

MONITORING OF RUSSIA'S ECONOMIC OUTLOOK:

TRENDS AND CHALLENGES OF SOCIO-ECONOMIC DEVELOPMENT

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TRENDS AND CHALLENGES OF SOCIO-ECONOMIC DEVELOPMENT

The global energy market moves toward profound modernization while shrugging off ongoing trends or agreements like the recent OPEC/non-OPEC output cut deal. The reason is that the market is faced with drastic changes brought by nonmarket, regulatory and administrative methods based on some of the biggest nations' common views of what constitutes ecology, common good, technological revolution and the anticipated effects thereof. Respective trends appear to be insurmountable because wealthier and more persistent nations are prepared to put up with today's loss-making projects, while the projects themselves are being scaled up at a level comparable with traditional ways of energy production.

Even though the scale of projects like, for example, the world's biggest solar power generation project of Saudi Arabia in partnership with Japan's Soft-Bank gives reasons for suspecting them of being too much self-promotion, the trend itself is clear indeed. Saudi Arabia, a leading oil producer, plans to pour \$200bn into building a solar project of 200 gigawatts (GW) by 2030 (comparable with the total electric power generation of Russia). In fact, China (led by the all-time party leader) has similar plans to increase the proportion of battery-powered cars by 20% of total sales seven years from now, with the absolute proportion of 100% as a strategic target for the 2030s. That's what remaps the world, considering that today's projections are still based on the assumption that crude oil demand will come first of all from China because of China's rapidly increasing vehicle fleet.

Russia hasn't joined the trends yet (rather showing some kind of activity in the sector), still focusing on traditional sectors and segments, primarily oil and gas production.

Russia cut its crude oil production (under the OPEC agreement) while increasing natural gas output, as noted in our experts' analysis of the 2017 performance results of the oil and gas sector. The experts also see positive effects of a so-called fiscal maneuver in the Russian oil industry to provide incentives for modernization of oil refineries and increase the crude oil refining yield to an all-time high of 81% in 2017 from previous years' 71–72% (90–95% in developed countries). Production and exports of residual oil fell as well (down by one third over the last three years), leading, together with oil output cuts, to a 2.4% decline in exports of crude oil and refined petroleum products to 401 million tons. However, the proportion of net exports of crude oil and refined petroleum products in crude oil production remained very high, 73.1% in 2017 (compared with 47.7% in 1990). Natural gas exports hit an all-time high of 210 billion cubic meters. The proportion of oil and gas sector of Russia's exports contracted to 52.8% from 65.2% since 2014 (the proportion of natural gas remained almost unchanged, 10.6% and 11.0%, respectively).

Note that if the OPEC agreement stays in force, Russian crude oil production will stagnate and natural gas production can be boosted only through exports because domestic consumption will remain the same at best in the offing.

The industry will continue to see the signs of lingering stagnation early in 2018, according to Gaidar Institute's business surveys. According to enterprises, there was an increase in demand in January, which then slowed to a stop in March. Similar developments were unfolding in output growth. Furthermore, the industry, according to enterprises, had sufficient resources (workforce, capacities, etc.) and a satisfactory level of investment (63% of enterprises said they had a "normal" level of investment). Today, only 14% of enterprises are unable to invest due to high bank interest rates: the factor of inaccessible credit facilities now ranks 4th among investment constraints.

Experts of corporate bank loan market point to a market buoyancy in 2017 that was also seen in early 2018. Banks issued Rb 38.4 trillion corporate loans in 2017, adding 8.1% to previous year's amount. In January 2018, corporate loans increased 22.9% from January 2017, hitting a fresh all-time high since 2014. However, the proportion of foreign exchange loans remained very small, \$62bn or less than 10% of the total lending a year earlier. More importantly, the loan market recovered relative to the size of economic activity as well: the 2017 ratio of outstanding loans to organizations' turnover stood at 25.1%, up 0.9% year on year. This is a long way still from the pre-crisis value 2013 (30.4%). No serious improvements were seen in the quality of corporate loan portfolio: in 2017, corporate borrowers reduced their debt to banks only by 0.2 p.p.s to 5.9%.

There was high growth in retail mortgage lending. Thus, experts of demographic policies point to the fact that since 1 January families are entitled to mortgage loans at a reduced rate of 6% for second or third child. This type of aid seems to be on top of the agenda. A survey of The Institute of Applied Economic Research of The Russian Presidential Academy of National Economy and Public Administration shows that 91.1% of respondents already spent their maternity capital (federal subsidies for multiple-child families) to improve their housing conditions. Furthermore, 63.5% of those who did so since the onset of the maternity capital program reduced their mortgages.

While presenting the third round results of a 2017 survey titled "People, Family, Society" (the first and the second rounds were dated 2013 and 2015, respectively), experts point to the fact that the Russian population think highly enough of national fertility promotion policies in force since 2007, and the bulk of policies in force since 2018 meet the population demand. However, the effect of the maternity capital program (which is highly appreciated though) decreased when it came to respondents' own fertility plans.

Deputy Minister of Industry and Trade of Russia Vasily Osmakov published his article in response to the article titled 'The rouble's exchange rate that will be best for Russian industry' that was published in the Monitoring of Russia's Economic Outlook: Trends and Challenges of Socio-Economic Development, No. 4 (Issue 65), March 2018). The article noted in particular that the effect of rouble exchange rate on Russia's industrial development depends on many factors, including enterprises' sectoral affiliation, long-term plans, export opportunities, etc. The effects of a stable, depreciating and appreciating rouble on the industrial sector are analyzed as well. ●

1. OIL AND GAS SECTOR: MAJOR TRENDS

Yu.Bobylev

In 2017, the volumes of crude oil production somewhat fell owing to Russia's commitments to curb production as a result of the oil output cut agreement between some OPEC and non-OPEC countries. Natural gas production and exports rose. Under the so-called tax maneuver in force in the oil industry, refining depth went up, production and export of fuel oil moved down and export of crude oil increased. The oil and gas sector products still constitute over half of the Russian exports.

