

MONITORING OF RUSSIA'S ECONOMIC OUTLOOK:

TRENDS AND CHALLENGES OF SOCIO-ECONOMIC DEVELOPMENT

No. 12(156) November 2022

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Monitoring of Russia's Economic Outlook

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

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1. THE RF CENTRAL BANK'S MONETARY POLICY EASING CYCLE IS PROBABLY OVER

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Following its board meeting on October 28, the Bank of Russia left the key rate unchanged at 7.5% per annum, which is in line with the analyst consensus forecast and financial market expectations. This decision was the result of a reversal in the inflationary trends, an increase in the inflationary expectations of individuals and businesses, and the proinflationary budget policy in 2022–2023. The Bank of Russia did not change its signal about the subsequent dynamics of the key rate.

According to the month-end results for October, annual inflation slowed down to 12.6%, and the level of consumer prices climbed by 0.18%, which amounts to 1.5% in annualized terms when seasonally adjusted. According to our forecast, the year-end inflation index is expected to reach 12.1%, which is close to the lower bound of the Bank of Russia's updated inflation forecast (12–13%). In 2023, annual inflation is projected to slow down to 5% in Q1, and then accelerate to 6.2% by the end of 2023.

On October 28, 2022, the Bank of Russia Board of Directors decided to leave the key rate unchanged at 7.5% per annum. Thus, the cycle of monetary policy easing, which began in April and consisted of 6 consecutive cuts in the key rate, is over.

This decision coincided with analysts' expectations¹ and was motivated by the following circumstances: the reversal of inflationary trends in September; the proinflationary budget policy planned for 2023; growth of the inflationary expectations of the population and across the business community; the unscheduled indexation of utility tariffs by 9% in December 2022 that was announced in September; fading-off of the ruble appreciation effect that occurred in Q2 2022 (the inflation projection for the end of the current year has been adjusted to 12–13%, and the lower and upper bounds of the forecast average inflation interval for 2023 were slightly expanded to 4.5–6.4%, from the values 4.3–7.5% set at the July board meeting).

The Bank of Russia did not change its signal about the key rate's further movement compared with its previous press release, still not ruling out the possibility of its potential raise in 2023 in response to a softer budget policy than in the current projections. The expected interval of the average key rate value for 2023–2024 likewise remained unchanged.

The Bank of Russia improved its GDP dynamics forecast for the current year with due regard for the increase in the gross fixed capital formation projection (now, it is expected to decline by 3–3.5% vs 4–6% in the July forecast), noting that business activity in Q3 was higher than previously expected. The GDP

¹ URL: <https://www.vedomosti.ru/economics/articles/2022/10/24/946962-konsensus-prognoz-vedomostei-tsb-sohranit-stavku>

dynamics forecast for 2023 was not changed: it is still expected to drop by 1–4%. This year, the main inputs in the gross domestic product decline will be made by the reduction in consumer demand and exports. In 2023, the shrinkage in GDP will occur due to a reduced investment demand and the continuing contraction of exports, which is expected to recover only in 2025. The Bank of Russia still predicts that inflation will return to the target no earlier than 2024.

The forecast for the monetary sector indicators for 2022 has been altered much more significantly than that for the real sector. The Bank of Russia raised its forecast money supply growth rate (national definition) for 2022 to 23–26% (from 12–17% in the July forecast). The forecast for the banking system's increased requirements for organizations and individuals has significantly improved, which can be explained by the lending market revival in Q3, which happened, among other things, due to the lower key rate. At the same time, the forecast for the lending movement pattern over the period 2023–2024 has remained unchanged.

The reasons behind the upgraded forecast for the M2 growth rate were its actual movement pattern in response to the lending growth mentioned earlier and the input of the budget channel to the money supply growth rate expected towards the end of this year. By the end of September, the growth rate of the money supply accelerated to 23.9% YoY (which is the record high of the past decade) from 16.6% at the end of May (*Fig. 1*). The main input into the increased money supply (by component) was made by growth in transferable deposits, which jumped by Rb3.3 trillion in Q3. The volume of term deposits over the same period gained only Rb1.3 trillion, which may be due to the lower interest rates and the waning attractiveness of term deposits. From March onwards, an important factor in the accelerated money supply growth was the devaluation of deposits. The share of term deposits denominated in foreign currency (placed by households and organizations) shrank from 64.5% at the end of February to 32.0% by the end of September. To a certain extent, this shrinkage occurred due to the currency revaluation in response to the ruble strengthening, but for the most part it was caused by the various restrictions imposed on settlements in the national currencies of certain developed countries and the fear of their further tightening.

