
**Strategic Choice
Advisory**
Strategy and Transactions

Russia Macro Foresight

Growth Slows Sharply in H1/2025 as Government Works to Prevent Overheating, yet Market Players Behave Prudently, Stash Cash

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Real sector figures deteriorate sharply, as many segments see contraction or growth slowdown. However, overall growth supported by some key sectors staying solid

- The Russian government finally succeeded in... cooling economic growth. The sky-high key rate, intended to tackle rampant inflation, has brought the economy to a near standstill! (Big round of applause.) The economy still managed to eke out **1.2-1.3% y/y real GDP growth in H1** (first estimate just released), which included **1.4% in Q1** and a lower still **1.1% in Q2**. Growth had made up 4.1% in full-2024, unchanged from 2023. EconMin still sticks to its 2.5% forecast for full-2025, but this seems a bit of a stretch. Other government officials have voiced expectations of 1.5-2%, and even that remains to be attained
- Only supply-side Q2 figures have been released thus far, showing **growth in manufacturing easing to 3.7% y/y vs. 8.5-8.7% in 2023-2024**. Restaurants and catering stay strong, and **construction surprised positively**, rebounding from a dismal 2024 (more on that below). As did agriculture, something we predicted, after the sector was impacted by last year's exceptionally cold and wet spring. Comprehensive Q1 figures show **investment exceeded expectations, growing 8.7%, although we expect this figure to come down**, based on leading indicators. HoReCa altogether grew 6.8% vs. 5.8% in full-2024, and finance and insurance remained in rip'n'tear mode (17.5%). At the same time, **household consumption grew a meagre 2.6% vs. 6.3% in 2024**, with spending by both households and corporates slumping. Interestingly, **gross savings rose 1.9% after contracting 7.6% last year**

Indicator, % y/y	2022	2023	2024	H1/ 2025	Segment, % y/y	2023	2024	H1/ 2025	Segment, % y/y	2023	2024	H1/ 2025
Industrial production:	0.7	4.3	4.6	1.4	Food products	6.6	3.5	-0.7	Chemicals	5.2	3.1	2.5
Manufacturing	0.3	8.7	8.5	4.2	Textiles	3.7	3.8	2.5	Rubber & plastic products	8.0	0.8	-4.0
Cargo transp. turnover:	-2.3	-0.6	0.4	-0.3	Apparel	15.2	5.9	-2.7	Pharmaceuticals	-0.4	18.0	14.5
Railway	-0.1	0.0	-4.3	-1.0	Metallurgy	3.0	-1.2	-3.4	Coke & oil products	2.5	-2.1	1.6
Automobile	5.8	15.4	6.5	5.7	Metal products	26.4	35.3	13.6	Machines & equipment	8.1	-2.7	-0.5
Agriculture	11.3	0.2	-3.2	1.5	Wood products	-1.6	4.2	-3.5	Electrical equipment	20.6	6.6	-1.5
Retail trade	-6.5	8.0	7.2	2.1	Furniture	11.5	7.7	-4.6	Automobiles	16.0	16.5	-16.6
Construction:	7.5	9.0	2.1	4.3	Building materials	0.9	4.4	-7.1	Computers & electronics	39.4	28.8	15.1
Housing	11.0	7.5	-2.4	-2.4								
Fixed capital investment	6.7	9.8	7.4	8.7*								

