Putin hits a bad patch

by Ian Bond
7 May 2020

Vladimir Putin could look forward to a good year when the Kremlin clocks signalled the start of 2020. His situation looks much less rosy now. Russia's problems may have implications not only for Putin but for Western countries.

At the turn of the year, Putin had celebrated 20 years in power, and faced no serious domestic opposition. Russia had achieved macro-economic stability, with inflation at 3 per cent (even if living standards for ordinary Russians had hardly risen in a decade). Oil prices, at around $60 per barrel, were high enough to boost Russia's already sizeable sovereign wealth fund. The US and EU were internally divided and pre-occupied with their own problems; and he had developed a strong relationship with President Xi Jinping of China, the leader of the rising superpower.

Putin used his annual address to the Russian Parliament on January 15th to announce significant increases in social spending; call for further improvements in the healthcare system; and propose a number of changes to the Russian constitution. In March, in an obviously staged manoeuvre, the Russian MP and former cosmonaut Valentina Tereshkova proposed a further constitutional amendment that would allow Putin to remain president until 2036. A popular vote was scheduled for April 22nd to endorse the package of constitutional amendments. On May 9th Putin planned to hold a grandiose military parade to celebrate the 75th anniversary of the end of the Great Patriotic War, with foreign leaders including Xi and French President Emmanuel Macron in attendance; his status would thus be acknowledged at home and abroad.

Since then, however, the oil price has collapsed and the COVID-19 pandemic has gripped Russia. Those two developments in combination are leading to a sharp contraction in GDP. The rest of 2020 will be very challenging for Putin.

When first China and then other countries began to shut down large parts of their economies in response to the outbreak of COVID-19, the oil price began to fall: Russia's Urals crude fell from a high point this year of $62 on January 9th to $50 on February 11th. At this point markets probably anticipated that Russia would join Saudi Arabia and other major oil producers in cutting production to match global demand.

Instead, Igor Sechin, the CEO of Rosneft, Russia's state-owned oil major, and a former KGB colleague of Putin, reportedly persuaded the president not to cut production, thus launching a price war. Sechin seems to have thought that this move would primarily hit US shale oil producers (whose production costs are much higher than Russia's); and that Saudi Arabia would cut production even if Russia did not, in order to prop up the price. The Saudis, however, reacted by lowering prices and increasing production, sending oil prices into free fall. Despite a subsequent agreement between Russia and Saudi Arabia to reduce production (seemingly brokered in part by Donald Trump), Urals crude fell to $12 by April 21st, before recovering to around $21 at the time of writing.

In 2019, income from oil and gas accounted for 39 per cent of Russia's federal budget revenues (down from 46 per cent in 2018). The budget breaks even at around $42 per barrel; if there is a budget surplus, it goes into the National Welfare Fund (which stood at $157 billion, 11 per cent of Russia's GDP, at the end of March 2020). With oil prices as low as they are currently, however, Russia will have to start taking money out of the fund to plug gaps in the budget – though according to finance minister Anton Siluanov the fund would still last until 2024.

While the oil market was in turmoil, COVID-19 began to spread in the country, increasing the economic damage. Russia responded slowly and in a piecemeal fashion. The first reported cases of COVID-19 in Russia involved Chinese nationals, and a ban on the entry of visitors from China was imposed on February 20th. By March 27th, almost all flights from Europe had been stopped. Lockdowns were also imposed gradually, region by region and with varying restrictions. Moscow was among the first places to issue a stay-at-home order, and with the strictest measures, obliging people to get a permit for almost all movement outside their homes.

Despite the steps taken, the daily increase in cases in Russia is second only to that in the US, and does not yet seem to have peaked. As of May 6th, Russia had recorded almost 166,000 cases, comparable to Germany's 167,000 cases; reported deaths in Russia, however, were only 1,537, compared with Germany's 6,993. There are suspicions that Russia is under-reporting COVID-19 deaths. There are also concerns about the ability of the healthcare system to cope, particularly outside major cities. An unofficial count shows that healthcare workers make up 7 per cent of total deaths (compared with an estimated 0.6 per cent in the UK). Putin admitted in a television broadcast to the nation at the end of April that there were shortages of personal protective equipment for medical staff.

The spread of COVID-19 has forced Putin to postpone the celebration of the end of the war – though not before a significant number of soldiers rehearsing for the parade had caught COVID-19. For now, Putin has lost the chance to underline his status by appearing alongside other world leaders in Red Square.

More importantly, Putin has had to postpone the popular vote on the amendments to the constitution. In legal terms, the changes can enter into force without such a vote, but having offered the population a chance to state their views Putin may find it politically difficult to cancel it altogether. A vote later in the year, however, would take place against a very different economic background, which might discourage Russians from voting for (potentially) 16 more years of Putinism.

