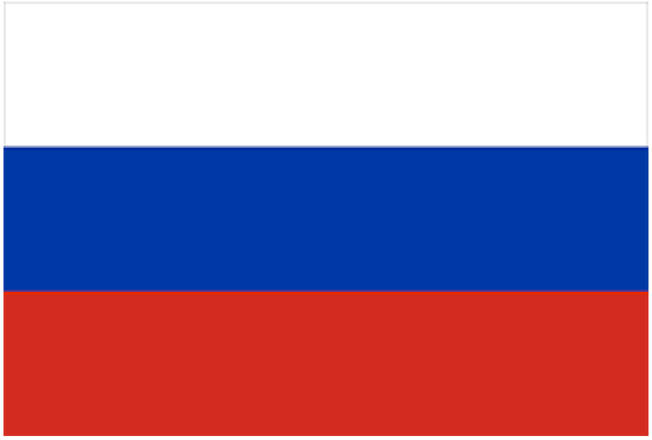
Charles Kintner 19 September 2021

Russia Macroeconomic Report



Economic Profile

Country	Russia
Currency	Russian Ruble
Population	144.4 Million
Economy	Mixed
GDP	1.7 trillion USD
GDP PPP	4.05 trillion USD
Largest Trading Partner	China

Market Outlook

Point in Cycle	Right-of-Trough
Outlook	Bullish

Source: Russian Federal State Statistics Service

<u>Macroeconomic Thesis:</u>

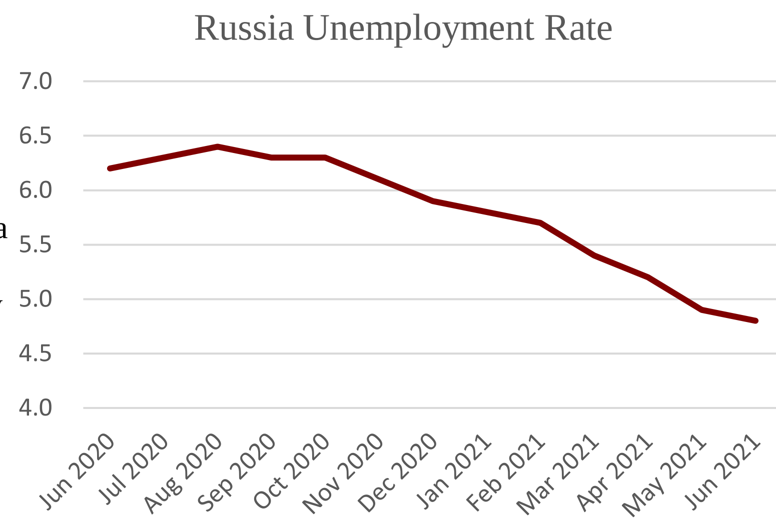
After analyzing a variety of economic indicators, I believe that Russia's position is right-of-trough in the current economic cycle. While the coronavirus pandemic affected the Russian economy particularly hard, recovery has been strong. This recovery is due in part to rising commodity prices and the strength of demand for industrial products. Secondary industrial products such as base manufacturing materials make up the majority of industrial output, and demand is increasing from Europe and North America who are responding to heightened needs for heavy machinery and tertiary products. Oil prices have risen for the past six months due resulting from arbitrage done by OPEC – because Russia's energy industry makes up thirty percent of GDP, energy prices have bolstered economic growth. Because of recent OPEC production cuts, it seems this trend will continue until the end of the year.

Geopolitical concerns are not to be discounted, however. Unsurprisingly, Vladimir Putin once again won the General Election by an extremely slim margin (50.2%), beating out the Communist Party for the third election in a row. Because of this, Putin now has the ability to run for reelection up to and including the 2030 election. Putin's economy is distinctly corporatist, where the Kremlin exerts an undue influence on companies in return for political and geopolitical support. As a result, market autonomy is diminished, which reduces efficiency. Due to the instability of free-market activity, foreign investment is becoming increasingly rare. International investors fear the instability of the Russian economy from sporadic government interaction, and languishing growth from suffocating Western sanctions. While these influences hamper growth, the economy is still strong, with or without foreign capital.

