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coface FOR TRADE

Russia ViewPoint
Macroeconomic and Sectoral Review and Outlook
1H2020

Edition 1
September 2020

Part 1

Macroeconomic Review and Outlook 1H2020

EXECUTIVE SUMMARY

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Double dip on pandemic-related restrictions and brutal drop in commodity prices and sales volume led to severe economic slowdown in 2Q2020.

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Base scenario: -4.6% GDP by the end of 2020, as losses are somewhat mitigated by significantly boosted government spending.

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Inflation will not exceed 3.5% this year under accommodative monetary policy. We expect final 25 bps cut of policy rates to 4% in September.

—

Ruble's dependence on oil prices has somewhat weakened due to the "budget rule" and the reduction of external debts of corporations and banks.

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Increase in unemployment rate and decrease in household real disposable income is greater than official data shows.

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Drop in trade balance happened mostly due to oil prices drop, going forward volume restrictions will play a bigger role.

—

Capital outflow from Russia accelerated – more in equity than in debt investments.

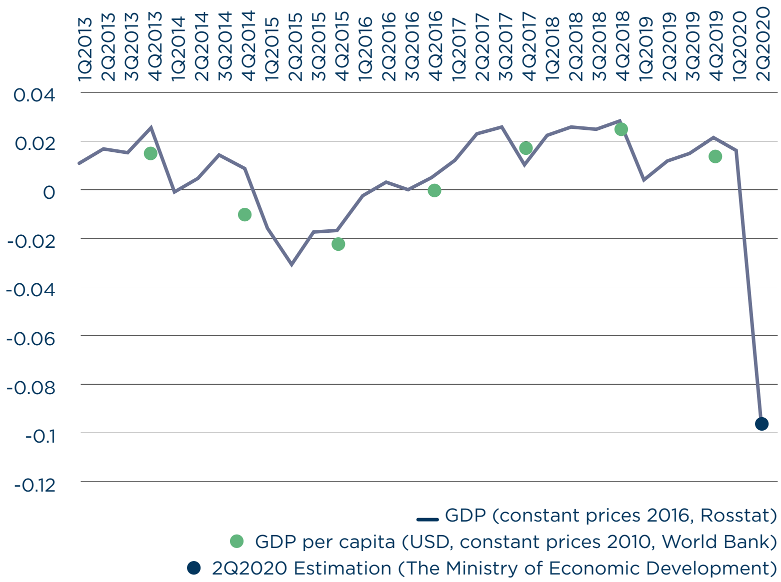
—

Bankruptcies reduced due to official moratorium, but we expect an increase after the end of freeze.

EXTREMELY NEGATIVE 2Q2020 AND 1H2020, IMPROVED PROSPECTS FOR THE REST OF THE YEAR AND 2021

- A double shock from pandemic lockdowns and a significant drop in prices of commodity goods as well as their sales volume have led to a sharp decline of the Russian economy.
- -8,5% GDP drop YoY in Q2 (initial assessment of Rosstat), total losses due to pandemic – around 4% of annual GDP.
- According to the baseline scenario, the Russian GDP will record a decline of 4.6% by year-end, with increased budget spending (increased by over 50% since March) partially offsetting the negative impact of external shocks. The current forecast envisions a GDP drop of -4.6% in 2020, +3.5% growth in 2021 and +2.3% in 2022.
- Social spending picked up even before pandemic, while about 4% were added in March-June.
- Overall, after fast immediate recovery, normalization of economy will be slow in 2H2020, with big business and state sector minimally impacted.

Chart 1:
GDP dynamic and Q2 2020 estimation



Source: Rosstat, World Bank, The Ministry of Economic Development

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The economic slowdown in the second quarter of 2020 reached -8.5% vs 2Q2019, as per the initial assessment of Rosstat. That is better than earlier expectations. The economic recovery began in June with the removal of quarantine restrictions on business activities and the subsequent recovery of retail and services. Current numbers from electricity providers and railways are consistent with the fast recovery from lows, but stabilization is 3-5% below 2Q2019 numbers. We expect that the total losses due to anti-pandemic measures will be about 4% of the annual GDP and will not be fully recovered in 2H2020. In the base scenario of the Ministry of Economic Development, the annual decline will be about 3.8% of GDP – with some of the losses mitigated by strong budgetary expansion (+25% in 2Q2020 vs 2Q2019).

According to Coface economists, GDP growth rates in Russia: -4.6% in 2020, +3,5% in 2021 and +2.3% in 2022. We expect a sizable recovery in 2021 – assuming the global situation improves

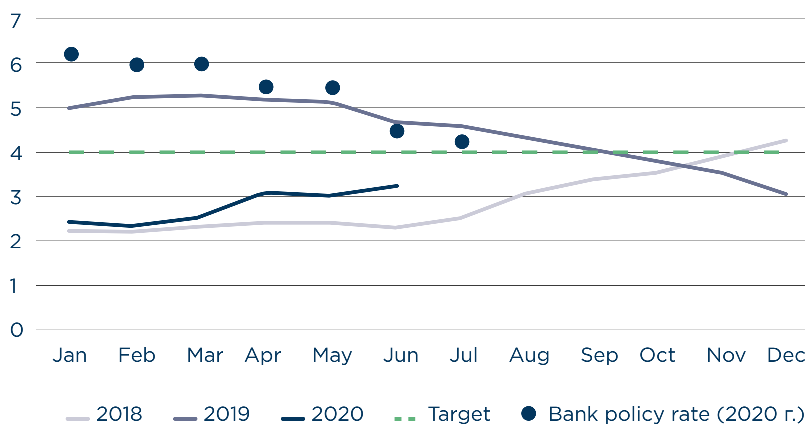
Chart 2:
Key macro parameters, base scenario

	2018	2019	2020F	2021F	2022F
GDP growth (%)	1,7	1,4	-4.6	3,5	2,3
Inflation (%)	3,2	3,2	3,4	3,2	3,8
Key rate (Dec 31) (%)	7,75	6,25	4	4	4,5
RUB/USD (Dec 31)	65	61,5	69	66	66
Brent price (avg)	68	65	43	48	55

LOW INFLATION AND ACCOMMODATIVE MONETARY POLICY

- **Inflation in 1H2020 was significantly lower than in 1H2019 due to elimination of VAT hike effect and severe reduction of economic activity due to anti-pandemic measures.**
- **Picked up in March-May due to the ruble weakening, rush demand and high level of uncertainty – but did not go far.**
- **Several bank policy rate cuts: 6.25% => 4.25% since February and outright shift to accommodative monetary policy in June. The long-term neutral rate also shifted by 1 pp signaling the victory over the inflation.**
- **We expect the final cut of this cycle of 25 bps in September.**
- **Basic scenario: inflation at 3.5% in 2020 and staying below target in 2021 – which indicates a slow recovery of the consumer and corporate demand.**

Chart 3:
Monthly YoY inflation in 2018, 2019, 2020, Bank of Russia policy rate



Source: The Central Bank of Russia

Inflation in 1H2020 was significantly lower than in 1H2019, as 2019 base was high because of the VAT hike and severe reductions of the economic activity this year outweighed the impact of the oil price drop and a weaker ruble. In March-May consumer inflation slightly picked up on market movements and increased demand for certain products due to the COVID-19 pandemic. However, prices stabilized by June, and inflation will not exceed 3.5% this year. The Central Bank was able to cut key rate by 350 bp since June 2019 and 200 bp since March. "The long-term neutral policy rate" was also shifted down by 1 pp, signaling the victory over the inflation. We expect the final rate cut of this cycle in September of 25 bps. After that rate cuts are possible only if the inflation falls further, or if the economy slows sharply due to the second wave of the pandemic.

RUBLE REACTION ON OIL PRICE DROP

- Drastic decline in oil price in March-April 2020 due to failure to extend OPEC+ deal resulted in the ruble weakening.
- Targeted interventions from the National Wealth Fund, according to the "fiscal rule", stabilized ruble by May, though the rate remains floating.
- Ruble volatility has reduced compared to 2014 – and international reserves remain relatively stable.
- We expect ruble to strengthen by the year-end, after bout of weakness in July-August – year end target – 69.
- Improved situation in gold and agriculture exports made currency less dependent on oil revenues.

Dramatic fall in oil prices that occurred in March-April 2020 (due to the coronavirus pandemic and initial break-up of the OPEC+ deal) led to a weakening of the ruble, but actions of global central banks and modest interventions from the National Wealth Fund in accordance with the "budget rule" softened the ruble's fluctuations. After the restoration of OPEC+ deal and the subsequent recovery in oil prices, the ruble also recovered. If compared with the situation in 2014, it is noticeable that the ruble's dependence on oil prices has somewhat weakened due to the "budget rule" and the reduction of external debts of corporations and banks. We expect ruble to strengthen after the recent bout of weakness on dividend payouts and global sell-offs – our year end forecast – 69.

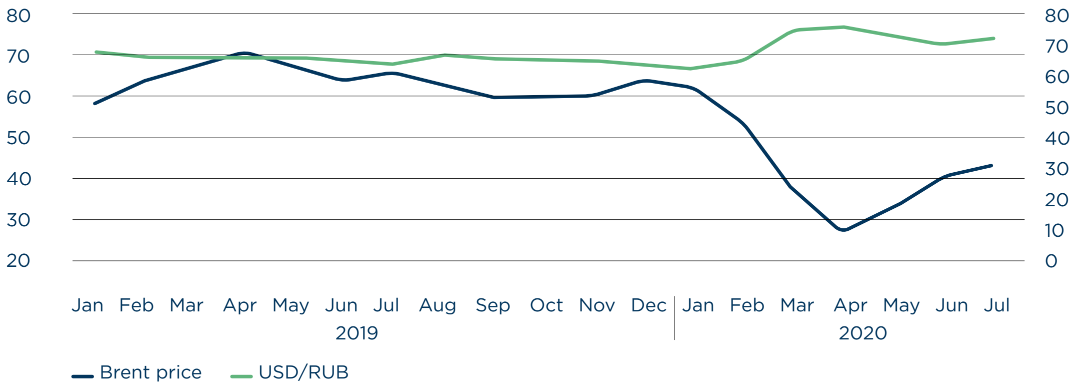


Chart 4:
Brent price and ruble exchange rate

Source: The Central Bank of Russia

UNEMPLOYMENT AND REAL HOUSEHOLD INCOME

- Higher unemployment: limited increase due to the government support, tendency to cut wages but not fire people, biggest impact of crisis on industries with big informal employment.
- Household income dropped dramatically after several years of stability (increase in 2019 was caused by Rosstat methodology change) – in addition to wage cuts, interest income and small business revenues were cut sharply.
- We expect the year-end drop in household incomes of 5%, with the increase of 4% in 2021. Major urban centers and middle class workers are likely to suffer more than retirees, public employees or rural residents.

Real disposable income declined significantly in 1H2020 – by 8% – after several years of stability. In 2019 Rosstat changed the methodology for calculating the disposable income; new estimates showed no change instead of a fall in income in 2018 and a small increase instead of a fall in 2019. We expect the year-end drop of 5%, with the increase of 4% in 2021 – with bigger losses in the corporate sector and in small businesses and relative stability in the public sector.

Unemployment rate has inevitably increased this year: in March-May 2020 the unemployment rate was 5.5%, while in January-March 2020 it was 4.6% (in March-May 2019 – 4.7%). The increase is limited due to the government support, tendency to cut wages but not fire people, biggest impact of crisis on industries with big informal employment.

