Weekly Review
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BOFIT

Russia

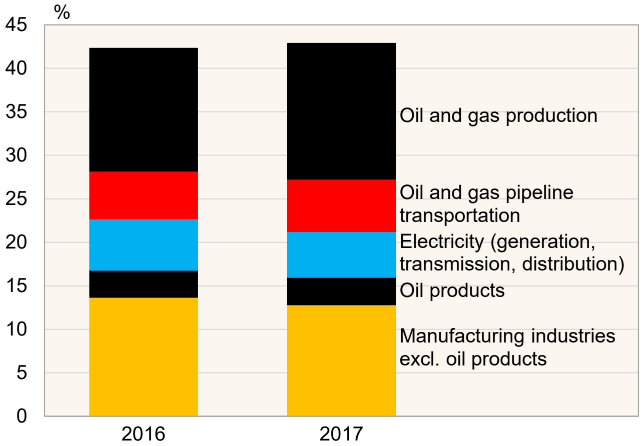
Russian investments focused increasingly on oil & gas last year. After years of contraction, Russia's total fixed investment grew by 4.4 % in 2017. The fresh Rosstat figures show, however, that the recovery in the first nine months of the year was more tepid than earlier figures suggested, and that strong growth was concentrated in the fourth quarter. Despite the come-back, fixed investment was still down by nearly 8 % from 2013, and on par with the 2008 or 2011 levels.

Fixed investment of large and medium-sized companies (LMEs) and the state sector increased by over 4 %. Rosstat regularly tracks these investments in its fresh investment statistics, and its figures show they have represented about 75 % of all fixed investment in the past few years. Rosstat estimates that other fixed investment (by small firms, households and grey economy) rose roughly 5 % last year.

After growing briskly in previous years, LME and state investment in oil & gas production increased by 13 % last year. Investment in pipeline transmission rose by 12 % after two years of contraction. Over half of LME and state investment growth came from investment in oil & gas production or pipeline transmission. After two years of decline, investment in production of oil products rose slightly. Fixed investment in the electrical power sector contracted for the fifth consecutive year. The combined share of the four energy blocks increased to 30 % of all fixed investment.

The two-year decline in investment in manufacturing industries (excl. oil products) moderated. Last year's contraction was due to the decline in investment in metal industries. The chemical industry, the other large investment branch in manufacturing, saw an investment drop after several years of growth.

Shares of oil & gas, electricity and manufacturing in total fixed investment of large and medium-sized companies and the state



Source: Rosstat.

CBR prepares strategy paper on improving access to banking services in 2018–2020. While access to banking services in Russia overall is quite satisfactory by international standards, disparities across regions and various population groups are large. Many pensioners, for example, have poor access to banking services, and about a third of them do not even have bank accounts. The key goals of the strategy draft paper concern access to high-quality financial services outside big cities and development of online banking services. These goals necessarily overlap, as web and mobile services are seen as critical in bringing banking and other financial services to households even in small localities and sparsely populated areas. Digitalisation of financial services and financial supervision are also supported in the central bank's 2018–2020 Fintech programme.

Besides technical solutions, expansion of access to financial services requires greater financial awareness. Survey studies in recent years have found that the average Russian's level of financial literacy is quite rudimentary. In particular, understanding of basic economic concepts such as inflation and interest rates is feeble. In October 2017, the government approved a strategy developed by the finance ministry and CBR to promote financial literacy during 2017–2023. The financial literacy campaign seeks, among other things, to introduce new teaching materials, both online and printed, laying out fundamental economic concepts to be integrated into regular school curricula.

Gas dispute between Russia and Ukraine continues to flame. The Stockholm arbitration court ruled last week (Feb. 28) on gas transit fees as part of the Gazprom–Naftogaz dispute. The court said Gazprom should pay Naftogaz $4.56 billion in lost transit fees. The court also found that the contract obliges Gazprom to pay transit fees for the expected 110 billion cubic metres of gas to be transmitted via Ukrainian pipelines through to the end of 2019.

In the arbitration court's ruling in December 2017 on gas supplies to Ukraine, Naftogaz was ordered to pay Gazprom $2 billion for its unpaid gas bills. Naftogaz's take-or-pay purchases were limited to 5 billion cubic metres per year in the 2018–2019 contract period. In practice, Ukraine has not imported any gas from Russia since 2015. Following the decision, the companies agreed to resume gas deliveries in early March.

Gazprom, however, rejected last week's arbitration court decision, noting it would not abide by the transit or take-or-pay findings. Consequently, Gazprom also rejected the agreement on resuming gas supplies to Ukraine, forcing Naftogaz to cover its gas needs with imports from Poland and elsewhere. If negotiations continue to drag on, it is possible that the matter will not be resolved before the current contract term expires at the end of 2019.

