

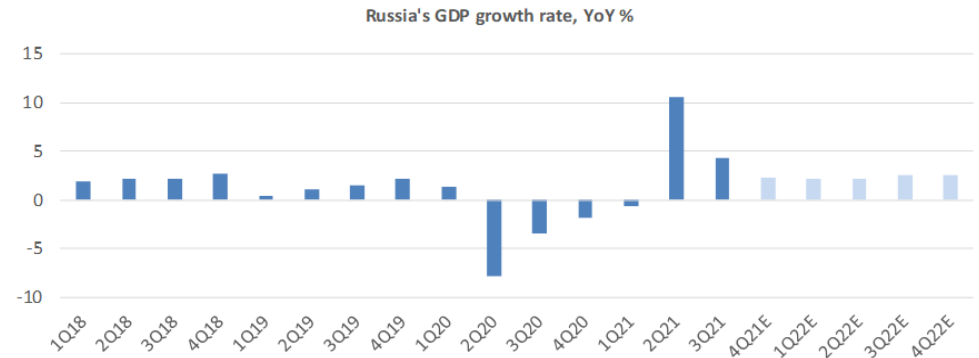
Russia Economy

Current Trends and Prospects

- ❑ The economy is showing a broad recovery, aided by a very strong government financial position. Rising inflation and the high interest rate are the main concern
- ❑ The government will focus more on its own resources to fund projects, social improvements and to incentivize investment
- ❑ Growth is set to slow in 2022 and (possibly) 2023 due to an expected decline in private sector investment
- ❑ Sanctions risk, linked to the situation on the Ukraine border, is also affecting the investment outlook
- ❑ The major long-term concern for the economy is the steady decline in the available workforce and how the government can counter this
- ❑ Russia's recovery plan is based on diversification, localization and incentivization

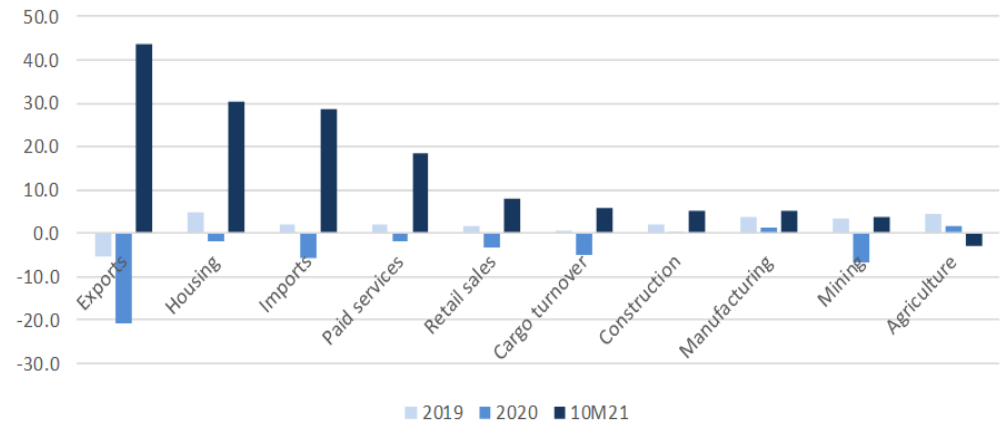
- ❑ Growth is slowing due to A) base effect, B) slower recovery in investment spending, and C) the impact of higher interest rates
- ❑ MED expects growth of 3% in 2022, after 4.5% this year. More likely growth will slip to 2.5%
- ❑ Agriculture is the main drag on growth this year, due to weather factors

