Weekly Review
19 • 9.5.2018
BOFIT

Russia

Putin's newest May Decree sets out typical government target and task list through 2024. As with Putin's third inauguration in 2012, he laid out on Monday (May 7) a new to-do list for the cabinet during his fourth six-year term. General goals include population growth and rising living standards, including cutting by half the number of Russians living in poverty and improving housing conditions, a rate of economic growth above the global average, technological advancement (e.g. innovation and digitalisation) and a high-productivity export sector. The list mentions nothing regarding foreign or domestic security, foreign policy or the recent years' theme of import substitution.

The government was tasked with creating or modifying national projects and programmes covering twelve sectors. The demography programme will seek to improve the birth rate and ease the entry of mothers to working life. The healthcare project seeks to reduce mortality of working-age individuals and infants, eliminate Russia's healthcare labour shortage, improve access to first aid and define tariffs for care. The education project will seek to improve the quality of general education through the adoption of new teaching methods and modernise vocational training to make it more oriented and flexible to practical demands. The housing and urban environment project is to increase annual home construction volume by 50 % through different financing modes (including a mortgage interest rate ceiling), subsidies for standard construction, reduced regulation on housing construction and efficient land usage for mass construction.

The employment programme has links to child and education policies. Tax incentives and less red tape are to improve labour productivity. The goal of raising productivity by 5 % a year will apply to at least 10,000 mid-sized and large companies operating in basic industries outside the resource extraction sector. The project for small and medium-sized firms and private entrepreneurs seeks strong growth in the numbers of people employed by them through simplified tax reporting, beneficial credit and public procurements. The export development programme seeks to boost Russian exports beyond basic commodities. Measures include reduced regulation, export support, improvements in logistics and border-crossings. The only trading partners mentioned are members of the Eurasian economic union, along with targets for the trade volume within the union and final common market objectives.

R&D spending will rise under the science project. Digital economy's own programme includes rapid spending increases and IT performance & security enhancement based primarily on domestic designs. Digitalisation is also emphasised in various other projects.

The road project seeks e.g. to reduce traffic deaths, and impose heavier punishments for traffic violations. There is a separate agenda for large national traffic corridors and electricity projects. The Decree also has environmental focuses. The project extends to waste handling and waste dumps, air pollution in large industrial centres, drinking water quality, and clean-ups of Russia's various lakes, rivers and shorelines. The culture programme stresses stronger national identity.

Sale of Rosneft stake to CEFC cancelled. The deal that was announced last autumn involved the Chinese CEFC's acquisition of a 14 % stake in Rosneft from a consortium of Glencore and the Qatar Investment Authority (QIA). A Glencore press release last week said the deal had been cancelled. The consortium will also be dissolved and the stake meant for CEFC will go to a QIA subsidiary. Under the new arrangement, QIA will own 18.9 % of Rosneft and Glencore 0.6 %.

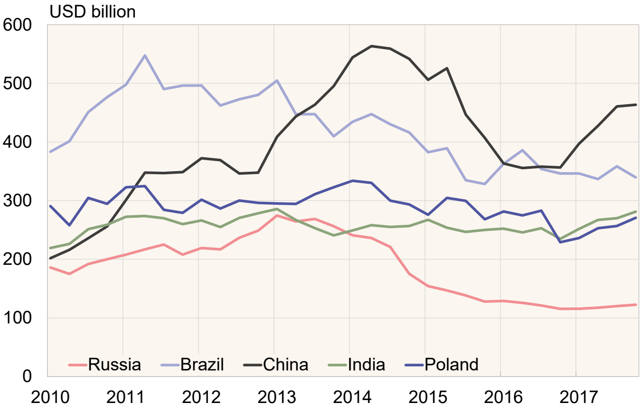
CEFC failed to raise the money to finance the deal after its chairman was detained by Chinese officials. China's state-owned investment company Citic Group has bought out CEFC's assets in the Czech Republic, but not foreign assets elsewhere nor the option on Rosneft stake. CEFC participated last autumn in the IPO of the Russian energy company En+. En+ last month was placed on the US SDN sanctions list.

Foreign bank lending to Russia has declined notably. The Bank for International Settlements (BIS) reports that the total lending of foreign banks to Russia at the end of 2017 amounted to $122 billion. The figure includes lending of all foreign bank units to Russian borrowers. The lending stock has declined by a bit more than 50 % since the end of 2013, apparently on weak trends of the Russian economy and impacts of sanctions on long-term borrowing of certain companies. Lending recovered only slightly in 2017.

Among reporting countries, France was Russia's biggest lender ($27 billion), followed by Italy ($22 billion), Austria ($14 billion) and the US ($13 billion). All these countries have bank operations in Russia.

Foreign bank lending to many other emerging economies only fell slightly or even grew during the same period. For example, lending to India and Indonesia rose by nearly 20 % in the period. Foreign banks' lending to China fell by 7 % during the whole period, but last year it returned to brisk growth.

Foreign bank lending to select emerging economies



Source: BIS.

