



BOFIT

BOFIT Weekly Review
Yearbook 2021



The Bank of Finland Institute for
Emerging Economies (BOFIT)

BOFIT Weekly Review
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The opinions expressed in this paper are those of the authors and do not necessarily reflect the views of the Bank of Finland.

BOFIT Weekly Review 2021

8 Jan 2021 BOFIT Weekly 2021/01

Russia

- Robust third-quarter recovery in private consumption last year, Russian fixed investment contracted
- While consumption fell, Russian economic indicators generally point to recovery in November
- Central Bank of Russia kept key rate unchanged
- Crude oil prices rise above \$50 a barrel

15 Jan 2021 BOFIT Weekly 2021/02

China

- IMF puts China's public sector deficit near 20 % of GDP in 2020
- China and EU reach agreement on investment
- Stock prices in China continue to rise in January
- China presses Australia

22 Jan 2021 BOFIT Weekly 2021/03

Russia

- Gradual recovery in Russian foreign trade continues, capital outflows rise
- At close to \$600 billion, Russia holds the world's fourth-largest foreign currency and gold reserves
- Moscow stock exchange made gains in second half of 2020
- National Welfare Fund again close to 12 % of Russian GDP

29 Jan 2021 BOFIT Weekly 2021/04

China

- Chinese GDP stages V-shaped recovery in 2020, bouncing back from covid-19 lockdowns to positive on-year growth
- Latest forecasts show China putting the covid-19 crisis behind it, even as other emerging economies struggle
- Chinese debt-to-GDP ratio approaches 300 %
- National carbon trading scheme expected to help China reach more ambitious climate targets

5 Feb 2021 BOFIT Weekly 2021/05

Russia

- Latest economic data for Russia looks promising
- Even with domestic demand and imports plunging, the Russian economy contracted less than expected in 2020
- Russian agriculture enjoys another year of growth
- Russian banking sector enjoyed brisk growth last year

12 Feb 2021 BOFIT Weekly 2021/06

China

- Volume of Chinese goods exports showed exceptionally strong growth amidst pandemic
- Officials hope to rein in real estate sector risks in China
- Hong Kong's real economy remains weak
- China is Myanmar's most important trading partner

19 Feb 2021 BOFIT Weekly 2021/07

Russia

- Gold and wheat exports partly compensated for drop in value of Russian oil exports last year
- Central Bank of Russia keeps key rate unchanged
- Russian government spending in stimulus mode last year
- IMF's annual Article IV consultation with Russia raised a wide range of economic issues

26 Feb 2021 BOFIT Weekly 2021/08

China

- New travel restrictions subdue start of Chinese Lunar New Year celebrations
- China ranked the world's top FDI recipient in 2020
- China's current account surplus last year increased to about 2 % of GDP
- Given the overall outlook for China, provincial GDP growth targets look rather modest

5 Mar 2021 BOFIT Weekly 2021/09

Russia

- Fixed investment in Russia recovered in late 2020
- Russian oil production and exports contracted sharply last year
- Production and exports of natural gas declined last year
- Finnish trade with Russia collapsed last year

12 Mar 2021 BOFIT Weekly 2021/10

China

- China's National People's Congress sets economic policy course
- NPC elects to restrain growth in budget spending this year
- A quarter of all international patent filings last year were made in China
- While Finland's imports overall were down sharply last year, imports from China grew by 9 %

19 Mar 2021 BOFIT Weekly 2021/11

Russia

- BOFIT Forecast 2021–2023 for Russia sees recovery amid exceptionally large risks
- Russia records huge mortality increase in 2020
- Russia expands price monitoring significantly; food prices under pressure to rise
- Russian and Chinese arms exports decline

26 Mar 2021 BOFIT Weekly 2021/12

China

- Latest BOFIT forecast for China sees economic growth slowing in coming years after strong performance this year
- China's new five-year plan emphasises industrial development and self-sufficiency
- Bumpy first high-level meeting between China and Biden administration officials
- The EU, US, UK and Canada all impose sanctions on Chinese officials for Xinjiang human rights violations
- New initiatives to ease capital controls in China

1 Apr 2021 BOFIT Weekly 2021/13

Russia

- CBR raises key rate to 4.5 %
- Russia has enjoyed relatively stable economic conditions during the first two months of this year
- National Welfare Fund assets invested in yuan-denominated debt securities
- Russia shows cautious interest in green financing

9 Apr 2021 BOFIT Weekly 2021/14

China

- IMF says global outlook has improved significantly from three months ago
- Financial performance of Chinese banks last year all over the map
- PBoC's digital currency project moves ahead

16 Apr 2021 BOFIT Weekly 2021/15

Russia

- Russian GDP contracted by 3 % last year; domestic demand revived in second half
- Russian foreign trade further on path to recovery, capital flows dwindle
- Geopolitical concerns weigh on ruble exchange rate
- Russia hopes to attract investment in the Arctic territory

23 Apr 2021 BOFIT Weekly 2021/16

China

- China's first quarter economic figures show V-shape part of recovery has passed
- Covid situation in China quite good; pace of vaccination accelerates
- Income growth slightly lags Chinese GDP growth
- Strong first quarter for Chinese foreign trade

30 Apr 2021 BOFIT Weekly 2021/17

Russia

- New US sanctions reduce presence of foreign investors in Russia's bond market
- Recovery of Russian economy continues
- Russian CBR hikes key rate again
- Defence spending rose yet again last year

7 May 2021 BOFIT Weekly 2021/18

China

- China increases surveillance of large technology firms through anti-monopoly law
- China slightly tightens monetary stance to cool lending growth
- Housing market heats up in China's major cities

14 May 2021 BOFIT Weekly 2021/19

Russia

- Covid crisis reduces Russian real incomes to lowest level in a decade
- Rapid housing loan growth in Russia continues
- Corporate profits return, with differences across sectors in Russia

21 May 2021 BOFIT Weekly 2021/20

China

- China's industrial output perks up, domestic consumption still in the doldrums
- China's dependency ratio deteriorates and population urbanises
- Chinese increasingly likely to attend university, nearly all young adults are literate
- China continues to create ever larger and more powerful state enterprises

28 May 2021 BOFIT Weekly 2021/21

Russia

- Russian economy continues to recover
- Robust growth in Russian goods imports
- Government sector revenues in Russia have turned to rise, spending growth still brisk even if strong stimulus behind

4 Jun 2021 BOFIT Weekly 2021/22

China

- Yuan appreciation ignites policy debate in China; PBoC raises forex deposit reserve requirement
- European China sentiment sours
- China's new three-child policy unlikely to have much effect on the country's birth rate
- Finland's goods imports from China experience strong growth in the first three months of this year

11 Jun 2021 BOFIT Weekly 2021/23

Russia

- April output exceeded pre-covid levels in many Russian branches
- Developments in industry, trade and fixed investment vary across Russia
- National Welfare Fund divests its dollar assets

18 Jun 2021 BOFIT Weekly 2021/24

China

- Pace of industrial growth in China stabilises; retail sales continue to gain steam
- Oversight of payments for land use rights shifted to tax authorities to curb inappropriate use of funds by local governments
- China passes law countering foreign sanctions; US revises its list of Chinese firms barred to investment
- Old problems still complicate their operations, but Western firms operating in China are generally upbeat

24 Jun 2021 BOFIT Weekly 2021/25

Russia

- Covid case numbers rising in Russia; officials struggle with vaccine hesitancy
- CBR hikes key rate again
- Significant differences in pace of development in various sectors of the Russian economy
- Construction of new Rosatom reactor units in China gets underway

2 Jul 2021 BOFIT Weekly 2021/26

China

- China's Communist Party celebrates a centenary of twists and turns
- Early 2021 exuberance of mainland China stock exchanges begins to fade
- China pulled back on direct investment in Europe and the United States last year

9 Jul 2021 BOFIT Weekly 2021/27

Russia

- Despite this year's sharp rise in oil prices, ruble sees only marginal appreciation
- Russia's speedy economic recovery pushes up prices and wages
- Russian government works on changes in taxes next year and price controls

16 Jul 2021 BOFIT Weekly 2021/28

China

- China's second-quarter economic growth accelerates from first quarter, but still below pre-pandemic pace
- PBoC lowers reserve requirements for commercial banks
- China's foreign trade growth gains steam in the second quarter
- China's international payments system CIPS sees higher use

23 Jul 2021 BOFIT Weekly 2021/29

Russia

- Russia's foreign goods trade recovered; corporate capital outflow rose
- National Welfare Fund stabilises at 12 % of GDP
- Surveys published by Russia's Commissioner for Entrepreneurs' Rights show low confidence in safety of the local business environment
- OPEC+ group agrees on raising crude oil production ceilings; markets down on new information about spread of coronavirus delta variant

30 Jul 2021 BOFIT Weekly 2021/30

China

- China's plunge into indebtedness has slowed in recent months
- China now has the world's second largest bond market after the US
- China launches a national carbon emissions trading scheme
- Finland-China relations defined by continuity and economic cooperation

6 Aug 2021 BOFIT Weekly 2021/31

Russia

- CBR continued to tighten monetary policy in July
- Russian economy has recovered from last year's recession, but pace of recovery varies considerably across branches
- International Monetary Fund predicts high economic growth this year for rich economies and tepid growth for many emerging economies

13 Aug 2021 BOFIT Weekly 2021/32

China

- China struggles with delta variant outbreaks
- China's sudden rule changes cause headaches for investors and corporate management
- Hong Kong's weak economic recovery

20 Aug 2021 BOFIT Weekly 2021/33

Russia

- Russian GDP back to pre-covid levels
- Russian exports take off with recovery in global demand for raw materials
- Russian government budget revenues rise, spending growth slows and budget deficit shrinks
- New sanctions on Belarus foreign trade

27 Aug 2021 BOFIT Weekly 2021/34

China

- China sees across-the-board economic slowdown in July
- Chinese developer Evergrande continues to struggle as real estate sales falter
- China's latest data security law enters into force in November
- China and Russia most active in imposing trade barriers on EU countries

3 Sep 2021 BOFIT Weekly 2021/35

Russia

- Russian economic recovery begins to cool
- Russian pensioners and select public sector workers receive notable one-time stimulus payments this month
- Bulls run at Moscow Exchange
- Panel discussion at Turku Europe Forum 2021 examines EU-Russia economic relations

10 Sep 2021 BOFIT Weekly 2021/36

China

- President Xi spotlights China's income distribution issues
- China launches campaign against disparaging economic reporting
- New measures on school curricula and student free time
- Plans announced for mainland China's third stock exchange in Beijing

17 Sep 2021 BOFIT Weekly 2021/37

Russia

- Latest BOFIT Forecast for Russia sees moderate growth ahead, large risks persist
- CBR raises key rate again; monetary policy guidelines for 2022–2024 announced
- Fixed investment increased in Russia, government plans funding for investment projects
- Russia and Belarus agree on deeper economic integration

24 Sep 2021 BOFIT Weekly 2021/38

China

- Latest BOFIT Forecast for China sees GDP growth falling below pre-pandemic levels in 2022 and 2023
- On-year growth in retail sales slowed further in August
- Share prices drop globally as construction giant Evergrande teeters on brink of default
- China makes targeted relaxes to capital outflows

1 Oct 2021 BOFIT Weekly 2021/39

Russia

- Few surprises in Duma election
- Prices of oil and other major Russian export commodities up sharply; ruble barely appreciates
- Construction work on Nord Stream 2 gas pipeline finishes up
- Finnish-Russian trade stages a comeback in the first half of this year

8 Oct 2021 BOFIT Weekly 2021/40

China

- Dwindling coal supplies and rising prices have created a widespread electricity crunch in China
- United States wants to resume trade talks with China
- EU Chamber of Commerce in China sees harsher operating environment ahead
- Finnish goods exports to China surpass 2019 levels; services exports slower to recover

15 Oct 2021 BOFIT Weekly 2021/41

Russia

- Russian export earnings near all-time highs; capital outflows increase
- Russian fixed investment bounces back after the Covid Recession
- Russia's government budget expected to show surpluses as efforts are ahead to slow spending growth
- Russia approves anti-corruption plan for 2021–2024

22 Oct 2021 BOFIT Weekly 2021/42

China

- China posts weak third-quarter GDP growth figures; headwinds increase for rest of year
- China's strong goods export performance continued in the third quarter
- China's debt growth slowed in September; no monetary easing
- The issue of digital yuan progresses

29 Oct 2021 BOFIT Weekly 2021/43

Russia

- CBR raises again key rate as inflation climbs; releases updated growth forecast
- With covid cases soaring, Russia implements short partial lockdowns on several parts of the economy
- Russia's development plans are complemented with strategic initiatives
- Commercial banks participating in CBR's digital ruble pilot trial

5 Nov 2021 BOFIT Weekly 2021/44

China

- China publishes lists of systemically important banks
- More Chinese construction companies miss scheduled offshore debt payments
- China's property taxation experiments continue

12 Nov 2021 BOFIT Weekly 2021/45

Russia

- Topics at BOFIT 30th Anniversary Conference include central bank digital currencies and the impacts of sanctions on foreign trade
- Russia's economic growth has continued, though slowing a bit
- Russian bank lending remains strong
- Russia launches action plan until 2025 under its programme of population policy

19 Nov 2021 BOFIT Weekly 2021/46

China

- Sluggish economic growth continued in October; construction activity in China declines
- Plenary session of Central Committee fortifies Xi Jinping's position as party leader
- China publishes guidance document on its climate goals, making joint plans also with the United States

26 Nov 2021 BOFIT Weekly 2021/47

Russia

- Russian government budget revenues and spending at high levels; deficit vanishes
- Russia approves strategy for reducing greenhouse gas emissions
- EU's planned carbon border adjustment mechanism could cause additional costs for Russian exporters
- After a long pause, Ukraine receives new loan tranche from the IMF

3 Dec 2021 BOFIT Weekly 2021/48

China

- Yuan's exchange rate strengthens
- Trading on new Beijing Stock Exchange finishes third week
- China nears euro area in terms of consumed foreign value added of goods and services

10 Dec 2021 BOFIT Weekly 2021/49

Russia

- Russian economic growth remained brisk in October
- Moscow stock indices and oil prices still up for the year
- Russian goods export growth lost momentum in the third quarter; import growth flat

17 Dec 2021 BOFIT Weekly 2021/50

China

- China sets out priorities for 2022 economic policy
- PBoC lowers bank reserve requirements, but no large relaxions in overall monetary stance
- Chinese inflation accelerated and economic growth slowed in November
- The financing troubles of developers in China's real estate sector continue

23 Dec 2021 BOFIT Weekly 2021/51

Russia

- Russian inflation rises to levels not seen for years
- Central Bank of Russia continued to tighten monetary policy
- Recovery in services boosts on-year GDP growth; seasonally adjusted GDP contracts from previous quarter
- Fixed investment in Russia has grown

31 Dec 2021 BOFIT Weekly 2021/52

China

- China updates its negative list on foreign investor access to China; US imposes new investment restrictions on Chinese companies
- Strong increase in use of industrial robots in China
- Maize boosts this year's grain harvest in China

Russia

Robust third-quarter recovery in private consumption last year, Russian fixed investment contracted.

Revised figures show that Russian GDP shrank in the third quarter by 3.4 % y-o-y. For the first three quarters of 2020, Russian GDP diminished by 3.4 % y-o-y. In the third quarter, seasonally adjusted GDP increased by 0.7 % from the previous quarter. Russia appears, at least for 2020, to have weathered the effects the covid-19 pandemic with considerably less economic harm than most European countries.

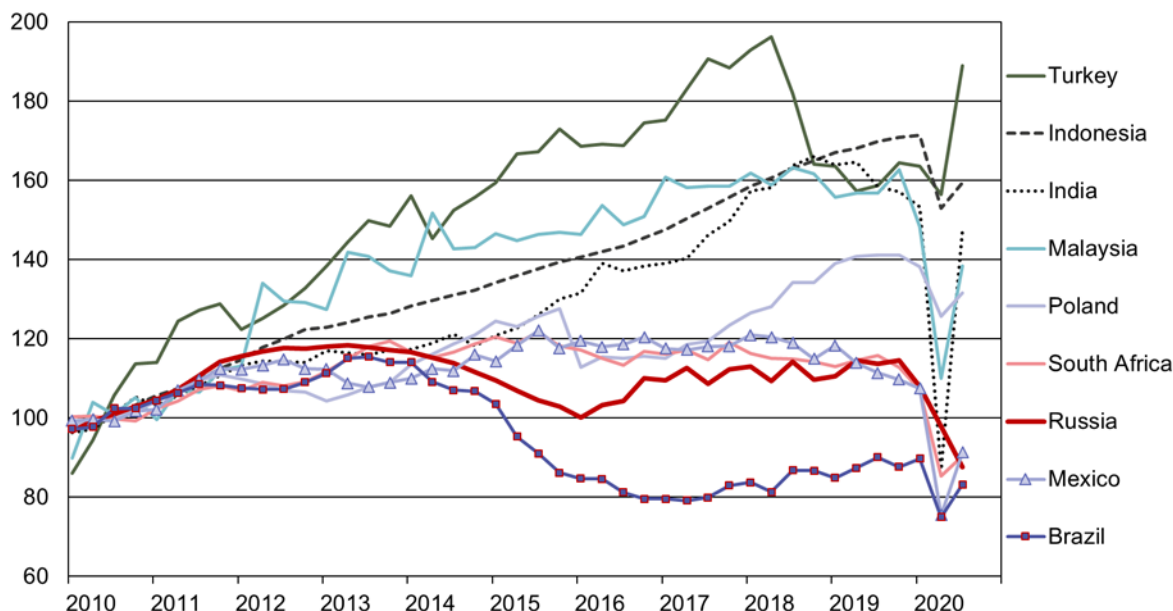
Rosstat recently released revised GDP figures for 2018 and 2019. Its earlier figures showed that Russian GDP in those years grew by 2.5 % and 1.3 %, respectively. The revised growth numbers are 2.8 % for 2018 and 2.0 % for 2019. Part of the 2019 improvement, for example, reflects higher figures for output of extractive industries (2.6 %) and manufacturing output (2.8 %).

Demand-side data from the national accounts suggest Russia experienced wide uneven swings in demand last year. In the third quarter of 2020, for example, private consumption sprang back from a second-quarter low, but was still down by 8.4 % y-o-y. Public consumption, which rose by 1.8 % y-o-y in 3Q20, helped support overall demand in Russia.

Russia's GDP figures also have been bolstered by growth in net exports, albeit much of this reflects depressed imports. Indeed, the volume of imports in the second and third quarters plunged by over 20 % y-o-y. While the volume of exports was also down, it was clearly not as severe as the drop in imports.

From the standpoint of Russia's future growth, low fixed investment is worrisome. Fixed investment was particularly weak in the third quarter, which was the third quarter in a row of negative growth (down by 6 % y-o-y for the first nine months of 2020). Most notably, fixed investment in many other emerging economies recovered sharply in the third quarter. Fixed investment during the past decade peaked in Russia in the first half of 2013.

Fixed investment trends in select emerging economies over the past decade, 2010=100, volume, seasonally adjusted.



Sources: National statistical agencies, Macrobond and BOFIT.

While consumption fell, Russian economic indicators generally point to recovery in November. The economy ministry estimates that Russian GDP contracted by 3.7 % y-o-y in November, i.e. slightly less in on-year terms than in October. Much of the improvement came from reviving industrial output. November's seasonally-adjusted industrial output grew by 1 % m-o-m. Anyhow, while industrial output growth has continued almost uninterrupted since June, the November industrial output figure was still lower by 2.6 % y-o-y due to the sharp drop in output last spring.

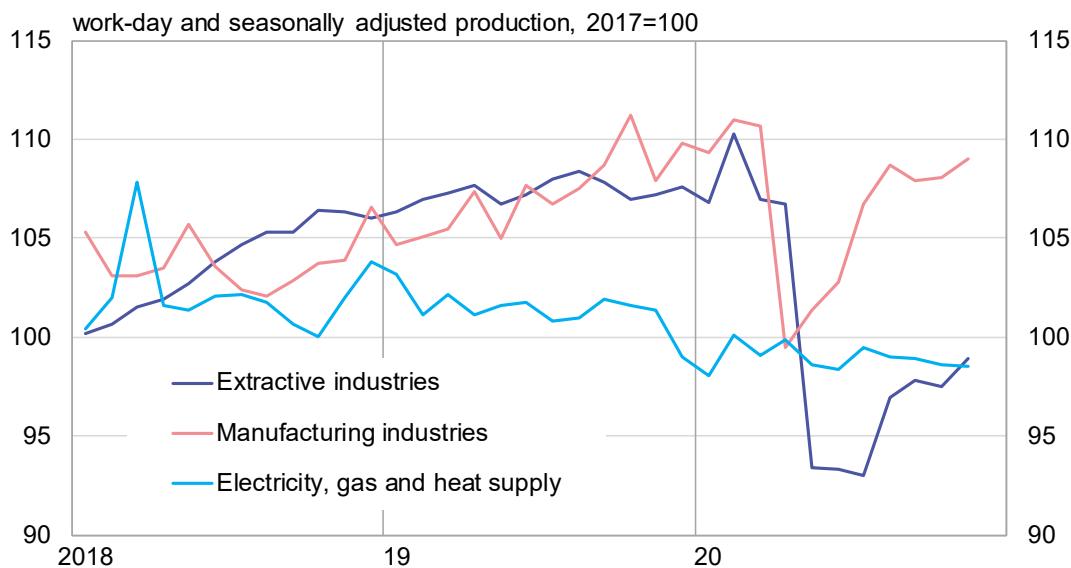
Production of extractive industries, which includes production of crude oil and natural gas, was still down by nearly 8 % y-o-y in November despite recovery in the autumn. The extractive industry sector has been depressed by crude oil

production, which showed a drop of 11 % y-o-y both in October and November. Russia has limited its oil production as part of the OPEC+ agreement. Seasonally-adjusted manufacturing output recovered in November by nearly 1 % from October, and was up by about 1 % y-o-y. Growth in recent months has been strong in the chemical and pharmaceutical industries as well as several branches in the machinery & equipment category.

The volume of November retail sales was down by 3.1 % y-o-y, i.e. deeper than in late summer and the whole autumn (when the drop was on the order of 1–2 %). The November dip supports earlier assessments that household consumption demand in previous months included purchases in anticipation of covid-19 second wave. The Central Bank of Russia estimates that the November contraction in fixed investment slowed slightly from previous months, scoring about -3 % y-o-y. Due to the gradual recovery in industrial output, the volume of goods transport in November was no longer down by more than slightly over 2 % y-o-y.

The December reading of the composite purchasing managers' index (PMI) showed a stabilisation of economic activity relative to November. The manufacturing PMI reading rose from 46.3 in November to 49.7 in December. New industrial orders contracted slightly, however. A PMI reading of 50 indicates that economic activity remains unchanged from the previous month. The December services PMI fell from 48.2 in November to 48.0 in December. New services orders and the volume of customers also contracted slightly. The CBR survey showed a slight uptick of consumer confidence in the economy in December.

Main sectors of Russian industry on a path to recovery since spring and summer, although extraction remains weak.



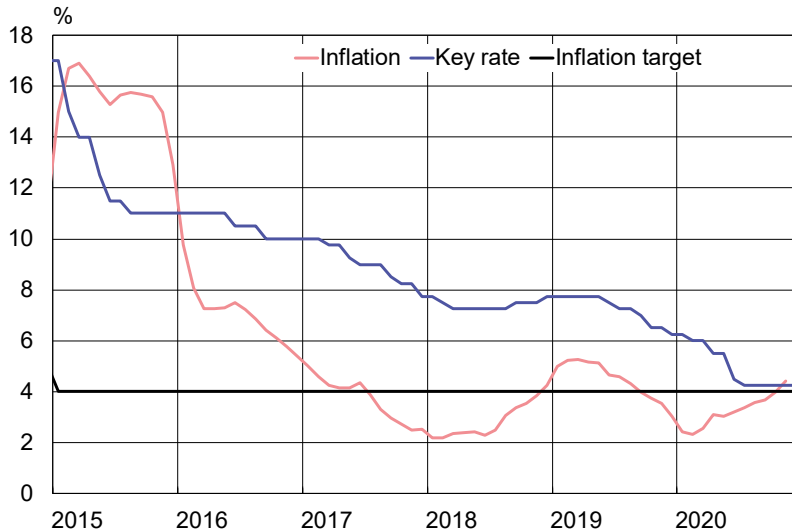
Sources: Rosstat and BOFIT.

Central Bank of Russia kept key rate unchanged. On December 18, the CBR decided to keep the key rate unchanged at 4.25 %, the level at which it has remained since last July. In issuing its decision, the CBR noted that it had not fully ruled out the possibility of a rate cut in following key rate review meetings.

According to the CBR's October forecast, 12-month inflation was forecasted to be running at 3.9–4.2 % p.a. at the end of last year. Consumer prices, however, rose by 4.4 % y-o-y in November, and preliminary Rosstat figures show consumer prices were up by 4.9 % in December. The current acceleration in inflation is associated with higher prices for certain food items ([BOFIT Weekly 51/2020](#)), as well as increased inflation expectations on the part of households and firms. Ruble depreciation since last summer has also placed upward pressure on prices. At the end of 2020, the ruble's exchange rate was still 6 % lower against the US dollar and 15 % against the euro compared to the beginning of June (and despite the ruble's strengthening in the end of the last year on rising oil prices). From early November to the end of December, the ruble's exchange rate has strengthened by 9 % against the dollar and 2 % against the euro. One dollar currently buys 74 rubles and one euro 91 rubles.

The CBR expects 12-month inflation to be running at 3.5–4 % at the end of 2021. Thereafter the expectation is that inflation will stabilise around 4 %. The CBR's inflation target is 4 % p.a.

Russian key rate, annual inflation and the CBR's inflation target.



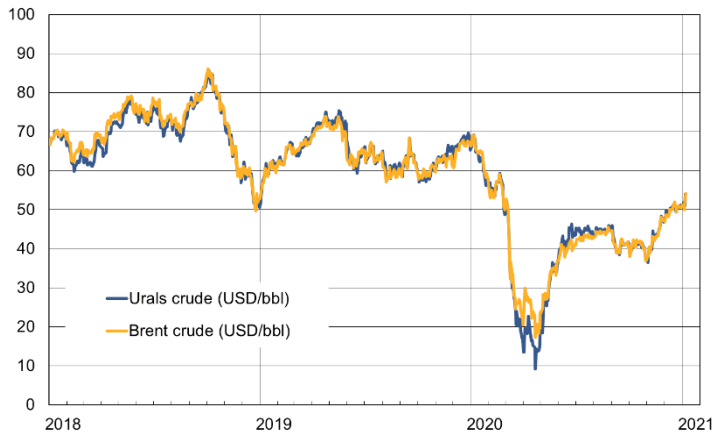
Sources: Central Bank of Russia, Rosstat, Macrobond and BOFIT.

Crude oil prices rise above \$50 a barrel. With a pandemic wiping away demand, the price of crude oil last spring collapsed to unprecedented lows. The price of e.g. Brent crude stabilised at around \$40 a barrel in subsequent months after Russia and OPEC members (the OPEC+ group of oil-producing countries) reached agreement on production ceilings in mid-April. At that time, OPEC+ agreed to cut production by nearly 10 million barrels a day in May and June, and by nearly 8 million barrels a day in July-December 2020 ([BOFIT Weekly 17/2020](#)). The plan calls for a cut in oil output of nearly 6 million barrels a day through April 2022. While the parties to the agreement have generally held rather well to their agreed production ceilings, Saudi Arabia has unilaterally moved to support the price level through deep voluntary production cuts.

As the latest OPEC+ meeting wound up on Tuesday (Jan. 4), a vigorous discussion arose about how to continue with production ceilings. The matter was resolved with an exceptional solution – Russia was granted permission to increase its production by 65,000 barrels a day, even as OPEC members agreed to hold to their original production ceilings. In addition, Saudi Arabia announced that it would voluntarily reduce its production by 1 million barrels a day. As a result, the overall production of OPEC+ countries is on track to contract sharply. This has buoyed oil prices. On Friday (Jan. 8), the price of North Sea Brent was above \$54 a barrel.

Even with the current price level at about double that of last March, it is still well below the average price during 2017–2019. As the Russian government finances are designed to tolerate the current price level, Russia may continue to press for increased production in order to retain market share. The finances of many OPEC members require significantly higher oil prices to achieve balanced budgets, which has made the cartel members amenable to efforts to restrain production to support prices.

World crude oil prices have rebounded since their collapse last spring.



Sources: Reuters and BOFIT.



China

IMF puts China's public sector deficit near 20 % of GDP in 2020. The International Monetary Fund (IMF) last week released its annual country report for China ([IMF Article IV Consultation Report](#)). The report finds that the Chinese economy recovered rapidly as the coronavirus was subdued through effective containment measures after the initial outbreak. The economic recovery has nevertheless been uneven; driven by large-scale government support while domestic consumer demand has recovered slowly. Prior to the covid-19 crisis, the economy had moved toward more balanced growth by shifting away from a heavy emphasis on industrial production and fixed asset investment towards services and consumption based economy. That development now appears to have backtracked. Moreover, China's public investment stock in relation to GDP is very high compared to other countries even as returns on investment are diminishing.

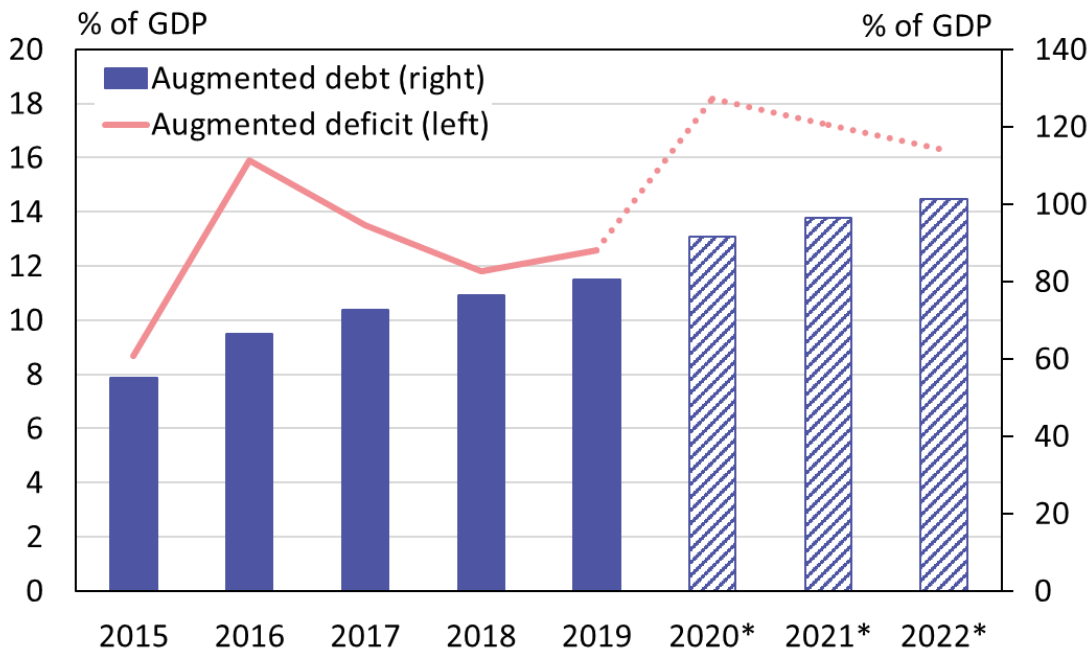
Last year's growth was largely supported through public spending. The IMF estimates that the augmented public deficit increased by nearly 6 percentage points last year to over 18 % of GDP, while augmented public debt rose to 92 % of GDP. The IMF further expects China to transition slowly away from its current public support policies. Thus, deficits will remain large and public debt will exceed 100 % of GDP next year. IMF's augmented deficit and debt include estimates of local government off-budget liabilities and operations of various public funds. Thus, it offers a broader and internationally more comparable picture of China's public finances than provided by China's official figures.

Progress in economic reforms has also been uneven. The reforms of recent years have centred on financial markets, but there has also been progress in relaxing the *hukou* household registration system by easing transfer of domicile to small and mid-sized cities. Nevertheless, the access of migrant workers to public services remains a large issue. Overall, the IMF team recommends that the fiscal policy emphasis shift from supporting macroeconomic growth to supporting improvements in social safety nets. There has been virtually no progress in critical reforms such as reform of state-owned enterprises or dealing with the preferable treatment given to state-owned enterprises.

The country report also assesses the costs of US-China technology decoupling, which is not only economically damaging to China and the United States, but also other countries. The calculations suggest that decoupling is especially harmful to third parties if they must choose whether to do business with China or the United States.

The report finds that the covid-19 crisis has heightened risks on the financial system, noting corporate debt has increased significantly. A large increase in non-performing bank loans is expected this year. In particular, the situation of smaller banks that were struggling before the pandemic has only become worse. Moreover, some local governments are now heavily indebted, which is putting pressure on local banks and enterprises. Housing prices have soared during the past decade and a large correction could destabilise the entire financial sector. According to the IMF, measures to contain financial stability are needed urgently. The IMF's suggestions include establishing a national bank resolution regime and strengthening the supervisory framework. Bailouts of troubled banks with public assets should be a last resort.

China's augmented general government debt and deficit have increased rapidly.



*) estimate.

Sources: IMF and BOFIT.

China and EU reach agreement on investment. After roughly seven years of talks, China and the EU said late last month that they are nearing completion of a comprehensive agreement on investments (CAI). Finishing the agreement was important for Germany, which hoped to reach it before its six-month term in the EU's rotating presidency ended in December. The agreement should make life easier for investors in both the EU and China, as well as assure fair treatment of firms and increase transparency about state subsidies. China also promised to ease its joint-venture requirements in many branches, which should improve opportunities of European firms operating in China. The CAI will replace existing bilateral agreements between China and individual EU states.

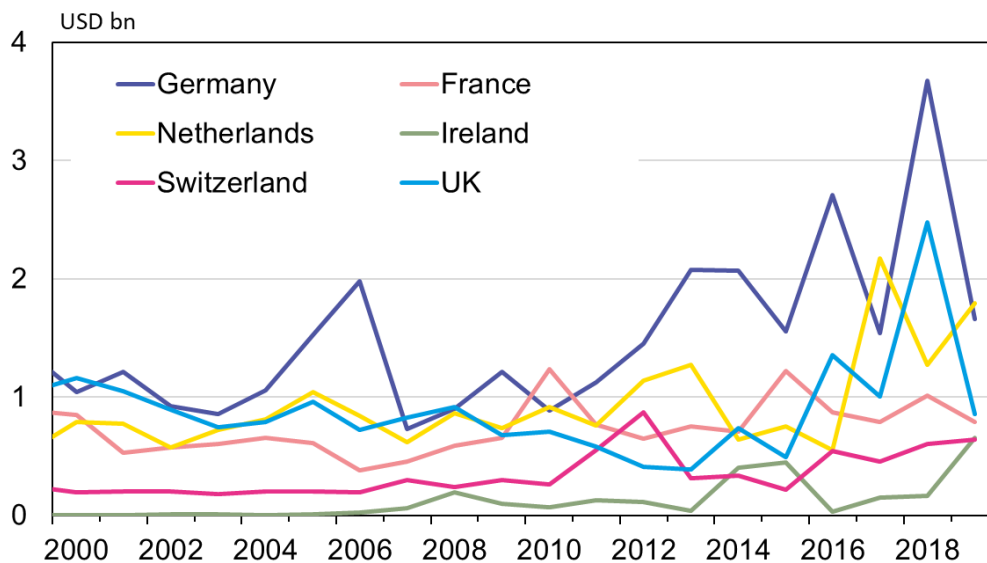
Although a common understanding has been reached, the agreement still requires formulation of the final details. The agreement language must be reviewed, finalised and translated before it goes to an EU summit and the EU parliament for ratification. These steps require a minimum of several months. Some of the issues have been postponed, e.g. dispute resolution processes.

Straightforward ratification within the EU is not self-evident. The negotiation process has been criticised for its lack of transparency. Not all member countries are fully clued in or aware of the negotiation details, and many see the CAI as favouring large EU countries such as Germany and France. In addition, the EU has been criticised for wanting to increase cooperation with China without addressing such issues as the country's human rights violations. Prominent coverage has gone to forced labour (re-education) camps for Uighurs in the Xinjiang province. China has committed to uphold better its International Labour Organization (ILO) commitments on treatment of workers and agreed to make "continuous and sustained efforts" to ratify ILO convention that bans the use of forced labour, but no timetables have been set. The CAI framework includes a special working group on labour issues and other sustainable development matters that arise with the implementation of the CAI.

EU countries are also doubtful about how China's other promises will be fulfilled. The European Commission reports that it will establish several oversight mechanisms, including various working groups and regular high-level meetings. The Commission also said that the CAI will include an ad hoc mechanism for rapid response in specific instances. China and the EU will establish a regular dialogue and practical measures such as ways for firms and organisations to participate in the implementation process.

The new investment agreement is seen as most beneficial to industry, which, according to the European Commission, accounts for over half of EU investment in China (the largest investors are the car industry and companies in the basic materials sector). China commits to easing investment in many service branches including cloud services, financial services, private healthcare, environmental services, as well as international shipping and air freight. For China, the agreement gives improved possibilities, especially with regard to increased investment in environmental technology and renewable energy in Europe. The agreement is mostly a strategic achievement as Chinese investors can already invest freely in Europe.

Germany has long been Europe's leading direct investor in China.



Sources: China Ministry of Commerce, CEIC and BOFIT.

Stock prices in China continue to rise in January. China recovered rapidly from the decline in share prices that followed the outbreak of the coronavirus crisis at the start of 2020. Share prices had their first steep rise during last summer, and another steady climb at year-end. That rise has continued in the first two weeks of 2021. On Wednesday (Jan. 13), the Shanghai composite index was up 18 % y-o-y, and the Shenzhen composite index up 39 % y-o-y. The biggest gains were posted by the Shenzhen stock exchange's ChiNext index of growth firms, which was up 70 % y-o-y.

The rise in share prices last summer was fuelled by China's domestic media, which have encouraged people to invest in equities. Just as during the 2015 share price bubble, a large amount of shares were purchased on margin ([BOFIT Weekly 28/2020](#)). Share prices have generally been supported by the rapid economic recovery, increased money supply, faster adoption of coronavirus vaccines and stimulus measures in China and elsewhere in the world. With the stunning rise in share prices, some Chinese stock market indices such as the CSI 300 have broken above their record levels in 2015.

In recent days, capital has flowed from mainland China to the Hong Kong bourse via the Stock Connect programme. After US investors were banned from owning or trading shares in certain Chinese firms after Monday (Jan. 11), Chinese investors jumped into the market to purchase billions of dollars of shares in the banned firms ([BOFIT Weekly 50/2020](#)). The Hong Kong stock exchange's Hang Seng index has risen by nearly 5 % in the first two weeks of 2021. Much of the investment was directed at shares of the telecom giants China Mobile, China Unicom and China Telecom, which the US sees as having connections to the Chinese military and thereby poses a national security threat to the US. The banned firms have already been dropped from several international stock indices (MSCI, FTSE Russell and S&P Dow Jones) and after some wobbling the New York stock exchange. Foreign investment assets have flowed into mainland China's markets via the Stock Connect trading programmes since November. Earlier last autumn, China still had a net outflow of capital.

Stock indices in mainland China have climbed to levels not seen in years.



Sources: Macrobond and BOFIT.

China presses Australia. In late December, Chinese officials banned the import of Australian coal, leaving dozens of freighters offshore waiting to offload their cargoes due to the uncertain situation. The Chinese have yet to comment officially on the dispute over coal imports, which Australian prime minister Scott Morrison considers unfortunate for both countries.

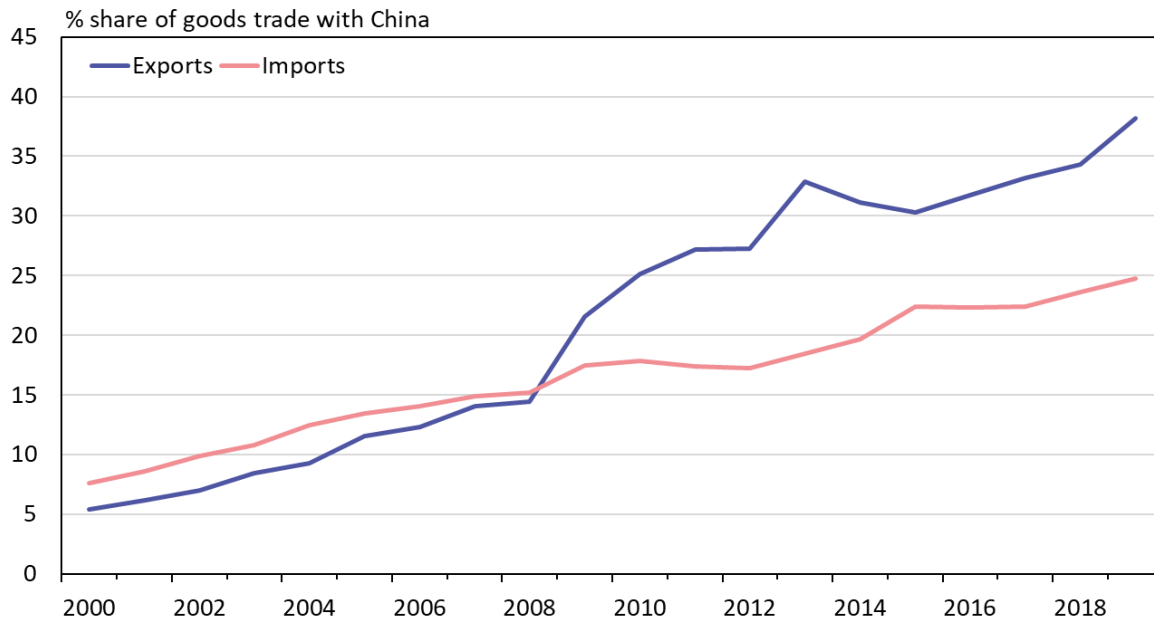
The ban on coal imports is one of many restrictions China has imposed on Australian goods imports. China has imposed hefty import duties on Australian wines and barley. It has resorted to other measures such as phytosanitary restrictions to prevent imports of timber, shellfish, red meat and wool. The Australians have lodged complaints with the World Trade Organization (WTO) over the barley tariffs.

China-Australia political and trade relations began to decline sharply after Australia (among many countries) last May supported an investigation into the origins of the covid-19 epidemic by an international team of forensic scientists. The Chinese were also particularly irked by Australia's decisions to ban Huawei's participation in 5G projects, impose restrictions on direct investment from China and criticize the human rights situation in China.

Australia is also an active member in the informal Quadrilateral Security Dialogue (Quad Alliance), which also includes India, Japan and the United States. The Quad Alliance is seen unofficially as Asia's NATO, operating as a counterforce to China in its surroundings. The group last November organised joint naval exercises in the Indian Ocean.

China's response has been hard for the Australians to stomach as China is its largest export market, accounting for nearly 40 % of all Australian goods exports in 2019. Although Australia only accounts for roughly 6 % of China's goods trade, it provides over half of China's critical iron ore imports, which are difficult to replace from alternative sources. The trade dispute is a two-edged sword. It highlights China's power, but also serves as a warning to others against getting excessively dependent on China as a trading partner.

Australia has seen China's role in its foreign trade increase substantially in recent decades



Sources: Australian Department of Foreign Affairs and Trade, Macrobond and BOFIT.



Russia

Gradual recovery in Russian foreign trade continues, capital outflows rise. Preliminary figures released by the Central Bank of Russia show revenues from exports of goods and services recovered slightly in the fourth quarter of 2020, but were still nearly 25 % below a year earlier. Earnings from exports of oil, petroleum products and natural gas were down by over 40 % y-o-y, mainly due to last year's slump in prices of these key export commodities. In contrast, exports of other goods posted more positive earnings for the entire second half by roughly matching those of second half of 2019. Revenues from exports of services were still off by more than 35 % y-o-y because of a very drastic loss of travel earnings.

Russian spending on imports of goods and services recovered slightly further in the fourth quarter. Spending was still about 15 % lower than a year earlier. The situation appears relatively promising with respect to goods imports as spending on imports was only off by a few percent from a year earlier (due to a shift in the euro-dollar rate, the on-year change in goods imports was -10 % in euro terms but just -2 % in dollars). While services imports also took a slight turn for the better, import spending was still down by about 40 % y-o-y. Again, much of this reflects the collapse in Russian travel abroad.

As the drop in import spending was slightly less than the contraction in export revenues, Russia's goods trade balance has been significantly smaller than usual for nearly a year. Nevertheless, Russian spending while on travel abroad and sharp contractions in the amounts of dividends and interest paid by Russian firms out from the country, kept Russia's current account in surplus even if the surplus headed down towards 2 % of GDP.

The financial balance between Russia and the rest of the world showed a notably larger deficit last year than in most previous years. Part of this was due to the fact that the government bond market attracted relatively small amounts of foreign investment because, among other things, the government has managed to finance an overwhelming chunk of the growing fiscal deficit through domestic borrowing. The net outflow of capital abroad from the private sector increased to nearly 3.5 % of GDP, one of the largest figures seen in several years. The net capital outflow from the banking sector was rather moderate.

The net flow of capital from the corporate sector increased to more than 2 % of GDP – a larger amount was last seen during the 2014–2015 economic recession. The background for last year's net figure was an almost complete drying up of foreign direct investment inflows to Russia. Additionally, an exceptional amount of portfolio investment was pulled out from Russian firms last year and the corporate sector made an exceptionally large amount of outward portfolio investment. On the other hand, outward direct investment from the corporate sector was much smaller than usual.

Russia's current account surplus in 2020 was relatively small, while the financial account deficit was relatively large.

	USD billion							% of GDP						
	2014	15	16	17	18	19	20	2014	15	16	17	18	19	20
	(preliminary)							(preliminary)						
Current account	58	68	24	32	116	65	33	2.8	4.9	1.9	2.0	6.9	3.8	2.3
- Exports of goods & services	563	393	332	410	509	482	374	27.1	28.7	25.8	26.1	30.5	28.3	26.4
- Imports of goods & services	429	282	266	327	344	353	303	20.6	20.6	20.6	20.8	20.6	20.8	21.4
Trade balance, goods	189	148	90	115	195	165	89	9.1	10.8	7.0	7.3	11.7	9.7	6.3
- Exports of goods	497	341	282	353	444	420	330	23.9	24.9	21.9	22.4	26.6	24.7	23.3
- Imports of goods	308	193	191	238	249	255	240	14.8	14.1	14.9	15.1	14.9	15.0	17.0
Trade balance, services	-55	-37	-24	-31	-30	-37	-18	-2.7	-2.7	-1.9	-2.0	-1.8	-2.2	-1.3
- Exports of services	66	52	51	58	65	62	45	3.2	3.8	3.9	3.7	3.9	3.6	3.1
- Imports of services	121	89	75	89	95	99	63	5.8	6.5	5.8	5.6	5.7	5.8	4.4
Other current account items	-76	-43	-42	-51	-49	-64	-39	-3.7	-3.2	-3.2	-3.2	-3.0	-3.7	-2.7
- income on investments and credit	43	34	37	42	49	50	37	2.1	2.5	2.9	2.7	2.9	2.9	2.6
- expenditure on investments and credit	101	66	70	82	86	100	67	4.9	4.8	5.5	5.2	5.1	5.9	4.8
Financial account & net errors	-123	-66	-15	-9	-76	2	-46	-5.9	-4.8	-1.2	-0.6	-4.6	0.1	-3.2
Government (excl. central bank)	30	-10	4	12	-7	21	3	1.4	-0.7	0.3	0.8	-0.4	1.3	0.2
Private sector total (A+B)	-151	-58	-19	-23	-68	-21	-48	-7.3	-4.2	-1.5	-1.4	-4.1	-1.2	-3.4
A. Banks	-86	-34	1	-23	-33	-18	-18	-4.1	-2.5	0.1	-1.5	-2.0	-1.0	-1.3
B. Other private sector, incl. net errors	-65	-23	-21	1	-35	-3	-30	-3.1	-1.7	-1.6	0.0	-2.1	-0.2	-2.1
- Direct investment	-38	-14	11	-9	-24	6	-5	-1.8	-1.0	0.8	-0.6	-1.4	0.4	-0.3
- to Russia	18	6	31	27	6	29	1	0.8	0.5	2.4	1.7	0.4	1.7	0.1
- from Russia	55	20	20	36	30	23	6	2.7	1.5	1.6	2.3	1.8	1.3	0.4
- Portfolio investment	-18	-8	-4	-10	-2	-7	-24	-0.9	-0.6	-0.3	-0.6	-0.1	-0.4	-1.7
- to Russia	-12	-5	0	-5	-1	-4	-14	-0.6	-0.3	0.0	-0.3	0.0	-0.2	-1.0
- from Russia	6	3	4	5	1	2	10	0.3	0.2	0.3	0.3	0.1	0.1	0.7
- Foreign currencies in cash *	9	14	5	6	7	8	2	0.4	1.0	0.4	0.4	0.4	0.5	0.2
- BoP net errors and omissions	8	3	-5	3	2	-2	4	0.4	0.2	-0.4	0.2	0.1	-0.1	0.3
- Other items under B. Other private sector	-26	-18	-27	10	-18	-9	-7	-1.2	-1.3	-2.1	0.7	-1.1	-0.5	-0.5

* Positive value = decrease in the stock of foreign currencies in cash

Sources: Central Bank of Russia, Rosstat and BOFIT.

At close to \$600 billion, Russia holds the world's fourth-largest foreign currency and gold reserves. At the end of 2020, the value of Russia's total international reserves, including gold, amounted to \$596 billion. The value of the reserves increased by slightly more than 7 % last year. Most of the growth in value reflects the fact that the reserves are measured in US dollars. The dollar value of reserves increased because gold prices went up and the euro appreciated against the dollar. Central Bank of Russian Federation (CBR) last year intervened sparingly in forex markets, allowing markets to largely define the ruble's external value.

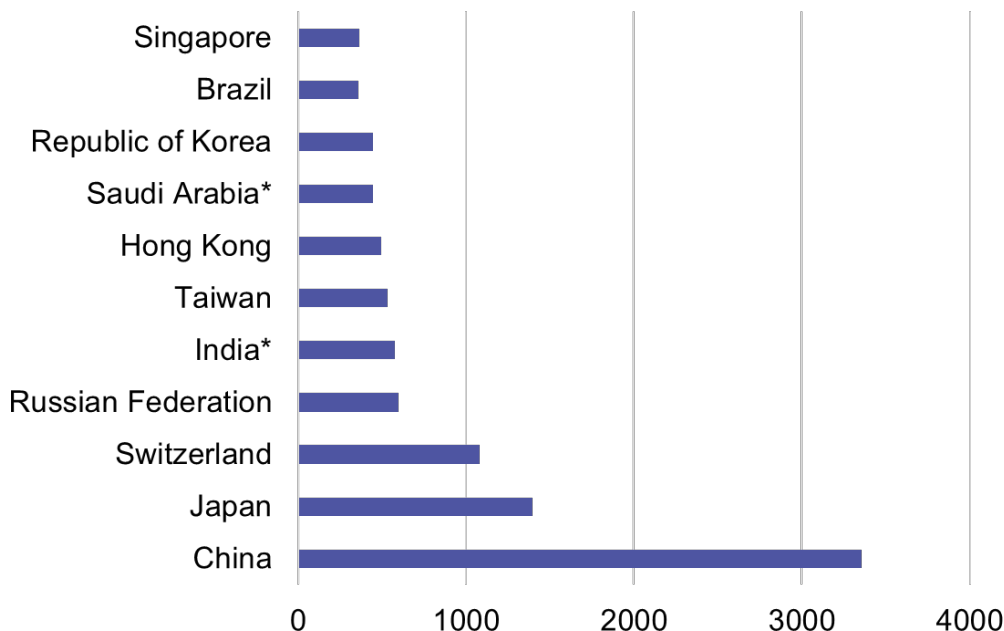
Russia's currency and gold reserves are the world's fourth largest after China (\$3.36 trillion), Japan (\$1.40 trillion) and Switzerland (\$1.08 trillion). Managed exchange rates are an important reason for the large forex reserves of China, and even more in Switzerland's case. The Bank of Japan, in contrast, allows the yen to float freely. Much of the large forex reserves of Saudi Arabia and Hong Kong can be attributed to their fixed exchange rate policies.

The size of national forex reserves relative to GDP varies considerably across countries. In many large economies, however, forex reserves typically fall in the range of 20–30 % of GDP. For example, the reserves of China and India are about 22 % of GDP, while they represent about 28 % of GDP for Japan and South Korea. Russia stands at a relatively high 41 % of GDP, but it is still a far from joining the group of countries with reserves exceeding a year's worth of GDP: Singapore (107 % of GDP), Hong Kong (144 %) and Switzerland (153 %).

At the end of June 2020, the value of Russia's gold assets included in its international reserves surpassed the value of US dollar assets. The value of reserves totalled \$561 billion as of end-June. Of that, about 30 % was held in euros, 23 % in gold and 22 % in US dollars. In the second quarter of 2018, the CBR shifted about 15 % of its foreign currency reserves into Chinese yuan ([BOFIT Weekly 2019/03](#)). By the end of June 2020, the yuan share of reserves had declined to about 12 %.

The structure of Russia's foreign currency reserves, especially with respect to yuan holdings, is quite exceptional by international standards. IMF figures show that the Chinese yuan accounts for less than 2 % of the world's total foreign currency reserves.

The size of international reserves is not necessarily proportional to the size of the economy, USD billion, December 2020



*) November 2020

Sources: IMF, central banks and BOFIT

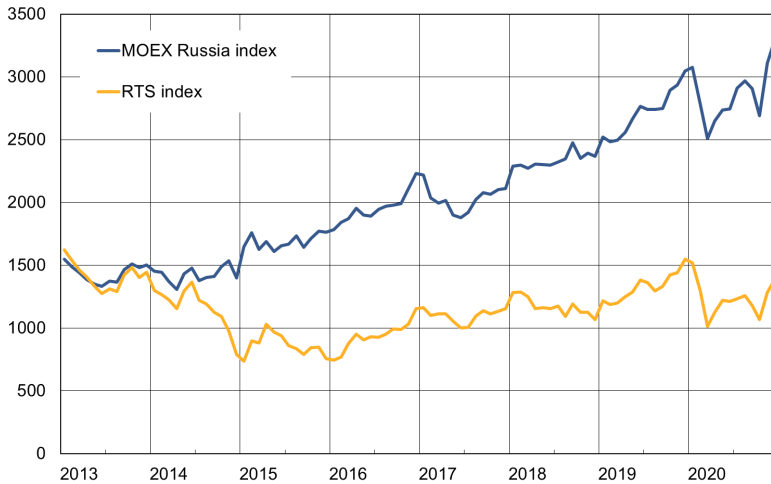
Moscow stock exchange made gains in second half of 2020. Last spring the drop in oil prices and the collapse of international financial markets were reflected immediately on the Moscow Exchange. In the second half of 2020, interest in exchange-traded shares re-emerged, driving the ruble-based MOEX Russia Index to historical highs at the end of the year. The ruble's depreciation last year, however, kept the widely used dollar-based RTS Index rather flat for the duration. At the start of January 2021, the RTS Index was still down about 10 % from a year earlier.

As earlier, foreign investors accounted for about half of all share trading volume last year (45 % in December). The market capitalisation of the Moscow Exchange and trading volume growth have been supported by increased interest from small domestic investors. At the end of 2020, 8.8 million Russians had set up investment accounts, an increase of nearly 5 million accounts from the end of 2019. Private individuals represent an increasing share of trading volume, which reached 44 % in December (37 % in December 2019). The eagerness of private individuals to invest their assets in the stock market was driven in part by declining bank deposit interest rates and a change in tax treatment of bank deposits, as well as increased availability of online financial services. Three large commercial banks (Tinkoff, Sberbank and VTB) manage the lion's share of investment accounts of private individuals in Russia.

After a two-year break, the Moscow Exchange last year held two major IPOs. The first was the IPO of the maritime shipping giant Sovcomflot, the first listing of a state-owned firm since 2013. The second IPO featured Samolet, one of Russia's biggest residential real estate developers. The October IPOs of Sovcomflot and Samolet raised 43 billion rubles (\$550 million) and about 3 billion rubles, respectively. The amounts raised, however, were modest compared to the amount raised by Russian online retailer Ozon in its US IPO (about \$990 million) in November. The previous billion-dollar class Russian company IPO in the US was the Netherlands-registered Yandex in 2011.

The Moscow Exchange is characterized by the large weight of oil & gas companies, the miniscule role of domestic institutional investors (e.g. pension funds) and the small share of publicly traded shares. On average, the free float of top 50 companies is about 30 percent.

The ruble-based MOEX Russia index reached a new record level last year.

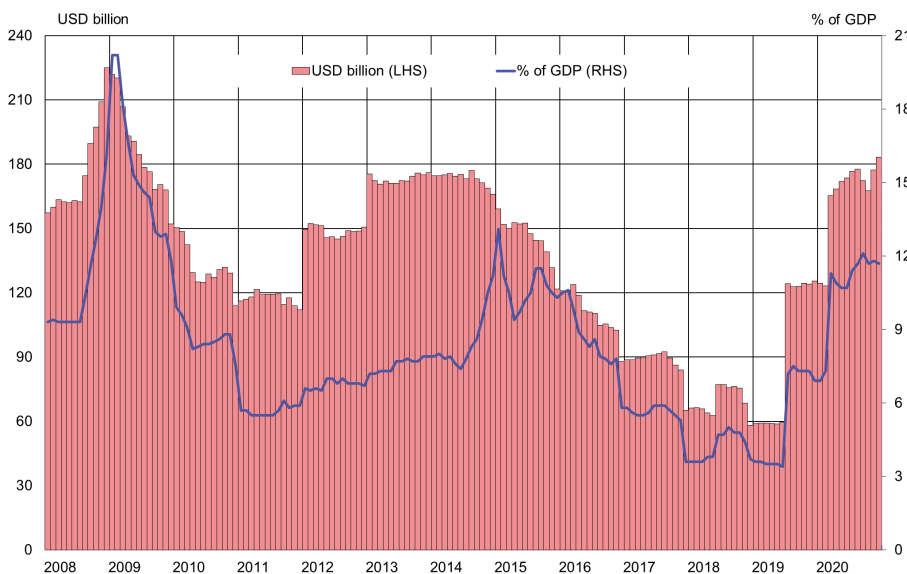


Sources: Moscow Exchange and BOFIT.

National Welfare Fund again close to 12 % of Russian GDP. At the end of 2020, Russia’s “excess” earnings on energy and higher share prices boosted the value of the National Welfare Fund to \$183 billion. In accordance to the government’s fiscal rule, excess oil and gas earnings must be set aside in the Fund. In March 2020, for example, the government’s excess energy earnings for 2019 were transferred to the Fund ([BOFIT Weekly 2020/37](#)). Since then, much of the Fund’s further increase in value has come largely from the increase in the price of Sberbank shares and euro’s appreciation against the US dollar. In dollar terms, the Fund is now as large as it was in 2009.

The Fund includes about \$115 billion in highly liquid public sector bonds and treasuries of large OECD countries. The central bank manages these assets as part of its foreign currency and gold reserves ([BOFIT Policy Brief 2015/4](#)). The Fund also holds the bulk of Sberbank shares (\$41 billion). Some assets have also been deposited in the state-run VEB development bank.

The value of Russia’s National Welfare Fund has returned to levels not seen since 2009.



Sources: Russian Ministry of Finance and BOFIT.

China

Chinese GDP stages V-shaped recovery in 2020, bouncing back from covid-19 lockdowns to positive on-year growth. China's National Bureau of Statistics reports that GDP grew by 6.5 % y-o-y in the fourth quarter of 2020 and increased by 2.3 % for the year overall. In nominal terms, GDP was valued at 102 trillion yuan (about 13 trillion euros). While the economy recovered quickly from the economic collapse of the first quarter, the covid-19 pandemic prevented China from reaching its 2012 goal of doubling 2010 real GDP by 2020. No annual GDP growth target was announced for 2020. Chinese official growth figures have long been suspect. For example, the Bank of Finland's updated [calculations](#) suggest that China's first-half covid-dip was deeper and the subsequent recovery slower than official figures report.

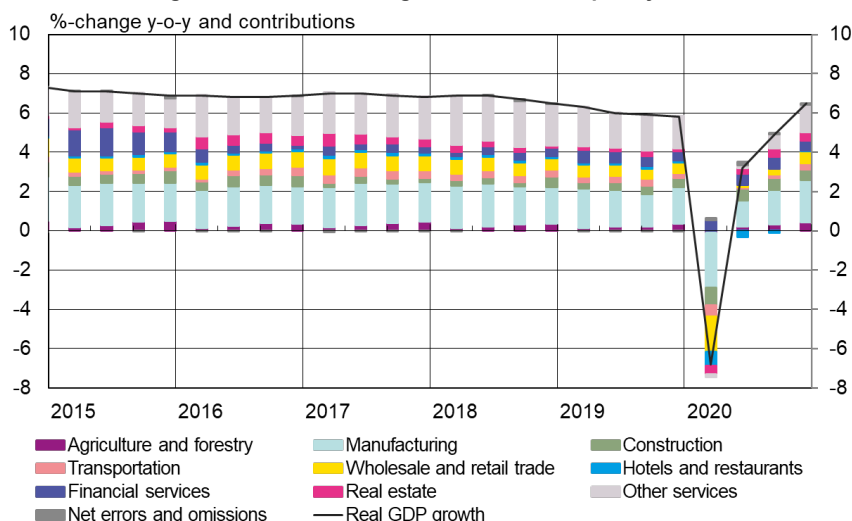
The NBS announced in December that its revised figure for 2019 GDP had been adjusted slightly lower (2019 GDP growth fell from 6.1 % to 6.0 %). The largest downward revision was made to industrial output, adjusted by more than 500 billion yuan. Revised service sector output was raised slightly from the previous estimate.

For all of 2020, real industrial output increased by 2.3 % y-o-y, supported by a strong fourth-quarter performance (up 7.3 %). Construction output for 2020 grew by 3.5 % y-o-y. Service sector output rose by 2.1 % y-o-y. The hotel and restaurant branch, which has been clobbered by the covid crisis, experienced a real contraction of 13 % last year. Real on-year growth in the wholesale and retail branches was slightly negative (down 1.3 %), despite picking up towards the end of the year. Even if exports grew strongly in the second half of the year, they were only up by 4 % in dollar terms for the year as a whole. Imports contracted by 0.4 % in dollar terms.

Real per capita disposable household incomes increased by 2 % y-o-y last year. In urban areas, household incomes were only up by 1 % y-o-y, while rural household incomes increased by 4 %. Per capita household spending overall contracted by 4 % y-o-y in real terms. For city-dwellers, per capita household spending declined by 6 %, while rural residents continued to spend at about the same level as in 2019. Survey-based unemployment rate in urban areas fell back to around 5.2 % in December, i.e. the same level as in December 2019. It peaked at 6.2 % in February last year. Like official growth figures, China's official unemployment figures do not give an accurate picture of the situation in China's labour markets.

Consumer price inflation rose from -0.5 % in November to 0.2 % in December. Despite higher figures early in the year, the rise in consumer prices was just 2.5 % for all of 2020, more than a percentage point lower than the goal set for last year. Industrial producer price inflation and purchasing price inflation remained negative throughout 2020 (-1.8 % and -2.3 %, respectively).

China's official figures show economic growth recovered quickly from the covid-19 shock



Sources: China National Bureau of Statistics, CEIC and BOFIT.



Latest forecasts show China putting the covid-19 crisis behind it, even as other emerging economies struggle. According to both the IMF's just-released World Economic Outlook [update](#) and the World Bank's latest [forecast](#), the global economy contracted in 2020 slightly less than originally feared. The revisions have been largely influenced by a stronger-than-expected recovery in private consumption and positive news about vaccine development. Uncertainty about the 2021–2022 forecasts, however, remains large as new waves of infection and mutated strains of the covid-19 virus continue to emerge.

China is expected to grow considerably faster than the global economy again this year (about 8 % due to the low basis point last year). Media reports suggest that the same 8 % could also become China's official 2021 GDP growth target. Growth is likely to slow next year, but will still remain at a respectably high level of about 5.5 %. China's strong performance is unique among emerging economies.

The covid pandemic is generally considered to have inflicted long-term damage on emerging economies by reducing investments and stagnating development of human capital. Many countries have put off critical economic reforms for years into the future. The pandemic has had largest impact on countries heavily dependent on tourism, the service economy or commodity exports (oil in particular), as well as those that saw the largest domestic outbreaks. Countries in this latter group include India, which saw its economy contract by 8–10 % last year despite a solid economic recovery in the second half of 2020. The big uncertainty associated with India's growth figures is also reflected in the wide range of recent forecasts. The largest contractions registered among the BRICS group of large emerging economies (Brazil, Russia, India, China and South Africa) were posted by India and South Africa.

South Africa, which has experienced the worst covid-19 case rate of any countries in Sub-Saharan Africa, was forced into lockdowns that caused the economy to contract by about 8 % last year. Without its broad-based programme of economic stimulus, the situation would have likely been considerably worse. Moreover, the expected rate of recovery in 2021–2022 is rather low. Economic growth in Turkey recovered briskly in the second half of 2020 on major stimulus efforts (with the result that the Turkish economy posted slightly positive growth for all of last year). Turkey's near-term prospects, however, will depend to a large extent on the return of international tourism. The number of covid deaths per capita has been especially high in Latin America. Private consumption and fixed investment in Brazil, however, recovered at a rapid pace in the second half of 2020 due to favourable credit conditions and it is expected that economic growth this year would rise by more than 3 %. The Russian economy was hit hard last year both by covid lockdowns and the global collapse in crude oil prices. Russian GDP is now estimated to have contracted by about 4 % last year. The latest round of forecasts, however, expect a return to pre-crisis levels of economic growth as soon as the second half of 2021.



Emerging economies have shown remarkably different degrees of success in recovering from the covid-19 pandemic

GDP forecasts published in January 2021

World	2020	2021	2022	Turkey	2020	2021	2022
IMF	-3.5	5.5	4.2	IMF	1.2	6.0	3.5
World Bank	-4.3	4.0	3.8	World Bank	0.5	4.5	5.0
Bloomberg*	-3.8	5.2	3.9	Bloomberg*	0.5	3.7	4.1
	(-4.7 -2.5)	(2.0 6.4)	(3.0 5.0)		(-4.0 1.5)	(2.3 5.9)	(2.0 4.8)
China				Brazil			
IMF	2.3	8.1	5.6	IMF	-4.5	3.6	2.6
World Bank	2.0	7.9	5.2	World Bank	-4.5	3.0	2.5
Bloomberg*	2.1	8.4	5.5	Bloomberg*	-4.6	3.5	2.5
	(1.7 5.5)	(4.8 10.5)	(4.5 7.0)		(-5.1 -4.1)	(2.6 4.8)	(1.8 3.0)
India				South Africa			
IMF	-8.0	11.5	6.8	IMF	-7.5	2.8	1.4
World Bank	-9.6	5.4	5.2	World Bank	-7.8	3.3	1.7
Bloomberg*	-8.1	9.2		Bloomberg*	-7.2	3.5	2.2
	(-14.7 -5.7)	(6.0 16.2)			(-9.0 -7.0)	(2.0 6.4)	(3.0 5.0)
Russia							
IMF	-3.6	3.0	3.9				
World Bank	-4.0	2.6	3.0				
Bloomberg*	-3.8	3.0	2.5				
	(-4.5 -3.0)	(1.1 3.7)	(2.0 3.5)				

*Bloomberg's forecasts are collected from investment banks and financial institutions: median and range (in parentheses). The number of forecasts varies from country to country.

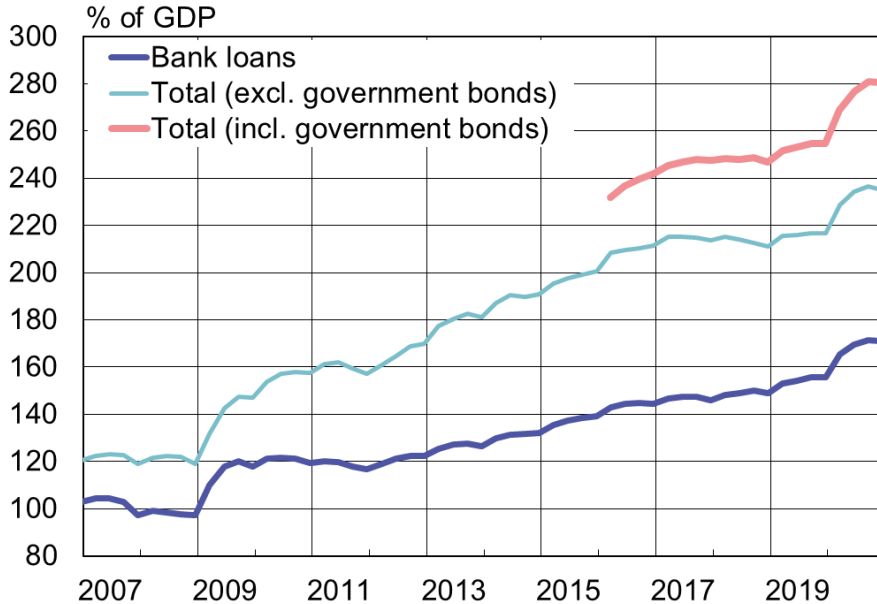
Sources: IMF World Economic Outlook Update, World Bank Global Economic Prospects, Bloomberg and BOFIT.

Chinese debt-to-GDP ratio approaches 300 %. The People's Bank of China reports that the combined domestic debt of corporations, households and the public sector increased last year to a level equivalent to 280 % of GDP (285 trillion yuan or 36 trillion euros), up from 255 % of GDP in 2019. When China's foreign debt (which the PBoC estimates to be 14.5 % of GDP at the end of June) is included, total debt rises to about 295 % of GDP.

Due to the covid crisis and related measures, the debt-to-GDP ratios of many countries increased significantly last year. Figures from the Bank of International Settlements (BIS) for over 40 countries suggest China's the increase in debt-to-GDP ratio from the start of 2020 to end of June was quite ordinary compared to the other countries. China's debt-to-GDP ratio, nevertheless, is distinctly higher than in other emerging economies and on par with US and euro area, which have more developed financial markets.

China's piling on of debt has long raised concerns among observers of the Chinese economy because rapid descents into indebtedness in other countries have typically led to major economic collapse or severe banking crises. Moreover, China was already engaged in efforts to bail out small and medium-sized banks before covid-19 struck, with so at least 500 billion yuan ([BOFIT Weekly 40/2020](#)) in public funds already expended. The lion's share of Chinese debt exists in the form of bank loans taken by the corporate sector. During the covid pandemic, certain branches experienced significant declines in the ability of firms to service their debts. Stress tests released by PBoC in November showed that 10 of 30 banks were would fail even under the mildest stress scenario, which only assumed that GDP growth would be 1.6 % in 2020 and 7.8 % in 2021. The stress tests comprised all of China's systemically critical banks.

China's debt-to-GDP ratio continued to grow last year



*) Official public debt, 45 % of GDP. IMF estimates general government liabilities corresponded to 92 % of GDP at the end of 2020. Sources: PBoC, National Bureau of Statistics, CEIC and BOFIT.

National carbon trading scheme expected to help China reach more ambitious climate targets. China made a significant shift in climate policy last September with president Xi Jinping's announcement that the country would seek to be carbon neutral by 2060. Under the Paris climate accord, China is committed to ending growth in carbon emissions by 2030. The announcement, which preserves Paris targets, also adds some new stricter targets. China will now seek to reduce its carbon intensity (ratio of CO₂ emissions to GDP) to at least below 65 % of the 2005 level by 2030 (the earlier target was a range of 60–65 %). In addition, China seeks to increase the share of non-fossil fuels in energy consumption mix to at least 25 %, up from an earlier goal of 20 %. At the moment, that non-fossil energy component is only about 16 %.

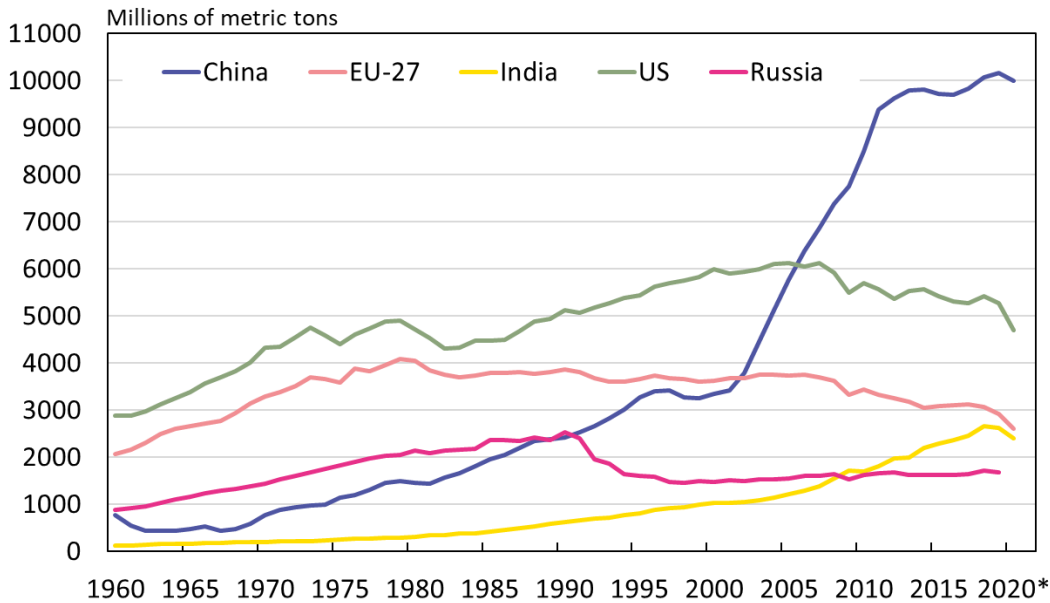
During 2017–2019, growth of China's carbon dioxide emissions averaged 1.6 % a year. Over the same period, carbon emissions declined in the EU and US. The Global Carbon Project, which has studied emissions since the start of the 2000s, estimates that global carbon emissions declined by 7 % last year due to the effects of the covid-19 pandemic on industrial production and travel restrictions. While emissions in China also declined by nearly 2 %, it was relatively little compared to the 11 % reductions registered in the EU and US.

The impact of covid-19 on emissions within China was minor, however, because the lockdowns in early 2020 were short and output revived quickly in the spring. In addition, the Chinese government continued to apply economic stimulus. These policies include investment in new coal-fired power plants, even if coal is by far the country's largest source of carbon emissions. China is also a major investor, consumer and producer of renewable energy technologies, yet the share of renewables in China's energy palette has only grown slowly ([BOFIT Policy Brief 14/2020](#)).

The new climate targets have accelerated development of the national emissions trading system, which has been tested and developed for years at the local level. For example, the city of Beijing has long experience with a carbon-trading scheme that covers power plants, cement plants, petrochemical plants, as well as other industrial enterprises. Civil aviation was also included in the Beijing scheme last year. Although the launch of emissions trading at the national level has been postponed several times ([BOFIT Weekly 32/2020](#)), it now appears that it will officially launch on February 1, 2021, when the new rules enter into force. Getting the trading scheme up and running, however, may take time. By some estimates, the system will be operational at earliest by this summer. The initial "trial period" runs from January 1 to December 31, 2021. It covers the 2019 and 2020 emissions of 2,225 enterprises in the energy sector. The number of firms under the scheme will gradually increase

in coming years as other large energy-intensive producers join the scheme. China's national carbon-trading scheme is expected to be the world's largest such trading scheme.

Even with a global pandemic, China's CO₂ emissions appear to have barely dipped in 2020



*) Estimate.

Sources: Our World in Data, Global Carbon Project and BOFIT.

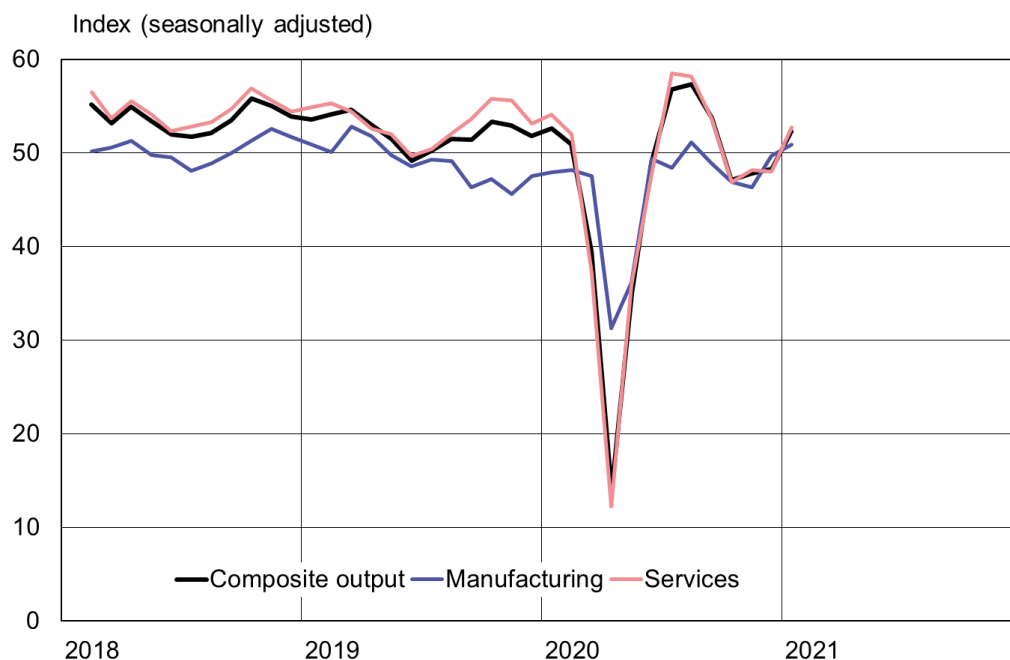
Russia

Latest economic data for Russia looks promising. The acceleration of the covid-19 pandemic in Russia during the second half of 2020 reduced economic activity due to such factors as restrictions on personal movement. Late last year and apparently in January, however, the economic outlook seems to have brightened a bit, thanks in part perhaps to positive coronavirus vaccine news. The Markit IHS purchasing managers' indices (PMIs) for Russia illustrate this current improving sentiment. More importantly, they augur a gradual return of economic confidence in Russia. The readings for the manufacturing PMI (50.9) and services PMI (52.7) both exceeded a neutral reading of 50 points in January, thus indicating increasing business activity. The last time both indices were above 50 points was in September 2020. Confidence about the future in services rose sharply to a level last seen in October 2019.

