Weekly Review
23 • 9.6.2017

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Russia

Despite falling stock and oil prices, the ruble has appreciated this year. Given that over half of the weight of firms listed on the Moscow stock exchange are firms involved in the oil & gas industry, it is not surprising that the Moscow stock exchange indices rise and fall in tandem with oil prices. The price of Urals crude has fallen 10 % in dollar terms this year, while the Moscow exchange's dollar-denominated RTS index is down 9 % for the year so far. Observers attribute part of the stock market decline to profit-taking by some investors following the surge in share prices last year and loss of hope for an early lifting of US sanctions on Russia.

Similarly, the ruble's exchange rate tends to follow oil prices. However, even with falling oil prices, the ruble this year has appreciated 8 % against the dollar and 1 % against the euro. Many analysts attributed the ruble's rise to short-term "carry trade" with attempts to exploit Russia's relatively high yields. Central Bank of Russia governor Elvira Nabiullina noted, however, that the level of carry-trade operations in Russia has been moderate. The CBR sees the ruble's appreciation as stemming from seasonal fluctuation in the trade surplus, capital inflows associated with the Rosneft share sale last December and an increased foreign investor interest in the Russian market.

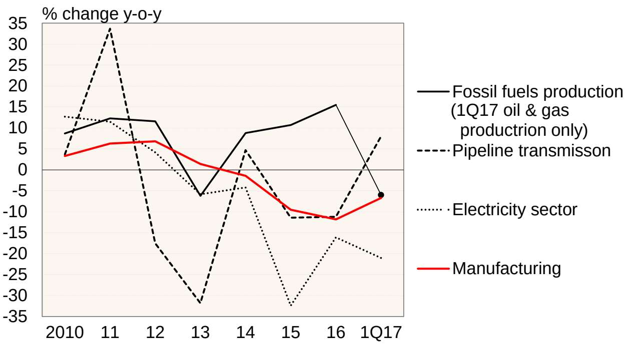
RTS index, ruble exchange rate and Brent oil price, 2015–2017

Source: Macrobond.

Investment sluggish in Russia. Fixed investment was up 2.3 % y-o-y in the first quarter. Rosstat reports that on-year growth in total fixed investment excluding small firms and those that operate in the grey economy was 0.4 % and thus lagged the pace of total investment growth, like it did in previous years as well. The lion's share of fixed investment in this category comes from large and mid-sized private firms and government investment. Estimates of seasonally adjusted fixed investment developments vary somewhat. Rosstat calculations show investment grew from the previous quarter in the second half of 2016, but remained flat in the first quarter of this year.

The first quarter brought shifts in oil & gas investment. After three years of robust growth, investment in oil & gas production fell. Investment in pipelines for transmission of oil & gas increased after five years of nearly continuous decline. The sharp drop in investment in the electricity sector continued. Investment in manufacturing dropped further too.

Real growth in fixed investment (large and mid-sized firms)



Source: Rosstat.

President Putin evaluates economic programme proposals. In late May, president Putin was presented with two economic development programmes that Putin had requested, but a decision is yet to be made of what will be the final development programme. The two proposals differ mostly in their approaches to monetary and fiscal policy. The proposal prepared by the team led by former finance minister Alexei Kudrin pushes for stable economic development based on the pursuit of moderate monetary and fiscal policies. In contrast, the "Stolypin Club" proposal would take a lighter monetary and fiscal stance and calls for large stimulus measures funded by the central bank and government budgets.

The proposals are closer to each other in terms of structural policy. Both call for e.g. measures to improve the business environment, spending on education & retraining and healthcare, as well as development of technology and the digital economy. Kudrin's plan calls for openness in trade policy, while the Stolypin Club favours a more protectionist line.

Putin is expected to combine measures proposed in both proposals as well as in a programme prepared by the government. The president's economic policy line has often highlighted economic stability and independence, which means e.g. restraining inflation and the government budget deficit, while encouraging import substitution. In addition, "digital economy" emerged as the term *du jour* at the St. Petersburg economic forum last week.

No matter what the final programme's composition, the biggest challenge will be its implementation. The successes at implementation of earlier Russian development programmes have been modest.

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China

Trade policy differences overshadow EU-China summit. The main themes at the 19th EU-China summit held in Brussels on June 1–2 were trade policy and environmental issues. However, differences between the parties prevented them from issuing a joint statement after the meeting. The EU says that China continues to give preferential treatment to its domestic firms, forcing foreign firms to submit to stricter regulation. The EU, in contrast gives Chinese firms relatively free rein in its domestic markets. China responded that the EU needs to stop withholding market-economy status now that China has completed 15 years of WTO membership. Moreover, China considers the EU's anti-dumping tariffs imposed on Chinese steel to be protectionism. The EU and China were more closely in agreement on climate issues.

