

## Russia Macro View

### Is there more room to consume?

- **Concerns about a budding consumer bubble have come to the fore.** While the Russian economy may be struggling, the Russian consumer seems to be flourishing. Strong consumer spending is at least partly driven by a decelerating, yet still robust, retail lending, which is expanding at rates fast outstripping those of nominal GDP. The regulator is taking notice, arguing that a worrying consumer bubble could be forming in Russia.
- **A common response to such concerns is that the Russia consumer is only very mildly leveraged relative to counterparts in other EM economies.** One way to assess whether the Russian consumer is too leveraged is to divide the stock of outstanding consumer debt by GDP. On that measure, Russia compares favorably to other EM economies, with a ratio of only 14.3% against an average of 26.7% for 17 EM economies in our sample. This is commonly taken as sufficient evidence for downplaying concerns of a consumer bubble in Russia.
- **However, looking at retail ex-mortgage data paints a much more nuanced picture of where the Russian consumer stands relative to EM peers.** The retail loan data may be distorted by the large country variability of mortgage loans, so that looking at retail ex-mortgage data may be a more appropriate way to assess consumer indebtedness. This is even more critical in the case of Russia, because the significant increase in the retail loan to GDP ratio over the last two years has been almost exclusively driven by non-mortgage debt. On that measure, Russia appears much more in line with the rest of the EM sample, with a retail ex-mortgage debt to GDP of 10.4% vs an average of 11.5% for the rest of the group.
- **This points to a much more limited scope for the kind of rates of growth in retail lending that we have seen recently.** After peaking at 44.4% YoY in mid-2012, retail loan growth moderated to a still strong 30.1% YoY in October 2013. A further fall to about 20% in 2014, as we expect, should also alleviate fears of a bubble.
- **However, further scaling the data by per capita GDP suggests that the Russian consumer finds itself in a sweet spot in terms of its level of consumer indebtedness.** Accounting for different per capita income levels, we find that the current level of consumer indebtedness is just right for Russia's economic fundamentals.
- **A slowdown in retail lending, partly related to regulatory actions, may, all things considered, constrain growth in 2014 and create room for a more accommodative monetary policy.** We find tenuous support for the claim that strong consumer demand has contributed to slower GDP via import leakage. Rather, we think growth was impeded by collapsing investment. In that sense, more moderate retail lending may constrain growth and allow for easier monetary policy.

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## Is the Russian consumer too leveraged?

**Strong rates of retail lending growth have fuelled fears of an impending consumer bubble in Russia.** Such fears are usually driven by looking at the flow data for retail lending growth (Figure 1). And indeed, while corporate loans have been expanding at low double-digit numbers, retail loans have seen a much more robust rate of growth. This has led to concerns that consumers may have become too exposed to bank loans, thus fuelling fears of large indebtedness.

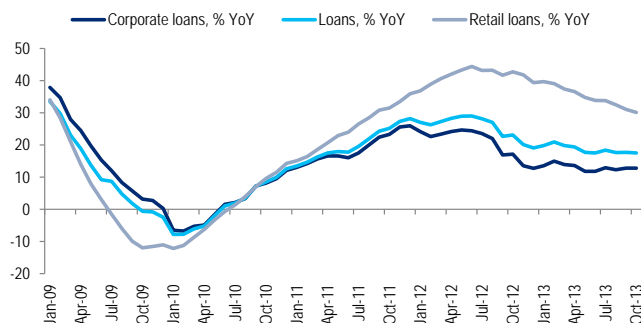
**In addition, retail lending growth has far outpaced that of nominal GDP, further raising concerns about the unsustainability of the situation.** A better way to assess this is to juxtapose retail loan growth to that of nominal GDP (Figure 2). Since mid-2011, retail loan growth has been significantly outpacing that of nominal GDP, sparking concerns that consumers have been recently borrowing at rates not justified by economic fundamentals. In particular, the difference in growth rates between retail lending and nominal GDP grew from zero around mid-2011 to a peak of 32% in mid-2012 to a still-worrying 23% as of 3Q13.

