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

K.Rogov

***Political and economic environment: a strong-arm approach***

*Russia's diplomatic and information efforts on the eve of signing a Euro-Ukrainian association agreement should be considered the key topic of the political and economic environment in November 2013. Russia's representatives repeatedly stated that if the association agreement is signed, the Russian-Ukrainian trade terms would deteriorate. Ukraine's President Victor Yanukovich met up with the Russia's President on November 9, 2013 during his "secret" visit to Russia, and on November 21, 2013 Yanukovich unexpectedly announced that Ukraine is going to unilaterally terminate the negotiations on the association agreement with the European Union which took two years to prepare and was scheduled for signing on November 28, 2013. However, no content of the Kremlin's alternative proposals which made the Ukrainian party change its mind was disclosed. In the Russian perspective these events should be treated as a new round of mounting tension between Russia and the European Union. Diplomatic maneuvers were accompanied by stronger anti-EU rhetoric in the Russia's public mass media.*

*A non-face-to-face dispute between Vladimir Putin and Dmitri Medvedev concerning the Russian Investigative Committee's initiatives seeking to at least regain the Committee's right to launch criminal cases without having to obtain tax authorities' consent has become the main public news. Law enforcement agencies were deforced of the foregoing right in 2009 as part of Then-President Dmitri Medvedev's initiatives aimed at improving business environment in Russia and restricting law enforcement agencies' intervention into the economy. However, the initiatives were subject to orderly revision by Vladimir Putin after he regained the presidential office. President Putin took the liberty of criticizing in the harshest (for the first time ever in the "tandem" history) terms the Prime Minister who opposed such a revision, having suggested that Medvedev should resign if he remains in disagreement over the issue.*

*Furthermore, in November 2013 the State Duma approved in a very quick manner a law on the abolishment of the Supreme Arbitration Court (SAC). The law was strongly opposed by the business community and experts; no well-defined objectives of the reform which requires amendments to the Constitution were formulated. There is a common unofficial explanation which is restricted to that Dmitri Medvedev is going to be appointed the Chairman of the United Supreme Court after his resignation as Prime Minister.*

*In November 2013, Astrakhan Mayor Mikhail Stolyarov was arrested on suspicion of bribery. It was the fourth arrest of a duly elected mayor since the beginning of 2013; some of the previous headline-making arrests concerned Yaroslavl Mayor Yevgeny Urlashov and Makhachkala Mayor Said Amirov. Such a practice creates a conflict of laws: as duly elected heads mayors are virtually stripped of immunity vs., for instance, federal assembly members, thereby making the former depend largely on the federal and regional authorities and actually disowning their status of elected officials.*

*In November 2013, Vnesheconombank announced build-up of a loan depreciation provision of Rb 215,3bn. This implies that preparations for anticipated defaults of companies involved in the construction of venues for the upcoming Winter Olympic Games in Sochi have been launched, in which case their debts under respective agreements will be directly paid off with budget funds. According to market participants, it is these extra expenditures imbedded into the Olympic construction financing scheme that have triggered unexpected transfer of money from non-governmental pension funds to the budget.*

*Finally, on November 20, 2013, the Central Bank of Russia revoked the banking license of Master Bank in Moscow on the ground of claims ranging from violation of the anti money laundry law to a balance-sheet "hole" of Rb 2bn arising from additional assessment of provisions for Rb 20bn loans issued to persons affiliated with the bank's managers. In the meantime, the bank has Rb 30bn of ensured deposits which are to be repaid.*

***Macroeconomic background: Oil prices fail to support the ruble***

*Oil prices began to grow since the second week in November 2013 after two months of fall as the US dollar weakened vs. the Euro. This, however, had no effect on the dynamics of Russia's stock market indices. International funds were leaving the Russian market: cash outflow amounted to $408m in the period of October 31, 2013 thru November 20, 2013, as reported by the Emerging Portfolio Fund Research (EPFR).*

*A weakening ruble remains the key factor governing the macroeconomic situation in Russia. Throughout the entire November 2013 the Bank of Russia allowed the ruble weaken by 3%: the dual currency basket value increased from Rb 37,38 as of October 30, 2013 to Rb 38,58 as of November 30, 2013. Furthermore, the Bank of Russia spent $2,96bn in support of the national currency in the period of November 1, 2013 thru November 26, 2013. The ruble is effected by fundamental factors, namely the positive current account balance in Q3 2013 dropped to a record-low $1,1bn (no such values have been reported since 1998). A weaker ruble position is also reflected through changes in the foreign exchange structure of retail and corporate bank accounts. For instance, the amount of retail ruble-denominated bank accounts increased 0.6% (Rb 83bn), whereas USD accounts went up 2.0% ($1,8bn) in October 2013, having reached a new highest of $93bn. The amount of corportate bank accounts dropped 1.3%, the amount of bank accounts denominated in foreign currencies increased 1.1% in US dollar terms, whereas the amount of ruble-denominated bank accounts declined 2.0% (see Russia's banking sector).*

