Weekly Review
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Russia

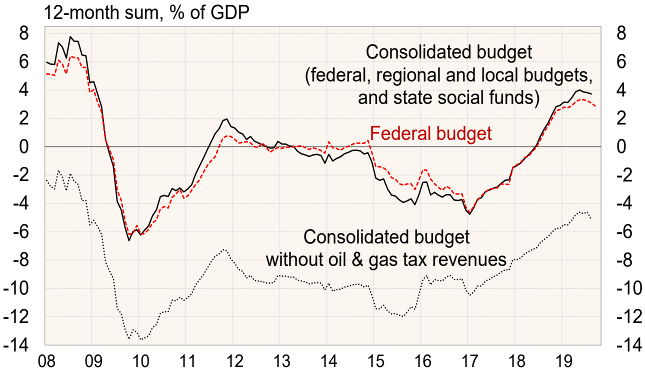
Russian economy enjoys growth spurt. Russia's third quarter economic performance was surprisingly strong, but further gains are likely to be short-lived. Growth was driven by industrial production (up 3 %) and agricultural production (up 5 %). Forward-looking indicators, however, suggest that the outlook for industrial output is not rosy. For example, inventories have reached historical highs. Construction and transport activity were about the same as a year earlier.

Consumer demand remains modest. Despite the fastest rise in real incomes in years, on-year growth in retail sales slowed in July-September to below 1 %. Some observers suspect that the recorded 3 % growth in real incomes is overestimated. They are critical of the statistical methods used in determining income trends.

After posting growth in the first half of this year below 1 %, Russia's economy ministry estimates that GDP grew at a nearly 2 % on-year pace in the third quarter. The ministry noted, however, that growth was largely based on transient factors such as inventory build-up and expects growth to slow in the fourth quarter of this year.

Russia's large federal budget surplus begins to shrink. Despite the third-quarter reversal, the federal budget surplus for the last 12-month period still amounted to nearly 3 % of GDP. The turn reflects shifts in both revenues and expenditures. After having risen by 10 % in the first half of the year in nominal terms, budget revenues now rose by just about 2 % y-o-y. On-year growth in spending accelerated as expected to 16 % y-o-y in the third quarter, after scoring about 1 % in the first half.

Russian government sector budget balance, 2008–2019



Source: Ministry of Finance.

Budget revenues from oil & gas taxes went into a tailspin in the third quarter (down 20 % y-o-y) after posting large gains in numerous previous quarters. It was the first decline in oil & gas tax revenues since autumn 2016. Growth in other revenues accelerated and rose to 17 % y-o-y for January-September. More of the gains came from improved tax collection rather than the impact from the VAT hike on January 1, 2019.

Defence expenditures, the sole government budget sector spending category funded entirely from the federal budget, fluctuates considerably within each year. Defence spending turned to sharp rise in the third quarter, lifting spending growth to about 5 % y-o-y for January-September.

Modest development in Russian incomes continues this year. While real disposable income of Russians has increased marginally this year, the weak development in previous years puts it on par with the 2011 level. The average Russian income is about 35,000 rubles (500 euros) a month, while the average monthly wage is 45,000 rubles (640 euros) and average monthly pension is 14,200 rubles (200 euros).

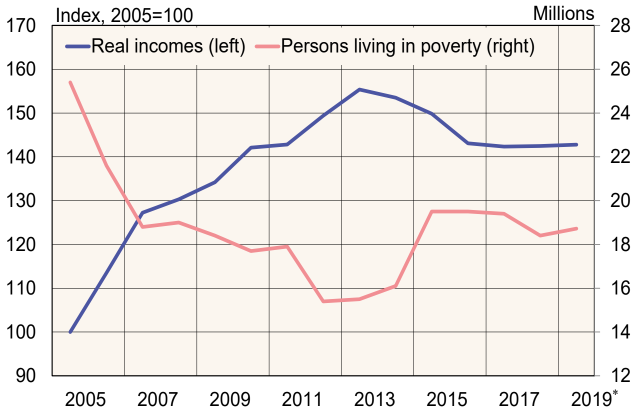
Wealth trends appear similar as income trends. The recent assessment from Credit Suisse finds that the median wealth of Russian adults this year was about 3,700 dollars (3,400 euros), or about the same as in 2012.

Poverty has increased in recent years, but seems to have stabilised at levels last seen about a decade ago. Nearly 20 million Russians (about 14 % of the population) live below the official subsistence minimum. The official subsistence minimum this year is about 11,000 rubles (160 euros) a month per person. A recent survey from the non-governmental Levada Center found that Russians themselves define the poverty level as about 12,500 rubles a month.

The distribution of income and wealth in Russia has not changed notably in recent years. The Gini coefficient, a rough indicator of income disparity, was 0.41 last year. The World Bank finds that income equality is roughly the same as in the United States. Relatively high income equality is found in the Nordic countries (Gini coefficient below 0.3), while the greatest income inequality is typically found in certain countries of Latin America and Africa (Gini coefficient above 0.5).

