Weekly Review
4 • 27.1.2017

BOFIT

Russia

Russian output recovers, but consumption slump drags on. Industrial output in November-December 2016 rose by about 3 % y-o-y. Growth was slightly over 1 % for all of 2016. Rosstat noted that its full-year data for 2016 include the largest changes that firms in its reporting system have submitted. The published figures for earlier periods of 2016 may change, as could the seasonally adjusted data that show a notable rise in industrial output in November-December.

Output of mineral extraction industries, which includes fossil fuels, was up on-year in November-December by nearly 3 % and 2.5 % for all of 2016. Most of the gain could be attributed to higher oil production. Manufacturing output in November-December increased 2.5 % y-o-y, but showed hardly any growth for the whole 2016 from 2015.

Agricultural production in 2016 exceeded the previous year's output by nearly 5 %, thanks largely to bumper harvests. The volume of goods transportation rose by nearly 2 %. Construction activity fell for the third year in a row. The decline was nearly as steep as in 2015 (down over 4 %). Unlike earlier years, fewer apartments were built. Measured by the number of apartments completed, the drop was 1 % from 2015. In terms of floorspace, the decline was over 6 %.

The seasonally adjusted volume of retail sales dropped still in December, extending the slide to two years. The on-year decrease in 4Q16 matched the fall for the full year, i.e. about -5 %. Retail sales in 2016 were 15 % below their 2014 level. Real household disposable incomes fell 6 % last year.

Russian oil production hits post-Soviet record; growth in output expected to slow. Last year Russia produced roughly 550 million metric tons (an average of 11 mbd) of crude oil (includes gas condensates). It was the highest level of production since the dissolution of the Soviet Union. Production was up nearly 3 % y-o-y. Fastest growth was recorded in the new oil fields in the Sakhalin and Yamal-Nenets regions, while output at mature fields continued to decline.

Because growth in oil production depends on new deposits that are more difficult to exploit, output growth is expected to slow considerably during this year and in coming years. In addition, this year's output should be restricted (at least in the first half) under the agreement between Russia and other oil-producing nations. Energy minister Alexander Novak reports that production will gradually be cut from last October's level to around 10.9 mbd in May and June. At that level, Russian oil production in the first half of this year would roughly match that of 1H16. Prior to the agreement on restricting output, Russia's economy ministry expected oil production to rise by 0.7 % this year. IEA's forecast that was published after the agreement sees Russian output rising 0.3 % this year, while OPEC's forecast expects a drop of 0.2 %.

The Joint Ministerial Monitoring Committee of the countries involved in the deal held its first meeting last weekend. While there were no production figures for this year yet available, the ministers said that production in their countries has fallen as planned. The price of oil jumped as the deal was signed at the end of November. Since then the Brent crude spot price has stabilised around $55 and the futures contract price at end-2017 around $57 a barrel.

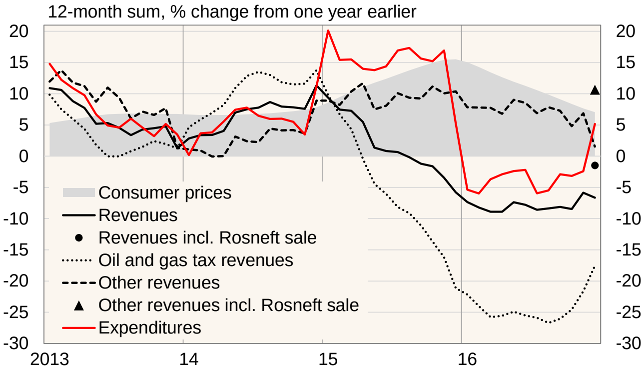
Extraordinary budget measures in Russia boosted federal revenues and expenditures in late 2016. Budget revenues were significantly increased with the sale of a minority stake in state oil giant Rosneft. Money from the sale was channelled as dividends from a state-owned enterprise that owned the shares and came as revenue to the federal budget. Thus, budget revenues contracted in nominal ruble terms in 2016 by just 1.5 %. If the sale of Rosneft shares is omitted, revenues would have declined nearly 7 %. The sale of state property is not typically treated as budget revenue, but rather as an item to finance the budget deficit.

Revenues from oil and gas taxes declined last year by nearly 20 %. This was a slightly smaller drop than in 2015. In the final months of 2016, the revenues exceeded the level of 12 months earlier. Value-added tax revenues (which go entirely to the federal budget) rose by nearly 8 %, or about the same as in 2015 (even if inflation no longer lifted the nominal value of VAT collections as much as in 2015). Other budget revenues (excl. revenues from oil and gas taxes, VAT and sale of Rosneft shares) fell sharply from their 2015 peak.

Federal budget spending took a big bounce in late 2016, when the defence industry was given a large sum to pay back their bank debts. Without this special operation, nominal budget spending for the year would have been roughly the same as in 2015. The operation lifted spending growth to 5 %. Defence spending growth slowed from previous years but was still nearly 20 % due to the special operation. Nominal spending on domestic security and order, which comes almost entirely from the federal budget, again declined slightly. Nominal growth of other spending was only 2–3 %.

