

# ONLINE MONITORING OF RUSSIA'S ECONOMIC OUTLOOK

TRENDS AND CHALLENGES OF SOCIO-ECONOMIC DEVELOPMENT

**No. 12(30) July 2016**

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## MAIN TRENDS AND CONCLUSIONS

The diminishing threat of a Fed interest-rate hike (the U.S. central bank seems to become increasingly reluctant to raise the interest rate) and growing doubts that the British ruling class have peace in mind (especially after Boris Johnson's appointment as Foreign Secretary) are not the only but important factors that have an effect on the global economic equilibrium. However, there are factors and facts that can hardly impact the world, but they can make an impressive chapter in textbooks on economics.

There are still plenty of politicians who oppose, silently and openly, the free market in the first quarter of the 21st century, and it's unlikely they will reduce in number in the face of the fact that Venezuela, one of the oil richest countries in the world (its oil resources are not easy to reach though) has been led to the brink of collapse as a result of conscious and deliberate disregard of market economy rules. However, those in doubts have had an opportunity to witness in real time a vivid example of economic suicide. Chronologically, in the final acts of the Venezuelan drama the Defence Minister was put in charge of coping with total deficit as part of the Great Mission for Sovereign and Safe Supply, and 35,000 Venezuelans poured into neighbouring Colombia to buy foods, medicine and toiletries during 14-hour border opening.

Russia, having passed through numerous periods of total deficit, can watch – from a great distance in terms of geography and, hopefully, history – what's going on out there. However, Russia is still exposed to on-and-off calls and recommendations of the kind that may very likely end up as a “sovereign supply”. Indeed, Russia maintains adherence to the basics of market economy (largely non-regulated prices, and a free trade), but it has to manoeuvre with increasing intensity within its shrinking budget and keep watching crude oil price quotations.

Crude oil prices are being very jittery now, which may lead to an assumption that crude will be placed on a new months-long price plateau. Under the circumstances, factors impacting price dynamics tend to fall into small conflicting fragments, which is similar, for example, to the developments observed around the world over the past few weeks: oil production dropped in Texas but increased in Alaska; commercial crude stockpiles diminished, whereas drilling rigs increased in number; the Fed was standing still; attacks on oil-related properties stopped in Nigeria, whereas tensions raised in the South Sudan; Saudi Arabia increased its oil production, but the gains were used entirely to meet the internal demands, and so on down the list, from China's renminbi to the Libyan Tuaregs.

Indeed, the bad thing is that there is still relationship between Russia's budget and the Libyan Tuaregs. The good thing is that the relationship between rouble and crude price quotations has been broken. Oil prices are on the slide, whereas the rouble is stable and even raising. It has been said that the relationship will be kept broken for as long as companies are busy paying dividends and exchanging foreign currency for roubles they need. Anyway, we are witnessing a fairly optimistic correlation between the rouble exchange rate and inflation: the rouble exchange rate rather keeps prices down now, as distinct from what we used to observe over the last two years.

Our experts have analysed the dynamics of consumer prices and the exchange rate pass-through to prices to forecast that Q3 2016 will see no substantial ramp-up in inflation. The experts have forecast that the consumer price index will increase 4.3% by September 2016 (compared to December 2015). In such a case, prices of non-food products are expected to grow faster than those of food products (by 4.9% and 3.4%, respectively). With trends like these, the experts do not expect annual inflation to go beyond 6.5–7%.

However, foreign trade statistics give far less reasons for optimism. This refers to real effects rather than anticipated effects, namely the drastic decline in Russia's exports in the period between January and May 2016. In volume terms, the exports accounted for mere 69.5% of the previous year level (and 49.3% of that in 2014). While exports of primary commodities have remained the same in terms of volume, they have dropped in terms of value not only for fuel commodities but also metals and fertilizers. Exports of grain have topped the list of positive dynamics, whereas exports of highly processed industrial goods have declined both in terms of value and volume despite increased competitive advantages for Russian suppliers as a result of rouble devaluation. According to the experts, the reason is drastic damping of demand in traditional market outlets (CIS countries), administrative barriers to supplies to Ukraine, heavy reliance on imported parts and components, scheduled (i.e. relating to termination of contracts) discontinuation of some large export supplies.

A drastic decline in various industries' export revenue may slash profits for export-led enterprises this year, which in turn may affect their investment potential, because it is self-financing that has a dominant role in enterprises' investments.

The Russian economy has found itself in the so-called "investment break" since 2013, which, according to the experts, is characterized by an increasing role of self-financing at enterprises. Moreover, this trend has been observed since 2010. For example, equity capital was accounted for more than 51% of enterprises' capital investments in 2015 (37% in 2009), whereas budget funds and extra-budgetary funds represented less than 17% of investments (22% in 2009). Traditionally, Russian banks keep playing a small part in this, with bank loans accounting for less than 6% of investment financing (7.2% in 2009). According to experts' estimations, enterprises' own investment resources (net income after taxes and amortisation) increased more than Rb 2 trillion to Rb 14 trillion in 2015. However, less than a half of such resources were turned into investment in real practice, which leads to a conclusion that in 2016 enterprises may spend on capital investments about Rb 6.2 trillion of their equity capital (Rb 6.5 trillion under the best-case scenario), compared to Rb 5.3 trillion in 2015.

Theoretically, personal (household) savings are considered a substantial investment resource, too. According to the prevalent economic and political context, as well as, consequently, available news, individual behaviour models during the past 2–3 years varied between an upsurge in consumer spending, buying foreign exchange, withdrawing funds from bank accounts and a decline in consumption and growth in propensity to save. However, growth in retail bank accounts (and in corporate bank accounts, too) is obviously an insufficient condition for transforming savings into investment. A declining inflation rate, but, more importantly, a steadily low inflation rate may become one of the many factors required for such transformation. ●

## 1. PASS-THROUGH EFFECT: RISE IN PRICES IN Q3 WILL SLOW DOWN

Y. Ponomarev

*The analysis of consumer prices dynamics and the forecast based on the model of exchange rate pass-through effect indicates that in the Q3 2016, one should not expect significant inflation growth. The forecast of price dynamics in consumer segments is quite heterogeneous: the prices of non-food products will grow more (4.9% relative to December 2015) than the prices of food products (3.4% relative to December 2015), while in the latter group, the biggest growth will be observed in products with a significant share of imports among them (fish and seafood, sugar, sunflower oil). If expectations concerning the increase in prices are met and the dynamics of inflation projected for Q3 2016 continues until the end of the year, the level of inflation can stay at 6.5–7% per annum.*

One of the significant effects of changes in the terms of trade that occurred in late 2014 and continued in 2015, which was accompanied by ruble depreciation, was a significant rise in prices observed in all major sectors of the Russian economy<sup>1</sup>.

Much of this rise can be explained<sup>2</sup> by the so-called exchange rate pass-through effect resulting from the law of one price – the equality of prices of tradable goods in different countries adjusted for transportation and transaction costs.

Generally, changes in the exchange rate influence prices through three channels: (1) change in final consumer prices of imported goods, (2) increase in the cost of imported production factors, (3) “reverse” pass-through effect of exchange rate changes due to short-term changes in the competitiveness of domestic tradable goods that can be exported and the growth in demand for them on the part of domestic and foreign consumers<sup>3</sup>.

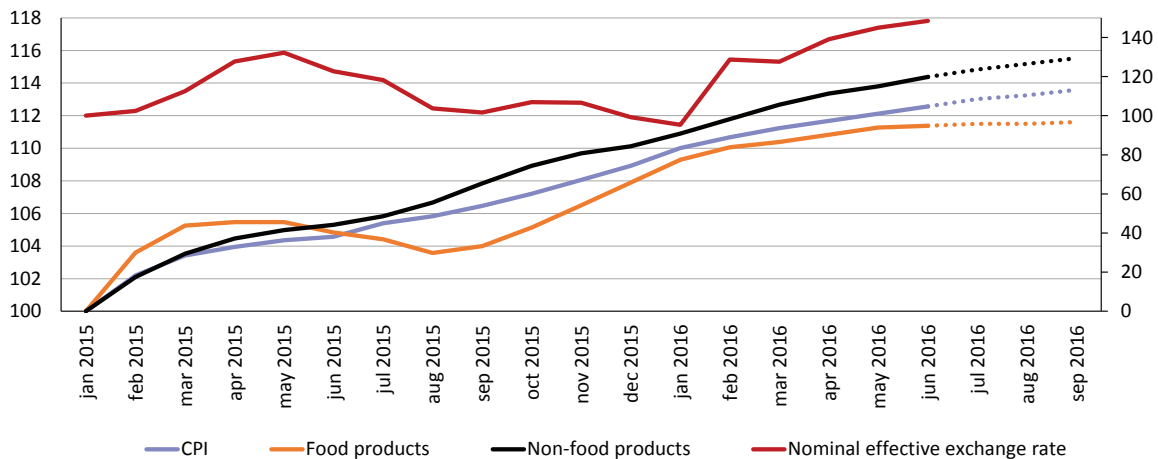
Ultimately, these factors lead to an increase in consumer prices following depreciation of the national currency. The effect from the exchange rate changes appears with some lag, fading over time. This thesis may be illustrated by the graph demonstrating the changes in the consumer price index and the price indices for food and non-food products (*Fig. 1*).

