Russia Monthly Economic Developments April 2020

The COVID-19 pandemic is severely affecting global economic activity as countries race to stem the spread of the virus. A sharp rise in risk aversion has led to the EMDEs witnessing record portfolio outflows since the beginning of the year compared to any recent episode of sudden stops of capital flows. Brent crude oil prices fell to a multi-decade low of US$20/bbl, 70 percent below their January peak. The WTI Cushing contract for delivery in May fell to -US$37/bbl. On April 12, OPEC+ reached a new production agreement, and agreed to cuts of 9.7mb/d in May and June 2020, dropping to 7.7mb/d for 2020H2, and 5.8mb/d from January 2021 to April 2022. The Russian ruble weakened on the back of lower oil prices and slowing activity due to lockdown measures, reaching an average of 73.7 RUB/USD in March (compared to an average of 63.9 RUB/USD in February). Amidst a weaker ruble, annual consumer price inflation accelerated to 2.5 percent, up from 2.3 percent in February. In annual terms, in February 2020, industrial production growth accelerated to 3.3 percent, y/y, compared to 1.1 percent, y/y, in January, partly reflection a leap year factor. Labor market dynamics were positive in February 2020. In the first three months of 2020, the federal budget surplus dropped to 0.05 percent of GDP (cash basis) from 2.2 percent of GDP in the same period last year. On April 10, the CBR sold its controlling stake in Sberbank to the government (Ministry of Finance). To counter the socio-economic effects of the COVID-19 pandemic, preserve financial stability, and provide support to the real economy, the Russian Government and the Central Bank (CBR) have announced a range of policy response measures.

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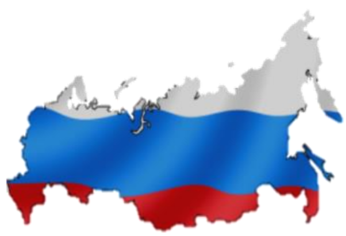
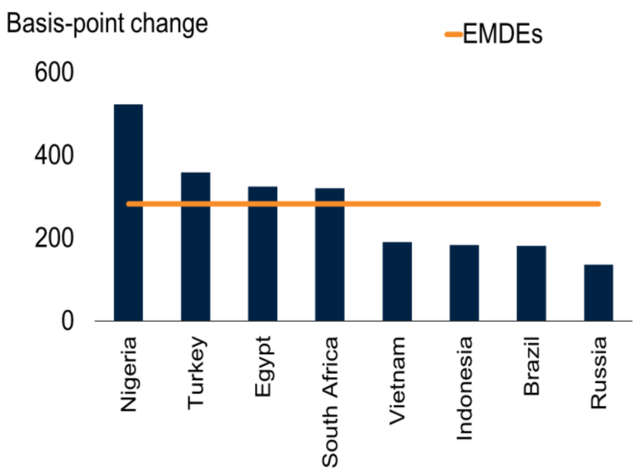
The Global Context



The COVID-19 pandemic is severely affecting global economic activity as countries race to stem the spread of the virus. Although the size of economic disruption remains uncertain, incoming data suggest that the scale of damage is exceptionally severe. In February, a contraction in China's economic activity dragged the global composite PMI down by 6.1 points to 46.1—the steepest single month decline since October 2001, and the lowest level since the 2009 global recession. However, as China's cases dwindle and its economy recovers, the surge in cases elsewhere will continue to pull down global activity, with U.S. retail sales in March registering their largest single month decline in history. Nearly every country in the world has now reported COVID-19 cases, with official numbers reaching two million worldwide on April 15. The U.S. leads in the number of confirmed COVID-19 cases, but Euro Area countries continue to experience significantly higher death rates, with Belgium and Italy leading at 12.8 percent and the United Kingdom not far behind at 12.7 percent.

