RUSSIA: Economic losses manageable so far, but clouds on the horizon

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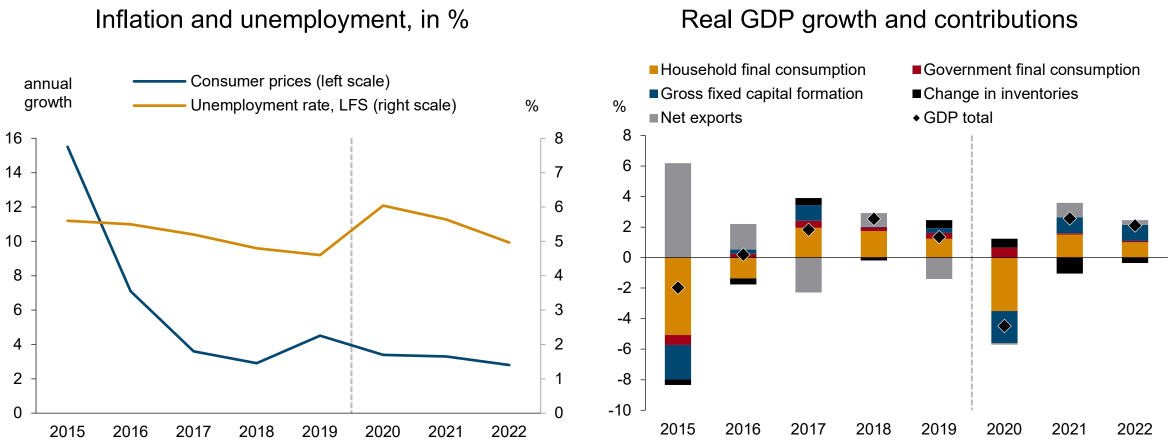
In the second quarter, the economy shrank by a relatively moderate 8%, and the subsequent rebound has been reasonably strong. However, a recent upsurge in new infections and the currency's weakening will dampen economic activity in the months to come. In the baseline scenario, GDP is expected to decline by 4.5% this year, with a moderate recovery of 2-2.5% per year projected for 2021-2022.

Figure 4.18 / Russia: Main macroeconomic indicators



Source: wiiw Annual Database incorporating national and Eurostat statistics, own calculation. Forecasts by wiiw.

Russia has been hit hard by the Coronavirus pandemic, and many Russian regions faced strict lockdowns during April-May. The number of new infections declined only slowly over the summer months and started rising again in September (to around 15,000 a day at the time of writing), which is above the levels recorded in spring. In response, some Coronavirus restrictions have been reimposed (notably in Moscow), and another strict lockdown cannot be ruled out, should the situation deteriorate further. Poor compliance by the population with the existing restrictions, such as social distancing rules and the wearing of masks, only increases the chances of a new lockdown.

…but the economic fallout has so far been relatively modest. In the second quarter, real GDP fell by 8% on a year-on-year (yoy) basis – rather moderate, given the circumstances. The main drags on growth were private consumption (-22.2%) and, to a lesser extent, gross fixed capital formation (-11.7%); meanwhile net exports contributed positively, thanks to a strong contraction in real imports (-22.2%). The relatively mild GDP decline, despite the very strong contraction in private consumption, is explained by the fact that the latter accounts for only half of Russian GDP[18] (its share has fallen still further, to 47%, during the crisis). The two

18 As of the second quarter of 2019.

sectors that have been especially hard hit by the pandemic – hospitality and catering (-57% in value-added terms in the second quarter) and culture and recreation (-28%) – each account for only 0.9% of GDP.[19] At the same time, trade – which is a much bigger sector – proved more resilient during the lockdown (-13%).

Private consumption has declined much more than real disposable incomes (which dropped by 8% in the second quarter yoy), suggesting a sharp rise in the propensity to save in the face of lockdown and uncertainty. As is often the case in Russia, the negative demand shock has primarily been absorbed by falling wages[20] and incomes, while the increase in unemployment has been relatively modest – from 4.7% before the pandemic to 6.4% in August, according to LFS methodology. However, given the widespread incidence of short-time work and unpaid leave, unemployment is likely to climb, especially once the many government support measures expire (for more on that, see below).

