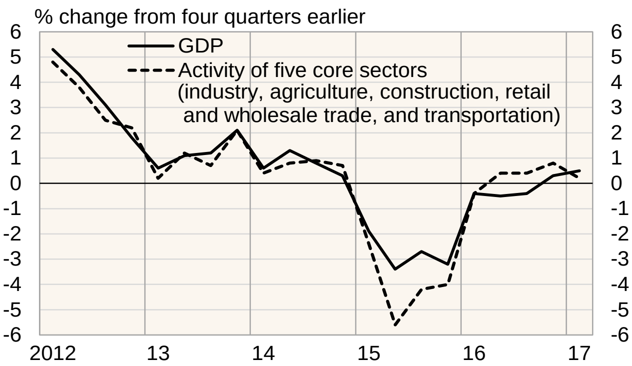
Weekly Review
20 • 19.5.2017
BOFIT

Russia

Russian GDP growth remains positive. Rosstat's first estimate shows 0.5 % y-o-y GDP growth in the first quarter. The growth pace supports earlier reports from the economy ministry and central bank that the revival of seasonally adjusted GDP growth that gradually began in 2016 went on in 1Q17. Rosstat emphasized that the figure was preliminary, which partly reflects the earlier discussion in Russia about complexities in implementing its new GDP methodology.

The 4-quarter GDP growth figure is fairly good considering that first-quarter industrial output was essentially unchanged from a year earlier and that construction and retail sales decreased. Goods transport and wholesale trade, on the other hand, saw strong growth. Moreover, making early estimates of GDP growth is complicated by the fact that monthly data are not collected for real estate sector operations or public sector activities such as administration, healthcare and education, which together represent a third of GDP. From the demand perspective, GDP growth has been supported by buoyant gains in Russian export volumes.

Real growth of Russian GDP and five core sectors



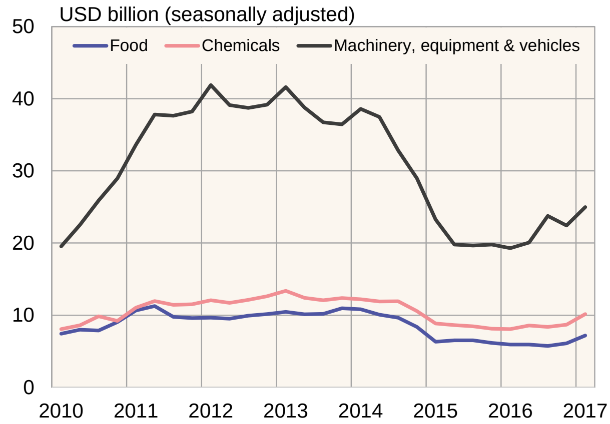
Source: Rosstat.

Brisk growth in Russian foreign trade. Russian goods trade in the first quarter saw increases with nearly all trading partners across all main product categories. The value of exports exceeded \$80 billion, while imports reached nearly \$50 billion. The value of both exports and imports was still about a third less than in the peaks of 1Q12 and 1Q13.

The value of goods exports rose 36 % y-o-y in dollar terms, mainly on higher oil prices. Export volumes also increased in nearly all major goods categories. Growth in crude oil exports was less than 1 %, while exports of petroleum products turned to a growth of 7 % and exports of natural gas grew by 10 %. In addition, export volumes of many metals, fertilisers and wood products increased on year. Half of goods exports went to EU countries, about 20 % to Asia and 10 % to countries in the Eurasian Economic Union.

The value of goods imports in dollar terms rose by 26 % y-o-y in the first quarter. Imports of chemical products and machinery, equipment & transport vehicles climbed by nearly 30 % y-o-y. The value of food imports was up 16 % y-o-y. EU countries provided 37 % of imported goods, Asian countries 34 % and Eurasian Economic Union members 8 %.

Quarterly value of Russian imports in largest product groups



Sources: CEIC, Russian customs, BOFIT.

EBRD continues financing freeze on Russian projects. The majority of shareholders in the European Bank for Reconstruction and Development (EBRD) decided in summer 2014 to halt any new projects in Russia in response to Russia's annexation of Crimea and its involvement in the conflict in Eastern Ukraine. Disbursements under earlier EBRD financial commitments, however, were allowed to continue.

Russia already previously asked to have the decision reversed. Bringing the matter to the EBRD annual meeting this month resulted in a vote where an overwhelming majority of the bank's 67 shareholders (65 countries plus the EU and the European Investment Bank) found that the financing freeze on Russia complied with the EBRD's rules. Media reported that three CIS countries and Mongolia joined Russia in seeking to overturn the decision, with two CIS countries abstaining from voting. Russia holds a 4 % stake in the EBRD and has a 4 % voting share.

At his address to the annual meeting, economy minister Maxim Oreshkin explained how Russia saw the restriction as violating the EBRD articles of establishment. Oreshkin said that the bank's income, 30 % of which has come from Russia in recent years, would be reduced by keeping the financing ban in place. Less officially, Oreshkin suggested that the current situation would make the EBRD's AAA credit rating questionable, and Russia would draw the attention of credit rating agencies to the slide in the bank's income from Russia.

