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 activisation 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