



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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Editorial board: Sergey Drobyshevsky, Vladimir Mau, and Sergey Sinelnikov-Murylev.

Editor: Vladimir Gurevich.



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1. THE BANK OF RUSSIA'S KEY RATE HITS ITS RECORD HIGH SINCE MAY 2017

Yuri Perevyshin, Candidate of Economic Sciences, Docent, senior researcher, the Center for Central Banks Issues, IAES, RANEPA;

Pavel Trunin, Doctor of Economic Sciences, Director of the Center for Macro-Economics and Finance, Gaidar Institute; Director of the Center for Central Banks Issues, IAES, RANEPA

On February 11, the Bank of Russia's key rate was increased by 1 p.p. to 9.5% per annum. This is its highest value since May 2017. The decision was adopted in response to the ongoing inflation acceleration that resulted from an actively expanding aggregate demand, shortage of labor resources, the proinflationary situation on world markets, and high inflationary expectations. The Bank of Russia did not play down the severity of its signal compared to its previous press release, which points to the high probability of a continuing monetary tightening cycle. Annual inflation in January skyrocketed to 8.7%, which is its record high since February 2016. Given the inertia in the movement of annual inflation, it will remain above its target of 4% throughout 2022, to return to the target no earlier than mid-2023.

On February 11, 2022, the Bank of Russia Board of Directors decided to increase the key rate by 1 p.p. to 9.50% per annum, which is its record high since May 2017. This is the eighth increase in the key rate, and so over the course of the current monetary tightening cycle the key rate has jumped by 525 b.p. overall.

The decision was motivated by the ongoing inflation acceleration in response to the actively expanding aggregate demand, which had continued to exceed the capacity to build up output; the deficit of labor resources; the proinflationary situation on global markets and high inflationary expectations. Thus, the Bank of Russia has not changed its monetary policy stance (as compared to its previous press release), and it remains tough.

In view of the persisting proinflationary risks and the recent signal from the Bank of Russia, it can be argued with some confidence that the monetary tightening cycle will continue, and following the regulator's board meeting on March 18, 2022, the key rate is highly likely to reach a two-digit level. Over the course of the past 12 months, the RF Central Bank has decided on such a significant increase in the key rate for the third time in a row. The reason behind that decision was the significantly upgraded inflation forecast: the average annual inflation for 2022 jumped by 1.6–1.7 p.p. (from 5.2–6.0% to 6.8–7.7%) on the October forecast; and the average key rate, by 1.7–2.7 p.p. (from 7.3–8.3% to 9–11%). At the same time, while in 2020 the real policy rate (based on actual inflation)¹ hovered around 1.7% (the average nominal rate stood at 5.1%; and the average annual inflation rate, at 3.4%), in 2021, as inflation accelerated, the real policy rate of interest moved to around -1% (the average nominal rate amounted to 5.7%; and the average annual inflation rate, to 6.7%). As of the end of January 2021, the real rate was already at -0.2%, and in early February (after the regulator's board meeting) it became positive, having increased to 0.7%.

¹ From a theoretical point of view, it would be more correct to calculate the real interest rate (to be applied in the assessment of monetary policy rigidity) on the basis of expected inflation, and not actual inflation; however, given the significant adaptability of the inflationary expectations of economic agents in the Russian Federation, both these estimates would be quite close in value.

Later on, alongside an inflation slowdown, the real rate will continue to climb. The return of the rate into the neutral range is planned to happen in 2024. Thus, over the next 2 years, we can expect the continuation of a tight monetary policy, which will slow down the growth rate of aggregate demand.

In the autumn of 2021, the growth rate of the money supply (national definition) increased significantly. The growth rate of M_2 at the end of 2021 amounted to 13% (YoY), which was nearly the same as at the end of 2020 (13.5%) (*Fig. 1*). The reason behind the acceleration (by component) was the growth of term deposits (primarily those placed by individuals), because their attractiveness increased due to rising interest rates. At the same time, in December the growth rate of M_0 continued to slow down (to 5.4% YoY) from its peak achieved in H2 2020. In 2022, the money supply growth rate is expected to become slower in response to the higher interest rates and macroprudential measures designed to suppress lending growth.

