



Russia Outlook

Dealing with Sanctions and National Projects

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- ❑ Government needs to get back to higher growth and faster by mid-term (March 2021)
- ❑ Finally, there is a growing sense of urgency in government
- ❑ A great deal of hope is now placed in National Projects
- ❑ People are very frustrated with the slow pace of change
- ❑ Continuing sanctions and low confidence are hampering investment
- ❑ The economy is either in the last phase of transition or in an extended period of stagnation – we will know which in mid-2020

Why the Need for Change?

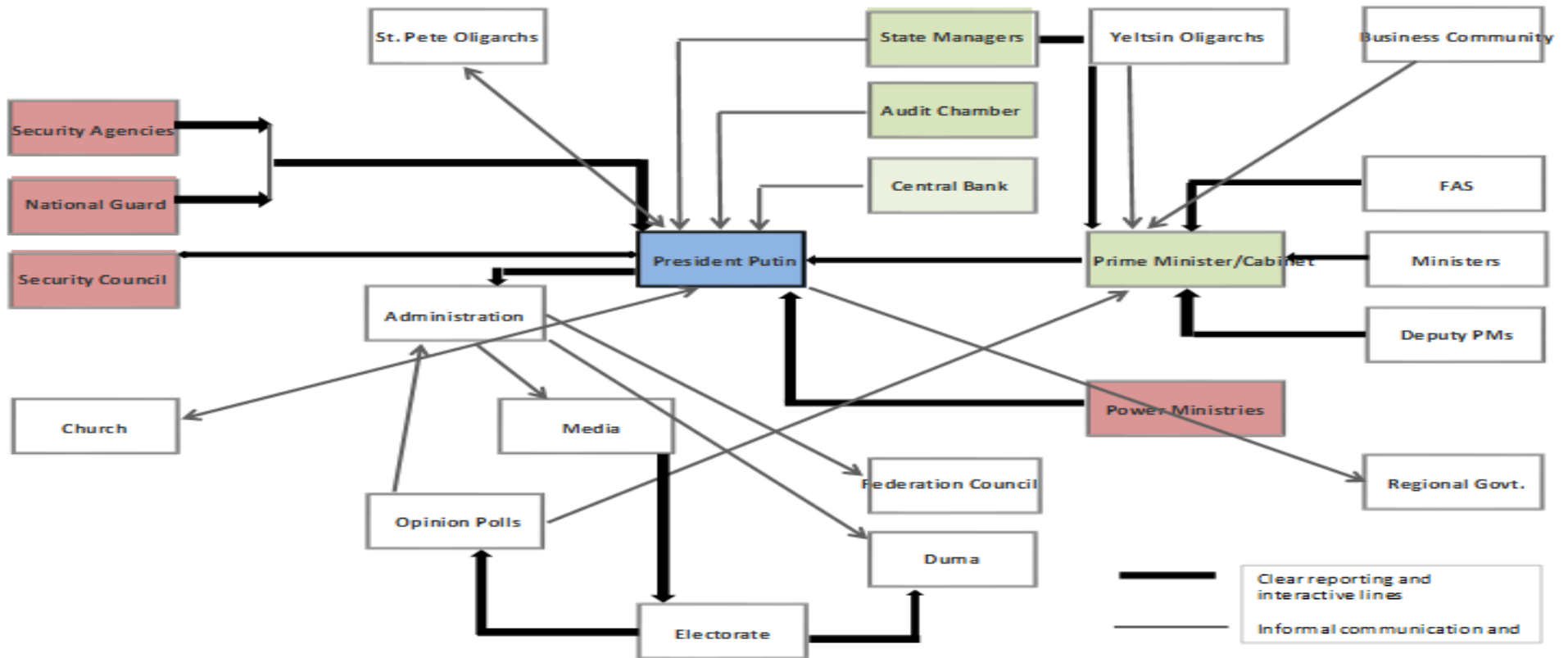
Russia is again at a crossroads:

