MONITORING OF RUSSIA'S ECONOMIC OUTLOOK:

TRENDS AND CHALLENGES OF SOCIO-ECONOMIC DEVELOPMENT

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MAIN TRENDS AND CONCLUSIONS

A forthcoming change in the Federal Reserve's top management and the permanent nature of China's political leadership, globalization of U.S. sanctions against Russia and unexpected growth in crude oil prices make up a unique set of overseas uncertainties that potentially can affect the Russian and the global economies.

The change in Fed's top management raises questions about the continuity of Fed's policy, and about the independence of the new Fed's Governor faced with President Trump's unveiled desire to influence the world's most powerful financial regulator.

By contrast, the recent National Congress of the Communist Party of China left no doubts as to the outmost and long-lasting strengthening of the Chinese President. However, there are doubts as to where China's economy is heading. Except for the acknowledgement of environmental issue, the rest of the statements were deliberately blank as though serious challenges facing China were hidden behind the veil of political slogans and ceremonies. A lack of intelligible answers is a true factor of global economic uncertainty.

A new package of U.S. sanctions against Russia and Russia's foreign partners has turned out to be as such. While being in many ways similar to the existing list of sanctioned companies and organizations involved in the mechanic, tool and aircraft engineering industries, a new list is extended to include any potential foreign partners of such companies and organizations. There is a deliberate lack of definitions, although the point at issue is nothing but so-called major transactions. In other words, both decisions on sanctions and concerns about their imposition are embraced by a vast uncertainty, including, besides Russian enterprises, foreign suppliers and foreign buyers (even, potentially, civil aerotechnics). New oil-related sanctions appear to be insignificant in this context: the sanctions will cover overseas deepwater, arctic and shale projects of Russian companies, if any of these kick off next year. Small in numbers, such projects are not critical for Russian producers (they are used mostly for exchange of assets with foreign partners).

What is really critical for them and for the economy as a whole is the crude oil price which is now beyond $60 per barrel despite most of downbeat projections. According to estimates, this may generate extra Rb 250bn in federal budget revenues. What is most critical, however, is the reliance on and enduring interest in any oil dynamics: quotations, inventory movements, infrastructural construction, changes relative to other sources of energy. Regrettably, no sought-for economic dynamics derive from this.

Researches of the Gaidar Institute have concluded that in H1 2017 the industrial production dynamics exhibited deceleration in growth rates that were seen earlier in the year, and that the third quarter dynamics continued to follow the trend developed in the first half of the year. Industries that are neither related to infrastructural projects nor consumer-led continued to exhibit zero or negative dynamics. Manufacturing industries experienced growth in the manufacture of means of transport (owing to the extension of a demand promotion state program) and in the manufacture of chemicals.

Overall, the manufacturing sector has just a few clear-cut growth drivers, whereas the minerals extraction sector (whose figures were traditionally on the rise) has recently experienced a minor decline mainly because of oil output cuts as agreed under the recent OPEC oil cut deal.

Anyway, it is the increase in fuel and energy exports amid rising prices of respective products that contributed most to positive dynamics of the Russian exports as a whole. When analyzing the foreign trade turnover for January–August 2017, the authors have pointed to the fact that fuel and energy exports (61.4% of total exports) saw most of the increase at that time, up by 31.8% YoY. This was a major contributor to a positive foreign trade balance of $79.5bn. Meantime, imports saw quite a dynamic rise (up by 26.8%), too, which, according to our experts, was driven mostly by an appreciating rouble's real exchange rate, with an emphasis on the fact that this correlation was pronounced enough: the rouble's real exchange rate is a major contributor to export dynamics (in money terms).

The foreign market potential should play its part for at least some of enterprises. This may turn out to be essential when the industrial sector is faced with escalating sales problems.

Business surveys of Russian enterprises have shown that as of the end of Q3 2017 the balance of product demand assessments that looked extremely upbeat earlier in the year started to fall in July and went negative by September. Russian industrial enterprises' investment plans were not that optimistic as much as they were in Q1 2017, although their financial capacity did not deteriorate. Now, two thirds of enterprises consider their credit availability as normal (similar to what was recorded earlier in the year), however, the banking sector is faced with a situation that can hardly be regarded as absolutely normal owing to recent notorious bankruptcies and sweeping bank resolutions.

According to our experts, the Russian banking sector is faced with profit growth deceleration arising from extensive losses discovered in banks under resolution, although the book profit as of the end of the first three quarters of 2017 ran at Rb 675bn (the same period of 2016 saw the profit of Rb 635bn). The losses of banks under resolution emerged following the appointment of provisional administration – a compulsory procedure as part of the financial recovery (resolution) process – moving a great deal of assets to higher risk categories, which required immediate increase in provisions for losses on such assets. According to the experts, the financial statements of these banks released shortly before the commencement of financial recovery contradicted the reality, which brings some scepticism towards the performance figures of other banks, as well as leads to a conclusion that the Bank of Russia, as a banking market regulator, de facto has turned out to have limited control over financial status of most banks.

Excluding the top four loss-making banks, the rest of the credit institutions reached a profit of Rb 1141bn in January-September 2017 (up by 80% from the same period previous year). In addition, a great deal of profit was generated from regular banking operations, but this indicator was highly volatile in the course of the year. A significant contribution of state-run banks to the banking sector profit reflects their leading position in the market. However, low profitability of private banks discourage their owners to increase equity, thus securing their subordinate position to the public segment of the banking sector.

In the meantime, the retail banking segment appeared to be more vivid than the corporate sector faced with low lending activity. However, this was driven in part by an upturn in lending to higher than low-income and even low-income groups of population and therefore can hardly be regarded as positive factor if only because the real income dynamics still remains negative.

In this respect, the experts assess negatively the use of the minimum wage mechanism and a rise in the minimum wage as a way of reducing the level of poverty and regulating the labour market. For example, according to their estimates, increasing the minimum wage to be in line with the living wage can reduce the level of poverty by mere 0.6 p.p. from 13–15% currently. The final conclusion is radical enough: conditions in Russia are so diverse that the minimum wage, if there is still any sense behind it, should be used primarily at the regional level rather than at the federal one.

1. THE RUSSIAN INDUSTRY IN Q3 2017: THE SAME TRENDS GO ON[1]

A.Kaukin, E.Miller

In Q3 2017, the dynamics of the industrial production index follows the H1 trends. Reduction of oil production in compliance with the extended agreement with the OPEC is observed. The expected growth in industrial output early in 2018 on the back of macroeconomic structural reforms and introduction of new state measures to support investment lending is not underpinned yet by the manufacturing sectors' output indicators.

H1 2017 saw a slowdown of growth observed in the beginning of the year in the dynamics of industrial production. The industries which were not related to infrastructure projects or aimed at consumer demand kept demonstrating zero or negative dynamics[2].

