

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

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Political Background: The PM's Top Guns Are Put in the Cross Hairs

Russia's political background in May was determined by the mounting tension in the top echelons of the political bureaucracy. The sacking of Deputy Prime Minister Vladislav Surkov – one of the authors of the soft authoritarianism of the 2000s – was a manifestation of yet another personnel reshuffle in Russia's corridors of power.

Surkov's dismissal from his post was preceded by the activities of the Investigation Committee of the Russian Federation, which looked into the financial operations of the Skolkovo Foundation supervised by Surkov (the Foundation had been created on the then RF President Dmitry Medvedev's initiative), and a public polemic between the Deputy Prime Minister and representatives of the Investigation Committee. The information leaked on the incident with another of Medvedev's cronies – Deputy Prime Minister Arkady Dvorkovich, who for some time had been prevented by security personnel from attending a meeting at the Russian president's Sochi residence Bocharov Ruchei, was also viewed as a demonstration of mistrust towards the key figures in the Medvedev Government. Also in May, Vladimir Putin canceled Russia's joining the international Open Government Partnership (OGP). Like the Skolkovo Foundation, the idea of participating in the Open Government Partnership was one of Medvedev's major projects designed to create around him a specific political infrastructure.

And finally, in late May, rector of the Moscow New Economic School Sergei Guriev, one of the leading Russian economists, known to be close to Arkady Dvorkovich and Medvedev's Open Government, left Russia and declared that he was not coming back because of the pressure exerted on him by state prosecutors in connection with the Yukos affair. This investigation was launched against the panel of experts that had conducted an independent probe of the Mikhail Khodorkovsky affair on Dmitry Medvedev's order, and provided evidence that the charges brought against Khodorkovsky in the 'second Khodorkovsky case' had been unsubstantiated. The prosecution was trying to find evidence that would lead to obstruction of justice charges against the experts (the offence is covered by Article 294 of the Criminal Code of the Russian Federation), and so since January 2013 they had been interrogating the panel's members and confiscating documents from their offices.

All these events point to a major revision of the 'political legacy' of former RF President Dmitry Medvedev, who – at least verbally – proclaimed the necessity of liberalizing Russia's political and economic life, and also spoke of the final takeover of the initiative in the field of domestic politics by that part of the political bureaucracy which is usually called by experts 'the power structures'. Another manifestation of the same political course was Vladimir Putin's refusal to grant amnesty to businessmen imprisoned for the so-called 'economic crimes', and his rejection of the amnesty draft developed by the business community and put forth by Boris Titov, the Presidential Plenipotentiary for protecting businessmen's rights.

An important feature of the political background has remained the ongoing trial in Kirov against the opposition activist Alexei Navalny; another one is the opening of hearings into last year's Bolotnaya Square riots. Meanwhile, to mark the first anniversary of the riots, on 6 May the opposition held a 'meeting of solidarity with the 6 May prisoners' which drew approximately 30,000 people according to independent sources, or 8,000 according to the official police records – which points to a rather high level of opposition activist mobilization in Moscow.

Macroeconomic Background: Inflation against the Backdrop of Stagnation

After their April decline, in the first ten days of May the futures prices for oil began to rise, thus putting off the danger of their possible drop below \$ 100 per barrel; the current prices have stabilized within the interval of \$ 101–104 per barrel (ICE, Brent). On the one hand, this trend con-

tributed to a revival of foreign investors' interest in short-term investment on the Russian market, which manifested itself in an inflow of money into the investment funds operating in Russia and in an upward adjustment of the stock indexes. On the other hand, this price level (below the oil price budget projection) put the ruble under pressure and pushed down its exchange rate; besides, given the slowdown in the rate of economic growth, it has made problematic the budget execution in 2013.

Over May, the ruble to USD exchange rate declined from Rb 31.26 as of 30 April to Rb 31.59 as of 31 May, while the ruble to Euro exchange rate changed only slightly (from Rb 40.84 to Rb 40.96). As a result, the price of the bi-currency basket climbed from Rb 35.57 (30 April) to 35.80 (31 May). Thus, since the beginning of April its value had increased by 2.26%.

