

ONLINE MONITORING OF RUSSIA'S ECONOMIC OUTLOOK

TRENDS AND CHALLENGES OF SOCIO-ECONOMIC

DEVELOPMENT **№ 4(22) March 2016**

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MAIN TRENDS AND CONCLUSIONS

In March, economic statistics have at long last acted as a soothing ointment poured on our macro-economic wounds. March brought us a long-awaited decline in the inflation rate, a rise in oil prices, a notable strengthening of the ruble, calm on the forex market, and rumors about the possible reduction in the RF CB's key interest rate. Also, there was a lull in the flow of negative news from China and the emergence of some positive news from the European Central Bank, which had softened its policy (thus giving a significant boost to oil prices and the ruble) to an extent that now it is worth thinking about abolishing money altogether – bearing in mind that its value is continually tending toward zero. Naturally, each barrel of oil that has now become more expensive contains a fly that spoils the ointment. The inflation rate has fallen mainly against the backdrop of last year's high base; the role of the RF Central Bank's key interest rate is becoming less important because of the current overabundance of liquidity in the banking system (and this overabundance has emerged because the State is spending its much dwindled forex reserves), while oil prices are going up not because of the verbal interventions of oil exporting countries (which, at least, would have been a sop to their ego), but because of the current repairs at some pipelines in Iraq and Nigeria and due to a significant drop in shale oil production. But the pipelines will soon be back in operation, and as far as shale-oil producers are concerned, it should be said that these zombies sometimes come back because, as soon as oil prices climbs to \$ 50-60 per barrel, the market itself resurrects the zombies, and so they once again attack it.

However, the prophets of doom who predicted that oil prices would plunge to \$ 20 per barrel have all fallen silent. Although the International Energy Agency's recent statements that oil prices may have finally bottomed out may sound too optimistic, expectations regarding oil prices, the exchange rate of the ruble, and the inflation rate have clearly improved. It should be said that it is hard to share the views of those who see an analogy between the situation today and that in the spring of 2015, which was marked by a similar rise in market optimism (later proved to be unfounded). The predominance of non-catastrophic pessimism regarding the foreseeable future is a guarantee, of sorts, against severe disappointments in the future, and highly inflated forecasts and expectations.

Such moods and feelings are also becoming the determinants of consumer behavior as well. Trying to economize wherever possible and saving money have become a 'new norm' for a considerable majority of the Russian population. According to a survey of family income and expenditure in 2015, the share of family income spent on goods and services hit a 16-year low. At the same time, over the course of 2015, the share of savings grew up considerably, although mainly in regard of the more well-off households (which accounted for most of the rise displayed by bank accounts). However, most of the population simply did not have any money to save. The drop in real incomes and the high rate of inflation have considerably increased the number of people at risk of poverty.

Under these circumstances, some people were surprised by the recent government decision that the minimum living standard for Q4 2015 should be decreased by 2.3% relative to Q3 2015 (bearing in mind that the CPI for that period did not decline at all, but on the contrary demonstrated a 2% growth). Our experts have explained this alleged inconsistency, among other things, by the difference between the structure of the consumer basket used for calculating the minimum living standard and the structure of family expenditure used for calculating the behavior of retail prices. The drop in the minimum living standard was also reflected in the decline, in Q4 2015, in the prices of some food products included in this basket.

Without questioning the applicability of these calculations, it should be noted, however, that such a successful combination of the consumer basket with the behavior of the prices for some goods, which makes it possible to decrease the minimum living standard against the background of high inflation, is unlikely to resolve the issue of growing poverty. One of the more reliable methods for its resolution would be a radical decline in the growth rate of prices.

The economic events of the first two months of 2016 have given the expert community some good reasons to affirm that the relevant trend has already begun to manifest itself - to say the least. It should also be noted that the current growth rate of inflation is outpaced by the growth rate of prices for nonfood products, whose contribution to the total year-on-year growth in retail prices has hit an historic high (due to the growth of prices for imports, for example, household electric appliances, caused by the recent depreciation of the ruble). In the future, growth in money supply may give an additional impetus to inflation, while the strengthening of the ruble and a calm situation on the forex market may reduce the inflation rate. Experts have also noted that over the course of 2015, the nominal effective exchange rate of the ruble experienced approximately the same drop in value as the currencies of other raw material exporting countries, including Norway, Australia and Canada. It should be said that the majority of such countries also registered a reduction in their trade balances.

This trend has clearly become manifest in Russia as well. Moreover, the simultaneous reduction in both exports and imports, which took place during last year, was continued also in the first two months of 2016. By the end of January, Russia's trade surplus touched a multi-year low of 8.5bn. The drop in exports was undoubtedly caused by the general fall in prices for raw materials, while the decline in imports resulted from the weakening of the ruble and the decline of business activity.

It is clear that food purchases have also dropped under the influence of the ban on import supplies. Although this restriction with regard to, for example, investment-goods imports (Russia has imposed a ban on corresponding purchases under scores of positions in the state sector) is not total as yet, it has already provoked a considerable growth of prices for the Russian analogues of the banned goods. However, a more important reason for the drop in such imports was the decline in investment activities.

In 2015, investment in fixed assets took the deepest plunge (-8.4%), and it should be noted that both the state-owned banks and state programs significantly reduced their productive investments. However, an investment pause – the absence of real growth of investments in fixed assets – has been taking place in Russia since 2013; it has become the longest investment pause

in the last 17 years. It is noteworthy that in the last few years, there was a growth of investment in housing and non-residential buildings, while investment in machinery and equipment did not grow. The investment prime driver was investment in housing, which accounted, in 2015, for 15% of investment growth (it should be said that nowadays it is hard to say whether or not housing construction remains the prime driver behind investment growth). The main source of investment remains self-financing (more than half of total investment). Experts assume that in 2016, due to the good financial results of past year, Russian enterprises will be able to increase investment at the expense of their own financial resources. To achieve this end, any positive changes in both the economic and institutional environment will suffice.

The latest business surveys conducted by the IEP indicate that Russian industrial enterprises do not define the lack of investment as one of the highly important factors hampering production growth. In their view, the same is also true of the dearth of bank credits – in Q1 2016, like in Q4 2015, only 23% of enterprises characterized it as an obstacle to growth. The number one obstacle to growth (53% in both quarters) is the deficiency of domestic demand, while the number two obstacle (48%) is the uncertainty of the economic situation. The attitude of the surveyed enterprises to the weakness of the ruble is rather negative – according to one third of the respondents, expensive imports restrict production growth, while expectations of growth in export demand are slow to materialize despite the low exchange rate of the ruble. According to most of the respondents, one obstacle to their production growth has completely disappeared: foreign competition. In January 2016, imports being sold on the Russian market were characterized as an obstacle to growth by a mere 12% of the surveyed enterprises (vs. one third as late as the autumn of 2013). It is quite logical: when one or other factor is absent on the market, it cannot be an obstacle for many market participants. On the other hand, when it is present on the market it obviously helps something – but this issue should be analyzed separately. ●

1. INCOME AND EXPENDITURE: POVERTY RISKS ARE ON THE RISE

E.Grishina

Since November 2014, the population's real disposable money income have been steadily on the decline. Data for January–September 2015 point to a rising poverty rate. In 2015, the share of personal income spent on commodities and services hit its record low of the past 16 years. The share of saving in the personal money income structure significantly increased.

A stable decline of the population's real disposable money income and real wages has been observed since November 2014. The population's real disposable money income (income less mandatory payments, adjusted by the Consumer Price Index) shrank in January 2016 on the corresponding period of 2015 by 6.3%, real wages – by 6.1%. Real pensions have remained practically unchanged and amounted to 100.8% of the same index for the corresponding period of 2015, which can be explained by the low base effect (Fig. 1). According to preliminary data, the average monthly per capita money income in nominal terms for January 2016 amounted to Rb 21,365, the average nominal monthly charged wage – to Rb 32,122, and the average size of allotted monthly pension – to Rb 12,081.

On the whole over the course of 2015, the population's real disposable money income declined on the previous year by 4.0%, real wages – by 9.5%, and the real allotted monthly pension – by 3.8%.

