SUOMEN PANKKI FINLANDS BANK EUROSYSTEM 1811

Weekly Review
6 • 8.2.2019

BOFIT

Russia

Russian economy's growth rate accelerated in 2018. Rosstat's first GDP growth estimate for all of 2018, released on Monday (Feb. 4), surprised both Russian and foreign analysts. Rosstat estimates Russian GDP last year grew by 2.3 %. Preliminary figures for the first nine months of 2018 indicated GDP growth of 1.6 %, and available monthly data indicated no significant pick-up in growth.

One factor in the higher-than-expected growth figure was a significant revision of the construction activity data. It appears that a large share of construction work at the massive LNG facility on the Yamal peninsula was only booked in the end of 2018.

Despite the positive surprise, the acceleration in growth has not been broad-based. Growth in private consumption last year slowed to 2.2 % (3.2 % in 2017) and growth in public consumption remained at just 0.9 % (2.5 %). Preliminary figures indicate that fixed investment rose last year by only 2.3 % (5.5 %). The positive surprise in GDP growth in 2018 was largely due to increase in net exports. The growth in the volume of exports rose last year to 6.8 % (5.0 % in 2017), while growth in the volume of imports slowed to 3.8 % (17.4 %). First estimates of GDP are, however, still subject to several rounds of revisions.

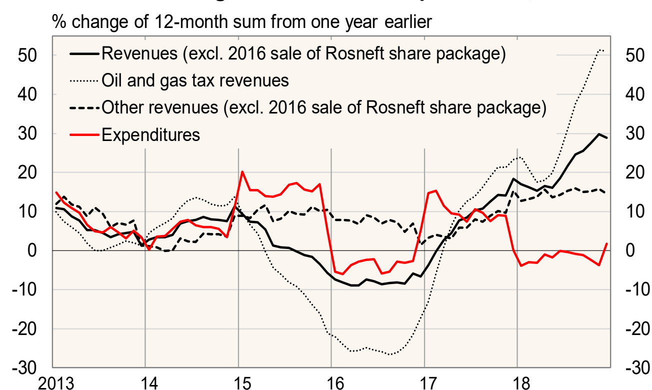
Higher oil prices boost surplus of Russian federal budget. 2018 budget revenues were up 29 % last year. Much of the gain came from higher revenues from oil & gas taxes, which saw a boom especially in autumn. The price of Urals-grade crude oil in early autumn hit 78–79 dollars a barrel, while weakening of the ruble's exchange rate raised the ruble-denominated oil price to an all-time high. Revenues from oil & gas revenues accounted for 46 % of all federal budget revenues in 2018, with the ratio of revenues from energy products to GDP rising to nearly 9 %. During the 2011–2014 peak period, the ratio was only slightly higher (9.3 %).

Growth in other budget revenues accelerated to over 14 % last year mainly thanks to a 17 % increase in value-added tax revenues. VAT revenues accounted for 58 % revenues of other than oil & gas revenues. VAT's share of other revenues has not been this high in roughly one and a half decade. Revenues from corporate profit taxes and dividends from state-owned enterprises also increased substantially.

Federal budget spending rose in nominal terms by just 2 % in 2018. Defence spending declined slightly. Spending on domestic security saw large increases to the agencies responsible for security, prosecutorial and investigatory functions. The federal budget covers nearly all of these spending items.

The federal budget surplus rose in 2018 to a level equal to 2.7 % of GDP. The last time the federal budget showed such a large surplus was in 2011. Federal cash reserves also rose significantly in the second half, finishing the year at nearly 10 % of GDP. The sum includes liquid reserve fund assets (i.e. National Welfare Fund). The boost in assets was partly driven by oil prices well in excess of the basic calculation price defined under the fiscal rule (last year's calculation price was just under 41 dollars a barrel). The Russian Federation last year issued ruble bonds equivalent to roughly 1 % of GDP. Repayments of ruble-denominated bonds corresponded to 0.5 % of GDP.

Russian federal budget revenues and expenditures, 2013–2018



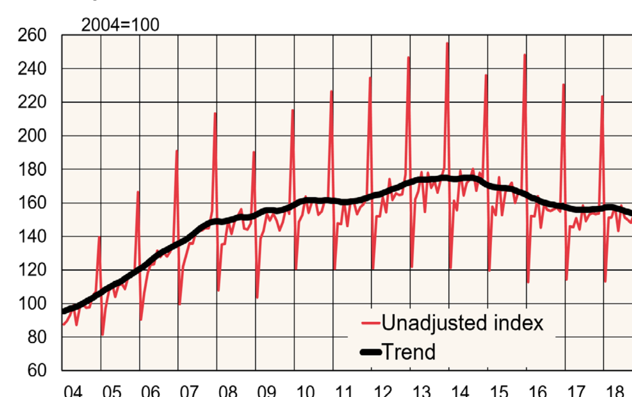
Source: Russian Ministry of Finance

Russian real disposable income still well below 2014 level. Russian real disposable household incomes last year were essentially unchanged from 2017. Revenues initially showed gains in the first half of the year, only to decline in the second half. In the post-Soviet era, the peak in real incomes was reached in 2014. At the end of 2018, real disposable incomes were about 13 % below the 2014 level.

