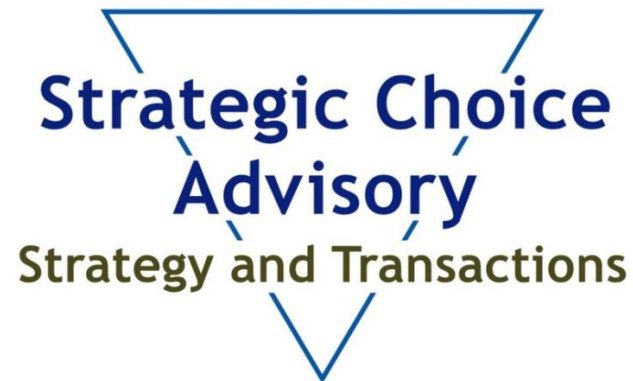


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**Strategic Choice  
Advisory**  
Strategy and Transactions

**Russia Macro Foresight**

**So Far So Good: Economy Affected, but not Impaired; Businesses  
Busy with Workarounds; Authorities Focus on Tax Collection.  
What Next?**

**August 2022**

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Last time around, we published a report on Feb 11 titled “Strong Recovery Takes Place in 2021, Despite Pandemic and Rampant Inflation, but is it the Calm before the Storm?” Well, something was obviously in the air, and Feb 24 brought what it brought, so now we are trying to understand just how the Russian economy is coping with all the sanctions and restrictions. At the time we received quite a few responses from readers that perhaps we are too optimistic, should worse come to worst and if a military conflict is about to erupt.

So far, a common trope in mass media is that the escalations and sanctions have only boosted oil&gas and other commodity prices, thereby benefiting the Russian state (while damaging Western economies). With this report we take a more in-depth look at the Russian H1/2022 macro and industry figures. This is not so easy to do this time, as the stat data is obviously in total disarray, and much of it is withheld from public view by Russian authorities. Thus, as usual, we rely also on our own observations and discussions with various local experts.

# Monetary sector indices show liquidity shortage, but still fairly solid. External sector, state budget figures stay exceptionally strong

## MONETARY AGGREGATES

- Growth of national-definition (RUB) money supply sped up to 16.8% y/y in H1 vs. 13% in full-2021 and 13.5% in full-2020. At the same time, broad-definition monetary base (including FX funds) shrank 0.7% y/y after growing 10.1% in 2021 and 9.8% in 2020. Thus, **despite relative abundance of RUB liquidity, boosted by all the restrictions on FX transactions, overall liquidity remains rather tight**
- Interestingly, while cash in circulation rose only 3.6-4% y/y in both RUB and RUB+FX terms, RUB bank deposits surged 20.4% y/y! After mass withdrawals at the start of the pandemic (explaining partly the low base), **it seems there is still trust in local banks (even if in somewhat forced circumstances), despite all the geopolitical and economic turbulence**

## EXTERNAL SECTOR

- **RUB strengthened 4.9% y/y vs. USD, 16.4% vs. EUR in real terms in H1**, as authorities fought to overcome the impact of sanctions. RUB/USD rate jumped from 76.77 on Feb 22 to 120.38 on Mar 11, but then tumbled all the way to 51.16 on Jun 30 (actually dipping below 50 intraday). **CBR then weakened the RUB to reduce the damage from over-appreciation to export competitiveness and budget revenues.** The rate has now stabilized around 60. A strong RUB makes imports more affordable and foreign debt payments easier to make, but at some point not only did export revenues decline, but in many sectors producers became less competitive, especially with the significant logistics costs typically tacked on due to Russia's vast size, which now also soared due to geopolitical complications. Authorities will continue this balancing act, and RUB might weaken further, depending on where commodity prices go
- **FX & gold reserves slid from USD 643.2bn on Feb 18 to USD 571.2bn on Jul 29** (up USD 5.9bn over the past two weeks after CBR weakened the RUB). This does not account for the fact roughly USD 300bn worth of reserves were blocked by international sanctions
- At the same time, the **current account surplus soared by almost USD 100bn y/y to USD 138.5bn in H1 vs. USD 39.7bn a year ago.** Exports surged 37%, while imports dipped 7% due to the various sanctions and many importers' hesitation to sell goods to Russia. Federal Customs Service and CBR stopped publishing detailed breakdowns by type of goods (as Russia works around sanctions by conducting transactions through third countries and/or does not want to put counterparties at risk), thus it is not possible to make detailed conclusions. In any case, companies are busy realigning trade partners and payment systems to counter the sanctions
- Encouragingly, **external debt declined USD 9.2bn ytd to USD 472.8bn, even though it rose USD 21.4bn in Q2, driven by a rebound in state debt and a moderate rise in corporate debt.** There are, of course, certain issues with accounting debt volumes due to arguments over payment currencies and methods