Russia's GDP Growth Rates: Fact & Forecast, % Change YoY



Source: State Statistics Agency, Macro-Advisory estimates

Growth Trends by Main Sector, % Change YoY



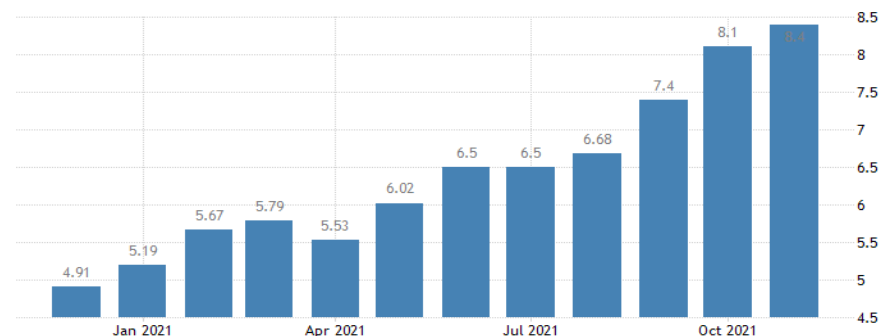
Source: State Statistics Agency

- ❑ **CBR hikes rate by 100bp, retains a hawkish signal.** In a widely anticipated move by the market, Russia's Central Bank decided on December 17th to raise its key 1-week repo rate by 100 bps to 8.5%. Although this decision puts the real key rate into a positive territory for the first time since October 2020, it also shows that CBR has significant concerns over the future inflation trend and therefore prefers to keep a hawkish stance in the monetary policy area
- ❑ **In our base-case scenario we expect no more rate hikes...** we see a hawkish signal from CBR more as a verbal intervention and a PR exercise. As of late, the bank has been experiencing significant political pressures to act decisively against rising inflation from various quarters, including the Kremlin
- ❑ **RUB exchange rate is the key.** During late spring period, the role of the currency rate in framing of inflation becomes critical: lower RUB leads to higher import prices and, through that, to acceleration in CPI rate, while stable and/or stronger RUB rate helps to keep import prices under control and thus greatly facilitates moves to control inflation. We therefore expect that CBR will continue to make efforts aimed at keeping the local FX market balanced
- ❑ **Stable RUB rate as real key rate remains positive.** Provided we do not see a major deterioration in global geopolitical area and a massive spike in world inflation, we expect Russian ruble exchange rate to remain stable in the RUB70-75/US\$1 corridor. We also forecast a gradual softening in the domestic CPI rate with annualized inflation falling below 8% YoY mark in March-April 2022

- ❑ Inflation is the main economic, political and social concern
- ❑ Partly “global” and partly because of the poor harvest
- ❑ Food inflation is near 11%
- ❑ Government is capping fuel and food prices
- ❑ Central Bank is very hawkish – the key rate is at 7.5%, from 4.5% in January

Russia Inflation and Rates

Headline Inflation, % Change YoY



SOURCE: TRADINGECONOMICS.COM | FEDERAL STATE STATISTICS SERVICE

Source: Tradingeconomics.com, Federal State Statistics Service

Key Rate, % (LHS) and Interbank Rate, % (RHS)



SOURCE: TRADINGECONOMICS.COM

Source: Central Bank of Russia

- ❑ The ruble had rallied 7% versus the US dollar and 13% versus the euro until the recent oil price fall and the tensions over Ukraine
- ❑ The ruble is driven by:
 - Oil price
 - Sanctions concern
 - Rising interest rates
 - Economic recovery and Covid-19
- ❑ The government prefers a stable ruble in a RUB68-73/US\$ range

Ruble-Dollar Exchange Rate



source: tradingeconomics.com

Source: Trading Economics

- ❑ The draft budget specifies that such investment should:
 - Generate annual income at levels not lower than federal borrowing costs that year
 - NWF funds would comprise no more than 25% of the entire investment in any project
 - Economy Ministry has selected 32 infrastructure and other projects that would be eligible to receive NWF funding from 2022-24

- ❑ The draft budget also assumes a surplus of 1.1% and 0.3% of GDP in 2022 and 2023, respectively, and a deficit of 0.2% of GDP in 2024. The oil price (Urals US\$/bbl) average assumption is conservative, based on:

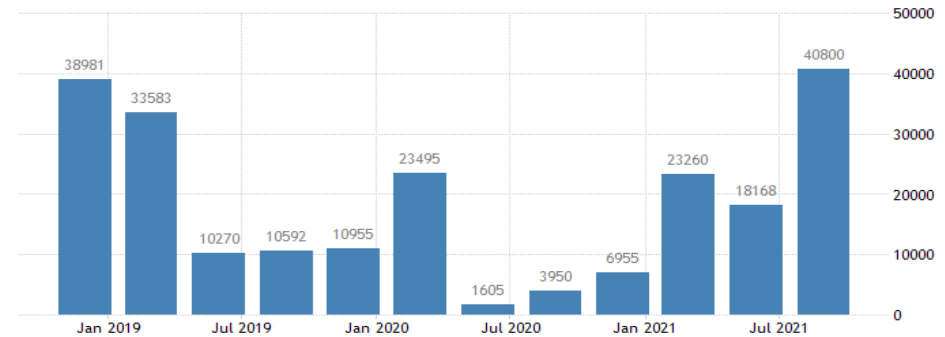
| | |
|--------|----------|
| ▪ 2021 | US\$66.0 |
| ▪ 2022 | US\$62.2 |
| ▪ 2023 | US\$58.4 |
| ▪ 2024 | US\$55.7 |

