

# Russia View

## 2020 outlook: Getting everything ready for a breakthrough

2019 is approaching its end and it is time to discuss the prospects for 2020. The key focus of this note is national projects that are now a primary axis of economic policy in Russia. FX and macro projections reflect our expectation of a relatively stable year ahead.

### 2020 is a crucial year for 2024 national goals

While 2019 was mostly about increasing the buffers of Russian economy even further, 2020 should be a year of finalising the preparatory work needed to break out from a 1.5% growth trap to reach global average growth of 3%. In our view, the key task in this work is to finalise the pipeline of infrastructure projects for 2021-24 as well as the accompanying project documentation, and to complete the so called "regulatory guillotine" (a comprehensive overhaul of the business regulation framework). If this is not done, we see a risk that the gap between actual performance and the ambitious 2024 targets could widen very quickly. Assessing the results will, however, remain a complicated task given the opaque reporting on the progress across 76 federal projects consolidated in 13 national projects.

### RUB: cautious optimism ahead of 2020

Thus far, 2019 has been a good year for the RUB, which strengthened through most of the year and has enjoyed decreasing volatility. 2020 may well end up a being pretty stable year for the RUB if the global outlook improves following a synchronised monetary easing across the globe in 2019. However, we do not see a lot of room for further strengthening, as the support from massive capital inflows to previously undervalued Russian assets has largely played out. Sanction risks is now completely priced out by the market, implying to us that any material return of this topic on the agenda may cause quite some volatility.

### Forecasts

We remain quite cautious in our growth forecasts for Russia. We are not yet ready to pencil in growth of more than 2% for 2021 but hope to be able to do so if we see more energy in the execution of national projects next year. The key rate has relatively limited potential to be lowered further. We expect two more cuts in the first half of next year, bringing it to 6%. Lower interest rates should act as a support factor for growth in 2020.

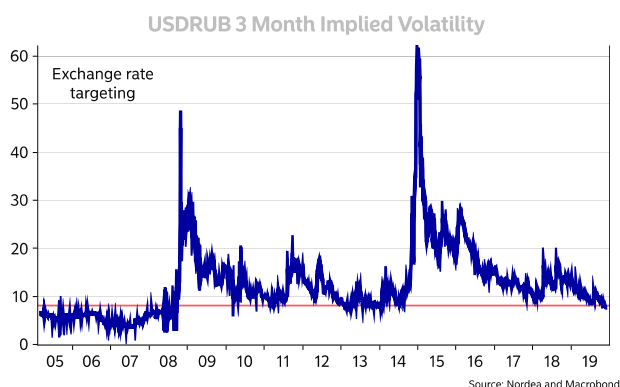
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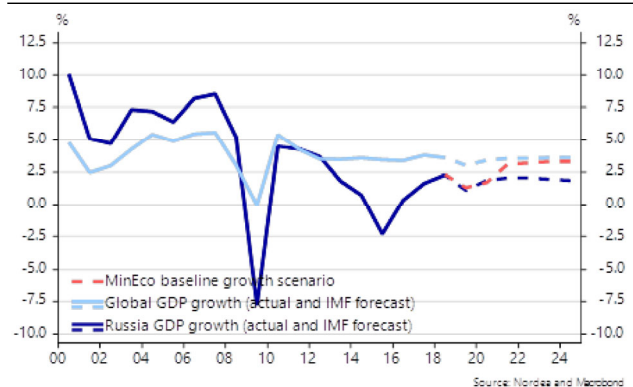
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#### RUB volatility is back to record low levels



#### Authorities expect economy to take off in 2021



# 2020: A crucial year for 2024 national goals

2020 will be very important for delivering on national goals set for 2024, as most of the preparatory work has to be finished to set the stage for higher growth starting from 2021.