As seen by data as of the end of January 2022, annual inflation in Russia over the previous 12 months had climbed 8.7% (vs 5.2% (YoY) in 2020), thus exceeding by 4.7 p.p. the target set by the RF Central Bank and hitting its record high since February 2017 (*Fig. 2*). In January of this year, the Consumer Price Index (CPI) gained 0.99% (vs 0.67% in January 2021). When seasonally adjusted, consumer inflation in January amounted to 0.71% (MoM), or 8.9% in annualized terms,¹ having accelerated on December 2021 (0.60% and 7.4%, respectively)².

The stable nature of inflationary processes has been confirmed by the movement pattern of core inflation, which accelerated relative to December³ (0.82% (MoM) in January 2022 vs 0.63% (MoM) in December 2021). Annual core inflation rose to 9.2% in January, thus having stayed above the CPI curve for 3 months in a row, which points to slower growth rates of administratively regulated prices and seasonal components of the CPI compared to its other components (*Fig. 2*).

One of the inflation acceleration factors was the pass-through effect of the ruble depreciation that occurred in November 2021 – January 2022 (over the course of 3 months, the ruble lost 7% against the US dollar) (*Fig. 3*). The pro-inflationary effect of this factor, in spite of the ruble stabilization and strengthening in late January – early February, is going to persist for another 3 to 6 months because of the lagged exchange rate pass-through effects.

As before, the key factor behind the acceleration of inflation in January was the rapid recovery of consumer demand in late 2021. According to data released to Rosstat,⁴ retail trade turnover over the course of Q4 2021 gained 4.3% (YoY) (including 5.3% (YoY) in December), and so turned out to be 2.5% above its 'pre-pandemic' level of Q4 2019 (including 3.1% higher in December).

The inflationary expectations of consumers, the business community and analysts are becoming an increasingly significant proinflationary factor. While having declined, in January 2022, by 1.1 p.p. to 13.7%,⁵ the one-year ahead inflation expectations of households remain close to multi-year highs, that is, above the range of 8–10% where this index stayed during the period of low inflation in 2018–2019. According to the inflation expectations and consumer sentiment analytics released by the Bank of Russia,⁶ companies' three-month

1 Monthly inflation raised to the power of 12.

2 Seasonal inflation adjustment was generated in the R package 'Seasonal'.

3 Excluding prices pegged to seasonal and administrative factors.

4 URL: <https://rosstat.gov.ru/storage/mediabank/osn-12-2021.pdf>

5 URL: https://www.cbr.ru/analytics/dkp/inflationary_expectations/Infl_exp_22-01/

6 URL: http://www.cbr.ru/statistics/ddkp/price_expectations/

1. The Bank of Russia's key rate hits its record high since May 2017

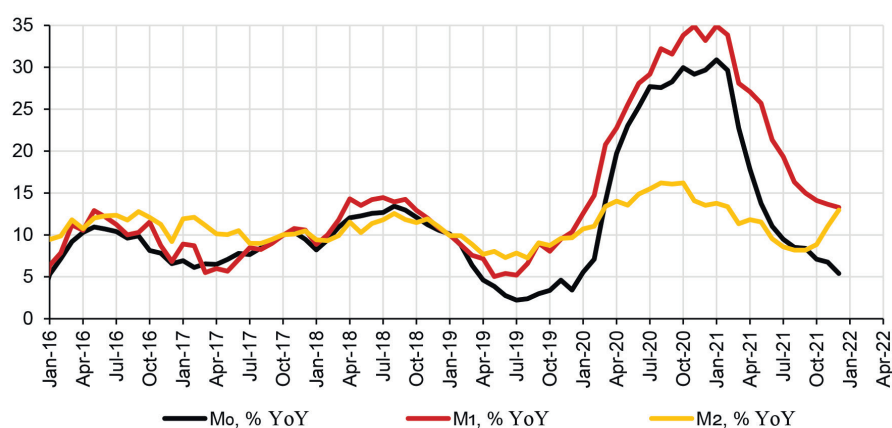


Fig. 1. The movement patterns of monetary aggregates over the previous 12 months

Source: Bank of Russia.

