The 2021 Russia Budget – Economic Numbers
Tough to predict the rouble but all the inputs you need!

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Executive summary:
What you need to know for your 2021 budget (1)

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- Your 2021 budget planning faces the greatest uncertainty in 50 years.
- The rouble rate for 2021: The current consensus ($67-69 to $) may be too upbeat.
- Executives do not want to get caught in a 2021 budget trap forecasting a too strong rouble.
- A range of 71-74 to $ and 81-85 to Euro is sensible given current drivers and outlook.
- There are some big imponderables for sanctions: Navalny, Belarus, US elections.
- GDP will sink this year by -5.3% and then rise in 2021 by 3.6%.
- The outlook in 2022-25 is not exciting with GDP growth averaging per annum in a range of 1.6% to 2.2%.
- We presume an average Brent oil price in 2020 at $38-43 and at $48-54 in 2021 rising towards year-end in both years.
- Inflation is under control: after an average of 3-4% in 2019 and 2020, we anticipate much the same in 2021 with average 3.8%.
- Producer prices (input costs) were flat/negative in 2020 and will be flat or soft in 2021 (0% to +5%).
- The key central interest rate is 4.25% at start of September and will fall to 4.0% later in 2020.
- In 2021 we expect the key rate to stay low at just above inflation. So, around 4.0% to 4.25%.
- The budget balance was positive +1.2% in 2019 and fell to -4.5% this year and will stay around -2.1% in 2021.

Executive summary:
What you need to know for your 2021 budget (2)

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- The social/medical and fiscal response from the Russian government has been mixed at best. Fiscal expansion kicked more only June.
- The National Projects have been extended from 2024 to 2030 with less expenditure per annum and some projects pushed back.
- The consumer sector (and globally) is recovering better than industrial and investment.
- All indicators slump in 2020 but household and retail spending pop back up in 2021 both by about +3.5%.
- Industry grows by 3.8% in 2021 and investment will be up by +5.0%.
- Real wages after inflation will sink in late 2020 but then average +3.2% in 2021. Currently public sector pay is out-performing private sector. .
- Official unemployment will be about 6.6% in December and through 2021 with unofficial numbers close to 8-9%.
- 10mn Russians obtain the majority of their income from the informal economy.
- Russians will spend $20bn less on foreign holidays in 2020 and $10bn in 2021.
- Mortgagees have host up this year (+12%) thanks to government support which may shrink back in 2021.
- More Russians see the attractions of returns from the stock markets (but may be under-valuing the risks).

Global overview – the figures

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New economic scenarios 2020/2021 - real GDP growth global and regions and markets

	Pre-crisis	Current scenario	Worst case	2021
Global	3.1%	-4.0%	-4.5%	5.4%
Developed markets	1.7%	-6.2%	-8.0%	4.6%
Emerging markets	3.9%	-1.8%	-3.5%	6.0%
USA	1.9%	-5.0%	-5.8%	4.5%
China	5.9%	2.0%	-1.0%	7.8%
Eurozone	1.1%	-8.0%	-9.3%	5.9%
Germany	1.2%	-6.8%	-9.0%	4.8%
United Kingdom	1.2%	-8.5%	-10.5%	5.9%
Russia	1.9%	-5.3%	-6.5%	3.6%
CEE region (excl. Russia)	2.9%	-5.1%	-6.0%	5.0%
South Africa	0.7%	-7.0%	-8.4%	3.5%
Brazil	1.4%	-6.4%	-6.9%	3.7%

Source: DT-Global Business Consulting

Russia – economic scenarios and outlook (1)

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The new Russia economic and currency outlook 2020 and 2021

	Pre-crisis 2020 forecast	Current trend 2020	2021
GDP	1.9%	-5.3%	3.6%
Inflation (average)	3.5%	3.6%	3.8%
Budget deficit	1.2%	-4.5%	-2.1%
Current account	2.5%	-0.5%	-0.5%
Rouble to USD (average)	63-65	71-73	71-74
Rouble to EUR (average)	71-74	79-82	81-85
FX reserves in USDbn (end-year)	575	560	580
Household spending	2.4%	-6.0%	3.5%
Real wages	2.8%	-4.0%	3.2%
Retail sales	2.3%	-5.1%	3.4%
Official unemployment (annual average)	4.8%	6.8%	6.0%
Industrial output	2.7%	-5.9%	3.8%
Fixed investment	3.0%	-9.1%	5.0%

Source: DT-Global Business Consulting

Russia – economic scenarios and outlook (2)

