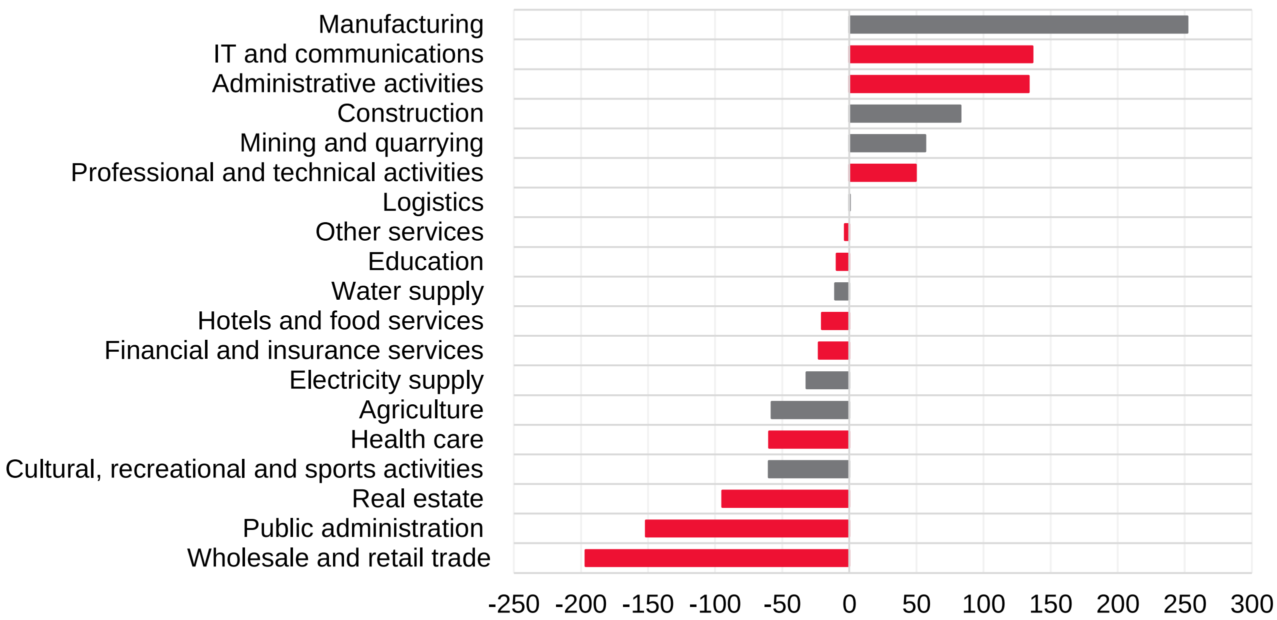
Sources: Rosstat, R&F Department calculations.

Figure 20. "Do you have any apprehensions regarding your job? Specify, if any", %



