

MONITORING OF RUSSIA'S ECONOMIC OUTLOOK:

TRENDS AND CHALLENGES OF SOCIO-ECONOMIC DEVELOPMENT

No. 9(165) November 2023

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1. ACCELERATING INFLATION WILL REQUIRE A HIGHER KEY RATE IN 2023–2024

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Based on October results, the year-over-year inflation (for the past 12 months) has sped up to 6.7% with the level of consumer prices in October increasing by 0.83%, thus amounting to 9.7% in terms of annual growth rates of prices with seasonality adjusted. On October 27, the Central Bank of Russia raised the key rate by 200 basis points to 15.0% annually; as a result, in the current cycle of the monetary policy tightening which began on July 21, the key rate has already increased twofold. The signal of the monetary policy's further direction was mitigated and the regulator put its future decisions in dependence on the inflation rate's actual dynamics in the forthcoming months. The Central Bank of Russia's updated forecast allows growth in the key rate by another 100 basis points in December and its average increase by 150 basis points in 2024.

On October 27, 2023, at its regular meeting on the monetary policy the Board of Directors of the Central Bank of Russia made a decision to raise the key rate by 200 basis points to 15.0% annually. The rate was increased at the fourth meeting in succession (including the extraordinary one held on August 15) and since July 21 its growth has amounted to 750 basis points. Earlier, the key rate was only twice at the level of 15% or more: from December 2014 till March 2015 and from March to April 2022. The tightening of the monetary policy was caused by a growing inflationary pressure which peak was observed in September on the back of domestic demand expansion, as well as growing inflation expectations.¹ The decision turned out to be tougher than expected; analysts predicted an increase of 100 basis points in the key rate.²

The Central Bank of Russia has mitigated the signal of future dynamics of the key rate by putting its further steps in dependence on the inflation actual data in the forthcoming months and noting that at the final meeting in December they may increase the key rate by another 100 basis points. In the updated forecast, the Central Bank of Russia raised the average annual level of the key rate in 2024 straight by 150 basis points (to 12.5–14.5%)³ as compared with the September meeting and the average inflation forecast for 2024 by 0.8–0.9 basis points (up to 5.8–6.5%). Also, the report on the monetary policy says that the Central Bank of Russia increased its evaluation of the real neutral interest rate by 50 basis points to 2–3% because of a softer fiscal policy than it was earlier expected.⁴

1 URL: https://www.cbr.ru/press/pr/?file=27102023_133000key.htm

2 URL: <https://www.interfax.ru/business/927849>

3 URL: https://www.cbr.ru/Collection/Collection/File/46535/forecast_231027.pdf

4 URL: https://www.cbr.ru/Collection/Collection/File/46552/2023_04_ddcp.pdf

Monitoring of Russia's Economic Outlook

The Bank of Russia raised its expectations regarding GDP dynamics in 2023 to 2.2–2.7% owing to the improvement of the forecast of gross capital formation dynamics. The forecast of GDP growth in 2024 remained unchanged as compared with the September version, but the dynamics of GDP components were adjusted. So, the private consumption forecast got worse: in 2024 the regulator expects a decrease of 1–2% in this indicator on the back of reduction in consumer lending because of high interest rates and households' saving behavior next year. At the same time, expectations regarding export dynamics were raised (a 1.5–3.5% growth in this GDP component is predicted). The forecast of growth in GDP and its components in 2025–2026 remained unchanged. In 2024, the forecasts of growth rates of lending to companies and individuals (including mortgage lending) declined by 2 p.p. because of a higher trajectory of the key rate relative to the September estimates. At the same time, the forecast of growth rates of money supply in the national definition remained unchanged owing to the budget channel's large contribution to the formation of money supply, as well as continued devaluation of banks' assets and liabilities.

The Central Bank of Russia has raised the inflation forecast as of the end of 2023 to 7.0–7.5% owing to continued growth in domestic demand which exceeded capacity to increase supply, as well as labor shortages which caused growth in companies' costs. The inflation forecast as of the end of 2024 increased to 4.0–4.5%, the forecast of average inflation in 2024 picked up by 0.8–0.9 basis points to 5.8–6.5%. The revised forecast suggests either slowdown of the current inflation to 4% as early as the end of Q1 2024 or its value being below 4% in H2 2024.

At the same time, based on results of October 2023, the inflation rate over the previous 12 months kept accelerating and amounted to 6.7% (Fig. 1). Annual inflation growth which started in May 2023 was justified by appreciation of prices for non-food and food products in July–October 2023 and high growth rates of prices for services which had appreciated actively since the mid-2022; in October they accounted for about 40% of annual growth in prices of the consumer basket as a whole (Fig. 1).

In October, the level of consumer prices increased on average by 0.83% MoM. Over 50% of appreciation of the consumer basket was justified by a pickup in prices for food products without fruits and vegetables (+0.43 p.p.) (Fig. 2).

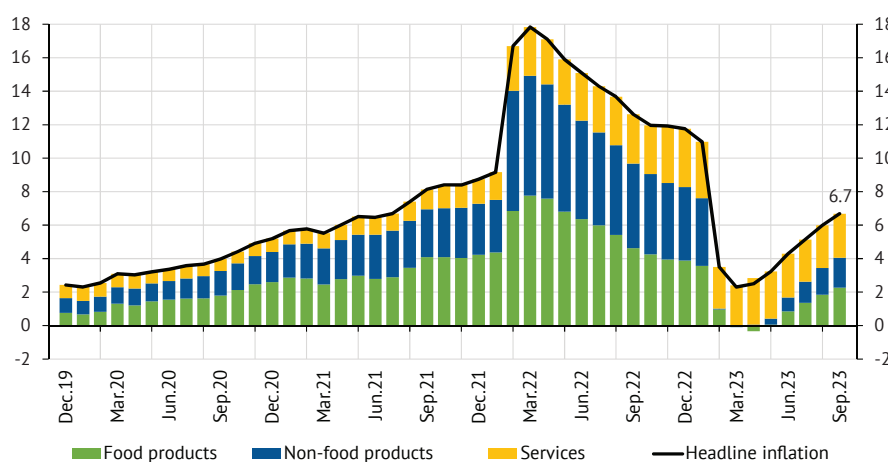


Fig. 1. Components' contribution to annual inflation, basis points

Source: Rosstat.

1. Accelerating Inflation will Require a Higher Key Rate in 2023–2024

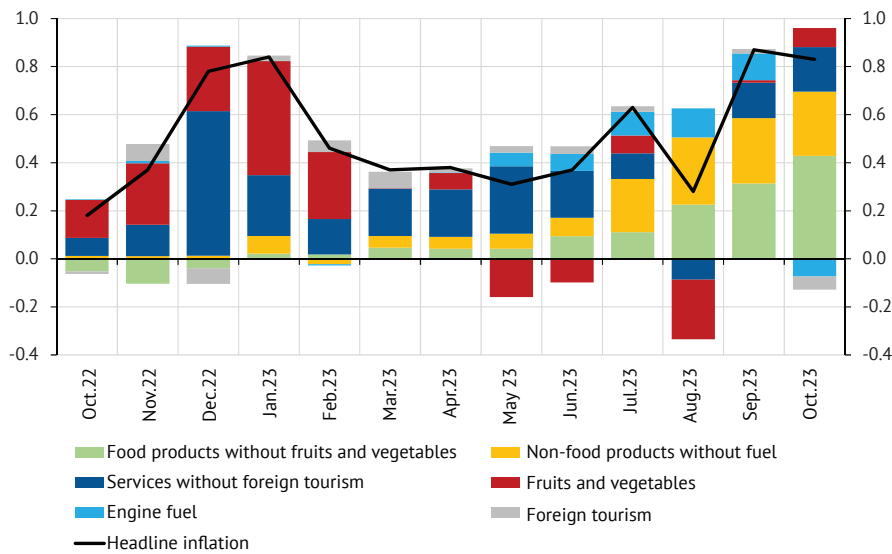


Fig. 2. Contribution of individual components to monthly inflation, basis points

Source: Rosstat, own calculations.

