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The review "Russian Economy. Trends and Outlooks" has been published by the Gaidar Institute since 1991. This is the 42th issue. This publication provides a detailed analysis of main trends in Russian economy, global trends in social and economic development. The paper contains 6 big sections that highlight different aspects of Russia's economic development, which allow to monitor all angles of ongoing events over a prolonged period: global economic and political challenges and national responses, economic growth and economic crisis; the monetary and budget spheres; financial markets and institutions; the real sector; social sphere; institutional changes. The paper employs a huge mass of statistical data that forms the basis of original computation and numerous charts confirming the conclusions.

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Olga Izryadnova

4.1. Dynamic and structure of GDP and investments[1]

4.1.1. Internal and external demand

Internal epidemiological restrictions and external shocks have had a significant impact on economic growth in Russia. Unfavorable changes in the global market environment increased the impact of external factors on economic dynamic: starting from 2019, the scale of exports in terms of value and physical volume decreased; the decline in the contribution of net exports to GDP dynamics was partially offset by an increase in domestic demand on the back of the outstripping growth of manufacturing industry and the segment of paid services to the population.

From the outset of the spread of coronavirus infection, there was a simultaneous reduction in demand and supply in the domestic market. The situation was complicated by a drop in demand and prices on the world market of hydrocarbons, which came amid a decline in the ruble exchange rate and an increase in the level of inflation. The negative effects of the uncertainty and potential risks of the pandemic affected the nature of business structures, consumer behavior, and led to changes in the structure of government spending, the corporate sector, households, and the demand for financial resources (*Table 1*).

In Q1 2020, the nature of economic processes was determined by the impact of the trends of the previous year, GDP dynamic remained within positive values. At GDP growth rate of 1.6% in Q1 2020, household consumption gained 1.4%, fixed capital investment gained 2.2% and exports dropped by 2.4% compared to the corresponding period of the previous year. It should be noted that a sharp increase in consumer demand seen at the end of Q1 2020 was determined by the influence of soared inflation expectations of the population and high demand in response to the anxiety of the epidemiological situation. At 2020 Q1-end, the retail sales turnover in both the food and non-food markets was at the highest level over the last five years.

1 This section was written by: *Izryadnova O.*, Leading Researcher, IAES RANEPA; Head of Structural Policy Department at the Gaidar Institute.

Table 1

Main factors of the development of the Russian economy in 2017–2020, in % to corresponding period of the previous year

	2017	2018	2019	2020	Quarters 2020			
					I	II	III	IV
GDP	101.8	102.8	102.0	96.9	101,4	92,2	96,5	98,2
External factors								
Foreign trade turnover (on balance of payments)	125.0	117.2	97.4	84.7	91.9	76.1	82.3	88.5
Export	125.3	125.8	94.6	79.0	87.0	69.5	76.0	83.1
Import	124.5	104.4	102.3	94.2	100.8	87.0	92.1	97.1
Balance	127.0	170.2	84.7	55.7	70.6	41.9	48.2	58.8
Oil prices, USD/bbl.	54.39	70.07	64.03	42.30	50.53	31.43	42.72	44.52
Official exchange rate (RUB/USD), at the period-end	57.60	69.47	61.91	7388	77.73	69.95	79.68	73.88
Internal factors								
Fixed capital investment	104.8	105.4	102.1	98.6	103.5	94.7	95.0	101.2
Consumer demand	103.7	104.3	103.2	91.4	103.3	77.8	91.6	98.4
Retail sales turnover	101.3	102.8	101.9	95.9	104.4	84.0	98.4	97.2
Paid services to the population	100.2	101.4	100.5	82.7	98.1	63.9	82.7	86.8
Output of goods and services by basic types of economic activity	103.6	103.6	102.0	97.3	102.8	91.5	97.0	98.2
Industry	103.7	103.5	103.4	97.1	102.6	93.3	95.2	97.5
Extraction of natural resources	102.1	104.1	103.4	93.0	101.0	91.0	88.5	91.6
Manufacturing industry	102.5	102.6	103.6	100.3	105.6	94.9	99.0	101.1
Production of electricity, gas and vapor; air conditioning	99.6	101.6	99.2	97.5	96.0	96.7	97.5	99.5
Agriculture	102.9	99.8	104.3	101.5	103.0	103.1	103.3	97.0
Construction	98.8	106.3	102.1	100.1	102.8	96.1	101.1	100.8
Transportation	105.6	102.7	100.7	95.1	96.1	91.8	94.7	97.8
Social parameters								
Real disposable income of the population	99.5	100.1	101.0	96.5	101.0	92.1	94.7	98.3
Real accrued wages	102.9	108.5	104.8	102.5	106.2	99.9	101.8	102.2
Real amount of assigned pensions	100.3	100.8	101.5	102.3	103.2	102.7	102.2	101.3
Share of the population with cash income below the subsistence level, in % to the total number of the population	12.9	12.6	12.3	n/a	12.6	13.2	13.3	n/a
Labor market								
Number of employed	99.7	100.3	99.2	98.1	99.8	97.9	97.4	97.5
Unemployment rate	5.2	4.8	4.6	5.8	4.6	6.0	6.3	6.1
Financial conditions								
Key rate (at period-end)	7.75	7.75	6.25		6.0	4.50	4.25	4.25
Consumer price index (to December of the previous year)	102.5	104.3	103.0	104.9	101.3	102.6	102.9	104.9

Source: Rosstat.

The spread of coronavirus infection in Q2 2020 required the imposition of stringent restrictive measures on economic and social activities, as well as put in place special relief measures to support the population and businesses. The shutdown in the segment of paid services to the population led to the deepest drop in the household private consumption over 25 years of observations – by 21.7% compared to Q2 2019. As a result of the contraction of domestic demand, the decline in GDP in Q2 2020 hit 7.8% compared to a year earlier. In Q3 2020, GDP dynamic emerged from the steep plunge of the previous quarter on the back of an easing of domestic demand and export constraints and a reduction in the pressure of epidemiological restrictions, and an increase in oil prices. In the last quarter of 2020, despite the return of partial lockdown measures, the economy seems to have adapted to the COVID-19 pandemic, which was also reflected in GDP dynamic (*Fig. 1*). Overall, real GDP fell by 3.1% in 2020.

The change in the structure of the formation and use of resources in 2019-2020 was driven the shift towards growing importance of the domestic market. The change in the share of imports in the resources of the domestic market with an increase in the imports of producer durable goods supported the domestic market and expanded opportunities for economic diversification (*Fig. 2*).

The concentration of activities in industries that displace the more expensive imports from domestic market, and the buildup of export potential for the development of niches in the foreign market that are emerge amid sanitary and epidemiological restrictions becomes the mechanism of adaptation of domestic producers to the simultaneous contraction in demand and supply and to the devaluation of the ruble. The increase in the share of intermediate demand

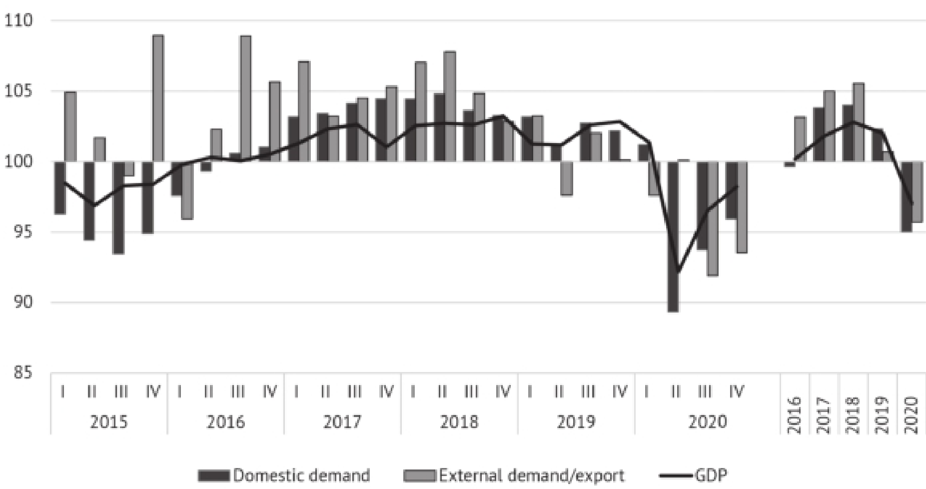

Fig. 1. GDP dynamic by components of domestic and international demand 2015–2020, in % on the corresponding period of the previous year

Source: Rosstat.