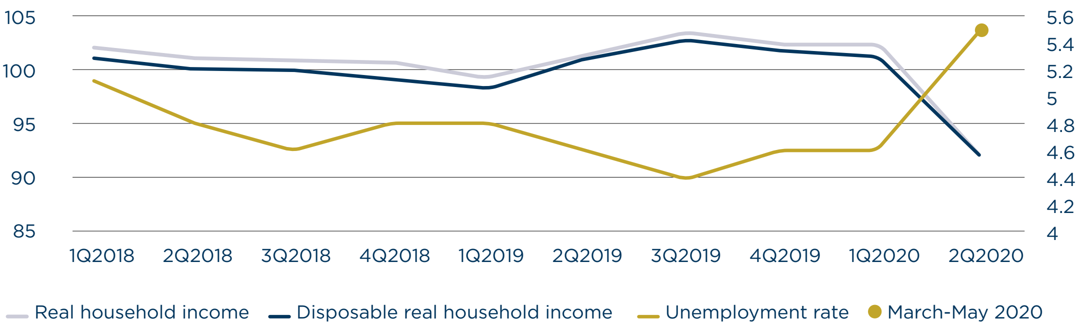


Chart 5:
Household income and unemployment rate, YoY%

Source: Rosstat

REDUCTION OF OIL EXPORT: MOSTLY PRICES BUT VOLUME TOO

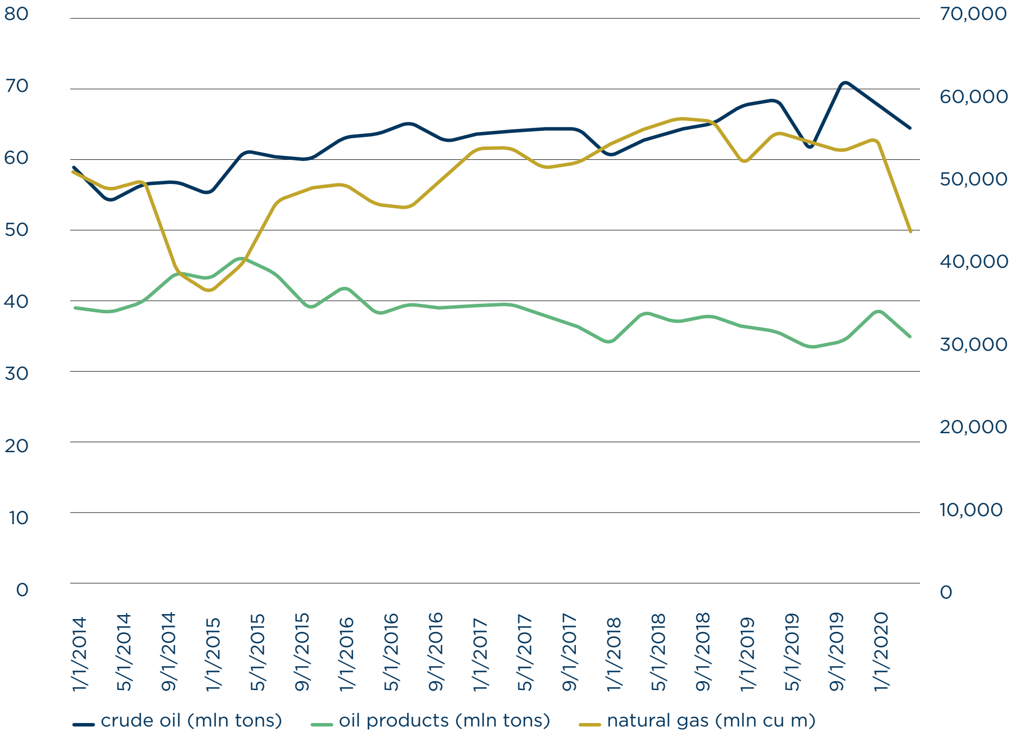
- Trade balance decline caused by COVID-19 pandemic, somewhat mitigated by decline in imports.
- Import of goods and trade balance in services decreased.
- We expect trade balance to stay positive for the year, but way below 2019 numbers.

Chart 6:
Trade balance: 1H2020 vs. 1H2019 ($bln)

	Jan-Jun 2020 (est.)	Jan-Jun 2019	YoY, %
Trade balance in goods	46.3	86.4	-46%
Export	156.1	204.0	-23%
crude oil	38.4	59.7	-36%
oil products	25.9	34.1	-24%
natural gas	10.4	23.1	-55%
liquefied natural gas	4.0	4.5	-11%
other	77.4	82.6	-6%
Import	109.8	117.7	-7%
Trade balance in services	-8.8	-15.0	-41%
Service export	21.1	29.5	-28%
Service import	29.9	44.5	-33%

Source: The Central Bank of Russia

Chart 7:
Oil, oil products and natural gas export volume



- In addition to the fall in price volumes of oil, oil products and natural gas physical output decreased too.
- The decrease was caused mostly by the COVID-19 pandemic, but also by OPEC+ production reduction.
- Outlook for 2H2020 and 2021 is improving, but OPEC+ will restrict production, with sanctions remaining a remote but dangerous risk.

Source: The Central Bank of Russia, The Federal Customs Service of Russia

The coronavirus pandemic and related restrictions have negatively affected Russia's balance of payments. The trade balance has significantly decreased compared to the first half of 2019, primarily due to a decrease in raw material exports: for example, oil exports in value terms fell by 36%, petroleum products – by 24%, and natural gas – by 55%. Also, imports of goods, as well as exports and imports of services, fell slightly due to a lower domestic and external demand due to restrictions on economic activities in connection with the COVID-19 pandemic. We expect trade balance to stay positive for the year, but way below 2019 numbers.

The decline in exports of oil and petroleum products in value terms is related both to the fall in oil prices (to a greater extent), and with the drop in the physical volume of oil exports (to a lesser extent). The fall in oil prices is related to a decline in demand as a result of the pandemic and the non-signing of the OPEC+ deal in March 2020. The drop in the physical volume happened due to a drop in the aggregate demand due to the pandemic, as well as due to a reduction in oil production under the OPEC+ deal.

TRADE WITH THE EU IS AFFECTED MORE THAN WITH CHINA

- Export to EU – mostly fuel – decreased, while imports collapsed on pandemic and euro strengthening.
- Chinese supplies became more competitive, with a significant share of exports covered by long-term contracts and less dependent on spot prices.

Chart 8:
Geographical trade breakdown: 5M2019 vs. 5M2020
Source: The Federal Customs Service of Russia

	Export Jan-May 2019/2020 Bln USD				Import Jan-May 2019/2020 Bln USD			
	2019	2020	Share (2020)	Change YoY	2019	2020	Share (2020)	Change YoY
World	174.04	134.98	100.0%	-22%	93.60	87.09	100.00%	-7%
EU	80.79	57.30	42.5%	-29%	32.95	30.37	34.87%	-8%
APEC	45.75	39.09	29.0%	-15%	39.16	37.03	42.52%	-5%
out of which China	22.26	19.64	14.6%	-12%	20.16	19.85	22.79%	-2%
CIS	21.45	17.02	12.6%	-21%	10.75	9.38	10.77%	-13%
out of which Eurasian Union	14.60	11.89	8.8%	-19%	7.73	6.79	7.80%	-12%

Chart 9:
Main goods export, Jan-May 2020
Source: The Federal Customs Service of Russia

Good, $ mln	Jan-May 2020	Change to Jan-May 2019, %	Share
	$ mln	%	%
Mineral Products	77 337.3	66.6	57.3
Metals and articles made of them	13 004.7	80.2	9.6
Food products and agricultural raw materials (other than textiles)	10 952.5	120.9	8.1
Precious stones, precious metals and products made of them	9 364.3	211.9	6.9
Chemical industry products, rubber	9 203.1	87.0	6.8
Machinery, equipment and vehicles	8 094.8	88.5	6.0
Wood and pulp and paper products	4 781.5	89.1	3.5

Chart 10:
Mineral product export breakdown, Jan-May 2020
Source: The Federal Customs Service of Russia

Good	Jan-May 2020		Change to Jan-May 2019, %		Share of mineral product export
	thousand tons	$ mln	thousand tons	$ mln	%
Crude oil	104 440.2	33 677.2	96.7	67.4	43.5
Oil products	60 143.7	22 192.5	99.0	76.7	28.7
Diesel fuel that does not contain biodiesel	22 944.0	9 940.3	102.2	78.7	12.9
Natural gas, bln cu m	73.0	9 687.1	76.7	47.4	12.5

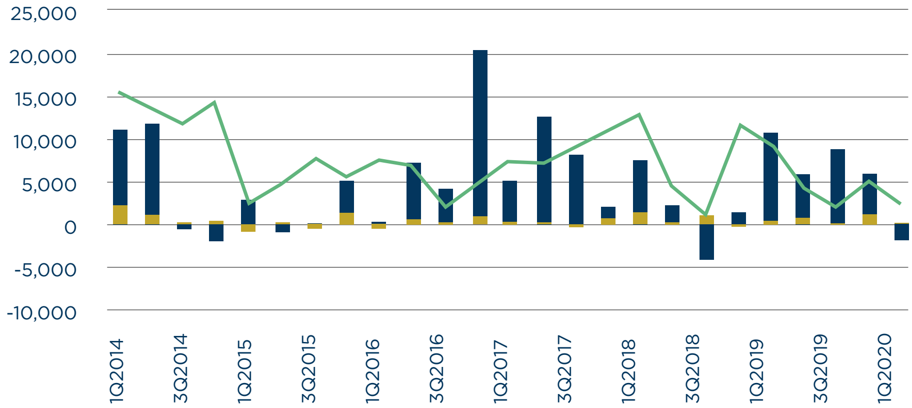
Chart 11:
Main goods import, Jan-May 2020
Source: The Federal Customs Service of Russia

Good	Jan-May 2020	Change to Jan-May 2019, %	Share
	$ mln	%	%
Machinery and equipment	40 048.0	42.8	46.0
Chemical industry products, rubber	16 235.6	17.3	18.6
Food products and agricultural raw materials (other than textiles)	12 285.2	13.1	14.1
Metals and articles made of them	6 024.2	6.4	6.9
Textiles and footwear	5 599.6	6.0	6.4

CAPITAL OUTFLOW: MOSTLY FROM EQUITY, NOT FROM DEBT

- **Capital outflow is caused by COVID-19 pandemic as in all developing countries because of a high level of uncertainty.**
- **There were a significant capital outflow from the banking sector in 2Q2020 while other sectors started to recover.**
- **Capital outflow from the banking sector will probably continue throughout 2H2020.**

Chart 12:
Foreign direct investments ($mln, balance of payments)



Source: The Central Bank of Russia

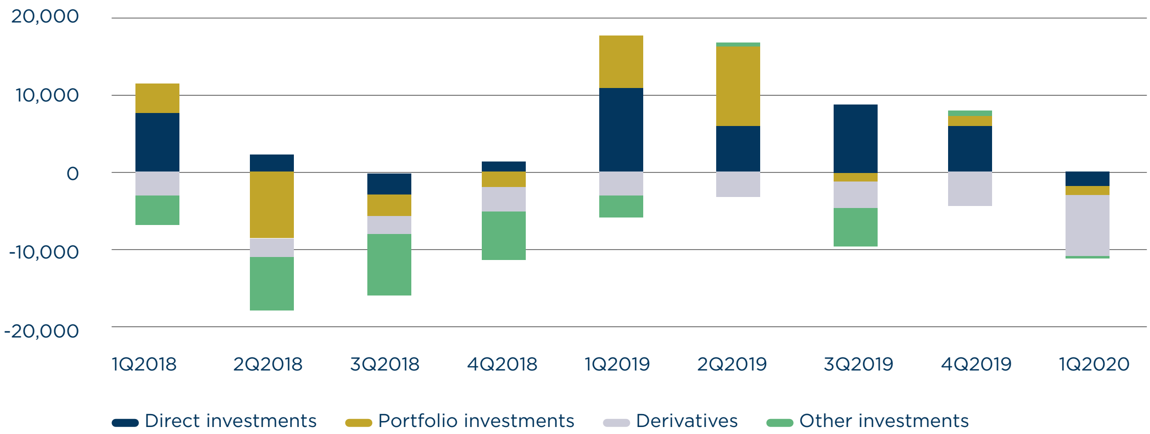


Chart 13:
Investments in Russia, breakdown

Source: The Central Bank of Russia

Having barely recovered from the fall in 2018, the volume of foreign investments began to decline in 2020. The current economic crisis significantly increases uncertainty, which traditionally causes capital outflows from developing countries. On the other hand, spread in interest rates on ruble bonds remains attractive vs. low or negative rates in developed markets.

