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The review provides a detailed analysis of main trends in Russia's economy in 2010. The paper contains 6 big sections that highlight single aspects of Russia's economic development: the socio-political context; the monetary and credit spheres; financial sphere; the real sector; social sphere; institutional challenges. The paper employs a huge mass of statistical data that forms the basis of original computation and numerous charts

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Russian Industrial Enterprises in 2010

This paper was prepared based on the materials of the surveys among managers of industrial enterprises, conducted by IEP in compliance with the European harmonized methodology monthly, from September 1992 and cover the entire territory of the Russian Federation. The panel is about 1100 companies, which employ more than 15 per cent of the total employment in the industry. The panel is biased towards large enterprises in each of the sub-industries. Feedback on questionnaires is 65-70 per cent.

Industrial surveys (IS) among business leaders is a quick way to gather information about the assessment of the situation in their enterprises and the expected (planned) changes in the key performance indicators of the enterprise. This is a relatively new tool of economic analysis. The first survey was conducted by IFO Institute (Munich, Germany) in 1949. Soon afterwards such polls have been held in Great Britain, France and Italy. Since 1962, the EU is making efforts to harmonize (make comparable) the surveys in the countries of the continent.

There is a rather small number of questions in the IS questionnaire (no more than 15-20). The questions are of qualitative, rather than quantitative nature. Simple design of questions and answers allows the respondents to fill out the forms quickly and without involvement of other employees or any documentation. It is essential that the respondent in each enterprise should be the Manager of the top level, who has a complete Fig. of the situation at the enterprise and directly involved in the company management. In 2008 28 per cent of responses to the IS questionnaires were received from the Directors of enterprises, 37 per cent - from the Deputy Directors, 22 per cent - from the leaders of economic departments.

In analyzing the results of industrial surveys a specific derivative index is applied, known as balance. Balance is calculated as the difference between the percentage of respondents given the answer about their business standing as "increasing" (or "above regular" indicators) and the percentage of respondents whose assessment was as a "declining" (or "below regular"). The resulting difference allows sorting the answers to each question by one number with the sign "+" or "-".

Balance is interpreted as the first derivative or the process rate. If the balance of answers to the question about the expected price change is with the sign "+", it means that the average prices in the near future will continue to grow (for example, there dominating the companies, reported on an expected increase in their prices). The increase of the balance within a month from +10 to +17 per cent means that average prices in the industry will grow more intensely as the increased prevalence of companies, predicting growth. A negative balance means a decrease in average prices (more companies are going to lower their prices). Changing the balance from -5 per cent to -12 per cent is interpreted as plans of the intensity of prices lowering.

4.2.1. First Quarter: an Attempt to Recover from Crisis

In early 2010, Russian industry continued its recovery from the crisis. The dynamics of sales and estimates of the demand allowed businesses to maintain output growth and demand forecasts, backed up by the portfolio of orders, showed the formation of the most popular hopes for recovery from the crisis.

In January 2010, the demand for industrial production for the first time during the current crisis has ceased to decline: the share of reports on falling sales reached the level equal to the reported growth. However, the improvement of the dynamics of demand in comparison with quarter IV of 2009 was negligible and noticeable only to those that was close to zero. Here-with, the original data quite adequately reflected the nation-wide ten-day vacations, having demonstrated the decrease, which is not cleaned from seasonal factors balance by 8 points versus January level, recorded in 2002-2008. Thus, the January (2010) dynamics of the demand proved to be quite comparable to the pre-crisis level.

This thesis is confirmed by the indicators of satisfaction of the total demand. The share of normal ratings has increased immediately by 10 points and reached 42 per cent for the industry in general, which was the maximum peak over the months preceding the crisis (see *Fig. 7* at the end of this section). January 2010 was not such a disaster for the Russian industry, as one might expect is projected November - December 2009.

In January 2010, industrial production, as estimated by businesses, continued (after cleaning from seasonal factors) its growth with the same intensity. Thus, the surveys recorded the output growth over the past five months. The initial data (before treatment on the season) showed, of course, in January the decline in production, but it was the same as happened in January 2002-2008 and two point five times less than in January 2009. In other words, the dynamics of output began to come back to normal after the level of demand.

Production plans of enterprises at the beginning of the year have been improved as compared with the plans, registered in December, by 52 points at a time. Such a sharp rise in optimism has not been mentioned even once in the original surveys over 1992-2010. Clearance from seasonal factors significantly adjusted growth of this indicator (up to 10 points), but the result was still decent (it gave way to Crisis maximum only by 1 percentage point).

The growth of optimism in the plans of production output had quite certain grounds in the industry. According to the companies, the new year of 2010 started with the active portfolio extension. The orders scope for the quarter increased from 4.9 to 6.5 months and therefore, reached the pre-crisis level (January 2006 – 6.7; in 2007 – 6.7; in 2008 - 7 months).

Pricing policies of enterprises in early 2010 was influenced by the growth in demand for manufactured products and the traditional New Year upsurge in prices and tariffs. However, both factors at this time, though not as strong as at the best of times, pushed up the actual price dynamics and price plans of the manufacturers, although a modest crisis result of January 2009 was, of course, surpassed. In January 2010 a moderate decline of prices in November - December gave way to a more intensive growth. The January growth rate of the wholesale prices reached the maximum of the previous crisis months and had all the chances to continue - pricing plans for businesses, too, have reached the crisis peak in January.

HR plans of enterprises suffered in January 2010 the most significant changes. Within the month the balance of intentions has changed from sharply negative (reduction of employees) (-25 points) to expressly positive (recruitment) (+7) and has become another crisis maximum peak (see *Fig. 8*). Thus, the Russian industry for the first time during the current crisis has declared of the desire to abandon the dismissals and start to hire employees.

Reductions in the number of employees and the positive dynamics of the main industry performance indicators have helped the companies to recover the situation with the payroll. In early 2010, the normal level of salaries of workers and engineering manpower went to the Russian industry 49 per cent of enterprises (see *Fig. 9*). Before the crisis, this figure exceeded, as a rule, 50 per cent and reached 60 per cent, while the share of enterprises with low wages

(below normal level) was then about 40 per cent. In January 2010, the latter indicator dropped from the crisis peak of 59 per cent (in the II quarter of 2009) to 47 per cent.

In February the industries have again demonstrated the dynamics of sales and production, similar to the pre-crisis level. The growth of demand rate (based on initial data) in February has improved significantly for the first time during the current crisis and ceased to be negative, i.e., the share of enterprises whose sales have increased, becoming equal to the shares of the enterprises, decreasing the sales. But the removal of seasonality has reduced the optimism of the data cleared from seasonal factors - in the industry there were only minimal for the current crisis reduced demand for products, which, incidentally, also looked very good as compared with what happened a year earlier.

In February, the share of normal estimates of demand fell by 9 points and rolled off to the level of September - October 2009. This figure indicated the sharp swings since November 2009, which indicates the disorientation of producers, who do not seem to understand what is happening with the economy and what sales volumes should be considered adequate to the current economic situation.

Production growth rates in the Russian industry (after seasonal clearing) got stabilized at a moderate increase in output. A baseline data, as well as data on demand, have demonstrated quite traditional for 2003-2008 February upsurge. It seems that the dynamics of output in the Russian industry was returning to the pre-crisis trend. Production plans of enterprises in February, too, traditionally (like in pre-crisis period) have improved since the January jump-up in optimism. As a result of the initial data for January - February 2010, the balance of the planned changes in production rose by 68 points: from -25 in December to 43 in February (in 2008 the growth in the same period totaled to 48 points in 2007 - to 43 points and in 2006 - by 51 points). Clearance of the seasonal factors has the New Year growth before stabilization at the level of 21 points, which was the crisis maximum peak.

