Weekly Review
38 • 20.9.2019

BOFIT

Russia

Lower growth in Russian construction activity. According to Rosstat, annual real growth in construction activity in 2018 was still 5.3 %. This year, growth has been nonexistent. The volume of construction rose by just 0.2 % y-o-y in January-August.

However, the total floor area of residential buildings that were completed during January-August was more than 7 % greater than in the same period last year. That said, last year's base level is rather low as construction declined from 2017 to 2018 by 4.5 %. The long-running rise in housing prices levelled off slightly in the first half of this year, and in some regions prices of older apartments even declined a bit. Housing prices vary tremendously across regions.

Housing construction activity may continue to slow due to a legal amendment that entered into force in July. It forbids construction companies from using up-front payments received from a customer to fund their other construction sites not connected to the customer. With the ban, a larger share of building costs will have to be financed through bank loans taken by the builder. The change is expected to drive small and low-profit builders out of the market.

Russian competition bureau has plenty on its plate. As part of the release of the 13th annual report of Russia's competition agency, the Federal Anti-Monopoly Service (FAS), agency head Igor Artemyev briefed the government on the report's contents. It covers a range of topics, including government and state-owned enterprise procurements, access to services provided by natural monopolies, agreements that limit competition, commodity exchanges, administratively regulated prices, national projects, 18 sectors as well as a state of the art review of the FAS 2018–2020 plan to promote competition. The plan has further been processed into goals and measures for Russia's regions and municipalities.

Artemyev said that all major competition laws currently in process and agreed in the government are being reviewed further because they have received negative appraisals from the state-legal directorate of the Presidential Administration. A draft law, which prohibits the establishment of state unitary enterprises in competitive markets, was eventually submitted to the Duma despite resisting lobbying efforts of several regional leaders and only via consent of the prime minister and the president. Another proposed law submitted to the government would prohibit federal, regional and municipal government entities from acquiring shares in firms doing business in markets deemed subject to competition.

The FAS report finds that the target in government procurements with regards to the share of small firms has already been nearly achieved, but the targeted share of small and medium-sized firms in state-owned enterprise procurements has a way to go. Work continues in order to tackle discriminatory practices with regards to user access especially to gas and heating grids, as well as rail and port services. The non-discrimination policy approach also applies to rights to extract natural resources and sales of property confiscated by the state, for which Artemyev characterised the current practices as closed or half-closed.

Development of commodity exchanges continues, making trade of basic commodities such as natural gas, coal, oil products, grain, and various primary chemical products easier and less discriminatory. Besides the exchanges, various databases are providing more open price information also for medicines, construction and government contracts.

For administratively regulated prices such as electricity, water, gas and rail transport, the FAS legislative draft seeks to establish clear and more unified criteria in the setting of tariffs and to prevent regions from implementing rate hikes that vastly exceed federal limits. It also seeks to eliminate huge rate variations that have appeared even within regions. A further goal is to shift to 5–10 year plans in which rate hikes are held slightly below the inflation rate.

Regarding cartels and other agreements to restrict competition, the FAS has pursued numerous cases especially in road construction and pharmaceuticals. Reported competition violations by state agencies have overall declined steeply in recent years whereas their participation in agreements to limit competition rose sharply last year.

The FAS notes that implementation of national projects requires greater government budget spending, yet they contain no prerequisites for applying competition practices. The FAS sees that this may lead to limitations on competition. The same assessment also applies to promoting investments through special investment agreements between individual industrial firms and state authorities.

Russia and Belarus discuss deeper economic integration. At the beginning of September, Russian Prime Minister Medvedev and Belarusian Prime Minister Rumas signed an action plan on creating a road map for economic integration. The integration program should be ready for presidential signing in December.

While no plan has been officially released, the Russian business daily Kommersant describes it in detail. The plan envisions integration of tax regulation, foreign trade policy, economic legislation, bank supervision and regulation of energy markets. On the other hand, discussion of issues like shared government structures and common currency are postponed. The integration process should begin in 2021.

Officially, Russia and Belarus have been in a rather close state union for two decades. In practice, however, the relationship has been strained e.g. by disagreements over oil and gas supplies and foreign policy. Furthermore, the relevance of the union became less clear in 2010 as Russia, Belarus and Kazakhstan established the Eurasian Customs Union which was later renamed Eurasian Economic Union (Armenia and Kyrgyzstan also joined it). This union of five states has similar goals as the bilateral union of Russia and Belarus. The new plan by Russia and Belarus may further complicate integration process within the Eurasian Union.

Bank of Finland • Institute for Economies in Transition, BOFIT
P.O. Box 160, FI-00101 Helsinki
Phone: +358 9 183 2268 • Web: www.bofit.fi/en

Editor-in-Chief Jouko Rautava• Email: Jouko.Rautava@bof.fi

China

Despite China's economy slowing, African swine fever causes inflation to accelerate. All common economic indicators for China point to a further slowdown in growth in August. Industrial output growth fell to 4.4 % y-o-y, its lowest level in two decades. Even as the severe drop in passenger car production appeared to stabilise last month, passenger car sales were still down by 7 % y-o-y. Hence, real growth in retail sales fell slightly to 5.6 % y-o-y in August.