Russian economy cemented its fundamental strength in 2019

It seems that 2019 has turned out to be a quite moderate year for Russia, sandwiched between the massive construction activity ahead of the 2018 World Cup and the start of new projects aimed at achieving ambitious national goals set for 2024. As widely expected, we believe growth is unlikely to exceed 1.3%, reflecting drag from higher taxes on consumption and a failure to rapidly reinject collected taxes back into the economy in the form of higher public investment. At the same time, 2019 proved to be another year when Russia cemented its stability buffers. International reserves increased by 16%, the National welfare fund reached 7.3% of GDP (versus 4.4% last year), and we expect the budget to remain in surplus (1.4% of GDP) for the third year in a row. As a result, Russia has regained investment grade ratings from all three major rating agencies, after Moody's went for an upgrade in February 2019. The markets meanwhile started to price in further upgrades, as reflected by the country risk premium having narrowed to its lowest level since 2008.

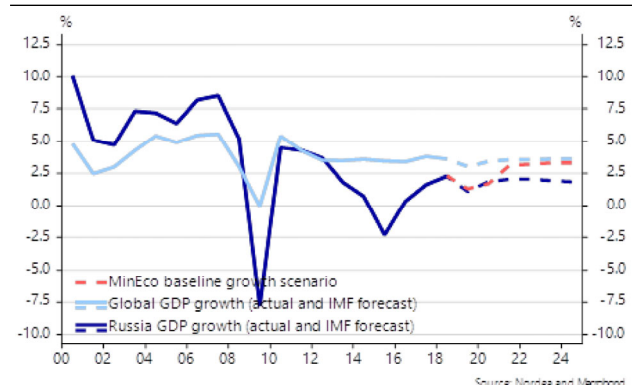
Monetary stimulus to provide some support to the economy in 2020

We find that the lack of economic dynamism remains the key challenge for Russia as it enters 2020. The economy is likely to get some support from easier monetary policy, as rapid rate cuts (125 bp in total) executed by the central bank in the second half of 2019 translate into more favourable financing conditions. The key rate has actually dropped to its lowest level since early 2014 and interest rates for corporate borrowers are close to historical lows.

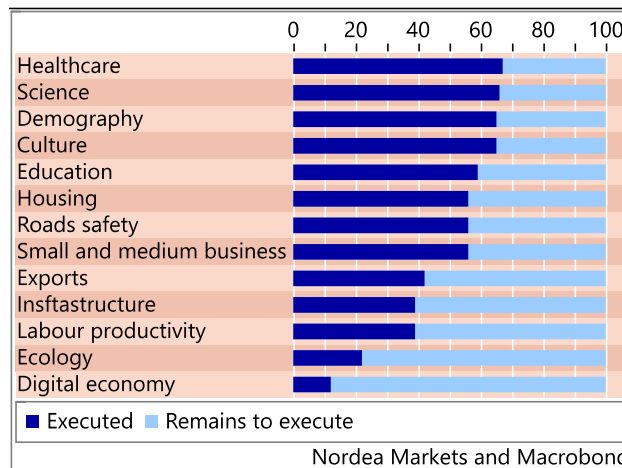
National projects are the core of the government's efforts to speed up growth

The policy response to the lack of growth is a set of ambitious national projects, which now form an axis of the government's economic policy. Their execution in 2019 was behind the schedule, with only 52% of the total planned budget financing being spent in the first nine months of 2019. Some of the spending is likely to be postponed till 2020, and hopefully budget execution will improve next year as the procedures and cooperation between authorities gets better streamlined.