- ❑ Sovereign debt is expected to reach 19.4% of GDP in 2022 and increase to 20.1% of GDP in 2023 and 20.8% of GDP in 2024. From 2022-24, the Government plans to borrow US\$3 bln externally each year

- ❑ Some extra budget spending to boost consumer sectors and construction
- ❑ Focus on value-added investment in energy, natural resources and in sectors where Russia has competitive advantages
- ❑ Tax-based incentives for investors, mostly at a regional level
- ❑ But an effort to raise taxes in areas seen to generate super-profits (metals) and where owners are paying higher dividends than investment spend
- ❑ Priority is to control, and reduce, inflation
- ❑ Creating a stable economic and social backdrop – because of global risks and global uncertainties

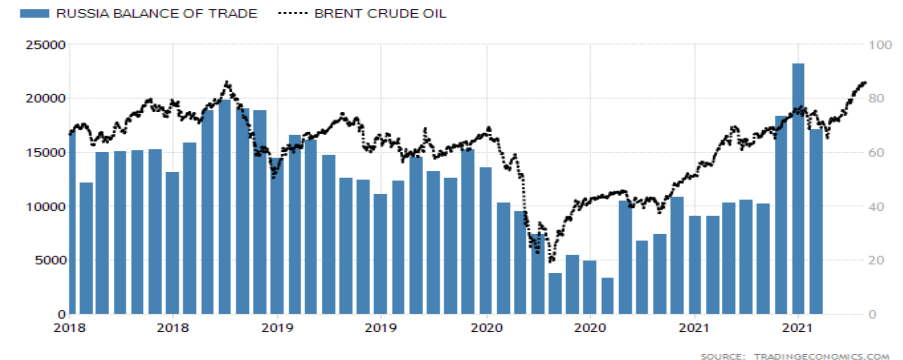
- ❑ Record CBR reserves - US\$622.5 bln
- ❑ US\$191 bln in National Welfare Fund
- ❑ Rising budget surplus
- ❑ Budget breakeven is US\$55/bbl oil
- ❑ Record 3Q21 current account surplus
- ❑ Total national debt is 19% of GDP
- ❑ Household debt is low at 22% to GDP