As can be seen from the graph, the greatest effect from the ruble depreciation in the end of 2014 was observed in Q1 2015. Then, consumer price inflation decreased, which was due to the relative stabilization of the exchange

1 See Idrisov G., Kaukin A., Ponomarev Y. Pass-through effect: Rise in prices in the production sector will continue // Real-time monitoring of the economic situation in Russia. Trends and challenges of social and economic development, No.4 (March) 2015.

2 Ponomarev Y., Trunin P., Ulyukayev A. Exchange rate pass-through in Russia // *Voprosy Ekonomiki*, No.3. 2014.

3 For example, ruble depreciation in the case of domestic products which can be supplied to the domestic market as well as for export will lead to “raising” of domestic prices of these products to the level of world prices expressed in roubles due to increased demand for them on the part of domestic and foreign consumers; this will provide equal profitability of supplies to the domestic and foreign markets.



NB: The dotted line denotes the forecast of indices for 2016.

Sources: Rosstat, author's calculations.

Fig. 1. The dynamics of the ruble nominal effective exchange rate (right axis), indices of consumer prices in 2015, and forecast for Q3 2016, calculated on the basis of the exchange rate pass-through effect (January 2015 = 100)

rate in Q2. Slowdown in growth rates in the non-food sector was much less significant than that in the food sector.

The new round of decline in oil prices and the corresponding ruble depreciation in autumn 2015 led to an acceleration of growth of consumer prices, but the subsequent recovery in oil spot prices since the beginning of 2016 led to moderate ruble strengthening<sup>1</sup>. Due to the asymmetry of the pass-through effect<sup>2</sup>, this ruble appreciation will put downward pressure on inflation, but not as significant in absolute terms as in case of inflation acceleration due to weakening ruble. At the same time, the consumer inflation forecast suggests that in the short term (Q3 2016), significant acceleration of rise in prices should not be expected.

According to the forecast (Table 1), the consumer price index will rise by 4.3% by September 2016 in relation to December 2015; the rise will be somewhat more substantial in some commodity groups. Among the leaders, there are: sugar – its price will grow by 11.6%, fish and seafood – by 9.3%, sunflower oil – by 7.4%. These commodity groups belong to those most dependent on supplies of imported products.

If expectations concerning the prices increase are met and the dynamics of inflation projected for Q3 2016 continues until the end of the year, the level of inflation can stay at 6.5–7% per annum. It should be clarified, however, that the forecast is highly reliable only for the next few months, because at the longer time interval, effects of future changes in the exchange rate will play a significant role.

1 Brent crude oil price rose from \$29 per barrel in mid-January 2016 to more than \$50 per barrel in end-June 2016. Strengthening of the nominal effective exchange rate January to June 2016 was 55.7%. Ruble nominal effective exchange rate strengthening in January–June 2016 was 55.7%.

2 Oppositely directed changes (strengthening and weakening) of exchange rate have a different impact, in absolute value, on domestic prices in the Russian economy. For details, see: Ponomarev Y., Trunin P., Ulyukayev A. Exchange rate pass-through in Russia // Voprosy Ekonomiki, No.3. 2014.

Table 1

ACTUAL CHANGES AND FORECAST OF INCREASE IN CONSUMER PRICES  
IN Q1–3 2016, % OF THE PRECEDING MONTH

|  | Apr   | May   | Jun   | Jul   | Aug   | Sep   |
|--|-------|-------|-------|-------|-------|-------|
| CPI  | 100.4 | 100.4 | 100.4 | 100.4 | 100.2 | 100.3 |
| Food products                                    | 100.4 | 100.4 | 100.1 | 100.1 | 100.0 | 100.1 |
| Non-food products                                | 100.6 | 100.4 | 100.5 | 100.4 | 100.3 | 100.3 |
| Alcoholic beverages                              | 100.8 | 100.4 | 100.6 | 100.5 | 100.6 | 100.5 |
| Grain and legumes                                | 102.1 | 102.9 | 101.9 | 101.6 | 102.0 | 102.3 |
| Pasta  | 100.8 | 100.2 | 100.5 | 100.6 | 100.5 | 100.9 |
| Sunflower oil, kg                                | 101.0 | 100.6 | 100.0 | 100.2 | 101.1 | 101.7 |
| Butter, kg                                       | 100.7 | 100.3 | 100.2 | 100.3 | 100.4 | 100.6 |
| Milk and dairy products                          | 100.6 | 100.2 | 100.1 | 100.0 | 100.1 | 100.2 |
| Meat and poultry                                 | 99.7  | 100.0 | 99.8  | 99.9  | 100.0 | 100.1 |
| Fruit and vegetable products, including potatoes | 99.9  | 100.6 | 98.9  | 98.4  | 95.0  | 100.1 |
| Fish and seafood                                 | 101.0 | 101.1 | 100.7 | 100.5 | 100.9 | 101.1 |
| Sugar, kg  | 98.0  | 98.5  | 102.4 | 102.5 | 103.4 | 101.6 |
| Eggs   | 97.1  | 91.7  | 92.0  | 94.4  | 97.3  | 99.8  |

NB: Italics denotes the forecast of indices for 2016, calculated on the basis of the exchange rate pass-through effect.

Sources: Rosstat, own calculations.

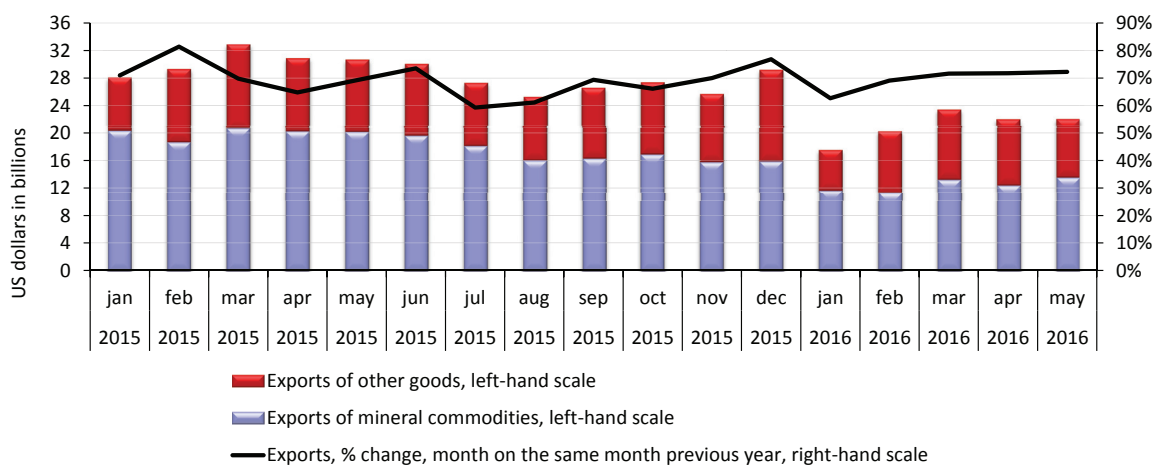
## 2. RUSSIA'S EXPORTS IN JANUARY–MAY 2016: FACTORS OF DECLINE

A. Knobel, A. Firanchyuk

Russia's exports continued to fall in May 2016, accounting (in January–May 2016) for 69.5% of the level seen in January–May 2015. Primary commodity exports continued to decline, with exports remaining stable in terms of volume, due to falling global prices of fuel commodities, fertilizers, metals. Exports of wheat and meslin (a mixture of wheat and rye) almost doubled in terms of volume despite nose-diving grain prices. Exports of highly processed industrial products fell in January–May 2016 despite strengthening competitive advantages as a result of the rouble devaluation. The foregoing developments were driven by slumping demand in traditional markets (CIS countries); administrative barriers to supplies to Ukraine; heavy reliance on imported spare parts; Ukraine forcing Russia's products out of external markets (in the railway sector); scheduled termination of some major export contracts (supplies of components for a German supercomputer project).

