SUOMEN PANKKI FINLANDS BANK EUROSYSTEM

Weekly Review
44 • 2.11.2018

BOFIT

Russia

Central Bank of Russia keeps key rate at 7.50 %. At the monetary policy meeting on October 26, the CBR noted that short-term inflation risks remained elevated. The annual rate of consumer price inflation was 3.4 % in September. The CBR also said it expected the inflation rate to climb to around 4 % p.a. by the end of this year and slightly exceed 5 % by the end of 2019. One-off factors such as the VAT hike at the start of next year may accelerate inflation. Under the CBR's forecast, inflation should subside to the long-term target level of 4 % in the first half of 2020.

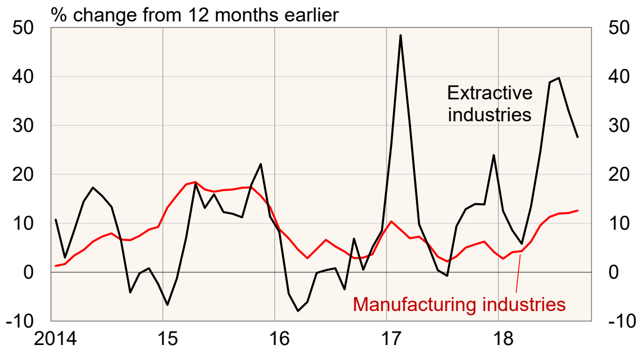
The overnight interbank market rate (MIACR) closely tracks the CBR's key rate. The rate on ruble-denominated loans to corporations granted by banks (excluding Sberbank) averaged about 170 basis points above the CBR's key rate in January-August. The average rate on corporate loans in August was slightly below 9 % (slightly below 6 % in real terms)

Higher export prices drive up industrial producer prices in Russia. The rise in producer prices for supplies to domestic customers has accelerated this year, exceeding 14 % y-o-y in September. Extractive industries (includes oil & gas) have seen prices for their products score 30–40 % y-o-y in recent months.

As in the two previous years, the price of crude oil supplied to domestic users has risen sharply with the export price. However, domestic prices of crude oil stay quite a bit lower due to export tariffs. In recent years, the domestic tax-free producer price has been about two-thirds of the export price.

The domestic oil price and export prices for refined oil products have caused prices of oil products to rise inside Russia. Oil and oil products represent about a quarter in the domestic industrial producer price index. Hikes in gasoline prices in the distribution chain last spring were quick, inducing the government to reduce the excise tax on gasoline until the end of this year.

Rise in industrial producer prices for domestic supplies



Source: Rosstat.

Domestic producer prices have also risen along with export prices in the chemical, metal and forest industries. In these branches, domestic prices have been up in recent months by around 10–15 % from a year ago.

Eurasian Economic Union is taking steps to harmonize external tariffs and lower internal barriers. The union has evolved on top of earlier economic cooperation agreements among former Soviet republics. Upon the breakup of the Soviet Union, twelve of its 15 members (all except the Baltics) established the Commonwealth of Independent States (CIS). Free trade relations were established among the countries, but there was no deeper integration. Consequently, Russia, Belarus, Kazakhstan, Kyrgyzstan and Tajikistan founded the Eurasian Economic Community in 2000. As integration stalled also under this new framework, Russia, Belarus and Kazakhstan established the Eurasian Customs Union (EACU) in 2010 and the Eurasian Economic Union (EAEU) in 2015. Armenia and Kyrgyzstan acceded in 2015.

The Union's basic idea and governing structure largely mimic the European Union, but its functions have been limited to supporting economic integration. According to the founding treaty, the Union's mission is to incrementally implement the free movement of goods, services, labour and capital. Further goals include macroeconomic policy harmonization and perhaps a currency union. A fairly ambitious schedule has been set for market unification: a common electricity market by 2019, oil by 2024, natural gas by 2025 and finance by 2025. Implementation of all plans, however, requires the conciliation of differing views and interests among the member states.

To date, the Union has made progress mainly on making border crossings easier. Customs inspections on internal borders have nearly ceased, and customs procedures and payments on external borders have been to some extent harmonized. The adoption of a common customs code at the start of this year has facilitated trade across the Union's external borders. The electronic customs declaration system also helps to monitor shipments through the Union territory. Without oversight, it would be difficult for the Union to make free trade agreements with other countries and unions because such agreements typically apply only to goods manufactured in the countries that are parties to the agreement. In addition to unified customs rules, the Eurasian Economic Commission seeks to eliminate some individual barriers to competition. Among other things, it has begun promoting reciprocal recognition of academic degrees, more open public procurements and open waterways for member country vessels.

While former Soviet states are the focus of expansion, the Union's name intentionally does not rule out membership of any country on the Eurasian continent. The Union also seeks to improve its external trade relations. It has signed a free-trade agreement with Vietnam and looser cooperation agreements with China, Egypt and Iran. The Union's effort to seek closer economic relations with countries in Western and Southern Asia partly overlaps with China's Belt and Road Initiative, even if cooperation of these projects was officially agreed upon in 2015.

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

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China

Growth in Chinese car sales stalls. Sales figures for China's automobile industry indicate that passenger car sales in the third quarter declined compared to a year earlier. Sales were down by 12 % y-o-y in September. At the same time, profits of car manufacturers has also fallen sharply.

