Weekly Review
3 • 18.1.2019

BOFIT

Russia

Russian oil fund shrank in 2018, but central bank foreign currency reserves grew. The National Welfare Fund, where the state's excess revenues from oil and gas taxes are deposited, stood at 58 billion dollars at end of 2018. The size of the Fund declined by 11 % from the end of 2017.

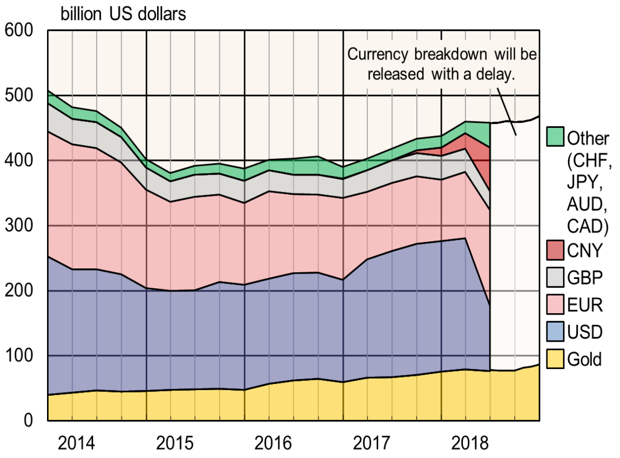
Last year's budget surplus will be transferred to the Fund later this year. According to preliminary figures, the Fund corresponded to just under 4 % of gross domestic product at the end of last year. Under the 2019 budget, the Fund's size should rise to around 7.5 % of GDP by the end of this year. The Fund should then continue to accumulate assets so that in 2021 it equals 12 % of GDP. The large savings should help Russia weather weaker economic performance in coming years.

Investments of the National Welfare Fund fall into two categories. The first category consists of assets that are invested in liquid, high-grade sovereign bonds of OECD countries. The second category includes deposits at the state development bank VEB, which then lends the assets forward to fund development projects. At the end of last year, 58 % of the National Welfare Fund's assets were invested in assets of the first category. Of that, 45 % was held in debt securities denominated in euros, 45 % in US dollars and 10 % in British pounds.

The Central Bank of Russia's foreign currency and gold reserves increased by 8 % last year to a value of 468 billion dollars. The share of gold in the reserves rose last year, and currently stands at about 19 % of assets. Russia's reserves are now sufficient to cover about 22 months' worth of goods imports. By this measure, Russia's reserves are substantial by international standards, especially given the small size of Russia's foreign debt. Russia's foreign currency and gold reserves are the world's fifth largest after China, Japan, Switzerland and Saudi Arabia.

There was a notable shift in Russia's currency reserves last year. The amount of dollar assets declined sharply in the second quarter, while holdings in euro and yuan assets soared. The Central Bank sold off half of its 200 billion in dollar holdings in the second quarter. According to several analysts, the Central Bank was seeking to become better hedged against possible US sanctions. At the end of June 2018, euro made up 32 % of Russia's currency and gold reserves, dollar 22% and yuan 15 %. According to the International Monetary Fund, the average composition of global currency reserves was quite different. At the end of June 2018, dollar made up 62 % of them, euro 20 % and yuan just under 2 %.

Composition of Russia's currency and gold reserves



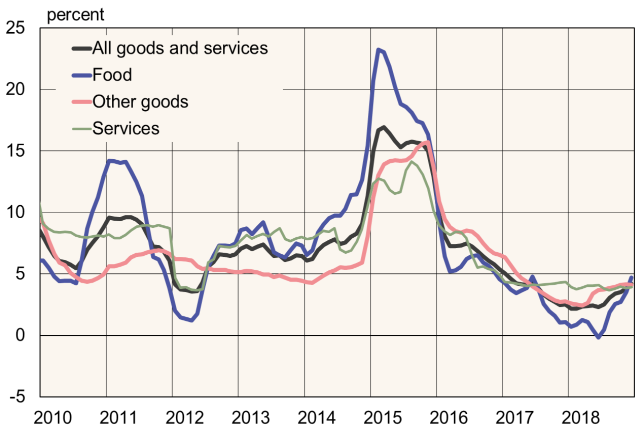
Sources: Central Bank of Russia, BOFIT.

Consumer price inflation accelerated in Russia. The year-on-year change in consumer prices picked up in December to 4.3 %. In early autumn, consumer price inflation was running at 3.5 % and in November was still well below 4 %. The price spike exceeded all major forecasts, which had expected inflation to stand at 4 % at the end of the year. Prices rose by 0.8 % from November to December. This was much higher than in two previous years.

Food prices saw particularly sharp increases, reaching 4.7 % y-o-y at the end of December. Excluding alcohol, food prices were up more than 5 % y-o-y in December. From November to December, they climbed 2 %. The end-of-year spike in food prices was due mainly to higher prices for fruits, greens and root vegetables, which soared by 9 % in December. This is a rather exceptional change.

The year-on-year change in the prices of non-food goods and services was about 4 % at the end of December. As in previous months, the rise in prices of non-foods and services was quite modest, suggesting that the general hike in the value-added tax from 18 % to 20 % at the start of this year had almost no impact on prices before it came into force. Rosstat reports that consumer prices were up by 0.7 % in the first two weeks of 2019, i.e. the fastest price rise since July 2015. The value-added tax hike does not apply to food, which is subject to a 10 % rate.