Idle capacities for the planned increase in production by industrial enterprises were sufficient enough. In late 2009 - early 2010, the excessive capacity (in view of the anticipated changes in demand) were available in 30 per cent of enterprises (see *Fig. 10*). Thus, it is not just idle capacity, its power capacity whose use is impossible even with quite optimistic forecasts of demand. The minimum level of security with such "square" was the capacity registered in early 2008 - up to the peak of the very strong heating of the Russian industry made - and 11 per cent.

Another indicator of the possibility of rapid recovery of growth is the mentioning of the lack of equipment by enterprises as an obstacle to growth in production output - from the beginning of 2009 - averaged 10 per cent and was three times lower than the historical maximum (32 per cent), registered in mid-2007 (see *Fig. 11*).

The growth of prices at the beginning of the year in the industry remained at the highest in the previous 18-month level. Businesses for the third time during the current crisis have turned to price up surging. The first attempt in March 2009 resulted in the balance of price changes by 2 points, the second one (in September 2009) - by 7 points, in February 2010 for the second consecutive month the price growth was kept at 11 points. The pricing plans reflected the intention of businesses to continue, or at least to keep such price growth rate in coming months.

In February 2010, the industries have recorded the most moderate rates of staff dismissal since the beginning of the crisis assessments. Balance within the month has grown by 23 points and almost reached the zero level (no layoffs in general in the industry). In February,

recruitment of workers is resumed in the food, light and building industries. The balance for plans of changes in employment for the first time during the current crisis has entered the positive zone - the companies confirmed their intention to move from a reduction of workers to their employment.

Availability of credits in the industry has reached 64 per cent (see *Fig. 12*) in February 2010. Average minimum lending rate has decreased to 16.4 per cent per annum in rubles. Banks continued to reduce the thresholds to access to their monetary resources. In the first place – to the ferrous metallurgy entities (normal access was provided to 98 per cent of the enterprises, the average minimum rate of 14.4 per cent per annum), to chemistry and petrochemistry enterprises (79 and 14.1 per cent), to food businesses (66 and 14.7 per cent) and machine-building (61 and 13.7 per cent) sectors.

The share of bad credits in the industry has declined in early 2010 to 23 per cent (the share of businesses with loans and not able to serve them). Crisis maximum of this index (49 per cent) was registered in April 2009

The first quarter of 2010 was the best since the crisis began, but clearly worse in terms of dynamics. Recovery from the crisis has slowed down. In March, the dynamics of demand has shown only a stabilization of about zero, the fall in demand has decreased, while there was no growth yet. As a result, two thirds of businesses were dissatisfied with sales of their products and only one-third considered them normal. The most comfortable feeling in the first quarter of 2010 was observed among the businesses of food industry (64 per cent of satisfaction), chemistry and petroleum chemistry (55 per cent) and non-ferrous metallurgy (54 per cent). Demand forecasts for the I quarter 2010 have stabilized, remaining the best since the crisis beginning and comparable with the level of the first post-default years. Despite the lack of sales, the businesses had not allowed the increase in surplus stocks of finished goods at their warehouses. Balance of estimated reserves in general in the industry did not change and remained at the crisis level (less the upsurge in November 2009) and at the level of reasonable redundancy, typical for the pre-crisis years.

The intensity of output growth by the end of the first quarter of 2010 has reached the rate of growth of +34 balance points, which was normal for the pre-crisis years. Purification from seasonal factors has decreased the growth rate to +11 balance points, which was the best during crisis and was already comparable to the pre-crisis value of this indicator. Plans of output, as well as demand forecasts, have demonstrated the record in stability (before and after purification from seasonal factors) in the first quarter of 2010. Growth of output in the second quarter should have dominated in all sectors.

The growth of wholesale prices in Russian industry in the first quarter of 2010 remained the highest in the current crisis in terms of intensity. In March all sectors increased the prices, except for the construction industry, which has turned from the policy of reducing prices to the stability thereof. The most intensive growth took place in March in chemical and petrochemical industries (+35 b.p.). However, in the second quarter industry was planning to slow down the prices growth: the New Year inflation upsurge was over. The balance of anticipated changes in prices within March has decreased by 6 points and returned to the level of November 2009. After that, the industry started "price attack" for four months, whereas the previous two ones lasted for two months each.

In March 2010 the industry for the first time during the current crisis has turned from layoffs to hiring employees. Such plans have appeared in January, survived in February, and finally were realized (see *Fig. 8*). Layoffs continued only in metallurgy and timber industry,

while in the other industries the number of personnel was growing, particularly intensively in food and light industries. Positive trend in employment growth gained in intensity during all the I quarter.

4.2.2. Second Quarter: a Pause

At the beginning of the II quarter the Russian industry demonstrated an adaptation to the stagnation of I quarter 2010. Growth rate in demand for industrial products got stabilized in both, according to the initial data and purified from seasonal factors. But the dynamics of demand within January - April was the best since mid-2008, when the global financial crisis has only started in Russia. However, demand forecasts, which jumped up in January, started to decline.

The assessments of finished products stocks have also stabilized since December 2009 - excessive stocks the industry has established the traditional for the pre-crisis months (see *Fig. 13*). The majority and stable part of the enterprises (60-64 per cent) believed their stocks were normal since September 2009. In Q1 2010 the physical volume of stocks of finished products continued to reduce. However, the rate of decline gradually reduced, but the plans for the II quarter reflected the intention of businesses to increase the intensity of the stocks reduction.

In April, the change of the output rate has not undergone fundamental changes. Manufacturing continued its growth with a modest (by pre-crisis standards) intensity, which according to the businesses estimates, has not changed since September 2009, when the producers did not recon on special demand growth. In April, output plans have undergone the strongest negative adjustments in January 2009. A small but steady growth in production in April resulted in industrial capacity utilization to 66 per cent (see *Fig. 14*). With such intensity the equipment was used prior to the crisis in 2005. Herewith, the crisis minimum indicator was recorded in January 2009 and amounted to 53 per cent.

Estimates of excessive capacity have confirmed the positive dynamics of their utilization. In the II quarter of 2010 the share of companies with excessive capacity has decreased to 24 per cent, which also corresponds to the level of 2005. In January 2009 43 per cent of responses "more than enough" have been obtained. Absolute pre-crisis minimum (January and April 2008) of this indicator was 11 per cent.

The businesses continued to regard the insufficient demand for their production as the main obstacle to the growth of output. In the II quarter of 2010, it was mentioned by 53 per cent of manufacturers (the crisis maximum of Q1 2009 was 67 per cent). In the second place was the lack of funds, which was mentioned in the list of barriers by 45 per cent of the companies. Decrease of this hindering effect during the crisis quarters was only 5 points - that is, there were no significant changes here. The third place was taken by the main problem of the Russian industry, i.e., the lack of staff! It was mentioned by 26 per cent of enterprises, the crisis minimum a year earlier amounted to 14 per cent. In the fourth place there were non-payments of customers and competing imports. Mentioning of non-payment has reduced during the crisis from 41 to 22 per cent, mentioning of imports has increased from 13 to 21 per cent. Vagueness of the current economic situation made it difficult to take decisions only to 20 per cent of the directors of industrial enterprises. A year ago, this factor was considered a hindrance by 45 per cent of IEP (among which 90 per cent were enterprise directors, their deputies and heads of economic units). Thus, the management of enterprises was clearly better informed of the situation.

