

**GAIDAR INSTITUTE FOR ECONOMIC POLICY**

**RUSSIAN ECONOMY IN 2016  
TRENDS AND OUTLOOKS  
(ISSUE 38)**

**Gaidar Institute Publishers  
Moscow / 2017**

UDC 338.1(470+571)"2016"

BBC 65.9(2Poc)

- R95      **Russian Economy in 2016. Trends and Outlooks. (Issue 38)** / [V. Mau at al; ed. S. Sinelnikov-Murylev (editor-in-chief), A. Radygin]; Moscow: Gaidar Institute Publishers 2017. – 480 pp. – ISBN 978-5-93255-502-6

The review provides a detailed analysis of main trends in Russian economy in 2016. The paper contains 6 big sections that highlight single aspects of Russia's economic development: the socio-political context; the monetary and budget spheres; financial markets; 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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ISBN 978-5-93255-502-6

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#### 4.4. Fixed investment in Russia in 2016<sup>1</sup>

##### 4.4.1. Investment resources and financial environment for investment

The period of 2014–2016 saw mixed investment dynamics driven by the factors and conditions for (1) recovery from the crisis of 2009–2012 and (2) for Russian economy's adaptation amid restricted access to global capital markets. Russia's investment crisis hit a peak in H1 2009, and fixed investment recovered bouncing back to pre-crisis levels by 2011 year end. Fixed investment accounted for 19.7% of GDP, one percentage point below the average of 2007–2008, despite a faster rate than GDP growth in the period of 2010–2011. In 2012, the year-on-year fixed investment growth of 6.8% was bolstered by major infrastructure and social investment projects in progress. However, with the savings available at that time, the fixed investment share in 2012 was still smaller than what it was prior to the crisis. Although fixed investment growth rates was close to zero in 2013, the year-on-year growth of 0.8% influenced the investment demand dynamics in the years that followed.

The investment crisis of 2014–2016 was the longest crisis (11 quarters of downturn) over the past 17 years, having its own specific features: the internal market was shrinking as personal and corporate incomes declined; supplies of imported investment products slowed amid sanctions; the structure of investment resources changed; access to global capital markets was restricted.

The investment crisis entered its acute phase in 2015, when fixed investment dropped 8.4% year on year. Fixed investments were discouraged by a soaring cost of credit facilities, mounting inflation, Russian ruble's devaluation, changes to the pricing structure for imported investment products. The central bank key rate in 2015 varied within a range of 17.0% (December 16, 2014) and 11.0% (August 3, 2015), thus affecting the demand for fundraising for investment and for inventory build-up purposes. In 2015, prices of products manufactured by the investment/construction complex rose 10.3% relative to 2014, thus narrowing the market demand for its services, and therefore the investment/construction complex saw its ROA fall to 3.8% vs. 8.3% in 2013.

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<sup>1</sup> Author of chapter: O. Izryadnova – Gaidar Institute, RANEPA.