Both direct investment and portfolio investment for the private sector – banks and corporates – became negative. However, in the second quarter, according to the Central Bank's estimation, there was a recovery in corporate investments – against the background of continued capital outflows from the banking sector.

	1Q2020	2Q2020 (est.)	1H2020 (est.)	Background		
				1Q2019	2Q2019	1H2019
Federal government agencies	0.6	1.0	1.6	7.2	10.1	17.4
Central Bank	-1.0	-1.5	-2.5	2.2	-2.8	-0.6
Banks	-7.0	-8.7	-15.7	-3.2	-6.7	-9.8
Others	-3.6	7.7	4.1	5.7	13.0	18.7

Chart 14:
Investments in Russia, breakdown by recipients ($bln, balance of payments)

Source: The Central Bank of Russia

	01.01.2020	01.04.2020
Direct investments	586 994	479 031
Capital participation, investment fund shares or units	**437 042**	**339 951**
Debt instruments	**149 952**	**139 080**
Portfolio investments	302 253	209 862
Capital participation, investment fund shares or units	**211 459**	**134 035**
Debt instruments	**90 794**	**75 826**
Derivatives	5 733	10 850
Other investments	259 798	247 734

Chart 15:
Russian International Investment Position, liabilities

Source: The Central Bank of Russia

In the first quarter the decline in direct investment in the Russian economy was primarily due to a decrease in equity participation and only to a small extent due to capital outflows from debt instruments: equity participation fell from $437 bln to $339 bln, while capital outflows from debt instruments amounted to about $11 bln (external liabilities decreased from $150 bln to $139 bln). A similar pattern is observed for portfolio investments: equity participation fell from $211 bln to $134 bln, and debt obligations fell from $91 bln to $76 bln, mostly due to capital outflows from OFZ (Federal Loan Obligations) and exchange rate differences. We expect 2Q2020 numbers to be poor, with the debt sector harmed significantly less.

CORPORATE IMPACT OF MACRO

- **While the Central Bank proclaimed soft monetary policy, real interest rates remain positive. Moreover, regulatory actions imposed in March-May will mostly expire in September-October. Thus, lower official rates will impact corporate lending and bond issuance slowly and unequally, with the increased attention to the credit quality.**
- **Government spending is likely to stay high until early 2021, but consolidation that will impact most non-essential sectors is due in 2021-2022. Therefore, reliance on government contracts should be limited in the medium-term aside from the health care and educational sector.**
- **Consumer demand will be supported by government programs and loans, but overall will stay depressed. Therefore, basic products and services will be better protected from slump than car or high-end home equipment.**
- **Social payments, especially for children have already increased and are likely to stay higher – protecting related markets.**
- **Exchange rate already benefitted domestic suppliers and added pressure on importers. Further strengthening in 2H2020 is expected to be slow on depressed trade and capital inflows.**
- **Measures to limit capital outflows and increase taxation of dividends announced in March-May looking less dangerous as they are translated into laws and amended tax treaties. No big changes should be expected before 2021.**

BANKRUPTCY OUTLOOK

- **Moratorium on bankruptcy was imposed in Russia for companies that suffered from COVID-19 pandemic.**
- **All listed companies are automatically included in “moratorium”, but can be excluded at request.**
- **Being protected sets several restrictions on companies’ activities: for example dividends are banned.**
- **By the end of June 517 thousand companies and 1,62 mln individual entrepreneurs were included in “moratorium” lists.**

Chart 16:
Corporate bankruptcy: differences

Source: Fedresurs

- **Decline in the number of individual bankruptcies is slightly lower than in the corporate bankruptcy.**
- **As courts were shut down in March-May we expect a slow movement in Q3 but a big jump in all types of bankruptcies in Q4.**

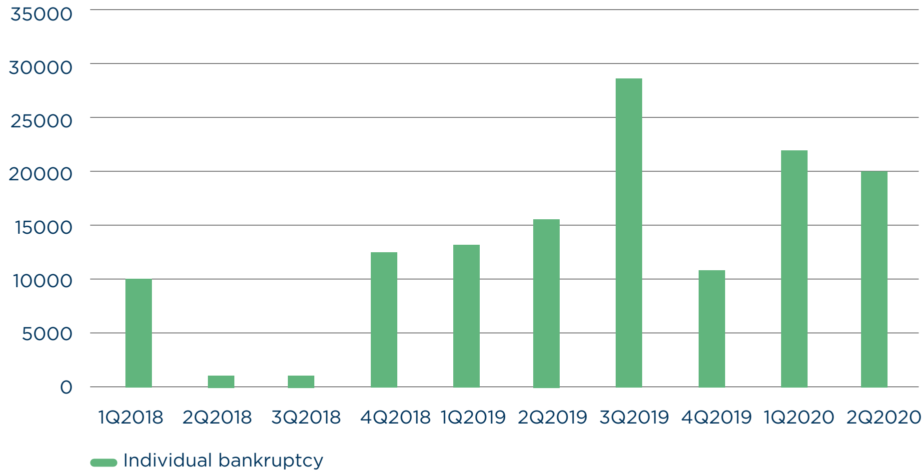


Chart 17:
Individual bankruptcy (including individual entrepreneurs)

Source: Fedresurs

The law on insolvency includes possibility of personal bankruptcy since 2015. Number of personal bankruptcies is steadily growing year after year. A partial decline in 2020 is due to a decrease in the number of bankruptcies of individual entrepreneurs, because of the moratorium, and courts closure for two months. **However, we expect a wave of bankruptcies in late 2020, especially after the law on simplified bankruptcy comes in force on September 1st.**

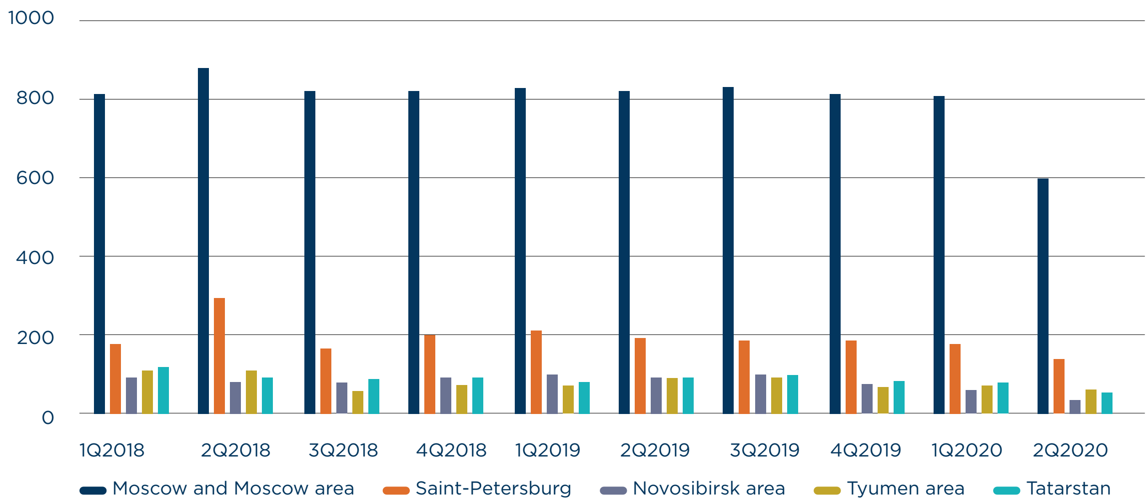


Chart 18:
Corporate bankruptcy: geographical breakdown (main regions)

Source: Fedresurs

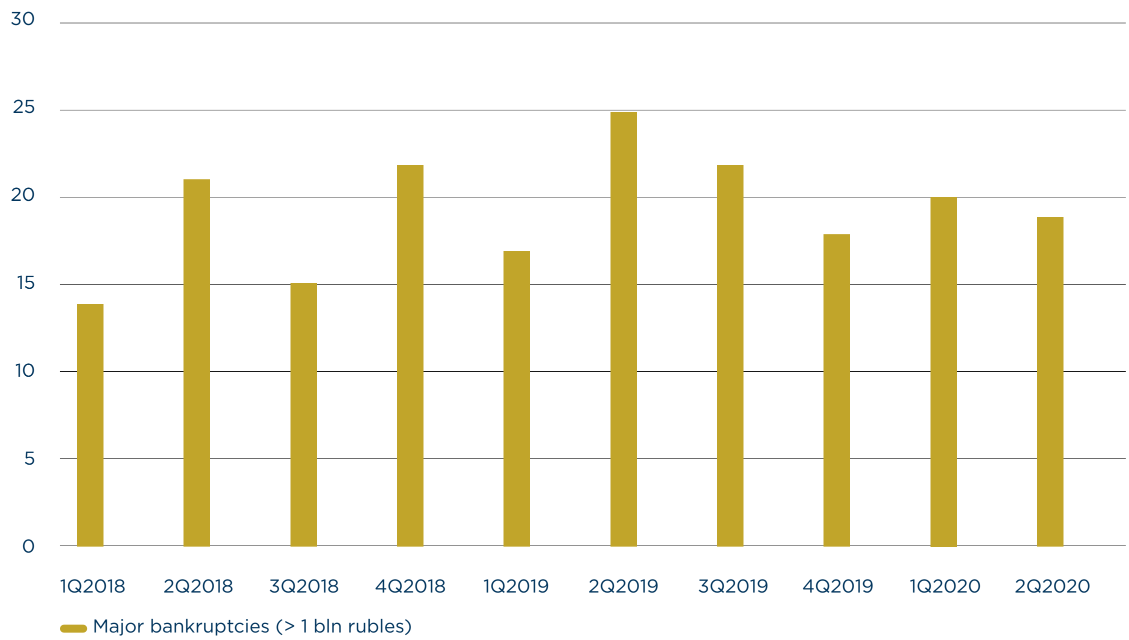


Chart 19.1:
Corporate bankruptcy: scale breakdown

Source: Fedresurs (from caselook.ru)

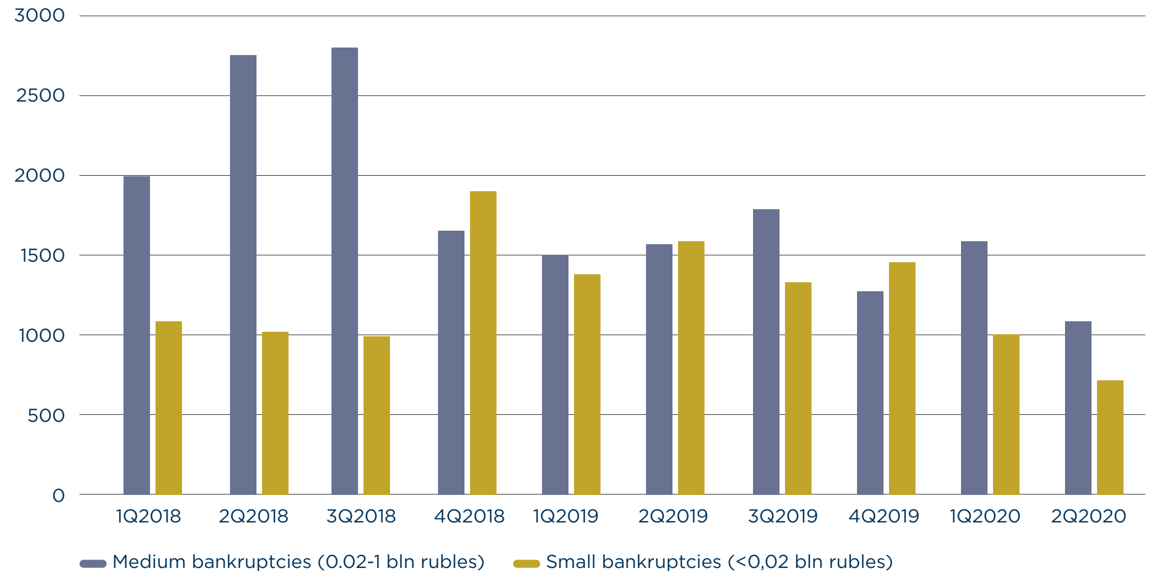


Chart 19.2:
Corporate bankruptcy: scale breakdown

Source: Fedresurs (from caselook.ru)

COVID-19 CORPORATE BANKRUPTCY MORATORIUM

Since April 2020, the Russian government has the right to impose a moratorium on initiating bankruptcy. At the end of April, the law on insolvency was amended to provide that the company can withdraw from the moratorium. These changes allow companies to avoid a number of restrictions imposed on them by the bankruptcy moratorium. In particular, during the moratorium, "protected" companies are not allowed to pay dividends.