- ❑ 1990s – *establishing new order + Oligarchs*
- ❑ 1998-99 - *crisis forced a turning point.*
- ❑ 2000-13 – *oil & credit funded boom*
- ❑ 2014-17 – *oil and sanctions crisis*
- ❑ 2018-24 – *diversification strategy*

- ❑ Hydrocarbon wealth became a weaker growth driver from 2013
- ❑ Sectoral sanctions (2014) forced some efficiencies
- ❑ Oil collapse (August 2014) showed how vulnerable Russia had become
- ❑ 2017 sanctions raised the stakes and reduced inward investment
- ❑ People are losing patience and are more willing to protest

- ❑ Putin is often more of a referee than an autocrat
 - ❖ Liberals want fast change and a focus on economic reforms
 - ❖ State “oligarchs” are only interested in their sectors
 - ❖ “Hardliners” have a security and geopolitical agenda
 - ❖ Others within “*Siloviki*” simply want to enrich themselves

- ❑ It means that the process of change is usually very slow



Source: Macro-Advisory Limited

- ❑ No point in talking about “broad reforms”
- ❑ Ruble policy has changed – was destructive but now boosts competitiveness
- ❑ Federal Budget is no longer as vulnerable to oil volatility
- ❑ Important changes to structure of government, aimed at faster implementation of investment policy
- ❑ Ministers and Governors are more accountable – investment is now a big part of their KPIs

Current Macro Position

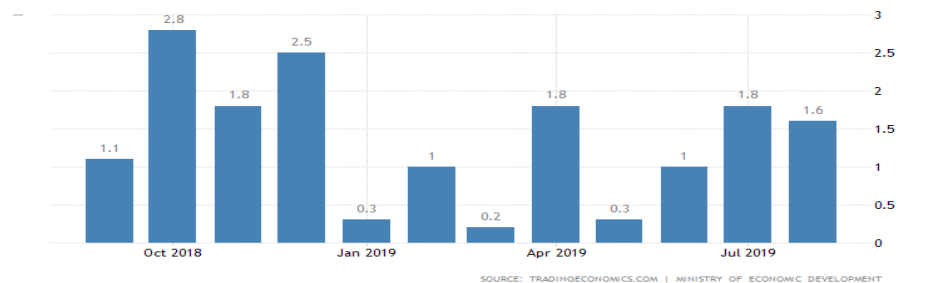
- ❑ Growth in 1H19 was weak – as expected
- ❑ Indicators for 2H19 are “mixed”
- ❑ Most agencies have downgraded for this year and next – assuming National Project spending will not pick up
- ❑ Sectors reliant on the consumer/households are suffering the most

GDP % YoY Change, Quarterly



Source: Federal Statistics Service

GDP Leading Index: Still strong in August



Source: Ministry of Economic Development

- ❑ Both agree that National Project spending must be the key catalyst
- ❑ Economy Minister is fearful of rapid growth rate in retail lending – CBR is more relaxed
- ❑ Extra budget spending will help, but not be enough

Central Bank of Russia forecasts (% change, volume)

	2018	2019E	2020E	2021E	2022E
GDP growth, % change	2.3%	0.8%-1.3%	1.5%-2.0%	1.5%-2.5%	2.0%-3.0%
Household spending, % change	2.3%	1.0%-1.5%	2.0%-2.5%	2.0%-2.5%	2.0%-2.5%
Gross fixed capital formation, % ch:	2.9%	0%-1%	3.5%-4.5%	3.5%-4.5%	2.5%-3.5%
Corporate credit growth, %	8.4%	7%-10%	6%-10%	6%-10%	6%-10%
Retail credit growth, %	22.0%	15%-20%	10%-15%	10%-15%	10%-15%
Inflation (year end), %	4.3%	4.0%-4.5%	4.0%	4.0%	4.0%
Inflation (average for year), %	2.9%	4.6%-4.8%	4.0%	4.0%	4.0%
Oil price (Urals), \$/bbl	\$69.8	\$63.0	\$55.0	\$50.0	\$50.0

