Weekly Review
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Russia

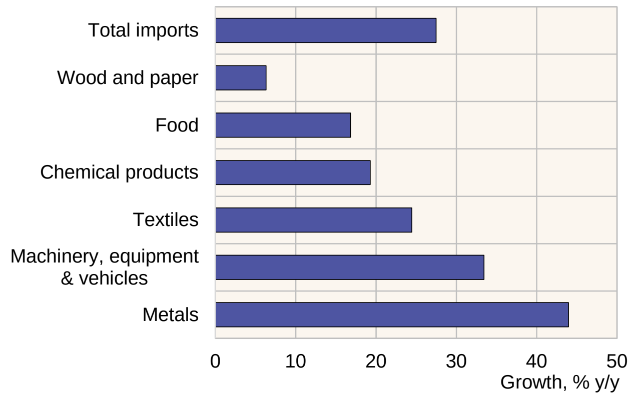
Brisk growth in Russian goods trade continues. The dollar value of goods exports and imports rose by nearly 30 % y-o-y in the first six months of 2016. In the second quarter, import growth accelerated slightly and export growth slowed. Despite high growth, the levels of exports and imports were well below peak levels of earlier years.

Driven largely by higher export prices, the value of goods exports continued to rise in the second quarter. Total export volumes also appear to have increased slightly. Export volumes of e.g. natural gas, iron ore, coal, wheat and copper increased, whereas export volumes of crude oil and oil products contracted relative to 2Q16.

The value of goods imports grew by double digits in the second quarter in most product categories. Imports of metal goods grew – both in terms of volume and value – by roughly 50 % y-o-y. The value of imports of machinery, equipment & transport vehicles increased by over a third.

The country structure of goods trade has remained largely unchanged this year. EU countries accounted for 44 % of Russia's trade, Asian countries 27 %, Eurasian Economic Union member countries 9 % and the United States 4 %.

Growth in value of select categories of Russian imports, 1H17



Source: Russian customs.

Russia has the most barriers to trade for European exporters. The European Commission published its latest report on barriers to trade in June. The report, which is based on information from European firms, identifies 372 barriers to trade currently in use, with the largest stock of barriers (33) imposed by Russia. Brazil, China and India each had stocks of 23 barriers against European firms.

Russia accounted for six of the 36 new barriers introduced in 2016. These measures included restrictions on imports and regulations to favour domestic firms in procurements by state-owned enterprises, new certification requirements for cement and pharmaceuticals, as well as restrictions on transit. Russia also announced plans for introducing requirements for psychological and educational safety of toys that would be unique in international practice.

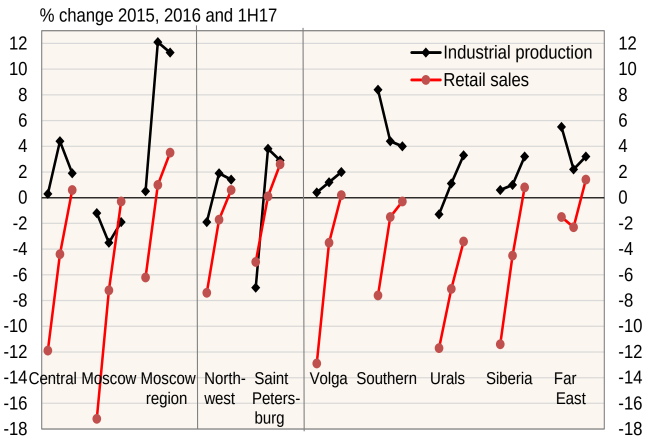
Industrial output in Russian regions rises, while consumption gradually recovers. Industrial output growth continued in the first half of this year in all of Russia's eight federal districts (each district comprising several administrative regions). Production rose by 1.5–2 % y-o-y in the Northwest, Central and Volga Federal Districts, as well as in the mega area of Moscow City and the surrounding Moscow region. In other major federal districts and Saint Petersburg industrial output continued to rise at a 3–4 % pace.

Over the past couple of years, neither industrial output overall nor manufacturing overall has not contracted in any of Russia's federal districts. Industrial output has even increased briskly in 2015–16 and this year in the Southern Federal District due to high growth in manufacturing and in the Far East Federal District driven by growth in the mineral extraction industries.

Retail sales have turned to growth, albeit slowly, in six federal districts. In Russia's Northwest and Central Federal Districts, for example, the volume of retail sales in the first six months of this year rose by just a little over 0.5 % y-o-y. After collapsing in 2015–16, retail sales volumes this year have been similar to levels seen in 2010–12 in the Central, Northwestern, Southern and Volga Federal Districts. The retail sales levels in the Siberia and especially the Ural Federal Districts are at even earlier and lower levels.

Of Russia's over 80 administrative regions, about a dozen in recent years witnessed no contraction or only slight contractions in retail sales to 2013–14 levels. Most regions have experienced a fall in retail sales to roughly the same levels that prevailed in the early years of this decade. The retail sales volumes in nearly 20 administrative regions both overall and per capita have sunk to levels similar to those last seen in 2005–08. Among them, Moscow is rather specific as considerable parts of retail sales and also industrial production have over many years moved out of Moscow City to the surrounding Moscow region.

Real on-year change in industrial output and retail sales in Russia's federal districts and major metropolises, 2015–2017



Source: Rosstat.

