

Russian state support is kicking in; look at industrial production

Russian industrial output was up 3.3% year on year in June, beating expectations. We attribute this to activation of the state-sponsored 'National Projects'. With state spending on the industries planned to accelerate from 1% YoY in 1H19 to c.30% YoY for the full-year, 2H19 industrial output could outperform the 2.6% YoY growth in 1H19



Source: iStock

3.3% Russia industrial production (YoY)
2.6% YoY for 1H19
Higher than expected

The recent data on the Russian industrial output growth showed acceleration from 0.9% YoY in May to 3.3% YoY in June, which is a positive surprise both to us (we expected 1.4%) and the market (consensus was in the range of 0.5-2.8%). The acceleration itself is not a surprise, because May

2019 data was heavily pressured by the calendar factor (2 fewer workdays than in May 2018), while June 2019 had only one workday less than June 2019. However, the calendar factor explains only 0.9 percentage points of the acceleration. The remaining 1.5 pp of acceleration is attributable to the genuine improvement in the growth rate.

The primary driver of the improvement in the industrial output growth was a better performance in the manufacturing sector (from -1.0% YoY in May to 3.4% YoY in June), and we attribute this to the higher activity in the state sector. According to the preliminary data by the Finance Ministry, the federal spending on the 'National Economy' item (representing the direct support to the industries) was up 18% YoY in June following a 4% YoY decline in 5M19. This acceleration follows the recent criticism by the Audit Chamber regarding the too slow progress on the 'National Projects' programme that entails large state infrastructure spending in 2019-2024. The full-year budget plan on the state spending on the industries assumes c.30% YoY growth for the full year, which means that much more support is yet to come.

Overall, the likely acceleration in the state infrastructure spending suggests that the 2.6% YoY industrial output growth in 1H19 could be outperformed in 2H19 - provided the output in the infrastructure-driven sectors offsets the stagnation or even deterioration in the other sectors. According to recent polls, the overall business community is becoming less optimistic about the growth prospects and cite uncertainties in the taxation and other regulatory environment as primary obstacles.

An important implication from the June industry data and the confidence polls is that the disappointing GDP growth rates in May 2019 (0.2% YoY) and 5M19 (0.7% YoY) have little to do with monetary policy, as suggested by some market participants and state officials. This does not mean that the Central Bank of Russia (CBR) should not cut the rate - we believe there is a room for a 50-75 basis point cut in the current 7.50% level in the next 6-12 months (including a 25 basis point cut on 26 July) - but it's important to understand that it will be just a reaction to the weaker-than-expected CPI. And the latter is not a symptom of weak demand, but rather a result of favourable external inputs, including lower pressure on the agricultural commodity prices and global rally-driven appreciation of RUB. According to our estimates, without the material slowdown in the global wheat price growth from 20% YoY in 2018 to flat prices now and the 10% year-to-date ruble appreciation to the US dollar, the current local CPI would have been around 1.6 pp higher than the actual 4.7% YoY. As the primary causes for the better-than-expected CPI trend are external and could be volatile, any attempt to address the weak GDP growth rate with monetary tools would be a challenge to the balanced macro policy framework and a risk to the market perception of the CBR's independence.

Author

Dmitry Dolgin

Chief Economist, CIS

dmitry.dolgin@ing.de

Disclaimer

This publication has been prepared by the Economic and Financial Analysis Division of ING Bank N.V. ("ING") solely for information purposes without regard to any particular user's investment objectives, financial situation, or means. *ING forms part of ING Group*

(being for this purpose ING Group N.V. and its subsidiary and affiliated companies). The information in the publication is not an investment recommendation and it is not investment, legal or tax advice or an offer or solicitation to purchase or sell any financial instrument. Reasonable care has been taken to ensure that this publication is not untrue or misleading when published, but ING does not represent that it is accurate or complete. ING does not accept any liability for any direct, indirect or consequential loss arising from any use of this publication. Unless otherwise stated, any views, forecasts, or estimates are solely those of the author(s), as of the date of the publication and are subject to change without notice.

The distribution of this publication may be restricted by law or regulation in different jurisdictions and persons into whose possession this publication comes should inform themselves about, and observe, such restrictions.

Copyright and database rights protection exists in this report and it may not be reproduced, distributed or published by any person for any purpose without the prior express consent of ING. All rights are reserved. ING Bank N.V. is authorised by the Dutch Central Bank and supervised by the European Central Bank (ECB), the Dutch Central Bank (DNB) and the Dutch Authority for the Financial Markets (AFM). ING Bank N.V. is incorporated in the Netherlands (Trade Register no. 33031431 Amsterdam). In the United Kingdom this information is approved and/or communicated by ING Bank N.V., London Branch. ING Bank N.V., London Branch is authorised by the Prudential Regulation Authority and is subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority. ING Bank N.V., London branch is registered in England (Registration number BR000341) at 8-10 Moorgate, London EC2 6DA. For US Investors: Any person wishing to discuss this report or effect transactions in any security discussed herein should contact ING Financial Markets LLC, which is a member of the NYSE, FINRA and SIPC and part of ING, and which has accepted responsibility for the distribution of this report in the United States under applicable requirements.

Additional information is available on request. For more information about ING Group, please visit www.ing.com.