Source: Central Bank of Russia

Economy Ministry Forecasts

	2017	2018	2019E	2020E	2021E	2022E
GDP growth, % change	1.6%	2.3%	1.3%	1.7%	3.1%	3.2%
Real incomes, % change		1.1%	0.8%	1.7%	2.3%	2.4%
Gross fixed capital formation, % change	5.2%	2.9%	2.0%	5.0%	6.5%	5.8%
Current account balance, % of GDP	2.1%	6.9%	4.3%	3.2%	3.1%	2.5%
Inflation	3.7%	2.9%	3.8%	3.0%	4.0%	4.0%
Urals \$ p/bbl, average			\$62.2	\$57.0	\$56.0	\$55.0

Source: Russian Government

- ❑ Wages increase for public sector workers and pensions increase
- ❑ Additional spending for healthcare and education
- ❑ Reducing the total budget surplus - but sticking with a surplus

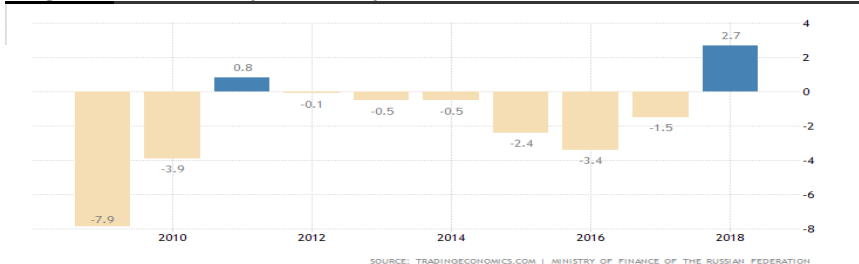
Budget Assumption Revisions 2019-20

	2018	2019 forecast	2020 Old	2020 New	2021 Old	2021 New	2022
GDP RUB billion	103,876.0	108,414.3	110,732.0	112,863.1	118,409.0	120,364.4	128,508.3
GDP growth	2.3%	1.3%	2.0%	1.7%	3.1%	3.1%	3.2%
Inflation, year end	4.3%	3.8%	3.8%	3.0%	4.0%	4.0%	4.0%
Budget Surplus, % of GDP	2.7%	1.7%	1.1%	0.7%	0.8%	0.6%	0.4%
Non Oil & Gas Seditit, % of GDP		-5.8%	-6.1%	-5.8%	-6.0%	-5.9%	-5.8%
Urals, US\$/bbl	\$70.0	\$62.2	\$59.7	\$57.0	\$57.9	\$56.0	\$55.0
Average USDRUB, R/\$1	62.5	65.4	63.8	65.7	64.0	66.1	66.5

Source: Government of the Russian Federation

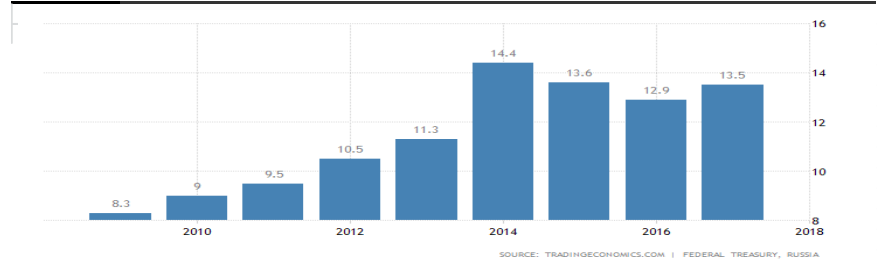
- ❑ Sixth lowest national debt in the world...approximately 14% of GDP; total sovereign foreign debt is 3.3% of GDP
- ❑ Sixth highest in the world (at \$532 bln - \$110 bln in gold -as at Sept. 30th)
- ❑ National Wellbeing Fund is close to \$140 bln (7% of GDP) target
- ❑ Household debt is only 17.2% of GDP
- ❑ Budget surplus, Trade Surplus, Current Account Surplus

