BLOG

Russian economy hit by COVID-19 and oil market turmoil

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AUTHOR

Heli Simola
Senior Economist

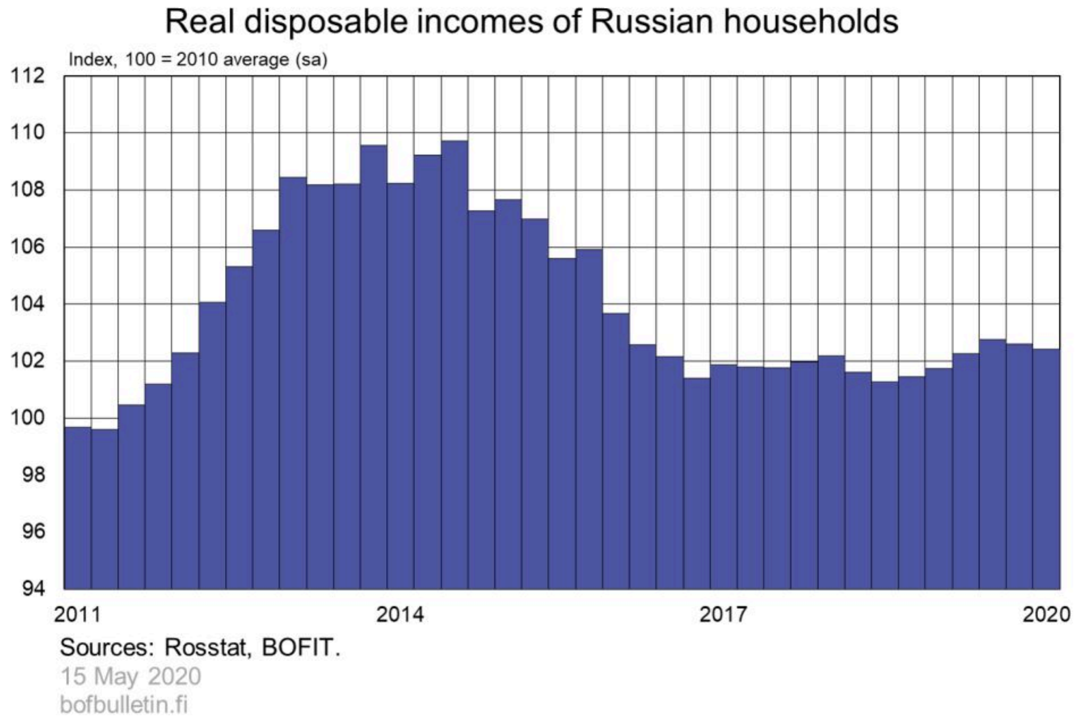
With GDP growth expected to pick up to around 2 % this year, Russia entered January with fairly bright economic prospects. The arrival of the COVID-19 pandemic and turmoil in the oil markets changed the outlook completely, however. Russia imposed strict lockdown measures similar to many countries, resulting in sharp reductions in demand and production. The collapse of oil prices and Russia's commitments to cutting back its oil production cause further economic damage. It is very difficult to evaluate Russia's near-term economic prospects under the current exceptional uncertainty, but we can examine various factors influencing the Russian economy.

The COVID-19 pandemic has spread rapidly in Russia in past weeks and Russia has over 250,000 confirmed COVID-19 cases. To contain the spread of the virus, president Putin announced that the period from March 30 to May 11 would be a paid holiday. This was a de facto lockdown for a large part of the Russian economy, even if certain sectors were excluded and regional governors were given broad discretion on the implementation of control measures. Strict quarantine rules were introduced, especially for the high-density environments of Moscow and other cities. Russia is now beginning a gradual opening up, but many restrictions still apply. By various estimates,[1] the six-week lockdown could have already wiped off 1.5–3 % of Russia's GDP this year. Additional negative effects will arise from reduced export demand caused by lockdown measures in other countries. Exports account for about 30 % of Russian GDP.

The COVID-19 pandemic has reduced global oil consumption sharply, generating a second shock to the Russian economy. The International Energy Agency expects global oil consumption to decline by about 20 % on year in the second quarter and 9 % for all of 2020. The downturn in oil markets was exacerbated in March by worries over excess supply after the OPEC+ oil producer countries initially failed to agree on extending their production restrictions. Even after the parties agreed to unprecedented production cuts in April, markets remained unconvinced and oil prices tumbled to historical lows. Extremely low oil prices have slashed Russia's export and budget income. Oil and gas account for half of Russia's exports of goods and services and over 20 % of Russia's consolidated budget income. Moreover, Russian energy minister Alexander Novak estimates that Russian oil production will decline by 11–14 % this year if Russia fully complies with the OPEC+ agreement.

The price of Urals oil is currently down about 60 % from the beginning of the year, Russia's stock index is off by nearly 30 % and the ruble has lost almost 20 % against the US dollar (Chart 1). Russian financial markets struggled already in March, but indicators of the real economy were less affected. Industrial output was still slightly up in March and retail trade sales volume grew on year by nearly 6 % (although some of this growth was likely supported by precautionary demand due to ruble depreciation and the announcement of an impending lockdown). According to preliminary estimates by Russian officials, GDP growth amounted to 1.5–2.0 % y-o-y in 1Q20. Forward-looking and high-frequency indicators for April pointed to a steep worsening of the economic situation. The decline in electricity consumption, for example, bodes a 15 % y-o-y contraction in production. Various indicators on payment statistics also imply an average fall of 20–25 % in corporate sales. Corporate expectations about the future have plummeted to levels last seen in 2008–2009.

