Weekly Review
7 • 17.2.2017

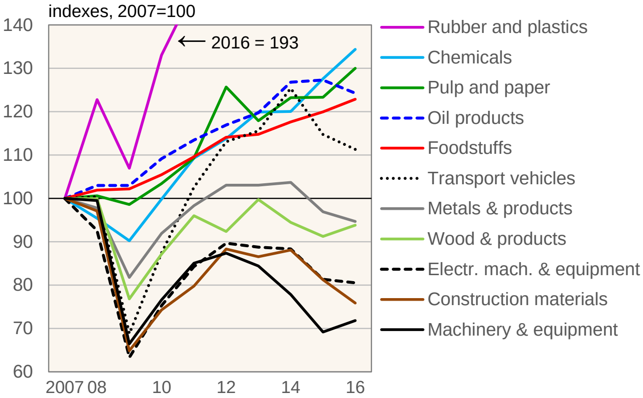
BOFIT

Russia

Varying performance in Russian manufacturing branches last year. In 2015, the volume of manufacturing output fell 5.4 %. Last year, the output was virtually unchanged from 2015. Credit for ending the overall decline goes to 5–6 % gains in output in the sizeable chemical branch and a couple of per cent gain in the large food industry. The smaller rubber and plastics branch, a boom industry, also returned to growth. Growth of machinery & equipment output ended years of decline (thanks to two sub-branches), and output rose in forest industries.

Manufacturing was pulled down mainly by three branches. Production of oil products fell after many years of growth, while the metal and construction material industries experienced their second year of decline in a row. Production of electrical machinery & equipment, as well as transport vehicles, continued to contract.

Output of various Russian manufacturing branches, 2008–2016



Source: Rosstat, BOFIT.

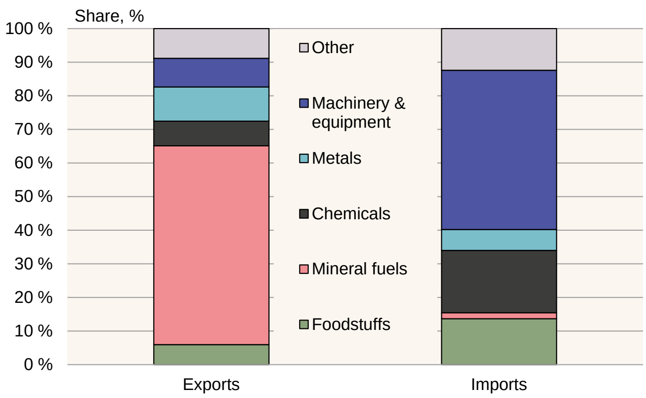
Growth returns to Russian goods trade. Fourth-quarter goods imports were up 9 % y-o-y in value terms. Growth was seen in all largest product categories, with highest growth posted for imports of machinery, equipment & transport vehicles. Import growth should continue this year on gradually reviving demand and a stronger ruble. The ruble's real effective (trade-weighted) exchange rate was up 34 % y-o-y in January from its low in the first months of last year.

The value of goods exports rose in the fourth quarter by 2 % y-o-y, due largely to higher commodity prices. The volume of crude oil exports remained unchanged from a year ago, while exports of oil products fell substantially. Natural gas exports continued to rise. The volumes of oil & gas exports are expected to rise only slightly this year. Among other goods, brisk growth continued e.g. in the exports of sawn timber. President Putin recently ordered the government to examine if there is a need to impose duties or quotas on exports of sawn timber.

The value of goods imports in 2016 contracted by less than 1 % to about $190 billion. About half of goods import consisted of machinery, equipment & transport vehicles. Chemicals and foodstuffs were also important goods categories. The value of goods exports was $280 billion, nearly 20 % less than in 2015. The sharp decline in oil prices also reduced the share of oil and natural gas in exports (just 60 % in 2016). Correspondingly, the shares of other goods categories in exports increased slightly, even if the value of their exports also fell.

The EU was still Russia's most important trading partner last year, accounting for nearly half of exports and almost 40 % of imports. 22 % of exports went to countries in Asia, and 34 % of imports came from Asia (China's shares were 10 % and 21 %, respectively). CIS countries accounted for roughly 10 % of Russia's imports and exports.

Structure of Russian goods trade in 2016



Sources: Russian customs service, BOFIT.

Slight reduction in foreign debt of Russian banks and other firms. Preliminary CBR figures show companies and banks in Russia (Russian and foreign-owned) owed $470 billion (€446 billion) in foreign debt as of end-2016. The external debt-to-GDP ratio remained roughly unchanged at 36 %. Banks owed $119 billion (end-2015 $132 billion) and firms $351 billion (end-2015 $345 billion). For comparison, the domestic bank loans to firms amounted to $426 billion.

Unlike in the previous two years, the ruble's appreciation in 2016 supported the forex valuation of the foreign debt held by banks and especially other firms. Nearly 20 % of corporate debt and 13 % of bank debt is denominated in rubles. Banks continued to pay down substantial chunks of foreign debt last year, although the repayments were only about half of what they had been in the two previous years (effect of ruble exchange rate changes on dollar-value of debt eliminated). Corporate foreign debt payments became even more minor than in 2014–15 when they were already relatively small due to renewal of debt and postponed repayments. Unlike previous years when firms received some debt from parent companies and subsidiaries abroad, they slightly reduced this debt last year. Repayments of the other foreign debt of firms were very small compared to the two previous years.