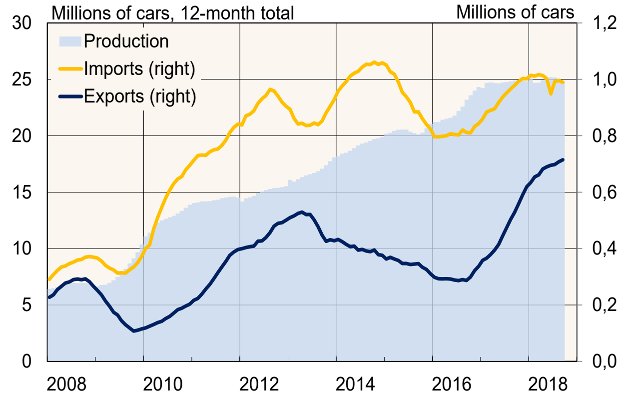
China is the world's largest car market. Sales currently are running at about 25 million new cars a year. Sales in the number-two US are about 17 million cars a year. Chinese sales growth has been sluggish this year, however, with total sales over the past twelve months in September on par with a year earlier. Foreign makes, which are mainly produced and assembled in China, account for 60 % of domestic car sales.

Car production growth also has plateaued. Some 25 million cars are manufactured in China each year, with about 700,000 vehicles exported. China imports about 1 million cars a year.

The flagging car sales trend reflects changes in household demand in China. Moreover, different kinds of fixed-term subsidy schemes for car buyers and changes in taxation have caused fluctuations to car sales. Recent news reports say the government is planning to lower the tax on car purchases to support car producers and economic growth.

Despite the slowdown in car sales, growth in sales of electrical cars has risen rapidly. China accounts for about half of global sales of plug-in electric vehicles (fully electric and plug-in hybrids). In the third quarter, plug-in electric vehicles accounted for about 5 % of new cars sold in China.

China's passenger car production, exports and imports



Source: CEIC.

FDI outflows of Chinese firms still below 2016 level. Even as China's trade war with the US escalated, foreign direct investment flows into China increased in the first nine months of this year compared to the same period in 2017. Also Chinese outbound FDI also increased. The picture of investment trends, however, show some variation depending on the statistical data used.

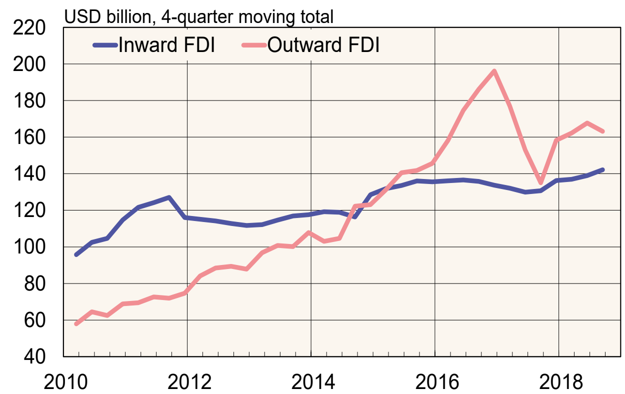
China's commerce ministry (MOC) reports that FDI flows into China (excluding the financial sector) amounted to 98 billion dollars in January-September, an increase of 6 % from the same period last year. However, China's balance-of-payments figures diverge considerably from the number offered by the commerce ministry. According to the first-half balance-of-payments figures, 126 billion dollars in foreign investment flowed into China – more than double the amount of 1H17.

Compiling FDI statistics is notoriously difficult in every country and interpreting them even more so, as in the current globalized world investments may not originate from the investor's home country. Commerce ministry figures show that Hong Kong accounts for 65 % of inward FDI to China. Other Asian countries and certain tax havens also provide considerable amounts of FDI. The EU accounts for around 9 % of investment flows into China, while the US contributes just 2 %. As part of its trade negotiations, China has opened up certain branches such as the car industry and finance to more extensive foreign ownership in an effort to encourage more FDI inflows. The trade war itself has forced many foreign firms to consider pulling their production out of China altogether.

Commerce ministry figures show the flow of outward FDI of Chinese firms in the first nine months of this year amounted to 89 billion dollars, an increase of 6 % y-o-y. Outward FDI growth was quite strong in the first half, but turned negative in the third quarter. China's balance-of-payments figures show outward FDI roughly following a similar trend to that shown in the commerce ministry figures. The value of investment in January-June (46 billion dollars) was up 12 % y-o-y.

According to the China Global Investment Tracker (CGIT) database compiled by the American Enterprise Institute and Heritage Foundation, foreign investment of Chinese firms abroad fell in the first half relative to 1H17. In the January-June period, large FDI expenditures of Chinese firms (FDI of more than 100 million dollars) amounted to only 56 billion dollars, down from 101 billion dollars in the same period last year. Last year's figures, however, got a huge boost from the June 2017 purchase of the Swiss agribusiness giant Syngenta for 43 billion dollars. CGIT reports that in the first half of this year, 35 % of investments went to Europe and 10 % to the US. These shares were slightly smaller than in the first half of 2017.

China's inward and outward FDI flows (MOC figures)



Sources: China Ministry of Commerce and CEIC.

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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