In May 2016, exports continued to fall compared to 2015 (Fig. 1). In terms of value, exports dropped to \$105.6bn in M5 2016 (which represents 69.5% of the 2015 level and 49.3% of the 2014 level). Furthermore, the decline hit not only energy commodities but also non-energy medium and highly processed products: exports of non-mineral commodities dropped to \$43.0bn (which represents 83.3% of the 2015 level and 75.3% of the 2014 level).

Exports expressed in terms of dollars decreased for 7 of the 10 major aggregated analytical commodity groups selected by Russia's customs service (Table 1). In terms of value, exports increased only for food products and agricultural raw materials (except textile raw material) (up 6%); weapons and ammunition (up 11%), precious metals and stones, textile fabric, textiles and footwear (up 11%) contributed most within the 'Other goods' commodity



Source: own calculations based on the data released by Russia's Federal Customs Service.

Fig. 1. Dynamics of Russia's exports in 2015–2016



## 2. RUSSIA'S EXPORTS IN JANUARY–MAY 2016: FACTORS OF DECLINE

group. Fuels contributed most to the negative dynamics of exports, accounting for about 80% of the total decline (\$37.9bn out of \$46.6bn).

Table 1

### RUSSIA'S EXPORTS BY COMMODITY GROUP IN JANUARY–MAY 2016

| Commodity group  | M5 2015                | M5 2016 | Change in terms of value | Growth rates, % |
|--|------------------------|---------|--------------------------|-----------------|
|  | US dollars in millions |         |                          |                 |
| Food products and agricultural raw materials (except textile raw material) | 5.896                  | 6.270   | 374                      | +6,3            |
| Mineral commodities  | 100.411                | 62.465  | -37.946                  | -38             |
| Chemical products, rubber  | 10.658                 | 8.305   | -2.353                   | -22             |
| Raw hides and skins, furs and articles thereof                             | 164                    | 132     | -32                      | -19             |
| Wood in the rough and pulp and paper products                              | 4.025                  | 3.949   | -75                      | -1,9            |
| Textile fabric, textiles and footwear                                      | 296                    | 329     | 33                       | +11             |
| Precious metals and stones and articles thereof                            | 3.864                  | 3.783   | -81                      | -2,1            |
| Metals and metal products  | 15.159                 | 10.844  | -4.316                   | -28             |
| Machinery, equipment, means of transport                                   | 9.541                  | 7.137   | -2.404                   | -25             |
| Other goods  | 2.029                  | 2.257   | 228                      | +11             |
| Exports, total   | 152.043                | 105.471 | -46.571                  | -31             |

Source: own calculations based on the data released by Russia's Federal Customs Service.

The nominal exchange rate of the rouble against the US dollar and the euro weakened about 18% (in January–May 2016, the US dollar was traded at 71.3 roubles compared to 58.4 roubles in January–May 2015, and the euro was traded at 79.5 roubles compared to 65.0 roubles in January–May 2015). According to the Bank of Russia, the index of nominal exchange rate of the rouble against foreign currencies in January–May 2016 decreased by 13.4% from January–May 2015 (down 8.8% for the ruble real effective exchange rate)<sup>1</sup>. This could have had a positive effect on exports due to enhanced competitiveness, but exports continued to fall anyway.

The dynamics of **primary** commodity exports can be well explained by changes in terms of trade for Russia (prices of the key export commodities). Supplies of most these commodities increased in terms of volume: (pipeline) natural gas (up 8%), crude oil (up 5%), hard coal (up 3%) (Table 2).

**Food products and agricultural raw materials.** Note that supplies of grain (wheat and meslin) increased considerably amid slumping prices (down 23% for wheat) due to rapid growth in supplies in terms of volume, accounting for 93%, although wheat exports were partially restricted by a high wheat export duty in 2015.

Falling export prices were the main culprit for substantial devaluation of exported **metals** (down \$4.3bn or 28%). Exports remained unchanged in terms of volume: exports increased a bit for some items (pig iron, flat-rolled carbon steel products, nickel) and decreased slightly for others (ferro-alloys, carbon steel semi-finished products, copper, aluminium). A broad supply of various types of inexpensive, high-grade steel products from China was the main obstacle to expansion of exports, which is determined, among other

<sup>1</sup> Russia's central bank: Basic Derived Indicators of Ruble's Exchange Rate Dynamics in 2016.

Table 2

## CHANGE IN PRICES AND VOLUMES OF SUPPLIES OF KEY EXPORTED GOODS

| FEACN CODE                                   | Item  | Price        |              | Price change, % | Change in volume, % | Change in value % | Share of exports in Jan-May 2016 |
|--|---|--------------|--------------|-----------------|---------------------|-------------------|----------------------------------|
|  |   | Jan-May 2015 | Jan-May 2016 |                 |                     |                   |                                  |
| Food products:                               |   |              |              |                 |                     |                   |                                  |
| 1001   | Wheat and meslin, \$ per tonne  | 227          | 175          | -23             | 93                  | 48                | 1.4                              |
| Fuels:                                       |   |              |              |                 |                     |                   |                                  |
| 2701   | Hard coal, \$ per tonne   | 68           | 51           | -25             | 3                   | -23               | 2.9                              |
| 2709   | Crude oil, \$ per tonne   | 394          | 247          | -37             | 5                   | -34               | 24.6                             |
| 2710   | Petrochemicals, \$ per tonne  | 423          | 252          | -40             | -13                 | -48               | 15.9                             |
| 2711110000                                   | Liquefied natural gas, cbm  | 278          | 147          | -47             | 19                  | -37               | 1.5                              |
| 2711210000                                   | Natural gas, tcm  | 250          | 159          | -36             | 8                   | -31               | 12.1                             |
| Chemical products:                           |   |              |              |                 |                     |                   |                                  |
| 3102   | Nitrogenous fertilizers, \$ per tonne   | 255          | 190          | -25             | 20                  | -11               | 0.9                              |
| 3104   | Potassic fertilizers, \$ per tonne  | 268          | 223          | -17             | -35                 | -46               | 0.8                              |
| 3105   | Mixed fertilizers, \$ per tonne   | 371          | 311          | -16             | 3                   | -14               | 1.1                              |
| 2814100000                                   | Anhydrous ammonia, \$ per tonne   | 434          | 263          | -39             | 22                  | -26               | 0.4                              |
| 4002   | Synthetic rubber, \$ per tonne  | 1.484        | 1.216        | -18             | 7                   | -12               | 0.5                              |
| Wood and products of wood:                   |   |              |              |                 |                     |                   |                                  |
| 4403   | Wood in the rough, cbm  | 75           | 69           | -9              | 9                   | -1                | 0.5                              |
| 4407   | Timber, cbm   | 229          | 192          | -16             | 14                  | -4                | 1.2                              |
| 4412   | Plywood, cbm  | 475          | 373          | -21             | 19                  | -7                | 0.4                              |
| 4702-4704                                    | Wood pulp, \$ per tonne   | 530          | 519          | -2              | 5                   | 3                 | 0.4                              |
| 4801   | Newsprint, \$ per tonne   | 417          | 391          | -6              | -8                  | -14               | 0.2                              |
| Metals and metal products:                   |   |              |              |                 |                     |                   |                                  |
| 72   | Ferrous metals, \$ per tonne  | 398          | 287          | -28             | -1                  | -28               | 4.7                              |
| 72 (except 7201-7204)                        | Ferrous metals (except pig iron, ferro-alloys, waste and scrap), \$ per tonne                   | 420          | 303          | -28             | 0                   | -28               | 3.4                              |
| 7201   | Pig iron, \$ per tonne  | 314          | 193          | -38             | 8                   | -34               | 0.4                              |
| 7202   | Ferro-alloys, \$ per tonne  | 1.784        | 1.545        | -13             | -1                  | -14               | 0.4                              |
| 7207   | Carbon steel semi-finished products, \$ per tonne   | 359          | 248          | -31             | -3                  | -33               | 1.4                              |
| 7208-7212                                    | Flat-rolled carbon steel products, \$ per tonne   | 447          | 317          | -29             | 1                   | -29               | 1.0                              |
| 7403   | Refined copper, \$ per tonne  | 5.917        | 4.626        | -22             | -9                  | -29               | 0.9                              |
| 7502   | Rough nickel, \$ per tonne  | 13.596       | 8.432        | -38             | 1                   | -37               | 0.7                              |
| 7601   | Rough aluminium, \$ per tonne   | 2.071        | 1.401        | -32             | -6                  | -37               | 1.9                              |
| Machinery, equipment and means of transport: |   |              |              |                 |                     |                   |                                  |
| 840130                                       | Fresh (non-irradiated) fuel rods, thousands \$ a piece  | 493.7        | 486.6        | -1              | -40                 | -40               | 0.28                             |
| 8411123009                                   | Other gas-fired turbines, more than 44 kN but not more than 132 kN, thousands \$ a piece        | 3.822        | 3.230        | -15             | 25                  | 5                 | 0.34                             |
| 8450111100                                   | Household washing machines, pieces  | 184          | 162          | -12             | 112                 | 86                | 0.05                             |
| 85287240                                     | LCD television receivers, pieces  | 330          | 260          | -21             | -10                 | -29               | 0.04                             |
| 8526100009                                   | Radar equipment, thousands \$ a piece   | 250          | 338          | 35              | 60                  | 117               | 0.19                             |
| 860692                                       | Open-top railway cars, pieces   | 16.957       | 15.669       | -8              | -42                 | -47               | 0.02                             |
| 8703231910                                   | Moto vehicles with engine displacement of more than 1500 cm3 but not more than 1800 cm3, pieces | 7.401        | 7.137        | -4              | -48                 | -50               | 0.11                             |
| 8704229108                                   | Cargo vehicles with gross weight of 5-20 tonnes, others, pieces                                 | 30.447       | 32.505       | 7               | -12                 | -6                | 0.05                             |

