MONITORING OF RUSSIA'S ECONOMIC OUTLOOK:

TRENDS AND CHALLENGES OF SOCIO-ECONOMIC DEVELOPMENT

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MAIN TRENDS AND CONCLUSIONS

Digital currencies – the unreal, in a certain sense, sector of global economy – were given an alternative status in the final weeks of 2017. Representatives of the Bundesbank dismissed the possibility of legalizing digital currencies in the eurozone, whereas the Venezuelan president and the Belarus president announced their broad legalization. In other words, well-run markets are by and large wary of digital currencies, while low-performing and collapsed markets present them as a financial remedy, a product of another economic civilization.

Healing powers, however, are also attributed to some real-economy products, particularly when their price is rising, although such powers are thought to be for the most part pernicious at times of low prices. Steadily increasing oil prices at the year's end and hopes that they will not fall in 2018 encourage calculation of how many trillions of roubles in additional revenues will go to the federal budget and to reserve funds while discouraging attempts of any structural reforms because things start looking positive even with no reforms in place, and the public funds allocation mechanism that has a weak influence on the nature of developments starts gearing up.

Meanwhile, the year-end showed that the evaluation of economic developments encountered statistical surprises interfering with understanding whether the developments are negative or positive. The deep and unpredicted tumble in industrial output in November raised questions about the recovery growth having possibly stopped gaining momentum. Although it is retrospectively clear that the unexpected production upsurge (3.4%) in November 2016 could predetermine a relatively weak year-on-year value in November 2017, this cannot explain entirely the depth of the fall.

The steady gap between the increase in real pay and retirement benefits and the decline in real income is yet to be given a plausible explanation. A version about the concurrent decline in labour compensation in the non-observed sector seems credible enough, but it doesn't answer the question of the extent to which the developments seen in the "observed sector" mirror the Russian economic reality.

While noting that households' final consumption expenditure increased both in nominal and real terms (5.2% and 0.7%, respectively; here and below – in the first 10 months of 2017) amid declining real income, our experts pointed to the fact that the proportion of consumer spending in households' cash income climbed to 73.7% (adding 1.5 percentage points to the value seen in the same period a year earlier).

Household savings were characterized by mixed dynamics. Households' bank deposits increased Rb 0.72 trillion (down by 36.4% year-on-year) as rouble accounts and deposits in Russian banks increased Rb 1.06 trillion (a decline of 8.7%). The negative dynamics of foreign currency deposits (including the revaluated exchange rate) that emerged a year earlier (-0.3% of the foreign currency deposits) accelerated in 2017: individuals withdrew an equivalent of Rb 333bn from their foreign currency accounts and deposits (or -6% of the foreign currency they held in Russian banks). The increase in cash in circulation accelerated in that context: there was an increase in roubles circulating outside the banking system and in foreign cash in hands, Rb 375bn and Rb 0.66 trillion, respectively. That was due to a steadily decreasing deposit yield rate. However, year-on-year household savings (in banks and in cash) increased in total and in nominal terms and relative to cash income.

Bank lending recovery became the primary factor contributing in 2017 to the increase in households' consumption (and to steady savings dynamics). Individuals' loan-related indebtedness to banks increased 1.01 trillion (+Rb 114bn a year earlier), including a 0.56 trillion increase in consumer loans (-0.28 trillion in 2016).

According to experts, however, households' financial standing and relationship with banks are by no means stable. First, the increase in consumption was led by the increase in borrowed money rather than income. Second, individuals ceased to be net creditors for the banking sector in 2017 – loan-related indebtedness outpaced the influx of deposits. Although the situation may somehow straighten out in December on the back of seasonal factors, the trend generally means that banks have lost one of the most stable sources of their liabilities.

In addition, bank deposits will most likely continue to lose their appeal if the central bank's key rate is cut further. Given low inflation and, accordingly, descending interest rates, individuals, having found themselves in uncharted waters, will start looking for other ways of investing.

While analyzing the decline in inflation, our experts consider it logical that the central bank's key interest rate was cut straight away to 7.75%. The experts assume that the central bank will continue to ease its moderately tough monetary policy by making incremental cuts (within a 1.5–2-year horizon) in the key rate to reach a neutral level of 6–7%. The Fed's policy, sanctions against Russia and volatile oil markets are viewed as potential inflationary factors.

Furthermore, while analyzing the oil market, analysts noted a successful implementation of the OPEC-plus deal and predict that average oil prices in 2018 will be higher than in 2017, forecasting an average between $52–60 a barrel for Russian Urals crude oil in the global market.