## PUBLIC SECTOR

- On the back of a strong balance of payments (BoP), **the federal budget surplus expanded to RUB 1.37tn in H1 vs. RUB 515bn in full-2021.** Revenues overshot the target, driven by strong tax and duty collection. Expenses were also slightly above target, showing little if any sign of under-fulfillment across categories, spanning both industrial construction and social service infrastructure
- Our understanding is that **government's top priority at this point is tax collection, often at the expense of enterprises' well-being.** Filling up budget coffers is considered more important than various stimuli and support measures (which are also provided)

# Banking sector growth slows and profit dips amid Ukraine events, but banks dig in, fight back

## BANKING SECTOR

- CBR has concealed a lot of banking sector indices after the start of the military conflict, including total asset, aggregate profit and overdue debt data. This was due to banks hustling to work around sanctions, which affects key indices, plus CBR eased reserve and capital formation, and other regulations to support the struggling banks. Interestingly, banks' correspondent accounts in other banks shot up, **possibly as banks reshuffle assets and liabilities, and rely on interbank transactions** for their normal activities
- Among key indices that are still being published, **y/y growth in Jan-May** (latest available data) **hardly changed, compared to last year**. Corporate loans grew 10% vs. 11.3% in Jan-May 2021; retail loans - 14.8% vs. 20% (we had expressed concern over excessively rapid growth, thus the slowdown is actually quite welcome); corporate deposits - 17.4% vs. 17.2%; retail deposits - 4.7% vs. 4.3%
- Worth noting, ytd growth this year is lower than last year for many indices, but this is actually a typical trend that growth slows at year-start during and after the lengthy New Year break, and then business activity, spending (and growth of savings ahead of the long holidays) pick up toward year-end. This year is anything but normal, but it seems the banking sector and monetary indices are trending in much the same pattern. **Growth of retail lending and other indices is said to be picking up again in May-Jul**
- Negatively, our banking sector sources say **growth of overdue debt is also picking up**. In our previous report we noted that retail overdue debt growth had slowed notably, but remained too high for comfort, while corporate overdue debt declined in 2021 after rapid growth in 2019-2020
- **Aggregate banking sector profit is also said by industry experts to have declined this year** due to risk revaluations resulting in higher cost of funding, **although liquidity so far remains manageable**. A strongly supportive factor is **surprisingly robust growth of aggregate corporate profit**, which we dwell on in further slides on real sector data
- Looking closer at liabilities, we see completely opposite dynamics in corporate and retail funds and deposits. With corporates, deposits inched down ytd, whereas funds on correspondent accounts gained notably, as companies need liquidity for additional spending in the face of accelerating inflation. Meanwhile, retail funds on correspondent accounts are down ytd, as some clients withdraw more money for daily purchases or rush to buy products that become unavailable due to import restrictions, but deposits have surged, of which long-term (over 1 year) deposits are down slightly, but mid-term ones (1-12 months) have shot up. Thus, it appears that **customers retain overall trust in banks** and try to increase savings, as investment in securities has collapsed

Indicator, % y/y	2019	2020	2021	Jan-May 2022
Loans to individuals	18.6	13.5	25.1	14.8
Loans to corporates	5.8	9.9	17.0	10.0
Individuals' funds	9.7	4.2	5.7	4.7
Corporates' funds	4.7	14.4	17.0	17.4

