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Strategy and Transactions

Russia Macro Foresight

Growth Continues in 2024, Supported by Retail Consumption, but Corporates Start to Bend under Pressure, Budget Execution Worsens

February 2025



Real sector annual figures look quite comely, but hide sharp broad-based deterioration in H2, as sanctions and anti-inflation measures cool economic growth

- **Real GDP growth made up 4.1% y/y in 2024, unchanged from 2023 (figure revised upward from 3.6%).** Practically matching government's forecast, growth made up 3.1% y/y in Q3, and then picked up to 3.8% in Q4. Household consumption grew 5.5% vs. 7.5% the previous year, gross savings rose a meager 3.7% vs. 19.7%, while capital investment gained 10.2% vs. 7.7% (per RosStat GDP data)
- **Industrial output growth stayed solid at 4.6% vs. 4.3% in 2023, as manufacturing led the charge with 8.5% expansion vs. 8.7%.** But what the annual figures do not show is how much growth actually slowed over H2/2024 in many key sectors. There are different factors involved in different industries, but the overall picture is now far from rosy
- **Agriculture declined 3.2%,** and as we explained last time, the weather was anything but favorable last year, from cold spells and snowfalls in early May to severe heat or downpours in summer and autumn. Cargo turnover edged up 0.4%, an improvement from the previous year, but railway turnover dropped 4.3%, as government opted to support some sectors at the expense of others and the railway monopoly amid soaring tariffs, infrastructure bottlenecks and railcar overproduction. Construction was heavily affected by CBR hiking the key rate to combat inflation, effectively undermining construction supply and demand, with housing especially hard-hit

Indicator, % y/y	2021	2022	2023	2024	Segment, % y/y	2022	2023	2024	Segment, % y/y	2022	2023	2024
Industrial production	6.3	0.7	4.3	4.6	Food products	1.1	6.6	3.5	Chemicals	-2.4	5.2	3.1
Cargo transp. turnover:	5.6	-2.3	-0.6	0.4	Beverages	6.7	1.1	9.4	Rubber & plastic products	0.2	8.0	0.8
Railway	3.7	-0.1	0.0	-4.3	Textiles	-3.8	3.7	3.8	Pharmaceuticals	9.3	-0.4	18.0
Automobile	5.0	5.8	15.4	6.5	Apparel	9.1	15.2	5.9	Coke & oil products	-0.6	2.5	-2.1
Agriculture	-0.4	11.3	0.2	-3.2	Metallurgy	-0.8	3.0	-1.2	Machines & equipment	-0.7	8.1	-2.7
Retail trade	7.8	-6.5	8.0	7.2	Wood products	-10.0	-1.6	4.2	Electrical equipment	1.1	20.6	6.6
Personal services	16.7	5.0	6.9	3.3	Furniture	10.7	11.5	7.7	Automobiles	-44.2	16.0	16.5
Construction, o/w:	7.0	7.5	9.0	2.1	Building materials	3.9	0.9	4.4	Computers & electronics	9.4	39.4	28.8
Housing	12.7	11.0	7.5	-2.4								
Fixed capital investment	7.7	6.7	9.8	8.6*								

* - Jan-Sep 2024

B2C segments holding up well, together with some positive B2B exceptions, however many other sectors struggling. Corporate profit edges down, but deep pockets largely intact across the board

