

# ONLINE MONITORING OF RUSSIA'S ECONOMIC OUTLOOK

TRENDS AND CHALLENGES OF SOCIO-ECONOMIC DEVELOPMENT

№ 5(23) March 2016

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## MAIN TRENDS AND CONCLUSIONS

The chronicle of current economic events appears to be almost serene, one typical feature of it being the disappearance (albeit temporary) from the vocabulary of media news reports of the phrase high volatility. However, this is by no means indicative of the lack of any significant developments that either confirm the existing trend or give rise to new ones.

Among these developments is the refusal of the majority of western banks to buy Russian Eurobonds, which are quite reliable and can offer a rate of return that is more than profitable in view of the current situation in the stock market, the reason being the insistent recommendations voiced by the US and EU administrations. Possibly, the RF Ministry of Finance will nevertheless find a way to attract the desirable \$ 3bn to cover Russia's budget deficit. However, the situation unequivocally leads to the following conclusion: there is no more any sense in saying that the sanctions are 'sectoral', they are really global and in fact informal, and all recommendations now available are vague and unreliable. From this follows a practical conclusion: the scenario for the next few years may be oriented, with an increasing assurance, to the lowest possible foreign borrowing indices

In their turn, such expectations make it difficult to find ways to cover Russia's budget deficit. On the one hand, the situation creates incentives for budget cuts, while on the other hand it gives rise to stimuli for emission of money and its various manifestations. This theme is being discussed with increasing frequency not only by the expert community, but also by the government, including the country's leaders.

As noted by the RF President, he is now forced to constantly listen to arguments for and against funding the national economy by means of money emission. For now, this has to do in the main with the RF Industry Development Fund (the proposal that it should be increased manifold having been declined by the President) and the project funding program. The arguments against its expansion are being put forth by those government departments that substantiate these arguments by the fact that the projects need to be further elaborated, and quite a lot. But the main reason, most probably, is their fear that the Bank of Russia will soon have to provide direct financing to the economy, and on an increasing scale. Moreover, it is precisely such demands, only based on a figure of a higher magnitude and coupled with the demand to lower all taxes and to issue non-market loans on a massive scale, that are voiced on the political level, as part of the election campaign. As a result, the government departments suggesting that financing should be increased in 'homeopathic doses' are effectively acting as precursors of hyperinflation.

The members in the equation 'money-growth-inflation-stagnation' may trade places in many possible ways according to their taste, but still some place will have to be found where this country's population can actually be squeezed. People suffer from both inflation and stagnation, let alone stagflation. The government, which during the fat years of a splendid economic situation failed to acquire an experience of effective social policy, is now try-

ing to apply at least those tools that are at hand. For example, it raises the minimum wage. However, these tools, borrowed from another era that is already a thing of the past, are ill-suited to the task of providing social support. The accounting and fiscal function that was once assigned to the minimum wage resulted first in fines and penalties being pegged to it, followed by the mandatory social taxes paid by self-employed individuals and individual entrepreneurs. In other words, millions of entrepreneurs and millions of people punished by a fine will start to pay more (in this case, by 20%), but it is nearly impossible to say how many people will become better off as a result, and how much better.

However, a more much fundamental discovery is the increasing awareness, growing into confidence, that temporary difficulties are now here to stay.

The surveys conducted by the RANEPA's Institute for Social Analysis and Forecasting (INSAP) demonstrate that over a year's period (from February 2015 through February 2016), the number of respondents who expected an improvement in this country's economic situation shrank nearly by half, while the share of those who were preparing for a long period of economic decline doubled.

People react to their bleak expectations mainly by passive forms of adaptation – first of all reducing their consumption. The only notable answer in the February 2016 survey (given by 24% of respondents) that can be estimated as a manifestation of activity was the intention to resume the reliance on the crops yielded by their private land plot as a source of income.

It must be admitted that today there exist fewer opportunities for active 'anti-crisis' behavior patterns than, say, in the 1990s. That was the period of unbalanced markets, and differences in the structure and price levels (both domestic and international), as well as other misbalances offered many possibilities for informal employment, unorganized trade, and so on. By now, many of these possibilities have become unavailable, while small-scale entrepreneurship can hardly be regarded as a source of existence for any more or less significant of social groups. Rather, small businesses are becoming less active, which is also obvious if one looks at the lending market indices for 2015.

On the whole, the volume of corporate ruble-denominated loans issued over last year declined by nearly 10% (while loans denominated in foreign currencies plunged nearly twofold). The slowdown took place first of all in the sphere of lending to small businesses: while the volume of (ruble-denominated) lending to big business shrank over the year by 5%, that of lending to small and medium-sized enterprises – by 30%, and individual entrepreneurs borrowed practically half of the amount of money borrowed a year earlier. Meanwhile, it is in the group of small and medium-sized businesses that the share of outstanding debt against loans almost doubled over the same year – to 15.4%. The share of outstanding debt for big clients rose only slightly, amounting as of the beginning of 2016 to 6.4% of debt against ruble loans and 3.7% against FX loans. The leaders in the growth of outstanding debt against loans are the construction and trade sectors, while the same two sectors were fastest in reducing their debt to banks and the least likely to take new loans. Agricultural companies, on the contrary, borrowed much more than they had done in 2014, and the most active borrowers were the oil-refining industry, the food industry, and the pulp-and-paper industry.

It can be assumed that the shrinkage of the corporate lending market occurred in part due to the tougher lending conditions. Nevertheless, judg-

ing by the results of the February survey of Russian industrial enterprises (conducted as part of the regular surveys by the Gaidar Institute's experts), loan availability is estimated to be one of the less important issues. Moreover, in January–February 2016, 50% of enterprises across Russia's industry estimated the situation with regard to loan availability as being normal (that is, somewhat higher than in summer 2015). This is rather good index, given the fact that the ongoing discussions often rely on the argument that the low availability of borrower money is supposedly the main problem currently plaguing the Russian economy. Meanwhile, according to the same February survey, the producers are much more concerned about the low demand for their products.

Against this background, paradoxically, the enterprises were planning to raise producer prices on a bigger scale. It is quite possible that such plans are the upshot of yet another plunge of the ruble against the world's major currencies that occurred in January–February. So the producers, in expectation of a new inflation surge, began to prepare for the necessity to raise their own prices. It is not easy to understand how such a policy can be possibly in face of the low demand that is pointed to by the same producers as one of the major constraints. The obvious conclusion is that the frequently voiced opinion – that enterprises have already successfully adapted to the new conditions – is somewhat premature.