**This may, however, represent a catching-up effect from the immediate post-crisis period of deleveraging.** One possible pushback to this view is to recognize that the more recent phenomenon may be just a catching-up from the immediate post-crisis period (mid-2009 to mid-2011) when consumers deleveraged and banks were averse to lending, as they were building up liquidity buffers and strengthening balance sheets.

**Overall loan and deposit growth have recently moved in tandem, which may also point to smaller macro vulnerabilities.** Also, from a theoretical perspective, one would not like to see significant discrepancies between overall loan growth (retail and corporate) and deposit growth. Figure 3 shows that the banking system was accumulating deposits in the post-crisis period, but that it then transitioned to a situation where loan growth was indeed outstripping that of deposit around end-2011. After about a year when the situation reversed, deposits resumed their faster pace of growth than that of loans around the start of this year, possibly because dimmer economic growth led to less desire to increased indebtedness. This all suggests that, save for the two years in the wake of the 2009 economic collapse, loan and deposit growth have moved in tandem, pointing to fewer macro vulnerabilities.

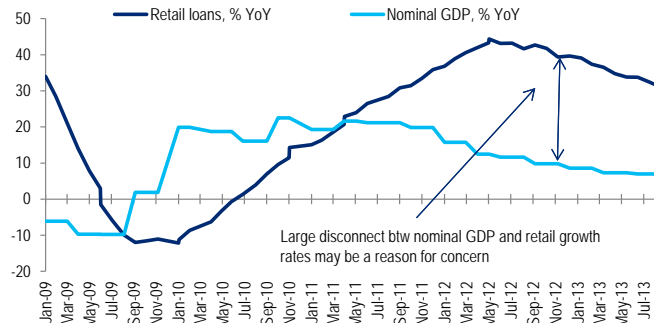
**Of course, this masks the underlying differences in the strength of retail and corporate lending.** The above argument may be relevant for assessing the broader health of loan demand, but it fails to recognize the possibility of different balance sheet dynamics in the corporate and retail segment (Figure 4). Hence concerns that Russia may now be experiencing a worrying consumer bubble may still apply.

Figure 1. Retail loans have been growing fast...



Source: Rosstat, Citi Research

Figure 2. ...and outpacing nominal GDP growth

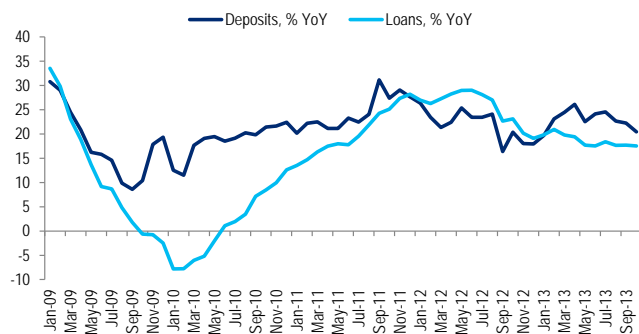


Source: Rosstat, Citi Research

**More broadly, the disconnect between struggling economic growth and flourishing consumer spending has caught the attention of the regulator.**

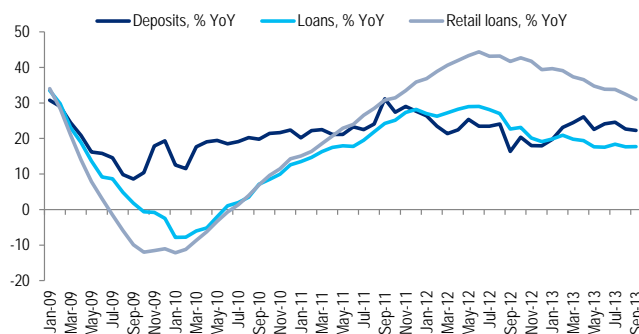
While the Russian economy may be struggling, the Russian consumer seems to be flourishing. Strong consumer spending is at least partly driven by decelerating yet still robust retail lending, which is expanding at rates fast outstripping those of nominal GDP. Such disconnects often end up badly, with rising consumer defaults and bank NPLs. The regulator is taking notice, arguing recently that a “worrying consumer bubble” could be forming in Russia.

Figure 3. Deposits are keeping pace with overall loans...



