

RUSSIA'S ECONOMY IN JULY 2013: PRELIMINARY DATA AND PRINCIPAL TRENDS

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Socio-political background: neither prohibit nor permit

Escalation of socio-political tensions in July 2013 was caused by upcoming elections in various regions on September 8, 2013. The tension, in its turn, reflects general uptrend in political activity, which has been of cellular nature so far, of both common citizens and elite groups. Main collisions in July have been developing around the upcoming mayoral elections in Moscow and St. Petersburg, as well as municipal elections in Yaroslavl.

In Yaroslavl, confrontation was boosted after opposition incumbent mayor Yevgeny Urlashov announced his intention to run as leading candidate for Mikhail Prokhorov's *Grazhdanskaya Platforma* (Civil Platform) instead of *Edinaya Rossiya* (United Russia) in the upcoming municipal elections. Such a development would guarantee a major defeat for United Russia and total loss of control in the city by the same. The Yaroslavl Municipal Duma (City Council) made attempts to ouster the popular mayor, who eventually was arrested in the night of July 3, 2013 on the charge of attempting to solicit a bribe and bribetaking. In spite of its initial representations, the Investigative Committee of the Russian Federation has failed to provide a convincing evidence of the charge within a month and its witnesses began to alter their evidence. The foregoing totally contradicts the common practice, when bribe extortion and bribery charges are regarded as having real prospects in court subject to physical evidence, typically, when the accused has been caught with the mainour. Furthermore, the case in hand deals with a legally elected mayor. This is why Urlashov's arrest and detention can be regarded as politically motivated action. In fact, any other mayor might be arrested through such a scheme (on unsatisfactory extortion charges). Anyway, at the end of July the Yaroslavl municipal electoral commission refused under a far-fetched pretext to register Civil Platform for the upcoming municipal election.

Contrariwise, main opposition candidate Aleksei Navalny was registered as Moscow mayoral election candidate with the aid of municipal authorities in Moscow. On the following day, however, he was charged with defrauding Kirovles, a state-owned timber company, by Kirov Court. The prosecution used the same scheme which was initially tested in the second YUKOS case: the difference between two transactions was

regarded as evidence of damage caused to the first seller, then the total transaction amount was regarded as the amount of damage based on an absurd ruling of the Supreme Court, whereby any business transaction might be regarded as severe criminal offence, depriving a person of the right to stand for elections *ad vitam* under another provision (in direct contradiction to the Constitution of the Russian Federation). Aleksei Navalny was arrested in the courtroom, but unexpectedly released – contrary to the common practice – on the following day. He may therefore participate in the Moscow mayoral election campaign. The biggest ever unauthorized action in support of Navalny was held downtown and attended by at least 10,000 persons prior to Navalny's release.

Analysts have explained such an unusual behavior of Moscow municipal authorities towards Navalny by the fact that certain political groups are seeking to lend more legitimacy to Sergei Sobyenin's election as Moscow mayor, thereby strengthening his political weight. Some assume that it may be indicative of Sobyenin being considered a candidate for successor-backup of President Putin who is losing ground.

One way or the other, these collisions show that government authorities in politically active regions are facing two tasks which contradict one another, namely lend more legitimacy to elections and prevent opposition forces from getting stronger. Attempting to solve these tasks, government authorities have to use more risky combinations which act as destabilization factor. Quiet and smooth elections are passing.

Macroeconomics:

quiet summer and military and political budget

The July macroeconomic conditions were governed by insignificant increase in oil prices and stabilization of the ruble exchange rate and inflation. A growth in oil prices to \$108 per barrel by July 10 (106.2% of the price at June end) encouraged an increase of 4.9% (from 1330 points as of June 28 to 1400 points as of July 12) in the MICEX index. The monthly ceiling of the index was reached on July 17, 1431.8 points. A growth 20.3% in Gazprom shares in the interval between July 1 and 17 against long-term downtrend in company's capitalization (the price per stock halved against post-crisis peaks in April 2011) was the most dramatic event in the stock market. However, the growth reflected the

impact of a market factor: Gazprom received from the Russian Government a few oil fields located in the Barents Sea and the Kara Sea. In general, the stock market was growing in July through state-owned companies, namely oil and gas, energy and metallurgical companies, whereas consumer, financial, and innovation sectors were stagnating.

Though in July the ruble exchange rate downtrend remained unchanged, it slowed down drastically: average price of the bi-currency basket amounted to Rb 37,30 in July against Rb 36,98 in June. In general, the basket has gained 7.3% since February 2013. Currency exchange dynamics in July were smoothed by Bank of Russia's interventions.

In July, the consumer price index grew up 0.8% against the previous month. Therefore, inflation was reduced to 6.5% on a year-on-year basis against 6.9% in June and 7.4% in May. However, it would be premature to speak about steady downtrend for inflation: high values of monthly growth in consumer prices in the summer of 2012 (0.9% in June and 1.2% in July) were driven by lower annual values. As expected, inflation rate in July was basically governed by increased tariffs of communal services. On the one hand, prices may further raise in response to a bad crop due to adverse weather conditions in several regions; on the other hand, inflation may be mitigated by domestic demand and slower growth rates in money supply against the previous year (growth rates in M2 slowed down on a year-on-year basis from 20.9% as of June 1, 2012 to 15.3% as of June 1, 2013).

In June, excess reserves of commercial banks increased by 12.6% to Rb 1145,9bn, whereas banks' debt under repo transactions increased by 7.8% to reach Rb 2,19 trillion; according to the data on July 25, banks' debt under repo transactions amounted to Rb 2,26 trillion. Interbank lending market rates saw a downtrend in June thru July: in June, the average monthly MIACR on overnight interbank ruble loans stood at 6.3% (against 6.37% in May 2013) while the average rate in the period of July 1 thru 24 stood at 6.01%.

