MONITORING OF RUSSIA'S ECONOMIC OUTLOOK:

TRENDS AND CHALLENGES OF SOCIO-ECONOMIC DEVELOPMENT

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1. THE CENTRAL BANK OF RUSSIA KEEPS TIGHTENING THE MONETARY POLICY

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In September, the Central Bank of Russia's Board of Directors took a decision to tighten monetary policy. The key interest rate was raised by 0.25 p.p. to 6.75% per annum, the maximum value since December 2019. Such an increase was substantiated by intensified inflationary pressures on the back of expansion of demand amid existing problems related to supply of goods and services, as well appreciation of global prices. From results for August 2021, year-on-year inflation amounted to 6.7%, close to the 5-year heights. In our opinion, in 2021 the inflation rate is going to be over 6% and this suggests further tightening of the monetary policy.

On September 10, the Central Bank of Russia's Board of Directors took a decision to raise the key interest rate by 0.25 p.p. to 6.75% per annum, the maximum value since December 2019. It is the 5th rise in the interest rate this year after it was adjusted upward by 0.25 p.p. to 4.5% per annum in March, 0.5 p.p. each in April and June to 5.5% and 1 p.p. to 6.5% in July. The decision was justified by strong pro-inflationary factors amid fast expansion of demand with the prospects of increasing supply of various goods being rather limited.

In September, the interest rate rise turned out to be minimal (0.25 p.p.) contrary to a surge of 1 p.p. in July, which can probably be explained by the fact that the peak of the interest rate cycle is not far off and can be achieved as early as this year. Further tightening of monetary policy was justified: from results for August 2021. the inflation rate (CPI) rose to 6.7% as compared with August 2020 (3.6% in August 2020 and 4.3% in August 2019), having surpassed by 2.7 p.p. the Central Bank of Russia's target of 4% in a similar period and approached 5-year heights (6.9% in August 2016 on August 2015) (*Fig. 1*). It is noteworthy that most countries saw rising inflation on the back of quick recovery of composite demand incited by government support measures amid the existing aggregate supply-related problems caused by the pandemic.

Also, core inflation dynamics (without prices related to seasonal and administrative factors taken into account) point to strong inflationary developments. So, in January through August 2021 the inflation rate increased from 4.6% (January 2021 on January 2020) to 7.1% (August 2021 on August 2020) (3.1% in August 2020 on August 2019 and 4.3% in August 2019 on August 2018).

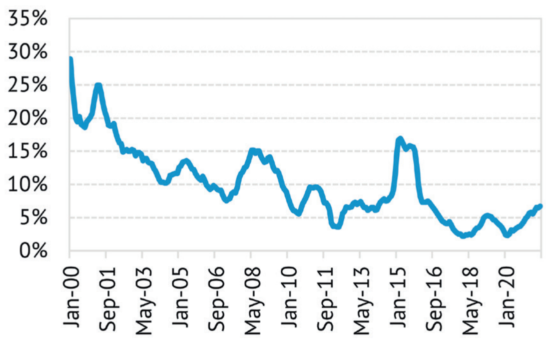

Fig. 1. CPI in the previous 12 months, %

Source: Rosstat.

In August 2021, consumer prices appreciated by 0.17% despite seasonal deflation of -0.51% of food products (-0.77% in August 2020). It is noteworthy that the slowdown of the inflation rate (-8.39% in August 2021 against -8.30% in August 2020) was driven largely by depreciation of prices of fruits and vegetables.

In August, prices of nonfood products appreciated by 0.8% (0.4% in August 2020). As demand for nonfood products picked up actively, August saw the highest rates of appreciation of prices of audio and visual goods (2.2% in August 2021 against 0.1% in August 2020), electrical products and other household appliances (0.8% in August 2021 against 0.4% in August 2020) and motor gasoline (1.4% in August 2021 against 0.3% in August 2020).

In August, fee-based services to households appreciated by 0.32% (0.37% in August 2020). Notably, prices increased considerably for hotel services (+3.4%) and passenger transport services (+2.1%) on the back of a seasonal pickup in demand for such services, as well as restrictions on travelling abroad.

Fast recovery of consumer demand is still a key pro-inflationary factor as opposed to output growth potential. So, retail trade growth rates in July 2021 on July 2020 amounted to 4.7% against -0.5% in July 2020 on July 2019 and +1.5% in July 2019 on July 2018. Real wages growth rates increased considerably and were equal to 4.9% in July 2021 on July 2020 (0.6% in July 2020 on July 2019, 2.9% in July 2019 on July 2018). As estimated by the Sberindex,[1] in August 2021 households' consumer spendings increased by 16.2% in nominal terms as compared with August 2020 (0.4% in August 2020 on August 2019) owing among other things to lump-sum payments of Rb10,000 to parents of school children.

In Russia, accelerating inflation is driven by a pickup in global prices for most goods and services. In January through August 2021, there was appreciation of global prices of fertilizers (65.9%), metals (19.5%), mineral raw materials (23.3%) and energy commodities (51.9%).[2] The food price index rose from 108.5% in December 2020 to 127.4% in August 2021. In January through August 2021, global prices of meat, grain, sugar and vegetable oils appreciated by 18.7%, 12%, 37.9% and 26.4%, respectively.[3]

An upturn in inflation was registered both in developing and developed countries. In January through August 2021, inflation (measured by the consumer price index relative to the same month of the previous year) increased from 1.4% to 5.3% in the US, while in Germany and Canada from 1% to 3.9% and from 1% to 4.1%, respectively. Also, developing countries which target inflation experienced intensified inflationary pressures: in Brazil the inflation rate rose from 4.6% to 9.7%, in South Africa – from 3.2% to 4.6% and in Poland – from 2.6% to 5.5% (*Fig. 2, 3*).

