

# Russia

## Pace of industrial decline eased in July

### Key findings

- Industrial output in Russia fell at weakest annual rate in seven months.
- Manufacturing PMI improved to ten-month high in July.
- GDP fell 10.9% yr/yr in Q2, but set to rebound in Q3.

### Slower fall in production

Data released by the Federal Statistics Service (FSS) on 17 August showed that Russian industrial output continued to fall sharply on an annual basis in July. Compared to July 2008, production declined 10.8%. However, this was the slowest fall since December 2008 and output of factories, utilities and raw material extraction rose 4.7% on one month previously. Manufacturing output was 4.9% higher than in June, which followed a largely seasonal rise of 9.9% in the previous month.

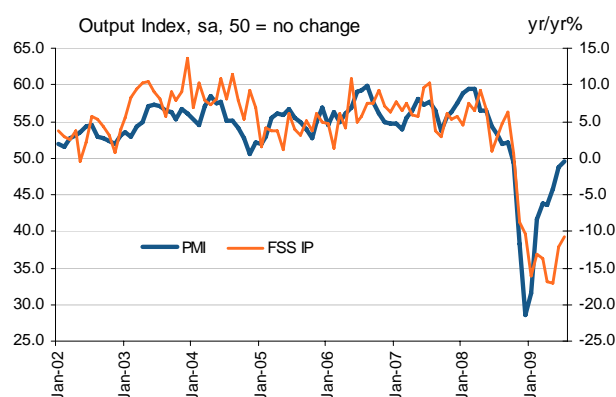
### PMI data continued to rebound

PMI data from VTB Capital covering Russian manufacturing business conditions provided an early signal that the prolonged downturn across the sector had slowed further moving into the second half of 2009. Despite having now spent twelve months below the neutral level of 50.0 – which indicates contraction – the headline seasonally adjusted Russian Manufacturing PMI® rose to 48.4. That was the highest reading since September 2008 and pointed to only a modest rate of decline.

The key finding from the latest survey results was an increase in the volume of new business received by Russian manufacturers. This brought to an end the survey-record nine-month sequence of contraction initiated last October when global financial markets crashed. Moreover, the ratio of the new orders and stocks of finished goods indices was at its highest

since April 2008. This indicates an imminent end to de-stocking as firms rebuild warehouse inventories, boosting output in the coming months.

Chart 1: Manufacturing PMI vs official data



Manufacturing PMI output data for Russia have a good track record against the seven-year official industrial production series, exhibiting a correlation of 0.79 with the annual rate of change. This improves to 0.82 if PMI data are advanced by one month.

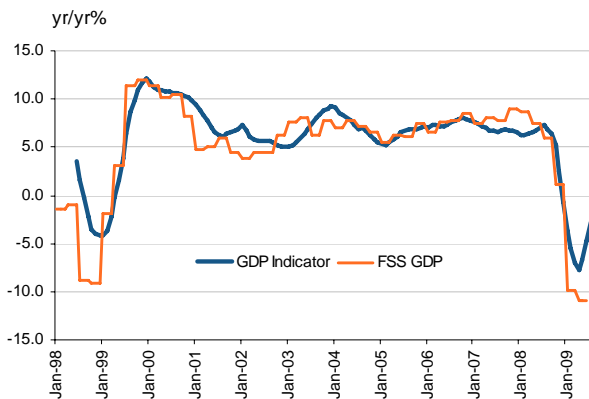
### Record drop in GDP in Q2

The encouraging official numbers for Russia's industrial sector followed poor results for the overall economy in the second quarter. The FSS reported on 11 August that gross domestic product (GDP) had shrunk by a record 10.9% year-on-year in the three months to June, despite a rise of 7.5% since the first quarter. The annual drop was slightly worse than expected by both market analysts and the Economy Ministry.

A monthly GDP series derived from PMI data for the Russian manufacturing and services sectors understated the extent of the severe contraction in official Russian GDP since the second half of last year, as shown in Chart 2. Regression analysis applied to the best fit of a composite PMI output index against official GDP signalled an annual contraction of 6.4% over the second quarter. While that mirrored the official

series in that it was a record low, it underestimated the rate of decline. This is partly due to the limited sector coverage of the PMIs, which do not cover the construction industry in particular. The PMI surveys also focus on current business conditions in manufacturing and services, and so may not fully capture the crucial impact of oil prices on the Russian economy, or of capital investment and inventory depletion. Additionally, the PMI surveys use an up/down/same methodology, which will inevitably find it hard to accurately track trends in sectors that experience massive changes in activity.

**Chart 2: GDP Indicator vs official data**



**Downturn has passed worst phase**

As the chart shows, the GDP Indicator also understated the late-90s recession in Russia, but accurately tracked the subsequent rapid recovery. A key advantage of the PMIs lies in their performance in identifying turning points in the economy, a trait strengthened by high signal to noise ratios. The GDP Indicator has improved for the past three months, backing the wider view that the Russian economy has passed the worst phase of the current downturn and will see a slower decline in Q3. This is underlined by rising oil prices, with Mediterranean Urals Crude trading at \$64.50 in July, 63% higher than their four-year low last December. Additionally, a recent biannual outlook survey by Markit for KPMG showed that over half of Russian manufacturers expect business activity to rise over the next twelve months, while only 6% foresee a reduction.

**Forthcoming release dates (August data):**

- Russian Manufacturing PMI: 1 September 2009
- Russian Services PMI: 3 September 2009
- Russian GDP Indicator: 4 September 2009

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