Weekly Review
45 • 10.11.2017

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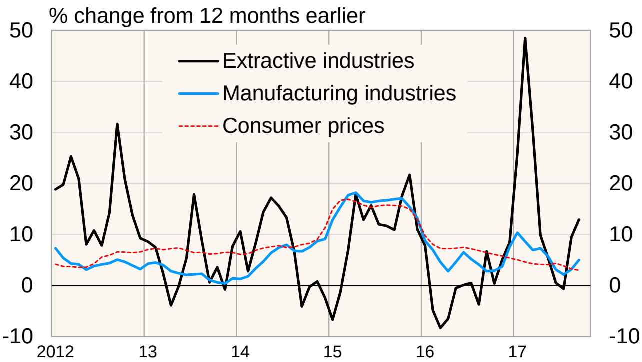
Russia

Brisk rise in Russian industrial producer prices. Prices of industrial products delivered domestically were up by nearly 8 % y-o-y this year so far. The rise matched last year's pace, even if it has moderated in recent months. The brisk pace was basically due to an acceleration of increases in extractive industry prices to 15 % y-o-y. The rise in manufacturing producer prices slowed slightly from last year's pace and in recent months has been running at around 6 % y-o-y.

The rise in producer prices in both extractive industries and manufacturing came focally from oil, oil products and the metal industry that have heavy weights in the industrial producer price basket. As in previous years, their domestic producer prices have tracked the rise in export prices in these branches. In various manufacturing branches with longer processing chains, the increases in domestic producer prices this year have been considerably more moderate.

Changes in world market prices of oil, oil products and metals feed more broadly into inflation in Russia via their domestic producer prices that track the export prices. Higher producer prices in these three basic commodity groups affect costs in other manufacturing branches and generate price pressures that roll further on into consumer prices. The impact on Russian prices via this channel is tangible. The three commodity branches account for nearly 15 % of the total domestic delivery volume of goods and services. True, consumer prices are also affected by imports, particularly when ruble exchange rate fluctuations are large. However, in periods when the ruble's exchange rate is fairly stable the role of imports is limited as import prices change only modestly, even if imports of goods and services equal over a fifth of Russia's domestic demand.

Russian Industrial producer prices & consumer prices, 2012–17



Source: Rosstat.

CEFC China Energy actively investing in Russia, but goods trade remains the focus of economic relations. An under-the-radar Chinese firm, CEFC China Energy, which had never invested earlier in Russia, has in recent months been preparing several corporate acquisitions in relation to a few Russian and international actors. CEFC announced in August plans to purchase a 14 % stake in Rosneft, part of a stake that had been acquired at end-2016 by a joint venture of the Swiss Glencore and the Qatar Investment Agency (QIA). Last week, CEFC participated in the IPO of Russian power and aluminium producer En+, as did the QIA. The Russian VTB might lend CEFC much of the money needed to finance these acquisitions. VTB earlier provided credit to Glencore and QIA in the initial Rosneft deal. In addition, VTB is a minority stakeholder in En+ and its major creditor. Glencore will also get a stake in En+ through a share swap. According to media reports, both CEFC and QIA have also negotiated about acquisitions or joint ventures with the NNK oil company, which is owned by Rosneft's former CEO Eduard Khudainatov. Both Rosneft and NNK are subject to certain US economic sanctions. The total value of CEFC's planned purchases is estimated to exceed 12 billion dollars.

Otherwise, Russia-China economic relations continue to be dominated by goods trade. Russian exports to China last year were worth approximately 30 billion dollars, while the value of imports from China was about 40 billion dollars. China has been Russia's biggest provider of goods imports for several years, accounting for over 20 % of goods imports. This year China also became Russia's top goods export destination, accounting for 11 % of Russian goods exports in January-August. Oil represents the lion's share of Russia's exports to China. Natural gas exports are expected to start in coming months as the massive Yamal peninsula LNG project, which includes Chinese investors, becomes operative. Pipeline transmission of natural gas is scheduled to begin in December 2019. Services trade between the two countries is much more modest than goods trade, but has been supported e.g. by the recent boom in Chinese tourism. Nearly 1.3 million Chinese tourists visited Russia last year, making them Russia's fourth largest tourist group.

Russia ranks higher in World Bank Doing Business survey than in most comparisons. The World Bank's latest *Doing Business* international comparison of regulatory environments ranks Russia 35th out of 190 countries surveyed. Russia came in just behind Japan and a few notches above Ruanda. China ranked 78th. Among the survey's 10 topic indicators, Russia scored high marks e.g. in property registration (12th) and getting credit (29th). Property registration was, however, seen in the report considerably easier in e.g. Ruanda and Kyrgyzstan than in Russia, while getting credit was substantially easier in e.g. Zambia and Nigeria.

To maximise international comparability of the Doing Business results, the survey focuses on very narrowly defined example cases that may not necessarily be applicable to the business environment generally. Moreover, the comparison does not take e.g. corruption into consideration. In other international comparisons, Russia ranks lower. For example, Transparency International's latest Corruption Perceptions Index ranks Russia 131st of 176 countries surveyed. In the World Economic Forum Competitiveness report's institutional pillar Russia ranks 83rd of 137 countries surveyed.