The inflation rate in May amounted to 0.6% (as of 27 May) against 0.5% in May 2012, which in per annum terms corresponds to 7.33% and 6.52% (12 month moving average). As in April, the accelerating price growth was in the main contributed to by the prices of food and services. It is noteworthy that an accelerated inflation rate is observed against the backdrop of stagnating demand and prices in industry, as well as a slowdown in the growth of money supply (the per annum growth rate of M2 dropped from 21.2% as of 1 April 2012 to 14.6% as of 1 April 2013). Over the next few months, the price growth rate can be expected to be further pushed up by the upward adjustment of the housing and utilities tariffs from 1 July and the forecasts of low crop yields due to the unfavorable weather conditions in the spring of 2013. At the same time, the per annum price growth rate may decline due to the base effect – in June-July of 2012 the inflation rate rose to 1% per month.

In April, the volume of commercial banks' excess reserves shrank by 13.9%. At the same time, the volume of banks' outstanding debt against REPO operations increased by 32.9% – to the level of Rb 2.06 trillion, where it then remained until the end of May. The downward trend displayed by the banking sector's liquidity was made more pronounced by the need to transfer the quarterly tax payments and the increased share of cash in circulation in money mass on the eve of the May holidays. This phenomenon pushed up the rates on the interbank market from 6% in March to 6.2% in April, and then to 6.38% as of 20 May. The RF Central Bank, while leaving unchanged the refinancing rate, for a second time over the past month-and-a-half period decreased the interest rates on its long-term operations (by 0.25 pp.).

The decline in foreign trade revenues (by 1.6 pp. of GDP) and internal revenues (by 0.6 pp. of GDP) resulting from the slowdown in economic growth pushed down the amount of federal budget revenue over January–April by 2.2 pp. of GDP on the same period of 2012. However, this was not translated into an increase in budget deficit, thanks to the adequate and timely reduction in the amount of expenditure. Thus, the expenditures on social policy were decreased by -1.5 pp. of GDP, on health care – by -0.3 pp. of GDP, on education – by -0.2 pp., and on interbudgetary transfers – by -0.2 pp. In this connection, in May 2013, the RF government submitted to the State Duma a draft law on introducing alterations in the law on federal budget, whereby a redistribution of budget allocations in the amount of Rb 171.2bn was envisaged, including the additional allocation of Rb 4.3bn to the preparation for the Sochi 2014 Winter Olympics.

The Real Sector: The Economy Does Not Grow on Credit

Although in March industrial production began to increase in volume after a two-month period of slump, the unsatisfactory April have provided yet another proof that the fundamental factors responsible for the economy's slowdown are here to stay.

The volume of investment in fixed assets in April amounted to 99.3%, and that over the period of January–April – to 99.8% of their previous year's levels respectively. The movement of the investment index was negatively influenced by the worsening financial situation faced by enterprises: the positive balance-sheet results stated in companies' financial reports in January amounted to 82.8%, in January–February – to 78.8%, and that for Q1 – to 70.9% of the corresponding figures for the same period of the previous year respectively (in Q1 2012 – 106.6%). As a result, in Q1 the share of loss-making enterprises rose on Q1 2012 from 35% to 36.5% of all the surveyed enterprises (in the extractive sector – from 41.0% to 45.6%; in the processing sector – from 33.6% to 36.3%). Besides, the downward trend in state capital investment has continued. The general decline in the investment volume could not be reversed by the positive trends in foreign investment, whose volume increased on Q1 2012 by 65%. This phenomenon resulted in the main from the increasing lending volume

(which amounted to 89% of the total foreign investment volume), but foreign direct investment also increased by 63% (this, however, also occurred due to the dramatically increasing volume of loans received from foreign stakeholders, while the share of investment in capital declined).

The population's consumer activity continued to be on the decline. The per annum growth rate of the retail turnover in April amounted to 4.1% against 7.0% a year earlier, and that of commercial services rendered to the population – to 1.7% against 3.5% respectively. On the one hand, personal real disposable money income in April increased as a result of the indexation of pensions and other types of social benefits – by 7.3% in per annum terms against 1.3% a year earlier. On the other hand, the pace of growth of real wages dropped to 104.2% against 111.1% in April 2012. Thus, personal income was being redistributed in favor of the poorer and socially less secure strata; such a situation evidently influenced the behavior of the most solvent groups of the population. The pace of growth of consumer loans continued to decline (to 36% in per annum terms, as seen by the results of April), while the growth of individual deposits with banks hit in April its record high for that time of year (+3.1%, or Rb 458bn).

