

# MONITORING OF RUSSIA'S ECONOMIC OUTLOOK:

## TRENDS AND CHALLENGES OF SOCIO-ECONOMIC DEVELOPMENT

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## Monitoring of Russia's Economic Outlook

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## TRENDS AND CHALLENGES OF SOCIO-ECONOMIC DEVELOPMENT

Considering the execution of the RF federal budget for Q3 2019, the experts note that its revenues have increased by more than Rb1 trillion compared to the same period of 2018, but remained at the same level in relation to GDP (18.8%). Having said that, **oil and gas revenues decreased by 1 p.p. of GDP, which was partially compensated by the growth of VAT revenues due to an increase in its rate.** At the same time, budget expenditures decreased by 0.3 p.p. of GDP, which eventually led to **an increase in the budget surplus to 3.8% of GDP. Non-oil and gas deficit keeps going down – from 5.0% to 3.7% of GDP.** As for the low level of cash execution of the budget for 3 quarters, it is partly explained by the adopted budget amendments, according to which the annual volume of the newly approved appropriations has been increased by more than Rb845 bn.

As of October 1, 2019, public domestic debt constituted Rb10.5 trillion (an increase of Rb1,338 bn over January-September) and external debt amounted to \$53.6 bn (an increase of \$4.469 bn).

The authors analyzing the state of regional budgets in January-September 2019 point out that **the slowdown in the growth of revenues compared to the comparable period of the last year was compensated by the growth of inter-governmental fiscal transfers.** Consolidated budget revenues increased in almost all subjects of the Russian Federation (by 12% in total) except for Bashkortostan, Khakassia and Yakutia (which is partially explained by a high revenue base in these republics last year). The increase in revenues was also due to an 18.5% increase in transfers from the federal budget. **Expenses were growing even a bit faster than revenues (by 13.3%), while fears over poor performance of regional budgets did not materialize:** this indicator was on average for 2011–2019.

**Public debt of the regions continued to decline,** amounting by early October to Rb1.99 trillion (7% lower than in September last year). This being said, debt decreased in 71 subjects of the Russian Federation, and increased – in 14. Only Mordovia had a high level of debt, exceeding 100% of regional revenues, but still began to decline.


Business surveys of industrial enterprises conducted by the Gaidar Institute experts suggest that Russian industry in October-November maintained output growth at nearly the level of previous months, although demand declined and stocks of surplus products were on the rise. Nonetheless, forecasts of demand increased, and **14% of enterprises reported a shortage of workers (a three-year maximum), which testifies, rather, in favor of the expectation of production growth.** However, the shortage of staff reflects the growth of dissatisfaction with the level of wages in the industry (23% of enterprises estimate it as being below “normal”), although at the beginning of the year the level of “dissatisfaction” was at its historic minimum.

This autumn, according to industrial enterprises, **the minimum interest rate on loans fell to its lowest level** since 2009 – to 10.7% per annum in rubles. From April 2018 to September 2019, according to their estimates, it was in the range of 11.4–11.8%.

Considering the dynamics of corporate lending in the banking sector for 3 quarters of this year, our experts note its growth by 2.1% compared to the same period of 2018. They point out that **this year there was both an absolute and relative slowdown in corporate lending**. The growth of the corporate loan portfolio is largely due to an increase in lending in rubles, while lending in foreign currency dropped by 12.2% (in contrast, it increased by 9.8% in the first 10 months of last year). In the total corporate loan portfolio, ruble loans accounted for 76.2% at the end of October. As for outstanding debt of legal entities, its growth rate has accelerated, and its share in the loan portfolio amounted to 7.4% as of November 1 (6.1% on the same date in 2018).

It is noted that the government and the Bank of Russia are taking measures to stimulate corporate lending. The program of concessional lending, according to preliminary estimates, will allow this year to give additional Rb1 trillion to small and medium-sized businesses. And the growth rate of lending to individual entrepreneurs in January-October made 9.6%, about three times higher than last year's dynamics. In order to stimulate lending, the Bank of Russia is gradually changing the procedure for calculating the standards of banking capital adequacy

Our experts point out that, according to data for 3 quarters of 2019, **household lending and bank deposits overtake cash income in terms of growth rate**. The latter grew by 5.8% in nominal terms (compared to the same period last year), which, given low current inflation, indicates an improvement in income dynamics. However, both deposits and loans to the population grew faster. This is illustrated by the annual dynamics (from October 1, 2018 to October 1, 2019): retail deposits during this period grew by Rb2.4 trillion and loans owed by Rb2.9 trillion (by 9 and 20.4%, respectively). In this case, bank savings of the households almost twice exceeds the retail debt before banks. In relation to the monetary income of the population credit indebtedness amounted to 39% (34% was the ratio a year ago).

Assessing the role of credit in the households' consumption, our experts note that in **9 months of 2019, the issuance of consumer loans (not including mortgages) amounted to 18.5% of income, 31% of wages and 33.5% of retail trade turnover**. At the same time, the population was paying back the loans already taken, and while during this period they received consumer loans to the tune of Rb8.1 trillion, their debt rose by Rb1.3 trillion. That is, the net increase in consumption due to such loans amounted to Rb6.8 trillion or 15.5% of income. 

