# RUSSIAN INDUSTRY IN Q1 2016: THE ONSET OF STAGNATION?[1]

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*In Q1 2016, the production index in the majority of segments across the real sector of the national economy demonstrated low growth rates, which were often close to zero. Hardly any consequences of the ruble's plunge and the declining prices of oil in late 2015 are visible now. The exhausted potential of the existing demand-side and supply-side favorable factors can be the first signal of the Russian economy entering a long period of zero rate of growth.*

For the Russian economy, the year 2015 was the period of overall downward movement towards the bottom point, which was the result of the combined effects of both the demand- and supply-side negative factors: the changed terms of trade; real income shrinkage; increasing uncertainty and rising risks; increased debt load on companies; the sanctions introduced against Russia, and Russia's retaliatory sanctions. Due to the differences in their growth models, in early 2015 the production indices in terms of physical volume were displaying multi-vectored movement in different industries. Some of the industries were able to take advantage of the existing favorable factors, and first of all those associated with demand, and so achieved some growth; in other industries – those that had been most noticeably damaged by the recent shocks – output was on the decline[3]. Towards the year's end, no further growth of this 'polarization' could be seen, and on the whole, it can be said that the majority of industries had hit the bottom point of their decline[4].

In late 2015 and early 2016, the economy was faced with further deterioration of the terms of trade; however, in contrast to the changes that had taken place in 2014, this plunge was not a permanent one. It appears that the changing world prices of oil and the resulting movement of the ruble's exchange rate against major world currencies can now be viewed as fluctuations caused by the instable situation in the foreign markets. The production statistics for Q1 2016 released by *Rosstat* on April 19[5] can be treated as evidence that Russian enterprises likewise view these changes in the same way.

The Gaidar Institute's experts decomposed these statistical data and removed the trend component[6] of the by-sector industrial production time

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3 See, e.g., G. Idrisov, A. Kaukin, O. Morgunova, M. Turuntseva. The two poles of Russian industry. Online Monitoring of Russia's Economic Outlook, No 12 (September) 2015; G. Idrisov, A. Kaukin, O.Morgunova, M. Turuntseva. The deepening industrial slump: trends have become a fact. Online Monitoring of Russia's Economic Outlook, No 9 (June) 2015.

4 G. Idrisov, A. Kaukin, O. Morgunova, M. Turuntseva. Russian industry rebounds from the bottom. Online Monitoring of Russia's Economic Outlook, No 15 (November) 2015.

5 Information on the social and economic situation in Russia, January–March 2016, Rosstat.

6 The trend component was removed by using Demetra software package based on X12-ARIMA.

series. The decomposition results demonstrate that in Q1 2016, the situation in industry was sufficiently stable, and no significant decline similar to that observed in late 2014 – early 2015 could be seen. Moreover, we can even speak of growth, however slight (approximately 0.7% in Q1 2016 on December 2015).

Industrial production growth over the first few months of 2016 had to do in the main with the increased production index in the extracting industry, where the situation was not so bad even during the most tricky periods of 2014–2015; the manufacturing industry in general is more likely to be undergoing a period of stagnation (*Table 1, Fig. 1*), while in each of its subsectors the situation is by no means homogeneous. The variability of its by-sector production indices can be explained by the different development models applied in each of these sectors. Depending on their specificity and the configuration of each related market, a slower growth rate or a declining output rate can be caused by a variety of demand-side and supply-side factors[1]. As a rule, when speaking of the 'demand-side problems', economists imply that a decline of the real demand for goods and services displayed by economic agents had taken place, its most obvious effects being unemployment, underused production capacities, and a declining price growth rate. When the supply-side is mentioned, it means availability of skilled labor, competitive production capacities, economic productivity, access to financial resources and technologies, competition and regulation, and administrative barriers to doing business. The most obvious consequences of the existence of supply-side problems are a slowdown in the potential/structural rates of economic growth[2] and rising prices.

The slight but rather stable growth in the extracting sector of the economy, which was observed, as mentioned earlier, in the beginning of 2016, became possible because the impact of negative factors on that sector was by no means crucial. No doubt, the major shock experienced by Russia's economy in 2014–2015 was on the demand side, and it took the form of changed terms of trade, when the Russian economy began to get less income for the same quantity of crude oil[3] (according to our estimations – by $ 180bn). However, due to the specific structure of Russian export duties and the delayed movement of contractual prices relative to oil price quotes on the exchanges[4], there were positive effects on the supply side – Russian companies began to receive more money in ruble terms for each sold tonne of oil. As a result, even at the new level of demand for (and prices of) oil in dollar terms, it was worthwhile to increase the production of energy resources, and so output surged. The old 'growth model' in this sector is still working, which is confirmed by statistics.

