



Outlook for 2021 improved but shadowed by
geopolitical threats

Russian Economy in 1Q20

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Key takeaways

Recent events in 1Q21 for the Russian economy

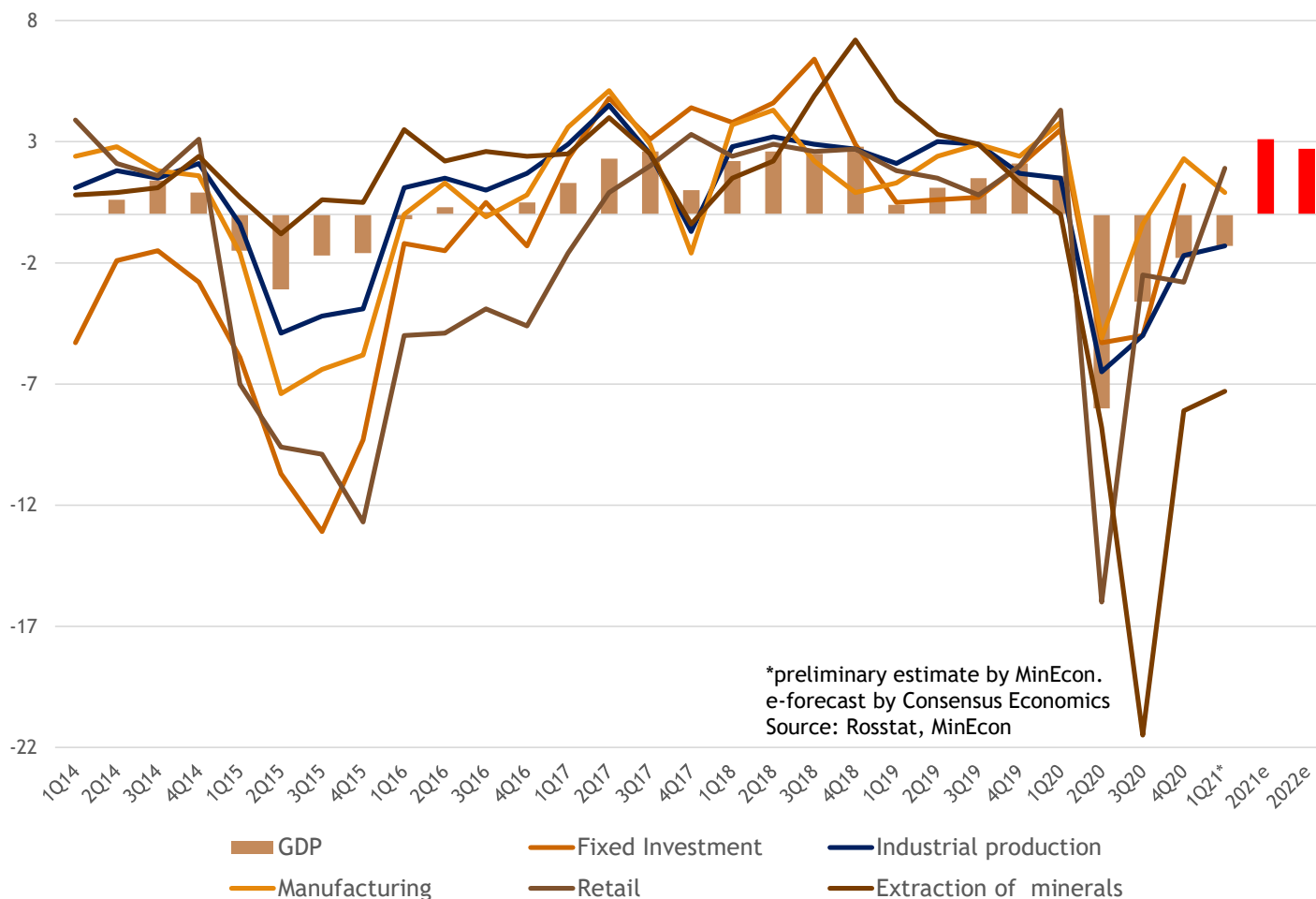
- ▶ **Recovery continued in 1Q21.** Real GDP contraction narrowed to -1.3 % (y/y) in 1Q21 (vs -2.3 in 4Q20). Manufacturing sectors and retail were the main sectors for the positive dynamics.
- ▶ **Geopolitical pressures weighing on the Rouble despite high oil prices.** Threat of new sanctions from the U.S. finally imposed on April 15th, military tensions on the Eastern border of Ukraine induced non-resident investors to pull back funds from Russia but the speed of capital flight is still less than in 2014. At the same time, budget-rule mandated currency purchases by state contributed further to a weaker Rouble.
- ▶ **Inflation accelerating and Central Bank responding with stronger than expected Key interest rate hikes.** High growth in food prices ended the consumer price inflation at 5.8 % in March. To alleviate the effect of food price hikes, the state has imposed export bans and price caps on important products such as grains, sugar and sunflower oil. Higher than expected inflation fueled by stronger demand induced the Central Bank to raise its interest rate twice in a row to 5 % in April.
- ▶ **Russian state finances significantly improved due to higher non-gas and oil revenues.** Non-oil and gas revenues to state budget have increased by 25 % in 1Q21 due to import and export levies for example for wheat. Oil revenues are constrained by the OPEC+ production cut agreement. The federal budget is expected to be on surplus already this year despite increases in social spending.
- ▶ **Unemployment improving strongly but real disposable incomes declining faster again.** Unemployment has decreased across all sectors and unemployment rate is down to only 5.4 %, which is still higher than before the crisis. At the same time, real disposable incomes have contracted faster (-3.5 % y/y) compared to the previous quarter, even though real wages were still growing in 1Q21.
- ▶ **Consumer spending upbeat.** Consumer started to spend their unprecedented savings accumulated during 2020 and especially services are expanding compared to a year ago.
- ▶ **Manufacturing and services sentiments positive.** Manufacturing and services sentiments are looking stronger as infection levels seem to be low and despite growing rumours of a third wave. Also, consumer confidence has improved in the last months but still remains lower than before the crisis.

Russian economy in 1Q21

Recovery advancing in 2021, Rouble weak due to accumulated geopolitical pressures

