

RUSSIA'S REAL SECTOR: FACTORS AND TRENDS IN JANUARY–OCTOBER 2014

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In January–September 2014, the index of physical volumes of GDP amounted to 100.8% on the respective period of 2013.

The positive factors behind positive quarterly dynamics of GDP are, firstly, the speed-up of growth rates of manufacturing industries to 3.6% year-on-year in October 2014 against 0.6% a year before, secondly, growth in consumer demand though its rates are much lower than the index of October 2013 and, thirdly, growth in the net export despite a decrease in the foreign trade turnover. In January–October 2014, a 2.5% reduction in investments in capital assets on the respective period of the previous year had a negative effect on the domestic market.

According to the preliminary estimate of the Rosstat, in January–September 2014 the index of the GDP physical volume amounted to 100.8% on the respective period of the previous year. According to the estimate of the Ministry of Economic Development of the Russian Federation, the result index of GDP growth in 2014 amounted to 100.5% on the respective index of 2013.

Slowdown of growth rates of the Russian economy is justified by a simultaneous effect of domestic macroeconomic and geopolitical factors. Limitations justified by introduction of sanctions determined a change in the level of demand on goods of Russian export and structural changes in import, triggered a drop in foreign investments with growth in outflow of Russian private capital and affected the dynamics of the ruble exchange rate which situation eventually resulted in a speed-up of the rate of inflation. However, the impact of domestic factors justified by the structural specifics of the Russian economy remains a substantial one.

Depreciation of the ruble exchange rate had an ambiguous effect on the Russian economy. On the one side, it weakened the impact of external factors on individual sectors of the Russian economy and contributed to import substitution, while, on the other side, it resulted in growth in production costs due to appreciation of the import, in particular, machines, equipment and other investment goods.

Higher economic uncertainty, worsening of producers' expectations, growth in prices on investment-purpose goods, as well as limited options to replace the lost external sources of funding intensified a drop in the domestic investment demand.

The dynamics of the domestic demand is much affected by a decrease of 2.5% in investments in capital assets as compared to January–October 2013. It is to be noted that in October 2014 a year-on-year drop in investment activities intensified to 2.9%. A drop in investment activities on the domestic market was ac-

companied by growth in capital outflow. In January–September 2014, the net capital outflow amounted to \$85.2bn, including the export of capital by the non-financial sector (69.1bn) which value exceeds by 100% the index of the respective period of the previous year. It is to be noted that in Q3 2014 the export of capital by the private sector exceeded by 60% (\$33.8bn) the respective index of the previous year due to the need to repay the foreign debt in a situation of limited feasibility to refinance it because of sanctions though it is worth mentioning that the impact of that process was eased by the influx of capital to the banking sector (\$20.8bn).

A main factor behind the positive trend of the Russian economy is still consumption by households, however, the contribution of households and state administration to the dynamics of GDP is getting much weaker as compared to the 2012–2013 period. In the pattern of households' cash income, in January–September 2014 the share of savings amounted to 6.2% and was 2.6 p.p. lower than the index of 2013 with the share of expenditures related to purchasing of foreign currency rising in 2014 to 5.5% against 4.3% in 2013. Slowdown of growth rates of income with prevalence of a high social and economic differentiation and irregular distribution of incomes resulted in a higher level of poverty and affected consumption.

In January–October 2014, growth in retail trade volume and paid services amounted to 2.2% and 1.1%, respectively, on the same period of 2013. The indices of the volumes of retail trade and paid services remained at the minimum level since March 2010. In October 2014, growth rates of the retail trade volume and paid services to households amounted to 101.7% year-on-year (103.3% in October 2013) and 101.0% year-on-year (102.6%). Also, slowdown of the retail trade volume took place in the segment of food products (100.1% in January–October and 99.5% on the respective period of the previous year) and non-food

products (103.9% in January–October and 103.5% in October). In October 2014 and January–October 2014, the index of the headline inflation amounted to 108.3% year-on-year and 107.1%, respectively which values were 2.0 p.p. and 1.4 p.p. higher, respectively, than the corresponding indices of the previous year. In 2014, growth in food prices had a dominating effect on the rate of the inflation: 9.6% in January–October against 5.5% a year before. In January–October 2014, the index of prices on non-food products and paid services grew at a lower rate: 105.0% and 106.8%, respectively. Consumer confidence was at the record-low level which situation justifies the estimate of growth in retail trade volume at about 2.2% on the basis of the results of the year which value is half as much the index of 2013¹.

The dynamics of consumer demand is affected by slowdown of growth rates of real income, growth in the level of households' debt on loans and speed-up of the rate of inflation. In October 2014, households' real disposable cash income increased by 2.1% year-on-year (5.1% in October 2013) with growth in the share of social payments and revenues from property in households' cash income. In October 2013, real wages and salaries which account for the dominating portion of households' income were the mere 0.3% higher (5.4% in October 2013 as compared to October 2012) than the respective index of the previous year. According to our forecasts, on the basis of the results of 2014 growth in expenditures on households' ultimate consumption will amount to 100.9% as compared to the previous year².

