

BUSINESS PERFORMANCE

THE 2005 SURVEYS OF INDUSTRIAL ENTERPRISES: RESULTS AND FORECASTS

S.P. Aukutsionek, N. V. Zhukova

Results of 2005

Results of monthly surveys of managers of industrial enterprises conducted by "The Russian Economic Barometer" (REB) show that for the majority of surveyed enterprises, 2005 was generally better than the previous year in terms of many indicators.

Monthly increase in OUTPUT was observed at 45% of the enterprises on the average. This is 2 percentage point higher than a year ago, and a recurrence of the 2003 score. Let us remind that this indicator was at its top levels in 1999 (49%) and in 2000 (47%).

ORDER-BOOKS in 2005 were replenished every month at 48% of the enterprises, which coincides with the value of this indicator a year ago. The total relative volume of order-books also has not changed from the previous year - 82% of its normal monthly level (which is taken by the respondents as 100%). This is the "thickest" size of order-books in the whole period of our observation, which was started in 1993.

ACCUMULATION OF INVENTORIES of finished goods in 2005 went on every month at 46% of the enterprises. This is only 1 percentage point less than in 2004 and a reiteration of the results of 2002-2003. The relative volume of inventories has increased by 1 percentage point from 2004 to reach 90% (of their normal level). This is the highest level of inventories in the period after Russia's sovereign default (1998-2005).

CAPACITY UTILIZATION RATE increased by 2 percentage points on the year to reach 76%. By standards of a normal market-oriented economy, this rate of capacity utilization is still rather typical of a recession. However, in our case it is record high in the last fourteen years.

LABOR UTILIZATION RATE - 89% - was also record high in 2005. This is 1 percentage point higher than in 2004.

As for EMPLOYMENT, the majority of industrial enterprises were reducing their personnel, as they had been doing last year, and only 41% of them were increasing it each month. This share is lower than it had been in 2004, but higher than in 2002-2003 (37%).

Indicators of INVESTMENT ACTIVITY continue to improve. While in 2001-2002, 45% of the enterprises on the average reported monthly that they had not bought any equipment for two and more months in a row, in 2003, their share was 42%; in 2004, 41%, and in 2005, 40%. This was the best score over the entire period of our measurement of this indicator (since 1993). Increased purchases of equipment were observed monthly at 30% of the enterprises on the average, which is the same share as in 2003-2004 and is also the record high level in the last thirteen years.

Last year, the general VOLUME OF PRODUCTIVE CAPACITIES has increased at 34%, declined at 31 %, and remained unchanged at 35% of industrial enterprises. Generally speaking, this result is not at all inferior to that of 2004, which let us remind, was the best score in the last thirteen years. For the second year in a row, the balance indicator stays in positive territory: the share of enterprises with increasing capacities was 3 percentage points higher than that of the enterprises with declining capacities (in 2004, the excess had been 8 percentage points). This is a sign that the volume of fixed capital stock in the Russian industry is growing.

As in the past, changes in PRICE STRUCTURE were unfavorable for most producers. However, the situation has got rather better since last year: the share of enterprises with more favorable changes in price structure has increased from 35% to 38%. This is a fairly good result, considering that higher values of this indicator were observed only twice: in 1997 (40%) and in 2001 (39%).

CONDITIONS OF BANK BORROWINGS have improved at 49% of the enterprises. This is only 1% below the level that was recorded in 2003-2004. Let us remind that contrary to most other REB indicators, in

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this case the most favorable (for the economy) result will correspond rather to the middle of the scale (exactly to 50%) than to its ends (either 0% or 100%). If this index goes too low, this means that the majority of enterprises are losing external financing. If it goes too high, this can be considered a symptom (of a forerunner) of accelerated price inflation.

Reduction in the scale of NON-BORROWING SECTOR in the Russian industry has continued. In 2001, about 40% of the surveyed enterprises did not use bank credits; in 2002, their share was 37%; in 2003, 34%; in 2004, 32%, and in 2005, 30%. This is the best score since 1995 (when 28% of all enterprises regularly went on with no borrowing at all).

