

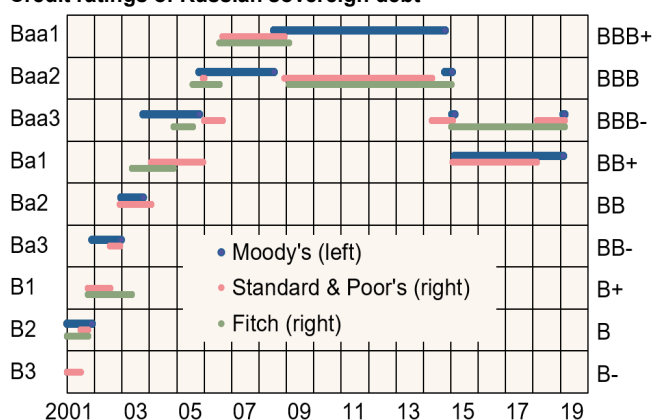
Russia

Credit rating agency Moody's upgrades Russian sovereign debt. On February 8, Moody's upgraded Russia's credit rating score by a notch from Ba1 to Baa3, its tenth-best rating score. Bonds in the top-ten ratings categories are generally considered "investment grade," while those below are considered "junk." The assessments of all the big three international ratings agencies are now consistent. Standard & Poor's made a similar upgrade to its rating of Russian sovereign bonds in February 2018, while Fitch never dropped its rating as far, preferring to keep with its BBB- rating in recent years.

According to Moody's, the Russian government has implemented prudent fiscal policies during recent years. At the core of these policies is the accumulation of foreign currency into the National Welfare Fund. In addition, the Russian government has relatively little debt, and the amount of debt owed to foreigners has decreased. Moody's notes that the fiscal policies have contributed to the government's ability to weather both a major slump in oil prices and the pressures of sanctions. On the other hand, Moody's observed that the government's heavy involvement in the economy drags down growth.

There are other indications that the financial situation of state entities may be changing to some extent. The state-owned gas giant Gazprom plans to return to issuing dollar-denominated bonds. However, the debt may include the same unusual clause that Gazprom used already in November when it issued euro-denominated debt. Apparently to hedge against further sanctions, Gazprom reserved the right to pay back the debt in a currency other than euros if, for some reason beyond its control, it was unable to repay in euros. The Russian government also used a similar clause last year.

Credit ratings of Russian sovereign debt



Sources: Moody's, Standard & Poor's, and Fitch.

Russian population declines slightly in 2018 as immigration flows drop considerably. According to Rosstat, Russia's population was 146.8 million at the end of the year. However, the figure includes the 2.3 million people of the Crimean Peninsula, which Russia illegally annexed in 2014. The Russian population shrank by 0.1% last year. There were 1.6 million births and 1.8 million deaths. Russia's population shrank continuously from the mid-1990s to 2009, when the population began to grow again. 2018 was the first year since 2009 that the Russian population declined. In this decade, population growth has been driven by an increase in immigration and life expectancy. The World Health Organization reports that the current average life expectancy of a Russian woman is 77.2 years and a Russian man 66.4 years.

Russia's birth rate has also declined over the past two years. In 2017, the total fertility rate was 1.62, which is typical also for EU countries and China. At the end of 2018, Rosstat forecasted that Russia's population will continue to decline slowly. By their projection, the Russian population would be 144 million in 2036.

Last year, net immigration was no longer sufficient to make up for the gap between births and deaths. Rosstat says that net immigration was only about 125,000 persons, down from about 210,000 in 2017. Following the established pattern, many immigrants and emigrants are from former Soviet countries. Last year, the largest sources of net immigration to Russia were Tajikistan and Kazakhstan.

Corruption dies hard in Russia. Russia has performed equally worse in Transparency International's (TI) Corruption Perception Index rankings during recent years. Russia's overall point score has hardly changed since 2012.

The 2018 index placed Russia 138th out of the 180 countries surveyed, on par with Iran, Papua New Guinea, Mexico and Lebanon. Countries at the low end of the TI rankings have typically weak economic and political institutions such as judiciary, media, civil society and public administration. Denmark, New Zealand and Finland have held the top positions in TI's rankings in recent years.

Public sector corruption 2012–2018

	Score 2018	Rank 2018	Score 2015	Rank 2015	Score 2012	Rank 2012
Belarus	44	70/180	31	106/168	31	123/176
India	40	78/180	38	76/168	36	94/176
China	39	87/180	37	83/168	39	80/176
Brazil	35	105/180	38	76/168	43	69/176
Armenia	35	105/180	35	95/168	34	105/176
Moldova	33	117/180	33	102/168	36	94/176
Kazakhstan	31	124/180	28	123/168	28	133/176
Kyrgyzstan	29	132/180	28	123/168	24	154/176
Russia	28	138/180	29	119/168	28	133/176
Azerbaijan	25	152/180	29	119/168	27	139/176
Tajikistan	25	152/180	26	136/168	22	157/176
Uzbekistan	23	158/180	19	153/168	17	170/176

Source: Transparency International.

