

RUSSIA'S EXTRACTING SECTOR IN JULY–AUGUST 2015¹

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Our analysis of the dynamics of industrial production is indicative of the continuing output decline in the processing industries, while the extracting sector has been demonstrating a stable positive trend. If in the short-term perspective the economy is not shattered by any new shocks produced by changing terms of trade, significant expansion of the imposed economic sanctions and financial instability, there will emerge some grounds for a cautious optimism: the general industrial production index may depart from the 'bottom' as early as the end of the year 2015.

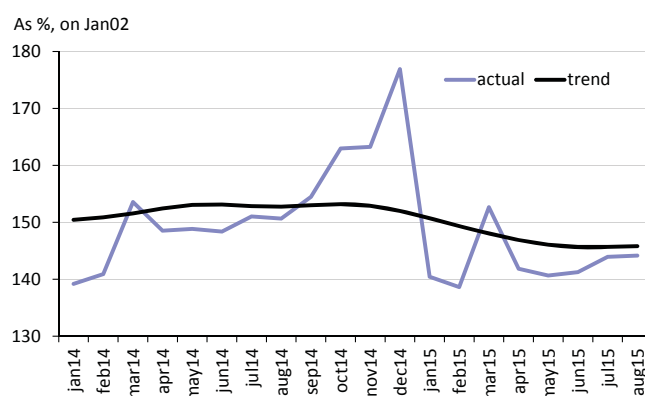
¹Industrial production continues to decline: in August, its index amounted to 95.7% of its value for the corresponding period of last year, or to 99.7% of the previous month's index. A decline is likewise observed in the processing sector (93.2% and 99.1% respectively); however the extracting sector, according to official data, has been demonstrating a slight growth (100.8% and 101.7% respectively).

It is important to note that the interpretation of the situation in industry, which is based on the unprocessed data (unadjusted by the calendar and seasonal factors) published by *Rosstat*, is rather arbitrary. In order to be able to speak more precisely of the persistence or disappearance of negative trends in some industries, it is necessary to perform a decomposition and to isolate the trend component of the time series – it is presented in *Fig. 1–4*.

*Fig. 1*² shows the movement of the industrial production index in 2014–2015 and its trend component. Our calculations demonstrate that, over the period of July–August 2015, there was a certain slowdown in the industrial production decline, which had started in the autumn of last year.

For an analysis of the causes of slowdown in the decline, it is necessary to analyze its by-sector dynamics. *Fig. 2* shows the trend component of the production indexes in the extracting and processing sectors, as well as in that of production of electric energy, gas and water.

The production of electric energy, gas and water (a contribution of approximately 13.5% to the general industrial production index) demonstrated a decline over the period from mid-2014 through April 2015, which later on gave way to growth. In our opinion, it is difficult to adequately interpret the movement pat-



Source: Rosstat, authors' calculations.

Fig. 1. The Movement of the Industrial Production Index in 2014–2015, Actual Data and the Trend Component, As % of the January 2002 Level

tern of the index's trend component within relatively short intervals: this sector is sufficiently governed by inertia, and the trend fluctuations are largely associated with the effects of 'cold winter' and 'hot summer', which result in a situation where the seasonal wave as assessed by standard statistical data processing techniques either underestimates or overestimates the actual seasonality.

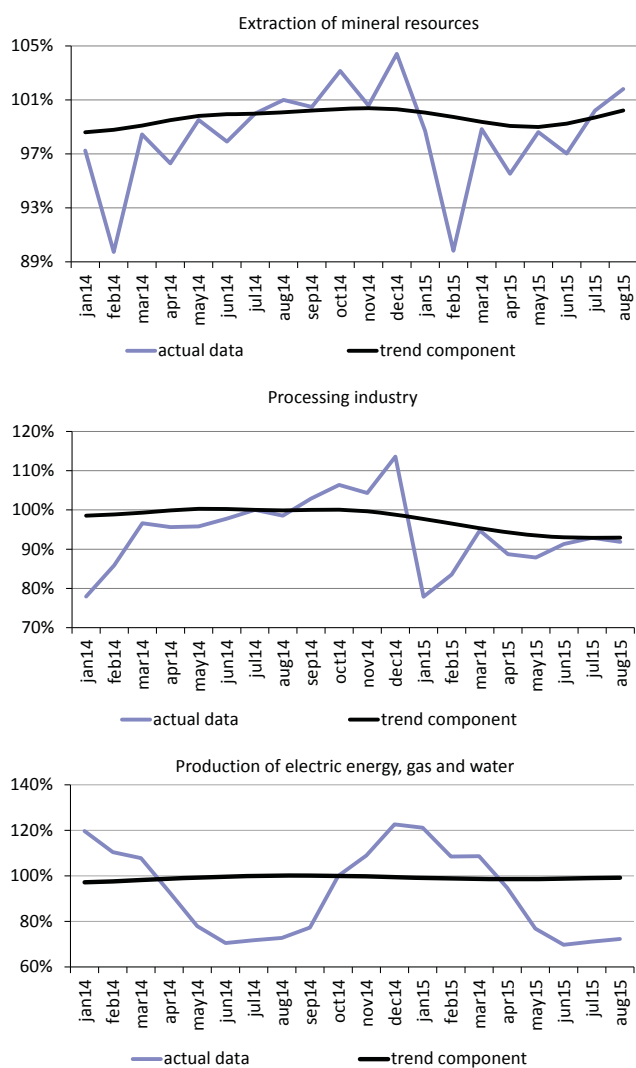
An analysis of the dynamics of the processing industry in late 2014 – early 2015 demonstrates³ that over that period, the Russian processing industry broke up into two groups according to the degree of its response to the deepening economic crisis.