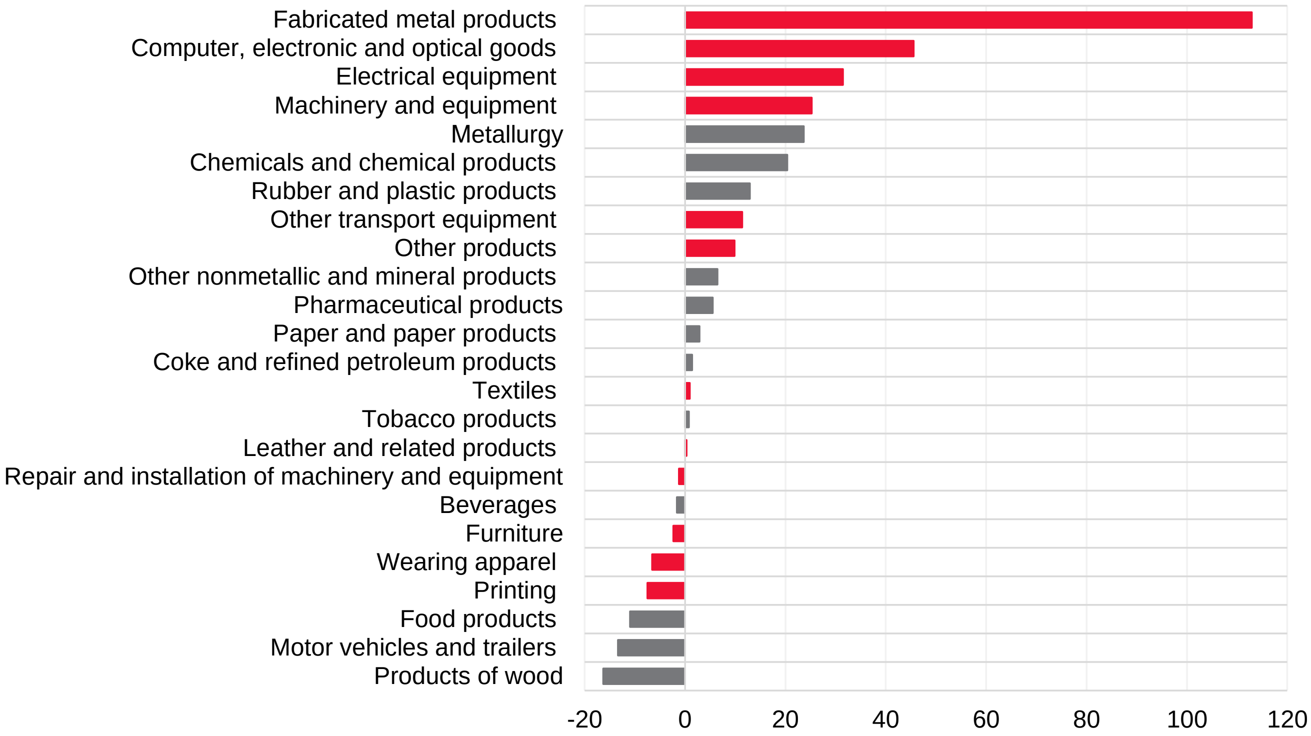
Source: Superjob.

Figure 21. Change in employment headcount across economic activities in 2023 Q4 relative to 2021 Q4, thousand people



Sources: Rosstat, R&F Department calculations.

Figure 22. Change in employment headcount in manufacturing industries, 2023 Q4 relative to 2021 Q4, thousand people



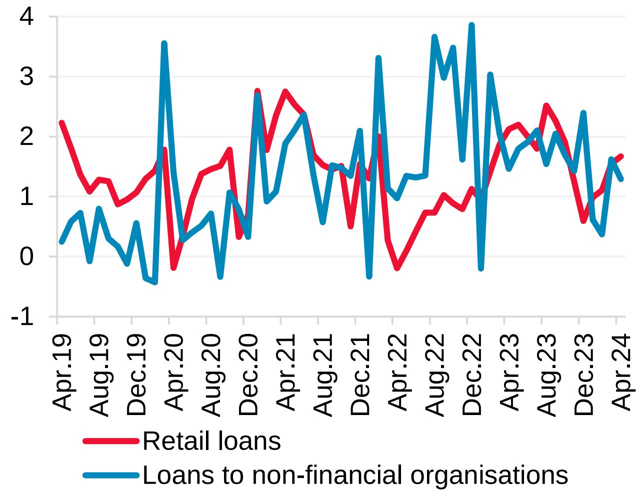
Sources: Rosstat, R&F Department calculations.

2.2. Rate of lending growth remains elevated

- April's rate of lending growth remained elevated relative to levels needed for ensuring sustainable disinflation: a marginal slowdown in the segment of loans to non-financial organisations was offset by an acceleration in the retail segment.
- Retail lending expansion accelerated to 1.7% MoM SA in April from 1.6% MoM SA (Figure 23). Average growth over January–April came in at 1.3% MoM SA. This is comparable with the average number for the same period in 2023 (1.4% MoM SA), when market interest rates (on unsubsidised credit products) were much lower.
- A substantial input to growth continues to be provided by expansion in lending under subsidised programmes (Figure 24): after the terms and conditions of loan provision under the mass programme Subsidised Mortgage Lending had been tightened, demand for the Family Mortgage Loan programme increased. That said, demand for mortgage loans at market rates in the secondary market remains subdued (Figure 25).
- Acceleration in retail loan portfolio growth was also fuelled by unsecured loans (Figure 27). Consumer loan portfolio expansion may have been underpinned by loans provided via credit cards issued earlier. The auto loan segment saw some cooling after sharp growth in demand ahead of the tightening of rules for charging the disposal fee. Nevertheless, the rate of auto loan portfolio growth remained elevated.
- Expansion in ruble loans to non-financial organisations slowed to 1.3% MoM SA in April from 1.6% MoM SA in March. Overall, the rate of lending growth in this segment since the start of 2024 has been slightly below the 2022–2023 average. Nevertheless, an overall rise in lending (together with retail lending and loans to non-financial organisations) remains the key source of dynamic money supply expansion after the fiscal contribution had contracted (Figure 29).
- The impact of monetary policy's deposit channel remains more pronounced than that of the credit channel. Indeed, the pace of household funds growth has softened to a low level compared with recent years, standing at just 1.0% MoM SA after 2.3% MoM SA in March[7] (Figure 26). At the same time, expansion in corporate ruble deposits accelerated to 9.5% MoM SA after contracting 0.1% MoM SA in March. This is likely a temporary development owed to the postponement of tax payments from April to May.

