

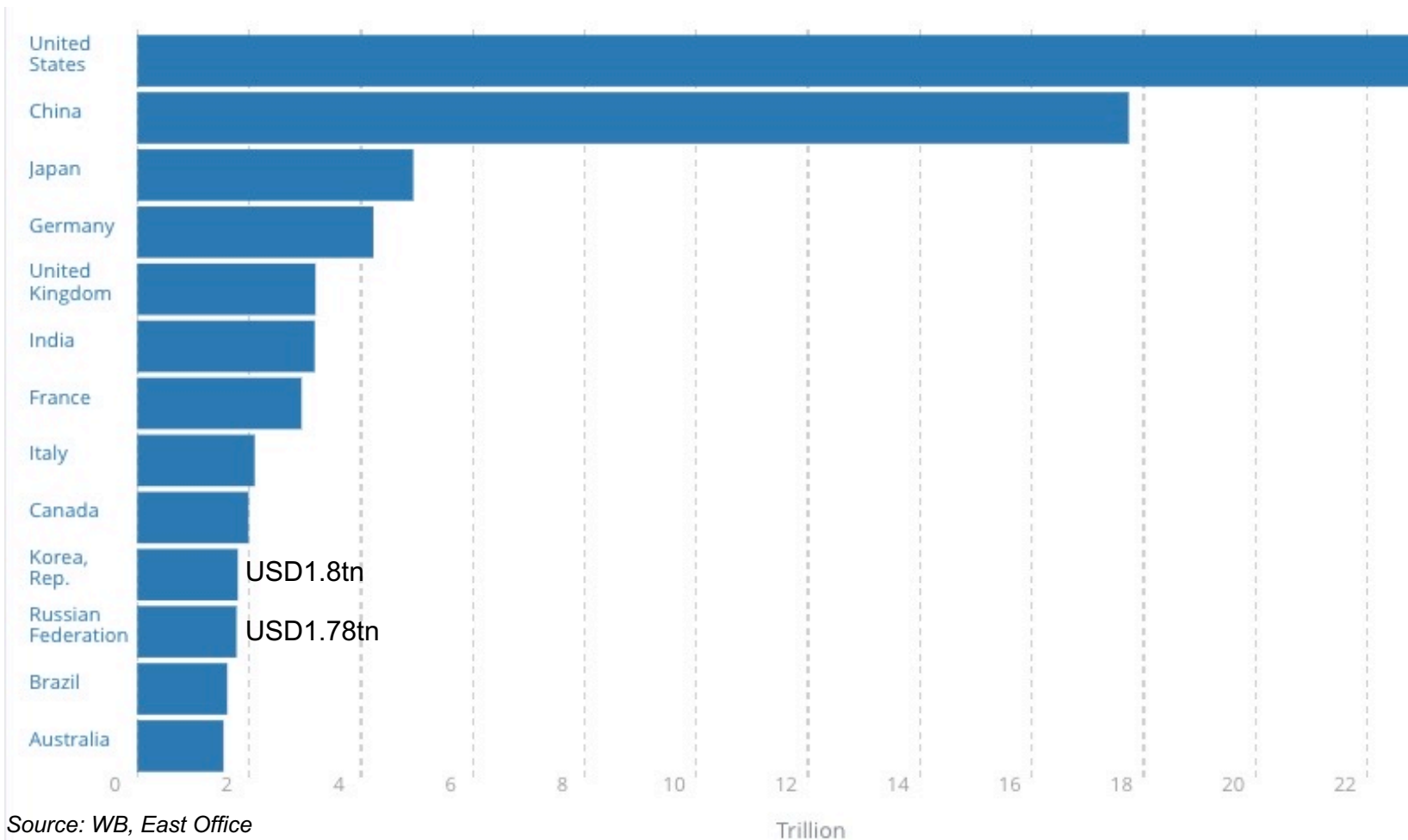


"Mobilizing" the Russian economy

November 16, 2022

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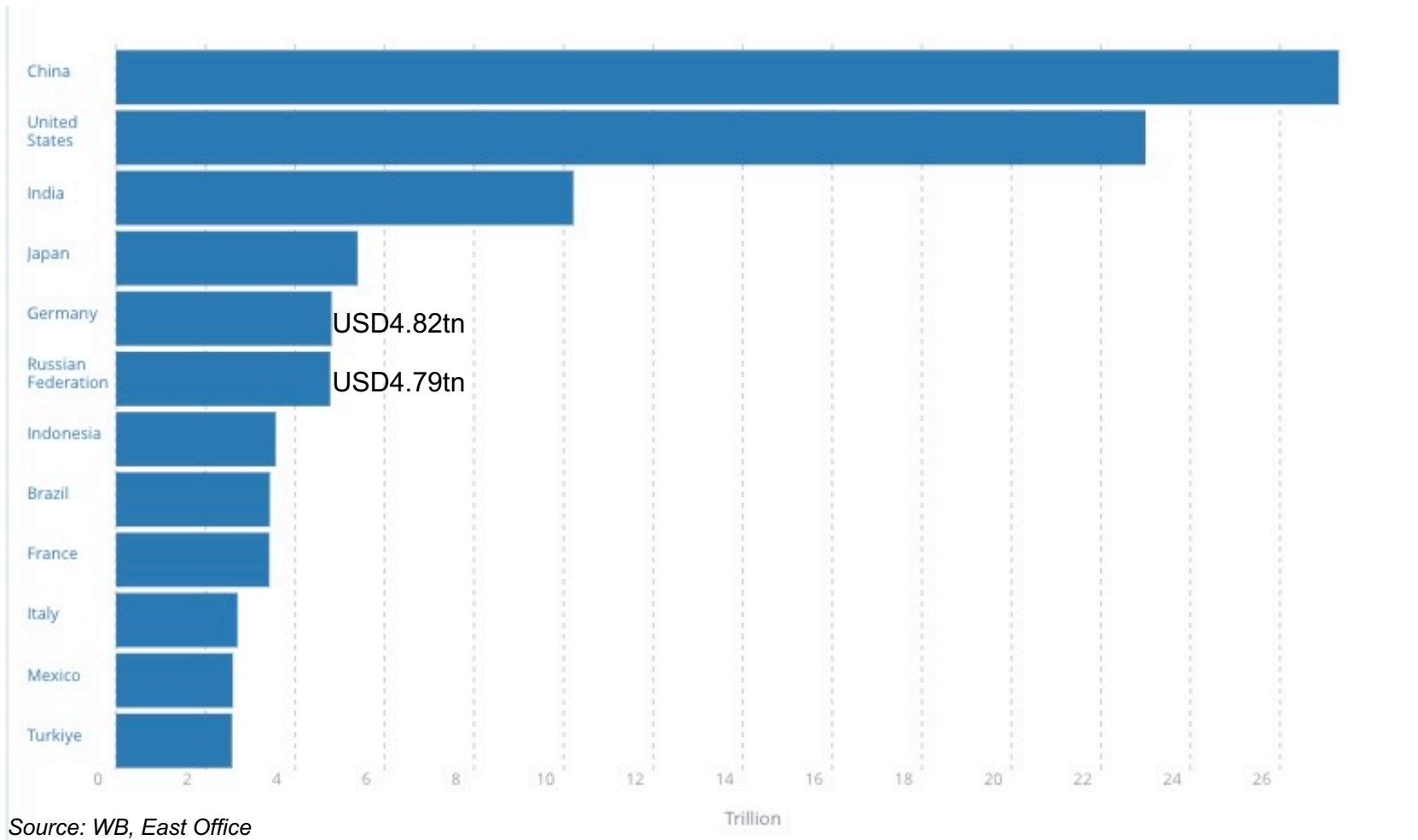
Russian economy in the world: #11 in current USD terms in 2021, far from the giants



Source: WB, East Office

- Russia has been far away from being an economic superpower.
- In nominal USD, Russia's GDP makes 1.9% of world's GDP vs. 24% share the US makes and 18% share China makes.
- Yet, it does not give the full picture of its impact on the global economy.
- We prefer to look at GDP based on purchase power parity (PPP), which cancels the effect of FX manipulations by the governments, compares people's living standards, considering cost of living in different places.