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Nr.	Indicator	2018 FY	2019 FY	2020 FY	2021 FY	2020 Jan	2020 Feb	2020 Mar	2020 Apr	2020 May	2020 Jun	2020 Jul	2020 Aug
1	Real GDP	2.5	1.3	-5.3	3.8	n/a	n/a	1.6	-12.0	-11.0	-6.4	-4.7	n/a
2	Consumer price inflation	4.3	4.5	4.4	3.8	2.4	2.3	2.5	3.1	3.0	3.2	3.4	n/a
4	Retails sales year on year	2.8	1.6	-9.2	3.2	2.7	4.6	5.6	-23.4	-19.2	-7.7	-2.6	n/a
5	Consumer confidence (quarterly)	-10.0	-14.0	-25.0	-12.0	n/a	n/a	-11.0	n/a	n/a	-30.0	n/a	n/a
6	Household spending	3.3	2.6	-7.5	3.5	3.2	4.7	5.8	-26.0	-24.0	-14.0	-8.0	n/a
7	Real wages after inflation	6.9	2.3	-5.0	2.8	6.5	5.7	5.9	-2.0	1.0	0.6	-1.0	n/a
8	Unemployment (official)	4.8	4.7	7.5	6.0	4.7	4.6	4.7	5.8	6.1	6.2	6.3	n/a
9	Industrial production	2.9	2.7	-5.9	3.9	1.1	3.3	0.3	-6.6	-9.6	-9.4	-8.0	n/a
10	Construction	n/a	n/a	-4.0	3.8	1.0	2.3	0.1	-2.3	-3.1	-0.1	-0.2	n/a
11	Agricultural output	-0.8	4.0	3.8	3.0	2.9	3.1	3.0	3.1	3.2	3.0	4.0	n/a
11	Car registrations 000s	145	147	100	135	111	120	161	39	63	120	142	n/a
12	Business confidence	-6	-7	-12	-5	-3	-2	-2	-7	-9	-6	-5	-5
13	Manufacturing PMIs	50	47	40	49	47	48	47	31	36	49	48	n/a
14	Rouble to dollar end period or monthly	69	62	67	66	62	64	76	75	70	71	74	74
15	Rouble to Euro end period or monthly	79	69	87	85	71	74	88	79	77	80	87	88

The Rouble Budget FX rate for your 2021 Budget (1)

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- 2020 has already been a roller-coaster year for FX fluctuations and dollar rouble has gone almost quarterly: 61 to 79 to 68 to 74.
- I think the current consensus for 2021 is to optimistic on the rouble and will need to change.
- The consensus for $-rouble in 2021 is 67-69 and presuming a Euro-$ rate of 1.18 in 2021 then Euro-rouble would be 78-82.
- I feel this is a little strong and opt for a softer version for the rouble in 2021.
- While this consensus view is as recent as mid-August, it seems a little behind the times.
- But we all realise that we are looking for an average FX rate for 20201 and not trying to guess the figure next week or this autumn.
- The rouble is affected by the Euro-dollar trends and more so now.
- For the rest of 2020 much depends on the US election result: if Trump wins the dollar will stay soft at current levels or even weaker at 1.23 and 1.25 to the Euro; if Biden wins, then the $ can strengthen to 1.13/1.15 range.
- So until November we presume the Euro will stay strong about 82-86 to rouble.
- BUT your corporate budget rate is for 2021.

(continued on next slide)

The Rouble Budget FX rate for your 2021 Budget (2)

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- We think the consensus will trend to a slightly weaker rouble and **executives do not want to get caught in a 2021 budget trap forecasting a too strong rouble.**
- **Therefore I think a range of 71-74 to $ and 81-85 to Euro is sensible given current drivers and outlook** (see details in next slides).
- With Euro-dollar at about 1.17.
- There is tremendous uncertainty regarding global business scenarios depending on how the Virus dynamics pan out in the next 6-12 months.
- So uncertainty provisos are probably higher than any time in the last 50 years and HQ needs to know that.

Some special rouble risks to consider

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1. Today, 2 September, the Russian rouble fell 2-3% on the Euro and dollar on the news of the Novichok poisoning of Navalny (confirmed by German authorities).
   - The FX fear is that this develops into new US and European sanctions on Russia.
   - The crisis could abate or deteriorate. Risk is elevated.

2. Social media in the US reports Russian interference on websites to interfere with the US elections. This could spiral into renewed sanctions.

3. **But the BIG risk to monitor in September and autumn is political unravelling in Belarus**. This is the BIG risk. In a worst case, Russia gets embroiled in supporting Lukashenko with overt or covert security troops, the US imposes stringent new sanctions and is accompanied by the EU with new sanctions against Belarus and Russia and the rouble loses 5-15%+. This is not yet a central scenario but is a rising risk if participants "mis-play their hands". It would also have long-term negative consequences for inflation, consumption and FDI. One presumes that the Russian authorities will not go this route out of economic self-interest. But Crimea and more especially eastern Ukraine testifies that imagined geo-political interest can out-weigh rational economic ones.

What are the drivers behind estimated FX rate? (1)

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The oil price is up but the rouble is not. Why?

On 31 August Brent oil was at $46.0 while the rouble dollar rate was 74.3, the Euro rouble rate sat at 88.5 and the euro-dollar rate at 1.20.

The rouble is wobbling a little against the dollar (but well within our estimated band) but is worse against the euro. Why?

1. **The BIG reason** is that, as we predicted, the Russian Central Bank has reduced its protection of the currency. "Protective sales" of dollars and Euros fell from $4.8bn in April to just $0.9bn in August. As long as the oil price stays steady around $44+, then Bank protection will stay limited and the rouble will vary on other financial and political factors.

