

Kirill Rogov

The Russian Economy in December 2012: Preliminary Data and Major Trends

The Political Background: A Quest for a New Mainstay

The most noteworthy events of December 2012 were the adoption, by the U.S. Congress, of the so-called ‘Magnitsky Law’, whereby sanctions were introduced against the Russian officials directly involved in human rights violations; and the passing, by the RF State Duma, of a retaliatory anti-American law. The adoption of the ‘Magnitsky Law’ was inherently related to the abolition of the Cold-War-era Jackson-Vanik Amendment. In retaliation for the ‘Magnitsky Law’, the Kremlin, greatly pained by the passage of the new U.S. legislation, instructed the Russian State Duma to adopt a ‘symmetric’ anti-American law. This retaliatory law (the ‘Dima Yakovlev Law’) introduced a ban on the financing of Russian non-governmental organizations by U.S. funds, forbade dual U.S./Russian nationals to participate in the activities and functioning of Russia’s NGOs, and banned the adoption of Russian children by US citizens. And it was the ban on adoptions that immediately caused a wave of indignation all over the world, including to some extent Russia. The case in point is that the brunt of the anti-adoption measures announced in the ‘Dima Yakovlev Law’ will be carried by disabled children, who have no chance to be adopted or receive proper medical and rehabilitative assistance in Russia. Also, the ‘Dima Yakovlev Law’ contradicts the U.S.-Russia Adoption Agreement and the United Nations Convention on the Rights of the Child.

One of the aims of that law is to prevent European countries from passing laws similar to the ‘Magnitsky Act’: the ‘Dima Yakovlev Law’ directly envisages that its sanctions should be extended to any country which follows the example of the United States in this respect. At the same time, the ‘Dima Yakovlev Law’ apparently also has some domestic purposes: anti-Americanism is frequently used by hybrid regimes as a means of political consolidation. Although by the end of 2012 the decline in the popularity of Russia’s political regime and its leaders had become less rapid than in 2011, the negative trend had not been eliminated. Therefore the quest for a new consolidation agenda remains a top political priority for the Russian authorities.

In his first post-reelection annual Presidential Address to the RF Federal Assembly, Vladimir Putin was relatively restrained in his rhetoric and did not touch upon the most acute problems, including his relations with the Opposition. As far as the political initiatives put forth in Putin’s speech are concerned, special attention should be paid to the idea of restoring single-member electoral districts and allocating 50% of State Duma seats to their representatives.

A number of years ago, the abolition of single-member electoral districts was an important step in the implementation of the Kremlin’s strategy of creating a one-and-a-half-party system in Russia. In such systems, the rule of one or other party becomes permanent, and that party rapidly establishes itself as the most important element of state governance, the vehicle for inter-elite interaction and the principal control and feed-back mechanism in the central authority’s relations with regional elites. This type of authoritarianism is considered to be the most stable one. Seen in this light, the Kremlin’s proposal that Russia should return to the old

system (and its decision to restore direct gubernatorial elections) means an indirect acknowledgement of *United Russia's* defeat at the December 2011 elections and represents an important step toward restoring Russia's political institutions which existed in the early 2000s. Moreover, this proposal means an acknowledgement of the fact that Putin's political reforms of the mid-2000s have largely failed. The restoration of single-member electoral districts will make it possible for *United Russia* to gain a majority of State Duma seats in a situation when it cannot win a majority of the votes cast in party-list elections. At the same time, the restoration of the old model will increase the representation, in the State Duma, of the interests of regional authorities, who can exert considerable influence on the outcome of elections in single-member districts.

The second highlight of the Presidential Address was Putin's call to stimulate Russia's domestic production and economic growth through economic measures similar to those used by developed countries - that is, to boost her economy by increasing budget expenditure and by expanding central bank liquidity provision. It is quite possible that these measures will even include the abolition of the recently adopted budgetary rule. The ideas stated in the Presidential Address were further elaborated in the December letter of the RF Ministry of Economic Development. The letter acknowledged the fact that Russia's economic growth had considerably slowed down in the second half of 2012. As a result, the 2012 economic growth rate could amount to 3.5% (vs. 4.3% in 2011). According to the Ministry of Economic Development, this drop in economic growth should be countered by an increased emphasis on domestic consumption.