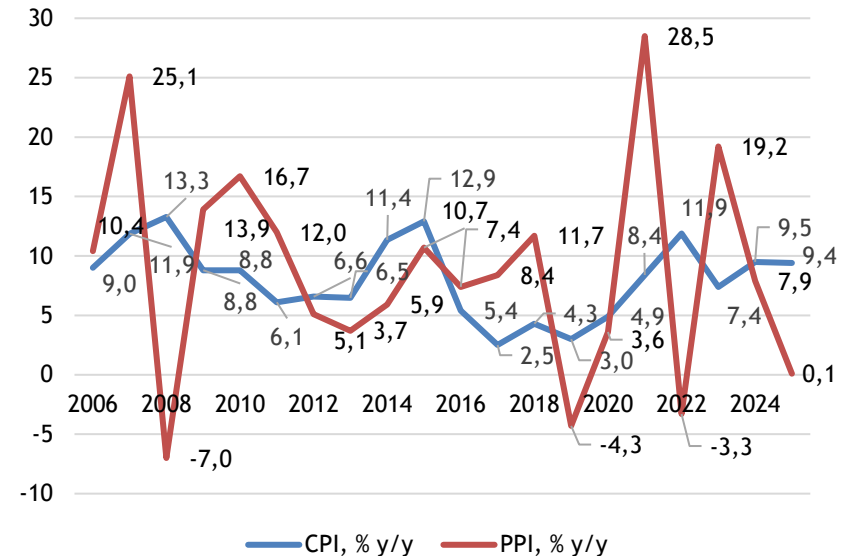
* - Q1/2025

PPI inflation comes to a halt, and CPI inflation starts to slow, allowing CBR to lower key rate. Real income and nominal wage growth remain robust, but real wage growth slumps...

- Before we do our usual outline of how things are going in different sectors, we want to first describe trends in inflation and income that affect consumption and, subsequently, further production
- CPI inflation cooled a bit to 9.4% y/y in June (3.8% ytd) vs. 9.5% y/y in Dec 2024.** It peaked at 10.34% y/y in March before slowing by just under 1 pp, allowing CBR to finally bring down the key rate from 21% then to still high 18% in July. **PPI inflation slowed to 0.1% y/y in June (-4% ytd).** Agricultural prices have risen just 0.7% ytd (12.8% y/y), while prices of investment goods are up 3.9% ytd (9.4% y/y)
- In CPI inflation, food prices rose 4.6% y/y in June, non-foods - only 0.6%, services - 6.5%. Rapid inflation was seen in meat & poultry, fish, dairy, sunflower oil, and fruits & vegetables. Biggest price hikes in non-foods were in building materials, pharmaceuticals, and gasoline; services - healthcare, passenger transport, and recreation
- In PPI inflation, extraction prices dropped 17.8% ytd, while prices in manufacturing slid 0.4%. Inflation in metals was significant in y/y terms (9.1%), but prices are down 3.1% ytd. Strong price growth continued in extraction of building materials (7.3% y/y and 5% ytd). **Inflation in investment goods was minimal, likely as demand dipped**

- Nominal wage growth remained solid at 14.3% y/y in Jan-May, albeit coming down from 2024's spike-up to recent averages. Nominal income gained 17.5% y/y in H1. However, **while real disposable income growth was robust at 7.8% y/y, real wage growth slowed sharply to just 3.8% y/y in Jan-May.** This is owed to towering inflation. Companies are still raising wages regularly amid a labor shortage, but **if this trend is sustained, it will inevitably curb consumption and economic activity**
- Positively, after a pent-up we noted last time, **wage arrears finally dropped back to last year's levels in June.** Again, it remains to be seen whether this turnaround will hold in a challenging macro environment
- Both ILO-definition and official unemployment stayed record low, at 2.2% and 0.4%, respectively. Still, **there are reports that hiring is being tempered or put off now in many sectors due to weak demand**

CPI & PPI



Indicator, % y/y	2022	2023	2024	H1/2025
Real disposable income	4.5	6.1	7.3	7.8
Real wages	0.3	8.2	9.7	3.8*
Nominal wages	14.1	14.6	19.0	14.3*

* - Jan-May 2025

While many sectors struggle in high inflation and interest rate environment, companies remain flexible, with some managing to hike prices and focusing on lucrative niches (1/2)

