

Russia: Consumer confidence takes a hit

Russian consumers ended 2020 on a downbeat note, as retail trade underperformed expectations and the consumer sentiment index is near its historical lows. Consumer optimism seems to be hampered by the lack of confidence in income growth, as the room for further state support appears limited



A man making a choice in a Russian supermarket

Retail trade underperforms expectations despite better-than-expected income

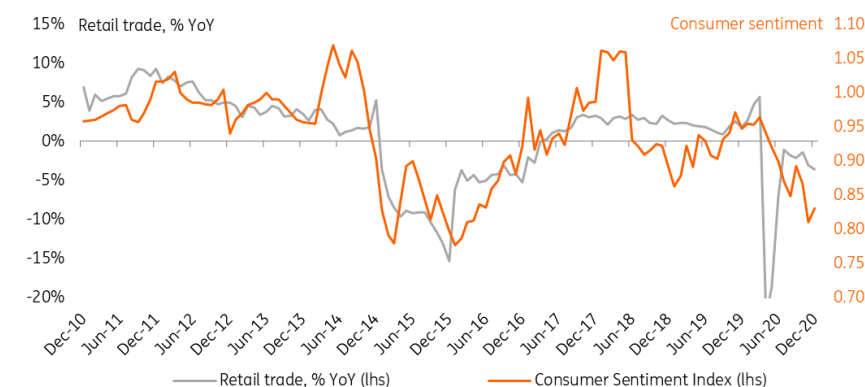
The December retail trade drop of 3.6% year-on-year in December is a disappointment relative to Reuters consensus of -2.5% and our expectations of -2.2%. December was the third consecutive month of retail trade deterioration, and the 4Q20 drop deepened to -2.8% YoY after a -1.6% YoY decline in 3Q20. The full-year drop of 4.1% YoY is slightly worse than the 4.0% drop we expected. We have the following observations and takeaways:

- The deterioration in the retail trade dynamic is in line with the downbeat consumer sentiment index, which slid to its lowest level since mid-2016 (Figure 1). Consumption of services also did not show material improvement, showing a 12.5% YoY drop in December,

close to rates seen since September. Meanwhile, while services might have been restrained by anti-Covid restrictions enforced as a response to the second wave of infections, retail trade shouldn't have suffered given that there were no material restrictions for shopping.

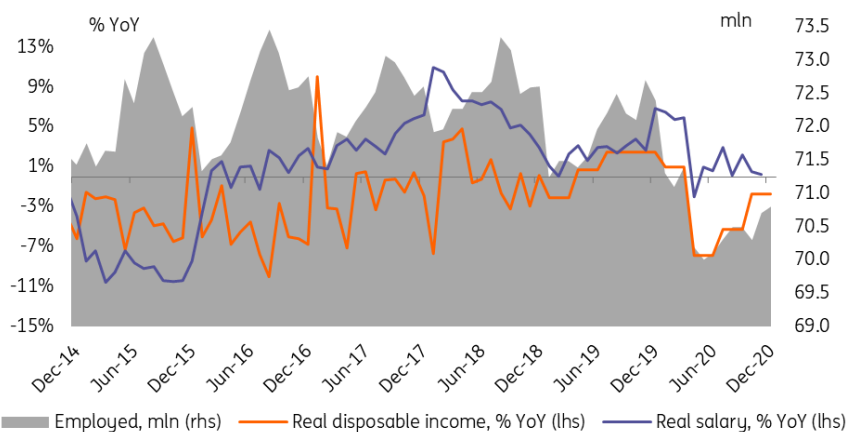
- The origins of the continued pressure on the consumer trend are not obvious, given that the real disposable income, as well as real salaries and employment continued to post a recovery since their 2Q20 fall (Figure 2). December unemployment came in 0.2 percentage points lower than expected, while real salary growth remained positive despite the acceleration in CPI and also contrary to expectations. The real disposable income drop narrowed noticeably to -1.7% YoY in 4Q20 from -5.7% YoY in 3Q20.
- Banking sector data offers a partial explanation to the weakness in the consumer trend (Figure 3). Retail lending growth continued to decelerate amid a redemption of consumer loans, while mortgage lending gained traction. Simultaneously, retail deposits after showing a relatively stable growth throughout the year dropped to 4% YoY (net of FX revaluation effect), the lowest rate since 2015. It also appears that FX retail deposits increased by US\$4.5bn, or 5%, in November-December. This suggests that at least part of the local consumer weakness could be explained by a resurgence of foreign tourism, which became more available in 2H20, and redistribution of income and savings into real estate amid the subsidized mortgage programme. This however does not explain downbeat consumer sentiment.
- We do not exclude, that the deterioration of consumer sentiment represents a lack of confidence in the income prospects. First, with a 3.5% drop in real disposable income, 2020 has become the seventh consecutive year (with the exception for near-zero growth in 2019) of income decline, putting the current income level at a more than 10-year low (Figure 4). Second, the structure of the 2020 household income suggests increased dependence on state, as additional social payments were made as part of the 4% GDP fiscal stimulus package, while public sector (23% of Russia's employees) salaries showed 9% nominal growth in 2020 vs. 5-6% Russia average. This means that outside the public sectors income dynamic has been under significant pressure. According to our estimates, the direct state support to household income increased by RUB2.7tr, or 2.5% GDP in 2020, without which the Russian real disposable income would have dropped by 7.8%. In the meantime, this level of state support to household income, which totals 22% of GDP and 58% of total consolidated spending, is already at historical highs and has little room for further increase (Figure 5).