Current Account, US\$ million - Record Q3 Surplus



Source: Central Bank of Russia

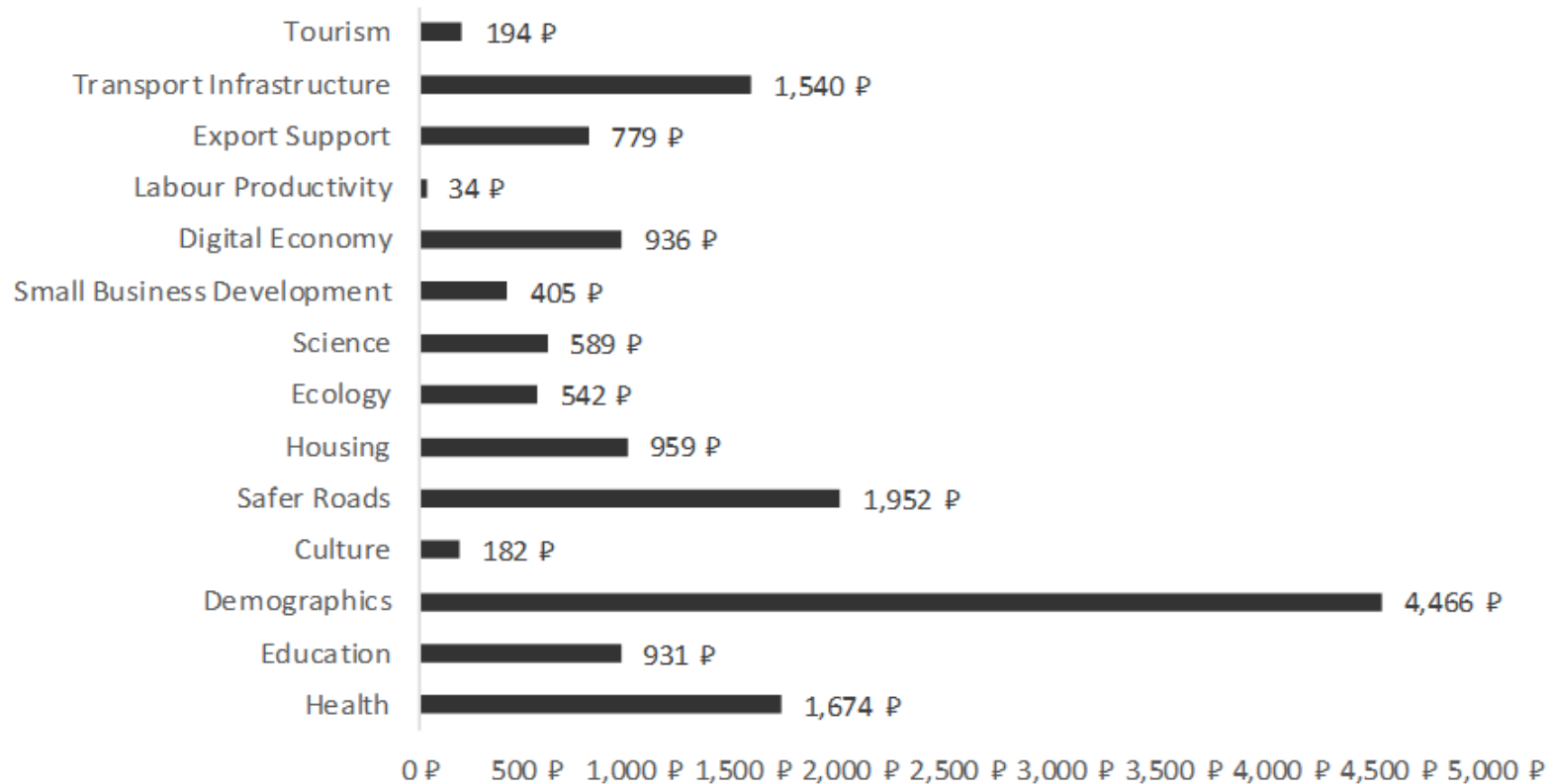
Trade Surplus (\$ mln) is rising with Oil and Gas Exports



Source: Central Bank of Russia

- Investment into sectors that can create high-pay employment can diversify exports and protect the economy
- Value-added processing in all extractive industries, such as chemicals, timber, metals
- Tax reforms that can A) incentivize investment and B) cap dividend payments
- Localization, but with a more realistic approach
- Focus on rising social conditions and raising real disposable incomes

National Projects: Spending Allocations, RUB billion



Source: Ministry of Economic Development

National Goals KPIs to 2030

| Maintaining Population | Self Realization and Talent Development | Environment | Labor and Entrepreneurship | Digital Transformation |
|--|--|---|---|--|
| <ul style="list-style-type: none"> • Sustainable population growth • Increasing life expectancy from 71 in 2020 to 78 by 2030 • Halving the poverty rate from 13% in 2020 to 6.5% in 2030 | <ul style="list-style-type: none"> • Russia in top 10 education systems • Russia in top 10 for scientific research and development • Moral and cultural education • 15% of Russians involved in volunteer activity • Triple visits to cultural events | <ul style="list-style-type: none"> • Improve housing for 5 million families annually • 120 million sqm per year • 50% improvement in urban environment • 85% of roads to urban quality level • Non-recycled urban waste down 50% • Harmful emissions down 50% • Remove polluting objects from water objects, including the Volga, Baikal, Teletskoye | <ul style="list-style-type: none"> • GDP growth faster than global average • Incomes grow faster than inflation • 70% growth in investment relative to 2020 • Non-commodity exports grow 70% relative to 2020 • 25% of workforce in SMEs | <ul style="list-style-type: none"> • "Digital maturity" in key sectors especially healthcare and education • 95% of social services supplied digitally • 97% of households with high speed internet • 300% rise in investment in domestic IT |

Source: Government Statements

| | 2021(F) | 2022(F) | 2023(F) |
|-------------------------------|---------|---------|---------|
| ❑ GDP | 4.5% | 2.4% | 2.3% |
| ❑ Inflation, year end | 8.4% | 4.8% | 4.1% |
| ❑ CBR, key rate | 8.5% | 7.5% | 6.5% |
| ❑ Retail Sales, % YoY | 8.7% | 2.9% | 3.4% |
| ❑ Budget Balance, % GDP | 1.3% | 1.5% | 1.1% |
| ❑ Average oil price, \$ p/bbl | \$67 | \$75 | \$78 |
| ❑ RUB/US\$, year end | 74.3 | 70.6 | 71.1 |
| ❑ RUB/Euro, year end | 84.1 | 85.4 | 86.7 |