As of June 25, the "moratorium" lists, according to the Federal Tax Service, included 517 thousand legal entities and 1.62 million individual entrepreneurs from the industries mostly affected by the pandemic.

Thus, taking into account the moratorium, the number of bankruptcies has significantly decreased vs. 2019, because many companies have used the right to a moratorium, which is granted automatically: company is included until the company itself declares otherwise.

A long period of time (on average, 1-3 years) elapses between filing of the bankruptcy case and its dissolution. In addition, not all companies that are being sued by creditors are declared bankrupt. The commercial court may refuse to recognize the debtor as bankrupt or terminate bankruptcy proceedings – and does it relatively often.

Part 2 Russian Sectoral Overviews and Bankruptcies outlook

Pharma and Health Care | Automotive | Construction materials | Metals | Electronics

EXECUTIVE SUMMARY

Sectoral impact from anti-pandemic measures and crisis differed significantly:

—

Pharma and health care industries benefitted from increases in both public and private spending, electronics got a higher demand during self-isolation, while the demand for construction materials suffered temporarily.

—

Steel and ferrous metals were hit by a low demand, somewhat mitigated by weak currency and government support, while gold producers were boosted by high global prices.

—

Automotive sector is the biggest loser this year, with the recovery heavily depending on special government programs.

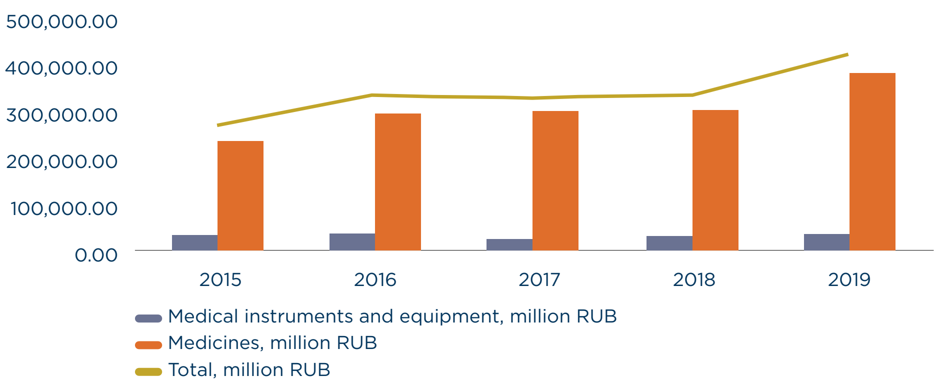
—

Bankruptcies were slow in 2Q2020 because of moratorium and court closures in April and most of May. We expect a significant increase in filings after October – when most support programs expire and bankruptcy is the best resource for many businesses.

PHARMA AND HEALTH CARE INDUSTRY

- **The overall pharmaceutical market has been relatively stable over the past five years. The "Lion's share" of medical products produced and sold in Russia is not medical equipment, but medicines, mostly generics.**
- **After the pandemic we expect a significant increase of private and public spending on health care, with focus on import-substitution, which would be beneficial for the industry but will stimulate its consolidation in 2020 and later.**
- **Prices of medical products are expected to increase due to a weaker ruble, demographic trends and new priorities – in unregulated segment we expect prices to grow by 10-15% – roughly in line with exchange rate expectations.**

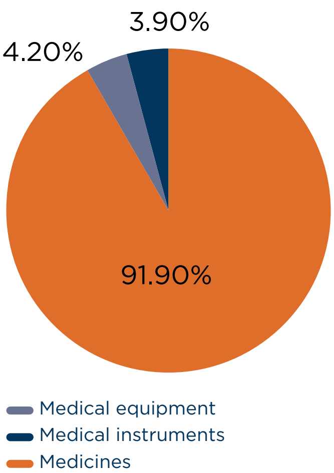
Chart 20:
Output by health care products in 2015-2019, RUB mln



Source:
The Ministry of Industry and Trade, Rosstat, The Federal Customs Service of Russia, expert assessment

In contrast to developed countries, the largest volume of production of medical products is accounted for not by medical equipment, but by drugs.

Chart 21:
Structure of production of medical products in Russia by segments in 2019, %

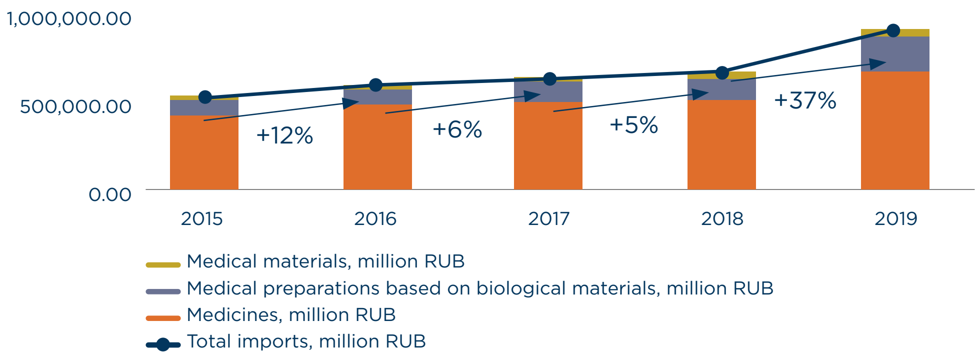


Source: The Ministry of Industry and Trade, Rosstat, The Federal Customs Service of Russia, expert assessment

Unlike the medical equipment market, the Russian pharmaceutical market is one of the most profitable ones in the world. According to experts the profitability of sales in 2019 was about 20%, further growth of the profitability of the pharmaceutical business is expected in 2020, which will also be facilitated by the introduction of mandatory labeling of medicines from 2020, which is designed to eliminate counterfeit and untaxed products from the market.

Russian pharmaceutical market is dependent on imports. In 2019, the volume of imports exceeded the domestic production by more than 200 times, and the trade balance in this segment was in deficit (-266.1 billion rubles). Import substitution is likely to remain a priority for the next several years but the impact would be felt slowly.

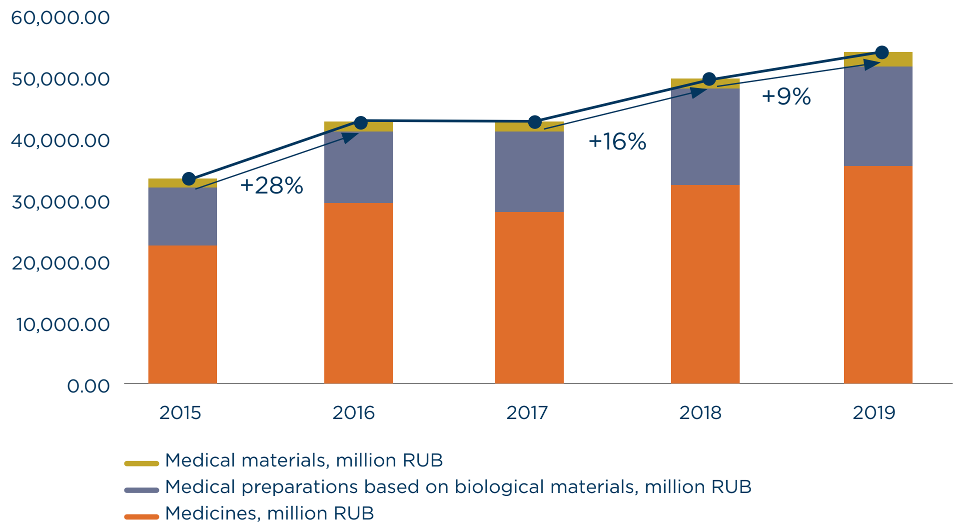
Chart 22:
Imports in 2015-2019, RUB mln



In early 2020, import of medicines to Russia significantly decreased, for example, in January-March 2020, import of finished medicines totaled 60.4 billion rubles, which is 52% less than in the previous year.

Export of medical products is still extremely insignificant, which is explained by both a low level of domestic production, and a high level of entrance requirements of most foreign markets.

Chart 23:
Exports in 2015-2019, RUB mln



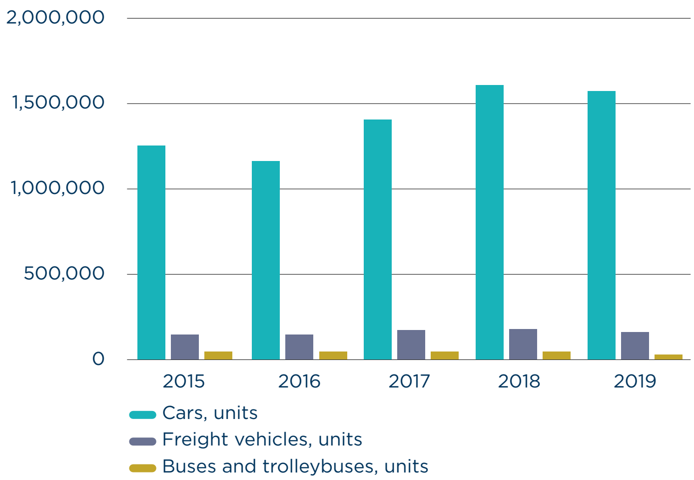
KEY RISKS AND OPPORTUNITIES

The spread of coronavirus has prompted the government to increase its spending on pharmaceutical products and medical equipment, which has proven to be a major growth driver for the market.
Thanks to the state support, the vaccine market has also gained momentum and expanded. Authorities continue to implement stringent regulatory measures aimed at making the market more transparent, fighting counterfeit goods, preventing unauthorized reselling and enforcing price control. We expect the market to consolidate due to abolition of the single tax on imputed income. **After the pandemic we expect more focus on import-substitution, which would stimulate its consolidation and involvement of quasi-government companies in 2020 and later. The volume of domestic production of medicines, medical instruments and equipment may increase significantly, some of them going into public reserves.**

Prices of medical products are expected to increase due to a higher demand, a weaker ruble and demographic trends. We can expect a faster than inflation growth in the next several years in segments without the direct price control (about 90% of the market).

