

# **MONITORING OF RUSSIA'S ECONOMIC OUTLOOK:**

TRENDS AND CHALLENGES OF SOCIO-ECONOMIC DEVELOPMENT

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Monitoring has been written by experts of Gaidar Institute for Economic Policy (Gaidar Institute) and Russian Presidential Academy of National Economy and Public Administration (RANEPA).

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

Editor: Vladimir Gurevich



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## TRENDS AND CHALLENGES OF SOCIOECONOMIC DEVELOPMENT

While the RF annual Presidential Address to the Federal Assembly of the Russian Federation was somewhat reticent on the sources of resources for future economic development, the President said quite enough, about one of the enabling conditions for this development, to warrant the following conclusion: ‘the new macroeconomic reality’ that has emerged in Russia is an established fact, no matter what socio-economic and military doctrines and plans might be put forth or implemented. The key element and manifestation of this reality is low inflation.

One can easily recall a number of different plans suggested in recent years, which are capable of rather quickly destroying this reality, or point out some new plans that may become incompatible with it. As of today, however, this reality is an incontestable fact, and low inflation remains high on the government priority list.

Our experts indicate that the rate of inflation in the Russian Federation continues to decline. In January 2018 it amounted to 0.3% (vs. 0.6% in January 2017), while the annual inflation rate has hit its new historic low (2.2%). Preliminary data for February confirm this trend. The largest contribution to the deceleration of prices was made by the ongoing fall in the rate of food inflation (to 0.7% in January 2018 relative to January 2017). At the same time, prices also decelerated in the non-food segment and in the services sector. It should be noted, however, that prices in the education sector in general, and those of pre-school education services in particular, were growing at an accelerated rate. The strengthening of the ruble in January also contributed to the weakening of inflation. Core inflation (the Core CPI does not include price changes related to seasonal and administrative factors) continues to decline: in January 2018, the Core CPI inflation rate on a yearly basis amounted to 1.9% vs. January 2017. This fact alone confirms the stability of the current process of inflation deceleration.

In February 2018, the RF Central Bank reduced its key interest rate to 7.5% per annum. This lowering of the CB’s key rate is viewed by experts as an indication of the financial regulator’s gradual transition from a moderately tough monetary policy to a neutral one (that is, a policy aimed neither at an inflation slowdown nor at inflation speedup). It is expected that at a time horizon of one and a half to two years, the key rate will be reduced to 6–7%. Potential inside-country inflationary risks are related to the eventual recovery of consumer demand, while potential ‘international’ risks are associated – quite traditionally – with the possibility of the ruble’s weakening due to toughening of the FRS’s policy, the introduction of new sanctions, and a decline in energy prices.

The achievements of Russia’s foreign trade in 2017, and primarily the increased revenues from energy exports, have played an important role in stabilizing the behavior of the ruble. As far as the results of Russia’s foreign trade in 2017 are concerned, experts note a practically synchronous rise in both exports and imports (by 25% and 24.5% respectively). At the same time, it is noteworthy that growth in fuel and energy exports (to the value of more than \$ 211bn, which represented a 27.2% rise on 2016) slightly outpaced

the general upward trend in exports. Nevertheless, fuel and energy exports still remained far below their pre-crisis highs (amounting to just 57% of their 2011 levels), while all other exports practically recovered their previous volumes. As far as imports are concerned, there remains a stable correlation between their volumes and the exchange rate of the Russian ruble to the US dollar, which continues to be an extremely important factor behind the formation of demand for imports in Russia.

The Gaidar Institute experts, who carry out regular business opinion surveys of Russian industrial enterprises, confirm the results of their previous investigations indicating that most of Russian industrial enterprises preferred the ruble to be strong. The experts mention that as far back as February 2015, strengthening of the ruble came top of the list of anti-crisis measures most desirable in the eyes of industrial enterprises. This development induced the experts to include, in their business opinion surveys, the issue of industrial enterprises' attitude to the ruble's exchange rate alterations.

As a matter of fact, the only factor that makes a certain weakening of the ruble's current strength (December 2017) desirable for the surveyed enterprises is potential growth in foreign demand for their exports. However, a weaker ruble would be able to stimulate, in 2018, a growth in foreign demand only with regard to a quarter of all producers, because 37% of enterprises have no hopes whatsoever of selling their products overseas, while 22% are interested not in a weak ruble but in its stable exchange rate, which could greatly facilitate the planning of their export activities. In practically every other respect, Russian enterprises need the ruble to be strengthened. In 2018, 54% of enterprises are eager to see the ruble gaining in strength, thus enabling them, as they hope, to reduce their costs (21% of enterprises consider that their costs do not depend on the ruble's exchange rate). 48% of enterprises believe that a stronger ruble would help them to invest in their business and to attract investments (20% of enterprises hold the view that this purpose can be achieved by merely keeping the ruble's exchange rate stable). And finally, 38% of enterprises are sure that a stronger ruble would stimulate growth in internal demand (in order to achieve this aim, only 7% of enterprises wished the ruble to weaken). Our experts note that although many officials and experts are convinced that the ruble's weakening is desirable from the point of view of industrial development, enterprises themselves unambiguously and persistently prefer the ruble to become stronger.

The strengthening of the ruble against the US dollar was partly responsible for the decline, by more than RUB 0.5 trillion, of personal bank deposits (from the record-high RUB 26.1 trillion to RUB 25.6 trillion) which took place in January 2018: the index of money kept in individual deposit accounts was pushed down by the adjustment by the ruble's foreign exchange rate, as its 'foreign currency component' was recalculated in ruble terms. However, the major part of the January outflow of funds from individual bank accounts was accounted for by ruble-denominated bank accounts and deposits (while foreign currency denominated deposits even displayed growth – from \$ 93bn to \$ 94.5bn). It should be said that relative to January 2017, the outflow of deposits in January 2018 increased more than threefold. The start of 2018 was also marked by a surge in the volume of bank lending to the population which, according to experts, contradicts the tradition of January being a period of lull in lending (in January 2017, the amount of personal debts due to banks dropped by RUB 48bn, while in January 2018 it increased by RUB 82bn).

According to our experts, these unordinary dynamics was caused by the population's efforts to sustain its living standards against a backdrop of falling incomes. As demonstrated by the Gaidar Institute's estimates, in January 2018 the nominal income of the population declined by 3.5% (on the corresponding period of the previous year), which is equivalent to an almost 6% drop in income in real terms. At the same time, in 2018, consumption expenditures continued to grow. Thus, the existing situation with regard to debts owed to banks etc. was caused by the shrinkage of personal savings and by the intensification of personal borrowing activity.

According to the experts from the Institute for Social Analysis and Forecasting of the RANEP, who investigated, in 2017, the adaptation strategies of the population, the main adaptation resources included the amount of personal current income and savings, the ownership of a second home, professional education, and involvement in social networks. The experts also focused on the issue of how different population groups adapt themselves to the current economic situation, as well as on the thorough analysis of their adaptation strategies. Our researchers have come to the conclusion that, in accordance with the criteria set by them, 20.4% of the population have high adaptation potential, 40% show average adaptation potential, and 39.2% have low adaptation potential. Over the course of the past 2 or 3 years, the majority of individuals with high adaptation potential experienced no worsening of their material situation, and almost one-third of them even improved it, while almost half of the individuals with low adaptation potential stated that their material situation had deteriorated.

