

Russian consumer: In search of lost

March 2019

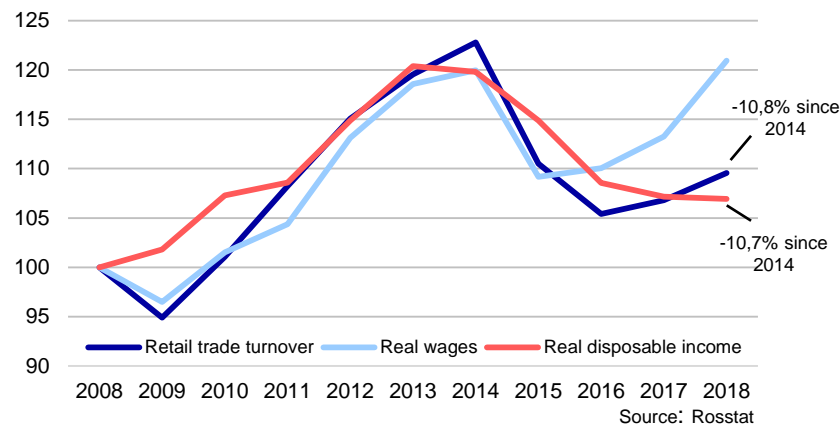


Consumption has not yet recovered to the pre-crisis level

Several years may pass before this happens

- Retail sales turnover in Russia in 2018 was still 10.8% lower than before the 2014 crisis. Recovery of consumer activity is much slower than after the 2009 crisis when the pre-crisis level was achieved a year after the crisis.
- The reason for that is declining real incomes which are still 10.7% lower than in 2014. Income dynamics were lagging behind real wages growth due to the decrease in property income, entrepreneurial income and deposit interest income as well as the rise in compulsory payments (taxes in particular).
- The consumer confidence index has fallen to the lowest level since 2016 because of the VAT hike and the RUB depreciation. Previously when consumer confidence was at the current level, consumption would be declining.
- The recovery of real disposable income and consumer activity will remain slow, as the electoral cycle and accompanying wage increases are over, deposit interest rates are likely to fall and property taxes are likely to increase. Consumption will hardly bounce back to the pre-crisis level before 2021-2022.

Real disposable income, wages and retail trade turnover indexes (2008=100%)



