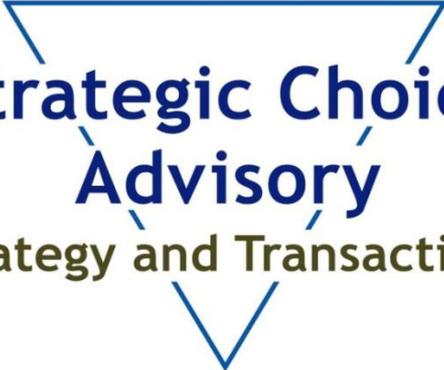


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**Strategic Choice  
Advisory**  
Strategy and Transactions



**Russia Macro Foresight**  
Special Report: Covid-19 Impact, Outlook, Strategic Options



June 2020

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## Observed impact of Covid-19 epidemic and related restrictive measures on Russia's economic performance

- After a period of slow but steady overall growth, which actually included robust expansion in industries driven by import substitution, **severe contraction started to be observed in a number of sectors** in April
- Lockdown and other restrictive measures forced multiple businesses to shut their doors or seriously downsize operations, which **has started to affect industries formally not under the restrictions**, e.g. manufacturing and cargo transportation
- **CPI inflation accelerated slightly** to 3.1% y/y in April, driven by food prices amid mass hoarding, as well as RUB depreciation, **but remains subdued** due to weak purchasing power. Meanwhile, strong PPI deflation is observed at -10.4% y/y, due to the demand slump
- Official unemployment has shot up 3.5-fold over Mar-Apr, as government introduced corresponding benefits for the unemployed, while **ILO-definition unemployment surged** from 4.6% to 9-year high 5.8% in April
- Income & wage data has not yet been published for April (an unusual occurrence), but it is fairly clear the **population's incomes have been hit badly**
- **Banking sector data is not overly representative at this point**, as there are various government support measures affecting credit quality and other key metrics. **But fallouts will be only natural**, going forward
- Foreign trade data is only available through March, but as oil prices dropped sharply, exports were down 20% y/y already, while imports were slowing less sharply. It is obvious that **weaker purchasing power will keep affecting imports, and notably reduced exports will also shrink the trade surplus**, constraining already tight market liquidity. Oil prices are starting to recover, though, which can support the surplus.

# Balanced scorecard of epidemic's influence - but first, a backdrop on pre-Coronavirus dynamics

Indicator, % y/y	2016	2017	2018	2019
Industrial production	1.3	2.1	2.9	2.4
Cargo transport turnover:	1.8	5.5	2.7	0.6
Railway	1.6	6.4	4.2	0.2
Automobile	0.4	2.3	2.3	5.8
Agriculture	4.8	3.1	-0.2	4.1
Retail trade	-4.6	1.3	2.8	1.6
Construction, o/w:	-4.3	-1.2	6.3	0.6
Housing	-6.0	-1.3	-4.5	4.9
Fixed capital investment	-0.6	4.4	5.4	1.7

Segment, % y/y	2018	2019	Segment, % y/y	2018	2019
Food products	4.9	4.9	Textiles	3.6	-1.1
Bottled water	14.3	17.6	Apparel	4.1	0.6
Chemicals	2.7	3.4	Footwear	3.7	-5.8
Fodder feed	3.4	2.8	Confectionery	5.6	-0.6
Medical equipment	43.3	36.7	Machines & equipment; related:		
Pharmaceuticals	8.2	19.6	Electrical equipment	2.9	0.6
Computers & electronics	-1.5	8.0	Tractors	-2.1	-8.1
Washing machines	2.4	5.1	Metal-cutting equipment	2.6	-0.1
Metal products	1.3	8.9	Automobiles	13.3	-1.9
Wood products	10.6	5.3	Car tires	6.9	-9.3
Building materials	4.4	4.6	Truck tires	1.9	-16.6