Macroeconomics: A Year When Oil Prices Did Not Grow

In December 2012, oil prices remained stable. On the whole, in Q4 2012 the average price of oil was the same as in Q3. As a result, the average annual prices of Brent Crude and Urals Crude were practically the same as in 2011. This circumstance should certainly be taken into account when analyzing the development of the Russian economy in 2012. The point in fact is that Russia's economic growth in 2010 and 2011 was taking place against the background of a year-on-year rise in average annual oil prices: in 2010 average annual oil prices were 28% higher than in 2009, and in 2011 they were 39% higher than in 2010.

In December, Russia's stock exchanges demonstrated a steady growth in quotations, thus gradually compensating for their decline in the previous two months. At the same time, by the end of 2012, the Russian stock market had failed to produce a definite trend (the MICEX Index fluctuated between 1400 and 1500 points). It should be noted that in 2012 the stock exchanges of developed countries (the EU, the USA and Japan) demonstrated a 10 to 20% annual growth in quotations. Over the course of 2012, the price of shares in *Gazprom* dropped by more than 18% (December 2012 vs. December 2011). In comparison with their April 2011 record high, the price of shares in that company fell by 40%. At the same time, by the end of 2012, Russia's oil companies had shown a considerable rise in capitalization.

Over the course of December, the Russian ruble steadily strengthened against the US dollar (+2%), although its rise was not as intensive as in the final ten days of November. Pulled down by this process and by the volatility of the euro, the value of the bi-currency basket dropped from Rb 35.17 as of 30 November 2012 to Rb 34.80 as of 30 December 2012.

Over the course of December, the international reserves of the RF Central Bank increased by \$ 3.8bn, to \$ 532bn. Thus, since the beginning of the year, these reserves have grown by 6.8%, to 89% of their pre-crisis record high registered in 2008. According to the Bank of Russia, over the period from September through November 2012, the outflow of capital from Russia amounted to \$ 59bn. The Bank of Russia forecasted that net capital outflow from Russia in 2012 would amount to \$ 65 to 75bn. As a result, the outflow of capital would be only slightly smaller than that in 2011 when it amounted to \$ 80bn.

In December, consumer prices rose by 0.5%, bringing annual inflation to 6.6%, which is 0.5 percentage point higher than in 2011. In the first half of 2012, the annual inflation rate in Russia hovered around 4%; in the autumn it rose to 6.5-6.6%. Thus, in Q4 2012, the difference between Russian inflation and inflation in the EU amounted to +4 percentage points.

In November, after declining for three months in a row, Russia's broad monetary base registered a growth (+2.6%). In year-on-year terms, the broad monetary base grew by 10.6%. In November, the Russian banking sector's liquidity situation notably improved. After suffering a significant decline in October, the excess reserves of commercial banks began to grow once again (+17.5%). The Bank of Russia continued its policy of providing funds to the banking sector. The benchmark interest rate of overnight ruble loans at the interbank credit market also continued to grow, eventually reaching 6.5%.

At the end of 2012, the Russian personal savings rate considerably increased. However, neither this rise in bank deposits nor the ongoing active assistance rendered by the State to the banking sector could prevent a slowdown in the growth of loans provided to the population and corporate borrowers. In the final months of 2012, in spite of the fact that Russia's monetary authorities remained the principal creditor of credit institutions, the banking sector continued to be the main channel of capital flight from the Russian Federation.

The Real Sector of the Economy: A General Slowdown

In November 2012, the volume of investment in fixed assets and the volume of construction work increased, on November 2011, by 1.1% and 0.3% respectively. Bearing in mind that the level of investment activity was rather low in October and November 2012, it was expected that in Q4 2012 the rise in the investment volume would amount to 103.7% by comparison with Q4 2011. As a result, the RF Ministry of Economic Development forecasted that in 2012 the annual growth rate of investment in fixed assets would amount to about 107.8%, vs. 108.3% in 2011. The unstable dynamics and lack of any qualitative changes displayed by the investment activity in 2012 also influenced the forecasts for 2013. According to the data update released by the RF Ministry of Economic Development, it is expected that 2013 will see the growth rate of investment dropping to 106.5%, which is by 0.7 percentage point lower than the corresponding estimated figure included in the federal budget for 2013.