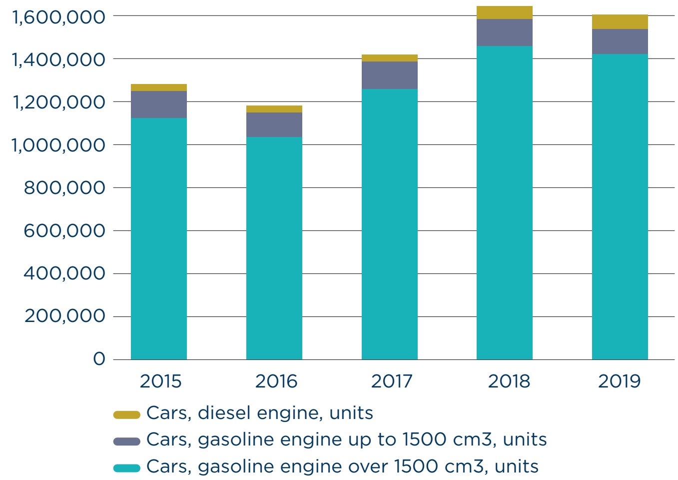
AUTOMOTIVE INDUSTRY

Chart 24:
Production of vehicles (by groups) in 2015-2019, units



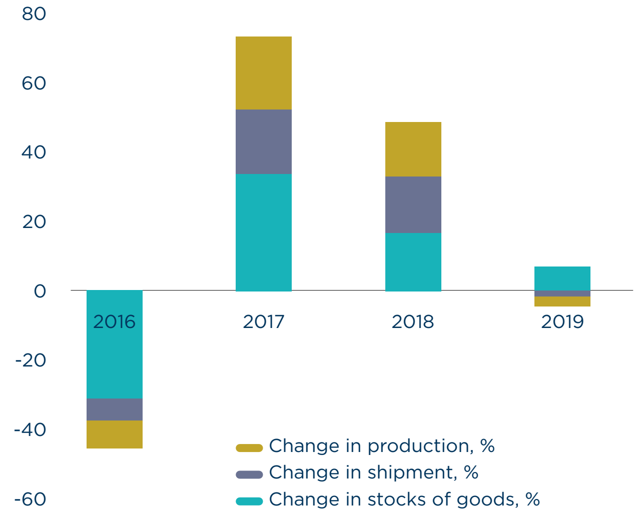
Source: The Ministry of Industry and Trade, Rosstat, The Federal Customs Service of Russia, own estimates

Chart 25:
Production volumes by product groups in 2015-2019, units



Source: The Ministry of Industry and Trade, Rosstat, The Federal Customs Service of Russia, own estimates

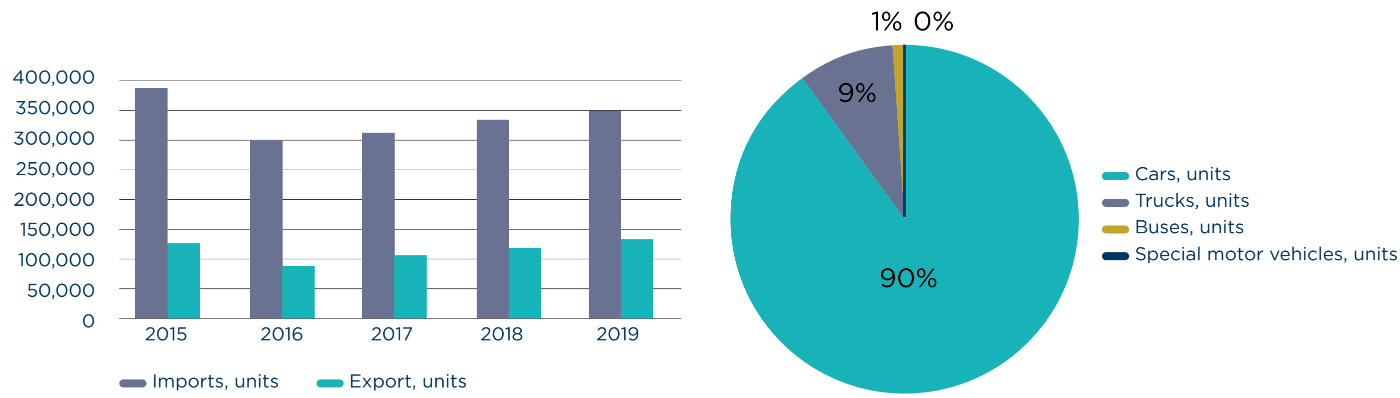
Chart 26:
Change in production, shipments and stocks in 2016-2019,%



Source: The Ministry of Industry and Trade, Rosstat, The Federal Customs Service of Russia, own estimates

- **According to the Association of European Businesses (AEB), in April 2020, 38,922 new passenger cars were sold in Russia (-72.4% vs April 2019). But the situation improved in May (-51%) and June (-15%). The overall 1H2020 sales dropped by 23%.**
- **In July sales increased 7% y-o-y on the pent up demand and low rates, but we expect a drop of 15% for the year under the base scenario. 2021 prospects depend on re-introduction of special support programs.**

Chart 27:
Export and import (by groups in 2019) of vehicles in the Russian Federation for 2015-2019, units



Source: The Ministry of Industry and Trade, Rosstat, The Federal Customs Service of Russia, own estimates

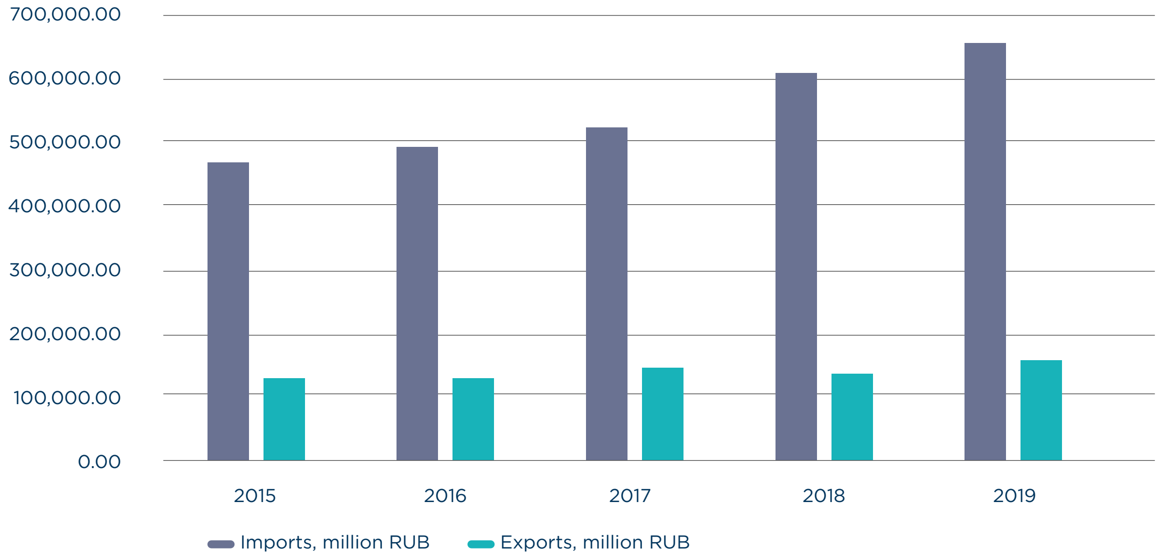


Chart 28:
Export and import (by groups in 2019) of vehicles in the Russian Federation for 2015-2019, million rubles

Source:
The Ministry of Industry and Trade, Rosstat, The Federal Customs Service of Russia, own estimates

Chart 29:
Average prices for passenger cars in 2019, thousand USD / unit

Customs prices, Import, USD / unit	26 171,35
Consumer prices, Foreign brand cars, USD / unit	15 413,43
Customs prices, Export, USD / unit	14 649,58
Producer prices, USD / unit	13 758,07

Source:
The Ministry of Industry and Trade, Rosstat,
The Federal Customs Service of Russia,
own estimates

- **The average share of imports in the domestic market is about 20 percent. We expect a modest decline of the imports share.**
- **Current export volumes of passenger cars are insufficient to protect the industry from future negative external influences, as well as to keep an export infrastructure and thus limit the potential for export sales.**
- **In 2020 prices are likely to increase modestly – 5-6% for the domestic production with imports under pressure due to a weaker currency and prices increasing somewhat below 10%, with the impact of Euro strengthening offset by lower margins. Domestic production by foreign companies is likely to consolidate further.**

KEY RISKS AND OPPORTUNITIES

- We expect a decrease in demand and sales. **Negative foreign global outlook and domestic recession will be somewhat mitigated by lower interest rates. In 2021 and later forecasts depend on recovery of incomes and corporate demand** – which in turn heavily depend on government programs.
- As economy is likely to stay under strain, competitive pressures are likely to remain high in the future. Some manufacturers may respond by offering incentives to meet their sales targets, putting the entire sector under additional pressure.

Program of renovation and other programs, financed by the government have greatly increased the demand for construction materials in 2019.

Building material production is one of the key industries in Russia. Drywall, tongue-and-groove plates, reinforced concrete, dry building mixtures, paints and varnishes and many other materials production has grown in recent years.

In 1H2020 the volume of construction work suffered for most of the quarantine period, that impacted materials market as well. However, the pent up private demand has compensated some of losses and annual sales are likely to stay flat in most segments.

Russia remains a major importer of building materials, but in recent years, active import substitution has taken place, which is likely to continue due to the weak ruble and price pressures.

Chart 30:
Dynamics of construction and production of building materials in 2015-2019 (in comparable prices)

Source: RBC

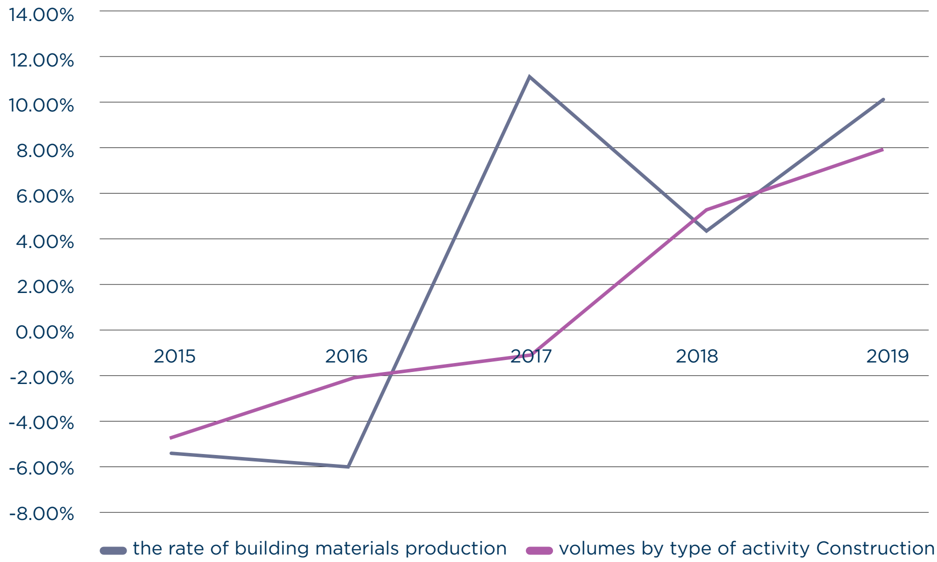


Chart 31:
Dynamics of construction materials production in Russia in 2015-2019

	2015	2016	2017	2018	2019
ready-mixed concrete, cbm	27	27	29,5	28,8	32,7
aerated concrete, cbm	13	11,9	11,6	11,6	12,5
ceramic tiles, million sq m	171,6	167,6	181,5	181,1	182,5

Source: RBC

Data for 2Q2020 so far is spotty and not overly relevant, but construction – both corporate and DIY sectors – has begun a fast recovery – so the overall impact of the crisis should be modest, unlike in previous recessions.

