

MONITORING OF RUSSIA'S ECONOMIC OUTLOOK:

TRENDS AND CHALLENGES OF SOCIO-ECONOMIC DEVELOPMENT

No. 17(35) November 2016

MAIN TRENDS AND CONCLUSIONS (V.Gurevich).....	3
1. POPULATION'S SOCIAL SENTIMENT AND RISKS OF FALLING LIVING STANDARDS (E.Avraamova, D.Loginov)	6
2. BANKING INDUSTRY: PROFIT GOES UP, BUT RATE OF RETURN REMAINS SUPPRESSED (M.Khromov)	9
3. WILL RUSSIA REMAIN THE WORLD'S LARGEST WHEAT EXPORTER? (N.Shagaida).....	11
4. INDUSTRY IS ADAPTING TO THE CRISIS: Q3 2016 DATA (S.Tsukhlo).....	16
5. THE RECOVERY OF IMPORTS OF INVESTMENT GOODS: IMPORT SUBSTITUTION PROCESSES ARE SLOWING DOWN (G.Idrisov, A.Kaukin, P.Pavlov)	19
AUTHORS.....	23

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РАНХиГС
РОССИЙСКАЯ АКАДЕМИЯ НАРОДНОГО ХОЗЯЙСТВА
И ГОСУДАРСТВЕННОЙ СЛУЖБЫ
ПРИ ПРЕЗИДЕНТЕ РОССИЙСКОЙ ФЕДЕРАЦИИ



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MAIN TRENDS AND CONCLUSIONS

V.Gurevich

The month-long period of high oil prices ended with their notable plunge amid the talks of the ruble's significant weakening. The 'energy behind promises' (the promises to agree on a deal to reduce crude output) has petered out to nearly zero, but this should be regarded as a rather positive development. Because the longer the market is sustained by purely verbal interventions, the deeper would be its potential ultimate downfall. Indeed, it may be possible for the time being to get some additional money by resorting to verbal declarations and keeping alive the illusion that the oil market can be fundamentally influenced in some way, but much more can be lost as a result of the increasing volatility of the oil market, a factor that has been plaguing the Russian economy over recent years.

The month-end results for October 2016, which saw a surge in Russian companies' Eurobond placements, made it even more evident that money is by no means the topmost factor. The market conditions became quite acceptable, and the economic sanctions were no longer an obstacle. Nevertheless, nearly all of the attracted money was used to refinance the existing debts, and not to fund real investment, new projects, or the like. In fact, such projects are either non-existent, or the associated investment risks (including the volatility factor) appear to be too high. In other words, at the moment one can observe many (if not all) of the circumstances known to trigger stagnation.

'Stagnation' was the word most frequently used by the mass media and the expert community to describe the recently prepared long-term (until 2034–2035) forecasts of Russia's socioeconomic development and the prospects for its budgetary system. This pessimistic attitude goes hand-in-hand with an almost universally widespread conviction that any predictions of what might happen twenty years from now make little sense. Nevertheless, such are the requirements stipulated in the law on strategic planning. And besides, such are the initial data that the RF Ministry of Economic Development and the RF Ministry of Finance must rely on in their estimations.

With the exception of one of the available forecast scenarios (the 'target' one), where everything is pictured to be better than just good, all the other scenarios offer only grey shades, with few variations. This is quite understandable, as they picture inertia. However, even inertia is shown in its more optimistic version. But what else could be expected? The two government departments cannot just add up their planned growth rates and become more optimistic than their opponents, who have been regularly promising growth rates of 7% or 10% per annum. Nor can they determine (in spite of being repeatedly asked to do so) the so-called growth points that are expected to function as fountains gushing out high growth rates, because the behavior of both those growth points and those growth rates will be determined by the global market - and also by the ability of Russia's institutions to respond to them. At the current level, this country can produce a growth rate of about 1.5–2%, with a 'plus'.

Until recently – meaning a year ago, or even six months ago – everything seemed to be signified by the minus sign: real income, wages, people's ex-

pectations, bank profit, the industrial production index, and many other indices. Our experts point out that recently, the situation has begun to alter, however slightly.

As stated in the latest survey report released by the RANEP's Social Analysis and Forecasting Institute (September 2016), a significant positive shift in the reported estimations of the economic situation in this country has taken place. Nearly half of the respondents note that the situation is stabilizing, and this index is a record high of the entire observation period (since February 2015). The number of those believing that it will take one or two years more for this country to exit from the crisis diminished, while the number of those who hope that this can happen sooner increased. However, when speaking of their employment prospects, the respondents reported a 5% increase in their risk perception over recent months; and more than 20% expected their employer's situation to get worse. Nevertheless, on a positive note, our experts point to a shrinking share of people strongly hit by the crisis.

Certain positive shifts have also been observed by our experts in their analysis of the situation in various segments of the national economy. Thus, the banking sector continues to demonstrate a significant growth of profits: over the first three quarters of 2016, profits amounted to Rb 635bn (a five-fold jump on the same period of 2015). It should be noted that last year (less the indices reported by Sberbank), the banking sector demonstrated no profits, reporting instead total loss. This year, profits have been generated largely by the reduced deductions to reserves against potential losses. But this was not the only factor: the profits generated by regular banking operations likewise increased. On the other hand, no gains were produced by the recalculated balance value of foreign currency denominated bank accounts (last year, banks had handsome earnings as a result of the ruble's plunge against foreign currencies), and there was even a slight loss. The distribution of profits across the banking sector showed some changes, although these were far from being radical: over the first three quarters, the bulk of profit, though by no means all of it (76%), was held by Sberbank, while the rest was distributed among biggest state banks. Private credit institutions, taken together, were balancing somewhere near zero profit point. This segment has remained very attractive for investors. As a result, state banks will continue to grow in strength, and the entire sector will see further asset concentration.

Agriculture is another sector where overall changes have been positive (for more than one year in a row, and with regard to different indices). Thus, Russia has evolved into a major exporter of cereals, including wheat. According to some predictions, in the 2016/2017 agricultural year, Russia's share in world wheat exports may be up to 20%. It is believed that this figure may be increased still further, and significantly so. In this connection, the experts warn that Russia is indeed capable of increasing her wheat supplies, the demand for which will be on the rise, while its price is unlikely to demonstrate notable growth, and so Russian wheat producers can hardly hope to see their incomes increase at the same pace as before. And the experts also point to the fact that the USA and Canada, while ceding their former positions in the wheat market, are switching over to the more profitable soybean production.

