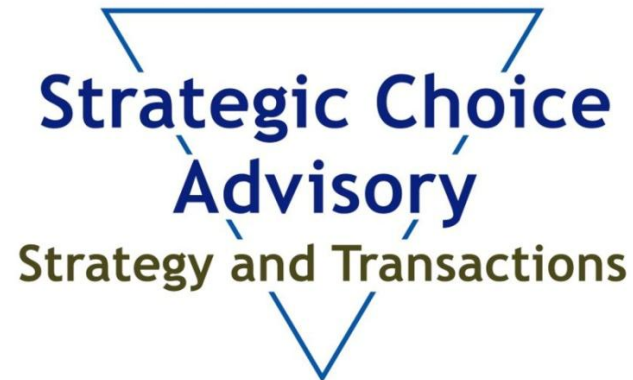


---



**Strategic Choice  
Advisory**  
Strategy and Transactions

**Russia Macro Foresight**

**Broad-Based Recovery Seen in H1/2021, but Growth Stays Vulnerable to Covid-19 Pandemic Surges. Inflation Soars - is Russia's New Infatuation with Non-Fuel Exports to Blame?**

**August 2021**

---



# Current account surplus rebounds on economic recovery, higher export prices and export diversification. Money supply growth slows, but state budget execution solid. Banking sector indices improve, but lending remains highly troublesome

## EXTERNAL SECTOR

- Driven by recovering global economic sentiment amid Covid-19 vaccination progress, Russia's **current account surplus rebounded 71.7% y/y** to USD 43.1bn in H1/2021 after shrinking to a multi-year low USD 32.5bn in full-2020 (CBR data). Not only did the trade surplus regain lost ground (USD 62.4bn in H1), helped by higher commodity prices, but the **service deficit also pitched in, decreasing more than 2-fold y/y** to USD 3.6bn. The share of crude oil and natural gas in goods exports made up 32.1%; adding oil products and LNG as processed goods - 49%
- **FCS Jan-May export data shows continuing diversification.** The share of fuel & energy dropped 3.4pps to 53.1% in volume terms. Metal products gained 1.2pps to 10.7%; chemicals - 1.1pps to 7.8%; machines & equipment - 0.6pps to 6.6%. Foods slid 0.3pps to 7.8% after strong growth. Among imports, the share of machines & equipment rebounded 3.7pps to 49.6%, while textiles and footwear declined 0.7pps to 5.7%
- Despite pandemic woes, external debt rose just 0.9% ytd, declining 2.5% y/y. **State debt declined, while corporate debt has stayed put**

## PUBLIC SECTOR

- **The federal budget was executed with a surplus for the first time in a while**, making up RUB 625bn (USD 8.4bn) after the deficit widened sharply to 3.8% of GDP in full-2020. Still, expenses tend to be back-loaded, and the government still expects a deficit over the full-year. At that, FinMin now says it may make up 1% of GDP, in the absence of external shocks, vs. 2.4% projected initially

## MONETARY AGGREGATES

- Growth of monetary aggregates receded to 2019 levels in H1. Broad-definition monetary base rose 5.7% y/y vs. 9.8% in 2020 and 4.7% in 2019, national-definition money supply - 9.5% vs. 13.5% and 9.7%, respectively. This shows **liquidity for economic expansion stays quite tight**

## BANKING SECTOR

- Activity picked up, as pandemic concerns eased despite a still high caseload and death toll. **Sector profit surged** after sliding in 2020
- **What is not healthy is that higher asset and profit growth was driven mainly by retail lending.** People's debt burden is mounting, and coupled with tiny growth of funds on bank accounts (deposits are even down ytd), latest trends show spending is funded increasingly via loans vs. savings. Retail overdue debt growth slowed to 14.4% y/y, but this is still a departure from the pre-pandemic decline
- Corporate loans grew much slower than retail loans, although growth was higher than in previous years, which should be a bit of a boon for the borrowers. At the same time, **we are quite worried about rapid growth of corporate overdue debt.** This may be a ticking time bomb for Russian banks, as even more may be set to fail, going forward

Indicator, % y/y	2018	2019	2020	H1/2021
Banking sector profit	70.3	71.9	-6.2	49.7
Total assets	6.2	5.9	12.5	15.0
Loans to individuals	22.7	18.6	13.5	21.8
Loans to corporates	7.3	5.8	9.9	11.2
Total overdue debt, o/w:				
Individuals	-10.4	0.5	22.0	14.4
Corporates	7.8	25.9	13.6	20.3
Individuals' funds	6.3	9.7	4.2	2.9
Corporates' funds	5.4	4.7	14.4	14.6

