

Russia

CBR lowers key rate; oil, ruble and stock markets down in recent weeks. The Central Bank of Russia continued monetary easing at their first board meeting of the year, lowering the key rate by 25 basis points. Effective from February 12, the key rate is 7.5 %. The key rate was last cut by 50 basis points on December 15.

The CBR explained the rate cut was chiefly justified by low inflation and reduced inflation risks over the near term. At the end of January, consumer price inflation was 2.2 %. The central bank noted that permanent factors may have more impact on inflation than previously estimated, adding that it seems less likely the official 4 % inflation target (12-month average) will be exceeded this year. Near-term inflation risks have abated, but still prevail over the medium term. Overall risks have shifted towards economic growth factors. In this environment the CBR will continue to reduce the key rate.

Stock exchange indices around the world see-sawed over the past two weeks. Over half of the Moscow exchange's main share index is weighted to oil and gas companies, so share prices tend to track closely oil prices. Since the beginning of February, however, the price of Urals-grade oil, measured in dollars, declined 12 % while the Moscow exchange's dollar-denominated RTS index dropped 5 %. The ruble-dollar rate has weakened by nearly 3 % (ruble-euro by under 2 %). Last year, the ruble's exchange rate occasionally diverged noticeably from changes of the oil price.

Machinery, equipment and vehicles drove the growth of Russian goods trade. The value of both goods exports and goods imports rose by about 25 % in dollar terms in 2017. The value of goods exports amounted to 350 billion dollars and goods imports 240 billion dollars.

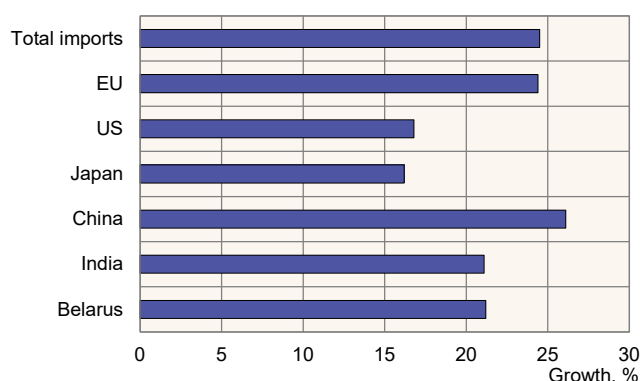
The rise in exports was due to both price and volume changes. Prices of oil and metals rose, while the export volume of oil and oil products contracted by 5 % and the export volume of metals remained flat. Natural gas export volume, in contrast, rose by about 5 %. The volume of exports of machinery, equipment & vehicles grew by 24 %, although presumably partly due to one-off deliveries. The volume of food exports grew by 22 %, mainly on last year's record grain harvest. Most of Russia's exports consisted, as usual, of oil, petroleum products and natural gas. They accounted for nearly 60 % of total exports last year. The preliminary estimate of the Russian officials of the value of arms exports last year was around 15 billion dollars, or about 4 % of goods exports.

All goods imports categories showed fairly brisk growth. Growth in the value of imports was led by machinery, equipment & vehicles (up 28 %), buoyed by a moderate recovery in investment demand. The value of imports of chemical products was up 17 % and foodstuffs 16 %. Imports in several food categories were also up slightly in volume terms.

The structure of goods trade by country remained practically unchanged. EU countries continued to account for over

40 % of Russia's trade turnover, Asian countries just under 30 %, countries in the Eurasian Economic Union 9 % and the US 4 %. China was Russia's largest single trading partner in terms of both exports (11 %) and imports (21 %).

Growth in value of Russian goods imports by country, 2017



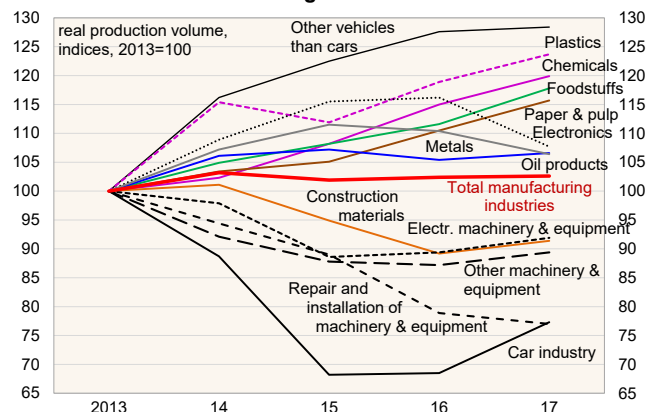
Source: Russian customs.

Wide variations in Russian manufacturing branches last year. Total manufacturing output recovered only slightly last year. After two weak years, output in 2017 was still slightly below the 2014 level. Growth in the food industries, one of the largest categories in manufacturing, continued at 2–3 % pace as the rise in foodstuffs production accelerated. Growth of the chemical industry remained high, especially in pharmaceuticals but also e.g. plastic products.