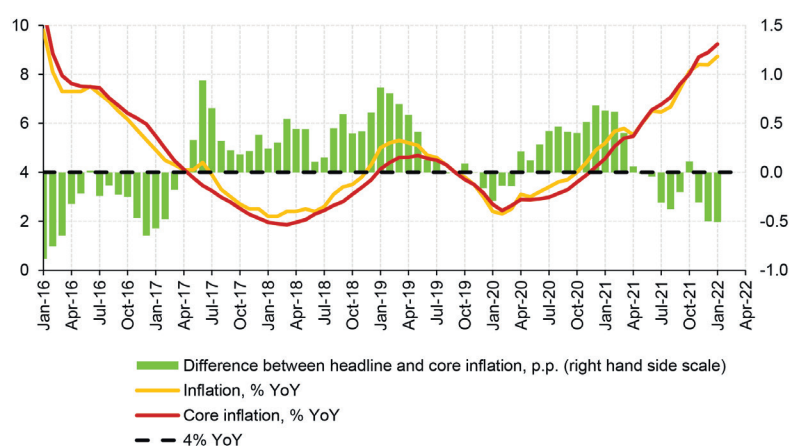


Fig. 2. The movement patterns of headline and core inflation, %

Source: Rosstat.

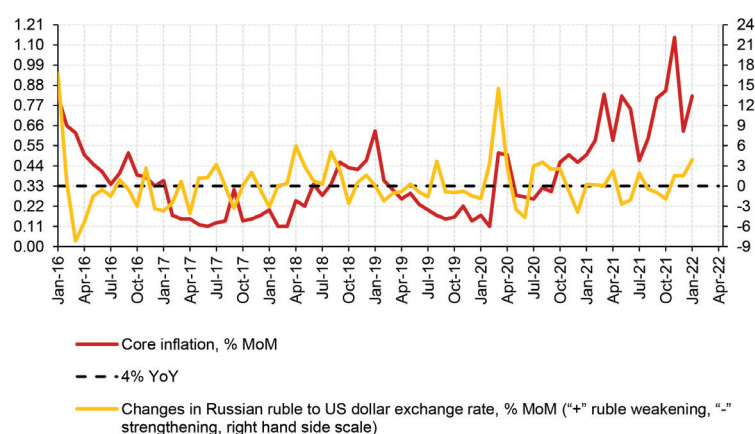


Fig. 3. The core inflation and Russian ruble to US dollar monthly movement patterns, %

Source: Rosstat; Bank of Russia.

ahead price expectations continued to go up, having hit their record high since May 2008, while the average price growth rate expected by them in the next three months equaled 5.8% in annualized terms.

A proinflationary factor on the supply side has remained the rapid increase in wages, which grew in double-digit rates in November in nominal terms, by 12.1% YoY (acceleration in real terms to 3.4% YoY). The high rate of wage growth has been sustained by the low unemployment rate, which has remained at its record low of 4.3% for 4 straight months (since September 2021). Labor shortages can drive up wages and cost inflation even further, while high consumer demand will make it possible for producers to pass along their rising costs to their product prices. In addition, cost-push inflation is being sped up by the rising purchase prices of intermediate goods due to the continuing upward movement of global food prices (the FAO price index continued to climb in January, gaining 1.1% on December 2021) and prices for energy resources (the world price of Urals crude oil in January 2022 increased by 18.5% on December 2021).

Among the CPI components, the highest acceleration in January was demonstrated by services. In particular, this was true for outbound tourism services, which can be explained, firstly, by technical factors, namely the increased weight in the consumer basket of vacation trips to Turkey (from 0.2 to 0.4%) and the inclusion into the basket, from 2022, of vacation trips to Egypt (0.1%); and secondly, by the ruble depreciation in January 2022. The accelerated prices growth across the other categories has to do with the ongoing recovery in the volume of paid services provided to the population (according to the results of Q4 2021, this index jumped by 14% (YoY), and 2.1% relative to Q4 2019). According to the weekly data release by Rosstat, over the first 4 days of February consumer prices rose by 0.17%; and according to the estimates released by the RF Ministry of Economic Development,¹ annual inflation accelerated to 8.8%. Considering the base effects of early 2021, annual inflation is most likely going to peak in April 2022, and then from May onwards this indicator will begin to decline steadily.

In January, global inflation acceleration continued. Practically in all major developed and developing countries (with very few exceptions), consumer price growth was on the rise (*Fig. 4 and 5*).