According to the data of the OOO InFOM's survey, in August inflation expectations in Russia decreased by 0.9 p.p. to 12.5%. They are still at a sustainably high level close to multiyear heights. According to the Central Bank of Russia's monitoring,[4] the balance of enterprises' answers regarding the expected price performance increased from 25.3 p.p. in July 2021 to 25.9 p.p.

1 URL: https://sberindex.ru/
2 URL: https://www.worldbank.org/en/research/commodity-markets
3 The data of the Food and Agriculture Organization of the United Nations (URL: http://www.fao.org/).
4 URL: http://www.cbr.ru/statistics/ddkp/price_expectations/

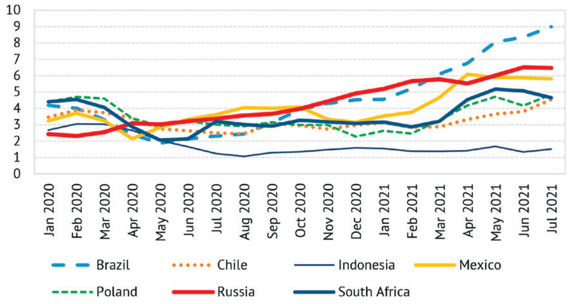

Fig. 2. Inflation in the previous 12 months in a number of developing countries, %

Source: The IMF.

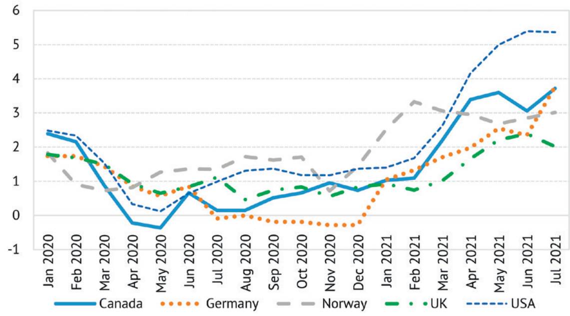

Fig. 3. Inflation in the previous 12 months in a number of developed countries, %

Source: The IMF.

in August 2021 and surpassed the peaks seen in 2019–2020. As stated in the InFOM's survey, higher price expectations are still driven by growing costs.

In August, households' inflation expectations decreased somewhat owing to appreciation of the ruble in summer. Amid the stable forex market situation in summer, the ruble exchange rate was close to its fundamentally justified values.[1] Note that the existing fiscal rule in Russia is used to prevent appreciation of the ruble during a favorable situation on the global oil market and mitigate depreciation of the ruble when prices of oil fall below the cut-off price. From results for August, the Ruble/US Dollar exchange rate was equal to Rb73.57 per $1. The ruble is underpinned by high price of oil amid global economic recovery, the Central Bank of Russia's rising key interest rate and growing attractiveness of Russian assets.

We believe that the Central Bank of Russia's decision taken on September 10 to raise the key interest rate, as well as the signal that the key rate is highly likely to be increased further in the near future will facilitate a decline in inflation as early as this autumn. However, taking into account pro-inflationary factors, the inflation rate will remain above the target of 4% for a protracted period of time. With tightening of monetary policy, the annual inflation rate will start declining in Q4 2021 and returning gradually to the target level set for 2022–2023. By our estimates, based on results for 2021 the inflation rate in Russia will be equal to over 6% (December 2021 on December 2020), while the key rate, at a minimum of 7%.

1 Estimates were received using the nominal exchange rate model which takes into account prices of oil, interest rate differential in Russia and abroad, volatility index on financial markets (Vix), as well as dummy variables for the RF Ministry of Finance's foreign-exchange interventions (for more details, see *A.V. Bozhechkova, S.G. Sinelnikov-Murylev, P.V. Trunin*. Ruble Exchange Rate Movement Factors in the 2000s and the 2010s // The Voprosy Ekonomiki. 2020. Issue No.8. P. 1–18.

2. RETAIL LENDING, JANUARY THROUGH AUGUST 2021: RECORD-HIGH GROWTH IN THE MARKET'S HISTORY

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In 2021, retail lending has been the most dynamically growing banking market segment spurring banking revenues growth. The worsening of loan portfolio quality was driven by rising inflation, stagnation of households' real incomes and the epidemiological situation, which factors could not but cause the monetary authorities' concern and make them take additional measures to cool the credit market in order to prevent a pickup in households' debt burden and reduce market risks.

As of August 1, 2021, individuals' overall loan debt to Russian banks was equal to Rb23.3 trillion. In January-July 2021, aggregate portfolio growth amounted to Rb3120.2 trillion or 15.6% and surpassed growth both in overall bank assets (8.2%) and corporate loans (9.3%). In the same period of 2020, retail lending increased by Rb1023.2 bn or 5.8%. So, in 2021 its growth rates have surpassed threefold the relevant index seen in 2020 and hit record-high during the entire period of the Russian credit market.

Loans in rubles account for Rb23.1 trillion or 99.7% of the overall loan debt. Loans in foreign currency can be still found in Russian banks' product lines, but there has been a steady decrease in such debts since April 2020 when the pandemic broke out. So, the Central Bank of Russia's measures to increase risk weights in respect of foreign currency loans to discourage the extension thereof to households in order to reduce risks related to exchange-rate changes yielded results.

An overall overdue debt increase since the beginning of the year is equal to 6.8% with the total volume amounting to Rb996.2 bn. However, the share of overdue debt in credit portfolio remains virtually unchanged: as of August 1, 2021, it was equal to 4.3% (4.7% in 2020). Overall, overdue debt indicators are lower than those in corporate credit portfolio (5.9%). As of the end of H1 2021, the level of loan-loss provisions for the overall retail loan portfolio was equal to 112.8% (107.7% in the mid-2020). This index growth was driven by a reduction in bad debts owing to partial writing-off and reassignment thereof to debt collectors. At the same time, banks are in a position to reduce simultaneously the volumes of reserves for potential losses: the analyzed CoR[1] on the retail loan portfolio was equal to 1.4%, a substantial decrease as compared to last year (4.4%).