Non-food products without engine fuel kept contributing for three consecutive months to monthly growth of 0.27 basis points in the cost of the consumer basket. At the same time, for the first time since February 2023 prices for engine oil depreciated in October on the back of a return to the initial version of the damper mechanism, as well as the ban on exports of petrochemicals from September 21.¹ However, this consumer basket component has appreciated by 8.3% since the beginning of the year. Also, prices for foreign tourism services decreased in October (a decline of 7.7%).

With seasonal adjustment,² we assess consumer inflation in October at the level of 0.8% MoM or 9.7% in SAAR terms³ after acceleration to 14% in September (Fig. 3). In October, among the components of seasonally adjusted inflation appreciation of prices for food and non-food products slowed down, while growth rates of prices for services remained at the September level. Despite the slowdown, growth rates of consumer basket components surpassed considerably the level of 4% in October; the current inflation has been above the target since May 2023, while a three-month moving average of seasonally adjusted inflation in SAAR terms exceeded 11% in September and October (Fig. 4). This is caused by increased consumer demand as indicated by high growth rates of retail trade and fee-based services to the population in Q3 2023 (11.3% and 4.9%, respectively⁴), the effect of the passthrough of depreciation of the ruble exchange rate over the past 12 months to prices (in October 2023 the index of the nominal effective exchange rate of the ruble pointed to a 36% depreciation of the national currency over the past year), as well as labor shortages which translated into wage growth (in January–August real wages increased by 7.5% on the relevant period of the previous year), while with increased demand for products companies shift growth in costs to prices for goods.

1 URL: <http://static.government.ru/media/files/fGt9B6J6lk0SZINAKnna2U4v2AMGWG0c.pdf>

2 Inflation seasonal adjustment is made by means of R program with use of the seasonal package.

3 Monthly inflation raised to the power of 12.

4 URL: <https://rosstat.gov.ru/storage/mediabank/osn-09-2023.pdf>

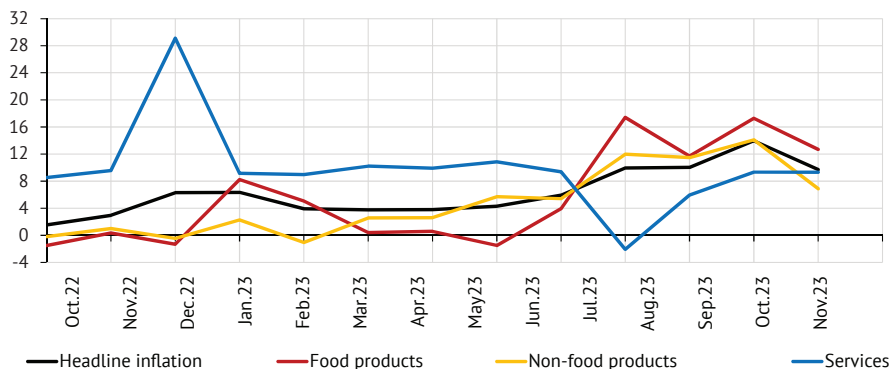


Fig. 3. Dynamics of headline inflation and its main components, % SAAR

Source: Rosstat, own calculations.

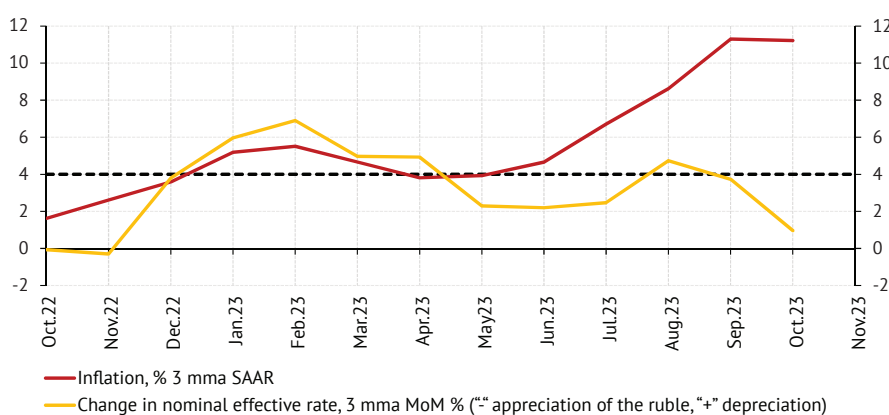


Fig. 4. Inflation and dynamics of the Russian ruble/US Dollar exchange rate, MoM, %

Source: Rosstat, the Central Bank of Russia.

In September, the exchange rate of the ruble against the currencies of Russia's main trade partners stabilized, while in October it appreciated by 0.8%¹ on the back of improved terms of trade and passed decisions on tightening of the monetary policy and return of the requirement for mandatory sale of foreign exchange earnings.² However, the passthrough of depreciation of the ruble exchange rate which took place in H1 to prices is going on and is still a pro-inflationary factor. Another pro-inflationary risk can be seen in the fiscal policy mitigation in terms of revision of the value of base oil and gas revenues: instead of the fixed value of Rb8 trillion in nominal terms this indicator's calculation will be based in 2024 on the Russian oil price of \$60 per barrel,³ thus making it feasible to increase expenditures by Rb 1.7 trillion.

By Rosstat's estimates, on November 1–7 consumer prices appreciated by 0.37%,⁴ a considerable increase as compared to the upward price trajectory in the relevant period of the previous year. From the beginning of 2023 till November 7, prices appreciated by 5.9%, while by the estimates of the Ministry of Economic Development the annual inflation sped up to 7.0%.⁵ Most likely, prices

1 URL: https://www.cbr.ru/vfs/statistics/credit_statistics/ex_rate_ind/03-ex_ru_23.xlsx


2 URL: <http://government.ru/news/49778/>

3 URL: <http://publication.pravo.gov.ru/document/0001202311020013?index=2>

4 URL: https://rosstat.gov.ru/storage/mediabank/175_10-11-2023.html

5 URL: https://www.economy.gov.ru/material/file/fb369cecbc19d5a2211444b697c63c0f/o_tekushchey_cenovoy_situacii_10_noyabrya_2023_goda.pdf

1. Accelerating Inflation will Require a Higher Key Rate in 2023–2024

in November will grow by 0.9–1.0% MoM which corresponds to the annual inflation of 7.3–7.4%, while based on results of December the inflation is expected to be equal to 7.5–7.6% year over year. According to our model projections, the annual inflation will reach its peak (8.0%) late in Q2 2024, while by the end of 2024 it slows down to 5.5–6.5%. The quarterly seasonally adjusted inflation will start declining as early as Q4 2023. The main reasons for the slowdown will be the cooling of consumer and investment demand owing to the tight monetary policy, as well as a gradual exhaustion of the effect of the passthrough of the ruble exchange rate to prices. 