In the money income structure, the share of entrepreneurial income hit in 2015 its historic high of the entire post-Soviet period – 7.3%. At the same time, in 2015 the share of capital gains in the form of interest on bank deposits, securities, and dividends increased on 2012 from 5.1% to 6.6%. According to data released by the Bank of Russia, in 2015 the amount of individual deposits with banks increased by 25.2% (or by 16.8% without adjustment for foreign exchange rate). This growth was caused by shrinking personal con-

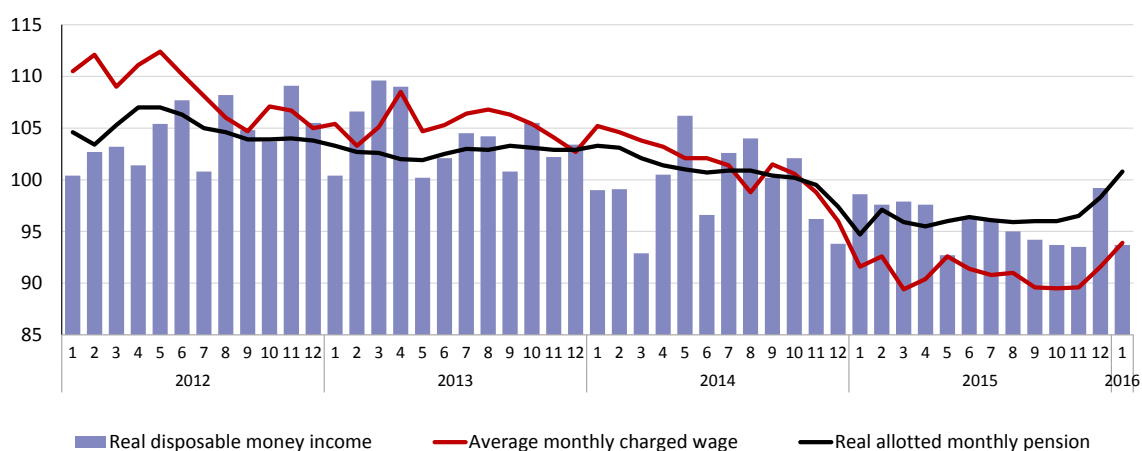


Fig. 1. The Movement of the Population's Real Disposable Money Income (Real Monthly Charged Wage and Real Allotted Monthly Pension) in 2012–2016, as % of the Corresponding Period of Previous Year

sumption expenditure and an increased inclination of some population groups to save. The statistics published by the Deposit Insurance Agency demonstrate that deposit growth in 2015 occurred due to biggest deposits: the highest growth rate was displayed by deposits in excess of Rb 1m¹.

In 2015, compared to 2014, the share of money income spent on commodities and services shrank by 4.0 p.p. (from 75.3% to 71.3%), and in Q4 2015 compared to Q4 2014 – by 5.5 p.p. Thus, as shown by the year-end results of 2015, personal consumption of commodities and services was reduced in response to consumer price growth. At

the same time, in January 2016 there was a seasonal surge of the share of money income spent on commodities and services (to 94.6%).

Last year, the share of personal money income spent on foreign cash purchases shrank by 1.6 p.p. (4.2% in 2015 vs. 5.8% in 2014), and in Q4 2015 compared to Q4 2014 – by 3.2 p.p.

The share of money income used on saving formation increased in 2015 by 7.2 p.p. on 2014, and by 4.3 p.p. on 2013. Compared to 2014, the share of saving in the form of deposits and securities likewise increased in 2015. Besides, compared to period 2011–2013, over 2014 and 2015 the share of ‘other saving’, including the movement of cash flows in the bank accounts of individual entrepreneurs, the movement of loan debt, acquisition of immovable property, and purchases of cattle and poultry by individuals (Fig. 2).

Rosstat’s statistics indicate that, in January 2016, there was an outflow of money from bank accounts. The negative movement pattern displayed by saving can be explained in part by the seasonal factor.

In accordance with Decree of the RF Government of 10 March 2016, No. 178, the subsistence indexes for Q4 2015, per capita and for each major socio-demographic group across the Russian Federation are as follows: per capita – Rb 9452; for the able-bodied population group – Rb 10,187; for pensioners – Rb 7,781; for children – Rb 9,197. The subsistence index for Q4 2015 declined on the previous quarter by 2.3%, while the consumer price index in Q4 2015 compared to the previous quarter amounted to 102.0%². It is adjusted by the differences between the structure of the consumer basket applied in calculating the subsistence index and the consumption expenditure structure applied in weighing the consumer price indexes. Besides, the decline of the subsistence index had to do with the lowered prices of some foodstuffs included in the consumer basket, for example the prices of potatoes and some other vegetables in Q4 2015.

The lower subsistence index may push down the poverty level as estimated by Rosstat. At the same time, the estimations, by respondents in popular

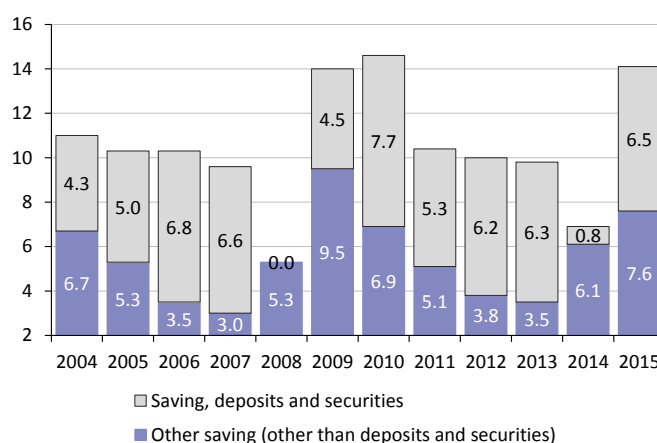


Fig. 2. The Share of Money Income Used on Saving Formation, Including Deposits and Securities, in 2004–2015, as % of Total Money Income

1 Deposit Insurance Agency. Analysis of the Market of Households' Deposits in H1 2015. See http://www.asv.org.ru/agency/for_press/pr/366084/

2 Rosstat, Quarterly consumer price indexes for commodities and services, http://www.gks.ru/wps/wcm/connect/rosstat_main/rosstat/ru/statistics/tariffs/#

opinion polls, of their personal material status in 2016 will, most probably, continue to deteriorate. Thus, according to *Rosstat's* data, in Q4 2015, the share of Russia's population estimating their current personal material status to be 'bad' or 'very bad' was 30.2%, which is 4.2 p.p. above the rate recorded for the corresponding period of last year¹. Our analysis indicates that, in face of rising prices and the plummeting purchasing power of personal money income, poverty risks begin to rise. The increasing share of saving, in 2015, at the expense of the top quintile alongside the rising nationwide poverty rate across leads to the assumption that the gap between the top and bottom quintiles will be widening. ●

1 Rosstat, *Population opinion poll on current material status*, http://www.gks.ru/wps/wcm/connect/rosstat_main/rosstat/ru/statistics/population/level/#

2. INFLATION AND THE FOREIGN EXCHANGE MARKET: NO PANIC

A.Bozhechkova, P.Trunin

Over the period March 2015 – February 2016, the growth rate of prices declined to 8.1%, while the corresponding index for February 2015 – January 2016 amounted to 9.8%. As demonstrated by the results of a survey published by the Bank of Russia, in February the median inflation expectation index for the next year also declined by 1.0 p.p. to 15.7%. As shown by the year-end results for 2014–2015, the plunge of the nominal effective exchange rate of Russia's national currency was much more dramatic than the downward movement of the national currencies of the other countries–exporters of raw materials, although their terms of trade were also deteriorating at a comparable rate.

The sharp plunge of the ruble's exchange rate against the world's major currencies in late 2015 – early 2016 gave rise to fears that this year we were going to experience yet another surge in inflation. However, so far the growth rate of consumer prices has continued to be on the decline. The Consumer Price Index in February 2016 rose on the previous month by 0.6% (vs. 2.2% in February 2015), and over the period from March 2015 through February 2016 it gained 8.1%, while in January its value in per annum terms had amounted to 9.8% (see Fig. 1). In February, core inflation¹ amounted to 0.7%, having gained 0.1 p.p. on the previous period, besides, the core inflation index for that month rose 0.1 p.p. above the rate of growth of the Consumer Price Index. On the basis of these data it can be concluded that the upward pressure on prices was exerted in the main by seasonal factors.

In February, for the first time since September 2015, the growth rate of prices of foodstuffs declined, to 0.7%. In this connection, under the influence of the seasonal factor, the prices for fruit and vegetable products displayed the highest surge. The growth rate displayed by the prices of nonfood commodities, on the contrary, rose to 0.8%, which is a manifestation of the strong effect of the situation in the forex market, which had been pushing up, first of all, the prices of household utensils. It should be noted that for the first time since June 2012, the input of the nonfood commodity group in the movement of CPI was the biggest by comparison with the inputs of all the other components of CPI, amounting to 42.9% (see Fig. 2). The prices and tariffs established for commercial services rendered to the population in February increased by 0.3%, and so their input in CPI growth amounted to 26.7%.

