Weekly Review
15 • 15.4.2016
BOFIT

Russia

IMF lowers its forecast for Russian GDP. The IMF's newest *World Economic Outlook* projects a nearly one-percentage point deeper contraction in Russian GDP in 2016 than in its January forecast. The IMF still expects the Russian economy to return to low growth next year.

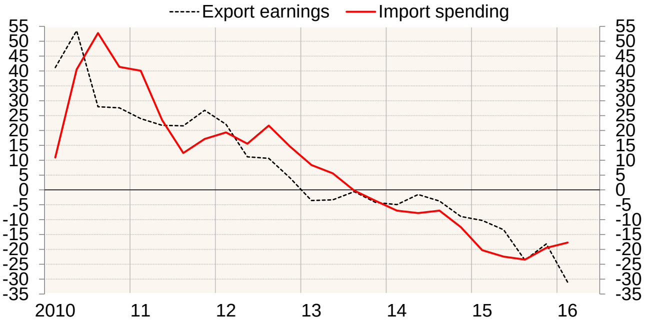
The World Bank came out with a similar projection last week, but sees a slightly stronger recovery path than the IMF forecast. Most forecast risks, however, are on the downside. The combined effects of US and EU sanctions, as well as Russian countersanctions are weakening the economy's development. The World Bank's forecast sees Russian economic growth accelerating in 2017 to 2 % if general uncertainty abated and sanctions were lifted.

Forecasts of Russian GDP growth, % change

	2016	2017
Bank of Russia (3/16)	-1.5 – -1.3	-0.5 – 0.5
IMF (4/16)	-1.8	0.8
World Bank (4/16)	-1.9	1.1
BOFIT (3/16)	-3	0
Consensus (3/16)	-1.5	1.1

Russian export earnings and import spending continue to fall. Preliminary balance-of-payments figures from the Central Bank of Russia show export earnings from goods and services fell by a third in the first quarter from 1Q15 (and they were not very much larger than at the bottom of 1Q09). The on-year drops in earnings on exports of crude oil, oil products and natural gas exceeded 40 %. Earnings on other goods exports slumped more than 20 %. In both energy and non-energy categories, export earnings were depressed mainly by low commodity prices. Service export earnings also contracted further (down nearly 20 % y-o-y).

Russian export earnings and import spending (EUR), % change y-o-y



Source: CBR.

First-quarter spending on imported goods and services was down nearly 20 % y-o-y, scoring the same amount as in 1Q10. Spending on goods imports was no longer down more than about 15 % y-o-y, while spending on services imports was off almost 30 % due to a pullback in spending of Russian travellers abroad (down well over 40 %).

Due to the huge drop in export earnings, the goods trade surplus was the smallest it has been since the 2009 slump. That, in turn, reduced the current account surplus to an unusually low level (less than $12 billion) despite smaller deficits in services trade and other current account items.

Capital flows between Russia and the rest of the world remain small. Especially in light of seasonal variations, the net flow of private capital abroad was very small in the first quarter. Like last year, banks continued to pay down foreign debt (even if there was less to pay than last year) while repatriating their assets from abroad in the same amount.

In the corporate sector, the net capital outflow dwindled to a trickle as there was little to pay back on outstanding loans. The outflow of direct investments still contracted slightly and was quite modest. Continuing the earlier trend, FDI inflows to Russia were even smaller. The outflow of grey capital from Russia was still marginal. Following the trend of recent years, there was a slight decrease in the stock of foreign currency cash held outside banks.

Accounts Chamber of Russia criticizes special economic zones. An investigation by the Accounts Chamber of Russia (ACR) finds that special economic zones (SEZs) have given only little support to the economy. The administration in the SEZs has often been inflexible and irresponsible, and budget monies to SEZs have been used inefficiently or misapplied. Over the past decade, 520 billion rubles (€7 billion at the current exchange rate) of budget funds have been dispensed for SEZs and construction of related infrastructure. The ACR further found that SEZs have created only about 18,000 new jobs.

The first Russian SEZs based on the current model were launched in 2006. They were supposed to attract investment through reduced tariffs and tax breaks, less red tape and ready infrastructure. There are now 33 SEZs specialised in industrial activity, technology manufacture and development, port operations or tourism.

The ACR also noted a boom in SEZ-like regional development policy instruments, like technology parks and innovation clusters. The ACR said the current approach is overbroad and the most ineffective measures should be ended.

Last year saw the creation of "territories of accelerated development" (TORs) aimed at boosting development mainly in Russia's Far East. TORs are now also touted as a solution to Russia's "company town" problem, where everybody suffers if the local business falters. The car-making city Tolyatti, for example, is establishing a TOR that its city elders hope will generate 24,000 jobs over the next decade. According to the ACR report, Tolyatti's existing SEZ that was established in 2010, has created fewer than 300 jobs.

