

MONITORING OF RUSSIA'S ECONOMIC OUTLOOK:

TRENDS AND CHALLENGES OF SOCIO-ECONOMIC DEVELOPMENT

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TRENDS AND CHALLENGES OF SOCIO-ECONOMIC DEVELOPMENT	3
1. CONSUMER PRICES: A LENGTHY DISINFLATION PERIOD A. Bozhechkova, P. Trunin	5
2. NATIONAL PROJECT BUDGETING IN CONDITIONS OF THEIR LOW CASH EXECUTION G. Idrisov, Yu. Pleskachev	8
3. COMMERCIAL BANKS' FINANCIAL RESULTS IN Q3 2019 S. Zubov	12
4. THE INDUSTRY STARTED TO LACK LABOR IN Q3 2019 S. Tsukhlo	15
5. PRIORITIES OF RUSSIAN DEVELOPMENT ASSISTANCE IN 2018 YEAR Yu. Zaitsev, A. Knobel	17
AUTHORS	22

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TRENDS AND CHALLENGES OF SOCIO-ECONOMIC DEVELOPMENT

Having analyzed **the factors contributing to the current slowdown in inflation** in the Russian economy, experts give the palm to the low growth rate of demand, the good harvest and the modest strengthening of the ruble. They also note that in 2019, the month-on-previous-month growth rate of consumer prices was on the steady decline from February through September (with the exception of July): such a long period of disinflation has been observed for the first time since 2011. In October, the rate of inflation rose just 0.1%. Reflecting this trend, inflationary expectations of the population have been decreasing as well.

The Bank of Russia has lowered its annual inflation forecast for 2019 to 3.2–3.7% (and expects that annual inflation will come in at 3.5–4.0% in 2020). Our experts believe that if everything goes according to this forecast, the RF Central Bank may abstain from cutting its key rate once again and will keep it at 6.5%, as it was established at the RF Central Bank Board of Directors meeting in October. But if the rate of disinflation turns to be higher than expected, Russia's **monetary policy could be softened even before the end of the current year**. Our experts believe that such a step will be reasonable due to a considerable growth of real interest rates.

Having analyzed **the structural and quantitative changes in the expenditures on the implementation of national projects** envisaged in the draft law on the federal budget for 2020-2022, our authors come to the conclusion that the apparent trend towards increasing public spending on such projects is definitely positive. However, bearing in mind that the rate of cash execution of such expenditures with regard to a number of projects in 2019 was insufficient, they draw attention to the **risk of the national project phases envisaged for one or other years being implemented just formally, not substantively – simply for the purpose of timely project delivery**.

The expenditures on national projects embedded in the draft federal law exceed those specified in their certificates by an average of 4.8%. At the same time, the share of federal budget funds allocated, in 2019, to finance national projects (12.4% of the federal budget's total expenditure) will be increased by 2.7 pp relative to 2019 (9.7%). However, the funds planned to be allocated to finance the development of small and medium-sized businesses and the improvement of labor productivity cannot be deemed sufficient.

Having analyzed the financial performance of commercial banks in Q3 2019, our experts point to a considerable growth of their profit (to Rb 1.3 trillion, or by 36% relative to the same period of 2018). They associate this growth, first of all, with the introduction of a new procedure for the accounting treatment of loan loss provisions. The experts expect that there will be a modest short-term decrease in the growth rate of profitability of the banking sector, resulting from the decline in interest rates, the rise in past due loans issued to physical persons, and the measures being taken by the financial regulator in order to stem consumer credit growth.

Over the course of the first nine months of 2019, corporate lending increased by 3.6% (vs by 5.5% during the same period of last year), while the amount of loans issued to physical persons grew by 14.9% (vs by 16.7% during the same period of 2018). Over the course of the first three quarters of 2019, the amount of past due loans issued to non-financial institutions increased by 31.1% – purely due to technical reasons, that is, to the inclusion in this index, from this year onwards, of outstanding receivables and lapsed rights connected with the assignment of legal claims. As far as bank loans issued to physical persons are concerned, the rise in past due loans amounted to 5.4% of issued loans, which represented a decline, however small, relative to the beginning of the current year. Our experts believe that if the ratio between the amount of loans issued to physical persons and the amount of deposits thereof is to be taken into account, **lending to physical persons still has potential for further growth.**

The business surveys of industrial enterprises regularly carried out by the Gaidar Institute indicate that **the relationship between output dynamics and the reception of loans is very weak.** Just 2–4% of the surveyed industrial enterprises stated both this year and last year that they did not get enough loans. At the same time, in Q3 2019, **90% of the respondent enterprises characterized their financial and economic situation as 'good' or 'satisfactory'.** Such a level of satisfaction is just slightly below its historic high (92%) registered in 2017 and at the beginning of the current year. It should be said that industrial enterprises were more skeptical concerning the demand for their products: just 59% of the respondents characterized it as 'normal' at the beginning of last year, as well as and later on. **According to the respondent industrial enterprises, in Q3 2019, they began to experience a notable worker shortage.**

Our experts continue to analyze the data on **Russia's Official Development Assistance in 2018**, released in October. As before, most of this assistance (63%) was provided on a bilateral basis, **its largest recipients being Cuba, the Democratic People's Republic of Korea, Kyrgyzstan, and Tajikistan.** Apart from direct assistance, Russia also finances these countries within the framework of her cooperation with international organizations. The amount of Russia's Official Assistance to Development in 2018 (\$ 999.08m) was almost as much as the annual amount of such assistance in 2015-2018, when it slightly exceeded \$ 1bn.

As regards the structure of Russia's Official Development Assistance in 2018, it was aimed at **promoting health care and food security. It also included Russia's writing off more than \$ 400m in debt.** The amount of funds allocated, by Russia, to financing various UN institutions in 2018 remained high (almost \$ 105m). More than one half of the funds earmarked for multilateral financing was transferred to the regional development banks (\$ 225m), while Russia's cumulative investment portfolio in the Eurasian Development Bank amounted to \$ 3.5bn, or more than 42% of the Bank's aggregate financing. 

1. CONSUMER PRICES: A LENGTHY DISINFLATION PERIOD

A. Bozhechkova, P. Trunin

The Bank of Russia's decision to reduce the key rate by 0.50 pp to 6.5% was caused by an inflation slowdown to 3.8% in October 2019 relative to October 2018, with a high probability of its continuing downward movement. In this connection, the Bank of Russia has revised its inflation projections for 2019 from 4.0–4.5% to 3.2–3.7%. It is expected that the annual inflation index in 2020 will amount to 3.5–4.0%, and then it will be hovering around its target level of 4%. Thanks to this year's good harvest, a slow growth rate of domestic demand, and the ruble's strengthening, inflation slowdown may become even more pronounced than the Bank of Russia is currently expecting it to be. These developments may once more prompt monetary policy easing before this year's end.