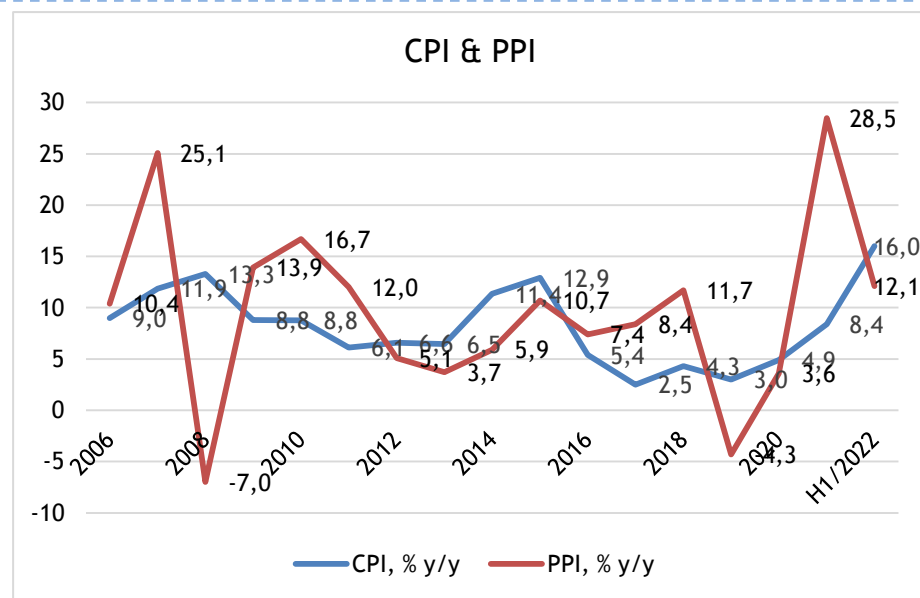
# Nominal wage growth picks up to keep up with higher inflation, but real income still dips. Towering inflation remains major constraint, but shows signs of slowing

- Speaking about people's welfare, **nominal wage growth accelerated further to 12.9% y/y in Jan-May**. But because inflation sped up even faster (*see below*), **real wages and real disposable income contracted slightly** after posting solid readings last year
- **Retail trade turnover declined 3.4%** after growing 7.3% in full-2021, as non-foods dropped 6.9%. Although incomes were definitely affected, **we are inclined to attribute the drop rather to the departure of major foreign retailers and importers**. Restaurants and catering, paid services all stayed robust, shrugging off the effects of the (still intact) pandemic. It does not seem like purchasing habits have changed much, at least yet
- **ILO-definition unemployment slid further to 4%**, official unemployment - to below 1%. As we noted last time, there is a labor market deficit in many sectors, and full-time, part-time and contractor hiring are all growing strongly. It remains to be seen how the situation will change as **more departing companies resort to lay-offs**. **But it seems investors are queuing up**, anxious to lay their hands on the prized assets

Indicator, % y/y	2019	2020	2021	H1/2022
Real disposable income	1.0	-2.0	3.0	-0.8
Real wages	4.8	2.5	4.5	-0.9*
Nominal wages	9.5	6.0	11.5	12.9*

\* - Jan-May 2022

- Indeed, inflation remains a major threat. **CPI inflation sped up further to 16% y/y in June (over 17% in Apr-May) vs. 8.4% in Dec 2021 and 3% in Dec 2019**. Consumer prices rose 11.4% ytd, with foods and non-foods surging 12.5% and 12.9%, respectively. Food producers let loose as soon as the military conflict started, while among non-foods, household chemicals prices rose strongest amid departures by foreign majors. Service prices rose just 5% ytd
- As we noted earlier, **local entities are prone to use any commotion whatsoever to hike prices**, and while RUB has appreciated dramatically after the initial plunge, prices have declined just slightly. As the old saying in Russia goes, prices can only go up, not come down... At that, **May-Jul has indeed seen prices decline gradually**, beyond the typical summer deflation
- Also, **PPI inflation slowed notably from 28.5% y/y in full-2021 to "just" 12.1% in June**, with prices up only 4.6% ytd. The highest growth was seen in coal, transport, building materials, textiles & apparel, all explained by the shakeups and departures



## Real sector dynamics mixed, but holding up fairly well, as corporate profit skyrockets thanks to price hikes. Remains to be seen over the coming year how supply chain issues are resolved

