

# Russia

## Industrial contraction gathered pace in October, following PMI's decline

### Key findings

- **PMI slipped back into negative territory.**
- **Official series showed faster year-on-year output drop in October.**
- **GDP fell 8.9% yr/yr in Q3.**

### Manufacturing PMI below 50.0 in October

The latest VTB Capital PMI, compiled by Markit, signalled that overall Russian manufacturing business conditions deteriorated in October. Although output, new orders and purchases of inputs all continued to grow, the rates of expansion slowed compared to one month previously. Moreover, manufacturers shed jobs at a faster pace than in September.

The headline seasonally adjusted Russian Manufacturing PMI fell from 52.0 in September to 49.6 in October, signalling an overall deterioration in the business climate at the start of the fourth quarter. It was the first month-on-month fall in the headline index since it plummeted to a record low (33.8) in December 2008, although the latest figure was indicative of only a marginal rate of decline.

### Industrial decline quickened in October

Data released by the Federal Statistics Service (FSS) meanwhile showed that Russian industrial output rose 0.8% on a monthly basis in October. That was a worse outcome than the 5.1% gain registered in September. Moreover, the annual rate of decline sharpened to 11.2%, from 9.5% in September. But the ratio of the new orders to stocks of finished goods indices for the manufacturing sector shows that gains in industrial production look likely in the coming months.

Manufacturing PMI output data for Russia have a good track record against the seven-year official industrial production series, exhibiting a correlation of 0.74 with the annual rate of change. This improves to 0.80 if PMI data act with a lead of one month.

Chart 1: Manufacturing PMI vs official data

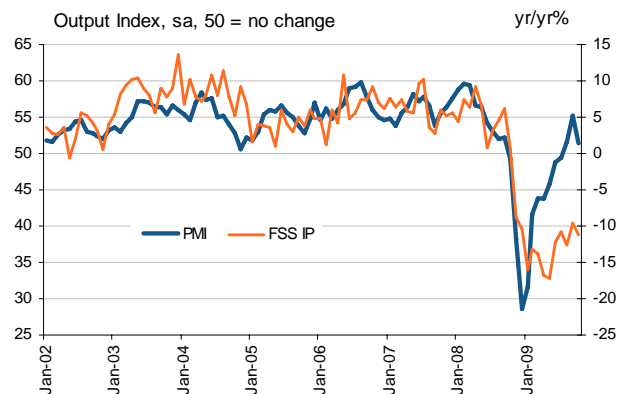
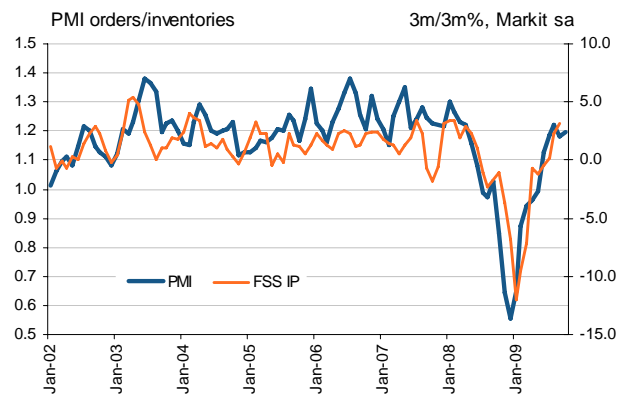


Chart 2: Manufacturing PMI vs official data

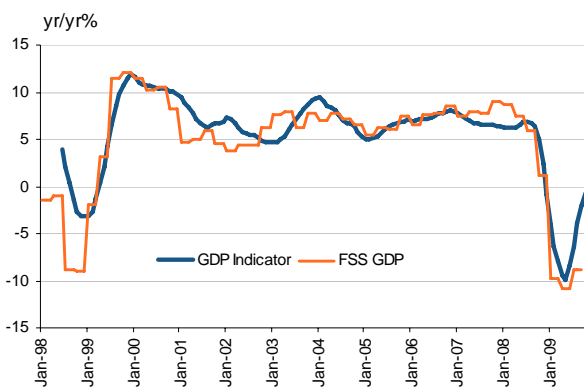


The latest FSS quarterly GDP data recorded an annual rate of decline of 8.9% in Q3, following a record contraction of 10.9% in Q2. In October, the International Monetary Fund (IMF) reported that it expected the Russian economy to shrink by 7.5% over 2009 as a whole, the worst performance among the G8 economies. The current official government forecast is a decline of 8.5%.

The PMI-based GDP Indicator understated the extent of the downturn in the first three quarters of 2009, averaging a revised -6.2% in Q1, -9.2% in Q2 and -4.1% in Q3. This is partly due to the limited coverage of the PMIs, which do not cover the construction and retail sectors in particular. A detailed sector breakdown

of official Q3 GDP was not available in the preliminary release but, only including those sectors covered by the PMI surveys, GDP fell by 10.1% yr/yr in Q2, closer to the GDP Indicator figure of 9.2%. As the PMI surveys focus on current business conditions in manufacturing and services, it is possible that they may not fully capture the impact of oil prices on the Russian economy.

**Chart 3: GDP Indicator vs official data**

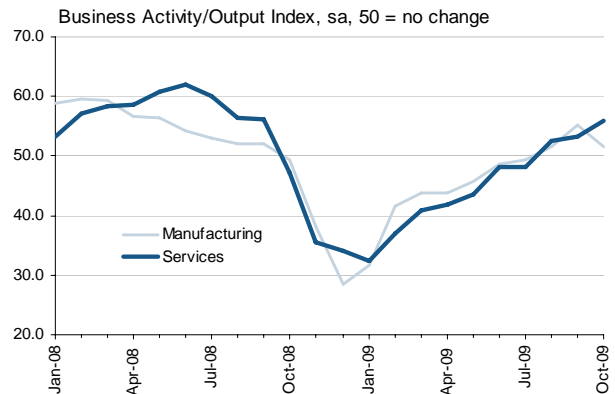


**Downturn passed worst phase, but recovery set to be slow**

A key advantage of the PMIs lies in their performance in identifying turning points in the economy, a trait strengthened by their high signal to noise ratios. The GDP Indicator has improved for the past five months, and in October posted its highest level since slipping below neutrality back in December 2008. Underpinning the positive momentum was the services sector, which posted a third monthly increase in business activity in

October, and the fastest rate of growth since September 2008.

**Chart 4: Services vs manufacturing**



However, other official series are less positive than the services survey, suggesting that the overall economic recovery will be slow. Car sales continued to fall on a monthly basis in September and, in the same period, retail sales were down 9.9% and capital investment 18.6% lower on an annual basis. The release of November data will provide a clearer picture of whether October's manufacturing slump was a blip, and if momentum has continued to grow in services.

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

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

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