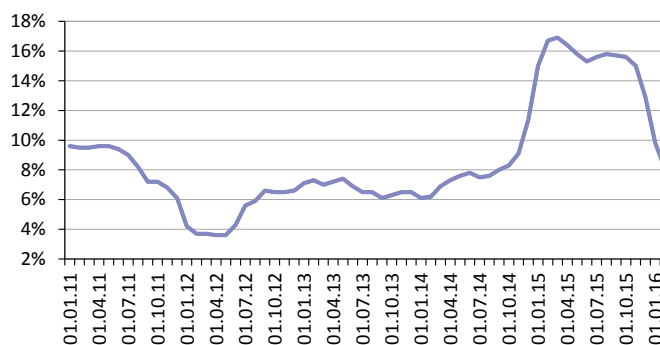
As demonstrated by the results of a survey published by the Bank of Russia, in February the median inflation expectation index for the next year, after having been in the rise for three previous months in a row, also declined by 1.0 p.p. to 15.7%. Inflation expectations remain high, and so there exist significant risks that inflation might rise above the target set by the RF Central Bank

¹ The core consumer price index reflects the level of inflation on the consumer market after adjustment for the seasonal factors (prices of vegetable and fruit products) and administrative factors (regulated tariffs for certain types of services, etc.). This index is also calculated by the RF Statistics Service (Rosstat).

in its forecast for 2016 (5.5–6.5%). Besides, it should be borne in mind that the rapid decline, early in 2016, of the inflation index that had been climbing over the previous 12-month period can be explained first of all by its high core value observed in early 2015, when it surged in response to the pass-through effects of the ruble's exchange rate decline in Russia's sector of consumer goods and services.

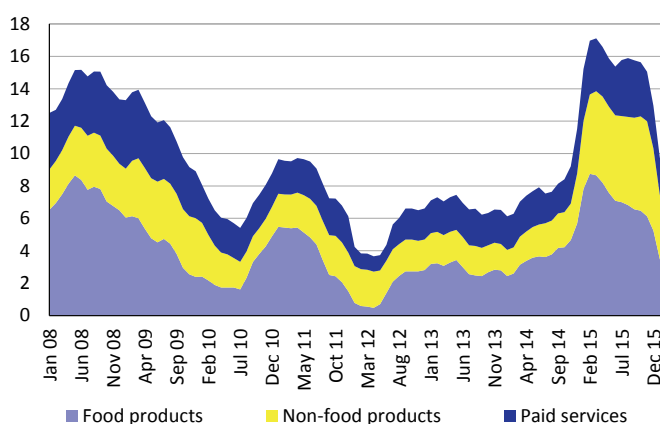
An upward pressure on inflation may also be exerted by the accelerated growth rate of money aggregate M2, which has become evident over recent months. Thus, over H2 2015 this index rose from 7% to 11.5% in per annum terms (on the corresponding month of the previous year). Money supply has been on the rise, among other things, because the RF Ministry of Finance has been spending the RF Reserve Fund. Inflation can be brought down somewhat if the ruble's strengthening, observed over February–March 2016, should prove to be sustainable.

It should be noted that, in spite of the significantly weakened national currency, the RF Central Bank continued its policy of non-involvement in the situation on the foreign exchange market. Moreover, in the course of the month of February the volume of its international reserves increased by 2.4% to \$ 380.5bn as of 1 March 2016. The growth of international reserves resulted in the main from the repayment, to the Bank of Russia, of the loans denominated in foreign currencies by the resident banks. In February, the volume of foreign currency obtained as repo loans by banks from the RF Central Bank shrank by 15.1% to \$ 20.5bn (\$ 24.2bn as of the end of January 2016), including \$ 9.3bn (\$ 18.9bn as of the end of January 2016) for 365-day operations and \$ 10.6bn (\$ 5.2bn as of the end of January 2016) for 28-day operations (see Fig. 3). These changes in the structure of the banking sector's debt, denominated in foreign currencies, to the RF Central Bank occurred because from 14 December 2015 onwards the Bank of Russia resumed its 365-day FX REPO auctions, while at the same time raising the cut-off rate to LIBOR + 3 p.p. (previously it had been set at LIBOR + 2,5 p.p.). Over the period from 1 January through 9 March, 365-day FX REPO auctions were held 9 times, and only three of them managed to find bidders (with the volume of attracted funds amounting to \$ 29.2m at an average rate of 4.2% per annum), which can be explained by the high cost of funding. Commercial banks were much more willing to participate in 28-day FX REPO auctions. Thus, over the period from 1 January through early March 2016, a total of \$ 18.8bn at an average rate of 2.5% per annum was borrowed in the framework of such auctions.



Source: Rosstat.

Fig. 1. The CPI Growth Rate over 2011–2016, % per Annum



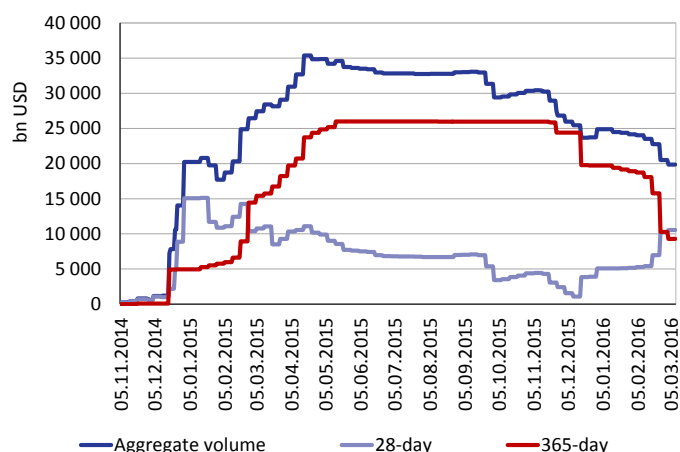
Source: Rosstat.

Fig. 2. Inputs of CPI Main Components in 2008–2016, in per Annum Terms over Period 2008–2016

So, in spite of yet another plunge of the ruble's exchange rate in late 2015 and early 2016, the substantial sums paid to redeem Russia's foreign debt in December (the repayments of principal debt in the amount of \$ 21.9bn, and scheduled interest payments in the amount of \$ 2bn), and the increase in the US Federal Reserve's interest rates, the demand of banks for refinancing their loans denominated in foreign currencies is on the decline. In all probability, credit institutions are not experiencing any shortage of their foreign exchange resources accumulated over the course of last year.

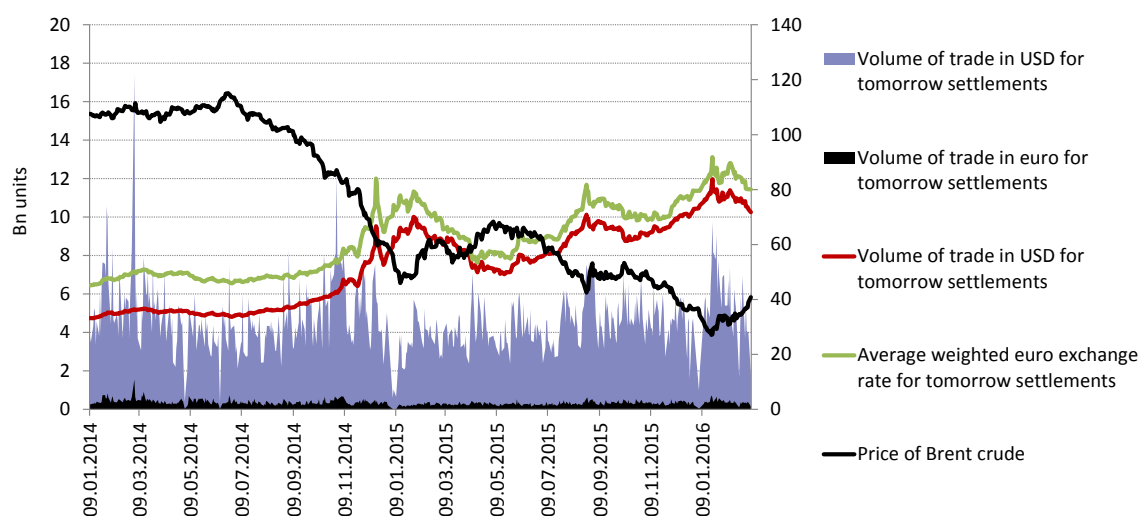
On the whole, the low demand for foreign currency displayed by banks is indicative of the persistently stable situation in the foreign exchange market and the low probability of a panic similar to that observed in late 2014. So far, the movement pattern of the ruble's exchange rate has been determined by that of prices of oil. Thus, as a result of the rise in Brent oil prices from \$ 33.98 per barrel in early February to \$ 40.88 per barrel as of 12 March, the ruble-to-USD exchange rate gained 7.9% and rose to 70.3 (see Fig. 4).

In general, over the period 2014–2015, the plunge of the ruble's real effective exchange rate was much deeper than that of the national currencies of the other major exporters of raw materials. For reference: over the period 2014–2015, the real effective exchange rate of the Russian ruble dropped by 39.1%, that of the Brazilian real by 27.3%, that of the Canadian dollar by 17.3%, that of the Norwegian krone by 14.6%, that of the Chilean peso by 8.2%, and that of the Australian dollar by 7.1% (Fig. 5). Over that period, the terms of trade for the Russian economy lost 21.7%, while the same index for Norway amounted to 24.3%, and that for Australia – to 16.2%.