In October 2019, the inflation index in Russia amounted to 0.1% (vs 0.4% in October 2018), and in annual terms (relative to the previous 12 months) it rose to 3.8% (compared with 3.5% in October 2018). This, it plunged 0.2 p.p. below the target set by the Bank of Russia (*Fig. 1*). **After reaching its peak in March 2019 (5.3%), over the last 7 months inflation has been stably on decline.** In this connection, since June 2019 the Bank of Russia had reduced its key rate four times: thrice by 0.25 p.p., and once by 0.5 p.p. - at its latest Board of Directors meeting in October. As a result, the key rate now is 6.5% per annum, thus approaching its level of early 2014. The other factors that influenced this decision are the prevalence of disinflationary risks over pro-inflationary ones, the relatively stable situation on foreign markets, and the lowering inflationary expectations.

Over the period from February through September 2019, the month-over-month growth rate of consumer prices was consistently on decline. The only exception was July, when after a zero growth in June it sped up to 0.2%. It should be noted that such a **lengthy period of disinflation has been observed for the first time since 2011**, and it became possible due to a good harvest, a certain strengthening of the ruble, and a slow growth of domestic demand.

Having declined in August-September, food prices gained 0.2% in October after the harvest season was over, compared with 0.6% in October 2018. Nonfood prices increased by 0.3% (vs 0.5% in October 2018), and over the course of the next 5 months they demonstrated a stable growth of only 0.2% per month. **The prices of paid services rendered to the population in October lost 0.2% (vs -0.1% in October 2018).** In

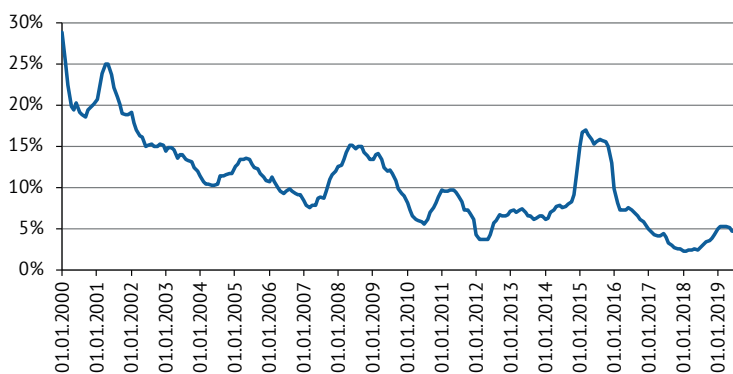


Fig. 1. Inflation (% , relative to the previous 12 months)

Source: Rosstat.

September and October 2019, their downward movement pattern had to do with a seasonal drop of passenger transport tariffs and the prices for resort and spa services, and for outbound tourism services.

The index of core inflation (cleared of fluctuations caused by seasonal and administrative factors) **likewise demonstrated a stable decline in per annum terms – from 4.7% in May 2019 to 3.7% in October 2019**. At the same time, since June its growth rate had remained stable, at around 0.2%.

The inflation slowdown has been accompanied by **lowering inflationary expectations**. The median inflation expectation for the year ahead, according to the InFOM survey results released by the Bank of Russia, was 8.6% in October, having lost 1.8 pp relative to its year-beginning value (*Fig. 2*). According to the Bank of Russia's estimates, the inflationary expectations reported by enterprises also demonstrate a certain decline due to the ruble's strengthening.

Consumer inflation slowdown was also contributed to by the ruble's movement pattern: towards the end of October, the ruble climbed against the USD by 3.2%, to RUB 64. Its temporary plunge in August 2019 (by 4.9%) in response to sliding price of oil and capital outflow from the developing markets evidently had no significant effect on companies' pricing policies. On the whole, the ruble's strengthening has been sustained by stable oil prices (*Fig. 3*), as well as capital inflow in the developing markets.

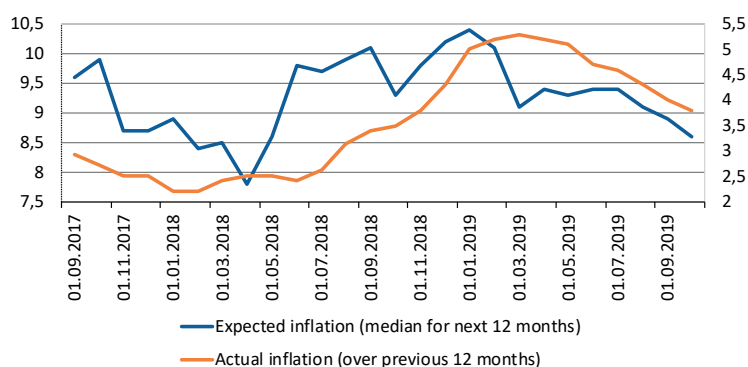


Fig. 2. Inflation and inflationary expectations

Source: Rosstat; Bank of Russia.

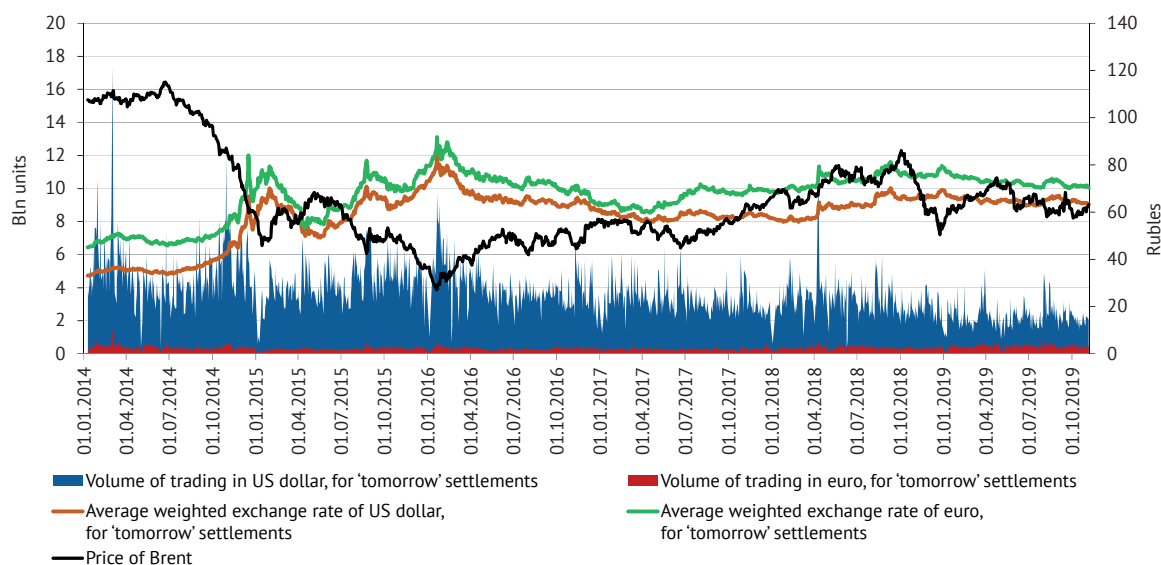



Fig. 3. The movement of the USD-to-ruble and euro-to-ruble exchange rates on the FX exchange; trading volume in the FX market; price of Brent

Source: RF Central Bank; Finam.