In our research, the term 'adaptation strategy' includes saving and investment behavior, overtime work and secondary employment, career change and professional status improvement, migration, personal subsidiary farming, etc. As far as the data obtained by our experts are concerned, the following observations are to hand: 37% of the respondents lack any kind of adaptation behavior; active behavior is typical of 29.2% of the population; active adaptation combined with personal subsidiary farming was displayed by 23% of the respondents; and 10.8% of the respondents intensified their personal subsidiary farming without resorting to any other kind of adaptation. ●

## 1. INFLATION CONTINUES TO SLOW DOWN

A.Bozhechkova, P. Trunin

*In January 2018, inflation hit its record low of 2.2% relative to January 2017, while the Bank of Russia further eased its monetary policy by reducing the key rate by 0.25 pp to 7.5%. In absence of new inflation-triggering shocks, inflation this year may once again plunge its target set by the RF Central Bank.*

The Bank of Russia Board of Directors, at this year's first meeting on 9 February, decided to reduce the key interest rate by 0.25 pp, to 7.5%. By doing so, the RF Central Bank continued its gradual switchover from a moderately tough to neutral monetary policy (that is, a policy aimed neither at an inflation slowdown nor at inflation speedup). The Bank of Russia's decision was the upshot of inflation stabilization at a relatively low level and of the lower inflation expectations. It should be reminded that from July 2017 onwards, the inflation rate has been hovering below its target (4%), and now it is moving away from that target still further.

As demonstrated by the month-end result of January 2018, the inflation index is at 0.3% (0.6% in January 2017). In annual terms, it has moved below its historic high to 2.2% (5.0% in January 2017 relative to January 2016) (Fig. 1). Over the first 19 days of February, inflation amounted to 0.2% (0.2% in February 2017).

The highest input in the inflation slowdown was made by the movement of food prices (0.7% in January 2018 relative to January 2017 vs. 1.1% in December 2017 relative to December 2016). However, by all indications, over the next few months prices in this commodity group are going to rise at a faster rate, as agricultural stocks become increasingly depleted. The growth rate of prices for non-food products also plunged from 2.8% in December 2017 relative to December 2016 vs. 2.6% in January 2018 relative to January 2017. The prices of paid services rendered to the population in January 2018 rose by 3.9% relative to January 2017 (4.4% in December 2017 relative to December 2016). Notable inputs in the upward movement of the prices of paid services were made by prices for education services (на 7.5%), communications (4.7%), outbound tourism (4.7%), and pre-school child care services (4.7%).

In January, core inflation (the change of prices other than those influenced by seasonal and administrative factors) continued to slow down. As a result, core inflation in January 2018 amounted to 1.9% relative to January 2017 (2.1% in December 2017 relative to December 2016), thus underlining the fact that the inflation slowdown trend is sustainable.



Fig. 1. CPI growth rate in 2011–2018, % relative to the previous 12 months

Source: Rosstat.

## 1. INFLATION CONTINUES TO SLOW DOWN

The population's inflation expectations in January became somewhat higher, after a lengthy period of decline in 2017. The median inflation expectation for the year ahead, according to the InFOM survey results released by the Bank of Russia, was 8.9% in January 2018 (8.7% in December 2017). The RF Central Bank's estimations based on the respondents' opinion of the expected inflation movement demonstrate that the population's inflation expectations will stay at a low level. Thus, the estimated probability of inflation for January was 2.3%, which is below the corresponding index for December by 0.1 p.p.

We believe that on the whole, in absence of any strong negative shocks, inflation expectations will continue their downward slide throughout 2018, while inflation itself will plunge, most probably, below its target set by the RF Central Bank, in spite of the gradual reduction of the key rate.

Inflation slowdown is also contributed to by the current situation in the Russian forex market (Fig. 2). Over January 2018, the ruble climbed against the USD by 2.3%, to RUB 56.29 (overall in 2017, growth of the USD-to-ruble exchange rate in nominal terms amounted to 5.1%). The ruble's strengthening has had to do in the main with rising prices of energy carriers and the increasing demand displayed by non-residents for Russian assets, especially government and corporate bonds.

Nevertheless, the risks of the ruble's weakening remain significant. The US output of shale oil is on the rise, which is fraught with the risk of a new plunge of prices of energy carriers. Besides, investor expectations with regard to monetary policy toughening in the USA and the resulting uncertainty

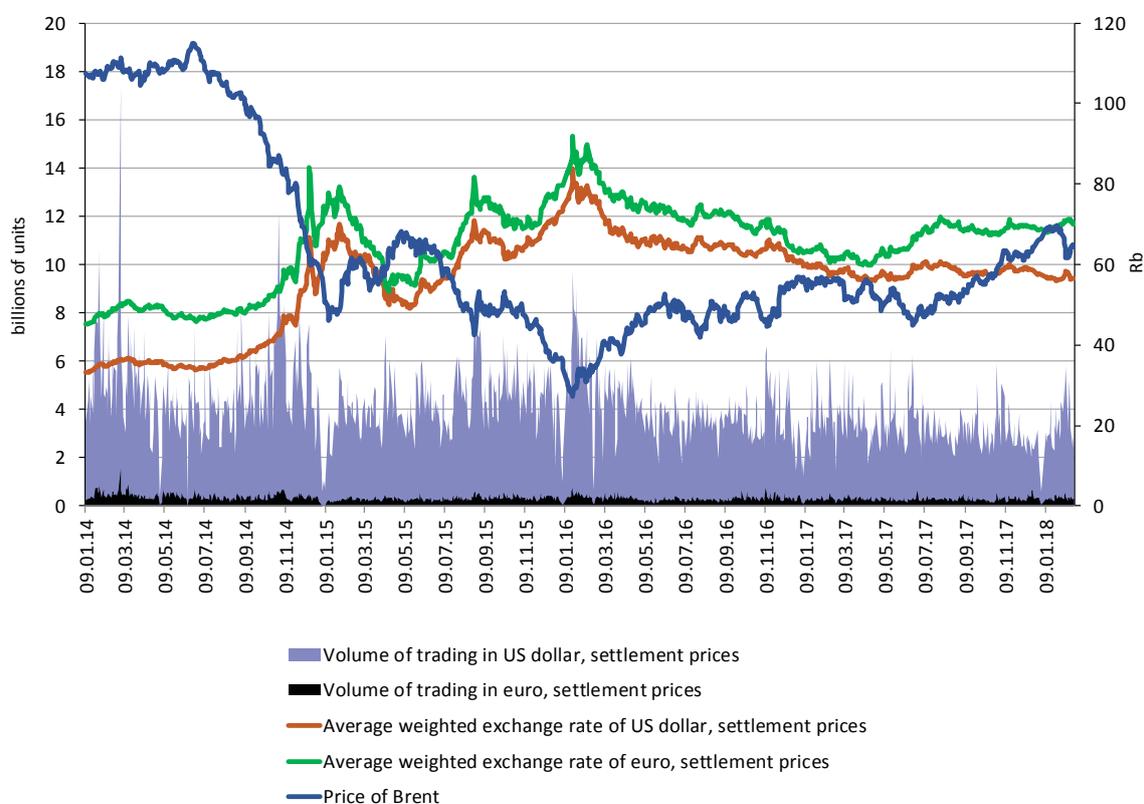


Fig. 2. The movement of the USD-to-ruble and euro-to-ruble exchange rates on the FX exchange; trading volume in the FX market; price of Brent

Source: RF Central Bank; Finam.

on the global financial markets create risks of capital outflow from Russia. One example of the possible realization of such risks could be observed in late January and early February 2018, when over the period from 25 January through 9 February Russian stock indices fell by 5–10%, and the ruble lost 2.3%, plunging to RUB 57.7 per USD. And finally, the probability of new economic sanctions being introduced against Russia remains high.