1 Hausmann R., Rodrik D., Velasco A. Growth diagnostics. The Washington consensus reconsidered: Towards a new global governance. 2008, pp. 324–355; Rodrik D. Diagnostics before prescription. The Journal of Economic Perspectives, 2010, V. 24, No. 3, pp. 33–44.

2 See, e.g., M. Kazakova, S. Sinelnikov-Murylev, S. Drobyshevsky, M. Alexeev. Decomposition of Russian GDP Growth Rates. Published Papers Series No 167, Gaidar Institute, 2015. 128 pp.; M. Kazakova, . Drobyshevsky. Decomposition of GDP: Can the Russian economy grow faster? Forbes, December 11, 2014; M. Kazakova , S. Sinelnikov-Murylev, S. Drobyshevsky. Decomposition of Russian GDP Growth Rates in 1999–2014. Economic Policy (In Russian). 2014. No. 5. P. 7–37.

3 See Idrisov G.И., Ponomarev Y. Y. Sinelnikov-Murylev S. G., Terms of Trade and Russian Economic Development. Economic Policy (In Russian). 2015. No. 3. pp. 7–37.

4 Bobylev Yu, Idrisov G., Kaukin A., Rasenko O. Oil, budget and tax maneuver. Online Monitoring of Russia's Economic Outlook, No. 15 (November 2015), pp. 11–14.

*Table 1*

**THE BY-SECTOR MOVEMENT OF OUTPUT INDICES, APRIL 2016 ON JULY 2014**

| | Share in total industrial production index, % | March 2016 on July 2014, % | Changes over recent months |
|---|---|---|---|
| Industrial production index | | 96.94 | slow growth |
| Mineral extraction | 33.99 | 100.86 | slow growth |
| Manufacturing industry | 52.50 | 93.53 | stagnation |
| including | | | |
| production of foodstuffs, including beverages, and tobacco products | 17.05 | 103.72 | growth |
| textiles & textile products manufacturing | 1.43 | 83.69 | growth |
| leather production and leather products & footwear manufacturing | 0.32 | 96.73 | growth |
| timber & wood product processing | 2.20 | 97.62 | stagnation |
| cellulose & paper production | 3.92 | 95.69 | slow growth |
| production of coke & petroleum products | 18.78 | 101.16 | slow growth |
| chemical production | 7.46 | 111.10 | slow growth |
| manufacturing of rubber & plastic products | 2.26 | 97.12 | stagnation |
| manufacturing of other non-metallic mineral products | 4.41 | 84.28 | decline |
| metallurgical production & finished metal products | 17.23 | 92.60 | growth |
| machinery & equipment manufacturing | 6.24 | 92.43 | growth |
| electrical, electronic and optical equipment manufacturing | 6.05 | 90.18 | slow decline |
| production of means of transport and transportation equipment | 7.06 | 79.91 | decline |
| other industries | 5.59 | 84.96 | stagnation |
| Electricity, natural gas & water | 13.51 | 98.66 | slow growth |
| Retail trade | | 86.66 | decline |
| Wholesale trade | | 89.28 | stagnation |
| Transport | | 100.40 | slow decline |
| Construction | | 90.86 | slow decline |
| Commercial services rendered to population | | 97.15 | slow decline |

In the manufacturing sector, confident growth rates are demonstrated only by the industries specializing on production of consumer goods (foodstuffs, garments and footwear), as well as metallurgical production (due to growth in the fuel-and-energy complex, and machinery and equipment manufacturing)[1] and machinery and equipment manufacturing (recovery

1 Idrisov G., Ponomarev Y., Sudakov S. Russian metallurgy: the ruble weakness alone does not suffice any longer. Online Monitoring of Russia's Economic Outlook, No 18. (December 2015), pp. 12–15.