2. FEDERAL BUDGET EXECUTION AT THE END OF 10 MONTHS OF 2023: BETTER-THAN-EXPECTED SITUATION

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The dynamic of federal budget revenues in January-October 2023 in comparison with the same period of the previous year was multidirectional: the growth of non-oil and gas revenues by 2.1 p.p. of GDP was followed by a decrease in rent revenues by 2.8 p.p. of GDP. The related increase in public expenditures by 0.7 p.p. of GDP in the first 10 months of 2023 as compared to the same period of 2022, although it slightly increased the federal budget imbalance as compared to the corresponding values of the previous year (increase in the budget deficit by 1.4 p.p. of GDP), but there is no noticeable increase in the risks of short-term budget instability. At the end of the current year, due to the adjustment of taxation of the oil and gas sector, which makes it possible to prevent a further decline in rent revenues, preservation of the dynamics of VAT revenues outstripping the GDP growth rate, as well as incomplete utilization of the planned annual volume of expenditures, a budget deficit in the range of Rb2–2.5 trillion can be expected. If the planned volume of expenditures is achieved, the deficit may exceed this level.

In January-October 2023, the federal budget revenues amounted to Rb23.1 trillion or 19.2% of GDP, which is 0.7 p.p. lower than in the same period of the previous year (Table 1). At the same time, the volume of oil and gas revenues dropped by Rb2.6 trillion or 2.8 p.p. of GDP, mainly on the back of a decline in oil and gas revenues. The share of oil and gas revenues in the total volume of budget revenues also decreased to 31.2% against 44.2% a year earlier.

Table 1

Main parameters of the federal budget for 10 months of 2022–2023

	January-October 2022			January-October 2023			Change in 2023 against 2022	
	Billion rubles	% GDP	Cash execution, %	Billion rubles	% GDP	Cash execution, %	Billion rubles	% GDP
Revenues including:	22 139	19.9	79.6	23 106	19.2	80.6	967	-0.7
oil & gas revenues	9 788	8.8	84.5	7 210	6.0	81.3	-2 578	-2.8
non-oil and gas revenues, including:	12 351	11.1	76.1	15 896	13.2	80.2	3 545	2.1
Expenditures	21 785	19.6	70.0	24 341	20.3	76.8	2 556	0.7
Budget surplus (deficit)	354	0.3		-1 235	-1.1		-1 589	-1.4
Non-oil and gas deficit	-9 434	-8.5		-8 445	-7.1		989	-0.7
For reference: GDP (in current prices), Rb bn	124 000			131 400				

Source: Ministry of Finance of Russia, Russian Treasury, Portal “Electronic budget”, Rosstat, own calculations.

2. Federal budget execution at the end of 10 months of 2023

The cash execution of oil and gas revenues of the federal budget for 10 months of the current year amounted to 81.3% vs. 84.5% for the same period of 2022. A slight lag in actual volumes from the projected ones is noted for all hydrocarbon components, except for mineral extraction tax (MET), the actual execution of which amounted to Rb1.3 trillion, already exceeding the projected annual volume (slightly more than Rb1.2 trillion). The MET is slightly behind in cash execution, however the situation is not alarming given the positive monthly dynamics of revenues: in October, the volume of oil and gas revenues increased 2.5 times against January values (Rb1108 bn vs. Rb438 bn) including oil revenues of Rb952.2 bn vs. Rb364.1 bn, respectively.

In recent months, rent revenues to the budget have been supported not only by a relatively high oil price and a relatively cheap ruble, but also by Gazprom's monthly payments of additional MET in the amount of Rb50 bn (this tax is expected to remain in force until the end of 2025). However, in October, the ruble strengthened and continued strengthening in November as did the decline in oil prices. The continuation of these trends until the end of the year is fraught with the risk of slowing down the positive dynamics of oil and gas revenues for the budget, but with high probability the September estimates of the Russian Finance Ministry¹ regarding the annual volume of oil and gas revenues in the amount of Rb8,863 bn at the average export price for Russian oil of \$63.4/bbl and the exchange rate of 85.2 Rb/dollar will be exceeded. According to our estimates, rent revenues to the budget at the year-end will amount to about Rb9.3 trillion.

Non-oil and gas revenues at the end of 10 months of 2023 relative to 2022 have grown significantly: by Rb3.5 trillion in nominal terms, or by 2.1 p.p. of GDP. Revenues from import VAT (+0.8 p.p. of GDP) and other non-tax revenues (+0.9 p.p. of GDP) were the main drivers of growth. Receipts from non-oil and gas revenues to the budget are in reality higher, but their total volume is formed taking into account the damper payments² (about Rb1.14 trillion was returned to oil companies in the first nine months of this year).

The level of cash execution of the federal budget on non-oil and gas revenues for 10 months of the current year amounted to 80.2% of the annual projected volumes. According to our estimates, by the end of 2023, the volume of non-oil and gas revenues may amount to around Rb19.2 trillion instead of the September forecast of the Russian Ministry of Finance of Rb19.8 trillion, mainly due to more restrained dynamics of direct tax payments.

The federal budget expenditures in January-October 2023 rose by Rb 2.5 trillion, or by 0.7 p.p. of GDP versus the corresponding period of the previous year with a higher level of funds utilization (76.8 vs. 70.0% of annual volumes according to the consolidated budget statement). GDP against the corresponding period of the previous year with a higher level of funds utilization (76.8 vs. 70.0% of the annual volumes according to the Consolidated Budget Statement). The absence of publicly available data on the execution of expenditures in the functional breakdown for the period under review makes it impossible to assess changes in their structure, but given the outstripping financing of power expenditures during the current year, there is a high probability of a slight decrease in the share of productive expenditures in the total volume of federal


1 According to the Explanatory Note to the Draft Law on the federal budget for 2024 and the planning period of 2025 and 2026.

2 A mechanism to compensate refineries for revenue shortfalls when selling gasoline and diesel fuel on the domestic market. Used to curb domestic prices for motor fuel.

budget expenditures. This trend is quite consistent with the provisions of the law on the federal budget for the coming three-year period adopted by the State Duma of the Russian Federation.

According to the results of January-October of the current year, the federal budget deficit amounted to about 1.1% of GDP against the official forecast of 1.8% of GDP. The monthly dynamics of the budget balance reveals a rather pronounced tendency towards a decline in the deficit during the year: Rb3.0 trillion in April, Rb2.6 trillion in July, Rb1.2 trillion in October. At the same time, the final value of the federal budget deficit depends primarily on the execution of the planned volume of expenditures: in case of their full utilization and taking into account the previously announced estimates of budget revenues, the deficit may grow up to Rb3.5 trillion.

Domestic borrowings will continue to be the main source of deficit repayment, their accumulated volume as of 01.11.2023 came to Rb20.4 trillion.¹ In the period under review, the National Welfare Fund accounts were not replenished and the total amount of withdrawals amounted to Rb560.7 bn. As of the end of September of the current year, the Fund's resources amounted to Rb13.6 trillion against Rb10.4 trillion at the beginning of the year; this growth was mainly due to the exchange rate difference.

In general, the situation with the federal budget execution for the first 10 months of 2023 can be characterized as quite favorable despite much more pessimistic expectations at the beginning of the year. Nevertheless, the main risks of budget imbalance in the form of lower oil prices in the wake of the global recession and sanctions, strengthening of the ruble in response to the monetary policy pursued by the Central Bank of the Russian Federation, slowdown in the dynamics of the Russian GDP due to the exhaustion of growth drivers, increase in power expenditures not only persist, but also grow. It is very likely that the potential issues of federal budget execution expected by experts earlier are not going away, but are only being shifted to the next year. 