Meanwhile, Russia's oil extraction industry so far has no plans of raising the producer prices, and their sharp plunge (and the resulting income plunge) was offset by rising crude output and sales volume. In 2015, crude output hit its record high since 1990, while oil exports (including exports of petroleum products) rose to a historic high. The share of net exports of crude oil and petroleum products in total output exceeded 77%. This is an exceptional achievement, given that more than 3/4 of the entire oil production is taken up by exports, and it can in part be explained by the decline of domestic consumption in response to economic slump. Moreover, if Russia's oil refining industry should finally upgrade its technologies, and the depth of oil refining become level with the corresponding indices for the developed countries, the domestic demand for crude oil will decline even further. Then, it will become possible to distill a smaller amount of crude to produce the same amount of motor fuel – the principal product of primary crude oil distillation.

However, the records of 2015 are probably indicative of the fact the production capacity of Russia's oil extraction industry has reached its peak. The mature oil fields are becoming increasingly depleted, the new ones require an expensive transport and production infrastructure, while the huge oil reserves that are still untapped due to lack of proper development. Today, Russia's oil extraction coefficient is approximately 1.5 times lower than in the developed countries (and the state of affairs in the oil industry was the same in the Soviet era). This is also the upshot of the tactical approach of big oil companies, which prefer simply to move on to new oil fields (the small and medium-sized businesses in the oil industry, as they are more inclined to exploit smaller oil fields and low-output oil wells, are probably even worse off at the present moment than those operating in other industries), and the lack of modern technologies. The latter problem has been only aggravating over the past two years, after the introduction of a ban on the supplies to Russia of equipment for oil extraction at sites with worse geographical and mining parameters.

The terms of trade have been deteriorating not only as a result of economic sanctions, but also because Russia's relations with some of her partners in trade have worsened. One vivid example is the issue of international auto shipping between Russia, on the one hand, and Poland and Ukraine on the other. The partial disruption of auto shipping routes seriously affected the cargo flows and made them more expensive. Firstly, the costs of transport services jumped due to the altered routes; secondly, the proceeds of freight forwarders plunged; and the proceeds of transport companies also plunged. In this connection, according to expert estimations, the losses of Polish and Ukrainian auto shipping companies have become higher than those sustained by Russian ones. The temporary agreement (until the year's end) recently achieved between Poland and Russia will help reduce these costs. However, the very fact that such costs have arisen, and that they are quite unrelated to any sanctions, is a sign that the potential risks for economic cooperation are on the rise, and unlikely to disappear. ●

## 1. SOCIAL WELL-BEING: THE EXPERIENCE OF THE 1990S WILL NOT HELP

E.Avraamova, D.Loginov

*Optimism registered in H1 2015 about the extent and duration of crisis phenomena gave way to growth in negative expectations. The latest survey carried out within the frameworks of permanent research in social well-being of the Russians by the RANEPA's Institute of Social Analysis and Forecasting points to that explicitly. The share of those who believe that the situation changed much for the worse rose by 12% as compared to November 2015 and amounted to last year's values when panic sentiments of the end of 2014 – beginning of 2015 were observed.*

Table 1

DISTRIBUTION OF ANSWERS TO THE QUESTION:  
“HOW WILL THE ECONOMIC SITUATION CHANGE IN THE COUNTRY?”,  
% BY COLUMN

Nature of change	The share of respondents who chose the respective answer, %		
	February 2015	November 2015	February 2016
The situation will change for the better soon	22.2	23.0	11.8
No further deterioration, the situation is getting stable	25.4	25.9	16.5
The situation will be changing for the worse within 1-2 years	24.5	22.3	37.1
The situation will be changing for the worse for over 2 years	11.5	13.8	20.8
Difficult to answer	16.4	15.0	13.8

As compared to previous surveys, the share of optimists believing that the situation will soon change for the better decreased by 50%. The share of those who believe that the crisis is going to last for over 1–2 years has doubled. The general nature of the dynamics of perceptions about the duration of the crisis is negative. At the same time, there are virtually no large-scale sentiments of apprehension that a full-scale economic crisis is on the way. There is a high extent of uncertainty in assessment of the prospects of exit from the crisis: the evidence of that is the fact that 14% of respondents found it difficult to answer that question.

Throughout the entire period of surveys, the share of households who think they are invulnerable to the crisis has not virtually changed, but it is within the range of only 10%.

The share of those directly affected by the crisis (either greatly or slightly) is aggregately rather high: in February 2016 it exceeded by 3 p.p. the value of November 2015 and amounted to 78%. Growth took place due to those who were affected the most.

So, negative effects of the crisis (job losses, cuts in wages and salaries and partial employment) are gradually spreading over a large number of population strata and economic activities.

Table 2

DISTRIBUTION OF ANSWERS TO THE QUESTION: "DID CHANGES IN THE ECONOMIC SITUATION IN RUSSIA AFFECT YOUR FAMILY AND YOU?",  
% BY COLUMN

Nature of change	The share of respondents who chose the respective answer, %		
	February 2015	November 2015	February 2016
Did not affect and are unlikely to affect	6.2	8.2	7.0
Did not affect so far, but may affect in future	24.3	11.4	13.4
Affected slightly	46.1	44.7	44.4
Affected greatly	20.2	31.1	33.9
Difficult to answer	3.2	4.6	1.3

For the time being, such an extent of crisis phenomena affecting more and more people does not suggest revision of the existing model of economic and, in particular, labor behavior, but, on the contrary, makes a large number of Russians believe that they should just wait till this unfavorable period is over without taking any efforts, that is, cuts in consumption of goods and services alone would be sufficient enough.

Generally, the monitoring's data point to explicit shrinkage of consumer activities not only among low-income people, but also middle-class and relatively high-income people<sup>1</sup>.

Table 3

REDUCTION/RISKS OF REDUCTION OF EXPENDITURES DEPENDING  
ON THE LEVEL OF MATERIAL WELL-BEING, % BY LINE<sup>2</sup>

Level of material security (self-evaluation)	Reduction of expenditures			
	have already happened		may happen in future	
	February 2015	February 2016	February 2015	February 2016
On relatively expensive goods				
Low	38.6	50.3	8.3	9.7
Average	39.4	37.3	21.6	21.5
Above average	17.4	18.6	30.8	28.3
Generally	34.8	39.2	19.6	18.2
On medicine				
Low	28.7	36.0	32.9	28.7
Average	21.0	14.5	31.4	32.5
Above average	8.1	8.1	19.9	26.3
Generally	20.7	21.4	29.6	30.2
On education services				
Low	7.6	9.7	6.2	7.6
Average	7.6	7.6	8.2	9.2
Above average	7.5	5.5	5.6	8.1
Generally	7.6	8.0	7.1	8.4

1 High-income groups are not normally among respondents of large-scale surveys, so it is people with a higher income as compared to other groups of the population that are meant here.

