



MONITORING OF RUSSIA'S ECONOMIC OUTLOOK:

TRENDS AND CHALLENGES OF SOCIO-ECONOMIC DEVELOPMENT

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TRENDS AND CHALLENGES OF SOCIO-ECONOMIC DEVELOPMENT

The multidirectional movement of oil prices in the aftermath of the OPEC+ agreement to boost oil production is indicative not so much of the current situation in the oil market, as of the continuing uncertainty in the global economy at large.

Among other things, this uncertainty has been created by the recent decision of the FRS to persist in toughening its policy and the ECB's decision to scale back quantitative easing, moves that increase potential risks for developing economies and could lead to capital flight, whose speed and scope they would be unable to estimate in advance. However, a much greater contribution to the whole atmosphere of uncertainty has been made by the US administration's behavior towards American partners, that greatly exceed the already existing sanctions. After the conclusion of the trade talks between Washington and Peking, universally described as a 'positive result', the United States formulated much tougher demands and terms in the field of technologies and investment, which are reputedly planned to be extended to US relations with all the other countries of the world.

Although the history of US external economic affairs over the course of the past two years indicates that not all US plans and threats have been brought to fulfillment, the very fact of their emergence influences the behavior of companies, and the policy of governments and central banks. Russia is hardly an exception in this regard. Although the decision to increase the VAT rate from 18% to 20% looks more unexpected than the decision to raise the retirement age, this move perfectly conforms to the current trend towards concentrating resources in the hands of the state, which is being justified by the worsening of external conditions and the rise in risks.

Having pointed out that the main purpose of the VAT rise is to replenish the budget in order to make it possible to fulfill the May 2018 Presidential Executive Order, our experts analyze the possible macroeconomic effect of this decision. It should be said that they base their analysis on the so-called baseline version of Russia's economic development – that is, in absence of tax reform and any changes in RF fiscal policy (this version is characterized by them as theoretical and non-realistic). According to their estimates, such a rise in VAT would result in a drop in GDP, consumption, investment, exports and imports approximately by 0.4–0.6% (by comparison with the baseline scenario). If the planned rise in state expenditures is to be financed by an increase in insurance contributions, their rate should be increased by approximately 4%, which would result in a 0.8–1.1% drop in GDP and a 1–1.5% drop in consumption and investment. On the other hand, if the rise in state expenditures is to be financed by an increase in profits tax, it would result in a 0.6–1% drop in GDP and a 0.4–0.7% drop in household consumption.

Therefore, our experts have arrived at the conclusion that in the current situation a rise in VAT will be preferable to any other solution. However, they note that there exist more efficient measures of economic policy that could, theoretically, solve the issue of fulfilling the May 2018 Executive Order without resorting to an increase in taxation – for example, by increasing the efficiency of the state sector and state purchases, and by reducing the level of corruption.

It should be noted that the potential impact of a VAT rise on the inflation rate, although fully recognized by our and other experts, is not considered to be a menace (in our example, the inflationary potential is estimated to amount to an additional 0.9–1.5% next year). A restrained fiscal policy, which does not pose a threat to financial stability, remains one of the government's top priorities – in full accordance with the Russian and international experience.

In this connection, our experts draw attention to the problems experienced by Argentina (in June 2018, the IMF approved a \$ 50bn credit line to this country). Apart from having a very negative credit history, which includes eight defaults, the latest having taken place as recently as 2014, Argentina is pestered with high external debt (that had reached almost \$ 320bn by the beginning of 2018), double-digit inflation, the continuing devaluation of the peso, and the involuntary rise of interest rates by Argentina's central bank (to 30–40% and higher).

When viewed against such a background, Russia's monetary and budgetary policies look healthy and well balanced. Nevertheless, this fact alone cannot guarantee either technological modernization or a more or less acceptable pace of economic growth.

According to the business surveys carried out by Gaidar Institute experts, in Q2 2018, Russian industry remained in the positive growth zone, although the pace of growth was small. The demand for the products of industrial enterprises was also low (35% of the surveyed enterprises are unsatisfied therewith). Despite this fact, in the spring of 2018, they began to actively increase the prices for their products, partly in response to the ruble's weakening, but later on, in June, they somewhat adjusted their pricing policies. Nevertheless, the enterprises are ready to welcome investment if the demand index goes up, and 66% of them consider the terms of bank lending to be normal. According to the surveys of enterprises, in April–June 2018 the interest rates offered by banks on their loans amounted to 11.8% per annum (a record low since the beginning of interest rate monitoring in September 2009). And finally, in H1 2018, 80% of industrial enterprises believed that they were paying their workers normal wages (compared with 42% of enterprises in 2009). It should be added that large enterprises (with more than one thousand employees each) were most positive in appraising the wages they were paying their workers.

