

Kirill Rogov

## The Russian Economy in November 2012: Preliminary Data and Major Trends

### ***The Social and Political Background***

The major political events of November were: the dismissal of Minister of Defense Anatoly Serdiukov; the investigation launched against his close associates in the top echelons of the RF Ministry of Defense; and a number of sensational denouncements of corruption by the VIPs – including former Deputy Minister of Regional Development Roman Panov (who was consequently arrested), the top managers of *Rostelecom*, and the former topmost officials from the RF Ministry of Agriculture. The active coverage of these scandalous developments by the mass media indicates that the authorities are eager to boost their popularity by initiating an ostentatious anti-corruption campaign. According to public opinion research agencies, the approval ratings of the authorities were on the decline throughout the second half of 2012.

The ouster of Serdiukov as Minister of Defense and his replacement by Sergei Shoigu also demonstrates that Russia's political leadership is striving to achieve a compromise with the military top brass who were utterly displeased with Serdiukov. Such a compromise will apparently mean suspension of the implementation of some of Serdiukov's reforms. Thus, the first consequence of his sacking will be the softening of the RF Ministry of Defense's approach to the defense industry. It should be noted that, as far as defense purchases were concerned, Anatoly Serdiukov was known to be relatively rigorous in his demands with regard to the prices and quality of armaments to be bought. He also lobbied for the purchase of armaments from alternative overseas sources. In 2010, Russia's state defense order was not fulfilled because of disagreements over prices. In recent years the defense order issue has become the bone of contention for the Russian ruling elite. Seen against the background of a steady rise in budget allocations to the defense industry, the sacking of the Defense Minister actually means that the interests of the defense industry have prevailed over the trend towards comprehensively rearming Russia's armed forces.

However, the anti-corruption campaign does not promise Russia's political leadership an easy way to gain laurels. The anti-corruption investigations are aggravating the inter-clan conflicts in the corridors of power, while society is clearly waiting for criminal proceedings to be initiated against top officials and VIPs, and not against some relatively unimportant figureheads. But most likely, the political leadership is still not ready to fulfill these expectations.

### ***The Macroeconomic Background***

November saw no changes in the most important external factors that had largely been determining the macro-economic situation in Russia. The price of Brent crude oil continued to fluctuate in the range of 105 to 111 USD per barrel. As a result, the Russian stock market and foreign exchange market remained in the doldrums. Over the second half of November, the ruble was strengthening against the US dollar. Having compensated for its earlier fall, the ruble returned to its mid-October level (31.06 Rb per USD as of 30 November). The bi-currency

basket obligingly followed suit (Rb 35.17 as of 30 November). The MICEX Index hovered around 1,400 points ( $\pm 40$  points).

The withering of the effect of the recent tariff indexation for housing and utilities services determined a deceleration in the rate of inflation in October and November. Over the course of October, prices rose by 0.5%; in November, they grew by 0.3%. Thus, Russia's inflation rate in November 2012 was lower than in November 2011 (0.4%), the annual rate of increase in prices dropped to 6.4%, while the inflation accumulated since the beginning of the year amounted to 6.0%. The rate of inflation was considerably restrained by the shrinkage of money supply: as of 1 October 2012, the annual M2 growth rate was 14.9% vs. 21.4% as of 1 October 2011. Although the rate of inflation is expected to increase in December, the annual rate of inflation cannot be expected overshoot the official forecast (7%), while being slightly higher than in 2011 (6.1%). At the same time, it should be noted that in October, Russia's level of inflation was once again 3.4 pp higher than that of European inflation (EC-27).

In October, the excess reserves of commercial banks continued to dwindle: over the course of that month they shrank by 2.6% - to Rb 822.2bn. The shortage of liquidity did not abate, as evidenced by the rise in borrowing from the RF Central Bank. Like last year, the main source of replenishing liquidity were the Bank of Russia's Lombard loan auctions.

According to the RF Central Bank's preliminary estimates, over the course of the first nine months of 2012, Russia's net capital outflow amounted to \$ 61bn (vs. \$ 60bn over the same period of 2011). The outflow reduction forecasted by the Bank of Russia did not materialize. In the last few years, the major cause for the capital outflow from Russia was the financial watchdog's reluctance to interfere in the functioning of the foreign exchange market. If the current trends persist, Russia's current account surplus in 2012 will be approximately the same as in 2011, which means that her capital outflow will also remain at last year's level. In other words, Russia's capital outflow in 2012 will, most likely, amount to between \$ 75bn and \$ 85bn.

### ***The Real Sector of the Economy***

The upsurge in investment activity registered in the first half of 2011 and the first half of 2012 was succeeded by its sharp deceleration in July and August 2012. This drop in investment activity resulted in a shrinkage of the growth rate of fixed asset investment in Q3 2012 – to 101.4% by comparison with the same period of the previous year. However, in October 2012, the growth rate of fixed asset investment amounted to 104.9% by comparison with October 2011; and the volume of construction work and the volume of newly commissioned housing returned to their previous levels (105.1% and 111.0% respectively). On the whole, over the period from January through September 2012, fixed asset investment grew by 9.5%. In January-September 2012, the volume of foreign investments in the Russian economy amounted to only 85.6% of their volume registered in the same period of 2011. At the same time, it should be noted that this drop affected, almost exclusively, short-term credits (up to 180 days), while direct investments grew by about 4.6% over the course of January-September 2012. The volume of long-term credits was also on the rise.

Over the course of 2012, Russia's consumer market remained one of the major factors contributing to her economic growth. It is expected that, by the end of the year, it will grow by 6.1% (vs. 7.0% in 2011). As compared with October 2011, in October 2012 the real disposable

income index and the real wage index amounted to 102.4% and 105.2% respectively. As compared with the same period of 2011, in January-October 2012 these indices amounted to 103.5% and 108.8% respectively. Although the rise in incomes and wages was significantly higher than in the previous year, the consumer demand growth rate gradually declined with each successive quarter; in October, total retail trade turnover rose by 103.8% on October 2011 (vs. 9.1% in 2011).

Over the course of 2012, the rate of industrial growth demonstrated a steady downward trend: in October 2012, the industrial production index amounted to 101.8% by comparison with October 2011; the same index for the mineral resources extraction sector – to 102.1%; in the processing industries – to 103.0%. Over the first 10 months, the production index for the basic types of economic activity amounted to 2.9% (against 5.6% for the period of January – October 2011); and industrial production growth amounted to 2.8% (against 5.1% in 2011). The rate of slowdown was most noticeable in machine-building – the sector which in the previous period displayed significant growth. In October 2012, the production index for machines and equipment amounted to 101.8% (against 100.5% for the period of January – October 2011).

The surveys conducted by the Gaidar Institute also point to the pessimistic mood among industrial enterprises. Major industrial indicators, including demand, output and prices, once again began to demonstrate a downward trend. According to available data, weak sales expectations clearly outnumber sales growth expectations. The slump in demand was followed by a decline in the rate of output: the October shrinkage in the rate of output is comparable with that in June-July 2012, when this index had hit its record low since mid-2009.

Bearing in mind the existing trends, it is highly doubtful that Russia may actually manage to achieve the annual industrial output growth of 103.6% envisaged in the RF Ministry of Economic Development's forecast for 2012.