The decline in investments has been almost entirely confined to the small-business segment. According to estimates, fixed investment outlays by small businesses plunged by 36% in the second quarter (yoy), while those of medium-sized and large companies remained nearly unchanged (-0.4%), probably due to inertia in corporate decision-making. Therefore, in the remainder of the year the investment dynamics is likely to change for the worse, particularly given the high degree of uncertainty and the reduced levels of capacity utilisation.

High-frequency data present a picture of a reasonably strong economic rebound during the summer months, albeit weakening recently. In June-July, retail trade turnover and paid services to households picked up by a cumulated 20% (compared to May), although on an annual basis both remained in negative territory. However, in August retail trade turnover went negative again (-1.5% month on month (mom)), potentially suggesting that the one-off effect of delayed consumer demand is now exhausted. The recovery in industrial production lost pace as well: after healthy growth in July and August (on a monthly basis), both extraction industry and manufacturing production turned negative in September (-0.6% and -0.3% mom, respectively). On an annual basis, overall industrial production in September remained in deep red (-5%).

Macroeconomic policy has been relaxed markedly in response to the crisis, especially on the monetary side. The policy rate has been slashed by a total of 175 basis points since the start of the year, to 4.25% (although, unlike in most other CESEE countries, it is still positive in real terms). As a result, the volume of credit to the real economy picked up by nearly 12% in the first eight months (although non-performing loans have been on the rise as well). Particularly popular has been the programme of subsidised mortgages at an interest rate of 6.5%. However, in the face of supply-side constraints, this has primarily translated into booming housing prices, rather than increased construction, so that the effect of monetary easing policies has not been very significant.

In contrast, the fiscal stimulus has been relatively modest, despite ample fiscal space: the public debt amounts to only 12% of GDP, while the National Welfare Fund (NWF) likewise accounts for some 12% of GDP. The latest government plan envisages supporting measures of overall 6% of GDP in 2020-2021. However, it also includes items that had already been earmarked, such as infrastructure

[19] As of the second quarter of 2019.

[20] According to official statistics, real wages *grew* by 4.3% in the first half of 2020. But this does not square with anecdotal evidence and the sharp decline in personal income tax collection, and raises doubts over the validity of the statistical methodology under the conditions of a lockdown and various government support measures.

projects. In addition, two thirds of this fiscal package have already been spent this year. Government measures have targeted households (50% higher unemployment benefit, extra child benefit and credit holidays in the event of a steep loss of income), businesses (salary subsidies, subsidised salary credits, tax holidays and a moratorium on bankruptcies) and especially SMEs (credit holidays, delayed rent payments and lower social security contributions). However, many of these measures expired before 1 October and have not been prolonged – despite the fresh upsurge in Coronavirus cases.

For 2021-2023, the budget adopted by the parliament in the first reading envisages a moderate fiscal consolidation of around 0.9 pp of GDP (compared to 2020); of this, revenue-side measures account for 0.6 pp. These include higher corporate taxes in the oil industry, increased mineral extraction taxes on metals and chemicals, a tax on interest from bank deposits over RUB 1 million (some USD 13,000), and a hike in the excise tax on tobacco (from 4 to 20%). Besides, the 13% flat personal income tax, which has been in place for the past two decades, will be scrapped starting from 2021, with a tax rate of 15% on annual incomes over RUB 5 million (some USD 60,000). Although the move is rather symbolic, it does represent a step in the right direction in the current economic environment, which is different from that of the early 2000s (and is characterised by a generally smaller degree of tax evasion), and will contribute, even if marginally, to a reduction in the high level of income inequality in Russia. On the expenditure side, the deadline for many of the so-called 'national projects' – flagship government programmes aimed at raising living standards and making Russia the world's fifth biggest economy by 2024 – has been pushed back to 2030, and the respective allocations for 2021-2023 have been cut accordingly, particularly for the environment and digitalisation.

External balances have deteriorated strongly, mostly on account of the oil price shock. In the first nine months of 2020, the trade surplus nearly halved, and the current account surplus more than halved in US dollar terms compared to the same period last year. Nominal exports of crude oil, oil products and natural gas plummeted by 41%, 32% and 48%, respectively, on account of weak demand, low prices and later oil production cuts within the framework of the OPEC+ deal. At the same time, income from foreign investments declined by 38% and travelling abroad by 73%, as the borders were effectively closed. Both of those factors have helped keep the current account in positive territory. By contrast, the contraction of goods imports was much more modest (-7%), despite rouble depreciation.