The indices displayed by industry are far more modest, but the estimates and outlooks of heads of Russian enterprises, as demonstrated by the results of business surveys conducted by the Gaidar Institute, are still sufficiently high. Anyway, in Q3 2016, the so-called Index of Adaptability (the share of

enterprises estimating their current economic situation to be ‘normal’) has hit its record high (74%) of the entire observation period (since 1994). This integral index incorporates, among other things, the estimated sufficiency of production capacity and demand indices. The latter is already estimated to be ‘normal’ by 56% of all respondent enterprises (vs. only 45% in early 2016), which can hardly be regarded as a sign of crisis. For reference: at the onset of the previous crisis (2008–2009), it indeed plunged (from 60% to 23%), and then stayed at that low level for at least six months. Sectoral indices demonstrate that the highest satisfaction with the level of demand for their industrial products was expressed by enterprises operating in the chemical and food industries, while those operating in light industry and the construction materials sector were at the other end of the spectrum. However, even they are evidently expecting a rise in demand, because they are less frequently estimate their existing production capacities to be excessive.

On the other hand, the expert estimations of industry’s success in import substitutions are far from being optimistic. This is certainly true of investment goods, whose share in Russian imports amounts to approximately 40%. In spite of the fluctuations of the ruble’s exchange rate against the world’s major currencies over the period 2014–2016, the share of that group of goods (including ground transport and spare parts thereto, telecommunications equipment, etc.) remained practically unchanged. The only significant development was the redistribution of demand in favor of cheaper versions of the same product. Moreover, this year the share of imports in the total machinery and equipment turnover, which used to stand at 30%, began to increase. ●

1. POPULATION'S SOCIAL SENTIMENT AND RISKS OF FALLING LIVING STANDARDS

E.Aвраamova, D. Loginov

Findings of survey report released by the Institute of Social Analysis and Forecasting (RANEPA) demonstrate a reduced dramatics of the economic situation in the country and reduced duration of the crisis. However, negative expectations are still strong first of all in the sphere of employment. Consumption activity still remains depressed.

The latest survey (September 2016) has demonstrated a significant growth of positive assessments of shifts taken place in the economic situation of the country (Table 1). Nearly half of respondents indicate stabilization of economic situation – this is the all-time maximum registered from the probe's onset (since February 2015).

Table 1

ESTIMATES OF CHANGES IN THE ECONOMIC SITUATION OF THE COUNTRY
(TOTAL)

Nature of changes	% of answers of the number of respondents			
	Feb 2015	Sep 2015	June 2016	Sep 2016
Improved	2.7	3.6	4.6	7.4
Not improved	17.3	38.4	38.0	45.7
Deteriorated negligibly	32.6	27.4	22.8	20.1
Deteriorated noticeably	37.1	21.2	24.6	17.3
Ongoing full-fledged crisis	7.9	5.0	6.6	5.8
No answer	2.4	4.4	3.6	3.7

Moreover, the share of those believing that it will take one or two years more to the country to exit from the crisis diminished, while the number of those who hope that this can happen sooner increased (Fig. 1).

General and overall positive assessments of prospects of weathering the crisis do not correspond with information about the extent the citizens suffer from it. Positive shifts are revealed in the fact that the share of population affected by the crisis has diminished to a great extent. The number of those who are slightly affected (45%) and of those who are still unaffected but are afraid of it in the future (16%) has somewhat increased.

At the same time, in comparison with the previous probe (June 2016), assessment of the situation in employment has somewhat gone for the worse: a share of those who feel threatened of a job loss has increased by 5%; 31% of respondents remain in the zone of this risk perception.

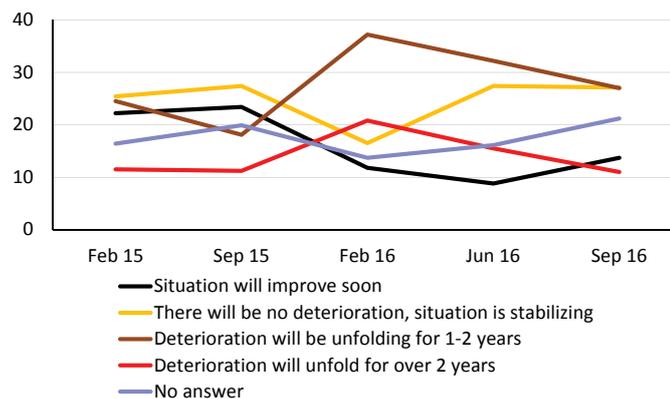


Fig. 1. Assessment of duration of negative effects in economy, % of answers of the number of respondents

40% of jobholders noted that over the last month, the state of their enterprises has gone for the worse and 22% think that it will be even worse in the months to come. High professional stance does not warrant stable employment, although the highest risk of job loss has been observed among the less qualified employees. 10.5% of the respondents are in two minds about a chance to retain a job and think that the prospects of further employment are uncertain.

Assessment of adjustment of wage rates has somewhat shifted to the negative in comparison with the previous probe: approximately by 2% contracted the number of those who were not affected by a wage rate reduction and unlikely to be affected. To the same degree has gone up the share of those who is afraid of wage rate drop.

At the same time, the level of negative expectations regarding employment does not go down. To compare last year's expectations regarding certain events (job loss, going on leave without pay, part-time working week, pay pause and wage reduction) and actual occurrence of such events, one can come to the following conclusions:

- concerns of those who expected wage rate adjustment have been amply demonstrated and the level of negative expectations regarding this event has remained at the same level;
- concerns related to the pay pause have been confirmed;
- concerns regarding job loss have been confirmed by more than half of those who expressed them a year earlier and the volume of negative expectations of this prospect remained at the same level; in other words, part of the population views the prospect of a job loss as a suspended prospect.

The place of residence is the key factor, which determines maximum likelihood of risks in employment. The residents of a metropolis face maximum risks possibly owing to the fact that their employment to a greater extent goes beyond a relatively more stable budgetary sphere.

Stick out those types of activity, which differentiate by the likelihood of risks. Among the least risky are first of all public administration and law enforcement agencies (over 60% of employed in these spheres do not feel risks). Those employed in industry, construction, transport, and communications express the highest concerns.

The September survey has demonstrated a lack of consumer activity neither on the whole nor on certain types of goods and services. Consumption contraction continues to be passive but it is the most widespread form of adaptation, which Russian low and middle walks of life practice. On the whole, the population takes changes rather quietly owing to savings during the fat years, which permits to reduce spending on purchasing durable goods without negatively affecting the quality of life.

