

# 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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# 1. THE MONITORING OF THE SPREAD OF THE CORONAVIRUS PANDEMIC AND ANTI-COVID-19 MEASURES IN JULY-AUGUST 2021

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*In July-August 2021, a rise in coronavirus cases worldwide was related to high incidence of coronavirus variants and a high holidaymaking season. Russia succeeded in overcoming the negative trend seen early in summer – the incidence rate was gradually declining. However, the vaccination rates and scope remain insufficient enough to prevent new possible outbreaks of the disease; numerous experts predict the fourth wave of the pandemic in the early-mid autumn.*

## The COVID-19 current situation worldwide

### **Incidence rate**

In July-August, the incidence rate kept growing (in July the WHO declared the onset of the pandemic's third wave), while by the beginning of September its rates stabilized at the level of about 4.5 mn new cases per week. If in April-May the incidence rate stood at 800,000–900,000 persons per day with a subsequent decline to 300,000–400,000 persons per day in mid-summer, in August a negative trend emerged again. The number of new cases exceeded by a large 600,000 cases rising up to 860,000 cases (on August 13 and August 20). In many countries (Europe and North America), the prevalence rate  $R_t$  surpassed 1 (Fig. 1).

As of September 1, 2021, the number of COVID-19 cases worldwide was equal to 218.56 mn persons (for comparison: 183.07 mn as of July 1, 2021), while the number of deaths, to 4.5 mn persons (about 3.96 mn persons as of July 1). Overall, 18.6 mn persons remained ill worldwide (an increase of 11.475 mn persons as compared to July 1) and over 195.3 mn persons recovered.

At the same time, owing to the widespread incidence of new coronavirus variants with vaccines probably becoming less effective, Israel, one of the world's leaders as regards the rates of vaccination, reported the maximum number of new cases since the outbreak of the pandemic. The situation in the US is quite difficult: as of August 31, the US accounted for over 25.6% of new cases. India accounted for 7% of new cases, while the UK, Iran, Brazil, Turkey and Malaysia, for about 3–5%. Russia is rated the 4<sup>th</sup> as regards the total number of cases (Fig. 2).

### **Case fatality dynamics**

The case fatality rate increased, too: if in June it fluctuated within the range of 6,000–10,000 per day, by the end of August it exceeded now and then 11,000 (the peak values of December 2020 used to surpass 17,000 per day). The largest number of coronavirus deaths a day (1,232 deaths on August 31) was registered in the US followed by Brazil (882), Russia (795), as well as Iran, Indonesia, India and South Africa (Fig. 3). Russia's coronavirus fatality rate rose to 2.88% by August 31.

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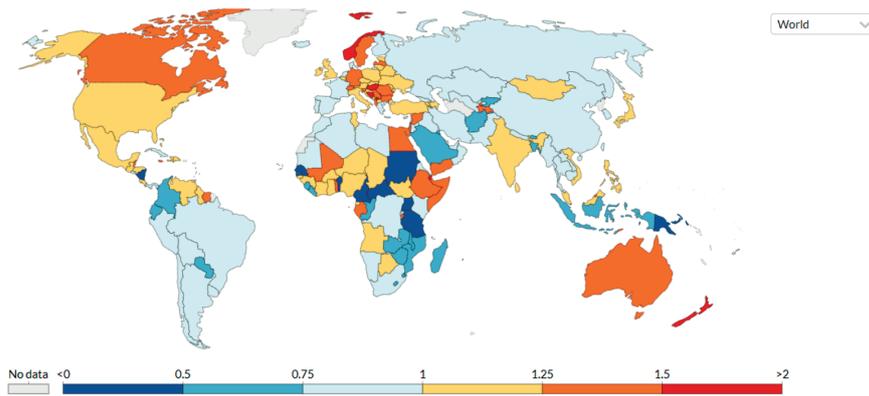


Fig. 1.  $R_t$  estimate across different countries worldwide

Source: Ourworldindata, August 29, 2021.

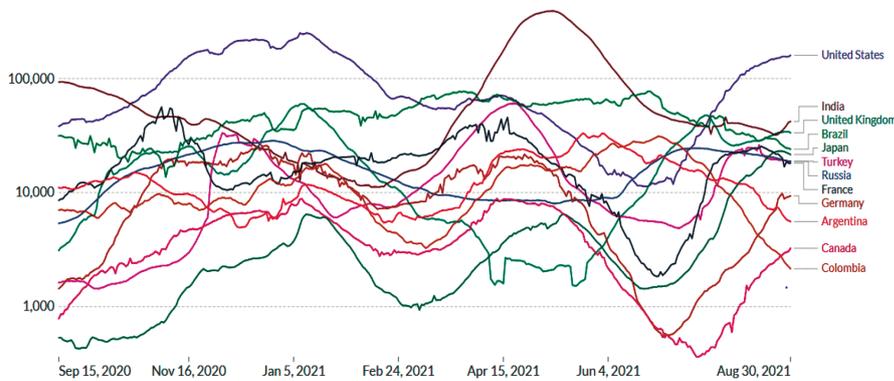


Fig. 2. The trajectories of new cases across different countries (log scale), moving average per week

Source: ECDC.

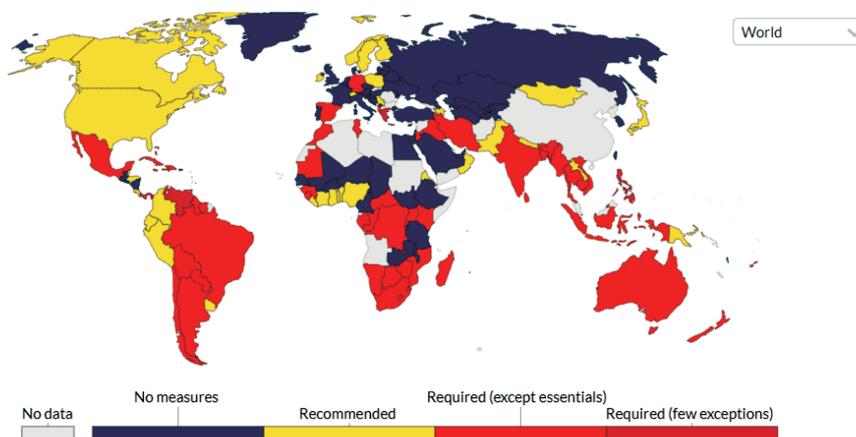


Fig. 3. Dynamics of deaths per day across countries, smoothed value over week

Source: OurWorldInData.

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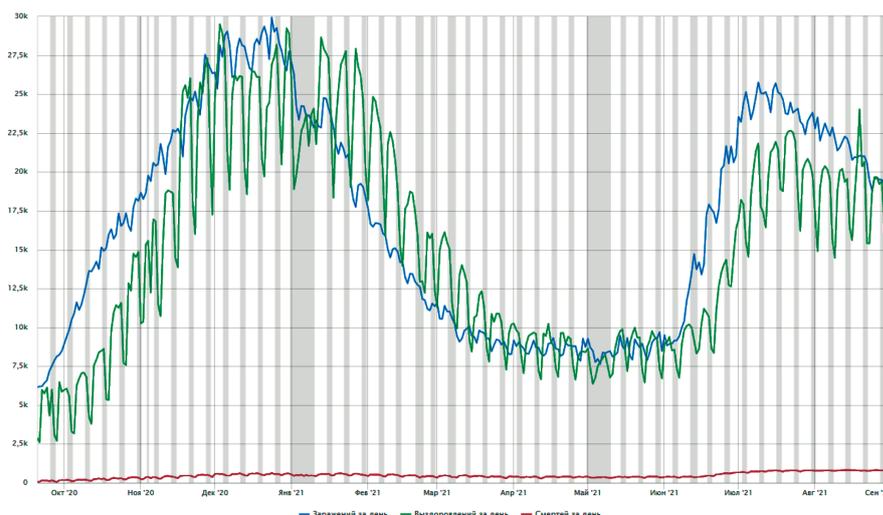


Fig. 4. Strictness of quarantine measures – a self-isolation requirement

Source: OurWorldInData, August 31, 2021.

## Policies

As of the end of August, the situation with restrictions was not homogeneous in different countries. Stricter measures were introduced in Latin America, India and Australia (Fig. 4).