Source: Rosstat, Citi Research

Figure 4. ...but not with retail ones



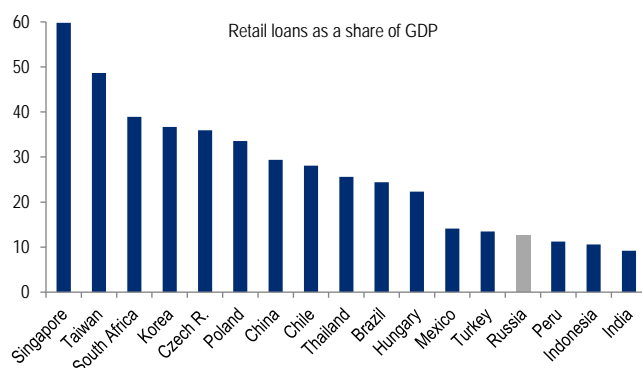
Source: Rosstat, Citi Research

## Consumer indebtedness seems fine...

**Even if the flow picture may be somewhat worrying, the stock picture should be much more relevant in assessing the indebtedness of the Russian consumer.** Looking only at the flows of retail loans may not reveal whether consumers have the ability to repay. This should be assessed against their incomes. A proxy for that would be the ratio of outstanding loans to GDP.

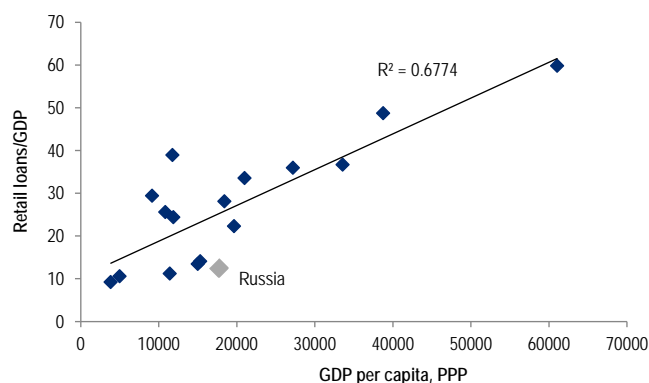
**This measure reveals that the Russia consumer is only very mildly leveraged relative to counterparts in other EM economies.** We use a sample of 17 EM economies from CEEMEA, Asia and LatAm to test this hypothesis with 2012 retail loan data (Figure 5). On that measure, Russia compares favorably to other EM economies, with a ratio of only 12.5% against an average of 26.7% for the rest of the 17 EM economies in our sample. This is commonly taken as sufficient evidence for downplaying concerns of a consumer bubble in Russia.

Figure 5. Consumer indebtedness appears quite low...



Source: National bank authorities, Citi Research estimates

Figure 6. ...including when scaled by per capita incomes



Source: Citi Research estimates

**Scaling by per capita GDP to control for different country wealth levels supports this view.**

The correlation between per capita incomes and consumer indebtedness quite strong as demonstrated by the high  $R^2$  (Figure 6). This link between the two suggests that richer countries tend to exhibit larger consumer indebtedness. Russia is an outlier, as it appears to be too rich to have retail loans account for only about 12.5% of GDP. If Russia were to move to the average line describing the relationship between the two parameters, retail loans should almost double as a share of GDP at the existing per capita income. From this perspective the Russian consumer appears too underleveraged.

**...but only when mortgage data is included**

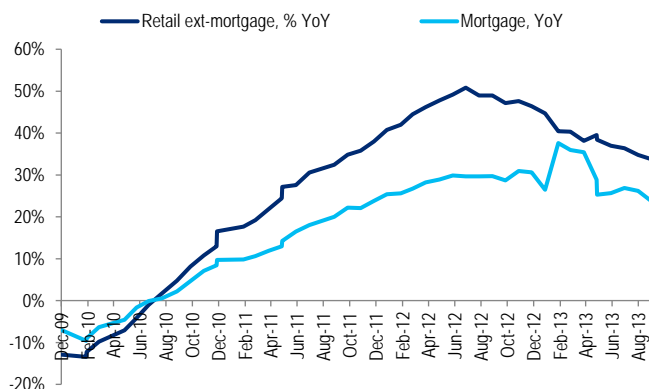
**However, the stock retail loan data may be distorted by large country variability of mortgage loans, which are included in the overall retail loans.**

Therefore, we strip mortgage lending from overall retail lending to arrive at retail ex-mortgage lending. This is even more critical in the case of Russia, because the significant increase in the retail loan to GDP ratio over the last two years has been almost exclusively driven by non-mortgage debt (Figures 7 and 8). At the same time, mortgage debt has remained relatively constant as a share of GDP.

