Weekly Review
15 • 12.4.2019
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Russia

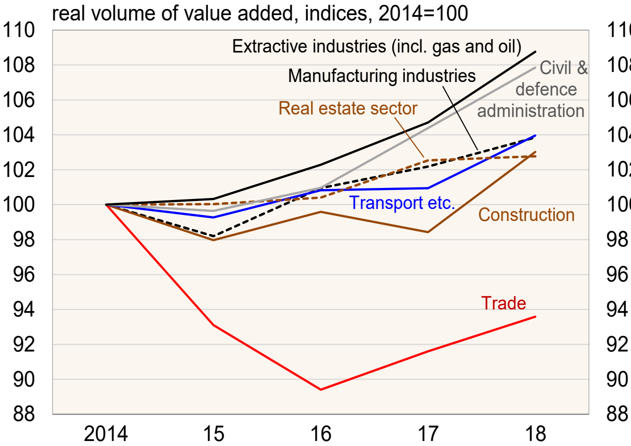
Russian export earnings rather flat; recovery in imports continues to stall. Central Bank of Russia balance-of-payments figures show that earnings from exports of goods and services, which had recovered fast in 2017–2018, were essentially unchanged in the first quarter from the same period a year earlier. This concerned both the energy category, which had seen a hefty rise in export prices, other exports of goods, as well as exports of services. Spending on imports of goods and services were unchanged on-year for the third quarter in a row. This has been the situation in goods imports for the past three quarters and Russians' travel spending abroad for the last half year.

The current account surplus was still large in the first quarter, rising to more than 7 % of GDP. The net private capital flow out from Russia climbed, increasing to 4.5 % of GDP for the past four quarters.

Russian growth in the past couple of years driven largely by extractive sector, trade and public administration. New GDP data show that among the largest sectors output of extractive industries and related services, as well as civil service and defence administration have been the fastest drivers of real growth over the past three years. The trade sector, as well as transport and warehousing also recovered gradually over the past two years and construction over the past year. After showing good growth a couple of years back, manufacturing saw a slowdown. In GDP statistics, output is measured by value-added produced in each sector.

Health care and social services stand out among the weakest sectors and have seen their value-added decline in real terms slightly in recent years. Increases in government budget spending on health care have largely focused on wage increases (especially last year) for workers in the sector. In practice, the rise in wages has mainly been reflected as higher prices in health care.

Real growth of the economy's largest sectors, 2015–2018



Source: Rosstat.

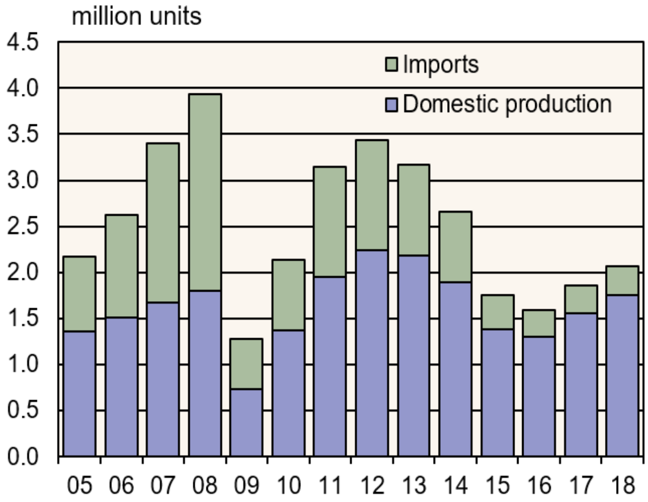
Russia's car manufacturing industry continues to recover. Rosstat reports that Russian car production rose by 13.3 % from 2017 to 2018. A total of 1.8 million passenger vehicles, busses and lorries were built in Russia, with another 300,000 vehicles imported. Russia currently has about 50 million cars on the road. Russia's domestic production has gradually recovered in recent years from a dip in 2014–2016, but this winter the recovery has been slower.

The role of foreign brands in the Russian car market has fluctuated over the past three decades. Domestic production declined during the 1990s, and over half of the flow of cars into the market were imports by 2008. Since then, however, domestic production has made a comeback as foreign carmakers moved their assembly work to facilities in Russia.

Russian partners are often involved in plant projects of foreign automakers. Such joint ventures, for example, have allowed AvtoVAZ, known for its production of the Lada, to preserve significant market share. The popularity of German, American, Japanese and Korean cars has remained, but today four out of five cars that come to the Russian market are assembled in domestic plants. In recent years, foreign companies operating in the Russian market have shut down some of their production lines. FordSollers, the joint venture of the American Ford and Russian Sollers (formerly Severstal-Avto), announced in March that they were ceasing passenger car production and focusing on other light vehicles.

The core manufacturing centres of Russia's car industry are located along the banks of the Volga River between Samara and Yaroslavl. Foreign manufacturers have also been attracted through various incentive arrangements to establish production in Kaluga, the Kaliningrad enclave and St. Petersburg. Lower car sales can have significant local impacts in smaller municipalities. For example, the city of Togliatti, with a population of about 700,000 people, is home to the AvtoVAZ plant. Even after major layoffs, the plant still employs 37,000 people.