According to Bank of Russia's preliminary estimate, capital outflow from the country reached \$10bn in Q2 2013 and totaled \$38,4bn in H1 2013, being just \$1,7bn less than in H1 2012. Moreover, capital outflow in Q2 2013 exceeded by \$5bn that in 2012, being undoubtedly a downright unpleasant news for Russia's economic authorities. Net capital outflow amounted to \$19,4bn in the banking sector and \$18,9bn in other sectors over the period of January thru June 2013.

In spite of reduction (by 2.1 p.p. of GDP) in budget revenues due to deteriorated foreign trade conditions (oil and gas revenues dropped by 1.6 p.p. of GDP) and slower Russia's economic growth rates, Russia mana-

ged to run a federal budget surplus of 0.9% of GDP in H1 2013. A positive moment is that budget oil-and-gas deficit fell from 10.6% to 8.9% of GDP. However, budget balance was attained through respective reduction of expenditures under such budget items as 'Social Policy' (-0.6% p.p. of GDP), 'National Economy' (-0.4%), 'Education' (-0.4%), 'Healthcare' (-0.4%). In particular, it suggests that healthcare expenditures has seen a reduction of more than one third as percentage of GDP against H1 2012, whereas expenditures under such items as 'National Defense' and 'National Security' increased by 0.2 p.p. in aggregate. As a result, Russia's budget resembles more the budget of a military-police state in terms of spending: the share of military and security expenditures has been increased from 28.8% to 33% in total budget expenditures, whereas the share of educational and medical expenditures has seen a reduction from 11.3% to 9.4%.

Real sector: from slowdown to stagnation

The Q2 results show that the situation in the real sector keeps deteriorating, beginning with slowdown in economic growth and moving towards stagnation. This is supported by negative dynamics of investments (against Q2 2012) and reduction in production in the manufacturing industry.

Further deterioration of financial performance results of enterprises and organizations (in January thru May 2013 profit and loss account balance stood at 78.3% year on year) interferes with their ability to finance investments with their own resources. Capital investments were basically based on public funding, whereas direct foreign investments were insignificant. All in all, in H1 2013 capital investments stood at 98.6% and scope of works in the construction industry 98.1% year on year.

In addition, deterioration of financial performance results of enterprises reflects not only shortage of funds, but, above all, earnings dilution. It is weak demand against high costs that serves as the key constraint factor for enterprises. As is evident from weak investment activity. The fact that weak investment activity is connected with the foregoing factors rather than shortage of funds is supported by prevalence of term bank deposits in the total amount of funds which corporate bank clients hold in banks: they account for 54.6% of total corporate deposits in banks, or around Rb 6,5 trillion. However, the June growth in corporate bank funds was observed in settlement and current accounts, whereas the volume of term bank deposits dropped by Rb 14bn during the month.

For the first time since 2009 industrial production in H1 2013 remained at the previous year level. However, the situation changed in the second quarter against

the first one: while in Q1 2013, reduction in the manufacturing industries amid weak growth in processing (1.2% against Q1 2012) had an adverse effect on industrial performance figures, in Q2 2013 mining was growing (+2.7%), whereas manufacturing industries saw negative growth rates on a year-on-year basis (-1.3%). Production growth in manufacturing industries was observed in chemical and petrochemical industries, rubber and plastics industry, whereas metallurgic industry and machine building sector showed market cutback in production. For instance, production of machinery and equipment stood at 93.5% and electrical equipment, electronic and optical equipment at 94.7% against Q2 2012.

Consumer demand has becoming less supporting to the economy. Growth rates in retail trade turnover (+3.7% against H1 2012) and paid services to households (+2.0%) have almost halved against the previous year due to both reduction in growth rates of real disposable income and real wages and slowdown in growth rates in retail lending (issued retail loans have grown 33.3% over 12 months against 39.1% as of the beginning of 2013, and 42.5% in the preceding year), which, in its turn, reflects a heavy debt load (household expenses on payment of interests and principal redemption accounted for 11.5% of disposable income in the period of January thru May 2013). In addition, household consumer behavior has been changing in 2013: thrift propensity has been growing, whereas the share of costs on purchase of products has been reducing. Retail bank deposits increased by 2.1% in June 2013 and 20.0% during 12 months. The foregoing has triggered growth in relative investment potential of bank deposits (actual value of retail term deposits in

banks reached 6.7% p.a. in H1 2013) and resulted in more moderate households' forecast of economy prospects and their own financial standing.

Further development of adverse trends in the industrial sector had an adverse effect on growth (for the first time since the beginning of the year) in unemployment in June against May 2013 (104.7%) and June 2012 (102.7%). Stock balance growth in H1 2013 is indicative of that no changes are to be expected in the foregoing trends in a short-term period.

The data obtained by Gaidar Institute's business surveys also show that anticipations concerning consumer growth in May, which encouraged enterprises to increase their output, were not borne out, and the increase become a problem for the industrial sector, having triggered drastic growth in the level of dissatisfaction with sales and made enterprises to revise demand forecasts, output and employment plans in favor of a negative scenario in June–August. In addition, according to business surveys, the industrial sector shifted in June towards absolute price cutting against scheduled growth in tariffs in summer. As a result, 2013 year-end financial performance results might be found to be even more frustrating for enterprises than those in H1 2013.

Data on Q3 2013 may be found to be more encouraging due to the base effect: the economy began to slow down in Q2 2012. However, it will happen, provided that adverse trends of H1 2013 stop developing, otherwise growth cessation might become an official statistical factor, and, indeed, transition to a recession doesn't seem to be an unthinkable scenario in the context of the Q2 data. ●