RUSSIA

Highlights

- **The Covid-19 pandemic has dealt a serious blow to the economy.** The collapse of the price of oil, which accounts for a major share of Russia's exports, has exacerbated the situation.
- **Russia's strong macroeconomic situation entering the crisis has helped to limit the damage.** Several years of conservative macroeconomic policies to protect the economy in the face of international sanctions mean it is well placed to weather external shocks.
- **A comprehensive recovery plan is being implemented.** The plan includes a range of measures to strengthen the health system, support households, small and medium-sized enterprises (SMEs) and large-scale investments. However, the timetable for broader, medium-term national development goals and projects has been extended.

Key priorities for 2021

- **Efforts to diversify away from commodity exports should be intensified.** A renewed focus is needed on investing in technology and digitisation of the economy in order to improve the competitiveness of non-military sectors, such as manufacturing, agriculture and services.
- **Further reforms to improve the business environment are needed.** Priorities include reducing the state's role in the economy, addressing physical infrastructure gaps and implementing business-friendly measures to enhance private-sector competitiveness.
- **Planned public investments need to be well targeted to contribute to growth.** The delayed timetable for the National Projects partly reflects challenges in implementation. In this regard, key priorities include coordination among public institutions and inclusion of stakeholders in the planning and implementation phases of public investments.

Main macroeconomic indicators %

	2016	2017	2018	2019	2020 proj.
GDP growth	0.2	1.8	2.5	1.3	-4.5
Inflation (average)	7.1	3.7	2.9	4.5	3.2
Government balance/GDP	-3.7	-1.5	2.9	1.9	-3.5
Current account balance/GDP	1.9	2.0	6.9	3.8	1.2
Net FDI/GDP [neg. sign = inflows]	-0.8	0.5	1.4	-0.6	0.0
External debt/GDP	40.1	32.9	27.3	28.9	n.a.
Gross reserves/GDP	29.5	27.5	28.1	32.7	n.a.
Credit to private sector/GDP	53.1	52.1	50.9	52.4	n.a.

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Covid-19: macroeconomic implications

Before the Covid-19 pandemic, the Russian economy was in a relatively strong position. At the end of the first quarter of 2020 the trade, current and fiscal accounts were all in surplus, and inflation was at an historical (post-Soviet) low. This was largely thanks to several years of conservative macroeconomic policies, including an overhaul of the budget, which gave rise to a much lower breakeven oil price of US$ 42.45 per barrel, the introduction of a fiscal rule that helped lower the rouble's sensitivity to oil price fluctuations, and the adoption of a flexible exchange rate. In early 2020 the government announced a RUB 2.1 trillion (US$ 27 billion) social spending package to support real incomes. It also pledged to push the 12 National Projects, a US$ 400 billion investment aimed at modernising and revitalising Russian society, the implementation of which had been behind schedule.

The Covid-19 pandemic hit both the supply and demand side of the economy. The global nature of the crisis led to a plunge in the prices of oil and gas, key exports for Russia. The main effects of these shocks were a drop in consumption, driven by a two-month lockdown of the entire economy, a significant fall in external demand for commodity exports, and supply chain bottlenecks. The economy contracted by 8.0 per cent year-on-year in the second quarter of 2020, but activity started to pick up again in the third quarter, as did oil and gas prices.

Foreign reserves have increased despite the economic downturn. By September 2020 the level of reserves exceeded US$ 600 billion. This contrasts sharply with previous crises, and can largely be explained by the flexibility of the exchange rate. Although the cost of the recovery plan has turned the budget surplus into a deficit, this has been funded by profit received by the central bank of Russia (CBR) from the sale of Sberbank shares and the placement of domestic rouble debt. The government has not so far needed to tap the National Wealth Fund (NWF), which stood at US$ 176 billion as of September 2020.

A recovery is expected in 2021. Overall, the economy is expected to shrink by 4.5 per cent in 2020, followed by a rebound of 3.0 per cent in 2021. This forecast is subject to significant upside and downside risks, depending on the path of oil prices, the possibility of a second wave of the pandemic, and the outcome of several geopolitical issues.