As far as the sources of money supply are concerned, the main input in the dynamics of M2 in Q3 was made by an increase in claims on non-financial organizations (loans to firms) in the amount of +Rb3.3 trillion. The second most important source of money supply in Q3 was the growth of net claims to government bodies in the amount of +Rb1.3 trillion (the so-called budget channel). A positive input in the money supply in Q3 was made by the banking sector's claims on individuals (retail loans), which amounted to +Rb1.0 trillion.

Thus, the growth of the money supply over Q3 was ensured by an increase in lending, budget expenditures, and devaluation of deposits.

In view of the gradual cooling of the lending market in October,¹ the upgraded forecast for the money supply growth (national definition) most likely happened in response to the expectations of a further decrease in the percentage of deposits denominated in foreign currencies and an increase in net claims to government bodies over the last few months of the calendar year, when budget expenditures are pushed up by seasonal factors. Over time, the accelerated growth of M2 will lead to an increase in inflationary pressure and may require a tightening of monetary policy by the regulator.

1 URL: https://www.cbr.ru/press/pr/?file=28102022_133000Key.htm

1. The RF Central Bank's Monetary Policy Easing Cycle Is Probably Over

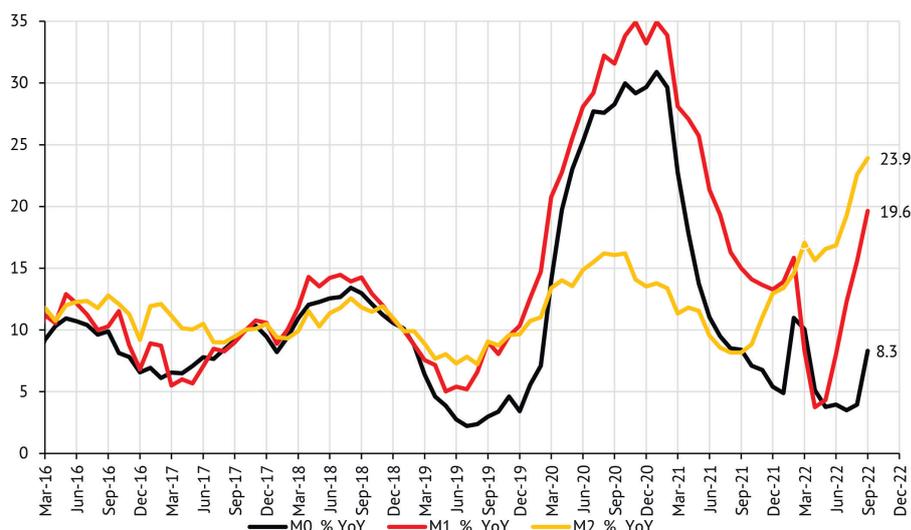


Fig. 1. The movement patterns of monetary aggregates over the previous 12 months

Source: Bank of Russia.

According to the month-end results for October 2022, inflation in Russia over the previous 12 months plunged to 12.6% (Fig. 2). In October, the level of consumer prices gained 0.18%. When seasonally adjusted,¹ consumer inflation in October amounted to 0.12% (MoM), or 1.5% in annualized terms,² which is below the Bank of Russia's target (in September, this indicator was close to the target, at 3.7%). Core inflation³ slowed to almost zero in October, amounting to 0.03% MoM (vs 0.3% MoM in September). Consequently, in October, the prices of regulated and volatile components grew faster than the prices of other goods. Thus, as of end of October, annual core inflation fell to 16.2% YoY (from its multi-year high of 20.4% YoY achieved in April).

In terms of the Consumer Price Index components in October, the input of food products was highest (about 0.11 p.p.), but this happened entirely due to the seasonal surge in prices for fruits and vegetables (which gained 3.45% in October, and its input in overall inflation amounted to 0.16 p.p.).

Prices for non-food products in October increased slightly (0.04%), which translated into a near-zero input of this group in the overall inflation (0.01 p.p.).

Prices for services in October climbed by 0.24%, and their total input in the CPI dynamics amounted to 0.06 p.p.

An important factor in the slowdown in inflation over July-October was the ruble strengthening, which occurred in Q2 (the nominal effective exchange rate of the ruble in Q2 jumped by 33.8% on Q1 2022, and based on the period-end results of the first 9 months of 2022, the ruble was 18.5% stronger than in the same period of the previous year), and its gradual pass-through effect (Fig. 3). However, the input of that factor is gradually waning, and by the end of Q4 2022 it will no longer affect the movement of consumer prices.