The influence of this factor on the Russian economy (including, e.g., the industrial sector) is difficult to assess, if only because market players' assessments tend to change quickly enough and by no means always support Rosstat's data. For instance, in the middle of the year industrial enterprises were faced with a marked reversal of previously growing demand, according to Gaidar Institute's business surveys. In November, however, business surveys showed the opposite: key indicators were heading upward, enterprises said the demand for their products was growing, with upbeat forecasts.

It should be recalled in this context that in November the Russian industry was hit painfully, to say the least, by a slump, according to Rosstat.

1. GROWTH IN CONSUMER LENDING AS A TEMPORARY SOURCE OF WELL-BEING

M.Khromov

Recovery of consumer lending has facilitated growth in expenditures on ultimate consumption and brought about stability of households' savings amid the ongoing decline of real incomes. However, in the long-term prospect this situation will put at risk both the financial stability of households and the resource base of the banking sector.

In 2017, households' budgets were formed amid the ongoing stagnation of real incomes. During 10 months of 2017, households' cash incomes rose in nominal terms by 3.1%, however, in real terms they turned out to be 0.7% lower during that period than a year before. In the same period, households' real disposable cash income fell even further by 1.2%.

Despite weak income growth, expenditures on ultimate consumption increased both in nominal and real terms. The volume of consumption in nominal terms rose by 5.2% and turned out to be in the positive area even in real terms (+0.7%). Based on the results of ten months of 2017, the share of expenditures on ultimate consumption in the total volume of households' cash incomes amounted to 73.7%, which is 1.5 p.p. higher than within the relevant period of 2016.

In 2017, households' savings saw mixed dynamics as regards various components thereof. Within 10 months of 2017, households' bank deposits increased by Rb 0.72 trillion, which is 36.4% less than in the respective period of 2016 (in 2016 savings in individuals' bank accounts and deposits rose by Rb 1.14 trillion). Also, the share of households' incomes used for replenishment of bank accounts fell from 2.7% in January–October 2016 to 1.6% in January–October 2017.

Reduction of the influx of households' funds to banks affected both deposits in roubles and, to a greater extent, accounts and deposits in foreign currency. So, within 10 months the influx of households' funds to rouble accounts and deposits with Russian banks amounted to Rb 1.06 trillion, having decreased by 8.7% or Rb 100bn as compared to the relevant period of 2016. Dynamics of deposits in foreign currency (with adjustment to the exchange rate revaluation) were negative in 2016, too. In the same period, the reduction of foreign currency deposits in the rouble equivalent amounted to about Rb 20bn, that is, 0.3% of the total volume of deposits in foreign currency. In 2017, the outflow of funds from foreign currency deposits intensified considerably and within 10 months the reduction amounted to Rb 333bn in the rouble equivalent (over 6% of households' foreign currency accounts and deposits with Russian banks).

Simultaneously, with the inflow of individuals' funds to banks slowing down growth in cash funds in the circulation both in roubles and foreign currency picked up. Within 10 months of 2017, the monetary aggregate M0 – cash funds beyond the banking sector – increased by Rb 375bn (2.7 times more than in the same period of 2016). Consequently, in 2017 the share of cash funds in the money supply volume stopped shrinking. As of 1 November 2017, the M0/M2 ratio was equal to 20.3% (20.1% higher than at the beginning of the year).

The volume of cash foreign currency[1] increased, too. During ten months of 2017, the cash foreign currency volume increased by Rb 0.66 trillion. A year before, its growth was 1.5 times lower, that is, about Rb 0.4 trillion in the rouble equivalent. However, in our view it would be premature to speak about substantial growth in foreign currency predominance. A larger portion of growth in cash foreign currency can be explained by the abovementioned reduction of foreign currency deposits with banks. In 2017, the aggregate deposits in foreign currency (both cash and non-cash) turned out to be lower than a year before.

A greater appeal of cash funds as compared to bank deposits can be explained by a sustained decrease in income on bank deposits. So, as regards rouble deposits for the term of up to one year the average interest rate fell from 7.1% per annum in January–October 2016 to 6.0% per annum in January–October 2017. As regards rouble deposits for the term of over one year, the reduction was even more dramatic (from 8.6% to 7.0% per annum).

The income on foreign currency deposits fell substantially, too. If in 2016 USD deposits could yield the income of 1.2–2.1% per annum, in 2017 they earned only 0.7–1.4%. The income in euro fell, too, having virtually amounted to zero values. In 2017, the average income on deposits in the European currency for the term of up to one year was equal to the mere 0.3% per annum as compared to 0.7% per annum in 2016.