2 Line amount is not equal to 100 as the data on those who did not consume respective goods and services before the crisis and those who found it difficult to answer are not provided.

Use of the unfavorable period for promotion of human capital growth (investments in education and healthcare) is not wide-spread – maximum 15% of respondents. Utilization of a personal subsidiary plot for receiving income is more popular: in February 2016 24% of households said that they were going to resume that activity again.

It is to be noted that explicit institutional factors are behind domination of passive forms of households' adaptation to negative developments. The options which were available to people during the transformation crisis of the 1990s are now virtually exhausted.

Disorderly trade was ousted by large retail store chains, while depreciation of the ruble and a drop in households' solvent demand make that sector of the economy unprofitable. In any case, it cannot create as many jobs as existed in the 1990s when shuttle trade was on the rise.

Small business without investments, but with a large number of administrative barriers which emerged in the past decade and became a curse for small business entrepreneurship in Russia does not create new jobs, nor is it able to produce sources of subsistence to large social groups of the population.

Unofficial employment was a creation of the 1990s and played an important role in households' adaptation to a social stress. However, the fact that in the past few years the extent of unofficial employment does not depend directly on economic parameters and even if it depends there is a substantial time lag suggests that unofficial employment volumes are in equilibrium which is adequate to the existing pattern of the economy and the labor market. Due to the above, the unofficial economic sector is unlikely to react vigorously to the economic crisis by creating new unofficial jobs and play a serious damping role.

At present, institutional capacities which had an important adaptive role to play during the crisis of the 1990s are not available to people.

The latest outputs of the monitoring point to the fact that the commodity-based economy which was formed in the past 15 years had an impact on formation of large-scale models of socio-economic behavior. People proceeded from the fact that, first, growth in personal and family well-being took place on its own regardless of efforts aimed at promotion of competitive edge and labor efficiency and, second, the state was behind the source of growth in personal and family well-being. It was growth in parental orientations and relevant behavior models that gave rise to such perceptions. Implementation of those models was of rational nature when the economic situation was favorable, but it is counterproductive during the crisis. The problem consists in the fact that change in earlier dominating behavior models is complicated due to a lack of institutional environment for implementation of behavior models based on self-fulfillment, utilization of own social development resources and individual competitiveness. ●

## 2. BANK LENDING TO CORPORATE BORROWERS: THE CONTRACTING PHASE

M.Khromov

*In 2015, the volume of loans extended by banks to enterprises and organizations drastically declined. The volume of new loans granted during the year plummeted, while the amount of debt owed to the banking sector by corporate borrowers remained practically unchanged. The decline rate of credit extended to big businesses was lower than the overall median, and the quality of their accounts payable was higher than the average, while the small and medium-sized business borrowers that had shown a considerable laxity of repayment discipline were much less able to secure bank loans.*

In 2015, the credit market for corporate borrowers significantly contracted. The volume of ruble-denominated loans extended to corporate borrowers dropped by 9.8% relative to 2014 – from Rb 33.2 trillion to Rb 30.0 trillion. The volume of loans granted in the forex segment of the market simply plummeted: the volume of new loans extended to corporate borrowers dropped almost twofold relative to the previous year: \$ 68.6bn in 2015 vs. \$ 134.5bn in 2014.

Despite a significant decline in new loans extended to corporate borrowers, the amount of their ruble-denominated debt to the banking sector increase by a mere 1.1% over the course of 2015. A similar situation was seen in relation to forex loans. The two-fold drop in new loans resulted only in a small (2.7%) decline of corporate debt in US dollar terms. The aforementioned change in the ratio between the amount of corporate debt and the amount of new loans can apparently be explained by a considerable increase in the loan period. During 2015, the share of loans with the repayment period exceeding three years in the total amount of debt accumulated by non-financial organizations increased from 47% to 51%.

The slowdown in the growth rate of loans extended to the economy in the year 2015 was accompanied by a notable deterioration in the quality of debt servicing on the part of corporate borrowers. The amount of their overdue accounts payable increased at an accelerated pace: the volume of overdue ruble-denominated loans grew almost 1.5-fold (by 48.6%), while the volume of overdue forex loans rose by 80%. As a result, over the course of 2015, the share of overdue ruble-denominated loans increased from 5.0% to 8.8%, while the share of forex loans increased from 2.1% to 3.8%. At the same time, the quality of forex loans remained much better than that of ruble-denominated loans.

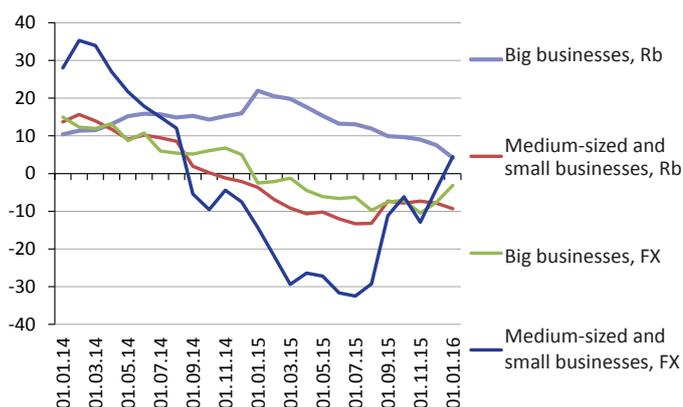
As far as the size of a borrower business is concerned, it should be said that the slowdown in the growth rate of loans extended to corporate borrowers mainly affected small and medium-sized businesses. Thus, in the ruble segment of the credit market for corporate borrowers, the amount of credit extended to big businesses dropped only by 5%, while the amount of loans extended to small and medium-sized businesses – by 30%. The slowdown in the growth rate of loans extended to individual entrepreneurs was even more pronounced: the amount of loans extended to them in 2015 dropped almost two-fold relative to 2014.

Quite naturally, the aforesaid dynamics of new-loan lending resulted in a change in accounts payable. As far as big businesses, small businesses and individual entrepreneurs are concerned, their accounts payable to banks declined, over the course of 2015, by 4%, 10% and 27% respectively.