Source: own calculations based on the data released by Russia's Federal Customs Service.

things, by various forms of state support and by restrictions on Russian products in a few countries. Moreover, demand in some important markets (e.g., Kazakhstan and Belarus) was lower than that in 2015.

Falling prices of fertilizers (down 15–25% for all types of fertilizers), discontinuation of exports of precious metal compounds (replaced with exports in the form of metals), falling prices of petrochemicals (monomers, alcohols, ammonium, synthetic rubber) were the key drivers of negative dynamics of **chemical product** exports.

Overall, in terms value, the decline in exports of food and agricultural products, energy commodities and medium processed products (chemical products, non-precious metals and metal products) can be well explained by the downtrend in prices for Russian exporters.

In terms of volume, the decline in supplies was the key factor that affected the decline in exports of **machinery, equipment and means of transport**. The decline that took place despite the rouble devaluation in both nominal and real terms can be explained by a variety of factors.

*Firstly*, a big part of exports of machinery and equipment (84-87 and 89-92 commodity groups) to countries of the “far abroad” in 2015 was related to the supplies for the German supercomputer project (in which Russia had a small value added) (the supplies were worth about \$1.4bn in January–May 2015, which affected the basic level).

*Secondly*, the substantial decline, in terms of volume, in supplies of machinery, equipment and means of transport, as well as other goods (basically finished industrial products) was also driven by weakening demand. In Kazakhstan and Azerbaijan, the decline was related to falling crude prices. For example, motor vehicle imports to Kazakhstan from all countries dropped by 72%, from Russia by 76%; the same is true for railway transport. In Ukraine, demand weakened due to the lingering economic crisis. In Belarus, demand dropped due heavy reliance on the Russian market driven by downward trends.

*Thirdly*, restrictions on exports to the Ukrainian market continued to be in effect. Furthermore, Ukraine is purposefully focused on replacing imports from Russian with imports from other countries – for example in the nuclear industry<sup>1</sup>. Note that, considering similar technical characteristics and target markets, there is a budding tendency for Ukraine to force Russian railway transport exports out of external markets: in January–April 2016, Ukraine’s gross exports of railway transport increased 17% (to \$80m) in terms of volume, whereas Russia’s gross exports dropped 37% (to \$121m).

*Fourthly*, with small volumes of Russian supplies, exports of machinery and equipment in this group are sensitive to certain developments such as termination of some contracts, loss of a market with no alternative found<sup>2</sup>. Following listed are some of the facts that illustrate no growth or decline in supplies in terms of volume in January–May 2016 compared to January–May 2015:

1 For more details please refer to *Kazaryan M.O., Knobel A.Y.* Risks and potential effects of breaking up trade and economic cooperation on enterprises in Russia and Ukraine // ‘Russian Entrepreneurship’ 2016, No.17, Vol. 2, pp. 155–166.

2 For more details please refer to *Knobel A.Y., Kuznetsov D.E.* Some indicators of Russia’s exports at the level of selected exporters // ‘Russian Entrepreneurship’ 2016, No.17, Vol. 3, pp. 339–350.

- 2.5-fold cutback in supplies of railway cars (86 FEACN) to Kazakhstan and 3–4-fold cutback in supplies of means of land transport (87 FEACN);
- Substantial (9-fold) cutback in supplies of railway transport spare parts to the United States;
- Substantial (approx. 10-fold) cutback in supplies of railway cars and spare parts to Azerbaijan by Russian companies such as UralVagon-Zavod, Metrowagonmash and Novozybkovsk Machine-Building Plant;
- Substantial cutback in supplies, in terms of volume, of cargo vehicles and spare parts to Turkmenistan by Kamaz company;
- Almost complete discontinuation of supplying marine tankers, floating or underwater drilling platforms to the Netherlands by companies such as SCF Prirazlomnoye (LLC) and Gazpromneft-Sakhalin (LLC);
- Almost complete discontinuation of supplying vessels and tug-boats to Singapore;
- Termination of the contract on supplying supercomputer components to Germany by Russian T-Platforms (OJSC).

Exports of commodity groups that include many products for military purposes was driven by negative dynamics, too. Supplies of wheeled vehicles, including combat vehicles (87 commodity group), decreased by \$0.39bn or 26%. Traditionally, weapon supplies vary substantially from quarter to quarter, according to deadlines of major contracts<sup>1</sup>.

*Fifthly*, unlike in January–April 2015, the decline of *exports* in terms of volume in January–April 2016 was by far deeper than the decline in *production* volumes for corresponding products (*Table 3*). With declining imports, this suggests an increase in internal consumption of domestically manufactured products, and in particular retargeting demand from imports towards internal supplies.

*Table 3*

INDICES OF EXPORTS, IMPORTS AND PRODUCTION IN TERMS OF VOLUME FOR MANUFACTURING INDUSTRIES THAT MANUFACTURE HIGHLY PROCESSED PRODUCTS IN JANUARY–APRIL 2016 COMPARED TO JANUARY–APRIL 2015

| Industry  | Export volume index | Import volume index | Industrial production index |
|---|---------------------|---------------------|-----------------------------|
| Subsection DK Manufacture of machinery and equipment                      | 96.7                | 100.5               | 104.4                       |
| Subsection DL Manufacture of electrical, electronic and optical equipment | 71.7                | 97.8                | 96.7                        |
| Subsection DM Manufacture of means of transport and equipment             | 84.9                | 80.6                | 95.8                        |
| Subsection DN Other industries  | 69.5                | 85.4                | 90.0                        |

*Source:* own calculations based on the data released by Russia's Federal State Statistics Service and Federal Customs Service.

*Sixthly*, an important factor is some industries' heavy reliance on costs of imported spare parts (*Table 4*), especially in the manufacturing industry, namely the manufacture of means of transport (with imports accounting for 40%), machinery and equipment (for 36%), textiles (for 29%), which diminishes the possibility to harness competitive advantages achieved through

<sup>1</sup> See also *Knobel A., Firanchyukl A. Russia's industrial and foreign trade dynamics // Russian Economic Developments, 2016, No.4, pp. 27–32; Firanchyukl A.. Russia's foreign trade dynamics // Russian Economic Developments. 2016. No.6, pp. 18–22.*

the rouble devaluation. Rouble-denominated export revenue tend to increase with a weakening rouble, but the costs themselves grow faster than the share of imports thereof. Thus, the heavier the reliance on imports, the slower the growth of competitive advantages<sup>1</sup>.