Data on the behavior of the Russian segment of international web trading and online payments clarify how the Russians tend to spend their earnings. Although the share of web trading is still very small relative to the total amount of sales (about 3%), the growth rate of this segment is very high. According to forecasts, in 2018 it will rise to RUB 1.25 trillion (while the trans-border segment – to almost RUB 0.5 trillion). Last year, the volume of web sales amounted to RUB 1.04 trillion, which represents a 13% increase on 2016). Along with the turnover of web trading, web trading penetration rates in Russia also increased: while in 2013, the share of the urban population older than 15 who used the Internet for ordering goods and services amounted to 17.9%, in 2017 it increased to 32.6%. One of the factors restricting web trading in the Russian Federation is the relatively low level of development of the existing payment infrastructure. However, it should be noted that this drawback is being gradually corrected. Nevertheless, despite all the progress achieved so far, it is only in Moscow and the surrounding region that the cost of transactions regarding payment for goods and services by debit or credit cards has exceeded the volume of cash withdrawn from ATMs. ●

1. VAT INCREASE FROM 18% TO 20%: MACROECONOMIC EFFECTS

A.Polbin

The government proposes to increase VAT from 18% to 20% from January 2019. Main objective is to fund the budget as stated in the Presidential May 2018 Decree. According to our calculations, the rate increase will lead to a decrease in GDP, consumption, investments, exports and imports compared to the theoretical economic scenario which envisages no changes in fiscal policy. Still, VAT increase, compared to other possible ways of funding the planned rise in state spending, is an adequate measure of economic policy.

Choosing between options of increasing VAT, PIT, corporate insurance contributions, corporate profits tax, the VAT increase seems the most feasible as it has the smallest distorting impact compared with other taxes on economic agents' decisions in consumption and investments. It should be noted, that the Eurozone countries have been proactively discussing the issue of partial substitution of income taxes with VAT (the point is to boost the economy by way of injecting capital and labor into production in the context of neutral budget maneuver).

Let's try to consider possible consequences of VAT increase, as well as raising other taxes for ranking available alternative scenarios. However, first of all let us assess the base-case scenario of economic development without the tax reform and without any changes in fiscal policy (this scenario is considered only in theory because no changes can lead to the pension system crisis.)

One of hypothetical scenarios of economic development could be a scenario envisaging cuts in defense spending in favor of pension expenditure. From economic point of view, such scenario is effective as consumption of goods and services of all population groups can be raised. However, in the wake of the current geopolitical situation feasibility of its implementation is close to zero.

The transmission mechanism of VAT increase lies in the fact that the rate increase translates into the inflation rise. Onwards, in the context of the maneuver one can expect a decrease of purchasing power of the working population due to the price growth (pensions are going to be indexed, and it is debated that pensions will be increased faster than the price growth).

The cumulative impact of the tax maneuver on the aggregate consumption is not so obvious, as at first glance, a simple redistribution of income from one group of population to another will be observed amid constant aggregate income. However, decrease of purchasing power of the working population (decrease of real wages) due to price growth will lead to a fall in work incentives and decrease in total hours worked in the economy. This, in its turn, will provoke a fall in the real output and the real total income which will cut the actual aggregate consumption.

Investments will also fall – lower employment will lead to a decrease in return on capital, price growth cuts profits of equity owners. According to our

calculations based on the general equilibrium model, the VAT rate increase from 18 to 20% will determine a decrease of GDP, consumption, investments, exports and imports by around 0.4-0.6% against the above mentioned basic scenario of economic development.

The transmission mechanism of PIT and insurance contributions changes is quite similar to the VAT increase transmission mechanism. The PIT rate increase will reduce incentives for the working population, which will cut aggregate labor supply, while an increase in insurance contributions negatively affects the hiring rate that decreases labor demand. In both cases, we have lower real income of the working population, smaller number of hours worked, and, as a result, smaller volume of capital, output and less investment in the economy.

However, the advantage of the planned public spending growth by way of VAT increase, instead of PIT and insurance contributions growth is that VAT has a larger tax base, which implies a smaller tax rate increase. For example, covering of planned public spending growth by way of raising insurance contributions would have meant a 4% rise of such contributions, which would have led to 0.8–1.1% GDP fall in the long-run and to a decrease by 1–1.5% in aggregated consumption and investments.

Scenario of funding the planned public spending growth by way of the corporate income tax will mainly affect the aggregate investments. In the context of corporate income tax rate growth the investment projects yield and optimal level of capital go down, which result in decreased investment activity. With time, as the capital rate decreases against the above-mentioned base scenario of economic growth, the labor demand from businesses will decrease as well, along wages and aggregate consumption of households. According to our calculations, funding of the planned public spending growth by way of reasing the corporate income tax would result in decrease of investment by 1.8–2.5%, aggregate consumption of households by 0.4–0.7%, and of real GDP by 0.6–1%.

Consequently, if we choose from the above-mentioned alternatives, funding of the possible public spending increase by way of VAT increase from 18–20% appears to be less harmful. Will such tax maneuver lead to the stagnation of economic growth in the foreseeable future? The answer depends on the choice of base scenario of economic growth to be compared with. In reality, given base scenario depends on expectations from the current economic policy, which prevailed in public before the news of VAT increase. In the event the economic agents made their decisions regarding consumption and investments parting from the expectations that no taxes will be raised, the planned VAT increase from January 2018 will, most likely, halt economic growth in 2019. According to our calculations, under this scenario, the VAT increase will decrease growth rates of GDP and households' consumption in 2019 by 0.2–0.35%, investments will fall by 0.4–0.7%, imports by 0.35–0.45% while inflation in 2019 will go up by 0.9–1.5%. However, there will be no slow-down of GDP growth in 2018. 2018 will see a small surge in households' consumption. Households will increase current consumption, while the prices are stable against expectations of a sharp rise of prices. According to our calculations, this effect can increase household's consumption rate in 2018 by 0.15–0.3% and will compensate the negative effect on the output from decrease in other components of the aggregate demand.