It is to be noted that as growth rates of real wages and salaries go down the gap with growth rates of labor efficiency becomes narrower. Taking into account unfavorable demographic trends and limited potential to increase the number of the workforce, the issue of promotion of labor efficiency is becoming a priority. With a fairly stable number of the gainfully employed population in the past three years, growth in that number was determined by guidance towards reduction of the rate of unemployment with a lack of consistent practice of restructuring of employment and creation of new jobs. That situation resulted in growth in partial employment and reduction in the number of worked hours per worker.

In October 2014, the number of gainfully employed population remained at the level of the previous year

and amounted to 72.0m persons. In October 2014, the number of the unemployed (according to the methods of the ILO) was estimated at the level of 3.9m persons, while the level of unemployment amounted to 5.1% and turned out to be 0.4 p.p. lower and 0.2 p.p. higher than the index of October 2013 and the index of September 2014, respectively. In October 2014, the number of the unemployed registered with state employment offices remained at the level of the previous month and amounted to 796,000 persons (98.3% on October 2013). On the basis of the results of 2014, according to our estimates the total number of the unemployed will remain at the level of the previous year and amount to 4.1m persons³.

In 2014, the trading sectors of the economy (mining, manufacturing and agriculture), which account for nearly a half of all the jobs and investments in capital assets remain the main source of support of economic growth. In October 2014, the index of industrial production amounted to 102.9% year-on-year and exceeded by 1.9 p.p. the index of October 2013. In 2014, manufacturing regained the leading position which it lost in 2013. In September–October 2014, the index of manufacturing increased to 103.6% year-on-year against 100.6% a year earlier. In January–October 2014, output growth in manufacturing amounted to 2.5%, which points to the fact that stagnation of January–October 2013 was overcome. However, one should pay attention to high differentiation of growth rates by the type of economic activities. From H2 2014, the obvious drivers behind growth were an increase in October in production of food products (3.5% year-on-year), rubber and plastic articles (12.6%) and coke and oil products (6.7%).

A drop in investment demand caused further output gap of 9.6% and 7.7% in manufacturing of machines and equipment in October and January–October 2014, respectively as compared to the respective periods of the previous year.

In October 2014, the index of production of "transportation means and equipment" amounted to 109.8% year-on-year; it is to be noted that dynamic growth of 34.8% in production vessels, flying and space vehicles and other means of transportation completely leveled down a 13.7% drop in the automotive industry. Development of high-tech production in shipbuilding and the aerospace industry had a positive effect on the dynamics of related industries producing electric, electronic and optical equipment whose year-on-year growth amounted to 107.8% in October 2014 and resulted in overcoming of the crisis phenomena of 2013.

1 See: Model Calculations of Short-Term Forecasts of Social and Economic Indices of the Russian Federation. October 2014. The Gaidar IEP.

2 See: Model Calculations of Short-Term Forecasts of Social and Economic Indices of the Russian Federation. October 2014. The Gaidar IEP.

3 See: Model Calculations of Short-Term Forecasts of Social and Economic Indices of the Russian Federation. October 2014. The Gaidar IEP.

Changes in the extent of foreign economic activities by high-tech types of goods had an important effect on the dynamics of development of the above-state industries, too. The existing geopolitical situation weakened the positions of Russian engineering. As compared to January–August 2013, the export of goods of the aerospace industry fell by nearly one-third; it is to be noted that if in January–August 2013 there was a surplus of foreign trade operations, in the respective period of 2014 a dramatic increase in the import volumes resulted in a negative foreign trade balance. Dynamics of export of electric, electronic and optical equipment is more favorable (it accounts for one-fifth of the export of high-tech products), however, the import of that equipment exceeds nearly 5 times over in monetary terms the export and, certainly, has a considerable impact both on production and the market. Probably, the dynamics of production by high-tech lines of engineering will be determined till the rest of the year by a change in the ratio between the resources of the domestic market and the external demand.

In October 2014, the index of production of coke and oil products amounted to 106.0% year-on-year which situation was determined by growth of 6.6% and 6.2% in the volumes of oil refining and output of finished oil products, respectively. Structural changes in export in favor of a higher share of oil products with

a decrease in physical volumes of export of crude oil contributed to growth in oil refining volumes.

In October 2014, the mining index amounted to 101.9% year-on-year, including 102.1% in the fuel and energy sector. In October, production of primary fuel and energy resources fell due to a drop of 11.4% year-on-year in production of gas with growth of 0.2% and 2.9% in production of oil and coal, respectively. A drop in production of gas is related to a decrease in export supplies with meeting of domestic market demand in full.

Table 1

**EXPORT AND IMPORT OF HIGH-TECH PRODUCTS
IN JANUARY–AUGUST 2013–2014
AS % OF THE RESPECTIVE YEAR**

	Export		Import	
	2013	2014	2013	2014
High-tech products	121.2	92.1	103.8	107.4
including: goods of the aerospace industry	124.6	68.9	126.7	151.8
Computer and office equipment	98.6	5.7 times over	88.1	106.6
Electronic and telecommunications equipment	106.2	133.5	92.8	101.4
Pharmaceuticals	107.9	109.1	118.0	82.4
Scientific instruments	117.1	91.7	107.9	87.0

Source: The Rosstat.