A sharp rise in risk aversion has led to the EMDEs witnessing record portfolio outflows since the beginning of the year compared to any recent episode of sudden stops of capital flows. In March alone, portfolio outflows from EMDEs (excluding China and Taiwan (China)) reached US$50 billion including nearly US$30 billion of debt outflows – the largest monthly drop of capital inflows on record. Meanwhile, issuance of new debt in many EMDEs (down by 65 percent in March) has been canceled or delayed amid weak global demand and higher spreads. These massive capital outflows have been reigniting currency depreciation pressures and triggering the loss of reserves across many EMDEs. Weaker currencies, in turn, are contributing to higher borrowing costs and debt distress in EMDEs with large levels of the foreign-currency denominated debt as well as in countries where nonresident investors account for a sizable share of the local bond markets (Figure 1).

Figure 1: Weaker currencies are contributing to higher borrowing costs and debt distress in EMDEs



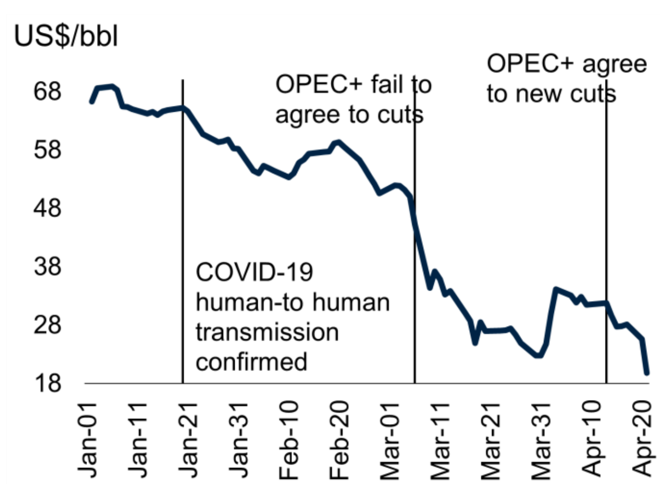
Source: J.P. Morgan, World Bank.
Note: Figure shows chnage in J.P. Morgan Emerging Market Bond Index (EMBI) spread since January 2, 2020. Last observation is April 17, 2020.

Initial signs that the epidemiological curve is beginning to flatten have spurred some countries to begin relaxing mitigation measures, signaling a moderate rebound in equity markets and a stabilization of private borrowing costs, which had more than doubled since the beginning of the year across many debt segments. Massive monetary easing measures and fiscal support packages have attempted to provide desperately needed funding to at-risk businesses and to quell market volatility, but sky-rocketing unemployment numbers—such as in the U.S., where 22 million people filed for unemployment since mid-March—raise concern as to the sheer magnitude of additional funding necessary to tide economies over until COVID-19 cases diminish.

Oil prices plummeted in April. Brent crude oil prices fell to a multi-decade low of US$20/bbl, 70 percent below their January peak. The WTI Cushing contract for delivery in May fell to -US$37/bbl. The magnitude of the collapse was due to both fundamentals—weak demand and limited storage capacity—and technical factors. On the technical side, the drop reflected the fact that the May contract expired on April 21, and there was very limited storage capacity available for physical deliveries for the contract. In contrast, the contract price for delivery in June (less immediately affected by these issues), did not see a decline of the same magnitude.

However, subsequent price movements of other benchmarks and contracts confirm that the fundamentals of weak demand and limited storage capacity are becoming increasingly severe across the crude oil market. Demand for oil has collapsed as a result of COVID-19 mitigation measures which have sharply curtailed travel and transport, which accounts for around two-thirds of oil demand. Crude oil demand fell 6 percent in 2020 Q1 (y/y), and the International Energy Agency expects the fall to deepen to 23 percent in 2020Q2—an unprecedentedly large decline. The fall in prices was exacerbated by the breakdown of the production agreement by OPEC and its partners, including Russia, in early March, with Saudi Arabia announcing it intended to increase production to 12mb/d in April. The group reached a new production agreement in April, and agreed to cuts of 9.7mb/d in May and June 2020, dropping to 7.7mb/d for 2020H2, and 5.8mb/d from January 2021 to April 2022. However, prices were little changed after the announcement, suggesting markets do not expect the cut to be sufficient to offset the sharp fall in demand.

Figure 2: In April, Brent crude oil prices fell to a multi-decade low



Source: Bloomberg.