It should be said again, that given estimates of the negative impact on output resulting from the VAT increase in medium and long runs are calcu-

1. VAT increase from 18% to 20%: macroeconomic effects

lated in terms of the base scenario of economic growth where there are no changes in the tax system. In practice, such proposal can turn out to be quite unrealistic. Discussions regarding the tax reform in Russia have been taking place for some time and economic agents, one way or another, while making current decisions were considering potential changes in the tax system in the future. It is quite possible, that businesses' expectations regarding an increase in insurance contributions and corporate income tax which have a very negative effect on the economy is one of the factors of slow economic growth. In this context, VAT increase and not other taxes can boost the Russian economy growth compared to the current growth rates.

Another positive factor – is the decrease of uncertainty in Russian economic policy. Lately, academic studies demonstrate more and more evidence about negative impact of uncertainty including in economic policy on economic activity. Therefore, new information regarding VAT increase cuts the number of tax system development scenarios, brings in some certainty in the rules of the game, and thus, affects positively economic activity.

Summarizing, one may conclude, that planned VAT increase from 18% to 20% for funding public spending growth is a rather advantageous measure of economic policy, if choosing from alternatives which can be practically. There are, however, more effective measures of economic policy, which in theory could without the tax rise solve the problem of execution of May Presidential Decree. Among examples are raise effectiveness of public sector and state procurements, cut the levels of corruption and so on. Saved funds from these measures could be directed, for example, to raising pensions. In reality, the RF government has been discussing these lines of economic policy and are being presented as the priority targets. However, prospects are rather blurred. In given context the VAT increase can be considered as an adequate solution for funding public spending issue. ●

2. THE ECONOMIC TROUBLES OF ARGENTINA: NEW PROBLEMS OR ERRORS OF THE PAST?

A.Kiyutsevskaya, P. Trunin

The toughening, by the central banks of developed countries, of their monetary policies has triggered a capital outflow from the developing countries. To control the inflation caused by a significantly weakened national currency, the central bank of Argentina had to sharply toughen its monetary policy.

For a long time, the Argentine authorities have been maintaining significant foreign exchange restrictions, their upshot being an actively developing shadow forex market where the price of the Argentine peso dipped far below its official exchange rate. The deviation of the unregulated exchange rate from the official one peaked in Q2 2013, when it soared above 40% (Fig. 1).

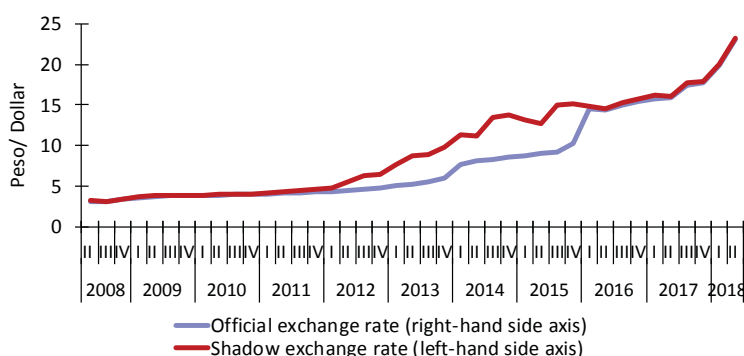


Fig. 1. The exchange rate movement pattern of the Argentine peso
Source: International Monetary Fund.

At the same time, the country had been accumulating a huge foreign debt, which in late 2017 was in excess of \$ 319bn (50.2% of GDP), and 87.7% of its total amount was denominated in foreign currencies, thus creating a number of additional risks for the national economy. Meanwhile, the amount of government foreign debt rose above 22% of GDP. In 2018, Argentina will have to pay \$ 33bn against its obligations, and in 2019 – \$ 32.4bn, the amount of government debt redemption over the next decade totaling \$ 111bn.

After the country gained its independence in 1816, the Argentine government eight times defaulted on its obligations, the last time being in 2014; the biggest default in the country's history occurred in 2001, to the total value of \$ 100bn. The history record can serve as an additional explanation of why Argentina starts selling government securities whenever the national economy faces any problems.

In 2015, after Mauricio Macri was elected president, the Argentine authorities switched over to a floating forex rate and inflation targeting. The new policy made it possible to resolve some of the existing problems, and to eliminate the shadow forex market, among other things. As early as 2016, the exchange rate of the Argentine peso in the unregulated

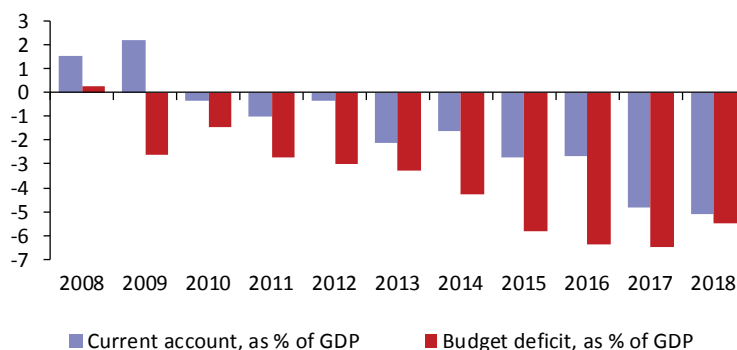


Fig. 2. The current account deficit and budget deficit
Source: International Monetary Fund.

