Weekly Review
14 • 6.4.2018

BOFIT

Russia

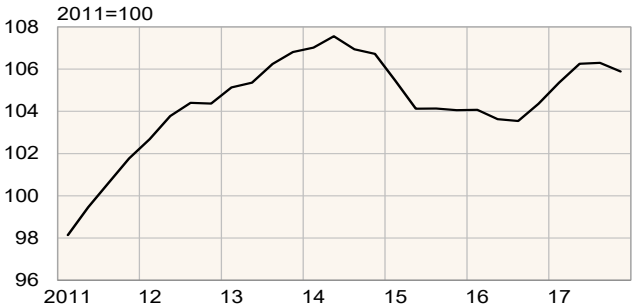
More light on developments in the Russian economy last year. Rosstat reports that seasonally adjusted GDP grew briskly from the final months of 2016 to mid-2017. The revival then came to a halt in the autumn and GDP contracted in the fourth quarter. From four quarters back, GDP grew by slightly under 1 % after the on-year growth in the second and third quarters had been 2.2–2.5 %. This year has seen some improvement. The economy ministry tentatively estimates that GDP grew on-year by around 1.7 % in January-February.

The rise in GDP slowed on easing fixed investment growth towards the end of the year. Fixed investment growth rose to a very rapid pace last spring, which assessments note was supported to a large degree by progress in various major infrastructure projects. Rosstat further reported growing inventories faced a notable turn downwards in the final quarter. In contrast, the recovery in household consumption accelerated in the second half to over 4 % y-o-y and growth of the export volume climbed to about 5 %.

On the production side, the economy's recovery towards the end of the year was hurt especially by a steepening of the decline in industrial output that eventually stabilised this year. Growth in imports slowed in the second half of last year, but was still running above 15 % y-o-y in the fourth quarter.

As usual, Rosstat's release of past year's quarterly data also brought some revisions to figures for the entire year, mostly concerning certain demand-side GDP items. The new data revised the earlier-reported decline in public consumption to slight growth. The pace of recovery in fixed investments increased to over 4 % y-o-y, while the volume of exports grew slightly slower than earlier reported, but still above 5 %. Other focal growth figures remained unchanged. GDP last year grew by 1.5 %, household consumption by nearly 3.5 % and imports by 17 %.

Seasonally adjusted Russian GDP



Source: Rosstat.

Russian central bank plans to start "bad" bank. Central Bank of Russia deputy governor Vasily Pozdyshev said Monday (Apr. 2) that problem loans and certain other assets of the banks that are under control of the central bank will be placed in a new "bad" bank. Three major privately held Russian banks went under the control of the CBR last year: Otkrytie, Binbank (B&N Bank) and Promsvyazbank. They all had earlier taken on other problematic banks for restructuring. The bad bank will be built on the basis of Trust bank that was under restructuring by Otkrytie. It will be used to marshal bad loans and certain other assets also from Binbank and Promsvyazbank worth a total of 1.1 trillion rubles (16 billion euros), or just over 1 % of the total assets of the Russian banking sector. Pozdyshev estimates that 40–60 % of the bad loans could be recovered, but many observers of the Russian banking sector see this statement as overly optimistic. The CBR will not capitalise the bad bank directly, but rather fund it through low-interest loans.

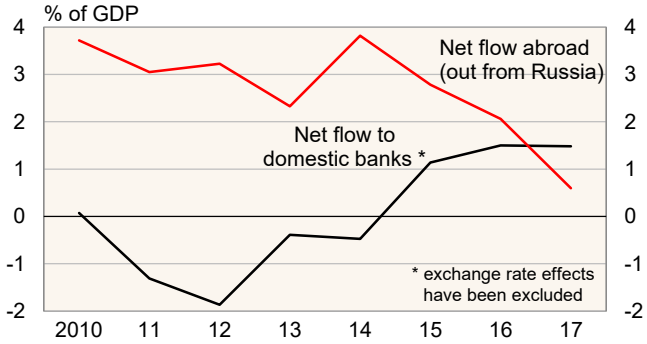
Pozdyshev reports that the CBR has currently spent a total of nearly 630 billion rubles (9 billion euros) for capitalization of Otkrytie Bank, Binbank and Promsvyazbank. He estimates that Promsvyazbank still needs an additional injection of 130 billion rubles (nearly 2 billion euros). The current plan is to sell Otkrytie and Binbank to private investors once their distressed loans are transferred to the bad bank. Promsvyazbank, in turn, would become a state-owned bank focused on providing finance to defence contractors.

Profits of Russian firms have supported out-of-pocket funding for investments; bank borrowing has been low. Rosstat reports that the net profits of large and medium-sized firms (excluding the financial sector) dropped last year in both nominal terms and relative to company turnover. The net profits, nevertheless, were still quite good, equal to over 8 % of turnover and 11 % of GDP.

Profits over the past couple of years have allowed firms to increase their out-of-pocket investments. As total fixed investments contracted until last year, the share of fixed investments financed from other sources has shrunk, including domestic bank loans that already earlier had a small share.