Budget has returned to surplus after six years of deficit



Source: Ministry of Finance

Government Debt to GDP (%) is one of the Lowest in the World



Source: Ministry of Finance

- ❑ Ruble is no longer (as) correlated to the oil price
- ❑ Government is intent on keeping the rate close to R65-66/\$1
- ❑ Short periods of volatility will result from, e.g. sanctions news, global trends, oil spikes or dips
- ❑ Weaker-for-longer ruble is a key policy to help boost domestic competitiveness and to diversify exports

Ruble-US Dollar Exchange Rate: Reverting back to R/\$65



Source: Trading Economics

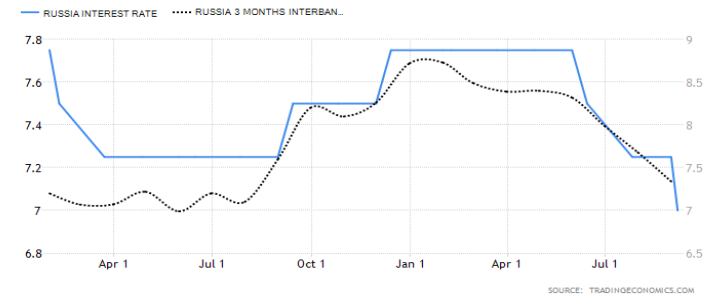
❑ Central Bank is very dovish and is under pressure to make further rate cuts

❑ Headline inflation is now below 4% and justifies another 25-bps cut in the Key Rate this year

❑ The rapid decline in Producer Price Inflation is a big concern – it shows there is weak end-user demand and no pricing power in the economy

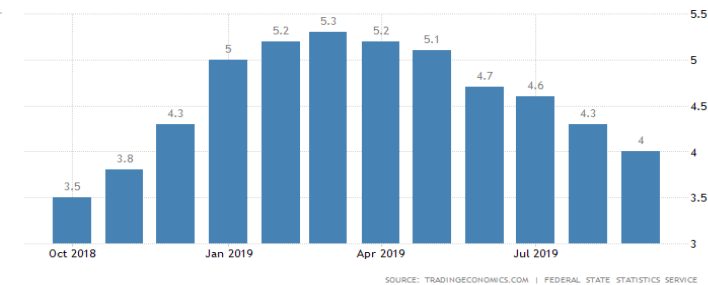
Interest Rate & Inflation

Russia Key Rate (LHS) and Interbank Rate (RHS)