2. The economic troubles of Argentina: new problems or errors of the past?

forex market segment was practically the same as its official exchange rate (Fig. 1). However, the government was maintaining soft budget constraints, and so, while in 2008 the state budget had been properly balanced (with a surplus of 0.2% of GDP), in 2016–2017 it began to demonstrate a deficit in excess of 6% of GDP (Fig. 2). Besides, for many consecutive years, the country has been facing an increasing current account deficit, which in 2017 amounted to 4.8% of GDP.

This year, the macroeconomic problems that had been piling up in Argentina were further aggravated by the refusal, of the monetary authorities of developed countries, to follow an ultra-loose monetary policy. The US Federal Reserve raised its benchmark funds rate to 1.75–2.0% per annum. Its lead was followed by the central banks of Canada and the UK. And the European Central Bank (ECB) announced that its monthly asset purchases would be reduced to € 15bn from September 2018, and ended completely from January 2019. Not unexpectedly, the increased attractiveness of the less risky financial assets issued by the developed countries stimulated capital outflow from the developing economy and, as demonstrated by Argentina's experiences, the economies plagued by unresolved internal problems proved to be the most vulnerable ones.

The value of the Argentine peso fell 17% relative to its average December 2017 level, which was the upshot of the country's trade balance shrinkage (due to declining exports caused by bad crops and increasing imports in response to the rising prices of energy carriers). For reference: over the course of last year, the Argentine peso lost 10.8% relative to 2016 (Fig. 3).

Until late April 2018, the Bank of the Argentine Nation had been trying to stem the peso's fall by launching forex interventions. As a result, over the period from February through April, Argentina's international reserves shrank by more than \$ 5.5bn to \$ 56.6bn. In conditions of an increasingly rapid capital flight, that policy proved to be a failure.

In addition to forex interventions, the Bank of the Argentine Nation relies on interest rate policy mechanisms. In April, at an extraordinary meeting, it was decided that the 7-day direct and reverse repo reference rates should be reduced by 3 p.p. to 31% and 29.5%. However, even these measures failed to produce the desired effect – a week later, in May, the reverse repo rate was raised by 3 p.p., and the direct repo rate by 7.25 p.p., to 32.5% and 38.25% per annum; and the very next day, the rates jumped to 33% and 47% respectively. In June, the Bank of the Argentine Nation was forced once again to adjust its interest rate corridor. This, the reverse repo rate was raised by 4 p.p. from 33% to 37% per annum, while the direct repo rate, on the contrary, was reduced by 4 p.p. from 47% to 43% per annum. At the same time, the Bank raised its inflation target for 2019 from 10% to 17%, that for 2020 – from 5% to 13%, and that for 2021 – to 9%; the 5% target was moved to 2022.

On 8 May, Argentina applied to the IMF for financial aid. In response, on 13 June, the IMF's

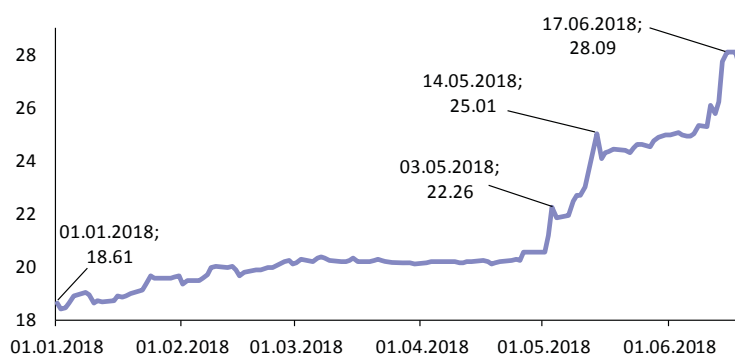


Fig. 3. The movement pattern of the Argentine peso-to-USD exchange rate in 2018

Source: <https://ru.investing.com/currencies/usd-ars-historical-data>

Managing Director Christine Lagarde¹ approved a \$ 50bn credit line to Argentina, on condition that a recovery plan should be implemented in the Argentine economy (geared to the ambitious goal of bringing down the existing budget deficit and inflation, improving medium-term budget planning, and increasing the central bank's independence); the final decision approving the provision of the aforesaid financial support to Argentina was taken by the IMF a week later.

