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**RUSSIAN ECONOMY IN 2020**

**TRENDS AND OUTLOOKS**

*(Issue 42)*

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The review “Russian Economy. Trends and Outlooks” has been published by the Gaidar Institute since 1991. This is the 42th issue. This publication provides a detailed analysis of main trends in Russian economy, global trends in social and economic development. The paper contains 6 big sections that highlight different aspects of Russia’s economic development, which allow to monitor all angles of ongoing events over a prolonged period: global economic and political challenges and national responses, economic growth and economic crisis; the monetary and budget spheres; financial markets and institutions; the real sector; social sphere; institutional changes. The paper employs a huge mass of statistical data that forms the basis of original computation and numerous charts confirming the conclusions.

Reviewers:

*Kharlamov A.V.*, Doctor of sciences (Economics), Professor of the Department of General Economic Theory and History of Economic Thought, Saint Petersburg State University of Economics.

*Yakobson L.I.*, Doctor of sciences (Economics), Professor, Vice-President of the National Research University Higher School of Economics.

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#### **4.2. The industrial production dynamic in 2020:**

The imposition of the restrictive measures to contain the spread of the coronavirus infection (self-isolation regime, shutdown of public facilities, etc.) adversely affected the dynamic of Russian industrial sectors in H1 2020. The manufacturing industries that produce consumer durable goods, which sales most strongly depend on changes in the income of the population, suffered the most. The collapse of the OPEC+ deal and its subsequent renewal on tougher conditions for daily oil production adversely affected the extracting sector dynamic. The decomposition analysis has demonstrated that the Russian economic recession was relatively small, the ownership structure of major industrial enterprises, the weak integration of Russian industrial sectors into global value added chains and a significant share of industrial production in the economy played a positive role.

1 This section was written by *Kaukin A.*, Candidate of Economic Sciences, Head of Sectoral Market and Infrastructure Department, Gaidar Institute, Center for Real Sector, Gaidar Institute; Head of Sectoral Market System Analysis Department, IORI RANEPa; *Miller E.*, Senior Researcher, Sectoral Market System Analysis Department, IORI RANEPa. The authors express their gratitude to *M. Turuntseva* and *T. Gorshkova* for their help in conducting statistical analysis.

To correctly interpret trends in certain industries, it is necessary to perform decomposition of their output into components: calendar variations, seasonal variations, irregular movements and trend. The interpretation of the latter is of particular interest, that is why the Gaidar Institute experts cleared the series of indexes of all industrial production sectors for 2014–2020 from the seasonal and calendar components and filtered out the trend component<sup>1</sup> by using the latest statistical data released by Rosstat across production indexes in industrial sectors of the economy.

The results of time series analysis for the industrial production index on the whole are presented in Fig. 13. Fig. 14 exhibits the results of the aggregate indexes