Russian economy on positive in March

Real economy indicators, 1Q14-1Q21

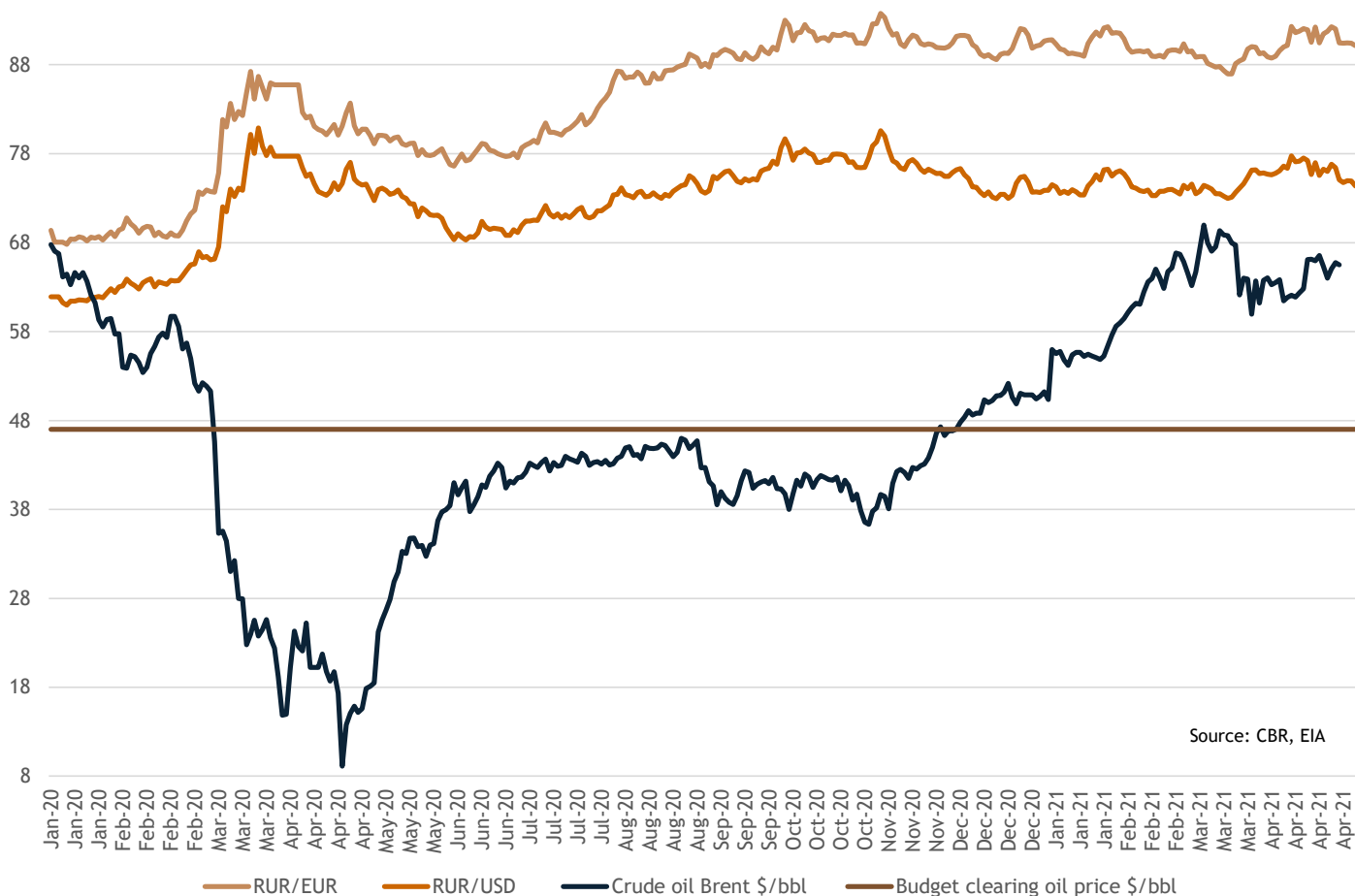


Russian economy growing in March by 0.5 % (y/y)

- ▶ Russian GDP contracted by only -1.3 % (y/y) in 1Q20 despite high output background in Jan-Feb 2020 on the eve of the corona crisis.
- ▶ Manufacturing sectors were again the main positive drivers in 1Q21 by growing 0.9 % in 1Q21. Aided by the low base level in March, manufacturing growth accelerated to 4.2 % (y/y) from a decline of -1.7 % (y/y) in Feb.
- ▶ The strongest performers in 1Q21 were machine-building (13.9 %), chemicals (12.2 %) light industry (8.8 %), wood (3.3 %) and food processing (0.8 %), which were the same sectors that maintained economic activity during 2020.
- ▶ At the same time, decline in the extractive sector (-7.3 %, y/y) was dragging down economic output, mainly due to OPEC+ agreement mandated production cuts.
- ▶ Retail sector showed improved dynamics in 1Q21 (-1.6 %) despite disappointing results for March (-3.4 % y/y).

Geopolitics keeping the Rouble weak in 1Q21 along with state currency purchases

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



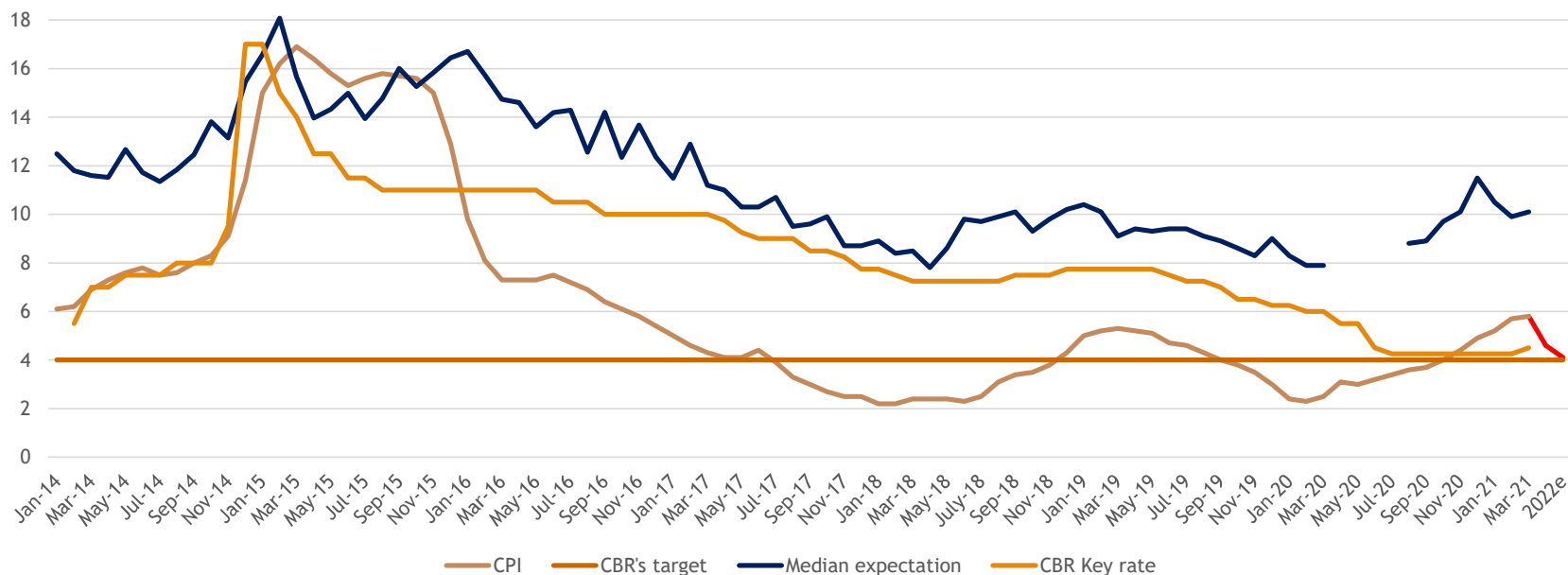
Source: CBR, EIA

Rouble weak due to geopolitical tensions, halt in oil price growth and budget-rule mandated RUB sales

- ▶ Geopolitical tensions took a serious turn in 1Q20 as the fighting in Eastern Ukraine's Donbass region intensified and Russia assembled a vast number of troops near the Ukrainian border.
- ▶ At the same time, threat of new sanctions from the U.S. has weakened the RUB in the start of April. However, on April 15th the RUB strengthened again when the sanctions imposed were less severe than feared.
- ▶ These tensions induced a capital flight by non-residents from Russian state (OFZ) bonds worth 383 bln RUB since beginning of March. The share of non-resident in OFZ is now 29 % (down from 44 % in March 1st) and 40 % of this is U.S.-owned.
- ▶ According to the CBR, capital flight is underway in net terms but is still less pronounced than in 2014 and the recent OFZ releases have raised interest.
- ▶ There are also other factors keeping the RUB value low (at 90-92 against the EUR) for the next coming months: the budget-rule mandated currency purchases for the National Welfare Fund when the oil price is above the budget-clearing level.

Peak in yearly inflation likely to have passed in March

CPI & CBR key rate (y/y, %)



March-2021 % y/y	
CPI	5.8
Food	7.6
Non-food	5.9
Services	3.2

Source: CBR

Accelerated food prices growth maintained high inflation in 1Q21

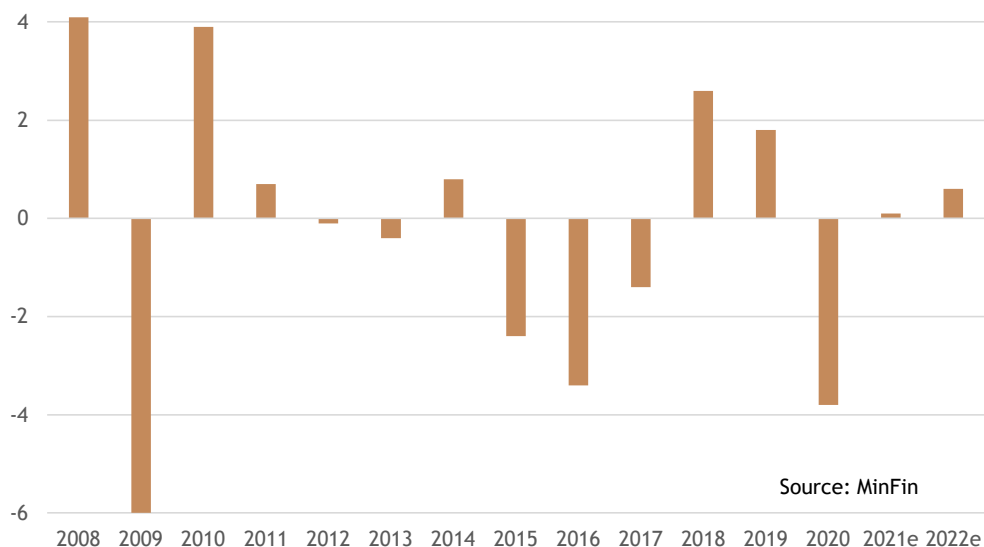
- ▶ Since December 2020, inflation in food prices accelerated fast and is believed to have reached its peak in March. Accelerated inflation in food prices continued especially in meat and poultry, and sunflower oil and sugar (due to high global prices) but decelerated for fruit and vegetables. In non-food consumer products, inflation accelerated slightly in yearly terms mainly driven by gasoline prices.
- ▶ Inflation is expected to decelerate but to remain above 4 % CBR target. If Russians are able to spend more of their accumulated savings abroad, inflation will moderate faster. In the case that borders remain closed, more money will be spent in Russia and add inflationary pressure.