Source: Bank of Russia

Fig. 3. The Amount of Banks' Repo Debt to the RF Central Bank Denominated in Foreign Currencies in 2014–2016



Source: RF Central Bank, ICE.

Fig. 4. The Situation in the RF Forex Market and the Movement of Oil Prices in 2014–2016

At the same time, if data for 2015 are taken separately from data for 2014, the downward movement of the Russian ruble's exchange rate was comparable with the depreciation rates of the national currencies of the other major exporters of raw materials. Thus, over the course of 2015, the ruble's exchange rate dropped on December 2014 by 8.4%, that of the Norwegian krone by 8.1%, that of the Australian dollar by 4.9%, that of the Canadian dollar by 12.9%, and that of the Brazilian real by 25.2% (*Fig. 5*). Over the past year, the Russian economy experienced a 19.9% deterioration in its terms of trade, while for Norway this index lost 9.0%, and for Australia – 12.4%.

Data for the first three quarters of 2015 indicate that most of the raw-material exporting countries experienced a notable decline of their trade balances (see *Table 1*). However, the less steep plunge displayed by their national currencies over the period 2014–2015 alongside the downward movement of their current account balances can be explained by the much weaker pressure exerted on their foreign exchange rates by the financial accounts of their balances of payments (Norway, Australia, Canada), which in the Russian Federation was very strong. The other factor is the spending of their international reserves in order to sustain the fixed exchange rates of the national currencies in the Middle East.

Table 1

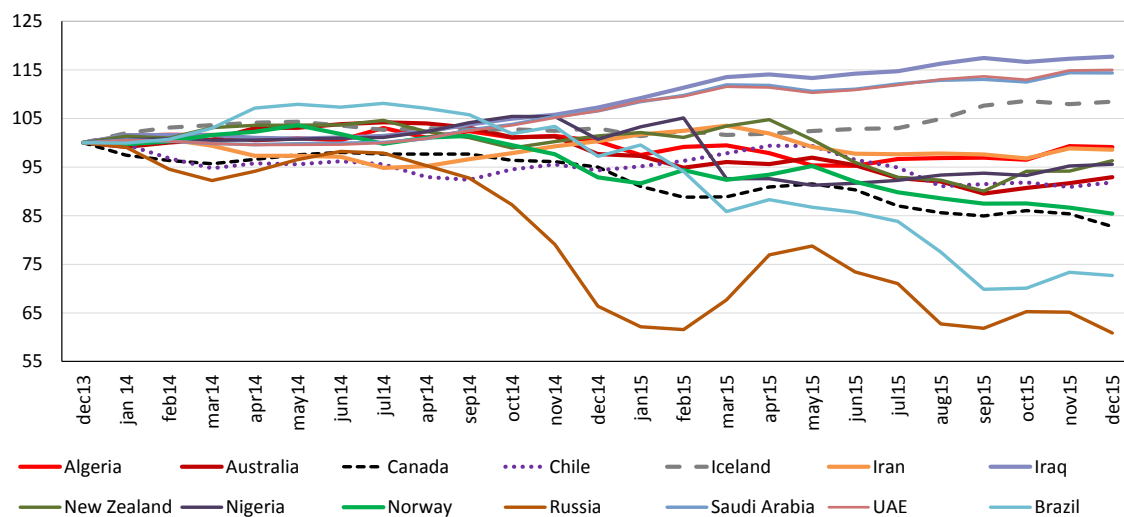
THE COMPONENTS OF THE BALANCES OF PAYMENTS OF THE COUNTRIES
EXPORTING RAW MATERIALS, BN USD

	Balance of foreign trade in goods and services (bn USD)		Financial account balance (bn USD)	
	2014	Q1 to Q3 2015	2014	Q1 to Q3 2015
Australia	-9.1	-16.3	45.4	34.4
Canada	-16.2	-21.3	38.9	31.9
Chile	4.0	1.0	3.8	3.8
Iceland	1.1	1.1	5.8	-0.9
Brazil	-15.0	-18.0	111.4	51.7
New Zealand	2.2	1.6	3.1	-3.7
Norway	43.7	11.7	-55.4	-4.4
Russia	134.5	86.1	-130.2	-58.0
Saudi Arabia	96.0	-15.5	-57.4	-47.4

Source: IFS, Central Reserve Bank of Peru.

Thus, the sharp plunge of the Russian ruble's exchange rate in late 2014 – early 2015 was caused, most probably, by the panic in the forex market caused by uncertainty with regard to the prospects for Russia's economy in view of the continuation of international economic sanctions and high geopolitical risks. As a result of the Bank of Russia's switchover to a freely floating foreign exchange rate of the national currency, currently its exchange rate is determined by the basic market factors that shape the supply of and demand for the national currency in the forex market, and first of all by prices of oil, as well as by the rates of return on assets denominated in the national and foreign currencies, with due regard for the associated risks. The truth of such a conclusion is confirmed, among other things, by the way the situation in the forex market was evolving in late 2015 and early 2016, when the rate of decline of the ruble's exchange rate against the USD was comparable with the movement patterns displayed by the national currencies of the other developing countries, and so the situation did not translate into a foreign exchange crisis similar to that observed in late 2014.

2. INFLATION AND THE FOREIGN EXCHANGE MARKET: NO PANIC



Source: IFS, BIS.

Fig. 5. The Movement, over Period 2014–2015, of the Nominal Effective Exchange Rates of the National Currencies of the World's Major Exporters of Raw Materials (December 2013 = 100)

3. IMPORTS AND EXPORTS: THE PLUNGE CONTINUES

A.Knobel, A.Firanchuk

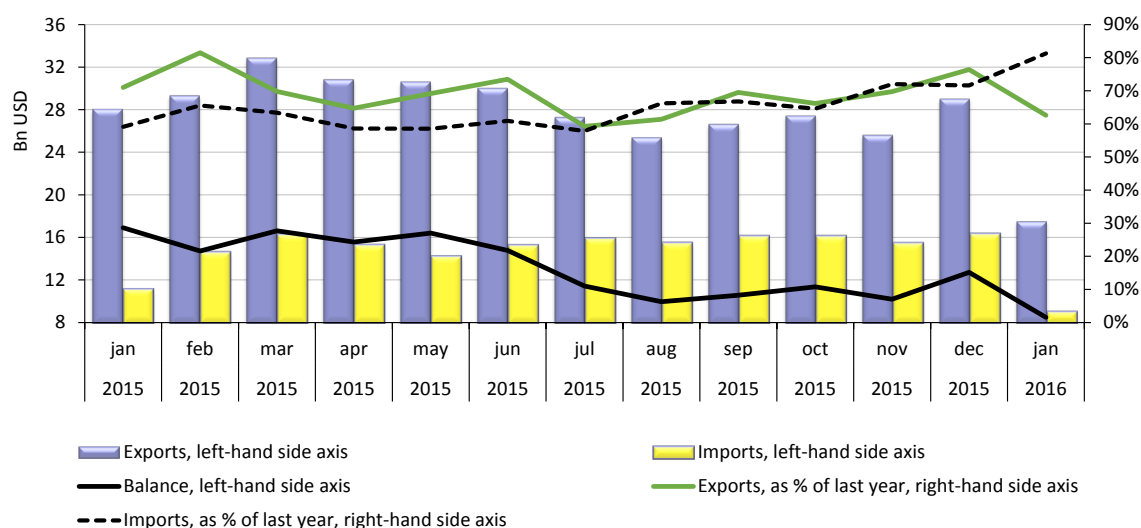
Export and import value indices were synchronous in their decline throughout the past year, 2015. The behavior of exports was naturally shaped by the plunge of prices of raw materials (even though their physical volume remained roughly the same), while the declining value of imports was caused by the shrinkage, by one quarter, of their physical volume and the slight decline of the average dollar prices of inward moving goods, including due to the US dollar's rise against practically all world currencies. In January 2016, the shrinkage of imports and exports continued; more particularly, the plunge of exports was deeper, and the balance of trade hit its record low of the last few years – \$ 8.5bn.

The Behavior of Exports and Imports

Total Imports and Exports

In 2015, exports and imports continued their synchronous plunge (Fig. 1). Export value shrank to \$ 343.4bn (to 69.0% on 2014), imports plunged deeper in relative terms – to \$ 182.4bn (63.6%), the balance of trade in commodities also shrank to \$ 161.2bn (76.3%). A slight recovery of imports and exports (relative to the corresponding month of 2014) observed over H2 2015 is by no means a manifestation of a U-turn in the general trend. Instead, this phenomenon can be explained by the low base effect, as the noticeable plunge of trade indices had begun in H2 2014.

