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Russia

Russian unemployment falls and wages continue to rise; real incomes contracted in August-September. Using the methodology of the International Labour Organization (ILO), Russia's unemployment rate continued to decline this year, falling to just 4.5 % in September. The national unemployment rate in September 2017 was 5 %. The unemployment rate in both Moscow and St. Petersburg was below 2 %.

The average nominal monthly wage in September was up by 11 % y-o-y to 42,200 rubles (530 euros). The decline in unemployment and emergence of labour shortages in some growth centres have supported strong wage growth, but the largest single driver continued to be the large wage hikes for public service workers. These hikes derive from a decree given by Putin after he was inaugurated as president in May 2012. The last of the decreed wage hikes in education, healthcare and culture sectors were implemented in early 2018, before the end of that six-year term in office.

In the first half, the rise in wages was sufficient to make up for the lower growth in other income streams (pensions, wealth transfers, capital income and entrepreneur income). After four years of contraction, real disposable household incomes increased slightly in the first half of this year relative to the same period last year. The slight slowdown in the pace of wage increases from January-March brought real income growth to a halt. Real incomes in the third quarter were unchanged from a year earlier. The weak trend in real incomes partly accounts for the low growth in retail sales. The average nominal wage in September was up 11 % y-o-y, while the volume of retail sales grew by only 2.2 % y-o-y.

Russia was ranked the 43th most competitive country by the World Economic Forum this year. The annual Global Competitiveness Report released last week included 140 countries. Russia's ranking has risen slightly over the past decade. While it trailed wealthy Western countries, it was close to the top among former socialist countries.

The ranking combines 90 indicators, most of which have been developed by other institutions. Their purpose is to describe a country's ability to succeed in global markets. The measures evaluate, for example, basic institutions, infrastructure, financial system, research, health and education.

In interpreting these results, it is important to note that not all indicators are adjusted to the size of the country. The size of the economy gets directly a 1/12 weighting and certain quality measures favour countries with large populations. For example, when counting the number of academic articles published and number of research institutes – even if quality is accounted for to some extent – large countries receive a high score rather easily. In this way, countries with large populations rank higher than they would if only the workings of their economies were evaluated as such.

According to the report, Russia's relative strengths include, among other things, market size (6th), quality of research institutions (12th), efficiency of train services (15th), airport connectivity (18th), scientific publications (22nd) and the adoption of information technology (25th).

Russia's weak areas include public health, financial system and institutions. Some of the biggest challenges from the competitiveness perspective are high labour tax rate (133rd), restrictions on the freedom of the press (121st), banks' regulatory capital ratio (114th), public sector corruption (113th), weak protection of property rights (112th), impediments to imports due to local regulations (113th), complexity of tariffs (110th) and low quality of roads (104th).

China ranked 28th in this year's report. Its strengths and weaknesses were similar to Russia's. However, China substantially outscored Russia in infrastructure comparisons.

IMF estimates that the government sector and public sector firms account for a third of Russia's GDP. The International Monetary Fund seeks to clarify the interpretation of the figure of 70 % it published in 2014. That is the *ratio* of the income of the government sector and public sector firms to GDP. This is not the same thing as their *share* of GDP, as it is often misinterpreted.

The IMF has now calculated their share of GDP to be one-third. In the economy's market-based block, the estimate is based on their share of income. In blocks where the income formation of firms and organisations is not market-based, it is based on their share of workers. The calculation includes the subsidiaries of the 20 largest state-owned enterprises (excl. banks) in Russia. The one-third share is estimated for 2016, but according to the calculations it was practically the same in 2012.

The IMF emphasises that the negative effects of public sector firms within the economy can be wider than suggested by their nominal GDP share, e.g. through excessive concentration and the lack of competition in some branches, lack of transparency in procurements of the government or SOEs, as well as preferred treatment through easier access to financing.

Researchers at the Russian Academy of National Economy and Public Administration and the Gaidar Institute published their own assessments of the public sector's contribution to GDP earlier this year. The government sector's share of GDP appears in Rosstat's GDP figures as just under 20 %, and this applies to this entire decade. SOEs are not included in Russia's GDP figures. The rough estimates of researchers put the share of GDP of SEOs and a few state corporations and the government's largest commercial institutions at over a quarter of GDP. This is based on a two-step calculation. In the first step, over 100 SOEs and the above-mentioned state corporations and businesses are found to generate about 12 % of the corporate sector's revenues. The second step assumes rather boldly that the ratio of value added to income estimated using the financial statements of Gazprom and Rosneft is equally applicable to all other SOEs.

