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TRENDS AND OUTLOOKS
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The review provides a detailed analysis of main trends in Russia's economy in 2015. 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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□ Gaidar Institute, 2016

Investment in fixed assets in Russia in 2015¹

4.5.1. Conditions and factors of investment activity

The crisis of 2008-2009 determined main structural changes in the formation of investment resources during post-crisis period up to 2015. Easing of economic growth rates was accompanied by a contraction of the share of gross savings in GDP from 30.2% in 2008 to 22.9% in 2014 and 23.1% in 2015 (*Table 13*). During 2010-2013 investment in fixed assets constituted around 20.0%. In 2014, owing to a reduction of revenues in the economy the share of investment in fixed assets fell to 17.8% and in 2015 came to 18.1% of GDP.

Table 13

Main characteristics of investment resources in 2008–2015, % to GDP

	2008	2009	2010	2011	2012	2013	2014	2015*
Gross savings	30.2	21.1	26.4	29.5	27.2	23.2	22.9	23.1
Gross fixed assets formation	22.3	22.0	21.6	21.4	21.9	21.8	20.6	16.2
Investment in fixed assets	21.3	20.6	19.8	19.7	20.2	20.3	17.8	18.1
Gross profit and other mixed income	32.7	30.7	32.6	31.0	33.9	33.0	32.4	30.8
Consolidated budget revenues	38.8	35.0	34.6	37.3	37.7	36.9	37.5	37.4
Budget funds for investment	3.4	3.4	2.8	2.9	2.8	2.9	2.5	2.1
Including at the expense of federal budget funds	1.3	1.8	1.4	1.5	1.5	1.5	1.3	1.2

*) Preliminary data.

Source: Rosstat.

Characteristic feature of the 2009-2015 Russian investment model consists in a decreasing norm for the transformation of gross national savings into fixed investment. If in 2008, the investment purposes accounted for 71.0% of gross savings and 95.0% of gross saving in fixed assets, then in 2015 these indicators came to 63.0% and 90.0%, respectively.

While analyzing volume, dynamics and structure of resource sources for financing investment, it is important to monitor changes in the investment potential of institutional sectors. In 2010-2015, the share of non-financial corporations and households was growing in the structure of investment resources and the share of the state sector was decreasing (*Table 14*).

Table 14

Structure of investment resources across institutional sectors, % to total

	2008	2009	2010	2011	2012	2013	2014	2015
Investment resources, total	100	100	100	100	100	100	100	100
Corporations	40.7	52.2	51.6	45.7	48.9	54.3	59.5	68.0
Including:								
Non-financial corporations	33.7	36.8	46.1	41.0	42.7	45.4	54.3	61.2
Financial corporations	7.0	15.4	5.5	4.7	6.2	8.9	5.2	6.8
Non-profit organizations servicing households	0.4	0.3	0.5	0.5	0.5	0.6	0.1	0.1
Households	28.2	68.3	46.2	30.7	31.5	36.1	32.1	31.7
Public administration	30.7	-20.8*	1.7	23.1	19.1	9.0	0.0	0.3

*) Negative value arose due to excess of capital transfers cost conveyed by state agencies to other sectors of the economy over its savings.

¹ Author of this section: Izryadnova O. – Gaidar Institute for Economic Policy.

Source: Rosstat.

The sector of non-financial corporations forms the majority share of the economy's investment resources. Easing of the economic growth dynamics in 2009-2015 was accompanied by the instability of indicators of the financial results of economic activity and limited saving of the investment resources. In 2014, balanced financial result constituted 63.4% of indicator a year earlier, which became one of the factors restricting the scale of the investment resources for the coming year. Amid decrease of economic growth rates and increased investment risks the non-financing sector responded with buildup of deposits whose rate of return was steadily increasing from 2009 and by late 2014 average weighted deposit rate for organizations hit 14.83% and exceeded the rate of annual inflation and composite price index on capital goods. Aside from that, behind the increased propensity of enterprises and organizations to save was the growth of credit resources cost from 5.5% (February 2, 2014) to 17.25% (December 16, 2015). In 2015, the impact of these factors remained and enhanced the fall of investment in fixed assets in the construction sector (*Table 15*). In the course of 2015, key rate was cut five times – to the level of 11.0% (August 3). However, it had no effect on the state of economic activity in construction and investment complex because as before possibilities to replenish working assets were limited by high cost of credit resources. Dominant source of investment resources in the Russian economy are own assets of enterprises and organizations.