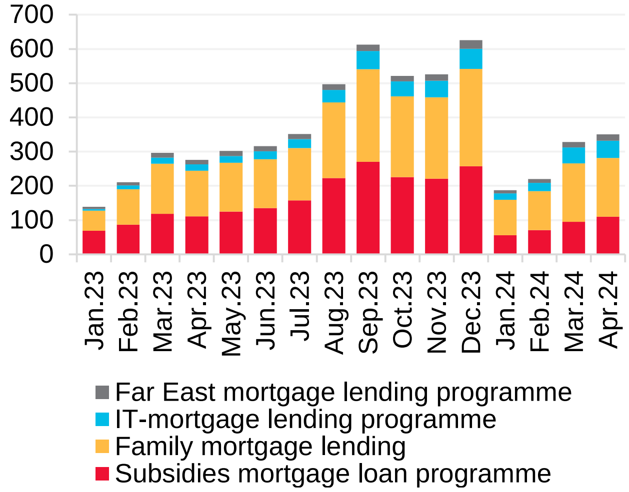
[7] Deposit growth accelerated to 2.1% MoM NSA in April from 1.9% MoM NSA, but the usual seasonal pattern suggests a faster pace of acceleration.

Figure 23. Ruble loans portfolio growth, % MoM SA



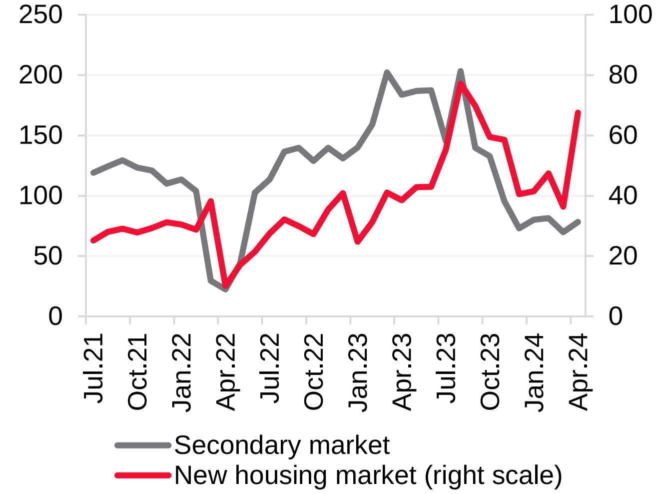
Sources: Bank of Russia, R&F Department estimates

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



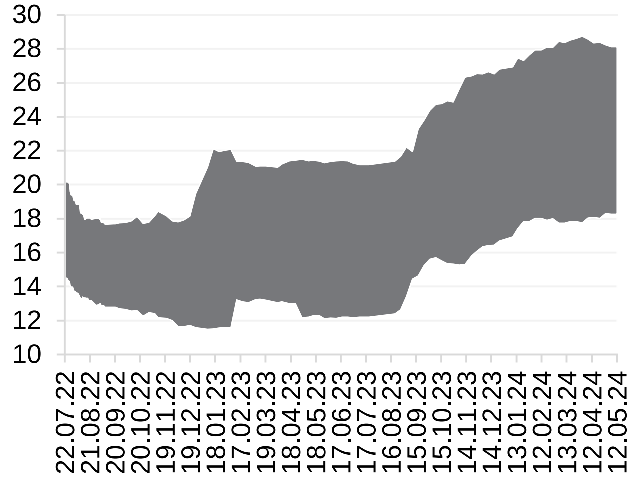
Sources: DOM RF, R&F Department estimates.