Key rate decisions

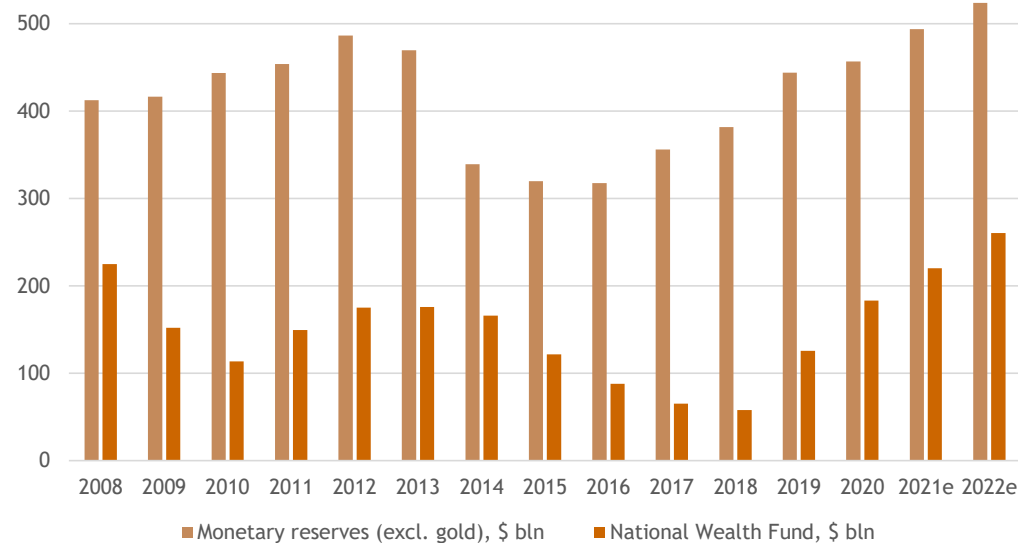
- ▶ Faster than expected inflation induced a hike in the Central Bank's Key rate for the second time in a row to 5.0 % in April. Inflation will remain in 2021 above the CBR's target and thus, further rate hikes are likely. In the case of for example a failed harvest in the Summer, inflation could accelerate faster than expected and the key rate would follow.

Russian state finances well-equipped to handle the anticipated impacts from geopolitical tensions

Budget balance (% GDP)



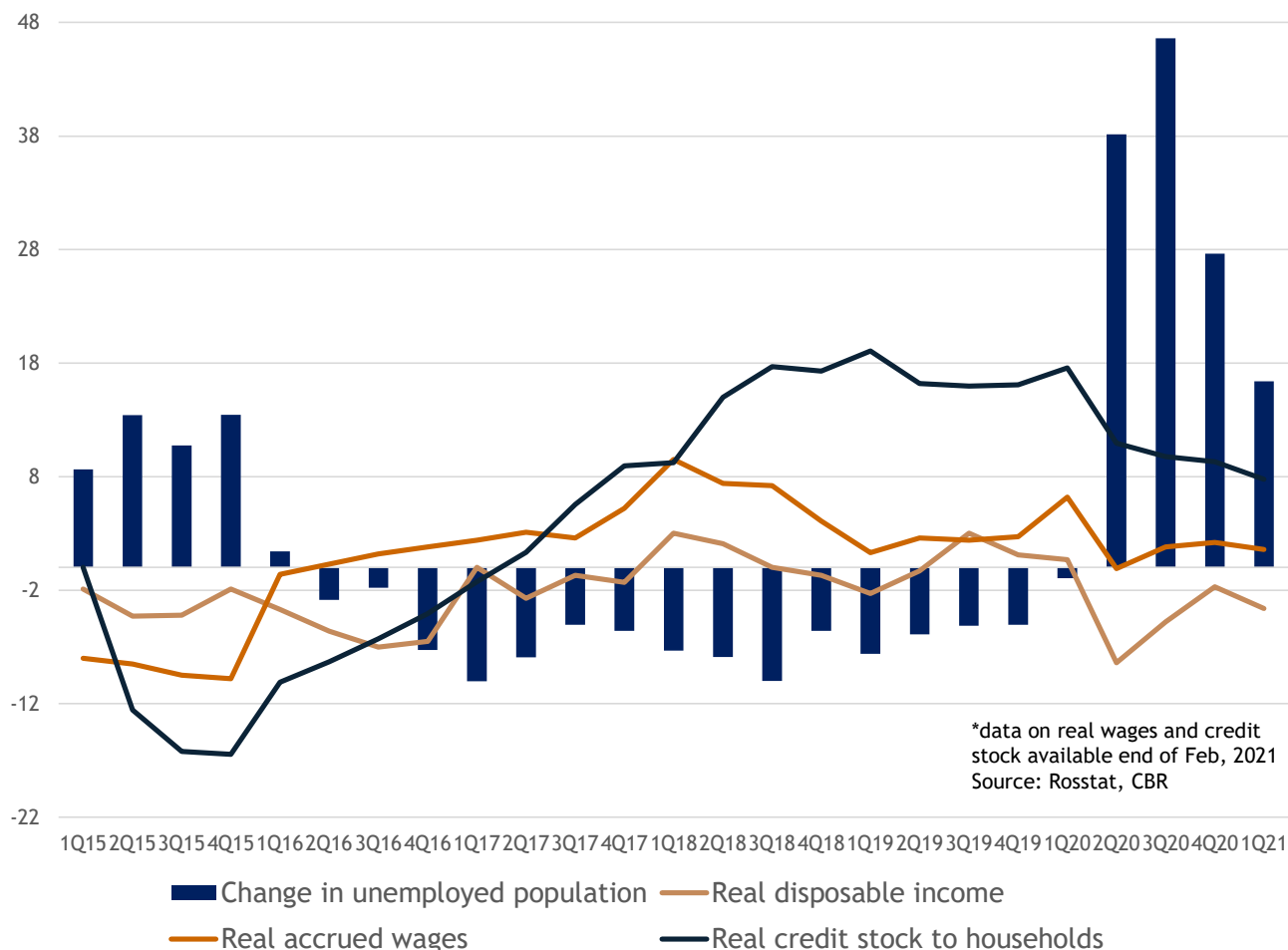
Federal reserves and Sovereign Wealth Funds



- ▶ Russian state budget is expected to turn to surplus in 2021 and maintained in 2022 with improvement in non-oil and gas revenues (oil revenues are constrained by the OPEC+ agreement) despite new plans for increased social expenses. Also the budget rule currency purchases have accumulated 4 trillion RUB of reserved in 1H20. The good state of Russian state finances means that the new U.S. sanctions on Russian state bonds (bought from the primary market) do not have significant impact even if they are extended to the secondary market at least for a few years.
- ▶ Also, the National Wealth Fund is expected to be accumulated above the level where its funds can be used for spending in 2022 (the liquid part has to be over 7 % GDP to be able to tap into its funds). Based on Putin's address to the Federal Assembly, the funds would be used at least for modernizing road infrastructure, infrastructure loans, schools and support for local tourism.