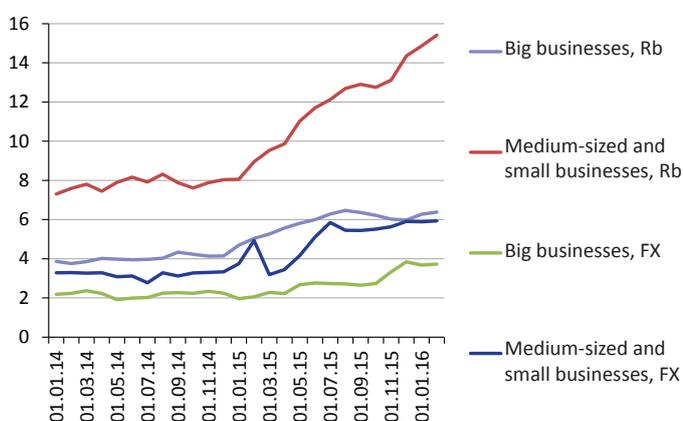
The situation in the forex segment of the credit market for corporate borrowers was slightly different. Firstly, there was a considerable fall in the amount of loans extended to all categories of borrowers. Secondly, the performance of medium-sized and small businesses with respect to borrowing from banks (-41%) was only slightly better than that of big businesses (-50%). Correspondingly, the dynamics of forex-denominated accounts payable of big businesses and all the other businesses was the direct opposite of the dynamics of ruble-denominated credit extended thereto. Big businesses reduced their forex-denominated debt to banks by 3.1%, while small and medium-sized businesses, on the contrary, increased theirs by 4.5%.

As shown by the results of the year 2015, the traditional observation regarding the quality of loans held true: the bigger the borrower, the better its debt was served. This observation held true both with regard to the ruble and forex segments of the credit market for corporate borrowers, as well as to the dynamics of overdue loans. The share of overdue loans extended to big businesses grew the least and remained lower than the share of overdue loans (both ruble-denominated and forex-denominated) extended to medium-sized and small businesses. Thus, over the course of 2015, the share of overdue loans extended to large corporate clients increased by a mere 1.6–1.7 p.p. By the beginning of 2016, the share of ruble-denominated loans extended thereto had risen to 6.4%, while that of forex loans – to 3.7%. The rise in the share of forex loans extended to small and medium-sized businesses was approximately the same: by +2.1 p.p., to 5.9% as of the beginning of 2016. At the same time, the quality of ruble-denominated loans extended to small and medium-sized businesses considerably decreased: over the course of 2015, the share of overdue ruble-denominated loans increased by almost 7 p.p., to 15.4%.

In 2015, the progress of bank lending to businesses involved in various types of economic activity was multidirectional. In the ruble segment of the credit market for corporate borrowers, there was a rise in the volume of loans extended to agricultural enterprises (by 12% relative to 2014) and to a



Source: Bank of Russia.  
 Fig. 1. The growth rate of credit extended to corporate borrowers relative to the corresponding date of previous year, %



Source: Bank of Russia.  
 Fig. 2. The share of overdue loans extended by banks to their corporate clients, %

Table 1

## THE MAIN PARAMETERS OF BANK LOANS EXTENDED TO VARIOUS BRANCHES OF THE ECONOMY IN 2015

	Ruble-denominated loans			Forex-denominated loans *		
	Rise in extended loans, as %, on previous year	Rise in debt, as %, on previous year	Share of overdue loans, as of 1.01.2016, %	Rise in amount of extended loans, as %, on previous year	Rise in debt, as %, on previous year	Share of overdue loans, as of 1.01.2016, %
Total	-9.8	1.1	8.0	-49.5	-2.7	3.8
mineral extraction	-21.9	9.0	2.1	-44.4	0.8	6.0
processing industries	37.4	13.2	5.9	-47.8	-10.0	2.2
production of food commodities, including beverages and tobacco products	83.3	8.7	8.5	-34.8	-5.8	1.1
timber processing & wooden product manufacturing	-28.5	-3.0	12.6	-73.6	-5.8	1.0
pulp & paper production; publishing activity	42.5	27.3	13.2	50.5	-15.6	2.3
production of coke, petrochemicals and nuclear materials	127.4	99.7	3.4	-47.6	-5.5	0.8
chemical production	-3.7	8.5	3.6	-84.5	-27.5	0.5
manufacturing of other non-metallic mineral products	-9.1	10.6	7.2	-43.4	4.4	17.9
metallurgical production & manufacturing of finished metal products	3.5	32.7	6.7	-19.9	16.0	0.3
manufacturing of machinery & equipment	-16.7	4.0	5.3	-69.6	-33.0	14.0
manufacturing of means of transportation & transport equipment	-7.0	6.9	1.8	-27.6	-18.5	1.8
production & distribution of electrical energy, gas & water	-16.0	6.8	2.2	-71.4	0.6	0.0
agriculture, hunting & forestry	11.6	5.0	9.9	-50.9	-28.9	23.2
building construction	-32.7	-12.4	22.4	-56.0	-12.9	3.4
transport & communication	-5.1	-6.2	6.6	-45.5	-9.6	5.0
wholesale & retail trade; repair of passenger-carrying vehicles, motorcycles, home & kitchen appliances & personal demand items	-23.3	-17.3	10.9	-40.8	-4.2	5.7
transactions with real estate; lease of property & rendering of services	-4.3	13.5	5.7	-48.8	-1.1	3.8
other types of activity	-12.4	8.0	5.9	-58.3	17.6	2.2

\* The growth rates of forex-denominated loans are calculated in US dollars.

Source: Bank of Russia.

wide range of processing industries. The largest recipients of loans from the banking sector that were mainly responsible for loan growth in 2015 were oil-refining enterprises (+127%); food industry enterprises (+83% relative to 2014); and pulp & paper and publishing enterprises (+42%). These industries also showed a significant rise in their ruble-denominated accounts payable to banks.

The greatest decline in the volume of bank lending extension was in the construction sector (a 33% drop in the volume of extended loans and a 12% drop in the volume of debt) and commerce (a 23% drop in the volume of new loans and a 17% drop in ruble-denominated debt).

The dependence of the lending market's behavior on the quality of loans was evident only with regard to those industries where the volume of bank loans issued to businesses was on the decline. The construction sector reached a record high in its volume of overdue debt, which amounted to 22% of the total volume of ruble-denominated loans extended thereto. The share of overdue loans in the total amount of loans extended to commercial enterprises is also higher than their average share with regard to all borrowers (11% vs. 8%).

Borrowers with low credit scores were also able to receive bank loans. Thus, while the quality of loan servicing remained high and the share of overdue debt amounted to a mere 3%, the quality of the loan portfolio of borrowers in the food industry was merely adequate (8.5%). ●

### 3. INDUSTRIAL ENTERPRISES: LESS DEMAND – MORE PESSIMISM

S.Tsukhlo

*The February business surveys' data showed falling demand on their products and commitment to cut output. Uncertainty of the economic situation becomes the main reason for producers' concern. However, they are not so active in curtailing their investment plans as it happened in 2015.*

#### **Demand for Industrial products**

The February data demonstrated deteriorating dynamics of demand on industrial products following relatively not so bad result posted in January when seasonally adjusted sales growth rate turned out to be above values registered during preceding months. February 2016 registered the most significant reduction of demand assessments on industrial output.

