

Russia

Russian president visits China. President Putin met with Chinese president Xi and attended the Shanghai Cooperation Organisation summit last week. As usual, during the presidents' meeting was signed a raft of various cooperation announcements and some business deals e.g. on nuclear power.

Russia-China economic cooperation has increased gradually in recent years, but nowhere near the most optimistic hopes in Russia. Last year, bilateral trade returned to brisk growth after weaker development. Russian goods exports to China in 2017 were worth about \$40 billion and imports from China nearly \$50 billion. China was Russia's single most important trading partner, accounting for more than 10 % of Russian exports and 20 % of imports. Russia only accounted for about 2 % of China's total foreign goods trade. Russia exports to China mainly crude oil and imports consumer goods.

Services trade has a smaller role. While the value of bilateral services exports and imports was just over \$2 billion last year, China was one of Russia's top trade partners in tourism.

Despite a few high-profile projects, investment between countries remains rather modest. The stock of recorded Chinese FDI in Russia last year was \$4.5 billion, while the stock of Russian FDI in China was about \$200 million. Determining country origins of FDI is, however, challenging particularly in the cases of Russia and China, where pass-through countries are often involved.

Changes in Russia's currency reserve composition.

Russia's gold and foreign currency reserves have grown notably since early 2017. They stood at nearly \$460 billion at the end of May. Some of the gains reflect forex purchases by the Central Bank of Russia on behalf of the finance ministry, while other gains came mainly from the rise in value of certain reserve assets. The forex purchases have added about \$30 billion to the reserves since they began in February 2017.

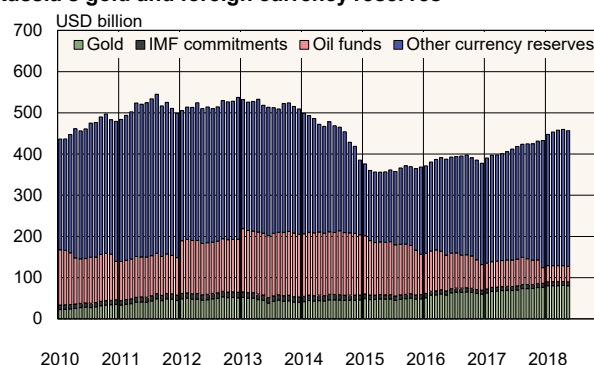
The structure of Russia's reserves has also evolved gradually over time. Gold's share has more than tripled in this decade as the CBR has built up its gold reserves. Gold accounted for nearly 18 % of the value of reserves at end-May.

The share of assets denominated in Chinese yuan has also grown significantly, standing at nearly 3 % of total reserves at the end of 2017. Nevertheless, most of Russia's currency reserves is still held in dollar- or euro-denominated assets.

Russia's foreign currency reserves also include the liquid forex assets of Russia's oil fund, which currently are worth about \$40 billion. Their share in currency reserves has diminished notably in recent years as fund assets have been used to finance budget spending. The currency reserves have not diminished, however, because the finance ministry has sold the forex-denominated assets to the CBR in exchange for rubles.

Russia's currency reserves provide a quite strong buffer in the event of an external financial shock. At the moment, the reserves are sufficient to cover e.g. about 17 months of imports or 140 % of Russia's short-term foreign debt.

Russia's gold and foreign currency reserves



Sources: CBR and Ministry of Finance.

FDI inflows to Russia remain at low levels. The net flow of inward foreign direct investment to Russia contracted slightly last year to \$28 billion. In 2016, FDI numbers were boosted by the sale of a minority stake in Rosneft to foreign investors. FDI flows are still far below levels at the beginning of this decade. Over the past two years, however, new FDI has again begun to flow into Russia, whereas in 2014–15 recession most FDI consisted of reinvested profits.

Russia's total inward FDI stock stood at \$535 billion (34 % of GDP) at the end of 2017. Nearly 70 % of that came from countries typically considered as pass-through countries or tax havens such as Cyprus and Bermuda. Much of these investments is considered to be of Russian origin.

Breaking down the inward FDI stock by sectors, the largest recipient (over 20 %) has been the extractive sector, which includes oil and gas. The shares of manufacturing, retail trade and financial sector have also been about 15–20 % each. In recent years, extractive industry has again risen as the largest FDI recipient sector, while retail and finance were the top sectors at the start of the decade.

The net outward flow of FDI from Russia last year amounted to \$39 billion, or nearly double the amount in 2016. The stock of Russian FDI abroad at the end of 2017 was \$470 billion. Over 70 % of that amount was invested in pass-through countries or tax havens and much of it has probably returned to Russia.

Russia's inward and outward FDI flows



Source: Central Bank of Russia.