The Central Bank of Russia specified the methods of calculating the debt service ratio (DSR) for individuals. It is the ratio of the overall sum of households'

1 Cost of risk, CoR is an indicator which is determined as the ratio of the sum of loan-loss provisions to the size of a credit portfolio. In case of banks, the lower this indicator, the higher the quality of a loan portfolio.

pre-arranged payments on loans to households' overall income. To avoid double accounting, in conformity with the new methodology interest payments on loans do not reduce households' disposable incomes as they have already been accounted for in the sum of pre-arranged payments. New calculation methods use additional data of bureaus of credit histories (NBCH, TCB and Equifax) and this helps segment credit portfolio and determine pre-arranged payments on credit cards[1], overdue debts, as well as fines and penalties. The introduced amendments lead to a decrease in the estimates of households' debt burden (as of January 1, 2021 DSR fell from 11.5% to 9.8%), while under the new methodology overall DSR dynamics remained virtually unchanged and saw sustainable growth during the past four years.

The Central Bank of Russia carried out a survey of 74 credit institutions regarding the outputs of their work on restructuring individuals' debts in the period from March 20, 2020 till August 25, 2021. Credit institutions received 3,842,200 applications from borrowers to change the terms of loan agreements, reviewed 99% of applications and approved 2,251,000 applications or 59.2% of those reviewed. It is noteworthy that 1,552,400 applications were turned down. Overall, banks restructured 2.1 mn loan agreements for the total amount of Rb987.7 bn[2]. The rates of restructuring slow down gradually owing to a decrease in the number of applications from customers; the percentage of bank approvals has not changed considerably and remained at the level of 60% since the beginning of the year.

In H1 2021, consumer loans portfolio was equal to Rb10.7 trillion, an increase of Rb949 bn or 8.9% during that period. A speed-up of debt growth rates was largely driven by attraction of borrowers from new customer segments, including the least well-off customers who spent over 50% of their income on debt servicing. So, the decision of the Central Bank of Russia's Board of Directors to increase risk weights in respect of unsecured consumer loans extended from July 1, 2021 – the decision was meant to reduce risks related to the overheating of the market – failed so far to have an impact on banks' lending policy: a record-high volume of 2.1 mn loans worth Rb646.7 bn was registered in August. Such a situation was partially justified by seasonal factors (the end of the holiday-making season and preparation for a new academic year), but at the same time a pickup in demand was driven by the existing low interest rates amid the prospect of upward adjustment thereof on the back of a rise in the Central Bank of Russia's key interest rate.

Amid low interest rates in nominal terms on retail loans, banks increase profit margin on loans by means of charging higher commissions, for example, with the share of insurance in the cost of products increased, banks receive higher commission income from insurance companies. With nominal rates of 5–12%, average effective interest rate (EIR; on all types of consumer loans) varies in the range of 14–15%, while on individual types of loans (general-purpose consumer loans and debt refinancing loans) exceeds 20%. In conformity with the Federal Law on Consumer Loans, banks may enter into agreements with the current average market EIR calculated by the Central Bank of Russia exceeded by one third. This brings us to the conclusion that this indicator has growth potential and borrowing costs are likely to increase on the back of rising interest rates and higher commissions.

1 Pre-arranged monthly credit card payment is deemed equal to 7.6% of the debt amount (annual payment of 68% of the debt amount).

2 URL: https://cbr.ru/Collection/Collection/File/36606/drknb_22_2021.pdf

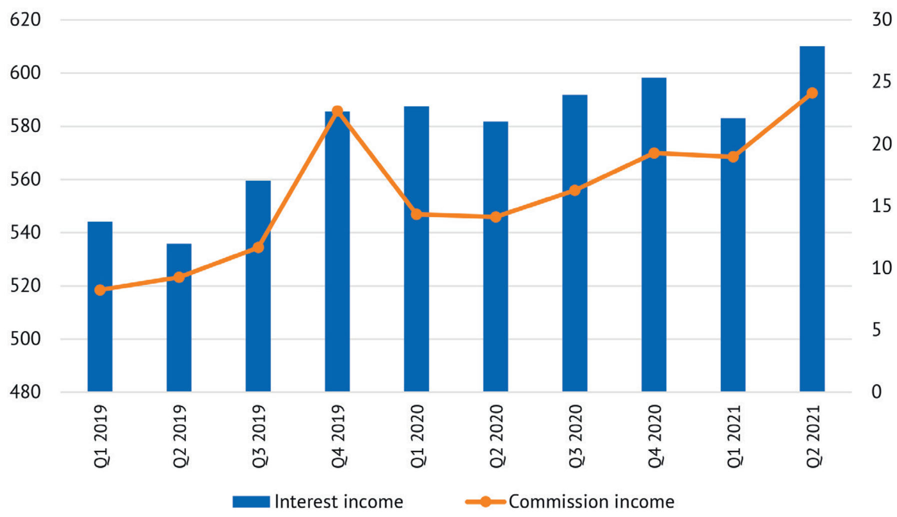

Fig. 1. Bank interest and commission revenues from retail lending in 2019–2021, trillion rubles

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

As stated in the previous issue of the Online Monitoring of Russia's Economic Outlook[1], a temporary decrease in banking revenues from retail lending in Q1 2021 is expected to be made up for by income growth over the next few quarters. In Q2 2021, banks registered record-high revenues from interest payments and commissions (*Fig. 1*).