Dynamics of investment resources have been significantly affected by the negative shift in the situation with the attraction of foreign investment in Russian economy. After more than twofold decrease of direct foreign investment in Russian economy in 2009, despite positive dynamics during subsequent four years there was no recovery of their volume to pre-crisis level. Russia's ratings downgrade and increasing risks have negatively told on the investment behavior of foreign investors. With the imposition of sanctions and restriction of borrowing on the external market direct foreign investment in the Russian economy in 2014 shrank threefold. By the period-end for 2016 constituted less than 20% of the indicator a year earlier. In 2014, Russian direct investment abroad shrank by 35% against 2013 amid increased contraction in 2015 to 62,1% against the of the previous year (*Table 15*). Thus, simultaneous decrease of direct investment in the Russian economy and reduction of revenues from the investment activity abroad was the factor for contraction of investment resources not only in 2015 but determined starting conditions for 2016.

Table 15

**Financial conditions for investment activity
in 2010–2015**

	2010	2011	2012	2013	2014	2015
GDP in % to previous year	104.5	104.3	103.4	101.3	100.6	96.3
Investment in fixed assets, in % to previous year	106.3	110.8	106.8	100.8	98.5	91.6
Volume of work in construction, in % to previous year	105.0	105.1	102.5	100.1	97.7	93.0
Commissioning of fixed assets, in % to previous year	93.4	129.0	108.7	101.0	97.3	n/a
Key rate (year-end), %	-	-	-	5.50	17.25	11.0
International reserves of the Russian Federation (year-end), USD billion	479.4	498.6	537.6	509.6	385.5	368.0
Net inflow (-) / outflow (+) of capital by private sector, USD billion	30.8	81.4	53.9	61.6	153.0	56.9
Price indices, in % December-on-December						
Consumer prices on goods and services	108.8	106.1	106.6	106.5	111.4	112.9
Producers' prices on industrial goods	116.7	112.0	105.1	103.7	105.9	112.4
Prices on building products (composite index)	109.1	108.0	106.9	104.9	107.2	110.3
including						
Construction and installation works, %	109.6	109.3	108.3	104.3	104.6	104.1
Machinery and equipment	106.1	105.6	103.9	103.1	112.3	120.1

Official rate USD/Russian rouble (by year-end) RB/USD	30.48	32.20	30.37	32.73	56.26	72.88
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Source: Rosstat.

Table 16

Dynamics of direct investment. Balance of payments transactions. USD million

	2008	2009	2010	2011	2012	2013	2014	2015
Direct investment	-19120	6697	9448	11767	-1766	17288	35051	16734
Abroad	55663	43281	52616	66851	48822	86507	57082	21575
In Russia	74783	36583	43168	55084	50588	69219	22031	4839

Source: Bank of Russia.

4.5.2. Material and productive resources of investment activity

One of the factors, which determine the character of investment activity in 2014–2015 was a firm reduction of efficiency of fixed assets usage. Dynamics of commissioning of fixed assets is significantly lagging behind the investment dynamics. Volumes of unfinished construction are growing. Indices of operation efficiency of the construction and investment complex are falling (Table 17).

Table 17

Commissioning of fixed assets per 1 rouble of investment across main types of economic activity. Annual average prices. Kopecks *

	2008	2009	2010	2011	2012	2013	2014
Total	65.1	80.6	68.6	80.5	80.8	82.4	80.9
Agriculture	70.0	88.9	101.2	102.0	81.1	81.5	84.5
Fishery, fish-farming	70.8	76.1	142.8	99.2	94.1	82.8	127.8
Extraction of raw materials	74.6	118.1	67.4	77.9	81.6	86.0	70.9
Manufacturing industries	63.7	78.4	67.8	77.3	69.7	79.5	79.0
Production of electricity, gas and water supply	51.9	57.4	60.3	89.5	87.8	89.5	88.0
Construction	49.8	55.5	41.0	72.2	66.2	51.7	51.6
Wholesale and retail trade	81.0	99.0	83.9	101.7	78.4	73.4	114.5
Transport and communications	59.9	65.5	44.5	69.7	77.6	67.3	71.5

*Data for 2015 will be available in late 2016.