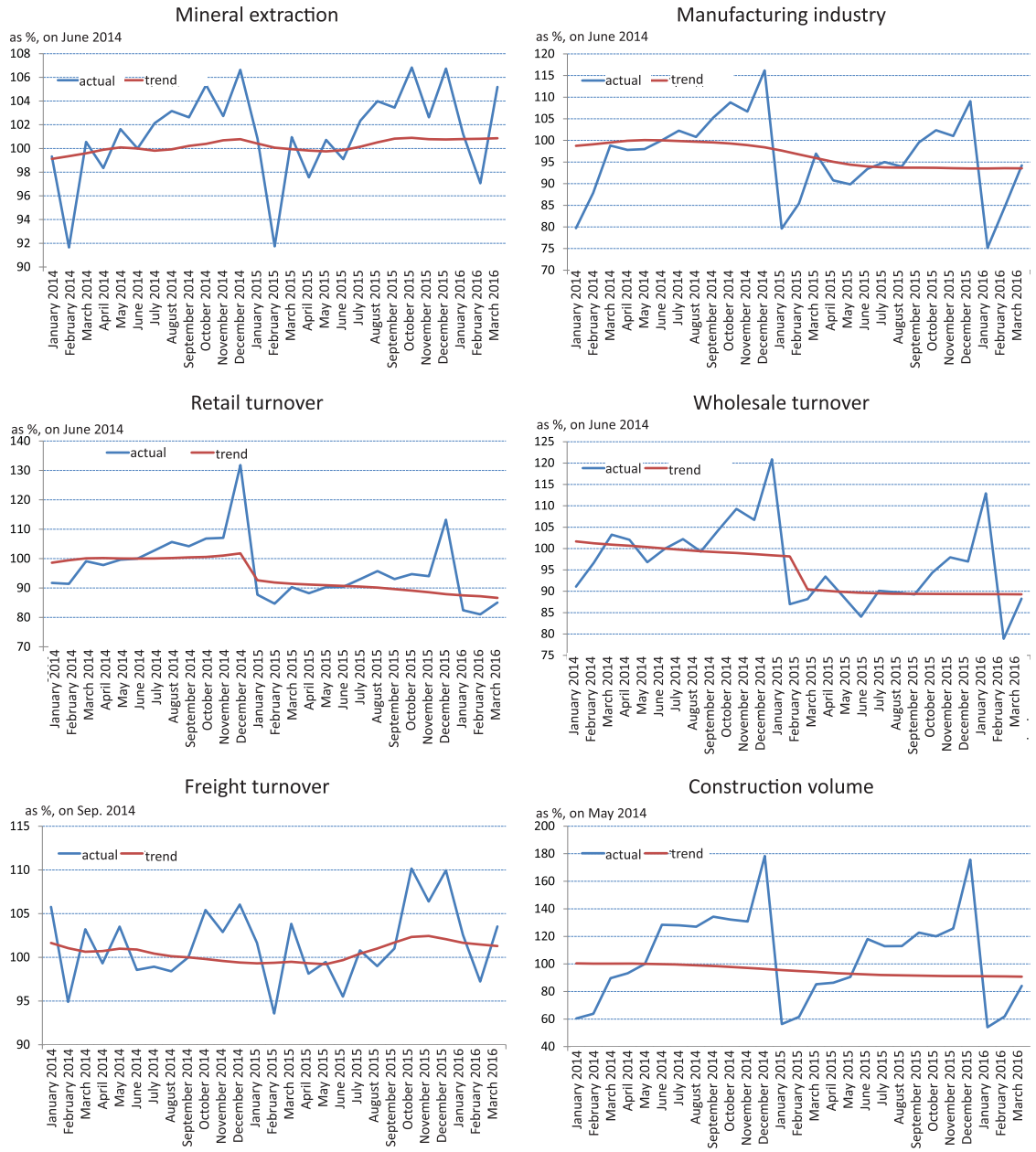
growth after last year's very deep plunge). In these sectors, negative factors were present both on the supply side (increased debt load on companies as a result of the weakened national currency, rising import prices of intermediate goods, lower competition as a result of retaliatory sanctions, increasing interest rates), and on the demand side (the initial surge of activity on the markets that later gave way to consumption decline, plummeting investments in response to increasing uncertainty, and budget sequestration in 2015). By now, the downward movement of consumer demand for domestic products has evidently been halted and gave way to stabilization (in light industry, it could even slightly increase on its pre-crisis level in response to the rising prices of foreign products in ruble terms), thus creating preconditions not only for curbing the downward movement of output, but for reversing it towards growth.

The movement of the other industries is proceeding at a rather lazy pace, which is very close to zero rate of growth; some of them continue to display decline (production of other non-metallic mineral products, electrical equipment, and means of transport). For all these subsectors, the main obstacles to growth appear to be on the supply side – high dependence on imports of intermediate goods and production factors, inadequate technologies, high interest rates on loans, low product competitiveness, etc. Clearly, there also exist some demand-side problems, but output can be boosted by demand only in the short-term perspective, while the medium- and long-term problems existing in these industries can be properly dealt with only after the supply-side bottlenecks are removed.

A similar picture can be observed in some other major industries of the real sector of the economy (*Fig. 1*).

The indices of retail and wholesale turnover have been declining at slow rates for a long time; the decline of wholesale turnover seems to be giving way to stagnation. A similar movement pattern is demonstrated by the construction volume index. Freight turnover, for which the end of 2015 was the period of slight recovery growth, in recent months has also remained practically unchanged.

The specific movement patterns of the trend components of production time series plotted for the most important segments of the real sector of the economy may be regarded as the first signal of the Russian economy's entry into a phase of zero growth, after the favorable effects of the demand-side and supply-side factors have been exhausted.




*Source: Rosstat*; own calculations.

*Fig. 1. The by-sector movement of production indices in 2014–2016, actual data and trend components*