Weekly Review
8 • 24.2.2017

BOFIT

Russia

Russian government revenues and spending continued to decline in real terms last year. The consolidated budget, which combines federal, regional and local budgets, and state social funds, showed a slight revenue increase from 2015 in nominal ruble terms. In real terms, revenues fell almost 5 %. If the funds received from last year's sale of the stake in Rosneft are included (as they are in the official budget data), the drop in real revenues was 2 %. In real terms, revenues were down by 17 % from 2014 and at the same level as ten years ago. Once again, it was falling revenues from oil & gas taxes that produced a weak total revenue performance last year. Other revenues rose slightly in real terms. Revenues from excise taxes on alcohol, tobacco and automobile fuels rose sharply. Income from mandatory social contributions, the government's largest revenue stream, grew briskly mainly due to a continuous fast rise of revenues from health insurance payments. Revenue growth for other large major taxes kept pace with inflation. Many of the minor budget revenue streams exceptionally declined.

In real terms, consolidated budget spending fell by about 1.5 % in 2016. Real spending was down 8 % from 2014 and at the level of 2011–2012. Besides the boom in defence spending, only the increase of healthcare spending managed to outpace inflation slightly. Pension spending and other social spending rose slightly slower than inflation as normally scheduled inflation adjustments e.g. to pensions were omitted last year. Other spending continued to plunge in real terms. The deficit amounted to 4.5 % of GDP.

Russia's government (consolidated budget) revenues, expenditures and surplus, 2014–2016

	2014	2015	2016 (prelim.)	
	% of GDP			with Rosneft sale
Revenues	**33.8**	**32.3**	**32.0**	**32.8**
Oil and gas taxes	9.4	7.0	5.6	
Other revenues	24.4	25.3	26.4	27.2
Value-added tax	5.0	5.1	5.3	
Excise taxes	1.4	1.3	1.6	
Corporate profit taxes	3.0	3.1	3.2	
Labour income tax	3.4	3.4	3.5	
Social taxes	6.4	6.8	7.4	
Other	5.3	5.7	5.3	6.2
Expenditures	**34.9**	**35.7**	**36.5**	
Administration	2.1	2.2	2.2	
Defence	3.1	3.8	4.4	
Domestic security and order	2.8	2.5	2.3	
Economy	5.7	4.5	4.5	
Housing sector	1.3	1.2	1.2	
Education	3.8	3.6	3.6	
Healthcare	3.2	3.4	3.6	
Social expenditures	11.1	12.6	12.7	
Pensions	7.7	8.4	8.6	
Interest payments on debt	0.7	0.8	0.9	
Balance	**-1.1**	**-3.4**	**-4.5**	**-3.7**

Sources: Ministry of Finance and BOFIT.

Procurements of public sector and state-owned enterprises in 2016 exceeded 30 % of Russian GDP. The economy ministry reports that public procurements in Russia last year were valued at 5.3 trillion rubles (€72 billion) and procurements of state-owned enterprises were valued at 21.1 trillion rubles (€285 billion) (not including procurements classified as secret). The sizeable procurements have been attempted to make more efficient and less costly through regulatory measures.

Legislation governing public procurement has been tightened in recent years. To increase efficiency and transparency, procurements should be carried out by electronic competitive bidding. The economy ministry reports that last year two-thirds of public sector procurements were subject to competitive bidding, but only 5 % of those by SOEs. The competitive bidding, however, has been criticized to be illusory to some extent. Competitively bid public sector procurements last year attracted on average less than three tender offers and most procurements were won by a handful of bidders. Planned measures to increase effectiveness of public sector procurement include the introduction of a standardized catalogue for most common procurements.

Lately, procurements have been used increasingly as a tool of industrial policy, thereby reducing competition and raising prices. Among other things, many import restrictions have been imposed on public sector procurements. Russia is not a signatory to the WTO Agreement on Government Procurement (GPA). In addition, many procurements of SOEs are subject to domestic-content requirements and provide preferable treatment to domestic suppliers. There are also procurement quotas for many large SOEs, requiring them to direct a certain share of purchases to small and medium-sized enterprises and to innovative products.

Russian social security system – expensive and rigid. A fresh World Bank report finds Russia's social security costly and complex. Social spending on federal and regional levels, and via social funds, is the consolidated budget's largest spending category – about 35 % of all spending in 2016 (12–13 % of GDP). Of that, about two-thirds consist of pension spending, with the rest going to other social safety spending. Many social benefits are tied to age, domicile or former profession. The average pension is small, so many social programmes are designed to complement pensions.

Despite the federal government's central role in financing social spending, implementation of social policies is dispersed. There is wide variation across regions for the amount and efficacy of programmes. Russia has over 150 social programmes managed by the federal government, and at least 500 programmes by the regions. Programmes often overlap. Only about 15 % of all social spending goes to means-tested programmes that take into account the needs of the recipients. Moreover, most of the support formats are rigid to administer and do not adjust flexibly to the changing circumstances of beneficiaries.