In the coming months, households' demand for loans will remain at a high level. Credit institutions will seek to underpin the current rates of lending to increase their revenues. However, in the long-term it may be required to cool the consumer finance market and reorient the banking sector to the corporate segment. In such a situation, market regulation by means of adjustment of risk ratios may be insufficient and the Central Bank of Russia will have to resort to direct quantitative restrictions.[2]

1 URL: https://www.iep.ru/ru/doc/36386/monitoring-ekonomicheskoy-situatsii-v-rossii-11-143-iyun-2021-g.pdf

2 The draft law which entrusts the Central Bank of Russia with the authority to introduce relevant restrictions was submitted to the State Duma.

3. FOREIGN TRADE, JANUARY THROUGH JULY 2021: NON-PRIMARY EXPORTS GROWTH

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In January-July 2021, the Russian foreign trade turnover surpassed considerably the pre-pandemic level (growth of 12.2% on January-July 2019). The value of exports of energy and primary commodities failed to return to the pre-crisis level (a decrease of 9.8% on January-July 2019). In January-July 2021, non-oil and gas exports increased considerably (40.8%) as compared with the pre-crisis level. In July they hit a record monthly high of $26.2 bn owing to a pickup in exports of metals during the month prior to introduction of export duties. Imports of goods overcame the slide caused by the pandemic and saw considerable growth (20.6%) as compared with the level seen in 2019.

Trends in trade

In January-July 2021, Russia's foreign trade turnover was equal to $419.8 bn, an increase of 12.2% relative to the pre-pandemic level (January-July 2019). We do not compare trade dynamics of this year with those of 2020 because the low base effect brought about by numerous restrictions introduced in Spring-Summer 2020 distorts the statistics. In 2021, a pickup in trade was driven by an increase in imports of goods (20.6% compared with January-July 2019) and positive dynamics of non-oil and gas exports (growth of 40.8%) with incomplete recovery of the value of exports of fuel and minerals to the level seen in 2019 (a decrease of 9.8%).

With lots of industries all over the world brought to a virtual standstill by the pandemic, global prices for energy commodities depreciated, while the cost of some intermediate goods, including metals and food products appreciated considerably. Sustainable growth in non-oil and gas exports was driven by a pickup in global prices of metals and grain. In July 2021, non-oil and gas exports hit a record high of $26.2 bn, a twofold increase (+105%) on July 2019. Such substantial growth in July can be explained by a pickup in exports of metals in anticipation of introduction of export duties. Consequently, in the next few months of 2021 volumes of these types of exports are expected to return to the pre-crisis level as adjusted for dynamics of global prices for the main non-resource non-energy commodities.

The value of exports of fuel and minerals surpassed the pre-crisis level (of the relevant month of 2019) only in June and this facilitated exports growth in summer 2021 (*Fig. 1*). In January-July 2021 overall exports of all goods amounted to $257.8 bn (an increase of 7.6% relative to 2019) of which non-resource non-energy commodities accounted for 45% ($115.4 bn).

In 2021, imports exceeded consistently the pre-crisis volumes, that is, 108–128% as compared with relevant months of 2019 (*Fig. 2*). Imports positive dynamics were facilitated by growth of 31% in imports of machinery and

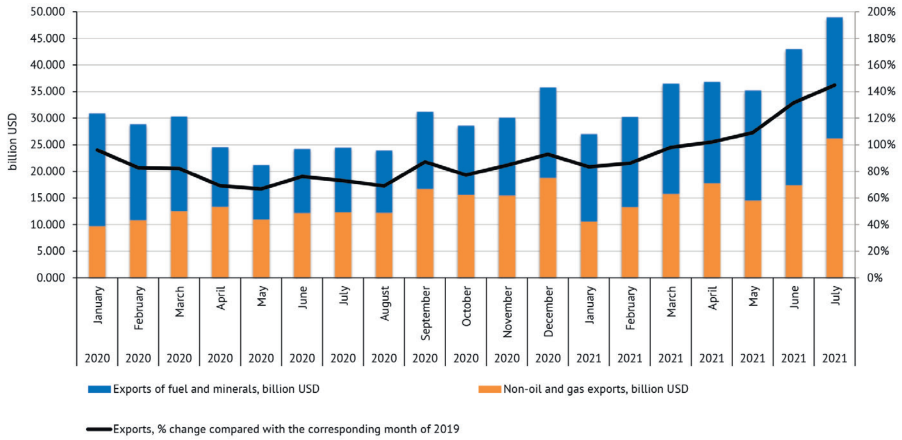

Fig. 1. Russian exports dynamics in 2020–2021

Source: own calculations based on the RF Federal Customs Service's data.

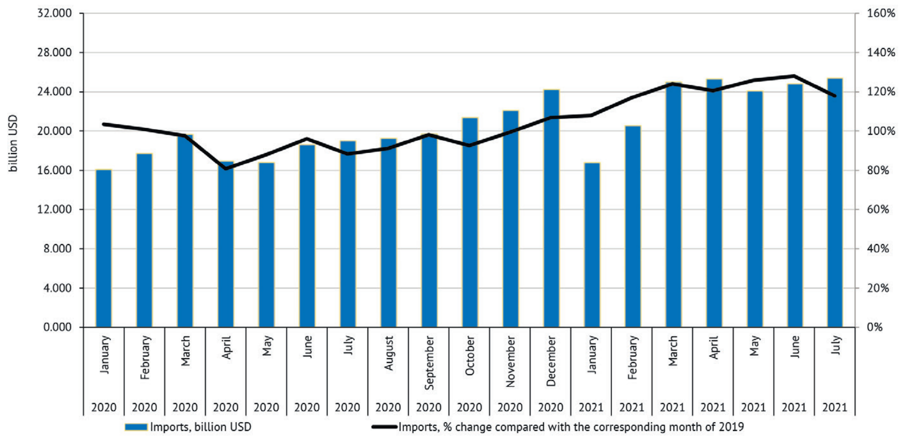

Fig. 2. Russian imports dynamics in 2020–2021

Source: own calculations based on the RF Federal Customs Service's data.

equipment from far-abroad countries (relative to January-July 2019) after a slight decrease of 7% in January-July 2020.