To analyze the dynamics of industrial production indices across individual sectors of the Russian industry in Q3 2017, the Gaidar Institute carried out on the basis of the up-to-date statistics published by the Rosstat a decomposition and singling out of the trend component of the series[3] in the breakdown as per the OKVED-2017 classification; the current year series were recalculated in compliance with the Rosstat's methods[4].

Presented in *Fig. 1–3* are the outputs of processing of the series of the industrial production index, the index of production in mining and the index of production in manufacturing. On the basis of the obtained data, it can be stated that the trends common to industrial production of the mid-2017 still prevail: the growth rates of around the zero level are observed. However, if the correlation between the dynamics of the manufacturing and mining sectors did not change much during the past few years, at present some changes are evident.

After the 2014 crisis, production of minerals started to demonstrate growth as early as the mid-2015 which fact could be explained by the level of prices that was acceptable to manufacturers and permitted them to increase the output[5].

However, according to the observations in the past three months (July–September 2017) the trend component of the output dynamics in mining demonstrated a slow decline. This correlation is related primarily to the extension of the agreement between the OPEC member-states on reduction of oil pro-

1 The authors express gratitude to M. Turuntseva and T. Gorshkova for their assistance in the statistical analysis.

2 For more details, see A. Kaukin and E. Miller. The Russian industry in the Mid-2017 // The Online Monitoring of Russia's Economic Outlook . Trends and Challenges of the Socio-economic Development. Issue No. 15 (53), September 2017.

3 Singling out of the trend component was carried out by means of the Demetra package with utilization of the X12-ARIMA procedure.

4 See A. Kaukin and E. Miller. The Rosstat's New Methods and Dynamics of Industries' Output Indices Early in 2017 // The Online Monitoring of Russia's Economic Outlook. Trends and Challenges of the Socio-economic Development. Issue No. 11 (49), June 2017.

5 For more details, see A. Kaukin and G. Idrisov. The Russian Industry in Q1 2016: The Beginning of Stagnation? // The Online Monitoring of Russia's Economic Outlook. Trends and Challenges of the Socio-economic Development, Issue No. 7 (25), April 2016.

duction for another nine months from July 2017 – the agreement in question was supported by Russia – and the agreement on monitoring of oil exports. It is to be noted that according to the statement made by A. Novak, RF Minister of Energy at the *Russia Calling* Investment Forum[1] the dynamics of other two components of the index of production – the natural gas and coal – would be positive at the end of the year. Natural gas production growth is related to higher export supplies required for replenishment of natural gas reserves at underground storages in the EU territory. According to the estimate by A. Miller, Chairman of the PAO Gazprom, on the basis of the year-end results the natural gas export volumes may grow to amount to Rb 200bn cubic meters[2]. Also, growth in coal production can be explained by an increase in exports, mainly owing to expansion of supplies to Chinese smelters.

It is worth mentioning the industry of manufacturing of transport vehicles which demonstrated growth (+103% in September 2017 on December 2016) starting from Q2 2017 which factor is probably related to the extension of the government program aimed at promoting demand and depreciation of the ruble early in Q3 2017. With the exchange rate difference taken into account, the products assembled in Russia are highly attractive in price terms which situation cannot but stimulate promotion of exports in this sector.

In September 2017, there was sustainable growth in the chemical industry (+127% and +108% as compared to July 2014 and De-

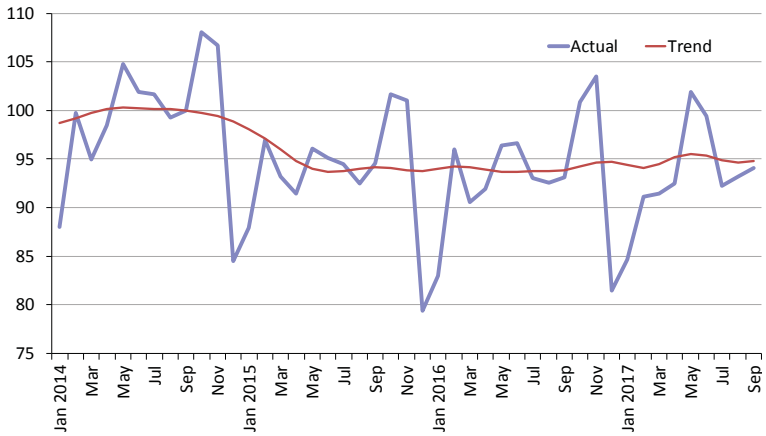

Fig. 1. The dynamics of the industrial production index in 2014–2017, the actual data and the trend component, % as compared to September 2014
Source: The Rosstat and own calculations.

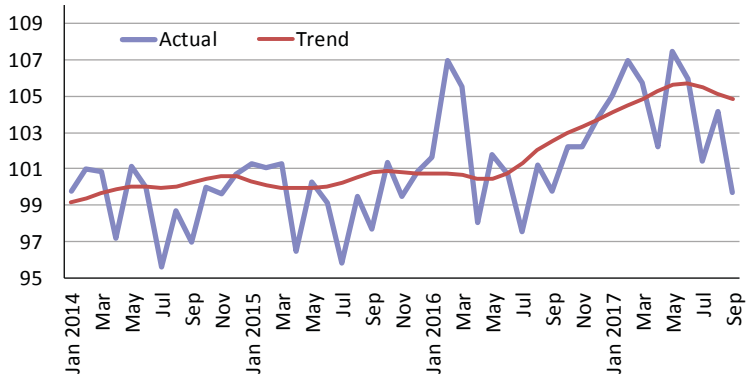

Fig. 2. The dynamics of the index of production in mining in 2014–2017, the actual data and the trend component, % as compared to June 2014
Source: The Rosstat and own calculations.

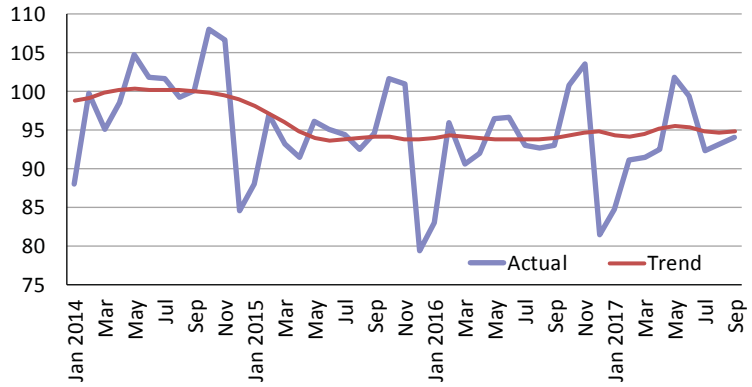

Fig. 3. The Dynamics of the index of production in manufacturing in 2014–2017, the actual data and the trend component, % as compared to September 2014.
Source: The Rosstat and own calculations.