- Going back to production dynamics (*table on p. 2*), here are a few more strokes to complement the sectoral picture. **Aggregate corporate profit declined 9.7% y/y in Jan-May** (not a bad result, actually, in current circumstances) after edging down 6.9% in full-2024. The share of loss-making entities increased 2.1pps to 31.1%, continuing to fluctuate around multi-year averages
- Among key sectors, cargo transport turnover inched down 0.3% y/y in H1, generally showing little change over the last few years. We do have some doubts about how representative sector figures are nowadays, what with the sanctions and ways of evading them. Maritime transport dropped 31.3% after last year's stellar gains, and river transport slumped (-3.9%). At the same time, automobile transport grew 5.7%, still strong, vs. 8.1% in H1/2024 and 6.5% in full-2024. And the decline in railways was less pronounced (-1% vs. -5.7% in H1/2024 and -4.3% in full-2024). Interestingly, cargo load in railways dropped 7.7%, reversing 2024's increase. This reflects the broad economic downturn, plus existing bottlenecks, but also reveals railway shipping distance has now risen substantially. Overall cargo load only rose 0.6% vs. 4.2% a year ago. Transport & storage profit rose 8.3% y/y in Jan-May, even though pricing power is impaired this year (only automobile transport managed to post a meaningful increase, of 5.8% ytd)
- As noted above, construction surprised positively, growing 4.3% in H1 vs. 2.1% in full-2024. Housing declined 2.4%, on par with 2024; a commendable result, with all the hindrances like sky-high mortgage rates, and cutbacks in government support, affecting home purchases. We are somewhat concerned over a housing bubble forming, though... Good to see developers are quite flexible, putting off finalization of some projects, needing to fill previously built homes. Strongest growth was observed in infrastructure construction (roads and bridges), as well as facilities for specific sectors, especially husbandry. Construction in pharmaceuticals was paused after last year's massive launches. Trade realty stayed robust, and there is a deficit of office space in many major cities. Intriguingly, construction sector profit jumped 39% y/y in Jan-May. Interested to see if this holds, as market players definitely need some breathing room (and are going to need assets and cash from previous fat years)
- Surprising negatively, though, was retail trade, which only grew 2.1% in H1 vs. 9.9% a year ago and 7.7% in full-2024. Equally lackluster figures were put up in foods and non-foods. Tellingly, wholesale trade dropped 3.2% vs. 6.9% growth in full-2024. In terms of profit, though, the indicator soared in wholesale trade, but contracted significantly in retail. Apparently, wholesalers' pricing power is still there. We will be watching further data in coming months, to assess longer-term prospects
- Personal services rose only 2.3% vs. 5% in H1/2024 and 6.9% in full-2023. Restaurants & catering remained buoyant, growing 8.1%, albeit a few pps slower than last year. Hotels gained 7.7%, IT & communication services - a staggering 21.5%, healthcare services - 4.9%. Profit growth in most of these sectors also stays solid
- Agriculture rebounded more or less (as we expected) from 2024's dismal performance, caused by especially unfavorable weather. The sector grew 1.4% in H1, and given that this year horticulture is so far off track (again, cold May-June in many regions to blame), there is further upside for H2 (weather permitting). As can be sensed above from construction data, new investment in husbandry is taking place. Meat & poultry, eggs, milk and other major agriculture products are seeing steady output growth. Sector profit is still down slightly, by 5.9% y/y. On a separate note, fishing seems to have overcome last year's bad catch in certain segments, and is back in growth mode, plus, profits are resurging

While many sectors struggle in high inflation and interest rate environment, companies remain flexible, with some managing to hike prices and focusing on lucrative niches (2/2)

