Russia: Federal budget deficit widens on healthcare and social support

In January-May 2020, the Russian federal budget was in a RUB0.4 trillion deficit, a material deterioration from the RUB1.3 trillion surplus seen in the same period a year ago. This widening has been driven entirely by increased spending, mainly on healthcare and social support

Source: Shutterstock

RUB 409bn

5M20 federal budget deficit

vs. RUB1.3 trillion surplus in 5M19

Lower than expected

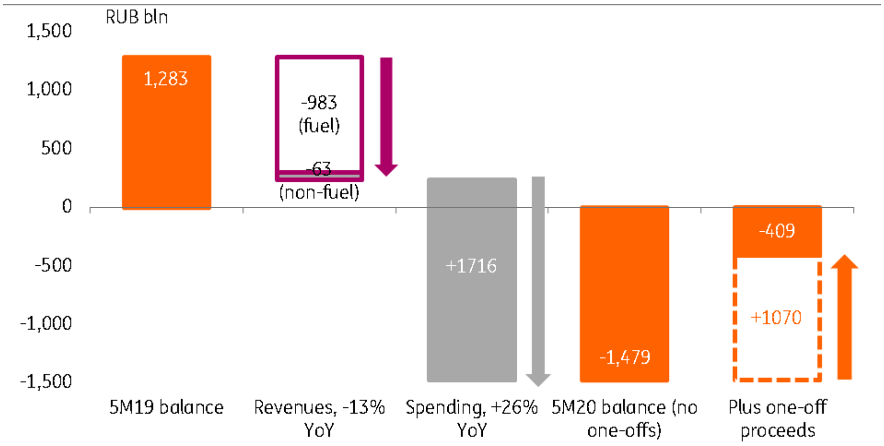
Budget deficit is widening on anti-crisis support

According to preliminary estimates by the Finance Ministry, the Russian federal budget was in a

RUB0.4 trillion deficit in the first five months of 2020, a significant deterioration from the RUB0.2 trillion seen in the year to April and slightly smaller than our RUB0.6 trillion expectation. We have the following observations from the statistics:

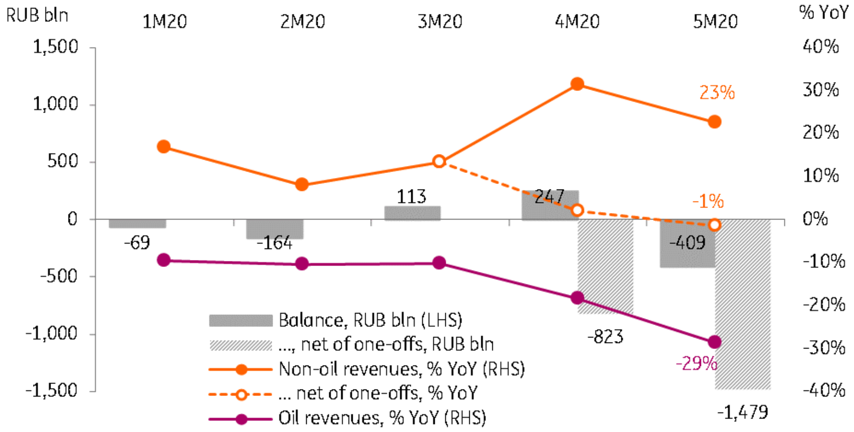
- The Minfin refrained from calculating the deficit as a percentage of GDP, which we believe is due to the poor accuracy of preliminary monthly GDP estimates amid high uncertainty regarding economic activity. While normally, preliminary GDP estimates are acceptable for the purposes of budget fulfilment, April 2020 saw a large discrepancy: the preliminary estimates showed a 27% year-on-year nominal GDP contraction (drawing media attention), but the subsequent estimates incorporating the broad macro activity data showed only a 12% YoY GDP contraction in real terms. The preliminary GDP estimates for May have been suspended in order to avoid a similar discrepancy.
- Since April, the federal budget balance has been affected by RUB1.1 trillion one-off proceeds from the Bank of Russia (as per the handover of a 50% equity stake in Sberbank). Net of this transaction, the 5M20 federal budget deficit would have been RUB1.5 trillion, a material RUB 2.8 trillion deterioration from the RUB1.3 trillion surplus seen in 5M19. This was the result of a 29% YoY (RUB1.0 trillion) drop in fuel revenues, as well as a 26% YoY (RUB1.7 trillion) spike in expenditures (see Figure 1). Spending growth has been gradually accelerating from 18% YoY in 1Q20 to 32% YoY in April and 49% YoY in May.
- The revenue trend has been deteriorating since 1Q20, with fuel revenues down on the decline in oil prices as well as Russia's production cuts enforced since May as per OPEC+ commitments. Non-oil revenue growth net of one-off proceeds has also been under pressure since 1Q20, turning negative in 5M20 (see Figure 2). VAT, import duties, profit tax are the key pressure points, which are likely to persist in the coming months amid declining consumption, imports, and corporate profits.
- As a result of a gradual acceleration in spending since 1Q20, the overall federal expenditure growth is 26% YoY in 5M20, corresponding to a RUB1.7 trillion YoY increase. As can be seen from Figure 3, over half of that increase (around 55%) is comprised of social payments (unemployment benefits and social support to low-income families with children), healthcare spending, and direct transfers to regional budgets – reflecting support measures in response to the Covid-19 pandemic and lockdown.