The example of Argentina has once again underlined the importance of pursuing a reasonable macroeconomic policy, maintaining a low inflation rate and a balanced budget, and preventing foreign debt accumulation. The countries that fail to follow these rules may be easily pushed into a crisis situation even by some minor external or internal shocks. In this connection, an irresponsible policy in the past may have long-lasting future reverberations. It can take years to bring the macroeconomic indices back to normal, and during all those years the country will remain vulnerable, while new crises will be further reducing its economic development rate. ●

1 IMF Managing Director Christine Lagarde Welcomes Argentina Government's Economic Policy Plans, www.imf.org

3. RUSSIAN INDUSTRY IN Q2 2018: DEMAND IS PERSISTENTLY LOW

S.Tsukhlo

In Q2 2018, the situation in Russian industry did not undergo any significant changes. Most of Russian enterprises continued to register persistently low demand, which enabled them to confidently control their finished product stocks and maintain their output growth rate at minimum. In Q2 2018, growth in selling prices hit its three-year high, although it should be said that in June prices experienced a sharp drop sufficient to roll back all their growth achieved in March, April and May. The investment plans of industrial enterprises have remained at their local maximum since February 2018.

According to the business surveys carried out by the Gaidar Institute, in Q2 2018 the demand for industrial products did not undergo any radical changes. Product sales indicate neither a crisis-style collapse nor a decisive exit from the current lengthy stagnation. Demand forecasts are hovering around zero, thus promising no breakthroughs in the summer months of 2018.

Such a situation taking place against the backdrop of a lengthy stagnation had become something very familiar for industrial enterprises – so much so that 60% of them have described their current sales volumes as normal. Dissatisfaction with the volume of demand has returned to its previous, relatively low level. At present, the volumes of sales dissatisfy 35% of enterprises. It should be noted that in early 2016, when industrial enterprises realized that the rebound from the crisis bottom which had been promised to them in 2015 would not take place, this index (dissatisfaction with sales volumes) amounted to 55%, its record high for the whole period 2013–2018.

In Q2 2018, industrial enterprises were able to confidently control their stocks of finished products. The share of ‘within the norm’ assessments amounted on average to 71%, which exceeds the average result of 2017 (69%). At the same time, the balance of the other assessments (‘above the norm’ and ‘below the norm’) has been hovering around zero since the beginning of the year. However, this apparently positive result has a negative connotation, because industrial enterprises lack any hopes that sales would increase in the near future. As indicated by the entire history of our surveys, the small excess stockpiles accumulated by industrial enterprises represent a clear sign of their positive expectations.

Viewed against the background of a zero-balance of assessments concerning their stocks of finished products, the modest, but at the same time non-crisis-style demand parameters indeed enabled industrial enterprises to maintain, in Q2 2018, their production output at marginally positive growth rates. In the aftermath of the all-embracing debacle in April (recognized even by the official Rosstat), the production movement pattern demonstrated an increase by 6 balance points in May 2018. In June, our survey statistics registered a small decline in the growth rate of industrial output, which nevertheless remained in the positive zone. Output plans have stabilized since March at a level of optimism that should be viewed as reasonable at a time

of lengthy stagnation. These plans clearly indicate that industrial enterprises are determined to overcome the current torpidity.

Over the course of Q2 2018, the pricing policy of Russian enterprises underwent a number of serious changes. In April, industrial enterprises registered the most intense price growth since February 2017. However, as early as March 2018, enterprises announced that, contrary to tradition, they were not going to hamper price growth after the similarly traditional jump of prices in January; their decision was apparently caused by the rather significantly increased production costs in Q2 2018. The April rise in this index was also provoked by a considerable weakening of the ruble's exchange rate. In May, the growth rate of producer selling prices jumped once again. As a result, over the course of the period from March through May 2018, the balance (pace of growth) increased by 11 points, thus hitting its three-year high. During the past few years, a more intensive rise in prices was observed only in early 2015, when the economy was 'digesting' the consequences of the ruble's depreciation. However, in June 2018 the situation sharply changed – the balance of actual changes in prices literally collapsed by 15 points, thus rolling back all the growth registered in March, April and May.

Over the course of Q2 2018, the level of employment in Russian industry also experienced some significant changes. In April, industrial enterprises continued personnel recruitment in the aftermath of the habitual surge in the rate of dismissals at the beginning of a calendar year. The ongoing rise in the number of personnel had been registered for the second month in a row, although, according to the recruitment plans of enterprises, it was expected either to come to a halt or to considerably decelerate in the next few months. The same conclusions were also drawn from the relatively lackluster forecasts of demand and output, and from the fact that industrial enterprises had achieved a record-high level of personnel sufficiency 'in connection with the expected changes in demand'. At the beginning of Q2, this level of personnel sufficiency was registered by 85% of enterprises, more than at any time since 1996. In May, as it had been expected by enterprises, the number of industrial workers abruptly declined, and the balance of actual changes in this index became negative. However, bearing in mind that industrial enterprises registered maximum personnel sufficiency (for the entire period of observations), and that their forecasts of demand and output were notably restrained, this circumstance should not result in an upsurge in personnel shortage in Russian industry. In June, industrial enterprises continued to dismiss workers.

In the crisis conditions of 2015–2016 followed by a lengthy stagnation, most of Russian industrial enterprises managed to pay their workers 'within the norm' wages. Moreover, during the reputedly crisis year 2015, the level of 'normalcy' of industrial wages (68%) was higher than that recorded in the non-crisis year 2014 (66%). In 2009, a really crisis year for Russian industry, only 42% of enterprises considered the wages paid by them to be 'within the norm'. And in H1 2018, as much as 80% of enterprises believed that their workers' wages were 'within the norm'. However, the assessments of payment for labor vary depending on the branch of industry and the size of enterprise. Over the entire period during which this index has been monitored (2007–2018), the majority of respondents considering their workers' wages to be 'within the norm' predominantly belonged to the category of biggest enterprises (with over 1,000 workers each). The frontrunners among the branches of industry were metallurgy and the food industry.