See table on slide 37 for more details

- ❑ Inflation and high debt service costs
- ❑ Demographic trends, an already tight labor market and rising real wages
- ❑ Supply chain disruptions – mostly out of Russia's control
- ❑ Legacy of geopolitics and sanctions risk
- ❑ The government's preference is to support big corporations
- ❑ Covid-19 – Emergence of Omicron

- ❑ The key risk is a conflict on the Russia-Ukraine border
- ❑ Both the US and EU have made clear statements that Russia will face “severe” and “economically damaging” sanctions if Russia invades Ukraine
- ❑ The main threat concerns the removal of Russia from SWIFT
- ❑ Before recent events, the US-Russia engagement was improving and, despite Ukraine, there have been more pragmatic moves this week
- ❑ The threat of sanctions has been removed from the NDAA (Defense bill) in the US
- ❑ It appears that the US wants a more predictable engagement with Russia while it focuses on repairing the German relationship and dealing with China

- ❑ Russia is not a strategic priority for the Biden Administration
 - Rebuilding alliances and mending fences with Berlin, Paris, and Brussels
 - China as the #1 national security concern and top adversarial power
 - Getting Iran back to the negotiating table and signing a new agreement
 - Right-sizing US presence in Mideast and Central Asia

- ❑ But a more engaged and constructive relationship with Russia is seen as necessary for these primary objectives

- ❑ NordStream-2 sanctions are deemed overly aggressive by the White House
 - These sanctions target Europe and Europeans rather than Russia

Belgian Entity

- EU regulated
- Shareholders are commercial banks
- Overseen by G-10

Messaging system

- Electronic instructions to transfer money
- Can be bypassed (inefficiently)

Sanctions

- Can cut off individual banks by removing them from instruction lists
- Sanctioned Iran under EU instructions

Counter Sanctions

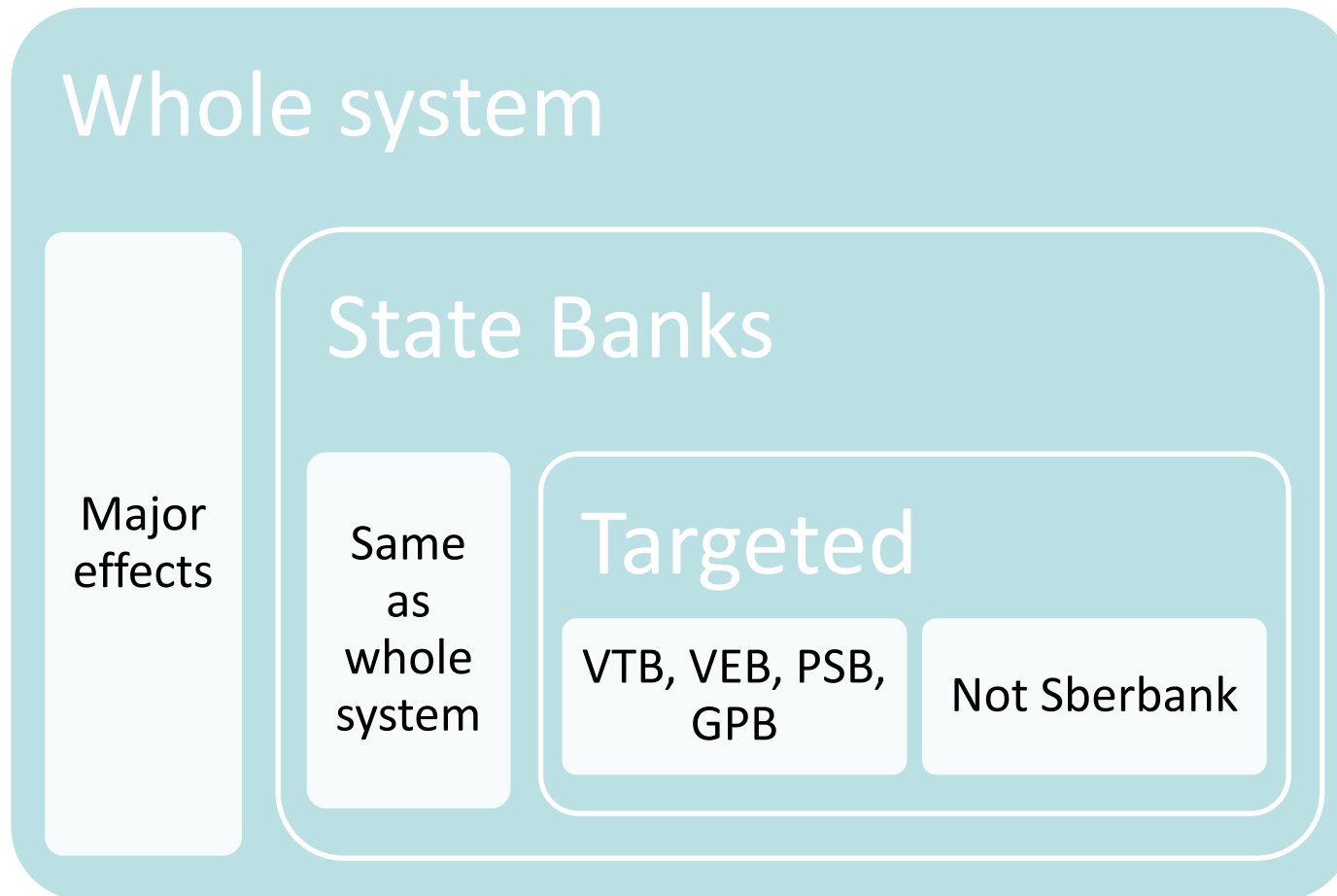
- Debt default (can't pay)
- Non-delivery of gas (can't be paid)

