

Russia: Industrial recovery stalls on calendar effect and moderation of state support

Russian industrial output dropped 7.2% YoY in August, showing only a modest improvement compared to the previous month. Partially it is due to the adverse calendar effect, which will be less of an issue until the year-end, but it also shows the fragility of the recovery to the fiscal support that moderated in August, with unclear prospects going forward



Russian industrial production posted a 7.2% year-on-year drop in August, which is an improvement compared to the July result of -8.0%, but also a disappointment to the market consensus of -6.4% YoY. Meanwhile, the result is closer to our -7.5% YoY expectations, which assumed a moderate recovery on a monthly basis (which was confirmed by the 0.5% MoM SA result) but with annual dynamics constrained by the adverse calendar for the second month in a row (both July and August 2020 had fewer working days than July and August 2019).

- Looking at the sectoral breakdown, commodity extraction (37% of the total industrial

production) led the recovery (from -15.1% YoY in July to -11.8% YoY in August) thanks to the easing in the OPEC+ output restrictions and to the fact that this sector is less sensitive to the working days dynamics. The recovery in the output of crude oil and natural gas (from -15.3% YoY to -12.0% YoY) explains the entire 0.8 percentage point improvement of the overall industrial output dynamics in August vs July. That said, following the August easing, the OPEC+ restrictions are to remain unchanged in coming months.

- Manufacturing (51% of industrial production) saw a deterioration in the annual growth rate from -3.3% YoY in July to -4.1% YoY in August, however we attribute it largely to the calendar effect. Still, despite the adverse statistical effects several subsectors managed to show improvement in dynamics, including food, pharma, and non-machinery finished metal goods (pipes, we suspect). We see this improvement as demand-driven and continuing some of the trends seen [previously](#). Meanwhile, the lack of improvement in the rest of the sectors, while partially reflecting the aforementioned statistical effects, could also reflect moderation in the fiscal support to the industrial sectors. Budget spending, having peaked at 36-38% YoY in May-June, has decelerated to 26-28% YoY in July-August, with spending on National Economy (direct support to the industries) slowing down from 30% YoY in 7M20 to 3% YoY in August.

We continue to believe in a further recovery of industrial output, and mainly thanks to consumer-driven sectors our -4.5% forecast for 2020 is achievable. However the performance in the investment- and state-driven manufacturing remains subject to uncertainties in the fiscal policy.

- First, even though the 2020 spending target has been raised from RUB20.6tr to RUB23.7tr, around one-third of the increase reflects a backlog from the previous years, with no guarantee (or obligation) to fulfil it this year. In fact, given the budget capabilities and the modest official deficit target of 4% of GDP, we would be surprised to see 2020 fiscal spending north of 20-25% YoY, a rate that has already been achieved in 7M20.
- Second, the postponement of the goals related to the National Projects (mostly public spending in infrastructure) from 2024 to 2030 could be seen as a sign of a shift in spending priorities towards social support, which could restrain the mood in the state-driven sectors.

We continue to see the full update of the fiscal parameters for 2020-23 as an important watch factor.

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