1 According to the Russian Finance Ministry website. URL: <https://minfin.gov.ru/>.

3. REGIONAL BUDGETS IN Q3 2023

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As a result of the accelerated growth of the Russian economy in Q3 2023, the growth rates of tax and non-tax revenues of the consolidated budgets of the subjects of the Russian Federation reached double-digit values, which, while maintaining relatively low growth rates of budget expenditures in Q2 and Q3, became a precondition for high indicators of fiscal balance of regional and local budgets following the results of 9 months of 2023.

Revenues

Excluding the data on the new subjects of the Russian Federation,¹ the total volume of the consolidated regional budget revenues amounted to Rb15.4 trillion in the first nine months of 2023, having increased by 9.8% as compared to the same period of 2022, which is higher than both the inflation rate² and the growth rate of budget revenues in H1 2023 (+7.3%). In H2 of 2023, the impact of the transition of taxpayers to the payment of taxes through a single tax account on the dynamics of budget revenues of the regions began to fade and this dynamic increasingly reflects the situation with the revenue base of regional and local budgets.

The rise in the growth rates of budget revenues in the first 9 months of 2023 is due to the high performance in Q3 when the revenues of regional and local budgets grew by 14.7% against the corresponding period of 2022.

The highest contribution to the growth of regional consolidated budget revenues in the first 9 months of 2023 was made by tax and non-tax revenues (+12.1%), which also became the driver of growth of budget revenues of the regions in Q3 2023 (+23.5%). The main role in this was played by GDP growth played the main role in this, the index of physical volume of which amounted to 105.5% in Q3 2023, according to the preliminary estimate of Rosstat.³

Among the main taxes, the highest growth in the first 9 months of 2023 was shown by: corporate income tax – +19.0% (+54.7% in Q3 2023), personal income tax – -12.0% (+24.9%) and taxes on total income – +8.8% (+14.3%). Other taxes grew at rates close to or below the inflation rate: excise taxes – +3.3% (-0.6%), property taxes – +5.0% (-13.8%). Non-tax revenues decreased – -2.9% (-0.7%) and uncompensated receipts from other budgets – -1.9% (-23.2%).

1 Hereinafter, unless otherwise specified, in order to ensure comparability of regional budget statistics, state and municipal debt as well as their growth rates, data are given without data for Donetsk and Lugansk People's Republics, Zaporizhzhya and Kherson Oblasts.

2 According to Rosstat, the consumer price index amounted to 106.0% in September 2023 vs. September 2022, and 105.4% in January-September 2023 vs. January-September 2022.

3 URL: https://rosstat.gov.ru/storage/mediabank/vvp_15-11-2023.html

Negative dynamics of fiscal transfers in Q3 2023 was observed in most types of inter-budget transfers: grants for balance showed -77.3%, subsidies – -15.0%, subventions – -43.5%, other fiscal transfers – -47.5%. And only the growth of grants to equalize fiscal capacity remained in the positive zone – +0.2%.

Sevastopol (+30.9%, the main growth was provided by subsidies for balance and gratuitous receipts from non-state organizations), the Leningrad Oblast (+27.4%, corporate profit tax and uncompensated receipts from state (municipal) organizations), Krasnodar Krai (+26.8%, corporate profit tax and uncompensated receipts from state (municipal) organizations), Smolensk Oblast (+24.4%, corporate profit tax, personal income tax and subsidies) and Jewish Autonomous Oblast (+22.5%, corporate profit tax and subsidies).

Of the 13 subjects that experienced a decline in budget revenues, 4 had a decline exceeding 10%: the Nenets Autonomous Okrug (-27.4%), the Republic of Khakassia (-21.1%), the Republic of Mordovia (-19.0%) and the Kemerovo Oblast – Kuzbass (-16.1%) where the main reason for the reduction can be attributed to the high base of 9 months of 2022.¹

The main sources of revenues of the new subjects of the Russian Federation in the first 9 months of 2023 were grants to support measures to ensure balanced budgets (28.0%), other grants not related to the leveling of fiscal capacity and ensuring balanced budgets (54.5%), personal income tax (7.7%), corporate profit tax (2.9%), as well as non-tax revenues (1.7%). Having said that, the share of tax and non-tax revenues (14.4%) had a steady upward trend since the beginning of the year.

The restoration of high growth rates of the regions' main tax revenues in Q3 2023 reduces the need to provide them with additional financial assistance and will contribute to maintaining the sustainability of subnational budgets.

Expenditures

As of the end of 9 months of 2023, the expenditures of the regional consolidated budgets came to Rb14.3 trillion, having gone up by 11.9% as compared to 9 months of 2022, which is higher than both the inflation rate and the growth rate of budget revenues (+9.8%). At the same time, the growth rates of expenditures during the year were uneven: after a sharp jump in Q1 by 20.0% in Q2 and Q3 of the current year, expenditures grew significantly slower (+8.4% and +9.4%, respectively).

The leaders of growth were expenditures on national security and law enforcement (+54.0%), housing and public utilities (+23.3%), general state issues (+18.4%), social security (+17.6%), culture and cinematography (+15.4%), agriculture and fishery (+14.5%), transportation (+14.0%) as well as general education (+13.7%). The significant growth of regional expenditures on national defense was due to the low base effect, since even after multiple increases the share of such expenditures amounted to only 0.6% of the total volume of the regional consolidated budgets expenditures.

Due to the curtailment of many anti-Covid measures, health care expenditures remained virtually unchanged (+0.1%) while the reduction in the volume of the regional commercial debt owing to its replacement by budget loans led to a significant reduction in expenditures on its servicing (-28.7%).

¹ The growth rates of the consolidated budgets revenues of the specified subjects of the Russian Federation at the end of 9 months of 2022 in relation to the same period of 2021 amounted to +20.4% in the Nenets Autonomous Okrug, +52.7% in the Republic of Khakassia, +42.0% in the Republic of Mordovia, +64.6% in the Kemerovo Oblast - Kuzbass.

3. Regional budgets in Q3 2023

Consolidated budget expenditures for the first 9 months of 2023 have grown in 76 subjects of the Russian Federation, and in 65 of them the growth exceeded inflation for the same period. The leaders in the growth of budget expenditures are Sevastopol (+38.3%, the main increase was in national defense, housing and utilities, social policy, health care and culture), the Republic of Adygea (+27.5%, general education, culture, social security), the Novgorod Oblast (+26.4%, road funds, education, culture), St. Petersburg (+25.7%, transport, road facilities, housing and utilities), the Smolensk Oblast (+25.2%, housing and utilities, road facilities and health care).

Budget expenditures decreased in the Tyumen Oblast (-11.5%), the Karachay-Cherkess Republic (-6.4%), the Nenets Autonomous Okrug (-4.3%), the Amur Oblast (-4.0%) and the Republic of Tyva (-3.9%). In the Tyumen Oblast this reduction was a correction rebound after the growth of 52.0% in 9 months of 2022 while in the other regions the reduction was small and did not have a significant negative impact on the current budget execution.

The structure of expenditures of the new subjects of the Russian Federation in H1 2023 differed from the structure of other regions by a smaller share of expenditures on the national economy (8.1% vs. 21.3%), housing and utilities (2.6% vs. 10.5%) and education (14.3% vs. 24.2%), but a larger share of expenditures on national security and law enforcement (5.1% vs. 1.5%), as well as social policy (50.0% vs. 20.1%). If we assess the difference in the structure of budget expenditures of the groups of the subjects of the Russian Federation under consideration as the sum of absolute values of deviations in the specific weights of budget expenditures by sections of the functional classification, a weakly pronounced tendency to its reduction can be noted in 2023.