Russian wealth distribution, however, is among the most skewed in the world. Credit Suisse estimates that the Gini coefficient for wealth distribution in Russia is 0.88, the highest disparity of about 200 countries surveyed. Russia's richest 1 % own nearly 60 % of the country's wealth. In most countries, the share is below 50 %.

Real disposable incomes of Russians and number of people living below the official subsistence minimum (poverty level)



Sources: Rosstat, BOFIT. ** = 1H/1-3Q19*

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China

China's economic growth continued to slow in the third quarter. The National Bureau of Statistics reports that GDP grew by 6 % y-o-y. The growth slowdown has been extremely even: down to 6.4 % in Q1 and 6.2 % in Q2. So, growth has remained within the official government target range of 6-6.5 % this year.

The role of fixed investment as an engine of growth has diminished. In the first nine months of the year, about a fifth of economic growth came from increased fixed investment. In the same period in 2018, fixed investment accounted for over a third of growth. The economic boost from rising consumer demand also waned. Consumer demand accounted for about 60 % of growth this year, down from 80 % in the same period last year. Growth in consumption of services grew faster than other forms of consumption. The NBS reported that services accounted for over half of household consumption demand. Net exports of goods and services have been a positive contributor to growth this year, accounting for about 20 % of first-half GDP growth.

Retail sales grew in the first nine months of this year by 6.4 % in real terms. Weakness in car sales slowed retail sales growth overall. Car sales account for roughly 10 % of retail sales of goods and services. The value of car sales in the official retail sales figures fell by 1 % in January-September. The China Association of Automobile Manufacturers (CAAM) reports that 10 % fewer cars were sold in January-September than in the same period last year. Industrial output growth revived in September, rising to 5.8 % y-o-y.

China finally changes rules to allow wider operating scope for foreign banks and insurers. In mid-October, the Chinese government announced rule changes that eliminate or ease restrictions on foreign financial institutions. In principle, the reforms take effect immediately, so the bank and insurance regulator (CBIRC) has promised to expedite guidelines on implementation of the new rules. In the past, however, officials have often used permitting processes to delay implementation of reforms.

In addition to joint ventures with Chinese banks, foreign banks can now open wholly owned subsidiaries and branches under the new rules. Rules on working capital and fields of operation have also been relaxed. The potential customer base of banks has been broadened by halving the required amount of individual time deposit to 500,000 yuan (70,000 dollars). In addition to eliminating ownership restrictions on insurance companies, the government has ended the requirement that firms have 30 year of experience in the insurance business and that they have had a representative office in China for at least two years.

When China joined the World Trade Organization in 2001, it committed to deregulation of financial institutions over the next five years. In fact, the opening up of China's financial sector has proceeded at a snail's pace. The latest liberalisation measures in banking and insurance make good on promises announced by the government in November 2017 and April 2018. The trade war with the US and the weakening of the economy have increased the urgency to move ahead with reforms. China this year has opened its markets to international credit ratings agencies. In October, China announced that it was eliminating foreign ownership rules on companies involved in futures trading, mutual funds and securities trade by 2020.

Despite extremely limited opportunities, dozens of foreign financial firms already operate in China. Their impact on the Chinese financial sectors is minimal, however. Foreign firms represent just 1.6 % of the total assets of the Chinese banking sector, and 6.4 % of the Chinese insurance sector.

Growth in real incomes slows in China; huge income disparities persist. The NBS reports that the real disposable incomes of households in urban areas have risen at just over 5 % y-o-y this year. Growth in real incomes in 2019 is likely to be lower than at any time in the 2000s.

The slowdown is largely due to higher inflation. The rise in nominal disposable incomes has held steady at 8 % y-o-y for several years now, and will continue to do so this year. The cut in income taxes about a year ago and increased income tax deductions at the beginning of this year have had some impact on income developments. The average monthly income per capita in January-September was 3,550 yuan (460 euros) a month in urban areas and 1,290 yuan (167 euros) a month in rural areas.

The income gaps in China are vast. China's official estimate of the Gini coefficient for income disparity is 0.47, which is already extremely high by international standards. However, the official figure does not include a large chunk of China's top earners. When they are included, the UN's World Institute for Development Economics Research (WIDER) finds that China has some of the largest income differences on the planet (Gini index 0.65).

The rise in incomes and asset prices (particularly housing prices) have boosted Chinese wealth. Credit Suisse's just-released global wealth report finds that the median wealth of a Chinese adult rose from 9,000 dollars in 2010 to nearly 21,000 dollars at the end of June 2019. That puts Chinese wealth on par with Poland or just over a third of Finnish per capita wealth (56,000 dollars).

Even with large income differences, Credit Swiss finds that the wealth disparities in China are notably smaller than the global average. Nearly a billion Chinese have wealth of less than 100,000 dollars. Over 4 million Chinese are millionaires. Only the US has more millionaires than China.

Due to the long continuous rise in wages and other production costs, China is no longer considered a cheap country for manufacturing. Manufacturing wages are significantly higher than in many other counties in South Asia or Southeast Asia. Thus, labour-intensive production has shifted away from China. The current trade war has accelerated the shifting of production elsewhere.

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