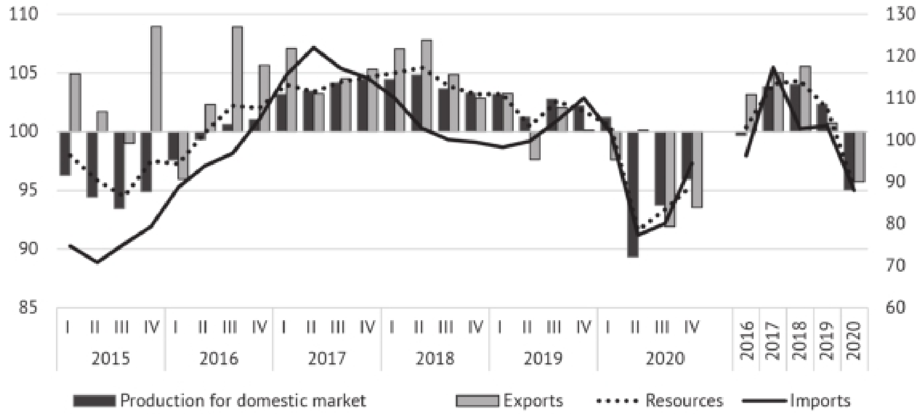

Fig. 2. Dynamic of formation and use of resources in 2015–2020, in % on the corresponding period of the previous year

Source: Rosstat.

goods in imports to values exceeding indexes of the last decade, supported the domestic output dynamic in 2018-2019. However, the tough conditions of competition in the world markets of goods and services, sanctions restrictions on the movement of capital and investment goods, changes in the ruble exchange rate relative to foreign currencies determined the weakness and instability of the export-oriented import substitution processes. Despite the fact that in 2019-2020, exports for the group of high-tech goods grew faster than imports, the Russian economy remained a net importer (*Table 2*). In 2020, the growth of non-primary exports by 17.8% and the acceleration of exports of high-tech goods to 116.2% against 107.3% a year earlier was a positive factor for the economic recovery after the 2015 crisis. In the wake of a general trend of a 5.8% drop in imports in 2020, imports of high-tech goods decreased by 5.0%, while investment goods stabilized at the level of the previous year.

Table 2

The pattern of imports by the functional use of goods and foreign trade of high-tech products in 2016–2020

	Pattern of imports by functional use of goods, in % to total			High-tech products			
				USD billions		Ration in total volume, %	
	Consumer	Investment	Intermediary	Export	Import	Export	Import
2016	35.6	26.5	37.9	36.0	118.8	12.8	67.0
2017	33.6	27.5	38.9	44.4	155.3	12.4	68.3
2018	33.2	25.4	41.4	49.3	160.2	11.0	67.2
2019	33.8	24.4	41.8	74.7	183.3	11.1	72.0
2020	32.8	25.3	41.9	86.7	174.1	26.1	72.6

Source: Rosstat.

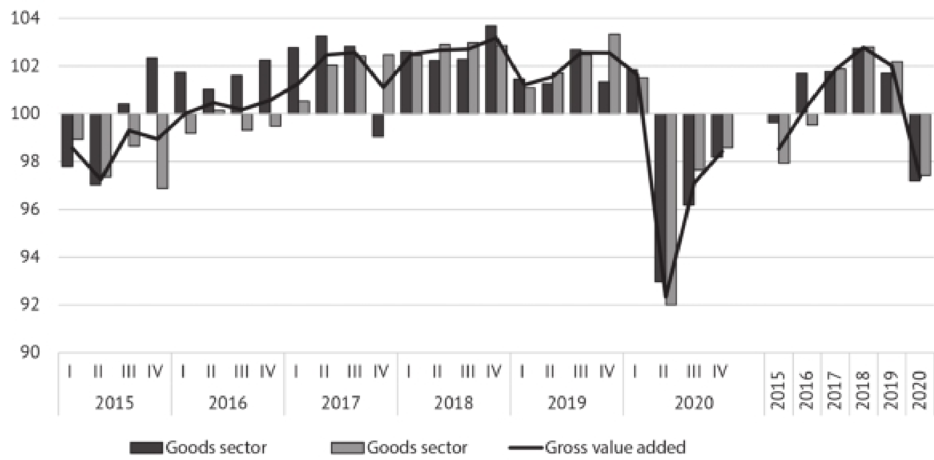

Fig. 3. Dynamic of goods and services sector in 2015–2020, in % on the previous year

Source: Rosstat.

Economic performance in the wake of the spread of the coronavirus pandemic in 2020 was marked by specific structural features. If the recovery of GDP upward trend in 2017-2019 with simultaneous growth in the goods and services sectors was supported by an increase in the latter's contribution, then the volume of the services sector declined considerably in 2020 (*Fig. 3*).

Against the background of the pandemic measures of social distancing and self-isolation were recorded in the segment of services focused on the household consumption. Retail sales turnover at end-2020 amounted to 95.9% compared to the previous year, including food products – 97.4% and non-food products – 94.8%, and regarding the Q2 dynamic (84.0%) was at the lowest level over 20 years of observations in the markets of both food (93.0%) and non-food (73.6%) products. Against the backdrop of the uncertainty of the economic development, strengthening of the downward trend in the household real incomes, changes in consumer behavior and a sharp drop in consumer spending, critically low performance indexes were recorded in the following sectors: passenger transportation, tourism, hospitality, sports and recreation, leisure and entertainment business, and household services. The situation was also aggravated by the fact that small and medium-sized businesses and individual entrepreneurs, whose economic activity has fallen sharply under the pressure of an unprecedented drop in public demand, prevail in the segment of consumer market services.

With the gradual easing of restrictive measures, the recovery in economic activity in Q3 2020 was extremely heterogeneous in terms of the types of services provided and consumer behavior. It should be noted that the dynamic of consumer activity and the partial recovery of the paid services sector were positively affected by the increase in budget expenditures within the implementation of relief measures for the population and the economy, including small and medium-sized businesses. The lifting of administrative restrictions on the activities of non-food retail sales, hospitality business, and parts of the consumer services sector has led to a revival of supply and demand in those segments of the consumer market. An additional factor in the recovery of supply in the service sector was the opening of domestic tourist and resort destinations, which supported activity in related services, but activity indicators remained at a critically low level over the past decade. In Q4 2020, despite the strengthening of the requirements for social distancing, the use of gained experience in adapting to epidemiological rules helped to weaken the negative trends in the market of paid services. At end-2020, the volume of paid services rendered to the population amounted to 82.73%, including public catering – 79.32%, transportation services – 60.9%, tourism – 46.7%, hotel – 64.9%, culture – 46.7%, sports and recreation - 67.4% compared to the previous year (*Fig. 4*). The recovery of the market of paid services to the population in 2021-2022 following its large-scale decline in 2020 will be slow moreover given the restrained trends in changes in the household cash incomes.