Unintended Consequences

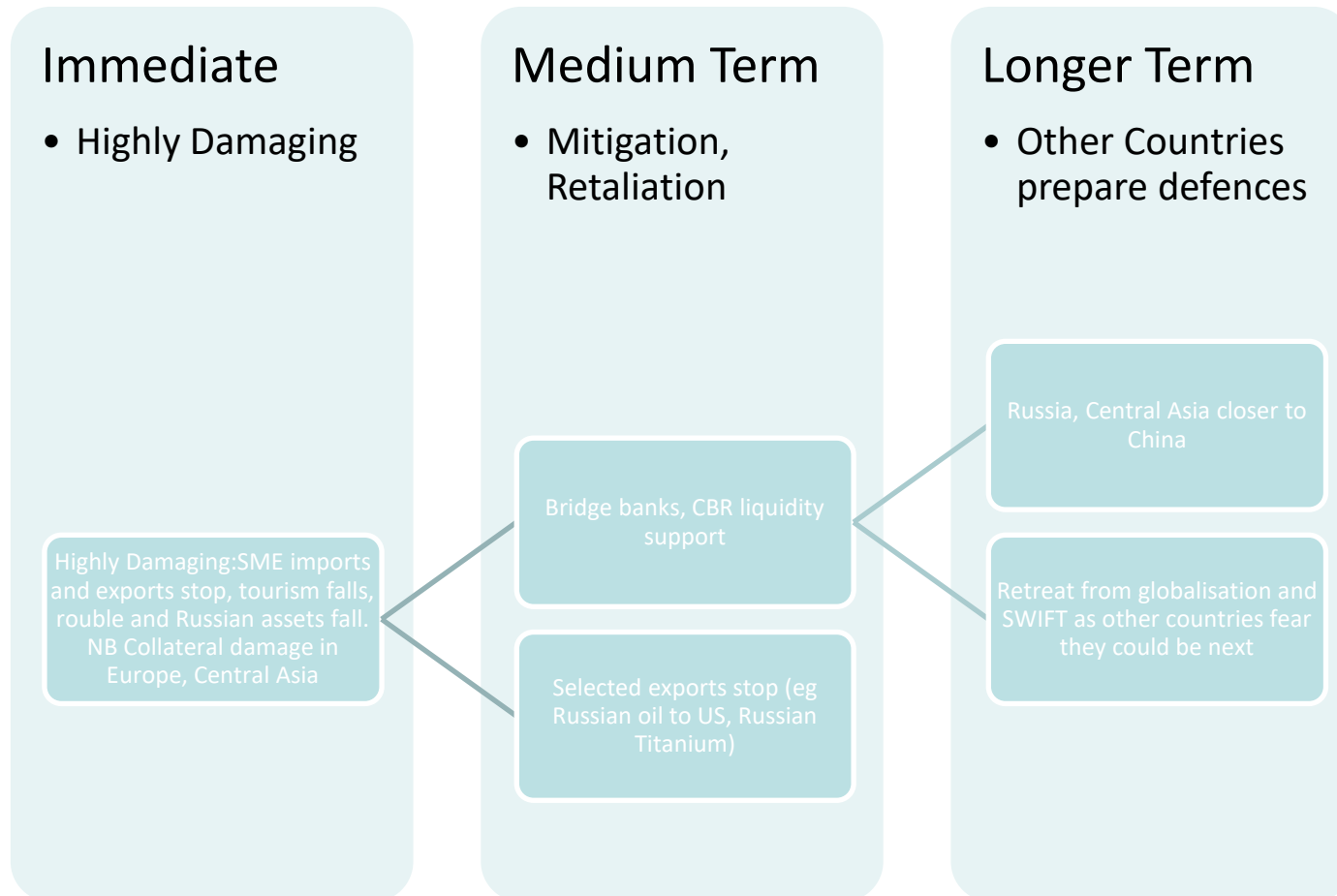
- Belarus sanctions hurt Lithuania rail
- Titanium sales to the US
- Rocket sales to the US