1. Consumer prices: a lengthy disinflation period

The movement pattern of real personal income has remained one of the factors that suppress inflation, having been continually on decline for the past five years, up until Q1 2019. In spite of the accelerating growth of real personal money income in Q3 2019, which increased to 3.3% compared with 0.7% in Q2, domestic demand has been demonstrating practically no upward movement. Thus, the average annual growth rate (over the previous 12 months) of **real wages over the period of January-October 2019 was only 2.0%** (vs 8.4% on average in January-October 2018). **The movement pattern of retail turnover was also slower**, its annual growth rate in January-October 2019 amounting to 1.5% vs 2.9% in January-October 2018.

A negative input into the domestic demand movement pattern in 2019 was also made by the budgetary policy. The contributing factors were a significant budget surplus and a slower than expected progress of implementation of the ongoing national projects.

With due regard for the possibility of inflation becoming even slower, the Bank of Russia expects that **in 2019 it will be around 3.2–3.7%, and in 2020 – 3.5–4.0%, and thereafter will hover around its target of 4%**. If this forecast should come true, in December the Bank of Russia may abstain from lowering the key rate, but the possibility of its further reduction next year will still be there. However, the good harvest, the slow growth of aggregate demand, and the ruble's strengthening may all result in a bigger slowdown of inflation than that expected by the Bank of Russia. Thus, the regulator might be forced once again to ease its monetary policy before the year's end. In our opinion, this measure will be quite justified, given the strong deviation of the actual inflation index from its target coupled with the robust growth of real interest rates. 

2. NATIONAL PROJECT BUDGETING IN CONDITIONS OF THEIR LOW CASH EXECUTION

G. Idrisov, Yu. Pleskachev

An analysis of changes in the structure and volume of budget expenditure earmarked for implementation of national projects in the framework of the draft Federal Law on the Federal Budget for 2020 and the 2021 and 2022 Planning Period has revealed some positive trends that point to an increase in the corresponding federal budget expenditure targets. At the same time, in connection with the insufficient cash execution of the budget expenditure allocated in 2019 to the implementation of some of the ongoing national projects, a number of questions have arisen. The first one is that the increased amount of budget expenditure allocated in 2019 to national projects with a low level of budget expenditure implementation gives rise to some increased risks associated with formal approached to implementing the measures planned for the next years. The second one has to do with a lack of proper balance in the distribution of budget expenditure: the amount of expenditure allocated to some of the ongoing national projects appears to be insufficient, if we give consideration to their importance. The third one is that growth of expenditure earmarked for some national projects occurs alongside a corresponding shrinkage of allocations to the other projects, and this happens in absence of proper coordination of long-term funding priorities by means of project- and program-based instruments.

In order to assess the planned amounts of funding earmarked for the implementation of national projects, we compared the corresponding expenditure targets set in the draft Federal Law on the Federal Budget for 2020 and the 2021 and 2022 Planning Period and in the approved national project certificates.

Table 1

Comparison of total volume of expenditure allocated to national projects

	2020	2021	2022
Federal budget expenditure allocated to implementation of national projects, billions of rubles:			
in accordance with draft Federal Law on Federal Budget for Year 2020 and 2021 & 2022 Planning Period	1,983	2,218	2,693
in accordance with national project certificates approved by Presidium of Presidential Council for Strategic Development and National Projects	1,895	2,124	2,558
Expenditure increase relative to targets set in national project certificates, %	4.6	4.4	5.3
Expenditure increase relative to previous year, %	13.6	11.9	21.4
Reference expenditure targets, based on draft Federal Law on Federal Budget for Year 2020 and 2021 & 2022 Planning Period			
Funding of national project, total, as % of GDP	1.76	1.84	2.10
Federal budget funding of national projects, % of federal budget expenditure	10.17	10.75	12.37
Nominal GDP, billions of rubles	112,863	120,364	128,508
Federal budget, billions of rubles	19,503	20,634	21,763

Source: Annex 14 to the draft Federal Law on the Federal Budget for 2020 and the 2021 and 2022 Planning Period; RF Ministry of Economic Development's Medium-term Socioeconomic Development Forecast of the Russian Federation until 2024 (baseline scenario) as of 1 October 2019, approved by the Presidium of the Presidential Council for Strategic Development and National Projects; own calculations.

2. National project budgeting in conditions of their low cash execution

The amount of funding allocated to national projects in the form of federal budget projections is, on the average, 4.8% above the corresponding expenditure targets set in the national project certificates. For 2020 and 2021, the planned increase is 4.6 and 4.4% respectively, and 5.3% for 2022. The year-over-year growth in the amount of aggregate budget expenditure earmarked for national projects will be 13.6%, 11.9%, and 21.4% in 2020, 2021, and 2022 respectively. It is important to note in this connection that the relative share of federal budget expenditure earmarked for the funding of national projects in 2022 (12.4%) in the total amount of budget expenditure will jump on 2019 (9.7%) by 2.7 p.p.¹

On the basis of these data it can be concluded that the planned increase in spending on national projects is significant, especially the target for 2022. However, it is also noteworthy that this increase in the expenditures earmarked for the implementation of national projects was being planned, in the course of preparing the draft Federal Law on the Federal Budget for 2020 and the 2021 and 2022 Planning Period, in conditions of a low cash execution of the budgets allocated to the majority of projects. It is only with regard to 2 out of 13 national projects ('Demography' and 'Healthcare') that the growth index was above the average level of federal budget expenditure implementation as of 1 August 2019 (Table 2).

Table 2

National project funding from the federal budget

National project (program)	Federal budget expenditure implementation (as of 1 August 2019, of total expenditure target for 2019), %	Draft federal budget, 2020–2022, billions of rubles	Certificates of national projects for 2020–2022, billions of rubles	Increased spending on national projects in new budget, 2020–2022, %
Demography	59.1	1,839	1,558	18.0
Healthcare	57.6	793	788	0.6
Science	46.2	213	177	20.8
Culture	43.3	53	53	0.1
Education	43.2	380	375	1.3
Housing and urban environment	41.5	403	403	0.0
Small and medium-sized entrepreneurship and support of entrepreneurial initiative	40.4	185	185	-0.1
International cooperation and exports	38.7	418	442	-5.4
Comprehensive infrastructure modernization plan	26.5	1405	1398	0.5
Labor productivity and employment support	23.9	21	21	0.0
Safe and high-quality motor roads	23.6	266	255	4.3
Digital economy of Russian Federation	16.0	560	560	0.1
Ecology	14.4	357	363	-1.5
Total	41.2	6,893	6,578	4.8
Average federal budget expenditure implementation level for 2019.	48.7			

Source: RF Federal Treasury; Annex 14 to the draft Federal Law on the Federal Budget for 2020 and the 2021 and 2022 Planning Period, approved by the Presidium of the Presidential Council for Strategic Development and National Projects; national project certificates; own calculations.

