Russian Economy in 3Q20

Recovery slowing down amid rising uncertainty

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Key takeaways

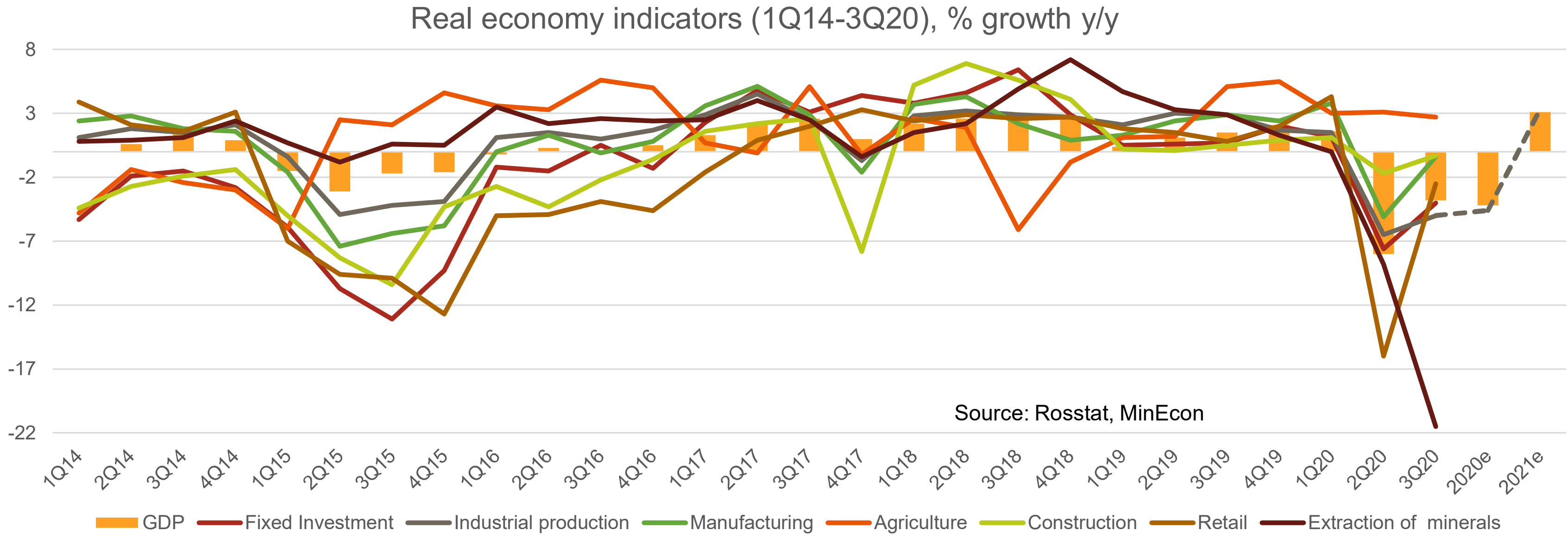
Recent events in 3Q20 for the Russian economy

- **Growth of COVID-19 has surged again to new highs of over 21 000/daily confirmed infections.** The level of infections is not directly comparable to the Spring levels as Russia is conducting nearly 600 th tests daily. Also, the positivity rate still remains at a relatively good level of 4 %, which could however be reversed fast.
- **Real GDP decrease in 3Q20 halved from the last quarter and estimated at -3.8 % (y/y).** Recovery was advancing fast in July but started to decelerate in August and came to a near halt in September.
- **Decline in industry deepened in September.** Manufacturing was recovering nicely in 3Q20 (-0.4 %, y/y) but prospects worsening again in September. Extractive industry decline deepened due to a weakening oil price and the OPEC+ production cut agreement.
- **Rouble depreciated to its lowest level since Dec 2014 in October but started to moderately appreciate after the U.S. presidential elections.** Rouble weakened considerably in 3Q20 as **the** threat of new sanctions and other geopolitical tensions intensified and due to negative news from EU area recovery. Most forecasts, however, see strengthening ahead for the end of 2020 and 2021 and view the Rouble as undervalued.
- **Inflation moderately accelerated to 4 % in October due to a weaker currency.** Inflation is currently exactly at the CBR target rate but expected to decelerate towards the end of the year due to new coronavirus restrictions that will constrain consumption demand.
- **Sentiments in industry worsening again after Summer recovery.** Sentiment in manufacturing industry turned to negative in September and darkened further in October while services sentiment remained moderately positive.
- **Real monetary incomes down -3.6 % but real wages still growing in 3Q20.** Real disposable incomes contracted by -4.8 (y/y) in 3Q20 (vs -8.4 % in 2Q20).
- **Mortgage market is experiencing a boom in Russia** due to a generous state support system, lower CBR key interest rates and a relative lack of alternatives for investment. The boom has raised worries of over-heating in the housing market and Central Bank is following the situation closely.
- **Unemployment decreased marginally in September but could be only short-lived.** The number of unemployed still remains 40 % than a year ago and the unemployment rate stands at 6.3 %.

Russian economy in 3Q20

Recovery advancing in 3Q20 but mixed results for the end of the period

Economic decline narrowed sharply in 3Q20 but recovery weakening in August-September

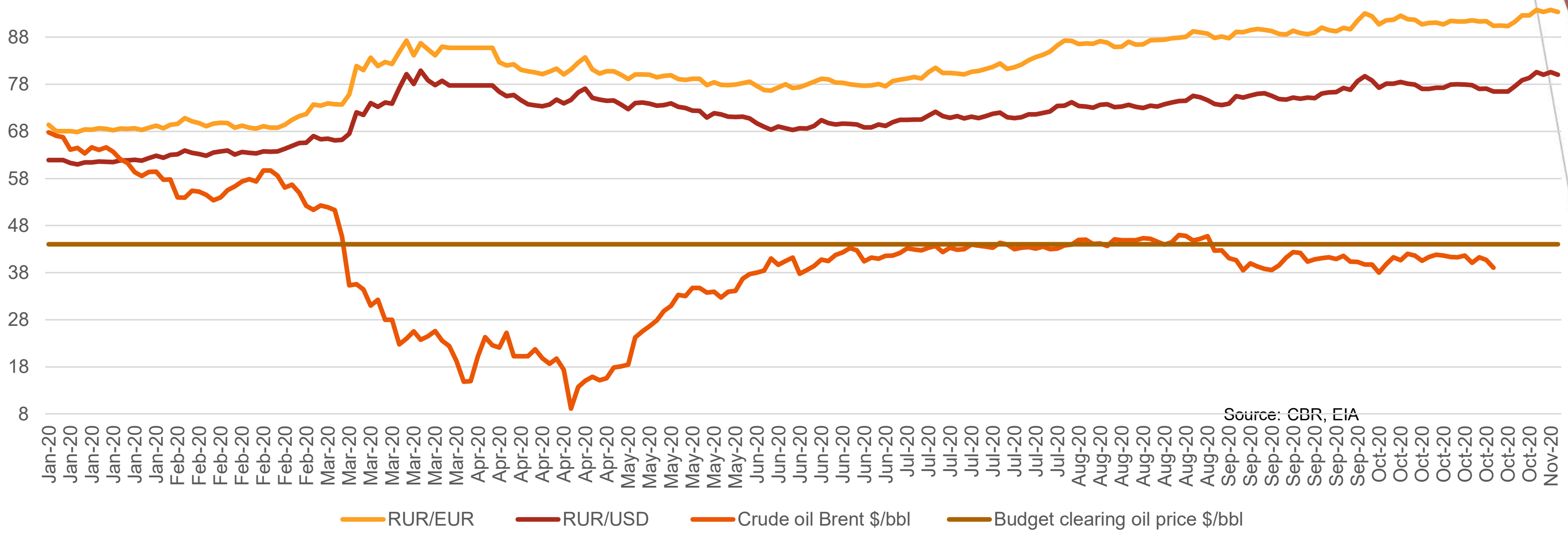


Real GDP contraction in 3Q20 estimated at around -3.8 % (vs -8 % y/y in 2Q30)

- Retail sector decline was -3 % in 3Q20 (y/y) improved from -16 % (y/y) in 2Q20 but recovery slowed down towards the end of the quarter. Service sector recovery was lagging behind most sectors and its output remained -22 % in 3Q20 compared to a year ago.
- Manufacturing recovered close to previous year's levels (-0.4 % y/y). The extractives sector contraction deepened to -21.5 % in 3Q20 (vs -8.8 % in 2Q20) mostly due to weak global demand and a high base level from last year.
- Construction sector contracted only -0.3 % (y/y) possibly boosted by continued strong demand for real estate supported by state mortgage support subsidies.
- Only agriculture showed positive (2.7 % y/y) but slightly weaker dynamics in 3Q20.