## Economy rebounds, but stays vulnerable to pandemic surges; worsening not excluded in H2 (1/2)

- Real sector growth rebounded in H1 after last year's pandemic slump. Most sectors that were already growing strongly last year saw either acceleration or sustained expansion, while most of those that were struggling managed to boost output. **Mining, manufacturing, transportation, retail trade, etc. all posted very nice gains**, with many sectors already returning to pre-pandemic output levels. **Growth in agriculture, though, has started to cool down**, as we predicted, as market players struggle with over-saturation, tough competition and input price pressures
- Overall, consumers (both B2C and B2B) are rushing to make up for lost time (while they can in the absence of all-out lockdowns), and producers and service providers are happy to cater to them again. Paid services to the population, a sector we expressed special concern about last time, has also managed to fight back, supporting the SME segment and overall population's incomes
- Aggregate corporate profit thus jumped 3-fold in H1/2021 after declining 23.5% in full-2020. Fixed capital investment grew 3.5% in y/y Q1 (latest available data) after last year's decline, also helping rekindle output growth across the board
- **Construction posted solid growth in all major segments** (housing, commercial, industrial real estate), defying our rather pessimistic outlook. Although government stimuli has been scaled back to tackle housing price growth, various support measures are still intact, and overall positive market sentiment is so far fueling real estate purchases. By the same token, growth in furniture and building materials revved up, as home refurbishment remains a thing
- **We are also very happy for growth in higher value-added segments, driven by import substitution.** Computers & electronics, machinery & equipment (including electrical equipment), chemicals, etc. are boosted by this trend, in turn supported by the weak RUB (not least thanks to Western sanctions) and ample government stimuli
- **But... not everything is so rosy.** From what we hear, the strong showings of H1 were driven largely by companies boosting depleted stocks in anticipation of/ in response to higher demand. And **this was taking place mainly before the Covid-19 delta variant hit Russia** in mid-May. It is hard to say where this will all go, as even in June (for some sectors, data is already available for July), the output growth continued, and the pandemic wave is slowly subsiding in some regions. Business optimism figures paint a mixed picture, with some sectors staying upbeat, whereas the **manufacturing PMI reading dropped to its lowest level in over a year in July**. Altogether this shows **the started recovery is still very fragile and vulnerable to pandemic surges**. We can only hope this modern-day plague will abate as soon as possible...

- **Real disposable income grew 1.7% y/y after dropping in full-2020** and growing just slightly in preceding years. Even some luxury goods are buoyant, as people try to replace travel abroad, going out, etc.
- **ILO-definition unemployment shrank 22.3% y/y in Jun 2021**, making up 4.9% of the workforce after peaking at 6.4% a year ago. Full-time, part-time employment; contractor hiring all rose strongly, with **the latter two notably outpacing the former**

Indicator, % y/y	2018	2019	2020	H1/2021
Real disposable income	0.1	1.0	-3.5	1.7
Real wages	7.4	2.5	3.8	3.0*
Nominal wages	10.3	7.2	7.3	8.8*

\* - Jan-May 2021

# Economy rebounds, but stays vulnerable to pandemic surges; worsening not excluded in H2 (2/2)

Indicator, % y/y	2018	2019	2020	H1/ 2021
Industrial production	2.9	3.4	-2.9	4.4
Cargo transport turnover:	2.7	0.7	-4.9	5.1
Railway	4.2	0.2	-2.2	5.2
Automobile	2.3	6.3	-1.4	5.4
Agriculture	-0.2	4.3	1.5	0.2
Retail trade	2.8	1.9	-4.1	10.2
Paid services	1.4	0.5	-17.3	18.7
Construction, o/w:	6.3	2.1	0.1	6.4
Housing	-4.5	6.2	0.2	29.7
Fixed capital investment	5.1	1.3	-1.4	3.5*

Segment, % y/y	2020	H1/ 2021	Segment, % y/y	2020	H1/ 2021
Food products	3.5	1.7	Textiles	8.9	18.5
Chemicals, overall	7.2	8.2	Apparel	0.6	11.5
Resins & plastics	3.2	16.2	Leather & products	-12.4	13.0
Coke & oil products	-3.0	-0.2	Furniture	3.7	39.6
Pharmaceuticals	23.0	20.7	Jewelry	-19.9	64.2
Computers & electronics	-1.6	20.0	Electrical equipment	4.2	12.2
Washing machines	8.0	30.2	Tractors	6.3	13.8
Metal products	2.0	11.8	Metal-cutting equipment	-1.9	16.5
Wood products	0.2	12.8	Cars	-17.5	44.3
Building materials	-2.3	9.8	Trucks	-8.7	59.7