Chart 32:
Export and Import of building materials in the Russian Federation in 2015-2019

Source: ITC Trade Map

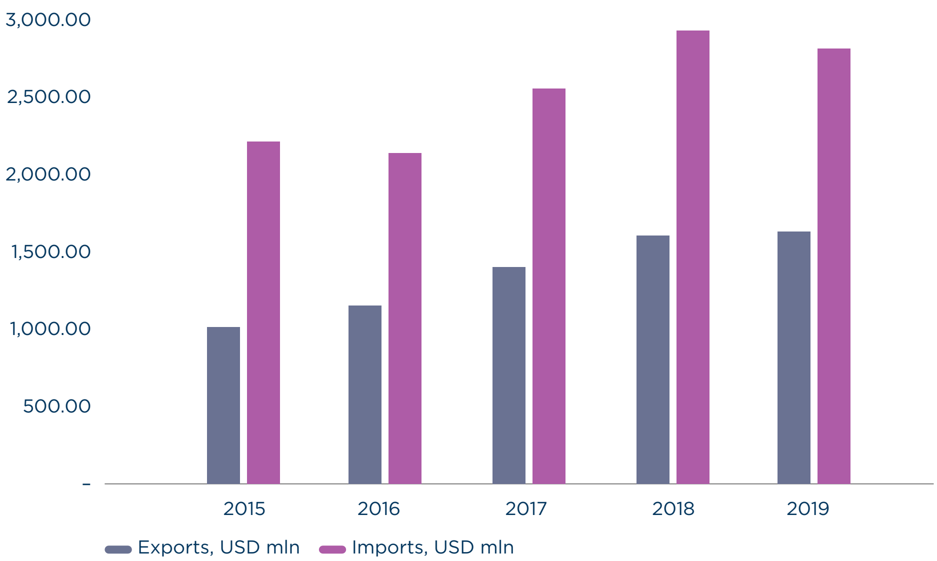
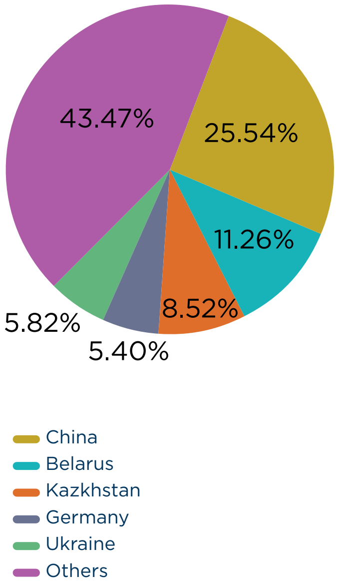


Chart 33:
Turnover in 2019

Source: ITC Trade Map



- **Russia remains a major importer of building materials, but in recent years, active import substitution has taken place and export is steadily growing. These trends are likely to continue.**
- **Prices are likely to grow somewhat higher than inflation (5-7%) with domestic producers increasing their share, and Chinese suppliers reducing their margins.**
- **Lower interest rates and a higher spending on housing and repairs will boost demand in 2H2020 and 2021.**

KEY RISKS AND OPPORTUNITIES

- The coronavirus pandemic and the economic crisis are certainly having a significant impact on the market. **Continuing decline in household incomes caused a shift to cheaper segments, while the weaker ruble made domestic producers more competitive. Moreover, consumers stepped up purchases, fearing impending price hikes.** The “non-working days” were used by many to carry out repairs, for which they previously did not have enough time.
- **Anyway market growth rates will decline in 2020, but will remain positive for most of the market. The pandemic leaves little to no chance to continued growth.** Prices are likely to grow along with the inflation at 5-7%.

- Metals is the leading export industry in Russia, second only to oil and gas.
- We expect that export of metals and the domestic demand for them will remain under pressure this year.
- We expect some pick up on higher gold prices and some improvement in the steel demand, with the annual output in the steel sector declining by about 3-5%.
- Gold producers are main beneficiaries of the current market and macro situation.

Chart 34:
Metals Production

	1H2020 vs. 1H2019, %
Metals	95,9
Iron, steel and ferroalloys production	98,4
Steel pipes, hollow sections and fittings	85,4
Manufacture of other steel products by primary processing	101,1
Production of basic precious metals	96,5
Metal casting	105,6

Source: Rosstat, The Federal Customs Service of Russia, The Ministry of Economic Development, expert assessment

Chart 35:
Export dynamics in January-June 2019 vs 2020, billion USD

Source: Rosstat, The Federal Customs Service of Russia, The Ministry of Economic Development, expert assessment

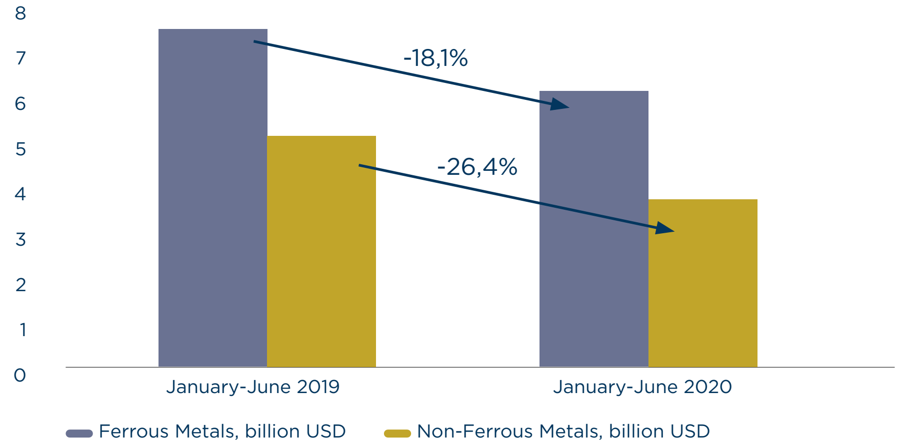


Chart 36:
Copper Export, thousand tons

Source: Rosstat, The Federal Customs Service of Russia, The Ministry of Economic Development, expert assessment

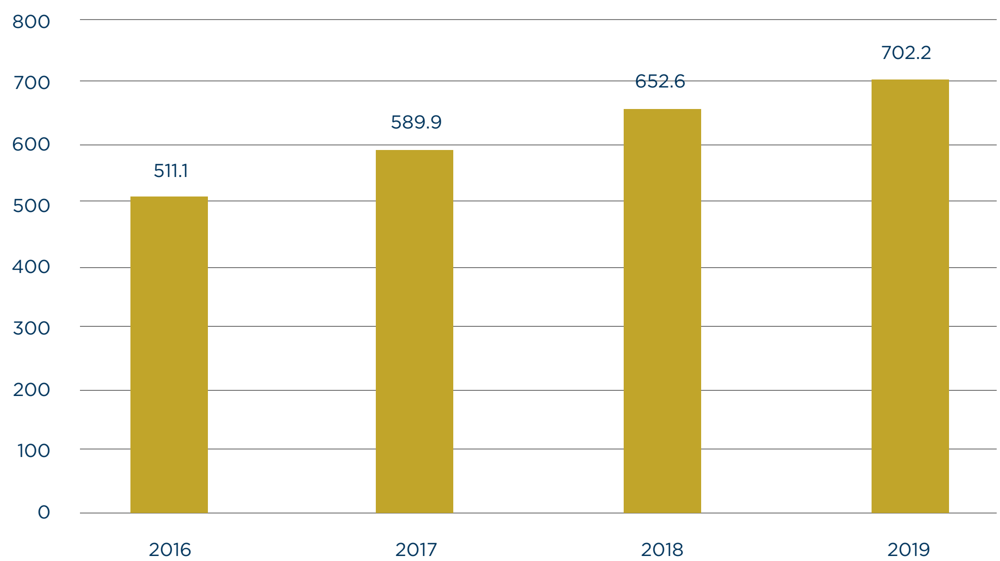
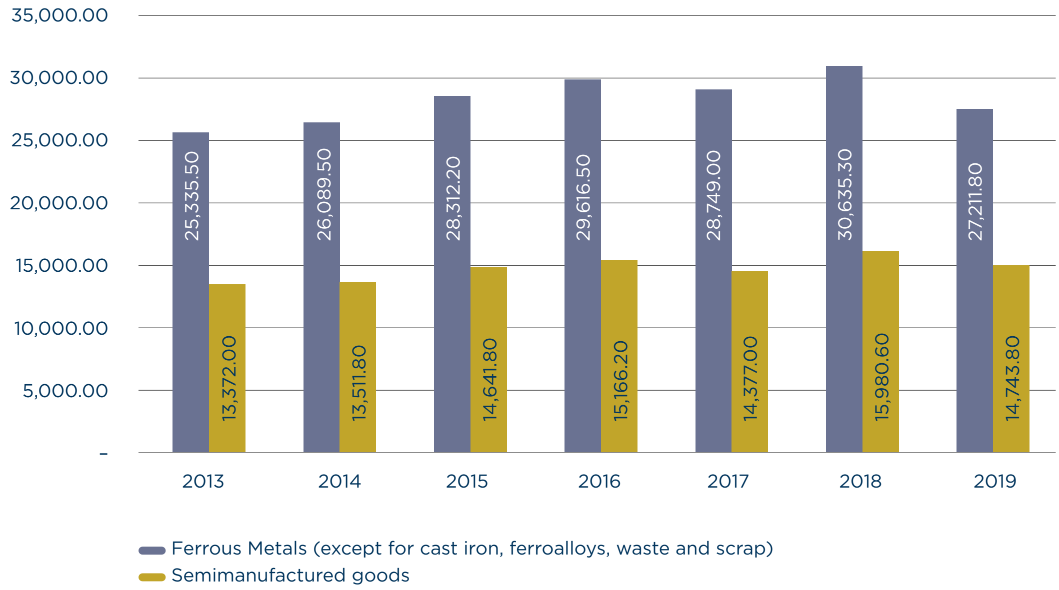


Chart 37:
Ferrous metals export, thousand tons

Source:
Rosstat, The Federal Customs Service of Russia, The Ministry of Economic Development, expert assessment



- **Import remains limited to highly-specialized products and alloys.**
- **A sharp decline in exports of ferrous and non-ferrous metals in January-June was a by-product of the crisis.**
- **The bottom was hit in May, after that production and exports have picked up.**

In 1H2020, the financial situation in the Russian metallurgy deteriorated sharply. Overall production volumes decreased in 1H2020 by 4.1% y-o-y compared to the same period of the last year. In non-ferrous metallurgy there was an increase in the production of aluminum (by 15.0% versus 2019), zinc, gold (unprocessed or semi-finished or in the form of powder) increased by 7.4% versus June 2019. Copper and aluminum were hit, and annual numbers are likely to be dismal.

For the whole 2020, **the export of metals and the domestic demand for them will remain under pressure, except for gold and other precious metals. The decline in production in the industry is expected to the tune of 5%.**

KEY RISKS AND OPPORTUNITIES

Slow global and domestic demand for metals is the biggest risk – while major infrastructure projects at home and abroad are likely to provide boost. A weak ruble and lower interest rates somewhat mitigated the negative impact of the recession and pressure on margins. **We expect the industry to be in a better shape at the exit from the recession than after 2008-2009 shocks as it is better prepared and most companies are vertically integrated and insured from price and supply shocks.** Producer prices in steel and non-precious metals are likely to decline – but precise levels heavily depend on global markets.

The share of the electronics industry in the Russian GDP is about 2 percent, with about 55% of the sector remaining under the quasi government control for both historic reasons and to avoid security risks. In 2019, the volume of the electronics market in Russia decreased by 3% compared to the previous year and amounted to 180 billion rubles. In 2020, this figure is likely to grow within 5% – due to higher sales in some segments.