Higher inflation gnawing on purchasing power but jobs market improving across all sectors

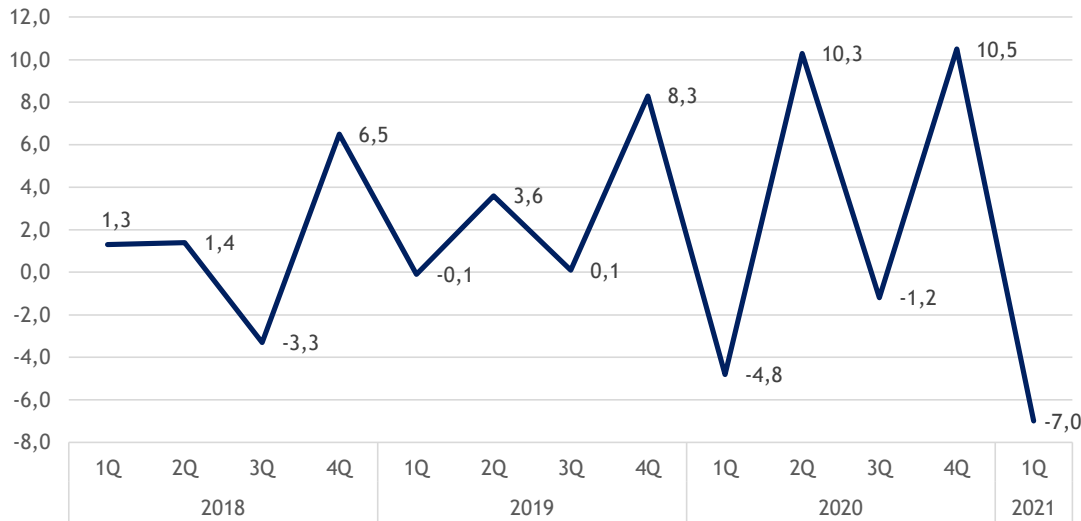
Income and change in unemployment (y/y, %)



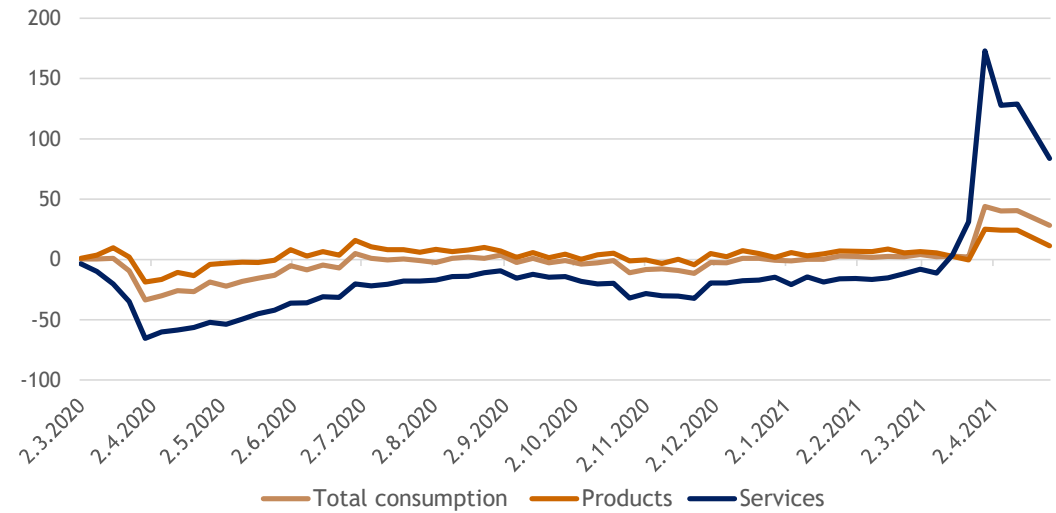
- ▶ Unemployment has decrease in 1Q21 and in March 2021 the number of unemployed stand around 16 % higher than a year ago. In March, the unemployment rate had decreased to 5.4 % (ILO definition).
- ▶ Real wages growth slowed down in 1Q21 to 1.6 % (y/y) largely due to accelerated inflation. Decrease in disposable incomes has sharpened again in 1Q21 to -3.6 %.
- ▶ Analysis of household spending in 2020 and beginning of 2021 provides mixed results.
 - ▶ In monetary value household consumption spending in Jan-Feb 2021 has clearly accelerated and grew by 2.5 % (y/y) despite a high base level from Jan-Feb 2020.
 - ▶ At the same time, according to consumer surveys, this spending spree is a reality only for some and does not reflect the large majority of consumers. For example, according to a Levada survey (December 2020), 2/3 of Russian see that their living standards have decreased and 59 % see that their chances to earn well are more limited. Only 26 % see that their living standards and incomes have not changed.

3. Consumers are spending their corona savings now, but the party could end soon

Change (-/+) in savings as a share of total consumption



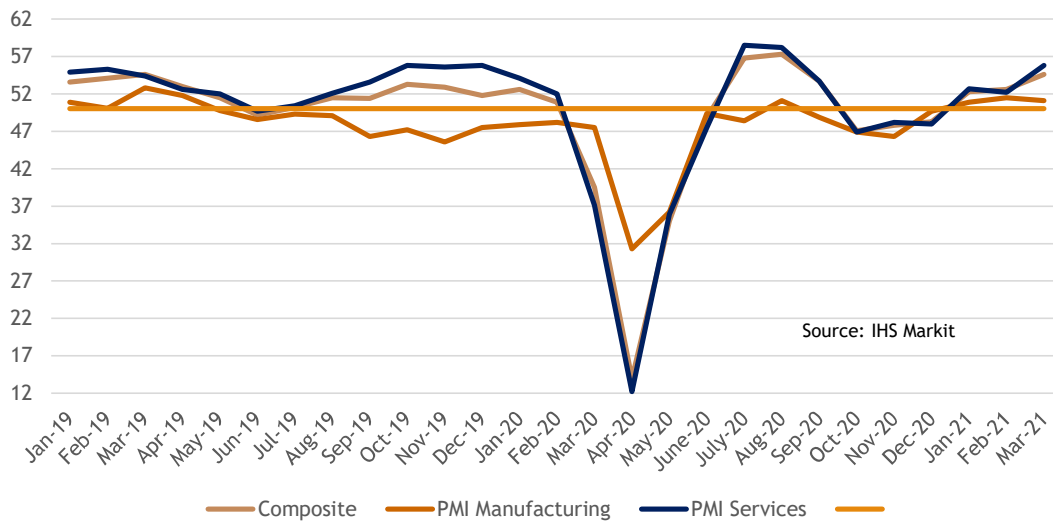
SberIndex weekly growth (y/y) in household consumption



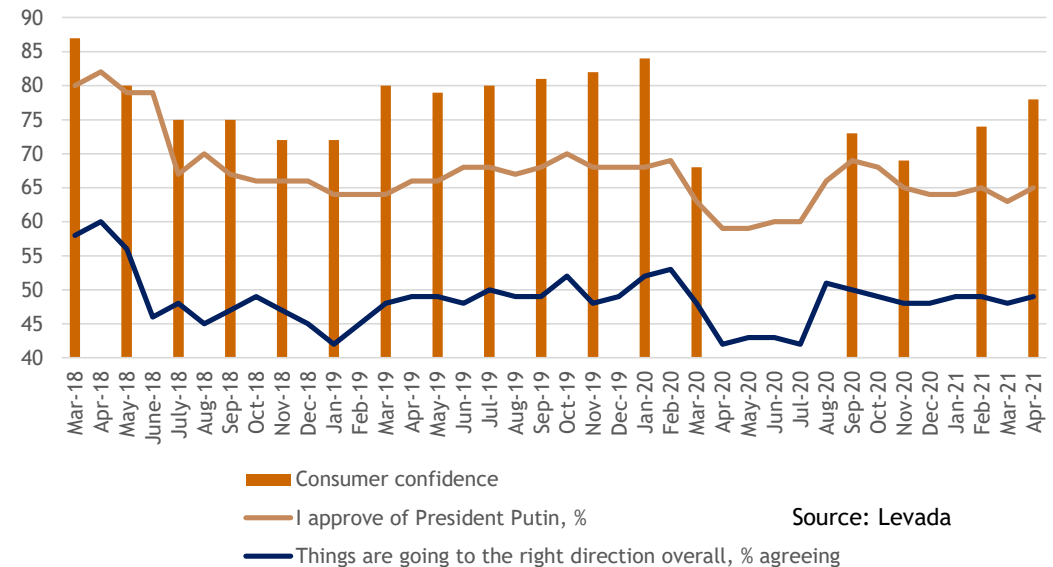
- ▶ Private consumption has been one of the most important driving forces for Russian economic development especially during the pandemic. Also growth in the services sector has been a strong driver for growth and Russia has the larger share of services in its GDP of all the upper-middle income countries.
- ▶ Consumer activity returned to longer term average levels already in Autumn 2020 but now also the money spent has partly surpassed pre-crisis levels.
- ▶ Russian households have saved unprecedented amounts especially during 2Q20 and 4Q20, when households saved an amount worth 17 % of disposable income, a share not witnessed for years. Lately, spending has shot up namely in terms of services.
- ▶ A third wave in infections could reverse this positive development. Unofficial accounts and also SberIndex modelling is suggesting strongly increasing infections but this has been so far contested by the officials.