Regional budget balance and public debt

The consolidated budget surplus was observed in 67 Russian regions and its total volume amounted to Rb1.1 trillion or 7.5% of total revenues of the regional consolidated budgets excluding subventions. Among the new regions, only Zaporozhskaya Oblast had a consolidated budget surplus.

High indicators of the current high indicators of the current balance of regional budgets are still not reflected in the dynamics of the public debt, the volume of which continued to grow and as of October 1, 2023 amounted to Rb3.15 trillion. Thus, the debt growth since the beginning of the year amounted to Rb356.5 bn or 12.8%, and as compared to the corresponding period of 2022 – Rb451.2 bn, or 16.7%. The main reasons for the growth of public debt at a high level of budget surplus are treasury credits to cover cash gaps incurred by the regions due to changes in the timing of tax revenues to the budget as well as provision of infrastructure budget credits to the regions, the amount of which does not depend on the budget balance.

Although the size of the regions' debt burden¹ increased from 20.0% to 21.5% between October 1, 2022 and October 1, 2023, it remains below the majority of values as of that date in the period since 2014 (*Fig. 1*).

The number of regions with debt burden over 50% increased from 23 to 25 in 12 months, but still does not pose a threat to the stability of regional budgets (*Fig. 2*).

¹ The debt burden of a RF region is defined as the ratio of the volume of public debt of the region to the volume of tax and non-tax revenues of the regional budget.

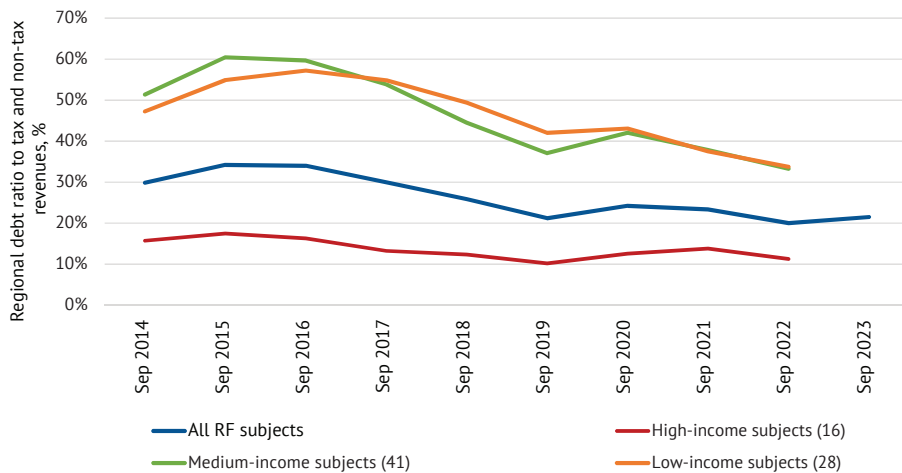


Fig. 1. Debt burden of RF subjects as of October 1, %

Source: own calculations based on RF Ministry of Finance and Federal Treasury data.

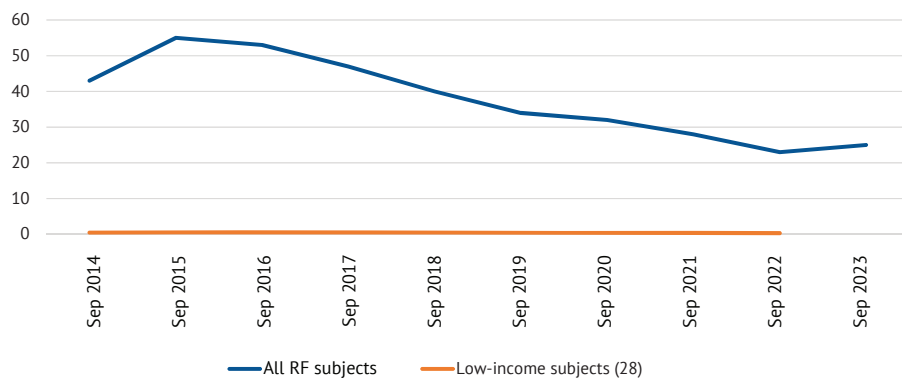


Fig. 2. Number of RF subjects demonstrating debt burden more than 50% as of July 1

Source: own calculations based on RF Ministry of Finance and Federal Treasury data.

ITS Having said that, for the first time in a long period of time, there were no subjects of the Russian Federation with a debt burden exceeding 100% of the volume of tax and non-tax revenues of the regional budget.

In general, over 12 months, from the end of September 2022 to the end of September 2023, the public debt increased in 73 subjects of the Russian Federation, and the debt load – in 47 subjects of the Russian Federation.

As a result of the policy pursued by the federal government in 2022–2023 of replacing the expensive to service regional commercial public debt (loans of credit institutions and government securities) with budget loans, the share of loans of credit institutions in the total volume of regional public debt decreased to 1.7% as of October 1, 2023, and the share of government securities – to 19.2%. In turn, the share of budget credits over 12 months increased from 69.6% to a record 77.9% (Fig. 3).

Thus, in Q3 2023 the trend of the previous months continued – the growth of regional public debt against the background of high indicators of budget balance – which, obviously, will be observed until the end of 2023 amid the continuation of provision of infrastructure budget loans. At the same time, the traditional December jump in public debt is not expected owing to both high current growth rates of own tax and non-tax revenues of regional budgets and the cumulative surplus in the first 9 months of 2023.

3. Regional budgets in Q3 2023

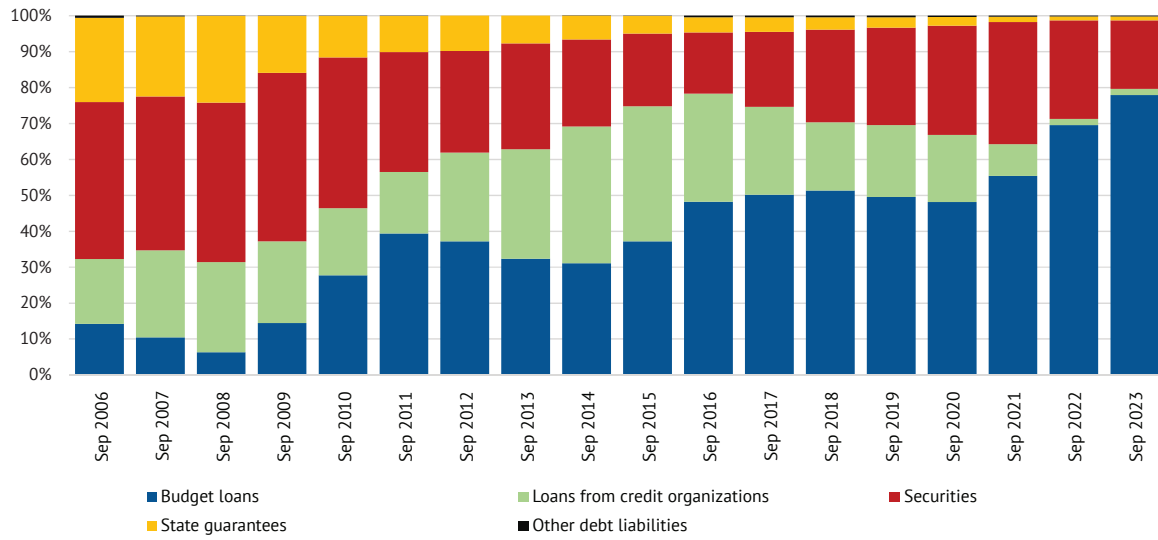



Fig. 3. Structure of public debt of the RF subjects as of October 1, % of total

Source: own calculations according to RF Ministry of Finance. 