Just before the summit, the EU Chamber of Commerce in China released its annual Business Confidence Survey. The findings support EU's claims that China coddles its domestic firms. For the fourth year in a row, over half of the survey respondents reported that foreign firms tend receive unfavourable treatment compared to domestic firms. In particular, firms reported barriers to investments and disproportionate enforcement of environmental regulations. The survey noted that implementation of the EU-China Comprehensive Agreement on Investment would relieve some of the problem. Even so, only 15 % of firms expect regulatory barriers to diminish in the near future, while 40 % expect the regulatory burden to grow heavier. Thanks to improved corporate profitability, the majority of European firms were more optimistic about the near future than in earlier surveys. The long-term outlook of the European firms, however, remained negative.

Asian trade policy on hold. With the United States' decision to withdraw from the proposed Trans-Pacific Partnership (TPP) free-trade agreement, the remaining potential TPP countries have been forced to reconsider their trade policy options. Without the US, TPP's coverage dwindled, reducing the incentive for TPP signatories to go it alone. As a result, the Regional Comprehensive Economic Partnership (RCEP) agreement has emerged as the leading alternative to TPP. China is not participating the TPP process, choosing instead to push for the RCEP at least until the withdrawal of the US from TPP. China's ambitions considering FTAs in the new situation remain to be seen.

The RCEP agreement, which is based on an ASEAN initiative, seeks to replace current bilateral FTAs between ASEAN's and six other Asian countries (China, India, Japan, South Korea, Australia and New Zealand). RCEP is less comprehensive than the TPP and therefore offers fewer benefits. A number of countries were pursuing negotiations over both agreements. The countries participating in RCEP talks are a fairly heterogeneous group, which together with TPP's shadow have made negotiations complicated.

China's participation in the talks is eased, however, by the fact that the RCEP does not seek complete lifting of tariffs or impose strict conditions related to worker rights and environmental protection. Easier market access is also attractive to Chinese sectors suffering from overcapacity problems. For other countries, the RCEP would open further up access to the Chinese market and possibly give them better opportunities to benefit from China's massive funding schemes such as "One Belt, One Road" (OBOR) projects. India and some other countries fear a flood of Chinese products onto their markets.

China has long promoted bilateral free-trade deals with its trading partners. China currently has 14 free-trade deals in effect, most with fairly small economies. Since 2012, China has also negotiated with Japan and South Korea on a trilateral free-trade arrangement.

The big push of Finnish firms to invest in their Chinese affiliates came in 2015. Statistics Finland figures for 2015 show that the affiliates of Finnish firms in China for the first time made China Finland's top investment destination, beating out both Sweden and Russia. The gross investment of Finnish affiliates in tangible assets in mainland China amounted to EUR 755 million (72 % y-o-y growth). Investment was accelerated by higher net sales in China in 2014, when turnover for Finnish affiliates rose by 32 %. Investments fluctuate greatly from year to year, however.

The number of Finnish affiliates operating in China rose to 230 last year. Despite the increase in the number of firms, the employee numbers continued to fall. Finnish subsidiaries employed around 50,000 people in 2015, down from about 70,000 in 2011. Finnish subsidiaries in China employed an average of 220 people in 2015 (down from 335 in 2011). Despite the lower employee numbers, they are still far higher than in Russia (121 people per firm) or the average for all Finnish international affiliates (98).

The turnover of Finnish affiliates in China fell by 4 % last year to EUR 10 billion, which is clearly more than affiliates in Russia (EUR 7 billion), but less than in Sweden (EUR 26 billion) or the United States (EUR 17 billion).

The 49 Finnish affiliates operating in Hong Kong are smaller than those operating in mainland China. Their net sales last year averaged just EUR 16 million (EUR 44 million in mainland China).

Finnish affiliates operating in China

	2012	2013	2014	2015
Number of firms	237	222	223	230
Turnover (€ million)	8,600	8,100	10,600	10,200
Share of Finnish affiliates total foreign turnover	5 %	5 %	8 %	8 %
Gross investment (€ million)	350	500	440	760
Share of Finnish affiliates total foreign investment	9 %	11 %	11 %	18 %
Personnel	69,000	58,600	55,500	50,500
Share of Finnish affiliates total foreign workforce	12 %	11 %	11 %	11 %

Source: Statistics Finland.

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