Export prices

In January-July 2021, the value of exports of *fuel and energy commodities* fell by 12.3% relative to the pre-crisis level (January-July 2019)[1] on the back of a decrease in the average export price of oil (-5%), petrochemicals (-8%), pipeline natural gas (-6%) and fossil coal (-17%). Oil exports shrank to 130 mn tons (-15%), while exports of petrochemicals increased to 85.3 mn tons (+5%). Pipeline natural gas supplies remained at the pre-crisis level of 123.8 bn m^3 (+2.5%).

Exports of *food and agricultural primary products* increased by 38% as compared with 2019. With export quotas introduced early this year and the dumping mechanism initiated since June, exports of grain became quite

1 As the base period for calculating changes in prices and export volumes of individual goods, the January-July 2019 period is used, that is, the period prior to the outbreak of the COVID crisis and a slump in global trade.

moderate despite a considerable pickup in global prices and a record-breaking harvest in 2020. Exports of grain (wheat and meslin) remained at the same level (+3%) with an increased average export price (19% as compared with January-July 2019).

Substantial growth in exports of *chemical products* (+24% relative to January-July 2019) was driven primarily by appreciation of prices of nitrogen fertilizers (+18%) and mixed fertilizers (+16%), methanol (+17%) and ammonia (+8%), while depreciation of prices of potassic fertilizers (-20%) was accompanied by a pickup in export volumes (+49%).

Also, the exports of *wood and articles thereof* surpassed considerably the pre-crisis level (+22%) owing to positive dynamics of export prices for sawn timber (+41%), plywood (+24%) and paper pulp (+9%) with export volumes of these commodities changed insignificantly. Despite overall growth in global prices of wood and articles thereof, prices and export volumes of newsprint remained below the pre-crisis level (-20% and -26%, respectively).

The value of exports of *metals and fabricated metal products* saw substantial growth of 60% relative to the pre-crisis level owing to global prices explosive dynamics which led to a pickup in average export prices of ferrous metals (+33%), copper (+38%), nickel (+38%) and aluminum (+30%). Export volumes of the above metals, except for nickel (-58%), increased: ferrous metals – 12%, copper – 3%, while the tonnage of exported aluminum grew 2.67-fold as compared with January-July 2019.

Exports of *precious stones and metals* increased 2.6-fold relative to January-July 2019.

Non-oil and gas exports

In January-July 2021, growth of 40.8% in non-oil and gas exports as compared with the relevant period of 2019 was driven by positive price movement (+20%) and export volumes (+17%) (*Table 1*). All large commodity groups (over $3 bn) saw a pickup in prices and physical volumes, except for machinery and equipment (-2%).

Growth in this type of export operations was spurred by precious metals and stones, that is, $14.5 bn worth of exports in January-July or 13% of non-oil and gas exports (+7.1 p.p. relative to the share in January-July 2019), which is almost equal to export volumes of agricultural primary products and food ($17.5 bn). It is noteworthy that a pickup in export volumes of precious metals is largely related to the decision of the RF Central Bank to stop purchasing gold for replenishment of reserves from April 2020. Base metals, which value of exports increased up to $35 bn accounting for 30% of non-oil and gas exports in January-July 2021(+3.8 p.p. as compared to the pre-crisis level) were another important factor facilitating growth in non-oil and gas exports. At the same time, the share of "machinery and equipment", one of the most advanced high technology industries, shrank dramatically to 11% of the overall volume of non-oil and gas exports (-3.5 p.p.) owing to moderate growth (+7%) in the value of exports amid a considerable pickup in exports of other commodity groups. The share of chemical products in non-oil and gas exports fell to 16% (-2.2 p.p.). Further, exports of non-resource non-energy commodities (cement) from the "mineral products" commodity group came virtually to a halt (-3.0 p.p.).

So, strong growth in non-oil and gas exports is facilitated by upstream and midstream process stage products with moderate rates of dynamics of exports of high technology industries; this is mainly the continuation of the trend which emerged last year.[1]

Table 1

Dynamic of non-oil and gas exports across commodity groups in January-July 2021

Commodity group name	Volume of supplies, billion USD		Change in January-July 2021 on January-July 2019, %		
	January-July 2019	January-July 2021	Price index	In volume terms	In value terms
Food products and agricultural primary commodities (except for textile)	12.7	17.5	38	22	13
Mineral products*	2.5	0.1	-96	-14	-96
Chemical products, raw rubber	15.3	19.0	25	4	19
Rawhide, furs and articles thereof	0.1	0.1	-1	-16	18
Wood, pulp and paper products	6.8	8.5	24	18	6
Textile, textile products and footwear	0.7	0.9	28	-3	32
Precious stones, precious metals and articles thereof **	4.5	14.5	3.2-fold	64	2.0-fold
Metals and fabricated metal products	21.7	35.0	61	28	26
Machinery, equipment and transport vehicles (without classified groups)	11.8	12.6	7	-2	9
Other goods	1.5	1.9	25	3	21
Classified commodity groups	4.3	5.2	23	–	–
Total	**82.0**	**115.4**	**40.8**	**20**	**17**

* Non-oil and gas exports of the "mineral products" commodity group include salt, lime carbonate and cement.

** Without diamonds and other classified commodity items.

Note. The index is calculated on the basis of price per unit of product across 10-place positions included in this commodity group with standard filters applied.

Source: own calculations based on the data of the RF Federal Customs Service.

