

## Russia

**No large economic policy changes expected from Russia's new cabinet.** On May 18 president Vladimir Putin approved the new cabinet proposed by prime minister Medvedev, consisting of 10 deputy prime ministers and 22 ministers. There were few surprises in the cabinet reshuffle and even most of the ministers coming outside the cabinet have long careers in government administration.

Anton Siluanov was named as the first deputy prime minister responsible for e.g. economic matters, but continues as finance minister as well. There were no changes in the ministers for economic development, industry & trade and energy. Dmitri Patrushev, head of Rosselkhozbank, was appointed as the agriculture minister. His father, Nikolai Patrushev, is secretary of the Security Council of Russia.

Numerous observers have characterised the new cabinet as conservative and technocratic, so hopes of major economic reforms are not very high. Alexei Kudrin, a father figure for reforms, did not make it to the cabinet but was named chairman of the Accounts Chamber of Russia.

**Reasonable recovery in Russian domestic demand; growth in output slower.** The recovery in seasonally adjusted retail sales continued in April. From twelve months earlier retail sales were up nearly 2.5 %. Real household incomes also rose by several per cent in on-year terms in the first four months of the year. The recovery in fixed investment slowed a bit from last year. Fixed investment in the first quarter was up 3.5 % y-o-y. After a long period of decline, construction activity also revived in April.

As in previous recoveries, the revivals of domestic demand increased imports, even if import growth has slowed in recent months. Domestic production has grown much more slowly. Rosstat reports that first-quarter GDP grew by 1.3 % y-o-y.

### Retail sales and industrial output in Russia, 2014–18



Source: Rosstat.

Signs of industrial recovery are still unclear. While seasonally adjusted industrial output has increased in recent

months, April industrial output was still on par with the level of early summer 2017. In the first four months of this year, on-year growth of industrial output was less than 2 %. In extractive industries, which include oil and gas, on-year growth was just over 1 %. Manufacturing in the period was up 2 % y-o-y, but in recent months manufacturing output has remained essentially flat.

### Russian Duma approves new counter-sanctions bill.

The bill was introduced last month after the US added new Russian entities and persons to its SDN sanctions list. The version of the bill approved in its third reading to the Duma on May 22, however, was formulated in notably more general terms than the original bill. Under the final version, the Russian president can, as needed, impose restrictions on unfriendly countries and firms operating under their jurisdiction. Possible counter-sanctions mentioned include import and export bans.

The Duma is also considering a bill that would criminalise enforcement of foreign sanctions in Russia, but it is still under discussion due to wide opposition.

### American sanctions affecting Russian firms.

The latest round of sanctions announced by the US Treasury Department on April 6 have significantly impacted targeted Russian firms, most notably one of the world's largest aluminium producers Rusal and its main stakeholder Oleg Deripaska. Rusal's global production activities have been severely impaired by the move, forcing its customers and investors to get determinations e.g. on how fast they need to cease their business relations with the sanctioned giant. US officials have been willing to show flexibility in Rusal's case e.g. on arrangements in corporate structures, partly because the mere threat of disrupting the company's production caused global aluminium prices to spike by about a third. This week global aluminium prices were up about 15 % from the start of April.

Deripaska owns Rusal via the energy-focused EN+ Group. He has promised to reduce his ownership stake in Rusal from 70 % to below 50 %. Following the sanctions announcement, Rusal's share price plummeted by over 50 %. Its share price is currently down about 65 % from the beginning of this year.

The US sanctions list also includes Viktor Vekselberg and his Renova Group conglomerate. Renova owns, among other things, several machine-building firms and a stake in Rusal. Vekselberg says Renova paid off about 1 billion Swiss francs worth of loans to Western banks before sanctions took effect. Renova says the loans were paid off out of pocket and through borrowing arrangements. A press release from the Russian finance ministry noted that Renova also obtained a loan from Promsvyazbank. The government plans to make Promsvyazbank a major lender to Russian defence industry to make sure that other Russian banks are not burdened with the risk of sanctions that could arise if they loaned money to companies subject to financial sanctions.