A number of countries introduced consistently tougher restrictions: on the back of worsening of the epidemic situation, Japan extended the emergency zone to its eight prefectures and Australia renewed lockdowns.

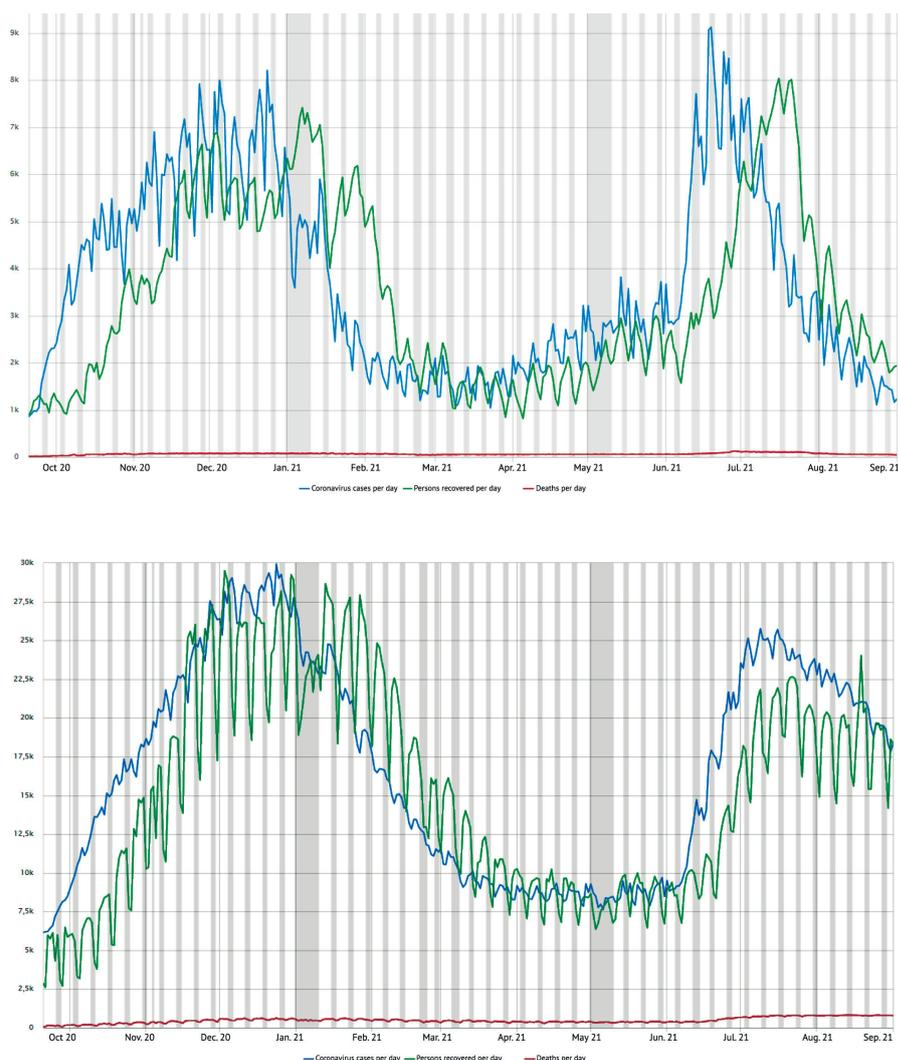
On the contrary, some countries eased the restrictions, but kept promoting vaccination and revaccination of the population. The UK lifted requirements to observe social distancing and wear face masks. After the EU declared that they had attained a 70% vaccination threshold, some countries (for example, Denmark) intended to lift all existing bans. Germany expanded the practice of applying restrictions in respect of people who had no vaccination certificate to avoid a new lockdown. Similarly, France and Italy extended the scope of the certificate (a sanitary pass) to restaurants, shopping centers, hospitals and air and railway service. In Greece, a vaccination certificate or PCR test are required for travelling between the country's mainland and the island region. At the same time, the EU restricted travels to countries with unfavorable epidemic situation, including the US and Israel.

## The current COVID-19 situation in Russia

As of September 2, 2021, Russia registered 6,956,318 coronavirus cases (a 25.6% increase since July 1, 2021). In August, average daily growth in the number of cases decreased by 15.8% as compared to July. The prevalence rate  $R_t$  is comparable with the values seen in May and amounts to 0.94 (0.99 on average in July and August), which is the evidence of slowdown of the spread of the disease.

In the period under review, Russia saw a gradual decrease in the rate of COVID-19 cases (Fig. 5) owing to the subsidence of the earlier begun epidemiological surge, growth in the number of vaccinated persons and a breakup in possible virus transmission chains because of the holidaymaking season. Though the incidence rate decreased, the share of active cases kept

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**Note.** Weekends and public holidays are shown in grey.

*Fig. 5. The number of new coronavirus cases, persons recovered and deaths in the second and third waves in Russia (upper fig.) and in Moscow (lower fig.)*

Source: Yandex, as of September 9, 2021.

growing up to mid-August (8% of the overall number or 553,500 persons): the number of new cases surpassed the number of those who recovered.

As of the end of August, the rate of COVID-19 cases was growing in eight regions and declining steadily in 47 regions, while in 30 regions it stabilized (*Fig. 6*). At the same time, the Rospotrebnadzor expects a seasonal spike in the incidence rate in the second decade of September.

The death rate remains steadily at a high level, probably, owing to new variants' high viral load. In August, the index of the number of coronavirus deaths renewed its maximum throughout the pandemic (+820 deaths per day on August 26).

Moscow saw a decrease in the number of hospitalizations and growing release in hospital bed capacities on the back of reduction in the number of new patients. However, as of the end of August the situation with bed capacities in various regions was not homogeneous: 34.8% in the Irkutsk Region, 29% in St. Petersburg and 16.3% in the Perm Region.

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Region	Number of new cases by day	Total number of	Coronavirus cases per 100,000	Total deaths	Total deaths per 100,000 persons
Moscow		1 570 631	12558.5	27 543	220.2
St. Petersburg		578 985	10818.2	20 654	385.9
Moscow Region		423 440	5643.3	7 817	104.2
Nizhny Novgorod Region		156 848	4848.8	5 895	182.2
Rostov Region		125 365	2970.4	6 043	143.2
Sverdlovsk Region		124 616	2881.1	5 262	121.7
Voronezh Region		119 493	5120.2	4 038	173.0
Krasnoyarsk Territory		105 907	3681.8	5 196	180.6
Irkutsk Region		98 553	4099.2	4 460	185.5
Samara Region		91 088	2852.3	3 272	102.5

Fig. 6. Russia's top 10 regions as regards the number of coronavirus cases

Source: Yandex, as of September 2, 2021.

## Anti-COVID-19 measures in Russia

In July-August, Russian regions started to ease gradually restrictive measures owing to the stabilization of the epidemiological situation. Face-mask requirements and social distancing were still to be observed. Most regions still maintained the self-isolation regime for people aged 65+ and high-risk groups.

After the incidence rate declined and the authorities stepped up the campaign on vaccination of individual groups of the population, restrictive measures were eased in Moscow and the Moscow Region. From July 19, 2021, they cancelled QR-codes for visits to restaurants and from August 13 the requirement to transfer a portion of employees to remote work. Regions expanded the list of leisure and recreation services which were allowed to reopen. The Moscow Region allowed to increase the number of participants in entertainment events for which QR codes were not needed.

In the past six months (in the period till September 2), 2.4 mn persons officially recovered from the coronavirus in Russia, while 37.4 mn persons received two jabs with 90% of those vaccinated developing antibodies, that is, by rough estimate, at least 36 mn people immune to the coronavirus by the beginning of the autumn (24.62% of the population).

After QR-codes for visiting public places were cancelled and the policy of mandatory vaccination was mitigated in other regions, the rates of vaccination returned virtually to the level seen early in summer (Fig. 7). It is noteworthy that even such regions as Moscow, the Moscow Region<sup>1</sup> and St. Petersburg<sup>2</sup> turned out to be incapable of complying with the federal government's and the Rospotrebnadzor's guidelines for vaccination of 60% of the population.