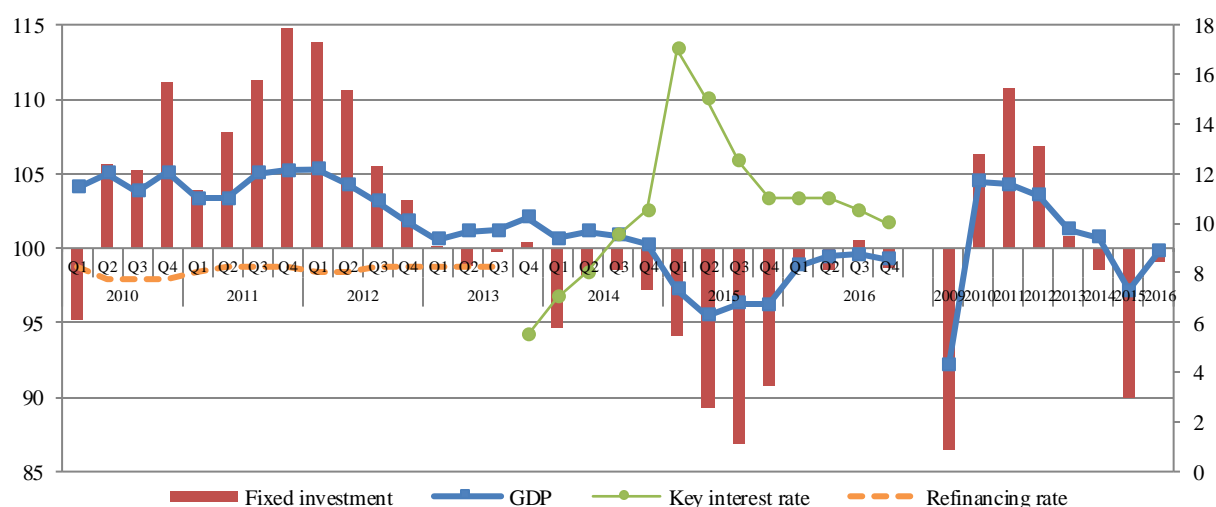


Fig. 22. Fixed investment dynamics in 2010–2016, % change, year on year

Source: Rosstat.

Although the investment crisis continued into 2016, there was an increasingly visible trend for the investment/construction complex toward adapting to a new economic environment.

In 2016, the decline in interests rates to 10.5% (July 14) and then to 10.0% (September 19) enabled the investment/construction complex to slow the fall rate and to recover some, albeit meager, growth in fixed investment (+0.5%) in Q3 2016. Note that the pricing policy of the investment/construction complex, which in 2014–2015 focused on anticipatory strong growth in prices, underwent drastic changes in 2016: the composite price index for investment products and services descended to 3.2% and the machinery and equipment price index decreased by 2.2% year on year. Therefore, the decline in fixed investment in 2016 was slower by 0.9% than that in 2015.

Table 11

Financial environment for investment in 2010–2016

Corrected	2010	2011	2012	2013	2014	2015	2016
Refinancing rate (year end), %	7.75	8.0	8.25	8.25			
Key interest rate (year end), %	-	-	-	5.50	17.00	11.0	10.0
Bank of Russia international reserves (year end), USD bn.	479.4	498.6	537.6	509.6	385.5	368.0	377.7
Net capital inflows (-) / outflows (+) in private sector, USD bn	30.8	81.4	53.9	60.3	152.1	57.5	15.4
Price indices, % change, Dec to Dec							
Consumer prices for goods and services	108.8	106.1	106.6	106.5	111.4	112.9	105.4
Industrial producer prices	116.7	112.0	105.1	103.7	105.9	112.4	107.4
Composite price index for imported investment products	109.1	108.0	106.9	104.9	107.2	110.3	103.2
Including							
producer prices for construction products	109.6	109.3	108.3	104.3	104.6	104.1	106.6
machinery and equipment	106.1	105.6	103.9	103.1	112.3	120.1	97.8
USD/Rb official exchange rate (year end), Rb/USD	30.48	32.20	30.37	32.73	56.26	72.88	62.10

Source: Rosstat.

The investment model of 2014–2016 had some specific features: an uptrend for the gross savings share due to a new ruble exchange rate emerged; growth in the share of profit and other mixed income in GDP amid a rising inflation rate had no significant effect on investment

decisions; budget-funded investment dropped to 2.0% of GDP, including federal budget-funded investment (down to 1.1% of GDP), in response to a harder line on budget constraints; high interest rates spurred an uptrend for corporate and retail deposits. For instance, in 2015, corporate money in credit institutions and retail deposits accounted for 22.8% and 27.9% of GDP, respectively. The dynamics of corporate deposits in 2016 slowed down to 19.1% of GDP in response to a decline in interest rates.

*Table 12*

**Key features of investment resources in 2011–2016, as % of GDP**

	2011	2012	2013	2014	2015	2016
Gross savings	31.2	29.6	26.3	28.6	30.2	30.6
Gross fixed capital formation	20.0	20.2	20.2	21.1	20.7	21.1
Fixed investment	18.5	18.8	18.9	17.6	17.5	17.0
Gross profit and other mixed income	41.5	41.1	39.1	38.9	43.9	42.7
Consolidated budget revenues	34.9	35.0	34.4	33.8	32.3	32.0
Budget-funded investment	2.7	2.6	2.7	2.2	2.3	2.0
Including federal budget-funded investment	1.4	1.4	1.4	1.2	1.4	1.1
Financial assets growth and real estate purchase	9.7	8.7	9.3	7.8	11.7	n/a
Retail deposits (individuals)	19.9	21.3	23.9	23.4	27.9	28.1
Corporate deposits (legal entities)	14.0	14.3	15.3	21.5	22.8	19.1

Source: Rosstat.