The decline in Russian industrial production as a whole displayed a relatively restrained rate of decline – by 2.9% by 2019. The decline in the production of goods in 2020, in addition to the lockdown, was affected by the instability of the situation on the global hydrocarbon market, changes in the foreign trade environment associated with a reduction in the scale of trade in goods and services and the disruption of interaction in value chains. The longer than anticipated effect of internal and external sanitary and epidemiological restrictions at the

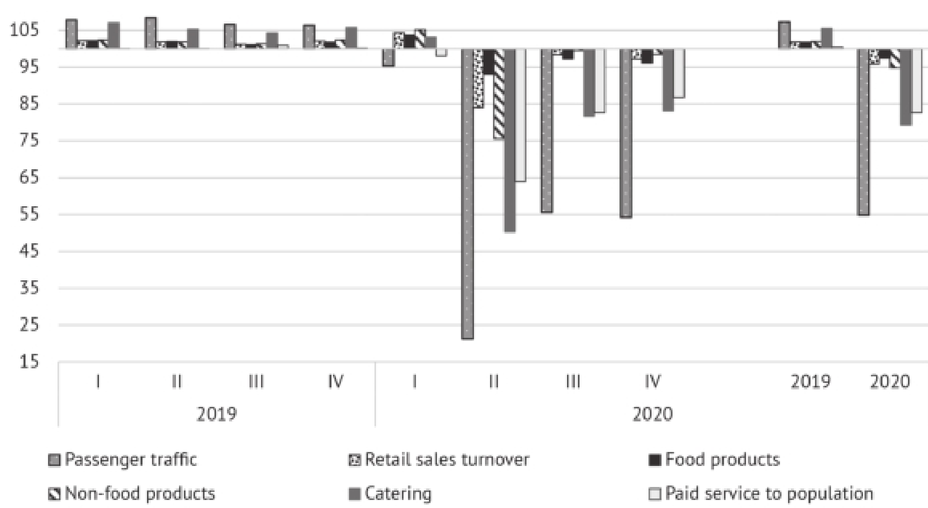

Fig. 4. Dynamic of consumer market of goods and services in 2019–2020, in % on the corresponding period of the previous year

Source: Rosstat.

initial stage of the pandemic has led to a decline in economic activity, with the extent of the decline greatly varying by type of activity.

The decline in production in extraction of mineral resources was noted for all types of observed aggregated positions. In Q2 2020, the volume of mineral extraction stood at 91.2%, in Q3 – 88.7% of the previous year. The main contribution to the reduction in extractive production output was made by the contraction in oil and natural gas production by 33.5% compared to January – September 2019, which was due to the fulfillment of commitments under the OPEC+ deal. Despite the fact that in Q4 2020 there was a slight recovery in the global mineral commodities market, at the year-end the decline in mineral production came to 7.0%, including 8.1% in oil and gas production, which was the highest drop since 1993 (*Fig. 5*).

In 2020, the manufacturing industry was marked by a more moderate reduction dynamic relative to extractive production. The main peak of the decline in manufacturing production occurred in Q2 2020, when production volumes were only 94.9% against the last year. The recovery of economic activity after the spring lockdown led to a gradual weakening of the rate of production decline, and at end-2020, the manufacturing output even exceeded the level of the previous year (100.3%). The structure of manufacturing production following a steep drop in output in April 2020 changed under the impact of an increase in the contribution of consumer goods production and intermediate demand.

Against the backdrop of weak upward trend of consumer-oriented industries, the proportion of domestic products in retail trade marketable resources in 2020 stood at the previous year level of 63%, which, amidst the demand compression, helped to mitigate the impact of a reduction in imports of consumer goods in the total volume of imports by 1.0 p.p. compared to the previous year.

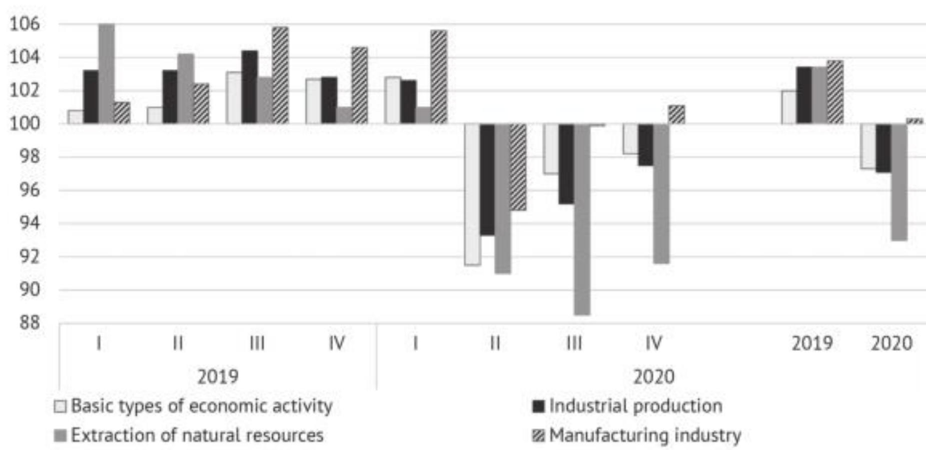

Fig. 5. Indexes of extraction of natural resources and manufacturing industry in 2019–2020, in % on the corresponding period of the previous year

Source: Rosstat.

The snowballing growth in the pandemic induced demand for medicines and sanitary materials gave a boost to a rise in the contribution of intermediate and final demand goods for medical use in the associated industries of machine-building and chemical industries, textile, clothing, and pulp and paper industries (*Table 3*).

Table 3

Dynamic of manufacturing industry by types of economic activity in 2019–2020, in % to corresponding period of previous year

	2019	2020	Quarters 2020			
			I	II	III	IV
Manufacturing	103.6	100.3	105.6	94.8	99.9	101.1
Including:						
Food production	104.1	103.5	109.2	103.6	101.5	100.6
Production of textile articles	101.8	108.9	108.2	104.3	110.0	112.4
Production of clothing	103.5	100.6	101.1	92.8	104.2	105.5
Production of leather and leather articles	98.4	87.6	100.2	71.3	89.8	91.3
Wood-processing and manufacturing of wood articles	106.2	100.2	101.3	91.8	102.5	105.2
Production of paper and paper articles	104.6	101.9	103.5	98.2	102.5	103.4
Production of charred coal and petrochemicals	101.6	97.0	105.8	96.3	93.8	92.5
Production of chemical products	103.4	107.2	108.2	103.4	107.1	109.9
Production of medicines and materials	127.4	123.0	112.0	123.5	121.1	134.2
Production of rubber and plastic articles	98.7	103.2	105.6	93.2	104.3	110.0
Production of other nonmetal mineral products	109.0	97.7	104.4	90.6	95.6	101.8
Metallurgical production	103.8	97.6	101.4	92.8	96.7	99.9
Manufacture of metal products	107.3	102.0	112.0	101.6	104.0	98.7
Manufacture of computers and electronic and optical products	110.6	98.4	116.0	80.4	107.9	100.0
Manufacture of electrical equipment	101.3	99.0	106.9	86.6	99.8	103.0
Manufacture of machinery and equipment	113.5	105.9	110.9	98.6	108.5	108.2
Manufacture of motor transportation vehicles	96.3	87.3	88.7	59.6	93.2	107.7
Manufacture of other means of transportation	99.0	98.9	97.1	84.9	97.8	108.2
Furniture making	102.1	103.7	104.0	86.1	111.5	109.8

Source: Rosstat.

The most difficult situation of all the manufacturing industries was in machine-building where the drop in output in Q2 2020 exceeded 25% compared to the corresponding index a year earlier. The manufacture of motor vehicles reacted in the most acute form to the irregularity of economic activity and the drop in demand down by 59.8% against Q2 2019, which amidst a developed system of manufacturing tides, had an extremely painful effect on the output dynamic of related machine-building enterprises, structural materials and components. At end-2020, the pace of manufacturing production stabilized at the level of the previous year.

In 2020, the output index of goods and services by basic types of economic activity stood at 97.3%. The dynamic of basic economic activities in 2020 was considerably affected by the contraction of demand for transportation and logistics services. The dynamic of cargo turnover and haulage of cargo since early 2020 compared to the previous year was in the region of negative values for almost all types of cargo transportation and amounted to 95.1% of the index a year earlier. Railway (97.8%) and pipeline (92.0%) types of transport that provide the dominant share of cargo turnover, as well as the haulage of goods by road (94.1%) responded most acutely to the change in the conditions of economic activity. If in Q1 2020, the demand for transportation and logistics services was supported by upward trend of wholesale and retail trade and industrial production, in Q2 the development of downward trends in these same types determined a sharp drop in the volume of activity of the transportation complex. Cargo turnover dynamic in Q2 2020 was determined by a reduction in the volume of transportation of export mineral commodities against the background of a significant increase in grain transportation by sea and rail.

In 2020, the volume of construction works stabilized at the level of the previous year, which is not typical for the crisis-led situations of the investment sector of the Russian economy. The output stabilization in this type of activity is associated, firstly, with mild sanitary-epidemiological and administrative restrictions in construction and, secondly, with pro-active government approach aimed at maintaining the potential of the construction complex as one of the conditions for economic recovery and the real estate market incentivization.