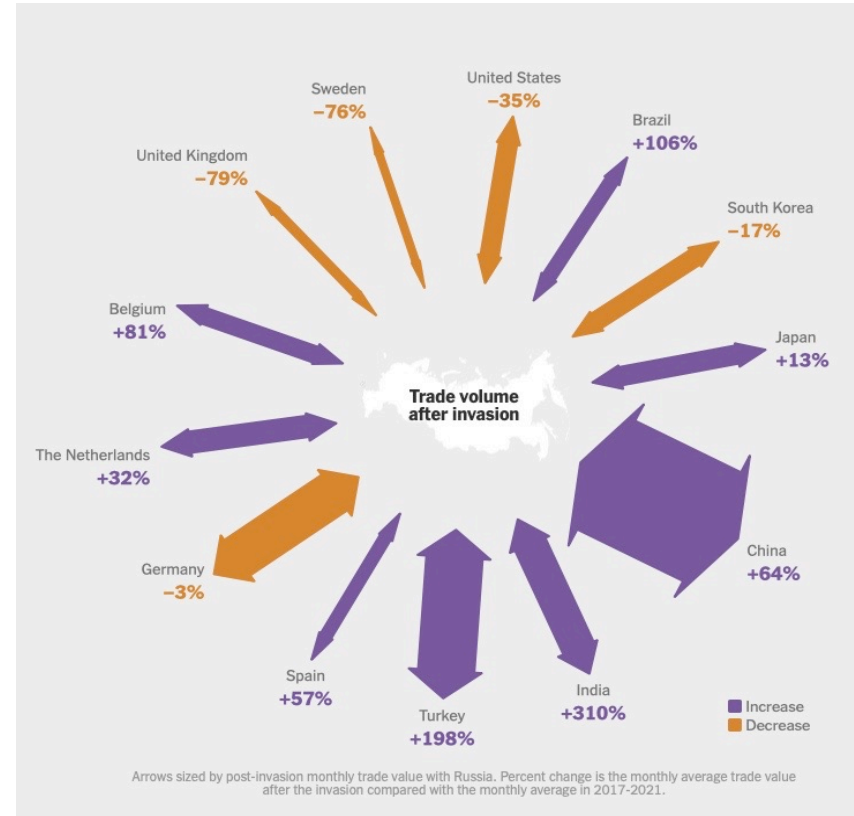
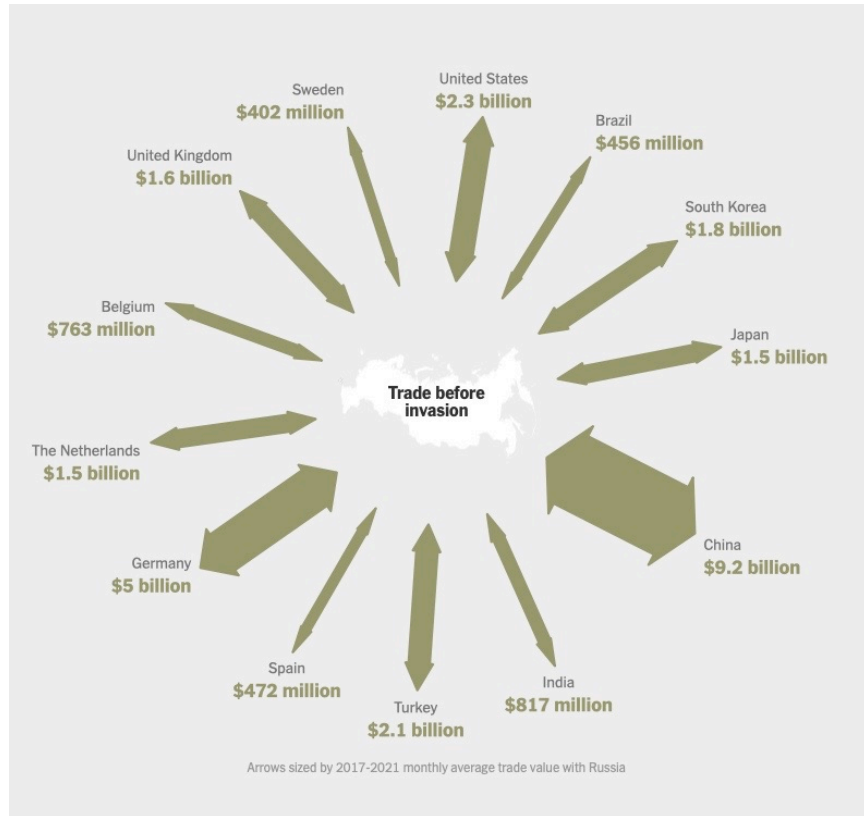
But by GDP based on purchase power parity in 2021 (current international USD) Russia stays firmly at 6th place



Source: WB, East Office

- In GDP PPP terms, for many years Russia has stayed firmly at the sixth place, while China's position has become stronger vs. the US.

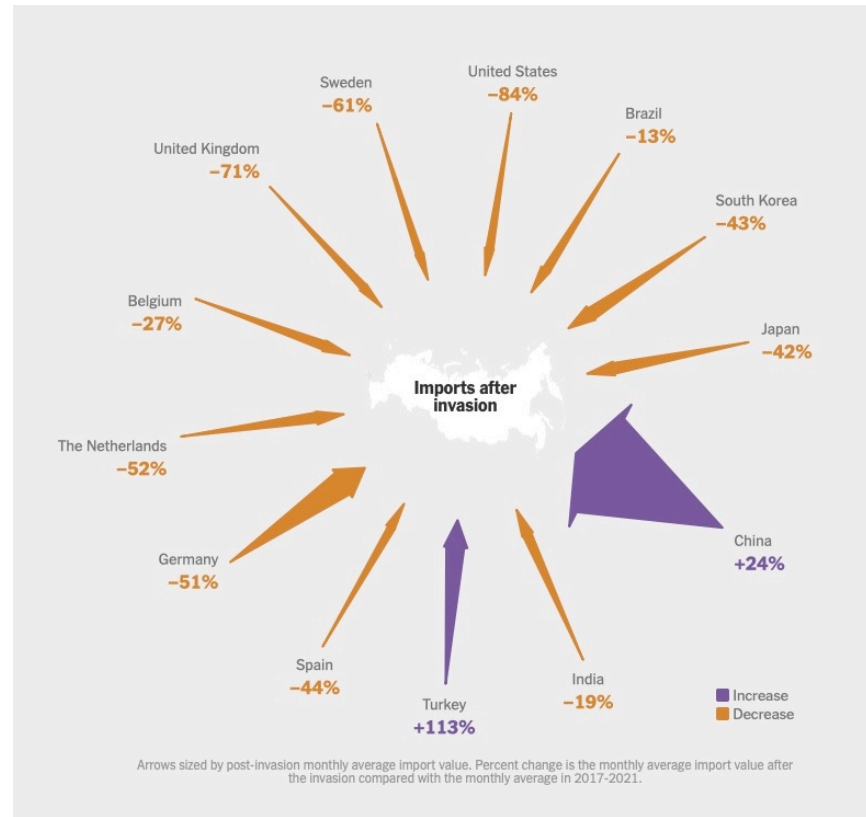
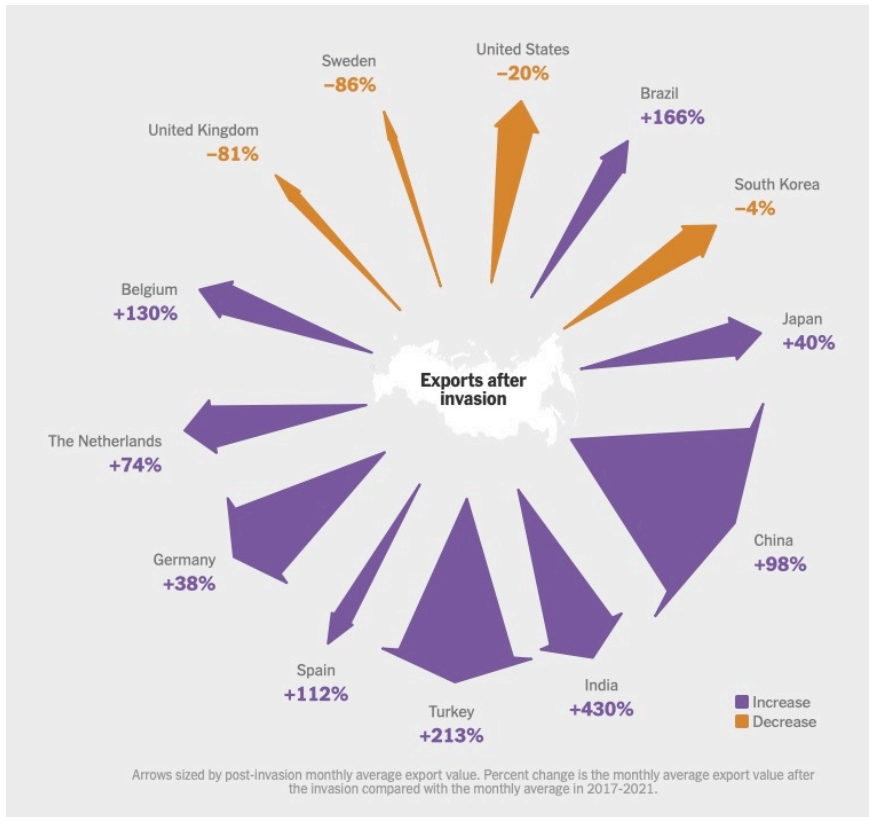
Sanctions, war and economic reality: international trade boomed with Russia in 2022 despite severe sanctions by the West and its allies



Source for both charts: NYT

- Since February 2022, the EU has named 1,236 people and 155 companies for sanctions, freezing their assets and blocking their access to the bloc.
- It has banned the trade of products in nearly 1,000 categories and hundreds of subcategories. It has put in place a near-total embargo on Russian oil.
- About one-third of the EU exports to Russia by value and two-thirds of imports have been banned.