- Total industrial production rose a modest 1.4% in H1 after 4.3%, 4.6% figures the previous two years. Extraction dipped 2.4%, more than the 0.9-1% declines of 2023-2024, unsurprisingly amid sanctions and high interest rates. Still, coal output rose 2.3%, metals - 3.2%. Extraction of building materials plunged 9.2%. Still, **profit in both metal and building materials extraction soared, even as steel manufacturers say they are having a hard time**. The situation seems to be more positive in non-ferrous metals
- Manufacturing grew 4.2%, less than half of the eye-popping 8.5-8.7% growth of 2023-2024. As noted above, the Q2 reading was an even lower 3.7%. That said, apart from standout January, growth was more or less stable at roughly 3-4% over Feb-Jun. Total profit in manufacturing edged down 6% y/y in Jan-May
- Looking at segment output data, it mostly shows either decline or sharp deceleration. Where, then, does the overall growth come from? Pharmaceuticals surged 14.5%, metal products - 13.6%, computers & electronics - 15.1% (albeit much slower than in previous years), medical equipment - 16.8%, machine & equipment repair - 7.5%. Growth in chemicals held up nicely at 2.5% in H1 vs. 3.1% in full-2024 (with profit skyrocketing 76.4% in Jan-May; and ammonia, fertilizers and herbicides serving as growth leaders)
- Non-auto transportation equipment soared 34.6%, but actually, solid growth was observed only in boats. From what we know, this segment also contains certain military equipment, and indeed, Russia has been ramping up its military complex for the war in Ukraine. Overall, **now we can see war-related items becoming key growth drivers across various segments, supporting the overall output growth figure** (such was not the case earlier, as we noted several times in previous reports)
- Production of food products appears to have hit a brick wall, possibly as soaring prices ward off consumers, in turn curbing output. Segments like poultry, potatoes, butter, fruit jam, and now even BAA are still expanding, but otherwise there is an evident slump. Producer price growth in foods, while still very high in y/y terms, made up only 2.9% ytd in H1. Food segment profit dropped 20.3% y/y in Jan-May. Meanwhile, in beverages previous growth leaders bottled water and soft drinks seem to have taken a break, and hard liquors (e.g. vodka and cognacs) are taking a nosedive, but production of still and sparkling wines is soaring (18.5% in H1). Lots of investment is going into this segment, and Russians are discovering and proudly consuming more and more local wines now
- Within the many sectors struggling now overall, some of the bright spots are: yarn, threads, and non-woven materials in textiles; uniforms in apparel; suitcases and the like in leather goods; fuel pellets, plywood and windows in wood products (which have generally turned the corner, as we noted earlier, with profit also growing 45.2% in Jan-May, but where production of practically all other items is down again y/y); publishing; tires for agricultural machinery in rubber products (an otherwise downbeat segment now); fiberglass in building materials (same negative overall trend); gas turbines and woodworking equipment (suffered heavily from the departure of foreign players, but now seems to be regaining lost ground) in machines & equipment (fighting it in general, even though pricing power seems to be above average amid maintained demand)
- **At that, business confidence in manufacturing fluctuated at 0-1 pts in May-Jul, per Rosstat data. Much lower than the record levels seen throughout 2023-2024, but still not in negative territory. Turnover in current prices is still growing strongly, even despite weaker pricing power**, and that seems to be keeping spirits and profits up. With only a few exceptions, including oil products, where world prices have declined, and cars, as the market is over-saturated with Chinese imports and Russian-assembled vehicles. For example, profit in metal products jumped 39.9% y/y, electrical equipment - 68.5% (despite 1.5% output decline)

Banking sector still in good condition thanks to strong profits, despite significantly slower loan growth. Worrying sign is increase of problem loans in both corporate and retail segments

BANKING SECTOR

- Despite the economic slowdown inevitably affecting key performance metrics, **the banking sector remained in pretty good shape**. We may have said this more than once. Corporate loan growth receded further to still admirable 11.5%. Retail loans grew a mere 4% a far cry from 26.5% in 2023. **Which is exactly what CBR wanted to do, to cool runaway lending growth**. Perhaps just not to this extent. Consumer loans actually dipped 1.3%, as consumers simply would not have it with such high rates. Mortgage loans rose 4.4% on maintained, albeit downsized, government programs, even as rates became prohibitive for most home buyers
- **The share of problem loans edged up 0.3pps to 4.1% of corporate loans, reversing a steady decline, and surged 1.1pps to 5.7% of retail loans**. CBR says it only reflects a natural evolution of the loan portfolio, but we only hope it does not get too far
- Retail deposit growth slowed, as deposit rates started to go down together with the key rate. **Corporate funds' growth eased further to 7.4%. Companies are obviously saving cash during a downturn**. Worth noting, corporate deposits shrank 6.7% ytd, and while some decrease is purely seasonal after companies put away funds for the long winter holidays, deposit levels have not yet recovered
- As retail deposit growth still stays high, while lending has generally dried up, banks are searching for alternative income sources. **Investment in securities is starting to increase now, especially in bonds**. Highly active local bond and stock markets, supported by a stronger RUB, also provide additional income for banks. **A reassuring statistic is growth of RUB liquid assets by 24.4% y/y**
- Also positively, **total profit made up RUB 1.7tn in H1, unchanged y/y**. Banks have made substantial profits in recent years to the tune of RUB 3.3-4tn per year, and have built sizable safety cushions
- On a separate note, we are told that CBR has started lowering loan loss reserve requirements for specific corporate borrowers at specific banks (a key profit driver for banks late in H1). **This is intended to support certain ailing companies in times of hardship**. Thus, even as the situation remains under control, the latest negative trends are definitely worth watching

