MONITORING OF RUSSIA'S ECONOMIC OUTLOOK:

TRENDS AND CHALLENGES OF SOCIO-ECONOMIC DEVELOPMENT

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TRENDS AND CHALLENGES OF SOCIO-ECONOMIC DEVELOPMENT

While what is commonly referred to as pension reform seems to be a project that is yet to be decided, a VAT hike is an accomplished fact (once the bill has passed third reading in the State Duma).

Since assessments of the effect of this new fiscal measure on the Russian economy are already predetermined, including a 1.5–2-fold increase in the current inflation rate and slower (by a quarter) than the previously forecast GDP growth in 2019, it appears that the expected fiscal effect (equal to extra revenues of Rb 600–700bn annually) is contemplated as being prevalent.

S&P Global Ratings has recently reaffirmed its Russia's investment grade long-term credit rating amid Russia's favourable fiscal figures as well as efficient monetary policy, which, according to the agency, gives evidence of Russia's capability to endure a possible tightening of sanctions. However, S&P predicts Russia will face low growth rates in the next few years because no institutional changes that can reverse this trend are expected to take place.

A well-known formula states that macroeconomic stability is a necessary but insufficient condition for successful development. In the today's context, however, "necessity" can easily turn into a synonym for "sufficiency". There is uncertainty about market trends, which is followed by sanctions-induced uncertainty plus trade and tariff uncertainty. Suppose a collapse of global platinum prices (in response to possible tariff barriers to trade in motor vehicles) is just an ad-hoc example from the expanding list of potential threats. In this context, measures to increase stability can easily outcompete measures to increase mobility, and even more so in a market where the state plays a dominant role.

The Q2'18 balance-of-payment data is another evidence of positive macroeconomic context. The BoP current account increased significantly over the same period previous year ($22.3bn and 1.9bn, respectively). The BoP hike was, for the most part, due to the improved balance of trade in goods with an increase to $46bn or by 83% over the last year's second quarter and by 3.1% over the first quarter this year. However, the negative balance of trade in services (-$7.2) and of investment income (-$13.8bn) remained unchanged, nearly equal to the value recorded in the same period in 2017. Capital outflows were recorded at $0.4bn, which was, for the most part, due to the fact that banks reduced their foreign liabilities. Inbound foreign direct investments (FDI) saw a sharp decline to $1.7bn compared to $12.6bn in the same period a year earlier. Investors' downbeat expectations affected the OFZ (rouble-denominated Russian government bonds) bond market: non-residents reduced their holdings of OFZ bonds by $6.6bn.

The weakening of the rouble amid improving terms of trade leads to a substantial increase in the BoP current account balance, as noted by our experts who expect seasonal factors to contribute to further growth in the current account balance in the third and fourth quarters this year. The experts also note that given the today's fundamental factors, they estimate the dollar's nominal exchange rate to be equal to or less than 58 roubles. According to the experts, the Russian rouble may appreciate late in the year, barring risks such as geopolitical exacerbation or plummeting energy prices.

Despite the uncertainty surrounding the above-noted factors, our experts/authors do not question the BoP statistics, which is however not the case for the industrial production output. According to experts from the Gaidar Institute, the main trends in Q1 2018 were slow growth in the extraction industry led by gas and coal mining sectors and close to zero growth rates in the manufacturing industry. However, The Russian Federal State Statistics Service (Rosstat) announced late in Q2 2018 that it would need to revise its statistics on industrial production dynamics. The arguments for the revision were as follows: the replacement of provisional data with actual data, the emergence of more of up-to-date statistics on production output of small-sized enterprises, etc. As a result, for example, the recalculated (by Rosstat) values of manufacturing production index show an increase in 2016–2018 by approximately 7–10% over the old values.

In light of this, the experts note that this is the second time in the past year and a half that the methodology of industrial indices calculation has been updated (new versions of the All-Russia Classifier of Products by Type of Economic Activities (OKPD2) and the All-Russia Classifier of the Types of Economic Activity (OKVED2) come out in 2017), thus having a crucial effect on the quality of evaluation of trends facing the real economy. This undermines the confidence in the released current/latest statistical data, makes it impossible to compare accurately statistical data on industrial production in the short and mid-term. There is a lack of transparency in the data revision methodology, which ultimately raises questions about the quality of Russian statistics on leading indicators for the real economy.

Researchers involved in a longstanding monitoring of industrial enterprises point to the specifics of the dynamics in recent years, spawned by both the economy and the Russian statistics. According to business surveys, the so-called industry adaptability index, which measures the percentage of enterprises assessing their performance figures as "normal figures", stood at 77% in mid-2018. The labour supply and the provision of capacities were assessed as highest by 85% and by somewhat more than 70% respondents, respectively. The percentage of enterprises with "normal" level of demand for their products reached 60% as the percentage of those with "normal" financial and economic standing rose from 83 to 89% since the beginning of the year.

Viewing the Russian industry's dynamics from the regional statistics perspective, the industrial production increased in 74 regions last year and in 62 in January–May this year. Although no investment statistics are available so far, it is safe to say that the housing construction sector has entered a positive zone (with growth posted by two thirds of the regions). The highest growth rates were recorded in the Moscow Oblast and the Leningrad Oblast as well as the Republic of Tatarstan.

