Weekly Review
30 • 26.7.2019

BOFIT

Russia

International Monetary Fund lowers growth forecast for Russia. The IMF's July update to its *World Economic Outlook* revise the forecast for Russia's projected 2019 growth down from 1.6 % in April to 1.2 % currently. The updated growth forecast for 2020 is 1.9 %.

The Fund, as well as all major institutions, expect Russian growth to accelerate slightly next year on higher public spending. The European Bank for Reconstruction and Development (EBRD) notes that growth this year has been restrained by such factors as the hike in value-added tax rates at the start of the year.

The IMF's July update lowers the growth projections for China and India in 2019 and 2020. The global growth outlook was also reduced a bit.

GDP growth forecasts

		2019	2020
RUSSIA	IMF (7/19)	1.2 %	1.9 %
	Consensus Economics (7/19)	1.1 %	1.9 %
	World Bank (6/19)	1.2 %	1.8 %
	EBRD (5/19)	1.5 %	1.8 %
UKRAINE	World Bank (6/19)	2.7 %	3.4 %
	EBRD (5/19)	2.5 %	3.0 %
TURKEY	Consensus Economics (7/19)	−1.5 %	2.3 %
	World Bank (6/19)	−1.0 %	3.0 %
	EBRD (5/19)	−1.0 %	2.5 %
INDIA	IMF (7/19)	7.0 %	7.2 %
	World Bank (6/19)	7.5 %	7.5 %
	Asian Development Bank (4/19)	7.2 %	7.3 %

Russia posts tepid first-half growth. Although Russian GDP grew by over 2 % last year, the pace of growth slowed to just 0.5 % in the first quarter of this year (BOFIT Weekly 21/2019). New data for June show manufacturing growth picked up in the second quarter to 3 %, while other sectors of the economy showed virtually no growth gains.

There was no on-year growth in construction in the first half, and growth in services was negligible. Growth in both goods transport and retail sales slowed in the second quarter to under 2 %. The volume of services to households contracted by well over 1 % from 1H18.

The rise in real wages was also slower in the first half than in the same period last year. In June, real wages were 2.3 % higher than in June 2018. The real disposable incomes of Russians in 1H19 contracted by more than 1 % y-o-y. Household borrowing, in particular, helped fuel growth in retail sales. The household credit stock was up 23 % y-o-y in June. Notably, the rise in consumer credit has aroused concerns about excessive indebtedness (BOFIT Weekly 25/2019).

Part of Russia's sluggish economic performance reflects a slowdown in the global economy, which, in turn, reflects the contraction in Russian exports. The latest balance-of-payments figures show that the value of exports and imports contracted in January-June by about 3 % y-o-y. Exports, in particular, took a nose-dive in the second quarter. Economic growth is expected to revive a bit in the second half of this year as the effects from planned public sector spending begin to kick in.

Significant economic differences across Russia's cities with populations of more than one million. Russia has 16 cities with more than a million inhabitants. The five biggest cities after Moscow and St. Petersburg are Novosibirsk, Yekaterinburg, Nizhny Novgorod, Kazan and Chelyabinsk. About 34.5 million people (24 % of Russia's total population) live in cities with at least a million people. Of that, 16.5 million live in cities other than Moscow or St. Petersburg.

The Russian consulting firm Strelka's latest survey of cities over 1 million shows that Russia's largest population centres contribute about a third of Russian gross domestic product. The large megalopolises of Moscow and St. Petersburg account for about 70 % of all the GDP generated by cities with populations over a million. The leading regional urban areas from an economic standpoint are Krasnodar, Yekaterinburg and Samara. Moscow's nominal GDP per capita is about double that of the richest regional cities with populations over a million such as Krasnodar and Yekaterinburg, and over three times greater than that of the poorest cities surveyed (Omsk and Voronezh). Differences in price levels across cities suggest that actual differences in living standards are smaller. Real wages in regional cities with more than a million are about 30 % lower than in Moscow on average.

The pace of economic development in regional cities with over a million people varies considerably. For example, the GDP of Kazan, Nizhny Novgorod, Novosibirsk, Samara and Ufa grew by more than 25 % in 2010–2017, while economic growth was negligible in Perm and Chelyabinsk. In Novosibirsk and Ufa, small and medium-sized firms were the main engines of economic growth. Growth was driven by large enterprises in Kazan and Samara.

Compared to the St. Petersburg and Moscow metropolises, Russia's regional cities with more than a million people constitute minor economic units and are quite sensitive to business-cycle fluctuations. These cities grew faster than Moscow or St. Petersburg at the start of the decade, only to contract more violently after Russia went into recession in 2015. Fixed investment in these regional cities with a million people fell much more than in Moscow or St. Petersburg.

The differences in living standards can also be seen in the quality-of-the-urban-environment index, which is jointly produced and maintained by Russia's Ministry of Construction, Housing and Utilities, Strelka and Dom.rf. The index captures urban quality of life generally, and is based on sub-indices that track e.g. housing quality, availability of public services and infrastructure. According to the index, the quality of life in Moscow is good (214/300) and satisfactory in St. Petersburg (181), but mediocre (135) on average for other Russian cities with populations above one million.