Policy response to Covid-19

A comprehensive recovery plan is in place. The National Plan for Economic Recovery, adopted in June 2020, is the government's programme to help the economy recover after the Covid-19 shock subsides and oil prices increase. It runs for 18 months, costs RUB 6.4 trillion (US$ 83 billion) and consists of 500 programmes. Some of these programmes overlap with the National Projects. Combined with measures introduced to address the immediate impact of Covid-19, this makes a total of RUB 7.2 trillion (US$ 93 billion) of support, or 7 per cent of GDP. Of this, RUB 5 trillion (US$ 65 billion) is budgetary funds (spending and missing revenues) and RUB 2.2 trillion (US$ 28 billion) is reserved for infrastructure investment. The funds foresee social support, of which the prime goal is to stabilise income trends, increase employment and liberalise and deregulate labour relations. A special section targets SMEs via offers of tax relief, grants and subsidies. There is also a section covering investment, the digital economy and import substitution, largely repeating what was in the National Projects goals.

Large investment projects remain a key part of the recovery and development plan. Once the impact of Covid-19 subsides, the heart of the government's structural reform programme remains the US$ 400 billion National Projects scheme, comprising key development targets for the period 2019-24 in the social, economic and environmental sectors.

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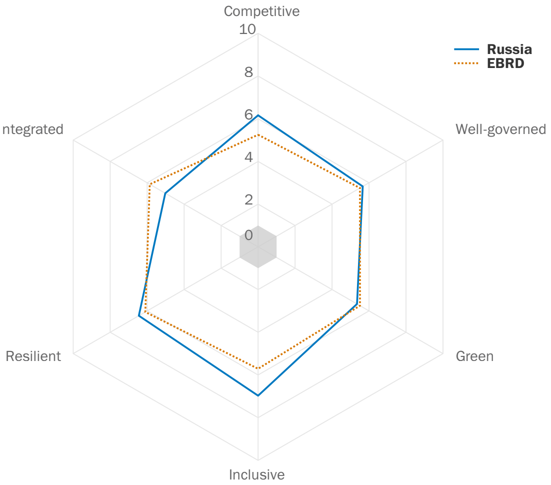
Assessment of transition qualities (1-10)



Structural reform developments

Following the constitutional amendments of July 2020, the President signed a decree that outlines a new set of national development goals for Russia. Instead of a National Projects-style roadmap of state-driven investment across 12 major areas, the new goals are less specific, and the timeline for completion has been extended from 2024 to 2030. Five development goals are outlined: maintain population, health and wellbeing; create possibilities for self-fulfilment and development of talents; a comfortable and safe living environment; effective labour and successful entrepreneurship; and digital transformation.

Local content provisions have expanded. One element of the government's import substitution strategy in recent years has involved the use of domestic content rules, notably in the electronics and information technology sectors, the segments of the economy in which Russia has one of the most broad-ranging and ambitious import substitution goals. In September 2020 the Russian Ministry of Industry and Trade proposed further changes to Decree 719 which regulates local content requirements for various industries and which applies to procurement by the public sector and state-owned enterprises.

Tax collection has improved drastically in recent years thanks to a digital overhaul of the Federal Tax Service. In recent months several further changes have been introduced which will help boost revenues. A progressive tax to apply above the 13 per cent flat tax has been proposed which will impact Russia's wealthier taxpayers. The mineral extraction tax has been increased, applicable to companies that mine metals, ores and rock used to make fertilisers, and all double taxation agreements are currently being reviewed, which would result in withholding tax being payable on dividend and interest payments by residents of the countries concerned.