In April 2010, Russian industries continued to increase the number of their employees. Growth rate remained unchanged as compared with March level, when for the first time during the crisis recruitment exceeded the dismissal level. Staffing plans of the enterprises in April have not changed – for the fourth month in the industries intentions to increase the staff were dominating. As a result, by the II quarter of 2010, industries got rid of the excess of employees in view of anticipated changes in demand: the share of "more than enough" estimates caught up with the share "insufficient" estimates; the balance was zero (see *Figure 15*). The crisis maximum of this balance has been registered in the I quarter of 2009 and made 26 points, the absolute minimum during the pre-crisis period (-20 points) was recorded in the I quarter 2008. At the level of individual industries a shortage of employees was noted: the answers "insufficient" became dominant in the light industry and construction industry.

Easy access to credits for the industries continued to grow: in April, the normal access to borrowed funds already had 61 per cent of the enterprises. However, within four months in 2010 this indicator increased only by 7 points, whereas in the IV quarter of 2009 it has grown by 14 percentage points. Lending recovery for the Russian industries has definitely slowed down. Average minimum interest rate on ruble loans offered by the banks was decreased in April for the industry in general to 15.7 per cent per annum.

The ability of businesses to serve the existing loans continued to increase. In April 2010, already 78 per cent of the holders of loans thought so, while in February there were 72 per cent of them. Crisis minimum of this indicator (50 per cent) occurred in April 2009. Minimum financial solvency in terms of credit in the II quarter of 2010 were: mechanical engineering (recognized by 24 per cent of businesses with loans), construction industry (also 24 per cent) and LESPROM (22 per cent). The highest self-esteem of solvency has been registered in the metallurgy: only 2 per cent of the industry have acknowledged their failure to service loans.

In May, the weak positive trend in demand for industrial production remained. The rate of sales growth has improved (after cleaning from seasonal factors) for further 2 points and has become more positive - sales began to grow more steadily. Since the beginning of the year, the indicator upgraded by 10 points – insufficient to overcome the crisis, but it is important that the growth is sustained, as in the IV quarter of 2009 the rate of changes in demand has stabilized at a negative level (i.e., the sales level was still declining). In May, the demand estimates were still positive (sales growth continued), but clearly less than at the beginning of the year.

In May 2010, the satisfaction in demand has increased to 58 per cent for the first time during this crisis having exceeded the share of responses "below normal" and has reached the pre-crisis level (September 2008). The gap from the crisis bottom (19 per cent, April 2009) has already reached 39 points. The highest satisfaction with sales volumes was registered in August 2007 and amounted to 72 per cent. Formally the difference between that absolute maximum made 14 points. The sharp increase in sales satisfaction in the previous months (23 points in March - May) at the background of a very slight change in their growth rate (by 6 points over the same three months) demonstrates, that the industries in the II quarter finally came to terms with the sluggish recovery from crisis and had little hope for restoration of former high growth in demand and output.

However, the normal level of demand for businesses before the crisis and that in 2010 is not the same, which is demonstrated by production capacity utilization. On average in 2007, the demand was considered normal if 77 per cent of capacities were utilized, and in the II

quarter of 2010 that level reached 72 per cent. In 2001 production capacity utilization with normal volumes of sales was 62 per cent.

The growth rate of output in May has increased (after cleaning of seasonal factors) to 15 points and as a result has reached the maximum of the previous crisis months and the level of the average indicator of the first half of 2008. In I quarter of 2010 the growth was 10 points, in the IV quarter 2009 - 9 points. Planned output growth has also reached the crisis maximum. In May 2010 they caught up with the plans of August 2008

In May, prices of enterprises continued to increase. The rate of their change since the beginning of the year was within the range of 9 + 13 points, which definitely indicated the confidence of producers in their market power (see *Fig. 16*). Within the twelve months out of twenty months preceding the crisis, companies have been forced to reduce prices.

At the end of the II quarter low demand for industrial products has become a matter of concern to enterprises, forcing them to amend prices and HR policies, but has not prevented the growth of output and control over stocks of finished products.

In June, the growth in demand for industrial products was sustained, but the rate of its growth has remained very low, little different from zero. Therefore, in the middle of the year there was only a pause in falling sales. The total growth of demand for industrial products has not yet begun. The situation of "neither growth nor decline" was recorded in October 2009 surveys, when the difference in changes of demand for the first time during the current crisis was close to zero. As a result, for the third consecutive quarter there was no substantial progress in the dynamics of sales in the industries.

This uncertainty provoked nervousness in the enterprises assessment of the current sales. Before July 2009 the share of "normal" assessments for about 8 months remained at the bottom of the crisis (satisfaction was at the stable level of 23 per cent), and then went up to the next level of 35 per cent. Then the uncertainty in the industries became to vary: the satisfaction jumped from 33 to 54 per cent at near-zero growth in demand (see *Fig. 7*). Producers seemed to be trying to figure out, what is happening in the economy and what volumes of demand are adequate to the situation. As the result, in the II quarter of 2010 the enterprises of ferrous metallurgy (74 per cent were satisfied with the sales), chemical and petrochemical enterprises (71 per cent), and food industry (64 per cent) were able better to adapt to the industrial demand dynamics.

Dynamics of stocks of finished goods assessments in the first half of 2010 had a steady positive trend, demonstrating a good management of supplies in this crisis. Only within six months (from November 2008 to April 2009) industries had the highest excessive reserves at their warehouses. In May 2009 the balance of assessments has returned to the level of 2004-2005, and from December 2009, it was declining gradually to the indicators of 2006-2007. The problem of stocks of finished goods, so acute in the Russian industries in the 90 years of the twentieth century, was the most easily solvable in this crisis.

According to the surveys, output growth in June reached the next crisis record and was closer to the values of this index began in 2008 (see *Fig. 17*). Therefore, the industries in September 2009 have demonstrated quite good and stable production growth in the time of crisis. Output plans in the first half of 2010 maintained high and relatively steady optimism.

In June the companies had again decided to use price leverage to promote sales of their products and suspended the growth of wholesale prices, which was in effect from the beginning of the year. Monthly rate of price growth has declined from the crisis peak to almost zero (see *Fig. 16*). There was no such a significant pricing adjustment since December 2008. And

the price plans of enterprises since March stabilized at the level of actual growth rate of January - May, indicating that the June adjustment was unplanned and demonstrating the desire to restore the growth of prices in the coming months.

In June, industries have continued recruitment, which began in March. The growth rate of employment within all those months was low, but stable. Businesses were accurate in labor market policies, selecting, apparently, the most skilled workers. Nevertheless, their forecasts for the next six months fell down to a minimum. According to the estimates, in 2010 the companies were more focused in planning its staffing policies on the forecasts of demand, rather than on the output plans. In 2009 the situation was reverse. In 2005-2007 hiring of employees was also dependant on the demand.

The ability of businesses to pay the loans was in the middle of 2010 81 per cent (among those who had credits), but remained virtually unchanged for two months. The worst indicator (monitoring began, unfortunately, only in March 2009) was recorded in April 2009. Afterwards only 50 per cent of the companies, who took loans, recognized their ability to pay its debts. Other 50 per cent critically assessed their ability as insufficient. This distribution of ratings in responses to such a delicate and painful issue demonstrates, in our opinion, the reliable answers of enterprises. The highest inability of businesses to service their loans was recorded in April - June 2010 in construction materials industry. It was noted by 26 per cent of businesses with loans. In second place was mechanical engineering - 22 per cent, in the third place - LESPROM (18 per cent). Only steel mills were confident in their credit ability for 100 per cent.

4.2.3. Third quarter: there is no more optimism

The lack of positive trends in the sales dynamics has misled the businesses, started to affect the forecasts and to restrain output growth at the beginning of the second half of the year.

The intensity of demand growth in July did not experienced significant changes and remained almost at the zero level: there was neither particular growth, nor significant reduction of sales in the industry. Similar dynamics of sales was recorded in the surveys in February 2010. The similar Fig. was observed at the baseline data (before cleaning from seasonal factors), although in this case the absolute levels were somewhat higher. But the conclusion was the same: no changes in the dynamics of demand for industrial products were observed in the first half of the year.