Source: Rosstat.

With change in business climate, the share for spending on purchase of machinery and equipment began shrinking with increasing share of spending on construction of buildings and facilities (Table 18).

Table 18

Composition of investment in fixed assets across types of capital stock 2010—2015 (less small businesses and parameters of informal activity), % to total

	2013	2014	2015
Investment in fixed assets	100	100	100
including:			
Housing	6.1	6.6	5.9
Buildings (less residential) and facilities	50.2	48.9	50.3
Machinery, equipment and means of transport	35.1	34.6	32.8
Other	8.6	9.9	11.0

Source: Rosstat.

High level of wear and tear of fixed assets, unfavorable age structure of the part of machinery and equipment represents a tight constraint of economic growth. Amid prolonged downward trend in the share of gross savings in fixed assets, GDP underwent a disruption of the normal

cycle of the renewal of fixed assets. With existing level of saving in fixed assets in GDP, the investment activity was limited by the functions of maintenance of accumulated potential. Positive fact during the recent years was the change of proportions of main funds by types with outstripping growth of fixed assets in manufacturing industries against extraction of raw materials and production of electricity, gas and water supply. Highest share in the composition of fixed assets of the Russian economy has been taken by fixed assets of transport and communication (27.1%), transactions with real estate, lease and provision of services (24.8%), extraction of natural resources (10.6%). By early 2015, manufacturing industries accounted for 8.5% of fixed assets of the economy.

Insufficient volume of commissioning of fixed assets in order to ensure their renewal is also attested by the ratio between commissioning and depreciation of fixed assets. Taking into consideration the difference in prices, the cost of annual commissioning of new machinery, equipment and means of transport barely offsets their annual depreciation. Furthermore, it is obviously insufficient to overcome observed during a prolonged period the trend of aging machinery and equipment.

Comparison of output indices movement and characteristics of labor and capital utilization demonstrate that while technical and economic features of productive facilities are decreasing, the industry was subject to “tradeoff” of inputs. High level of employment of manual labor and labor on outdated equipment allowed to offset the shortage of investment resources but at the same time resulted in technological stagnation of production. Shifts in structural characteristics of utilization and renewal of fixed assets have been accompanied by a reduction of the return of capital productivity ratio and increment of capital-labor ratio. Across types of economic activity and certain years ratio of utilization of labor and capital indices rather significantly differed and were determined both by structural and business environment factors.

In 2009-2015, major factors, which hampered the investment activity of organizations were flat demand, high interest rates as well as uncertain economic situation. The share of businesses indicating the shortage of own funds as a restriction for their economic activity remained high but stayed at average values during recent five-six years.

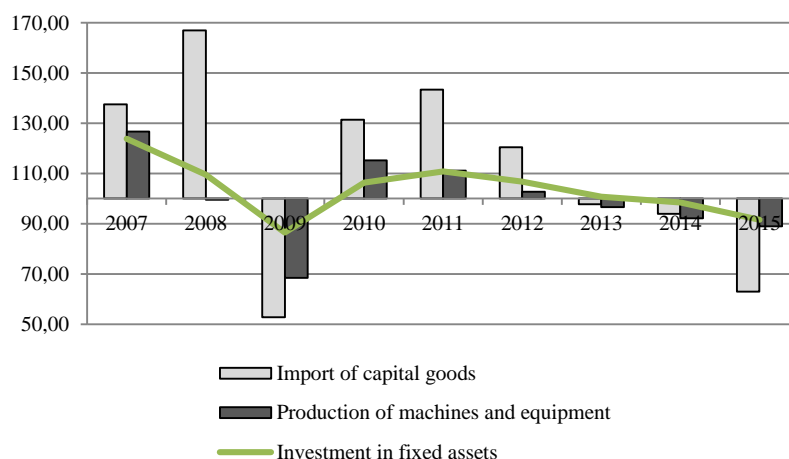


Fig. 31. Dynamics of domestic output of machine-building complex, import of machinery and equipment and investment in fixed assets in 2007–2015, % to previous year

Source: Rosstat.

