Weekly Review
17 • 27.4.2018
BOFIT

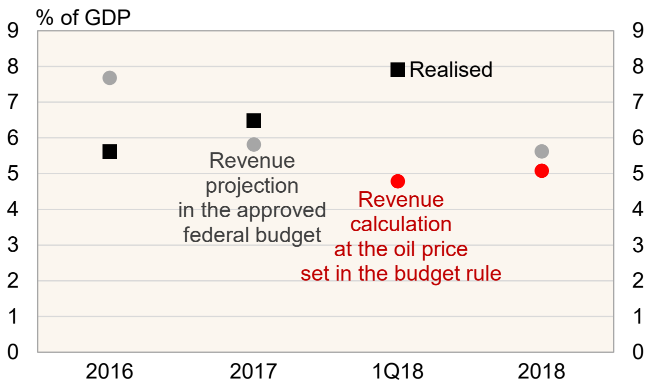
Russia

Russian government receives abundant excess oil revenues. Revenues to the federal budget continued to climb up rapidly in the first quarter of this year, rising by well over 10 % from a year earlier. Most of the revenue increase came from higher oil and gas tax revenues, which were up by over 20 % y-o-y. Rising revenues from value-added taxes provided an increase in non-oil revenues.

"Additional" budget revenues from oil and gas taxes in the first quarter corresponded to a whopping 3 % of GDP. Under the federal budget rule, additional revenues from oil and gas taxes are those resulting from an oil price above the "basic price" set in the rule (that price is applied to define budget expenditures). For this year, the budget rule sets a basic Urals oil price of slightly below $41 a barrel. The revenue projection of the approved federal budget assumes a price of just $44. In fact, the realised average Urals price in the first quarter was $65. The rule requires additional oil revenues to be set aside. Last year's excess oil earnings amounted to almost 1 % of GDP. The income set aside may be used later to cover budget deficits.

The past four quarters have seen the federal budget deficit decline to under 1 % of GDP. Under the approved 2018 federal budget, spending hardly rises at all even in nominal ruble terms this year. As a result, first-quarter spending declined from a year earlier. Defence spending increased a bit and domestic security spending more tangibly. Other spending fell quite sharply.

Oil & gas tax revenues in the Russian federal budget, 2016–2018



Source: Ministry of Finance.

Proposal on stricter import control for Russian state-owned enterprises. The proposal is related to an amendment approved at the end of 2017 that will enter into force at the beginning of July. Under that law, state-owned enterprises and their subsidiaries must seek approval from the government commission on import substitution for certain imported procurements. The law also applies to investment projects receiving state support. The current proposal details which products and services will need permission.

The law was initially planned to concern mainly ship and aircraft procurements. The newest list from the ministry of industry and trade incorporates over 200 additional products and services that extend to e.g. textiles, cement, industrial machinery and construction services. For most of the listed goods and services, the bill proposes that approval of import substitution commission would be needed for imports worth over 50 million rubles (€700,000) annually. The proposal is considered strict, but some observers expect its impact to be blunted by shortening the final list or raising the minimum ruble value on imports requiring approval.

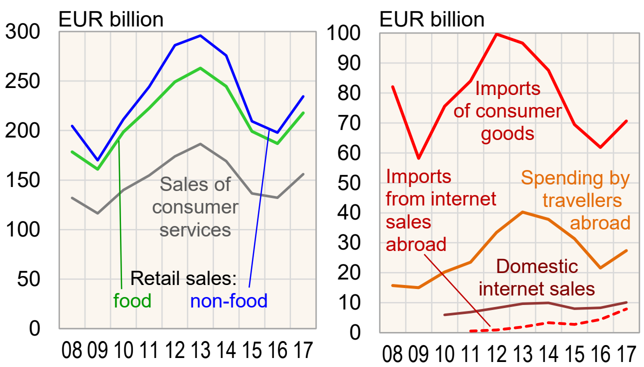
The legislative amendment is part of the government's import substitution policy that has been accentuated in recent years. The policy seeks to reduce the country's dependence on imported goods by replacing them with domestic products. The government has sought to promote import substitution especially by imposing procurement rules on the government sector and state-owned enterprises. However, these policies have so far yielded meagre results.

Russian household consumption recovers. Private consumption began to recover last year, increasing in real terms by about 3.5 % y-o-y after declining by a total of 12 % over the previous two years. Household consumption last year was slightly lower than in 2012, but still up around 25 % from a decade ago.

All the main categories of household consumption have started to revive. The strongest recovery last year occurred in spending of Russian travellers abroad on goods and services. On the other hand, consumption in all core categories last year was still far below the pre-recession peaks of several years back. Imports of consumer goods last year were still even below the 2008 level.

Domestic online sales and imports of goods ordered from foreign online sellers are still significantly smaller categories at present. After contracting during the recession two years ago, online sales have recovered. Over several years, there has been strong growth in online purchases especially from foreign sellers.

Segments related to household consumption, 2008–2017



Sources: Rosstat, CBR and the Russian Association of Internet Trade Companies (AKIT).

