Weekly Review
11 • 16.3.2018

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Russia

Russian oil production expected to remain at current levels also this year. Russia last year produced crude oil about 546 million metric tons or 11 million barrels a day (gas condensates included). Production levels were about the same as in 2016. Russia is one of the world's largest oil producers, accounting for about 11 % of global production. Most of Russia's oil still comes from its traditional production areas in the Ural and Volga federal districts. The share of the Ural Federal District, however, has contracted in recent years as new oil fields have come on stream in Eastern Siberia and the Far East. Several forecasts see Russian oil production remaining at current levels this year due to Russia's voluntary production ceiling agreement with OPEC. In 2019 and 2020, Russian oil production is expected to rise at 1–2 % a year.

Crude oil and oil products are still by far Russia's top export products. Last year they accounted for over 40 % of Russia's goods export income, or just over $150 billion. The volume of crude oil exports, however, declined by 1 % and oil products by nearly 5 %. Russia's economy ministry expects the total export volume of oil and oil products to increase by less than 1 % a year in 2018–2020. Most Russian exports of crude oil and oil products still go to EU countries, but last year China became Russia's largest single crude oil customer, accounting for over 20 % of Russian oil exports.

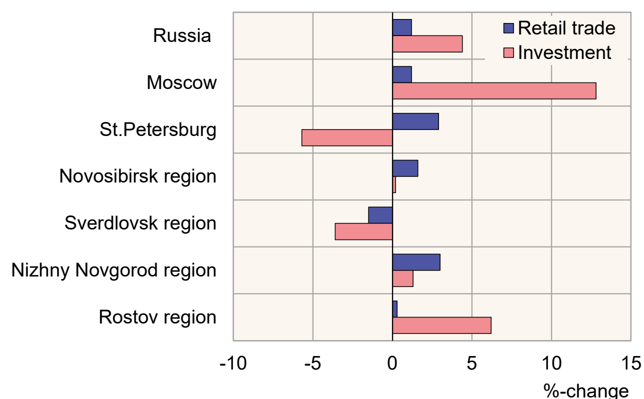
Uneven development in Russian regions last year. While Russian industrial output and retail sales overall grew by about 1 % last year, industrial output growth across federal districts (FD) ranged between 1–3 %. Retail sales increased in nearly all federal districts by 1–2 %, even if real incomes continued to fall in all federal districts except the Northern Caucasus. Industrial output and retail sales in Moscow increased near the average pace, while growth in St. Petersburg was somewhat higher.

Variations in fixed investment and construction were greater. Nationally, fixed investment increased by 4 %, while construction activity decreased by just over 1 %. Supported by e.g. the Power of Siberia pipeline project, fixed investment in the Far East FD soared by 17 % and construction by 9 %. Growth was also strong in the illegally annexed Crimea, due largely to the construction of the federal budget funded Kerch Bridge. About 13 % of all federal budget fixed investment last year went to Crimea and Sevastopol, whereas only about 9 % of investment went to the North Caucasian FD, 6 % to the Far East FD and 4 % to Arctic regions. In contrast to other federal districts, fixed investment contracted by 4 % in the Volga FD and construction fell by 12 % in the Northwestern FD on weak trends in St. Petersburg and the Komi Republic. In other regions of the Northwestern FD, however, fixed investment and construction grew rapidly. Regional variation within all federal districts was again large.

The economic recession of recent years has overall been reflected unevenly in the economic performances of Russia's regions. While Russian GDP overall contracted by about 3 % in 2015–2016, GDP growth across Russia's over 80 regions ranged from a contraction of 12 % to growth above 20 %. While there seems to be no clear geographical patterns, growth regions included e.g. northern oil and gas producer regions (Nenets and Yamalo-Nenets autonomous okrugs), the Republic of Chechnya (which relies heavily on federal budget funding) and the Tula region (which has benefitted e.g. from heavy defence spending in recent years).

Income levels also vary widely across regions. In terms of purchasing power, Russia's richest regions include Moscow and St. Petersburg, while the poorest regions are found in ethnic minority-dominated republics in southern and south-eastern Russia such as Ingushetia, Tuva and Kalmykia.

2017 retail trade and investment growth in selected regions, %



Source: Rosstat.

Russia and China score low in the OECD services trade index. The OECD's Services Trade Restrictiveness Index (STRI), published annually, compares regulatory environment of services trade across 44 countries and 22 service sectors. The STRI considers e.g. restrictions on foreign entry, restrictions on movement of people, barriers to competition and regulatory transparency.

The just-released STRI reading for 2017 places Russia and China near the bottom, with India occupying the cellar. Most of the numerous service-sector restrictions in these countries focus on market entry of foreign firms. Especially Russia's weak performance, however, reflects largely general problems with its business environment, not just restrictions related to its service sector.

The service industries with least restrictions in Russia are legal and accounting services, whereas the most restricted ones are logistics and warehousing services. The OECD reports that restrictions on services in Russia have increased in recent years e.g. with the new law on storing personal information. In China, the least restrictions are imposed on architectural and engineering services, and the most on courier services and the media branch. According to OECD, China has reduced barriers to services trade in recent years, particularly with regard to rail freight.

