

THE REAL SECTOR OF THE ECONOMY IN APRIL 2014: FACTORS & TRENDS

O.Izryadnova

In April 2014, the economic situation was determined both by slowdown of growth rates of consumer demand and a drop in investment demand. Investments in capital assets in April 2014 and January–April amounted to 97.3% and 95.7%, respectively, against the respective indices of the previous year. A decrease in growth rates of retail trade sales volumes year on year to 2.6% was determined by dramatic slowdown of households' real income and real wages and salaries. After a drop in January, year on year indices of industry demonstrated growth in February–April 2014. In April 2014, year on year growth rates of industrial production amounted to 2.4%, while in manufacturing and production of primary products, to 3.9% and 1.7%, respectively. However, despite the fact that the situation has improved to some extent the expected growth in industry in 2014 will amount by the estimate of the Ministry of Economic Development of the Russian Federation to 1.0%, which is justified by the expected 2.4% drop in investment activities in 2014.

According to the Rosstat's preliminary estimate, in the 1st quarter of 2014 GDP growth rates amounted to 0.9% against the 1st quarter of 2013 which value is almost equal to the index of the same period of the previous year. Sluggish economic growth was determined by slowdown of demand on the domestic market and a decrease in export volumes both in physical and monetary terms. A trend of reduction of investments in capital assets had a serious effect on the domestic market: the volume of investments in April and in January–April amounted to 97.3% and 95.7%, respectively, against the respective indices of the previous year.

In the 1st quarter of 2014, a trend of reduction of state capital investments – which trend existed throughout 2012–2013 – still prevailed. A drop in state investments was supplemented by a decrease in activities by large infrastructure companies due to a completion of a number of investment projects and adjustment of future plans with the expected changes in the market situation taken into account. In addition to the above, growth in lending rates to industries and higher geopolitical risks had a negative effect on the behavior of the private business. The unstable dynamics of the economic development determined a decrease in enterprises' revenues and consolidated the trend of a drop in investments in capital assets in January–April 2014. In the 1st quarter of 2014, the balanced financial result amounted to 82.3% of the respective index of 2013, including 25.0% in manufacturing, 49.9% in building and 66.0% in transport and communications.

In the 1st quarter, growth in capital outflow to \$50.6bn against \$27.5bn in the same period of the previous year had a negative effect on the state and prospects of business activities in the investment sector. As in 2014 – unlike the 1st quarter of 2013 – capital outflow was virtually completely justified by the export

of capital by the non-banking sector, corporate private business entities had fewer resources to finance investments in Russian capital assets.

A trend of slowdown of consumer demand still prevails. In April 2014, annual growth rates of the retail trade volume amounted to 2.6% against 4.3% in April 2013, while the volume of paid services to households decreased by 0.2% with the growth rates of the previous year being at the level of 2.6%. It is to be noted that both the high level of the inflation rate and slowdown of households' real income affect the consumer behavior. In April 2014, the year on year consumer price index amounted to 107.3% having exceeded by 0.1 p.p. the same index of April 2013. The growth rates of real wages and salaries from 108.5% in April 2013 against the respective period of the previous year slowed down to 100.8% in the same period of 2014. Despite indexation of pensions and other types of social payments, in April 2014 real disposable cash income increased by the mere 1.9% (year on year) against 8.1% a year before which situation affected as well the dynamics of the solvent demand and the pattern of households' cash expenditures.

In 2014, the dynamics of industrial output is characterized by instability. In January 2014, a 0.2% drop year on year in industrial output against the respective index of 2013 changed for recovery of growth in industry in the following three months which situation resulted in a 2.4% output growth year on year in April 2014. The main driver of growth in industry was manufacturing. In April 2014, the year on year growth rates¹ of manufacturing, production of primary products and production and distribution of power, gas and water amounted to 103.9%, 101.1% and 98.1%, respectively.

¹ In evaluation of the dynamics of manufacturing, it is important to take into account the low base of the previous year.

A drop in output of the engineering complex as compared to the same period of the previous year – the index of production of machines and equipment and that of production of electric, electronic and optical equipment amounted to 87.2% and 92.7%, respectively – had a negative effect on the dynamics of manufacturing industries in January–April 2014. In the above types of business activities, a decrease in output has been observed during the past two years.