The Russian machine-building complex regarding the development rates is lagging behind the dynamics of investment in fixed assets (*Fig. 31*). The shortage of domestic production of capital goods over a prolonged period was compensated for by import of machines and equipment. Procurement of foreign made equipment was advantageous for businesses for a score of reasons: owing to its low price, high quality, and envisaged after sale service. In the course of 2012-2014, the share of import of machines and equipment was gradually falling. In the economy as a whole, insufficient supply of new types of equipment was hampering replacement of the outdated and consumed assets, which negatively affected economic growth rates. From 2013, simultaneous contraction of imports and manufacture of capital goods enhanced the downward trend of investment in fixed assets. The 2015 situation was plagued by the retention of ramifications of 2009 acute crisis in domestic manufacture of machines and equipment.

4.5.3. Investment in fixed assets by type of ownership

In the course of 2010-2015, private enterprises retained growth rates of the nominal investment volumes and offset the instability of the investment activity performed by state owned and municipal enterprises. In 2015, the share of private property came to 46.2% of the total volume of investment in fixed assets and moved up by 1.8 p.p. compared to 2014.

The investment crisis developing in the state owned enterprises has taken a protracted character and has reflected low efficiency of their performance. If at the initial stage of emerging market economy the underdevelopment of the institutional structure in the short-term was partially compensated by utilization of the main factors of production then while resolving issues related to maintaining long-term growth increase of efficiency of the subjects of the investment process was getting paramount importance.

Participation of state enterprises and organizations in financing investment in fixed assets was declining from 19.1% in 2014 to 18.3% in 2015. However, one should bear in mind that the Russian economy still has a considerable share of mixed types of ownership both with state participation and private business. This enhances the uncertainty of the investment process mechanism and presupposes accelerating efforts aimed at optimization of the institutional structure and reduction of state participation in the economy and implementation of privatization programs.

Gradual weakening of the state companies' economic activity in 2012-2014, which was followed by an absolute decrease of investment in 2015 by around 21.4% from a year earlier, exerted negative impact on the investment processes.

Crises of 2008-2009 and 2014-2015 greatly affected the level of economic activity in the segment of foreign companies. In 2010, foreign companies' investment constituted 63.3% of the indicator for 2008. Recovery of the positive dynamics of foreign companies' investment in 2011-2012 was replaced by their decline during subsequent three years against general dynamics of investment in fixed assets in the Russian economy.

Investment strategy of the state effective in 2009-2015 proceeded from the recognition of big business as a major driver of national modernization and global competition. In recent years, the state was fully engaged in creation of state holding companies in aerospace, shipbuilding industries, and rail transport and oil sector. Another way of state participation in the investment process as a driver and source of financial resources was development of public-private partnership.

Crises of 2008-2009 and 2014-2015 enhanced disproportions in public investment management underlying inadmissibility of increased state participation policy and upscale of public

investment in the wake of budget deficit in the absence of efficient mechanism for increasing return on investment.

Main factors, which determine the level of economic activity in Russia still remain: inequality of rights of market agents; excessive influence and inefficient regulation of state and monopolistic sectors; lack of radical measures aimed at the restructuring of old companies, which receive state support; high barrier to entry for new companies; weak development of public-private partnership instruments aimed at stimulating investment and creation of new highly-productive work places.

4.5.4. Features of financing investment in fixed assets

Slowdown in rates of economic growth have determined enhancement of commitment to usage of own funds of enterprises for financing investment projects. The share of enterprises' own funds used for investment purposes moved up from 41.0% in 2010 to 45.7% in 2014 and to 55.1% in 2015 (*Table 19*).