On the manufacturing side, seasonally adjusted production has grown nearly uninterrupted since last summer, but was still down from 2019 by 2.5 % in the fourth quarter of 2020 (the on-year change in December was -0.2 %). The production ceilings on crude oil output under the OPEC+ agreement continued to depress the mineral extraction sector, but manufacturing output increased by an impressive 4.4 % y-o-y in December (2.9 % in November).

In the fourth quarter of 2020, production of services fell by 13 % y-o-y. Services output collapsed by nearly 40 % in spring and the subsequent recovery has taken time. The construction sector last year managed to preserve production levels under exceptionally trying conditions. In the fourth quarter, construction grew by 0.8 % y-o-y.

PMI readings of Russian firms show a general expectation of improving conditions



Sources: Markit IHS, Macrobond and BOFIT.

Even with domestic demand and imports plunging, the Russian economy contracted less than expected in 2020. The real volume of Russian GDP shrank by slightly more than 3 % last year – less than forecast. Reduced domestic demand, and with it the contraction in output, were specifically affected by the sharp drop in prices of crude oil and Russia's other basic commodity exports last spring, and naturally the spread of covid-19 and the accompanying restrictions to deal with the pandemic.

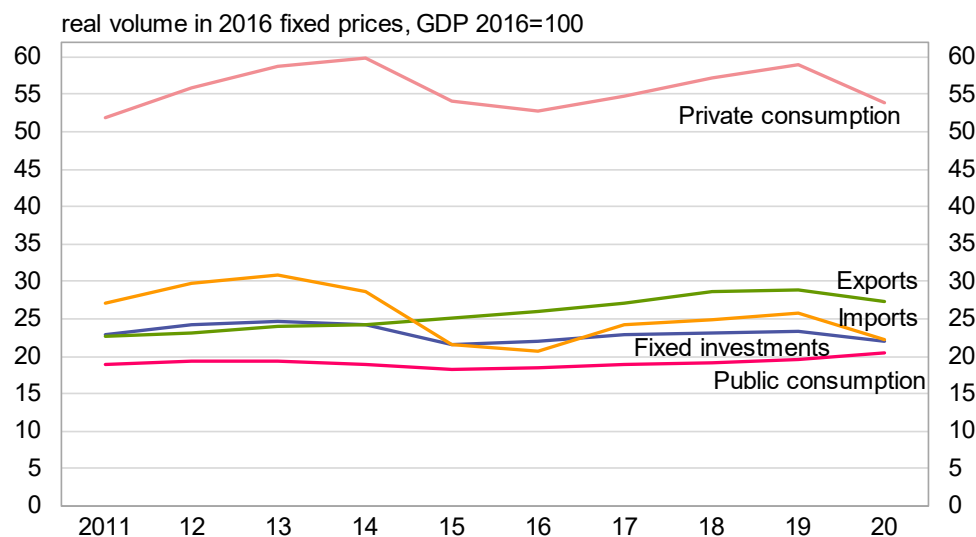
As in earlier economic recessions in Russia, the contraction in domestic output was limited by the fact that the reduction in demand centred more on imports, which shrank by nearly 14 % last year. At the background, the ruble's real effective (trade-weighted) exchange rate fell by 7 % from 2019 and Russian tourism abroad collapsed due to covid restrictions. The decline in

goods imports was notably milder. Previous recessions and the rather weak ruble have earlier depressed imports, which were down last year about 20 % from 2012–2014 and about 15 % down from 2008.

Among demand-side categories, private consumption contracted by about 8.5 % last year, which was almost as much as in the 2015 economic recession. Before the current recession, private consumption had recovered to a level roughly on par with the 2013–2014 level. In addition, fixed investment fell by over 6 % from 2019. About 10 % less fixed investment was made last year than in 2012–2014, and 5 % less than in 2008. Public consumption, in contrast, grew by 4 %, more than in many years. The government embarked on slowing the rate of economic contraction through increased government sector budget spending. Public consumption has grown steadily and last year was about 10 % higher than in the mid-2010s. The real volume of exports contracted by 5 % in 2020. However, exports were up during earlier years to the extent that despite last year's drop, exports were up by 20 % from about a decade ago.

On the production side of the GDP ledger, the real volume of value added fell by 25 % in Russia's relatively small restaurant and hotels branch, but in the wholesale and retail sector was down by a mere 3 %. Mostly the drop in GDP was driven by a 10 % decline in Russia's sizeable extractive sector (mainly due to crude oil production) as well as the transport and warehousing branches. Manufacturing growth plateaued, while the sector has been a top grower over the past five years (up 13 %). Rapid growth continued last year in the financial sector, with public administration experiencing notable growth.

Russia's private consumption, fixed investment and imports at low levels in 2020

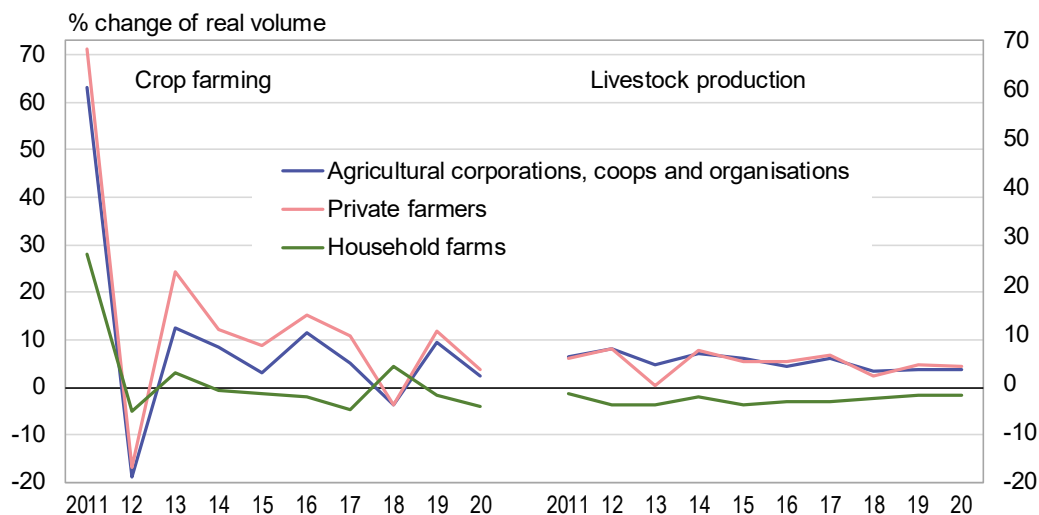


Sources: Rosstat and BOFIT.

Russian agriculture enjoys another year of growth. While agricultural output grew almost every year over the past decade, 2020 was no exception even if growth slowed down to about 1.5 %. Crop farming, which accounts for well over half of agricultural output, increased significantly slower than at nearly any time in recent history. Grain harvests overall, however, were up by 10 % last year, even approaching the record harvests of 2017. In contrast, production of certain crops such as potatoes declined considerably, and sugar beet production collapsed to levels not seen in many years. That was due to smaller areas under cultivation and smaller harvests per area. The steady growth of livestock production continued last year.

In particular, agricultural corporations, cooperatives and organisations have succeeded in rapidly ramping up production. They did so yet again last year and account now for about 55 % of Russia's crop production, and over 60 % of livestock production. The fastest growth, however, has been posted by private farmers. Their operations focus on crop farming, and their share of total crop production nationally has gradually risen to more than 20 %. Production of household farms on the other hand has contracted gradually over the past decade. Even so, household farms still account for nearly a quarter of crop production (and about two-thirds of potato production and over half of vegetables) not to mention almost a third of livestock production.

Russian agricultural production has risen for many years



Sources: Rosstat and BOFIT.

Russian banking sector enjoyed brisk growth last year. Measured by the final balance sheet total, Russia's banking sector grew by 12.5 % last year, clearly higher growth than in 2019. Growth in total assets has been largely supported by growth in the volume of housing loans and loans granted to small and medium-sized firms (SMEs). This growth has been underpinned by government interest subsidies to borrowers and other subsidy programmes ([BOFIT Weekly 35a/2020](#) and [35b/2020](#)). Despite the economic recession, payment defaults scarcely increased and non-performing loans for the credit stock of the banking sector overall remained steady at 6.1 %. On the other hand, many loans were restructured already at the end of spring ([BOFIT Weekly 29/2020](#)). At the end of last year, over 5.1 trillion rubles in loans of large firms were restructured, i.e. more than 14 % of the corporate lending portfolios of Russia's largest banks. Corporate troubles are expected to show up as eroding the quality of bank lending portfolios this year at the earliest. However, the banking sector at this point is still well capitalised and rather well positioned to absorb potential credit losses.

Despite a significant decline in real incomes, household bank deposits grew by 4.2 % last year, which was only a tad lower than the inflation rate (4.9 %). Household assets represent about a third and corporate assets about 31 % of the banking sector's total liabilities. These shares have remained fairly steady, but over the past year the structure of savings shifted a bit. Despite ruble devaluation, the popularity of foreign currency accounts has diminished. Rising uncertainty and the drop in deposit interest rates are reflected in the increasing popularity of keeping money on current account. At the end of December, assets held in household accounts were up 50 % y-o-y. The volume of household term deposits, in contrast, contracted slightly, reflecting the increased enthusiasm of households to invest in the stock market last year ([BOFIT Weekly 3/2021](#)).

China

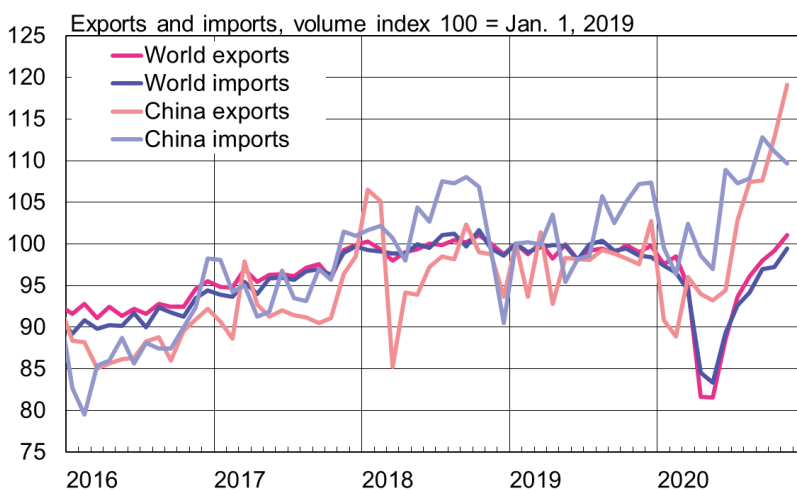
Volume of Chinese goods exports showed exceptionally strong growth amidst pandemic. In November 2020, on-year growth of the world goods trade returned to positive territory. Total trade volume grew by 1.5 % y-o-y. However, global trade developed weakly already before the covid-19 pandemic struck. Indeed, no overall growth in global trade occurred during 2018–2019. In November 2020, global export and import volumes achieved a level comparable to that at the end of 2017.

The volumes of exports and imports in China also limped along in the two years before the pandemic. In the second half of 2020, however, there was a major shift in Chinese trade. Exports volumes in November were up by more than 20 % y-o-y, along with a 2 % bump in imports. The growth reflects China’s swift repositioning to take on vast global demand for personal protective equipment such as masks and gowns, as well as technological products such as laptops and monitors as people around the world shifted to remote work, study and streamed content. In addition, demand for consumer goods such as furniture, toys and sporting goods revived globally, further boosting China’s export volumes. Indeed, China’s foreign trade almost single-handedly pulled global growth out of the covid hole last year. Recovery elsewhere in the world has been more modest. For example, export volumes in the euro area and the US in November were still down from twelve months previous.

While China’s export and import volumes rose, prices fell. As a result, the value of goods trade increased less than volumes. In dollar terms, China’s exports increased by 4 % in 2020, while imports contracted by nearly 1 %. China’s trade surplus grew to \$535 billion, up from \$420 billion in 2019. China increased its imports relatively more from neighbouring countries. In particular, the import shares of ASEAN countries and Taiwan rose last year. Import shares of the euro area and the US also grew in the second half. During 2020, African countries suffered the biggest loss in Chinese imports shares. With the exception of the US, export shares remained largely unchanged. The US share of Chinese exports surged at the end of the year after two years of contraction.

Assembly manufacturing continued to diminish last year, both as a share of exports and imports. It is worth noting that just a decade ago, assembly manufacturing represented half of all Chinese exports. Just two years ago, assembly production still represented roughly 35 % of exports. During the second half of 2020, the share of assembly production declined to about 30 % of exports. Domestic firms increasingly account for most of China’s exports. The export share of foreign-owned firms operating in China (including joint ventures with Chinese partners) peaked a couple years before the global financial crisis (about 60 % in 2006), and declined steadily ever since. At the end of 2020, foreign-owned firms accounted for about 35 % of exports.

China’s foreign trade last year clearly outperformed the world average



Sources: CPB World Trade Monitor and BOFIT.



Officials hope to rein in real estate sector risks in China. Since the start of the year, the regulators have started to restrain the possibilities for banks to grant loans to the real estate sector. Last year, officials imposed restrictions on large property developers' borrowing. Regulators fear that the rapid increase in developers' indebtedness could create a price bubble in the housing market and increase financial market risks. The payment problems of Chinese developers have been in the headlines for several years and their payment defaults have increased. Concerns have focused especially on Evergrande Group, the world's most-indebted property developer (\$110 billion in debt obligations at the end of 2020). Officials hope that redirection of bank lending away from debt-mired real estate developers to other sectors will also improve resource allocation in the economy.

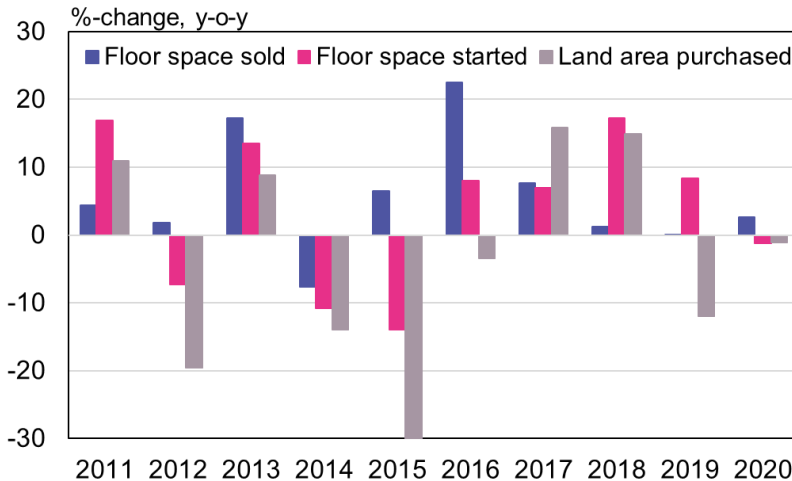
New guidelines issued by the central bank and China Banking and Insurance Regulatory Commission (CBIRC) entered into force on January 1. The new rules establish ceilings on both the property loans and mortgages issued by banks. The caps on lending shares depend on the bank's size and status. China's large banks are permitted a higher property-related lending share (40 % of their loan stock can go to loans in the real estate sector and 32.5 % to mortgage loans). In contrast, small village banks are subject to more restricted lending (just 12.5 % to the real estate sector and 7.5 % to mortgages). A transition period of unknown length has been granted to banks to reach the set ratios. In addition, regulations can be tightened or relaxed depending on the economic situation in the region.

The analytics firm Gavekal Research reports that in September 2020, the aggregate level of both mortgages (20 % share of bank lending) and property loans (29 % share) in the banking sector were well below the implicit upper limits weighted by bank size (28 % and 34 %). Many individual banks, however, exceed their maximum limits. The regulators have already tried earlier to get the indebtedness of property developers under control. In 2019, the government asked banks to review their lending to the real estate sector, limit bond issues of certain developers and banned trust companies from granting any new loans to developers.

Last August, the central bank and the housing ministry launched a pilot programme designed to reduce the financial market risks confronting property developers. While the regulations have yet to be published, media reports indicate that they target three "red line" ratios: the debt-to-equity ratio (must be below 100 %), debt-to-assets ratio (under 70 %) and ratio of short-term debt to cash on hand (cannot exceed 1). Only firms that do not cross all these lines will be allowed to take on more debt. The firms can increase their debt levels between 5–15 % a year depending on how many of the three conditions they meet. The pilot programme includes at least a dozen of China's largest developers (including Evergrande, which crosses all three red lines). In the last meeting with regulatory officials in January, a total of 20 developers were invited. The plan is to expand the pilot experiment to include all property firms at some point. *Bloomberg* reports that some developers have already figured out how to circumvent the new rules by increasing their off-balance-sheet borrowing as it is not included in the ratio calculations.

The new regulations are expected to slightly slow growth in housing loans and rein in growth in the real estate market. Measured by floor space, real estate sales last year increased by 3 % amidst the covid epidemic. The real estate sector and construction activity account directly for 14 % of China's GDP. When the indirect impacts are included, construction activity is estimated to generate up to 30 % of GDP. Majority of investment assets held by Chinese households is in the form of property. At the end of 2020, 69 % of the household borrowing was housing loans. Relative to income levels, housing prices in China's large cities are the highest in the world.

While real estate sales increased last year, the acquisition of land-use rights and construction starts were slightly down.



Sources: CEIC, China National Bureau of Statistics and BOFIT.

Hong Kong's real economy remains weak. While Hong Kong has weathered the covid-19 pandemic with relatively few infections, residents have had to deal with severe restrictions on movement and the economic consequences. Hong Kong's economy started to shrink already in summer 2019. The downturn continued all last year, reducing the GDP of the region by 6 % y-o-y. Even if the economy recovered slightly in the second half of 2020, its GDP still contracted by 3 % y-o-y in the fourth quarter. It appears that the recovery stalled in the fourth quarter as the volume of GDP remained unchanged from the previous quarter. The Hong Kong government has dealt with the latest epidemic wave by imposing local quarantines and restrictions on outdoor movement, which has also impacted economic trends.

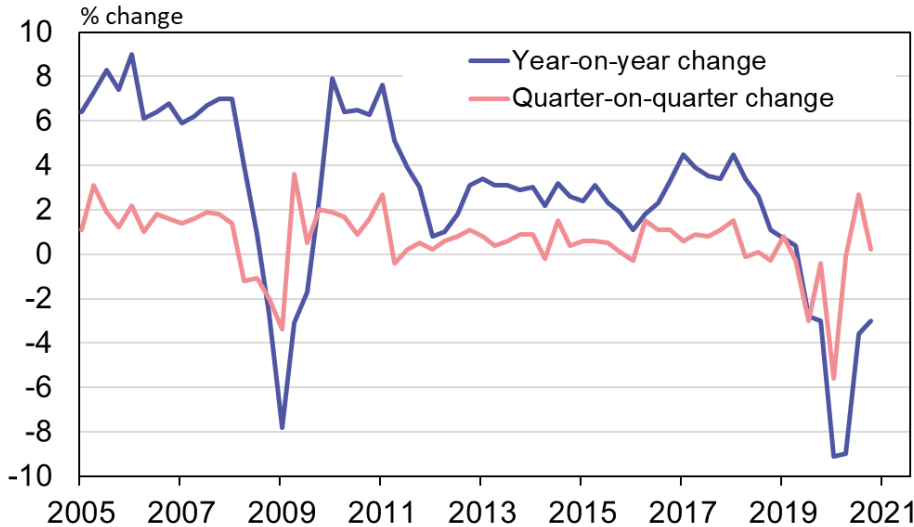
Private consumption, which is important to Hong Kong's economy, fell by 10 % last year. In the fourth quarter, GDP still contracted by almost 8 % y-o-y. The volume of retail sales in 2020 was down by over 25 % y-o-y. Restaurants and hotels, as well as tourism-related services, have been the hardest hit branches in the service sector. These branches have experienced dramatic increases in unemployment. Above all, the drop in Chinese tourists can be seen in the numbers of Chinese visiting Hong Kong. There are strict travel rules between the mainland and the SAR, even if the covid situation is relatively good in both Hong Kong and mainland China.

There was a large disparity in foreign trade of goods and services last year. Thanks to the rapid recovery of China's economy, the value of Hong Kong's goods exports approached the previous year's level. In the fourth quarter of 2020, goods exports already grew by nearly 6 % y-o-y. In contrast, services exports contracted by nearly 37 % y-o-y, mainly due to the collapse in tourism.

Hong Kong's large financial sector has managed better in exceptional circumstances than firms in the real economy. Indeed, the Hong Kong stock exchange was one of the world's best-performing stock exchanges last year. The strong performance was supported by capital flows from mainland China ([BOFIT Weekly 2/2021](#)). The role of Chinese investors has grown significantly as they have invested via Hong Kong stock connect, especially in firms in the technology sector.

Mainland China's tightening grip on Hong Kong and the political ramifications of that cloud the economic outlook for Hong Kong. The security law that entered into force last summer has led to increased arrests of activists and protesters. The UK has offered Hongkongers residence permits and the possibility to apply for British citizenship after six years of residency. The offer extends to all persons who have resided in Hong Kong since 1997, when the area was still part of the British Commonwealth. Other countries such as Australia and Canada have also relaxed their rules in immigration of Hong Kong citizens. By some estimates, as many as a million Hongkongers could move abroad. As a small open economy, Hong Kong's economic prospects depend also on trends in the global economy, and the Chinese economy in particular.

Hong Kong's rebound in real GDP growth remains bumpy.



Sources: Hong Kong Census and Statistics Office, Macrobond and BOFIT.

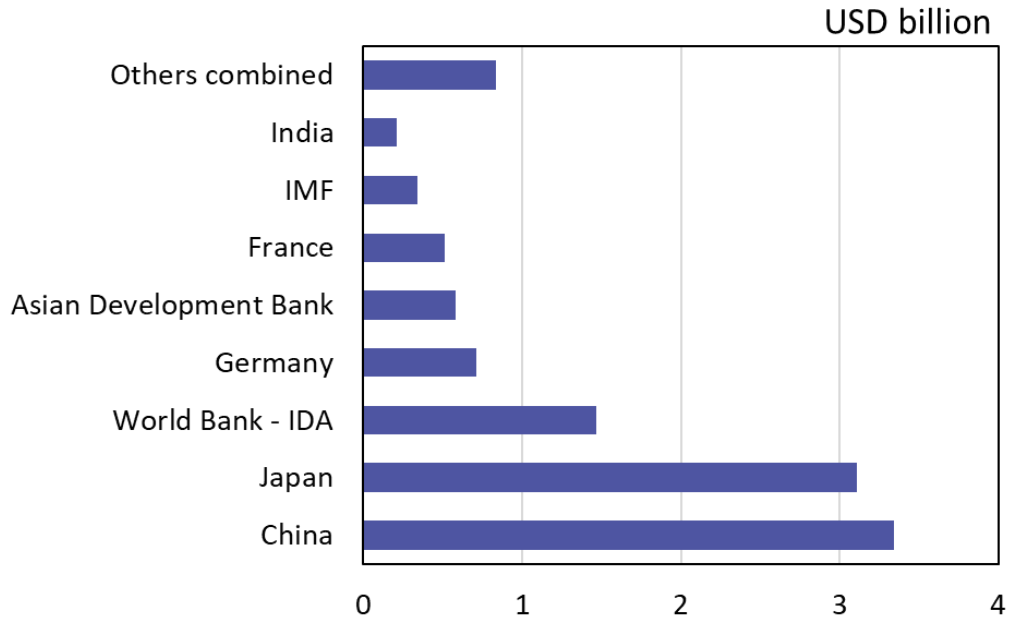
China is Myanmar's most important trading partner. At the beginning of February, China's foreign affairs ministry issued a tepid statement noting the military coup in Myanmar and hoped that the parties reach common understanding within the framework of Myanmar's constitution to maintain stability, and further that the international community should contribute to that stability. China and Russia also blocked approval of a statement from in the UN Security Council condemning the coup. Myanmar's situation deteriorated after the party supporting the military lost big in the November parliamentary election. In contrast, the party of Nobel peace-prize winner Aung San Suu Kyi, the National League for Democracy (NLD), garnered 82 % of the vote. The NLD's platform included a gradual phasing out the military's role in civilian governance in Myanmar.

Myanmar, which lies on China's southern border, is one of the poorest countries in Asia. International economic interest rose significantly when the government's administration changed in a democratic direction a decade ago. China is Myanmar's biggest trading partner, accounting for about a third of goods trade and about a third of Myanmar's foreign debt. As part of the Belt and Road Initiative, China is constructing an economic corridor from the Yunnan province through Myanmar to the country's southwest shores on Indian Ocean. Oil and gas pipelines already run from Myanmar to China. Other infrastructure plans include construction of the Yunnan-Burma railway from Kunming in Yunnan province in China to Myanmar's Kyaukpyu deep-water seaport on Maday Island in the Bay of Bengal. Myanmar's other major foreign investor, Japan, has long had economic cooperation with Myanmar. India this year will open the Sittwe deep-water seaport, which is also located in western Myanmar on the Bay of Bengal.

Construction of an economic corridor between China and Myanmar has been slowed e.g. by the long-running conflict in northern Myanmar between the Burmese military and ethnic rebel groups. From time to time, Burmese refugees have sought to escape the fighting to China. China has publicly tried to play the role of neutral peacemaker, but it has also been accused of supporting certain rebel groups. Myanmar's military, who recently staged a coup to reassume power, have in recent years been wary of Chinese initiatives to increase cooperation between the two countries.



China was Myanmar's largest foreign creditor in 2019.



Sources: World Bank International Debt Statistics and BOFIT.

Russia

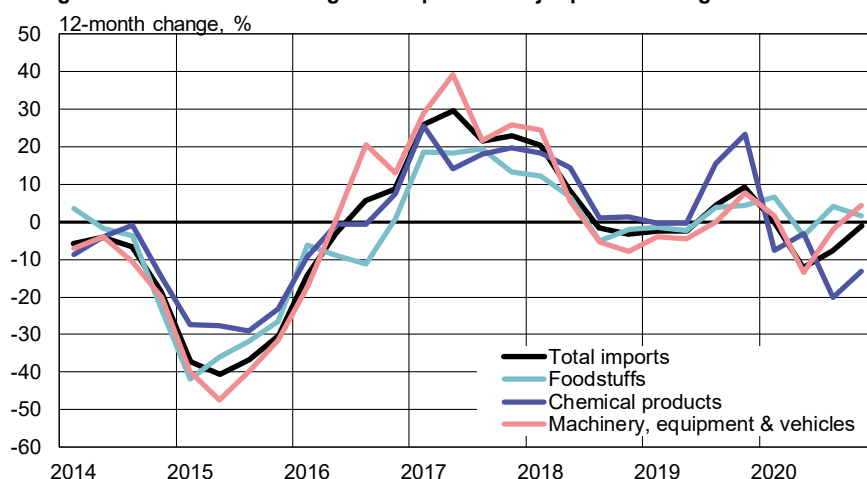
Gold and wheat exports partly compensated for drop in value of Russian oil exports last year. The 21 % contraction in the value of Russian goods exports last year largely reflected the collapse in demand for energy commodities and plummeting oil prices due to the covid-19 pandemic. Crude oil export volumes declined by 13 % last year, while natural gas volumes were down by about 8 %. The total export volume of refined oil products, however, fell by only roughly 1 % as the export volumes of gasoline and diesel fuels increased. Oil & gas accounted for about half of Russian goods exports.

Russian exports got a boost from precious metals and agricultural products, with the share of both category rising to about 10 % of Russian goods exports. Led by gold, the value of precious metal exports doubled. The value of food exports grew by 20 %, driven by robust growth in exports of grains and vegetable oils. Export volumes of wheat rose last year to all-time record level. Russia has even risen as the world's largest wheat exporter. The growth in food exports, however, also caused food prices to increase in Russia, especially late in the year. To subdue the price spike, Russia has imposed export quotas and export duties on certain agricultural exports.

Despite the massive reduction in demand caused by covid and ruble depreciation, the value of Russian goods imports shrank by only 5 % last year. Among the largest import product categories, chemical products saw the deepest decline with a 12 % reduction in import value. The value of pharmaceutical imports fell even by 30 %. In contrast, the value of food imports contracted by just 1 % and that of machinery, equipment & vehicles by 2 %. Import of machinery & equipment recovered especially at the end of last year. The value of electrical equipment imports even increased slightly in full year terms. The import volumes of several food items were also up last year.

The value of Russian goods exports in 2020 amounted to roughly USD 330 billion, and the value of goods imports was USD 240 billion. EU-27 countries accounted for about a third of Russian goods exports and imports. 15 % of exports were destined for China, which accounted for 24 % of Russian imports. Countries in the Eurasian Economic Union accounted for about 10 % of Russia's exports and imports.

Change in the value of Russian goods imports in major product categories in 2014-2020.



Sources: Russian customs, CEIC and BOFIT.

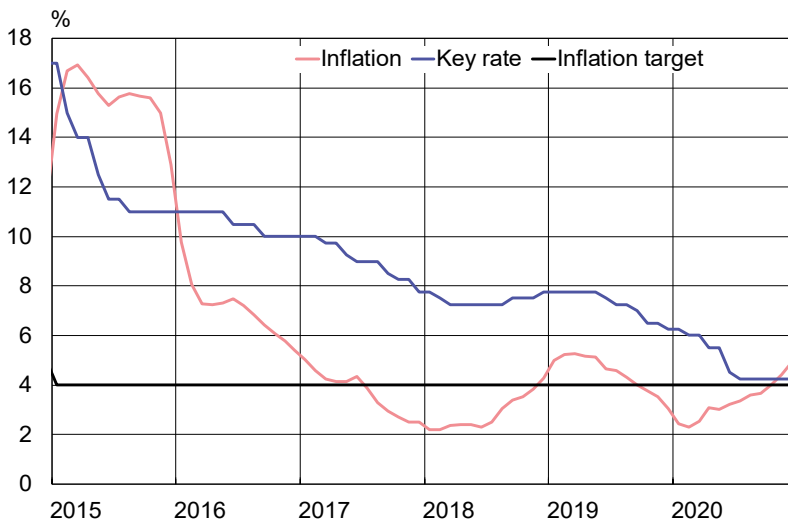
Central Bank of Russia keeps key rate unchanged. On February 12, the CBR decided to keep the key rate unchanged at 4.25 %. The decision was in line with the expectations of market analysts. The CBR's key rate has remained unchanged since July 2020.

Consumer prices rose by 5.2 % in January, slightly faster than the CBR's forecast. Inflation picked up due to such factors as supply-side shocks to the economy from the covid crisis, spikes in certain food prices ([BOFIT Weekly 51/2020](#)) and rising inflation expectations on the part of households and corporations. Prices have also been rising due to the ruble's depreciation since last summer.

The CBR expects inflation to peak this year in February-March. As a result, annual inflation is forecast to reach the range of 3.7–4.2 % (earlier 3.5–4 %) in 2021, after which it should remain close to 4 %. The CBR's inflation target is 4 %.

Under the updated guidance, the CBR will return gradually from the current accommodative stance to neutral monetary policy (key rate in the range of 5–6 %). CBR governor Elvira Nabiullina noted, however, that monetary policy will remain accommodative on average through this year. Although the Russian economy contracted less than forecast last year ([BOFIT Weekly 5/2021](#)), the CBR's growth forecast of the economy remains unchanged. The forecast sees GDP growth of 3–4 % this year, 2.5–3.5 % in 2022 and 2–3 % in 2023.

Russian key rate, annual consumer price inflation and the CBR's inflation target.



Sources: Central Bank of Russia, Rosstat, Macrobond and BOFIT.

Russian government spending in stimulus mode last year. Consolidated budget revenues declined last year by only about 3 % in nominal terms (the consolidated budget comprises federal, regional and municipal budgets, plus the budgets of the state social funds). The drop in revenues was mitigated by last spring's operation to transfer the main ownership stake in giant state bank Sberbank from the CBR to the government, and then return almost all of the resulting CBR surplus on the sale to the state budget. Without the Sberbank operation, government revenues would have fallen by about 6 %. Revenue performance was hit hardest by a fall of oil & gas tax revenues by one third. Other revenue streams increased slightly even without the one-time budget injection from the Sberbank operation. Budget spending was increased by about 14 % to fight the covid crisis and economic downturn. The amount is significant also in real terms as Russia's inflation rate was unusually low around 3.5 % for all of 2020, which meant that there was relatively little erosion of the government's purchasing power.

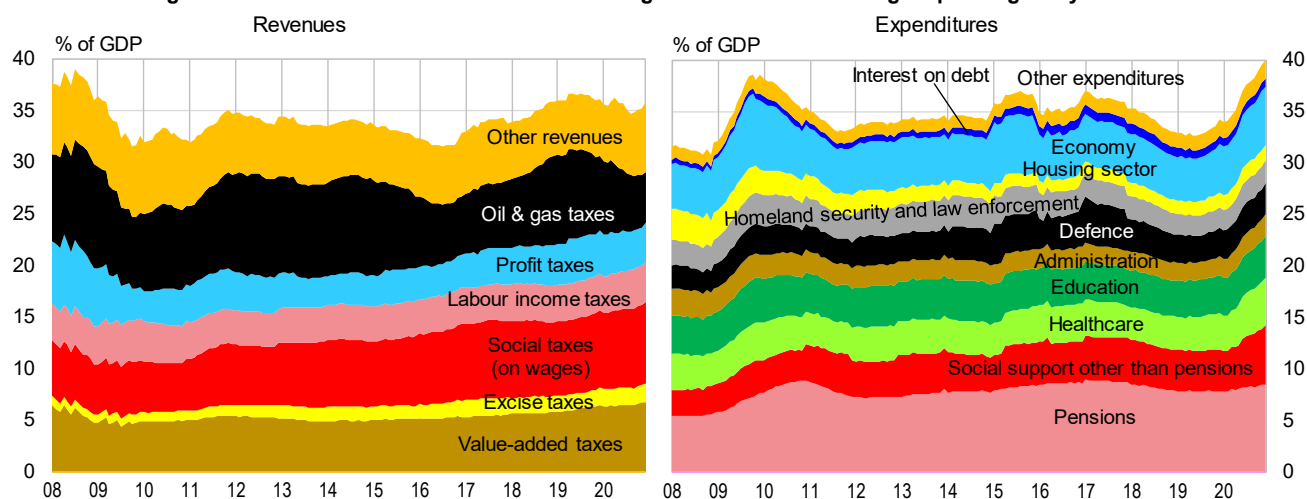
The ratio of revenues to GDP was about 36 %, of which 1 percentage point came from the Sberbank operation. Support and recovery measures boosted the government's expenditure-to-GDP ratio to nearly 40 %, a record level not seen since the spending in recession years of 1998 and 2009. The consolidated budget went from a notable surplus to a deficit of slightly over 4 % of GDP. The deficit was financed largely through borrowing from domestic banks. The government's total debt at the end of 2020 was about 18 % of GDP. The liquid assets of the National Welfare Fund, which is the government's reserve fund, corresponded to about 8 % of GDP.

The budget situation began to improve in the final months of 2020. Consolidated budget revenues exceeded those of a year earlier by several percent. Non-oil revenues in the fourth quarter of 2020 were up by well over one tenth y-o-y, which to some extent may have reflected the ending of forbearance periods on some tax payments. Even if contracting by more than one quarter y-o-y, revenues from oil & gas taxes declined less than in previous quarters. Spending stimulus fell slightly from the summer peak, but spending was still up by one tenth from a year earlier.

A downward effect on non-oil budget revenues came from a fall in revenues from corporate profit taxes. Other revenue streams including labour income taxes, social contributions by employers in conjunction with wage payments, as well as excise taxes and value-added taxes, increased or stayed unchanged from the previous year. Spending rose across the board for all government functions, largely due to supports and measures to deal with covid-19. Spending on social support other than pensions increased by about 40 % with a 2.5-fold increase in family support spending. Healthcare spending rose by

30 % and spending on various sectors of the economy such as telecommunications, transportation and roads grew as a whole by 17 %. Spending on public administration also increased by nearly 10 %. Spending on defence, homeland security and law enforcement, as well as education and pensions, grew by 5–7 %.

The role of oil & gas tax revenues in Russia's consolidated budget has diminished. Budget spending last year hit a record level.



Sources: Russian Ministry of Finance and BOFIT.

IMF's annual Article IV consultation with Russia raised a wide range of economic issues. The expert mission conducting the International Monetary Fund's latest [Article IV Consultation](#) projects the Russian economy to show 3 % GDP recovery this year and even higher growth next year. Central assumptions of the IMF's forecast are that the price of Urals crude oil will average around USD 50 a barrel, that Russia will make good progress in covid vaccination by mid-summer, and that oil exports will recover following the current OPEC+ agreement. The IMF notes that downside risks are likely to dominate in the next few years. These include possible protraction of the covid epidemic and the vaccination effort, possible oversupply on international oil markets, as well as geopolitical tensions with the west. The upside risks for the forecast include the possibility of strong growth of pent-up demand.

Largely due to the drop in fixed investment, the IMF estimates the Russian economy's growth potential has moved slightly down to 1.6 % a year, and actual growth is to slow towards that rate after 2022. The IMF team noted that total factor productivity was already around zero before last year's recession struck.

The IMF commended the central bank for its monetary response to the recession, i.e. a gradual but substantial lowering of the key rate in 2020. It recommended continued easing to avoid the risk that inflation might decline from its current accelerated pace to a level below the CBR's inflation target of 4 % p.a.

As to fiscal policy, the IMF encouraged Russia to keep with the reservation stated by the authorities that there is a need to be ready to re-evaluate plans to reduce the budget deficit if the economy weakens and additional spending support is required. The IMF experts said it would be appropriate to retain the upper and lower limits of unemployment compensation at the increased levels of last spring. Russia should move further to a profit-based oil taxation scheme from the current interim phase which involves subsidising domestic oil refining and fuel consumption. They hoped that this tax manoeuvre could be completed by 2024. The IMF also highlighted the benefits from scaling down tax rebates, which reached 4 % of GDP in 2019.

The IMF recommended that forbearance on balance-sheet valuations granted to the banking sector last spring should not be continued. This, with the phasing out of certain other breaks already earlier, concerns mainly loan quality appraisals and loss provisions on restructured bank loans. The IMF noted that Russia's recession-related losses do not seem to present risks for capital adequacy of systemically important banks. The IMF recommends that Russia refrain from excessively prolonging the housing loan subsidy programme, which, for its part, may be related to recent increases in house prices.

Regarding economic reforms alongside overall issues such as corporate business environment, governance and corruption, the IMF welcomed Russia's ongoing efforts to "guillotine" old regulations governing business operations and replace them with new rules. At the same time, the IMF team noted that the process should not become a substitute to increasing competition. The consultation report commented that the 13 national projects Russia launched in 2018 could



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improve the economic growth possibilities over the longer term as long as they do not increase the government's role in the economy but rather expand opportunities for private enterprises. It emphasized that the project procurement procedures should be fair and transparent.

China

New travel restrictions subdue start of Chinese Lunar New Year celebrations. The Chinese Lunar New Year came this year on February 12. In typical years, hundreds of millions of Chinese travel to their home districts to enjoy the week-long national holiday break. Due to local covid outbreaks, however, officials this year required travellers making the holiday journey to produce a fresh negative covid test and observe a two-week quarantine. Media reports indicate some provinces imposed even harsher travel restrictions.

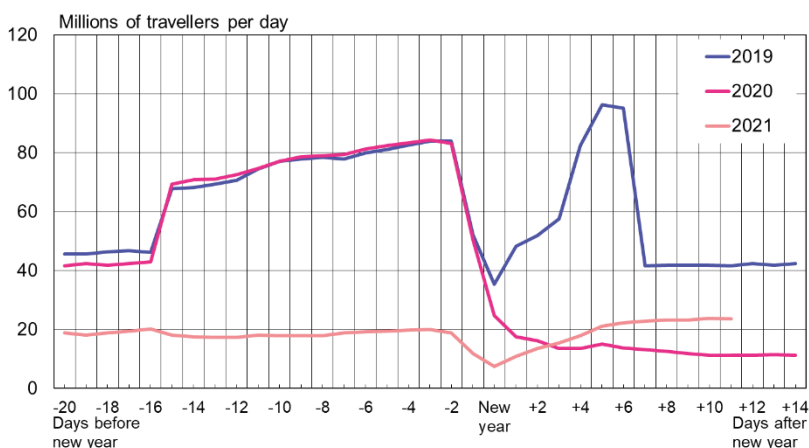
Given the complexities of a holiday getaway, China's transport ministry reports that passenger numbers for common carriers (buses, planes, ferries, trains, etc.) declined to a quarter of the previous two years in the week preceding the New Year's holiday week. In 2020, Chinese holiday-makers managed to make it to their home district only to be stranded as new travel restrictions made return impossible. Passenger numbers nosedived after the Lunar New Year in 2020.

Figures published by the commerce ministry show that retail sales and restaurant sales in the holiday week beginning on February 11, 2021, amounted to 820 billion yuan (just under \$130 billion). Sales were up by nearly 30 % from last year's holiday week, but still off by nearly 20 % from 2019, when sales over 1 trillion yuan were recorded. In its press release, however, the commerce ministry confusingly announced sales were up this year by several percent from 2019. Daily customer traffic at shopping centres in China's ten largest cities was down by 14 % from the 2019 New Year's holiday week.

China's official purchasing manager indices (PMIs) showed that economic activity in both service and manufacturing sectors was down from December in January, even if the PMI number was still over the neutral reading of 50. The official services PMI declined from 55.7 in December to 52.4 in January, while the manufacturing PMI went from 51.9 to 51.3. The alternative Markit PMI readings also declined in January. They were down by over four points for the service sector to 52 points, while the manufacturing PMI moderated to 51.5 points.

Last year's increase in share prices levelled off in early February, with sentiment weakening further after the New Year's holiday week. The CSI 300 Index, which comprises the 300 largest mainland China companies listed on the Shanghai and Shenzhen exchanges, was down 6 % on Wednesday (Feb. 24) from its pre-holiday level. At the same time, the Shenzhen bourse's ChiNext index of growth firms was off by nearly 12 %. The yuan's exchange rate has remained relatively stable since the beginning of January, however. On Thursday (Feb. 25), one US dollar bought 6.46 yuan, and one euro 7.89 yuan.

This Lunar New Year holiday week saw a significant drop in passenger travel by rail, road, air and sea compared to 2019 and 2020.



Sources: China Ministry of Transport, CEIC and BOFIT.

China ranked the world's top FDI recipient in 2020. In a trend running counter to the rest of the world, foreign direct investment flows to China increased last year amidst the global pandemic and flaring trade tensions.

Preliminary figures from the United Nations Conference on Trade and Development (UNCTAD) show that global FDI flows fell by 42 % last year. The biggest drops were in FDI flows to developed nations. The flow of FDI to EU countries declined by

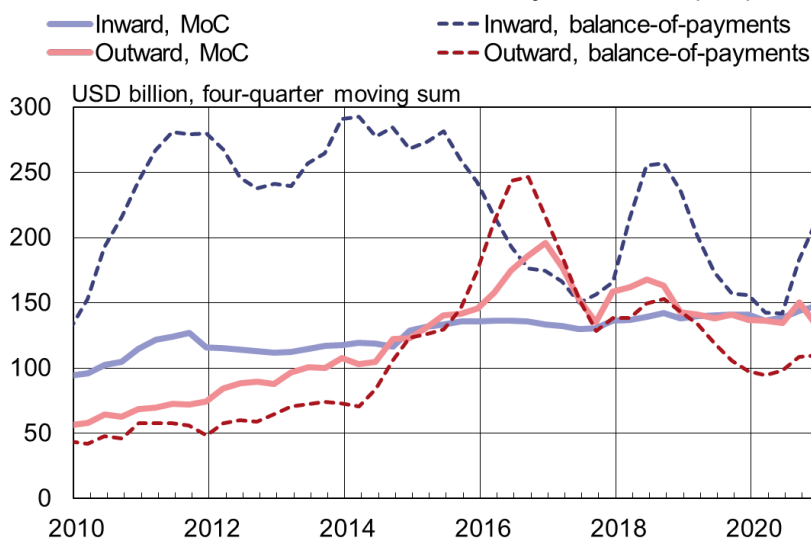
over 70 % (FDI inflows to Europe were even negative in 2020) and FDI flows to the US halved from 2019 to \$134 billion. UNCTAD figures estimate investment flows to China grew by 4 % to \$163 billion, making China the world's top FDI destination. FDI flows to India also increased last year, while investments in Russia almost completely dried up. Global FDI flows are expected to diminish further this year.

China's commerce ministry reports that in 2020, FDI inflows to China rose by nearly 5 % y-o-y. The figures still do not include investments in the financial sector that will be published later. In recent years, financial FDI has represented about 2 % of China's total FDI inflows. Total FDI, including financial sector investments, can be estimated to be roughly around \$147 billion. The FDI financial account figures in the balance of payments indicate significantly larger fluctuation and larger FDI inflows to China than the commerce ministry figures. The balance-of-payments figures show that FDI inflows to China grew by nearly 40 % last year. Balance-of-payments figures include e.g. reinvested earnings that are not included in the commerce ministry reporting.

Commerce ministry figures show that China's outward FDI contracted by few percent last year to \$133 billion. In the balance-of-payments reporting the outflow of direct investment increased. In contrast, however, figures that track individual Chinese investments abroad show a considerable drop last year. The [China Global Investment Tracker database](#), which is maintained by the American Enterprise Institute and the Heritage Foundation, seeks to record all foreign direct investments in excess of \$100 million made by Chinese companies. The data show that such investments fell by 66 % to only \$31 billion last year.

Despite rising investment flows, China's total FDI stock is relatively small compared to the size of its economy. In 2019, less than 5 % of the global FDI stock was in China and China's share of global outward FDI was 6 %.

FDI flows to and from China based on the official Ministry of Commerce (MoC) and PBoC balance-of-payments reporting.



* Commerce ministry inward FDI volume in 4Q2020 is an estimate based on FDI trends not yet including the financial sector.

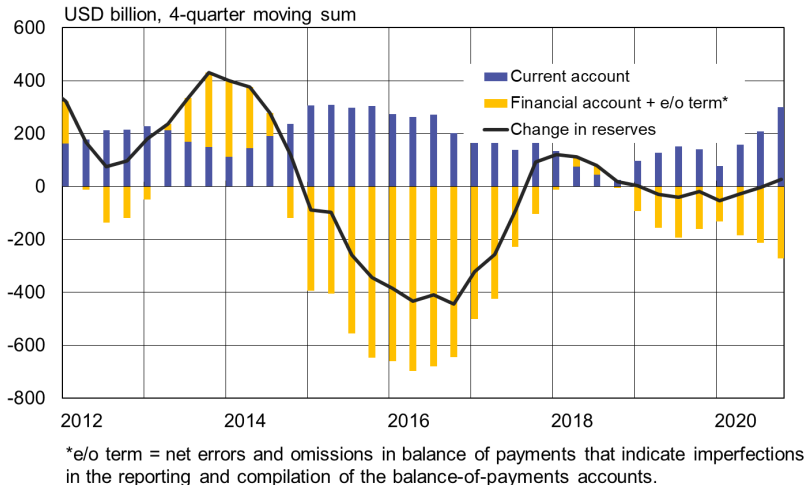
Sources: China Ministry of Commerce, SAFE, CEIC and BOFIT.

China's current account surplus last year increased to about 2 % of GDP. Preliminary balance-of-payments figures show that China's 2020 current account surplus was about \$300 billion, which corresponds to roughly 2 % of GDP. The 2019 current account surplus was \$140 billion, or about 1 % of GDP. The increase in last year's surplus reflects both a larger goods trade surplus and a reduction in the services trade deficit.

Driven by strong exports, which grew significantly faster than imports in the second half of 2020, the goods trade surplus rose to \$535 billion, a 25 % increase from 2019. The services trade deficit contracted to \$145 billion, or about half of recent years. A massive drop in Chinese tourism abroad was the biggest factor in reducing the services trade deficit as it caused services import numbers to plunge.

Even with solid growth in the current account surplus, China's foreign currency reserves increased by just \$28 billion. Significantly more capital was transferred abroad than in 2019. Detailed financial account figures will be released later, when also the current account figures are revised. Taking into account valuation changes, the value of China's foreign currency reserves at the end of December 2020 reached nearly \$3.4 trillion (includes gold, SDRs and IMF allocated reserves). China's forex reserves have remained relatively stable over the past four years.

China's current account surplus rose in 2020 to \$300 billion, while capital outflows also increased.



Sources: Macrobond and BOFIT.

Given the overall outlook for China, provincial GDP growth targets look rather modest. GDP growth slowed last year significantly from 2019, but stayed positive in all but one province. Hubei province, home to the initial Wuhan coronavirus cluster, suffered a massive output drop in the first quarter of 2020. Even if its economy began to recover in late spring and summer, provincial GDP still contracted by 5 % last year.

The largest growth gains in 2020 were posted by provinces and regions in Central and Western China. These administrative areas are generally less developed than the national average. Tibet, which has so far almost completely avoided covid, leads the growth figures. The Tibetan economy is supported by massive public investment ([BOFIT Weekly 2020/46](#)). Tibet's contribution to Chinese GDP, however, is vanishingly small. The powerhouse provinces drove national growth down last year. Regional figures are inconsistent with national GDP accounting, and the figures provinces report are often uncertain and subject to revision. Local officials are rewarded on growth performance, which can create an incentive to exaggerate growth figures.

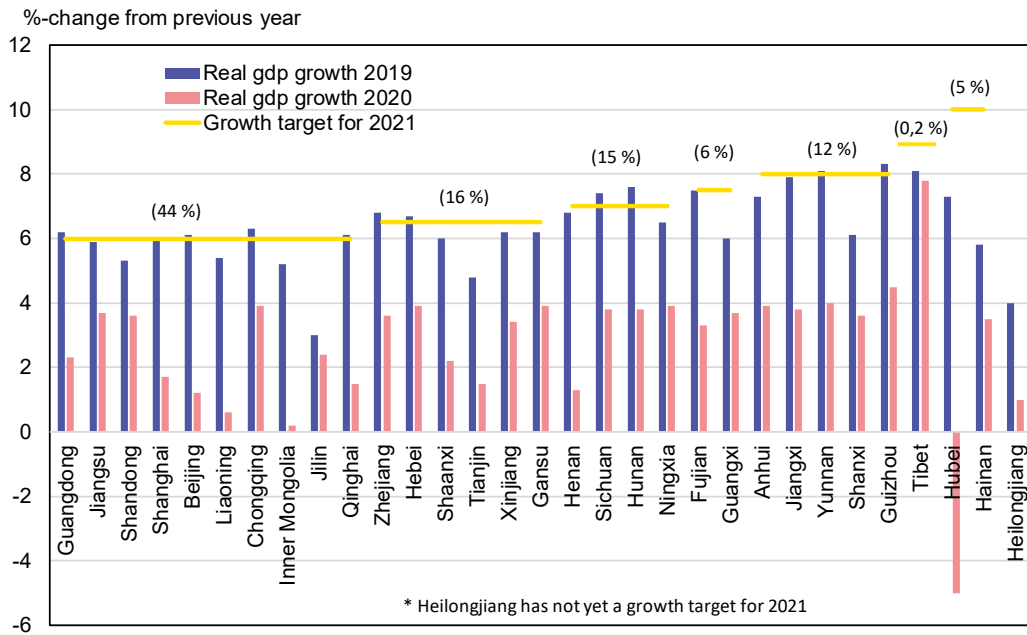
Official figures show China's GDP grew by 2 % last year. Although China has not declared an official GDP growth target for 2021, nearly all provinces have done so – in good time ahead of the annual National People's Congress next month. Many provinces have set cautious growth targets as the covid pandemic continues cause risks for China and the rest of the world. The weighted average of provincial growth targets (6.7 %) is modest given the last year's exceptionally low growth figures. The OECD, IMF and other forecasts of China's national GDP growth have generally been higher, around 8 %.

A number of economically largest provinces, including those with highest GDP per capita such as Guangdong, Jiangsu and Shandong, have declared 6 % growth targets. These export-driven industrial provinces weathered the covid crisis quite well and are thus expected to see more moderate recoveries. Shanghai and Beijing cities also have 6 % targets. As in many large cities, the covid epidemic and lockdowns have hurt service business and tourism hardest and the prevailing uncertainty continues to cloud the outlook.

The highest GDP growth targets (10 %) have been set for Hubei, which is still recovering from its covid shock, and Hainan Island in the South China Sea. Hainan's local administration has high hopes for growth fuelled by economic reforms. In January, restrictions on foreign investment were loosened in Hainan. There is also a plan for creating an internationally significant Hainan free trade port.

Regional differences are large in China. For example, the northeastern provinces of Heilongjiang and Jilin have GDP-per-capita numbers that are just over half of the national average and just a quarter of that of the Beijing and Shanghai. Covid has exacerbated regional differences in many ways, including increasing the indebtedness of firms and governments in poor provinces. The remittances of internal migrant workers from big cities and towns to their home districts, which are often an important income source for local economies, dried up last year as many migrant workers found themselves unemployed.

Real GDP growth of Chinese provinces in 2019 and 2020, as well as 2021 growth targets.



Source: BOFIT, CEIC and Macrobond.

Russia

Fixed investment in Russia recovered in late 2020. Following a decline last spring, fixed investment was down by about 5 % y-o-y in real terms in both the second and third quarters. It recovered in the fourth quarter, rising by over 1 % y-o-y. As fixed investment recovered and last year's second-quarter drop was more modest upon revision, the overall dip last year amounted to only about one-and-a-half percent. This is a significantly smaller fall than shown in the fixed capital formation number of -6 % as included in GDP accounting. The difference is due to statistical differences in calculation of the two indicators (e.g. coverage of datasets).

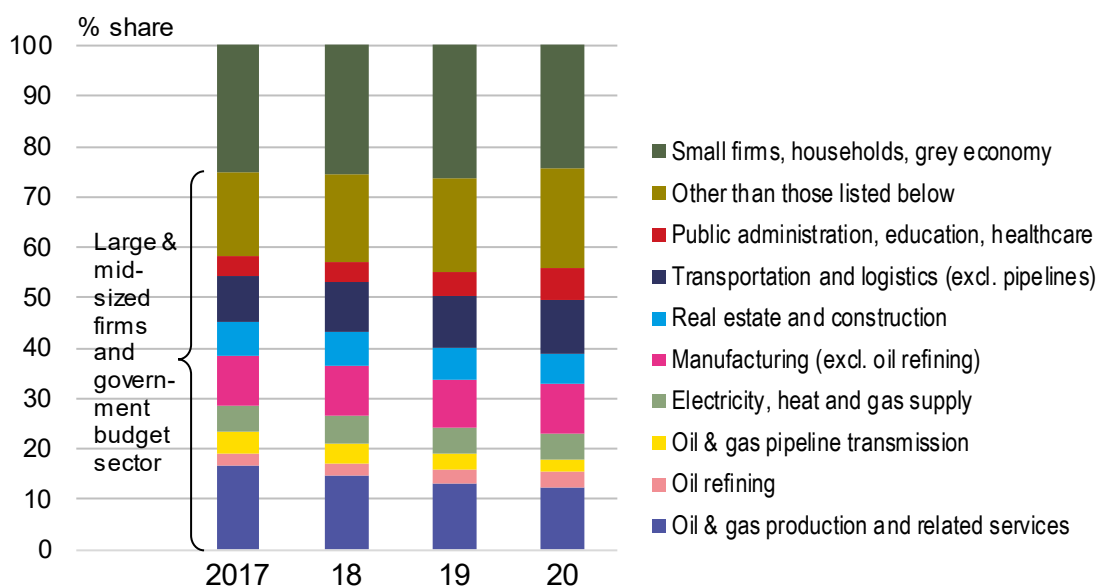
Fixed investment of large and mid-sized firms and the government sector fell by just 1 % last year. Government sector investment rose significantly as part of measures to counter the economic recession. Rosstat estimates that other fixed investment (i.e. small firms, households and grey economy) contracted last year by just over 2 %.

At this stage, Rosstat's annual data on the structure of fixed investment only covers the large and mid-sized firms and the government sector. These together account for about three-quarters of total fixed investment. The overall number for their decline was significantly affected by the reduction in investment in pipeline transmission of the oil & gas industry, which was down by a third last year after already having fallen sharply in 2019. On the other hand, investment in production of oil & gas increased by 2 %, having already experienced strong growth in 2019. Investment in oil-&gas-production-related services continued to decline. Investment in oil refining, which took off fast in 2019, rose at a 14 % y-o-y pace last year.

Investment in manufacturing (excluding petroleum products) fell another 2 % y-o-y after a drop in 2019. The biggest declines in fixed investment were seen in the metal products branch, as well as the machinery, equipment & vehicles branches. Fixed investment in metal manufacturing and pharmaceuticals rose strongly.

The impulse into the economy last year from increased government sector spending was also reflected in a rapid rise of investment in the healthcare field and public administration. These spending efforts essentially lowered the overall contraction in fixed investment. Investment from government sector budgets rose to about 15 % of total fixed investment.

The structure of fixed investment in Russia has evolved over recent years



Sources: Rosstat and BOFIT.

Russian oil production and exports contracted sharply last year. Russian crude oil production (including gas condensates) last year fell to 512 million metric tons (about 10.3 million barrels a day), a 9 % decline from the 2019 record level. It was the first decrease in Russian oil production since 2008.

The production drop largely reflects Russia's participation in last spring's agreement among the OPEC+ countries on new production ceilings. The agreement was finalised after it was clear that the covid-19 pandemic had caused a sharp drop in global oil demand and a collapse of oil prices on world markets. In combination with the recovery in oil demand, the OPEC+ agreement has supported oil prices. This has allowed participating countries to increase their production gradually under the agreement framework since last autumn. Yesterday the OPEC+ -countries decided to apply the production ceilings of March also in April. Russia and Kazakhstan are, however, allowed to slightly increase their production due to seasonal consumption patterns.

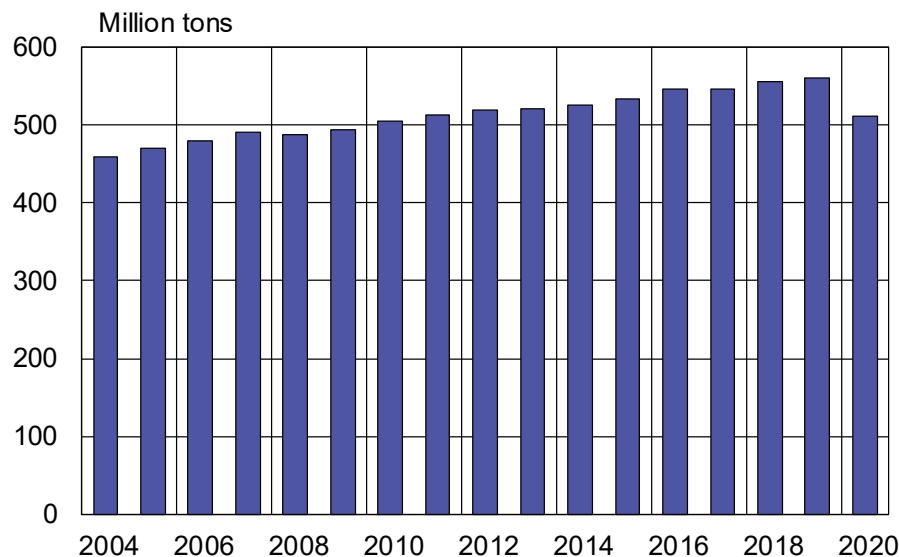
The current production-cut agreement extends to the first months of 2022, and thus will restrict Russian oil production throughout this year. OPEC's market outlook published last month forecasted that oil production in Russia will contract by 2 % in 2021. Russia's economy ministry expects that oil production could recover rather quickly once the restrictions are lifted and that the country could return to pre-crisis production levels in 2023.

Over the longer term, maintaining production at current levels is expected to require massive investment to bring new oil fields on stream. These fields are often located in areas with more demanding production conditions that drive up production costs. The economic crisis caused by the covid pandemic has limited corporate financing possibilities for investment. In addition, Western economic sanctions imposed on Russia restrict the access of targeted Russian oil companies to international financial markets and critical technology.

About half of Russian crude oil production goes directly to exports and some additional production in the form of refined petroleum products. Russia last year exported about 240 million tons of crude oil (roughly 4.8 million barrels a day), a drop of 11 % from 2019. Oil exports are expected to return gradually to growth as global demand recovers. About half of Russian crude oil exports still go to EU countries. The EU's share of exports, however, has contracted significantly as the allocation to Chinese market has increased. China accounted for 28 % of Russian oil exported in 2019.

Alongside Saudi Arabia and the United States, Russia has long been a top producer and exporter of crude oil. In recent years, Russia has accounted for 13–14 % of global oil production and exports.

Russian crude oil production last year saw its first decline since 2008



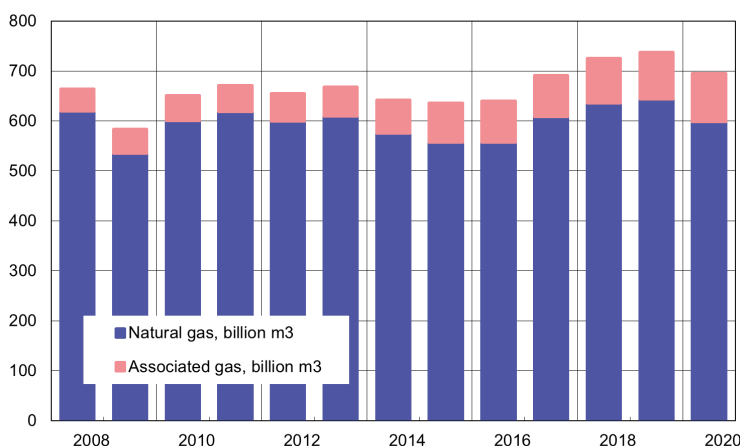
Sources: Rosstat, CEIC and BOFIT.

Production and exports of natural gas declined last year. The global economic recession caused by the covid-19 pandemic and last year's warm winter caused demand for natural gas in Russia's main export markets, particularly the EU, to decline. Traditional pipeline gas exports contracted by about 20 billion cubic metres from 2019, and total gas exports in 2020 were not quite 200 billion m³. The lack of demand caused gas prices to fall considerably in Europe, with the value of Russia's gas exports contracting by 40 % from 2019. The contraction in export demand also caused production of natural gas to decline. Russia last year produced 600 billion m³ of natural gas, a drop of 7 % y-o-y. Production of associated gas (typically off gases from production that contain other hydrocarbons such as ethane, and in contrast to dry gas, which is mostly methane) remained at 96 billion m³, unchanged from the previous year.

In contrast, production of liquefied natural gas (LNG) increased slightly last year, exceeding 30 million tons (about 42 billion m³). Russia's two main LNG production sites (on the Yamal Peninsula on the Arctic Ocean and Sakhalin Island on the Pacific Ocean) currently operate at full capacity. Thus, any significant production increase will require construction of additional LNG production facilities. Virtually all LNG production is exported (up 4.5 % y-o-y in 2020). Russia last year experienced a downside of the LNG market, when reduced demand caused LNG prices to fall, reducing the value of LNG exports by about 15 %.

Despite a decline, exports of pipeline gas reached a significant milestone in 2020 with the inauguration of Russia's first gas export pipeline to Asia. The Power of Siberia pipeline enables Russian gas exports to China. Although less than 5 billion m³ passed through that pipeline last year, exports are expected to rise gradually as production in Eastern Siberia will ramp up. Exports via Power of Siberia should eventually reach close to 35 billion m³ a year. Most Russian gas exports (traditional pipeline gas and LNG) will still go to the EU market.

Russian natural gas production was down last year



Sources: Rosstat and BOFIT.

Finnish trade with Russia collapsed last year. Preliminary figures from Statistics Finland suggest that the value of Finnish exports of goods and services to Russia contracted by about 20 % last year to around 3.5 billion euros. The declines were led by exports of services, which fell by over 40 %. Restrictions on cross-border travel imposed in both Finland and Russia to deal with the covid pandemic froze Russian tourism to Finland and dragged down the services exports. Russia accounted for about 4 % of Finnish exports, making Russia Finland's seventh-largest export market. The value of goods and services imported to Finland from Russia declined by 36 % to about 6 billion euro. Russia accounted for 7 % of Finland's total imports and was Finland's fourth largest import market. Both exports and imports fell to around their lowest levels in two decades.

The more detailed breakdown of goods trade from Finnish Customs, which is based on a slightly different methodology, shows that the value of goods exported from Finland to Russia contracted by 21 % last year. The drop in exports reflected the fall in Russian demand and ruble depreciation from the covid pandemic and collapse in oil prices. In addition, 2019 was an unusual basis year as export figures were coloured by exceptional gas pipeline deliveries. Steel pipe sections for the Nord Stream 2 project were coated in Finland, which meant they were first recorded as imports to Finland from Russia and later as exports from Finland to Russia. If this gas pipeline activity is removed from the numbers, goods exports contracted by about 11 % last year. Exports fell in all major goods categories. The largest contraction (22 % y-o-y) was seen in the value of exports of machinery & equipment.

Customs statistics show that the value of goods imported to Finland from Russia contracted by 35 % last year. While most of this reflects the fall in oil prices, the volume of oil imports also decreased. Oil & gas account for about 60 % of Finland's goods imports from Russia. The value of other significant imported goods such as wood and paper as well as various metals increased slightly last year.

Finland's trade in goods and services with Russia fell sharply last year



Sources: Statistics Finland, Bank of Finland and BOFIT.

China

China’s National People’s Congress sets economic policy course. The fourth session of 13th National People’s Congress (NPC), which ran from March 5 to 11, brought together nearly 3,000 parliamentary members. The NPC is China’s highest decision-making body, but its sole function in practice is to rubber-stamp proposals brought before it such as government initiatives, policy targets, budgets, as well as approve five-year plans and persons selected for top leadership posts.

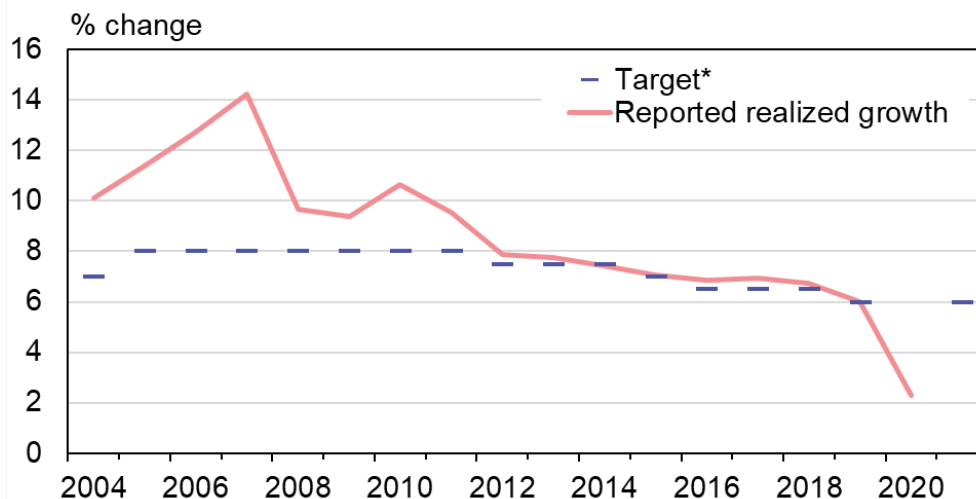
The NPC embraced a real GDP growth target for this year of “above 6 %.” Given that the 2020 basis for comparison is so low, the target is modest. Most international forecasters expect the Chinese GDP growth to substantially exceed the announced growth target. Thus, the emphasis of economic policies this year can be on making progress in structural reforms rather than accelerating economic growth. Other targets for this year include keeping the yuan’s exchange rate and the overall debt-to-GDP ratio stable, as well as cutting energy used per unit of GDP by 3 %. Consumer prices are expected to rise at about 3 %.

The emphasis of economic policy included the usual themes of maintaining stability, improving quality of life and continuing with the opening up of China’s economy to the world. The push for excellence in high technology fields continues with increased government funding for research & development and incentives for corporate innovation through allowing firms to deduct a larger share of R&D expenditures from their taxes. An increased amount of investment will be directed at development of China’s digital infrastructure such as building out the national 5G network. The “negative” list banning or restricting access of foreign firms to certain branches will be shortened. Branches mentioned include those involved with high technology, environmental protection and improving energy efficiency.

Efforts to help small businesses also will continue. For example, the covid crisis support granted to small firms last year through tax breaks and forbearance on loan servicing was extended. The income tax burden on small firms was also cut. Once again China’s large state banks were urged to increase their lending to small businesses.

The NPC approved also sweeping reforms of Hong Kong’s electoral system that significantly increase Beijing’s ability to influence election outcomes. For example, candidates must first be vetted to ensure only “patriots” are allowed on the ballot.

In earlier years, China regularly exceeded its official real GDP growth targets



*) The 2014 goal was “about 7.5 %”, “close to 7 %” in 2015, 6.5–7.0 % in 2016, “around 6.5 %” in 2017 and 2018 and in the range of 6–6.5 % in 2019. The target for 2021 is “above 6 %.”

Sources: China National Bureau of Statistics, CEIC and BOFIT.

NPC elects to restrain growth in budget spending this year. The National People’s Congress took up last year’s realised budget and approved this year’s proposed budget. According to the finance ministry’s budget report for 2020, budget

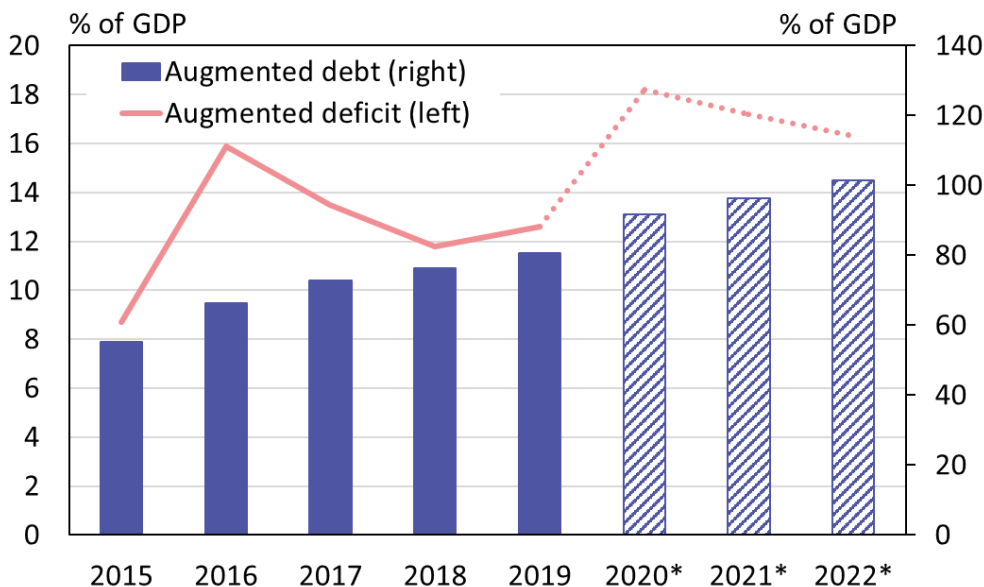
revenues to the central and local governments fell by about 4 % y-o-y to 18.3 trillion yuan (18 % of GDP). At the same time, expenditures rose by 3 % to 24.6 trillion yuan (24 % of GDP). This resulted in a budget deficit of 6.3 trillion yuan, or just over 6 % of GDP. Over a third of the deficit was covered with state and local government savings funds and other assets, so the official deficit as announced was just 3.7 % of GDP.

In its projection for 2021, the finance ministry said that financial policy would continue to support the recovery of the economy. Budget spending, however, is expected to rise by less than 2 %, which, if realised, would be the smallest increase in over 30 years. The rise would even be lower than the announced inflation target. The finance ministry said it wants to make spending more effective and hopes to focus spending more precisely this year. Budget revenues are expected to grow this year by 8 %, so the public sector deficit should shrink.

The finance ministry is concerned about public finances, particularly increased pressure to boost government spending. Under the approved policy framework, more funding will need to be targeted at branches such as technology development, emissions reduction, education & training, quality of life improvement, national security and debt servicing. The challenge of balancing China's public sector finances is daunting given the relatively low growth of public revenues. In addition, there is less to draw on from the covid-depleted state reserve funds. The inadequacy of assets in the Social Security Fund will grow more acute with the ageing population and pension hikes. Moreover, the ministry points out that the state of public finances varies greatly from province to province. Some regions have pronounced deficits and crushing debt burdens, while some local governments have continued to pile up unallowed "hidden" debt.

China's reporting on public finances does not conform to Western accounting practices and the budgets taken up by the NPC do not cover all public sector spending or revenues. There is a considerable amount of off-budget activity, which include the issuance of "special purpose" bonds by local governments. This year, 3.65 trillion yuan in such bonds will be issued, which is only slightly less than last year's 3.75 trillion yuan. The annual IMF broad assessment of China public sector finances takes into account off-budget activities and other factors normally included in budgets. The IMF calculates that China's public sector "augmented" deficit has exceeded 10 % of GDP over the past five years, and that last year the deficit rose to over 18 % of GDP. The IMF puts China's government debt at 92 % of GDP as of end 2020.

IMF estimates and 2021–2022 forecasts of China's public sector deficit and government debt



Sources: IMF and BOFIT.

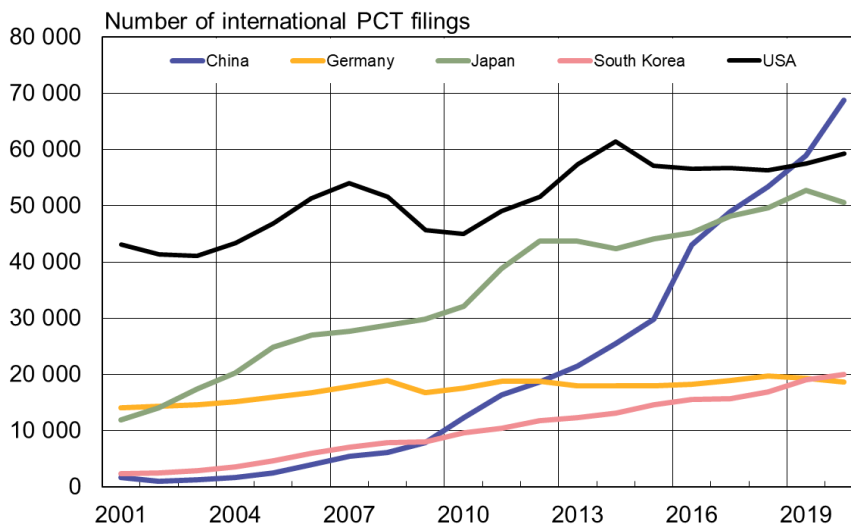
A quarter of all international patent filings last year were made in China. The World International Property Organization (WIPO) estimates that last year there were a total of 275,900 international patent filings under the international Patent Cooperation Treaty (PCT), a 4 % increase from 2019. China led the pack in patent applications (25 % of all filings).

The next biggest filing numbers were in the United States (22 %), Japan (18 %), South Korea (7 %) and Germany (7 %). The number of patent applications in China increased by 16 % y-o-y, a significantly larger increase than for any of the other major patent-filing nations. Patent filings fell by 4 % in Germany and Japan.

When patent filings are adjusted for population size, China is still a relatively minor player. Last year, there were just 48 patents filed per million population in China, while the comparable figures were 179 for the US, 223 for Germany, and 390 for both Japan and South Korea. 1,670 PCT patents were filed in Finland, which corresponds to about 300 per million population. Other large emerging economies come nowhere close to China's numbers. In India, the number of international patent filings were down by 6 % from 2019 to about 1,900 applications. That translates to just one filing per million population. The number of patent filings in Russia also fell 9 % y-o-y to 1,100 patents (7 patents per million population). A total of 700 patents (3 applications per million population) were filed in Brazil, an 8 % increase from 2019.

Looking at filings of firms, the leader was Chinese telecom giant Huawei, which saw its patent numbers rebound to the 2018 level of about 5,500 applications. In 2019, Huawei filed about 1,000 fewer patents than in the previous year. The next most active patent-filers were the South Korean Samsung (3,100), the Japanese Mitsubishi (2,800) and the South Korean LG Electronics (2,800). Of the 50 most active patent-seeking firms, 15 were Japanese, 13 Chinese, 12 American and 7 European. European filers were led by the Swedish giant Ericsson (2,000 patents, rank 6th), the German Bosch (1,400 patents, rank 13th). The Finnish Nokia was the fifth largest European filer (600 patents, rank 39th).

