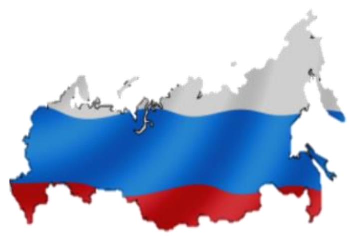
Russia Monthly Economic Developments
September 2020

Despite the continued spread of the virus, recent data suggest that global activity continues to gradually firm. Oil prices were stable in August, with the price of Brent crude oil trading between US$43/bbl and US$46/bbl throughout the month. However, prices fell slightly in September as concerns about the strength of the recovery in demand were compounded by rising supply. Elevated geopolitical risks and higher imports amidst the continued weakness of export receipts resulted in the ruble's depreciation in August. Concerns over a second wave of the pandemic, oil prices sliding slightly below the threshold price specified in the fiscal rule, and escalation of geopolitical risks led to even stronger downward pressure on the ruble in September. In August, the rebound in industrial production moderated despite stronger momentum in mining. Annual headline inflation accelerated to 3.6 percent compared to 3.4 percent in July. In September, the CBR paused its accommodative policy actions, leaving the key policy rate at a record low of 4.25 percent as the effect of short-term inflationary factors strengthened. The unemployment rate increased to 6.7 percent in August, up from 6.4 percent in July, sa. In the first eight months of 2020, the federal budget registered a deficit of Rub1,692 billion compared to a surplus of Rub2,674 billion in the same period last year. The government prepared a draft federal budget for 2021 – 2023, which suggests gradual fiscal consolidation backed by fiscal rule relaxation in 2021. Credit growth slightly rebounded in July. Banks' key credit risk and performance indicators remained largely stable, supported by the CBR support measures, including regulatory forbearance.

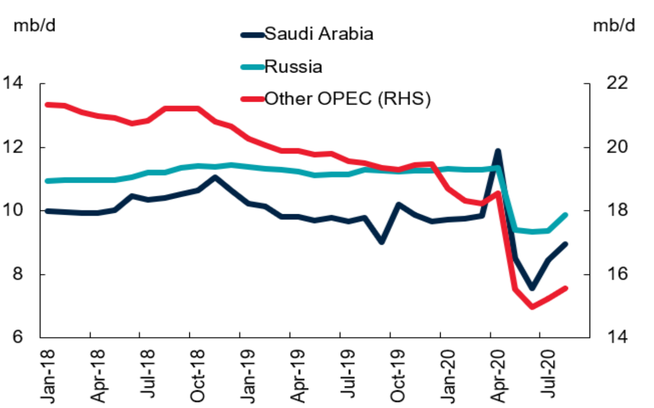
The Global Context



The number of confirmed cases of COVID-19 is approaching 34 million globally, with over 1 million deaths. Despite the continued spread of the virus, recent data suggest that global activity continues to gradually firm. The global composite PMI expanded to 52.4 in August on the back of improving services activity amid the easing of some lockdown measures. The fall in industrial production appears to have bottomed out but levels in July remain lower than one year ago. The contraction in global goods trade volumes eased somewhat in June, but new export orders point to continued weakness after shrinking again in August. Global equity markets continued to recover earlier losses by the end of August, but volatility remains elevated as September losses in certain sectors, such as information and technology, erased the gains made in August. The rebound in portfolio flows to emerging market and developing economies (EMDEs) lost steam in August and September, as EMDEs continued to grapple with the pandemic and rising policy uncertainty.

Oil prices were stable in August, with the price of Brent crude oil trading between US$43/bbl and US$46/bbl throughout the month. However, prices fell slightly in September as concerns about the strength of the recovery in demand were compounded by rising supply. In its September report, expectations for oil demand in 2020 and 2021 were revised downward by the International Energy due to the prolonged impact of COVID-19, with consumption in India expected to be particularly weak. On the production side, OPEC+ tapered its production cuts in August from 9.7mb/d to 7.7mb/d, in line with earlier announcements (Figure 1). Production in the United States has started to recover from its trough in May, although there were some modest disruptions to output in August from Hurricane Laura.