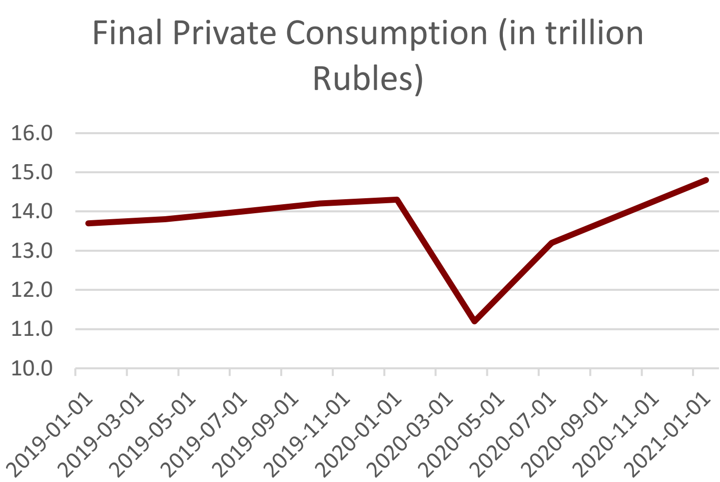
Economic Indicators

Unemployment

Russia's unemployment rate, like many other advanced economies, experienced a record high over the summer of 2020, reaching a rate of nearly 6.5 percent. However, with a broad economic recovery both in Russia and abroad, the unemployment rate continues to drop along with unemployment claims. Russia has a relatively lackluster social safety net (relative to the U.S.), which could be responsible for people's return to work. Regardless, this lagging indicator points to a strong recovery.



Source: Russian Federal State Statistics Service



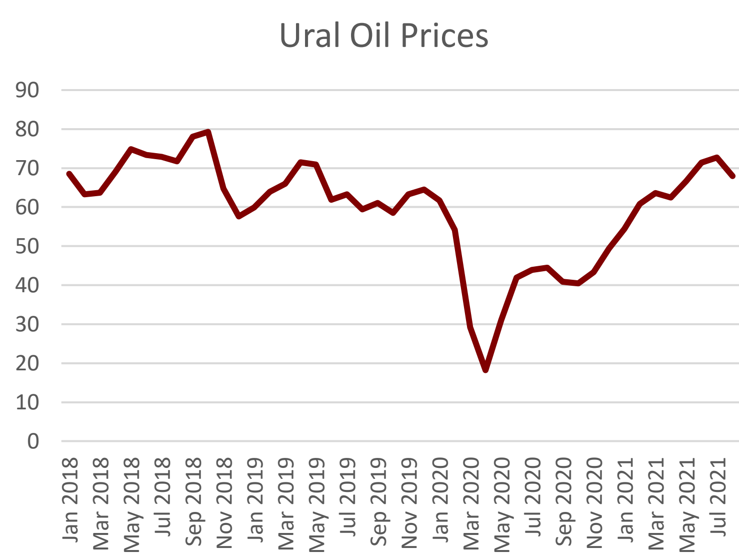
Source: St. Louis Federal Reserve

Consumer Spending

Consumer spending is arguably the most important short-run determinant of economic growth, and the largest component of GDP. The coronavirus pandemic and its ensuing economic turmoil drove this index down nearly thirty percent from February to May of 2020. The strong recovery is due mainly in part to the unleashing of pent-up demand, excess savings, and an increase in consumer confidence. According to Deloitte, many Russians are purchasing more luxury items and expensive foodstuffs in Q2 2021 relative to Q1 2020. All of these insights indicate a recovery in consumer expenditure, keeping GDP stable.

