RUSSIA'S REAL SECTOR OF ECONOMY IN H1 2014: FACTS AND TRENDS

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GDP advanced 0.8% in H1 2014 relative to the corresponding period of 2013, according to the preliminary data from Rosstat (Federal State Statistics Service). The products and services output index by basic type of economic activity remained near a positive value of 100.3% on an annualized basis in July 2014 compared to July 2013. The industrial production index stood at 101.5% in July 2014, including the manufacturing industry (102.4%) and the mineral extraction sector (100.2%). Reduction in both exports of traditional raw materials and their by-products, and the scale of output in the construction and investment sector had an adverse effect on the dynamics of general economic indicators.

The index of output of products and services by basic type of economic activity stood at 100.3% in the period of January to July 2014 relative to the corresponding period of the previous year. The following sectors saw growth during the first seven months of the current year vs. the corresponding period of 2013: industrial production (1.5%), agriculture (3.5%), the demand for transportation services (1.3%), retail trade turnover (2.4%), and retail paid services rendered to individuals (0.9%). A decline of 2.6% in fixed investment and 3.0% in scope of works in the construction sector relative to the corresponding period of previous year had an adverse effect on the overall economic situation in the period between January and July 2014.

The economic growth in the period of January to July 2014 was supported by a growth of 8.8% in net exports relative to the corresponding period of the previous year, according to the preliminary data from the Central Bank of Russia. The foreign trade turnover (measured using the balance of payments methodology) dropped 2.1% in the period of January to July 2014 relative to the corresponding period of 2013, while exports and imports fell by 0.2 and 5.0% respectively.

While the contribution of imports to economic resources saw no decline, the structure of imports tended to change – the share of investment and intermediate demand products increased as the share of consumer goods diminished. As a result, the share of imports in the structure of marketable resources in retail trade dropped to 41.0% in Q2 2014 vs. 43% in the first quarter and an average of 44% in 2013.

The volume of marketable resources of food products for import stood at 34% in Q2 2014 and lowered by 1.0 p.p. compared to the corresponding period of the previous year (under comparable terms).

Positive dynamics of industrial production annual growth rates had a significant effect on the structure of the domestic demand. The industrial production index stood at 101.5% in the period of January to July 2014 compared to the corresponding period of the previous year (101.5% in July 2014 compared to July 2013). In January to July of the current year the production of minerals increased at a rate of 0.8% amid an increase of 0.7% in the production of fossil fuels and 2.0% in the production of minerals of other types. The crude oil production volume increased by 1.4% while crude oil refining by 5.7% within the first seven months of the current year compared to the corresponding period of 2013. The refined petroleum product output index stood at 106.3% in the period of January to July 2014 compared to the corresponding period of the previous year. Natural gas production during dropped 1.7% the period under review compared to the volume observed in the same period of 2013.

The manufacturing output index year stood at 102.6% in the period of January to July of the current and 102.4% in July relative to the corresponding values observed in 2013. The output of the following consumer goods kept growing during the first seven months of 2014 relative to the corresponding period of the previous year: food products (103.3%), textile and garment (106.0%) and leather products and footwear (101.6%). However, it is only the output of food products that saw positive dynamics (104.7%) in the values among these types of activity in July compared to the values observed in July 2013.

Both the output of rubber goods (104.3%) compared to January–July 2013 (107.9% in July 2014 against July 2013) and coke and refined petroleum products (105.6% (101.3%) remained the leaders in the segment of intermediate demand goods. The weakening of the demand for metals in the machine building and construction sectors determines structural features of the development of the metals manufacturing sector. The index of metals manufacturing and finished metal products sectors stood at 101.6% during the first seven months of the current year relative to the corresponding period of 2013, including metals (102.5%), finished metal products (99.5%). The non-ferrous metal production index stood at 100.9% over the period under review 2014 and 99.8% in July against the corresponding period of 2013, the increase in the output compared to the previous year was determined basically by growth in the output of precious metals and products of higher degree of technological readiness against diminishing export supplies of aluminum in the current period.