Possessions can be nominally divided into household goods, gadgets and luxury goods, which determine higher quality of life. *Table 2* demonstrates that representatives of all walks of life equally boast of household goods (TV,

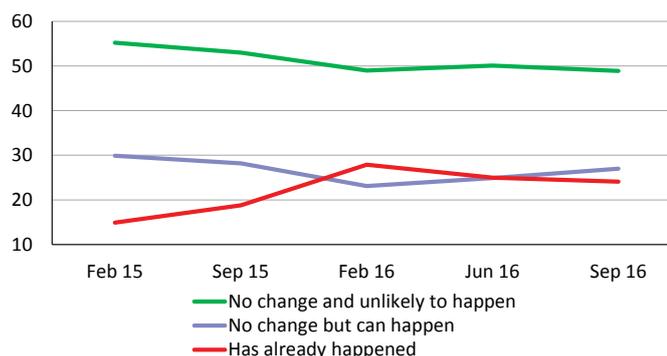


Fig. 2. Assessment of adjustment of wage rates, % respondent choosing one or another answer of the number of respondents

fridge, and washing machine). In this respect a 100% saturation has been accomplished. Gadgets (mobile phones, smartphones, computers, etc.) are also widely owned and one can speak about the introduction of gadgets among needful goods. At the same time, the number of owners of corresponding goods is noticeably shifting towards upper stratified groups especially towards core of the middle class who nearly all own them. Regarding luxury goods (dishwashers, and air conditioners), they largely are owned by representative of the core of the middle class¹.

Table 2

POSSESSIONS OF STRATIFIED GROUP REPRESENTATIVES, %

	Level of property in possession		
	Having fridge / washing machine	Having dishwasher / air conditioner	Having PC / smart phone / internet
Low walk of life	98.1	10.5	80.9
Far periphery	98.9	17.4	90.5
Close periphery	99.5	25.5	91.7
Core	98.5	39.0	96.6
Total	98.8	22.0	89.5

The middle class core stands out as the most comfortably off people, although 30% of them need renovation of possessions and solely half of them are financially able to implement it. Options of walks of like beyond this core are far less. Contraction of the consumer activity currently can be viewed as a rather compressed in time adaptability strategy. In the long run this strategy will miss the mark and one can project collision not between a “fridge and a TV set” (food products, albeit with a reduced quality will be accessible to all segments of the people) and between TV set and, for example, a smartphone.

Besides economy on spending, work of a subsidiary plot of land is getting an even greater expansion as adaptability strategy. Adaptation behavior in the sphere of employment on the contrary is depressed. ●

¹ In case of matching criteria pertinent to the middle class (social and professional status, level of material well-being, and self-identity) there is a core of the middle class, which constitutes 18.5% of respondents; two criteria – ‘close periphery’ – 30.2%; one criterion – ‘far periphery’ – 25.5% of respondents.

2. BANKING INDUSTRY: PROFIT GOES UP, BUT RATE OF RETURN REMAINS SUPPRESSED

M.Khromov

The banking sector profit has grown significantly. At the same time, problems with the rate of return in the banking sector have not evaporated. State owned banks account for nearly all profit. Private banks are balancing on the verge of zero rate of return. Concentration of assets in the banking system remains.

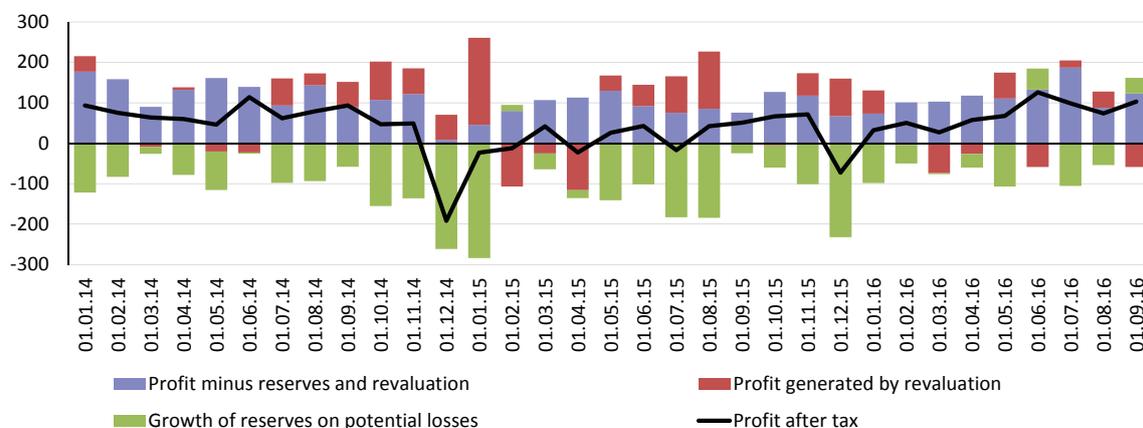
During three quarters of 2016, the Russian banking industry has generated Rb 635bn of accounting profit. This is five times more than a year earlier (for the same period of 2015, the banking system generated solely Rb 127bn of profit) and three times more than the profit generated for the entire 2015, which constituted Rb 192 bn.

Return on assets (ROA) in annual terms has been gradually recovering. Over nine months of 2016, its level has hit 1.0% in annual terms, which is not only higher than the 2015 level (0.2%), when the banks profit was minimal but even higher than the 2014 index (0.9%). Furthermore, despite a significant growth of profit in the banking industry, its volume still remains rather modest in comparison with the pre-crisis level. In 2011–2012, return on assets surpassed 2% in annual terms.

Quarterly dynamic of profit is also positive. If in Q1 2016, its volume constituted Rb 109bn, then in Q2 2016, it hit Rb 251bn, and in Q3 – Rb 275bn.

In 2016, return on assets went up from 0.5% in Q1 to 1.4% in Q3. In other words, even during the most profitable quarter of 2016 profitability of the banking industry remained below the pre-crisis level.

The fact is that the growth of profit has resulted from slowdown of provision of reserves for potential losses, the so-called “crisis” component. For example, for three quarters of 2016, growth of bank reserves for potential losses and other assets came to Rb 358 bn, which is significantly less than was registered for the corresponding periods of 2014 (Rb 649 bn) and 2015



Sources: Bank of Russia, IEP's estimates.

Fig. 1. Main components of banking profit, Rb bn

(Rb 63 bn). Thus, easing of loan loss provisioning, in other words when the risk level in bank assets has slowed down, has become the main factor for profitability growth in the banking industry in 2016.

Simultaneously, net profit of banks generated by revaluation of accounts denominated in foreign currency has gone down. During Q1–Q3 2016, it was negative (Rb -42bn), meanwhile a year earlier for the same period banks earned Rb 288bn on ruble's depreciation. This is due to the dynamic change of the cost of national currency. Owing to the fact that banks maintain positive currency position, currency assets surpass currency liabilities, ruble's strengthening results in losses and ruble's depreciation leads to additional earnings. During three quarters of 2016, ruble strengthened to US dollar by 13.3%, and to euro – by 10.9%. A year earlier in H1 2015, ruble exchange rate to US dollar, on the contrary fell by 16.9%, and to euro – by 7.9%.

At the same time, net operating income, in other words revenue minus increment of loan loss provisioning and net income generated by revaluation of accounts denominated in foreign currency, has also gone up. During three quarters of 2016, net operating income constituted Rb 1,035bn, which is by 29% more than for the same period of 2015 (Rb 802 bn). Return on assets according to this component somewhat moved up during the year constituting 1.7% in annual terms in comparison with 1.4% in H1 2015. As a comparison, up to 2014, in H1 the banks managed to generate net operating income to the tune of 2.7–2.9% of the volume of medium term assets on year-on-year. This means that currently profitability of net operating income is nearly half its normal level characteristic for the periods of sustainable development of the banking industry.