There was no significant recovery in consumer demand in Q3 2022 (according to data released by Rosstat,⁴ retail trade turnover in Q3 declined

1 Seasonal inflation adjustment was generated in the R package "Seasonal".

2 Monthly inflation raised to the power of 12.

3 Excluding prices pegged to seasonal and administrative factors.

4 URL: https://rosstat.gov.ru/storage/mediabank/ind_09-2022.xlsx

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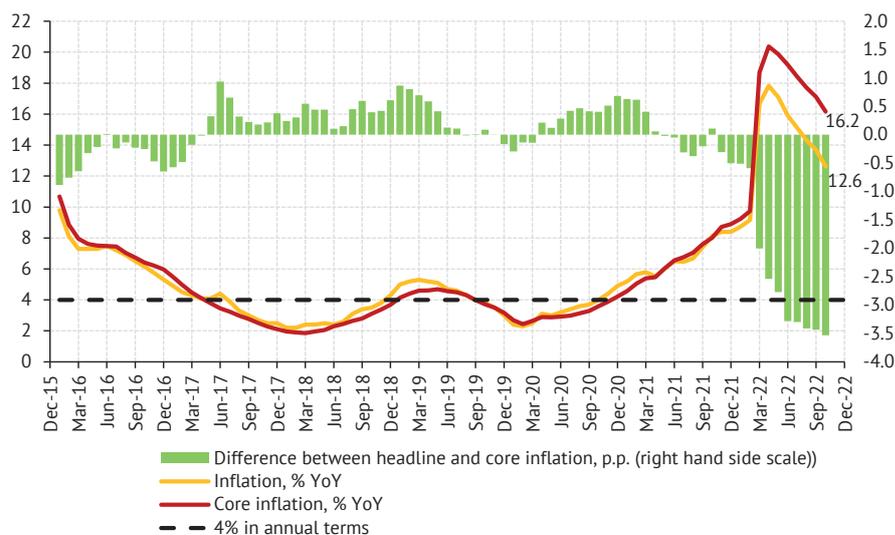


Fig. 2. The movement patterns of headline and core inflation

Source: Rosstat.

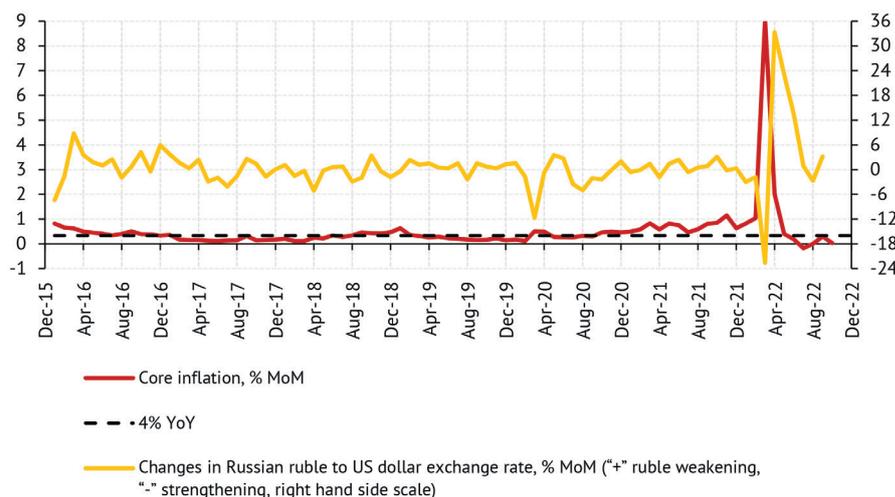


Fig. 3. The core inflation and Russian ruble to US dollar monthly movement patterns

Source: Rosstat; RF Central Bank.

by 9.2%, vs 9.8% YoY as of the end of Q2 2022). The low consumer activity will continue to limit the cost pass-through opportunities for product sellers.

Over Q3, the movement patterns of the inflation expectations of households, businesses and analysts were multi-directional: a slight decrease in July gave way to growth in August-September. Thus, in Q3 2022, the one-year ahead inflation expectations of households averaged at 11.8%, which is 0.6 p.p. lower than the corresponding index for June. Nevertheless, the future price expectations of households, calculated with due regard for the October data, have been on the rise for the third month in a row.¹ Therefore, this factor had no significant disinflationary effect in Q3 or in October, and towards the end of the year it may become one of the factors responsible for inflation acceleration.

1 URL: https://www.cbr.ru/analytics/dkp/inflationary_expectations/

1. The RF Central Bank's Monetary Policy Easing Cycle Is Probably Over

In October 2022, the adjustment of prices for goods and services after their sharp rise in March remained an important reason for a slowdown in inflation. However, it can be said with a high degree of probability that the impact of that particular factor has already been exhausted, because 6 months is a sufficiently lengthy period for properly adjusting prices to the changed conditions for doing business.¹

According to our model-based inflation forecast,² price growth in November and December will amount to 0.3% and 0.4% MoM, respectively. However, within the framework of the model, it is impossible to predict the acceleration of inflation that will occur in December as a result of indexation of amenities tariffs.³ Therefore, it is necessary to adjust the forecast for the amenity fees to be increased in December by 9%; in 2022, their share in the consumer basket amounts to 6.1%. Thus, the input of the December indexation of amenity tariffs in the CPI growth will be approximately 0.55 p.p. So, the model-based inflation forecast for December and at the year-end needs to be increased by that value, as a result of which the inflation projection for December will be 0.95% MoM, and by the end of 2022, it is expected to be at the level of 12.1%, which is close to the lower bound of the Bank of Russia's updated forecast.

