Weekly Review
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Russia

Russia's economic growth remained slow. The preliminary Rosstat figure shows Russian second-quarter GDP growth was 0.9 % y-o-y. When combined with first-quarter GDP growth of 0.5 %, first-half growth was 0.7 %.

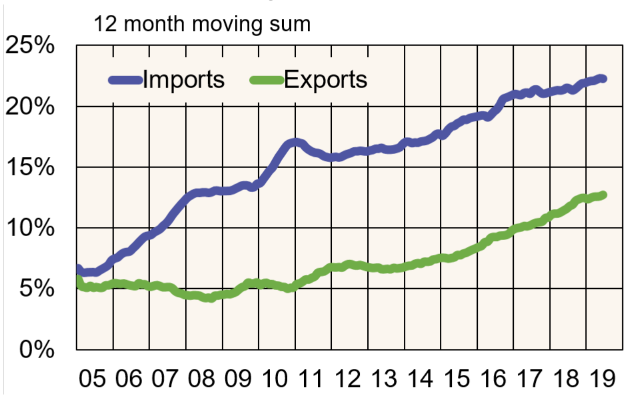
Growth in domestic demand has gone fairly sluggish. Retail sales in May-June were up 1.4 % y-o-y and by just 1 % in July. Fixed investment growth increased slightly from 0.5 % y-o-y in the first quarter, but just to a mild 0.7 % in the second quarter.

Manufacturing output growth rose to about 3 % y-o-y in June-July, while growth in mineral extractive industries (includes oil & gas) slowed to around 2.5–3 %. After a couple of years of brisk growth, growth in the volume of goods transported has slowed notably this year. Growth fell to 1.3 % y-o-y in the entire January-July period and further to around zero in the May-July period.

Russia's goods trade stays rather flat. According to Russian customs service, the dollar value of Russian goods imports in the second quarter declined by 3 % y-o-y. The earlier sharp increase in imports began to level off already last year. The value of Russian goods exports in dollars was down by 9 % in the same period.

As the euro weakened slightly against the dollar between the second quarter of 2018 and the second quarter of 2019, the value of Russian imports measured in euros did not fall but rather remained roughly at the same level. As nearly half of goods imported to Russia come from the euro zone, the euro-dollar exchange rate has a major impact on the trade figures. The decline in the value of exports can be attributed to some extent to a decline in oil prices.

China's share of Russian goods trade



Source: Russian Federal Customs Service.

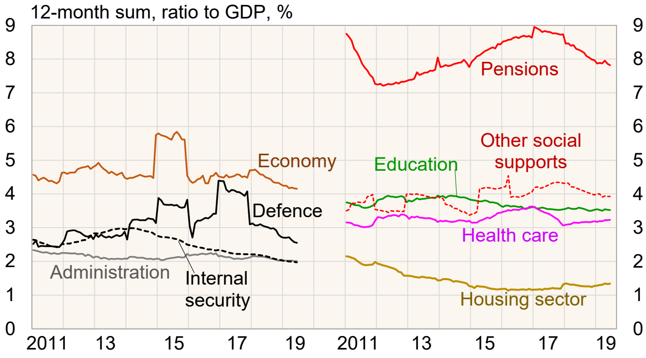
China continues to gain importance as a major trading partner with Russia. For the 12-month period ending in June, 22 % of all Russian goods imports came from China, while 13 % of Russian goods exports went to China. In recent years, China's share in both imports and exports has risen by about one percentage point a year. Oil, gas and coal account for about three-quarters of Russian goods exports to China. Other major export goods include wood, metals and fish. About half of Russia's goods imports from China consist of machinery and equipment. Other goods include various intermediate products and consumer goods such as shoes, clothing, toys and furniture. Russia trades similar goods with other countries and the composition of Russian-Chinese trade has not changed considerably during recent years.

Moderate rise in Russian government spending. Revenues to Russia's consolidated budget (federal, regional and municipal budgets plus state social funds) in the first half of this year were up by over 10 % y-o-y. Growth in consolidated budget spending held at roughly the same pace as in the previous three years, i.e. around 5 % y-o-y, or slightly higher than headline inflation. The rapid growth in revenues combined with the relatively slow growth in spending so far this year has boosted the overall budget surplus. In June, the 12-month consolidated budget surplus amounted to nearly 4 % of GDP.

Budget revenues from sources other than oil and gas taxes increased by 13 %, i.e. the same swift pace as last year. They accounted for 78 % of all revenues to the consolidated budget. In particular, revenues from corporate profit taxes continued to climb fast (by 20 %), while VAT revenues, thanks in part to the VAT increase at the start of the year, were up by 18 %. Revenues from income taxes and wage-based mandatory social taxes continued to show fairly strong growth (up 9 %).

As last year, spending increases largely went to health care, education and the housing sector. Spending on pensions and other social supports continued to show moderate rises that roughly matched the inflation rate. Spending on administration, domestic security and the economy rose by just a couple of per cent, while defence spending shrank. The ratio of spending-to-GDP has declined for many spending categories due to their low rates of increase. However, growth in budget spending overall is expected to pick up in the second half of this year to the extent that implementation of national projects set forth in president Putin's 2018 May decree gets underway more properly.

