Weekly Review
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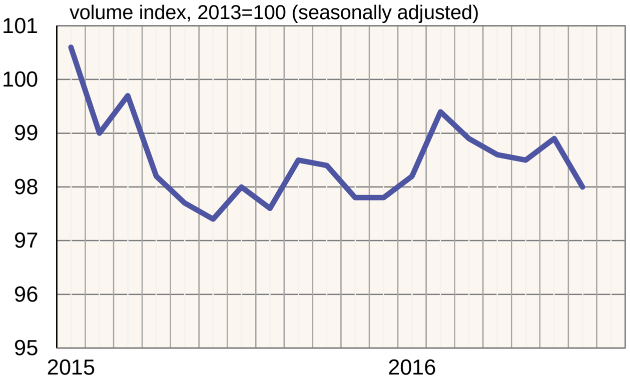
BOFIT

Russia

Russian consumption and output declined in July. The volume of retail sales (seasonally adjusted) contracted further last month and was 5 % smaller than in July 2015. The decline from a year ago was slightly smaller than in the second quarter of this year. Household real disposable income also continued to fall, to a level 7 % below July 2015, even if real wages were up slightly. Fixed investment, for which only quarterly reporting is published after last year, declined roughly 4 % y-o-y in the second quarter. The drop was nearly 5 % in the first quarter.

Seasonally adjusted industrial output declined by almost 1 % from June to July. Most of the drop was due to a reversal in manufacturing output, which was down 1.5 % y-o-y. Output of extractive industries, in contrast, showed slightly higher on-year growth (1.8 %) compared to previous months. Most of the increase came from crude oil production, which was up 1.7 % y-o-y in July (1.3 % in 2Q2016).

Russian industrial output 2015−2016



Source: Rosstat

WTO panel confirms Russian import duty violations. A WTO panel last week agreed with the EU's claim, filed at the end of 2014, that Russia has levied excessive import duties on certain goods. The panel confirmed that Russian import duties on certain paper and paper board products, palm oil and refrigerators exceeded WTO "bound" rates. The panel rejected the EU's claim of systematic application of higher duties targeting numerous products due to insufficient evidence. The panel's ruling becomes binding if neither party files an appeal within 60 days. At that point, Russia would have to bring its import duties into compliance with WTO rules as soon as possible. Failure to comply with the ruling could lead to compensation or retaliation measures. Russia has, however, brought its customs practices into compliance for some of the products concerned already in the course of the panel proceedings.

Other EU complaints about Russia still pending with the WTO include automobile recycling fees and bans on imported pork. The EU also recently introduced anti-dumping duties on some Russian and Chinese steel products.

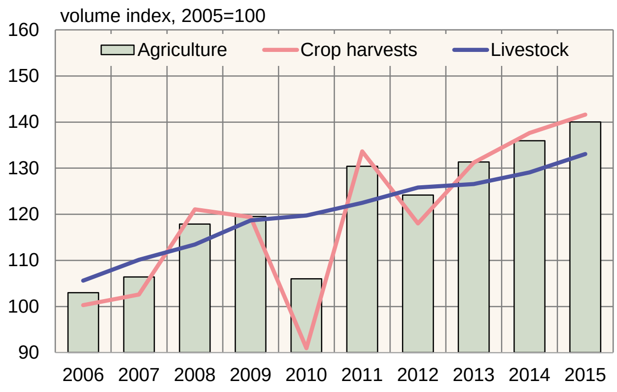
Russian farm production growing gradually. Bans on imports of certain foods and policies favouring domestic producers have had only minor impact on production volumes of domestic farmers. Russian production of grains and livestock has grown a few per cent a year in recent years. The value of total agricultural output as well as livestock production in 2015 grew 3 % in real terms and has continued to increase at the same pace in 2016. Grain harvest was last year approximately on the previous year's level. However, production of certain other crops such as sugar beets and soybeans grew rapidly last year. This year's grain harvest is expected to be considerably larger than last year's.

Production of meat and poultry was up 4 % last year and about 6 % y-o-y in the first months of 2016. While dairy production has shown virtually no growth overall, production of certain dairy products has increased. Highest growth has been in cheese production, which was up 17 % last year. Growth in cheese production appears to have levelled off, however, at around 2 % growth in the first half of this year. This year, especially production of certain vegetables has grown rapidly. Food production overall rose 2 % in 2015 and 3 % y-o-y in 1H16.

Retail food sales continue to diminish, but reduced foreign competition has allowed domestic producers to increase their market shares. The absence of competition has allowed price increases, which has enhanced profits of both farmers and the food industry. Even so, there are no signs of increased investment in the sector. In 2015, investment in farming and livestock fell 13 %.

With the contraction in real incomes and rapidly rising prices for many food items, food represents an increasingly large share of household consumption. At the end of 2015, food accounted for about 30 % of the consumer spending of Russian households.

Russian agricultural output 2006–2015



Sources: Rosstat, BOFIT.