Overall, individuals' earnings have stopped declining in 2018, except for 50 regions where they continue declining. Regions' budgets began to deteriorate last year, budget revenues increased 10% (over the comparable period previous year) in the first five months of 2018, including a 13% rise in revenues from the personal income tax on the back of substantial extra payments on salaries as part of measures to implement a series of presidential executive orders issued in May. Budget expenditure rose rapidly by 9%. The overall regional and municipal debt was reduced by 7% over the first five months of the year, but experts note that the debt always tends to increase at year's end.

1. RUSSIA'S BALANCE OF PAYMENTS, Q2 2018: POSITIVE BOP POSITION

A.Bozhechkova, A.Knobel, A.Lavrischeva, P.Trunin

The Russian current account balance rose in Q2 2018 year-on-year on the back of, among other things, rising positive balance of trade. Non-residents reduced their holdings of OFZ bonds over downbeat geopolitical expectations. Some extra growth in the current account balance can be expected in the second half this year, and the Russian rouble may appreciate late in the year, barring risks such as geopolitical exacerbation or plummeting energy prices.

According to the Bank of Russia's preliminary data on the 2018 BoP, Russia's current account balance in Q2 2018 stood at $22.3bn, 11.7 times the value recorded in Q2 2017 when it was $1.9bn (it was marginally lower, however, than in Q1 2018 when the current account balance reached $30.8bn).

The increase in the balance of payments was, for the most part, due to the improved balance of trade in goods, up $46bn in Q2 2018, 3.1% up compared to $44.6bn in Q1 2018 (adding 83% to $25.2bn in Q2 2017).

The negative balance of trade in services remained almost unchanged (-$7.2bn) in the second quarter (-$6.6bn in Q1 2018 and -$7.6bn in Q2 2017). The investment income balance stood at -$13.8bn, nearly equal to -$13.3bn recorded in the same period in 2017 (-$4.2bn in Q1 2018).

Unlike the afore mentioned main BoP accounts, the sub-accounts of the current account such as compensation of employees balance, rent balance, secondary income balance continued to represent a small share with no strong effect on the current account balance.

The following is a more detailed description of each of the three main categories of BoP.

The balance of trade in goods. Exports in Q2 2018 were found to be much greater compared to Q2 2017, for the most part due to increasing export prices. Average prices for supplies increased for all of the Russian principal export commodities, except aluminium facing a decline in both average export prices and physical supply volumes (*Table 1*).

In Q2 2018, the growth in imports (relative to Q2 2017) slowed to 9.4% (from $58.7bn in Q2 2017 to $64.2bn in Q2 2018), leading to an increase in the balance of trade by $20.8bn or 82.5% (from $25.2bn in Q2 2017 to $46.0bn in Q2 2018).

Imports declined, for the most part, due to the rouble's exchange rate movements: the rouble's real effective exchange rate lost 2.3% in H1 2018 compared to H1 2017[1].

The balance of trade in services. The second quarter of 2018 saw exports increase (for the most part due to inbound tourism associated with the FIFA World Cup) and imports of services rise (on the back of transport

1 Concerning the effect of exchange rate dynamics on trade see also A. Knobel, A. Firanchuk. Russia's Foreign Trade in 2017 // *Russian Economic Developments*. 2018. Vol. 25, No. 3, pp. 6–13.

Table 1

AVERAGE EXPORT PRICES AND PHYSICAL SUPPLY VOLUMES OF RUSSIA'S PRINCIPAL EXPORT COMMODITIES

Commodity	Proportion in Russia's total exports in Q2 2018, %	Average export price in Q2 2017, USD/ tonne	Average export price in Q2 2018, USD/ tonne	Percentage growth in average export price in Q2 2018 compared to Q2 2017, %	Percentage growth in physical supply volumes in Q2 2018 compared to Q2 2017, %
Crude oil	29	356	488	+37	+2.9
Refined petroleum products	17	386	500	+29	–2.1
Natural gas	11	$175/m3	208/thous. m3	+19	+18
Ferrous metals	5.7	440	513	+17	+26
Hard coal	3.5	76	82	+8.0	+19
Wheat and meslin	1.9	182	188	+3.3	+88
Fertilizers	1.7	216	228	+5.2	+19
Liquefied natural gas (LNG)	1.3	$126/m3	138/m3	+9.2	+51
Copper	1.0	5577	6728	+21	+41
Aluminium	0.9	1676	1616	–3.6	–4.5
Nickel	0.5	9110	14275	+57	+14

Source: own estimates based on data from Russia's Federal Customs Service.

services and international travel) over the preceding quarter (exports were up 21.8%, or from $14.2bn to $17.3bn, as imports rose by 17.3%, or from $20.8bn to $24.4bn). Both exports and imports of services rose relative to Q2 2017 (exports picked up 16.9%, or from $14.8bn to $17.3bn, as imports gained 8.9%, or from $22.4bn to $24.4bn). Should the rouble's real effective exchange rate be stable in the near term, exports and imports of services will follow the same trend[1], thereby maintaining negative values for the balance of trade in services.

The investment income balance. The negative investment income balance remained almost unchanged (-$13.8bn) in Q2 2018, compared to the same period in the prior year (-$13.3bn in Q2 2017).