As for the enterprises that continued to borrow, the volume of their DEBT TO BANKS was, on the average, 84% of the level considered normal by our respondents. This is 2 percentage points lower than in 2004, and almost a reiteration of the result obtained in 1999. In general, stabilization of the relative volume of liabilities to banks at about 80-90% of its normal level is being observed during the last 8-10 years (the earlier data are non-existent).

Among LIMITS TO PRODUCTION, «shortage of demand» took the first place, gaining 61% of the voices of our respondents. This is 1 percentage point higher than in 2004, and represents a new record level of toughness of demand constraints.

As a year ago, «shortage of financial resources» remained in the second place. In 2005, 45% of all respondents on the average pointed at this limitation. This was a 2 percentage points decline from the level of the previous year. Such soft financial constraints were observed only in 1992 (when 45% of all respondents also referred to this point of the questionnaire).

The third place, as before, belonged to «shortage of raw materials and semi-finished products», which was reported by 14% of the REB respondents. This is the lowest value of this indicator in the entire period of market-oriented reforms. The assessment of rigidity of supply constraints of material inputs has declined by 5 points at once since 2004.

The share of BARTERED industrial output in total sales has not changed on the year and was 6%. This is practically the same level of barter as the one that was observed in 1992 when its value stayed in the range of 4-8%, and it is probably the natural (background) level of barter in the contemporary Russian industry. The share of SELLING FOR CASH (ready money) in the enterprises' sales declined by 3 percentage points from 2004 and reached 20% of the sales value. It was lower only in 1997-1998 (16%). It was never measured before that time.

The share of enterprises, which assessed their FINANCIAL CONDITION as «good» or «normal», has increased by 6 percentage points. In 2005, it was 69%. This is the absolute record for the entire period since 1992. As for forecasts of financial condition, in 2005 its improvement was anticipated every month by 58% of the respondents on the average - two percentage points more than in 2004, and as many as in 2003. This is the top level of "financial optimism" in all years of our measurement since 1993.

In 2005, the SHARE OF LOSS-MAKING ENTERPRISES has declined from 27% to 25%. There was also a decline from 15% in 2004 to 11% in 2005 in the share of enterprises whose top managers believed they were really facing BANKRUPTCY in the next one or two years. This is the lowest value of this indicator since 1992.

As for DEMAND FOR PRODUCTS ANTICIPATED WITHIN TWELVE MONTHS, in December 2005 we have got the following assessments (estimates made in the previous year are given in brackets). Production capacities were considered redundant by 40% (39%) of the respondents; normal by 48% (50%); and deficient by 12% (11%). Similar assessments of labor force were the following: it was considered redundant at 13% (19%) of the enterprises, normal at 62% (62%), and insufficient at 25% (19%).

Generally speaking, the results of monthly surveys of managers of industrial enterprises conducted by the REB demonstrate that situation at the majority of Russian industrial enterprises is getting apparently better, and that economic growth has accelerated in 2005.

EXPECTATIONS FOR 2006

As usual, in the beginning of the year, managers of the enterprises responding to the REB survey gave their forecasts for 2006.

In their opinion, the average rate of increase in prices for production of the sampled enterprises since December 2005 till December 2006 will be 10%. This is 3 percentage points higher than the estimate that was obtained in the survey of the previous year (see Table 1).

Although the expected rate of inflation in absolute terms has become higher, the structure of price expectations has remarkably improved from last year. While vast majority of the enterprises (77%) still predict that prices for their products will go up, their share, however, has become 9 percentage points lower than it was in the previous year survey. And on the contrary, the share of those that expect that prices for their products will be stable has risen from 11% to 20%.

Table 1
Distribution of Enterprises by Expected Direction of Price Changes in the Next Twelve Months and Average Rate of Price Increase in the Sample (%)

| | Survey time ¹⁾ | | | | | | | |
|--|---------------------------|------|------|------|------|------|------|------|
| | 1999 | 2000 | 2001 | 2002 | 2003 | 2004 | 2005 | 2006 |
| Decline | 7 | 6 | 1 | 8 | 2 | 1 | 3 | 2 |
| Stability | 12 | 5 | 13 | 15 | 9 | 11 | 11 | 20 |
| Increase | 81 | 89 | 86 | 77 | 89 | 88 | 86 | 77 |
| Average expected rate of annual price increase | +31 | +24 | +21 | +10 | +13 | +10 | +7 | +10 |

¹⁾ January of each year.

