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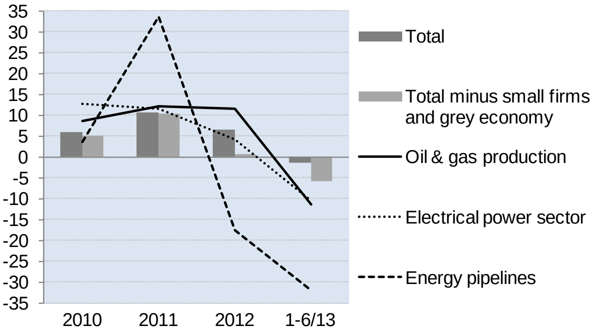
Russia

Sharp drop in Russian energy sector investment. Rosstat reports that after the end in the boom in construction of oil & gas pipelines last year, a further sharp contraction in the investment occurred in the first half of this year. Investment in production of oil & gas and the electrical power sector also declined considerably, and growth in manufacturing investment came to a halt. (These Rosstat figures do not include investment by small firms or investment in the grey economy. The data cover about 85–90 % of total energy sector and manufacturing investment.)

Presidential adviser Andrei Belousov told the cabinet this summer that the investments of large infrastructure companies such as Gazprom, Russian Railways and the state-owned electrical grid operator FSK, as well as public sector investment, fell about 10 % last year, and that a similar contraction is expected this year.

Rosstat estimates investment of small firms and grey-economy investment rose considerably in 2012 and the first half of this year. Without such investment, growth in total investment came to a near standstill last year and went into precipitous decline in the first half of this year.

Fixed investment volumes, on-year change (%)



Source: Rosstat

Russia-Belarus tiff over potassium exports widens. The export joint venture of Russian potassium producer Uralkali and the Belarussian Belaruskali formed in 2005 fell apart in August with both sides accusing the other of breaching their agreement. After the split the companies will compete against each other in the export market, which is expected to depress substantially the global potassium price. The joint firm controlled over 40 % of the global potassium market.

With the break-up of the joint venture, Belarus officials arrested Uralkali's Russian CEO at the end of August in Minsk during a negotiation trip. He was then charged with abuse of authority. Two days later, Russian pipeline operator Transneft announced that the oil pipeline running through Belarus needed immediate repairs, forcing Russia to reduce it September oil export quota to Belarus by about 25 %. On the same day, Russian health officials confirmed that a number of dairy products imported from Belarus failed to comply with health and other standards.

Slowing Russian economic growth evident in Finnish-Russian trade. The value of Finland's exports to Russia rose 2 % y-o-y in the first half to €2.6 billion. All of the growth was in the first four months; the value of exports declined in May and June. Some 9 % of Finland's exports went to Russia.

Petroleum products showed the highest export growth in the first six months of the year, rising nearly 30 % y-o-y in value terms. Petroleum products also became the largest single product category for Finnish exports to Russia. Other important export goods from Finland going to Russia included paper, pharmaceuticals, earth-moving equipment, cheese and butter. Broken down by category, machinery & equipment and chemical products clearly dominated. Exports of metals and textiles displayed brisk growth, while exports of mobile phones and passenger cars plunged 30 % y-o-y, reflecting a sharp decline in re-exports from Finland of products produced in third countries.

Transit freight moving through Finland to Russia contracted 16 % y-o-y in the first half. Finnish Customs puts the value of goods freight transiting Finland in the first half at about €9.2 billion. Machinery & equipment, cars and textiles remained the most common categories of transit products. The number of cars being brought into Russia via Finland continued to fall, with the number of cars transported down by a fifth from 1H2012.

The value of Finland's imports from Russia rose by 1 % y-o-y in the first half and was valued at €5.2 billion. Russia accounted for 18 % of all Finnish imports. Over 80 % of all Finnish imports from Russia were mineral products, mainly crude oil. Russia is by far Finland's main oil supplier. In the first six months of this year, 86 % of Finland's crude oil imports came from Russia. Oil imports from Russia have become more and more important for Finnish exports. Exports of petroleum products to Russia and other countries accounted for over 10 % of Finland's total exports.