1 Novak: Russia will increase gas production by 12% in 2017 // TASS, 24.10.2017. [http://tass.ru/ekonomika/4671704]

2 The Gazprom forecasts a higher export price of gas // RBK, 06.10.2017. [http://www.rbc.ru/business/06/10/2017/59d76d019a7947ab57ea2e7c]

Table 1

OUTPUT INDEX CHANGES ACROSS DIFFERENT INDUSTRIES OF THE ECONOMY

	Share in the industrial production index, %	September 2017 on July 2014, %	September 2017 on December 2016, %	Changes in the past few months (July–September)
Industrial production index		98.07	100.20	Slow decline
Mining	34.54	104.92	101.11	Slow decline
Manufacturing	54.91	94.60	100.04	Stagnation
including:				
Production of food products, including beverages and tobacco	16.34	109.37	103.46	Slow growth
Textile and sewing industries	1.14	99.56	107.28	Decline
Production of leather, articles made thereof and footwear	0.27	91.34	96.85	Decline
Wood-working and production of wood products	2.02	104.30	102.21	Growth
Pulp and paper industry	3.35	74.70	90.04	Decline
Production of charred coal and petrochemicals	17.25	98.35	100.49	Stagnation
Chemical industry	7.56	127.45	107.62	Growth
Production of rubber and plastic goods	2.14	105.66	103.57	Slow growth
Production of other nonmetallic mineral products	4.02	87.36	102.25	Stagnation
Metallurgy and manufacturing of finished metal products	17.42	103.19	113.52	Slow growth
Manufacturing of machinery and equipment	6.97	87.16	93.55	Stagnation
Manufacturing of electrical, electronic and optical equipment	6.27	88.42	98.41	Slow decline
Manufacturing of transportation vehicles and equipment	6.75	82.64	103.42	Growth
Other industries	2.42	80.77	97.67	Stagnation
Electricity, gas and water supply	13.51	100.80	99.53	Stagnation

Source: The Rosstat and own calculations.

cember 2016, respectively), production of rubber and plastic goods (+106% and +104% as compared to July 2014 and December 2016, respectively). This trend is expected to continue on the back of completion of many large investment projects in those industries late in Q3 (opening of a BASF plant in St. Petersburg, industrial facilities for production of highly concentrated formaldehyde in the Republic of Tatarstan and other).

So, in Q3 2017 the dynamics of the trend components of the manufacturing series points to the fact that trends of growth rates being close to the zero level still prevailed in most of the sectors. Some decline is observed in the mining sector. The industries which are able to compete on the international level have demonstrated small growth. Consequently, short-term economic growth forecasts (according to M. Oreshkin, RF Minister of Economic Development structural support measures, such as, for example, project financing and state guarantees will be factors of growth and creation of new manufacturing facilities)[1] as regards industrial production cannot be unambiguously proved and should be interpreted quite cautiously: at present only few explicit drivers of growth can be found in the manufacturing sector.

1 Maksim Oreshkin. The Russian Economy is Called the Best in the World // RBK, 24.10.2017. [http://www.rbc.ru/interview/economics/24/10/2017/59ef70019a79472530b39a42?from=center_1].

2. JANUARY–AUGUST 2017: SIMULTANEOUS GROWTH IN IMPORTS AND EXPORTS

A.Knobel, A.Firanchyuk

The positive dynamics of exports in value terms can be explained by improvement of pricing environment in respect of Russian export main commodities with relatively stable dynamics of exports in volume terms. The positive dynamics of imports in value terms is justified by appreciation of the ruble real exchange rate. Geographically, the trade turnover started to stabilize with an adjustment to slight growth in the trade with China.

Starting from November 2016, exports have exceeded the indices of the relevant months of the previous year (*Fig.* 1). In the first eight months of 2017, exports in value terms rose to $222.7bn, which is a quarter higher (+26.3%) than the level of January–August 2016. However, it is still lower than the indices of the earlier periods (94.8% and 64.4% of the level of January–August 2015 and 2014, respectively). The volume of exports of fuel and energy producing commodities (Customs Commodity Code 27) amounted to $136.6bn (61.4% of the aggregate exports), while that of other goods, to $85.7bn (38.6%). In the first eight months of 2017, growth in fuel and energy exports turned out to be more considerable (+31.8%) than that in exports of other goods (+18.6%). However, it is still below the level of January–August 2015 (–11.2%), while exports of other goods surpassed the level of 2015 (+3.9%), having approached the pre-crisis values (87% of the indices of 2013–2014).

In the first eight months of 2017, imports in value terms amounted to $142.7bn which is 26.8% higher than the relevant indicator of 2016 (*Fig.* 2). Nevertheless, imports are still much below the pre-crisis level of 2014 (-26.1%).

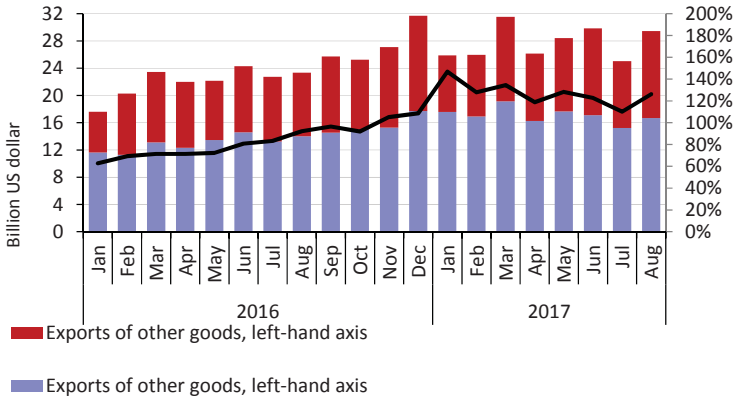

Fig. 1. The dynamics of Russian exports in 2016–2017

Source: own calculations based on the data of the Federal Customs Service of the Russian Federation.

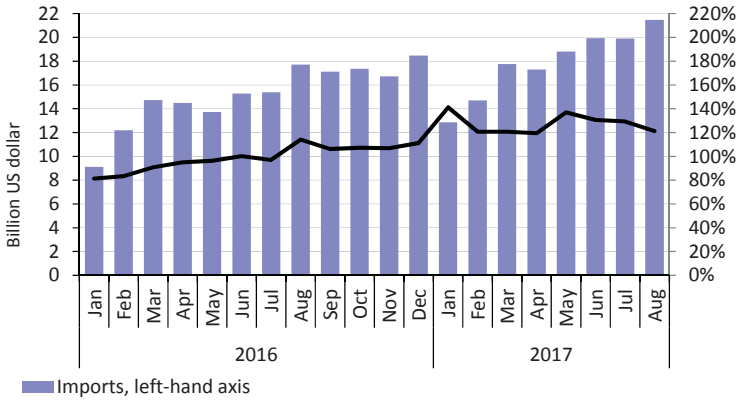

Fig. 2. The dynamics of Russian imports in 2016–2017

Source: own calculations based on the data of the Federal Customs Service of the Russian Federation.

