Weekly Review
26 • 28.6.2019

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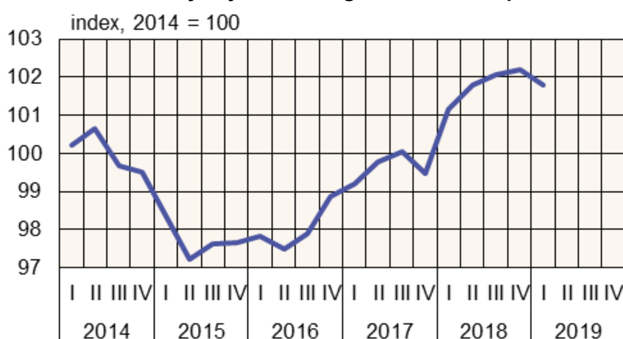
Russia

Russian first-quarter growth supported by extractive sector and certain service-sector branches. The latest Rosstat figures show Russia's seasonally adjusted gross domestic product in the first quarter contracted by 0.4 % from the previous quarter. Prior to that, seasonally adjusted GDP had grown almost uninterruptedly since mid-2016. Russian GDP in the first quarter of this year was 1.8 % larger than it was in 2014.

Russian GDP rose by 0.5 % y-o-y in the first quarter of this year. Growth was supported in particular by high growth in the extractive sector (4.6 %), even if the pace of growth slowed from late 2018. There was also high growth in some service branches. Financial services increased by 7.6 % y-o-y, while tourism was up by 4.8 %. Both fields have experienced strong growth since 2017. Manufacturing growth in the first quarter was up by just 0.6 % y-o-y. There was virtually no growth in the construction sector.

Russia's seasonally adjusted real gross domestic product



Source: Rosstat.

Russia tries to strengthen import substitution policy. In February, Russia's ministry of industry and trade released a draft decree which would limit public procurement. The decree would require government agencies to purchase computer, communications equipment and household appliances from domestic producers if suppliers selling the requisite goods are available. Domestic producer is defined as a firm that is at least 50 % Russian-owned.

The legislation is part of Russia's import substitution policy. Russian industry is currently heavily dependent on imported machinery. In particular, the market shares of Russian companies in quality product categories are quite small. Officially, restrictions on imports are intended to reduce dependence on foreign countries and diversify the domestic production structure. Usually these measures target the location of end-product assembly or the ownership of the firm doing it rather than the production of added value along the entire production chain. In practice, the import substitution policy can be influenced by special interest groups such as the stakeholders of a large factory in a particular city. To the extent that the measures protect special interests and preserve existing business structures, they hardly promote the goals of reducing dependency and diversifying Russian production.

Russia already has several measures favouring domestic manufacturers. In 2014, Russia restricted imports of certain foods from the West in response to Western sanctions on Russia for annexation of Crimea and war in eastern Ukraine. In addition, favouring of domestically produced goods and services has been seen in the pharmaceutical, transport vehicle, telecom and software industries. The effectiveness of these measures is limited as Russia cannot offer serious domestic alternatives.

Russia has traditionally had high barriers to imports. Since joining the WTO in 2012, Russia has incrementally lowered its import duties, but barriers to imports are still quite high. The UN reports that Russia's average trade-weighted most-favoured-nation customs duty in 2017 was about 5 % of the value of the goods. Thus, the average duty was not particularly high, but duties varied depending on the trade partner and the product category. In addition, Russia's regulatory environment presents a major obstacle to trade.

Russia suspends flights to Georgia after July 8. Last Friday (Jun. 21), President Vladimir Putin signed a decree suspending direct flights between Russia and Georgia citing heightened security concerns. Thousands of protesters took to the streets in the Georgian capital of Tbilisi last week after a representative of the Russian Duma addressed the Georgian parliament as part of a meeting of the Interparliamentary Assembly on Orthodoxy. Relations between Georgia and Russia have stayed tense since the August 2008 war between the two countries. While they have not restored diplomatic ties, tourism and trade have remained brisk.

About a million Russian tourists visited Georgia last year. Given that Russians constitute the largest tourist group, observers estimate that Georgia's loss in revenues due to the ban on flights could go as high as 300 million euros this year. Russia's food safety agency (Federal Service for Veterinary and Phytosanitary Surveillance) has also blocked specific wine shipments from Georgia. Russia banned imports of Georgian wines altogether from 2006 to 2013. Russia last year accounted for 13 % of Georgia's total exports, about a quarter of which was wine.

The ban on flights to Georgia is not the first instance of Russia imposing restrictions on tourism abroad. Russia halted all flights to Egypt in 2015 after a suspected luggage bomb brought down a charter flight from the Red Sea resort town of Sharm el-Sheikh to St. Petersburg. Before the bombing, over 2 million Russians visited Egypt each year. Since then, official figures show the number of Russian tourists visiting Egypt has fallen to less than a thousand annually. Tourist numbers to Egypt failed to recover, even after scheduled direct flights between Cairo and Moscow were re-established last autumn, and there are plans to reinstate charter flights later this year.