The domestic source of inflation risks, as before, is the recovering consumer demand, sustained by real wage growth coupled with inflation slowdown (besides, the volume of retail loans is likewise on the rise<sup>1</sup>). Thus, in 2017, the real wage growth rate was 3.4%. In addition, from April 2017 onwards, retail turnover was on the rise, climbing over the period from April through December to an average of 2.0% relative to the corresponding period of 2016, which was caused, most probably, by growth in the retail lending sector.

In view of all these factors, the RF Central Bank has chosen a cautious approach to monetary policy easing. We believe that gradually, over a horizon of 1.5–2 years, the regulator is going to bring its key rate to a neutral level of 6–7%. ●

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1 See the article by M. Khromov in this issue of Monitoring of Russia's Economic Outlook (MREO).

## 2. EXPORTS AND IMPORTS DEMONSTRATE GROWTH

A.Knobel, A.Firanchuk

In 2017, exports of fuel and energy commodities as compared to 2018 increased by 27% (57% on the 2013 level). Exports of other commodities grew by 22%, having virtually returned to the pre-crisis values (94% on the 2013 level). Growth in exports of fuel and energy commodities, metals, raw rubber and timber is primarily related to substantial improvement of the pricing situation, while that in exports of mineral fertilizers and grain, to growth in volume terms.

Within a year, imports increased by 25% on the back of growing import prices and supply volumes. Appreciation of the exchange rate of the rouble had a positive effect on import volumes.

In 2017, exports in value terms increased largely from the value seen 2016 (Fig. 1): in 2017 they rose to \$357.1bn (125.0% compared to the value seen in 2016). Exports of fuel and energy commodities increased by 27.2% to \$211.5bn. Exports of other goods demonstrated similar dynamics, having grown by 21.9% to \$145.6bn.

However, exports of fuel and energy commodities are still below the pre-crisis level (57.0% of the value seen in 2013), while exports of other goods virtually returned to the level of 2013 (93.8%) (Fig. 2). Last year, overall exports amounted to  $\frac{2}{3}$  of the level seen in 2013 (67.9%), a much better result than in 2016 (overall exports amounted then to 54.3% of the level seen in 2013).

In 2017, in value terms imports increased, too, by 25% to \$227.0bn (124.5% compared to the value seen in 2016) (Fig. 3). It amounts nearly to  $\frac{3}{4}$  of the pre-crisis volumes of imports (72.0% compared to the value seen in 2013) (Fig. 2).

### The Exchange Rate of the Rouble

In 2017, there was still a strong positive correlation between Rouble/Dollar exchange rate and the value of imports

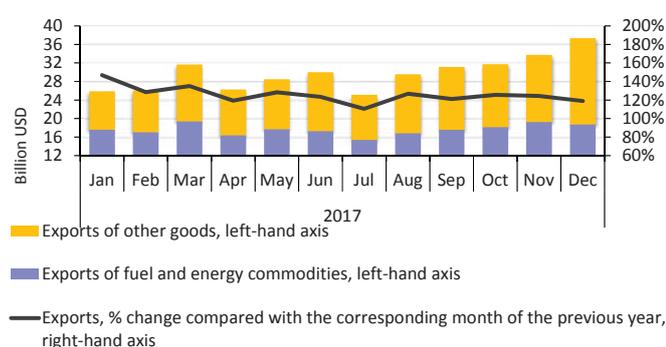


Fig. 1. Russia's export dynamics in 2017

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

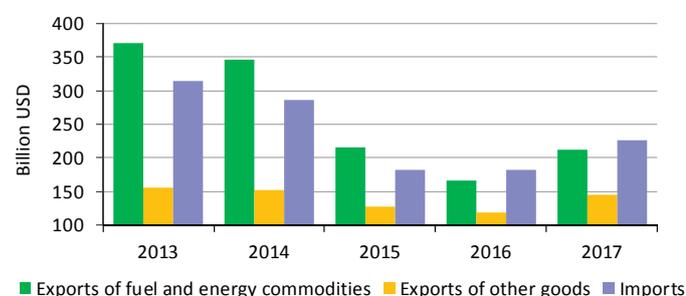


Fig. 2. Dynamics of Russia's Exports and Imports in 2013–2017

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

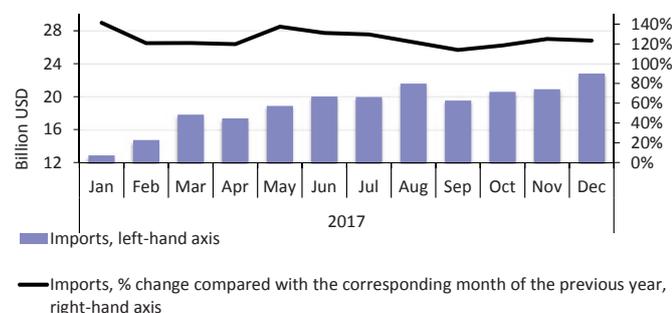


Fig. 3. Dynamics of Russia's imports in 2017

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

(in USD) (Fig. 4). So, it can be stated that the exchange rate of the rouble remained an important factor behind demand on imports in Russia<sup>1</sup>. The ratio of correlation between the index of the value of imports (% change compared with the relevant month of 2013) and the index of Rouble/Dollar real exchange rate (% change compared with the relevant month of 2013) amounted to 0.93 in 2014–2017. The only instance of substantial discrepancies in the dynamics of the Rouble/Dollar exchange rate and imports was observed in spring 2015.

It is noteworthy that the exchange rate of the rouble largely depends on prices of Russian export main (raw material) commodities and this factor together with the explicit correlation between the Rouble/Dollar exchange rate and the volume of imports leads to a simultaneous movement of Russian exports and imports<sup>2</sup>. Note that as the value of exports largely surpasses that of imports, the synchronic dynamics of these indicators mean an increase in the trade balance surplus with growth in trade (which took place in 2017 as compared to 2016) and reduction thereof when export supply volumes fall (for example, such a situation was observed in 2015 as compared to 2014). As regards the current account balance, it is primarily determined by the balance of trade in services and the investment income balance<sup>3</sup>.

In 2014–2017, the index of the value (in USD) of total exports, except fuel and energy commodities and the index of the Rouble/Dollar real exchange rate had a highly positive correlation with the ratio of 0.62 (Fig. 5). A similar correlation for exports of machinery, equipment and transport is equal to 0.40. Consequently, it can be stated that depreciation of the rouble real exchange rate and, accordingly, a decrease in dollar-denominated export prices did not result in overwhelming growth in the volume of exports of machinery and equipment.