Chart 38:
Share of Electronics industry

Source:
Rosstat, The Federal Customs Service of Russia, The Ministry of Economic Development, expert assessment

Electronics industry	Share of the sector		Change, %	
	2019	January-June 2020	January-June 2020	June 2019/2020
Telecom	36%	35%	6%	-6%
IT-sector	19%	20%	17%	19%
Audio/Video	15%	14%	4%	-8%
Large Home Appliances	17%	17%	12%	0%
Small Household Appliances	9%	10%	17%	21%
Office Equipment	4%	3%	-6%	-14%
Photo Goods	1%	1%	-23%	-50%

Chart 39:
Sales Volume, Electronics Industry

Source:
Rosstat, The Federal Customs Service of Russia, The Ministry of Economic Development, expert assessment

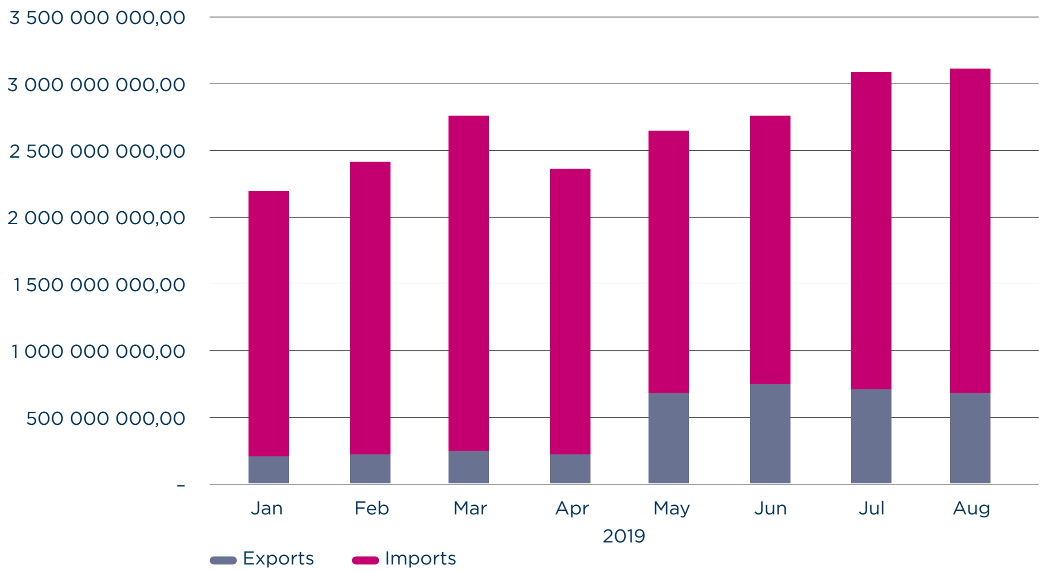
Electronics industry	Growth, %			
	2020	March 2019/2020	April 2019/2020	May 2019/2020
Sales volume, units	-1%	8%	-30%	-10%
Sales volume, rubles	9%	34%	-19%	3%
Weighted average price, rubles	10%	24%	16	14%

- **Electronics survived the pandemic relatively well, with more demand from people and businesses due to self-isolation and massive switch to work from home – requiring equipment upgrades.**
- **For the whole 2020 we are likely to see increases in most segments.**

According to GfK's retail sales monitoring data, in general, for the period from January to June 2020, the demand for equipment decreased by 1% in units. Highest growth rates were detected in IT products – mainly due to laptop orders for remote work. The small household appliances sector is showing good results: + 17% in monetary terms in 1H2020. After difficult April, the sector became the fastest growing one in June (+ 21%). The main drivers of growth were oral care equipment (+ 54%), small climate equipment (+43), hair clippers (+56%), robotic vacuum cleaners (+86%) and vertical vacuum cleaners (+47%). In June, manufacturers of household and electronic equipment were able to increase production and, in some cases, return to the 2019 levels.

Chart 40:
Exports and imports of electronics, USD

Source:
Rosstat, The Federal Customs Service of Russia, The Ministry of Economic Development, expert assessment



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Both imports and domestic production will be costly due to the impact of the exchange rate on components (mostly imported) and products themselves.

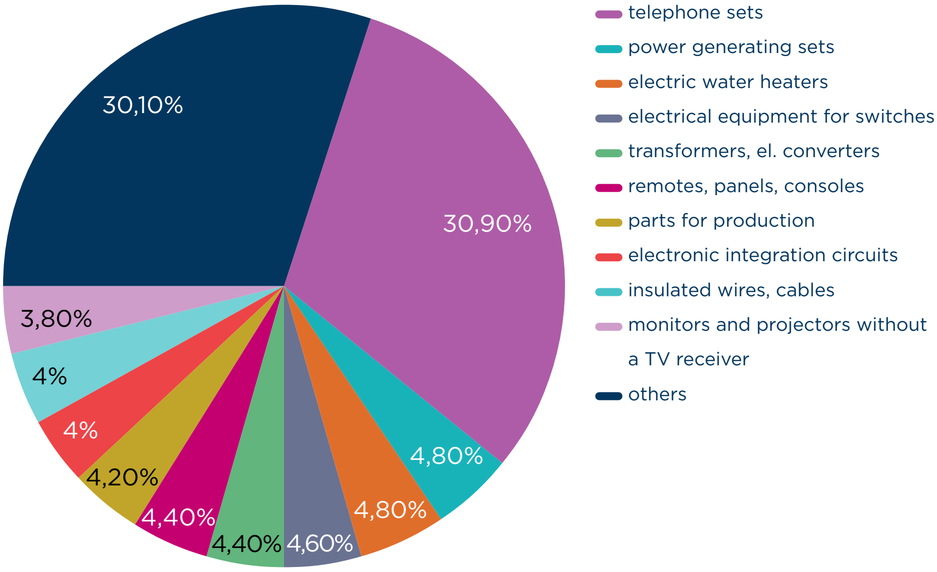
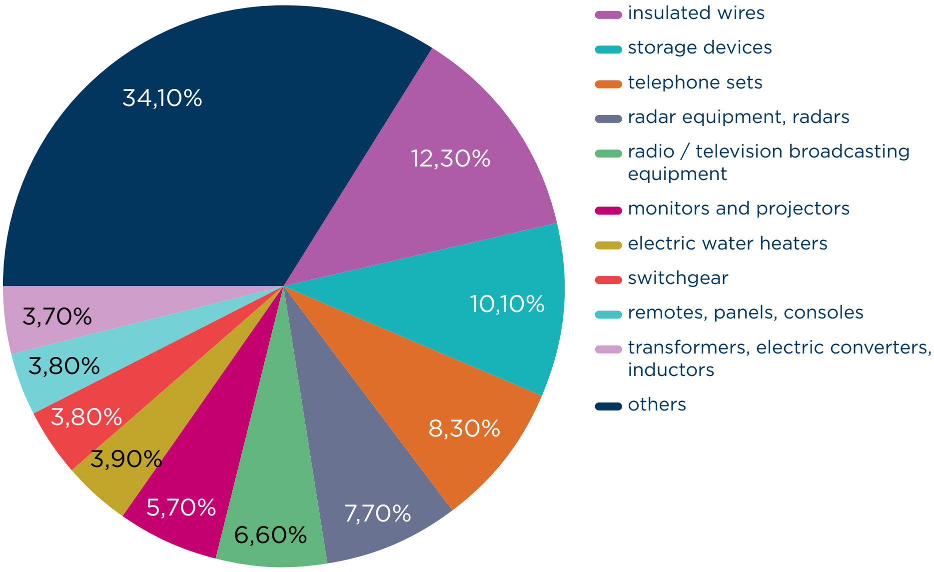


Chart 41:
Main imported goods, %

Source:
Rosstat, The Federal Customs Service of Russia, The Ministry of Economic Development, expert assessment

Chart 42:
Main exported goods, %

Source:
Rosstat, The Federal Customs Service of Russia, The Ministry of Economic Development, expert assessment



KEY RISKS AND OPPORTUNITIES

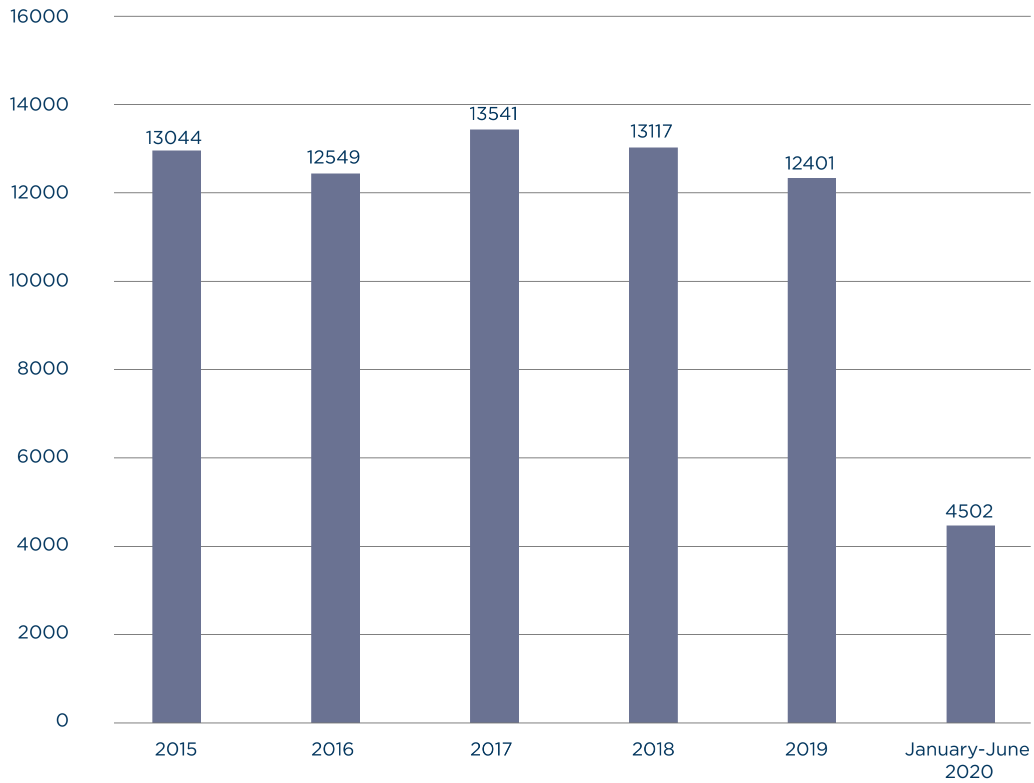
In 2020 government funding and emergency loans are needed to boost the corporate segment of the industry, while household income decline will put pressure on domestic equipment and gadgets. **Major government programs on digitalization are likely to support the sector in 2021 and later. We may expect further steps to increase import substitution in government contracts – to stimulate domestic production even by transnational companies.** Another risk is delays or cuts in digital plans of the government and corporations.

SECTORAL BANKRUPTCIES

- In 1H2020, courts declared 4502 Russian companies bankrupt, 26.0% less than in the same period of 2019 (6083 pcs.). Courts were closed in April and most of May and the full capacity was reached only by July.
- Government programs provided life support to a sizable segment of companies, including moratorium on many filings until October.
- In January-June 2020, courts introduced 69 external administration and financial recovery procedures, or 0.9% of all procedures, compared to 114 (1.0%) in January-June 2019.
- We expect growth in company bankruptcies in 2020 (about 12 500) with a bigger impact in 2021 – as court capacity is limited and proceedings tend to be slow.

Chart 43:
Dynamics of Bankruptcies

Source:
Fedresurs



In many industries in 1Q2020 there were no significant changes in the intensity of corporate bankruptcies*

Metallurgy, construction (construction materials industry included): unchanged

* the actual number of bankruptcy proceedings – published decisions by Arbitration Courts