The dynamics and the structure of capital formation for investment purposes were heavily influenced by restrictions on inward foreign investment in the Russian economy. In 2009, inward foreign direct investment in Russia's economy failed to recover in volume terms to the pre-crisis levels of 2008 despite positive dynamics within four years after a slump by more than a half.

*Table 13*

**Russia's direct investments in 2007–2016 (balance of payments), Rb bn.**

	2007	2008	2009	2010	2011	2012	2013	2014	2015	January-September 2016*
Direct investment	-11.1	-19.1	6.7	9.4	11.8	-1.8	17.3	35.1	15.7	6.0
outward	44.8	55.7	43.3	52.6	66.9	48.8	86.5	57.1	22.2	17.1
inward	55.9	74.8	36.6	43.2	55.1	50.6	69.2	22.0	6.5	11.2

\* '+' is positive direct investment balance; '-' is negative direct investment balance.

Source: Bank of Russia.

Foreign investors behavior was strongly affected by downgraded sovereign ratings and mounting risks. Both direct investment in the Russian economy and returns on Russia's outward investment declined amid sanctions and restricted access to global capital markets. Inward foreign direct investment in the Russian economy in 2015 contracted by more than 3.4 times compared to 2014, to less than 10.6% over 2013, and outward investment dropped by 2.6 times, down 25.7% over 2013. In 2016, the scale of inward foreign direct investments increased in response to an economic relaxation in Russia, running at USD 11.2bn in the first three quarters compared with USD 6.5bn in the aggregate in 2015. Note that Russia is a net capital exporter since 2009.

**4.4.2. Tangible assets of the construction/investment complex**

Fixed investment basically focus on new construction projects, representing nearly 3/5 of total investment.

As a result of this policy, the average age of machinery and equipment fell to 11.5 as of the beginning of 2016, compared to 13.5 in 2010. Note, however, that the machinery and equipment

fleet is generally characterized as having a high depreciation rate, a big share of used up and low-retirement-rate machinery and equipment. Such an imbalance of the reproductive structure of the machinery and equipment fleet impairs the effectiveness of fixed capital and makes the Russian economy less competitive. (see *Table 14*).

*Table 14*

**Fixed assets key features as of the beginning of 2016**

	2011	2012	2013	2014	2015	2016
Fixed assets depreciation rate (at year end), %	47.1	47.9	47.7	48.2	49.4	47.7
The share of used up machinery and equipment (at year end), %	21.0	22.0	21.8	22.1	23.1	24.5
Machinery and equipment average age	13.5	13.3	13.3	13.0	12.4	11.5
Renewal coefficient (new fixed assets, as % of fixed assets at year end, in constant prices)	3.7	4.6	4.8	4.6	4.3	3.9
Retirement rate (fixed assets liquidation, % of fixed assets as of the beginning of the year, in constant prices)	0.8	0.8	0.7	0.7	0.8	0.8

Source: Rosstat.

The share of machinery, equipment and means of transport in investment spending increased because new fixed investment targets were set, as well as owing to type-related specific characteristics of spending on new construction projects, reconstruction, modernization and upgrading of production facilities.

*Table 15*

**Structure of using fixed investment by type of activity (in effective prices, excluding small businesses and investment volumes unobservable by direct statistical methods)\***

	2005	2010	2011	2012	2013	2014	2015
Fixed investment – total	100	100	100	100	100	100	100
including:							
construction	54.5	61.1	58.1	58.3	57.7	59.2	58.6
modernization and reconstruction	21.7	18.8	19.3	19.5	18.8	17.4	17.3
acquisition of new fixed assets	23.8	20.1	22.8	22.2	23.5	23.4	24.1