Consumer confidence index plummeted rapidly

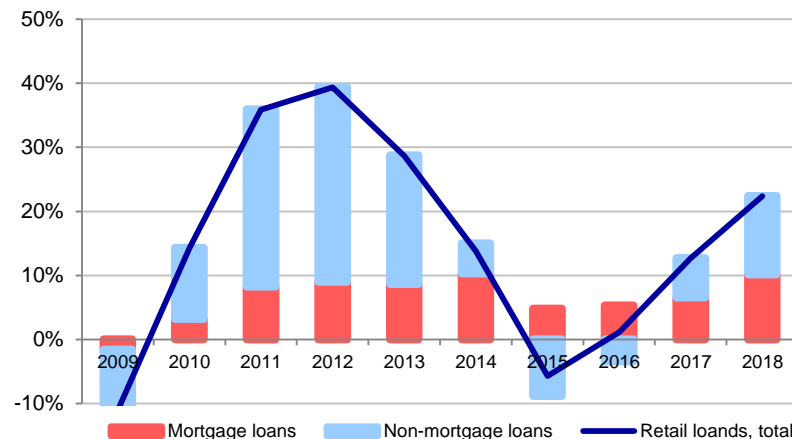


Consumer borrowing prevented an even steeper drop in consumption

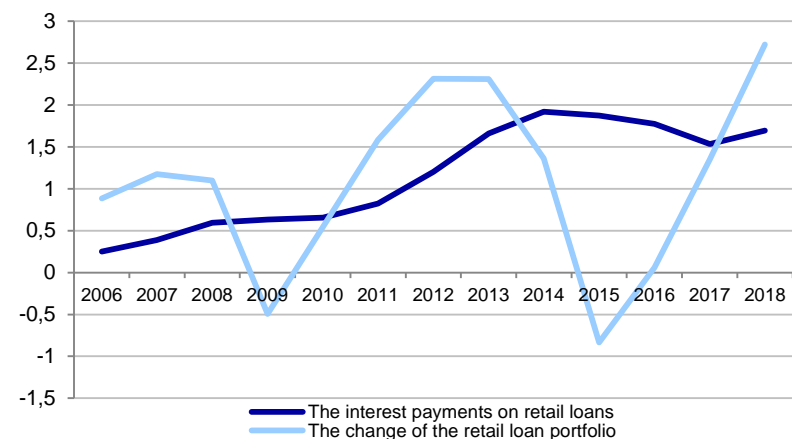
However, this factor alone cannot push consumption to a sustainably higher trajectory

- Consumer lending has been rising at double-digit rates since 2017. This trend has mitigated the negative influence of the real income decrease on consumption, but was unable to completely offset this effect and become a basis for a sustainably higher consumer activity.
- Despite a sharp increase in consumer lending since 2017, it was not until 2018 that the volume on new loans exceeded interest payments for the first time since 2013.
- In spite of rapid consumer lending growth, the debt burden remains adequate for now and is still significantly below its peak in 2014.
- Nevertheless, as income dynamics are still very modest, continued rapid lending growth may lead to a worrying increase in consumer debt burden.
- The Bank of Russia is watching consumer lending trends closely and is taking measures to prevent bubbles in this market. That indicates that consumption will hardly get a substantial boost from lending activity in the near future.

Consumer credit growth has accelerated to the maximum levels since 2013



New consumer loans exceeded interest payments in 2018 for the first time since 2013



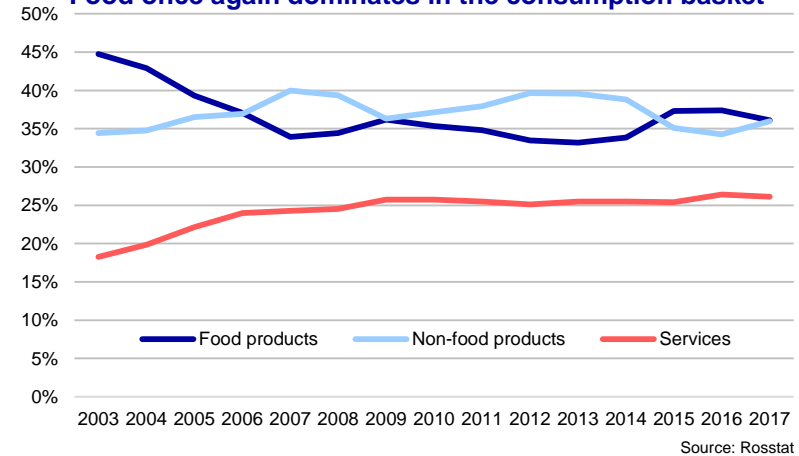
Source: CBR, Rosstat

Consumption structure still different from 2014

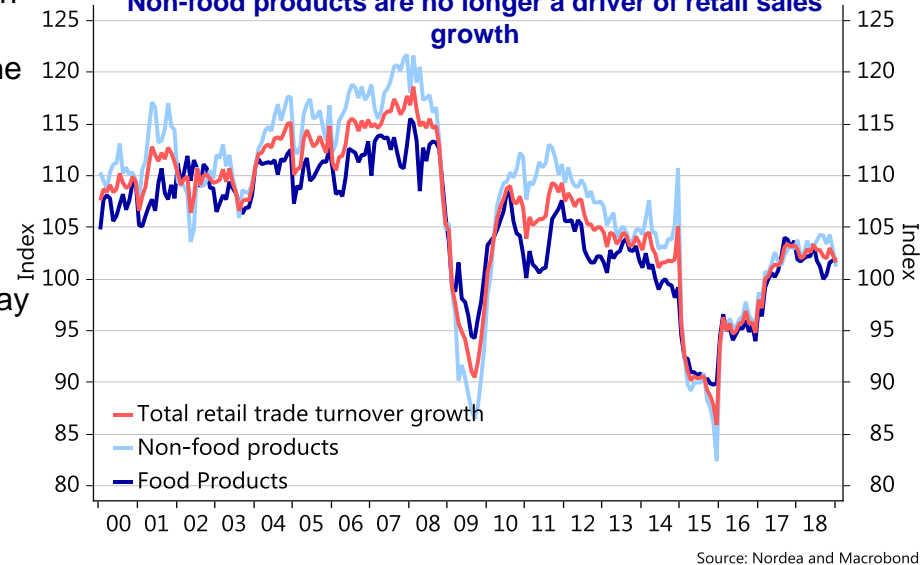
It reflects weaker household purchasing power