Table 4

SHARE OF IMPORTED RAW MATERIALS, MATERIALS, PURCHASED ITEMS FOR PRODUCTION AND SALE OF PRODUCTS (GOODS, WORKS, SERVICES) OF EXPENDITURE (ACCORDING TO THE 2014 DATA), %

| Industry  |    |
|---|----|
| Subsection DM Manufacture of means of transport and equipment                   | 40 |
| Subsection BA Fishing and aquaculture   | 38 |
| Subsection DK Manufacture of machinery and equipment                            | 36 |
| Subsection DB Manufacture of textiles and wearing apparel                       | 29 |
| Subsection DH Manufacture of rubber and plastic products                        | 28 |
| Subsection DE Manufacture of pulp, paper and paperboard                         | 23 |
| Subsection DL Manufacture of electrical, electronic and optical equipment       | 22 |
| Subsection DG Manufacture of chemicals and chemical products                    | 16 |
| Subsection DA Manufacture of food products                                      | 16 |
| Subsection DC Manufacture of leather, leather goods and manufacture of footwear | 14 |
| Subsection DI Manufacture of other non-metallic products                        | 11 |
| Subsection DJ Manufacture of metals   | 10 |
| Subsection DD Woodworking and manufacture of goods                              | 10 |

Source: calculations based on the data released by Russia's Federal State Statistics Service.

1 For more details please refer to *Idrisov G., Kaukin A. Russia's industry in Q1 2016 // Russian Economic Developments, 2016, No.5, pp. 24–28.*

### 3. SOURCES OF FIXED INVESTMENT: CHARACTERISTICS OF INVESTMENT PAUSE

O. Berezinskaya, M. Chromov

*The Russian economy entered a period of investment pause in 2013. In terms of financial resources available for the investment process, it is characterized by substantial increase in enterprise self-financing for investment projects with cutbacks in financing through external borrowing. The foregoing developments were observed amid shrinkage of financial resources available in the economy. Activating the investment process through economic enterprises' own resources is an option that can alleviate the investment decline.*

The issue of limited resources is still relevant in discussions on fixed investment that have been held in recent years. In 2014/2015, the investment process became more limited for Russia and the economy was found itself in the investment pause.

Gross disposable income – GDP (volume) adjusted for BOP non-trade current account transactions, representing all the current year earnings of economic agents – forms the basis for generating financial resources in the economy.

Final consumption expenditure derive from gross disposable income, and the remainder of financial resources make up gross savings in the economy. Comparing gross savings with gross accumulation (a broad definition of fixed investment, including fixed asset renewal costs (repairs) as well as changes in inventories) shows the extent to which savings are transformed into investment in the economy. The difference between these indicators represents net credit to the rest of the world.

However, besides gross savings, funds raised from foreign investors can be harnessed as resources for investment, too. Besides gross accumulation, investment in foreign assets is an alternative way of allocating financial resources.

Since the mid-2000s, there has been correlation between the dynamics of fixed investment and the volume of financial resources available in the Russian economy (a total of gross savings and funds raised from abroad). This substantiates the apparent regularity: declining savings and a lack of external loans tend to spur a decline in investment. The financial resources available in the Russian economy were facing a steady decline from 31% of GDP in 2011 down to 19% of GDP in 2015. Considering the same period, the dynamics of fixed investment worsened from a hike of 10.8% in 2011 down to a fall of 8.4% in 2015.

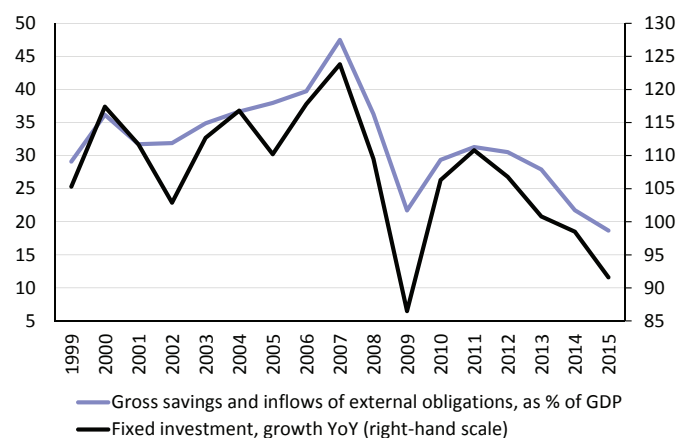


Fig. 1. Investment dynamics and share of financial resources available in the economy of Russia

### 3. SOURCES OF FIXED INVESTMENT: CHARACTERISTICS OF INVESTMENT PAUSE

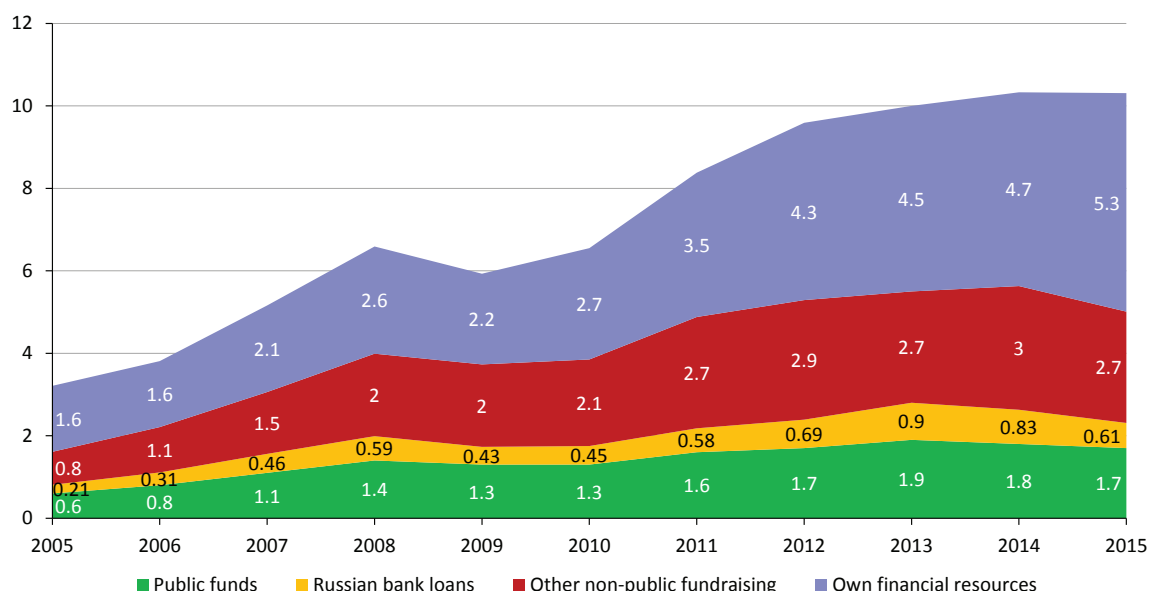
Economic enterprises' own resources were the major source of finance for fixed investment in the period between 1999 and 2015. Since 2010 they have been playing an increasingly important role in providing resources for the investment process.

Up until 2009, the expansion of fixed investment was governed by growth in financing from raising non-public funds, with public funds becoming less important in supporting the investment process and with slower growth in enterprises' self-financing for investment projects.

The expansion of fixed investment in the period between 2010 and 2015 was driven mainly by growth in financing fixed investment from enterprises' own resources amid unstable dynamics of investment project financing from Russian bank loans, as well as deteriorated dynamics of raising other non-public funds and of state support to economic enterprises with regard to fixed investment.

In the period between 2013 and 2015, fixed investment financing was characterized as follows:

- more than 51% of fixed investments were financed from enterprises' own resources (37% in 2009), and enterprises' self-financing for investment projects continued to grow at faster than normal rates;
- state support to the investment process decreased, less than 17% of investments were financed from *budget and off-budget funds* (22% in 2009);
- Russian bank investment loans continued to be weak and unstable: *Russian bank loans* accounted for less than 6% of investment financing (7.2% in 2009);
- investment financing from *funds allocated by senior organizations* (e.g., holding companies) dropped sharply to account for 10.5% of the investment source structure in 2015 compared to 17.8% in the period



**Note:** Public funds refer to budget and off-budget funds; Other non-public fundraising refer to all the funds raised, except Russian bank loans and public funds.