Russian consumer price inflation



Source: Rosstat.

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China

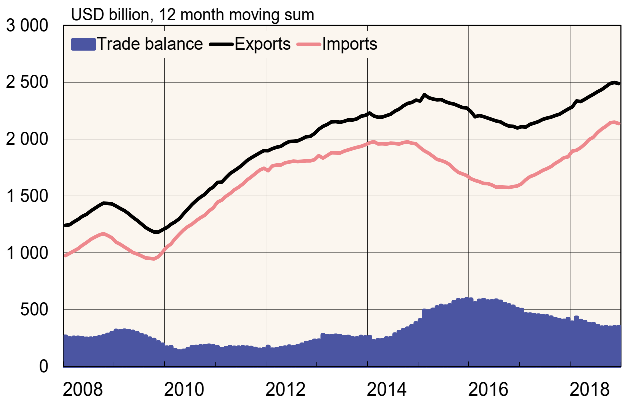
China's export and import growth turned negative in December. Following strong growth in the early autumn, growth of China's foreign trade slowed significantly already in November. In December, the value of goods exports measured in dollars was down 5 % y-o-y, while imports declined by nearly 8 % y-o-y. The value of exports for all of 2018, however, was still up by 10 % and the value of imports up 16 % from 2017. The goods trade surplus fell from about 420 billion dollars in 2017 to around 352 billion dollars last year.

China saw sluggish export growth in all of its main markets. Exports to the United States, which accounts for 18 % of China's exports, dropped by 4 % in December. Growth in exports to the EU (17 % share) also slowed over the past two months. December exports to the EU matched the December 2017 level. Growth in exports to Japan (6 % share) were down 1 % y-o-y, while exports to Hong Kong (12 % share), which is an important hub of re-exports, declined 25 % from its December 2017 level. The trends reflect both the impact of the US-China trade war and uncertainty in the global economy.

The sharp slowdown in import growth reflects both the general slowing of the Chinese economy and global developments. While December commodity prices were slightly lower on average than in December 2017, most of the fall in imports stemmed from other causes as imports from the US (-36 %), South Korea (-18 %) and Japan (-11 %) all declined much more than the average. Imports from the EU were down 3 % y-o-y.

Besides China's weak domestic demand, the drop in imports reflects developments in international production chains. Imports and exports related to processing trade for November and December were much weaker than average.

Chinese foreign trade in goods



Source: CEIC.

Signs of deteriorating employment conditions in China. With the slowdown in economic growth, the employment situation appears to be weakening. While official unemployment figures consistently show urban unemployment just below 5 %, other information suggest the employment situation has deteriorated substantially since summer.

China's official purchasing managers' indices (PMI), which are based on company surveys, and their sub-indices concerning employment show that the employment situation in both the manufacturing and service sectors deteriorated substantially during the autumn. Readings for both sub-indices are now around 48. Indeed, only in the construction sector the employment sub-index is still above 50. The last time the employment situation in the manufacturing and service sectors was this weak was in 2016, when China's actual economic growth is estimated to be much lower than official figures suggested.

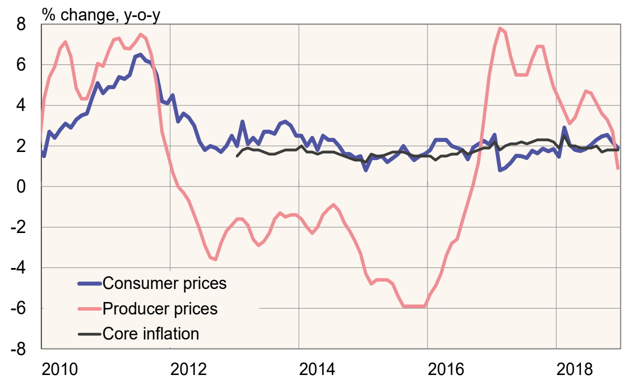
The deteriorating employment situation is further evidenced by official promises of extraordinary efforts to support employment. China's official news agency *Xinhua* reports that the government is considering cuts in social security contributions and reimbursing corporations that refrain from laying off workers. Securing employment was declared a top priority of 2019 at the Central Economic Work Conference held in Beijing in December. Media reports claim conference participants also agreed to lower this year's GDP target from last year's "about 6.5 %" to a range of 6-6.5 %.

Chinese consumer price inflation held steady at around 2 % last year. Consumer prices on average were up 2.1 % y-o-y in 2018, which meant that China's leadership achieved inflation below last year's target ceiling of 3 %. 12-month inflation was 1.9 % in December.

Core inflation, with excludes food and energy, was 1.8 % in December and 1.9 % for all of 2018. Prices of food, which has a 32 % weighting in the consumer basket of items used to calculate China' consumer price index, showed little variation last year.

Producer prices have fluctuated more than consumer prices. In December, the on-year rise in producer prices slowed to 0.9 %. Producer prices declined from November to December. Producer prices fell every year from 2012 to 2016. Despite a couple years of increase, the producer price index in December was at the same level as it was six years ago.

Chinese inflation trends



Source: Macrobond.

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