Weekly Review
20 • 20.5.2016

BOFIT

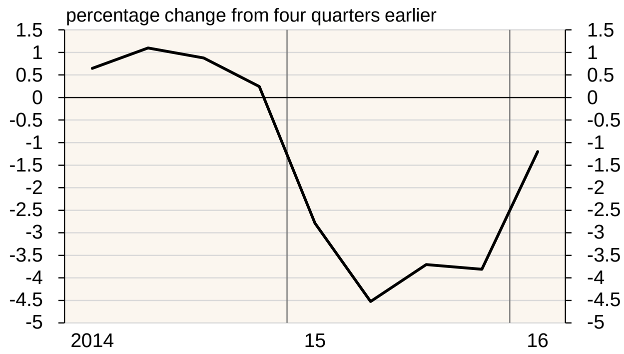
Russia

Contraction of the Russian economy slowed this year. Rosstat reports that GDP fell 1.2 % y-o-y in the first quarter. Russia's economy ministry noted that the impact of leap year blunted the drop. The ministry's estimate meant that without the leap-year effect, the first quarter fall in GDP would have been about 2 % y-o-y. Moreover, the GDP figure got a small boost from an exceptional increase in Russian crude oil output in the first quarter. However, fresh estimates of Russian oil production this year by Russian and international energy authorities see growth in oil production slowing during the remainder of the year.

After the release of Rosstat's GDP figure for the first quarter, Russia's economy ministry estimated that seasonally adjusted GDP contracted 0.2 % q-o-q in the first quarter. Portraying figures reliably is hard, however, due to the fragmentation of Rosstat's GDP time series. This is because Rosstat is recalculating its GDP statistics moving back through time from the present. The recalculations use methodologies that are based on more updated international recommendations than those applied earlier.

Most of the latest forecasts estimate Russian GDP will shrink 1.2–1.3 % this year. The economy ministry's projection of a contraction of 0.2 % is among the most favourable.

Russian GDP growth



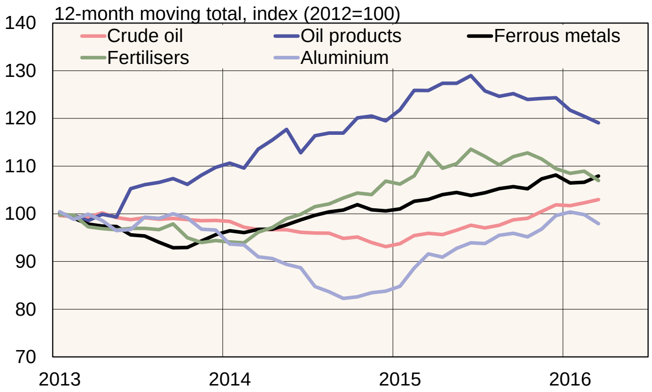
Source: Rosstat.

Fall in Russian imports begins to moderate. The value of goods imports in January-March contracted 15 % y-o-y to just under $40 billion. The contraction in imports slowed considerably in all main product categories, and Russia's Federal Customs Service noted that import volumes of certain products even recorded growth. The EU's share of Russian imports rose slightly to nearly 40 %. Russian imports from e.g. France and Estonia were up nearly 20 %. Russian imports from China contracted 12 % y-o-y, but China, which accounted for over 20 % of Russia's imports, was still the single most important import provider by far. Imports from Turkey were down 60 % y-o-y, partly due to Russia's decision at the end of last year to ban imports of many Turkish food products.

The value of Russian goods exports contracted in January-March by about a third to $60 billion due largely to lower export prices. The average price of Urals-grade crude oil was $32 a barrel for the period, down from $53 a barrel a year earlier. In addition, the growth in export volumes of major commodities slowed or went into decline. Growth in crude oil exports slowed to 4 % y-o-y and the export volumes of oil products shrank by 16 %.

Among key metal products, export volumes of ferrous metals and aluminium went into slight decline, whereas in exports of copper and nickel growth slowed visibly. The ruble's real effective (trade-weighted) exchange rate in 1Q16 was still 5 % lower than a year earlier.

Export volume trends of select Russian export commodities



Sources: Macrobond / Federal Customs Service of Russia.

Russia signs on to OECD's Automatic Exchange of Information initiative. The OECD and G20 countries have developed the Automatic Exchange of Information (AEOI) standard procedure as a way to increase international cooperation among tax officials and thereby reduce tax evasion. Under the AEOI, tax officials in participating countries agree to automatic annual exchange of information about the asset-holdings of citizens. Currently, there are 82 signatory countries to the agreement, including a number of tax havens such as the British Virgin Islands. Russia's participation is set to commence in September 2018, but bilateral agreements still need to be signed.