As expected by the respondents, general volume of industrial production in Russia by December 2006 will increase by about 5% from the level of December 2005. This is 2 percentage points higher than the estimates made by our respondents a year ago (see Table 2).

The highest increases are expected in building materials (+11%), in chemicals (+10%), in metals (+10%) and in food industry (+6%). Decline in production is expected only in the machinery sector (-3%).

Table 2
Changes in Output within Twelve Months as Expected
by Managers of Industrial Enterprises in the REB Sample
(December of the current year to December of the previous year, %)

| | Survey time ²⁾ | | | | | | | | | Difference (10)-(9H8) |
|--|---------------------------|------|------|------|------|------|------|------|------|--------------------------|
| | 1998 | 1999 | 2000 | 2001 | 2002 | 2003 | 2004 | 2005 | 2006 | |
| | (1) | (2) | (3) | (4) | (5) | (6) | (7) | (8) | (9) | |
| Industry, total | 94 | 91 | 108 | 105 | 105 | 102 | 103 | 103 | 105 | +2 |
| 1. Building materials | 87 | 94 | 100 | 103 | 109 | 105 | 103 | 106 | 111 | +5 |
| 2-3. Chemicals | 96 | 113 | 100 | 101 | 109 | 111 | 105 | 106 | 110 | +4 |
| 2-3. Metals | 99 | 103 | 111 | 107 | 104 | 103 | 100 | 113 | 110 | -3 |
| 4. Food | 114 | 90 | 104 | 94 | 99 | 97 | 93 | 98 | 106 | +8 |
| 5. Other industries ¹⁾ | 87 | 95 | 114 | 102 | - | 96 | 95 | 104 | 103 | -1 |
| 6. Light industry | 86 | 99 | 112 | 115 | 117 | 98 | 96 | 95 | 101 | +6 |
| 7. Logging, woodworking, pulp and paper | 100 | 92 | 109 | 101 | 100 | 96 | 107 | 99 | 100 | +1 |
| 8. Machinery | 96 | 88 | 115 | 110 | 111 | 103 | 108 | 104 | 97 | -7 |

¹⁾ Excluding fuel and electric power.

²⁾ January of the relevant year.

In general, we can state that the degree of optimism has become higher since the previous survey. Improvement in predictive estimates (in comparison with similar estimates made a year ago) was recorded in five industries, while deterioration was expected only in three. Growth is anticipated in six industries at a time, but decline is predicted only in one (although a highly important one). The spread of expectations by industry has become much narrower: 14 percentage points against 18 points last year.

Finally, turning to the level of individual enterprises, we can point at a significant rise in the share of producers that are expecting their output to increase: now it is 70%. This is 14 points higher than in the survey of the previous year, and a record high level in the recent 11 years. At the same time, the share of enterprises that are expecting their output to decline has reduced by 10 points. In this case as well, this is the record (low) value of this indicator - only 8% (see Table 3).

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Table 3
Distribution of Enterprises by Direction of Expected Changes in Output after Twelve Months (%)

| | 1996 | 1997 | 1998 | 1999 | 2000 | 2001 | 2002 | 2003 | 2004 | 2005 | 2006 |
|-----------|------|------|------|------|------|------|------|------|------|------|------|
| Decline | 42 | 40 | 29 | 27 | 16 | 16 | 15 | 21 | 12 | 18 | 8 |
| Stability | 26 | 31 | 30 | 25 | 16 | 20 | 19 | 20 | 26 | 26 | 22 |
| Increase | 32 | 29 | 41 | 48 | 68 | 64 | 66 | 59 | 62 | 56 | 70 |
| Balance | -10 | -11 | +12 | +21 | +52 | +48 | +51 | +38 | +50 | +38 | +62 |

The structure of responses to the latest survey has no close analogues in the time interval between 1996 and 2005. So far, we never observed such a great numerical superiority of the "increase group" over the "decrease group" (62 percentage points). Even in the beginning of the period of economic growth, in 2000, the corresponding indicator was 10 points lower.

Generally speaking, we can state that 2005 has been better than the preceding year in terms of many parameters. Moreover, **assessments of growth in 2006 are the most optimistic ones in the whole period of economic reforms.**