In early 2023, annual inflation is expected to slow down, and it may plunge to 5% at the end of Q1. However, the quarterly seasonally adjusted inflation index will begin to accelerate from May 2023 onwards, which will also push up the annual inflation rate. By the end of 2023, it is projected to be at 6.2%, which is also in line with the inflation range in the Bank of Russia's scenario, and the average inflation for 2023 is expected to be at the level of 5.9%. The main factors responsible for the acceleration of inflation will be the gradual closure of the negative output gap as a result of a recovery in demand and a decline in supply, as well as the ruble weakening alongside growing imports. 

1 In [Bozhechkova A.V., Evseev A.S. Price Rigidity Analysis Evidence from the E-commerce Market // Economic Policy. 2020. V. 15. No.5. P. 3–59] it is argued that sellers, on average, revise their prices at least once a month.

2 For more details about the model, see Perevyshin Yu. N. "Short-term Inflation Forecasting in the Russian Economy" // Economic policy. 2022. V. 17. No.5. P. 1–18.

3 URL: <https://tass.ru/ekonomika/15850419>

2. REGIONAL BUDGETS IN Q3 2022

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According to the results of Q3 2022, total revenues of consolidated budgets of the subjects of the Russian Federation amounted to Rb14.06 trillion, which is by 17.9% higher than the value of this indicator for the same period in 2021 and exceeds the annual inflation rate. These figures have been achieved on the back of 19.4% growth of tax and non-tax revenues of the regions, which amounted to Rb11.26 trillion. Intergovernmental fiscal transfers grew more slowly (+10.6%), amounting to Rb2.60 trillion. The continuing reduction of the average level of debt burden of the regions, the reduction of the number of subjects with a high value of this indicator, the reduction of the share of the volume of expenditures of regional budgets on public debt service, as well as the replacement of commercial loans by budget loans contribute to the growth of fiscal sustainability of regions and reduce the risk of their debt problems.

Revenue

Among the main revenue sources of regional and local budgets, corporate income tax (+21.7%), excise taxes (+20.1%), tax collected in connection with the application of the simplified taxation system (+25.2%), non-tax revenues (+34.6%), as well as subsidies (+47.3%) grew the most during the first three quarters of 2022. Personal income tax (+15.2%), property taxes (+13.5%) and subsidies (+0.3%) were increasing at somewhat lower rate, while subventions (-18.5%) and other intergovernmental fiscal transfers (-5.1%) demonstrated a negative trend.

At the same time, it should be noted that the high overall figures of budget revenues in the three quarters were due to significant growth rates in the first five months (+26.9%), while in Q3 2022 revenues went up by only 6.1%. This was primarily a result of 20.1% decline in corporate income tax revenues in Q3 after 52.1% growth in the first five months of 2022.

In terms of territorial location, the situation in 9 months of 2022 appeared to be stable: most of RF subjects (79) demonstrated positive growth in consolidated budget revenues, while 45 of them were above inflation rate over the period under review. Only six regions failed to reach the level of 9 months of 2021: Belgorod Oblast (-12.2%), Kursk Oblast (-0.4%), Lipetsk Oblast (-10.3%), Kaliningrad Oblast (-6.5%), Chelyabinsk Oblast (-3.8%), and Magadan Oblast (-9.9%). In the case of Belgorod, Kursk, Lipetsk and Chelyabinsk oblasts, the decline in revenues is due to the high base in the same period of 2021,¹ as well as to the structure of the economy, where iron ore mining and (or) the

¹ The growth rate of income in these regions in 2021 exceeded 40%, while the average level in Russia is +19.6%.