METALLURGY

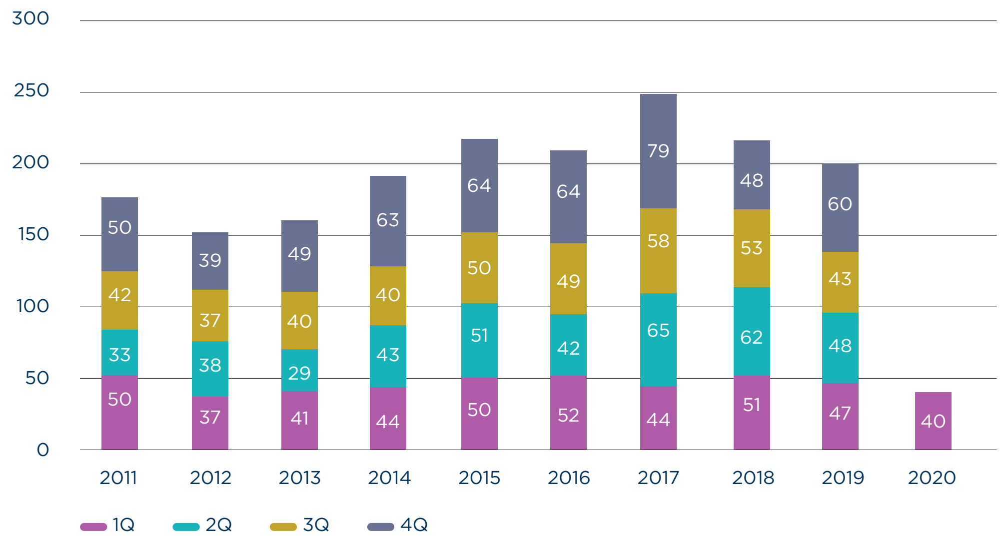


Chart 44:
Bankruptcies in Metallurgy

Source:
www.forecast.ru

Electronics and Engineering, Transport (Auto incl): slight decline*

***the actual number of bankruptcy proceedings – published decisions by Arbitration Courts**

CONSTRUCTION

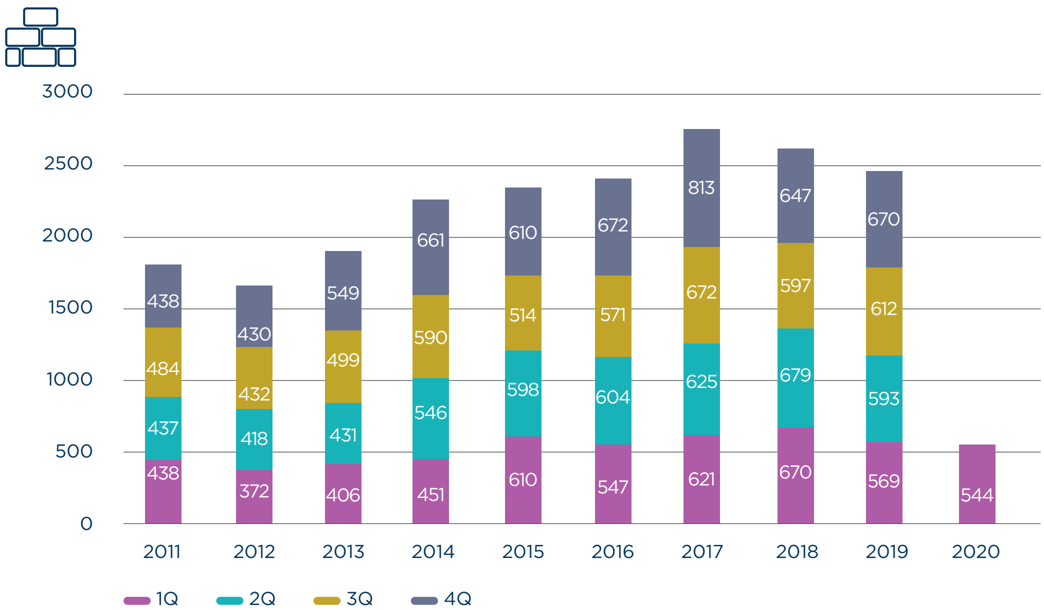


Chart 45:
Bankruptcies in Construction

Source: www.forecast.ru

TRANSPORT (AUTO INCL)

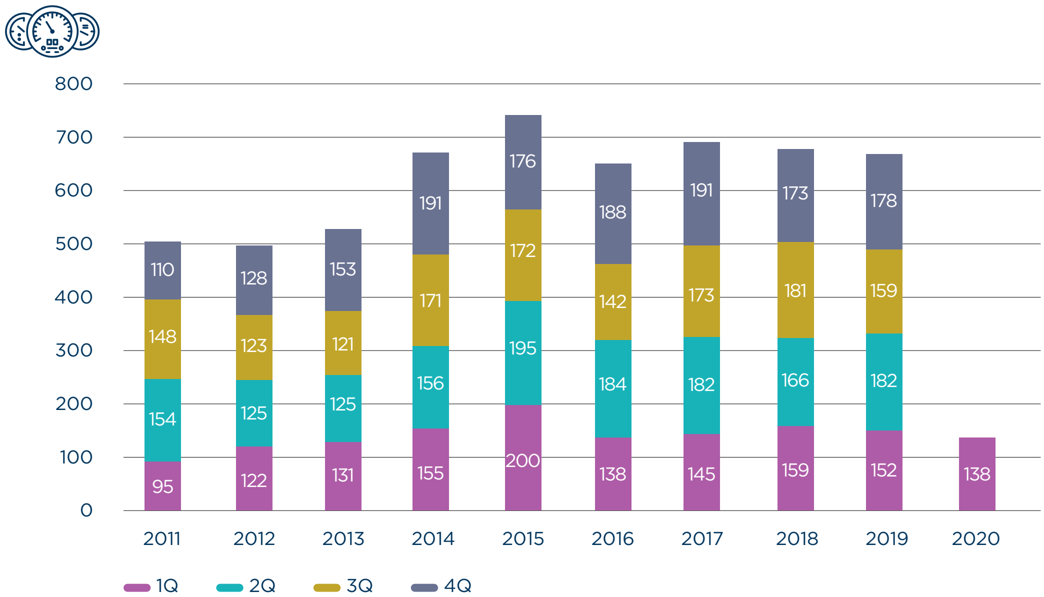


Chart 46:
Bankruptcies in Transport (Auto Incl)

Source: www.forecast.ru

ELECTRONICS AND ENGINEERING

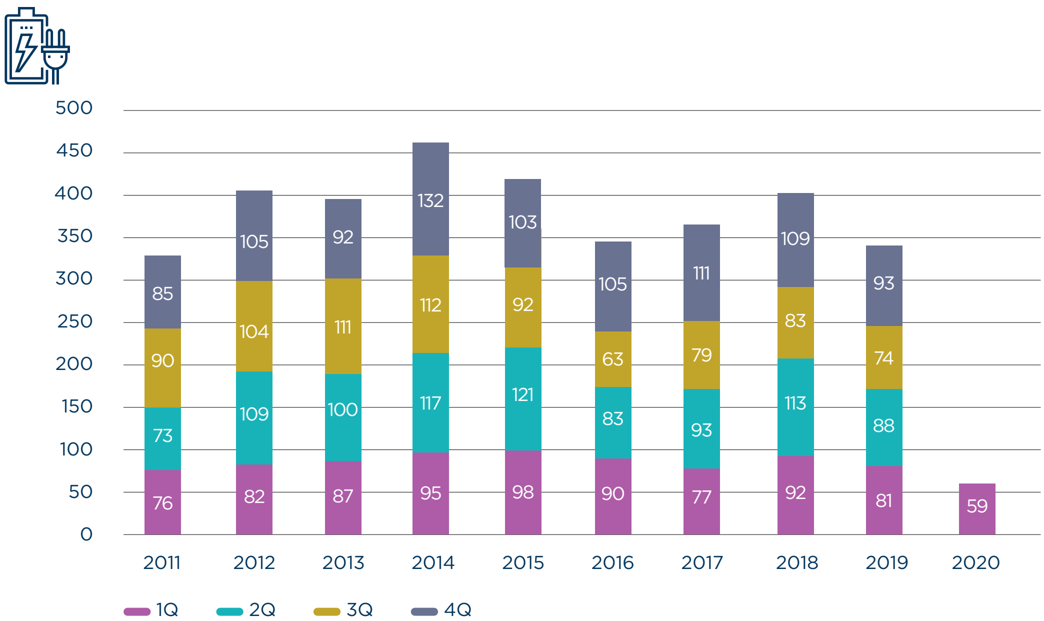


Chart 47:
Bankruptcies in Electronics and Engineering

Source: www.forecast.ru

PHARMA AND HEALTH CARE

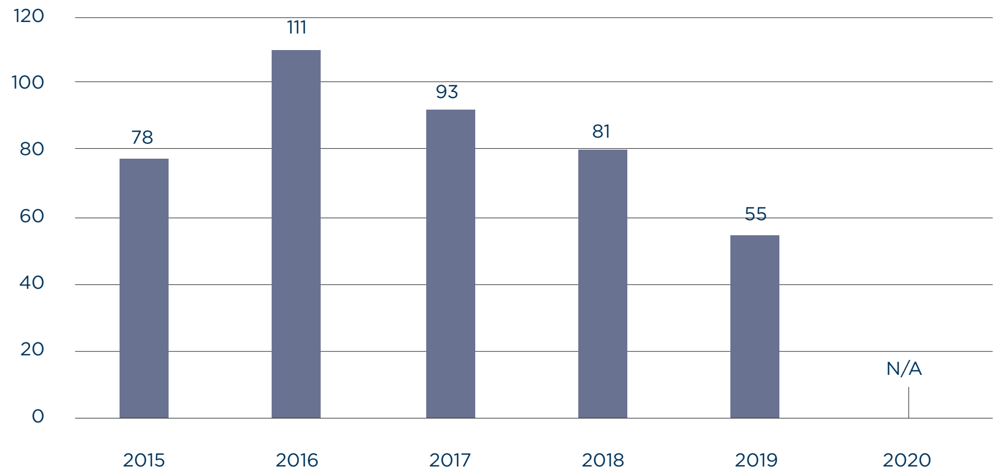
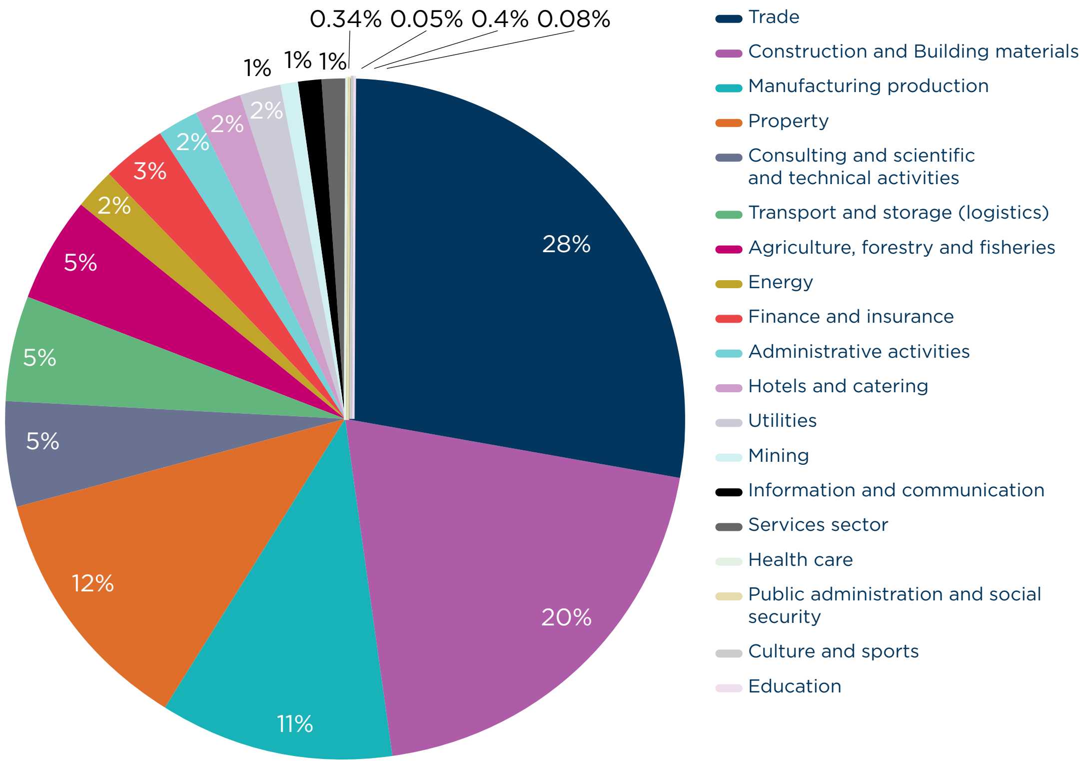


Chart 48:
Bankruptcies in Pharma and Health Care 2015-2019

Source: www.spark-interfax.ru

- **In covered sectors we expect filings by construction materials producers to increase – metals and auto producers and suppliers are likely to get a sizable government support in 2020, with the impact of the recession spread towards 2021 and later.**
- **1Q2020 on Pharma and Health Care is not available, but we expect the decline in bankruptcies to continue in 2020-21.**

Chart 49:
The number of bankruptcy filings in 1H2020



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