Bank of Russia

TALKING TRENDS
Economy and markets

Research and Forecasting Department Bulletin

JULY 2024

CONTENTS

Executive summary 3

1. Inflation 4

1.1. Price rises remain accelerated in June 4

2. Economic performance 8

2.1. Structural transformation and neutral interest rate 9

2.2. Economic activity remains strong 10

2.3. Buoyant lending growth hampers disinflation 13

In Focus. Labour market amplifies proinflationary risks 16

The Research and Forecasting Department prepared this bulletin based on data as of 12.07.2024.

Please send your comments and suggestions to dip1@cbr.ru

Cover photo: Shutterstock /FOTODOM

Bldg. V, 12 Neglinnaya Street, Moscow, 107016

Bank of Russia website: www.cbr.ru

Executive summary

Monthly summary

- In April–June, the disinflation trend unfolded, including because of volatile and one-off factors. However, underlying inflationary pressures in the economy were up as well, although not considerably. Households' and businesses' inflation expectations increased. Banks raised interest rates, which was because the Bank of Russia had tightened its monetary policy signals, among other reasons. Nevertheless, demand continued to expand in 2024 Q2 at a pace exceeding the economy's capacity, while economic and credit activity was high. To bring inflation down to the target and return the economy to a balanced growth path, monetary conditions should be tighter in 2024 H2 than in 2024 H1. Moreover, they should remain tight for an extended period.
    - The current growth rates of consumer prices soared in May–early July. In addition, inflation expectations and the measures of underlying inflation, namely price growth medians, trend inflation and modified core inflation indices, rose as well, although not as significantly. In order to timely bring inflation back to the target of 4%, it is necessary to ensure tighter monetary conditions as compared to 2024 H1.
    - According to our estimates, as of the end of 2024 Q2, GDP was up by 0.8% quarter-on-quarter (seasonally adjusted) as a result of its fast increase in May–June. This expansion of the economy, coupled with the acceleration of price growth, is clear evidence that the economy is still overheated and the supply of goods and services lags behind surging demand.
    - Fixed-rate bond yields rose due to higher inflation expectations, market participants' expectations of an increase in the key rate and its elevated level for a long period, as well as high demand for borrowings in the federal government bond market. Difficulties with importers' cross-border payments entail proinflationary risks, and their impact is stronger than the disinflationary effect of the earlier ruble appreciation.

In focus. Labour market amplifies proinflationary risks

- The Russian labour market features strong competition for personnel: most indicators hit all-time highs/lows or were close to them in H1 2024.
- Labour demand has reached a historical peak continuing to rise, with the picture varying across industries.
- Potential for labour supply expansion is limited by adverse demographic trends.
- This situation provokes wage growth at a rate outpacing labour productivity by far, thus creating additional proinflationary risks.
- Tight monetary policy to be implemented for a long period of time can help balance the labour market via cooling of labour demand. This would balance the situation in the economy and labour market, given that the adjustment of goods and services supply in the market through investment in new equipment and technologies takes a long time.

1. Inflation

Current price rises and annual inflation alike gained pace in May–June, still fuelled by buoyant consumer demand expansion. This was coupled with expectations of a rise in the costs of import deliveries to Russia, which can only partially be offset by ruble strengthening. As a result, an increase in the consumer prices of goods and services heavily dependent on the exchange rate accelerated rather than lost momentum.

This means a rise in the contribution of supply-side factors to accelerated price movements. That said, the balance of demand-side factors remains proinflationary. Monetary policy traditionally reacts to demand-side factors and secondary effects arising from supply- and demand-side factors.

In this context, we note that household and business expectations responded to accelerated price movements by climbing in May–June. At the same time, interest rates have also increased recently, reflecting mounting inflation risks. Even as inflation expectations rise, this heightens the level of monetary stance tightening compared with the previous months. A tighter monetary stance is required for a sustainable price rise slowdown to resume in the second half of this year and annual inflation to return to 4% in 2025.

1.1. Price rises remain accelerated in June

- May–June saw average monthly price rises at almost 10% in annualised terms. This is largely owed to moves in individual volatile components. The rate of growth in stable price components of the consumer basket remained elevated relative to the inflation target.
- Proinflationary risks have mounted. Household inflation expectations and businesses' price projections have also risen somewhat. Consumer activity stays on a high level. For inflation to come back to target, monetary stance may need to be tightened, with tight monetary policy maintained for a long time.

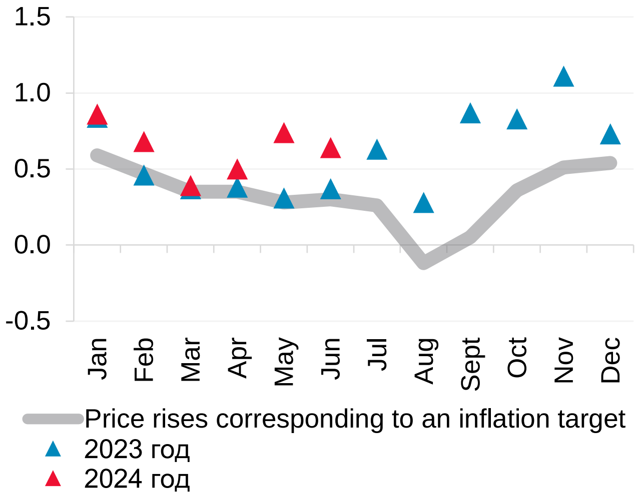
After a slowdown at the start of the year, the pace of price rises almost doubled in May and June relative to April, to 10.7% MoM SAAR and 9.3% MoM SAAR, respectively. Annual inflation climbed to 8.6% (Table 1). The deviation from the trajectory propelling inflation to about 4% for the year, notably widened (Figure 1). The key contribution to inflation acceleration is provided by volatile components, but the steady component of price rises stays above the inflation target.

Table 1. Inflation and its components

	Jun. 2022	Jun. 2023	Apr. 2024	May 2024	Jun. 2024
% YoY					
All goods and services	**15.9**	**3.3**	**7.8**	**8.3**	**8.6**
Core inflation	**19.2**	**2.4**	**8.3**	**8.6**	**8.7**
Food	18.0	0.2	8.3	9.1	9.8
Non-food goods	17.9	1.0	7.0	7.1	7.0
Services	10.2	11.0	8.1	8.6	8.8
% MoM SAAR					
All goods and services	**-3.6**	**5.8**	**5.9**	**10.7**	**9.3**
Core inflation	**1.3**	**5.7**	**9.1**	**11.6**	**6.9**
Food	-8.9	4.0	4.4	8.2	12.3
– net of fruit and vegetables	**4.5**	**6.3**	**7.9**	**10.1**	**7.7**
Non-food goods	-3.8	6.3	5.3	6.3	4.7
– net of refined petroleum products	**-4.0**	**4.4**	**5.0**	**6.3**	**3.2**
Services	5.4	7.7	8.6	19.8	10.7
– net of housing and communal services	**6.4**	**9.2**	**9.9**	**28.0**	**12.7**

Sources: Rosstat, R&F Department calculations.

Figure 1. Price rises corresponding to an inflation rate of 4%, % MoM



Sources: Rosstat, R&F Department calculations.

Food price increases accelerated to 12.3% MoM SAAR in June from 8.2% MoM SAAR in May. The key input to price moves came from acceleration in fruit and vegetable price growth, stemming primarily from the consequences of frosts in early May and in part from difficulties in import logistics. Russia's agriculture ministry is expecting price stabilisation in hardest hit fruits and vegetables, thanks to, among other things, imports and a fall in the "borshch set" vegetable prices towards the end of the summer.

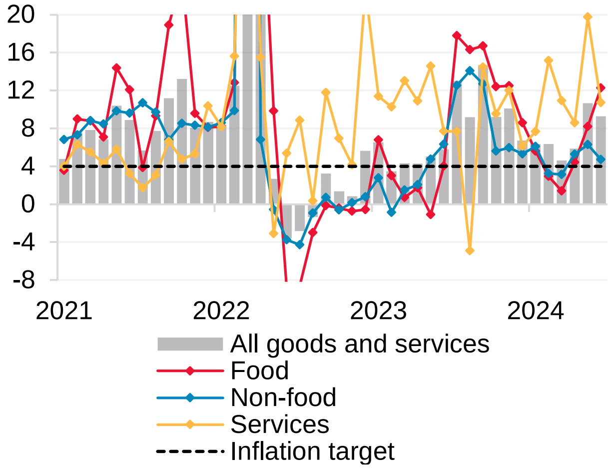
Net of fruit and vegetables, food price growth slowed but remained fast at 7.3% MoM SAAR after 10.1% MoM SAAR. This was chiefly owed to a slowdown in meat product prices after an acceleration in May.[1] Producers attribute this to a seasonal rise in demand and expect price stabilisation going forward through a gradual expansion in supply. An elevated pace of price growth continues across a wide range of items, including dairy products, butter, confectionaries and baked products.