Government sector main spending categories, 2011–2019



Source: Russian Ministry of Finance.

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China

Chinese economic growth continues to slow. While the unreliability of official statistical data makes it difficult to assess actual economic conditions in China, numerous measures, including official figures, reveal a slowing trend in economic growth. In July, nearly all main indicators showed deteriorating conditions in China. The export figures of China's neighbours also indicate weakening conditions in the region.

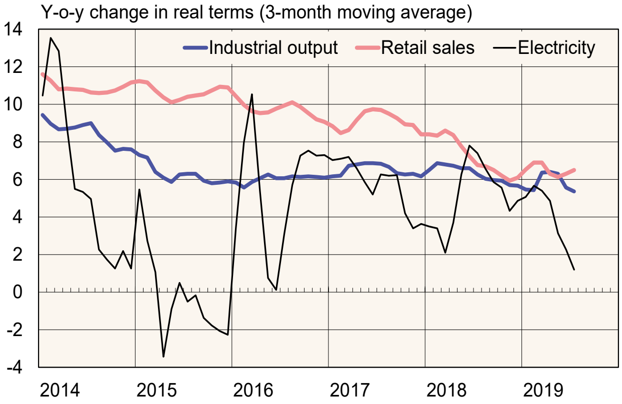
On-year growth in Chinese industrial output slowed from over 6 % in June to below 5 % in July. Notably, on-year growth in car manufacturing has been negative in every month for over a year according to the China Association of Automobile Manufacturers (CAAM). Manufacture of passenger cars was down 18 % y-o-y in July. Real growth in retail sales slowed over one percentage point to below 6 %.

The two main purchasing manager indices (PMIs) confirmed slowing growth. Both the official and private (Markit) manufacturing PMIs remained below the 50-point mark, which signifies the approach of industrial downturn. This year, the official PMI has climbed above the 50-point mark (i.e. rising production) only in March and April. While the services PMIs for both index producers fell from June to July, they were both still well above the 50-point mark.

Producers face the challenge of producer price deflation. In July, after a long slowdown, producer prices contracted by 0.3 %. It was the first time since August 2016 that there was an on-year decline in producer prices. Lower prices hurt corporate bottom lines, which in turn makes firms reluctant to invest. Consumer price inflation (2.8 %) was practically unchanged from the previous months.

China's economic slowdown, combined with the negative impacts of the trade war on international production chains were evident in the value of exports to China from its neighbouring countries. In January-July, China exports were down sharply for Japan (down 9 % y-o-y), South Korea (down 17 %) and Taiwan (down 8 %).

Official NBS figures for Chinese output indicators



Source: Macrobond, BOFIT.

United States postpones September tariff hikes on some Chinese goods until December. On August 13, the US announced it would delay until December 15 the 10 % tariff hike on some of the nearly 300 billion dollars in goods that would otherwise have gone into force on September 1. The deferral applies to over 500 products (e.g. smart phones, chemical products, clothing and footwear) that represent some 155 billion dollars in imports annually. President Donald Trump said the delay was needed to protect retailers and consumers in the upcoming Christmas shopping season.

Even so, the US will go ahead at the beginning of September with the earlier-announced additional 10 % tariff on Chinese imports worth about 130 billion dollars a year. From the beginning of June, about 250 billion dollars in Chinese goods have been subject to punitive 25 % tariffs. After the December hike goes into effect, essentially all Chinese goods imported to the US will be subject to punitive tariffs.

American firms were also granted a 90-day extension this week to supply equipment and software updates to Chinese telecom giant Huawei. The countries will continue to talk by phone before the tariff hikes kicks in next month. While a fact-to-face meeting is set for September, few observers hold out hope that the two sides will resolve their differences.

China introduces new reference rate for pricing bank loans. Last Friday (Aug. 16), the People's Bank of China announced that commercial banks should price their new lending according to a "loan prime rate" (LPR) published by the National Interbank Funding Center (NIFC). The LPR is based on rate quotes by a panel of 18 banks offered to their most creditworthy customers. The LPR is published on the 20th day of each month.

The new LPR is defined so that the panel banks announce their rates relative to the rate of central bank financing (primarily medium-term lending facility (MLF) rate). Panel banks' quotes were previously linked to the PBoC's benchmark rate. Now the LPR can be more flexible fine-tuned to reflect changes in the monetary policy stance. The rate reform also includes quoting of a longer maturity (5 years and over) LPR.

Banks earlier based their loan pricing on the PBoC's benchmark rates. The mechanism was unclear after the nominal deregulation of rates in 2015 that gave, in principle, commercial banks autonomy to price their loans. Introduction of the new reference rate is seen as further progress in deregulation of interest rates and a shift to more market-based pricing. An important motive is also the need to lower corporate borrowing costs in uncertain economic times.

The one-year LPR rate in August is 4.25 %, while the PBoC's benchmark rate is 4.35 %. The five-year LPR is 4.85 %. According to some sources, most of the benefits of lower interest rates could go to large state-owned enterprises and loan prices for smaller firms may remain high even with the reform. The new reference rate will not have an immediate effect on corporate debt-servicing costs as most of current loans remain tied to the PBoC's benchmark rate, which has remained unchanged since 2015. The dynamics of the new LPR have yet to be established.

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