Estimates of how badly low oil and gas prices and COVID-19 will affect the Russian economy vary, but two of the most pessimistic forecasts come from the Central Bank of Russia, which estimates a 4-6 per cent fall in GDP this year, and from Aleksey Kudrin, chair of the Russian Audit Chamber (the equivalent of the UK's National Audit Office), who forecasts a 7-8 per cent fall in GDP. That would be similar to the impact of the global financial crisis, when Russia's GDP fell by 7.8 per cent in 2009.

Unlike many Western governments, the Russian authorities have so far taken only modest steps to mitigate the economic effects of COVID-19, providing less than 3 per cent of GDP in loans and fiscal assistance (by comparison, according to the Bruegel think-tank, Germany is making available around 60 per cent of GDP and the UK about 21 per cent). This reflects Putin's reluctance to borrow money abroad (fearing the political leverage it might give creditors) or even to draw too heavily on the National Welfare Fund (which he sees as a guarantee of national sovereignty rather than a tool of economic management). The government could issue more rouble-denominated debt to domestic lenders, but seems reluctant to do so at present.

Despite making so little funding available, at the beginning of April the Russian government drew up a list of 646 'systemically important' enterprises whose financial health it would monitor and to which it would provide financial support if needed. These included not only large Russian companies such as Gazprom and Rosneft, but also Russian subsidiaries of firms like Volkswagen and Renault. These firms can get tax relief and direct support. SMEs can get a six-month tax holiday, plus loans or grants to cover part of their salary costs; and the regulatory burden on them has been reduced. There are serious doubts that the amount made available will be enough to cushion the twin impacts of low hydrocarbon prices and the coronavirus lockdown, however.

Some Russian commentators worry that there is too little support for SMEs, and that Putin, who has admitted that he instinctively sees retailers as swindlers, will not be unhappy if more of the Russian economy ends up in the hands of state-owned enterprises or companies controlled by his associates. Others are more optimistic, thinking that the crisis is an opportunity for the government to launch long overdue structural reforms. A prolonged recession, however, is likely, since global demand for hydrocarbons will probably recover only slowly. It would be hard for the government to stimulate private sector investment and innovation against such an economic backdrop, even if the authorities could create a better business environment. Putin may not be able to make good on his promises of increased social spending – even if some of those pledges are included in the constitutional amendments.

Not for the first time, Putin has responded badly to a domestic crisis: in the early stages, the Kremlin seemed mainly to want to push responsibility onto regional governors to ensure that they would take the blame for any shortcomings, rather than showing Putin taking control of the situation. Recent opinion polls show that Putin still has approval ratings that any Western leader would envy – 59 per cent – but that is the lowest figure since he became prime minister in 1999. If his response to the crisis still seems inadequate once the pandemic is over and the focus turns to economic recovery, he may struggle to regain altitude, even if the constitution gives him the right to remain in power more or less for life.

In this situation, relations with China will be even more important than before. Despite being the first country affected by COVID-19, China seems to have suffered less than most others, and is getting back to work. Nonetheless, its growth this year is likely to be much lower than originally predicted. If the Chinese authorities turn to infrastructure investment as an engine of recovery, Russia will be well-placed to supply the commodities needed. But lower global prices will also increase Beijing's leverage: Russia will need China as a buyer more than China needs Russia as a supplier. Even China, however, cannot rescue the Russian economy on its own.

The question for the West is how Putin deals with the economic crisis and the decline in his popularity, and whether he might look to rally popular support with a foreign adventure, or instead try to improve relations with the West. The past offers little help in predicting his next steps. In the early 2000s, as the economy grew stronger, Putin became more assertive externally, culminating in the invasion of Georgia in August 2008. In 2014, with economic growth slowing and oil prices falling, the annexation of Crimea reversed a fall in his popularity.

For the moment, reassuringly, the Russian domestic media has toned down its criticism of the West (even if externally RT and other channels continue to spread conspiracy theories about COVID-19, including blaming the US military for it). But the leading Russian sociologist Alexey Levinson has warned that if the economic situation causes social tension in Russia, anti-Western rhetoric is likely to resume. The West needs to monitor Russian domestic and external narratives closely for danger signs, such as propaganda designed to inflame Russian public opinion against an external enemy, or to persuade Western public opinion that (say) one of Russia's neighbours is behaving in a way that justifies Russian intervention.

At the same time, the COVID-19 pandemic also offers an opportunity for the West to show itself in a positive light in Russia. Though Putin proposed to G20 leaders in March that there should be a "moratorium" on sanctions, he has done nothing to deserve the lifting of Western measures imposed after his intervention in Ukraine. But as the medical situation in many European countries begins to improve, they should consider offering more assistance to Russia, and include Russian scientists in international collaboration to come up with vaccines and treatments for the coronavirus. The West should be guided by pragmatic self-interest when it comes to combating an infectious disease in a country bordering on Europe.

Ian Bond is director of foreign policy at the Centre for European Reform.