Sberbank still accounts for a major share of banking profit. During three quarters of 2016, Sberbank's profit hit Rb 555bn – 76% of the profit of entire banking sector, in other words Sberbank, which accounts for less than 30% of total assets in the banking sector, has generated 5-time more profit than all other banks taken together. However, this is a step forward in normalization of income in the banking industry because at end-2015 profit of Sberbank (Rb 282bn) surpassed profit of the entire banking sector (Rb 192bn) – all other banks as a whole registered losses.

Sberbank together with banks affiliated to the RF government and the largest state company Gazprom¹, account for nearly Rb 555bn of profit of Rb 635bn generated by the entire banking industry.

This demonstrates that other private banks teeter on the brink of zero profitability. Private segment of the banking sector remains highly unattractive from the investment point of view for the owners of banks. Assistance provided to banks by the private capital is limited to mainly maintaining resiliency of the existing business without significant investment in rapid development. This fact most likely will result in further strengthening of positions of state banks on the market of banking services and continued growth of assets concentration in the banking industry. ●

1 VTB Group banks (VTB, VTB24 and Bank of Moscow), Rossekhozbank and GPB.

3. WILL RUSSIA REMAIN THE WORLD'S LARGEST WHEAT EXPORTER?

N.Shagaida

Russia has become the world's biggest wheat exporter, and it has a chance to remain as such. A downswing trend in global food markets and a weakened effect of rouble devaluation may reduce success rates of Russia's grain exports in years to come.

Russia exported 13,9 to 30,7 million tonnes of grains in 2008–2015. Overall, Russia's exports of grains have been growing steadily since 2013. Wheat, Russia's main export crop, exhibits a similar dynamics. In contrast, exports of corn and barley (cereal grains that exhibit the second largest export volumes after wheat grains) show no stable growth.

The 2016 wheat crop has almost been harvested by 98%, according to the data as of 9 October 2016. The initial weight of the yield after threshing amounted to 75,7 million tonnes, which is 16% above the value recorded in the previous year and in excess of the forecast value. Wheat exports are estimated at 24,45 million tonnes in 2015/16 and at 31,5 million tonnes in 2016/17, with total grain exports at 34,7 and 42,5 million tonnes respectively¹. Following the USDA projections for world wheat import volumes at 155,5 and 157,8 million tonnes², it is reasonable to say that Russian wheat accounted for 15.7% of imports in 2015/16³, and that it will represent as much as about 20% in 2016/17. Historically, this phenomenon has never been observed before, as is evident from the data on previous years (*Table 1*).

Table 1

FIVE BIGGEST EXPORTERS' SHARE OF WORLD WHEAT EXPORTS,
AS % OF TOTAL EXPORTS

	Australia	Canada	Russia	USA	France
2015	10.1	13.9	12.5	12.4	11.7
2014	12.1	16.0	14.6	16.2	13.5
2013	13.0	14.2	10.0	24.0	14.2
2012	22.7	17.3	15.5	24.9	15.9
2011	16.3	13.5	12.5	27.1	16.8
2010	15.5	18.0	11.6	27.0	20.6
2009	20.1	18.6	16.2	21.2	16.3
2008	24.7	28.8	12.4	31.8	17.2
2007	17.5	20.5	16.8	38.3	16.7
2006	22.7	18.7	9.8	23.6	16.8
2005	21.3	14.5	10.8	28.4	16.8
2004	37.9	21.2	6.6	44.3	20.8
2003	15.4	13.1	8.5	28.4	18.2
2002	29.6	18.2	12.6	29.7	16.8

Source: Comtrade.

1 A forecast made by Petrichenko V.. ProZerno Company. Russian Crop Production Conference 2016/17, <http://www.agroinvestor.ru/conference/23394/materials/>

2 USDA Agricultural Projections to 2024. http://www.usda.gov/oce/commodity/projections/USDA_Agricultural_Projections_to_2024.pdf

3 There is the difference between the data presented in the Table and the data herein because the Table presents volumes within a year, whereas volumes herein are shown within a crop-to-crop season.

Wheat is grown as the main export crop in Russia. This country accounts for about 8% of world's total gross production of wheat (Russia's share of wheat-growing areas is more than 11%). Russia is steadily expanding wheat-growing areas (*Table 2*).

Table 2

RUSSIA'S SHARE OF WORLD WHEAT PRODUCTION						
	1990	2012	2013	2014	2015	2016
Wheat-growing areas, million hectares						
Rest of the world	231.3	217.2	218.3	221.6		
Russian Federation	24.2	24.7	25.1	25.3	26.8	27.7
Gross output, million tonnes						
Rest of the world	592.3	667.5	711.1	729		
Russian Federation	49.6	37.7	52.1	59.7	61.8	71.3
Russia's share, %						
growing areas	10.5	11.4	11.5	11.4		
gross output	8.4	5.6	7.3	8.2		

Sources: FAOstat, Rosstat.

Russia's Agriculture Minister Aleksandr Tkachev says Russia will be able to export 50 million tonnes of grains in the near future¹. Theoretically, one may suggest that growth over the currently existing level driven largely by wheat grains may be absorbed by the market without a dramatic drop in prices (with few assumptions though). For instance, demand for wheat imports (including wheat flour) can increase 16% or 24,5 million tones until 2024, according to the USDA projection². Had not other countries increased exports, Russia would have found itself in a good position because growth in export opportunities coincides with the forecast increase in demand. If other suppliers boost their supply, wheat prices may drop because production growth, according to the estimates made, will have already been higher than demand for grains.

According to the US Department of Agriculture, Indonesia and Egypt will become the biggest importers by 2024, with each being expected to reach more than 10,5 million tonnes of imports of wheat and wheat flour. Collectively, consumption is expected to grow by 4,8 million tonnes annually in countries such as China, Vietnam, Philippines, Bangladesh and Thailand, according to the USDA report. Imports are expected to grow by more than 10,4 million tonnes in Africa and in the Middle East. Saudi Arabia will discontinue wheat production and increase imports to 4 million tonnes due to draught conditions. Iran is the sole country in the region that is expected to reduce imports. The countries that increase imports are geographically close to Russia, which provides Russia with extra competitive advantage over other exporters.

According to the USDA projections, wheat demand for domestic purposes in Russia will be growing faster than wheat exports. This is, however, extrapolation of the trends that emerged prior to 2014. The fall in the rouble exchange rate has made exports appealing while the decline in household incomes has resulted in food demand contraction, mostly meat demand while grain demand remained unchanged. Domestic consumption is stable enough as opposed to export volumes.