# 1. THE FEDERAL BUDGET EXECUTION FOR 9 MONTHS OF 2019

S. Belev, T. Tischenko

*The dynamics of the main parameters of the federal budget in January-September 2019 compared to the same period of the previous year showed that:*

- *there was a stabilization of revenues at the level of 18.8 p.p. of GDP; having said that, the reduction in the level of oil and gas revenues was partially offset by the growth of VAT revenues;*
- *the decrease in oil and gas revenues was primarily due to the application of a deduction for excisable goods of certain petroleum feedstock;*
- *the increase in VAT revenues was due to an increase in the basic rate; however, the increase in the rate did not result in a serious reduction in the tax base;*
- *decrease in expenditures by 0.3 p.p. of GDP led to an increase in the budget surplus to 3.8% of GDP, which is mainly due to the backlog of cash execution on all functional budget items, except for inter-governmental fiscal transfers.*

According to the Federal Treasury, **the volume of federal budget revenues in the first 9 months of 2019 as a share of GDP has not changed** as compared to the same period of the previous year and amounted to 18.8% of GDP; in absolute terms revenues increased by Rb1,048.6 bn (*Table 1*). We should note **the growth of non-oil and gas revenues during all three quarters of this year:** at the end of Q1 by 0.6 p.p. of GDP, at the end of the H1 by 0.7 p.p. of GDP, and at the end of 9 months by 1.0 p.p. of GDP relative to the same periods in 2018, and **the negative dynamics of oil and gas revenues**, which declined by 1.0 p.p. of GDP over the first nine months GDP compared to the same period of the previous year. The actual execution of the revenue part of the federal budget for January-September of the current year amounted to 74.5% of the projected annual volume against 71.9% of the actual annual volume for 9 months of 2018.

**Federal budget expenditures as of January-September of this year against 9 months of 2018 went down by 0.3 p.p. of GDP** with a slight **decrease in the level of cash execution of the budget (62.4% vs. 68.0%)**; in absolute terms there is an increase by Rb578.0 bn. **The federal budget surplus for the first 9 months of 2019 was 3.8% of GDP** (Rb3,086.5 bn), which is 0.3 p.p., or Rb470.6 bn higher than the budget execution surplus for the same period of 2018; the non-oil and gas deficit declined from 5.0% of GDP to 3.7% of GDP or by Rb764.7 bn.

Overall, **in January-September 2019 tax revenues** (*Table 2*) **increased by Rb681.8 bn and decreased by 0.2 p.p. of GDP to the level of 9 months of 2018**; the reduction in tax revenues was due to the negative dynamics of revenues from foreign economic activity by Rb317.9 bn, or 0.6 p.p. of GDP, with an actual execution of 75.1% of the projected annual volume. In addition, there was a reduction in revenues from domestic excise duties owing to the deduction of excisable goods of some types of oil raw materials by 0.4 p.p. of GDP. **The dynamics of tax revenues** in nominal terms and as a share of GDP **improved** by 0.1 p.p. of GDP (Rb181.1 bn) regarding **the corporate income tax**, by **internal and external VAT** by 0.4 and 0.2 p.p. of GDP, respectively (Rb504.4 bn and Rb286.6 bn), and

## Monitoring of Russia's Economic Outlook

Table 1

### Main parameters of the federal budget for January-September 2018–2019

Indicator	January-September 2018			January-September 2019			Change in 2019 against 2018	
	Rb bn	% GDP	% of actual annual volume	Rb bn	% GDP	% of planned annual volume	Rb bn	p.p. of GDP
<b>Revenue, including:</b>	<b>13 986.1</b>	<b>18.8</b>	<b>71.9</b>	<b>15 034.7</b>	<b>18.8</b>	<b>74.5</b>	<b>1 048.6</b>	<b>0.0</b>
oil and gas	6 302.1	8.5	69.9	6 008.0	7.5	72.9	-294.1	-1.0
non-oil and gas	7 684.0	10.3	73.6	9 026.7	11.3	75.6	1 342.7	1.0
<b>Expenditure, including:</b>	<b>11 370.2</b>	<b>15.3</b>	<b>68.0</b>	<b>11 948.2</b>	<b>15.0</b>	<b>62.4</b>	<b>578.0</b>	<b>-0.3</b>
interest cost	621.3	0.8	77.1	532.2	0.7	65.0	-89.1	-0.2
non-interest cost	1 0748.9	14.5	67.6	11 416.0	14.3	62.3	667.1	-0.1
<b>Surplus/Deficit</b>	<b>2 615.9</b>	<b>3.5</b>	<b>-</b>	<b>3 086.5</b>	<b>3.8</b>	<b>-</b>	<b>470.6</b>	<b>0.3</b>
Non-oil and gas deficit	-3 686.2	-5.0	-	-2 921.5	-3.7	-	764.7	1.3
<i>Reference: GDP (in current prices, Rb bn) *</i>	74 389			79 760				

\*Preliminary estimate for 9 months of 2019.

Sources: Finance Ministry, Rosstat, Federal Treasury, own calculations.

Table 2

### Proceeds from main taxes to the federal budget over January-September 2018–2019

Indicator	January-September 2018			January-September 2019			Change in 2019 against 2018	
	Rb bn	% of GDP	% of actual annual volume	Rb bn	% of GDP	% of actual annual volume	Rb bn	p.p. of GDP
Total tax revenues, including	12 721.4	17.0	-	13 403.2	16.8	-	681.8	-0.2
corporate income tax	736.9	1.0	74.1	918.0	1.1	81.5	181.1	0.1
VAT on products sold in RF territory	2 655.7	3.6	74.3	3 160.1	4.0	76.8	504.4	0.4
VAT on products imported into RF territory	1 745.3	2.3	71.5	2 031.9	2.5	70.0	286.6	0.2
excises on goods produced in RF territory	684.7	0.9	79.5	702.0	0.9	71.7	17.3	0.0
excises on goods imported into RF territory	65.0	0.1	67.5	62.2	0.1	63.9	-2.8	0.0
Mineral Extraction Tax	4 269.6	5.7	70.4	4 589.7	5.8	74.8	320.1	0.1
Revenues from foreign economic activity	2 564.2	3.4	69.1	2 246.3	2.8	75.1	-317.9	-0.6

Sources: Federal Treasury (real-time data), own calculations.

by 0.1 p.p. of GDP (Rb 320.1bn) on **mineral extraction tax**.<sup>1</sup> The federal budget revenues from import excises over the period in question did not change and amounted to 0.1% of GDP with a decrease of Rb2.8 bn.