Comparison of the real Ruble/Dollar exchange rate and the value of imports in US dollars points to the fact (*Fig.* 3) that there is still quite a strong correlation between these indicators. The above factor is in agreement with the idea that the real effective exchange rate of the national currency determines the dynamics of imports in value terms[1]. In January–August 2017, the real Ruble/Dollar exchange rate rose by 19.9% compared to the corresponding period of 2016, which is consistent with growth in imports in the same period (+26.8%)[2].

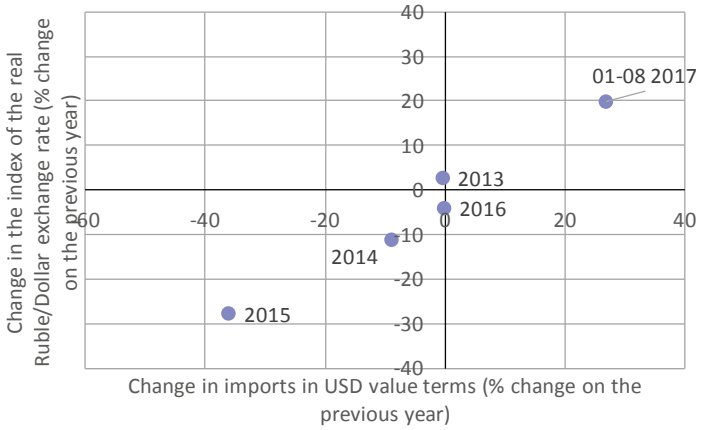

Fig. 3. Dynamics of Russian imports and the ruble exchange rate in 2013–2017

Source: own calculations based on the data of the Federal Customs Service of the Russian Federation and the Central Bank of the Russian Federation.

The first eight months of 2017 saw a considerable appreciation of prices of Russian export main goods, except for mineral fertilizers (-6%) and condensed natural gas (-10%). Export prices of crude oil and petrochemicals appreciated by a third (+31% and +38%, respectively); the price of gas formed in relation to the oil price of the previous months started to grow, as well (+10%). All the main metals appreciated in value by 9–38%; prices of timber and wood products increased by 3–16%. It ensured growth virtually in all the main export positions despite the fact that export supplies of some wood products and metal products decreased considerably in volume terms. Among primary products, exports of condensed natural gas and nickel fell significantly in value terms (-7% and -22%, respectively).

Exports of industrial goods saw mixed dynamics. Export prices of the main commodity positions of the *machinery and equipment* group changed in the range of -24% (fuel elements) to +46% (carriages); changes in volume terms were mixed, too: from -33% (LED TV sets) to +32% (cars with the engine volume of 1.8–2.3l). Export volumes in value terms changed from -21% (trucks) to +86% (carriages). As regards the latter, such a huge growth covered a decrease of the previous year[3].

The dynamics of exports in January–August 2017 can be explained by the following factors.

1 See A.Yu. Knobel. Assessment of the Function of Demand on Imports in Russia // Applied Econometrics. 2011. No. 4 (24). P. 3–26.

2 Also, it is noteworthy that on October 25, 2017 the Government of the Russian Federation expanded the list of goods subjected to the food embargo having banned imports of hogs, pork fat and pork edible by-products from the EU, Norway, the US, Canada, Australia, Iceland, Albania, Montenegro and Ukraine. It is to be reminded that on 21 March 2017 Russia finally lost at the World Trade organization the dispute which began as early as April 2014 when the EU turned to the WTO with objections as regards the ban on supplies to Russia of pork and hogs from all the EU countries due to a threat of African swine fever. On 19 April 2017, Russia declared that it was not going to fulfill that decision until 6 December 2017.

In the past three years (September 2014 – August 2017), the volume of the aggregate imports of trade positions – specified in the resolution – from all the countries amounted to $702.4m of which $110.9m (15,8%) accrued to the countries which were under the embargo.

3 See A. Knobel, A. Firanchyuk. The Foreign Trade in January–October 2016 // Russian Economic Developments. 2017. No.1. P. 14–20.

Table 1

CHANGE IN PRICES AND VOLUMES OF THE MAIN EXPORT GOODS SUPPLIES IN AUGUST–OCTOBER

Customs Commodity Code	Name of position	Price		Price change, %	Change in volume terms, %	Change in value terms, %	Share in exports 01-08 2017, %
		January–August 2016	January–August 2017				
Food products							
1001	Wheat and meslin, USD per ton	169	179	+6	20	27	1.34
Fuel							
2701	Fossil coal, USD per ton	51	74	+46	8	57	3.8
2709	Crude oil, USD per ton	271	356	31	0	32	27.1
2710	petrochemicals, USD per ton	275	380	38	-1	37	17.5
2711110000	Natural condensed gas, USD per cubic meter	141	127	-10	3	-7	0.9
2711210000	Natural gas, USD per thousand cubic meters	156	174	12	9	22	10.5
Chemical products							
3102, 3104, 3105	Mineral fertilizers, USD per ton	224	209	-6	6	-1	2.04
4002	Synthetic rubber, USD per ton	1265	1803	42	2	45	0.54
Timber and wood products							
4403	Rough timber, USD per cubic meter	68	75	12	-3	8	0.43
4407	Sawn timber, USD per ton	194	212	10	12	23	1.15
4412	Glued veneer, USD per cubic meter	376	436	16	-1	15	0.32
4702–4704	Wood pulp, USD per ton	467	494	6	-3	3	0.30
4801	Print paper, USD per ton	396	409	3	7	10	0.14
Metals and metal products							
72	Ferrous metals, USD per ton	311	428	38	-5	32	5.2
7403	Refined copper, USD per ton	4629	5812	26	10	38	0.97
7502	Raw nickel, USD per ton	8792	9590	9	-29	-22	0.40
7601	Raw aluminum, USD per ton	1415	1651	17	-15	-1	1.5
Machinery, equipment and means of transportation							
840130	New fuel elements, thousand USD per unit	494	378	-24	11	-16	0.22
8411123009	Gas turbines with draught of over 44 кN, but no more than 132 кN, thousand USD per unit	3433	3847	12	-1	11	0.28
8450111100	Household washing machine, USD per unit	162	166	2	21	23	0.05
85287240	LCD TV sets, USD per unit	281	351	25	-33	-16	0.03
860692	Open railway cars, USD per unit	15 209	22 246	46	27	86	0.02
8703231940 (8703231910 – before 2017)	Cars with an engine of 1500–1800 cm^3, USD per unit	7255	8684	20	-16	0	0.08
8703231981 (8703231921 – before 2017)	Cars with an engine of 1800–2300 cm^3, USD per unit	15 900	17 175	8	32	43	0.04
8703231989 (8703231922 – before 2017)	Cars with an engine of 2300–3000 cm^3, USD per unit	36 154	31 334	-13	24	7	0.10
8704229108	Other trucks with full weight of 5–20 tons, USD per unit	32 116	33 549	4	-24	-21	0.03

Source: own calculations based on the data of the Federal Customs Service.