This situation has forced the companies to change their estimates of demand again. As a result, in July they were improved by 13 points (in June, deteriorating by 17 points was noted), and got increased again - the share of answers "below normal" again proved to be in the minority. This indicator was highly volatile from the beginning of 2010, which indicated the absence of estimates of the current situation. Confusion in the state industrial statistics resulted in further aggravating of the situation. The lack of positive trends in demand has brought pressure on optimistic forecasts of businesses. In July, the expected changes in demand were the most pessimistic since the beginning of 2010.

In July, the surplus stocks of finished goods were expired in the industries in general – i.e., the share of responses "below normal" caught up with the share of replies "above normal". A similar situation was quite rare for post-default period: companies still prefer to have a small surplus of finished goods inventory to meet unexpected orders. In mid-2010 the share of replies "above normal" has fallen to historic minimum, while the share of responses "normal" has reached the historic maximum (see *Fig. 18*). This was the result of intense reduction of

volumes (not to be confused with estimates!) of stocks in the II quarter. In the III quarter the industries planned, despite the forecasts of Ministry of Economic Development, to continue to reduce their stocks, and most intensively in 2010.

Low demand has begun to hinder the growth of production in the Russian industry. In the III quarter it was mentioned as an obstacle to growth in output, which increased by 9 points and reached 61 per cent. In the second place remained a lack of operating assets, but the prevalence of this interference was reduced to 30 per cent, which was an absolute (!) minimum within total monitored period since 1993. The Fig. is complemented with 5 per cent share of responses on the lack of credits, which was recorded in the surveys of two consecutive quarters. In the third place there was the lack of personnel (a quarter of enterprises suffered from this factor over the past two quarters) indicated not so much about the current issues of industry, but demonstrated the high readiness of enterprises to respond on increased demand and that the businesses remember the staffing problems of pre-crisis years.

After five months of stable and relatively high (in terms of crisis indicators) increase of selling prices, in June - July the businesses attempted to activate demand for their products due to more moderate increase in prices. If in January - May 2010 prices were rising at the rate of 11 balance points, in June - July that rate fell down to 4 b.p. However, such an adjustment of price policy was not scheduled. This is reflected in the price plans of enterprises, who have maintained a high anticipated rate of price growth up to July.

HR policy of enterprises in the middle of 2010 was influenced by two opposing trends. On the one hand, the lack of growth in demand forced the companies to be cautious in hiring employees. On the other hand, the lack of growth in demand from month to month increases the probability of its recovery in the next month. The latter increased the industries readiness for the post-crisis breakthrough and urged them to accumulate resources for it (even more so - reserves), and in the first place - the most deficient ones. And in the pre-crisis years it was the personnel. As a result, at the beginning of the III quarter the businesses returned to the same (as in March - May) rates of increase of the number of employees (see *Fig. 8*).

Assessments of the current number of employees have confirmed the preparation of the businesses to increase production. In the III quarter due to anticipated changes in demand, the staff shortage in the industries has increased. For the first time the shortage (i.e., prevalence of "less than adequate" estimates) was recorded in the surveys of Q2 2010. Meanwhile, there was no deficit in production capacity, typical for post-crisis output growth. The balance of capacity ratings was positive, i.e., responses of "more than enough" were dominating. In the III quarter capacity prevalence has even increased as compared with the Q2 2010, when hopes for an early exit from the crisis were stronger.

The struggle for deficient personnel forced the businesses to increase wages. In Q3 2010, a normal (though, according to business leaders) salary level was achieved in 56 per cent of the plants (see *Fig. 9*). In the pre-crisis 2007, that indicator rose to 60 per cent, and during the crisis in 2009 it fell down to 37 per cent. In mid-2010 the estimates of the ratio of wages of employees has reached the pre-crisis level. It should be noted, that this is the estimated, rather than the absolute range of salaries.

In August, the Russian industries maintained the same rate of growth of output, prices, employment, but the deterioration in estimates of demand, sales, production planning and recruitment, prudent inventory management policy were demonstrating the growing uncertainty of enterprises.

Decreased demand growth in August did not surpass the zero level, which was sustained since February 2010, i.e., the businesses did not register demand growth for seven months and got used to this situation. The latter urged businesses to make more realistic assessment of sales - in August 63 per cent of businesses estimated their sales volumes as normal (growth in comparison with July by 13 points). However, estimates of sales index remained the most volatile in 2010. Demand forecasts in August also demonstrated negative dynamics. Both, the original, and cleared from seasonal factors estimates indicated willingness of the industries to zero growth in demand in autumn 2010, whereas in the I quarter of the year the businesses expected sales growth at the rate of +10 ... +13 balance points. Therefore, the optimism of the beginning of the year gradually diminished. In August, for the second consecutive month, the businesses reported an absence of surplus stocks of finished products in the warehouses in the industries in general. The balance of assessments stopped in the negative zone, indicating that the growing prevalence estimates of "below standards" over assessments "above normal" and the uncertainty in demand growth.

Output growth in August, according to the businesses, survived and did not change as compared with previous months in 2010. However, in the autumn months the companies planned to move to a less intensive output growth. Estimated production growth decreased to the annual minimum, according to both, the initial and cleared from the seasonal factors indicators.

In August, the industries continued to hold their prices growth at one of the lowest level in 2010, and in general have not yet succumbed to inflationary fever of abnormally hot July - August. But the food industry, which to increase prices in May - July, in August has reported on the most intensive growth in 2010.

In August the industries returned to the former (+ 5points, as in March - May), rate of employees' recruitment. Therefore, the businesses continued the recruitment, even in the absence of growth in demand and with a deterioration of forecasts for output and sales. But in the next few months these positive processes were expected to stop. Plans to change employment rate in September - October have been reduced to the annual minimum and reached zero - the industries planned to stop recruitment.

Availability of credits after stabilization in May - July at 65 per cent in August has increased to 69 per cent - the banking system has again lowered the requirements to the borrowers from the industries (see *Fig. 12*). In August, it has involved mainly machine building plants, whose access to credits has increased from 64 to 71 per cent. The banks and food businesses were in the same position. But the metallurgy still remained at the first place (78 per cent). The light industry is treated by the banks in the worst manner. Average minimum interest rate for ruble credits offered by the banks in August has decreased to 13.5 per cent per annum, with a normal (for the businesses) availability of credits, it was 12.5 per cent.

The ability to service existing credits in the industries has stabilized at 80 per cent (of the number of businesses with loans) from April 2010. During this period 16-19 per cent of the enterprises recognized their failure to meet liabilities to the banks. Therefore, the prevalence of bad loans (of borrowers) in the industries in general has become stable. The greatest credit risks were registered in the construction industry (31 per cent of enterprises), in light (29 per cent) and wood processing (25 per cent) industries.

Final assessments of enterprises of their real (not reporting - for tax) financial and economic standing has stabilized in Q2 and Q3 2010 (see *Fig. 19*). The overwhelming majority (69 per cent) of producers estimated their position as satisfactory; herewith the share of such as-

assessments did not change during four quarters and has become very close to the middle values of this index in the pre-crisis 2007, when it made 73 per cent. Therefore, the industries have definitely overcome the crisis in financial terms. In the second place by prevalence were the businesses, estimating their financial and economic standing as "bad". They have stabilized too and averaged 21 per cent (10 per cent before the crisis). In the worst quarters of the crisis the share of these estimates increased to 36 per cent. The share of estimates "good" in the II and Q3 2010 has reached the crisis maximum of 9 per cent, but was too far from the average indices of 2007 (17 per cent).

In September, there were no significant positive changes in the dynamics of majority of indicators in the industries. Herewith the assessments of stocks of finished goods and recruitment policies have shown a growing uncertainty of the businesses in the future.