**The increase in VAT receipts is due to an increase in the basic VAT rate.** Since VAT payments come with a quarter lag from their tax base, VAT receipts for Q2 and Q3 2019 just match the tax base for the first and second quarters of 2019, when the 20% VAT rate began to apply.

<sup>1</sup> The lower oil price for the first 3 quarters of 2019 (compared to the first 3 quarters of 2018) was offset by the lower ruble exchange rate.

## 1. The federal budget execution for 9 months of 2019

According to Rosstat, **the volume of imports in H1 2019 amounted to 20.9% of GDP, the same level as in H1 2018.** This being said, the effective VAT rate on imports was 13.4% in H1 2019 against 12.6% in H1 2018, which indicates some improvement in the administration of external VAT.

Final consumption in H1 2019 also remained at the level of the previous period (70% of GDP). However, the effective VAT rate on domestic consumption rose from 7.3% to 8.4% (H1 2018 to H1 2019).

Such low sensitivity of the tax base to changes in the basic VAT rate is caused by the fact that the slowdown in the growth rate of physical volumes of the base was compensated by the growth of the cost of goods. In particular, Rosstat data show that at the end of H1 2019, retail turnover in nominal terms went up by 7.5% relative to the level of H1 2018. At the same time, physical volumes of retail turnover grew by only 1.5% in H1 2019 against 2.8% a year earlier.

**In the context of the functional classification of federal budget expenditures in the first 9 months** of 2019 relative to the corresponding period of 2018 (Table 3) the following changes are observed:

- decrease in the volume of financing as a share of GDP, including by 0.1 p.p. of GDP for each of the sections: “National defense”, “National security and law enforcement”, “Social policy”, “Inter-governmental fiscal transfers”, and by 0.2 p.p. of GDP to “State debt service”;
- an increase by 0.1 p.p. of GDP in expenditures on “Housing and utilities”, “Environment protection”, “Healthcare” and “Physical training and sports”;
- for other sections the expenditures as a share of GDP remained unchanged.

Table 3


### Federal budget expenditures in January-September 2018–2019

	January-September 2018			January-September 2019			Change in 2019 against 2018	
	Rb bn.	% of GDP	% of actual volume	Rb bn.	% of GDP	Cash execution, %	Rb bn.	p.p. of GDP
<b>Total expenditure, including:</b>	<b>11 370.2</b>	<b>15.3</b>	<b>68.0</b>	<b>11 948.2</b>	<b>15.0</b>	<b>62.4</b>	<b>578.0</b>	<b>-0.3</b>
Nationwide issues	814.6	1.1	64.8	853.1	1.1	52.3	38.5	0.0
National defense	1929.4	2.6	68.2	2 018.1	2.5	62.8	88.7	-0.1
National security and law-enforcement	1304.3	1.8	66.1	1 333.4	1.7	59.1	29.1	-0.1
National economy	1369.3	1.8	57.0	1 430.8	1.8	49.5	61.5	0.0
Housing and utilities	97.4	0.1	65.5	152.6	0.2	54.2	55.2	0.1
Environment protection	86.0	0.1	74.2	145.4	0.2	74.2	59.4	0.1
Education	485.8	0.7	67.2	555.6	0.7	62.0	69.8	0.0
Culture and cinematography	63.6	0.1	67.0	72.3	0.1	51.7	8.7	0.0
Health care	358.0	0.5	66.6	482.3	0.6	65.2	124.3	0.1
Social policy	3452.5	4.6	75.3	3 599.4	4.5	74.1	146.9	-0.1
Physical culture and sport	39.1	0.1	61.1	38.2	0.0	42.9	-0.9	0.0
Mass media	58.9	0.1	66.6	63.1	0.1	69.9	4.2	0.0
Government and municipal debt servicing	621.3	0.8	77.1	532.2	0.7	65.0	-89.1	-0.2
Intergovernmental fiscal transfers	689.8	0.9	63.0	671.5	0.8	64.6	-18.3	-0.1

Sources: Federal Treasury, own calculations.

## Monitoring of Russia's Economic Outlook

The low level of cash execution of the budget for January-September of this year is noted in the sections “National economy” and “Physical culture and sports” (less than 50%), and in the sections “Nationwide issues”, “National security and law enforcement”, “Housing and utilities”, “Culture and cinematography” (less than 60%). This is partly due to the adopted amendments to the law on the federal budget, under which the annual volume of approved budget allocations for 2019 was increased by Rb845.7 bn including, among other things, by sections: “Nationwide issues” by Rb207.5 bn, including Rb151.9 bn under the “Reserve funds” item; “National economy” by Rb180.3 bn; “Healthcare” by Rb62.1 bn, including Rb34.5 bn under the “Outpatient care” item.

In January-September of the current year, the amount of state domestic debt moved up by Rb1,337.6 bn and as of October 1, 2019 amounted to Rb1,514.0 bn, **the amount of state external debt** rose by \$4,469.0 mn to \$53,625.5 mn. The total amount of the Sovereign Wealth Fund in ruble terms as of October 1, 2019 was Rb7,927.7 bn, with an increase in balances over the first nine months of the current year of Rb 3,891.6bn, including due to the crediting in June 2019 of additional oil and gas revenues from the federal budget received in 2018 in the amount of Rb 4,122.1 bn. 



