

RUSSIA'S ECONOMY IN SEPTEMBER 2013: PRELIMINARY RESULTS AND MAJOR TRENDS

K.Rogov

Political Background: Neither Stability Nor Change

Russia's single voting day on 8 September 2013, when voters cast their ballots in the course of the election of regional bodies of authority in some RF subjects, became yet another illustration to the controversial political situation in this country. It is becoming increasingly difficult for the Kremlin to hold on to its formerly enjoyed electoral advantages in the politically active regions: independent and opposition candidates won in the elections in Yekaterinburg and Petrozavodsk, while one of the opposition's leaders, Aleksey Navalny, in spite of the unfavorable conditions of the Moscow mayoral election campaign, managed to seize 27.2% of the vote, while his rival Sergey Sobyenin, backed by the Kremlin, in spite of his enormous advantages in publicity and organization, showed results much worse than expected. In the politically inert and inactive regions the waning enthusiasm for the 'party of power' manifests itself in the increasing indifference of voters, visible by the significant drop in voter turnout.

While in Moscow the counting of votes was relatively honest, in some regions the scale of vote tampering was even more impressive than usually (thus, in Ivanovo Oblast, more than 20% of voters cast their votes 'from home'). Almost all the traditional systemic parties, especially the LDPR and Fair Russia, have been losing voter support. The alterations to legislation whereby the registration procedure for new parties has been simplified are going to speed up this process even more. Thus, the systemic parties will have either to resort to stronger criticism of the Kremlin and United Russia, or to become marginalized. In the Committee of Civil Initiatives' report on the election results, the current situation is described as 'a crisis of the former party and electoral system'. At the same time, one cannot but note the weakness and lack of consolidation amongst the opposition. So far, there have emerged no structures capable of harboring the rising public skepticism on a nation-wide scale, which was vividly reflected in the overall picture of the elections held on 8 September.

In September the RF Government approved the draft federal budget for 2014-2016, and it was immediately introduced into the State Duma. The final version of the draft reflected numerous compromises and adjustments caused by a sharp decline in current economic indicators and forecasts of Russia's economic development. At one

of its meetings in September, the RF Government announced that all expenditure items of the 2014 Budget, with the exception of a few 'sacred cows' ('protected items'), would be cut by 5%. Nevertheless, the draft budget was clearly focused on expenditure (first of all, on the RF Government's much advertized social liabilities). As a result, it can be said that the forecast of budget revenues as reflected in the draft looks hugely overoptimistic. Yet another sign of the rising nervousness in the RF Government's economic policy was its sudden decision to seize the contribution assets accumulated in private pension funds (unconvincingly explained by the necessity to convert those funds into joint-stock ventures and to establish an 'insurance fund'). As the actual aims of that initiative remain unclear, experts believe it to be an ominous signal pointing to Russia's unstable financial situation and to the unpredictability and non-transparency of her financial policy.

Macroeconomic Background:

External Support vs. Internal Weakness

Russia's macroeconomic background in September was determined, on the one hand, by favorable trends in international markets, however temporary those trends might be, and by a number of indications that her economic growth was beginning to falter on domestic factors, on the other.

In August and early September the global oil market saw a steady climb in oil prices. As a result, the average price of Brent crude oil during that period amounted to \$ 110.2 per barrel vs. \$ 103.1 per barrel in spring 2013. The main factors behind the rise in oil prices were expectations that the US Federal Reserve System would not halt the third round of quantitative easing (QE3), and the aggravation of the Syrian crisis. As a result of the rise in oil prices, in September the MICEX Index grew by 4.8% on August. Unfortunately, that episode cannot be seen as the beginning of an upward trend, indicating that Russia's stock market has finally ended its long spell of stagnation.

In September, the changing situation in world markets and the continuing weakening of the dollar against the euro resulted in a rather sharp trend reversal in the behavior of the ruble's exchange rate: having weakened in August against the bi-currency basket to the lowest level since 2009 (Rb 37.95), in September the ruble began to strengthen against the US dollar (climb-

ing from 33.43 rubles per USD as of the end of August to 31.58 Rb/USD as of 20 September, and then to 32.25 Rb/USD as of the end of September). In September, the Central Bank of Russia widened the floating corridor of its bi-currency basket by 5 kopecks. Thus, the new corridor extended from 32.25-39.25 to the basket.