The number of Chinese patent filings has surged in recent years.



Sources: WIPO and BOFIT.

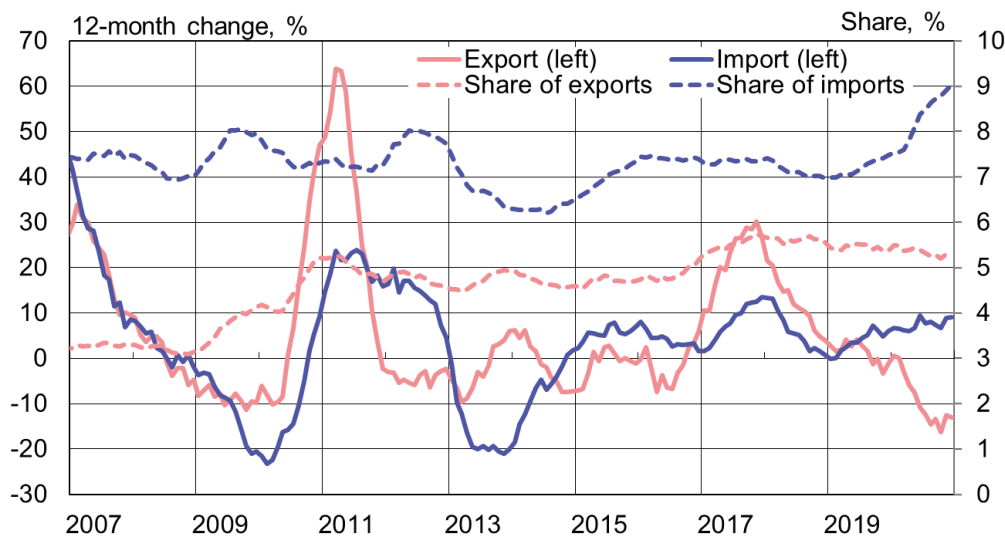
While Finland's imports overall were down sharply last year, imports from China grew by 9 %. The value of goods exports from Finland to China last year was just 3 billion euros, a 13 % decrease from 2019. Finland's exports to China contracted slightly more than exports overall (down by 12 %). Imports from China increased by 9 % to 5.4 billion euros, even as Finland's total imports contracted by nearly 10 %. China's share of Finland's exports remained at just over 5 %, but its share of imports increased by a couple of percentage points to 9 %.

A quarter of Finnish goods exports to China consisted of wood pulp and over 7 % other wood and paper products. The value of forest product exports declined sharply from a year earlier. Machinery & equipment saw its share of exports increase last year by one percentage point to 33 %. The share of foodstuffs nearly doubled to 5 %. The value of meat product exports grew by over 100 % and dairy products by 56 % from 2019. The largest declines were registered in exports of hides and pelts (down by 56 %), as well as exports of iron and steel (down by 48 %). Both categories only represent about 2 % of Finnish exports.

Over half of China's imports last year belonged again to the machinery, equipment & vehicles category. The value of such imports increased by 10 % in 2020. Due to the covid pandemic, Finland's imports from China rose on higher imports of electronics devices and equipment needed to facilitate work, study and entertainment at home. Massive demand for facemasks and other PPE appears in Finland's import figures under "other manufactured textile products," a category that saw its value quadruple last year from 2019. The category's share of total imports grew from 1 % to 5 %. In contrast, imports of clothing (10 % share) remained at the same level as in 2019, while imports of footwear (2 % share) fell by 13 %. The value of imports of pharmaceutical products rose by 114 % y-o-y, but their share of total imports was still miniscule (0.3 %).

Preliminary figures from Statistics Finland show that Finland's services exports to China fell to 1.5 billion euros last year, a 20 % drop from a year earlier. Finland's services exports overall fell by roughly the same amount. Tourism in 2019 accounted for about 10 % of Finland's total services exports. Last year they fell to about 4 %, a decline in export value of 65 %. Services imports from China fell by 10 % last year to just under 1 billion euros. Finland's services trade surplus with China remained at 530 million euros, even if the total services exports balance showed a deficit of 1.9 billion euros.

Finland's goods exports to China contracted last year.



Sources: Finnish Customs and BOFIT.

Russia

BOFIT Forecast 2021–2023 for Russia sees recovery amid exceptionally large risks. Our latest [Forecast for Russia](#) sees Russian GDP recovering from last year’s 3 % dip by growing nearly 3 % p.a. in 2021 and 2022. While the covid-19 pandemic is expected to ease when we enter next year, market expectations foresee oil prices turning into a gradual slide from the rise of recent months and going well below \$60 a barrel in 2023. The global economy should show good growth. Next year Russia’s growth pace should pick up a bit with the return of oil output along with the expiration of the OPEC+ agreement on production ceilings. Following last year’s hike in government budget spending, the government plans to cut spending slightly in real terms this year and next to reduce the budget deficit. Economic growth will slow after 2022, gradually approaching Russia’s long-term growth prospects. Reforms such as shifts in official practices in a scale that would substantially improve Russia’s economic growth are not presumed.

The recovery in consumption will move ahead with consumption returning in 2023 to levels on par with those of 2014 and 2019. Recoveries proceed in employment and household incomes. General increases in government sector wages are expected to follow the pattern of the last few years in that they will stay at the level of inflation. Instead, pensions will rise about 2 % faster than inflation under an earlier government decision. Consumption will get extra to its turn when households spend their assets set aside during the recession to satisfy pent-up demand, and as travelling abroad unfolds properly.

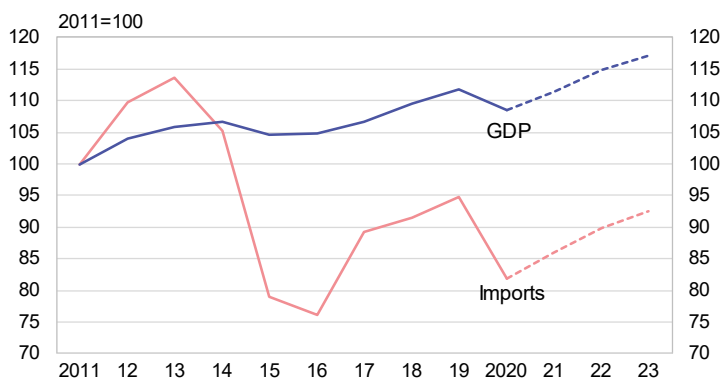
The recovery in fixed investment plods ahead. Growth may be rather subdued as there is no pressing need to increase fixed investment anytime soon because capacity utilisation since early last spring has been at its lowest level in a decade. A major survey found that an increasingly large share of businesses sees factors limiting fixed investment such as economic uncertainty and investment risks. The long-term growth prospect of the Russian economy has been reduced somewhat by the fact that fixed investment since 2014 has been considerably lower than in the years 2012–2014.

The expected rise in the total volume of exports will be limited this year by uncertainties over Russian energy exports and the recovery of tourism. Exports next year will get support from the expiration of the OPEC+ agreement. At the same time, energy branch estimates suggest that exports of petroleum products will remain stable and natural gas exports will see a rather moderate increase, weighing on expectations of total export growth.

Russian imports overall are expected to recover partly this year, but the timing of the return of Russian tourism will affect considerably the pace of overall import recovery. The recovery in imports is supported by current higher oil prices and thus higher export earnings for Russia. On the other hand, the pace of recovery could be moderate as the ruble’s real exchange rate is expected to remain low due to Russia’s reasonable inflation and the gradual slide in oil prices. Imports will remain substantially lower than in 2011–2014.

Beyond the essential risk of a prolonged covid pandemic, our forecast identifies several other significant upside and downside risks. The recovery of economies around the world could be weaker than expected. A substantial drop in oil prices would press Russia’s private and public sectors, as well as import demand. The pace at which oil & gas production returns will significantly affect the pace of GDP recovery. Private consumption and imports, especially Russian spending while on travel abroad, could rather quickly swing with a lifting of travel restrictions and a release of pent-up household demand and assets built up during the covid crisis. The government could rapidly relax its current strict spending policies if needed.

While Russian GDP will grow, the recovery in imports probably takes long



Sources: Rosstat and BOFIT.

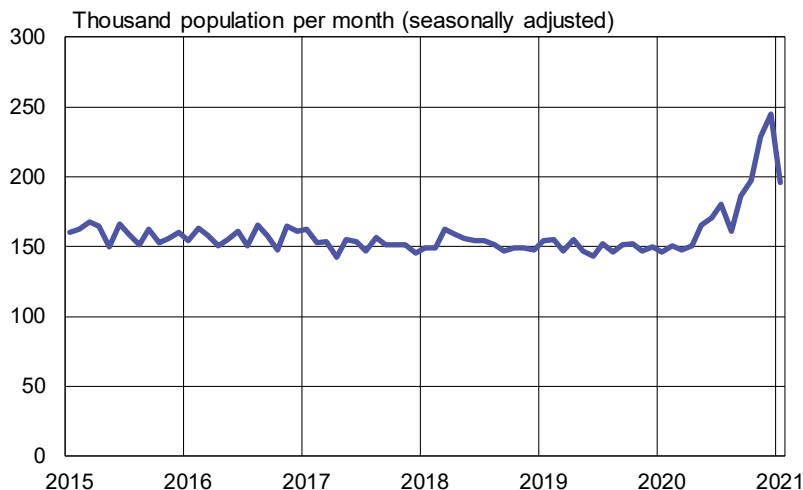
Russia records huge mortality increase in 2020. At the end of 2020, the Russian population was about 143.8 million people (does not include the population of the illegally annexed Crimean peninsula). The Russian population declined by 0.4 %, a slightly faster drop than in previous years. Most of the decrease in the Russian population reflects the large increase in mortality partly due to the covid-19 pandemic and the ongoing drop in the Russian birth rate. While net migration was positive, it was down significantly from previous years.

Roughly 2.1 million people died last year in Russia. Mortality grew by 320,000, an increase of 18 % y-o-y, which is a far greater increase than at any time in the past two decades. Excess mortality saw its sharpest increase in North Caucasus regions, particularly Chechnya (mortality up 45 %). Death rates also climbed strongly in Western Siberia in Russia's top oil & gas-producing Yamalo-Nenets and Khanty-Mansi autonomous areas (nearly 30 %), as well as in Moscow and St. Petersburg (23 %). The growth in mortality in Eastern Siberia and the Far East Federal District was more modest than elsewhere in Russia. Official figures released by Russia's health ministry show that covid-19 to date has caused the deaths of about 93,000 people in Russia.

About 1.4 million babies were born in Russia last year. The birth rate fell by 3 %, or slightly less than in previous years. Russia's goal, however, has been to increase the birth rate in order to mitigate the coming contraction in the labour force. In 2019, Russia began to increase the retirement age gradually. This should increase the size of the working-age population slightly in next years. Over longer run, however, the number of working-age persons is expected to return to decline. Raising the pension age eases the pressure of pension spending on state finances, but its impact on increasing the size of labour force could be limited. In recent years, about 30 % of pensioners under the age of 73 were still working. Moreover, pensioners may not be particularly well suited to jobs that need filling.

Immigrants, particularly labourers from Central Asia, have long contributed to making up gaps in the Russian workforce. Due to the covid pandemic, however, many migrant workers lost their jobs last spring and returned to their home countries. Even with the improvement in the labour market, they have not returned to Russia due to travel restrictions imposed to control the spread of covid. The number of immigrants to Russia declined last year, while the number of emigrants from Russia increased. The net migration flow was still positive, but it was less nearly 200,000 persons or 60 % smaller than in the previous year. The reduction in the influx of migrant workers has even caused labour shortages in certain branches and regions.

Russia saw a sharp rise in mortality last year



Sources: CEIC, Rosstat and BOFIT.

Russia expands price monitoring significantly; food prices under pressure to rise. A government regulation will extend price monitoring widely by including a monitoring list of goods and services that constitute about three-quarters of the goods and services contained in the official average consumption basket of goods and services used to measure changes in consumer prices. The monitoring list includes almost all foods, as well as alcohol, gasoline and diesel oil, textiles, clothing and footwear, furniture, household chemical products, household electronics, and construction materials. It also contains a broad range of services such as communications, passenger transport, housing sector, health care, education and cultural activities. The main responsibility of price monitoring rests with the economy ministry with essential support from Rosstat

and the Federal Antimonopoly Service. Categories of goods and services subject to regulation are shared across nine ministries and two government agencies. Each responsible body needs to assess the causes of rapid price increases or an emerging risk of a rapid price rise. When such issues are detected, the officials are tasked with proposing regulatory measures “to balance the market”.

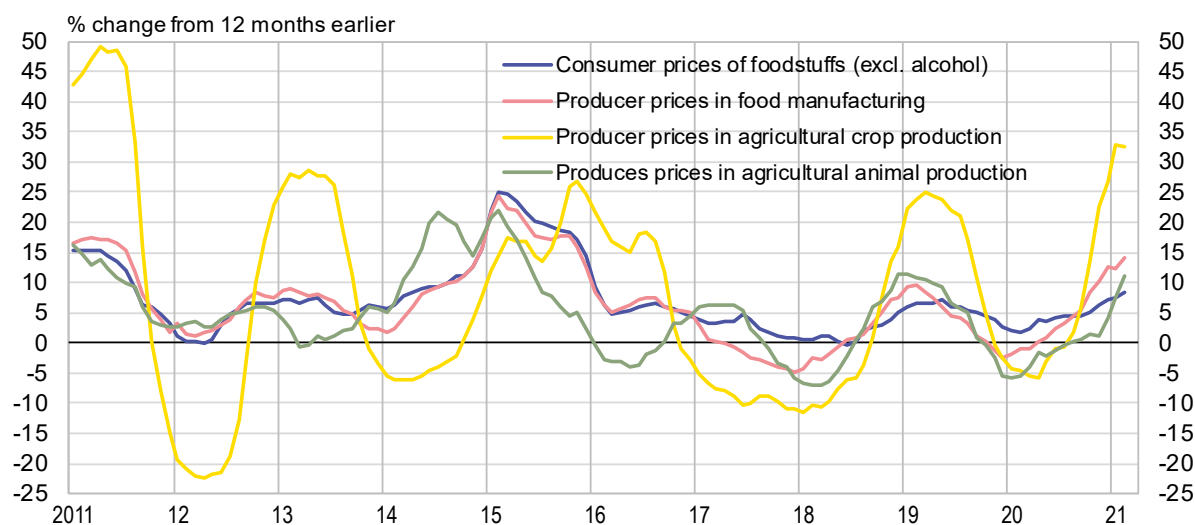
The law was amended this winter to lower regional price ceiling on products of social significance that could trigger government price restrictions. Agreements involving producers, sellers and ministries on limiting price increases of certain foodstuffs and agricultural products were signed last year. The move also included the introduction of a few export quotas and export tariffs that remain in force until 30 June ([BOFIT Weekly 2020/51](#)). These measures will be complemented on 1 June, when a moving export tariff on wheat is launched to offset the difference between the export price and the domestic price.

With price controls focused on certain food items (e.g. sugar and sunflower oil), the rise in those consumer prices came to a halt in recent months. The seasonally adjusted rise in consumer food prices overall has slowed slightly this year. The acceleration in the rise in the second half of 2020 was due mainly to increased world prices for farm crops, a drop in the ruble’s exchange rate and poor domestic harvests of certain crops. The rise in prices has been quite rapid. Food prices in February were up by 7.7 % y-o-y (8.4 % without alcohol). This includes an on-year increase in prices of fruits and vegetables of 16–17 % and a 6.5 % rise in prices of other food items. Foodstuffs represent a third of the products in the consumer price basket of goods (not including alcohol).

Pressures on consumer food prices appear. Food industry producer prices, which have risen at an accelerated pace since last autumn, were up over 14 % y-o-y in February. The rise in agricultural producer prices calmed in January, but after soaring last autumn they were up by nearly 20 % y-o-y in February. The on-year increase in the crop farming category in the first two months of this year was as high as 32–33 %.

According to a study by the central bank of Russia, price restrictions have created different measures for managing their business in firms operating in branches covered by the restrictions as well as related branches, i.e. agriculture, industry, wholesale and retail, and exports. Some companies have refrained from raising prices, while some wholesalers have passed along some of the price pressures on to retailers. Uncertainty has increased in estimates and planning. Some farmers plan to increase or decrease the area of land under cultivation for particular crops. Harvest assessments have risen or fallen, depending on perceived changes in incentives. Some industrial firms see a need to lower production. Some farmers are considering shifts to growing other crops, while some industrial firms are looking at increasing reliance on imported raw materials. Besides planned government support for firms from the federal budget, the situation is varied regarding support from regional and local budgets. The survey concludes that assessments of business conditions have weakened and producers refer to risks for reduced profitability and weaker incentives.

Food prices in Russia have increased



Sources: Rosstat and BOFIT.

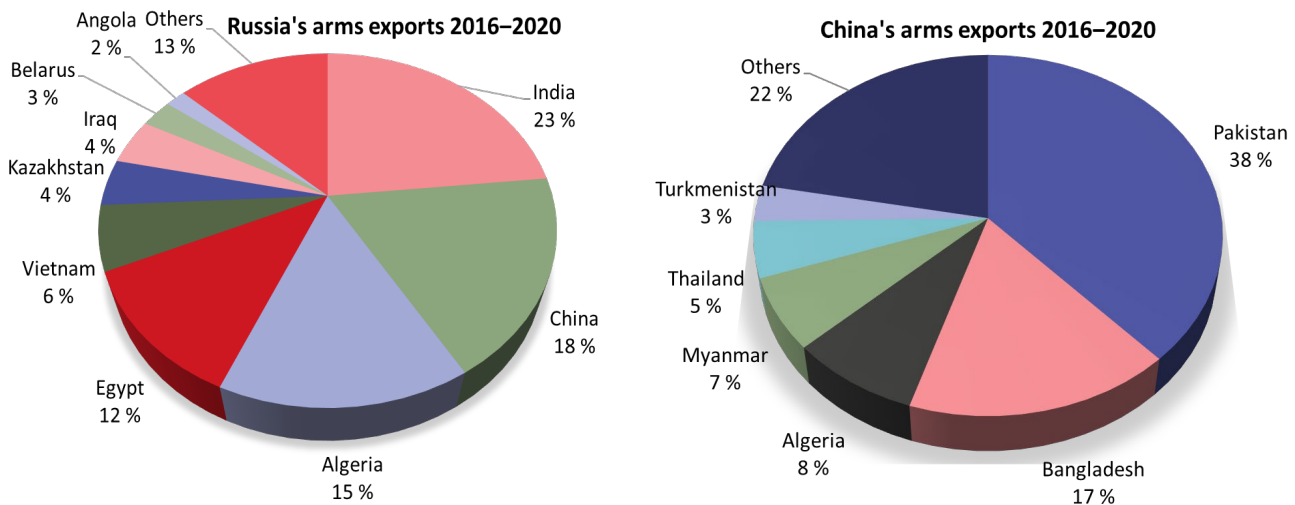
Russian and Chinese arms exports decline. The recent update of the Stockholm International Peace Research Institute's [SIPRI Arms Transfers Database](#) shows that the volume of the international arms traded during the latest five-year assessment period (2016–2020) was largely unchanged from the previous 2011–2015 period. SIPRI averages arms trade volumes of over several years as annual variations can be huge. The global arms trade appears to have peaked around 2016–2017 and then dropped significantly thereafter.

The arms export trends for some countries, however, defy the general trend. The covid-19 pandemic has also depressed the arms exports of several of the largest arms producers. For example, [an article posted on the Russian RBC website](#) found that Russian arms exports apparently declined last year by about 11 % to \$11.5 billion. China's arms exports have declined for several years. Compared to SIPRI's previous five-year assessment period, the United States, France and Germany all increased their exports during 2016–2020. In combination, these following countries accounted for about three-quarters of global arms exports in the past five years: US (37 %), Russia (20 %), France (8 %), Germany (6 %) and China (5 %).

The growth in arms imports was fastest in the Middle East, where arms imports grew by 25 % during 2016–2020. The biggest arms importer in the period was Saudi Arabia with 13 % of imports. India, which accounted for 10 % of global arms imports, saw its imports decrease by a third during the latest assessment period. This had knock-on effects not just for Russian arms exports, but the US as well.

Russia's top customers for arms exports during 2016–2020 were India (23 % of exports), China (18 %), Algeria (15 %), Egypt (12 %) and Vietnam (6 %). These countries are also traditionally Russia's biggest arms customers. Chinese arms exports focused as always on other countries in Asia. During 2016–2020, China's top customers were Pakistan (38 % of Chinese arms exports), Bangladesh (17 %), Algeria (8 %) and Myanmar (7 %).

Russia had a wider geographic distribution of arms exports in 2016–2020 than China (% of total arms exports).



Sources: SIPRI and BOFIT.

China

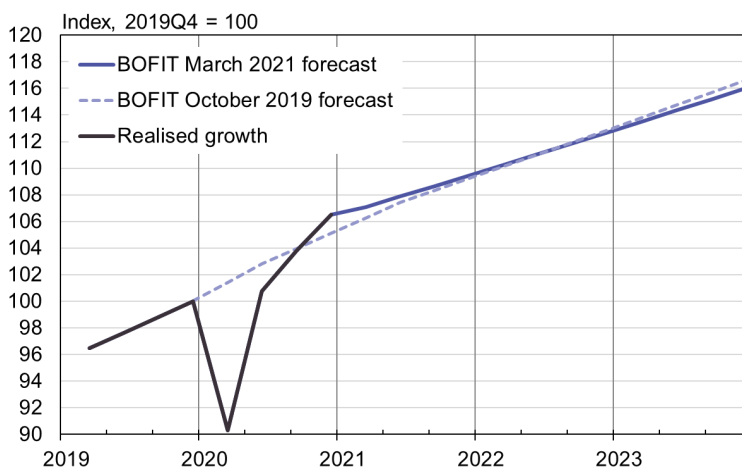
Latest BOFIT forecast for China sees economic growth slowing in coming years after strong performance this year. Our most recent [forecast for China](#) predicts that the Chinese economy will grow rapidly this year at around 8 % p.a., a pace in line with major international forecasters. The high growth figure reflects last year's low basis of comparison and a rapid recovery in the second half of last year. The rapid growth above the government's official "over 6 %" target would leave an opportunity to pull back on stimulus measures. However, only mild fiscal tightening is expected this year and the rapid dive into off-budget indebtedness by local governments is expected to continue. Public finances have eroded rapidly and growth of public sector debt is likely to remain high. The government has limited room to tighten monetary policy as the growth in indebtedness has rapidly increased the debt-servicing costs of firms even at current interest rates.

During the out years of our forecast, 2022 and 2023, we expect quarterly growth to roughly match this year's pace, meaning on-year growth will slow substantially to around 3 %, or closer to China's long-term potential growth. We see that China could allow more modest growth levels without it having significant impacts on e.g. employment. This would allow the government to concentrate on policies to rebalance the economy and implement reforms that reinforce growth over the long run. There is, however, a risk that economic policy will remain obsessed with hitting high GDP growth target figures. This would exacerbate economic imbalances and heighten financial sector risks.

Lower growth should be expected for China as most of the slowdown reflects structural factors such as the shrinking working-age population. Moreover, the government has put off many reforms needed to improve productivity. The new five-year plan calls instead for increased self-sufficiency and an even greater role for the government in guiding economic development. Domestic consumption will not necessarily serve as the hoped-for engine of economic growth. China's failure to implement supportive reforms hinders the growth of private consumption. As a result, China's household savings rate remains high even as the rate of household indebtedness soars. Savings and indebtedness fall differently on each household, leading to ever greater wealth disparities.

Dealing with the covid-19 crisis has increased economic imbalances in ways that will depress future growth. China's debt-to-GDP ratio is estimated to have risen last year by nearly 30 percentage points to close to 290 % of GDP. The impacts of the covid crisis on the economic condition of companies remains partly unclear. The forbearance programmes that allowed firms to postpone their loan repayments have been extended to this year. Deteriorating foreign relations also create risk to the Chinese economy. The US is not expected to ease up on its current China policies. The current technology export bans and withdrawal of US financing from certain Chinese firms will have concrete impacts on their operations. In the coming months, the Chinese government will likely seek to keep the political environment and financial markets stable while celebrations ramp up for the 100-year anniversary of the Communist Party of China in July.

Level of real GDP in the BOFIT forecast



Sources: China National Bureau of Statistics, CEIC and BOFIT.



China's new five-year plan emphasises industrial development and self-sufficiency. The National People's Congress convened this March to approve China's 14th five-year plan (2021–2025), as well as set out policy directions through 2035. Although many of the latest plan's policy themes are familiar, there has been a distinct change in emphasis to reflect increased competition among the great powers.

Over the next five years, China's policy priority is to bolster development of its high-technology sector and increase the nation's self-sufficiency. Spending on research & development will rise by 7 % a year. There will also be an effort to focus support on select strategic fields that typically relate also to national security. Fields mentioned include quantum information science, artificial intelligence, microchips and biomedical science. China's long-discussed, but slowly proceeded structural reforms towards an economy driven by services and consumption have been moved to the back burner in the latest five-year plan. Over the short-run, China will return its focus to industry with the goal of keeping industrial output growth at least on par with growth of the service sector.

Unlike previous five-year plans, China did not set a five-year GDP growth target, even if the country is unwilling to give up on the GDP growth target per se. Instead of abandoning targets, the five-year plan calls for setting GDP growth targets each year. President Xi Jinping stated at late last autumn that a doubling of Chinese GDP between 2020 and 2035 was "entirely possible." In practice, this statement is seen as anchoring annual growth targets for the next 15 years.

President Xi announced last autumn that China will seek to be carbon neutral by 2060 and the target was expected materialize in the new five-year plan as more ambitious pollution limitation efforts than seen before. However, it appears that few major changes from previous trends have been included. Like in previous plan, the new plan calls only for a gradual reduction in the ratios of emissions to GDP and energy consumption to GDP from current levels. The plan also sets a target for increasing the area of forested land.

The issue of raising the retirement age is also discussed in the plan. While raising the retirement age has been under consideration for many years, it has been hard to push forward with this change. China indisputably needs to raise its retirement age as the current pension age is just 50 or 55 for women and 60 for men. Moreover, the average Chinese life expectancy has risen to 77 years, the population structure is aging rapidly and the working-age population (15–64 year-olds) is dwindling. Many Chinese choose to continue working after reaching retirement age, of course, as pensions are generally quite meagre. In addition, retired grandmothers often assume a large share of responsibility in caring for grandchildren so the parents can go to work. For this reason, the plan sees also improvements in day care and preschool programmes. Raising the pension age would also slow the growth of government pension spending.

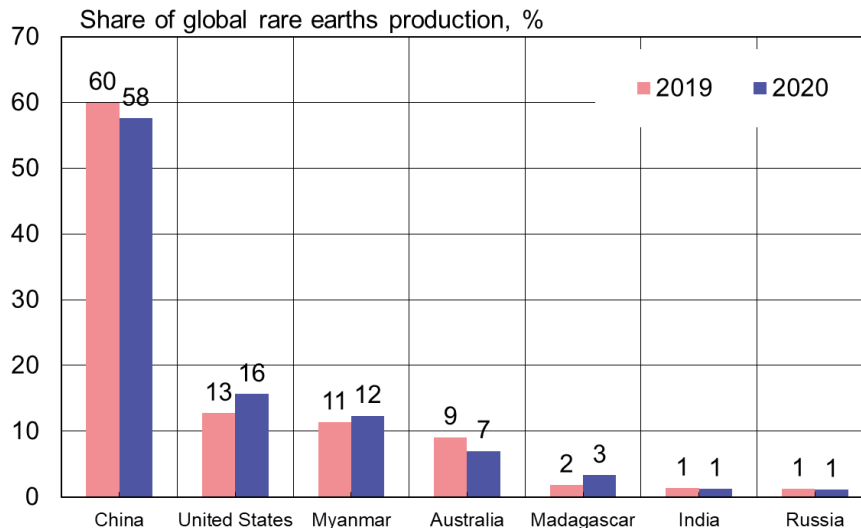
Bumpy first high-level meeting between China and Biden administration officials. US secretary of state Anthony Blinken and national security adviser Jake Sullivan met with China's foreign minister Wang Yi and China's top-ranking diplomat Yang Jiechi in Anchorage, Alaska on March 18 and 19. It was the first high-level meeting of the two countries since Joe Biden took office. The first day of the meeting kicked off with both sides hurling criticism at each other. Things calmed on the second day, and both parties left the meeting claiming that the talks had been productive.

In the meeting, the parties found shared interests in finding solutions to global issues such as climate change, as well as dealing with third-country issues such as Afghanistan, Iran and North Korea. The biggest points of contention related to China's human rights violations in Xinjiang, the ever-tightening grip on Hong Kong and new pressure on Taiwan. The meeting adjourned, as expected, without the issuance of a joint communiqué or announcement of major decisions.

The increased tariffs imposed during the trade war and the phase one US-China trade agreement in February 2020 are still in force on both sides. Moreover, the Biden administration has reiterated its commitment to doing everything it can to protect American companies and jobs. The [US-China Phase One Tracker](#) maintained by the Peterson Institute for International Economics (PIIE) shows that last year less than 60 % of the increases in Chinese imports agreed to under phase one had been implemented.

In response to US actions against China, China has again threatened to curb its production of rare earth metals and limit exports. Certain rare earths are essential to the American defence industry, including the manufacture of fighter jets. Rare earth metals are also used extensively in the car industry and production of 21st century technologies. China accounted for nearly 60 % of global rare earths production in 2020. The US, with 16 % of global production, was the second-largest producer. This share was up several percentage points from 2019 as the United States managed to boost its domestic output by over 35 % in just a year. With rising domestic production, imports fell by over 30 % from the previous year to \$110 million. China still provides about 80 % of US rare earth metal imports.

Most global production of rare earth metals still takes place in China.



Sources: US Geological Survey and BOFIT.

The EU, US, UK and Canada all impose sanctions on Chinese officials for Xinjiang human rights violations.

On Monday (Mar. 22), the European Union imposed its first sanctions on China for human rights violations in Xinjiang province. The sanctions list includes four Xinjiang officials as well as the general security agency for Xinjiang's production and construction corps. In addition to travel bans, assets of those on the sanctions list have been frozen. The united front also includes the United Kingdom, United States and Canada, which all have imposed their own sanctions for the repression and mass detentions of the Uighur minority. Australia and New Zealand published a joint statement on Monday praising the EU, US, UK and Canada for the measures.

China quickly hit back with counter-sanctions. On Monday (Mar. 22), China released its own [sanctions list](#) naming 10 individuals (including members of the European Parliament, scholars and diplomats) as well as EU Parliament's subcommittee on human rights, the European Council's political and security committee, the Mercator Institute in Germany and the Alliance of Democracies Foundation in Denmark. Those on the list are banned from travel to mainland China, Hong Kong and Macao, and not allowed to take contact with persons in China. European Parliament president David Sassoli quickly responded, noting that China's imposition of retaliatory sanctions will have their own consequences. It seems clear that the finalisation of the investment agreement between the EU and China will now be at least protracted.

The sanctions against China are the first imposed by the EU and UK in over 30 years, when arms exports to China were banned in the wake of the 1989 Tiananmen Square protests. The US imposed its first sanctions for human rights violations in Xinjiang last July. In 2020, the US imposed further sanctions on a number of Chinese officials for the crackdown on Hong Kong democracy.

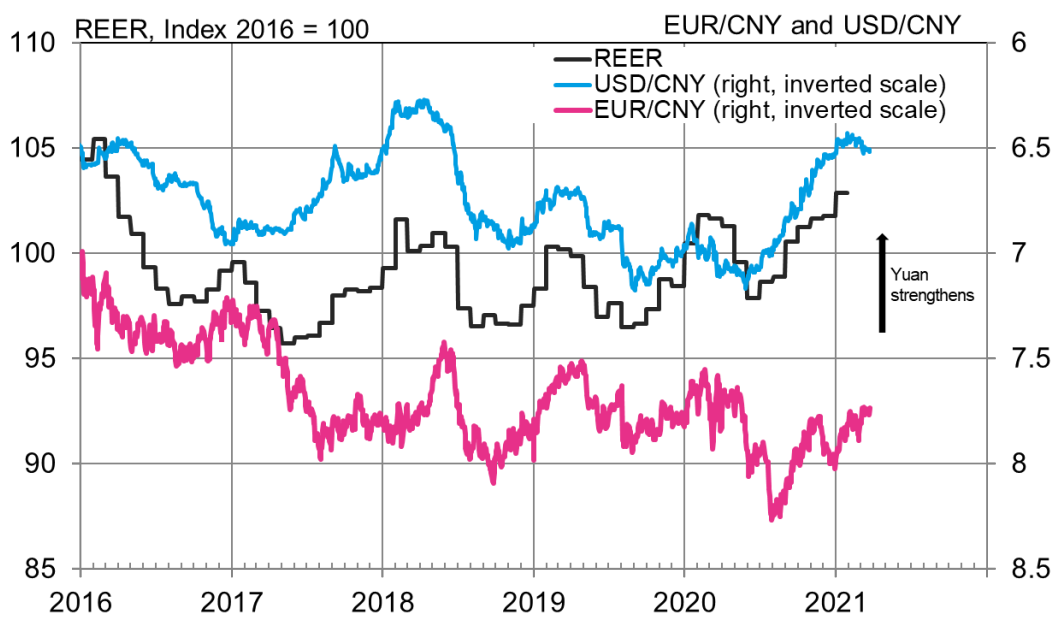
New initiatives to ease capital controls in China. China's central bank, the People's Bank of China, and the State Administration of Foreign Exchange (SAFE) announced in mid-March the launch of a pilot programme to relax capital controls on ten large firms. The easing allows these firms to e.g. convert foreign currency freely within a set quota and integrates corporations' yuan and forex cash pools which were previously required to be kept separate. The selected firms operate either in Beijing or Shenzhen, and include the oil major Shell as well as several of China's large state-owned enterprises.

In February, SAFE announced that it was looking into the possibility of also deregulating household security investments abroad. At the moment, such investment is strictly regulated. SAFE is considering a measure that would allow Chinese persons to use \$50,000 of their annual forex purchasing quota to buy foreign securities. In addition, it seems that the opening of

“southbound” trading under the Bond Connect arrangement is moving forward. The programme would give Chinese investors the possibility of investing in bonds traded in Hong Kong. China’s stock of portfolio investment is currently similar in size to that of Sweden’s, which is very small given the size of the Chinese economy.

The deregulation measures are important steps towards opening the capital account. Most of deregulation efforts in recent years have focused on capital flows into China, but the new measures mainly apply to outward capital flows from China. The current deregulation effort has been helped by the yuan’s appreciation since last summer and expectations that the yuan will continue to strengthen against other major currencies.

The yuan has appreciated against the US dollar and the euro over the past year. The yuan’s real effective exchange rate (REER) has also strengthened.



Sources: People’s Bank of China, BIS, Reuters and BOFIT.

Russia

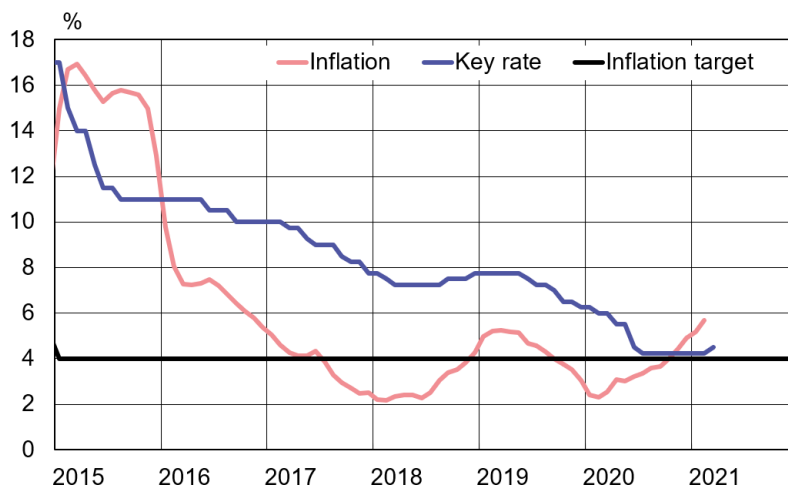
CBR raises key rate to 4.5 %. On March 19, the Board of Directors of the Central Bank of Russia decided at their monthly inflation meeting to raise the key rate by 0.25 percentage points to 4.5 %. Market analysts had generally been expecting the CBR to leave its main policy rate unchanged. The key rate was last increased in December 2018.

The CBR board commented that the decision reflected the recent burst of inflation. Russian consumer prices rose by 5.2 % y-o-y in January and 5.7 % in February. Although Russian producer prices fell considerably last year, they rose sharply in the first two months of this year, increasing by 7.2 % in January and 9.8 % in February.

Recent drivers of higher inflation include supply disruptions in the economy due to the covid crisis and rising food prices ([BOFIT Weekly 11/2021](#)). The CBR also points to a more rapid than expected recovery in domestic demand and that the inflation expectations of both households and businesses continue to be elevated.

CBR governor Elvira Nabiullina said that the central bank is at the beginning a gradual shift from an accommodating monetary stance to a more neutral one with a key rate in the range of 5–6 %. In accordance with the new guidance, a further hike in the key rate is possible at the CBR's next inflation meeting. The CBR expects to hit its inflation target, i.e. a rise in consumer prices of around 4 % a year, by the first half of 2022.

With Russian consumer price inflation again climbing, the CBR decided to raise the key rate



Sources: Central Bank of Russia, Rosstat, Macrobond and BOFIT.

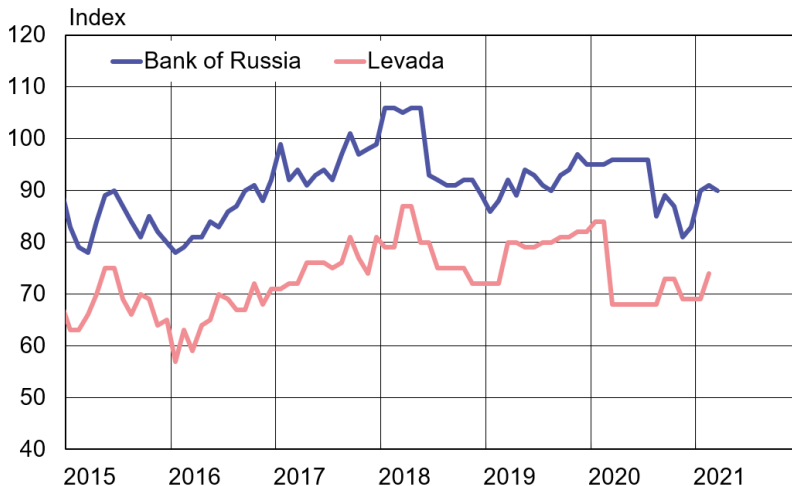
Russia has enjoyed relatively stable economic conditions during the first two months of this year. Several Russian economic indicators for January and February suggest that production and consumption were largely unchanged from the end of 2020, even if Russia is still struggling with the fallout from the covid epidemic. Indeed, the percentage changes are usually negative when compared to the beginning of 2020. For example, the economy ministry's monthly GDP indicator contracted in February by 2.5 % from February 2020.

Industrial output volume contracted by 1.9 % y-o-y in January and 3.7 % in February. Output continued to decline especially in the mineral extraction industries, largely due to output ceilings imposed under the OPEC+ agreement. Manufacturing output shrank by 1.3 % y-o-y in January-February, but when the output indicator is seasonally adjusted, it reveals that most of covid dip has already passed. The volume of construction in January-February was at the same level as in the same period the previous year. Construction has suffered surprisingly little from the impacts of the covid epidemic, due in part at least to the fact that very little of construction activity has been shut down at any time during the pandemic.

Retail sales fell by 0.7 % y-o-y in January-February. For the retail sector, the current view is that most of the impacts from the covid crisis have also already passed. Demand is returning as unemployment declines and real wages again rise. The February unemployment rate was 5.7 %, down from a peak of 6.4 % last August. In addition, bank lending to households continues to soar. Lending in both January and February was up 15.4 % y-o-y. The increase slightly exceeds the already blistering growth pace of 15.3 % maintained last year.

The improving economic situation is also reflected in surveys of consumer confidence, which are up sharply from just a few months ago. Consumer confidence, however, is still lower than it was prior to the covid crisis. In March manufacturing purchasing managers' index stood at 51.5, indicating improving conditions for that sector, although index declined slightly from reading of 51.7 in February.

Russia's main consumer confidence indices show a slight uptick since last year's lows



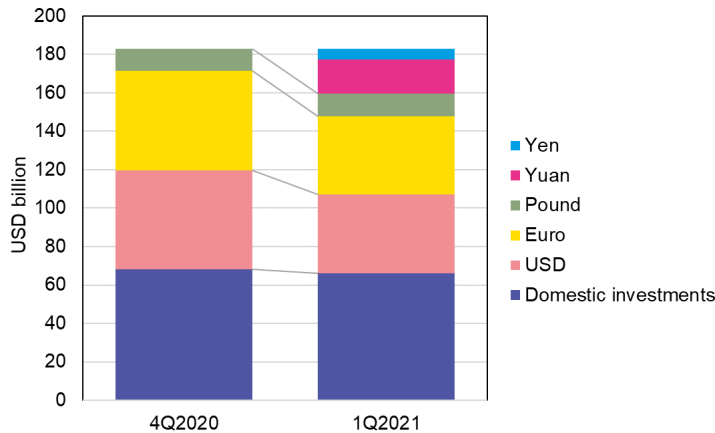
Sources: Central Bank of Russia, Levada Center, Macrobond and BOFIT.

National Welfare Fund assets invested in yuan-denominated debt securities. At the beginning of March, the value of Russia's National Welfare Fund (NWF) stood at \$183 billion, or almost 12 % of GDP. Most NWF assets are invested in highly liquid bonds and treasuries of foreign governments. Early in March, the value of such liquid investments was about \$117 billion, which corresponded to 7.5 % of Russian GDP. Until recently, debt securities denominated in dollars and euros each made up about 45 % of holdings, with the British pound accounting for most of the remaining 10 %. In February, however, the finance ministry shifted some dollar and euro assets into instruments denominated in Chinese yuan and Japanese yen. At the beginning of March, Welfare Fund's foreign currency allocations were 35 % dollar, 35 % euro, 15 % yuan, 10 % pound and 5 % yen. The CBR made a similar adjustment to its foreign exchange reserves already in the second quarter of 2018, when it shifted 15 % of its forex reserves into Chinese yuan. Compared to other countries, the large yuan share in Russia's forex reserves and the NWF, the nation's main sovereign wealth fund, is quite exceptional ([BOFIT Weekly 3/2021](#)).

About a third of NWF assets are invested domestically for the longer term. The largest domestic investment by far (\$41 billion) is in Sberbank shares. NWF assets are also deployed as subsidised deposits with the VEB state development bank and two major commercial banks (VTB and Gazprombank).

Each year a share of tax earnings from oil & gas raised by the federal government is set aside under the government's fiscal rule, whereby all revenues from oil & gas earnings above a reference price will be set aside and placed in the NWF. The average price of Urals grade crude last year was \$41.60 a barrel, which turned out to be quite close to the reference price. The value of the NWF also fluctuates due to changes in the price of securities it holds and changes in exchange rates.

Russia recently reallocated its foreign currency holdings in the National Welfare Fund



Sources: Russian Ministry of Finance and BOFIT.

Russia shows cautious interest in green financing. According to media reports, Russia's central bank and finance ministry have launched initial discussions on the possibility of issuing green government bonds. In addition, the City of Moscow has announced it is considering the issuance of its own green bonds this year. For the moment, only a few Russian corporates have issued green bonds in the spirit of testing the waters. Green bonds are typically used as a way to raise funding for projects that help the environment through reducing emissions, e.g. a switch to renewable energy production or low-emission transport. The main purpose of government green bonds, however, is to make it easier to price private-sector bond issues.

Russian policymakers are not heavily focused on measures to mitigate or reduce climate change, and the Russian economy remains heavily dependent on extraction and exports of hydrocarbon fuels (see [BOFIT Policy Brief 6/2021](#)). On international financial markets, however, actions to reduce climate change play an ever-increasing role. Several major financial institutions have announced plans to divest their holdings in the oil, gas and coal sectors. This shift could raise the price of financing for Russian energy firms. For example, the latest [estimate](#) from Russia's Strategic Research Center finds that only 45 % of the external financing of Russia's large oil & gas firms comes from domestic sources. Thus, pushing forward the green projects that reduce emissions or increase energy efficiency might play a key role in controlling companies funding costs.



China

IMF says global outlook has improved significantly from three months ago. The April edition of the International Monetary Fund's [World Economic Outlook](#) sees the global economy growing by 6 % this year, half of a percentage point higher than its January global growth forecast. The improved outlook was due to broad-based stimulus in many countries and faster than expected rollout of covid vaccination programmes. The IMF projects higher growth across the board, apart from the low-income developing countries. Developed economies are now expected to see GDP growth this year of 5.1 % (0.8 percentage point above the January forecast), while emerging economies will grow at 6.7 % (a 0.4 percentage point increase). The United States saw the largest upward adjustment of its growth figures. With the enactment of major stimulus packages, US growth this year was increased by 1.3 percentage points from January forecast to 6.4 %. The overall pace of global growth will moderate next year to 4.4 %.

The IMF expects the Chinese economy to grow by 8.4 % this year and 5.6 % next year. While 2021 growth got a 0.3 percentage point boost, the outlook for next year remains unchanged from the January forecast. The IMF credits China's strong recovery to effective measures to suppress the spread of the coronavirus, robust stimulus through public investment and timely liquidity support provided by the central bank.

Russia's growth forecast for 2021 was also revised up from January by nearly a percentage point to 3.8 %. The same growth pace is now expected to continue through 2022. Some of this improvement reflects the IMF's assumption that oil prices this year will average 30 % higher than last year. India's economic growth this year was lifted by a percentage point from the January forecast to 12.5 % as lockdown measures so far have been less severe than expected. The Indian economy is expected to grow by 6.9 % in 2022.

The recovery of emerging economies from the covid crisis depends on many factors and varies considerably across countries. The seriousness of each country's infection situation and its effect on the healthcare system, the structure of the economy and its dependence on branches heavily impacted by the pandemic (e.g. international tourism), as well as possibilities to apply effective stimulus measures all have an impact on the speed of recovery.

The April edition of the IMF's World Economic Outlook (WEO) raises regional growth forecasts across the board

	April 2021 WEO		January 2021 WEO	
	2021	2022	2021	2022
Developed economies	5.1	3.6	4.3	3.1
United States	6.4	3.5	5.1	2.5
Euro area	4.4	3.8	4.2	3.6
Japan	3.3	2.5	3.1	2.4
United Kingdom	5.3	5.1	4.5	5.0
Emerging Economies	6.7	5.0	6.3	5.0
China	8.4	5.6	8.1	5.6
India	12.5	6.9	11.5	6.8
Russia	3.8	3.8	3.0	3.9
Brazil	3.7	2.6	3.6	2.6
South Africa	3.1	2.0	2.8	1.4
World	6.0	4.4	5.5	4.2

Sources: IMF and BOFIT.

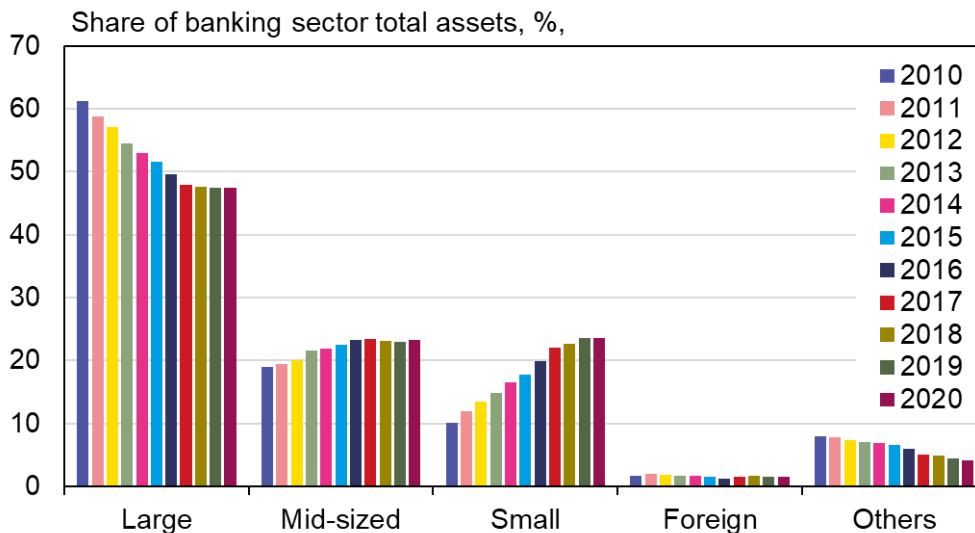
Financial performance of Chinese banks last year all over the map. China’s large banks appear to have weathered the first year of the covid pandemic in relatively good shape. Financial reporting in recent weeks shows that most big banks managed to increase their profitability last year. Higher lending volumes helped them to overcome the narrowing of net margins and slight deterioration in their return on assets, a common measure of profitability. In contrast, small and mid-sized banks seem to have been hit more severely by the pandemic. Profits of city commercial banks and rural banks declined and their capital adequacy ratios nosedived. Even before the pandemic, several distressed small and mid-sized banks had to be bailed out with public assets.

It was initially feared that the pandemic would inundate Chinese banks with non-performing loans (NPLs). Official figures, however, suggest that the volume of NPLs for the banking sector overall only increased last year at a pace similar to that of previous years and the stock of NPLs remained a level of less than 2 % of total lending as in previous years. However, some NPLs that would have been recorded in a normal year were likely kept off the books as many small and medium-sized enterprises were granted forbearance on their loans last year, allowing them to postpone scheduled payments on principal and interest to this year. Moreover, the actual stock of NPLs held by Chinese banks is believed to be considerably larger than official reporting suggests (see for example [BOFIT Discussion Paper 2/2020](#)).

The NPL trend varied last year considerably depending on bank type. NPLs of large banks grew significantly (up by 20 % y-o-y), while city commercial banks saw their NPL volumes fall by more than 10 %. Some of the reduction in NPLs of city commercial banks may reflect last year’s completion of rescue operations for couple of city commercial banks. In addition, local governments were granted permission to recapitalise banks through issuance of special purpose bonds that would allow banks to clean up their balance sheets.

On the policy side, attention has been turning from last year’s stimulus efforts to the risks of the financial sector. At the end of March, the central bank directed banks to keep their new lending volumes at last year’s level. Tighter regulation is also planned for the large banks. Last week the central bank and banking supervision authorities released a draft version of the new banking crisis recovery and resolution plan that includes an increase in the systemically important banks’ capital adequacy ratio by 0.25 to 1.50 percentage points. The current capital adequacy ratio for large banks is 11.5 %.

Over the past decade, small and mid-sized banks have increased their shares of the China’s banking sector.



Sources: People’s Bank of China, CEIC and BOFIT.

PBoC’s digital currency project moves ahead. With the successful trials of state-issued digital currency in four cities (Shenzhen, Suzhou, Chengdu and Xiong’an), the People’s Bank of China will now expand the experiment to include other major cities, including Beijing and Shanghai. China’s issues of “digital yuan” are still small for the moment. For example, 20 million in digital yuan lottery winnings were issued in Shenzhen and 10 million in Beijing at the start of the year.



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The rapidity of this development is evidenced by the fact that China's giant state-owned banks have already launched marketing campaigns to raise public awareness of the convenience of the new digital currency. The high demand in China for electronic payment services has been a driving factor in development of a state digital currency. Many Chinese today pay for their purchases on proprietary platforms provided by private service companies (Alibaba, Tencent, etc.). The PBoC's digital yuan also gives the Chinese government better possibilities to track payment flows.

While commercial service providers and central banks around the world have been studying the potential benefits of digital currencies, China's central bank is at the forefront. While no schedule has yet been announced, the digital yuan is expected to be in wider use already at the 2022 Beijing Winter Olympics.

The PBoC is also testing use of the digital yuan in cross-border payments in cooperation with the central banks of Hong Kong, Thailand and the United Arab Emirates. It is hoped that the tests will provide new information on the technological limits of cross-border payments with central bank-issued digital currency, as well as how such digital currency might complement current international payment practices. Chinese officials have been active in drawing up digital currency standards via e.g. the Bank of International Settlements (BIS).

The Chinese have long criticised the international financial order for over-reliance on Western currencies, particularly the US dollar. The dollar's central role in international trade and payments gives the US opportunities to impose strict economic sanctions to coerce behaviour of other countries. This was seen last autumn, for example, when the US imposed economic sanctions on certain officials in mainland China and Hong Kong in response to the crackdown in Hong Kong. China's adoption of its own digital currency may help to advance China's challenge to the incumbent financial order.

Russia

Russian GDP contracted by 3 % last year; domestic demand revived in second half. Rosstat released revisions of Russia's national accounts at the beginning of this month. While its earlier reporting showed Russian GDP contracting by 3.1 % in 2020 ([BOFIT Weekly 5/2021](#)), the new adjusted figures have GDP contracting by just 3.0 %. As the numbers harden, it is increasingly evident that Russia has faced milder economic impacts from the covid-19 pandemic than most G20 countries. The least economically impacted G20 members in 2020 now appear to be China (positive GDP growth of 2.0 %) and Turkey (+1.8 %). Other G20 countries experiencing smaller GDP contractions than Russia's include South Korea (negative GDP growth of 1.0 %), Indonesia (-2.1 %) and Australia (-2.4 %). Russia has been more reticent since last summer than most countries about using lockdowns. Moreover, the structure of the Russian economy, e.g. low reliance on service industries such as tourism, seem to have helped it escape some of the harsher economic effects of the pandemic.

On the economy's supply side, output of extractive industries notably contracted by 9.5 % y-o-y. Much of this was due to Russia's participation in the OPEC+ agreement on crude oil production ceilings. As in many countries, Russia's service branches faced severe distress due to covid lockdowns and travel restrictions. For example, hotel and restaurant services declined by 25 %, while transport services were off by 11 %. Financial services, in contrast, grew by 7.3 % last year. Some of this strength reflects the growth of digital services in Russia, particularly in online securities trading.

On the demand side, private consumption was particularly hard-hit last year, falling by 8.6 % y-o-y. Growth in public consumption (up 4.0 %) reflected government efforts to preserve domestic demand. Russia's use of stimulus was similar to that of many other countries in their response to the covid shock in 2020. Heightened risk and uncertainty, along with reduced overall demand, led to a 4.3 % contraction in fixed investment. The volume of fixed investment in 2020 was lower than in 2013. The OPEC+ agreement drove the drop in export volumes last year.

Rosstat has updated all its quarterly national accounts data back to 2018, putting understanding of the Russian economy in a new light with these adjusted figures for GDP and its core components. For example, the drop in fixed investment in the second quarter of 2020 was considerably smaller than previously thought. In the fourth quarter of 2020, GDP contracted by 1.8 % y-o-y. On a seasonally adjusted basis, GDP contracted by 0.2 % q-o-q. Components of domestic demand recovered at the end of the year.

Russia's national accounts show a rise in public consumption, but big drops last year in private consumption and fixed investment.

	Changes in GDP and its components, %						Nominal GDP and its components, RUB billion
	2015	2016	2017	2018	2019	2020	2020
GDP	-2.0	0.2	1.8	2.8	2	-3.0	106,968
Private consumption	-9.5	-2.6	3.7	4.3	3.2	-8.6	52,425
Public consumption	-3.6	1.4	2.5	1.3	2.4	4.0	22,149
Fixed capital investment	-10.6	1.3	4.7	0.6	1.5	-4.3	23,273
Exports	3.7	3.2	5.0	5.6	0.7	-4.3	27,302
Imports	-25.0	-3.7	17.3	2.7	3.4	-12.0	21,992

Sources: Rosstat and BOFIT.

Russian foreign trade further on path to recovery, capital flows dwindle. Preliminary balance-of-payments figures released by the Central Bank of Russia for the first quarter show that export earnings and imports continued to claw their ways back from the fall of last spring and summer. As in some earlier time periods, developments do not unfold from headlines because the US dollar, used by Russia in recording foreign trade, was down by about 9 % y-o-y against the euro in the first quarter of 2021. Thus, while Russian earnings on exports of goods and services were down by 4 % y-o-y in dollar terms, they were still down 12 % in euro terms. Revenues from exports of crude oil, petroleum products, pipeline gas and LNG remained rather weak, down by about 20 % y-o-y in euro terms. Other earnings from goods exports increased on year by several percent.

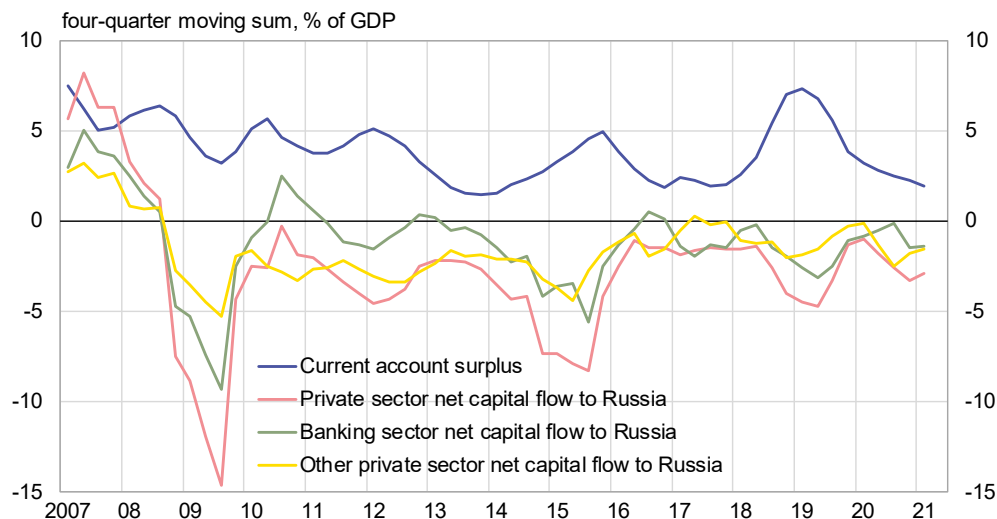
Russian spending on imported goods and services in the first quarter of 2021 already reached the same level as year ago in dollar terms, but were down by 8 % in euro terms. Goods imports made a healthy recovery as the value of imports was up

by several percent on year even in euros. The tepid recovery in earnings on goods exports and the rise in goods imports held Russia's usually very large goods trade surplus at an exceptionally moderate level.

Exports and imports of Russian services were still weak, particularly as nearly all travel was continuously at a standstill. Other services trade also showed modest performance. In any case, Russia's services trade deficit shrank to lows rarely seen due to the almost complete lack of spending on Russian travel abroad. In addition, the deficit in capital income and spending remained quite small while both the income and spending have decreased. Notably, spending accruing from foreign investments into the corporate sector declined tangibly last year. Similarly, foreign investment income of Russian businesses and banks also decreased gradually last year continuing in the first quarter of this year.

Russia's current account surplus shrank further with the 12-month moving sum falling to about 2 % of GDP in the first quarter. The notable financial account deficit continued into the first quarter of this year, i.e. the net outflow of capital from Russia was rather substantial. Some of this reflected an unusually large withdrawal of foreign investment from secondary markets for government bonds. The net capital outflow of the private sector remained relatively large. Inward foreign direct investment (excluding banks) was still small. The gradual withdrawal of foreign investments in Russian corporate bonds continued, and so did contraction of foreign debt of Russian firms. Outward corporate DI was highest since early 2019 and corporate investment in foreign bonds continued. The amount of banks' foreign receivables increased considerably.

Russia's current account surplus has been declining while net capital outflow has remained substantial.



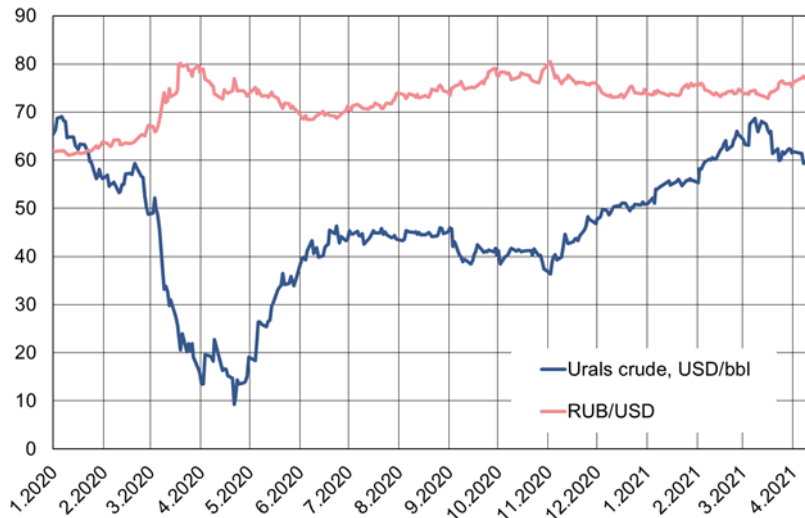
Sources: CBR and BOFIT.

Geopolitical concerns weigh on ruble exchange rate. The price of Urals-grade crude oil almost touched the \$70 mark in early March, but has since settled back to near the \$60 level. Since November last year oil prices have almost doubled, but the RUB-USD exchange rate has remained fairly constant at around 75 rubles to the dollar. The poor growth outlook along with forex-buying according to the government's fiscal rule and geopolitical tensions have dampened appreciation pressure on the ruble. In recent weeks, the ruble has weakened sharply against the dollar. Much of this appears to reflect heightened tensions with the West and the latest round of sanctions announced by the US on Thursday (Apr. 15).

When oil prices collapsed in March 2020, the ruble weakened to a level of nearly 80 to the dollar. With the situation stabilising and rising oil prices, the ruble appreciated last summer. The Russian currency faced renewed downward pressure in autumn as uncertainty surrounding emerging markets, political unrest in Belarus and the poisoning of opposition politician Alexei Navalny weighed on the ruble. At the end of September, the CBR forex sales and the issuance of guidance to large state-owned enterprises on their forex positions calmed the situation somewhat ([BOFIT Weekly 41/2020](#)).

The combination of a weak ruble and high oil prices has been a boon both for the Russian government's finances and large commodity-exporting firms. On the flip side, the weak ruble drives up import prices, which erodes the purchasing power of Russian consumers. It could also slow growth of already beleaguered domestic fixed investment. Rising uncertainty drives ruble's depreciation and diminishes the interest of international investors in the Russian market. The share of foreign investors holdings in Russian government ruble-denominated bonds fell to 20 % in March, a level not seen since 2015. In February 2020, that share was still 35 %.

The ruble has seen a slight depreciation against the US dollar in recent weeks.



Sources: Reuters and BOFIT.

Russia hopes to attract investment in the Arctic territory. Russia has recently approved new strategies framing its policy in the Arctic region. This is particularly topical as Russia is about to assume the two-year rotating chairmanship of the Arctic Council. The Arctic territory, which spans 4 northern regions in whole and 5 in part, generates about 6 % of Russia's GDP and is home to about 2 % of its population. Most economic activity in Russia's Arctic territory involves exploitation of natural resources. It accounts for over 80 % of the natural gas produced in Russia and 17 % crude oil (our Finnish-language [BOFIT Policy Brief 6/2021](#) presents a more detailed look at the oil & gas sector in Russia's Arctic territory, English version coming).

Russia's current Arctic territory policy is based on two framework documents approved last year: The principles of Russia's Arctic Policy for 2035 and the Development Strategy of Russia's Arctic Territory and national security for 2035. These documents largely view the Arctic territory from the perspective of Russia's national security needs. The loss of population due to unfavourable living conditions, rapid global warming and increased risk of military conflict are seen as the most important threats to the Arctic territory's development. In response to these threats, the strategies prescribe economic development and better living standards, improved monitoring of climate and natural conditions, as well as support for military readiness.

The oil & gas sector plays a major role in the 2035 development strategy. In recent years, the Arctic territory has been lifted by the establishment of a liquefied natural gas (LNG) production hub on the Yamal peninsula. The strategy assumes LNG production will continue to enjoy rapid growth. The increased production levels have been facilitated in part by improved transportation possibilities due to the loss of annual ice cover in the Northeast Passage. The Northeast Passage has already seen cargo volumes soar in recent years with the LNG and crude oil shipments. Last year, net tonnage of freight about 30 million metric tons was shipped last year, of which only about 1 million tons was transit freight. The development strategy assumes that transport of raw materials will continue to rise rapidly. The Northeast Passage has sometimes been described to an alternative to the Suez Canal, linking Asia and Europe. The 2035 development plan only anticipates net tonnage of transit freight to reach 10 million tons by 2035. Ships with a net tonnage of about 1 200 million passed through the Suez Canal in 2020.

To meet its long-term strategy for the Arctic territory, the Russian government approved a 2021–2024 development programme at the end of March. The programme is divided into two parts: attracting investment and supporting economic and social development. For attracting investment, the Russian state is offering subsidies for construction of infrastructure, labour costs and credit. The government has set aside 20 billion rubles (220 million euros) of budget funds for these measures during 2021–2024. The hope is that these enticements will attract another 180 billion rubles from extra-budgetary sources. No budget funds have been set aside to support economic and social development. The government would like to get 20 pieces of legislation dealing with economic development passed by 2024.

China

China's first quarter economic figures show V-shape part of recovery has passed. The figures released by the National Bureau of Statistics last week show that GDP in the first quarter of 2021 rose by over 18 %. Such high on-year growth is hardly a surprise as the reference basis was China's weakest quarter at any time during the covid crisis.

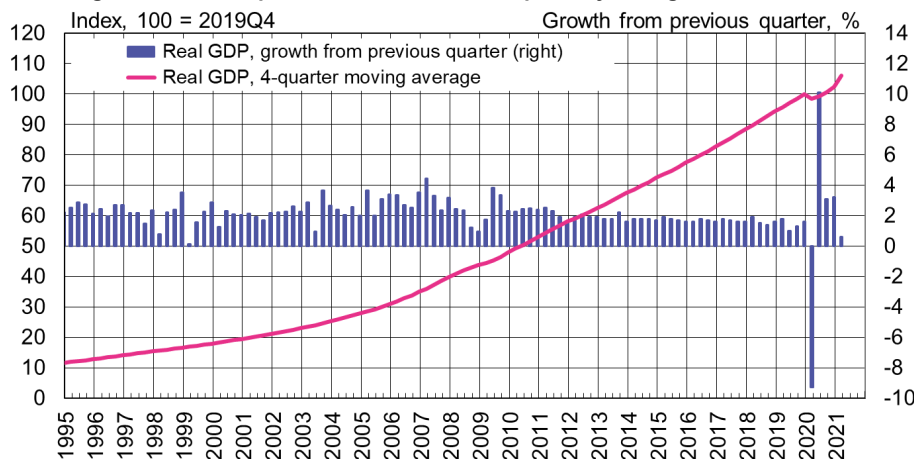
One way to get a better overall picture of the situation is to consider GDP growth in January-March compared to the previous quarter (October-December). The NBS reports that GDP grew by 0.6 % q-o-q in the first quarter adjusted for seasonal variations including holidays (2.4 % annualized rate). Quarterly growth was clearly lower than in the second half of 2020, when it was around 3 %. Quarterly growth of less than 1 % is rare in China. Before the covid crisis, such an episode was last seen at the late 1990s.

A second way to get a better overall growth picture is to see how much GDP has grown compared to pre-covid times. If the situation is compared to the first quarter of 2019, the volume of Chinese GDP is more than 10 % higher in the first quarter of 2021. Even with the pandemic, China has managed to grow at an average rate of 5 % over the past two years. China recovered quite quickly from its January-March 2020 output collapse. GDP is now already 6 % higher than at the end of 2019.

Chinese GDP can be roughly divided into three sectors: construction & industry, services and agriculture. In recent years, slightly over half of the value-added generated in China came from the service sector, about 40 % from the construction & industry sector and about 8 % from agriculture. Construction & industry have played a significant role in China's recovery. The sector contracted in the first quarter of 2020 slightly more than the service sector, but its recovery was faster. The value-added generated by the construction & industry sector in the first quarter of 2021 was 7 % higher than at the end of 2019. The corresponding value-added generated by the services sector was up by less than 6 %. Growth in the agriculture sector has been slower, but even there output rose 4 % from the end of 2019. Prior to the covid crisis, the service sector averaged annual growth of 8 %, well above growth in the construction & industry sector (5.5 %).

Several alternative indicators are also used to get a clearer picture of Chinese GDP trends. Our updated alternative [GDP figure for China](#) shows real growth of just over 17 % in the first quarter, which is well in line with China's official figure. However, our alternative indicator suggests that GDP over the past two years has grown much slower than official figures suggest. According to its estimates, China's GDP growth in 2019 was already below 4 % (6 % official figure). In covid year 2020, growth was basically zero (2.3 % official figure).

Excluding the covid collapse, China's most recent quarterly GDP growth was weakest in over 20 years.



Sources: China National Bureau of Statistics, Macrobond and BOFIT.

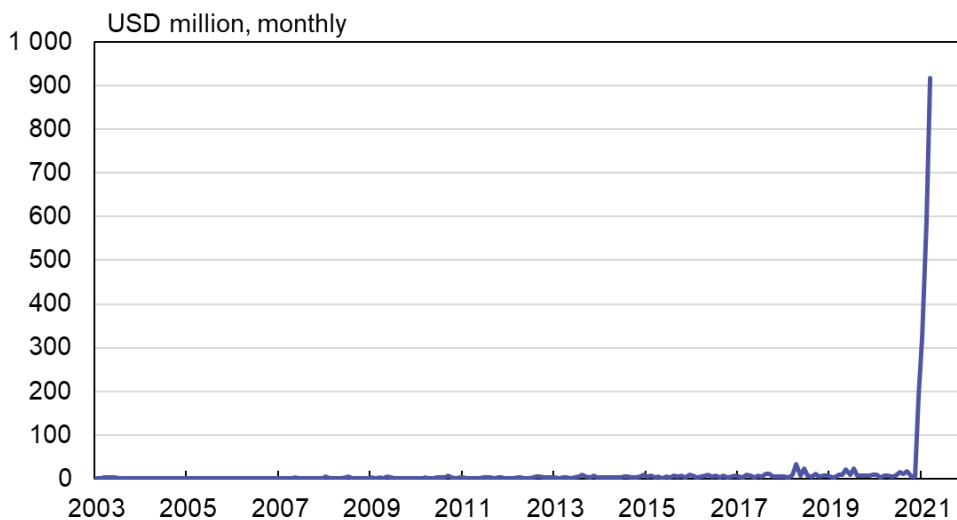
Covid situation in China quite good; pace of vaccination accelerates. After covid infections spiked in the Hubei province surrounding Beijing in January, the government imposed strict lockdowns in several cities. Officials also urged people to avoid travel during the Lunar New Year holiday week. New reported infections declined in February and since then the infection rate has remained low and officials claim that most covid cases have been brought in from abroad. Over the past two weeks, official figures show an average of just over ten confirmed covid cases a day nationally – not much for a population of 1.4 billion.

It took a while for China to get in national vaccination mode, the pace of pace of vaccination has picked up substantially in recent weeks. The National Health Commission reports that only 5 million vaccine doses had been administered at the start of this year. As of Wednesday (Apr. 21), about 200 million people had received a covid shot, of which over 130 million had received their shots during the first three weeks of April. While the official goal is to vaccinate 560 million people by the end of June, the current average pace of 4 million doses a day is still insufficient to meet that goal. Because China was slow to get underway with its vaccination programme and the Chinese are suspicious of vaccines, the country has vaccinated a much smaller share of its population than e.g. Finland.

The four covid vaccines approved for use in China are all domestically produced. CoronaVac is an inactivated virus vaccine developed by Sinovac Biotech. The single-dose Convidecia vaccine from CanSino Biologics is a viral vector vaccine for which a nasal-spray version is under development. Sinopharm's two inactivated virus covid vaccines work similarly to CoronaVac. None of the Chinese vaccines have demonstrated the same immunogenicity as vaccines approved in the West. However, Chinese officials have yet to approve a single foreign-developed covid vaccine.

Dozens of countries, particularly emerging economies, have agreed to buy Chinese vaccines. They include such countries as Brazil, Indonesia, Mexico, Serbia, Turkey and Hungary. China has also given small quantities of vaccine to numerous low-income and developing countries. The Chinese hope these gifts improve foreign relations and burnish China's image internationally. In addition to exports of Chinese covid vaccines, AstraZeneca's vaccine is being produced in China among many other countries, while the Russians just agreed to start producing Sputnik vaccine in China. China's vaccine exports have soared this year. In March 2021, the value of China's vaccine exports was \$920 million, or roughly the value of all Chinese vaccine exports between 2005 and 2020. As a special gesture in March, China made it easier for foreigners vaccinated with a Chinese covid vaccine to get a visa. According to media reports, China has been in April granting the same eased visa requirements for all persons who have received a covid vaccine.

China's vaccine exports expanding rapidly with covid vaccines, monthly value of exports.



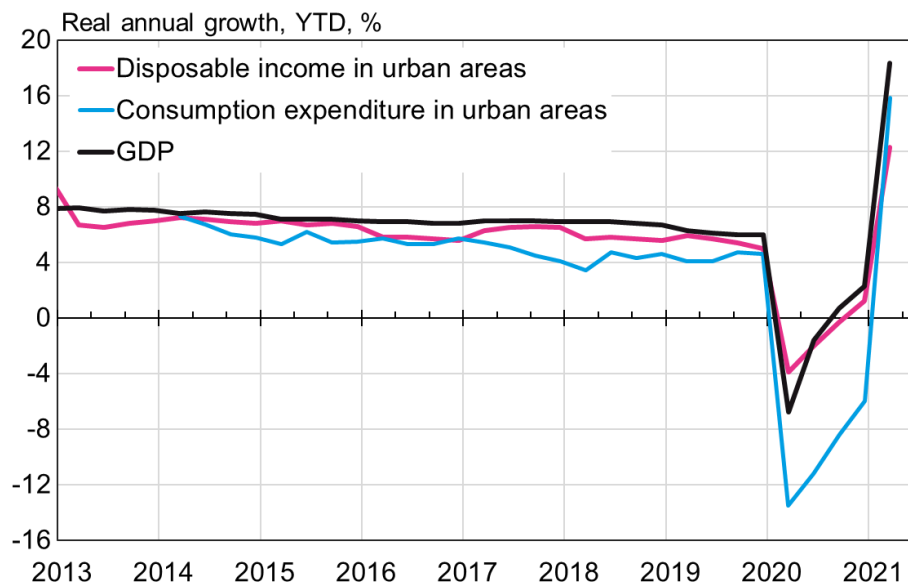
Sources: China Customs, CEIC and BOFIT.

Income growth slightly lags Chinese GDP growth. China's National Bureau of Statistics reports that average per capita disposable income rose last year to 32,190 yuan (4,090 euros). In real terms, disposable income grew by 2 % y-o-y. Average disposable income in urban areas grew by just 1 % in real terms (43,830 yuan, 5,570 euros), but was still clearly higher than average rural income (17,130 yuan, 2,180 euros). There are also huge differences across urban areas. Shanghai's average was over 76,000 yuan. The average in Heilongjiang was just over 31,000 yuan. NBS figures for average per capita consumption expenditure declined by 4 % last year in real terms and by 6 % in urban areas.

In the first quarter of this year, disposable income growth climbed rapidly due to last year's low basis reference. Still, the pace was slower than GDP growth. Real disposable income rose in January-March by 14 % y-o-y and by 12 % in urban areas. Average consumption spending last year declined sharply in the first quarter of 2020, while in the first quarter of this year growth was high. Average consumption expenditure grew by 18 % and 16 % y-o-y in urban areas. Under the five-year plan announced in March, China seeks to hold growth in per capita income a level roughly on par with GDP growth. In recent years, consumer spending has grown more slowly than incomes, which has hindered China's transition to a consumption-driven growth model.

According to official figures, China's employment situation has roughly returned to pre-covid levels. Even if China has shifted away from reporting the number of registered unemployed people to releasing survey-based unemployment figures, also the new approach fails to provide a comprehensive picture of China's overall employment situation. There is strikingly little fluctuation in the numbers over time. In March, for example, official urban unemployment was 5.3 %, the same level as in January 2020. In February 2020, when the covid shock hit, the government reported that unemployment had risen briefly to 6.2 %, even if by some estimates one out of five workers were temporarily out of a job.

Growth in per capital incomes in urban areas has tracked economic growth fairly closely, while growth in per capita consumption has lagged a bit.



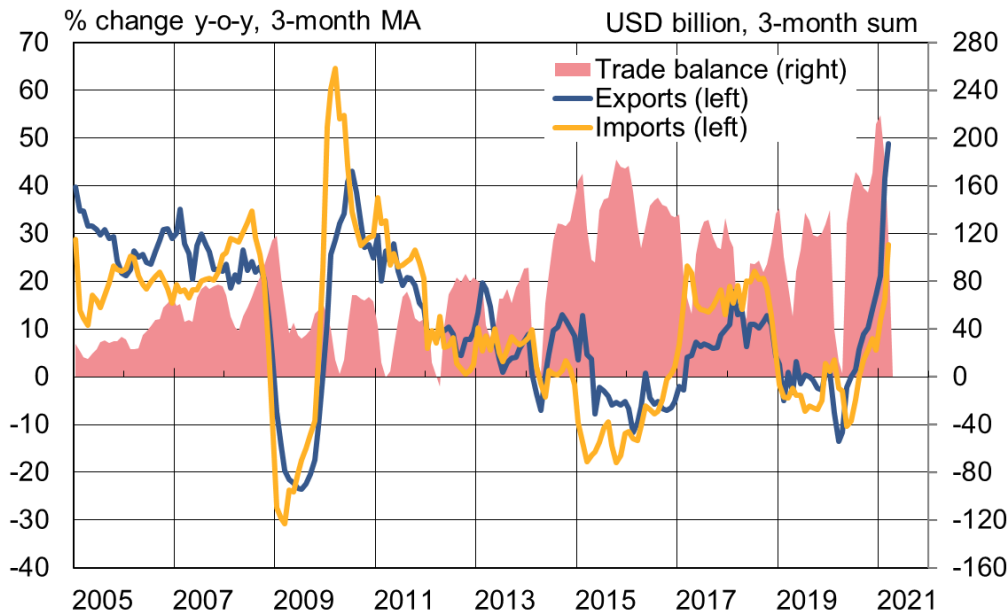
Sources: China National Bureau of Statistics, CEIC and BOFIT.