Rouble weakening fast in 3Q20

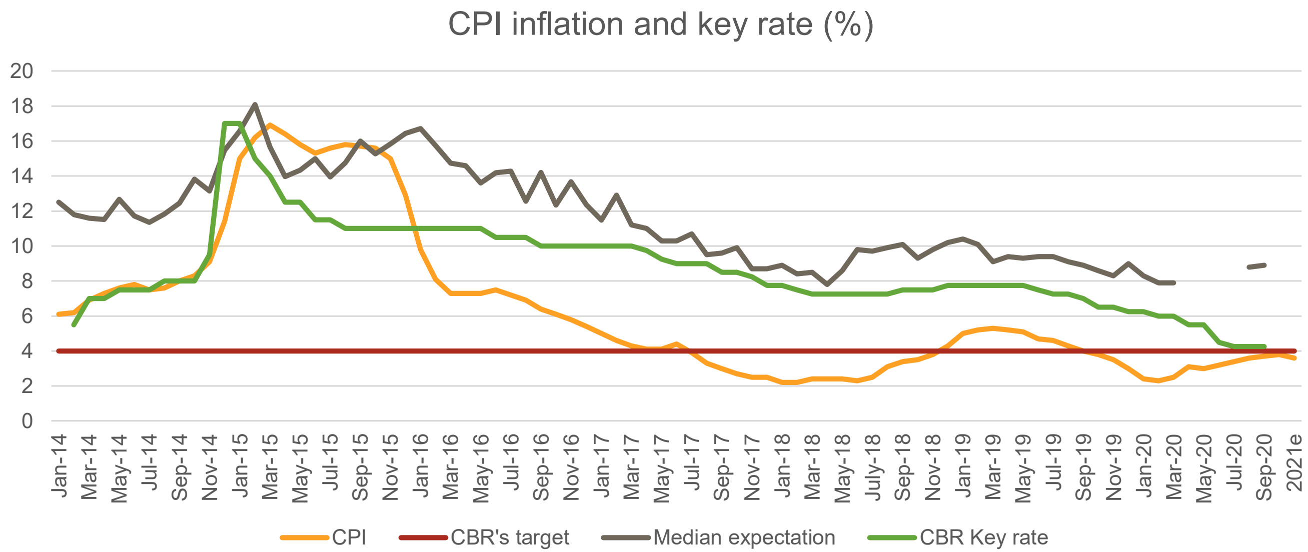
Rouble FX rate EUR, USD and oil price (Brent $/bbl)



Rouble depreciated in October to its lowest level since December 2014

- RUR has sharply depreciated throughout 3Q20 following heightened geopolitical tensions, subsequent interest rate cuts and negative news on economic development. The geopolitical woes were mostly related to the U.S. presidential elections and EU sanctions related to the poisoning of opposition leader Navalnyi.
- During the last month, the decline in oil prices amid the pandemic and the expansion of restrictions in Europe puts pressure on the Russian currency against EUR and the U.S. elections. Rouble has actually been slightly upbeat since the U.S. election day. If the debate or recount demands for the elections drag on for long in the U.S., it will have a clear negative effect on currency market and accumulate uncertainty.
- RUR depreciation is restrained by the sale of foreign currency by the Bank of Russia and the Finance Ministry is expected to sell about RUR 83 bn worth of foreign currency under the budget rule. This slightly below Oct-20 levels but should provide some support for the RUR.
- RUR is expected to stay weak against the EUR but appreciate in December and settle below 90. Recovery in the RUR is expected to continue in 2021 to closer to 80 given no adverse surprises.

Inflation moderately accelerated in 3Q20 driven by a weaker currency



September-2020 % y/y	
CPI	3.7
Food	4.4
Non-food	3.8
Services	2.5

Source: CBR

Inflation accelerated but deceleration of services demand slowing inflation

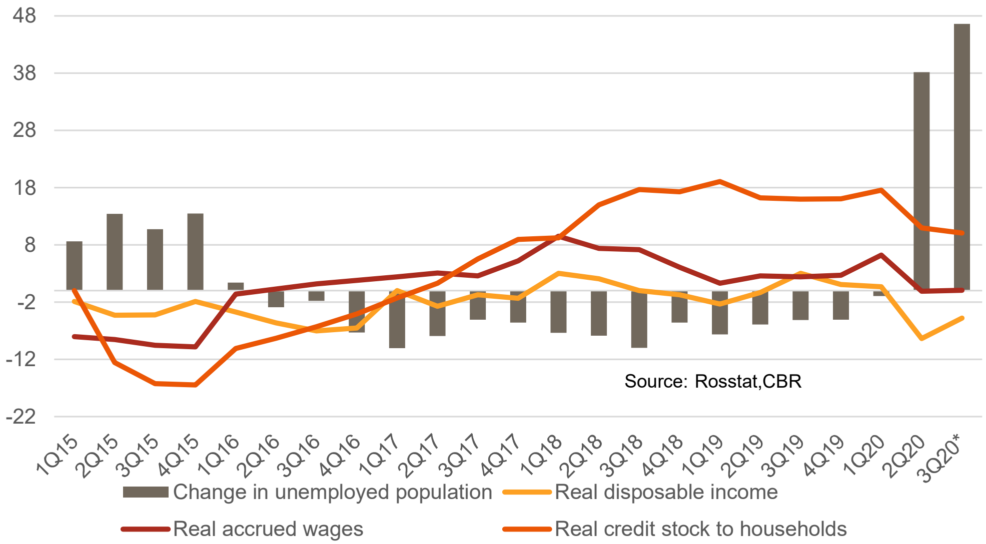
- The inflationary impact was mainly due to the weakening of the rouble, while the growing food supply, restrained demand, and low growth rates of regulated prices for certain services had a limiting effect on inflation.
- Most forecasts expect inflation to remain at the CBR target of 4 % at maximum in 2020 and the moderate acceleration is backed by recent data on consumer inflation expectations. However, new major restrictions due to the pandemic that are likely to be implemented at least regionally, inflation could again decelerate.

Key rate decisions

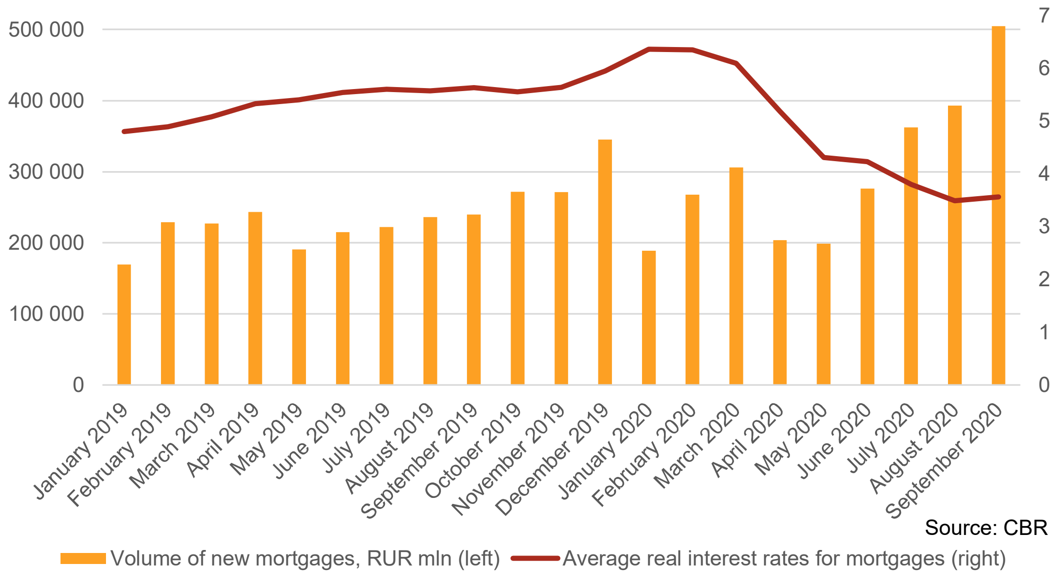
- CBR lowered its key interest rate in July-20 to a record low of 4.25 % to boost weakening economic activity. Since then the CBR has announced readiness to perform a further cut of 0.25 % but has refrained from doing so due to the weakening currency. Key rate is likely to stay at the current level or slightly lower at least up to the second half of 2021.

