Weekly Review
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BOFIT

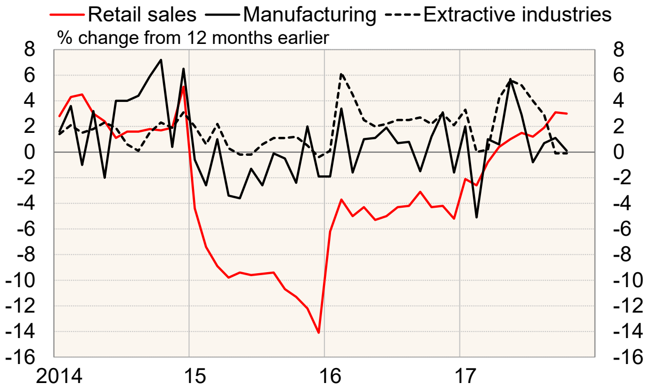
Russia

Recovery in Russian output stalls. The Russian economy performed poorly in October. After already contracting for a couple of previous months, workday- and seasonally-adjusted industrial output fell again a tiny bit last month. Output was lower than in the spring and summer, and unchanged from a year earlier. The contraction in output of extractive industries (including oil & gas) halted with October and September output on par with a year earlier. Crude oil production in September-October was smaller than a year earlier, and the boom in natural gas production earlier this year has subsided. Seasonally-adjusted manufacturing output has remained largely flat in recent months, and in October output was unchanged from a year earlier. Manufacturing output was pressed down by the metal industries and oil refining.

Following good growth in August and September, October agricultural output was down from a year earlier. The continued slight slide in construction last month brought a substantial on-year drop. In contrast, the volume of goods transport still in October was considerably higher than a year earlier.

The recovery in retail sales continued in October. As in September, the volume of retail sales was up 3 % y-o-y. The high fixed investment growth of the second quarter faded to a couple of per cent in the third quarter.

Russian retail sales and industrial output, 2014–17

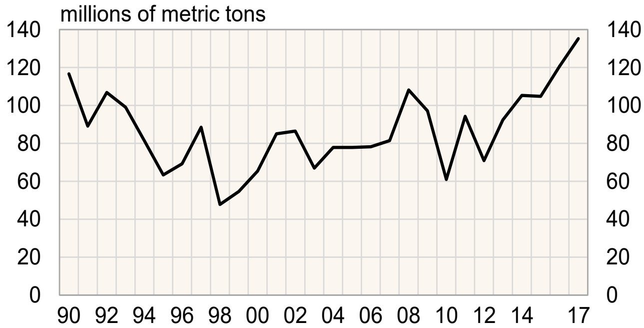


Sources: Rosstat.

Russia posts record grain harvests. By the conclusion of the harvest season on November 1, over 135 million metric tons of grains and other grain staples had been harvested – an all-time record for Russia. The harvest was 13 % larger than last year's and 45 % larger than the annual average harvest over the previous decade. The record harvest was entirely due to a strong improvement in crop yields. This and previous years have no longer seen increases in the area of land under cultivation. Harvests of other important staples, i.e. potatoes, sunflowers, sugar beets and vegetables were lower than last year, but the brisk growth of previous years meant that the harvests were still fairly large.

While the share of farm cooperatives, farming corporations and similar organisations has gradually declined, they still produce over 70 % of grains and other grain staple crops. Private career farmers (Russian *fermeri*) have gradually increased their share towards 30 % of all those crops. Small home plots continuously account for nearly 80 % of potato production and about two-thirds of vegetable production.

Grain and grain staple harvests in Russia, 1990–2017



Source: Rosstat.

Proposed changes to Russian legislation could reduce economic transparency. The government this week submitted to the Duma draft legislation that modifies rules on public disclosure of certain financial information. Protections from disclosure were earlier limited to state secrets. Under the bill, the government can define also other special cases for which it can restrict disclosure of financial information.

For corporations, the changes would affect e.g. financial reporting and auditing. Information related to the special cases determined by the government could not be published with financial reporting. If this information is impossible to decouple from other business activities, effectively all financial reporting could not be published. The same principle would apply to auditing as well. The government could define also for public procurements special cases for which information would not be publicly disclosed. Under current legislation, open tenders on internet must be arranged for most public procurements. In addition, the list and selection criteria for banks allowed to perform financial operations related to government defence orders would no longer be public.

The explanatory note for the draft proposal refers e.g. to national security and securing defence capabilities. Many observers see the proposal as a response to the threat of widened US sanctions against Russia. Anatoly Aksakov, chairman of the Duma's financial markets committee, said the bill would primarily concern companies operating in the defence industry, and possibly some other strategic companies. Some observers worry that the changes would promote abuses in public procurements and reduce transparency in business.

The proposal will be taken up by the Duma next month. The government is expected to prepare the specifying decrees for the bill by mid-December.