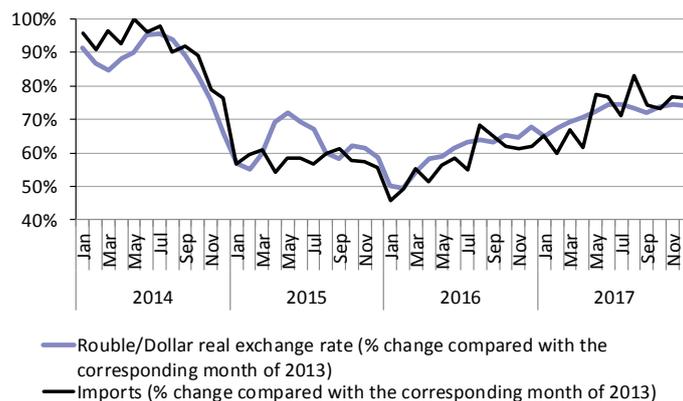


Fig. 4. Dynamics of imports and the Rouble/Dollar real exchange rate in 2014–2017

Source: own calculations based on the data of the Federal Customs Service of the Russian Federation and the Central Bank of Russia.

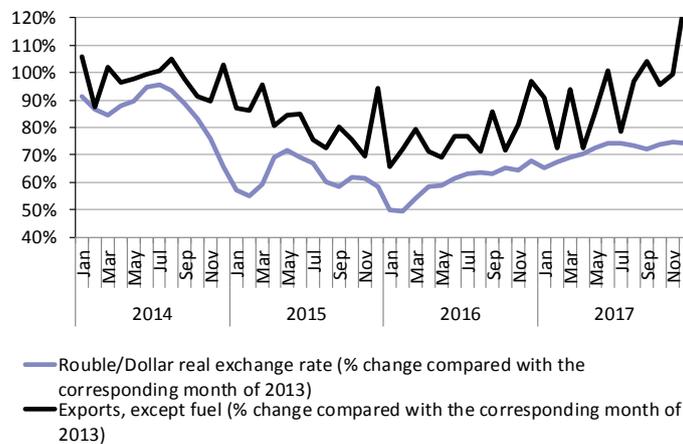


Fig. 5. Dynamics of non-fuel exports and the real exchange rate of the rouble in 2014–2017

Source: own calculations based on the data of the Federal Customs Service of the Russian Federation and the Central Bank of Russia

1 For comparing dynamics of imports from far abroad countries and dynamics of the Rouble/Dollar nominal exchange rate see: A.Knobel. The Foreign Trade: A Drop in Exports Justified a Decrease in Trade Surplus // Economic Development of Russia. 2016. No. 5. P. 16–18.

2 Simultaneous dynamics of Russian exports and imports were observed earlier, too, see: A.Knobel, A.Firanchuk. Exports and Imports: Almost Simultaneous Drop // Economic Development of Russia. 2015. No.12. P. 44–47.

3 For detailed analysis of the balance of payments in 2017, see: A. Bozhechkova, A.Knobel and P.Trunin. The Balance of Payments of the RF in 2017 // Economic Development of Russia. 2018. No 2. P. 8–11.

### Export Prices

As seen from *Table 1*, export prices appreciated as regards all large export commodity groups (singled out by the Federal Customs Service) except for mineral fertilizers, while export volumes saw mixed dynamics. Note that growth in prices had a stronger effect on the value of exports than volume fluctuations.

Growth in exports of ***fuel and energy commodities*** (27.4%) can be explained by a substantial increase in export prices (9–39%) and mixed dynamics of exports in volume terms: exports of oil and petroleum products fell by 1% and 5%, respectively, while exports of natural gas increased by 6% (*Table 1*).

In 2017, exports in value terms increased 37% largely driven by a 30% growth in the volume of grain exports (wheat and meslin). The factor of a 5% appreciation of export prices was significant, too. Exports pertaining to the commodity group ***“food and agricultural raw materials”*** saw an overall increase of 21.5% in value.

***Chemical product*** exports increased by 15.2%, the weakest growth among commodity groups (singled out in the classification of the Federal Customs Service) except rawhide (a 9.2% growth). Prices of mineral fertilizers saw mixed changes (from -7% to +7%), the price of ammonia did not virtually change (a 1% growth), while the price of synthetic rubber appreciated a great deal (30%) due to an increase in prices of raw materials. The volume of exports of mineral fertilizers and rubber rose, while that of ammonia fell.

The effect of price rises on ***timber and paper products*** (from 3% to 16%) together with positive volume dynamics spurred a 20.7% growth in the value of exports of this commodity group.

***Metal*** exports increased the most in value (28.1%) among all the commodity groups (except for “other goods”). Export prices of ferrous metals appreciated substantially (from 10% to 48%). Also, prices of copper, nickel and aluminum rose by 31%, 11% and 19%, respectively. Note that the volume of metal exports, except copper, fell by 2–27%.

Growth in exports of energy commodities, metals, rubber and timber in value terms is primarily related to considerable improvement of the pricing situation<sup>1</sup>, while that in value of exports of mineral fertilizers and grain, to growth in export volumes.

Exports of ***machinery, equipment and transport vehicles*** increased in value terms by \$3.78bn to \$28.1bn (15.5%). Exports of goods pertaining to the ***“other goods”*** group increased by \$1.83bn (33.3%).

### Import Prices

As seen from *Table 2*, the volume of imports of all ten commodity groups increased by 6–38%. Imports in volume terms rose as regards 19 main commodity positions out of 22 positions.

Commodity sub-groups within the group ***“food and agricultural raw materials”*** saw mixed changes though import prices of most goods appreciated and supply volumes thereof increased. The overall volume of imports of this commodity group amounted to \$28.8bn, having grown by 15.7% as compared to 2016. Note that imports of meat and fish increased in value terms (growth

<sup>1</sup> The dominating effect of the pricing situation on the value of exports as compared to changes in the volume of supplies was observed in the previous year, too, see: A.Knobel, A. Firanchuk. The Foreign Trade in 2016 // Economic Development of Russia. 2017. No. 3. P. 8–17.

Table 1

## CHANGES IN PRICES AND VOLUMES OF MAIN EXPORT COMMODITY SUPPLIES IN 2017

FEACN	Name	Price		Price change, %	Volume change, %	Value change, %	Export share in 2017, %
		2016	2017				
<i>Food products:</i>							
1001	Wheat and meslin, USD/ton	166	175	5	30	37	1.6
<i>Fuel:</i>							
2701	Fossil coal, USD/ton	54	75	39	9	52	3.8
2709	Crude oil, USD/ton	289	369	28	-1	27	26.0
2710	Petroleum products, USD/ton	295	392	33	-5	27	16.2
2711110000	Natural condensed gas, USD/cubic meters	120	130	9	1	9	0.9
2711210000	Natural gas, USD/thousand cubic meters	157	181	15	6	22	10.6
<i>Chemical products:</i>							
3102	Mineral nitrogen fertilizers, USD/ton	170	182	7	0	8	0.7
3104	Mineral potassic fertilizers, USD/ton	196	193	-1	16	15	0.6
3105	Mixed mineral fertilizers, USD/ton	282	262	-7	13	5	0.8
2814100000	Liquid ammonia, USD/ton	226	228	1	-13	-13	0.2
4002	Synthetic rubber, USD/ton	1314	1709	30	4	35	0.5
<i>Timber and articles thereof:</i>							
4403	Unprocessed timber, USD/cubic meter	67	75	12	-3	9	0.4
4407	Processed timber, USD/ton	197	221	13	11	25	1.1
4412	Plywood, USD/cubic meter	385	446	16	1	17	0.3
4702–4704	Wood pulp, USD/ton	464	522	12	-2	11	0.3
4801	Newsprint, USD/ton	403	416	3	6	9	0.1
<i>Metals and metal goods:</i>							
72	Ferrous metals, USD/ton	326	442	36	-2	33	5.2
72 (except 7201–7204)	Ferrous metals (except for cast iron, ferro-alloys, waste products and wrenching iron), USD/ton	347	482	39	-3	35	3.9
7201	Cast iron, USD/ton	228	338	48	-6	39	0.5
7202	Ferro-alloys, USD/ton	1595	1761	10	-3	8	0.4
7207	Carbon steel semi-products, USD/ton	295	419	42	-5	35	1.7
7208–7212	Carbon steel flat rolled stock, USD/ton	371	528	42	-3	38	1.3
7403	Refined copper, USD/ton	4703	6181	31	15	52	1.0
7502	Unfinished nickel, USD/ton	9173	10145	11	-27	-19	0.4
7601	Unfinished aluminum, USD/ton	1433	1703	19	-8	10	1.5