**GDP GROWTH IN RUSSIA**  
Authorities expect economy to take off in 2021



**SPENDING ON NATIONAL PROJECTS – 9M 2019**



Government aims to make 2021 the last year with growth rate below 2%

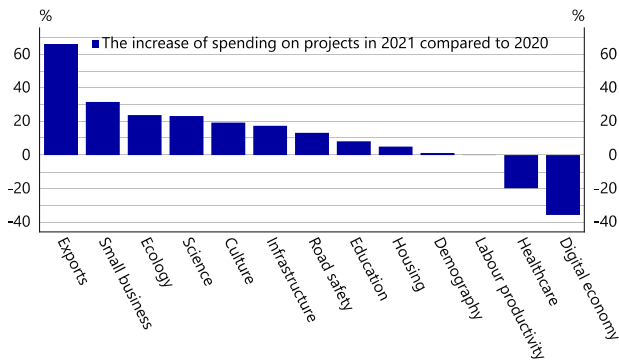
Even though 2024 still seems to be distant, we believe that 2020 will be a crucial year for achieving national goals set for 2024. The official government forecast of the Russian growth trajectory meant to make Russia the fifth-largest economy in the world in purchasing power parity terms by 2024 implies that 2020 is the last year when growth may remain moderate (below 2%). A breakthrough to a sustainable 3% annual growth is to occur in 2021, according to the government. Successful completion of this goal requires that all the preparatory work scheduled for 2019-20 be accomplished in time. Otherwise, the gap between actual growth and the very ambitious targets set across all economic development dimensions is set to accumulate quickly.

2019-20 is mostly about setting the stage for a higher growth starting from 2021

The analysis of national projects shows that in many cases the period of 2019-2020 is reserved for preparatory work, which consists in developing necessary legislation (notably in such spheres as business regulation and supervision, digital economy,

support to export and to small and medium businesses, ecology and labour productivity) or infrastructure project documentation. One of the key reforms that is to be accomplished by the end of 2020 is regulatory guillotine (a complete overhaul of the current business regulation that encompasses more than 20000 norms some of them almost 100 years old). The reform aims to cancel obsolete regulation and to make a new much more transparent framework for each industry. The importance of this reform shouldn't be underestimated as according to the calculations of the ministry of economic development better regulation should contribute the most (4.8% points) to acceleration of economic growth on 2024 horizon. Improved regulation is seen as a key capable of unlocking investment potential for Russian companies.

**SPENDING GROWTH ON NATIONAL PROJECTS – 2021**



Source: Macrobond and Nordea

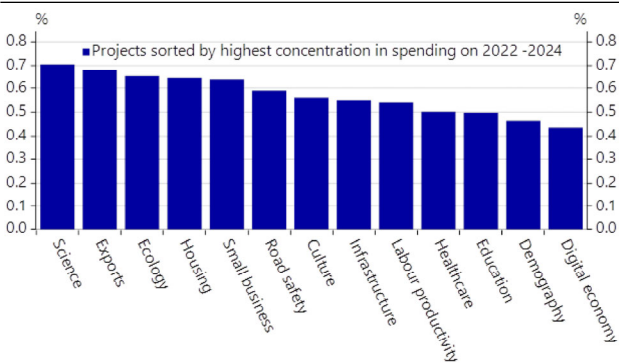
Spending on some infrastructure projects set to increase in 2020

Another crucial dimension of the national projects for 2020 is the comprehensive plan to modernise the country's infrastructure. The plan accounts for a quarter of the total national project financing scheduled through 2024. Significant construction activity (roads, railways, ports and airports) is included in the plan and is meant to send waves of higher internal demand throughout the economy. The projects related to sea port development, better functioning of the Northern passage, railway construction, and road building between centres of economic growth should get on a more active track in 2020, contributing to economic growth. In our view, delivering on 2021 growth targets hinges on continuous progress in these projects, as well as on additional spending on high-speed railway construction.

Non-energy exports were underperforming compared to targets in 2019

Support for non-energy exports is the third pillar of economic development on the 2024 horizon. The official target is to almost double the value of these exports by the end of 2024, bringing it to USD 250bn USD, from USD 180bn in 2018). The government considers metals, chemistry, agriculture and machinery exports as the key drivers of this breakthrough. So far in 2019, the actual performance has been noticeably behind the target. The underperformance was broad-based, with metals, wood and agriculture lagging the most. Subdued global demand amid an economic slowdown acted as an external obstacle. Hopefully, 2020 may turn out slightly better thanks to significant monetary stimulus added in 2019 around the world. However, if noticeable underperformance persists in 2020, the 2024 goals may start looking very distant.