Unemployment growth halted in September and mortgage market booming

Income and change in unemployment (y/y, %)



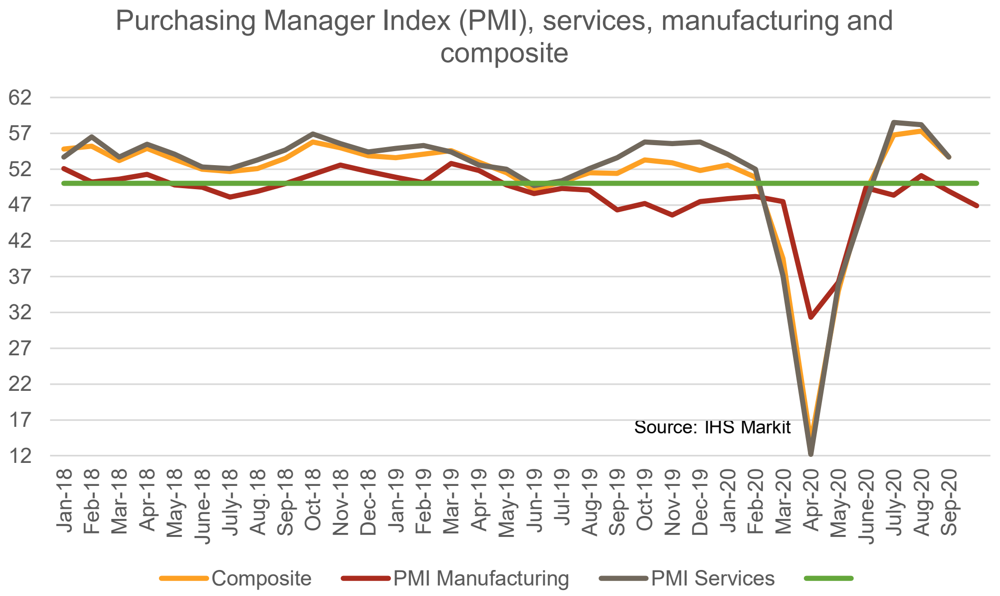
Mortgages and average interest rates on mortgages

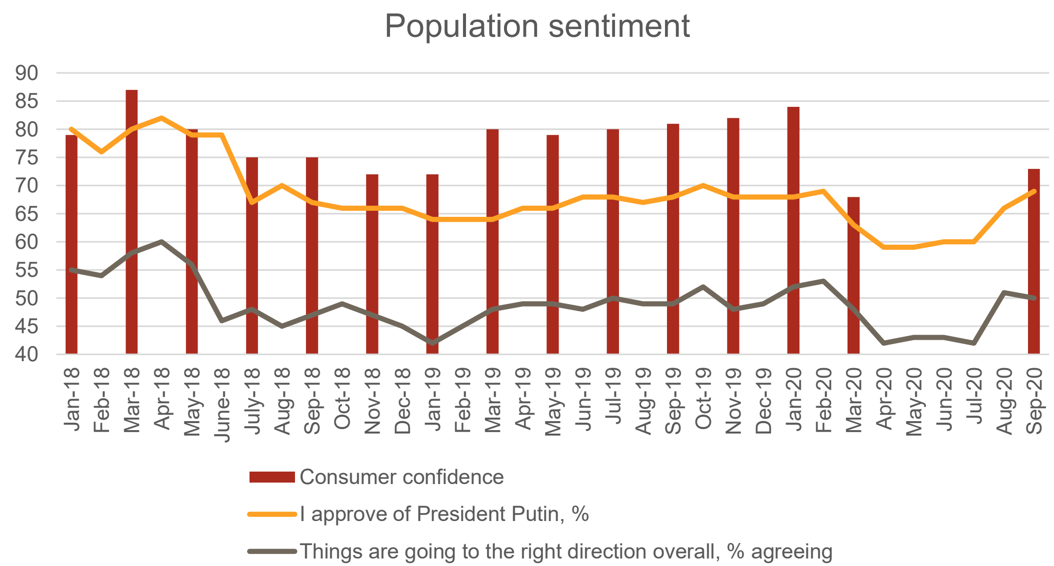


- Unemployment decreased marginally in Sep-20 vs Aug-20 but remains over 40 % higher in than a year ago
- Real wages growth was barely positive in Aug-20 (0.1 %) after a strong July with 2.9 % (y/y) growth. Most experts believe that this increase in real wages implies that the mostly low-paid workers were laid off.
- This is reflected in looking at dynamics in real incomes: real disposable incomes decreased by -4.8 % in 3Q20 (vs -8.4 % y/y in 2Q20) and real incomes by -3.6 % in 3Q20. Declines in real incomes show a prolonged distress for entrepreneurs.
- Unemployment rate (ILO standard) stands at 6.3 % in September (vs 4.6 % a year ago).

- Russia is experiencing a housing boom with the volume of granted mortgages in Sep-20 more than double compared to a year ago and constitues as the highes growth rate recorded in Russia.
- The boom is induced by a generous state support system, lower CBR key interest rates and a relative lack of alternatives for investment apart from the stock exchange. The state support program will continue at least up to the middle of 2021.
- The staggering growth of mortgages is raising worries of over-heating the market especilly during a severe recession in the real economy. CBR chief Nabiullina estimates that there is no housing bubble in Russia but the situation bears close surveillance.

Population and firm sentiments higher in 3Q20 with some reverse in September as infections rising again





- Sentiments especially in the services sector improved significantly in July as restrictions were eased in Russia and have remained still on the positive side in the Autumn. The relatively positive outlook in services reflects the emergence from complete lock-down to kick-starting the operations and a relatively calm period in the pandemic during the Summer.
- Manufacturing sentiment was raised to modestly positive August but has again worsened in Sep-Oct as recovery in the economy as a whole slowed down.

- President Putin's approval ratings have improved from the record lows of Spring but still remain lower than prior to the last presidential elections in March 2018.
- The share of people seeing that Russia is going in the right direction has increased in August after relief from the relatively good state of Russia related to wages and the epidemic as a whole.
- Consumer confidence that fell sharply in March (and was not polled in Apr-Aug) has also improved to the 2019 levels, which can be seen as a positive, albeit weak, sign for consumer sectors.