By choosing the cash mode of savings in foreign currency, the depositor avoids risks related to the Russian banking sector, primarily, the risk of a bank license being withdrawn and the need to buy again the foreign currency and spend the money on the exchange rate difference. It is noteworthy that deposits are compensated in roubles only.

As regards rouble deposits, the effect of reduction of the interest rate happened to be less significant, but even in this segment households in general became less motivated to keep money on bank accounts.

However, within ten months of 2017 overall growth in households' savings in bank deposits and cash increased both in nominal terms (from Rb 1.64 trillion to Rb 1.76 trillion) and cash income terms (from 3.8% to 4.0%) as compared to the relevant period of 2016 .

Recovery of bank lending has become the main factor both behind growth in households' consumption and maintaining of the dynamics of savings in 2017.

Within 10 months of 2017, individuals' debt on bank loans increased by Rb 1.01 trillion, which is nearly 9 times more than a year before (Rb 114bn). In relation to households' cash income, the significance of loan debt growth rose from 0.3% in 2016 to 2.3% in 2017.

Consumer landing was the main contributor to the expansion of the loan portfolio. In this money market segment, the sustained decline of the debt gave way to its growth in March 2017. As a result, within 10 months of 2017 households' consumer lending debt to banks rose by Rb 0.56 trillion after a drop of Rb 0.28 trillion in the relevant period of 2016.

1 The most recent estimates of the Central Bank of Russia as regards the volume of cash foreign currency are given as of 1 July 2017. The value as of 1 November 2017 is the IEP's estimate.

Home equity lending demonstrated positive dynamics, too. Within 10 months, households' home loan debts increased by Rb 0.46 trillion against Rb 0.39 trillion in the corresponding period of 2016.

It appears that in the near future the existing situation with households' finances and relations between banks and households will appear highly unstable.

Firstly, as was stated above, consumption growth and even stability of households' savings are underpinned by growth in borrowed funds, rather than higher incomes. This source of households' well-being can be regarded only as a temporary one. In the long-term prospect, any loan reduces the nominal value of households' disposable finances by the value of interest payments. It means that amid a lack of sustainable cash income growth active refinancing of loan debts is inevitable. Probably, such a process is already underway driven by falling loan interest rates. However, reduction of interest rates has its own limits and both for borrowers and lenders it is crucially important that by the time when interest rates cease to go down the Russian economy could embark on the trajectory of sustainable growth ensuring a substantial increase in households' real incomes.

Secondly, in 2017 households ceased to be the net creditor of the banking sector: growth in accounts payable turned out to be higher than that in depositors' funds. The situation is likely to change for the better in December when bank deposits demonstrate normally considerable growth by virtue of seasonal factors. However, generally, for banks such a trend means a loss of one of the most stable sources of their liabilities. Amid reduction of external borrowing volumes, corporate lending which is less profitable as compared to the retail one will continue to stagnate.

2. RUSSIAN INFLATION KEEPS TUMBLING

A.Bozhechkova, P.Trunin

Inflation in Russia dropped to 2.5% year-on-year in November 2017, hitting lows not seen in Russia's recent history, in response to a good crop, Russian rouble appreciation and slow demand recovery. It appears to be unlikely that consumer price growth will leap over 2.5–2.7%. The economic contraction has prompted the Bank of Russia to double down on easing the monetary policy, cutting the key interest rate by 0.5 p.p., straight away to 7.75%, on 15 December.

The Bank of Russia decided on 15 December to cut the key interest rate by 0.5 p.p. to 7.75%. The key interest rate was therefore down by 2.25 p.p. in 2017 as inflation (on a month-to-month basis) dropped by 2.6 p.p..

The decision turned out unexpected because most experts anticipated a 0.25 p.p. key rate cut. However, consideration should be given to the fact that consumer inflation has long been well below the target rate, and therefore its further deceleration is undesirable. Considering that inflation in the first 11 days of December stood at 0.2%, it's unlikely that it will end the year (2017) over 2.5–2.7%, with the 4% official target rate.

Indeed, the gap between the actual and target inflation rate is largely due to temporary factors such as the crop-induced growth in agricultural produce supply as well as the rouble's appreciation led by relatively high energy prices. Inflation will approach the next year's target rate, but it's unlikely that it will leap over the target in the absence of strong negative shocks. Moving faster from a moderately tight to a neutral monetary policy appears to be reasonable enough in this context.