**Looking at retail ex-mortgage data paints a much more nuanced picture of where the Russian consumer stands relative to EM peers.** The large gap that existed between Russia and the rest of the EM economies has now almost disappeared (Figure 9). On this measure, Russia appears much more in line with the rest of the EM sample, with a retail ex-mortgage debt to GDP of 9.5% (10.4% as of Sep 2013) vs an average of 11.5% for the rest of the group.

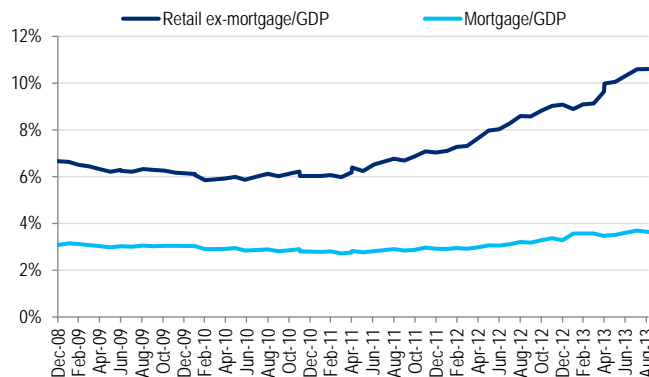
**Scaling by per capita GDP to control for different country wealth levels suggests that Russia's current level of consumer indebtedness is broadly in line with fundamentals.** The scatter-plot of retail ex-mortgage loans (% of GDP) vs per capita incomes does not reveal such a strong correlation as the one that includes all retail loans (Figure 6), but still provides a useful comparison between countries (Figure 10). Clearly, Russia is no longer the outlier it was before. For its income levels, Russian consumers should have about 11% of GDP retail ex-mortgage indebtedness, which is quite close to its current 10.4% level (Sep 2013). For example, while consumer ex-mortgage indebtedness in Russia is larger than that in India, Indonesia, Chile or Mexico, it is smaller than that in China, Brazil, South Africa, Thailand, Poland and the Czech Republic.

Figure 7. Ex-mortgage retail loans grew faster than mortgage ones...



Source: Central Bank of Russia, Citi Research

Figure 8. ...leading to a surge in their share in GDP



Source: Central Bank of Russia, Citi Research

**This points to a much more limited scope for the kind of strong rates of growth in retail lending that we have seen recently.** After peaking at 44.4% YoY in mid-2012, retail loan growth moderated to a still strong 30.1% YoY in October 2013. A further moderation to Citi's estimate of about 20% YoY in 2014 should also alleviate fears of a consumer bubble.

**More importantly, it does not lend credibility to the view that there is a consumer bubble in Russia, although there could be some layers of the population that are more vulnerable than others.** In our view, the data demonstrates that, on average, the Russian consumer is now at a sweet spot in terms of its level of indebtedness. The very fast growth rates of retail lending in the last two years have only served to close the gap with other emerging market economies and bring Russia close to where it should be when judged against per capita income levels.

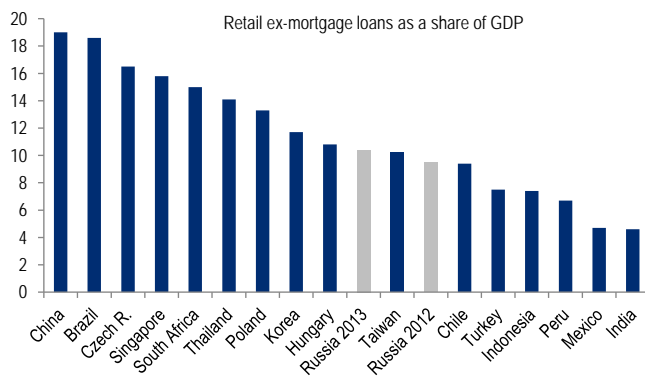
## There are still moderate risk levels compared to other EM economies

**An alternative way to assess consumers' ability to pay is to look at unemployment rates.** Figure 11 plots retail ex-mortgage debt as a share of GDP vs unemployment rates for our sample of 17 EM economies. The Figure is divided into four zones, the safest being the zone with low unemployment and low consumer indebtedness and the riskiest with high unemployment and high indebtedness. Countries that have lower unemployment rates should find it easier to finance aggregate consumer debt, while countries with higher unemployment should experience more difficulties meeting their obligations.