February sales volumes do not satisfy 55% of businesses, which is the worst result registered during three recent years. Although in August 2015, unsatisfactory assessments of demand constituted only 39% and in August 2014 – 38%. Russian industry attempts to increase output volumes taken in late 2015 – early 2016 were not ensured by sufficient demand volumes.

#### **Stocks of finished products**

Somewhat deterioration of assessments of stocks of finished products confirms the previous conclusion. In February 2016, balance of these assessments hit maximum since May 2014, i.e. during 20 preceding months (those months are far from being simple) Russian industry strongly controlled balance between demand and supply keeping surplus stocks over most months at the minimum level, which fact previously was registered in 2006–2007. During these recent 20 months, the share of assessments of stocks as 'normal' hit the all-time high of 75%. Now (in January–February 2016) normal stocks of finished products account for 70% of businesses. Moreover, this situation cardinally differs from what was going on during past crisis: at the peak of crisis years of 2008–2009, the indicator immediately fell to 42%, in default year of 1998 – to 30%, and in 1994 – to 22%.

#### **Industrial output**

February assessments regarding changes in output after seasonal adjustment demonstrated solely small deterioration of the indicator compared to January values. Russian industry as before is not committed to take risks in complicated economic and geopolitical conditions and so far prefers to maintain existing output volumes.

However, this situation can last only awhile. Firstly, output plans of Russian industry during three recent months have shed 14 points and have dropped to 44-months minimum level. Secondly, in 2016, Russian industry commitment to sacrifice output volumes in case of crisis has grown more than 1.5-times against 2015.

Third reason for the Russian industry to remain in a state of uncertain balancing for a short while was increased at the beginning of 2016 by "un-

certainty of the current economic situation and its prospects”. Responses with this factor went up in January 2016 by 8 p.p. compared to October 2015 and hit 48%. This factor is strong second on the rating list, which hamper industrial growth in early 2016. However, without adding this “unclear current economic situation and its prospects” this factor already six quarters takes second place.

#### **Business pricing policy**

Further slowdown of actual growth of the factory gate price was expected in February. As a result, now the price growth rate went back to the levels of Q3 2015. Unexpected became planned further acceleration of price growth: balance of price projections went up in February by 7 points and event surpassed values of December balance (2015). In other words, in February, industry planned more accelerated price growth than in December, when we observed another devaluation hike and expected traditional tariff growth. It is feasible that enterprises have exhausted both possibilities to cut their prices and implement moderate price policy amid lack of its impact on sales volumes.

#### **Investment plans**

Investment plans of Russian industry in February 2016 improved by 4 points, but still went negative (in other words, there were more investment reduction plans than investment growth ones) and do not leave the corridor where they have been staying since May 2015. Investment growth posted in H1 2016 should not be expected in all likelihood. However, a reduction of the investment program in 2016 as the anti-crises measure lowered its popularity among industrial enterprises in comparison with 2015 by 9 points (it was the most significant reduction) and now practiced by solely 31% of enterprises. Shortage of investment hampers output growth in Q1 2016 of 22% of enterprises (Q1 2015 – 12%). Industry, thus, starts to feel the deficit of investment, but still is not ready to invest in production.

#### **Industrial lending**

Availability of loans was assessed in January–February 2016 as normal of 50% of Russian enterprises. In August–December 2015, this indicator varied between 43–52%. Average minimal rate, which banks offer industrial enterprises declined in February to 16.1% annualized in rubles. In August–January, it averaged 16.5%. ●

## 4. DEVELOPMENT OF THE OIL SECTOR: POSSIBILITIES AND LIMITATIONS

**Yu.Bobylev, O.Rasenko**

Russian oil sector has achieved maximum levels of production and exports. Oil extraction is at the highest point since 1990 and oil exports are at the all-time maximum. Meanwhile, prospects for the development of the oil sector are determined by deterioration of the oil extraction conditions owing to the depletion of producing deposits located in the developed regions and considerably higher costs required for the development of new oilfields and tight oil deposits. Sectoral technological sanctions imposed on Russia and the low world oil prices hamper the development of the oil sector.

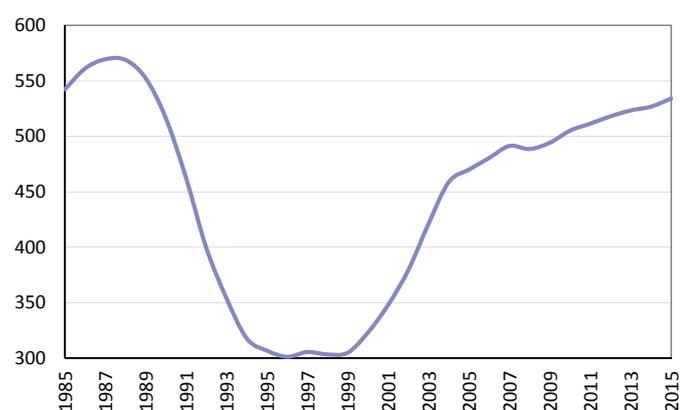
Table 1

RATIO BETWEEN PRODUCTION, CONSUMPTION, AND EXPORT OF OIL IN RUSSIA								
	2000	2005	2010	2011	2012	2013	2014	2015
Oil								
Production, mn tons	323.2	470.0	505.1	511.4	518.0	523.3	526.7	534.0
Exports, mn tones	144.5	252.5	250.4	244.6	239.9	236.6	223.4	244.5
Net exports, mn tons	138.7	250.1	249.3	243.5	239.1	235.8	222.6	241.6
Domestic consumption, млн т	123.0	123.1	125.9	140.7	142.1	137.5	141.3	122.2
Net export in % to production	42.9	53.2	49.4	47.6	46.2	45.1	42.3	45.2
Petroleum products								
Exports, mn tons	61.9	97.0	132.2	130.6	138.1	151.4	164.8	171.5
Net exports, mn tons	61.5	96.8	129.9	127.2	136.8	150.0	162.8	170.2
Oil and petroleum products								
Net exports of oil and petroleum products, mn tons	200.2	346.9	379.2	370.7	375.9	385.8	385.4	411.8
Net exports of oil and petroleum products in % to oil production	61.9	73.8	75.1	72.5	72.6	73.7	73.2	77.1

Sources: Rosstat, Ministry of Energy of Russia, FCS of Russia, own calculations.