2. Regional budgets in Q3 2022

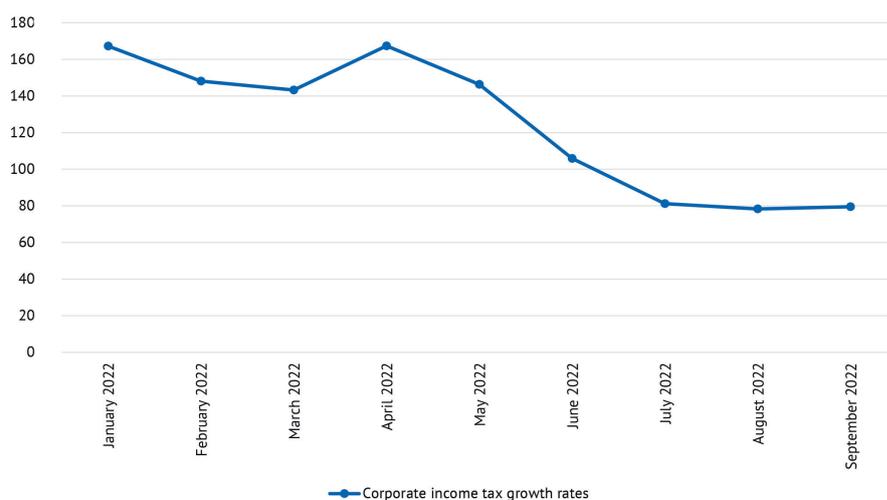


Fig. 1. Growth rate of corporate income tax in the consolidated budgets of the RF subjects for the month as compared to the corresponding month of the previous year, %

Source: Own calculations on the Federal Treasury data.

metallurgical industry, which is currently experiencing some problems, occupy a significant share. The main driver in the drop in revenues in these regions was the corporate income tax, while the Kaliningrad and Magadan oblasts faced a reduction in intergovernmental fiscal transfers.

Given the current downward dynamic of corporate income tax revenues (Fig. 1), which is a consequence of the problems in the Russian economy, as well as their expected impact on other own revenue sources of regional and local budgets, the growth rate of consolidated regional budgets may fall to the level of inflation by 2022 and even be slightly below it, although remaining, however, in the positive zone.

Expenditure

Expenditures of consolidated regional budgets for 9 months of 2022 amounted to Rb12.76 trillion, having increased by 16.7% relative to the relevant period of 2021, which is somewhat higher than inflation rates and still lower than the growth rate of budget revenues.

Expenditures on the national economy grew the fastest (+27.1%), including road facilities (+26.3%), housing and communal services (+26.2%), as well as physical culture and sports (+24.2%), slightly slower grew the expenditures on nation-wide issues (+18.9%), transport (+14.1%), preschool education (+10.2%), general education (+18.8%), culture and cinema (+18.4), health care (+4.5%) and social policy (+7.9%), including social security (+4.6%) and family and child protection (+12.8%). Having said that, due to the replacement of a significant amount of more expensive commercial loans together with state and municipal securities by budget loans, in the structure of public and municipal debt expenditures on its servicing dropped by 21.3% amounting only to 0.45% of the total expenditures of the consolidated budgets of the RF subjects.

In general, the results of the first nine months suggest a cautious shift of expenditures of consolidated regional budgets towards investment expenditures. That, however, does not yet allow us to speak about the spreading of this trend throughout 2022: the effect obtained may be associated with an earlier than in

2021 application of budget funds for investments, rather than with a change in the budget policy priorities.

Over the period under review, consolidated budget expenditures moved up in 84 RF subjects and in 59 of them the growth exceeded inflation over the same period. Kaliningrad Oblast was the only region where budget expenditures decreased (-5.1%), which is related to a serious reduction in targeted intergovernmental fiscal transfers from the federal budget. Such regions as the Tyumen Oblast (+52.0%), the Belgorod Oblast (+40.9%) and the Yamal-Nenets Autonomous District (+37.4%) were leading in terms of budget expenditures growth.

Balanced regional budgets and public debt

By the end of 9 months of 2022, 66 subjects of the Russian Federation had a surplus of their consolidated regional budgets, which amounted to Rb1.29 trillion or 9.4% of their total consolidated budget revenues, not including subventions.

As of October 1, 2022, the total volume of government debt of the RF subjects amounted to Rb2.69 trillion, having increased by 5.41% vs. the same period in 2021 and by 8.9%YTD. Despite some growth of the total amount of debt, thanks to a more rapid growth of tax and non-tax revenues of regional budgets themselves (+20.6%), the debt burden¹ decreased to 20.0% (Fig. 2), having reached its lowest level for the period of 2014–2022.