- Taking a closer look, the situation was mixed within macro sectors, with evident divergent trends. For example, in transport things look bleak on the surface, due to issues with external trade and logistics. But actually, while cargo turnover barely grew overall, affected by railways, **truck, maritime, air, and pipeline segments rose nicely** (6.5%, 5.5%, 11%, 4.5%, respectively). Railway cargo load gained 5.5%, truck load - 8.3%, confirming our conclusion that **now it is mostly short-distance, broken up into stages, by modes of transport**. Passenger transport rose 6.3% - slower than bounce-back 12.8% in 2023, but all segments now growing
- Horticulture output declined across the board, as crop yields plummeted due to bad weather. Still, **agriculture profit rose 13.9% in Jan-Nov 2024, bucking the overall trend, as total corporate profit slid 15.4%** after 30.2% growth in full-2023. It is notoriously difficult to make predictions for agriculture in our rapidly changing and more extreme climate, and thus far winter in Russia has been much warmer than usual and practically snowless in many regions (which affects horticulture both positively and negatively). But barring further weather calamities, the sector should be able to recover fairly quickly
- **Construction is definitely struggling now**, as government slashing ultra-low-rate mortgage programs has left both builders and buyers ailing. The main purpose was to stop the housing craze that was driving up prices, and to let air out of the forming real estate bubble. **One can say government has succeeded in this respect**. Yet, with president Putin personally supporting low rates for families buying housing for themselves, as opposed to speculative, investment-type purchases, government is likely to continue these programs to a certain extent. At the same time, industrial construction was obviously impacted by key rate hikes, as many investment projects were delayed or stretched out. Still, the construction sector eked out 7.5% profit growth, and **it appears that market players, having profited heavily in recent years, will simply wait out the current lull** and then get right back to work
- Extraction output inched down 0.9%, basically the same as in 2023. **Sector profit grew 10.8%, with double-digit gains posted by oil&gas and metals**, even despite massive sanctions. Natural gas production surged 8.7%, while data on crude oil is now withheld
- What is concerning is that although full-year growth rates look positive, checking them vs. H1 numbers (*please refer to our report dated Aug 12, 2024*), one can easily see **growth in H2 in numerous segments was near or even below zero!** For example, in foods (despite multiple bright spots), textiles, overall chemicals, resins & plastics, and automobiles (Chinese market players seem to have overstocked and overcrowded the market, and are now scaling down). Metallurgy, coke & oil products, and fish simply stay weak. On the whole, manufacturing sector profit declined 11.2% (while remaining solid). Of course, the high-base effect may be kicking in now, after stellar growth, but **the main reasons appear to be toughened sanctions and key rate hikes**
- Standout performers who managed to keep up brisk growth or even accelerate in H2 were beverages, apparel, building materials, and pharmaceuticals (18% y/y in 2024, likely as newly built capacity was launched, judging by construction data). **Robust growth is still seen in computers & electronics, electrical equipment, non-auto transportation equipment, and metal products**, while wood products seem to have turned the corner. Combing through detailed product breakdowns, we could find little evidence that war-related spending is to thank for the growth sprees. **Many of the segments are B2C-oriented, while some are also driven by import substitution**. Retail trade growth continues to impress at 7.2% (albeit slowing to 5.8% y/y in H2). HoReCa gained 9% (vs. 13.9% in 2023), while personal services slowed more than twofold to 3.3%. **Profit in retail surged 21.2%** in Jan-Nov, HoReCa - 35.6%. **It simply skyrocketed in real estate services, tourism, and healthcare** (up 65.3%, 4.2-fold, and 86.5%, respectively)

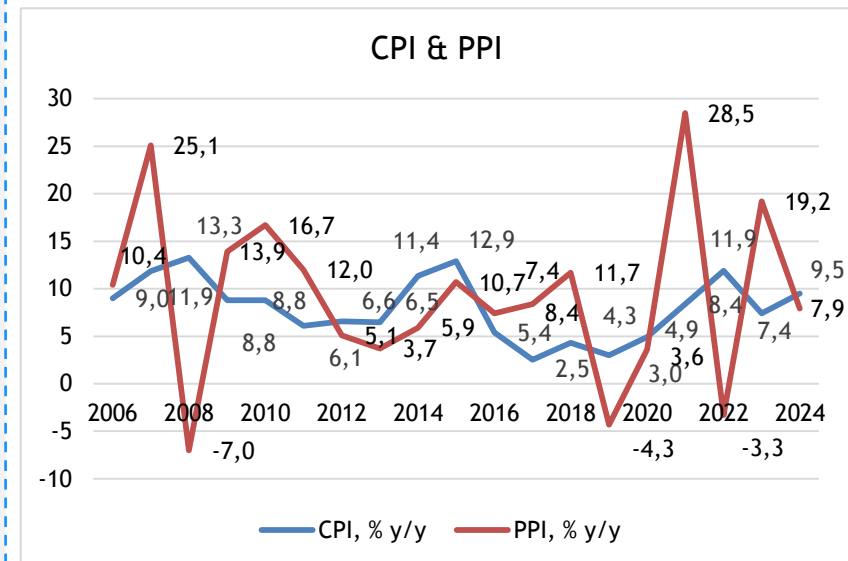
Real wage and income growth stays solid, even despite strong CPI inflation. PPI inflation has moderated overall, but price growth in key sectors remains rampant

- It comes as no surprise that B2C-oriented sectors and retail trade are performing so strongly, when wage and income growth is as high as it is now. At the same time, real disposable income growth made up only 4.1% y/y in Q4. Wage arrears jumped 43.5% m/m suddenly in Jan 2025, ending up 46.4% higher y/y and reversing a steady decline. It remains to be seen whether this is a one-off event or will form a new worrisome trend
- Meanwhile, ILO-definition unemployment declined further to just 2.3% at end-2024 vs. 3% a year ago, while official unemployment slid to 0.4%. **The shortage of highly-skilled workers in a transforming economy remains acute, but now there are signs of improvement.** The number of full-time staff rose 0.6% y/y in Jan-Nov after a lengthy decrease, as part-time staff and contractors increased 5.2% and 3.4%, respectively. Still, HRs point to a high churn rate, as workers often jump ship in an employees' market