Recent economic developments

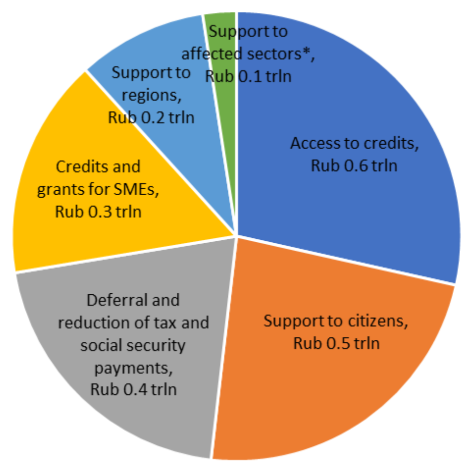
As of April 23, 62,773 COVID-19 cases (555 deaths) were registered in Russia. Starting March 30, all non-essential work has been suspended in Moscow and Moscow oblast until April 30 and people are advised to stay at home. The regional governments have been urged to follow these measures. A QR code pass system to allow residents to leave their homes for essential reasons has been launched in Moscow, Moscow oblast and some other regions.

To counter the socio-economic effects of the COVID-19 pandemic, preserve financial stability and provide support to the real economy, the Russian Government and the CBR announced a range of policy response measures amounting to RUB 2.1 trillion (1.9 percent of GDP) [1] (Figure 3). The government deferred the tax payments (except VAT) for vulnerable sectors such as transport; culture, leisure and entertainment; cinemas; health and sports; dental services; tourism; hotel industry; catering; supplementary education organizations, non-state educational institutions; operations on conferences and exhibitions organization; non-food retail; consumer services (repairs, laundry, dry cleaning, hairdressing and beauty treatment); construction. For SMEs, additional key measures include (but are not limited to) a six-month deferral on social security payments as well as a temporary deferral of rental payments on state or municipal property; a reduction of security requirements for SME contracts in public procurement; a social tax rate cut from 30 percent to 15 percent; a six-month moratorium on fines, bankruptcy, and inspections; interest free loans aimed at salary payments for SMEs and large companies. Microbusinesses will be given more time to make social security payments. The Moscow city government expanded the measures for Moscow SMEs. Additional measures include an exemption from rental payments on Moscow property until July 1 (this applies to organizations in the field of culture, fitness and sports, exhibition, entertainment and education, which suspended their activities); deferral of tax payments (property and land tax, trade fee) until December 31; compensation of 50 percent of land and property taxes to property owners who halve rents; expansion of subsidies and grants to SMEs.

For the duration of the pandemic, unemployment benefit is set to equal the minimum wage (about US$160); formal sector workers who lost their jobs and got registered as unemployed after March 1 will be paid unemployment benefits for three months. From April to June medical staff in contact with COVID-19 patients will receive additional monthly payments (financed through the federal budget). Families entitled to maternity capital and those families in which parents lost work will receive additional payments. Citizens affected by the virus (who fall sick or lose more than 30 percent of their income) will be able to delay loan repayments on both mortgages and non-mortgage loans. In addition, measures address an expansion of a special tax regime for self-employed workers, starting July 2020, and a moratorium on cutting utility services for debts and fines for late payments by the end of 2020.

RUB 200 billion (US$2.6 billion) will be allocated to the regions to balance their budgets.

Figure 3: The package of government policy response measures aims to support businesses in the most affected sectors and households



Source: Government RF, World Bank staff calculations.
*Aviation, travel agencies, tourism, hotels, pharmacy.

The set of CBR's measures include (i) continuously providing FX liquidity. It also increased the limit on its FX swap operations; (ii) allowing regulatory forbearance for banks and micro-finance organizations to allow the restructuring of loans for SMEs and individuals affected by the pandemic, and softening requirements for lending

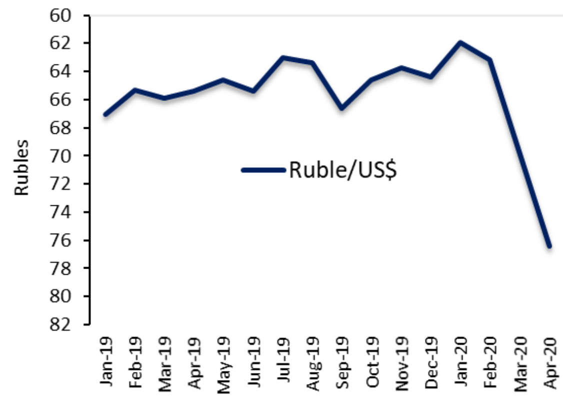
[1] Source: Government RF.

