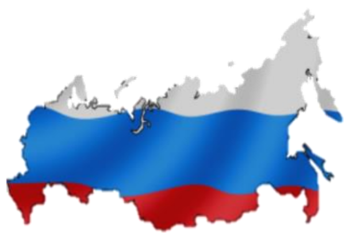
Russia Monthly Economic Developments
October 2020

Following the collapse in output in the second quarter of 2020, the strength of the global rebound is quickly fading as persistently high new daily COVID-19 cases hinder activity. The global composite PMI fell from 52.4 in August to 52.1 in September. Oil prices fell nearly 7 percent in September, with the price of Brent crude oil averaging US$40/bbl. The daily number of COVID-19 cases in Russia continued to significantly increase, reaching 15,982 per day on October 19. Concerns over the pandemic's second wave, oil prices sliding slightly below the threshold price specified in the fiscal rule, and further geopolitical risks resulted in the average ruble exchange rate depreciating 2.6 percent with respect to the US dollar in September, m/m. In the third quarter of 2020, the current account (CA) surplus fell to US$2.5 billion from US$10.7 billion in the same period last year largely due to a fall in energy exports. In August, output in five basic sectors continued rebounding yet at a slower speed. The Russian Composite PMI fell to 53.7 in September of 2020 from 57.3 in the previous month, pointing to continuing recovery although with easing growth rate. The growth in real wages accelerated to 2.9 percent, y/y, compared to 0.6 percent, y/y, in June. In September, the annual headline inflation increased further to 3.7 percent compared to 3.6 percent in August. Banks' key credit risk and performance indicators remained largely stable, supported by the CBR's support measures, including regulatory forbearance. Credit growth for households and companies slightly accelerated in annual terms following the rebounding of the economy and an accommodative monetary policy.

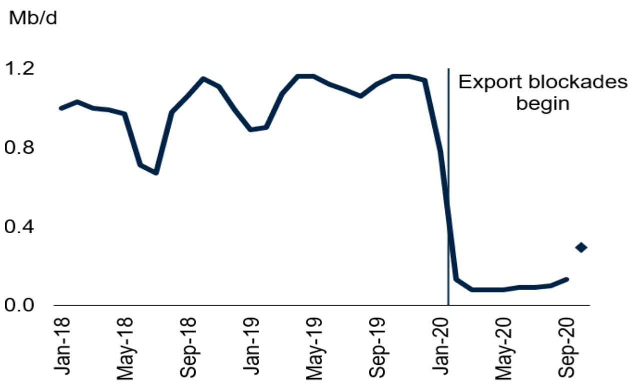
The Global Context



Following the collapse in output in 2020Q2, the strength of the rebound is quickly fading as persistently high new daily COVID-19 cases hinder activity. The global composite PMI fell from 52.4 in August to 52.1 in September, reflecting a decline in the services index despite a slight improvement in the manufacturing index. Although global goods trade volumes registered positive growth (m/m) in both June and July, it remains about 5 percent below its pre-pandemic level. New export orders PMI also firmed, rising to 49.9 in August, and daily seaborne shipping volumes point to improving goods trade in September. Trade in commercial services remains exceptionally weak, however, and international tourist arrivals are more than 90 percent below last year's levels in many countries. The number of daily commercial flights has stabilized at just over half of 2019 values in recent months. Meanwhile, borrowing costs remain at record low levels, supporting corporate bond issuance and residential housing markets. Nevertheless, market volatility remains elevated, pointing to persistent risk aversion. The recovery of portfolio flows to EMDEs slowed sharply in August and September as rising COVID-19 caseloads and policy uncertainty weighed on investor sentiment.

Oil prices fell nearly 7 percent in September, with the price of Brent crude oil averaging US$40/bbl. On the demand side, the renewed outbreak of Covid-19 cases in many countries and subdued international travel led to concerns about oil demand, with the International Energy Agency (IEA) revising their 2020 demand forecast down 0.2mb/d; demand for oil is now expected to fall by 8.4 mb/d compared to 2019. Though demand in 2021 is expected to increase by 5.5 mb/d, it will remain 3 percent below its 2019 level. On the supply side, an easing of the oil export blockade in Libya was followed by an increase in the country's production to an estimated 0.3 mb/d during the first week of October, compared to 0.1 mb/d in August. Prior to the blockade, production in Libya exceeded 1mb/d (Figure 1). However, offsetting this impact, a labor strike across six oil and gas fields in Norway is expected to lower output by 0.3 mb/d, around 8 percent of Norway's total production. In addition, production in the United States has also been disrupted by Hurricane Delta, which forced the shut-in of more than 90 percent of the Gulf of Mexico's production.