The balance of financing between firms and domestic banks has also shifted. Although the flow of funds from firms to banks has decreased over the past couple of years, borrowing by firms from banks has declined to such an extent that the net flow of funds, unlike in previous years, has been going from firms to banks. Partly this situation is also due to drops in the net outflow of funds from firms to outside Russia.

Net flow of funds from firms to banks and abroad



Source: CBR.

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
14 • 6.4.2018

BOFIT

China

Profits of China's biggest banks surged last year. China's five biggest banks released their 2017 financial reports in late March. The largely state-owned banks include Commercial Bank of China, China Construction Bank, Agricultural Bank of China, Bank of China and Bank of Communications. The combined net profit of the Big Five banks rose by over 3 % y-o-y, even if capital yield declined slightly. The net interest margin, which reflects the profitability of traditional banking operations, rose at four of the five banks (BoComm was the exception).

The Big Five control the vast majority of retail deposits, which forces smaller banks to resort to funding mainly from the interbank market. Thus, the big banks can exploit a general rise in interest rates when lending their surplus assets to other banks. Non-performing loans (NPLs) fell to just 1.5–1.8 % of the total credit stock, but many observers believe the actual figures are considerably larger. Last year, banks were required to set aside provisions 150 % of their NPL aggregates, a requirement all the Big Five passed. NPL provisions this year will be decided on a case-by-case basis, with the lower limit for some banks declining to as low as 120 % (BOFIT Weekly 11/2018). Officials want to make sure banks are adequately capitalised as tighter regulation of the shadow banking sector shifts lending back to the balance sheets of mainstream banks.

The China Banking Association (CBA) and financial consultants PwC annually survey a group of nearly 2,000 Chinese bankers. The latest survey found that the surveyed bankers highlighted credit risk as the biggest source of uncertainty facing banking operations. Credit risk has risen as economic conditions have deteriorated in certain geographic areas and business branches. It has also become more difficult for banks to dispose NPLs. Over 90 % of respondents said that regulation of banking operations had become stricter. Nevertheless, the near future looks bright as bankers believe the stock of NPLs should shrink further over the next three years and profits should rise even faster than last year.

China-US trade policy dispute heats up. In late March, US president Donald Trump announced plans to impose a 25 % import tariff on certain Chinese goods if China refused to open its markets and continued to infringe on intellectual property rights. That threat materialised on Tuesday (April 3), when, as expected, the US issued a list of over 1,300 Chinese imports subject to the additional tariff. The value of affected goods imported from China to the US last year was roughly $50 billion dollars (about 10 % of the total US imports from China). The list includes a range of pharmaceuticals, hospital equipment, machinery, electronics and other goods. The Trump administration says that the tariffs are a targeted response to China's protectionist industrial policies.

China's response was swift. On Wednesday (April 4), China issued its own list of 106 American imports that would be subject to a 25 % additional tariff. Like the US, China's retaliatory measures targeted specific imports with an annual value of about $50 billion (32 % of China's imports from the US). The list includes soybeans, commercial aircraft and cars.

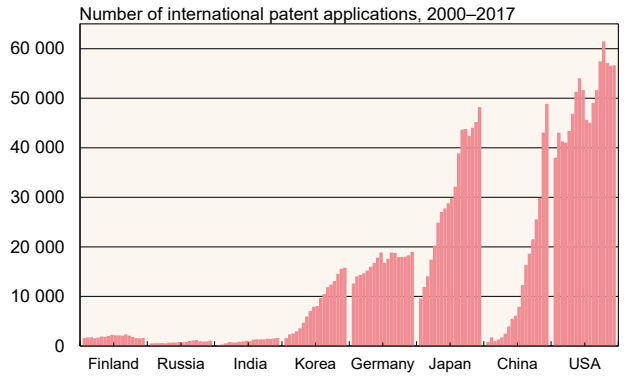
While the situation seems to be trending in a dangerous direction, there remains hope of a negotiated solution. The US tariff hikes and Chinese retaliatory measures would only enter into force in late May at the earliest after a mandatory hearing process. China has long given lip-service to reforms the US now seeks (and others hope for), thereby providing a basis for resolving the matter amicably. However, already on Thursday (April 5), president Trump responded with a further threat of additional tariffs targeted at another $100 billion in Chinese imports.

Every fifth international patent application now comes from China. The latest annual report from the World Intellectual Property Organization (WIPO) notes that globally 243,500 patent applications under the Patent Cooperation Treaty (PCT) were filed in 2017, an increase of 4.5 % over 2016. Patent applications in China have risen at a rate of over 10 % a year since 2003. China last year overtook Japan as the world's second-most active patent-seeking country.

In 2017, the five biggest countries in international patents were the United States, China, Japan, Germany and South Korea. India ranked 16th with 1,603 patent applications, just ahead of Finland with 1,595 applications. The number of patent applications from Russia (ranked 23rd) increased by nearly 23 % to 1,097.

Chinese telecom giants Huawei and ZTE are the world's biggest patent seekers, accounting for 3 % of all PCT patent filings last year. The top ten patent-seeking companies include seven from Asia, two from the US and one from Sweden. The biggest group of PCT filings in China and South Korea related to digital data transfer, while they tended to focus on electrical machinery in Japan, computer technology in the US and transport technology in Germany.

China rising: PCT patent applications, 2000–2017



Source: WIPO.

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