More optimism in industry and consumer sentiments but political views unchanged

Purchasing Manager Index (PMI), services, manufacturing and composite



Population sentiment



- ▶ As the last restrictions have been lifted and the growth in corona infections has been falling, sentiments in manufacturing and especially services have stayed on the positive side.
- ▶ Manufacturing as a whole has survived the crisis well (especially compared to the services' sector) but there is heterogeneity between the sectors, which is reflected in the weak optimism in the manufacturing PMI.
- ▶ One concern related to the services sector is how actively Russians are willing to take the vaccine as according to a recent poll by state-owned WCIOM 46 % of Russians are willing to be vaccinated. Currently, the vaccination coverage is only 10 % (target is 70 %).

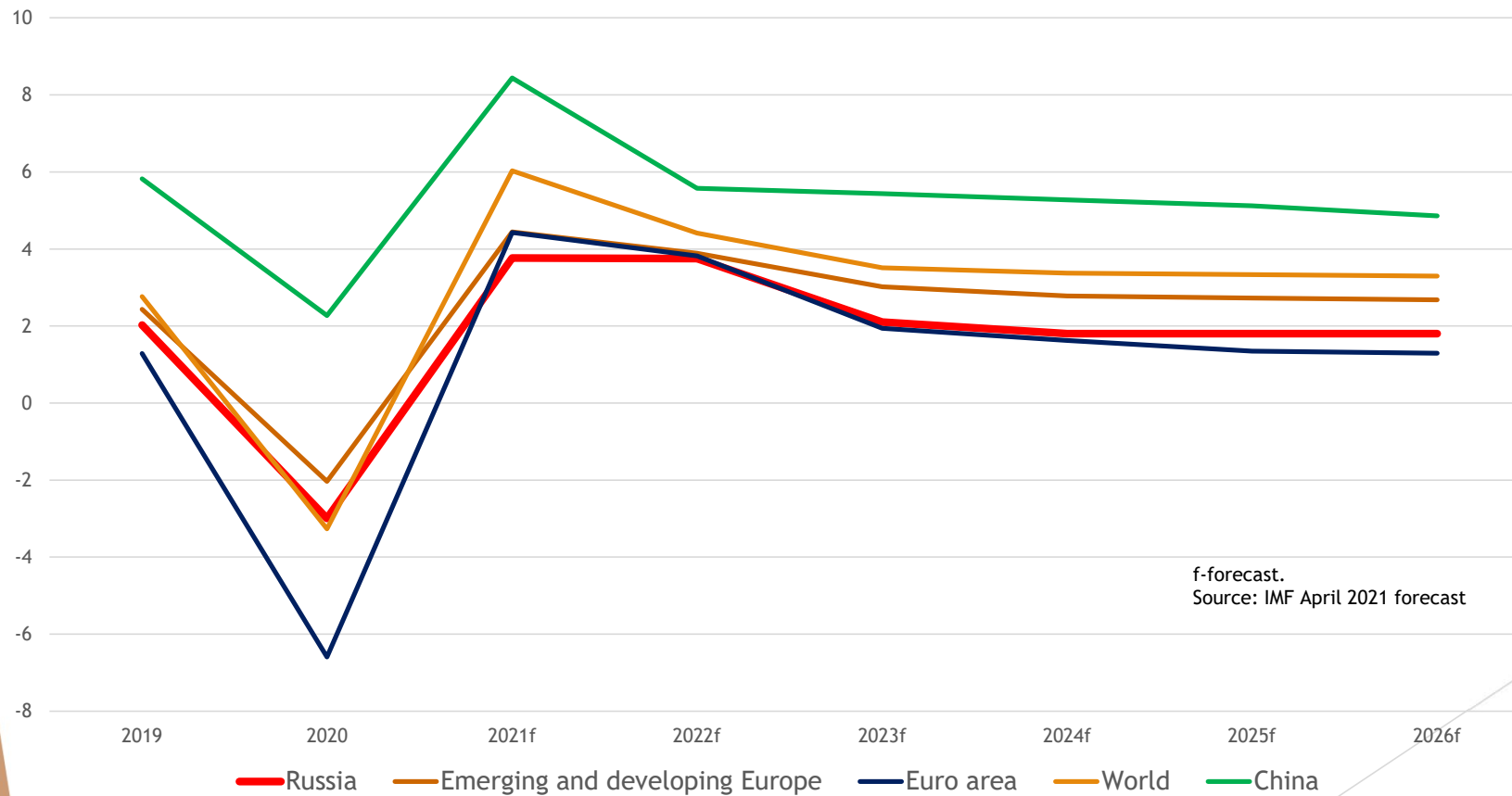
- ▶ President's approval ratings have decreased moderately in March again.
- ▶ Similarly, satisfaction with the state of the country remains at a slightly lower level just below 50 % of the respondents, which is however not an especially bad result when looking at the historical data of the same survey.
- ▶ Consumer sentiment has improved to its highest level in a year, which reflects the improved outlook for employment and economic recovery despite higher levels of inflation.

Outlook: Can Russia combine economic growth and sustainability?

Russia needs to both surf the waves of the global economic boom and advance its sustainability and reform goals

Stronger than expected recovery but slowdown after 2023

Recovery in Russia and the World, %-change (y/y) in real GDP



Combining economic growth and sustainability in Russia

- Russia's growth formula in last two decades has been determined by growth private consumption, capital investments, energy exports and greater export orientation in the commodity-dependent manufacturing sector, albeit taking some steps back after 2014.
- Momentum for stronger efforts on ESG (Environmental, Social and Governance) is sharply rising in Russia due to internal and external pressure, the latter of which is more significant. At the same time, strong resource boom is here as the world recovers from the pandemic.
- Russia's future growth (at least) after 2023 will be heavily influenced by the E and S of ESG and how Russia handles these challenges/opportunities.

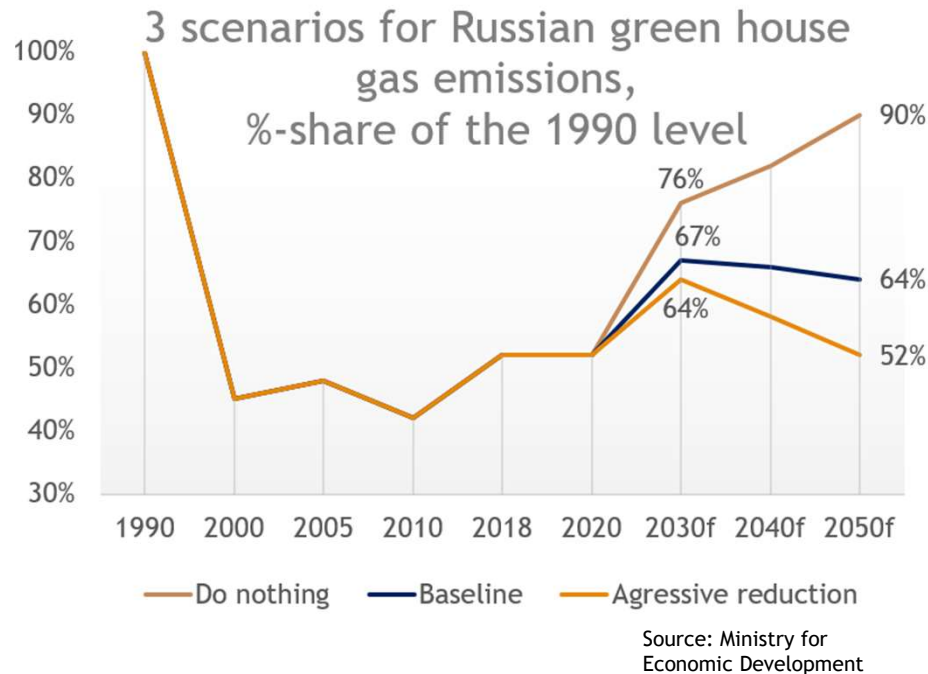
Three issues are shaping Russia's sustainable growth agenda:

1. Russia and external pressure to step up on climate efforts: Why the moment to act is now?
2. State investments, climate efforts and poverty reduction: What is done and is it enough?
3. Consumers and ES(G): How do Russians view the E and S of ESG?

