Weekly Review
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BOFIT

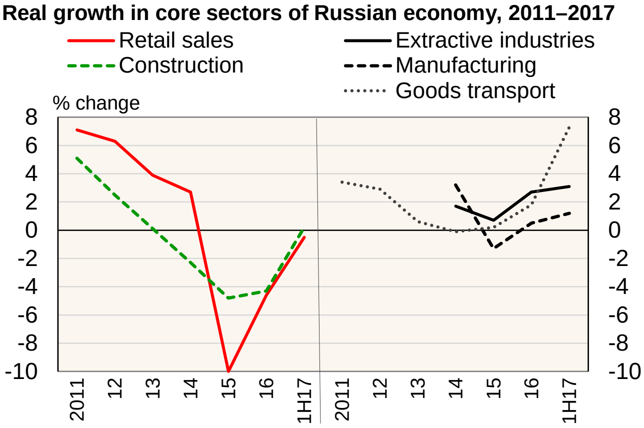
Russia

Russian economy gradually recovers. After rising throughout the spring, seasonally and workday-adjusted industrial output contracted slightly in June. In on-year terms, industrial output was up in June by 3.5 % and by 2 % in the entire first half of the year. Mineral extraction industries (includes oil & gas) have grown through the past one-year period, and were up over 3 % y-o-y in the first half of this year. Natural gas production has climbed 13 %, while crude oil production was up by nearly 2 %. Manufacturing growth turned down in June, and first-half growth was less than 1 % y-o-y.

The volume of seasonally adjusted retail sales increased slightly further in June, with retail sales up in the May-June period by about 1 % y-o-y. Household consumption this year has recovered slightly faster than the retail sales figures indicate, because Russian shopping abroad has recovered quite sharply. Real household disposable incomes have risen in recent months, recovering to the same level as in May-June 2016. The revival in private consumption has been stronger than income growth, reflecting the fact that households have been saving less and borrowing more than last year.

Growth in agricultural output has remained slack all this year, up just 0.2 % y-o-y in the first half. Construction, in contrast, picked up in May-June after a lengthy period of decline. Construction activity was up 4–5 % y-o-y. Goods transports have been a boom sector of the economy showing robust growth due to increased rail transport and pipeline transmission of oil & gas. The volume of goods transportation was up by over 7 % y-o-y in the 1H17.

Real growth in core sectors of Russian economy, 2011–2017

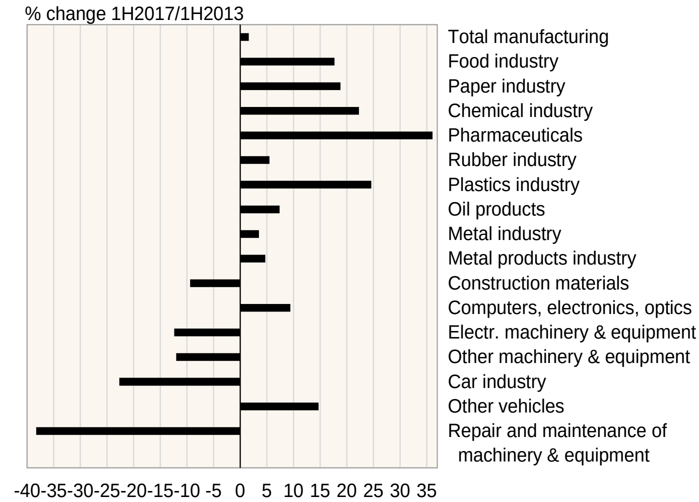


Source: Rosstat.

High variation in growth trajectories among Russia's manufacturing branches. Manufacturing output overall showed a small rise in the first half of the year, but the differences across branches were large. In the important food and chemicals industries, production growth remained brisk. In contrast, growth in production of petroleum products remained rather sluggish, while the decline in metal production became more severe. After about three years of weak performance, production growth was seen in both the machinery and equipment categories and the car industry.

While manufacturing as a total has performed poorly in recent years, big structural changes have taken place in manufacturing. Among the large manufacturing branches, food and chemicals each grew by roughly one fifth from the first half of 2013. Production of oil products after 2014 has increased really slowly and metals output has hardly risen. Largely due to drops in investment, production, maintenance and repair of machinery & equipment have contracted quite steeply, as well as construction materials.

Real output change in Russian manufacturing branches from 2013 to 2017



Source: Rosstat.

Russia releases 2011–13 GDP figures produced with new methodology. GDP and its components for the years 2011–16 have now all been revised in accordance with a unified SNA 2008 methodology. As Rosstat has been working backwards, the revised figures for 2014–15 were released in early 2016, together with partly improved data for 2011–13 based on a temporary methodology. The newest 2011–13 figures for fixed capital formation (fixed investment), which impact the GDP figures, now include acquisition of large weapons systems as well as economically beneficial R&D activities.

In the latest round, the value of fixed capital formation during 2011–13 was increased by roughly 10 % from the earlier figures (the previous revision already boosted the value of private consumption by about 10 %). The value of GDP in the years 2011, 2012 and 2013 rose 1–3 %. In the previous temporary revision, the rise in the value of GDP for the period was about 7 % from the old figures.

