Russia: Industrial recovery held back by OPEC+ commitments

The drop of Russian industrial output deepened in May, but that was largely due to OPEC+ mandated cuts in oil production. Manufacturing has largely bounced off the April lows, as the nation-wide lockdown restrictions were lifted in mid-May. The path to full recovery may still be challenged by the weakness in demand

-9.6%

Worse than expected

May industrial production, YoY

down from -6.6% YoY in April

May industrial output challenged by OPEC+, end of food and paper stockpiling, and calendar effect

The overall Russian industrial production saw a deepening in the drop from -6.6% YoY in April to -9.6% year-on-year in May, being on the pessimistic side of the consensus range and below our 7.0% expectations. Meanwhile, looking at the details, we do not take the overall result too negatively.

- **The May cut in oil production mandated by OPEC+ seems to be the main drag**: the extraction of oil and gas dropped 14.3% YoY in May (vs. -1.1% YoY in April). Overall, the commodity extraction sector (accounting for around 37% of the total industrial output) saw the drop intensify from -3.2% YoY in April to **-13.5% YoY in May. The latter assured around a 5.0 percentage point out of 9.6% YoY drop in the overall industrial output in May** (vs. -1.2 pp out of -6.6% YoY in April). The 4.1% YoY drop in oil refining (7% of industrial output) also seen in May knocked off another 0.3 pp out of overall industrial output volume. The recently negotiated one-month extension in the OPEC+ agreement suggests that this pressure factor is likely to remain in the coming months but may evaporate later along with the expected recovery in global oil demand.
- Another pressure factor in May was some softening in the production of food, beverages, and paper, which however had previously benefited from the panic stockpiling ahead of the Covid-19 lockdown. The May performance of those sectors (much like commodity extraction) is therefore not a huge surprise.
- **Manufacturing** (51% of total industrial production) is **showing signs of bouncing back from the trough**, as the drop narrowed from -10.0% YoY in April to -7.2% YoY in May. Moreover, we do not exclude that **net of the adverse calendar effect** (1 working day less vs. May 2019) **the overall result of the industrial output in May could have been 1 pp better**.
- Most of the manufacturing sectors, other than those mentioned above, are showing signs of recovery. As an example, car manufacturing recovered from -79.2% YoY in April to -45.6% YoY in May, with production of domestic appliances, as well as construction and investment-focused industries also showing recovery. Moreover, pharmaceuticals and other medical supplies are showing unsurprising acceleration of growth from 13.5% YoY in April to 22.4% YoY in May. Meanwhile, outside the medical subsegments, it remains unclear to what extent the recovery has been the result of the lifting in the nation-wide lockdown restrictions since mid-May.

We do not take May's 9.6% YoY drop of industrial production as too negative, as around 5.0 pp out of it was related to the cut in commodity extraction, while the manufacturing sectors, accounting for over half of overall industrial output actually bounced back from the April lows along with the easing in the nation-wide lockdown.

Meanwhile, this doesn't mean that the path to recovery will be fast and easy. First, the OPEC+ restrictions are here to stay for at least the next couple of months, while the revival of the manufacturing sector will be challenged by uncertainties with the local demand.

Industrial output is likely to show a 5-8% YoY decline in the coming months, and we do not exclude that the calls from the industries to further ease fiscal and monetary policy may intensify.

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