Figure 1: Widening in deficit driven by higher spending, somewhat masked by one-off proceeds



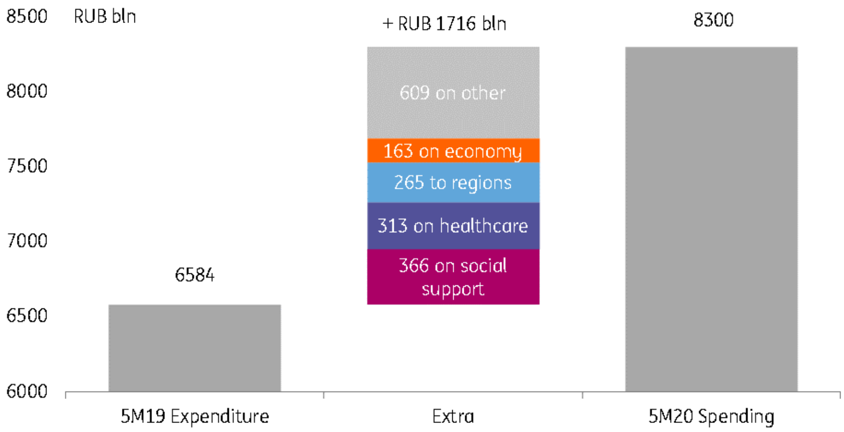
Source: Finance Ministry, media, ING

Figure 2: Non-oil revenue growth net of one-offs is deteriorating



Source: Finance Ministry, media, ING

Figure 3: Over half of federal spending increase is directed to healthcare, social support and other regional spending



Source: Finance Ministry, ING

The 5M20 budget fulfillment is generally in line with our expectations of the federal budget deficit widening to around RUB5.0 trillion (4-5% GDP) in 2020. With the ongoing anti-crisis mode and upcoming 1 July nationwide voting on constitutional amendments proposed by the president, spending growth is set to remain high, while the revenue side is likely to remain under pressure on the sharp decline of economic activity in 2Q20.

Regional budgets are important sources of state spending on education, housing, non-pension social payments, and healthcare (regional spending on those account for 63% of total consolidated spending on such items), and are likely to suffer from the likely drop in profit tax, personal income tax, and property tax (together they account for almost 80% of the regional tax revenues). This means higher regional dependence on transfers from the federal budget as well as regional debt placement, however, this option is only available to a limited number of regions.

A widening in the non-oil budget deficit will be financed by additional local debt placement (we see it at around RUB3.5 trillion this year), while fuel revenue under collection (RUB1.5 trillion) could be financed via spending of the National Wealth Fund, a sovereign fund.

An acceleration in budget spending as well as an increase in the debt placement programme may serve as an additional argument in favour of a gradual approach to reduce the key rate by the Bank of Russia.

Author

Dmitry Dolgin
Chief Economist, CIS
dmitry.dolgin@ing.de