Inflation stood at 2.5% year-on-year in November 2017, way below the value seen a year earlier (7.2%) (*Fig. 1*). As a reminder, consumer inflation was on a constant slide, down to 2.5% from 4.9%, in the period between January and November 2017, with just a minor spike in June. Furthermore, the target rate was for the first time achieved in mid-May 2017, and the Russian economy saw a deflation of -0.5% in August and -0.1% in September for the first time since August 2011.

Foodstuff prices were responsible for the deceleration of inflation (3.2% year-on-year in November 2017 vs. 6.1% year-on-year in November 2016). For instance, the industry saw a deflation in July–September 2017 (-1% in July, -1.8% in August, -0.7% in September) driven mostly by falling prices of fresh fruit and vegetables (-8.3% in July, -15.5% in August, -6.9% in September) driven by a record-high crop. A similar slump of foodstuff prices (-1.7%) was seen only in August 2003, with a 7.2% fall of prices of fresh fruit and vegetables.

Non-foodstuff price growth decelerated from 8.4% year-on-year in November 2016 to 2.7% year-on-year in November 2017. The deceleration of inflation was led primarily by prices of home appliances (down by an average of 1% year-on-year in November 2017) and medicines (-2.8% year-on-year in November 2017) that were driven down by the rouble's appreciation, given a large proportion of non-foodstuff imports.

Prices of paid services to individuals increased 4.3% year-on-year in November 2017 (5.3% year-on-year in November 2016). The major contributors to the increase were prices of educational services (+7.4%) and passenger transport services (+7.0%).

The core inflation, an indicator excluding changes linked to seasonal and administrative factors, was on a smooth slide in 2017, from 5.5% year-on-year in January 2017 to 2.3% year-on-year in November 2017, thus evidencing that the deceleration of inflation in 2017 was overall resistant to temporary factors.

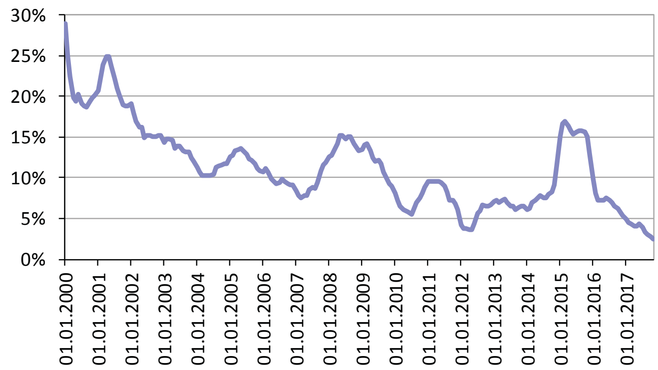

Fig. 1. CPI growth rate in 2011–2017, percentage change over the past 12 months

Source: Rosstat.

Household inflation expectations continued to fall in November, with the median one-year ahead expected inflation rate down to 8.7% in November 2017 (10.9% in January 2017), according to InFOM's survey published by the Bank of Russia. Bank of Russia's estimates based on the data obtained from the respondents of an inflation expectation survey is another evidence of declining household inflation expectations. For instance, the inflation probability estimate in November was 2.4%, down 2.2 p.p. from the value recorded in January.1 Note that the median one-year ahead expected inflation rate in January–November 2017 was higher than the actual inflation rate seen over the past 12 months by 5.8–7.1 p.p..

Overall, relatively elevated inflation expectations, including their unstable and sluggish nature, have been a headwind to the transition from a tight to a neutral monetary policy. However, the fact that inflation expectations are higher than the target inflation rate is typical of both developed and developing countries. It's therefore unlikely that inflation expectations will slip to 4%, although in 2018–2019 they will probably reach a steady-state level, allowing the Russian central bank to switch to a neutral monetary policy.

As noted, the deceleration of inflation was also influenced by the Russian foreign exchange market (*Fig. 2*). The rouble's appreciation during the year was linked primarily to the growth in energy prices as well as a higher-than-expected non-residents' demand for Russian assets, particularly government and corporate bonds. In addition, the rouble was probably also bolstered by the recently extended OPEC output cut agreement, enhancing the likelihood of next year's high crude oil prices. Further strengthening of the rouble's exchange rate was hindered by Finance Ministry's foreign currency purchases. In January 2017, the Ministry was not involved in purchasing foreign currencies, whereas Rb 485.3bn were purchased in the period of February–November 2017, of which Rb 110.4bn were purchased in November alone. The Ministry plans to spend Rb 200bn on purchasing foreign currencies in December, breaking a monthly record high.

