BOFIT Weekly

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Russia

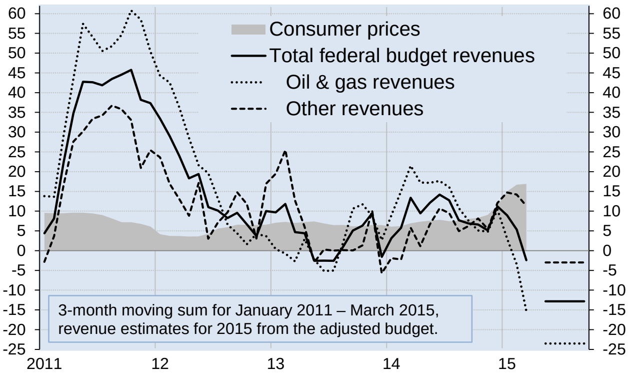
Russian Duma approves adjustments to federal and social fund budgets for 2015. The Duma made no change to the government's proposed federal budget in aggregate, even if the modifications had caused heated debates within the cabinet as they were hammered out. Spending will be cut 2 % from the earlier-approved 2015 budget. Spending rises 10 % in ruble terms from 2014, if the rather massive budget infusion in December to fund the deposit insurance agency's recapitalisation of banks is not included. With the infusion, budget spending rises less than 3 % this year. Given that consumer price inflation should hover at more than 15 % this year, spending will plummet in real terms.

The need to cut spending reflects a precipitous deterioration in the government's revenue outlook. Under the Duma-approved bill, federal budget revenues in rubles decline 13 % this year. The figure entails revenues from oil and gas taxes will fall by nearly a quarter and that other revenue streams will decrease by a couple of per cent. In such case, the budget deficit will be around 3.7 % of GDP. The price of Urals crude is assumed to average $50 a barrel this year, while GDP would contract 3 %. In January-March, revenues to the federal budget fell over 2 % y-o-y.

The Duma only made minor adjustments to the federal spending structure. Defence spending rises this year about 25 %, while spending on national security and law enforcement remains virtually unchanged. Budget transfers to regions were reduced and will decline by over 10 %.

Notably, transfers to the Pension Fund were increased and will rise by 25 % this year. The hike is to make up for a slight reduction in estimated revenue from a slower rise in wages than earlier projected. The estimate of Pension Fund out-go was also raised. Further pension hikes have been needed as inflation last year came in higher than assumed when earlier pension increases were set. Pension Fund spending will rise about 25 % this year and spending from all social funds even faster. The combined deficit of social funds amounts to about 1 % of GDP.

Federal budget revenues, % change y-o-y



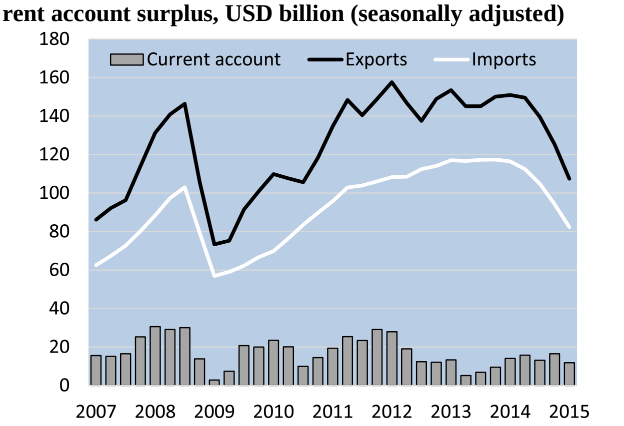
Sources: Finance ministry, Rosstat

Falling imports kept Russia's current account in surplus. Preliminary balance-of-payments figures show that Russia's current account surplus contracted slightly on-year in January-March, but was still substantial at nearly $24 billion. The combined current account surplus of latest four quarters corresponded to more than 3 % of GDP.

Depressed by lower oil prices, the value of goods exports shrank 30 % y-o-y. The average price of Urals-grade crude was in 1Q15 only about half of what it was a year ago. The value of other goods exports also fell 13 %. The value of goods imports was down 36 % in dollar terms and 23 % in euro terms. The contraction in imports has slightly moderated after January, however, with the recovery of the ruble. The ruble's effective (trade-weighted) exchange rate in the first quarter was down about a third from a year earlier in nominal terms and about a quarter in real terms.

The services trade balance was still in the red, even if the value of services imports in dollars fell by 24 % y-o-y in the first quarter. Import of travel services fell slightly faster than other services.

Exports and imports of Russian goods and services and current account surplus, USD billion (seasonally adjusted)



Sources: CBR, BOFIT

Capital outflow from Russia continued strong due to foreign debt payments. The net capital outflow of private sector in the first quarter was $33 billion, down from $48 billion a year earlier. Banks paid down considerably more old debt than took new, but also actively repatriated assets from abroad. Non-bank firms appear to have been able to extend their foreign loans as their net payments of foreign debt were much more modest. More forex cash was sold than bought in Russia for the first time in over a year.

