Eco Analysis

Russia: Industrial production in sharp decline

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This Friday will be remembered in Russia for the first ever meteor blast near a large city – Chelyabinsk. News agencies reported minor structural damage to many buildings and hundreds of people injured from shattered window glass. Our deepest sympathies are extended to Chelyabinsk citizens.

Headline IP in sharp decline...

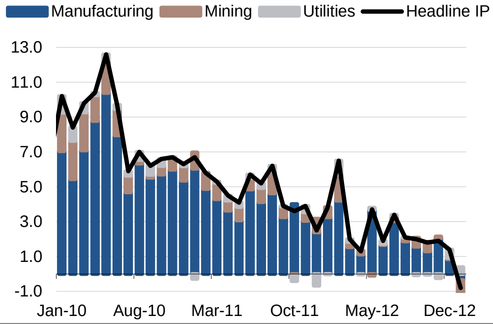
In a surprisingly disappointing development, Russian IP contracted in January for the first time since the 2009 recession. While the usual January statistical noise obscures the true momentum, the underlying trend looks to be stagnant at best, which is clearly not encouraging. Policy-wise, slumping IP should add to the growing arguments in favour of monetary accommodation and we believe the CBR board meeting in April, following the first sign that headline CPI has peaked, might mark the beginning of the easing cycle in Russia.

Rosstat reported that Russian IP dropped -0.8% yoy in January (following 1.4% yoy in December), marking the first contraction since autumn 2009 when the economy was starting to recover from the deepest recession this millennium. The slump in yoy growth rate is even more surprising given the favourable calendar effect (additional working day compared to January 2012). Adjusted for seasonality and calendar effects, the sequential trend also looks fairly poor, with headline IP posting a huge 1.5% mom drop from the December level. The weakness looks to have been widespread across all sectors: mining (-1.0% mom sa), manufacturing (-1.8%) and utilities (-1.7%).

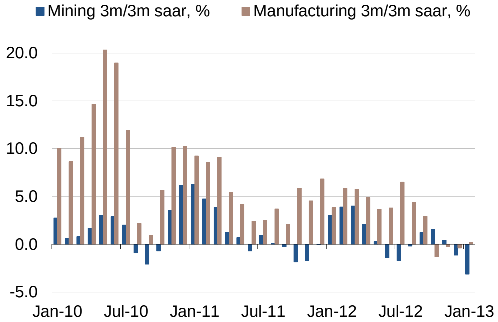
... but underlying trend is hard to discern

The above said, we would tend to caution against reading too much into the headline IP number as historically, January IP readings tend to be particularly choppy (no surprise given the prolonged New Year and Christmas holidays). Besides, looking deeper into the details we find the slump in oil extraction and refining was the major drag which is somewhat surprising (oil output tends to be flattish) and very likely a one-off. Otherwise, fertiliser, steel and pipes output also weighed on the industrial sector. At the same time, car manufacturing and building materials output has actually accelerated, pointing to stable (admittedly lacklustre, but not collapsing) growth in domestic demand.

January marked first post-crisis IP decline



Sequential trend is also not encouraging



Source: Rosstat, SG Cross Asset Research/ Economics

Stabilisation in headline CPI should open the door for easing

On the balance, the trend in IP is clearly not encouraging, but perhaps not as dire as the January headline number suggests. Policy-wise, the weak IP print should add to the pressure on the CBR to ease the monetary stance. Hence, we are firm in our view that easing will come in the coming months and the CBR board meeting in April looks to be the most likely timing, as the first downtick in headline inflation in the March CPI report should ease the regulator's fears of deteriorating inflation expectations. That said, we still believe that outright cuts to headline policy rates are a more distant prospect as the CBR is well advised to improve the transmission mechanism at first (reform the refinancing system), which by itself should bring about substantial monetary easing.

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