Table 2

RUSSIAN EXPORTS IN JANUARY–AUGUST 2016 AND 2017 BY COMMODITY GROUPS

Customs Commodity Code	Name	January 2016	January–August 2017	Change in 2017 on 2016	Growth rates, %
		Million USD			
01-24	Food products and agricultural raw materials (except for textile)	9 930	11 896	1 966	19.8
25-27	Mineral products	105 472	139 091	33 619	31.9
27	Fuel and energy producing materials	103 645	136 568	32 924	31.8
28-40	Chemical products and raw rubber	13 240	15 268	2 028	15.3
41-43	Raw hides, furs and articles thereof	186	209	23	12.4
44-49	Wood and paper products	6 407	7 558	1 151	18.0
50-67	Textile and textile goods and footwear	576	666	90	15.6
71	Precious stones, precious metals and article thereof	5 491	6 982	1 491	27.2
72-83	Metals and metal goods	18 177	23 143	4 966	27.3
84-90	Machinery, equipment and transport vehicles, including:	10 173	11 216	1 043	10.2
84	Reactors, equipment and mechanical devices	3 994	4 741	747	18.7
85	Electrical machinery and equipment	2 229	2 213	-16	-0.7
86	Railway transport	277	351	73	26.5
87	Surface transport vehicles	2 271	2 208	-63	-2.8
89	Vessels, boats, floating constructions	560	636	76	13.6
90	Optical instruments and devices	842	1 067	225	26.7
68-70, 91-97	Other goods	1 198	1 534	336	28.1
SS	Secret code	5 076	4 708	-368	-7.3
	Exports, total	175 926	222 271	46 345	26.3

Source: own calculations based on the data of the Federal Customs Service.

A considerable growth in exports of ***fuel and energy producing commodities*** (32%) is driven by appreciation of prices by 12–16% as compared to January–August 2016 and an increase in exports of coal and natural gas in volume terms (*Table* 1).

Growth in exports of grain (wheat and meslin) in January–August 2017 (an increase of 20% as compared to January–August 2016) and a 6% appreciation of prices resulted in growth of more than 25% in exports of goods pertaining to this commodity position. Exports of ***food products and agricultural raw materials*** in value terms increased by 19.8%.

A 6% depreciation of export prices of mineral fertilizers was made up for by growth in exports in volume terms (+6%). Generally, exports of ***chemical products*** rose by 15.3%.

The appreciation of prices of ***wood and paper products*** coupled with mixed changes in exports of wood products, plywood, paper pulp and paper in volume terms led to growth of 18.0% in exports in value terms.

Exports of ***metals*** in value terms grew by 27% on the back of a huge appreciation of global prices.

Growth in exports of energy producing commodities, chemical products, metals and other medium-processed goods (wood and raw hides) in value terms was mainly driven by improvement of the pricing environment on the global markets.

Exports of ***machinery, equipment and transport vehicles*** (Customs Commodity Code: 84–90) increased in value terms by $1.05bn (or 10%) for no apparent reason: both prices and volumes of the goods of the main commo-

dity positions demonstrated mixed dynamics. Note that exports of the secret commodity group fell by 7.3%.

Geographic Pattern of Russia's Trade Turnover. The first eight months of 2017 saw stabilization of the geographic pattern of Russian exports. The share of the EU did not virtually change and remained at the level of 43.0% (*Table* 3). The shares of the European Free Trade Association (EFTA) and Turkey did not undergo serious changes. The share of Ukraine in the trade turnover remained (-0.03 p.p.) at the same record low level of 2.1%. Growth in the share of Kazakhstan (+0.22 p.p.) surpassed a decrease in the share of Belarus (-0.08 p.p.), which situation resulted in moderate growth in the share of the Eurasian Economic Union in the trade turnover. Such a situation has been observed for three years running. It is noteworthy that the share of the APEC member-states has changed a great deal (+1.05 p.p.), having amounted to 30.8% of Russia's turnover. Such dynamics can be explained by growth in the share of China (+0.97 p.p.), which situation is generally in line with the long-term trend of growth in China's foreign trade turnover. According to the data of the General Administration of Customs of the People's Republic of China[1], in H1 2017 China's trade turnover with the APEC increased by 22%, while with Russia, by 33%.

Table 3

GEOGRAPHIC PATTERN OF RUSSIA'S TRADE TURNOVER
IN THE FIRST EIGHT MONTHS OF 2013–2017 BY MAIN TRADE PARTNERS

Region/country	Share in Russia' trade turnover* (%)					Changee (p.p.)
	01–08 2013	01–08 2014	01–08 2015	01–08 2016	01–08 2017	01–08 2017 against 01–08 2016, p.p.
EU in trade turnover	49.9	49.1	45.7	43.3	43.0	-0.34
EFTA	1.8	1.2	1.1	1.3	1.3	+0.02
Turkey	3.8	3.9	4.6	3.4	3.5	+0.06
APEC, including:	24.5	26.3	27.7	29.7	30.8	+1.05
China	10.5	11.0	11.7	13.9	14.9	+0.97
The US	3.2	3.8	4.1	4.2	4.0	-0.20
Japan	3.9	3.9	4.0	3.5	3.3	-0.25
Republic of Korea	2.9	3.4	3.4	3.4	3.6	+0.24
Vietnam	0.5	0.4	0.6	0.8	0.8	-0.04
CIS, including:	13.4	12.7	12.5	12.3	12.3	-0.04
Ukraine	4.5	4.1	2.7	2.1	2.1	-0.03
Eurasian Economic Union, including:	7.5	7.2	8.1	8.6	8.7	+0.15
Armenia	0.1	0.2	0.2	0.3	0.3	+0.00
Belarus	4.3	4.1	4.5	5.3	5.2	-0.08
Kazakhstan	2.8	2.7	3.1	2.8	3.0	+0.22
Kirgizia	0.3	0.2	0.3	0.3	0.3	+0.01.

Source: own calculations based on the data of the Federal Customs Service.

1 General Administration of Customs of the People's Republic of China: Review of China's Foreign Trade in the First Half of 2017.

3. INDUSTRIAL ENTERPRISES IN Q3 2017: DEMAND GETS THINNER

S.Tsukhlo

Gaidar Institute's recent business surveys have revealed a downward trend in demand for products of Russian industrial enterprises as of the end of Q3 2017. The deseasoned balance of enterprise responses is steadily sliding to negative values – demand has started to drop, whereas in the first half of the year it was driven rather by upward dynamics.

Most of the surveyed Russian industrial enterprises considered the demand for their producers as "normal" in Q2 2017.

In February 2017, the balance of demand forecasting reached an all-time high on the back of increasingly upbeat expectations developed over the previous eight months. In March–June, the Russian industrial sector exhibited a high enough degree of anticipated boost in sales. However, the balance of responses started to fall in July and went negative by September. The decrease, albeit minor enough, is sufficient to challenge successful results at 2017 year-end.

