Weekly Review
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Russia

Russian industrial output contracted in September. Total seasonally and workday-adjusted industrial output contracted slightly in September from August. The volume of production was down 0.8 % y-o-y. The production is currently close to the levels seen in 2011.

September manufacturing witnessed a stronger contraction, down 1.6 % y-o-y. Although a turnaround in manufacturing has been expected for months, any signs of recovery have remained faint. The differences across branches, however, were significant. Production of foodstuffs and chemical industry products showed a distinct rise, while falling production continued in production of many petrochemicals and construction materials.

Extractive industry output fell slightly from August to September, but was still up 2.1 % y-o-y. Growth has however, slowed down from the beginning of the year when crude oil production increased strongly.

The contraction in retail sales continued in September, but at a more moderate pace than earlier this year. The volume of retail sales was down 3.4 % y-o-y. Retail sales were supported, however, by a halt in the contraction in private sector real wages. Real disposable incomes overall contracted by nearly 3 % y-o-y.

Russia and India agree on new arms sales, but overall trade between the countries continues to shrink. During the BRICS summit in Goa last week, India revealed it was buying new weapons systems from Russia. In recent years, India has been Russia's most important arms customer. The Stockholm International Peace Research Institute (SIPRI) estimates that about 40 % of Russian arms exports went to India during 2011–2015.

Under the current deal, India will buy, among other things, an S-400 air defence system. The deal, which will take several years to perform, is valued at about $5 billion. In addition, India and Russia agreed on local assembly of certain equipment such as Kamov military helicopters in India. The deal also included purchase of two frigates capable of launching cruise missiles, with India later producing two similar frigates in its own shipyards. Russia continues work on the two nuclear reactors at the Kudankulam power station in Tamil Nadu. The first Russian-built reactor was commissioned in October 2013 and the second last week.

In conjunctions with the BRICS summit, Russia's state-owned oil company Rosneft announced that it was involved with a group of international investors in the joint acquisition of the Indian oil company Essar Oil. Rosneft will take a 49 % ownership stake. The deal, valued at $13 billion, should be finalised by the end of the year. Rosneft is also preparing to sell a further 11 % stake in its Vankorneft subsidiary to the Indian ONGC Videsh. After the acquisition, Indian oil companies will control 49.9 % of Vankorneft.

With the Russian economic recession and the ruble's depreciation, Russia's trade with India has declined in recent years. Russian exports to India in the first eight months of this year were worth about $3 billion and imports from India about $1.5 billion. The dominant product categories for Russian imports from India were pharmaceuticals (nearly a third) and electronic equipment (slightly over 10 %). In Russian exports to India precious gems accounted for nearly 20 % and machinery & equipment for slightly over 10 % of exports.

Neither India nor Russia are very important to each other as trading partners. India accounts for only 1–1.5 % of Russian exports and Russia about 0.5 % of Indian exports.

Government subsidies keep Russia's inefficient car producers on life support. The economy ministry last week released a study that found that Russia's car industry received state subsidies of about 400 billion rubles (nearly €9 billion adjusted to annual average exchange rates) from 2009 to 2015. Last year, one in three cars in Russia was purchased with state support. The report stated that the subsidies have prevented large reductions in production capacity but allowed non-competitive carmakers to remain in the market. The economy ministry estimates that in the coming years as much as a third of the Russian car industry's annual production capacity of 3.3 million vehicles will be idle. Most of this production is not competitive in export markets and domestic demand is only expected to recover slowly. Even so, the economy ministry is not advising to cancel subsidies to carmakers, but rather redesign the support to be more efficient. The car industry accounts for about 0.5 % of Russian GDP and directly employs about 500,000 people.

About 1.5 million new passenger cars were sold last year in Russia which is about half of the peak levels before the current crisis. Car sales have declined already for three years and in the first nine months of 2016 were down 15 % y-o-y.

Last year, 1.2 million cars were produced in Russia, and another 350,000 cars were imported. Imports as a share of consumption have declined notably over the past decade as the result of foreign car makers putting up assembly plants in Russia. Majority of Russian production today is assembly work. The average degree of localisation is only about half, however, because local component production simply does not exist. Imports have also been reduced by high import duties that Russia must gradually lower in coming years under its WTO commitments. Russia also introduced a vehicle recycling fee in a 2012 which has been contested in WTO.

Russia last year exported about 100,000 passenger cars. Car exports have fallen for two years and in the first half of 2016, they fell further 30 % y-o-y. Demand has been weak in Russia's main export markets, the CIS countries. Exports to Kazakhstan this year collapsed with the introduction of vehicle recycling fees. Russian brands are mostly not competitive outside the CIS and the export competitiveness of Russian assembly production is hampered e.g. by high logistics costs.