1 <http://tass.ru/ekonomika/3457242>

2 http://www.usda.gov/oce/commodity/projections/USDA_Agricultural_Projections_to_2024.pdf.25

3. WILL RUSSIA REMAIN THE WORLD'S LARGEST WHEAT EXPORTER

Russia's Ministry of Agriculture has determined an objective of boosting exports if other major exporters (USA and Canada) are set to reduce slowly their wheat-growing areas. With such a policy being in place, yield growth will result in insignificant growth in production and in small reduction of grain exports. For instance, wheat-growing areas are expected to be reduced by almost 9% in the United States in the period between 2014 and 2024¹. By 2024, US exports are planned to be cut by 9.5% compared to 2013/14 and by 15% more than in 2014/15.

Indeed, Russia is becoming the world's number one wheat exporter while other countries are standing down. What is the reason for it?

The US forecast until 2024 shows growth in wheat exports that may be regarded as substantial ones only in the European Union and Russia (8,9 and 8 million tonnes respectively). Other major exporters are expected to see a growth of not more than 1 million tonnes per country. According to the foregoing forecast, although demand for wheat imports will be increasing, its growth rates will lag behind demand for other products that are yet exported in small volumes from Russia. For example, imports of soybeans and soybean products will grow steadily at higher pace than wheat imports. This forecast growth in demand that is higher than wheat demand makes the soya market more appealing in the longer term. Additionally, soybeans can generate higher profits. Why?

A simple comparison between the planned export growth and profitability of crops shows that long-term planning considers the relative production efficiency for agricultural producers rather than market demand for additional products (*Table 3*).

Table 3

FORECAST EXPORTS OF CROP PRODUCTS FROM USA

Product	Exports 2024/2025 vs 2014/15, %	Net income/variable costs per acre, 2024, forecast
Corn	147	0.76
Sorghum	100	0.42
Barley	100	0.41
Oats	100	0.28
Wheat	115	0.63
Soybeans		1.32
Legumes	107	
Oil	143	
Soybean products	95	

Source: USDA.

A comparison between US and Russia's agricultural producers and government export plans is presented in *Table 4*.

Table 4

COMPARISON BETWEEN US AND RUSSIAN FOREIGN MARKET ACCESS STRATEGIES

	2013	2014	2015	2024	Government's export forecast
USA					
\$ /bushel	6.87	5.9	5.0	4.85	15% export growth from 2014/15
Rb/100 kg*	808.2	824.3	1127.3	1087.7	
Russia					
*Rb/100 kg	730	727.50	923.50	n/a	Considerable export growth

*farm price.

Sources: USDA, Russia's Unified Interdepartmental Statistical Information System.

1 USDA Agricultural Projections to 2024 http://www.usda.gov/oce/commodity/projections/USDA_Agricultural_Projections_to_2024.pdf

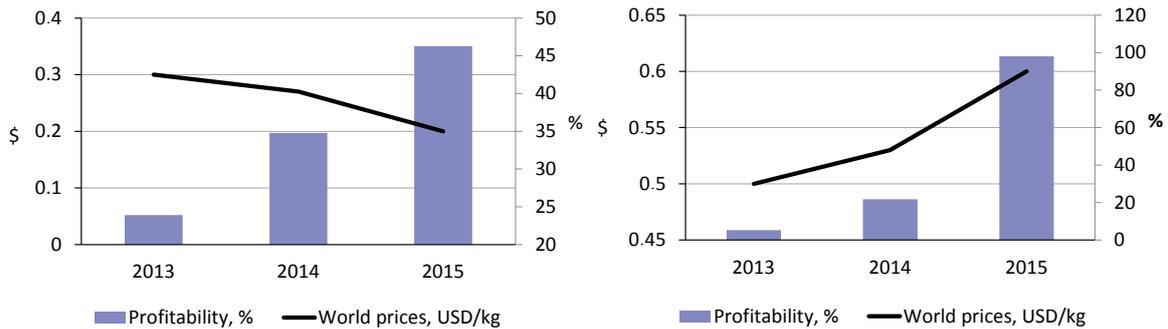


Fig. 1. Dynamics of prices in the world wheat market, and wheat production profitability for agricultural enterprises; wheat (right column), buckwheat (left column)

The growth in wheat prices in Russia can be explained by the rouble depreciation because the dollar-denominated price in the external market was on the slide. The price is forecast to fall in the longer term. In this regard, Russia's ambitious wheat export plans seem to be too optimistic with regard to generating profit from this type of activity by Russian agricultural producers rather than with regard to export volumes. If wheat sales revenues contract, according to the US forecast, agricultural producers will refocus to other, more profitable, production. In this context it is hard to say that Russia has sidelined other exporters.

Wheat prices in the external market are falling. Indeed, prices, as calculated using the ComTrade database¹, dropped from \$349 to \$257 per tonne in the period between 2013 and 2015. Russia's rouble-denominated wheat exports remained appealing because of the rouble devaluation (Fig. 1).

If there is no further devaluation, the ongoing price fall (which, for example, the USDA forecast relies on) is unlikely to encourage Russian producers to double exports, given the existing internal costs.

There is another aspect that deserves consideration and refers to grain exporters. All the five biggest grain trans-shippers are subject to foreign jurisdiction, one of which is assumed to be a Russian company, ООО ТД РИФ, that is registered offshore. The success of Russia's exports is driven by the fact that the Russian grain market has international players that have embedded Russia's grain exports into the already-existing framework (Table 5).

Therefore, on the one hand, the external market offers good opportunities for Russian grains: wheat consumption is projected to grow until 2024, potential importers are geographically close to Russia. On the other hand, wheat prices are forecast to drop, the effect of devaluation may be depleted, export operations will become less profitable. Additionally, the United States as the second biggest exporter has a potential to boost its production that is not employed at full capacity because the country continues expanding to the external market by means of crops that produce higher profits for US farmers.

However, Russia has a product, buckwheat, that can help Russia hold the status as the world's number one exporter. Unlike prices of grains and legumes, soybeans and sunflower, prices in the world buckwheat market are on the upswing. Indeed, the buckwheat market is narrow one, of which, however, Russia accounts for almost 23%.

1 <http://comtrade.un.org/>

Table 5

BIGGEST GRAIN IMPORTERS (COMPANIES)

Company	Share of grain trans- shipping, % (2014–2015)*	Founder
MZK LLC (ООО МЗК)	9	100% FIRADA B.V. (The Netherlands)
GC Cargill (ГК Каргилл)	8	100% Cargill International Luxemburg 2 SARL (The Netherlands)
TD RIF LCC (ООО ТД РИФ)	7	99.9% Laparkan Investments Ltd. (Cyprus) and 0.1% Grain Ltd. (Virgin Islands)
ООО Outspan International (Аутспан Интернешнал)	5	Olam International Ltd. (Singapore)
Louis Dreyfus LLC (ООО Луис Дрейфус)	5	100 Sungrain Holdings SA (Switzerland)
Total	34	

* <http://agro2b.ru/ru/news/23139-Rejting-eksporterov-Eksport-zerna-Rossii-Sezon.html>

Source: SPARK – Interfax, August 2016.