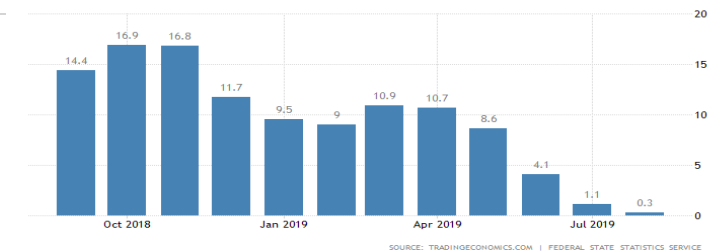
Source: Central Bank of Russia

Headline Inflation Rate (YoY % Change) - Trend Confirms CBR Optimism



Source: Tradingeconomics.com, Federal State Statistics Service

Producer Price Inflation: Nearing deflation



Source: Tradingeconomics.com, Federal State Statistics Service

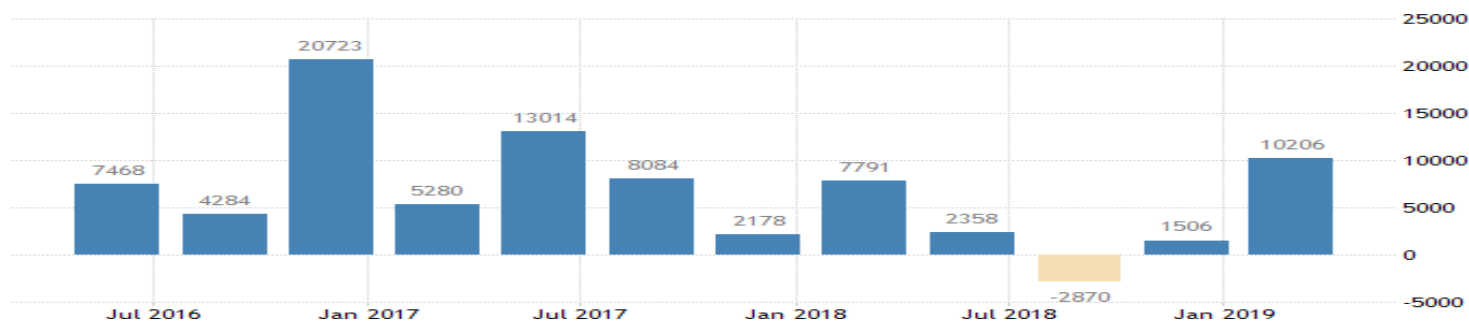
Medium-Term Forecasts

	2019(F)	2020(F)	2021(F)
❑ GDP	0.9 -1.3%	1.6-2.2%	2.2-2.8%
❑ Inflation, year end	3.7%	3.5%	3.5%
❑ CBR, Key Rate	6.75%	6.25%	5.75%
❑ Retail sales, % YoY	1.5%	2.0%	2.4%
❑ Budget Surplus, % GDP	1.6%	1.0%	0.8%
❑ Average Oil price, \$ p/bbl	\$62	\$56	\$55
❑ RUB/US\$, year end	66.0	65.0	64.0

Investment & National Projects

- ❑ Investors ran scared of sanctions
- ❑ FDI used be oil & gas dominated but is now starting to diversifying
- ❑ Investment is impacted by:
 - Economic stability and predictability
 - Sanctions
 - Government policies
 - Corporate Governance & Corruption, e.g. the Barings Vostok case

FDI (incl reinvestment), \$ mln : Big pick-up in Q1



SOURCE: TRADINGECONOMICS.COM | THE CENTRAL BANK OF THE RUSSIAN FEDERATION

Source: Central Bank of Russia

- ❑ PMI Manufacturing indicator is negative (below 50) and at the lowest since May 2009 – economy was in deep recession then
- ❑ But the Service PMI is recovering – this is a good lead-indicator for manufacturing
- ❑ Consumer confidence is recovering slowly but remains very weak

Confidence is Weak

Markit Russia PMI Manufacturing Index Plummets In September



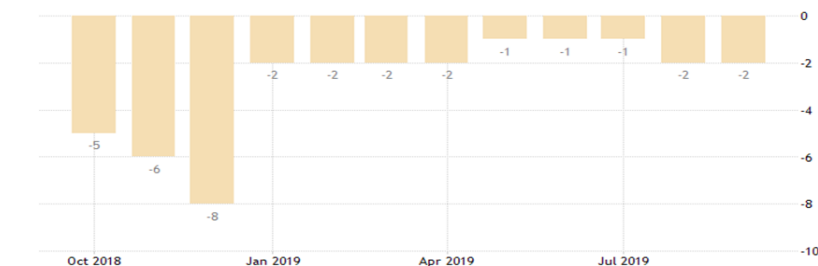
Source: Markit

Markit Russia PMI Services Index Up Again In September



Source: Markit

Business Confidence Flat in September



SOURCE: TRADINGECONOMICS.COM | FEDERAL STATE STATISTICS SERVICE

Source: Tradingeconomics.com, Federal State Statistics Service

- ❑ Government plans to invest \$390 bln in thirteen project areas
- ❑ Very ambitious timeline
- ❑ Investment in infrastructure, healthcare, demographics, skills training, etc.
- ❑ Aim is to improve lifestyles and to diversify economic activity and exports – to create sustainable economic growth
- ❑ This is Putin's legacy plan

