Weekly Review
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BOFIT

Russia

Forecasts see smaller slide for Russian economy than earlier. Both the IMF World Economic Outlook update released this month and the July consensus forecast of various major forecasters see Russian GDP contracting around 1 % this year. Forecasts published in late spring and early summer were somewhat cooler, although the Central Bank of Russia already at that time projected the GDP would only drop about a half a per cent, and the economy ministry drew up an even milder outlook. Several forecasts expect the volume of Russian imports to contract 4–7 % this year.

A major factor behind the improved outlooks is an almost across-the-board upward revision of the oil price assumption. Forecasts now put the average price of oil this year in the range of $40 to $45 a barrel, with the price climbing to $45–50 in 2017. Notably, Russia's economy ministry and the central bank are offering a slightly more cautious assumption of $40 a barrel.

In addition, economy ministry estimates show Russian GDP this year fell only 0.9 % y-o-y in January-June, which was less than previous forecasts. Economic contraction was smaller on brisk growth in oil output, but it seems the GDP slide was mitigated especially by a milder fall of inventories, after inventories had declined strongly for a couple of years. This picture emerges from the first quarter GDP data and the wholesale sector that recovered through last spring.

Forecasts for Russian GDP growth in 2016 and 2017, %

	2016	2017
Russian economy ministry (5/16)	-0.2	0.8
Central Bank of Russia (6/16)	-0.7 – -0.3	1.1 – 1.4
IMF (7/16)	-1.2	1.0
World Bank (6/16)	-1.2	1.4
OECD (5/16)	-1.7	0.5
EU Commission (5/16)	-1.9	0.5
EBRD (5/16)	-1.2	1.0
Consensus forecast (7/16)	-0.8	1.2

Russia prepares for serious budget tightening. The government earlier this month gave its initial approval to the 2017–19 federal budget framework. Finance minister Anton Siluanov said the budget revenue forecast was based on a fairly cautious assumption of $40 a barrel for Urals-grade crude oil and 2017 revenues would drop slightly even in nominal terms.

The federal budget deficit next year would be limited to slightly over 3 % of GDP (about the same as estimated for this year). Thereafter, following instructions by president Vladimir Putin, the target is the deficit would shrink by one percentage point of GDP annually.

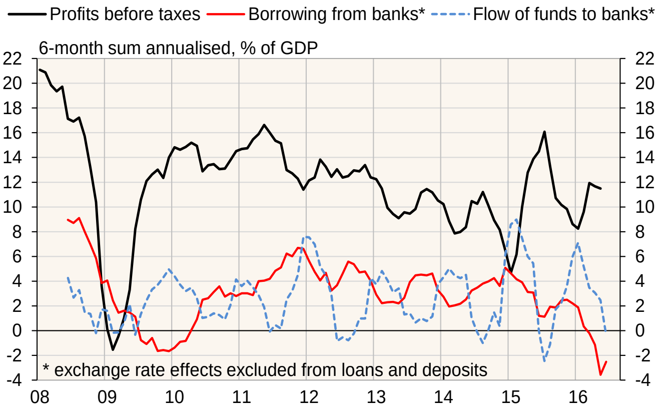
Siluanov noted that the starting point for federal budget spending is this year's targeted nominal sum, after cuts from the budget approved last winter, which would remain the same in coming years. This would mean a further downward slide of government spending in real terms, even if spending has already declined by roughly 10 % over the past year and a half. Siluanov added that the government is set to safeguarding entitlements related to pensions and other social benefits, as well as public sector wages. He expects cutting budget spending in other categories will be an exceptionally challenging task.

Increase in profits of Russian firms supports capital flows abroad and to banks. Despite a recessionary economy, profits of Russian companies were up again in January-May relative e.g. to companies' business turnover and GDP. Profit data is based on Rosstat figures that aggregate firm-level numbers determined according to Russian bookkeeping standards. By that measure, profits have risen to levels not seen since 2012–13. The surge in profit this year reflects another slide in the ruble's exchange rate. The ruble fell rather continuously from summer 2015 to early 2016, which fuelled profits of export firms, in particular. The largest sums of profits were seen in almost all of the same branches as in early 2015, i.e. oil production, metal refining, chemical production and wholesale activities. Food industry profits were also up. Not surprisingly, these fields are also among the most profitable in Russia.

Higher corporate profits have yet to induce a recovery in domestic investment. Even if far less than in previous years, flows of outbound corporate sector assets have remained quite notable this year and last. Outbound flows have consisted mainly of direct investment and granted credit.

Otherwise, companies have shifted a couple of times the focus of their assets allocation to financial activities during this recession. In the first half of 2015, firms concentrated on paying down foreign debt. In the second half of 2015, the focus was on restoring their funds at banks. The theme of the first half of 2016 was reducing indebtedness to domestic banks. Reminiscent of the behaviour of households last year, companies became net lenders to banks.