4. MORTGAGE LENDING IN JANUARY-SEPTEMBER 2023

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

In the first three quarters of 2023, the volume of mortgage loans issued significantly exceeded (by 71.8%) the same indicator of the corresponding period of 2022. The growth of household incomes, preferential mortgage lending programs, expectations related to its tightening, as well as joint programs of banks and developers are drivers of demand growth. Recently, there has been a deterioration in lending standards: the share of mortgage loans to borrowers with high debt burden ratio (DLR) has been increasing.

As of October 1, 2023, the aggregate portfolio of residential mortgage loans (HML) hit Rb16.9 trillion. The aggregate portfolio growth for the three quarters of this year amounted to Rb3.1 trillion, or 22.1%, which is significantly higher than in the same period last year when the mortgage loan portfolio grew by Rb1.3 trillion, or 11.2%.

In total, in the first nine months of 2023 around 1.5 million loans totaling Rb 5.5 trillion were originated, while the corresponding values of the previous year amounted to 0.9 million loans totaling Rb3.2 trillion, with a 71.8% increase in the value of originations compared to last year's period. In general, the volume of originations has already exceeded the total volume of originations for the whole of 2022 and at the end of the year may surpass the record volume of mortgage loans originated in 2021 (Rb6.2 trillion).

The structure of originations did not undergo major changes: under the influence of the extension of government programs with reduced interest rates, the volume of mortgage lending in the primary market (HML under CIA¹) accounted for 40.1% of the total volume of originations (in 2022 over the same period, this indicator was 44.5%).

Absolutely all transactions were concluded in the ruble segment. Starting from July 2022, no foreign currency loans were issued. Currently, the debt on foreign currency loans amounts to Rb7.7 bn, or less than 0.1% of total mortgage loans outstanding. Providing loans in foreign currency is inexpedient both for borrowers (due to ruble instability) and for banks (due to the barrier to risk coefficients (from 200% and higher depending on the FLV²).

The average mortgage loan size increased by 16.5% year-on-year to Rb4.6 mn (October 2022 – Rb3.95 mn), which was driven by the growth in real estate prices in the wake of strong demand. At present, the price is no longer the most important factor for bank customers when signing a deal, they are more focused

1 Residential mortgage loans secured by rights of claim under the co-investment agreements.

2 Full loan value.

4. Mortgage lending in January-September 2023

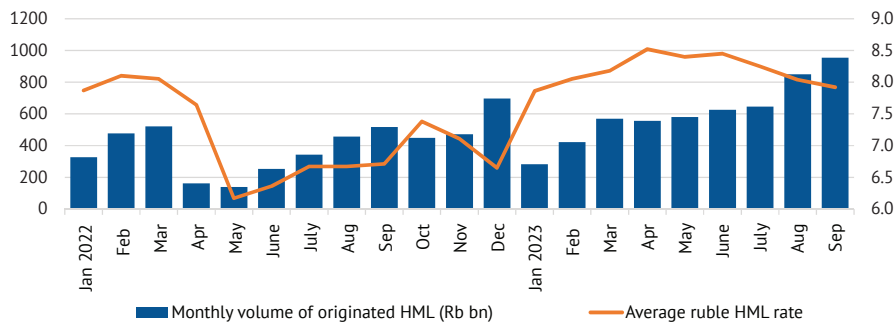


Fig. 1. Dynamics of monthly loan volumes and interest rates on the housing mortgage loans market in 2022–2023

Source: Residential housing lending. URL: <https://www.cbr.ru/statistics/pdko/Mortgage/ML/>

on the size of the monthly payment, which, in turn, also increased by 15.0% and as of October 1, 2023 amounted to Rb30,800 (a year ago – Rb26,800).

By the end of Q3 of the current year, the weighted average loan term increased and amounted to 24.6 years. A year earlier, this indicator was equal to 23.2 years (6.0% growth). The increase in the loan term allows reducing the monthly debt burden on borrowers, thereby reducing the risk of loan default.

A positive trend in 2023 is the reduction in the share of refinancing in the total portfolio of mortgage loans issued – at the end of Q3 2023 it amounted to 0.4% of total debt (a year ago this indicator corresponded to 2.5%). During the year the demand for refinancing decreased under the influence of market rates growth.

The volumes of securitization grew by 25.1% to the level of Rb1.15 trillion. However, the share of securitization transactions in the loan portfolio remained virtually unchanged at 6.7% (6.9% a year ago). Thus, the expected development of mortgage securitization after the adoption of legislative amendments facilitating the issuance of mortgages for co-investment agreements and the spread of digital mortgages did not occur.

The portfolio credit quality remains at an acceptable level – overdue indebtedness for three quarters of the current year has grown insignificantly – 2.2% and as of 01.10.23 constitutes only 0.4% of the total debt on HML (as of the end of Q3 2022 – 0.5%), which is much lower than for other types of bank lending (about 4%).

In the first half of the current year, the weighted average rate on mortgage loans tended to increase. However, in Q3 despite a sharp increase in the key rate of the Central Bank of the Russian Federation, the weighted average rate adjusted downward due to an increase in the share of lending under the state support programs. By the end of Q3, the primary market rate amounted to 5.9%, while the secondary market rate amounted to 9.9%. The dynamics of lending volumes and the weighted average rate on ruble HML are shown in Fig. 1.

Despite the low level of overdue debt, the CBR is forced to state that mortgage lending standards in Russia are deteriorating.¹ About half of mortgage loans are granted to borrowers with an DLR of 80% or higher.

The spread of joint programs between banks and developers, which were initially designed to boost demand by reducing the loan rate (“near-zero” mortgages), led to a general rise in the price of housing in the primary market and

1 URL: <https://realty.ria.ru/20231009/ipoteka-1901468783.html?ysclid=losrp6sfwf100964904>


a widening of the price gap with the secondary market. In this context, bank risks on loans granted on the primary market are increasing due to the inability to sell the apartment at the primary market price in the event of the borrower's insolvency.

In this regard, the Central Bank decided to increase from May 1, premiums to the risk coefficients on mortgage loans: banks must form additional reserves, the amount of which is determined by the level of down payment (in the range from 10 to 30%). However, the regulator was soon forced to recognize that the May increase in mortgage premiums was not enough.

From October 1, the Bank of Russia again raised premiums to the risk coefficients for mortgage loans to curb the risks of borrowers and banks. The increase affected premiums to risk coefficients depending on the level of down payment (from 0 to 100%) and the value of the borrower's DLR.

Despite the deterioration in mortgage lending standards and measures related to the market cooling, the Bank of Russia is considering the possibility of creating separate loan products for customers whose financial position is worse than average but still allows for regular debt servicing. Usually banks do not provide long-term loans to such customers. Thus, the Central Bank's initiative is related not to restriction, but to stimulation of banks' lending activity, which in the long run may lead to the growth of the population's creditworthiness and, as a consequence, to the increase in the number of bankruptcies of individuals.