In 2017, oil extraction in Russia hit 546.8 m tones or 99.9% in comparison with the previous year (Tables 1, 2). In the meantime, natural gas production (including natural, associated and condensate) went up to 704.1 billion cubic meters, which was an all-time high.

Russia boasts of significant capacity potential to maintain and increase oil and gas extraction. At the same time, the oil sector faces deteriorated production conditions. Considerable share of producing fields demonstrate a downward trend of extraction and the new deposits in the majority of cases have not as good mining- and-geological and geographic parameters. Their development requires higher investment, running and transportation costs. In order to offset falling production on the brown fields, it is necessary of develop both new oil deposits in regions with underdeveloped infrastructure or in those regions that lack infrastructure all together, and to develop low quality deposits in developed regions.

Таблица 1

PRODUCTION AND REFINING OF CRUDE OIL IN RUSSIA IN 2010–2017

| | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 |
|--|-------|-------|-------|-------|-------|-------|-------|-------|
| Extraction of crude oil including gas condensate, million tons | 505.1 | 511.4 | 518.0 | 523.3 | 526.7 | 534.0 | 547.6 | 546.8 |
| Primary crude oil refining, million tons | 249.3 | 258.0 | 270.0 | 278.0 | 294.4 | 287.2 | 284.5 | 284.0 |
| Share of crude oil refining in crude production, % | 49.4 | 50.4 | 52.1 | 53.1 | 55.9 | 53.8 | 52.0 | 51.9 |
| Crude oil refining depth, % | 71.1 | 70.8 | 71.5 | 71.7 | 72.4 | 74.4 | 79.1 | 81.0 |

Sources: Rosstat, Russian Energy Ministry.

Year 2017 demonstrates that the tax maneuver has delivered positive outputs: a structural tax reform in this sector envisages gradual reduction of export duties on both crude oil and petroleum products, as well as higher mineral extraction tax (MET)¹. According to the adopted parameters of tax maneuver, effective marginal export duty rate was cut from 59% in 2015 to 30% in 2017. Meanwhile, export duty rate on heating oil went up from 66% to 100% from crude oil export duty rate. Such restructuring of the tax system has created incentives for upgrading of oil refining capacities and has resulted in trend changes.

New trends emerged in 2015–2016, and some of them deserve to be mentioned here:

¹ See Yu. Bobylev. Tax Maneuver in Oil Industry. Russian Economic Developments. 2015. No. 8. P. 45–49.

- Firstly, oil-refining depth increased notably as production and exports of fuel oil declined;
- Secondly, crude oil exports, more lucrative for state budget revenues than fuel oil exports, increased;
- Thirdly, crude oil refining declined in volume terms due to the above two factors.

In 2017, oil-refining depth hit Russia's all-time high of 81%. Note that in the period of 2000–2014, that is, during a long period until the “tax maneuver” took force, depth of oil refining in Russia constituted 71–72%, meanwhile, this indicator comes to 90–95% in leading industrial countries. Over last three years production of heating oil in Russia contracted by 33.7% (Table 2).

Table 2

PRODUCTION OF CRUDE OIL, PETROLEUM PRODUCTS AND NATURAL GAS
IN 2010–2017 IN% TO PREVIOUS YEAR

| | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 |
|--|-------|-------|-------|-------|-------|-------|-------|-------|
| Extraction of crude oil including gas condensate | 102.1 | 100.8 | 101.3 | 100.9 | 100.7 | 101.4 | 102.5 | 99.9 |
| Primary crude oil refining | 105.5 | 103.3 | 104.9 | 102.7 | 104.9 | 97.3 | 98.7 | 99.8 |
| Gasoline | 100.5 | 102.0 | 104.3 | 101.3 | 98.8 | 102.3 | 101.9 | 98.4 |
| Diesel fuel | 104.2 | 100.3 | 98.7 | 103.1 | 107.4 | 98.9 | 100.2 | 101.4 |
| Heating oil | 108.5 | 104.6 | 101.6 | 103.3 | 102.0 | 91.1 | 80.2 | 90.7 |
| Natural gas | 111.4 | 102.9 | 97.7 | 102.1 | 95.7 | 98.7 | 101.0 | 107.9 |

Sources: Rosstat, Ministry of Energy of Russia.