to the most affected industries; (iii) expanding subsidized lending and partial credit guaranty programs to SMEs, and (iv) lowering cost of electronic money transfers, among others. Moreover, the CBR approved measures to maintain the availability of insurance services, to support professional participants in the securities market and trading and clearing infrastructure, to protect retail borrowers suffering from the pandemic, and to support collective investment market participants.

On April 10, the CBR sold its controlling stake in Sberbank. The MoF purchased 50 percent stake using the National Welfare Fund (NWF) in one move at a price of RUB 189.4 per share. The total amount of the deal is RUB 2.1 trillion (US$ 28 billion). Due to legal technicalities, the transfer of 1 share remaining with the CBR will be effected by May 6, 2020.

The ruble weakened on the back of lower oil prices and slowing activity due to lockdown measures amidst COVID-19, reaching an estimated average of 73.7 RUB/USD in March (compared to an average of 63.9 RUB/USD in February) (Figure 4). Negative dynamics were also registered for other emerging market currencies, as the MSCI International Emerging Market Currency Index declined by 3.5 percent in March, after a 1.5 percent decline in the previous month. The CBR has taken preventative measures to address exchange rate volatility. With the oil price going below the fiscal rule threshold, starting March 10, the CBR has switched to foreign currency (FX) sales in the fiscal rule framework. In addition to that, on March 19, the CBR established a mechanism for additional FX sales on the domestic market. In case the price for Urals oil falls below US$25/bbl, the CBR will conduct FX sales to compensate for oil, gas, and oil products exporters' revenue fallout. The CBR will use FX from the government's purchase of Sberbank shares.

Figure 4: In March, the ruble weakened with respect to the U.S. dollar on the back of lower oil prices

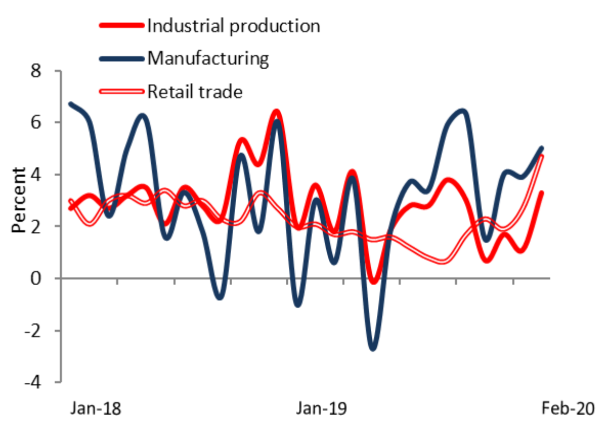


Source: Bank of Russia.

The current account (CA) surplus shrank in 2020Q1, compared to the same period in the previous year, as the trade balance narrowed largely amidst lower energy commodities prices. In 2020Q1, the CA surplus decreased to US$21.7 billion from US$33.6 billion in the same period last year. The trade balance surplus registered at US$32.1 billion, compared to US$47 in 2019Q1, mostly due to a fall in commodities exports on the back of lower commodity prices due to the spread of COVID-19 and the OPEC+ fall-out. Net private capital outflows narrowed to US$17 billion compared to US$24 billion in the previous year, mainly in line with transactions by the non-banking sector, which allocated less assets abroad and reduced external liabilities. International reserves gained US$5 billion in 2020Q1 compared to US$18.6 billion in the same period last year, largely due to FX purchases in the domestic market in line with the fiscal rule.

In annual terms, in February 2020, industrial production growth accelerated to 3.3 percent, y/y, compared to 1.1 percent, y/y, in January, partly reflection a leap year factor (Figure 5). In particular, the extraction of coal, gas, and other minerals grew by 2.3 percent, y/y, (versus -0.4 percent in January) and contributed the most to industrial production growth. At the same time, growth in manufacturing increased to 5.0 percent in February, y/y, from 3.9 percent, y/y, in January. For the period of January-February 2020, industrial production grew by 2.2 percent compared to the same period of 2019.