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

of 14–17%). Raw sugar import supplies ceased completely (a 94% decrease) and prices appreciated a great deal due to administrative measures aimed at preventing duty-free imports of sugar to Russia via the EEU's partner states<sup>1</sup>.

1 The Vedomosti daily of 13 September 2017. "Russia Limits Sugar Imports from Kazakhstan and Belarus" <https://www.vedomosti.ru/business/articles/2017/09/13/733523-ogranichit-import-sahara>

Table 2

## CHANGES IN PRICES AND VOLUMES OF MAIN IMPORT COMMODITY SUPPLIES IN 2017

FEACN	Name	Price		Price change, %	Volume change, %	Value change, %	Import share in 2017, %
		2016	2017				
<i>Food products:</i>							
0201-0204	Fresh and frozen meat, USD/ton	2 822	3 211	14	3	17	0.90
0207	Fresh and frozen poultry meat, USD/ton	1 413	1 582	12	2	14	0.16
0302-0304	Fresh and frozen fish, USD/ton	2 734	2 658	-3	20	16	0.50
0402	Milk and condensed cream, USD/ton	2 160	2 173	1	4	5	0.23
0405	Butter, USD/ton	3 794	5 364	41	-3	37	0.23
0805	Citrus fruits, USD/ton	760	760	0	2	2	0.52
0901	Coffee, USD/ton	3 012	3 370	12	11	24	0.28
0902	Tea, USD/ton	3 335	3 110	-7	3	-4	0.23
170112 - 170114	Raw sugar, USD/ton	425	646	52	-94	-92	0.00
1701991000	White sugar, USD/ton	533	475	-11	-9	-19	0.05
1801	Cacao beans, USD/ton	3 318	2 550	-23	12	-14	0.06
1806	Cacao products, USD/ton	4 580	4 645	1	32	34	0.20
22	Spirits and non-alcoholic beverages	-	-	-	-	37	1.09
2402	Cigarettes and cigars	-	-	-	-	-7	0.07
<i>Fuel:</i>							
2701	Fossil coal, USD/ton	13	21	61	14	84	0.21
2710	Petroleum products, USD/ton	1 134	1 279	13	3	17	0.38
<i>Medicines and chemical products:</i>							
2941	Antibiotics	-	-	-	-	13	0.05
3003-3004	Medicines	-	-	-	-	21	3.76
3808	Chemical weed and pest killers, USD/ton	6 406	6 864	7	12	20	0.39
4001-4002	Natural and synthetic rubber, USD/ton	1 759	2 165	23	9	35	0.19
<i>Garments and footwear:</i>							
61-62	Garments	-	-	-	-	25	2.88
6403	Leather footwear, USD/pair	24,4	29,9	22	14	40	0.68
<i>Metals and metal goods:</i>							
72	Ferrous metals, USD/ton	650	715	10	45	59	2.11
72 (кроме 7201-7204)	Ferrous metals (except for cast iron, ferro-alloys, waste products and wrenching iron), USD/ton	673	743	10	44	59	1.83
7304-7306	Steel pipes, USD/ton	1 546	1 453	-6	50	41	0.46
<i>Machinery, equipment and transport vehicles:</i>							
84-90	Machinery and equipment	-	-	-	-	28	48.27
8703	Cars, thousand USD/unit	22,56	25,0	11	0	11	2.93
8704	Lorries, thousand USD/unit	50,8	62,8	24	57	94	0.87
9401-9403	Furniture	-	-	-	-	24	0.73

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

The overall value of imports of **medicines and chemical products** increased to \$40.3bn (19.2%).

Imports of **ferrous metals and steel pipes** rose by nearly 50%, though import prices within this commodity group demonstrated mixed dynamics. The

overall growth in the group “metals and metal goods” amounted to 37.3%, up to \$15.6bn.

Growth in the value of imports of **machinery, equipment and transport vehicles** was equal to 27.8%. The overall volume of this commodity group rose to \$110.3bn (48.6% of overall imports). The volume of imports of cars remained at the last year level, while that of trucks increased by 57%.

### Geographical Pattern of Trade Turnover

In 2017, a trend of the past few years towards reduction of the share of the EU (and EFTA) and growth of the share of APEC states in Russian exports and imports virtually came to naught. Within a year, the share of EU countries in the trade turnover fell by the mere 0.6 p.p. to 42.2% in 2017, that is, 7.4 p.p. lower than in 2013 (*Table 3*). In 2017, the share of APEC states amounted to 30.5%, that is, 0.6 p.p. and 5.7 p.p. higher than in the previous year and 2013, respectively. Growth in the share of APEC states is primarily related to promotion of trade with China (a 4.4 p.p. growth in the trade turnover within four years).

The share of Ukraine in Russia's trade turnover stabilized to 2.2%, which is much lower than that before the bilateral relations got worse<sup>1</sup>.

A 0.19 p.p. growth in the share of the Eurasian Economic Union in Russia's trade turnover was mainly driven by a 0.12 p.p. increase in the share of Kazakhstan.

*Table 3*

#### GEOGRAPHIC PATTERN OF RUSSIA'S TRADE TURNOVER IN 2013–2017 BY MAIN TRADE PARTNER – COUNTRIES

Region/ country	Share in Russia's trade turnover, %					Change, p.p. 2017 on 2016
	2013	2014	2015	2016	2017	
EU	49.6	48.1	44.8	42.8	42.2	-0.64
Ukraine	4.7	3.5	2.8	2.2	2.2	+0.01
Turkey	3.9	4	4.4	3.4	3.7	+0.34
Norway	0.3	0.3	0.3	0.3	0.2	-0.06
Switzerland	1.4	0.9	0.9	1.1	1.0	-0.02
APEC, including:	24.8	26.9	28.1	29.9	30.5	+0.57
China	10.5	11.3	12.1	14.1	14.9	+0.76
USA	3.3	3.7	4.0	4.3	4.0	-0.29
Japan	3.9	3.9	4.1	3.4	3.1	-0.30
Republic of Korea	3.0	3.5	3.4	3.2	3.3	+0.07
Vietnam	0.5	0.5	0.7	0.8	0.9	+0.08
CIS, including:	13.4	12.3	12.5	12.3	12.4	+0.10
APEC, including:	7.4	7.2	7.9	8.5	8.7	+0.19
Armenia	0.2	0.2	0.2	0.3	0.3	+0.01
Belarus	4.1	4.1	4.5	5.1	5.2	+0.05
Kazakhstan	2.8	2.7	2.9	2.8	3.0	+0.12
Kirgizia	0.3	0.2	0.3	0.3	0.3	+0.01