Indicator, % y/y	2021	2022	2023	2024
Real disposable income	3.2	4.5	6.1	7.3
Real wages	2.9	0.3	8.2	8.7*
Nominal wages	9.8	14.1	14.6	17.8*

* - Jan-Nov 2024

- **CPI inflation accelerated strongly toward year-end, reaching 9.5% y/y in December** after slowing notably to 7.4% in 2023. Food and service price growth sped up to 11.1% and 11.5%, respectively, while non-foods rose 6.1%, roughly the same as in 2023. Biggest price hikes were seen in dairy products, fruits & vegetables, seafood, gasoline, medicines, overseas tourism, recreation & entertainment, telecoms, utilities, and healthcare
- **Average annual PPI inflation made up 12.1% y/y**, but the slowdown we noted earlier continued in H2. December y/y inflation was only 7.9%. Extraction prices rose 4.4% y/y, manufacturing - 8.4%. What worries us is that strongest price growth was seen in core products and services driving up inflation overall, even as investment goods prices grew only 8.1%. Metals soared 20.4%, transport equipment - 15.4%, machine & equipment repair - 12.6%, utilities - 14.9%, wood products - 10.8%, building materials - 9.8%, cargo transport prices - 13.6%. Price growth in some sectors accelerated toward year-end
- Therefore, **robust input price pressure can be expected to stay in place** for the time being, even as CBR focuses on tackling inflation. This will remain a major constraint on output and profit growth



Money supply, lending growth slows, but deposits buoyed by high rates. External sector mostly solid, yet exports and FDI hit by tougher sanctions. Budget deficit widens, as high rates pose risk

BANKING SECTOR

- The banking sector stayed in fairly good shape, despite real sector woes and tougher sanctions, having got a nice liquidity cushion. **Corporate loan growth eased just a bit**, as banks fund already started investment projects and construction, where rates tend to be lower. Consumer loans rose 11.2% in 2024 vs. 15.7% in 2023. Mortgage loan growth dipped to 13.4% from 34.5%. Given torrid realty price growth and concerns over a forming bubble, this is a positive. The share of problem loans slid another 0.6pps to 3.8% of corporate loans, but rose 0.5pps to 4.6% of retail loans
- The inflow of retail deposits continues, and corporate funds' growth cooled just slightly. Total profit is reported at RUB 3.8tn ex subsidiary banks, RUB 3.4tn ex securities revaluation, and RUB 4tn altogether vs. RUB 3.3tn in 2023. Either way, this shows **sector liquidity is still plentiful**, as also proved by relevant liquidity indices staying stable throughout 2024

Indicator, % y/y*	2021	2022	2023	2024
Loans to individuals	25.1	9.5	26.5	14.2
Loans to corporates	10.6	14.3	20.7	17.9
Individuals' funds	3.1	6.9	19.7	26.1
Corporates' funds	16.7	20.6	14.7	11.9

MONETARY AGGREGATES

- Interestingly, **growth of national-definition (RUB) money supply stayed at 19.2% in 2024 vs. 19.4% in 2023**. But underlying dynamics changed noticeably (and unsurprisingly), as **cash in circulation rose just 0.8% vs. 11%**, while **deposits leapt 23.1%** after 21.4% in 2023, due to high rates. Growth of broad-definition monetary base (including FX funds) picked up slightly in H2, reaching 5.5% in 2024

EXTERNAL SECTOR

- The external sector appears to be in better shape than one may have feared amid sanctions. FX & gold reserves grew USD 20.8bn since our last report to USD 626.9bn on Feb 7, having fluctuated in a narrow USD 560-600bn band for over a year. After notable RUB weakening mid-year, CBR now has to stem RUB strengthening to boost budget export revenues, ever since US president Trump's reelection. **RUB weakening turned out much softer in real terms - 4.3% y/y vs. the USD, 1.6% vs. EUR, 1.1% vs. the FX basket in 2024**
- **Foreign debt dropped USD 18.8bn q/q, USD 27.5bn y/y in Q4**. Government, corporates rushed to cut debt as RUB weakened, while CBR debt receded after a recent pent-up. **The current account surplus rose USD 3.7bn y/y to USD 53.8bn, despite a weak Q4 (USD 4.8bn)**. The trade surplus made up USD 122.6bn, service deficit - USD 38.3bn (up just USD 3bn y/y), income deficit - USD 30.6bn (vs. USD 36.2bn). **Accumulated FDI slid further to USD 235.2bn at end-September vs. USD 279.3bn at year-start, USD 497.7bn at end-2021**

