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23 • 6.6.2014

Russia

Russia, Belarus and Kazakhstan agree to form Eurasian Economic Union. May 29 saw the signing of a treaty on the creation of the Eurasian Economic Union (EEU), set to launch January 1, 2015. The treaty lays a basis for a common market with unrestricted movement of goods, services, labour and capital.

The free movement of goods was included already in the agreement on the customs union made up of Russia, Belarus and Kazakhstan that started in 2010. The customs union arrangement, however, exempted several major goods categories, including oil, gas, electricity, pharmaceuticals and automobiles. Many administrative barriers also were left in place. The countries nevertheless moved ahead with the creation of a Single Economic Space in 2012 to allow free movement of labour, services and capital. The goals of this second stage also remain largely unrealised.

The Eurasian Economic Union hopes to push ahead with all these earlier objectives over the coming years. For example, the countries will begin to coordinate their economic policies under several common criteria: annual budget deficits may not exceed 3 % of GDP, public sector debt may not exceed 50 % of GDP and consumer price inflation cannot exceed the lowest inflation rate within the EEU by more than five percentage points. 2025 should see the inauguration of a unified market for oil and gas, as well as integration of national financial markets. Plans also call for a common system of agricultural subsidies by 2016 and creation of a common electricity market by 2019.

Negotiations on the establishment of a Eurasian Economic Union have been contentious with each country aggressively pursuing its own interests. However, compromise was finally reached even on one of the thorniest issues – the pricing mechanism for Russian crude oil supplied to Belarus. The Belarusian economy is highly dependent on cheap supplies of oil from Russia.

IMF gives Russian public sector financial reporting mixed review. At the request of Russia's finance ministry, the IMF evaluated the country's fiscal reporting, budgetary and forecasting methods and risk management practices. The report Russian Federation: Fiscal Transparency Evaluation was released on May 26.

The IMF states that Russia's budgeting arrangements and fiscal reporting now comply to a large extent with IMF standards for good budgetary practices. Fiscal risk management has improved considerably and recent budget legislation defines clear accounting rules for every level of government. Routine public reporting has also increased at all levels. The IMF notes that adopting a medium-term budgetary framework has improved fiscal policy planning and centralized strict oversight has put limits on public borrowing at all levels.

The IMF, however, criticised Russia for using a too-narrow definition of the public sector that excludes more than 30,000 government-controlled enterprises. This leads to exclusion of a large share of liabilities (including loans) that would be categorized as public under international standards. The IMF recommends that Russia include organisations operating on non-market basis in general government statistics and prepare consistent statistics on other state-owned enterprises. This would provide a much more comprehensive overview of the state's role in the economy.

The IMF further criticised the fact that 14 % of Russia's federal budget spending is classified "secret" as a matter of national security. The share is exceptionally large relative to most countries.

Finnish-Russian trade contracted in first quarter. Finnish Customs reports that the value of goods imports from Russia in the first quarter fell by nearly 20 % from a year earlier. Much of the drop came from the largest product group, mineral fuels (over 80 % of total imports), particularly imports of crude oil. Nevertheless, the total value of goods imports still exceeded €2.3 billion, making Russia Finland's largest import supplier.

The value of goods exports contracted 16 % y-o-y in the first quarter to just under €1.1 billion. Reduced demand and ruble weakness caused declines in all major export product categories. The value of exports in the machinery & equipment and chemical products categories, which together represent about half of Finnish exports to Russia, declined by nearly 20 %.

A significant share of Finnish exports to Russia still involves re-exports, i.e. goods produced in a third country but exported from Finland to Russia. While mobile phones and cars earlier dominated Finland's re-exports to Russia, they have now all but dried up. The top re-export categories these days are e.g. pharmaceuticals, hand tools and petroleum products. The latest assessment from Finnish Customs finds that re-exports last year constituted 24 % of Finland's exports to Russia. Last year re-exporting activity contracted notably more than Finnish exports to Russia overall.

The erosion of Russian consumers' purchasing power and increased economic uncertainty has hurt Russian tourism in Finland. For the first quarter, overnight stays by Russians in Finnish hotels and inns were down 6 % y-o-y and Finland-Russia border crossings were off 4 %.

Transhipping of goods via Finland into Russia contracted some 20 % y-o-y in the first quarter. The road transit freight may suffer further when TIR agreements are ended at the Finnish-Russian border from the start of July. Less than 10 % of Russia's imports now enter via Finland, down from a third a decade ago.