Revised plans for quick recovery from the crisis of 2015–2016 forced enterprises to reconsider their stock levels that are sufficient for the recovery. In September, the balance of inventory assessments exhibited a decline in surplus all the way by 5 points, whereas in March–August the industrial sector maintained this value within a range of +9 ... +11 points. The values reached a three-year high, that is, a similar level was recorded in early 2014.

The finished goods inventory was adjusted owing to the actual output. The industrial sector started making some minor cuts in the inventory.

Nevertheless, industrial enterprises have not given up their plans to boost output in late 2017. The balance of industrial expectations in August–September was up by 6 points, reaching values that are good enough in times of crisis. However, there are two things that can challenge the plans. First, the actual output dynamics depreciated instead during these months. Second, demand projections became negative despite upbeat projections early in the year. In this context, production plans for the upcoming months may see a reversal.

Despite sales problems, the Russian industrial sector pushed up consistently the price rate in Q3 2017. While this indicator turned out to be negative as of the end of the second half of the year (e.g., enterprises switched to absolute cuts in factory-gate prices), the balance of actual price changes increased 27 points to +20 points since July. Such values are normally registered in January: +17 bp in January 2016, +22 bp in January 2017.

In the meantime, industrial price plans exhibited stability since April 2017 (e.g., for two consecutive quarters), varying within a range of +6 ... +9 b.p. Such a moderate price forecasting appears to be an attempt to strike a balance between weak demand and increased costs. The latter, according to enterprise responses, accelerated strongly in Q3 2017 following the deceleration in the second quarter. While the balance of actual cost changes dropped to +2 points (an all-time low in 1997–2017), it increased in the third quarter

to +16 points, and enterprises predict that it would grow up to +28 points in Q4 2017. Note that both prices and costs are traditionally expected to rise early next year.

The industrial sector continued to hire workers despite the deceleration in recovery from the crisis of 2015–2016. The balance of change in the number of employees remained moderately positive over seven of the first nine months of 2017. Industrial enterprises have thus taken the brunt of fighting against unemployment in 2015–2017. Note that in the non-crisis years of 2013 and 2014 the Russian industrial sector could not afford new workers while being faced with shortage of employees that was above 20% during some quarters (the proportion of enterprises that were reportedly faced with shortage of employees). The shortage of employees dropped to 11–13% in 2015–2016 and to 10% in 2017.

In the meantime, the excessive employment rate that tend to grow in times of crisis declined instead in 2015–2016, being always below the rate of shortage of employees in the Russian industrial sector. However, the principal outcome in both 2015–2016 and 2017 was the achievement of better staff headcount (the period of our monitoring of 1996–2017). This indicator increased from 72 to 84% during the period in question.

In the third quarter, Russian industrial sector's investment plans were not that optimistic as much as they were in Q1 2017, reaching a five-year high in Q2 2017. The balance of investment plans retuned back to zero in Q3 2017 – the initial upbeat expectations were gone in the absence of downbeat projections (a negative balance). In this context, the investment growth that was recorded in H1 2017 is likely to decelerate. Sixty two percent of surveyed enterprises considered their investment as 'normal', reaching a five-year high. Enterprises' satisfaction with investment lost 5 points in the third quarter following the decline in upbeat investment plans.

Terms of lending to the Russian industrial sector remained stable over the entire Q3 2017. Now, two thirds of enterprises consider their credit availability as normal. This level of credit availability has been recorded by surveys since February 2017 and is not too far from inter-crisis values. The average minimum interest rate (13.3% p.a.) on rouble-denominated bank loans to industrial enterprises was also stable in the third quarter.

4. RUSSIAN BANKS: PROFIT GROWTH DECELERATES

M.Khromov

The Russian banking sector has recently been faced with profit growth deceleration arising from extensive losses discovered in banks under resolution. Russia's biggest state-run banks have accumulated a great deal of profit among banks that continue to operate "in normal mode". Profits from regular banking operations remain volatile enough.

The Russian banking sector ran a book profit of Rb 675bn as of the end of the first three quarters of 2017. The annualized ROA and ROE of the same period reached 1.1% and 10.7%, respectively.

The above figures are close to what they were during the same period of 2016, when the banking sector ran a profit of Rb 635bn[1], with ROA and ROE standing at 1.0 and 10.6%, respectively. The banking sector profitability remains lower than what it was during the pre-crisis period of 2011–2012.

The deceleration in the banking sector growth rates in 2017 was caused by losses in large banks that were placed under financial recovery in Q3 2017. As of the end of three quarters of 2017, there were top four loss-making banks, namely Bank Otkritie FC (-Rb 279.3bn), Rost Bank (-Rb 82.8bn), Trust Bank[2] (-Rb 72.9bn) and Binbank (-Rb 31.9bn), making a total of -Rb 466bn.

The losses emerged following the appointment of provisional administration to the banks – a compulsory procedure as part of the financial recovery (resolution) process – moving a great deal of assets to higher risk categories, which required immediate increase in provisions for losses on such assets. Therefore the banks had to spend more on increasing their provisions, thus deteriorating their financial performance figures. The financial performance figures were satisfactory enough until financial recovery came into force.

For instance, Bank Otkritie FC, which was placed under resolution on 29 August 2017, reported a profit of Rb 7.1bn as of the end of July 2017, whereas Rb 31.8bn in losses were recorded shortly after in August. The primary negative financial performance results of Rb 254.5bn were posted in September.

Binbank and Rost Bank, which were placed under financial recovery on 20 September 2017, were officially considered as profit-makers (Rb 2.1bn and Rb 1.3bn, respectively) as early as late August 2017, whereas substantial losses were recorded in September.

Trust Bank has disclosed its financial reports on an irregular basis since its resolution in December 2014. Its financial performance figures were most likely negative throughout the entire period of financial recovery. For example, the bank posted Rb 9.6bn in losses as of the end of the first three quarters of 2016.

1 See M.Khromov. Banking industry: profit goes up, but rate of return remaines suppressed // Monitoring of Russia's Economic Outlook. 2016. No. 17(35). P. 9–10.

2 Financial recovery procedure for Trust Bank commenced as early as 2014, with active involvement of Bank Otkritie FC. This affiliation enables us to include Trust Bank in the group of banks that were placed under resolution in Q3 2017.

