Weekly Review
3 • 19.1.2018

BOFIT

Russia

Russian foreign trade continues to recover; capital outflows up slightly. Russian revenues from goods and services exports, as well as spending on goods and services imports were each up roughly 20 % y-o-y in the final quarter of 2017. Growth in goods imports was about 20 %. Russian spending on travel abroad was up by nearly 30 %, matching the growth pace of previous quarters. The trade and current account surpluses of the fourth quarter were notably large on export earnings from higher oil prices.

Russian foreign trade continued to climb out of a deep two-to-three-year hole. Even with the recovery, however, levels of revenue and spending on goods and services trade in the last quarter of 2017 were still several per cent below the 2014 level and about 20 % below the level of 2012–13.

Net outflow of private capital abroad was quite notable in the latter half of 2017. The corporate sector (excluding banks) received relatively little foreign direct investment. The outflow of corporate FDI from Russia continued evenly over the course of last year and was slightly larger than FDI inflows. Companies made only small repayments of their foreign debt. In the second half of 2017, other outflows of corporate capital showed an increase. Banks, in contrast, actively paid down their foreign debts throughout the year.

Main Russian balance-of-payments categories, 2015–17

	USD billion			% of GDP		
	2015	2016	2017 (preliminary)	2015	2016	2017 (preliminary)
Current account	**69**	**26**	**40**	**5.0**	**2.0**	**2.6**
- Exports (goods & services)	393	332	412	28.6	25.7	26.4
- Imports (goods & services)	282	266	326	20.5	20.5	20.9
Trade balance (goods)	148	90	116	10.8	7.0	7.4
- Exports	341	282	354	24.9	21.8	22.6
- Imports	193	192	238	14.1	14.8	15.2
Services trade balance	-37	-24	-30	-2.7	-1.8	-1.9
- Exports	52	51	58	3.8	3.9	3.7
- Imports	89	74	88	6.5	5.7	5.7
Other current account	-43	-41	-45	-3.1	-3.2	-2.9
Financial account & net errors	**-67**	**-17**	**-17**	**-4.9**	**-1.3**	**-1.1**
Government (excl. central bank)	-10	4	13	-0.7	0.3	0.8
Private sector total (A+B)	-58	-20	-31	-4.2	-1.5	-2.0
A. Banks	-34	1	-29	-2.5	0.1	-1.8
B. Other private sector	-24	-21	-3	-1.8	-1.6	-0.2
- Direct investment	-14	11	-7	-1.0	0.8	-0.4
- Inbound	6	31	23	0.5	2.4	1.5
- Outbound	20	20	30	1.5	1.6	1.9
- Portfolio investment	-8	-4	-11	-0.6	-0.3	-0.7
- Inbound	-5	0	-6	-0.3	0.0	-0.4
- Outbound	3	4	5	0.2	0.3	0.3
- Foreign currency cash *	14	5	6	1.0	0.4	0.4
- Fictitious transactions	-2	-1	-1	-0.1	-0.1	-0.1
- BoP net errors and omissions	3	-5	4	0.2	-0.4	0.2
- Other	-18	-28	6	-1.3	-2.1	0.4

* Positive value = decrease in the stock of foreign cash

Source: Central Bank of Russia.

Russian currency reserves rose by 55 billion dollars last year. The largest gains came from exchange rate fluctuations and gold reserves. Increase due to transactions was 23 billion dollars. Under the current monetary policy, the Central Bank of Russia abstains from intervention in forex markets and therefore direct interventions did not cause any changes in currency reserves. The CBR, however, did buy on behalf of the finance ministry last year roughly 15 billion dollars in foreign currency to soften the effects of oil price volatility on budget revenues and ruble exchange rate. Currency reserves also increased due to Russian banks' repayments of foreign currency liquidity that the CBR provided them earlier.

At the beginning of the year, Russia's foreign currency and gold reserves were valued at 433 billion dollars: 77 billion dollars in gold reserves, 10 billion dollars in SDR and IMF obligations and the rest 347 billion dollars in other reserves. Russia's oil fund savings account for over 50 billion dollars of the other reserves. Most of Russia's reserves are held in dollar- or euro-denominated assets. Chinese yuan assets represent about 0.1 % of currency holdings. Based on common rules of thumb, Russia's currency reserves appear quite solid. They are sufficient to cover about 17 months of imports or five times its short-term foreign debt.

Concerns over Russia's regional budget deficits. Regional budgets (consolidated budgets of the regional and local levels) represent slightly over a third of Russia's government-sector spending. Regional budgets are largely responsible for funding housing, education and culture as well as covering a big bulk of health care costs. Most of the government sector's low-paid employees are on the payrolls of regional or local governments. Since 2012, defined government-sector wage hikes and other spending increases have been a considerable strain on budget balances in some regions in particular.

Rising regional indebtedness in 2013–15 reflects the fact that many regions covered their deficits with bank loans. In 2015, debt-servicing costs of regions were reduced by refinancing these bank loans with three-year loans from the federal budget. Even so, some regions have been overwhelmed by their debt-servicing costs. In October, several regions, including the Republics of Udmurtia, Khakassia and Karelia, publicly requested help from the finance ministry to cover their expenses. Some of the federal budget loans maturing this year will now be turned over with extended maturities and lower interest rates.

As a whole, regional budgets are almost in balance, but there are large variations across regions. Many regions have limited opportunities to lower spending or increase revenues. About half of regional budget revenues come from corporate profit taxes and personal income taxes. Transfers from the federal government to regional budgets on average account for less than 20 % of total revenues. Transfers, however, fund about 40 % of regional budgets in the Far East Federal District and about 70 % in regions of the North Caucasus. The two federal districts each have a number of poor regions that are completely dependent on budget transfers and budget loans.