Kazakstan, Ukraine and Belarus

Recovery at risk

Kazakh economy to out-perform other CIS and emerging countries in 2020

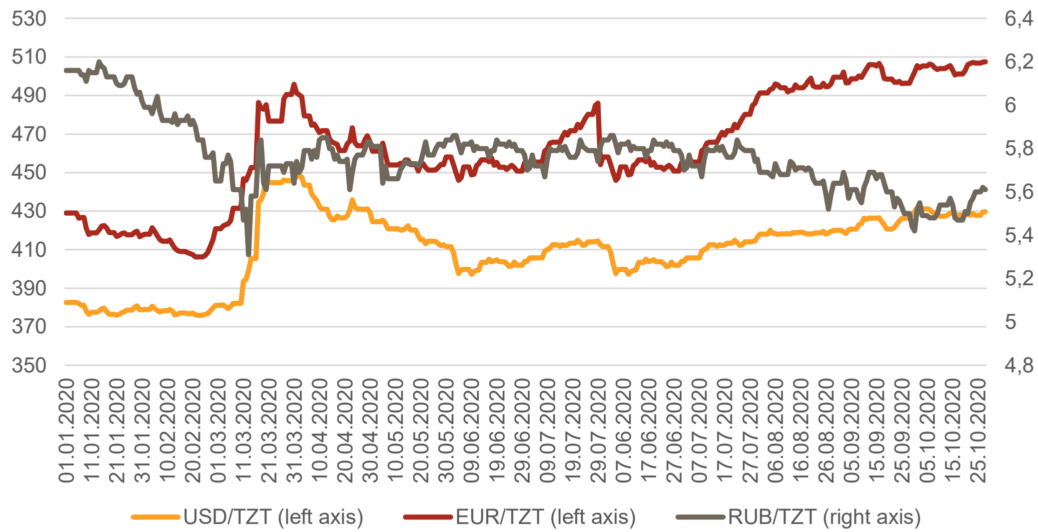
Kazakhstan is likely to survive the corona crisis with a relatively small decline in the economy as a whole (-2.4 % y/y real GDP in 2020). Based on the first 9 months of 2020, large scale decline in the economy was averted with strong results from manufacturing (+3.3 % y/y), construction (+10.5 %) and agriculture (+5 %).In addition, the important extractive sector, namely oil, natural gas and uranium extraction, contracted by only -2.2 % in Jan-Sep 2020.

The decline in business activity has taken its toll on banks. A growing number of creditors in Kazakhstan are struggling to keep up with loan repayments because of the economic crash caused by the coronavirus outbreak. According to the National Bank, the volume of overdue loans is up by 10 % since January. In September, a major bank, Tengri, was deprived of its license for conducting banking and other operations, after the bank's share of non-performing loans had exceeded 80 per cent of its overall credit portfolio. Just over a year ago, in June 2019, president Tokayev made precedent by approving to lighten the debt burden of around 3 million citizens. The government has not indicated its willingness to reprise this expensive gesture.

After the first set of Covid-19 restrictions were relaxed at the beginning of summer, the pandemic quickly spread again, and the second national lockdown was introduced early July. The lock-down was then removed on the 16th of August. Though the situation seemed to stabilize after that, the country started to prepare for the possible second wave by building new hospitals and purchasing medical equipment in advance. Kazakhstan was planning to end its suspension of visa-free regime for citizens of 57 countries 1st of November, but it was extended quite suddenly until May 2021 due to increasing daily numbers. The president Tokayev has set the date of parliamentary elections for January 10th. These will be the first parliamentary elections after Tokayev succeeded Nursultan Nazarbayev 2019.

Analysis by Sinikka Parviainen and Sanna Hentunen

Tenge FX rates against EUR, USD and RUR



Main economic indicators	Real		Forecast	
	2019	9m20	2020	2021
GDP, % y/y	4.5	-2.5*	-2.4	3.8
Industrial production, % y/y	7.1	0.0	-2.3	3.2
Inflation, % y/y	5.4	7.1	7.1	6.3
Current Account Balance, USD bn	-0.9	-5.5**	-5.7	-4.2

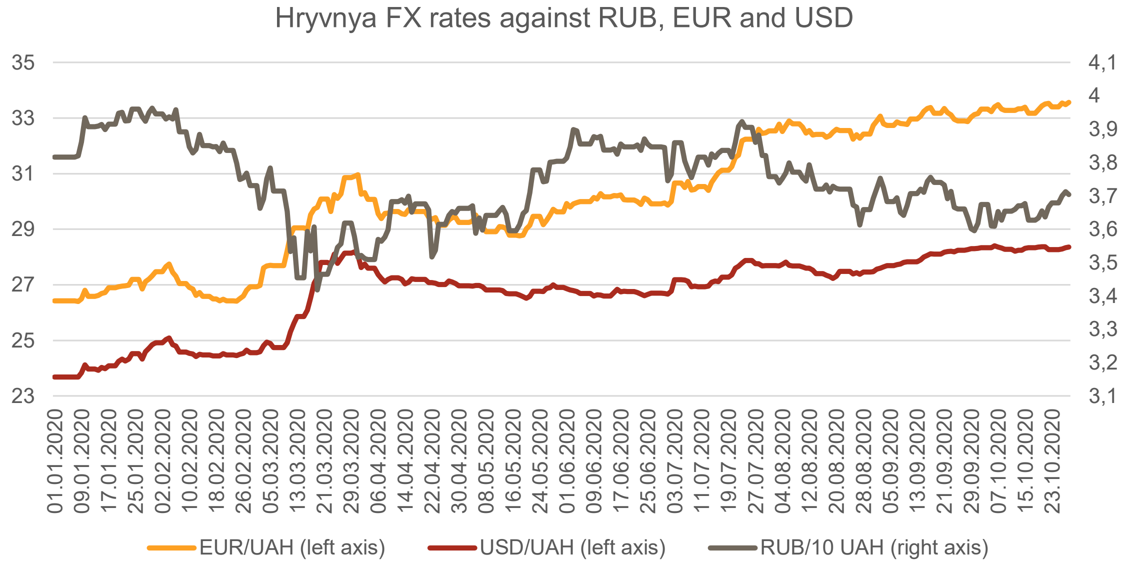
*short-term economic indicators for the main sectors' output **preliminary estimate.
Source: Natinal Bank of Kazakhstan, Ministry of National Economy of the Republic of Kazakhstan Committee on Statistics
Forecasts from Consensus Economics Oct 22, 2020 survey

Recovery taking leaps but major hurdles ahead for Ukraine on several fronts

Ukraine is lapsed in a continued loop of economic and political crises since the war started in Eastern Ukraine that is exacerbated by resurging COVID-19 infections. In 3Q20, however, economic dynamics improved compared to 2Q20. Industrial output contracted by 4.6% (vs 11.4% decline in 2Q20), agricultural output retreated 11.5% versus a 24.9% contraction (due to severe drought), and retail sales rebounded to show 9.6% growth, a substantial recovery from the 5.4% drop in 2Q20. There are some promising results from the first months of Autumn. In September, retail sales jumped 11.6%(y/y) vs 8.7% growth in August, likely supported by recovering real wages and expanding lending.

However, the pandemic is hampering these positive dynamics. Ukraine had to close its borders already the second time in August for 30 days from all foreign arrivals, which was even more notable, since most European countries were doing better at the time. On September 28, Ukraine reopened its borders. Despite tough restrictions, Ukraine´s Minister of Health Maksym Stepanov announced in November that the virus control efforts would be aimed at surviving these challenges with minimal costs as a new wave is imminent. Ukraine has already surpassed its previous daily records of new cases, hospitalized people and fatalities.

IMF and EU have delayed the $5 billion deal president Zelensky's government secured in June because of inability to tackle corruption and growing concerns over the independence of the National Bank. On October 27, Ukraine's Constitutional Court stripped the country's anti-corruption agency of some of its critical powers, which may have hurt the IMF deal and visa liberalization with the European Union even further. The court ruling was also controversial because four judges are under investigation by the anti-corruption agency. Ukrainians have protested this decision loudly in rallies along with president Zelensky, who has asked the parliament to vote to dissolve the Constitutional Court and reinstate anti-corruption laws it struck down. At the same time, the Council of Europe has warned, that terminating the powers of the judges would be a “flagrant violation” of Ukraine’s constitution.