The shrinkage in the growth rate of loans to individuals was in part contributed to by their increasing average weighted value (17.7% per annum in Q1 2013 against 16.5% a year earlier), as well as by the accumulated volume of individual debt to banks: in Q1, the planned household expenditures on the servicing of bank loans amounted to 12% of disposable income. As of 1 May, the size of outstanding debt against bank loans had increased, since the year's beginning, by 15%, while its growth over the entire period of last year had amounted to only 6%. All these factors have a negative influence on individual purchasing ability and limit promotional opportunities with regard to consumer demand.

In the current market situation, the government is pinning their hopes of stimulating economic growth primarily on the banking sector, which is urged to increase credit provision to industrial enterprises. However, both the banking sector and industry are beset by a number of problems having an adverse effect on the dynamics of economic growth. The most noteworthy problem is the outflow of capital. Thus, in Q1 2013 Russia lost \$ 25bn in capital flight, almost all of which, unlike last year, was accounted for by the export of banking capital. On the other hand, industry's low demand for raw materials and industrial purpose products and the worsening financial situation of industrial enterprises have reduced – and will further reduce – their demand for credits. Thus, April saw yet another shift in the capital structure legal entities: the amount of financial resources kept by them on their settlement and current accounts dropped by 3.1%, while the volume of their deposits grew by 2.5%. As a result, the share of fixed-term deposits rose to 55% of the total amount of funds kept by enterprises in banks. Having stagnated at the beginning of the year, growth in credits to enterprises resumed in the spring. Nevertheless, the annual credit growth rate continues to dwindle: in April, credits rose by 1.7% (Rb 311bn), but the annual credit growth rate declined to 13.4%, which corresponds to its level in early 2011.

In annual terms, industrial production expanded by 2.3% in April (March 2013: by 2.6% year-on-year). This means that the acceleration in March was not sustained in April. Much of the blame for this should be pinned on the dynamics of the manufacturing industry, where the growth rate of production, in annual terms, amounted to 1.2%. Thus, the economy is still very far from resuming its upward trend, characterized by accelerated growth of the manufacturing industry. Machine building, the key sector of the manufacturing industry, continues to slump: in April, the production index for machinery and equipment manufacturing amounted to 98%; the production index for electrical, electronic and optical equipment manufacturing amounted to 96% compared to last year. In April, the production of means of transportation and transport equipment increased by 4.0% in annual terms, which could not compensate for the slump of the previous several months (a 97.5% drop on January–April 2012).

The business opinion surveys carried out by the Gaidar Institute have revealed pessimism widespread among the surveyed enterprises. The enterprises' estimates of the current demand pointed to a sharp decline in demand comparable with the drop registered in July 2012. As far as the stocks of finished products are concerned, in March and April 2013 the proportion of responses 'above the norm' had grown to its record high since September 2009, when industry had just got rid of its crisis-time excess inventory. The balance of changes in output (the pace of output growth) declined

to +6 points, although in the previous post-crisis years it had never dropped below +20 points, and even in the crisis year 2009 the balance of changes in output had amounted to +9 points. In fact, April data represented the worst result since June 2009 when Russia's industry began to exit the acute phase of the latest crisis. Having

Having briefly entered the positive zone in March after a long seasonal pause, the investment plans of the surveyed enterprises failed to remain in a positive trend and once again returned to zero, with 50% of enterprises planning to increase investment and another 50% planning to reduce it. A downward adjustment of the investment trend took place in machine-building, the timber industry, the chemical industry and light industry. Positive changes in investment plans were registered only in the food industry. In April 2013, the aggregate ('above the norm' + 'within the norm') credit availability remained practically unchanged. At the same time, the mean minimum rate on ruble-denominated credits offered by banks to enterprises dropped to 12.9% per annum, thus having shed 0.2 p.p. over the course of two months. ●