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China

National People's Congress blesses party's constitutional supremacy with almost no dissent. On Sunday (Mar. 11), the National People's Congress (NPC) voted near unanimously for a package of constitutional amendments that bolster the power of the Communist Party of China (CPC) and blur the boundaries between the CPC and state. The most debated of the 21 amendments has been the elimination of presidential term limits. In practice, presidency of the state is entitled to the CPC secretary general, who also serves as commander-in-chief of the military. The terms of the latter two posts were never limited to definite periods. Xi became the first living Chinese leader since Mao to have his name inscribed in the party articles, and on Sunday his personal ideology "Xi Jinping Thought" was incorporated into the preamble of the Chinese constitution.

The NPC also approved the party's proposed broad administrative reforms of state institutions. Parts of old ministries and agencies will be eliminated and merged, while new ones will be created, raising the total number of ministries and commissions by one to 26. For example, the banking and insurance supervisory commissions will be combined, while the pursuit of macroeconomic stability will shift in part to the central bank. The market regulatory authority will occupy the field in such areas as corporate antitrust and competition regulation as well as product safety. The new national health commission will now focus on the challenges presented by an aging population. The Ministry of Environmental Protection will be bolstered by the integration of activities currently performed in several other ministries and agencies. Appointments to top leadership positions will be made before the NPC adjourns next Tuesday (Mar. 20).

The constitution was amended to include a newly created National Supervisory Commission. It comprehensively oversees the country's internal monitoring, anti-corruption activities, ideology and political work on behalf of the party.

Accepted constitutional amendments enable CPC to take a firmer grip on society. Although the NPC has never rejected a proposed amendment from the party, open opposition now appears to be rarer than before. The constitutional amendments were approved in a vote of 2,958 to 2. After the changes enter into force, the CPC will be China's sole governing authority under the constitution. Official addresses to the NPC stressed strengthening the party's role in governing as crucial to administrative efficiency and moving ahead with reforms.

China broadens capital tools for banks and lightens provisions for non-performing loans. Tighter regulation of shadow banking credit instruments is hoped to move lending back to banks' balance sheets, but could at the same time weaken banking sector profitability and erode capital buffers. Therefore, the China Banking Regulatory Commission (CBRC), the PBoC and three other regulators released a guidance on increasing bank capital and encouraging the increased use of "innovative" debt instruments for this purpose.

The IMF warned in December that China's banking sector needed to increase capital to bolster financial stability. International credit rating agency Fitch also warned that capital levels in big Chinese banks fail to meet international standards. Even with a nominal 9 % increase in bank total assets last year, the credit stock increased even more (by 13 %). Agricultural Bank of China recently announced it would increase its capital base by selling 100 billion yuan ($16 billion) in shares to government-connected investors.

The CBRC also eased provisions that banks need to set aside for non-performing loans (NPLs). Banks were earlier required to set aside 150 % of their NPL aggregate and 2.5 % of the bank's total loan stock. Now these buffers can be applied on a bank-by-bank basis. The loan-loss provisions can be decreased to 120 % of the NPLs and to 1.5 % of total loans. Officials say this is intended to encourage banks to be more frank in declaring NPLs and should encourage them to write down NPLs faster. Banks currently have considerable leeway in determining which loans are reported as non-performing.

While the 120 % requirement is still high by international standards, it is widely believed that Chinese banks extensively under-report their NPLs. Official figures show the NPL ratio for the banking sector overall is below 2 % (and just over 5 % including the "special mention" loans that are likely to be non-performing). In contrast, the IMF estimates that 13 % of Chinese bank loans at end-2016 were likely non-performing. The CBRC has recently tightened banking supervision and imposed fines on several banks for NPL concealment.

While the new measures are hoped to promote bank lending to support growth, smaller NPL buffers and novel debt instruments will increase banking sector risk exposures.

Rapid growth in Chinese R&D spending. Preliminary figures released by China's National Bureau of Statistics show that Chinese entities spent 1.750 trillion yuan ($260 billion) on research & development (R&D) in 2017, an increase of 12 % y-o-y (11 % in 2016). Firms accounted for 78 % of R&D spending, while 14 % was made by research institutes.

The ratio of R&D spending to GDP remained at 2.1 % due to rapid growth in nominal GDP. China's leaders want to increase R&D spending to 2.5 % of GDP by 2020, so it is expected that state will promote spending on R&D more aggressively this year. Much of the growth in R&D spending reflects evolution of the Chinese economy, which now strives to move from low levels of value added in goods production to high-tech goods production and services.

China still lags behind the OECD R&D spending average, which was 2.4 % of GDP in 2015. China also lags its regional competitors, Japan and South Korea. In 2015, Japan's R&D spending corresponded to 3.3 % of GDP, while South Korea spent a stunning 4.2 % of GDP. China, however, surpassed the EU average in 2012. Finland's R&D spending is about 2.8 % of GDP. Russian R&D spending has long been stuck at slightly over 1 % of GDP.

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