The non-food segment saw price growth slow to 4.7% MoM SAAR in June from 6.3% MoM SAAR in May. This was largely driven by a car price decline after price hikes for a number of car makes in May. This was partially offset by an acceleration in fuel price hikes, with market participants expecting fuel price stabilisation in a short time, given record high output of refined petroleum products in July–August after refinery repairs and maintenance have come to an end.

Ruble strengthening is yet to have an effect on consumer prices. Moreover, the median of price increases in goods and services highly sensitive to exchange rate movements went up in May and June (Figure 3). This is likely due to importers passing increasing logistics and payment costs through to prices.

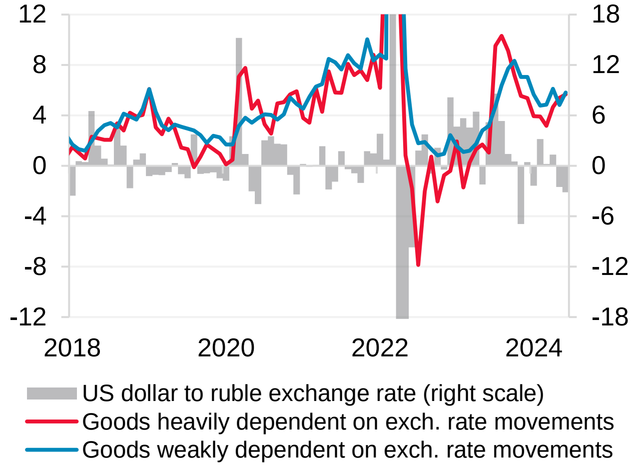
[1] Mutton prices increased most of all, but other meat types also saw accelerated price hikes. In particular, chicken meat prices started to climb.

Figure 2. Seasonally adjusted price growth, % MoM SAAR



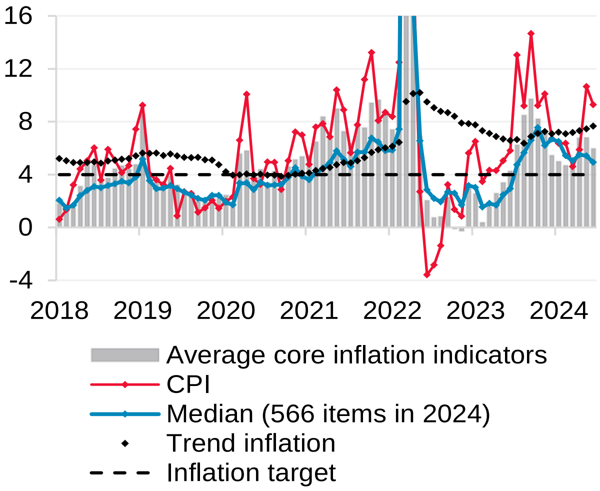
Sources: Rosstat, R&F Department calculations.

Figure 3. Median CPI (% MoM SAAR) and US dollar to ruble exchange rate (%)



Sources: Bank of Russia, Rosstat, R&F Department calculations.

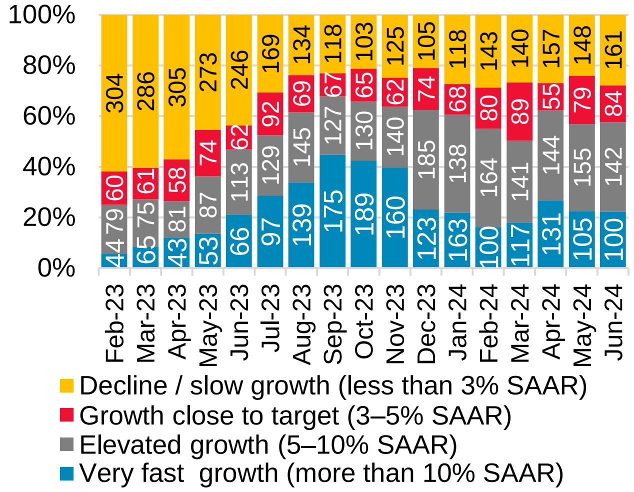
Figure 4. Modified core inflation indicators* (% in annualised terms) and trend inflation estimate (%YoY)



** Indicators are computed using the method of excluding the most volatile components and the truncation method.*

Sources: Rosstat, R&F Department calculations.

Figure 5. Aggregate weight of goods and services* distributed based on seasonally adjusted price growth



**Net of fruit and vegetables and regulated services.*

Note. The figures represent the number of items.

Sources: Rosstat, R&F Department calculations.

In services, the pace of price hikes slowed to 10.7% MoM SAAR after a surge of 19.8% MoM SAAR in the most volatile components (transport and tourism) in May. The rate of price rises in tourism services slowed tangibly in June but remained high. Domestic travel prices are showing a much faster pace of growth than that for foreign destinations. That said, change in people's preferences towards domestic tourism may in part move up the estimates obtained for seasonally adjusted price growth.[2] On top of that, Russia's regions saw a rise in the prices of urban public transport services continue in June. Net of tourism, air and rail transport, the

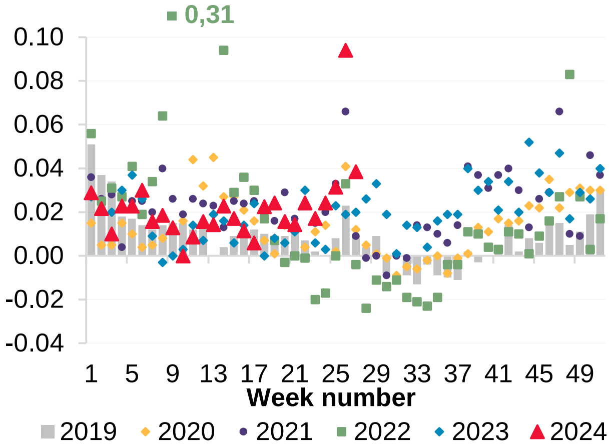
[2] Growth in the prices of travel to the Black Sea coast was the fastest at 24% MoM in May and 8% MoM in June, but we cannot obtain an accurate seasonal adjustment of these figures because of a short observation period: these services were only included in the basket as late as 2023.

pace of services prices slowed to 7.4% MoM SAAR from 8.2% MoM SAAR, but remained elevated.

Analytical indicators of price movements suggest that persistent inflationary pressure in May–June stood somewhat above the Q1 indicators and the inflation target. The mean of modified core inflation indicator estimates declined to 6.0% in June from 6.8% in May in annualised terms (Figure 4). The median of price growth distribution also edged down, with the total weight of items going up in price at an accelerated pace remained on the same level as in May. (Figure 5). This suggests a notable input of individual items to an acceleration in current price rises in May–June. That said, the trend inflation estimate climbed for the fourth consecutive month to 7.65% in June from 7.46% in May.

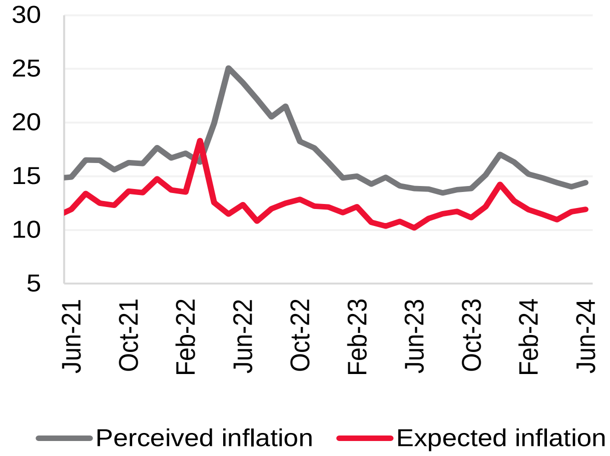
Weekly price growth accelerated early in July, standing at 0.77% on 8 July (Figure 6). This indicator, however, largely reflects the one-off indexation of housing and communal services prices as of 1 July, accounting for 0.5 pp of the increase. The prices of goods are continuing the trends of late June. The pace of food price hikes slowed in most enlarged categories but remains accelerated, driven by fruit and vegetables, where price growth is at the upper bound in seasonally adjusted terms. The non-food segment continues to show an accelerated pace of price rises in construction materials and fuel.