1. Russia and external pressure to step up on climate efforts

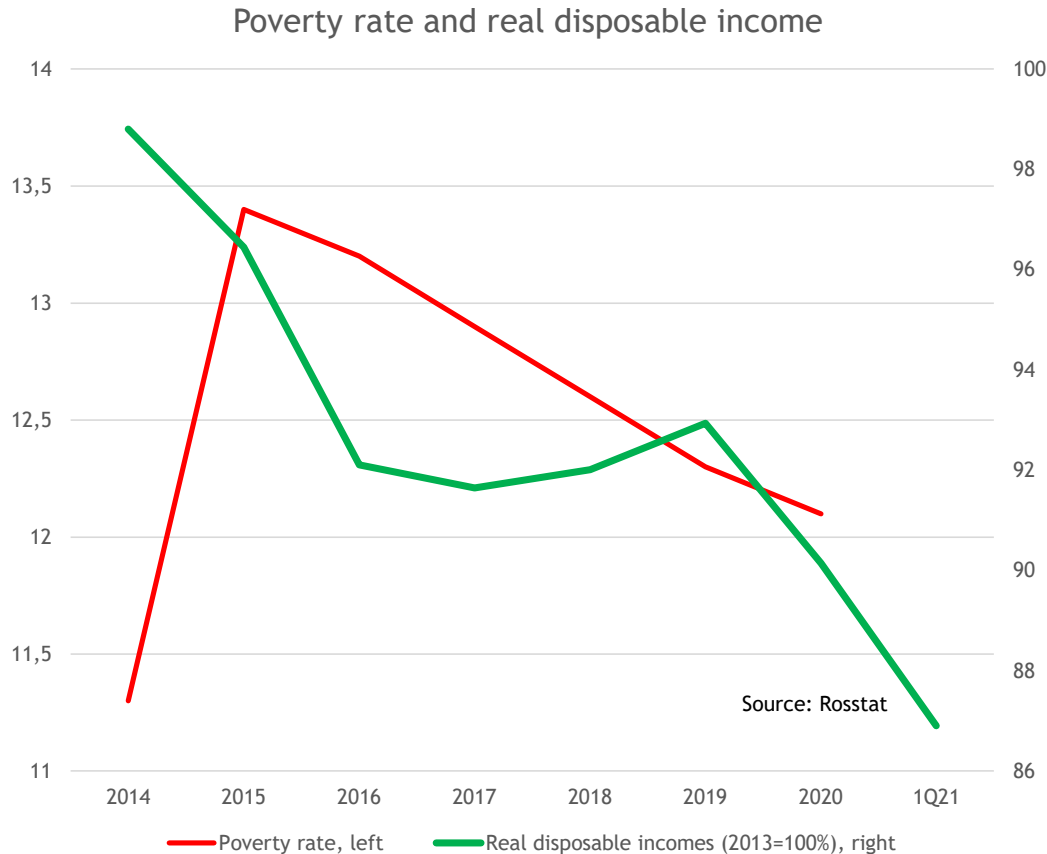
- ▶ Russia's climate ambition is rising and environmental issues are now more than just pretty words. The major change in mindset was probably induced from the outside.
- ▶ According to the International Energy Agency, the projected volumes of the world oil consumption in 2040 in a sustainable development scenario involving achievement of climate goals are -32% lower than in the inertial scenario, gas -36% lower and coal - 61% lower.
- ▶ Russia's main trading partners EU and China are embarking on ambitious green programs, where the regulation will spill over to imports from Russia.
 - ▶ EU will impose a carbon tax for imports, so called carbon border adjustment mechanism, or CBAM, that will become effective from 2023 onwards. According to Russian estimates, the anticipated loss to Russian exporters only for oil, oil products, gas and LNG, as well as polyolefins would be 1.4-2.4 billion EUR annually and on fertilizers 0.2-0.5 billion EUR. Details are expected from the EU Commission this summer for a pilot program.
 - ▶ China has pledged to become carbon neutral by 2060 and no "dirty" advantages will be given to foreign products.
 - ▶ U.S. is back in the Paris agreement with a stronger carbon reduction program. U.S. actions will have less direct impact on Russia, but indirectly U.S. leadership gives a strong push for global action and technology development.

2. E in ESG - Efforts for attaining sustainable growth



- ▶ Last November, President Putin signed a decree stipulating that greenhouse gases be reduced by up to 70% from the 1990 level taking into account the absorption level of forests and other ecosystems in accordance with the Paris Agreement. Currently, Russia is in full-compliance of the Agreement.
 - ▶ Deputy Prime Minister Viktoria Abramchenko announced in January of increased support in boosting the so-called “green” sectors of the economy (more details are set to follow). Abramchenko also announced the implementation of an experimental carbon-trading project in the Sakhalin Region, lessons from which will shape the carbon-trading and reduction agenda for the future.
 - ▶ In April, the State Duma in the first reading approved the first full-fledged environmental bill on greenhouse gas emissions.
 - ▶ The Ecology project is the third largest investment in the national projects program (after infrastructure and road construction). According to the government's plans, of more than 25 trillion rubles will be invested in it from public and private sources by 2024–2025.
- ▶ More requirements are coming for companies and households. Putin announced in his Annual Address of mandatory adaptation plans for municipalities and more recycling requirements for companies. Previously, the business commodity has rejected mandatory requirements for environmental reasons, but now these are overlooked for the good of the climate goals.
 - ▶ Largest corporations in Russia, ESG issues have risen to the fore and these tendencies will strengthen as the state is adding pressure. Large banks are eagerly developing infrastructure for green and ESG bonds. Currently, interest has been limited but lately growth has accelerated in investing in ESG assets. This trend is set to continue as ESG issues are important for new generations of Russians.
 - ▶ Despite all the optimism Russia still has a long way to go. According to Climate Change Performance index, Russia ranks in 2021 at 52 out of 61 countries. Also, the Center for Strategic studies under the Ministry for Economic Development sees that “*climate policy in Russia is one of the most controversial and difficult development areas*”.

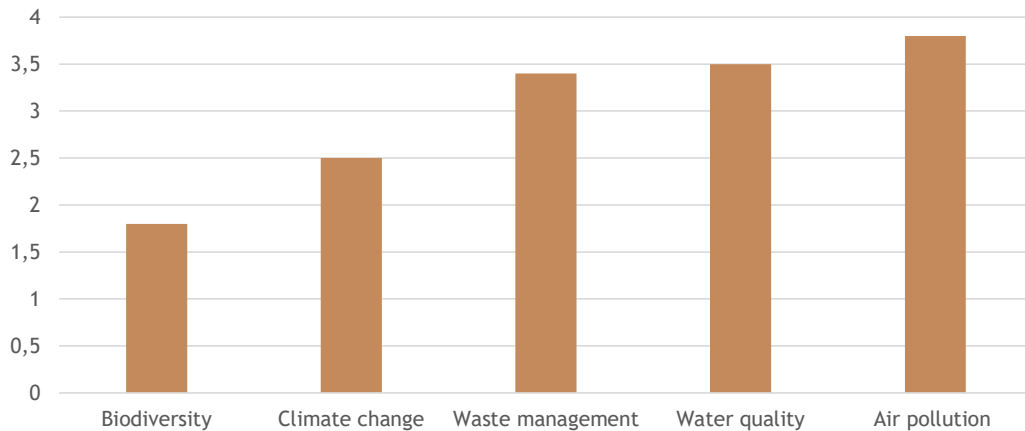
2. S in ESG - Efforts for inclusive growth



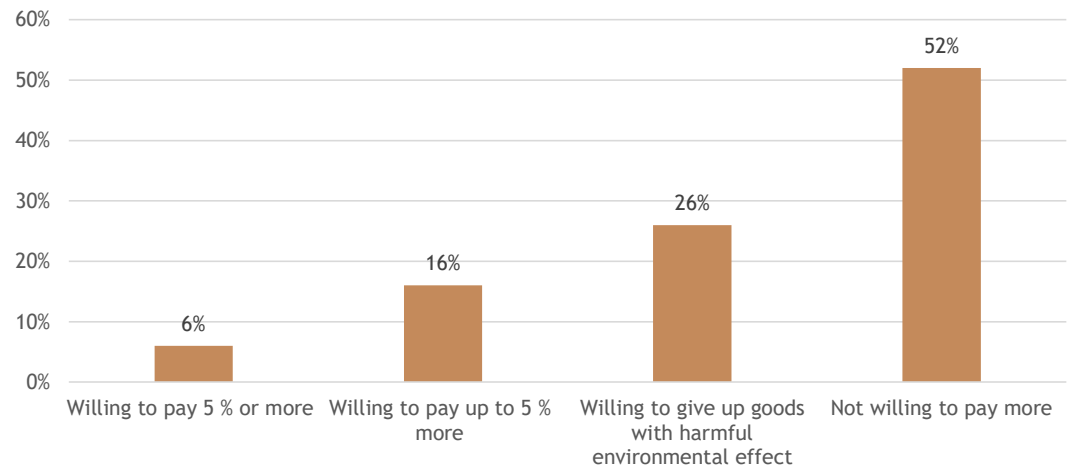
- ▶ One of the National Goals outlined in 2018 is that poverty should be decreased to 6.6 % (currently at around 12 %) by 2024.
- ▶ Russians' disposable incomes are at 2009 level after 2020 and in 1Q21 the decrease has even sharpened. Rightfully, the Kremlin is seeing this as a clear political risk. Declining welfare is one of the driving forces behind especially the youth's disillusionment with the Kremlin.
- ▶ There is some indication that social transfers to dampen the blow to the poorest in 2020, has been effective and poverty rates have not erupted. However, the size of the middle class seems to be decreasing, albeit depending on the definition used.
- ▶ The World Bank estimates that (given no adverse surprises) the 6.6 % goal can be achieved.
- ▶ Therefore, as opposed to climate action, Russia has been allocating more budget money into social transfers with a special focus on families and children, also the unemployment benefits were increased and self-employed
- ▶ The increased efforts to alleviate poverty (e.g. announced by Putin on April 22nd) are at least partly related to the upcoming Duma elections. However, future efforts to decrease poverty in a sustainable way, would involve addressing declining real disposable incomes and rising inflation.