The general public's strong negative approach to vaccination made even worse by the authorities' conflicting signals do not facilitate the development of herd immunity (which should be over the earlier declared 60% in order to be resistant to the Delta variant). As per the data of the Levada-Center, late in July 55% of the population<sup>3</sup> were not prepared to get vaccinated; 52% – late

1 URL: <https://tass.ru/obschestvo/12269621>

2 URL: <https://www.fontanka.ru/2021/09/01/70112354/>

3 URL: <https://www.levada.ru/2021/08/09/vaktsinatsiya/>

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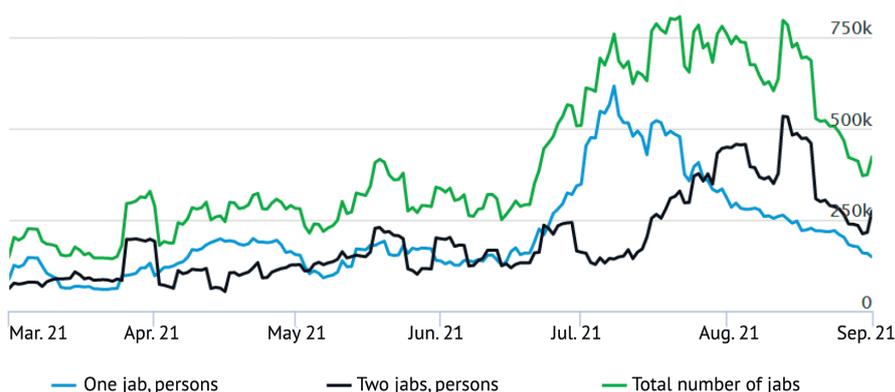


Fig. 7. Rates of vaccination, persons per day, 7-day moving average

Source: vaccination statistics Gogov.ru, 02.09.2021. (URL: <https://gogov.ru/articles/covid-v-stats>)

in August.<sup>1</sup> With the abovementioned factors taken into account, 50–55% of the population are likely to be vaccinated by the end of the year.

Russian regions orientated on domestic tourism introduced additional restrictions. Travelers arriving in the Krasnodar territory without vaccination certificates were required to get vaccinated within three days. In the city of Sevastopol, tourists were temporarily denied hotel accommodation unless they had a vaccination certificate or proof of antibodies.

To speed up the rates of vaccination, federal and regional programs were initiated to promote vaccination.

Russia opened up borders and resumed air service with a number of countries (France, the Czech Republic, South Korea and other).

### Forecasts of further development of the COVID-19 situation

According to the IHME forecast<sup>2</sup>, with hitting its peak early in August the fatality rate has been gradually declining since mid-August and is expected to keep subsiding in the near-term. By mid-September, the number of death cases is predicted to fall to the level of April-May 2021.

In the long run, the prospect of further development of the situation is not quite obvious: some experts believe that Russia may face a new wave in October (because of the insufficient number of vaccinated persons, while the summer wave was mitigated owing to the holidaymaking season), while others say that the statistics does not take into account a large number of persons who recovered from COVID-19 without seeing a doctor, so that the actual share of persons immune to the disease may turn out to be sufficient enough to resist effectively new coronavirus variants. ▀

1 URL: <https://novayagazeta.ru/articles/2021/09/01/vlast-i-narod-na-sotsialnoi-distantcii>

2 URL: <https://tinyurl.com/y47sbc5y>

## 2. THE FEDERAL BUDGET EXECUTION IN H1 2021: REVENUES EXCEEDED PRE-PANDEMIC LEVEL

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*According to the results of H1 2021, the federal budget revenues exceeded the level of 2019, hitting 20.9% of GDP. The main contribution to this outcome was made by an increase in VAT receipts, primarily due to an increase in the consumption of non-food products with a slight increase in the consumption of food products (measured in terms of physical volumes of retail turnover).*

The federal budget revenues for January-June 2021 increased as compared to the same period in 2019 (by 2.3 p.p. of GDP, or by Rb1,715.9 bn) (Table 1), and compared to 6 months of 2020 (by 2.1 p.p. of GDP, or by Rb2173.9 bn). Cash execution of revenues in the first half of this year amounted to 60% relative to the projected annual volumes, including oil and gas revenues – 63.1% and non-oil and gas revenues – 58.6%.

The volume of oil and gas revenues for 6 months of 2021 amounted to 7.2% of GDP, or Rb3,898.8 bn, in real terms has not yet reached the level of revenues for January-June 2019: the difference was (-)Rb685.3 bn. At the same time, compared to H1 2020, the dynamic is positive: the growth amounted to Rb1,379.3 bn, or 2 p.p. of GDP.

The volume of additional oil and gas revenues for H1 2021 amounted to Rb851.4 bn with an average oil price of \$63.3/bbl against Rb39.6 bn for 6 months of the previous year, with an average oil price of \$39.7/bbl.<sup>1</sup>

Non-oil and gas revenues of the federal budget for 6 months of 2021 increased both relative to the same pre-pandemic period in 2019 prices by Rb1,497.5 bn, and compared to 6 months of 2020 by Rb894.6 bn, or 0.1 p.p. of GDP. The growth of tax non-oil and gas revenues amounted to Rb790.7 bn in real terms compared to January-June 2019 and Rb1,297.1 bn, or 1.4 p.p. of GDP by 6 months of 2020.

The main contribution to the increase in non-oil and gas revenues was made by the increase in VAT receipts, which is due to the recovery of consumption. In particular, the operational data of Rosstat demonstrate an increase in retail turnover in comparable prices in H1 2021 compared to the same period of 2019 in the amount of around 4%. At the same time, the retail turnover of food products, among which a significant share of goods taxed at a preferential VAT rate, increased by less than 1% in physical terms. The retail turnover of non-food products increased by around 7% in constant prices. In addition, non-food products include durable goods, the pent-up demand for them also contributed to an increase in the consumption of non-food products.

1 With the adjustment for excise reimbursement.

Table 1

## The federal budget execution for 6 months of 2020 and 2021

	January-June 2019		January-June 2020		January-June 2021		Change, 2021 against 2019		
	Rb bn	% GDP	Rb bn	% GDP	Rb bn	% GDP	Rb bn	Rb bn (in 2019 prices)	p.p. of GDP
Revenues, 1 including:	9 549.9	18.7	9 091.9	18.8	11 265.8	20.9	1 715.9	812.2	2.3
- oil and gas, including:	4 269.5	8.4	2 517.5	5.2	3 896.8	7.2	-372.7	-685.3	-1.1
- MET	3 116.9	6.1	1 983.0	4.1	3 014.9	5.6	-102.0	-343.8	-0.5
- export duties	1 152.6	2.3	534.5	1.1	881.9	1.6	-270.7	-341.5	-0.6
- non-oil and gas revenues, including:	5 280.4	10.3	6 574.4	13.6	7 369.0	13.7	2 088.6	1 497.5	3.4
- corporate income tax	585.8	1.1	536.8	1.1	636.7	1.2	50.9	-0.2	0.0
- VAT on goods sold in RF	2 059.6	4.0	2 078.6	4.3	2 651.0	4.9	591.4	378.8	0.9
- VAT on goods imported to RF	1 299.2	2.5	1 255.1	2.6	1 730.4	3.2	431.2	292.4	0.7
- excises on goods sold in RF 2	380.1	0.7	466.7	1.0	487.4	0.9	107.3	68.2	0.2
- import customs duties	335.9	0.7	292.4	0.6	421.2	0.8	85.3	51.5	0.1
- other revenues	619.8	1.2	1944.8	4.0	1442.3	2.7	822.5	706.8	1.5
Expenditure, including:	7 854.1	15.4	9 915.0	20.5	10 491.1	19.5	2 637.0	1 795.5	4.1
- interest	356.4	0.7	349.7	0.7	506.1	0.9	149.7	109.1	0.2
- non-interest	7 497.7	14.7	9 565.3	19.8	9 985.0	18.6	2 487.3	1 686.4	3.9
Surplus (deficit) of budget	1 695.8	3.3	-823.1	-1.7	774.7	1.4	-921.1	-983.2	-1.9
Non-oil and gas deficit	-2 573.7	-5.0	-3 340.6	-6.9	-3 122.1	-5.8	-548.4	-298.0	-0.8
GDP (in current prices), Rb bn	51 120		48 419		53 800				

Sources: Ministry of Finance, Federal treasury, own calculations, GDP for Q22021 – own estimates.