In particular, annual inflation in the USA as of the end of January 2022 jumped above its 40-year high to 7.5% (while core inflation stood at 6%). In January 2022, a slowdown in annual inflation was observed in Germany (4.9% in

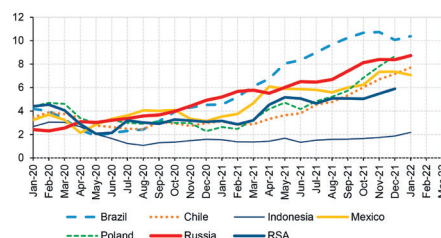


Fig. 4. Inflation over the previous 12 months in some developing countries, %

Source: IMF.

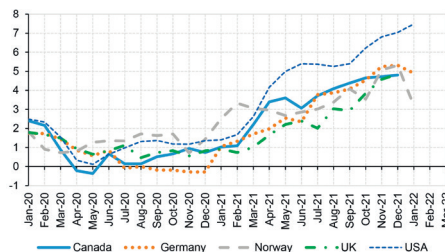



Fig. 5. Inflation over the previous 12 months in some developed countries, %

Source: IMF.

1 URL: <https://www.economy.gov.ru/material/file/e9037b2dade7d57acaa8b6ad4f0fc4d7/09022022.pdf>

1. The Bank of Russia's key rate hits its record high since May 2017

January vs 5.3% in December) and Mexico (7.1% in January vs 7.4% in December). The factors responsible for the persistently high global inflation index have remained unchanged: rising prices for tradable goods as a result of increased container shipping rates and longer delivery time; growth of world prices for energy carriers; and low crop yields in some countries.

The Bank of Russia's decision to raise the key rate, as well as its signal that the key rate is going to be further increased at its forthcoming board meetings, will conduce to pushing down both inflation and inflationary expectations. Nevertheless, given the inertia of annual inflation, its steady slowdown can be expected not earlier than the summer of 2022, while throughout the year 2022, inflation is going to remain above its target of 4%, and it will meet the target once again not earlier than mid-2023. 

2. INDUSTRIAL PRODUCTION DYNAMICS IN Q4 2021¹

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

Year 2021 saw extractive industries' growth on the back of a pickup in demand for power-generating coal and natural gas on the part of European and Asian countries, as well as ebbing restrictions related to the OPRC+ agreement (owing to higher quotas on daily oil production volumes in member countries). In 2021, the manufacturing sector saw growth, too. It was achieved as a result of higher 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.² The interpretation of the latter is of a particular interest. Experts at the Gaidar Institute cleared seasonal and calendar components from all manufacturing industries' indices for 2003–2021 and singled out the trend component³ based on the statistics published by Rosstat on output indices in industrial sectors of the economy.

The resulting series for the industrial production index as a whole 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*.

Based on results for Q4 2021, the trend component of the industrial production index saw growth driven by all three sectors: extraction of minerals, manufacturing and production and distribution of electricity, gas and water.

Growth in the extractive industries was substantiated by a pickup in production of fuel and energy materials (oil, gas and coal) and metal ore. At the same time, as seen from results for 2021 the extractive industries failed to surpass the pre-pandemic level due to oil production limitations imposed by the

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

2. Industrial Production Dynamics in Q4 2021

OPEC+ agreement (oil production accounts for a larger share of the extractive industries).

Oil production with NGL accounted for was growing in October through December 2021 as compared with the relevant period of 2020 (in October 2021 it increased by 8.9% as compared with October 2020; in November 2021, by 9.3% as compared with November 2020; in December 2021, by 8.6% as compared with December 2020). The factors facilitating this sector's growth were still the same: recovery of global demand for oil and the OPEC+ response: from August the agreed-upon level of oil production within the framework of the deal started to grow (by 400,000 barrels per day on a monthly basis; for Russia an increase was equal to about 100,000 barrels per day¹). According to the data of the RF Ministry of Energy, Russia's obligations regarding cuts in oil production under the OPEC+ agreement were fulfilled for 116%, 85% and in full based on the results for October 2021, November 2021 and December 2021, respectively.

