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Import Substitution Failing On All Fronts, Except Food — Moody's

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President Vladimir Putin

The Russian government's drive to substitute imports of foreign goods in all key sectors of the economy is failing, with the exception of food production, according to a report published by the Moody's rating agency on Tuesday, news agency RBC reported.

The U.S.-based agency's quarterly Global Macro Outlook report found that the food industry is Russia's only economic sector benefiting from the government's import substitution campaign, while the machinery and equipment manufacturing sectors are declining rapidly.

Import substitution was launched by the Russian government last year in response to economic sanctions imposed on Moscow by Ukraine and a number of Western nations in response to the annexation of Crimea and support for pro-Russian rebels in eastern Ukraine.

In the last Moody's Global Macro Outlook report, published three months ago, the agency's analysts characterized Russia's import substitution efforts as “a push for growth,” pointing out that low oil prices, a weak ruble and geopolitical uncertainty would drive down demand, RBC reported.

But just three months on, Moody's analysts said there are no obvious signs that import substitution is actually stimulating domestic production.

Although Russia has been experiencing an economic recession since 2013, the trend was aggravated by Western sanctions last year, as well as Russia's key export — oil. Falling oil prices sent the ruble into free-fall, causing it to lose over 40 percent of its value against the U.S. dollar last year.

According to Moody's, in the second quarter of 2015, Russia's economic recession worsened, and “households continue to bear the burden of the crisis,” RBC quoted the report as saying. This has translated into a 9.3 percent drop in retail sales year-on-year.

Russia's gross domestic product dropped by 4.6 percent in the second quarter of 2015 compared to the same period last year, according to data published by state statistics agency Rosstat.

Moody's forecasted that Russia's GDP would shrink by 3 percent this year, and in 2016 the Russian economy will be stagnant with no growth, according to RBC.

In terms of industrial output, Rosstat data shows that in the first half of this year output dropped by 2.8 percent compared to the same period in 2014. Russia's industrial output by the end of 2015 will not likely exceed levels seen when Russia entered its economic crisis, Moody's predicted.

Alexander Isayev, an economist specializing in Russia and the CIS and VTB Capital, told The Moscow Times that it is too early to draw conclusions on the success of Russia's import substitution drive.

“In many sectors, such as engineering, the investment cycle is longer, so we can't see the results yet,” he said.

Isayev also pointed out that while the government provides incentives to conduct import substitution, producers themselves are expected to finance the development of new production lines themselves or with private investment. Access to loans has been made difficult by high interest rates, Isayev said.

However, Isayev said a general improvement in domestic production is inevitable, and that results will be visible by the end of this year.

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