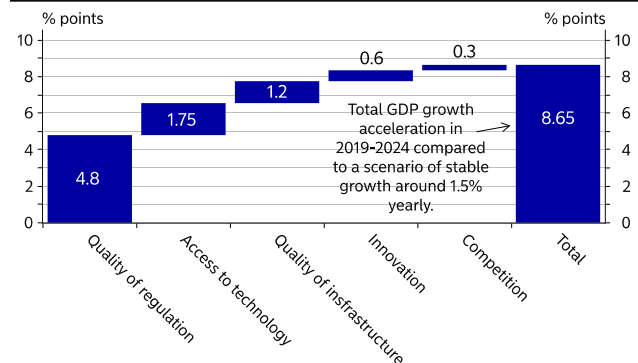
**CONCENTRATION OF SPENDING ON NATIONAL PROJECTS**



Source: Macrobond and Nordea

**GDP GROWTH COMPONENTS**

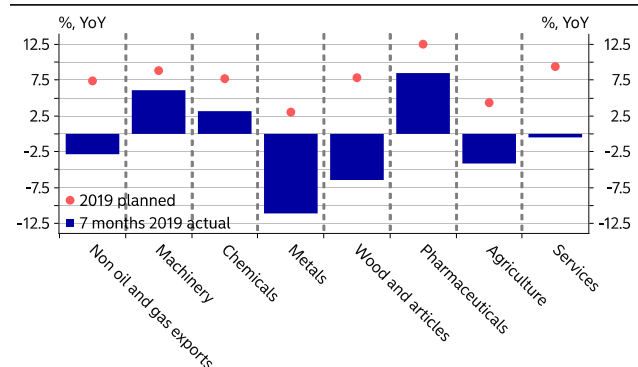
Better regulation is the key to a higher growth



Source: Macrobond and Nordea

**EXPORT SEGMENT GROWTH**

Non-oil exports not growing as expected in 2019



Source: Macrobond and Nordea

# RUB: Moderate optimism ahead of 2020

Our RUB outlook for 2020 largely reflects our general stance on emerging markets. We expect the second half of the year to be more positive than the first one.

## Lowest volatility since 2014

After a sharp weakening to above 66 to the USD in August, the RUB returned to more comfortable levels and has been range bound since mid-October, remaining most of the time between 63.5 and 64.5. Most of the moves within this band were generated by trade war-related news in an otherwise uneventful market. RUB volatility continued to decline and is currently at the lowest level since the crisis of 2014. RUB history shows that without exchange rate targeting lower volatility is hardly possible.

## Moderate trade war escalation is a key risk for H1 2020

Developments relating to US-China trade talks - which are highly uncertain - remain the key driver of the RUB, in our view, meaning that the volatility could actually rise at any time. A lot of positive news has been priced in by the market, which appears to be expecting a so-called Phase 1 deal between US and China. However, we believe that a deal, if any, will most likely be delayed until 2020. It is now much easier to disappoint market participants than to positively surprise them with trade talk developments. That's why in our forecast RUB risks are tilted to a moderate weakening (to around 65 for USDRUB) in the next 6 months.

## Don't forget about sanctions during the election year

Sanctions risk, though in our view completely priced out by the market right now, still cannot be taken off the table. Most existing sanctions threats are linked to alleged Russia's meddling in US elections. This topic could easily re-emerge during the US elections cycle. We believe that even a simple discussion of sanctions initiatives after a long break could put some pressure on the RUB. Thus, we see sanctions as another factor supporting our expectation of a moderate RUB weakening in the next 6 months.