In part, the shrinkage of foreign trade volume in terms of value can be explained by the surge, in 2015, of the USD exchange rate against the world's major currencies¹ (by 17% against the Euro, by 13% against the yen, and by



Source: own calculations based on the Federal Tax Service's data.

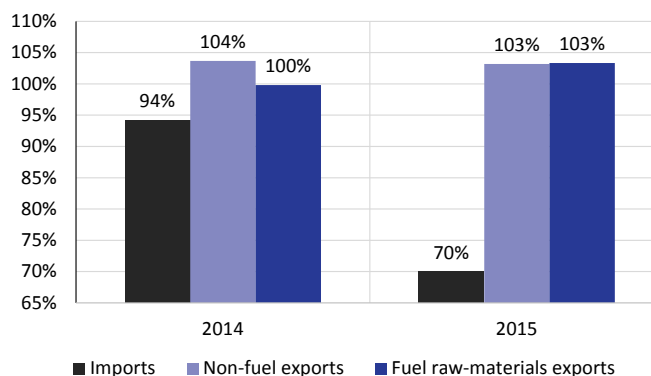
Fig. 1. The Behavior of Russia's Foreign Trade in 2015

1 The average foreign exchange rate in dollar terms in 2015 compared to 2014. See IMF, <https://www.imf.org/external/np/fin/ert/GUI/Pages/CountryDataBase.aspx>

3. IMPORTS AND EXPORTS: THE PLUNGE CONTINUES

7% against GBP). Thus, when Russia's foreign trade value is recalculated in euro terms (the euro being the national currency of her major partners in trade), it can be seen that the shrinkage of import value in 2015 amounted to 23.7%, that of export value – to 17.2%, that of the trade balance – to 8.4%, and that of non-fuel export value (less Group 27 of the Commodity Classification of Foreign Economic Activity (CC FEA) remained practically unchanged (growth by a mere 0.4%).

An analysis of Russia's trade valued at 2013 prices less the classified commodity group (Fig. 2) indicates that the physical volume of exports did not change in any significant way. Thus, exports of fuel raw materials (Commodity Classification of Foreign Economic Activity (FEACN of the CU 27) rose in 2015 by 2.8%, while non-fuel exports shrank by only 0.5%. At the same time, the volume of imports in 2015 (at constant 2013 prices) plunged sharply by 25.7%.

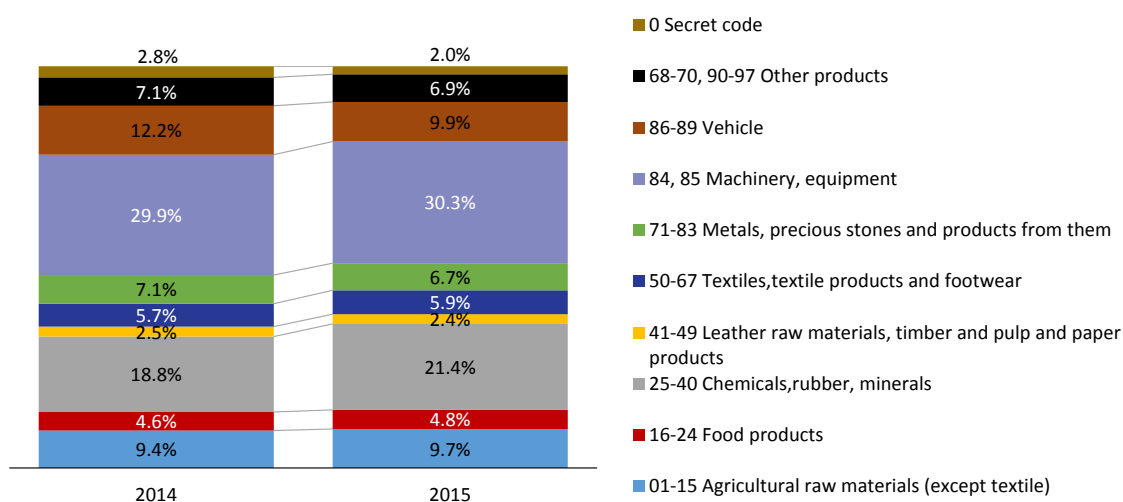


Source: own calculations based on the Federal Tax Service's data.

Fig. 2. The Behavior of Russia's Imports and Exports, in Terms of Physical Volume, as % of 2013

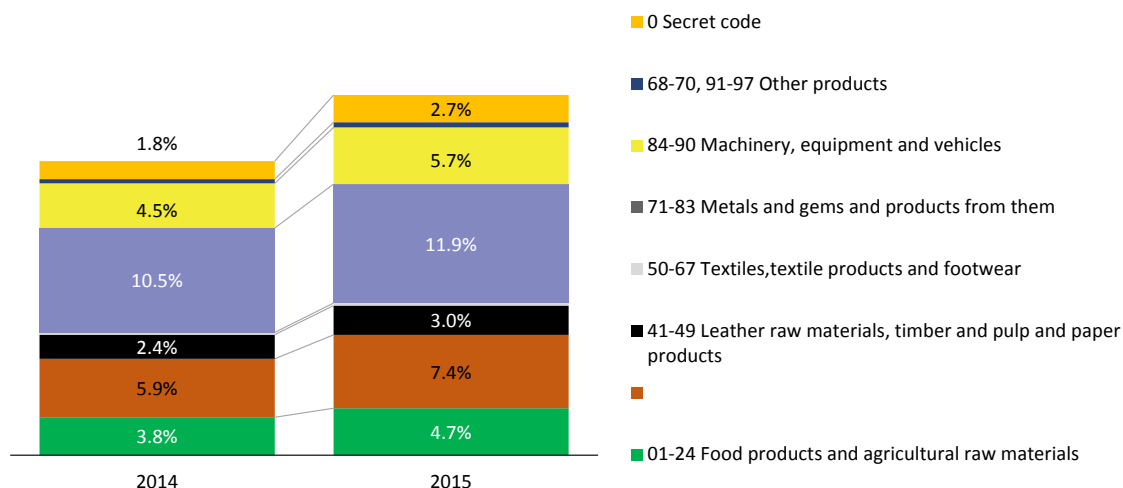
The structure of imports, and exports, by commodity type and geographic distribution

The shares of major commodity groups in total imports in 2014 and 2015 were sufficiently stable (Fig. 3). The deepest plunge of imports was observed in the following groups: *Transport means* (FEACN of the CU 86-89) – to \$ 18.0bn (51.5% of 2014) and *Metals, gemstones and precious metal articles* (FEACN of the CU 71-83) – to \$ 12.3bn (60.1%); the least decline of imports occurred in the group *Chemical industry products, mineral raw materials* (FEACN of the CU 25-40) – to \$ 38.9bn (72.3%). The other commodity groups demonstrated nearly similar import behavior indices which varied between 61% and 67% of



Source: own calculations based on the Federal Tax Service's data.

Fig. 3. The Structure of Russia's Imports in 2014–2015



Source: own calculations based on the Federal Tax Service's data.

Fig. 4. Structure of Russia's Exports in 2014–2015

2014, which points to the similarity of factors influencing the movement of imports: the weakening ruble and the declining business activity.

The shares of major commodity groups (other than mineral products) in total exports were following a similar pattern in 2014 and 2015 (Fig. 4). The steepest decline was observed in the group *Mineral products* (FEACN of the CU 25-27) – to \$ 219.3bn (62.5% of 2014), and their share in total exports shrank to 63.8% vs. 70.5% a year earlier. The least decline of exports was observed in the groups *Machines, equipment and transport means* (FEACN of the CU 84-90) – to \$ 19.6bn (88.0% on 2014) and *Chemical industry products, mineral raw materials* (FEACN of the CU 25-40) – to \$ 25.3bn (86.7%). The

