Weekly Review
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BOFIT

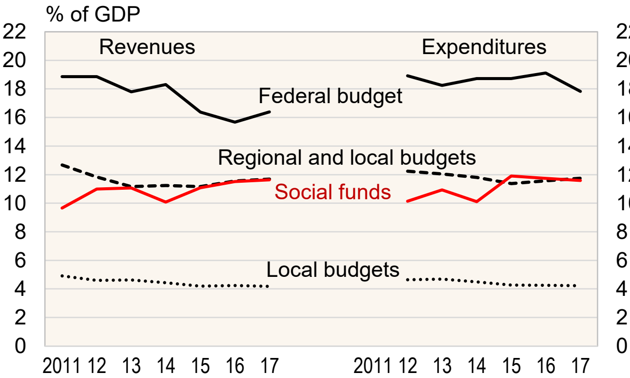
Russia

Foreign currency sovereign credit ratings on Russia upgraded. Standard & Poor's last week raised its rating of Russian sovereign foreign bonds to investment grade (BBB-). The earlier junk-grade rating of BB+ lasted for three years. The rating of Russia's local currency government bonds were also upgraded by one notch to BBB. S&P Global Ratings noted that Russia's macroeconomic policy has allowed the economy to adjust to lower commodity prices and international sanctions. The outlook for the Russian economy is stable. S&P's rating for Russian sovereign foreign bonds now matches that of Fitch, while Moody's continues to apply a junk rating (Ba1).

The S&P upgrade means that two of the big three international credit ratings agencies now give investment grade on Russia's foreign bonds. Demand for the bonds may increase as this status allows large international institutional investors again hold them. The Russian government currently faces no compelling need to borrow from abroad as the current fiscal outlook is rather good thanks to the rise of oil prices and fiscal discipline. This year's federal budget has plans to issue about 7 billion dollars in foreign-currency bonds.

Improvement of Russia's government sector finances at all budget levels. Last year saw large gains in federal budget revenues (up 18 %), while tax revenues flowing directly to state social funds also increased by 8 % after rapid growth in 2016 as well. Annual inflation was below 4 %. Federal transfers to social funds increased abundantly after a one-year pause. Spending of social funds increased by 6 %. The deficit of the funds already shrank in 2016, and last year turned into a small surplus thanks to improved revenues and the federal transfers.

Government levels of Russia's consolidated budget, 2011–17



Source: Russian Ministry of Finance.

After contracting in most of the previous years, transfers from the federal budget to regional and local budgets increased by over 8 %. Tax revenues and payments flowing directly to these budgets maintained growth above 8 %. Revenue streams from corporate profit taxes and labour income taxes rose well. Expenditures of regional and local budgets increased by 9 %, due e.g. to spending on the economy, particularly the transportation sector.

The combined deficit of regional and local budgets nearly evaporated in 2016 and increased only slightly last year. The differences across regions, however, remained large when measured e.g. with the deficit relative to tax revenues flowing to the regional budget. Regions and localities over the past two years have as a whole managed to pay down their bank debts slightly. Last year the federal government in net terms hardly had to grant them any credit.

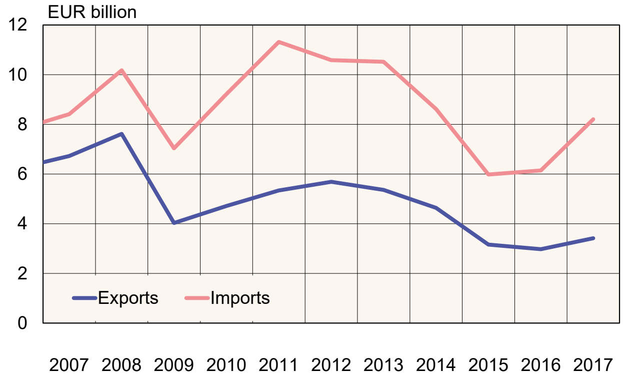
Strong growth in Finnish-Russian trade. The value of goods exports rose by 15 % last year to 3.4 billion euros. Strongest growth was in the machinery & equipment category, with the value of exports rising by over 25 % y-o-y. Otherwise, export development varied. From core export product groups e.g. foodstuffs grew by 5 %, while exports of chemical products and metals contracted slightly. Russia's share of Finnish goods exports was still below 6 %.

Until last year, the value of goods exports to Russia declined four years in a row and hit bottom in 2016 with the value of exports less than half of the 2008 peak. At that time, however, nearly 40 % of exports consisted of re-exports, i.e. goods not made in Finland. For example, re-exports of passenger cars and mobile phones have nearly ceased. In recent years, re-exports have comprised about a quarter of Finland's exports to Russia, consisting mainly of pharmaceuticals and products in the machinery & equipment category.

Finland's services exports to Russia also revived last year, driven in part by services related to tourism. Overnight stays by Russian travellers in Finland increased by 16 % last year. In January-September, Finland's total service exports to Russia increased by 20 % y-o-y. Growth in goods and services exports should continue this year on recovering Russian demand, but the rate of growth is likely lower than last year.

The value of Finnish goods imports from Russia grew by a third last year to 8.2 billion euros. The rapid growth mainly reflects higher oil prices and one-time supplies of gas pipes. Russia accounted for 13 % of Finland's goods imports.

Finnish goods trade with Russia



Source: Finnish Customs.