Indicator, % y/y*	2022	2023	2024	H1/2025
Loans to individuals	9.5	26.5	14.2	4.0
Loans to corporates	14.3	20.7	17.9	11.5
Individuals' funds	6.9	19.7	26.1	21.4
Corporates' funds	20.6	14.7	11.9	7.4

Money supply growth slows, CA surplus shrinks, budget execution deteriorates sharply, and external debt resurges. But FX reserves keep growing amid RUB appreciation, and FDI rebound

MONETARY AGGREGATES

- Also coming as no surprise, growth of key monetary indices slowed visibly in H1. **National-definition (RUB) money supply rose 15% y/y vs. 19.2-19.4% in 2023-2024.** The indicator is up just 1.6% ytd. Again, strong growth of deposits was offset by near-zero growth of cash in circulation. **Broad-definition monetary base (including FX funds) grew only 3.2% in H1 vs. 5.5% in full-2024**

EXTERNAL SECTOR

- The situation in the external sector is mixed. Only partial BoP data has been released thus far for Q2. It shows the current account (CA) surplus dropping to USD 7.3bn in Q2 vs. USD 17.7bn in Q1/2025 and USD 24.9bn in Q1/2024. **The total CA surplus for H1 made up USD 25bn vs. USD 42.1bn a year ago. The trade surplus actually stays solid at USD 57.3bn in H1 (USD 27.2bn in Q2), a rather mild decline from USD 70.9bn in H1/2024. The service deficit has widened to USD 20.7bn in H1 from USD 16.1bn a year ago, in Q2 - to USD 12.9bn from USD 9.3bn. The income deficit decreased slightly to USD 11.6bn from USD 12.7bn in H1/2024. Russia obviously has to rely on additional services from foreign partners amid broad-based sanctions and restrictions**
- Fascinatingly, in quite the turnaround, **accumulated FDI jumped USD 48.1bn q/q in Q1 to USD 264.5bn.** The indicator had plunged all the way to USD 216.4bn at end-2024 from USD 279.3bn at end-2023 and USD 497.7bn at end-2021. It remains to be seen whether this is foreign investors encouraged by the start of US-Russia talks early this year on the Ukraine war, or Russian money returning home (for much the same reason). Cannot wait to see the full Q2 statistics when they are released
- **FX & gold reserves reached USD 686.4bn, growing USD 76.9bn (12.6%) ytd,** after having fluctuated within USD 560-600bn for over a year. RUB has strengthened to 78.47 vs. USD at end-June, that's by 30.1% from 101.74 at year-start. It also gained 27.2% vs. the trade-weighted currency basket over H1. **In real terms, it appreciated 32.3% vs. USD, 11.2% vs. EUR, 15.9% vs. CNY, and 14.1% against the trade basket. CBR now has to stem RUB strengthening to support budget revenues, boosting its FX reserves in the process. What RUB appreciation does (apart from shrinking budget revenues) is it increases trust in the local currency, economy and banking system, and reduces the cost of imports, thereby curbing overall inflation**
- Meanwhile, **foreign debt surged USD 26.7bn in Q1 to USD 317.5bn.** The indicator had gone down to USD 290.8bn from USD 497bn at end-Q3/2021 before the sudden spike-up. Interestingly, **it increased markedly across all segments:** government, CBR and banks, and corporates. Lower rates and RUB appreciation make borrowing in foreign currency more attractive for Russian entities now. The increase was mainly in short-term debt, and is only partly explained by FX-denominated bond issuance

