Weekly Review
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Russia

Russian economic growth remains sluggish. GDP growth edged up from 1.3 % y-o-y in the first quarter to 1.8 % in the second quarter. Growth in the entire first half was 1.6 % y-o-y.

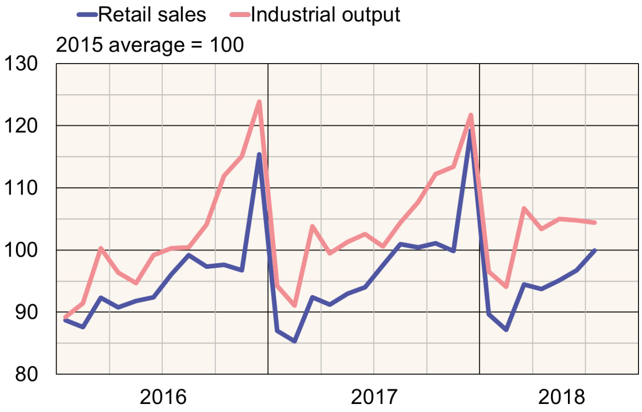
Industrial output growth climbed from slightly over 3 % in the second quarter to nearly 4 % y-o-y in July. Manufacturing output grew by 4.6 % y-o-y in July, or slightly faster than in the second quarter. Growth in extractive industries accelerated to over 3 %. Judging by Rosstat's previous data revisions, the industrial output data for recent months could later be revised even higher, especially manufacturing output.

Fixed investment in the first half was up by over 3 % y-o-y. Fixed investment growth slowed in the second quarter to under 3 %. Construction activity remained depressed, contracting about 1 % y-o-y in the June-July period.

Officially reported real wage information continued to show significant gains in July, up 8 % y-o-y. The rise of household disposable real income, on the other hand, remained at 2 % y-o-y in July. The difference reflects developments in grey-economy wages, as well as meagre gains in non-wage household income.

Retail sales growth, which quite naturally tracks real income trends, was 2.5 % y-o-y in July, the same pace as in the first half of the year. Seasonally adjusted retail sales dipped a bit in July, however.

Monthly volume of retail sales and industrial output



Source: Macrobond.

Tax code revisions impact Russia's oil sector. In recent years, the emphasis on taxation of the oil sector has gradually shifted from exports to production. New revisions of the tax code, signed by president Putin on August 3, will end export tariffs on crude oil and oil products altogether during the next six years. At the same time, the mineral extraction tax on crude oil production will be raised incrementally. The revisions to the tax code are designed to basically have neutral impact on oil tax revenue streams to the federal budget.

The increases in the mineral extraction tax will raise the domestic price of crude oil. To compensate for the resulting losses on profitability of domestic refineries, the excise tax on petroleum products will also be adjusted. A share of excise tax revenues will go to supporting domestic refiners after the transition period. The level of support to refiners will depend on e.g. refinery location and the refinery's product range. Refiners are also promised favourable excise tax treatment if they are affected by Western sanctions. Numerous uncertainties surround the actual implementation of the revised approach to excise taxes.

Russia will continue to sell crude oil to Belarussian refineries at domestic prices, but due to the replacement of export tariffs with the higher mineral extraction tax, the price Belarussian refiners pay will be higher. Eliminating such structural boons may have been one of the goals of the tax reform.

Russia approves changes in taxation on consumption and corporations. The changes to the tax laws signed by president Putin early this month enter into force at the beginning of 2019. Although the value-added tax will generally rise from 18 % to 20 %, it will remain at 10 % for certain foods, children's goods, printed publications and pharmaceuticals. The economy ministry notes the full VAT rate applies to about three-quarters of goods and services. A zero VAT rate will be extended to cover domestic flights to and from the Russian Far East.

Excise taxes on alcoholic spirits and beer will remain unchanged next year, while the tobacco tax goes up by 10 %. Excise taxes on alcohol and tobacco will be adjusted in 2020–21 to keep up with the projected inflation rate, i.e. 4 % p.a., while taxes on tobacco products will go up slightly faster. Excise taxes on passenger cars will be adjusted for inflation. Taxes on motor fuels rise by 10 % next year from their level in the first half of this year (they have been reduced for the rest of this year to contain price increases). After 2019 they will be adjusted to roughly keep pace with inflation. Taxes on lower-grade gasolines, however, will remain unchanged in 2019–20 and the tax on heavy fuels used e.g. by cargo ships will stay at 0 % during 2019–21.

The revisions of tax laws keep the combined rate (based on wages) for mandatory social contributions at 30 % as the component going to the Pension Fund will remain at 22 %. Regional budgets will get some relief as regions will no longer have to pay social taxes into the health insurance fund for designated special groups of non-working people.

The tax on the physical capital of companies, which was limited to a maximum of about 2 %, will no longer apply to moveable assets (the tax will remain e.g. for buildings). As the tax has partly covered even relatively new production capital, it has been deemed to burden production while not doing very much to encourage investment. Unified principles will be applied to define the tax bases for taxes on real estate and the land tax.