The EBRD has financial commitments to Russia of €3.7 billion (less than 10 % of the bank's total commitments). In 2012, financing commitments to Russia exceeded €10 billion (26 %). Of the projects in Russia with EBRD participation, 84 % are in the private sector. The EBRD was established in 1991 to support progress towards market-oriented economies in the bank's countries of operation that today comprise over 30 countries in Central and Eastern Europe, Central Asia, and the Eastern and Southern Mediterranean.

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

Weekly Review
20 • 19.5.2017

BOFIT

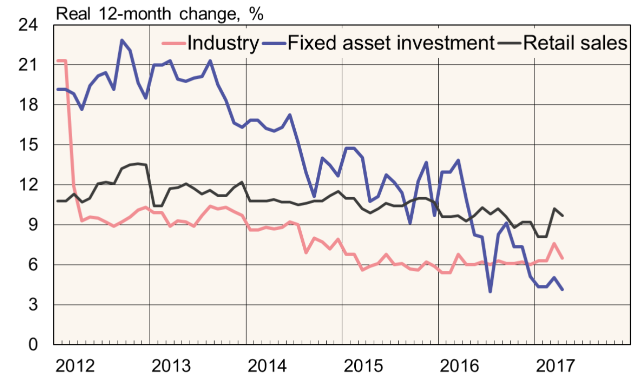
China

Rate of China's output slowed in April. National Bureau of Statistics figures show that on-year GDP growth accelerated to 6.9 % in the first quarter, but several indicators last month suggested again a slowdown in on-year growth. For example, industrial output growth fell to 6.5 % in April, due in part to 3 % y-o-y drop in passenger car production. For the first four months of the year, car production was still up nearly 5 % compared to the same period in 2016. Despite a slight slowdown from March, retail sales volumes were still up nearly 10 % y-o-y in April.

The growth in urban fixed asset investment (FAI) is a significant monthly demand-side item, as it should reflect the capital formation component of GDP growth. Nominal 12-month growth in the value of urban FAI slowed in April on sharply lower growth in private investment. If a cautious rise in prices of investment goods is assumed, real growth of FAI was only about 4 % y-o-y. Moreover, realised on-year growth in investment in January-April slowed from over 12 % in 2016 to below 5 % in 2017.

Because capital formation still has larger weighting than private consumption in total demand, it is harder for private consumption to take up the slack in GDP growth when investment growth slows. Moreover, the trend in disposable incomes gives no indication of further acceleration in the already rapid rise in household consumption demand. Foreign trade (net exports) presently plays a minor role in the Chinese GDP trend. The volume of goods imports also increased faster than exports in the first quarter.

China's industrial output, retail sales and fixed investment



Sources: Macrobond, CEIC.

United States and China announce limited measures to promote more open markets. During president Xi's visit to the US last month, the countries agreed to engage in talks over the next 100 days on reducing barriers to trade. Last Thursday (May 11), during the lead up to this week's Silk Road summit, the United States and China issued a 10-point itemisation of breakthroughs in the current talks. Most of the achievements were broadly formulated and several were already agreed in principle.

Hard dates were set for when China will begin to allow imports of US beef and credit card companies will be allowed to file for operating licences in China. China also promised to allow foreign companies to provide credit ratings services and accelerate application processing for permits to import of genetically modified grains. Correspondingly, the US will allow the import of cooked poultry from China and export of liquefied natural gas to China. In addition, the United States formally recognised China's Silk Road project and sent an official delegation to the summit last weekend.

These small advances are largely seen as an indication of the willingness of the two economic giants to cooperate, thereby reducing fears of a trade war between the two countries. China and the US are considering extending the 100-day trade talks to a year. Companies on both sides of the Pacific are withholding judgement on talks until they see more concrete outcomes.

China's Silk Road project moves ahead. The "One Belt, One Road" (OBOR) summit was held in Beijing on May 14–15. The meeting featured delegations from over 100 countries, as well as the IMF, the World Bank and UN leadership. President Xi Jinping called OBOR the "project of the century," as OBOR seeks to significantly increase investment in infrastructure and cooperation in Asia, Europe, as well as eastern and northern Africa. During the meeting, China promised a total of 580 billion yuan ($84 billion) in new funding for OBOR projects to be channelled via the Silk Road Fund, the Asian Infrastructure Investment Bank (AIIB) and China's policy banks. China will also set up a separate investment fund to provide financing for projects that support cooperation in northeast China and the Russian Far East.

The OBOR project is basically an umbrella term covering a range of potential projects rather than a well-defined list of actual investment projects. To date, at least 1,700 projects have been started or green-lighted in OBOR's name and have been allocated hundreds of billions of yuan in credit. The cost of financing is cheap. While some projects would very likely be implemented without OBOR support, others seem to lack viable economic basis.

China emphasises the economic benefits of the OBOR project will benefit all participating parties. At the same time, it is clear that the project increases Chinese influence in the region and creates demand for products made by branches in China now suffering from overcapacity. The OBOR project has been criticised for its lack of transparency and lop-sided treatment of foreign companies willing to participate in projects. As a result, numerous countries including Germany and France were unwilling to sign all of the summit's final communiques. The project is not considered as a geopolitical smash hit by all parties. India boycotted the summit and criticised the project as neo-colonialism. Russia is concerned that the project will increase Chinese influence in several former Soviet Union countries.

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