The short-term prospects are clouded by the recent upsurge in new Coronavirus cases and by the recent weakening of the rouble. The second wave of the pandemic will weigh on consumer and investment demand even in the absence of a full-fledged lockdown. As for the rouble, there was an initial slump in the early stages of the pandemic, and since July the depreciation has resumed – a trend that has been reinforced by the risk of new western sanctions following the alleged poisoning of opposition politician Alexei Navalny and the (albeit lukewarm) Russian support for the embattled Belarusian President Alexander Lukashenko. All in all, since the beginning of the year the rouble has depreciated by about 20% in nominal terms against the US dollar – the third-worst currency performance among emerging markets so far.

According to the baseline scenario, we project a real GDP decline of 4.5% for 2020, followed by a modest recovery of 2.5% next year and 2.1% in 2022. This scenario assumes no further strict lockdown and the availability of an effective vaccine against COVID-19 by mid-2021 at the latest (the merits of the existing Russian vaccine 'Sputnik V' are currently disputed). Besides, the projection is based on a further relaxation of oil production quotas under the OPEC+ agreement (reflecting a gradual pick-up in demand) and a gradual recovery of the oil price substantially above USD 42.4 per barrel – the ‘break-even’ price required to balance the Russian budget in ‘normal times’. However, these times are not normal, and the budget will remain in deficit over the forecast horizon (albeit diminishing over time), regardless of the oil price, mostly on account of Coronavirus-related expenditure. These deficits will be mainly financed by borrowing without tapping the NWF, resulting in a moderate increase in the public debt-to-GDP ratio. Even in this rather favourable scenario, growth will remain moderate in the years to come, reflecting the long-standing (above all institutional) structural bottlenecks. The risks to the above forecast are primarily on the downside and will materialise if the second wave of the pandemic prompts further lockdowns and if the oil price declines markedly from current levels in the face of global weakness.