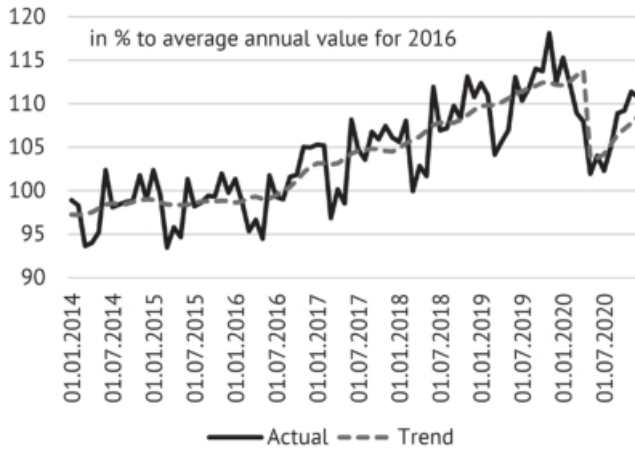
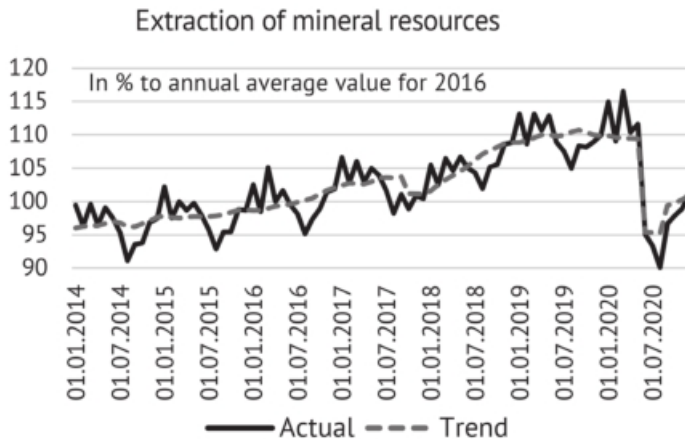
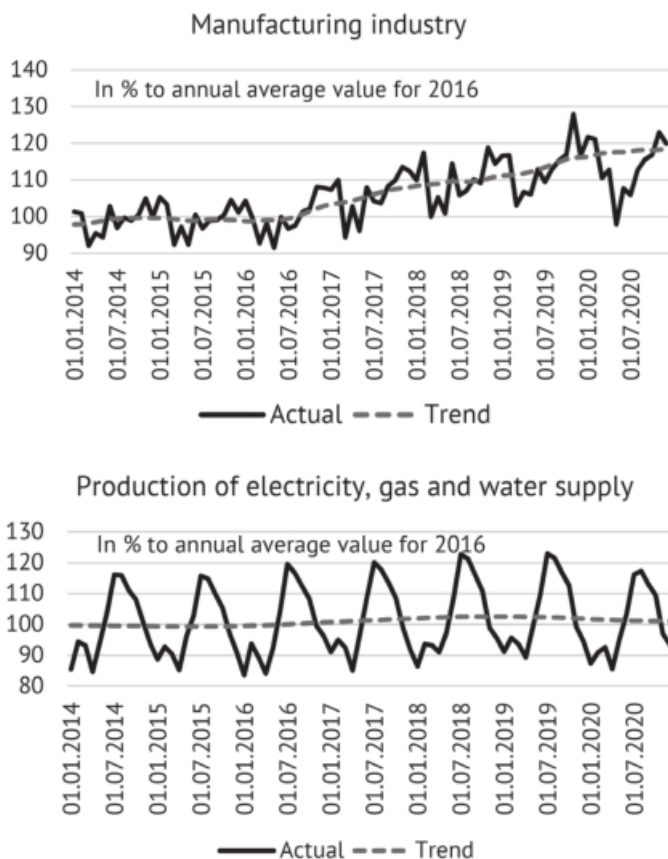


Fig. 13. Industrial production index dynamic in 2014–2020 (actual data and the trend component), in % to annual average value 2016

Sources: Rosstat, own calculations.



<sup>1</sup> The trend component was filtered out by applying Demetra packet and procedure X12-ARIMA.



*Fig. 14.* Production index dynamic in extractive industries and industrial manufacture, production of electricity, gas and water supply in 2014–2020 (actual data and the trend component), in % to annual average value for 2016

Sources: Rosstat, own calculations.

of the extracting sector, the manufacture sector, and the production and supply of electricity, gas, and water. In case of other time series, the decomposition results are represented in *Fig. 15* as well as in *Table 14*.