Consumer demand recovery on the back of real pay increase amid decelerating inflation remains a source of risks of inflation. The retail trade turnover has been increasing since April 2017 (for the first time since December 2014)

1 The Bank of Russia Bulletin "Inflation Expectations and Consumer Sentiment", No. 8, August 2017.

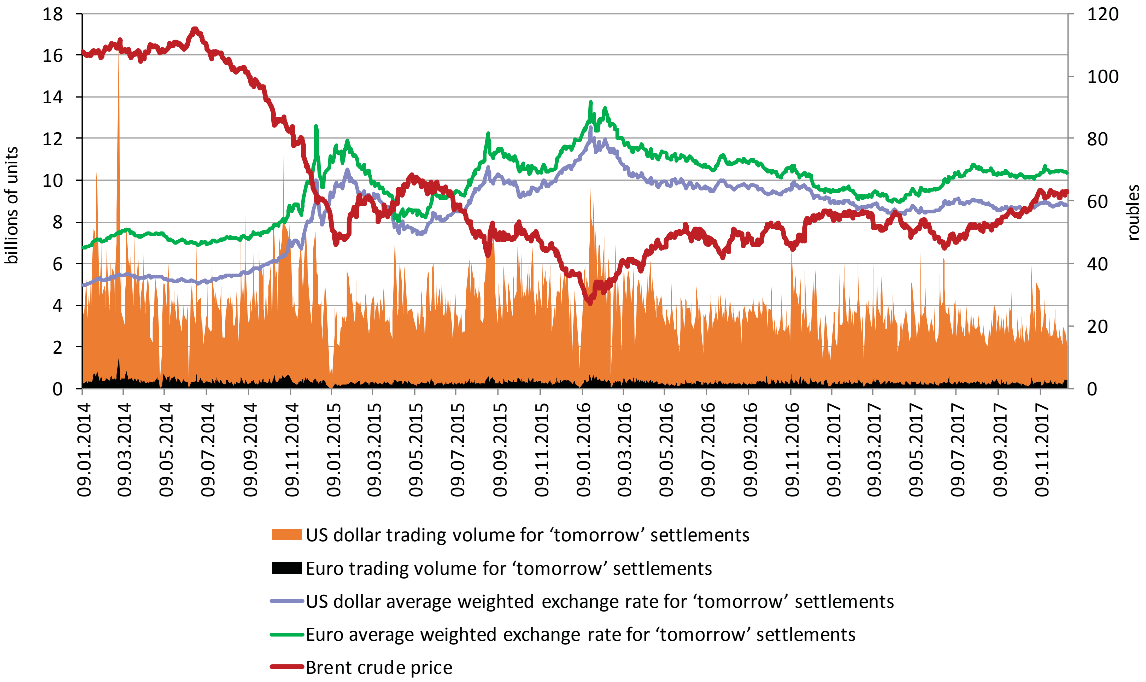

Fig. 2. Dynamics of Rouble/Dollar and Euro exchange rate, foreign exchange market trading volume, Brent crude price
Sources: Central Bank of Russia, Finam.

to an average of 1.0% year-on-year in April–October, most likely due to the growth in consumer lending.

Another source that can possibly boost inflation in the next few months is persisting uncertainty about external environment for the Russian economy; in particular, the oil market remains unstable, and capital inflows into Russia can be decreased if the Federal Reserve tightens its monetary policy along with a key interest rate cut in Russia. In addition, there is a risk of new package of tough sanctions against Russia that can weaken the Russian rouble.

We overall assume that the Russian central bank will continue to ease the monetary policy through incremental cuts in the key interest rate to reach a neutral level of 6–7% within a 1.5–2-year horizon.

3. GLOBAL OIL MARKET: OUTPUT CUTS AND PRICES

Yu.Bobylev

Global crude oil prices surged in 2017 on the back of the production-cut agreement between OPEC and a group of non-members including Russia. In January–November 2017, Russian crude oil was traded at an average of $52/bbl in the global market, adding $10 to the previous year's price. In late November, the agreement was extended until the end of 2018. The crude oil price in 2018 is therefore projected to stay above the 2017 average.

Crude oil prices were pushed down by a recently developed steady supply glut in the global oil market. Crude supply was up on the back of U.S. shale-oil production bolstered by advanced drilling methods. In that context, OPEC countries switched to a policy of retaining their global market share while opting not to cut their output. As a result, Russian Urals crude oil dropped in the global market to $41.9 a barrel in 2016 and to $51.2 in 2015 from $107.1 in H1 2014 (*Table 1, Fig. 1*).