Table 3

RATIO OF PRODUCTION, CONSUMPTION AND EXPORTS OF CRUDE OIL
AND NATURAL GAS IN 2010–2017

| | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 |
|---|-------|-------|-------|-------|-------|-------|-------|-------|
| Crude oil, m t | | | | | | | | |
| Production | 505.1 | 511.4 | 518.0 | 523.3 | 526.7 | 534.0 | 547.6 | 546.8 |
| Exports, total | 250.4 | 244.6 | 239.9 | 236.6 | 223.4 | 244.5 | 254.8 | 252.6 |
| Exports to - non-CIS countries | 223.9 | 214.4 | 211.6 | 208.0 | 199.3 | 221.6 | 236.2 | 234.5 |
| Exports to CIS countries | 26.5 | 30.2 | 28.4 | 28.7 | 24.1 | 22.9 | 18.6 | 18.1 |
| Net exports | 249.3 | 243.5 | 239.1 | 235.8 | 222.6 | 241.6 | 254.0 | 252.0 |
| Domestic consumption | 125.9 | 140.7 | 142.1 | 137.5 | 141.3 | 122.2 | 138.3 | 147.1 |
| Net exports as% of production | 49.4 | 47.6 | 46.2 | 45.1 | 42.3 | 45.2 | 46.4 | 46.1 |
| Petroleum products, m t | | | | | | | | |
| Exports, total | 132.2 | 130.6 | 138.1 | 151.4 | 164.8 | 171.5 | 156.0 | 148.4 |
| Exports to non-CIS countries | 126.6 | 120.0 | 121.2 | 141.1 | 155.2 | 163.3 | 148.1 | 137.4 |
| Exports to CIS countries | 5.6 | 10.6 | 16.9 | 10.3 | 9.6 | 8.3 | 8.0 | 11.0 |
| Net exports | 129.9 | 127.2 | 136.8 | 150.0 | 162.8 | 170.2 | 155.3 | 147.7 |
| Crude oil and petroleum products, m t | | | | | | | | |
| Net exports of crude oil and petroleum products, m t | 379.2 | 370.7 | 375.9 | 385.8 | 385.4 | 411.8 | 409.3 | 399.7 |
| Net exports of crude oil and petroleum products as% of crude oil production | 75.1 | 72.5 | 72.6 | 73.7 | 73.2 | 77.1 | 74.7 | 73.1 |
| Natural gas, billion cubic meters | | | | | | | | |
| Production | 665.5 | 687.5 | 671.5 | 684.0 | 654.2 | 645.9 | 652.6 | 704.1 |
| Exports, total | 177.8 | 184.9 | 178.7 | 196.4 | 172.6 | 185.5 | 198.7 | 210.2 |
| Exports to - non-CIS countries | 107.4 | 117.0 | 112.6 | 138.0 | 124.6 | 144.7 | 164.7 | 175.9 |
| Exports to CIS countries | 70.4 | 67.9 | 66.0 | 58.4 | 48.0 | 40.7 | 34.0 | 34.3 |
| Net exports | 173.5 | 179.2 | 171.6 | 189.3 | 165.5 | 178.4 | 189.8 | 201.4 |
| Domestic consumption | 492.0 | 508.3 | 499.9 | 494.7 | 488.7 | 467.5 | 462.8 | 502.7 |
| Net exports in% to production | 26.1 | 26.1 | 25.6 | 27.7 | 25.3 | 27.6 | 29.1 | 28.6 |

Sources: Rosstat, Russian Ministry of Energy, Federal Customs Service, own calculations.

In the context of falling crude oil production in Russia, its exports declined somewhat. Crude oil and petroleum products exports in 2017 came to USD 401.0 million tons down 2.4% against last year (*Table 3*). 2015–2017 saw a notable growth of 13.1% of crude oil exports spurred by the “tax maneuver” and a 10% decline in exports of petroleum products mainly owing to a fall of fuel oil exports.

Analysis of Russia’s crude oil exports over the course of a long period demonstrates a significant increase in the export-led component of oil industry. The share of net exports of crude oil and petroleum products in crude oil production went up from 47.7% in 1990 to 73.1% 2017. This, however, is due not only to the increase in absolute volumes of exports but to market transformation of the Russian economy, more efficient oil consumption and the replacement of petroleum products by (heating oil) natural gas.

Exports of natural gas in 2017 went up 5.8% in comparison with the previous year and hit 210.2 billion cubic meters, which is an all-time maximum. Exports growth was achieved due to deliveries to countries of far abroad, exports of natural gas to CIS countries was falling over recent years. Share of net exports in the natural gas production in 2017 constituted 28.6%.

At the same time, selling price of crude oil and natural gas on the world market has markedly fell. Rapid growth of shale oil production in the US due to the new technologies resulted in a stable oil supply glut.

Table 4

WORLD CRUDE OIL PRICES IN 2010–2017, USD/BBL

| | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 |
|--|-------|-------|-------|-------|-------|-------|-------|-------|
| Brent crude price, UK | 79.6 | 111.0 | 112.0 | 108.8 | 98.9 | 52.4 | 44.0 | 54.4 |
| Urals crude price, Russia | 78.3 | 109.1 | 110.3 | 107.7 | 97.7 | 51.2 | 41.9 | 53.1 |
| Prices on Russian gas on European market, US\$/thousand cubic m. | 296.0 | 381.5 | 431.3 | 402.0 | 376.0 | 267.9 | 156.7 | 197.7 |

Sources: IMF, OECD/IEA, Rosstat.

Significant plunge of crude oil prices recorded in 2016 motivated the oil producing countries to act decisively regarding cutting the oil production. At the end of 2016, OPEC and a group of oil producing countries from outside OPEC, including Russia, concluded a production cut agreement in effect since 1 January 2017¹. In 2017, parties to the agreement took a decision to extend the effective date of the agreement through the end of 2018. Implementation of this agreement has resulted in a reduction of excessive supply of oil and significant growth of world prices on crude oil.

Prices on Russian natural gas exported abroad on long-term contracts, as a rule, are linked to the prices of petroleum products and owing to this factor follow the



Fig. 1. Urals crude price in 2008–2017, US\$/b

Source: Rosstat.

1 See Yu. Bobylev. World oil market in 2017: production control and prices. Russia’s Economic Developments. 2018. No. 1. P. 12–14.

world crude oil prices. Following a significant decrease in 2015-2016, the sale price on Russian gas on the European market in 2017 went up to USD 197.7 per thousand cubic meters (up 26.2% compared to the previous year).

Owing to the plunge of global prices on crude oil and natural gas, the share of oil and gas sector products in Russian exports also declined – in 2014, it accounted for 65.2% including crude oil and petroleum products – 54.2%, and natural gas – 11.0%, and already in 2017 it accounted for 52.8%, of which crude oil and petroleum products – 42.2% and natural gas – 10.6% (*Table 5*). At the same time, in spite of the price plunge oil and gas sector products constitute above one-half of Russian exports.

Table 5

VALUE AND SHARE OF EXPORTS OF OIL AND GAS SECTOR PRODUCTS
IN RUSSIA'S EXPORTS IN 2017

| | Exports, billion US dollars. | In% to total volume of Russian exports |
|----------------------------------|------------------------------|--|
| Oil and gas sector, total | 189.70 | 52.8 |
| Crude oil and petroleum products | 151.55 | 42.2 |
| Crude oil | 93.31 | 26.0 |
| Petroleum products | 58.24 | 16.2 |
| Natural gas | 38.15 | 10.6 |

Sources: FCS, own calculations.