Figure 1: On the production side, OPEC+ tapered its production cuts in August from 9.7mb/d to 7.7mb/d

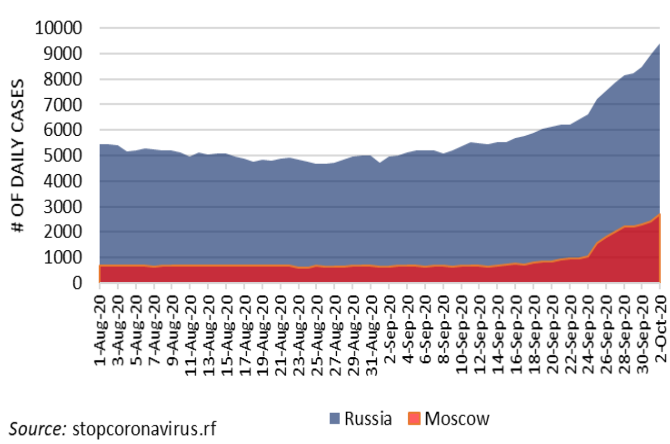


Source: IEA.
Note: Other OPEC includes all current OPEC except Saudi Arabia.
Last observation is August 2020.

Recent economic developments

The daily number of COVID-19 cases in Russia has been gradually increasing since the beginning of September 2020 (Figure 2). As of October 2nd, Russia had registered 1,194,643 cases (21,077 deaths). In terms of the number of cases, Russia now ranks fourth in the world (after the USA, India, and Brazil). The number of new cases in Russia increased to 9,412 on October 2nd, up from 4,993 at the end of August. The number of new cases in Moscow, about 25 percent of total number of new cases, more than doubled during the period September 24 – October 2 and reached 2,704. The Moscow authorities resumed self-isolation for people over 65 years and persons with chronic diseases till October 28. Working pensioners over 65 years old and persons with chronic diseases must switch to the remote work mode or take a vacation. Companies must shift at least 30 percent of employees to remote work starting October 5. Moscow authorities announced 2-week school break, so schoolchildren will stay home for an extra week this fall. Currently, three vaccines are at different stages of trials. The voluntary vaccination of medical personnel with the Sputnik vaccine started in September.

Figure 2: The daily number of COVID-19 cases in Russia has been gradually increasing since the beginning of September