TURKEY

Highlights

- **Covid-19 has been a major shock to both the demand side (domestic and external) and supply side of the economy.** Before the pandemic, a fiscal and credit stimulus had helped the economy recover from the recession of 2018, and economic growth in 2020 was expected to be robust, but the economy contracted sharply in the second quarter.
- **The authorities have brought in a range of mitigating measures in response to Covid-19.** Several measures were introduced to support vulnerable households, workers and businesses and limit the economic impact of the pandemic, including social assistance programmes, short-time work allowance, a ban on layoffs, loan holidays and low-cost loans through state banks.
- **Expansionary monetary policy has put pressure on the exchange rate and foreign reserves.** A significant easing of monetary policy via policy rate cuts, quantitative easing and other measures to increase liquidity, and the extensive expansion of credit, have put pressure on the exchange rate, and attempts by the authorities to support the lira have resulted in a significant depletion of reserves.

Key priorities for 2021

- **Efforts to help the economic recovery need to be balanced carefully with measures to maintain macroeconomic stability.** The Turkish economy's longstanding reliance on external credit alongside the extensive use of credit stimulus to generate growth in recent years has made it vulnerable to sudden stops of capital inflows. A key priority is preserving the credibility of the central bank in order to increase the effectiveness of monetary policy.
- **There should be tighter rules for the recognition of non-performing loans (NPLs).** The use of asset ratios to encourage credit expansion risks is giving rise to further asset quality issues, at a time when the NPLs hanging over from the 2018 crisis have not been fully addressed.
- **Structural reforms need to be enacted to ensure a genuine rebalancing of the economy.** Reforms are needed to improve workforce skills, promote firm-level innovation and develop domestic capital markets. The recent trend towards shorter supply chains may provide significant opportunities for Turkish companies.

Main macroeconomic indicators %

	2016	2017	2018	2019	2020 proj.
GDP growth	3.2	7.5	2.8	0.9	-3.5
Inflation (average)	7.8	11.1	16.2	15.5	12.0
Government balance/GDP	-1.3	-1.6	-1.9	-2.9	-5.4
Current account balance/GDP	-3.1	-4.8	-2.7	1.1	-3.7
Net FDI/GDP [neg. sign = inflows]	-1.2	-1.0	-1.2	-0.8	-0.7
External debt/GDP	47.0	52.8	56.4	57.1	n.a.
Gross reserves/GDP	12.3	12.6	12.1	13.8	n.a.
Credit to private sector/GDP	69.8	70.8	68.0	66.0	n.a.

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Covid-19: macroeconomic implications

The Covid-19 pandemic resulted in a shock to both the demand and supply side of the economy. Domestic demand was hit by containment measures, external demand contracted sharply, and the economy has suffered from the collapse in travel and tourism. The partial lockdown in the country had a major impact on domestic consumption, in particular the retail sector, which constitutes 26 per cent of GDP. Production facilities were also hit hard, with many companies shut down for a period due to the containment measures and resulting supply chain disruptions. The economy contracted by 9.9 per cent year-on-year in the second quarter of 2020.

The authorities have responded to the crisis with fiscal and monetary measures. Fiscal measures to address the crisis amounted to around 6.5 per cent of GDP (see below for details). Meanwhile the central bank's policy rate has been slashed from 24 per cent in July 2019 to 10.25 per cent as of September 2020, contributing to an annualised rate of credit growth in 2020 of 25 per cent, principally driven by state banks. The credit stimulus has led to rising inflation and a widening current account deficit (mainly from rising imports), despite the weakening of the exchange rate by around 20 per cent in relation to the US dollar since the start of 2020. This depreciation has arisen despite the authorities spending US$ 60 billion of reserves defending the currency so far in 2020, on top of the US$ 30 billion spent in 2019. In the face of declining reserves, the central bank has engaged in swap agreements, mainly with state banks, to tap the extensive foreign exchange deposits of Turkish residents.

Signs of economic recovery are emerging, but significant risks remain. GDP is projected to contract by 3.5 per cent for the year as a whole, with economic activity recovering in the second half of 2020. This recovery should support growth of around 5.0 per cent next year. If policy tightening addresses the depreciation of the lira, the contraction in domestic demand alongside lower oil prices should keep inflation and the current account deficit relatively contained. However, risks to our forecast are on the downside, especially if there is a second wave of the pandemic, which would likely lead to further containment measures. Other key risks are those associated with a possible further significant depreciation of the lira and withdrawal of foreign exchange deposits from the banking system.