Bank of Finland • Institute for Economies in Transition, BOFIT
P.O. Box 160, FI-00101 Helsinki
Phone: +358 9 183 2268 • Web: www.bofit.fi/en
Editor-in-Chief Jouko Rautava• Email: Jouko.Rautava@bof.fi

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China

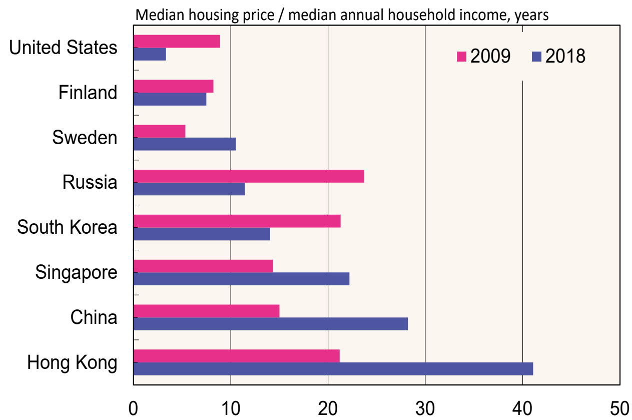
Housing price rise in China's big cities lower than national average. Real estate portal operator SouFun reports the deceleration in the average rise in housing prices continued in the first quarter of this year. Chinese housing prices in March 2017 averaged a rise of 17 % y-o-y in SouFun's survey of 99 cities. Housing prices this March were up just over 6 % y-o-y. Price growth in large cities has been considerably lower than the national average. SouFun reports that the average price of new apartments in March in its surveyed cities was 14,100 yuan (€1,800) per square metre of liveable floorspace. For example in Shanghai, apartments were going for 47,000 yuan (€6,100) per square metre.

The volume of apartment sales in the first three months of this year (measured in terms of floorspace) was up 3 % from a year ago. Because the volume of apartment building completions was down 14 % y-o-y in the first quarter, the volume of pending sales of apartments fell 25 % y-o-y. New building starts, however, were up sharply in the first quarter, with new projects up by nearly 40 % y-o-y. Most of the new starts were apartment buildings.

Despite the moderation in price growth, rising indebtedness, overbuilding and receding affordability relative to income levels cause concern. Part of the overheating of China's housing markets also reflects efforts by local governments to raise money through the sale of land use rights. Purchasing an apartment in China on average now consumes nearly 30 years of household income. Apartment affordability is even worse in big cities.

Officials hope the long-planned property tax based on appraised value will make it easier for local government budgeting, reduce speculation in housing markets and increase the popularity of renting apartments. At the National People's Congress last month, Premier Li Keqiang announced that the government will steadily push forward legislation on property tax, but no specific timetable on its roll-out was mentioned.

Housing prices compared to annual household incomes, years

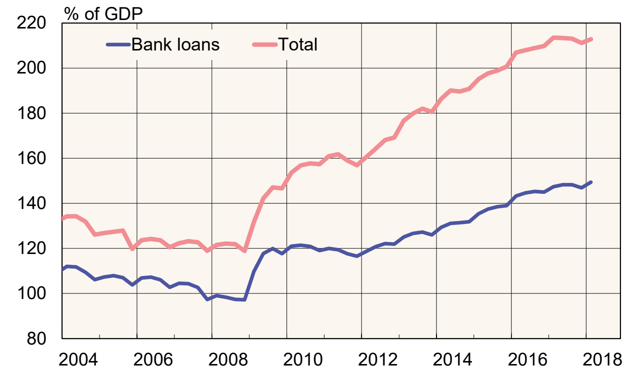


Sources: Numbeo and Macrobond.

Despite the aim of curbing financial market risks, the Chinese continue to pile on debt. As of end-March, the People's Bank of China's broad measure of credit (total social financing or TSF), which includes corporate and household borrowing, stood at 179.9 trillion yuan, or 213 % of GDP. While acceleration in nominal GDP growth caused the TSF-based debt-to-GDP ratio to fall slightly in the final three quarters of 2017, China's debt-to-GDP ratio began to head back up in the first quarter of this year.

Rapid growth in bank lending continued with the total stock of bank lending rising to a record high of nearly 150 % of GDP. The stock of bank loans granted to households in March was up 23 % y-o-y, while the total stock of yuan-denominated loans rose by 13 %. 26 % of yuan loans went to households. The stock of trust loans continued to swell (up 23 % y-o-y), while the stock of entrusted loans, another major product of the shadow banking sector, fell year-on-year for the first time ever. Regulation of entrusted loans was increased significantly this year.

Domestic private sector borrowing (stock of TSF)



Sources: PBoC, Macrobond and BOFIT.

Renewed efforts to rein in local government debt in China. The massive accumulation of debt by local governments has become a primary concern for Chinese economic policy. Over the past two months, officials have announced a number of new measures to bring the situation under control. As an initial measure, local administrations were ordered to implement by August a debt-swap programme that was initially approved in summer 2015. The programme calls for conversion of debt (mostly bank loans) of local governments to bonds. Officials hope the debt swap will make it easier to assess the debt situation of local governments and reduce their debt-servicing costs. Additionally, state-owned financial institutions are now banned from lending to local governments in any manner other than purchasing their bonds. Granting of new bank loans to off-budget local government financial vehicles (LGFVs) is also prohibited.

As of end-2017, local government debt exceeded 16 trillion yuan ($2.5 trillion) or 20 % of GDP. When LGFV debt is included, local government debt is estimated to well exceed 40 % of GDP.