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

1 For more information on risks and implications related to deterioration of the bilateral relations for trade turnover, see: M.O. Kazaryan, A.Yu. Knobel. Risks and Possible Implications for Russian and Ukrainian enterprises due to Termination of Trade and Economic Cooperation // Russian Enterprising. 2016. Vol. 17. No. 2. P. 155–166. doi: 10.18334/rp.17.2.2205

### 3. THE RUBLE'S EXCHANGE RATE THAT WILL BE BEST FOR RUSSIAN INDUSTRY IN 2018

**S.Tsukhlo**

*Russian industry, after the ruble's sharp plunge in late 2014, for more than three straight years existed at a new exchange rate of the national currency, when its value was determined exclusively by market forces. During those years, all the participants in that process accumulated some practical experience of operating under the new conditions, were able to properly test their previous (theoretical) notions of the possible effects of the ruble's depreciation on the Russian economy, to adapt, over the period 2015–2017, to the actual movement pattern of the national currency, and to shape their ideas of what its desired parameters in 2018 might be.*

The ruble's depreciation in December 2014 became quite an ordeal for Russian industry – in February 2015, the ruble's strengthening came top of the list of the most necessary anti-crisis measures pointed out in the business-opinion surveys of industrial enterprises. This result appears to be logical when set against the business surveys conducted in 2012–2014, when sharp depreciation of the ruble was considered to be an anti-crisis measure by only 1–4% of enterprises.

The first indications that most Russian industrial enterprises were negatively disposed toward any weakening of the national currency induced us, in 2015, to start monitoring the opinions, across Russian industry, of the desirable movement pattern of the ruble. In December 2017, for the fourth time since 2015, Russian industrial enterprises were asked to specify what change in the ruble's exchange rate would be most desirable for them, so that it could boost the domestic demand for their products, as well as their exports, while at the same time reducing their production costs, increasing their investments, and boosting their competitive capacity. The outcome of the latest business survey was completely in line with the results of the three previous surveys, and it appears to be quite logical in view of the situation in the Russian economy as it has been evolving over the period 2014–2018.

Russia's industry needs a weaker ruble (relative to its December 2017 level) only in order to increase foreign demand for its exports. For all the other indicators (among those cited above) to display a positive movement pattern, the surveyed enterprises more frequently desire a stronger ruble. However, a weaker ruble is expected to boost export demand in 2018 only by a quarter of Russian industry, represented by those enterprises that have traditionally relied on exports, or are hoping to enter the export market. At present, the bulk of enterprises operating in industry (37%) cannot aspire to sell their products abroad. Another group of enterprises (22%) need a stable ruble in order to be able to more reliably plan their export activities. An estimation of the traditional distribution of opinions demonstrates that the desire for a weaker ruble as a factor capable of boosting exports is not so strong as it might have been imagined. On the contrary, the need for a stronger ruble is much more pronounced (*Fig. 1*).

For most part, the ruble's strengthening in 2018 is desired by enterprises in order to bring down their costs. Such a situation appears to be logical, in view of the high dependence of Russian industry on purchases of imported equipment and raw materials. In 2014, about 40% of enterprises stated that they would not discontinue such purchases, no matter how high the prices of imports might climb. Now, the necessity to strengthen the ruble in order to bring down their costs is pointed out by 54% of enterprises. And only 21% of enterprises consider their production costs to be independent of the ruble's exchange rate (in 2015, this 'independency index' amounted to 15%).

Investment growth is likewise linked to the ruble's strengthening. However, in this case the dependence is not as strong as that cited for the reduction of costs. This can be explained by the fact that, during our observation period, Russian industry was demonstrating a low investment activity. Nevertheless, high equipment prices come second on the list of obstacles to investment activity across industry in early 2018. And the scale of import substitution with regard to purchases of machinery equipment in January 2018, as shown by the results of our latest quarterly import substitution survey, is on decline across Russian industry. While in Q2 2015 a total of 30% enterprises reported a shrinkage of the share, in terms of physical volume, of imported machinery and equipment in their purchases, by Q4 2017 that index had plunged to 7%. It seems that Russian industry has 'eaten up' the entire output of that sector in RF territory (or at least has attempted to do so), and no longer can (or wants to) maintain the same rate of intensity of import substitution in their equipment purchases, the reason being the absence of relevant production in RF territory or unsatisfactory quality of domestic equipment.

At present, the adaptation level of investment plans across Russian industry to the ruble's current exchange rate is 20%, which means that one-fifth of all enterprises are quite satisfied with the results that they have achieved in terms of import substitution in that sector, having launched or planning to launch their investment projects based on the new equipment prices, and having assessed their potential for product sales and their pricing policy. Thus, they no longer need a change in the ruble's exchange rate, with due regard for the adaptability of buyers to the new prices of their products in ruble terms.

However, it should be noted that the adaptation index of investment activity across Russian industry to the new exchange rate is still far below its need for a stronger ruble that could truly boost the ongoing investment processes. While 20% enterprises wished for the ruble to stay at its current level, 48% of them pointed out their need for the ruble's strengthening in order to enhance their investment activity in 2018. In other words, the number of those who prefer a stronger ruble is 2.4 times higher than the number of those who favor its stability. Interestingly, in the previous years, the ratio between the former and the latter was even more biased towards the former. In 2017, it was 49 vs. 16; in 2016 – 73 vs. 8; and in 2015 – 61 vs. 12.

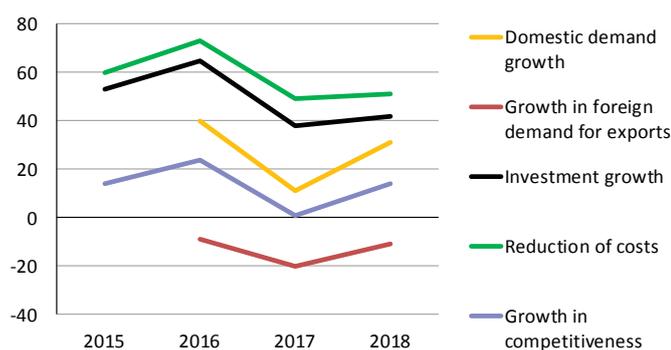


Fig. 1. Balance of changes in ruble movement pattern needed for positive movement patterns of main industrial indices, 2015–2018, p.p.

While the true attitude of Russian industrial enterprises to the ruble's movement pattern in terms of its influence on export demand, production costs, and investment was recognized both by expert analysts and government officials, the same 'attitude factor' from the point of view of its influence on domestic demand is hardly compatible with the established notions of the benefits of the national currency's depreciation. Our monitoring of the changes in the ruble's movement pattern desirable for Russian industrial enterprises as a means of increasing domestic demand for their products, has always revealed their need for a stronger ruble, and consequently, for cheaper imports, meaning both the imported products purchased by Russian industry and the imports competing with their Russian analogues.