The pace of real annual GDP growth now rose by 0.4 percentage points for 2012–13, because growth of private consumption was revised up by 0.7 percentage points. In contrast, annual growth in fixed capital formation weakened by 0.7 percentage points for 2012–14.

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China

Most recent GDP growth forecasts agree with China's official growth targets. The IMF this week released its updated outlook for the global economy. The IMF expects Chinese growth to reach 6.7 % p.a. this year and fall to 6.4 % next year (slightly higher than its earlier forecast). Several other major institutions have also upgraded their forecasts recently, with the consensus now around 6.5 % (see table). China's official goal of doubling GDP between 2010 and 2020 requires average GDP growth of about 6.5 % p.a. Most of the forecasters, including the IMF, note that the risks associated with China's debt-fuelled high-growth strategy continue to accumulate. Without the government propping up the growth, the natural pace of growth of the Chinese economy would be slowing due to such factors as a contracting workforce, ongoing structural reform of the economy and the fact that most of the easy productivity gains have already been taken.

Selected GDP forecasts for China, %

	2017	2018	2019	Release
IMF	6.7	6.4		July
JP Morgan	6.8	6.4		July
ADB	6.7	6.4		July
BBVA	6.5	6.0	5.2	July
World Bank	6.5	6.3	6.3	June
OECD	6.6	6.4		June
BOFIT	6	5	5	March

China drops FDI restrictions; European Chamber wants more market access. At the end of June, China's Ministry of Commerce (MofCom) and the National Development and Reform Commission (NDRC) released their latest *Foreign Investment Industrial Guidance Catalogue*, which sets out incentives and restrictions applicable to foreign direct investments in coming years. The new catalogue took effect today (July 28).

The catalogue lists those branches where incentives are available to foreign firms, as well as branches that are on the "negative list", i.e. where access by foreign investors is constrained. The catalogue divides branches on the negative list into two groups: those subject to a complete FDI ban and those subject to conditions (such as formation of a joint enterprise with a Chinese partner and ownership restrictions). While foreign firms receive nominally neutral treatment in relation to Chinese firms in branches not mentioned in the FDI catalogue, foreign firms report facing discrimination.

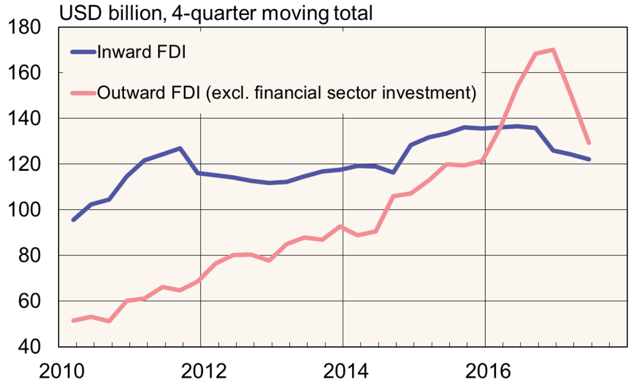
Officials report that the new catalogue reduces the number of restricted branches to 63 compared to 93 in the previous catalogue. Instead of 36 branches previously, only 28 of the 63 branches are still fully off-limits to foreign investors. The most extensive deregulation targets the service sector as well as the manufacturing and mineral extraction sectors. For example, motorcycle manufacturing or road passenger transport services are now free of foreign investment restrictions.

The EU Chamber of Commerce in China released a less sanguine assessment of the new catalogue. The Chamber noted that, even if 30 branches are supposedly open to foreign investment, only 18 of the branches are actually available to foreign investors. The remaining 12 branches were listed as off limits to both domestic and foreign actors in the 2016 Market Access Negative List, which has priority over the FDI catalogue. The Chamber also strives for transparent, simple FDI regulation. The Chamber above all is concerned about equal market access, noting that the new catalogue does nothing concrete to rectify the matter. The access of European firms to the Chinese market is still very restricted, while Chinese firms enjoy largely unfettered licence to operate within the EU.

Foreign direct investment from China and to China contract. Measures introduced by the central government to stifle capital outflows from China have effected investment flows in the first half of 2017. Since last December, officials have paid special attention to outbound direct investment (ODI). Last week, the government announced that the intensified scrutiny would continue. In particular, real estate, hotels, the film industry and sports investment have received closest scrutiny. China's Ministry of Commerce notes that ODI (excl. financial sector) fell to around 48 billion dollars in the first half, down by 46 % from 1H16.

Inward foreign direct investment (FDI) also fell to 66 billion dollars in the first half, a decline of 5 % from 1H16. In yuan terms, the value of inbound FDI remained at the 2016 level as the yuan has weakened against the dollar. As usual, Hong Kong's dominance as an FDI source continued with the share of investment (including investment routed via tax havens) rising to 74 %. The EU accounted of the 8 % of FDI inflows to China.

China's inward and outward FDI flows



Source: China Ministry of Commerce.

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