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China

China's financial regulator takes over the country's third largest insurance company. The China Insurance Regulatory Commission (CIRC) announced last Friday (Feb. 23) it had seized private insurer Anbang to prevent its collapse into insolvency, protect clients from losing coverage and shield investors from loss. Anbang's founder and key shareholder Wu Xiaohui, who was arrested last June for improprieties, now faces formal charges for financial crimes. Officials said their stabilisation plan for the next 1–2 years would require recapitalisation of the firm and bringing in new partners. CIRC has also expressed concerns about abuses by other insurers.

In terms of total assets (USD 310 billion), Anbang ranks 139th on the *Global Fortune 500*. The company, which aggressively expanded its operations this decade domestically and internationally, strayed into businesses unrelated to insurance such as financing, real estate and hotels. The aggressive expansion model was built on novel insurance products and financing from the shadow banking sector. Regulatory changes and tighter enforcement aimed at the insurance and shadow banking nexus, however, squeezed Anbang's revenue. Chinese officials have also been tracking the company's foreign investments. With the company struggling with solvency problems, it has begun to sell off assets.

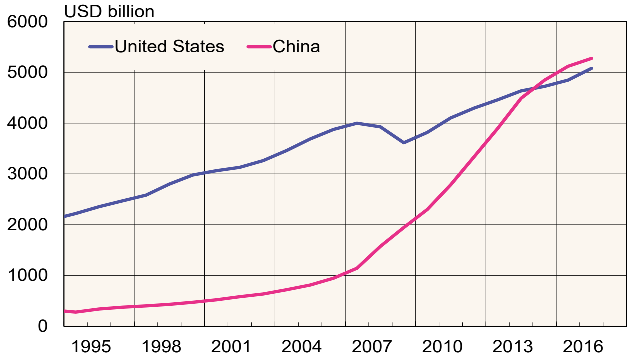
The Anbang seizure captures in microcosm the risks facing China's financial system, where many firms have funded their expansions with debt. Besides Anbang, firms such as Fosun, HNA, Wanda and CEFC have got a lot of publicity during the last twelve months due to their possible debt and business model problems.

More joining the ranks of China's consumer class. Measured in dollar terms, China became the world's largest retail market two years ago, surpassing the valuation of the United States in domestic retails sales.

The average annual per capita disposable income of China's nearly 1.4 billion citizens last year reached about 26,000 yuan (USD 4,000). The annual disposable income of urban residents was about CNY 36,000 (USD 5,600), or roughly two-and-a-half times rural disposable incomes. Nearly 60 % of the Chinese population lived in cities at the end of 2017. While the share has risen rapidly, the extent of urbanisation could still increase further, and thereby sustain growth in incomes and consumption. For comparison, 83 % of South Koreans and 94 % of Japanese live in cities.

As the middle class grows and acquires more wealth, economic dynamics shift. This evolving structure of consumer demand also affects the trade flows to China. For example, the share of consumer goods and vehicles in total imports has risen faster than other types of imports. 24 million new cars were sold in China in 2017, while just over 17 million new cars were sold in the US.

Value of retail sales in China and the United States



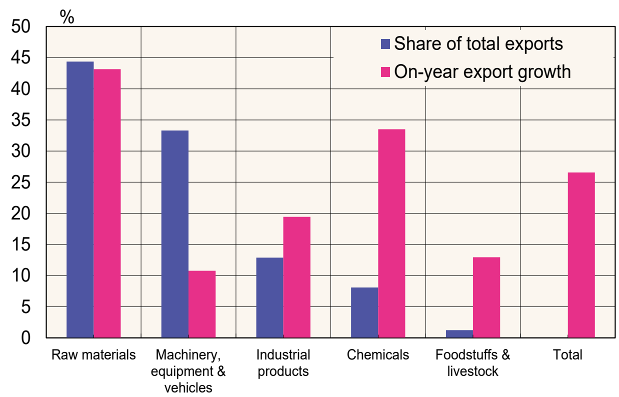
Sources: NBS, US Census Bureau and Macrobond.

Finnish goods exports to China rising much faster than exports generally. Finnish Customs reports that, while Finnish goods exports overall increased by less than 15 % last year, the value of Finnish goods going to China rose by 27 % to 3.4 billion euros. China's share of goods exports increased by half a percentage point to just under 6 %. Imports from China rose 12 % to 4.5 billion euros, accounting for roughly 7 % of Finland's total imports. Finland's trade deficit with China contracted by 16 % to 1.1 billion euros, but still accounted for nearly half of Finland's total goods trade deficit of 2.5 billion euros.

Finnish Customs noted that over a fifth of Finnish exports to China in 2016 were re-exports, i.e. goods produced in a third country. In 2016, re-exports rose by 17 %, making China Finland's third largest destination for re-exports after Sweden and Russia. The largest re-export category was electrical machinery & equipment.

Statistics Finland's figures show that Chinese accounted for 7 % of the over 3 million foreign travellers visiting Finland last year. These foreign travellers recorded nearly 6.6 million overnight stays in paid lodgings, or 14 % more than in 2016. Overnight stays of Chinese tourists increased by 34 %, more than for any other nationality. Russians, Germans, Swedish and British tourists had more overnight stays than the Chinese, who posted 311,000 overnight stays in Finland last year.

Finnish goods exports to China by category in 2017



Source: Finnish Customs.