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China

FDI spending of Chinese firms hit record in 2016. China's official figures show outward foreign direct investment flow (excluding financial sector investments) last year amounted to $170 billion, an increase of 40 % from 2015. While final FDI numbers for the financial sector have yet to come in, they typically represent 10–20 % of total FDI. Thus, the total value of FDI outflows from China last year was probably around $200 billion. The value of FDI inflows to China, on the other hand, fell last year to $126 billion. Outbound FDI of Chinese firms also exceeded inbound FDI in 2015.

Official Chinese figures fail to give a complete picture of where investment ultimately ends up. The statistics don't give a correct picture of the final-destination countries or even branches. Alternative estimates confirm the rise in FDI, however. For example, the Rhodium Group estimates that Chinese FDI flow increased by about 40 % last year to some $200 billion. China Global Investment Tracker (CGIT), which monitors large foreign investments of Chinese firms, reports that such FDI rose 46 % last year to $169 billion.

Chinese investments in Europe have risen particularly fast. The Rhodium Group reports that FDI flows from China to Europe reached €35 billion last year, a nearly 80 % increase from 2015. Two thirds of all FDI going to EU countries came from privately held Chinese firms. The flow of FDI from EU to China fell last year to around €8 billion. Also figures from the CGIT database show that FDI flows from China to EU countries grew about 80 % last year.

The largest direct investment by a Chinese firm in Europe last year (€6.7 billion) was made by Tencent to purchase a majority stake in the Finnish mobile video game company Supercell. According to Rhodium, the acquisition by itself was sufficient to make Finland the fifth-largest cumulative recipient of Chinese FDI in the EU. Large acquisitions in Europe last year included investments in advanced machinery (Midea's purchased a large stake in German robot-maker Kuka AG and ChemChina's acquisition of German industrial machinery-maker KraussMaffei), as well as companies in the fields of renewable energy and entertainment. Investment in real estate fell. ChemChina has also made a $43 billion offer for Swiss agribusiness giant Syngenta. The deal awaits clearance by competition officials in the EU and US.

The growth of outward FDI flows from China should slow this year as officials pay increased attention to "irrational" investments by state-owned enterprises. The government wants to attract FDI into China by opening new branches to foreign firms and allowing broader access to domestic financing. In January, the State Council published goals on allowing more access for foreign firms in branches such as the financial sector, manufacturing, the telecom sector, transport and education. No schedule or details on the reforms have yet been released. EU countries have repeatedly criticised China for limiting entry of foreign firms to certain branches.

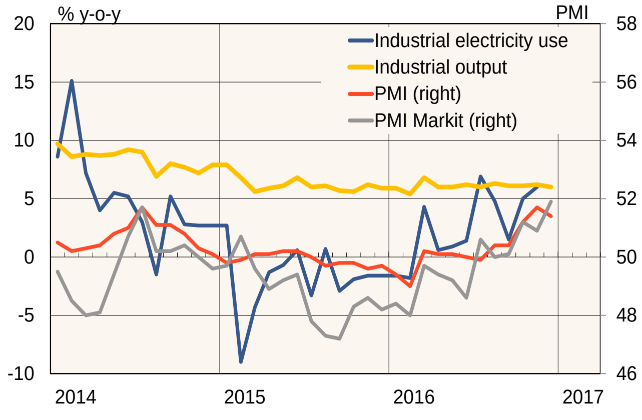
Reliability of China's output statistics raise questions. Early this month, *Bloomberg News* reported that China's deputy prime minister Zhang Gaolin was pushing statistics officials to ensure reliable reporting. For sure, there are good reasons for this as the reliability of official statistics is an issue that has been surfacing repeatedly for a long time. Last time matters came to a head in January with widely reported revelations about a massive, multi-year manipulation of official statistics in the Liaoning province.

Looking at economic growth figures over the past two years, eerily unwavering growth performances catches one's eye. For example, on-year GDP growth figures last year were reported as 6.7 % p.a. in each of the first three quarters of the year, and 6.8 % in the fourth quarter. In 2015, reported GDP growth was 6.9 % just about as stable as last year. Given that the Chinese economy is undergoing a massive readjustment, such stable growth figures are dubious.

In the same vein, reported industrial output figures show remarkably steady growth in 2015–2016 (see chart). Other indicators of industrial activity give quite different assessments. For example, both the official and private purchasing manager indices for manufacturing (PMI and Markit PMI) suggest growth came to a halt and began to fall in early 2015. Strict interpretation of the weak PMI index trends suggests that 12-month industrial output growth had fallen to around zero or even below it by the start of 2016. This dreary view is backed by industrial electrical power consumption figures. The inference of a substantial slowdown in the growth of electricity consumption holds even if figures for troubled heavy industry is not included in the industrial electrical power consumption figures. Interestingly, an indicator made from satellite images further support the notion there was a severe slowdown in industrial output growth.

Looking at recent growth figures and forecasts, the notion that they merely reflect official growth targets rather than actual economic dynamics does not seem far-fetched. In any case, rigid growth targets no longer serve the needs of responsible economic policy in present-day China. Moreover, their elimination would remove the incentive to fabricate numbers.

Indicators for Chinese industrial output growth



Sources: Macrobond, BOFIT.

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