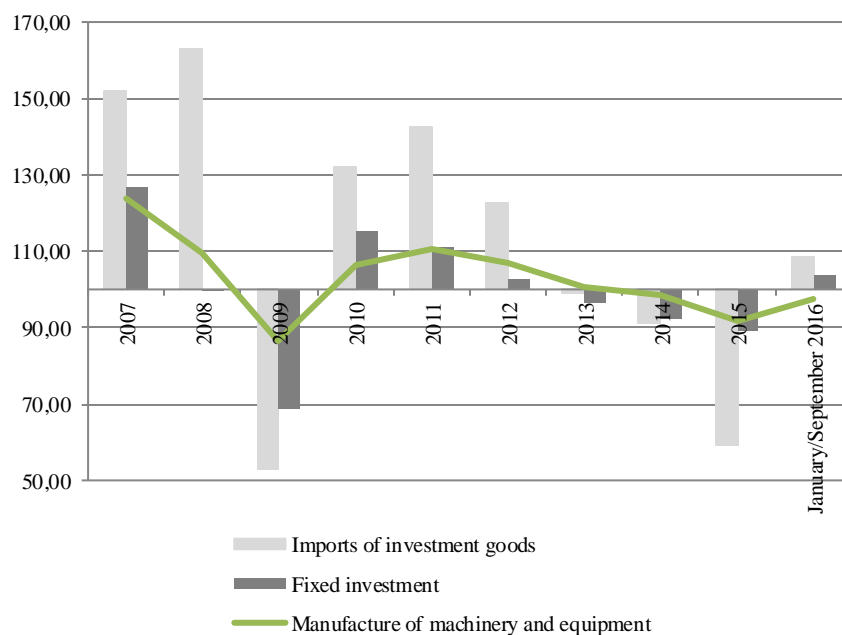
\*The data for 2016 will be released in H2 2017 as prescribed by the regulation for publishing statistical data

Source: Rosstat.

Investment money was reallocated by type of fixed assets under an updated price structure for investment products and services. Price correction was prompted by a 18.2% upsurge of prices of imported investment products in 2014-2015, including spending on machinery and equipment (up 34.9%). In 2016, price indices for investment machinery and equipment stood at 97.8% December over December. The adopted pricing strategy helped reduce costs and attain a positive net result. In 2013–2016, a lack of demand for products, high interest rates, as well as uncertainty about economic prospects, were the key factors preventing companies from investing. The share of enterprises considering the lack of own capital as the main investment constraint was equal to the average over the last five or six years, however, this was worsened by a lack of incentives for enhancing production technologies. Comparative analysis of changes to the structure of main types (by type) reveals an extremely low characteristics of adaptation to varying demand environment and production technologies. There is still a high degree of deterioration and obsolescence of fixed assets, an adverse age composition of the machinery fleet, slow rates of renewal and retirement.

Russia's machine-building complex has long been developing at a slower pace than fixed investment dynamics. The lack of domestically produced investment products was offset by imports of machinery and equipment. Prior to the financial crisis of 2008–2009 and the ruble's

devaluation of 2014–2015, enterprises purchased foreign equipment because of relatively low prices, high quality, and availability of after-sale service and support.



*Fig. 23. Domestic production dynamics in machine-building complex, imports of machinery and equipment, and fixed investment in 2007–2016, % change, year on year*

In January-September 2016, imports of investment products in volume terms accounted for 24.6% of total imports, adding 2.3 percentage points to the level seen in 2015. Positive dynamics of investment product imports and output of domestically manufactured machinery and equipment recovered simultaneously in Q3 2016 relative to the same period previous year, thus contributing to a positive fixed investment dynamics.

The dynamics of domestic production and technical and economic features of fixed assets in the investment/construction complex are definitely not strong enough to be able to boost economic modernization. There are some positive changes though. First, the share of fixed assets by type has changed over the last five years amid a faster than normal growth and renewal coefficients of manufacturing fixed assets as compared to the mineral extraction performance figures, as well as to the production and supply of electricity, gas and water; second, transport fixed assets increased at a fast pace; third, the share of trade and finance fixed assets increased showing an extremely high renewal coefficient; fourth, the share of social funds increased, with renewal coefficients being above the economy-wide average. Improved characteristics of fixed assets can facilitate the labor productivity growth potential contingent upon changes to qualitative characteristics of human capital. The Russian economy is facing growth in the capital-labor ratio amid declining capital-output ratio and labor productivity. Obviously the investment issue shouldn't be limited to just fixed assets reproduction, it should include human capital investment, too.

*Table 16*



**Capital-labor ratio index and capital-output ratio index in 2013–2015,  
% change, year on year\***

	Capital-labor ratio index			Capital-output ratio index		
	2013	2014	2015	2013	2014	2015
<b>Total</b>	105.2	104.0	103.8	96.7	97.0	93.3
including:						
agriculture, hunting and forestry	103.1	103.7	104.5	103.3	99.6	100.5
fishing and fish hatchery	101.5	104.6	100.6	102.3	100.0	97.5
mineral extraction	107.0	107.1	104.8	90.8	95.9	94.8
manufacturing	107.9	108.0	108.0	98.2	94.7	89.4
production and supply of electricity, gas and water	107.9	106.0	106.3	92.2	94.1	94.0
construction	103.6	104.0	105.4	96.4	94.7	90.5
wholesale and retail trade	106.5	104.2	106.6	93.9	95.4	84.7
transport and communications	107.0	103.4	102.4	96.0	96.6	96.7
real estate operations, renting and provision of services	101.4	100.6	100.0	98.8	96.7	95.7

\* The data for 2016 will be released in H2 2017 as prescribed by the regulation for publishing statistical data.