Sources: Rosstat (Russia's Federal State Statistics Service), own calculations.

Fig. 2. Structure of sources of finance for fixed investment in the Russian economy in 2005–2015, roubles in trillion



between 2010 and 2012; this was due to sanctions that restrict Russian companies' access to financial resources in global markets;

- investments from *other resources* (e.g., borrowings from other organizations, fundraising through stocks, corporate bonds) increased at the start of the investment pause and remained unchanged in 2015, that is, economic enterprises had extremely limited opportunities to compensate for the lack of financing from alternative sources.

Fixed investment finance faced substantially limited resources in the period between 2013 and 2015. The crisis-hit structure of sources of fixed investment finance was driven by a few factors: the state was less able to support the investment process, banks enhanced diligence in long-term lending in the period of economic downturn, enterprises of the real and financial sectors of the Russian economy were restricted from accessing financial resources in global markets. More than a half of all the fixed investments were financed from enterprises' own resources.

In the period of investment pause, with severely limited resources, enterprises' self-financing for investment projects is considered basically the sole real resource that can boost the investment process in the Russian economy. To kick off this resource, (1) economic enterprises' own resources for investment should be generated in increasing volumes, and (2) their motivation to invest own resources in business development should be elevated.

In 2014, the volume of economic enterprises' own resources for investment amounted to Rb 11.8 trillion, that is, a total of amortization and disposable profit (profit left over after paying profit tax). Importantly, in 2012–2013 enterprises' own resources for investment increased insignificantly by Rb 0.5 trillion a year, in 2014 they increased by Rb 1.7 trillion, and in 2015 they exceeded, according to our estimations, Rb 2 trillion (no 2015 end-of-year statistics are available yet).

Table 1

GENERATION OF OWN RESOURCES FOR INVESTMENT  
IN THE RUSSIAN ECONOMY IN 2011–2015

|  | 2011 | 2012 | 2013 | 2014 | 2015  |
|--|------|------|------|------|-------|
| Profit, roubles in trillions   | 8.5  | 8.8  | 8.4  | 9.4  | 11.3  |
| Profit tax paid, roubles in trillions  | 2.3  | 2.4  | 2.1  | 2.3  | 2.4   |
| Disposable profit, roubles in trillions<br>(line 1 less line 2)                | 6.3  | 6.4  | 6.4  | 7.3  | 8.8   |
| Amortization, roubles in trillions   | 2.8  | 3.3  | 3.7  | 4.7  | 5.2*  |
| Own resources for investment, roubles in trillions<br>(total of lines 3 and 4) | 9.1  | 9.7  | 10.1 | 11.8 | 14.0* |

\* own estimations.

Sources: Rosstat, FCS (Russia's Federal Customs Service), own calculations.

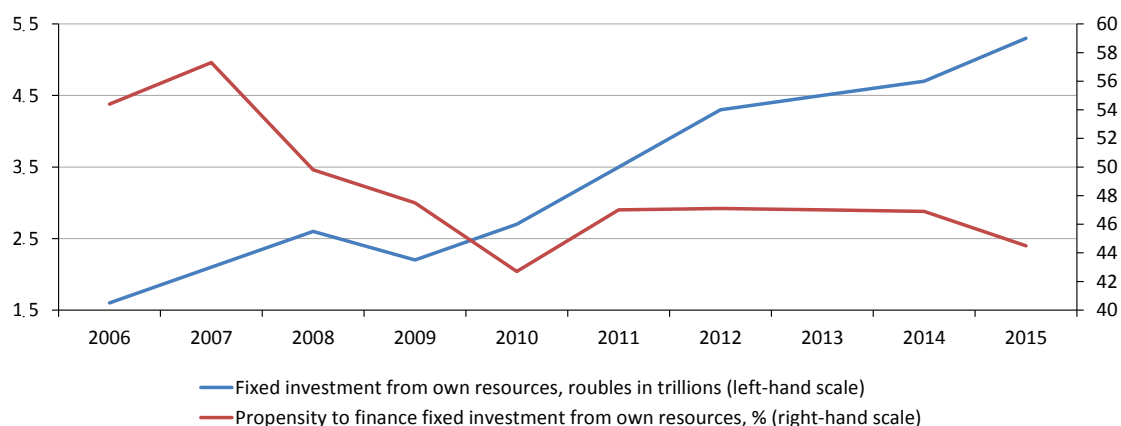
Enterprises' self-financing for investment projects has increased in terms of utility amid severely restricted access to resources, and economic enterprises do have an opportunity to activate the investment process using their own resources.

The propensity to finance investment from own resources (the ratio of fixed investment from own resources to the volume of own investment resources earned in previous year) for a few years stood at a stable level of about 47%, but in 2015 it dropped markedly down to 44.5%.

With the same level of enterprises' propensity to finance investments from own resources, fixed investment from own resources in 2015 would,



### 3. SOURCES OF FIXED INVESTMENT: CHARACTERISTICS OF INVESTMENT PAUSE



Sources: Rosstat, own calculations.

Fig. 3. Dynamics of fixed investment financing from own resources and economic enterprises' propensity to finance investments from own resources in 2006–2015

according to our estimations, equal Rb 5.6 trillion, adding Rb 0.3 trillion to the actual volume.

The decline may be of local nature and for a short period of time, like that in 2009, and recovery to economically normal level of enterprises' propensity to finance investments from own resources can generate about Rb 6.6 trillion of fixed investment from enterprises' own resources in 2016.

However, this also may be the beginning of a longer period of decline in enterprises' propensity to finance fixed investment from own resources due to deterioration of the business climate (both general economic situation and adverse trends in the investment climate). With enterprises' propensity to finance investment projects from own resources staying as low as 44.5% in 2016 and based on the estimated volume of own resources for investment generated in 2015, one can expect fixed investment from enterprises' own resources to run at about Rb 6.2 trillion.

Economic enterprises, based on the disposable profit generated in 2015, have great opportunities to increase self-financing for fixed investment in 2016. Investment from enterprises' own resources may grow by Rb 1.3 trillion under the best-case scenario, and by nearly Rb 1 trillion under the business-as-usual scenario, which may contribute about 6.5–9% of nominal growth in fixed investment.

Within the period of investment pause, 2016 may turn out to be the year of most active nominal expansion of fixed investment. ●

## 4. STRATEGIES OF FINANCIAL BEHAVIOUR OF THE POPULATION: UNDER THE PRESSURE OF “NEWS-DRIVEN ECONOMY”

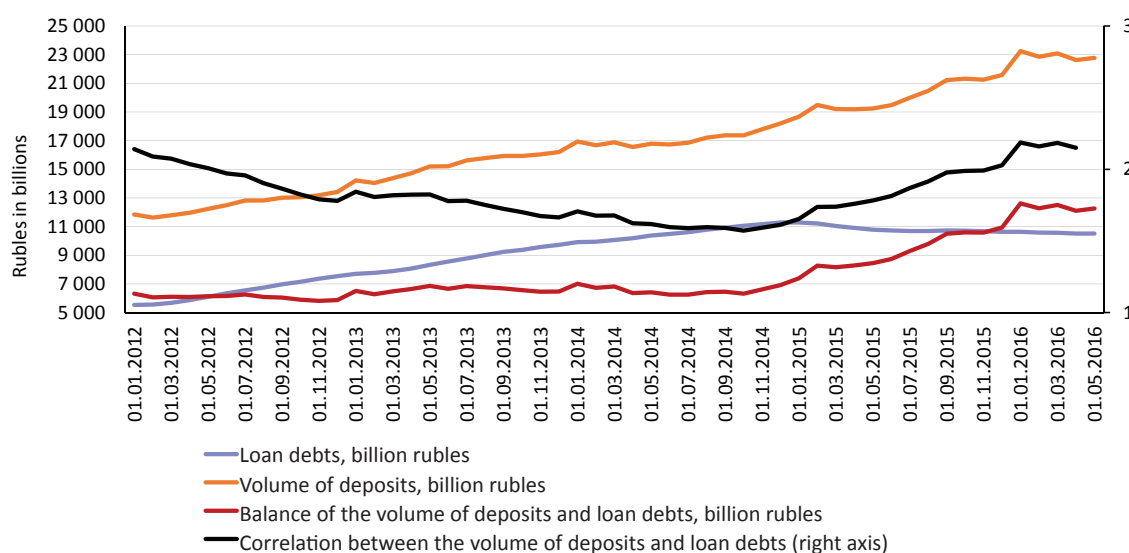
A. Polyakova

*Analysis of the dynamics of lending and household deposits allows to find interesting models of consumer behaviour from the perspective of consumption and savings balance. They fit into four provisional, sequentially alternating types of population's activity, which often depend on the number and content of information in the “news-driven economy”. In these circumstances, archaic strategies of financial behaviour gain ground.*

The data used in the analysis concerned the volume of loans provided to the population, loan debts, household deposits, retail trade turnover, as well as funds people spend on purchasing foreign currency, and the number of transactions.

