

## Russia: Economic growth set to moderate in 2H21

By the middle of 2021, the employment and economic activity is broadly back to pre-Covid levels, which is a positive development. In 2H21, the growth rates should naturally moderate, with elevated inflation and outward tourism being pressure factors. However, the high lending growth and fiscal support keep us overall constructive until the year-end



Source: Shutterstock

### Recovery in employment is the key positive from 1H21

June economic activity data for Russia pointed at a well expected moderation. Retail trade slowed from 27.2% year-on-year in May to 10.9% YoY in June, which is slightly below expectations. The growth for 1H21 totalled 10.2% YoY, which in general is a solid recovery compared to the 5.4% YoY drop seen in the Covid-laden 1H20. Here are the key points of interest:

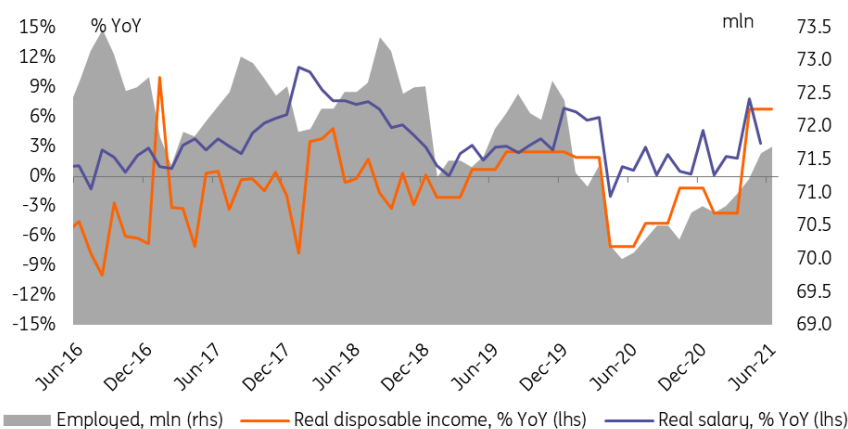
- On the positive side, the employment figures have shown a sustainable recovery over the last 12 months. The unemployment rate has rolled back from its 6.3-6.4% peak seen in 3Q20 to the current 4.8%, while the number of officially employed has recovered by 1.6 million vs mid-2020 to the level of 71.6 million, which is a post-2019 high. The recovery

in employment, which could partially be supported by easing in the labour immigration restrictions, is supportive of the income trend (Figure 1).

- Still, the income trend remains a watch factor, as the 6.8% YoY increase in real disposable income reported for 2Q21 after the 7.1% YoY drop seen in 2Q20 suggests that real incomes have not yet recovered to the pre-Covid levels. Real wages (the latest available data is for May) have recently underperformed expectations, though mainly due to the volatility in the oil&gas production segment, while construction, retail, and other services, including oil throughput, outperformed. Wage dynamics have softened in the state-driven education and healthcare sectors, but they may see a boost around the time of upcoming Parliamentary elections in September. The [elevated inflation](#) however, remains a watch factor, potentially limiting real income growth in 2H21.
- A broader look at the retail trade dynamic suggests that in 1H21 its recovery was supported by (in addition to stronger employment and income) higher borrowing (Figure 2), both mortgage and consumer-focused, and more active spending of savings, as suggested by the slowdown of retail deposit growth to 5-year lows (Figure 3). According to our estimates, around one-third of the YoY growth in consumer spending on local goods and services in 1H21 was financed by the unsecured lending. The [increase in the key rate](#) and the concerns about the unsecured lending growth expressed by the central bank suggest that some cooling is on the cards for the banking sector and therefore consumption going forward.
- The lack of outward tourism has been another support factor for the local consumption until recently. At the same time, starting this July, trips to Turkey and other popular resort destinations have become available again. Should the overall spending on foreign trips recover to around US\$1.0-1.5bn per month in 2H21 (which is 30-45% of the peak levels seen in 2H19), that should knock off 3-4 percentage points from the retail trade growth rates YoY, all else being equal.

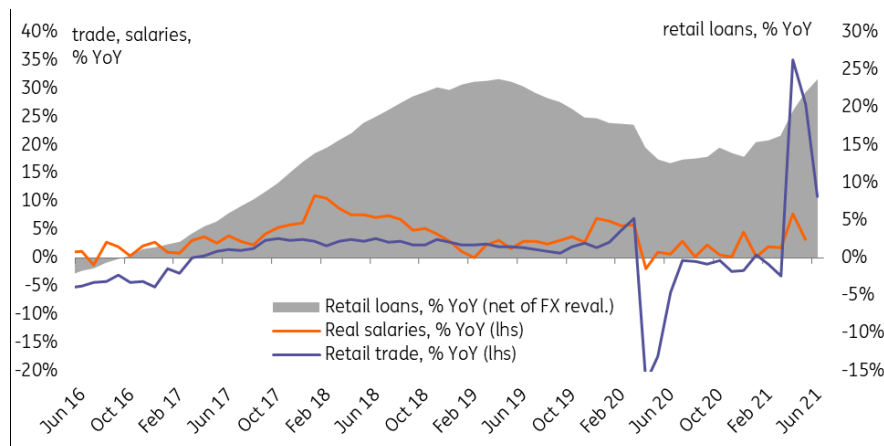
Overall, we are constructive on consumption for 2H21. Even with some moderation related to base effects, inflation, stabilisation of lending, and pick-up in foreign tourism, we see 7.5% retail trade growth for the full year as realistic. At the same time, the post-electoral 2022 would require new growth drivers in order to assure growth above 2.0%.