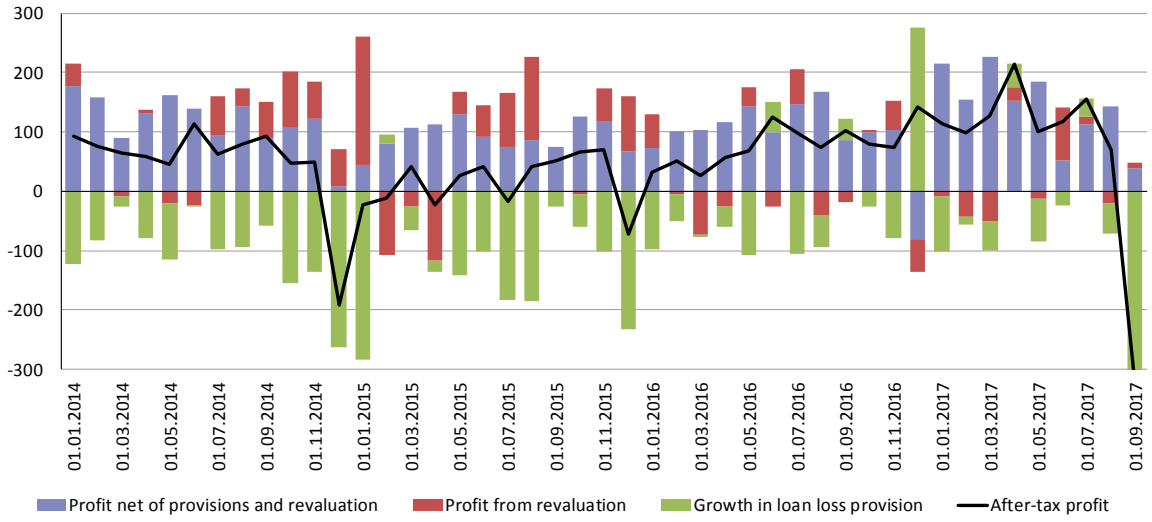

Fig. 1. Principal components of bank profit, billions of roubles

Source: Bank of Russia, Gaidar Institute's estimates.

The banking sector profitability was heavily affected by the performance figures of problem banks, showing considerable growth in costs on loan loss provisions that increased Rb 605bn during the first three quarters of 2017, including an increase of Rb 370bn in September alone. The banking sector posted an increase of Rb 361bn in loan loss provisions as of the end of the first three quarters of 2016.

The banking sector profit related to the revaluation of foreign exchange accounts turned out to be zero over the first three quarters of 2017, whereas bank losses totalled Rb 42bn as a result of exchange rate dynamics over the same period previous year.

Thus profit from regular banking operations in January–September 2017 amounted to Rb 1279bn, up by 28% from Rb 996bn a year earlier. The result could have been regarded as a positive signal if it were not for the fact that profit from regular banking operations remains volatile enough. The profit from regular banking operations in January–September 2015 was higher than what it was over the first three quarters of 2016. The profit varied during the first nine months of 2017, from Rb 207bn in January 2017 to Rb 47bn in September.

The sharp decline in the performance figures of banks under resolution gives evidence of long-brewing problems facing the banks. This leads to a conclusion that the financial statements of these banks released shortly before the commencement of financial recovery contradicted the reality. This brings some scepticism towards the performance figures of other banks. The Bank of Russia, as a banking market regulator, de facto has turned out to have limited control over financial status of most banks.

Therefore, there is close relationship between Russian banking sector's financial performance figures and its high concentration, when financial performance figures of some banks, including also smaller banks, can have a strong effect on the entire banking sector. Excluding the top four loss-making banks, the rest of the banks reached a profit of Rb 1141bn in January–September 2017, up by 80% from the same period of 2016.

Another aspect of such a concentration is a persistently big number of state-run banks. For instance, the four biggest state-run banks (Sberbank,

VTB, VTB24 and Gazprombank) ran a profit of Rb 675bn during the first three quarters of 2017, which means that the entire banking sector profit was generated by state-run banks. A significant contribution of state-run banks to the banking sector profit reflects their leading position in the market. Therefore, by accumulating a great deal of financial resources for equity build-up, these banks have a bigger development potential than private banks. A kind of vicious circle is therefore developing. Low profitability of private banks discourage their owners to increase equity, thus securing their subordinate position to the public segment of the banking sector.

5. IS THE MINIMUM WAGE IN NEED OF REFORM?

V.Nazarov

The Russian government approved a few months ago a draft bill that is intended to raise the minimum wage to be in line with the living wage: proposals to raise the living wage to 25000 roubles have been made. This will expectedly reduce poverty and enhance labour productivity, and promote declared wages. Estimates show, however, that the anticipated minimum wage reform will help to achieve none of these desirable objectives.

The idea of raising the minimum wage has recently come into focus of both the federal government and opposition politicians, with figures varying from raising incrementally the minimum wage from the 7800 roubles currently to be in line with the living wage (which is 11163 roubles currently for working-age population) to an immediate increase in the minimum wage to 25000 roubles monthly.

It would be unreasonable to discuss a minimum wage increase unless we understand why it should be raised. If the minimum wage is used as a tool designed to regulate the labour market, then it would have an adverse effect on the economy because this can:

- boost unemployment;
- promote informal employment;
- lead to discrimination of age-sex groups (e.g., it would be more difficult for young people to find a job);
- reduce other payments (benefits) workers are entitled to.

The latter is related to the fact that under the Russian legislation the worker may be entitled to, besides the wage, other social benefits (payment for education, meals, passenger fare, utility services, cash aid, etc.). These are not regarded as labour remuneration and cannot be accounted when the worker's wage is in line with the minimum wage. A minimum wage rise can therefore result in a situation where higher labour costs will be offset by cuts in social benefits.

According to own model-based estimates that rely on The Russia Longitudinal Monitoring Survey (RLMS) – a series of nationally representative surveys designed to monitor the effects of Russian reforms on the health and economic welfare of households and individuals in the Russian Federation[1] – a rise in the minimum wage to be in line with the living wage would reduce poverty by 0.6 percentage points from 13–15% currently, so nothing will change because poverty in Russia is concentrated in households having a big number of dependents such as children, non-working physically challenged persons, jobless persons. In the meantime, low paid workers often have extra

1 "The Russia Longitudinal Monitoring Survey (RLMS) conducted by the National Research University "The Higher School of Economics (HSE)"". The project has been run jointly with the Carolina Population Center at the University of North Carolina at Chapel Hill and the Demoscope team in Russia and The Institute of Sociology of the Russian Academy of Sciences (ISRAS). (RLMS-HSE official websites: http://www.cpc.unc.edu/projects/rlms and http://www.hse.ru/rlms).

sources of income (they are entitled to retirement benefits or they receive aid from well-off members of their household).

Another proclaimed goal of minimum wage rise is the enhancement of labour productivity. This conclusion is based on the assumption that jobs involving higher labour productivity are paid higher wages, which is wrong for several reasons. First, it is the value added that is created by labour that should be considered. For example, some high paid managers or supervisors can create a negative value added. Labour productivity is therefore not identical to wage. Second, elimination of low paid jobs will raise the average wage in Rosstat's (the Federal State Statistics Service) reports, but it will also boost the unemployment rate and expand the informal economy. It would be unreasonable to improve labour productivity while reducing legal jobs through public regulation measures.