Contraction of volumes and share of raised funds in the sources of financing was accompanied by a change in their structure. State demand for goods and services of Russian enterprises has been maintained via realization of planned investment projects in the sphere of transport, telecommunications, etc. realized within Federal Target Programs and Federal Target Investment Program. In line with the priorities of state investment, the investment funds have been allocated on modernization and development of strategically important for the country facilities of industrial infrastructure, as well as implementation of investment projects on introduction of modern technologies for the production of competitive goods at enterprises of machine-building complex as well as carrying out works for ensuring security of power engineering, transport, waterworks and forestry facilities. The share of budgetary funds in the sources of investment funding in 2009-2013 constituted around one fifth of the total volume of fixed investment.

Table 19

Structure of investment in fixed assets by funding sources (less small businesses and investment non-observable by statistical methods), % to total

	2009	2010	2011	2012	2013	2014	2015
Investments in fixed assets, total	100	100	100	100	100	100	100
Including by funding source:							
own funds	37.1	41.0	41.9	44.5	45.2	45.7	55.1
raised funds	62.9	59.0	58.1	55.5	54.8	54.3	48.9
Including:							
bank credits	10.3	9.0	8.6	8.4	10.0	10.6	7.8
among them the credit granted by foreign banks	3.2	2.3	1.8	1.2	1.1	2.6	1.9
borrowed funds of other organizations	7.4	6.1	5.8	6.1	6.2	6.4	5.7
investments from abroad					0.8	0.9	0.9
budgetary funds	21.9	19.5	19.2	17.9	19.0	17.0	16.5
Of which:							
from the Federal budget	11.5	10.0	10.1	9.7	10.0	9.0	9.7
from the budgets of the subjects of the Russian Federation	9.2	8.2	7.9	7.1	7.5	6.5	5.6
resources of extra-budgetary funds	0.3	0.3	0.2	0.4	0.3	0.2	0.3
funds of organizations and individuals, raised for shared construction	2.6	2.2	2.0	2.7	2.9	3.5	3.0
including individuals' own funds	1.3	1.2	1.3	2.1	2.3	2.7	2.4
other	20.4	21.9	22.3	20.0	15.6	15.7	14.7
including							
funds of higher level organizations	15.9	17.5	19.0	16.8	13.0	13.2	10.5
funds received from the issue of corporate bonds	0.1	0.01	0.00	0.04	0.02	0.1	1.6
funds received from share issues	1.0	1.1	1.0	1.0	1.0	0.1	0.5

Source: Rosstat.

The situation has not changed from H2 2014 when reduction of budget funds in the sources of financing of fixed investment was registered. In 2014, the share of budgetary funds in fixed investment contracted by 2p.p. compared to a year earlier. In 2015, contraction of the share and volumes of funds of the RF subjects in financing fixed increased to 0.7% of GDP (*Fig. 32*).

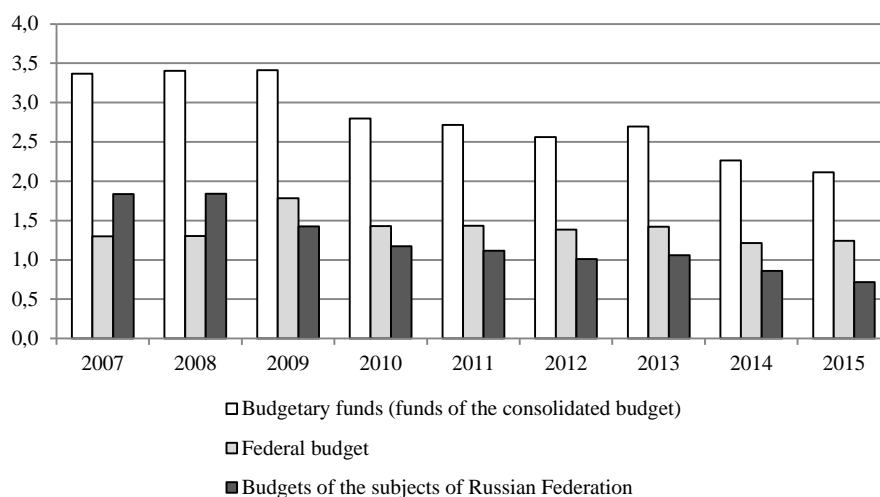


Fig. 32. Share of budgetary funds in fixed investment in 2007–2015, % of GDP

Source: Rosstat.

