

THE REAL SECTOR OF THE ECONOMY IN OCTOBER 2015: FACTORS AND TRENDS

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In October 2015, the negative factors in the Russian economy included, firstly, declining consumer demand on the back of a drop of 11.7% and 5.2% in retail trade volume and households' real income, respectively, secondly, a 5.2% reduction of investments in capital assets and, thirdly, a higher slump of up to 5.9% in manufacturing (all the above data are given on a year-on-year basis). In addition to the above, throughout 2015 weakening of contribution of net exports to the GDP dynamics was observed. In October 2015, gross wages growth rates slowed down to 3.0% against 8.9% a year before and the real wages downward trend consolidated: there was a 10% year-on-year drop in real wages. In October 2015, higher differentiation in labour remuneration across all the lines of economic activities with growth of 8% year-on-year and 13.7% year-on-year in the general rate of unemployment and the number of registered unemployed with the public employment service, respectively, complicated the situation on the labour market.

According to the Rosstat preliminary estimate, in January–September the GDP physical volume index amounted to 96.3% with weakening of the rates of slump from 4.6% in Q2 to 4.1% in Q3 as compared to the respective period of 2014. According to the forecast of the RF Ministry of Economic Development, with the existing trends prevailing GDP in 2015 will amount to 96.1% against the level of the previous year.

Dynamics of the Russian economy is determined by a simultaneous impact of domestic macroeconomic factors and geopolitical ones. Changes in the market situation and global prices had an adverse effect on demand in Russian export goods. Limitations related to sanctions and countersanctions determined reduction and structural shifts in imports. In January–September 2015, the export and import volumes of goods in monetary terms fell by 31.8% and 38.5%, respectively, on the respective period of 2014. Declining exports of goods were justified by worsening of the global market situation: prices on Russian export goods, crude oil and petrochemicals fell by 34.3%, 47.2% and 43.1%, respectively. A drop in prices in January–September 2015 against the indicators of the previous year was partially compensated by a 3.5% growth in physical volumes of exports: crude oil (8.4%) and petrochemicals (4.9%). The export of natural gas fell by 1.3%. Reduction of imports is related to a number of factors, mainly, the following: general economic slump in the Russian economy, falling investments and households' incomes, as well as restrictions on imports of individual categories of goods. In January–September 2015, physical volumes of import supplies fell by 32.3% against the indicator of the previous year.

Despite the export surplus on the back of depreciation of the rouble and declining imports, its contribution to GDP is getting discernibly weaker. In Q3 2015, net exports stood at \$27.1bn against \$43.0bn in Q2.

Depreciation of the rouble failed to make up for a shortfall in income due to changes in foreign economic parameters and had an ambiguous impact

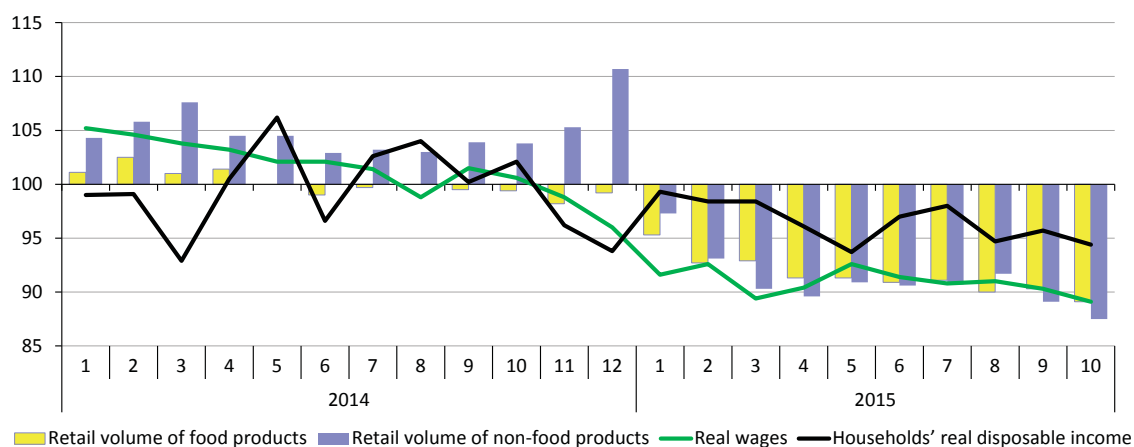
on the Russian economy. On the one side, it weakened the effect of external factors on individual sectors of the Russian economy and contributed to promotion of import substitution, while, on the other side, led to higher production costs due to appreciation of imports. Amid economic uncertainties, changes for the worse in manufacturers' expectations, price rises, as well as limited options of replacing external sources of funding, a slump in domestic demand consolidated.