#### 4.2.1. The industrial production index dynamic in Q1

In Q1 2020, the industry producing fuel and energy resources continued to be affected by the factors of 2019: sluggish demand for energy resources from the main consumer countries due to the policy of reducing solid fuel consumption and switching to renewable energy sources (RES), warm weather conditions, and

1 Zhemkova A.M., Kaukin A.S., Miller E.M. Chapter 5.6. Industry, transport, construction: crisis and support // Society and Pandemic: experience and lessons of facing COVID-19 in Russia. – Moscow: 2020.–744 p.

high occupancy of gas storage facilities in Europe. Suspension of the three-year OPEC+ deal to adjust downwards crude oil production<sup>1</sup> which resulted in further unbalance of the crude oil market due to price war between Saudi Arabia and Russia. The OPEC and non-OPEC oil producers signed a new deal in early April on tougher terms for all oil producers, which translated into a reduction by 9.7mb/d <sup>2</sup> against 3.2 mb/d cut until the end of 2020 proposed at OPEC+ meeting in early March.

The following industries of the manufacturing sector (including results of Q1 2020) exhibited growth trend, in particular:

- production of food and beverages owing to stable growth in the production of agricultural raw materials and increasing export shipments;
- chemical engineering, including due to the growing demand in the CIS countries for domestic generics (antibiotics, antimicrobial drugs);
- metallurgical production and production of fabricated metal products due to the growth in production of pipes, profiles, structures and aluminum parts, as well as gold mining.

Reduction in production volumes was recorded in wood processing and woodwork due to slump in timber prices, introduction of new phytosanitary requirements and border closure with major consumer – China.

The slow growth in retail sales was due to panic buying of foodstuffs and essential goods, and in wholesale trade due to the growth in the production of chemical and pharmaceutical products against the backdrop of the situation with the coronavirus. The decrease in the provision of paid services to the population is a decrease in its activity owing to the imposition of restrictive measures: self-isolation regime on arrival from foreign countries (the measure was effective on a voluntary basis from early March 2020), shutdown of public facilities (schools, sports and cultural venues, restaurants, etc.) from mid-March 2020, and imposition of “regime of non-work days” from end of March 2020.

Thus, at Q1-end 2020, the industries did not exhibit any signs of a crisis resulting from the introduction of “regime of non-work days”, since the commencement of the reduction in domestic and external demand fell at the end of the period under review, and the deployment of available industrial inputs allowed to offset the pressure of rising prices for imported components.

#### 4.2.2. Index dynamic in Q2<sup>3</sup>

The “non-work days” regime was effective from March 30 until May 8, 2020<sup>4</sup>, followed by easing of measures to contain the spread of the coronavirus infection:

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- 1 *Bobylev Yu., Kaukin A., Miller E.* Current state and prospects of the global oil market // Monitoring of Russia's Economic Outlook: trend and challenges of socio-economic development. 2020. No. 7 (109), pp. 28–34.
  - 2 The 10th (Extraordinary) OPEC and non-OPEC Ministerial Meeting concludes// OPEC. 12.04.2020. URL: [https://www.opec.org/opec\\_web/en/press\\_room/5891.htm](https://www.opec.org/opec_web/en/press_room/5891.htm)
  - 3 *Zhemkova A.M., Kaukin A.S., Miller E.M.* Chapter 5.6. Industry, transport, construction: crisis and support // Society and pandemic: experience and lessons of facing COVID-19 in Russia. – Moscow. 2020. –744 p.
  - 4 Executive Order of the President of the Russian Federation No. 206 published on March 25, 2020 imposed non-work days with full wages from March 30 until April 3, 2020. Later, Executive order

the resumption of work of industrial enterprises, the reopening of organizations operating in services business, non-food shops, etc. The timing and list of measures depended on the epidemiological situation, vacant beds available and testing rollout in each specific region of Russia.<sup>1</sup>

The extractive industries continued demonstrating a downward trend in Q2. Russia strictly adhered to its commitments on cutting crude oil production in June (production decline amounted to 2.47 mb/d, and according to the OPEC+ deal, the reduction had to be 2.53 mb/d). The reduction in of external demand affected decline in gas and coal production.

Industrial production was not evenly hit by the spread of coronavirus infection: the production of durable consumer goods (household appliances, furniture, jewelry, leather products) was the most affected due to the hypersensitivity of these sectors to changes in household incomes.