In future, global demand for oil will grow, which will allow Russia to retain and even to increase current volumes of crude oil exports. This being said, shifts in the regional structure of global oil demand prompt diversification of crude oil exports, expansion of shipments to China and other countries of Asia. Meanwhile, potential of the Russian oil sector development to a significant degree will rely on the world oil prices. The oil market outlook is marked by factors, which will be contributing to the retention of relatively low oil prices. The most important factors are extensive shale oil reserves in the U.S., which will be rapidly put into production and create oil glut with global oil price above USD 60 per barrel, which will drag oil prices down. In the context of low crude oil prices, options for the development of new oilfields and unconventional reserves will be significantly restricted in Russia because investment in the cost demanding projects will be unprofitable (first of all, it is true to the implementation of the Arctic shelf projects). In this context enforced technological sanctions against Russia, which ban exports to Russia of equipment and technologies for the development of deposits located on the Arctic shelf, deep-water oil fields and shale oil deposits will negatively affect the oil industry development.

In order to ensure sustainable development of the oil industry it is paramount to implement such measures of economic policy: completion of structural tax reform including phase in reduction of crude oil and petroleum products export duties up to their complete revocation and higher Mineral Extraction Tax; introduction of special windfall tax¹; conduct coordinated efforts with OPEC countries and other oil producers aimed at maintaining acceptable level of world oil prices; promotion of import substitution capacities of oil exports to East, development of import substitution technologies aimed at upgrading oil extraction index and development of non-conventional oil reserves. ●

1 See Yu. Bobylev, O. Rasenko. Windfall tax to introduce in oil industry. Russian Economic Developments. 2017. No. 10. P. 65–68.

2. INDUSTRIAL ENTERPRISES IN Q1 2017: CAUTIOUS PESSIMISM

S.Tsukhlo

In early 2018, main features of the lingering stagnation inherent from 2015–2016 crisis persisted. The January optimism seemed unstable for enterprises and did not result in projections' optimism. At the quarter-end, dynamics of major indexes demonstrated validity of pessimism.

Most of the surveyed in January Russian industrial enterprises reported a rather high for recent years demand growth for industrial products. For the second month in a row, the balance of change remained at a level of +2 points. This at first sight moderate result was a logical continuation of positive changes seen in industry in late 2017. However, in February growth was slowing down and in March halted. By the way, demand forecasts for Q1 2018 demonstrated low level of responses with preservation of positive processes seen in late 2017. Balance of projected demand changes dropped in January by 6 points. Industrial sector learned from the 2015 statements that a rebound from the crisis bottom was to take place soon and failed attempt to rebound from the crisis of early 2017 and, as a result, exhibited reasonable cautiousness in its projections.

This approach justified itself. January surge of output growth rates registered by our business surveys and by Rosstat was replaced in February by extremely low index value. This fact forced experts to better apply seasonal adjustment to the data and correctly use indexes year-on-year in description of business activity. March data on output dynamics in Russian industrial sector demonstrated similar to February picture – weak growth which requires seasonal adjustment and expert handling of required positive results. In their output projections, Russian industrial sector demonstrated in 2018 reasonable care (similar to demand projections). The balance of plans hit multi-year highs in November 2017 and in January 2018 scaled back to the worst levels of 2017 and remained the same in February-March.

This demand and output dynamics together with their forecast determined in Q1 2018 rather logical and what is more important stable trajectory of estimates of finished products. The latter should be underscored especially because in Q4 2017 industrial sector demonstrated uncommon sharp monthly oscillations of estimates which most likely suggest the uncertainty in stability of positive changes. In January 2018, amid upbeat demand the balance again was zero and then began gaining “weight” but highly slow and cautiously. In February, it moved up to +2 points, and in March – to +4. Thus, industry pessimistically assesses quick and final recovery from the crisis but preserves minimal surplus of stock of finished products which speaks about enterprises' readiness to look for a way out of the existing situation.

Meanwhile, the crisis and ongoing stagnation have notably simplified the enterprises to manage their stock of finished products. Precisely during the crisis 2015–2016 years Russian industrial sector brought the share of their normal estimates to 71 and 72% respectively, which was an all-time high. In March 2018, enterprises raised the share of normal responses to 77%. One

more positive outcome of Q1 2018 was a reduction of uncertainty in stock responses to all-time (1992–2018) low, in other words, industry boasts now as never before of coordinated estimates of volumes of their stocks.

Traditional new-year spike of factory-gate prices seen in 2018 turned out to be weaker than in 2017 – +16 points against +22 points registered a year earlier. In February, industrial enterprises in the same traditional way commenced to slow down their price growth – the balance fell to +11 points. However, in March, businesses were forced to raise price more intensively that look uncommon (the January price hike traditionally came to naught in the following months). In this case inflationary expectations experienced by Russian industrial sector were fueled by uncommonly high growth of costs which over three months demonstrated transition from all-time low of +2 points to +27 points.

In early 2018, the Russian industry was well provided with primary resources “amid projections of demand changes”, in other words, possible, although not quick recovery from the slow rolling crisis.

The shortage of qualified staff is felt by solely 11% of enterprises – close to the all-time low index after the default of 1998. Prior to default, the scale of shortage was still lower (6–8%). However, businesses had to “pay” for it by the overhang of excessive workforce (40% of enterprises reported about it in 1996–1998). Currently, only 12% of enterprises report excessive workforce, which gives zero balance of staff headcount estimates. However, this is true of the industry as a whole and the entire territory of the country. Due to the fact that labor mobility is very low in Russia certain enterprises in certain regions can suffer from the shortage of headcount.

The Russian industry reports less shortage of production capacities and at the same time higher overhang of production capacities surplus. The shortage of production capacities in 2012–2017 was reported by 6–8% of enterprises and in Q1 2018 – 7%. Sufficient provision with production capacities in 2017 reported 77% of enterprises which was an all-time high (1993–2017) of the index. In Q1 2018, this index hit 73% with 20% surplus of production capacities. Thus, downbeat of investment plans has not resulted in a surplus of production capacities in the wake of prolonged recovery from the crisis.

