Weekly Review
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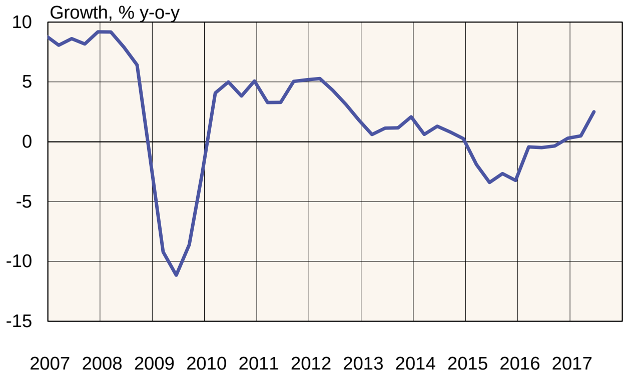
BOFIT

Russia

Russian growth accelerates. Rosstat preliminarily estimates Russian GDP grew by 2.5 % y-o-y in 2Q17, up from 0.5 % growth in the first quarter. The 2Q acceleration seems to be partly supported by temporary factors, so growth should slow down again in coming months. For the first half overall, GDP grew at a rate of 1.5 % y-o-y. BOFIT's most recent forecast (spring 2017) sees GDP rising by 1.5 % this year overall.

Several forecasters have slightly upped their predictions on Russian GDP growth during this year. The most recent key forecasts see Russian GDP rising by 1–2 % this and next year if the oil price remains around 50 dollars a barrel. Modest recoveries in domestic demand and exports should fuel gradual growth. Forecasts for import growth range more widely: 2–10 % real growth this year and 2–4 % next year.

Russian GDP growth



Source: Macrobond.

Moscow launches ambitious housing programme. At the beginning of August, Moscow mayor Sergei Sobyanin confirmed the list of apartment buildings to be included under an ambitious programme of resettlement and urban renewal. Most buildings on the demolition list are crumbling five-storey *Khrushchyovka* apartment blocks constructed in the 1950s and 1960s. The residents will be displaced mainly to new apartment buildings constructed under the programme. The massive project, far larger than the resettlement programs of recent years, covers more than 350,000 apartments and total liveable floorspace of over 16 million m². The programme is planned to be finished by 2032 and Moscow's deputy mayor Marat Khusnullin estimates the total costs of the programme at 3–3.5 trillion rubles (40–50 billion euros).

Some residents in apartment buildings slated for demolition organised protests this spring and summer against the programme on fears they may be getting a raw deal. To pacify their concerns, guarantees about e.g. the location and size of the new apartments have been written into law and the residents have had the possibility to vote on opting out or into the city's apartment building programme.

Moscow's plan is quite large even at the national scale. In recent years, housing built under resettlement programs outside Moscow and St. Petersburg has annually amounted to about 2.5–3 million m² according to the state corporation for housing and communal services. The corporation estimates that there are still over 650,000 people living in uninhabitable housing outside Moscow.

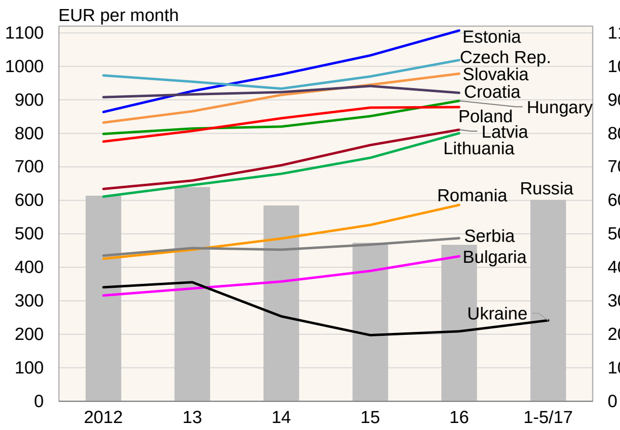
Looking at the impact on Russian housing construction overall, the Moscow programme would account for about 1 % of annual housing production volume nationally. Housing production increased at a rate of about 8 % a year during 2011–15, but contracted by 6 % in 2016 and 11 % y-o-y in the first half of this year.

Wages in Russian industry recover to pre-recession top levels. Between 2014 and mid-2016, wages in Russian industry declined relative to many countries on the ruble's sharp devaluation. In the manufacturing sector, the average monthly wage relative to European countries was so far at its highest in 2013–14, when it was about 65o euros (gross wage before income taxes). By summer 2016, the Russian wage had fallen by about a third to around 450 euros.

More recently, Russian manufacturing wages have come back strongly, recovering close to their 2013–14 levels. In nominal terms, ruble wages continued to rise at around 8 % a year even in the recession years of 2015–16. In the first five months of 2017, they were further up about 9 % y-o-y. Adding to the increase, the ruble has appreciated rapidly since early 2016, roughly 30 % against the euro.