The possible explanation for that phenomenon – that enterprises simply do not understand how the ruble's exchange rate really influences the situation in Russian industry – can hardly be treated seriously, because by now, industry has accumulated sufficient experience of operating in conditions of both the ruble's highs and lows. The claims that the respondents participating in the Gaidar Institute's business opinion surveys are not properly qualified to provide reliable information do not seem to be well-substantiated, either, because for more than 25 years already, our surveys have been conducted across a panel that consists of 90% of directors, deputy directors and other CEOs of industrial enterprises. The question concerning the effects on the ruble's exchange rate on domestic demand was asked repeatedly, in the traditional format, over a lengthy period of time. The obtained results are quite compatible with the results of other surveys addressing the ruble's movement pattern, import substitution, and depreciation issues.

Overall, as demonstrated by our business opinion surveys, Russian industry more frequently linked domestic demand growth with the ruble's strengthening than with its weakening. Especially notable was the need for a stronger ruble in early 2016, when it was at its record low, and industry was still unable to overcome the crisis. Then, the ruble's strengthening as the factor that could boost domestic demand was pointed out by 52% of Russian industrial enterprises. And only 12% of them expected that a further plunge of the ruble could indeed trigger growth in domestic demand. In 2017, in response to the ruble's climb and the onset of exit from the crisis, the need for a stronger ruble as a demand growth factor became significantly lower (27%), but it was still above the percentage of those who needed a weaker ruble (16%). At the same time, the independence of domestic demand from the ruble's movement pattern was then recognized by 33% of enterprises. In late 2017, the need for the ruble to strengthen over the next year (2018) once again increased – it was noted by 38% of enterprises. Meanwhile, a weaker ruble could boost domestic demand only according to 7% enterprises. This level of 'demand for a weak ruble' was lowest for the entire period 2016–2018.

These monitoring results are quite compatible with the monitored movement pattern of another set of factors – the obstacles to (or constraints on) output growth.

The ruble's plunge in December 2014 cut by half the negative effect of competition with imports across Russian industry, and this level (14–15%) could be maintained throughout the subsequent three-year period.

The effect of the national currency depreciation produced not only a positive, but also a negative effect on Russian industry, especially in early

2016, when the ruble's plunge and rising prices of imported equipment and raw materials were considered to be the factors that restricted their output growth by 36% enterprises. However, the slight climb of the ruble over the course of 2016 coupled with industry's gradual adaptation to its new exchange rate reduced the negative effect of a weak ruble to 7% in 2017. Meanwhile, the 'overpriced' ruble prevented output growth only for 3% of enterprises.●

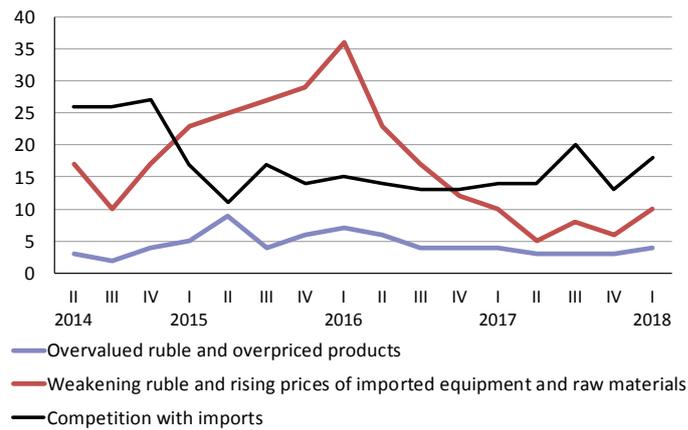


Fig. 2. 'Exchange-rate' constraints on output growth in Russian industry, 2014–2018, %

## 4. BANK DEPOSITS AND LENDING IN JANUARY 2018: UNORDINARY DEVELOPMENT

**M.Khromov**

*In January 2018, households' savings contracted against debt growth on bank loans, which is very unusual for the first month of the year. Consumption indexes – retail trade turnover and spending on paid services – continued growing. The households strive to maintain acceptable standard of living by mobilizing all available financial possibilities.*

In January 2018, retail bank deposits contracted by more than RUB 500 bn in nominal terms. As of 1 January 2018, the volume of households' bank deposits peaked RUB 26.1 trillion and a month later, it fell to RUB 25.6 trillion. In a way, this is due to the January strengthening of the national currency. During the month, the ruble exchange rate has gone up by 2.5% to the dollar resulting in the decrease of the ruble equivalent of the savings in foreign currency. Even with the adjustment to exchange rate dynamics, the contraction of bank deposits remains significant – RUB 381 bn or 1.5% of the total volume of households' bank deposits.

Major part of the deposits outflow fell on ruble accounts and deposits of the population. Over the month, they declined by RUB 452 bn. Deposits denominated in foreign currency and calculated in US dollars, on the contrary, have gone up slightly from USD 93.3 bn to 94.6 bn.

It is obvious that the January reduction of the deposits is largely due to the new-year transfer of salaries payment when instead of the first days of the next month, December salary hits the account during the last days of December and is recorded in the banker books at the onset of the calendar year. It has been confirmed structurally – predominant reduction of the ruble denominated accounts and not currency denominated accounts, which are traditionally long-term ones. Among the ruble denominated accounts short-term accounts with 30 days due and less including call deposit accounts were reduced.

However, if we compare with the past year, the outflow of deposits has grown significantly. For January 2017, the nominal volume of households' bank deposits fell by merely RUB 162 bn. The ruble denominated accounts and deposits have accounted for RUB 130 bn and the ruble equivalent of deposits denominated in foreign currency has accounted for RUB 32 bn. Inasmuch as the year earlier the ruble also was strengthening to the dollar then taking into consideration the adjustment to exchange rate revaluation the reduction of the households' bank deposits in January 2017 was still less – RUB 108 bn or under 0.5% of the overall volume of deposits recorded for the onset of 2017. Thus, outflow of deposits registered in January 2018 has grown by 3-fold compared to the same period of the previous year.

The opposite is being observed at the onset of 2018 on the market of retail bank lending. Usually, in January the lending market is calm. Even during the period of the credit market brisk growth the January growth rates of the credit exposure are close to zero or are even negative. However, in January 2018, the volume of retail bank debt went up by RUB 82 bn or by 0.7% of

the total debt volume as of the onset of the month. A year earlier, in January 2017, retail bank debt, on the contrary contracted by RUB 48 bn (-0.4%), which was a more traditional dynamics for the first month of the year.

What is the reason for this unusual dynamics of the households' budget registered in January 2018? According to the preliminary data released by Rosstat, real disposable income in January 2018 has remained unchanged compared to January 2017, which indicates the growth of the nominal income by around 2.2%. However, these estimates do not take into consideration one-time payments to the pensioners carried out in January 2017. According to the Gaidar Institute estimates, the real nominal volume of income registered in January 2018 contracted by 3.5% compared to January 2017, which corresponds to the real drop in income by around 6%.

At the same time, final consumption expenditure<sup>1</sup> in 2018 continued to grow. For instance, in January 2018, households spent on goods and services in the nominal terms 5.5% more than a year earlier. If in January 2017 the ratio of consumer expenditure to the cash income constituted 84% then in January 2018 – already 92%. Obviously, this ratio could have been ensured solely by a significant contraction of savings. From the economic perspective, such behavior is not irrational and creates additional risks for the stability of the households financial balance. However, the first month's results of the year can be updated.

