THE REAL SECTOR OF ECONOMY: FACTORS AND TRENDS IN H1 2013

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The trend towards slower economic dynamics by basic types of economic activity kept progressing in the period of May thru August 2013. With industrial production stagnating at the level of January–August 2012, manufacturing and electric power production contracted by 0.2% and 1.1% respectively. Freight turnover annual rates have declined since June 2013. Performance of works in the construction industry have become more irregular with declining capital investments. Consumers' demand which is determined by real wage increases remains the factor that promotes economic growth.

Macroeconomic situation this year has been characterized by gradual slowdown in growth rates. The GDP actual volume index accounted for 101.6% in Q1 2013, 101.2% in Q2 2013, and 101.4% at the end of H1 2013 of the level observed during the corresponding periods in 2012. Stagnation in the Russian economy in the period of January thru August 2013 was determined by simultaneous effect of external and internal factors. Global market trends which have been persisting since H2 2012, pushed down cost and physical export volumes and determined slow development dynamics of the extracting sector and related mineral resources refining industries. In H1 2013, mineral extraction's contribution in GDP was 0.9 p.p. less than the corresponding value observed in the previous year. Industrial production's weaker demand for mineral extraction which account for more than 1/10 of gross value added, almost 23% of capital investments and profits of enterprises and organizations in the Russian economy at large, had an adverse effect on the dynamics of manufacturing sector and transport services. Negative growth rates in the manufacturing industry have been observed on a year-on-year basis since May 2013. Outgrowth of rates in the extracting sector vs. the industry composite index in January–August 2013 couldn't compensate for the decline in the manufacturing sector and production of electric power, gas, and water. The manufacturing index in January–August 2013 accounted for 99.8% of the value observed during the corresponding period of the previous year, while production and distribution of electric power, gas, and water accounted for 99.1%.

The situation was aggravated by a long-lasting trend toward cost-price inflation related to the tariff policy of infrastructural monopolies, and outgrowth in wage increases. Worse financial performance results of enterprises and organizations restricted limited the capacity for adjusting the pricing policy in order to maintain competiveness, as well as capital investment financing. The volume of capital investments contracted by 1.3% during the period of January thru August 2013 and by 3.9% in August as compared to the corresponding periods of 2012. It is the functionality dynamics of machine building and metallurgical industries that was affected most by the decline in investment activity. In the period of January thru August 2013, production of machinery and equipment contracted (by 7.0%), cargo trucks output (by 6.7%), and production of assembled steel sections (by 2.5%) against the corresponding period of the previous year.

In August 2013, retail sales index accounted for 104.0% of the value observed in the previous year, including food products (103.7%) and non-food products (104.0%). It is worth noting that uptrends in retail sales turnover were to a greater extent related to the labor remuneration policy. Equalization of wages at budget-funded sectors with average amounts in the economy was the key growth element, but this factor's contribution has been weakening this year. In August 2013, real personal income increased 2.1% on a year-on-year basis, up from 9.3% last year, while real wages increased 5.9%, up from 6.0% last year.

The situation at hand determined the need to update basic parameters of the Russian economy development until the end of 2013 which outlined a forecast of social and economic development for 2014 and the planning period of 2014–2016. According to the estimates made by the Ministry of Economic Development of Russia, dynamics of basic macro indicators are expected to speed up in H2 2013, thereby allowing a 101.8% growth rate of GDP to be approached at year-end.

The Ministry of Economic Development of Russia has estimated quite optimistic social development parameters until the end of 2013. The situation in the labor market is expected to stabilize: unemployment rate is expected to remain at a level of 4.1 million persons, a minimum value over the past decade, or 5.7% of total gainfully employed population. Real personal income dynamics saw a slowdown in H2 2013, but growth rate

