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16 • 17.4.2014

Russia

Economy ministry lowers its GDP forecast. The economy ministry's forecast for Russian growth this year was yet again revised down on the anticipation that e.g. capital outflow would rise and growth in demand for Russian natural gas would flatten to zero for EU countries and demand would contract in the case of Ukraine.

Deputy economy minister Andrei Klepach says the ministry now expects GDP growth this year to reach 1.1 % at best. The forecast assumes federal budget spending will increase more than planned up to now. The ministry wants an increase in budget spending this year of 350–700 billion rubles, or €7–14 billion (0.5–1 % of GDP). Part of the extra spending will go to Crimean development. The ministry foresees net capital outflow from Russia will reach $100 billion this year. Private capital net exports for all of last year amounted to $60 billion.

GDP growth will stay at 0.5 % without increased budget spending. In this case, fixed capital investment will decline and consumption growth will slow strongly. Finance minister Anton Siluanov this week said the current GDP growth estimate for 2014 was still 0.5 %, but growth could also fall to around zero.

The economy ministry also mentioned a darker, but less likely, development path that sees a GDP contraction fuelled e.g. by higher capital exports ($150 billion).

The ministry's previous forecast, released in December, projected GDP growth of 2.5 % this year.

The IMF World Economic Outlook published last week also cut the IMF's earlier growth estimate for Russia this year from 2 % to 1.3 %. The World Bank estimated last month that Russian GDP would grow just over 1 % this year, cautioning that GDP could contract nearly 2 % if the effects of the Crimean situation were worse than assumed.

Lower imports increase Russian current account surplus. The Central Bank of Russia's preliminary balance-of-payments first-quarter figures show the current account surplus was slightly larger than in 1Q2013. The current account surplus for the past four quarters, however, was still well below 2 % of GDP. The goods trade surplus rose slightly and for the past four quarters amounted to nearly 9 % of GDP. On the other hand, deficits in the services trade balance and other current-account components deepened a bit, to 7 % of GDP.

Earnings from Russian exports of goods and services fell in the first quarter a couple of per cent y-o-y. Export earnings have been falling for over a year now. Export earnings on services continued to increase. Export earnings from goods exports contracted overall, as well as with respect to exports of crude oil, petroleum products, natural gas, and other goods. The export volume of crude oil fell strongly early this year, and petroleum products took a dip. Export prices for oil, petroleum products and gas were also slightly lower than a year ago.

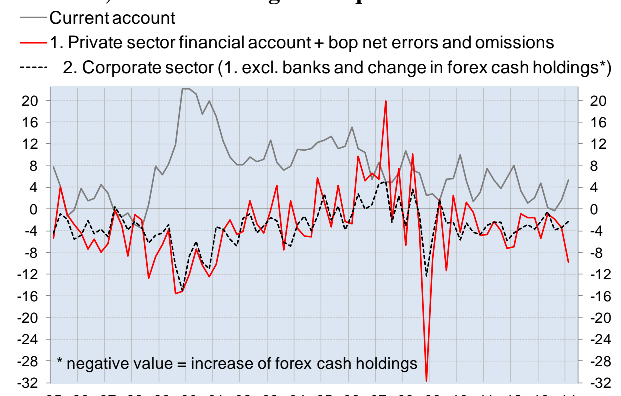
The value of goods and services imported to Russia in the first quarter was down considerably from 1Q2013. The value of goods imports contracted by nearly 10 %. Spending on services imports was still slightly larger than a year earlier. This was due almost entirely to Russian travellers spending abroad, even if annual growth in spending during foreign travel slowed to less than 10 %.

Considerable capital outflows from Russia continue; sharp increase in cash foreign currency holdings. Preliminary balance-of-payments figures from the CBR show a continuing net outflow of capital from Russia's private sector and sharp growth in the amount of foreign currency cash held by the economy's non-bank sector, basically households. These two flows combined rose to over $50 billion in the first quarter. Of this, nearly $20 billion came from hoarding cash in foreign currencies. Russians bought foreign currency cash both with money withdrawn from banks and rubles held as cash. Foreign currency cash holdings have not shown such a spike since the final months of 2008 when the financial crisis struck. During the last four quarters, the above-mentioned two capital flows combined equalled 4 % of GDP, the highest since autumn 2012.

The net flow of private capital abroad in the first quarter was about the same as in 1Q2012 and 1Q2013 (about $30 billion). Banks increased their net capital exports substantially (to almost $20 billion) to balance their forex positions as domestic forex deposits with banks increased sharply.