3. Russian industry in Q2 2018: demand is persistently low

Having achieved yet another local maximum in February 2018, the investment plans of Russian industrial enterprises have been staying at that level for the fifth month in a row. So, those enterprises are evidently psychologically prepared to enter a new investment growth phase.

In Q2 2018, 66% of enterprises considered the terms of bank lending to be 'within the norm', which is slightly worse (by 2 points) than the assessments obtained in Q1 2018. In the period April–June 2018, the average minimum interest rate offered by the banking sector to Russian industrial enterprises stabilized at around 11.8% per annum, which represents a historic low of its entire monitoring period since September 2009. ●

4. THE DYNAMICS OF THE RUSSIAN SEGMENT OF E-COMMERCE AND E-PAYMENTS

A.Polyakova

The development of e-commerce which is growing in Russia at a high rate modifies the model of consumption and leads to a reduction of the buyer's transaction costs owing to a less amount of time spent on purchasing of goods and price cuts.

The share of sales through the internet in the overall sales volume is not large: the online trade volume amounts to about 3% of the overall retail trade volume¹ in the Russian Federation. However, this segment is characterized by high growth rates. In 2017, the market increased by 13% to Rb 1.04 trillion (in 2016 growth was equal to 21%)². According to the initial data, in Q1 2018 market growth exceeded the average indicator of 2017 and its Russian segment and cross-border segment are expected to grow at this year-end to Rb 1.25 trillion and Rb 470bn, respectively³.

The very fact that sellers turn to this mode of trade has a favorable effect on sales growth in the offline segment because numerous buyers use online shops as a source of information for making purchasing decisions: in 2017 the search for information on goods and services is the third most popular

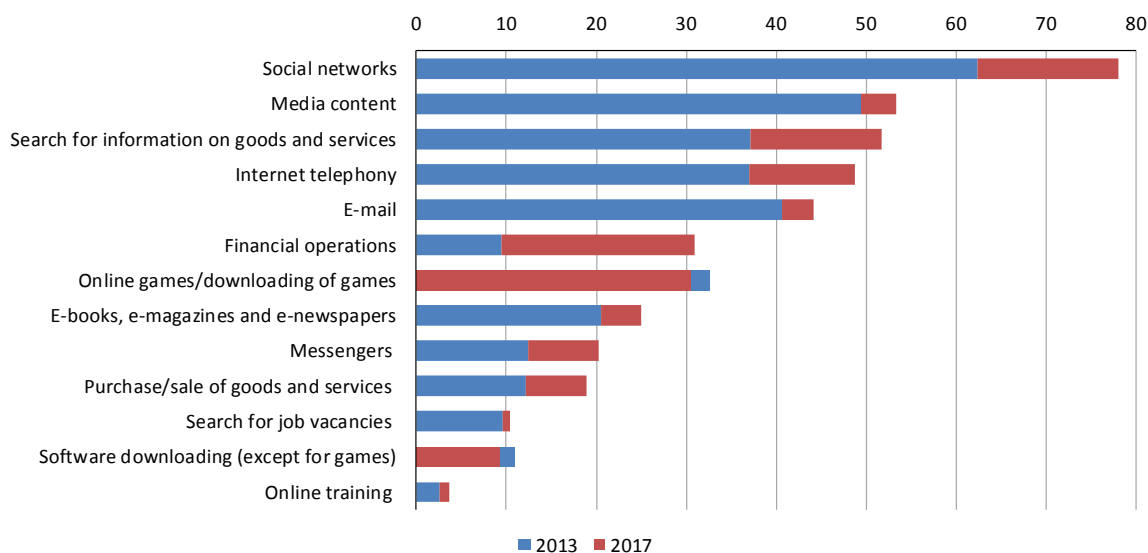


Fig. 1. The share of households using the internet by the purpose, % of the total number of households which used the internet during the past three months

1 What do the Trends Point To. Macroeconomics and Markets. April 2018/ The Central Bank. URL: http://www.cbr.ru/collection/collection/file/5913/bulletin_18-03.pdf

2 Based on the data of the Association of Online Retailers/ AKIT. URL: <http://www.akit.ru/оборот-российского-рынка-интернет-ри/>

3 According to the forecast of the Association of Online Retailers / AKIT. URL: <http://www.akit.ru/оборот-российского-рынка-интернет-ри/>

4. The Dynamics of the Russian Segment of E-Commerce and E-Payments

motivation for Russian households to surf the internet (*Fig. 1*) (51.7% of the respondents specified it)¹.

Note that as compared to 2013 growth in the share of the Russians using the internet for the search of information on goods and services was the third largest one (+14.6 p.p.) after social networks (+15.7 p.p.) and financial operations (+21.4 p.p.)². The use of the internet for the purpose of buying goods or services was reported by 12.2% and 18.9% of the respondents in 2013 and 2017, respectively.