Q4 2021 saw a pickup in gas production volumes (in October 2021 gas production increased by 9.2% as compared with October 2020; in November 2021, by 4.8% as compared with November 2020; in December 2021, by 2.8% as compared with December 2020). In this period, production growth was facilitated by internal market demand (owing to a pickup in production of nitrogen fertilizers) and an increase in gas supplies to China via the *Sila Sibiri* pipeline. Recovery of the Chinese economy after the pandemic and China's preparations for the Olympic Games spurred it to increase gas reserves; this demand was also driven by acute shortages of power-generating coal.

In December 2021, export gas supplies increased as compared with the relative period of the previous year. Potential for demand growth on the part of Europe still exists because of low replenishment of European underground gas storage facilities (UGSF): 77% in October 2021 against 95% in October 2020; 73% in November 2020 against 93% in November 2021; 60% in December 2021 against 80% in December 2020.

In Q4 2021, coal production picked up: in October 2021 it increased by 8.6% as compared with October 2020; in November 2021, by 10.8% as compared with

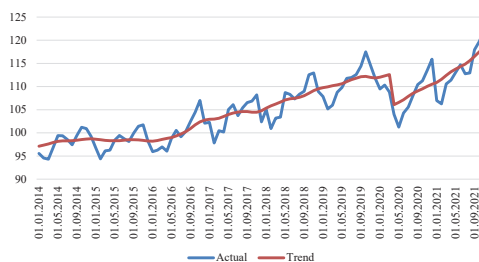


Fig. 1. Industrial Production Index Dynamics, 2014–2021 (actual data and trend component), % change relative to average annual value in 2016

Source: Rosstat, own calculations.

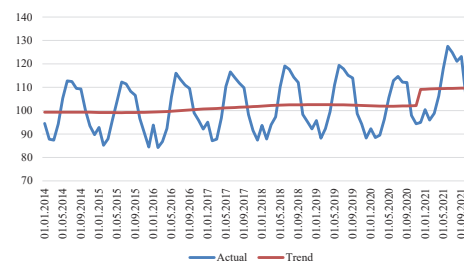
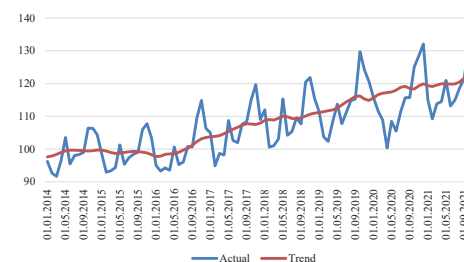
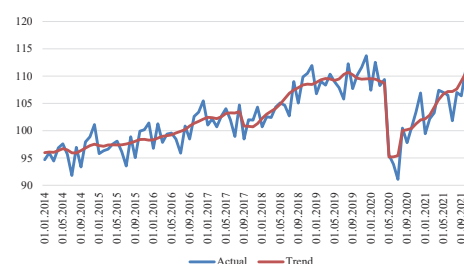


Fig. 2. Production indices' dynamics across sectors, 2014–2021 (actual data and trend component), % change relative to average annual value in 2016

Source: Rosstat, own calculations.

1 This increase in production was extended till the end of January 2022, see: 23st OPEC and non-OPEC Ministerial Meeting concludes // OPEC. 02.12.2021. URL: https://www.opec.org/opec_web/en/press_room/6736.htm

November 2020; in December 2021, by 4.8% as compared with December 2020. Growth in demand for coal in Asian and European countries is a major factor which is still influencing production outputs. Appreciation of prices for natural gas made coal mining highly competitive. Increased demand on the part of Asian countries is not fully realized because of the existing infrastructure limitations in the Far East, complicating the railway transportation of the overall extra volume of coal to the markets of the Asian-Pacific Region.

In October through December 2021, metal ore production was growing as compared with the relative period of 2020 (in October 2021 output increased by 1.0% relative to October 2020; in November 2021, by 2.0% relative to November 2020; in December 2021, by 3.1% relative to December 2020). Growth in metal ores output volumes was driven by a pickup in demand on the part of domestic producers in engineering and export supplies.