**Russia looks safe in this regard, as relatively low unemployment should ensure ability to pay.** Russia in fact lies in the safest segment of the chart, suggesting a much better position relative to countries like Czech, Poland, Hungary, China and Brazil. On the other hand, Russia fares worse only relative to Indonesia, Mexico and India.

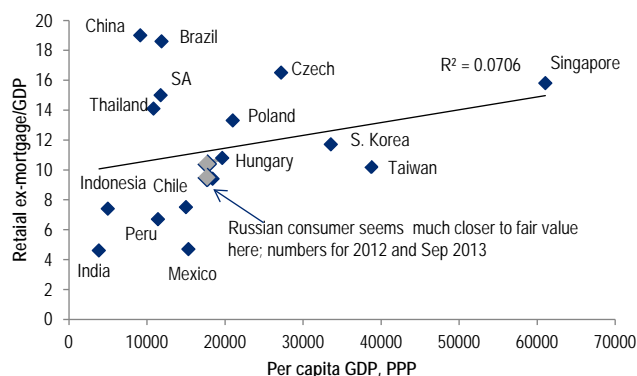
**Similarly, one can look at whether country savings, as measured by the current account position, support the ability to meet outstanding obligations.** Countries that save more should be in a better position to do so than countries that don't, although current account balances include both the private and public sectors and, therefore, may not provide the perfect yardstick for assessment.

Figure 9. The Russian consumer appears much less out of line when mortgages are excluded...



Source: National bank authorities, Citi Research estimates

Figure 10. ...and just where it should be relative to per capita incomes

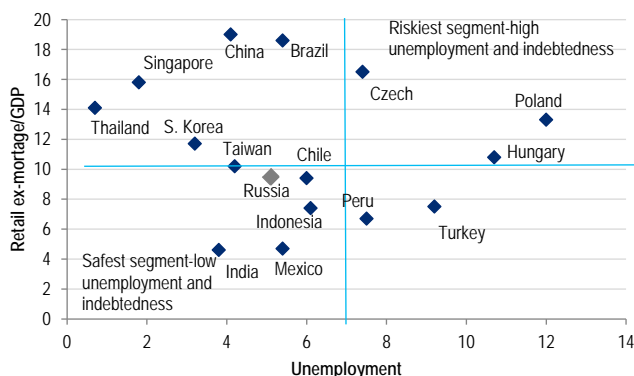


Source: Citi Research estimates

### Russia once again looks as one of the safest countries on this measure.

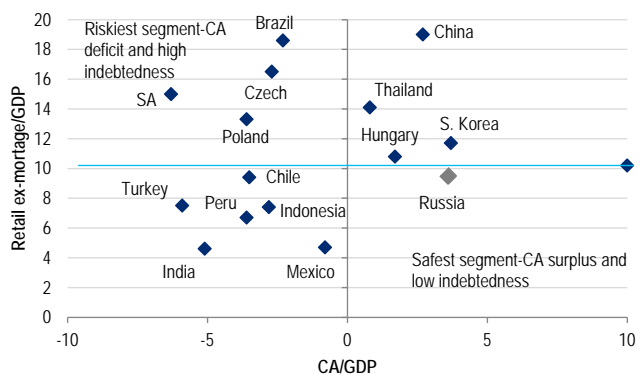
Russia again lies in the safest segment of the chart, with a current surplus exhibiting the ability to meet outstanding obligations (Figure 12). In fact, Russia is the only country in that segment and it appears in the best position on these metrics.

Figure 11. Russia seems in a relatively safe spot as lower unemployment ensures that outstanding retail ex-mortgage debt can be paid...