Figure 6. Average daily price growth, %



Sources: Rosstat, R&F Department calculations.

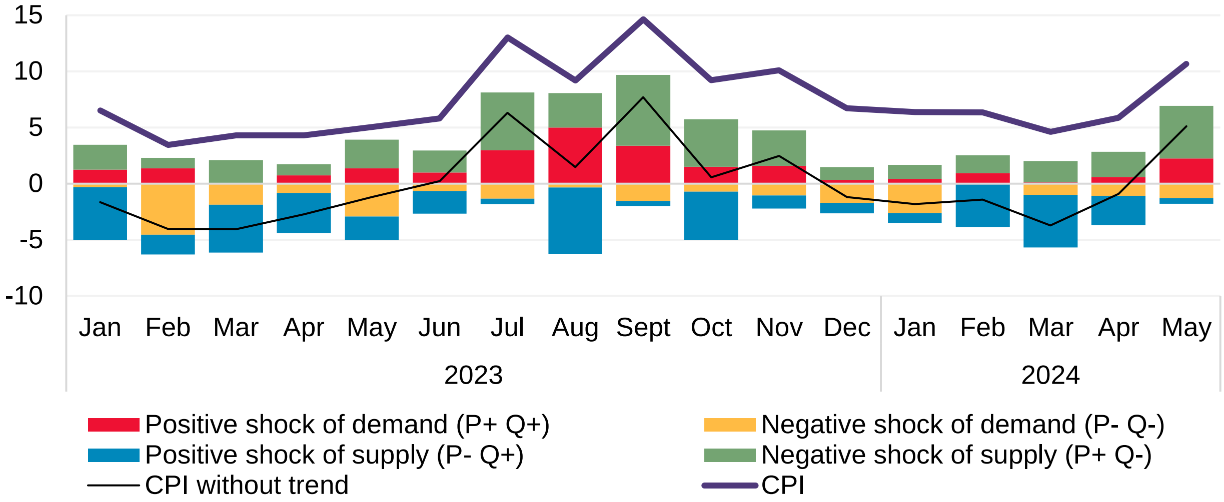
Figure 7. Direct inflation estimates by households: median readings, annual percentage change



Source: inFOM.

The risks of accelerated price growth continuation or overly slow and unsustainable return to target remain. The estimates of perceived inflation and inflation expectations by households continued to rise in June (Figure 7), with firms' price expectations resuming their rise as their costs climb. While supply-side factors made a substantial contribution to the current pace of price growth, the proinflationary effect of demand-side factors also gained strength in May (Figure 8). For the disinflation process to resume, monetary stance needs to be tighter in the second half of 2024 than it actually was in the first half of the year and the duration of tight monetary policy is required to be longer.

Figure 8. Price growth decomposition, % MoM SAAR



Sources: Rosstat, Sapova, Kharlamova (2023), R&F Department calculations.

2. Economic performance

Statistical and real-time data suggest that April's growth lull has been overcome. Economic activity again notably picked up in May and June. At the same time, the growth picture started to vary much more across industries. Indeed, the services sector clearly lost momentum, not unlikely dragged down by business services. This may have stemmed from adverse external conditions for some of Russian exports, in particular, coal, and from transportation restrictions on shipments to eastern destinations.

Also noteworthy are contradictory signals from the labour market. The seasonally adjusted unemployment rate and the HeadHunter Index[3] have for the first time in recent months shown a token increase. This may have stemmed from the rising labour mobility and more frequent changes of job in search of better employment terms. At the same time, the latest Bank of Russia business poll has indicated a rise in labour shortage across the board for all enlarged worker categories.

As regards the consumer market, the situation has remained unchanged here: except for demand fluctuations in the car market, consumption of goods and services is still dynamically rising.

Overall, one can conclude that the economy is moving towards balanced growth, but this will not have an immediate effect on the labour market. Therefore, the economy's exit from overheating will be gradual.

---

[3] It shows a ratio of active CVs to vacancies. The lower the reading of the index, the stronger competition for personnel.

2.1. Structural transformation and neutral interest rate

The Russian economy's structural transformation driven by external and domestic factors entails a number of macroeconomic changes. They are hard to identify and the more so to quantify. One can point out the diminishing openness of the Russian economy, evidenced by a drop in the share of imports and exports in GDP and an increasing role of domestic demand and production. We are also seeing a switchover from external to domestic sources of finance, except where formally external finance is provided by Russian residents.

Domestic demand has received a substantial impetus from public spending financed by the extra oil and gas rent generated through an increase in the cut-off price as part of the fiscal rule and an even greater rise in the oil price under which the budget gets balanced. Government-subsidised lending programmes have enabled a credit lever to be created, heightening the impact of budget spending on the economy (i.e. the multiplicator of budget expenditure).

As a result, government demand (direct or indirect) for goods and services has generated demand for production factors. Full or partial import substitution with domestic goods and services, even unrelated to government demand, also creates substantial additional demand for production factors.

This structural change has produced a sustainable rise in demand for labour and capital (investment). Overall, such macroeconomic shifts are supposed to raise the level of potential GDP and accelerate its growth.

At the same time, GDP growth on this scale requires larger financing. Given limited sources of external finance, domestic finance sources, i.e. savings, should be boosted. This will likely lead to a sustainable increase in the savings ratio. This requires improving the attractiveness of savings relative to consumption. This in turn implies a higher level of deposit rates and, eventually, of a neutral interest rate, which would balance savings and investment, ensuring price stability amid potential GDP growth. The greater sustainable demand for financing (the rate of investment) will be, the higher neutral interest rate should be, other things being equal.

What is important from a practical perspective is not only the future level of the neutral interest rate, which is hard to determine, but also a likely direction of its change and the balance of risks of its further shifts. Accordingly, it would be appropriate to adjust monetary policy to the current and forecast price movements in order to bring inflation down to 4%, assuming that subsequent maintenance of inflation at target may require maintaining higher real interest rates because of ongoing structural shifts in the economy and a rise neutral rate related to this.

2.2. Economic activity remains strong

- Real-time indicators suggest that dynamic GDP growth is continuing in Q2 after its acceleration in Q1[4] (Figure 10). Growth is still chiefly driven by steady growth in private demand. Meanwhile, according to data obtained from the financial flows of the Bank of Russia's payment system (Figure 9), the economy has enjoyed increasing support from government and external demand. As export orders resumed growth[5] and government purchases were stepped up, business optimism remains strong, although varying across industries[6] (Figure 11).
- After a short-lived lull in April, industrial output resumed growth in May. Mining and quarrying partially made up for its setback in April (Figure 12), with growth accelerating in the group of ***investment goods*** industries, primarily the "heaviest" ones, i.e. those with a heavy weight in the structure of gross value added in the group of investment goods industries (Figure 13).
- A number of ***intermediate*** manufacturing industries (manufacture of refined petroleum products and manufacture of chemical products) posted a sustainable ascending trend. It stemmed from, among other things, strong external demand and an extension of petrol export permission until the end of July[7] and may continue after the unscheduled repair and maintenance operations at refineries have been completed.
- The group of ***consumer goods*** industries have shown an uninterrupted expansion since the start of the year, fuelled by both elevated domestic demand (Figure 14) and restriction on imports along with their diminishing price attractiveness. Household consumer activity remains strong (Figure 15) amid fast labour income growth outpacing a rise in productivity (Figure 17). We expect its further performance amid the high level of financial satisfaction and a rise in the willingness to make major purchases (Figure 17) to primarily depend on the labour market condition and the tightness of monetary stance (for details see the In Focus section).
- The labour market continues to suffer a substantial shortage of workforce. That said, the HeadHunter Index registered a minor rise, with a gap between labour supply and demand narrowing for the first time over a long period (Figure 19). According to seasonally adjusted Rosstat data, the unemployment rate has increased (Figure 20).