Given the poor Chinese statistical data, it is particularly difficult to assess investment demand which is still a key component of the Chinese economy. According to available data, real growth in fixed asset investment (FAI) appears, however, to have been at most 2–3 % y-o-y in January-August.

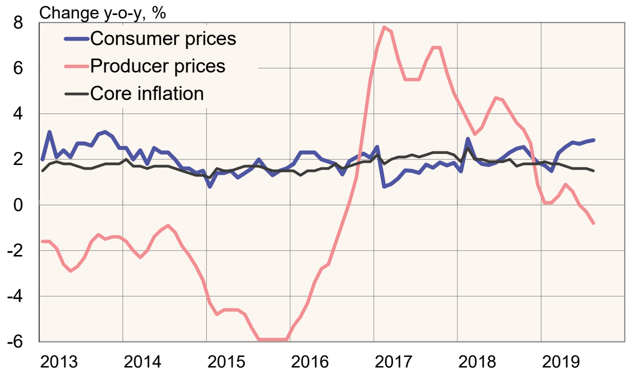
Negative growth in producer price inflation (down 0.8 % in August), which erodes corporate profitability and diminishes corporate appetite for investment, is seen as further evidence of weakening economic conditions.

The most important factor in price trends at the moment has been food prices. Consumer price inflation accelerated to 2.8 % in August on higher prices for food and, in particular, pork. Pork prices shot up 47 % y-o-y in August as domestic pork supplies have fallen to a ten-year low. Since the African Swine Fever (ASF) outbreak a year ago, about a third of pigs in China has died or been slaughtered. China has increased pork imports. This week, ahead of the 70th National Day holiday in early October, the government released pork supplies from its strategic food reserves.

China accounts for about half of global demand for pork products. As domestic supply keeps declining and prices keep rising, the situation has significant impacts also on global markets for meat products and animal feed.

The ASF crisis has become a major political headache for Beijing as pork is a central part of the Chinese diet and even symbolic of rising living standards to many people. The situation is aggravated by the fact that the crisis has revealed serious systemic and political problems (e.g. downplaying of risks and problems, cover-ups, corruption and failures in government regulation).

Price trends in China



Source: Macrobond.

China lowers bank reserve requirements. An across-the-board 0.5 percentage-point cut in the bank reserve requirements ratio (RRR) came into force on Monday (Sep. 16). The average RRR (not including bank-specific exemptions) now stand at 13 % for large banks, 11 % for mid-sized banks and 7.5 % for small banks.

The RRR for smaller regional banks will also drop by a total of 1 percentage point in two steps (October 15 and November 15). The action should support growth in the real economy by reducing financing costs and improve access to financing for smaller firms. A goal of the recent reference rate reform is also to lower bank lending rates (BOFIT Weekly 34/2019).

Reserve requirements were lowered several times since April 2018, when the RRR for large banks was 17 %. China's monetary policy stance otherwise remains unchanged. For example, the central bank's rates in its open market and lending operations are untouched. No significant changes have been reported in money-market rates.

Setting monetary policy in China involves balancing the demands of domestic pressures to support economic growth and external pressures to combat exchange-rate depreciation and capital outflows from the country. Monetary easing also fuels indebtedness, which has already reached levels that threaten China's economic development. The People's Bank of China reports that it now uses targeted monetary stimulus rather than broad measures.

Declining exports of foreign firms operating in China. China Customs reports that goods trade in August sustained the downward trend of previous months. Imports continued to contract and exports were at the same level as in August 2018, with the result that the trade surplus increased. Although there was now a contraction in imports from the EU, August foreign trade trends with individual countries were generally unchanged from earlier months.

Export trends for domestic and foreign firms have been diverging this year. Growth in goods exports by Chinese firms has remained fairly brisk (up 4 % y-o-y in January-July), while exports of foreign firms (including joint ventures) were off by 5 % in the same period. In the first seven months of this year, the share of exports produced by Chinese firms rose to 60 % and exports by foreign firms operating in China declined to 40 %. Many foreign firms have announced that they have moved their export-oriented production elsewhere due to the trade war.

The trade war is also reflected in China's processing trade. Figures from China Customs show that exports based on foreign parts and assembly contracted by 7 % y-o-y in January-August, while conventional exports increased by 3 %. Some 29 % of goods exports this year have come from the processing trade, down from 32 % last year. At its peak, ahead of the global financial crisis, processing trade accounted for 55 % of exports. Rising production costs have driven manufacturing out of China to other countries, while some parts of production chains have been shifted entirely to China.

Bank of Finland • Institute for Economies in Transition, BOFIT
P.O. Box 160, FI-00101 Helsinki
Phone: +358 9 183 2268 • Web: www.bofit.fi/en

Editor-in-Chief Jouko Rautava• Email: Jouko.Rautava@bof.fi