As many enterprises during the pandemic began to review their investment programs and cut costs related to modernization and technological re-equipment in order to reduce costs, the machine-building industry, in particular, railway, road construction, and oil and gas engineering, was hit the hardest.

Among the slightly less affected industries was the production of materials and components. The industry has managed to move sales online and to courier delivery.

The pharmaceutical industry and the manufacture of medical equipment and instruments were virtually unaffected, and in some ways even benefited from the pandemic. The chemical and food industries suffered little, and the demand for their products also moved up during the “regime of non-work days.”

The positive dynamic in retail sales remained on the back of the easing of the self-isolation regime and the reopening of non-food stores in certain Russian regions from mid-May 2020, as well as the surge in the online consumer goods market. The recession went on in the transportation sector due to a reduction in international and interregional operations, as well as in logistics operations in trade.

Thus, in Q2 2020, the industries that make the largest contribution to GDP (metallurgy, chemistry, energy and food industry) were either not affected by the crisis triggered by the spread of the coronavirus infection, or had a small adverse impact. The main concern at the end of H1 2020 was a further development of the unfavorable situation in the fuel and energy industry, as a sharp reduction in demand for the main export products - oil and gas - combined with a collapse in prices for them and increased competition with other producers on the shrinking market began to lead to a reduction in export revenues (both budget revenues and free cash flow of companies), investments and orders from the fuel and energy sector, respectively, to a notable contraction of the country's GDP.

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of the President No. 239 dated April 2, 2020 extended non-work days regime for the period from April 4 to 30 and by Executive Order No. 294 dated April 28, 2020 for the period from May 6 to 8.  
1 Roadmap for exit from self-isolation // Стопкоронавирус.рф. August 7, 2020. URL: <https://стоп-коронавирус.рф/information/>.

### 4.2.3. Dynamic in Q3<sup>1</sup>

In September 2020, Rosstat recalculated the production indexes for 2019-2020, which was owing to the receipt of updated information from respondents.<sup>2</sup>

The trend component of the extractive sector continued to exhibit close to zero growth rates in Q3 2020, the reasons remained the same: almost complete compliance with the terms of the OPEC+ deal to adjust downward daily oil production, a reduction in global energy demand, including stemmed from the spread of the coronavirus infection.

At end-Q3, the manufacturing sector saw a rise in the trend component. A significant contribution to the current dynamic was made by: chemical production on the back of the demand growth for medicines and materials for medical purposes, chemical and mineral fertilizers (mineral fertilizers were included in the list of goods whose railway transportation is subsidized;<sup>3</sup> the introduction of a preferential tariff for routes to the Far East increased the export rates of phosphorus fertilizers from Russia to China); metallurgical production driven by export volumes to South-east Asia that recovered faster from the “first wave” of the pandemic, as well as owing to the depreciated ruble that allowed Russian companies to ramp up shipments of galvanized steel to Europe; manufacture of electrical equipment due to an increase in production of radio-location and radio navigational devices and medical equipment; manufacture of means of transport on the back of railroad passenger cars rollout growth (in particular, for the renewal of the fleet in suburban areas in Russian regions), automobiles and minibuses due to pent-up demand and expansion of state support.<sup>4</sup>

The manufacture of machinery and equipment exhibited a downward trend in Q3 2020. That was sparked by a contraction in the investment programs aimed at the modernization and technological re-equipment of production facilities, as well as to losses incurred in H1 2020 stemming from the imposition of restrictive measures.

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1 *Kaukin A.S., Miller E.M.* Dynamic of Industrial Production in Q3 2020. // Russian Economic Developments. 2020. Vol. 27. No. 11 pp. 28–32.