Source: Citi Research estimates

Figure 12. ...while higher savings also point to ability to meet debt obligations

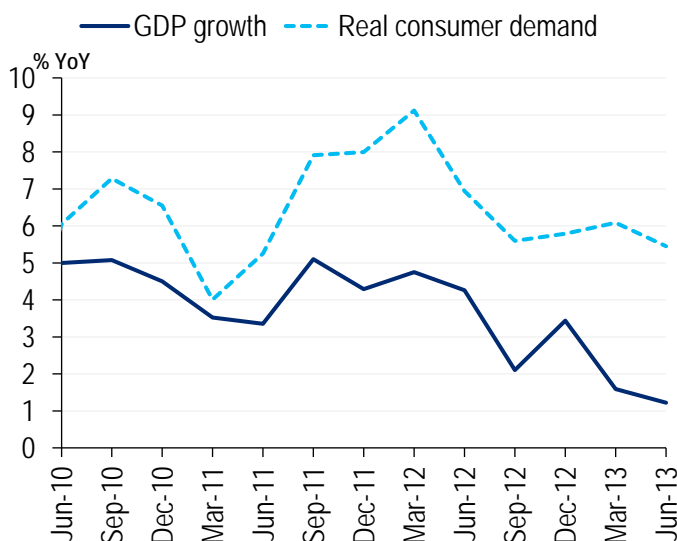


Source: Citi Research estimates

## What does it all mean for monetary policy?

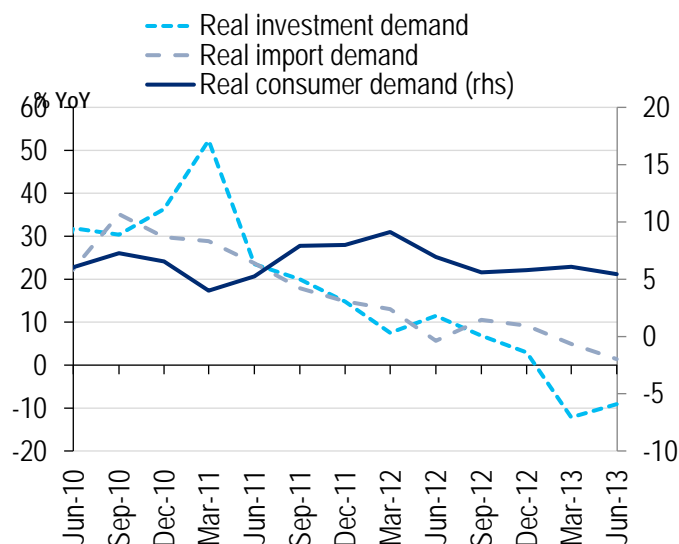
**We do not find that the disconnect between strong credit and weak GDP can be explained by import leakage.** One appealing explanation for the co-existence of a robust pace of retail lending (and consumer spending) and weaker GDP is that stronger consumer demand is leaking through imports, thus subtracting from GDP. One way to assess this is to use national accounts data and compare the rates of growth of real consumer spending and real GDP. As Figure 13 shows, there is a positive, rather than a negative correlation with growth, suggesting that there is a different reason at play for the disconnect.

Figure 13. There is positive correlation between GDP and consumption



Source: Rosstat, Citi Research

Figure 14. It is investment and not consumption that is driving import



Source: Rosstat, Citi Research

**Struggling GDP is rather driven by collapsing investment spending.** In our view, the slowdown in GDP can be more usefully explained by the recent collapse of investment, which has seen a very fast deterioration in growth in 2013. As demonstrated by Figure 14, strong consumer growth is not well correlated with weakening import growth. It is struggling investment that is driving imports.

**In that sense, a moderating pace of retail lending (and consumer spending) should weaken rather than strengthen GDP and create more room for the CBR to cut rates.** If strong retail loan and consumer demand is associated with strong rather than weak GDP, then the expected moderation of loan growth, at least partly related to regulatory actions, should be negative for the pace of overall economic activity. This, in our view, could generate some headwinds for GDP, which could be counteracted by a more pronounced easing bias by the central bank in the next year.

**This will also be consistent with downward pressure on the RUB.** Implications for the currency are then also negative, as lower expected rates decrease RUB's attractiveness.



## Appendix A-1

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