Source: Rosstat.

#### 4.4.3. Fixed investment financing by source and by type of ownership

In 2016, own capital, 51.8% of total fixed investment in volume terms, remained the principal source of recourse formation and investment financing at enterprises and organizations. The dynamics and the structure of using own capital to finance fixed investment corresponds closely with financial performance figures. In 2016, the net financial result saw slower growth rates, and profits from sold goods, products and services dropped to 8.2% (January-September) vs. 9.5% a year earlier. This determined structural shifts and the size of fundraising to finance investment programs. In 2016, the share of bank loans was up to 10.6% (+2.4 percentage points over 2015), including Russian banks (up to 7.6%, +1.2 percentage points) and foreign banks (up to 2.9%, +1.2 percentage points). Although inward foreign fixed investment saw absolute decline compared to 2015, it was totally offset by a hike in foreign bank loans. The extent of bank participation in financing investment programs in 2016 was positively influenced by an upturn in the Russian banking sector, on the one hand, and by a slack in the capital outflow trend, on the other hand.

In 2016, budget funds as a source of investment financing represented 16.0% of total fixed investment in volume terms, down by 2.3 percentage points compared to 2015. The transformation of the 2016 year-end structure of budget-funded investment was driven by an increase in volumes and in the share of Russian subjects' budgets and local budgets, thus compensating for the decline in the scale of federal budget-funded investment. In 2016, the federal budget accounted for 9.0% of total fixed investment in volume terms compared to 11.3% in 2015.

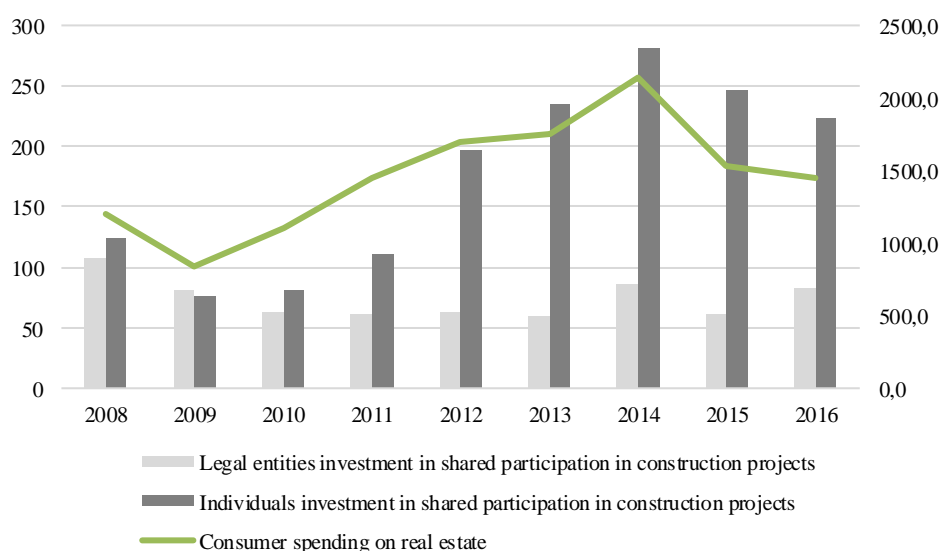
Investment by individuals in 2015–2016 was characterized by an absolute decline in volume terms in shared participation (co-ownership) in housing construction projects. In 2016, the share of individual co-investors in housing construction projects shrank to 2.0% of total fixed investment compared to 2.4% a year earlier. In 2016, individual developers that used own capital and bank loans for construction investment accounted for 39.6% of total commissioned residential property, compared to 41.2% in 2015.

