

## Russia

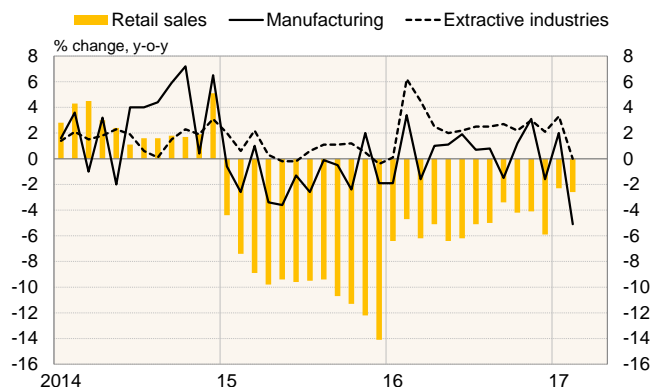
**Russian economic situation remains weak.** In the first two months of this year, seasonally adjusted and workday-adjusted industrial output continued to lack clear direction. After lurching ahead in January, production fell considerably in February. The volume of industrial production for January-February was slightly lower than a year ago, whereas the on-year drop in February was more than 2.5 %. Part of February's weakness reflected a difference in the number of workdays compared to February 2016.

Manufacturing output fell 5 % y-o-y in February, with a combined January-February drop of nearly 2 % y-o-y (and well over 2 % less than three years ago). Production of extractive industries was up 1.7 % y-o-y in January-February, with crude oil output rising by 2 % and natural gas output up by nearly 10 %. Economy minister Maxim Oreshkin said that the industrial output figures may well be revised later this year, noting that the switch-over to a new statistical classification system had not proceeded successfully.

After a two-year slide, seasonally adjusted retail sales rose slightly in the January-February period. Even so, the sales volume was down by a couple of per cent from a year ago. Food sales were still down 4 % y-o-y, while sales of non-food goods were no longer down more than 1 %. The performance in retail sales was sluggish compared to real household incomes.

Real incomes in January-February were up as a total by 1 % y-o-y, even if they dipped markedly in February. Real incomes were supported by higher real wages and two substantial pension pay-outs. In January, all pensioners received (as promised in the lead-up to last autumn's Duma elections) a hefty one-time payment. At the start of February, pensions of non-working pensioners were adjusted fully for inflation. Pensioners continuing to work, due to a rule change last year, are no longer entitled to the annual inflation adjustment. Russians kept a large part of the household income increases in January-February in their bank accounts.

### Real growth in retail sales and industrial sectors, 2014–2017



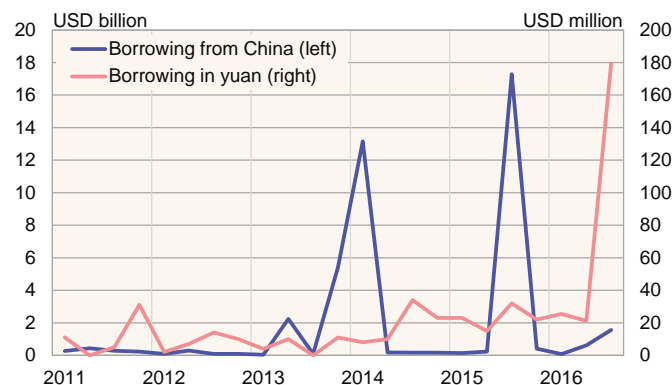
Source: Rosstat.

**CBR opens representative office in Beijing.** The Central Bank of Russia opened its first overseas office last week in Beijing, making it the 13<sup>th</sup> representative office of a foreign central bank in that city. In Moscow, People's Bank of China opened the first yuan clearing bank in Russia this week. There are about 20 yuan clearing banks in the world.

In recent years, Russia and China have sought to intensify cooperation in the financial sector. Russians are eager for access to Chinese financing, especially since Western sanctions have made it harder to get foreign loans. China, in turn, wants to promote increased international use of the yuan.

While use of the yuan in bilateral transactions has increased in recent years, it is still relatively modest. In the first nine months of 2016, Russia's private sector (excluding banks) borrowed \$2.2 billion from Chinese lenders, which amounted to about 5 % of the private sector's entire foreign borrowing. Yuan-denominated borrowing amounted to about \$200 million. About 10 % of bilateral trade last year was conducted in yuan and 4 % in rubles. The Russian government holds no yuan-denominated debt, but has planned to issue yuan bonds. None of Russia's currency reserves are presently invested in yuan assets.

### Russia's private sector (excl. banks) borrowing from China and yuan-denominated borrowing, flows in 1Q2011–3Q2016



Source: Central Bank of Russia.

### European Commission invites comments on EU-Gazprom gas dispute.

An investigation launched in autumn 2012 into European gas markets initially found that Gazprom violated EU competition rules in many EU member countries of Central and Eastern Europe. Commission findings on the matter were delivered to Gazprom in April 2015. Gazprom recently responded to the Commission with its own proposal on revisions of its practices found to violate EU competition rules. The Gazprom commitments include e.g. a promise to eliminate restriction on gas resellers and increase pricing flexibility. The Commission last week released Gazprom's response for comment. Customers and stakeholders have until the end of April to give input. The commissioner in charge of competition policy, Margrethe Vestager said Gazprom's proposed solution enables the free flow of gas in Central and Eastern Europe at competitive prices.

