Russian activity slowed down in 3Q, more headwinds seen for 4Q

September activity data is hinting that the recovery in consumption might be running out of steam. Faster inflation, anti-Covid lockdowns and cautious monetary and fiscal stance are likely to restrain GDP growth in 4Q21 and 2022 and make it more dependent on the recovery in the commodity-focused sectors

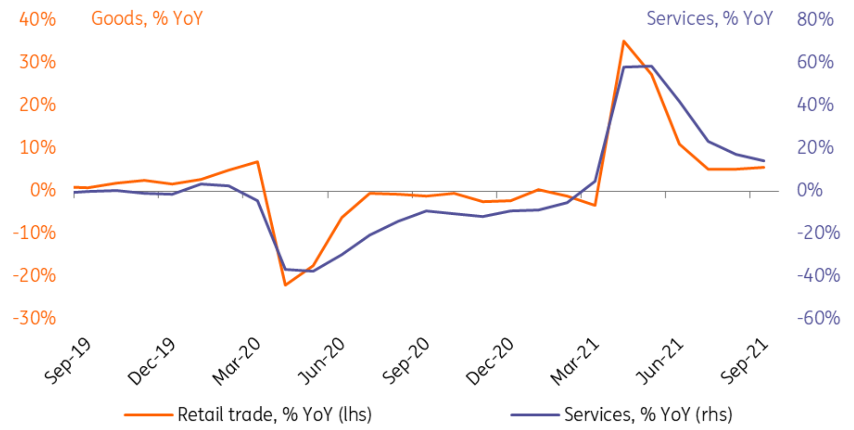
Tank farm for storage of petroleum products in Volgograd, Russia

Consumption fails to accelerate in September despite social support

Russian retail trade growth managed to post 5.6% year-on-year growth in September, which is a modest acceleration compared to the 5.3% YoY in August, but it was below consensus and materially lower than our expectations, as September consumption data was supposed to receive a material boost from the pre-election social payments worth RUB700bn, or 0.6% of GDP, or 1.0% of the annual household income. The September retail trade performance was in line with a somewhat supportive base effect of 2020, suggesting no material uptick despite an increase in the consumer confidence indicator to 93 (according to the Bank of Russia), a post-Covid high. The 3Q21 retail trade growth decelerated to 5.3% YoY, and the 9M21 growth to 8.4%, suggesting a 4.3% increase over the pre-Covid 9M19 level.

We note that services consumption growth also did not show any improvement (Figure 1), as the slowdown to 14.2% YoY in September from the 17.2% YoY in August was also in line with the base effect. With 18.8% YoY growth in 9M21, the services consumption level is still 1% below the pre-Covid period of 9M19.

Figure 1: Russian retail trade and consumer services unspectacular in September

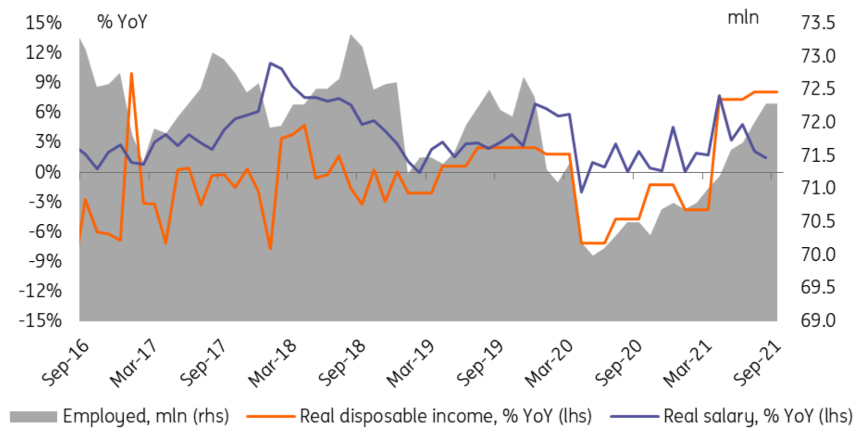


Source: Rosstat, ING

Household income received a one-off boost, prospects of core labour income uncertain after recovery

The social payments did manage to support household income, as the real disposable income growth picked up to 8.1% YoY in 3Q21 (Figure 2), despite a somewhat adverse base effect and the 0.9 percentage point pick-up in average inflation rate in 3Q21. The social payments helped to assure real disposable income's return to pre-Covid levels in 9M21. The labour income growth dynamic (August is the latest available data point on that) and employment suggest a moderation after a rapid post-Covid recovery.