Labour productivity is normally improved because the entrepreneur, seeking the highest possible profit, tends to enhance the effectiveness, to introduce new technologies and to fire redundant workers. The state must not prevent this, but what it must do is to provide unemployment benefits, help laid-off workers find a new job or undergo retraining. It works totally in reverse in Russia: regulatory authorities prevent entrepreneurs from generating profit, regional labour laws are heavily restrictive, and implicit layoff restrictions are suppressing innovations, unemployment benefits are scarce, and there is no benefit in place that could hold households' income in line with the living wage, and employment services are ineffective. In this context, it is not a good idea to raise the minimum wage. This will have no effect whatsoever (or will take toll) on wages and on labour productivity.

It is highly questionable whether a minimum wage rise can help promote declared wages. Employers can place their workers on a part-time schedule, increase worktime standards and pay the minimum wage only for the accomplishment of worktime standards.

That the minimum wage fails to work as a tool for enhancing labour productivity, reducing poverty and promoting declared wages is evidenced by the fact that the government authorities of 35 regions inhabited by 56% of Russia's population have already set the minimum wage for employees of non-state-funded organizations and for individual entrepreneurs at a level close to (more than 95%) or higher than the regional living wage (*Fig. 1*).

A great deal of these regions exhibit figures for poverty or economic development that are not looking good versus comparable territories. For example, the poverty level in the Republic of Karelia and in the Republic of Mariy-El is way higher than the Russian average and has been increasingly growing over the past few years despite the regional minimum wage is in line with the living wage. Neither have these regions reportedly achieved any success in "whitening" wages and in enhancing productivity. In the meantime, there are successful regions (e.g., Ulyanovsk Oblast) with the minimum wage being far below the living wage while their socio-economic development figures are higher than in some high-minimum-wage regions.

Overall, it is pointless to apply any federal standard to wages in Russia because of great diversity in regional labour market environment, cost of living, authorities' ability to control shady employment, and in other parameters. The minimum wage in Moscow has already been set at 164% of the federal living wage. Considering the Moscow economic development level, this is unlikely to be a strong headwind to business development. By contrast, in the

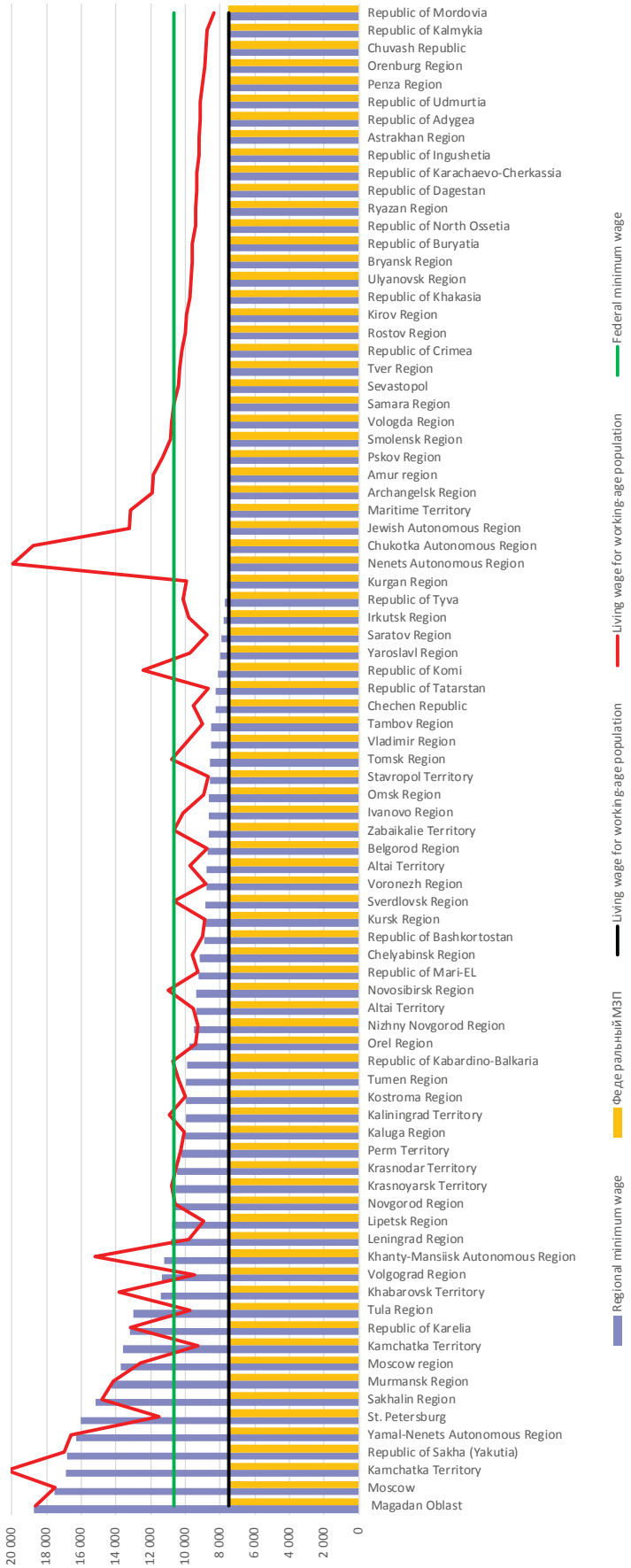

Fig. 1. Ratio of regional and federal minimum wages (MWs) and living wages (SMs)

Source: own calculations.

Republic of Dagestan, raising the minimum wage to be in line with the living wage would mean a 40% increase in the minimum wage from what it is now. It is clear that such a drastic increase cannot avoid growth in unemployment and will require extra spending out of the regional budget as well as will lead to shadow economy expansion. If there is a strong need to intervene in the labour market, then it should rather be done by regional authorities because they will be able to see quickly and clearly the outcome of such intervention and to promptly adjust the minimum wage size, which is exactly what they are doing in practice.

In addition, a rise in the minimum wage will increase the size of temporary disability benefits for ensured persons with a qualifying insurance period of less than six months, of maternity benefits for ensured women with a qualifying insurance period of less than six months, as well as will increase budget spending on labour remuneration in state-funded enterprises and organizations. According to estimates, federal budget expenditure on labour and on labour allotments regarding the rise in the minimum wage be in line with the living wage for working-age population would increase more than Rb 93bn annually.

Overall, the practice of sharp increase in the minimum wage on 1 January 2009 has shown that the increase equalises wages of low- and high-skilled workers, with the former standing to gain. The issue of raising the wage of ancillary workers to be in line with the minimum wage can reduce manpower standards for these workers, which is by no means always substantiated.

In this context, it is necessary to avoid tying the minimum wage to the living wage because this measure can relax the control over further increases. The living wage is revaluated on a regular basis, which so far is not the case with the minimum wage. It is irrational to create it because it would hamper dismantlement of the minimum wage institution, which, in our view, could be a rational solution.

While it is impossible to scrap the minimum wage, it should not be indexed, thus moving consistently towards its removal. It would at least be necessary to give every assistance to its regionalization: methodological recommendations on the establishment of regional minimum wages are given at the federal level while laying the ground for the establishment at a lower-than-federal level.

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