Policy response to Covid-19

The government announced a relief package in mid-March 2020. The package, entitled the Economic Stability Shield, involved tax holidays and value-added tax cuts for hard-hit sectors, and funding for workers. It introduced a mix of financial support, credit support and employment-related measures to help citizens and businesses during the Covid-19 crisis. Measures taken to ease liquidity, particularly for small and medium-sized enterprises, include loan repayment deferrals, credit guarantees and low-cost financings, particularly through public banks. Low-interest loans have been provided for various sectors, from tourism to housing and automotive, in order to revive domestic demand. Social assistance programmes for low-income households and increases in pension payments have also been implemented.

The government unveiled measures to support labour markets. These measures include a temporary working allowance for workers who partially or fully suspend their activities. A temporary nationwide ban on layoffs was imposed to mitigate the impact of the pandemic, while employers were allowed to put employees on unpaid leave with the state providing a daily income subsidy corresponding to half the minimum wage during this period.

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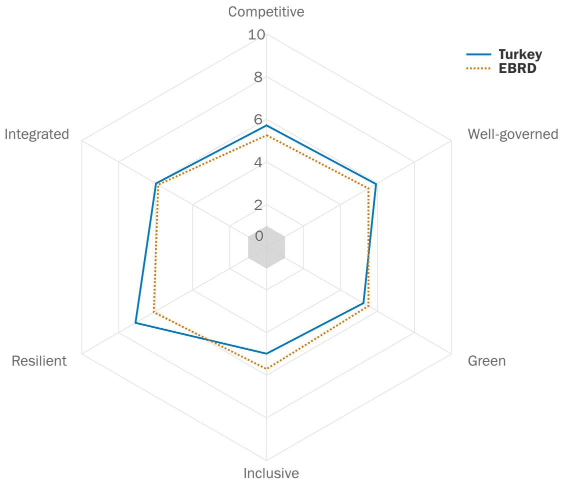
Assessment of transition qualities (1-10)



Structural reform developments

There has been backsliding over the past year in terms of governance and policymaking. Perennial concerns about the concentration of power within the Presidency and consequent lack of independence of key institutions such as the central bank continue. The central bank has cut rates heavily in the past year to the extent that real policy rates are negative, and it seems reluctant to use rate hikes to tighten policy, instead reverting to using the interest rate corridor. This results in less transparent policymaking.

Further capital market controls were introduced during the year, although some have recently been lifted as part of a wider normalisation exercise. Attempts to support the currency in the face of negative real policy rates have involved the introduction of a variety of measures that may be detrimental to investment. These include minor capital controls, including foreign exchange transaction taxes and settlement delays, and bans on shorting and lending certain Borsa Istanbul stocks. Other restrictions include those on offshore swap markets, which have made it difficult for foreign investors to hedge Turkish investments. These measures have resulted in the share of non-resident participation in the Turkish domestic bond market falling to historically low levels. Furthermore, import tariffs and other import restrictions have been introduced or increased on a wide variety of products in the past year. Some of these measures have recently been alleviated as part of a normalisation exercise.

Turkey has joined Euroclear bank. This move, which took place in June 2020, enables international investors to settle trades in Turkish government bonds. It should open up Turkish debt to more cautious investors such as sovereign wealth funds and pension funds, and is potentially important for the development of local debt markets.

The ongoing push to use credit stimulus to engineer a fast recovery has been relaxed in the face of recent lira weakness. Over the first half of 2020 several initiatives were introduced to support increased lending, including a significant increase in the size of the Credit Guarantee Facility to TRY 50 billion (US$ 7.7 billion), differential reserve requirements and remuneration to favour banks meeting certain lending targets, and asset ratios requiring banks to maintain certain levels of loan supply, government bond holdings or swaps with the central bank. Recently, in the face of ongoing weakness of the lira, these measures have been relaxed.