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China

Chinese debt levels continue to rise. The People's Bank of China reports that its broad measure of private-sector borrowing (total social financing or TSF) rose by 13 % y-o-y in October. Growth has continued at roughly the same pace over the past three years. 70 % of the total credit stock now consists of bank loans, 15 % of shadow-banking sector credit (trust loans, entrusted loans and bank bills) and 15 % as corporate bonds and equities. Flows of credit via the shadow-banking sector have witnessed a sharp increase this year, with the stock of shadow-banking credit up 19 % y-o-y in October. In contrast, growth in corporate bond issues slowed to 5 % y-o-y as interest rates on bond markets have risen and the costs of bond financing for firms has increased.

Chinese indebtedness has caught global attention as such rapid increases in debt have earlier ended in financial crisis in many countries. Even China's own leaders have begun to stress the need to rein in or mitigate financial market risks and do something about the current debt craze. While the growth in credit overall has remained stable, China's nominal GDP growth has accelerated with the pick-up in price inflation. This trend has significantly slowed growth in the debt-to-GDP ratio. The PBoC's TSF measure suggests that the debt-to-GDP ratio fell slightly in the second and third quarters. Seasonal variation in the total credit stock, however, is quite large. When seasonal swings are taken into consideration, the debt-to-GDP ratio is likely rising.

Figures from the Bank for International Settlements (BIS) show that the structure of Chinese debt has shifted slightly. The ratio of corporate debt to GDP has seen a marginal decline, while indebtedness of households and the public sector has increased rapidly. The BIS reports that China's debt-to-GDP ratio was 258 % at the end of March.

China tightens regulation of asset management products. In a joint statement released last week, the People's Bank of China and banking, insurance, securities and foreign exchange regulators announced new unified regulations on asset management products. The rules not only bring consistency to regulation of products and providers, but clarify the properties of investment products. The new rules also seek to rein in banks' efforts to circumvent financial regulation through the use of asset management products. Seller can no longer promise fixed or guaranteed returns. Firms must also set aside 10 % of their fees collected from investors to offset investment losses. The comment period on the proposed regulations runs until mid-December, and the period of transition to the new regime extends through June 2019.

Demand for asset management products in China has soared on the promise that such products offer much higher returns than bank deposits. Even with a vast range of investment options, large investment losses are seldom reported as the asset product sellers prefer to cover investor losses out of their own pockets. Investors also assume asset management products to be implicitly backed by the government.

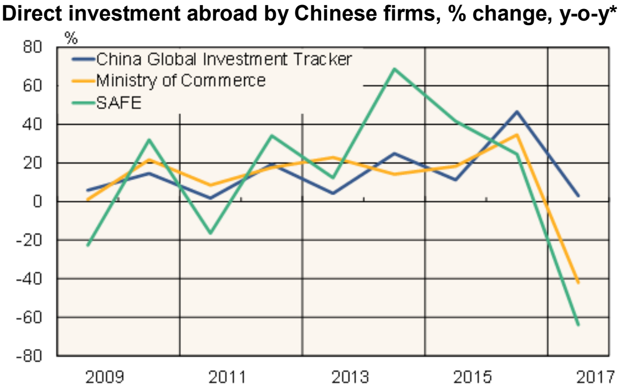
Outward FDI growth of Chinese firms stalls this year. To deal with outflows of foreign currencies, declining forex reserves and depreciation pressure on the yuan, China over the past year has significantly tightened its rules on limiting and monitoring capital exports. The stricter rules also affect foreign direct investment (FDI) of Chinese firms.

Difficulties in keeping track of outward Chinese FDI mean that estimates vary widely. For instance, China Global Investment Tracker (CGIT), which is run by the American Enterprise Institute, tries to monitor all investments of Chinese firms that exceed 100 million dollars. CGIT indicates the outward FDI of Chinese firms last year amounted to 171 billion dollars. China's commerce ministry reports that FDI outflows from China in 2016 amounted to around 196 billion dollars. The State Administration of Foreign Exchange (SAFE), which compiles the data for China's balance-of-payments reporting, claims 217 billion dollars in outward FDI last year. Although estimates on FDI volumes rarely agree due to differences in methodologies and intended uses of the figures, the statistics of all the above organisations suggest that investment growth rose rapidly up until last year.

This year's trend has been substantially weaker. The commerce ministry and SAFE report that the outward FDI of Chinese firms contracted by 40–60 % y-o-y in the first nine months of 2017. CGIT notes, however, that FDI in the first half remained at about the same level as in 1H16, largely due to the June booking of the acquisition of Swiss Syngenta by ChemChina for 41 billion dollars. When the Syngenta deal is excluded, Chinese outward FDI as measured by CGIT declined by over 40 %.

Chinese FDI abroad last year exceeded China's FDI inflows for the first time. The trend has now reversed. The commerce ministry valued Chinese outward FDI (excluding financial sector) in the first ten months of this year at 86 billion dollars (-40 % y-o-y), while inward FDI to China was valued at 101 billion dollars (-3 %). It is unclear whether China's own figures will include the Syngenta deal.

Direct investment abroad by Chinese firms, % change, y-o-y*



** 2017 data refer to the situation in September or June (CGIT).*
Sources: CGIT, CEIC, BOFIT.

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