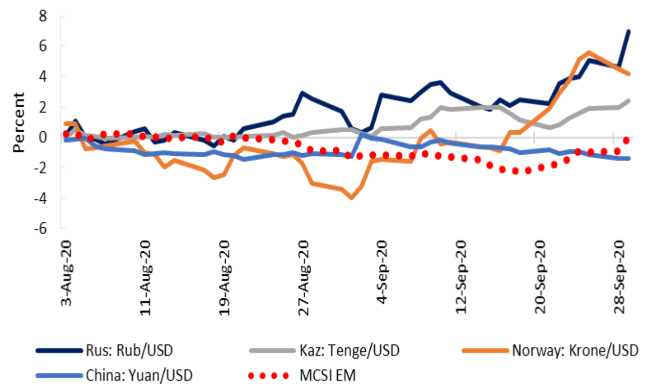
Source: stopcoronavirus.rf

Elevated geopolitical risks and higher imports[1] amidst the continued weakness of exports receipts resulted in the ruble's depreciation in August. Concerns over the pandemic's second wave, oil prices sliding slightly below the threshold price specified in the fiscal rule, and further geopolitical risks led to stronger downward pressure in September. In August, despite increasing geopolitical risks, the financial markets' response was moderate. At the end of August, the RTS index was at the same level as the beginning of the month. The Russian government bond index (reflecting changes in the bonds' price dynamics) lost 0.7 percent by the end of the month. The average ruble exchange rate depreciated by 3.5 percent with respect to the USD. Yet, at the end of September, rising concerns over the pandemic's second wave, which affected all EMDE currencies, and the escalation and widening of geopolitical risks amidst oil prices sliding slightly below the threshold price specified in the fiscal rule, spurred a more pronounced financial market response. The RTS index lost 7.3 percent in the period from end August - September 29th, and the Russian government bond index lost a further 1.3 percent. Credit Default Spreads (CDS) increased to 125 from 97 at the end of August (larger spreads indicate more volatility). The ruble-dollar exchange rate depreciated by 5.4 percent since end-August, underperforming other EMDE currencies (Figure 3). The track record of the CBR's actions to reduce FX market volatility (the most recent of which was in March 2020), macro-fiscal stabilization policies, and accumulated buffers will help Russia. As of September 1, 2020, the assets of Russia's sovereign wealth fund – the NWF – reached a robust US$178 billion (13.6 percent of GDP), while its liquid part reached 9 percent of GDP. International reserves stand at a comfortable US$592 billion (23 months of imports). Russia's external debt, at about 34 percent of GDP, favourably compares to the 60 percent EMDE average. Additional sales of the FX currency in the framework of the Sberbank purchase,

[1] Including tourist imports with more Russians travelling abroad due to fewer restrictions on travel (flights were open to Turkey, Maldives, the UAE, some other countries).

announced by the CBR since October 1, will also support the ruble.

Figure 3: The ruble has been underperforming against other EMDE currencies in August - September (selected EMDEs, MSCI EM, Norway: ER change compared to August 1, 2020)

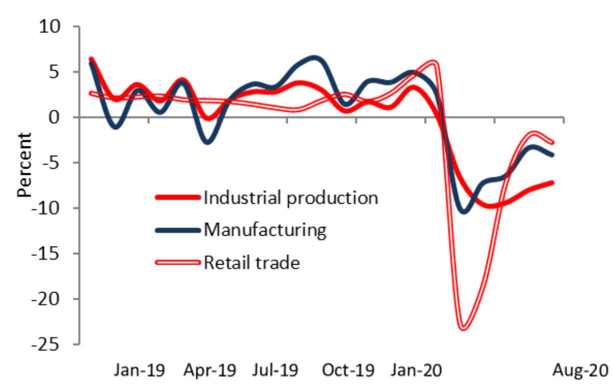


Source: Haver Analytics.

The current account (CA) surplus shrank in the January-August 2020 period compared to the same period in 2019 as the trade balance narrowed amidst decreasing exports. In January-August, the CA surplus decreased to US$23.3 billion, down from US$49 billion in the same period last year. According to preliminary estimates, the CA registered a deficit of US$1.3 billion in August compared to a surplus of US$2.1 billion in July. Potentially better dynamics in goods and tourist imports (re-opened flights to Turkey, UAE and Maldives), as well as dividend payments weighed on the CA while export receipts remained subdued. In the first eight months of 2020, net private capital outflows grew to US$34.8 billion compared to US$20 billion in the previous year. A fall in the external liabilities of the banking and non-banking sectors drove net capital outflows. International reserves dropped by US$8.9 billion in the January-August period on the back of FX sales and public debt payments.

In August, the rebound in industrial production moderated despite stronger momentum in mining (Figure 4). In line with the OPEC+ agreement, oil production increased in August by 5.1 percent, m/m, but it was about 14 percent lower than in the same period last year. Overall, the output of the mineral resource extraction sector dropped by 11.8 percent in August compared to 15.1 percent in July. In August, the manufacturing output shrank by 4.1 percent, y/y, compared to 3.3 percent drop in July. A further decline in metallurgical production, transport vehicles and other machinery drove down the sector's output. Meanwhile, other subsectors in manufacturing (food products, chemicals, medical products) demonstrated strong positive dynamics. The services sector dynamics were mixed, with a somewhat weaker performance in retail trade and a continued rebound in market services. The agricultural sector continued its robust growth at 4 percent, y/y.