The AEOI is expected to support implementation of new tax laws developed in recent years to reduce hiding capital assets abroad. These include a ban on foreign assets of individuals in government service and stricter taxation of Russian income originating abroad. Increased taxation of offshore capital has been sought also by an amnesty law enacted last summer. The law allows Russians to avoid possible punishments related to offshore assets through voluntary disclosure. The law so far has resulted only in a couple hundred voluntary asset declarations and will remain in force until end-June.

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China

April's economic numbers confirm China's ongoing slowdown. After slight improvements in key economic indicators in March, April's figures were weaker than most observers had expected. Growth in industrial output last month slowed to 6 % y-o-y and retail sales were up about 9 %. Growth in fixed investment slowed a bit, but differences across sectors were huge. For January-April, public sector investment was up 24 % y-o-y, while growth in private sector investment remained at 5 % y-o-y.

Chinese exports in January-April were down 8 % y-o-y in dollar terms. The drop moderated last month, however, to an on-year fall of just a couple per cent. The value of imports was down again last month by over 10 %, a trend that has persisted all year. The drop largely reflects low commodity prices – import volumes of many important commodities actually increased. In January-April, import volumes were up 19 % for crude oil, 29 % for copper and 8 % for iron ore.

China's financial markets have been relatively calm since February and capital outflows from the country have been modest. As in recent months, the value of China's currency reserves hovered around $3.2 trillion. Current government challenges include a worsening debt problems and partial overheating in the housing market. The general fall in housing prices in many cities ended a year ago and prices today are soaring in many large cities. SouFun's survey of 99 major cities shows that the average apartment sale price in April was up 9 % y-o-y. Price trends ranged widely across cities.

Swings in yuan-dollar exchange rate get larger. Last August's foreign exchange overhaul was designed to allow larger swings in the yuan-dollar exchange rate. The People's Bank of China has accomplished this goal to some extent as the volatility in both the yuan-dollar exchange rate fixing and the USD/CNY market exchange rate has increased significantly since August. At the same time, yuan volatility against multi-currency indexes has decreased.

The PBoC began last December to publish three multi-currency exchange rate indexes (the CFETS index, which comprises 13 currencies; the IMF's SDR index based on four major currencies; and the BIS index of 40 currencies). Commercial banks that submit price proposals on which the central bank bases its daily dollar-yuan "fixing" rate have been instructed to take into account market price at the end of the previous day's trading and the yuan's trend against all three main indexes. This request is impractical in many respects as the proposed dollar reference exchange rate submitted by reporting commercial banks would have to take into account the yuan's movements against all index currencies. Yuan's dollar fixing rate has closely followed the market exchange rate since the reform was introduced.

Despite the PBoC's goal of broadening market perspective on yuan exchange rate, forex markets remain largely focused on the yuan-dollar exchange rate. Some of this is natural; e.g. the vast share of yuan trading is conducted in relation to the dollar. Moreover, the central bank's CFETS index is an arbitrary construct with no other practical application.

The needs of a country with a large, rapidly developing economy that is opening up and deregulating capital movements are best served by a flexible exchange rate regime. China has declared its plans of shifting to a freer exchange rate regime, so recent improvements in flexibility are welcome. The current situation still allows for managed increases in flexibility.

Yuan-dollar rate with CFETS and SDR multi-currency indexes

Sources: Macrobond and BOFIT

Boom in Chinese foreign travel continues. Chinese foreign travel has soared in recent years. Compared to 2010, the number of trips abroad doubled last year and the amount spent abroad was six times larger. China's National Tourism Administration reports that Chinese made nearly 130 million trips abroad last year. PBoC balance-of-payments figures further show Chinese travellers abroad spent a total of approximately $300 billion in 2015 (the equivalent of about 3 % of GDP). The UN's World Tourism Organization (UNWTO) reports that both the number of tourists and the money spent per traveller have increased so much that Chinese are now the world's most significant tourist group. American tourists were the second-biggest spenders abroad last year ($120 billion). Russian travellers spent $35 billion.

The top destinations for Chinese are countries in East and Southeast Asia, Europe and North America. The Chinese typically travel in groups and often purchase luxury products. Chinese are expected to travel even more in coming years as the country grows more affluent.

Finland's national tourism promotion board "Visit Finland" reports that the number of Chinese visitors arriving in Finland last year exceeded 500,000, or about a third more than in 2014. The Chinese were the fourth largest tourist group after Russians, Swedes and Estonians, and the second biggest spenders after Russians. Chinese arriving in Finland as transfer passengers at the airport make up a third of Chinese tourists, but the number of overnight stays by Chinese travellers also increased some 40 % last year.

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