The first group, which can be arbitrarily labeled the 'positive pole' (the production of foodstuffs, wood processing, the production of coke, petroleum products, other non-metal mineral products; chemical production; metallurgy – a contribution of approximately 35% to the general industrial production index), over

1 This article is part of Operative Monitoring of the Economic Situation in Russia. Trends and Challenges of Socioeconomic Development]. No 12. September 2015.

2 The isolation of the trend component was achieved by applying the Demeter package based on X12-ARIMA.

3 G. Idrisov, A. Kaukin, O. Morgunova, M. Turuntseva. Deepening Industrial Slump: Trends Have Become a Fact // Operative Monitoring of the Economic Situation in Russia. Trends and Challenges of Socioeconomic Development. No 9. June 2015.

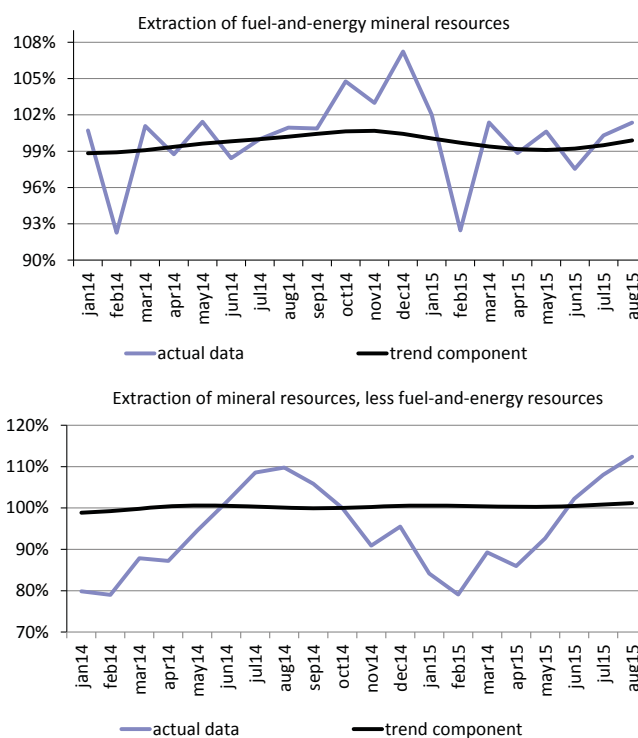


Source: Rosstat, authors' calculations.

Fig. 2. The Movement of the Trend Component of the Industrial Production Index in the Extracting and Processing Sectors (As % of the July 2014 Level) and in the Sector of Production of Electric Energy, Gas and Water (As % of the October 2014 Level) in 2014–2015

the short-term period was laboring under the favorable influence of the foreign economic situation and had opportunities for import substitution, and so in late 2014 – early 2015 it demonstrated some growth, which dwindled as these advantages waned.

The second group, the 'negative pole' of industry (the textile and clothing industry; the pulp and paper industry; the manufacturing of leather, rubber and plastic products; the manufacturing of machines and equipment; the manufacturing of electrical equipment – which account for approximately 17% of the general industrial production index) suffered from the rising prices of imported intermediate goods to a larger degree than the first group, or was heavily dependent on loans. For those reasons it demonstrated a gradually accelerating decline.



Source: Rosstat; authors' calculations.

Fig.3. The Movement of the Trend Component of Industrial Production Index in the Extraction of Fuel and Energy Resources (As % of the July 2014 Level) and Other Mineral Resources (As % of the October 2014 Level) in 2014–2015

An analysis of the trend component of sectoral production indexes shows that the trend that first emerged in the second half-year is still there. However, it should be noted that the additional weakening of the ruble that occurred in August-September – if no rapid rebound of the Russian currency takes place – may become an obstacle to the processing sector's rapid exit from stagnation.