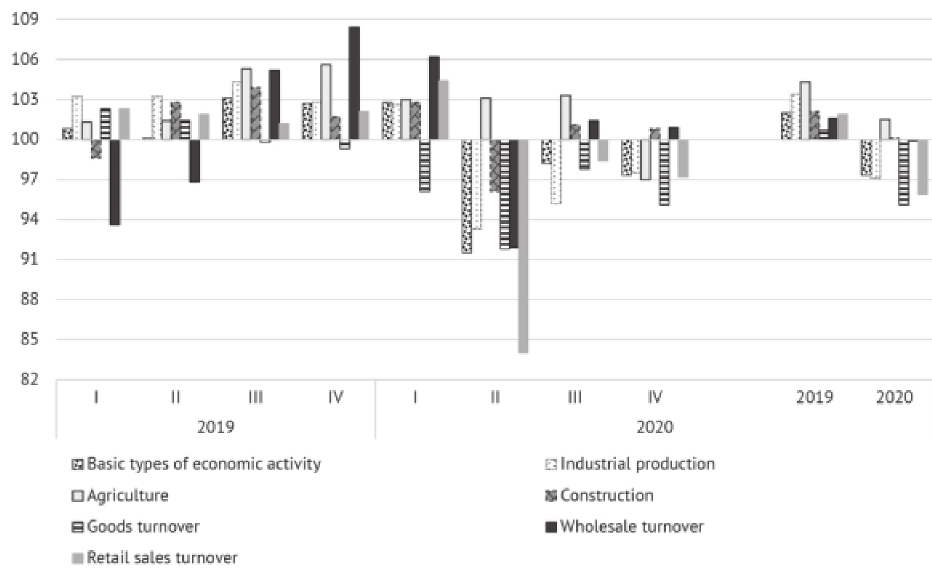

Fig. 6. Output indexes by basic types of economic activity in 2019–2020, in % on the corresponding period of the previous year

Undoubtedly, the trend of a steady increase in the contribution of agriculture to the dynamic of the domestic and foreign markets had a positive impact on the economic situation. Agricultural production generates resources for the sustainable growth of agro-industrial food production, for the market of final demand food products and the market of non-food agricultural products of intermediate demand. Under the difficult 2020 conditions, agriculture not only supported the domestic market, but also helped to scale up the volume of agricultural exports. In 2020, the position of agriculture in the world market has strengthened: exports of food products and agricultural raw materials gained 19.2%, while imports, on the contrary, decreased by 0.9% compared to a year earlier (*Fig. 6*).

4.1.2. Use of GDP: final household consumption

The analysis of GDP by end-use components enables us to identify the features of the crises of 2008-2009 and 2014-2015, as well as the specifics of 2020 in a critical medical and biological situation. A common feature of the three crises over the past 20 years has been a steeper drop in fixed capital investment relative to household final consumption expenditure. The investment crisis of 2009 was the most profound, but the implementation of the anti-crisis program to support the real and financial sectors of the economy determined the nature and dynamic of construction and investment activities. The active policy of supporting the household income and the recovery of household final consumption in 2010 at the pre-crisis level created an additional momentum to the growth of fixed capital investment, supported by the implementation of large-scale infrastructure and socially significant projects. With an annual lag, overcoming the investment downturn fallout in 2011 determined economic recovery to pre-crisis levels.

The distinguishing feature of the 2015 crisis was an unprecedented deep drop in the household final consumption, which forerunner was the decline in real incomes of the population observed a year earlier, as well as the resumption of the decline in the construction and investment complex. With the increasing effect of external factors, the investment and consumer crisis took on a protracted character, and the 2020 starting conditions were determined by the indexes of household final consumption at the level of 96.8% and in fixed capital investment at 99.2% of the pre-crisis index of 2013-2014.

The coronavirus pandemic has enhanced the impact of accumulated structural imbalances, but in contrast to previous critical situations, the 2020 crisis was marked by a restrained decline in household consumption and fixed capital investment, while implementing systemic measures to support the population and businesses by boosting government spending (*Fig. 7*).

The epidemiological crisis of 2020 and the response of political institutions to the introduction of measures to restrict economic activity have significantly changed the role of household consumption. If the cyclical downturn is marked by a relatively weak reaction of household consumption compared to other GDP end-use components, then in the crisis of 2020, the fall in private consumption in Q2 hit 21.7% compared to the corresponding period of the previous year, which was the deepest drop over 25-year span of observations.

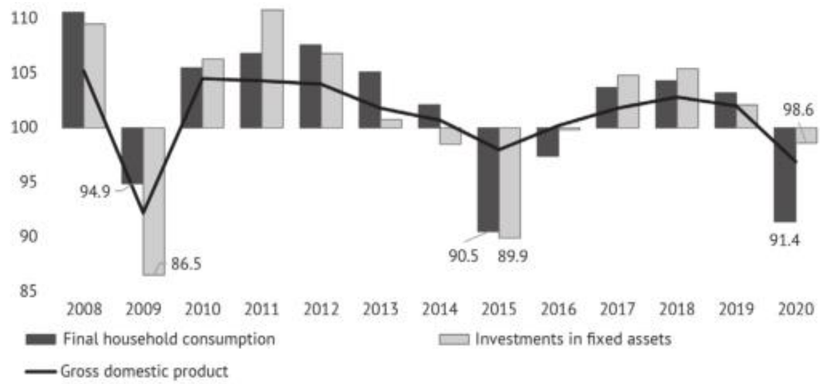

Fig. 7. Dynamic of domestic demand by the end-use components in 2008–2020, in % on the corresponding period of the previous year

Source: Rosstat.

In the wake of a sharp deterioration in the indexes of the sanitary and epidemiological situation and stringent restrictions on economic and social activities in April – May 2020, the government's measures to support the population, businesses and certain types of economic activities and enterprises reached their maximum values. During this period, the increase in government spending on final consumption played a key role in social support of the population, reducing tension in the labor market. Growth in the share of government spending on individual and public consumption in Q2 2020 up to 23.3% of GDP, with an average long-term value of this index at 18.2% of GDP, helped to mitigate the shock of falling labor incomes of the population and guarantee the fulfillment of social obligations (*Table 4*).

Table 4

Dynamic and structure of final consumption expenditure in 2015–2020

	2015	**2016**	**2017**	**2018**	**2019**	**2020**	**Quarters 2020**			
							I	II	III	IV
% on previous year/quarter										
Gross domestic product	98.0	100.2	101.8	102.8	102.0	96.9	101,4	92,2	96,5	98,7
Final consumption expenditure	92.0	98.5	103.4	103.5	103.9	94.8	102,6	85,4	94,4	96,8
- households	90.5	97.4	103.7	104.3	103.2	91.4	102,2	78,3	90,9	94,3
- public administration	96.4	101.4	102.5	101.3	102.4	104.0	103,6	104,1	104,2	104,1
% to total, in current prices										
Gross domestic product	100	100	100	100	100		100	100	100	100
Final consumption expenditure	70.4	71.7	71.1	68.1	69.6	70.4	76,9	69,8	69,5	65,5
- households	52.3	52.8	52.5	50.0	50.8	49.1	54,5	46,1	48,9	46,9
- public administration	17.8	18.5	18.2	17.7	18.4	20.8	21,9	23,3	20,1	18,2

Source: Rosstat.

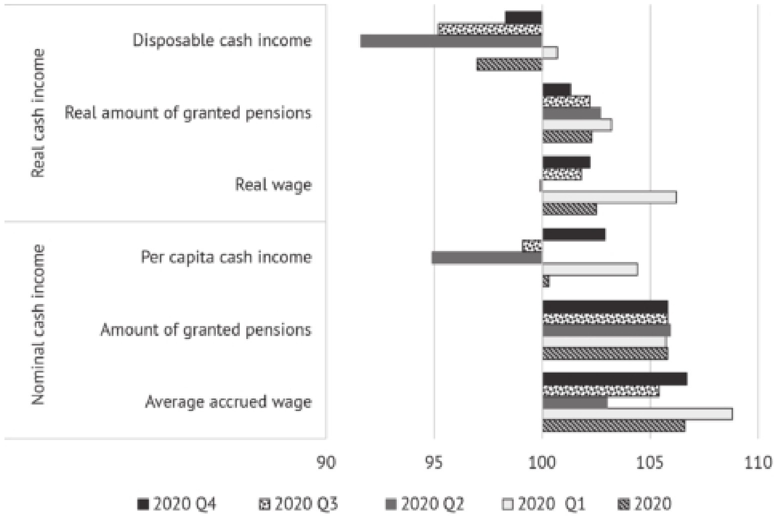

Fig. 8. Dynamic of real and nominal incomes of the population in January-September 2020, in % on the corresponding period of the previous year

Source: Rosstat.