Trade turnover geographic pattern

The share of the EU[2], Russia's main trade partner, remained close to the minimum values of the last decade, that is, 35.8% owing to low prices of energy commodities in January-July 2021 (*Table 2*). On the contrary, the UK, which left the EU, increased its share as compared to the pre-crisis level (+1.2 p.p.) on the back of Russian gold supplies. The share of APEC rose relative to the pre-crisis level (+2.4 p.p.) owing among other things to the increased presence of China (+1.5 p.p.) and the US (+0.6 p.p.) in Russian trade turnover, thus making up for shrinkage of the share of Japan (-0.4 p.p.). It is noteworthy that the share of China in the crisis year 2020 was even higher (+18.4 p.p.) on the back of faster recovery

1 For more details on the pattern of non-oil and gas exports in 2020, see: *A.Yu. Knobel, A.S. Firanchuk* Foreign Trade in 2020: Overcoming the Fall // Russia's Economic Development. Vol. 28. Issue No. 3. P. 12–17.
2 27 EU countries without the UK.

of output and demand in that country during the pandemic as compared with other large economies.

Table 2

Russia's trade turnover geographic pattern in 2019–2021 across main trade partner-countries

Region/country	January-July 2019	January-July 2020	January-July 2021	Change: January-July 2021 on January-July 2019, p.p.
EU-27	**40.0**	**34.8**	**35.8**	**-4.26**
UK	2.0	3.9	3.3	1.24
Ukraine	2.0	1.8	1.5	-0.53
Turkey	3.8	3.7	4.3	0.44
APEC	**31.8**	**34.5**	**34.2**	**2.44**
including:				
China	16.2	18.4	17.7	1.46
US	4.1	4.5	4.7	0.63
Japan	3.0	3.1	2.7	-0.38
CIS	**12.2**	**12.9**	**12.0**	**-0.16**
of which EEU,	***8.6***	***8.9***	***8.8***	***0.27***
Including:				
Armenia	0.3	0.4	0.3	0.02
Belarus	5.1	4.9	4.9	-0.18
Kazakhstan	2.9	3.3	3.3	0.41
Kirgizia	0.3	0.3	0.3	0.02

Source: own calculations based on the RF Federal Customs Service's data.

The share of the CIS returned to the pre-crisis level of 12% (-0.2 p.p.) because higher ratios of the crisis 2020 year were related with greater sustainability of the Russian trade with CIS countries. The share of Ukraine in the Russian trade turnover kept falling to 1.5%. As compared with trade with other countries, dynamics of trade with the EEU turned out to be somewhat better: an increase of 0.3 p.p. on the pre-crisis level (up to 8.8%). At the same time, the share of Belarus declined (-0.2 p.p.), but it was made up for by expansion of the share of Kazakhstan in the Russian foreign trade turnover (+0.4 p.p.).

Trade in services

The pandemic and anti-COVID-19 restrictions took a heavy toll on foreign trade in services which remained a great deal below the pre-crisis level (-28.9%): \$63.9 bn in January-July 2021 against \$64.1 bn and \$89.5bn in relevant periods of 2020 and 2019, respectively. A decrease in imports of services as compared with the pre-crisis year 2019 (-34.5%) was twice the size of decrease in Russian exports of services (-19.7%) (*Table 3*). Such a difference in the dynamics was related to the prevalence of "travelling" – the hardest-hit sector of services which shrank fivefold because of the pandemic – in the pattern of imports. A considerable contraction of 29% and 20% took place in the volumes of imports and exports of transportation services, respectively. "Telecommunication, computer and information services" saw substantial growth and became the second largest in exports of services (+26%) and the third largest in imports (+36%), thus catching up with "travelling" as regards the volume of imports.

Table 3

Dynamics of exports and imports of services across sectors in 2019–2020

Sector of services	Exports				Imports			
	2019, billion USD	2020, billion USD	2021, billion USD	Change in 2021 on 2019, %.	2019, billion USD	2020, billion USD	2021, billion USD	Change in 2021 on 2019, %.
Transportation services	11.9	9.7	9.5	-20	8.5	6.6	6.0	-29
Travelling	6.4	2.1	1.3	-80	20.3	7.0	3.6	-82
Building	2.6	2.4	2.7	7	2.7	3.7	3.4	25
Telecommunication, computer and information services	3.1	3.4	3.9	26	2.6	3.0	3.6	36
Other business services	7.4	6.6	7.5	1	11.5	8.2	10.3	-10
Services to individuals and services of the cultural and recreation sectors	0.3	0.2	0.2	-8	0.8	0.6	0.6	-24
Other services*	4.0	3.0	3.5	-13	7.4	7.4	7.7	4
Total	**35.6**	**27.5**	**28.6**	**-19.7**	**53.9**	**36.6**	**35.3**	**-34.5**

Source: own calculations based on the data of the Russian Central Bank.

4. CORPORATE PENSION PLANS: TRENDS AND PROSPECTS FOR THEIR IMPLEMENTATION

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Russia is faced with an increasing need to modernize the existing mandatory pension savings system[1] in order to improve the efficiency of portfolio management and make corporate pension plans available for 70–80% of this country's working age population. An important role in dealing with these issues could be played by some new forms of collective investment, such as lifecycle funds.

Pension savings and pension reserves in Russia

In Russia, the prospects for developing corporate pension plans are still uncertain. As can be seen from *Table 1,* so far, the total value of pension savings and reserves has not yet shrunk in absolute terms, but it is already noticeably lagging behind the growth rates of GDP and household financial assets. In Q2 2021, it amounted to Rb6.5 trillion (vs Rb6.4 trillion in 2020). Over H1 2021, the amount of pension savings and reserves as share of GDP declined from 6% to 5.6%; and as share of household financial assets, from 8.6% to 8.5%. The downward trend in the share of pension savings and reserves was especially pronounced in the period from the beginning of 2017 through Q2 2021.

Table 1

Pension savings* and reserves, from 2017 through Q2 2021

	2017	2018	2019	2020	Q2 2021
Trillions of rubles	5.53	5.58	6.11	6.36	6.48
% of GDP	6.1	5.4	5.6	6.0	5.6
% of household financial assets** value	11.2	9.7	9.9	8.6	8.5

* Mandatory pension savings under the management of NPFs, public and private asset managers.