In contrast to that of the processing sector, the trend component of the mineral resources extraction time series (a contribution of approximately 34% of the general industrial production index) has been demonstrating an identifiable growth over the last few months. The interpretation of such growth becomes clear if we look at more detailed data: the time series for extraction of fuel and energy resources, and the time series for other mineral resources taken separately. In Fig. 3 it can be seen that, while the first time series points to a significant decline from autumn 2014 onwards, which in June 2015 gave way to recovery growth, the second time series demonstrates practically no change over the entire period under consideration.

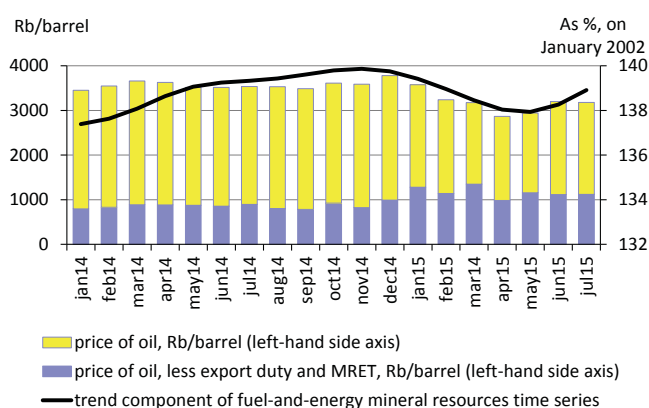
The practically unchanged level demonstrated by the trend of 'other' mineral resources extraction (these are, in the main, metal ores and raw materials for construction and chemical production) is evidently a reflection of the fact that this type of raw materials

is exported in far smaller volumes, they are processed in Russia's territory, and so are less dependent on fluctuations of the ruble's exchange rate against foreign currencies and the situation on foreign markets.

Besides, the situation in late 2014 – early 2015 in those sectors of the processing industry that are the main consumers of the afore-said types of raw materials (chemical production, metallurgy, construction) was noticeably better than in the other sectors due to the favorable situation on world markets and substitution of imported goods, including traditional imports from Ukraine¹.

The decline of production in the fuel and energy segment of the Russian extracting sector in 2014–2015 and its subsequent rebound are phenomena of significant interest. The causes of the delayed and relatively modest drop of the production index in the extracting sector have to do with the differences in the concurrent dynamics of ruble-denominated prices for Russian oil exports and the US dollar to Russian ruble exchange rate. In 2014, the ruble-denominated prices for Russia's oil exports (data on actual oil supplies released by the Federal Tax Service) began to decline with a time lag relative to the downward movement of the exchange prices for oil denominated in US dollar and the onset of the ruble's weakening (*Fig. 4*), which can be explained by the altered policy of the Bank of Russia as it chose no longer to suppress the fluctuations of the ruble's exchange rates against major foreign currencies.

The rapid strengthening of the US dollar compensated practically entirely for the downfall of price for oil in dollar terms; the ruble-denominated export price of Russian oil did not decline (and sometimes even slightly increased) until the end of 2014. Later on, after the stabilization in the foreign exchange market and a slight increase of oil prices in dollar terms on



Source: Rosstat; authors' calculations.

Fig. 4. A Comparison of the Ruble-denominated Price of Oil and the Trend Component in the Extraction of Fuel and Energy Mineral Resources in 2014–2015

world exchanges (Q1 and Q2 2015), the ruble-denominated export prices of oil began to decline; however, this actually occurred with a three-month lag relative to the downfall of the exchange prices for oil and the ruble's weakening. As a result, output in the mineral resources extraction sector of the Russian economy began to shrink only in the first months of 2015.

The beginning of the year 2015 was a period of negative expectations, which became manifest in the downfall of prices for oil forwards and futures; but in terms of real supplies, as seen from *Fig. 4*, oil prices began to rise towards their previous level as early as mid-spring. According to the opinion voiced by V. Alekperov², the current level of oil prices, in spite of their fall, is still acceptable to oil producers from the point of view of their output growth. This has to do, firstly, with the fact that the bulk of the oil industry's costs is denominated in rubles; and secondly, the decline of oil prices had a stronger impact on government revenue (generated by the export duty levied on oil), and not on the incomes of oil producers.

1 See, for example, D. Gordeev, G. Idrisov, A. Kaukin, Yu. Ponomarev, S. Sudakov, E. Felicheva. Russian Industry in 2014: Main Trends // Operative Monitoring of the Economic Situation in Russia. Trends and Challenges of Socioeconomic Development]. No 2 (February) 2015; G. Idrisov, Yu. Ponomarev. Russian Metallurgy: From Regulation to Subsidizing // Operative Monitoring of the Economic Situation in Russia. Trends and Challenges of Socioeconomic Development]. No 10. June 2015.

2 See, for example, the interview with V. Alekperov: Kitaiskie kredity – samye dorigie v mire [Chinese Credits Are the Most Expensive in the World] // Vedomosti, 6 September 2015 [http://www.vedomosti.ru/business/characters/2015/09/07/607751-kitaiskie-krediti-samie-dorigie-v-mire]