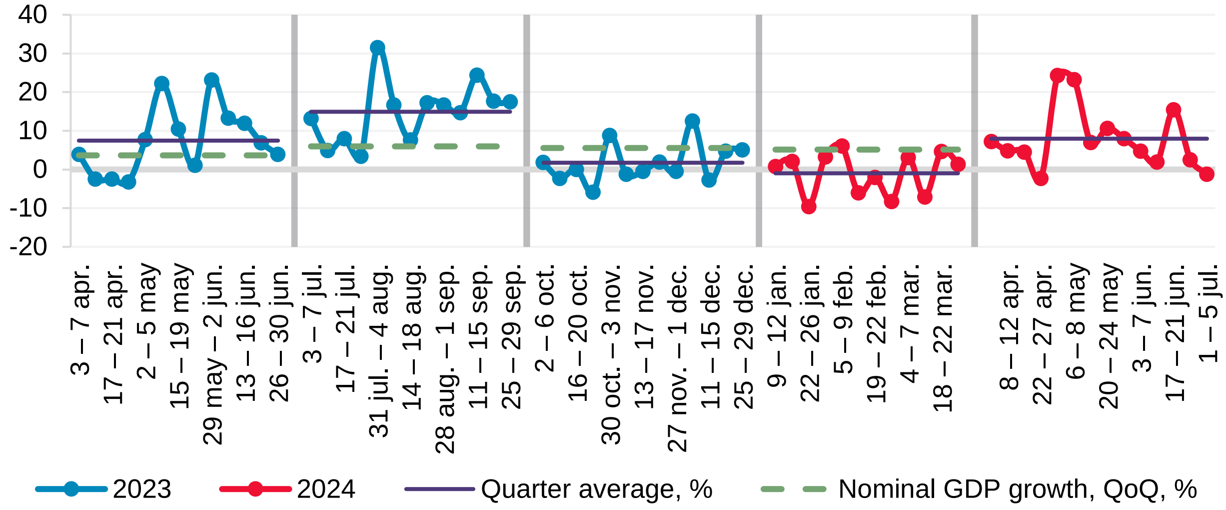
[4] To 1.4% QoQ SA in Q1 2024 from 1.1% QoQ SA in Q4 2023 according to an updated R&F Department estimate based on the initial GDP estimate from Rosstat. That said, Q1 growth was presumably overstated due to an incomplete adjustment for the leap-year factor.

[5] According to a PMI survey, new export orders in manufacturing rose for the first time over 3 months.

[6] According to a PMI survey, business expectations in the manufacturing sector were the strongest over the last 3 months. In services, optimism regarding output prospects on a one-year horizon was the lowest since July 2023. The industrial optimism perceptions in surveys by S Tsukhlo were more reserved than in PMI polls, but remain strong by historical standards.

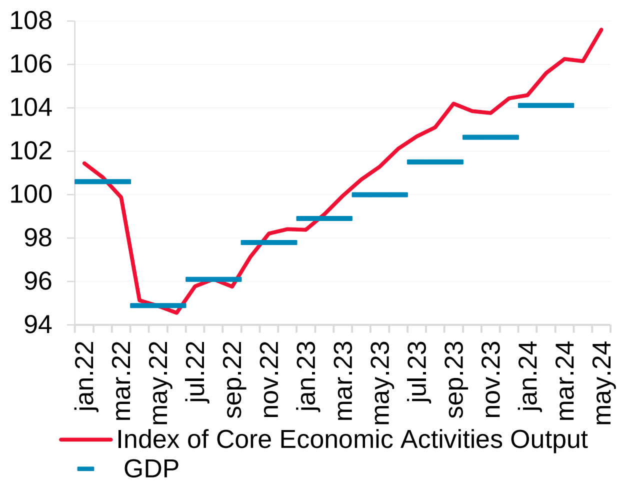
[7] The suspension of the embargo on petrol exports extended until the end of July.

Figure 9. Incoming payments growth[8] relative to the previous quarter average weighted by industries' shares in gross value added, seasonally adjusted, %



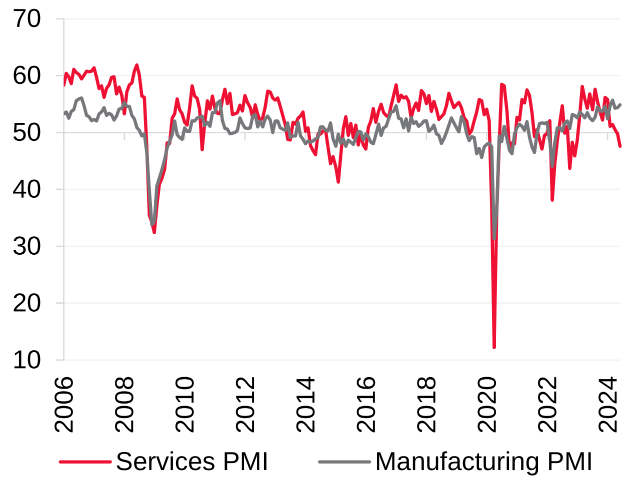
Sources: Bank of Russia, Monitoring of individual industries' financial flows.

Figure 10. Core economic activities output and GDP, Q4 2021 = 100



Sources: Rosstat, R&F Department calculations.

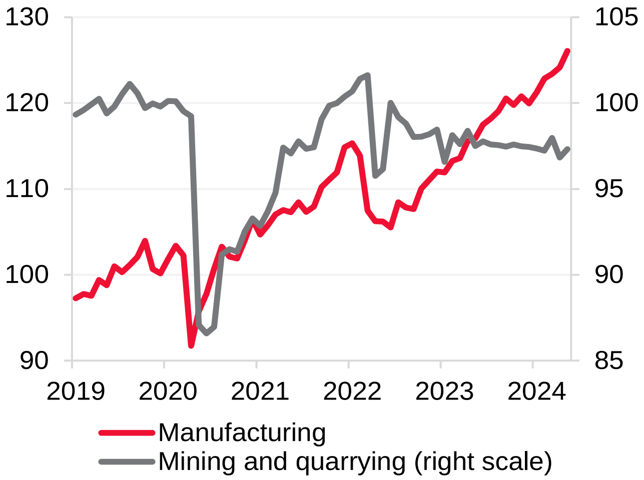
Figure 11. Russia's Manufacturing and Services PMI, points



Source: S&P Global.

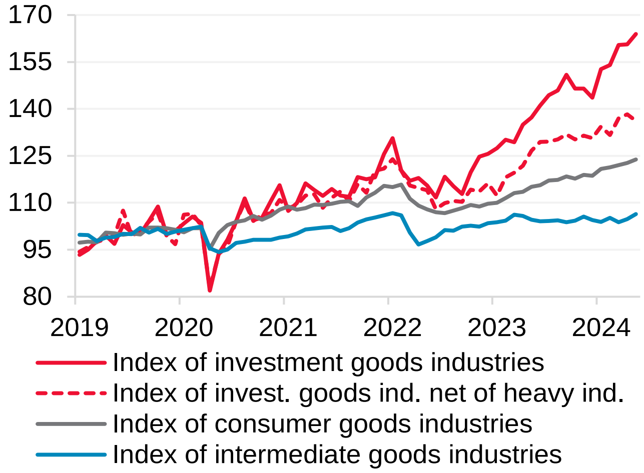
[8] Growth means a percentage change in the value: $g = \frac{(x_1 - x_0)}{x_0} * 100$.

Figure 12. Mining and quarrying and manufacturing indices (2019 = 100), SA



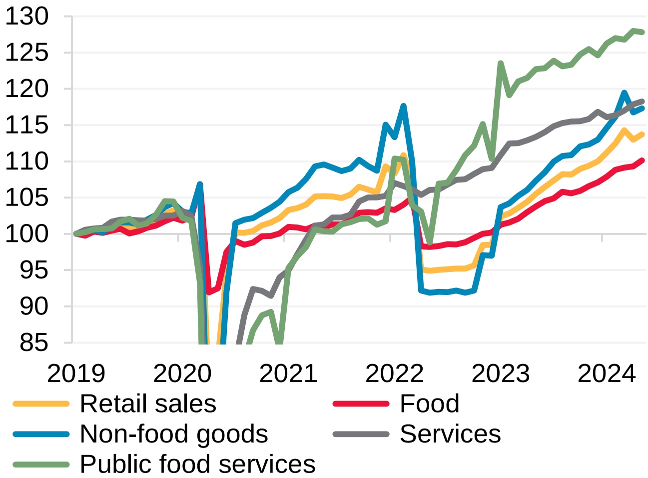
Sources: Rosstat, R&F Department calculations.