National Projects Spending Sources (RUB and US\$ billion)

Source	Ruble Spending	US\$ spending	%
Human Capital			
Health	1,725.8	26.21	6.7%
Education	784.5	11.91	3.1%
Demographics	3,105.2	47.16	12.1%
Culture	113.5	1.72	0.4%
Quality of Life			
Safe and better roads	4,779.7	72.58	18.6%
Housing	1,066.2	16.19	4.1%
Ecology	4,041.0	61.37	15.7%
Economic Growth			
Science	636.0	9.66	2.5%
Small Business	481.5	7.31	1.9%
Digital Economy	1,634.9	24.83	6.4%
Labor Productivity	52.1	0.79	0.2%
Export Support	956.8	14.53	3.7%
Transport Infrastructure	6,348.1	96.40	24.7%
Total	25,725.3	390.67	100.1%

Source: Government of the Russian Federation

- ❑ This is more like an eight year program – it is more important that it is seen to be working by mid-term
- ❑ It will take time to “get started” – we can gauge it better in mid-2020
- ❑ Why it has a better chance this time. Specifically:
 - There has been much more serious planning
 - Some long-talked about changes have finally happened in recent years
 - Ministers have been given KPIs related to the National Projects
 - A monitoring system has been set up, for spending and performance monitoring
- ❑ KPIs for Deputy Prime Ministers and Governors
- ❑ Strong Audit Chamber oversight

Sanctions

- ❑ There was strong momentum for new Russia sanctions coming into the fall session
- ❑ This is now sidelined because of other more urgent distractions in DC
- ❑ But new sanctions are likely only delayed and not abandoned
- ❑ Expect to see some bundling of existing bills to create a new super-bill
- ❑ Only two issues are of concern to investors:
 - *Will there be a ban on investing in Russia sovereign debt?*
 - *Will there be a \$1 mln limit put on energy sector investment?*
- ❑ OFAC is expected to further extend the GAZ waiver

- ❑ Democrats realize Trump can win
- ❑ Russia remains a core tactic to discredit and attack the President
- ❑ Expanding Russia tactic to attack other Republicans, i.e. “Moscow Mitch”
- ❑ This means:
 - Will limit the ability of legislators to follow any constructive approach to Russia and sanctions Democrats are moving toward “wrapping themselves in the flag” as they try to color Republicans along with the administration as being “Russian assets”
 - Linking Russia with leading Republicans will be central to Democratic campaign strategy

Energy focused:

- **PEES Act** ... aims to block Nord Stream 2
- **ESCAPE Act** ... targets any new energy export routes from Russia and would put a cap of \$1 mln on any new investment by a US investor in a Russian energy project

Finance focused:

- DASKA Act** ... this bill has been revised this year and would tighten existing sanctions while aiming to expand their scope and restrict the Executive Branch's ability to interpret and delay or avoid taking actions
- DETER Act** ... aims to place restrictions on the banking sector and to restrict debt issue mechanisms
- Secure our Democracy Act** ... broadly similar objectives to the other two bills
- NDAA Amendment** ... tagged onto the Defense Appropriation Bill by the House. Aims to prohibit investment into new Russia sovereign debt

- ❑ The Kremlin's position is clear – it does not want to add new counter-sanctions. It does not want to make it any more difficult for foreign investors to work in Russia
- ❑ Most current Duma bills are expected to be diluted or suspended
- ❑ The EU is not expected to add any new sanctions – but EU companies are “covered” by US sanctions because of secondary-sanctions
- ❑ EU-Russia relations should improve in 2020, if there is a new Ukraine gas transit deal and if there is any progress in Donbass