2 Revision was conducted on the following grounds:

- Preferential treatment of the provision of statistical information for certain producers, because of which, the calculation of the production volumes of these categories of producers were traditionally conducted on the latest available data. Such enterprises comprise: micro businesses that report once a year; non-small enterprises that have an average number of employees of no more than 15 persons in the previous 2 years, and an annual turnover of no more than Rb 800 mn, which report once a quarter;
- switchover from the beginning of 2020 to the new base year-2018. As a result, the recalculation of the retrospective indexes for 2019 was conducted on the basis of the production data available at the time;
- provision of operational reports by large and medium-sized enterprises on the 4th working day (often an estimate value) and their update in subsequent periods;
- in September 2020, Rosstat received annual reports from respondents (large and medium-sized organizations, micro businesses, and small enterprises) that update previously provided operational data on the production and shipment of goods, works, and services.

3 RF Government Decree dated May 21, 2020. No. 715 “On Amendments to the Decree of the Government of the Russian Federation dated April 6, 2019. No. 406.”

4 *Vladimir Putin* unveiled relief measures for automobile sector // Kommersant. April 24, 2020. URL: <https://www.kommersant.ru/doc/4331699>.



According to Rosstat, real incomes of the population went on falling in Q3 2020, which took a toll on the retention of negative dynamic in other sectors of Russian economy - in retail sales and paid services to the population. The drop in freight turnover was due to a decrease in crude exports in the wake of global trends of falling demand for energy resources. The growth was demonstrated by such industries as construction on the back of the extension of subsidized mortgages and construction of new roads and crossroads; wholesale commerce driven by deliveries of grains, medicines, and chemical fertilizers.

Consequently, the analysis of trend components in Q3 2020 did not allow to talk about a notable industrial recovery after a plunge induced by the spread of the coronavirus infection and the implementation of restrictive measures. At the moment, one of the main risks of ongoing decline in industrial output was the further aggravation of the epidemiological situation, the potential tightening of containment measures in certain industries or regions, and the formation of corresponding adverse expectations among businesses and the population.

#### 4.2.4. Q4

In Q4 2020, the negative impact of factors related to the implementation of the terms of the OPEC+ deal to cut daily crude oil production continued, which adversely affected the dynamic of the trend component of the mining sector.<sup>1</sup> The growth of external demand for Russian coal from China and Europe had a positive effect on the sector. In the first case, growth was driven by the ban on the import of Australian coal from November 2020,<sup>2</sup> in the second, it was due to a hike in prices on natural gas and decrease in domestic production volumes.

According to the results of the fourth quarter of 2020, the substitution of imported products, including due to the shift in consumer demand to a lower price segment, had a positive impact on a number of industries in the manufacturing sector, including: production of medical equipment; food industry, tech-style and clothing production, furniture production.

The drop in demand for leather from external and domestic markets reinforced the negative dynamic of the trend component of the production of leather, leather products and footwear in Q4 2020. Export volumes fell owing to restrictive measures to counter the spread of the coronavirus infection and the shutdown of production facilities in the countries that consume Russian leather products. The domestic demand sank following lower incomes of consumers, who reduced their spending on goods related to the leather industry (production of cars and furniture) and switched over to a lower price segment (products made of artificial materials).

1 *Kaukin A.S., Miller E.M. Crude Oil Market in Late 2020. // Russian Economic Developments. 2021. No. 1 (28), pp. 7–10.*

2 On November 6, the Chinese authorities announced the suspension of coal imports from Australia: in November 2020, the order was made orally to large traders, the embargo officially began to take effect on December 14, 2020. The conflict between the countries started in August 2018 because of the obstacles to the introduction of Chinese-made 5G technology in the Australian market: the ban on the use of Huawei and ZTE telecommunication solutions. The escalation of the conflict took place, among other things, after Australia accused China of spreading the coronavirus infection.

The reason for maintaining the negative dynamics of the trend component of pulp-and-paper industry in Q4 2020 can be a reduction in packaging consumption amid the suspension of manufacturing processes in a number of industrial sectors and in the services sector, as well as a reduction in demand for writing and printing types of paper due to the transition of the main consumers to a remote format of work and, consequently, to electronic document flow.