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China

The official GDP growth target continues to dictate China's economic policy. In his opening address to the 3,000 delegates at National People's Congress (NPC) on Monday (Mar. 5), premier Li Keqiang laid out this year's growth targets. He said the country would seek GDP growth of "about 6.5 %" and the same inflation ceiling as last year, i.e. 3 %. Unlike earlier, no targets were announced for growth in the money supply or credit stock. New goals included the creation of 11 million jobs in cities and reducing the number of rural poor by 10 million.

Economists have long wished that China would abandon numeric GDP targets, because such targets in China's current situation leads to distortionary economic policies. Even so, China continues to adhere doggedly to its goal of doubling 2010 GDP by 2020, a goal that requires growth above 6 % p.a. over the next three years. The pursuit of this goal will likely exacerbate difficult debt issues and increase risk to the stability of the financial system.

For the first time ever, China has set an unemployment target based on surveys of urban areas. This year's target level is less than 5.5 % for this survey-based unemployment rate, which includes, among other things, migrant workers. The National Bureau of Statistics has published a survey-based unemployment rate for 31 cities since 2016. The rate has remained steadily in the range of 4.8–5.1 %. The NBS also compiles a survey-based nationwide unemployment figure, but that figure is only released sporadically. A comprehensive unemployment figure will be important for setting policy if officials want to reduce their reliance on GDP targets.

The NPC meeting will adjourn in the latter half of this month. Several major appointments and constitutional amendment are expected, including an end to presidential term limits.

Assessing true condition of China's public sector finances remains challenging. Under the draft proposal presented to the NPC, the combined deficit of China's central and local government budgets this year will amount to 2.6 % of GDP. Last year's 3 % deficit target was exceeded by about one percentage point, as actual spending exceeded budget.

This year's budget reflects the policy lines formulated in the autumn. Spending will be boosted for poverty eradication and environmental protection. Defence spending and the larger spending category of domestic security will increase faster than the budget overall. Budget revenues should match nominal GDP growth (9 %), while spending will lag slightly.

The IMF notes that China's local governments have been burdened with some of the world's heaviest spending obligations – without much possibility to influence revenue streams. Partly for this reason, local governments have had to constantly increase their debt loads, only part of which is visible in official budget statements. A reform plan published in 2016 was intended specifically to address this revenue and spending imbalance.

Whatever is happening China's public sector finances is difficult for outsiders to decipher. Chinese budget figures are not comparable to those of other large economies. The IMF's own estimate of public sector finances in 2016 was: 28 % of GDP for revenue, 32 % of GDP for spending and nearly 4 % of GDP for deficit. When off-budget activities of local governments are included, the IMF, using a wider definition of deficit, finds that the 2016 deficit was as high as 12 % of GDP.

Combined central and local government budget, % of GDP

	2014	2015	2016	2017	2018
Revenues	22	22	21	21	21*
Expenditures	24	26	25	25	23*
Deficit	2	3	4	4	2.6*
Expanded deficit **	10	10	12	13	13

* China's Ministry of Finance budget proposal, nominal GDP expected to rise 9 % p.a. in 2018.
** IMF estimate based on augmented budget definitions.

Sources: China's budget report 2017–2018, IMF and Macrobond.

China may introduce retaliatory measures as the US goes ahead with steel and aluminium import tariffs. On Thursday (Mar. 8), president Donald Trump made good on his blunt protectionist threat to apply general import tariffs on steel (25 %) and aluminium (10 %). However, it is still unclear whether "allies" will be exempted, and thus the question of possible countermeasures remains open. Canada is by far the most important supplier of these products to the US.

China is not a major provider of steel and aluminium products to the US nor do the exports of affected products ($2 billion per year) play a big role in Chinese exports. The tariffs are unlikely to reduce the US trade deficit with China. The value of affected Russian metal products sent to the US is about the same as for China, but the US aluminium market is important to Russia.

China has been a popular whipping-boy of Trump-era trade policy. First major tariff hikes were introduced in January, when 20–50% punitive tariffs were placed on Chinese solar panels and washing machines. Last month, the US also decided on anti-dumping tariffs on Chinese aluminium foil.

The politburo's top economic advisor Liu He last week travelled to Washington DC to discuss China-US economic relations. The talks were confidential, but the countries promised to continue discussion of trade policy disputes in Beijing. China has threatened a response to the tariff hikes, but to ease tensions, it has also repeated its commitment to opening up its markets to the world.

China's overproduction and subsidising of steel have fuelled of a long-running dispute also with the EU. The EU imposed a 17–28 % anti-dumping tariff on Chinese corrosion-resistant steel last month. This week the EU announced it would also continue its antidumping tariffs on steel pipe.

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