In September, there were no actual changes of demand for industrial products. Therefore, the stagnation of sales (growth rate does not exceed the range -3 ...+ 3 points) remained in the Russian industries since the beginning of the year. Prospects for growth in demand for products also improved in September as compared with August and also have not undergone significant changes against previous months of 2010. Businesses still have not seen tangible opportunities to increase sales of their products. Herewith, satisfaction with the current sales in September has decreased by 6 points, which was a modest change after the growth by 16 points within the previous two months (see *Fig. 7*). The industries, therefore, still remain in some hesitation about volumes of demand, which are adequate to the current economic situation.

The dynamics of assessment of stocks of finished products more and more clearly indicated, that the confidence of the businesses in the fast sales growth was getting less month by month in 2010. The share of responses "below normal" has reached in September 2010 the seven-years (!) maximum. Meanwhile, the share of responses "above normal" has reached the absolute (1992-2010 years!) minimum. As a result, the balance has decreased to 10 points after -2 and -3 points within the preceding months. It means that the prevalence of estimates of "below normal" has become even greater in the industries. Such a low value of the balance of estimates for the reserves has not been observed in the Russian industries since 2000, when the businesses believed in the sustainability of the post-default growth and have moved from policy of minimized stocks to maintaining their abundance. In the III quarter there was observed a reverse trend in the situation development. However, there were no objective limitations for replenishment of the warehouses in the industries, some capacities were idle, there was no problem with staffing, and credits became cheaper, sales volumes were low. However, the businesses need excessive stocks for quick execution of the new (unplanned) orders. Therefore, the reduction of warehouse stocks in 2010 was a deliberate policy of the Russian producers, who were losing confidence in the appearance of new customers and in soon transfer from stagnation to a noticeable increase in demand.

In general, until September the industries with extreme caution reacted to the inflationary boom, generated by the anomalous heat. The balance of the prices growth varied from +6 to +8 points (see *Fig. 16*). The reaction of food companies was, of course, the most expressed. While in June – July the share of reports on unchanged prices in the industries amounted to 92-95 per cent, in September it dropped to 62 per cent, whereas the share of reports on price growth has increased from 2 to 38 per cent. But plans to change the prices indicated the desire of the businesses to recover this inflationary impulse in future. In September, pricing intentions have not changed and remained within the indices of the preceding seven months. The

exception was, of course, in the food industry, which had an intention to retain high actual rate of prices growth of September in October and November.

In August - September industries have nearly stopped the recruitment of personnel. The growth rate of the number of workers decreased to +3 points after + 8 points in July and +5 points in March - May. The businesses in spring and summer of 2010 began to create a reserve of skilled personnel in anticipation of a possible increase in demand, but the extended recovery from the crisis has forced them to suspend the process. Meanwhile, within recent months of the year, the industries planned to resume the dismissals.

The decreasing tendency of the businesses to improve productivity has become was one of the results of activation of recruiting policy in the II and III quarters of 2010. The index, calculated on the basis of changes in the plans for changes in the output staffing number, has declined to 25 per cent, whereas in Q1 its value made 36 per cent. Those indicators can be interpreted as the share of industrial enterprises, which are ready to increase output faster than the number of employees.

In autumn the banks continued to expand opportunities of industries crediting, but only at the expense of reducing the proposed interest rates on loans to enterprises. In September, this indicator decreased generally in the industries up to 13.2 per cent per annum in rubles against 13.7 per cent in August. The lowest rates were offered to large (over 1000 people. employees) businesses – 11.2 per cent; to small and medium businesses, in the best case, at the rate of 15.7 per cent per annum (see *Fig. 20*).

4.2.4. Fourth Quarter: What is Going on in the Russian Industry?

In October there were no significant changes in the dynamics of demand. The balance of that indicator has remained between -3 ...+ 3 points. Within nine consecutive months the sales growth rate differed little from zero - the stagnation of demand was sustained. Due to this circumstance, businesses have been forced to assess their scope of sales less critically. In August - September the satisfaction of demand in the Russian industries averaged 58 per cent, which became the crisis record. Demand forecasts in October remained at September's level - at the best level of the preceding nine months. The industries have maintained some hope for growth in demand, but the New Year holidays will reduce the optimism of these forecasts.

The stocks of finished products in the Russian industries continued to decline. In October the share of answers "below normal" increased to 22 per cent, resulting in the maximum level from May of 2001 (see *Fig. 18*). Then, in early 2001, the Russian industries have finally believed in the sustainability of post-default (and importantly - non-barter) growth in demand and have moved from policy of minimized stocks to their abundance. In the second half of 2010, the belief in the imminent restoration of the pre-crisis growth, by contrast, began to decline. It forced more and more companies to minimize their inventories of finished products against the regular levels. As a result of growth in the share of estimates "below normal" and reducing share of estimates "above normal", the balance (i.e., the difference) between them has declined in October to -12 points and has reached the 10-years minimum. Negative balances were recorded in all industrial sectors, indicating a widespread uncertainty of businesses in the early industrial growth.

Dynamics of production in October, according to the businesses' estimates, has not undergone fundamental changes as well. The balance remained between +11 ... +16 points, which was sustained over eight months. Production plans of enterprises remained at the level of the

crisis maximum peak. The industry has not finally parted with the hope for significant industrial growth recovery.

Low demand remained the main obstacle to the output growth, but its mentioning has considerably reduced during both, after the crisis peak in January 2009 (69 per cent), and after Q3 2010 (55 per cent). In late 2010 in only 43 per cent of businesses the demand prevented increase of the output. The lack of working capital has reached the historic minimum in hindering the effect of the Russian industries output in Q3 2010, when, perhaps, a modest faith in output growth has matched with the provision of its own resources and the increasing availability of bank access. In Q4 the frequency of this factor mentioning has increased by 5 points.

The lack of staff has undergone the strongest changes during the current crisis. Before the crisis (in Q3 2008) a half of the Russian industry suffered from the lack of staff. Afterwards, in Q2 and Q3 2009, the frequency of rate of that obstacle mentioning has increased up to 14 per cent, and to the IV quarter of 2010 it rose up to 32 per cent. Therefore, the businesses have faced the staff deficient already at the stage of stagnation. The combination of the lack of personnel with the dynamics of employment (termination of recruitment and the intention to reduce the personnel) indicates the structural problems in the labor market and the growing prudence in personnel policies of enterprises.

Defaults of payments, which were the main fear at the beginning of the crisis, have reduced their negative impact on the Russian industries. In late 2010, their impact has fallen to 17 per cent after 41 per cent at the peak of the crisis. The imports, on the contrary, have gradually, but still very slowly recovered the impact on domestic producers. At the peak of the current crisis the restraining influence of import fell down to 13 per cent after 31 per cent in the mid-2008 (absolute maximum of all period under review). Within seven crisis quarters of 2010 the imports have already managed to win back 10 points and in the IV quarter of 2010 had interfered with 23 per cent of the businesses. We would like to note, that the default and ruble devaluation in 1998 there was a decline of negative impact of imports on the Russian industries by 3 per cent (in Q3 1999 there was an absolute minimum).

Pricing policies of the businesses have undergone significant changes in October. First, the industries have demonstrated the most significant growth in prices during the current crisis. After saving a relatively modest price growth in June - September at the rate of 8.4 points, the balance growth in October has reached 13 points. Secondly, the price forecasts of the businesses have also increased significantly in October after the seven months of gradual slowdown.

The lack of positive changes in the dynamics of demand and output has forced the businesses to stop recruitment. In October the rate of employment growth in the industries has definitely lost its positive indicators, but has not yet turned negative: recruitment has apparently ceased, but substantial layoffs have not started yet. However, the plans of enterprises indicated a high probability of the sustained negative trends in the dynamics of employment. The balance of the expected changes in the number of employees as a result of the seven-month decline has become definitely negative, became negative and the worst in 2010 (see *Fig. 8*).