Therefore, the positive current account balance will increase by the end of 2018 if the today's movements of prices for primary export commodities and the rouble's real effective exchange rate remain stable. This will happen because of increasing balance of trade (due to increasing export revenues in response to higher prices for Russia's principal export commodities and slowing (down to zero) import growth rates) and stabilization of the other sub-balances.

The rise in the current account surplus came amid an increasing financial account deficit, -$9.9bn in Q2 2018 (compared to -$1.7bn in Q2 2017). The net capital exports by banks and enterprises ran at $0.4bn in Q2 2018, whereas the net capital imports amounted to $1.8bn in Q2 2017 (*Fig. 1*).

The dynamics of capital outflows was driven mainly by banks' transactions. Banks saw a net capital outflow of $2.1bn in Q2 2018 compared to $9.2bn in Q2 2017. Capital outflows from the banking sector were due to the fact that banks reduced their asset holdings and foreign liabilities by $7.4bn (-$2.5bn in Q2 2017) and $9.5bn (-$11.7bn in Q2 2017) respectively.

The non-financial sector saw a net capital inflow of $1.7bn in Q2 2018 (compared to $11.0bn in Q2 2017). Enterprises' net capital inflows were led, for the most part, by a $3.5bn growth in other liabilities ($3.5bn in Q2 2017) as other assets increased by merely $0.8bn ($2.6bn in Q2 2017).

1 См. A. Knobel, A. Firanchuk. External turnover in services, 2017 // *Russian Economic Developments*. 2018. Vol. 25. No. 6. P. 15–20.

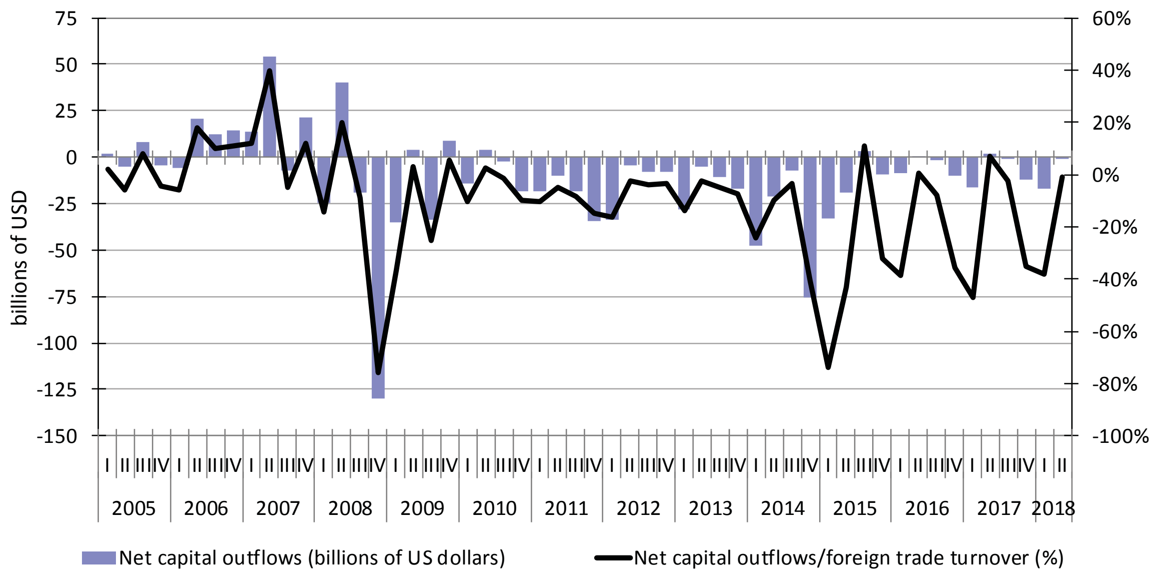

Fig. 1. Private sector's net capital outflows, 2005–2018

Sources: Bank of Russia, Gaidar Institute's calculations.

Inbound foreign direct investments (FDI) stood at merely $1.7bn (compared to $12.6bn in Q2 2017), while outbound FDI reached $4.2bn (compared to $7.6bn in Q2 2017). The second quarter saw enterprises reduce their liabilities, such as loans and credits payable, by $1.9bn (-$2.2bn in Q2 2017). Net outflows of portfolio investment were equal to $0.1bn due to reduced liabilities and assets by $0.6bn (-$1.0bn in Q2 2017) and $0.5bn (assets increased $1.1bn in Q2 2017) respectively.

Investors' downbeat expectations continued affecting the OFZ bond (rouble-denominated Russian government bonds) market. In Q2 2018, non-residents reduced their holdings of OFZ bonds by $6.6bn (compared to an increase of $2.4bn in Q2 2017).

The international reserves increased to $11.3bn in Q2 2018 ($7.5bn in Q2 2017) predominantly in response to MinFin's (Russia's Finance Ministry) foreign currency purchases of about Rb 892.9bn in the local foreign exchange market in compliance with the budget rule in effect.