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China

Officials in China seek to calm markets spooked by slowing growth. China's National Bureau of Statistics reports that real on-year GDP growth was 6.7 % in the first nine months of this year and that third-quarter growth slowed to 6.5 % y-o-y. Some of the lower growth reflects the rising contribution of services to output. In the last 12 months, services accounted for 52 % of total output, while the contribution of industry and construction combined was less than 41 %, and primary production (mostly agriculture) just over 7 %.

While acknowledging the low reliability of official Chinese statistical data, even they show growth slowing. Indeed, all three of China's most-tracked growth indicators showed on-year growth below 6.5 % in September. While real growth in retail sales fell only slightly below the 6.5 % level, industrial output growth dropped below 6 %, and real growth in fixed investment remained around zero, as it has for a long time.

The combination of the slowdown in growth, China's debt problems and uncertainty over trade policy has made markets nervous. To calm the markets, China's government again promised measures to improve access of privately held firms to financing and clarified regulation related to wealth management products sold by investment funds. Due to the nature and breadth of the problems, however, calming markets with such individual promises is difficult. Market disturbances are an inevitable part of China's development. Chinese markets this week also felt pressure from global stock prices.

Little progress in core reform of China's state enterprises. In recent years, China has implemented various programmes and subsidies to make state-owned enterprises (SOEs) bigger and stronger while limiting options for companies in the private sector. The share of industrial assets of SOEs have slightly increased this year after falling earlier.

As economic growth has slowed, concerns over future growth has increased and international criticism of China's SOEs has grown, China's leaders have responded by talking more about the importance of the private sector. A letter by president Xi Jinping published last weekend stressed the importance of the private sector. Vice premier Liu He has recently also come out as an ardent advocate for the private sector.

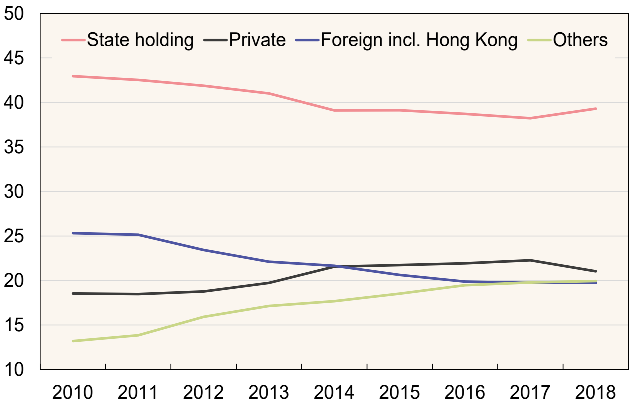
The most critical move in helping the private sector would be to create a level playing field. Most of China's financial sector is in state hands and bank lending policies tend to favour state companies no matter what their financial condition or whether their projects make any financial sense. Banks assume SOEs enjoy implicit state guarantees that will protect them when risk materialises. This distorts the pricing of risk, which has allowed many SOEs to become over-indebted. Allowing firms to go on reckless borrowing sprees means that banks likely hold large stocks of bad loans. Chinese government has long been urged to end implicit state guarantees to SOEs to end this distortionary effect.

Even if modernisation of SOEs is a central tenet of structural reform, little progress has been made on this front. A campaign was launched some years ago to sell partial stakes in SOEs to private investors (mixed-ownership reform), but the results to date have been modest. In some cases, SOEs have been sold to active management.

A big problem in pushing through reforms is that they may conflict with the interests of the decision-makers themselves. SOEs have tight connections with political decision-makers, with corporate leaders typically tapped by the party elite. This creates a system that cycles the same people through executive ranks of state-owned firms, top positions at decision-making bodies in public administration and high regulatory posts. Decision-makers also use SOEs as instruments for implementing economic policy in order to guarantee that they meet politically defined growth targets. Giving up of such direct tools is difficult. Connections to SOEs are often important in personal career advancement within the party hierarchy and wealth accumulation.

Currently, 96 conglomerates operate under the auspices of the State-owned Assets Supervision and Administration Commission (SASAC), which works directly under the central government. The government has reduced the number of such conglomerates through mergers. The OECD reports that when the number of subsidiary corporations within conglomerates and other firms directly under central government administration are included, there were about 50,000 such firms at the end of 2015 employing 20 million people. When local-level firms and their subsidiaries are included, some 160,000 SOEs operated in China at the end of 2015. 25,000 of these firms were involved in industry, 15,000 in the real estate sector, 13,000 in primary production and 10,000 in the transport sector. The OECD reports that these firms employ a total of 40 million people, with 11 million engaged in primary production, 7 million in industry and 5 million in the transport sector. By some official estimates, Chinese SOEs employ around 60 million people. In any case, SOEs employ a relatively small part of the Chinese workforce (770 million), but enjoy a disproportionate share of many other resources.

Share of industrial assets by ownership, %*



** Situation in August of every year.*

Sources: CEIC, NBS and BOFIT.

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