- ❑ A more serious planning phase is now over ...
- ❑ ... but the economy remains close to stagnant ...
- ❑ ... the government has resources to use ...
- ❑ ... and is likely to spend more, and faster, if there is no evidence of stronger recovery in spring ...
- ❑ ...expect a livelier debate, with more “blame-gaming” and an increasing sense of urgency this winter



Forecasts & Timeline

Russia: Macro Trends & Medium Term Forecasts

	2012	2013	2014	2015	2016	2017	2018	2019E	2020E	2021E
GDP, RUB bln, nominal	66,865	70,499	77,200	84,320	90,222	95,004	103,600	110,230	116,624	123,621
GDP, US\$ bln	2,150	2,210	2,000	1,360	1,347	1,635	1,650	1,683	1,781	1,932
Growth, real % YoY	3.4%	1.3%	0.7%	-2.8%	-0.2%	1.5%	2.3%	1.2%	1.8%	2.4%
CPI - year-end, % YoY	6.6%	6.5%	11.4%	12.9%	5.4%	2.5%	4.3%	3.7%	3.5%	3.5%
CPI- average, % YoY	5.1%	6.8%	7.8%	15.6%	7.2%	3.8%	2.9%	4.2%	4.0%	3.6%
Gross fixed investment, real % YoY	6.0%	0.9%	-1.0%	-11.0%	0.8%	3.5%	4.3%	1.8%	2.3%	3.5%
Industrial production, real % YoY	3.4%	0.4%	1.7%	-0.8%	2.2%	2.1%	2.9%	2.4%	3.0%	4.0%
Agricultural output, % change YoY	-3.6%	3.1%	1.2%	3.5%	4.8%	2.4%	-0.8%	2.6%	2.8%	3.0%
Central bank key rate, %			17.0%	11.0%	10.0%	7.75%	7.75%	6.75%	6.25%	5.75%
Bank average lending rate, %	9.1%	9.5%	11.3%	16.0%	13.0%	10.5%	10.0%	9.0%	8.3%	8.0%
Retail sales, % YoY	5.9%	3.9%	2.5%	-10.0%	-5.2%	1.2%	2.6%	1.5%	2.0%	2.4%
Real disposable income, % YoY	7.3%	4.8%	-1.0%	-6.5%	-5.9%	-1.7%	0.1%	0.1%	0.6%	0.9%
Unemployment, % EOP	5.7%	5.6%	5.3%	5.6%	5.4%	5.0%	4.7%	4.7%	4.7%	4.6%
Budget, balance % of GDP	0.0%	-0.5%	-0.5%	-2.4%	-3.4%	-1.4%	2.7%	1.6%	1.0%	0.8%
Current account, % GDP	3.7%	1.6%	3.0%	5.3%	1.9%	2.1%	7.0%	4.8%	3.9%	3.4%
RUB/US\$, year-end	30.8	32.9	61.4	73.5	61.3	57.7	69.4	66.0	65.0	64.0
RUB/US\$, average	31.1	31.9	38.6	62.0	67.0	58.1	62.8	65.5	65.5	64.0
RUB/EUR, year-end	40.3	45.3	72.0	79.7	64.5	69.7	79.5	73.0	74.0	73.0
RUB/EUR, average	40.0	42.3	51.5	67.0	74.0	68.0	73.9	73.0	74.5	73.0
Brent, US\$ p/bbl, average	\$110	\$108	\$100	\$54	\$45	\$55	\$72	\$62	\$56	\$55

Source: State Statistics Agency, Central Bank, Macro-Advisory estimates

- ❑ **Falling short of expectation.** This table shows the possible trend in the economy up to 2028 and using the Base Case scenario assumptions. Under these assumptions, growth would only very gradually pick-up and would be at only 2.5% in 2024. That would be well short of the target set by President Putin as part of the May Decrees