Main economic indicators	Real		Forecast	
	2019	9m20	2020	2021
GDP, % y/y	3.2	-11.4*	-5.7	3.8
Inflation, % y/y	7.9	2.3	3.0	6.1
Industrial production, % y/y	-0.5	-7.0	-6.6	3.0
Current Account Balance, bn USD	-1.3	4.2**	1.6	-3.7

*For 1H20. **8m20. Source: National Bank of Ukraine, UkrStat
Forecasts from Consensus Economics Oct 22, 2020 survey

Belarus has so far weathered the crisis better than most but political turmoil is set to exacerbate the recession

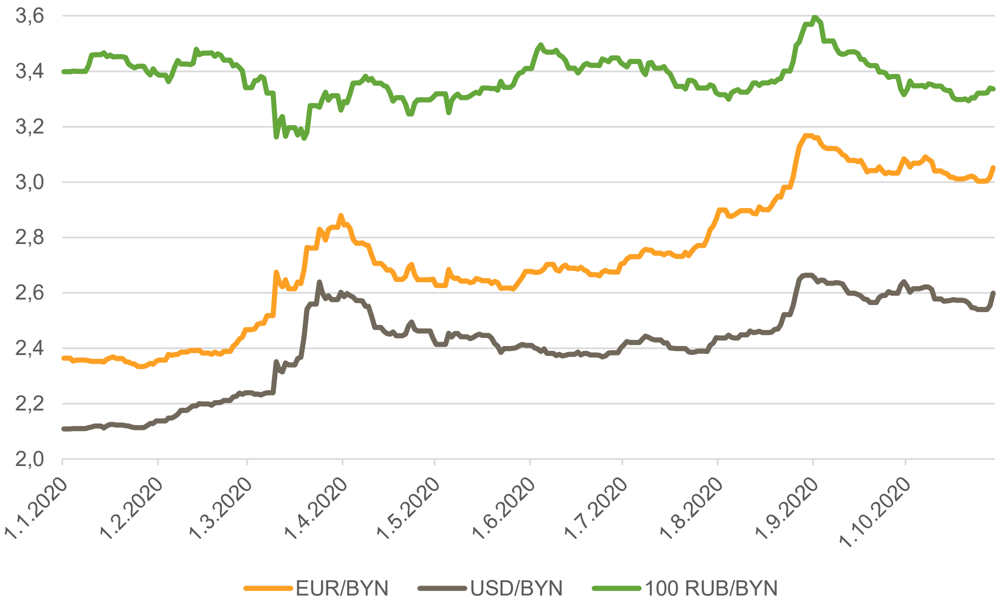
The coronavirus seems to have had a smaller than expected effect on the Belarus economy and the effect of relatively laxed virus restrictions have resulted in a decline in real GDP of only -1.3 % in Jan-Sep 2020. The main reason for this has been the ability of industrial enterprises to largely continue production. Retail demand also contributed positively (+2.7 % y/y in 8m20) and agriculture growth amounted to 7.9 % (y/y) in 8m20. However, the political impasse since the presidential elections and the general strike induced since Oct 25th by the opposition is likely to have a more negative effect on the economy towards the end of 2020.

Belarus rouble has been under pressure since large protests started after the presidential elections. The currency depreciation has led the National Bank to hike its key rate, which will constrain consumption and affect economic development negatively in the last quarter of 2020.

After 3 months since the disputed election, Belarusian protests are still going strong. Although Lukashenko's regime has introduced mass arrests, intimidation tactics, violence and threats, people keep rallying around the country.

The opposition candidate, Tikhanovskaya, who is widely considered the actual winner of the elections, managed to re-mobilize people on late October by giving Lukashenko an ultimatum and threatening him with a national strike. The Deadline was set to 25th of October, Sunday, a day that witnessed 200 000 protesters in the streets of Minsk. There are some records of arrest around factories, hundreds of arrests in the rallies and factory workers testimonies on Youtube on how the KGB has threatened them. Due to lack of independent media and no international media presence in Belarus, there is no reliable estimate of how large-scale the strike is. It seems clear, though that the strike has so far failed to stop the production at state-run companies.

Belarusian Rouble rate against EUR, USD and EUR



Main economic indicators	Real		Forecast	
	2019	9m20	2020	2021
GDP, % y/y	1.2	-1.3	-4.4	1.5
Inflation, % y/y	5.6	6.1	5.5	5.8
Industrial production, % y/y	1.0	-1.8	-5.4	1.0
Current Account Balance, USD bn	-1.2	-1.1*	-2.2	-1.8

*for 1H20. Source: National Bank of Belarus, Sberbank
Forecasts from Consensus Economics Oct 22, 2020 survey

Moscow city and St. Petersburg

Northern capital facing a worsening second wave

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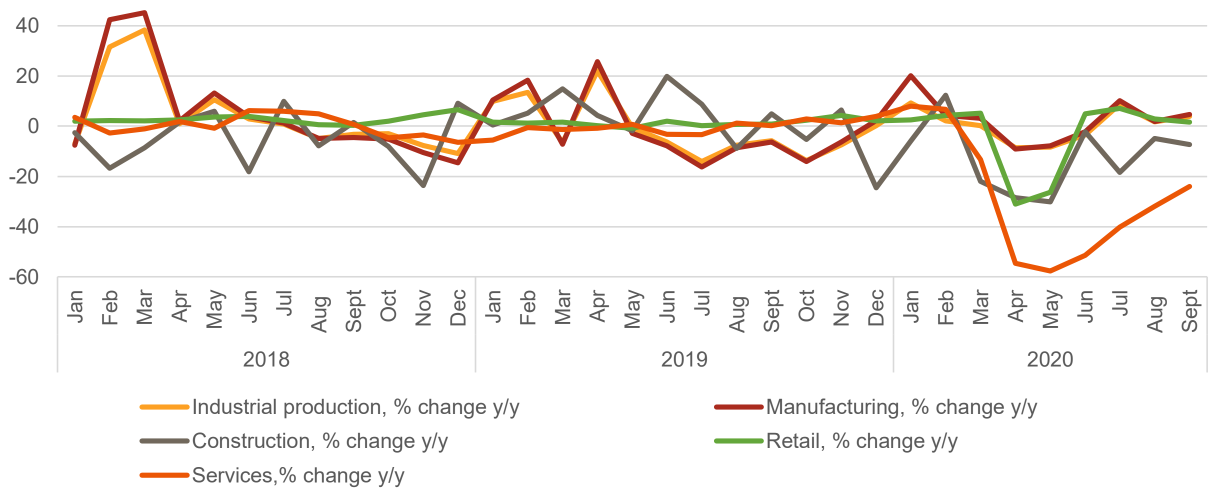
Recovery on track in Moscow after a record drop in the city's economy

Especially Moscow's service sector has suffered under the strict lock-down but showed weak signs of bottoming-out in June. Especially due to the large service and retail sector as well as the strictest lockdown, Moscow is the worst affected region in the country. Also, the city's construction sector has reached its low point in the recession by May. However, retail and industrial production were showing signs of weak recovery already in May. Even though nominal wages managed grow in Russia in Jan-May 2020 nominal wages in Moscow decreased due to large share of people working in services and retail. Unemployment also increased to over 145 th. people in the city but still remains at a low level (2 %) compared to the national average (6.2 %).

As Moscow has been hit by a rapid new spike in Corona cases, the Russian capital has ordered all organizations to ensure that at least 30 per cent of their staff work remotely. The mayor Sobyanin, who was re-elected as a mayor in September, ordered employers to file weekly updates with the city that include their personal information, such as phone numbers and vehicle registration information. Failure to provide this information can result in fines up to RUB 200,000 (US$2,600). Many have criticized the new regulations as infringing on the right to privacy.