4. INDUSTRY IS ADAPTING TO THE CRISIS: Q3 2016 DATA

S.Tsukhlo

Final estimate given by the Index of Adaptability¹ for Q3 2016 has confirmed the increased level of Russian industry adaptability to the crisis of 2014–2016. The indicator has conclusively registered its all-time maximum at 74% for the entire period of monitoring 1994–2016 (Fig. 1). Review by enterprises of their industrial capacities estimates was the main factor of growth of the Index of Adaptability.

In Q3 2016, industry sharply raised the share of capacity responses as “sufficient” at the expense of reduction of responses “more than sufficient”. Thus, significant part of surplus expectations regarding changes in capacity demand was shifted by businesses to “sufficient” category. As a result, the share of normal (sufficient) sufficiency of industrial capacities has moved up to 76%, which is nearly an all-time high of the indicator. Superior value (all-time high) was registered in Q2 2012 and constituted 78%. Excessive capacity overhang has fallen to nearly local minimum (2009–2016). Currently 16% of enterprises report excessive capacity. In 2011, this indicator was at the level of 14–15%.

At the same time, capacity difficulties in Russian industry was constantly registered by merely 5–9% of enterprises. It should be noted that their responses regarding capacity, businesses link to their changes in demand, in other words to their projections of demand. Projection accuracy is rather high and mistakes in vast majority of cases fall into one side – upward bias of future sales volumes.

Thus, in 2016, industry boasts of all-sufficient production capacity capable to satisfy the most optimistic projections of demand on domestic products².

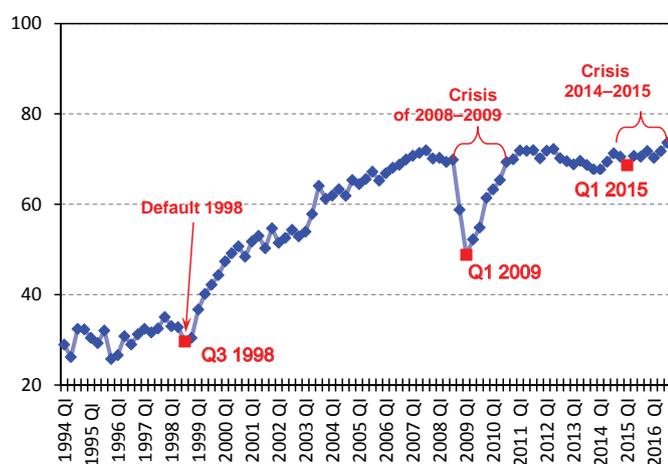


Fig. 1. Index of Adaptability (normality) of industry, 1994–2016, % (share of enterprises estimating their indicators as “normal”)

1 The Index is computed as arithmetical average of a share of normal estimates of six indicators: demand, stocks of finished products, stocks of raw materials, available production capacities, current employment, financial and economic state of enterprises. Gaidar Institute for Economic Policy has been analyzing a set of these estimates since 1994. The Index is computed on a monthly basis. The Index of Adaptability (normality) shows the level of adaptation of the Russian industry to current economic conditions. Or: to what extent normal are current conditions for Russian industry performance.

2 However, one should bear in mind that estimates of available capacity and laborers in Q3 have been obtained according to the schedule of business surveys conducted in July 2016 when industry was strongly affected by the first marks of recovery from the current crisis and due to this reason boasted of excessive expectations regarding the rate of positive

Demand estimates have also contributed to the dynamics of the Index of Adaptability. Satisfaction with sales has made a full recovery following the frustration of Q1 2016 when the share of normal responses of demand decreased to the crisis minimum (45%). Moreover, in Q3 2016, it reached maximum (during the crisis period) of 56%. At the beginning of the current crisis (Q1 and Q2 2015) satisfaction with demand constituted 51%. It should be noted that at the beginning of the previous crisis (2008–2009), this indicator crashed from 60% to 23% and stayed at the minimum during two quarters during that crisis following which over a year and a half it has mounted a comeback to the same levels.

Estimates of the stock of finished products maintained growth of the composite Index and estimates of stock of industrial inputs in Q3 kept the same nearly maximum values.

And solely estimates of headcount sufficiency (this refers exclusively about skilled laborers) prevented higher growth the Index of Adaptability (normality) in the last quarter. In Q3 2016, normal sufficiency of laborers decreased by 5 p.p. to 75% following the all-time high registered in Q2. The share of businesses with excessive employment has dropped to 9% and the scale of shortage of laborers has correspondingly grown to 16% and still exceeds the scale of shortage of production capacity.

Sector indices of adaptability by the end of Q3 2016 demonstrated sharp growth of “normality” responses in many sectors of Russian industry (Fig. 2).

The most significant increase of the indicator was registered in chemical industry, which according to normal responses (89%) has become the leader. Increase of sector Index has ensured the review by enterprises of sufficiency of available capacity in sectors: the share of their responses as “normal” has gone up during quarter by 37 p.p. and hit 97%. Meanwhile, surplus sector capacity have gone and in the foreseeable future can create problems with products supply. However, now chemical industry reaps the benefit of correct investment strategy implemented prior to crisis and of the ruble’s devaluation, which secured high demand for quality and cheap (in hard currency) Russian products. As a result, nearly all enterprises of the sector (96%) estimate their financial situation as good or satisfactory. Solely estimates of current demand lag behind high estimates of other indices registered by chemical enterprises: satisfaction with the current demand in Q3 2016 constitutes on average across the sector barely 75%.

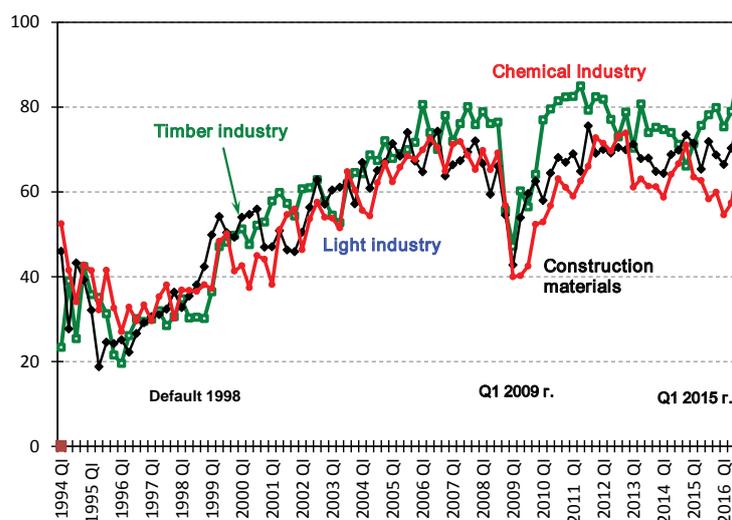


Fig. 2. Sectoral Index of Adaptability (normality), 1994–2016, % (share of enterprises estimating their indicators as “normal”)

changes. Estimates of production capacity and laborers in the coming quarters most likely will be revised towards more precise understanding of the rate of recovery from the current crisis taking into consideration actual changes taking place over recent months.