Flow of cars into the Russian market, 2005–2018



Source: Rosstat.

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China

EU gets reform commitments from China that benefit European firms. At the 21st annual EU-China summit held on Tuesday (Apr. 9) in Brussels, the parties signed a joint statement that said that they were committed to, among other things, supporting multilateral rule-based world trade and WTO reform including rules on government subsidies. Both the EU and China unequivocally rejected forced technology transfer policies.

Progress has been slow in negotiations on the EU-China Comprehensive Investment Protection Agreement which began in 2013. Now the joint statement affirms that the EU and China are committed to accelerate the process so that the agreement could be signed as soon as next year. The agreement would assure improved market access, elimination of discriminatory demands and practices on foreign investors and establish a balanced investment protection network. The EU considers approval of the investment protection agreement a precondition to starting free-trade talks. The parties also pledged to foster China's accession to the WTO's Government Procurement Agreement.

Both sides agreed that steel overcapacity and dealing with government supported export credit were global challenges. The parties will also seek to create synergy between the EU strategies on Connecting Europe and EU Trans-European Transport Networks and China's Belt and Road Initiative in order to improve connections between Asia and Europe.

The EU has lately honed its China policies. This was clearly expressed in the strategy paper released by the European Commission last month (*EU-China – A strategic outlook*). This week it seemed that the EU might walk away from the joint statement if China failed to commit to concrete steps to solve long-standing trade-policy problems. While the nature of problems suggests they cannot be dealt with quickly, this time the parties managed to agree on tracking mechanisms to monitor progress in meeting their commitments.

Special audit reveals big problems in China's small rural banks. China's National Audit Office late last week submitted a special audit report on rural banks in Henan province. Of 42 banks inspected, a dozen were found to hold non-performing loans (NPLs) in excess of 20 % of their loan stocks. Several had NPL ratios above 40 %.

At the end of 2018, Henan banks reported NPL ratios of around 2.5 % on average, which was still above the nationally reported average of 1.9 %. However, Chinese banks are famously reluctant to report or write down bad loans, so it is evident that similar problems of mischaracterisation of loan status found in Henan are fairly widespread. Banks allow non-performing receivables to accumulate after funding unprofitable projects under political pressure. Chinese banking rules require banks to hold reserves to cover such bad loans, but if NPLs were reported honestly, their reserve buffers would have to be increased dramatically to meet official requirements.

The situation for China's banking sector overall was relatively stable last year. Lending grew steadily and banks managed to slightly widen the interest rate spread between loans and deposits from which banks derive most of their earnings. Banks also managed to boost solvency ratios. Profitability measures (ROE, ROA) remain quite low, though. Overall, the situation within the banking sector remains one in which large banks perform much better than small banks by just about any performance measure.

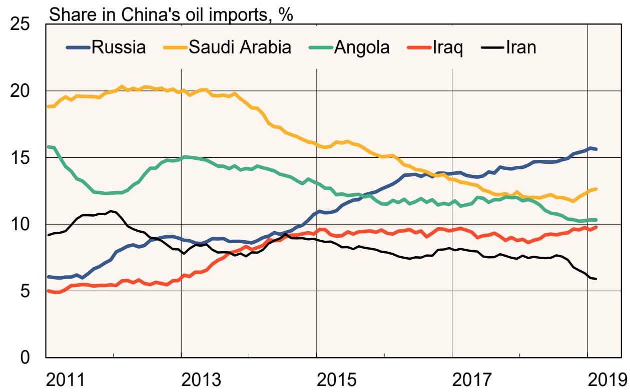
Most banks consider the current operating environment challenging. In addition to external uncertainties, growth of China's domestic economy is slowing, thereby increasing problems with loan repayments and competitive pressures from the large financial technology (FinTech) firms.

Russia strengthens its position as China's biggest oil supplier. China imported 462 million metric tons of crude oil last year, an increase of 10 % from 2017. China's domestic oil production witnessed a third consecutive year of decline from a peak of 215 million tons to just 189 million tons last year. The country's dependence on oil imports continues to rise (71 % of crude oil consumed in China is now imported).

China has been quite strategic in distributing its sources of foreign oil. In recent years, Russia (16 % of China's oil imports) has surpassed Saudi Arabia as China's most important oil supplier. The shift reflects the completion in early 2011 of the China branch of the Eastern Siberia Pacific Ocean (ESPO) pipeline, as well as the inauguration of an additional pipeline section to China in January 2018. China's oil imports from Russia rose by about 20 % last year to 72 million tons, of which about half was transmitted via the ESPO pipeline's China branches. About a quarter of Russian crude oil exports now go to China.

Iran, long a major supplier for China, saw a sharp decline in the volume of oil exports to China last autumn. The drop likely reflects harsher US sanctions on Iran. Venezuela, which only a year ago accounted for over 5 % of China's oil imports, has recently seen its share fall below 4 %.

China's top crude oil suppliers



Source: CEIC.

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