The federal budget expenditures in H1 2021 compared to the same period of the previous year increased by Rb576.1 bn, but as a share of GDP decreased by 1.0 p.p. (Table 2) with a comparable level of cash execution of about 45% of the approved annual volume.

The structure of the expenditure part of the federal budget has also undergone changes. The volume of budget allocations under the “national economy” section increased by 0.6 p.p. of GDP, directed to further support of production and the financial sector. Expenditures under the section “social policy” decreased by 0.9 p.p. of GDP. There is also a decrease in the volume of financing under the “inter-budget transfers” section by 0.6 p.p. of GDP, which is due to the low rate of disbursement of funds, which amounted (as a percentage of the approved annual volume) to 45.2% for 6 months of 2021 against 60.8% for 6 months of 2020.

The growth rate of federal budget revenues for the 6 months of 2021 is ahead of the dynamics of expenditures, which allowed us to increase the budget surplus to Rb747.7 bn against the negative balance of budget execution for the 6 months of 2020 in the amount of (-)Rb823.1 bn.

Despite the positive balance of budget execution, borrowings in the domestic market are not reduced, they amounted to Rb1,536.0 bn for 6 months of 2021 (41.9% of the approved annual volume) against Rb1,612.6 bn for 6 months of 2020. The volume of funds allocated to repay domestic borrowings in the first half of this year amounted to Rb262 bn, or 26.6% of the approved annual volume

1 With the adjustment for excise reimbursement.

2 In 2019 and 2021 without the adjustment for (negative value) excises on petroleum feedstock, targeted at refining.

## 2. The federal budget execution in H1 2021: revenues exceeded pre-pandemic level

Table 2

### The federal budget expenditure over 6 months of 2020 and 2021

	January-June 2020		January-June 2021		Change, 2021 on 2020	
	Rb bn	% GDP	Rb bn	% GDP	Rb bn	p.p. GDP
Expenditure total, including:	9915.0	20.5	10491.1	19.5	576.1	-1.0
Nationwide Issues	647.9	1.3	719.0	1.3	71.1	0.0
National Defense	1514.8	3.1	1522.5	2.8	7.7	-0.3
National Security and Law Enforcement	948.7	2.0	994.0	1.8	45.3	-0.1
National Economy	1045.5	2.2	1507.5	2.8	462.0	0.6
Housing and Utilities	155.6	0.3	255.2	0.5	99.6	0.2
Environmental Protection	124.0	0.3	215.9	0.4	91.9	0.1
Education	448.1	0.9	535.5	1.0	87.4	0.1
Healthcare	654.8	1.4	573.0	1.1	-81.8	-0.3
Social Policy	3194.8	6.6	3046.4	5.7	-148.4	-0.9
Public Debt Servicing	349.7	0.7	506.1	0.9	156.4	0.2
Intergovernmental fiscal transfers	710.4	1.5	490.9	0.9	-219.5	-0.6
Other expenses	120.7	0.2	125.1	0.2	4.4	0.0

Sources: Federal Treasury, own calculations.

(for the same period in 2020 – Rb516.5 bn, 88.3% of the approved annual volume). The volume of funds raised on the foreign market for 6 months of 2021 amounted to Rb134.2 bn, or 61.8% of the annual volumes. The strengthening of the ruble, which began in the spring of this year, led to a decrease in the value of foreign currency assets; thus, the exchange rate difference, taken into account as sources of repayment of the budget deficit, amounted to Rb354.7 bn.

The volume of the National Welfare Fund in ruble equivalent increased by Rb28.9 bn in the first 6 months of this year and amounted to Rb13.574 trillion as of July 1, 2021.

The increase in federal budget revenues is associated with significant VAT receipts. This, in turn, is due to an increase in household consumption, mainly due to non-food products and with a slight increase in food consumption (measured in terms of physical volumes of retail turnover). This kind of dynamic indirectly indicates that the demand for durable goods, delayed due to the pandemic, is behind the increase in consumption. In this case, the main factor of growth in federal budget revenues may be exhausted by 2022. 

### 3. REGIONAL BUDGETS IN H1 2021: INCOME GROWTH

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*According to data for H1 2021, own tax and non-tax revenues of the consolidated budgets of RF subjects recovered after their fall in 2020 and showed an increase, compared to the same period in 2019. The structure of expenditures of regional consolidated budgets changed in 2021 compared with their pre-pandemic structure, indicating changing priorities of territorial budget policy. The rapid growth of own tax and non-tax revenues in H1 2021 reduced the territorial debt burden to the lowest level for this period since 2009.*

#### Revenues

According to results of the consolidated budget execution by RF subjects in H1 2021, total revenues amounted to Rb7.51 trillion, having increased by 18.6% compared to the same period in 2020. However, the regions' own tax and non-tax revenues increased by 23.6%, while inter-budgetary transfers from other budgets remained practically unchanged (+0.1%).

These results can be explained by their low base in H1 2020, marked by low growth rates of regions' own revenues in their consolidated budgets (-7.2% to H1 2019) and growth in transfers (+57%) due to the impact of the crisis, caused by the spread of COVID-19, as well as by restrictive measures of the federal government. Relative to H1 2019, revenues of regional and local budgets increased by 21.1%, including tax and non-tax revenues, i.e. by 14.7%; transfers from other budgets grew by 57.2%.

Primary sources of revenues of regional and local budgets showed the following growth dynamics in H1 2021, compared to the same period in 2020 and 2019: corporate income tax (+31.5 and +13.2%, respectively), PIT (+17.8 and +17.6%), excise taxes (+19.9 and +23.7%), tax levied in connection with simplified taxation (+56.9 and +38.7%), property taxes (+11.9 and +3.9%), non-tax revenues (+19.5 and +2.4%), grants (-32.3 and +11.1%), subsidies (+50.1 and +172.9%), subventions (+12.0 and +41.5%) and other intergovernmental fiscal transfers (32.1 and 98.3%). Thus, despite the ongoing pandemic, the revenues of the consolidated budgets of RF subjects exceeded not only the level of the crisis year 2020 (except for grants) in regard to their main components, but also the level of a prosperous 2019 (for all components). Positive growth rates were typical for both nominal and real income.<sup>1</sup>

In most subjects of the Russian Federation (79) income growth rates of consolidated budgets were positive in H1 2021, and in three regions, they exceeded 40%: in Nenets Autonomous okrug (+52,5%), Lipetsk (+51,2%) and Samara regions (+46,0%). Respective revenues failed to reach their 2020 level only in six regions, with three located in the Far Eastern federal okrug, which showed the lowest revenue growth rate in the regional consolidated budget (+4.2%) among federal okrugs. Negative results of the six regions (except for

<sup>1</sup> The consumer price index grew 106.50% in June 2021 compared to June 2020 and 110% to June 2019.

### 3. Regional budgets in H1 2021: Income growth

Sakhalin) are associated with a relatively high base in H1 2020, when growth in these territories significantly outran the average All-Russia level.

Since the major shock of reduction in own tax and non-tax revenues of regional budgets in 2020 fell on H1, their growth rates are expected to slow down in H2 2021. Nevertheless, it can be expected by the end of the year that double-digit growth rates of regional and local budget revenues will remain.

#### Expenditures

In H1 2021, expenditures of regional consolidated budgets amounted to Rb7.06 trillion, having increased by 7.9% against the same period in 2020, that is, slightly higher than the inflation rate and significantly lower than the growth rate of budget revenues.

After the implementation of many anti-crisis fiscal policy measures, one might expect a return in 2021 to the level of 2019. This is partly what happened: health care expenditures in H1 2020 grew by 84.8% (growth of all expenditures at that time was 18.9%) and fell in one year by 14.1%.

However, on the whole, if we consider the overall deviation of the spending structure from the base year as the total of the absolute value of deviations in the structure of spending by subsection of the budget classification, the results of regional consolidated budget execution in H1 2021 differ from the same period of 2019 more significantly than in H1 2020,<sup>1</sup> i.e. there is more change in the structure of spending in 2021 compared to the pre-crisis period. Moreover, the change is obvious when compared with the spending structure on average for the period 2013–2019.