Figure 5: Industrial production output growth accelerated in February

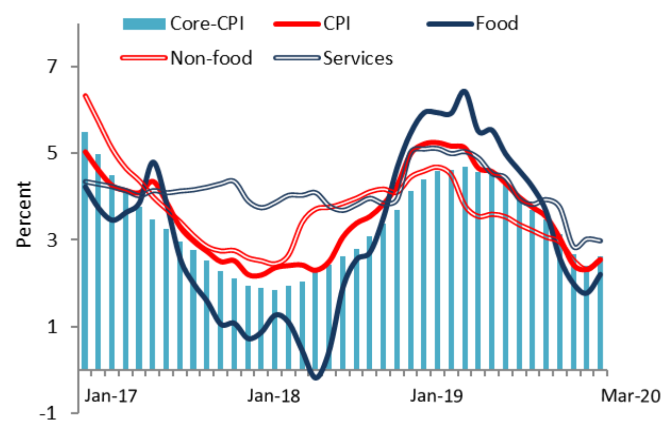


Source: Rosstat, Haver Analytics, World Bank team.

In March 2020, annual consumer price inflation accelerated to 2.5 percent, up from 2.3 percent in February (Figure 6). The weaker ruble (nominal effective exchange rate depreciated by 11.7 percent in March, m/m) was the main factor for inflation acceleration. 12-month food inflation increased to 2.2 percent, y/y, compared to 1.7 percent in February. Core consumer price index increased to 2.6 percent in March, up from 2.4 percent in February. In March, households' inflation expectations remained unchanged (7.9 percent in annual terms) partly reflecting that the survey was conducted in the beginning of March, before major bouts of volatility in the ER. The share of enterprises expecting price increases in the coming three months rose to 18.0 percent in March, up from 13.4 percent in February, on the back of the ruble depreciation, one-off increase in demand, and expectations of increased production costs.

On April 24, the CBR decided to cut the policy rate by 50 bp to 5.50 percent in annual terms. The CBR noted that it switched to accommodative monetary policy (after putting monetary easing on hold in March) and hinted possible further policy rate cuts. In view of the regulator, the disinflationary pressure of weak demand will offset the effect of temporary pro-inflationary factors (the ruble weakening and the observed elevated demand for individual products). A rise in inflation expectations is considered as temporary. The CBR noted a slight stabilization in global financial markets as compared to March, which was largely driven by measures being implemented by the central banks of reserve-currency countries. The regulator's decision on policy rate is based on its new macroeconomic forecast with much slower growth. The CBR expects GDP to decrease by 4-6 percent in 2020. In 2021 – 2022, the economy is expected to return to growth of 3–5 percent and 1.5–3.5 percent, respectively. The next Board Meeting is scheduled for June 19.

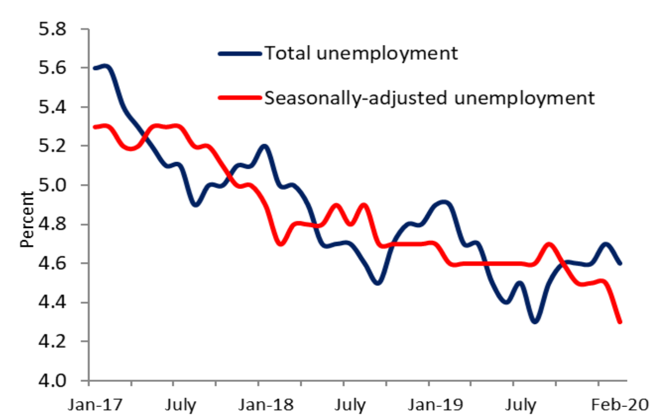
Figure 6: In March, annual consumer price inflation accelerated



Source: Haver Analytics.