- Delving into real sector figures, we can see it holding up much better than feared, and not only in commodity sectors. **Industrial output, transport, construction growth did slow, but not dramatically**, staying more or less in line with recent annual averages
- Looking closer, though, we can see **Q2 dynamics were a lot more negative**, with the deterioration becoming more evident in June. Manufacturing rose 0.7% y/y in H1 vs. 5% in full-2021, but dropped 3.3% y/y in Q2; extraction went from 8.5% growth in Q1 to no growth in Q2. Growth in electricity generation and distribution also slowed visibly in Q2, but this we attribute to very warm weather
- **There is evidently a group of sectors benefiting from import substitution, especially with the departure of key foreign players**, including beverages, building materials, pharmaceuticals, machinery & equipment, computers & electronics, marine products, packaging materials, hygiene products, publishing services, metal (steel and aluminum) structures, etc.
- **Housing construction is on a roll**, and it seems like other construction segments keep on fulfilling orders. Perhaps players are trying to finish projects “while supplies last”, but the trend is surely encouraging. **Transport has lost some routes and is exploring others**
- At the same time, **some sectors are suffering from loss of component and equipment suppliers**, first of all cars, non-ferrous metals, chemicals, textiles & apparel, electrical equipment, paper, etc. In some segments the overly strong RUB also curbs exports. Still, as we see, **local players are managing to find new suppliers**, and the next few months should tell if solutions are found
- Amazingly, **total corporate profit grew 50.9% y/y in Jan-May**, with even sectors seeing output decline or growth slowdown enjoying hefty profit rises, including wood products, manufacturing, textiles & apparel, chemicals, retail trade, etc. Price hikes are to blame!

Indicator, % y/y	2019	2020	2021	H1/2022
Industrial production	3.4	-2.1	5.3	2.0
Cargo transport turnover:	0.7	-4.7	5.3	0.5
Railway	0.2	-1.9	3.4	1.2
Automobile	6.3	-1.3	5.0	1.8
Agriculture	4.3	1.3	-0.9	2.2
Retail trade	1.9	-3.2	7.3	-3.4
Paid services	0.5	-14.8	16.7	4.5
Construction, o/w:	2.1	0.7	6.0	4.0
Housing	6.2	0.2	12.7	44.2
Fixed capital investment	2.1	-1.4	7.7	3.3*

Segment, % y/y	2021	H1/2022	Segment, % y/y	2021	H1/2022
Food products	3.2	1.4	Chemicals, overall	6.0	-1.5
Beverages	8.6	9.4	Resins & plastics	7.7	1.6
Textiles	7.5	-3.9	Pharmaceuticals	11.5	26.5
Apparel	3.0	-2.8	Coke & oil products	3.6	-1.2
Metal products	3.4	1.3	Machines & equipment	13.8	10.9
Wood products	7.9	-3.3	Electrical equipment	6.3	-4.1
Furniture	14.1	4.9	Automobiles	13.8	-39.6
Building materials	7.5	7.0	Computers & electronics	7.9	11.8

\* - Q1/2022

- **The Russian economy seems to be holding up fairly well, or should we say, much better than expected.** This is not only reflected in the high oil&gas prices and large BoP surplus. **Federal budget execution is way above target, and no key expenditures are getting underfinanced.** Foreign debt stays low, even though there is controversy regarding payment currencies. Monetary and banking sector indices stay quite strong, as do most real and service sector output and sales figures. **Corporate profit has grown substantially across the board,** as producers have responded to the turbulence by hiking prices
- **Consumer purchasing power has no doubt been eroded by the rapid inflation of Jan-Apr,** and confidence affected by deficits of various imported products. Yet wage growth stays robust, and **slight deterioration of real disposable income should not alter spending patterns notably.** The income breakdown reveals growth of extra (unverified) income, showing some people are taking on extra work (side gigs) to compensate for lower payouts at their main job
- **Russian companies have developed a certain resilience to various crises over the years,** and many people here believe this is simply Russia's fate: if it's not one thing, it's the other, be it a global financial crisis, pandemic, or now a military conflict. Enterprises have hunched down, grinded their teeth (again), and went to work reconfiguring whatever needs reconfiguring now. Below the radar, we see new suppliers, intermediaries, sales markets, payment schemes and other workarounds of all trades emerging, and it is only a matter of time and stiffening that proverbial upper lip
- Of course, there are deficits of equipment and components, various logistics issues, but **local companies weren't wasting no time rewiring their businesses** as soon as the whole thing started (many even started on it before). **H2 will show how fruitful all these efforts are, and who will take the space left open by the departed companies**
- Further sanctions including export price discounts/limitations, extra logistics costs, whatever - **it is always the final consumer that pays for it all.** The Russian people will continue to persevere, for better or for worse. **Hopefully, government will not only focus on tax collection,** but introduce additional stimuli and punitive measures, to de-incentivize companies from raising prices first and foremost as the go-to solution for all crises



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