Figure 13. Output in groups of manufacturing industries, SA, 2019 = 100%



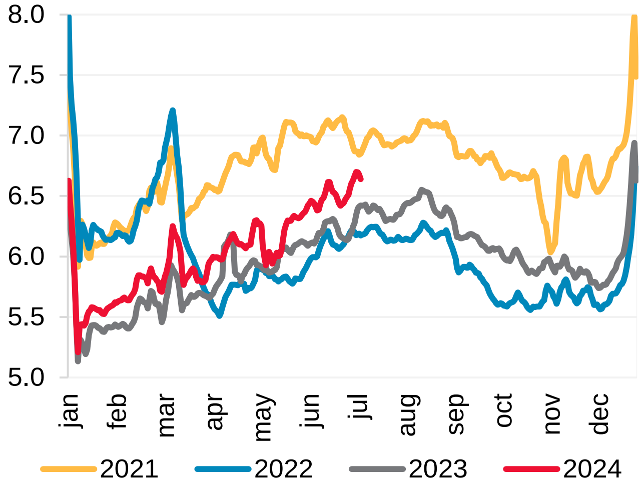
Sources: Rosstat, R&F Department calculations.

Figure 14. Retail sales, sales of the paid services segment and public food services, 01.2019 = 100, SA, %



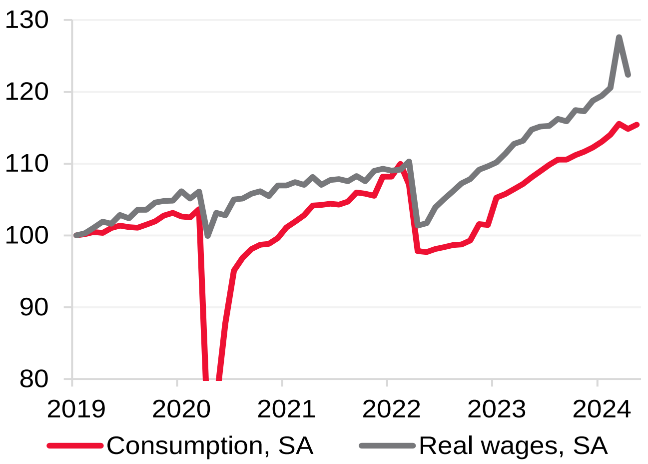
Sources: Rosstat, R&F Department calculations.

Figure 15. Tinkoff consumer and business activity index, points



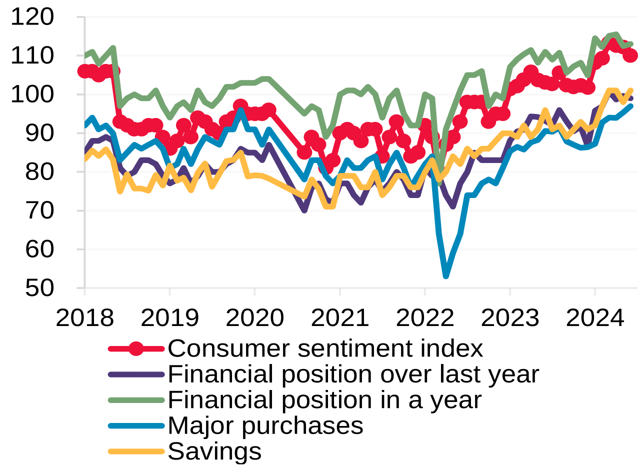
Source: Tinkoff.

Figure 16. Proxy indicator for consumption (sum of retail, services and public food services sales) and real wages, 01.2019=100, SA, %



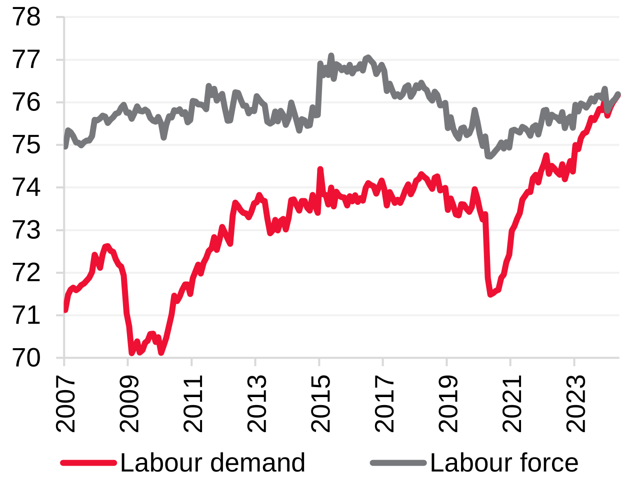
Sources: Rosstat, Bank of Russia, R&F Department calculations.

Figure 17. Consumer sentiment index and its subindices, points



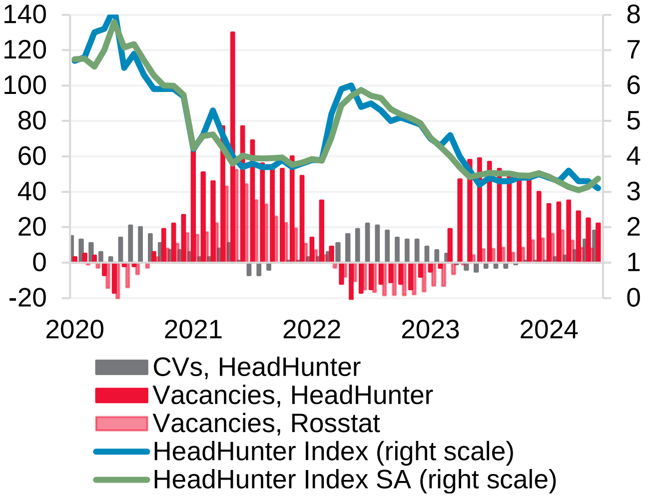
Source: inFom.

Figure 18. Labour force and labour demand, mln people, SA



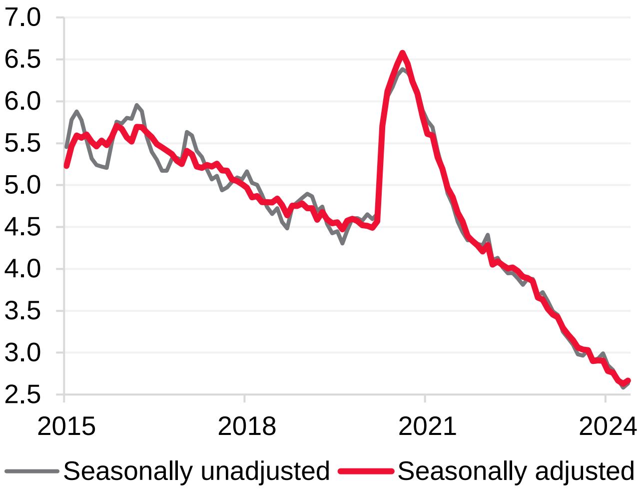
Sources: Rosstat, R&F Department calculations.

Figure 19. CVs, vacancies (% YoY) and HeadHunter index (points)



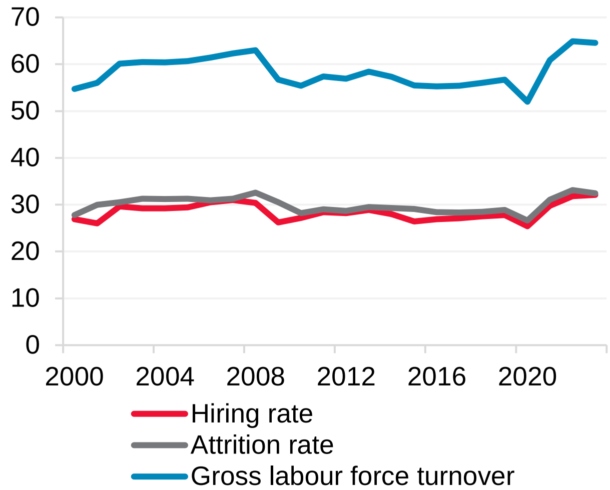
Sources: Rosstat, HeadHunter, R&F Department calculations.

Figure 20. Unemployment rate, %



Sources: Rosstat, R&F Department calculations.

Figure 21. Hiring and attrition rate, gross labour force turnover, %



Sources: Rosstat, R&F Department calculations.