Thus, the pandemic resulted in a temporary change in the spending structure of regional and local budgets and also influenced longer-term budget policy priorities.

Major growth occurred in expenditures on transport (+41.6%), road facilities (+22.0%), housing and communal services (+13.8%), general education (+14.3%), family and childhood protection (+59.8%) and physical education and sports (+12.6%) among the largest consolidated regional budgets in H1 2021, compared to the same period in 2020. There was reduction in spending not only for health care but also for nation-wide concerns (-2.0%), agriculture and fishery (-8.2%) and social services for households (-5.2%). Thus, regional budgetary policy changed in the direction of development of regional human capital and infrastructure.

Expenditures of the consolidated budgets increased in 78 RF subjects, and growth exceeded inflation in 53 during the period under consideration. Among federal okrugs, the North Caucasus led in growth of budget expenditures (+16.1%), but budget expenditures for all regions grew faster than inflation.

#### Regional budget balance and public debt

The total public debt of RF subjects grew by 17.4% by the end of H1 2021, compared to the same period of 2020, reaching a record Rb 2.51 trillion. However, even faster growth of own tax and non-tax revenues of regional budgets (+24.5% excluding local budgets) resulted in a slight reduction of the debt load<sup>2</sup> from 23.4 to 21%, which is their lowest level since 2009 (Fig. 1).

1 The total absolute value of deviations in the spending structure by subsection of the budget classification system changed by 14.1 and 17.7% in H1 2020 and 2021, respectively, from the structure in H1 2019.

2 Debt load of a subject is defined as a ratio of the public debt size to the size of tax and non-tax revenues of the budget of the RF subject.

## Monitoring of Russia's Economic Outlook

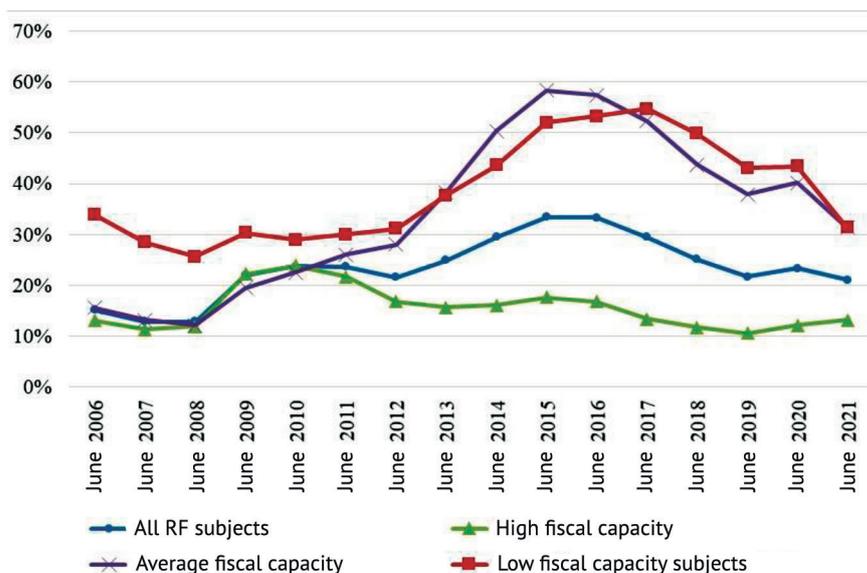


Fig. 1. Assessment of Regional Debt by fiscal capacity (June): The ratio of RF subjects' public debt categorized by fiscal capacity to tax and non-tax budget revenues (subjects' debt load), %

Source: own calculations according to data provided by Ministry of Finance and Federal Treasury.

The debt load decreased most significantly in regions with average and low fiscal capacity,<sup>1</sup> but in those regions, it still exceeds the average Russian level (31.3% and 31.4% respectively). A high level of public debt, exceeding 100% of regional tax and non-tax revenues, remains only in the Republic of Mordovia (145.3%).

Public debt increased in 45 RF subjects and the debt load in 9 subjects in the period from July 1, 2020 to July 1, 2021.

The dynamics of the regions' public debt structure over the past twelve months largely repeated the dynamics of previous years: the share of budget loans decreased slightly to 46%, while the share of loans from lending institutions fell to 17.2% and state guarantees to 1.5%. However, the share of state securities increased significantly to 35%.

The rapid growth of own tax and non-tax revenues of regional budgets in H1 2020 neutralized the growth of the total regional public debt and for debt servicing at 8.7%, and it did not go far beyond the overall growth of budget spending. Thus, the regional debt situation remains under control. There is only one region exceeding the maximum permissible debt load (100% of tax and non-tax revenues), which weakens the need for exclusive measures aimed at provision of additional financial support to regions in particular need. A gradual reduction in the volume of commercial borrowing should be expected by the end of fiscal year and their replacement with budget loans, which in the long term will make it possible to compensate for the growth of interest rates in the economy and restrain the growth of spending for servicing regional debt. ▀

<sup>1</sup> Fiscal capacity of the RF subject is determined according to the methodology approved by the RF Government Resolution of 22.11.2004 No. 670 "On the distribution of subsidies to equalize fiscal capacity of RF subjects." It shall be assumed that (16) subjects of the Russian Federation are considered to be high incomes regions with estimated fiscal capacity exceeding 1.0 according to calculations for 2021, 41 RF subjects have average incomes with estimated fiscal capacity for 2021 prior to distribution of equalizing subsidies from 0.6 to 1.0, and 28 RF subjects are low-income regions with estimated fiscal capacity for 2021 below 0.6.

## 4. THE BANKING SECTOR'S FINANCIAL PERFORMANCE IN JANUARY-JULY 2021: PROFIT GROWTH

**Sergei Zubov**, Candidate of Economic Sciences, Senior Researcher, the Structural Studies Department, IAES RANEPА

*In January-August 2021, the banking sector's profit hit the record-high of Rb1.4 trillion on the back of a pickup in lending volumes and simultaneous reduction in loan-loss provisions. Growth in revenues from commission operations owing to increased income from settlement and cash services and intermediary services on the financial market had a positive impact on the consolidated financial result.*

In January-July, 2021, the banking sector's profit amounted to Rb1428 bn, an increase of Rb453.3 bn or 46.5% on the relevant index of 2020 (Rb974.7 bn as of August 1, 2021). As of August 1, 2021, in Russia there were 340 banking and credit institutions of which 249 institutions (73.2%) reported positive financial results. Banking profit growth surpassed the banking sector's assets and equity capital growth. So, return on assets was equal to 2.1% (1.9% a year before) and return on equity, to 19.8% (16.8% a year before).

Based on the H1 2021 results, the top-5 most profitable credit institutions included the same banks as a year ago: the Sberbank (47.5% of the banking sector's overall profit against 53% a year ago), the VTB (12.5% against 7%), the Alfa-Bank (6.5% against 8.1%), the Gazprombank (5.5% against 2%) and the FK Otkrytie (4.1% against 3.6%). The share of the top-5 most profitable banks in the banking sector's overall profit was equal to 76.1% (73.8% a year before).

In the past few years, amid structural liquidity surplus and low interest rates, banks' strategy was aimed at the expansion of loan offer and simultaneous optimization of borrowings' interest expenses. From the beginning of 2020, as market interest rates were declining and despite the fact that banks stepped up their activities on the money market owing largely to the Russian Central Bank's stimulus measures (concessional lending, easing of reserve requirements), credit institutions' overall interest income stagnated as seen in *Fig. 1*. However, during the pandemic banks managed to adapt themselves quickly to new conditions and even build up considerably net profit income<sup>1</sup>, primarily, by means of reducing interest expenses on deposits even though interest income from loans and other active banking operations decreased.

In Q1 2021, the banking sector's overall interest income amounted to Rb1,509.1 bn, the minimum one in the past three years. However, as pro-inflationary risks increased banks raised interest rates on loans. It happened partially on the back of growth in the Central Bank of Russia's key rate which led in its turn to soaring floating rates (mainly on corporate loans). As a result, in H2

<sup>1</sup> Net interest income is the difference between the bank's all interest income from extended loans (including interest income from investments in bonds and bills of exchange and promissory notes) and the bank's all interest expenses from attracted loans, deposits, customer account balances, as well as issued bills of exchange and bonds.