On the back of the recovery in economic activity, wage growth accelerated in H2 2020, which helped to slow down the downward trend of nominal cash and real disposable incomes (*Fig. 8*). Nevertheless, in 2020 the real disposable cash incomes shed 3.5% compared to the previous year.

The response of the population to changes in the level of income during 2020 was extremely heterogeneous.

If in Q1 2020, consumers responded to the uncertainty of the epidemiological situation with a surge in activity in the goods market amidst increased inflation expectations, then in Q2, spending on the purchase of goods decreased by 26.7% and on payment for services – by 31.4% compared to a year earlier, and their proportion in total household spending at the period-end corresponded to the lowest level during observations since 2013.

Stringent administrative measures to regulate activities in the market of paid services to the population, retail sales, and passenger transportation have led to a change in the model of private consumption with the dominant share of spending on essential goods and services. Given the uncertainty of the development of the economic situation, changes in consumer expectations and a reduction in irregular incomes, the volume of retail sales in Q2 2020 constituted 83.4% compared to a year earlier (for food products – 92.9%, for non–food products – 74.5%), the volume of paid services – 63.9%, public catering - 50.3% and stood at the lowest level over a period of 20-year observation.

The opening of non-food retail, hospitality business, domestic tourism and resort destinations in May-September 2020 and the implementation of the announced government measures to support consumers led to a revival in demand and an increase in spending on goods and services.

In Q3 2020, amid the easing of epidemiological restrictions, opportunities for the realization of pent up demand for non-food products, recreational and leisure services went up. The growth in demand for the services of the tourist and recreational complex was supported by both the accumulated funds of the population and the government's measures to partially reimburse the costs of tourist packages. The economy displayed a recovery in retail, hospitality business, public catering and passenger transportation. At 2020 Q3-end, structure of the total income of the population demonstrated expenditures on the purchase of goods to go up to 63.35% (+9.3 p.p. relative to Q2) and services - to 16.3% (+3.5 p.p.) (*Table 5*).

Table 5

Structure of the use of household income for current expenses and savings 2015–2020, %

	2015	2016	2017	2018	2019	2020	Quarters 2020			
							I	II	III	IV
Revenue, total	100	100	100	100	100	100	100	100	100	100
Current expenses	77.2	77.5	79.1	80.7	80.8	76.1	87.1	67.4	80.4	71.0
Purchase of goods					59.8	59.0	65.3	54.0	63.3	54.7
Payment for services					18.0	15.9	19.6	12.8	16.3	15.1
Mandatory payments and contributions	13.7	13.8	14.1	15.1	15.3	15.5	15.5	14.5	16.4	15.6
Savings	9.1	8.7	6.8	4.3	3.9	8.4	-2.6	18.1	3.2	13.4
Deposits, securities, purchase of real estate, change in debt on loans and on accounts of individual entrepreneurs	10.1	6.6	4.6	1.8	3.4	4.0	-4.8	10.3	-1.2	10.0
Cash in hands	-1.0	2.1	2.2	2.5	0.5	4.4	2.2	7.8	4.4	3.4

Source: Rosstat.

Throughout 2020, the savings behavior of the population changed. Changes in the level of household consumption were reflected in the indicator of the population's propensity to save. The decrease in savings in Q1 was replaced by their increase in the following periods - firstly, due to forced savings/savings amidst the supply curtailing in the domestic market, and secondly, due to increased credit activity of the population, boosted by financial and monetary policy.

Given the uncertainty of the development of the situation and lowered expectations regarding labor income the accumulated monetary resources of households fueled consumer confidence in selection of the current consumption model (in Q3), but at the same time expanded the investment potential of the population (in Q4) and boosted activity in the real estate market on the back of the implementation of the government's package of measures on mortgage lending.

The peculiarity of generation of reserved funds in 2020 was determined by the increase in the share of cash in hands to the highest values over the past 7 years, which probably reflected the preservation of unspent income in cash due to the precautionary motive in the face of growing uncertainty and fear of new risks (*Table 6*).

Table 6

Investment potential and investment activity of the population in 2015–2020

	2015	2016	2017	2018	2919	2020
% of GDP						
Retail deposits	27.9	28.3	28.3	27.4	28.0	30.8
Retail loans	12.9	12.6	13.3	14.3	16.2	18.8
Including housing mortgage loans	1.41	1.73	2.21	2.91	2.62	4.03
% on cash incomes of the population						
Retail deposits	43.7	44.5	46.2	48.7	49.2	52.7
Retail loans	10.94	13.71	16.66	20.25	16.21	21.43
Including housing mortgage loans	2.20	2.73	3.61	5.16	4.61	6.90
% on banking sector assets						
Retail deposits	30.0	32.7	33.3	33.0	34.4	31.6
Retail loans	13.8	14.6	15.6	17.3	19.9	19.3
Including housing mortgage loans	1.51	2.00	2.60	3.50	3.22	4.14
For reference:						
Weighted average interest rate	12.89	11.56	9.79	9.66	9.00	7.36
Share of outstanding debt on IHC to total debt on IHC, %	1.66	1.57	1.33	1.14	0.97	0.78
Housing market price index, in % on the previous year						
Primary housing market	99.7	99.6	101.0	106.3	108.0	112.0
Secondary housing market	96.8	97.0	98.4	104.1	103.8	109.5

Source: Rosstat.

In 2020, the nature of consumer behavior was shaped on the back of the household high credit activity. In 2020, the share of bank loans originated to households hit the maximum value for the period of ten-year observations and came to 18.8% of GDP and 32.2% of cash incomes of the population.

4.1.3. GDP formation by sources of income: wages and labor productivity

The government relief measures aimed at retention of jobs and wages while reducing the tax burden have significantly reduced the impact of quarantine restrictions on the economic activity and on the level of nominal wages, which ultimately led to higher labor costs and lower production profitability. The share of wages in Q2 2020 at 54.6% of GDP was the highest since 2013. The redistribution of income between the population and business has avoided labor market shocks and social discontent (*Table 7*).

Table 7

GDP formation by sources of income in 2015–2020, % to total

	2015	2016	2017	2018	2019	2020	Quarters 2020			
							I	II	III	IV
Gross domestic product	100	100	100	100	100	100	100	100	100	100
Including:										
Earnings of employees (including latent)	47.8	48.2	47.8	45.3	46.3	49.5	51.9	54.6	46.1	46.7
Net taxes on production and import	11.1	11.0	10.9	11.7	11.3	10.8	11.3	11.0	10.0	11.1
Gross profit of economy and gross mixed income	41.1	40.8	41.3	43.0	42.4	39.7	36.8	34.4	43.9	42.1

Source: Rosstat.

In 2020, the change in the structure of cash income of the population was defined by a simultaneous growth in the share of labor income to 58.9.8% (+1.2 p.p. compared to 2019) and social benefits to 21.0% (+2.1 p.p.). The growth rate of average monthly wages in the past year was quite significantly differentiated, but the ratio of wages by type of economic activity remained in the range of long-observed values. In 2020, wages in such sectors as public health and social services (114.5% compared to 2019), information and communications (109.6%), public administration (106.7%), finance and insurance (107.8%), education (106.2%), agriculture (107.0%), and mining (106.5%) grew at a rate exceeding the national index. Manufacturing industries as a whole exhibited a restrained dynamic in this respect (104.4%): the acceleration of the rate of labor remuneration compared to the same period of the previous year was observed in the production of medicines and materials used for medical purposes (110.9%), in the production of medical textiles (108.3%) and came amid an increase in government orders. In the segment of machine-building industries, the rate of change in wages was lower than the combined indexes for manufacturing and the economy as a whole.