3. Consumers and ES(G): what is concerning the Russian consumer?

Main environmental concerns for the Ivanovs (scale 0-5)

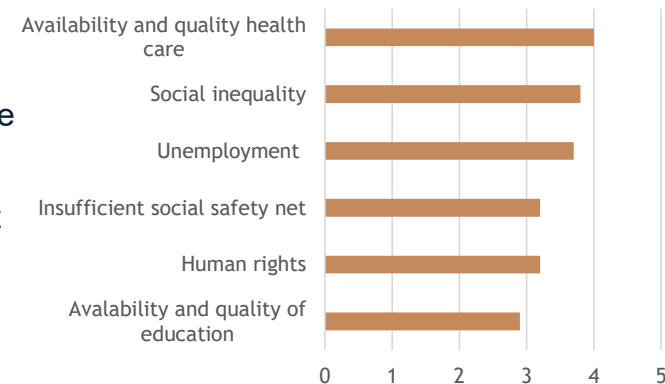


Willingness to pay for environmentally friendly products



- ▶ Social problems concern (82%) Russians more than environmental problems (76 %) according to Sberbank's Ivanov (average Russian) survey from April 2021. 12 % see that these are not of concern.
- ▶ Environmental issues=quality of life. Clean air, pollution and waste. 88 % think the state should take the lead in environmental protection and climate actions.
- ▶ VCIOM (state pollster) survey shows that 93 % acknowledge the climate change and 57 % see that it has an impact in their lives.
- ▶ 78 % are not willing to pay more for environmentally friendly goods.

Main social concerns for the Ivanovs (scale 0-6)



Obstacles and advantages on Russia's road to sustainability

With the right incentives, Russia potentially has the scientific foundations to develop new technological solutions.

Russia's dependence on raw materials could be decreased at the same time. Manufacturing has strong potential in some sectors: between 2015-19, 70 % of greenfield FDI in Russia went to manufacturing sectors.

Russian banks are already strongly developing ESG related finance infrastructure and large (even oil and gas) corporations are working on ESG issues.

Macrostability well-maintained and budget less dependent on the oil price than prior to 2018.

The decline in the working age population could turn into growth thanks to the pension reform.

Geopolitics:

- How much buffer does Russia has to keep against "non-friendly" states?

- New tech needed to advance on energy-efficiency, which are often from the West.

Elites will resist change if/when there are losses in revenue and status.

Taxes and fees need to be increased to raise more funds (Sberbank is betting on more progressive payroll tax), which could backfire due to resistance.

Despite good intentions, implementation could fail due to corruption, vested interests and problems in chain of command.

If the oil and gas revenues drop too fast, funds may not suffice for sustainability efforts.

Kazakhstan, Ukraine and Belarus

Improved outlooks for 2021

Recovery in Kazakhstan progressing in 1Q21 despite decline in extractives



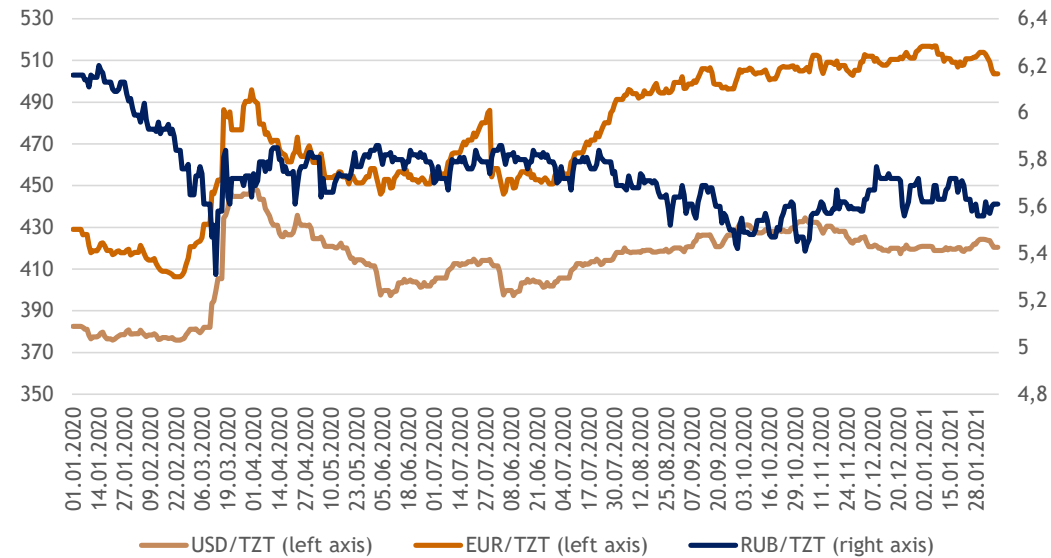
Contraction in the Kazakh economy appears to have narrowed with the short-term indicator for the economy (covers 60% of GDP) showing a decrease of -1.8 % (y/y). Largest driver in advancing recovery is attributed to the manufacturing sector that was showing robust growth of 7.5 % (y/y). Industrial production as a whole managed to grow by only 0.1 % (y/y) as the mining and quarrying sector that decreased by -6.9 % (y/y) had a continued negative impact due to the OPEC+ production cut agreement. Economic growth is forecasted to accelerate in 2Q21 with global demand recovery and the resulting commodity boom. The Kazakh economy is believed to expand by over 3 % in 2021 by most forecast, which would largely offset the economic losses from 2020.

Kazakhstan has adopted a new National Development Plan through 2025. It outlines Kazakhstan's long-term priorities and its government's goal to become one of the world's 30 most developed nations by 2050. The program states that the country will focus its efforts on ten national projects, which are listed under three individual blocks – the welfare of citizens, quality of institutions and building a strong economy. Some of the top priorities listed are digitalisation, quality education, open economy and new green agenda: the country wants to decarbonize its economy and decrease its reliance on oil, gas, and mining. These are not new initiatives, as in fact the current president Tokayev has talked about all of these since he took office in 2019.

Next week, the EU-Kazakhstan Cooperation Council will hold its 18th meeting in Brussels, first after the pandemic. It is co-chaired by the Foreign minister of Kazakhstan Mukhtar Tileuberdi and the EU foreign policy chief Josep Borrell. Kazakhstan's green agenda is expected to be one of the main aspects in the meeting, as the EU sees many possibilities in this area for cooperation. President Tokayev pledged last December, that Kazakhstan would become climate neutral by 2060.