2.3. Buoyant lending growth hampers disinflation

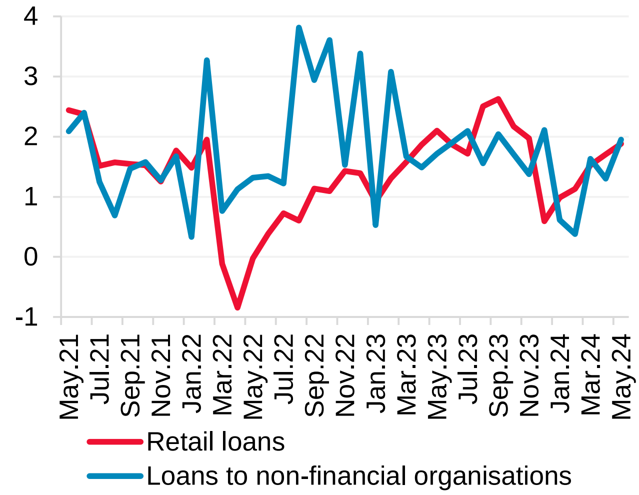
- Lending expansion accelerated in May. This stems in part from one-off factors, but net of them its pace still remains faster than what is called for to help sustainable disinflation.
- Retail lending growth accelerated to 1.9% MoM SA from 1.7% MoM SA in April (Figure 22), driven most of all by an acceleration in mortgage loan portfolio expansion to 1.7% MoM SA from 1.2% MoM SA, owing to, above all, transactions in the new housing market associated with subsidised lending programmes (Figure 23, Figure 24). A temporary activity surge in May–June arose from the expectations of subsidised mortgage loan programme termination by the government as of 1 July and changes in the terms of family

mortgage loan programme. Starting mid-June, a number of banks stopped accepting applications for loans under some programmes due to the depletion of limits. In the months to come, the mortgage lending segment will likely see a cooling with a minor shift towards the secondary market.

- Growth in unsecured consumer lending amid strong consumer activity accelerated to 1.7% MoM SA from 1.5% MoM SA, outpacing its expansion in previous years (Figure 25). Almost one third of unsecured consumer loans were extended via credit cards, whose portfolio steadily shows an accelerated pace of growth. Going forward, macroprudential measures[9] will likely cause the structure of loan provisions to shift towards customers with a low debt-to-income ratio and may slow portfolio growth.
- Auto loan portfolio expansion accelerated to 4.9% MoM SA from 4.0% MoM SA (Figure 25). Its sustainably fast growth is helped by expectations for further interest rate hikes, discounts from car dealerships,[10] and trade-in programmes. The imposition of macroprudential requirements may somewhat slow growth in this portfolio on account of customers with a debt-to-income ratio of more than 50%.
- Growth in ruble loans to non-financial organisations accelerated to 2.0% MoM SA in May from 1.3% MoM SA in April. Overall, lending remains the key driver of broad money supply expansion (Figure 26).
- A slowdown in household funds growth at banks to 1.0% MoM SA in April was temporary, compensated by an acceleration to 3.5% MoM SA in May (Figure 27). The deposit channel of monetary policy’s transmission mechanism remains effective, helping a buoyant build-up of household savings. Expansion in household funds sustainably surpasses consumer lending growth.
- After April’s spike caused by an adjournment of part of tax payments from April to May, corporate ruble funds contracted 4.0% MoM SA. That said, their average growth from January to May is on a par with the same period of 2023 at 1.5%.
- The banking sector continues to post a strong profit. It stood at 281 billion rubles in May, which is comparable with the 2023 figure. The profit was buttressed by growth in lending and acquiring, as well as by income from cash management and payment services. The strong profit in turn enables capital expansion, building up potential for further lending.

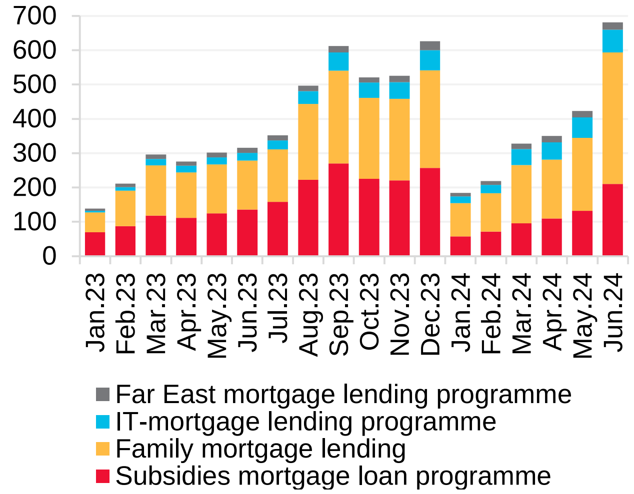
[9] Cuts to macroprudential limits and an increase in risk-weight add-ons for loans to customers with a high debt-to income ratio.
[10] AVTOSTAT Operativka: May 2024 results.

Figure 22. Ruble loans portfolio growth, % MoM SA



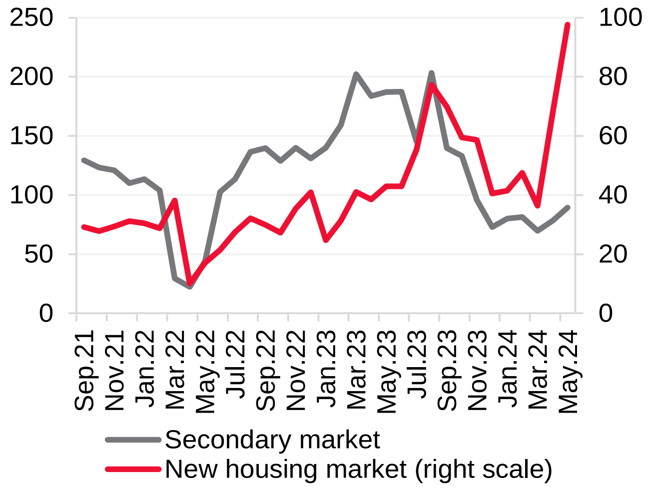
Sources: Bank of Russia, R&F Department calculations.

Figure 23. Loan issuance under subsidies mortgage loan programmes, billion rubles



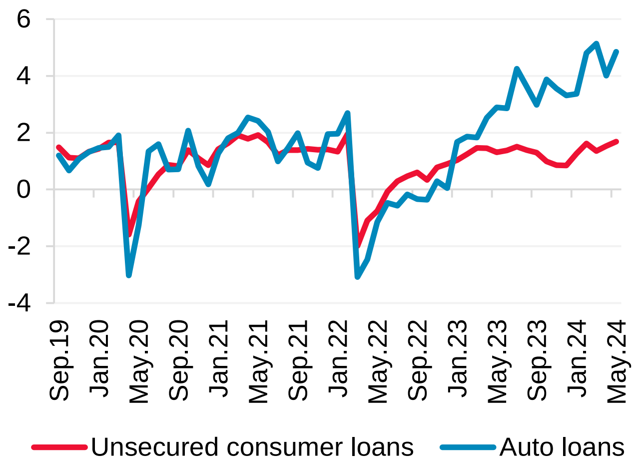
Sources: DOM.RF, R&F Department calculations.

Figure 24. Approved mortgage loan applications, thousand



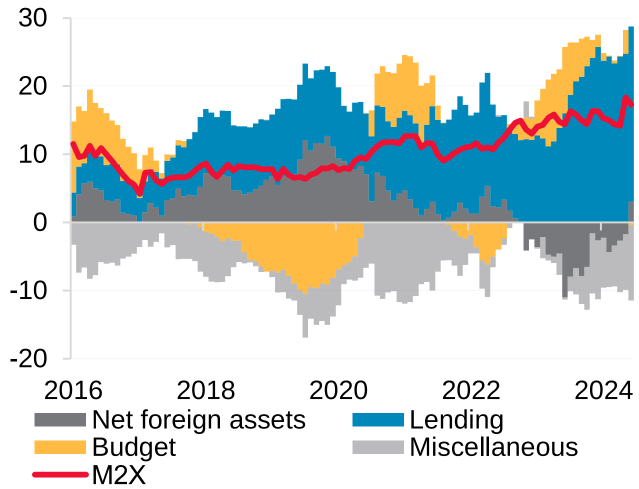
Sources: DomClick, R&F Department calculations.

Figure 25. Ruble loans portfolio growth, % MoM SA



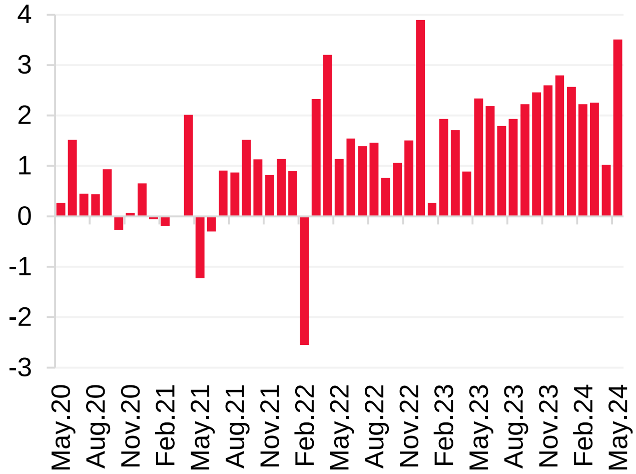
Sources: Bank of Russia, R&F Department calculations.

