

## RUSSIA'S ECONOMY IN APRIL 2013: PRELIMINARY DATA AND MAJOR TRENDS

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### ***The Socio-Political Background of April: A Velvet Glove Witch Hunt***

*The socio-political background of April 2013 was determined by the ongoing attacks on the government launched by the RF President and the law enforcement agencies; by the continuing debate around the issue of how to find the most effective way of stimulating economic growth; and by the Kremlin's massive onslaught on civil society organizations.*

*In his speech at a government meeting in Elista, Vladimir Putin threatened to sack the entire cabinet. Although that outburst was reputedly 'not for the record', somebody leaked the relevant fragment of video footage to the central TV channels controlled by the Kremlin. The campaign launched by the law enforcement agencies against the Skolkovo Innovation Center at the same time indirectly targets the government, and so creates a negative information backdrop for its chairman, Dmitry Medvedev. Public opinion surveys indicate that corruption remains the Achilles' heel of the current Russian administration, because it seriously undermines public confidence in Russia's political system. According to a number of commentators, the activities of the law enforcement agencies aimed against Dmitry Medvedev's personal project, and the evidently orchestrated issue of 'the inefficient use of funds' at Anatoly Chubais' Rosnano, the questions about which were put to Putin at his recent major press-conference, must be viewed as an attempt to pin the blame for corruption on the 'modernizer wing' of the regime.*

*At the end of April, the RF President held a meeting, in Sochi, with the cabinet ministers in charge of economic matters and a number of high profile experts. They discussed the need to resort to extraordinary measures in order to 'consolidate' economic growth in the face of a sharp drop demonstrated by the economic indices in Q1 2013. Traditionally for such discussions, there was a clash of opinions between the proponents of a rigid dirigistic approach – which implies considerable monetary and fiscal expansion (Sergey Glaziev, State Duma representatives), the proponents of moderate monetary and fiscal expansion (RF Minister of Economic Development Andrei Belousov), and the advocates of structural and institutional changes that can be carried out within the framework of a conservative monetary and fiscal policy. Andrei Belousov and Elvira Nabiullina were asked to submit a comprehensive package of coordinated proposals on those matters by the middle of May.*

*In April, the punitive campaign against NGOs, including civil society and rights organizations, rose to a crescendo. This campaign had been launched as a result of Vladimir Putin's speech at a FSB collegium meeting in mid-February 2013. Between late March and late April, no less than 240 NGOs were 'checked' by public prosecutors and justice ministry officials accompanied by officers from regulatory bodies such as federal migration agencies, fire safety departments and tax services. In fact, some of these organizations were checked twice. The wave of spot inspections had two aims: to find evidence of the receipt of foreign funds and to impose heavy fines (sometimes under absurd pretexts) detrimental to their financial health.*

*Public opinion surveys indicate that the social situation has remained relatively calm, and that Putin's presidential approval rating has – at least temporarily – stopped its downward slide (according to Levada Center's latest surveys, 63% of respondents approved and 36% disapproved of his performance as president). At the same time, public confidence in Putin continues to decline (in April, when asked 'to please name 5–6 politicians whom you trust most', only 31% of respondents named Putin – vs. around 40% one year earlier). The approval ratings of United Russia are also on the decline: according to Levada Center, in April the percentage of respondents sharing the view that united Russia is 'the party of crooks and thieves' for the first time surpassed the 50% mark. It should be noted that the ongoing conflict between the Executive Office of the RF President and the Government also weakens Russia's executive branch as a whole.*

### ***The Macroeconomic Background of April: A Continuation of the Downward Trends in External Demand***

*The macroeconomic background of April 2013 was determined by a downward trend in the movement of oil prices during the first half of the month, and then by their partial recovery during the second. In mid-April, Brent crude oil traded below \$ 100 per barrel. In April, it averaged \$ 103.2 per barrel vs. \$ 109.2 in March. The drop in oil prices was accompanied by the continuing decline in the prices of other traditional Russian exports, including non-ferrous metals. Traditionally, the drop in oil prices had a negative effect on the exchange rate of the ruble, and it also pulled down Russia's stock market. In April, the lowest level of the MICEX Index was registered on 17 April, when it dropped to 6.53% below the level at the beginning of the month. However, by the end of April the MICEX Index had grown to 1,372.2 p.p. Initially, the ruble weakened against both the euro and the dollar, but later gained back some strength. The value of the bi-currency basket rose from 34.91 rubles in March to 35.58 rubles in April.*

*Having decelerated in March, inflation picked up again in April, rising to 05% vs. 03% in 2012. As a result, in April 2013, the annual rate of inflation returned to 7.2%. At the same time, the prices of food products, non-food products and services climbed by 8.8%, 5.1% and 8.0% respectively, in annual terms. Core inflation amounted to 5.7% (vs. 5.3% in April 2012). The upsurge in inflation was heavily contributed to by the rise in the prices for housing and public utilities services, which had grown by 9.9% since April 2012, and transportation tariffs (e.g. rail freight rates and passenger charges had grown by 9.9%). At the same time, there are reasons to believe that the next rise in tariffs scheduled for 1 July and expectations of a poor harvest will keep the current inflationary trend very much alive in the middle of the current year. It should be noted that the current upsurge in inflation is taking place against the background of a decline in the growth rate of money supply (the annual M2 growth rate dropped from 21.8% as of 1 March 2012 to 14.2% as of 1 March 2013). Such a situation restricts the ability of Russia's economic authorities to 'consolidate' growth by boosting lending to businesses.*