Long term

- Russia, China invest more in digital currencies
- EU will look to protect itself long-term from extra-territorial US actions



If Sanctions are Imposed



Domestic

- Fast payments system is 20% of Russian market, can be expanded
- Although NB Russian software projects often fail at scale
- Domestic credit card systems can operate

International

- Banks can build “bilateral SWIFT”, especially at wholesale level
- Options via Russian subsidiaries of international banks, foreign branches of Russian banks

Reality since 2014

- Central Bank has had time to push systemic banks to crash-test their systems
- Individual banks have contingency plans

Geopolitics

- Russia and China will draw closer, economically and politically
- Alliance not a marriage
- Central Asian states drawn in

Globalisation

- Other countries will fear they will be a similar target in the future
- What if Trump had this option?
- All countries build reserves and redundancy to mitigate

Russia free to act

- “Only when you have lost everything, only then are you truly free.” - Solzhenitsyn
- Now it no longer fears the ultimate sanction, Russia will not feel the need to cooperate with the West

- ❑ The economy has come out of the 2020-21 crisis in good financial shape and with minimal disruption
- ❑ Workforce demographics represent a major challenge for 10-15 years
- ❑ Geopolitical threats and sanctions risk had started to ease but have reemerged and may affect investment in 2022-23
- ❑ Russia knows it needs to improve the investment climate to attract more private investment
- ❑ Actively engaging in global and domestic climate management offers real opportunities