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 Jouko Rautava• Email: Jouko.Rautava@bof.fi

Weekly Review
15 • 15.4.2016

BOFIT

China

International financial institutions expect Chinese growth to slow only slightly. The IMF's April *World Economic Outlook* projects 3.2 % baseline growth of the global economy this year and 3.5 % in 2017. The IMF raised China's GDP growth forecast slightly, and thanks to stimulus policies, now expects growth to be 6.5 % this year. The forecast matches the lower boundary of the growth target range set by the Chinese government for this year. As China makes progress in structural rebalancing, the IMF expects growth to slow to 6 % in 2018, a level at which growth should remain at least through the end of this decade. The IMF pointed out, however, that China's structural reforms may prove to be more difficult than anticipated, which could hurt economic growth. A more-severe-than-forecast slowdown in China would also hurt growth of the world economy.

The March forecast of the Asian Development Bank (ADB) predicts a growth trend for China in 2016–2017 that essentially matches the IMF's forecast. The World Bank (WB), in contrast, expects the Chinese economy to grow at a pace of 6.5 % a year through 2018.

Forecasters at the IMF, WB and ADB all expect India to maintain robust economic growth. India, partly due to its very low average income level, is set to enjoy the highest growth among the world's large economies. Despite slower-than-hoped progress in economic reforms, India benefits e.g. from declines in energy prices.

GDP growth forecasts for China and India, %

	2015	2016	2017
China			
IMF (4/16)	6.9	6.5	6.2
WB (4/16)	6.9	6.7	6.5
ADB (3/16)	6.9	6.5	6.3
India*			
IMF (4/16)	7.3	7.5	7.5
WB (4/16)	7.3	7.5	7.7
ADB (3/16)	7.3	7.4	7.8

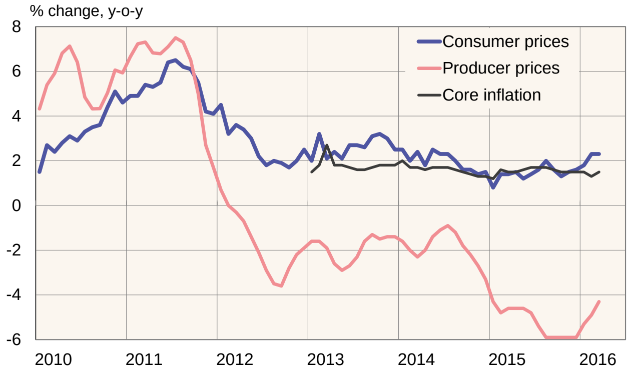
** 2015 figures for India are estimates.*
Sources: IMF, WB and ADB forecasts.

China's foreign trade stumbles in first quarter. The value of China's goods exports fell 10 % y-o-y to $464 billion in the first three months of this year. Exports to all of China's main markets declined. Exports to the US were down 10 %, 5 % to the EU and 3 % to Japan. The value of goods imports slid 13 % y-o-y in the first quarter to $339 billion. The drop was largely due to lower prices. Import volumes of many commodities were actually up in the first quarter.

While the March value of exported goods rose 12 % y-o-y in US dollars, most of the increase in exports reflects the relatively low comparison figure for March 2015. The drop in goods imports slowed as imports in dollars last month fell 8 % y-o-y. Dollar appreciation hurt trade figures. In March, the central bank's reference yuan-dollar rate was 6 % weaker than in March 2015.

Is Chinese producer price deflation finally abating? March consumer price inflation was unchanged from February at 2.3 % y-o-y. Core inflation (excluding food and energy prices) accelerated slightly to 1.5 %. A visible shift, however, seems to be occurring in the producer price trend. Producer prices were down nearly 6 % y-o-y at the end of last year, but down only 4.3 % in March. Moreover, while the on-year price change was still negative, producer prices in March rose from February. It was the first time an on-month rise had been seen since September 2013. If the new trend becomes established, it may dissipate many policy concerns related to the deflationary trend even at the global level.

Chinese price trends



Source: Macrobond

As China and Russia boost military spending, so do their neighbours. New data compiled by the Stockholm International Peace Research Institute (SIPRI) show that military spending of governments increased 1 % last year, corresponding to about 2.3 % of world GDP. Measured in dollar terms, the United States accounted for 36 % of total military spending, China 13 %, Saudi Arabia 5 % and Russia 4 %. The weak ruble was the main reason Saudi Arabia overtook Russia in the rankings.

Military spending declined last year from 2014 in most parts of the world, but China, Russia and Saudi Arabia posted increases of 6–8 % y-o-y in constant dollars. The growth in military spending was even higher in countries in Central Europe and the Baltic region that share borders with Russia or Ukraine. The rise of tensions in the South China Sea was also reflected in sharp spikes in military spending in the Philippines, Indonesia and Vietnam.

Russia's military spending climbed last year to 5.4 % of GDP, driven up by Russia's economic recession and the intense military modernisation. Rapid economic growth in China has helped hold the relative share of increased military spending to a level of around 2 % of GDP. The ratio of military spending to GDP in the United States fell to 3.3 % last year.

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 Jouko Rautava• Email: Jouko.Rautava@bof.fi