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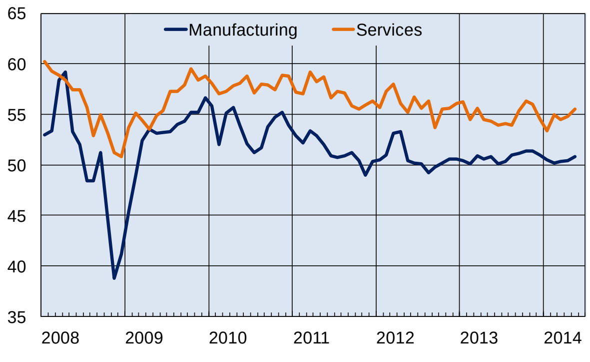
China

Company surveys indicate no big shifts in Chinese economic trends. The latest readings of China's official purchasing manager indices (PMI) for the manufacturing and service sectors reinforce the earlier view that Chinese economic growth remains stable and that the slowdown in the first four months of the year has not foreshadowed a substantial downturn. The official manufacturing PMI strengthened 0.4 points in May to 50.8, while the reading for the services PMI rose 0.7 points to 55.8. The unofficial HSBC manufacturing PMI (includes smaller firms than the official PMI) rose in May to 49.4 points, while the HSBC services PMI declined to a four-month low of 50.7. A value below 50 indicates a weakening economic outlook.

The positive survey responses reflect growing domestic order books. Moreover, the employment situation in China appears stable with the service sector absorbing workers leaving the manufacturing sector. Prevailing labour market conditions in China have been largely unchanged for two years with no significant shifts yet appearing on the horizon. China's refocusing on growth driven by services and domestic consumer demand appears to be proceeding.

The recent PMI readings reflect the fact that China's economic growth is smoothly slowing down to a permanently lower level. No big changes in the economic outlook or PMI readings are expected in the near term. In light of available economic indicators, there seems to be no need for a wide-ranging fiscal and monetary stimulus at this point. Thus, China's leadership has an opportunity to focus on reining in rising debt and move ahead with structural reforms.

Official PMI readings for manufacturing and services



Source: Macrobond

China becomes the world's largest buyer of industrial robots. China last year purchased nearly 37,000 industrial robots, in increase of 60 % from 2012. Thanks to the rapid increase in robot acquisition, China last year surpassed Japan as the world's top purchaser of industrial robots. A *Financial Times* story notes that figures from the International Federation of Robotics (IFR) show Japan last year bought approximately 26,000 industrial robots, while US manufacturers bought nearly 24,000. Roughly 168,000 industrial robots were purchased globally last year, an increase of 5 % from 2012.

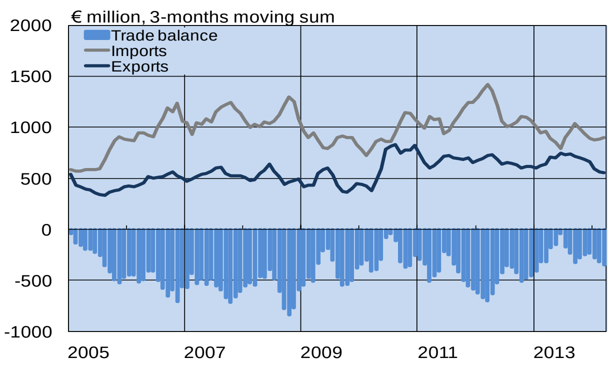
Carmakers, who lead the push in industrial automation, account for about 60 % of Chinese robot demand. Although demand for industrial robots has been rising for years in China, there is still plenty of room to grow. China's car industry in 2012 had 213 robots per 10,000 workers. In other industries, the ratio averaged just 11 robots per 10,000 workers. Japan, the world leader in industrial automation, had 2012 ratios of 1,562 per 10,000 workers for its car industry and 219 for other industries.

The IFR estimates that about half of the world's more than 1.2 million industrial robots at the end of 2012 were located in Asia. In terms of absolute robot numbers, China ranked fifth after Japan, the US, Germany and South Korea.

Slowdown in Finnish-Chinese trade continued in first quarter. Finnish exports to China nosedived in the first quarter of this year. Finnish Customs reports that the value of exports to China in the first quarter declined 14 % y-o-y. The fall in machinery & equipment accounted for a large share of the decline. The category saw exports off by 24 % from a year earlier. Machinery & equipment account for about 40 % of all Finnish exports to China. A drop in earlier booming exports of furs and pelts added to the overall slide in exports. Furs and pelts last year accounted for about 14 % of the value of Finnish exports to China. The same figure for the first quarter was below 3 %.

Finnish imports from China also declined in the first quarter, with the value of imports down by 6 % y-o-y. Most of Finland's imports from China consist of machinery & equipment and finished goods such as clothing. China accounts for about 5 % of Finland's foreign trade.

Finland-China trade, 3-month moving total, € million



Source: Finnish Customs

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