Russia: Industry still sluggish, signals weak investment trend

Russian industrial output dropped in June due to the sluggish performance in intermediary and investment sectors. With fiscal priorities shifting towards social spending, consumer demand-driven sectors are less of a concern in the near term

-9.4%

Worse than expected

June industrial production, % YoY

up from -9.6% YoY in May

Manufacturing sector underperforms despite favourable calendar effect and recovery in consumer-driven sectors

Russian industrial production dropped 9.4% year-on-year in June, showing little improvement vs. the 9.6% YoY drop in May. The June result is worse than the -7.2% consensus and is even further away from our more optimistic expectations of -6.0%.

- The negative result comes despite the favourable calendar effect. Even accounting for the extra day-off related to the constitutional vote (Wednesday, 1 July), the number of working days in June 2020 was still exceeded by that of June 2019 by 1 day, while the calendar effect for May was exactly the opposite. July and August will be facing adverse calendar effects of 1 lost working day each.
- The June 14.2% YoY drop in commodity extraction (after -13.5% YoY in May) contributed to the overall performance, however, it was not a surprise given Russia's OPEC+ commitments, which persist in the current form until August, when some relaxation seems to have been agreed upon recently.
- The primary reason for the worse-than-expected industrial performance in June was the very modest improvement in the manufacturing dynamic from -7.2% YoY in May to -6.4% YoY in June. Looking at subsectors, the main drag on the latter was caused by intermediary and investment sectors, including chemicals, semiconductors, construction materials, while consumer-focused segments, such as food, clothes, household appliances and electronics, car manufacturing posted a healthy recovery.
- The overall industrial result may seem to clash with the mounting fiscal support, as the federal budget deficit widened massively to RUB0.7 billion in June and RUB1.0 trillion in 1H20 on both a decline in revenues and acceleration of spending to 48% YoY in June and to 28% YoY in 1H20. However, looking at the structure of 1H20 spending, the picture becomes more consistent, with just 26% YoY growth of spending on the corporate economic activity vs. an 80% YoY increase of non-pension social payments (funding the unemployment benefits and childcare support), 109% YoY increase in healthcare expenses, and 64% YoY increase in transfers to regional budgets.

With the 5.2% YoY drop in industrial output in 1H20, our -4.5% expectations for the full-year are still achievable. The June industrial output data combined with the budget fulfillment eases some of our concerns regarding the near-term consumer trend, while putting construction and investment activity on the spot.

Longer-term fiscal policy may also feed into the potential divergence of consumption and investments: while the RUB4.0 trillion (3.5% of GDP) cash portion of the announced fiscal stimulus package for this year seems to be evenly split between support to corporates and households, the longer-term budget priorities seem to shifting towards the social sphere. First, the deadline for the fulfillment of the RUB26 trillion (around 3.5% GDP per year) National Projects programme (mainly state infrastructure investment) has been pushed back by 6 years to 2030. Second, following the current fiscal stimulus package, the share of spending on household income (through state sector salaries, pensions, and other social benefits) in the consolidated budget will increase from the already high 56% in 2019 to around 60%, which will be difficult to reverse. This means that following the eventual budget consolidation, the state investment spending is more likely to face reduction than other items. This may contribute to a fragile mood in the state-driven sectors in the medium term.

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