The trends in the domestic market have a significant effect on the dynamics of the development of mid-tech and high-tech production facilities in machine building and metals production sectors. Due to slowdown in growth rates in the effective demand driven by diminished fixed investment, the machinery and equipment manufacturing index stood at 91.0% in the period of January to July 2014 relative to the corresponding period of 2013: The output of mechanical equipment dropped by 4.1%, engineering tools by 10.1%, special-purpose machinery and equipment by 16.6%. It's worth noting that the output of drilling rigs dropped by 40.1% in response to a decline, during the first seven months of the current year, of 7.4% and 2.7% respectively in the total volume of development drilling and outpost drilling in the crude oil production sector, as well as in natural gas production by 30.3% and 51.3% respectively.

Poor competitiveness of certain types of products manufactured by the domestic agricultural machinery industry triggered a decline of 1.3% in the output of machinery and equipment designed for the agricultural and forest sectors during the period under review in 2014 vs. January–July 2013, while the weakening of the consumer demand determined a 9.8% fall in the output of household appliances.

The strengthening in the demand for road-building equipment required as part of the investment projects being implemented in the road, commercial and housing construction sector is a positive aspect in this situation.

The index of electrical, electronic and optical equipment stood at 96.0% during the first seven months of 2014 compared to the level observed in the corresponding period of 2013. A positive contribution to the dynamics of the industry was made through growth in the output of electronic components, radio, TV and communication equipment, which was determined by the import substitution process, by 17.6% compared to January–July 2013, and by 37.3% in July vs. July 2013.

The index of manufacturing of transport means and equipment in the period of January to July 2014 relative to the corresponding period of 2013 stood at 114.8%, which was determined basically by a growth of 30.6% in the output of seaships, air and spacecrafts and other transport means. The following sectors saw growth driven by the substitution of imports from Ukraine, as well as an increase of 5.7% in the railway cargo turnover in the period of January to July 2014: passenger mainline cars by 22.0% and freight mainline cars by 12.7% compared to the corresponding period of the previous year.

Driven by the weakening of the effective demand from individuals and legal entities, as well as saturation of the market, the output of motor cars and cargo motor vehicles stood at 99.3% and 79.9% in January–July 2014 and 103.3% and 87.0% respectively in July vs. the corresponding values observed in 2013.

In the first half of the current year the financial result of enterprises and organizations (profit and loss balance) reached 116.7% relative to the value observed in H1 2013, a the cost effectiveness of sold goods increased to 8.9% against 7.7% in the previous year. It's worth noting, however, that this can be largely explained by the low base in H1 2013, when the financial result dropped by 22.9%. Additionally, the current year shows a drastic hike in prices of the products manufactured by industrial producers. In July 2014, the industrial producer price index stood at 106.0% (101.1% in July 2013), 209.1% (102.85) in the mineral extraction sector, 105.8% (100.0%) in the manufacturing industry, and 102.3% (103.3%) in the production and distribution of electric power, gas and water.

This year dynamics of the domestic market is supported by growth in the retail trade turnover and paid services rendered to individuals. At the same time, in July 2014 the consumer demand on an annualized basis strengthened at a slower rate than a half of the values observed in the previous year. In the period of January to July of the current year, the turnover in the market of non-food products stood at 104.1% and food products at 100.3%, while in July at 102.5% and 99.4% respectively compared to the values observed in the corresponding period of the previous year.

Headline inflation during the first seven months of 2014 was recorded at a level of 105.3% against 104.4% in the previous year. The food price index stood at 107.6% (105.2% in 2013) in July 2014 compared to that in December 2013, and 109.2% vs. July 2013. Growth in food prices is the keynote of the change in households' consumer behavior amid slowdown in growth rates of money and real incomes of individuals. Real disposable incomes in the period of January to July 2014 compared to January–July of the preceding year increased 0.2% against 4.3% in the previous year, real wages by 3.1% (against 5.5% in 2013) and the real value of assigned pensions by 1.8% (against 2.6% in 2013). It's worth noting that