*Table 17*

**Fixed investment structure by source of financing (excluding small businesses and investment volumes unobservable by statistical methods), %**

	2011	2012	2013	2014	2015	2016
Fixed investment total	100	100	100	100	100	100
Including by source of financing:						
own capital	41.9	44.5	45.2	45.7	50.2	51.8
fundraising	58.1	55.5	54.8	54.3	49.8	48.2
of which:						
bank loans	8.6	8.4	10.0	10.6	8.1	10.5
Russian bank loans	6.8	7.2	8.9	8.0	6.4	7.6
including foreign bank loans	1.8	1.2	1.1	2.6	1.7	2.9
fundraising from other organizations	5.8	6.1	6.2	6.4	6.7	5.4
inward foreign investments			0.8	0.9	1.1	0.5
budget funds	19.2	17.9	19.0	17.0	18.3	16.0
including:						
federal budget funds	10.1	9.7	10.0	9.0	11.3	9.0
subjects of Russia budget funds	7.9	7.1	7.5	6.5	5.7	5.9
off-budget funds	0.2	0.4	0.3	0.2	0.3	0.2
money generated from investment in shared participation in construction projects (legal entities and individuals)	2.0	2.7	2.9	3.5	3.2	2.8
including individuals	1.3	2.1	2.3	2.7	2.4	2.0
other	22.3	20.0	15.6	15.7	12.8	12.1

Source: Rosstat.



*Fig. 24. Investment in shared participation in construction projects, and consumer spending on real estate in 2008–2016, Rb bn.*

Source: Rosstat.

Amid a declining real personal cash income In 2015–2016, the share of consumer spending on real estate in total personal cash income and savings shrank gradually from 4.5% in 2014 to 2.9% in 2015, and to 2.5% (preliminary estimates) in 2016.

The national investment strategy of 2009–2016 rested on the acknowledgment that large businesses are major contributors to the national modernization and global competitiveness. To trigger the investment process, the state, first, was actively involved in developing the Russian corporate sector, focusing on the establishment, optimization and structural evolution, as well

as improving competitiveness, of large companies. The state over the last few years was actively involved in the establishment of state-owned holding companies in aerospace and shipbuilding industries, railway and oil sectors. However, the financial crises of 2008–2009 and of 2014–2016 deepened the imbalance of public investment management, thus making it clear that in the absence of well-running ROI enhancement mechanisms the state should restrain from a policy of increasing its involvement and public investment amid budget deficit.

The share of state-owned enterprises and organizations in fixed investment financing contracted from 18.3% in 2008 to 13.7% in 2016. Investment processes were adversely affected by gradually weakening business activity of state-owned corporations.

*Table 18*

**Fixed investment indices in current prices by type of ownership,  
% change, year on year**

	All types of ownership					Excluding small businesses	
	2011	2012	2013	2014	2015	2015	2016
Fixed investment - total	120.6	114.0	106.9	103.4	104.7	104.3	107.0
public	118.1	113.6	109.5	89.4	96.6	104.4	110.5
municipal	117.7	116.8	114.4	100.8	81.7	93.6	100.0
private	114.8	106.7	113.6	108.0	110.6	107.1	104.2
Russian mixed ownership	192.0	115.8	83.7	106.3	97.7	100.9	85.8
state-owned corporations	162.6	117.5	108.4	103.9	77.7	78.6	110.1
foreign and mixed Russian/foreign ownership	106.1	144.7	98.3	100.9	103.7	105.8	127.5

Source: Rosstat.

In the period between 2010 and 2016, privately-owned enterprises contributed to further growth in investment in nominal terms and compensated for inconsistent investment activities of state-owned and municipal enterprises. The share of fixed investment by private enterprises increased markedly, while the investment crisis at state-owned enterprises tended to continue and reflected their low efficiency.

The investment crises of 2008–2009 and of 2014–2016 severely affected foreign-owned enterprises. Positive investment dynamics for foreign-owned enterprises and joint ventures recovered at a moderate pace relative to the overall fixed investment dynamics in the Russian economy, as evaluated in current prices.

Analysis of capital formation for fixed investment by type of ownership, excluding small businesses, in 2016 shows that the private sector continued contributing positively to the investment process amid stabilized rates of public and mixed ownership and corrective growth in investment by state-owned corporations.

#### 4.4.4. Fixed investment dynamics

The fixed investment downturn hit the bottom in Q3 2015. In 2016, the investment quarterly dynamics continued to follow the downtrend in the first half of the year, while there was a tiny growth in the third quarter. The annualized fixed investment and completed construction works stood at 99.1% and 95.7%, respectively, at the 2016 year end.