Main economic sectors in Moscow, %-growth y/y



	Russia 9m20	9m20	2019	2018	2017
Inflation,CPI % y/y	3.7		3.4	4.3	3.8
Unemployment rate, (% average for the period)	6.4	3.3	1.4	1.2	1.4
Nominal wage, average monthly RUR	49 306*	101 551*	93 866	83 581	73 153
Nominal wage, Moscow city	-4.9*	-8.3*	12.3	14.3	2.8
Share of loss-making firms, (% average for the period)**	33.2*	34.6*	24.5	24.3	23.3

*data from May.
Source: Rosstat

Analysis by Sinikka Parviainen and Sanna Hentunen

Promising recovery in the Northern Capital threatened by a new stronger wave of infections

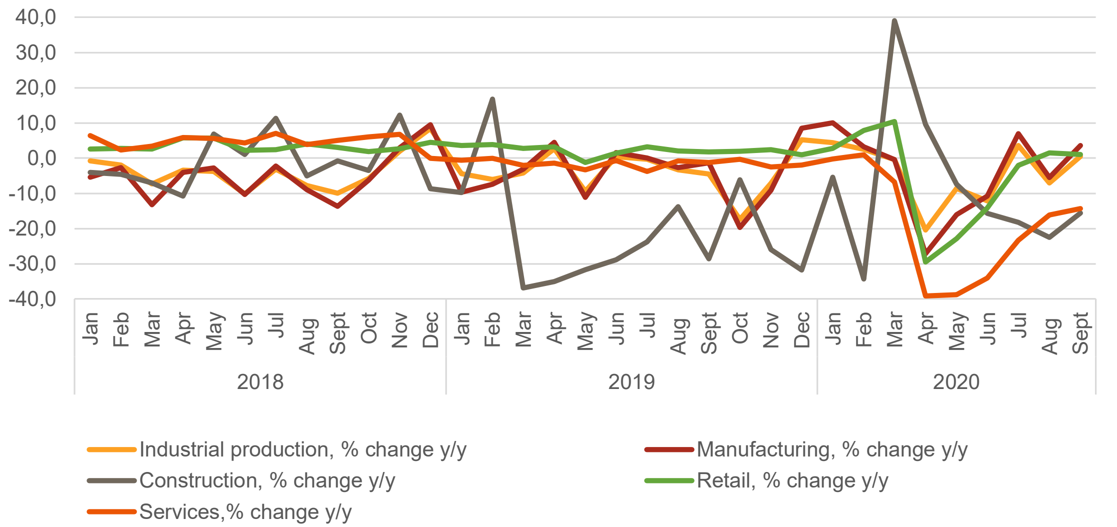
St. Petersburg's industry has suffered from the pandemic slightly more (-3.7 % y/y in 9m20) than the Russian average (2.9 %) due to a large share of consumer driven sectors (e.g. tourism). In 2Q20 the export-driven manufacturing and freight sectors that are a lifeline for the city have not recovered significantly from last quarter. The most affected areas are the consumer sector, tourism and culture. As in the country as a whole, recovery has advanced in 3Q20 but with differences between sectors. Namely, the important and most-affected service and retail sectors have continued to recover since April.

However, he resurging pandemic in the regions gain paints a rather gloomy outlook for the city's economy for the end of the year. During the past weeks, St. Petersburg has has witnessed a strong second wave of the virus that is feared to worse than the first wave. The city's mayor Beglov has recently warned his citizens that if they fail to comply with the requirements posed to them, such as using the protective equipment, the city government would have to introduce more restrictive measures.

The city government has supported its businesses moneywise and the last package was 18 billion RUR introduced in October. The second wave will move the "normality" further though, especially for tourism industry, which means the city is under pressure to develop new support measures.

Analysis by Sinikka Parviainen and Sanna Hentunen

Main economic sectors in St. Petersburg, %-growth y/y



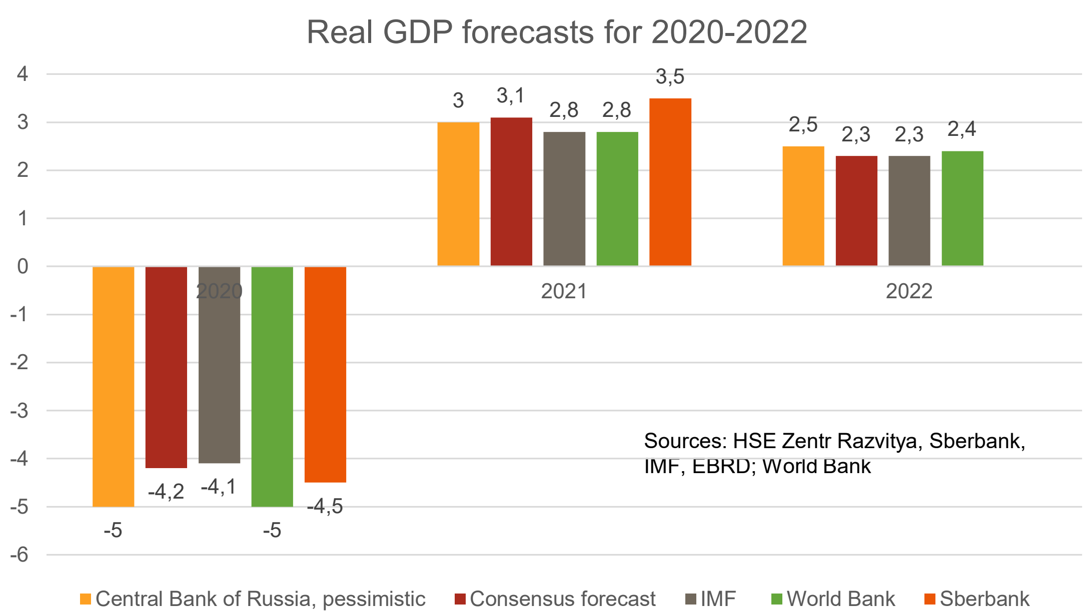
	Russia 9m20	9m20	2019	2018	2017
Inflation,CPI % y/y	3.7		3.0	3.9	3.7
Unemployment rate, (% average for the period)	6.4	3.8	1.4	1.5	1.7
Nominal wage, average monthly RUR*	49 306*	62 298*	63 235	60 225	54 321
Nominal wage, % growth y/y	-4.9*	-7.0*	5.0	10.9	11.5
Share of loss-making firms, %	33.2*	27.7*	18.6	19.4	18.5

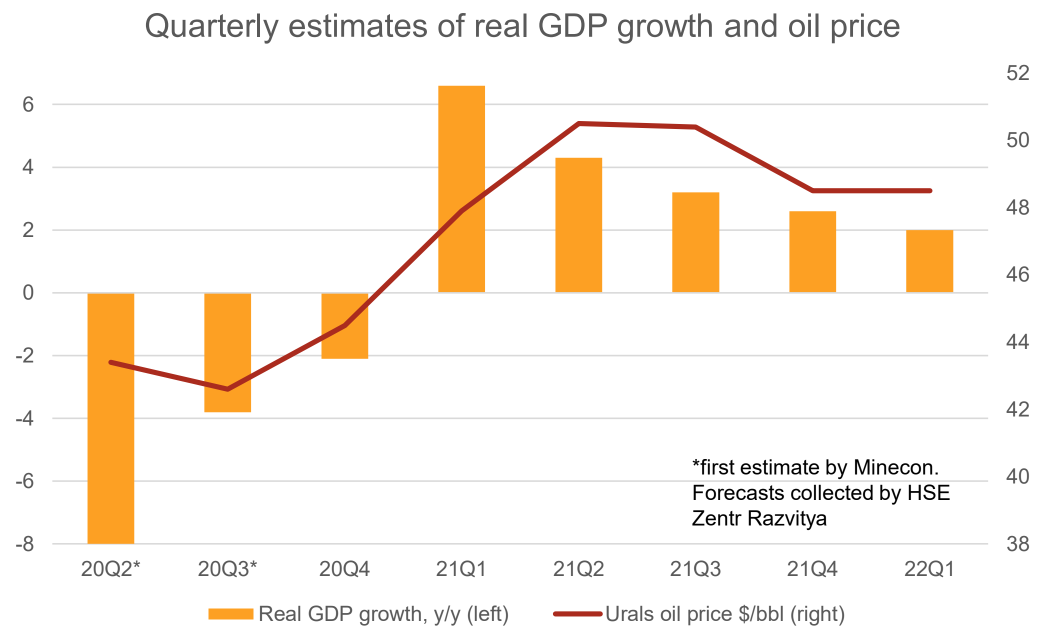
*data from August.
Source: Rosstat

Outlook: Delayed recovery ahead

Russia could out-perform the world average in 2020 but prospects for recovery in 2021 weaker

Decline in 2020 estimated less severe than feared but forecasts for 2021 more pessimistic





- Compared to our Q2 report, most forecasters are expecting a less severe recession associated with a slower recovery.
- Economic fall in 2020 expected to be -4 % and the bounce back in 2021 of around 3 %. Relatively small significance of services in the Russian economy is an advantage in this crisis.
- Interestingly, in quarterly terms growth is forecasted to start one quarter earlier in 1Q21 than in the previous forecasts.
- Main threat now is the falling global demand and Russia's worsening corona situation. Also, the OPEC+ oil production cut agreement will limit growth prospects for 2020-2021.
- Visibility remains low but the effects of how a lock-down effects consumer behaviour and GDP growth are more clearly identified.