- Purchasing power dropped so much after 2014 that food once again became a dominant part of the consumption basket in 2015-2017 for the first time since 2005.
- Lower spending on durable goods became a form of austerity. During previous consumption booms (2000-2008, 2010-2014), the non-food segment was the main driver of consumption growth. Since 2014 outperformance of this sector is no longer the case, reflecting weak income dynamics.
- Nevertheless, some areas see consumer activity growth. Mobile devices (+45% real sales growth compared to 2014 in 2017) and construction material (+3%) were considerably outperforming overall consumption activity. In some areas the drop in consumption is less pronounced than for the whole consumption basket (-13% in 2017 compared to 2014): cosmetics and perfumes (-2), meat (-2%), dairy products (-7%), vegetables and fruits(-3%).
- Consumption growth in the listed food product categories may possibly reflect the favorable effect of import substitution on prices of these goods.

Food once again dominates in the consumption basket



Non-food products are no longer a driver of retail sales growth

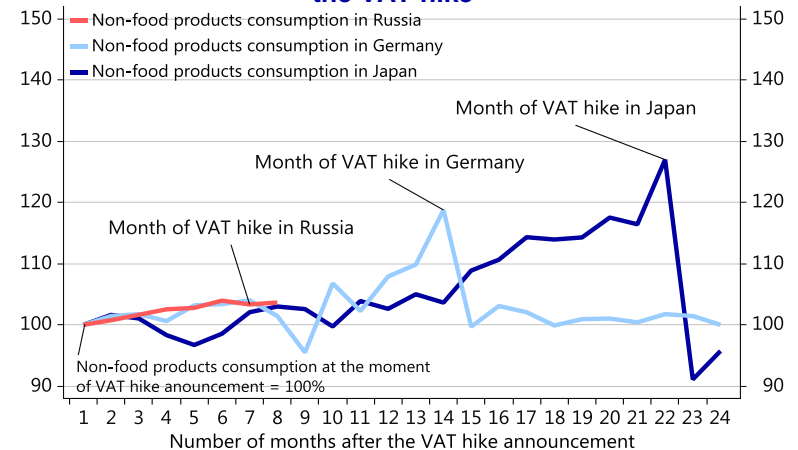


Reaction to the VAT hike is quite moderate for now

Consumption effects in Russia may be quite different from other countries' experience