However, even the “worst” result posted by the chemical industry regarding this indicator was extremely high on the background of current demand estimates registered by other sectors of Russian industry. In Q3 2016, the food industry managed to register close to chemical enterprises levels of satisfaction with current sales. 63% of food industry enterprises estimated demand for its products as normal amid significant reduction of real income of the population and decrease of spending on food. The lowest level of satisfaction with demand (30–31%) was registered in the light industry and construction materials industry. This fact has a logical explanation: investment activity of enterprises is easing and the population refuses to renew wardrobe.

However, manufacturers of construction materials and cloths, it seems, hope to rebuild investment and consumer demand. This is due to a wide scale review by enterprises of these sectors of their estimates of surplus capacity in favor of sufficient owing to projections of demand shifts. However, the scale of shortage of capacity remained the same extremely negligible level. Precisely shifts in the estimates of capacity ensured growth of the Index of Adaptability in Q3 2016 to the highest levels posted during the current crisis (*Fig. 2*).

It must be said that other components of sector Indices of adaptability have demonstrated positive growth. In the light industry normal responses of stock of finished products (69%) and stock of raw materials (81%) have hit crisis maximum. Positive dynamics of estimates of stock is registered in the construction industry.

All indicators except estimates of stock of industrial inputs ensured growth of the Index of adaptability in timber industry to pre-crisis maximum. They declined during the quarter by merely 4 points to 79%. On the whole, by the end of the first three quarters of 2016, nearly all sectors of industry demonstrate high sufficiency with industrial inputs. ●

5. THE RECOVERY OF IMPORTS OF INVESTMENT GOODS: IMPORT SUBSTITUTION PROCESSES ARE SLOWING DOWN

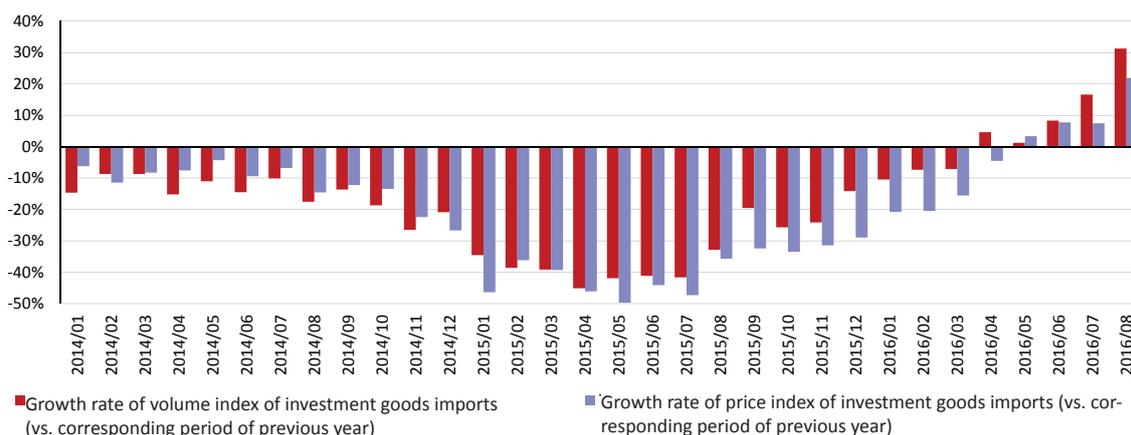
G.Idrisov, A.Kaukin, P.Pavlov

The sharp fluctuations of the ruble's exchange rate in the period 2014–2016 have not resulted in a reduction of the share of investment goods in the price structure of Russian imports. At the same time, domestic demand has visibly reoriented towards cheaper analogues. The recovery of imports of investment goods visible since the second half of 2016, which in part can be attributed to the strengthening of the ruble, points to a temporary halt of import substitution processes.

According to the Bank of Russia, over the period from January 2014 through September 2016, the Russian currency weakened by approximately 25%¹, which resulted in a corresponding rise in the ruble prices of imported goods. As a result, the volume of imports shrank. At the same time, the share of investment goods in total imports remained stable throughout the period under consideration, amounting to approximately 40%.

In fact, the fluctuations of the ruble's exchange rate, including its explosive fall in late 2014, did not result in any shifts in the price structure of imports between investment and non-investment goods.

From January through September 2016, the real exchange rate of the ruble against the US dollar increased, thus pushing down the ruble prices of imports and conducing to a transition to positive growth rates of imports of investment goods (both in terms of their price index and volume index) by the end of the first half-year of 2016 (*Fig. 1*).



Source: Own calculations, based on data released by the RF FTS.

Fig. 1. The price and volume of imports, as a percentage of the corresponding period of a previous year

1 The real effective exchange rate of the ruble against foreign currencies (Index, January 2014 = 100 pp) amounted to 64 pp. in January 2016 and to 76 pp. in September 2016. This corresponds to the following averages of the nominal exchange rate of the US dollar: 31.51 rubles in January 2014; 76.25 rubles in January 2016; and 64.6 rubles in September 2016.

The structure of imports

When estimating the shifts in the structure of imports of investment goods that were taking place before and after the significant changes that occurred in the macroeconomic conditions associated with the new constraints on tradability of goods¹, one should make note of its sufficiently high stability. Over the period 2013–2016², the main groups of imports included motor cars, accessories and spare parts for various types of motor vehicles, and telecommunications equipment (*Table 1*).

Table 1

STRUCTURE OF IMPORTS OF INVESTMENT GOODS, VALUE VOLUME

FEACN Groups (four-digit code)	Share in imports, %	
	2013	2016
8517 – telephone sets, including telephones for cellular networks ...	5.52	8.60
8703 – motor cars and other motor vehicles ...	12.32	8.25
8708 – motor vehicles; parts and accessories thereof ...	8.33	7.85
8419 – machinery, plant (not domestic), or laboratory equipment ...	1.79	6.70
8471 – automatic data processing machines and units thereof ...	3.58	4.83
8481 – taps, valves and similar appliances for pipes, boiler shells ...	1.68	2.33
8414 – air or vacuum pumps, air or other gas compressors ...	1.74	1.81
8413 – pumps; for liquids, whether or not fitted with measuring device, liquid elevators ...	1.64	1.78
8479 – machinery and mechanical appliances; having individual functions ...	1.95	1.75
8529 – parts suitable for use solely or principally with the apparatus of ...	1.85	1.48
8707 – bodies; (including cabs) for the motor vehicles ...	2.94	1.38
8407 – reciprocating or rotary internal combustion piston engines ...	1.89	1.30
8704 – vehicles; for transport of goods ...	2.16	1.28
8502 – electric generating sets ...	2.35	1.12
8429 – bulldozers, graders, levellers, scrapers, angledozers ...	2.24	0.90
Other groups	48.03	48.64
Total	100	100

Source: Own calculations, based on data released by the RF FTS.