## Balanced scorecard of epidemic's influence on selected range of sectors (1/2)

Period	2019	2020	2021	2022-2023	2020-2023
Weight in Balanced scorecard	--	0.4	0.3	0.3	1.0
Industry/Segment (scale: 1-5)   Horizon	Pre-Coronavirus	Current*/Short-term	Mid-term	Long-term	Total
Extraction, oil & gas	2	1	2	3	1.9
Extraction, non- oil & gas	3	2	3	3	2.6
Manufacturing	3	2	2	3	2.3
Food & beverages	4	4	4	3	3.7
Textile & apparel	3	2	2	3	2.3
Wood products	4	2	2	3	2.3
Pulp, paper & printing	3	4	3	2	3.1
Oil products	3	2	2	3	2.3
Chemicals	4	4	4	4	4.0
Pharmaceuticals	5	4	4	4	4.0
Resins & plastics	3	2	3	4	2.9
Building materials	4	2	3	3	2.6
Metal products	3	2	3	3	2.6
Computers & electronics	4	2	2	3	2.3
Machinery & equipment	4	2	2	4	2.6
Transportation equipment	4	1	2	3	1.9
Furniture	3	2	2	3	2.3
Medical equipment	5	4	4	4	4.0

\* - Latest data for Jan-Apr 2020

Color legend	1.0-1.4	1.5-1.9	2.0-2.4	2.5-2.9	3.0-3.4	3.5-3.9	4.0-4.4	4.5-5.0
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## Balanced scorecard of epidemic's influence on selected range of sectors (2/2)

Period	2019	2020	2021	2022-2023	2020-2023
Weight in Balanced scorecard	--	0.4	0.3	0.3	1.0
Industry/Segment (scale: 1-5)   Horizon	Pre-Coronavirus	Current*/Short-term	Mid-term	Long-term	Total
Agriculture	4	4	4	3	3.7
Retail trade	3	2	2	3	2.3
Cargo transportation	3	2	2	3	2.3
Construction	3	2	2	3	2.3
IT & Communication	4	4	4	4	4.0
Personal services	3	2	2	3	2.3
Delivery services	4	4	4	3	3.7
Entertainment	4	1	2	3	1.9
Tourism & Hospitality	4	1	1	2	1.3
Restaurants & Catering	3	1	2	2	1.6
R&D, Innovation	4	3	3	4	3.3
Healthcare services	5	4	4	4	4.0
Banking & Insurance	3	2	2	3	2.3
Education	3	3	3	3	3.0
Repair services	3	2	3	3	2.6
Utilities	3	3	3	3	3.0
Passenger transportation	3	1	2	3	1.9

\* - Latest data for Jan-Apr 2020

Color legend	1.0-1.4	1.5-1.9	2.0-2.4	2.5-2.9	3.0-3.4	3.5-3.9	4.0-4.4	4.5-5.0
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## Comments on Balanced scorecard methodology

- The scores are assigned on a scale of 1 to 5, and the higher the score, the better the outlook
- The colors are assigned in line with the traffic light color pattern: thus, the closer to the red end of the color spectrum, the worse; the closer to the bright green end, the better. Yellow means generally safe/stable (not a warning sign!)
- Although the scores are difficult to quantify in terms of exact measurements, as each sector contains numerous, very diverse segments, here are the general principles:
  - ✓ 5 - output growth at the level of tens of percentage points (pps) y/y, or generally very robust
  - ✓ 4 - growth somewhere from 3-4% y/y (above average for the Russian economy) to 10-12% y/y
  - ✓ 3 - growth in the lower single-digits, or marginal declines (just below zero), after robust growth in previous years (thus, it may have plateaued and/or is affected by the high base)
  - ✓ 2 - declines from lower single-digits to around 10% y/y (the latter, if rather strong readings had been observed previously)
  - ✓ 1 - output contraction at the level of tens of pps y/y
- Scores for 2020 are assigned both for current performance (based on latest available Jan-Apr data), as indicated in the column title and footnote, and the outlook for the remainder of the year
- Our base scenario, considering our focus on working in the healthcare sector, and experience in dealing with the latest and other known coronaviruses, is that there will be several waves of the epidemic (three major ones, most likely). The overall duration of the acute phase of the pandemic is expected to make up around three years from the start of the outbreak, i.e. from late 2019
- We are also mindful of the fact that such viruses sometimes disappear suddenly or become less aggressive (only to come back stronger and more effective in several years or even decades). Therefore, it is important to think in scenarios, and make plans for the business accordingly