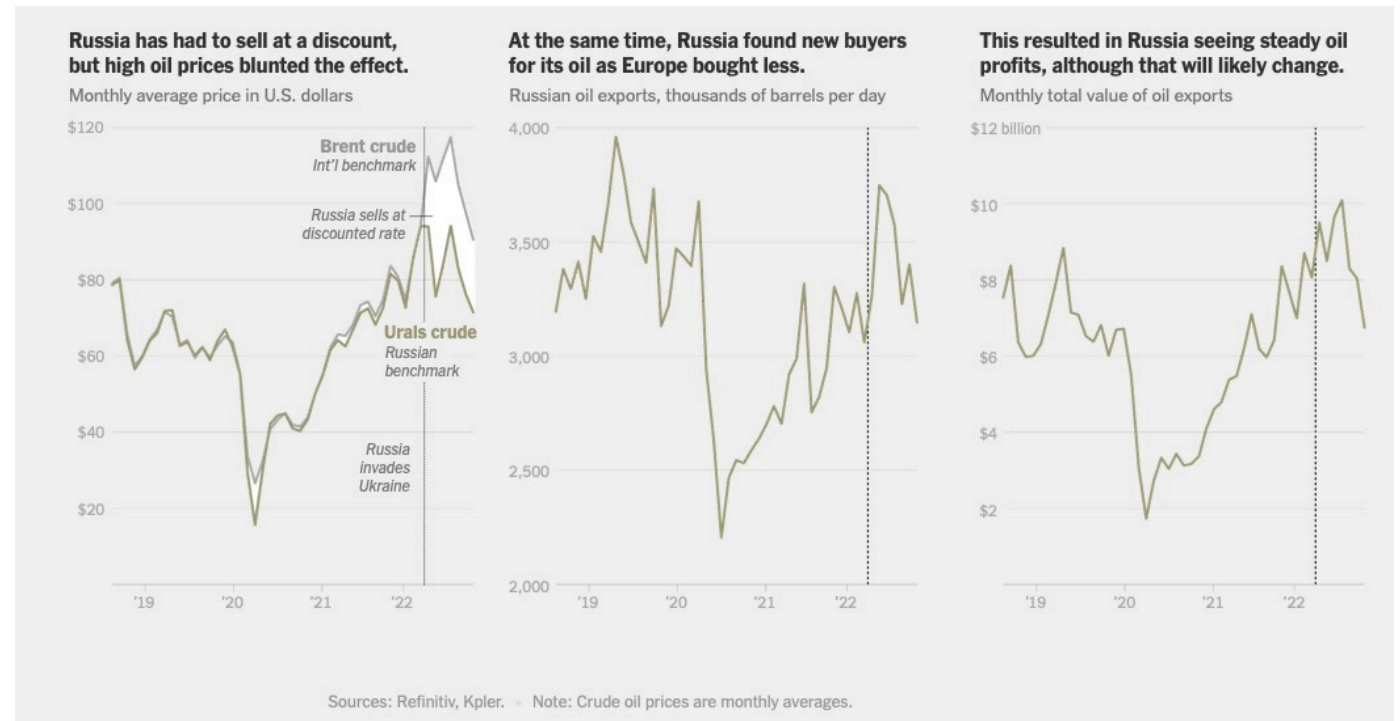
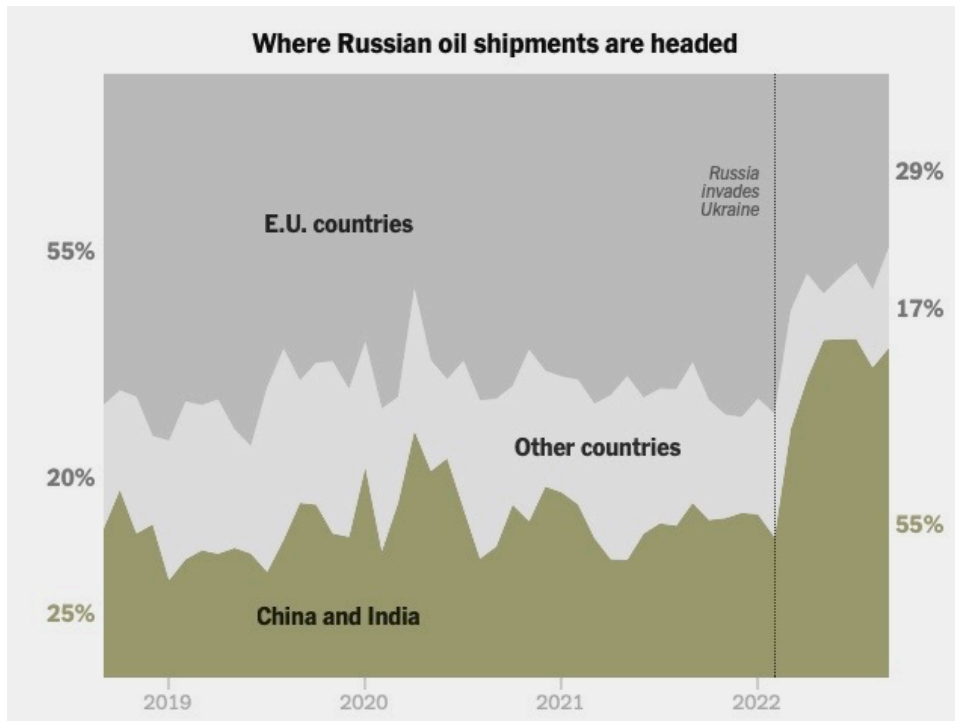
Russia is still generating significant amount of money through its foreign trade



- Despite a severe drop in imports with the Western countries and their allies, flows are simply rerouted through "neutral" countries.
- "Parallel" imports have been used for many consumer goods. For example, pre-orders for Apple's iPhone 14 in September 2022 were significantly higher than pre-orders for the models a year earlier.
- Increasing energy prices have inflated exports to the EU and pushed revenues of Russian energy companies to all-time highs, despite lower shipped volumes.

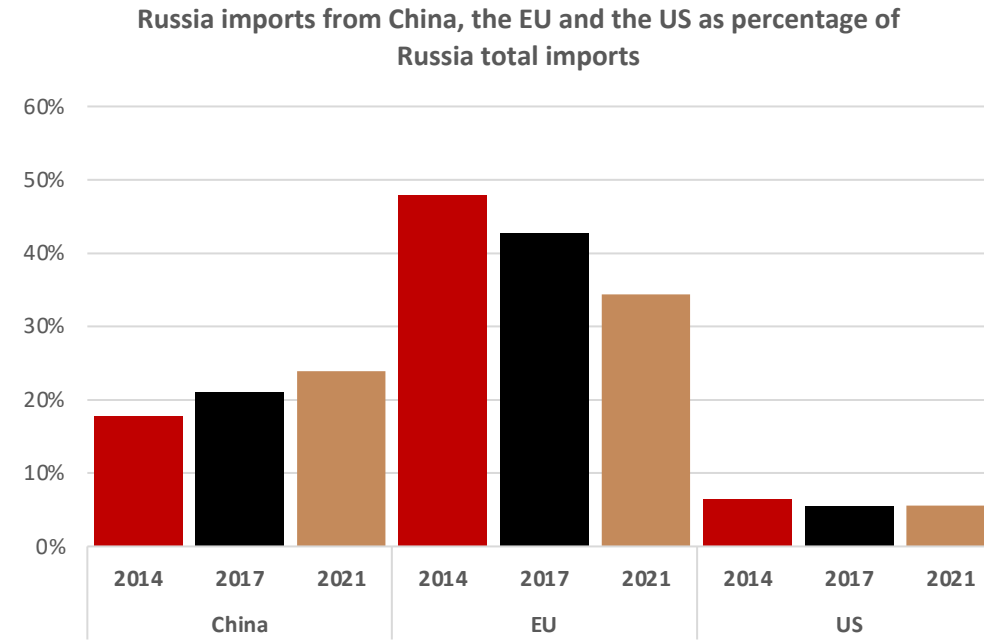
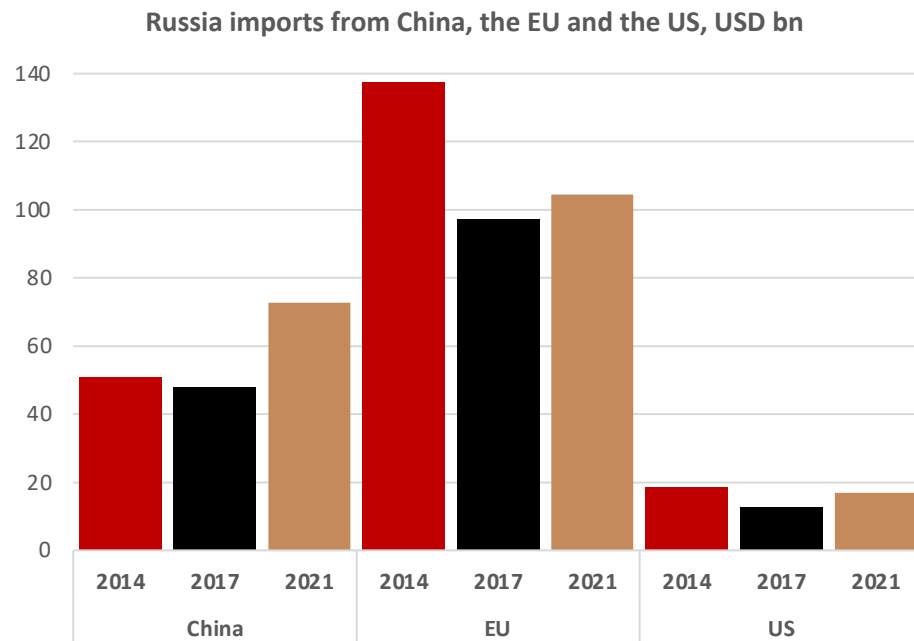
Source for both charts: NYT