¹ In 2019, the federal budget expenditure target for the funding of national projects was Rb 1.746bn, or 9.7% of the total federal budget expenditure.

The bulk of spending in the draft federal budget for the period 2020–2022 is allocated to ‘Demography’, ‘Healthcare’, ‘Comprehensive Infrastructure Modernization Plan’, and ‘Digital Economy of the Russian Federation’, which appears to be justified due to the significance of the targets set for these national projects.

At the same time, the amount of federal budget expenditure earmarked for the national projects ‘Small and Medium-sized Entrepreneurship and Support of Entrepreneurial Initiative’, as well as for ‘Labor Productivity and Employment Support’, is still rather low — just Rb 206bn out of a total of nearly Rb 7 trillion of planned budget spending on the implementation of all national projects over the period 2020–2022, thus giving rise to some serious questions in view of the need to boost productivity across the national economy, which is one of the key factors of achieving some of the proclaimed national goals.¹

By its level of federal budget expenditure implementation, the national project ‘Safe and High-quality Motor Roads’ is 3rd from bottom (23.6%, the average budget implementation level for national projects being 41.2%). However, at the same time, that projects ranks 3rd among the leaders in federal budget expenditure growth over the period 2020–2022 (growth by 4.3%).

As for the national projects ‘Science’ and ‘Education’, for which the amount of federal budget spending is also to be increased over the period 2020–2022, the level of federal budget expenditure implementation over the course of 2019 was below the average level observed this year (Table 2).

It will be worthwhile to consider the by-function growth of the planned share of expenditure allocated to national projects in the federal budget (Table 3).

Table 3

The planned share of expenditures earmarked for national projects, by federal budget function, for the period 2020–2022

Federal budget function	Share of expenditure earmarked for national projects, by federal budget function, %		
	2020	2021	2022
Housing and amenities	47	49	60
National economy	26	31	40
Healthcare	30	26	27
Environmental protection	18	19	20
Education	19	20	17
Social policy	11	11	12
Nationwide issues	3	4	6
General interbudgetary transfers to budgets of RF budgetary system	3	3	3
National security and law-enforcement activity	1	1	1
Mass media	0	0	0
National defense	0	0	0
Government (municipal) debt servicing	0	0	0
Physical culture and sports	0	0	0
Total	10.2	10.7	12.4


Source: Annex 14 to the draft Federal Law on the Federal Budget for 2020 and the 2021 and 2022 Planning Period; own calculations.

Meanwhile, under the ‘Housing and Amenities’ function in the draft budget, the share of expenditure allocated to national projects by 2022 will amount

1 For example, Goal 8: ‘Making the Russian Federation one of the top five economies of the world, ensuring her economic growth rate at a level above the world growth rate while preserving macroeconomic stability, including inflation at a level not more than 4 per cent’; Goal 3: ‘Ensuring sustainable growth of real personal income, as well as growth of pension provision at a level above the inflation level’; Goal 4: Reducing by half the poverty level in the Russian Federation’.

2. National project budgeting in conditions of their low cash execution

to 60%, compared with 47% in 2020. Similarly, the share of corresponding allocations under the 'National Economy' function (to be distributed among 9 national projects) will increase over the period 2020–2022 from 26% to 40%. No significant changes are observed with regard to the other functions, which leads us to the conclusion that **the volume and share of funding allocated by means of project-based instruments is impressively on the rise.**

Thus, the observed increase in the amount of federal budget expenditure allocated to some national project alongside cuts in the amount of spending on the other national projects over the period 2020–2022 is taking place in conditions of a low level of cash execution of the budget expenditure earmarked for the implementation of national projects over the course of the current year, and is indicative of a significant redistribution of budget funds between program- and project-based budget implementation instruments, in favor of the latter. 

3. COMMERCIAL BANKS' FINANCIAL RESULTS IN Q3 2019

S. Zubov

In January-September 2019, banks' profits increased largely as compared to the same period of 2018. It has mainly happened owing to the introduction of the new accounting procedure for loan loss provisions and the handover of rescued banks to the Banking Sector Consolidation Fund. In the near future, some slowdown of the banking sector's profitability growth can be expected and this will be driven by the following factors: cuts in the interest rates, a higher rate of defaults on loans and the regulator's moves to slow down the growth rates of consumer lending. However, based on the results of the first three quarters of 2019 it should be taken into account that the ratio between the volume of consumer loans and the volume of deposits (60% against 80–90% in the EU) is the evidence of the remaining strength of growth in lending to individuals.

In the first three quarters of 2019, **the overall net profit of the Russian banking sector amounted to Rb 1.5 trillion, an increase of 36% on the same period of the previous year** (Rb 1.1 trillion).

As of October 1, 2019, **454 credit institutions operated in Russia** (484 credit institutions as of the beginning of the year), of which 368 credit institutions reported profit of Rb 1658bn, while 82 credit institutions, a loss of Rb 157.4bn. So, the share of loss-making institutions decreased to 18% (29% as of the same date last year).

An important factor, which had an effect on the financial performance of the Russian banking sector, was the new accounting procedure, which became effective from January 1, 2019, in respect of loan loss provisions. The new documents of the Central Bank of Russia suggest application of the IFRS 9¹ standard. Also, additional balance-sheet accounts and symbols of the report of financial results were introduced into the bank accounting for provision adjustments to be displayed. Also concerned by the changes in question were the methods of interest income accounting.

Owing to the above decisions by the Central Bank of Russia, **the profit-earning capacity of Russian credit institutions has increased** despite the pressure of a decreased interest margin on banks' profitability. By the end of Q3, 2019, the return on assets ratio (ROA)² amounted to 1.9%, while the return on equity ratio (ROE)³, to 17.7%. A year before, those indices amounted to 1.4% and 12.4%, respectively. It is highly likely that in the near future bank analysts will include in their practice the calculation of profitability cleared of provision adjustments in compliance with IFRS 9. Note that this index has

1 IFRS 9 is an international financial reporting standard which establishes the procedure for preparation and submission of financial reporting as regards financial assets and financial liabilities, requirements to recognition and appraisal and depreciation, derecognition of the general procedure of hedging and principles of recognition of the expected credit losses over the entire effective period of the financial instrument.

2 The profitability of assets (return on assets, ROA) is a financial ratio which specifies the return on the entity's all assets.

3 The profitability of own capital (return on equity, ROE) is the indicator of the net profit compared with the entity's own capital.

3. Commercial Banks' Financial Results in Q3 2019

recently shown the stagnation of bank profitability (13.1% as of July 1, 2019 against 13.8% as of July 1, 2018).

In January-September 2019, the banking sector's financial result pattern underwent some changes as compared to the same period of 2018.