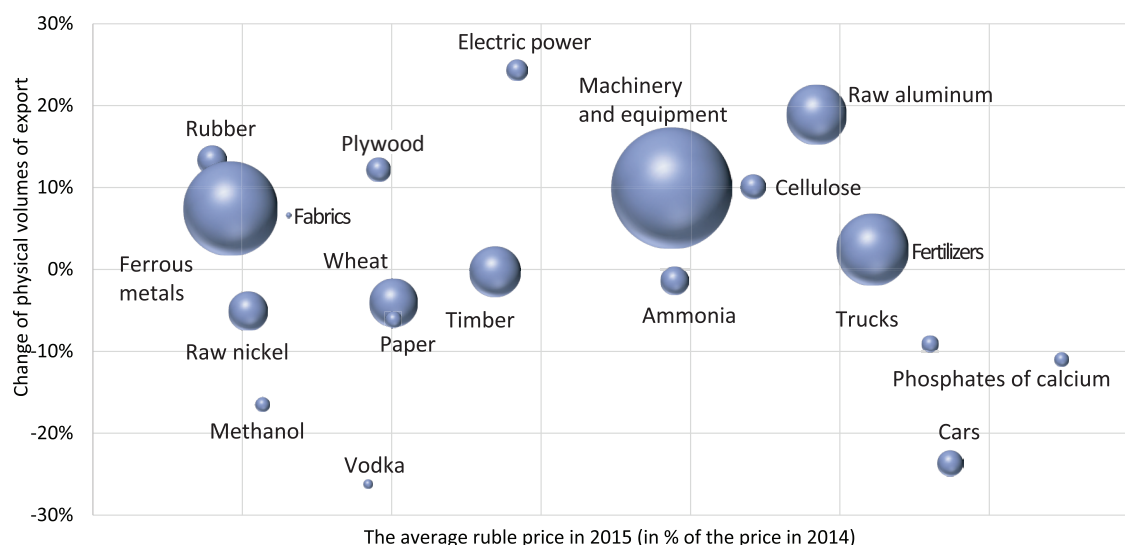
Table 1

THE GEOGRAPHIC STRUCTURE OF RUSSIA'S FOREIGN TRADE

Region/country	Imports				Exports of mineral fuel (FEACN of the CU 27)				Other exports			
	2014 (bn USD)	2015 (bn USD)	Growth rate (as %)	Share of region/country	2014 (bn USD)	2015 (bn USD)	Growth rate (as %)	Share of region/country	2014 (bn USD)	2015 (bn USD)	Growth rate (as %)	Share of region/country
EAEU	20.0	13.6	68.1	7.5	14.5	11.2	77.0	5.2	20.6	15.8	76.5	12.4
Armenia	0.3	0.2	62.6	0.1	0.7	0.6	90.6	0.3	0.4	0.4	104.1	0.3
Belarus	12.3	8.6	70.3	4.7	11.8	9.0	76.0	4.1	8.2	6.3	76.6	4.9
Kazakhstan	7.4	4.8	64.5	2.7	2.0	1.6	78.0	0.7	12.1	9.1	75.6	7.2
CIS	13.1	7.4	56.3	4.0	13.6	6.8	49.9	3.1	16.1	11.9	73.7	9.3
Ukraine	10.7	5.7	52.8	3.1	10.3	4.2	41.2	2.0	6.8	5.1	74.7	4.0
Europe	124.7	74.2	59.5	40.7	218.0	131.7	60.4	60.9	48.2	39.3	81.6	30.9
EC	118.5	70.1	59.2	38.5	215.3	129.5	60.2	60.0	43.9	36.1	82.2	28.3
North and South America	30.3	20.1	66.2	11.0	5.0	3.9	78.8	1.8	13.8	11.6	84.6	9.1
USA	18.5	11.4	61.9	6.3	3.8	3.0	79.8	1.4	6.8	6.5	95.9	5.1
Asia and Oceania	95.7	64.8	67.7	35.5	92.6	61.4	66.3	28.4	46.0	41.1	89.3	32.3
China	50.9	34.9	68.7	19.2	27.8	18.9	68.1	8.7	9.7	9.7	99.5	7.6
Japan	10.9	6.8	62.4	3.7	17.2	11.9	69.3	5.5	2.7	2.6	97.0	2.0
Africa	2.8	2.3	83.3	1.3	2.4	1.1	45.7	0.5	7.0	7.7	110.5	6.0
Total	286.7	182.3	63.6		346.1	216.1	62.4		151.7	127.4	84.0	

Source: own calculations based on the Federal Tax Service's data.

3. IMPORTS AND EXPORTS: THE PLUNGE CONTINUES



Source: own calculations based on data released by the Federal Tax Service and the RF Central Bank.

Note: The size of each circle is proportional to the export value index.

Fig. 5. The Dispersion of Changes Displayed by Russia's Exports in 2015, in Terms of Physical Volume, and the Average Price, in Rubles

other commodity groups demonstrated approximately similar results –77% to 85% of 2014.

The geographic structure of Russia's foreign trade is shown in *Table 1*. The share of the **EAEU** in Russia's total commodity turnover somewhat increased. However, in 2015, Russian non-fuel exports to **EAEU markets** shrank significantly— by 25.5%, while the decline of exports of fuel raw materials was less steep.

The behavior of trade with the other **post-Soviet states**, as before, is determined by that of Russia's trade with Ukraine, whose commodity turnover shrank by 46.2%.

The index of trade with the **EU** is slightly below the average index of Russia's total foreign trade volume. The steeper decline of imports has been caused, among other things, by the food embargo introduced in August 2014. The index of exports to the **USA** is noteworthy for its higher stability: exports of mineral fuel shrank by 20.2%, while other exports – by a mere 4.1%. This can be explained first of all by the rising exports of non-organic chemical products (by 5%), fertilizers (by 39%) and aluminum (by 5%).

The volume of non-fuel exports remained practically unchanged with regard to **China** (-0.5%) and **Japan** (-3.0%), while with regard to the countries of **Africa** it increased (by 10.5%).

A comparative analysis of changes in average price and export volume

A comparative analysis of the behavior, in 2015, of average ruble-denominated export prices and export volume (*Fig. 5*) point to growth of exports, in terms of physical volume, of many commodity types. At the same time, no significant correlation between the upward movement of average ruble-denominated prices¹ and physical volume of exports could be traced.

A Comparison of the Behavior of Trade and Output for Some Commodity Types

¹ Prices in dollar terms (based on data released by the Federal Tax Service) were recalculated by the average foreign exchange rate set by the RF Central Bank.

Table 2

TRADE AND OUTPUT VOLUME INDICES IN RUSSIA IN 2015 COMPARED TO 2014, WITH REGARD TO SOME TYPES OF AGRICULTURAL PRODUCTS AND FINISHED FOODSTUFFS

Rosstat's Commodity Code – corresponding FEACN of the CU Code	Output in 2014, thousand tons	Change in output		Change in imports		Change in exports	
		Physical volume, thousand tons	as %	Physical volume, thousand tons	as %	Physical volume, thousand tons	as %
Slaughtered animal meat and subproducts – FEACN of the CU: 0201- 0206, 0209	1987.6	258.4	13.0	-318.8	-26.5	7.7	48.2
Poultry meat and subproduct foodstuffs – FEACN of the CU: 0207	3941.6	378.4	9.6	-201.1	-44.3	11.9	19.3
Fish (other than canned fish) – FEACN of the CU: 03	2911.0	198.0	6.8	-289.3	-38.1	28.7	2.2
Unrefined sunflower oil and its fractions – FEACN of the CU: 1512	4023.1	-362.1	-9.0	-5.4	-61.5	-231.0	-13.8
Wheat and wheat-and-rye flour– FEACN of the CU: 1101	8925.5	178.5	2.0	-10.5	-29.5	138.4	110.4

Table 2–4 demonstrates the comparative changes, in terms of physical volume, in the behavior of Russia's output (based on Rosstat's data) and that of Russia's foreign trade (based on data released by the Federal Tax Service).

Agriculture and food industry

A comparative analysis of a sample of major groups of agricultural output and the food industry demonstrates that a change in the trade balance, in terms of physical volume, in most cases is significantly offset by a corresponding change in output. However, output growth is higher than the growth of the trade balance only with regard to poultry meat and flour. The imports of these commodity groups declined significantly (by tens of percents), while exports moved in the same direction as output. It should be noted that the consumption¹ of poultry meat increased (by 165,000 tons), while that of slaughtered animal meat decreased (by 68,000 tons), as did the consumption of fish, with the exception of canned products (by 120,000 tons). This fact

Table 3

TRADE AND OUTPUT VOLUME INDICES IN RUSSIA IN 2015 COMPARED TO 2014, WITH REGARD TO SOME TYPES OF LOW VALUE ADDED INDUSTRIAL PRODUCTS

Rosstat's Commodity Code – corresponding FEACN of the CU Code	Output in 2014, m tons	Change in output		Change in imports		Change in exports	
		Physical volume, m tons	%	Physical volume, m tons	%	Physical volume, m tons	%
Plastics, primary forms – FEACN of the CU: 3901-3914	6.68	0.54	8.1	-0.73	-24.3	0.21	16.8
Pig iron – FEACN of the CU: 7201	51.4	2.26	4.4	0.00		0.98	22.5
Gasoline (light distillates) – FEACN of the CU: 271012	38.3	0.9	2.3	-0.9	-55.3	1.0	3.7
Diesel fuel – FEACN of the CU: 27101942, 27101946, 27101948	76.7	-0.8	-1.1	0.0		2.9	6.0
Fuel oil – FEACN of the CU: 27101966, 27101964, 27101962	78.5	-7.0	-8.9	0.0		7.9	12.0

1 The difference between domestic output and trade balance.

Table 4

TRADE AND OUTPUT VOLUME INDICES IN RUSSIA IN 2015 COMPARED TO 2014, WITH REGARD TO SOME TYPES OF TRANSPORT MEANS, HOUSEHOLD UTENSILS AND FOOTWEAR