*According to the data available as of November 27, 2013, banks' debt on repro transactions exceeded Rb 2,5 trillion. In November 2013, credit institutions' debt under other loans secured by non-market assets and guarantees increased 10.8%, having exceeded Rb 957,7bn. The interest rate in the interbank lending market averaged 6.15% (6.06% in October 2013 and 5.4% in January 2013). The decline in the interbank interest rate observed in October 2013 is partially related to Rb 500bn of loans placed by the Bank of Russia at 5.76% at the 3-month auction of loans secured by non-market assets at a floating interest rate. In November 2013, interest rates increased in response to mounting tensions in the interbank lending market due to the revocation of Master Bank's banking license (see Inflation and monetary policy section for details).*

*Inflation background which accelerated in October 2013, remained the same in November 2013: like in October, the consumer price index gained 0.6% during the month (against 0.3% in November 2012), thereby annual inflation rate increased up to 6.5% (5.9% since the beginning of the year). Inflationary pressure was related to increased prices of food products (a 0.9% growth) despite a good crop. Under the circumstances the Russian Government had to officially admit that inflation will be 6% above the target value at 2013 year-end. However, inflation is likely to reach 6.5% at the year-end (the consumer price index stood at 0.2% over a week, October 26, 2013 thru December 2, 2013) and is not going to differ as compared to the previous year (6.6%).*

*At 10-month period-end federal budget revenues contracted 1.5 p.p. of GDP, which is better than in August 2013 when the revenues contracted 2.2 p.p. year over year. However, cost cutback (which was 1.7 p.p. in August 2013) fell down to 1.1 p.p. Oil and gas deficit kept shrinking to 8.6% at 10-month period-end against 8.9% in January–August and 9.1% in January–October 2012, whereas the consolidated budget went into the red (0.1%) at November month-end.*

***Real sector: Stagnation gets steady***

*The main event at the beginning of the fall is that economic recovery anticipated at the end of 2013 by many experts has not yet begun. Such anticipations were partly related to the base effect: in Q3–Q4 2012 the Russian economy slowed down after successful Q1–Q2 and partly due to expected investment recovery. However, the dynamics are not encouraging. According to preliminary data, GDP in Q3 2013 gained 1.2% (similar to Q2 2013) as compared to Q3 2012. There were a few factors which determined the unfavorable dynamics, namely 1) the aforementioned weakening of fundamental macroeconomic indicators, 2) further decline in investment activity, 3) steady slowdown in consumer demand growth rates.*

*Like in the previous periods, the mineral extraction sector dynamics remain steadily positive (101.8% in October 2013 against October 2012). Note accelerating multidirectional trends within the sector. In January–September 2013, the oil sector total drill footage accounted for 105.6% and capital investments in current values for 103.9% of the level observed in the corresponding period of 2012, whereas the gas sector total drill footage dropped to 81% against the level observed in 2012, while investments in current values declined 32% (see Real sector of the economy: factors and trends section for details).*

*In October 2013 the manufacturing industry demonstrated negative growth rates for six consecutive months (98.1% in October 2013 against October 2012); average slowdown rate was -1.7% in year-over-year terms. Preliminary data on transport dynamics (106.3% against October 2012) look unexpectedly optimistic; statistically they have a positive effect on GDP final dynamics, but can hardly reflect actual economic trends.*

*Investment and construction growth rates have been showing negative values for three consecutive months (98.1% and 96.4% respectively against the level of October 2012), with an average 3-month contraction of -2.5% and -3.2%. Given negative dynamics in construction works, housing commissioning has been growing for three consecutive months (with an annual gain of 21.9% in October 2013).*

*Slowdown in consumer demand growth rates was caused by less intensive gains in consumer lending. For the first time since August 2011 annual growth rates in households' loan debt to banks were found to be below 30% in October 2013 (29.4% at October month-end). In January–October 2013, food market and non-food market turnover stood at 2.4% and 4.8% respectively against 4.0% and 8.9% in the corresponding period in 2012. Growth rates in real disposable income during 10 months in 2013 remained at the same level which was observed in the previous year (103.9% against 103.8% in January–October 2012). However, both growth rates in real wages (+5.5% against +9.0%) and actual amount of accrued pensions (+2.5% against +5.1%) slowed down visibly during the 10-month period. Note that it is the state that now plays the key role in the consumer demand growth: the public sector demonstrated the highest growth rates in wages in response to the famous Presidential Decrees dated May 7, 2012. As a result, wages dynamics are detached from fundamental economic trends.*

*Business surveys in the fall of 2013 show no optimism. Enterprises are making attempts to adapt to new, untoward conditions, in particular through cost optimization. For instance, since the end of 2010 not more than one third of industrial enterprises assessed their efficiency as low ("below standard"), whereas in October 2013 the share of such assessments increased up to 41%. This determines the transition to a headcount optimization policy at enterprises. Enterprises' investment plans have been showing the lowest level for three consecutive months since the beginning of 2010. Machine-building and metallurgy industries show the most severe situation with anticipated decline in investments.*