Chart 1.



The latest forecasts view Russian GDP contracting by 1–6 % this year and returning to 2–5 % growth next year (Table 1). Most baseline forecasts anticipate a slightly less severe GDP contraction for Russia than the -8 % recorded during the international financial crisis. Indeed, Russia is better equipped to deal with the current crisis due to changes in its economic policy framework in recent years. The floating ruble softens the blow caused by the oil price collapse to the economy and the latest fiscal rule has reduced the dependence of Russia's budget on oil prices. Russia's private sector, particularly banks, has also substantially reduced its foreign debt exposure after the economic crisis in 2014–15 and the imposition of Western sanctions. Most forecasters stress, however, that the risk of a much weaker outcome remains significant in the current exceptionally uncertain situation.

Table 1.

April-May forecasts for Russian GDP growth, %

	2020	**2021**
World Bank	−1.0	1.6

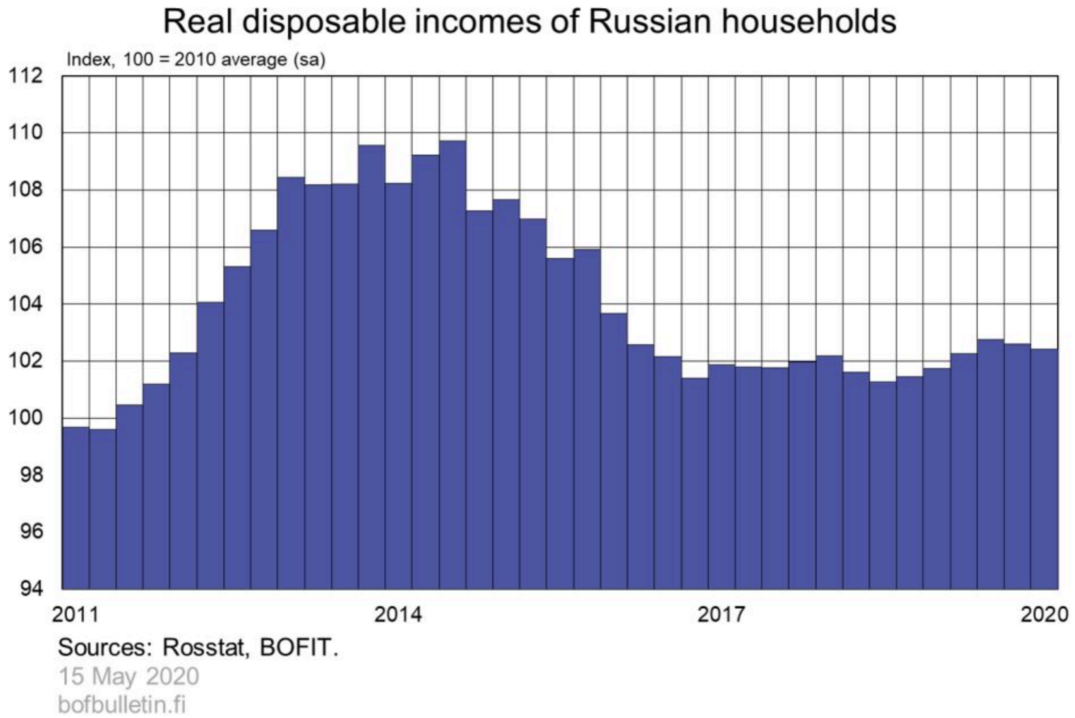
Consensus Economics	−3.8	3.0
EBRD	−4.5	4.0
IMF	−5.5	3.5
Central Bank of Russia	−4–6	2.8–4.8

Russia's crisis-related public sector support measures have been quite moderate so far. An easing of fiscal policy was already set before the current crisis hit Russian economy with the consolidated budget framework for 2020–2022 foreseeing a 6–7 % annual increase in public spending. Russian officials have promised this spending will not be touched despite falling budget revenues (but there has also been no official information on further expenditure hikes either). Some of budget expenditure will be redirected to cover support measures related to dealing with the coronavirus pandemic.

The Russian government says that the COVID-19-related support measures already agreed to in late April amount to about 2 trillion rubles (roughly 2 % of GDP). These measures are mainly targeted at SMEs and specific sectors.[2] Many of the measures provide temporary liquidity support for companies without requiring additional spending from the government (e.g. postponement of taxes and other payments, and credit holidays).[3] Direct support measures for households and companies are currently estimated to amount to about 0.5 % of GDP.[4]

A recent survey found that only 35 % of Russians considered the government's social support measures to be adequate.[5] Russian households had yet to recover from the 10 % loss of real disposable income from Russia's previous economic crisis in 2014–15 (Chart 2). Income declined again in the first quarter of this year and is set to contract further with wage cuts and increasing unemployment. Russian companies are even less satisfied; 60 % view the support measures as merely postponing problems or completely useless.[6]

Chart 2.



Thanks to the sizable oil income savings collected in the National Welfare Fund, Russia possesses the resources for additional support measures. However, a large chunk of Russia's savings is needed just to maintain budget expenditure at planned levels in the face of declining income. Finance minister Anton Siluanov estimates that, taking into account current budget claims, 7 trillion rubles (7 % of GDP) should still remain in the National Welfare Fund at the end of 2020. These funds could be used to finance additional support measures, although it would require circumventing the fiscal rule. The reluctance of Russian officials to commit to rapid spending decisions could reflect the uncertainty related to the extent and duration of the crisis.

Key words

BOFIT, COVID-19, COVID-19, Russia