The retail sales and paid services to households exhibited the negative dynamics because of a drop in households' real disposable incomes. After being negative, the trend component of cargo turnover picked up a little following an increase in exports of coal and fertilizers. The wholesale trade showed a slight uptick in Q4 2020 owing to sales of grain, medicine and chemical fertilizers.

The analysis of decomposition findings and identification of the trend component has revealed that despite the slump caused by the coronavirus pandemic, the decline in the Russian industry was relatively small (*Table 14*). Among the possible causes of this effect, the following factors can be mentioned:

- large industry-forming and strategically important enterprises are directly related with the state either through the state-guaranteed order system or by virtue of their ownership pattern; consequently, the problem of falling consumer demand for such enterprises is not an acute problem for independent small and medium-sized enterprises;
- the weak involvement of Russian industries in global value-added chains (except for the extraction of fuel and energy commodities) during global recession has a positive effect (however, in the longer-term this factor may slow down development during the global economic recovery);
- in the structure of Russian economy, a notable proportion is occupied by industry, whose enterprises operate in a continues mode, which means that they cannot be stopped even if epidemiological restrictions are imposed on other companies.

*Table 14*

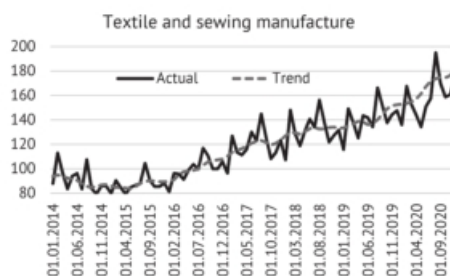
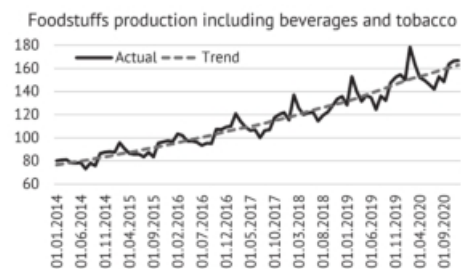
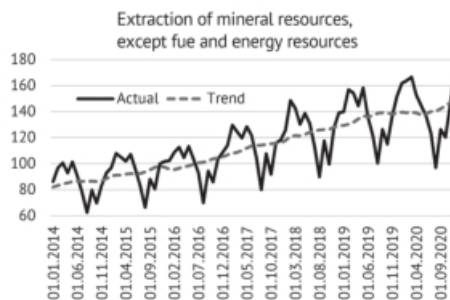
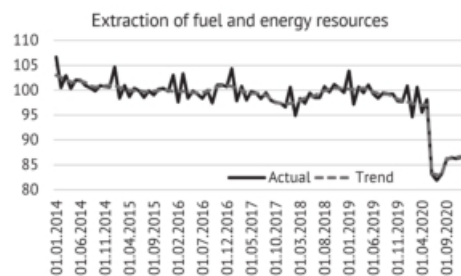
**Change in the output index across industrial production, %**