PUBLIC SECTOR

- Worryingly, **the state budget deficit shot up at year-end to RUB 3.5tn in 2024 vs. RUB 0.9tn in H1**. This is just a tad bit higher than in 2022 and 2023 (RUB 3.24-3.35tn), but much higher than initial RUB 1.6tn and revised RUB 2.1tn government targets. Revenues grew 26%, spending - 24.2% y/y. **RUB 2tn worth of OFZ state bonds had to be issued in December at around 21% to plug the hole**. National Welfare Fund shrank RUB 1.2tn y/y to RUB 11.9tn, while state domestic debt grew RUB 2.1tn to RUB 23.7tn

Summary: economy still in expansion mode, not coming apart at the seams, but cracks and stresses emerge. Putin-Trump talks bring hope. Now what happens next is anyone's guess

- Just as we were working to finalize this report the other day, Mr. Trump called Mr. Putin. May or may not have been the first time they spoke, this time around, but the conversation and following statements from both sides sure sent shockwaves through the entire world. While many in Russia (and not only) started to rejoice that a mutually acceptable Russia-West conflict resolution may be at hand, we also started to realize we may have to rethink or rewrite a significant part of the report. Russian stock and bond markets immediately headed skyward, RUB strengthened below 90 (after almost touching 110 late-November), and everything we had written by then seemed to go up in smoke. However, as a final solution appears some ways off, what we have said about the results of 2024 and the latest positive and negative trends still holds. The question is what happens next
- For now, let us share some thoughts about what we see affecting the Russian economy, based on what we have observed thus far. The recent tightening of Western sanctions added to the impact of CBR hiking the key rate to 21% to combat inflation, and destroyed a sense of normalcy that had finally set in. The latest transaction restrictions and ensuing payment complications have caused many partners even from Russia's "friendly countries" to turn away in fear. Domestically, key rate hikes have also stifled the robust economic growth, import substitution, and investment that were observed prior, causing dissent and doubt in monetary policy among key Russian government figures. Changes at the helm of Russia's monetary policy regulators cannot be excluded, as inflation continues speeding up, further affecting consumption and economic growth. In our previous report, we noted "...it appears that widened secondary sanctions are catching up with a number of sectors... growth is slowing in many segments, partly being attributed to the high base effect." Also, "CBR is frantically trying to curtail consumption and inflation, but judging from banking sector dynamics, it is just barely managing to do so."
- Keeping the key rate at 21% at its latest meeting on Feb 14, CBR raised the 2025 CPI inflation forecast to 7-8% from 4.5-5%. It also lifted its average annual inflation forecast to 9.1-9.8% from 6.1-6.8%, noting the indicator may even exceed 10% at some point, and is likely to stay above the 4% goal for a long time. The regulator only said what everyone knew all along... The average annual key rate is now expected at 19-22%, up from 17-20%. The 2025 GDP growth forecast was revised from 0.5-1.5% to 1-2%. We must note that government's growth forecasts and initial estimates are usually revised upward, but the situation remains quite concerning
- Adding insult to injury, budget execution worsened notably in late 2024. Although the state budget deficit stayed roughly in line with recent averages, it significantly overshot initial targets. According to local experts, some of the spending for 2025 was financed early, which seems to be proved by the Jan 2025 deficit falling notably below target. Also, federal government is apparently helping out regional budgets, which have been hit by recent corporate tax shortfalls (at the same time introducing strict covenants local authorities have a hard time accepting, in light of vast social obligations). But the main problem now is the high cost of financing
- On a positive note, many sectors are holding up well, buoyed by consumer demand, import substitution, and deep cash pockets. Plus, latest Jan-Feb 2025 oil&gas sector data shows Russian exporters and their foreign partners are finding ways out amid sanctions, and payment issues are gradually getting resolved, even as higher price discounts are applied. Russia has proven remarkably resilient in light of external pressures, and is already busy devising new workarounds. Now, a new hope has been sparked by US-Russia talks, but the Ukraine conflict scenarios are too diverse to even begin adjusting economic forecasts. We may even have to publish a Special Report on the subject once more clarity is obtained. So stay tuned... Same foresight report, same creaky channel.

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