## 2. REGIONAL BUDGETS FOR THREE QUARTERS OF 2019: WILL THERE BE COST REDUCTION?

A. Deryugin

*Inter-governmental fiscal transfers largely allowed maintaining a relatively high growth rate of revenues of the regional consolidated budgets amid the reduction of the revenue base for corporate income tax and low growth rates of other taxes. It was the transfers that largely compensated for the slowdown in the growth rate of tax and non-tax revenues.*

*Despite concerns about the possible low level of cash execution of regional budgets, it remained at the average level for 2011–2019.*

*The slowdown in the growth rate of regional budgets, which is expected up to the end of 2019, may have a negative impact both on the further growth rate of their expenditures, and on the budgetary balance. In the first case, it will mean the need to reduce expenditures, including those associated with the implementation of national projects. In the second case – a possible exit from the parameters of agreements with the Russian Finance Ministry, concerning the conditions of granting equalization transfers, as well as the restructuring of previously received budgetary credits.*

### Revenue

Total revenues of the consolidated budgets of the subjects of the Russian Federation in the first nine months of 2019 **increased by 12.0%** vs. the same period of 2018. This confirms the previously voiced **assumption that the growth rate of budget revenues is going to slow down by the end of this year.**<sup>1</sup>

**The main sources of revenue** growth were excises (+19.2%), taxes on total revenue (+14.2%), as well as transfers from the federal budget (+18.5%), including subsidies (+35.2%), subventions (+21.1%) and other inter-governmental fiscal transfers (+87.3%). It was the growth of inter-governmental transfers in July-September that prevented the growth rate of regional revenues from falling below the level of 12%.

Corporate income tax, which was in the lead in the first 7 months of 2019 (+20.3% vs. the corresponding period of 2018), demonstrated a negative trend throughout August-September, resulting in a decrease in its growth to 16.1% at the end of 9 months. **The general reduction in profits of profit-making organizations, which has been observed since May 2019** was the main reason for the deterioration of the dynamics of this tax.

Personal income tax (+8.6%) and non-tax revenues (+7.5%) grew somewhat more slowly, while proceeds from the corporate property tax continued declining, amounting to 94.8% of the 2018 level for the comparable period. This is due to the exemption of movable property from this tax.

Almost all subjects of the Russian Federation **demonstrated positive growth rates of consolidated budget revenues** over the first nine months of 2019. The exceptions were the Republic of Bashkortostan (96.8% of the 2018 level), the

<sup>1</sup> Deryugin A.N. Regional budgets in January-July 2019: Revenue growth is slowing down // Russian Economic Development. 2019. Vol. 26. No. 10. P. 54–57.

Republic of Khakassia (88.5%) and the Republic of Sakha (Yakutia) (98.7%), whose low revenue growth rates were partly due to the high base of last year.

**The long-term trend of increasing differentiation of budget revenues between the better-off and the worse-off regions also persists:** the growth rates of tax and non-tax proceeds of the consolidated budgets with high fiscal capacity (13 subjects, not receiving in 2019 equalization transfers), medium-revenue (41 subjects) and lower-revenue (31 subjects) regions in the first nine months of 2019 against the corresponding period of 2018 were 112.2%, 109.2% and 106.1% respectively. This trend, observed for the third year in a row, shows that the state budget policy with regard to the regions has not yet led to the smoothing of territorial disparities in the sphere of their socio-economic development.

Preliminary data on the execution of consolidated regional budgets for October 2019 confirm **the tendency to reduce the growth rate of their revenues, which by the end of the year may be below 10%.**

### Expenditure

In the first three quarters of 2019 against the corresponding period of 2018 the growth of expenditures of the consolidated budgets of the RF subjects amounted to 13.3%, **which is significantly higher than the inflation rate and slightly higher than the growth rate of budget revenues.**

Positive growth in expenditures was observed in 83 regions, and in 80 of them exceeded inflation over the same period.

**The leaders in the growth of budget expenditures** were the Chukotka Autonomous District (137.3% of last year's level), the Sakhalin Region (135.1%), which are also the leaders in revenue growth, as well as Sevastopol (133.1%). The Republic of Mordovia (89.6%), which has been tackling the problem of reducing

Table 1

Functional structure and dynamics of expenditures of the consolidated budgets of the subjects of the Russian Federation for 9 months, %

	Expenditure structure			Growth	
	2017	2018	2019	2019/2017	2019/2018
<b>Expenditure, total</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>23.5</b>	<b>13.3</b>
Nationwide issues	6.2	6.4	6.3	25.0	10.1
National security and law-enforcement	1.0	1.1	1.0	25.4	7.4
National economy, including:	19.4	18.8	19.5	24.6	17.8
Agriculture and fisheries	2.6	2.1	2.0	-6.0	6.3
Transportation	4.7	4.3	4.8	26.2	26.1
Road facilities (Road funds)	7.8	8.0	8.1	27.8	14.5
Other issues in the sphere of national economy	4.3	4.4	4.7	35.3	21.0
Housing and utilities	8.8	8.4	9.3	31.5	26.3
Environment protection	0.2	0.3	0.3	59.9	0.2
Education	26.2	26.7	26.0	22.7	10.0
Culture and cinematography	3.6	3.9	3.7	24.5	7.2
Health care	7.9	8.2	8.3	29.9	15.0
Social policy	22.4	22.3	21.9	20.8	11.4
Physical culture and sport	2.4	2.3	2.2	17.6	11.5
Mass media	0.4	0.4	0.4	29.9	12.9
Government and municipal debt servicing	1.4	1.1	0.9	-22.9	-5.7

Source: own calculations on the data released by the Federal Treasury.