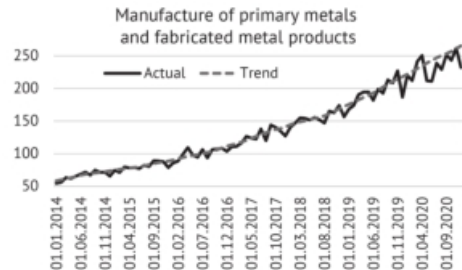
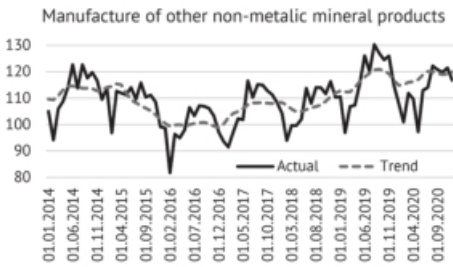
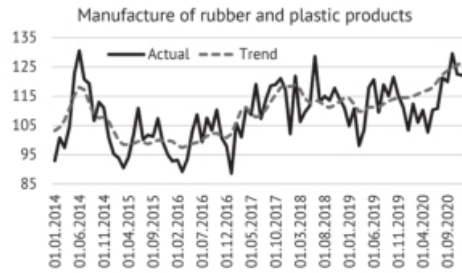
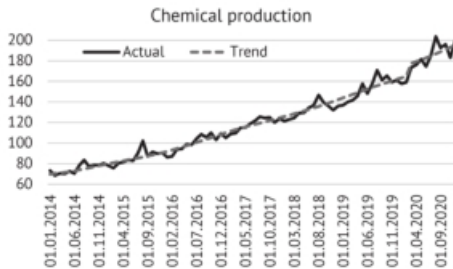
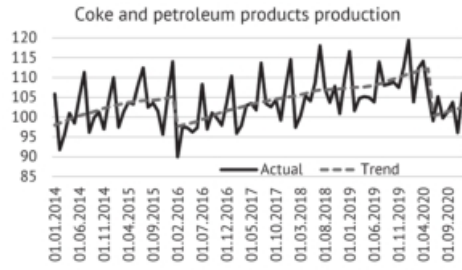
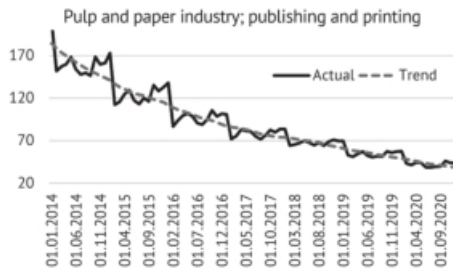
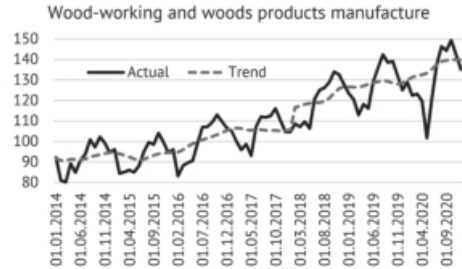
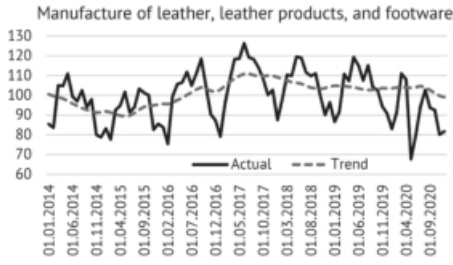
Sector	Share in industrial production index, %	December 2020 to June 2020, %	December 2020 to December 2019, %	Last months' change
The industrial production index		104.63	96.77	Growth
Extraction of natural resources	34.54	105.85	91.89	Growth
Manufacturing, including:	54.91	100.79	102.09	Stagnation
Food production, including beverages, and tobacco	16.34			Growth
Textile and sewing industry	1.14	104.93	110.21	Growth
Manufacture of leather, leather products, and footwear	0.27	108.05	118.70	Recession
Wood-working and wood products manufacture	2.02	95.05	95.60	Stagnation
Pulp and paper industry	3.35	103.44	108.78	Recession