As of end-March, Russia's total foreign debt was $560 billion. The value of debt has declined substantially since the peak at over $730 billion in mid-2014. Part of the reduction in the value of the debt reflects the ruble's depreciation (about a quarter of Russian foreign debt is denominated in rubles). In 1Q15 the effect of exchange rate changes has, however, been more modest. The public sector accounts for less than 10 % of foreign debt.

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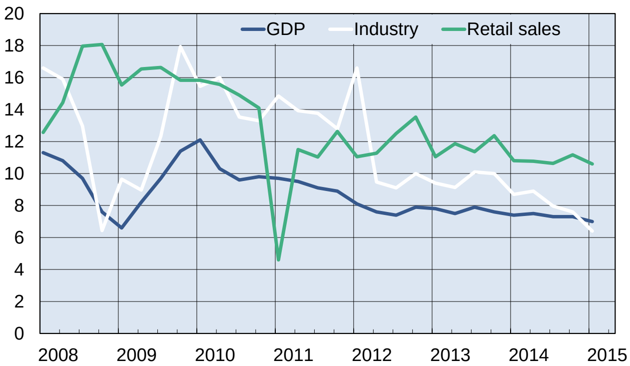
China

Chinese economic growth slows as expected in the first three months of the year. China's National Bureau of Statistics reports that the country's on-year GDP growth slowed to 7.0 % in the first quarter of this year, down from 7.3 % in the fourth quarter of 2014. Seasonally adjusted quarterly growth slowed to 1.3 % q-o-q, which corresponds to an on-year rate of 5.3 %.

Nearly every key economic indicator registered the expected lower growth. On-year industrial output growth slowed in January-March to 6.4 %, and last month came in well below 6 %. China witnessed a particularly large slowdown in its mining industry. Growth in electricity production, which is often used as a proxy indicator of total economic output, was close to zero for the first quarter.

Output growth in China, %



Source: Macrobond

In the service sector, output continued to grow by nearly 8 % in the first quarter, almost matching overall growth for 2014. Within the service sector, retail sales climbed 11 % for the first quarter as a whole, although March growth was closer to 10 %. The evolution of China's production structure has accelerated over the past few years as services have increased their share of GDP. Services now account for about 49 % of annual economic output, surpassing industrial output at 42 % and primary production (mainly agriculture) at 9 %.

Structural change can also be seen on the demand side. Growth in fixed asset investment (FAI) slowed sharply in the first quarter, as e.g. the number of new construction projects (measured in terms of floorspace) fell in the first quarter by about 20 % y-o-y. The evaporation of investment growth has been offset by robust growth in private consumption. Disposable household income increased in the first quarter about 8 % in real terms. Moreover, the employment situation has yet to show any significant weakness, despite the general economic slowdown. The NBS reports service sector growth has helped keep the unemployment rate at around 5 %.

On-year Chinese consumer inflation in March was unchanged from February's figure of 1.4 %. Producer prices, which have been declining for quite some time, were down 4.6 % in March.

Chinese export growth slowed in first quarter; value of imports plummeted. Exports in the first quarter grew 5 % y-o-y, down from 9 % in the fourth quarter of 2014. Exports to the US rose 11 % y-o-y, while exports to the EU were up 6 %. Exports to Japan slid a further 12 %.

Imports in the first quarter shrank 18 % y-o-y. Underlying the contraction in imports was in part the slide in global prices for oil and other commodities. Trends in import volumes, however, were varied. For example, volumes of crude oil imports were up 8 % from a year ago, while copper imports were down 18 %.

March's exceptionally large 15 % drop in exports mainly reflects the late arrival this year of the Chinese Lunar New Year holidays.

IMF forecasts uneven development for the global economy. In its latest World Economic Outlook (WEO) released this week, the IMF sees economic growth strengthening in advanced economies this year, while growth in emerging economies will slow for the fifth year in a row.

China's stimulus policies have exerted a large influence on growth in other emerging economies since the international global financial crisis. The IMF says China should now focus on dealing with the fallout from its stimulus policies, including dealing with debt and other problems, as well as move ahead with reforms. As China's growth continues to slow, it will depress commodity prices and slow the growth of commodity producers.

The IMF revised significantly downward from last October its growth projection for Russia. Factors for the increased pessimism include the collapse of global oil prices, the Ukraine crisis, on-going sanctions and the country's structural weaknesses – all of which have eroded confidence in the Russian economy.

IMF forecasts of GDP growth, %, f = forecast

	2014	2015(f)	2016(f)
World	3.4	3.5	3.8
Advanced economies	1.8	2.4	2.4
United States	2.4	3.1	3.1
Eurozone	0.9	1.5	1.6
Emerging economies	4.6	4.3	4.7
China	7.4	6.8	6.3
India	7.2	7.5	7.5
Russia	0.6	-3.8	-1.1
Brazil	0.1	-1.0	1.0

Source: IMF World Economic Outlook, April 2015

Bank of Finland • Institute for Economies in Transition, BOFIT
P.O. Box 160, FI-00101 Helsinki
Phone: +358 10 831 2268 • Web: www.suomenpankki.fi/bofit_en

Editor-in-Chief Seija Lainela • Email: Seija.Lainela@bof.fi