## Monitoring of Russia's Economic Outlook

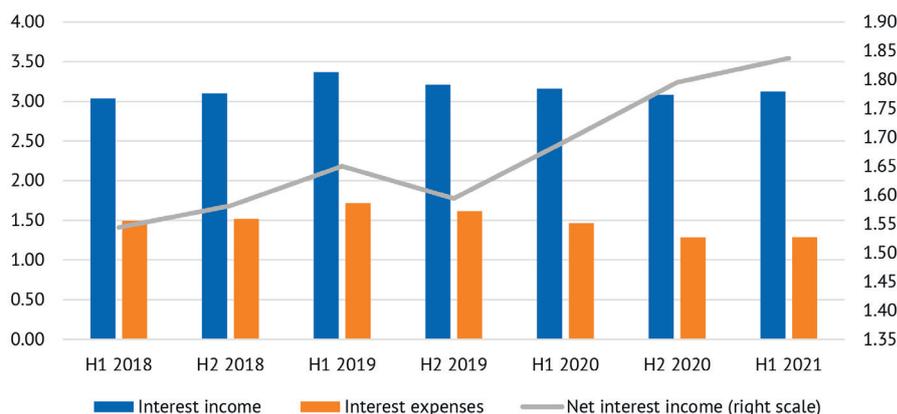


Fig. 1. Bank interest income, interest expenses and net interest income, trillion rubles

Source: Profit and loss statement (Form No. 102) for the January 1, 2019 – July 1, 2021 period / The Central Bank of Russia. URL: [http://www.cbr.ru/banking\\_sector/otchetnost-kreditnykh-organizatsiy/](http://www.cbr.ru/banking_sector/otchetnost-kreditnykh-organizatsiy/), own calculations.

interest income increased up to Rb1,617.1 bn (or 7.2% on H1), top performance since the end of 2019. So, income growth from retail lending was equal to 4.7%, while from lending to non-state business enterprises, to 8.3%.

A pickup in commission income from active banking operations (lending, investment in debt instruments and other placement of funds) became another source which made up for a decrease in interest income on loans. This type of income includes commissions for opening and maintenance of accounts, SMS-notifications, insurance, payments for rates reduction and other types of income. H1 2021 saw a substantial pickup in this type of income up to Rb126.7 bn or by 46.7% (as of July 1, 2020 the income was equal to Rb86.4 bn, while a year-on-year increase, to 11.3%). Commission incomes received from non-state business enterprises and individuals increased by 51.9% and 51.3%, respectively.

In H1 2021, banks' overall income from commission operations (settlement and cash services and brokerage operations on the financial market) amounted to Rb982.3 bn, a 28.1% increase on H1 2020. The most substantial growth in commission income was facilitated by property trust management operations (88.2%), intermediary services on brokerage and similar agreements (58.9%) and consulting and information services (49.7%).

Optimization did not affect costs related to the maintenance of credit institutions' activities. Overall growth in this type of expenses as compared with the mid-2020 turned out to be rather substantial (18.6%). Staff costs increased by 8.7% and operational and administrative costs, by 11.8%. If earlier amid margin narrowing and high risks related with active operations banks had to introduce "cost-conscious" technologies which limited considerably this type of expenses, at present, taking into account high profitability of bank operations, credit institutions lack motivation to save on organizational and administrative costs. At the same time, the expansion of bank operations, penetration into the non-banking business domain and utilization of the *phygital* model<sup>1</sup> may lead to further growth in maintenance costs. It is noteworthy that Russian banks still have a high margin of safety in terms of efficiency of business. Russian

1 A combination of digital innovations with an effective network of bank staff physical presence.

## 4.The Banking Sector's Financial Performance in January-July 2021: Profit Growth

largest banks' CIR<sup>1</sup>, an operating efficiency indicator, points to a high operating performance margin, for example, the Sberbank – 27.9%<sup>2</sup>, the VTB – 33.5%<sup>3</sup> and the Alfa-Bank – 50.2%.<sup>4</sup>

As per the estimate of the Central Bank of Russia<sup>5</sup>, with easing of reserve requirements in respect of restructured loans abandoned, additional reserves worth Rb1.4 trillion would have been required. However, in the past few months as easing of some requirements in the context of anti-crisis measures was cancelled the banking sector started to build up lending volumes and simultaneously reduce the level of allowances for provisions, thus facilitating growth in taxable banking profit. At present, the volume of loan loss provisions formed with IFRS 9 revaluations and adjustments taken into account is equal to Rb6.3 trillion or 8.6% of the volume of outstanding loans (including acquired bills receivables and invested funds). At the same time, as per the data of the Central Bank of Russia, problem loans overdue for over 90 days amount to Rb4.3 trillion. Taking into account the fact that the volume of restructured loans exceeded Rb8 trillion, while the share of prime loans (that is, high-quality loans with no credit risk) on Russian banks' balances is less than 50%, doubts may arise about the adequacy of banks' credit risk assessment methods.

It is worth mentioning that the establishment of reserves is not the only way of managing credit risks. Banks use actively credit-related insurance and various forms of collateral security. During the pandemic, banks stepped up networking with debt collection agencies and have resorted increasingly to their services at the early stages of default of terms. So, with the option of selling or transferring receivables to the outsourcing being available, banks

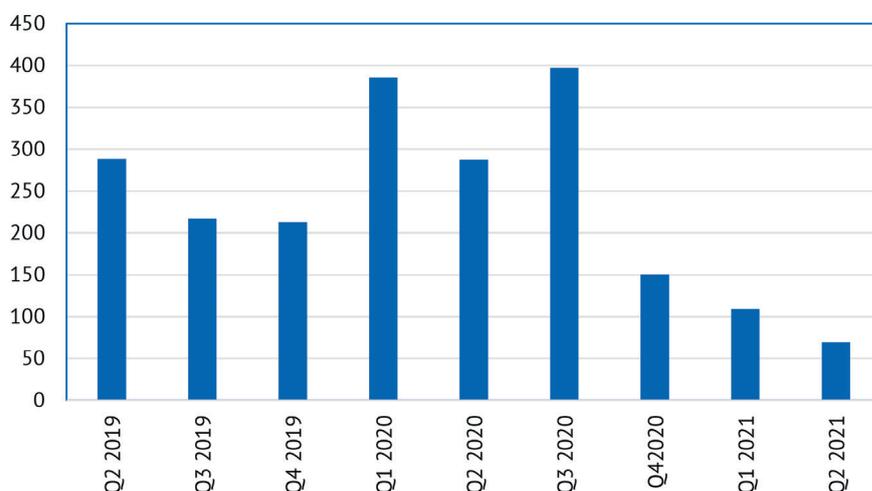


Fig. 2. The volume of net reserves with IFRS 9 adjustments taken into account, billion rubles

Source: Profit and loss statement (Form No. 102) for the January 1, 2019 – July 1, 2021 period / The Central Bank of Russia. URL: [http://www.cbr.ru/banking\\_sector/otchetnost-kreditnykh-organizaciy/](http://www.cbr.ru/banking_sector/otchetnost-kreditnykh-organizaciy/), own calculations.

- 1 CIR (cost-to-income ratio) is the ratio of administrative costs to operating income. Banks always seek to reduce this ratio.
- 2 SberBank releases Financial Highlights for 7 months of 2021 (under RAS, non-consolidated) – SberBank.
- 3 VTB Group announces IFRS results for 1Q 2021 – VTB Group – VTB Bank.
- 4 URL: <https://www.gazprombank.ru/en/press/6415981/>
- 5 URL: <https://cbr.ru/press/event/?id=9697>

## Monitoring of Russia's Economic Outlook

carry out a more aggressive credit policy provided that losses from the sale of debts with a discount are made up for completely by a pickup in income from higher volumes of lending.