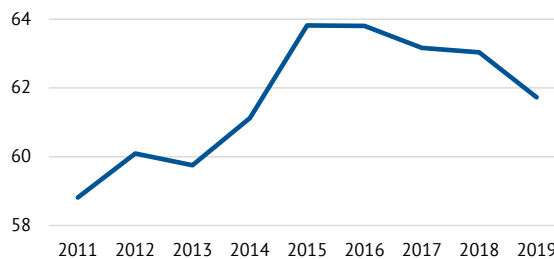
## 2. Regional budgets for three quarters of 2019: will there be cost reduction

the state debt, and the Republic of Khakassia (93.3%), which has been facing low growth rates of current income, **were the leaders in reduction of budget expenditure.**

The reduction of public debt and lower interest rates in the economy led to a decrease in expenditures on its servicing. Their share in the structure of expenditures for 9 months of 2019 stood at 0.9%. This is the lowest value for this period since 2013.

Expenditures on environment protection demonstrated almost zero growth (by 0.2%). On the one hand, this is due to the high growth rate of relevant expenditures in the same period of 2018. On the other hand, the fact that in the first nine months of 2019 regions spent only 36.6% of the annual amount approved by the consolidated budget estimates for these purposes (*Table 1*), while in previous years this share was above 50%. **Expenditures on housing and utilities sector (up 26.3%) and transport (up 26.1%) grew most significantly.**

Generally, despite concerns over a possible low level of cash execution of regional budgets due to a low level of execution of the federal budget (primarily with regard to expenditures on national projects), its value was average over the period 2011–2019 (*Fig. 1*).

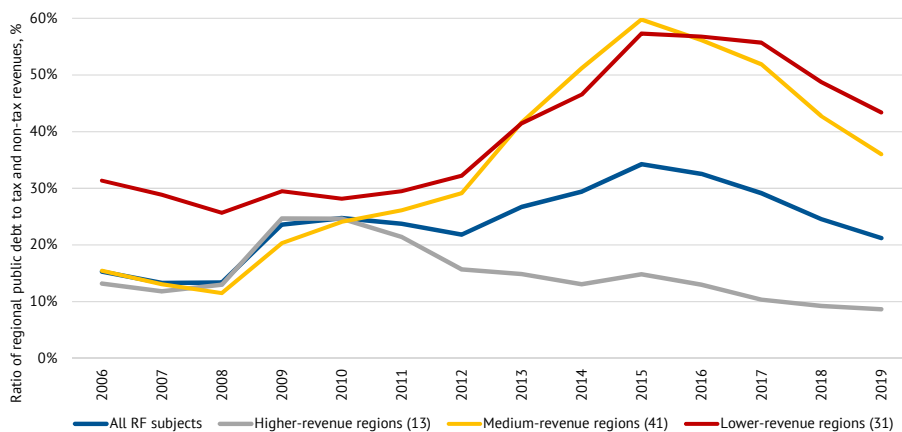


Source: own calculations on the data released by the Federal Treasury.

*Fig. 1. Cash execution of consolidated regional budgets for 9 months, % of the approved consolidated budget quarterly breakdown*

### Balance and public debt

Despite the fact that the growth rates of revenues of the consolidated regional budgets began to lag behind the growth rates of their expenditures, **the public debt of the regions continued to decline:** by the end of September it amounted to Rb1.99 trillion, which is 9.8% lower than at the beginning of the year and by 7.0% lower than in September 2018. Over the period from September 2018 to September 2019, the public debt decreased in 71 subjects of the Russian Federation, and increased in 14. Since the beginning of the year, the leaders in its reduction were the Krasnoyarsk Territory (-Rb21.9 bn), the Krasnodar Territory



Sources: own calculations based on data released by Finance Ministry and Federal Treasury.

*Fig. 1. Debt burden of the RF subjects with various level of fiscal capacity, %*

(-Rb17.2 bn) and the Nizhny Novgorod Region (-Rb12.0 bn), while the leaders in its growth were the Moscow Region (Rb29.3 bn), the Sverdlovsk Region (Rb5.1 bn) and the Khabarovsk Region (Rb2.5 bn).

**The average debt burden of the subjects of the Russian Federation decreased to 21.2%, which is the lowest value (for the end of September) since 2009 (Fig. 2).** The debt burden of medium- and lower-revenue regions remains relatively high (36.0% and 43.4%, respectively), but it is they who are currently experiencing the fastest reduction. Only the Republic of Mordovia has a high level of public debt, which exceeds 100% of regional tax and non-tax revenues (218.7%), but it has also been gradually decreasing.

**The structure of public debt was still dominated by budget loans,** which accounted for 49.6% of the total volume of public debt, having slightly decreased as compared to September 2018 (51.4%). On the contrary, the share of more expensive to service government securities (27.1%) and loans of credit institutions (20.0%) slightly increased. 

### 3. RUSSIAN INDUSTRY IN OCTOBER-NOVEMBER 2019

S. Tsukhlo

*In October-November the Russian industry retained the output growth almost at the level of the previous months despite the negative demand dynamics and growth of redundant stocks of finished products. Enterprises' plans and forecasts did not undergo any negative adjustments either, and hiring intentions demonstrated atypical optimism for this time of year. In Q4 2019, the industry reported a reduction in the minimum loan rate offered by banks.*

In November, **the dynamics of solvent demand worsened according to enterprises' estimates**. The balance of actual changes in sales after clearing of seasonal and random fluctuations lost 3 p.p. and forfeited stability registered in the first 10 months of this year. Hence, the August 2018 low has been renewed and now November 2019 was the worst month for this indicator since 2015. However, demand forecasts are still stable and for 12 consecutive months they had been in place in the interval of +3...+4 p.p. The industry is not ready yet to revise its expectations either towards greater optimism or greater pessimism.