Finnish-Russian exports and imports, € billion

Source: Finnish Customs

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China

Shanghai free-trade zone prepares for launch. A recent press release from China's Ministry of Commerce reports that the State Council has given the green light to the proposed Shanghai free-trade zone. The new free-trade zone covers Shanghai's existing bonded areas including Pudong airport, the Waigaoqiao logistics park and Yangshan port. The areas are all incorporated under the new pilot project. Beyond playing the role of a traditional duty-free zone, the project is geared to promoting international trade, freeing up capital movements and encouraging investment by reducing red tape and bureaucratic barriers.

The commerce ministry says the government is seeking new ways to open up mainland China to foreign firms and investors. The initiative goes beyond solely developing the Shanghai economic area to overhauling the reform model for the whole country. The pilot project should give China's leadership a clearer understanding of the consequences of opening up China's markets and provide a sound basis for implementing reforms elsewhere in the country. The project can thus be seen as part of the structural reform that China's leaders hope will secure sustained economic growth over the long term.

The press release emphasises the importance of opening and reforming the banking sector. The project may portend further deregulation of China's financial markets if authorities decide to carry out new financial market experiments in the zone.

Shanghai's status as an international logistics and finance centre is enhanced once the market-based reforms under the plan are implemented. Regulation of interest rates and capital controls currently prevent serious competition with Hong Kong. Strict capital controls and relatively high corporate tax rate in mainland China have traditionally pushed many foreign investors to set up operations preferably in Hong Kong.

The details and timetable for the reforms will be announced later. The *South China Morning Post* reports that implementation could start as soon as this month. Ai Baojun, Shanghai's current vice mayor, will oversee development of the new free-trade zone.

China has a long history of experimenting with pilot reform projects at the regional level. The Shenzhen special economic zone developed rapidly after it was established in the late 1970s thanks to special privileges and tax breaks for companies in the zone. The city of Wenzhou is currently experimenting how to formalise private credit market in order to improve e.g. the access of SMEs to finance and bring oversight to the grey banking sector.

Chinese yuan could soon become one of the world's top 10 global payment currencies. According to the Society for Worldwide Interbank Financial Telecommunication (SWIFT), the yuan was used in 0.9 % of international payments in July. Although there was no change from the previous month, yuan use in international payments doubled from July 2012. The Chinese yuan overtook the Norwegian krone and the Thai baht in June to become the world's 11th most used payments currency, and was hot on the heels of the 10th Swedish krone.

The share of euro in international payments was nearly 38 %. It was followed by the US dollar with 36 % and the British pound with nearly 9 %. The Japanese yen, often a benchmark for the yuan, had a 2 % share of the payment currency market in July, putting it in 4th place. The Hong Kong dollar ranked 8th with an approximately 1 % market share.

Chinese statistical data show that about 11 % of foreign trade payments in China were made in yuan in July. After a rapid increase up to the end of 2012, the share of the yuan in foreign trade payments has held steady.

Pressures build for China to deal with its urbanisation issues. A report from the United Nations Development Programme (UNDP) published at the end of August, China National Human Development Report 2013, tackles the issues facing China as a result of on-going urbanisation. The report was drafted in cooperation with several Chinese agencies, including CASS and the NDRC. Urbanisation has long been a driving factor for Chinese economic growth and China's current leadership emphasises its importance also as an engine for growth in the future. If China's current rate of urbanisation continues, the report estimates China would add another 310 million city-dwellers by 2030 and that cities would be home to about 70 % of the population.

The move to cities has brought many problems. Urban housing prices have soared, income disparities have widened, social security is inadequate and the status of migrants is weak. Development of social services, public transport and road infrastructure has also failed to keep up with urbanisation's pace. The environmental problems in Chinese cities are daunting: nearly 70 % of cities lack adequate fresh water supplies and poor air quality is a big health issue in most cities.

The report calls for rapid implementation of bold reforms. Without them, the problems of cities will continue to get worse, and will become increasingly costly to fix. Among the report recommendations are that success of cities should be measured not just in terms of economic growth but a range of criteria. This would give city leaders greater incentive to focus on sustainable development policies. China also needs to see improvements in urban planning, and internal migrant workers should have access to the same benefits and public services as official residents. Use of resources also needs to become more efficient and there needs to be a greater emphasis on environmental protection.

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