Table 4.18 / Russia: Selected economic indicators

	2017	2018	2019 1)	2020 1Q	2020 2Q	2020 1-2Q	2020	2021 Forecast	2022
Population, th pers., average	146,842	146,831	146,765	146,711	146,602	146,640	146,660	146,600	146,600
Gross domestic product, RUB bn, nom.	91,843	104,630	110,046	25,318	23,288	48,606	105,100	112,100	119,000
annual change in % (real)	1.8	2.5	1.3	1.6	-8.0	-3.4	-4.5	2.5	2.1
GDP/capita (EUR at PPP)	17,840	19,630	19,540	.	.	.	.	.	.
Consumption of households, RUB bn, nom.	48,178	51,363	55,020	13,491	10,756	24,248	.	.	.
annual change in % (real)	3.7	3.3	2.5	3.3	-22.2	-9.8	-7.0	3.0	2.0
Gross fixed capital form., RUB bn, nom.	20,189	21,293	23,114	3,887	4,630	8,517	.	.	.
annual change in % (real)	4.7	0.2	1.5	1.8	-11.7	-6.1	-10.0	5.0	5.0
Gross industrial production 2)									
annual change in % (real)	2.1	3.5	3.3	2.9	-6.5	-1.9	-3.5	3.0	3.5
Gross agricultural production									
annual change in % (real)	2.9	-0.2	4.3	3.0	3.1	3.0	.	.	.
Construction output									
annual change in % (real)	-1.2	5.3	0.6	1.1	-1.8	-0.5	.	.	.
Employed persons, LFS, th, average 3)	72,142	72,532	71,933	71,289	70,112	70,700	70,000	70,300	70,800
annual change in %	-0.3	0.3	-0.8	-0.2	-2.1	-1.1	-2.7	0.4	0.7
Unemployed persons, LFS, th, average 3)	3,967	3,658	3,465	3,464	4,468	3,966	4,500	4,200	3,700
Unemployment rate, LFS, in %, average 3)	5.2	4.8	4.6	4.7	6.0	5.4	6.0	5.6	5.0
Reg. unemployment rate, in %, eop 4)	1.0	0.9	0.9	1.0	3.7	3.7	.	.	.
Average monthly gross wages, RUB	39,167	43,724	47,867	48,293	50,725	49,509	51,000	54,800	58,600
annual change in % (real, gross)	2.9	8.5	4.8	7.4	1.5	4.3	3.0	4.0	4.0
Consumer prices, % p.a.	3.6	2.9	4.5	2.5	3.2	2.8	3.4	3.3	2.8
Producer prices in industry, % p.a. 5)	7.7	12.1	2.0	-2.4	-12.1	-7.3	-7.0	5.0	4.5
General governm.budget, nat.def., % of GDP									
Revenues	33.8	35.7	35.5	36.4	37.2	36.8	36.0	36.6	36.6
Expenditures	35.3	32.8	33.6	34.0	43.5	38.5	41.0	40.1	39.1
Deficit (-) / surplus (+)	-1.5	2.9	1.9	2.5	-6.3	-1.7	-5.0	-3.5	-2.5
General gov.gross debt, nat.def., % of GDP	12.6	12.0	12.3	13.8	14.0	14.0	16.0	19.0	20.0
Stock of loans of non-fin.private sector, % p.a.	3.5	13.9	6.5	11.6	8.9	8.9	.	.	.
Non-performing loans (NPL), in %, eop 6)	5.2	4.7	5.4	5.3	5.4	5.4	.	.	.
Central bank policy rate, % p.a., eop 7)	7.75	7.75	6.25	6.00	4.50	4.50	4.25	4.00	3.75
Current account, EUR mn 8)	28,504	98,142	58,335	20,043	-459	19,607	15,700	33,900	33,500
Current account, % of GDP	2.0	6.9	3.8	5.8	-0.2	3.1	1.2	2.4	2.3
Exports of goods, BOP, EUR mn 8)	312,636	376,612	374,854	80,345	62,993	143,364	261,500	290,300	307,700
annual change in %	22.9	20.5	-0.5	-11.0	-30.2	-20.6	-30.2	11.0	6.0
Imports of goods, BOP, EUR mn 8)	211,161	211,127	227,313	50,977	49,057	100,040	198,800	206,900	217,200
annual change in %	22.1	0.0	7.7	4.1	-11.1	-3.9	-12.5	4.1	5.0
Exports of services, BOP, EUR mn 8)	50,970	54,845	56,057	12,212	8,879	21,096	37,500	40,800	42,900
annual change in %	11.5	7.6	2.2	0.6	-36.7	-19.3	-33.1	8.8	5.1
Imports of services, BOP, EUR mn 8)	78,716	80,366	88,389	18,380	10,986	29,375	52,100	56,800	60,800
annual change in %	16.9	2.1	10.0	5.6	-50.1	-25.4	-41.1	9.0	7.0
FDI liabilities, EUR mn 8)	25,296	7,453	28,548	-3,454	5,580	2,117	7,000	.	.
FDI assets, EUR mn 8)	32,559	26,620	19,574	516	4,182	4,695	11,400	.	.
Gross reserves of NB excl. gold, EUR mn 8)9)	297,823	333,617	396,378	402,206	389,476	389,476	.	.	.
Gross external debt, EUR mn 8)	433,606	397,860	438,727	413,376	428,140	428,140	435,800	434,400	416,500
Gross external debt, % of GDP	31.1	28.1	28.9	32.3	33.4	33.4	34.0	31.0	28.0
Average exchange rate RUB/EUR	65.87	73.87	72.51	73.11	79.64	76.38	82.0	80.0	80.0

Note: Including Crimean Federal District.

1) Preliminary. - 2) Excluding small enterprises. - 3) From 2018 population 15+, population 15-72 before. - 4) In % of labour force (LFS). - 5) Domestic output prices. - 6) According to Russian Accounting Standards overdue debt is defined as debt service overdue, therefore the data are not fully comparable with other countries. - 7) One-week repo rate. - 8) Converted from USD. - 9) Including part of resources of the Reserve Fund (in 2017) and the National Wealth Fund of the Russian Federation.

Source: wiiw Databases incorporating national statistics. Forecasts by wiiw.