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Russia

Exports of Russian pipeline gas down over 10 % last year. The Central Bank of Russia reports that about 175 billion m^3 of natural gas were exported last year. Exports to Ukraine were down significantly, falling by 44 % to 15 billion m^3. Exports to Europe and Turkey declined by 9 % to 126 billion m^3. In addition, Gazprom's pipeline grid transmitted 20–30 billion m^3 of gas to Europe from Central Asian countries (mainly Kazakhstan, Turkmenistan and Uzbekistan). Gazprom said that last year it sold 147 billion m^3 of gas to European and Turkish markets.

There are four main pipeline routes for exported gas: Nord Stream, which runs along the Baltic Sea bottom; Blue Stream, which passes under the Black Sea to Turkey; the Yamal-Europe pipeline through Belarus; and the Druzhba pipeline that goes through Ukraine. Druzhba is by far the biggest and most important of these four pipelines, with about half of the gas piped to the EU moving through it.

Gazprom has long sought to circumvent transmission routes through Ukraine. The South Stream pipeline, the brainchild of a consortium led by Gazprom, would run under the Black Sea to Bulgaria. The project was abandoned, however, in December 2014, largely on opposition from the EU. In response, Gazprom announced it was planning a similar pipeline to run under the Black Sea to Turkey that would stream gas to the markets in both Turkey and the EU. This "Turkish Stream" project is pending final approval from the countries involved.

In September 2014, construction of the first gas pipeline to Asian markets was officially christened. A year ago, Gazprom and China's CNPC concluded a 30-year gas supply agreement that provides China with 38 billion m^3 of gas delivered every year. The "Power of Siberia" pipeline should be operational in 2019.

The required investment in the Power of Siberia pipeline and development of gas fields in Yakutia and Irkutsk in eastern Siberia are huge, both in terms of scale and cost. Russia has long sought agreement from China on a more western route that could stream gas from existing fields in western Siberia. In conjunction with the Moscow visit of Chinese president Xi Jinping, Gazprom and CNPC agreed on May 8 to go ahead with construction of this Altai pipeline. No details on the agreement have yet been released.

At the moment, only liquefied natural gas (LNG) is exported from Russia to markets in Asia. LNG production and exports last year remained at around 14 billion m^3, the same levels as in 2013. Russia' sole LNG producer is currently Sakhalin II in Russia's Far East Federal District. An LNG terminal is under construction at the northern tip of the Yamal Peninsula. It is majority-held by the private gas company Novatek. Gazprom has plans to build LNG facilities in the Gulf of Finland in Ust-Luga and in Vladivostok in the Far East Federal District. These plans, however, will likely remain on the drawing board in the coming years.

Russia and China conclude cooperation agreements during Xi Jinping's visit to Moscow last week. Most of the agreements are very general in nature and their implementation will require long negotiations and agreement on details. Goals of the agreements include developing cooperation in the fields of finance, investment and production technology.

Russia hopes especially for investments and financing from China, which is ready to provide 300 billion rubles (€5.3 billion) in financing to build a high-speed rail connection between Moscow and Kazan. The rail project is part of a planned transportation corridor between Moscow and Beijing.

During the visit, the Eurasian Economic Union and China representatives said they were beginning wide-ranging negotiations on trade and economic cooperation. Such cooperation would include measures to facilitate trade other than the elimination of customs duties.

Russia's foreign trade collapsed in the first quarter. The value of goods exports plunged 28 % y-o-y, mainly on lower export prices. Export volumes of many products, in fact, increased. Crude oil exports were up 13 % y-o-y and petroleum products over 24 %. Export volumes of copper and fertilisers increased sharply, while grain exports were up slightly from a year earlier. Oil and gas accounted as usual for two-thirds of goods exports. Other important export products included metals and chemicals.

The EU remained Russia's biggest export market by far, accounting for half of all exports. The value of exports fell by a third, however. APEC countries took over a fifth of Russia's exports.

The value of goods imports slid 37 % y-o-y. Imports were down significantly in all product categories on the weak ruble, poor consumer demand and the lack of investment demand. APEC countries were the biggest suppliers of imported goods to Russia, surpassing the EU as imports from the EU declined 44 %. China remained the largest single import provider. Its share of Russia's overall imports rose to more than 20 %, even though imports from China fell by nearly a third.

The sharpest drop in Russian foreign trade was again seen with CIS countries. Ukraine trade fell by nearly 60 % y-o-y (a year ago Ukraine was still Russia's biggest CIS trading partner). Russian trade fell considerably with Belarus and Kazakhstan, too, which are partners with Russia in the Eurasian Economic Union (EEU). Russian imports from Armenia, which joined the EEU at the beginning of this year, fell even more than imports from Ukraine.