In November, the surveys have registered positive signals from Russia's industries, while maintaining a number of negative factors. The growth in demand and output continued, the forecasts of these indicators remained at the peak of the crisis. Changes in the estimates of stocks of finished products have demonstrated the readiness of the businesses to the larger increase in demand. Anyway, the acceleration of price growth rates and expectations of inten-

sive growth of costs (most likely due to increased insurance deductions) should have a negative impact on sales. The dynamics in the availability of credit has been reduced.

The source (not cleared from the seasonal factors) data on the dynamics in demand have again showed zero growth in November. This situation with the sales persisted in the industries since August. However, after clearance from seasonal and calendar factors, the growth rate of sales has acquired a positive value: the demand grew, with growth in October and November 2010 - the maximum for the current crisis. A similar situation was observed with the sales forecasts. On the eve of the New Year holidays, the businesses expected to reduce sales of their products, it becomes commonplace for producers and consumers. But the removal of seasonal factors has demonstrates the retention of the highest level of optimism in the forecasts of demand in the industries during the crisis. Positive dynamics of actual sales and forecasts have stabilized by estimates of satisfaction in the demand. After the August upsurge up to 62 per cent, the volatility in the share of normal estimates sales have gradually faded and were fixed at 58 per cent (see *Fig. 7*).

In November, the businesses have refused to minimize the stocks of finished goods and once again moved to the sustainability of a reasonable surplus. During the preceding five months the share of estimates "below normal" was slowly, but steadily growing up due to reduced share of responses "above normal". As a result, the balance of estimated reserves has become negative and has declined to the ten-year minimum. The industries were clearly losing the belief in fast recovery of the growth in demand and have minimized their accumulation of storage, prepared for quickly satisfaction of the orders for new buyers. Such a policy of inventory of finished goods control in the businesses was usual in the 90 years of the twentieth century. It has reached the highest peak after August of 1998, when the growing demand and a lack of faith in the stability of post-crisis recovery of the industries have brought the balance of reserves estimates to the record of -25 ...- 21 points in the second half of 1999.

In November, the balance of reserves estimates became zero after 11 points in October. Continuation of this trend in the next few months will mean that the industry has found faith in a speedy recovery. Although we cannot exclude that the growth of surplus stocks has been associated with the rejection of a moderate pricing policy and a transition (possibly forced) to a more intensive increase in the price.

Production capacity utilization rate indicates a growing intensity of the use of machinery and equipment in the industries. In the IV quarter of 2010, this index has increased to 68 per cent and reached the level of the end of 2005. However, since the II quarter of 2010 the load has increased by only 3 percentage points (see *Fig. 14*).

The assessment of overcapacity also did not change within this period. The excess of equipment remained in the industries at the level of 13 points. In this case, 71 per cent of businesses had a normal, according to them, provision with the capacity for a possible increase in demand for their products. The latter index has returned to the pre-crisis level.

In November the rate of price growth has increased by several points and has reached the peak of the crisis - selling prices of businesses did not grow up so intensively since August 2008. After a relatively moderate price growth in June – September; from October the industries demonstrated their record growth. As judged by the forecasts, the companies were willing to increase prices, most likely, at the expense their sales volumes. Indeed, the sales growth rates were still very low and did not give industries sufficient grounds for demonstration of their market power. Moreover, comparison of changes in demand and prices has demonstrated, that in November the outpacing increase in prices against demand growth was registered

in the industries already at 29 per cent of the businesses, whereas within the preceding (except for the first, the most inflationary) months of 2010, this ratio of changes in demand versus prices was noted only at 18-22 per cent of the enterprises.

Since the traditional New Year's upsurge of prices and tariffs was to come only in January 2011, we have to assume, that the industry was preparing for growth rate of insurance contributions (former UST). According to a special survey of IEP, conducted in May 2010, increased selling prices would be the most common reaction of businesses on this tax innovation. 70 per cent of respondents planned to behave this way. And it seems that in November the companies have already started preemptive increase in prices, reducing the effectiveness of counter-inflationary policy of the authorities. The second most common response to the growth of the insurance payments should be reduced profits of the businesses, the third one - reduced social deductions for personnel.

Intensification of the actual increase in prices and the intention to maintain it was supported by the forecasts on excessive growth. In November in the Russian industry there was recorded the highest increase of overhead excessive costs over the past seven years. The balance of this index has increased within the quarter by 26 points and has reached +50 (see (See *Fig. 21*)).

In November, the industry in general did not aggravate the situation in the Russian labor market at the expense of staff reduction. The rate of change of the index has not decreased, as it could be expected, according the October forecasts, to distinctly negative values. It remained in the zero zone, which showed the hold-on in employment, but did not mean the beginning of significant layoffs. The businesses seemed not to be able to define their staffing policies. Uncertainty was increased by the lack of positive dynamics in sales. If in Q2 2010, industry got rid of (as a result of layoffs, and the growth of expectations for growth in demand) from the surplus labor resources, in Q3 it clearly noted a lack of personnel, in Q4 this positive trend for the period of crisis has been broken. The lack of personnel has decreased by 7 points or almost disappeared. Plans to change the number of employees reached the annual minimum in November. Reductions were planned in all sectors, except for timber industry. The most intensive - in the construction industry and mechanical engineering.

By the end of the year, the situation in the Russian industry was influenced by contradictory trends. On the one hand, data on the dynamics of demand and output, cleared from seasonal factors, has shown the achievement of the next crisis records. The situation with employment has not deteriorated (as it was expected). On the other hand, reduction of staff was still in the plans. The growth of availability of credits has stopped.

Initial data on the dynamics of demand in December have not changed: the rate of the growth rate remained at the zero level. Therefore, in the industries in general, nearly within entire second half of the year the share of reported sales growth was equal to the reports on their shares decline. Anyway, in December, 2010, formal methods of clearing from seasonal factors have demonstrated an increase in demand growth. As a result, it has reached a crisis peak and the level of their pre-crisis indicators.

In December evident improvement of the demand dynamics has not affected the estimates of its volumes. Satisfaction of demand remained at the level of the preceding months (see *Fig. 7*). Therefore, it was not too bad, because within Q2 and Q3 quarters the percentage of normal estimates of demand has been subjected to strong fluctuations, indicating the uncertainty of the businesses in which the volumes of sales could be considered adequate to current

economic conditions. At the end of the year the situation has become probably more understandable for the businesses.

Clear improvement of the dynamics of demand in December did not affect the estimates of its scope. Satisfaction of demand remained at the level of previous months (see *Fig. 7*). This, however, is not too bad, because in Q2 and Q3 the percentage of normal estimates of demand has been subject to strong fluctuations, indicating that the uncertainty of enterprises in which the sales take adequate current economic situation. At the end of the year the situation seems to be become more understandable for companies.

Despite the fact, that in the second half of the year the output growth, according to the initial responses of the businesses were demonstrating surprising stability, remaining since May in the range between +13 ... + 20 points (while excluding October and November, there is a unique range between +18 ... +20), after cleaning from seasonal factors has revived such a monotonous *Fig.*. As a result, in December, the highest rates of output growth during the current crisis have been received.

Since the beginning of the latter quarter, the industry has fundamentally changed its pricing policy and switched to steady increase in sales prices. If in Q3 the balance of price changes made 6 points, in Q4 of this index was released by an average of 17 points. The leader in intensity of prices growth within the preceding three months of the year was not the food industry, but the light and chemical industries.