Strong first quarter for Chinese foreign trade. The value of China's goods exports in January-March climbed to \$710 billion, an increase of 50 % y-o-y and 30 % more than in the first quarter of 2019. The value of goods imports rose to \$590 billion at a pace grew slightly lower than exports (28 % y-o-y and 25 % from 1Q19). The goods trade surplus in the first quarter rose to \$120 billion. Foreign trade growth was accelerated by recovery of China's domestic economy and the global recovery from the pandemic. At the same time, demand for Chinese covid-related products and devices remained strong.

Growth in foreign trade has been geographically broad-based. Goods exports to the United States rose by 75 % y-o-y in the first quarter and 30 % from the first quarter of 2019. The value of imports rose by 70 % y-o-y and by 63 % from the first

quarter of 2019. China's US imports were still running at levels considerably below what the parties had committed to a year ago when they signed their phase 1 trade agreement. China's goods trade surplus with the US continues to increase. The value of imports from the EU was up by 33 % y-o-y and up 24 % the first quarter of 2020. China's exports to the EU have grown somewhat faster than imports.

China's goods trade and trade surplus have risen over the past year.



Sources: China Customs, CEIC and BOFIT.

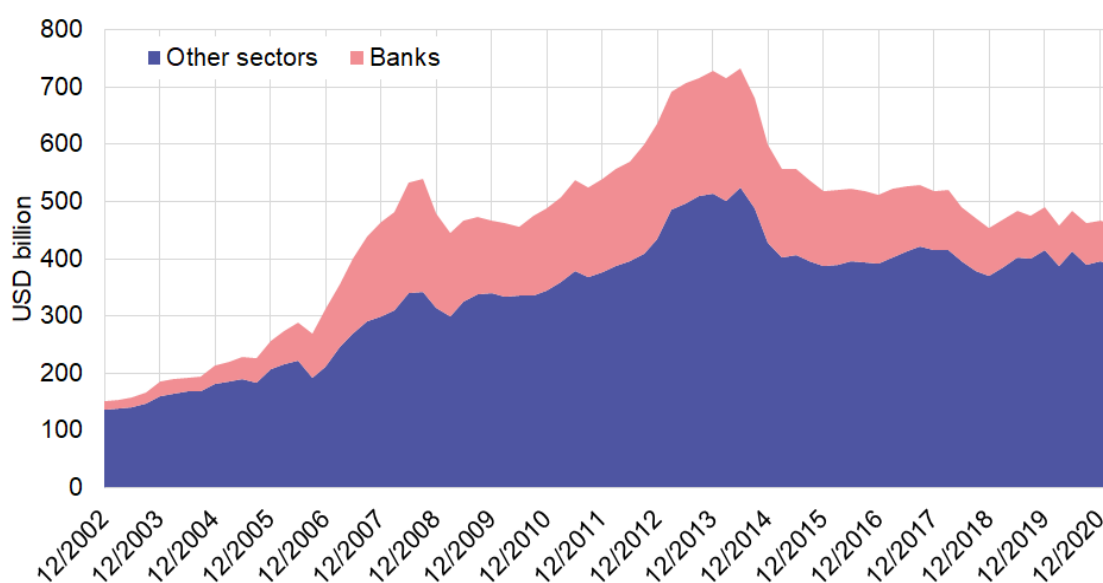
Russia

New US sanctions reduce presence of foreign investors in Russia’s bond market. On April 15, United States officials at the behest of president Joe Biden announced new sanctions to take effect on June 14. The sanctions prohibit US financial institutions from participating in Russian sovereign bond issues or lending money to the Russian government. US officials said that the sanctions are a response to actions by the Russian government and its intelligence organisations against US sovereignty and its interests. At the same time, the US imposed sanctions on six Russian technology firms suspected of working with Russian intelligence officials in “malicious cyber-enabled activities” against the US and its allies. In addition, the US, European Union, United Kingdom, Canada and Australia imposed various new sanctions for Russia’s illegal annexation of Crimea.

Some of the new US sanctions were expected ([BOFIT Weekly 15/2021](#)), so markets largely shrugged off the announcement. The ruble weakened slightly, but was stronger at the end of the week than at the start. The Central Bank of Russia and finance ministry announced, however, that they are tracking the situation and are ready to support financial stability with a range of measures. Foreign investors have been getting out of the Russian bond market for a while. At the beginning of April, foreign investors held 19.7 % of government debt securities. At the peak in February 2020, foreign investors held about 35 % of Russian government bonds. During March, foreign investors still purchased about 10 % of new bond issues.

The impact of Western sanctions can be seen most clearly in their impact on Russia’s foreign debt. Since financial sanctions were imposed in 2014, the foreign debt of Russian banks and other sectors has declined substantially. In essence, sanctions have cut off parts of the Russian economy from international capital markets. It is also worth noting that Russia has not managed or even wants to compensate for its reduction in borrowing from e.g. the EU with borrowing from Chinese entities. As of end-March, Russia’s foreign debt was USD 459 billion, 37 % less than at the end of 2013. The foreign debt of Russian banks was USD 74 billion, or about a third of what it was at the end of 2013. Russia’s two largest banks, Sberbank and VTB, are ineligible for loans of over one month from creditors in the US or EU (for more on Western sanctions, see e.g. [BOFIT Policy Brief 2/2019](#)).

Russian foreign debt has declined since 2013 (amounts in USD billion; end of 4Q2002 to end of 1Q2021).



Sources: Central Bank of Russia and BOFIT.

Recovery of Russian economy continues. Russia's Ministry for Economic Development estimates that GDP grew in March by 0.5 % y-o-y, while GDP was still down by over 2 % y-o-y in January-February. The economy ministry also estimated that the on-year change for all of the first quarter was -1.3 %.

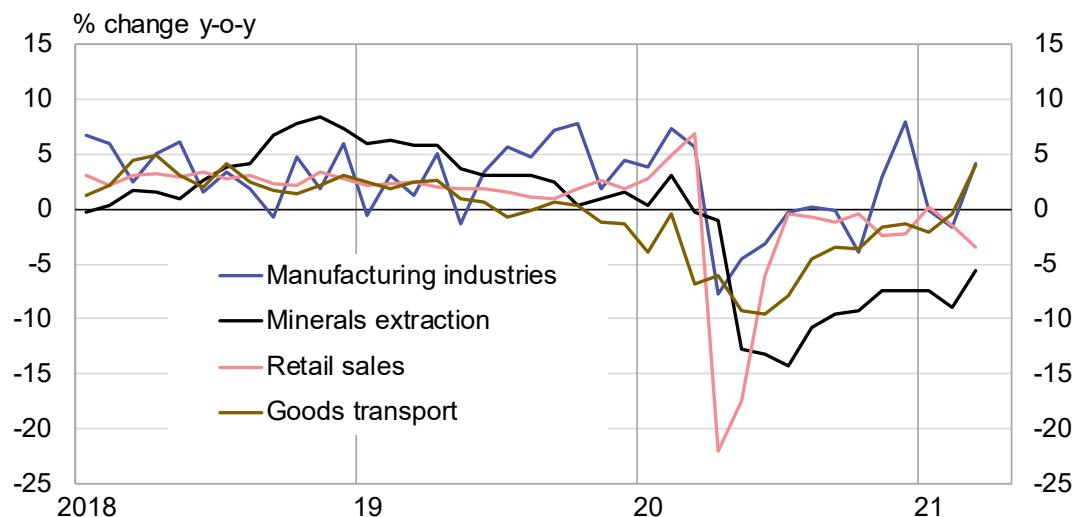
Industrial output in the first quarter was 1.3 % smaller than four quarters earlier, but the situation is quite different in industrial main categories. Mineral extraction output has recovered gradually. In February-March, seasonally adjusted growth of mineral extraction was nearly 1 % m-o-m. However, in March the output was still down by 5-6 % y-o-y and in the first quarter the on-year drop was over 7 %. This basically reflects the ongoing OPEC+ agreement on oil production ceilings that should gradually come to an end by April 2022. The agreement has reduced Russia's oil production by about 10 % y-o-y. In contrast, production of natural gas and coal bounced back from their last year's falls in the first quarter (up by 8 % y-o-y and 10 %, respectively). A significant category consists of oil & gas-related services, which have remained several percent lower on-year since spring 2020.

Seasonally adjusted output of manufacturing industries continued to rise in February and March at about 1 % m-o-m. March manufacturing output was up by over 4 % y-o-y, and by nearly 1 % y-o-y for all of the first quarter. Not counting oil refining, manufacturing output has increased for five consecutive years. Production also grew slightly amidst last year's recession, and in the first quarter production was up by 2 % y-o-y. Much of the rise came from a revival of growth in the machinery, equipment & vehicles categories, as well as ongoing growth in pharmaceutical and chemical production. Chemical industry remains an important branch of growth to Russia. The sector has grown by nearly 50 % since the first quarter of 2014. Pharmaceutical production continues to spearhead industrial growth, with output tripling over the past seven years.

The recovery in household consumption in the homeland has been sluggish. The volume of seasonally adjusted retail sales remained quite unchanged in February and March. Retail sales in the first quarter were down by 1.5 % y-o-y. This was due to a roughly 3.5 % y-o-y drop in March. The figure partly reflects the unusual retail spike of March 2020, when people hoarded goods they expected to need during the impending covid lockdown. The situation has improved in service branches (excluding public sector services), but they were still down by over 4 % y-o-y in the first quarter.

Goods transport increased significantly in March, raising the freight volumes for the first quarter to 0.5 % y-o-y. Large transport volumes are produced by rail freight and pipeline transmission of oil & gas, which both recovered close to their 2020 first quarter levels.

Core sectors of the economy have experienced quite different recovery paths from last year's shocks



Sources: Rosstat and BOFIT.

Russian CBR hikes key rate again. On April 23, the Central Bank of Russia raised its key rate by 50 basis points to 5 %. In its previous rate hike a month earlier, the CBR raised the key rate by 25 basis points. With the rate hikes, monetary stance has shifted from accommodative into the neutral range (key rate 5-6 %).

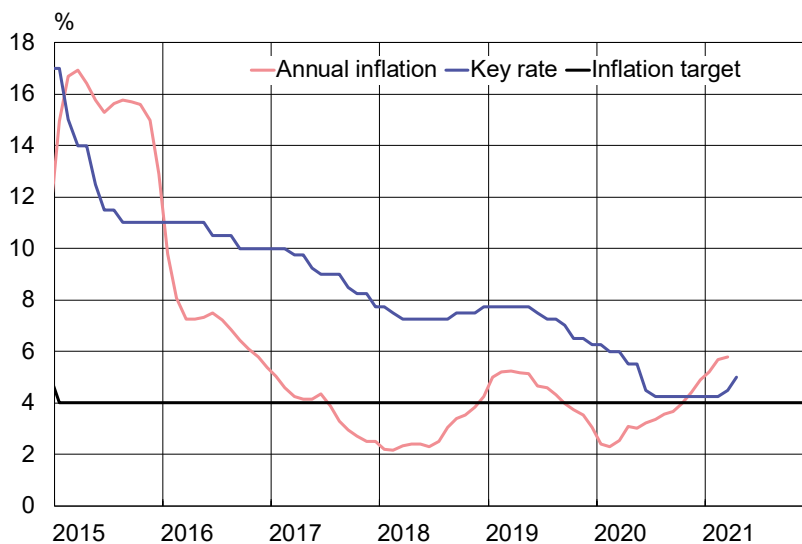
The CBR indicated the hike was mainly a reflection of rising consumer prices. Consumer prices were up by 5.2 % y-o-y in January and 5.8 % in March. Inflation has accelerated due to a recovery in domestic demand, rising food prices, cost pressures

on firms from higher commodity prices and supply disturbances caused by the covid pandemic. The inflation expectations of both households and firms are still elevated.

The CBR expects consumer prices to increase in the second quarter of this year at roughly the same pace as in the first quarter. The rise in consumer prices is expected to slow in the second quarter of this year. The CBR now sees 12-month inflation at the end of this year in the range of 4.7–5.2 % (earlier 3.7–4.2 %). The CBR expects to get back to its 4-percent inflation target by mid-2022 (previously first quarter of 2022). Thereafter, 12-month inflation should remain close to the inflation target.

The CBR kept unchanged its forecast for Russian GDP growth. It sees the economy growing by 3–4 % this year, 2.5–3.5 % in 2022 and 2–3 % in 2023. The CBR added a new feature to its forecast: an estimate of the average key rate during the 3-year forecast period. According the central bank, the annual average of key rate this year should be in the range of 4.8–5.4 %, next year 5.3–6.3 % and 5–6 % in 2023. By publishing its estimate about the average key rate through the forecast horizon, the CBR hopes to increase transparency of its communication and ultimately enhance the efficiency of monetary policy transmission. In its forward guidance, the CBR implied that a further hike in the key rate is possible at upcoming meetings.

With Russian consumer price inflation accelerating, the CBR raised its key rate.



Sources: Central Bank of Russia, Rosstat, Macrobond and BOFIT.

Defence spending rose yet again last year. The latest figures from the Stockholm International Peace Research Institute (SIPRI) show that the military spending of governments around the world continued to rise last year. Real global military expenditure rose by 2.6 % y-o-y and was up by about 9 % from a decade ago. In real terms, Russian military spending grew by 2.5 % and China's spending by 1.9 %.

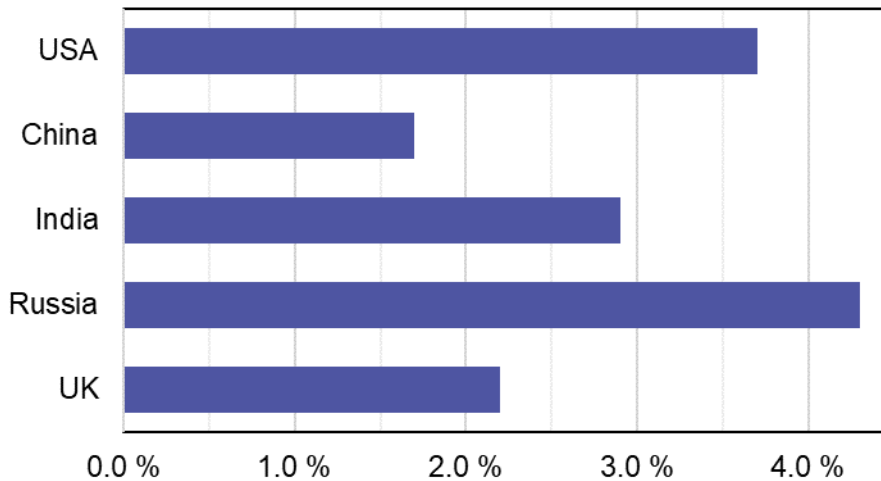
The biggest military spenders in the world are the US and China. The rapid growth of China's economy and military spending lifted it to the number-two position in the early 2000s. The US share of global military spending has declined from about 50 % to under 40 %, while China's share has risen from less than 5 % to over 10 %. SIPRI estimates that China's defence spending last year amounted to USD 252 billion, or 13 % of global military spending. China's military spending has grown roughly at the same pace as its GDP, and the ratio of defence spending to GDP over the last 20 years has been slightly less than 2 %. In 2020, the ratio was 1.7 %, which is well below the defence-spending-to-GDP ratios of all other large powers.

SIPRI estimates that Russia's 2020 defence spending amounted to USD 62 billion, or 4.3 % of GDP in 2020. Russia's military spending grew briskly up to 2016, but thereafter growth has been more modest. Russian military spending is more than double that of China in relative terms (both per GDP and population).

Russia last year had the world's fourth highest defence spending after the United States, China and India. Russia's share of global military spending was 3 % and India's 4 %. Saudi Arabia's defence spending over the past two years has declined substantially, which helped lift the UK into fifth place globally in military spending.

Russia's military spending is relatively high given the size of its economy.

Defence spending as recorded by SIPRI, % of 2020 GDP



Sources: SIPRI and BOFIT.

China

China increases surveillance of large technology firms through anti-monopoly law. China has had anti-monopoly legislation to prohibit the abuse of market power for over a decade, but instances of enforcement of competition law against cartels has been quite rare. Since the announcement of an anti-cartel campaign at the Communist Party's leadership meeting last December, the government has sprung to action. In February, the State Administration for Market Regulation (SAMR) clarified its guidance on what technology companies should do to comply with anti-cartel and anti-monopoly laws. The anti-monopoly law is being revised this year, with amendment proposals to be presented to decision-making bodies by December.

At the beginning of April, the online commerce platform Alibaba was fined a record \$2.8 billion for competition violations. Soon after the Alibaba fine was issued, SAMR summoned the leadership of China's large technology firms onto the carpet to warn them of heavy fines if they continued to abuse their dominant market positions. In total, 34 companies involved in online commerce, food delivery, video apps and gaming were given a month to shape up. At the end of the month, SAMR still handed out small 500,000 yuan fines to ten firms and announced an investigation had been launched into food delivery giant Meituan.

Due in part to the earlier ambiguity of cartel laws and their previously relaxed enforcement, China's huge tech firms have been able to dominate market segments by forcing vendors to choose between their services and that of rivals. Tech firms have also been accused ignoring privacy protections of user data and permitting the sale of counterfeit products on their platforms. The recent actions of the watchdog SAMR now make it easier also for clients, consumers and competitors to bring civil actions against tech firms that commit regulatory abuses.

In addition to the amended anti-monopoly law, the government has added new regulations with teeth. One example is how the regulator has approached Alibaba's payment and credit services subsidiary, the Ant Group ([BOFIT Weekly 46/2020](#)). The Ant Group and other fintech firms, which have long benefited from looser regulation compared to the traditional banking sector, have become market leaders as a result. Since the anti-cartel campaign was launched at the party leadership conference, regulators have adopted a distinctly harder line. For one, the Ant Group has been forced to reorganise itself as a financial holding company, placing its operations entirely under the supervision of China's financial regulators and the central bank. Capital requirements on financial holding companies were tightened last November, so the Ant Group, like others, will see a significant increase in its capitalisation requirement.

The motivation for stricter capitalisation requirements reflects several sad instances of firms that expanded rapidly with borrowed money only to subsequently be bailed out by the government to preserve systemic financial stability. It appears that the Ant Group has been made an example of China's brave new regulatory environment. Another fintech giant, JD Technology, had to abandon its IPO plans at the beginning of April. According to media reports, JD Technology is also establishing a financial holding company.

China slightly tightens monetary stance to cool lending growth. Although policy rates are still unchanged, the People's Bank of China has begun to use other instruments in its monetary toolkit to quell rising indebtedness. Policy tightening should reduce financial market risk, but policymakers fear substantial tightening and higher rates could destabilise markets and weaken the ability of firms to service their debts.

The PBoC has kept its benchmark bank lending rate, the one-year Loan Prime Rate (LPR) at 3.85 % since April 2020. The LPR is based on the PBoC's one-year medium-term lending facility (MLF) rate. Both MLF rates and standing lending facility (SLF) rates have been kept unchanged. The central bank uses reverse repos in its open market operations and their rates have also been unchanged. It has made no changes in the levels of bank reserve requirements during the past year. Interbank market rates rose briefly in the first quarter, but have since tracked PBoC policy rates.

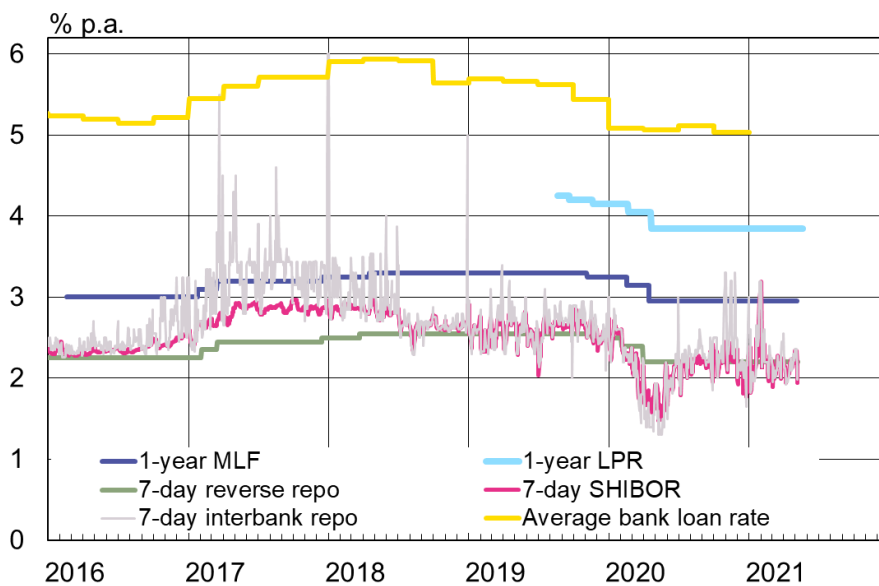
The PBoC this year has achieved a net reduction in market liquidity through its open market operations. The PBoC's lending facilities have been used to grant banks less new funding that has matured. The PBoC operations resulted in a net reduction in market liquidity of nearly 500 billion yuan in January-March. In the same period in 2020, the central bank boosted market liquidity by nearly 1.4 trillion yuan.

In typical Chinese style, the PBoC has sought to stem lending growth by issuing direct orders to banks ("window guidance"). According to media reports, the PBoC instructed banks in March to keep their lending this year to last year's level.

Bloomberg reports that certain foreign banks have also been separately admonished to reduce their lending. The PBoC is worried about the rapid growth of the credit stock. According to media reports, banks were instructed to keep their first-quarter new lending no higher than year ago (7.1 trillion yuan) or preferably less. However, lending somewhat overshot the mark (7.7 trillion yuan) in the first quarter.

The bank lending stock grew by 13 % y-o-y in the first quarter of this year. The PBoC has announced its target of keeping growth in the credit stock roughly in line with the pace of nominal GDP growth. For example, the IMF expects China to experience nominal GDP growth this year of just under 12 %. At the end of March, the bank credit stock was about 170 % of GDP and the PBoC's broad credit indicator, "aggregate financing to the real economy" (AFRE), corresponded to 278 % of GDP. The PBoC figures show that the ratio of AFRE to GDP fell slightly from the end of last year, due in part to reduction in the stock of shadow banking sector instruments.

Policy rates have remained unchanged for a year. Interbank market rates have largely tracked policy rates.



Sources: CEIC, People's Bank of China, National Interbank Funding Center and BOFIT.

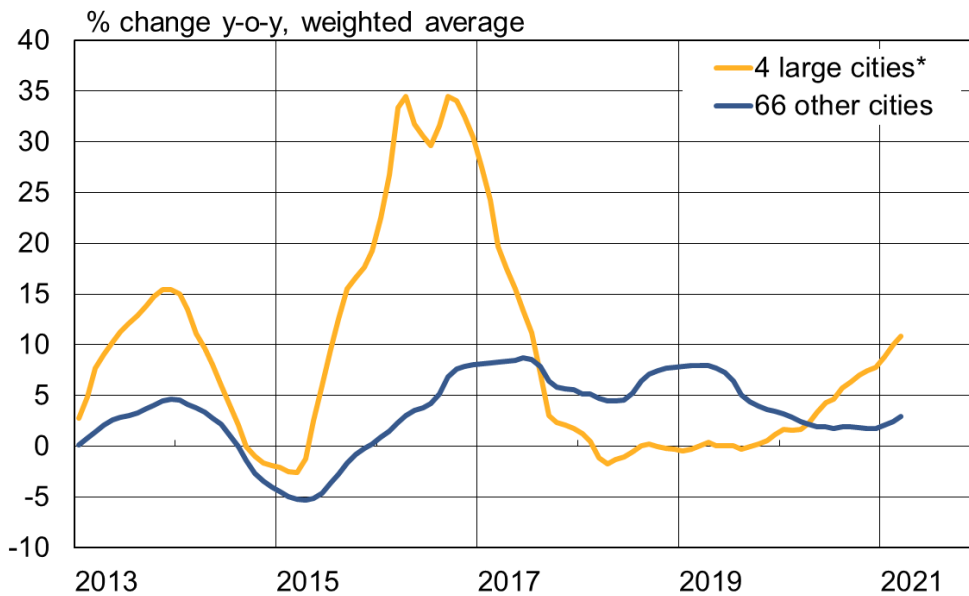
Housing market heats up in China's major cities. China's National Bureau of Statistics reports the sold floor space of apartments has been much higher in the first quarter than in the first quarter of 2019 and in March prices for existing residential housing in Beijing and Shanghai were up by 10 % y-o-y. Price increased in the southern China cities of Guangzhou and Shenzhen have been even somewhat faster. Price trends elsewhere vary, but on average they are up considerably in most cities. However also price declines have been registered in such cities as Tianjin and cities in northeastern China. The rise in prices of new apartments was slightly slower than for apartment prices generally.

Housing construction bounced back last year after the spring's covid crisis, but in the first three months of this year saw fewer new housing starts (measured in square metres of liveable space) and fewer housing construction projects completed than in the months preceding the covid crisis. The tightening of covid restrictions in January 2021 by officials seems to have caused delays in many construction projects. There were far more active construction projects in March than in the first quarter of 2019.

Officials have long been concerned about China's high housing prices and the rapid rise in household indebtedness. Since last autumn, regulation of the sector has been intensified. New restrictions were imposed on bank lending to the real estate sector at the start of this year, while in Autumn the government presented measures that limit indebtedness of large builders ([BOFIT Weekly 6/2021](#)). The PBoC guided banks in March to hold off on lending in general, and followed up in April with demands for banks to adjust their lending structure. By some estimates, the regulatory crackdown has already depressed construction activity.

About 75 % of Chinese real estate investment goes to construction of residential housing. Construction of office and commercial buildings still account for over 10 % of all construction, but the investment has been declining for several years. The value in investment in office and commercial buildings in the first quarter of 2021 was similar to the first quarter of 2015. The trend reflects a shift to online commerce and increased possibilities for telecommuting that began already before the covid crisis.

Housing prices are headed back up in China's four largest cities.



*) Beijing, Shanghai, Guangzhou and Shenzhen.
Sources: China National Bureau of Statistics, CEIC and BOFIT.

Russia

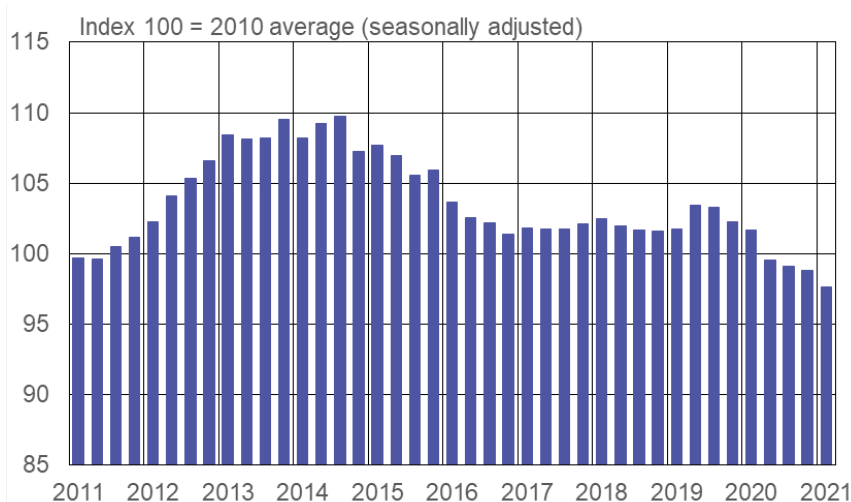
Covid crisis reduces Russian real incomes to lowest level in a decade. The real disposable incomes of Russian households were down by nearly 5 % in the first quarter of this year compared to the fourth quarter of 2019 (i.e. before the Covid Recession). While the economy has begun to recover, incomes have yet to start rising this year. Because income development had been muted for several years already and consumer prices continue to rise, the real incomes of Russians have regressed to the levels in the early 2010s.

As in many countries, the impacts of the covid crisis have been distributed quite unevenly in Russia. In the hardest-hit branches in Russia, which include hotels and restaurants, jobs have decreased markedly and workers have had to accept pay cuts. Income from entrepreneurial activity has contracted, with the incomes of small-business owners in particular falling sharply. Russia has yet to see a substantial wave of bankruptcies, however, due to a government moratorium on declaring bankruptcy, as well as a range of public-sector subsidy measures. On the other hand, the number of available jobs has increased and wages are rising rapidly in branches such as pharmaceuticals and courier services.

Despite worries about increased poverty from the Covid Recession, preliminary information seems to suggest this was not the case. About 18 million Russians lived below the official 2020 monthly poverty line (11,300 rubles, or about 140 euros), or 12 % of the population. That share is similar to the levels in the early 2010s. The growth of poverty was mitigated last year through covid-crisis support payments, a large share of which went to families with small children and the unemployed. The supports were targeted at poorer households, which meant that Russia's income disparity narrowed slightly last year. Most of the support payments were one-time payments, however, so their economic impact is expected to be short-lived.

Russia this year is changing the way it officially calculates poverty (subsistence level). Since the late 1990s, a "subsistence minimum" has been based on the cost of purchasing a basket of necessary goods and services. Moving forward, the subsistence level will be defined as 44.2 % of the monthly household median income, which this year is 11,600 rubles (calculated in 2019 earnings). The subsistence level, however, will not be lowered even if the median income declines. While the methodological change is not expected to change Russia's poverty rate much, it makes it harder for observers to compare poverty levels with previous years. For example, using the poverty line defined by the OECD (50 % of median income), 12.7 % of the Russian population lived in poverty in 2016. Under Russia's own poverty definition, 13.2 % of the population lived below the poverty line in 2016.

The real incomes of Russians have fallen during the Covid Recession.



Sources: Rosstat, CEIC and BOFIT.

Rapid housing loan growth in Russia continues. The growth in mortgage lending accelerated in the first three months of this year. In March alone, banks granted new housing loans worth a total of 500 billion rubles, or 52 % more than a year earlier. In January-March, 1.16 trillion rubles in housing loans were granted, a 43 % increase from 1Q20. The share of housing loans in total household bank loans rose to 47 %, its largest share ever.

Housing markets have been supported for several years by numerous state investments and support programmes. Housing demand has been propped up e.g. with family benefits (“maternal capital benefits”) and since 2018 a housing loan programme for families with small children. Yet another support programme was introduced in April 2020 that made certain households eligible for a housing loan carrying a fixed rate of just 6.5 % p.a. for the purchase of a new apartment. The subsidies do not apply to the market for old apartments.

The growth in demand supported by the cheap loans has been reflected in housing prices. In the October-December period last year, prices of new apartments climbed on average by 12 % y-o-y. The variation was large from city to city, however, with housing prices in some places rising clearly faster. The Federal Antimonopoly Service (FAS) has been instructed to look into pricing practices among construction companies. Price increases stem not just from high demand, but also higher construction costs due to labour shortages caused after a large share of guest workers have been unable to return to Russia due to covid restrictions.

The housing credit market is solidly in the hands of Russia’s state-controlled banks. Sberbank controls about 50 % of the market, with VTB having another 20 %. The combined market share of the next three largest state banks (Gazprombank, Rosselkhozbank and Rosbank) is about 10 %. Housing loans in Russia are granted at a fixed rate. Thus, the rise and fall of interest rates is not reflected in household debt-servicing costs. The discussion about permitting adjustable interest rate housing loans continues, but no major changes are expected in the near future.

The combination of a rising credit stock, soaring housing prices, and a decline in real household incomes will likely increase banking sector risks. The volume of non-performing housing loans in the first quarter of 2021 rose by over 10 % y-o-y. Due to the rapid growth in the credit stock, however, the relative share of non-performing loans declined to under 1 %. The market consensus presumes that Russia’s large state-owned banks have sufficient resources available to withstand a substantial increase in credit losses.

Growth in new housing loans remains impressive.



Sources: Central Bank of Russia, BOFIT.

Corporate profits return, with differences across sectors in Russia. There has been a strong rebound in net profit of Russia’s corporate sector after last spring’s sharp decline that resembled the recoveries after 2009 and 2015. Net profit has recovered rapidly to the tune that in January-February it was up by about a quarter from last year’s pre-covid level. While the net profit statistics are formed from the profits and losses of individual firms, Rosstat’s monthly figures do not include small firms, companies in the financial sector, or state agencies.

The lion’s share of the net profit of the corporate sector is generated in three economic categories. When crude oil and natural gas production and related services, production of petroleum products, pipeline transmission of oil & gas, as well as the production, transmission and distribution of electricity are included in the energy sector, the share of the energy sector in the net profit of the entire corporate sector has fluctuated between less than 30 % to over 40 % over the past couple of years. Russia’s manufacturing sector’s branches (excluding production of petroleum products) has generated 20–30 % of the net profit, of which 8–13 percentage points has been contributed by metals production. The large fluctuations in global commodity prices particularly affect the profits of Russia’s oil and metals industries. In any case, the government absorbs

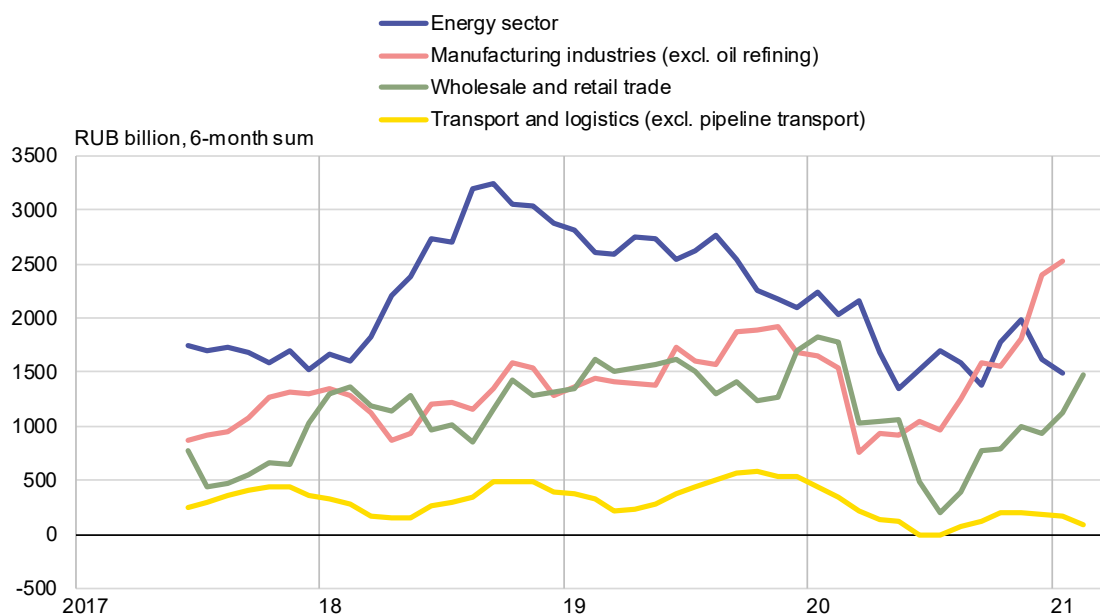
part of the higher export earnings of the oil sector as it applies export tariffs and production taxes which are linked progressively to the export price of oil.

The statistically recorded figures show that wholesale and retail trade together account for 17–20 % of the corporate sector’s net profit, with wholesale alone contributing as much as 13–18 percentage points. On the other hand, a significant chunk of profit-and-loss information in the retail branch is not covered by these statistics because the branch includes a large number of small firms and individual entrepreneurs. Wholesale’s share of net profits fell to just 5 % during the recession last year due to the decline in retail activity, corporate output and investment.

The recovery in corporate sector profits over the past seven months has largely been driven by manufacturing branches (not counting oil refining), and especially soaring profits in the metals industry have boosted the net profit of the entire corporate sector. Wholesale has seen its profitability recover for a rather large part from last year. Since last spring, profits in the energy sector, however, have remained relatively low.

Because Russian firms traditionally fund a large share of capital investment out of pocket, profits are important in this respect. Last year, the share rose to a record near 57 % (not including small firms, for which timely investment financing data are not compiled). About 60 % of the firms responding to Rosstat’s annual investment survey say that they have experienced insufficient own funds as a constraint on their investments. At the same time, the top investment concerns of responding companies also include other issues such as the uncertainty associated with the Russian economy and investment risks. About a tenth of Russian general government budget revenues come from taxes on corporate profits.

Russian corporate profits mostly on the mend – especially in the manufacturing and trade sector.



Sources: Rosstat and BOFIT.

China

China's industrial output perks up, domestic consumption still in the doldrums. Based on April reporting, the economy followed a bifurcated trend. On-year growth was high due to last year's low covid crisis base. Even so, retail sales growth, a rough indicator of domestic consumption, have yet to return to pre-covid levels. While retail sales in April were up by 16 % y-o-y in real terms, it was up by just over 5 % from April 2019. That translates into average growth of less than 3 % a year. April retail sales growth in month-on-month terms slowed sharply from March.

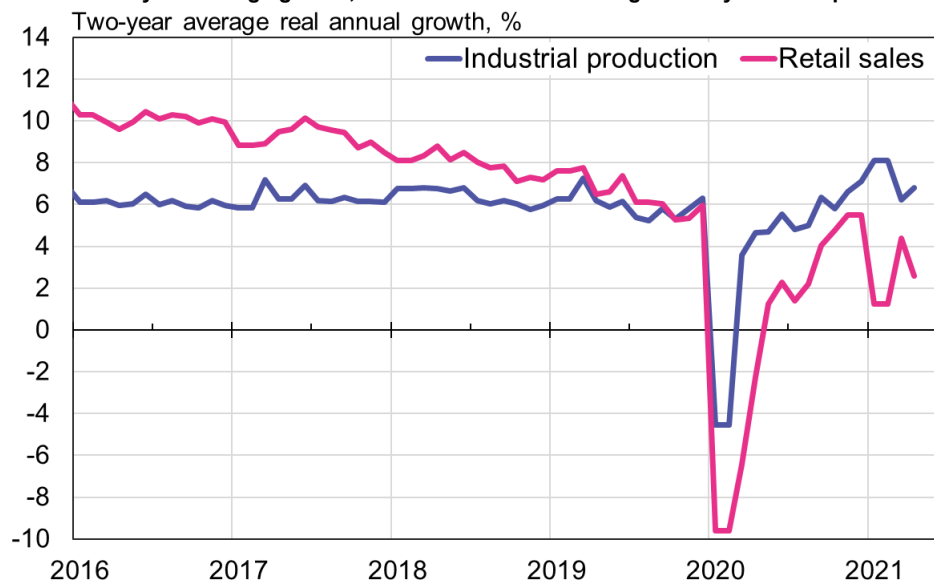
It is impossible to get a consistent picture of the trends in fixed asset investment (FAI) from China's official monthly statistical releases (see [BOFIT Weekly 52/2020](#)). According the reported official on-year growth figures, FAI rose by 8 % in nominal terms compared to January-April 2019. Based on yuan-denominated FAI figures, however, investment fell by 8 % in the same period. (The discrepancy may be due to a fact that the NBS does not revise the historical series for yuan-denominated investment when it makes changes to the sample of corporations.) The NBS also releases seasonally adjusted month-on-month growth figures. The series history changes significantly, however, from one month to the next, and they give completely different picture than the year-on-year figures. For example, if FAI is calculated based on the month-on-month figures released in April, the level of FAI is still 11 % lower than in April 2019.

Industrial output, which recovered rapidly from the covid shock, has grown a bit faster this year than before the covid crisis. Industrial output was up by 10 % y-o-y in April and up by 14 % from April 2019 (average growth of nearly 7 % a year). On-month growth slowed slightly, however, from the first months of the year.

Foreign demand has supported industrial output. Indeed, the on-year growth figures for foreign trade this year have been stunning. The two-year average annual growth in the value of exports in dollars was 17 % in April (14 % in January-April). Import growth has also revived, but still slightly lag export growth (two-year average annual growth was 11 % in April and 12 % in January-April).

Production of steel and aluminium hit record levels in April, even if producers had been asked to limit their production to reduce emissions. The production restriction plans, higher world market prices and speculation have contributed to higher commodity prices in China. This has been reflected in producer prices, the rise of which accelerated in April to 6.8 % y-o-y (4.4 % in March). Consumer prices, however, rose by a modest 0.9 % y-o-y in April (0.4 % in March).

Based on two-year average growth, retail sales have slowed significantly from the pre-covid period.



Sources: China National Bureau of Statistics, CEIC and BOFIT.

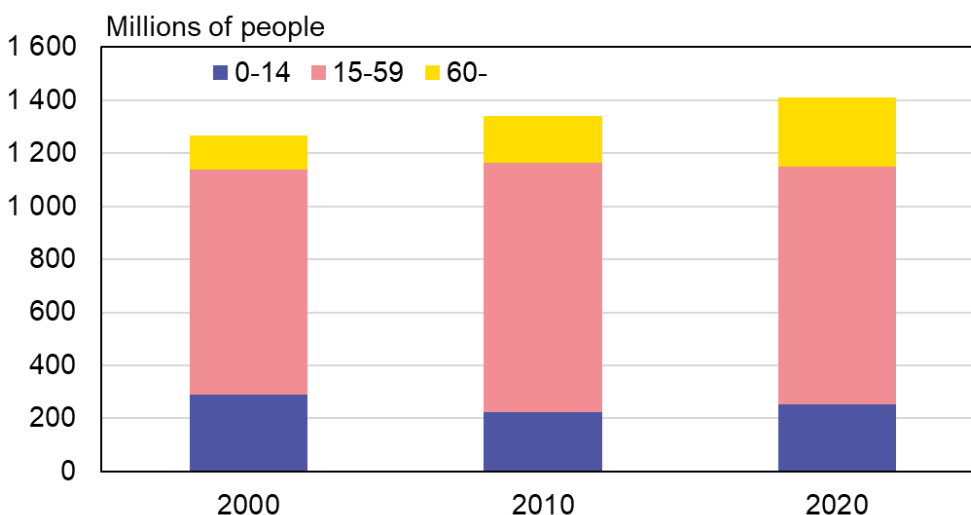
China's dependency ratio deteriorates and population urbanises. National Bureau of Statistics census figures put mainland China's population in 2020 at about 1.41 billion. China conducts its census every 10 years. The latest census was conducted in November 2020. The population had grown by 72 million from the 2010 census, the slowest increase in population in the nearly 70-year history of the modern Chinese census.

The census figures reinforce the general view of China's evolving demographics. China's population is aging and becoming urbanised. The number of working aged people and the birth rate are falling. Between 2010 and 2020, the working age (15–59) share of the population declined by 7 percentage points to 63 % of the total population. At the same time, the over-60 population grew by over 5 percentage points to 19 % of the total population. Surprisingly, census showed that the 0–14-year-old population grew by over 1 percentage point from 2010 to 18 % of the total population. The overall fertility rate declined to 1.3 children per woman. China's move to the cities continued with 64 % of the population now living in cities and just 36 % of the population living in the countryside. Moreover, the number of migrant workers continues to increase.

The census highlights, originally to be released in April, were postponed to May. The delay ignited media speculation that the census might show that China's population has already gone into decline. According to the census, however, population growth continued and there were 12 million more people than reported in 2019. Curiously, the census figures show that there were 14 million more 0–14-year-olds than the annually released birth figures for 2006–2019 suggest. Finding millions of children outside birth statistics further boosted suspicion that China's officials are fudging the numbers to give a rosier picture of the situation. The UN's annual [total population prediction](#) for China in 2019 was based on an assumption that the population would only begin to decline after 2030, but the weakening birth rate has caused many to question whether China's population decline will begin sooner. China has not considered taking more migrants from elsewhere as a way to deal with its worsening dependency ratio.

China's population policy seeks modest population growth and urbanisation, but both goals are hamstrung by strict policy measures. Even if procreation policies have been relaxed a bit in recent years, China's leaders remain reluctant to make sweeping reforms. The one-child policy was modified after nearly four decades to a two-child policy only in 2016. Thereafter, the government strongly supported families that chose to have a second child. China's birth rate ticked up slightly in 2016 and 2017, but ever since has again been on the decline. Many Chinese, who already see rearing children as an expensive enterprise, felt that the covid pandemic only further increased their economic uncertainty. The situation is particularly dire for migrant workers as the domicile of their children is defined by the *hukou* household registration system. Under *hukou*, the children of migrants may not attend schools in the cities where the parent work or take advantage of other public services that children of city residents enjoy. China has recently made it easier for migrant workers to register in small and mid-sized cities, but moving of one's domicile to China's largest metropolises is strictly limited.

China's population is aging rapidly.



Sources: NBS population calculations, CEIC and BOFIT.

Chinese increasingly likely to attend university, nearly all young adults are literate. The latest census data released by the National Bureau of Statistics includes information about education levels of various segments of the population. According to the new data, about 220 million Chinese (15 % of the population) had a college or university-level education. This highly educated share of the population increased substantially over the past decade. In 2010, only 9 % of the population had a higher-level degree. During the past decade, China established 380 new institutions of higher learning in response to strong demand. Chinese persons over 15 stayed in school for almost a year longer on average than their counterparts in 2010, when the average time spent on education was about the same as the basic education requirement (9 years).

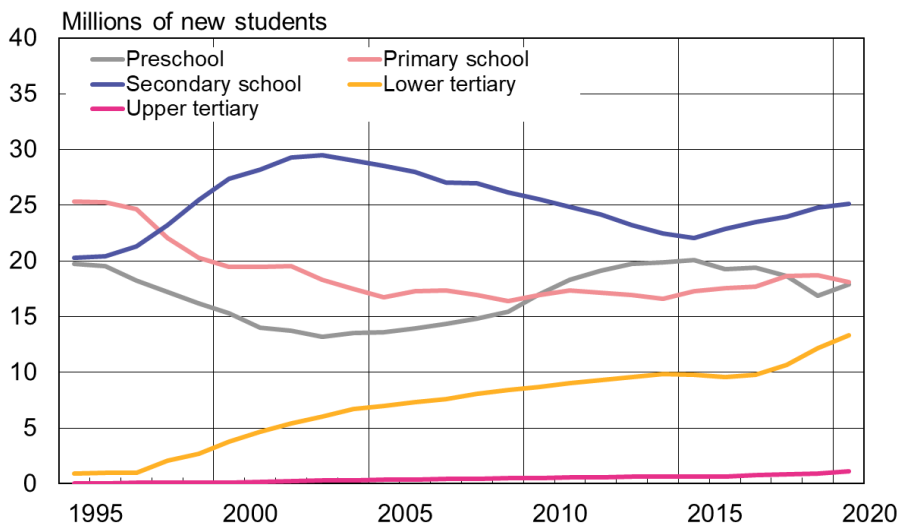
Illiteracy has declined for decades in China. In 2020, only 2.7 % of the population could not read. In the world's most populous country, that small percentage still translates to nearly 40 million people. Most illiterate adults in China are elderly. The World Bank reports that nearly all of China's 15–24 year-olds can read (99.8 %).

According to China's Ministry of Education, about 30 million students in 2019 were pursuing bachelor's degrees, nearly 2.5 millions were working on their master's degrees and 420,000 were doctoral students. Over a third (35 %) of students in 2019 embarking on their master's studies were studying engineering. The next most popular fields were public and business administration (15 %), medicine (10 %), education (8 %) and natural sciences (7 %). Slightly more students studied law (6 %) than economics (5 %). The least-popular master's programmes were in history (1 %), philosophy (0.5 %) and military science (0.1 %).

Nearly 500,000 foreign students studied in Chinese universities in 2019. The largest contingent by far consisted of students from South Korea (10 %). Asian students represented well over half of all foreign students in China. About 15 % of students were from Europe (74,000). In contrast, about 1.6 million Chinese studied abroad in 2019, of which nearly a quarter were enrolled in degree programmes in the United States. The next top study destinations were Australia (10 %), the United Kingdom (8 %), Japan (6 %) and Canada (5 %).

Six Chinese universities made the [Shanghai ranking list](#) of the world's top 100 research universities. The same six universities also made the top 100 of the more rounded [World University Rankings 2021](#), which takes into account the quality of teaching, research, knowledge transfer and international outlook. China's top two universities, Tsinghua University and Peking University, are located in Beijing. China has a total of nearly 2,800 universities or other institutions of higher learning.

The number of students pursuing higher degrees in China has increased in recent years.



Sources: China's Ministry of Education, CEIC and BOFIT.

China continues to create ever larger and more powerful state enterprises. China this month finalised the merger of two country's large state-owned chemical producers. Both SinoChem and ChemChina will now be held under the newly created SinoChem Holdings. The new firm will employ 220,000 people and operate in 150 countries. The combined



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revenue of SinoChem and ChemChina in 2019 amounted to roughly USD 150 billion, which would put the new company among China's ten largest firms and making the Fortune top 40 list of the world's largest corporations.

The merger, which had been discussed for a few years, was given the green light in March. The successor firm will have the same administrator as the previous two firms: the State-owned Assets Supervision and Administration Corporation (SASAC). Analysts see SinoChem as a financially solid firm, while ChemChina is struggling with debt from its 2017 acquisition of Swiss Syngenta for over USD 40 billion, which is still the record for a foreign acquisition by Chinese company.

The merger of the chemical companies reflects China's thinking on reform of state firms. For years, "reform" has implied improving the profitability of state-owned enterprises (SOEs) through merging companies into ever larger agglomerations combined with various programmes to improve their administration. Privatisation of state firms beyond through the sale of minority stakes to investors has not been on the agenda. The urge to merge is evidenced e.g. by the fact that SASAC still administers 97 firms, down from over 150 a decade ago. Many of these firms have a myriad of subsidiaries, not to mention that local governments have their own asset supervision and administration commissions managing a vast number of firms. Taken together, the OECD estimates that China has a total of about 150,000 SOEs.

The creation of ever larger and more powerful SOEs is further seen in SASAC's portfolio of firms under its administration. SASAC reports that the total assets of its central and local government administered SOEs was about 120 trillion yuan (174 % of GDP) at the end of 2015. By the end of 2020, the value of SASAC assets had risen to 220 trillion yuan (215 % of GDP). Researchers note that state-owned and local-government-owned firms in China are less efficient than their counterparts in the private sector, and that their increased role in the economy generally erodes productivity.

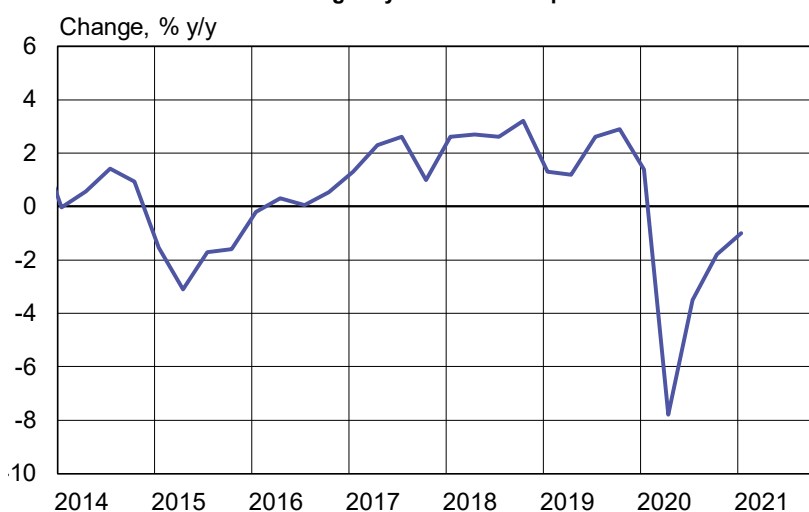
Russia

Russian economy continues to recover. Preliminary figures show Russian GDP contracted by about 1 % in the first quarter of this year. In the fourth quarter of 2020, GDP was still shrinking by about 1.8 % y-o-y ([BOFIT Weekly 15/2021](#)). While the more detailed GDP figures have yet to be released, it is possible to conclude from other economic indicators that seasonally adjusted first-quarter GDP growth was positive relative to the final quarter of 2020. Notably, Russia's seasonally adjusted GDP had already begun to contract in the latter half of 2019 before the covid pandemic suggesting that the Russian economy is experiencing also problems unrelated to covid-19. In the fourth quarter of 2020, GDP was 4.2 % less than in the second quarter of 2019.

Industrial output rose by 7.2 % y-o-y in April, while the on-year change was still -0.9 % in the first quarter of this year. The on-year change for many economic components is likely to be quite large in coming months as the reference base of spring 2020 was so low. Like many economies, the Russian economy struggled with lockdowns and other restrictions on movement a year ago. Seasonally adjusted industrial output in April was unchanged from the previous month. Much of the growth was driven by manufacturing, which was up by 14.2 % y-o-y. Extractive industry output fell by 1.8 % as the OPEC+ agreement on production ceilings continued to constrain Russian crude oil production. Oil output contracted by 5.7 % y-o-y in April.

There were some clear signs of recovery in the Russian labour market. The unemployment rate in April was just 5.2 %, down from a peak of nearly 6.5 % last autumn. The traditional flexibility of Russia's labour market has helped to keep the unemployment rate in check. The employment rate was still somewhat lower than at the end of 2019.

Russian GDP was still contracting on-year in the first quarter of 2021

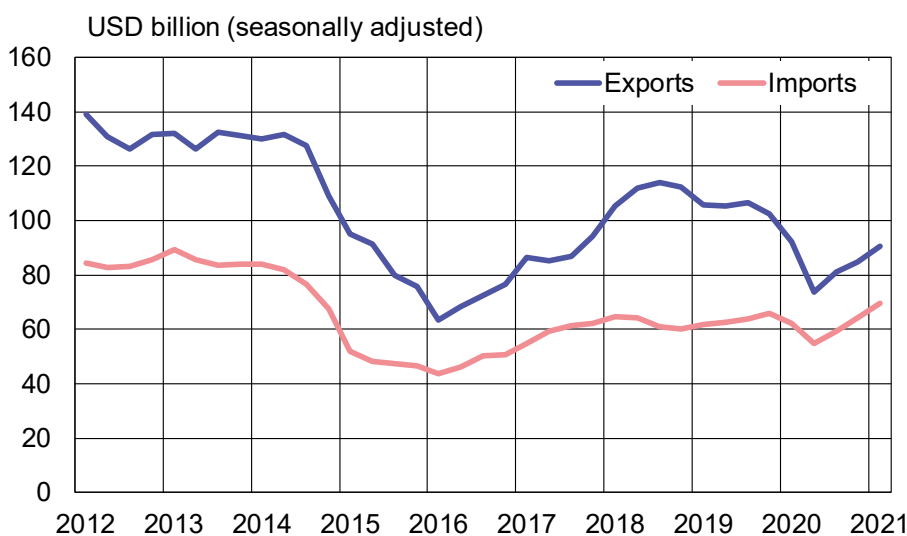


Sources: Rosstat, Macrobond and BOFIT.

Robust growth in Russian goods imports. Supported by a recovery in demand, the value of goods imports rose 14 % y-o-y in the first three months of this year. Goods imports have already exceeded their pre-pandemic levels. The recovery was led by the machinery, equipment & vehicle category, which accounted for nearly half of all imports. The value of machinery & equipment imports rose by roughly 20 % y-o-y. This was supported by rapid recovery in fixed investment and robust construction activity throughout the crisis. Figures from the Association of European Businesses (AEB) show that sales of new construction machinery in Russia rose by nearly 30 % y-o-y in the first quarter of the year. Sales of new passenger cars rose nearly as fast during January-April. The number of passenger vehicles imported in the first quarter was up by nearly 50 % from a year earlier. Among other major import items, the value of e.g. pharmaceuticals imports doubled. Imports of several foodstuffs also rose rapidly and import volumes of e.g. sugar and vegetable oil doubled. Prices of these products in Russia have soared in recent months, due largely to poor domestic crop harvests last autumn.

The rise in imports has been fuelled in part by a recovery in Russian export earnings. The value of Russian goods exports increased by 3 % y-o-y in January-March. Exports were supported by a strong recovery in global commodity demand in response to strong stimulus efforts in many countries. While the volume of Russian crude oil exports declined by 20 % y-o-y in the first quarter, export volumes of natural gas, certain metals, grains and raw timber grew briskly. Commodity prices have rebounded sharply with the recovery in global demand. The average price of Urals oil, Russia's top export, hit USD 60 a barrel in the first quarter, more than 20 % higher than in the first quarter of 2020. World prices for metals, grains and raw timber have increased even faster than oil prices. Russia has even imposed temporary export quotas and increased export duties on certain items (e.g. wheat and maize) and is considering more (e.g. certain kinds of raw timber and scrap metal) in order to rein in price increases on the domestic market.

Russian goods imports already exceed pre-pandemic levels



Sources: CEIC, Central Bank of Russia and BOFIT.

Government sector revenues in Russia have turned to rise, spending growth still brisk even if strong stimulus behind. The consolidated budget, which comprises federal, regional, municipal and state social fund budgets, saw first quarter revenues rise by 9 % y-o-y in nominal terms, significantly outpacing Russia's inflation rate. Following a drop last spring and summer, incomes have rebounded, growing by 7 % y-o-y already in the final quarter of 2020.

Revenues from special taxes levied on the oil & gas sector (i.e. production taxes and export duties) were still about 10 % lower than in the first quarter of 2020. Crude oil production – and crude oil exports in particular – were held well below the levels of a year earlier due to weak international demand and the OPEC+ agreement on production cuts. The export price of crude oil was also still a few percent lower than 12 months ago as it lags global market prices which were already substantially higher than a year ago.

Other budget revenues have increased well. In the first quarter, other revenues were up by 13 % y-o-y, rising nearly as fast as in the final quarter of 2020. Due to the economy's slow recovery, however, certain types of major taxes such as mandatory social contributions of employers on worker wages, labour income taxes and corporate profit taxes only increased by a few percent in the first quarter, barely keeping pace with inflation. The rise in the first quarter actually had some special features. Revenues from value-added taxes were up by about 25 %, which may partly reflect further improvements in tax collection. In addition, budget revenues got rather large support from the CBR's final payment of the surplus generated from the sale of its stake in Sberbank to the government last year, as well as large settlements paid to the government for major water pollution damages.

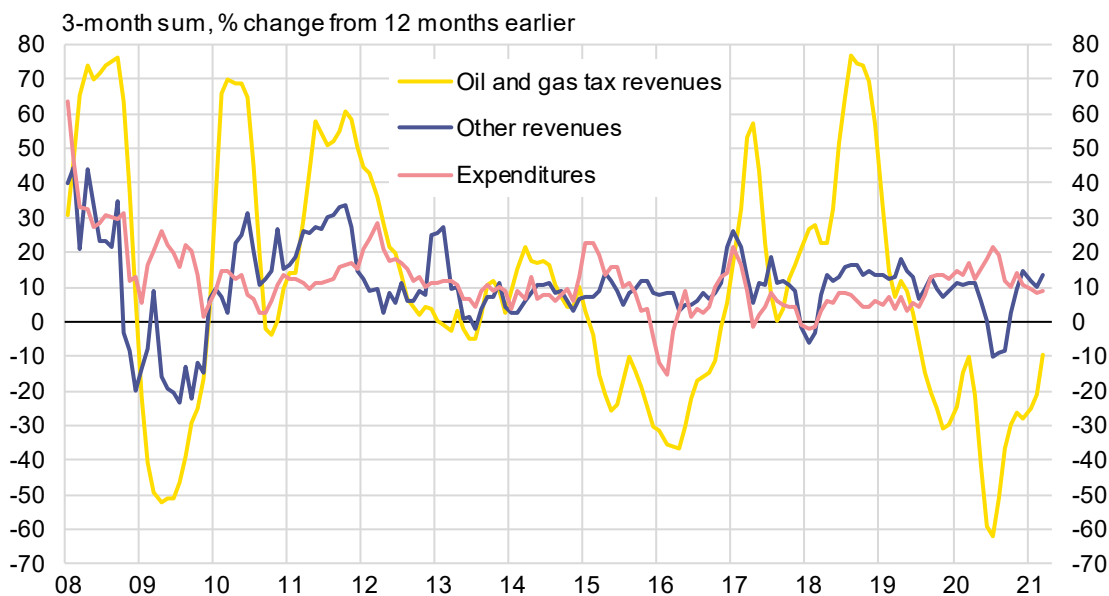
Increases in consolidated budget spending have slowed since the strong stimulus packages in the first half of 2020. Nevertheless, spending still grew in the first quarter of this year by 9 % y-o-y, which was only slightly lower than in the second half of 2020. Targeted spending to various branches of the economy in particular and also the housing sector came back with a rise exceeding 30 % y-o-y. Growth of other social support spending than pensions soared last year at a near 40 % y-o-y pace, yet it still increased by over 20 % y-o-y in the first quarter. A clearer slowdown was seen in health care, where on-

year spending growth was a clip over 10 % after hitting 30 % last year. As last year, spending on education and domestic security & law enforcement increased by a fairly moderate 5–7 % this year.

The rise in budget expenditures in the first quarter of this year did not reflect moves towards the government’s policy guidelines of last autumn, whereby spending growth was to be kept this year to a couple of per cent to reduce the budget deficit. Given the rise in budget revenues and oil prices well above the guideline’s assumptions, Russia can reduce the consolidated budget deficit and at the same time maintain higher spending growth this year than set out in the guidelines. Indeed, the consolidated budget showed a notable surplus in March. This brought the 12-month deficit from rather deep levels seen in the two previous months back to the figure of late last autumn, i.e. about 4 % of GDP.

In his parliamentary address this spring, president Vladimir Putin stressed the need to increase certain forms of social support. Finance minister Anton Siluanov noted that all of the proposed increases have been taken into consideration in the current federal budget. Regional budget spending could be increased somewhat compared to the above-mentioned policy guidelines with the intended release of federal funds to regions as long-term loans to finance infrastructure development. Any revised government budget policy guidelines not been released.

Russia’s government budget revenues and expenditures have increased briskly this year



Sources: Russian Ministry of Finance and BOFIT.



China

Yuan appreciation ignites policy debate in China; PBoC raises forex deposit reserve requirement. The Chinese currency has strengthened to a level last seen in early summer 2018. The yuan has gained 10 % against the dollar over the past twelve months. While part of this reflects general dollar weakness, the yuan's nominal effective (trade-weighted) exchange rate (NEER) and the central bank's trade-weighted forex index, CFETS, have both strengthened by about 6 % y-o-y. The yuan has also gained about 2 % against the euro over the past 12 months.

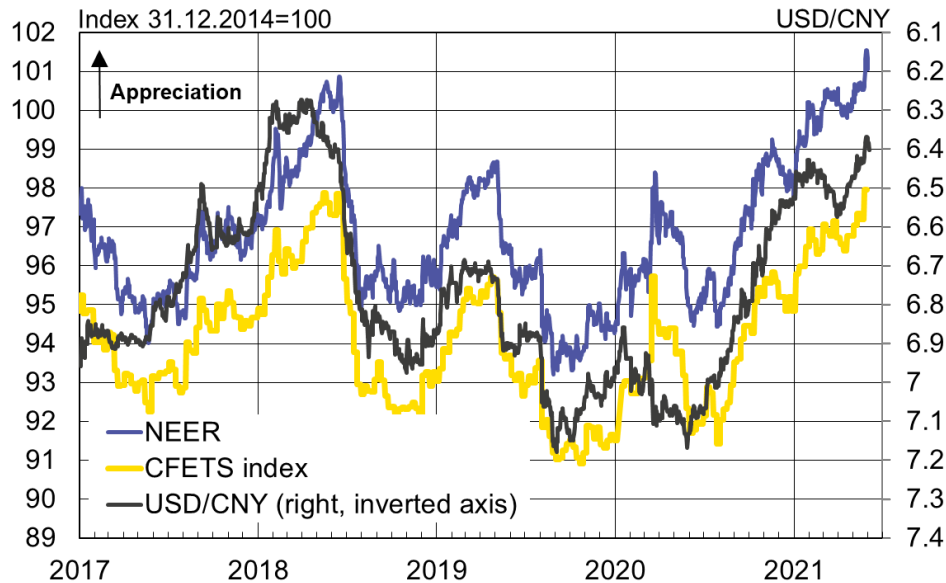
The strengthening of the yuan can be attributed to robust performance of the Chinese economy, a growing trade surplus and capital inflows. The yuan's appreciation has triggered a surprisingly strong discussion in China. In a now-deleted post, the head of research at the Shanghai branch of the People's Bank of China remarked that China could tolerate stronger exchange rate in order to subdue domestic inflation caused by rising global commodity prices. The director of the PBoC's finance research institute also commented in a speech that China needs to move to a freely floating currency in order to achieve greater global use of the yuan, and that this will lead an appreciation of the yuan against the dollar over the longer run. The discussion got a quick response from the PBoC's top officials. Deputy governor Liu Guoqiang commented that the PBoC does not seek to guide the yuan's exchange rate and is not planning an overhaul of its exchange rate regime. According to Liu, the yuan's exchange rate is set by the market. It has remained "basically stable" and the incumbent exchange rate regime serves China well now and in the future. The PBoC further stressed in a later post that it is not possible to bet on exchange rate swings when rates are set by the market and all speculation should be avoided. It also underlined that the exchange rate cannot be used to support weak exports through depreciation or to offset rising prices through appreciation.

The PBoC nevertheless announced it was raising the forex reserve requirement for commercial banks from 5 % to 7 %, effective June 15. The forex reserve requirement was last changed in 2007. An increase in the forex requirement reduces the amount of forex available on the market. The official reason for the move was to strengthen the forex liquidity management of the financial sector, but the move was seen more as a signal that the PBoC is prepared to intervene to affect trends in the forex market. The impact of such measures on financial markets overall is marginal.

Forex deposits in mainland China banks have grown fast on rising export earnings and capital inflows. Their value in April was over \$1 trillion (33 % y-o-y growth). The increase in the reserve requirement reduces liquidity by about \$20 billion.

The PBoC has not officially intervened in the forex market for years, but it has many other measures in its monetary toolkit for influencing exchange rate trends, including guidance for state-owned commercial banks. China's official exchange rate regime is a managed floating with a reference to a basket of currencies. In practice, the yuan's exchange rate is permitted to fluctuate 2 % against the US dollar from the daily fixing midpoint rate set each morning. The PBoC's dollar-yuan fixing rate is based on estimates from large commercial banks. The banks are supposed consider changes in yuan's external value relative to the forex basket. From time to time, the commercial bank estimates were also expected to include vaguely defined "countercyclical factor" necessary to prevent excessive exchange rate swings. However, the use of a countercyclical factor was abandoned last October. Daily fixing rates are also set for other currencies with broader fluctuation bands. The freely convertible offshore yuan (CNH) traded in Hong Kong presumably exists outside this regulatory framework, but as a big chunk of CNH trading is conducted by China's large state-owned banks, the CNH rate can also be affected. The CNH rate has recently stayed very close to the CNY rate.

The yuan has appreciated against the US dollar and also against nominal trade-weighted exchange rates NEER and CFETS-index



Sources: Macrobond, BIS, CFETS and BOFIT.

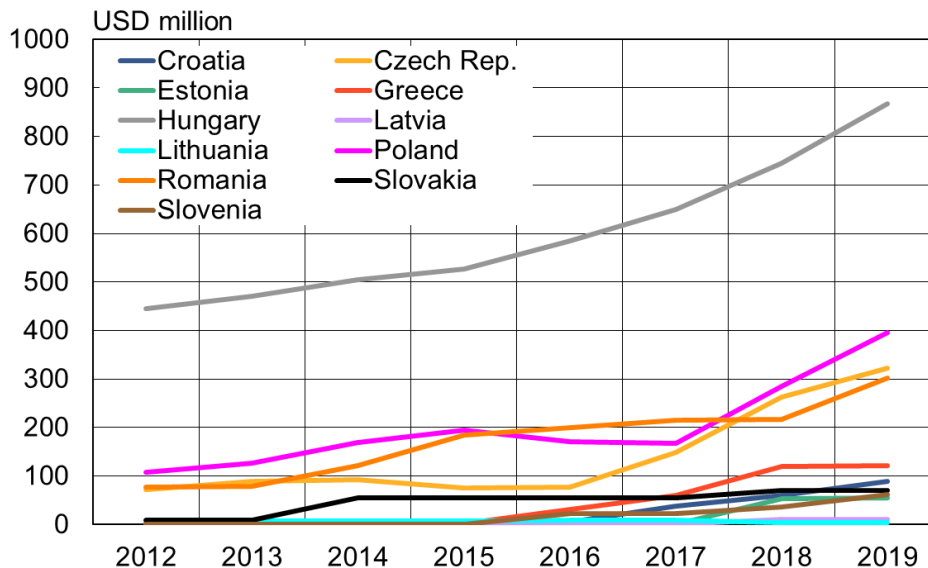
European China sentiment sours. On May 20, the European Parliament voted to suspend temporarily ratification of the China-EU Comprehensive Agreement on Investment (CAI). In its [press release](#), the European Parliament said it was postponing its consideration of CAI until after China lifted its counter-sanctions on European entities. China imposed sanctions in March after the EU imposed sanctions on Chinese individuals and entities for human rights violations in Xinjiang autonomous territory ([BOFIT Weekly 12/2021](#)).

The European Parliament took no stance one way or the other on CAI, but said that its review of the agreement must include consideration of the human rights situations in mainland China and Hong Kong. Ratification of CAI has been uncertain from the start as it aroused considerable opposition within the EU not just for China's human rights record but for the lack of transparency ([BOFIT Weekly 2/2021](#)). China hopes that EU-China cooperation will continue.

Several days after the European Parliament's vote, Lithuania's foreign minister Gabrielius Landsbergis announced that his country was leaving the 17+1 group of countries of Central and Eastern Europe engaged in cooperation with China. Landsbergis said the group is divisive as far as EU common policy was concerned and hoped that all EU members would support a more unified approach to dealing with China. The 17+1 group was a cooperation platform established in 2012 consisting of China and countries from the Balkans and former Eastern bloc. Group members initially aspired to attracting Chinese investment and improving their opportunities for exporting to China. Many countries, however, have been disappointed by tepid investment growth and ongoing troubles in gaining access to the Chinese market. Countries have also begun to distance themselves from China due to its increasingly aggressive diplomatic posture. Quite exceptionally, China's relations with Hungary have thrived under the arrangement. FDI flows from China to Hungary have risen steadily, and in coming years the Chinese computer-maker Lenovo will open a manufacturing facility in Hungary, while Shanghai's best-known research university, Fudan University, plans to establish a satellite campus.

Many EU countries seem to be increasingly reluctant to make policy compromises for the sake of maintaining good trade relations with China. In addition to human rights, Taiwan's status has traditionally been an issue complicating relations with China. In its press release, the European Parliament said that the EU-China investment agreement cannot be an obstacle to better EU-Taiwan economic relations. Lithuania also announced plans to open a trade office in Taiwan.

China's cumulative direct investment in the 17+1 group of EU countries.



Sources: China's Ministry of Commerce, CEIC and BOFIT.

China's new three-child policy unlikely to have much effect on the country's birth rate. China's state media report that the Communist Party politburo decided at the start of this week to change the current two-child policy to a three-child policy. It is not clear when the decision takes effect, but it was taken after a drop in the birth rate showed up in recent census data (BOFIT Weekly 20/2021). China seeks to increase its birth rate and diminish demographic strains over the longer term by relaxing the limits on the number of children per family. The change is unlikely to have much effect as the 2015 replacement of the one-child policy with a two-child solution failed to produce a baby boom officials expected. In addition, China has long allowed exceptions to the child quota. It is curious that the party leadership still bothers to regulate procreation as the new rule only applies to a tiny sliver of families.

Starting a family in China is limited by a range of factors, not least that raising children is expensive even if couples manage to resolve the conflict of work and raising a family. Many city-dwellers also feel they lack the time to devote to child-rearing, even those that managed to have a child under the one-child policy. Rather than change the child quota, commenters in Chinese social media would prefer that the government focus on improving public services and reinforcing social safety nets to encourage couples to have children.

Finland's goods imports from China experience strong growth in the first three months of this year. During the first quarter of this year, Finland imported goods from China worth over 1.3 billion euro. The value of imports was up 13 % y-o-y in the first quarter and up 18 % from the first quarter of 2019. Finland's imports from China rose significantly faster in the first quarter than total imports (up 0.8 % y-o-y). China's share of Finnish goods imports increased during the first year of the covid-19 crisis. China's share was about 7.5 % in 2019, rising to around 9 % in 2020. That share was about 8.5 % in the first quarter of this year. In January-March, Finland imported from China phones, computers and other machinery & equipment worth about 590 million euro (44 % of total imports). Their value increased about 18 % y-o-y and about 30 % from the first quarter of 2019.

The value of Finland's goods exports to China in the first quarter was 850 million euro, an increase of 21 % from a year earlier and a 5 % increase from two years earlier. The value of Finnish goods exports to China increased faster in the first quarter than goods exports in total (3.7 %). China's share of Finnish goods exports in the first quarter was close to 6 %, a share slightly higher than last year's average.

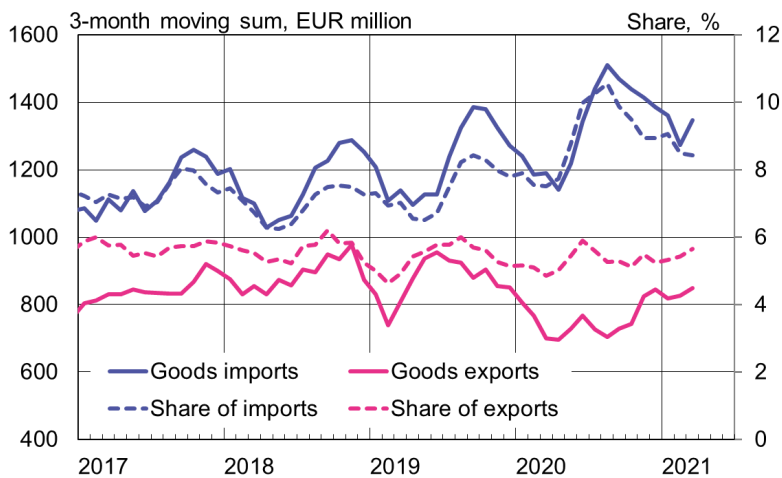
Finland's top export product to China was wood pulp (27 % of total exports). The value of pulp exports in the first quarter of this year was 230 million euro, about the same amount as in the first quarter of 2019 and a 63 % increase from year ago.

Altogether, pulp & paper goods accounted for nearly 35 % of Finnish exports to China. Some of the rise in the value of pulp exports reflects higher world commodity prices, which were up by 60 % on average in the first quarter compared to the first quarters of 2019 and 2020. Specialised equipment for various branches formed the second largest category of exports to China (nearly 120 million euro or 14 % of total exports). The value of specialised machinery & equipment was about double that of the first quarters of 2019 and 2020. The combined share of the machinery, equipment & vehicle category in total exports was 28 % in the first quarter.

While Finland has long run substantial deficits in its bilateral goods trade with China, it has typically run a services trade surplus. Exports of services, however, has contracted sharply during the covid-19 crisis. The value of services exports with China in the first quarter of 2021 was just under 330 million euro, a 5.5 % drop from year ago and a 20 % decline from the first quarter of 2019. The value of Finland's total services exports in the first quarter of this year was €5.9 billion, a 17 % decline from two years earlier. Total services imports fell by nearly 15 % from two years ago to 6.7 billion euro in January-March of this year. Despite the decline, imports of services from China grew in the first quarter to about 250 million euro, which was 13.5 % more than in the same period last year and nearly 8 % more than in the first quarter of 2019.

At the end of May, Statistics Finland released experimental value-added foreign trade indicators for 2019. In that year, the value of exports from Finland to China was €5.3 billion, of which €3.4 billion was domestically generated value added. The domestic content of Finnish goods exports to China was 64 %, a couple percentage points higher than Finnish exports generally. Measured in terms of value added, China, with an almost 6 % share, was Finland's fourth most important trading partner after Sweden, Germany and the United States. Statistics Finland noted that China's share of domestic value added in exports overall was slightly higher than its share of gross exports of goods and services.

Finland's goods imports from China increased sharply during the first phase of the covid-19 crisis.



Sources: Finnish Customs and BOFIT.

Russia

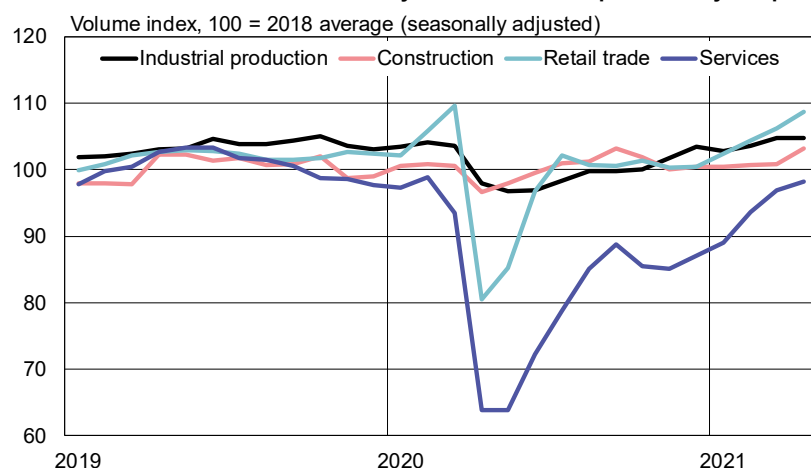
April output exceeded pre-covid levels in many Russian branches. Many parts of the Russian economy posted eye-popping on-year growth figures in April, thanks largely to the low base reference from April 2020 which was the trough of the covid crisis. According to preliminary estimates released by the Ministry of Economic Development, GDP in April climbed nearly 11 % y-o-y. The ministry estimates, however, that GDP in April was still slightly below pre-crisis levels. The purchasing managers' indices suggest that the economic recovery continued in May. The most recent forecasts also generally expect Russian GDP to grow by about 3 % this year.