Figure 26. Key drivers of annual growth in broad money supply on the asset side, %



Sources: Bank of Russia, R&F Department calculations.

Figure 27. Household funds at banks, % MoM SA



Sources: Bank of Russia, R&F Department calculations.

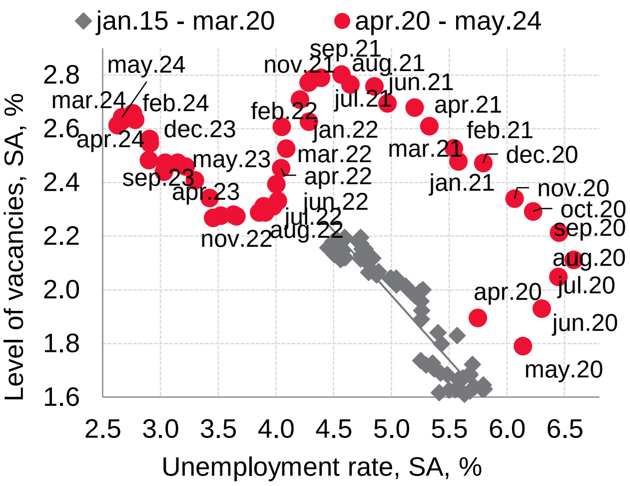
In Focus. Labour market amplifies proinflationary risks

- The Russian labour market features strong competition for personnel: most indicators hit all-time highs/lows or were close to them in H1 2024.
- Labour demand has reached a historical peak continuing to rise, with the picture varying across industries.
- Potential for labour supply expansion is limited by adverse demographic trends.
- This situation provokes wage growth at a rate outpacing labour productivity by far, thus creating additional proinflationary risks.
- Tight monetary policy to be implemented for a long period of time can help balance the labour market via cooling of labour demand. This would balance the situation in the economy and labour market, given that the adjustment of goods and services supply in the market through investment in new equipment and technologies takes a long time.

The Russian labour market experiences a significant overheating, which was aggravated in the first half of the year. As labour demand was growing fast amid limited supply, the unemployment rate and HeadHunter Index time after time hit new lows, with employment headcount and economic activity at all-time highs (Figure 18 – Figure 20).

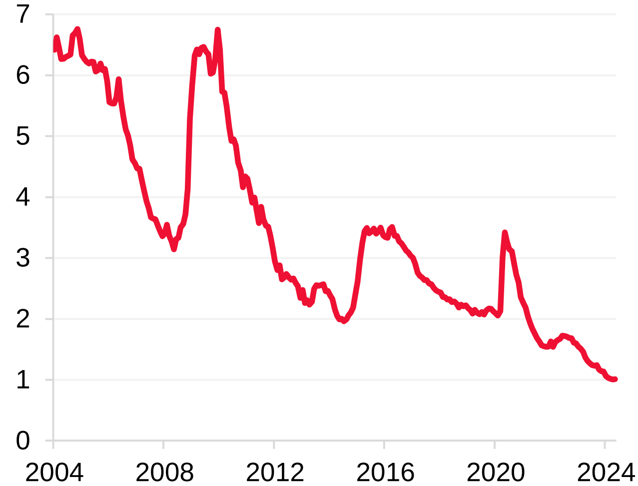
A rise in the labour market tightness due to the economy overheating and fast growth in labour demand is reflected as an upward movement to the left along the Beveridge curve, which is clearly seen in Russian data (Figure 28). After a temporary deviation of the curve to the right during the Covid crisis giving rise to the structural transformation of labour demand and an emergence of a significant gap between required and offered skills (*skill mismatch)*, the years 2021–2023 saw the curve return to the 2015–2019 trajectory, but with a higher level of vacancies and an all-time low of the unemployment rate.

Figure 28. Beveridge curve



Sources: Rosstat, R&F Department calculations.

Figure 29. Ratio of number of unemployed people to employers' demand for workers, SA

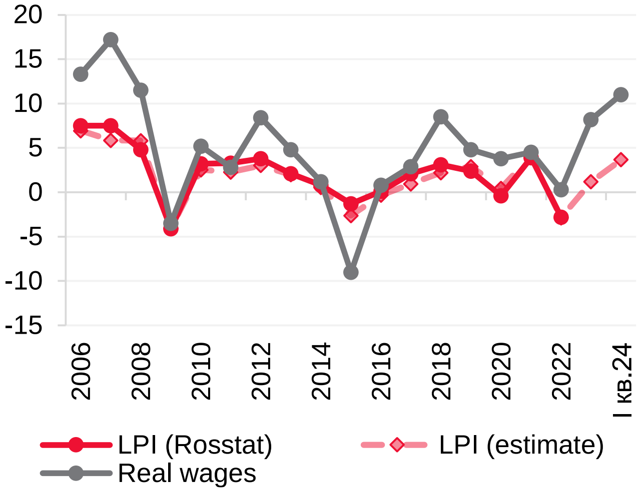


Sources: Rosstat, R&F Department calculations.

Given the ongoing strong competition for personnel, the rising labour demand provokes accelerated wage growth. As a result, recent quarters have seen a significant widening of the gap between growth in real wages and labour productivity (Figure 30).

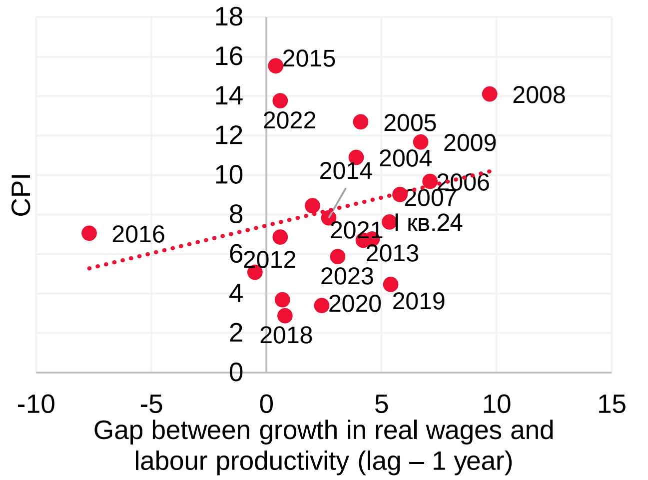
To achieve price stability, the gap between growth in real labour income and that in labour productivity needs to be bridged, because this incurs additional proinflationary risks, creating conditions for spurring the prices–wages–prices spiral (Figure 31). A rise in companies' unit labour cost, which is a significant part of per-unit production cost, stimulates price rises for keeping up marginality. This is especially notable amid faster growth in demand. It is the current gap between wages and productivity that suggests faster growth in households' purchasing power versus the economy's production capacities.

Figure 30. Real wages and labour productivity index (LPI), % YoY



Sources: Rosstat, R&F Department calculations.

Figure 31. CPI and gap between growth in real wages and labour productivity (lag – 1 year), % YoY

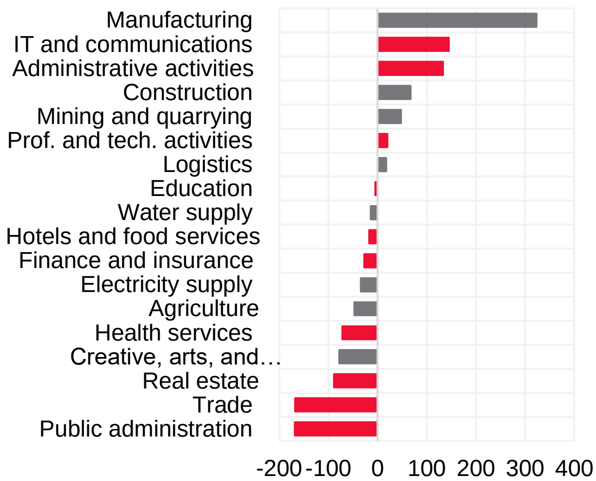


Sources: Rosstat, R&F Department calculations.