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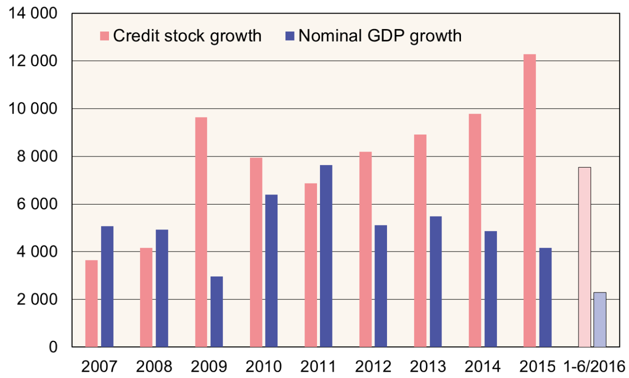
China

China's credit expansion creating less and less economic growth. Financial circles are increasingly worried about China's soaring indebtedness in the face of faltering economic growth. China's credit stock grew 15 % y-o-y the first half of this year, then slowed slightly to 13 % y-o-y last month. At the end of July, the value of yuan bank loans in China climbed to 102 trillion yuan, or about 144 % of GDP.

Using the Chinese central bank's broadest credit measure (total social financing, TSF), the credit stock in July was up 12 % y-o-y to an equivalent of about 210 % of GDP. Indicators of activity in the shadow banking sector suggest that the use of banker's acceptance bills has fallen significantly this year, while the stock of trust and entrusted loans has increased (up 17 % y-o-y in July). Among the various TSF categories, the stock of corporate bonds grew fastest (up 30 % y-o-y at the end of July). The money raised by companies through equity issues has also increased rapidly this year.

A highly disconcerting aspect of China's rising indebtedness is the fact that companies are devoting an ever-increasing share of new borrowing to servicing existing debt. There are also signs that borrowed money is going elsewhere than investment in production in hope of quicker returns. Last year, the stock of yuan-denominated loans grew by 12 trillion yuan, which was roughly three times more than the growth of nominal GDP. The ratio has persisted this year as well.

Annual growth of credit and GDP in China, CNY billion



Sources: Bloomberg, CEIC & BOFIT

Sharp slowdown in Chinese investment growth. Growth in private investment, which accounts for over 60 % of all Chinese investment, has slowed sharply since the second half of 2015. Private investment last month dipped below the July 2015 level. The pace of public investment also slowed sharply in July compared to the first half of the year. Consequently, real growth in fixed asset investment (FAI) fell below 5 % y-o-y last month.

FAI figures reported on a monthly basis do not correspond directly to the quarterly national accounting figures for fixed capital formation. However, also real growth in capital formation fell to just over 5 % in the first half (down from over 6 % growth in 1H15). Capital formation represented 45 % of total demand last year, highlighting the potentially significant impact of shrinking investment on GDP growth. Domestic consumer demand, in turn, becomes much more critical than earlier in sustaining rapid growth.

July output growth slowed slightly from June. Industrial output grew 6 % y-o-y, while growth in retail sales, which reflects both service sector and consumption activity, fell to slightly below 10 % in real terms.

Slight uptick in Chinese housing construction; price trends uneven across cities. Following a downturn in production last year, housing construction revived strongly in the first seven months of this year. Measured in terms of square metres of liveable floorspace, there was a 20 % increase in completions of new apartment buildings and a 13 % jump in new apartment building starts. The rate of new building starts, however, faded a bit with the onset of summer. Compared with previous years, builders are also buying less land use rights for building lots, a trend that suggests only moderate growth in housing construction lies ahead.

The uptick in construction reflects the recovery in apartment sales, which were up sharply in the first half of this year, both in terms of liveable floorspace and value of sales. Private real estate portal SouFun's latest survey of around 100 cities found that the average price of a square meter of floorspace in July was 12,000 yuan (€1,600), an increase of 12 % y-o-y. The growth of average housing prices accelerated from June. From the standpoint of emerging risks, it should be noted that on-year growth in the stock of housing loans accelerated in the second quarter to 31 %.

Housing markets in China are quite heterogeneous. Average apartment prices (CNY/m^2) runs from about 4,000 yuan (€540) in Baoji in Central China to 53,000 yuan (€7,200) in Shenzhen. While the fastest rise in apartment prices has been in the big cities, the number of smaller cities witnessing on-month overall price declines started to rise in July. SouFun found that apartment prices were falling in almost a third of cities surveyed.

China gives go-ahead to Shenzhen-Hong Kong Stock Connect. On Tuesday (Aug. 16), the State Council approved linking of Hong Kong and Shenzhen stock trading without giving a specific start day. A Hong Kong stock exchange press release said that trading was expected to begin within four months. The Shenzhen-Hong Kong Stock Connect project follows the Shanghai-Hong Kong Stock Connect programme launched in November 2014. As with the sister Stock Connect programme, trading in shares on the Shenzhen exchange via the Hong Kong exchange (and vice versa) are subject to daily quotas. An innovation is that there will be no overall quotas, and they have now been abolished for Shanghai-Hong Kong trading as well.

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