** The value of household financial assets was calculated on the basis of data released by the Bank of Russia (URL: http://www.cbr.ru/statistics/macro_itm/households/), taking into account the reduction in household investment in non-marketable equity instruments.

Source: own calculations based on data released by the Bank of Russia and Rosstat.

In 2014, one of the reasons for introducing a moratorium on pension savings was the inadequate performance of non-government pension funds (NPFs). As shown in *Fig. 1,* the next few years saw no noticeable changes in this area. Over the period 2010–2020, the average annual return on pension savings portfolios held by NPFs was 6.6%, practically at the same level as the average annual

1 The public pension system, introduced in 2002. Since 2014, there has been a moratorium on pension contributions to its funded part.

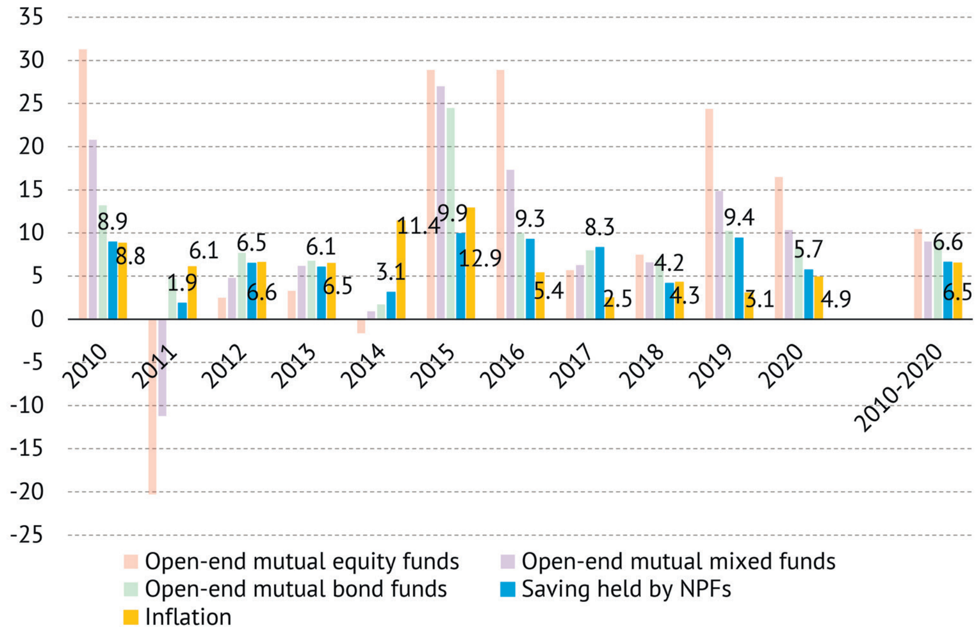

Fig. 1. The average returns on pension savings portfolios held by NPFs, the portfolios held by open-end mutual equity funds, mixed investments, bonds, and inflation, 2010–2020, % per annum

Source: own calculations based on data released by the Bank of Russia, Rosstat, Investfunds.ru (URL: https://investfunds.ru/), and Constructor of NPFs (URL: https://ipei.ranepa.ru/ru/npf-ru).

inflation (6.5%). Savings pension, based on accumulated pension savings, prevent insured persons from getting an additional upward adjustment of the lost earnings coefficient, and in this they differ from insurance pensions, where the indexation of payments is tied to the level of inflation. Given such investment results, the replacement of part of their insurance pension with funded plans brings no tangible benefits for insured persons.

At the same time, other forms of collective investment that are comparable to NPFs (open-end mutual funds (OPIFs)) have demonstrated, by contrast, higher returns: equity funds, 10.4%; bonds, 9.1%; and mixed investments, 9%. The long-term returns offered by mutual funds are the result of their flexible requirements for the composition and structure of assets, as well as a higher transparency of their information on the profitability and risks of OPIF portfolios. These factors have boosted competition in asset management between the funds.

The corporate pension reform options suggested after 2014, in the form of individual pension capital (IPC) or guaranteed pension plans (GPP), tended to focus, as a rule, on the relatively limited range of people aged 15 to 64 years (working age population) endowed with sufficient incomes for additional retirement savings. The surveys conducted by the Levada Center (currently recognized as a foreign agent) in June 2019 showed that 63% of respondents were not ready to make any additional contributions to NPFs because of their low income.[1] At present, the number of those who have concluded agreements NPFs on additional pension contributions is only 6.2 mn, or 7.6% of the working age population, which testifies to the fact that these services are unaffordable for an overwhelming majority of employed people.

1 *Karaeva O., Goncharov S.* The formation of pension savings. Levada-Center, June 6, 2019. URL: https://www.levada.ru/2019/06/06/formirovaniya-pensionnyh-nachislenij/

Trends in the accumulative pension schemes in foreign countries

Mandatory funded pension plans that provide their participants with tax incentives in the form of tax credits can help solve the problem described in the previous section. In this model, part of the money supplied by an employee's mandatory social contributions is returned to him or her in the form of deductions that go to an individual pension account. As shown in *Table 2,* in the majority of countries that have implemented mandatory pension saving systems, the level of the working age population coverage with corporate pension plans is between 70% and 100%. In Russia, this figure stands at 79.1%; in Kazakhstan, at 78.2%; in Chile, at 87.9%; in Estonia, at 88.2%; and in Latvia, at 100%.