## China

**Guangdong, China's largest province, has an economy as big as Spain's.** After almost four decades of rapid growth, some Chinese provinces have GDP numbers like those of mid-sized national economies. China's National Bureau of Statistics reports that the nominal GDP of Guangdong province last year reached \$1.2 trillion, putting it size-wise on par with the Spanish economy and approaching Russian GDP. China's second-largest provincial economy, Jiangsu, had a GDP larger than Mexico's, while number-3 Shandong province's GDP was nearly as large as Mexico's. Looking at China's megalopolises, both Beijing and Shanghai had larger economies than either Hong Kong or Singapore.

China's provincial GDP data should be viewed with considerable caution, however. Much of the problem arises from the fact that provinces are expected to hit their hard growth targets. Failure to do so can be harmful to the career trajectories of regional leaders. Provincial administrations, which have strong connections with both regional firms and financial institutions, are well positioned to support economic growth. When this is still insufficient, however, officials may resort to falsification of their statistical data. Aware of the problem, the NBS has long performed its own surveys with a view to confirming or adjusting the figures reported by provincial officials. Like in previous years, the combined reported provincial GDP figures last year were slightly larger than the official national GDP figure.

Growth targets have also become increasingly difficult to achieve in recent years, especially for provinces involved in traditional heavy industries. In January, officials uncovered an unprecedented case of widespread statistical fraud in the Liaoning province. The latest NBS figures slash Liaoning's GDP figures by about 23%. Liaoning is unlikely to be the sole province guilty of fabricating statistical data. The *Financial Times* reported last week that the reported GDP figures of four other provinces traditionally engaged in heavy industry (Hebei, Shaanxi, Shanxi and Inner Mongolia) were surprisingly strong in 2012–2016, even as output volumes of their main products declined and prices fell.

**GDP and populations of select Chinese provinces and nations**

	GDP (2016), USD billion	Population (2015), million
Russia	1 280	147
Spain	1 210	46
Guangdong	1 200	108
Jiangsu	1 150	80
Mexico	1 050	121
Shandong	1 010	98
Netherlands	780	17
Zhejiang	700	55

Sources: CEIC, Macrobond and IMF.

**PBoC again slightly raised rates used in its financial market operations.** In response to the US Federal Reserve's 25-basis-point rate hike on March 16, the People's

Bank of China responded immediately by hiking rates used in its open market operations and lending programmes. The increases were small. For example, the 7-day reverse repo rate increased from 2.35% to 2.45%. Also most of the lending rates for liquidity programmes (SLF and MLF) were lifted by 10 basis points. While the rate hikes indicate a slight tightening of the monetary stance, they suggest the PBoC is better prepared than earlier to react to changes in the financial markets. Rates were also raised in February.

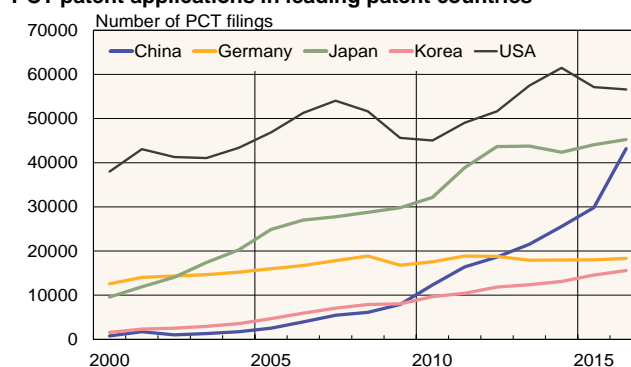
The impact of rate hikes on the economy, especially regarding debt growth, is expected to be marginal. On money markets, rates were up slightly. Today (Mar. 24), the 7-day SHIBOR stood at 2.8%.

**China's filings of international patent applications jump last year.** The number of Chinese patent applications in 2016 increased by 45% y-o-y, totalling 43,170 filings. Patent application filings globally under the international Patent Cooperation Treaty (PCT) amounted to 233,000, an increase of 7% y-o-y. Almost all of last year's increase in patent application filings reflects the increase in Chinese activity. The US remained the top filer of the applications but its number of applications fell slightly to 56,600. Some 1,530 PCT filings last year came from India (up 8% from 2015), 1,520 from Finland (down 4%), and 850 from Russia (down 3%). Russian patent applications have fallen significantly from their peak in 2013, when nearly 1,200 applications were filed.

Shenzhen-based telecom company ZTE was most active in filing patent applications (4,120 filings), with second place going to its neighbour telecom giant Huawei (3,690). Third place in PCT filings went to San Diego-based Qualcomm (2,470).

In terms of numbers, the explosion of patent activity in China would seem to imply an impressive boom in innovation. However, the quality and relevance of Chinese patent filings are often quite modest relative to those of advanced economies. The OECD reports that the growth in the number of patent applications has largely been driven by state subsidy rules, which favour large state-owned enterprises and high-tech firms. The benefits of Chinese patents are usually rather low, and the share of genuine inventions represents only a minuscule share of patent applications and thus have little impact on productivity in China.

**PCT patent applications in leading patent countries**



Source: World Intellectual Property Organization.