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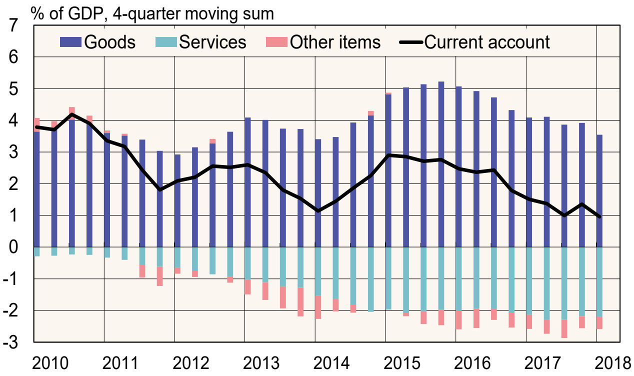
China

China shows large current account deficit for January-March. This year's $28 billion first-quarter current account deficit set a historical record for China. It partly reflects the typical dip in the first-quarter goods trade surplus and China's growing services trade deficit. In the first three months of this year, spending of Chinese tourists abroad increased by 14 % y-o-y to a record $74 billion. Tourist spending in China, in contrast, remained at the 1Q17 level and the travel services trade deficit was $64 billion. Overall, there was a record services trade deficit of $76 billion. The value of goods exports was up 11 % y-o-y and the value of imports was up by 21 %, narrowing the goods trade surplus to $53 billion.

The goods trade surplus has traditionally kept China's current account in the black. Over the past 25 years, the current account only briefly dipped into negative territory in 2001. China's current account is still in the black on year, but the overall surplus has shrunk to just 1 % of GDP. The current account surplus is expected to shrink in coming years as China shifts to a service economy, rapid growth in household consumption cuts into the goods trade surplus and the tourism deficit rises along with Chinese living standards.

China's main current account categories relative to GDP



Sources: SAFE and Macrobond.

China-US trade dispute worsens as lists of demands lengthen. On May 3 and 4, president Trump's trade policy delegation, led by US treasury secretary Steve Mnuchin, visited Beijing to assuage tensions in the current bilateral trade dispute. The main takeaway from the meetings was that the parties agreed to keep talking. In some respects, trade relations between the two countries seemed to take a turn for the worse, with the Americans presenting additional demands and China responding with its own new demands.

The US now wants to reduce its annual bilateral goods and services trade deficit with China by $200 billion a year by 2020. The Trump administration had earlier asked for a reduction by $100 billion a year within 12 months. The request is not small – the 2017 imbalance was $337 billion. *Bloomberg* reports that the US also reiterated earlier demands that China open up its markets and cut tariffs, that Chinese firms desist from further IP violations and that China drop the subsidy elements of its "Made in China 2025" industrial policy.

China said US firms would only get to enjoy opening of its markets if the US, among other things, ends restrictions aimed at Chinese technology firms, refrains from raising tariffs and grants China market economy status in the WTO.

The lengthening lists of demands from both sides highlights the seriousness of the situation. The US decision to focus on direct and immediate reduction of its trade deficit with China is both unworkable and counterproductive. Indeed, it endangers the legitimate goals of accelerating China's opening and eliminating existing protectionist schemes. One of the biggest threats from the current situation is that the countries go through with customs duty hikes and launch into a full-blown trade war.

Bilateral talks will continue in Washington DC next week, when a delegation led by Chinese vice-premier Liu He arrives.

China still has a long way to go to achieve full deregulation of bank deposit and lending rates. China's last remaining interest rate limits were officially dropped in October 2015 (see <u>BOFIT Weekly 44/2015</u>). While it has been ostensibly left to commercial banks to set their own interest rates on loans and deposits, the reality is that the People's Bank of China continues to determine the price ranges of banks through its "window guidance" policy. At PBoC and commercial banks meetings, the central bank can extend lending limits and objectives, as well as provide guidance on pricing of loans and deposits. The central bank additionally continues to issue reference rates for loans and deposits, even if they have not been adjusted since interest rates were deregulated.

Commercial banks also agree among themselves on pricing of loans and deposit rates. *China Daily* reported in April that commercial banks had discussed in their meetings the possibility of raising deposit interest rate range to 140–150 % of the PBoC reference rate. The current range is 130–140 % of the reference rate. In addition, since the deregulation of rates, lending rates have closely tracked reference rates. According to PBoC figures, over two-thirds of new bank loans are priced at 90–130 % of the reference rate. The average interest rate on new bank loan at the end of 2017 was 5.7 % p.a., and the one-year reference lending rate was 4.35 %.

New central bank governor Yi Gang has stated that China will continue transition to a market-based interest-rate regime and end the current dual-rate market. Money markets are currently free to set interest rates, but the retail rates are still in the control of the central bank. News agency *Caixin* reported in April that the PBoC had decided to let commercial banks set higher interest rates on certificates of deposit, but the decision did not extend to bank deposits. For example, large commercial banks can now offer interest rates on their deposit certificates at up to 150 % of the reference rate. The previous ceiling was 140 %.

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