The prospects for the preferential mortgage program remain uncertain at present. The program of preferential mortgages with state support should end, according to the plan, in mid-2024. The likelihood of its extension in the format in which it existed for the last few years (starting from 2020) is low – the growing difference between the preferential and market rate, which reaches 8–9 p.p., is becoming increasingly difficult for the state to cover. However, complete abolition seems unlikely – a drop in demand for real estate and lower sales will have a negative impact on the development of the construction industry, which will lead to a slowdown in economic growth as a whole. Therefore, the most likely option is to update the preferential program with the introduction of differentiated rates linked to the level of income of citizens in different regions of the country.

Until the end of this year, mortgages with state support will keep the market from collapsing: with the share of subsidized mortgages growing, the total number of loans issued will stagnate. However, the potentially high demand will allow banks to adapt to the changing conditions over time and continue their aggressive policy in the form of increasing the mortgage loan portfolio. A possible way out of the crisis will be the development of budget mortgage options (green mortgages, mortgages for the construction of private houses) and their partial support by the state. 

5. MONITORING OF GLOBAL AND RUSSIAN OIL MARKETS

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Repeated and rather frequent changes in the parameters of tax legislation, typical for the oil industry of the Russian Federation, may cause growth in the overall level of oil market uncertainty and a respective decline in the incentives for investment in development and modernization.

Agreement on updating OPEC+ oil production volumes

The 35th OPEC and non-OPEC Ministerial meeting resulted in a decision to reduce total crude oil production by 1.4 mln barrels per day (b/day), to be achieved mainly by Angola, Congo, Nigeria and Russia.

Table 1 shows the dynamics of the required oil production volumes in January-December 2024. The next meeting of the OPEC countries is scheduled for November 26, 2023, where it is suggested to discuss the possibility of implementing the announced plan.

Russia will extend its voluntary oil production cut by 500.000 b/day for the third time² by the end of 2024 (excluding gas condensate). The reduction will be calculated from the production level agreed on June 4, 2023 (9.8 mln b/day).

International forecasts regarding future oil price

According to EIA³ forecasts, price for Brent oil will grow from \$90/barrel in Q4 2023 to \$94/barrel in H1 2024. This growth is due to a slight decline in global oil reserves in H1 2024. The agency assumes that the extension of voluntary cuts under the OPEC+ agreement until the end of 2024 will keep actual crude oil production well below the target levels (presented in *Table 1*). If OPEC+ production is closer to target levels, this could result in lower prices in 2024.

Table 1

Dynamics of the required oil production volumes under the OPEC+ deal in August 2022 – December 2024, thousand b/day

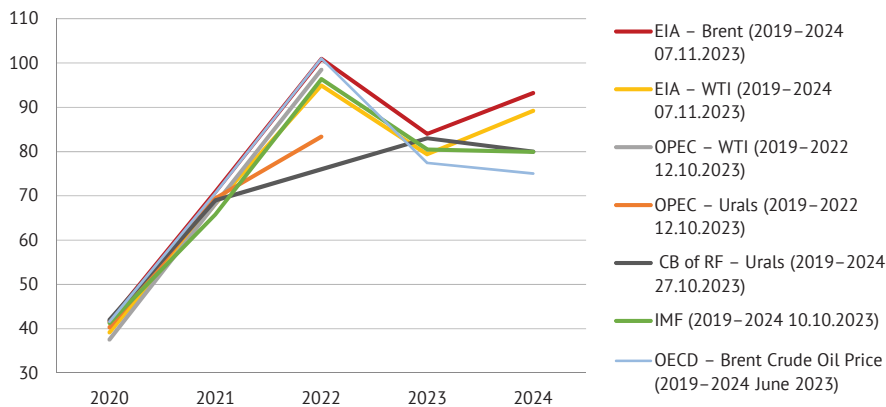
Countries	November 2022 – December 2023	January 2024 – December 2024
Algeria	1 007	1 007
Angola	1 455	1 280
Congo	310	276
Guinea	121	70
Gabon	177	177
Iraq	4 431	4 431
Kuwait	2 676	2 676
Nigeria	1 742	1 380
Saudi Arabia	10 478	10 478
UAE	3 019	3 219
Azerbaijan	684	551
Bahrain	196	196
Brunei	97	83
Kazakhstan	1 628	1 628
Malaysia	567	401
Mexico	1 753	1 753
Oman	841	841
Russia	10 478	9 828
Sudan	72	64
South Sudan	124	124
OPEC 10	25 416	24 994
None-OPEC	16 440	15 469
OPEC+	41 856	40 463

Source: MOMR June 2023.

1 35th OPEC and non-OPEC Ministerial Meeting concludes// OPEC. 04.06.2023. URL: https://www.opec.org/opec_web/en/press_room/7160.htm

2 On March 1, 2023 Russia has voluntarily cut oil production by 500.000 barrels per day. The first time it extended the decision until June 2023, the second time – until the end of 2023, the third time – until the end of 2024.

3 Short-term energy outlook. Crude oil prices // EIA. 07.11.2023. [<https://www.eia.gov/outlooks/steo/marketreview/crude.php>].



Note. The date of the forecast publication is given in parentheses.

Fig. 1. Forecast for oil prices, dollars/barrel

Source: own calculations based on EIA, OPEC, IMF, CB RF, OECD.

Moreover, there are following assumptions included into EIA's price forecast: (1) Iraq's continued lack of access to the pipeline (essentially limiting access to the global market) in 2024 due to a dispute with Turkey following an international court ruling;¹ (2) continued stable oil production in Russia in 2024; (3) expectation of modest growth in Venezuelan oil production due to lifting of U.S. export sanctions for 6 months on October 18, 2023, subject to electoral reform (significant future growth will require noticeable contribution after several years of deferred equipment maintenance and lack of access to capital); (4) geopolitical tension in the Middle East regions due to military conflict, thereby creating risks for oil delivery, including existing excessive production capacity.

According to OPEC forecast, average prices for Urals crude oil will be around \$61.1/barrel by the end of 2023. Global oil demand growth in 2023 will remain at 2.4 mln b/per day: OECD oil demand will increase by 0.1 mln b/day and non-OECD by 2.3 mln b/day. It is expected that in 2024 global oil demand will grow by 2.2 mln b/day, while main drivers of growth in liquid hydrocarbon supplies will be the USA, China, India, the Middle East and other Asian countries.

The Bank of Russia has raised its forecast for the price of Urals oil in 2023 to \$83/bbl from \$55/bbl. In 2024, the regulator expects the oil price to be at \$80/bbl.²

The International Monetary Fund forecasts average oil prices for major grades at \$80.5/bbl in 2023 and \$79.9/bbl in 2024.³

Fig. 1 shows oil price forecasts given by international agencies.

Review of changes in legislation regulating oil industry

In 2023, there have been a number of changes in the legislation regulating oil industry of Russia:

1 Access was terminated as of March 25, 2023, for example: Turkey suspends oil exports from northern Iraq after international court ruling // Interfax. 27.03.2023. URL: <https://www.interfax.ru/world/893032>

2 Medium-term forecast of the Bank of Russia based on results of the Board of Directors meeting on the key rate // Bank of Russia. 27.10.2023. URL: https://cbr.ru/Collection/Collection/File/46535/forecast_231027.pdf

3 World Economic Outlook Update, 10.10.2023 // IMF. URL: <https://www.imf.org/en/Publications/WEO/Issues/2023/10/10/world-economic-outlook-october-2023>

5. Monitoring of global and Russian oil markets

1. Suspending the provision and spread of official statistics on a number of products and economic activities for the year from April 2023,¹ which makes the analysis of the current dynamics of key indicators of the Russian oil sector activity difficult, considering that export statistics for oil and oil products have been closed since 2022.