Oil & Gas Industry

Oil has had a particularly tumultuous year, with barrel prices hitting a decade low of eighteen dollars in March of 2020 due to a price war between the Russian Federation and Saudi Arabia. Oil and gas make up sixty percent of Russia's exports and thirty percent of GDP. Hence, the price of oil and natural gas can be indicative of the Russian economy. Russia leads OPEC+, a secondary group of oil exporters that work in concert with OPEC. Through arbitrage, they have managed to increase the price of oil steadily, driving the barrel price to its yearly peak. This combined with an increase in the price of natural gas due to Asian cold snaps makes for a bullish energy market, thus stimulating the energy sector.



Source: Statista

Economic Indicators

Source: Russian Federal State Statistics Service

Heavy Industry

Heavy industry makes up 1/3 of Russian GDP. Industrial output has been heavily impacted by COVID-19 shutdowns and ensuing supply chain problems – as a result, a record low was achieved in the first quarter of 2020. After this rut, industrial output continues to increase at a decreasing rate – this is the result of increased input costs as well as a general lack of consumer confidence. Despite rising costs, there is a surge in demand for primary and secondary industrial goods in the European and North American markets.

Inflation

The Consumer Price Index, or CPI, is the measure of inflation in a given country. The inflation rate in Russia can most likely be attributed to a high cost of inputs that drive up "checkout" prices, also called the cost-push inflation spiral. Since the trend has flattened out as of late (and has not increased dramatically relative to years prior) we can surmise that inflation will most likely be at normal levels moving forward, and of less concern. This is due in part to the raising of interest rates by the Russian Central Bank, up nearly three percentage points YOY.

Source: Russian Federal State Statistics Service

Source: Russian Federal State Statistics Service

Gross Domestic Product

Real GDP, or Gross Domestic Product, is the value of all goods and services produced in a given year in a country. Real GDP is adjusted for the price level index of the year, which makes it a more accurate measure than conventional GDP that is not weighted against a currency. Extrapolating from the most recent economic data (Q1 and Q2) it seems that Russian GDP has recovered, even surpassing 2019's peak. This shows that the Russian economy was able to pull out of an economic tailspin better than many countries, mainly due to a surge in demand for industrial goods and rising oil prices.

Geopolitical Indicators

__Russian Elections__:

The Russian elections were once again a tumultuous one – Vladimir Putin's United Russia party took the election by a slim majority (50.2%), beating the Communist Party by nearly thirty-one percentage points. This election, like many before it, are marred by accusations of voter fraud, intimidation, and racketeering. Unless the alleged voter fraud cases are explored and rectified, it seems likely that Vladimir Putin shall remain the President of Russia for at least another decade, running in his last election in 2030 as allowed by the current constitution, which he also amended to retain continuous power. Russia has remained a superpower due to their geopolitical influence derived from wielding nuclear weaponry. This has given power to Russia, assisting in Putin's annexation of Crimea, creating the People's Republic of Donetsk and Luhansk, a Russian puppet state. While Russia has gained territory from this war, it also incurred vast financial and trade restrictions from the European Union and the United States. As a result, the exporting economy shrank along with industrial and agricultural businesses. This example is one of many that demonstrate Putin's negative influence on the Russian economy through his violent geopolitical agenda.

__Oligarchy and Economic Influence:__

After the fall of the Soviet Union in 1991, the industry of Russia was not privatized in a democratic manner. The industrial power of the Russian Federation was divided amongst a dozen or so oligarchs close to the Kremlin. As a result, the Russian government possesses a unique influence over the economy, which is why it is characterized as being a mixed or corporatist economy. This interaction between the Russian government and the oligarchs reduces the efficiency of the free market, disincentivizing foreign investment who believe their capital is not entirely under the management of the recipient. In addition, investors fear increasing nationalism, Western sanctions, and economic stagnation. As a result, several infrastructure projects have gone to pot between 2016 and 2020 due to a languishing supply of foreign capital. Financial sanctions still remain in place as of 2021, which still hinders Russia's infrastructure projects.