Table 1

GLOBAL CRUDE OIL PRICES IN 2014–2017, US$/BBL

	2014	2015	2016	2017 March	2017 June	2017 September	2017 October	2017 November
Brent crude price, UK	98.9	52.4	44.0	52.0	46.9	55.2	57.6	62.6
Urals crude price, Russia	97.7	51.2	41.9	49.8	45.7	54.2	56.4	61.3

Sources: IMF, OECD/IEA.

Oil production was tapered off in cost intensive, primarily in U.S. shale-oil, fields amid low prices in 2015–2016. The cut was basically set off by increased production in OPEC countries seeking at least a partial compensation for slimmed-down revenues (*Table 2*).

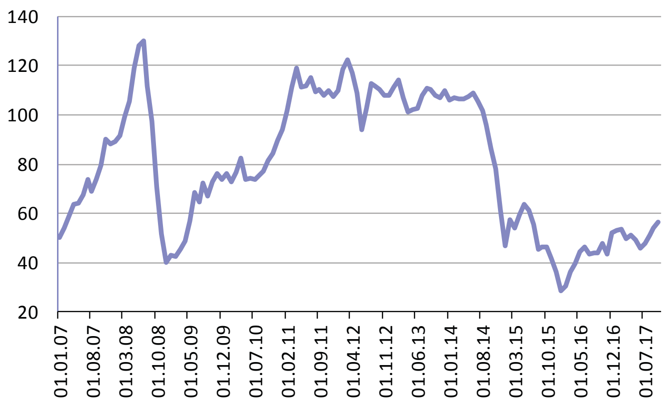

Fig. 1. Urals crude oil price in 2008–2017, US$/bbl

Source: OECD/IEA.

However, the drastic slump of oil prices in 2016 prompted oil producers to cut output even further. Late in 2016, OPEC countries and a group of non-OPEC oil producers, including Russia, entered into a six-month output cut agreement, beginning with 1 January 2017, under which OPEC countries and 11 non-OPEC countries pledged to cut their output by 1.2 mb/d and 558,000 b/d, respectively, with Russia taking on 300,000 b/d, compared with October 2016. Since Russia increased oil production, peaking highest in October 2016, Russia's commitments under the agreement meant no increase in output, thus returning to the 2016 average output in 2017.

Table 2

CRUDE OIL PRODUCTION IN THE UNITED STATES AND OPEC COUNTRIES IN 2015–2017, B/D MILLIONS

	2015	2016	2016 Q4	2017 Q1	2017 Q2	2017 Q3	2017 Q4 (estimate)
USA	9.42	8.86	8.81	8.99	9.10	9.29	9.57
OPEC countries, total	31.75	32.68	33.25	32.08	32.32	32.89	32.53
Saudi Arabia	10.01	10.42	10.55	9.98	10.09	10.18	
Iraq	4.03	4.43	4.61	4.46	4.44	4.50	
Iran	2.80	3.57	3.73	3.80	3.81	3.83	

Source: U.S. EIA.

The OPEC countries and the other parties to the production-cut agreement signed late in May 2017 a nine-month (from July 2017 till March 2018) extension to the agreement in order to further reduce the oil supply glut.

The agreement helped reduce the supply glut, leading to a marked increase in oil prices globally. For example, Brent crude oil climbed from $44 a barrel in 2016 to $53.5 on average in January–November 2017. Russian Urals crude oil averaged $52.1 a barrel in January–November 2017, adding $10 to the 2016 price. Furthermore, Urals crude oil was up to $61 a barrel in November 2017, adding $17 to the price seen in November 2016 (the month immediately preceding the month of the agreement) and $9 to the price set in December 2016.

The surplus of commercial crude stockpiles (crude oil inventories) dropped considerably, thus evidencing a gradual market rebalancing. According to the International Energy Agency (IEA), while OECD countries’ commercial crude stockpiles in January 2017 were 302 mb above the five-year average, they were down to 111 mb, or by more than 60%, in October 2017.