In the transport and logistics complex, nominal wages gained 3.6% compared to the 2019 index with a positive dynamic of wages in the freight transportation segment. Despite the measures taken to support the transport sector, the decrease in wages was recorded in the types of activities with a high level of passenger traffic – in railroad transportation (98.2%) and air service (90.0%).

Measures to support the labor market and retain jobs in the event of a decline in business activity resulted in an increase in business costs. The share of the gross profit of economy in GDP in 2020 dropped to 39.7% (-1.4 p.p. compared to 2019), and in Q2 stood at a minimum level (34.4%) for the period of ten-year observations, the financial results of the economy as a whole constituted 77.9% of the 2019 index. The high differentiation of the profitability level by type of economic activity was driven by the structure of domestic prices, the movement of the ruble exchange rate, the redistribution of production factors between types of economic activity, domestic and international demand. Profitability in the economy as a whole in January – September constituted 8.9% and shed 2.4 p.p. compared to a year earlier (*Table 8*). The decline in financial results in extractive industry was determined by the combined impact of the factors of changes in world prices for fuel and energy products and the reduction in their production volumes. An extremely difficult financial situation was observed in hospitality business and tourist and leisure complex, in the passenger transportation segment of the transport complex. At the same time, it should be noted that the vigorous activity of government agencies in implementing measures to support mortgage lending has led to an increase in the efficacy of the financial, credit and insurance markets as well as real estate operations.

Table 8

Profitability of goods, works, and services sold by types of economic activity in 2017–2020, %

	2017	2018	2019	2020
Total in the economy	7.5	12.3	11,4	9,9
Agriculture, hunting and forestry	17.3	20.2	18,6	22,9
Extraction of natural resources	24.6	33.6	29,6	23,0
Manufacturing	10.9	12.8	12,1	12,2
Electricity, gas and vapor production, air-conditioning	8.3	8.8	9,2	8,4
Construction	3.8	6.1	7,0	8,1
Wholesale and retail trade	4.1	7.3	6,4	5,1
Hotels and catering	7.0	7.1	5,9	-0,9
Transportation and storage	3.4	8.8	8,7	3,4
Information and communications	12.0	14.6	16,0	12,8
Finance and insurance	0.8	11.2	11,8	34,7
Real estate operations	18.5	15.9	13,7	24,3
Public administration and military security; social security	-1.5	2.4	15,2	19,3
Education	2.7	4.2	6,7	9,5
Public health and social services provision	7.0	10.4	9,8	9,9

Source: Rosstat.

The decline in business profitability has become a factor limiting the pace of the economic recovery from the pandemic crisis. The movement of financial results was formed amid the temporary suspension of economic activity and the retention of wage commitments in compliance with government decisions on social support for those employed in the economy. The economic recovery is likely to require a change in the structure of the use of production factors, with the possible option of a painful restructuring of the labor market and cutting labor costs.

4.1.4. Investment in the wake of the pandemic

In 2020, changes in financial and credit regulation indexes markedly affected the nature of investment activity. Compared to 2019, the terms for financing investment activities were determined by a reduction in the key rate from 7.5% to 5.5% (June 19, 2020) and to 4.25% (September 3, 2020). The threat was the increase in the scale of private net capital outflow to $47.8 bn against $22.6 bn in 2019, while the volume of foreign direct investment in the Russian economy and abroad decreased.

In 2020, the proportion of gross fixed capital formation in GDP remained close to the previous year's figure, and the share of fixed capital investment in GDP in 2020 increased to the maximum over the last five-year index of 18.9% (*Table 9*).

Table 9

Investment activity in 2014–2020: dynamic, conditions, factors

Index	2014	2015	2016	2017	2018	2019	2020
Dynamic of construction and investment activity, in % on the previous year							
GDP	100.7	98.0	100.3	101.8	102.8	102.0	96.9
Fixed capital investment	98.5	89.9	99.8	104.8	105.4	102.1	98.6
Volume of construction works	97.7	96.1	97.9	98.8	106.3	102.1	100.1
Share of construction and investment complex in GDP, %							
Fixed capital investment	17.6	16.7	17.2	17.5	17.1	17.7	18.9
Construction	6.8	6.3	6.4	6.0	5.6	5.5	5.7
Real estate operations	10.6	10.2	10.2	10.0	9.5	9.8	10.4
Financial conditions							
Key rate (at period-end), %	17.0	11.0	10.0	7.75	7.75	6.25	4.25
International reserves of the Russian Federation (at year-end), USD bn	385.5	368.0	376.3	432.1	468.5	549.8.	597.4
Price indexes on December of previous year, %:							
Consumer	111.4	112.9	105.4	102.5	104.3	103.0	104.9
Industrial producer	106.3	112.1	107.5	108.4	111.7	95.7	103.6
Investment purpose products Including:	107.2	110.3	103.2	103.1	107.3	105.1	104.8
Construction products	104.6	104.1	106.6	104.9	106.5	105.0	102.9
Purchase of machinery and equipment	112.3	120.1	97.8	101.1	108.9	107.1	109.3
Official exchange rate USD/RUB (at year-end)	56.26	72.88	60.66	57.60	69.47	61.91	73.88

Sources: Rosstat, Bank of Russia.

The growth of budget expenditures on investment programs to 2.7% of GDP had a positive impact on the level of investment activity in 2020 (*Table 10*). Furthermore, the activity of the corporate sector and households in the monetary market has increased. Corporate and retail deposits in 2020 moved up to 62.8% of GDP (+9.0 p.p. compared to 2019) and corporate loans and retail loans, including outstanding debt – to 60.7% of GDP (+8.9 p.p.).

Table 10

Key features of investment sources in 2015–2020, in % of GDP

	2015	2016	2017	2018	2019	2020
% of GDP						
Gross savings	24.6	24.2	26.6	33.2	31.2	31.6
Gross capital formation in main funds	20.6	21.9	22.0	20.7	21.1	21.4
Gross profit and other mixed income	41.1	40.8	41.3	43.0	42.4	39.7
Consolidated budget revenue	32.3	32.9	33.8	35.8	36.2	35.5

	2015	2016	2017	2018	2019	2020
National Wealth Fund	6.1	4.7	3.6	3.7	6.8	11.7
Budgetary investment funds	2.3	2.2	2.2	2.0	2.2	2.7
Of which federal budget funds	1.4	1.2	1.1	1.0	1.0	1.2
Loans issued to:						
Corporate clients	42.1	38.4	36.8	36.6	35.7	42.0
Individuals	12.9	12.6	13.3	14.3	16.2	18.8
Deposits:						
Corporate	32.6	28.4	27.0	27.0	25.8	32.0
Retail	27.8	27.9	28.3	27.4	28.0	30.8
USD bn						
Direct investment in Russian economy	6.9	32.5	28.6	8.8	32.0	3.4*
Direct Russian investment abroad	22.1	22.3	36.8	31.4	21.9	1.0*
Private sector financial operations (net lending (+)/borrowing (-))	57.1	18.5	24.1	65.5	22.6	47.8

* January - September.
Sources: Rosstat, bank of Russia.