Rosstat's Commodity Code – corresponding FEACN of the CU Code	Output in 2014	Change in output		Change in imports		Change in exports	
		Physical volume	%	Physical volume	%	Physical volume	%
Tractors for agriculture, forestry, etc. – FEACN of the CU: 870190, 870120 (thousand units)	6.75	-1.61	-23.8	-24.81	-51.9	0.88	29.4
Freight carriages – FEACN of the CU: 8606 (thousand units)	55.15	-25.15	-45.6	-3.45	-71.1	3.62	64.5
Buses and coaches – FEACN of the CU: 8702 (thousand units)	44.22	-7.52	-17.0	-3.61	-75.5	-1.40	-41.2
Freight automobiles (including chassis) – FEACN of the CU: 8704 (thousand units)	153.58	-22.58	-14.7	-39.04	-63.4	-2.45	-10.9
Passenger automobiles – FEACN of the CU: 8703 (m units)	1.68	-0.46	-27.7	-0.35	-50.3	-0.03	-24.6
Refrigerators and freezers for household use – FEACN of the CU: 8418 (m units)	3.70	-0.59	-15.8	-0.74	-32.2	-0.07	-11.3
Television sets (receivers) – FEACN of the CU: 8528 (m units)	16.11	-7.48	-46.4	-8.39	-35.9	-0.54	-33.6
Footwear – FEACN of the CU: 64 (m pairs)	108.14	-17.84	-16.5	-51.48	-19.9	0.004	0.0

points to the replacement, in the consumer basket, of the more expensive animal meat and fish by poultry meat.

Low value added industrial products

A comparative analysis of a sample of major low value added industrial products (*Table 3*) indicates that in 2015, their imports declined significantly while exports increased, and that the movement of output was multi-vec-tored.

Transport means, household utensils, footwear

The outputo indices for the main types of transport means, household utensils and footwear demonstrated two-digit percentage decline (*Table 4*). Imports, in terms of physical volume, of footwear shrank by 1/5, of house-hold utensils – by 1.5 times, transport means – by 2–4 times. Exports of buses and coaches, passenger and freight automobiles also declined sharply, but this decline is negligible when compared to imports and output. These data point to the dwindling demand for automobiles and household utensils (re-frigerators and receivers).●

4. 2015 – THIRD YEAR OF THE INVESTMENT PAUSE

O.Berezinskaya

Following two years of relative stability, in 2015 fixed investments shrank by 8.4%. Analysis of structural features of the investment activity allows to suppose that in 2015 the bottom of the recession was passed. However, without significant positive changes in economic and institutional environment solely slow and weak correction is feasible. In order to get back to the trend of sustainable fixed investment growth, significant increase of their financing through raised funds is required.

In 2015, fixed investment amounted to Rb14.6 trillion. Following minimal real increase posted in 2013 (+0.8%) and small decrease in 2014 (-1.5%), last year fixed investments shrank by 8.4%.

Nominal growth of fixed investments from Rb12.6 trillion in 2012 (eve of the investment pause in Russian economy) to Rb14.6 trillion in 2015 is mainly due to the investment activity of small enterprises and the investment volume beyond direct statistical monitoring methods. Out of Rb2 trillion nominal increase in fixed investments, this segment of Russian economy accounted for Rb1.3 trillion, whereas fixed investments made by medium and large enterprises in the course of three-year investment pause are changing insignificantly and exceed 2012 indicator by merely Rb0.7 trillion.

Table 1

FIXED INVESTMENTS IN CURRENT PRICES, RB TRILLION

	2012	2013	2014	2015	Increase during 3 years
Full circle of organizations, including:	12.6	13.5	13.9	14.6	2.0
Less small enterprises and investments non-observed by direct statistical methods	9.6	10.1	10.4	10.3	0.7
Small enterprises and investments non-observed by direct statistical methods	3.0	3.4	3.5	4.3	1.3

Source: Rosstat.

Giving credit to Rosstat's optimism regarding the investment activity in non-observed segment of the Russian economy, one should register by far weaker investment activity of large and medium enterprises whose activity is directly statistically verifiable. In 2015, investment decrease in this segment constituted 10.2%, which practically coincides with the Ministry of Economic Development projected contraction of fixed investments.

In the context of deepening investment pause, the nominal growth of fixed investment is offset to the price increase. In 2015, enterprises financed the same volume of fixed assets to the tune of Rb14.6 trillion as in 2008 (in real terms investment has not practically changed). But seven years ago it amounted to Rb8.8 trillion. Nominal expansion of investment by 1.7 times was mainly compensated by the price hike during the implementation of the investment projects.

For the second time since 1998 (similar phenomenon was observed solely in pre-crisis year of 1999) enterprises financed more than half of all fixed in-

vestment at the expense of their own funds – 51.1%. By contrast, 2015 was marked by an abysmal record set by the Russian banks regarding support of the investment projects (overall 5.9% in sources of investment financing) and reduced share of state funds (16.8%). In 2014–2015, loans extended by the Russian banks and state funds for the investment purposes have fallen not only as a share in the structure of investment sources but when taken in nominal terms.

Table 2

SOURCES OF FINANCING FIXED INVESTMENT*

	2012	2013	2014	2015
Sources of financing of fixed investment, Rb trillion				
Own funds	4.27	4.55	4.74	5.26
Raised funds, including:	5.32	5.52	5.64	5.02
Russian banks' loans	0.69	0.90	0.83	0.61
Budget and extra budgetary funds	1.75	1.94	1.79	1.73
Structure of sources of investments financing, %				
Own funds	44.5	45.2	45.7	51.1
Raised funds, including:	55.5	54.8	54.3	48.9
Russian banks' loans	7.2	8.9	8.0	5.9
Budget and extra budgetary funds	18.2	19.3	17.2	16.8

*Less small enterprises and investments non-observed by direct statistical methods.

Source: Rosstat.

Nominal increase of fixed assets was due exclusively to the investment in structures and facilities. In the course of 2012–2015, investment in machinery, equipment and means of transport persistently remained at Rb5 trillion per annum and were decreasing in the investment composition. Investment in nonresidential buildings and facilities went up to Rb6.0 trillion after stable Rb5.6 trillion (2012–2014). Finally, investments housing construction are behind the investment growth: they progressively grew in nominal terms from Rb1.5 trillion in 2012 to Rb2.2 trillion in 2015 and in the investment structure – from 12.2% to 15.0%. Precisely investment in housing construction supported by corresponding state programs was the main driver for nominal fixed investment growth in the Russian economy.

Table 3

TYPE OF INVESTMENT IN FIXED ASSETS

	2012	2013	2014	2015
Investment in fixed assets, Rb trillion.				
Investment in housing	1.53	1.68	2.01	2.19
Investment in buildings (less residential) and facilities	5.56	5.58	5.67	6.03
Investment in machinery, equipment and means of transport	4.73	5.21	5.05	5.05
Structure of investment in fixed assets by type, %				
Investment in housing	12.2	12.5	14.5	15.0
Investment in buildings (less residential) and facilities	44.2	41.5	40.7	41.4
Investment in machinery, equipment and means of transport	37.6	38.8	36.3	34.7

Source: Rosstat.

Investment pause of 2013–2015 has become the first longest period of absence of real growth of investments in fixed assets in the last 17 years. Following nearly five-fold real decrease in 1990s, investment have been progressively growing and their increase outpaced GDP and industrial output increment. They stimulated activity in the Russian economy. In 2013–2015, contraction of investment turned out to be more profound than GDP and industrial output reduction. Investment pause significantly reduces demand in economy, thus deteriorating not only its current dynamics but also its prospects.

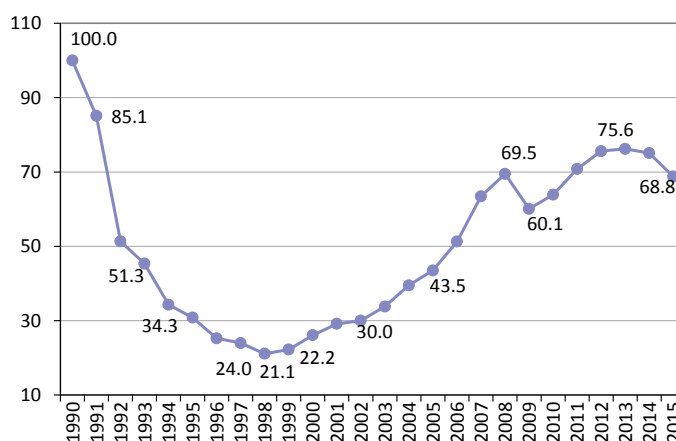
Characterizing prospects of the investment process in the Russian economy in 2016, one can note the following.