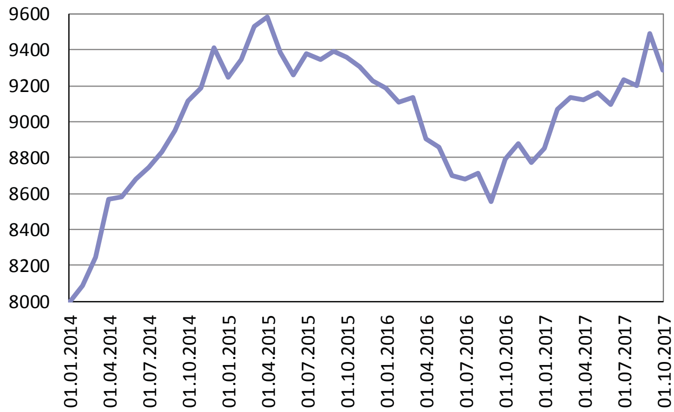

Fig. 2. U.S. crude oil production in 2014–2017, b/d/1k

Source: U.S. EIA.

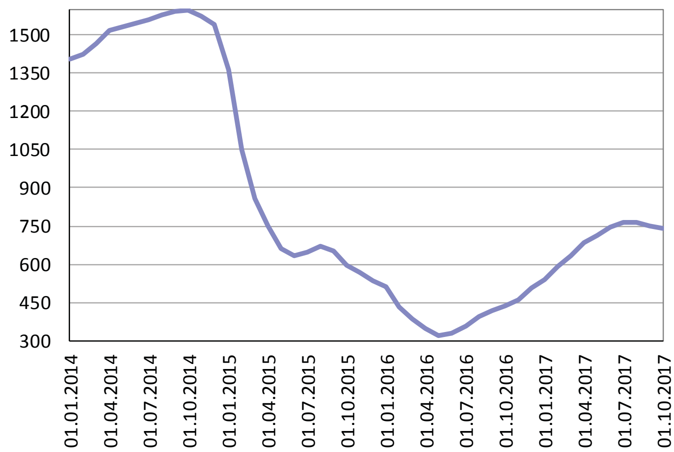

Fig. 3. Number of producing oil rigs in the United States in 2014–2017

Source: Baker Hughes.

A markedly buoyant demand also had a positive effect on the market balance and on oil prices. Global oil demand increased 1.5 mb/d in 2017 (or 1.6% year-on-year), according to IEA’s estimates.

However, the effect of the agreement was dimmed by recovering shale oil production in the United States as well as increased production by some other non-OPEC countries. Advanced drilling and cost-effective methods allowed the U.S. oil industry to adapt to relatively low oil prices. As a result, 2017 saw an increase in the number of operating oil rigs and in oil production in the United States (*Figures 2, 3*). According to U.S. Energy Information Administration's (EIA) estimates, the United States produced 9.24 mb/d in 2017, adding 0.38 mb/d (4.3%) to the previous year's level.

Most recent forecasts show that, in 2018 global crude oil prices are expected to leap over the 2017 average level amid further market balancing. EIA's and Word Bank's projections for 2018 show that Brent crude oil will be traded globally at $57.26 and $56.0 a barrel, respectively (the average price of Brent, Dubai and WTI crude oil). Leading foreign banks' (Goldman Sachs Group, UBS, Credit Suisse, JPMorgan, Citigroup, Barclays) Brent crude projections for 2018 vary within a range of $54–62 a barrel.

Thus, considering the key contributing factors, in 2018 Russian Urals crude oil is forecast to average between $52 and $60 a barrel in the global market. Positive price dynamics can be affected by most critical risks such as, first, an increase in oil production in the United States as well as some other countries, which can neutralize largely the effect of the output-cut agreement, second, an oil production growth recovery in OPEC countries and in the other parties to the agreement as early as in 2018, that is, prior to agreed final date of the output cut deal.

4. RUSSIAN INDUSTRY IN H2 2017: HOVERING BETWEEN PESSIMISM AND OPTIMISM

S.Tsukhlo

The second half of 2017 was a tough period for Russian enterprises; in particular, in the middle of the year industrial enterprises saw the demand for their products expand at slower pace. In November, however, a representative indicator set of Gaidar Institute's business survey statistics exhibited positive changes in key indicators. Demand and output, including forecasts, and finished goods inventory were led by upward dynamics that continued into December.

The first few months of H2 2017 saw a slow reversal of feeble positive trends that were seen earlier in the year. The pace (balance) of actual changes in demand saw a reversal to a negative trend in July. Demand forecasts also continued to lose the business optimism gained by February 2017. The industrial sector was still, albeit less intensively, hoping for an increase in sales. In that context, the industry continued to reduce the surplus in finished goods inventory, which was reasonable enough amid uncertainty about the time of switching to a statistically indisputable increase in output. Another logical result from that was the decelerating increase in output.

