Weekly Review
29 • 20.7.2018

BOFIT

Russia

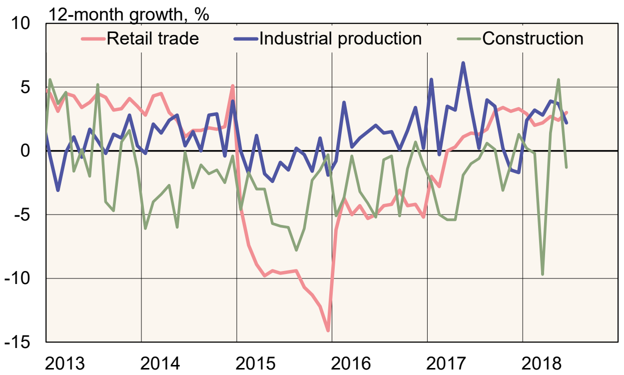
Russian economy continues mixed performance. June economic growth was mostly driven by private consumption. After perking up in the spring months, the trend in investment-driven branches weakened. Despite mixed performances, the Russian economy generally appears to be on a modest growth track in line with earlier expectations.

On-year growth in retail sales accelerated slightly in June to 3 %. Factors supporting growth included growth in household borrowing and the FIFA World Cup soccer matches that began in mid-June. Real household incomes, in contrast, showed nearly zero growth. Real wage growth slowed slightly, but was still up 7 % y-o-y.

On-year growth in industrial output slowed in June to around 2 %. On-month seasonally adjusted industrial output volume even contracted a bit last month. Most of the slowing came from lower manufacturing growth. The extractive sector saw gains on increased oil & gas production. The spring growth spurt in construction activity ended in June with construction down over 1 % from a year earlier.

In their latest estimates, the Central Bank of Russia and economy ministry find that Russian GDP growth accelerated from 1.3 % p.a. in the 1Q18 to close to 2 % in the 2Q18.

Trends in core sectors of the Russian economy



Source: Macrobond.

Russian and U.S. presidents met in Helsinki. At the Helsinki summit last Monday (July 16), discussions focused on foreign and security policy, but also economic relations were touched upon. Putin said he had agreed with Trump e.g. on the creation of a high-level business working group on developing bilateral economic relations.

Neither country is a particularly important partner for the other in economic terms and bilateral economic relations have developed poorly in past years given Russia's weak economy and ongoing political tensions between the two countries. The value of US-Russia bilateral goods trade last year was about $25 billion. The US accounted for 4 % of Russian goods trade, while Russia's share was less than 1 % in the case of the US. Russia mostly exports fuels and metals to the US and imports machinery & equipment and chemicals.

Even if direct investment figures should be viewed with caution, they show the stock of American foreign direct investment in Russia last year was only about $3 billion, less than 1 % of Russia's total FDI stock. The stock of Russian investment in the US was about $7 billion, which is also a miniscule share of the total US FDI stock. Russia this year has also significantly reduced its holdings of US treasuries that according to some views could be related to sanctions risks.

For the moment, US sectoral sanctions have restricted access to financing and exports of oil exploration technology to certain Russian firms. Additionally, several Russian firms and persons have been placed on the Specially Designated Nationals (SDN) sanctions list, which calls e.g. for freezing of assets. Further measures are under discussion from time to time, including a proposal this week to sanction the Nord-Stream 2 undersea gas pipeline. Russia has restricted food imports also from the US, among other countries, with Putin last week extending the sanction up to the end of 2019.

New tariffs also complicate trade this year. Russia's economy ministry reports that US import duties levied on steel and aluminium products this spring incur on Russia costs of $540 million. Russia recently imposed retaliatory tariff hikes on certain US imports such as technology used in construction and oil drilling. Russia has also joined a number of countries in a complaint to the WTO about US tariff policies.

FIFA World Cup provides small boost to Russian economic growth. Russia's FIFA World Cup Local Organising Committee (LOC) reports that the soccer tournament drew nearly 600,000 foreign spectators to the matches and a total of 5 million foreign tourists from June 14 to July 15. Sberbank estimates that foreign tourists spent a total of $1.5 billion during the games, double the amount of the same period last year.

Official figures report that Russia spent about 680 billion rubles ($13 billion) in preparation to host the World Cup, which is estimated to have made it the most expensive World Cup in history. Most of the money went to construction or refurbishing of sports venues and transportation infrastructure (270 and 230 billion rubles, respectively). Financing was largely provided from the federal budget.

Russia's LOC estimates a positive effect to the Russian economy of $870 billion rubles ($17 billion) during 2013–18, with most of the benefits coming from investments in infrastructure and increased tourism. The LOC said that in 2017–18 the tournament added a quarter of a percentage point to GDP growth. Most other estimates put the growth benefit of the games in the range of 0.1-0.2 percentage point this year.

The LOC expects the event to add 150–200 billion rubles a year to the economy over the medium term, assuming full advantage is taken of opportunities created by the new investment. Other estimates are more pessimistic, as e.g. most of the new stadiums are considered unprofitable investments.