Figure 1: On the supply side, an easing of the oil export blockade in Libya was followed by an increase in the country's production to an estimated 0.3 mb/d during the first week of October

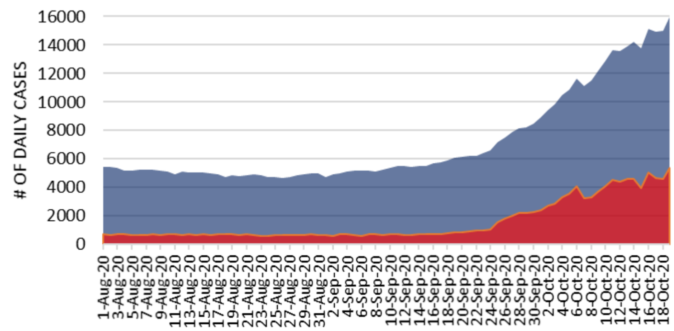


Source: EIA, Reuters, World Bank.
Note: Diamond indicates estimate for October production.

Recent economic developments

The daily number of COVID-19 cases in Russia continued to significantly increase (Figure 2). As of October 20, Russia had registered more than 1.4 million cases (24,366 deaths). In terms of the number of cases, Russia ranks fourth in the world (after the USA, India, and Brazil). The number of new daily cases in Russia increased to 15,982 on October 19, which is above the level at the peak of the pandemic in May. Different regions started to introduce their own restrictions depending on the epidemiological situation. The number of new cases in Moscow, 26 percent of total number of new cases, reached 5,376. The Moscow authorities have resumed a policy of self-isolation for people over 65 years and persons with chronic diseases until October 28th. Working pensioners over 65 years and persons with chronic diseases must switch to remote working or take a vacation. Since October 5th, all companies have been obliged to shift at least 30 percent of employees to remote work and to update the Moscow Government on a weekly basis. Distance learning is resumed for high school children (grades 6-11). Starting October 19, access of employees and visitors to nightclubs, bars, open from 0:00 am to 6:00 am, is possible only with a QR code (registration via phone numbers). Reduced fares and free travel for schoolchildren (grades 6-11) and people over 65 has been suspended. Currently, three vaccines are at different stages of trials. The voluntary vaccination of medical personnel with the Sputnik vaccine started in September.

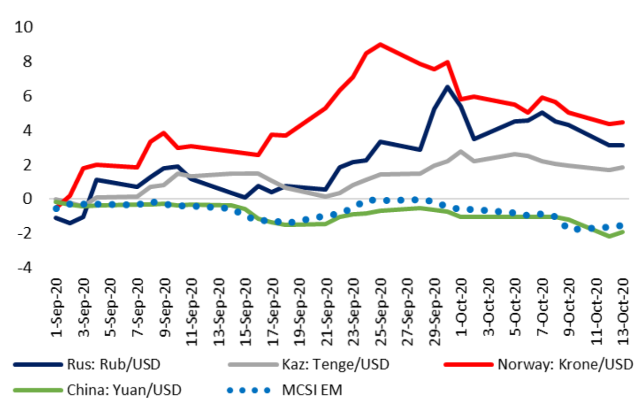
Figure 2: The daily number of COVID-19 cases in Russia has been gradually increasing since the beginning of September



Source: stopcoronavirus.rf

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 the ruble depreciating in September (Figure 3). 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, resulted in the average ruble exchange rate depreciating 2.6 percent with respect to the US dollar. Additional sales of the FX currency in the framework of the Sberbank purchase, announced by the CBR since October 1st, somewhat supported the ruble in October.

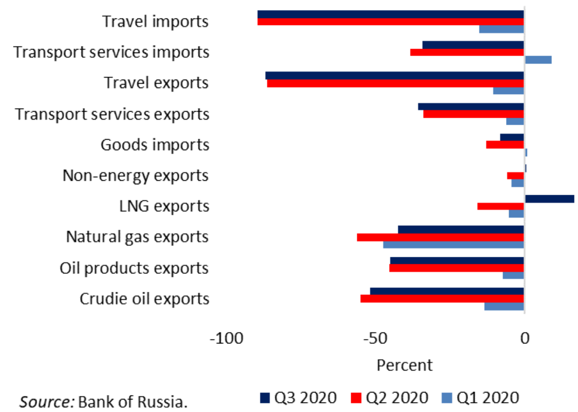
Figure 3: The ruble underperformed against other EMDE currencies in September (selected EMDEs, MSCI Emerging Markets Index, Norway: ER change compared to September 1, 2020)



Source: Haver Analytics.