An unfavorable combination of economic performance factors in 2020 – such as the contraction of the domestic market, the drop in the ruble exchange rate, and the financing of emergency measures in the public health sector and related economic activities - had a considerable impact on the dynamic and structure of investment. In 2020, in fixed capital investment dropped by 1.4% in real terms. As a result of the impact of quarantine restrictions, in fixed capital investment fell by 5.3% in Q2, but these indexes did not decline to the lowest values over the last decade (2009 and 2015). A feature of 2020 was the relatively restrained reaction

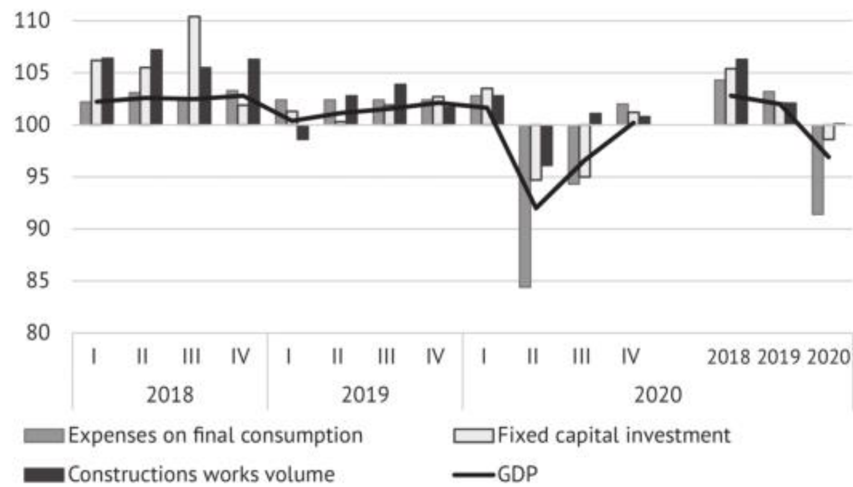

Fig. 9. Dynamic of GDP, fixed capital investment and household final consumption in 2018–2020, in % on the corresponding period of the previous year

Source: Rosstat.

of the investment and construction complex in comparison with the compression of consumer demand and the dynamic of production of goods and net exports, which is due to the faster exit of the construction complex from quarantine restrictions (*Fig.* 9).

The formation of investment resources retained the dominant role of the own funds of enterprises and organizations. In 2020, the share of investments made from organizations' own funds reached the maximum level of 56.7% of the total fixed capital investment over the period of 20-year observations. It should be noted that the increase in the share of own funds of enterprises and organizations in the sources of financing in 2020 came amid a decrease in the share of profit and other mixed income to 39.7% of GDP, financial performance of the economy as a whole – by 23.5% year-on-year, and the level of profitability – to 8.9%.

The participation of the banking sector in the financing of investment activities in January–September 2020 was marked by an increase in the share of loans by 0.3 p.p. compared to the previous year. In the structure of financing sources of fixed capital investment, the volume and share of loans from foreign banks decreased to 2.0% (-0.8 p.p. compared to 2019), while the share of foreign investments remained at 0.4%. Loans from Russian banks in the amount of investment resources fully compensated for the absolute reduction in the volume of foreign loans and the flow of foreign investment.

The scale of budget financing of investment programs has gone up. The share of budget funds in the total volume of investment resources in 2020 increased to 18.7% (+2.5 p.p. compared to the previous year) with a change in the proportions across budgeting levels. Investment financing from the budgets of the federal subjects and local budgets has increased the most relative to the investment expenditures of the federal budget. In 2020, the increase in the share of budget funds in the structure of financing sources of fixed capital investments was recorded in most federal districts, but with a high level of differentiation by territory. Budget financing of investments was focused on expanding the capacity of healthcare institutions, updating technologies for providing educational and cultural services, and supporting the technological base of information and communication services (*Table 11*).

Table 11

Structure of fixed capital investment by financing sources in 2015–2020, in % to total (less small businesses and informal activity parameters)

	2015	2016	2017	2018	2019	2020
Fixed capital investment	100	100	100	100	100	100
Own funds	50.2	51.0	51.3	53.0	55.0	56.7
Raised funds	49.8	49.0	48.7	47.0	45.0	43.3
Including: Bank loans	8.1	10.4	11.2	11.2	9.8	9.5
Of which: Foreign banks loans	1.7	2.9	5.4	4.4	2.0	2.0
Russian banks loans	6.4	7.5	5.8	6.8	7.8	7.5

	2015	2016	2017	2018	2019	2020
Borrowed funds of other organizations	6.7	6.0	5.4	4.3	4.8	4.6
Foreign investments	1.1	0.8	0.8	0.6	0.4	0.4
Budget funds	18.3	16.4	16.3	15.3	16.2	18.7
Of which: Federal budget	11.3	9.3	8.5	7.6	7.6	8.4
Budgets of subjects of the Russian Federation	5.7	6.0	6.7	6.6	7.4	9.1
Local budgets	1.3	1.1	1.1	1.1	1.2	1.2
Funds of extrabudgetary funds	0.3	0.2	0.2	0.2	0.2	0.2
Funds raised for shared equity construction (organizations and population)	3.2	3.0	3.3	3.5	4.3	3.0
Including funds of the population	2.4	2.3	2.5	2.5	3.2	2.5
Other	12.1	12.2	11.5	11.9	9.3	7.0

Source: Rosstat.

In 2017-2020, the role of the state as a subject of the investment process increased, and the share of state-owned investments in 2020 rose to 22.5%, mainly on the back of a decrease in the share of private Russian and foreign property (*Table 12*).

Table 12

Structure of fixed capital investments by forms of ownership in 2016–2020, in %, in current prices

	For a full range of businesses				Less small businesses and informal activity parameters	
	2016	2017	2018	2019	2019	2020
Fixed capital investment, total	100	100	100	100	100	100
Including by forms of ownership						
Russian	83.1	83.8	85.1	85.6	82.7	84.2
State	15.2	14.4	14.8	15.6	20.0	22.5
Municipal	2.7	2.5	2.3	2.7	3.4	3.8
Private	55.9	58.1	58.9	59.9	50.3	50.0
Mixed Russian	7.8	7.5	7.9	6.4	7.7	6.8
State corporations	1.4	1.2	1.2	1.0	1.2	1.0
Foreign	7.4	7.4	6.6	7.0	8.0	6.9
Joint Russian and foreign	9.5	8.8	8.3	7.4	9.3	8.9

Source: Rosstat.

4.1.5. Fixed capital investment by types of activity

Fixed capital Investments of large businesses, which form 4/5 of investments in the national economy, in 2020 amounted to 98.9% of the previous year.

Extractive industry reacted most acutely to the change in the macroeconomic conditions of investment activity – a decrease of 3.1% compared to 2019. In the extractive industry, investments in crude oil and natural gas production increased in 2020 to 102.0% compared to the previous year, while investment activity in coal production decreased to 66.1%.

In manufacturing, fixed capital investment gained 1.7% in 2020, compared to a 0.4% increase a year earlier.

The leader in investment activity in 2020 was the production of medicines and medical supplies: the growth rate of 183.3 % compared to a year earlier, the share in the total volume of in fixed investments in the economy increased to 0.6% (+0.3 p.p.).

As in 2019, the upward trend in construction and investment activity remained in the oil refining complex (115.0% against 2019). The growth of fixed investment of the metallurgical complex in 2020 came amid a change in the proportions between metallurgical production and the production of finished metal products. Capital investments in the machine-building complex and in the production of construction materials declined. In the machine-building complex, the drop in fixed capital investment in manufacture of motor vehicles by 21.8%, and electrical equipment by 30.0% results in curbing the processes of technical and technological update of these industries. The decline in investment in manufacture of computers and electronic-optical products is also alarming – by 3.9%, in the wake of growing demand for these types of products (*Fig. 10*).

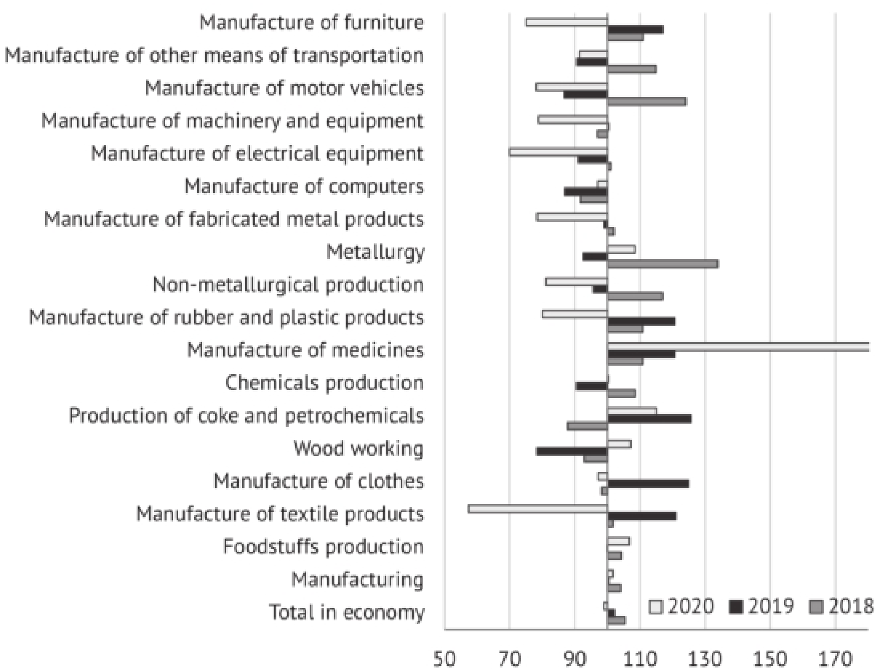

Fig. 10. Fixed investment dynamic in manufacturing industry in 2018–2020, in % to the previous year

In the service sector, in 2020, there was an acceleration in the growth of fixed investments in education, public health, and tourism. It should also be noted such positive aspects as the outstripping growth of investments in information technology, in professional and scientific and technical activities (*Fig. 11*). At the same time, investments in the development of transportation and logistics and trade and sales services declined, which is especially important in the context of the implementation of plans for modernization and expansion of trunk infrastructure (*Fig. 12*).