In December the price plans of the businesses have also significantly changed. The industries, like in the pre-crisis time, planned a significant increase in their prices within the first months of the new year (see *Fig. 16*), even, perhaps, to the detriment of sales. But it seems, that the increase in the tax burden did not leave any other choice to the businesses. Such a sharp revision of the price plans has not been observed in the Russian industries since September, 1998.

By the end of the year, despite the clear intention of the preceding months to reduce staff, the industries have kept in general the number of employees at the same level – there was no significant recruitments or layoffs. In December, the level of pessimism in plans has decreased. If in November it has reached the year (2010) maximum of 5 points, (i.e., extensive dismissals were expected), in December balance of plans improved by 5 points, although it remained negative: the industries still expects to reduce staff. In Q4 2010 the estimates (not absolute indicators!) of salaries of workers and specialists have reached the pre-crisis level. 59 per cent of business leaders considered the level their employees' wages normal, and 36 per cent considered it below normal (see *Fig. 9*). A similar ratio was observed in 2007 and in early 2008. At the peak of crisis the assessments were reverse: only 37 per cent of the managers recognized salaries as normal, 59 per cent of leaders considered it "below normal".

By the end of 2010, the growth of credit availability has stopped. The share of normal assessments of this indicator in the second half of the year has stabilized at 66 per cent. Therefore, the banks have stopped mitigating the credit conditions of the real sector in view of continuing uncertainty. Stabilization of the interest rate, offered by the banks in general for industries at the level of 13 per cent for ruble credits, confirms this conclusion. Herewith, for small and medium-sized businesses the rate has been frozen at 15.0-15.5 per cent, for large businesses it has been maintained at the level of 11-12 per cent per annum.

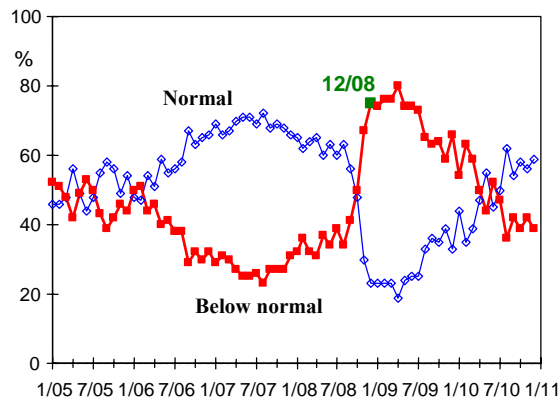


Fig. 7. Dynamics of the main estimates of effective demand

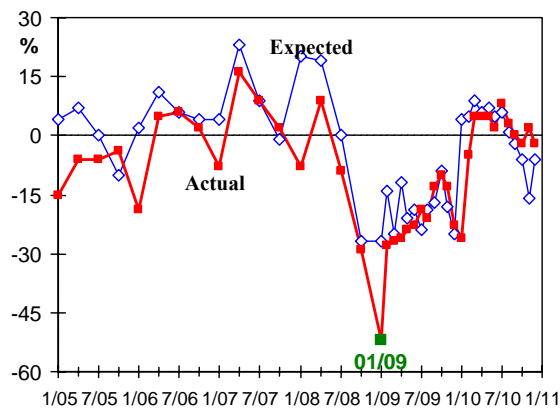


Fig. 8. Change in employment (balance = % growth - % decrease)

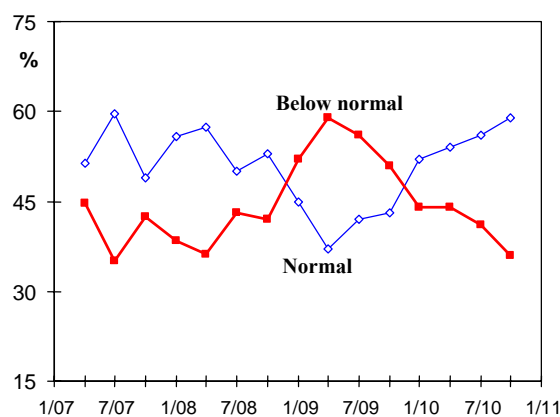


Fig. 9. Evaluation of salaries of workers and specialists by enterprise managers

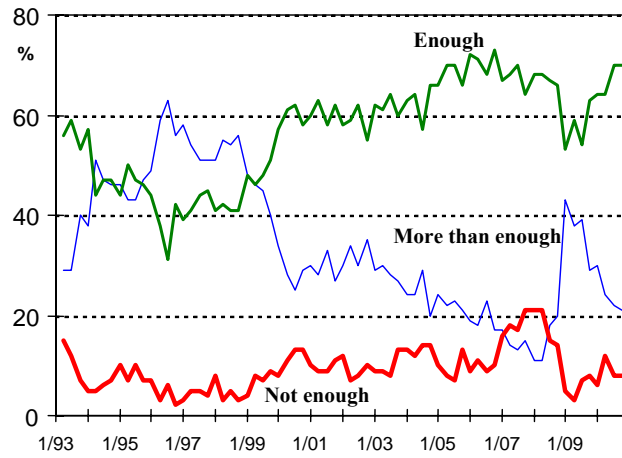


Fig. 10. Share of businesses with excessive, adequate and insufficient facilities

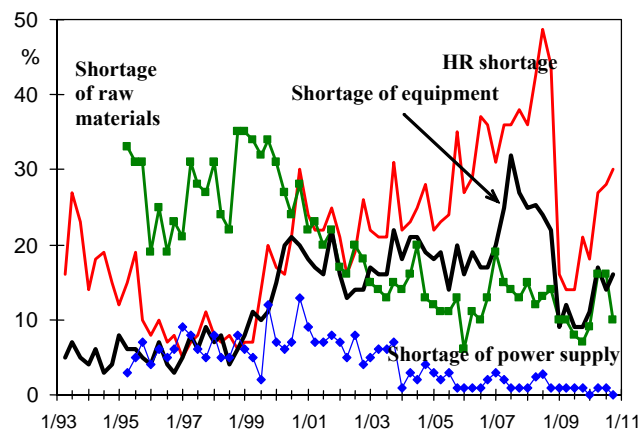


Fig. 11. Resource barriers in output growth

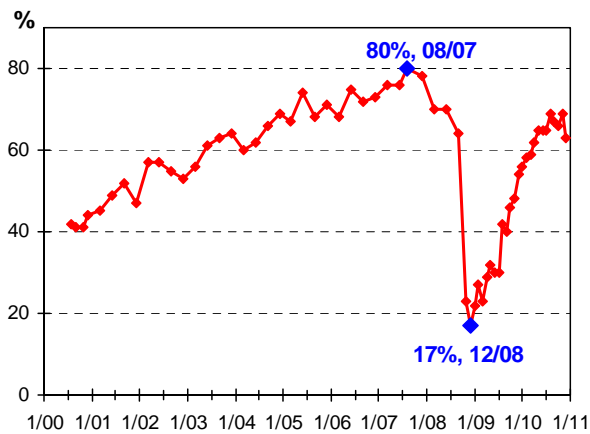


Fig. 12. The share of enterprises with normal access to credits

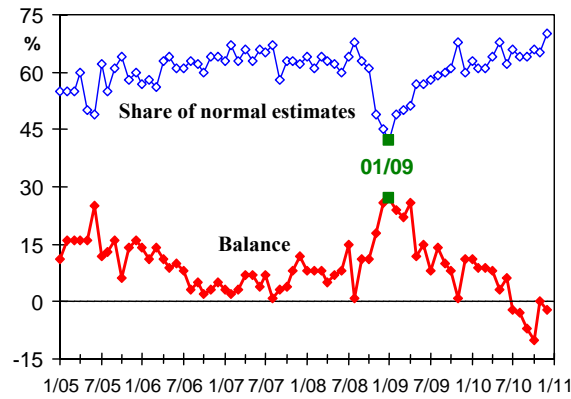


Fig. 13. Estimates of stocks of finished products balance (balance =% higher than normal -% below normal)