In 2015, the Russian oil industry made two records: crude oil extraction reached 534 mn tons, which is the highest level since 1990, and the Russian oil exports (exports of crude oil and petroleum products in volume terms) hit 416 mn tones, which is an all-time high (Table 1, Fig. 1). The share of net exports of crude oil and petroleum products in the oil production amounted to 77%. Growth of exports was due to both extraction increase and decline of domestic oil consumption owing to the economic recession.

Growth of crude oil exports allowed Russia not only to preserve but some-



Sources: Rosstat, Ministry of Energy of Russia.

Fig. 1. Oil production in Russia, mn tones

what increase its share on the world markets. According to our calculations, in 2015, Russia's share in the European countries' oil imports increased from 26.1% to 26.9% and in Chinese oil imports – from 9.5% to 10.5% (*Table 2*).

*Table 2*

REGIONAL PATTERN OF RUSSIAN OIL EXPORTS, %

	2014	2015
European countries	62.1	61.7
Asian countries	26.3	27.3
CIS member states	10.8	9.7
Other countries	0.8	1.3
Russian share in oil imports of European countries	26.1	26.9
Russian share in Chinese oil imports	9.5	10.5

Sources: FCS of Russia, OECD/IEA, ITC, own calculations.

At present, Russian oil-producing industry is at the peak of its production capacity. Significant part of the producing oilfields is in declining production and the new deposits in the majority of cases are of inferior mining-and-geological and regional parameters. Their development requires higher capital investment, operating and transport costs. At the same time, despite high level of depletion on many oilfields and significantly higher costs on the development of new deposits, there are feasible possibilities to sustain achieved levels of oil production and exports.

Russia boasts of significant oil reserves, which allow maintaining high levels of production in the course of many years. There is a strong potential for oil production both due to the development of non-producing reserves in developed regions and deposits in the new production regions. At the same time, additional extraction is feasible on producing deposits owing to their deeper exploitation. Oil recovery index in Russia amounts only to 28%, which is significantly below average world level. In the US this coefficient stays in the range of 35–43% and in Norway is comes to 46%.

According to HIS Inc. calculations, Russia is among those countries, which can obtain the highest increment in oil production due to horizontal drilling and hydraulic fracturing at "old" low production traditional deposits. Potential for additional oil production in the country at the expense of implementation of new technologies comes to 12 billion barrels. According to this indicator, Russia is second (after Iran) among most promising in this regard countries outside of the United States. Moreover, exceptionally high is potential of undeveloped non-traditional deposits. According to the YS Energy Information Administration, regarding technically recoverable shale oil Russia takes the first place in the world (USA is second).

Russia's oil refining potential is rather significant. However, it lags behind in terms of technological development from the level of advanced economies. At present, the refining depth in Russia stands only at 74%. Meanwhile, in advanced economies it reaches 90–95%. Raising refining depth will allow to satisfy domestic demand in gasoline with lesser volumes of oil consumption.

In the long view, the global demand for crude oil will be growing, which allows Russia to preserve and even to increase current volumes of oil export. Herewith, owing to demographic trends and rising energy efficiency one should expect a reduction of oil demand in Europe, which is the main export market for Russia. Meanwhile, one can forecast a significant growth of oil demand in Asia, first of all, in China. In this regard, it is necessary to change

regional pattern of Russian export of oil by expanding infrastructure potential for oil supplies to the East.

The development of the Russian oil industry will significantly depend on global oil prices. In recent years, conditions of the oil market are characterized by predominance of factors, which will contribute to the retention of relatively low oil prices. Major driver for the world oil prices growth was fast increase of shale oil production in the US thanks to use of state-of-art technologies and high oil prices during previous years. Despite the oil price fall OPEC refused to cut the oil production moving over to retention of their market share. As a result in 2015, average price on Russian oil on the world market dropped from \$51 per barrel, which was half the price during three preceding years and during the first months of the current year fell to \$30–40 per barrel.

Situation on the world oil market is characterized by predominance of factors, which will contribute to the retention of relatively low oil prices. Among major factors are significant shale oil resources in the US, which will be quickly developed and increase supply with global oil prices above \$60 per barrel, slowdown of economic growth in China, decline of discipline in the OPEC as well as growth of shipments from Iran due to lifting of sanctions. In this context, most feasible range of world oil prices around \$40–60 per barrel. According to the latest forecasts made by leading foreign organizations, the bottom of the oil prices will be navigated this year. In the future their gradual increase is expected, which however will be rather slow. According to IMF projection, average world price of oil in 2017 will constitute \$41.0 per barrel, and in 2018 – \$44.5 per barrel. According to the US Energy Information Administration, oil price for Brent in 2017 will come to \$40.1 per barrel.

In Russia, in the wake of low oil prices, potential for the development of new oilfields and nontraditional resources will be significantly limited because investments in the most cost-intensive projects will be economically inefficient. First of all, the Arctic Shelf projects will be economically inefficient.

Financial and technological sanctions imposed on Russia will limit the development of the oil sector. Besides financial sanctions, which restrict access of Russian companies to foreign sources of financing, a number of advanced countries (US, EU, Norway and Australia) imposed a ban on deliveries to Russia of equipment and technologies for deep-water drilling, development of deposits of the Arctic Shelf and extraction of shale oil. It should be taken into account that technologies used for the development of shale oil deposits (horizontal drilling and hydraulic fracturing) are also used for the development of conventional oil reserves, first of all on the oilfields with high depletion of reserves. That is why restrictions for deliveries of equipment for horizontal drilling and hydraulic fracturing can also lead to early closing of producing oilfields as due to inability for deeper drilling.

In the context of low global crude oil prices and effect of sectoral technological sanctions, the traditional crude oil reserves should become the basis for further development of the Russian oil sector. This being said, deeper recovery on the producing oilfields and increased oil recovery rate will be very important. It is necessary to both actively use of free of sanctions foreign equipment applied in this sphere and accelerated development of import substitution technologies required to increase oil recovery rate. Potential for

the oil production maintenance will to a greater extent depend on the technological progress in this sector.

Creation of conditions for the operation of small and medium companies will be important for further development of the oil sector. The activity of major oil companies, as a rule, focuses on the implementation of large-scale and highly profitable projects and small and less profitable projects turn out to be beyond their interests. This creates potential for expanded activity of small and medium companies in the oil producing business. They can be rather efficient in such spheres as deeper recovery on the producing fields, development of small deposits and tight oil resources, geological exploration works and provision of services

At present, the sector of small and medium oil producing enterprises is exceptionally weak in Russia. The structure of Russian oil industry is characterized by predominance of major vertically integrated companies. At the same time, the share of five major oil companies account for 80% of total oil extraction in the country.