   Russian Central Bank FX sales to protect the rouble:

March	$1.1bn
April	$4.8bn
May	$2.7bn
June	$2.9bn
July	$1.8bn
August	$0.9bn

What are the drivers behind estimated FX rate? (2)

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1. It's the Euro that is getting stronger, not the rouble falling!! The Euro has appreciated in recent weeks/months from 1.12 to the US dollar to 1.20. Thus, the rouble is moderate against the dollar but struggling versus the Euro.
2. The Euro strengthened because of rising political and medical risk in the US and thanks to the announcement of the new pan-European aid program end July. However, it is likely that some of this Euro optimism proves short-lived and thus the Euro could lose at least some of its recent gains.
3. "Trend rates" suggest the rouble is currently 4 percentage points too low.
4. In late August there is some rising political risk with the Navalny poisoning and recent mini-sanctions imposed by the US.
5. Summer is the high season for foreign dividend payments and these spike to $13bn in July compared with $2bn in May.
6. The real yield on the rouble (after inflation) was as strong as 3 percentage points 2-3 months ago but as interest rates fall and inflation creeps up the yield has fallen from 3 points to about 1.2 points with the key interest rate at 4.25% in July-August and inflation at 3.4% in July.
7. Foreign portfolio investment into Russian government bonds has been close to flat since June.
8. Net capital outflow recorded (so-called capital flight) rose to $6bn in July and is running at about $35bn to end July which is a bit higher than the last couple of years.
9. The announcement of the Russian anti-Covid vaccine "Sputnik" had no impact at all on the markets… which speaks volumes about the assessment.

What are the drivers behind estimated FX rate? (3)

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10. We repeat this point because it alludes to the really big risk out there. In September watch out for any political unravelling in Belarus. This is BIG risk. In a worst case, Russia gets embroiled in supporting Lukashenko with overt or covert security troops, the US imposes stringent new sanctions and is accompanied by the EU with new sanctions against Belarus and Russia and the rouble loses 5-12%+. This is not quite yet a central scenario but a rising risk if participants "mis-play their hands". It would also have long-term negative consequences for inflation, consumption and FDI. One presumes that the Russian authorities will not go this route out of self-interest. But Crimea and more especially eastern Ukraine testifies that imagined geo-political interest can out-weigh rational economic ones.

Some good news does remain

- The consensus is that some Central Bank rouble-supportive sales will continue in Q4. This is very important.
- As we expected, in reverse the rouble is unlikely to strengthen to 65 to the dollar because the Russian Central Bank would cut its protection off the rouble to prevent over-strengthening.
- Russian citizens continue to hold 66% of savings in roubles.
- **And foreign travel by Russians could be down 40-50% this year: normally foreign travel takes $40bn out of the country.**

What are the drivers behind estimated FX rate? (4)

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- **This year we think this will be down by half and so $20bn will stick at home which means much fewer roubles spent abroad which could help the rouble by about 2%.**
- FX reserves ($562bn in July 2020) were the fourth highest in the world.
- The current account surplus was still solid at $23.5 bn last year although oil cuts will bring this down to about $15bn in 2020: still fine.
- Public debt is still very small at 18% of GDP in 2020.
- This isn't meant to be a whitewash of the rouble and risks prevail, but whenever things get too scary, the Central Bank is likely to step in.
- The good news is that the Russian Central Bank is a competent, professional and independent organisation and out-performs its counterparts in many other markets including for example Turkey.

Comparing the rouble with other emerging market currencies (1)

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Rouble tables comparison with other emerging market currencies

- Other EM currencies suffer and I think the rouble is in better shape than the Turkish lira and the Russian Central Bank is professional and capable. Sadly for us, they have relatively little interest (maybe a little, little) in the FX concerns of western investors!! ☹
- The recent rouble softening does not damage the currency much in international comparisons.

Versus the euro, the rouble on 1 September is:

Down only -11% on January 2019
Down -27.5% on 8 January 2020
Down -3.5% on 21 March 2020

Versus the euro on 8 January 2020 compared to 1 September 2020:

The rouble is down	-27.5%
The Mexican peso down	-25.7%
The South African rand down	-27.0%
The Turkish lira down	-34.5%
The Brazilian real down	-45.4%

Comparing the rouble with other emerging market currencies (2)

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The trend is similar with the US dollar compared with 8 January and 1 September:

Rouble -19.9% *(but the rouble is +8% stronger than its 21 March figure! When the rouble was weak against the dollar and Euro)*
Mexican peso: -16.0%
Turkish lira: -25.0%
S. African rand: -18.0%
Brazilian real: -34.9%

- Given the oil price has collapsed 35%, GDP will be down by -5% and there is a global pandemic, the rouble has performed fairly well!

A few factors and imponderables to confuse the FX picture for you! ☺ (1)

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- The rouble is currently fluctuating because of the key factor: the Russian Central Bank is quite relaxed with current FX rates.
- Until end January this year the Bank had spent 3 years selling roubles to stop the rouble getting too strong. In February it introduced two programs to protect the rouble by selling dollars and Euros. The Bank decided in July that it had done enough protection and eased off into neutral.
- The rouble therefore weakened especially as the Euro strengthened.
- However, one interesting trend: the rouble has almost touched 90 to the Euro on 3 occasions this year and each time it does not break through. My hunch is that the Central Bank is intervening here to keep the rouble better than 90 to the Euro.
- But if the Euro rises in the coming weeks unstoppably against the dollar (say to 1.25 or 1.30), the Russian Central Bank may well decide to save its fire-power and let the rouble go to 93-95-98 to the Euro. Also do bear in mind that if a constitutional crisis blows up in the US on 3 November with Trump refusing to accept the election result, the dollar could slump for many weeks pushing the Euro up.
- If global confidence wobbles in late autumn on US political uncertainty, constitutional crisis or Trump re-election, then the dollar could stay low and the Euro strong.
- Alternatively we could have a better outlook at the turn of the year: the virus developments are not too bad over the winter and Biden is elected without turmoil and the dollar picks up.