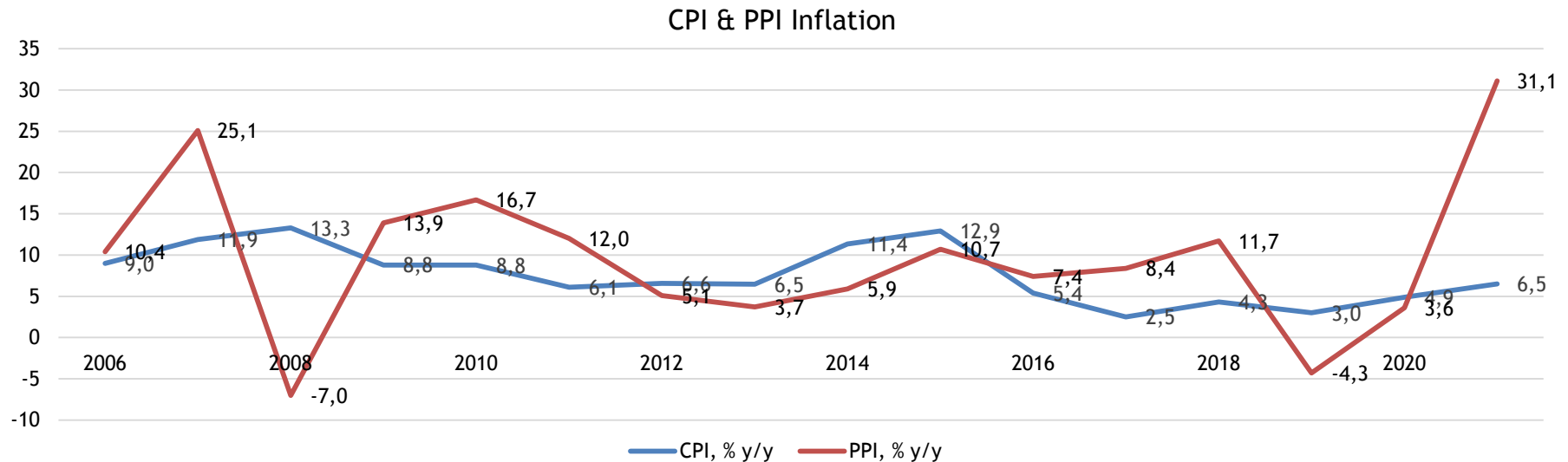
\* - Q1/2021

# CPI inflation speeds up, PPI inflation becomes rampant. Who is to blame and what to do?

**The biggest threat for the Russian economy remains inflation.** As we had warned, inflation has now largely gotten out of control of local authorities, reaching the highest level since the introduction of Western sanctions in 2014-2015. **CPI inflation sped up further to 6.5% y/y in June**, spurred by both soaring food prices and now also non-foods. Government's mid-term annual target had been 4-4.5%, with this year's 5% goal likely to be raised again. **PPI inflation hit a staggering 31.1% y/y**, with rampant price hikes across the board. We said in our previous two reports that something like this was about to happen, but the magnitude of the spike-up surprised even us. There are several main factors:

1. Improving global economic sentiment pushed up oil&gas and other commodity prices, together with postponed demand for various goods and services. This effectively drives up local prices through the export parity mechanism applied in various export-oriented sectors
2. Russia has started exploring export markets in a growing range of sectors, thanks to the weak RUB, import substitution and government stimuli. In many industries this creates local deficits, e.g. in metals, timber and wood products, agriculture, etc., driving up prices
3. Last but not least, this is typical local mentality, anything but customer-centric or efficiency-focused. Whenever there is an excuse (financial crisis, pandemic, higher taxes, input price pressure, logistics inefficiency, etc.), local players' primary response is to hike prices. There is even a joke in Russia, that prices can only go up, not come down

The inflation surge has disrupted profit margins and the overall balance of things for most sectors. **Authorities are trying to use price cap mechanisms** in various sectors (foods, metals, oil products, etc.), arousing much criticism. Still, **we think the measures may be justified** - at least during the pandemic, and given the need to reverse companies' inclination to use price hikes first and foremost to offset sales declines or input price inflation. There is much bargaining to be done between parties involved, but **the trick for government will be offering various benefits and compensation to producers, while also protecting local purchasing power and public welfare.**



*For additional information,  
please contact:*

**Andrew Afanasiev**

Managing Partner, CEO

Mob. +7 (903) 745 7330

E-mail: [aafanasiev@strategicchoice.org](mailto:aafanasiev@strategicchoice.org)

**Strategic Choice Advisory**

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

Tel.: +7 (495) 135 2830

<https://www.strategicchoice.org>