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China

Few surprises emerge from Trump-Xi meetings. The first official visit of United States president Donald Trump to China on Wednesday and Thursday (Nov. 8–9) was a part of his 10-day Asia tour. Going into the China visit, the two countries faced next to impossible challenges to resolving tensions with North Korea and reducing the large imbalances in US-China trade.

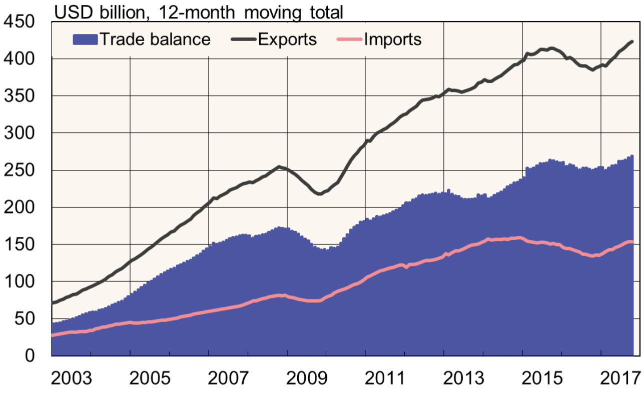
Based on released comments on Thursday, progress in resolving these issues was indeed modest. Even though it was claimed that US firms had signed deals with Chinese counterparts worth a total of 250 billion dollars, most of them were just letters of intent or deals that had been agreed earlier. Trump blamed the current trade deficit problems on policies of previous US administrations. American firms said they would like to see more concrete measures to open Chinese markets and assurances of fair treatment. North Korea figured heavily in the headline addresses, but no new initiatives to resolve tensions were announced.

Trade between China and the United States has grown in recent years. According to Chinese figures, China's goods exports to the US rose 11 % in dollar terms in the first ten months of this year, while imports were up 17 % y-o-y. Even if import growth has been faster than export growth, China's trade surplus with the US in the January-October period increased to 225 billion dollars from 209 billion dollars in the same period last year. Trump's has repeatedly talked about the trade imbalance, even if bilateral imbalance is hard to address from a policy standpoint in the current global economy. According to US figures, the trade deficit with China in the first nine months of this year exceeded 274 billion dollars, or nearly half of the entire US trade deficit.

China and the US are important trading partners for each other. The US accounts for about 20 % of Chinese exports and it is China's largest single export market. Although the EU is China's biggest import market, the US accounts for 7 % of Chinese imports and is about as large a trading partner with China as Japan, South Korea or Taiwan. China purchases 8 % of US exports and provides 21 % of all imports to the US. In terms of imports, China is by far America's largest trading partner. In exports, only exports to Canada and Mexico are greater.

Both countries invest heavily in each other. According to foreign direct investment figures compiled by the Rhodium Group, the cumulative FDI of American firms in China at the end of 2016 exceeded 240 billion dollars, while the stock of Chinese FDI in the US amounted to roughly 110 billion dollars. Chinese investment in the US soared in recent years, but this year investment has slowed due to the clamp-down on capital exports from China. In any case, the US accounts for a significant share of outward Chinese FDI, which has even raised a discussion in the US over the wisdom of *restricting* Chinese investment.

China's trade with the US



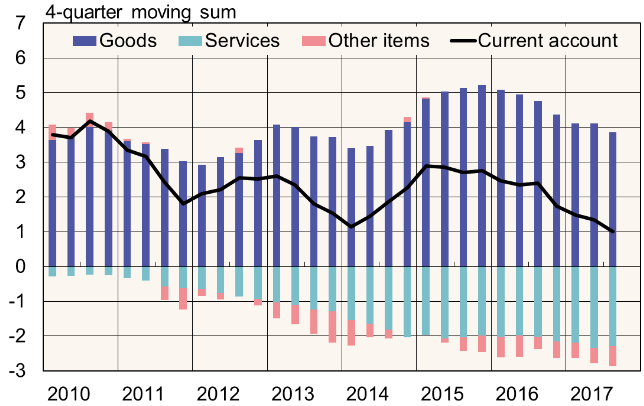
Source: Macrobond.

China's current account surplus shrinks; foreign currency reserves increase. New balance-of-payments data show that China's current account surplus for the first nine months of this year was about 106 billion dollars. The goods trade surplus fell to 335 billion dollars, while the services trade deficit, driven by a tourism deficit of 172 billion dollars, expanded to 203 billion dollars. On-year, the current account surplus fell to 1.0 % of GDP.

Balance-of-payments figures also highlighted the fact that FDI outflows from China in the first nine months of the year amounted to 65 billion dollars, while FDI inflows to China were 86 billion dollars. After having been 47 billion dollars in the red last year, net FDI flows turned positive. Other items in the financial account showed that capital outflows from China slowed significantly in the first half compared to last year. Some observers argue that this trend continued in the third quarter, but official third-quarter figures have yet to be published.

China's currency reserves at end-October were 3.109 trillion dollars. China's currency reserves have increased by 99 billion dollars this year. In 2015–2016, they fell by 833 billion dollars. With gold and other assets included, China's reserves totalled 3.204 trillion dollars at the end of October.

China's current account trends relative to GDP, %



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