A few factors and imponderables to confuse the FX picture for you! ☺ (2)

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- There is also a possibility of 2021 being a year of two halves:
- 2021 starts badly with winter flu epidemics, a steady virus, less social mobility, weaker confidence and a lower oil price and emerging market currencies and the rouble come under more pressure.
- But this is then followed by the arrival in May of a proper vaccine and global confidence shoots up at least temporarily; the oil price jumps, the dollar rallies and the Euro falls and the rouble is given a positive injection.
- We stick with our estimates for rouble FX in 2021.

How does 2020 compare with previous crises?

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- If the rouble today matched the trend after 1998, then it would be trading about 250 to the dollar! The 2020 crisis is a different one! It is global whereas 1998 and 2014-15 were more specific Russia crises. At least MDs based in Moscow don't get asked again by global HQ: "What's wrong with Russia?"
- This crisis is different in that we have national lockdowns which will impact consumption in different/worse ways. This crisis is much more time-defined: lockdowns will finish eventually (unless the virus revives) and there will be a major market and psychological rally when a vaccine is found and distributed in spring-summer 2021 (perhaps?).
- The consensus is for 3.6% GDP growth in 2021 (with some upside) compared with -5.3% this year 2020.
- In the interim (until a vaccine), consumption and economic behaviour globally and in Russia will be peculiar and weird: sitting in restaurants wearing masks? But readjusting could be quicker.
- The likely GDP fall this year is about -5.3% and compared with -5% in 1998, -7% in 2009 and -2.3% in 2015, this crisis is about "par for the course".
- Government counter-crisis measures are so far limited (see the new program on the slides below) and will have relatively little boost impact compared with other countries.
- But 2020 is much better in that inflation is subdued (see slides below) at 4-5% range rather than 15% in 2015 and 84% in 1998!! This has a <u>relatively</u> positive impact on confidence and consumption.
- And again, the rouble is in (much) better shape than in previous crises. The authorities have learned lessons and rouble support is so far effective. The rouble in this crisis is down about 15-18% on its 2-3 year average compared with a fall of 300% in 1998.
- But short-term informal unemployment is going to be (temporarily) high. The employment outlook in 2021 is weak and nominal and real wages will be negative this year but then grow by 3% in 2021.

GDP and economic trends (1)

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- The not so good news is 1) Russia has not coped well with the social/medical aspects of the virus crisis and is perceived as 3-5 weeks “behind” most European nations and 2) the level of fiscal stimulus (at least until the new June package) has been small at 2-3% of GDP when other European governments have dedicated 4-10% of GDP. There is always the question of using the funds efficiently and that applies to all countries.
- There is some growing concern that a second wave on a national or regional level could return as it has done in some Balkan countries and Australia etc. The medical outlook in the US remains bleak.
- We presume a central scenario of a global-Russian economic recovery starting in Q3 and then running through 2021 before we reach pre-crisis levels of output in December 2021 to March 2022.
- This is the consensus with risk either side, up or down.
- Unemployment* is improving quite well in some markets as the service sector unlocks, Chinese manufacturing is back at 95% of pre-crisis levels, Chinese hotels are 75% full, European unlocking and open travel with neighbours is starting, the stock markets are surging (too much?), the oil price is over $40.
- (* Official unemployment numbers globally and in Russia fail to capture the hit that is taken in the informal economy. Unemployment could rise again in autumn/winter as various government support programs unwind.)

GDP and economic trends (2)

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- All this has potential to help Russia at the margins.
- But the downside is the limited virus resurgence which recurred in several countries in mid-summer and the more disturbing trends in the US. There are concerns that lax compliance of social distancing and few mask wearers in the metro could facilitate a second wave in Russia.
- More executives question how much they should open their Moscow offices.
- At the start of September daily new cases in Russia are stubborn at close to 5,000 and few people have confidence in the methodology of the mortality calculations and believe that they underrepresent the real number.
- The Russian Sputnik vaccine has generated a lot of concern. Anecdotally I know of many doctors and nurses who will refuse to take it.
- Central Bank Governor Nabiullina estimates that GDP will fall in a range of -4.0% to -5.5% and former Finance Minister Alexey Kudrin expects -5% and we estimate -5.3% and the IMF plumps for -5.5%. In late August the Ministry of Economic Development opted for an upbeat estimate of -3.9% in 2020. The consensus is then that a recovery of +3.4% will take place in 2021.
- The 2020 result would be worse without the moderate rally in the oil price.
- First quarter corporate/business results in Russia were good or better (see our Business Report) followed by the major slump in April-May and June (see monthly table in this report).
- Estimates were that 33% of the economy was not functioning in March-April.