This gap can be narrowed by accelerating labour productivity growth. This, however, requires substantial investment in the modernisation and automation of production, fine-tuning of equipment, personnel training and retraining. All of these processes take a long time. Therefore, in the short and medium term, stabilisation of the labour market situation can and should be achieved by cooling current labour demand which cannot be met without providing substantially higher level of wages than that of productivity. This can also allow balancing out changes in employment across sectors, which have started to vary notably across sectors in the past two years (Figure 32).

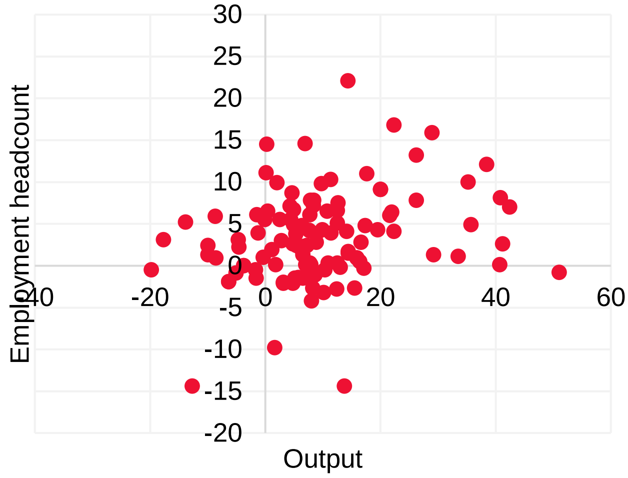
Employment headcount significantly increased in the industrial and IT sectors, as well as administrative activities, where growth was chiefly driven by security services, as well as construction, which was massively buttressed by subsidised mortgage lending programmes. That said, industries which posted employment contraction, are still short of workers, agriculture, hotels and public food services also suffer a clear shortage of personnel, for which they have to compete, including with the above sectors (Figure 34).

Figure 32. Changes in employment headcount by economic activity type in Q1 2024 relative to Q1 2022, thousand people



Sources: Rosstat, R&F Department calculations.

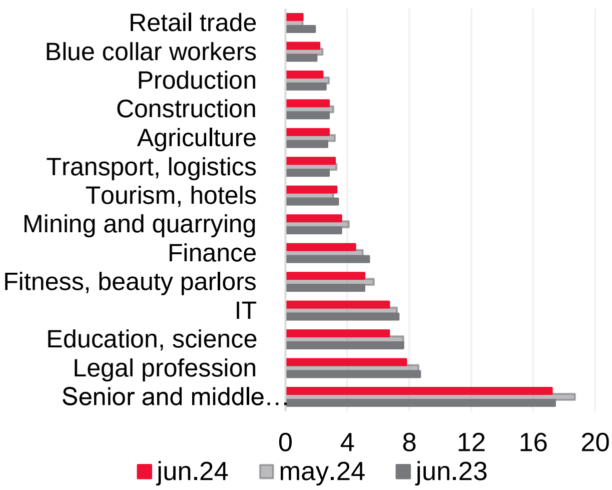
Figure 33. Output and employment headcount in production industries in Q1 2024, growth, % YoY



Sources: Rosstat, R&F Department calculations.

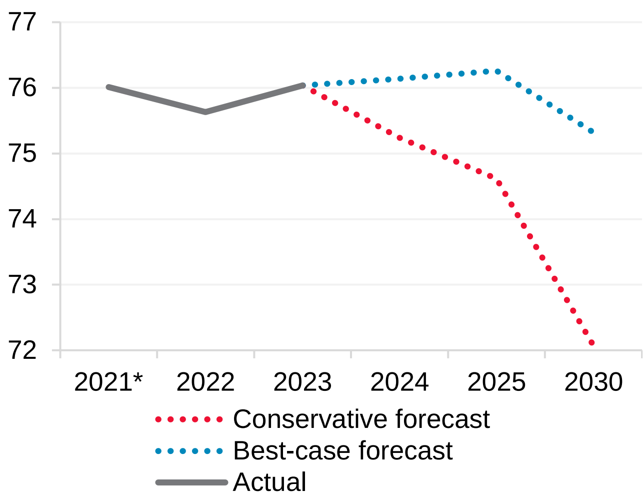
It is noteworthy that there are also industries in which an output decline is accompanied by employment growth (Figure 33). This may reflect firms' strategies to retain workers and build up a personnel reserve amid the labour shortage, despite output and income contraction, for instance, in expectation of situation improvement going forward. This situation adversely affects the allocation of labour resources in the economy.

Figure 34. HeadHunter Index in professional fields, pp



Source: HeadHunter.

Figure 35. Labour force, million people



** Estimate, based on Census-2020.*

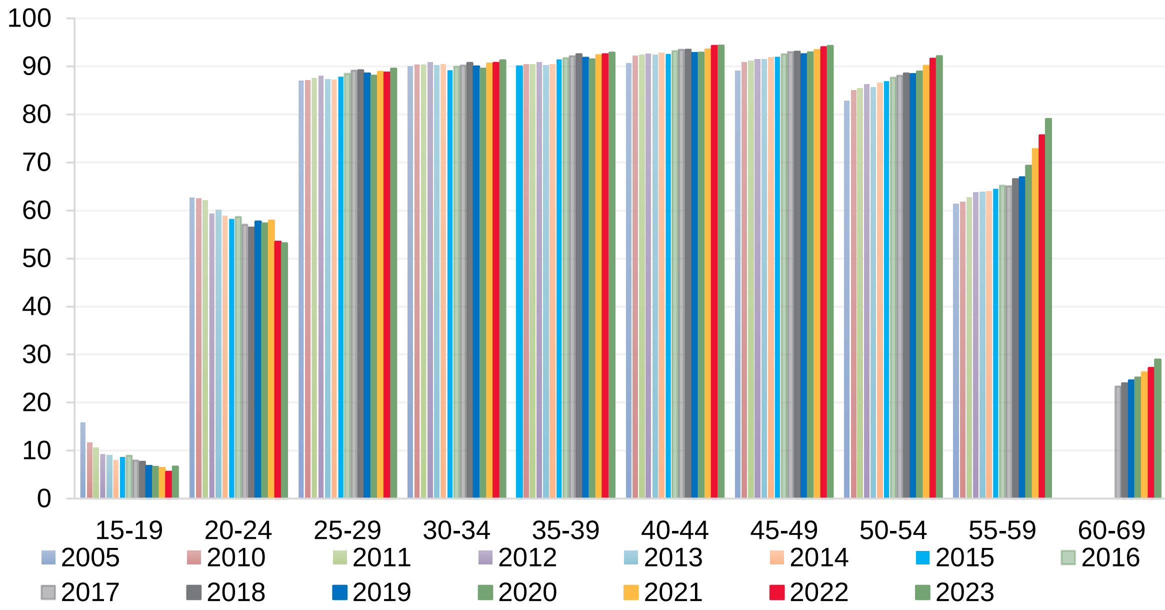
Note: The conservative forecast assumes that the labour force participation rate in all age cohorts stays on the current level, the best-case forecast expects the continuation of the current performance, including fast growth of economic activity in senior cohorts amid pension reform.

Sources: Rosstat, R&F Department calculations.

At the same time, a rise in the gross turnover of workforce and an increase in the number of CVs show people's greater preparedness for changing jobs, including in search of a higher pay (Figure 21). On the one hand, this may help normalisation of the situation due to the rising labour mobility and a more efficient reallocation of labour resources among companies and industries, and on the other hand, exert an upward pressure on wages due to companies' need to retain or lure away personnel.

Should the current adverse demographic trends continue on a five-year horizon, constraints on the side of labour supply may become even more pronounced. Although the labour force participation rate in 2023 reached a maximum in most age cohorts, especially those affected by pension reform, this only succeeded in compensating for the contraction of working age population (Figure 36). On a five-year horizon, the maintenance of the current level of economic activity in all age groups would mean a notable contraction in labour supply. Only if growth in the labour force participation rate were to continue, will there be stabilisation of the workforce headcount, while potential for this is all but exhausted in the most productive age groups.

Figure 36. Labour force participation rate by age group, %



Source: Rosstat.

Tight monetary policy will help the normalisation of the labour market situation via the cooling of overheated labour demand. This will also lead to narrowing of the gap between wage and productivity growth, and probably to raising demands on workers and improve the workforce quality. The restoration of the labour market balance will be contained by low interindustry and interregional mobility of labour resources and restrictions on migration from the former USSR member countries. At the same time, one can expect improvements in the process of labour reallocation to more productive and efficient industries.