Table 1

FORECAST BASIC INDICATORS BY BASIC OPTION (1), AS PERCENTAGE OF THE PREVIOUS YEAR

	2012	2013		2014	2015	2016	2016 against 2012
	report	H1	assessed per year	forecast			
Consumer price index at year-end	106.6	103.5	106.0	104.5–105.5	104–105	104–105	
Gross domestic product	103.4	101.4	101.8	103.0	103.1	103.3	111.7
Industrial production index	102.6	100.1	100.7	102.2	102.3	102.0	107.4
Agricultural index	95.3	102.0	107.0	102.0	103.0	102.6	115.3
Capital investments	106.6	98.6	102.5	103.9	105.6	106.0	119.2
Retail sales turnover growth rate	106.3	103.7	104.2	104.0	104.4	104.7	118.5
Scope of paid services to the general public growth rate	103.5	102.2	102.2	102.5	103.1	103.4	111.7
Real household disposable income	104.4	104.4	103.4	103.4	103.3	103.3	114.1
Real wages	108.4	105.5	106.2	104.0	103.8	104.2	119.4
Foreign trade turnover	103.6	93.3	99.0	100.6	101.7	103.1	104.4
Export	102	96.2	96.9	99.0	100.1	102.1	98.1
Import	105	104.4	102.3	102.9	103.9	104.5	114.3
Employment volume in the economy	100.3	100.3	99.6	99.7	99.5	99.4	98.5
Labor productivity	103.0	–	102.2	103.3	103.7	103.9	113.7

Source: Ministry of Economic Development of Russia.

is estimated to reach 103.3% in 2013 and remain as such within the next three years. Should real wages growth rate increase in H2 2013, it is estimated to exceed by 0.7 p.p. the 2012 value and stand at 106.2%. The forecast retains the trend towards outgrowth in wage increases vs. labor productivity, and higher labor costs in GDP. Outgrowth in wage increases vs. labor productivity is estimated to lead to a 24.4% growth in the share of remuneration of salary-earning workers in GDP. Within the next three years (2014–2016) a 104% annual average growth rate of wages is expected to retain the share of labor remuneration in GDP at the 2013 level. Should wage increases keep outgrowing labor productivity in the next three years, the cost-price inflation trend would remain in place. It should be noted that in this case, all other factors being equal, economy cost-effectiveness would remain at the level reached in 2013.

The forecast that expects growth rates to accelerate in H2 2013 is based on the assumption that domestic consumer demand and investment demand would expand. However, the following should be taken into account: (1) regulated prices and tariffs of services provided to the general public increased in H2 2013, (2) growth in prices of manufacturers of industrial products has been accelerated since June 2013, and (3) prices of imported goods increased in response to a weaker ruble exchange rate. In H2 2012, these factors slowed down growth rates in sales turnover, irrespective of higher growth rates in real personal income as compared to the current situation.

Slower dynamics of capital investments and scope of works in the construction sector in the period between January and August 2013 can be explained by high base during the corresponding period in 2012. However, it should be accepted that the decline in capital investments in September–December 2012 was related to domestic problems occurred in response to cut back on investment programs at the backdrop of drastic slowdown in economic growth rates, influenced by production contraction, and for both external and internal markets. Inertial development of the situation remains the same this year. Investments in mineral extraction in H1 2013 contracted by 7.9%, including production of fossil fuels (by 11.5%), against the corresponding period of the previous year. Industrial production and retail sales turnover dynamics have been far behind import growth rates.

The assumption of faster growth in domestic demand against GDP dynamics is a key element of the forecast for 2014–2016. Therefore, structural changes to capital investments must be focused on gradually increasing investments in manufacturing industry and types of economic activity which provide services. Though capital investments are expected to account for an average of 20.8% of GDP in the period of 2014–2016, these resources may be found to be insufficient for a large-scale modernization of the economy. Though economic growth rates are projected, investment demand in the period of 2014 thru 2016 will still be satisfied through outstripping growth rates in import of investment goods vs. domestic production. Furthermore, domestic production industry still depends on import of intermediate consumption products.

Faster rates in domestic demand for domestically provided goods and services implies quality changes to mechanisms of influence and motivation. Analysis of the capital investment financing structure shows that equity capital, public funds, and borrowings account for about 70%. Loans from foreign banks, as well as funds allocated by controlling holding and joint-stock companies and industrial-financial groups, which account for 12.4% of total capital investments, dropped drastically in nominal terms in H1 2013 as compared to the corresponding period of the previous year. One may hardly expect any investment surge within the next four months in 2013 with the existing dynamics of financial performance results in H1 2013 and subsequent scrapping of investment programs at largest companies. This fact is especially alarming, because in such a case, one may hardly forecast more intensive investment activity to be seen in 2014.

The projection of investment dynamics for the period of 2014 thru 2016 is based on the conditions of changing the quality of institutions which support entrepreneurship and upgrading the public-private partnership mechanism, thereby allowing investment projects to be structured in a different manner, including projects which are to be implemented with National Wealth Fund's resources, ensuring protection against investment risks, and increasing total volume of investments.