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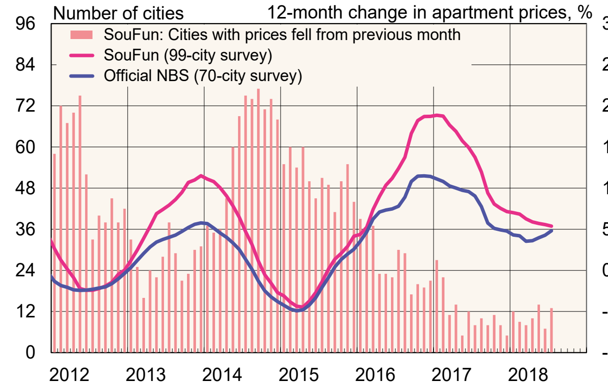
China

Rise in Chinese apartment prices moderates. Chinese housing-market tracker SouFun reports that apartment prices in Chinese cities have generally risen this year, but at a slower pace than last year. SouFun's 99-city survey of apartment prices shows that the average price for one square metre of apartment floorspace in July was 14,400 yuan (1,800 euros), an increase of just over 5 % y-o-y. In the four biggest cities in the survey, the average square-metre price in July was 5,100 euros, unchanged from the start of the year.

New apartment construction starts in the first seven months of the year were up by more than 25 % from the same time last year. In the same period, construction starts on new office buildings and commercial space ran at the same pace as a year earlier. In the January-July period, the volume of apartment sales measured in terms of liveable floorspace increased by about 3 % y-o-y. The volume of completed apartment (m^2 of floorspace) declined by 18 % from a year earlier, and, consequently, the volume of pending sales of apartment also deteriorated steadily.

Apartment prices in Chinese cities



Sources: SouFun, NBS and Macrobond.

Big trouble for China's P2P platforms. About 250 online peer-to-peer lending platforms went insolvent during recent months, as investors withdrew from China's P2P lending market. The collapse started as the government is tightening its regulatory grip on the P2P sector, thereby raising fears among investors that P2P platforms will face new problems. The industry was already struggling to shake the damage from numerous fraud cases (e.g. Ponzi schemes). Investors who have lost their money tried to organise demonstrations to show their displeasure, only to be blocked by officials.

P2P platforms intermediate loans from private individuals or firms to borrowers who otherwise lack access to credit. Due to the increased risk involved, the lending rates and yields are significantly higher than bank loans or bank deposits. While the P2P market limits the size of a single corporate loan to 1 million yuan (145,000 dollars) and a total of 5 million yuan in P2P loans per borrower, the amounts lost in a single platform collapse can be prodigious. Reuters' sources estimate the Chinese P2P loan stock at close to 220 billion dollars, an amount greater than all of the P2P lending market in the rest of the world. While over 1,800 platforms in China are still standing since the first waves of platform collapses, most are not expected to survive under tightened regulatory conditions.

Reuters reports that financial supervision officials have turned to the government's largest asset management companies (bad banks) for assistance in cleaning up the P2P sector mess.

China want to make the Pearl River Delta a world-class urban centre. Last week, a high-level working group held its initial meeting in Beijing to discuss development plans of the Pearl River Delta Greater Bay Area initiative. The initiative seeks to blur borders through creation an economically integrated region that grows the roles of mainland China cities of the Guangdong province (particularly Shenzhen and Guangzhou) through enhanced cooperation with the Hong Kong and Macao special administrative regions. While Guangdong's nine major cities cover less than 1 % of China's land area, they contain about 4 % of China's population and generate nearly 10 % of China's GDP.

The initiative seeks to build on the strengths of each area, while increasing the mobility of people, goods and capital within the region. Hong Kong will focus on financial markets, Macao on entertainment services and tourism, and cities in mainland China on services and high-technology sectors. Guangdong's provincial government announced in August plans to invest 450 billion yuan (65 billion dollars) over the next three years in high technology, while encouraging local officials to attract more electronics firms and car manufacturers to the region.

An infrastructure goal is to improve travel within the Pearl River Delta. This year will see the opening of the world's longest highway bridge (55 kilometres). It will link Hong Kong, Zhuhai and Macao. A bullet train connection linking Hong Kong, Shenzhen and Guangzhou also opens this year. Improvements are planned for numerous tunnels, ferry terminals and highway networks. Starting in September, residents of Hong Kong, Macao and Taiwan can apply for a Chinese personal ID that will give them access to a range of public services in mainland China, including education and housing services.

A goal of regional development is to ease Hong Kong's lack of land for building by enabling those who work in Hong Kong to live also outside the city. Naturally, the project has also caused apartment prices in the mainland China side to soar. Apartment prices in some cities of the Pearl River Delta region have risen by over 70 % since 2015. The regional population is expected to reach 120–140 million by 2040.