The US provide a good example of efficiency small and medium companies in the oil industry. Precisely these companies played the major role in the 'shale revolution'. Companies with production volume of up to 2.5 nm tones of oil per year (to 50,000 barrels per day) account for 46% of oil production in the US, and in Russia merely 3%.

Development of small and medium oil producing companies requires the creation of corresponding organizational and legal regime including significant reduction of the administrative barriers in granting the use of subsoil areas

Implementation of these measures will contribute to oil production maintenance in the country and to more rational use of the oil resources. ●

## 5. ROAD FREIGHT TRAFFIC BETWEEN RUSSIA AND POLAND: RISKS AND CONSEQUENCES

E.Ponomareva, S.Sudakov

*A suspension of trucking between Russia and Poland and subsequent shut-down of road freight transportation between Russia and Ukraine have made Russian freight carriers switchover partially their routes to those via the Baltic States. It is to be noted that Poland and Ukraine which initiated border closure for carriers were affected the most by suspension of trucking. Probably, assessment of negative effects prompted Russia and Poland to exchange permits to trucking (170,000 licenses to each side till the end of the year) on 1 April 2016.*

According to the data of the World Bank, road freight transportation is a key method of land carriage of goods between countries and it accounts for about 80% of goods traffic by land.<sup>1</sup> The world practice of international trucking is a license issued to non-resident carriers to transport freight via the territory of a foreign state. Early in February 2016, Russia and Poland failed to agree on cargo traffic<sup>2</sup> quotas and permits and that situation resulted in a short-term suspension (for a month) of trucking between the two countries, switchover of carriers to other routes and shut-down of road transportation between Russia and Ukraine.

Bilateral road transport agreements<sup>3</sup> concluded between countries providing those services are the main documents which regulate access to the market of international road freight transportation services<sup>4</sup>. Access management is carried out by means of issuing of cargo transport licenses within the limits of approved quotas which also limit rendering of similar services by companies of third countries which are not parties to the agreement. Licenses are normally issued on an annual basis.

Flows of goods from Poland to Russia and from Russia to Poland are relatively low: the share of foreign trade turnover between those two states amounts on average to 2.5–2.9%<sup>5</sup> in Russia's foreign trade turnover with all the countries of the world. The indicator of trade with all the EU countries amounts to 42–48%<sup>6</sup>, which is evidence of the fact that road freight trans-

1 Quantitative Analysis of Road Transport Agreements (QuARTA) // World Bank, 2013.

2 For more details, see the official Web-site of the RF Ministry of Transport: [http://www.mintrans.ru/news/detail.php?ELEMENT\\_ID=29685](http://www.mintrans.ru/news/detail.php?ELEMENT_ID=29685). In particular, in the official letter of E Schmit discontent was expressed due to state control getting tougher over international road transportation and change of responsibility for violation of the procedure for fulfilment thereof in Russia. Currently, the countries renewed road trucking till 15 April 2016 having exchanged 20,000 licenses each.

3 Bilateral road transport agreements.

4 According to the data of the World Bank, coastal shipping is banned by 90% of all the bilateral agreements. For more details, see The Quantitative Analysis of Road Transport Agreements (QuARTA) // World Bank, 2013.

5 The data of the Federal Customs Service on Russia's foreign trade with the main countries and groups of countries in the 2015-2016 period.

6 Ibid. According to the data of the Federal Customs Service, in 2015 the foreign trade volume between Russia and the EU amounted to about \$236bn.

portation between Russia and European countries<sup>1</sup> is the most required one for carriers both from Poland and Russia. Early in 2016, Poland reduced the number of transit permits to Russian carriers. As a result, according to the estimates of the Russian Association of International Road Transportation<sup>2</sup>, the share of Russian carrier en route from Western Europe to Russia via Poland currently amounts maximum to 30%.

Due to the above, Russian shipping companies reoriented to other trucking routes to Western Europe, for example, through Ukraine, Latvia, Lithuania and Estonia.<sup>3</sup> As a result of reorientation of carriers to routes via Ukraine, first unofficial (from the Ukrainian side) and then official shut-down<sup>4</sup> of road transportation between Russia and Ukraine till 25 February 2016 followed<sup>5</sup>.

Suspension of licenses to trucking has the following consequences:

- Transportation services become more expensive due to growth in costs by virtue of change in the route. As regards trucking from Russia to Western Europe, a switchover of Russian carriers to a land route via Ukraine makes the distance of transportation 500–1000 km<sup>6</sup> longer with the average length of the route from Western Europe to the European part of Russia amounting to about 4000–6000 km and the average cost, to euro 4000–6000 per trip or about euro 2000–3000 a day (with a 1.5–2 day average duration of a trip)<sup>7</sup>. So, growth in costs per truck amounts to about 10–20%, or euro 500–1000. However, from 11 February to 25 February 2016 that route was not an accessible alternative.<sup>8</sup> Another route between Russia and Western Europe runs through Lithuania and Sweden with a ferry crossing between the city of Klaipeda (Lithuania) and Karlshamn (Sweden). In that case, the distance of transportation becomes 1000–1200 km longer of which ferry crossing accounts for 420 km, while an increase in the land route is equal to about 600–800 km. In such a case, a cost increase is made up of appreciation of land route costs (euro 600–800) and the cost of ferry crossing (euro 230–300<sup>9</sup>); growth in transportation costs per vehicle amounts to 16–22% or euro 800– 1,100. It is to be noted that due to the specifics of the types of transport<sup>10</sup> and the fact that the length of other alternative routes as compared to traditional transportation routes is much higher<sup>11</sup>, the share of alternative route

1 Mainly, Germany, the Netherlands, Italy and France.

2 The official Web-site of the Vzgyad daily, <http://vz.ru/economy/2016/2/12/793892.html>.

3 For more details, refer to the official Web-site of Gazeta.ru [http://www.gazeta.ru/auto/2016/02/19\\_a\\_8082899.shtml](http://www.gazeta.ru/auto/2016/02/19_a_8082899.shtml).

4 The official suspension of road freight transportation first became effective on the part of Russia in response to unofficial blocking of passage of Russian carriers through the territory of Ukraine.

5 For more details, refer to the official Web-site of the Ministry of Transport: [http://www.mintrans.ru/news/detail.php?ELEMENT\\_ID=29955](http://www.mintrans.ru/news/detail.php?ELEMENT_ID=29955).