The absolute and relative volumes of the net interest income are almost just the same as last year, but the effect of foreign currency revaluation is virtually non-existent. A lack of growth in interest income and foreign currency income makes banks look for additional sources of profit. In the period under review, operating non-interest incomes saw positive dynamics: net commission income (growth of Rb 63bn in H1 2019 or 12% on the relative period of 2018); net income from securities trading (growth of Rb 88bn or a 2.8-fold increase); and net income from other operations (twofold growth of Rb 20bn on the similar period of the previous year).

At the same time, banks keep developing technologies for optimizing business processes, such as Lean and Kaizen. They plan more carefully their expenditures related to their activities, including costs on the personnel, operations with fixed assets and intangible assets and management. **The operating efficiency of Russian credit institutions has grown on average across the sector:** in Q2 2019 the cost-to-income ratio (CIR) reflecting the ratio of administrative expenditures to the operating income decreased to 41%, which is evidence of higher efficiency of management of the above costs (in most EU countries this ratio is equal to minimum 50%).

It is noteworthy that based on the results of Q3 2019 **the interest income received from lending to individuals exceeded the interest income from lending to corporate customers** (Fig. 1). This situation can be justified by growth in consumer and mortgage lending where interest rates, according to statistical materials published by the Central Bank of Russia, are higher than those on loans to legal entities: so, in August the interest rate on loans to individuals for the term of 90 days to 180 days amounted to 19.24%, while on loans to legal entities for the same term, to 9.87%.

In addition, the banking sector's financial result is influenced by changes in the pattern of banking assets and liabilities.

With fast growth in profits (36%), **the main indices of banks' performance increased insignificantly and were in line with the dynamics of the previous year.** Within 9 months of 2019, assets of credit institutions grew by 3.2% (4.1% in the relevant period of the previous year), while banks' own funds, by 3.5% (0.5%).

Despite a decrease in interest rates on deposits, **banks have managed to build up by 5% the volume of individuals' deposits in 3 quarters of 2019, an increase of 1.7% on the index's value for the same period of 2018.** This growth was partially justified by

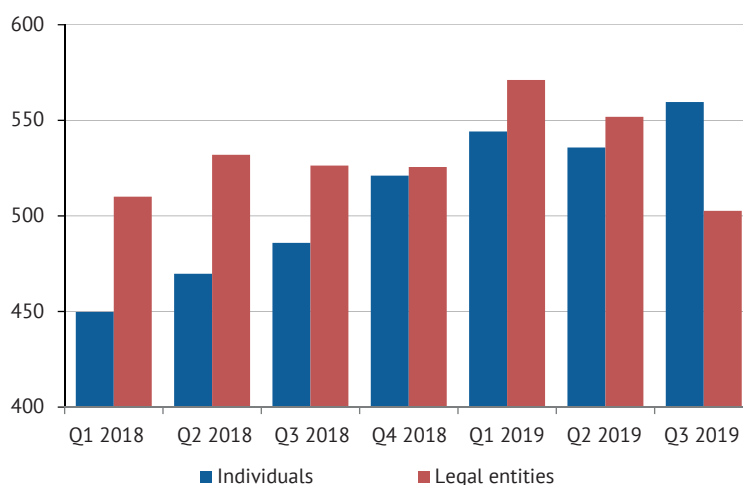


Fig. 1. Interest income on loans, billion rubles

Source: The Central Bank of Russia, own calculations.

the capitalization of interests accrued by banks on deposits. The overall growth in deposits contributes to the slowdown of growth in the net interest income because of a high cost of this type of banking liabilities.

The situation is somewhat different as regards funds borrowed from other entities. In the first nine months of 2019, the overall volume of deposits and account balances fell by 0.8% (no changes took place in the same period last year).

As regards active banking operations, over nine months of 2019 growth in **corporate lending** amounted to 3.6% against 5.5% in the relevant period of the previous year.


Growth rates of retail lending have somewhat slowed down this year, too: from 16.7% in 9 months of 2018 to 14.9% in the same period of 2019.

In January-September 2019, the overdue debt on loans to nonfinancial institutions increased by 31.1%, however, it was justified by a technical factor – from 2019 overdue receivables and purchased overdue bills receivable were included in this index (operations on debt purchasing and assignment). **As regards loans to individuals, growth in the overdue debt amounted to 5.4% of the overall volume of the extended loans, that is, it has decreased somewhat since the beginning of the year owing to credit portfolio growth.**

Assessments by the representatives of the banking community of the situation on the consumer lending market greatly vary. Some bankers see serious risks in the intensive growth of consumer lending, while other speak about the lack of global refinancing of Russian borrowers. The latter believe that there are no prerequisites for the credit bubble to emerge in the short-term prospect.

It is noteworthy that based on the results of three quarters of 2019 the ratio between the volume of consumer loans and the volume of deposits amounted to 60% as compared to 80%–90% in the EU, which fact is evidence of **the remaining strength of growth in lending to individuals.**

In addition, a factor which is expected to influence the policy of banks in the near future is the debt burden index (DBI) which was introduced by the Central Bank of Russia from October 1, 2019 for regulation purposes; it suggests establishment of risk ratio premiums depending on the condition of the credit portfolio.

In the long term, the banking sector's pattern of assets and liabilities, as well as the dynamics of profits will be determined by the following factors: the monetary policy of the Central Bank of Russia, financial rehabilitation processes in large credit institutions, as well as partial reorientation of banks on other segments of the financial market, primarily, the securities market. The banking sector's sustainable growth is an important prerequisite to facilitate economic growth and social stability in the country. According to the forecast of the RF Ministry of Economic Development ("Monetary Performance in 2019–2024"), until 2024 the annual average growth in loans and deposits to households and nonfinancial institutions will amount to about 10% with simultaneous growth in banks' free liquidity. With this factor taken into account, the stabilization of the financial result of the banking sector can be expected: the net interest income will increase somewhat, while profitability indices stabilize. 

4. THE INDUSTRY STARTED TO LACK LABOR IN Q3 2019

S. Tsukhlo

The results of monthly business surveys have shown a somewhat decrease in the level of satisfaction of the Russian industry with the results of Q3 2019 as compared to the record-high indicators of the previous quarter. The industry adaptability index (normality) fell 3 points after it had achieved its historical maximum in Q2 2019 over the entire period of calculations (1994–2019). A decrease in the level of satisfaction with the current state of things measured by the index of normality is in harmony in the industry with the stable positive value of the overall indicator, that is, the industrial confidence indicator. More importantly, late in Q3 2019 the latter amounted to the five-month maximum, which is quite in line with the data of the official industrial statistics.