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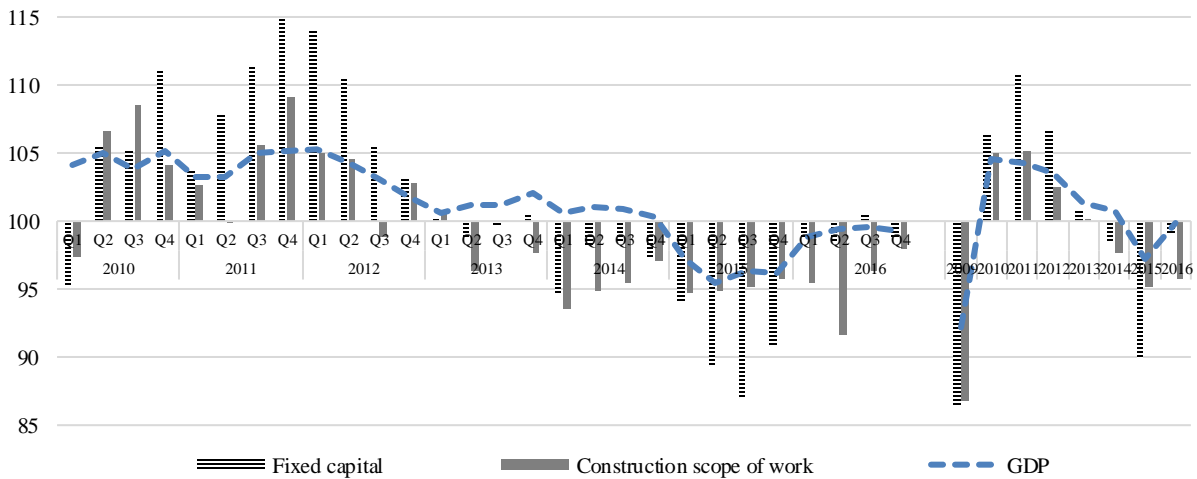


Fig. 25. Fixed investment dynamics in 2010–2016, % change, year on year

Source: Rosstat.

A wide gap which in late 2014 developed between the rate of commissioned residential property and the rate of scope of work reflected a decline in the required backlogs and accelerated the downturn in the construction complex in 2015–2016. While the 2014 fast-paced growth in housing construction mitigated the effect of shrinking industrial construction volumes on the overall scope of work dynamics, the simultaneous decline (since H2 2015) in commissioned residential, industrial and social property accelerated the downturn.

In Q3 2016, the rate of commissioned residential property recovered to positive values after a four-quarter-long negative dynamics. The recovery of growth in volume terms was supported by increase in construction investment (100.5% over January-September 2015) and real estate operations (101.8%). The decline in commissioned residential property and residential floor space got stronger in Q4 2016, and therefore the year-end decline was 6.5%, for the first time since 2010.

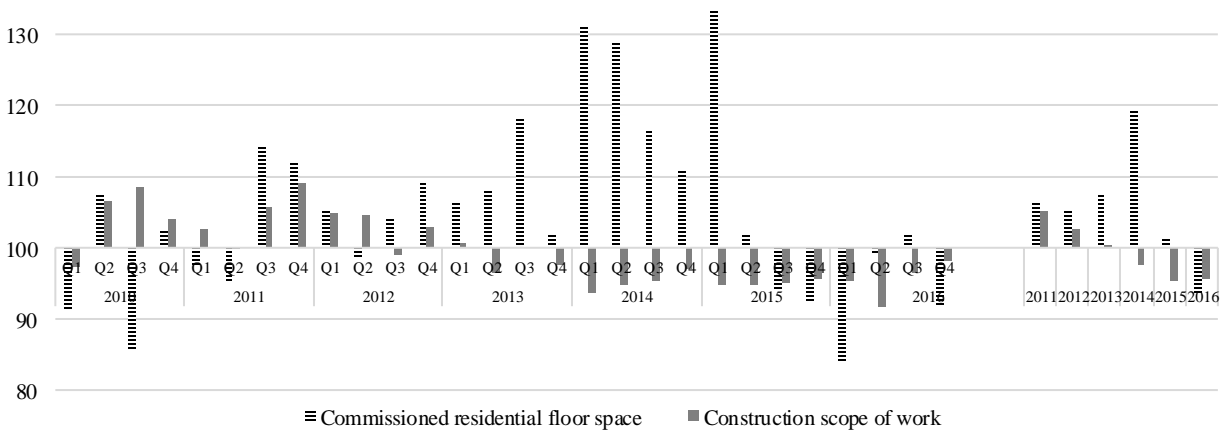


Fig. 26. Dynamics of commissioned residential floor space in 2010–2016, % change, year on year

Source: Rosstat.

