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Russia

Russia's economy ministry lowers growth forecast for 2015. While the ministry reiterated its forecast of 0.5 % GDP growth for 2014, it lowered the growth projection for next year to 1 %, a considerable reduction from its previous forecast. Growth in retail sales next year is foreseen to slow to about 0.5 %, while fixed investments would increase by 1.5 % on a recovery from this year's dip of a couple of per cent. The economy ministry expects a nearly 8 % contraction in Russia's imports this year – deeper than earlier forecast – and a rebound of less than 1 % next year. The inflation outlook, on the other hand, has been raised to over 7 % at year's end and 6.5 % at the end of 2015.

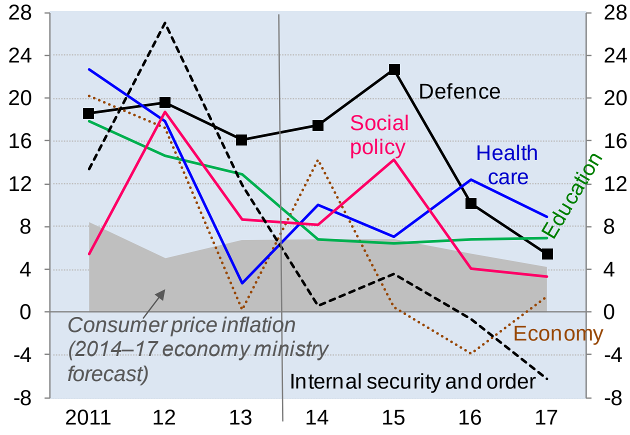
Government budget framework 2015–2017 anticipates only slow growth in several major spending areas, save defence. Total government spending (federal and regional budgets, plus state social funds) under the cabinet-approved policy framework, which forms the basis for further annual budgeting processes, is projected – after next year's surge – to increase with only a pace that matches consumer price inflation. In fact, spending overall and spending in several major categories could decrease in *real terms* as consumer prices to date have been rising notably more slowly than prices of public consumption and capital investment. At the same time, there are larger differences among the various spending categories than in previous years.

Defence spending, which has risen swiftly in recent years, shows accelerated growth this year and next. Defence spending will rise to nearly 11 % of total government spending or about 4 % of GDP. Spending on internal security and order will decline in real terms already this year following large increases in recent years, especially wage hikes. Social spending will climb briskly next year, mainly on higher expenditure on pensions. Pensions and other forms of social security will continuously consume about a third of all government spending and equal some 12 % of GDP.

The finance ministry expects increases in healthcare spending to improve in 2016–2017 after relatively slow growth in 2013–2015. Growth in spending on education will remain more modest. Combined spending on healthcare and education will increase slightly as a share of total government spending, staying above 20 %, and correspond to just over 8 % of GDP.

Government spending on various sectors of the economy will decrease a lot in real terms, including categories such as roads and other transport. The downslide will be offset slightly by long-term loans from the National Welfare Fund to finance major transportation infrastructure projects. There is also an effort to increase government guarantees mainly granted for loans from state banks to state-owned enterprises, such as the defence industry. In addition, Russia's ban on imports of many foodstuffs and agricultural inputs is bolstering efforts to achieve food self-sufficiency, and assessments circulating e.g. in government circles suggest government funding will be needed for that purpose.

Actual and forecast government spending in major categories (% change) and inflation rate (%)



Sources: Finance ministry, Rosstat, economy ministry

Lean times continue for regional budgets in years ahead. The finance ministry's assessment in the government budget policy framework for 2015–2017 sees revenues to federal and regional budgets (including transfers from the federal budget) will barely keep up with inflation. Growth in regional budget revenues declined to the inflation rate in 2012, and revenues to both federal and regional budget levels grew far slower than inflation last year. The federal budget this year has gotten some temporary respite through dollar-denominated taxes and export duties on oil as the ruble has been weak compared to last year. Regional budget revenues, however, will grow at rates well below inflation even this year.

In the next few years, growth in regional budget revenues will be partly constrained by reduced transfers from the federal budget. Instead, the federal government will increase contributions to the Pension Fund. Other federal spending growth will only keep pace with inflation.

The finance ministry expects regional budget spending will grow even a bit more weakly than federal spending while regional budget deficits increase slightly to just over 1 % of GDP. The finance ministry also expressed concerns about the problems for regional budgets under the policy framework. It plans actions to reduce regional budget deficits to around 0.5 % of GDP. Besides possibly allowing regions to impose a sales tax, the ministry proposes restrictions on public sector wage hikes and regional administrative spending, as well as granting regions the right to limit social entitlements on the basis of need. The finance ministry also wants tighter limits on regional and municipal indebtedness, borrowing volumes and debt servicing costs.