## We become more positive on the longer horizon of 2020

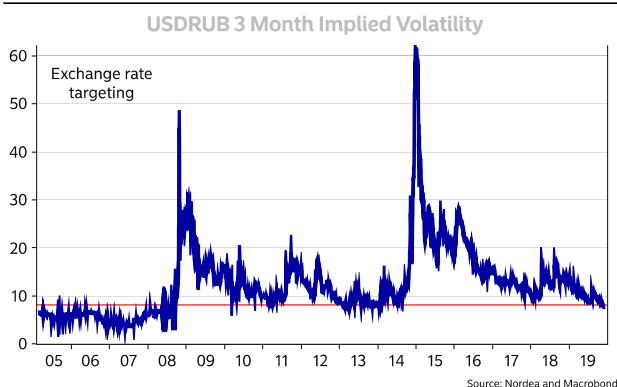
We used to expect that a RUB recovery would come in in 2021, driven by stronger global growth momentum. However, we now see decent chances of an earlier recovery of the world economy thanks to decisive monetary easing by major central banks in developed and emerging economies in 2019. This may improve risk sentiment on the global markets and support the RUB. In our new forecast, we therefore expect some moderate RUB rebound in H2 2020 to levels around 64.

## The EUR might rebound after another shaky three months

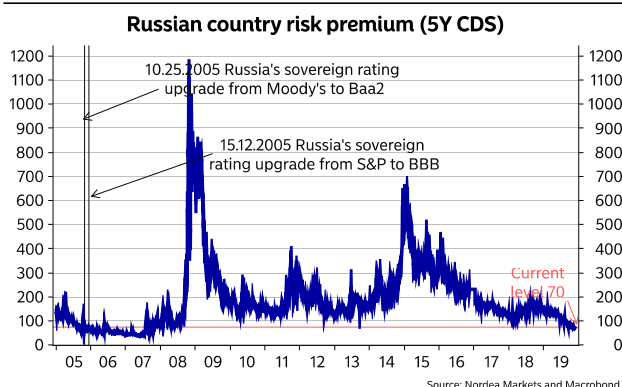
The EUR will likely continue to face challenges in the next three months as the European economy is still struggling. The flip side of this is a relatively stable EURREB of around 70-71. At the same time, we still see a possibility of a rebound of the EUR in H2 2020, supported by stronger economic performance in the EU and by an increasing probability of an orderly Brexit. Thus, the RUB might move towards 74.9 versus the EUR by the end of 2020.

We have become less bearish on the RUB, in line with our [slightly more optimistic view on EM](#). Still given that by now the markets have priced in quite a lot of positive news it's easy to get disappointed if trade war negotiations get off the rail. That is why we still see downside risks or at least limited appreciation space on 3-6 months horizon. The second half of next year may give more hope.

### USDRUB VOLATILITY BACK NEAR TEN-YEAR LOWS



### ANOTHER RATING UPGRADE STARTING TO BE PRICED IN



# Nordea forecasts for Russia

## MACRO FORECASTS FOR RUSSIA

	2017	2018	2019E	2020E	2021E
<b>Real GDP, % y/y</b>	<b>1.6</b>	<b>2.3</b>	<b>1.1</b>	<b>1.5</b>	<b>1.8</b>
Private consumption, % y/y	3.3	2.3	1.7	1.8	2
Fixed capital investments, % y/y	5.2	2.9	1.5	3	5
Industrial production, % y/y	2.1	2.9	2.5	3	3
Unemployment rate,% y/y	5.1	4.8	4.5	4.3	4
Inflation, % y/y	2.5	4.3	3.5	4	4
Federal budget balance	-1.7	2.6	1.8	1	0.8

Source: Macrobond, Nordea estimates

## FINANCIAL FORECASTS FOR RUSSIA

	Spot	End 2019	Mid-2020	End 2020	End 2021
USD/RUB	63.9	64.5	65.0	64.0	66.0
EUR/RUB	70.4	70.3	73.5	74.9	80.5
Policy rate	6.5	6.25	6	6	6

Source: Macrobond, Nordea estimates

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