The federal budget deficit was 3.5 % of GDP. Without the income from the Rosneft sale, the deficit was 4.4 % of GDP.

Russian federal budget revenues and expenditures, 2013–2016



Source: Russian Ministry of Finance.

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China

Growth of Chinese economy continued to slow as expected last year. China's gross domestic product in 2016 rose 6.7 % in real terms, down from 6.9 % in the previous year. Nominal GDP increased to about 74.4 trillion yuan ($11.2 trillion). The usual caveats apply and the numbers should only be taken as rough indicators, as China's GDP growth seems implausibly stable and the reliability of statistics has its issues. Statistical problems were highlighted in January with the revelation of a massive statistical manipulation that had gone on for years in the Liaoning province.

China's production structure is changing as growth slows. Services last year contributed 52 % of GDP, while the share of industrial and construction activity fell to around 40 %. Agriculture and other primary production accounted for less than 9 % of the Chinese economy's total output, even though the farming sector employed over a quarter of the workforce. Industry employs slightly more than primary production, but its share of the workforce overall also began to shrink a couple of years ago. At the same time, the number of people employed in the service sector has soared. Services now employ perhaps 44–45 % of the workforce.

Demand-side GDP figures will only be released later. The available indicators show that fixed asset investment (FAI) has experienced a dramatic slowdown in growth. The pace of private investment growth fell to 4 % in real terms. Even the stimulus policies that drove 17 % growth in public investment failed to offset the impact of the slowdown. This suggests investment represents a dwindling share of total demand, while the significance of private consumer demand is rising (even if the growth in real disposable incomes has slowed to around 6 %). The rapid growth in consumer demand and tepid growth in foreign trade has reduced foreign trade's share of GDP. This has been expected, and does not signal a waning of the general importance of openness or international economic relations to China's development.

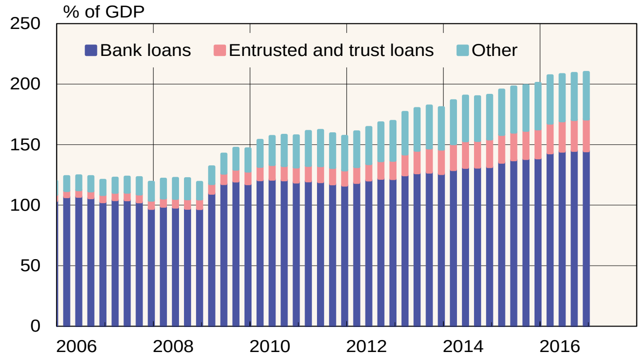
Main indicators of Chinese economic growth

Sources: Macrobond, BOFIT.

Chinese credit stock continues to rise faster than output. The stock of bank loans issued in yuan increased by 13.5 % last year, even if the pace of growth slowed slightly from 2015. Growth in the corporate loan stock slowed, but the pace at which new loans were granted to households increased to over 60 %. The share of new household loans rose from a third in 2015 to half of all new loans made last year. About 80 % of household loans are housing loans. The stock of loans denominated in foreign currencies continued to diminish.

Under the central bank's broader definition of credit, total social funding (TSF), the credit stock (domestic borrowing of households and businesses, excluding financial sector) grew 13 % last year, rising to 210 % of GDP. The stock of shadow banking sector's trust and entrust loans grew by 19 %, while the stock of bank acceptance bills declined sharply. In lieu of bank loans, firms increasingly sought to raise money through bond issues. In December, however, corporate bond issues fell and the use of shadow banking instruments increased.

China's domestic debt (excl. central and local government debt)

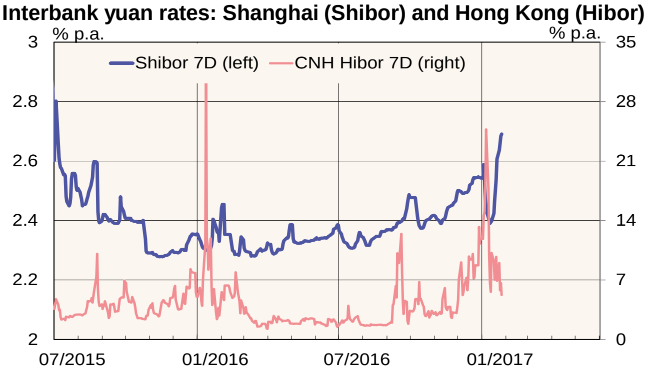


Sources: CEIC, BOFIT.

Central bank of China boosts liquidity of money markets ahead of New Year's holiday week. The People's Bank of China has increased the money supply via open market operations, credit instruments and special arrangements ahead of the week-long Lunar New Year holiday that starts today (Jan. 27). Media reports note that the reserve requirements on large banks have also been eased temporarily to prevent excessive tightening in money markets.

In contrast, the PBoC's 10 basis point hike in rates on its medium-term lending facility (MLF) loans to commercial banks on January 24 has increased costs of long-term funding and signals a tightening in the monetary stance. The interest rate charged on a one-year MLF credit rose to 3.1 %. Market interest rates in China have been rising for a while.

Interbank yuan rates: Shanghai (Shibor) and Hong Kong (Hibor)



Source: Macrobond.

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