In the period between April and June 2018, the Russian rouble lost 9.6% against the US dollar, with the exchange rate of 62.76 roubles per dollar. Nevertheless, according to our estimates, given the fundamental factors as they are now, the dollar's nominal exchange rate is estimated to be not higher than 58 roubles. The rouble's drastic depreciation in April was caused by heavy-handed Western sanctions against Russia and the respective revaluation of risks associated with investment in this country. The situation was also aggravated by economic agents' expectations about further tightening of sanctions, including sanctions on the Russian sovereign debt, as well as the military conflict in Syria. Despite the fact that the rouble was propped up by oil prices, its further depreciation induced capital outflows from emerging markets amid tightening monetary policy in some developing countries. MinFin's foreign currency purchases contributed to this as well[1].

1 See A.Bozhechkova, P.Trunin // Monitoring of Russia's Economic Outlook. 2018. No. 13(74).

Overall, the weakening of the rouble amid improving terms of trade leads to a substantial increase in the BoP current account balance. Furthermore, seasonal factors will contribute to a higher current account balance in the second and third quarters of 2018. The Russian rouble may appreciate late in the year, barring risks such as geopolitical exacerbation or plummeting energy prices. What should not be shrugged off, however, is that the afore mentioned risk scenarios may play out.

2. INDUSTRIAL PRODUCTION DYNAMICS, H1 2018: ROSSTAT REVISES ITS STATISTICS[1]

A.Kaukin, E.Miller

Rosstat announced late in Q2 2018 that it would need to revise its statistics on industrial production dynamics. As a result, growth rates, which were close to zero in the first quarter, turned positive for both the manufacturing and extraction sectors at the half year's end. A lack of transparency in the data revision methodology raises reasonable questions about the quality of Russian statistics.

According to Gaidar Institute's estimates of trend component series of industry-specific production indices in Q1 2018, the main trends early in the year were slow growth in the extraction industry led by gas and coal mining sectors and close to zero growth rates in the manufacturing industry[2].

The Russian Federal State Statistics Service (Rosstat) announced in mid-June 2018 a major revision of the data on industrial output dynamics for 2016–2018. Rosstat provides the following list of main changes in the calculation methodology by which it recalculated retrospectively industry-specific production indices[3]:

1. Replacing provisional data on manufacture of products and on the scope of delivered works and services with the actual data provided by respondents throughout the 2017–2018 period.

Enterprises are required to meet tight deadlines to provide their statistics on the fourth day after the financial (reporting) month due to a short time frame for Rosstat to release information on industrial production indices[4]. Therefore many enterprises, including large ones, provide provisional (often underestimated, according to Rosstat) data as their day-to-day data that are further updated in their monthly and annual reports.

2. More of up-to-date statistics on production output of small-sized enterprises have emerged.

Under the existing Russian laws and regulations, small-sized enterprises (excluding micro-sized enterprises) are surveyed quarterly on a sample basis, while micro-sized enterprises and self-employed individuals are surveyed once a year. Since small business accounting is important for some commodities and types of economic activity, the information available as of the estimation date is evaluated for this sector in the course of the year, and a total survey of small and medium-sized enterprises is conducted once in five years.

1 The authors acknowledge with gratitude the statistical analysis support from M. Turuntseva and T. Gorshkova.

2 A. Kaukin, E. Miller. Industrial production in the first quarter of 2018 // Russian Economic Developments. 2018. No. 5. P. 35–38.

3 Rosstat "Industrial production in January–May 2018" // http://www.gks.ru/bgd/free/B04_03/IssWWW.exe/Stg/d03/114.htm

4 Much shorter than deadlines for publication of such information in developed countries, e.g., 26 days after the financial month, in the United Kingdom.

The most recent survey was conducted at the 2015 year-end, with the aggregate data released in April 2018[1].

3. Data revision for companies while switching to new versions of the All-Russia Classifier of Products by Type of Economic Activities (OKPD2) and the All-Russia Classifier of the Types of Economic Activity (OKVED2).

In 2017, according to Rosstat, many respondents had issues trying to identify both the type of their products and economic activity; therefore, manufacturers still continue to "re-indentify" their products while providing their statistics, whereby data time series for 2016–2018 were updated.

The introduction of the changes in the methodology for industry-specific production indices calculation – even those unadjusted for seasonal variation that are published by Rosstat – induced significant deviations from the values available before June 2018. For the most part, the series exhibited an upward shift[2]; for example, the recalculated (by Rosstat) values of manufacturing production index show an increase in 2016–2018 by approximately 7–10% over the old values, with a more moderate increase of about 1–2% in the mineral extraction sector.

The Gaidar Institute performed decomposition of series to subtract the trend component[3] based on the revised data. *Fig. 1* presents a comparative analysis of trend components of the industrial production index before and after the data revision by Rosstat. In fact, the Rosstat's revision of input data shows almost concurrent upward shift since 2016 in the trend for industrial production compared to the trend estimated using old data. A somewhat gap between the old and new version of the trend was already seen back in 2015, which probably was due to the specific features of a series smoothing procedure.

In June 2018, the extraction sector posted an increase of 102.9% over the 2017 year-end and of 103.3% over June 2017 (*Table 1*). The increase was probably driven by the following factors: first, bullish global oil market on the back of the OPEC+ output cut agreement; second, the agreement terms were eased (oil-exporting countries agreed to boost their average daily production at a meeting in Vienna late in June. Furthermore, the positive dynamics could be linked to the wearing out of high base effect early in 2017 and the increase in gas producing industry.