Major risks for Russia's foreign trade arise from upcoming bans on oil by the EU officials, while global reshuffling of energy markets is likely to help Russia's trade



Source for both charts: NYT

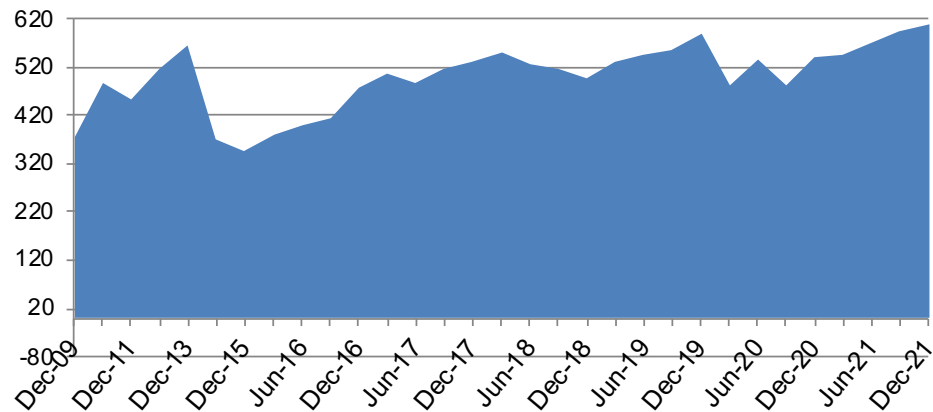
Since 2014 Russia's imports from China have steadily increased, although the major flow has come from the EU



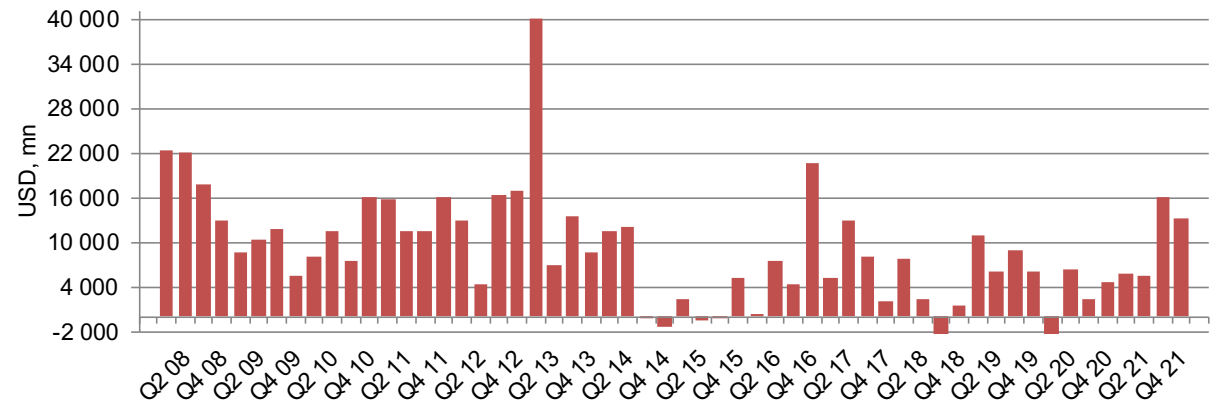
Source for both charts: Russian Customs, CBR, European Commission, East Office

FDI to Russia reached multi-year highs on the brink of the war, while net inflows skyrocketed

