Weekly Review
33 • 17.8.2018
BOFIT

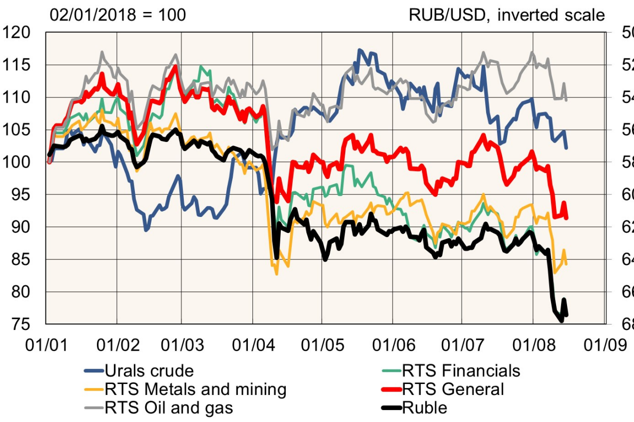
Russia

Ruble struggles and Russian share prices slide as US adds sanctions, oil prices fall and emerging markets face problems. Since the end of July, the Russian ruble has lost about 6 % of its value and Moscow's RTS stock index, which is denominated in dollars, has sunk 8 %. While multiple factors underlie the ruble's depreciation and declining share prices, the single most important reason is probably US sanctions. A new round of US sanctions was announced on August 8, and a US Senate draft bill on additional sanction legislation came to light.

The new sanctions come in response to the Skripal poisoning incident. They include restrictions on the export of certain electronic devices and dual-use devices to Russia. While these restrictions as such have a minor impact, the US is prepared to expand the restrictions in 90 days if Russia brushes them off. For that, Russia is required to assure that it will refrain from using banned chemical weapons and permit inspections of facilities where such weapons are allegedly under development. The next round of sanctions would grant the US government authority to suspend e.g. all Aeroflot flights to the US and ban a large swath of Russia-US bilateral trade. The draft bill includes even more significant measures such as restrictions on the ability of the Russian state and Russian companies to acquire funding and carry out money transactions.

A plan to significantly increase taxation of firms in Russia also emerged from the Kremlin last week. The proposal drafted by the president's office mentioned 14 major firms and caused an immediate drop in their share prices. Russia's financial markets were already roiled by declining oil prices. Oil prices have fallen as forecasts of global growth have been lowered and oil-producing countries have boosted production. The price of Urals-grade crude oil is down about 5 % from the end of July.

Ruble rate, Urals oil price, Russian stock indices in 2018



Sources: RTS and Reuters.

General uncertainty about emerging economies, particularly Turkey, also dragged down Russian markets. Turkey is an important trading partner for Russia. In the first half of this year, 5.3 % of Russian goods exports went to Turkey. The bulk of the exports were natural gas and oil, but Russia also exports metals and metal products to Turkey.

Russia's largest bank, Sberbank, also acquired the Turkish Denizbank in 2012 for 3.6 billion dollars, making it Sberbank's largest stake in any foreign bank. Denizbank has operations in countries neighbouring Turkey as well. In May, Sberbank announced it was selling its stake in Denizbank to Emirates NDB for 3.2 billion dollars. The deal is pending until official approvals are completed.

Higher oil prices drove growth in earnings from Russian goods exports in first half. The value of goods exports (measured in dollars) was up by 27 % in the first half of this year compared to 1H17. On-year growth was 23 % in the first quarter and 30 % in the second quarter.