In April 2014, production of means of transportation and equipment increased by 19.6% year on year which situation can be explained in full by a 39.4% growth in production of ships, aircraft and space devices and means of transportation with a decrease of 3.8% in automotive vehicles.

Positive dynamics is observed in the segment of production of intermediary products which situation is partially related to the low base of the previous year. In March–April 2014, in the iron and steel industry the rates of change in output demonstrated growth after a drop in output in the previous five months. In April 2014, production of oil products retained the leading positions as regards the year on year growth rates (111.4%) which situation is related to dramatic growth of 108.5% in the volumes of oil delivered to oil refineries. It is to be noted that in the pattern of production the output of diesel fuel and residual oil grew at a priority rate with the output of motor petrol reduced.

In May, the Ministry of Economic Development of the Russian Federation presented an updated forecast and scenario conditions of social and economic development in the 2015–2017 period, as well as the expected estimates of performance of the Russian economy in 2014¹ developed on the alternative basis with the same assumption of external conditions and different instruments of the state policy and behavior of private business.

The baseline scenario (1) is the main one for development of the budget and suggests preservation of inertial trends, conservative investment policy of private companies and limited expenditures on development of companies of the infrastructure sector with stagnation of state demand. The moderate optimistic scenario (2) suggests reduction of negative consequences of geopolitical tensions, securing of a greater confidence of the private business, utilization of additional sources of funding of new infrastructure projects, promo-

tion of lending to the most vulnerable sectors of the economy and allocation of more funds for development of human capital.

In 2014, Russian GDP growth rates are estimated at the level of 100.5% against the previous year (-1.5% as compared to the forecast published in September 2013). The main factor behind slowdown of the dynamics of economic growth was the expected change in the path of the investment demand under the effect of higher geopolitical risks. According to the updated estimates, in 2014 a 2.4% drop in investments as compared to 2013 is expected (in the previous scenario a 103.9% growth in the investment demand was expected). Revaluation of the level and dynamics of investments in capital assets was justified by the underestimate of the effect of negative trends in the investment demand (which trends were formed in the infrastructure sector in 2013) in the previous scenario of the forecast, as well as changes in the behavior of private companies: with higher risks a 2.6% decrease in private investments is expected (according to the September version there was growth of 5.0%). In such a case, the share of investments in GDP will amount to 18.9% which is 1 p.p. lower than the index of the previous year.

With the expected slowdown of the dynamics of development of the economy, a drop both in profitability and the share of enterprises' and entities' profit in GDP can be expected; due to such a situation investments at the expense of own funds will be limited. In addition to the above, access to borrowed funds on the external and domestic markets is expected to be more complicated. Growth in loans to non-financial entities is estimated at the level of 110.6% as compared to the index of 2013 (-5.4 p.p. as compared to the September version). With dramatic growth in capital outflow in the 1st quarter of 2014 taken into account, on the basis of the results of the year that index is estimated at the level of \$90bn which is nearly \$40bn more than the 2013 index.

With prevalence of trends which were formed in 2013 and the 1st quarter of 2014, reduction of industrial and business reserves will have a negative effect on the dynamics of gross savings.

According to the forecast, the net export volume will make a positive contribution to the GDP dynamics. On the basis of the results of the 1st quarter of 2014, export and import decreased by 1.8% and 6.8%, respectively, against the relevant indices of 2013. With growth in the forecasted price on oil on the basis of the results of 2014, the monetary volume and the physical volume of the export will amount to 98.9% and 99.7%, respectively, against the relevant indices of 2013. According to the data of the forecast, in

¹ The main conditions and the main parameters of the forecast of the social and economic development of the Russian Federation and the ultimate levels of prices (tariffs) on services of companies of the infrastructure sector in 2015 and the planned periods of 2016 and 2017. The Ministry of Economic Development of the Russian Federation, Moscow, May 2014. <http://www.economy.gov.ru/wps/wcm/connect/economylib4/mer/activity/sections/macro/prognoz/201405207>