2. Introduction of markup to export duty on gasoline and diesel fuel from 01.01.2023. In order to prevent the use of fictitious contracts and abuses in fuel exports, in particular, the export of oil products that were purchased on the domestic market and for which a fuel damper was paid from the budget, an additional payment to the export duty in the amount of Rb20.000/t was introduced.² When there are certificates of operations available, involving the refining of petroleum raw materials or operations involving straight-run gasoline, the formula for calculating export duty on petroleum products remains the same. Setting a fixed rate (independent of oil price and exchange rate) causes risks of its adjustment in case of changes in external conditions, which is confirmed by practice: from October 6, 2023 the additional payment was raised to Rb50.000/t.

3. Introducing a discount for Urals oil relative to Brent from 01.04.2023 (\$34 from April, \$31 in May, \$28 in June, \$25 in July, \$20 from September). These changes have been caused by attempts to reflect the fair value of raw materials, using Urals quotes from Argus agency, to preserve tax revenues to the budget. Prior to 2022, the basis of supply was CIF Rotterdam and CIF Augusta (products are delivered to the buyer's specified port of destination; while insurance of the main transport, unloading and trans-shipment is paid by the seller. After 2022, Urals' quotes in the EU destination ports no longer fully reflect fair value of raw materials, as most transactions were conducted on confidential terms and regular price signals from market participants ceased to be available. Urals crude oil quotations began to be calculated on the basis of FOB Primorsk, Ust-Luga and Novorossiysk delivery plus delivery costs to European ports (freight price, port fees, cargo insurance. The discount of Urals to Brent began to grow rapidly. In order to maintain budget revenues, on 16.02.2023, amendments to the Tax Code were adopted, thereby limiting from April 1, 2023 the discount for Russian Urals in relation of North Sea Dated for calculating oil taxes. From 01.09.2023 the discount has been reduced to \$20/bbl. In 2024 it is expected to be reduced to \$15/bbl, in 2025 to \$10/bbl and in 2026 to \$6/bbl.

4. Approval of a Russian exchange index of oil and petroleum product prices for tax assessment. Argus stops publishing Russian oil quotations on a CIF basis from 2024, but continues to calculate and publish Urals price quotations based on FOB in Russian ports (Primorsk, Ust-Luga and Novorossiysk), Urals quotations in Indian ports (West Coast India), and Russian ESPO FOB quotations in the port of Kozmino. SPIMEX, Ministry of Finance, Ministry of Energy, Ministry of Economic Development and the CB discuss adjustments to the Tax Code, which will allow using SPIMEX prices as the source of information for determining the

1 The products included: oil and gas mixture (well fluid); dehydrated, desalted and stabilized oil; unstable gas condensate. The activities included: production of oil and oil (associated) gas (APG); production of natural gas and gas condensate; natural gas and gas condensate production.: RF Government Edict of April 26, 2023 No.1074-r // State legal information system. 10.11.2023. URL: <http://publication.pravo.gov.ru/Document/View/0001202304280072>

2 RF Government Decree of 24.06.2023 No.1032 "On amendments to the methodology for calculating rates of export customs duties on certain categories of goods produced from oil".

export duties, MET and the EPT. The budget estimate for 2023–2026¹ suggests to postpone using SPIMEX oil index for 2025, although it is still proposed in the draft bill submitted to the State Duma to use the highest of the values to calculate taxes: the Urals price, the discounted Brent price or the OTC index (SPIMEX oil index). This uncertainty makes preparation of the budget for 2024–2026 unclear in terms of revenues from the oil industry.

5. Reduction of damping markup by 2 times from 01.09.2023,² later replaced by alternative mechanisms. To reduce budget expenditures on subsidizing oil companies amid reduced demand for Russian petroleum products, a coefficient has been introduced into the formula for calculating the difference between the export alternative and the average wholesale price of sales in the Russian Federation, which reduces payments under the damping mechanism for gasoline and diesel fuel by a factor of 2. It is anticipated that from early October 2023, the damper will be paid at the same rate, and the budget offset for these payments will come from:

- gas condensate MET growth for PJSC Gazprom and its subsidiaries³, for coefficient characterizing surcharges for motor gasoline and diesel fuel⁴ increased by 1.5 times. Refineries produce fuel from condensate and in return get a damper without paying MET on oil. This measure equalizes them in rights with other fuel producers, however also creates a risk of price growth for consumers of LPG, methane and gasoline by increasing the tax burden. Due to disparity of oil refining volumes in general and gas condensate production by Gazprom (276 mln tons vs 18.3 mln tons in 2022), it can be expected that this measure will only partially cover the dampening costs;
- reduction in reverse excise duty payments for refineries which do not supply 40% of Class 5 gasoline and diesel fuel from the total production of light petroleum products to the domestic market (the requirement does not apply to the state-owned companies of more than 25%). The amount of reduction will be Rb390/t for tax periods from January 1 to August 31, 2024 and Rb250/t from September 1, 2024. The measure takes into account only part of the interests of large state-owned companies, and Volgograd Refinery (LUKOIL), Kirishi Refinery (Surgutneftegaz), TAIF fall into the risk zone in case export direction is prioritized.

Thus, the analysis of international agencies' forecasts has shown that in 2024 oil prices can be expected to rise due to the extension of voluntary cuts in oil production by OPEC+ countries in addition to the established quotas; conflicts in the Middle East are not expected to have a significant impact on price volatility.

As for the decision to compensate for growth in the fuel damper for Russian oil companies by increasing the tax burden on PJSC Gazprom and reducing payments for some non-state refineries in addition to such effects as balancing Gazprom's rights with other fuel producers, may create certain risks: 1) growth of additional burden on Gazprom, which is highly sensitive due to expectations of

1 Draft bill No. 448554–8 "On federal budget for 2024 and for planning period of 2025 and 2026" // State legal information system. 10.11.2023. URL: <https://sozd.duma.gov.ru/bill/448554-8>

2 Draft bill No. 369931-8 "On amendments to Parts 1 and 2 of the RF Tax Code, certain legislative acts of the Russian Federation and on suspension of sub-paragraph of the second paragraph 1, article 78, part 1 of RF Tax Code (in terms of implementation of certain provisions of the main directions of tax policy)."

3 Share of gas production in relation to hydrocarbon production is less than 35%.

4 Coefficient that takes into account premium for petrol or diesel fuel when changing parameters of damper.

5. Monitoring of global and Russian oil markets

poor financial results for 2023; 2) price increase for LPG, methane and gasoline consumers due to increased tax burden; 3) only partial coverage of dampening costs due to the incomparability of oil refining volumes on the whole and gas condensate production by Gazprom and taking into account interests of large state-owned companies (measures could bring more revenues to the budget if they involved all market participants; 4) no binding condition on limiting export supplies to the ruble exchange rate; in case of ruble weakening, the measure may be economically inexpedient; 5) no consistency between gasoline and diesel fuel supply norms for the domestic market, set in regulatory documents and exchange rules.

It follows from the above that if parameters of tax system in the oil industry will not be further adjusted, while sanctions and their enforcement will not be tightened, the revenues from the oil industry, at least, will not decrease. At the same time, frequent adjustment of tax legislation is a negative signal for business taking into account investing in the development and modernization of their production facilities. 