Russian industry: February slump confirms fragility of the recovery

In February, industrial production dropped 3.7% YoY, underperforming market expectations, but an even deeper drop was prevented by weather conditions and acceleration in budget spending. Industrial output is now less that 1% below the pre-Covid levels, suggesting limited room for a further catch-up recovery, unless budget policy is eased further

Russian industrial production dropped 3.7% year-on-year in February, which is a deterioration vs. the upwardly revised -1.9% YoY (from an initial -2.5% YoY) seen in January and a material underperformance vs. -2.0% YoY Reuters consensus. Meanwhile, the result is still better than our conservative forecast of -4.8% YoY, which was based on expectations of restrained economic activity and adverse calendar effect related to the 2020 leap year. We have the following takeaways:

- To remind, any first estimate of Russian industrial production needs to be taken with a pinch of salt, as it does not incorporate data from small & medium enterprises and is subject to material revision afterwards. This is illustrated by the cascade of revisions, including that of January 2021.

- Nevertheless, a statistical deterioration in February vs. January of at least 3-4 percentage points YoY was to be expected given the high base effect of the leap February 2020. This effect was to be partially offset by the higher electricity and heat output driven by the fact that in February 2021 the average temperature in Russia was 9 degrees Celsius lower than a year ago. Those assumptions seem to have been proven correct.
- Still, the actual result was better than we expected, which we attribute to continued acceleration in the budget spending, also due to higher industrial support. Overall, looking at the revised historical numbers, industry dependence on government spending seems to be high: the 2.1% YoY spike in industrial production in December 2020 was followed by a 1.9% YoY drop in January 2021 (in seasonally adjusted MoM terms, it represents +4.3% followed by -4.2%) seems correlated with the year-end spike in the budget spending and the closure of the financial year followed by the usual slow start of the year.
- Based on the initial estimates, the February industrial output was 0.8% below the level of March 2020 (the last month before the Covid-related plunge), which suggests that the scope for the 'easy' recovery is nearly exchausted. Nethertheless, the March 2021 number will statistically benefit from a favourable calendar effect of an additional working day, masking the potential weakness in the underlying trends.

In the longer run, we still expect some improvement in the industrial output thanks to the expected relaxtion of OPEC+ constraints. Recovery outside the commodity extraction sector is less certain and will depend on the current consumption trend (to be released this Friday) and on the **budget discussion**.

- We continue to expect that this year's official spending plan may receive a 0.5-1.0% GDP boost.
- Moreover, the recent media report suggests that Russia is considering additional infrastructure investments from the National Wealth Fund this year. The details and the likelihood of that scenario is so far unclear, but the threshold for the liquid FX savings of the NWF, after which they can be diversified into more risky assets, is 7.0% of GDP, and according to our expectations, the actual sum may reach 8.0-8.5% of GDP this year. This means that **the government could potentially invest up to 1.5% of GDP from the National Wealth Fund this year**, in addition to direct and transparent budget spending. A confirmation of such plan would improve the mood in the state-driven industrial sectors but may also reinforce the hawkish stance by the Bank of Russia.
- But the clarity on the subject is more likely to follow in April, during the process of amending the annual budget draft, i.e. after the upcoming key rate meeting this Friday.

Author

Dmitry Dolgin
Chief Economist, CIS
dmitry.dolgin@ing.de

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