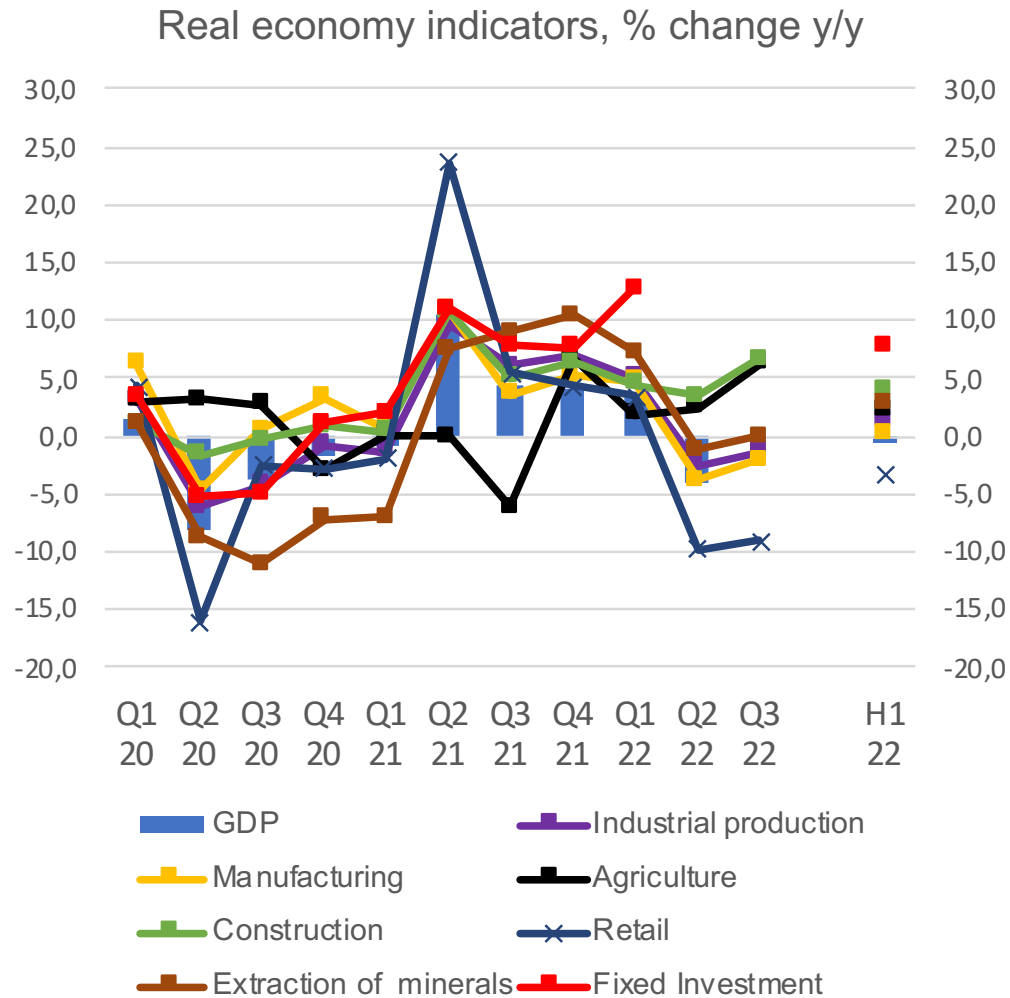
Total Inward FDI Accrued, USD bn



FDI to Russia, net flows, USD mn



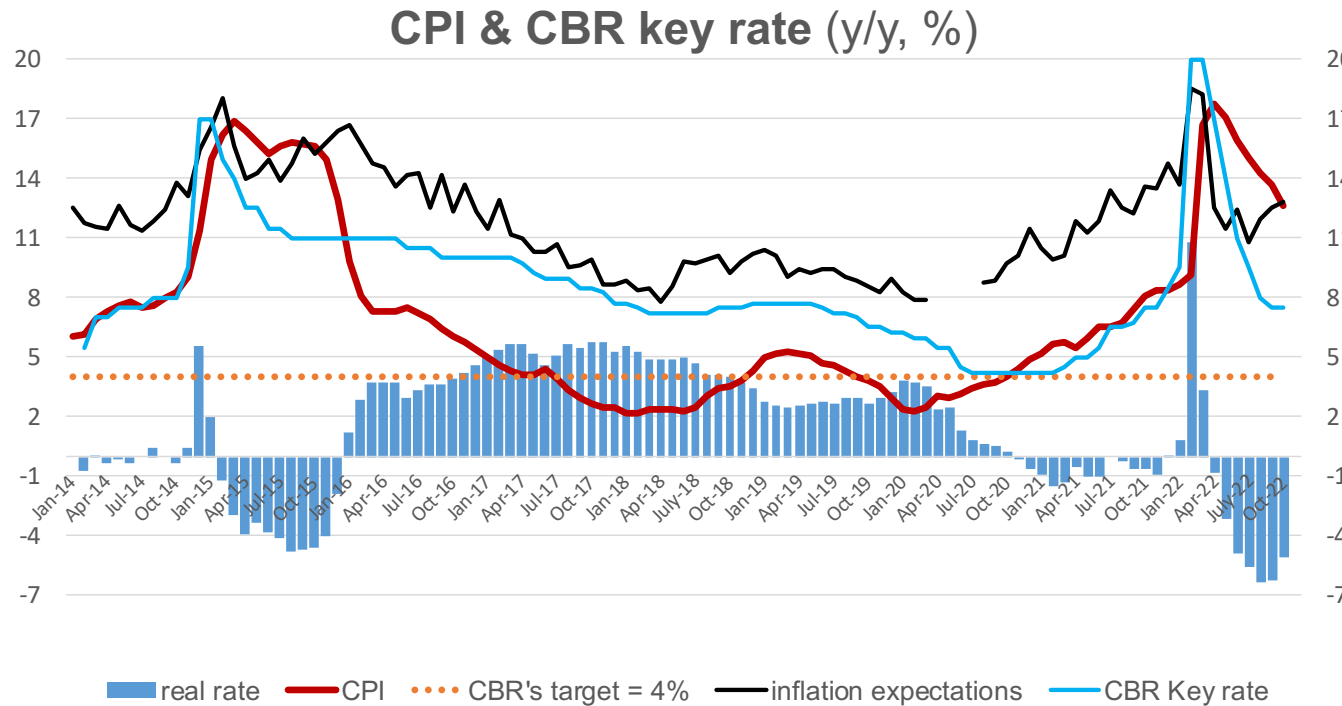
Retail and manufacturing remain subdued, while construction and fixed investments carry on



Russian real GDP down by -0.4% (y/y) in H1 22:

- Overall, economic activity in Russia slowed significantly at the end of September 2022.
- Most negative developments continue in retail sales due to significant inflation in durables and rising uncertainty in labor markets. As a curiosity, the Bank of Russia expects that payments to mobilised troops should cushion the negative effect on consumer demand.
- Fixed investments are on surge as infrastructure projects continue to use government financing.
- The Western sanctions have hit entire sectors of the Russian economy and caused major disruptions in the automotive and some industrial sectors.

Inflation is set to decelerate as the CBR stays cautious, while real rates will remain in the negative territory for a while



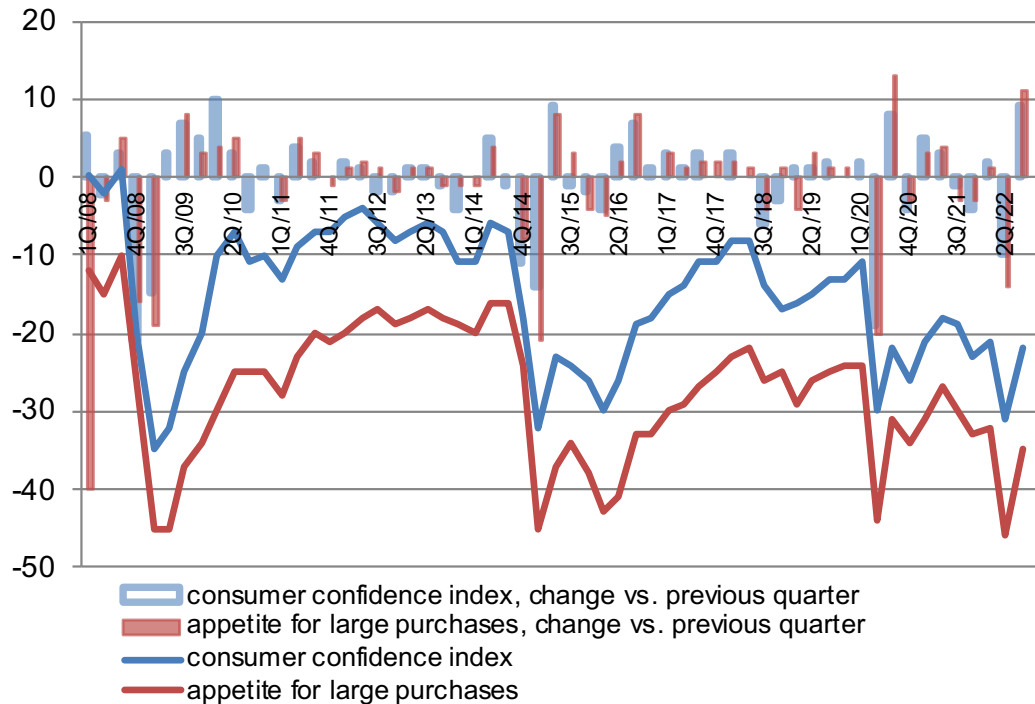
Source: CBR, East Office

October 2022, % y/y	
CPI	12.6
Food	12.1
September 2022, % y/y	
CPI	13.7
Food	14.2
Non-food	14.9
Services	11.0

Source: CBR, Rosstat, East Office

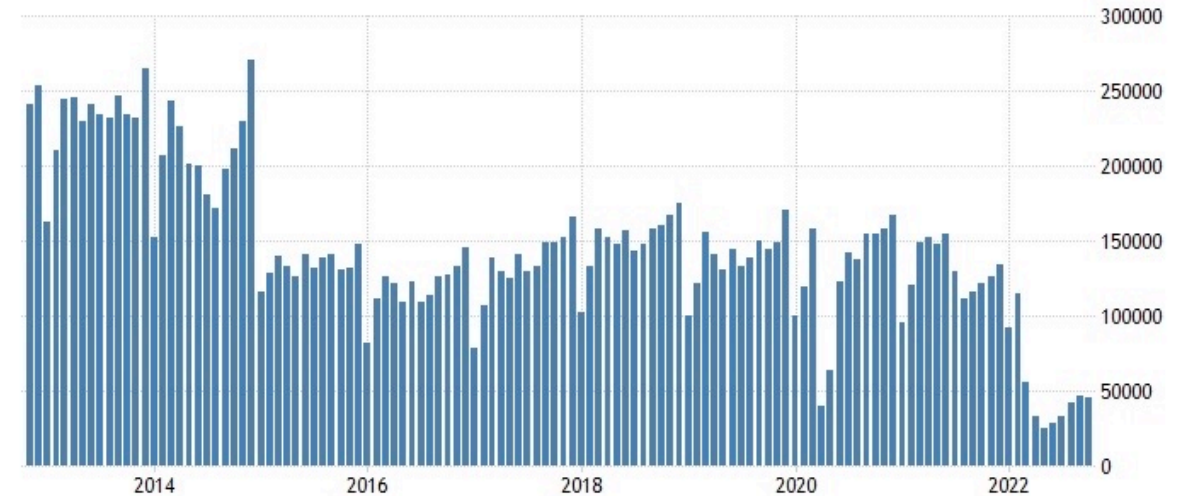
Appetite for large purchases is taking off from its deepest bottom since 2008