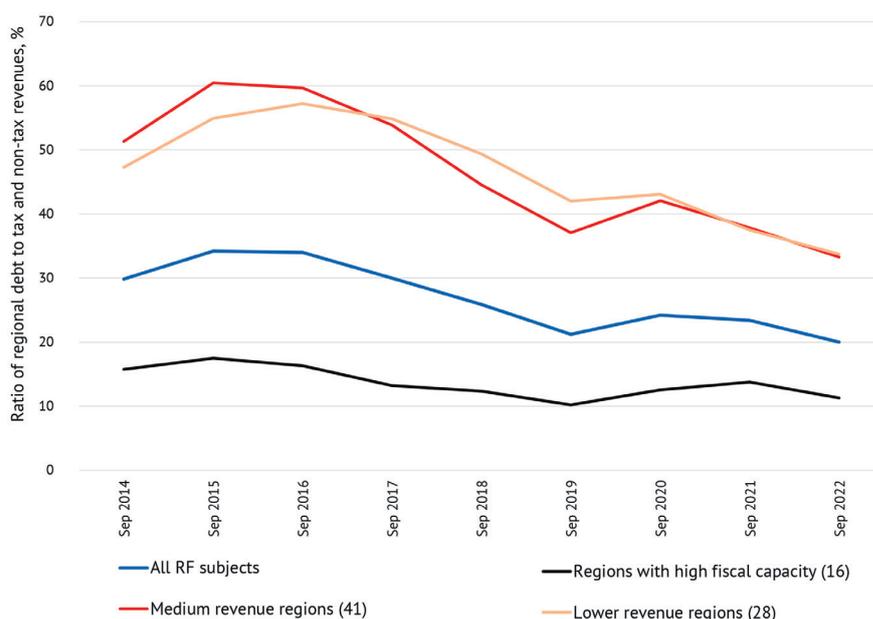


Fig. 2. Debt burden of RF subjects, %

Source: Own calculations on the basis of Russian Ministry of Finance and Federal Treasury.

Not only the average amount of debt burden continues to decline, but also the number of regions with a high value of this indicator. Thus, as of early October, the number of regions with a debt burden above 50% came to 23, while a year earlier there were 28 of them (Fig. 3).

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

2. Regional budgets in Q3 2022

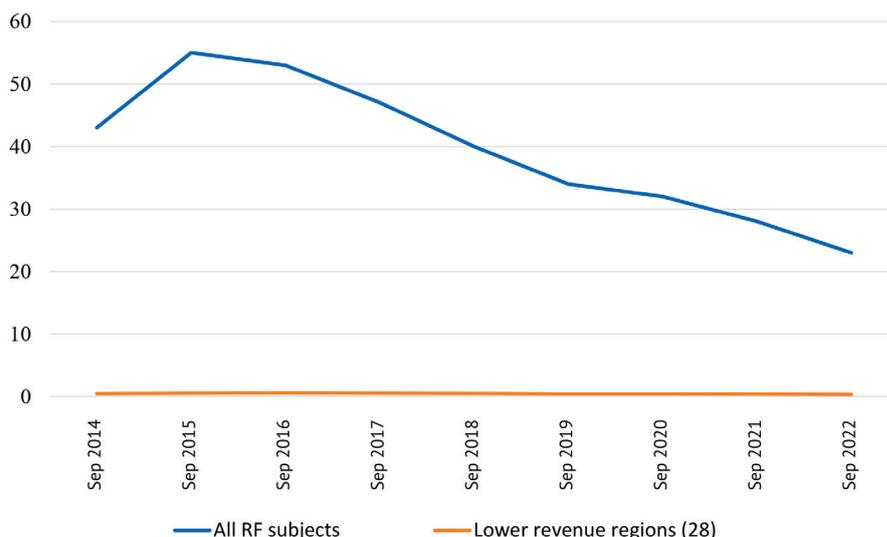


Fig. 3. Number of RF subjects with debt burden above 50%

Source: Own calculations based on data released by Russian Finance Ministry and Federal Treasury.

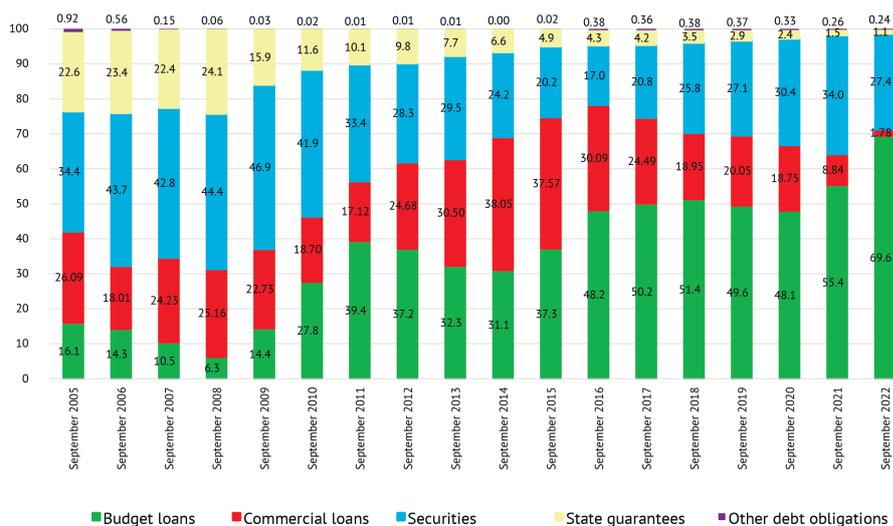


Fig. 4. Public debt structure of RF subjects, % of total

Source: own calculations of data released by Finance Ministry of Russia.