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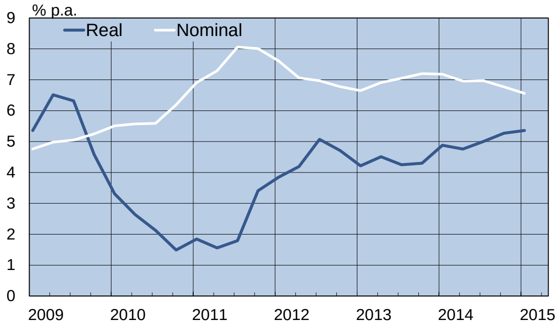
China

PBoC cuts interest rates and continues deregulation of deposit interest rates. On Monday (May 11), the People's Bank of China lowered its reference credit rates by 25 basis points. The one-year credit reference rate for banks now stands at 5.1 % and the deposit reference rate at 2.25 %. The rate cuts reflect the weak growth outlook and low inflation environment. Consumer price inflation accelerated only marginally to 1.5 % in April, while producer prices were down 4.6 % y-o-y, the same as in March.

The rate cut has only minor effect on the real economy as credit rates were deregulated in summer 2013. Interbank rates have gone down sharply over March–May, but this has yet to be reflected in general interest rates (see chart).

The deregulation of deposit rates is actually more important than the reduction of reference rates. Banks are now permitted to pay deposit rates 50 % above the reference rate (earlier 30 % above the reference rate). As a result, the ceiling on deposit interest rates is now 3.38 %. The formal deregulation of deposit rates is no longer a big step, although even after that China's banking system and monetary policy will not automatically function on a market-driven basis due to the central role of the state banks.

Average bank lending rates, %



Sources: Macrobond, BOFIT

Growth in number of migrant workers slows. The millions of internal migrant workers who leave their rural homes to work in cities is a special feature of China's labour market. A survey released in conjunction with labour market statistics showed that, according to the survey's definition, there were 274 million migrant workers in China last year, or 5 million more than a year earlier. The growth of the number of the migrant workers has slowed in recent years, and is now around 2 % a year.

Migrant workers lack official residency in the cities where they work due to China's household registration system (*hukou*). When work ends, they must often return to their rural domicile as many social services are tied to residency. While migrant workers increase labour market flexibility, they make it hard to judge labour market conditions, as migrant workers are not included in official unemployment figures.

Migrant workers traditionally have had little education, so they ended up in low-wage fields such as assembly, manufacturing or construction. The nearly endless flow of low-wage migrant workers to cities in past decades has helped fuel the Chinese economy's high growth and avoid large-scale labour shortages, even in coastal regions where growth was highest. The surge in wages, however, suggests pressure on labour markets.

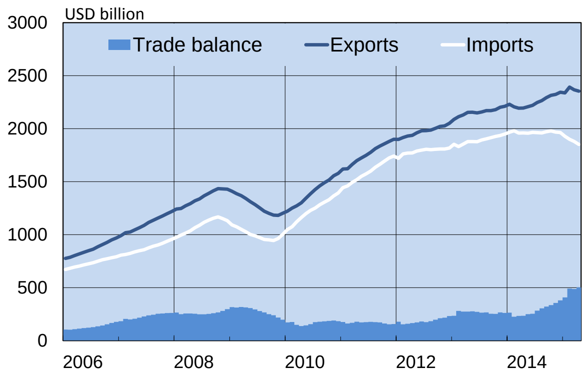
Slowing growth in the number of migrant workers indicates structural change in China's labour markets. The demand for low-skill cheap labour has fallen as assembly work has shifted to countries with lower labour costs. The Chinese economy's development and structural changes have shifted the focus away from production in low value-added branches to e.g. the service sector. Lower growth in the number of migrant workers also indicates that workers are increasingly finding work near their homes, so moving to big cities is no longer necessary.

Gradual evolution in structure of China's foreign trade. China's foreign trade slipped in April, with exports down 6 % y-o-y and imports off 16 %. China's April trade surplus amounted to $34 billion. The sub-index of new export orders in the purchasing managers' CPI also indicated a weak outlook for foreign trade.

There were large differences across export product groups. Exports of high-tech products fell only 2 %, while exports of mobile phones increased by nearly 24 %. Exports of labour-intensive goods plunged. For example, clothing exports were down 21 %. Underlying this trend are China's rising labour costs that have boosted prices of export products, and yuan appreciation. This trend, in turn, reflects the structural adjustment of the Chinese economy as it transitions from low add-value assembly industries to high value-added production.

While the on-going slide in commodity prices is partly responsible for the drop in imports, the volume of imports was also down about 8 % y-o-y in the first quarter of 2015.

China's foreign trade, 12-month moving total



Source: Bloomberg