Consumer confidence is bouncing up



Source: Rosstat, East Office

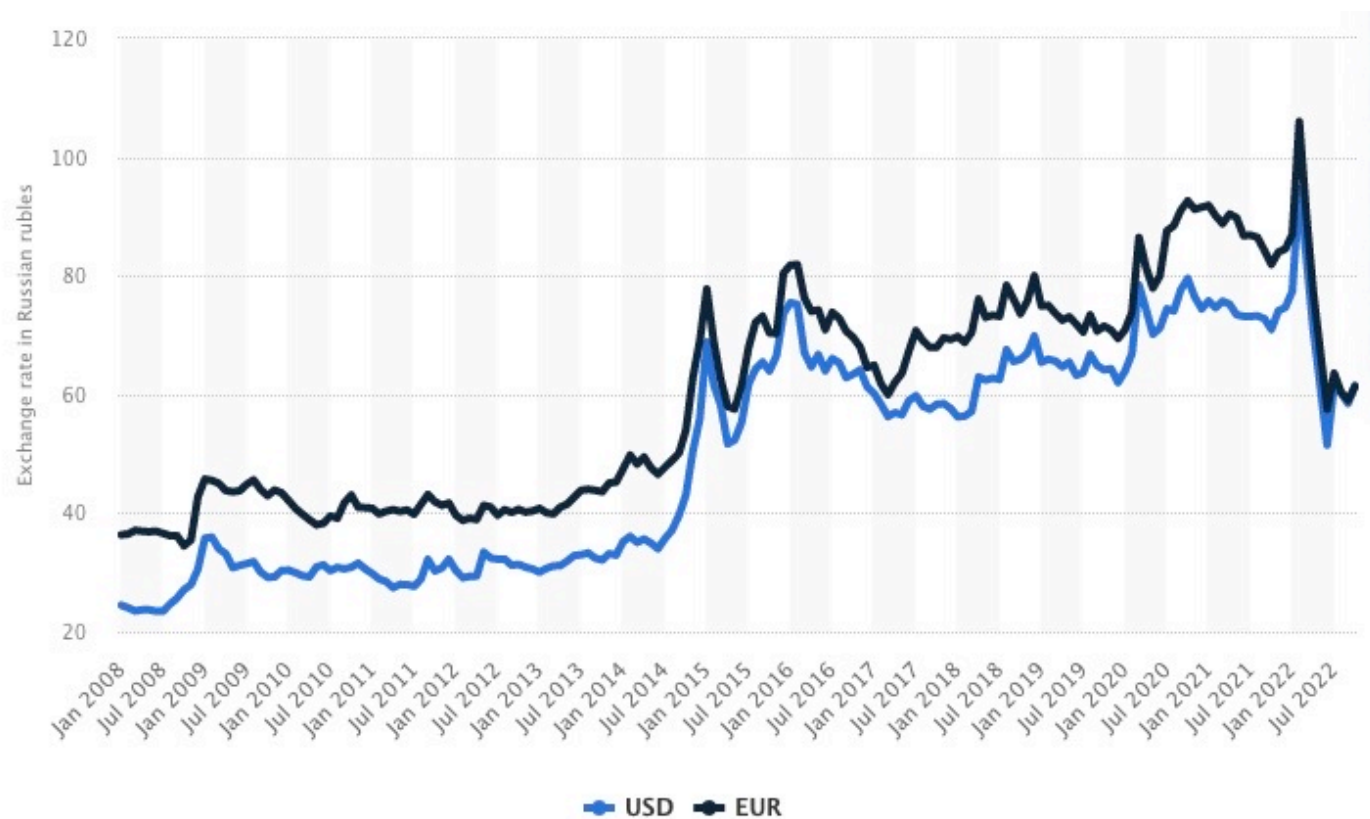
Russia's new car sales* in October 2022 were far from ten-year average as sanctions impede new deliveries



* Monthly AEB data does not include sales figures from BMW, Mercedes-Benz Rus following BMW Group, Mercedes-Benz AG decisions to change the frequency of their sales data publication from a monthly to a quarterly basis. Since May 2022, monthly AEB data does not include sales figures from Chery.

Source: Trading Economics, AEB

Russian rouble: a boring currency with manual regime



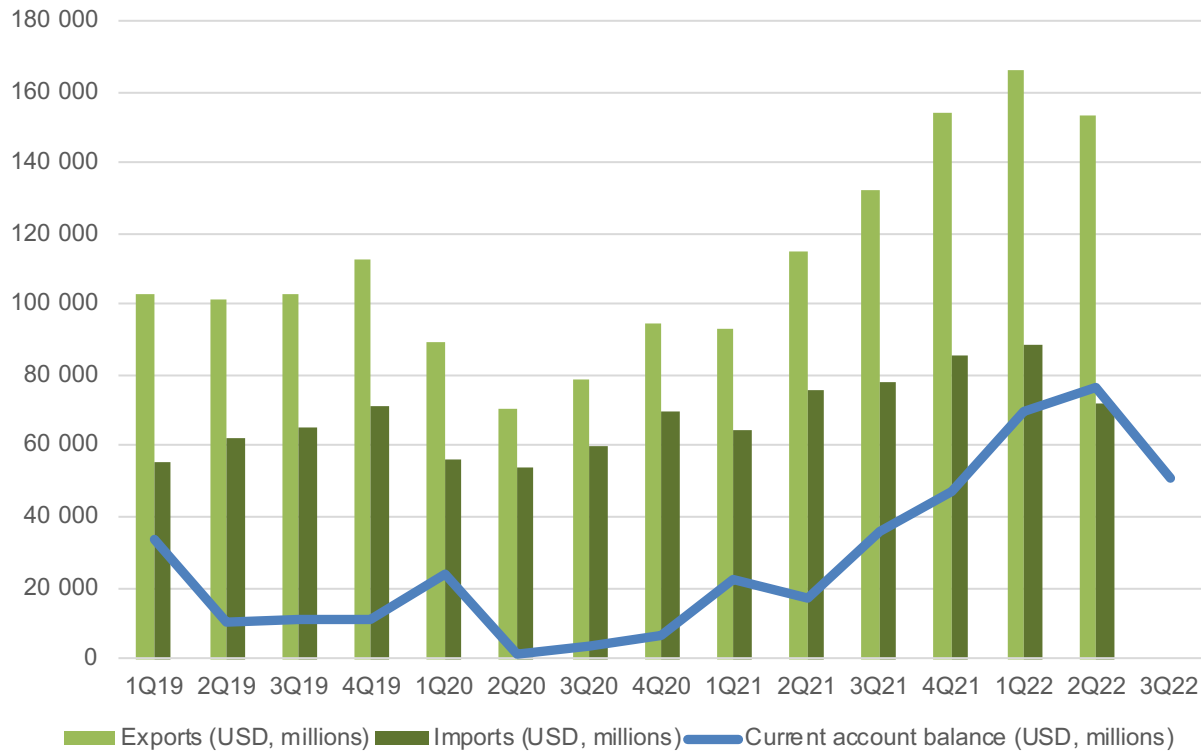
Source: Statista

Major factors to watch in the current environment:

- Oil price
- Tax periods: export-focused firms usually convert foreign exchange revenues into roubles to pay domestic liabilities, which supports the Russian currency.
- Change in sanctions regime
- War news
- Global tightening
- Capital controls by the CBR
- CBR's rate decision

Russia's strong current account surplus adds to country's macro stability

Russia's current account massive surplus is likely to deflate in 2023 on lower exports

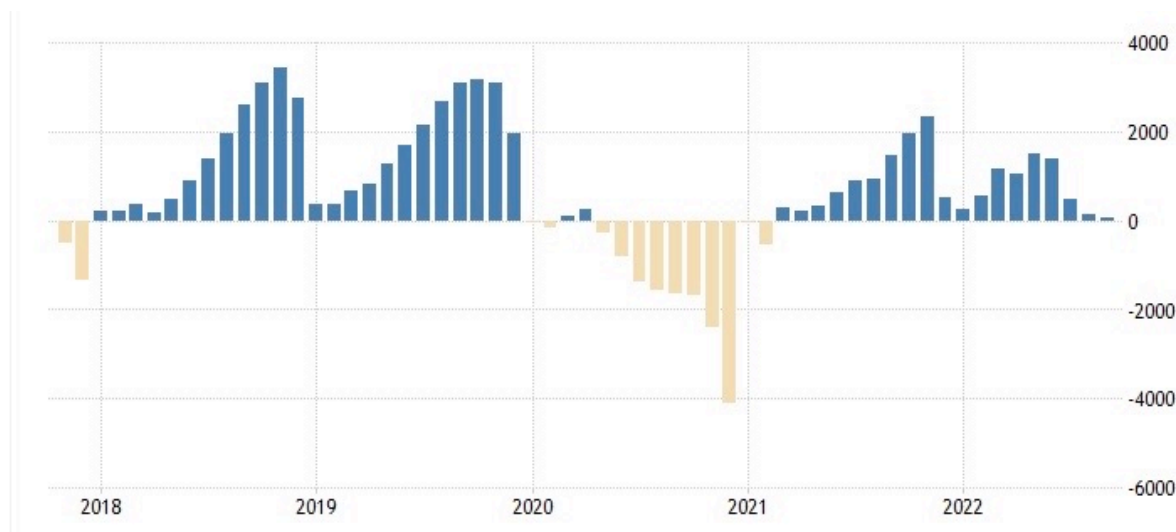


- According to the Bank of Russia's preliminary estimate, the current account surplus of the balance of payments January-October 2022 continued to strengthen and amounted to USD215.4bn, which is two times higher y/y.
- A decisive role in the current account dynamics was played by an increase in the surplus of balance on goods and services as a result of growth in exports of goods with a slight decline in the value of imports of goods y/y.
- Total deficit in primary and secondary income grew, among other things, due to reduction in received investment income and current transfers.