In the context of such a symbolic negative dynamics of demand businesses reported equally symbolic **deterioration of estimates of finished goods inventories**, i.e. the balance of this indicator increased (thus, deteriorated from +4 to +7 p.p., which was the maximum redundancy since December 2017. However, the moderate deterioration of stock assessments should not be a cause for concern and can, if necessary, be easily neutralized by enterprises in the coming months, first of all, by adjusting output. In 2019, the industry managed to stop the production slowdown relevant for 2018 and achieve steady, albeit minimal, growth in output. November does not seem to be an exception as well. However, the optimism (balance) of output plans in H2 2019 has stabilized at +12 p.p. after clearing of seasoning and random factors, which is lower than the balance of H1, which averaged +15 p.p.

Since the crisis of 2015, the Russian industry has been demonstrating success in terms of supplying production with raw and other materials. The share of normal estimates of these stocks remains in the range of 77–82%, while the balance (difference) of responses “above the norm” and “below the norm” differs less and less from zero each quarter. In H2 2019, only 11% of enterprises assess their stocks of raw materials and supplies as insufficient.

Amid reducing inflation and negative dynamics of demand, industry reported absolute price declines for the second month in a row. The initial balance remains negative, and after clearing seasonal and random fluctuations, the chart shows **the lowest (+1 p.p.) growth in the industry selling prices since mid-2017**.

However, if the decline in prices was a short-term phenomenon at that time, the result of October-November 2019 looks like a logical outcome of a process that began back in the middle of 2018.


Initial price forecasts show very moderate plans for businesses to traditionally raise prices at the beginning of the next calendar year, and after clearing,

the balance has remained in the range of +6...+7 p.p., where it rests since the beginning of H2 2019.

In November, industry continued losing workers: both the initial and the cleared balance of actual changes in the number of employees remained negative. This fact will make it difficult to eliminate the personnel shortage at enterprises, which occurred in H2 of this year. **For the second quarter in a row, 14% of businesses reported an insufficient number of employees, which was a three-year high.** Only 6% of businesses registered a surplus of personnel, which is close to the historical minimum. The balance traditional for conjuncture surveys turned out to be negative and the worst for the last 5 years, i.e. there has not been such a large-scale shortage of workers in industry since mid-2014.

Nevertheless, the industry does not give up hope of restoring the number of workers it needs. Already in November, enterprises' plans for hiring personnel reached a very high level of optimism. Usually, surveys register such large-scale hiring intentions in February-March, i.e. after the January peak of layoffs.

The shortage of personnel in H2 resulted in **growth of dissatisfaction with the level of wages in the industry.** The share of responses "below the norm" increased to 23%, which was a three-year high for this indicator. Notwithstanding, at the beginning of the year the dissatisfaction with the level of wages was at historic lows. Businesses express no hope to improve the wages related situation in the near future. The balance of expected changes in wages at the end of 2019 became negative and the responses about a decline in wages prevail in the industry.

In Q4 2019, **the industry started reporting a reduction in the minimum loan rate offered by banks.** By November, the indicator fell to 10.7% per annum in rubles. This was the minimum for the entire period of its monitoring, which we began in September 2009. It should be noted that from April 2018 to September 2019, the minimum rate offered to enterprises showed relative stability, being in the range of 11.4-11.8%. 

## 4. CORPORATE LENDING IN JANUARY-OCTOBER 2019

S. Zubov

*Taking measures to cool the consumer credit market (in particular, the introduction of a personal credit rating and mandatory calculation of the debt load indicator), the Bank of Russia together with the government is stimulating corporate lending. The implementation of budget subsidizing programs of concessional lending to small and medium-sized businesses continues, which should contribute to the expansion of credit supply. It is planned to introduce softening with regard to evaluation of credit risks on loans provided to companies, which will reduce the burden on the bank's capital in lending to legal entities.*

*Overall, the corporate lending market grows at a rate no higher than the growth of total bank assets. Meanwhile, the strengthening of the ruble had a significant impact on the reduction of lending in foreign currencies.*

The total volume of lending to Russian enterprises of all forms of ownership in the non-financial and financial (except for banks) sectors and non-resident legal entities (except for banks) increased by Rb795.9 bn, or by 2.1% from the beginning of the year in the first 10 months of 2019. Last year, in the corresponding period, the increase amounted to Rb3,435.5 bn, or 10.2%. Total assets of the Russian banking sector in January-October 2019 grew by 9.0% (last year's growth in the same period stood at 5.4%), **which indicates both absolute and relative slowdown in the growth rate of corporate lending this year.**

The growth of the total corporate loans portfolio was largely provided by the increase in lending in national currency by 7.6% (in the corresponding period of the last year an increase of 10.3%), while lending in foreign currency dropped by 12.2% (in the first 10 months of the last year a rise of 9.8%). As a result, ruble loans accounted for 76.2% in the total portfolio of corporate lending as of the end of October.

The growth of outstanding debt slightly accelerated. **Over 10 months of this year the total overdue debt of legal entities went up by 32.2%**, a year earlier the growth was 11.5%. As of November 1 overdue debt reached 7.4% of credit portfolio, last year on the corresponding date this figure stood at the level of 6.1%.

The government implements measures to stimulate corporate lending. At the end of 2018, the Russian Government adopted Resolution No. 1764 "On Approval of the Rules for Granting Subsidies from the Federal Budget to Russian Credit Organizations for Reimbursement of Lost Income on Loans Granted in 2019–2024 to SMEs at a Reduced Rate". In early 2019, the program of preferential lending under the national project "SMEs and support for individual entrepreneurial initiative" was unveiled. The Ministry of Economic Development of Russia approved 70 banks from 29 regions of Russia for preferential lending to small and medium-sized enterprises (SMEs) at a rate of 8.5% (15 authorized banks participated in the 2018 program, the preferential rate constituted 6.5%).