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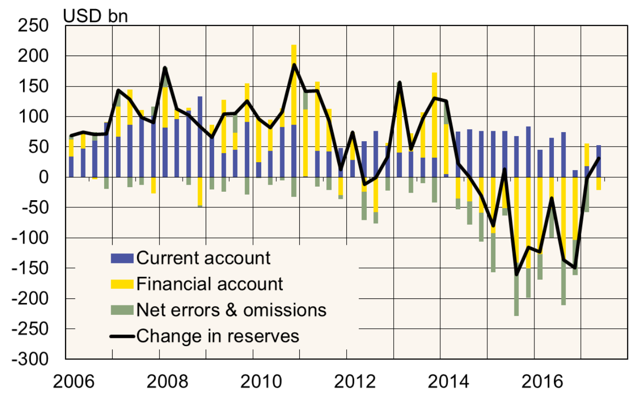
China

Tightened capital controls dampen Chinese capital exports, but fail to fix true problems. Driven by goods exports, China's current account surplus rose in the second quarter to 53 billion dollars. The first-half current account surplus this year reached 71 billion dollars, compared to 110 billion dollars in 2016. The 12-month current account surplus shrank to 1.4 % of GDP, or about a percentage point less than a year ago.

Although a detailed breakdown of the financial account figures is still forthcoming, it is clear that the net capital outflow from China has slowed significantly from 2015 and 2016. In the first half of 2016, the financial account and the "net errors and omissions" term, which together indicate the net outflow of capital from China, reached nearly 270 billion dollars. In 1H17, the net capital outflow was just 40 billion dollars. At the same time, the depletion of foreign currency reserves halted and even recovered slightly. Monthly figures show that China's foreign currency reserves last month rose by 24 billion dollars to 3.08 trillion dollars. Most of this increase likely reflects appreciation of the euro and other major reserve currencies against the dollar.

Main categories in China's balance-of-payments figures*



* 2Q17 financial account includes "net errors and omissions" term.
Sources: Macrobond, BOFIT.

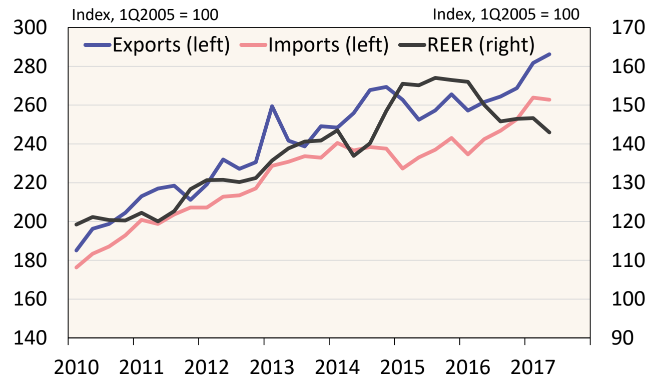
In order to stem capital outflows, falling currency reserves and depreciation pressures on the yuan, Chinese officials have substantially tightened capital controls and regulatory oversight. One major focus of the recent tightening has been on foreign investments of Chinese firms. Balance-of-payments figures show that outbound foreign direct investment of Chinese firms in 1H17 amounted to just 40 billion dollars, down from 124 billion dollars in 1H16. Despite efforts to encourage capital imports, first-half FDI inflows to China fell from 75 billion dollars a year earlier to 55 billion dollars.

While the payments balance has levelled off, efforts to correct imbalances through administrative decree are unlikely to put China on a sustainable footing. Circumvention of regulations is common. Indeed, some of the reduction in the current account surplus comes from an explosion in tourism spending that many suspect includes substantial amounts of illicit capital exports. Officials are responding to the situation by increasing the monitoring of use of payment cards by travellers abroad starting from September. The current round of regulatory tightening, however, does not tackle the natural need of Chinese firms and households to diversify their operations and investments. The need for diversification goes up when domestic uncertainty and risks are heightened by rising mountains of debt, the emergence of asset bubbles and political foot-dragging on needed reforms.

Robust growth in Chinese foreign trade. Growth in Chinese foreign trade has recovered significantly after a weak development seen in recent years. China customs reports that the dollar value of goods exports has grown this year by nearly 10 % y-o-y and goods imports by close to 20 %. Rapid growth in imports in particular reflects higher commodity prices than last year, but the rise in the volumes of exports and imports has been rapid too, both increasing nearly 10 % y-o-y in 1H17. The resurgence of foreign trade has been quite broad-based both by commodity group and by country. Trade figures of customs authorities in other countries confirm the strong growth in China's trade, and tend to dispel suspicions that the sudden rise in goods trade involves greater evasion of capital controls than earlier. The suspicions initially arose when the recovery in imports began last year at the same time China cracked down on capital movements.

The recovery of exports has been promoted by weakening of the yuan's real effective (trade-weighted) exchange rate (REER) over the past year and a half, which has bolstered the price competitiveness of China's exports. The REER is now about 10 % weaker than at the start of 2016. The pick-up in Chinese export growth has also boosted imports, as China still continues to import a relatively large share of components for assembly or further processing before they are exported further along the production chain. This "process trade" currently represents a third of all Chinese exports.

Volume of Chinese goods exports & imports (seasonally adjusted) and REER



Sources: UNCTAD, WTO, BIS, China customs and BOFIT.

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