Table 1

BALANCED FINANCIAL RESULT AND COST EFFECTIVENESS BY TYPE OF ECONOMIC ACTIVITY IN H1 2013 AND 2014

	Profit (+) and loss (–) balance as a % of		Cost effectiveness of sold goods, products, works, services	
	H1 2012	H1 2013	H1 2013	H1 2014
Total	77.1	116.3	7.7	8.9
of which: agricultural sector, hunting and forestry	61.3	192.1	6.3	15.8
fishing, fish farming	68.7	186.0	20.8	32.9
mineral extraction sector	92.4	123.8	26.8	27.6
including: production of fossil fuels	95.2	124.8	25.7	26.0
manufacturing sector	71.5	123.9	9.1	9.4
production and distribution of electric power, gas and water	89.1	128.1	5.3	5.8
construction sector	49.1	91.1	2.7	2.0
wholesale and retail trade; repair of motor vehicles, motorbikes, household appliances and personal appliances	73.3	104.8	6.9	8.7
transport and communications	83.0	88.9	10.9	9.6
of which: railway transport	33.4	43.6	3.4	3.2
pipeline transportation	85.5	107.9	15.9	15.1
communications	108.4	92.8	29.3	26.0
Financial business	24.1	151.6	0.2	0.8

Source: Rosstat *(The Federal State Statistics Service)*.

individuals' propensity to save is declining in the current year amid growth in the share of expenses as payment for goods and services to 76.9% of the total volume of incomes in the period of January to July 2014, up by1.4 p.p. the value observed in the previous year.

Moderate rates in the real sector of economy were attended by outstripping growth in real wages, thus increasing the burden on budgets in the social sector and deteriorating manufacturing efficiency and competiveness in the real sector.

The situation in the labor market in the period of 2013–2014 was determined by the persistent trend towards growth in the employment of economically active population. In July 2014 the number of persons employed in the economy amounted to 72,2 million, by 0.5% (by 400,000 persons) over the number observed in the previous year. The unemployment rate, as measured using the ILO method, dropped in July 2014 to 4.7% of economically active population (3.7 million persons) from 5.3% in July 2013. The current year shows growth in the demand for employees for the employment service departments announced at public agencies. Given the growing number of job vacancies to 2198 as of the end of July, the tension coefficient for announced 100 job vacancies was 46,8 persons against 60,6 persons in the previous year.

Part-time employment has been increasing in the labor market. In Q2 2014, persons under part-time employment initiated by the employer or under agreement between the employee and employer accounted for 2.1% of the organizations' manning table (exclusive of small-sized business entities), and 6.8% of such part-time employees had unpaid furlough days at their request. The biggest size of part-time employment was noted at enterprises in the manufacturing sector, where employees in downtime occasioned by employer's fault and for reasons beyond the employer's and employee's control accounted for 3.1% and employees on unpaid furlough for 15.0% of the organizations' manning table. The highest level of part-time employment was recorded in such sectors and machine building and metals manufacturing, construction materials manufacturing. This employment management mechanism allows enterprises and organizations to retain their human resource potential while facing uncertainty in the development in the short run.

Considering the prevailing dynamics of the economic development in the period of January to July 2014, the Ministry of Economic Development of Russia updated late in August 2014 the prediction estimation of the key macroeconomic indicators of the base-case scenario for 2015–2018. With the key evaluations of macroeconomic indicators for 2014 remaining at the level of the base-case scenario of the projected development of the Russian economy, GDP growth rate in 2015 has been downgraded to 1.0% (2.0% previously), which can be explained by downward revision of investment activity indicators driven by further capital outflow amid the devaluation of the ruble and rise in inflation, as well mounting risks in response to a severe geopolitical situation. According to the projected estimations of The Gaidar Institute for Economic Policy (IEP)[1], annual final evaluations of the year of 2014 don't contradict the figures of the base-case scenario of the development of the Russian economy developed by The Ministry of Economic Development of Russia[2].

1 Model calculations of the short-term forecasts of socio-economic indicators in the Russian Federation. Electronic bulletin "Gaidar Institute Newsletter.ru" 07/14 /

2 Scenario conditions, the forecast key parameters of the socio-economic development of the Russian Federation and the ceiling of prices (tariffs) for the services of companies in the infrastructural sector in 2015 and the planning period of 2016–2017. The Ministry of Economic Development of Russia, May 2014.