**Figure 1: Number of employees has recovered to pre-2020 levels, reinforcing the overall income trend**



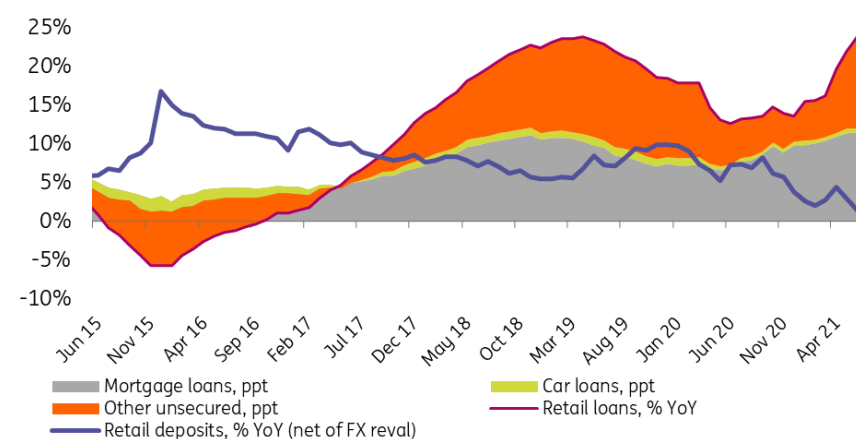
Source: Rosstat, ING

**Figure 2: Retail trade is set to normalise on base effects and outward tourism, but is supported by lending**



Source: Bank of Russia, Rosstat, ING

**Figure 3: Consumption is increasingly reliant on borrowing and savings**



Source: Bank of Russia, ING

**Producer side upbeat, credit demand is there, local investments out of sovereign fund are to be watched**

The producer activity data was also generally constructive. While industrial output growth of 10.4% YoY came in short of expectations, the overall structure suggests that in 2H21 the support can come from the expansion of oil production, as per agreed easing in the OPEC+ constraints, while consumer-focused manufacturing will largely depend on the household mood, which seems to be stabilising.

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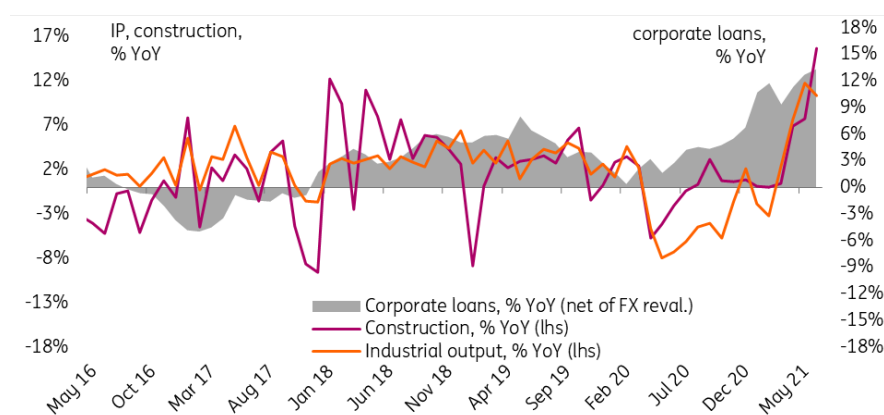
Construction was the highlight of June, spiking 15.7% YoY for the month and 6.4% YoY for 1H21. Housing construction, which went up 34.9% YoY in June and 29.7% YoY in 1H21, was an important driver, thanks to the subsidised mortgage programme, which has recently been extended.

On the positive side, the recovery in producer trends seem to be accompanied by an acceleration in corporate loan growth (Figure 4) to a 6-year high of 13% YoY (net of FX revaluation), which is a sign of a broad-based recovery. It also appears that this acceleration was not materially damaged by the recent tightening in the monetary policy stance.

Going forward, the producer trend may be affected by the moderation in the local consumption, and the eventual ending of subsidised mortgages, restoring the role of fiscal policy as an important variable, at least for the state-driven sectors. For now, the federal budget spending is headed into deceleration, from 7% YoY as of 1H21 presumably to 1-3% for the full-year. At the same time, the plans for local investments out of the National Wealth Fund into infrastructure projects and newly discussed Gazprom projects, if implemented, would result in up to an annual US\$10bn of quasi-budget support throughout 2021-2023, equivalent to 0.5-0.6% of GDP.

We believe that with 4.4% YoY growth for 1H21, industrial output volume is back to pre-Covid levels, and even assuming some natural moderation in 2H21, the full-year growth should total at least 5.5% this year. However, as with the case of consumption, the 2022 prospects are less certain and will remain a function of the state-driven sectors.

**Figure 4: Producer mood upbeat and supported by credit expansion**



Source: Bank of Russia, Rosstat, ING

### Watch factors for 2H21

The June economic activity and the banking sector data reinforce our earlier [call](#) on 3.8% YoY GDP growth for the full-year, with further moderation seen in 2022. Our view for this year is slightly less optimistic than consensus and Bank of Russia expectations, accounting for the risk related to the third wave of Covid, which is characterized by high mortality amid a mediocre vaccination rate. We also believe the potential for credit and deposit financing of the consumption growth to be largely exhausted. At the same time, the fiscal policy stance, which has some room for easing through direct and indirect support, is the key opportunity for some improvement in the near-term view.

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