In the next few months, the Central Bank of Russia is highly likely to take measures to cool the money market; as a result, banks will probably have to create additional provisions and this will slow down considerable bank profit growth. Unless any serious changes in the existing trends in case of the absence of external shocks take place until the end of the year, banks will stabilize their interest income and keep increasing commission income, while administrative costs continue growing at a moderate rate. So, based on the 2021 results, banks are expected to receive record-high profit of over Rb2 trillion. 

## 5. INDUSTRIAL PRODUCTION DYNAMICS, MAY THROUGH JULY 2021: GROWTH FACTORS<sup>1</sup>

**Andrei Kaukin**, Candidate of Economic Sciences, Head of the Sectoral Market and Infrastructure Department, Gaidar Institute; Head of the Sectoral Market System Analysis Department, IAES RANEPa;

**Evgenia Miller**, Senior Researcher, the Sectoral Market System Analysis Department, IAES RANEPa

*Analysis of trend components of production indices for May through July 2021 suggests that growth factors in trends for the extractive industries since the beginning of 2021 continue to have effect for two reasons: a pickup in demand for power-generating coal on the part of European and Asian countries and an ebbing restrictions related to the OPEC+ agreement, owing to increased quotas on daily oil production volumes in member countries. The manufacturing sector's trend component keeps growing, too, on the back of high prices and active external demand for industry products, which account for a substantial share of production (metallurgy, oil refining and the chemical industry).*

To provide accurate interpretation of trends in individual industries we decompose their output into calendar, seasonal, non-recurrent and trend components<sup>2</sup>; the interpretation of non-recurrent is of particular interest.<sup>3</sup> Experts at the Gaidar Institute and RANEPa cleared seasonal and calendar components from a number of manufacturing industries' indices for 2003–2021 and singled out the trend component<sup>4</sup> based on statistics published by Rosstat on output indices in industrial sectors of the economy.

The resulting series for the industrial production index from 2014 to the present are presented in *Fig. 1*. Shown in *Fig. 2* is the result for aggregate indices of the extractive and manufacturing sectors and production and distribution of electricity, gas and water. The results for the decomposition of other series are presented in *Table 1*.

As noted above,<sup>5</sup> from January through April 2021, the OPEC+ agreement restrained growth in the extractive industries; the trend component of the mineral production index saw positive dynamics on the back of increased demand for coal and gas on the European and Asian markets. Also, the manufacturing sector's trend component picked up, mainly owing to growing

1 The authors express gratitude to M. Turuntseva and T. Gorshkova for assistance in preparing the statistical analysis.

2 "Trend component" is a well-established term in the literature; however, it is noteworthy that this component is not a "trend" in a strict sense and is used in econometrics for analyzing time series: in this particular case, it is the remainder after the time series have been cleared from calendar, seasonal and non-recurrent components. It is incorrect to use the "trend component" for forecasting time series: for most industrial production indices it is time-varying in levels (and time-invariant in differences), but can be used for interpreting short-term dynamics and for comparison with events that have taken place.

3 The effect of measures containing the spread of the coronavirus infection, in particular, the introduction of a regime of non-work days late in April 2020 was included in the non-recurrent component.

4 The trend component was determined using the Demetra package with the X12-ARIMA procedure.

5 A.S. Kaukin, E.M. Miller. Industrial Production Dynamics in March-April 2021 // Russia's Economic Development. 2021. No.6 (28).

global prices of products manufactured by the industries that accounted for a considerable share of Russian industrial production (metallurgy, the chemical and woodworking industries).

From May through July, the trend component in the extractive industries kept growing slowly. The main growth factors for coal mining and gas remained the same: the slow growth in exports of natural gas to Europe because of low replenishment of local underground gas storage facilities (UGSF)<sup>1</sup>; a pickup in exports of power-generating coal to Asian countries (because of China's refusal to import coal from Australia) and Europe (because of a decrease in the price affordability of natural gas, due to growing demand for electricity and a reduction in supplies from Columbia). Further, oil production increased owing to the mitigation of limitations within the framework of the OPEC+ agreement.<sup>2</sup>

Based on results for May through July 2021, the manufacturing sector's trend component saw slow growth. This slow dynamic was mainly caused by the chemical industry, owing largely to the growth of external demand. Export growth followed as a result of recovery of the global economy, particularly, of exports from China, including chlorides, insecticides, herbicides, and amino compounds, and as a result of the price environment on the global market. The domestic market saw negative dynamics on the back of advance purchases of primary products late in 2020 and early in 2021; as a result, large inventories of fertilizers and primary polymers were created and switched over to future periods. Domestic demand is expected to recover in H2 2021 in metallurgy, owing to growth in exports and domestic supplies – a result of appreciation of global prices for metallurgical products) and of expectations of new higher customs duties to be introduced on a wide range of the industry's products. Future output dynamics will depend on the stability of the adopted parameters in the customs legislation (calculation formulae and export duty rates are important factors in formation of producers' expectations), as well as on opportunities to carry out export operations duty-free through the

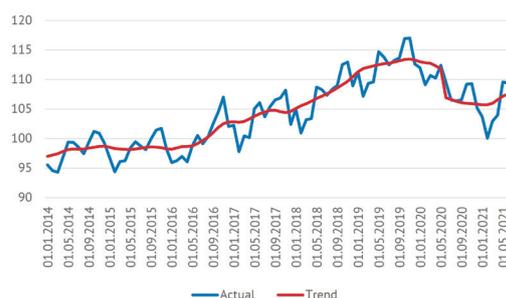


Fig. 1. Industrial Production Index Dynamics, 2014–2021 (actual data and trend component), % change relative to average annual value in 2016

Source: Rosstat, own calculations.

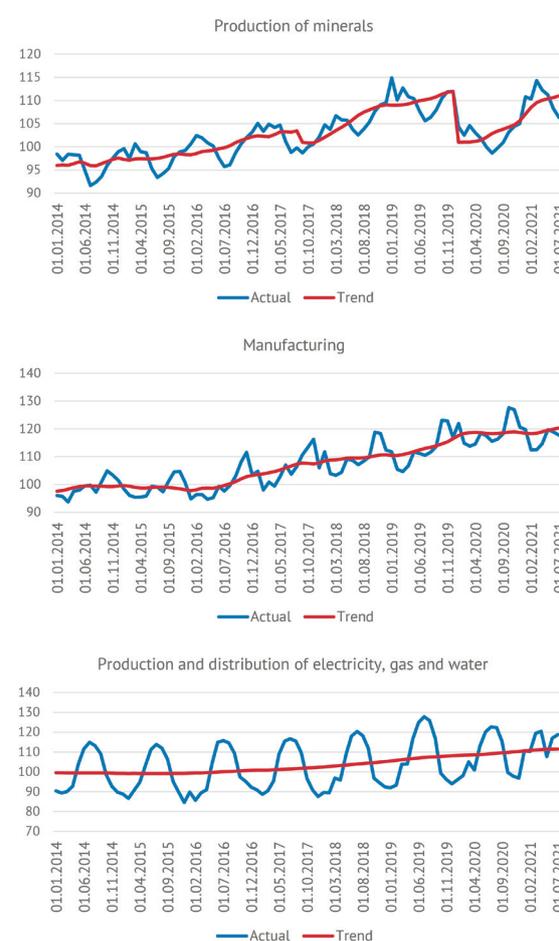


Fig. 2. Production indices' dynamics across sectors, 2014–2021 (actual data and trend component), % change relative to the 2016 annual average value

Source: Rosstat, own calculations.

1 A pickup in demand for Russian natural gas on the part of European countries, particularly, Germany, Italy, Turkey, France, the Netherlands and Poland in Q1 2021 because of heavy snow storms and cold weather led to the low supply at UGSF by Q2 2021.

2 A.S. Kaukin, E.M. Miller. The Oil Market Situation in Q2 2021 // Russia's Economic Development. 2021. No.8 (28).

## 5. Industrial Production Dynamics, May through July 2021: Growth Factors

EEU countries. In engineering, output will grow mainly because of a pickup in the manufacturing of new cars (supply has remained low since the end of 2020 because of enterprise closure during lockdown) and because early in 2021 of a shortage of foreign components – electronics, primarily microcircuits, whose production fell because of the pandemic. A pickup in demand for cars late in H1 2021 was related to appreciation of prices due to increased costs on the back of growth in global prices of steel (the share of metal in the cost of a car is up to 40%). In oil refining, output will grow due to continued recovery of economic activity in Russia.