The fixed investment dynamics is differentiated by large and small enterprises. With a 0.9% decline in total fixed investment in volume terms in 2016, fixed investment by large and medium-sized enterprises contracted by 1.2%.

*Table 19*

**Dynamics of fixed investment in physical volume,  
in 2010–2016, % change, year on year**

	2010	2011	2012	2013	2014	2015	2016
Fixed investment (all types of ownership, including recalculations of investment unobservable by direct statistical methods)	103.7	105.0	109.6	100.8	98.5	89.9	99.1
Large and medium-sized entities (fixed investment excluding small businesses and investment volumes unobservable by direct statistical methods)	96.2	112.1	108.6	93.1	102.3	89.8	98.8

Source: Rosstat.

In 2016, the fixed investment structure by type of economic activity underwent changes compared to the previous year. Mineral extraction investment accelerated by 14.4% in 2016 relative to 2015 as investment in manufacturing and in production and supply of electricity and water dropped by 11.8% and 11.2% respectively, and therefore investment in the industrial sector contracted by 0.5% year on year.

Structural changes in manufacturing sector were determined by a fall in fixed investment in the machine-building complex (down 21.6%) and construction materials (down 29.7%). The specific features of changes to the structure of investment in the machine-building complex in 2016 were influenced by a slump (relative to 2015) in investment in electrical, electronic and optical equipment (down 22.9%) and machinery and equipment (down 35.2%), and means of transport (down 15.1%).

Another specific feature of 2016 was growth in fixed investment in chemicals and chemical products (up 8.3%), pulp and paper (up 20.1%) and metals (up 13.1%), which was related to both an increase in the export potential of these industries, as well as import substitution processes. Investment in refined petroleum products and in consumer sector dropped by 29.4% and 12.3% respectively, compared to 2015.

*Table 20*

**Fixed investment by type of economic activity (excluding small businesses  
and investment in volume terms unobservable by direct statistical methods),  
% change, year on year**

	2011	2012	2013	2014	2015	2016
Total	108.3	106.6	99.8	95.7	89.8	98.8
Agriculture, hunting and forestry	114.6	92.8	96.0	93.0	89.1	110.6
Fishing and fish hatchery	137.4	127.4	77.4	83.3	60.1	100.0
Mineral extraction	110.9	107.4	96.8	99.9	93.9	99.5
Industry	113.8	111.8	93.6	105.9	110.7	114.1
Production and supply of electricity, gas and water	105.3	106.7	101.4	98.6	90.5	88.2
Agriculture, hunting and forestry	114.7	101.7	95.8	92.9	70.1	88.8
Construction	90.6	79.9	84.0	81.2	83.7	103.5
Wholesale and retail trade	90.0	107.1	103.1	110.7	102.9	103.8
Transport and communications	118.3	98.4	88.5	92.1	86.4	99.7
Finance	136.8	111.4	80.8	74.9	81.5	107.4
Real estate buy/sell transactions	91.9	100.8	104.4	103.1	84.3	88.7
Public administration	112.4	98.7	93.7	84.4	88.7	110.0
Education	122.0	85.2	77.9	97.4	81.9	77.4
Healthcare and social security services	113.0	93.6	98.8	71.9	79.8	91.1
Other services	103.5	111.8	75.0	72.7	82.7	91.8

Source: Rosstat.

As regards the issues of promoting economic growth, it is infrastructure that should have been focused on, however, investment in transport and communications in 2016 was down 0.3% compared to 2015, including a 11.2% decline in investment in transport via pipelines. Retail trade investment dropped by 2.4% due to narrowed internal demand, whereas wholesale trade investment increased 27.8%.

The 2016 year-end fixed investment accounted for merely 88.2% of that in 2013, representing the 2017 initial operational terms and conditions for the investment/construction complex. Investment activity was driven by the following key factors: unequal rights for market agents; undue government influence and inefficient regulation of public and monopolized sectors; lack of drastic measures to restructure state-supported old companies; highly limited market access by new companies; poorly developed public and private partnership tools for promoting investment and creating new efficient jobs.