Figure 2: Household income growth resumed on base effect and one-off payments



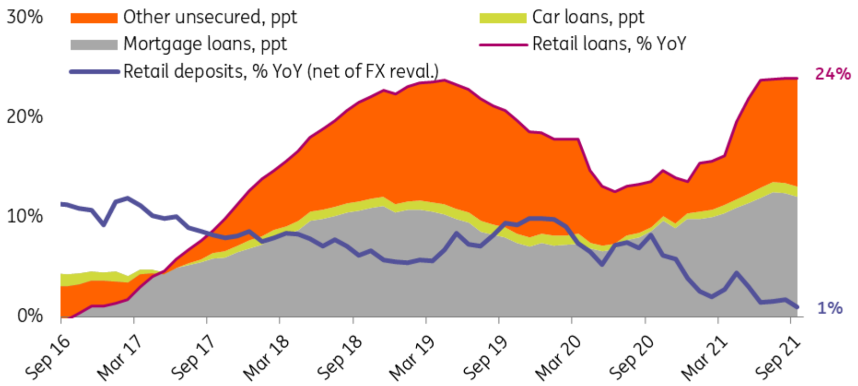
Source: Rosstat, ING

Household income channeled into debt servicing and real estate

Another surprise from September household data was that extra income failed to translate not only into higher consumption but also into higher savings. The banking sector data suggests no material inflow into bank accounts (Figure 3) amid a continued increase in leverage, predominantly unsecured consumer loans. At the same time we note the continued growth in escrow accounts (+RUB131bn in September, +RUB1.4tr in 9M21) to RUB2.6tr, or 2% of GDP, suggesting that real estate remains popular, supported by 27% YoY growth in the banks' mortgage portfolio. The stock market has become less popular than in 2020, with only RUB 35bn net retail inflow into equities seen this September and RUB263bn in the last 12 months vs. RUB65bn and RUB341bn, respectively in 2020.

We have the following interpretation of the September consumer activity and retail banking data. It appears that the lower-income households did indeed benefit from the additional RUB700bn paycheck in August-September, partially using it for consumption of goods, partially to service interest payments on accumulated loans: according to our estimates, the year's interest payments are totalling c.RUB220bn per month. Meanwhile, the medium and high-income households are focused more on property purchases and foreign travel, which became more available due to the relaxation of outward travel restrictions and more desirable, given the abnormally cold weather in September.

Figure 3: Consumption is increasingly reliant of leverage and spending of savings



Source: Bank of Russia, ING

Corporate activity is supported by the commodity boom

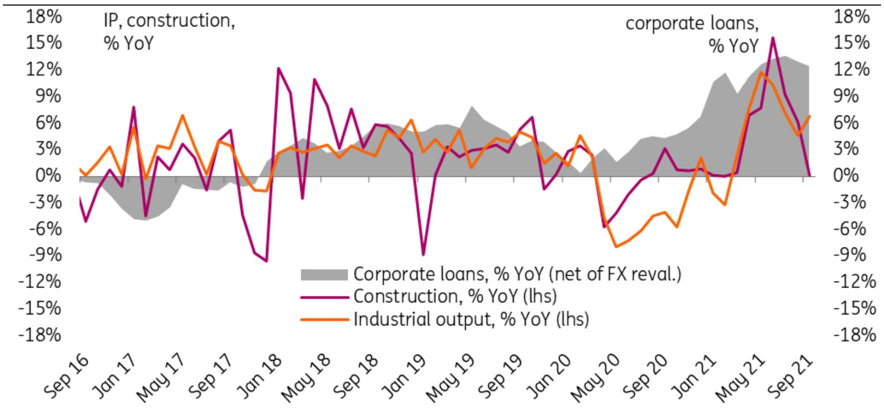
Producer numbers for September are painting a mixed picure. Industrial output managed to exceed expectations picking up to 6.8% YoY in September (4.7% YoY for 9M21), mainly on solid support from the commodity extraction sector, which benefitted from an easing in OPEC+ restrictions and high demand for metals, gas, and coal. The other support factor was cold weather that propelled local demand for electricity and heating. Manufacturing, the core subsegment, showed a mixed performance, with oil downstream posting acceleration, while most of the non-commodity items, including car manufacturing being sluggish.

The construction sector also failed to show positive results (Figure 4), even though housing construction continued to show strong 31% YoY growth, reflecting a buoyant real estate market.

The near-term trends here are largely dependent on the fate of the subsidised mortgage programme. So far, a total of RUB1.9tr was disbursed, 90% of the pre-allocated sum, suggesting a possibility of an upoming cooling of the market, unless the government and the Bank of Russia agree to extend it despite the risks related to inflation.