The banking sector's participation in financing the investment activity has noticeably weakened. In 2015, the share on bank loans in the structure of sources of funding constituted 7.8% and was 2.6 p.p. below the index of last year. Changes in the structure of bank lending is characterized by a decrease of volumes and share of loans extended by Russian banks. Compared to 2014, loans extended by the Russian banks plummeted to Rb 200.7bn (*Fig. 33*). Increase in the volume and share of loans extended by foreign banks and investment originated from abroad are explained by the nature of transfer of foreign currency into rubles in current prices.

In 2015, retention of capital outflow trend exerted a negative influence on the level of banks' participation in the financing of investment programs. According to preliminary assessment of the Bank of Russia, net capital outflow carried out by the private sector constituted \$56.9bn, including that by the banking sector - \$33.4bn

Crisis of 2014-2015 was characterized by high of decline of foreign investment in Russian economy against dynamics of domestic investment. Contraction of foreign lending volumes together with simultaneous decline of direct foreign investment predetermined a stable decrease of the share of total volume of investment proceeding from abroad in the structure of fixed investment to the minimum level for the twenty years of monitoring – 0.9% in 2015.

In 2015, there was a turning point in the housing construction trend. Following an increase in the volume of housing construction observed in 2011-2014, commissioning of new living floor space in 2015 constituted 99.5% of the previous year. The share of private housing construction in total commissioning of houses in 2015 came to 40.9% of the total volume of housing and by 2.6 p.p. less than in 2014.

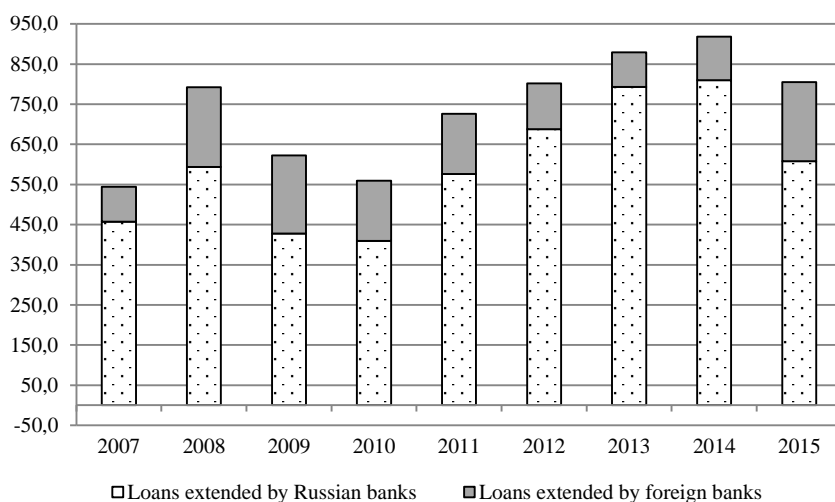


Fig. 33. Bank loans for financing fixed investment in 2007–2015, Rb bn

Source: Rosstat.