When comparing the structure of imports of motor cars in terms of their physical volume in H2 2013 (on the eve of the 'macroeconomic turbulence' period) and H2 2015, one notable feature is the significant growth of the share of Japanese and German brands³. This can be in part explained by the fact that the average ruble price of these motor car brands did not jump as highly as that of motor cars produced in the US and the UK⁴, and in part by the marketing policies of certain companies that wanted to retain their marked shares by reducing their profit rates, and the altered structure of car fleet imports.

When looking at the related segment of motor vehicles for the transport of goods, we should note the altered structure of demand depending on their country of origin. Over the period from July 2013 through December

1 The regime of economic sanctions introduced against Russia and Russia's retaliatory sanctions.

2 The 'year 2016' is understood as the period from January through August 2016.

3 Their share was calculated with regard to the number of motor vehicles from the given country in the total number of imported motor vehicles. Growth from 19.3% to 29.2% and from 10.2% to 17.2% respectively.

4 The average prices of UK and US motor cars in US dollar terms gained 5% and 12% respectively, while those of Japanese and German brands (also in US dollar terms) lost 17% and 19% respectively.

2015, the share of trucks imported from Thailand increased dramatically¹. According to data released by the Federal Customs Service, in Q3–Q4 2013, the average price of a vehicle of gross combined weight rating under 5 t was as follows: for imports from Germany – \$26,100; for imports from Thailand – \$18,600. Meanwhile, in Q3–Q4 2015, the average price for the same category of motor vehicles was \$19,400 (for imports from Germany) and \$17,100 (for imports from Thailand).

Russian consumers reoriented to cheaper technological products. The noted shrinkage of the price interval within one and the same category of imported goods depending on their country of origin is a sign of a reducing available product variability that illustrates the evolving crisis trends.

Another notable fact is the shrinkage of the price and volume indices of imports of goods road motor vehicles produced in Belarus against the backdrop of their average price rising by 30% (in US dollar terms). The structure of demand for this commodity category also changed, in that the share of more expensive motor vehicles (including super-heavy goods road motor vehicles like, for example, mining dump trucks of the BELAZ Series²). The emergence of this trend can be explained by the satisfactory development of the economic situation in the mining sector (including the extraction of coal³ and metal ores), which is oriented to exports and thus enjoys a winning position in face of plummeting national currency.

Import substitution factors

Over the period from Q3 2014 through Q4 2015, the share of imports in the turnover of motor vehicles and spare parts and accessories thereof was consistently on decline (*Fig. 2*). However, the import substitution process in that segment halted some time around late 2015 and early 2016. The ruble's strengthening triggered a simultaneous growth of the share of imports in these commodity groups. At the same time, while over the previous period the share of imports in the total turnover of machines and equipment stayed at approximately 30%, from early 2016 onwards it also began to expand⁴.

Among the main factors that can help promote the import substitution policy in Russia we may note the following ones: the weakening national currency; the constraints on tradability of goods created by the mutually imposed economic sanctions; the consistent policy implemented by the government's economic departments. The statistical data for 2015 demonstrate⁵ that the potential offered by the import substitution policy was low, and that the new opportunities were taken advantage of by only a handful of industries. The ruble's strengthening observed in Q1–Q3 2016 became one of the factors working against the import substitution processes. The effects of the 'import substitu-

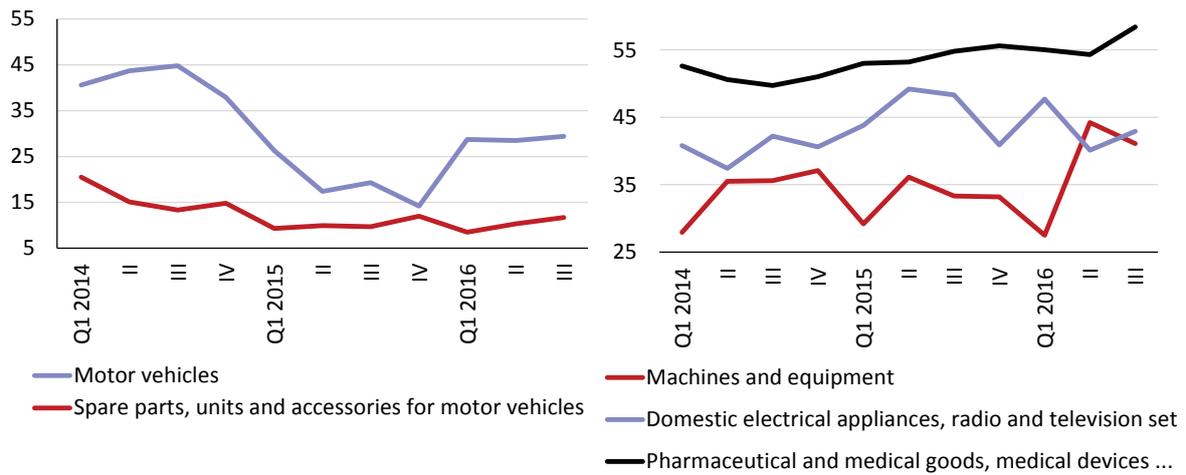
1 From 9.36 to 36.71% in terms of physical volume, and so Thailand now topped the structure of Russia's imports (the leaders over the previous period were: Italy – 15.%; Germany – 14.4%; Korea – 12.9%). The value volume (in US dollar terms) increased only slightly – by 5%.

2 The price of BELAZ 7571 Series trucks with payload capacity of 450 mt is up to \$7.5m. See http://naviny.by/rubrics/economic/2014/08/22/ic_articles_113_186370

3 In 2015, the output of black coal, brown coal and peat increased by 3.4%; that of metal ores – by 2.2% (on 2014).

4 In some commodity groups, the share of imports continued to increase (at a monotonous rate) even during the ruble's plunge, which points to absence of their domestically produced analogues.

5 *Kaukin A., Pavlov P.* Import Substitution in Russia's Manufacturing Industry. Russian Economic Developments, No.3. 2016, pp. 63–66.



Source: Rosstat.

Fig. 2. The share of imports in total trade turnover, %

tion successes¹ proved to be short-lived: the temporary advantages created for some sectors by the ruble's plunge and the introduction of economic sanctions were not backed by any transformations that could lay a foundation for sustainable growth in the medium- and long-term perspective. ●

1 See, e.g., Medvedev D. A. Social and economic development of Russia: Finding new dynamics. Voprosy Ekonomiki, 2016, No.10, pp. 5–30 (In Russian).

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