Weekly Review
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BOFIT

Russia

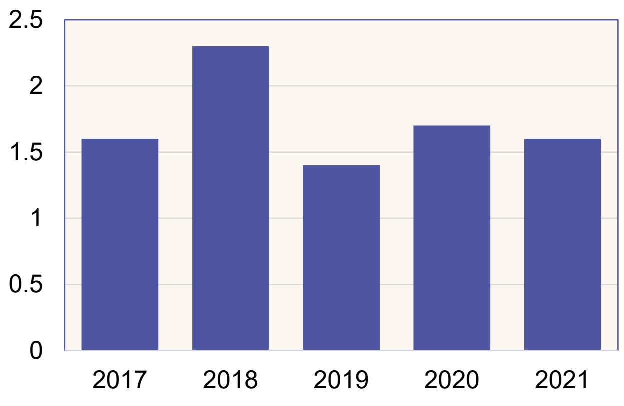
BOFIT forecast sees lower growth of Russian economy ahead. While Rosstat's 2.3 % initial estimate for Russian 2018 GDP growth clearly exceeded expectations, our latest BOFIT Forecast for Russia 2019–2021 sees growth slowing this year. Lower growth in public sector wages and a modest pick-up in inflation bode lower real wage growth. Growth in private consumption will be curtailed by a two-percentage-point increase in value-added taxes at the start of the year. Growth in household borrowing, a bulwark of private consumption over the past two years, should remain high, even if higher on-year growth is unlikely.

If oil prices remain at current levels, the public-sector budget should remain in surplus. The rise in budget revenues will slow and the government's fiscal rule should limit growth in public consumption. Private consumption in Russia corresponds to roughly half of GDP, while public consumption accounts for just under 20 %.

Numerous investment programmes associated with the state-lead national projects are set to get underway in 2020 and 2021. The project spending should slightly boost economic growth, especially in 2020. In contrast, there are no signs of a broad-based recovery in private investment. The government hopes to attract investment through such measures as subsidising domestic production, increasing domestic-content requirements and guiding large firms to participate in the financing of national projects. The business environment remains burdened by uncertainty and structural problems with the economy. The pick-up in investment growth is likely to be temporary and the economy's investment rate should remain at just over 20 % of GDP.

Substantially higher growth in export volumes relative to import volumes supported economic growth last year. During the forecast period, this gap between export and import growth will narrow. Growth in the state's overall presence in the economy and lack of market reforms depress the growth outlook in the years ahead.

Realised Russian GDP growth and forecast for 2019−2021, %



Sources: Rosstat, BOFIT Forecast for Russia 2019−2021.

Growth in Russian industrial output revived in February. Industrial output growth rose to 2.6 % y-o-y in January-February. The figure moved up towards the growth figure for all of 2018. Extractive industries led growth, with production increasing by nearly 5 %, up from an annual growth pace below 3 % over the past three years. Growth of crude oil production was up, while natural gas production increased rapidly for the third consecutive year. As in previous years, the volume of services related to their production grew at such a pace that the services also now had a major impact on extractive sector growth. The weight in terms of the value of these services in extractive sector production figures is slightly larger than the weight of natural gas output.

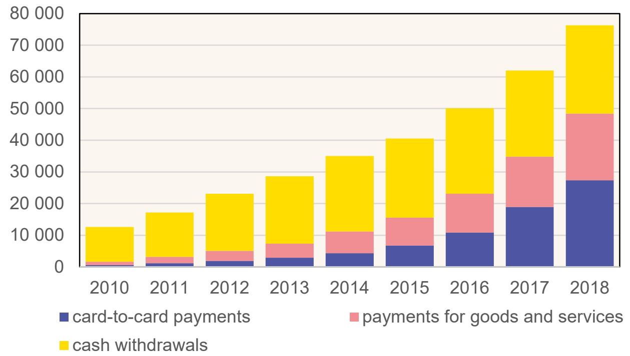
Having been around 2.5 % y-o-y for the previous three years, manufacturing output growth was under 2 % in January-February. Years of rapid growth in the food industry continued. Growth also strengthened in some of the other large branches such as oil refining and metal industries, while production performance weakened in the chemical industry and in the machinery & equipment category.

Rapid growth in use of payment cards in Russia. The use of new forms of electronic payments has increased rapidly in Russia, and the Central Bank of Russia has clearly indicated its intention to participate in this trend. The CBR aims to create safe payments systems that are independent from foreign banks and financial institutions. With this goal in mind, since 2014 Russia has built e.g. CBR-owned national payment systems, and the national payment card Mir.

At the beginning of this month the CBR launched its own fast payment system SBP, designed to allow for immediate transfer of funds between client accounts. Although a group of 40 banks has signed up to participate in the system, Sberbank, Russia's biggest bank and the unchallenged market leader in card payments, has yet to join.