GDP and economic trends (3)

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- Economic numbers for the first half-year were a bit mixed and neither especially good or bad.
- Numbers were trending noticeably better already in June.
- Russia mirrors a key trend seen globally: the consumer side of the economy is recovering quicker than industry/investment/B2B and the latter is hit by less government spending, much smaller corporate investment, less global trade (down -10% to -15%) and a shrunken energy sector and the constraints of the OPEC+ deal to limit oil output.
- Automotive is also a weak link in russia as it is globally. But the numbers are not as bad as anticipated in this sector.
- We estimate that quarterly growth of GDP and all **quarterly** indicators (industry, household spending, retail, investment) will be negative probably through until December 2020 or through to February 2021.
- But some monthly indicators might get back to pre-Covid levels in Q3 or Q4: for example, car registrations (?), manufacturing PMIs while agriculture looks like remaining positive through the year and posted +4% in July.
- Annual GDP slumps this year and does not catch up entirely in 2021 and this is a global trend again.
- Russian GDP will get back to December 2019 levels in early 2022 again matching global trends.

GDP and economic trends (4)

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- After 1.3% GDP growth in 2019, before the virus we had anticipated 1.9% for 2020 as the National Projects and other government spending would boost the economy moderately.
- Instead, coronavirus and a still weak oil price lead the economy into recession with falling global growth and trade along with the spring shutdowns. Projects and investments globally and in Russia are postponed. Russia is inter-connected to the world and the first hits will be to investments in automotive and aerospace while at the same time the service sector in Russia including hotels, restaurants and leisure activities declined by -50% to -90% in the spring and early summer.
- We do not see a sharp, sustained V-shaped recovery in 2021-22 in Russia nor globally.
- But rather more of a Nike-Squoosh shape: down and then up for part of the time and then flat-lining. This means that Russian GDP will not be great but once again sufficient as in the past to sustain reasonable business levels for western companies.
- We then see the global economy returning to par of 3.2% from 2022 through 2025.
- **And in 2022-25 we see no reason why the Russian economy should get out of a sub-par growth trend of about 1.7% to 2.3% per annum. This is the bad news.**
- There is some possibility that the post-virus rally continues into 2022 and that year could post 2.5% to 3.3% growth.
- But most scenarios suggest a slow-moving relief rally from summer 2020 through 2021 with a short-lived big boom when/if a vaccine is announced.
- **The Russian economy will need until January-March 2022 to get back to its January 2020 level.**
- **The recovery in 2021 will not be strong enough to compensate for the level of decline in 2020.**

GDP and economic trends (5)
National Projects, revisions, spending plans

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- On 21 July President Putin signed off on a new “Decree on National Development Goals until 2030”.
- Essentially this plan will revise and extend the existing National Projects.
- The new detailed plan is to be prepared by 30 October. As with most over-arching plans, this one sets more general targets and gives a "feel” of government priorities.
- During the first half of 2020 spending on corporate economic activity grew 26%, +80% on non-pension social payments (including unemployment benefits and childcare support) while healthcare spending was up 109% and transfers to regional budgets were up 64%.
- After this stimulus, the share of government budget spending directed to household income rises from 56% in 2019 to 60% in 2020. Longer-term plans also seem to be shifting more to the social sphere.
- The National Projects which had a focus on infrastructure and investment have been pushed back in completion from 2024 to 2030.
- If this means relatively a little less spent on roads, then this may be no bad thing given that road construction often sees “fund diversion”.
- Some of the changes in plans include:
  - Russia no longer intends to aim for a slot in the 5 largest economies in the world this decade
  - This decade the annual real investment target is 5.4% instead of 6.0%
  - Annual non-energy exports growth of 5.4%
  - 25mn people employed in SMEs by 2030 and not by 2024
  - Halving the poverty rate by 2030 instead of 2024
  - 120mn sq. meters of new residential space by 2030 instead of 2024

GDP and economic trends (6)
Industry & investment

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- As government funds focus on the consumer sector, then industry and investment is relatively softer.
- Industry averaged 1.1% growth in Q1 before slumping to -6.6% in April and then deteriorating, as expected, to an average of -9.5% in the two months May-June before nudging better to -8.0% in July.
- Weaker oil volume under the OPEC deal will ensure lower industrial growth this year of -5.9% followed by a 3.8% rally in 2021.
- Investment will slump this year by -9.1% and then recover by 5.0% next year. Much will depend on government decisions regarding the National Projects.
- The proportion of spending on the revised National Projects will define whether this year 2020 for B2B is just very bad or verges on disastrous. But B2B will be tough this year in any case.
- **Manufacturing** PMI numbers reflect the economic mood and picture: the April figure at 31 was the worst ever recorded. But the good news is that already in May, this recovered to 36 and then surged to 49 in June and steadied at 48 in July.
- The **service** PMI already collapsed in March to 37 from 52 (the biggest one month drop ever recorded) until the catastrophic figure of 12 in April which was the worst figure on record by a factor of 5. Again the good news is that this bounced back strongly in May to 36 and then also rallied to 47 in June.
- Car registrations similarly crashed to their 2006 level at 40,000 but rose to 60,000 in May and surged again in June to 120.000. The average monthly figure in recent years has been 135.000.
- Business sentiment declined this spring but perhaps not as badly as expected: in January the figure was seasonal -3, -2 in March, -7 in April and “only” -9 in May and back to -6 in June and recovering more to -4.7 by August.