Russian manufacturing wages this spring exceeded 600 euros a month, putting them again broadly on par or slightly above average manufacturing wages in the lowest-income EU countries. Even with the recovery, Russian manufacturing wages are still lower than in the other of the eleven countries in Central and Eastern Europe (including the Baltic countries) that have joined the EU since 2004. In 2016, the average monthly manufacturing wage was about 620 euros in China and about 560 euros in Brazil.

Average gross manufacturing wage, 2012–2017



Source: National statistics agencies.

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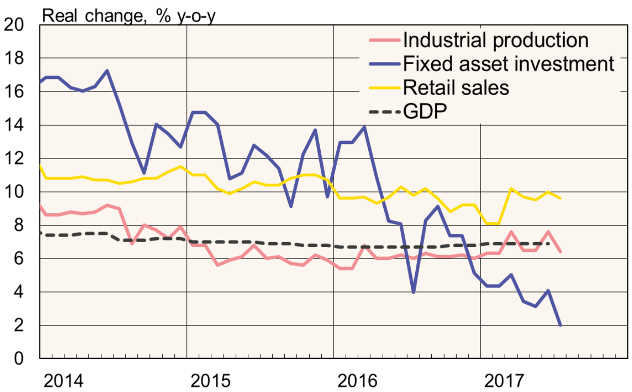
China

After a strong first half, China's economic numbers dip in July. Figures just released by China's National Bureau of Statistics show on-year growth in industrial output, retail sales and fixed investment slowed last month. July industrial output growth fell in real terms by over a percentage point to 6.4 %, while real growth in retail sales slowed to 9.6 %. Growth in on-line commerce remained brisk.

The long-term declining trend in real growth in fixed asset investment (FAI) in urban areas continued with July growth barely surpassing 2 %. As private investment has long languished, the reduction in public investment was the biggest driver in last month's slowdown. The level of private investment in July remained at the same level as in July 2016. While the concept of urban FAI does not correspond the standard notion of fixed investment in China's national accounts, decline in FAI has been a good predictor of slowdown in fixed investment growth in this decade.

Consumer price inflation slowed in July to 1.4 %. Producer price inflation was 5.5 % for the third month in a row.

Headline indicators of Chinese economic performance



Sources: Macrobond, CEIC, BOFIT.

China seeks to be the world leader in artificial intelligence. China's State Council last month released an ambitious national development guideline on pushing the frontiers of artificial intelligence (AI). The development of AI technologies is to be promoted through legislative policy, including tax breaks. The State Council has also encouraged Chinese firms to gain AI expertise from abroad through mergers or acquisition. AI refers to machines and devices (e.g. smart cars and robots), as well as software that mimic human reasoning.

The AI directive has a three-step goal. First, make China a global player in AI by 2020 by reaching the level of leading countries in AI technologies and their utilization. Second, become a world leader in AI by 2025. Finally, make China the global centre of AI innovation by 2030.

AI offers the Chinese economy remarkable economic opportunities. For example, the McKinsey Global Institute notes that about half of jobs now performed in China could be fully automated. McKinsey and others point out that AI could significantly boost Chinese economic growth. So, China's political leaders want to make AI the new engine of economic growth.

Artificial intelligence has applications outside manufacturing and commerce that crosses many disciplines from psychology and medicine to military technology and social control. Global interest has recently been piqued by the Chinese planners' intension to construct an Orwellian-sounding "social credit system," whereby every citizen would be scored for social reliability based on his or her online and other behaviour.

China's recently tightened censorship rules are directly at odds with the freedom demanded by an innovation economy. For example, president Xi Jinping's calls for tighter ideological controls at universities are unlikely to promote free thought or effective use of research time. In practice, the push for ideological purity limits the access of Chinese researchers to studies in related fields by their colleagues abroad. In recent weeks, China has initiated a crackdown on virtual private networks (VPNs) that are used to circumvent online censorship. Apple recently had to pull over 60 VPN apps from its Chinese App Store. Media reports also claim Amazon has been pressured to remove VPN apps from its Chinese cloud servers.

CPC tries to elevate its role in China's state-owned enterprises. Media reports claim the recent campaign by the Communist Party of China (CPC) to increase the state's role in corporate operations is increasingly apparent even for Chinese state-owned enterprises (SOEs) listed on the Hong Kong stock exchange. The *Wall Street Journal* reports that at least 32 Chinese firms listed on the Hong Kong exchange have amended their corporate articles of incorporation since 2016 to give a CPC committee an advisory role in board decisions. Most of these changes have occurred in recent months. The *Financial Times* noted that the articles of association in roughly 100 SOEs held by the central government and administered by the SASAC had been amended to increase the party's role in firm governance.

It is unclear why there is now a need to elevate the role of party committees and how the campaign pertains to planned reforms designed to make SOEs more efficient. An important part of corporate reforms is incremental privatisation of SOEs to increase the efficiency of their governance and operations. It is difficult to see how the strengthening of party committees would help to reach these goals particularly as the pool of competent people for such committees remains limited.

The efforts of the CPC to increase power in governance of listed SOEs is at odds with promised market reforms and quite off-putting to foreign investors. The matter could even affect current policy debates in Europe and North America on restricting Chinese investment and corporate acquisitions.

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