The online retailing segment has huge prospects of growth. Potential Russian buyers are internet users whose number is constantly growing in the Russian Federation. According to the Rosstat's survey of Russian households in 2017³, 76.3% of households had an access to the internet, including 72.6% of households with a broadband access. It is quite logical that in urban areas there are more internet users than in rural areas (79.5% against 66.5%).

Let's refer to the detailed parameters of the Russian online retailing segment. In 2017 it was made up of the domestic commerce (64%) and cross-border commerce (36%) (for comparison: in 2013 with the online commerce volume of Rb 544bn the domestic commerce and cross-border commerce accounted for 76% and 24%, respectively). In 2017, a substantial increase in the market volume was driven by the cross-border commerce (growth of 24%), while domestic online sales rose by 8%.

In 2017, the sales of household appliances and consumer electronics (35% on the domestic market and 33% on the cross-border market) and clothes and footwear (27% on the domestic market and 38% on the cross-border market) dominated the e-commerce commodity pattern⁴.

The main volume of imports from foreign online shops comes from China (91% of parcels) the EU (3%) and the US (2%). Distribution of Russian buyers' costs is as follows: China (53%), the EU (22%) and the US (12%). Note that purchases worth less than euro 22 and purchases worth between euro 22 and euro 50 account for 61.4% and 22.2% of all foreign transactions, respectively.

According to the Rosstat's data, four Russians in five aged over 15 made at least one online purchase. Note that in 2017 alone 32.6m people used the internet to buy goods or services (36.4% of the entire internet audience at the age of 15–74). As compared to 2013, the number of users of the e-commerce has nearly doubled (94%), while owing to the fact that broadband communication channels became available in rural areas the number of active online buyers in rural areas increased by 147.4% in the same period. As regards the extent of the spread of the online commerce, the share of the urban population at the age of over 15 buying online goods or services rose from 17.9% in 2013 to 32.6% in 2017.

1 A random federal statistical sampling as regards utilization by households of information technologies and information and communication networks (Information and Communication Technologies (ICT) survey) / The Rosstat. URL: http://www.gks.ru/free_doc/new_site/business/it/fed_nabl-croc/index.html

2 The ICT survey has been carried out since 2013 (from 2015 in the Republic of Crimea and the City of Sevastopol).

3 In 2017, the total number of 55, 367,600 households were surveyed, including 41,762,400 households in urban areas and 13,605,200 households in rural areas.

4 What do the Trends Point To. Macroeconomics and Markets. April 2018/ The Central Bank. URL: http://www.cbr.ru/collection/collection/file/5913/bulletin_18-03.pdf

If one takes the other part of the Russian audience aged over 15, that is, those who do not use the internet for ordering goods or services, it appears that over a half of it (54.5%) prefers a traditional mode of making purchases, while 42% declares that they have no need or interest in making such operations. Note that the share of respondents sharing such an opinion is similar both in urban and rural areas. In terms of types of residence, differences in estimates among those who refuse to make online purchases are minimal.

Other motives behind the refusal are quite illustrative, too. So, 17.8% of the Russians aged over 15 who has never used the internet for ordering goods or services declares that they have no confidence in this mode of purchasing. In particular, an important factor constraining the e-commerce in Russia is a lack of confidence in reliability of the supplier or shipping entity which makes a delivery. Numerous complaints about violation of delivery terms, misgrading, noncompliance with the declared quality and damage caused during the delivery undermine households' confidence even in bona fide online retailers.

It is noteworthy that the extent of the spread of broadband internet and provision of users with relevant devices is not an obstacle on the way of development of e-commerce in Russia: less than 1% of the respondents point to a lack of technical feasibility or technical limitations as the reasons for which they do not buy online goods or services. It is known that as regards this parameter Russia outperforms most countries of Europe and the US. A more serious problem declared by respondents as a reason for not buying goods or services online is a lack of experience in doing it; this reason was referred to by 5.3% and 7.1% of urban residents and rural residents, respectively, from among those who never used the internet for ordering online goods and services in 2017.

During a long period of time, in Russia an important factor which limited the development of the online commerce was insufficient development of a payment infrastructure. Though that problem was largely resolved, households still have doubts. So, 5.0% of urban residents (and 3.6% of rural residents) turn down the idea of making online purchases because of apprehension for their bank card safety. Also, people are equally concerned about disclosing their personal data in the internet (on average 4.9% of the Russians aged over 15 did not use the internet to make online purchases in 2017).

If one refers to the factor of development of the payment system, it is worth mentioning such an important change since 2013 as substantial growth in the share of bank cards in the overall volume of payments for goods and services ordered online via the internet. So, if in 2013 cash funds paid to a courier upon delivery of goods prevailed in the pattern of payments (45.4% of the respondents mentioned them as the main mode of payment), while bank cards were used only in 39.3% of cases, in 2017 the share of cash payments fell to 33.9%, while payments by a bank card were mentioned by 75.9% of the respondents.

The difference in the situation of urban and rural residents in the context of the mode of payment for online purchases is notable: if in 2013 the second most popular mode of payment was a funds transfer through a post office (30.9% against 33.9% by a bank card), in 2017 payments via a post office system were made by one in five rural residents, while bank cards became virtually as much widespread as in cities (71.5% against 76.7%).