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China

Chinese inflation accelerates. Consumer prices rose 2.5 % y-o-y in January, up from 2.1 % in December. Core inflation, which excludes food and energy prices, also picked up to over 2 %. The rise in prices of many items has been quite even, while prices in the travel industry rose nearly 10 % y-o-y in January. The true inflation picture was distorted somewhat by the fact that the Lunar New Year holidays occurred in January this year and February last year. The increase in producer prices picked up from 5.5 % y-o-y in December to 6.9 % in January. The increase in producer prices is largely driven by rising global commodity prices.

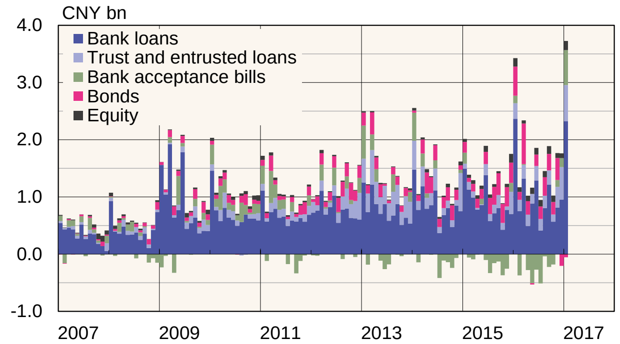
Even so, China's inflation rate remains modest, and is even expected to fall a bit February as the impact of the Chinese New Year holiday fades. Inflation is also below the target of "about 3 %" set by the People's Bank of China last year. The PBoC is expected to announce this year's inflation target at the National People's Congress next month.

Chinese still borrowing like there's no tomorrow. The PBoC reports that January issues of total social financing (TSF), a broad measure of the credit supply, broke all historical records last month. Especially financing provided by the shadow banking sector soared (i.e. bankers' acceptances, trust loans and entrusted loans). January is typically a big month for new lending in China. The stock of TSF lending in January was up about 13 % y-o-y.

The Bank of International Settlements (BIS) estimated that the total debt held by Chinese firms, households and the public sector equalled 255 % of GDP in June 2016. In other words, China has much more debt than in other emerging countries. China's piling debt is considered as a huge risk to both the country itself and the global economy. Most of the other countries that have experienced similar high debt growth have then seen rapid decelerations in economic growth. In many countries, it has also led to banking crises. China's debt is almost entirely domestic, which alleviates foreign exchange risk from the debt.

China has only taken minor measures to slow the pace of rising indebtedness. Its economic policy has been geared to sustain high GDP growth and assuring that China's goal of doubling GDP between 2010 and 2020 is not threatened. The monetary policy stance remains loose, even if the PBoC raised rates slightly in January-February on its lending to the financial sector. At the same time, however, it also boosted liquidity on the market by other means, especially ahead of the New Year's holiday week. The central bank last week announced targeted relaxation of bank reserve requirements. Banks that lent extensively to small businesses and agriculture last year will be entitled to lower reserve requirements (15–16 %) from the end of February. Similar targeted incentives have been used before and banks that fail to keep with the policy track lose their eligibility for the lower reserve requirement. The usual reserve requirement is 16.5 % at present.

New credit issues (broad TSF measure), monthly

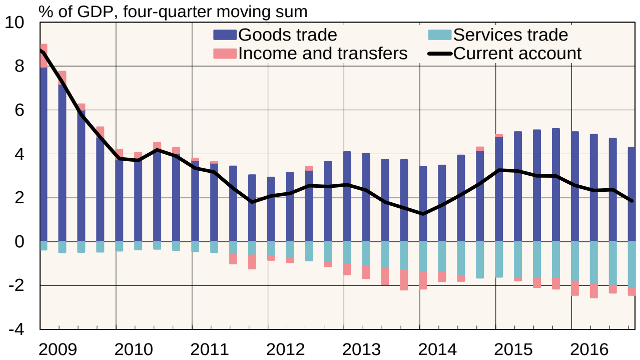


Sources: Macrobond, PBoC and BOFIT.

China's current account surplus fell below 2 % of GDP in 2016. Preliminary balance-of-payments figures show China's goods trade surplus last year was $485 billion (4.3 % of GDP). The value of goods exports was $1.989 trillion and imports $1.504 trillion. The value of exports contracted more than the value of imports, causing the goods trade surplus to shrink from the previous year. The value of services trade also fell from the previous year. The value of China's services exports last year amounted to $282 billion, while services imports were worth $525 billion. Thus, the services trade deficit increased to $242 billion, of which the deficit in travel services alone hit $223 billion (2 % of GDP). The total current account surplus fell to $210 billion (1.9 % of GDP).

China's balance-of-payments figures showed that Chinese travellers abroad spent $341 billion last year. Measured in yuan, travel spending rose 25 % y-o-y. Foreign travellers spent $118 billion in China last year. According to China's National Tourism Administration, Chinese tourists made 122 million trips abroad, 4 % more than in 2015. Spending on tourism has increased much faster than the number of tourists. Balance-of-payments figures show spending on tourism last year was nearly triple compared to 2013, while the volume of tourism increased by 25 %. Statistics suggest that the Chinese tend to be bigger spenders abroad than other nationalities. Some suspect, however, that part of phenomenal growth in tourism spending actually reflects capital outflows that are improperly recorded as tourism imports.

China's main current account categories, 2009–2016 (% of GDP)



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