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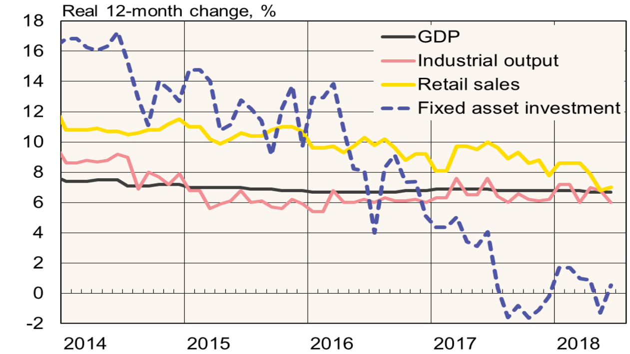
China

Official figures show Chinese economic growth slowing only marginally in the second quarter. China's National Bureau of Statistics reports that GDP grew at 6.7 % y-o-y in the second quarter, a slight slowing from the 6.8 % pace of the previous three quarters. China's eerily consistent GDP growth figures do not reflect the severe slowdown in the monthly figures for fixed asset investment (FAI). Fixed asset investment data indicate on-year drop in second-quarter public sector investment, which is also reflected in a significant slowdown in growth of infrastructure investment.

The NBS further noted that final consumption expenditure contributed to nearly 80 % of April-June GDP growth. NBS figures, however, show slowdowns in both retail sales and income growth. Real disposable income per capita rose by 6.7 % y-o-y in real terms in the first half of 2018 (7.3 % growth in 2017). Growth in retail sales slowed in the second quarter with real on-year growth falling to 7 % in June.

Consumer price inflation held steady at 1.9 % in June, while producer price inflation sped up a bit to 4.7 %.

Chinese economic indicators



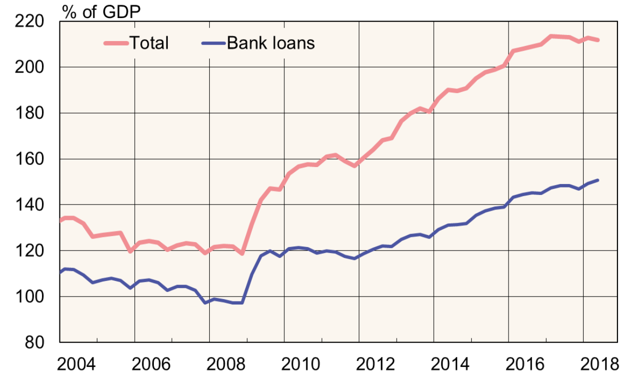
Sources: CEIC, Macrobond and BOFIT.

Stock of bank lending continues to grow, even as China's shadow banking sector lending declines. The broad descriptor of domestic private sector credit (total social financing or TSF) corresponded to 212 % of GDP in end-June. The figure indicated a slight drop in the debt-to-GDP ratio that stemmed from a crackdown on lending outside the official banking sector. The TSF aggregate includes some type of shadow banking sector instruments such as trust loans, entrusted loans and bank acceptance bills (a kind of IOU). This unofficial lending component, which equals roughly 30 % of GDP, shrank for the first time, falling by 5 % between December 2017 and June 2018. Bank lending grew by over 12 % y-o-y and now exceeds 150 % of GDP.

The TSF aggregate describes private sector financing. The Bank of International Settlements reports that the total Chinese credit stock (including government debt, but excluding financial sector debt) was 256 % of GDP last year. BIS figures show that China's debt-to-GDP ratio declined in the fourth quarter of 2017 for the first time since 2011.

The shrinking debt-to-GDP ratio may be short-lived, however. To preserve growth amid market uncertainties, the monetary policy stance has been made more accommodative and China may also need to relax its stiff stance on curbing shadow bank lending to reduce financial market risk. Media reports note, for example, that implementation of tighter regulation of wealth management products has been delayed.

Private sector credit (TSF) relative to GDP



Sources: Macrobond, People's Bank of China and BOFIT.

Banks still the largest issuers of green bonds in China. Bonds intended to finance environmental protection projects such as waste-water treatment facilities or climate-saving technology such as solar power arrays are referred to as green bonds. The international expert organisation Climate Bonds Initiative (CBI) reports that last year the amount of green bonds meeting international standards reached $156 billion globally. Of these, 25 % were issued in the US, 15 % in France and 15 % in China. The largest green bond in 2017 was issued by the French government ($11 billion), followed by the China Development Bank bond ($5 billion). In the first six months of this year, Chinese issuers launched 22 new green bonds worth over $3 billion in total.

While a total of $36 billion in green bonds were issued in China last year (an increase of 5 % y-o-y), a large share (38 %) only qualified as green under China's own criteria. Banks, which dominate the green bond market, accounted for 74 % of last year's issues. Although the banks' share has fallen, it is still substantially larger than the global average of 25 %.

Unlike international green bond standards, China includes projects involving e.g. clean coal, improvements in coal-burning efficiency and efficiency optimization of fossil fuel power plants. Moreover, international standards require that in practice all funds raised through the issue to be dedicated to green projects, while Chinese standards allow up to almost a half of the money to be used, for example, for servicing banks loans or augmenting corporate capital.

The People's Bank of China say the county would need to spend about 2–4 trillion yuan ($320–640 billion) a year on environmental protection and measures to mitigate climate disruption. The various policy measures used to promote green bonds were recently bolstered by including them as acceptable collateral in central bank financing.

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