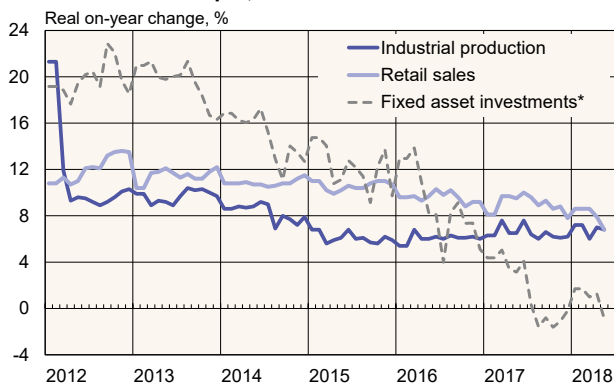
China

Slowdown in Chinese growth more broad-based in May. Monthly indicators released by the National Statistics Bureau show that the nominal increase in fixed asset investment (FAI) in May was below 4 %. Even with modest price assumptions, real growth in FAI was negative due to the contraction in public investment. In the first five months of 2017, public investment still rose faster than private investment.

The slowdown in growth of fixed investment is a long-term trend as Chinese economic growth becomes increasingly dependent on consumption demand. Growth in retail sales, a rough measure of consumption, fell to below 7 % y-o-y in May in real terms. Industrial output grew by nearly 7 % y-o-y.

As in April, May consumer-price inflation hovered at 1.8 % p.a. Producer price inflation accelerated slightly to 4.1 % p.a.

Chinese industrial output, retail sales and fixed investment



* Investment trend for April-May 2018 based on estimated prices.

Sources: Macrobond, CEIC, NBC and BOFIT.

China further reduces import duties on consumer goods.

From July 1, import duties in China will fall from an average of 15.7 % to 6.9 % in 1,449 consumer goods categories. For example, the average import duties on clothing, footwear, kitchenware, and ready-to-eat food items will be reduced by about half to 7 %, while the import duties on some fresh foods and foodstuffs fall by twenty percentage points to around 5 %. Import duties on washing machines and refrigerators will fall from over 20 % to 8 %. Import duties on cosmetics and health products will fall from over 8 % to 3 %, while import duties of medicines will be eliminated completely. The measures are a follow-on from the latest round of import duty reductions for consumer goods implemented in December 2017 (see [Weekly 48/2017](#)).

The reductions in import duties brings China's customs level closer to that of developed economies, even if the differences are still considerable. The WTO reports that in 2016 the average import duties in China were 9.9 %, compared e.g. to 5.2 % for the EU and 3.5 % for the US. In 2016, Chinese products encountered US import duties averaging 4 %. EU import

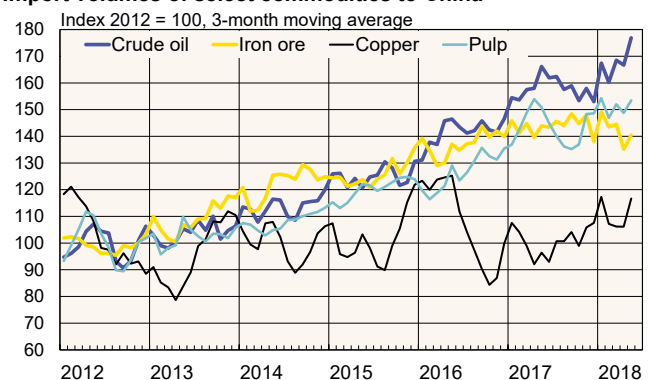
duties on Chinese goods average 11.9 % for agricultural products and 4.5 % for other products. On the flip side, China extracted duties on goods from the EU and the US to the tune of about 15 % for agricultural products and 9 % for the rest.

China imported a record amount of crude oil in the first five months of this year. China's imports of crude oil rose by 8 % y-o-y in the first five months of this year. The period included several months of historical record highs in monthly oil import volumes. A total of 190 million metric tons of crude was imported in the January-May period, which translates to an average of about 9.3 million barrels a day. For January-May 2017, the average was 8.6 million barrels a day. China's domestic oil production continues to decline, so it has to import more oil and has become the world's largest oil importer. The volume of crude oil imported from abroad already exceeded the volume of China's domestic crude oil production in 2009.

Demand for imported crude oil certainly exists. Refineries increasingly depend on imported crude as China's domestic production has steadily declined since the second half of 2015. The causes of the production drop include ageing production facilities, high production costs and the depletion of some domestic oil deposits. In March 2018, China produced about 3.7 million barrels a day, the same amount as a decade earlier. Still three years ago, daily production exceeded 4.3 million barrels. Besides oil, the import volumes of other key commodities increased in the first five months of the year, particularly copper imports (up 17 %).

The overall value of Chinese goods imports in the first five months of the year amounted to nearly USD 860 billion, an increase of 21 % y-o-y. The value of goods exports was up 12 % to USD 960 billion. The trade surplus shrank in January-May by nearly a third from the same period a year earlier. Some of the change in export and import growth figures reflected the impact of exchange rate fluctuations. The yuan was on average 8 % stronger against the dollar in January-May compared to a year earlier. Measured in yuan, imports grew by 11 % and exports 3 %. China Customs estimates that the volume of imports increased by 7.5 % y-o-y in the first quarter of this year, while the volume of imports grew by 8.5 %.

Import volumes of select commodities to China



Source: Macrobond.