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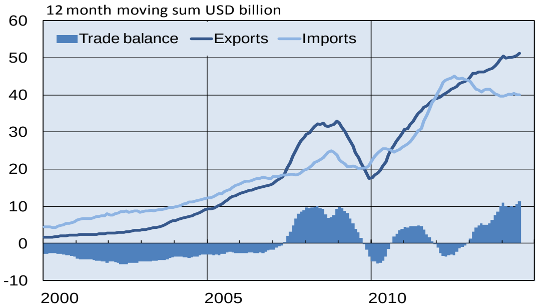
China

Fossil fuels continue to dominate and govern outlook for Chinese imports from Russia. While China's exports to Russia have enjoyed robust gains, China's imports from Russia have been flat in recent years. In keeping with this trend, the value of China's exports to Russia increased about 6 % y-o-y in the first seven months of 2014, while imports from Russia increased less than 2 %. Russia accounts for just over 2 % of China's total exports and imports. Although Russia has gained in its share of China's exports a bit, Russia's share of China's total imports has decreased slightly.

China-Russia trade 2000–2014, USD billion



Source: CEIC

Imports from Russia remain driven by increasing import volumes of Russian crude oil. In the first seven months of this year, China's oil imports from Russia were up about 20 % y-o-y. China currently imports about 27 million metric tons of crude oil a year from Russia, or about 10 % of China's total oil imports. Crude oil and petroleum products accounted for over 70 % of China's imports from Russia and raw timber and other primary forest industry products nearly 10 %. When base metals and other goods with low degrees of processing are included, such commodities represent over 90 % share of what Russia sends to China. Goods in the machinery & equipment and transport vehicle categories together represented just 1 % of China's imports from Russia.

China's exports to Russia, in contrast, represent a great diversity of goods. Some 30 % of exports to Russia from China come from the machinery & equipment category. Textiles, clothing and footwear made up over a quarter of exports. Base metal products and plastic products both constituted over 5 % of China's exports to Russia. Transport vehicles now account for nearly 6 % of exports to Russia. China exports about 60,000 passenger cars a year to Russia, which represents about 15 % of China's total car exports.

Russia's trade with China is structurally similar to that of Russia's other main trading partners – raw materials are imported from Russia and finished goods exported to Russia. Under last year's Rosneft-CNPC long-term crude oil supply deal, the volume of China's oil imports from Russia should increase substantially in years ahead. A China-Russia gas deal signed in May opens an import route for Russian gas to China by the end of the decade. There are no indications of any further diversification of Russian exports to China.

While Asia and China provide natural export markets for Russian commodities, there are no signs of deeper integration. Russia's inward looking, statist and highly protectionist policies have made it almost impossible for Russia to adjust its production structure and integrate into the global economy. Asian markets have not offered and will not offer Russia concessions in the ground rules of global trade and economic integration.

China strives for improvements in healthcare through reduced regulation and greater public financing. The commerce ministry reports China will permit 100 % foreign-owned hospitals in seven trial areas, including Beijing, Shanghai and Tianjin. As a general rule, foreigners are not allowed to own more than 70 % of a hospital. The pilot programme is designed to increase hospital access in larger metropolitan areas with long wait-times for medical attention. Chinese officials also hope that less regulation will increase competition between the private and public sector, and encourage technology transfer to China.

Commerce ministry figures show that while only a very modest amount of foreign investment goes to the healthcare sector, the rate of growth of foreign investment has taken off. A recent survey by the EU Chamber of Commerce in China noted that European firms involved in healthcare delivery have been relatively successful in China. This might arouse further investor interest in the future.

China's rising wealth and aging population make higher public healthcare spending inevitable. The urbanisation process also drives demand for more services by bringing more people closer to healthcare services. The finance ministry reports that China spent 550 billion yuan during January-July on public healthcare, a 20 % increase from the same period a year ago. Healthcare now accounts for 7 % of public sector spending.

OECD figures show China's private and public healthcare spending in 2012 equalled 5.4 % of GDP (OECD average 9.3 %). The health ministry says China should boost spending on healthcare to 7 % of GDP by 2020. Additional investment is needed, however, as the country has relatively few doctors per capita by international standards; about 1.6 doctors per 1,000 persons (OECD average 3.2).

There is room of improving efficiency in healthcare delivery. According to some estimates the occupancy rates of hospital beds in smaller townships are often below 50 %, while there is a huge lack of bed space in larger cities. Better use of healthcare resources is a primary reason China wants to direct internal migrants to smaller cities.

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