The lackluster performance of the residential construction industry notably aggravated the situation in the housing market. Thus, the housing availability index rose by 9%, while the average growth rate of housing prices notably exceeded the growth rate of population incomes. In 2012, the decline in the average weighted interest rate on the housing mortgage loans in rubles issued since the year's beginning, recorded over the course of 2010 and 2011, was replaced by growth. Thus, the average weighted interest rate on the housing mortgage loans in rubles issued

over the course of a month rose from 11.4% as of 1 December 2011 to 12.4% as of 1 November 2012.

In November 2012, the growth rate of retail trade turnover rose by 4.4% on November 2012 (while in November 2011 it rose by 9.1% on November 2010); over the course of the first 11 months of 2012, the growth rate increased by 6.0% on the corresponding period of 2011 (by 6.8% one year earlier). In the second half of 2012, a decline in the rates of growth was also registered in the commodity market and the services sector. It was caused, most likely, by the decrease in the growth rates of real wages and real disposable incomes by comparison with the end of 2011 and the beginning of 2012.

The fact that wage growth outpaces labor productivity growth by 5.4 percentage points (according to preliminary estimates for 2012) results in a rise in production costs and in the general worsening of the financial and economic indicators of enterprises. In the first half of 2012, the share of gross profit in GDP was by 1.7 percentage points lower than in the corresponding period of 2011. As regards Russia's economy as a whole, the profit margin from the goods sold from January through September 2012 amounted to 10.0% (vs. 11.2% in the corresponding period of 2011), including to 32.6% in the extraction industry (vs. 36.4% in 2011) and to 11.9% in the manufacturing industry (vs. 13.4% in 2011).

In the period from January through November 2012, the industrial production index amounted to 102.7% (vs. 105.0% in the corresponding period of 2011), including in the extraction of mineral resources – to 101.2% (vs. 101.9% in 2011), and in the manufacturing industry – to 104.4% (vs. 106.8% in 2011). At the same time, in November 2012 the volume of mineral resource extraction and the volume of manufacturing output declined by 2.2% and 0.3% respectively on November 2011. A considerable role in the decline of the growth rate of the Russian economy was played by the poor performance of the agro-industrial complex (in November 2012, Russian agricultural output amounted to 92.6% of November 2011's output) and a slow-down in the machine-building complex (107.5% vs. 114.5% in November 2011). In 2012, the share of domestically-produced goods in the structure of retail-trade commodity resources notably dwindled – thus, unlike in 2011, the share of food imports in retail-trade resources significantly increased.

The negative trends reflected by official statistics are confirmed by the results of recent market studies. In the final months of 2012, the IEP Industrial Optimism Index continued to decline due to a weak demand for industrial products. In November, the key indicators of demand dropped to their three-year lows registered in July 2012 (-17 points). It should be noted that enterprises did not expect that the situation would improve in the nearest future. The Sales Satisfaction Index dropped by 18 points to its 32-month low: 54% of enterprises considered the volume of sales to be 'below the norm', and 45% of them considered it to be 'within the norm' (while only one month earlier the situation was exactly the reverse).

However, enterprises did not reduce their output: for several months in a row, the corresponding index hovered around zero. As a result, in November the percentage of enterprises where changes in output outpaced changes in demand rose to 31%. Thus, the afore-mentioned stagnation in demand increased the risk of output collapse, when enterprises would be forced to adjust their output to match demand. The correspondence between production plans and demand

forecasts rose to 80% in November 2012. It should be noted that in November 2008 this index climbed to 83%, and reached 88% in December 2008.

In order to balance demand and output, enterprises also resorted to cutting prices: over the course of one month, the balance dropped to -13 points, to its four-year (2009-2012) low. It was the sharpest drop in disbursing prices since December 2008, which had been the time of the apogee of the current crisis. Production plans indicated that enterprises were ready to continue to use prices as an instrument of sales intensification. It should be noted that, in November 2012, industry managed to slower the decline in the number of workers, which had already dropped to a critical level.

The investment plans of enterprises continued to lose optimism: in November they dropped by another 4 points, while over the course of the past two months they dwindled by 8 points. Investment plans remained positive only in the fuel sector, non-ferrous metallurgy and the timber-industrial complex. In all the other sectors, quarter balances shifted into the negative zone within the range from -3 points in machine building to -17 points in light industry. At the same time, according to enterprises, November saw no principal changes in the terms of loans issued to industrial enterprises: aggregate credit availability ('above the norm' + 'within the norm') amounted to 69%, which corresponded to the average aggregate credit availability registered in the second half of 2012.