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China

Most forecasts see China's GDP growth in line with official growth target. Major institutional forecasts are largely in agreement that China's economy will grow by 6.2–6.4 % this year. China's official figures show GDP grew by 6.3 % in the first half. Most forecasters base their forecasts on China's official figures, and thus also the global growth outlooks reflect China's reported development. Some alternative estimates indicate China's actual growth likely being somewhat lower than official figures (BOFIT Weekly 29/2019).

The updated IMF July forecast cuts China's economic growth this year from the 6.3 % April number to 6.2 %, while the global 2019 growth reading ticks down from April's 3.3 % to 3.2 %. The forecasted development would mean that China would still account for well over a third of all global growth (with purchasing power parity weights). The recently updated outlooks see China's slowdown in growth be a bit faster than earlier expected due to uncertainty caused by the trade war with the US and lower growth of the global economy. The baseline scenarios of the IMF and World Bank both assume that trade tensions between the US and China will not escalate further, but the imposed punitive and retaliatory tariffs will remain in place.

GDP growth forecasts for China, 2019–2021 (%)

	2019	2020	2021
IMF (7/19)	6.2	6.0	6.0
World Bank (6/19)	6.2	6.1	6.0
Asian Development Bank (4/19)	6.3	6.1	
OECD (5/19)	6.2	6.0	
European Commission (5/19)	6.2	6.0	
Citi Research (6/19)	6.4	6.0	5.8
J.P. Morgan (7/19)	6.2	6.1	
Capital Economics (7/19)	6.3	6.0	5.8
Oxford Economics (7/19)	6.2	5.9	5.7

Shanghai stock exchange's new technology board launches. The Shanghai Stock Exchange rolled out its new Star Market on Monday (Jul. 22). The new board enables technology and science companies to list on the exchange with less strict requirements on e.g. firm profitability than the main boards at the Shanghai and Shenzhen exchanges. Star Market listing also does not require government approval, making listing faster and easier. Market makers price the firm and the Shanghai exchange approves each listing.

Trading launched with 25 firms on the list and over 100 firms are on the waiting list. Restrictions on trading and limits on daily price swings are more relaxed than for other markets in mainland China. For example, short-selling of shares on the new board is permitted, where in the main boards it is usually restricted. However, only investors with e.g. a trading history of at least two years and over 500,000 yuan (65,000 euros) in investment capital may trade on the Star Market. The requirement is designed to diminish the number of naïve speculators in the market. Despite this, Star Market shares were up on average 140 % on the first day of trading. IPOs were wildly oversubscribed. Only officially qualified foreign institutional investors (QFIIs) can trade in Star Market listings.

In particular, China would like to attract its own tech giants to the new list as many of them currently list offshore. The Star Market also allows Chinese firms listed abroad to raise capital by issuing Chinese Depository Receipts (CDRs). Investor interest in the new market has yet to be established. Response to the Shenzhen exchange's ChiNext tech board, which launched in 2009, has been underwhelming.

The new list's market value climbed to 529 billion yuan (77 billion dollars) in its first day of trading, and was 537 billion yuan on Thursday (Jul. 25). The Shanghai exchange will release an index tracking the Star Market price developments later. The key exchange indexes were relatively stable despite the release of a new market. Prices on mainland China stock markets have been fairly stable since May.

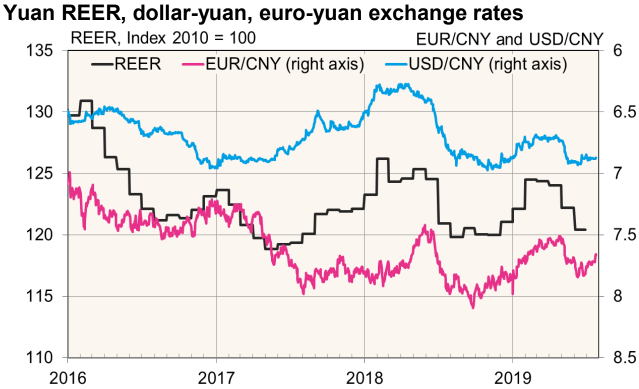
Key indices on mainland China and Hong Kong stock markets

Source: Macrobond.

Yuan exchange rate has been stable for months. Since the latest round of US tariff hikes against China that entered into force on May 10, the yuan's exchange rate has held at a rate of about 6.9 yuan to the dollar. Yuan's dollar exchange rate is about the same as it was at the start of the year, but has gained about 2 % against the euro over the same period.

BIS figures show that the yuan's real effective (trade-weighted) exchange rate (REER) in June was down 1 % from the end of 2018 and off 3 % from a year earlier.

Yuan REER, dollar-yuan, euro-yuan exchange rates



Sources: BIS and Macrobond.

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