Source: CBR, East Office

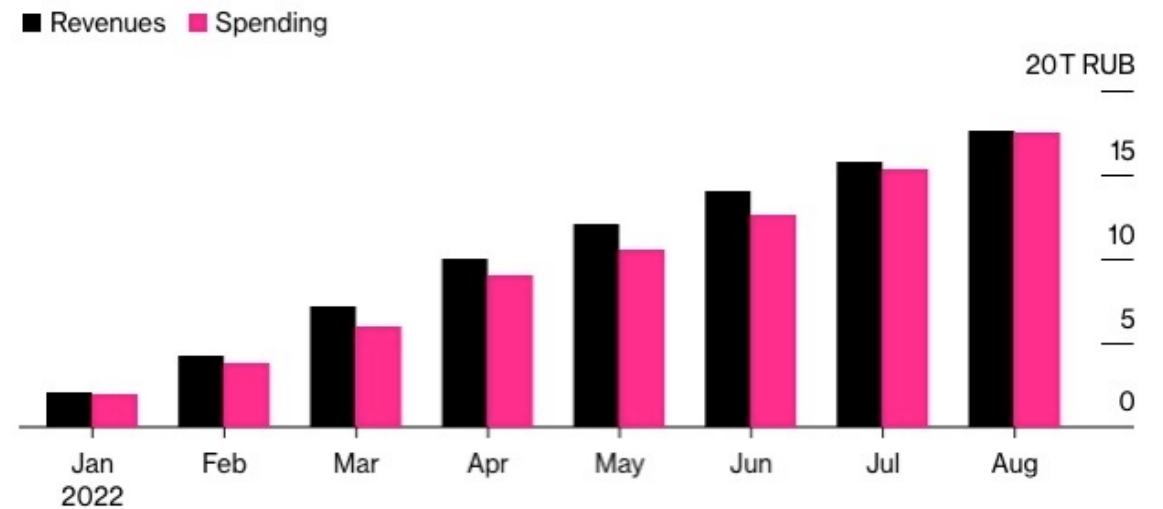
Federal budget surplus shrinks on increasing spendings and revenues under pressure: lower energy production and sanctions continue to weigh

Russia's budget surplus (RUB, bn) is melting again after the post-pandemic rebound



Source: Trading Economics, Treasury of Russia

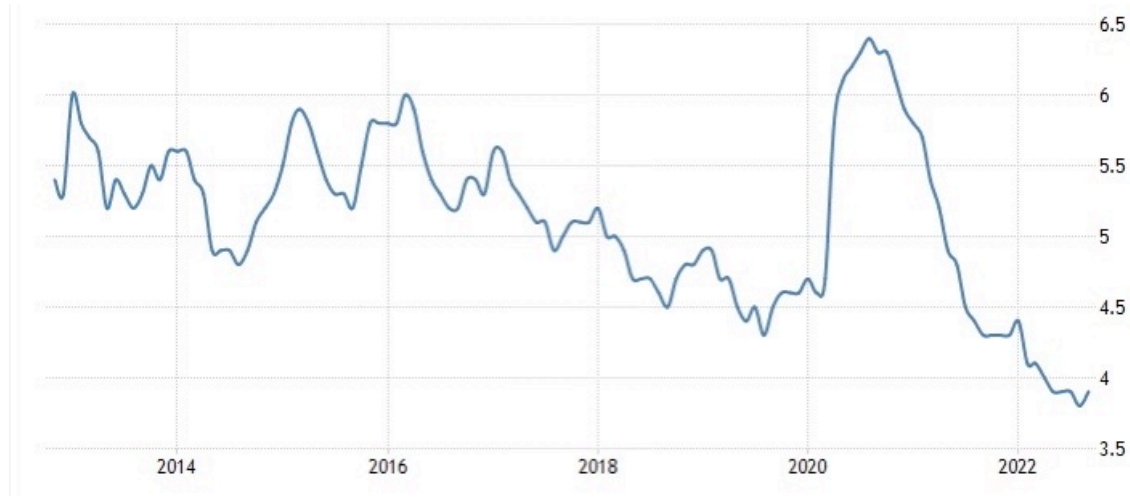
Growing military and social spendings may lead Russia to budget deficit in 2023



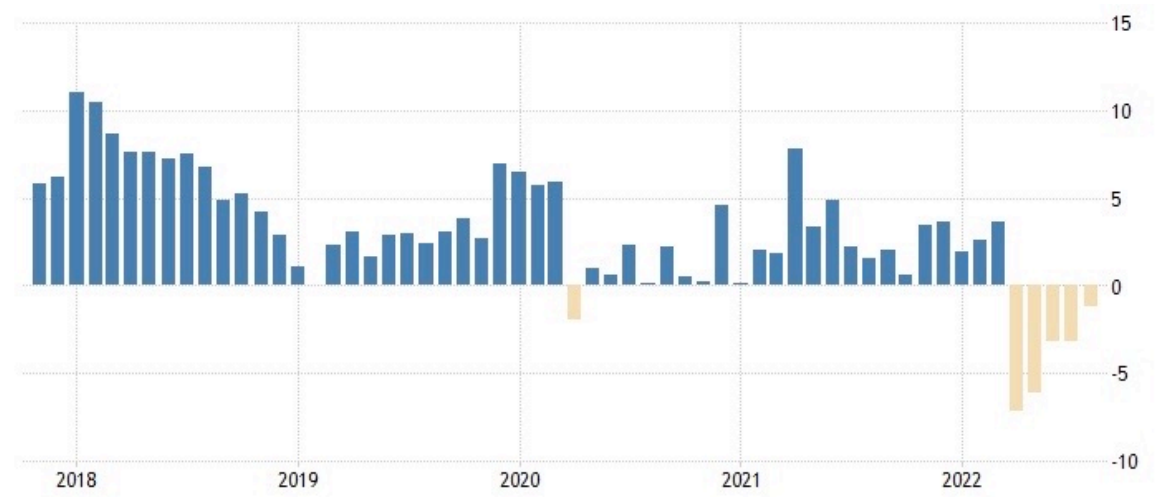
Source: Bloomberg, Russia's Finance Ministry

Labor market: partial mobilization and migration create shortages in manufacturing sectors

Russia's unemployment rate (%) hits historical lows reflecting mostly long trends in demographics



Russia's real wages (% change, y/y): inflationary shock hits purchase power

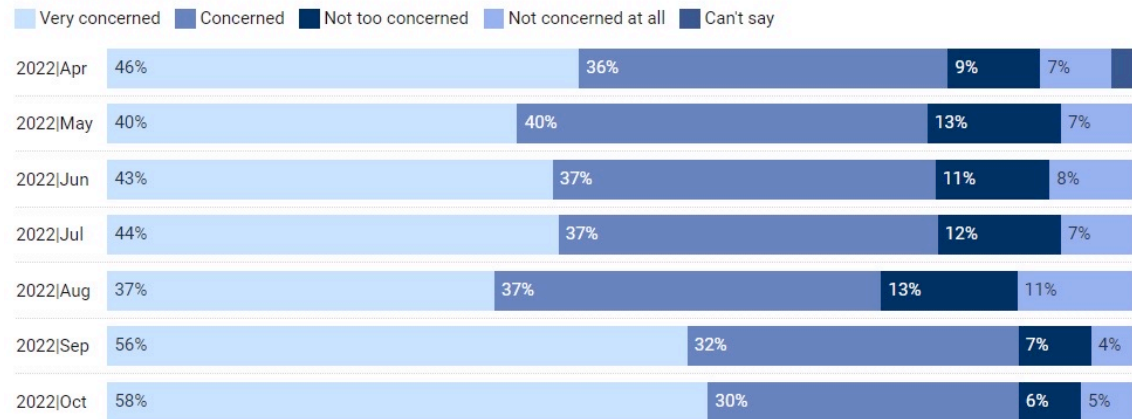


Source for both charts: Trading Economics, Rosstat

Public woes and stress increase as the war continues

Are you concerned about the current state of events in Ukraine?