Consumption-driven branches in particular have developed briskly this year, and their robust growth continued in April. Retail sales, for example, were already much higher than before the pandemic. Other service branches also recovered rapidly, but their output in April was still 6 % below April 2019. Services production saw the sharpest decline across sectors last spring as the lockdowns hit service branches particularly hard. Rising wages and increased employment in the first quarter of this year have helped the recovery in consumption. The average real wage rose by nearly 2 % y-o-y in the first three months of this year.

Despite a small drop from March to April this year, manufacturing has recovered rapidly to levels of output exceeding pre-crisis levels. Extractive industries have also experienced rising output in recent months, but production growth is still restricted by the ceilings imposed on crude oil production under the OPEC+ agreement. The current agreement allows Russia to gradually increase its crude oil output slightly further in the coming months, but requires that Russian oil production remain well below pre-covid levels until the end of April 2022.

Economic growth was further supported in April by the construction and agriculture sectors, which have generally been less affected by the Covid recession. Construction output, which remained resilient last year, showed robust growth in April. Total fixed investment in the first quarter of this year was up 2 % y-o-y (up 3.5 % y-o-y in the first quarter of 2020). Agricultural output even rose slightly last year. In April this year, it was at the same level as in April 2020.

Most branches of the Russian economy continued their rapid recovery in April



Sources: Rosstat, CEIC and BOFIT.

Developments in industry, trade and fixed investment vary across Russia. The magnitude of the economic contractions experienced in spring 2020 varied considerably across Russia's federal districts, with some regions even experiencing growth. In any case, the duration of the contraction was fairly brief for most of Russia. This is reflected in the figures for the full year 2020. Manufacturing output barely contracted in those five federal districts (out of the total of eight) that together account for over 90 % of all of Russia's manufacturing activity. In the Central and Ural federal districts, 2020 manufacturing output even rose by 5–6 % from 2019, while it declined by only a half percent to two percent in the three other federal districts (Northwestern, Volga and Siberian). The volume of retail sales in the Northwestern Federal District was the same as in 2019. It decreased by 2 % in the Central Federal District and by about 3–4 % in five other federal districts.



Fixed investment at its deepest contracted by 3–4 %, which concerns two important federal districts, including the Central Federal District, and remained largely unchanged in three other significant federal districts, including Northwestern.

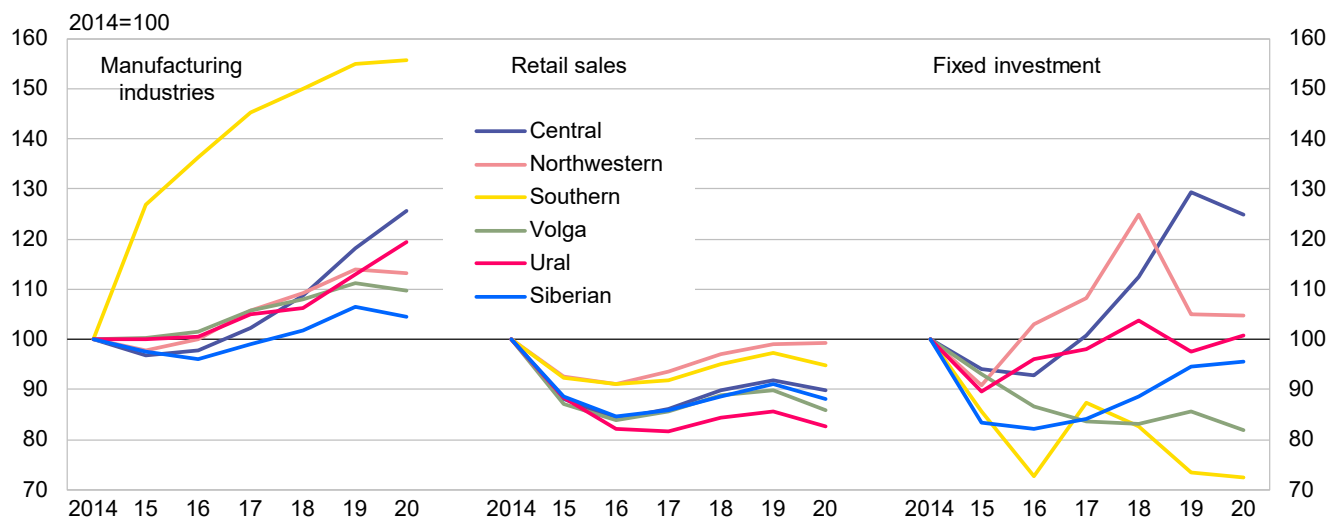
Differences are apparent also when comparing current levels to levels before last year's Covid recession. The change in manufacturing output from January-April 2019 to January-April 2021 varied quite widely in the five federal districts where most manufacturing occurs. In the Central Federal District, growth from two years previous was 18 %. Half of the increase came from a nearly 20 % jump in output from the City of Moscow, which is an extension of the growth in Moscow's manufacturing that began in 2018. Moscow accounts for 15 % of the entire country's manufacturing output. The City of Moscow is further surrounded by the Moscow region (Moscow oblast), which accounts for 6 % of the country's manufacturing. The region's manufacturing continued to rise for the sixth consecutive year and was up by 25 % in January-April from the same period in 2019. In the Northwestern Federal District, manufacturing output in January-April was up by less than 3 % from two years previous. This includes the Leningrad region (Leningrad oblast), where production rose by 7 % (over 2 % of national manufacturing output). After a couple of years of high growth, there was no growth in manufacturing output in the City of St. Petersburg, which accounts for over 5 % of manufacturing. In the three other federal districts with substantial manufacturing activity there were also large differences (up 7 % in Volga, up 14 % in Ural and down 3 % in Siberian).

Changes in the volume of retail sales in the first four months from two years ago show less variation. The rise in retail sales in Russia has come more or less fully from sales growth in the Central, Northwestern and Southern federal districts, which together account for 55 % of retail sales nationally. Retail sales in these three federal districts have increased by 7–9 % from two years previous, while the change in nearly all other federal districts has been only between -1 % and +2 %. In the Central and Northwestern federal districts, 85 % of retail sales growth has come from large urban areas. In Moscow, which accounts for 15 % of the nation's retail sales, retail sales were up by over 6 % after increasing reasonably well in the two previous years as well. St. Petersburg, which accounts for nearly 5 % of retail sales, saw growth of nearly 11 % after growing quite briskly in the two previous years. The Moscow region, with a nearly 8 % share, and the Leningrad region surrounding St. Petersburg, saw growth of 12–13 %, continuing their latest growth surge that began in 2017 to become concentrations of commercial activity which includes serving e.g. Moscow and St. Petersburg.

Movements in fixed investment are uneven for different parts of Russia, while it is also worth having caution in mind when comparing short periods especially in investment activity which varies seasonally as well as due to large projects. Much of the rise in fixed investment between the first quarter of 2019 and the first quarter of 2021 came from Moscow, where fixed investment rose by over 20 %, continuing a rapid rise that began in 2017–2018. Moscow accounts for 17–18 % of the country's total fixed investment. Moscow also drove the investment growth figure in the Central Federal District to over 12 % and a 30 % national share. In the Northwestern Federal District (over 10 % share), much of the nearly 10 % drop in fixed investment was due to a 30 % fall in the Leningrad region from the first quarter of 2019, ending a multi-year investment boom, as well as a nearly 8 % drop in the City of St. Petersburg after a strong rise in 2018. With respect to fixed investment in the Ural and Volga federal districts, which each account for 14–15 % of investment nationally, growth was in the range of 1–3 % from two years previous.

Since the mid-2010s, manufacturing output and fixed investment in particular have followed divergent trends in various parts of Russia. Differences in retail sales are also apparent, but even last year retail sales in Russia's six most important federal districts were still below their 2014 levels that preceded the downslides. In the Northwest Federal District, retail sales last year nearly matched their 2014 levels.

While trends in retail sales have generally been weak in Russia's federal districts, manufacturing has grown and fixed investment trends have ranged widely



Sources: Rosstat and BOFIT.

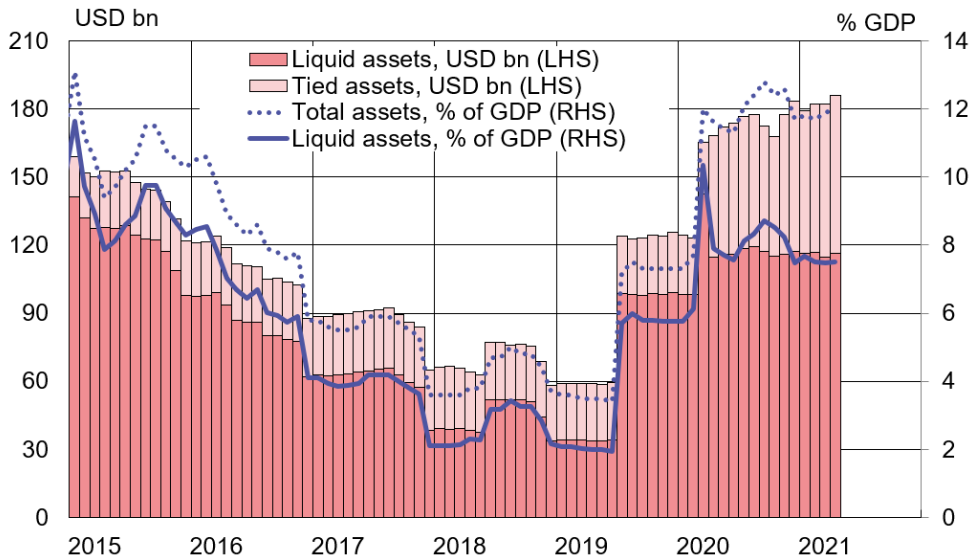
National Welfare Fund divests its dollar assets. Finance minister Anton Siluanov told at the St. Petersburg International Economic Forum (June 2–5) that Russia plans to divest its liquid dollar-denominated assets in the National Welfare Fund and exchange them for assets in other currencies over the coming month. Currently, about 35 % of the Fund's liquid assets are in dollars and about the same amount in euros. In the future, the Fund's liquid assets will be deployed as follows: 40 % in euros, 30 % in Chinese yuan, 20 % in gold, 5 % in British pounds and 5 % in Japanese yen. Siluanov did not mince words; the move is needed to avoid the risks of further US sanctions. Russia has previously attempted to defend the government-sector economy and investments from harms caused by sanctions.

The total value of Russia's National Welfare Fund at the end of April was about USD 186 billion, which was equivalent to about 12 % of Russian GDP. Of that amount, USD 116 billion was invested in highly liquid debt securities such as government bonds. The remaining assets were tied up in longer-term domestic investments ([BOFIT Weekly 13/2021](#)). Higher oil prices boost the Russian government's tax take and increase the size of the Fund accordingly. As recently as summer 2019, the size of the Fund had dwindled to about USD 60 billion. The Central Bank of Russia invests liquid assets of the Fund in accordance with instructions from the Ministry of Finance ([BOFIT Policy Brief 4/2015](#)).

The CBR's foreign currency reserves, including gold, reached an all-time high at the end of May 2021 with a valuation of USD 605 billion. Gold represented about USD 140 billion of that amount. The CBR reports on its quarterly allocation of foreign currency holdings with six-month delay. In September 2020, the asset breakdown for its forex reserves was 29 % in euros, 22 % in dollars and 12 % in Chinese yuan. Gold accounted for about 24 % of reserves. Russia's reserve holdings of both gold and yuan are very high by international standards.

In 2018, the CBR shifted a significant chunk of its holdings from dollars to Chinese yuan ([BOFIT Weekly 03/2019](#)). It is worth noting, however, that the forex allocation differs from the geographic distribution of investments. For example, last September, about 7 % of Russia's forex reserves were invested in US securities and deposits. The largest share of dollar investments was in assets issued by non-US entities. China, with a 15 % share, was the largest asset issuer country for Russia in September 2020.

The liquid assets in Russia's National Welfare Fund now equal nearly 8 % of GDP



Sources: Russian Ministry of Finance, Macrobond and BOFIT.

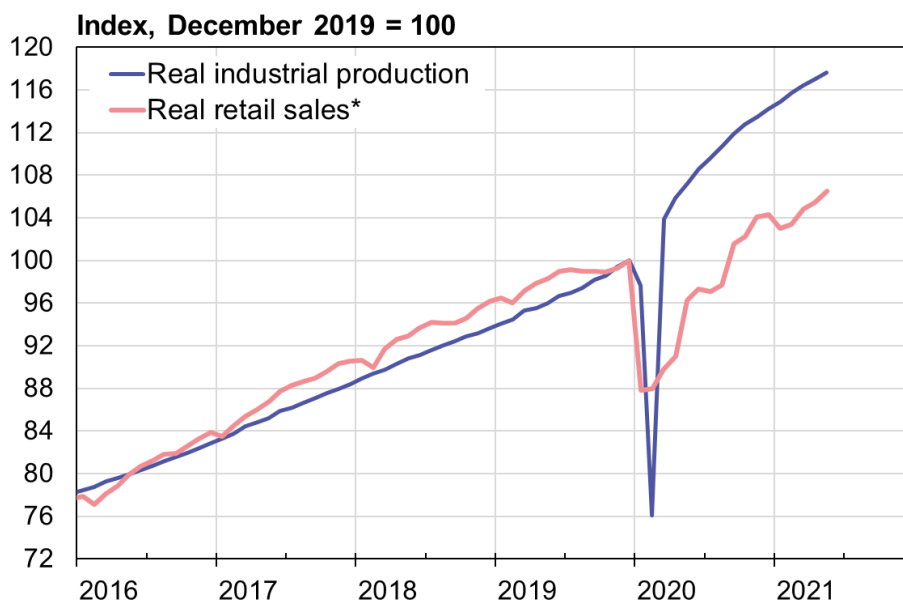
China

Pace of industrial growth in China stabilises; retail sales continue to gain steam. May on-year industrial output growth reached nearly 9 % with the strongest performances coming from high-tech products such as electric cars (up 166 % y-o-y), robots (50 %) and microchips (38 %). Industrial activity picked up rapidly after the first wave of the covid pandemic, and production growth has returned to pre-covid levels. The growth is stabilising as for both April and May, real seasonally-adjusted output grew by 0.5 % m-o-m, roughly the same pace as in 2019.

The recovery of domestic consumer demand has been slower. Real growth in retail sales in May exceeded 10 % y-o-y and were up by about 1 % from the previous month. On-month growth during March-May was clearly more robust on average than before the covid crisis, indicating rising domestic consumer demand. Exceptionally strong growth was seen in online commerce, the value of which jumped by nearly 25 % y-o-y in January-May. While restaurant sales have rebounded since last year, their nominal value barely exceeds the 2019 level.

Growth in foreign trade remained strong in May. The value of goods exports rose by 28 % y-o-y in dollar terms, while goods import growth was up by 50 %. In yuan terms, the growth figures were about 10 percentage points lower. Growth in exports of mechanical and electrotechnical products was exceptionally strong, climbing by about 30 % y-o-y. Despite strong import growth, China's trade surplus was still \$46 billion.

Real industrial output and retail sales growth have returned to their long-term trends



*) Nominal retail sales deflated with consumer prices.

Sources: China National Bureau of Statistics, CEIC and BOFIT.

Oversight of payments for land use rights shifted to tax authorities to curb inappropriate use of funds by local governments. Led by the finance ministry, Chinese officials earlier this month announced they were putting local tax offices in charge of collecting the proceeds from land use right sales. Revenues are collected currently by the local governments' natural resource departments that are expected to transfer them to the local treasuries responsible for managing the funds. In recent years, China's National Audit Office has reported numerous instances of delayed booking of land use right proceeds that have instead gone to funding such things as indebted local government financial vehicles (LGFVs). While local governments continue to receive the land transfer income, the central government now has greater latitude in overseeing how money is spent. Local tax offices were unified in 2018 under the state tax authority, giving central administrators the

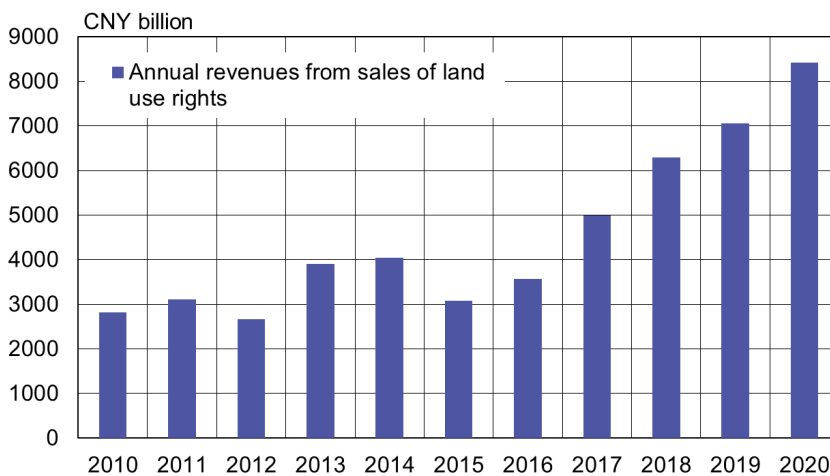
possibility of direct oversight. On July 1, the reform will initially pertain to six provinces and one city. At the start of 2022, the reform will apply nationwide.

Ever-rising indebtedness by local governments has long been one of the primary concerns for Chinese economic policy. Nevertheless, political opinion on local debt regularly contradicts this view. China's leadership showcased reduction of indebtedness a top priority in the previous five-year plan to no avail. Recent attempts to curb local government indebtedness have included limiting credit supply to local governments and directly suspending local infrastructure projects ([BOFIT Weekly 17/2018](#)). When economic conditions warrant, local governments get a mixed message encouraging them to increase debt-financed spending on new projects ([BOFIT Weekly 36/2018](#)). This is precisely what happened when the pandemic hit. Local government spending rose and the quotas on special purpose bond issues were greatly increased. Special purpose bonds should be used to finance fixed investments such as infrastructure projects that later generate sufficient income to repay the bond. Last year, however, the finance ministry made it possible to channel money from bond issues to other purposes such as supporting consumer demand.

With many believing that the worst waves of the pandemic now behind, the central government is again publicly calling on local governments to slow their pace of borrowing. For example, two major bullet train projects were put on ice by April. For the first time in three years, LGFVs issued less new debt in May than the amount of maturing debt. The value of bond issues was down by nearly 50 % from a year earlier and off by 80 % from April.

This year's annual audit from China's National Audit Office, which was published this month, found substantial abuses in the use of special purpose bonds issued by local governments. Some had been squandered on entirely non-productive investment, while others went to funding projects that were different from their intended purpose. The audit also revealed that state-owned financial institutions and local banks had illegally provided loans to local governments and their LGFVs.

Revenues to local governments from sales of land use rights have nearly tripled over the past ten years



Sources: China Ministry of Finance and BOFIT.

China passes law countering foreign sanctions; US revises its list of Chinese firms barred to investment.

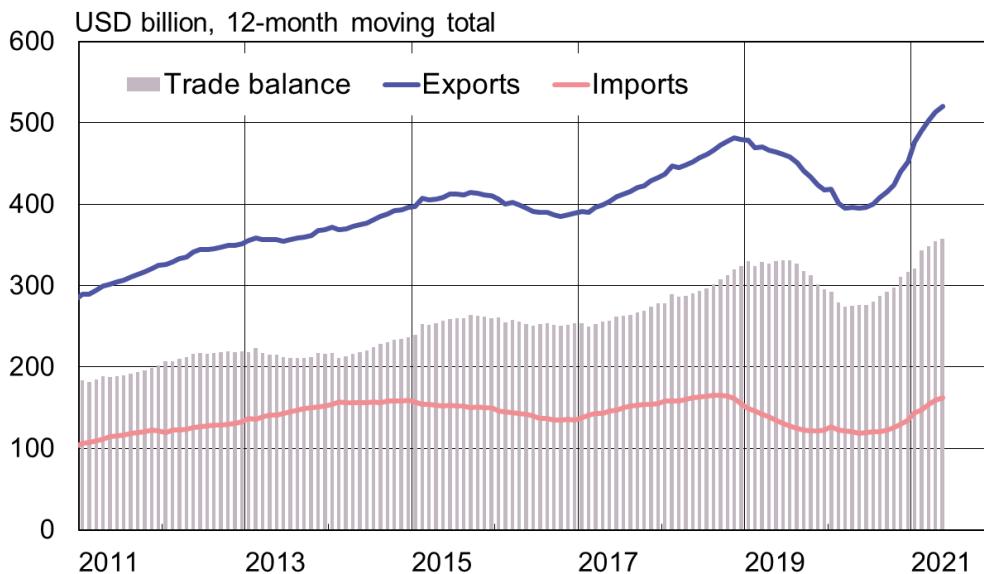
The National People's Congress last week approved an anti-foreign sanctions law. The law, drafted behind closed doors, took effect immediately and permits freezing of assets, restricting access to China, as well as the banning of cooperation and transactions in China for persons or organisations that engage in imposing or implementing foreign sanctions or discriminatory restrictive measures against China. The law extends to family members and the management of targeted firms or organisations with which sanctioned individuals are affiliated. The vagueness of the law leaves room for interpretation and its effect on foreign firms operating in China depends whether or how it will be enforced. The EU Chamber of Commerce in China strongly criticised the lack of transparency in the law's enactment. The law follows a directive issued in January by the commerce ministry requiring Chinese firms to report to officials any economically discriminatory acts taken against China.

Earlier this month, president Joe Biden issued a new executive order banning US investment in numerous Chinese firms seen as threats to US national security or democratic values. President Donald Trump last November issued an executive order requiring the Department of Defense to maintain a list of firms that US investments are forbidden ([BOFIT Weekly 50/2020](#)). The new Biden executive order updates the [list of companies](#), which is now maintained and updated by the US treasury department. The list currently includes 59 Chinese firms. While some firms were dropped from the previous list, several new firms (e.g. firms involved in surveillance technologies) were added. The executive order enters into force on August 2, but gives investors a year to divest their holdings.

Following an executive order from president Trump, the New York Stock Exchange suspended trading in the American Depositary Receipts (ADRs) of three Chinese state-owned telecom companies (China Mobile, China Unicom and China Telecom) in January and delisted the firms in May. Most American investors have been able to exchange their ADRs for shares issued in Hong Kong. Both China Mobile and China Telecom have announced IPO plans for the Shanghai Stock Exchange, where China Unicom is already listed. In March, the New York Stock Exchange suspended trading in the ADRs of China's state oil company CNOOC and announced plans to delist the company.

The eagerness of Chinese firms to list on US exchanges does not appear to have waned in the first months of this year despite the actions. According to Ernst & Young, half of new foreign listings in the US during January-March were Chinese (18 IPOs raising a total of \$4.2 billion). During the same period, 101 IPOs with a combined value of \$11.8 billion took place on mainland Chinese exchanges. A New York Stock Exchange representative commented that roughly 60 Chinese firms were planning IPOs this year. In May, there were 248 Chinese firms listed in the United States. Of those, eight are owned by China's central government.

Despite bilateral tensions, China's goods exports to the US and imports from the US have rebounded rapidly since last summer



Sources: China Customs, Macrobond and BOFIT.

Old problems still complicate their operations, but Western firms operating in China are generally upbeat.

Member surveys conducted by the American Chamber of Commerce in China (AmCham China) and the European Union Chamber of Commerce in China (EU Chamber) find that both American and European firms are generally confident about growth of the Chinese market. Firms expressed concerns about covid-19 and politicisation of trade, as well as the fact that they still do not consider China's business environment to offer a level playing field. The AmCham survey, which was conducted in October and November 2020, was based on responses from 345 US firms operating in China. The EU Chamber survey, conducted in February 2021, garnered responses from 585 European firms.

China's economy recovered rapidly after the first wave of covid-19 in spring 2020 and generally brightened business prospects. Some 75 % of American firms operating in China said that they expected growth of China's markets and economic

recovery to continue, thus boosting their own prospects. Some 68 % of European firms in China were optimistic about the next two years. The 2020 EU Chamber survey found that 64 % of European firms operating in China expected their net sales to decline, but the latest survey shows that only 24 % of respondents had experienced lower sales. Consumer trade made the greatest contribution to sales growth of European firms. The EU Chamber suggests this is due to travel restrictions that have led China's middle class to focus its spending on products such as cars, cosmetics and clothing.

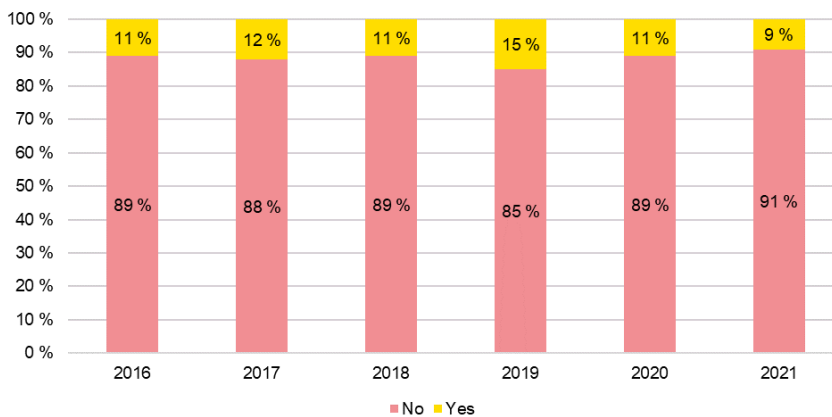
The covid pandemic has affected the ability of firms to do business. Half of the responding European firms said covid was one of their biggest hurdles to their ability to conduct business in China. Companies noted that covid limited their business travel both within China and internationally, and made it difficult for foreign workers to enter China. Additionally, some firms reported that covid disrupted their supply chains and reduced demand for their products and services.

The surveys found that several familiar issues still dog firms trying to do business in China. Firms report discriminatory treatment with respect to market access, public procurement, licencing and government subsidies. They also note that China's regulatory environment is opaque and capricious. Some 41 % of European firms felt that the business environment had become more politicised, explaining that this was mainly the fault of the Chinese government and Chinese and international media. Nevertheless, foreign firms operating in China remain committed to serving the Chinese market and staying put. Indeed, like a similar proportion of the American firms in China, 59 % of European firms said they planned to expand their operations in China.

Responses from American firms emphasised the significance of US-China relations. Nearly all respondents saw good bilateral relations as important to their businesses. A large majority (78 %) said that heightened tensions in relations was the biggest challenge for the own business. US firms felt that phase 1 of the US-China trade agreement had somewhat calmed bilateral tensions. Responses submitted after the US presidential election tended to be more optimistic and showed greater expectation that bilateral relations would improve. Firms responding to the AmCham survey expressed hope that the US would refrain from exacerbating the situation, and that coming talks would focus on improving market access and protection of intellectual property in the Chinese market. Despite the frictions, the share of US firms planning to increase their investments in China has remained remarkably constant over the years, with only a small portion of firms even considering shifting their production away from China to other markets.

Fewer European firms than ever are considering leaving China (percentage of respondents).

"Is your company considering shifting current or planned investments in China to other markets?"



Sources: European Union Chamber of Commerce in China and BOFIT.

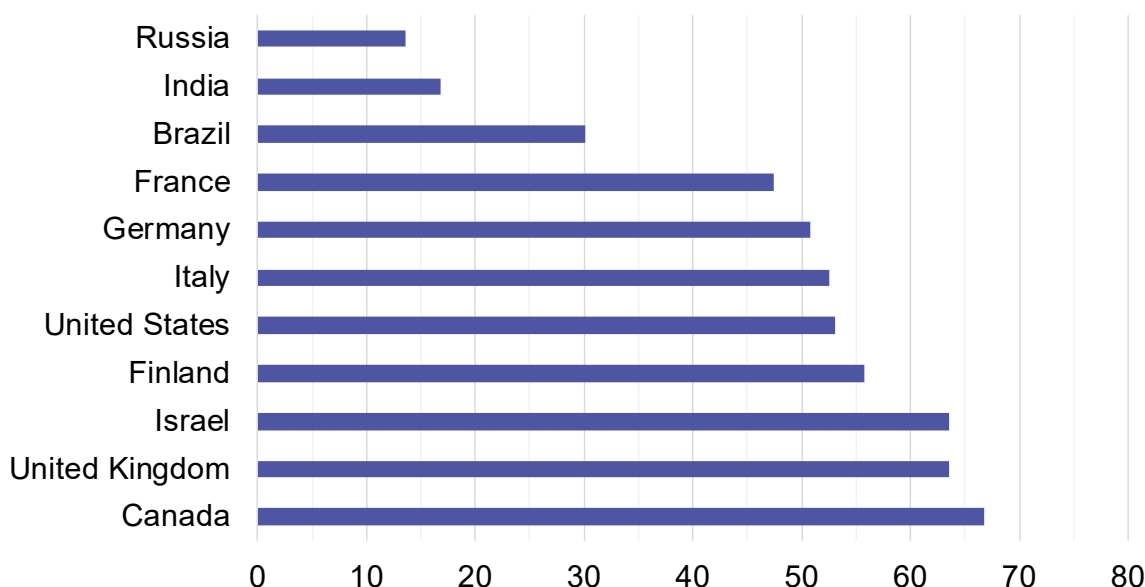
Russia

Covid case numbers rising in Russia; officials struggle with vaccine hesitancy. The number of confirmed covid-19 infections has risen sharply in Russia in recent weeks. Case growth has been fastest in Moscow, but St. Petersburg has also seen a rise in infections. Between mid-March and early June, the officially reported daily covid case numbers remained below 10,000, but in recent days that number has jumped to over 15,000 a day. Relative to its population Russia's current covid situation (about 110 cases daily per million inhabitants in the third week of June) is substantially harder than in most European countries (although e.g. the UK is back up to a rate of about 150 cases a day per million). Finland is currently seeing about 15 infections a day per million. Notably, the rise in covid cases in Russia is stretching hospital capacity.

Even with this new wave, Russian officials have been unwilling to significantly restrict people's movements or limit their access to different services. The exception is foreign travel, which remains highly controlled in various ways. However, some regions have imposed their own restrictions. In Moscow, for example, the opening hours and maximum capacity of bars and nightclubs is limited and certain public spaces have been closed altogether. Many municipalities across Russia are limiting access to certain events to people who can produce documentation of vaccination or recovery from covid.

The situation is complicated by the fact that Russians are quite reluctant to get vaccinated against a possible covid infection – even if all of them can currently get vaccinated. At the end of last week, only about 20 million Russians (slightly less than 14 % of the Russian population) had received at least one dose of vaccine. Slightly over 16 million people have received both of the two doses. Officials have launched a wide variety of incentives to get people to take the Sputnik V vaccine. For example, in Moscow and the surrounding Moscow region, instructions require that at least 60 % of workers be fully vaccinated in service branches that require physical proximity to customers. Many Russian regional governments have also announced that public sector workers are expected to get vaccinated. In several covid-themed surveys, Russian respondents said they believed their vaccine hesitancy was justified as e.g. the epidemic was already over or they worried vaccines might have harmful side-effects.

Covid-19 vaccination rates in select countries: At least one shot by June 21, 2021, share of population (%)



Sources: Our World in Data and BOFIT.

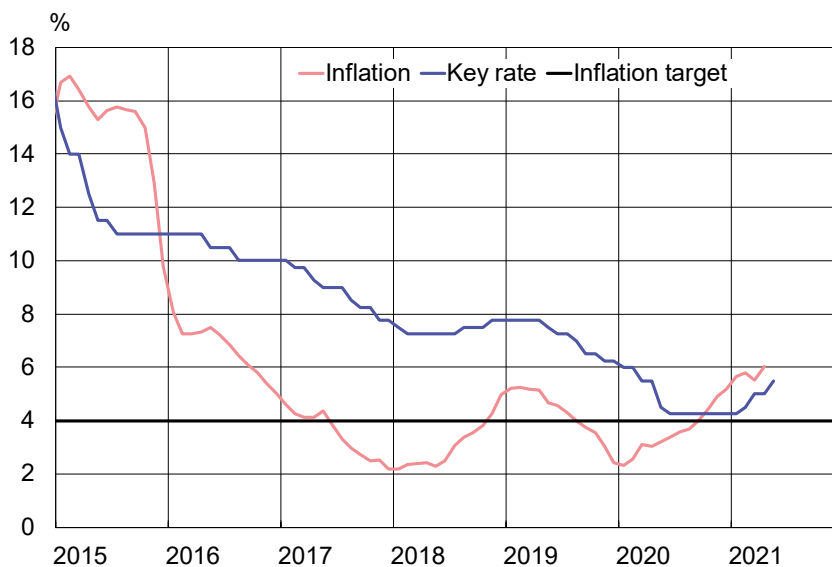
CBR hikes key rate again. On June 11, the Central Bank of Russia (CBR) raised its key rate by 50 basis points to 5.5 %. It was the CBR's third hike this year for a total increase of 125 basis points. As part of its guidance, the central bank noted that a further hike in the key rate is possible at its next inflation meetings.

The CBR said the hike was mainly a reflection of rising 12-month inflation faster than forecasted. Consumer prices rose last month by 6 % y-o-y. May food prices rose by 7.4 % y-o-y, non-food goods by 6.7 % and services by 3.3 %.

Inflation has picked up steam due to such factors as the recovery in domestic demand from last spring's Covid Recession ([BOFIT Weekly 23/2021](#)) and rising commodity prices on the global market. Moreover, short-term inflation expectations of households and corporations are still elevated. The government has sought to curb the rise in consumer prices by implementing price control measures ([BOFIT Weekly 11/2021](#)).

The CBR expects 12-month inflation to remain below its current level, but exceed its April forecast (4.7–5.2 % at the end of 2021). It also expects to reach its inflation target of 4 % a year by the second half of 2022 (earlier by mid-2022). Thereafter, it expects 12-month inflation to remain close to the inflation target.

Consumer price inflation in Russia has picked up and the CBR has hiked its key rate



Sources: Central Bank of Russia, Rosstat, Macrobond and BOFIT.

Significant differences in pace of development in various sectors of the Russian economy. Manufacturing activity, when measured in the real volume of gross value added produced (GVA), has been quite flat since summer 2019 and showed hardly any downward impact from the Covid Recession last year. Over the longer term, manufacturing has experienced rather steady growth, with the GVA volume increasing by about 20 % since 2011. In contrast, the GVA volume in the minerals extraction industries (including oil & gas) in the first quarter of this year was on par with the 2011 level, and about 14 % lower than its 2019 peak. The reduced volume largely reflects the OPEC+ agreement on production ceilings requiring cuts in Russia's crude oil production.

The wholesale & retail branch has recovered to a notable degree from spring 2020. So much so that the GVA volume already in the second half of 2020 was only some 2 % less than in 2018 and 2019. In the first quarter of this year, the figure was slightly above zero. However, the recovery in wholesale and retail from the deep contraction of 2015–2016 has yet to occur. The branch's GVA volume is still 10 % lower than its 2012–2014 peak and 5 % below its 2011 level.

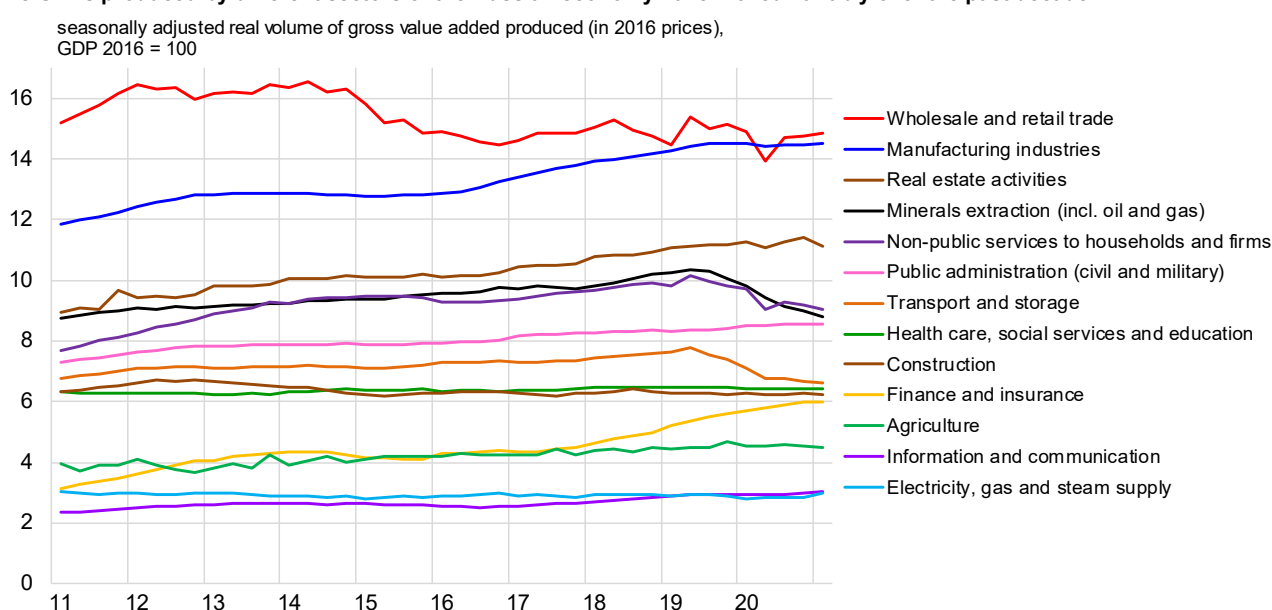
The transport and warehousing branch contracted over the past two years, a reflection of the weak performance of trade and oil production cuts that have reduced the volume of oil transmitted by pipeline. The branch's GVA volume is still 10 % less than its 2018–2019 levels and about 3 % below its 2011 level, which to some extent may reflect logistical improvements in transport and distribution. While construction activity did not decline during last year's Covid Recession, the sector has not experienced growth for years. The real estate sector with its various sizeable activities, in turn, has grown steadily. It also weathered 2020 rather well.

Various services to firms and households, largely provided by private firms, experienced a considerable GVA volume drop as a whole during the past two years. These services have seen no sign of recovery, and their collective GVA volume remains at the 2014 level. Separately, information and communications branches, in contrast, have grown almost steadily at a fairly good pace, with only a mild dip during the Covid Recession. The financial sector has been Russia's fastest-growing category, experiencing especially high growth in each of the past three years. Part of this growth can reflect efficiency gains from

embracing digital technology. In addition, the growth in bank lending last year was accelerated by stimulus efforts on the part of the government and the central bank.

Public administration (civil and military administration), which has enjoyed growth for most of the past decade, got a further kick last year from government budget spending increases, even if most public administration jobs are not on the front lines in the fight against covid. The healthcare field has long experienced growth, though it is not up by more than 15 % from 2011. Measured in GVA volume, growth in the healthcare field came to a halt last year. This may reflect disruptions in the provision of other healthcare services due to the struggle with covid. Developments in the education branch have been notably uneven, with an overall decline for nearly three years. Thus, the branch's activity measured in GVA volume is slightly lower than in 2011.

The GDPs produced by different sectors of the Russian economy have moved variably over the past decade



Sources: Rosstat and BOFIT.

Construction of new Rosatom reactor units in China gets underway. China announced in late May that construction work on new reactor units was underway at the Tianwan and Xudapu nuclear power plants. Rosatom will supply two new VVER-1200 reactors to both plants. The supply agreement was finalised in June 2018 as part of a broader bilateral agreement on nuclear energy. Tianwan previously had four Rosatom-supplied VVER-1000 reactor units and two reactors of similar electrical capacity based on Chinese technology. The most recently completed reactor unit of this pair, Tianwan-6, went into commercial service at the beginning of this month.

Xudapu (Xudapao) is located in the Liaoning province in Northeast China. Tianwan is located in the Jiangsu province, about halfway between Shanghai and Beijing.

China has invested heavily in developing its own nuclear power capabilities. Experts now consider the country to have reached the R&D frontier in many areas of the nuclear industry. This sophistication is evidenced by the fact that Rosatom has only been contracted to supply its latest model reactor. The bulk of the construction at Tianwan and Xudapu sites is being performed by the Chinese. Russians delivered Tianwan's first two units on a turnkey basis. During construction of the next two units, the Chinese were responsible for construction and installation works in cooperation with Rosatom.

The 50 nuclear reactors currently operating in China have a combined capacity of about 48.5 GW(e). Besides the reactor units provided by Rosatom, China is planning or already building over 30 power facilities based on domestic engineering. Despite the intense pace of construction, nuclear power accounts for less than 5 % of the country's total electrical power production.



China

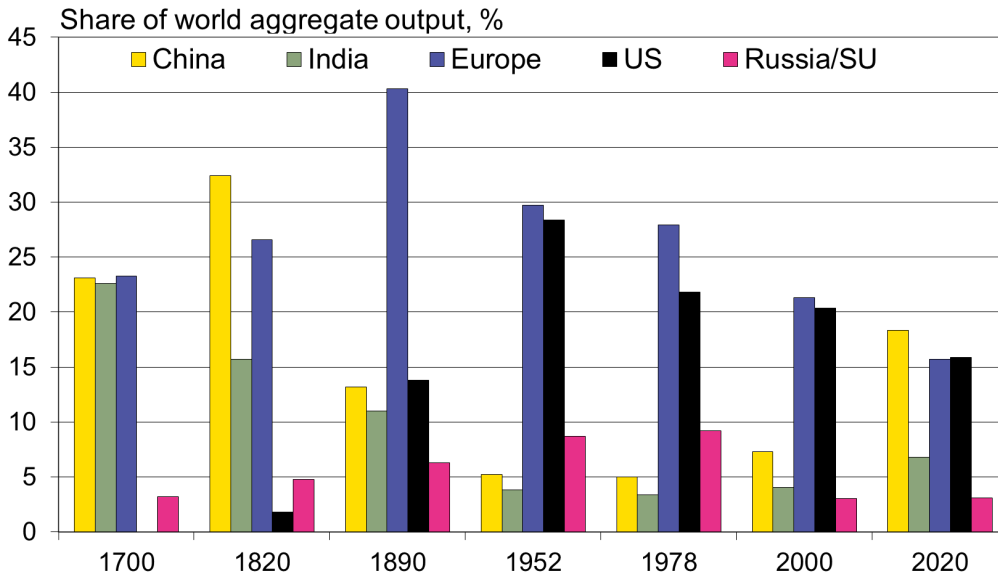
China's Communist Party celebrates a centenary of twists and turns. On Thursday (Jul. 1), the Communist Party of China (CPC) celebrated the 100th anniversary of its founding. The CPC was established during the time of the Republic of China (1912–1949), eventually seizing power in mainland China after defeating the nationalist Kuomintang party in a civil war that ended in 1949. The CPC became the unitary political force in China, fully entwining the interests of state and party.

China is now the world's largest economy if GDP is adjusted for purchasing power parity (PPP) according to IMF statistics. Much of China's economic achievement is the product of reforms adopted after 1978 and an "open-door" policy that helped China integrate with the rest of the world. This huge change was preceded by roughly one-and-a-half centuries in which the Chinese economy struggled under imperial, republican and communist power. During the end part of the Qing or Manchu Dynasty, China's economy was held back by weak administration, war, as well as Western and Japanese colonialism. This led to social unrest, revolution and the establishment of the Republic of China in 1912. During the time of the Republic of China, economic development was hindered by political instability, a Japanese invasion, civil war and an episode of hyperinflation. The People's Republic of China attempted to modernise its economy by adopting a command-economy system focused on heavy industry. However, neglect of agriculture led to a great famine during the "Great Leap Forward" campaign (1958–1960). During Mao Zedong's rule, the economy took a back seat to political campaigns and purges of political dissidents.

With Deng Xiaoping's reforms of 1978 and the introduction of the open-door policy, China embarked on a growth path unmatched in human history. Due to the very low starting point, China was able to sustain GDP growth averaging over 10 % a year until the 2010s. Growth thereafter slowed, but even with the covid-19 pandemic rocking the global economy, China posted positive economic growth in 2020. China's economy has benefited from following an industrialisation strategy driven by exports of consumer products that mimicked the approach taken earlier by the Four Asian Tiger economies (Hong Kong, Taiwan, South Korea and Singapore). Under this export and rapid industrialisation approach, gains in human capital and technological capability provide a ladder that allows firms to ascend to increasingly demanding technology-based industries. Even with successful pursuit of this strategy, however, China's GDP per capita is significantly smaller than that of the Four Asian Tigers.

Xi Jinping, who has led the Communist Party and the country since 2012, has overseen China's emergence as a major player in the global economy, with outreach coming e.g. in the form of financing to developing nations for infrastructure projects. The rise of China has fuelled nationalism on China's part as well as international tensions, particularly with the West. During the Xi era, China's political climate has become more regimented. For example, power within the CPC has been increasingly concentrated under the rubric of fighting corruption. Crushing terrorism has been used to justify the increased repression of the Muslim population in Xinjiang province. Hong Kong's long-standing political freedoms were curtailed significantly on July 1, 2020, when new security laws for the special administrative region went into effect. The 14th five-year plan, approved in spring 2021, largely assumes few changes to the existing economic policy framework, but increases efforts at national self-sufficiency ([BOFIT Weekly 12/2021](#)).

China has historically played a major role in the global economy.



Sources: Maddison (1998), IMF for 2000 and 2020, BOFIT. "Europe" in 2000 and 2020 comprises EU countries, the UK, Switzerland and Norway.

Early 2021 exuberance of mainland China stock exchanges begins to fade. Share prices on Chinese stock exchanges in the first half of this year have given a generally flat performance relative to last year and the rest of the world. After rising in the first two months of this year, share prices plunged in March and were followed by a lacklustre second quarter. On Wednesday (June 30), stock indices in mainland China (CSI 300) were at about the same levels as in early January. In contrast, share prices in emerging markets (MSCI EM) were up about 7 %. In the US, the S&P 500 was up by 14 %, while Japan's Nikkei 225 was up 5 %. The FTSE All World global stock index was up by 13 % from the start of the year.

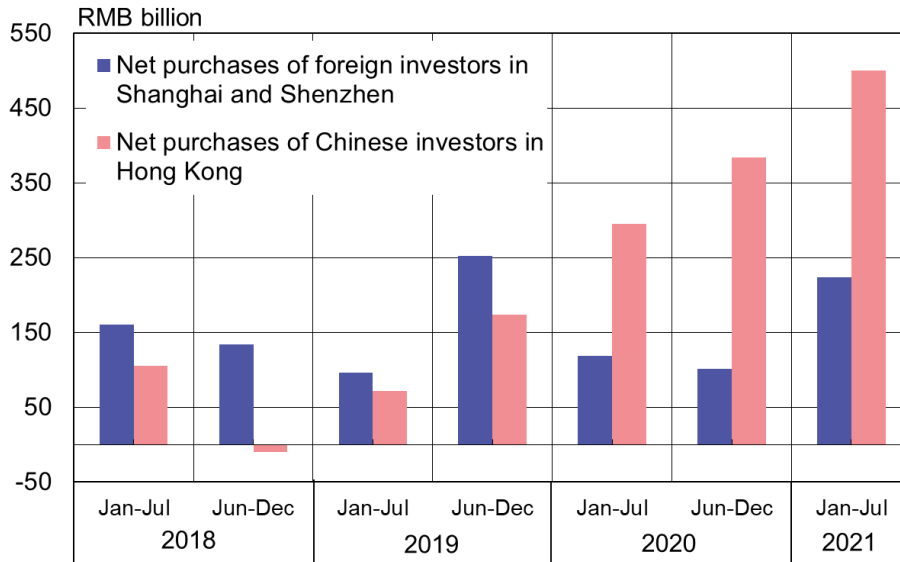
The net purchases of Chinese investors (purchases minus sales) via the Stock Connect programme, which links mainland exchanges with Hong Kong, soared to record levels in the start of this year as capital was exported from mainland China, especially to buy shares of Chinese firms where sanctions prevented American investors from trading or owning ([BOFIT Weekly 02/2021](#)). Share-buying have since levelled off, and the purchase volumes roughly matched sales in June. Nevertheless, as much as 500 billion yuan (€65 billion) in mainland China investment assets flowed to the Hong Kong stock exchange between January and June. Last year, net purchases had already reached a record 680 billion yuan.

To some extent, the diminishing interest in the Hong Kong stock exchange is the product of investigations by Chinese officials into large technology firms for possible violations of cartel and antitrust laws ([BOFIT Weekly 18/2021](#)). Increased oversight has decreased the market value of large technology firms, which has been directly reflected in share prices e.g. on Hong Kong's Hang Seng index. During April-June, there were no IPOs of mainland China tech firms in Hong Kong. Their share of IPOs on mainland China exchanges has also dropped off significantly. Despite of ongoing antitrust investigation, the Chinese ride-hailing services company Didi, nonetheless, raised over \$4 billion in its IPO late June on the New York Stock Exchange. It was the largest international IPO in the US since the 2014 listing of the e-commerce giant Alibaba, which raised over \$25 billion.

Despite the political tensions between China and the West and the talks about US-China decoupling, European and American asset management firms are showing increased interest in the Chinese market. For example, US-based Goldman Sachs, BlackRock and JPMorgan have announced they are in negotiations on initial cooperation agreements with mainland Chinese banks. Similar agreements have been penned by European firms such as the French Amundi and the British Schroders. Under these agreements, foreign actors can offer their own asset management products directly to customers of Chinese banks.

Over 220 billion yuan (nearly €30 billion) in assets of foreign investors flowed into mainland China stock exchanges during the first half of this year via Stock Connect. The first-half sum matches that of the entire 2020 total.

The amount of investment flowing from mainland China to Hong Kong under the Stock Connect has increased significantly.



Sources: CEIC and BOFIT.

China pulled back on direct investment in Europe and the United States last year. Investments have declined significantly after the peak year 2016, a result of China's stricter outward investment and capital controls. In addition, screening of Chinese investment has been increased in the United States and Europe in recent years and the covid-19 pandemic last year caused many firms to postpone their investment plans. Despite improving economic conditions, the future appetite for investment could be limited by China's deteriorating political relations with the rest of the world and reduced access of Chinese firms to cheap financing.

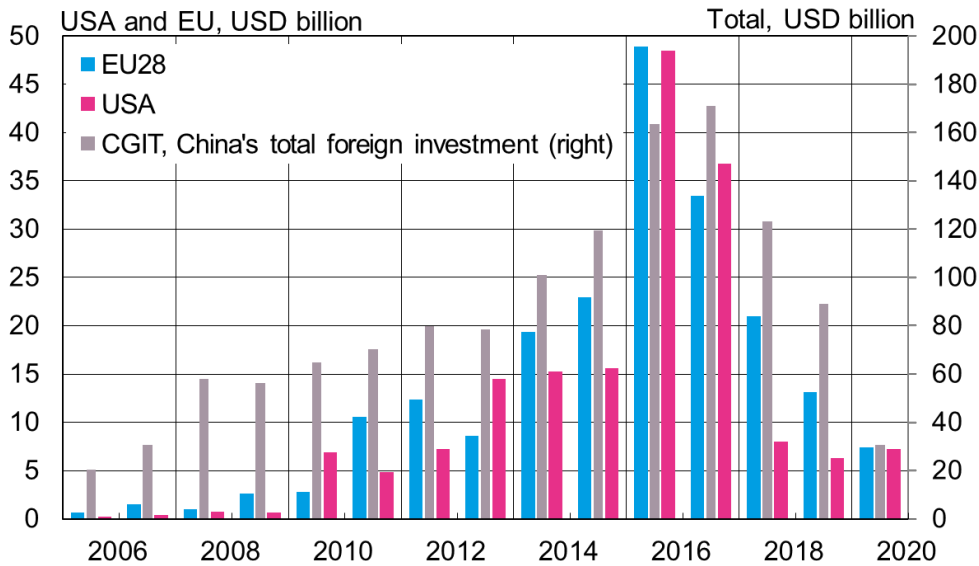
According to a new [report](#) from the Mercator Institute for China Studies (Merics), the value of China's direct investment in EU countries and the UK declined by 45 % last year to €6.5 billion. Most of China's direct investment in Europe has involved corporate acquisitions, but greenfield investments totalling €1.3 billion last year exceeded those of previous years. Chinese investment was largely directed at firms involved in transportation, construction and infrastructure, ICT and electronics. In a sharp drop from many previous years, only 18 % of Chinese FDI came from state-owned firms. In 2020, 30 % of Chinese FDI went to Germany, 13 % to Poland, 12 % to the UK and 10 % to France. Poland's share is explained by the largest Chinese investment in Europe last year, when the Australian Goodman Group sold its operations in Central and Eastern Europe to the Chinese GLP consortium. Merics figures show China's cumulative investments in Finland during 2000–2020 amounted to €13.3 billion, a €1.3 billion increase from 2000–2019.

According to the Rhodium Group's [US-China Investment Project](#), China's direct investments in the US last year amounted to \$7.2 billion. While the value of investment rose by 14 % from 2019, it is still significantly less than in the peak years of 2016 and 2017. The share of greenfield investment remained small, and China's acquisitions in the US were increasingly aimed at consumer products and services, as well as the entertainment industry. The number of investments remains small, so the rise in value reflects the price tags of major acquisitions such as the \$3.3 billion paid by Tencent for a stake in Universal Music Group. The report also noted that last year several Chinese firms divested their US holdings. The most significant sale was the now-bankrupt HMA Group's divestment of Ingram Micro to US-based Platinum Equity for \$7.2 billion.

According to the China Global Investment Tracker (CGIT), China's total outward FDI last year amounted to \$30.5 billion, a 66 % decline from 2019. CGIT tries to register all foreign investment by Chinese firms with a value of at least \$100 million. Merics estimates that Chinese corporate acquisitions abroad last year fell by 45 % to around \$28 billion. The trend diverges considerably from the figures released by China's commerce ministry, which show outward FDI fell by just 3 % last year to \$133 billion ([BOFIT Weekly 8/2021](#)). Commerce ministry figures for January–May 2021 show that the outward FDI flow increased by few percent compared to the same period in 2020.

According to UNCTAD's [World Investment Report 2021](#), global FDI flows contracted by 35 % last year to their lowest level since 2005. China was among a handful of countries that saw its FDI inflows increase last year. China was the world's largest FDI investor last year and the second largest FDI recipient after the US. The UNCTAD figures for China are based on commerce ministry data. UNCTAD expects global FDI flows to increase by 10–15 % this year and another 15–20 % next year.

Chinese direct investment in EU28 countries and the US have declined sharply and in line with all Chinese FDI.



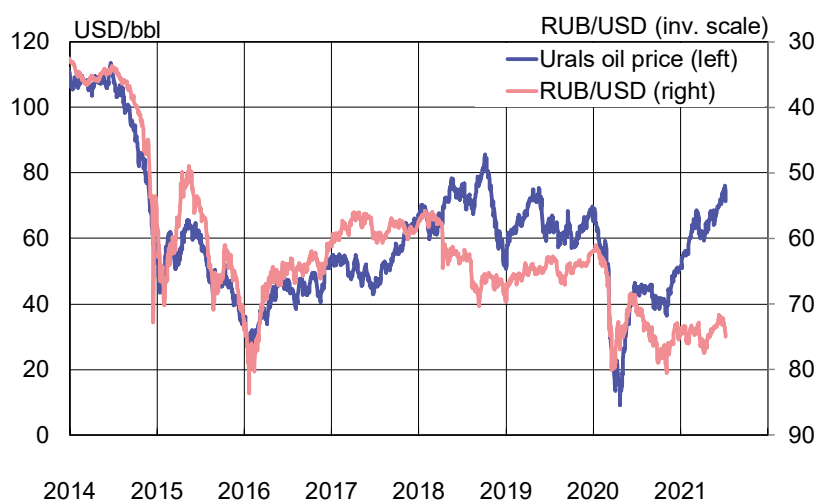
Sources: China Global Investment Tracker (total), Merics (EU), Rhodium (USA) and BOFIT.

Russia

Despite this year's sharp rise in oil prices, ruble sees only marginal appreciation. The price of Urals-grade crude oil hit \$74 a barrel at the end of June, a 45 % increase from the start of the year. Oil prices have not been this high since 2018. The soaring prices of crude oil and other commodities have largely been driven by the recovery of the global economy from the depths of last year's Covid recession. OPEC estimates that demand for crude oil increased by roughly 6 % y-o-y in January-June, but was still 5 % below 2019 pre-covid levels. Oil prices have also been supported by the production-ceiling agreement among the OPEC+ countries, even with the ceilings raised gradually to accommodate recovering demand. The OPEC+ group was set at the start of this month to revisit production ceilings for the remainder of 2021, but the meeting did not take place due to disagreements between Saudi Arabia and the United Arab Emirates. Oil prices have continued to climb in July as the anticipated OPEC+ production increases for coming months have not been confirmed.

Despite the solid rebound in oil prices, the ruble's end-June exchange rate was up by just 2 % year-to-date against the US dollar and 6 % against the euro. According to the Central Bank of Russia, the country had a substantial current account surplus for the first five months of this year, which largely reflects higher oil prices. Capital, mainly from the corporate sector, continues to flow out of Russia, however. The ruble appreciation has also been held back by the scheduled CBR currency-buying under the government's fiscal rule that was restarted this year.

Despite the rebound in the price of Urals crude, the ruble has shown only modest gains this year.



Sources: Reuters and BOFIT.

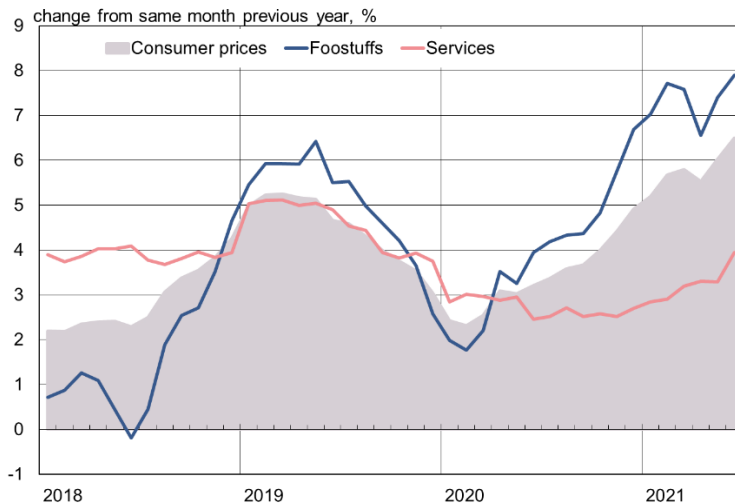
Russia's speedy economic recovery pushes up prices and wages. The rapid economic recovery continued in May. Even if the pace of growth slowed or remained unchanged from previous months in many branches, the pace of growth from last year's low base was impressive. May retail sales were up by 27 % y-o-y, and growth in the service sector overall was up by 52 %. The Ministry of Economic Development estimates that GDP in May grew by 10.9 % y-o-y, putting economic output just 0.3 % below the end-2019 level. Growth has been particularly robust in the agriculture, construction and manufacturing sectors, where output already exceeds pre-pandemic levels.

Private consumption is supported by the recovery in Russia's labour market. May unemployment fell below 5 %, only slightly above pre-pandemic levels. According to Rosstat, the average monthly wage in April was 56,614 rubles (622 euros), a 14 % increase from April 2020. Real wages rose by 7.8 % y-o-y in April. Heavy reliance on migrant labour in service industries, in particular, has resulted in labour shortages in some regions. Consumption growth has been supported by increased household borrowing and moderating savings rates. Real disposable household incomes have not recovered as fast as real wages, however. In January-March, real household incomes were still down by 3.6 % from 1Q20.

Rebounding domestic demand, climbing global commodity prices and last summer's somewhat poor crop harvests have all affected domestic price levels. Consumer and producer prices soared in the first half of this year. June consumer price inflation continued to accelerate (6.5 % p.a., up from 6 % in May). Consumer prices of foodstuffs and construction materials

have risen particularly fast. The rise in crude oil and metal prices is reflected in producer prices. Manufacturing producer prices in May were up by 26 % y-o-y, while mining industry producer prices were up almost 100 %. The government has turned to administrative decrees ([BOFIT Weekly 11/2021](#)) and monetary tightening to keep prices in check. The CBR, which has raised the key rate three times this year, has clearly indicated that further hikes are possible before the end of this year ([BOFIT Weekly 25/2021](#)).

Driven by soaring food prices, consumer prices have risen rapidly this year.



Sources: Rosstat, CEIC and BOFIT.

Russian government works on changes in taxes next year and price controls. As part of preparing Russia's 2022–2024 federal budget and assessment of the prospects of the entire government sector (also including budgets of regions, municipalities and state social funds), the government is considering a range of tax increases. These changes are aimed at increasing government budget revenues during the 2022–2024 period by the equivalent of nearly 0.4 % of GDP. The extra income divides rather evenly into four parts. The first contribution would come from higher production taxes on metals. Second, taxation on oil sector profits would be expanded. Third, improved excise tax revenues would be achieved through higher rates and better tax collection (this mainly concerns alcohol and sugary beverages). Finally, incomes of high-earners and wealthy private individuals would see some higher taxes. At the same time, large restaurant chains will become exempt from value-added taxes and their social taxes based on wages will be halved from 30 % to 15 %. More comprehensive information on changes in next year's taxation has yet to be published.

The budget preparation each year involves consideration of tax increases and decreases. For example, the finance ministry last autumn estimated that the tax increases decided would raise government budget tax revenues in 2021–2023 by about 0.4 % of GDP. The estimate assumed that part of tax breaks on oil fields would be rescinded as planned and taxation on Russian capital income abroad would rise as a result of renewed bilateral tax treaties e.g. with countries considered tax havens. The ministry estimated the budget would lose revenues equal to around 0.4 % of GDP from cutting the 30 % general rate for social taxes by employers in half for small and medium-sized firms.

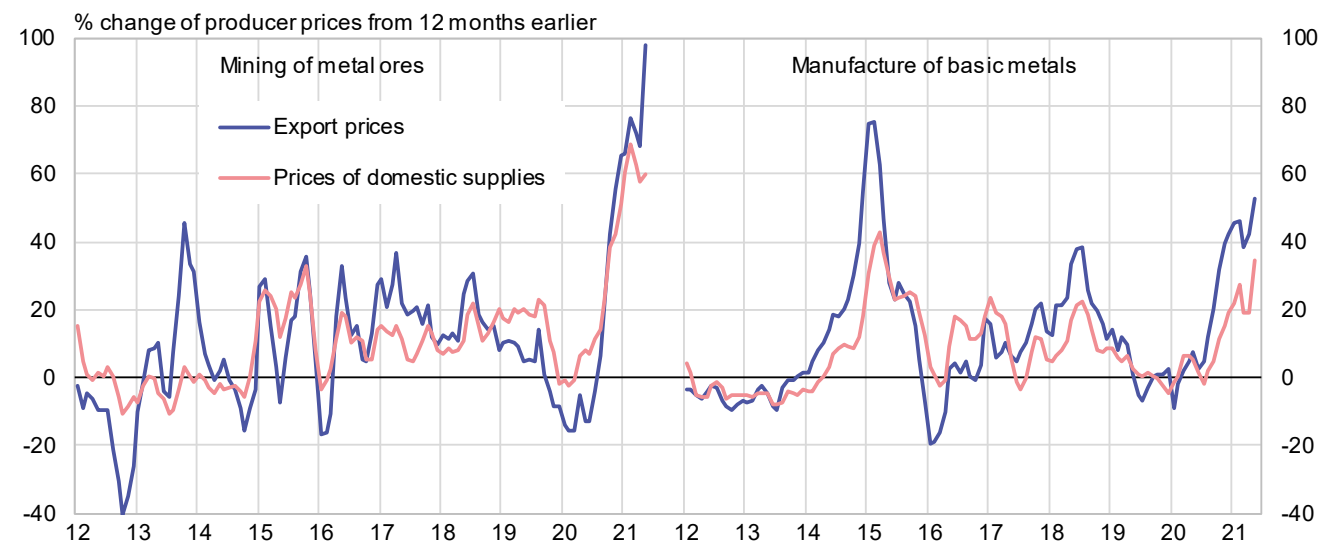
The increases of production taxes planned now on metals would follow up on a fresh decision to widen metal export duties from the beginning of August until the end of this year. This has two aspects. As metal prices have risen dramatically on global and thereby also on domestic markets, the increases are to limit exports and thus take pressure off domestic prices. At the same time, there is a desire to tax the profits now being raked in by metal companies from high prices.

Raising taxes on metal production and exports has rather long (and quite justifiably) been suspected. In 2018, a list prepared in the Kremlin was leaked to the public. The list named a number of metal producers, as well as companies involved in production of petrochemicals and other chemicals, which, due to high export prices, had enjoyed profits that were deemed excessive. Had those profits been taxed as planned in the list, the budget would have received extra revenues equivalent to over 0.5 % of GDP. Due to noises from Russia's industries, the list plan did not proceed. Permanent changes are now scheduled in taxation of metals, which could become similar to the tax system in the oil & gas sectors. For about the past two decades, oil & gas have been taxed mainly through production taxes and export tariffs based on predetermined formulas. No separate decisions are required as tax and duty rates adjust automatically (and progressively) to changes in world market prices.

Rising prices for specific products such as grain have also earlier been dealt through imposition of temporary export quotas and export duties. In late 2020, the government decided to increase export duties on grains and certain other agricultural products, along with imposing export quotas, to deal with surging impacts of global prices on domestic prices. Adjustments continue. Recently, the export duties on major grains have been transformed into duties floating with prices. The export duty on sunflower seeds just recently saw a steep hike and will remain in place until the end of August 2022. Export tariffs on soybeans, while freshly lowered, will also remain in place for longer than earlier decided.

The government is considering a broader permanent mechanism to moderate the impact of shifting global market prices on domestic prices. The planned mechanism is reported to cover prices of metals and other goods, especially fertilisers and foodstuffs such as meat and milk.

Russia's export prices for metals and domestic producer prices have soared.



Sources: Rosstat and BOFIT.

China

China's second-quarter economic growth accelerates from first quarter, but still below pre-pandemic pace.

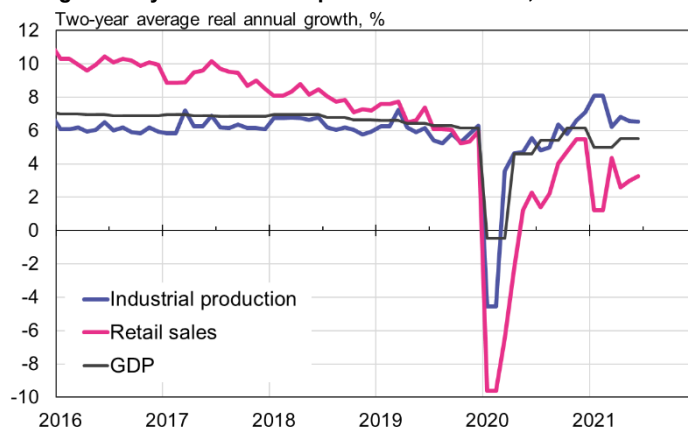
China's National Bureau of Statistics reports that GDP grew at 7.9 % y-o-y in the second quarter, slowing from 18.3 % in the first quarter. The y-o-y figures are affected by the very low basis during the covid pandemic especially in Q1 last year. The NBS on-quarter seasonally adjusted growth figures showed an acceleration in April-June growth to 1.3 % (5.3 % in annualised terms). January-March growth was revised down to 0.4 % q-o-q. The average two-year annualised growth also accelerated in the second quarter to 5.5 %.

NBS figures also show that over 60 % of first-half growth came from increased consumption. Fixed investment and net exports both contributed close to 20 %. Looking at the supply side, industrial and construction output grew slightly faster during the first half than in years before the pandemic (the two-year average for on-year growth in 1H21 was 6.1 %). The service sector growth, in contrast, has yet to recover to the pace of 2019, when growth was already slowing (two-year annualised average for 1H21 was 4.9 %).

June industrial output rose by 8.3 % y-o-y, while retail sales were up by 9.8 % in real terms. On-year growth in both categories slowed slightly from May. Looking at average two-year growth, the pace of growth in retail sales, even with a slight pick-up in June, was still well below pre-pandemic levels.

Consumer price inflation slowed slightly from 1.3 % in May to 1.1 % in June. Consumer prices were particularly affected by a drop in pork prices. The NBS points out that this effect itself was sufficient to lower June inflation by eight-tenths of a percentage point. Pork prices in China, which soared in 2019 due to an outbreak of African swine fever virus, had remained high until recently, when wholesale pork prices finally returned close to early 2019 levels. Producer prices in China have risen rapidly. Officials have been recently worried about their impact on the profitability of especially smaller firms. June producer prices still climbed by a brisk 8.8 % y-o-y, even if growth was down slightly from 9 % in May.

A strong recovery in industrial output continued in June, while retail sales growth still lag their pre-pandemic pace.



Sources: China National Bureau of Statistics, CEIC and BOFIT.

PBoC lowers reserve requirements for commercial banks. The required reserve ratio (RRR or the mandatory share of bank deposits held with the central bank) for most banks was lowered on Thursday (July 15) by 0.5 percentage point. The headline RRR level is now 12 % for large banks, 9 % for mid-sized banks and 5.5 % for small banks. In addition, targeted RRR reductions apply for banks that meet certain criteria. Individual banks RRRs are also periodically considered depending on bank's riskiness and systemic importance. The latest RRR reduction does not apply to banks that already enjoy the lowest RRR of 5 %. The People's Bank of China estimates that the average RRR for the banking sector overall dropped to 8.9 %. The RRR was last lowered for all banks in January 2020. Additional targeted reductions were made in April-May 2020.

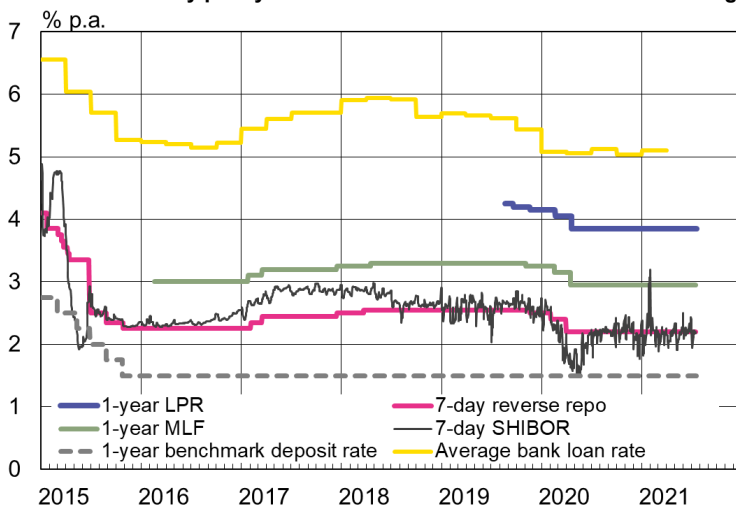
The PBoC emphasised that it was not implementing a general shift in monetary policy stance. It estimated the RRR reduction boosted market liquidity by 1 trillion yuan (130 billion euros) through the release of funds otherwise tied up in reserves. The PBoC expects the freed-up funds to be used for paying off maturing medium-term lending facility (MLF) loans, as well as assure adequate liquidity for tax payments due in July. On Thursday (July 15), the PBoC issued only 100 billion yuan in new one-year MLF loans as 400 billion yuan in MLF loans came due. The interest on the new loans was unchanged. The central bank's policy rates, including the bank lending benchmark loan prime rate (LPR), were last adjusted in April 2020.

The PBoC announcement of the RRR lowering on July 9 followed a State Council meeting at which officials were particularly worried about the plight of smaller firms struggling, among other things, with higher world commodity prices and signalled an RRR cut to help them. Small firms' lack of access to affordable credit is a long-standing problem in China. The RRR reduction should also ease stress on banks.

Reduction in loan pricing was aimed last month also through a technical adjustment in how banks can set their deposit rates. Reduction in the deposit rate ceiling is hoped to translate to lower lending rates especially for small firms. Although bank deposit rates in principle were deregulated in 2015, they remain controlled by the banking sector's self-regulatory body that is overseen by the central bank. The PBoC still publishes benchmark rates for bank deposits. Instead of using a multiplier factor, to set the ceiling on bank deposit rates (e.g. a multiple of 1.4), the latest adjustment calls for adding a defined margin to the benchmark rate.

Even with the latest reduction in reserve requirements, Chinese monetary policy has not been especially accommodative this year. Through its open market operations and central bank lending, in net terms the PBoC's withdrew 530 billion yuan from the markets in 1H21. After last year's round of economic stimulus measures, the PBoC has returned its focus to controlling indebtedness growth and financial market risks. On-year growth of the broader lending measure "aggregate financing for the real economy" (AFRE) slowed to 11 % in May and June, down from 13.7 % in October 2020. The size of AFRE relative to the general economy has also declined slightly this year. As of end-June, it was 276 % of GDP (280 % at the end of 2020, and 255 % at the end of 2019).

The central bank's key policy and benchmark rates have remained unchanged for over a year now.



Sources: People Bank of China, National Interbank Funding Center, CEIC and BOFIT.

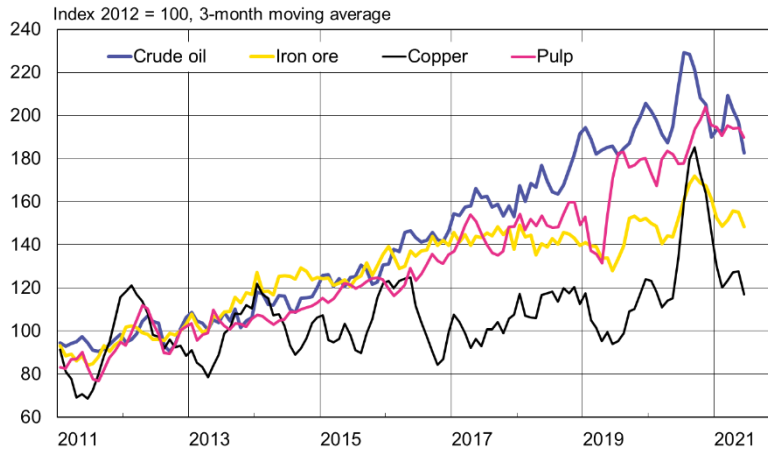
China's foreign trade growth gains steam in the second quarter. For the first half of 2021, the value of Chinese exports rose in dollar terms by 30 % y-o-y and 38 % from 1H19. In the second quarter (April-June), the value of Chinese goods exports rose to \$809 billion, a 30 % increase compared to 2Q20 or 2Q19.

The value of Chinese imports continued to increase as well. April-June imports were \$669 billion, up by 44 % from 2Q20 and up 30 % from 2Q19. The on-year increase in commodity prices partly explains the higher overall value of imports. At the same time, the import volumes of commodities have begun to decline as prices have risen. The June import volumes for crude oil, iron ore and copper fell slightly both on year and compared to early 2021. China imported an exceptionally large amount of semiconductors and other electronic components throughout the second quarter, however.

The restriction on foreign travel caused by the pandemic continue to be reflected in China's services imports. The value of tourism imports in January-May was only 34 % of the same period in 2019, and therefore China's overall services imports remained well below pre-pandemic levels.

China's foreign trade with all its main trading partners (i.e. ASEAN countries, the EU, the US and Japan) increased in the first half of this year. Growth in global economic demand has kept Chinese foreign trade humming since the second half of 2020. Uncertainty about future business conditions, however, has been heightened by the emergence of new coronavirus variants, disruptions in supply chains and rising commodity and transport prices. The latest readings of new export orders subcategory in China's official manufacturing purchasing manager index (PMI) was well below 50 for both May and June, suggesting that the export outlook may be cooling.

Volumes of China's key commodity imports fell slightly in June.



Sources: China Customs, Macrobond and BOFIT.

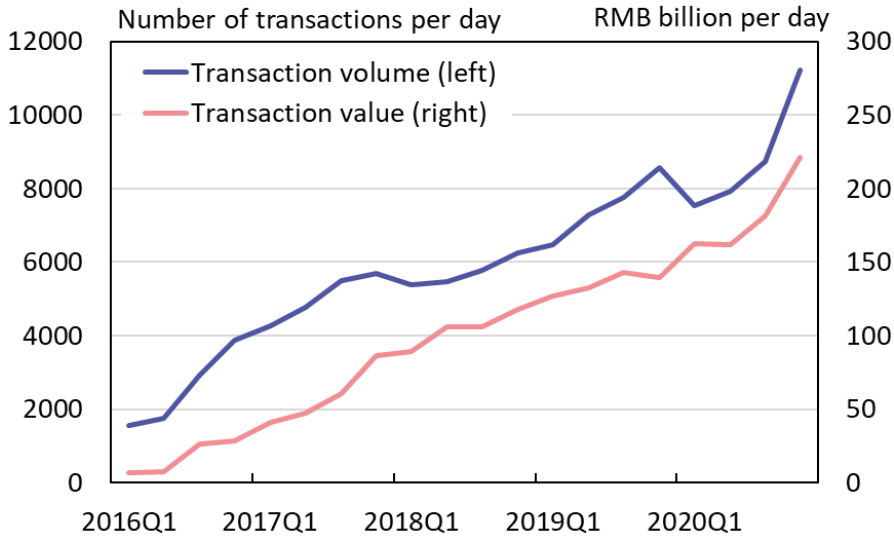
China's international payments system CIPS sees higher use. China's cross-border interbank payment system, CIPS, which is administered by the People's Bank of China, handled 2.2 million payment transactions last year with a total value of 45.2 trillion yuan. The volume of CIPS payment traffic last year rose by about 20 %, while the total value of transactions was up by over 30 %. Growth was particularly strong in the final quarter of 2020.