In 2015, a downward trend prevailed in investment demand. With some slowdown observed from August 2015, in October 2015 annual rates of decrease in investments in capital assets amounted to 5.2% against 5.6% in September. Generally, in January–October the indicator of capital investments in the economy stood at 94.3% of the 2014 level. Some weakening of the depth of slump in investments in the past three months did not affect the building industry. In October and January–October, the volumes of jobs in building fell by 7.9% year-on-year and 10.3% year-on-year, respectively, as compared to the respective indicators of the previous year. The volumes of construction contracts and provision of builders with orders keep falling. A lengthy investment pause changed the situation in housing development, though on the basis of the results of ten months of 2015 growth in commissioning of new housing amounted to 4.2%. It happened on the back of high growth rates in Q1, however, from June 2015 annual growth rates of housing commissioning started to fall and in October 2015 amounted only to 87.4%. Reduction of the share of housing commissioned at the expense of households' funds in the total floor space of housing as a result of slowdown of households' activities on the mortgage market due to both households' falling incomes and high mortgage lending rates had a particularly strong adverse effect on the dynamics of housing development. The key factor which may help overcome a slump in investments still consists in reduction of economic uncertainty, including through achievement of lower and stable rate of inflation, cuts in interest rates and upgrading of the business climate. According to the forecast of the Ministry of Economic Development of the Russian Federation, in 2015 a drop in investments in capital assets amounts to 10% on the previous year.

The specifics of 2015 consist in consolidation of the downward consumer demand trend. In October 2015, retail trade volume and paid services to households fell by 11.7% and 2.9% year-on-year, respectively. Consumer demand downturn was accompanied by shrinkage of demand both on food and non-food products.

In October 2015, the volumes of the markets of food products and non-food products amounted to 89.1% and 87.5%, respectively, as compared to October 2014. Adverse developments on the food market and non-food market were registered from June 2014 and the beginning of 2015, respectively. If prior to October 2014 retail trade volume was underpinned by positive dynamics of households' incomes, in the period from November 2014 till October 2015 the situation changed on the back of a sudden slowdown of growth in households' nominal incomes and high rates of inflation. In October 2015, households' disposable cash income fell 5.6% year-on-year, including monthly average gross wages (10.9%), while the average amount of accrued pensions, by 4.0% (as per the September data).

In the pattern of households' cash income, the share of labour remuneration keeps falling. Taking into account the fact that over 90% of the employed



Source: The Rosstat.

Fig. 1. Dynamics of households' real income and retail trade volume in 2014–2015 as % of the respective month of the previous year

work by hire, reduction of the share of labor remuneration in households' total incomes for three quarters running in 2015 affected badly the index of the standard of living.

With preservation of high socioeconomic differentiation and inequality in distribution of incomes, a drop in households' incomes affected the consumer behaviour. With reduction of differentiation of households by the level of income from 18.8% in January–September 2014 to 14.2% in January–September 2015, the share of less better-off households rose by 0.3 p.p. In H1 2015, the number of people with income below the minimum subsistence level amounted to 21.7m people (15.1% of the total number of the population) and increased by 2.6m people (2.0 p.p.) as compared to the previous year.

Reduction of consumer and investment demand had an adverse effect on the dynamics of domestic output and imports.

In October 2015, the industrial production index amounted to 96.4% on the respective index of the previous year. In 2015, structural specifics of industrial dynamics are determined by weak growth in production of minerals (101.4% and 100.4% against October and January–October, respectively) with a higher drop in manufacturing (94.1% and 94.7%, respectively).

In October 2015, year-on-year positive dynamics were registered only in the chemical industry (109.2%) and the food industry (101.4%). In 2015,

Table 1

THE PATTERN OF HOUSEHOLDS' CASH INCOME, % OF THE RESULT

	2014 Quarters			2015 Quarters		
	I	II	III	I	II	III
Incomes– total	100	100	100	100	100	100
Entrepreneurial income	8.3	7.3	7.8	7.9	7.1	7.5
Labour remuneration, including hidden wages	67.8	67.1	66.9	66.4	65.8	65.3
Social payments	17.0	18.8	18.2	18.1	18.8	18.6
Property income	5.0	4.8	5.1	5.7	6.3	6.6
Other incomes	1.9	2.0	2.0	1.9	2.0	2.0

Source: The Rosstat.

highly volatile dynamics of output of food products are observed: growth at the level of 103.5% in Q1 2015 was replaced by stagnation in Q2 and revival of production up to 101.5% in Q3 as compared to the respective periods of the previous year.

Changes in the pattern of demand had a favourable effect on chemical output volumes in 2015. On the back of depreciation of the rouble, reduction of the volume of imports which became more expensive permitted the Russian chemical enterprises to expand the niche for domestic goods on the internal market, on the one side, and increase physical volumes of exports, on the other side. The factor of import substitution had the most favourable effect on the dynamics of output of pharmaceuticals and household cleaning products, that is, growth of 11.9% and 7.6%, respectively, in January–October 2015 as compared to the same period of the previous year. It is to be noted that in the mid-term prospect the pharmaceutical industry has definite growth potential both due to state support and higher investment attractiveness for Russian and foreign investors. In the past three years, more than a dozen of new pharmaceutical plants were put into operation with simultaneous upgrading of the existing capacities and development by Russian producers of new competencies and know-how. Despite complicated macroeconomic conditions, cooperation with foreign companies is expanding: in St. Petersburg the Bayer company has concluded a contract with the Polisan company on production of three drugs of the German group in Russia; the Novartis company is building a plant (which is to be commissioned before the end of 2015); in the Kaluga Region AstraZeneca, a Swedish-British pharmaceutical company launched its local production (commercial output is expected in Q1 2016) and NovoNordisk, a Danish company has built an insulin-producing, insulin cartridge-filling and packaging plant; in the Kirov Region a contract has been concluded with the Merck company on localization of production at the Nanolek plant (euro 10m worth of investments).