Russia: Macro Trends & Medium Term Forecasts

| | 2016 | 2017 | 2018 | 2019 | 2020 | 2021E | 2022E | 2023E |
|--|--------|--------|---------|---------|---------|---------|---------|---------|
| GDP, RUB bln, nominal | 85,616 | 91,843 | 103,862 | 109,242 | 106,967 | 118,431 | 126,094 | 132,896 |
| GDP, US\$ bln | 1,276 | 1,575 | 1,657 | 1,687 | 1,482 | 1,617 | 1,818 | 1,895 |
| Growth, real % YoY | 0.3% | 1.8% | 2.8% | 2.0% | -3.0% | 4.5% | 2.4% | 2.3% |
| CPI - year-end, % YoY | 5.4% | 2.5% | 4.3% | 3.0% | 4.9% | 8.4% | 4.8% | 4.1% |
| CPI- average, % YoY | 7.1% | 3.7% | 2.9% | 4.5% | 3.4% | 6.7% | 6.6% | 4.2% |
| Gross fixed investment, real % YoY | -0.2% | 4.8% | 5.4% | 2.1% | -1.4% | 5.7% | 6.4% | 6.0% |
| Industrial production, real % YoY | 1.3% | 2.1% | 3.5% | 3.4% | -2.1% | 5.3% | 4.8% | 3.4% |
| Agricultural output, % change YoY | 4.8% | 3.1% | -0.6% | 4.3% | 1.5% | -2.0% | 1.9% | 2.5% |
| Central bank key rate - year-end, % | 10.0% | 7.8% | 7.75% | 6.25% | 4.25% | 8.50% | 7.50% | 6.50% |
| Bank average lending rate, % | 13.0% | 10.5% | 10.0% | 8.5% | 8.0% | 10.0% | 9.5% | 8.3% |
| Retail sales, % YoY | -4.6% | 1.3% | 2.8% | 1.6% | -3.2% | 8.7% | 2.9% | 3.4% |
| Real disposable income, % YoY | -4.5% | -0.5% | 1.1% | 1.0% | -2.8% | 3.6% | 1.2% | 0.9% |
| Unemployment - year-end, % | 5.3% | 5.1% | 4.8% | 4.6% | 5.9% | 4.6% | 4.5% | 4.5% |
| Budget, balance % of GDP | -3.5% | -1.4% | 2.7% | 1.8% | -3.8% | 1.3% | 1.5% | 1.1% |
| Trade Balance, \$ bln | \$90 | \$115 | \$195 | \$166 | \$94 | \$167 | \$136 | \$131 |
| Current account, \$bln | \$25 | \$35 | \$114 | \$65 | \$33 | \$123 | \$117 | \$80 |
| Current account, % GDP | 2.0% | 2.2% | 6.9% | 3.8% | 2.2% | 7.6% | 6.4% | 4.2% |
| RUB/US\$, year-end | 60.7 | 57.6 | 69.5 | 61.9 | 73.9 | 74.3 | 70.6 | 71.1 |
| RUB/US\$, average | 67.1 | 58.3 | 62.7 | 64.8 | 72.2 | 73.7 | 69.4 | 70.1 |
| RUB/EUR, year-end | 63.8 | 68.9 | 79.5 | 69.4 | 90.8 | 84.1 | 85.4 | 86.7 |
| RUB/EUR, average | 74.7 | 65.7 | 73.2 | 73.0 | 82.2 | 87.2 | 82.2 | 85.2 |
| Brent, US\$ p/bbl, average | \$44 | \$54 | \$71 | \$64 | \$42 | \$67 | \$75 | \$78 |

Source: State Statistics Agency, Central Bank, Macro-Advisory estimates

Our Russia coverage includes regular updates about economic and political trends, industry updates, business relevant themes and briefings

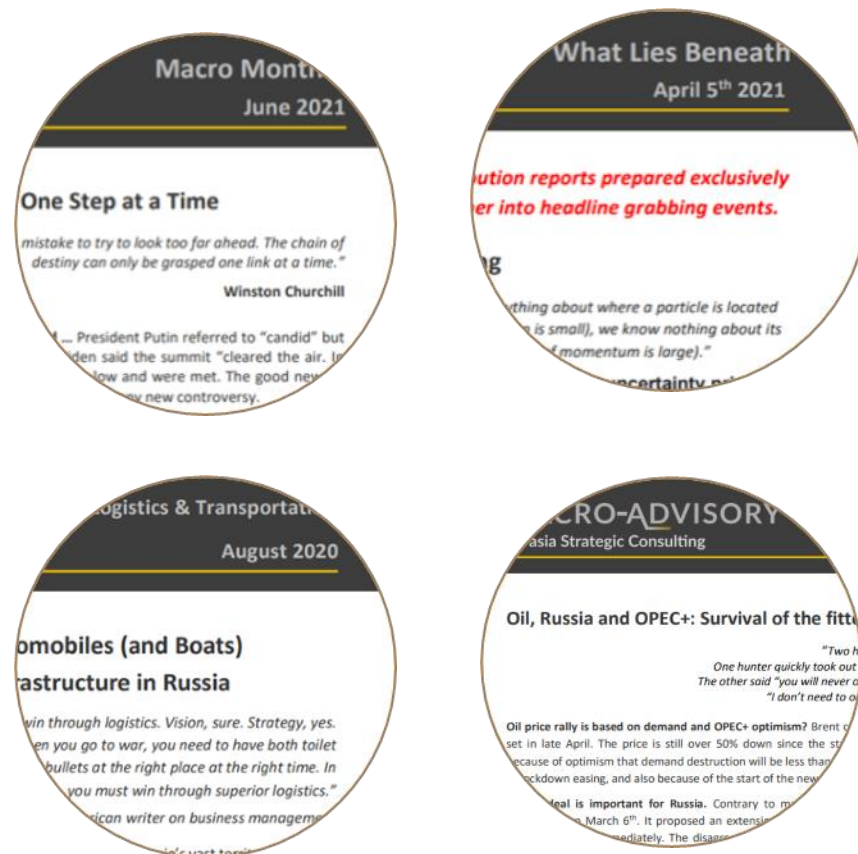
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