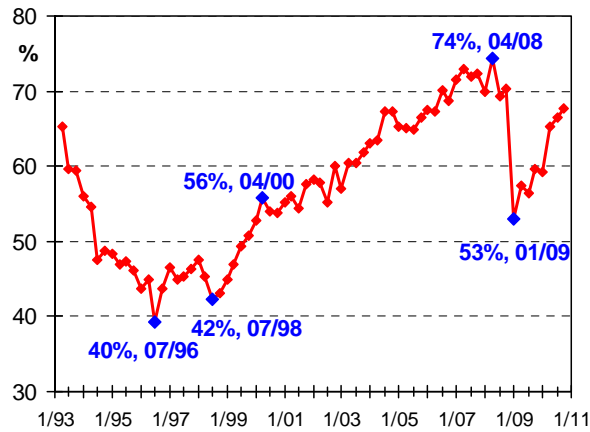


Fig. 14. Capacity utilization in industry, %

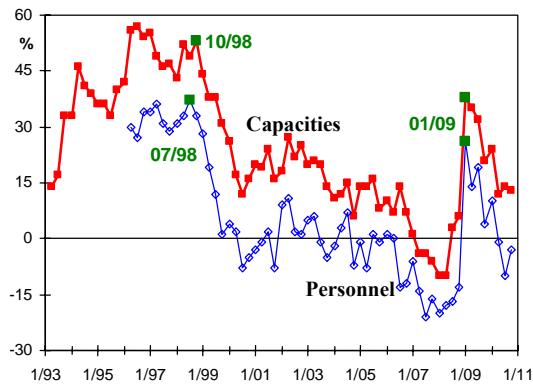


Fig. 15. Balances of capacities and staff (Balance = "more than enough"- "less than enough")

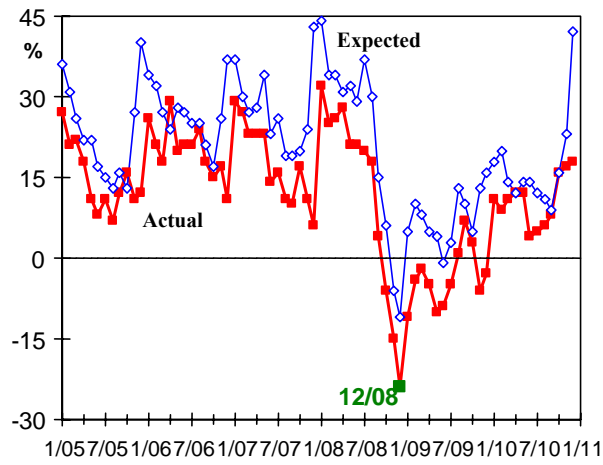


Fig. 16. Changes in selling prices (balance =% growth -% decrease)

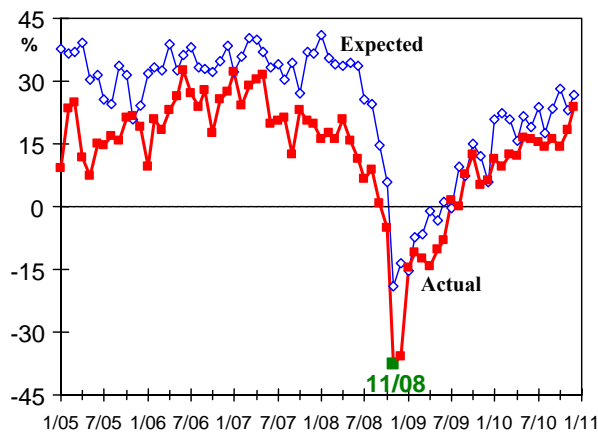


Fig. 17. Changes in production (balance =% growth -% decrease)

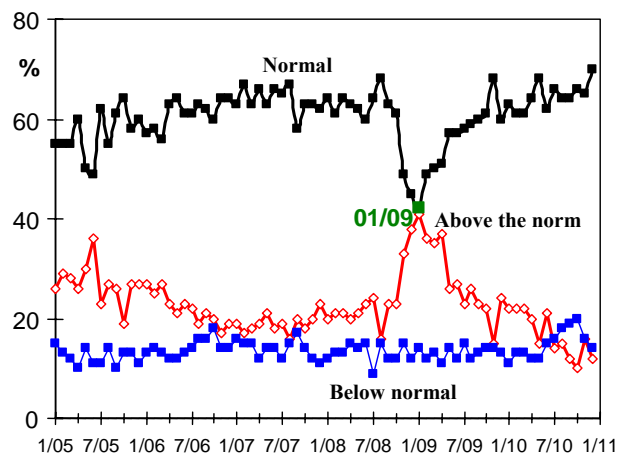


Fig. 18. Dynamics of assessments of finished goods stocks

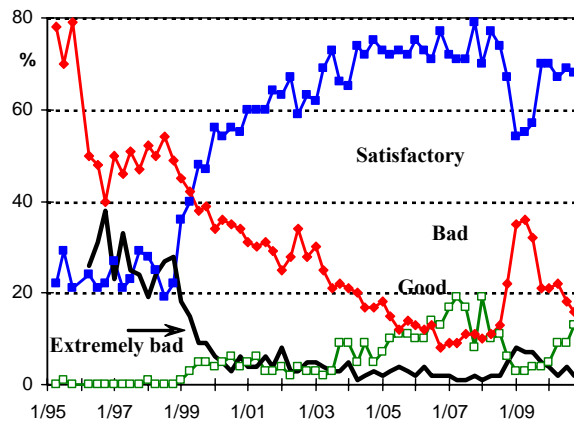


Fig. 19. Estimates of the economic situation of enterprises

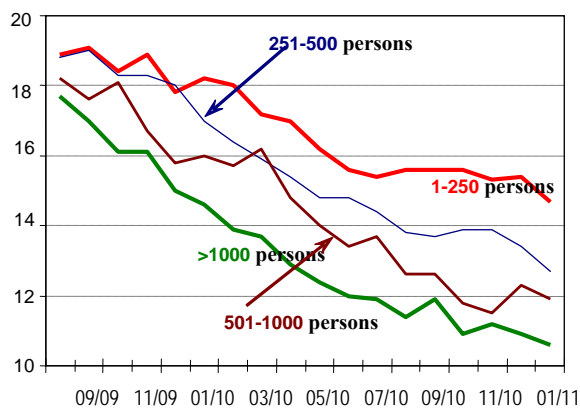


Fig. 20. The dynamics of the average minimum rate for ruble credits to businesses of different sizes, % per annum

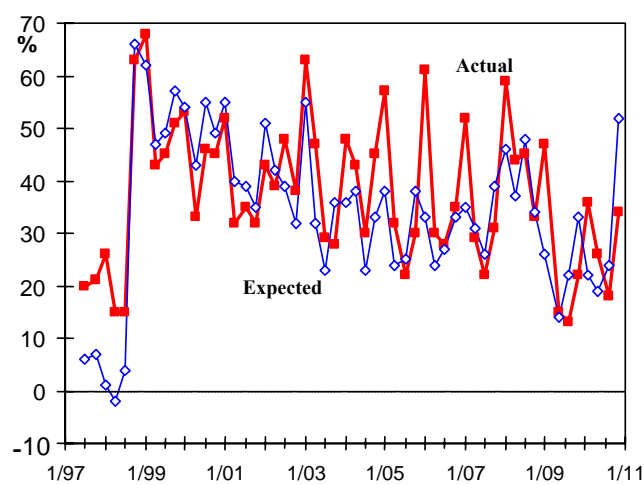


Fig. 21. Changes in the unit costs (balance =% of growth -% decrease)