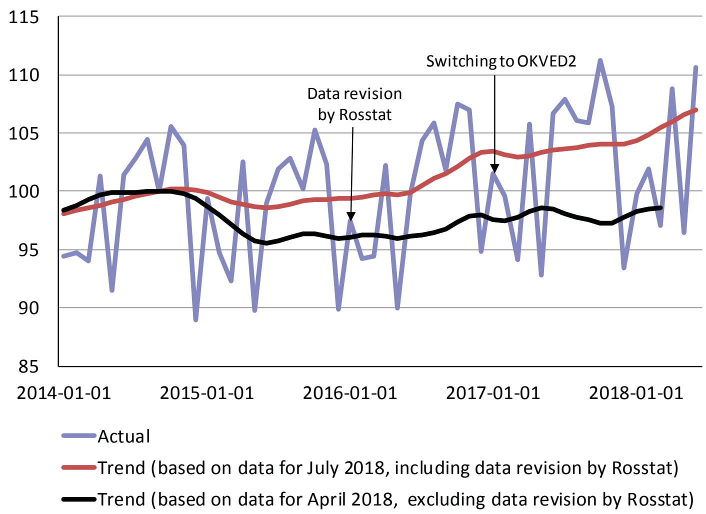

Fig. 1. Industrial production index dynamics, 2014–2018 (actual data and trend component), % change over September 2014

Sources: Data (calculated by both old and new methodologies) from Rosstat, own calculations.

1 Rosstat // 23 July 2018. URL: http://www.gks.ru/free_doc/new_site/business/prom/splosh.html

2 Excluding manufacture of chemicals and chemical products and manufacture of leather, articles of leather, and manufacture of footwear.

3 The trend component was subtracted using Demetra and X12-ARIMA.

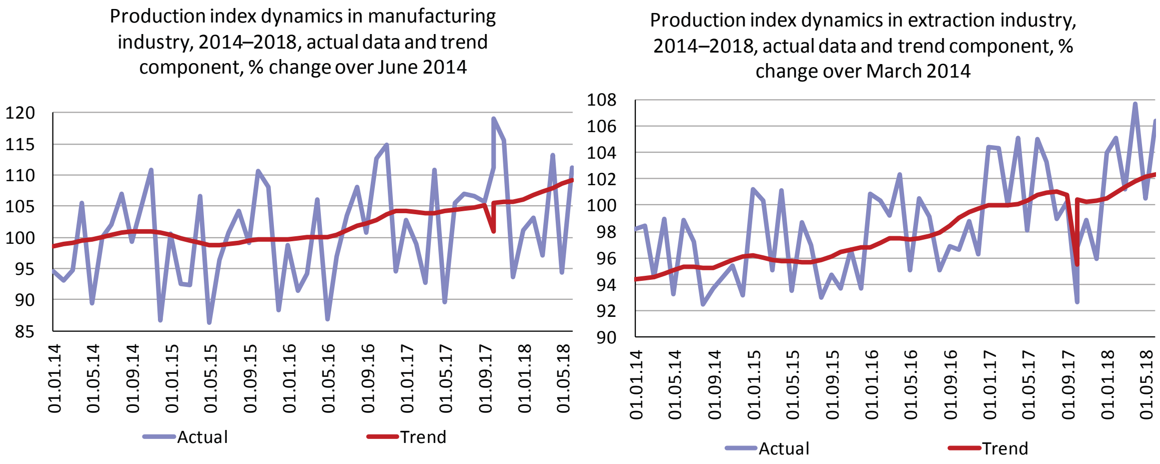

Fig. 2. Dynamics of industrial production indices in manufacturing and extraction industries, 2014–2018 (actual data and trend component)

Sources: Data (calculated by a new methodology) from Rosstat, own calculations.

The manufacturing industry, according to Rosstat's updated data, was on the rise in H1 2018: the trend component of the index gained 102% in June over December 2017 and 101.6% over June 2017. The main contributors to the Q2 2018's increase were the food industry due to the increase in manufacture of food supplements, beverages and baby foods; manufacture of other non-metallic mineral products due to the increase in manufacture of construction materials, thus boosting the construction industry; as well as the increase in manufacture of primary products and materials on the back of rising exports in sectors such as woodworking, manufacture of refined petroleum products, iron-and-steel industry.

The downturn in the machine-building industry over the last three months of 2018 was due to lower consumer demand by agricultural enterprises, the uncertainty about Ministry of Agriculture's soft lending measures, as well as the contraction in manufacture of power generation equipment such as turbines and AC generators.

Therefore, the estimates show a moderate growth that emerged in some of the industrial sectors in H1 2018. However, extreme caution must be exercised in interpreting the described changes. The estimates performed using the data updated by Rosstat's new methodology show that sector-specific growth rates of industrial output throughout the entire post-crisis period are higher than the estimates performed using the old statistics[1]. While the data analysis made prior to the calculation methodology revision[2] showed a remarkable industrial production downturn after 2014, the revised (after June 2018) statistics show a much smaller downturn.