In September, the monthly inflation rate amounted to 0.2% vs. 0.6% in September 2012. The main factors behind that drop in inflation were the seasonal fall in the prices of fruit and vegetable products and the stabilization of the housing and utilities tariffs and the prices of passenger transport services. As a result, the annual inflation rate dwindled to 6.1%. It is noteworthy that, in spite of the general deceleration of inflation, the past few months saw the prices of healthcare, education and household services rising faster than inflation. Later on, at the year's end, prices may experience upward pressure in response to the lower-than-normal crops yields; another contributing factor may become the weakening of the ruble. The factors suppressing the inflation rate's growth will be the declining domestic demand and the continuing slowdown in the growth rate of money supply (the per-annum growth rate of M2 dropped from 18.0% as of 1 August 2012 to 17.0% as of 1 August 2013). (For more details, see the 'Inflation and Monetary Policy' section).

In August, the surplus reserves held by commercial banks grew by 0.9%, to Rb 951.9bn, while the amount of banks' repo debt increased by 16.1%. As of 23 September, banks' repo debt amounted to over Rb 2.4 trillions. In conditions of the banking sector's continuing structural deficit of liquidity, the interest rate in the interbank market in July was on the average at the level of 6.11% (against 6.08% in July 2013). In September, the interest rate in the interbank market continued its upward trend: over the period from 1 through 23 September, the average interest rate was 6.18%.

In Q3 2013, net capital outflow from Russia increased to \$ 12.9bn. As a result, the outflow of capital from Russia over the course of the first three quarters of 2013 amounted to \$ 48.1bn, representing a significant increase on the same period of 2012. It should be said that the sole contributor to the outflow of capital from Russia was her non-bank sector, while the banking sector, on the contrary, was busily attracting capital inflows. According to the Bank of Russia, Russia's foreign debt as of the end of Q3 2013 amounted to \$ 719.6bn, which represented a 20% rise on 2012 (64% of that increase was accounted for by the non-bank sector). Thus, Russia, on the one hand, continues to be a net exporter of capital, while on the other hand, it steadily increases the share of external debt in total financing. Foreign direct investment in Russia's economy amounted to \$ 98.8bn, representing a 32.1 rise on

the first half year of 2012. At the same time, Russian investment abroad amounted to \$ 126bn (a 81.8% rise on the same period of 2012). Thus, Russia continued to experience a huge asymmetry between her inward and outward FDI (almost one-half of Russia's outward FDI – \$ 59bn – was received by the Virgin Islands). Russia's inward FDI continues to massively exceed her outward FDI. As we know, the trend towards investing abroad has emerged in Russia due to the drawbacks of her business climate and tax regime, while the remaining huge asymmetry between Russia's inward and outward FDI testifies that the Russian economy does not look very attractive to investors.

Over the period of January–August 2013, the volume of federal budget revenue dropped by 2.2% of GDP on the same period of 2012. The main factors behind that drop were the worsening of the external market situation (Russia's oil and gas revenues declined by 1.3% of GDP) and the slowdown of the Russian economy (domestic and external VAT revenues dwindled by 0.8% of GDP). At the same time, the volume of federal budget expenditure decreased by 1.7% of GDP because of the spending cuts applied to the following budget items: 'Social Policy' (-1.2 p.p.); 'National Economy' (-0.4 p.p.); and 'Healthcare' (-0.2 p.p.). The cuts in spending were motivated not only by the fall in budget revenues, but also by the RF Government's intention to redistribute the shrinking revenues in favor of such budget items as 'National Defense' (+0.1% of GDP), and 'Law-enforcement Activity' (+0.1% of GDP). Thus, the RF Government once again showed its prudence to non-productive expenditure and readiness to preserve and exacerbate the distortions on the expenditure side of the federal budget. However, it should be noted that the afore-mentioned changes in the revenue and expenditure sides of the federal budget reduced the non-oil and gas deficit from 9.7% of GDP in January–August 2012 to 8.9% in the same period of 2013. The consolidated budget of the Russian Federation's subjects dwindled by 1.9% of GDP. The main factors behind that drop were a considerable decline in profits tax revenues (-1.2% of GDP) and a reduction in government transfers (-0.8% of GDP). The asymmetrical reduction in regional budget expenditure was achieved at the expense of healthcare, social policy and the housing and utilities sector.