Table 1

**DYNAMICS OF UTILIZATION OF GDP – THE BASELINE SCENARIO (1) IN PRICES OF THE PREVIOUS YEAR
AS % OF THE YEAR BEFORE**

	2013	2014	2015	2016	2017
GDP utilized	1.3	0.5	2.0	2.5	3.3
Total ultimate consumption,	3.5	1.3	1.5	2.1	3.1
Including that by households	4.7	1.8	2.0	2.8	3.5
Gross savings	-6.1	-5.9	5.9	4.6	6.4
Gross savings of capital assets	-0.1	-2.5	2.4	1.7	4.7
Domestic demand	1.0	-0.2	2.5	2.7	3.9
Net export of goods and services	5.6	11.3	-5.3	-1.1	-8.4
Export	4.2	0.2	0.6	1.8	2.1
Import	3.7	-2.7	2.2	2.4	4.1

Source: The Ministry of Economic Development of the Russian Federation.

Table 2

**DYNAMICS OF THE MAIN MACROECONOMIC INDICES IN THE 2013–2017 PERIOD IN ACCORDANCE
WITH THE BASELINE SCENARIO (1) AS % OF THE PREVIOUS YEAR**

	2013	2014	2015	2016	2017
GDP	101.3	100.5	102.0	102.5	103.3
Industrial production	100.4	101.0	101.7	101.6	102.0
Agricultural production	106.2	101.6	102.9	102.4	102.9
Investments in capital assets	99.8	97.6	102.4	101.6	104.7
Retail trade volume	103.9	101.9	102.1	103.0	103.6
Real wages	105.3	101.4	101.9	102.9	103.9
Labor efficiency	101.6	101.1	102.1	102.4	103.3

Source: The Ministry of Economic Development of the Russian Federation.

2014 the import will fall at an advanced rate than export and consumer and investment demand. In 2014, the import decreased by 3.2% and 2.7% in monetary terms and in physical terms, respectively, as compared to the previous year.

In the forecast of the Ministry of Economic Development of the Russian Federation, slowdown of consumer income is adjusted. It is related to the fact that in the 1st quarter of 2014 growth in the retail trade volume was virtually completely financed by means of a drop in households' savings to 5.4% in households' income; the above value became the minimum one in the entire period of observation. Growth in households' real disposable income has stopped completely: in the 1st quarter of 2014 real disposable income fell by 2.4%, while in 2014 in general its growth is estimated at the level of 0.5% (-2.8 p.p. as compared to the September forecast). In addition to the above, in 2014 a 6.7% growth in consumer prices as compared to the previous year is expected, while in the September version of the forecast the average annual level of the inflation rate was estimated at the level of 5.6%.

In the forecast, the rate of unemployment was raised to 6.2% against 5.7% last year which situation resulted in a reduction of the estimate of the average annual growth rate of real wages to 1.4% against 5.3%

in 2013. As a result, the level of poverty (the number of the population with income below the minimum subsistence level) will remain at the level of 2013 and amount to 11.0%.

Simultaneous weakening of the consumer market and shrinking of the investment market had a negative effect on the dynamics of domestic demand. Taking into account the extent and dynamics of reduction of import, acceleration of growth in domestic production of goods and services is inputted in the forecast. In 2014, the industrial production index and the index of agricultural products will amount to 101.0% and 101.6%, respectively, against the level of 2013. It is to be noted that preservation of the trend of advanced growth in manufacturing industries as compared to that in production of fuel and energy resources is expected.

In prospect, in accordance with the baseline scenario acceleration of the dynamics of the economic development is expected. In 2017, GDP will increase by 8.5%, while investments in capital assets and the volume of the retail trade, by 6.3% and 11.1%, respectively, against the relevant indices of 2013. With the forecasted growth rates of industry and agriculture, the equilibrium of the domestic market resources will be maintained by acceleration of import. Fulfillment

of social guarantees will determine advanced growth in wages and salaries as compared to labor efficiency and limit feasibility of structural transformations. At the same time, it is important to take into account the

fact that the investment pause of 2012–2014 does not provide grounds for optimistic estimates – inputted in the forecast – of labor efficiency growth in the 2015–2017 period. ●