In this context businesses demonstrate satisfaction with their investment plans. The investment volumes registered in Q4 2017 and Q1 2018 are seen as normal by 63% of businesses. This is best result since 2011. However, industrial enterprises are ready to accelerate their investment activity.

Terms of lending seen in early 2018 reduced the negative impact on the investment plans of Russian industry by another 10 points (reduction for entire 2016 constituted 20 points), which placed this factor fourth on the rating list of investment plans constraints (according to enterprises responses). At present, solely 14% of enterprises are unable to invest due to high bank interest rates. Another factor – “difficulty in obtaining a loan” – is reported in 2018 by 10% of enterprises. ●

3. CORPORATE LENDING: MARKET EXHIBITS BUOYANCY

M.Khromov

Corporate lending market exhibits buoyancy in early 2018. Nominal volumes of new loans issued to corporate borrowers is close to pre-crisis maximum. However, corporate lending remains low against economic activity. The quality of credit portfolios can not be assessed positively yet due to the resolution of major banks.

The corporate bank loan market demonstrated buoyancy in 2017, which remains in 2018. During 2017, banks issued new corporate loans worth Rb 38.4 trillion up 8.1% from the previous year. In January 2018, the corporate bank loan market volume totaled Rb 2.7 trillion up 22.9% in comparison with January 2017. However, 2017 did not see the record volume of new loans – in 2014 indexes were higher in nominal terms – Rb 38.53 trillion. Nevertheless, results for January 2018 demonstrated transition of the corporate loan market to a new level – the previous January maximum was exceeded by 4.9%.

The rise in the lending market in 2017 was triggered by the increase in both rouble and foreign currency loans. During the year, banks issued loans denominated in the national currency totalling Rb 34.8 trillion up 7.5% against the previous year level. The increase in foreign currency loans was more impressive: it hit 29.4% in ruble terms and 8.1% in dollar terms.

However, the foreign currency lending share remains not too big. In 2017, banks issued foreign currency corporate loans to the tune of USD 62 billion or Rb 3.6 trillion, which constitutes less than 10% of the total loan volume. Moreover, January 2018 saw sharp fall in the number of foreign currency loans compared to January 2017 down 28.8% in the dollar terms and down 32.5% in the ruble terms. The share of foreign currency loans constitute solely 5.0% of the total volume of new corporate loans.

The loan market recovery has been seen not only in nominal terms but most importantly, also in the size of economic activity. During 2017, the volume of corporate bank loans reached 25.1% of companies' turnover compared to 24.2% a year before. However, as against the nominal lending volumes whose pre-crisis level was exceeded, the today's ratio of lending to economic activity in the lending market is far behind the maximum ratios seen in previous periods. The ratio reached 30.4% in 2013 (Fig. 1).

The upsurge in new loans has naturally led to a recovery in outstanding corporate bank loans. During 2017, its volume rose by 4.9% adjusted to revaluation of loans denominated in foreign currency, whereas credit exposure in 2016 dropped overall by 0.1%. During first months of 2018, outstanding cor-

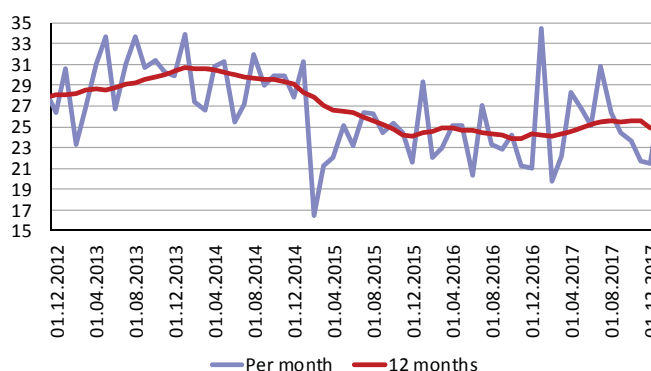


Fig. 1. Ratio of corporate bank loans to companies' turnover, %
Sources: Bank of Russia, Federal State Statistics Service, own calculations.

porate bank loans continued growing. During two months credit exposure rose by 1.2% including corporate ruble debt up 1.3% and corporate dollar debt up 0.7%. Total volume of corporate credit exposure as of March 1, 2018 hit Rb 29.4 trillion (Fig. 2).

To note, despite the reduction of new currency loans issued in January 2018 the credit exposure over two months demonstrated positive dynamics, which allows to suppose that there was a grow in new foreign currency loans in February 2018¹.

The current state of the quality of corporate credit portfolio does not demonstrate significant improvement. For 2017, overdue loans in the total volume of outstanding corporate bank loans decreased only by 0.2 p.p. from 6.1% as of January 1, 2017 to 5.9% as of January 1, 2018. During the first two months of 2018, the share of debt exposure rose to 6.3% due to seasonal factors (Fig. 3).

Foreign-currency components of overdue loans exhibited mixed dynamics. The share of overdue rouble loans in total outstanding rouble loans as of March 1, 2018 dropped by 0.5 p.p. in comparison with the same date of 2017, whereas the share of overdue foreign currency loans decreased by 0.1 p.p. This is due to the overall decline in outstanding foreign currency loans, in front of which the proportion of “bad” foreign currency loans becomes bigger.

A negative factor for the quality of the corporate credit portfolio is the recovered growth in the ratio of loan loss provisions to total credit outstanding due to the resolution of the major banks. Most likely, this issue can solely be resolved surgically – by keeping bad loans off the resolution banks’ books, for example, through setting up of toxic debt funds and dumping bad assets of resolution banks onto the funds balance sheets. ●

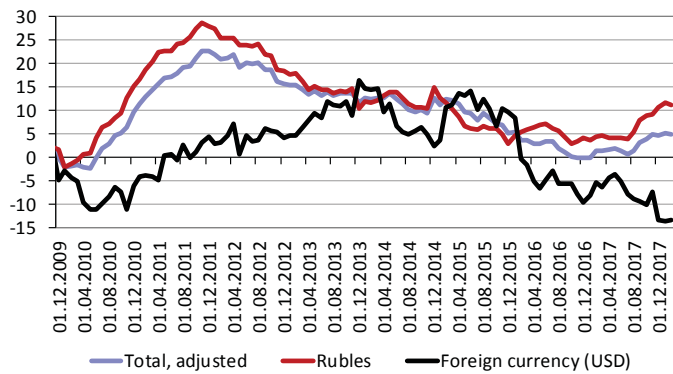


Fig. 2. Outstanding corporate bank loans for 12 months,%
Sources: Bank of Russia, own calculations.