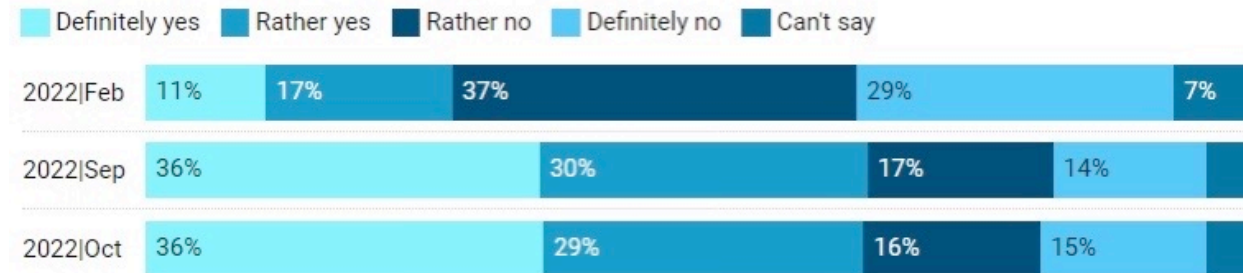
As %% of respondents



Source for both charts: Levada-Center

Do you have concerns that general mobilization will be announced because of military actions in Ukraine?

As %% of respondents



Partial mobilisation weighs on business sentiment and public opinion

Russia's services PMI gets knocked down as partial mobilization brings concerns over labor force shortages



Source: Trading Economics, East Office

- Russia's service sector contracted sharply in October 2022, dragged down by weak domestic and foreign demand, as well as slumping workforce numbers, which fell at the fastest pace in over two years.
- The decrease in workforce numbers gathered pace and was the fastest since May 2020. Lower staffing levels were attributed to weak client demand, the non-replacement of voluntary leavers and layoffs.

Putin's approval rating as of October 2022



Source: Levada-Center

Forecasts rebalancing during the war

	IMF		Bank of Finland		SEB		World Bank	
	2022	2023	2022	2023	2022	2023	2022	2023
In March 2022	-	-	-10 %	-	-	-	-	-
In April 2022	-8.5%	-2.3%	-	-	-8.0%	-5.0%	-	-
In June 2022	-	-	-	-	-	-	-8.9%	-2.0%
In July 2022	-6.0%	-3.5%	-	-	-	-	-	-
In August 2022	-	-	-	-	-4.0%	-3.0%	-	-
In October 2022	-3.4%	-2.3%	-4.0%	-4.0%	-	-	-	-

Source: IMF, Bank of Finland, SEB, World Bank

Major reasons behind drastic revisions:

- Russia's crude oil and nonenergy exports have held up well.
- Russian domestic demand is likely to recover, thanks to containment of the effect of sanctions on the domestic financial sector policy support, and a resilient labor market.
- Energy sector provides good cushion for economic stability, e.g. Gazprom posted a record-profit in H1 2022, even as shipments to Europe began to slump.
- Due to cautious monetary policy and stable domestic energy prices, inflation is likely to decelerate, despite surged prices for imports.

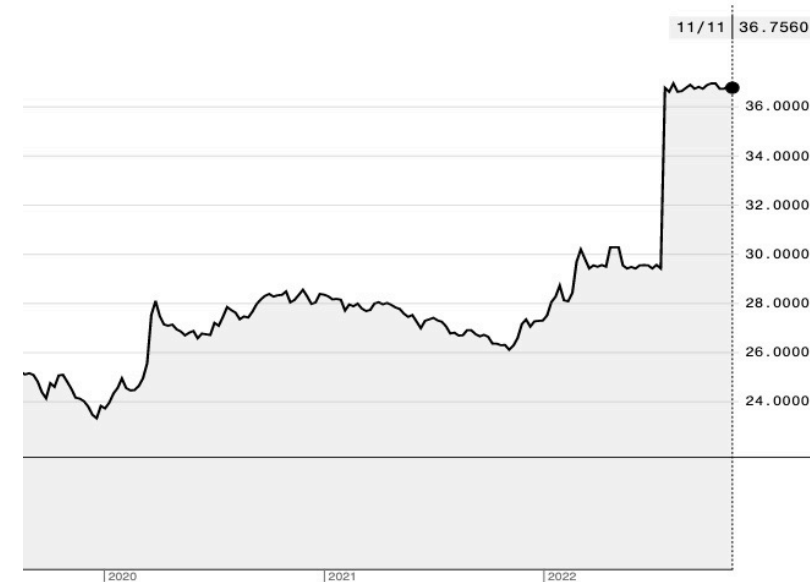
Ukraine and Kazakhstan

Ukraine's economic prospects for 2023 endangered as Russia destroys energy infrastructure, Kazakhstan follows global monetary tightening

Ukraine's economic recovery is at risk as Russia intensifies attacks on critical infrastructure

- In October 2022, CPI accelerated to 26.6% y/y, up from 24.6% in September. In monthly terms, prices increased by 2.5%.
- The war continues to cause the disruption of production and supply chains, the growth in businesses' production costs, ad-hoc increases in the demand for certain goods and services, and a decrease in the supply of goods. The indirect fallout from the war – exchange rate effects and worsening expectations of households and businesses – also affected prices.
- The poverty and social impacts of the war will be massive. According to the estimations of the World Bank Group, the population share with income below the national poverty line may reach 60% in 2022, up from 18% in 2021 with high upside risks if the war and energy security situations worsen.
- The risks of further UAH devaluation are likely to rise, if the West reduces amount of secondary income for the economy.
- Assuming the military and economic situation does not change substantially, GDP is likely to contract 30-35% in 2022 with a gradual rebound of 3-4% in the medium term. Upside risks to the forecast may come from a large reconstruction activity. Downside risks arise from deterioration of the security situation and/or energy shortage during the winter season.

USD/UAH as of November 2022



Source: Bloomberg

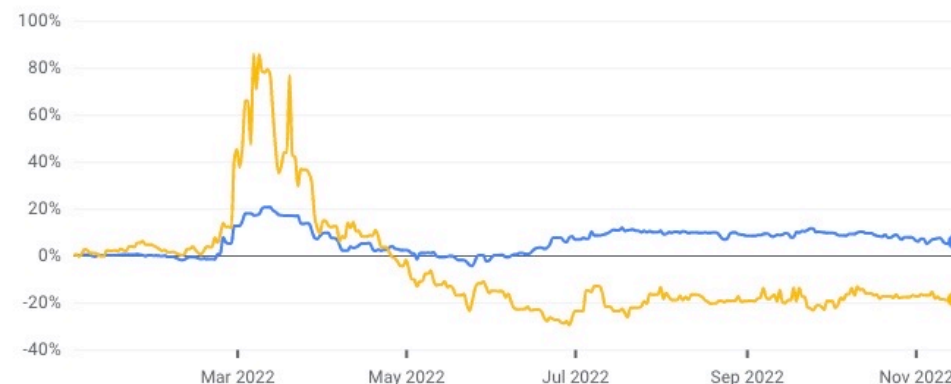
Main economic indicators	Actual		Forecast	
	2020	2021	2022	2023
GDP, % y/y	-3.8	3.4	-31.5	4.0
Inflation, % (end of period, y/y)	10.0	9.4	30.0	20.8
Current Account Balance, USD bn	5.3	-3.2	6.8	-8.0

Source: NBU

Kazakhstan: benefiting as an intermediary, while remaining exposed to global headwinds

- The impact of the Ukraine war on Caucasus and Central Asia (CCA) was milder than expected by international financial institutions. The IMF sees that the region's GDP is slowing to 3.8% in 2022. The IMF put CCA growth at 5.6% in 2021.
- In Kazakhstan this was due to an upward revision to Russia's GDP, unexpected inflows such as relocation of workers and firms from Russia and significant money transfers, resilient trade, and fiscal stimulus.
- The economy expanded 3.4% y/y in H1 22, slowing down from 4.1% in 2021. Retail sales expanded 1.2% y/y in H1 22. Investment grew by 3.6% y/y in H1 22 as FDI rebounded in the oil and gas sector after two years of decline. On the supply side, manufacturing, and services both contributed to growth.
- CPI reached almost 18% y/y in September 2022, double the rate a year earlier, driven by rising costs of food. The authorities continued to tighten monetary policy and imposed price caps on staple products and limited fuel and utility price increases.
- Current downside risks to the economic growth: The war in Ukraine could result in the shutdown of the Caspian Pipeline Consortium (which carries about 80% of Kazakhstan's oil exports) leading to large economic and fiscal revenue losses. Inflationary pressure may further erode incomes and exacerbate social tensions. Tightening global financial conditions could increase risk aversion, reduce inflows of FDI, and put pressure on the tenge exchange rate

The KZT as of November 2022: being traditionally a close proxy to the RUB, the KZT stabilizes after the turmoil in March 2022



USD / KZT	459.9298	+24.8376	↑5.71%
USD / RUB	60.7500	-14.0416	↓18.77%

Source: Google Finance, East Office

Main economic indicators	Actual		Forecast	
	2020	2021	2022	2023
GDP, % y/y	-2.5	4.0	2.9	3.1
Industrial production, % y/y	-0.7	3.6	1.7	2.7
Inflation, % (end of period, y/y)	6.8	8.0	13.9	9.8
Current Account Balance, USD bn	-6.3	-5.7	3.5	0.0

Source: Consensus Forecasts