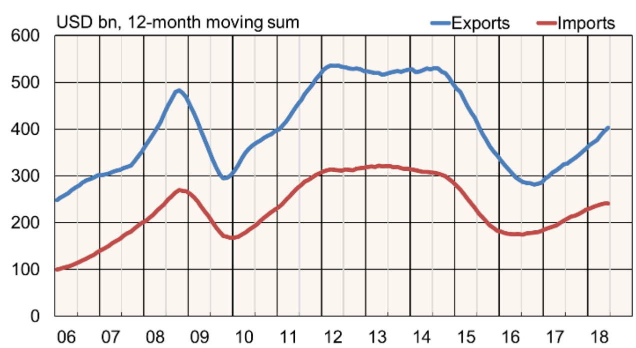
Mineral fuels accounted for 64 % of goods exports in the first six months of this year. The volume of oil exports was down slightly, while the volume of gas exports rose. Although the volume of fuel exports overall rose only about 3 %, higher prices meant their value was up by 24 % y-o-y in the first quarter and 37 % in the second quarter. Metals and metal products accounted for 11 % of goods exports and their value in 1H18 increased by 32 % y-o-y. The increase reflected higher prices and a 15 % increase in export volumes.

The value of imports in dollars was up about 13 % y-o-y in the first half, while in euros it was up just 2 %. Growth in the first quarter was 20 % y-o-y in dollar terms, but only 8 % in the second quarter.

There was little change in the structure of imports. Machinery, equipment & transport vehicles accounted for 48 % of imports in the first half. Imports in this category slowed significantly (in dollars, growth was 24 % in the first quarter, and 6 % in the second quarter). Growth of imports of chemical products (18 % of total goods imports) remained fairly good in the second quarter. Spending on food and raw material imports (12 % of total goods imports) rose slightly.

Both revenues from goods exports and spending on goods imports was still down by about one fifth from 2014 levels.

Russian goods trade



Source: Federal Customs Service of Russia.

Bank of Finland • Institute for Economies in Transition, BOFIT
P.O. Box 160, FI-00101 Helsinki
Phone: +358 9 183 2268 • Web: www.bofit.fi/en
Editor-in-Chief Jouko Rautava• Email: Jouko.Rautava@bof.fi
The information is compiled and edited from a variety of sources. The Bank of Finland assumes no responsibility for the completeness or accuracy of the information, and opinions expressed do not necessarily reflect the views of the Bank of Finland.

Weekly Review
33 • 17.8.2018

BOFIT

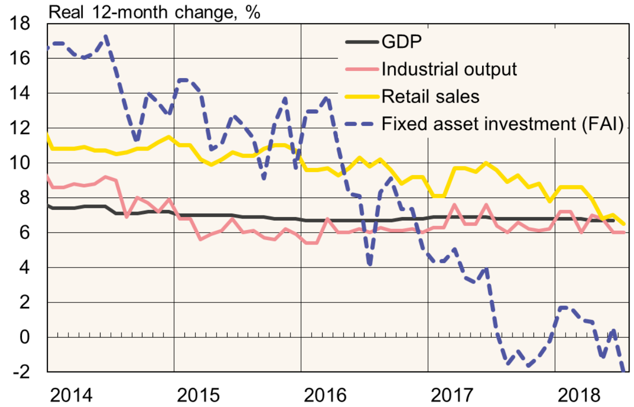
China

Lower fixed investment depresses Chinese growth. China's most important economic indicators suggest that the economy slowed more in July than the markets had anticipated. Real growth in retail sales fell well below 7 % y-o-y and industrial output growth was 6 % – also below market expectations.

Perhaps the most interesting July figure was the slack in fixed investment. Even using a cautious measure for price developments, the volume of fixed asset investment (FAI) was again well in the red. While real growth in private investment rose slightly, the volume of public investment fell in July well over 10 % y-o-y. Official figures show that fixed investment last year equalled 43 % of GDP and thus continues to play a large role in Chinese economic growth. It is hard to get a clear picture of the actual state of investment in China, however, as FAI figures do not correspond to the national accounting for fixed investment. The two indicators, which earlier moved in sync, seem to be diverging since last year.