As its name implies, CIPS is used for international transfers of yuan-denominated transactions between banks. Most CIPS payment traffic moves between Hong Kong and mainland China, although an exact breakdown is not revealed from the available CIPS statistics. Banks in ASEAN countries also use the system, accounting for 8 % of CIPS payment transfers last year and 15 % of value. Use of CIPS in Africa, Latin America and Europe is still marginal, accounting for only about 0.5 % of payment transactions and less than the 0.1 % of their value.

As of end-May, 1,189 banks representing roughly 100 countries used CIPS. Of these banks, 569 operated in mainland China, 355 elsewhere in Asia, 154 in Europe, 42 in Africa, 26 in North America, 23 in the Australia & Pacific region and 17 in Latin America. Many of the foreign bank branches are subsidiaries of Chinese banks. There are 47 direct member banks and most of the banks linked to the system (1,142) are indirect participants. Banks directly plugged into the system act as transfer hubs to pass payments on to indirectly linked participant banks. All direct participants are subsidiaries of large Chinese banks.

China decided to establish its own international payment system in 2012 and CIPS began its operations in 2015 ([BOFIT Weekly 26/2015](#)). The main purpose of the system is to encourage international use of the yuan, but it also provides an alternative to the western SWIFT payment system. Despite the rapid growth in CIPS payment traffic, the volume of payments handled by the system are tiny relative to the volume handled by the SWIFT system. SWIFT and CIPS have cooperated for years on integration of the two systems. The thread of the US imposing financial sanctions to some actors that limit their use of USD may have increased the interest in the CIPS alternative.

Yuan-based payment transactions through China's cross-border interbank payment system CIPS have climbed steadily over the past few years.



Sources: CIPS and BOFIT.

Russia

Russia's foreign goods trade recovered; corporate capital outflow rose. As expected, preliminary balance-of-payments figures from the Central Bank of Russia show that export revenues and import expenditures were much higher in the second quarter of this year than a year earlier when the first wave of covid-19 and economic decline diminished foreign trade. While export revenues and import spending were roughly at the same levels as in 2Q19, the situation for goods and services remained quite divergent.

Russian earnings on exported goods in the second quarter were up a few percent from two years ago. Revenues from oil & gas sector exports, however, were still down by about one tenth from their 2019 level. Revenues from crude oil exports remained significantly depressed. On the other hand, revenues from exports of non-oil-&-gas goods were up by over one fourth from two years previous. These other export goods also consist largely of basic commodities (e.g. metals) that have seen strong increases in their global prices. Russian revenues from services exports were significantly lower than two years previous especially because tourism to Russia remained small.

Spending on goods imports already in the first quarter of this year was substantially higher than two years earlier. In the second quarter, it was up by about one fifth from 2Q19, and actually at its highest in several years. Spending on services remained in a slump as Russian tourism abroad was still depressed while imports of other services were also down considerably from previous years.

Russia's second-quarter current account surplus remained substantial, and for the last four-quarter period reached a level equal to roughly 3.5 % of GDP. The current account surplus was supported by the continuously large goods trade surplus and a considerably smaller-than-usual services trade deficit. The deficit deepened for outward and inward payments accruing from direct and other investments as well as credit largely because, after a brief hiatus, outward payments of dividends and interest from the corporate sector increased.

The financial account deficit remained rather large. Repayment of Russia's sovereign bonds continued. Foreign-based investors this year also sold in net terms their holdings of Russian sovereigns on the secondary market. The net outflow of private capital diminished slightly, and over the last four quarters was equal to about 3 % of GDP. Most of it came from an increased net capital outflow of the corporate sector (not including banks). FDI inflows from abroad to Russian firms were still small (in the latest four-quarter period 0.7 % of GDP). Investors based abroad continued divesting their portfolio investments in Russian firms (0.9 % of GDP); these divestments started in autumn 2019. In addition, the non-bank corporate sector maintained relatively large outflows of direct and portfolio investments (0.9 and 0.8 % of GDP, respectively).

Revenues from goods exports and spending on goods imports have recovered.



Sources: Bank of Russia and BOFIT.

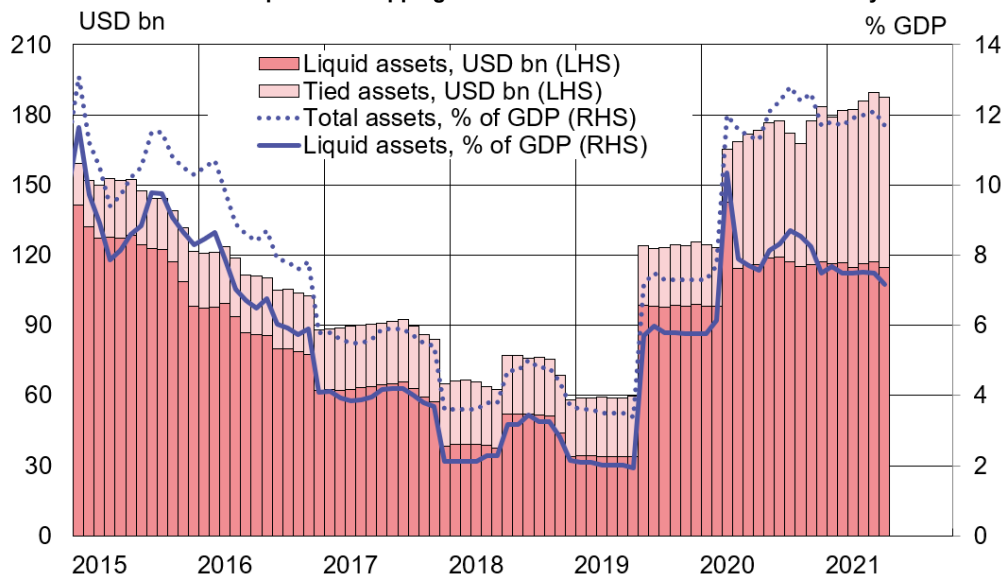
National Welfare Fund stabilises at 12 % of GDP. As of end-June, Russia's National Welfare Fund, which holds surplus oil & gas revenues, was worth about 187.6 billion USD or 11.7 % of GDP. While the Fund has grown slightly this year, nearly all growth has come from valuation changes in securities held by the Fund, particularly the rise in the price of Sberbank shares. The amount of the Fund invested in liquid securities such as government bonds has remained almost

unchanged since spring 2020. Despite a public sector deficit last year of 3.8 % of GDP, the Russian government refrained from dipping into Fund assets and covered the deficit instead with additional borrowing.

In early June, Russia's finance ministry announced ([BOFIT Weekly 23/2021](#)) plans to shift dollar-denominated NWF assets into assets denominated in other currencies. In June alone the amount of dollar investments decreased from \$35 billion to \$3 billion. At the same time, the amount of euro-denominated investments increased slightly. The big change was in assets denominated in Chinese yuan, which nearly doubled. Investments in gold rose from zero to \$21 billion. As of end-June, the composition of the highly liquid part of the NWF broke down as follows: 39 % in euro assets, 30 % in yuan assets, 18 % in gold, 5 % in British pound assets, 5 % in Japanese yen assets and 3 % in US dollar assets. The CBR invests the liquid share of the Fund on behalf of the finance ministry. Our BOFIT Policy Brief on Russia's international reserves and oil funds ([4/2015](#)) provides a good illustration of this process and its impact on the central bank's balance sheet.

As of end-June, the CBR's foreign currency and gold reserves were worth \$591.5 billion, of which \$130 billion (22 %) was held in gold. The CBR has gradually reduced its US dollar holdings since 2018. As of end-2020, the share of dollar assets in Russia's foreign currency reserves was just 21 %, while the euro's share rose to 29 %. Gold's share was 23 % and Chinese yuan-denominated assets 13 %. At the end of 2020, the CBR held yuan-denominated securities worth \$75.3 billion. IMF data show that the yuan only accounted for 2.1 % (\$269.5 billion) of global currency reserves at the end of 2020. Russia's share of this was an impressive 28 %. Russia's decision to ditch the dollar means that the composition of the CBR foreign currency reserves are distinct from those of any other central bank.

Russia has avoided the temptation of dipping into the National Welfare Fund for over a year.



Sources: Russian Ministry of Finance, Macrobond and BOFIT.

Surveys published by Russia's Commissioner for Entrepreneurs' Rights show low confidence in safety of the local business environment. Russia's Commissioner for Entrepreneurs' Rights (*biznesombudsman*), Boris Titov, submitted his latest wide-ranging annual report to the president this month. The annual reports include findings from surveys by Russia's Federal Protective Service (FSO) that map the business environment as regards conduct by authorities. Besides various matters related to official oversight and corporate inspections, the surveys ask about perceptions of laws and their enforcement as well as safety of doing business.

The respondents to this year's survey that addresses law and safety issues, conducted in March, included 830 persons representing 34 Russian administrative regions. Of that group, 215 were entrepreneurs, 250 experts (lawyers and legal scholars) and 365 employees from prosecutor offices (a new group included in this year's survey). Due to different respondent pools, comparisons with previous years' results are not perfect. For example, the 2020 respondent pool included 189 entrepreneurs and 279 experts representing 36 administrative regions.

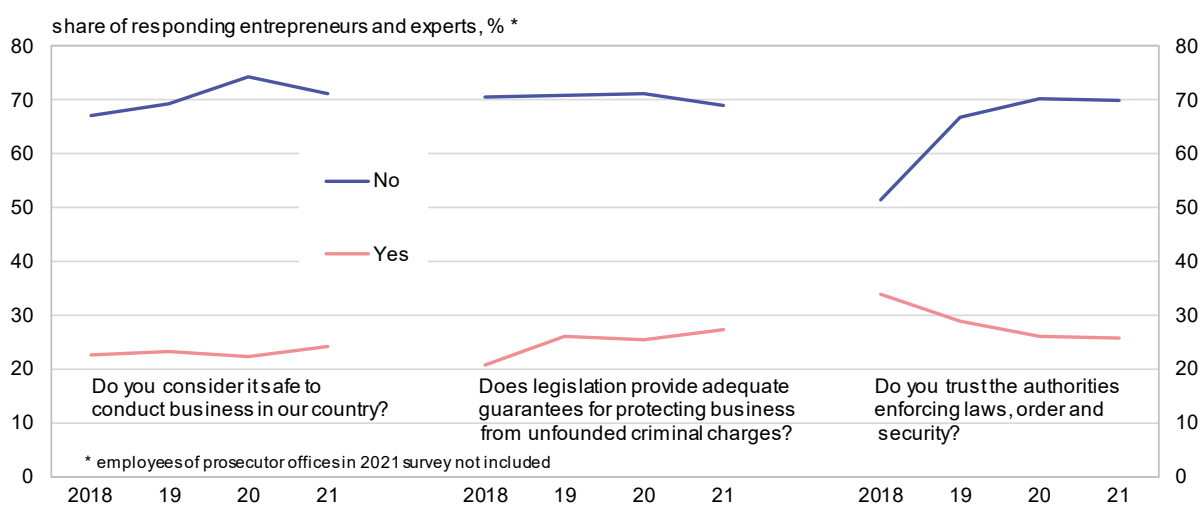
The responses of entrepreneurs in particular to certain heavy questions are hardly encouraging for Russia's economic prospects. Representatives of prosecutor offices, in contrast, mostly held opposite views. In this year's survey, nearly 80 % of entrepreneurs and 64 % of experts said that they did not consider it safe to conduct business in Russia (even if last year's

numbers were worse: 86 % and 74 %, respectively). Only slightly more than 20 % of prosecutor office respondents felt that way while over 70 % gave positive responses.

Nearly 80 % of entrepreneurs and over 60 % of experts felt that the law failed to provide adequate protections for businesses against unfounded criminal charges. A very similar question in another FSO survey was put to small firms (fewer than 15 employees), where 57 % of nearly 3,400 entrepreneurs and firm leaders gave negative responses. In the survey of the narrower pool, just 20 % of employees in prosecutor offices gave negative responses and nearly 80 % said yes.

Likewise, some 80 % of entrepreneurs and over 60 % of experts said they did not trust authorities enforcing laws, order and security (nearly 90 % and 65 %, respectively, in 2020). Only 12 % of prosecutor office respondents had such reservations, while 84 % said they trusted those authorities. This year's survey report did not include the question of trust in the judiciary. In the two previous years' surveys, over 55 % of experts said they did not trust the Russian court system.

Russian firms and business experts consistently report low trust in the safety of Russian business environment.



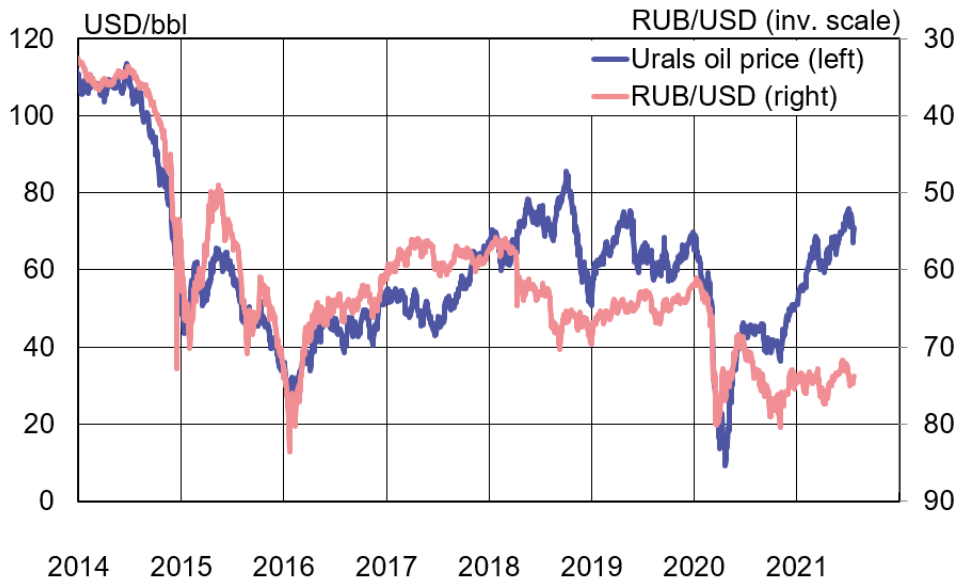
Sources: Annual Reports to the President from Russia's Commissioner for Entrepreneurs' Rights and BOFIT.

OPEC+ group agrees on raising crude oil production ceilings; markets down on new information about spread of coronavirus delta variant. The Organization of Petroleum Exporting Countries and Russia (OPEC+) finally reached agreement last week on raising oil production quotas. The higher production ceilings reflect an across-the-board increase in crude oil prices this year. The price of Russian Urals-grade crude, for example, was up by about 50 % year-to-date in the first week of July.

Under the current OPEC+ agreement, production is assumed to return to pre-pandemic levels by the end of 2022. Production ceilings will rise every month starting in August 2021. After the United States (production 11.3 million barrels a day), Russia last year was the world's second-largest crude oil producer (9.9 million barrels a day). Under the latest OPEC+ agreement, Russia's oil output can rise from the current 10.5 million barrels a day to 11.5 million barrels a day by the end of May 2022.

Prices of shares and commodities plunged at the start of this week on concerns about the spread of the delta variant of the coronavirus and its possible impact on global economic activity. The price of Urals crude fell below \$70 a barrel for the first time since the start of June. The ruble's exchange rate showed no change, however.

Although the price of Urals crude dropped sharply last week, the ruble's exchange rate barely wavered.



Sources: Reuters and BOFIT.

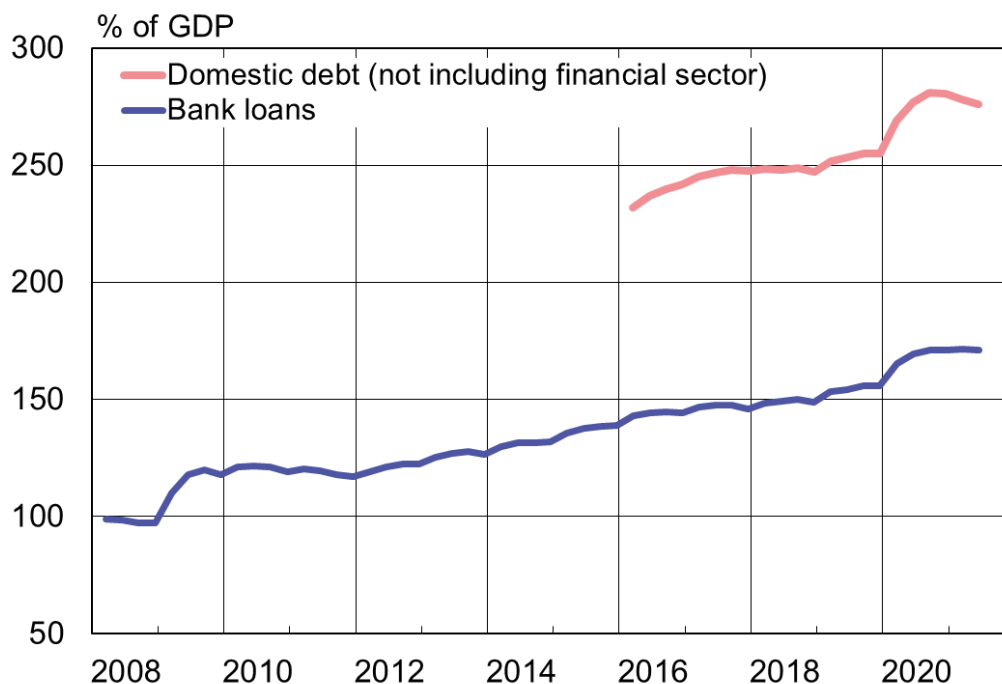
China

China's plunge into indebtedness has slowed in recent months. The People's Bank of China reports that on-year growth in aggregate financing to the real economy (AFRE, consisting of bank loans, debt securities, shadow banking and other forms of financing) slowed in June to below 11 %. AFRE growth, driven by the government's pandemic stimulus response, reached nearly 14 % last year. In the financial item category, growth in bank lending (64 % of AFRE) has slowed only slightly, while the on-year growth in the stock of corporate debt securities (10 % of AFRE) has fallen from over 20 % last summer to under 7 %. Growth in the stock of government-sector bond issues (16 % of AFRE) also slowed substantially.

Financing provided by the shadow banking sector has continued to shrink this year, and was down by 10 % y-o-y in June. Due to more heavy-handed regulation of China's credit markets, the shadow banking sector has shrunk for three consecutive years. The share of financing provided by the shadow banking sector has fallen from 14 % of AFRE in 2017 to below 7 % in June.

China's domestic debt-to-GDP ratio has fallen slightly with the slowing rise in indebtedness and rapid economic expansion. At the end of June, domestic debt corresponded to 276 % of GDP, down from 280 % of GDP at the end of last year. According to the State Administration of Foreign Exchange (SAFE), China's foreign debt at the end of March was equal to 15.5 % of GDP, of which 48 % was dollar-denominated debt and 43 % in yuan-denominated debt.

China's domestic debt-to-GDP ratio has diminished slightly this year



Sources: People's Bank of China, China National Bureau of Statistics, CEIC and BOFIT.

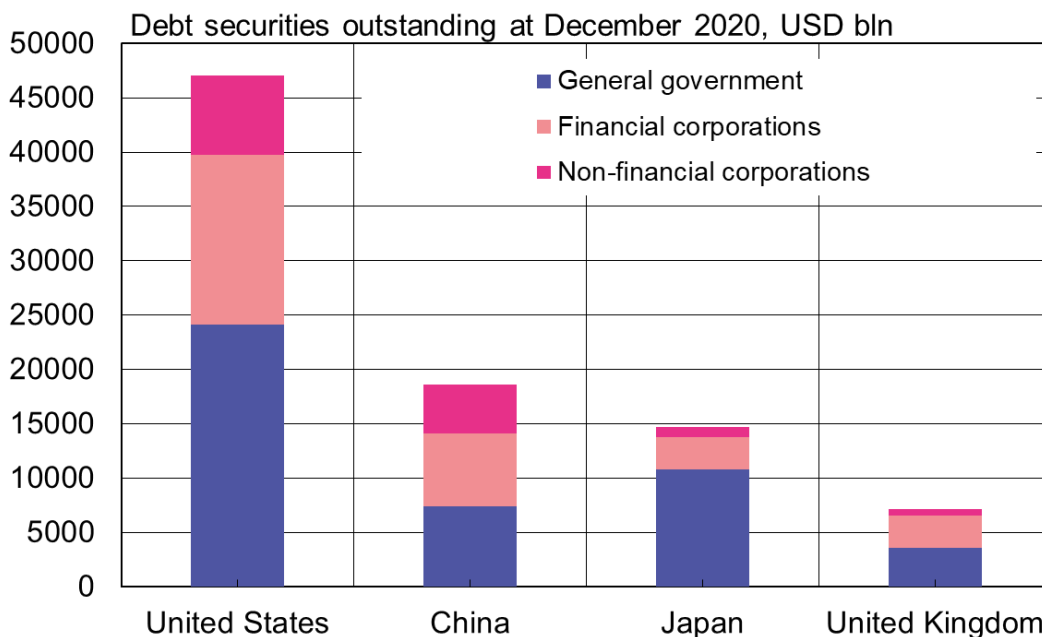
China now has the world's second largest bond market after the US. China's bond markets have grown remarkably in recent years. The value of corporate, financial and government bonds on issue climbed to \$18.6 trillion at the end of 2020, or nearly double the value of 2016 and over four times more in 2012. Although China's bond market is significantly smaller than the US bond market (just over \$47 trillion), it is already larger than that of Japan (\$14.7 trillion). Moreover, no other emerging-economy bond market even ranks in the same league as China. Brazil's bond market, for example, is less than a tenth the size of the Chinese bond market.

Even if the size China's bond market is nearly comparable to developed-economy bond markets, yields are higher and the role of the private sector is smaller. Most bonds in China are held by state-owned banks and they are not actively traded. As a result, China's bond market is both stable and illiquid.

Government bonds (central and local governments) represented about 40 % of China's bond market last year. Growth in government bond issues has been led by the increase in the volume of bond issues of provincial and municipal governments since 2015. With last year's stimulus measures, the share of bonds issued by local governments rose to 22 %, exceeding the share of central government bonds (18 %). The government's role in China does not stop there, however. Even if corporates account for a larger share of the bond market than in most countries, many firms are state-owned. In addition, a large chunk of financial institution bonds have been issued by China's policy banks.

In recent years, China's bond market has opened up more to foreign investors. The landmark event took place in July 2017 with the inauguration of Bond Connect linking the Hong Kong and mainland China bond markets, making it practical for foreign institutional investors to trade directly on China's interbank market without having to adhere to quotas or preliminary announcements. Since then, foreign investment in China's bond market has grown steadily. IMF figures show that about 3.5 % of current bond issues and about 10 % of China's government bonds are in foreign hands. At the end of 2018, national central banks held nearly 80 % of the Chinese bonds in foreign hands. Over the past two years, the bonds of China's public entities and policy banks have been incorporated into several major bond indices, which in turn has increased interest in Chinese bonds outside the realm of central banks.

China last year surpassed Japan to become the world's second largest bond market



Sources: BIS and BOFIT.

China launches a national carbon emissions trading scheme. In the first day of trading (July 16) of China's new national carbon emission trading scheme, some 4.1 million tons worth of carbon credits changed hands, with an average price settling at around \$8 per metric ton. The price of carbon credits is still well below that of the EU's emissions trading scheme (currently around \$60 a ton), but as the Chinese tighten emissions rules as planned, the price of carbon credits should rise.

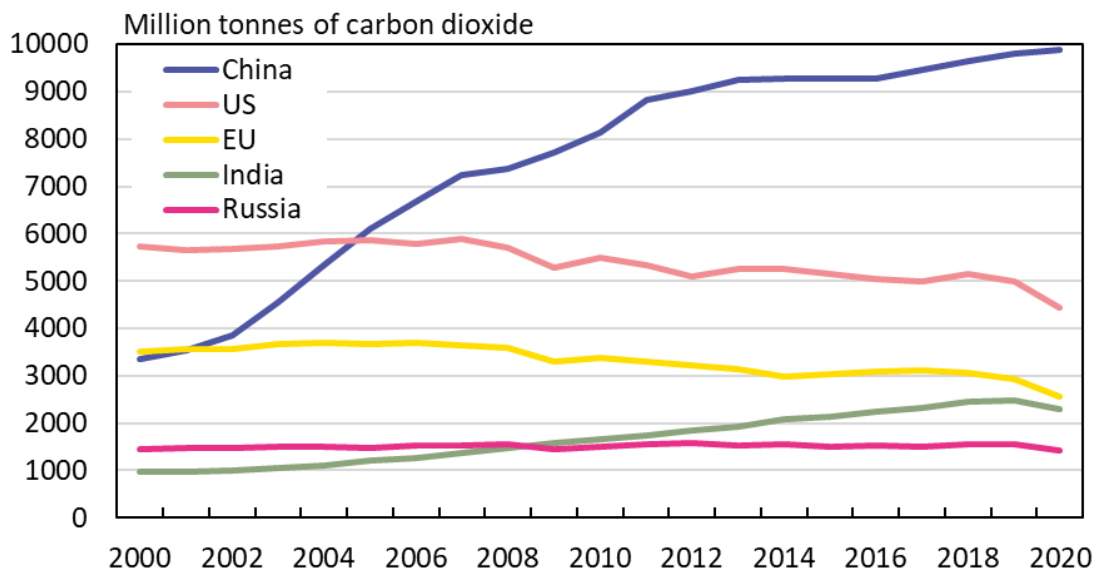
The plan initially extended to several sectors, but at the moment the carbon trading scheme covers only energy companies. Despite the limitation, China's now has the world's largest emissions trading scheme. China generates more than 30 % of global CO₂ emissions, of which about half come from the energy sector.

In China's carbon trade scheme, officials give annual emission permits for companies participating in the scheme according to i.e. their production type and historical production level. Companies that exceed their defined emissions quota are penalised, while those that stay within their quota can sell their available carbon credits to others. The sanction costs of exceeding the carbon ceiling, the market price of the carbon credits and expectations of tightening the carbon trade parameters create incentive for companies to improve their carbon efficiency.

Nearly 40 countries have adopted emissions trading schemes. China decided to go ahead with its scheme in 2010, beginning with the introduction of various pilot programmes at power plants and industrial sites in select large cities. Despite intentions to launch the national scheme six years ago, the rollout of the scheme has been postponed several times. Some observers claim that the delays had to do with the reliability of emissions data and political infighting.

The emissions trading scheme is a welcome new tool for Chinese environmental policy. Experts say that the scheme conditions need to be significantly tighter to be of any benefit in reaching climate goals. China's current announced goal is to begin reducing carbon emissions after 2030, and has no expectation of achieving carbon neutrality before 2060. [Climate Action Tracker](#) considers China's climate measures "highly insufficient" with respect to Paris climate agreement target.

China, by far the largest global source of carbon dioxide emissions, continues to release more carbon each year.



Sources: BP Statistical Review of World Energy 2021 and BOFIT.

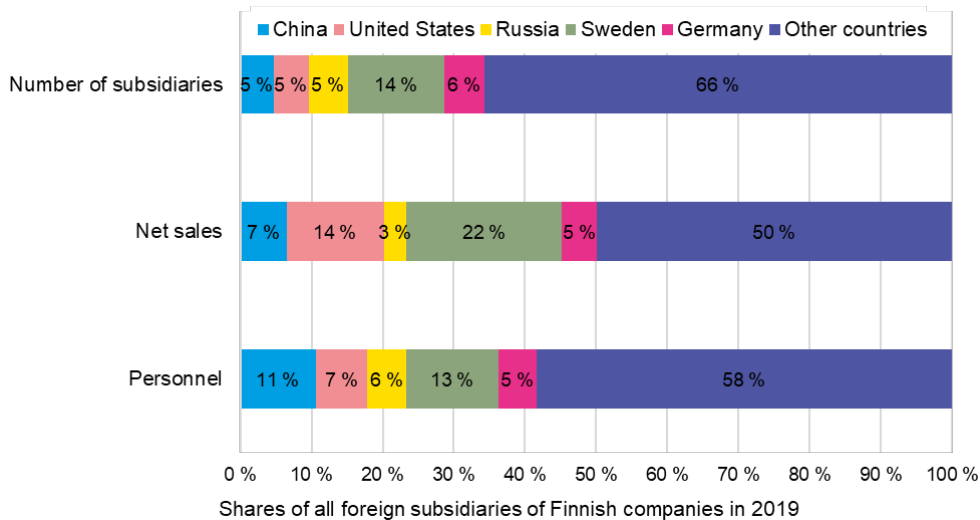
Finland-China relations defined by continuity and economic cooperation. At the start of June, Finland's Ministry of Foreign Affairs released the Finnish government's [second action plan for China](#). Finland's previous action plan for China was issued in 2010. The plan presents the Finnish government's consensus view of China. However, it does not include any new policy changes with respect to China, but it clarifies the current policies and methods of engaging with China. The plan sustains Finland's moderate China policies, which emphasise the importance of continuity and cooperation. Finland's relations with China mostly involve commercial or economic matters, but Finland and China have been working together in other spheres such as rule of law and environmental and climate issues.

According to the foreign ministry, it was an appropriate time to update its decade-old action plan to reflect changes in the operating environment and available information. The new action plan is more detailed and wide-ranging than its predecessor. It acknowledges China's geopolitical rise, the general increase in global tensions, which is reflected in the plan's weightings and harsher tone of voice. The action plan calls for levelling the playing field and ensuring reciprocity in economic relations echoes current EU China policy. China's human rights violations and global engagement also have greater emphasis on the new action plan. The plan gives considerable weight to cooperation among countries with similar views on China issues (EU, Baltic countries, Nordic countries and the US).

In June, Finland’s Ministry of Foreign Affairs and the Confederation of Finnish Industries released another [report](#) that discusses the impacts of the competing interests of the US and China on Finnish firms. The report notes that competition has increased risk in the high-tech sector, an important area for Finnish industry. The tougher operating environment could be evidenced in such measures as sanctions, restrictions on market access, increased regulation of public procurement and politicisation of standardisation, all of which may potentially affect Finnish firms. Thus, Finnish firms need to be more knowledgeable about the competitive struggles of China and the US, and related Finnish actors should work together more closely in assessing the situation and keeping each other informed.

China is important to Finnish businesses. Data collected by Statistics Finland show about 250 subsidiaries of Finnish firms operated in China last year, which represents nearly 5 % of all Finnish foreign subsidiaries globally. Together they generate 6.5 % of total net sales of Finnish foreign subsidiaries (€13 billion) and employ 11 % (62,600 people) of the total workforce of Finnish foreign subsidiaries. Measured in terms of net sales, the biggest Finnish players in China are industrial firms. In 2018, half operated in machinery and metal industries, 30 % in electrical and electronics manufacturing, and a bit over 10 % in the paper industry. China ranks among Finland’s top-five trading partners. The bulk of Finnish exports to China consist of forest industry products and machinery & equipment ([BOFIT Weekly 22/2021](#)).

Finnish companies have sizable subsidiaries in China, employing in total over 62,000 people.



Sources: Statistics Finland and BOFIT.

Russia

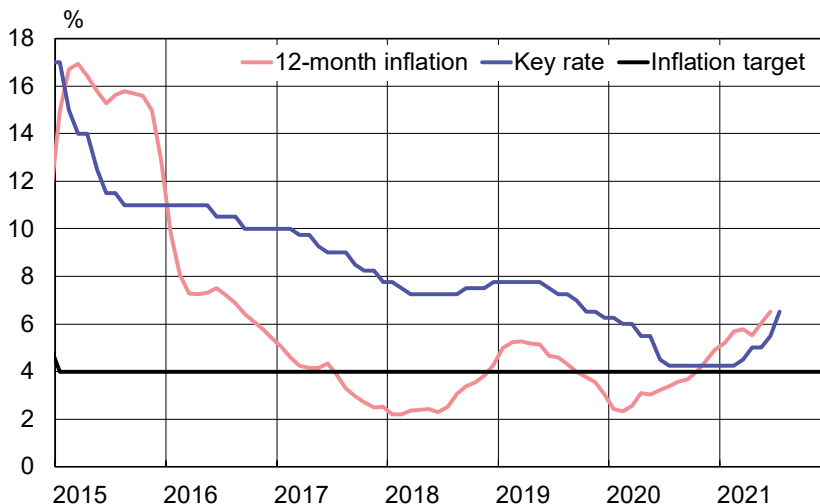
CBR continued to tighten monetary policy in July. At its July meeting, the Central Bank of Russia raised the benchmark key rate by 100 basis points to 6.5 %. With Russian consumer prices climbing rapidly in recent months, the rate hike came as no surprise to the market. 12-month inflation hit 6.5 % in early July, a pace well above the CBR's 4 % inflation target. Inflation expectations have also risen in recent months. Household inflation expectations in July were at their highest level in nearly five years.

The CBR attributes much of the recent uptick in inflation to the inability of supply to keep up with the better-than-expected recovery in demand. The central bank now believes that the Russian economy reached the pre-pandemic level already in the second quarter of this year. Not only is unemployment decreasing, but labour shortages have appeared in some branches, adding pressure to boost wages. Some of the recent burst in inflation is due to transitory factors. For example, the inability of most Russians to travel abroad on holiday this summer has caused a huge increase in prices of domestic travel services.

Given the current trends, the CBR decided last month to raise its 2021 forecasts for GDP growth and inflation. GDP is now forecast to grow by 4–4.5 % this year and 2–3 % p.a. in 2022 and 2023. The CBR expects inflation this year to remain in the range of 5.7–6.2 % before cooling next year to 4–4.5 %.

Commenting on the outlook of monetary policy, CBR governor Elvira Nabiullina said that, based on the central bank's current assessment, the key rate next year is likely to average in the range of 6–7 %. Thereafter, it should gradually fall to 5–6 % which the CBR sees as compatible with the 4 % inflation target in longer term. The CBR will, however, start the evaluation of its monetary strategy this autumn and consider e.g. whether it may be appropriate to lower the inflation target.

The CBR again raised its key rate last month in response to surging inflation



Sources: Macrobond, CBR, Rosstat and BOFIT.

Russian economy has recovered from last year's recession, but pace of recovery varies considerably across branches. The Russian economy has largely recovered from the recession in spring 2020, and most recoveries have gradually continued in recent months. In the first quarter of this year, GDP was already slightly higher than it was two years previous (i.e. in the first quarter of 2019). The Ministry of Economy Development reports that the increase in the second quarter was about 1.5 % from the second quarter of 2019.

The strength of the recovery varies among core sectors of the economy. For example, the output of extractive industries has recovered notably. In the second quarter of this year, it was down by just 2 % from two years previous. Under the OPEC+ agreement, crude oil output has gradually clawed its way back towards pre-pandemic levels and was down by 6 % from two years previous in the second quarter. Natural gas production was several percent higher than two years previous. Support

services for oil & gas production, which constitute a slightly larger branch than natural gas production alone, experienced growth of over 20 % from two years previous.

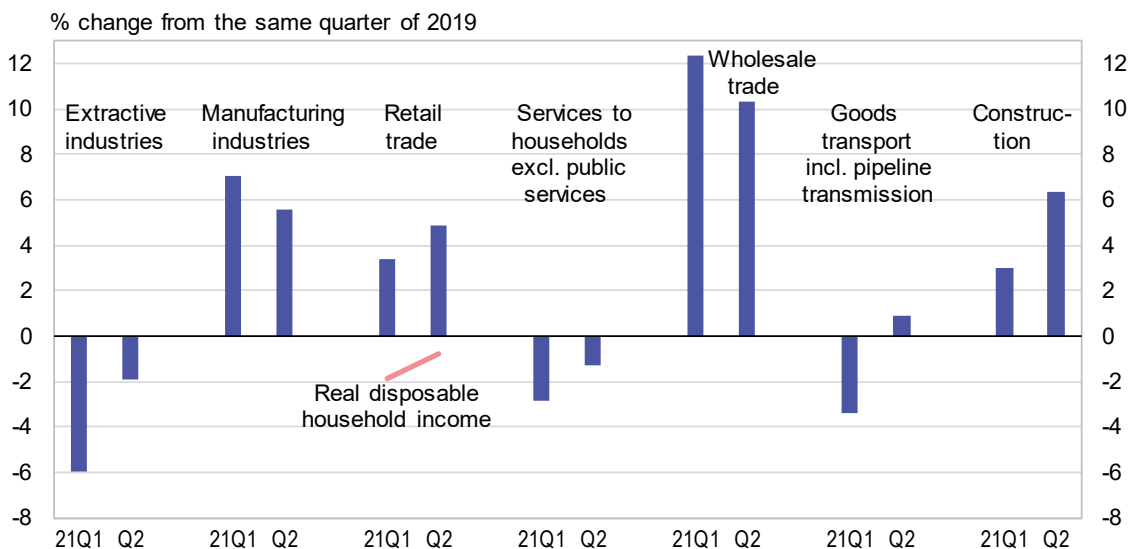
Manufacturing production has recovered quite well. Second quarter output was about 5.5 % higher than two years previous (7 % in the first quarter). Growth has been broad-based. In the six largest manufacturing branches, the increase from two years previous was 7–8 % in the food industry, more than 13 % in the chemical industry, over 30 % in the metal product industry, as well as 7 % in machinery and equipment branches. Of all manufacturing branches, only metal refining was down in the second quarter from two years previous. On the other hand, manufacturing growth has levelled of this year. In the past couple of months, seasonally adjusted output has declined. The seasonally adjusted manufacturing purchasing manager’s index (PMI) fell significantly in July on the heels of a few positive months. According to the survey, the drop reflects reduced production and fewer new orders. Rosstat’s company survey also found that near-term prospects for manufacturing output and orders were continuously quite tepid in July.

The volume of retail sales in the second quarter was up by 5 % from two years earlier, and no longer more than 5 % lower than in the second quarter of 2014, when retail sales hit their peak in the last decade. Seasonally adjusted sales have increased rather slowly in recent months, though. Services offered to households (excluding those provided by the public sector) recovered in the second quarter to a level only slightly below two years previous. Rosstat’s quarterly survey of consumer expectations of their own household for the next four quarters found modest expectations. The Bank of Russia monthly survey, which in recent months has found rather good expectations, dropped rather sharply in July.

The recovery in consumption has not been driven so much this year by real disposable household income, which was still down by nearly 1 % from two years previous in the second quarter. Consumption this year has been bolstered by very low net household saving compared to the recession in spring 2020 as well as 2019. Net saving includes net household borrowing from banks, which has increased in recent months as regards consumer credit. This is the mirror opposite of spring 2020, when net borrowing for consumption declined as is quite typical during economic downturns. In the second quarter, the number of people employed returned nearly to the same level as two years previous.

Wholesale has recovered strongly, up 10 % from two years previous in the second quarter. Construction activity is also up considerably from two years ago. The volume of goods transported (including pipeline transmission of crude oil, petroleum products and natural gas) was up slightly from two years previous.

Output levels in different branches of the Russian economy are quite varied when compared to levels in 2019



Sources: Rosstat and BOFIT.

International Monetary Fund predicts high economic growth this year for rich economies and tepid growth for many emerging economies. The IMF’s [July World Economic Outlook](#) sees global growth at 6 % this year (i.e. no change from its April WEO). According to the latest forecast, the global economy will grow by 4.9 % next year, which is half a percentage point more than in the IMF’s April WEO. The increases in this year’s forecast reflect the massive stimulus programmes implemented for the most part in rich industrialised countries. For example, the US economy is now expected



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to grow by 7 %, a 0.6 percentage point increase from the April WEO. The increase in next year's forecast for global economy is also driven mainly by the improved outlook for rich countries.

The IMF lowered its 2021 outlook for many emerging economies, including China and India. The covid pandemic has seriously eroded India's economic prospects, causing the IMF to reduce its forecast by three percentage points to 9.5 %. The World Bank and the OECD have also produced similar growth forecasts for China and India. Next year, China's GDP growth is expected to slow significantly as it has recovered from the trough of the covid crisis.

Looking at the Russian figures, e.g. the sharp rise in crude oil prices is reflected in a higher growth outlook for this year, with GDP rising by 4.4 %. In this respect, the IMF is substantially more optimistic than the earlier-released forecasts of the EBRD and World Bank. The 2022 growth forecasts of all these institutions, on the other hand, are nearly identical at around 3 %.

If the IMF forecast materialises, GDP growth between 2019 and 2022 would be 17 % in China, 10 % in India and 4 % in Russia. It is worth noting, however, that the expected growth pace varies widely across countries – poor countries typically grow faster than rich countries. The picture is quite different when comparing the July 2021 WEO forecasts to the October 2019 WEO forecasts. India's GDP, for example, is forecast next year to be nearly 13 % below the level that was expected in 2019 as the covid pandemic has hit the Indian economy particularly hard. Both China and Russia have taken much smaller hits to their GDP, each only dropping about 1 % from the 2019 WEO forecast.

Recent GDP growth forecasts for select countries (%).

	IMF (7/21)			EBRD (6/21)		World Bank (6/21)		OECD (5/21)	
	2020	2021	2022	2021	2022	2021	2022	2021	2022
Brazil	-4.1	5.3	1.9			4.5	2.5	3.7	2.5
India	-7.7	9.5	8.5			8.3	7.5	9.9	8.2
China	2.3	8.1	5.7			8.5	5.4	8.5	5.8
Russia	-3.0	4.4	3.1	3.3	3.0	3.2	3.2		
Turkey	1.8			5.5	4.0	5.0	4.5	5.7	3.4
Ukraine	-4.0			3.5	3.5	3.8	3.1		

Sources: International Monetary Fund (IMF), European Bank for Reconstruction and Development (EBRD), World Bank and Organisation for Economic Co-operation and Development (OECD).

China

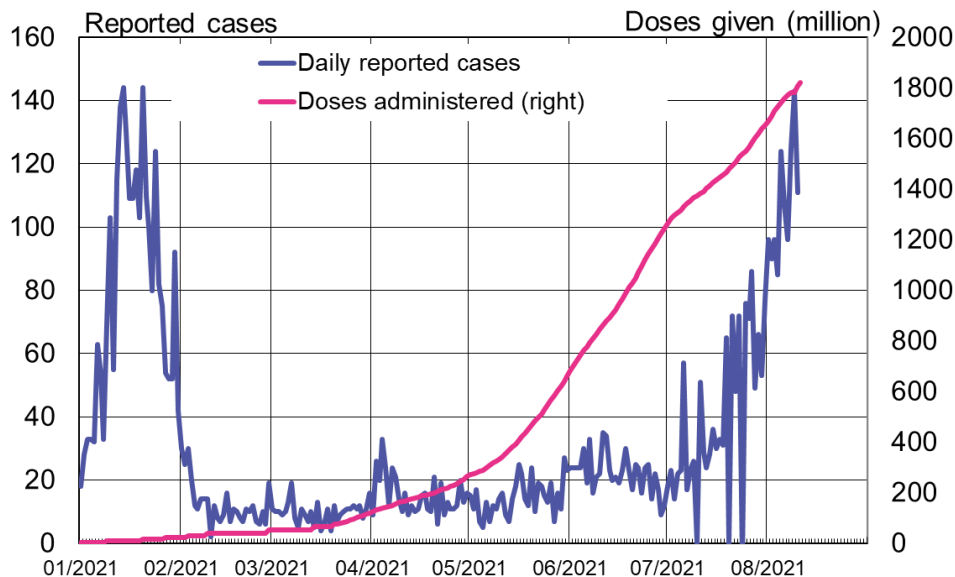
China struggles with delta variant outbreaks. Reported new covid-19 cases in China have increased steadily since July. On August 9, China surpassed 140 new cases in one day, a level not seen since January. The delta variant of covid, which has a much higher effective reproduction rate than the original virus of China's first wave, has spread to most provinces. China again finds itself restricting movement within and between cities, limiting the size of gatherings and cancelling live events.

China's covid-fighting strategy features aggressive testing and tracing, as well as isolation of infection clusters through strict lockdown. The pace of vaccination also picked up considerably this summer. By the end of the first week of August, China had administered nearly 1.8 billion vaccine doses, an amount sufficient to provide two doses of vaccine to about 64 % of the Chinese population. The last-released official figure on vaccination coverage is from early June, when just over 800 million doses had been administered. At that point, 43 % of the population (620 million) had received at least one vaccine dose, and 15.5 % of the population (220 million) was fully vaccinated.

It may well be that China's phenomenally successful suppression strategy no longer works with the highly infectious delta variant, which can still cause breakthrough infections and further spread among the vaccinated. In July, nine employees at the Nanjing airport tested positive for covid, even if over 90 % of the airport staff were already fully vaccinated. This month, five cases were found in the west Yunnan city of Ruili, where nearly 97 % of the population were already fully vaccinated.

A household survey conducted in April-June by the People's Bank of China found for the first time since the start of the pandemic a small increase in the share of households planning to increase consumption. And according to the China's National Bureau of Statistics, over 60 % of first-half growth came from increased consumption ([BOFIT Weekly 28/2021](#)). The economy overall, and the service sector and retail sales in particular, nevertheless were still experiencing significantly lower growth than before the pandemic. More extensive restrictions and lockdown measures in response to the delta surge could further delay the recovery in consumer demand.

China's latest wave of covid infections took off in July



Sources: Our World in Data, University of Oxford and BOFIT.

China's sudden rule changes cause headaches for investors and corporate management. China decided in June to implement a new data security law that applies broadly to the handling and processing of electronic and physical

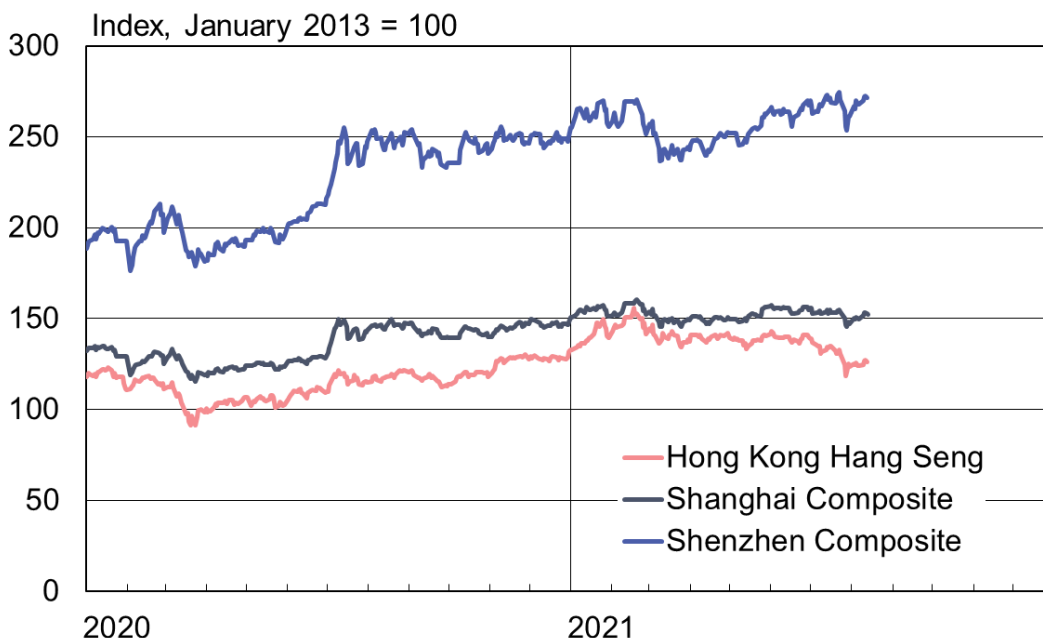
data by corporations and other entities. Under the law, data are categorised according to official directives. Data classified as “important data,” including “core state data,” cannot be transmitted outside the country’s borders without official permission. Because the law involves such matters as national security, it also applies to data handling outside China. The new law enters into force at the beginning of September.

China has traditionally been quite relaxed in its regulation of data and its handling and management, but the situation has clearly changed. In addition to the new data security law, an act on protection of personal data is in the drafting phase. The bill is expected to be presented to lawmakers for approval during the winter. China’s rush to update its data laws is driven partly by official fears that the data gathered by China’s giant tech firms on hundreds of millions of Chinese citizens could wind up in foreign hands. In the past 12-months, regulatory crackdowns have focused in those branches where large Chinese tech firms are most active. Last autumn, officials tightened rules for the fintech sector and intervened at the last minute to block the listing of Alibaba’s Ant Financial spinoff. Officials announced last winter that they were tightening their interpretation of cartel laws, and soon after new regulation on the “platform” economy was released.

Approval of the data security law quickly raised a range of data security issues. China’s cyberspace administration announced in early July that it was launching an investigation into the data collection and handling of the ride-hailing giant Didi Chuxing with respect to national security. The company had just held its IPO on the New York Stock Exchange a couple days before the investigation was announced. The investigation and potentially large fines sent the company’s share price from over \$16 to around \$9. Indeed, the very mention of surprise investigations and targeted official measures was enough to spook many investors. Chinese share prices briefly fell across the board in Shanghai, Shenzhen and Hong Kong. Following Didi’s IPO debacle, the US Securities and Exchange Commission announced that it would require Chinese firms listing on US exchanges to provide more information to prevent a repeat of the event. The China Securities Regulatory Commission followed with its own announcement that it was ready to engage in closer dialogue with American regulators.

Rules and their interpretation can change quickly and without warning in China as officials try to deal with problems in an environment characterised by the lack of transparency. As competitive frictions with the US rise, matters of national security will acquire greater significance.

Key indices have recovered from a brief July drop in mainland China and Hong Kong

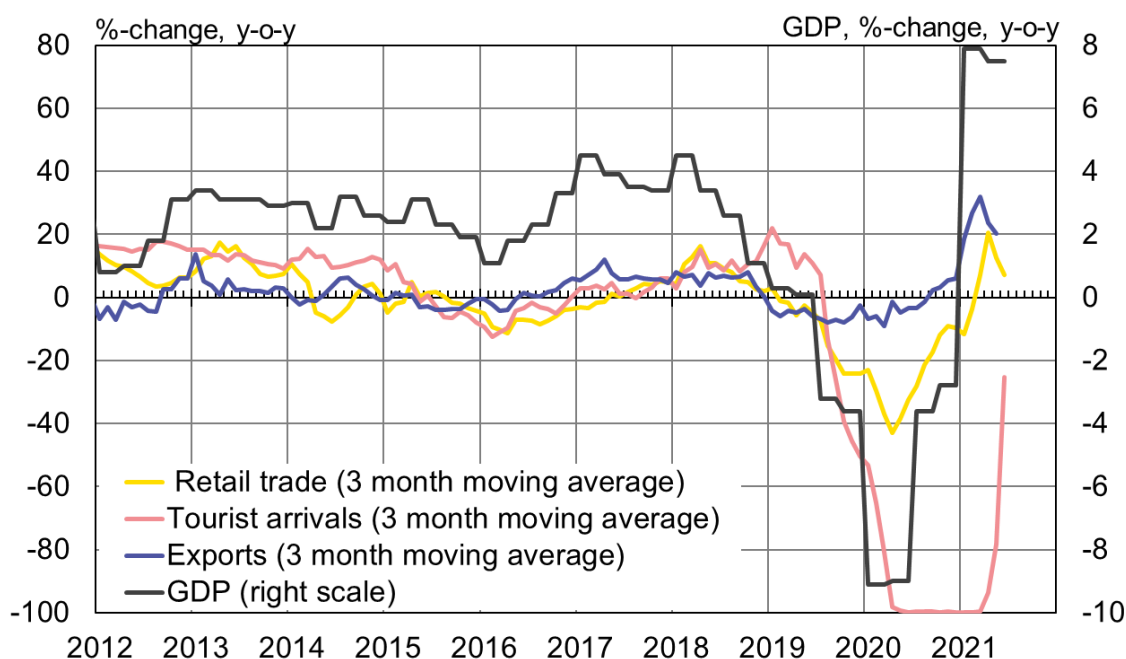


Sources: Shanghai, Shenzhen and Hong Kong stock exchanges, Macrobond and BOFIT.

Hong Kong's weak economic recovery. The Hong Kong Census and Statistics Department reports that the special administrative region's GDP rose by 7.8 % y-o-y in the first six months of 2021. The high on-year growth largely reflects the low basis reference of the first half of 2020. The recovery, however, took a small hit in the second quarter of 2021 as GDP contracted slightly from the first quarter. Goods exports and imports recovered in the first half to pre-pandemic levels, while private consumption rose in the second quarter by just 6.5 % y-o-y and services exports by 2.6 %. Hong Kong's weak comeback is further reflected in the unemployment rate, which is still higher than pre-pandemic levels. The June unemployment rate was 5.5 %, up from 2.8 % in the first half of 2019. Hong Kong has relied on a range of stimulus measures to support its economy. The government announced at the beginning of this month that it was initiating a new support package for the tourism sector.

The Hong Kong economy entered recession before the arrival of the covid pandemic due to the wide protests and the US-China trade war. As a result, the Hong Kong economy shrank for six quarters in a row starting in the third quarter of 2019. Hong Kong's economic distress has been compounded by the loss of tourist traffic. Hong Kong saw the arrival of an average of just 6,100 tourists a month during the first six months of this year, which is just over a tenth of a percent of the first-half of 2019 average (5.8 million tourists a month). In previous years, nearly 80 % of tourists came from mainland China. Hong Kong's tight entry restrictions remain in place, however. Even people coming from the mainland must submit to a minimum quarantine period of seven days. From an epidemiological standpoint, Hong Kong's situation is enviable. The last case of community transmission occurred in early June, and 41 % of the population is now fully vaccinated.

The lack of tourists has slowed Hong Kong's recovery



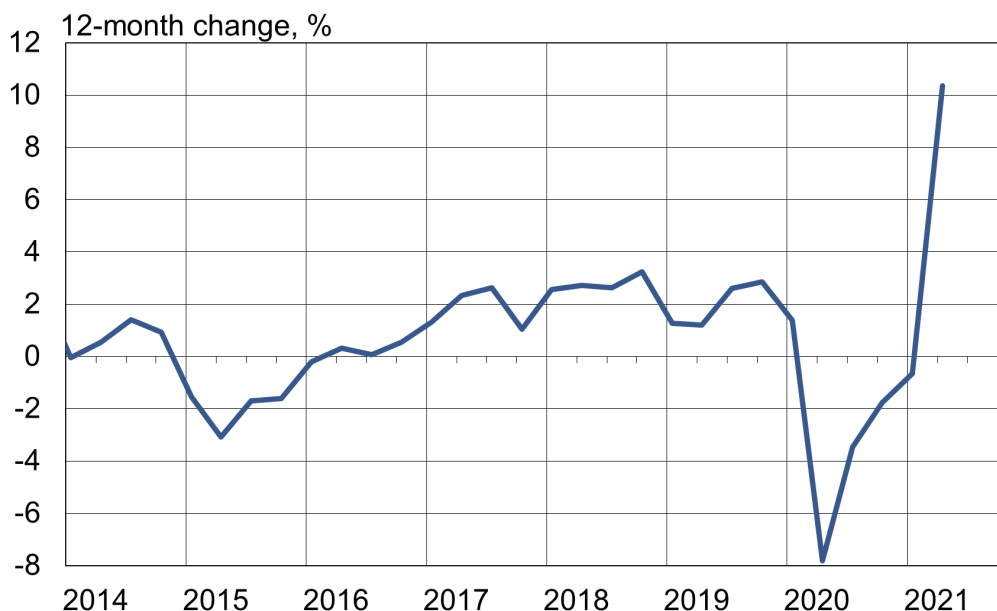
Sources: Hong Kong Census and Statistics Department, Macrobond and BOFIT.

Russia

Russian GDP back to pre-covid levels. Preliminary figures from Rosstat show that Russia’s gross domestic product rose by 10.3 % y-o-y in the second quarter. Russia struggled with the deepest part of the economic decline in the second quarter of 2020 induced by the first wave of the covid pandemic, so the on-year growth figure in the second quarter of 2021 was abnormally high. The pace of growth was slightly higher than the economic development ministry’s GDP estimate suggested. Compared to the second quarter of 2019, the GDP in the second quarter of 2021 was 1.7 % larger. Preliminary figures suggest that the second quarter saw particularly brisk growth in many services branches and the construction sector.

While Rosstat has yet to release seasonally adjusted national accounts for the second quarter, it appears that Russian GDP was about 1 % larger than in the fourth quarter of 2019. Recovery from the economic impacts of the pandemic has been faster than generally anticipated last winter. The Russian economy benefited from rising domestic demand, the faster-than-expected recovery of the global economy and higher crude oil prices ([BOFIT Weekly 31/2021](#)).

Russian on-year GDP growth scored high in the second quarter due to the low basis of last year caused by covid’s first wave



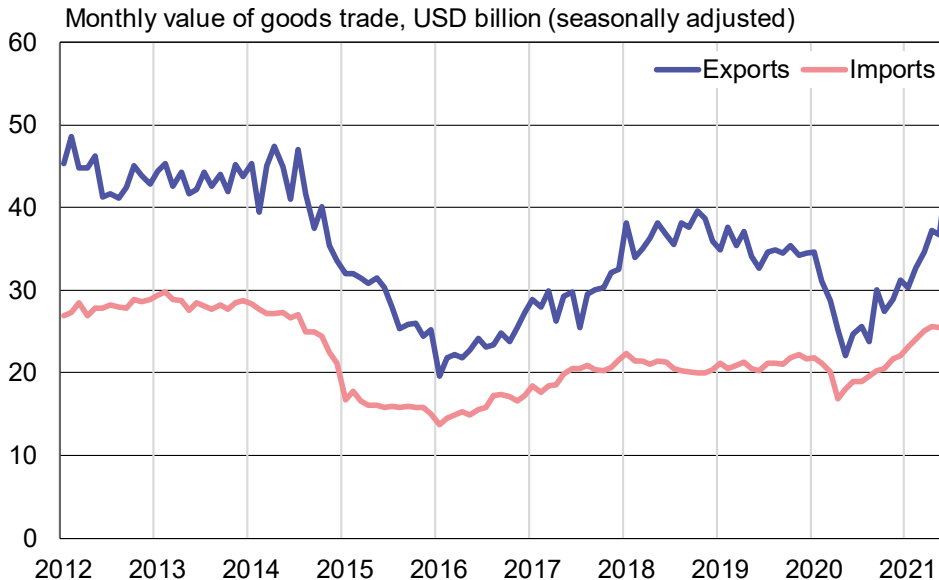
Sources: Rosstat and BOFIT.

Russian exports take off with recovery in global demand for raw materials. The value of Russian goods exports in the second quarter was up by 64 % y-o-y. Looking beyond the low reference base at the depths of the covid crisis last year, it is notable that the value of exports in June approached the record highs of 2013 and 2014. This high growth largely reflects the rapid rise in global commodity prices in recent months. While the volume of crude oil exports contracted slightly on-year in the second quarter and exports of petroleum products had yet to resume positive growth, export volumes of other major commodities such as natural gas, coal, fertilisers, raw timber and a range of metals increased briskly.

Following the rapid recovery in goods imports in the start of the year, growth has slowed in recent months. Even so, the value of imports in the second quarter was still up by 42 % y-o-y from the low point of last year’s Covid Recession. The value of imports also climbed to a level close to the 2014 peak. The increase in imports was driven by high demand in the machinery, equipment & vehicles category, which covers about half of Russia’s goods imports.

The value of Russian goods exports in the first half of the year amounted to \$210 billion. 37 % of Russian exports went to the EU, 15 % to China and 9 % to countries in the Eurasian Economic Union. The value of Russian goods imports was \$140 billion. The EU accounted for 33 % of Russian imports, China 23 % and members of the Eurasian Economic Union 8 %. Afghanistan accounted for 0.2 % of Russian exports, while imports from Afghanistan were essentially non-existent.

Higher world commodity prices have significantly boosted the value of Russian goods exports over the past year



Sources: Central Bank of Russia and BOFIT.

Russian government budget revenues rise, spending growth slows and budget deficit shrinks. Revenues to the consolidated budget (federal, regional and municipal budgets, plus state social fund budgets) in the second quarter of this year were up by a third from year earlier when they fell significantly. Revenues were also 17 % higher than two years ago. Real revenues of the budget have also grown as the nominal rise in revenues has considerably outpaced inflation, though inflation has also been quite high (consumer prices were up by over 9 % from two years previous, while industrial producer prices were up by about 15 %).

Budget revenues generated from production taxes and export tariffs on oil & gas sectors were up by as much as two-and-a-half times compared to the low-basis of the second quarter of 2020, largely due to the recovery in the oil export price. The oil and gas tax revenues were about the same as two years ago.

Other revenue streams to the consolidated budget also bounced back. In the second quarter they were up 20 % y-o-y (or 40 % if the spring 2020 transfer of most of the CBR's extra surplus that arose from selling the CBR stake in Sberbank is excluded). Other budget revenues were 20 % higher than two years previous. Revenue growth from value-added taxes has been particularly robust, up by over a third from the relatively small dip in spring 2020 and 30 % from two years previous. Besides larger production and imports, VAT collection also seems to have improved further. VAT revenues now account for about a fifth of consolidated budget revenues.

Revenues from corporate profit taxes and labour income taxes recovered fast, and revenues from mandatory social contributions of employers were also up briskly. Compared to two years ago, these budget revenue categories were up about 15–20 %. In addition, high growth in various smaller budget categories considerably impacted the increase in total budget revenues.

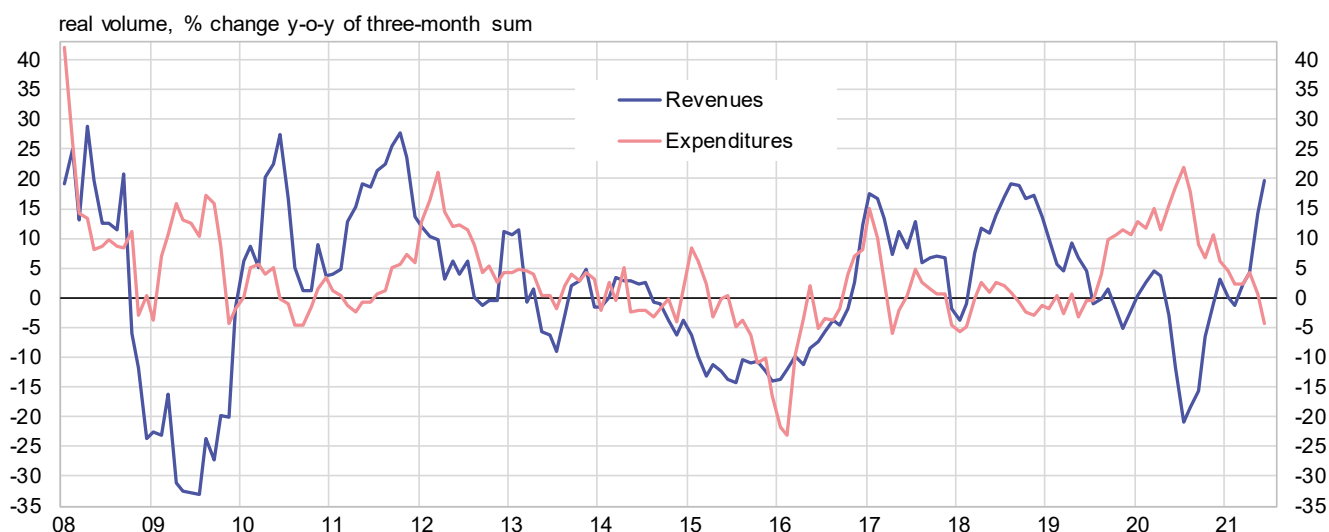
The push to increase budget spending initiated in spring 2020 to support the economy and mitigate the social impacts of the recession has largely waned. On-year growth in spending slowed below 7 % in the second quarter, and real spending shrank slightly. Notably, spending in spring 2020 was substantial (up by nearly 20 % y-o-y). Spending growth on various sectors of the economy remained robust (up 30 % y-o-y) in the second quarter, and growth in budget spending on the housing sector remained brisk (up 15 %). Growth in spending on education accelerated (up 10 %), while spending on healthcare went into decline. Spending on public administration, defence and domestic security and law enforcement have seen only modest increases this year. Pension spending has increased just slightly, while spending on other social support tapered off when compared to the heavy spending in spring 2020.

Looking back two years, spending on the different branches of the economy has soared (up 70 %) as has spending on other social support (up 45 %). Spending on healthcare and public administration has also increased considerably (each up by 25 %). Spending on education, defence, and domestic security and law enforcement have seen more moderate gains (up by 12–16 %). Pension spending has grown by less than 10 % amidst a gradual decline in the number of pensioners and following the 2018 decision to limit the average pension increases to 6–7 % a year. Due to the increased spending levels of

2020 and 2021, it is possible that any notable spending pick-ups preceding the upcoming Duma elections next month (e.g. a brisk on-year rise in federal budget spending in July) will be short-lived.

As earlier during post-recession recovery, Russia is aimed at reducing the budget deficit that came about during the slump. The rapid rise in revenues combined with the spending restraint has pushed the consolidated budget to show notable surpluses in recent months. In June, the budget deficit for the last twelve months fell below 2 % GDP, down from nearly 4 % of GDP in March.

Real revenues to Russia's consolidated government budget increased rapidly in recent months, while real expenditures have declined slightly from one year earlier



Sources: Russian Ministry of Finance and BOFIT.

New sanctions on Belarus foreign trade. Last week marked the first anniversary of the disputed Belarus presidential election. In the interim, the Belarus government has committed extensive human rights violations, as well as interfered with international air travel and organized irregular migrant flows into the EU. In response to these, the EU, US, UK and several other countries have incrementally implemented tightening sanctions on the Belarusian government. The EU's fourth sanctions package implemented in June, among other things, restricts exports of dual-use products, as well as trade involving fertilisers, petroleum products and products used in the manufacture of tobacco products. In addition, restrictive measures have been gradually imposed in Belarus' financial sector.

Last April, the US placed nine of Belarus' large state-controlled companies on its sanctions list. The US sanctions were extended last week to include a number of private firms and corporate clusters important to the government, as well as state-owned potash (potassium chloride) producer Belaruskali. Belaruskali produces about 20 % of the world's potash, mainly used in fertilizers. Potash is Belarus' second most important export product and second largest source of foreign currency income.

The US sanctions significantly complicate the payment traffic of the country's main export enterprises and force all participants in Belarus trade to take great care in the specifics of each transaction. The possibility of further expansion of the sanctions regime poses a risk to the many Russian firms that work with Belarussian companies on the sanctions list. The loss of access to dollar-based financing poses a particular threat to the Belarus economy as the country's financial system is extensively dollarised. Belarus government debt at the end of 2020 was almost entirely denominated in foreign currencies, and 47 % of the banks' credit stock was in forex. About 60 % of the general public's bank deposits are denominated in foreign currency. Loans granted to Belarus by Russia and the Eurasian Development Bank are also denominated in US dollars.

China

China sees across-the-board economic slowdown in July. Real industrial output rose by 6.4 % y-o-y in July, a distinct drop from previous months when growth rates were still partly raised by the lower reference basis from the first wave of the pandemic. In essence, industrial output growth has recovered to its pre-pandemic trend, as the average on-year growth over the past two years is about 5.5 %. Both China's official and the Markit manufacturing purchasing manager indices declined to a near-neutral level of 50 points in July (official 50.4; Markit 50.3), further indicating that most of the V-shaped drop and recovery has already occurred.

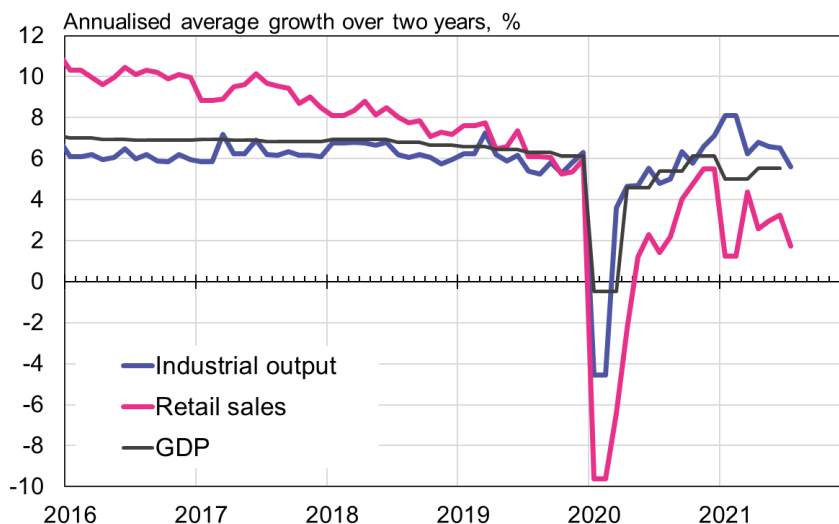
July real growth in retail sales (6.4 % y-o-y) suggests that consumer demand remains much weaker than in the pre-pandemic era with the two-year average annual growth falling below 2 %. Consumer demand also declined in July due to new restrictions imposed to deal with the spread of the delta variant. However, the service sector PMIs in July well exceeded the 50-point reading (official 53.3; Markit 54.9), indicating expanding market conditions.

It remains difficult to establish a coherent picture of China's fixed investment trends. Official figures for growth in nominal fixed asset investment (FAI) hit 10 % y-o-y in July, while seasonally adjusted monthly FAI growth suggested a much lower annual growth pace (2.5 %). In addition, China has ceased to release data on price developments of fixed asset investment, making the reviewing of the development in real terms even more challenging.

The rise in global commodity prices are reflected in Chinese producer price inflation, which in July was around 9 % y-o-y for the third month in a row. Consumer price inflation remained modest in July (1.0 %), well below the official ceiling of 3 % this year. Lower food prices, in particular, have helped keep consumer price inflation in check.

Growth in foreign trade remained strong in July, as goods exports rose by 19 % y-o-y in dollar terms and goods imports by 29 %. The effects of the 2020 covid shock that caused a very low basis in 12-month comparisons is also passed with respect to annual trade growth figures, and is expected to moderate further in coming months. Moreover, the latest survey of manufacturing purchasing managers indicates that new export orders have been shrinking since May. Robust growth in China's foreign trade has accounted almost solely for the recovery of the world trade. In June 2021, the volume of China's goods exports was up by 21 % from the end of 2019. At the same time, exports globally were up just 4 % from pre-pandemic levels (and US exports lagged the pre-pandemic levels by about 5 %). As a result, China's share of global exports climbed to 15 % last year.

Unlike industrial output, retail sales growth in China has remained weak this year.



Sources: China National Bureau of Statistics, CEIC and BOFIT.

Chinese developer Evergrande continues to struggle as real estate sales falter. July real estate sales measured by floorspace declined by 9 % y-o-y. Two-year average annual growth was zero. The value of real estate sales measured in yuan also declined from a year earlier, but was up from the two years ago. The 12-month growth figures for housing sales were disturbed by a collapse in housing sales in the first half of 2020 and a corresponding uptick in sales growth in the first half of this year.

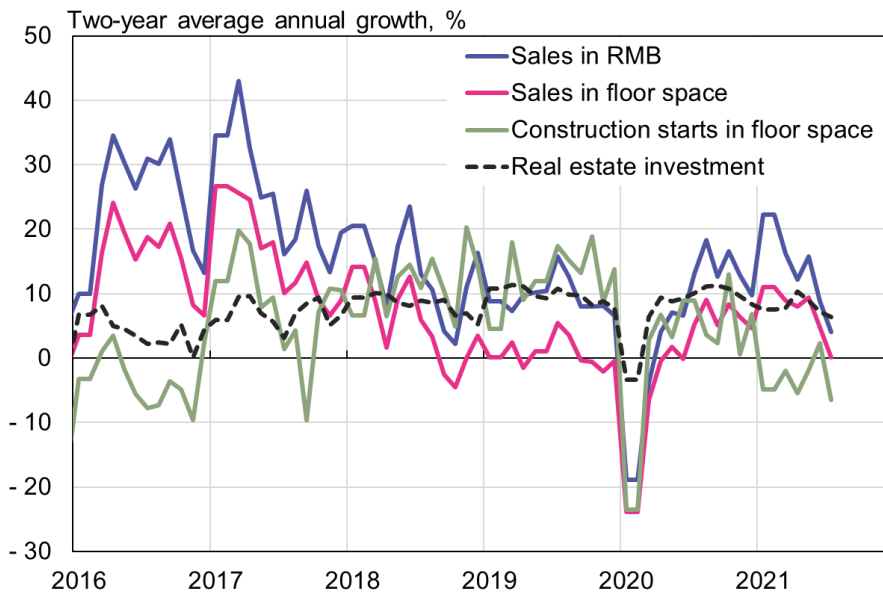
Reliable data on housing price trends in China are notoriously scarce. Figures posted on the privately operated SouFun real estate portal suggest a very stable, modest rise in housing prices in China's biggest cities (about 4 % y-o-y). July prices were still up on average by 6 % from July 2019.

Officials have tried to reduce the risk exposure of the heavily indebted real estate sector through tighter regulation and limits on access to cheap financing ([BOFIT Weekly 6/2021](#)). In recent months, officials have intervened in e.g. banks' illicit use of business loans for the real estate sector and increased reporting requirements of developers seeking to raise money through commercial paper issuance. As access to cheap financing has dried up, developers have turned increasingly to their sales revenue streams to keep going. This shift has reduced the number of new housing starts. In July, new construction starts based on floorspace were down by about 20 % y-o-y. Despite a slight increase at the beginning of last year, the number of units available for purchase has been generally falling in recent years and is well below the 2016 peak.

Evergrande, a conglomerate that expanded its operations beyond the real estate sector, currently finds itself in a world of hurt. The company's problems were compounded in July after a court froze its assets due to unpaid bills. Moreover, some banks have ceased to grant housing loans on apartments built by Evergrande. The international credit rating agency S&P lowered Evergrande's credit rating two notches to CCC in late July. Fitch and Moody's have also cut Evergrande's credit rating. Evergrande claims to have reduced its debt from 836 billion yuan a year ago to 570 billion yuan (\$88 billion) at present. S&P estimates that the company must pay over 240 billion yuan in bills over the next twelve months, of which 100 billion yuan in payments comes due before the end of this year. The share price of Hong Kong-listed Evergrande has fallen by nearly 40 % over the past month and by over 70 % since the start of the year.

The PBoC and the China Banking Regulatory Commission (CBRC) called Evergrande's management out on the carpet last week, admonishing them to reduce the company's debt risks and support stable development of financial markets and real estate sector. Evergrande's management claimed that they were doing all they could to get the debt problem under control. They were seeking, among other things, to sell company's electrical vehicle unit, property management businesses and the Hong Kong headquarters building.

Growth in the volume and value of real estate sales has slowed and new construction starts are declining.



Sources: China National Bureau of Statistics, CEIC and BOFIT.

China's latest data security law enters into force in November. The National People's Congress last week approved China's new Personal Information Protection Law (PIPL). PIPL's drafting began in 2003. The law broadly seeks to improve the protection of personal information in China by requiring entities that collect personal data to reveal how the information is used and request permission for the collection and use of personal data. PIPL also allows people to request deletion of their data or transfer their data elsewhere. While PIPL in some respects embodies the spirit of the EU's General Data Protection Regulation (GDPR), it also places a strong emphasis on "national security," a far-reaching concept in the Chinese context. For example, the international transmission of data can be restricted or banned entirely in the name of national security. Moreover, the law seems to be somewhat vaguely defined when it comes to authorities' access to and handling of personal data.

Regulations on data were already tightened earlier this summer, when the National People's Congress set September 1 as the date the Data Security Law (DSL) would enter into force ([BOFIT Weekly 32/2021](#)). Although the details of official guidance have yet to be released, this recent package of data legislation is expected to restrict significantly the ability of firms to gather, retain and exploit personal data. For example, the EU Chamber of Commerce in China expects the law to have a significant impact on companies operating in some branches like the car industry. The EU Chamber has encouraged European firms operating in China to make sure that their practices comply with the new Chinese laws. Moreover, the laws can also make it more difficult for foreign officials to access data from China.

China's traditional laissez-faire stance on data handling and use has given China's massive tech firms a competitive advantage over smaller firms, allowing them e.g. greater ease in AI development. Tighter rules aim to level the field on this respect. Tightened data protection has long been anticipated, especially with drafting underway for many years. The final push to put data protection measures in place reflects also increased superpower competition, particularly the fact that China does not want its information falling into foreign hands.

China and Russia most active in imposing trade barriers on EU countries. According to the EU's [Access2Markets database](#), China currently imposes 40 different trade barriers that inhibit EU goods exports to China. The trade barriers imposed by China affect a number of branches, but the largest number of such barriers affect agricultural products. Russia has 33 trade barriers that tend to focus on agricultural products or the car industry. The next largest numbers of trade barriers facing the EU have been imposed by India (28), the United States (26), Indonesia (26) and Turkey (25). The list leaders have held on to their top positions for several years, and the number of trade barriers imposed has grown in recent years.