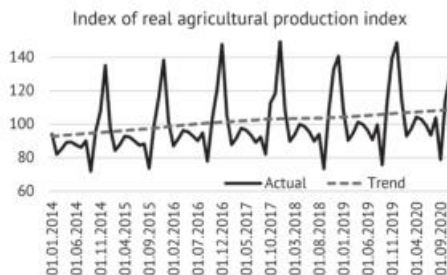
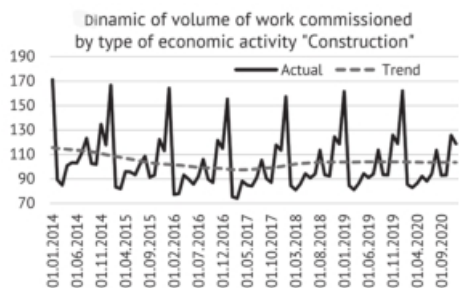
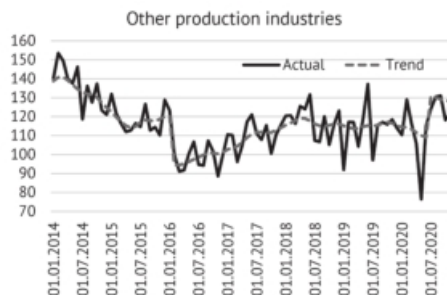
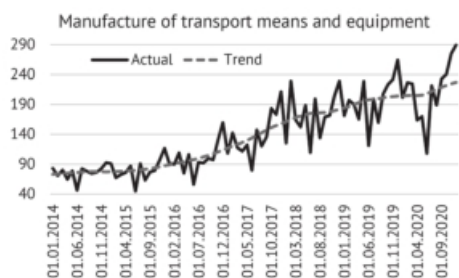
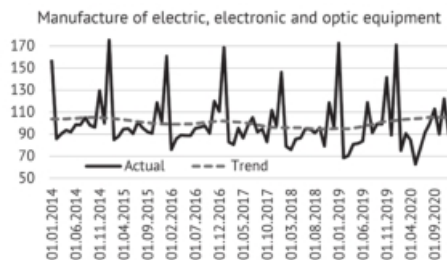
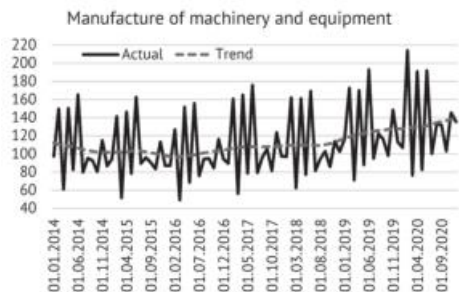
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Sector	Share in industrial production index, %	December 2020 to June 2020, %	December 2020 to December 2019, %	Last months' change
Coke and petroleum products production	17.25	89.27	77.40	Slow growth
Chemical industry	7.56	102.03	92.70	Growth
Manufacture of rubber and plastic products	2.14	106.75	120.56	Growth
Manufacture of other non-metallic mineral products	4.02	107.42	110.59	Stagnation
Manufacture of primary metals and fabricated metal products	17.42	100.94	102.73	Growth
Manufacture of machinery and equipment	6.97	109.25	121.80	Growth
Manufacture of electric, electronic and optic equipment	6.27	106.55	109.47	Stagnation
Manufacture of transport means and equipment	6.75	100.66	103.05	Growth
Other industries	2.42	109.12	111.22	Stagnation
Electricity, gas, and water	13.51	118.79	112.57	Stagnation
Wholesale trade		101.93	102.06	Slow growth
Retail sales		97.02	100.67	Recession
Goods turnover		101.32	96.95	Slow growth
Construction		100.04	99.68	Stagnation
Paid services to population		99.66	92.53	Slow growth

Sources: Rosstat, own calculations.







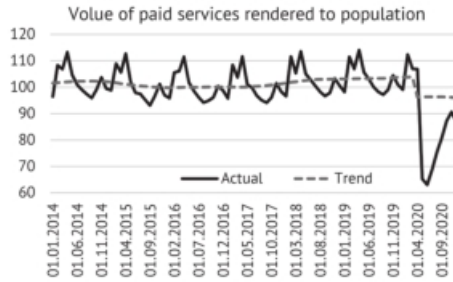


Fig. 15. Industrial production indexes dynamic in 2014–2020 (fact and trend component), in % to average annual value in 2016

Sources: Rosstat, own calculations.