Rosstat's explanations about its data revision methodology arises the following questions: Which of the values of the published series are based on online business surveys (which reveal, according to Rosstat, that production outputs are often underestimated) and which of them are based on the revised and updated data? Where does the boundary between the correct data on production output of small-sized enterprises and the recalculations

1 Some experts also noted a shift in the Rosstat's primary statistics; see, for example, M. Selikhov. In thrall to the statistical error: Why is Rosstat difficult to trust // RBC, 27 June 2018. https://www.rbc.ru/opinions/economics/27/06/2018/5b3201229a794725025a6958

2 See other reports of this monitoring for the past three years.

based on retrospective information lie? How often will data be revised in the same manner as it was done in June? First of all, a lack of responses undermines the confidence in the released current/latest statistical data because they cannot be used to estimate with surety the short-term trends in the real economy, and, second, makes it impossible to compare accurately statistical data on industrial production in the short and mid-term.

Table 1

OUTPUT INDEX CHANGE BY INDUSTRY, %

	As a % of industrial production index	June 2018 over June 2017	June 2018 over December 2017	Changes in recent months
Industrial production index		103.33	102.89	slow growth
Mineral extraction	34.54	101.57	102.01	slow growth
Manufacturing industry	54.91	104.53	103.30	growth
of which:				
Manufacture of food products including beverages and tobacco	16.34	112.61	107.59	growth
Manufacture of textiles and wearing apparel	1.14	110.93	106.46	growth
Manufacture of leather, articles of leather, and manufacture of footwear	0.27	96.53	99.10	decline
Woodworking and manufacture of articles of wood	2.02	108.82	107.51	growth
Manufacture of pulp, paper and paperboard;	3.35	84.18	92.30	decline
Manufacture of coke, refined petroleum products	17.25	101.98	101.37	slow growth
Manufacture of chemicals and chemical products	7.56	112.53	110.52	growth
Manufacture of rubber and plastics products	2.14	103.03	102.56	slow growth
Manufacture of other non-metallic mineral products	4.02	121.19	112.25	growth
Metallurgy and manufacture of finished metal products	17.42	130.13	131.06	slow decline
Manufacture of machinery and equipment	6.97	98.48	98.84	decline
Manufacture of electrical, electronic and optical equipment	6.27	90.79	97.28	stagnation
Manufacture of means of transport and transport equipment	6.75	135.09	117.80	growth
Other industries	2.42	110.64	105.37	growth
Electricity, gas and water	13.51	109.49	104.65	slow growth

Sources: Data (calculated by a new method) from Rosstat, own calculations.

3. RUSSIAN INDUSTRY ADAPTABILITY INDEX, Q2 2018: NORMALIZATION

S.Tsukhlo

In Q2 2018, the Russian industrial sector managed to recover to a normal state of operation from the failed start early this year. The percentage of enterprises assessing their state as "normal standing" neared an all-time high by mid-2018 (77% compared to 78% in H2 2017).

The most important contributor to recovery of the Industry Normality (Adaptability) Index was labour supply in the Russian industrial sector. The percentage of enterprises with sufficient number of employees in mid-2018 gained 9 points, thereby compensating in full for the first quarter's losses and hitting an all-time high of 85% in the entire monitoring period. Therefore, the Russian industrial sector managed to solve its labour supply problems amid protracted economic stagnation but "in light of the expected changes in demand". Only 7% enterprises are now faced with labour force deficiency, the lowest value recorded since early in 1999. Only once – before the Russian financial collapse (default) in 1998 – did the industrial sector post an even smaller labour force deficiency, but almost 40% enterprises said they had more employees than they needed.

2018 saw no material changes in the provision of capacities to the industrial sector (again "in light of the expected changes in demand"). A somewhat more than 70% enterprises consider they now have sufficient provision of capacities to meet current demand and the changes that expected in the demand. Therefore, the level of sufficient (normal) provision of machinery and equipment to the Russian industrial sector is lower than that of labour force. However, 90% Russian industrial enterprises are not limited in the provision of machinery and equipment.

In Q2 2018, enterprises reported the demand for their products was back to satisfactory levels, an increase of 2 points or to 60% of "normal" assessments.

In Q2 2018, the percentage of "normal" assessments regarding

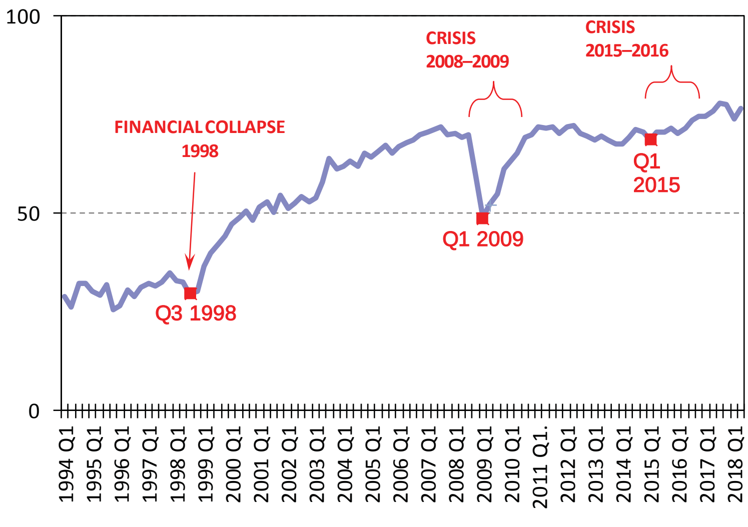

Fig. 1. Russia Industry Adaptability ('Normality') Index, 1994–2018, % (percentage of enterprises assessing their performance figures as "normal figures")

finished goods inventory dropped to 71% with zero balance of answers such as a "higher" or "lower" than normal level. Assessments of finished goods inventory turned out to be the only indicator showing a decline (an imaginary fall of 3 points, though) in Q2 2018.