In 2019, more than Rb9 bn were allocated from the federal budget to subsidize interest rates under this program. The program of concessional lending is estimated to provide around Rb1 trillion additional to small and medium-sized

businesses this year. Credit at 8.5% is granted for investment purposes of up to Rb1 bn for the term of up to 10 years and for the replenishment of circulating assets – up to Rb100 mn for the term of up to 3 years.

**Thanks to concessional lending programs, the volume of loans extended to small and medium-sized enterprises and businesses rose by 14.5%** (Rb4,476 bn) in the first 8 months of 2019 compared to the same period last year. At the same time, the loan debt decreased since the beginning of the year by 3.8% and amounts to Rb4,056 bn, which indicates that the volume of loans repayment exceeds the volume of their provision.

**Loans to individual entrepreneurs in 2019 are growing at a higher rate than in the previous year:** in January-October the increase amounted to 9.6% (a year ago to 3.6%). As of November 1, the total portfolio amounted to Rb514.5 bn, or 12.7% of the total credit portfolio of small and medium-sized businesses. The volume of indebtedness on foreign currency loans to individual entrepreneurs is insignificant (less than 0.5%) and continues to decline (for 10 months a drop of 19.4%).

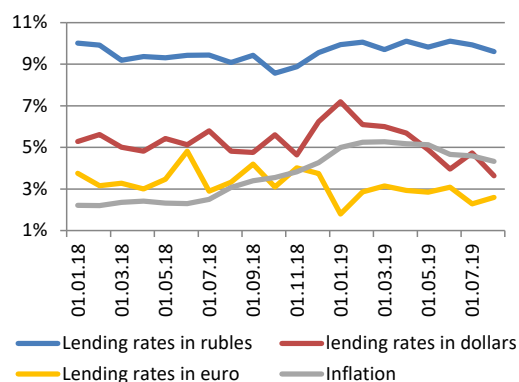
In 2019, within the framework of stimulating credit support to the economy, the Bank of Russia is gradually changing the procedure for calculating the bank's own funds (capital) adequacy ratios and introducing a new standardized approach to credit risk assessment. A new version of Instruction No. 180-И is being prepared (the expected date of entry into force is January 1, 2020) with an approach to credit risk assessment of requirements for banks and corporate borrowers depending on the borrower's creditworthiness level and performance indicators.

According to the requirements for corporate borrowers it is planned to allocate a category of "investment class" with a reduced risk factor of 65% (currently assessed with a risk factor of 100%).

It is also proposed to establish a reduced risk factor of 85% for claims to small and medium enterprises, assessed on an individual basis (currently applied risk factor of 100%), if the financial position of borrowers meet the highest quality categories (determined by banks on their own methods in accordance with the instructions of the Central Bank).

For the requirements to small and medium-sized enterprises assessed on a portfolio basis, corresponding to the criteria established by the current edition of the Instruction No. 180-И, the reduced risk coefficient of 75% remains.

In the short term, measures of the Bank of Russia should have a positive impact on the dynamics of the corporate lending market, but high credit risks may become a deterrent to the revival of this segment of the financial market. ▀



**Note.** Year-on-year for 12 months

*Fig. 1. Lending rates (for a period of 181 days to 1 year) and inflation rate, January 2018 – August 2019*

Source: Bank of Russia.



## 5. RETAIL LENDING AND BANK DEPOSITS IN Q1 THROUGH Q3 2019: FASTER GROWTH COMPARED WITH INCOMES

A. Burdyak

*Retail Lending and Bank Deposits in Q1 Through Q3 2019: FastAs of October 1 2019, the volume of banks' retail deposits amounted to Rb29.5 trillion, an increase of Rb2.4 trillion as compared with October 2018. Over the same period, households' loan debt increased by Rb2.9 trillion to the record-high value of Rb17.0 trillion. Lending is growing faster than savings which also in terms of growth rates outpaces households' incomes. It happens owing to consumer loans without counting in mortgage loans. Banks' retail loan portfolio is equal to 26% of the volume of households' annual incomes, including the mortgage loan debt which amounts to 11% of annual incomes.*

The preliminary results of January-September 2019 point to a **5.8% growth in households' cash incomes on the relevant period of the previous year<sup>1</sup>**; this is the evidence of a considerable improvement in incomes dynamics amid a low inflation.

**Based on results of 2018, loan debt and bank deposits volumes amounted to the record-high values** both in absolute terms and relative to households' cash incomes. As of the end of 2018, individuals' loan debt was equal to nearly a quarter of households' annual cash incomes; individuals' bank savings (deposits) twice surpassed households' overall loan debt to banks and were almost equal to a half of the Russian population' annual income.<sup>2</sup>

From October 1, 2018 till October 1, 2019, the volume of individuals' bank deposits increased by Rb2.4 trillion (+9%) and was equal to Rb29.5 trillion.<sup>3</sup> Households' loan debt was growing even at a higher rate, an increase of Rb2.9 trillion (+20.4%) and amounted to the record-high value of Rb17.0 trillion. Over Q3 2019, households' cash incomes calculated by Rosstat in accordance with the new methodology surpassed by 7.7% in nominal terms the relevant indicator of the previous year. Overall, **based on the results of Q1 through Q3 2019 households' savings and loan debt were growing faster than incomes.**

Loan debt was equal to 39% and 65% relative to households' cash incomes in January through September 2019 and wages volumes, respectively. (It is worthwhile to compare loan debt not only with incomes, but also with wages as the main source of payments to banks.) As of October 1, 2018, relevant indicators were equal to 34% and 58%, respectively (*Fig. 1*).<sup>4</sup>

1 The volume and pattern of households' cash incomes across the sources of revenues, updated information (new methodology) as of October 23, 2019 // Rosstat <https://www.gks.ru/folder/13397>

2 The Russian Economy in 2018. Trends and Outlooks. (Issue No. 40) / [V. Mau and other; edited by Sinelnikov-Murylev, Doctor of Economic Sciences (editor-in-chief), A.D. Radygin, Doctor of Economic Sciences]; Gaidar Institute for Economic Policy. Moscow. Gaidar Institute Publishers, 2019. 656 pages. P. 333.