4. The Dynamics of the Russian Segment of E-Commerce and E-Payments

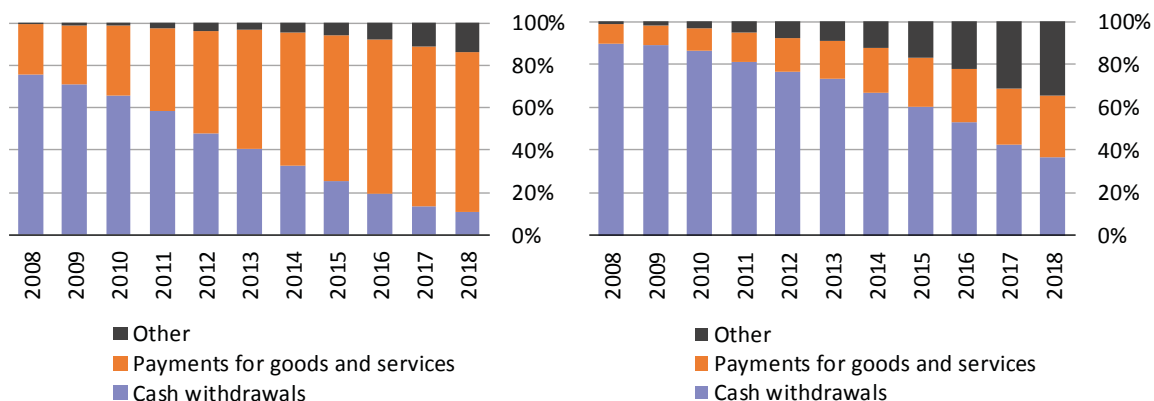


Fig. 2. The unit weight of relevant operations in the overall number of operations (left-hand) and value of operations (right-hand) carried out by means of bank cards (2018 – Q1 data)

Source: Operations carried out in the territory of Russia and beyond by means of bank cards issued by credit institutions by the type of customers / The Central Bank. URL: http://www.cbr.ru/statistics/print.aspx?file=p_sys/sheet014_1.htm&pid=psrf&sid=ITM_48796

As of the end of 2017, the number of active bank cards in Russia was equal to 157.6m units, which is 1.4 times and 2.8 times more than at the end of 2013 and at the end of 2008, respectively, while transaction volumes increased more substantially: 2.1 times over and 6.8 times over since 2013 and 2008, respectively.

Growth in the number of bank cards in the circulation was accompanied by changes in the pattern of operations. If in 2008 cash withdrawal operations accounted for 75.5% of total transactions, while payments for goods and services, only for 24.0%, by 2012 the values became almost equal (48.2% and 48.0%, respectively); in 2017 $\frac{3}{4}$ of all the operations with use of bank cards were related to payments for goods and services (Fig. 2). The above points to the fact that Russian households gradually switch over from cash to non-cash payments.

However, in terms of the value of operations the distribution of the shares is not yet in favor of e-payment for purchases: in Q1 2018 only 28.6% of the overall volume of transactions was related to payments for goods, while the share of cash withdrawals from ATMs was equal to 36.6%. Also, it is important to pay attention to growth in the share of other operations to 34.8% in the total value of transactions carried out by means of bank cards. Such operations include among other things funds transfers from one bank card to another.

In terms of absolute values, it is noteworthy that in 2017 Rb 16,066.5bn worth of goods and services was paid for by means of bank cards, while the volume of cash withdrawals from ATMs was 1.6 times higher (Rb 25,707.5bn). However, the importance of e-payments in the Russian economy is gaining momentum. If one compares the amount of funds spent by the Russians on payments for goods and services in Russia and abroad by means of bank cards with the retail trade volume and the volume of paid services to households, the correlation based on the data of 2017 is equal to 41.6%. For comparison: in 2013 and 2008 the value of this correlation was equal to 16.9% and 4.5%, respectively.

The analysis of the above data on the active use by the Russians of bank cards in the context of regions permits to determine the actual extent of trans-regional differentiation. So, in Q1 2018 Moscow and the Moscow Region

combined were the only territory in Russia where the value of operations related to payments for goods and services by means of bank cards exceeded (by 22%) the volumes of cash withdrawals from ATMs. In other regions, the value of transactions related to payments for goods and services make up maximum 80% (the Republic of Komi) of the cash withdrawal volume and minimum 4% and 5% in the Chechen Republic and Ingushetia, respectively. On average across the country, from the beginning of 2018 Rb 0.67 paid by means of bank cards for goods and services accounted for Rb 1 withdrawn from the ATM.

As regards the frequency of utilization of e-payments for goods and services as compared to the frequency of cash withdrawal transactions, the latter operations take place more frequently only in seven regions. The leader in this respect is Moscow where 20.7 transactions on payment for goods and services, as compared on average to 6.7 transactions across the country, account for one cash-withdrawal transaction.

So, amid development the e-commerce and e-payments, customers' priorities, as well as the parameters of frequency and quantity of consumption change dynamically. As compared to the traditional market segment, the internet segment has the specifics of its own and though its share is relatively small it has got quite a substantial growth potential that is able to bring about changes in the volumes of the traditional segment. These factors combined with the global nature of the e-commerce require development of legal norms and financial instruments for regulation of this sector. ●

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