Despite certain signs of slowing demand and output, the industrial sector continued to hire employees, having positive recruitment plans because the Russian industry was still running short of workforce on the back of "anticipated demand change". Although the shortage was relatively small, the very fact of its existence shows which resource-related issue is most critical for the Russian industry.

Russian industry's investment plans underwent sharp negative changes in July 2017, with this indicator balance losing 9 points during the month. While retaining this indicator at a five-year high level for months, the industrial sector was not prepared to invest in its own production amid protracted stagnation.

In August 2017, industrial sector's recovery from the protracted crisis of 2015–2016 continued to lose momentum. The month (August) happened to be a time of hardship for sales. Enterprises' self-assessments of current demand dropped to a 13-month low. The same was true for demand projections. In August 2017, enterprises lost the optimism they accumulated during the previous 15 months. Survey data also show that the industrial production continued to experience near-to-zero growth rates.

Industrial enterprises, however, revised their output plans upward rather than downward, adding 3 points to this indicator balance in August. There were still hopes for regaining growth, as evidenced by, among other things, the continuing staff recruitment by the Russian industry. The continuing recruitment was registered over six months of 2017 (excluding in January and May). The balance of projected changes in enterprises' staff headcount also remained positive, albeit moderate.

The data for September showed that enterprises were no longer hoping for being able to achieve the demand they needed for rapid recovery from the crisis. Actual changes in sales remained “below zero”, the forecast balance also went negative for the first time since early in 2017. Nevertheless, the proportion of enterprises that said their demand was “normal” still remained above 50%, thus indicating that the majority of enterprises were still satisfied with their sales volumes.

Revised plans of rapid recovery from the crisis prompted enterprises not to maintain their inventory at levels that can ensure the recovery. In September, the balance of inventories self-assessments indicated a decline in their surplus down to +6 points.

Finished goods inventory were updated in September on the back of current output – the industrial sector started making minor cuts in output while adhering to output boost plans for late in 2017. In August–September, the balance of output plans added 6 points, reaching values that were decent enough in times of crisis. That helped industrial enterprises continue to hire workers even amid slowing recovery from the crisis. Staff recruitment plans remained at a positive level. However, the investment plans balance approached again a zero line late in the third quarter – the industry had completely lost the optimism accumulated in Q1 2017 and maintained at the five-year highest level in Q2 2017.

In October, the dynamics of demand for industrial products continued to be driven by a downward trend. Nevertheless, the majority of enterprises said the demand for their products was “normal” in H2 2017. In October, there were 64% of “normal” answers, not less than 60% since April 2017. However, demand projections reflected dimming hopes of successful year-end outturns. The balance of those hopes neared a zero.

However, demand for industrial products exhibited positive dynamics in November 2017, according to Gaidar Institute’s survey statistics. Both baseline and deseasonized data showed positive changes and actual sales and sales projections. Most impressive was a sharp upsurge in the expected demand change shortly before public holidays in January.

The Russian industrial sector’s finished goods inventory were totally “depleted” due to positive sales dynamics in November and upbeat projections for growing demand. The balance of this indicator self-assessments lost another 6 points down to zero – the proportion of “above normal” answers was offset by the proportion of “below normal” answers, with “normal” answers showing an absolute and strong prevalence, 71% in November. The combination of finished goods inventory self-assessments amid increasing demand was supposed to further encourage enterprises to increase volumes of finished goods inventory due to the increase in output.

Indeed, surveys in November registered a positive change in enterprises’ actual output dynamics and production plans. November saw output reverse from negative to positive values. Output plans underwent drastic changes in November as well. The deseasonized balance rose during the month to +26 from +15 points, also hitting a multi-year high (like demand projections).

In December, enterprises continued to provide positive self-assessments. For instance, the demand growth rate remained above zero and even gained a few percentage points, thus enabling enterprises to be highly satisfied with their current demand, with 66% of “normal”, as before, answers. Demand projections were also at a steadily positive level, as was registered in H1 2017.

The industry’s response to the demand dynamics seemed logical enough – enterprises continued to increase output in December. The latter was used to meet the demand and to increase finished goods inventory. As a result, finished goods inventory self-assessments bounced back from a zero to above-zero balance, evidencing that the Russian industrial sector was prepared to recover from the crisis of 2015–2016. Enterprises’ investment plans also bolstered this scenario in late 2017/early 2018. While the balance of the plans stabilized, albeit still somewhat below zero, in November–December 2017, investment optimism may once again prevail over investment pessimism as long as there will be stronger confidence in success of another attempt to recover from the crisis.

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