Although disposable incomes have generally been on a downward trend over the past four years, real wages started growing already at the beginning of 2016. In addition to wages, disposable income also includes a variety of social entitlements such as pensions, as well as capital income and an assessment by the Russian Statistics Service of wages paid under the table.

The nominal average monthly wage in Russia last year was 43,400 rubles, up 11 % from 2017. In euro terms, this makes 585 euros, a decrease of over 1 % from 2017.

Real disposable income of Russians, 2004–2018



Sources: Rosstat, BOFIT.

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China

Even as China opens its financial markets to the world, strict controls on capital exports remain in place. At the end of January, the China Security Regulatory Commission (CSRC) published draft legislation geared to increasing foreign investment in Chinese securities. The proposal calls for consolidating the current investment quota system, streamlining permitting of foreign agents and offering a wider selection of investment instruments.

The draft bill would integrate the qualified foreign institutional investor (QFII) and renminbi qualified foreign institutional investor (RQFII) programmes and simplify the permitting processes. In addition to publicly listed shares and bonds, it would also let existing qualified investors invest in a broader range of financial instruments such as financial and commodity market derivatives.

The QFII programme, launched in 2002, was complemented in 2011 with the RQFII programme, which allows investment of yuan acquired outside mainland China in Chinese securities. These programmes have long served as the main conduit to China's stock and bond markets for foreign investors. In mid-January, the QFII programme quota was doubled to 300 billion dollars, even if only about 100 billion dollars of the old quota was employed. The new RQFII programme quota is 1.94 trillion yuan (USD 280 billion), and again, less than 650 billion yuan (nearly USD 100 billion) of it has been used. Since 2015, the stock and bond trading connections between mainland China and Hong Kong exchanges, as well other deregulation, have reduced the relative significance of the QFII and RQFII programmes as vehicles for bringing foreign capital into China.

While China's equities and debt security markets are the world's third largest after the United States and Japan, foreign investors only account for about 2–3 % of Chinese market participation. The attractiveness of China to foreign investors is likely to be enhanced, however, once western credit rating agencies gain access to Chinese markets. Indeed, S&P Global was last month granted permission to begin providing credit ratings for bonds in China's interbank market. International interest should also be boosted by the gradual introduction of Chinese securities to international financial market indices. Last June, share index producer MSCI started introducing with a tiny weighting of mainland Chinese shares into its global indices. Bloomberg recently announced that starting in April it will gradually add Chinese government and policy bank bonds to the Bloomberg Barclays Global Aggregate index. The move is a first step in incorporating Chinese debt securities into international benchmark indices. Other index producers have announced similar plans.

China's efforts to open up its financial markets have focused on attracting investment into China. Portfolio investment outflows from China are still tightly regulated, however. Aside from the Stock Connect programme, Chinese can invest in foreign securities in Hong Kong and China under the 2015 reciprocal Mutual Recognition of Funds (MRF) arrangement. Fewer than two dozen funds, however, currently are licenced to market themselves to Chinese investors, while in Hong Kong foreigners have been able to invest in roughly 50 Chinese funds. After a long permitting process, JPMorgan Asset Management last week won approval to market for two funds directed at Chinese investors under the MRF framework.

China allows new debt instruments to boost bank capital adequacy and spur lending. The central bank and The China Banking and Insurance Regulatory Commission (CBIRC) gave the green light last month to the issuance of "perpetual bonds" by commercial banks. The first issue of perpetual bonds by the Bank of China on January 25 was valued at 40 billion yuan (USD 6 billion).

The issuance of perpetual bonds should help recapitalise banks (additional Tier 1), and thereby help them increase lending. The government's main motivation is concern over banking sector stability as particularly some smaller Chinese banks are barely able to meet their minimum reserve requirements. The reduction in the use of off-balance sheet shadow banking sector instruments has boosted traditional bank balance sheets, which also necessitate further reinforcement of capital buffers. In its latest financial stability review, the IMF urged China to increase capitalisation of its banking sector.

Like many other bonds with good credit ratings, commercial banks can use perpetual loans as collateral with the central bank. To boost demand, the CBIRC will also allow insurance companies to invest in perpetual bonds issued by banks. Further, the People's Bank of China has introduced a new policy instrument that allows financial companies to swap perpetual loans issued by solid banks for PBoC bonds for up to three years at a time. The central bank bonds acquired in such swaps cannot be traded, but can be used as collateral for PBoC credit facilities.

The purpose of promoting this complicated swap arrangement is ultimately to support recapitalisation of banks. Swap operations are not a reflection of an easing of the monetary stance. The PBoC will not purchase the perpetual bonds of commercial banks, but only swaps them temporarily for its own bonds which are, at least for the time being, believed to be more attractive to investors than initial perpetual bonds.

In the recent public discussion of China's economic predicament, the inability of loose monetary policy to promote high growth has been one of the topical issues. According to media reports, the PBoC recently directed commercial banks to maintain their leading growth and volume of new lending at least at the same level as in the same period last year. While the PBoC has offered the banking sector substantial liquidity, the economic slowdown has depressed corporate borrowing demand and the willingness of banks to lend to riskier corporate borrowers. In such case, excess liquidity tends to flow elsewhere than the real economy.

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