The OECD's [FDI Regulatory Restrictiveness Index](#) measures investment restrictions on a scale of 0 to 1, where 0 signifies free access for foreign companies and 1 indicates a market that shut out foreign firms entirely. Using the OECD measure, the FDI barriers in China and Russia are roughly similar (0.2). The restrictions in these countries exceed the average of both OECD countries (0.06) and non-OECD countries (0.15). The index shows that regulation of China's financial sector was relaxed in the 2000s, which has generally improved China's index reading overall. Chinese media, however, is still heavily regulated. In Russia's case, overall restrictiveness has increased during the 2010s. The financial sector is one of Russia's most restricted branches at the moment.

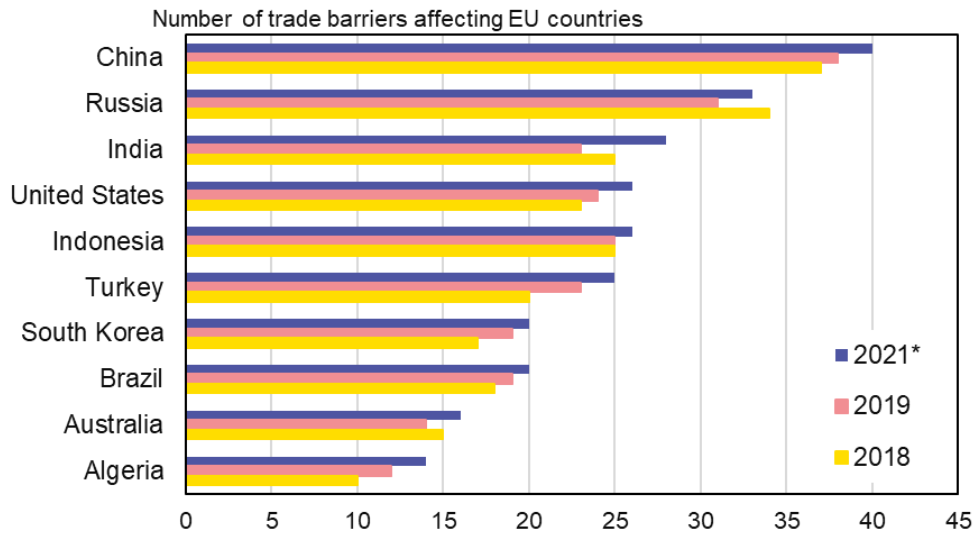
According to UNCTAD's TRAINS database, the most non-tariff trade measures globally are found in China (7,255) and the United States (6,757). In contrast, UNCTAD notes that Russia and the EU have relatively few measures in force (Russia 612, EU 417). Non-tariff measures comprise all policy measures excluding customs duties that affect volumes or prices of international trade.

The covid-19 pandemic has increased certain types of trade restrictions. The EU reports a total of 38 new trade barriers were applied by third countries due to the pandemic. UNCTAD says that most measures affecting global trade were implemented at the start of the pandemic in spring 2020, and that 60 % of those measures were still in force as of March 2021. Most covid-related trade barriers involve export bans designed to secure domestic supplies for healthcare and personal protection such as an adequate domestic supply of facemasks and other personal protection equipment. Some countries have also imposed export bans on staple food items for security reasons. On the other hand, UNCTAD says that over half of all covid-related trade measures, including tariff reductions, were intended to facilitate trade.

The number of trade barriers globally has increased in recent years, and the trend continues. China, EU countries and the US are all focused on measures to stimulate recovery of their own economies from the pandemic. The trade policy strategies of the major economic blocs tend to emphasise self-sufficiency and reciprocity more than before. Although negotiations of

the EU-China investment agreement wound up at the start of this year, the European parliament moved to table its ratification in May. The EU and US in June reached a resolution after 17 years of talks on state subsidies to aircraft manufacturers, but a return to talks on a free-trade agreement appear to be in neither party's interests. China-US trade relations have not shifted during the Biden administration.

The number of barriers to goods trade facing EU-based companies had increased in recent years.



*) Situation in August.

Sources: EU and BOFIT.

Russia

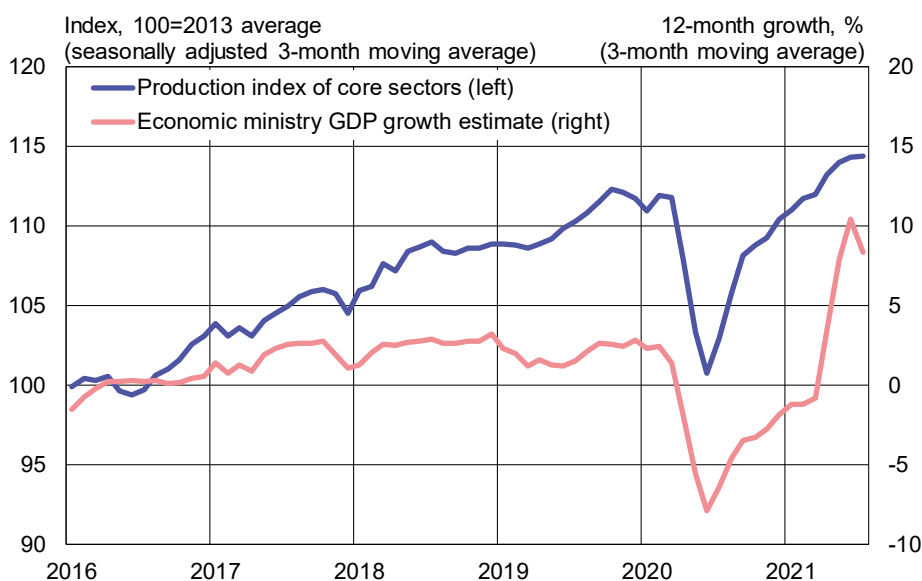
Russian economic recovery begins to cool. While Russian GDP recovered to pre-pandemic levels in the second quarter of this year, the pace of recovery in recent months has slowed. The July reading of the index of core sectors of the economy (agriculture, industrial production, construction, transportation, as well as retail and wholesale trade) remained unchanged from previous months. The annual growth figures are still high due to the low reference basis a year ago. Ministry of Economic Development estimates that GDP rose by 4.7 % y-o-y in July. The same ministry also reports that GDP grew by 4.8 % y-o-y in the first seven months of this year, and was up by 1.1 % from the same period in 2019.

Retail sales in July were unchanged from previous months, but the growth trends in most other service branches cooled down. Rising wages and improving labour market situation could support consumer demand in the months ahead. The average real wage was up by 5 % y-o-y in June. Unemployment fell to pre-pandemic levels, just 4.5 % in July.

July industrial output remained unchanged from previous months. Mineral extraction industries increased production as companies have been able to gradually raise crude oil production levels within the framework of the OPEC+ agreement. After conferring on Wednesday (Sept. 1), representatives of OPEC+ countries decided to keep in place the production ceiling framework agreed to in July. In contrast, manufacturing began to fade in July compared to earlier months. Growth in fixed investment remained brisk in the second quarter of this year supporting also construction. Construction activity was down in July, however, from the rapid growth of previous months.

Forward-looking economic indicators suggest no large changes in August. Economic growth should continue to slow gradually for the rest of this year. The most recent forecasts put the pace of Russian GDP growth at about 4 % this year.

Russia's economic rebound begins to slow.



Sources: Rosstat, Russian Ministry of Economic Development, CEIC and BOFIT.

Russian pensioners and select public sector workers receive notable one-time stimulus payments this month. On August 24, president Vladimir Putin decreed a one-time stimulus payment to pensioners in the amount of 10,000 rubles (115 euros). He proposed the payments just two days earlier at his meeting with representatives of the Duma's majority party, United Russia. On August 31, Putin decreed a one-time payment of 15,000 rubles to be paid in September to select federal officials such as interior ministry employees, customs workers, prosecutors, as well as contracted military and trainers. The decisions came with the approaching Duma election on September 19. In the 2016 Duma election, the announcement of a one-time payment to pensions also came down a couple of weeks before the election. At that time, the payments were sent out at the end of the year. Approximately 43 million pensioners receive the one-time payments now and

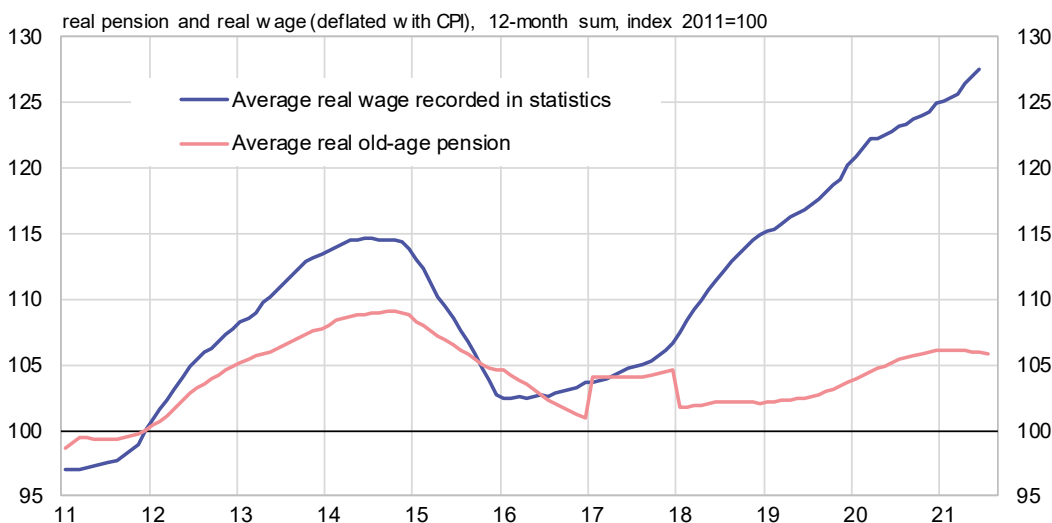
they constitute about 40 % of all eligible voters. The one-time payment corresponds to 63 % of the current average monthly old-age pension.

The funding needed to make the instructed one-time payment to pensioners represents over 0.4 % of Russia's annual GDP and close to one per cent of annual household consumption. All, or at least most, of the payments in the near term will temporarily boost private consumption. Russian pensioners on average have a lower savings rate than the population generally whose savings rate for bank deposits and cash on hand in recent years has also been fairly low (5–7 %). The money supports domestic production and imports to some extent via consumption. Their real volumes will temporarily increase to the degree that spending the payments does not affect inflation.

The hikes in real pensions in the 2000s coincided with elections and stimulus efforts during the 2009 recession. In the 2010s, the government was much less generous with pension hikes. Ahead of the 2016 Duma election, the government relied exclusively on the one-time payments. At that time, surveys showed that those in power already enjoyed high popularity in the wake of the illegal annexation of Crimea in early 2014, which lasted until June 2018 when the then prime minister Dmitri Medvedev announced a gradual increase in the general pension age and higher value-added tax rate.

Government leaders have paid public attention to the social situation of pensioners in connection with pension hikes starting in the mid-2000s during the economic boom. The ratio of the average old-age pension to the average real wage declined to its low point in 2007 at 23 %, when the ratio to the average wage of public sector employees paid from government budgets also decreased (to 26 % in 2007). The ratios then increased significantly with pension hikes by 2010 to 36 % and 39 %. The ratios have since fallen. In recent years, both ratios have been around 30 %.

The real average pension in Russia has increased slowly over the past decade.



Sources: Rosstat and BOFIT.

Bulls run at Moscow Exchange. The strong rise in oil prices ([BOFIT Weekly 27/2021](#)) and recovery of the Russian economy from the depths of last year's Covid Recession ([BOFIT Weekly 33/2021](#)) have lifted share prices on the Moscow Exchange. Between the start of the year and end-August, the ruble-based MOEX index climbed by 17 %. It currently stands at an all-time high. The dollar-based RTS index was up by 19 % from the start of the year. Due to ruble weakness, however, it is still about 30 % below its historical high of May 2008.

The rise in Russian stock market indices in the first half of this year has been supported by increased foreign investor interest. At the beginning of July, foreign investors held over 80 % of freely floated shares on the Moscow Exchange. About half of those shares were held in the portfolios of investors from North America. The other holdings of foreign investors divide rather evenly among British and other European investors. Last year foreign investors held 66 % of the Moscow Exchange's freely tradeable shares.

The interest of Russian retail investors in the stock market has also increased, further boosting the performance of equities on the Moscow Exchange. As of mid-August, 13.3 million Russians had investment accounts, an increase of more than 50 % from the end of 2020. Factors such as the reduction in bank deposit rates have helped fuel private individuals' appetite for investment. The role of Russian institutional investors on the Moscow Exchange is quite small.

The Moscow Exchange has several distinguishing features: the small share of publicly traded shares, dividends that are quite high by international standards and the heavy weight of oil & gas companies. The shares available for trading vary from company to company, but for top 50 companies the average is about 30 %. The average dividend yield of traded companies is over twice that of the average for emerging market exchanges. Companies in the oil & gas sector make up about 40 % of the MOEX index.

Both oil prices and the share prices on Moscow Exchange up during this year.



Sources: Moscow Exchange, Macrobond, BOFIT.

Panel discussion at Turku Europe Forum 2021 examines EU-Russia economic relations. Last Friday (Aug. 27), the Bank of Finland Institute for Emerging Economies (BOFIT) hosted a panel discussion at the Europe Forum 2021 ([video file](#) in Finnish) that dealt with economic relations between the European Union and Russia. Topics included the increased professionalism of Russian officials, as well as the chronic issues certain branches face with the operation of Russian customs. Panellists were fairly optimistic about the prospects for Finnish-Russian trade over the near term. From a longer perspective, however, national and supranational efforts to mitigate climate change could threaten Russian export earnings, thereby reducing Russia's external purchasing power and imports.

China

President Xi spotlights China's income distribution issues. At a meeting of the financing and economic affairs committee on August 17, president Xi Jinping said that a key feature of China's future development is common prosperity, that is more even distribution of wealth and income in Chinese society. Xi told his audience that regulation of the rich needs to increase, excessive incomes should be limited and the rich are encouraged to donate money for development of society. China's state news media reports that income inequality will be dealt also with through more progressive taxation, improved social security and increased income transfers.

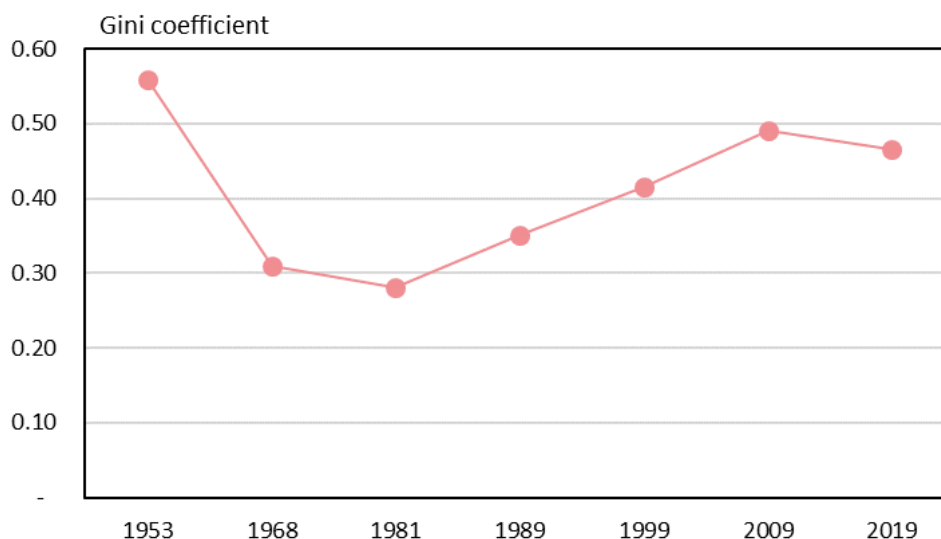
The common prosperity discussion has motivated companies to act. For example, technology firms Alibaba and Tencent have together promised over \$20 billion for improving social equality, healthcare, education and rural areas. In addition, certain state agencies such as the central bank have been quick to signal their support for the idea.

President Xi has talked about common prosperity at least since 2015. The theme was incorporated into the five-year plan and longer-term development targets approved last spring. In June, the state council selected Zhejiang province as a trial area. In July, 15 smaller areas in the province were selected for pilot testing of the common prosperity concepts. Authorities have big plans for the trial areas, as over the next five years they should be able to increase household incomes considerably, education should reach to a top national levels and health measures such as life expectancy, should improve to Western levels without raising the healthcare costs for households. Leading global technologies should also be adopted.

While measurement of income disparities in China is challenging, Chinese experts generally agree they are very large. China's official Gini coefficient for income differences is 0.47, a level very high by international standards. However, the official figure is seen to leave out the highest earners and Chinese studies suggest that income differences could actually be considerably higher. Rather than measure income, the World Bank, for example, measures consumption disparities, which in China's case are only slightly above the international average. Credit Suisse estimates that there are at least 5 million "dollar" millionaires in China, but the wealth differences between Chinese are not exceptionally high (on par with France and considerably smaller than in India).

Issues related to income distribution have always enjoyed a high profile in Communist China. During Mao Zedong's era, the party sought to distribute wealth more evenly, while under Deng Xiaoping's reform policies, getting rich was again permitted. President Xi's policies appear to be a step back from Deng's stance. However, campaign-type measures seen so far will have only limited impact. The focus should be on large-scale reforms on improving social security and social safety nets, and education across the country. The shift in the messaging from economic growth to wealth distribution may also signal that China is preparing for lower economic growth in the years ahead.

Income inequality, which declined during Mao Zedong's leadership, began to rise again after the economic reforms of the 1980s.



Sources: UNU-WIDER World Income Inequality Database (WIID) and BOFIT.

China launches campaign against disparaging economic reporting. Recent crackdowns on speech apply to articles posted online or social media that officials consider to be malicious commentary on China's financial markets, or present economic policy or economic numbers in a false light. Circulating foreign media reports "falsely" interpreting domestic financial topics is also forbidden. The campaign launched by China's cyberspace administration will initially last for two months. Its purpose is to promote a good-faith public discussion that encourages healthy economic development. For example, the message service Weibo announced it has closed certain popular accounts that provided investment tips.

Clampdowns on economic news are not new to China. China tightened information flows in response to the 2015 stock market crash. In conjunction with lower economic growth and an enflamed trade war with the United States, reporters in 2018 were told not to report on certain topics. Under an updated law on governance of the online information content ecosystem passed last year, China can block news stories or other content that might negatively affect national solidarity.

China lacks protections for freedom of speech and freedom of the press. According to Freedom House, China gets just nine points out of 100 in its political and civil liberties score (Finland, Sweden and Norway = 100). Internet freedom is the lowest of any of the 65 countries compared. Reporters Without Borders inform that China currently ranks 177th out of 180 countries surveyed, with only Eritrea, North Korea and Turkmenistan having worse press freedom (Norway, Finland and Sweden topped the list).

New measures on school curricula and student free time. In recent months, the government has been tightening rules regarding private schools that offer after-school tutoring. Private schools have seen their operations severely constrained with the imposing of a range of rules governing their financial channels, curricula and arrangements. For example, all schools must register as non-profit companies, their teaching staff must follow the official curriculum and teaching during school holidays is prohibited.

The education reform has been driven by a political urge to diminish the burden on school children and their families, reduce inequality in education and improve the quality of teaching in public schools. One in five Chinese students attended a private school in 2020. Under the new changes, primary schools are required to reduce homework and offer after-school tutoring and activities. Later on, the government would also increase the number of slots available to students at the most popular secondary schools.

Education reforms include the addition of Xi Jinping's "socialist thinking with Chinese characteristics" to the regular curriculum. The education ministry reports that this teach will help students understand socialism and its legacy in China. China's administration has also presented many other new rules concerning children and youth. For example, the video gaming of minors has been limited to three hours on weekend evenings and the opportunities for young people to use various entertainment phone apps will be limited. To replace them, officials have encouraged app developers to create more educational content. China says the restrictions are intended to protect youth from damaging content and addiction to online gaming. In August, the government also implemented specific rules governing online fan culture.

The Chinese government's passion for reform dovetails with its broader political goals such as reducing inequality and improving social welfare. [Merics](#) notes that culture, education and ideology have all received greater emphasis in China's latest five-year plan (2021–2025). The plan's concrete goals include improving the quality and capacity of public education, development of the professional skills of teachers and increasing the level of education of the population generally. The current plan calls for increasing the average schooling of working-age people from 10.8 years in 2020 to 11.3 years by 2025.

Plans announced for mainland China's third stock exchange in Beijing. In his address to the International Fair for Trade in Services, president Xi Jinping revealed plans to open a new stock exchange in Beijing. Soon after the announcement, the China Securities Regulatory Commission (CSRC) issued a [press release](#) (in Chinese). The new stock exchange is intended to help small, innovative firms with growth potential that otherwise have limited access to financing. No timetable on the stock exchange's launch has been released.

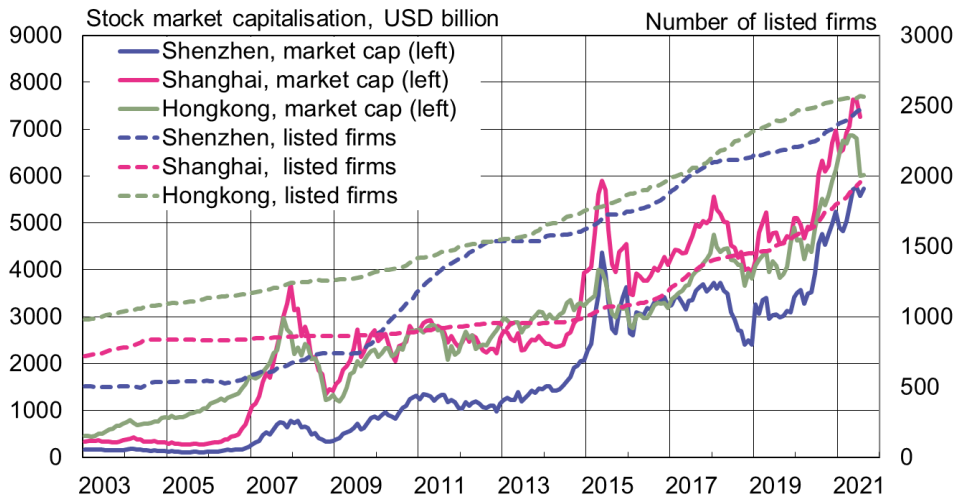
The starting foundation of the new Beijing stock exchange is China's national over-the-counter stock exchange (National Equities Exchange and Quotations, NEEQ). NEEQ was founded in 2013 with a view to improving access to market financing for small and medium-sized enterprises. NEEQ's shareholders are several Chinese stock and commodities exchanges, including Shanghai and Shenzhen stock exchanges. As of August, the NEEQ list contained about 7,300 firms, an impressive number compared to the Shanghai, Shenzhen and Hong Kong stock exchanges. However, the listed firms are considerably smaller, having a combined market capitalisation of just \$360 billion (e.g. the market cap of the Shanghai bourse is nearly 20 times larger). Only professional investors can buy and sell shares of NEEQ-listed firms.

Since July last year, firms listed on the NEEQ have been divided into three groups: basic list, innovation list and select list. Initially, just 32 firms qualified for the select list, i.e. firms that meet the strictest listing demands. That number has since risen to 66. Companies on the select list will be eligible for immediate listing on the Beijing stock exchange, that also

would be administered by the NEEQ. The total market capitalisation of select firms in August was 170 billion yuan (\$26 billion). New firms are expected to emerge on the Beijing stock exchange via the NEEQ basic and innovation lists with the Beijing stock exchange acting as an incubator for SME firms. Once a firm grows large enough, it could apply for listing on either of China's other two stock exchanges (Shanghai or Shenzhen).

The Shanghai stock exchange is Asia's largest and the world's third largest bourse after the New York stock exchange and the NASDAQ stock exchange. In July, the market capitalisation of companies on the Shanghai exchange was nearly \$7.3 trillion. The Shenzhen stock exchange is smaller than the Shanghai exchange, but its total market cap is still \$5.6 trillion making it the world's seventh largest bourse. Both exchanges have their own tech company lists. The ChiNext list, which brings together high-growth tech firms, was rolled out on the Shenzhen stock exchange in late 2009. The Shanghai stock exchange's Star Market list of tech firms was established a decade later. The Star Market was created to ease listing requirements and reduce trading restrictions ([BOFIT Weekly 30/2019](#)).

The market capitalisation of the Shanghai stock exchange has risen faster than that of the Shenzhen or Hong Kong exchanges.



Sources: World Federation of Exchanges, Macrobond and BOFIT.

Russia

Latest BOFIT Forecast for Russia sees moderate growth ahead, large risks persist. In our latest [Forecast for Russia](#), we see Russian GDP rising this year by over 3.5 % from last year's recession. Growth should slow in 2022 and 2023 to slightly over 2.5 % a year, towards Russia's long-term growth prospect, because no broader systemic changes are in sight that would improve the functioning of markets and the pace of economic growth in the next few years.

A number of other factors also influence growth in the forecast period. The covid pandemic will restrain growth next year, while some growth-supporting determinants have improved. The price of oil is up currently and market expectations of its gradual decline have become more temper and see the price at around \$65 a barrel in 2023.

Improved forecasts for the global economy support Russian export volumes. With the easing of oil production ceilings in the OPEC+ agreement this summer, the outlook has improved for Russian oil exports, and for gas exports as well. Russia's revenues from travel (over 2 % of total export earnings in 2019) should also recover in the later part of the forecast period.

With a growing economy, rising household incomes and employment will increase private consumption to the extent that it should slightly surpass the 2014 peak in 2023. The rise in pensions should exceed projected inflation by a couple of per cent in line with the 2019–2024 pension hike plan. Just recently ahead of the upcoming Duma elections this Sunday (Sept. 19), president Putin announced that pensioners are to receive one-time lump-sum payments that should provide a temporary push to consumption. Consumption should also see increases with the yet-to-happen unwinding of the unusually high accumulation of household assets last year. Travel abroad from Russia fell extremely low last year, which should reverse at a good pace in the out years of the forecast period.

The recovery in fixed investment will continue, and investment should exceed the 2012–2014 level by 2023. While the rise in fixed investment is not expected to be very rapid, as e.g. industrial capacity utilisation remains quite low, the government is planning extending financing from the National Welfare Fund for select projects in the close-by years. The aim is also to get corporate investment participate, thereby increasing the amounts of investment to the extent that the firms' other investment plans do not get crowded out.

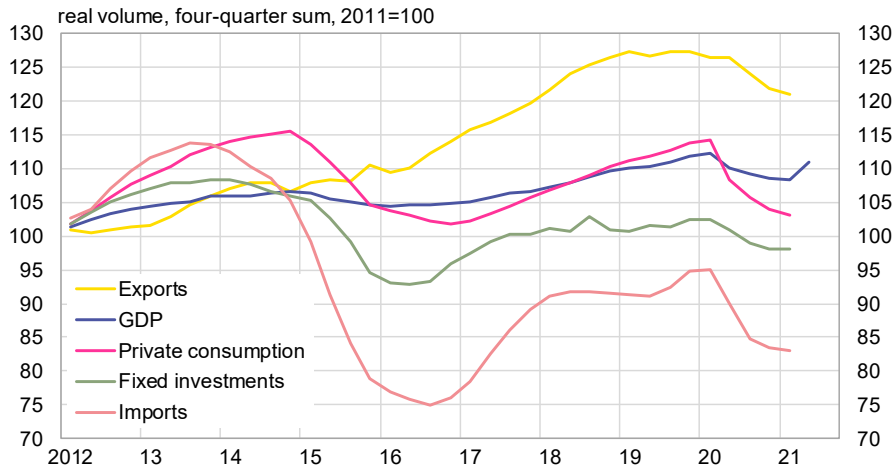
Russian goods imports, as well as imports of services other than Russian spending on travel abroad, should increase quite well as GDP rises. The growth in imports, however, will be limited by the ruble's real exchange rate, which is expected to remain fairly stable as Russian inflation should only slightly outpace inflation in Russia's trading partners. The recovery in spending on travel will increase Russia's total imports substantially as it accounted for 10 % of the total in 2019 before it collapsed. Russia's total imports should shorten their gap to the 2012–2014 peak to one tenth. Russia's current account surpluses will remain substantial throughout the forecast period.

There are no signs that the government is considering renegeing on its current plan to reduce the budget deficit (similar policies were also pursued in the wake of the 2009 and 2015 recessions). Rising fiscal revenues and improved revenue prospects from higher oil prices will translate to smaller deficits. This allows easing up on the plan's tight spending estimates.

Several significant uncertainties surround this forecast. The course of the covid pandemic, as well as global economic growth and oil prices, could experience deviations from expectations. Global markets and Russia's relatively non-integrated markets could generate inflationary pressures, which unleashed would increase the erosion in the purchasing power of households, companies and the state.

Higher-than-expected investment is also possible if companies join in the government-financed projects in ways that raise their investment overall. Increased government budget revenues will create a lot of room for higher budget spending. Certain post-recession upturns are still ahead and hard to predict. Covid situations, the speed at which borders reopen or when international travel returns to normal may vary. Surprise bumps in household consumption may appear with the unwinding of the household savings.

Russian GDP and real volumes of focal domestic demand components have performed tepidly, total imports remain depressed.



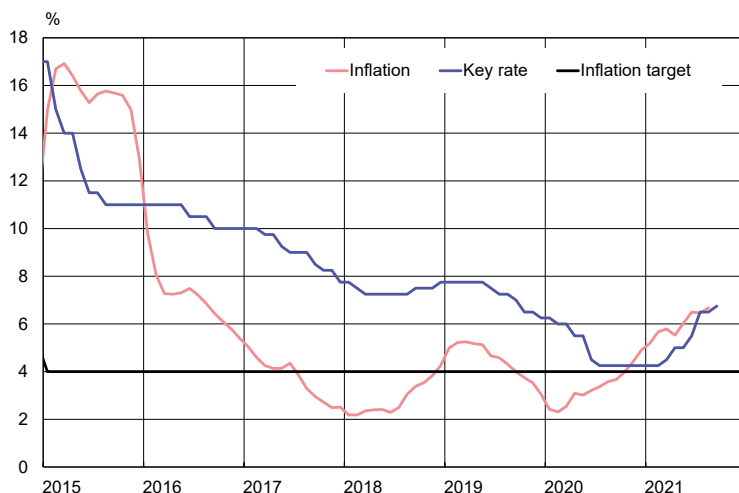
Sources: Rosstat and BOFIT.

CBR raises key rate again; monetary policy guidelines for 2022–2024 announced. On September 10, the Central Bank of Russia decided to raise the key rate by 25 basis points. The key rate now stands at 6.75 %. The CBR, which began to tighten its monetary stance last March, has raised the key rate by a total of 250 basis points since then. As part of its forward guidance, the CBR did not rule out the possibility of further hike at its next meetings.

The CBR said the decision to hike reflected the ongoing rapid rise in consumer prices of recent months. In August, food prices rose by 7.7 % y-o-y, non-food goods 8.0 % and services 3.8 %. August total consumer price inflation hit 6.7 % y-o-y, a level well above the CBR’s inflation target of close to 4 %. The recent uptick in inflation reflects the inability of supply to keep up with the better-than-expected recovery in domestic demand. The acceleration in inflation has also raised the inflation expectations of firms and households to levels not seen for nearly five years. The CBR’s forecast sees 12-month inflation slowing to a range of 5.7–6.2 % by the end of this year and to 4–4.5 % in 2022.

At the start of September, the CBR published a [draft](#) of its monetary policy guidelines for 2022–2024. The draft mentions monetary policy targets, principles and measures to be implemented within that framework. The key monetary policy principles remain pursuit of a publicly set inflation target (close to 4 %), the key rate and forward guidance, as well as predictable and transparent decision-making. The draft now moves to the president and cabinet for comment before a final version is submitted to the Duma.

The CBR raised the key rate to keep consumer price inflation in check.



Sources: Macrobond, CBR, Rosstat and BOFIT.

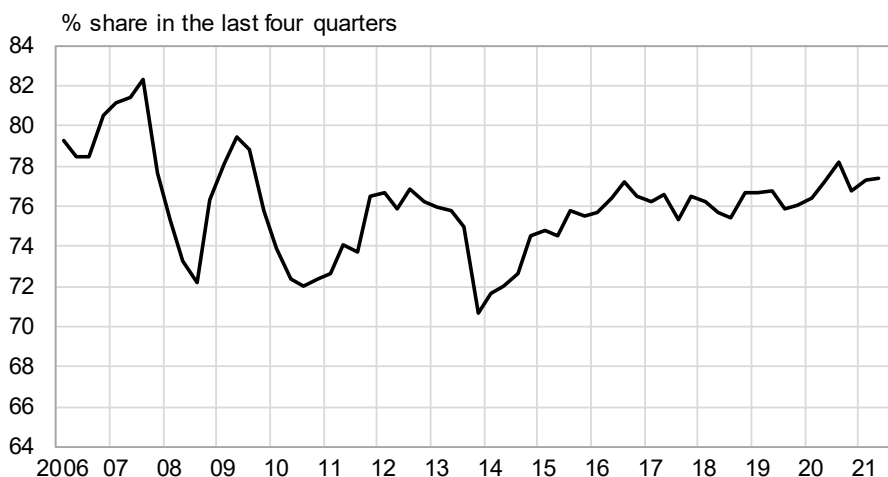
Fixed investment increased in Russia, government plans funding for investment projects. In the first half of this year, real fixed investment increased notably and was up by 5 % from two years previous. Even with their share of the value of total investment having risen for several years, growth in the real volume of fixed investment of large and medium-sized firms, as well as the state, has slightly outpaced total investment growth since 2019, which is rather rare.

The investment of large and medium-sized firms in oil & gas production declined in the first half to an extent that it returned to the same level as two years previous. Investment in production of petroleum products also contracted, but after last year's very strong rise was still much higher than two years previous.

In contrast, the investment of these firms in manufacturing industries (not counting production of petroleum products) increased briskly becoming several percent larger than in the first half of 2019. Investment growth in manufacturing has focused strongly on metal refining (up 25 % from two years previous). Chemical industry, another large investor in manufacturing, has reduced its investment (down by about 25 % from two years previous).

While the pace of investment growth in large government sectors such as healthcare and education has subsided this year, the investment is still up by several double digits from two years previous. With last year's government budget investment wave behind, the government is preparing plans to fund investment projects out of the National Welfare Fund (NWF). The law permits provision of NWF financing and investment in non-liquid assets as long as the NWF's liquid assets equal at least 7 % of GDP at the end of the following year. The NWF's liquid assets have slightly exceeded this 7 % threshold since spring 2020. Higher oil prices are translating to higher oil & gas revenues for the federal budget, part of which will be transferred to the NWF.

The share of large and medium-sized firms, as well as the state, in fixed investment in Russia has increased in several years.



Sources: Rosstat and BOFIT.

Russia and Belarus agree on deeper economic integration. On September 9, the prime ministers of Russia and Belarus signed an agreement, blessed by presidents Vladimir Putin and Alexander Lukashenka, that would deepen economic relations during 2021–2023. The plan consists of 28 “roadmaps” that address, among other things, harmonisation of tax administration, monetary policy, payment systems and labour laws. The Union State of Russia and Belarus was established already in 1999, but actual integration to date has been quite modest. Drafting of the now-approved roadmaps for harmonisation of legislation began in 2018.

In most cases, harmonisation is likely to mean that Belarus should adjust its laws to make them compatible with Russian practices. These changes might open new opportunities for Russian firms in their western neighbour's market. One challenge from Belarus' standpoint is its special economic system in which the state and state-owned firms play an oversized role. Adoption of Russian practices may imply that some branches in Belarus will have to shift to a more market-based system.

Belarus needs to embrace a common energy market to assure continued access to inexpensive natural gas supplies in the years ahead. Now the countries agreed to proceed with energy market harmonisation in only 2023. This may give Russia an option to postpone gas pricing harmonisation if implementation of other roadmaps does not proceed.

China

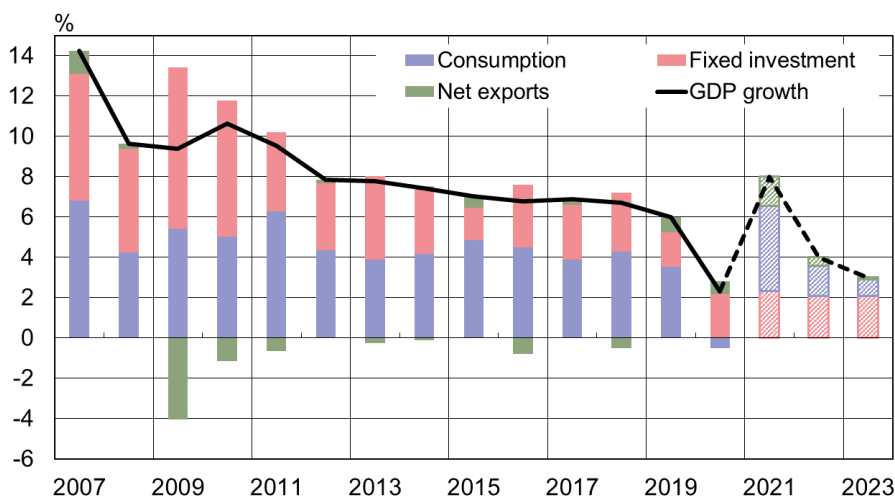
Latest BOFIT Forecast for China sees GDP growth falling below pre-pandemic levels in 2022 and 2023. Our most recent [Forecast for China 2021–2023](#), published last week, sees China’s on-year GDP growth hitting 8 % this year. This is due to the strong recovery from the covid pandemic as well as last year’s low basis reference. The speedy phase of the recovery is over, however. We expect lower growth in the years ahead as the pace of economic growth inevitably falls below pre-pandemic levels.

The Covid recession was quite brief in China’s case thanks to its aggressive suppression strategy and focus on channelling stimulus to firms and investment projects. However, there is also a dark side to the suppression strategy. Private consumption, in particular, has been hit hardest as the government has focused on a total suppression in combatting the virus as it continues to force provinces into lockdown. On the bright side, more than 70 % of the Chinese population has been fully vaccinated. Generally robust stimulus efforts around the world and an improving outlook for the global economy should support demand for Chinese exports, which in turn will keep industrial output humming in coming quarters. High capacity utilisation also bodes well for growth in industrial investment. Although the large covid stimulus is now behind, fiscal policies will continue to support growth, so that the public sector deficit remains large in the years ahead. Monetary policy must increasingly seek a balance between financial market risk and reducing indebtedness on one hand and preserving economic stability on the other.

The forecast sees quarterly GDP growth remaining around 1 % this year and next, before slowing further in 2023. On-year growth similarly falls to 4 % next year and close to 3 % in 2023. China’s unfavourable demographics are a major factor subduing growth. According to just-released census data, China’s population is ageing, the number of working-aged persons is declining and the birth rate has fallen faster than previously expected. In addition, extremely high debt levels and rising debt-servicing costs make it increasingly hard to deploy capital optimally. On the other hand, if China succeeds in reining in indebtedness, this will equally restrain growth at least in the short term. Productivity has been sluggish and actions to improve productivity have been few and far between. Recently, greater regulation and government oversight has been imposed on private firms in ways that have made the operating environment less predictable and thereby weakened their productivity. The role of the state has increased at various levels of Chinese society and political risk has risen.

There is a possibility of higher growth in the coming years if household consumption demand strengthens more than estimated. This could occur if the pandemic recedes faster than expected or China adjusts its pandemic strategy by lifting most covid restrictions. Demand could also strengthen if the government moves ahead with reforms that support consumption under the guise of the new common prosperity initiative. At the same time, the familiar risks of lower economic growth have increased during the pandemic. Growth could be significantly weaker than forecast if the debt burden becomes unbearable, financial market disruptions feed real economy uncertainty that generates social instability, or foreign relations hit an impasse.

China’s GDP growth, factors contributing to growth and BOFIT forecast for 2021–2023.



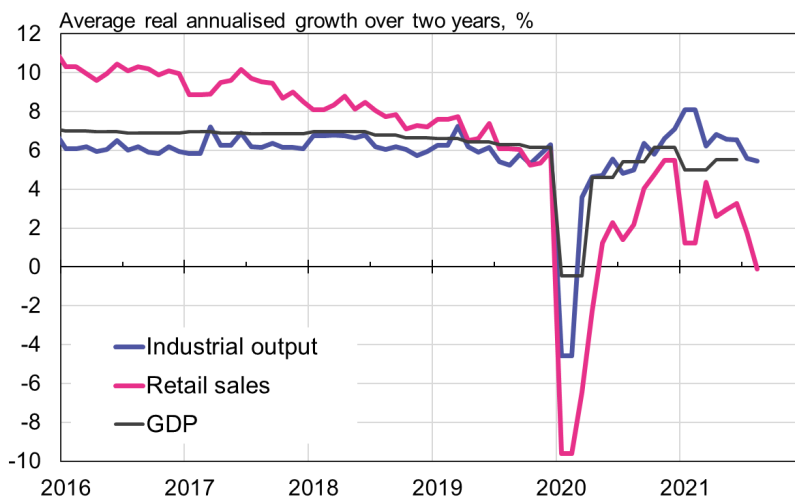
Sources: China National Bureau of Statistics, CEIC and BOFIT.

On-year growth in retail sales slowed further in August. Real on-year growth in retail sales fell to just 0.9 % in August, a rate so low that average two-year annualised growth turned slightly negative. Retail sales in yuan terms fell most in the case of communications devices (down by 15 % y-o-y) and cars (down by 7 %). Some of the drop-off in retail sales reflects the spread of covid infections to various provinces during July and August that forced officials to impose new restrictions on movement and assembly. In addition, a component shortage has delayed automobile deliveries and put a crimp in car sales. New infections were again on the rise in September, particularly in southwestern provinces.

Industrial output growth slowed in August to 5.3 %. Unlike retail sales, the slowing growth in industrial output merely reflects a settling back to pre-pandemic growth levels. Additionally, the manufacturing purchasing manager indices (PMIs) fell in August close to the zero-growth 50-point mark, i.e. the period of rapid recovery from the Covid recession is apparently over. Although growth of high-tech industrial output generally remained strong (up 18 % y-o-y), car production dropped by 13 % due to the component shortage. According to the PMIs, the volume of new manufacturing orders declined in August, while the number of new export orders has been falling since May. Even so, August export growth remained strong in dollar terms (up 25 % y-o-y and average two-year annualised growth of 17 %). In addition, imports rose briskly in dollar terms (up 34 % y-o-y, average two-year annualised growth of 14.5 %). The trade surplus has remained at record high levels in recent months.

Producer price inflation, which has been high for several months, increased further to 9.5 % y-o-y in August. Much of the increase has been driven by soaring commodity prices. The largest increases in producer prices were seen in the energy sector (coal, oil), as well as the metals and chemical industries. In addition, producer prices for manufacturing of electrical machinery & equipment hit their highest levels in ten years (producer price inflation was 6 % in August). Consumer price inflation (CPI), however, has remained modest, even falling slightly in August to 0.8 %. CPI continues to be subdued by lower food prices (down by over 40 % in August) as the pork prices, in particular, have returned to levels not seen since the African swine fever epidemic broke out. However, also the core inflation, i.e. CPI excluding volatile food and energy prices, dipped slightly in August to 1.2 %.

Retail sales growth has come to a standstill in recent months, while industrial output growth is back to pre-pandemic levels.



Sources: China National Bureau of Statistics, CEIC and BOFIT.

Share prices drop globally as construction giant Evergrande teeters on brink of default. The financial troubles of Evergrande, one of China's largest construction companies, began to make headlines last summer ([BOFIT Weekly 34/2021](#)). In recent weeks, the news has grown more dire. At the end of August, the company announced it could no longer meet all of its debt obligations unless it could continue building, selling off assets or refinance its loans. Evergrande was forced this month to postpone certain payments on its bank and trust loans, as well as payments on asset management products it had itself issued. The firm announced on Wednesday (Sept. 22) that it had settled maturing domestic bond coupons (232 million yuan or \$36 million). On the following day (Sept. 23), the company was unable to pay off coupons on time on its foreign-issued dollar-denominated bonds (\$84 million).

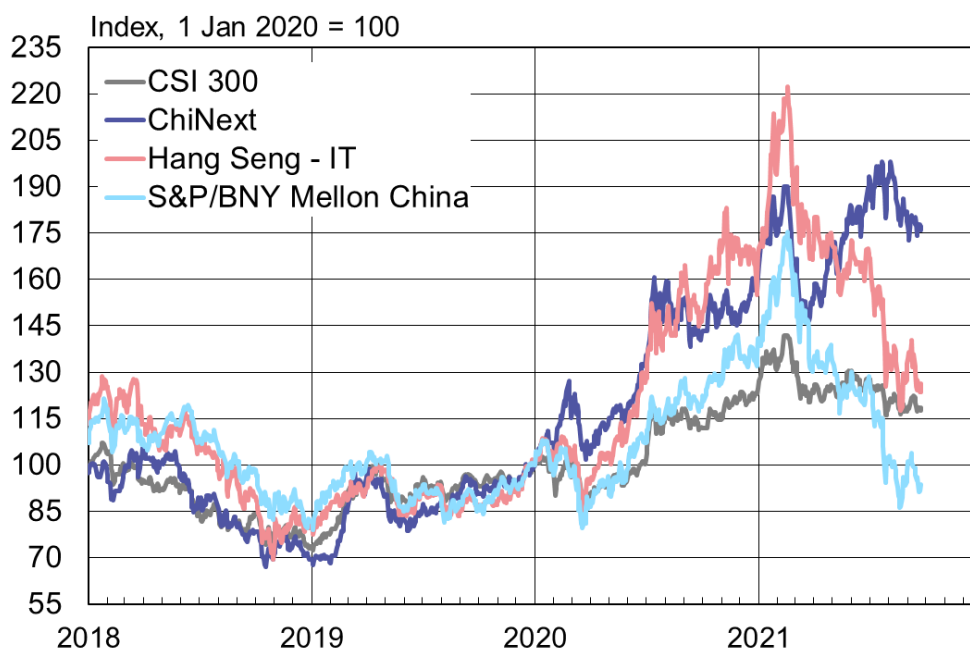
Concerns that Evergrande could become insolvent and the resulting contagion to the real estate sector and economy caused share prices around the world to plummet. Fears of a market meltdown quickly vanished, however, and most share

indices recovered somewhat in the following days. Mainland China bourses were closed for holidays on Monday and Tuesday, so China's general stock indices remained quite steady. Moreover, Evergrande's difficulties have received relatively little coverage in China's official media. The lack of news to some extent is the result of a campaign launched in late August to crack down on anyone disseminating information that could be seen as besmirching China's financial markets or providing distorted interpretations of economic policy or economic indicators ([BOFIT Weekly 36/2021](#)).

Although Evergrande's situation looks precarious, international credit rating agencies and others are cautiously hopeful that an uncontrolled collapse of the company will be avoided. Last week, for example, Fitch declared that even if some kind of default is likely, Evergrande's problems were manageable, but warned that the company's payment woes could impact several sectors. S&P followed this week with a similar message, stating that Evergrande was unlikely to create a systemic crisis for China's financial sector even if it would default and that the government has capacity to intervene in markets if there is a threat of broader contagion. According to the stress test results released by the People's Bank of China this summer, the rise in non-performing loans in the real estate sector should not pose a systemic-level threat to the banking sector. However, certain banks, e.g. Shengjiing bank, are believed to have a major exposure to Evergrande debt. For those banks, the company's inability to service its debts can pose a huge challenge.

Officials need to handle the situation with great care. Chinese officials have fought for years to reduce indebtedness of the real estate sector. A year ago, they imposed three red lines on real estate developers, which set limits to their indebtedness, while at the start of this year, bank lending to the sector was also restricted ([BOFIT Weekly 6/2021](#)). Evergrande, however, had already crossed all three red line before they were imposed. Officials have also sought for years to disabuse investors of their belief that the government will always come to their rescue as a lender of last resort and make them whole on any losses suffered. On the other hand, officials need to keep a handle on the situation by demonstrating an ability to prevent contagion to the rest of the real estate sector, the financial sector and the economy as a whole.

Shanghai CSI 300 shares remained steady as Chinese shares listed in Hong Kong and New York tanked.



Sources: Stock exchanges, S&P, BNY Mellon, Macrobond and BOFIT.

China makes targeted relaxes to capital outflows. The Bond Connect programme that allows foreign institutional investors to invest via Hong Kong in mainland China interbank market has been in place since summer 2017 ([BOFIT Weekly 27/2017](#)). The long-awaited possibility of investing in the other direction, i.e. from mainland China to Hong Kong, became reality today (Sept. 24). In recent years, restrictions on capital movements have begun to be lifted through a range of targeted programmes. While pressure to move money out of China doesn't seem particularly great at the moment, the situation could change, and officials still have the means to be able to move swiftly to stem capital outflows.

In the programme's initial phase, trading in Hong Kong for mainland investors is more restricted than the other way around. The now opened Bond Connect southbound leg allows trading for 41 financial institutions and Chinese institutional

investors that have been cleared for the QDII and RQDII programmes. The net cross-border outflow from bond trading under the programme is regulated as to the daily quota (20 billion yuan) and the annual quota (500 billion yuan). Chinese investors can make their bond investments in yuan or foreign currency. When a forex bond matures, however, the assets must be repatriated and converted to yuan. There are no corresponding quotas for foreign investors trading on the mainland bond market (i.e. northbound leg). The northbound programme currently has 689 approved foreign institutional investors and the average daily trading volume has risen this year to around 26 billion yuan, up from just 1.5 billion yuan in 2017.

Capital flows between mainland China and Hong Kong are further encouraged with opening of the Greater Bay Area investment programme that aims to increase financial links in the Pearl Bay Delta. The trial phase of ‘Wealth Management Connect’ opens on October 10. The programme allows residents of nine cities in Guangdong province to invest in certain wealth management products in Hong Kong and Macao. Residents of Hong Kong and Macao, in turn, can invest in select investment products of mainland China banks. Quite expectedly, the programme is subject to strict quotas that limit total annual investment flows to 150 billion yuan in either direction and one million yuan per investor (not to mention other demands such as demonstrating sufficiently long investment experience and adequate resources).

Qualified Chinese institutional investors are permitted to invest abroad under the QDII and RDFII programmes. Over the past twelve months, the number of participants in the QDII programme has grown from 152 to 173, while the total available investment quota has risen from \$104 billion to \$150 billion. The elimination of quotas for the qualified and renminbi qualified foreign institutional investor programmes in mainland China and the combining of the programmes was announced in 2019 and entered into force last year ([BOFIT Weekly 39/3019](#)).

While foreign ownership in China’s bond markets has increased rapidly, it still only accounts for about 3 % of the total market. Demand for Chinese bonds has also been boosted by their inclusion in a number of major international indices. In July and August, however, the pace of new investment slowed to a trickle. Nearly a third of foreign investment in mainland China’s bond markets are made through the Bond Connect programme.

Foreign investors continue to increase their holdings of Chinese bonds.



Sources: CEIC, Bond Connect Company Ltd. and BOFIT.

Russia

Few surprises in Duma election. On September 17–19, Russian voters went to the polls to select their next set of lower-house Duma deputies. Due to the restrictions keeping opposition candidates off the ballot, the campaigning leading up to the vote was fairly half-hearted. In the end, the ruling United Russia party took 324 Duma seats (down slightly from 343 seats in the previous Duma). The Communists took 57 seats (up from 42). For Truth, formerly A Just Russia, won 27 seats (up from 23). The Liberal Democratic Party of Russia (LDPR) took just 21 seats, down from 39. The just-formed New People party won 13 seats. Voter turnout was low for a Duma election, 52 % of eligible voters.

While the new Duma has yet to be seated, the election results suggest there will be little changes. President Vladimir Putin announced his support for current Duma Speaker Vyacheslav Volodin to continue in that post. Ballots in many Russian regions included choices for regional governor, regional duma representatives and local government offices. Chechnya governor Ramzan Kadyrov, for example, romped to re-election victory with 99.7 % of the vote.

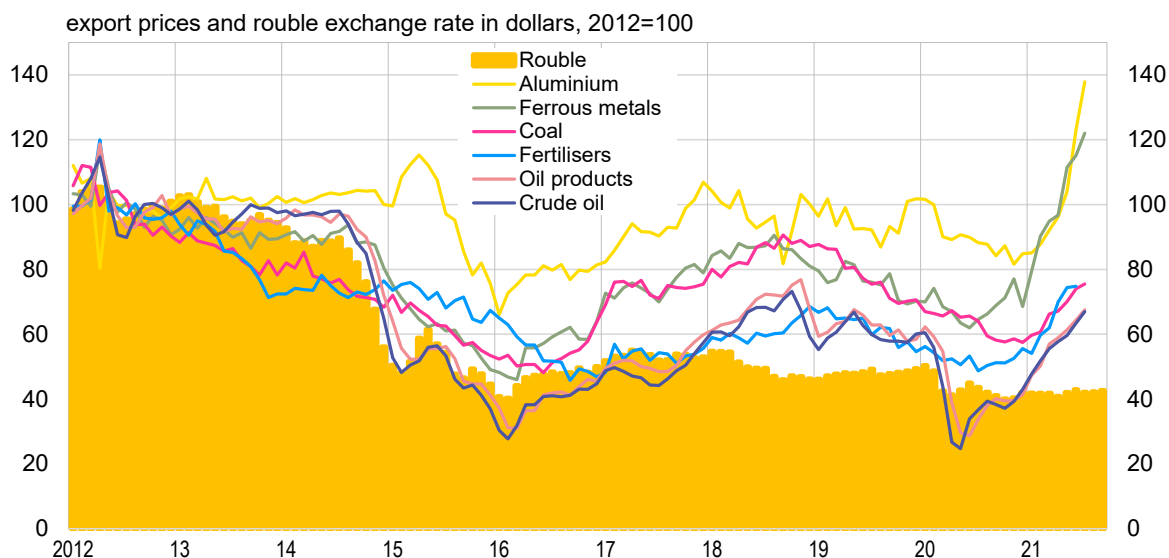
Prices of oil and other major Russian export commodities up sharply; ruble barely appreciates. Oil prices on world markets have climbed by about 20 % over the past six weeks. This week, the price of Brent crude climbed to nearly \$80 a barrel. World prices are also up for Russia's other big export commodities such as ferrous and non-ferrous metals, sawn timber, and fertilisers. The increases have sent Russian export prices to very high levels, some not seen in a decade. The increases reflect the strong recovery of the global economy and demand for certain commodities. With respect to oil, some countries covered under the OPEC+ agreement have also kept their production even below their agreed production ceilings.

While Russian export earnings have naturally been boosted by higher export prices, the ruble's exchange rate has barely budged. For example, the ruble's average exchange rate in September was up by less than 1 % against both the dollar and the euro from its August averages. Indeed, the ruble's exchange rate has also faced factors that put downward pressure on the exchange rate.

The only slight appreciation in the ruble's exchange rate in September suggests a substantial net outflow of capital from Russia. The situation emerged already in July and August, when export prices were on the upswing and, according to Bank of Russia preliminary figures, the net outflow of private capital from the country rose considerably. Similar situations have also arisen in a couple of earlier years with the ruble's exchange rate not keeping up with rising export prices.

In addition, foreign currency purchases under Russia's fiscal rule have returned in recent months to the average pace of 2018–2019. Under the rule, additional oil & gas tax revenues of the federal budget generated when the oil price exceeds the rule's reference price are converted into forex. These earnings are set aside and later placed in the National Welfare Fund.

Despite the rapid rise in prices of Russia's main export commodities this year, the ruble has appreciated only slightly.

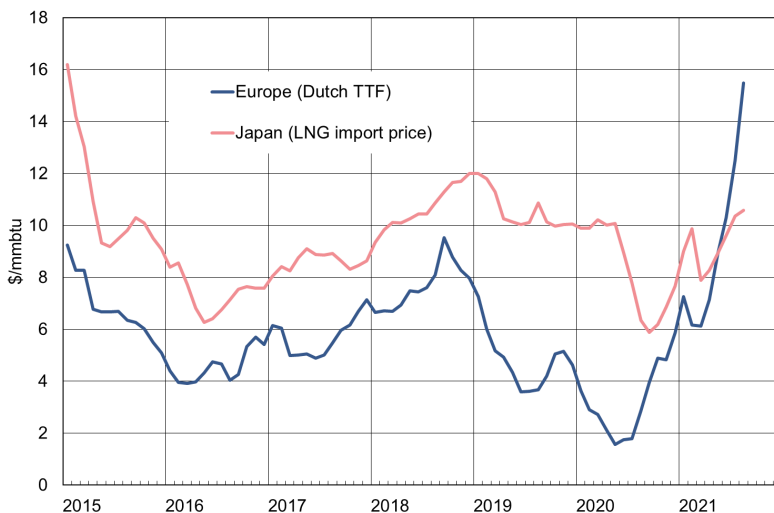


Sources: Rosstat and BOFIT.

Construction work on Nord Stream 2 gas pipeline finishes up. Construction work on the Nord Stream 2 gas pipeline, which runs along the floor of the Baltic Sea from Russia to Germany, was completed in mid-September. The pipeline builder, Nord Stream 2 AG, is owned by Gazprom. The company reports that the pipeline should be ready for commissioning by the end of this year. In addition to the technical finalisations, however, commissioning will depend on EU energy market regulators. In July, the Court of Justice of the European Union ruled that Gazprom could only use half of the pipeline's capacity. The capacity decision also applies to the Nord Stream 1 pipeline, completed in 2011–2012, which parallels the new Nord Stream 2 pipeline. The commissioning of the pipeline has aroused considerable discussion in recent weeks as natural gas prices soared to historical highs on European gas-trading exchanges.

The price rise reflects a resurgence of global demand. The volume of pipeline gas imports to EU countries has returned to pre-pandemic levels, while imports of liquefied natural gas (LNG) have not. At the same time, gas output in EU countries continues to decline. The gap has been made up with gas reserves in storage, which last summer fell to exceptionally low levels. Higher gas prices boost Russia's export earnings as increasingly the pricing of exported gas, in accordance with EU rulings, is tied to gas market prices.

The price of natural gas has soared on European natural gas exchanges to levels well above prices in Asian markets.

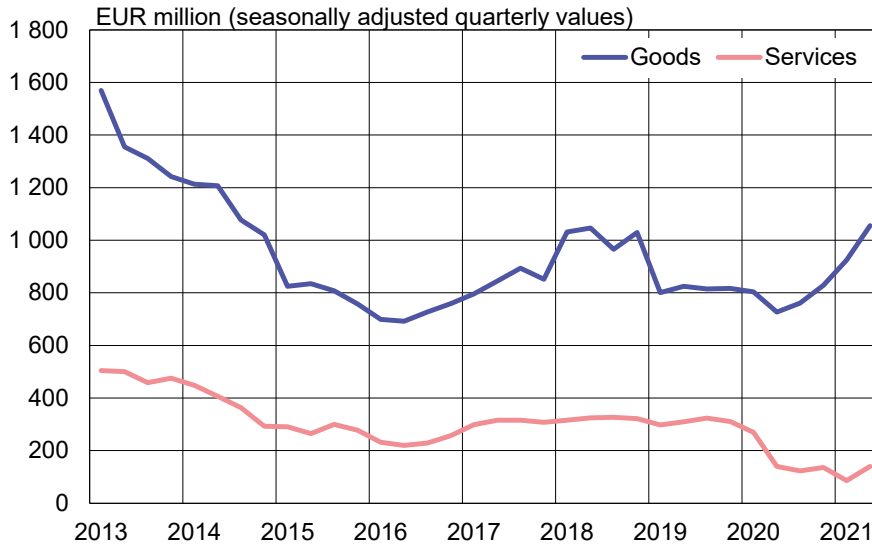


Sources: World Bank and BOFIT.

Finnish-Russian trade stages a comeback in the first half of this year. The value of goods and services exported from Finland to Russia rose by 11 % y-o-y in the first half of this year. In the second quarter, exports exceeded pre-pandemic levels, even after falling last year to historical lows. The recovery has been led by goods exports and particularly machinery & equipment exports have grown briskly supported by Russian investment demand. The favourable trend for goods exports continued also in July. In contrast, services exports have barely improved from the Covid Recession trough. Travel restrictions hit service exports particularly hard as both Finland and Russia imposed them to deal with the covid situation. In pre-pandemic years, tourism services accounted for about half of Finland's services exports to Russia. Last year, the share fell to about a third. Russia accounted for 5 % of Finland's total exports of goods and services in the first half of 2021.

The value of goods and services imported to Finland from Russia was up by 18 % y-o-y in the first half of the year, but was still well below previous peak figures in 2019. The value of imports has been boosted largely by a strong rise in commodity prices, while the import volumes of many goods have recovered slowly. The world price of crude oil, Finland's single most important import item from Russia, was in the first half of 2021 already close to the levels seen in the first half of 2019. The volume of Finland's imports of crude oil from Russia, however, were down by nearly half in comparison in the first half of 2019. The drop apparently reflects reduced demand as Russia continues to account for nearly 90 % of Finland's crude oil imports. Russia provided 8 % of Finland's total imports of goods and services in the first half of this year.

Finnish goods exports to Russia have recovered well this year, while services exports have shown only slight improvement.



Sources: Statistics Finland and BOFIT.

China

Dwindling coal supplies and rising prices have created a widespread electricity crunch in China. At least 20 of China's 31 provinces have restricted electricity use during September and October. While the restrictions most severely apply to heavy industry, many places have also seen power cuts to households and municipal infrastructure. Firms and households have also been asked to save electricity. The electricity shortages are the result of higher world energy prices and also partly China's efforts to curb emissions disrupting coal supplies. 68 % of China's electricity last year was generated by coal-fired power plants.

Electricity supplies have been restricted to some extent since early summer. Blackouts are not uncommon during the winter heating season, but the current electricity supply issues are reportedly more extensive than anything seen in years and affect provinces that generate the bulk of China's aggregate output e.g. Guangdong, Jiangsu and Shandong provinces. The problems are expected to depress industrial output in the second half of this year.

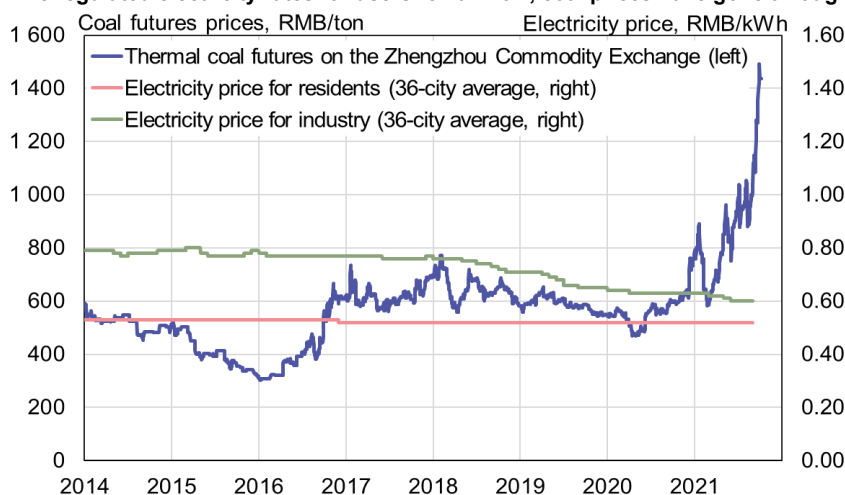
The price of coal in China has risen rapidly. Thanks to regulated and low electricity rates, production at coal-fired plants has become unprofitable. China's domestic coal production has failed to keep up with demand, which has meant companies have burned through their coal stocks. Several coal mines have been closed for environmental and security concerns. Working in Chinese coal mines is dangerous. Several major accidents have occurred at Chinese coal mines this year. In addition, as the China-Australia relations took a turn for the worse, China completely suspended coal imports from Australia in December. China has since been unable to make up for the shortfall with imports from elsewhere. Prior to the ban, 30 % of China's coal imports came from Australia. Between January and August this year, China imported 10 % less coal than in the same period a year earlier. At the same time, power generated by coal grew by 6 % and electricity consumption by 14 %. In addition to problems with coal supplies, natural gas prices have gone through the roof and droughts have reduced hydropower generation.

In August, the National Development and Reform Commission (NDRC) released a list of provinces that had failed to reach their emission reduction targets in the first half of this year. Provinces have subsequently limited their power consumption and generation. China's goal is to reduce its "energy intensity" (energy consumption/GDP) by 3 % this year and 13.5 % by 2025. Provinces have been given their own targets.

As coal supplies have become harder to come by, many provinces have increased their power prices by 10 %, the maximum regulators allow. Electricity rates in China are still strictly regulated, even if last year regulations were relaxed to allow regional electricity rates to be raised by as much as 10 % or cut by as much as 15 % in response to shifts in supply and demand. In September, the NDRC ordered coal companies and power generators to make longer term coal sales contracts that meet the coal demand and are priced at levels below current high spot prices.

With the problems continuing, restrictions on electricity generation have been eased. The NDRC has released government reserve coal to the market, relaxed capacity restrictions on coal production and called for increased coal imports. Last week, the central government ordered energy companies to guarantee electricity supplies for the winter heating season at "all costs." This week, the China Banking and Insurance Regulatory Commission (CBIRC) exhorted banks to increase their lending to coal and energy companies and strictly banned speculation in prices of commodities such as coal.

While regulated electricity rates for users remain low, coal prices have gone through the roof on China's commodity exchanges.



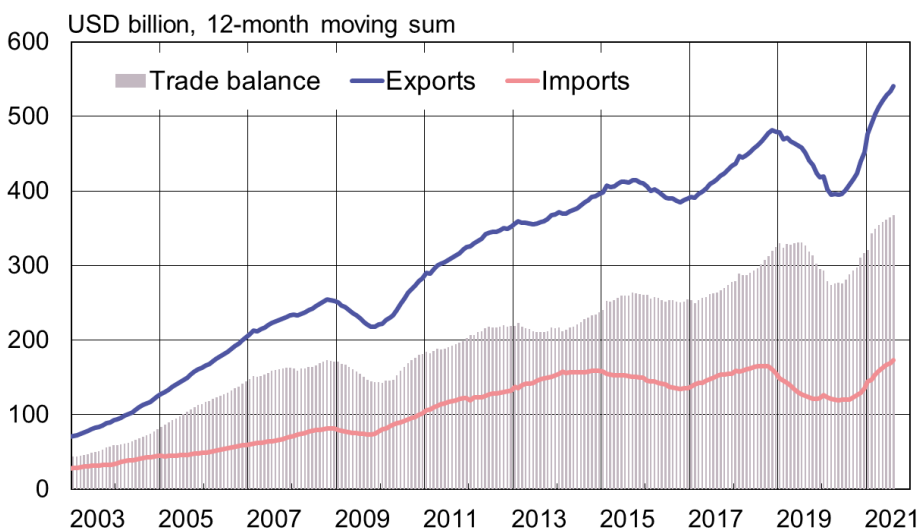
Sources: Zhengzhou Commodity Exchange, NDRC, CEIC and BOFIT.

United States wants to resume trade talks with China. On Monday (Oct. 4), US trade representative Katherine Tai outlined preliminary targets for the Biden administration’s China trade policy. The public statement was long-awaited as the new administration has up to the present kept fully in place trade measures introduced during the Trump administration. Under the goals announced on Monday, the US will seek to restart bilateral trade talks. Punitive tariffs will remain in place and US plans to press China to keep its promise to increase US imports as agreed in the phase one trade agreement. At the same time, the US said it was reinstating the possibility for US importers to apply for relief from tariff charges. The possibility to apply for an exemption from tariffs has been on hold since the start of the year. On Wednesday (Oct. 6), an administration spokesman announced that presidents Joe Biden and Xi Jinping are planning for a virtual meeting before the end of this year.

In the course of the US-China trade war, additional tariffs have been imposed on most bilateral goods trade. This caused bilateral trade to contract, especially during 2019. As the US still accounted for nearly 9 % of China’s goods imports in 2017, its share fell to below 6 % in the second half of 2019. At the same time, the US share of Chinese goods exports fell from 19 % to below 17 %. Phase one of the US-China trade agreement, which entered into force in February 2020, failed to significantly improve the situation, and China has missed the goals for additional US imports. According to the [US-China phase one tracker](#) maintained by the Peterson Institute for International Economics (PIIE), less than 60 % of agreed imports were realised last year. Figures from January to August indicate that China is heading this year to meet about 70 % of its commitment. In contrast, Chinese exports to the US have recovered strongly during the pandemic, so the bilateral trade surplus has risen to unprecedented levels.

In recent years, China has concentrated its efforts on improving trade relations at the regional level. Just a year ago, China signed the Regional Comprehensive Economic Partnership (RCEP) trade agreement with 15 Asian countries, and currently continues its trilateral trade talks with South Korea and Japan. Just a few days after the signing of the RCEP agreement, China announced plans to also join the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP). China’s trade minister Wang Wentao submitted China’s official accession application a few weeks ago to New Zealand trade minister Damien O’Connor. The CPTPP comprises eleven countries, including Australia, New Zealand, Canada, Mexico, Japan and Singapore. The UK launched accession talks in June. However, China CPTPP membership is looking highly unlikely. For starters, the trade agreement would require opening up of China’s service sector and significant tariff reductions, as well as implementation of legislation concerning e.g. state-owned enterprises and labour unions. The situation is further complicated by inflamed China-Australia relations as accession requires the unanimous approval of all eleven member states. To top things off, two days after China submitted its application, Taiwan filed its own accession application to which Japan gave its immediate support.

US-China goods trade has recovered from its trade war induced dip



Sources: China Customs and BOFIT.

EU Chamber of Commerce in China sees harsher operating environment ahead. At the end of September, the EU Chamber of Commerce in China released its annual [position paper](#). The European Chamber is concerned about

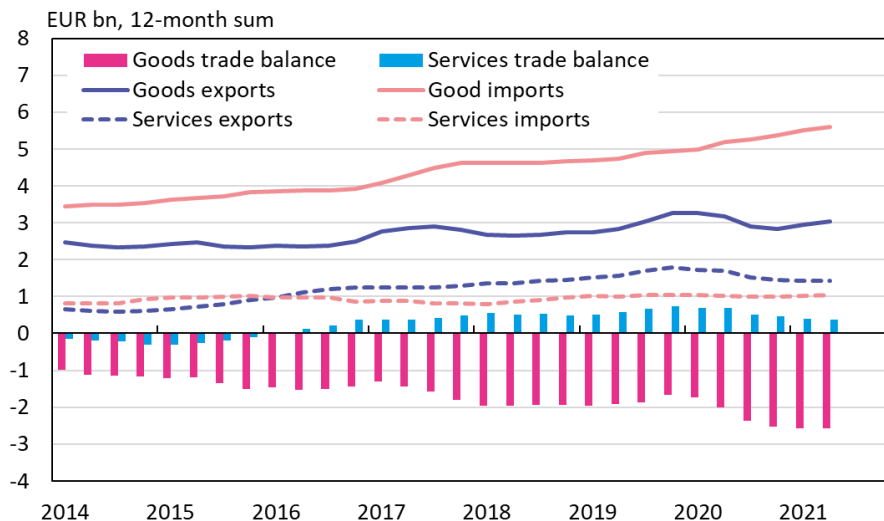
increasing evidence that China is turning inward as tensions with the US mount. The change in China can be seen in its increased emphasis on self-sufficiency. Moreover, the national security theme now appears entwined in many more contexts it used to.

The European Chamber noted that ultimately these developments will be manifested as reduced foreign direct investment, lower capacity for innovation, wasted resources, degraded foreign relations and challenges for Chinese firms operating abroad. The European Chamber also sees no evidence of a levelling of the playing field for businesses. Instead, Chinese state-owned enterprises continue to enjoy elevated status. At the same time, the government seeks to increase its control over the private sector and excluded foreign firms from sectors seen as strategically important. According to the European Chamber, the new laws on data infrastructure and data security will likely force European firms to shift their operations out of China. The European Chamber expects that turning inward will reduce the long-term growth potential of the Chinese economy. It recommends that China give up on its self-sufficiency efforts and narrow the scope of its national security concerns.

Finnish goods exports to China surpass 2019 levels; services exports slower to recover. Statistics Finland reports that Finnish goods exports to China were valued at 1.66 billion euros and services exports at 660 million euros in the first half of the year. The value of goods exports was nearly 9 % higher than in the first half of 2019. Finnish Customs show that Finnish goods exports to China in July were down by about 7 % from two years previous. Both in terms of volume and value, high-grade wood pulp used in making cardboard in particular has become an extremely successful export, accounting for about a third of all Finnish exports to China this year. In contrast, Finnish services exports to China are well below pre-covid levels. Much of this is due to covid travel restrictions. In 2019, the number of Chinese visitors averaged 20,000 a month. This year an average of just 200 Chinese a month have visited Finland. China accounted for more than 5 % of Finland's exports of goods and services.

In the first half of this year, Finland's goods imports from China were worth 2.77 billion euros and services imports 520 million euros. Goods imports from China continued to rise rapidly last year despite Covid Recession. The value of imports in the first half of this year was over 20 % higher than at the same period in 2019. In addition, services imports have suffered relatively little from the covid pandemic. For the first half, 8 % more services were purchased than in two year ago. China accounts for about 7.5 % of Finland's imports of goods and services.

Finland's goods trade deficit with China has widened, while the services trade surplus has shrunk



Sources: Statistics Finland and BOFIT.

Russia

Russian export earnings near all-time highs; capital outflows increase. Preliminary balance-of-payments figures from the Central Bank of Russia show that the value of Russia's exports of goods and services in the third quarter hit \$148 billion, a 65 % y-o-y increase. Export earnings were close to the peak years of 2011–2013, when crude oil prices soared to historical highs, averaging \$110 a barrel. In July-September, in contrast, the average oil price was just \$70 a barrel. Exports of goods other than oil & gas indeed had a substantial contribution to total export growth. The value of these exports broke an all-time record in the third quarter supported by the buoying demand and rapidly rising prices of several raw materials in the global markets.

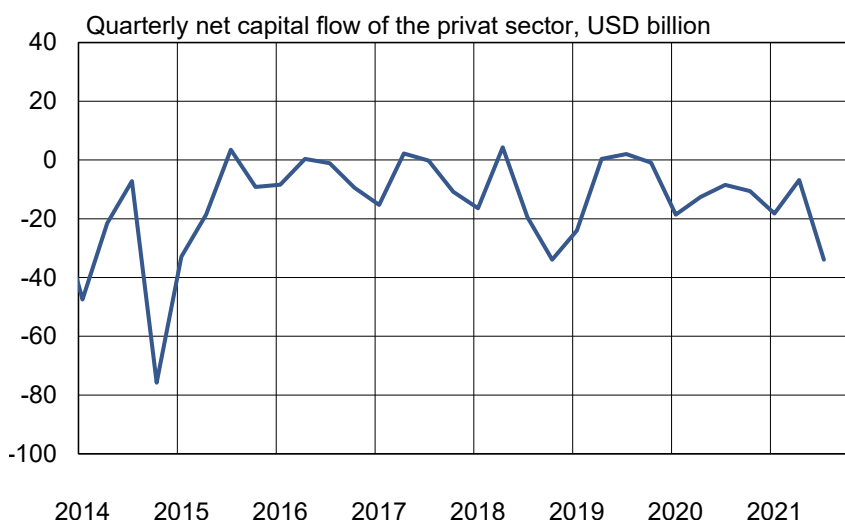
In the third quarter, the value of Russian goods and services imports was \$96 billion, an increase of 30 % y-o-y. The rise in imports slowed sharply from previous months, while imports exceeded pre-covid levels. Goods imports have driven the recovery in imports. Services imports have only slightly recovered since the Covid Recession.

The rapid growth in exports also lifted Russia's third-quarter current account surplus to a record \$41 billion. The total current account surplus for the last four quarters corresponds to about 5 % of GDP.

The increase in export earnings has also been reflected in Russia's foreign currency and gold reserves, the value of which stands at a historical high. The value of Russia's currency reserves was also boosted by IMF special drawing rights (SDRs) that were distributed in August to the central banks of IMF member countries to help with their covid recoveries. The value of Russia's share in this SDR allocation was \$17.5 billion. As of end-September, the value of Russia's foreign currency and gold reserves stood at \$614 billion (about 40 % of GDP).

Capital outflows from Russia increased rapidly in July-September. The net outflow of private sector capital amounted to \$34 billion, the largest net outflow in three years. The outflow was mainly driven by foreign investments and lending of non-bank corporates. The total private sector net capital outflows for the last four quarters corresponds to about 4 % of GDP.

Private sector capital outflows from Russia picked up in third quarter of this year.



Sources: Central Bank of Russia, Macrobond and BOFIT.

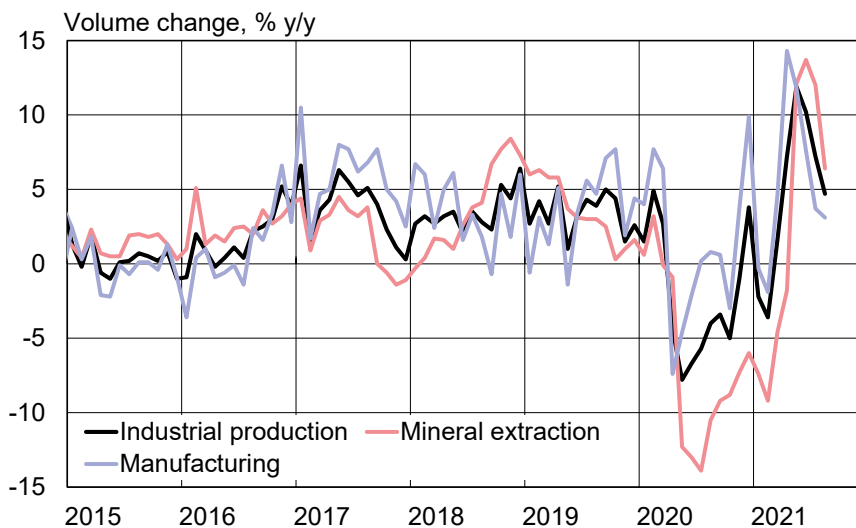
Russian fixed investment bounces back after the Covid Recession. Demand-side figures in Rosstat's national accounts show a strong rebound in seasonally adjusted growth in fixed investment in the wake of the Covid Recession of spring and summer 2020. Notably, growth was very high in the second quarter of this year, with the level of fixed investment exceeding the peaks of 2012 and 2013. Manufacturing enjoyed robust fixed investment growth ([BOFIT Weekly 37/2021](#)), particularly in metal refining.