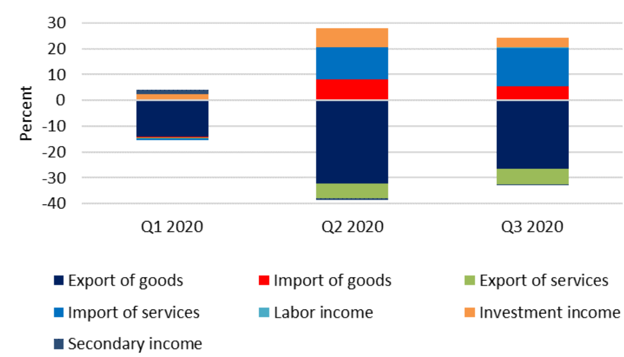
In the third quarter of 2020, the current account (CA) registered a surplus of US$2.5 billion, down from a US$10.7 billion surplus in the same period last year. Low oil prices continued to weigh on the trade balance, with energy exports dropping by 27 percent, y/y, to US$30.7 billion (Figure 4). Crude oil exports shrank the most, while the decrease in prices of oil products was somewhat mitigated by higher export volumes. Non-oil exports registered a slight increase in value, partly due to higher exports of gold. Supporting the CA, imports of goods dropped on the back of GDP contraction and the REER depreciation (Figure 5). The balance of services improved as the slump in tourism outweighed a decrease in exports of services. Despite the lifting of restrictions on travel, introduced in August (trips to Turkey, Maldives, UAE were allowed), travel abroad remained 90 percent below the level last year, the same as in the second quarter of 2020. An improved investment income balance also supported the CA. Import contraction and a stronger investment income balance amidst a resilient performance of non-oil exports resulted in the improvement of the non-oil CA deficit by about US$20 billion, reaching US$19 billion in the third quarter of 2020. Net private capital outflows grew to US$7.8 billion compared to US$2 billion of inflows 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$2.3 billion in the July-September period on the back of FX sales and public debt payments.

Figure 4: Energy exports dropped by 27 percent in Q2 2020, percent change, y/y.



Source: Bank of Russia.

Figure 5: Supporting the CA, imports of goods dropped on the back of GDP contraction and the REER depreciation (change by category in US$ billion, y/y)



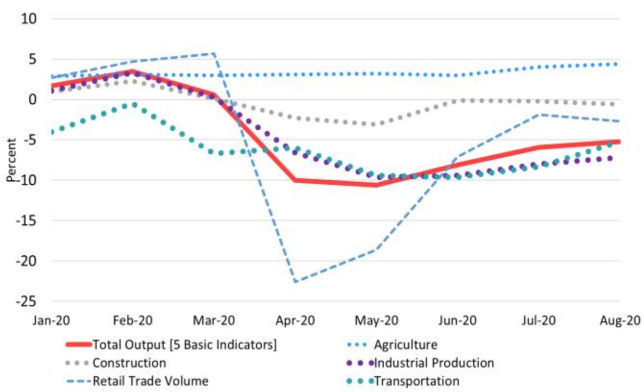
Source: Bank of Russia.

In August, output in five basic sectors [1] continued rebounding yet at a slower speed. Supported by stronger agricultural output and continued recovery in transportation (Figure 6), output in five basic sectors increased by 0.4 percent, m/m, sa (-5.2 percent, y/y) in August compared to 2.1 percent, m/m, sa (-5.9 percent, y/y) in July. Ministry of Economy estimated that GDP declined by 4.3 percent, y/y, in August, slight improvement from a contraction of 4.6 percent, y/y, in July. September PMI points to continued rebound in economic activity driven by services sectors although with easing growth rate: the Russian Services PMI

[1] Output in five basic sectors is an aggregate indicator, which includes agriculture, industrial production, construction, transport, retail, and wholesale trade.

declined to 53.7 in September 2020 from 58.2 in the previous month, the Manufacturing PMI declined to 48.9 from 51.1 in the previous month. The Russian Composite PMI fell to 53.7 in September from 57.3 in the previous month.