Russian enterprises finished 2015 with good financial results. Potential for financing investments from their own funds went up in 2016. At the same time, in 2015 for the first time in recent years a reduction of enterprises' intentions to self-financing of investment was registered. This fact can be of a local character connected with the producers' reaction to a sharp deterioration of economic situation. Any positive changes in the environment (both economic and institutional) can bring back the propensity to self-financing of investment to the previous level and on the back of profit growth and set aside a significant increase of investments at the expense of own resources.

At the same time, bank financing is limited, possibilities of the state to support investment projects of Russian companies are falling and raising resources on the global financial markets is restricted. Financing of investment at the expense of raised funds in recent years was growing slower than self-financing of investment projects. In 2015, it altogether decreased. With high probability, expansion of investment in 2016 will be in the minimal degree connected with their financing from raised funds.

In the absence of significant negative changes in economic and institutional environment in 2016, we can observe somewhat correction of fixed investment trend, which will be possible mainly owing to their financing growth at the expense of own funds. This correction can be buttressed by state programs of incentives in the form of support of targeted credit programs, privileges for self-financing of investment, etc.

However, such growth of investment will turn out to be minimal and correctional at best. Mere self-financing will be insufficient to overcome recession and move to a new path of fixed investment growth. ●



Source: Rosstat.

Fig. 1. Investment in fixed assets in constant prices, 1990 = 100%

5. RESTRICTIONS FOR INDUSTRIAL GROWTH IN 2016: ASSESSMENTS OF ENTERPRISES

S.Tsukhlo

In early 2016, Russian industry found itself in a precarious situation. Production dynamics demonstrate slight changes all around zero. As before, businesses are not ready to take risks in difficult economic and geopolitical conditions and so far prefer to maintain current output volumes. To judge by the way enterprises assess factors, which restrict economic growth, the situation is changing for the worse.

Production plans of Russian industry continue growing more pessimistic and decreased in early 2016 to their 44-months minimum. Resolve of Russian industry to sacrifice output volumes in case of full-scale crisis has gone up by more than 1.5 times compared to 2015. Moreover, at the beginning of the year, businesses more often pointed to such factor as “ambiguity of the current economic situation and its prospects.” Reference to this industrial growth barriers went up in Q1 2016 by 8 p.p. against Q4 2015 and hit 48% firmly taking second place in the rating of restrictions (according to domestic producers). Although despite this factor’s growth, “ambiguity of the existing economic situation and its prospects” has been taking second place for over six quarters (since Q4 2014). At the same time, traditional and accepted by everyone barrier, low domestic demand, “added” merely 1 (one) p.p. and currently hampers 53% of Russian industrial enterprises to increase production.

An unlucky train of factors explains sharp growth of the misunderstanding of the current situation and even of its short-term prospects. Firstly, the slow rolling type of the crisis has deprived the economy of chances for fast entry into the crisis and fast recovery. Secondly, protracted character of the crisis allowed getting to know a very wide and constantly reviewed specter of assessments of the current crisis and forecasts of its development. This most likely misled enterprises then contributed to a better understanding of current situation and its prospects. Thirdly, geopolitical component of the crisis definitely reduced predictability of the economic development.

New regime for the formation of the ruble exchange rate was another reason for the ambiguity growth. Sharp depreciation of the national currency in the context of its dependence on the crude oil price has a considerable and ever increasing negative impact on Russian industry. According to direct assessments of enterprises “understated ruble exchange rate and appreciation of imported equipment and raw materials” in early 2016 restrict the output growth for one third of Russian industry, which positioned this factor in third place on the rating list of 17 factors (Fig. 1). Although in July 2014, barely 10% of producers mentioned this restriction and they positioned it in the pre-crisis year on the ninth or even fourteenth place on the rating list of the same 17 factors.

Low export demand Depreciation of the ruble and appreciation of imported equipment and raw materials

Hopes for the export demand growth following ruble devaluation failed to come true for over than one fourth of domestic producers and positioned the factor “low export demand” on the fourth place in the rating list of restric-

tions for the output growth according to the domestic producers.

It should not be left unmentioned that competition with import has lower impact on the dynamics of industrial production. If in October 2013, import interfered with one third of industrial enterprises then in April 2015 – only 11%, and in January 2016 – 12% of enterprises. Default of 1998 reduced negative impact of this factor to 3-5% and ruble devaluation during the crisis of 2008–2009 – to 9%.

Thus, *ruble devaluation in 2014–2016 has strengthened positions of domestic producers in the markets (more likely – domestic ones) but created problems in the markets of equipment and raw materials*. Especially in the wake of stuck import substitution when there are no Russian analogues.

The last point is proved by a significant growth in early 2016 of such factor as lack of investments. Reference of this factor went up over the quarter by 9 p.p. and hit 22%, taking so far only eighth place on the rating list.

Other factors monitored by the IEP surveys were subject to insignificant changes (in the range of +/-2 p.p.) compared to Q4 2015 including bank loan rated for the industry. In Q4 2015 and Q1 2016 they slowdown output growth of 22–23% of enterprises. At the peak of the credit crisis (Q1 2015) surged to 20.8% annual rates restricted output growth of 31 enterprises.

When analyzing the surveys' results one should take into account the fact that questionnaires are filled out by respondents who occupy positions of different levels and who are differently competent in economic analysis. Our calculations for two position categories of respondents (in the first one are directors of enterprises and their deputies, in the second one are all junior employees) show that the sharp surge of reference "ambiguity of current situation and its prospects" at the beginning of this year against average results posted in 2015 happened solely in the second group (Fig. 2). Growth hit 22 p.p. as a result of which the level of disorientation of the second "echelon" of employees hit record 62% and in this group took the first place overtaking even such a traditional factor as "insufficient domestic demand."

Directors and their deputies have not corrected their level of misunderstanding current situation, which even in 2015 and in early 2016 constituted 36% (second place on the rating list for 2015 and 2016). Thus, directors of Russian industrial enterprises more cool-headedly assessed existing economic situation in early 2016 and, correspondingly, are better prepared to its feasible changes or, on the contrary, stagnation. The most significant and

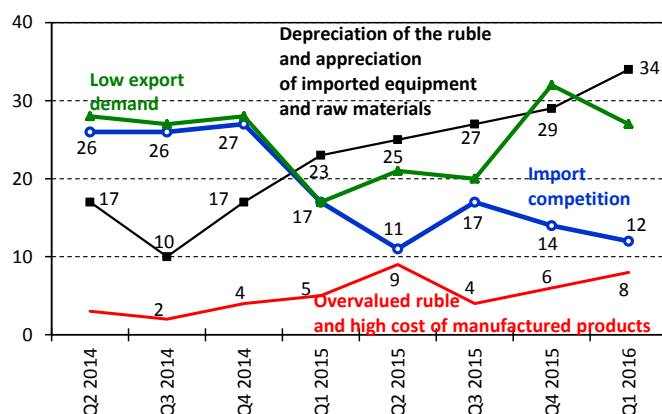


Fig. 1 "Exchange" restrictions of output growth in Russian industry, 2014-2016, %

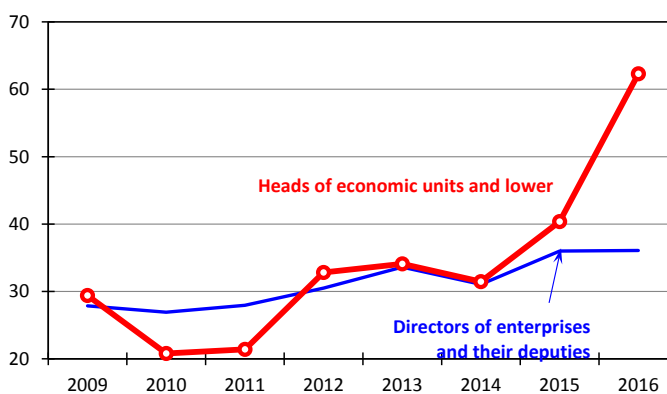


Fig. 2 "Ambiguity of the current economic situation and its prospects" for different position levels of respondents, 2009-2016, %

widespread restriction of industrial growth among upper echelon of enterprises' directors since 2009 remains domestic demand. What is startling, is the fact that its influence on the output volume during 2009-2016 is gradually decreasing.

The same situation is observed regarding assessments of "low export demand" impact on the dynamics of domestic industrial output. Directors of enterprises and their deputies retained their attitude to this factor in 2015–2016 by considering it negative in 19% of cases. Junior employees demonstrated in early 2016 increase of unsatisfactory responses regarding scale of export demand to 37% after an average volume of 27% posted in 2015. Such sharp deviation in assessments of export demand influence on the industrial output in the wake of ruble devaluation and ongoing policy of import substitution can be explained by high and unwarranted optimism for export demand among administrators of the second echelon and less illusions regarding this issue cherished by directors and their deputies. ●

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