Russia: Industry holds up in April

Russian industrial output dropped by a modest 6.6% YoY in April – not as severe as feared. Meanwhile, the likely drop in external demand, the inevitable drop in local household income, and possible redistribution of state spending may weigh on industrial recovery going forward

-6.6

April industrial output, % YoY

-0.6% YoY for 4M20

Better than expected

April drop of industrial output not as deep as expected

In April, Russian industrial production dropped by 6.6% year on year, which is better than both consensus (-10.5%) and our more optimistic expectations (-8.0%). Looking at the sectoral breakdown, there are several highlights from the data:

- Export-driven sectors so far have shown reselience with oil and gas production declining only by 1.1% YoY in April and metals extraction up 1.1% YoY. Other natural resources extraction showed sizable drops, although the share of those in overall commodity extractions are small for Russia. Manufacturing of oil products and other chemicals (admittedly, driven not only by external demand) was also up 0.7-2.4% YoY.

- Investment- and construction-driven manufacturing is holding up well, with bricks and concrete prodution down 3-4% YoY, agriculture machinery up 5-6% YoY, overall non-specific machinery output was down only 12% YoY.
- Several manufacturing sectors have benefited from the temporary surge in demand, with food production up 3.7% YoY (canned meat up 40% YoY), paper production up 4.2% YoY, and production of pharmaceuticals and other medical supplies up 13.5% YoY, with medical equipment output up nearly 100% YoY.
- Other consumer-driven sectors showed expectedly weak performances, with car manufacturing down almost 80% YoY, household appliances down around 75% YoY, production of clothes down 30-50% YoY, manufacturing of furniture and finishing materials down 30-60% YoY.

Recovery in 2H20 may be constrained by several risk factors

While we generally welcome the above-consensus performance of the industrial production and find it reasonable (the lockdown in place since the end of March should be hitting mostly services, rather than industries), we still see several risk factors that may constrain the eventual recovery in industrial output.

- Export-driven sectors may become challenged by Russia's OPEC+ commitments enforced starting in May, requiring a cut in oil supply to the global markets (by 23% in May-June), as well as a potential global drop in demand for key commodities. The pace of economic recovery in China and EU, Russia's main trading partners, will be the key watch factor.
- Consumer-driven sectors may face additional pressure along with exhaustion of the temporary surge in demand for some goods and the subsequent deterioration in the household income trend. The financial stress to the Russian SMEs, which employ around 25% of Russia's workforce, is likely to translate into a drop in household income (though not necessarily through much higher unemployment but rather through reduced working hours and variable portion of remuneration). The upcoming consumption and household income data for April, to be released next week, will provide the first glance at the scope of the problem.
- Investment-driven sectors, which have so far been driven by the state infrastructure spending (through the so called National Projects programme) may face uncertainty, as some portion of the public funds may eventually be redirected in favor of social spending. Even though the Russian fiscal response is becoming more active, the scope for a further increase in stimulus is still limited, and social support remains a priority.

As a result, for now we continue to expect a sizeable 4.5% YoY drop in industrial production this year, with only a modest 2.0% recovery in 2021. Our GDP forecast remains above-consensus at -2.5% YoY, on expectations of additional fiscal support and substitution of foreign travel with local consumption by the top earning households, however the risks to this view are skewed to the downside at the moment, especially in case of a slower-than-expected recovery in 2H20.

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