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China

WTO warns of rising protectionism ahead of G20 summit. On Monday (Jun. 24), the World Trade Organization released its 21st Monitoring Report on G20 trade measures. New measures to restrict imports have been introduced at a record pace in recent year. In the latest monitoring period (October 16, 2018–May 15, 2019), the WTO estimates that the coverage of new restrictions targeting imports amounts to around 336 billion dollars a year, an amount that corresponds to some 2.5 % of the imports of G20 countries.

Shifts in trade policy can be seen in the increase in trade coverage of import-restrictive measures, which was only larger in the immediately preceding monitoring period in 2018, when new restrictive measured covered 3.5 % of G20 imports. The WTO has made estimates of the coverage of import restrictions since 2012. Before 2018, however, the coverage of new imports subject to restrictions was only 0.1–0.6 %. Most of the recent increase reflects tariff hikes. The number of new import restrictions, however, were fewer than in the previous monitoring periods. The value of new measures to facilitate imports also hit a record level.

While the monitoring report technically catalogues trade policy measures implemented by G20 countries during the period, it also reveals simmering tensions within the WTO and in global trade. The WTO Secretariat hopes that the G20 countries will provide, among other things, clear rules on reporting of government subsidies. The report also notes that in services trade, while most new measures have facilitated trade, policies in several branches such as telecommunications and online services as well as investment in strategic fields have become more restrictive.

The WTO report avoids naming specific countries. It is not hard to guess, however, that a significant part of the reported new import restrictions is due to the trade war between China and the US. The report also shows that imports from China have overwhelmingly been the most usual target of anti-dumping and countervailing initiations by other G20 members (including Russia). Overall, the product groups hit hardest by these retaliatory measures have been metals, chemical products and plastics.

The WTO should be reformed in order to make its rules and operations to reflect changes in the global economy. However, the trade dispute between the United States and China will again overshadow the G20 summit in Japan on June 28–29, as well as any progress in reforming the WTO. Besides tariffs, the opening up of China's markets and the controversies surrounding Huawei, a new stumbling block to trade negotiations is posed by US allegations concerning the involvement of three Chinese banks in a scheme to circumvent sanctions against North Korea. Revelations this week in the *Washington Post* have only added to uncertainty surrounding the trade negotiations between the US and China.

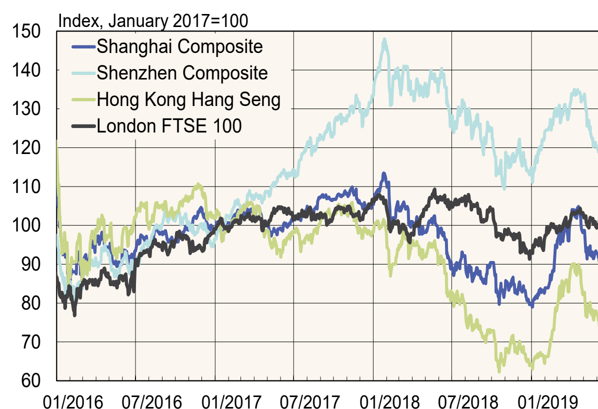
London-Shanghai Stock Connect launches. On June 17, China's financial markets took a small step towards internationalisation as the London Stock Exchange opened trading in depository receipts of Chinese firms. At the moment, however, foreign investors in London can only use the arrangement to trade in the depository receipts of a single Chinese company.

Unlike the Stock Connect programme that links the Hong Kong Stock Exchange with the Shanghai exchange, the London-Shanghai Stock Connect scheme relies on Global Depository Receipts (GDRs) issued by Chinese firms, while the listings of firms on the London exchange are based on Chinese Depository Receipts (CDRs) on the Shanghai bourse. The depository receipts represent ownership of ordinary shares of a foreign corporation and can be traded like regular shares. The custodian bank issues the depository receipts against the actual shares of the firm in its possession. The advantage of trading in depository receipts is that it removes the need for direct trading infrastructure between exchanges and eliminates such issues as time differences. The trading is subject to the rules of both exchanges. In Shanghai, trading is denominated in yuan and in London in dollars, pounds or yuan.

To launch the London-Shanghai Stock Connect, the Chinese brokerage Huatai Securities raised 1.5 billion dollars (about 9 % of the company's share capital) through the issue of depository receipts on the London exchange. No firm listed on the London exchange has yet issued depository receipts in Shanghai.

The Stock Connect rules are strict, so only a small number of exchange-listed firms are qualified to participate. For this reason, the arrangement is not expected to do much to increase the prospects of Chinese firms seeking foreign financing. Trading in both directions is subject to quotas and private Chinese investors cannot participate in the scheme without a large enough investment capital. Trading activity is expected to remain relatively modest, and the programme could end up being mostly a symbolic gesture.

Share price trends in mainland China, Hong Kong and London



Sources: Macrobond and BOFIT.

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