China

Trump extends time frame for US-China trade negotiations. The lead negotiators for China and the United States met again last week in Washington, DC, to work on pressing bilateral trade issues. Talks between lower-level team officials continued this week. President Donald Trump approved the idea of giving negotiators more time to work out a deal and promised to refrain from imposing additional tariffs in early March as threatened. No new deadline for the negotiations has been announced.

Despite advances in the talks, few concrete or specific points of agreement have emerged. From the beginning, it was clear that trade talks would be quite challenging, given that cuts in government subsidies and elimination of the special privileges of state enterprises strike at the heart of China's political and economic system. Easing market access, protecting intellectual property rights and increasing China's purchases of US agricultural products and energy are areas where it is probably easier for the Chinese and the Americans to find common ground.

Monitoring of compliance with the agreement terms has also raised thorny issues. The parties appear to have arrived initially at an arrangement in which official at the ministry-level would engage monthly, deputy minister-level quarterly and minister-level twice a year to resolve issues, raised by e.g. firms, in implementing the agreement. American negotiators have reserved the right to raise tariffs if consultations fail to resolve observed implementation problems.

Part of a trade deal with the Trump administration requires that China transparently conduct forex market interventions and refrain from yuan devaluations for competitive advantage. While details have yet to be released, the American team claims the matter is already resolved to some extent. Suggestion to refrain from beggar-thy-neighbour devaluations to improve price competitiveness is included in the recently revised NAFTA agreement as well as in an earlier G20 declaration that also China has committed to.

The inclusion of a yuan-dollar rate in the trade agreement could cause huge problems in interpretation. China's vast structural changes and decelerating growth will inevitably be reflected in the exchange rate. Things are complicated by the fact that China needs to adopt a more flexible exchange rate regime as a part of financial market reforms and the lifting of capital controls.

Chinese local government aluminium producer defaulted on off-shore bond payments. Last Friday (Feb. 22), Qinghai Provincial Investment Group (QPIG) defaulted on 11 million dollars in interest payments on a 300-million-dollar bond. The company is majority-owned by the government of the Qinghai province in western China. The notion of a state-owned enterprise being allowed to default on its foreign bonds is very exceptional for China and reflects the country's changing conditions.

For the time being, it has been widely held that the Chinese government would intervene to bail out struggling state-owned firms despite the fact that several state companies had been allowed to default on domestic bond issues in recent years. QPIG, which ran into insolvency problems already last year, was also believed to be bailed-out by the government.

Hong Kong economy hit by slowing growth in mainland China and trade war. Hong Kong's relatively small, open economy is highly dependent on mainland China. It saw GDP growth slow dramatically in the fourth quarter of 2018 to just 1.3 % p.a. GDP growth was still just under 3 % in 3Q18 and exceeded 4 % in 2H18. Growth averaged 3 % last year.

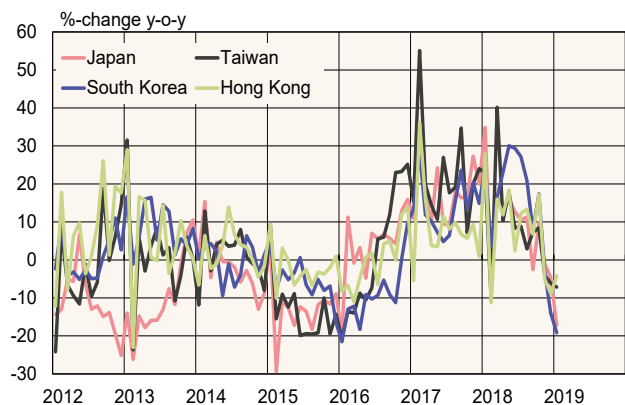
Despite the weakening in private consumption demand, it rose in the fourth quarter still over 3 % y-o-y. At the same time, fixed investment fell by more than 5 % y-o-y in real terms. This reflects a much-degraded outlook for Hong Kong firms. Fixed investment last year corresponded to roughly 20 % of Hong Kong's GDP.

The value of goods transiting Hong Kong to and from China increased sharply in the first three quarters of 2018, only to fall in the fourth quarter and in January. The movement of goods is critical for the success of the Hong Kong economy. Both the value of Hong Kong's goods imports and the value of goods exports exceeds 150 % of the special administrative region's GDP. The Port of Hong Kong's container terminals are still among the busiest on earth, despite the rapid development of mainland China's own ports.

While exports of goods produced in Hong Kong are tiny in relative terms, exports to China were up at the end of last year. In particular, the amount of jewellery sold to mainland Chinese has soared in recent months. Some observers speculate that the fascination with Hong Kong jewellery reflects Chinese propensities for skirting capital controls and seeking secure ways to preserve wealth.

Exports to China from neighbouring countries have been on the wane recently. In dollar terms, goods exports to China from South Korea, Japan and Taiwan contracted on year in January, the third consecutive month of decline.

Exports of neighbour countries to China



Sources: Macrobond and BOFIT.