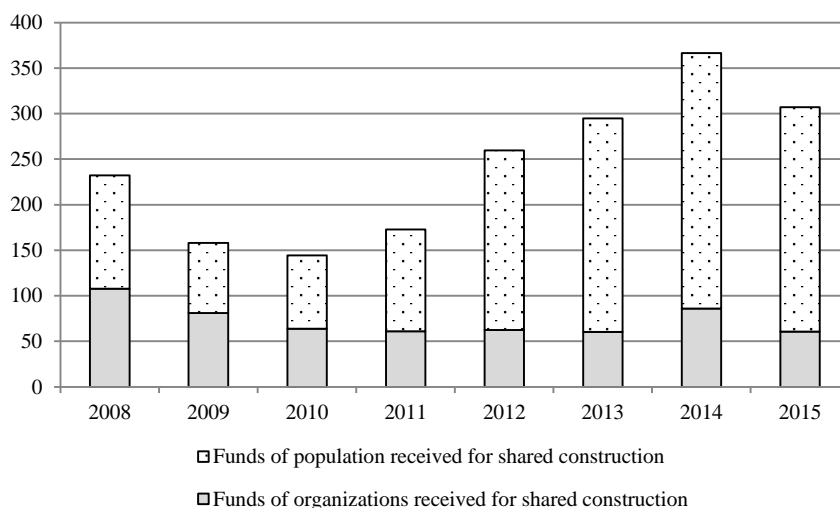


Fig. 34. Funds obtained for shared construction in 2008–2015, Rb bn

Source: Rosstat.

In 2015 against the previous year, absolute drop in the investment volume in housing construction was registered (*Fig. 34*). In the structure of fixed investment in the economy as a whole the share of investment in housing construction fell to 3.0% in 2015.

4.5.5. Dynamics of fixed investment in 2015

The trend towards contraction of fixed investment was rather predictable and was determined by slackening of the investment activity dynamics from H2 2012. In 2014-2015, the situation was complicated by general deterioration of macroeconomic conditions. As a reaction to ruble devaluation, key rate hike and inflation spiral the construction and investment complex

responded in 2015 with contraction of activity in construction by 7.0% and fixed investment by 8.4% against the previous year (Fig. 35).

Dynamics of fixed investment is different for small and large enterprises. With the reduction of the general volume of fixed investments by 8.4% posted in 2015, decrease of fixed investments in the segment of large and medium size enterprises constituted 10.2% (Table 20). The fall of the investment activity of large and medium size enterprises has been observed over last four quarters. Negative dynamics of fixed investments across the full circle of industries has been observed over eight quarters. Amid growing unpredictability of the situation on the domestic market, medium and small business with great caution treat investment decisions.

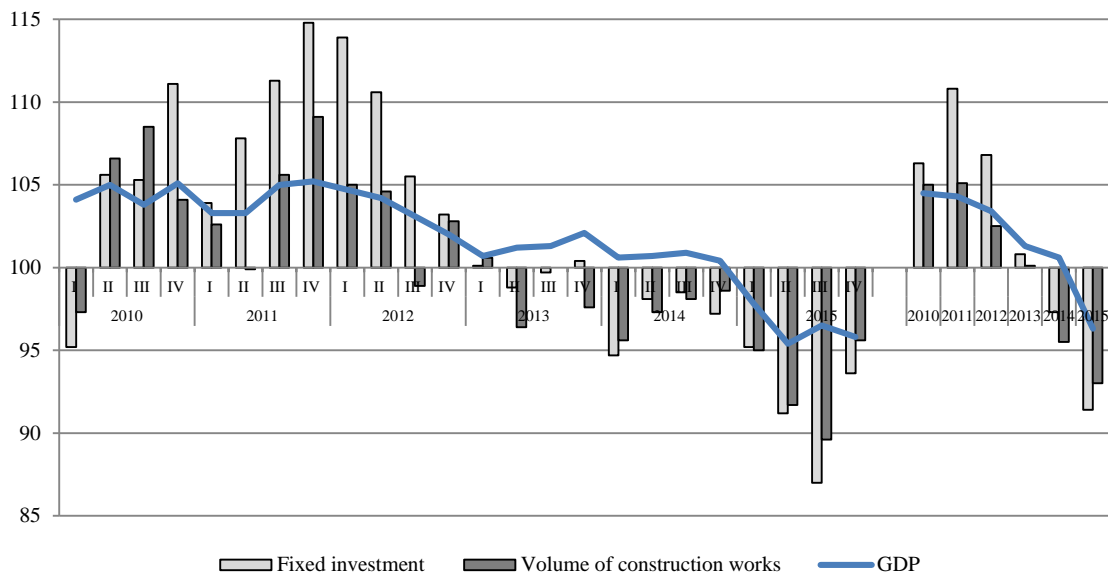


Fig. 35. Dynamics of fixed investment in 2010–2015, % to corresponding period of previous year

Source: Rosstat.