There were few surprises in July price trends. Consumer prices were up 2.1 % y-o-y and producer prices rose by 4.6 %. The survey of urban unemployment, now in use for a couple years, showed the urban unemployment rate surging from 4.8 % in June to 5.1 % in July. For China, this is a big shift in unemployment numbers. China's unemployment figures, however, should be regarded with suspicion.

Indicators of Chinese economic growth



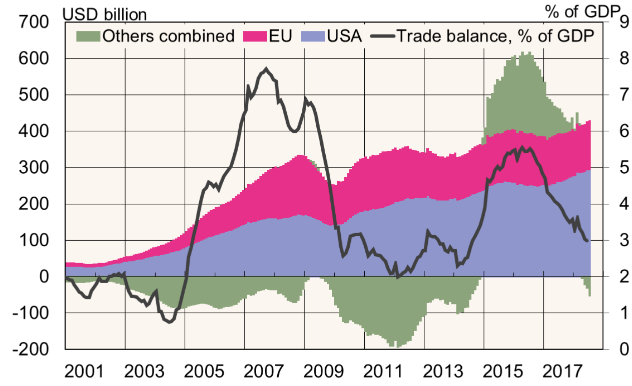
Sources: CEIC, Macrobond, BOFIT.

China's trade surplus continues to narrow. For the first seven months of the year, the value of Chinese goods exports rose to 1.39 trillion dollars (up 13 % from the same period in 2017). The value of imports increased to 1.22 trillion dollars (up 21 %). The trade surplus from the same period last year contracted by about 25 %.

China's bilateral trade surplus with the US continued to grow, however, reaching 162 billion dollars in the January-July period, and increase of 13 % y-o-y. Exports to the US in the first seven months of the year grew by 12 % y-o-y, while imports rose by 11 % (clearly lower than import growth overall). The US share of China's imports has been decreasing during the past year. The US now stands in fifth place after the EU, South Korea, Japan and Taiwan.

Some of the growth in exports and imports reflects exchange rate fluctuations. Despite the yuan's recent weakening, its average value in January-July was still 6 % higher than in the same period last year. The yuan-dollar exchange rate in July was roughly at the same level as in July 2017. Total exports in yuan terms grew by 6 % y-o-y in the January-July period, while imports were up by 14 %.

China's regional trade balance trends (12-month moving total)



Sources: Macrobond, BOFIT.

Bank loans gain popularity as regulators have limited the access to other credit sources in China. People's Bank of China figures show that Chinese banks granted 1.45 trillion in yuan denominated new lending in July (210 billion dollars). Growth in the stock of bank loans rose to 13.2 % y-o-y. For the first seven months of this year, the value of new bank lending reached 10.48 trillion yuan, an increase of 19 % from the same period in 2017.

In June and July, half of new bank loans went to companies and state organisations. Household borrowing accounted for about 40 % of new loans, down from well over 50 % a year ago. Financial institutions outside the banking sector have also increased their borrowing. For the first seven months of this year their stock of bank loans increased by 390 billion yuan, while in the same period last year it fell by 330 billion yuan.

Lending by small banks has grown faster than the lending of big banks. In the first half, small and mid-sized banks granted 25 % more new loans than in 1H17. The volume of new lending by large state-owned banks increased by 12 %. In the first half, large state-owned banks originated 39 % of all new loans, down from over half at the start of the decade.

The central bank has eased its monetary policy and officials are encouraging banks to increase their lending in response to a regulatory crack-down on shadow bank instruments. The PBoC reports that the average interest rate on bank loans has only risen modestly, standing at 6 % as of end-June.

Bank of Finland • Institute for Economies in Transition, BOFIT
P.O. Box 160, FI-00101 Helsinki
Phone: +358 9 183 2268 • Web: www.bofit.fi/en

Editor-in-Chief Jouko Rautava• Email: Jouko.Rautava@bof.fi
The information is compiled and edited from a variety of sources. The Bank of Finland assumes no responsibility for the completeness or accuracy of the information, and opinions expressed do not necessarily reflect the views of the Bank of Finland.