The Udmurt Republic (105.8%) retains a high level of public debt exceeding 100% of regional tax and non-tax revenues, while the longstanding leader in this indicator – the Republic of Mordovia (99.6%) has managed to leave this zone due to assistance from the federal center.

On the whole, in the period between October 1, 2021 and October 1, 2022, 59 RF subjects raised their national debt, while 24 subjects raised the debt burden.

Focused actions of the Ministry of Finance of Russia to replace with budget loans expensive commercial loans and government securities contributed to reduce of the share of commercial loans over 12 months from 8.8% to 1.8%,

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the share of securities – from 34.0% to 27.4%, and the share of budget loans went up from 55.4% to 69.6% (*Fig. 4*).

Taking into consideration the continuing decline in the average level of the regional debt burden, the reduction of the number of subjects with a high value of this indicator, the reduction of the share of regional budgets spending on public debt service, as well as the replacement of commercial loans by budget loans, it can be said that there are no debt issues at the regional level either now or in the near future. 

3. CORPORATE LENDING IN JANUARY-AUGUST 2022

Sergey Zubov, Candidate of Economic Sciences, Assistant Professor, Senior Researcher, Center for Structural Studies, IAES, RANEPА

The resilience of the Russian banking system on the back of the surplus of liquidity and capital security allows banks to expand supply on the corporate lending market amid the worsening issues of Russian business. An important role in maintaining the high rates of corporate lending was played by the monetary policy easing conducted by the Bank of Russia since April of this year. According to the results of 8 months of 2022, the overall growth in the volume of lending to legal entities did not significantly lag behind the previous year's rates. The quality of the loan portfolio remains satisfactory, the share of overdue debts is decreasing compared to the previous crisis years.

As of September 1, 2022, the total loan debt of corporate borrowers¹ to Russian banks hit Rb46 trillion. The growth of the corporate loan portfolio over the first 8 months of this year amounted to Rb3,197.2 bn or 7.5%. A year earlier the corporate loan portfolio of Russian banks for the same period went up by Rb3,342.3 bn or 9%. In the current situation, the decrease in the growth rate is largely due to the strengthening of the ruble: the ruble portion of the portfolio has grown by 14.9% against 11.9% over the same period last year, while the volume of foreign currency debt has decreased significantly – by 33.4% (a decrease of 4.6% a year ago), due to the strengthening of the ruble and negative revaluation of the foreign currency debt.

Meanwhile, the volume of loans for 8 months of this year amounted to Rb41.7 trillion, which is 23.5% less than during the same period last year (Rb54.5 trillion), the decrease is almost entirely due to the ruble loans (Rb36.4 trillion, against Rb50.1 trillion in 2021). Thus, we can conclude that the growth of the total loan portfolio of legal entities with a decrease in the volume of loans provided is owing to the restructuring of debt (provision of vacations, credit extensions) in the context of the financial crisis caused by the imposition of anti-Russian sanctions.

The level of overdue debt has decreased by 3.7% against the beginning of the year (in the same period last year it moved up by 17.9%) and reached the level of Rb2.8 trillion, which is 6% of the total credit portfolio (a year ago – 6.8%). These figures indicate some improvement in the quality of the loan portfolio however this situation is largely due to the Bank of Russia's loosening, in particular, the permission not to reflect the deterioration of the quality of loans if the borrower has problems owing to sanctions restrictions.

The sectoral structure of corporate loans has not undergone significant changes compared to the previous year. As of September 1, 2022, the leaders in terms

¹ Includes loans to non-financial and financial organizations, as well as individual entrepreneurs.

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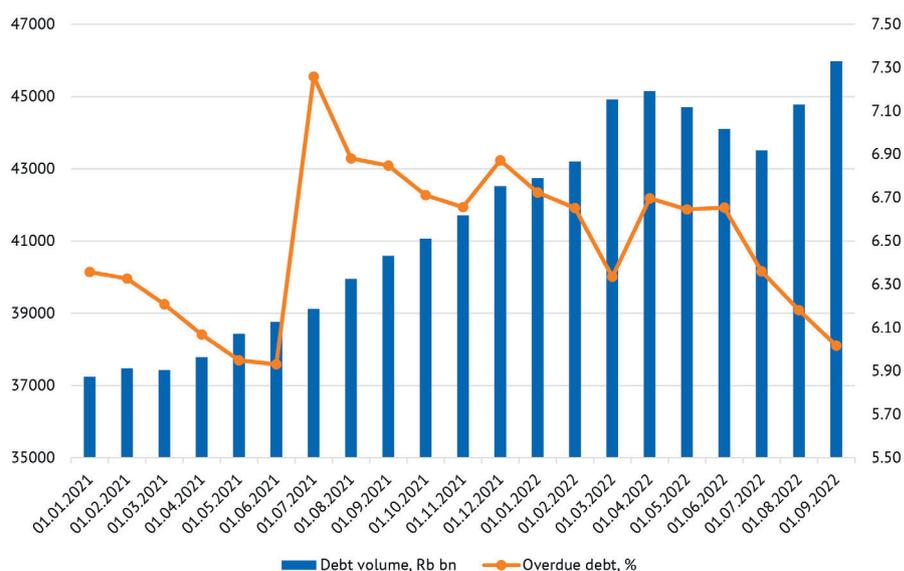