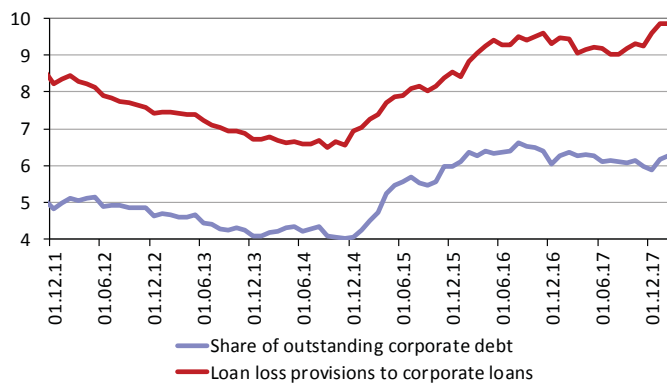


Fig. 3. Indexes of the quality of corporate credit portfolio,%
Sources: Bank of Russia, own calculations.

1 There were no new information on new corporate loans issued in February 2018 as of this writing.

4. DEMOGRAPHIC POLICY MEASURES: THEIR EFFICIENCY AND PREFERENCES OF INDIVIDUALS¹

E.Tretyakova, R.Khasanova

As seen from the analysis of the data of the third wave of the Man, Family and Society survey carried out by the Institute for Social Analysis and Forecasting, RANEPА, people rate highly birth-rate promotion measures undertaken by the RF Government from 2007. Most measures which came into effect in January 2018 (extension of the maternity capital program, payments to low-income families with children and provision of easy-term mortgage lending) meet the society's requests. However, though the maternity capital program is regarded as common good for all, its effect in respondents' estimates is diminishing when respondents' personal reproductive plans are concerned.

The third wave of the *Man, Family and Society* survey (the two previous waves took place in 2013 and 2015), carried out in 2017 by the Institute for Social Analysis and Forecasting (ISAF), RANEPА covered 9,500 respondents from all the regions of Russia. The survey dealt with the key issues of the socioeconomic and demographic development of the society, including those related to demographic policy measures². With an active birth-rate promotion (pronatalist) policy being in effect for over a decade, it is important to understand what people think of that policy's measures to estimate efficiency thereof. On 1 January 2018, the new initiatives related to a wider utilization of the maternity capital (MC), allocation of monthly payments to low-income families with children and introduction of an easy-term lending program became effective.

The Maternity Capital

As seen from the analysis of the data of the survey, most respondents support the government's policy to promote the birth rate, including the MC program³. Over 80% of respondents with minor children say that the undertaken measures had a positive effect on the level of the birth rate in this country. However, a subjective estimate of the MC program's effect on individuals' reproductive plans does not underpin this assumption: nearly 90% of the respondents believes that introduction of the maternity capital has virtually had no effect on their personal decision to give birth to a child. There is a contradiction: the program is viewed as common good for all, but its effect is denied whenever respondents' personal reproductive plans are concerned. Probably, respondents give an answer which is in line with the sentiments of the public at large fearing a condemnation from the outside ("they give birth for money").

1 The authors are grateful to A. Makarentseva, PhD (Economic), Head of the Department of Demographic and Migration Studies, ISAF RANEPА for assistance in preparing this article.

2 For more details on the outputs of the research, refer to: T. Maleva, A. Makarentseva, E. Tretyakova. The Pronatalist Demographic Policy As Viewed by People: Ten Years On // Economic Policy. 2017. Vol. 12. No. 6. P. 124–147.

3 Questions related to demographic policy measures were answered only by persons who had a child under the age of 18 (3,100 respondents).

From 1 January 2018, under Federal Law No.432-FZ the MC program was extended till 2022 and the range of application thereof expanded. Support of the maternity capital program by the general public and respondents' nationwide confidence in its efficiency made the program's extension a logical step towards development of the family-oriented policy.

From 2018, it is permitted to spend the maternity capital on pre-school education from the day a child is two months old (earlier it was allowed to do so only from the day a child is three years old)¹. A wider application of this program is justified by the fact that parents have problems with placing their children in state-owned nurseries. However,

this measure received no response (Fig. 1). Answering the question: "what do you think the maternity capital should be spent on first of all?", the maximum response (31% of those who answered) was given to "the voluntary medical insurance for children or other forms of medical services"; such a reaction is evidence of the fact that people are unsatisfied with the standard of state medicine and pediatrics. Note that only 5% of the parents with minor children were in favor of the option of payment of private nursery services for children under the age of three. Parents with children under the age of three preferred this option somewhat more often (8.2%). Most respondents who selected the "other" option suggested that the existing trend and extension of the MC program should remain unchanged.

As seen from the survey, application of maternity capital funds to payment of pre-school education does not solve the problem related to nursery groups. Private nurseries are still not in demand by most people because of a doubtful standard of quality of their services. Maternity capital funds can be paid only to institutions licensed to carry out education activities; for individual entrepreneurs it is quite a problem to receive a license to render child-minding services. As the procedure for receipt of such a license is rather complicated, most private nurseries operate without it and this makes people doubt the quality of services of all private nurseries. So, the MC program was expanded mostly on a pro forma basis and its effect is not going to be significant.