Figure 1: Retail trade weakened at the end of 2020, in line with consumer sentiment



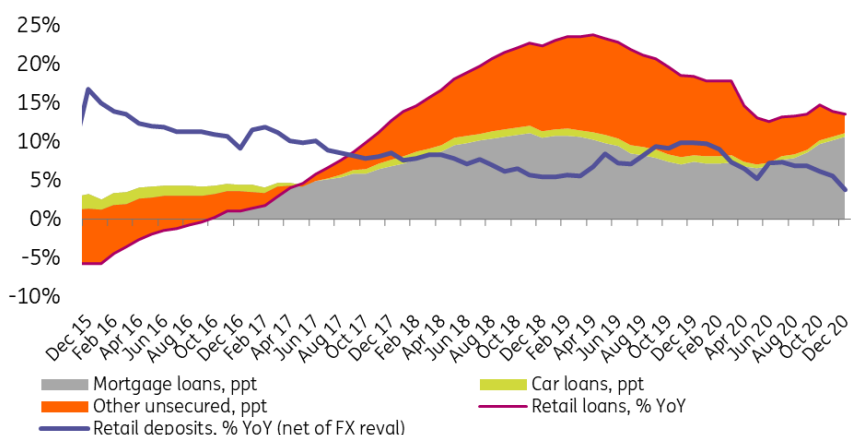
Source: Bank of Russia, Rosstat, ING

Figure 2: Employment and income are recovering



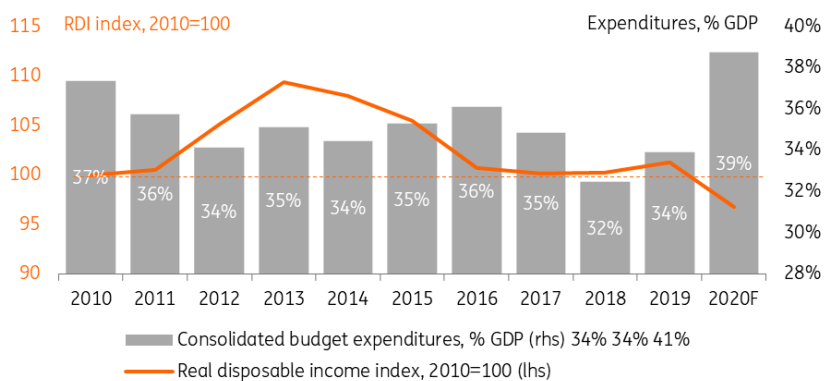
Source: Rosstat, ING

Figure 3: Retail deposits and consumer lending growth falls to multi-year lows amid spike in mortgages



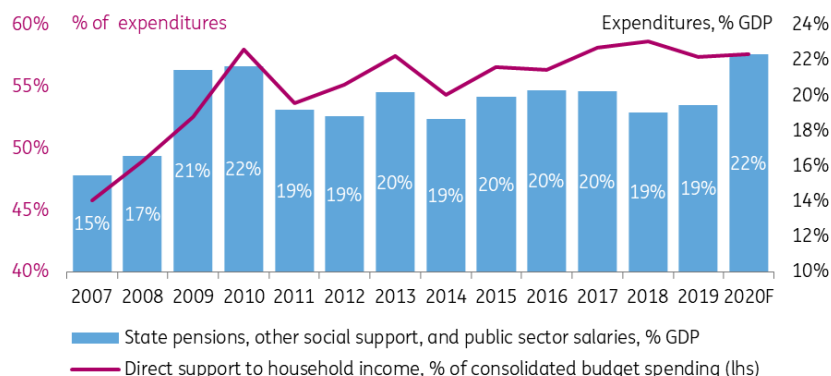
Source: Bank of Russia, ING

Figure 4: Real disposable income fell below the 2010 level despite increased fiscal spending



Source: Finance Ministry, Rosstat, ING

Figure 5: Direct budget support to household income is already close to historical high



Source: Finance Ministry, Rosstat, ING

The downbeat consumer sentiment in 4Q20 points at fragility of the recent recovery in consumer-focused **manufacturing**. Meanwhile, the limited fiscal room for further increase in the direct state support to household income heightens the urgency to address the issue of private sector confidence and business climate. With near-term economic growth prospects uncertain, we find it unlikely that Bank of Russia will be in rush to enter a key rate hike cycle anytime soon even despite the recent **increase in CPI risks**.

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