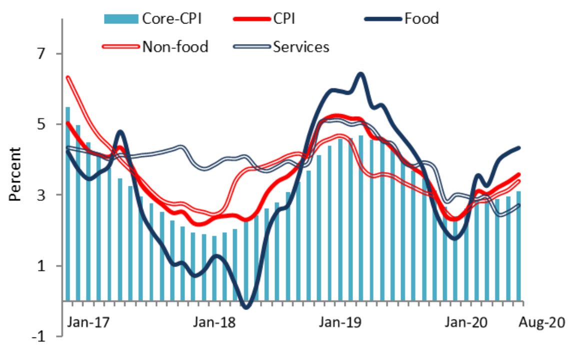
Figure 4: In August, the rebound in industrial production moderated despite stronger momentum in mining, percent, y/y.



Source: Rosstat, Haver Analytics, World Bank team.

In August, the annual headline inflation accelerated to 3.6 percent compared to 3.4 percent in July (Figure 5). Non-food inflation went up to 3.4 percent, y/y, versus 3.1 percent, y/y, in the month prior. Food inflation increased to 4.3 percent, y/y, (compared to 4.2 percent, y/y, in July), and inflation in services grew to 2.7 percent, y/y, (compared to 2.5 percent in July). In August, the core CPI, which excludes food and gasoline, slightly increased by 3.1 percent, y/y, up from a 3 percent, y/y, increase in July. The higher CPI inflation was driven by rebounding domestic demand following the lockdown (which exceeded expectations), and by the weakening of the ruble on the back of the increased volatility in global markets and higher geopolitical risks. The risks of growing disinflationary pressures have diminished, mainly due to the ongoing accommodative monetary policy as well as the strengthening of pro-inflationary factors, in particular, the weakening of the ruble. Both household inflation expectations for the twelve months ahead and corporate-sector price expectations for the next three months remain elevated, at 8.8 percent and 15.2 percent, respectively. In September, the CBR paused its accommodative policy actions, leaving the key policy rate at a record low of 4.25 percent.

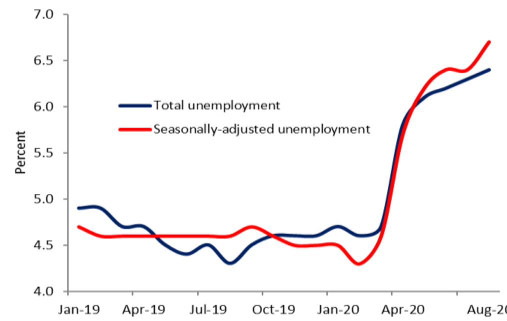
Figure 5: In August, consumer price inflation accelerated to 3.6 percent, y/y



Source: Haver Analytics.

Labour market dynamics deteriorated in August (Figure 6). The unemployment rate (seasonally adjusted) increased to 6.7 percent, up from 6.4 percent in July. Since January, the number of unemployed people has increased by 1.3 million, reaching 4.8 million in August. Meanwhile, the number of unemployed people registered at the state employment service increased even more, by 2.9 million since the beginning of the year, reaching 3.6 million in August. The number of unemployment benefits recipients increased from 0.6 million in January to 3.4 million in August. In July, growth in real wages accelerated to 2.3 percent, y/y, compared to 0.6 percent, y/y, in June (information on real wages is being published with a one-month lag). Overall, in the period of January-July 2020, real wages increased by 2.9 percent, y/y.

Figure 6: In August, labour market dynamics deteriorated



Source: Rosstat, Haver Analytics, World Bank team.