In the year-end perspective, the January 2018 results consolidate the credit model of the households' financial behavior. In 2017, only by December-end results total volume of households' bank savings exceeded growth of credit exposure. Up to this moment and especially in the second half of 2017, the inflow of retail bank deposits lagged behind the increase of the amount of credit exposure. In 2017 as a whole, households' bank deposits exceeded credit exposure by RUB 900 bn. Meanwhile, in January – November 2017 credits growth exceeded deposits growth. Consequently, the population is a net creditor. There are more deposits than loans.

In January 2018, net growth of retail bank loans (loans growth minus deposits growth) hit RUB 463 bn. Meanwhile, a year earlier this index came to merely RUB 60 bn. In the coming months the situation, undoubtedly, will be improving. However, by the year-end results net households' bank deposits will turn out to be noticeably less than in 2017 and the sustainability of the banking sector will to a large extent depend on the alternative sources of raising funds – corporate clients and the state. ●

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1 Total retail trade turnover, expenses on paid services and catering.

## 5. HOUSEHOLDS' ADAPTIVE STRATEGIES IN 2017

**E.Avraamova, D.Loginov**

*A large portion of the population has a low adaptive potential and sticks to passive adaptive strategies. At the same time, efforts in terms of active forms of adaptive behavior largely promote the standard of living.*

Due to unfavorable economic situation, most people have to take adaptive efforts to promote the living standard or at least prevent it from falling down further.

The research into households' adaptive strategies carried out by the IPACS RANEPА in 2017<sup>1</sup> required, first, assessment of the adaptive potential of different social groups, second, identification of risks related to reduction of the living standards and the extent of risk concentration in different social environments and, third, analysis of adaptive strategies proper.

The adaptive potential integrated index was built by totaling the main resources of adaptation: a) current income size; b) savings amount and ownership of another real-estate in addition to the main one; c) availability of vocational education and training; d) participation in social networks. Calculation-based conclusions point to the fact that the population is differentiated in conformity with the level of the adaptive potential: high, medium and low levels are registered with 20.4%, 40.4% and 39.2% of people, respectively.

Among Russians with a high adaptive potential, the share of people below the age of 45 who are residents of mid-sized and large cities and have a higher education degree and job of a manager or high-skilled expert is very high.

By its social and demographic composition and employment, a portion of the population with a medium adaptive potential is close to the total population, that is, such a level of adaptive potential is typical of the society as a whole.

Among Russians with a low adaptive potential, there are mostly people of senior age, residents of villages and small towns, without higher education, unemployed or workers with various skill levels, as well as ordinary workers of commerce and consumer services.

A correlation was established between the adaptive potential integrated index and the financial standing dynamics during the crisis. The financial standing of most people (68.4%) with a high adaptive potential did not get worse, while with 31.4% of people it even changed for the better. On the contrary, among the respondents with a low adaptive potential, nearly a half of respondents (47.5%) stated that their financial standing got worse and only one person in ten said that it improved.

The integrated index of risks related to reduction of the living standard was built by way of totaling the main risks related to the following: a) professional environment; b) dependency burden; c) probable worsening of housing con-

<sup>1</sup> A telephone survey method based on a representative sampling of the adult population of Russia; 3000 respondents were surveyed.

ditions; d) debt burden. Also, groups with low (26.3%), medium (48.2%) and high (25.5%) concentration of main risks were identified.

There are more women than men in the group with a high concentration of risks. A relatively larger portion of this group includes people of an active age in all senses: median age of 40–45 years old in general. These people are city residents without higher education and a permanent job (primarily unemployed persons of a working age) whose average income which does not exceed the median one in the areas of their settlement.

Also, the most wide-spread adaptive strategies, which the Russians practiced in the past 2–3 years were analyzed. The outputs of the research point to the fact that selection of adaptive activities amid dramatic social and economic changes was made by the Russians depending, first, on their life stage and, second, optimization of available resources. In case of resources being available, people often used them, while in case of absence thereof, they sought to attract them from outside. The strategy of borrowing outside funds (loans, credits and other) was utilized in groups in which risks of reduction of the living standard concentrated the most.

The investment and saving strategy was practiced by lots of people. During the crisis, most people had to spend their savings, however, representatives of this group sought to return to saving at any convenient moment. Apart from that, spending of savings became a form of protection from the rate of inflation. Though it is infeasible to estimate the extent of such a motivation, according to our data maximum a quarter of respondents knew how to invest their funds to protect them from the rate of inflation. In our view, this factor together with a low financial literacy and lack of long-term planning skills is a serious obstacle on the way to promotion of households' investment activities.

The strategy of labor burden expansion through working overtime is wide-spread among working Russians as the most available method of preserving and increasing their incomes. However, in terms of efficiency this strategy is applicable only to high-skilled experts, as well as ordinary workers of commerce and consumer services whose real income gain could be determined as compared to other representatives of the same professional groups.

The strategy of professional environment modification (building up of a human capital, changing of a job and/or professional status) is the most popular among people at the age below 40. As regards barriers on the way to a more wide-spread application of this strategy, insufficient involvement of people in the processes of uninterrupted vocational training is the main obstacle.

The migration strategy happened to be the least wide-spread among all the strategies reviewed. Migration sentiments prevailed more often among high-skilled and better-off population groups, that is, people with a higher education degree, high adaptive potential and managerial positions.

Private subsidiary farming (PSF) is an important component of the adaptive strategy, mainly, for residents of rural areas and small cities.

Here is the following classification of adaptive behavior based on the data received:

- Lack of adaptive behavior: 37.0%;
- Active adaptive behavior (one or several types): 29.2%;
- Active adaptive behavior, additional use of PSF: 23.0%;
- Active use of PSF without other types of adaptive behavior: 10.8%.

The largest share of those who was not affected by negative economic phenomena is concentrated among the representatives of the group which demonstrates active adaptive behavior. The number of those who were affected the most by the crisis is very small in this group. A lack of adaptive behavior is typical of the two quite opposite groups of the population: those who were not virtually affected by negative economic phenomena and those who had no or minimum adaptive resources.

An active adaptive behavior largely promotes life chances, but cannot guarantee a higher living standard. So, among people with an active adaptive behavior 18.4% of people expect to upgrade their financial standing, while 12.4% of people fear it may get worse. ●

## AUTHORS

**Elena Avraamova**, Head of Social Development Research Laboratory, INSAP, RANEPA

**Alexandra Bozhechkova**, Head of Monetary Policy Department, Gaidar Institute; senior researcher, Center for Central Banks Issues, IAES RANEPA

**Alexander Knobel**, Head of World Trade Laboratory, Gaidar Institute; Director of Center for International Trade, IAES, RANEPA

**Dmitri Loginov**, senior researcher, Social Development Research Laboratory, INSAP, RANEPA

**Pavel Trunin**, Director of Center for Macroeconomics and Finance, Gaidar Institute; leading researcher, Center for Central Banks Issues, IAES, RANEPA

**Alexander Firanchuk**, senior researcher, Foreign Trade Department, IAES, RANEPA

**Mikhail Khromov**, Head of the Financial Research Department, Gaidar Institute; senior researcher, Structural Research Laboratory, IAES RANEPA

**Sergey Tsukhlo**, Head of Business Surveys Laboratory, Gaidar Institute