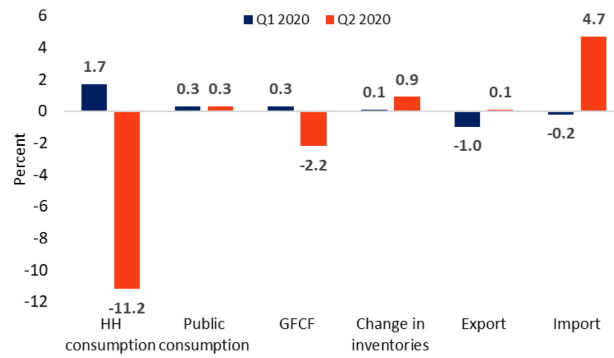
Figure 6: In August, output in five basic sectors continued rebounding yet at a slower speed



Source: Haver Analytics.

The slump in domestic demand weighed down on GDP growth in the second quarter of 2020. According to Rosstat's demand-side national accounts statistics, Russian household consumption dropped by 22.2 percent, y/y, as the economy was hit by both supply and demand shocks, and real incomes declined by 8 percent, y/y (Figure 7). This was an unprecedented contraction, not registered in any previous crisis. While this reading is lower than the contraction of average household consumption in the EU (-15.2 percent, y/y), it is at par with some EU countries which introduced strict lockdown measures such as Spain (-24 percent, y/y) and Italy (- 17.4 percent, y/y). Russia's gross fixed capital formation dropped to a less extent (-11.7 percent, y/y), supported by fewer restrictions on construction works during the lockdown as compared to other sectors of the economy. In the EU, gross fixed capital formation dropped by 19 percent, y/y, with countries hit the hardest registering up to a 70 percent decline (Ireland). Russia's export dynamics were strong (+0.3 percent, y/y), which could be attributed to higher demand from a quickly rebounding China and base effect (The Druzhba pipeline contamination resulted in an oil export decline in Q2 2019). Non-energy exports declined by a moderate 6 percent in nominal terms, and its resilient performance could be attributed to support from agricultural exports and gold. Net exports contributed a solid 4.8 pp to GDP growth in Q2 2020, as imports shrank with negative GDP dynamics and obstacles to trade.

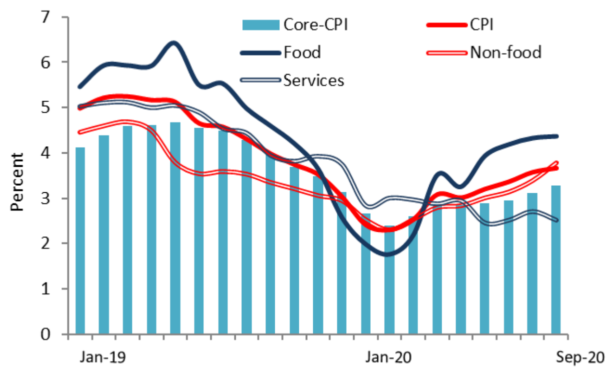
Figure 7: The slump in domestic demand weighed down on GDP growth in the second quarter of 2020.



Source: Rosstat.

In September, the annual headline consumer price index (CPI) inflation increased to 3.7 percent compared to 3.6 percent in August (Figure 8). The acceleration of non-food inflation contributed the most to the growth of the headline CPI, increasing to 3.8 percent, y/y, versus 3.4 percent, y/y, in August. Food inflation slightly increased to 4.4 percent, y/y, (compared to 4.3 percent, y/y, in August). Meanwhile, inflation in services decreased to 2.5 percent, y/y, from 2.7 percent in August. In September, the core CPI, which excludes food and gasoline, increased to 3.3 percent, y/y, up from a 3.1 percent, y/y, increase in August. The higher CPI inflation continues to be driven by the rebounding of domestic demand following the lockdown (which exceeded expectations), and by the weakening of the ruble. Both household inflation expectations for the twelve months ahead and corporate-sector price expectations for the next three months grew compared to the previous month. This indicates an increase of pro-inflationary factors, in particular, the weakening of the ruble. In September, household expectations and corporate price expectations reached 8.9 percent and 18 percent, respectively, versus 8.8 percent and 15.3 percent in August.