6 That is an estimate of extension of the land route via the territory of Ukraine near the Polish border.

7 The average value in pricelists of companies which carry out trucking and the estimate of the Web-site: [searates.com](http://searates.com).

8 The official Web-site of the RF Ministry of Transport, [http://www.mintrans.ru/news/detail.php?ELEMENT\\_ID=29892](http://www.mintrans.ru/news/detail.php?ELEMENT_ID=29892).

9 Cost estimate in accordance with the price list for Klaipeda-Karlshamn ferry crossing of commercial vehicles.

10 Some goods can be transported only by specific types of transport.

11 Substantial appreciation of haulage costs.

transportation is insignificant as compared to those mentioned above. According to E. Moskvichev, Chairman of the RF State Duma Transport Committee<sup>1</sup>, in 2015 Russian carriers carried out about 160,000 trips via Poland, that is, on average 440 trips a day. Average growth of euro 700–1,000 in costs of a trip will result in additional costs for Russian carriers in the amount of euro 380,000– 450,000 a day or euro 139–160m a year. Due to suspension of road transportation on the Russian-Ukrainian border, the flow of vehicles from Russia to Ukraine decreased by about 170–200 vehicles<sup>2</sup> a day. Losses related to reorientation to routes via Lithuania and Sweden can be assessed at euro 140,000– 200,000 a day or approximately euro 51–73m a year. Apart from appreciation of transportation costs due to a change in route, transportation time increases, too: a 500–1,000 km increase in the route<sup>3</sup> leads to a delay of 14–15 hours in cargo deliveries with a truck's average speed of 60 km/h and average road transportation speed of 45 km/h<sup>4</sup> (with duration of stops and time spent on execution of documents at border-crossing taken into account). As regards the route via Lithuania and Sweden with ferry crossing, an increase in transportation time amounts to about one day and makes transportation of perishable commodities and goods requiring special transport conditions virtually impossible.

- Russian shippers will receive less revenues as transportation time between Russia and European countries<sup>5</sup>, including that between Russia and Poland and between Russia and Ukraine increased. On the assumption that each truck running from Russia to Europe through Poland carries on average \$22,000 worth<sup>6</sup> of cargo the cost of a delivery delay can be estimated as 1/365 of the key rate of the Central Bank of Russia multiplied by the average cost of cargo in a truck, that is, \$6–7 per truck a day or about \$2,800–3,000 a day for all shippers transporting freight via Poland by means of Russian carriers. The average cost of cargo in a truck running through the Russian-Ukrainian part of the border amounts to about \$16,000<sup>7</sup>, while shippers' costs, to about \$4–5 per truck or about \$900–1,000 a day for all shipper transporting freight through Ukraine by means of Russian carriers.

1 The official Web-site of the RBK daily: <http://www.rbc.ru/business/01/02/2016/56adc10b9a79476a30b36f8e>.

2 The estimate is made on the basis of comparison of the data of the Federal Customs Service ("The Data on Load of Motor Vehicle Checkpoints for a Day", <http://customs.ru/avtochkp/>) on the number of transport vehicles which passed through checkpoints on the Russian-Ukrainian border on relevant weekdays during suspension of carriage (15 February 2016) and resumption thereof (21 March 2016) on the assumption that reduction of the flow of vehicles on the border is justified only by the fact that transportation via Ukraine is closed for Russian carriers.

3 That is transportation through Ukraine.

4 Estimate of the average speed of land transportation presented by searates.com.

5 On the assumption that there is no change in transportation service provider.

6 Calculated on the basis of the 2014 statistics of the Federal Customs Service (the later data are not available) on the monetary and physical volumes of exports passing through checkpoints on the border between Russia and Belarus and Poland, as well as the number of transport vehicles carrying relevant cargo.

7 Calculated on the basis of the 2014 statistics of the Federal Customs Service (the later data are not available) on the monetary and physical volumes of exports passing through checkpoints on the border between Russia and Ukraine, as well as the number of transport vehicles carrying relevant freight.

- The transport sector of Poland and Ukraine will receive less revenues than before. As closure of the border with Russia on the route under review makes it impossible for Polish and Ukrainian carriers to deliver goods to the place of destination, the losses of those two countries can be estimated on the basis of carriers' short-received profit. According to the data of the Polish Association of International Carriers, about 600 Polish trucks<sup>1</sup> went to Russia daily, while according to the data of the Federal Customs Service only 80–100 Ukrainian trucks<sup>2</sup> entered Russia from Ukraine. With the average cost of a trip amounting to about euro 2,000–3,000 a day<sup>3</sup>, Polish carriers short-received about euro 1.5m a day, while Ukrainian carriers, about euro 225,000 a day or about euro 548m and euro 82m a year, respectively.
- European shippers will not suffer losses as they (on the assumption that there is competition on the international freight transportation market) may change a carrier without getting into higher expenses.

In the light of the existing situation, Poland and Ukraine are hit the hardest due to the ban on passage through Russia (euro 1.5m a day and euro 225,000 a day, respectively). Losses of the Russian Federation are substantial (on average about euro 170,000 a day), too, however, they are much lower than those of Ukraine and Poland. In the long-term prospect, it is important to take into account adverse effects caused by suspension of deliveries of goods which have already been shipped, delays and appreciation of deliveries of import intermediate goods to Russia (due to a switchover to other types of transport and routes and transaction costs related to a change in a carrier); the above factors cannot but affect the volumes and quality of domestic production in the long-term period. With limitation of access of European goods (transported by trucks) to the Russian market for a long period of time, import substitution processes may consolidate, however, it is a long process and its effect may become explicit only in two-three years. Repetition of developments of February 2016 will definitely prompt Russian carriers to switch over to new routes (mainly via the Baltic States) which they are already familiar with.●

1 The official Web-site of Gazeta.ru, [http://www.gazeta.ru/auto/2016/02/04\\_a\\_8056457.shtml](http://www.gazeta.ru/auto/2016/02/04_a_8056457.shtml).

2 The estimate is made on the basis of comparison of the data of the Federal Customs Service ("The Data on Load of Motor Vehicle Checkpoints for a Day", <http://customs.ru/avtochkp/>) on the number of transport vehicles which passed through checkpoints on the Russian-Ukrainian border on relevant weekdays during suspension of carriage (15 February 2016) and resumption thereof (21 March 2016) on the assumption that reduction of the flow of vehicles on the border is justified only by the fact that transportation via Ukraine is closed for Russian carriers.

3 Assuming that on the market of road freight transportation between the RF and Western European countries carriers from different countries can compete with one another, costs of freight transportation services of Polish, Ukrainian and Russian carriers should be almost the same.

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