## China

**Threat of imminent US-China trade war subsides again.** A Chinese delegation led by vice premier Liu He met with their American counterparts in Washington DC last week (May 17–18) to assuage bilateral trade tensions. The US team included Treasury Secretary Steven Mnuchin, Commerce Secretary Wilbur Ross and White House Trade Representative Robert Lighthizer. At the wrap-up of discussions, the parties issued a joint statement that included a promise from China to significantly increase imports of goods and services from the United States (mainly food and energy products) to reduce the US's trade deficit with China. China also reiterated its promises to do a better job protecting intellectual property rights and open up its economy. While the joint statement announced a de facto cease-fire on the trade policy front, it lacked concrete measures. The United States announced it would next send a delegation to China to continue talks and agree on specifics.

The parties committed to refrain from threatened hikes in import tariffs during the talks, as well as a number of other allowances. China separately announced that it was cancelling its temporary import fee on sorghum produced in the US, which took effect in April. In addition, Chinese officials announced at the start of this week that they were reducing car import duties from 25 % to 15 % from the beginning of July. Media reports said the US was planning to lift its ban on component sales to Chinese ZTE.

It remains unclear what happens to tariffs already in force. These include general anti-dumping duties imposed by the US on solar panels, washing machines and steel and aluminium products, as well as Chinese duties imposed this month on e.g. certain American food products, steel pipes and recycled aluminium. The importance of these import tariffs relative to the US-China trade overall are marginal.

**Chinese firms increasingly missing bond payments as financing opportunities tighten.** This year has seen some twenty bond payment defaults by a dozen mainland China firms. Figures released by the China Central Depository and Clearing Company (CCDC) show that the value of missed bond payments (including interest) in January–April reached 13 billion yuan (USD 2 billion), or about a third more than last year. Many of the defaulters were listed firms. Some were state-owned enterprises.

Among defaulting firms were also subsidiaries of firms that expanded aggressively in recent years. For example, Kaidi Ecological and Environmental Technology, which is listed on the Shenzhen exchange, defaulted this month on about 700 million yuan (USD 110 million) in bonds and interest. The company's largest owner (about 30 %) is Sunshine Kaidi New Energy, which is also the parent of Kaidi Finland, which is planning to build a biofuel refinery in Kemi. CEFC Shanghai International, a subsidiary of CEFC China Energy that run earlier into financial problems and withdrew from the Rosneft deal,

missed this week over 2 billion yuan in scheduled bond payments.

Missing bond payments is still quite rare in China, and even fewer firms have been allowed to go bankrupt. The fact that news of such events is now making it into the public sphere suggests a changing situation and increased difficulties for firms in getting financing. It has long been hard to assess the true economic condition of Chinese firms, especially as debt payments could often be covered by simply borrowing more money. Regulatory oversight of shadow banking instruments, in particular, has been stepped up this year. This has made it harder for firms to get financing and refinance existing debt.

While China is shifting to a more market-based financial system, actual corporate risk is still not necessarily reflected in the pricing of credit, especially when investors assume the government provides an implicit guarantee. The threat of actual default has sobered investors to some extent. The government allowed the first bond default in 2014, and in recent years the number of bond defaults has risen to several dozen a year.

**Over 500 million Chinese have been lifted out of poverty in recent decades.** The World Bank defines the international poverty threshold as disposable income of USD 1.90 a day (PPP-adjusted). Under that definition, 88 % of the Chinese population lived in below the poverty line in the early 1980s. That ratio had fallen to just 2 % by 2013, when the number of persons living in poverty was just 25 million.

The global Multidimensional Poverty Index (MPI), which was developed at Oxford University and has been embraced by the UN, assesses poverty more broadly in such terms as years of education, nutrition, child mortality, access to necessities, healthcare and living standards. Under the MPI, 12.5 % of Chinese were poor in 2002, but just 4 % (56 million people) in 2014. Gains in poverty reduction mainly reflect better access to education and improvements in hygiene and public health.

China's official national poverty line is an annual income of 2,300 yuan a year (about USD 350 a year). Under this poverty definition, there were roughly 56 million impoverished Chinese in 2015. The government notes, however, that the number has fallen steadily by about 10 million people a year. Last year, the number of persons living in poverty was about 30 million.

President Xi Jinping would like to see all extreme poverty eliminated by 2020. The elimination of poverty is one of three pillars in the current five-year plan. The other main themes are reducing pollution and financial risks to the economy. The government also wants to relocate 100 million rural inhabitants to cities by 2020 and another 150 million by 2026. This goal integrates the most difficult phase in elimination of poverty, which involves bringing those in extremely rural areas into economic life and modern living standards. People are moved to cities or surround areas, or into newly built villages. Poverty reduction and urbanisation reinforce consumption and economic growth.