Only one out of six initial indicators of the industry adaptability index saw growth in the past quarter – the share of normal estimates of the stocks of finished products increased by the mere 1 percentage point. However, during the past five quarters this indicator, that is, the share of “normal” answers to the question “How do you estimate the stocks of finished products at the enterprise?” has seen a surprising stability and varied in the range of 72% to 74%. The index’s absolute record (1992–2019) was equal to 75% in Q3 2016, that is, during

the 2015–2016 crisis. The start of the crisis was unusual, too: in Q1 2015 the share of “normal” estimates of the stocks of finished products did not change as compared with Q4 2014 and amounted to 70%, while the balance of other estimates (“above the norm” minus “below the norm”) turned out to be equal to zero. Growth in the balance of estimates was registered in 2017 when the industry anticipated exit from the 2015–2016 crisis. However, in 2018–2019 the balance returned again the zero level, which fact is the evidence of a lack of expectations in the industry that the negative phenomenon of the previous years will be overcome. **The industry confidently controlled its stocks of finished products during the 2015–2016 crisis and in subsequent years.** The current stagnation creates prerequisites for enterprises to keep control as confidently as before over the stocks of finished products in the short-term prospect.

The level of satisfaction (the share of “sufficient” answers) with the actual number of workers fell dramatically. According to the estimates of enterprises, in the industry the sufficient provision with the personnel fell from the absolute

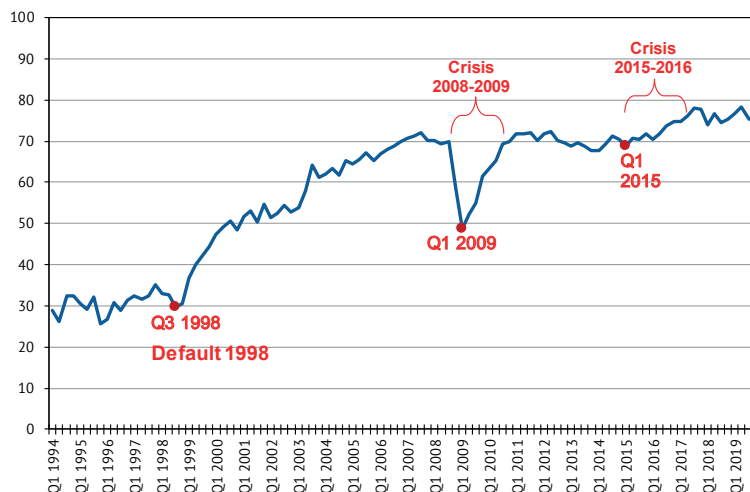


Fig. 1. The industry adaptability (normality) index, 1994–2019, % (the share of enterprises which assessed their performance as “normal”)

record of 86% to 80%, which became the worst value in 2019. The balance of estimates was negative and fell to the five-year minimum. **According to enterprises, the Russian industry has not seen such a shortage of labor since 2014.** As seen from the initial data of Q4, 2019, enterprises have failed to restore the previous level of provision with the personnel this year.

The normal provision of Russian enterprises with the personnel decreased by 4 p.p. in Q3 2019 after it had achieved the 7-quarter maximum in Q2 2019. As a result, **at present 73% of enterprises estimate their capacities as sufficient.** However, the balance of answers (“more than sufficient” – “less than sufficient”) remained positive – the industry as a whole has retained the surplus of production capacities.

In Q3 2019, the share of enterprises with normal stocks of raw materials fell to 77%, while a quarter earlier the index set the absolute record of 83%. **The industry has never seen such provision with raw materials since the beginning of the monitoring in 1993.** It seems that such unusual results were attained by the Russian industry in the beginning of 2019 on the back of the prolonged stagnation and minimal problems with the working capital.

In Q 3 2019, the industry’s estimates of its own financial and economic situation got worse by a symbolic 1 point; at present 90% of enterprises assess it as “good” or “satisfactory”. The index’s absolute record of 92% was registered twice in 2017 and early in 2019. The current result does not virtually differ from the record value and is in line with the official data on enterprises’ financial results.

The satisfaction with the current volume of demand is traditionally characterized by low absolute levels after the beginning of the 2008–2009 crisis. At present, 59% of enterprises believe that the volume of demand is normal. This result is not beyond the range of 58–61%, where the estimates of sales have remained since the beginning of 2018. In 2017 when the industry took efforts to exit the stagnation, the satisfaction with sales amounted to 65%.

The formal decrease in the index of normality of the Russian industry amid weak positive dynamics of output, stable forecasts of demand and relatively optimistic plans of output point to positive, in terms of the traditional analysis, results of Q3, 2019 and enterprises’ preparedness to take new efforts to come out of the stagnation which began in the industry as early as 2012.

Though demand is most often referred to as a deterrent to output growth, its negative influence on the industrial production does not increase. This cannot be said about the uncertainty of the current economic situation and its prospects. **The factor of uncertainty is mentioned by enterprises more often.** It is noteworthy that in 2018–2019 only 2-4% of enterprises lack loans to start statistically conspicuous industrial growth. 

5. PRIORITIES OF RUSSIAN DEVELOPMENT ASSISTANCE IN 2018 YEAR

Yu. Zaitsev, A. Knobel

According to statistics published in October 2019, Russia maintained a relatively high level of funding programs in the field of international development assistance in 2018. A large share (63%) of Russian aid was provided as in the past on a bilateral basis, and the largest recipients remained Cuba, DPRK, Kyrgyzstan and Tajikistan. Moreover, in addition to direct assistance, Russia finances these countries also in the framework of cooperation with international organizations. In 2018, distribution of aid was mainly related to healthcare and food security as well as to debt relief which exceeded \$ 400 million.

Assistance to international development provided by Russian Federation in 2018

In 2018, Russia kept implementing projects related to provision of economic assistance to developing countries in the amount of \$ 999.08 million. This is comparable to the previous period (2015, 2016 and 2017), when funding exceeded \$ 1 billion per year (Fig. 1)¹. It should be noted that the assistance provided is related to resolution of socio-economic problems and does not concern issues of military and other areas of cooperation².

Waiving of debts attributed to foreign countries in the amount of \$ 418.03 million remained the major trend of the Russian assistance to international development (ODA) in 2018 as well as in previous years. In particular, a protocol providing for Kyrgyzstan debt relief was ratified in February 2018 in the amount of \$ 240 million. (Fig. 2). Moreover, in the framework of the Russia-Africa Forum held in October 2019, it was announced

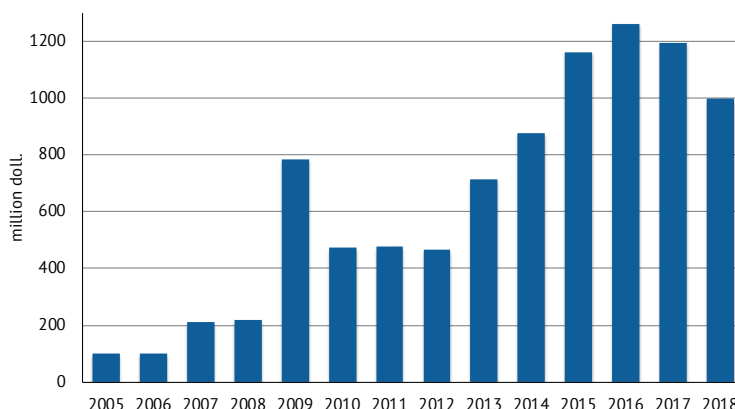


Fig. 1 Official development assistance provided by the Russian Federation in 2005–2018

Source: OECD DAC and Ministry of Finance of Russia database.