In absolute values, individual deposits<sup>1</sup> show stable growth throughout the whole considered period which includes the pre-crisis years of 2012–2013 as well as all subsequent dates till April 2016. Loan indebtedness peaked at the end of 2014, after which its stable decrease began (Fig. 1).

Until autumn 2014, the balance of deposits and loans remained relatively unchanged at 6400 billion roubles, which effectively meant that Russian population was a net creditor of the banking sector. The proportion between individual deposits and loans had been reducing until 01.10.2014, which reflected the general trend of the consumer segment's loan saturation. The

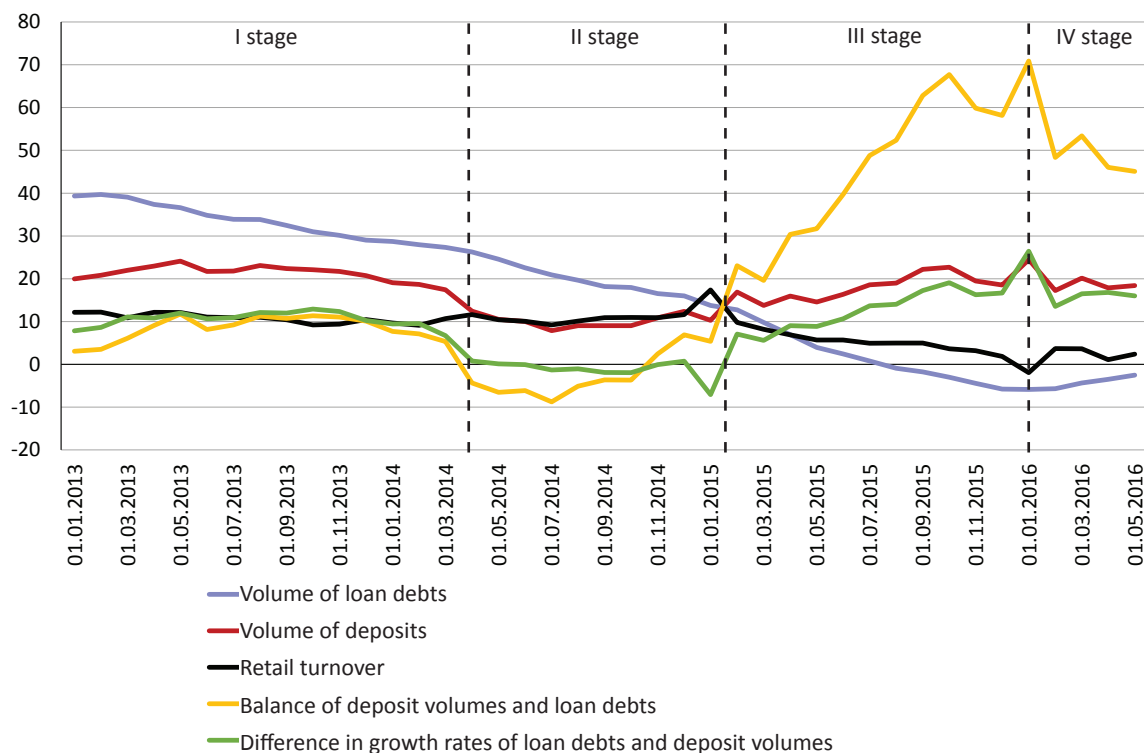


Source: comp. by authors on the basis of: Bank of Russia Statistical Bulletin No. 6 (277). – M.: Bank of Russia, 2016. – 310 p.

Fig. 1. Dynamics of the volumes of household deposits and individuals' loan debts

1 Individual (household) deposits are deposits and other funds of individuals borrowed by credit institutions (including savings certificates), outstanding commitments under contracts to raise funds with deposits and other borrowed funds as well as funds on individuals' other accounts. Funds of individual entrepreneurs, individuals' election funds, and capital transfers from and to Russia are not included into this indicator.

#### 4. STRATEGIES OF FINANCIAL BEHAVIOUR OF THE POPULATION



Source: comp. by authors on the basis of: Bank of Russia Statistical Bulletin No. 6 (277). – M.: Bank of Russia, 2016. – 310 p.; Retail turnover / EMISS. – [Electronic resource]. – URL: <https://fedstat.ru/indicator/31260> (accessed 01.07.2016).

Fig. 2. Normalized growth rate, % of the corresponding period of the previous year

latter can be traced clearly by the indicator of loan volumes growth rate compared to the same period of the previous year: by the end of 2014, loan volumes growth rate declined steadily from 39.7% in January 2013 relative to January 2012, to 17.4 % in December 2014 relative to December 2013. In 2015, the growth rate slowed down even more (Fig. 2).

It's interesting to look at the end of the first phase and the whole period of the second phase (hereinafter: the names are conventional and introduced to denote periods in a simpler way). The growth rate of individual deposits caught up with consumption growth rate, which can be interpreted as a crisis of confidence over the banking system. There is no inflow of individuals' funds into financial sector, therefore the role of household savings as a financial asset is declining; considering the shrinking of the financial market in general, the is akin to an outflow of investment resources. The latter, in turn, is causing direct and indirect damage to the economy. Another important factor is the lack of financial literacy among Russian population, which results in foreign currency cash market developing disproportionately in comparison, for example, with the market of collective investments (mutual funds).

Retail trade turnover remained stable in relative terms until December 2014, when the change in monetary policy was marked by speculative demand for many product groups. After that, a long-lasting recession took shape, pointing to an increasing propensity to save, notably in the most archaic forms of financial behaviour.

The chart presented in Fig. 2 shows that relative decline, or rather cessation of consumption growth was accompanied by an increase in individuals' funds on bank accounts. The same pattern was typical for the period before

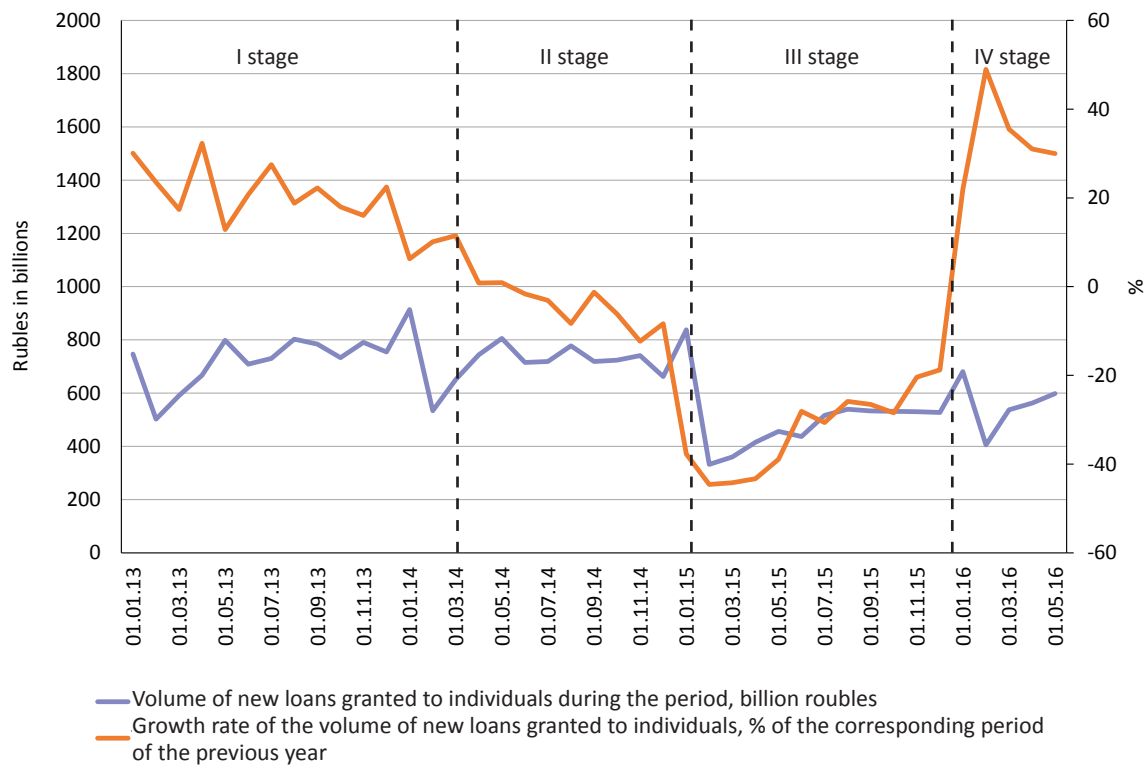


Fig. 3. Volume of loans to individuals in Russia in 2013–2016.