Table 2

The share of the working age population covered by mandatory pension saving plans as of June 2021, %

	Year of pension saving plan launch	Share, %
Latvia	2001	100.0
Sweden	1999	100.0
Estonia	2004	88.2
Chile	1981	87.9
Denmark	1964	86.2
Bulgaria	2002	85.1
Hong Kong	2000	84.6
Iceland	1974	83.2
Israel	2008	80.2
Russia (pension savings)*	2004	79.1
Costa Rica	2000	78.4
Kazakhstan	1998	78.2
Croatia	2002	76.5
Australia	1992	75.2
Mexico	1997	68.1
Uruguay	1995	64.7
Romania	2008	58.7
Colombia	1993	51.2
Russia (pension reserves)**		7.6

* Mandatory pension savings held by NPFs and asset managers, for which a moratorium on new contributions has been in effect since 2014.

** Additional (voluntary) pension plans launched by NPFs.

Source: own calculations based on data released by the OECD (2020), Pension Markets in Focus 2020, URL: www.oecd.org/finance/pensionmarketsinfocus.htm.

In the USA where, in 2020, the total value of 401(k) plans (company-sponsored retirement accounts) reached $6.7 trillion[1], they cover only 43% of the employed population, according to Morningstar (2020).[2] These plans are not mandatory, and they operate on the principle of auto-subscription. A sociological survey conducted by GOBankingRates in September 2019 showed

1 Investment Company Fact Book, 2021. Investment Company Institute.
2 *Benz C.* 100 Must-Know Statistics About 401(k) Plans // Morningstar on-line, Sept.4, 2020.

that 46% of respondents had no money to put aside for pension savings, while 64.3% had insufficient savings for their retirement.[1]

One of US President Joe Biden's pre-election tax initiatives was a reform of 401(k) plans, whereby tax benefits in the form of deduction of the contributions to pension plans from the taxable base for personal income tax were to be abolished, to be replaced by a tax credit, where part of the tax paid by employees to the budget would be returned to their corporate retirement savings accounts.[2] After the election, the proposal did not make it into the final tax reform package. However, in an abridged form, it was used during the coronavirus pandemic, when people with low incomes ($35,000 per year for singles) could receive a tax refund to their individual retirement savings accounts under 401(k) plans or IRAs, in the form of tax credit amounting to up to $1,000.[3] The Biden administration's initiative, even though it is still incomplete to date, acknowledges the fact that it is only the mandatory character of retirement savings established by legislation that can provide to the majority of the working age population the opportunity to participate in corporate pension plans stimulated with tax incentives.

John Recenthaler, an analyst from Morningstar,[4] has noted the trends towards unification of the standards applied in 401(k) plans and the growing popularity of target date funds[5] and index investment funds. An increasing number of employees participating in corporate retirement savings plans create their individual portfolios by relying on only a few funds. Thus, for example, 60% of participants in Vanguard Group, which serves 4.7 mn individual retirement savings accounts under 401(k) plans, have purchased only one issue of securities for their retirement savings portfolio; and in 97% of cases, this was a share issued by one of the lifecycle funds. According to Recenthaler, similar trends have also been demonstrated by the other major administrators of corporate retirement savings plans. Employer companies are increasingly interested in simplifying their corporate retirement savings plans and reorienting them toward lifecycle funds and index funds.

Rekenthaler provides a substantiation for the radical proposal that a single national plan for different employers should be set up, which will consist of a set of lifecycle funds with different target dates, each for their respective categories of participants. This proposal is unlikely to be implemented, but it reflects the practical idea that it is necessary to create mass-scale corporate plans on the basis of lifecycle funds using economies of scale.

A similar approach has been implemented, in part, since 2020 in Poland where, in accordance with the law on employee savings plans dated October 4, 2018,[6] the specialized NPFs that had been handling pension savings were liquidated, and their accumulated monies were transferred to individual retirement savings plans created under corporate retirement plans with an auto-subscription. The administrators of those individual accounts, to be chosen by employers, could

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1 *Dennison S.* 64% of Americans Aren't Prepared For Retirement – and 48% Don't Care // GOBankingRates, Aug 18, 2021.

2 *Brooks R.* President Biden's Proposed Changes to 401(k) Plans // U.S. News, Jan. 22, 2021. URL: https://money.usnews.com/money/retirement/401ks/articles/president-bidens-proposed-changes-to-401-k-plans

3 *Jarvis G.M.* More Retirement Savers May Be Able to Claim a $1,000 Tax Credit This Year. The MarketWatch on-line, April 10, 2021.

4 *Rekenthaler* J. The U.S. Needs Only One 401(k) Plan. The marketplace has delivered its verdict. Morningstar on-line, Sept. 9, 2021.

5 Mutual funds structured to grow assets in a way that is optimized for a specific time frame when its intended participants reach retirement age.

6 URL: http://orka.sejm.gov.pl/proc8.nsf/ustawy/2811_u.htm

be asset managers servicing a set of lifecycle mutual funds, pension funds that had not been managing mandatory savings, or insurance companies.

By way of conclusion, it can be said that in any variant of the future pension system, the requirements for the composition and structure of pension funds should provide more opportunities for investment diversification, by comparison with the current rules for handling pension savings established by NPFs, including global-scale asset diversification. The mandatory disclosure, by pension funds on a monthly basis, of the performance and risks of their portfolios could also be conducive to improving the management of those portfolios.

The experiences of the majority of developing countries, including Chile, Mexico, Latvia, and Poland, among others), where mandatory pension saving systems or auto-subscriptions are applied, have shown that mutual funds, as a form of a property complex managed by a specialized company, are more suitable for managing pension savings portfolios. They provide a higher level of information transparency for their participants concerning the returns and risks of their portfolios and a better control over management costs. In Russia, as has been shown earlier in our discussion, open-end mutual funds significantly 'outplay' the pension savings portfolios held by NPFs by their level of returns.

And finally, in addition to exchange-traded mutual funds (ETMF), it is necessary to develop lifecycle funds that could make it possible more flexibly to manage the pension savings of those people who are not ready to make their own independent decisions about investing their retirement savings.