Payments to Low-Income Families

The survey was carried out in 2017 when the new package of measures was not yet declared and it was believed that payments to low-income fami-

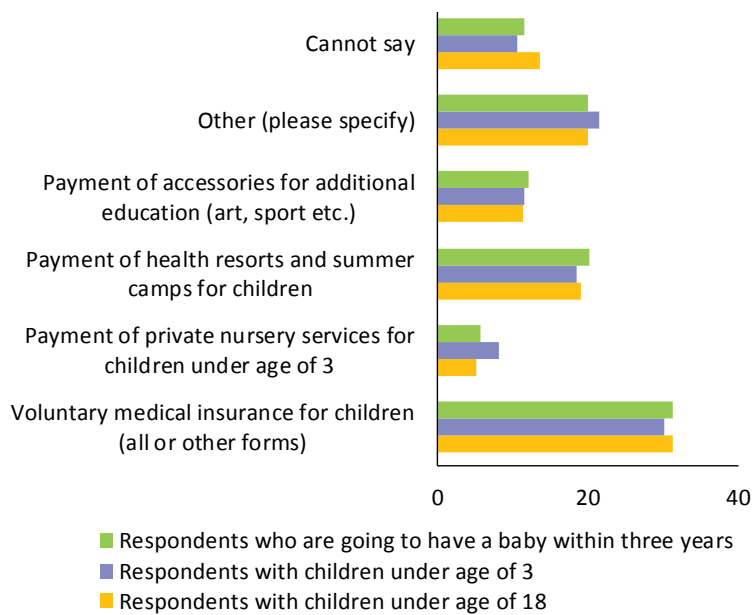


Fig. 1. Distribution of the answers to the question: "In Russia, the maternity capital can be spent on education of children, upgrading of housing conditions and mothers' funded pensions. What else should the maternity capital be spent on first of all?", %

1 Federal Law No. 432-FZ.

lies could replace MC, rather than supplement it. So, in the survey respondents were asked to make a choice between the maternity capital program and payments to low-income families with children. Most respondents were in favor of the MC program being extended (63.4%), while 30% of respondents preferred the other option. The extension of the program was supported by those who did not qualify for the category of low income persons and, so, would not benefit from replacement thereof, while the option of payments to poor families with children was preferred by people whose income was not high. It was not clearly specified in the questionnaire what criteria of the category of “poor families” were like; probably, due to this uncertainty respondents failed to attribute themselves to potential recipients of payments even in cases where they could actually qualify for them.

The level of income highly correlates with a respondent’s education and place of residence. Replacement of the maternity capital by payments to poor families was largely supported by persons who did not have higher education (35.2%). Note that only 21.9% of respondents with higher education and undergraduate degrees were in favor of such substitution. Among the respondents residing in rural areas, the share of those who were in favor of the replacement was equal to 37.3%, as compared to 27.2% in cities.

Generally, replacement of the maternity capital by payments to families with children was supported by people who potentially qualified for the category of recipients of such payments, while a more numerous category of people with a higher level of income wanted the program to remain unchanged. Federal Law No. 418-FZ¹, which came into effect from 1 January 2018 has met the requests of low-income families on one side, while the extension of the MC program and expansion of the range of application thereof permitted to meet the interests of both the groups, on the other side.

Mortgage

Maternity capital funds are mainly used for upgrading housing conditions. According to the official data of the Pension Fund, 91.1% of those who apply for MC certificate select upgrading of housing conditions. This statistics is underpinned by the survey’s data: among the respondents who used maternity capital funds the same 91.1% of respondents used them for upgrading housing conditions. Also, 63.5% of persons who spent funds on those purposes from the launch of the MC program reduced their debt on mortgages.

From 1 January 2018, families with the second or third child can apply for an easy-term mortgage (6% per annum). Families which have already had a mortgage at birth of the second or third child may refinance the outstanding mortgage balance at the interest rate of 6%. The program is applied only to the primary market housing and will be in effect for the period of 3 years and 5 years from the date of execution of a subsidy at birth of the second child and the third child, respectively.

According to the data of the survey, young couples with children often live in space-limited housing conditions: if in the total sample 27.7% of respond-

¹ From 1 January 2018, families with an average per capita income below 1.5 of the value of the minimum subsistence level of the able-bodied population in regions are entitled to monthly payments at birth or adoption of the first child. A family receives payments until the child is 1.5 years old; the amount of payments corresponds to the size of the regional minimum subsistence level envisaged for a child. If the second child is born, the family receives cash payments of a similar size, but they are paid out of the maternity capital.

ents live in such conditions, among young couples at the age under 35 with one or two children this share amounts to 41.7%. The housing issue for young families with children is rather topical: 45.3% of the respondents believes that they should postpone with a baby birth till relevant housing is bought and sustainable employment found. Among households, in which a respondent lives with a partner and one or two children, that is, the same category of people potentially entitled to an easy-term mortgage lending, this share amounts to 44.5% as in the total sample.

As seen from the survey, provision of easy-term mortgage lending for families with children is one of the most required lines of the pronatalist policy.

Generally, the *Man, Family and Society* survey of 2017 identified strong support by the population of measures aimed at promoting the birth rate and the standard of living of families with children. Most measures taken in December 2017 meet the requests of the society. An exception is permission to spend maternity capital funds on pre-school education from the date a child is two months old: despite problems with nurseries this option of utilization of maternity capital funds was selected by only 5% of the respondents – parents of children under the age of 18. However, it does not mean that this line is going to be stopped. There is a problem with placing a child with state-owned nurseries, but this issue cannot be solved exclusively through allocation of funds on payment for private nurseries' services. The absence of demand on private nurseries can be explained by mistrust of the general public to such institutions. Based on the data of the survey, it is feasible to identify other potential lines of the maternity capital utilization, for example, payment for voluntary medical insurance, health resorts and summer camps for children and other. ●

5. THE EFFECT OF ROUBLE EXCHANGE RATE ON RUSSIA'S LONG-TERM INDUSTRIAL DEVELOPMENT¹

V.Osmakov

The effect of rouble exchange rate on Russia's industrial development depends on many factors, including enterprises' sectoral affiliation, long-term plans, export opportunities, etc. However, surveys on preferable rouble exchange rates in industry often rely on senior managers' personal views.