1. **Possibility of Covid-19 second wave** this autumn, and third (subsequent?) wave(s) in 2021 (2022?), **dampens recovery prospects for a lot of sectors.** Performance can thus be very uneven, for some time to come, due to government restrictions and market inhibitions
2. **Sectors driven by import substitution are expected to recover faster,** pending a demand rebound. E.g. computers & electronics, machinery & equipment, R&D and innovation, chemicals, etc.
3. **Sectors boosted now by crisis demand are expected to return to normalized performance** in the long run. E.g. food & beverages; agriculture; delivery services; pulp, paper & printing, etc.
4. **Some sectors that are holding up fairly well so far,** coming off of strong performance in previous years and in Q1/2020, **are expected to slump** further this year and in the mid-term due to demand weakness. **But they should recover to generally positive readings** toward 2022, depending on the pandemic situation. E.g. textile & apparel, computers and electronics, cargo transportation, etc.
5. **Certain sectors will be supported by additional infrastructure investments,** including in the framework of emergency response and situation planning. **But growth therein should normalize, slowing in the long run.** E.g. construction, building materials, metal products, certain chemicals and pharmaceuticals, etc.
6. **Outperforming industries may be a bit tricky,** as pent-up demand in some segments may be offset by lack of attention and investment in others. E.g. healthcare, medical equipment and drugs, chemicals, IT
7. **Word of caution: sectors enjoying increased attention now may also see severe competition and lower margins** in the long run. Thus, thorough business planning is needed to succeed

## Key issues and risks for foreign businesses in negatively impacted sectors

- As in various countries worldwide, multiple sectors have been affected dramatically, and **even those holding up more or less, may deteriorate quickly** with further waves of the epidemic, or eventually succumb to general economic weakness
- This means a great deal of **insecurity about customers' ability or willingness to pay, suppliers suddenly jumping ship**, and various other disturbances in relations with local counterparties
- **Government regulation and support measures remain rather obscure and convoluted**, or available only in Russian, being tailored to local companies; and bureaucratic procedures to obtain available support often leave much to be desired. That said, authorities generally tend to react to public criticism
- There is a risk that local businesses or, at least, **locally manufactured products will receive further, oftentimes disproportionate support** in various tenders and, again, government support measures
- The effect of **recent RUB depreciation has not been fully reflected in input prices yet**, thus even though the RUB is strengthening again on higher oil prices, input price hikes cannot be excluded. In general, prices in Russia tend to go only up, and not come down to original levels once inflationary factors have gone away
- **Purchasing power is expected to remain weak** for some time to come, and already present **over-saturation** in various sectors (including those boosted by the pandemic) **can erode margins**

- **Opportunities still abound in manufacturing**, which is holding up better than extraction and services. Especially as government support for import substitution and production localization keeps strengthening, and RUB weakness amplifies the competitiveness of locally made products. Again, such decisions need to be supported by thorough market analysis and forecasting
- By the same token, we expect R&D and innovation to become all the more important for the local economy. Therefore **partnering with local innovators and R&D institutes may turn out to be a good bet**. Especially given the abundance of local talent in Russia!
- **Financial support from HQ can allow targeting new market niches**, leapfrogging slower competitors, and/or **offering better financial terms** to local customers and other counterparts
- For the latter, **relations with local banks**, likely in conjunction with financial institutions from your home countries, can **help develop offerings that will boost your competitiveness** in Russia
- Also, as consumers increasingly drift online for product/service purchases, it **makes sense to develop a broader online presence** and find ways to reach consumers faster, more effectively
- **Overall, digitization will be the key to success** in many sectors, from manufacturing (think: Industry 4.0 or Connected Society 5.0) to services, and beyond. **Finding ways to ramp up your IT platforms and products may become a gamechanger** for your Russian business
- Plus, now may be the time to optimize sales & distribution channels, **focusing on local partners who are the most motivated to sell your products**.
- Last but not least, **excelling in service quality can become a key differentiator** and ensure customers' loyalty

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