3 The banking sector's data. The data on funds placed and borrowed / The Central Bank of Russia <https://cbr.ru/statistics/pdks/sors/>

4 Households' cash incomes have been calculated by Rosstat according to the new methodology since 2013; for this reason, we do not provide data on the earlier period, but correlation between loans and incomes was lower then.

While mortgage lending in January through September 2019 (Rb2 trillion) remained below the relevant index of the previous year (Fig. 2), consumer lending with mortgage loans not counted in amounted to Rb8,1 trillion. So, **consumer loans are the main driver of retail lending growth.**

**The role of lending in consumption** can be illustrated by correlation between consumer loans extended to individuals in January-September and households' incomes, wages and retail trade volumes over Q1 through Q3, 2019. On one side, in January through September 2019 consumer lending was equal to 18.5%, 31% and 33.5% of incomes, wages and retail trade volumes, respectively. On the other side, households pay simultaneously on the earlier received consumer loans which reduce their consumer potential. Over the period from the beginning of the year, out of Rb8.1 trillion worth of newly received loans households' debt on such loans to banks picked up by Rb1.3 trillion. Ultimately, net consumption growth on the back of consumer lending in January through September 2019 was equal to Rb6.8 trillion or 15.5% of incomes.

It is noteworthy that **a major factor of lending growth in 2018 was a decline in interest rates on loans**, making them available to broader groups of the population: the cost of loan servicing and the amount of monthly payments decreased. Further, in some cases **borrowers of the previous years were refinanced at more favorable lower interest rates.** By the Sberbank's estimates<sup>1</sup>, 17% of mortgage loans and 14% of consumer loans were refinanced in 2018. After a rise in H1 2019, mortgage rates started to decline again following the rate of inflation and the Central Bank of Russia's key rate. Thus, the effect of refinancing on the statistics on loans issued should not be excluded in 2019, either. ▀

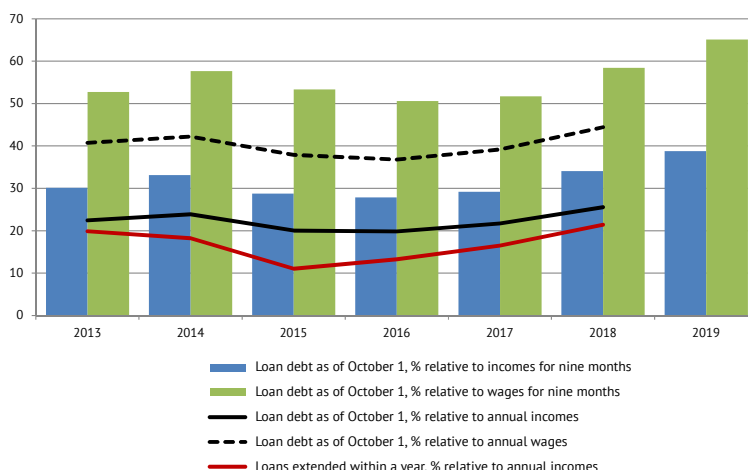


Fig. 1. Correlation of households' loan debt with cash incomes and wages

Source: data of Rosstat and the Central Bank of Russia, own calculations.

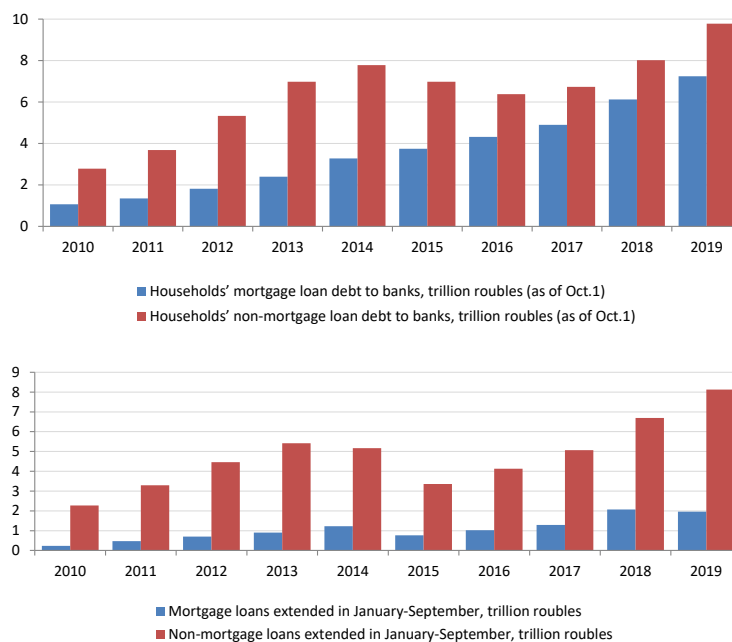


Fig. 2. Households' debt on mortgage and non-mortgage loans and extension of such loans

Source: The Central Bank of Russia's data.

1 Is there a bubble on the consumer lending market? / SberDannye. August 2019.

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