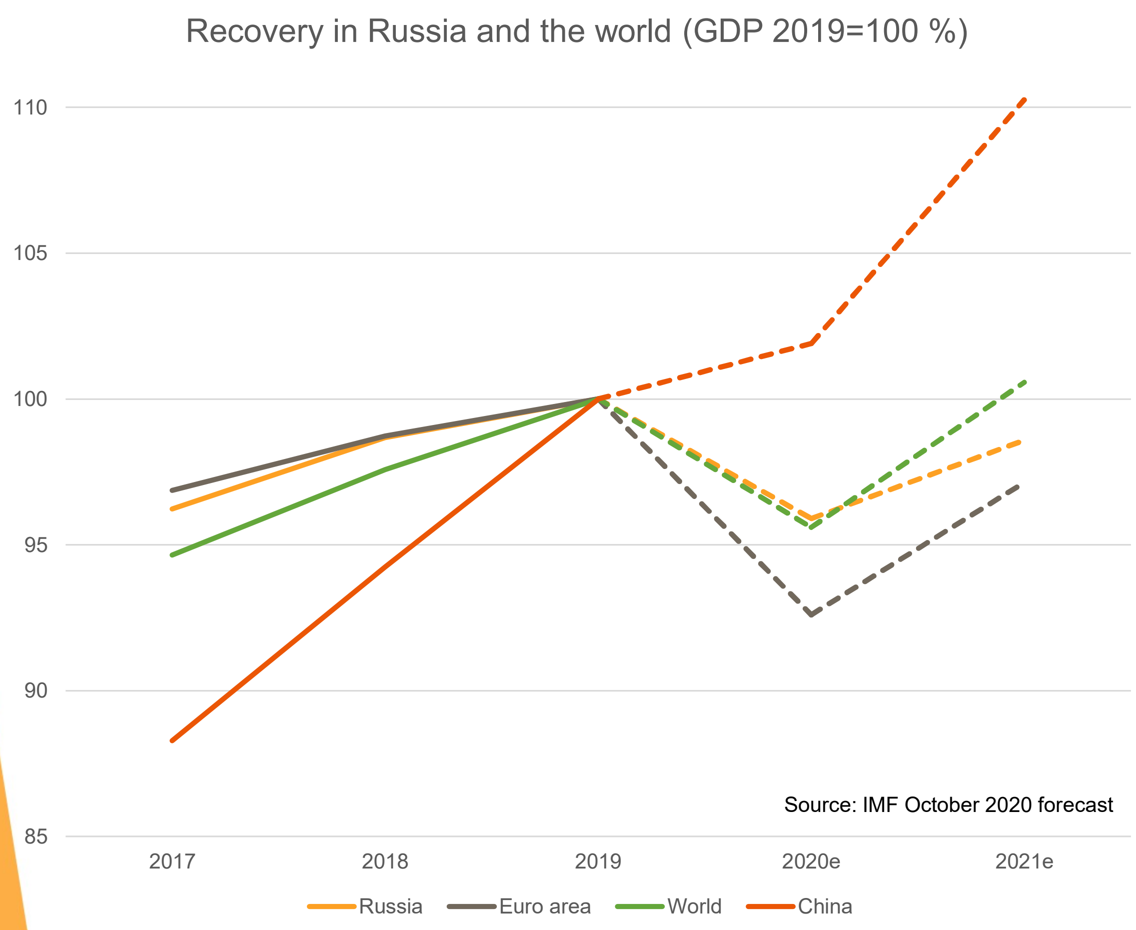
Risks to the forecasts remain on the negative side and recovery could be protracted

- Downside risks to the forecasts remain historically high:

1) **Russia facing a contradictory external economic environment**
2) **New spread of the virus**
3) **Geopolitical and internal tensions in the CIS.**

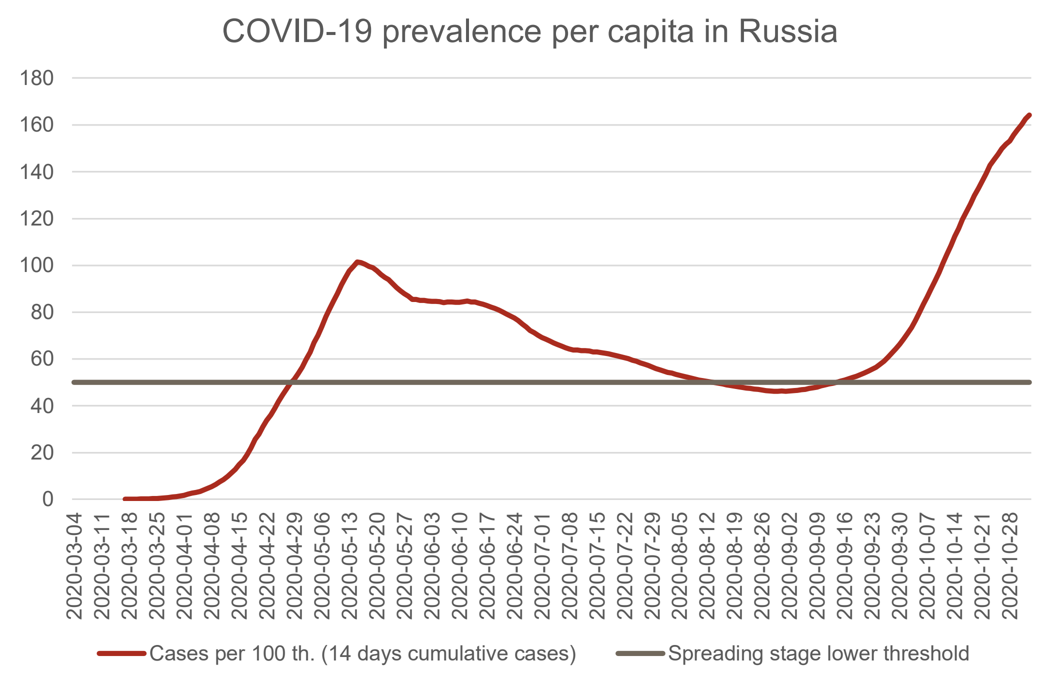
- Upside risk to the forecasts:
  - Russia has two vaccinations (Sputnik and Vektor) that are in phase three trials with partly positive results but also many concerns based on the published trial results.
  - However, vaccinations are due to start a bit later than first announced and there are new findings that achieved immunity against the virus could be only short-lived (from 3 months to a year).
  - There are, however, reports of production shortages for the vaccines that could postpone the vaccination further