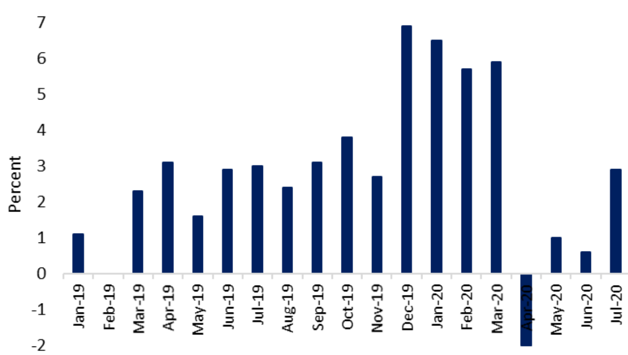
Figure 8: In September, consumer price inflation accelerated to 3.7 percent, y/y



Source: Haver Analytics.

The real wages growth accelerated in July (Figure 9). Rosstat reviewed the real wages data for the month of July. The growth in real wages accelerated to 2.9 percent, y/y, (previous estimations: 2.3 percent), 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 3 percent, y/y. The unemployment rate (seasonally adjusted) increased to 6.7 percent in August, up from 6.4 percent in July.

Figure 9: In July, the real wages growth accelerated



Source: Rosstat.

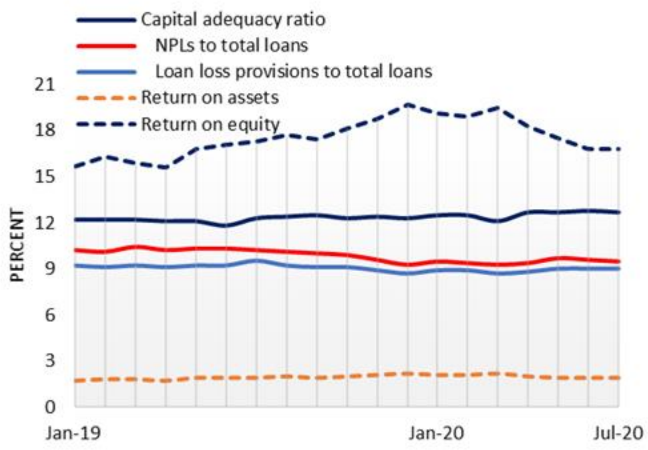
Banks' key credit risk and performance indicators remained largely stable, supported by the CBR's regulatory forbearance measures (Figure 10). As of August 1, 2020, the aggregate capital adequacy ratio stood at 12.7 percent (against a regulatory minimum of 8 percent). In August, the banking sector's profits were about Rub172 billion compared to Rub138 billion in July. The profit growth was mainly driven by several large banks due to FX revaluation, portfolio growth, and recovery in business activity. Overall, in January-August 2020, the net banking sector's profit remained substantially lower than in 2019 (Rub 933 billion (US$12.6 billion) compared to Rub1,354 billion (US$20.8 billion) in the same period in 2019). As of August 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 accelerated following the lifting of the strict lockdown measures and lower interest rates. Household lending continued to grow for the fourth month in a row since May: In August, it grew by 1.9 percent, m/m, compared to 1.7 percent in July, m/m. In annual terms, household lending slightly increased from 13.2 percent, y/y, in July to 13.3 percent, y/y, in August. Mortgage lending continues to be the major contributor to household credit growth. Credit growth to the corporate sector in rubles slowed down, increasing by 1.2 percent, m/m, in August versus 1.6 percent, m/m, in July. In annual terms, corporate lending accelerated to 9.4 percent, y/y, (after adjusting for FX changes) compared to 9.0 percent, y/y, in July. In August, the share of non-performing loans (NPLs) was relatively stable: In the household portfolio, it remained unchanged at 7.9 percent, while in the corporate portfolio it slightly decreased to 10.9 percent, down from 11 percent in the month prior. Overall, NPLs slightly decreased — to 9.5 percent of total loans, down from 9.6 percent in July – as banks benefited from the regulatory forbearance measures, which delay the accrual of loan loss reserves on restructured loans.

The demand from borrowers, both households and corporates, for the restructuring of their loans has slightly decreased since mid-September. Overall, for the period March 20th - September 23rd, banks restructured 1.5 million loan agreements of individuals, amounting to Rub767 billion. The volume of corporate restructured loan debt exceeded Rub4.3 trillion (13.4 percent of the total portfolio of the systemically important credit organizations, excluding SMEs) for the period March 20th – September 11th. The application period for payment holidays for individuals and SMEs ended on September

30th— this was adopted as an extraordinary crisis support measure.

Figure 10: Key credit risk and banking performance indicators remained stable



SOURCE: BANK OF RUSSIA.

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