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China

China once again releases GDP growth figure in line with official target. Third-quarter economic performance figures from China's National Bureau of Statistics show GDP growth held steady at a 6.7 % y-o-y for the third quarter in a row. Quarterly GDP growth was 1.8 % q-o-q, which corresponds to an annualized growth rate of 7.4 %. The underlying economic development behind the unconvincingly stable GDP growth figures, however, has been quite mixed. Nominal on-year GDP growth accelerated slightly in 3Q16 to 8 %.

Industrial output rose 6 % y-o-y in September, while retail sales were up nearly 10 %. Growth in fixed investment accelerated slightly, climbing 9 % y-o-y in September. The investments of state and state-owned enterprises have risen considerably faster (up 21 % in January-September) than private investment (up 3 %).

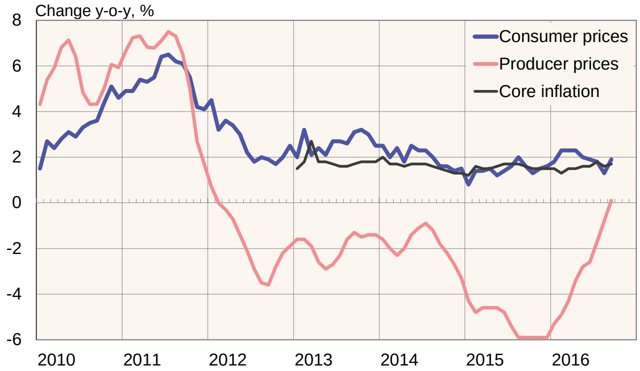
A disconcerting aspect of China's high growth is the quality of the growth. The growth has been supported by government stimulus measures financed with ever-increasing debt. Growth has also been boosted by the overheated real estate sector and increased borrowing for apartment purchases. Looking at the GDP components, the real estate sector's growth accelerated from below 4 % last year to 9 % in the first nine months of this year. Measured by liveable floorspace, apartment sales were up 27 % y-o-y in the first three quarters. The rapid rise in real estate prices has not ignited a construction boom, however. New construction starts, again measured by floorspace, increased 7 % in January-September, even as sales of the land rights for housing construction fell 6 %. Several cities have tightened apartment purchase conditions and downpayment requirements, so that the impacts of the real estate boom are likely to be quite transient.

The September figures give a two-track picture of progress in economic structural reforms. On the demand side, growth has largely been consumption-driven – in the first three quarters of this year, 71 % of GDP growth came from consumption. On the supply side, the service sector has grown to account for 53 % of economic output, while service sector growth has slowed and its contribution to economic growth has fallen slightly to 60 % of GDP growth. A standout feature of the new figures is the rapid slowing in income growth. In January-September, average disposable incomes grew 6 % y-o-y in real terms, down from 8 % growth a year earlier. Especially growth in migrant worker incomes has slowed fast.

Producer prices in China finally start to rise. After 54 consecutive months of decline, producer prices in September rose 0.1 % y-o-y, bringing to an end an unprecedented producer price deflation episode that began in March 2012. The protracted period of falling producer prices reflected both the drop in global commodity prices and China's overcapacity problems. The rise in prices has mostly been caused by the recovery in global commodity prices. Prices of liquid fuels, coal and metals all began to rise. Prices of almost all other products have generally held at roughly the same level as a year ago. An increase in producer prices creates upward pressure on China's export prices and possibly global producer prices as well.

The rise in consumer prices accelerated from 1.3 % in August to 1.9 % last month. Food prices were up sharply. Core inflation (excludes food and energy prices) has remained stable and below 2 % for over three years.

Price trends in China



Source: Macrobond and BOFIT.

Value of China's foreign trade declines even as trade volume increases. The fall in the value of China's exports since spring 2015 accelerated in September. Dollar-denominated exports were down 10 % y-o-y. After falling since autumn 2014, the value of imports rebounded slightly in August, only to sink again by 2 % y-o-y in in September. With the yuan down nearly 5 % y-o-y against the dollar last month, the drop in the value of foreign trade was more modest in yuan terms. The September foreign trade surplus fell to $42 billion.

The value of trade was depressed by drops in export and import prices, while the volume of exports in June-August was up 5 % y-o-y and the volume of imports up 3 %. Also foreign trade cargo figures from China's ports suggest a slightly stronger trend in volume growth than last year. Import volumes of many critical commodities have been rising. For example, China continues to build up its strategic oil reserves, with crude oil imports rising 15 % this year.

The IMF's latest World Economic Outlook (WEO) notes that the slowdown in growth of global trade arise from depressed global economic growth and slowdown in fixed investment growth in particular. Moreover, the growth in international trade has also been dampened by increased protectionism and decreased importance of international production chains. These factors are likely to underlie the slowdown also in the growth of Chinese foreign trade. Chinese statistical data show that the share of processing trade has fallen from about 55 % ten years ago to around 40 % today, and that this declining trend is apparently set to continue. Production-chain-related imports have also fallen in the past decade from about 50 % to just over 30 %, and have remained at that level for several years now.