In the first eight months of 2020, the federal budget registered a deficit of Rub1,692[2] billion compared to a surplus of Rub2,674 billion in the same period last year. This was on the back of higher spending and lower revenues. In January-August 2020, oil/gas revenues dropped by 37 percent, y/y. A weaker ruble could not fully compensate for the fall in oil prices and the drop in economic activity. Non-oil tax receipts also declined by 7.9 percent:[3] In the first eight months of 2020, VAT receipts dropped by 2.3 percent, y/y, and corporate income tax receipts dropped by 13.6 percent, y/y. Total fiscal revenues decreased by 11.8 percent, y/y, in the first eight months of 2020 (19.8 percent, y/y, not accounting for one-off channelling of the receipts from the Sberbank purchase). Primary expenditures increased by 27.8 percent in the January - August 2020 period. Spending on social policy, health, support to regional budgets, national defence and the national economy were the main drivers of this growth. Higher primary spending led to a deterioration of the non-oil/gas federal budget primary deficit, which reached Rub4.6 trillion compared to a deficit of Rub2.3 trillion in the same period last year. The federal budget deficit was largely financed by means of borrowing in the domestic market and liquid reserves from the previous year.

The consolidated regional budget primary surplus (Rub1075 billion in the January-July 2019 period), turned into a Rub5 billion deficit in January-July 2020 on the back of higher expenditures (+18.7 percent, y/y).

[2] Since May 2020, the Ministry of Economic Development has not been providing estimates of nominal GDP; thus, fiscal outcomes are reported in billion rubles.

[3] Not accounting for one-off channeling of the receipts from the Sberbank purchase (Rub1.05 trillion).

Notably, expenditure on healthcare rose by 88.1 percent, y/y, and spending on social policy and national economy also increased significantly (+19.2 percent, y/y, and +20.9 percent, y/y, respectively). Revenues of the consolidated regional budget increased by 2.1 percent, y/y, due to increased support from the federal budget (+63.8 percent, y/y), while own revenues of consolidated regional budgets dropped by 2.3 percent, y/y, in the first seven months of 2020. Deficits were registered in 49 regions.

On September 23rd, the government approved a plan of action aimed at restoring economic growth and growth of disposable incomes, mainly through subsidies and state guarantees, with measures estimated to amount to Rub 6.4 trillion. The plan contains about 500 specific measures till the end of 2021 and it is divided into three stages: The first stage (June-September 2020), which is already implemented, is in place to prevent a further drop in household incomes, as well as to support the most affected sectors of the economy such as transport, hospitality, retail, and entertainment. The second stage (October 2020 - June 2021) is aimed at ensuring the recovery of economic growth, a reduction of unemployment, and preventing a worsening of the sanitary and epidemiological situation due to the COVID-19 pandemic. The third stage (July 2021 - December 2021) is geared at achieving the national goals – 3 percent of GDP growth, unemployment growth below 5 percent, a decrease in the population living below the poverty line, and real wages growth by at least 2 percent— through targeted subsidies, digitalization of the public administration environment and communication with SMEs, massive deregulation, and infrastructure investment. The plan implies a decline in the nominal level of expenditures for 2021, a progressive tax scale for the population with an annual income above Rub 5 million, and a tax burden increase on the mining sector.

The government prepared a draft federal budget for 2021 – 2023 to be submitted to the Duma by the end of September. The budget is facing pressure from increased expenditures and lower than planned revenues in 2021 - 2022 due to the economic downturn. To avoid abrupt fiscal consolidation and reduce negative fiscal impulse in 2021, the government decided to proceed with the fiscal rule relaxation in terms of an expenditure cap and oil/gas revenues [4] to be financed largely through domestic borrowing. There are also measures to raise revenues through extraction taxes for metals and chemicals, reconsidering tax expenditures for oil companies, raising tobacco taxes, progressive personal income tax (PIT). These measures could bring the government 0.4 - 0.5 percent of GDP per year[5]. The government expects the federal budget deficit to be 4.7 percent, 2.5 percent, and 1.1 percent of GDP in 2021 – 2023. In 2022, the government plans to return to the usual fiscal rule practice: A primary deficit of about 0.5 percent of GDP at the threshold oil price to be compensated through domestic borrowing. With low public debt, Russia could possibly afford some deviation from the fiscal rule until the output gap remains negative. Given that the rebound will be gradual, it is likely that the output gap may not close before 2023. Thus, the fiscal rule could be relaxed to provide for more gradual consolidation in 2022 as well.