GDP and economic trends (7)
Retail and consumers

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- Retail sales rose by 5.6% in March, the best monthly figure in 10 years, as people stock-piled.
- Inevitably with lock-down, the retail sector collapsed in April by a record -23.4%, **the worst monthly figure in 25 years.**
- But by June retail was only down by -7.7% (breakdown food -3.7% and non-food durables -11.3%).
- By July the fall in retail sales had slowed to -2.6% (compared with July 2019).
- By the mid-autumn, monthly retail spending should be turning positive followed 1-3 months later by household spending.
- And there may be some more light: as we mentioned last year, it is uncertain to what degree Russian statistics are capturing all the aspects on e-commerce spending. So the "real" figures could be better.
- As in other countries, the "foot fall" is rising and some outlets are seeing a return of more than 75-85% of pre-crisis levels. BUT spending is not returning as quickly, at least for more discretionary products.
- While we note that state support has been comparatively limited, it has had positive effects in stemming the fall in household and retail spending:
- Federal budget spending in the first half of 2020 (year on year) includes an 80% rise in non-pension social payments (aimed at unemployment benefits and childcare support), 109% increase in healthcare expenses and a 64% rise in transfers to regional budgets.
- Such transfers mean that the share of spending on household income (through state sector salaries, pensions and other social benefits) in the consolidated budget will rise from a high level of 56% in 2019 to 60% in 2020.

GDP and economic trends (8)
Retail and consumers

RCIS RUSSIA-CIS Business Group

- Consumer spending will be soft as long as the virus is around, wages are low, credit is scarcer and employment is not secure.
- Russians are borrowing less and "saving for a rainy day". In June, new consumer loans were still growing by +12.6% but this was down on the +18% figure at end of Q1 2020. And the savings ratio has thus spiked: normally this is about 8-10% of GDP but in Q2 reached a record 23%+. The presumption is that the savings ratio will trend down to at least 12-15% as unlocking continues.
- Some premium products are doing well because less money is spent abroad, consumers are spending less on cars and they ought to be spending less on mortgages (but are not doing so for now).
- Travel restrictions play a role: each year Russians spend about $40bn on foreign travel. This year we estimate this will be down by -50% and so some $20bn will stay in the country (which should help the rouble).
- How will this "saved" money be used? Remains in bank accounts, spent on domestic holidays or products? In fact it seems that some of the saved money is being squirreled away in the stock market. With interest rates falling and raised taxes on bank deposits, Russian investors are dabbling in the stock market. More than 5.3mn individual Russians have brokerage accounts for the local stock market which is a rise of 1.5mn people since January!
- Retail investors accounted of 42% of trades in June compared with 34% one year before. The flows into private brokerage accounts rose to 65bn roubles in June up from 33bn roubles in April-May.
- This suggest that relatively wealthy Russians are transferring some funds into the stock market while Russians on more modest incomes or impoverished ones have to spend any income immediately on basics.

GDP and economic trends (9) mortgages

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- The mortgage trend has been a surprise – less consumer spending should have meant less mortgage spending. But a few factors have changed this:
- The return on savings is low and falling (as globally) and the deposit rate is falling with the key rate at 4.25% and set to go lower.
- The average mortgage rate this year has fallen from 10.5% to 7.4%.
- Thanks to low borrowing cost and government programs, mortgages actually rose a solid +12% in 2020 to August. In June alone mortgages were up by +28% on June 2019.
- Some 40% of mortgages are government supported with the rate capped at 6.5% on new homes to value of 12mn roubles.
- More than 80,000 mortgage have been approved under the scheme to end July.
- This expenditure on mortgages means that consumers will have less discretional spending left for other consumer products.
- Most of these mortgages are intended for people to leave in their new homes and there is much less buying to rent activity. So these people who chose not to invest to rent will retain discretional income.
- But if deposit rates stay low, there will be a growing appeal and appetite as in the UK and elsewhere to buy to rent.
- The big question is that the government support scheme for mortgages stops in October. If it does so, a lot of air will be taken from the market. People will spend less on mortgages and have relatively more to spend on other items. But if the program is extended, then the mortgage rally/boom will continue a bit longer.

The (un)employment and income picture (1)

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	Mar 2020	Jul 2020	Dec 2020 (estimate)
Unemployment rate (official)	4.7%	6.3%	6.6%
Unemployment rate (incl. **unofficial** estimate)	5.2%	8.8%	9.0%
Employed people official (mn)	71.4	70.0	66.5
Growth of real wages after inflation	+5.9%	-1.0%	-3.8%

Wage figures (summer 2020) are monthly in roubles:

- Minimum wage roubles 12,100
- Average wage manufacturing 47,200
- Average national wage 43,000
- Wages low skilled 19,900
- Retirement age men years 60.5+
- Retirement age women years 55.5+

The (un)employment and income picture (2)