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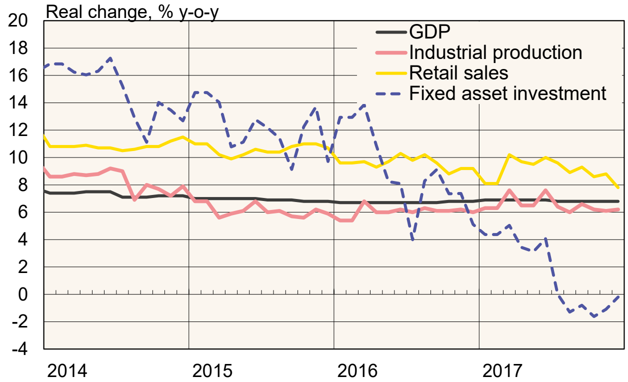
China

China's latest GDP growth figures in line with expectations. China's National Bureau of Statistics reports GDP growth last year being 6.9 %; 6.9 % in the first two quarters of 2017, and 6.8 % in the last two. GDP grew by 11.3 % in nominal terms to 82.712 trillion yuan (12.2 trillion dollars).

Many economists do not take China's official GDP growth figures at face value due to their uncanny consistency and failure to reflect business cycles, especially when other key indicators exhibit large movements. One of the most striking aspects is that significant slowdown in fixed asset investment (FAI) does not seem to have affected the GDP growth rate although investment is a major part of the aggregate demand.

Performance indicators for China's real economy



Sources: CEIC, Macrobond, BOFIT.

New cases of fudged statistics at provincial and local levels. A year ago, news of a long-running statistical fraud in the Liaoning province emerged. It was the tip of the iceberg apparently. Three weeks ago, officials in the Inner Mongolia Autonomous Region admitted they had artificially inflated their 2016 fiscal reporting. When corrected, the figure for industrial output was 40 % lower and regional tax revenues down by 26 %. Two weeks ago, the city of Tianjin announced that it had revised 2016 GDP figures for the Binhai New Area down by a third. This week, officials from Inner Mongolia's industrial city of Baotou, a relatively small city of 2.9 million, admitted to overstating fiscal revenue figures last year by about double.

Inner Mongolia accounted for about 3 % of China's officially reported economic output in 2016. The Binhai zone's contribution was just over 1 %. While the economic impact of these regions is marginal relative to the Chinese economy overall, there is a high probability that more statistical frauds will emerge at the local and provincial levels. Revelations of statistical fakery also reinforce scepticism about China's national GDP figures. The latest revision of the 2016 national GDP figure was just confirmed and the recent statistical frauds appear to have no impact on the growth rate.

Inner Mongolia's regional government, already stung by the false statistical reporting, this week confirmed that it had suspended work on Baotou's subway project, as well other infrastructure projects in the regional capital of Hohhot. High growth targets and lax monetary policy for years sustained gigantic, sometimes unprofitable, investment projects and added to regional government debt.

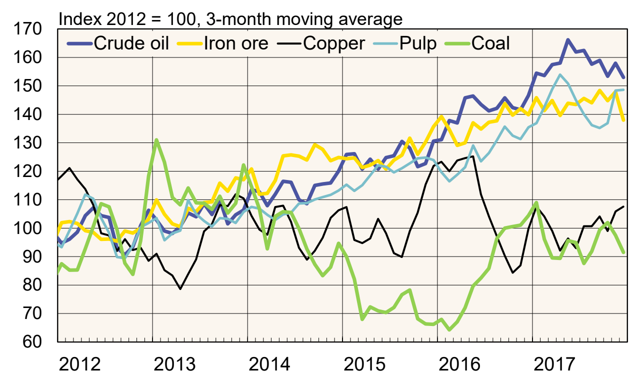
Growth rate in Chinese imports outstripped exports last year; trade surplus shrank. After two years of contraction, China's goods exports measured in US dollars rose last year by 8 % to roughly 2.265 trillion dollars. Driven by higher global commodity prices, the value of imports began to increase in late 2016 and continued throughout 2017. Last year's gain was 16 % to 1.84 trillion dollars. The volume of imports increased in the first eleven months of 2017 by an average of 11 %, while the volume of exports rose by 7 %. For all of 2017, the foreign trade surplus fell to 420 billion dollars, down by 90 billion dollars from 2016.

The rise in import volumes of key commodities continued. Highest growth last year was for pulp (up 13 %) and crude oil imports (10 %). Import volumes increased for coal (up 5 %) and iron ore (6 %), but with lower growth than in 2016. Copper was the exception; volumes were down by 5 % (copper prices rose nearly 30 % last year).

The EU last year increased its share of Chinese exports and imports. The value of exports to EU countries was up 13 % from 2016, and the value of imports from the EU was up by 21 %. Exports to the US, China's second-largest trading partner, were up by 12 %, while US imports rose by 5 %.

The structural evolution of the Chinese economy is well reflected in its trade figures. Over the past ten years, the ratio of foreign trade to GDP has fallen by nearly half. In 2017, exports accounted for 19 % of GDP and imports 15 %. Before the global financial crisis hit in 2008, exports were at 35 % and imports at 27 %. Structural reform is also apparent in supply chains and processing trade, which now accounts for a reduced share of total trade. E.g., imports of goods which are meant to be processed further accounted for 29 % of trade in 2017, down from nearly 50 % a decade ago.

Import volumes of key commodities to China



Source: Macrobond.

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