Figure 25. Approved mortgage loan applications, thousand



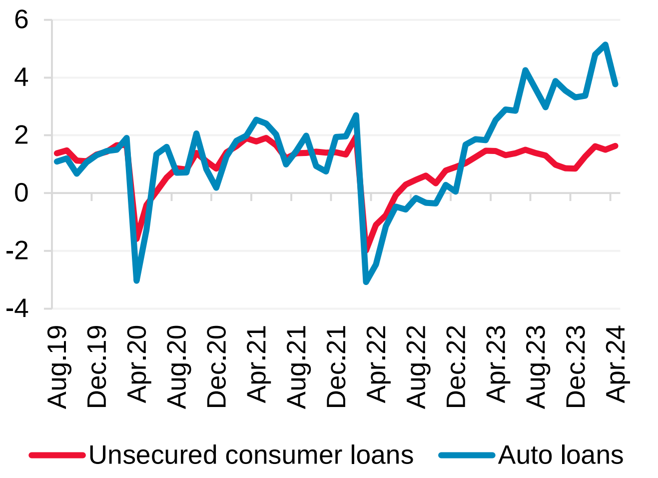
Sources: DOM RF, R&F Department estimates.

Figure 26. The range of average offered rates on consumer loans, %



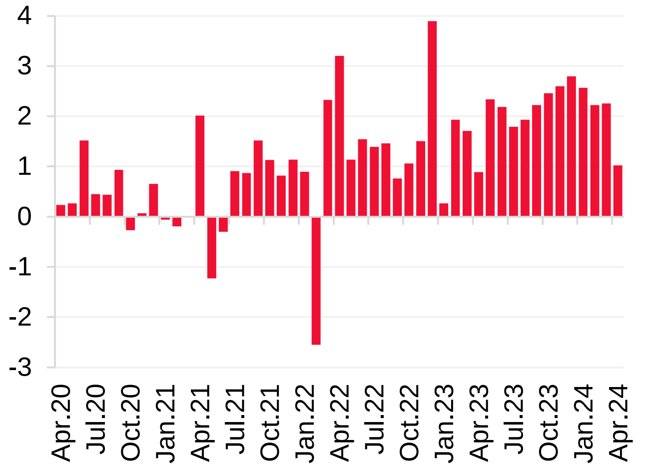
Sources: banki.ru, R&F Department estimates.

Figure 27. Ruble loans portfolio growth, % MoM SA



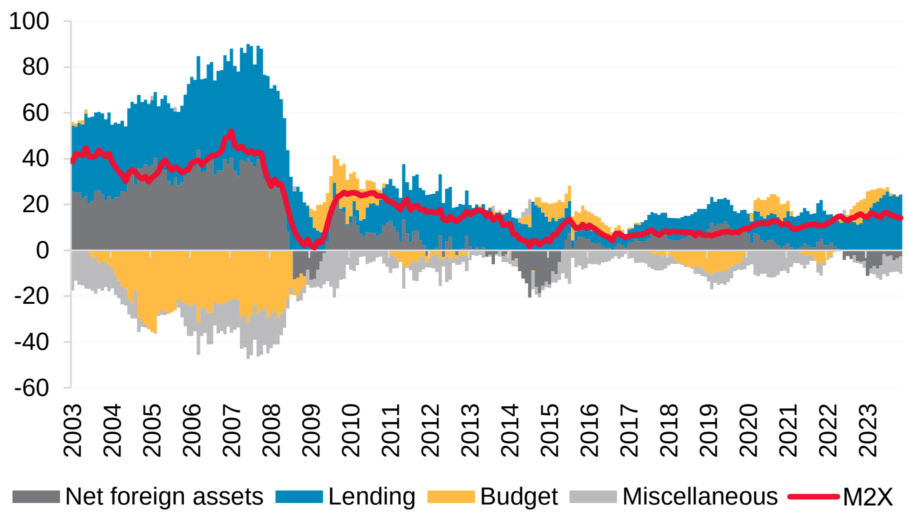
Sources: Bank of Russia, R&F Department estimates

Figure 28. Household funds with banks, % MoM SA



Sources: Bank of Russia, R&F Department estimates

Figure 29. Key drivers of annual growth in broad money supply on the asset side, %



Sources: Bank of Russia, R&F Department estimates