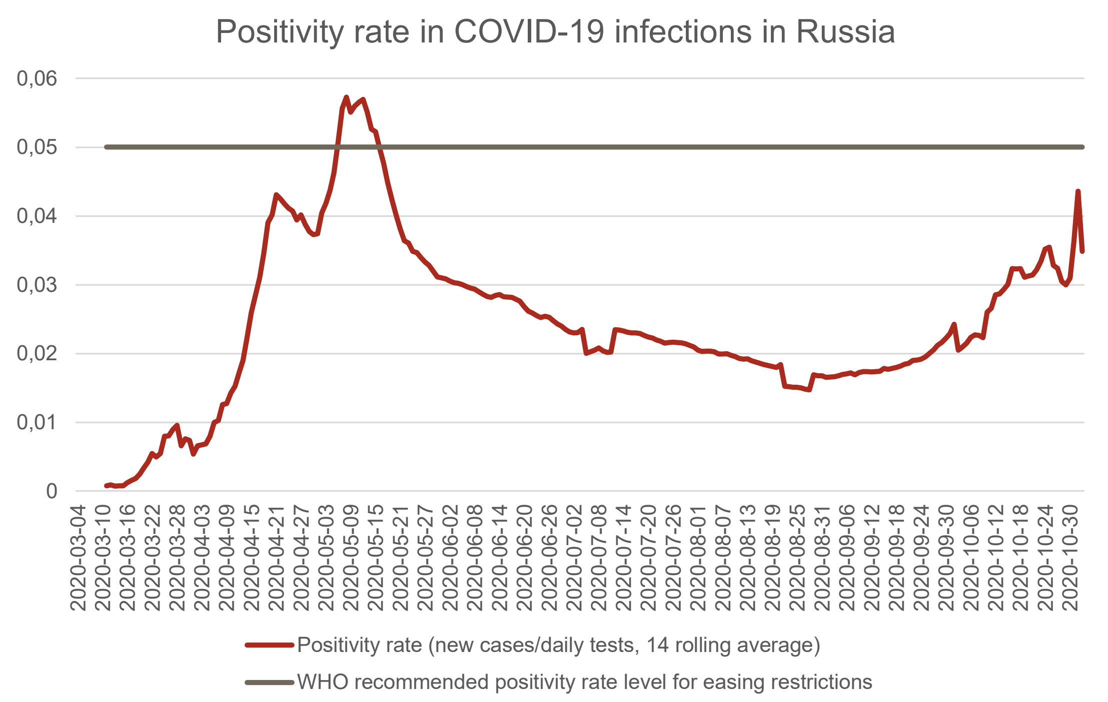
1) Recovery in Europe taking a nasty turn but China is already on a growth track



- Russia is forecasted to just about out-perform the world average in 2020 but could fall behind in 2021.
- In 4Q20, it is likely that forecasts for 2021-2022 will be adjusted downwards again as many rich countries are forced to resort to lock-downs.
- EU is nearly 40 % of Russian exports and severe outbreaks and even nation-wide lockdowns in EU will have negative effect on Russia, one which is cannot be compensated by the weakening RUR.
- However, China (slightly over 20% of Russian goods exports) is surpassing its 2019 GDP levels. Chinese demand will create demand for Russian raw materials and will benefit from low energy prices.

2) Why this wave is different…so far



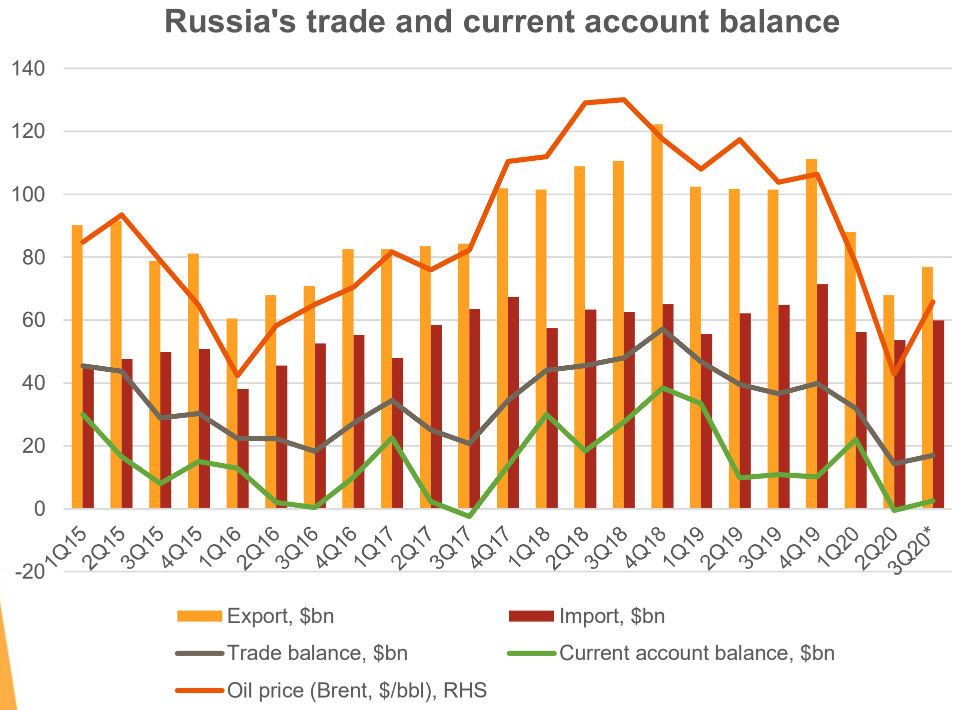


- As in most other countries, Russia is attempting to curb the rising infections with regional and sectoral targeted measures and wants to avoid full-scale lock-down as long as possible.
- In addition to the infections per capita measures, the WHO compares management of the pandemic in each country by a so-called positivity rate i.e. share of COVID-19 positive results to the tests made. WHO has used a benchmark of 5 % for the positivity rate to recommend easing of quarantine and other measures.
- Russia's positivity rate is still not alarming at around 4 % (vs. Finland approx. 2 %) and Russia conducts nearly 600 th. tests daily.
- What is alarming now is that the epidemic is raging more in the regions than in Moscow this time round and many regions are badly equipt in terms of hospital beds, doctors, instruments and other health care resources.

3) Geopolitics, internal politics and trouble in Russia’s backyard

- **Sanctions and the aftermath of the U.S. elections**
  - Prolonged court proceedings or counting of votes for the U.S. presidential elections will create more uncertainty in global markets and have a negative effect on global recovery. So far, markets have been calm since U.S. presidential elections.
  - U.S. is likely to impose new sanctions against Russia as Democrats and Republicans are unified against Russia with differences in what to target and coordination with ally countries. Sanction policy will be determined by Congress and the Semnate more than the president. Democrats have been more hawkish on lection meddling, human rights and Russia in general. The democrats have maintained their majority in the Congress but Senate balance will be determined by second round of votes at least in the sate of Georgia in January.
  - If Russia is found to have meddled in the U.S. elections in 2020, U.S. (namely Congress) will show no restraint in causing economic losses on Russia and EU companies will suffer.
- **Corona fatigue and the political sentiment:**
  - How willing are Russians to comply again with restriction/quarantines this time round? People are tired of the falling incomes, worsening living conditions and more recently of all the restrictions/quarantines.
  - Support for the central leadership has recovered from the Spring but this could changes again if new unpleasant restrictions are imposed and/or communication is vague on what is allowed/not allowed.
  - Current virus stategy rests on regional restrictions and thus, any negative sentiment is likely to smear the regional leaders. Divide between Moscow and the regions could widen unless central government will come to their aid.
- **Political turmoil in the CIS: Belarus, Nagorno-Karabakh, Kyrgyzstan, Moldova, Georgia**
  - Russia needs to balance between keeping its sphere of influence in the region and avoiding (military) conflict.
  - Political impasse in Belarus remains unresolved with neither side willing to surrender. Russia has openly showed restraint but likely there are covert operations in support of Lukashenko.
  - Armenia has asked Russia to provide military assistance in Nagorno-Karabakh against Azerbaidjan (backed strongly by Turkey) but Putin has so far announced that Russia’s security guarantees only apply to Armenian territory.

Mild recovery in exports in 3Q20



- Export revenue (of services and goods) decreased in 3Q20 by 24 % (y/y) and imports by 7.7 %.
- However, the current account balance in 3Q20 managed to be $2.5 bn on the positive side due to a decrease in imports of goods, investment income paid in favour of non-residents and in travel services for foreign travel.

- Merchandise trade value with most of Russia's main trading partners has developed negatively in Jan-Aug 2020 with Russian exports declinign more than imports to Russia.
- Main reason for this was the declined volume and price on raw materials.
- Only notable exception was trade with the UK that increased by 76 % (y/y) during these 8 months. The increase was mostly attributed to large hikes in the value of gold supplies from Russia to the UK.

Thank you

Any comments or questions?

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