Production of oil products increased by 1 % to the 2014 level. Forest industry growth was also further up to several per cent, mainly on higher production of paper products. Production of construction materials increased after two years of deep decline, while the metal industry slid substantially.

Growth in the machinery & equipment category (six branches) continued at about 1.5 %. Especially the car industry showed recovery. The boom in other vehicle production and electronics halted, likely due to a decline in defence industry orders. Services involving repair and installation of machinery & equipment continued to decline.

Trends in main manufacturing branches 2014–17



Source: Rosstat.

China

China's current account surplus fell to 1.4 % of GDP last year. Preliminary balance-of-payments figures from the People's Bank of China show that the goods trade surplus fell slightly last year from 2016 to a level of 476 billion dollars, while the services trade deficit increased to 261 billion dollars. The total current account surplus fell from 196 billion dollars in 2016 to 172 billion dollars last year (1.4 % of GDP).

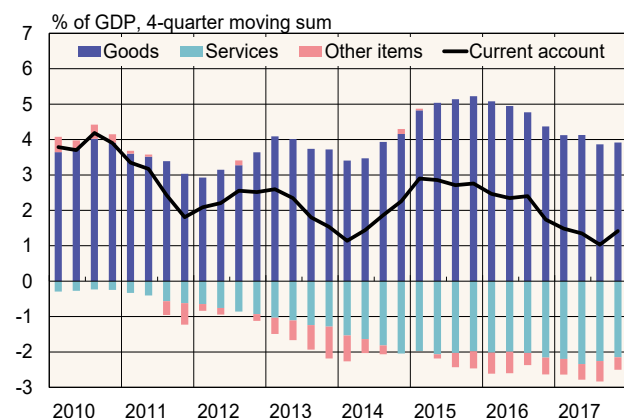
China's large services trade deficit reflects trends in tourism. While Chinese tourist spending abroad last year (tourism imports) did not increase, foreign tourists visiting China declined slightly (tourism exports). Thus, the tourism deficit rose to 221 billion dollars. The rest of the services trade deficit was explained by a 56 billion-dollar deficit in transport services. While other services trade categories are small, they were overall in surplus.

The flow of direct investment shown on the financial account turned positive again, i.e. more investment flowed into China (USD 165 billion) than out of the country (USD 101 billion). The change reflected China's implementation of stricter limits on capital exports. The flow of direct investment turned negative for the first time in 2016.

China's foreign exchange reserves started to increase again last year. The balance-of-payments figures show the rise in currency reserves was USD 92 billion. In the national accounts, currency reserves last year were up USD 138 billion indicating that a third of the value increase in reserves came from exchange rates and other valuation changes. The value of currency reserves in January (incl. gold, SDRs and IMF reserve funds) rose by USD 25 billion to USD 3,261 trillion.

China customs data show that January's trade surplus was just USD 20 billion as the value of goods imports rose to USD 180 billion. The value of goods exports was USD 201 billion. The timing of the Chinese Lunar New Year holiday impacts January and February economic figures. This year, the week-long celebrations began February 15.

Trends of China's current account components and GDP



Sources: Macrobond, BOFIT.

Market turbulence rocks China, too. Stock markets nose-dived globally as unexpectedly strong economic figures lifted interest rates and increased expectations of accelerating inflation in the United States. The rise in volatility put share prices in free-fall and spread to all major exchanges. The reactions on Chinese exchanges were especially strong. Both Hong Kong's general Hang Seng Index, and mainland China's Shanghai Composite Index declined by over 10 % in the first two weeks of February. The Shanghai drop erased all of last year's gains on the Shanghai Index, which returned to the same level as at the start of 2017. The climb in Hong Kong share prices had been steeper, so after the correction the Hang Seng was still up by over 30 % from the start of 2017. Share prices have recovered somewhat in recent days.

Just before the New Year holiday, the yuan depreciated somewhat against the euro, the dollar and a trade-weighted basket of major currencies. The rise in US interest rates has narrowed the gap with Chinese interest rates and is expected to dampen appreciation pressures on the yuan.

Stock exchange trends in mainland China and Hong Kong



Source: Macrobond.

China's January inflation slowdown was broad-based. Consumer price inflation in January fell to 1.5 %, three-tenths of a percentage point lower than in December. Core inflation, which omits food and energy prices, fell also by three-tenths of a per cent to 1.9 %. The dampening of consumer price inflation was most affected by price trends in certain recreational services as well as in transport and telecom services. At least part of this is explained by the timing of the Chinese Lunar New Year holiday. Prices of certain consumer items typically rise during the holiday. Last year's celebration kicked off in January and this year in February, which had a weakening effect on on-year price growth in January this year. Conversely, the later holiday this year may boost February's inflation figures.

The slowdown in producer price inflation that began last year continued in January. On-year growth in producer prices fell from 4.9 % in December to 4.3 % in January. Price cooling was strongest in industries and services related to production of coal and iron ore.