Fig. 1. Corporate lending dynamic and the overdue debt rate in 2021–2022

Sources: Granted Funds and Borrowings / Bank of Russia. URL: https://www.cbr.ru/statistics/bank_sector/sors/; own calculations.

of debt are manufacturing enterprises (Rb11.3 trillion or 24.6% of the total debt of enterprises), enterprises in the financial and insurance sector (Rb7.5 trillion or 16.3%) and wholesale and retail trade enterprises (Rb4.4 trillion or 9.6%).

By the volume of borrowings over the 5 months of this year, the leaders are financial and insurance businesses (Rb14.1 trillion or 33.9% of the total amount of loans), wholesale and retail trade (Rb8.8 trillion or 21.1%) and manufacturing businesses (Rb7.5 trillion or 17.9%).

The growth of rates following the key rate spike to 20% at the end of February, as well as more cautious approach of banks to the choice of borrowers amid growing uncertainty about financial sustainability of enterprises led to the reduction in the volume of corporate credit debt during March and May of the current year. Particularly notable reduction was observed in foreign currency loans due to changes in the structure of the economy and sanctions risks. Further, some support to corporate borrowers was provided by the state programs¹ of concessional lending to systemic enterprises (industry, trade and agro-industrial complex), adopted by the RF Government, which provided for the issuance of loans worth about Rb1.4 trillion.

Since June, there has been a gradual adaptation of enterprises in a wide range of industries to structural changes in the economy, which led to a revival of economic activity and a partial recovery of the volume of corporate lending. In September, the impact of the state support of systemic enterprises decreased and even a slight increase in foreign currency loans (in the ruble equivalent) was registered.

In general, there is still high uncertainty in the market regarding the future prospects of the corporate sector, forcing banks to opt for short-term loans and reduce the volume of long-term ones. Presently, about 70% of the corporate debt is represented by short-term loans of up to 1 year. Interest rates on short-

¹ RF Government Decrees of 16.03.2022 No. 375 and of 17.03.2022 No. 393 and RF Government Edict of 18.03.2022 No. 532-p.

3. Corporate lending in January-August 2022

term loans (up to 1 year) are also steadily higher than those on long-term ones (over 1 year).

The changes taking place (aggravation of the geopolitical conflict and international situation, partial mobilization) increase the level of uncertainty in the sphere of corporate business. The head of the Central Bank noted¹ that “the full economic consequences of the shift in the structure of employment are still difficult to assess. It will manifest itself gradually through the adjustment of wages and the possible strengthening of the flow of labor between industries and regions.” According to the estimates of the Central Bank of Russia, partial mobilization will be a restraining factor for the dynamic of consumer demand and inflation on the horizon of the next few months. However, its effects will be pro-inflationary later on due to the strengthening of supply-side constraints.²

Despite the fact that the banking sector as a whole has managed to adapt to the ongoing changes, the potential threat in the form of the accumulation of bad debts is still relevant. It cannot be ruled out that the banking sector may face a delayed effect of sanctions pressure on Russian business, which, in turn, will lead to veiled accumulation of bad loans in bank balance sheets. In this connection, the government and the regulator should develop additional measures of macroprudential regulation and, possibly, new programs to support enterprises through concessional lending.

In recent months, the Russian government and the Bank of Russia have managed to neutralize banking risks and maintain the level of lending to the corporate sector. However, the high concentration of corporate liabilities remains a potential source of systemic risk for the domestic banking sector. Accordingly, in the near term, measures will be needed to encourage the diversification of banks' corporate loan portfolios, which, in turn, will largely depend on the development of small and medium-sized enterprises, as well as on the implementation of the country's competition and antitrust strategy. 

1 URL: <https://finance.rambler.ru/money/49600476-eto-cto-to-novoe-nabiullina-predupredilatorossian/>

2 URL: <https://ria.ru/20221028/tsb-1827510827.html>