Enterprises' assessments of their financial and economic standing in the second quarter improved after a decline early in 2018, moving 9 points down to 83%. No surveys since the beginning of 2009 have registered such a sharp slump in the total of "good" and "satisfactory" answers. In mid-2018, however, 89% Russian industrial enterprises were at least satisfied with their financial performance outputs.

The dynamics of Industry Normality Index 2017–18 adds greatly to what is going on in the Russian industry. On the one hand, another attempt, early in 2018, to recover from the protracted and sluggish 2015–16 crisis failed to meet the expectations. On the other hand, the industrial sector continued smoothing out the specifics of last years' dynamics spawned by both the Russian economy and the country's statistics.

4. RUSSIAN REGIONS IN JANUARY–MAY IN 2018: NO SUSTAINABLE GROWTH

N.Zubarevich

In the first five months of 2018, socio-economic dynamic improved; however, there was no sustainable growth in most regions. Russian territories' budgets have also improved: in the course of presidential elections, regional transfers have substantially grown, and so have social expenditures.

Regional dynamics regarding the recovery from crisis varies greatly. The industrial production boasts of a better dynamics but it is not stable. If in 2017 the industrial production grew in 74 regions, then in January–May 2018 it grew only in 62. Among industrial territories, the fastest growing industrial production was recorded in Rostov region, Astrakhan region, Archangelsk region, Tambov region, Moscow (20–28%), as well as in Republic of Mordovia and Yamal-Nenets Autonomous Region (12-15%). Sources of growth are gas and food industries, automotive industry, electronics, pharmaceuticals, and cellulose and paper industry. Those industries have affected the dynamics in the regions where they are located. Fast industrial downturns was recorded in Nenets Autonomous Region (11%) due to cyclicality of the oilfields development, as well as in Tula Region and Republic of Udmurtia (7%) due to lack of defense procurements and acquisitions. Risks of recession in regions which specialize on defense industry are mounting

Investment statistical data for H1 is not available yet, one can only estimate the dynamics of housing development. Crisis in this sector continued until late 2017, new housing development in 2015–2017 fell by 8%. In H1 2018, housing development grew by 3.8%. In January–May, increase has been noted in two thirds of all regions. Among regions with high volumes of housing development, the highest rates of growth were recorded in adjacent areas of the largest agglomerations – Moscow Region (+44%) and Leningrad Region (+28), as well as Republic of Tatarstan (+19%). In Moscow and Saint Petersburg housing development commenced growing in 2017 due to the growth in mortgage loan activity, however in January–May 2018 saw a recession in this sphere.

The retail commerce is slowly increasing since 2017 due to consumer crediting, which maintained demand during continuing decrease of the household income. In Q1 2018, growth accelerated (2.6%) as a result of the substantial increase in real wages of public-sector employees before the presidential elections. In January–May, only six regions demonstrated negative dynamics in retail trade, including three Republics of North Caucasus – Chechnya, Dagestan, and Ingushetia where the statistics consistency is low in the wake of street markets predominance.

Unemployment is keeping low in Russia – 4.7% in June 2018, regional indicators have barely changed. Regional differentiation is also stable and is determined by the combination of demographic and economic factors: highest unemployment is continuing in the less developed North Caucasus republics and Siberia – Ingushetia (27% on average in March-May 2018), Tyva

(15%), and Chechnya (14%), relatively high (9-12%) in other economically-undeveloped republics, as well as depressed regions of Siberia, Urals, North-West (Republic of Buryatia, Zabaikalie Territory, Kurgan region, and Karelia Republic). Cities with federal status boast of minimal unemployment (less than 2%).

Household income downward trend terminated only in 2018, in January–April, household income grew by 3% against the same period of the previous year taking into account 2017 lump sum payment to pensioners. However, household income continued declining in 50 regions, for the majority of country's population income decline has not terminated. All-Russia growth has been achieved primarily owing to Moscow, Saint Petersburg, Tatarstan, and Tyumen Region. Growth of household income encouraged real wage growth in Q1 2018 by 10.2% against the same period of 2017, which was due to the additional payments to public-sector employees just before presidential elections, which was a part of Presidential May 2018 decree, as well as with pension indexation in early 2018. In April, May, and June 2018, fast growth of real wages slightly slowed down (7%), while household income growth terminated in May–June.

Regional dynamics across various socioeconomic indicators differ greatly, while information on household income is not completely accurate. Still, Moscow, Yamal-Nenets Autonomous Region, Saint Petersburg, Tatarstan, Voronezh Region, Belgorod Region, Moscow and Rostov Regions boast of higher sustainable development. They are dominated by developed territories with better-qualified administrations.