*In April, the debt incurred by banks under REPO transactions continued to grow, rising to over Rb 2 trillion. In response to the rising demand for liquidity caused by the exhaustion of the substantial financial resources received by the banking sector from the federal budget at the end of 2012, the weighted average interest rate at the interbank loan market rose from 5.4% in January to 5.7% in February, and then to 6% in March. From 1 through 25 April, it hovered around 6.2%.*

*Because of a significant decline in revenues from exports coupled with a shrinkage in the economic growth rate, Russia's budgetary situation had become rather tense by the end of Q1 2013. Federal budget revenues for Q1 2013 dropped by 2.1% of GDP on Q1 2012. Revenue from external economic activity dwindled by 1.2 p.p. of GDP on Q1 2012; mineral extraction tax revenue – by 0.5 p.p. of GDP; and domestic VAT revenue – by 0.3 p.p. of GDP. At the same time, in Q1 2013 federal budget expenditures were by 2 p.p. of GDP lower than in Q1 2012. As a result, the current budget deficit hit the deficit ceiling of 1% of GDP, set by the latest budget rule. It should be noted that the severity of spending cuts differed from one specific area to another. Thus, spending on public health care shrank to 65% of its volume in Q1 2012 (a drop by 0.5 p.p. of GDP), spending on education – to 75% (a drop by 0.4 p.p. of GDP), and that on social policy – to 83% (a drop by 1.3 p.p. of GDP). At the same time, spending on issues of nation-wide importance remained at the previous level, while defense spending grew by 4% (+0.2 p.p. of GDP), and spending on the national economy – by 16% (+0.3 p.p. of GDP).*

### ***The Real Sector of the Economy: Neither Recession Nor Growth***

*According to the RF Ministry of Economic Development's preliminary estimates, GDP over the course of Q1 2013 grew by 1.1% vs. by 4.8% over the course of the corresponding period of 2012. At the same time, fixed asset investment stabilized at last year's level, while the growth rate of retail trade turnover dropped almost twofold – to 3.9%. The growth rate of real wages also dropped – from 110.3% in January–March 2012 to 104.2% in Q1 2013. However, as a result of the latest indexation of labor pensions, the real available money incomes of the population rose by 8.5% (in annual terms) in March 2013, vs. by 2.4% in March 2012. On the other hand, the consumer activity of the population was considerably undermined by the ongoing decline in the growth rate of lending to individuals.*

*In March 2013, annual growth rates rebounded in mineral extraction and processing industries, rising by 0.6% and 3.4% respectively on March 2012. It should be noted that, while processing industries data for February–March 2013 definitely point to the resumption of growth after almost half a year of stagnation, the rise in mineral extraction should be seen in the light of that industry's poor performance in March 2012, which means that stagnation in mineral extraction has not yet ended. Moreover, external demand data do not suggest that the stagnation trend in mineral extraction will reverse any time soon.*

*Since December 2012, the productivity dynamics of processing industries has been negatively impacted by the ongoing drop in machinery manufacturing. In March 2013, the production indices for machinery and equipment manufacturing and electrical, electronic and optical equipment manufacturing dropped by 2.3% and 5.5% respectively on March 2012. Since Q4 2012, there has been a decline in transport vehicle and equipment manufacturing (in March, transport vehicle manufacturing shrank by 14.5% on March 2012).*

*The downward trend in investment activity resulted not only in a drop in the production of capital goods, but also in a reduction of the growth rate of demand for such imports as cars, transport equipment and transportation vehicles. In January–February 2013, the growth rate of demand for them rose by 1.9% vs. by 31.7% in the corresponding period of 2012.*

*Since the second half-year of 2012, there has been a decline in the growth rate of food products manufacturing. The index of production of manufactured food products rose by 0.5% on March 2012 and by 1.3% on January–March 2012, while in 2012 it had grown by 5.2% on March 2011 and by 6.2 on January–March 2011. It should be noted that the January–February period of 2013 saw an increase in the growth rate of imports of food products and agricultural raw materials for the food industry by 10.5% on the corresponding period of 2012. The share of these imports in the total volume of imports also increased.*

*Despite the sharp fall in the economic growth rate, the labor market did not experience any shrinkage in the demand for labor in comparison with March 2012. According to Rosstat [Russian State Statistics Service], in March 2013 the number of unemployed amounted to around 4.3m. Thus, in accordance with the International Labor Organization methodology, the unemployment rate stood at 5.7% of the economically active population. At the same time, the RF Ministry of Economic Development forecasts that over the course of 2013 real wages are set to rise by 4.5% (vs. by 3.7% in its previous forecast), while the real available money incomes of the population – by 3.0%. Besides, the Ministry forecasts that labor productivity over the course of 2013 will increase by around 2.5%, thus considerably lagging behind the growth in wages. As a result, the growth rate of profit in the Russian economy is expected to fall.*

*The latest business opinion surveys carried out by the Gaidar Institute for Economic Policy (IEP) do not inspire much optimism, either. Having climbed to zero level in February, the IEP's Industrial Optimism Index returned to the negative zone in March. Thus, for six months in a row, this index has been failing to enter the positive zone, standing on the average at -2.7 points. The Expectations Index has been on the decline for third month in a row. The unstable situation in industry is explicitly attested to by the dwindling proportion of enterprises believing their stocks of finished products to be within the norm, and also by the rising proportion of those believing their stocks of finished products to be below or, most importantly, above the norm. ●*