Analysis by Sinikka Parviainen and Sanna Hentunen

Tenge FX rates against EUR, USD and RUR



Main economic indicators	Real			Forecast	
	2019	2020	1Q21	2021	2022
GDP, % y/y	4.5	-2.6	-1.8*	3.6	4.5
Industrial production, % y/y	7.1	-0.7	0.1	3.2	4.5
Inflation, % (end of period, y/y)	5.4	6.8	7.0	6.4	5.8
Current Account Balance, USD bn	-7.2	-5.9	-1.2	-4.1	-4.0

*Short term indicators for the main sectors of the economy.
Source: National Bank of Kazakhstan, Ministry of National Economy of the Republic of Kazakhstan Committee on Statistics

Forecasts from Consensus April 2021 survey

Dynamics negative in 1Q21 in the Ukrainian economy, growth expected in 2Q21 due to low base level



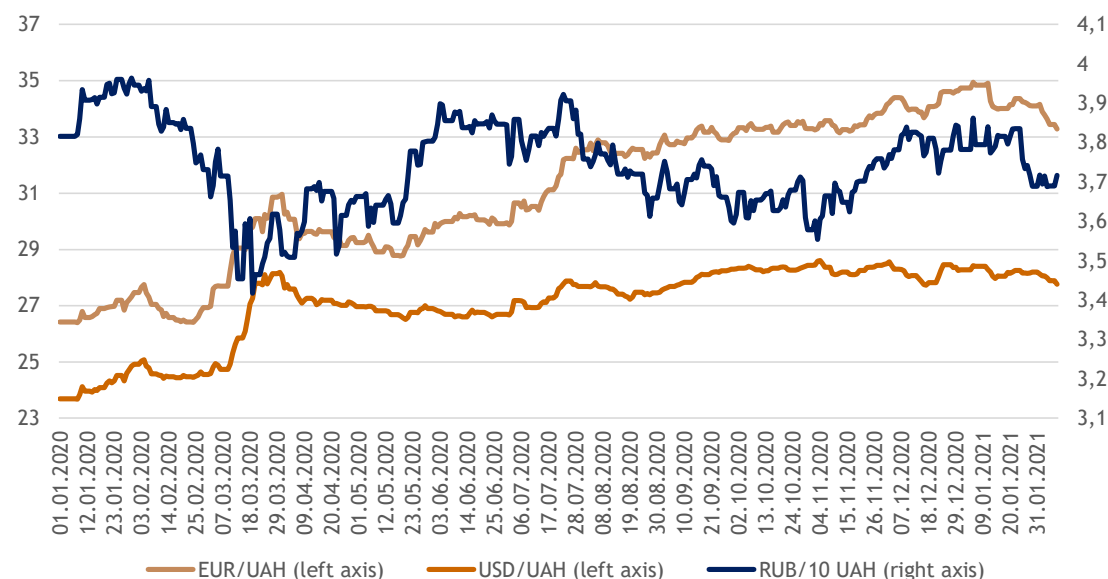
Ukrainian economic contraction worsened again in Jan-Feb 2021 as the basic sector output declined by -3.5 (y/y) with some signs of improvement in March as the basic sector output narrowed to -0.1 %. Despite a rough start, the Ukrainian economy is expected accelerate strongly in growth and end up close to the GDP level of 2019 this year. Main improvements were witnessed in industry in March (+2.1 % y/y after -4.6 % in Feb) and especially manufacturing (+2.4 % y/y vs -6.7 % in Feb). Accelerating inflation has plagued Ukrainian economy in 1Q21 due high food prices and increases in utilities tariffs such as gas. As the year progresses, inflation is expected to moderate and retail would again have a significant contribution to recovery as real wage growth becomes stronger.

Ukraine is still trying to gain access to the rest of the loan from IMF Zelensky negotiated a year ago. The loan has been constantly delayed due to concerns about reforms, central bank independence and the government's efforts to tackle corruption. According to Ukrainians, their parliament is on track to pass the necessary legislation by June.

EU and United States have also expressed another concern, over the Ukrainian government's decision to dismiss the highly respected Andriy Kobolev from his position as the CEO of state-own gas company Naftogaz. Kobolev is known as a reform-minded business leader who took over Naftogaz in 2014 and turned its course from a highly corrupted entity to a well-managed and profitable company. The government has defended its actions by claiming the dismissal was based on losses in 2020, but the company itself and some western critics see the move as politically motivated. In the past Ukrainian economy has felt the consequences of such direct interference in the management of state-own companies, and western countries and IMF have tried to steer the country away from such practices.

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Hryvnya FX rates against RUB, EUR and USD



Main economic indicators	Real			Forecast	
	2019	2020	1Q21	2021	2022
GDP, % y/y	3.2	-4.0	-3.5*	3.6	4.1
Inflation, % (end of period, y/y)	7.9	2.7	8.5	6.4	5.9
Industrial production, % y/y	-0.5	-4.5	-2.0	2.9	3.1
Current Account Balance, bn USD	-1.3	6.5	1.0*	-2.6	-3.6

*Data for Jan-Feb 2021. Source: National Bank of Ukraine, UkrStat
Forecasts from Consensus Economics April 2021 survey

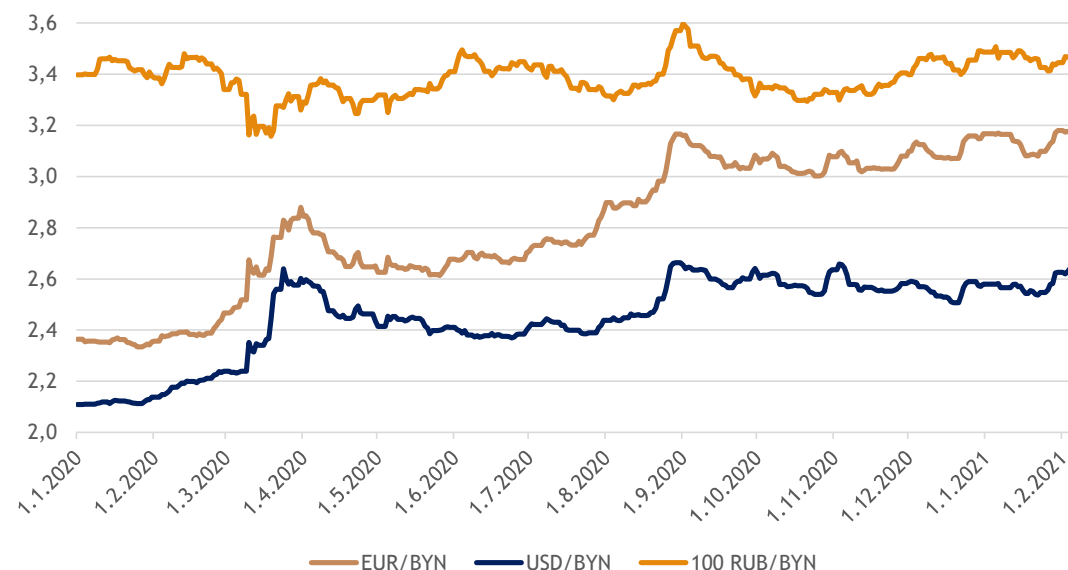
Belarus economy already growing in 1Q21 despite political back lock

Belarus' economy has ended the first quarter of the year on growth (+0.9 %) after relatively marginal losses for 2020 as the state refrained from any significant anti-virus quarantine measures or restrictions. This, albeit risky, approach seems to have saved the economy from major economic damage. Main driver for growth were found in revived industrial production (+9.2 y/y in 1Q21) and slower decline in agricultural output (-0.5% y/y). At the same time, retail decrease sharpened (-4.5 y/y) as the sector was adversely affected by slowing real disposable income growth and weaker currency.

The political situation remains volatile. President Lukashenko seems to be ready to go to great lengths to hold on to power and crush political opposition. First, Belarusian authorities included the opposition leader in exile, Sviatlana Tsikhanouskaya and other active opponents of the regime, in the list of persons involved in terrorist activities, which is a move used before against political opposition.

Secondly, in April Lukashenko announced there was a military coup d'état planned against him and the state of Belarus. Russia backed this up by telling it had detained two perpetrators in Moscow. The statements did not match with each other and the details made the story seem even more unbelievable: Russia said a military coup in Belarus was prepared by Belarusian generals with the support of the United States and Poland, while Lukashenko spoke of a conspiracy led by either the CIA or the FBI and accused them of planning his assassination. Experts have had a hard time finding a single clear benefit that this act has had, or even could have had for Lukashenko. It is possible that just as he used to intimidate Western countries by suggesting it was either him or Putin who reigned in Minsk, he now wanted to communicate the same message to Putin.

Belarusian Rouble rate against EUR, USD and EUR



Main economic indicators	Real		Forecast		
	2019	2020	1Q21	2021	2022
GDP, % y/y	1.4	-0.9	0.9	1.0	1.7
Inflation, % (end of period, y/y)	5.6	5.5	8.5	6.6	6.0
Industrial production, % y/y	1.0	-0.7	9.2	2.8	2.5
Current Account Balance, USD bn	-1.2	-0.2	0.34*	-0.9	-1.2

*Data for January 2021. Source: National Bank of Belarus, Sberbank
Forecasts from Consensus Economics April 2021 survey

Thank you

Any comments or questions?

Please, contact senior analyst Sinikka Parviainen

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