

Russia: Yet another Covid-19 update

Next week most Russians will be on paid leave, however banks and financial markets will remain open. Fiscal support will be expanded and will target the low-income population and SMEs. Tax on dividends sent offshore will be raised, high-income depositors will pay tax on interest income. This is not the last wave of response, we suspect



The most recent developments

Today, Russian president Vladimir Putin made an [emergency address](#) to the nation due to the global pandemic of Covid-19. Here are the key points and our observations:

- National vote on constitutional changes initially scheduled for 22 April, will be postponed until a later date.
- **Most Russians will be on paid leave for the entire week of 30 March-3 April** as a means to contain the spread of the virus. Banks, financial markets, and other essential infrastructure services, food and pharma retailers will remain open. Our take is that containment measures are less hawkish than expected, i.e. the movement limitations are still softer than in some neighboring countries. Nevertheless, a one-week off may result in a double-digit drop in the industrial output in March, as well as other sectors. Moreover, as the global Covid-19 outbreak appears far from containment, we would not exclude a further wave of measures to

follow in the coming weeks. This, combined with the general deterioration in the the global growth outlook forces us to treat our previous 2020 GDP growth forecast (+0.5%) as unrealistic. We now expect GDP contraction in the low single digit range, reflecting both supply and demand shocks.

- **Fiscal stimulus will be expanded and will target low income households and SMEs.** In addition to the 1.5 percentage point of GDP increase in the budget spending in 2020 vs. 2019, which had already been drafted before the Covid-19 outbreak, the Russian government will conduct additional social spending to those on sick leave and unemployed. On the tax revenue side, small and medium-sized enterprises (SMEs) will receive a 6-month tax holiday (except VAT), the payroll tax rate for SMEs will be *irreversibly* lowered from 30% to 15% (for the portion of the salaries exceeding the minimum monthly wage of c.US\$150). Those measures, in addition to the relief on administrative, regulatory, and credit pressure on SMEs announced earlier, will somewhat cushion the blow to SMEs and will be positive in the longer-term. However, given the latter's low share in GDP (15-20% according to various estimates) a contraction in overall activity in the near term seems unavoidable. The lost budget revenues from the measures are also unlikely to be large. Nevertheless, **the expected increase in budget spending in 2020 vs. 2019 combined with a likely drop in non-oil revenues suggest a fiscal stimulus of around 2% of GDP.** Adding this to the expected drop in the oil revenues caused by the drop in the oil price (including today's [downgrade](#) of oil price forecasts by ING), the **overall budget deficit may widen to 3-4% of GDP under average Urals of US\$36/bbl** in 2020. This will not be a problem, given the liquid fiscal savings of around 10% of GDP, however one cannot exclude more potential waves of fiscal support needed. So far large corporates and banks are not covered (neither believed to be in trouble). At the same time, the oil price forecast is also a subject to both way risks.
- **Individuals and SMEs affected (physically and financially) by Covid-19 will receive interest payment holidays and a moratorium on bankruptcy for 6 months.** Bank loans to individuals and SMEs account for RUB18 trillion and RUB5 trillion, or 18% and 5% of total bank assets, respectively. This suggests a potential NPL stress on the banking system, however the scale of it will likely be reduced by the relatively high quality of Russia's retail loan portfolio, some limiting criteria for being treated as affected by Covid-19 (to be clarified later) and potential support measures from the fiscal and monetary side.
- **Individual holders of bonds and retail deposits of over RUB1 million (US\$12-13,000) will start paying 13% income tax on the accrued interest.** While the overall financial effect of the measure is unlikely to be large (only 1% of retail deposits exceed RUB 1 million in size) we take it as a sign that higher-income households and businesses will have to co-finance the recovery. Overall local retail deposits of the top one-third of Russia's earners account for RUB24.5 trillion in local currency and US\$94 billion in FX (making local savings at around 28% of GDP, a high level for Russia), while the ultra high net worth households have around US\$110 billion (around 7% of GDP) in offshore accounts. Local bank accounts of the corporate sector total around 30% of GDP and is likely to be partially used to accommodate the president's strong verbal requirement for the large corporates to maintain stable employment.
- **Tax on dividends paid to offshore entities will be increased from 2% to 15%.** This measure may potentially affect markets and businesses with a cross-border shareholder structure, as according to Bank of Russia, gross investment income

outflow, which is a part of current account, totaled US\$93 billion in 2019, while the net outflow was US\$45 billion. It remains unclear what effect this measure will have on the corporate capital flows. Under normal circumstances this triggers additional capital outflow, as was the case with the withholding tax discussed in 2010-11, however the current situation is unique: Russian corporates, banks, and households have international assets of over US\$920 billion (c.60% of GDP), and in the current environment there are few safe havens for the Russian capital, while the foreign interest to Russia as a market and FDI partner should remain. On a separate note, it has recently become apparent that this year is unlikely to be fruitful in terms of dividends to share.

Forecasts are becoming very fluid

Our previous expectations of small positive GDP growth this year have become unrealistic given the rapid deterioration of the global GDP growth forecasts, which is still ongoing. Russia is so far facing negative, yet low single digit GDP contraction, the scale of which will be determined in the coming months.

The recent [downgrade in ING's Brent price forecast](#) for 2Q20 from US\$33/bbl to US\$20/bbl casts doubt on USDRUB's ability to return to the RUB70-75 range soon, however we understand that the risks to the oil price forecasts are coming from both ways. Under the new oil price scenario and given the announced fiscal measures, the Russian budget is facing a 3-4% GDP deficit this year, which appears controllable if temporary. We do not see any willingness at the top level to ruin fiscal discipline and expect financing the recovery to be co-sponsored by large corporates and high-income households.

The recent spike in consumer demand for various products combined with USDRUB depreciation suggests some alterations in the shape of expected CPI trajectory. While previously we expected inflation to accelerate gradually from 2.3% year on year in February to 4.2-4.5% by year-end, now it appears a much faster spike will take place in 2-3Q20, followed by demand-driven disinflation. As we [wrote](#) before, the Central Bank seems ready for this scenario and given the lower priority of interest rate tools at the current environment, is unlikely to react by increasing the key rate. The main focus will be on the measures on the FX market and in the banking sector.

We suspect it is not the last update on Covid-19 and on the government's response.

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