Labor market dynamics were positive in February 2020. Unemployment rate decreased slightly to 4.6 percent in February from 4.7 percent in January. The seasonally adjusted rate decreased even more from 4.5 percent in January to 4.3 percent in February (Figure 7). Information on real wage is now being published with one-month lag. In January 2020 this indicator increased by 6.5 percent compared to the same period of 2019.

Figure 7: In February, the labor market dynamics were positive

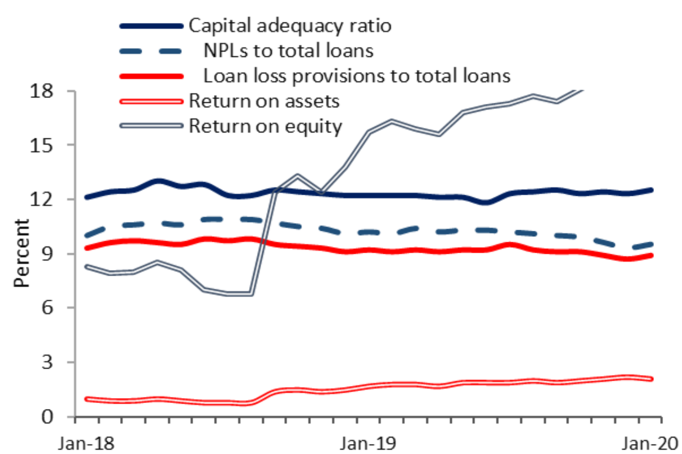


Source: Rosstat, Haver Analytics, World Bank team.

In the first three months of 2020, the federal budget surplus dropped to 0.05 percent of GDP (cash basis) from 2.2 percent of GDP in the same period last year. This came on the back of higher non-interest spending in January and March, while federal budget revenues slightly decreased. Non-oil/gas revenues grew to 11.3 percent of GDP in the January-March 2020 period compared to 10.5 percent of GDP in the same period last year. Growth was mainly registered in January and March and could be attributed to one-off factors (January) and to a weaker ruble with respect to the U.S. dollar on an annual basis (March). Oil and gas revenues dropped to 6.9 percent of GDP, down from 7.9 percent of GDP in the same period last year, as energy prices slumped. Primary expenditures increased by 2.5 percent of GDP in 2020Q1. Spending on health (0.9 pp), national economy (0.2 pp), and housing services (0.2 pp) were the main drivers of this growth. Higher primary spending led to a deterioration of non-oil/gas federal budget primary deficit, which reached 6.8 percent of GDP compared to a deficit of 5.3 percent of GDP in the same period last year. In March, the government transferred FX currency in the equivalent of US$43.5 billion to the NWF, which was purchased in 2019 in the fiscal rule framework. As of April 1, 2020, the NWF reached US$165.4 billion (9.8 percent of GDP).

Key credit risk and performance indicators remained stable (Figure 8), while credit growth in all segments slowed down. As of February 1, 2020, the capital adequacy ratio stood at 12.5 percent (against a regulatory minimum of 8 percent). Non-performing loans stayed elevated at 9.5 percent of total loans. In January-February, the net banking sector's profit amounted to RUB 337 billion (US$5.3 billion) compared to RUB 445 billion (US$6.7 billion) in the same period in 2019. As of February 1, return on assets (ROA) and return on equity (ROE) reached 2.1 percent and 19.1 percent, respectively, compared to 1.5 percent and 13.8 percent, respectively, in the beginning of the year. Lending to households continued to slow in February (17.9 percent, y/y, compared to 23.5, y/y percent in January). Credit to the corporate sector also slowed, reaching 4.1 percent after adjusting for FX changes, y/y, as of March 1, 2020.

Figure 8: In the beginning of 2020, key credit risk and banking performance indicators remained stable



Source: Bank of Russia.

The CBR continues to remove insolvent banks. As of March 1, 2020, there were 436 banks compared to 442 at the beginning of 2020

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Please contact Apurva Sanghi: asanghi@worldbank.org

Prepared by a World Bank team under the guidance of Apurva Sanghi, consisting of Peter Nagle, Collette Mari Wheeler, Olga Emelyanova, Katerina Levitanskaya, Mikhail Matytsin, Irina Rostovtseva and Lucie Wuester.