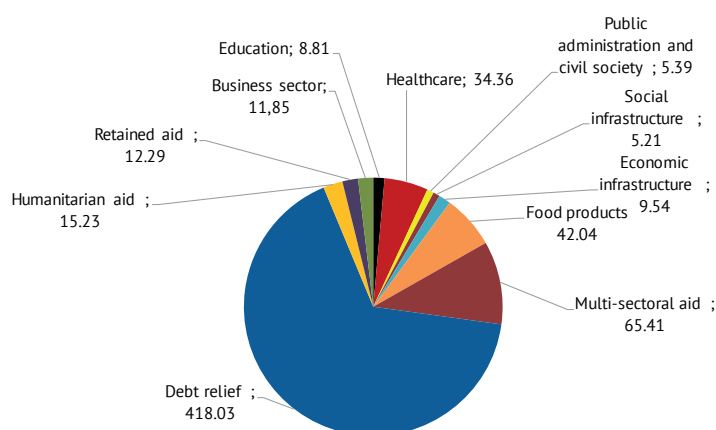


Fig. 2 Distribution of Russian aid across sectors in 2018, \$ million

Source: OECD DAC and Ministry of Finance of Russia database.

1 Yuri Zaitsev, Alexander Knobel. Russia as international donor in 2017 // Russian Economic Development. 2018. V. 25. No. 12. P. 8–12. URL: <https://elibrary.ru/item.asp?id=36613484>

2 Official Development Assistance. Definition and Coverage. OECD. URL: <https://www.oecd.org/dac/stats/officialdevelopmentassistance/definitionandcoverage.htm>

that the remaining debt of Ethiopia to Russia in the amount of \$ 163.6 million was written off under the “debt in exchange for development” scheme¹. **In total, Russia waived debts of African countries in the amount of \$ 20 billion².**

Other largest areas of Russian financing of international development were again **healthcare and food security** with \$ 34.36 and 42.04 million allocated respectively.

Financing of economic assistance programs through bilateral projects

(\$ 628.16 million) became traditional and it is the largest trend for Russia. At the same time, in 2018, multilateral assistance amounted to 37% of the total volume of official development assistance (ODA) (Fig. 3). (This topic will be discussed in more details below.)

Financing of UN institutions remains high and constituted \$ 104.71 million in 2018 (Table 1). For instance, Russia allocated \$ 2 million to United Office of counter-terrorism at the end of January 2018 for combating international terrorism. As from 2019, Russia plans to send \$ 500 thousand annually to support activities of this Office striving to provide assistance to countries subjected to terroristic threats¹. As for UN Development Program, Russia completed implementation of 4 projects in 2018 under UN Partnership Frame Agreement for the total amount exceeding \$ 3.6.

Projects were implemented in the field of combating disaster management, healthcare, trade and education (including countries such as Belarus and Tajikistan)².

More than half of multilateral funding resources goes to **regional development banks** (\$ 225.12 million). In particular, cumulative amount of the Russian portfolio in the Eurasian Development Bank amounts to \$ 3.5 billion exceeding 42% of the total size of financing³.

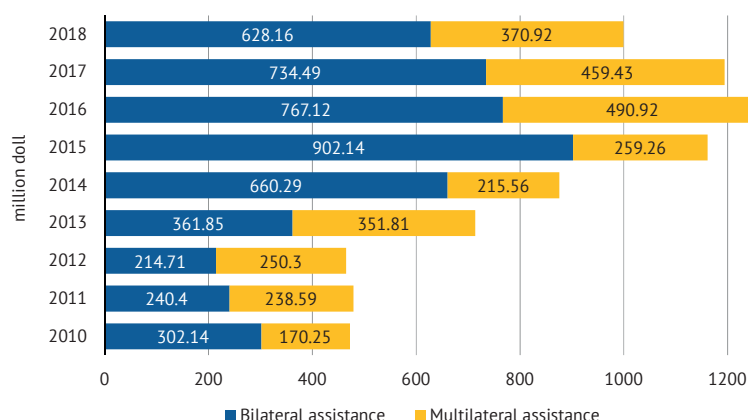


Fig. 3. Russian bilateral and multilateral assistance

Source: OECD DAC and Ministry of Finance of Russia database

Table 1

Russian financial participation in the activity of international development institutions in 2017, \$ million

International Institution	Financial amount of Russian participation
UN Institutions	104.71
World Bank institutions (IDA, IBRD, IFC, IAHR)	16.14
Regional development banks	225.12
Montreal Protocol ²	7.95
Other international institutions	17.01
Total	370.92

Source: OECD DAC and Ministry of Finance of Russia database.

1 Russia will allocate \$ 2 million to United Nations for combatting international terrorism. 23.01.2018. https://tsargrad.tv/news/rossija-predostavit-oon-2-milliona-dollarov-dlja-borby-s-mezhdunarodnym-terrorom_106650

2 On Russian partnership – UNDP. URL: <https://expertsfordevelopment.ru/partners/>

3 On Russian partnership – UNDP. URL: <https://expertsfordevelopment.ru/partners/>

5. Priorities of Russian development assistance in 2018 year

Bilateral assistance

Geography of bilateral projects includes mainly countries of CIS, Africa and Latin America (Table 2). Armenia, Kyrgyzstan, Cuba, DPRK, Syria, Tajikistan remained traditional beneficiaries of assistance in 2018.

In January 2018, Russia provided 2.8 tons of humanitarian aid to residents of Karfa settlement in the Syrian province of Dara. Assistance was designated to more than 400 families of refugees¹. The Russian government **actively cooperated with the countries of Central Asia**. The amount of \$ 11.48 million was sent to Tajikistan with 7 million in form of humanitarian aid². In addition to waiving off the debt of Kyrgyzstan in 2018, Russia continued to furnish this country with military assistance constituting \$ 125 million in the period of 2014–2018. However, this type of assistance is not included in ODA according to OECD DAC methodology³.

Russian government **allocated over \$ 10 million to Cuba in 2018** aimed at the renovation of the Capitol dome gilt in Habana⁴. It is now possible to account this category of financing as ODA became when statistical system of OECD DAC had been reformed. Nowadays, this category of financing is accounted as official development assistance. Military cooperation is also being implemented: Russia granted a public credit to Cuba in November 2018 in the amount of Euro 38 million for purchase of military technique⁵.

New definitions and approaches towards accounting of development assistance

Since 2019, OECD DAC introduced new approach towards accounting of development assistance. Main changes are associated with the use of grant equivalent³ statistics when accounting for loans as a type of ODA. Until recently, grants and loans were evaluated in the same way: flows of cash sent (or nominal value of loans) provided to developing countries minus any payments on loans were recorded. This method was used until 2018 in order to obtain data on official development assistance. New approach reflects a more realistic comparison of loans and grants.