Based on results for Q4 2021, the manufacturing sector's trend component saw growth. This dynamic was mainly facilitated by:

- *the light and food industries* (production of food products, textile and leather) owing to a shift in demand towards a lower price segment (it is most commonly represented to a greater extent by domestic products, rather than foreign ones);
- *the chemical industry* (production of pharmaceuticals and materials used for medical purposes; chemical production, manufacturing of rubber and plastic articles) owing mainly to a pickup in domestic and external demand for pharmaceuticals and materials used for medical purposes, as well as external demand for Russian nitrogen fertilizers (as the manufacturing technology is based on utilization of large volumes of natural gas, with appreciation of natural gas prices this production became unprofitable in Europe and demand for exports of these products from Russia surged);
- *engineering* (manufacturing of motor vehicles, trailers and semi-trailers; machine-tool industry, manufacturing of metallurgical, mining and agricultural equipment; aircraft engineering and shipbuilding) on the back of pent-up demand, lack of supply and state support measures.

The dynamics of the trend component of fee-based services to households were still negative, probably, because of pandemic-related restrictions which were still in effect early in Q4 2021. The dynamics of the trend component of cargo turnover saw near-zero growth rates: by the end of 2021, railway transportation and trucking made a negative contribution (overall, growth was facilitated by primary commodities – coal – which exports to the Asian-Pacific Region were complicated due to infrastructure limitations). Air carriage saw growth (it increased threefold as compared with the pre-pandemic level): airline companies transport goods together with passengers on passenger flights, but when the ban was introduced on passenger services in spring 2020, goods had to be transported anyway, with this type of carriage starting to pick up in the overall pattern in 2021.

Wholesale and retail trade grew slowly. Wholesale trade picked up mainly on the back of increased sales of pharmaceuticals and medical materials, chemical fertilizers, transport vehicles, machinery and equipment, while retail trade, owing to growth in sales of nonfood products amid highly increased consumer lending.

Table 1

2. Industrial Production Dynamics in Q4 2021

Output index change across economic sectors, %

Name of sector	Share in industrial production index, %	December 2021 on December 2020	December 2021 on September 2021	Change over past months
Industrial production index		108.25	102.67	growth
Extraction of minerals	34.54	110.28	103.10	growth
Manufacturing, including:	54.91	104.40	102.97	growth
Production of food products, including beverages and tobacco	16.34			
Textile and garment industry	1.14	113.81	103.34	growth
Manufacturing of leather, articles thereof and footwear	0.27	104.51	102.21	growth
Wood processing and woodware manufacturing	2.02	105.45	102.07	growth
Pulp-and-paper industry	3.35	104.08	101.67	growth
Production of charred coal and petrochemicals	17.25	88.14	97.22	decline
Chemical industry	7.56	106.87	101.42	slow growth
Manufacturing of rubber and plastic articles	2.14	115.11	104.39	growth
Manufacturing of other nonmetallic mineral products	4.02	102.48	105.29	growth
Metallurgy and manufacturing of ready-made fabricated metal products	17.42	108.56	101.34	slow growth
Manufacturing of machinery and equipment	6.97	124.33	107.15	growth
Manufacturing of electrical, electronic and optical equipment	6.27	117.01	103.54	growth
Manufacturing of transport vehicles and equipment	6.75	104.17	103.11	growth
Other industries	2.42	111.02	104.30	growth
Electricity, gas and water supply	13.51	100.57	102.82	growth
Wholesale trade		100.54	100.09	stagnation
Retail trade		106.18	102.63	slow growth
Cargo turnover		100.65	99.46	stagnation
Building		106.00	100.81	slow growth
Volumes of fee-based services to households		109.80	102.48	slow growth

Source: Rosstat, own calculations.

Based on the results of the analysis of trend components of industrial production and other related sectors index series, it can be concluded that the main risk factors of a slowdown of industrial growth remained the same: worsening of the epidemiological situation inside the country and in countries which Russia is linked with large trade flows (for example, exports of metallurgical and chemical products to China); a rise in prices for primary commodities on international exchanges; suspension of government programs and consumer demand incentives.

In 2022, the Russian industry may expect prevalence of an upward output trend with lower growth rates than in 2021. It can be substantiated by expectations of a slowdown of the global economy because of the tightening of the monetary policy by the world's largest economies and a gradual subsiding of recovery effects after the pandemic, so the odds are not in favor of a commodity market boom. Further, uncertainties related with emergence of new coronavirus variants should be taken into account, too. 