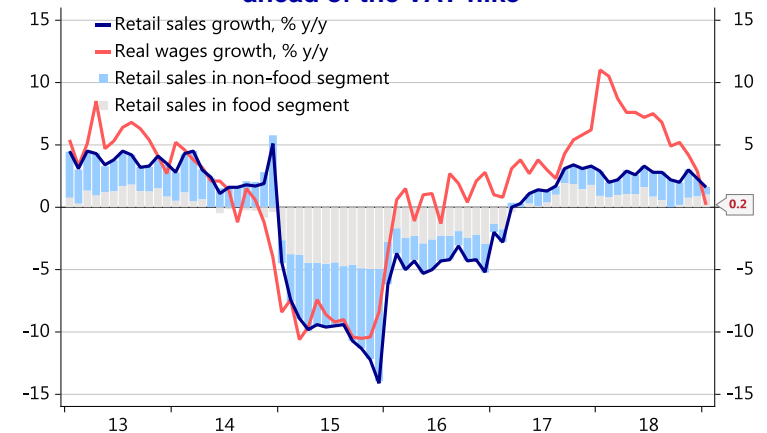
- Recent examples of VAT hikes in Germany (in 2007 from 16% to 19%) and in Japan (in 2014 from 5% to 8%) show that durable goods consumption usually accelerates in anticipation of a higher tax burden and then stagnates for about two years after the hike.
- Similar effects in Russia are for now manifesting themselves quite moderately. Front-loaded consumption of durable goods was barely noticeable. In August, September and November of 2018 growth accelerated to above 4% y/y (previously growth averaged around 3.3%). However, in the first month after the VAT hike, retail sales have quite significantly slowed down (to 1.6% y/y in January).
- Peculiarities of Russian consumers' reaction to VAT hike may be caused by weak internal demand. As incomes are stagnating, consumers may have decided to cancel some of their purchases altogether instead of shifting them to an earlier period.
- We forecast retail sales to grow by just 1.2% in 2019.

There was almost no front-loaded consumption ahead of the VAT hike



Source: Nordea and Macrobond

Increase in durable goods consumption was very moderate ahead of the VAT hike



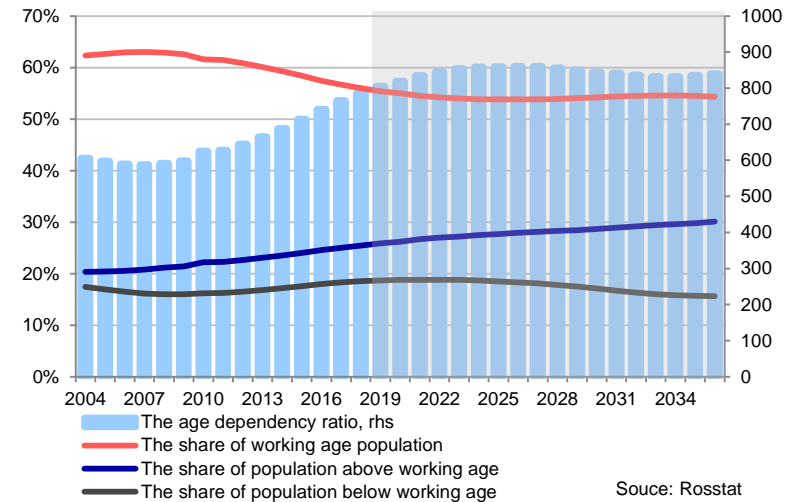
Source: Nordea and Macrobond

Aging population may become another obstacle for consumption growth

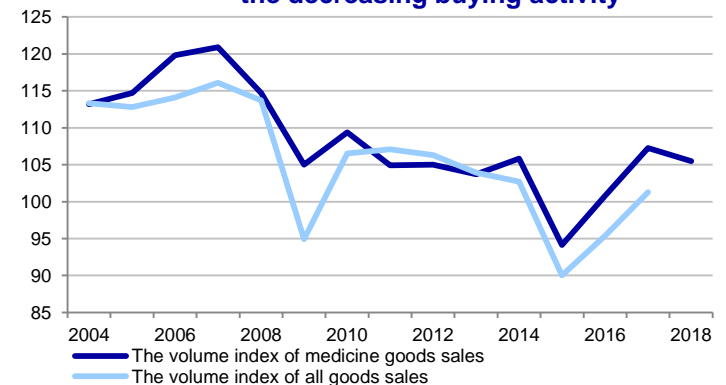
Consumption structure may change due to demographic factors

- Economic research (Luhrmann – 2005, Stover – 2012, Mao and Xu – 2014) about the connection between demography and consumer activity shows that population aging may reduce the overall consumer activity in a country.
- According to Rosstat demographic forecast, the share of the population at the age of 65 or above is going to increase from 24.4% in 2018 to 30.1% in 2036. This trend may limit the long run potential of consumption growth in Russia.
- As for the consumption structure, the aging of population usually increases the demand for medical services and pharmaceutical products.
- Medicine real sales index was systematically overperforming the overall retail sales growth index. This may partly be explained by the aging population and partly by the fact that weak purchasing power has a lower impact on the sales of medical goods.