RCIS RUSSIA-CIS Business Group

- As our table above shows millions will lose their jobs this year.
- The unemployment numbers follow global trends: they are bad but not as terrible as expected.
- But we will see what shape the unemployment situation is in late autumn as government support schemes run out and all companies take tough decisions based on their Q3 and Q4 results and expectations.
- Workers in the big state, para-state organisations will be best protected.
- But the official numbers do not capture those in the informal economy: **it is estimated that 10 mn Russians obtain the majority of their income from the informal economy.**
- And its they who have felt the full force of the slowdown. And an extra 2-3mn people could be "hidden unemployed" or on short hours and lower pay.
- The crisis also affects millions of workers from the CIS states who will send back fewer remittances and may start returning to their mother countries (perhaps not yet).
- Many low-paid and black economy workers are leaving Moscow to return to their homes in the regions: they can't afford their Moscow rent, so go back home to live with family. They may return or not.
- In SMEs many workers are also already paid "informally".
- Anecdotes suggest that 15-20% of SMEs will not survive and go bankrupt (and by end of May, the number of SMEs had indeed shrunk by -21%).
- Yes, newcomers/start ups will appear later but turmoil and uncertainty look certain. **As in other countries, once government income-support schemes run out, then companies could sack more people and this could see unemployment pop up in the autumn.**

The (un)employment and income picture (3)

RCIS RUSSIA-CIS Business Group

- During 2012-2019, some 65% of Russians had no effective savings according to the respected Levada Centre for polling.
- Among those with savings, the average is 180,000 roubles ($2,400 in April 2020) but the median average savings level among poor income households is a mere 25,000 roubles or $330.
- Many Russians struggle after a mere 3-6 weeks without direct, quick income support (cash in pocket or bank account).
- Product affordability will be key.
- Consumer behavior will change and probably in significant ways: price sensitive, on-line purchases and products for home consumption. But this is also a global trend.
- All the more so when we realise that the average national monthly wage per capita is 43,000 rubles.
- And the average Russian family needs 58,000 roubles to pay for basic necessities and hence why more than one member of household needs to work.
- Recent opinion polls conducted in early 2020 suggest that Russians think that an acceptable/average monthly salary needs to be 50,000 roubles in Siberia and 100,000 roubles in Moscow.
- The average, national rental cost is 11,000 to 15,000 roubles.
- Consumer confidence slumped to -30 at end of June and this is not surprising. This number is about the same as in 2015 but better than in 1998.
- Household spending will fall -6.0% this year after 2.5% growth in 2019 and then partially recover by 3.5% next year.

The (un)employment and income picture (4)

RCIS RUSSIA-CIS Business Group

- Real wages (after inflation) had recovered in 2019 and were hovering at 5-6% growth at the start of 2020, a very decent number.
- But real wages will slump on shorter hours and lower nominal pay and deferred payments.
- We presume nominal wages rising this year at best by 1% or more likely at zero/negative and with inflation about 3-4%, then real wages will finish the year by about -4%.
- However, there is a growing divide between the public and the private sector. Those working in state and para-state companies see more support for their incomes.
- Though the summer real wages after inflation have diverged: In May real wages in the public sector were up by +8% (after inflation of about 3% this means nominal wages were about 11.3%).
- But real wages in the private sector were down by -0.9% meaning that nominal wages were up 2.1%.
- This trend was continued through June and July with real wages in public sector at + 2-3% and in private sector at zero.
- Public and private sector pay was rising nominally at close to the same pace in the first quarter of this year but the crisis has intensified this new division.
- As well as this public-private split, we were seeing a division in economic/business sectors: the weaker ones for wages are not surprisingly: construction, trade, transport, hospitality and parts of IT.

The (un)employment and income picture (5)

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- Real disposable income (wages plus other activities) will fall more than pure wages.
- Disposable income was down -8.0% in Q2 compared with +1.2% in Q1 while in the summer nominal wages were +4% and real wages were flat.
- Many Russian and western newspapers have constantly banged the drum negatively on disposable incomes which paint a worse picture than wages.
- We have discussed this often in the past: only 66% of disposable income is composed of wages and the rest is entrepreneurial activity, rental and FX activity. These components were weaker than wages in recent years and they will be especially weaker in the new normal and hence why disposable income will be weaker again than wages: less income from rentals, yoga training, household repairs etc.
- Non-wage income is and will be down.
- This will negatively impact consumer confidence/household spending (-6.0% in 2020; +3.5% in 2021).
- The government spending for crisis support seems targeted more at those in state and para-state organisations: companies, banks, teachers, civil servants, military personnel.
- The percentage of the Russian population dependent on budget support is as high as 42%.
- With pensions and state salaries, 60% of consolidated budget spending supported household income before the virus.

Some financials: rates, debt, FX reserves (1)

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- The Central Bank continued to cut the key interest rate from 4.5% to 4.25% on 24 July (a post Soviet low).
- The Bank sees the inflation risk as diminished at about 3.5% to 4% this year and does not expect any threat from prices in 2021 either. Lockdowns and lower oil prices mean that the Bank is now more worried about the economic growth outlook.
- The Bank will probably cut rates at least once more this year to a level of 4.0% and quite possibly to 3.75%.
- With inflation at about 3.4% (July), the real yield on the rouble is now down to 1% which is still better than most other currencies such as the Hungarian forint (-2.3%) but the rouble yield is now lower than that on the Kazakh tenge at +2.0%. And the rouble yield will soon fall to 0.5% to 0.7%. Is that enough to choose the rouble over a saver haven? Perhaps not?
- The National Wealth Fund ($157bn in March 2020) will prove one source for crisis funding and the government may easily resort to issuing domestic bonds.
- Russia's fundamentals are strong going into the crisis and will need to be:
  - A budget surplus in 2019 of 1.8%
  - FX reserves at end of July 2020 of $591bn
  - Public debt in 2019 of 15% of GDP (very low)
  - Russia's external debt was also low at 29% of GDP in 2019