Russia Long Range Macro Forecasts...Base Case Assumptions

	2017	2018	2019E	2020E	2021E	2022E	2023E	2024E	2025E	2026E	2027E	2028E
GDP, nominal, US\$ bln	\$1,635	\$1,650	\$1,683	\$1,781	\$1,932	\$2,116	\$2,301	\$2,595	\$2,730	\$3,040	\$3,273	\$3,542
Growth, real, % YoY	1.5%	2.3%	1.2%	1.8%	2.4%	2.2%	2.4%	2.5%	2.6%	2.7%	3.0%	3.5%
Agriculture output, % change YoY	2.4%	-0.8%	2.6%	2.8%	3.0%	4.0%	3.3%	3.0%	3.0%	3.0%	3.0%	3.0%
Retail sales, % YoY	1.2%	2.6%	1.5%	2.0%	2.5%	3.0%	2.8%	3.3%	3.6%	4.0%	4.5%	5.0%
Budget balance, % of GDP	-1.4%	2.7%	1.6%	1.0%	0.8%	0.0%	-0.5%	-0.5%	-0.5%	-0.5%	-0.5%	-0.5%
CPI - average, % YoY	3.8%	2.9%	4.2%	4.0%	3.6%	3.2%	2.8%	2.6%	2.6%	2.6%	2.6%	2.6%
Interest Rate Lending, average, %	10.5%	9.0%	8.5%	8.3%	8.0%	7.5%	7.0%	6.5%	6.0%	5.5%	5.0%	5.0%
Real disposable income, % YoY	-1.7%	0.1%	0.0%	0.6%	0.9%	1.2%	1.5%	1.8%	2.0%	2.0%	2.2%	2.4%
Real wage growth, % YoY	0.7%	3.4%	6.8%	3.5%	4.0%	2.0%	2.5%	2.0%	2.5%	2.5%	2.5%	2.5%
Unemployment, % EOP	5.2%	4.7%	4.7%	4.7%	4.6%	4.8%	4.7%	4.6%	4.4%	4.4%	4.4%	4.4%
Trade balance, US\$ bln	\$115	\$194	\$170	\$160	\$150	\$145	\$130	\$120	\$125	\$120	\$120	\$120
Current account % of GDP	2.4%	7.0%	4.8%	3.9%	3.4%	2.6%	2.2%	1.7%	1.8%	1.5%	1.4%	1.3%
FDI, % of GDP	1.5%	0.3%	0.9%	1.1%	1.3%	3.1%	3.0%	2.9%	2.9%	2.7%	2.5%	2.3%
Foreign public debt, % of GDP	3.7%	3.3%	3.0%	3.0%	2.8%	3.8%	3.7%	3.5%	3.5%	3.1%	2.9%	2.7%
Total foreign debt, % of GDP	32%	28%	26%	25%	24%	29%	29%	28%	29%	29%	27%	25%
RUB/US\$, average	60.0	62.8	65.5	65.5	64.0	61.0	59.0	55.0	61.0	62.0	63.0	64.0
RUB/EUR, average	68.0	73.9	73.0	74.5	73.0	66.0	65.0	60.0	60.0	57.0	56.0	55.0
Average Brent, US\$ p/bbl	\$55	\$72	\$62	\$56	\$55	\$50	\$50	\$50	\$50	\$50	\$50	\$50

Source: Federal Statistics Service, Central Bank of Russia, Macro-Advisory estimates

- ❑ **Oct 7 – 11:** Golden Autumn (Food and Agriculture) Fair in Moscow
- ❑ **Oct 11:** Current Account, Q3
- ❑ **Oct 16:** Industrial production update, September
- ❑ **Oct 17:** Full macro update for September
- ❑ **Oct 21-23:** FIAC-Government meetings in Moscow
- ❑ **Oct 24:** Russia-Africa Summit, Sochi (first ever summit)
- ❑ **Oct 25:** Central Bank Policy meeting
- ❑ **Oct 27:** EaEU-Iran Trade Agreement comes into force
- ❑ **Nov 4:** National Holiday, Unity Day
- ❑ **Nov 13-14:** BRICS Summit, Brazil

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