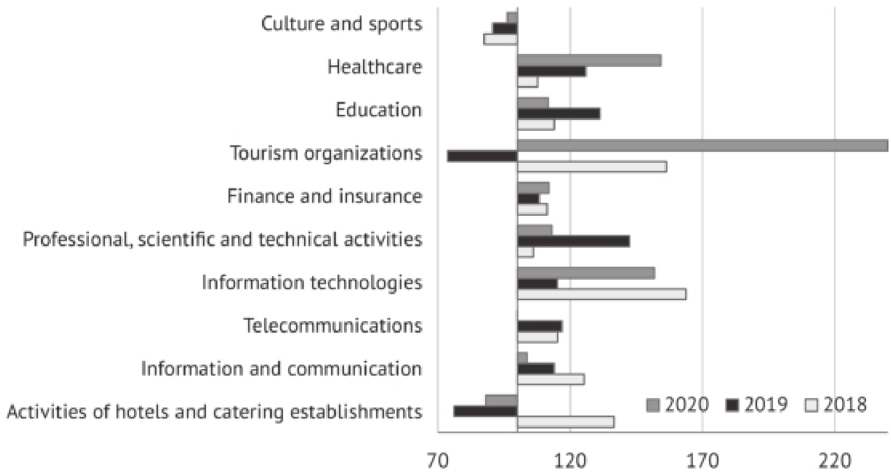

Fig. 11. Fixed investments in service sector in 2018–2020, in % to the previous year

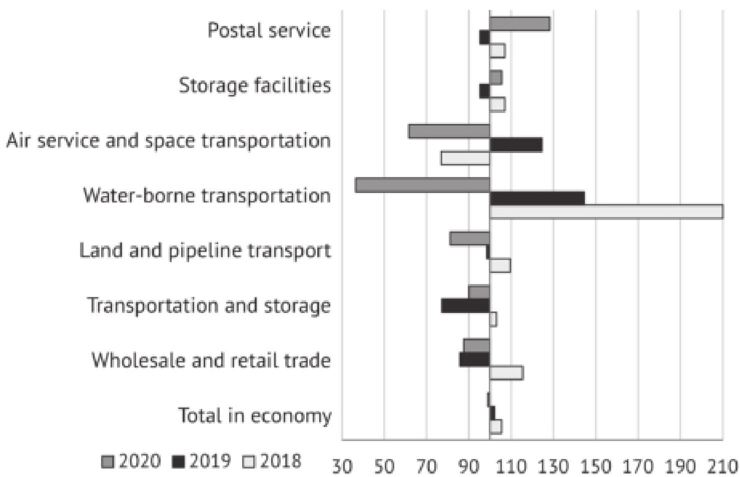

Fig. 12. Fixed investments in transportation and marketing complex in 2018–2020, in % to the previous year

The pandemic induced decline in freight and passenger traffic had a negative impact on the financial results of the transportation complex and raised difficulties with the maintenance of infrastructure, rolling stock and wages. In this regard, in 2020, the industry was granted direct subsidies for the payroll fund and the maintenance of property complexes, subsidizing rates under credit agreements, including small and medium-sized enterprises. Priority measures to support transportation companies relate to the settlement of current lease payments: for suburban passenger companies - Rb3,240 mn; for cruise river and marine companies - Rb320 mn (federal budget); for leasing contracts for buses, trams, and trolleybuses – Rb5.8 bn (budgets of the federal subjects).

In 2020, the volume of construction work almost remained at the level of the previous year. With a general trend to weaken the financing of construction works and services, their structure by type of capital stock showed a trend to stabilize the proportion of expenditures on machinery, equipment, and vehicles. The increased demand for new equipment in most cases is due to active measures to provide health facilities and related types of activities. The increase in the share of investments in information, computer and telecommunications equipment was also positive, which provided conditions for the rapid resolution of issues in the social sphere and acceleration of the introduction of digital technologies.

Table 13

Structure of fixed investments by types of capital stock in 2017–2020, in % to total

<table>
<tr><th rowspan="2"></th><th colspan="3">For a full range of businesses</th><th colspan="2">Less small businesses</th></tr>
<tr><th>2017</th><th>2018</th><th>2019</th><th>2019</th><th>2020</th></tr>
<tr><td>Fixed investment, total</td><td>100</td><td>100</td><td>100</td><td>100</td><td>100</td></tr>
<tr><td colspan="6">Including:</td></tr>
<tr><td>Residential buildings and structures</td><td>13.6</td><td>13.1</td><td>14.4</td><td>6.5</td><td>5.5</td></tr>
<tr><td>Buildings (minus residential) and facilities</td><td rowspan="2">43.8</td><td rowspan="2">42.4</td><td rowspan="2">38.4</td><td>43.7</td><td>43.4</td></tr>
<tr><td>Expenses on land reclamation</td><td>0.1</td><td>0.1</td></tr>
<tr><td>Machinery, equipment, means of transport</td><td>33.7</td><td>35.3</td><td>37.0</td><td>38.1</td><td>38.6</td></tr>
<tr><td>Of which information, computer and telecommunications (ICT) equipment</td><td></td><td></td><td></td><td>4.2</td><td>4.4</td></tr>
<tr><td>Intellectual property items</td><td>2.8</td><td>3.1</td><td>3.3</td><td>4.2</td><td>5.3</td></tr>
<tr><td>Other</td><td>6.1</td><td>6.1</td><td>6.9</td><td>7.4</td><td>7.1</td></tr>
</table>

Source: Rosstat.

In 2020, the overall share of investment in residential and non-residential buildings continued to decline (*Table 13*). In 2020, the decline in residential construction by 1.8% compared to a year earlier is particularly alarming for regions where the housing construction dynamic was around negative rates in the previous year.

The redistribution of investment funds by type of capital stock in 2020 happened on the back of an increase in the share of raised funds of the population in shared-equity construction. With the general trend towards a decrease in current expenditures and an increase in the savings rate, the investment activity of the population was significantly affected by an increase in demand for housing and mortgage loans.

The development of housing construction and housing services in government and program documents is defined as a priority direction for improving the quality of life and a condition for the modernization of the social sphere and the economy. Given the current level and structure of income and expenditure of the population, the implementation of mortgage programs for individual social groups is the main problem in housing construction.

Both growing demand of the population and the need to reduce the share of dilapidated and hazardous housing affect the dynamic and structure of housing construction costs. This set of issues drew the attention of the Russian Government to the issues of the performance of the construction complex and housing construction in the context of the post-pandemic recovery of economic activity.

Business activity in housing construction this year will be supported by such measures as the implementation of the program of subsidizing the interest rate on loans for the purchase of housing in newly constructed buildings, the program of preferential mortgages.

The unstable recovery of the investment complex, while maintaining the downward trend in domestic and external demand, leads to a revision of investment plans. In this regard, the combination of measures taken by the government to support the economy with the instruments of fiscal and monetary policy is of particular importance. In the same direction operate new financial instruments for investment support, the implementation of a system for supporting regional investment projects and the provisions of the agreement on the protection and promotion of capital investments.