Stable rouble: Lon-term investors' interests

Surveys of The Gaidar Institute for Economic Policy (The Gaidar Institute) as well as analytical research of The Russian Union of Industrialists and Entrepreneurs (RSPP) show high demand for a stable rouble in the Russian industry.

Considering that only one fourth of Russian companies (24.8% in 2016, according to RSPP's data²) have development strategies for periods beyond the five-year period, a stable rouble is an argument for predictable business environment and for the provision of opportunities for investment planning.

A 20% adaptability of investment plans to the recent rouble exchange rate, as noted by the Gaidar Institute, is very close to the proportion of companies that have long-term plans.

An example of how economic instability stemmed from, among other things, devaluation of the rouble put a break on rapid growth of enterprises is a severe working capital crunch facing the consumer goods industry in 2014.

Industrial sector's concerns about a weaker rouble come from the assumption that rouble devaluation can lead to higher domestic market prices, inflation rate and therefore banks' interest rates, thus making expensive credit facilities even less affordable than they are now.

Rouble appreciation: The need for equipment

Industrial enterprises are faced with equity capital squeeze and expensive enough fundraising. Therefore, they have to be thrifty when making investment decisions.

If the conclusion that imported products have to be purchased anyway seems to be true (the proportion of domestically-manufactured equipment cannot increase endlessly), then industrial development is contingent upon rouble appreciation and therefore lower import costs.

Gaidar Institute's business surveys show that nearly half of industrial enterprises would like to see a stronger rouble to be able to invest, that is to say that the issue of reliance on imported engineering equipment still exists (it is now far less hot though than it was, due to import substitution policy). The Russian engineering industry may fall into a trap though: products that the industry is unable to supply will have to be imported.

¹ This article is written in response to the article of Sergey Tsukhlo, 'The rouble's exchange rate that will be best for Russian industry', published in The Monitoring of Russia's Economic Outlook: Trends and Outlooks of Socio-Economic Development No. 4(65), March 2018.

² RSPP's Report on Russia's Business Environment in 2016.

Therefore, rouble appreciation is indeed beneficial for enterprises that need to upgrade their equipment, whereas it affects the competitive power of engineering products in the domestic market.

Surveys often rely on senior managers' personal views that focus on benefits for their enterprises, here and now. Considering that most of them have no long-term plans, neither export their products nor plan to do so, the solution of a sub-problem of technological modernization, imported equipment purchases for a specific enterprise does bring benefits here and now.

Respondents objectively view the effect of rouble appreciation on other non-surveyed industrial sectors and enterprisers as an external effect that does not require any consideration. Considering that rouble appreciation makes Russia-made products less competitive in the global market, today's solution of the modernization problem will inevitably lead to a problem of being unable to export products in the future, when domestic markets face a glut.

A few high-tech niche products that are exported now as well as equipment manufacturers in the domestic market will face immediate problems that could lead to shutdown of even relatively modern and competitive manufacturing facilities.

Ultimately, the rouble exchange rate will have to be "let down" in the future, possibly in a more abrupt manner and under worse conditions for the product manufacture structure.

Rouble depreciation: Exports gain most

Price competition in global markets is most peculiar to mass commodity goods. Therefore, Russian exporters of hydrocarbons, metals and mineral fertilizers Rouble depreciation are first to profit from a weaker rouble.

Sophisticated products, however, compete by the price/quality ratio (consumer properties, ancillary maintenance services, terms of supply, etc) rather than just the price tag. Therefore, rouble depreciation can hardly be viewed as the sole, universal or key way of expanding high-tech industrial exports.

Import substitution targets are expected to be reached by 2020. The industry average reliance on imports is expected to stay at about 50% (at about 60% for critical values), that is, some kind of reliance on imports will still exist.

This means that other things being equal a rouble depreciation will hit most of the industries (due to higher value of means of production) and affect seriously the competitive power of some (due to higher costs of materials and accessories) in the foreseeable future.

Such an attitude of respondents toward imports exhibits a limited effect of supporting means of production: if the government intends to reverse the momentum, the size and mechanisms of support the engineering industry (machine-tool manufacture, heavy engineering industry) have to be revised to the extent of implementing a government program for the production of means of production.

When conducting surveys of industrial enterprises, it's important to consider sector-specific characteristics of respondents as well. It is clear that the sectoral structure and the level of competition with imports in, for example, the consumer goods industry differ largely from respective figures for the heavy engineering industry. Generalized industry-wide data cannot help identify sectors that today have more to gain than to lose from rouble devaluation owing to less imported products.

National producers and importers occupy different niches in most domestic markets, with the former having no opportunities to expand their business and outcompete importers, while the latter see no economic reasons, at least with the exchange rates as they are now, for expanding their presence in the market.

Exchange rate policy “forks”

A *stable rouble* will dampen industrial development, whilst nonetheless allowing investment projects in progress, particularly long-term projects, to be implemented and encouraging the use of tools other than price advantage to enhance competitive power.

With a stable rouble, efforts should be focused on accelerating the output of means of production and parts and accessories, eliminating flaws in supplies of materials to industrial sectors, including localization of foreign production facilities within the Russian territory.

Experts of mass standardized products are the only ones who consider *rouble depreciation (devaluation)* as a preferred option.

Today, rouble devaluation is not overall beneficial for the manufacturing industry. The losses from higher value of imported parts and accessories out-run the gains from stronger price competitiveness in the domestic market. Most of enterprises do not consider export supplies as an alternative to the domestic market.

Rouble appreciation will facilitate industrial output for a wide range of industries until benefits from cheap imported equipment come up with the costs of lost price competitiveness and increased presence of foreign manufacturers in the market. A “tipping point” is determined by product profitability, reliance on imports of equipment, and price advantages over imported products.

A strong rouble policy requires substantial support of demand for Russian means of production. Overall, there will be no possibility for long-term industrial development: exports will face constraints and the domestic market will end up with a glut before long. ●

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