Regional budgets have already commenced to improve since 2017, revenues posted contraction only in nine of the regions. In January–May 2018, revenues of consolidated regional budgets grew by 10% against the same period of 2017. Those are the highest growth rates since 2011. Proceeds from the Personal income tax (PIT) increased by 13% due to large additional wage payments in line with the May 2018 decree. Such dynamic was not observed since 2008. Transfers grew by 12%, which is the most significant growth after 2011. Only in one region – wealthy Sakhalin Region – revenues contracted because of the reallocation of the large part of the profit tax to the federal budget.

Sevastopol boasted of the fastest budget growth (44%) due to transfers increase by 2.2-fold. Khanty-Mansi Autonomous Region reported growth of 38%, Republic of Yakutia (30%), and Tyumen Region (29%), which is the effect of the low base of the previous year. Republics of Kabardino-Balkaria and Karelia increased their budgets by 28-33%, which resulted from transfers growth by 42-42%, and in the Republic of Bashkortostan and Volgograd Region (28%) due to revenues growth.

Budget expenditures in January–May grew by 9%. It is the highest growth since 2012. Without Moscow, budget expenditures of other regions grew even faster (11%). Only three regions have cut their expenditures – Kaluga Region, Republics of Tatarstan, and Mari-El. During the election period, regions always increased social expenditures and this was true of 2018. In January–May, largest expenditure growth was on culture (19%) and healthcare (14%), with expenditures on regional medical care insurance fund it added up to 18%. Expenditures on education and social policy went up by 9%, including social transfers by 8%, mostly at the expense of Moscow. Such dynamic was not observed since the beginning of the budget crisis, during the elections budgetary expenditures become a strong political tool. Also, substantially grew expenditures on physical culture and sports (17%) because of the World Cup.

Moscow accounts for 20% of revenues and over 18% of budget expenditures of all regions, thus the capital dynamics strongly affect the general dynamics. In January–May in 2018, 0Moscow budget revenues and expenditures grew slower than expected (*Fig. 1*). Presidential elections and continued urban improvement before the World Cup determined the priorities: expenditures on the national economy contracted by 2%, expenditures on housing and public utilities rapidly grew due to increased funding of urban improvement (21%). Expenditures on culture dropped (-7%), expenditures on education stayed on hold, spending on healthcare grew at a slower pace (6% including regional medical insurance funds – 13%). However, expenditures on social security grew by 16%, including social transfers – by 31%.

Increase of regional social expenditures was secured not only by the increased budget revenues and transfers but also by the budget maneuver: expenditures on national economy grew slower (8%) due to Moscow and housing and utility services (3%). Without taking Moscow into consideration, regional expenditures on housing and public utilities shrank by 6% in January–May. As a result, regional budgets in first months of 2018 «focused» on elections, some of them also on the World Cup, while economic development goals, excluding preparing the transport infrastructure for the World Cup, became of the second importance.

Total regional and municipal debt from January 1 through June 1, 2018 shrank by 7%, however towards the end of the year it always grows. The budget of Republic of Mordovia boasts of the biggest debt – 2.1-fold higher than its revenues without transfers, in January–May 2018 its debt kept growing. In Kostroma Region and Republic of Khakassia, debt almost equals to their revenues, in other 13 regions debt is higher than 75% of their revenues.

Thus, the socio-economic dynamics became better in the first five months of 2018, however there was no stable growth in the majority of regions. Regional differentiation was stable and even grew in regards to the industrial dynamics, housing construction, retail turnover, employment market, and household income.

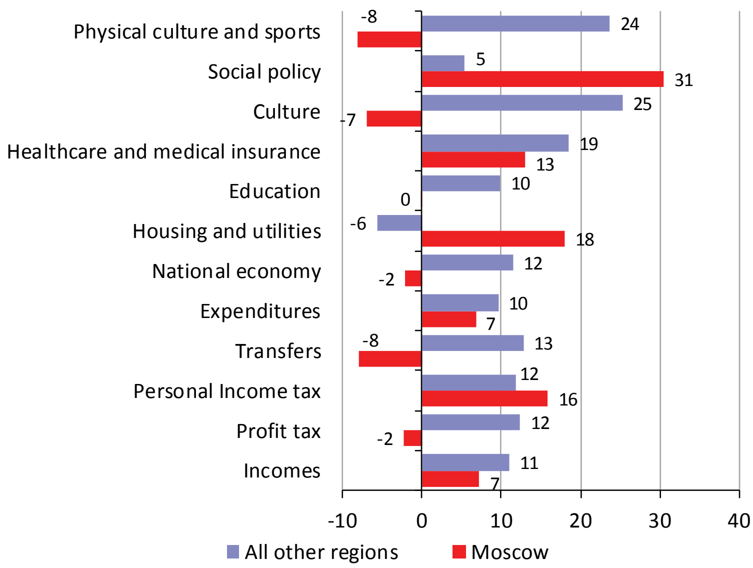

Fig. 1, Dynamics of revenues and expenditures of regional consolidated budgets in January–May 2018 in % to the same period of 2017
Source: calculations based on data released by the Federal Treasury.

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