Some financials: rates, debt, FX reserves (2)

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- The capital account, for now, is not a major worry: in mid-March the outflow from the local state bond market reached $1bn but local companies, banks and households are not drawing down excessively yet.
- The good news is that many companies in Russia entered 2020 after solid pre-tax profits in 2019: for example at a level of 27.3% in the wholesale/retail sector.
- **The above generally positive financial picture is supported by a recent Survey on the financial strength of 66 emerging markets which places Russia 4th (China 10, India 18, Czech Republic 19, Azerbaijan 23, Brazil 30, Kazakhstan 36, Turkey 44, Hungary 49, Ukraine 53).**

The oil price outlook

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- On 30 August the Brent oil price was $46 after touching $20-25 in spring and after starting the year on 1 January at $68.6.
- It's been a volatile year. And do remember that the oil price normally reacts negatively when global demand dips by a mere 1-2% and today the industry faces a demand collapse of -25% to -30%.
- The consensus view is that oil will average $38-43 through 2020 on a rising scale based on a mid-case global GDP scenario of a mild global recovery though second half 2020 and into 2021.
- Brent could finish the year 2020 at about $45-50 (depending on recurrence of second Covid wave) and the consensus for 2021 is for $48-54.
- Oil will never rise again sustainably over $70 because whenever the oil price touches $50-60, then the US shale "boys" come back to the market acting as a natural price cap.
- Of course bad market news can still take oil back (temporarily) to $20-25 range. But presuming that China continues to rally (even though oil stocks are full), then there is room for a moderate rally.
- We presume no excessive short-selling which is a large assumption.
- The Saudis and Russian negotiators were narrow-minded, greedy and incompetent in March when they sought to maintain output to raise prices and capture market share, only to fail in all these goals.
- Thankfully for oil producing nations, they U—turned and have since introduced production cuts in a new OPEC+ deal.
- This policy and rising global confidence have brought the oil price to $45.
- Price levels at $45-55 are not ideal for the Russian economy but sufficient to support moderate growth. These prices are worse for Mid-East producers and we think that the GCC markets will struggle for the next 2-3 years with the consequences of Covid combined with the lower oil price.

The inflation outlook: no threats ahead (1)

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- **Annual average inflation should be moderate in 2020.** This is the view of the Russian Central Bank, the consensus view and my view!
- Given the high base level of January 2019, it was no surprise that January 2020 monthly inflation fell to a low of 2.4% and then to 2.3% in February.
- March inflation was surprisingly muted at just 2.5% so no spring bump and this was followed by 3.1% in April, again subdued, and averaged 3.2% in May-July.
- For 2020, we expected **before the crisis** inflation at an average of 3.4% with year-end 2020 inflation at 3.6%. So, the range would have been firmly be 3-4%.
- With the rouble stabilising (until July) and global prices staying soft, national inflation has not taken off.
- **Unless the rouble deteriorates significantly, then our central forecast for 2020 average inflation is the same as last year at 3.4% with year-end inflation of 3.7%.**
- Currently we do NOT see strong average inflation in 2020 nor in 2021.
- We follow the consensus and expect 2021 average inflation at about 3.8% and year-end 2021 at 3.6%.
- We make the point that these numbers refer to national/federal consumer prices. On average Moscow prices are more elevated and your employees certainly mention this as Moscow inflation can be 25-75%+ higher than the national number: so for example if national inflation is 5%, then Moscow's level can range 7-8-9%.

The inflation outlook: no threats ahead (2)

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Inflation will stay flat or go down because of:

— Weaker energy costs
— Weaker demand and softer GDP
— Weak pricing power with promotions and discounts
— Relatively high interest rates in real terms --- even if they getting closer to zero.

Inflation could rise because:

— If the rouble continues its August softening, there could be an inflation threat BUT that is when the Central Bank would step in with strong rouble support.
— Food products account for 38% of the consumer basket and food commodity prices could go up this year: wheat in March was up 24% after a flat 2019 and in rouble terms grain prices were up 50% due to rouble inflation. But by May rouble price increases for wheat had subdued to 11% year-on-year.
— Usually, a 10-percentage point of grain price growth translates into 0.4 percentage points to inflation.
— On this basis inflation could rise an extra 2.0 percentage points. But the Russians may curb exports to keep more domestic grain at home.
— Non-food products (35% of the consumer basket) have not reflected the imported rouble inflation and this is probably because the slump in the rouble was short-lived. We will see if this ticks up again this autumn on a softer rouble.
— Inflation should also rise by 0.5 percentage points for every $10 rise in the oil price.

The inflation outlook: no threats ahead (3)

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— The middle-class Russians are not in London and Paris (well not all of them) so more domestic spending.
— Foregone tourism (50% of the annual total of about $40bn) means that $20bn is sitting at home and consumers may choose to pay for premium products or enhanced services which could tick up inflation.
— One piece of good news for companies is that producer price inflation will stay weak after falling from a 15-20% peak in autumn 2018 to an annual figure of zero in 2019: **input prices are no longer rising faster than output prices (but food prices could rise and some packaging prices are fixed to FX rates).**

- While these are arguments for some tick up in inflation, we underline our view that inflation will be subdued in Russia in 2020-21 as it will be globally.

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