Capital flows between Russia's corporate sector (excl. banks) and the outside world remained relatively small. Direct investment flows from abroad to the corporate sector stayed at just over 2 % of GDP while DI outflows from Russia's corporate sector were a bit larger. Despite a small uptick, corporate borrowing from abroad remained rather mild. The comparisons exclude the massive DI and foreign borrowing impacts from the TNK-BP ownership deal a year ago. The CBR estimates grey capital exports declined.

Current account surplus and private sector net capital inflows to Russia, % of the average four-quarter GDP



Source: Central Bank of Russia

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China

First-quarter figures show clear signs of economic slowdown. The National Bureau of Statistics reports that real GDP grew 7.4 % y-o-y in the first quarter of this year. As expected the data suggest China's economy is now definitely slowing. On-year growth was still 7.7 % in the fourth quarter of 2013. The slowdown is even more evident in the quarterly growth figures. First-quarter growth of 1.4 % q-o-q translates to on-year growth below 6 %.

12-month GDP growth in China, %

Source: China National Bureau of Statistics

Most economic indicators point to a slowdown. Although China has yet to release quarterly figures for demand-side GDP components, the foreign trade data show flagging export demand in the first quarter. Further, the pace of growth in fixed capital investment decelerated; real investment growth (excluding rural households) declined to 16 % y-o-y, down three percentage points from 1Q2013.

Lower growth in China is also an indication of structural adjustment in the economy. Services contribute an increasing share of output, while the pace of industrial growth consistently lags growth in retail sales. Household demand is sustained by steady income gains; real disposable incomes per capita were up nearly 9 % y-o-y in the first quarter. On the other hand, increased indebtedness and financial market problems have dampened investment growth.

The slowdown in growth in China has been long anticipated and largely reflects a shift to a more sustainable growth model. The facts that growth still looks quite robust by international standards, incomes continue to rise and the situation concerning employment and inflation (2.4 % in March) remains stable do not imply that China should change its basic macro policy stance. Rather the situation should be welcomed by decision-makers as it provides them with a window of opportunity to deal with problems brewing in the financial markets and move ahead on scheduled reforms.

China eases cross-border share trading as deregulation of capital movements continues. The official agencies regulating securities trading in China and Hong Kong, the CSRC and SFC, last week announced a joint programme to facilitate mutual stock market access on the Hong Kong and Shanghai stock exchanges. Under the proposed "through train" scheme, shares of Chinese companies listed in Shanghai could be bought or sold via the Hong Kong exchange. The scheme would give foreign investors direct access to Chinese capital markets. Similarly, investors in mainland China could buy and sell shares listed on the Hong Kong exchange via the Shanghai exchange. This would make it easier for Chinese investors to put their money outside mainland China. Officials hope to launch the scheme before the end of this year. A similar cross-border arrangement, initially proposed in 2007, was shelved at that time in light of turmoil in global financial markets.

The cross-border share trading will be restricted under a quota system, a familiar first-step approach of Chinese officials in implementing reforms. Quotas prevent large swings in the markets and allow officials to implement reforms incrementally. The quotas limit the flow of funds from Hong Kong to Shanghai exchange to 300 billion yuan (€36 billion), or about 10 % of the market capitalisation of the Shanghai stock exchange. The total daily value of trades cannot exceed 13 billion yuan (€1.2 billion), or 10–15 % of the Shanghai exchange's daily trading volume. Chinese investment in Hong Kong will be limited to 250 billion yuan (€30 billion) overall, and 10 billion yuan daily. Investments from Shanghai to Hong Kong will only be allowed for institutional investors and wealthy individuals.

Cross-border securities trading must currently take place within official schemes that use quotas and limit participation of approved investors. The Qualified Foreign Institutional Investor (QFII) programme applies to investment in mainland China with foreign currencies and the Renminbi Qualified Foreign Institutional Investor (RQFII) programme for yuan based investment. The Qualified Domestic Institutional Investor (QDII) programme allows Chinese investors to invest abroad. The "through train" scheme appears to allow investments outside of these programmes.

The reforms bolster Hong Kong's status as an international hub for yuan trading as shares listed in yuan can be purchased directly from local brokers. Hong Kong has historically played an important role in Chinese pilot programmes. For example, the Hong Kong exchange was the first to be approved as a QDII destination.

At the moment, there can be disparities in prices of shares of companies listed on both the Hong Kong (H-shares) and Shanghai (A-shares) exchanges. The current differences are due largely to capital controls and should narrow with freer capital movements.

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