Table 20

Dynamics of fixed investment volume in 2009–2015, % to corresponding period previous year

	2010	2011	2012	2013	2014	2015
Fixed investment (across full circle of organizations, including recalculations on investment, unobserved by direct statistical methods)	103.7	105.0	109.6	98.6	98.5	91.6
Large and small organizations (fixed investments without small businesses and investment volume unobserved by direct statistical methods)	96.2	112.1	108.6	93.1	102.3	89.8

Source: Rosstat.

The structure of fixed investments across types of economic activities in 2015 suffered some changes compared to the previous year. Decrease of investments in industry in 2015 amounted to 6.1% in comparison with the previous year. At the same time, growth acceleration in the

extraction of natural resources by 10.7% was accompanied by the contraction of fixed investments in manufacturing industry by 9.5% and in production of electricity, gas and water supply by 29.1%.

In the wake of the downward trend in fixed investments, there was a fall of investment in the development of associated productions in metallurgical and building complexes and in construction materials.

Structural changes in manufacturing industries were defined by the fall of fixed investments in machine building complex by 11.3%, in metallurgy – by 6.2%, in production of coke and petroleum products – by 13.2%, and in consumer complex – by 13.6% compared to 2014. In 2015, changes in the investment pattern in the machine building complex were defined by the growth of investment in production of electric equipment, electronic and optical equipment by 12.2% amid contraction of fixed investment in manufacture of means of transport by 21.0%, and in manufacture of machines and equipment by 4.4% on 2014.

Another specific feature of 2015 was fixed investment acceleration in chemical industry by 1.14-fold, which was both due to increased export potential of these industries and to import substitution.

In short- and medium-term, the Fund for Industrial Development can provide financial assistance in the sphere of industry according to the Federal law “On Industrial Policy in the Russian Federation” (No 488-FZ of December 31, 2014). In 2016 the Fund approved loans to the tune of Rb 20 bn for the implementation of 59 import substitution projects to the total value of over Rb 162bn, of which private investments amount to Rb 142bn. In the context of issues related to provision of incentives for economic growth, the priority should be given to the infrastructure development. However, the decrease in investments in transport and communication came to 13.6% compared to 2014. Meanwhile, investments in pipeline transport contracted by 11.4%. Reduction of domestic demand determined contraction of investment in the development of retail trade, hotel industry and restaurants. Long-term trend in investment reduction in education and healthcare is alarming (*Table 21*).

Table 21

Fixed investments (excluding small businesses and volumes of investment, not observable by direct statistical methods), % to previous year

	2010	2011	2012	2013	2014	2014
Total	106.0	108.3	106.6	99.8	95.7	89.8
Agriculture	89.1	114.6	92.8	96.0	93.0	89.1
Fishery, fish-farming	108.8	137.4	127.4	77.4	83.3	60.1
Industry	106.1	110.9	107.4	96.8	99.9	93.9
Extraction of natural resources	106.6	113.8	111.8	93.6	105.9	110.7
Manufacturing	101.5	105.3	106.7	101.4	98.6	90.5
Production of electricity, gas and water supply	112.5	114.7	101.7	95.8	92.9	70.1
Construction	110.9	90.6	79.9	84.0	81.2	83.7
Wholesale and retail trade	120.2	90.0	107.1	103.1	110.7	102.9
Transport and communications	102.4	118.3	98.4	88.5	92.1	86.4
Financial activity	112.9	136.8	111.4	80.8	74.9	81.5
Real estate operations	125.4	91.9	100.8	104.4	103.1	84.3
State administration	115.2	112.4	98.7	93.7	84.4	88.7
Education	84.9	122.0	85.2	77.9	97.4	81.9
Healthcare and social safety net	109.7	113.0	93.6	98.8	71.9	79.8
Provision of other services	103.6	103.5	111.8	75.0	72.7	82.7

Source: Rosstat

Current situation in the investment sphere does not give sufficient grounds for optimistic assessments for the development of construction and investment complex in 2016.