

Snap | 25 March 2020

RUSSIA

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.

Author

Dmitry Dolgin

Chief Economist, CIS

dmitry.dolgin@ing.de

Disclaimer

This publication has been prepared by the Economic and Financial Analysis Division of ING Bank N.V. ("ING") solely for information purposes without regard to any particular user's investment objectives, financial situation, or means. *ING forms part of ING Group (being for this purpose ING Group N.V. and its subsidiary and affiliated companies)*. The information in the publication is not an investment recommendation and it is not investment, legal or tax advice or an offer or solicitation to purchase or sell any financial instrument. Reasonable care has been taken to ensure that this publication is not untrue or misleading when published, but ING does not represent that it is accurate or complete. ING does not accept any liability for any direct, indirect or consequential loss arising from any use of this publication. Unless otherwise stated, any views, forecasts, or estimates are solely those of the author(s), as of the date of the publication and are subject to change without notice.

The distribution of this publication may be restricted by law or regulation in different jurisdictions and persons into whose possession this publication comes should inform themselves about, and observe, such restrictions.

Copyright and database rights protection exists in this report and it may not be reproduced, distributed or published by any person for any purpose without the prior express consent of ING. All rights are reserved. ING Bank N.V. is authorised by the Dutch Central Bank and supervised by the European Central Bank (ECB), the Dutch Central Bank (DNB) and the Dutch Authority for the Financial Markets (AFM). ING Bank N.V. is incorporated in the Netherlands (Trade Register no. 33031431 Amsterdam). In the United Kingdom this information is approved and/or communicated by ING Bank N.V., London Branch. ING Bank N.V., London Branch is authorised by the Prudential Regulation Authority and is subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority. ING Bank N.V., London branch is registered in England (Registration number BR000341) at 8-10 Moorgate, London EC2 6DA. For US Investors: Any person wishing to discuss this report or effect transactions in any security discussed herein should contact ING Financial Markets LLC, which is a member of the NYSE, FINRA and SIPC and part of ING, and which has accepted responsibility for the distribution of this report in the United States under applicable requirements.

Additional information is available on request. For more information about ING Group, please visit www.ing.com.