The Real Sector: Stabilization of Stagnation

The Russian economy is stagnating as before, although the situation in July-August was no longer worsening by comparison with the previous months. First of all, it should be noted that, over the three summer months, the financial situation faced by Russian companies became stabilized: as seen by the results of the period of January–July, the balance of the profit and loss account amounted to 79.8% of its level re-

corded in the same period of last year, while by the quarter-end results of Q1 2013 this index amounted to 70.9%. This means that profitability of production was no longer declining.

On the whole, industrial production in per annum terms demonstrated zero growth. The mineral extraction industry remains in the positive zone (in August – 102% on August 2012), while the growth rate in the processing industry remains negative, although practically approaching zero – which means that the threat of recession looms no longer (in August, the processing industry's result amounted to 99.8% per annum, while over the three previous months this index on the average had been at the level of 97.6%). At the same time, the depth of slump in the machine-building complex, while becoming less pronounced, is still impressive: over the period of January–August, the index of the production of machinery and equipment dropped by 7.0% on the same period of last year, that of production of freight vehicles – by 6.7%.

A positive growth rate of GDP in per annum terms as seen by the results of the first three quarters of 2013 may emerge due to the contribution of the services sector (103.7% on August 2012) and trade (104% on August 2012). At the same time, the consumer sector offers only very limited opportunities for promoting general growth. Although the growth rate of wages remains sufficiently high (105.9% on August 2012), growth of the population's real income in per annum terms was 2.1% against 9.3% a year earlier. The consumer behavior model is also undergoing a change: in conditions of restricted opportunities for further consumer lending, the population tends to accumulate saving and delay purchases. The growth rate of the population's payables continues to decline (to 31.7% in August in per annum terms), while the role of loans in sustaining household consumption is still increasing (it is estimated that the volume of newly issued loans in August amounted to 30% of aggregate retail turnover, public catering and commercial services). At the same time, the annual growth rate of the population's saving kept with banks amounts to approximately 20%, while the household saving norm increased to 5.6% from 4.8% a year earlier.

The ongoing decline in investment activity has a strong impact on the behavior of economic growth. In August, the situation once again worsened – investment over that month amounted to only 96.1% against August 2012. On the whole, while in the period from December 2012 through May 2013 the volume of investment was displaying zero growth, over the three summer months it once again declined, and so the results of January–August yield negative investment growth – 98.7% against the period of January–August 2012.

Another manifestation of low business activity is the behavior of companies' monies on bank accounts. Thus, August saw an outflow of cash from corporate clients' accounts (-1.2%); at the same time, while the volume of fixed date deposits was increasing (although at a lower rate than before: +1.1%). As a result, the share of fixed date deposits in the aggregate funds of the corporate sector increased to 55.3%, thus nearly hitting its record high of last May. The growth of corporate debt against bank loans issued over August amounted to 1.4%, and in per annum terms – to 13.2%, which is also near its record low of the last 2.5 years (for more details, see the 'The Russian Banking Sector' section).

The business opinion surveys also reflect a relative stabilization over the period of July–August, which was taking place alongside the persistently pessimistic outlooks concerning the Russian economy's future. Companies offered more optimistic estimates of the level of actual demand and the behavior of sales; positive trends are noted in the behavior of output; the July surge in the level of high surplus finished stocks had been adequately dealt with. However, the improved situation pushed up industrial product prices (a trend reflected in statistics since July; in the business opinion surveys, the balance of actual changes in prices became positive in August, after staying for four months at a zero level and in the negative zone). The stabilization of demand made is possible for enterprises to compensate for their increasing costs – a factor that represents a serious problem in an unfavorable economic situation: if in Q2 the growth rate of costs was estimated to be at the level of +5 points, by the end of summer it had risen to +15.

In the surveys, the demand level predicted for the period of September–October appears to be very pessimistic. The initial balance lost a total of 6 points over August, thus for the first time in 2013 failing to be positive (sales expectations became equal to sales' expected growth). Producer pessimism is also noticeable in the September entrepreneurial activity surveys conducted by Rosstat. Yet another acute problem is represented by labor shortage: as shown by the IEP's business opinion surveys, at present 22% of companies complain of insufficiency of human resources, while personnel shortage brings down the level of output for 37% of companies (for more details, see the 'Russian Industry in August 2013' section).

When estimating the slight improvement of the Russian economy's indicators displayed early this autumn, it should be borne in mind that in the autumn of 2012 the economy had already entered the phase of steep slowdown. ●