Clarification was made in relation to accounting of expenditures incurred for implementation of security measures and assistance to refugees. According to amendments, ODA includes only those expenditures that concern training of military personnel from partner countries. Expenses related to refugees also include expenses for the support of applicants for asylum under new rules but exclude funds aimed at refugees integrating into economy of their host countries¹.

1 Russian military handed over humanitarian aid to citizens of Syrian province Dara. 15.01.2018 <https://nation-news.ru/339050-rossiiskie-voennye-peredali-gumanitarnuyu-pomosh-zhitelyam-siriiskoi-provincii-dara>

2 Russia reduced humanitarian aid to Tajikistan twice in 2018. 19.01.2019. URL: <https://tj.sputniknews.ru/main/20190119/1028025595/russia-2018-god-sokratila-gumpomoshch-tajikistan-dva-raza.html>

3« Russia is not excluding Tajikistan from their protection zone». Radio Ozoli. <https://rus.ozodi.org/a/29719323.html>

4 Russia will spend Rb 642 million for renovation of Capitol dome gilt in Habana. RIA News. 16.08.2018. URL: <https://ria.ru/20180816/1526679311.html>

5 Russia and Cuba approved joint industrial projects. 12.09.2019. URL: <https://regnum.ru/news/polit/2716654.html>

3 If current cost of future loan repayment is lower than the amount of loan, the difference represents "grant - equivalent".

Table 2


Distribution of Russian bilateral assistance among recipient countries in 2012–2018 (\$ million.)

Designation of assistance	2012	2013	2014	2015	2016	2017	2018
Bilateral assistance, total	214.71	361.85	660.29	902.14	762.06	733.77	617.94
Afghanistan	0.45	0	4.95	2.56	0.04	0.04	1.01
Azerbaijan	1.73	-	0.48	0.01	0.05	2.49	0.69
Angola	0.28	-	-	0.06	6.37	-	0.37
Armenia	5.79	5.26	5.86	37.37	40.33	15.63	17.6
Bangladesh	0.1	-	-	-	-	-	1.35
Belarus	0.11	1.47	2.5	2.97	2.87	2.25	2.8
Burundi	0.14	-	-	-	-	0.04	-
Brazil	0.01	-	-	-	-	-	0.37
Burkina Faso	0.1	-	-	-	-	-	0.98
Vietnam	2.56	0.4	-	0.16	0.2	6.93	3.33
Ghana	0.19	-	2.37	-	-	-	0.37
Guinea	0.97	-	16.79	6.25	6.32	3.72	3.8
Egypt	0.07	-	-	0.78	-	0.03	-
India	0.06	0.01	-	-	0.38	0.46	0.37
Indonesia	-	-	-	-	-	-	0.55
Iran	0.1	-	1.3	1.3	-	-	-
Iraq	0.41	0.55	1.07	0.23	1.58	1.59	0.18
Jordan	2.6	5.44	3	4.99	0.5	1.67	0.66
Yemen	1.5	-	0.36	2.36	-	1	1.97
Kazakhstan	1.6	0.08	0.55	0.57	0.32	0.48	1.36
Cambodia	0.09	-	-	-	0.15	0.37	0.37
Kenya	2.88	2.19	2	-	-	1	-
Kyrgyzstan	37.92	76.73	202.87	322.81	198.81	129.81	59.54
Kiribati	-	-	-	-	-	0.01	-
Congo	0.28	-	-	1.21	-	1	1.97
Cuba	5.58	2.76	176.98	351.97	352	353.83	352.77
DPRK	15.5	33.61	68.42	59.77	58.63	57.71	58.13
Laos	0.23	-	-	-	-	0.17	1.51
Liberia	-	-	1.61	2.83	-	-	0.37
Madagascar	0.06	-	-	-	9.89	8.89	8.75
Marshall Islands	-	-	-	-	-	0.01	-
Mongolia	7.92	0.01	-	0.23	0.21	1.16	1.4
Moldova	0.64	0.39	-	0.78	1.53	-	0.37
Morocco	0.08	1.98	1.5	0.6	-	4.16	-
Mozambique	0.09	13.05	8	8	8	8	7.87
Myanmar	-	-	0.05	0.08	-	0.17	0.04
Namibia	0.09	0.46	-	0.06	-	1.5	-
Nepal	0.18	-	-	-	0.2	0.25	-
Nicaragua	10.86	36.4	17.24	5.56	12.04	14.01	7.57
Palau	-	-	-	-	-	0.01	-
Peru	-	-	-	-	-	0.4	-
Serbia	9.49	36.47	16.21	11.25	11.7	6.87	7.19
Somali	2.04	1	1	-	1	1	1.97
Sudan	0.01	2.56	0.05	1.54	0.01	1	-
Surinam	-	-	-	-	-	-	0.02
Syria	11.17	12.95	7.33	22.1	4	20.53	2.33
Tonga	-	-	-	-	-	0.01	-
Tajikistan	15.21	17.12	19.48	21.76	13.66	16.1	11.48
Tanzania	0.07	3.37	1.37	1.37	1.37	1.37	1.35
Tunis	0.04	1.98	1.65	1.12	-	5.66	-
Turkmenistan	0.9	-	-	0.78	0.05	-	0.42
Uzbekistan	0.92	0.34	1.15	0.52	0.05	2.98	2.25
Ukraine	1.15	0.69	6.82	-	5.62	5	-
Fiji	-	-	0.13	-	0.02	0.01	-
Chad	0.09	-	-	-	-	-	0.98
Ethiopia	0.04	2.08	-	0.21	1.81	-	0.41
Other countries	13.74	5.82	27.65	20.02	16.97	60.42	46.9

Source: OECD DAC and Ministry of Finances of Russia database.

5. Priorities of Russian development assistance in 2018 year

Government of the Russian Federation approved amendments to Article 122 “External Debt Claims of the Russian Federation” of the Budget Code¹. In particular, **new definitions were introduced: “official development assistance”, “public loan” and “public export loan”**. These innovations will allow to increase transparency of financing Russian ODA programs and strengthen discipline of their implementation. Legislative consolidation of financing mechanisms will allow to develop domestic contracting system for provision of assistance thus improving system of data collection and reporting, especially through bilateral programs.

Use of bilateral funding channels allows to make economic assistance programs targeted and focused, which will contribute to more efficient promotion of Russian national interests and resolution of issues in recipient countries. For example, technical assistance in the field of agriculture and energy can contribute to growth of exports of Russian products. 

¹ Budget Code of the Russian Federation of 31.07.1998 N 145-Φ3 (editing of 02.08.2019) (adopted as from 01.09.2019 including changes and additions). BC RF, article 122. Foreign debt demands of the Russian Federation. URL: <http://docs.cntd.ru/document/901714433>

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