Banks' key credit risk and performance indicators remained largely stable, supported by the CBR regulatory forbearance measures (Figure 7). As of July 1, 2020, the aggregate capital adequacy ratio stood at 12.8 percent (against a regulatory minimum of 8 percent and compared to 12.7 percent in the previous month). Non-performing loans remained broadly unchanged - at 9.6 percent of total loans - as banks benefited from the regulatory forbearance measures, which delay the accrual of loan loss reserves on restructured loans. In August, the CBR extended regulatory forbearance measures that allow Russian banks to further postpone the classification of loans restructured amid the coronavirus pandemic as problem loans. In July, the banking sector's profits were about Rub138 billion versus

[4] The government suggests budgeting for oil and gas revenues not accounting for OPEC+ oil production cuts, which would allow to increase expenditures further.

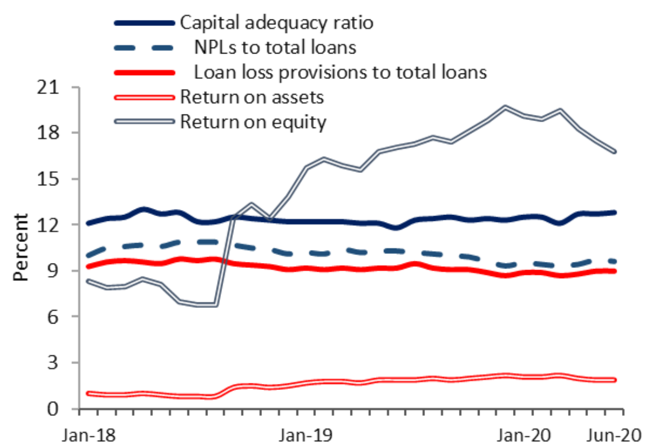
[5] According to the preliminary estimate of the Ministry of Finance.

Rub70 billion in June. The profit growth was mainly driven by several large banks due to FX revaluation, portfolio growth, and recovery in business activity. Overall, in January-July 2020, the net banking sector's profit remained substantially lower than in 2019 (Rub761 billion (US$10.7 billion) compared to Rub1,178 billion (US$18.1 billion) in the same period in 2019). As of July 1st, the return on assets (ROA) and return on equity (ROE) were 1.9 percent and 16.8 percent, respectively, compared to 2.1 percent and 19.1 percent, respectively, at the beginning of the year.

Credit growth slightly rebounded following the lifting of the strict lockdown measures. In July, household lending grew by 1.7 percent, m/m, compared to 1 percent in June, m/m, and 0.2 percent, m/m, in May. Mortgage lending continues to be the major contributor to household credit growth. In annual terms, household lending also showed growth, increasing to 13.2 percent, y/y, in July versus 12.6 percent, y/y, in June. Credit to the corporate sector in rubles accelerated to 1.6 percent, m/m, in July compared to 0.5 percent, m/m, in the month prior. The government support programmes, particularly the subsidized credits to systemically important enterprises, contributed to the recovery of corporate lending. In annual terms, corporate lending reached 9.0 percent, y/y, (after adjusting for FX changes) compared to 7.4 percent in June.

The demand from borrowers, both households and corporates, for the restructuring of their loans has slightly increased since the end of August. This growth was mainly due to applications for restructuring under the banks' own programs from persons whose credit holidays under the government program were cancelled due to the lack of confirmation of a 30 percent decrease in income. For the period March 20th - September 9th, banks restructured 1.5 million loan agreements of individuals, amounting to over Rub750 billion. The number of applications submitted by SMEs has also increased, especially requests for credit holidays. The total amount of restructured loans reached Rub753 billion as of September 9th. Overall, for the period March 20th – September 4th, the volume of corporate restructured loan debt exceeded Rub4.3 trillion (13.3 percent of the total portfolio of the systemically important credit organizations, excluding SMEs).

Figure 7: Key credit risk and banking performance indicators remained stable



Source: Bank of Russia.

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