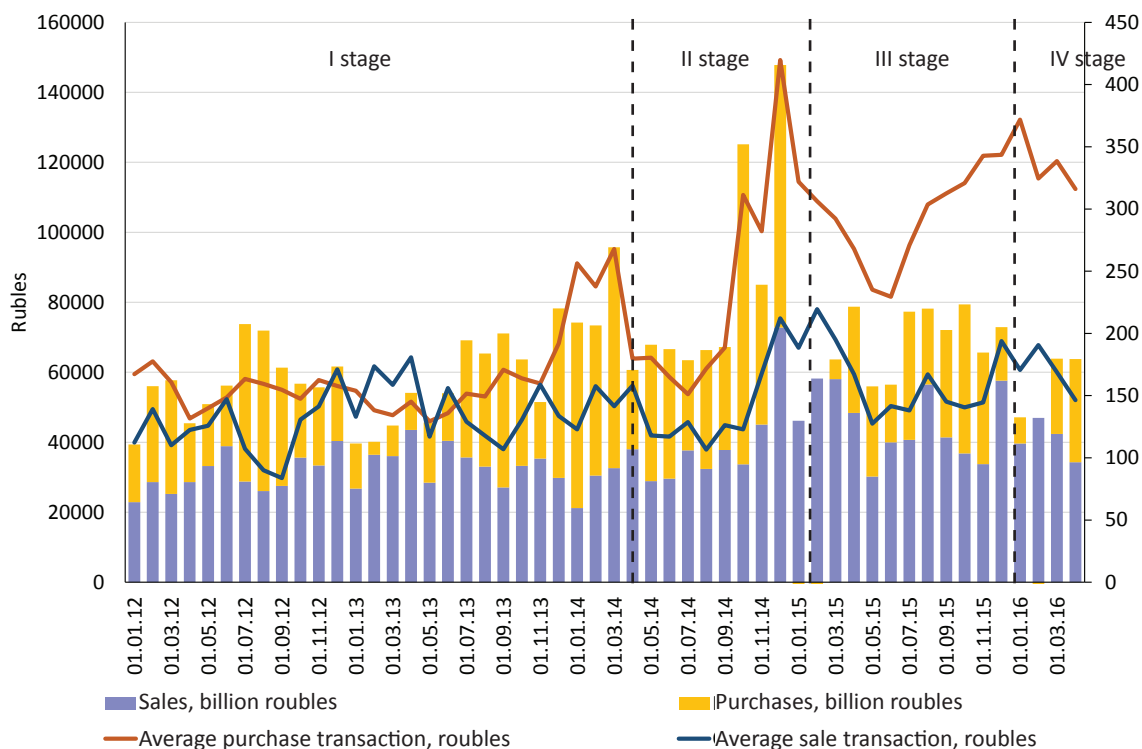
March 2014, with the only difference being that the consumption grew inertially and higher levels of savings were supported by the increase in real incomes, allowing the population to form some cash reserve.

In the period from March 2014 to January 2015, in the context of growing uncertainty and pessimistic expectations, people changed their behaviour pattern to the consumer one, with the result that relative growth rates of savings and spending equalled. But since the beginning of 2015, the growth rate of savings began to accelerate while consumption started to slow down.

Two remarks are noteworthy. First, January 2015 may be referred to as a turning point, since, as we see in Fig. 2, three lines intersect at this point, giving rise to new trends. Second, it is an “empirical trough” of the crisis. One of the most accurate indicators of post-crisis economic recovery is an increase in credit activity in the consumer segment: by January 2016, a reversal of the dynamics of consumer loan volumes had begun, which means that both banks and borrowers are generally positive about the outlook (Fig. 3).

In May 2016, there was an increase in total individual loan debts by 0.2% compared to the previous month. This was a consequence of the growing volume of loans provided to the population since January 2016: while positive growth rates are normal for this sector (Fig. 3), year-on-year comparison shows positive dynamics.

Throughout the first phase, which is presented as a kind of “normal” period for the purpose of comparison, the volumes of purchases and sales of foreign currency showed only seasonal changes while remaining in a given corridor of slightly growing trend. A more reliable indicator of the cash foreign currency market stability is the cost value of an average transaction size for a purchase or sale of foreign currency. During the pre-crisis phase, an average



Source: comp. by authors on the basis of: Review of the main indicators characterizing the state of the domestic cash foreign currency market (in the respective month) / Bank of Russia. – [Electronic resource]. – URL: <http://www.cbr.ru/analytics/?Prtd=bnksyst> (accessed: 07.01.2016).

Fig. 4. Transactions volumes of foreign currency purchases and sales by population

purchase ranged in a corridor of 45–60 thousand roubles per operation while sales were slightly more volatile (Fig. 4).

In December 2013 and QI 2014, abnormal growth of foreign currency purchases (measured in roubles) was observed, which can be interpreted as a realization of negative expectations about exchange rate fluctuations as a result of falling oil prices and developments in Ukraine. It is noteworthy that during the second phase, foreign currency sales, both total and average, remained in the corridor of 2012–2013 values. The growth of average sales of currency in November and December 2014 may be called speculative: this way, foreign currency holders reacted to the growing demand for foreign currency, while population had no other reason to sell greater amount of currency such as need to compensate for shortfall in income. In foreign currency purchases, another trend can be traced: rouble devaluation which accelerated in September 2014 stimulated increase in the average volume of foreign currency purchase transaction, while the amount of money spent on buying it was at the level of the corresponding period of 2013.

During the third phase, starting from June 2015, the average volume of foreign currency purchase transaction continued to grow until January 2016, while gross expenditure on foreign currency purchase (measured in roubles) was generally at the level of the corresponding periods of 2012–2013. It is natural that, given the change of the exchange rate, the amounts of currency being purchased decreased. This indicates that people adhere to the archaic saving strategy: the total number of people who are “able” to buy foreign currency, that is who have more income than is needed for paying their cur-

rent bills, decreased significantly as well as the total number of purchase transactions.

At the same time, the reduction of real incomes triggered the decrease in consumption in volume terms, while in value terms, an increase has been observed commensurate with the consumer price index. In other words, people preferred not to touch their savings in foreign currency and in bank accounts.

Potentially, there can be two reasons for that: the “concept” of consumer lifestyle has changed and people started to lean towards saving (retailers speak about the reduction in the average basket size, which generally indicates a decline in economic activity of the population), or there are expectations of recession. The second hypothesis is refuted by opinion surveys<sup>1</sup> as well as by more objective information from the banking system: in January 2016, for the first time since 2012, a reversal of the trend of consumer lending relative growth took place. This means that at least two parties – banks and the population – estimate that economic stabilization is the most likely scenario.

There were no economic prerequisites for the outflow of deposits and the jump in the demand for foreign currency at the end of 2013 and the first months of 2014. So we can talk about the political factor's impact on the economy. This phenomenon is described as “news-driven economy” or “event-driven economy”: political events break economic activity trends and behaviour patterns through mechanisms of information dissemination, resulting in increased risks and uncertainties. If the economy worked mainly on economic mechanisms and political factor and news did not have such influence while market-based institutions were of more importance, the system would be more stable and would not create internal shocks. ●

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1 Monthly monitoring of social and economic situation and self-assessment of the population: 2015 – May 2016 / The Russian Presidential Academy of National Economy and Public Administration; ed. by T.M. Maleva. 2016. – P. 19.

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