Corporate profits and flows of their bank assets and credit



Sources: Rosstat, Central Bank of Russia and BOFIT.

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China

Forecasters largely agree on trends in China's economy. The latest forecasts of major international institutions and commercial banks see the Chinese economy growing about 6.5 % this year, a level of growth well in line with the government's official GDP growth target. The lion's share of forecasters see growth slowing to around 6–6.5 % next year. Most forecasts this year have seen little adjustment. In fact, the current figures almost exactly match those of January.

Although it is expected that China's growth to remain strong in the near-term, all forecast bodies emphasise that uncertainty has been increasing. Growth this year has been supported with the usual means such as increasing government spending on infrastructure projects. Government led growth funded with borrowed money, however, only aggravates economic imbalances, which might unwind in a manner that causes disruption to the economy and leads to a sharp slowdown in growth. Forecasters also are in near-universal agreement on China's long-term growth outlook. They expect economic growth to slow as China's labour force begins to shrink, economic structures evolve and productivity gain become harder to come by as the country approaches the technology frontier. BOFIT releases its next forecast for China in September.

Select GDP growth forecasts for China, 2016–2017, %

	2016	2017	Released
BOFIT	6	6	3/2016
BBVA	6.4	5.8	7/2016
OECD	6.5	6.2	6/2016
Asian Development Bank	6.5	6.3	7/2016
IMF	6.6	6.2	7/2016
Deutsche Bank	6.6	6.5	7/2016
JP Morgan	6.7	6.4	7/2016
World Bank	6.7	6.5	6/2016

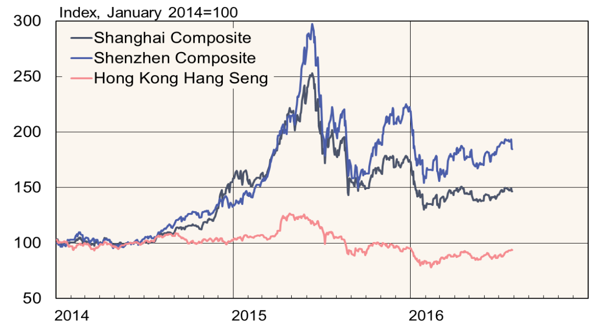
Market-economy status and steel on the table at the EU-China summit. Beijing hosted the 18th EU-China summit in mid-July. Top-level discussions touched on e.g. Brexit impacts and tensions in the South China Sea, but the hottest topic was perhaps if the EU would finally get around to granting China market-economy status. The decision is expected later this year. China claims that during its WTO membership talks, the parties agreed that market-economy status would be conferred automatically when China completed its 15th year of WTO membership in December 2016. On the EU side, however, a common view has not yet formed, whether to grant the status or not. The view is mixed both between the EU countries and between the EU institutions. The granting of such status would be a political recognition, but in practice the granting of market-economy status to China would make it more difficult to impose anti-dumping sanctions on Chinese exports to Europe.

After the meeting, European Commission president Jean-Claude Juncker linked the discussion of granting market-economy status to China's domestic steel overcapacity problems. The EU and China decided to create a joint working group on steel to allow frank discussion on overcapacity problems as well as monitor Chinese measures to resolve its steel issues. China accounts for about half of global steel production. At a time when its economic structures are changing, domestic steel demand is expected to fall and many fear that the country will try to dump even more steel onto the global market. The EU has already imposed anti-dumping tariffs on Chinese steel, claiming that China has been selling steel at prices below production cost in Europe. A week after the meeting, China decided to impose anti-dumping tariffs on certain types of steel imported from the EU, Japan and South Korea.

Slight bump in Chinese share prices. Even with the fall on Wednesday, stock indexes in Shanghai and Shenzhen are few percent up over the two months, but are still considerably lower than at the start of the year. Media reports suggest that new large institutional investors are coming to the Chinese stock market, as China's pension funds are finally starting their investment in shares, decided last year. Pension funds hold assets of about 2 trillion yuan (€270 billion), but only a fraction of that will be invested in local equity markets. The investment will be made over several years via the national social security fund. A goal of reinvesting pension assets is to improve the return on fund investments. China's undeveloped stock markets have been volatile in recent years, seesawing far more than the economic development would suggest. One possible explanation is the lack of large institutional investors to anchor the markets. The entry of pension funds into the market might slightly calm share price volatility.

Predicting profit of listed Chinese firms has proven a nontrivial task. A recent Bloomberg assessment found that per-share earnings of Chinese listed companies have been running about a third less that market analysts had forecast. Many of China's largest listed firms are involved in heavy industry. While China seeks to transform its economy to a more consumer-oriented, service-driven economy, firms in industrial branches suffering from overcapacity have seen their profitability weaken much more than analysts expected.

Main stock index performance in China and Hong Kong



Sources: Macrobond and BOFIT.