The dynamics of the trend component of fee-based services to households were still negative, probably because of restrictions in effect in some regions of Russia during the pandemic. The trend component of cargo turnover picked up on the back of export deliveries of fuel and energy primary products, fertilizers and metallurgical products. From results for May through July 2021, wholesale and retail trade grew slowly: wholesale trade mainly owing to slow growth in sales of chemical fertilizers, woodworking products and motor vehicles, and retail trade, due to slow growth in sales of food and textile products.

Therefore, from H1 2021 results, output of the extractive industries and manufacturing increased. Further growth will depend on the epidemiological situation in Russia and in countries with which it maintains large trade flows (for example, exports of metallurgical and chemical products to China), It will also depend on the stability of adopted parameters in customs legislation (calculation formulae and export customs duty rates on a number of categories of metallurgical products) and on the rate of recovery of domestic demand for chemical products as a result of the reduction in stocks early in 2021.

Table 1

### Output index change across economic sectors, %

Name of sector	Share in industrial production index, %	July 2021/ December 2020, %	July 2021/ July 2020, %	Change over past months
Industrial production index		101.86	101.09	slow growth
Extraction of minerals	34.54	105.09	107.90	slow growth
Manufacturing, including:	54.91	101.32	101.71	slow growth
Production of food products, including beverages and tobacco	16.34	108.08	114.22	growth
Textile and garment industry	1.14	110.22	116.51	growth
Textile and garment industry	0.27	106.85	111.00	growth
Wood processing and woodware manufacturing	2.02	105.94	109.23	growth
Pulp-and-paper industry	3.35	89.36	80.36	decline
Production of charred coal and petrochemicals	17.25	103.77	106.84	slow growth
Chemical industry	7.56	113.77	122.72	growth
Manufacturing of rubber and plastic articles	2.14	104.60	106.62	growth
Manufacturing of other nonmetallic mineral products	4.02	97.75	100.38	slow growth
Metallurgy and manufacturing of ready-made fabricated metal products	17.42	118.40	129.60	growth
Manufacturing of machinery and equipment	6.97	118.70	136.18	growth

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Name of sector	Share in industrial production index, %	July 2021/ December 2020, %	July 2021/ July 2020, %	Change over past months
Manufacturing of electrical, electronic and optical equipment	6.27	103.76	105.07	slow growth
Manufacturing of transport vehicles and equipment	6.75	125.69	147.04	growth
Other industries	2.42	104.01	107.99	stagnation
Electricity, gas and water supply	13.51	101.03	102.15	stagnation
Wholesale trade		101.86	103.33	slow growth
Retail trade		98.93	95.33	stagnation
Cargo turnover		106.71	111.52	growth
Building		104.94	107.49	growth
Volumes of fee-based services to households		102.62	104.38	Slow decline

Source: Rosstat, own calculations. 

## 6. RUSSIAN INDUSTRIAL SECTOR IN AUGUST 2021: SHORTAGE OF WORKERS

**Sergey Tsukhlo**, Candidate of Economic Sciences, Head of Business Surveys Department, Gaidar Institute

*The recommencing growth in demand increased the level of satisfaction with its volumes to 78% of the surveyed industrial enterprises. The dynamics of output lagging behind the growing demand and the logical caution in the context of the ongoing fight against coronavirus, keep manufacturers from filling warehouses of finished products.*

*In the context of the pandemic crisis, the industry is experiencing challenges in replenishing stocks of raw materials. The shortage of personnel emerged early in Q3, forced enterprises to take measures in July-August to restore the recruitment of workers. The increase in the key rate by the RF Central Bank in July did not affect the rate on loans offered to the industry.*

In August, according to enterprises' estimates, the growth in demand for industrial products has recovered. The balance of actual sales changes after relatively low values observed in March-July, increased in August by 8 p.p. straightway. Accordingly, the volume of the industrial products' sales achieved by August is estimated as "normal" by 78% of enterprises, while the share of unsatisfactory estimates of demand ("below the target") dropped to 17%. The forecasts for demand of enterprises have also undergone similar prompt positive adjustment. In August 2021, the balance of expected sales changes added 12 p.p. at once.

The growth of demand and the lagging behind output, as well as logical caution in the context of the ongoing anti-virus fight keep manufacturers from active replenishment of their warehouses of finished products. In August, the shortage of these reserves increased again, while the scale of surplus, on the contrary, dropped to a historical minimum. Currently, only 5% of enterprises estimate their stocks of finished goods as "above the target."

A shortage of raw products and materials in 2021 is experienced by 18% of enterprises (10-year maximum), while the excess of these stocks in the current year was recorded by only 2% of manufacturers (the absolute minimum of monitoring this indicator for 1993–2021). Accordingly, the traditional estimates' balance of the availability of stocks of raw materials and supplies for three quarters of the current year in the Russian industry dropped to -16 p.p., which was a 12-year low.

In August, there was a significant slowdown in the growth of selling prices. During the month, the balance of change (growth rate) of prices reduced by 17 p.p. Over the previous 12 months, the indicator increased by 50 p.p. The August slowdown in price growth is not the first attempt by enterprises to stem the inflationary wave caused by the lockdown and government support for the affected sectors of the economy. For the first time, the industry tried to slow

down the growth of its prices in Q4 2020, followed by attempts in February and June 2021. However, all previous attempts were insignificant in size and were immediately replaced by a more important growth in the indicator.

The current decline in the balance of actual price changes has greater chance of success and extension, as it is supported by the slowdown of inflationary expectations of enterprises. The last indicator has been falling for 3 months in a row after reaching a record level for all months of the XXI century in May 2021.

Clearly identified issues related to recruitment of personnel in Q2 2021, resulted in the developed shortage of workers in the Russian industry. At the beginning of Q3, the balance of estimates (“more than enough” minus “less than enough”) collapsed to -16 p.p., which was a 13-year minimum for the indicator. The enterprises have not experienced such a significant shortage of workers since July 2008.

This forced the Russian industry to take decisive measures in July-August to restore recruitment, and the balance of actual changes in the number of employees increased to +6 p.p. after 0 ... + 2 p.p. registered in Q2. However, the achieved result is far behind the hiring plans (+ 10... + 13 p.p.) that the industry had for these months. In September-October, enterprises plan to increase the recruitment rate to +16 p.p.

The results of the next (already the eighth) survey of enterprises regarding the reasons for the layoffs of workers make it possible to clarify the details of the aggravated personnel problems in the Russian industry. The voluntary retirement of workers remains the most common reason for layoffs in the industry. This applies to about half of enterprises.

The coercion to lay off workers reaching retirement age on the initiative of the administration faded away in 2021, although in 2013, 10% of enterprises reported such a practice. Apparently, core workers trained back in the days of the USSR are becoming more and more valuable for the Russian industry, but regretfully, they are an inevitably lost resource.

Low payment was on the second place among the reasons for resignation (26%). However, now, when the industry has not been so badly affected by the virus crisis, the reference to this factor is at a historic low, which was first recorded in 2017 when the industry was recovering from stagnation of 2012–2016.

Resignation of workers due to difficult working conditions in 2021 was registered by 21% of enterprises, which was a historical maximum according to results of our surveys. Most likely, the influence of the viral crisis affects the rapid development of new sectors here as well (primarily in the service sector), that attracted part of workers from “heavy” industries. The aggravated personnel problems and the disciplining impact of the virus crisis have reduced to a minimum the desire of enterprise managers to fire defaulters. Layoffs of redundant workers were practiced by only 4% of enterprises in 2021.

Lending conditions for industrial enterprises have demonstrated stability and a good level of credit availability for the fifth month in a row. Since April, the total estimates “above the target” and “normal” have been in the range of 69–73%, which is higher than the pre-crisis level of this indicator. The July increase in the key rate did not affect the loan rate offered to the Russian industry in August. As in the previous month, banks are prepared to lend to enterprises at best at 9.4% per annum in rubles. Apparently, all expectations regarding the dynamics of the key rate were realized back in May, when banks increased this indicator from 8.6% in April to 9.2%. It has to be noted that the 8.6% indicator has become a historic low. 