A sizable chunk of retail payments in Russia are made with the card-to-card payment systems mostly based on Visa and Mastercard. The authorities may hope the CBR's SBP system will move at least some payment traffic to domestic platforms.

Use of payment cards 2010−2018 (RUB billion)



Source: Central Bank of Russia.

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China

BOFIT Forecast for China: uncertainty casts shadow on Chinese growth outlook. China's economic growth, which witnessed a slowdown last year, continues to slow this year. While uncertainties that include the current trade war with the United States, domestic indebtedness and unreliable statistical data make it hard to judge China's true economic circumstances, our latest BOFIT Forecast for China 2019-2021 nevertheless sees an ongoing slowdown in annual GDP growth towards around 4 % by the end of the forecast period.

The drag on Chinese economic growth comes largely from structural factors. The population is ageing rapidly. The working-age population (15–64 years) has been shrinking since 2014, and the absolute number of people in the workforce declined last year for the first time in the modern era. The dependency ratio continues to deteriorate at a rapid pace. The structural evolution towards a services-driven economy also limits opportunities for productivity gains. It is difficult to boost investment growth much as the investment rate is already the highest among all large economies. The need to address China's environmental problems also depresses the country's growth outlook.

China has stubbornly clung to the political goal of doubling real 2010 GDP by 2020. The need to constantly apply stimulus to reach the growth targets has caused the country's indebtedness to soar. Moreover, statistics have been falsified in order to meet targets increasing uncertainty and complicating decision making at all levels.

Room to manoeuvre in economic policy is limited. As long as the fiscal policy stance remains extremely accommodative, the sustainability of local government indebtedness is highly problematic. In the corporate sector, further debt-driven stimulus is also difficult to justify in the face of rising defaults and bankruptcies. Moreover, debt financing beyond a certain point has diminishing returns as new borrowing goes to paying off old debt. Any increase in stimulus measures exacerbates the likelihood of sudden economic decline.

The government's focus on supporting economic growth has pushed needed structural reforms to the back burner, but the trade war brought them back to the fore. However, measures to consolidate the party's power and increase control over society conflict with economic reforms.

The likelihood of a sudden slump in economic growth has increased. In countries that have gone rapidly into debt like China, it is common to see the episode end with a sharp drop in GDP and a crisis in the financial sector. The current astronomical apartment prices relative to incomes poses a clear risk. A correction in housing prices would not just cause problems for households but for heavily indebted companies in the construction sector as well. In the banking sector, small and mid-sized banks are most vulnerable. Even if the trade war is resolved amicably, the US and China will continue to compete for global dominance, which will stoke trade and geopolitical tensions also in the coming years.

January-February figures show slowing Chinese economy. The National Bureau of Statistics reports industrial output growth slowed to 5.3 % y-o-y in the first two months of 2019 (over 7 % in the same period in 2018).

Retail sales rose by 7.1 % y-o-y in real terms during January-February. Although growth in online sales slowed, the value of goods and services sold online rose by 14 % y-o-y (37 % y-o-y in January-February 2018). Car sales, which represent about 10 % of retail sales, continued to contract as part of a trend that began last year. Apartment sales also slowed. Measured in terms of liveable floorspace, apartment sales in January-February declined by 4 % y-o-y.

The unemployment rate rose from 5.1 % in January to 5.3 % in February (4.9 % in December). The shift is significant by Chinese standards; since January 2017, the official survey-based urban unemployment rate has held solidly in the 4.8–5.4 % range.

Growth in the stock of bank lending continued to rise in January and February at 13 % y-o-y. Local governments accelerated their borrowing plans this year. In the January-February period, local government issued bonds worth 782 billion yuan (117 billion dollars).

Real growth in fixed asset investment (FAI) for January-February was estimated at about 2–3 %. Growth in infrastructure investment slowed significantly from the first two months of 2018. This slowdown was also apparent in construction. The NBS reports that new building starts rose by 3 % y-o-y in January-February, the lowest pace of growth since the series was first released in 2004. Chinese investment figures should be taken with a large grain of salt, however, as many series published at the moment only indicate nominal cumulative (year-to-date) growth. Yuan-denominated series have been discontinued. The FAI figures are also odds with China's national accounts figures.

NPC rushes through a new investment law. Last Friday (Mar. 15), the National People's Congress passed a new Foreign Investment Law designed to protect commercial secrets of foreign firms, ban forced technology transfers and assure foreign firms equal access to China's domestic markets. The new law will enter into force at the start of 2020.

A further revision to the bill added last week says that officials who pass information provided by foreign firms to third parties can be punished. The law complements earlier regulations such as those on free repatriation of corporate profits and other corporate assets. The new law has been criticised for its hasty 12-week preparation and its resulting vagueness. The financial website Caixin reports that the new law will likely be clarified through lower-level regulations and guidelines. Implementation of the law and its monitoring has already become a major trade policy issue.

The new law responds to the current trade war and US demands, and replaces three laws enacted during the 1970s and 1980s.

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