3. RESTRICTIONS ON INVESTMENT ACTIVITY OF INDUSTRIAL ENTERPRISES AT THE BEGINNING OF 2022

Sergey Tsukhlo, Candidate of economic sciences, Head of Business Surveys Department, Gaidar Institute

The monitoring of investment activity conducted by the Gaidar Institute makes it possible to build a hierarchy of factors constraining the industrial investment optimism in the beginning of 2022. First of all, it signifies that enterprises lack their own funds, then high prices for machinery and equipment followed by high cost of loans and difficulties to get them for long-term purposes, as well as low return on investment.

The investment optimism that the Russian industry has been demonstrating for 11 months is not enough, although it is marked by stability.¹ The latter makes relevant to analyze the restrictions of investment activity precisely from the perspective of enterprises. Such an analysis is feasible based on results of the monitoring, which we initiated as early as January 1996. Since then, every year we question managers of the companies what restricts most of all the growth of capital investments in the enterprise in the new year. The most recent data were obtained in January 2022.

“Lack of own funds” was and still remains the most common restriction of the investment activity. In 2022, this factor constrains the investment activity of 54% of enterprises. Compared to 2021, the lack of own financial resources was cited more often, while a year ago it was noted by 45% of enterprises. The absolute minimum of citations (43%) was registered in 2020 compared to the maximum (91%) in 1998. Growing downward pressure related to deficit of own funds against growth of the balanced financial result can be explained by the increase in prices for Russian machinery and equipment, which enterprises plan to purchase, as well as an increase in the cost of construction and installation works. Weaker ruble also creates challenges: thus, machinery and equipment manufactured in Western Europe secure the first rank of preferences of Russian enterprises even according to data of September 2021.

Indeed, high prices for machinery and equipment are in 2nd place in the ranking of restrictions. This factor is now indicated by 48% of enterprises (the absolute maximum of references to this restriction for all 27 years of our monitoring), while in January 2020 it was 30% (the absolute minimum).

The enterprises awarded a 3rd place in the 2022 ranking of restrictions to a high interest on loans. In one year (from January 2021 to January 2022) this factor evidenced the most significant growth, i.e. from 12% of references (absolute minimum) to 30%. The latter value is not the highest (i.e. the worst)

¹ The balance of investment plans since April 2021 remains in the range of +10...+15 p.p. In 2019, this indicator showed changes from -6 to +15 p.p.

3. Restrictions on investment activity of industrial enterprises at the beginning

for this indicator, however, no other factor has demonstrated such a rise in the number of references over the past year. However, such growth is not surprising at all. In 2021, surveys registered a minimum value of the rate on loans offered to enterprises (8.6% per annum in rubles), which then demonstrated growth and reached 11.3% by February 11, 2022. The next (February) regulatory decision on the key rate will definitely cause further growth of this indicator.

Difficulties in obtaining a long-term loan also showed a significant increase being a barrier to the investment growth. If only 6% of enterprises indicated this factor a year earlier (the absolute minimum), 17% of enterprises began to mention it early 2022. Hence, this barrier moved from the 10th to 5th place in the ranking over the year.

The low earning power of investments showed minimal growth compared to 2021, and 21% of enterprises consider it now as a constraining factor.

The next factor is the “uncertainty about the fast recovery of the Russian economy”. Unlike other, it has demonstrated an impressive decline over 12 months, from 31% to 12%. Consequently, the industry is now fairly confident in the domestic economic growth as a favorable factor for investment. A similar situation is developing in respect of the “uncertainty about the fast recovery of the global economy”. The constraining effect of the mentioned cause on the Russian investments dropped to 8% after the 20% cited in January 2021.

The excess of available capacities as a factor restricting the investment activity of enterprises demonstrated the third largest decrease in the number of references in January 2022. Whereas excessive capacities were regarded as a barrier by 12% of enterprises in 2021 (14% in January 2020), now it is cited only by 6% of enterprises. Such dynamics of references corresponds to a record-breaking shortage of capacities at the beginning of 2022 according to enterprises' estimates. However, a less significant negative impact of excess capacity on the investment activity of enterprises was recorded in the course of our 27-year monitoring. Thus, in 2005–2006 this factor was cited only by 2%. A similar result was obtained in January 2015 immediately after the start of the economic crisis. 