Growth of 6.5% and 3.6% in the output of main chemical agents in October 2015 and January–October 2015, respectively, as compared to the respective periods of the previous year was justified, in particular, by attainment of projected capacities by new petrochemical plants which were put into operation in the past few years: two large polypropylene-producing plants – the Poliom plant (the Omsk Region) and the Tobolsk-Polymer plant (the Tymen Region) – and RusVinil, a polyvinylchloride-producing plant in the Nizhny Novgorod Region. As a result, in January–October 2015 output of plastics in original forms rose by 9.0%, including that of vinyl chloride and propylene, that is, 25% on the respective period of the previous year.

It is noteworthy that in October 2015 gradual recovery of output growth is observed in such sectors of the chemical industry as varnish-and-paint production and chemical fibre production (116.2% and 112.1%, respectively as compared to October 2014). Unstable output dynamics of the above productions throughout the year can be explained by falling domestic demand and a lack of prospects of development due to noncompetitiveness of products on foreign markets even at a lower price.

In analysing the dynamics of the chemical industry, it is worth mentioning that it demonstrates quite good results. In October 2015, the producer price index in the chemical industry stood at 119.8% as compared to the beginning of the year and was ahead of producer prices in manufacturing (113.4%). As a result, in January–August 2015 the balanced financial result of

the chemical industry grew 2.8 times over, while the share of profit-making entities increased by nearly 6.8 p.p. as compared to the respective period of the previous year. In that situation, in January–September growth of 9.8% in nominal wages in the chemical industry (8.1% in manufacturing in general) became a factor, which underpinned retention of personnel in that industry.

In the Russian economy, a well-coordinated system of comprehensive measures aimed at improvement of general business conditions, rather than target support of individual industries is needed. If the initial reaction of intermediate demand industries with a high share of production aimed at appreciation of prices due to depreciation of the rouble was renewal of output growth, from April 2015 a slump was registered in that segment of manufacturing. An additional factor behind aggravation of slump in the segment of intermediate demand goods was reduction of demand on domestic components and materials on the part of investment goods industries. Reduction of output of domestic intermediate demand goods resulted in structural changes in imports: in H1 2015, the unit weight of intermediate demand goods in the total volume of imports fell by nearly 4 p.p. as compared to the respective period of 2014.

Falling output and imports of capital goods were justified by low investment demand. In H1 2015, the share of investment goods in imports fell by 3.3 p.p. as compared to H1 2014 with rates of import reduction accelerated by quarters of 2015. In October 2015, the indices of production of machines and equipment; electric, electronic and optical equipment; transport vehicles amounted to 94.1%, 84.0% and 90.3%, respectively, as compared to the same period of the previous year. Shrinkage of investment activities is justified by falling demand on building and construction materials. In October 2015, the indices of production of building materials amounted to 90.0% as compared to October 2014, while that of the iron and steel industry, to 93.1%.

In October 2015, reduction of output volumes in metallurgy was justified by falling demand, particularly, on high value-added products both on the domestic and external markets, as well as a drop in global prices virtually across the entire nomenclature of ferrous and nonferrous metals. It is to be noted that in case of a change in the situation the domestic iron and steel industry has high growth potential. With completion of large projects in the iron and steel industry contributing to promotion of import substitution, shortages of individual types of products were eliminated.

In October 2015, the index of production of coke and petrochemicals amounted to 94.9% year-on-year; the above was determined by decrease of 8.8% and 5.2% in oil refining volumes and output of petrochemicals, respectively. The factor behind falling oil refining volumes was structural changes in exports in favor of growth in export physical volumes of crude oil (8.4%) and petrochemicals (4.9%) in January–September 2015 as compared to the respective period of the previous year.

In accordance with the forecast of the Ministry of Economic Development of the Russian Federation, with the existing trend prevailing in 2015 the expected drop in manufacturing output will amount to 4.9% with a 0.1% increase in production of minerals.

In October 2015, the number of gainfully employed people amounted to 72.5m. The number of the unemployed (in accordance with the ILO methods) stood at the level of 4.2m people, while the level of unemployment amounted to 5.5% of the gainfully employed population and exceeded by

0.4 p.p. the respective index of 2014. In October 2015, the number of the unemployed registered with the offices of the public employment service amounted to 911,100 people (113.7% against October 2014). A negative factor consists in reduction of employers' need in workforce: in October 2015, it decreased by 47,900 vacant jobs. On the back of reduction of the number of vacant jobs, in October the intensity factor per 100 declared open positions after some decrease in September returned to the values of July–August and amounted to 86.2 people. According to the forecast of the Ministry of Economic Development of the Russian Federation, on the basis of the results of 2015 the general unemployment will remain at the level of 4.2m people. ●