PUBLIC SECTOR

- **The state budget deficit reached RUB 4.9tn in Jan-Jul 2025,** as revenues rose only 2.8% y/y to RUB 20.3tn, and spending surged 20.8% to RUB 25.2tn. Oil&gas revenue slid 18.5%, due to obvious reasons, while non-oil&gas revenue grew 14%. The deficit made up RUB 3.5tn in 2024, just an inch higher than in 2022-2023 (RUB 3.24-3.35tn), but seriously overshooting initial and revised targets
- FinMin claims the deficit is mainly attributed to extra budget funds being disbursed unusually early in the year, to support recipients and even out spending throughout the year. But it appears that also, **apart from military spending, social welfare and infrastructure projects are getting additional funds,** to compensate for higher inflation, and to support import substitution (in itself very expensive)

Summary: economy seriously impacted by anti-inflation measures and Western sanctions, but banks and corporates stay prudent and flexible. All eyes now on the US-Russia Alaska summit!

- For the second time in a row, just as we were combing through data for the report, some major events started taking place, causing us to realize we may have to make serious changes to our assessments and conclusions. This time we are in a hurry to release the report just before the US-Russia summit in Alaska starts. It has been quite interesting to examine just where Russia stands economically ahead of this pivotal moment
- Economic growth *finally* slowed considerably in H1, following lengthy and seemingly fruitless efforts by monetary authorities to cool the economy which risked overheating. Output and lending growth have been curbed, if not to say stopped ... in their tracks. Mission accomplished, to some extent. Whether government may have gone too far, remains to be seen, depending on future dynamics
- There are many bright spots among sectors and product/service segments, but generally, growth has slowed dramatically. PPI inflation has dropped to zero in y/y terms, and CPI inflation is also starting to slow, albeit reluctantly. CBR has thus nudged down its key rate by 3pps to still high 18%. Money supply growth is now slowing, as is real wage growth, affected by high inflation. This is already starting to hurt retail trade and consumption, with the effect likely becoming more pronounced further down the road (barring any abrupt end to the Russia-Ukraine war, which may provide serious impetus for the Russian economy)
- Fortunately, the banking sector stays in fairly good shape, supported by high profits and ample liquidity cushions. The pent-up in problem loans is a bit concerning, but banks and the government should be able to quell any potential disruptions if they occur
- Overall, market players seem to be behaving quite prudently: avoiding taking prohibitively expensive loans, deferring investment and other new projects that can be put off, and saving up money wherever they can, whether on bank accounts, or just by cost-cutting. Total corporate profit has declined, but only marginally, while some sectors still manage to increase profits
- Russia's external and fiscal balance have no doubt taken a big hit from the combination of tougher sanctions, lower world oil prices, high domestic inflation and weaker economic activity (mostly self-inflicted to avoid overheating). The budget deficit has increased substantially, as social welfare, infrastructure and military spending has grown notably. The current account balance is shrinking, even as the trade surplus remains strong. Also, foreign debt, while staying low by any standards, spiked up in Q1, as borrowing in foreign currency at lower rates has become more attractive
- At the same time, FX & gold reserves are increasing significantly, as CBR has to stem robust RUB appreciation. Also, FDI soared unexpectedly in Q1, just as US-Russia talks were starting up. Domestic investment growth also stayed strong in Q1, even though it can be expected to slow, following the economic downturn
- Going forward (and leaving US-Russia talks aside, at least hypothetically), an interesting question is what happens if inflation slows further and CBR cuts the key rate to more palatable levels. There are signs lending and spending growth may restart all too quickly, even though that would definitely support import substitution and production growth. Should US-Russia relations improve, and a roadmap of ending the Ukraine war is agreed by involved parties, any future foreign investment inflows and return of foreign majors to the Russian market can affect local players in different ways. On one hand, it can spur economic activity, but on the other, pose a risk to newly emerged local market leaders, undermine import substitution, and again drive up inflation. This is something Russian authorities are perfectly aware of, and would not make life too easy for returnees. So, stay tuned and don't switch the channel!

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