Corporate loan growth remains solid, though off its local peaks, suggesting that the recovery in activity is driven by the cash-rich commodity sectors, while local consumer-focused industries are taking the back seat.

Figure 4: Producer activity uneven, industrial output supported by commodity extraction



Source: Bank of Russia, Rosstat, ING

4Q21 trends to be challenged by Covid

According to preliminary estimates by the government, Russian GDP growth decelerated from 3.7% YoY in August to 3.4% YoY in September, totalling 4.0% YoY in 3Q21 and 4.6% in 9M21. While the final estimate for 3Q21 may still reach our 4.5% YoY expectations, the 4Q21 and 2022 result is set to be lower for the reasons of statistical base and fundamentals.

The most recent challenge is the re-imposed restrictions on business activity since the end of October in response to record-high new Covid infections and mortality amid a sluggish vaccination rate. The restrictions vary by region, but mainly limit non-essential offline retail and services, which in our estimates cost the economy around 0.1 percentage points of annual GDP per week of lockdown. So far, the negative effect is smaller than during the first lockdown of April-May 2020 (knocked off 0.25 ppt per week), but the final effect may be higher if this lockdown is extended in time and geography. The initial restrictions are scheduled to end after 1.5-2.0 weeks, but there is a risk of extensions. The strictest measures are applied in Moscow, Moscow region, and St. Petersburg, which are trade and services-heavy.

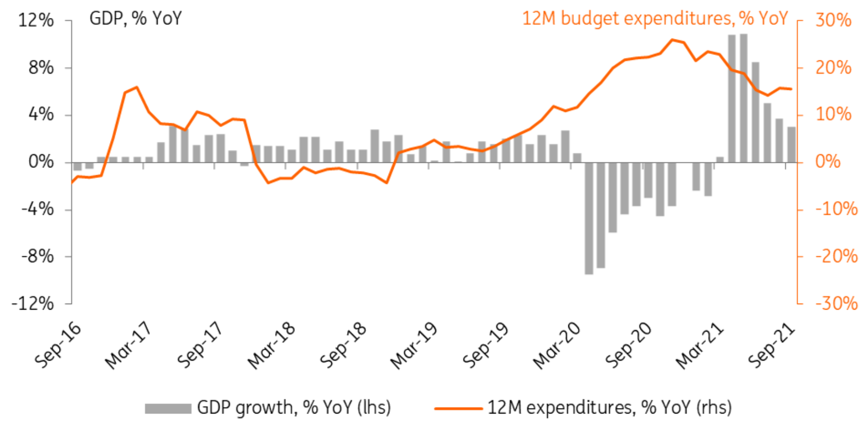
Other than Covid, restraints to economic activity include

- accelerating inflation, which is likely to eat into real income growth and is forcing the central bank to maintain hawkish approach
- Bank of Russia's concerns regarding the fast growth in non-mortgage lending, macroprudential and quantitative tightening in the segment
- cautious budget policy signals to consolidation. According to the budget draft, spending

growth is set to decelerate from the current 16% YoY (Figure 5) to 5% in 2021, while the 2022 draft assumes a 2% cut in nominal terms. While we believe the actual consolidation is unlikely to be that sharp, the overall reluctance to use fiscal support tools will remain.
- the return of employment, income, and overall activity to pre-Covid levels amid the lack of new growth drivers.

At the same time, the situation on the commodity markets, including high demand for energy, metals, agriculture, and chemicals should be supportive at least in the near term. We expect oil and gas production to continue its recovery amid an easing in the OPEC+ restrictions and higher global demand for gas. Also, the plans to invest annually up to US$12bn in 2022-24 into local infrastructure projects from the sovereign fund should send positive signals to state-focused construction and investment-focused sectors.

Figure 5: Russian GDP growth is moderating on base effect, moderation of fiscal support



Source: Finance Ministry, Ministry of Economic Development, ING

Maintaining our cautious view on 4Q21 and 2022

Weak consumption response to pre-election social spending, risks related to a Covid resurgence, higher inflation, lack of room for monetary easing, low tolerance to unsecured lending, and lack of willingness to use fiscal tools are the key reasons to expect further moderation of economic growth rate in 4Q21 an 2022. At the same time, recovery in export-focused sectors still allow us to keep our 4.3% GDP forecast for 2021 and 2.2% for 2022.

Author

Dmitry Dolgin
Chief Economist, CIS
dmitry.dolgin@ing.de

Disclaimer