The population aging will continue



The demand for medical goods is less depended on the decreasing buying activity

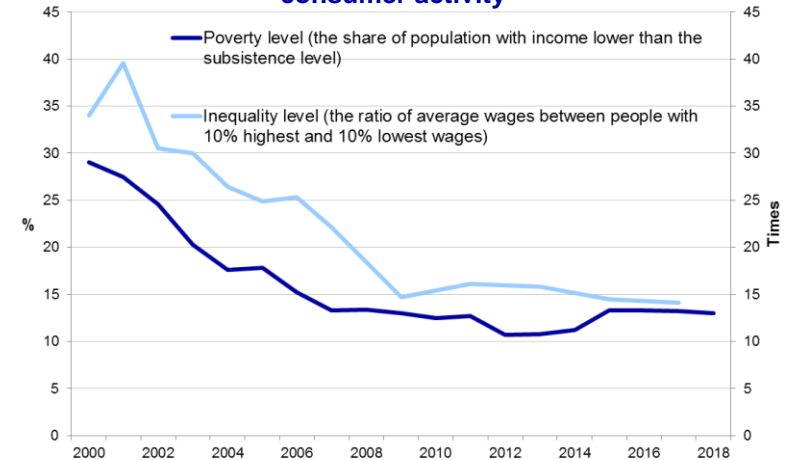


Consumption inequality remains quite high

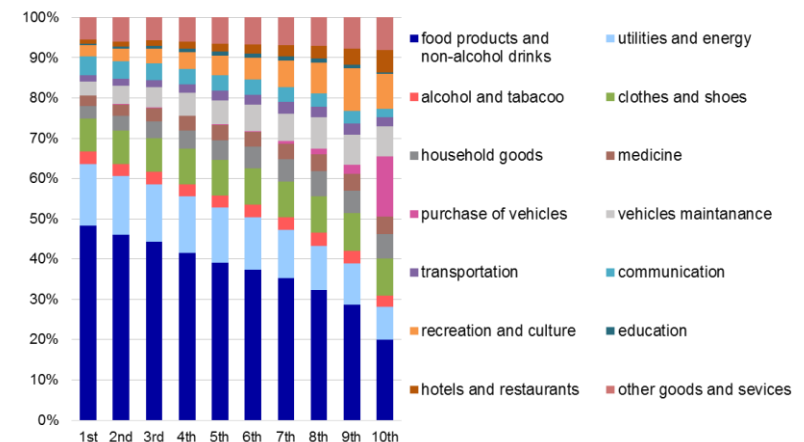
Recent trends are higher geographic concentration of incomes and a very slow decline in the poverty rate

- The poverty rate in Russia has significantly increased since 2014 (to 13.3% of population in 2015 compared to an average level of 11% in 2012-2014) and later has been decreasing very slowly. This is one of the reasons behind the very slow consumption recovery in Russia.
- Inequality rate in Russia has slightly decreased since 2014 (the ratio of an average salary of the richest 10% to poorest 10% dropped from 15.8 in 2013 to 14.1 in 2017). However, 20% of the population still account for 40% of all consumer spending.
- The geographical distribution of incomes has become more concentrated. In 2017 Moscow, the Moscow region and Saint Petersburg accounted for 37% of the population within the 20% group with the highest income (33.8% in 2013).
- The structure of consumer spending still differs a lot, depending on the income level. Only 30% of the population spend significantly less than 50% on food, housing and utilities services.

Higher poverty level is one of the factors behind a weak consumer activity



Consumption structure by 10% population income groups



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