Private consumption also recovered dramatically in the first half of this year. The seasonally adjusted consumption figures for the second quarter were the highest ever recorded. Private consumption has been driven by such factors as the

spending of savings accumulated during the pandemic. Russia's seasonally adjusted GDP rose by 3.5 % in the second quarter. Economic activity currently exceeds pre-pandemic levels.

In August, most on-year trends of key economic indicators were still well in positive territory: industrial output grew by 4.7 % y-o-y, manufacturing by 3.1 % and the volume of retail sales by 5.3 %. The economic development ministry estimates that GDP grew by 3.7 % y-o-y. The high annual growth figures, however, speak mostly to the low basis of summer 2020. Seasonally adjusted industrial output has been contracting since June, mostly due to reduced output in the extractive sector. The seasonally adjusted volume of retail sales has developed sluggishly in recent months. Russian economic growth has faded in past months.

On-year growth in Russian industrial output has slowed in recent months.



Sources: Rosstat, Macrobond and BOFIT.

Russia's government budget expected to show surpluses as efforts are ahead to slow spending growth. At the end of September, the federal budget and the budgets for the state's three social funds were submitted by the government to the lower-house Duma for approval. At the same time, the finance ministry released its comprehensive revenue and spending estimates for 2021–2024, which cover the entire consolidated budget, i.e. federal and social fund budgets, as well as regional and municipal budgets.

Nearly 20 % growth in nominal public sector revenues is expected this year. High oil & gas prices should boost revenues from oil & gas taxes by over 60 % from last year's covid dip. Other budget revenues are expected to increase by over 10 %. Spending growth will slow this year from last year's stimulus, but will still reach about 8 %. The budget balance turned deeply into red last year (4 % of GDP), but this year the deficit is expected to shrink to just 0.5 % of GDP.

Under the economic development ministry's forecast for 2022–2024, GDP growth is expected to remain at 3 % p.a. While the export price of Urals-grade crude is assumed to decline gradually from this year's \$66 a barrel to \$56 in 2024, crude oil production and exports are expected to rebound strongly in 2022 with the fading out of production ceilings under the OPEC+ agreement. With that, revenues from oil & gas taxes should increase appreciably still next year. Growth of other revenue streams in the consolidated budget such as VAT revenue is expected to slow already next year to around 5 % a year, i.e. considerably lower growth than in the years preceding the recession of 2020.

The target of lowering nominal growth of government sector spending to around 4.5 % a year in the next few years, only slightly faster than forecast inflation, is maintained like in the policy adopted last year. The level of spending will be higher than scheduled earlier due to rapid spending growth last year and this year. Spending relative to GDP will fall from 40 % last year to around 35 % a year during 2022–2024. Increased revenue estimates for the consolidated budget yield small surpluses.

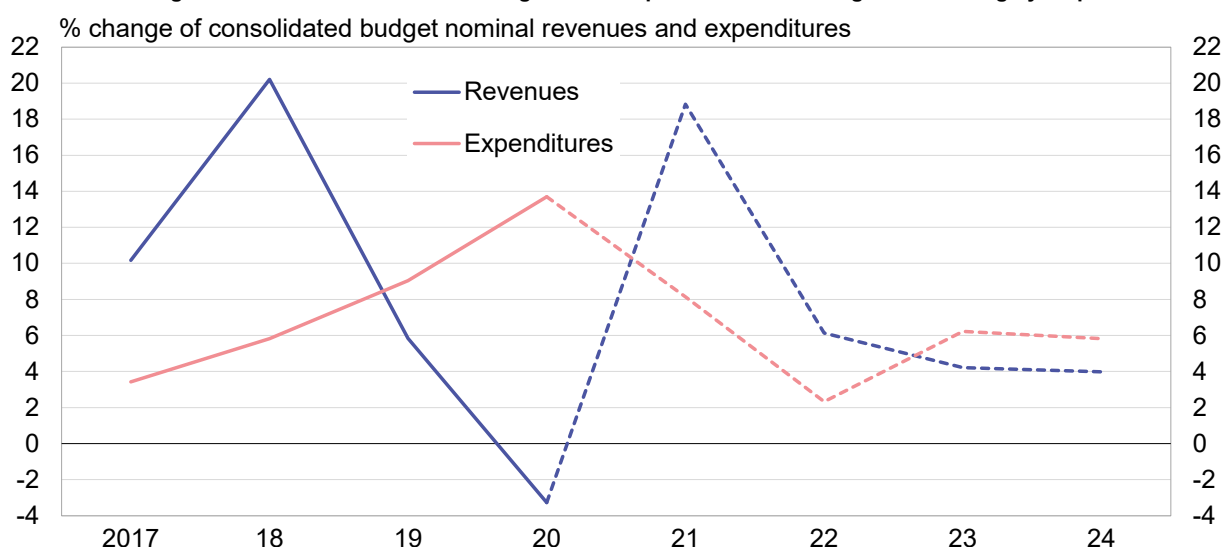
The estimates see education spending increasing rather steadily at 6–7 % p.a. in 2022–2024. After a long period of slow spending growth, spending on domestic security and law enforcement next year will increase sharply and then match inflation in subsequent years. Defence spending will increase slowly until 2024, when a notable increase is planned. After a rapid rise in 2019–2020, growth in spending on various sectors of the economy is set to be very slow. Spending on healthcare

has grown rapidly for several years but growth will now be slower than inflation. Such pace is also foreseen for spending on social supports (including pensions). The current plans are to freeze nominal growth in spending on public administration following high growth in 2020 and 2021.

General increases in wages of public servants are expected to only keep pace with inflation, with the exception of certain groups in healthcare and education who will get wage hikes in line with wage developments nationally. Pensions for those pensioners who do not work will be raised in line with a 2018 law so that the increases outpace inflation slightly.

Even with a slight surplus, the government continues to borrow from the domestic market as the government's fiscal rule calls for setting aside part of oil & gas tax revenues and transferring them to the National Welfare Fund (NWF). Government debt at the end of 2024 should be just over 20 % of GDP, while the value of NWF total assets should rise to 15 % of GDP. In the coming years, NWF assets will be lent to finance domestic infrastructure projects.

Government budget revenues are on the rise while growth of expenditures is slowing to levels roughly on par with inflation.



Sources: Russian Ministry of Finance and BOFIT.

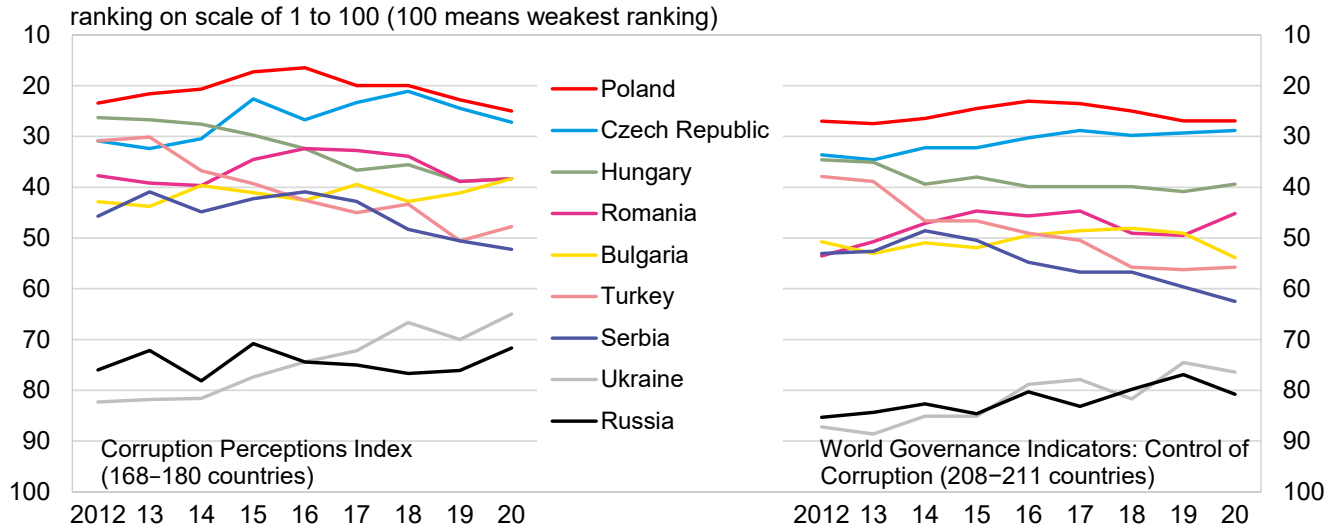
Russia approves anti-corruption plan for 2021–2024. In August, president Vladimir Putin issued a decree requiring numerous authorities at the federal, regional and municipal levels to adjust their anti-corruption plans, prepare reports on their corruption analyses and assessments, as well as make legal and regulatory proposals and recommendations of practice to deal with various aspects of corruption. The plan is based on an anti-corruption law approved in 2008 and extends the plan for 2018–2020.

The measures include extending the scope of legislation on anti-corruption restrictions to include public servants in temporary posts as well as more comprehensive application to members of regional parliaments, temporary prohibitions on persons fired from public service to work in the government sector or state-owned enterprises, as well as development of rules on receiving and reporting gifts. Persons sanctioned for corruption will see restrictions on work in the public sector on a wider basis. Procedural recommendations will be prepared to deal with general restrictions on participation in private sector entities.

Analyses will focus on various topics such as risks of corruption that arise when civil servants participate without compensation in the activities of state-owned enterprise governance bodies. The law shall be amended to define more accurately conflicts of interest. Improved procedures are needed for reporting corporate connections of persons arranging public procurements, as well as assessing risks of corruption associated with transfers of funds between government sector budgets. The procedures for verifying reported income, expenses and property of civil servants will also be improved. Transparency is needed in determining property value at sale or rental of government property, and at acquisition of property by the state.

In conjunction with anti-corruption measures, protection of information is set to improve, including procedures to provide such information to other official agencies, as well as protections for whistle-blowers. The plan pays considerable attention to education about anti-corruption measures and citizen participation.

Russia has long ranked low in international corruption surveys.



Sources: Transparency International, World Bank and BOFIT.

China

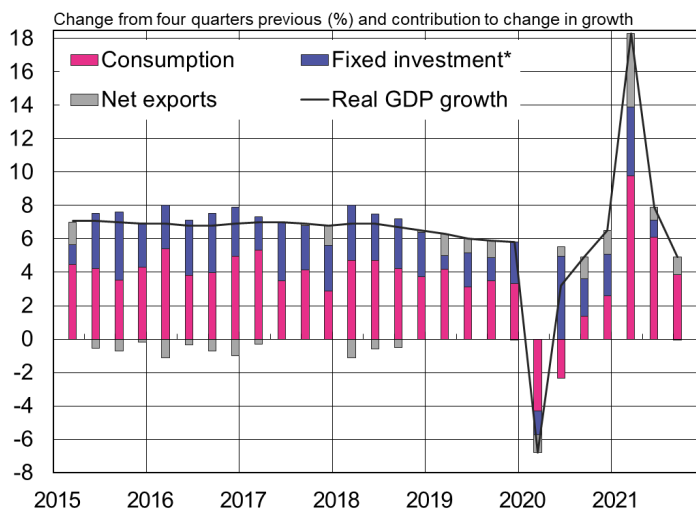
China posts weak third-quarter GDP growth figures; headwinds increase for rest of year. While real GDP was up by 4.9 % y-o-y in the third quarter, the National Bureau of Statistics reports that it grew by just 0.2 % from the second quarter. Some slowdown was expected, but the sluggishness of growth came as a surprise. Thanks to the low basis reference of 2020, GDP grew by a blistering 9.8 % y-o-y in the first nine months of the year, so there is little risk that China fails to meet its “over 6 %” growth target for this year. Next year’s growth legacy, however, is likely to be slim.

The Bank of Finland’s [alternative GDP calculations](#) indicate that the 3Q slowdown was sharper than official figures suggest. In the first and second quarters of this year, our alternative calculations line up closely with China’s reported official GDP growth figures.

China’s GDP figures show most 3Q growth came from increased domestic consumer demand, even if monthly retail sales growth was relatively low in August and September. Strong exports supported GDP growth. Somewhat surprisingly, fixed investment, including changes in inventories, contributed nothing to 3Q growth. On the supply side, industrial output growth has slowed steadily since spring. Real growth in September fell to just 3 % y-o-y. Steel and cement production, as well as the number of automobiles manufactured, contracted sharply on-year in July, August and September.

Barriers to higher growth seem to be piling up entering the fourth quarter. Vacation travel was down even from last year’s numbers in the National Day holiday break at the start of October. Electrical power shortages and outages ([BOFIT Weekly 40/2021](#)) seem to continue despite last week’s announcement by the National Development and Reform Commission (NDRC) of changes in electricity rates. Starting last Friday (Oct. 15), some coal-fired power plants have been allowed to increase their electricity rates by 20 % from the official base rate. The rates for some large industrial customers can be increased even more. Property sales in the construction sector and new building starts contracted in September. To date, at least, the government has not launched any significant measures to support the struggling construction sector.

Fixed investment contributed nothing to China’s third-quarter GDP growth.



Sources: China National Bureau of Statistics, CEIC and BOFIT.

China’s strong goods export performance continued in the third quarter. The value of Chinese exports grew in the third quarter by 24 % y-o-y. The value of exports for the first nine months of the year was USD 2.4 trillion, a 33 % y-o-y increase and up 32 % from the same period in pre-covid 2019.

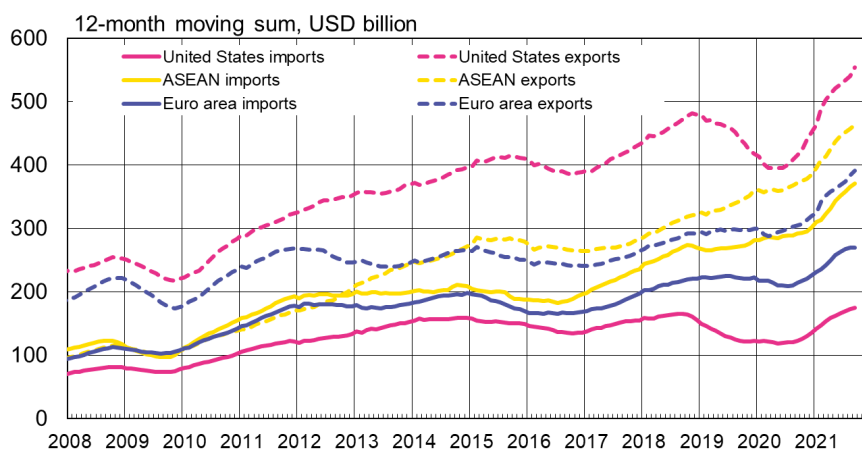
The value of imports in 3Q21 was up by 27 % y-o-y. The value of imports in January-September grew to USD 1.96 trillion, a 32 % increase from the same period in 2020 and up by 29 % from the same period in 2019. The trade surplus in the first nine months hit USD 439 billion, a 35 % increase from the same period a year earlier and up 46 % from 2019.

Import prices have risen mostly due to the spike in commodity prices of recent months. Unit prices of imported goods in May-August were up by an average of 17 % y-o-y. Much of the increase in the value of imports reflected higher prices; import

volumes were up in January-August only by 13 % y-o-y. Commodity import volumes continued to shrink. The volume of copper imports in the first nine months of the year were about 20 % lower than in the same period a year earlier. Imports of oil and coal fell by 7 %, and metal imports were off by 3 %. The trend in export prices has been considerably more modest. The y-o-y rise in the average unit price in May-August was less than 2.5 %. The volume of exports in the first eight months of the year was up by about 33 % y-o-y.

China's export growth with its main trading partners continued across-the-board. Exports in the first nine months of the year to the United States grew in dollar terms by 33 % y-o-y, to the euro area by 32 % and to ASEAN countries by 30 %. Import trends have been more country-specific. Compared to the same 9-month period in 2020, imports from the US grew by 44 % in dollar terms, by 32 % from ASEAN countries and by 28 % from the euro area. Much of the high growth in US imports to China reflects recovery from the plunge in bilateral trade during the trade war. Compared to 2018 before the plunge, China's imports from the United States have only increased by 7 % (compared to a rise of 41 % in imports from ASEAN countries and 22 % in imports from the euro area).

China's exports to its main markets have generally risen; greater variation in country-specific import trends.



Sources: China Customs and BOFIT.

China's debt growth slowed in September; no monetary easing. China's domestic stock of bank loans grew by 11.9 % y-o-y in September. Growth in the stock of bank loans and the People's Bank of China's (PBoC) measure "aggregate financing to the real economy" (AFRE) have slowed after last year's covid stimulus measures. AFRE includes categories for e.g. the shadow banking sector, IPOs and bond financing. September's 10 % y-o-y growth was the slowest since 2005, when the composition of AFRE was somewhat different from what it is at present. Corporate reliance on bond financing has slowed considerably this year and the shadow banking instruments' stock continues to shrink. At the end of September, AFRE was equivalent to 275 % of GDP, down from 281 % in September 2020.

In the third quarter, the share of loans granted to households in total new bank lending fell to less than third (the share was about 50 % at the end of 2019). Housing loans make the bulk of household loans. Their growth has slowed with the general slowing in the rise of housing prices, as well as stricter regulation of housing loans and increased uncertainty surrounding the payment troubles of China's construction companies. In September, growth in the household bank loan stock slowed to 11 % y-o-y (16 % y-o-y at the end of 2019). Growth in the stock of corporate loans remained relatively stable at around 12 %.

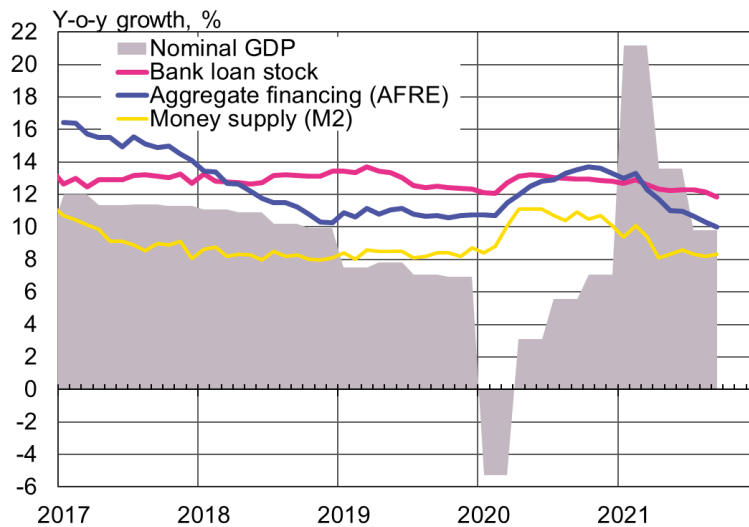
Despite the uncertainty from slowing economic growth, electricity shortfalls and the increased payment troubles of construction companies, the PBoC has not relaxed its monetary stance since summer. The reference rate for bank lending (the loan prime rate or LPR) has been unchanged since April 2020. The PBoC has only cautiously increased market liquidity this year through open market operations, lending programmes and changes in the reserve requirement ratio (RRR). PBoC operations generated a net liquidity increase of 280 billion yuan in the first nine months of the year (the increase was 1.53 trillion yuan for the same period in 2019).

The PBoC has long talked about dealing with indebtedness and financial market risks, and the current modest slowing in debt growth offers an opportunity for this. Soaring producer price inflation at the moment is not expected to significantly affect consumer prices. The PBoC points out that the rise in producer prices is temporary and mainly due to high commodity prices. September producer prices rose by 10.7 % y-o-y (9.5 % in August), while consumer prices grew by just 0.7 % (0.8 % in

August). In September, however, the central bank provided funds to banks to increase lending to small firms struggling, among other things, with soaring input prices.

Uncertainty with the property sector companies has yet to translate into significant capital flight pressures. Indeed, the yuan has appreciated slightly in recent weeks. On Friday (Oct. 21), the yuan's nominal effective (trade-weighted) exchange rate was up 3 % from the start of September. The yuan gained 1 % against the dollar. Inflows to China from growth in the current account surplus and the opening up of China's financial markets have supported the yuan's exchange rate.

Growth of the credit stock has slowed this year.



Sources: People's Bank of China, NBS, CEIC and BOFIT.

The issue of digital yuan progresses. Chinese citizens are now welcome to enrol in experimental use of the digital yuan by signing up on the *White List* announced by the PBoC in July. According to media reports, over 10 million people joined the pilot programme during the summer. In recent weeks, additional information has dribbled out about new transaction situations where digital cash can be used. These include the purchase of rail, bus and airline tickets, payment of parking fees, hotel services, as well as on-line purchases and vending machines. While the early marketing of digital cash focuses on consumer applications, several business applications have been announced, including an application rolled out China's largest online retailer JD.com.

Implementation of the technical network that supports circulation of digital yuan has begun. Current plans allow for use of digital cash without having to go online. The money is stored in an electronic wallet on the user's mobile device or a separate supported device such as a memory card. Digital cash stations are needed to support use of the digital cash. A number of firms have applied in recent months for permits to install digital cash automats that e.g. would allow visitors to the 2022 Beijing Winter Olympics to convert foreign currency into digital yuan. Bank of China, one of China's largest banks, last month held a demonstration of its latest bank automat supporting digital cash applications.

With the issue of digital money advancing, Chinese officials have cracked down hard on the use of foreign cryptocurrencies. China's official cryptocurrency policies were tightened in May with the imposition of restrictions on cryptocurrency mining. During the summer, officials arrested thousands of people for money laundering using cryptocurrencies. In September, the PBoC completely banned the use of cryptocurrency and the offering of related services. Although China's policy crackdown on cryptocurrencies led to a severe global downdraft on cryptocurrency prices (e.g. Bitcoin, Ethereum), prices have since returned to their previous levels. Numerous Chinese cryptocurrency companies have shifted their operations to other countries.

Russia

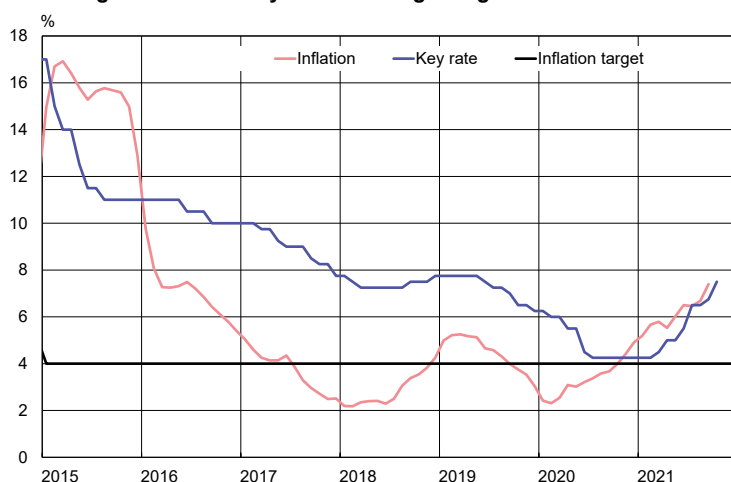
CBR raises again key rate as inflation climbs; releases updated growth forecast. On October 22, the Central Bank of Russia raised its key rate by 75 basis points, surpassing market analyst expectations. The key rate now stands at 7.5 %. The CBR began to tighten its monetary stance in March and has since increased the key rate six times. In its forward guidance, the CBR did not rule out the possibility of further hike at its next meetings.

The CBR mostly explained the decision to hike by a greater-than-anticipated acceleration in inflation. 12-month inflation hit 7.4 % in September (up from 6.7 % in August), a level well above the CBR's 4 % inflation target. In September food was up 9.2 % (y-o-y), other goods (8.1 %) and services (4.2 %). Russian inflation has not been this high since February 2016.

The acceleration in inflation has been driven by the failure of supply to keep up with the stronger-than-anticipated rebound in domestic demand from the covid-19 crisis in 2020. At the same time, the unemployment rate is record low and growth in bank lending is strong. Surging global commodity prices continue to fuel inflation. Moreover, the inflation expectations of firms and households have risen to record levels. For example, in October household inflation expectations for the next 12 months were 13.6 %, a level not seen in five years.

The CBR also released its October forecast for the Russian economy in the years 2021 to 2024. The GDP growth forecast was unchanged from the previous July forecast, i.e. the CBR still expects annual GDP growth of 4–4.5 % in 2021 and 2–3 % p.a. in the following years. Due to the acceleration in inflation and elevated inflationary factors, the central bank now expects 12-month inflation to reach 7.4–7.9 % (up from 5.7–6.2 % in the July forecast) by the end of this year. The forecast sees inflation running at 4–4.5 % at the end of 2022 and thereafter remaining close to the CBR's inflation target of 4 %. The CBR forecasts the average of the key rate to be in the range of 7.3–8.3 % (6–7 % earlier) in 2022 and 5.5–6.5 % (5–6 %) in 2023. The neutral rate of interest for the Russia economy is currently estimated to be around 5–6 %, which would mean that, on average, the monetary stance would be somewhat contractionary next year.

The CBR again raised its key rate following rising inflation.



Sources: Macrobond, Central Bank of Russia, Rosstat and BOFIT.

With covid cases soaring, Russia implements short partial lockdowns on several parts of the economy.

Following a cabinet recommendation, president Vladimir Putin last week decreed paid leave days from October 30 to November 7. Large part of firms and the public sector offices would have been closed in any case due to the holidays in November 4–7. The decree empowers the leaders of administrative regions to impose restrictions also before and after the decreed period depending on the covid and healthcare situation. The decree does not delineate branches, but requires the government and regional governments to define the working of healthcare and cultural branches and public organisations to maintain sufficient staffing to operate effectively. Under the president's newest guidance, restaurants and bars must be closed between 11 pm and 6 am. 30 % of unvaccinated workers and all unvaccinated workers over 60 will be shifted to remote work almost until the end of February.

The City of Moscow and the Moscow region imposed partial restrictions from October 28 to November 7, and St. Petersburg from October 30 to November 7. The lockdown covers shops except pharmacies and other firms where at least 30 % of sales consist of necessities, restaurants and cafes, excluding take-away or e.g. services for persons staying in hotels and other accommodation, as well as firms in various services branches. Banks are not listed for closure. Public services will not be offered at their usual operating sites, but remotely. Naturally, this will not apply to nursing care, and neither to certain cultural branches. Schools are closed. Restrictions in at least six other administrative regions have already been in place since October 25.

The restrictions are expected to reduce the rise of Russian GDP for all of 2021 by a couple of tenths of a percentage point. On the other hand, the government will again support small and medium-sized enterprises (SMEs) in the hardest-hit branches to compensate for part of their losses caused by these restrictions and the current introduction of covid passes. Assistance for SMEs was also noted in the president's decree. The government has approved a one-time support for SMEs in these branches to the amount of one-month's minimum wage per employee. About 3 million people are estimated to be eligible for this assistance.

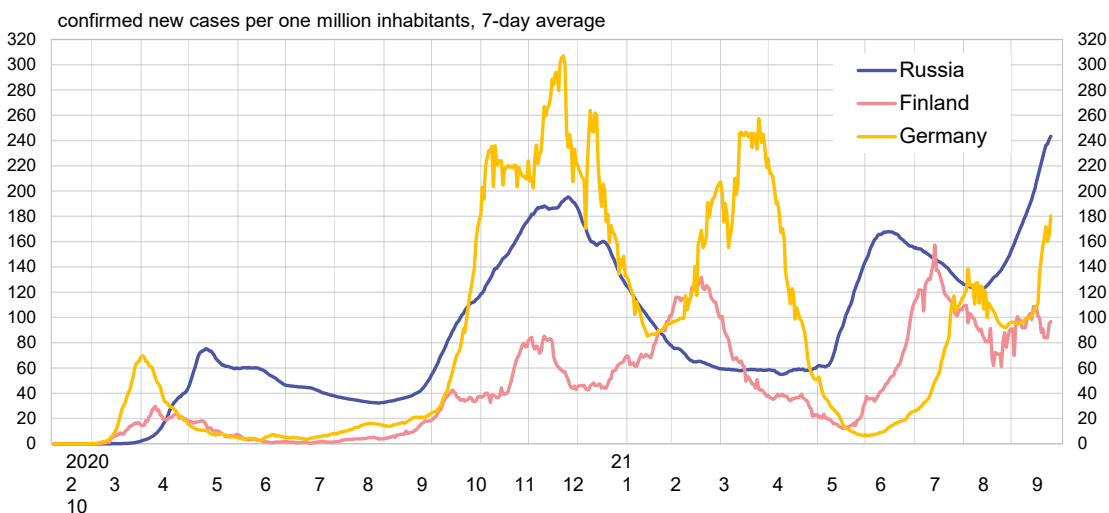
The cabinet is also preparing a support package with about 30 banks. It is based on a covid spring 2020 model, whereby companies in the hardest-hit branches are eligible for loans with state guarantees and interest subsidies at a 3 % interest rate on the condition that they retain at least 90 % of their workforce during the time of the loan (up to 18 months). For its part, the CBR recently decided on a credit package that provides banks with CBR loans at 4.5 % p.a. backed by guarantees from a specialised SME company on the condition that the banks then lend the funds on to SMEs in the affected branches at rates not in excess of 8.5 %. Certain regional governments are also planning covid supports e.g. in the form of tax reliefs.

Covid has risen in Russia. The number of confirmed cases has increased rapidly since mid-September, climbing to current peak levels (about 36,000–37,000 cases a day during the last seven days). The number of hospitalised covid patients has doubled since June to about 260,000. The number of beds available to them has also been increased with almost the same pace, mainly by repurposing beds. About 10 % of covid beds in hospitals are available. The daily number of covid deaths has also soared in recent weeks.

Only about a third of the Russian population has had two jabs of covid vaccine. About 36 % have had at least one jab. After dropping off during the latter part of the summer, the pace of vaccination picked up considerably this month. The president this week tasked the cabinet with preparing a recommendation that employers give employees two paid free days for their covid vaccinations.

Russian vaccine exports have shot up this year. For the first five months of this year, vaccine exports were valued at over \$300 million, up from an average of \$60 million per year in 2018–2020. Booked orders are currently reported for about 700 million doses, with the biggest orders from India, Palestine and countries in South America. Russia has also licenced the manufacture of over three billion doses of its vaccines to production facilities, especially in South Korea and India, and also China.

The number of covid infections in Russia has soared in recent months to peak levels.



Sources: Our World in Data and BOFIT.



Russia's development plans are complemented with strategic initiatives. Russia's long-term economic policy is based on the *National Goals for 2030* announced by president Putin in July 2020. The five umbrella themes of the 2030 national goals are a) preservation of the population, the health and welfare of the people; b) conditions for self-fulfilment and the unlocking of talent; c) comfortable and safe environment; d) decent and effective jobs, and successful enterprise; and e) digital transformation.

Currently, there are 15 national projects to support the national goals. Implementation of these national projects will annually cost 4–5 trillion rubles (3–4 % of GDP) during 2021–2024. About two-thirds of the money would be financed out of the federal budget. The most budget funds would go to road construction and other infrastructure projects, as well as the national demographic and healthcare projects (with most of that money going to fund the *maternity capital allowance* paid to parents of newborns, as well as for treatment and prevention of cancer and cardiovascular disease).

The newest additions to the family of 2030 plans are the *42 strategic initiatives* approved by the Russian government at the beginning of October that complement and support realisation of the national projects. The initiatives, which are quite heterogeneous, concern the social sector, construction, ecology, digitalisation and technological advancement. They place greater emphasis on issues related to climate change, but also call for such measures as developing new hydrocarbon deposits, substituting foreign production technology for liquefied natural gas (LNG) and other hydrocarbon extraction with domestic production technology, as well as increase the cargo tonnage shipped via the Northeast Passage. The projects also include such themes as self-driving vehicles and digitalisation of public services.

The government estimates that the financing needs for the strategic initiatives total 4.6 trillion rubles during 2022–2024. According to the finance ministry, the initiatives will receive about 1 trillion rubles in budget funding, of which about half is new funding.

Russia's economic development plans have increasingly stressed the role of the state-funded projects in recent years. From economic perspective, these projects may provide business opportunities for some firms, but their broader contribution to economic development may be limited. In Russia, government spending is typically inefficient and susceptible to abuse. Broad-based structural reforms have received less attention in Russia's economic development programmes, even if they are critical to improving the country's long-term growth prospects.

Commercial banks participating in CBR's digital ruble pilot trial. The Central Bank of Russia only began in earnest to plan the introduction of a digital currency last year, but the basic design of the digital ruble was already set forth in a [plan](#) released by the CBR last April. The digital ruble, which will be issued by the central bank, will serve the same function as cash, but will require households to access their digital rubles using applications provided by commercial banks.

Using their bank-issued app, customers would be able to make digital ruble transactions even offline. It is important to note that the customer's digital rubles in the proposed system are not liabilities of the commercial banks but the CBR. When the customer wants to transfer assets from her bank account to her digital wallet, the bank transfers the desired amount from the account to the wallet. The commercial bank then reports the transaction to the central bank, which then shifts on the liabilities side of its balance sheet the desired amount of digital rubles from the commercial bank's digital wallet to the private customer's wallet. The total amount of digital rubles remains unchanged. Payments with digital rubles could also be transferred via commercial-bank app, and the CBR would transfer then digital rubles between customer digital wallets.

In summer 2021, the CBR launched pilot testing of the digital ruble with twelve commercial banks. The pilot tests should establish that commercial bank apps integrate seamlessly and securely with the central bank's systems in transferring digital rubles between wallets. If successful, the pilot programme would be extended in January 2022 to other banks. No date has been set for the official introduction of digital rubles in regular use.

China

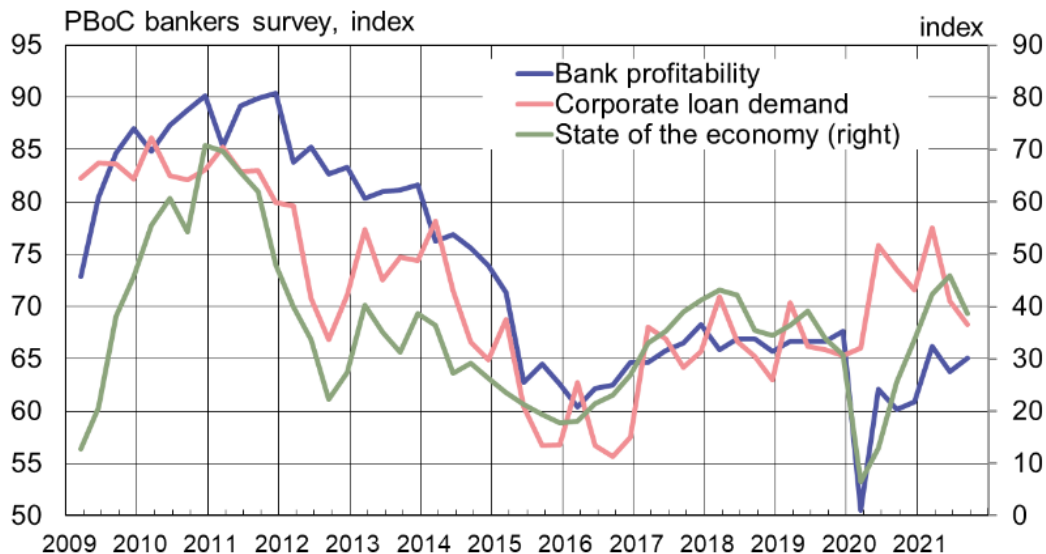
China publishes lists of systemically important banks. In mid-October, the People’s Bank of China and the China Banking and Insurance Regulatory Commission (CBIRC) released a list of China’s domestic systemically important banks (D-SIBs). The 19 banks on the list fall into four groups. These 19 banks face stricter rules with respect to e.g. public disclosure. The fourth, and most systemically critical, group is made up of China’s four giant state banks: Bank of China, China Construction Bank, Industrial and Commercial Bank of China and Agricultural Bank of China. The four state-owned behemoths are also classed as global systemically important banks (G-SIBs). The third group includes the state-owned Bank of Communications, China Merchants Bank and Industrial Bank. The first and second groups contain, among others, Postal Savings Bank of China, China CITIC Bank, China Everbright Bank, Bank of Beijing and Ping An Bank. Missing from the list are China’s policy banks: Agricultural Development Bank of China, Export-Import Bank of China and China Development Bank. The PBoC and CBIRC will update the D-SIB list every year.

Late last month, the PBoC, the finance ministry and CBIRC together issued new solvency regulations for Chinese G-SIBs. These banks are required to have a minimum total loss absorbing capacity (TLAC) of 16 % of risk-weighted assets by 2025 and 18 % by 2028. The timetable follows the recommendation for emerging economies from the Financial Stability Board, an international body that monitors the global financial system. In addition, the leverage ratios of these banks should rise to at least 6 % by 2025 and to 6.75 % by 2028.

The PBoC’s latest quarterly survey of commercial banks found that responding bankers generally felt economic conditions had weakened a bit in the third quarter. Corporate borrowing demand had also subsided from previous quarters. On average, banks had not seen much change in their own profitability in the third quarter. The pandemic and increase in payment defaults have affected small and mid-sized banks much more than big banks. All of the “Big Four” state-owned banks reported that their third-quarter profits were up by over 10 % y-o-y. They also said that their ratios of non-performing loans (NPLs) to the total credit stock was either unchanged or fell slightly from the second quarter. The actual amount of NPLs is generally thought to exceed the amounts reported by banks.

In order to bolster their balance sheets and reduce risk, Chinese officials have encouraged small and mid-sized banks to merge into larger entities. At the end of October, for example, Henan’s provincial bank, Zhongyuan Bank, announced plans to merge with three regional banks. One of those banks, Bank of Luoyang, is listed as a major creditor of troubled developer Evergrande. Zhongyuan Bank itself was created in 2014 through the merger of 13 small banks. After the planned merger, Henan province will be left with two city commercial banks. During the pandemic, other local banks in Shanxi, Sichuan and Liaoning provinces were also merged to create larger banks. Over 4,000 financial institutions classified as banks currently operate in China. Most are small regional operations.

Chinese banks saw a slight weakening of the economy in the third quarter, corporate borrowing demand decreased



Sources: People’s Bank of China and BOFIT.

More Chinese construction companies miss scheduled offshore debt payments. The problems of developer Evergrande have affected the access to financing of smaller construction companies. In October, several construction firms were unable to service their foreign debt obligations. With increased market uncertainty, real estate sales of builders are reportedly down sharply compared to last year, which has left many hurting. International ratings agencies have lowered builder credit ratings. Their share prices and the value of bonds have declined markedly.

Besides Evergrande, markets were stunned in October by a spate of offshore bond payment defaults. These included China Properties Group (\$226 million), Fantasia Holdings (\$206 million), Sinic Holdings (\$246 million) and Modern Land (\$250 million). Additionally, Xinyuan Real Estate Co. swapped \$205 million in maturing bonds for new bonds maturing in 2023. The value of bonds of other construction companies have also plummeted. Most notable among them is the Kaisa Group, which became the first Chinese construction company to default on its offshore bonds in 2015. Kaisa has a considerable amount of offshore debt. Today, trading of Kaisa's stocks was halted in Hong Kong stock exchange.

It is almost certain that some of the many firms that have bond payments coming due this year will fail at servicing their debts. The situation has deteriorated rapidly as issuing new bonds abroad has become significantly harder for Chinese firms. Foreign investors are worried by the fact that Chinese firms may prioritise their domestic bond payments and other debt commitments over the servicing of their offshore debts. As construction firms have considerably less international borrowing than domestic borrowing, their prime directive is maintaining creditworthiness in mainland China's market.

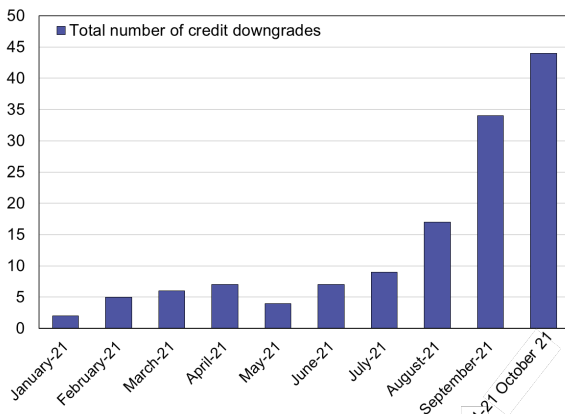
In October, Evergrande avoided an official declaration of payment default by paying a total of \$130 million in belated coupon payments on its foreign bonds within the 30-day grace period. The company's financial condition apparently has not improved. In October, Evergrande missed payment of another \$380 million of coupons. The first 30-day grace period ends on November 11. In November and December, the company must pay \$340 million in coupon payments of its foreign bonds and the foreign bonds of its subsidiaries. Evergrande owes a total offshore debt of \$19 billion, and a failure to pay by the deadline could trigger cross-defaults on all of these. The foreign debt is still a minor issue given the company's total debt of about \$300 billion.

The total offshore payment defaults of Chinese firms this year has already reached a record of about \$9 billion. Bloomberg reports that builders are responsible for about a third of defaults. Still, the value of defaults of construction companies is relatively small compared to their offshore bond issues (\$207 billion). The CRIC real estate research company reports 39 domestic defaults by Chinese construction companies in the first nine months of this year, a 160 % increase from the same period in 2020 (47 billion yuan, \$7 billion).

At a meeting with construction companies in late October, representatives of the National Development and Reform Commission (NDRC) and the State Administration of Foreign Exchange (SAFE) ordered the firms to submit reports on the foreign debt situation and provide a timely heads-up of possible troubles ahead. The PBoC commented on the struggles of construction firms for the first time in October, saying that the sector's risks are controllable and the situation of most construction companies is stable. Nevertheless, the PBoC exhorted developers to "actively" settle their outstanding foreign debt obligations. Central bank governor Yi Gang said that officials are working to contain the spread of Evergrande's problems. According to the PBoC, Evergrande's debts are not overly concentrated in a particular financial institution. No official measures to ease the debt situation of construction firms generally have been announced.

Indeed, most Chinese construction firms are not in as bad shape as Evergrande. Overall financial health of China's larger builders seems to have improved since last year, and fewer firms currently overstep any of the "three red lines" laid down last year by Chinese officials ([BOFIT Weekly 06/2021](#)).

Fitch, Moody's and S&P have all been bust lowering the credit ratings of Chinese construction companies



Sources: Bloomberg compilation based on figures from Fitch, Moody's and S&P; BOFIT.



China's property taxation experiments continue. At the end of October, the Standing Committee of the National People's Congress announced that it had authorised the government to prepare a framework for testing new property taxation models. Implementation of the taxation experiments would be left to the provinces themselves. The experiments include all forms of real estate except rural residential housing and cover also the land rights that go with real property. The five-year experiment is seen to have a wider scope than previous experiments. However, specific details on where the experiments will take place, the size of the taxes imposed and the mechanisms for setting the taxes are to be announced later.

China already applies a number of real estate related taxes. For example, commercial properties have been taxed since 1986. Although taxation of residential housing has been under discussion, apartment owners have long been exempted. Two property taxation models have been tested in Shanghai and Chongqing since 2011 ([BOFIT Weekly 5/2011, archived](#)). The goal of those experiments was to reduce speculation in the local real estate market and rein in soaring apartment prices. Both experiments, however, were quite limited, and the amounts of tax revenue raised as well as the impacts on real estate price trends were marginal.

The new initiatives also seek to discourage speculation and create of a new stable revenue streams for local governments. A large part of local tax revenue currently comes via transfers from the central government or from sale of land use rights. Some observers see that the new tax model will make it possible to eliminate other property-related taxes and thereby simplify the tax code.

China's reluctance about adoption taxes on residential real estate usually boils down to fears of reduced demand for apartment and falling apartment prices. In addition, policymakers are believed to commonly have extensive property holdings and an interest in resisting change. At its current stage, there are concerns the tax experiments could exacerbate the problems of the real estate sector if the current downturn continues. Announcement of a taxation experiment where the details are to be revealed later also fuels uncertainty in the real estate market.



Russia

Topics at BOFIT 30th Anniversary Conference include central bank digital currencies and the impacts of sanctions on foreign trade. Last Tuesday (Nov. 9), the Bank of Finland Institute for Emerging Economies (BOFIT) held its 30th Anniversary Conference in Helsinki and virtually. BOFIT was created on September 1, 1991 to study economic developments in former Soviet countries, particularly the Baltics and Russia. The presentations at the conference are posted [here](#). The entire conference can be viewed on the [Bank of Finland YouTube channel](#).

The conference [program](#) consisted of three parts, each with its own theme. The panel discussion, which included Bank of Finland governor Olli Rehn, Central Bank of Russia governor Elvira Nabiullina, People's Bank of China governor Yi Gang and European Central Bank executive board member Fabio Panetta, brought insights into central bank digital currency projects. Central banks have a variety of plans, but it was clear that the main function of digital cash will be as a substitute for physical cash as means of payment. It also was quite clear that China is well along in the trial phases for the digital renminbi.

The conference keynote speaker was Erik Berglöf, chief economist at the Asian Infrastructure Investment Bank. He spoke about trends in global value chains in emerging economies and the challenges of decarbonisation. He noted that there are still many untapped opportunities e.g. in improving transportation infrastructure.

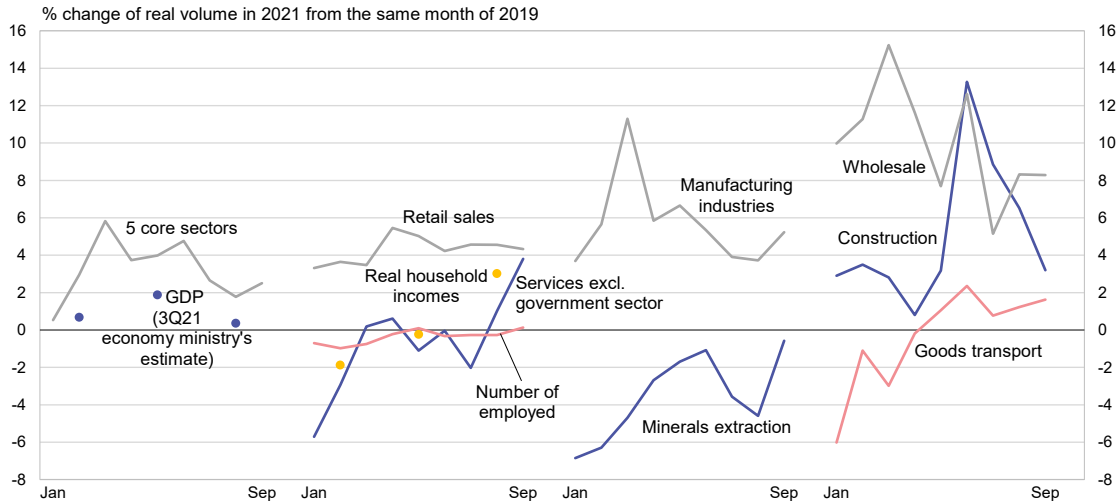
The third session kicked off with a presentation by Gabriel Felbermayr of the Austrian Institute of Economic Research (WIFO) on his quantitative study of the impacts of sanctions on international trade. His findings showed that strong economic sanctions significantly depress international trade and that it takes a while after sanctions are lifted before trade returns to normal. Zuzana Fungáčová (BOFIT) shared her research on the impact of Russia's presidential elections on bank lending behaviour and bank licence cancellation. Banks in Russia, including private banks, often increase their lending ahead of presidential elections. A similar phenomenon is seen in other countries, but is limited to state-owned banks seeking to influence election outcomes. In addition, the frequency of banking licence cancellations tends to drop around major elections in Russia.

Russia's economic growth has continued, though slowing a bit. While the on-year September increases in most sectors of the Russian economy were notably high, the economic development ministry notes that GDP in September was only up by 0.7 % from twenty-four months previous. The third-quarter GDP gain was less than 0.5 % from two years ago.

Some key parts of the economy have grown rather briskly from the time preceding last year's recession. The volume of retail sales during all months of this year considerably exceeded the levels of 2019. For third quarter, the volume of retail sales was markedly larger than in the small dip year ago. The seasonally adjusted volume of retail sales continued to rise, albeit rather slowly. Real disposable household incomes recovered in the third quarter, up 3 % from two years previous. Sales of services have also recovered.

The output of mineral extraction industries has revived. In September, it was down by just a half percent from two years previous, mainly due to the gradual increase in crude oil output towards levels preceding the OPEC+ agreement whose production ceilings continue rising. In recent months, manufacturing output, which had already exited its slump a year ago, is now substantially higher than it was two years ago. The volume of seasonally-adjusted manufacturing output, however, shows weak growth since early summer.

Output in most sectors of the Russian economy has grown from levels that preceded last year's recession

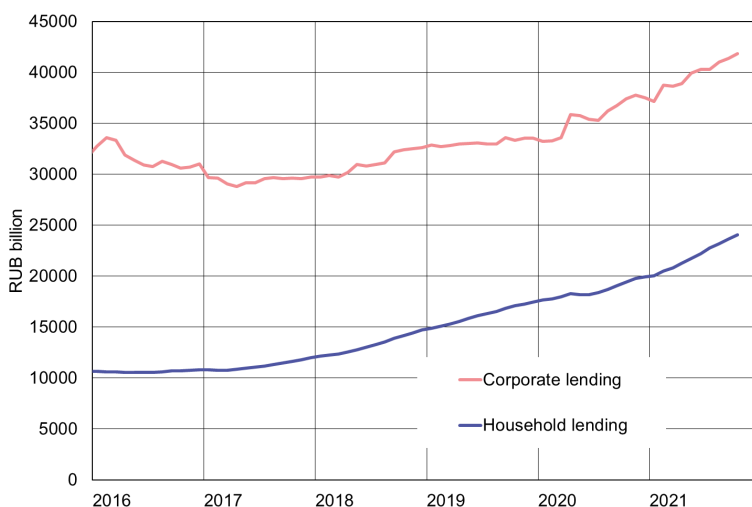


Sources: Rosstat and BOFIT.

Russian bank lending remains strong. The stock of bank corporate lending, which increased by about 10 % last year, has seen robust growth for all of this year. Helped especially by high growth in borrowing for oil & gas sector infrastructure projects, the credit stock grew briskly in September. As of end-September, the stock of corporate loans was up by 11 % y-o-y. About half of corporate loans have maturities over three years. Slightly over a fifth of corporate loans in recent year have had maturities of less than a year, but during the pandemic the short-term credit component of the credit stock climbed to over 25 %.

The pace of bank lending to households has picked up considerably this year, particularly due to strong growth in consumer credit. Despite a tightening of capital requirements for consumer loans in July, the growth in the credit stock has shown few signs of abating. The stock of consumer credit was up by 21 % y-o-y. Demand for housing loans has also remained strong this year, even if the interest subsidies for new apartment buyers were reduced slightly in June. The share of non-performing loans in the total credit stock also declined slightly in the first nine months of this year. Most households have fixed-rate loans, so changes in interest rates have little impact on their borrowing costs.

Growth in bank lending to households has been strong in recent years



Sources: Central Bank of Russia and BOFIT.

Russia launches action plan until 2025 under its programme of population policy. The plan is the final phase of the population policy guideline approved by president Vladimir Putin in 2007. In this stage, measures are directed both at the population as a whole and especially to families with young children and the elderly. As earlier, the action plan's wide areas focus on e.g. improved monitoring of health by the healthcare system, development of health monitoring at workplaces, as well as improved healthcare, particularly with respect to prevention and treatment of cardiovascular diseases.

Targets for social assistance to families with young children arise most concretely in the plan. The goal is to increase the number of families that receive support upon the birth of a child from the current slightly under 2.5 million families. This will happen mainly by increasing the number of mothers receiving the one-time maternity payment (maternity capital) from the current pool of slightly over one million. Another objective is to spread streamlined child-support application processes and automatic eligibility to cover 60 % of families with young children.

The programme seeks to lower child mortality to 4.5 deaths per thousand live births by 2024. The plan also calls for development of quality standards for pre-school day-care facilities. Families with three or more children would be granted parcels of land with technical infrastructure already in place. Another objective is to reduce the number of collection cases currently clogging in the judicial system that are the result of individuals not paying mandatory child support.

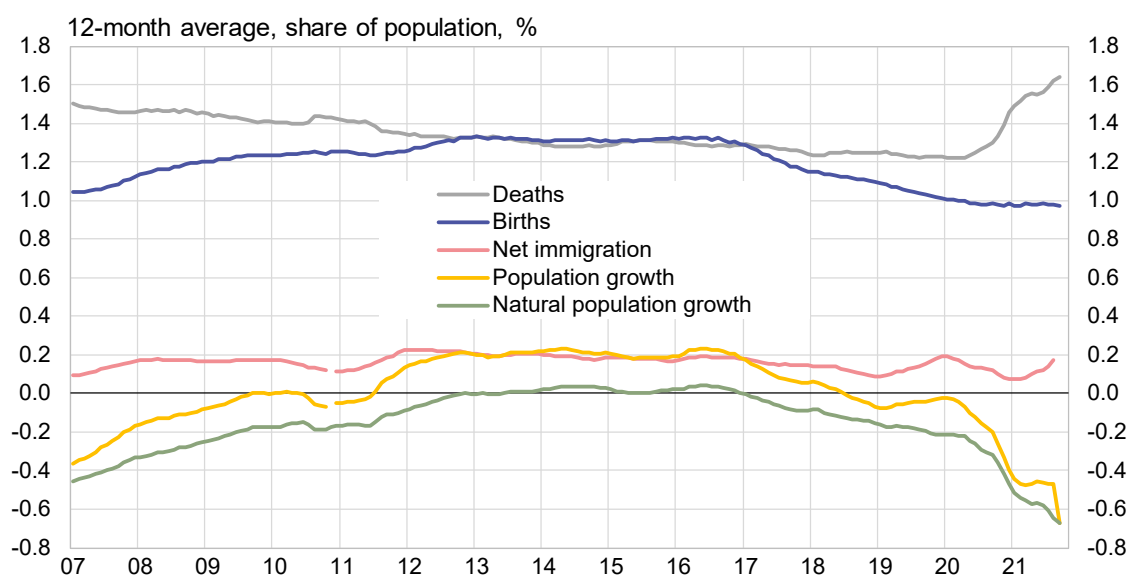
The plan calls for lowering the share of tobacco smokers to 26 % of the population by 2025 and to reduce per capita consumption of alcohol to 8.5 litres (in terms of 100 % alcohol) a year by 2025.

Russia's population turned to slide already before the covid pandemic in 2019. Natural population growth had been positive from 2013 to 2016, but since 2017 has been negative. The number of births and their share of the population has fallen almost continuously since 2017. Russia's fertility rate also began to decline in 2017 (comprises women of child-bearing age, defined in the statistics as women between the ages of 15 and 49). The number of deaths, which had been on a downward trend for years, naturally rose with the ravages of the covid pandemic.

A net inflow of people through immigration has helped fully or partly offset Russia's population decline. However, in 2020, the first year of the global pandemic, the number of migrants to Russia fell and has remained low this year. The number of people emigrating from Russia rose further in 2020 while it has since levelled off.

The base scenario of Russia's population forecast prepared in late winter of 2020 sees the population declining from about 146 million at present to 143 million in 2036. The low scenario sees the population falling to 134 million in 2036. The number of births is expected to start climbing again around 2030. The differences in the forecast scenarios are also due to differences in assumptions about net immigration.

Russia's population has been in decline in recent years.



Sources: Rosstat and BOFIT.

China

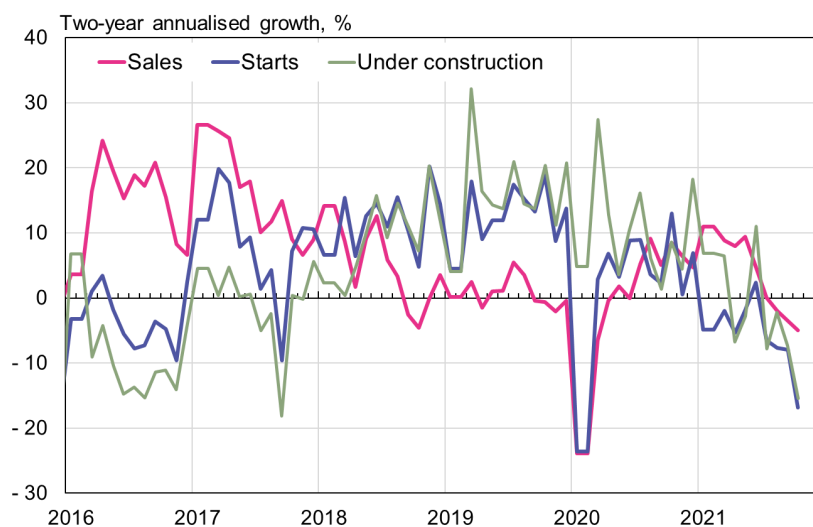
Sluggish economic growth continued in October; construction activity in China declines. Retail sales grew in real terms by 1.9 % y-o-y in October. China's rigorous efforts to suppress the spread of covid-19 hurt consumer demand. Car sales, which accounted for 8 % of all retail sales, declined by 12 % y-o-y in October. When car sales are excluded, October retail sales would have been almost two percentage points higher. In the first half of this year, on-year growth in retail sales was high mainly due to the low reference basis of last year. In August-October period, however, real growth averaged less than 2 % y-o-y.

On-year growth in *industrial output* slowed sharply in September to around 3 % before recovering slightly to 3.5 % in October. Electricity shortages and blackouts ([BOFIT Weekly 40/2021](#)) appear to have eased over the past weeks as China's National Development and Reform Commission (NDRC) launched a range of measures to quell the rise in coal prices and increase coal production and electricity supply. A cold winter could again exacerbate coal shortages. This week, an NDRC representative offered assurances that coal supplies would be sufficient to make it to spring, but warned that natural gas shortages could still lie ahead. Continued robust export growth is supporting manufacturing output (in dollar terms, the value of exports increased by 27 % y-o-y in October and 32 % y-o-y for the January-October period).

The contraction in *construction activity* continued in October as the financing problems facing developers have intensified. The volume of new construction starts fell sharply. Measured in terms of floorspace, the volume of real estate sales in October declined by 22 % y-o-y. The two-year annualised sales volume fell by 5 %. In addition, the value of sales contracted by 2 % in two-year annualised basis. The National Bureau of Statistics reports that apartment prices in large cities have declined somewhat since summer. Even so, they were slightly higher on average than in October 2020.

As in many other countries, inflation in China has accelerated driven by spiking energy prices. October *producer prices* rose by 13.5 % y-o-y (10.7 % in September). The rise was most brisk in mineral extraction industries and raw material production. Consumer price inflation in October was 1.5 % y-o-y (up from 0.7 % in September) and core inflation, which excludes food and energy prices, was 1.3 % (1.2 % in September). Chinese producer prices typically do not significantly bleed over into consumer prices, so consumer price inflation is expected to remain below this year's official ceiling of 3 % p.a.

Measured in terms of floorspace, building sales, starts and buildings under construction are all decreasing



Sources: China National Bureau of Statistics, CEIC and BOFIT.

Plenary session of Central Committee fortifies Xi Jinping's position as party leader. The 6th plenary session of the 19th Central Committee of the Communist Party of China (CPC) met last week in Beijing. A total of 348 committee members and alternate members were present. The session was devoted on deciding on resolution which contains a retrospective of party historical experience and major CPC achievements. The achievements of current leader Xi Jinping were elevated to the same high status as those of Mao Zedong and Deng Xiaoping. The final resolution stated that, among other things, Xi has succeeded in resolving tough long-standing issues where others have failed. The achievements of Jiang



Zemin and Hu Jintao received scarce mention. While outright failures of the CPC and its leaders were not mentioned, the CPC's overcoming of hardships was a repeated theme.

Similar resolutions have only been adopted twice in the CPC's history. In 1945, Mao cemented his place in leadership as China's civil war raged on after the war with Japan. In a similar fashion, Deng used historical analysis to boost his own position in 1981 and push through major economic and social reforms. The new resolution claims it was necessary to review party history because the country has embarked on a new journey to build a modern socialist state in all respects and because political unity is essential. The need to increase fighting strength and prepare for possible future challenges were also seen. From a practical standpoint, the resolution is seen as bolstering of Xi Jinping's position as party leader and paving the way for his continued leadership of the party and country, a role to be formalised at the party congress in autumn 2022.

China publishes guidance document on its climate goals, making joint plans also with the United States.

China released its climate policy framework in October. The "1+N" reference framework sets forth a path to the dual goals of a peak in carbon emissions by 2030 and carbon neutrality by 2060. The "1" in the reference framework stands for the "overall deployment" needed for hitting carbon targets. The "N" represents numerous "policy action plans and measures" in core industrial branches and sectors.

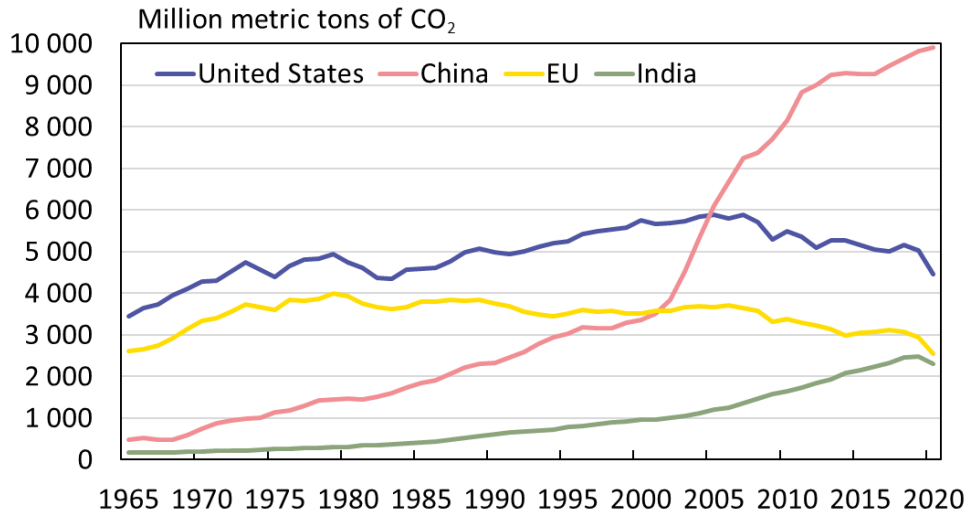
Overall deployment specifies goals and measures for both the current year and next five years, which are in line with the general five-year plan approved in spring 2021. Goals include reducing energy intensity, lowering greenhouse gas emissions and reforestation. The shift to green energy will be encouraged through changes in tax and price policies. The current five-year plan requires the setting of an initial framework for a green, low-carbon and circular economy by 2025 and greatly improve country's energy-efficiency. Public-private partnerships are emphasised in these measures, as well as international coordination (see [Working Guidance document here](#)).

China has also committed publicly to ending financing of coal-fired power plants outside of China. A [joint assessment](#) of CREA and the Global Energy Monitor found that two-thirds of planned coal-fired plants in Asia are dependent on Chinese financing. The power generation plans of Bangladesh and Sri Lanka would likely to be most impacted by China's decision to turn off the financing faucet.

During the Glasgow COP26 climate summit, China's special climate envoy Xie Zhenhua announced a joint effort by China and the United States to coordinate the two countries' climate efforts in this decade. Both parties saw reduction of methane emissions as a top priority and agreed on developing a detailed methane plan at their next meeting in the first half of 2022. The US announced its goal of 100 % carbon-pollution-free electricity by 2035 and that China would reduce its coal use gradually in the next five-year plan (2026–2030). The commitments laid out in the [US-China Joint Glasgow Declaration](#) have won broad praise. As with China's domestic climate goals, the actual impacts will depend entirely on later implementation of concrete measures.

US-China cooperation continued on Monday (Nov. 15), when presidents Biden and Xi met virtually for the first time (although the two have talked on the phone earlier). Both the Chinese and American official statements after the meeting implied that the talks were conducted in a constructive way, even if they also included touchy topics for China such as Xinjiang human rights abuses and tensions over Taiwan's future. The active dialogue represents a welcome change, as the trade war measures and countermeasures remain in full force. In early October, the US expressed its desire to continue trade negotiations ([BOFIT Weekly 40/2021](#)).

China was among a handful of countries that saw increased carbon dioxide emissions in 2020



Sources: BP Statistical Review of World Energy 2021 and BOFIT.



Russia

Russian government budget revenues and spending at high levels; deficit vanishes. Russia saw the pace of budget revenue growth accelerate further in the third quarter, i.e. a more than 40 % y-o-y nominal rise in revenues to the consolidated budget (covers federal, regional and municipal budgets, as well as state social fund budgets) and a 20 % rise from two years previous. Revenues were also up for January-September by nearly 20 % from two years previous.

The pace of spending growth accelerated in the third quarter. In January-September, the increase was 10 % y-o-y and 27 % from two years previous (an increase of about 14 % in real terms). The budget deficit evaporated similarly to the wakes of the previous two recessions (the wakes of 2010–2011 and 2017–2018). By September this year, the budget even showed a small surplus for the last twelve months.

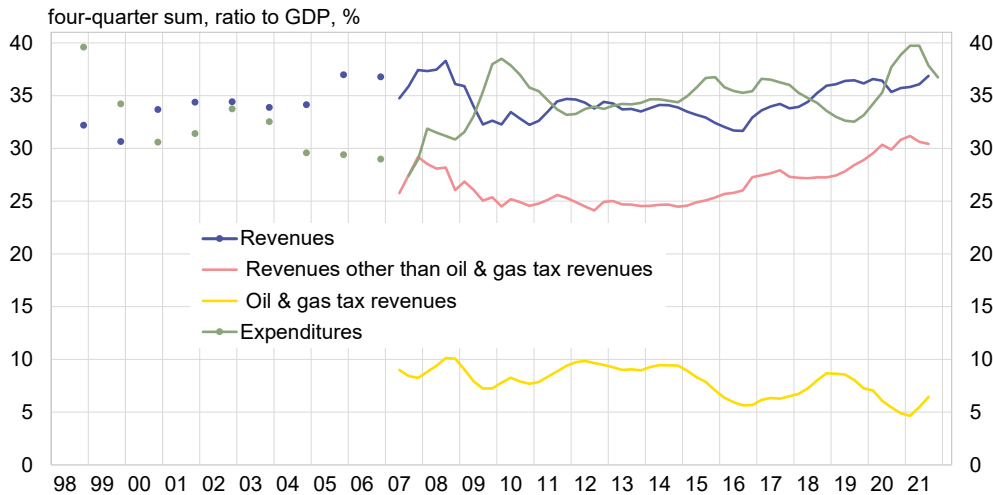
The ratio of budget revenues to GDP climbed in the third quarter to nearly 37 % for the last four quarters, a level last seen in 2008. The increase has been induced by gradual growth in revenues other than those from oil & gas taxes, a trend that extends back to 2015. Their GDP ratio is now over 30 % of GDP. In contrast, budget revenues from production taxes and export taxes on the oil & gas sectors have declined as a ratio to GDP since 2014, when oil prices last hit a record. Over the past four quarters, the ratio has been slightly over 6 %. The ratio of budget expenditures to GDP has fallen to below 37 % after hitting a record of nearly 40 % last year during the struggles with the pandemic and recession.

The rise in third-quarter revenues still reflected increased oil & gas tax revenues, which were up by nearly 50 % from two years previous. Other budget revenues, however, have also grown markedly from 2019. For January-September, the increase was over 20 % from two years previous, or 7–8 % in real terms. Value-added tax revenues continued to climb briskly. For January-September, VAT revenues were up by nearly 30 % from two years previous. Revenues from labour income taxes and social taxes from wages also showed rather good growth (up in January-September by 15–20 % from two years previous).

Revenues from corporate profit taxes soared in the third quarter, lifting their rise for January-September to nearly 25 % from two years previous. In addition, the Duma is currently considering increases on taxation of certain metals and mineral fertilisers. Under the changes, increased or modified production taxes are to be based mainly on sales prices. This approach to taxation naturally reduces firm profits which in these branches have long been considered excessive by many of Russia's top authorities during times of high prices.

Spending on social supports in the consolidated budget rose strongly in the third quarter, due partly to one-time payments e.g. to pensioners announced by president Vladimir Putin's almost on the eve of the Duma election in September. Growth in several other main spending categories slowed. For January-September, spending on various sectors of the economy has increased by over 20 % y-o-y (and by 50 % from two years previous). Spending on social supports has risen by 9 % y-o-y (up over 25 % from two years previous), and education spending has seen a 10 % y-o-y bump (17 % from two years previous). Spending on healthcare, defence and homeland security & law enforcement was largely unchanged in January-September from 2020. Still, healthcare spending in January-September was up by over 30 % from the same period in 2019.

Russia's consolidated government budget revenues and spending high relative to GDP



Sources: Russian Ministry of Finance, IMF, Rosstat and BOFIT.

Russia approves strategy for reducing greenhouse gas emissions. Issues related to climate change have recently gained prominence in Russia’s economic policy discussion. Much of the conversation has focused on the risks facing Russia from other countries taking measures to deal with climate change. Actual impacts of the climate change have received far less attention.

President Vladimir Putin announced in October that Russia would seek carbon neutrality by 2060. To support efforts to reach this target, Russia recently approved a low-carbon economic strategy extending through 2050. The purpose of the strategy is to secure Russia’s international competitiveness and robust economic growth in the midst of the global energy transition. The low-carbon strategy outlines a GDP growth of 3 % p.a. for Russia during 2031–2050 with greenhouse gas emissions falling at the same time. The target is ambitious given that most estimates see the long-term growth potential of Russian GDP closer to 1.5 % p.a.

Under the 2050 strategy, Russian greenhouse gas emissions would still rise slightly until 2030. By 2050, Russia’s net carbon emissions would be 60 % lower than in 2019. Much of the net reduction in carbon emissions would come from boosting the carbon uptake of Russia’s forests. Russia hopes to double the 2019 carbon-sequestering capacity of its forests by 2050. Figures from the UN’s Framework Convention on Climate Change (FCCC) suggest that Russia’s carbon-sequestering capacity has declined during the last decade.

The strategy sees actual carbon emissions reaching a level in 2050 that would be about 14 % lower than in 2019. The main components for reducing carbon emissions include increased reliance on nuclear, hydro and renewables such as wind and solar in electrical power generation, as well as application of advanced technologies at coal-burning power plants. Russia plans to electrify its transport grid and increase the energy efficiency of housing construction. Specific details on measures to reduce emissions would be released later.

EU’s planned carbon border adjustment mechanism could cause additional costs for Russian exporters. In July, the European Commission released a proposal on measures designed to bolster the more ambitious emission-reduction targets approved by the EU this year. One measure in the proposal is the *carbon border adjustment mechanism* (CBAM), whereby importers would be charged for the carbon emissions embodied or embedded in goods imports produced outside the EU. The main purpose of the CBAM is to prevent *carbon leakage*, i.e. the shifting of carbon-intensive production from countries with stringent emission restrictions to countries with lax policies or enforcement. Carbon leakage is currently dealt with through the allocation of free carbon allowances to European producers, but these allowances would be gradually phased out during the implementation of the CBAM. Under the European Commission’s proposal, the CBAM would cover certain cement, fertiliser, steel and aluminium products, as well as electricity imports. CBAM charges would be based on the price of carbon allowances in the EU’s emissions trading scheme (ETS). It would be based on the realized carbon emissions directly generated in the production of the imported goods. Where realized emissions data are unavailable, certain reference values would be used. The current plan is to launch the CBAM at the beginning of 2026.

A just-released [BOFIT Policy Brief](#) provides cost assessments of CBAM impacts on Russia and four other emerging economies. Although such calculations are subject to several uncertainties, the exercise shows Russia could incur costs of

roughly 2 billion euros a year with a carbon price of 60 euros a ton (the average price level in the ETS in recent months). This would correspond to 1.5 % of the value of total EU goods imports from Russia in 2019. The projected costs are for 2035 when free allowances would cease to be provided to European producers. Costs in the initial phase of the CBAM rollout would be significantly lower than in latter phases as EU producers would still receive free allowances under the ETS.

Estimates of annual costs to five emerging economies under the EU's carbon border adjustment mechanism in 2035.

	Russia	Ukraine	Turkey	China	India
Cost, EUR million	2,142	849	686	402	217
Ratio to total EU goods imports from the country, %	1.5	4.0	1.0	0.1	0.6

Note: The estimate is based on 2019 import volumes and a price of 60 euros per ton in the ETS carbon emission allowance.

It reflects the situation in 2035, when free ETS allowances will no longer be provided to EU producers.

Source: BOFIT Policy Brief 10/2021.

After a long pause, Ukraine receives new loan tranche from the IMF. On Monday (Oct. 22), the executive board of the International Monetary Fund granted Ukraine a loan tranche of \$700 million under its Stand-By Arrangement (SBA) programme agreed last June ([BOFIT Weekly 2020/25](#)). The \$5 billion SBA was supposed to last until the end of 2021, but has now been extended to June 2022. Under the current SBA, Ukraine has borrowed of \$2.8 billion. Prior to the latest loan tranche, Ukraine owed the IMF a total of \$9.3 billion, or about 5 % of Ukraine's GDP. The country's public debt equals roughly 54 % of GDP.

The release of the latest tranche was conditioned on e.g. Ukraine's ability to ensure central bank independence and sustainable fiscal policies in a way that protects the position of society's most vulnerable groups. In October, the IMF predicted that Ukraine's GDP would grow by 3.5 % this year. Given that Ukraine's GDP contracted by 4 % last year due to the covid-19 pandemic, it is not expected to recover to its pre-pandemic GDP level until the early part of 2022. The IMF sees GDP growth of 3.6 % in 2022. According to the average of forecasts compiled by the Consensus Economics, Ukraine's GDP should grow by 3.4 % this year and 3.7 % next year.

The hryvnia has appreciated against the euro this year.



Sources: National Bank of Ukraine and BOFIT.

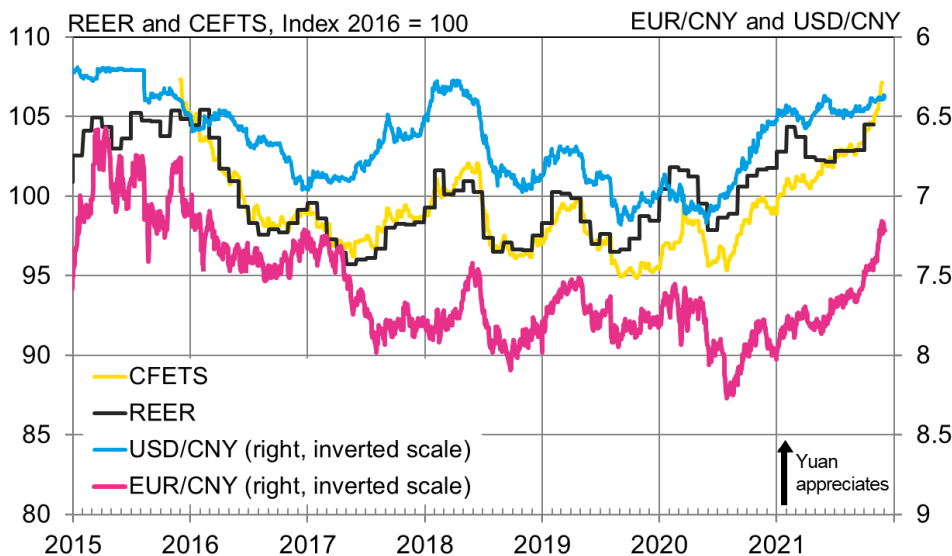
China

Yuan's exchange rate strengthens. The People's Bank of China started to use the China Foreign Exchange Trade System (CFETS) index to measure the external value of the yuan against a weighted currency basket of China's main trading partners in December 2015. In late November, the CFETS index hit its highest reading since 2015. Measured by the CEFTS index, the yuan has appreciated 8 % since the start of this year. The October figure for China's real effective (trade-weighted) exchange rate (REER) released by the Bank of International Settlements (BIS) last saw similar highs in February 2016.

The yuan has appreciated 2 % against the dollar since the start of this year. In the same period, the dollar has also gained against other currencies, so the appreciation of the yuan against the currencies of other trading partners has been stronger. For example, the yuan has strengthened 10 % against the euro since the start of the year. The yuan's exchange rate against the dollar has remained relatively stable. The exchange rate of the offshore yuan (CNH) traded in Hong Kong has closely tracked the mainland China yuan (CNY) the past years. On Friday (Dec. 3), the US dollar cost 6.4 yuan and the euro 7.2 yuan.

The Chinese economy's rapid rebound from the Covid Recession and burgeoning current account surplus have supported the yuan's exchange rate. The goods trade surplus has risen rapidly while the service trade deficit has contracted as Chinese tourism abroad has dwindled to near zero. In addition, deregulation of capital controls and the inclusion of mainland China shares and bonds in major international indices has swelled the flow of capital into China. The yields in China are currently higher than in many advanced economies. At the beginning of December, for example, the yield on China's 3-month government bond was 2.3 %. At the same time, the yield on a 3-month US treasury bill was 0.06 %.

Measured by the trade-weighted CFETS index, the yuan has climbed to levels not seen since 2015



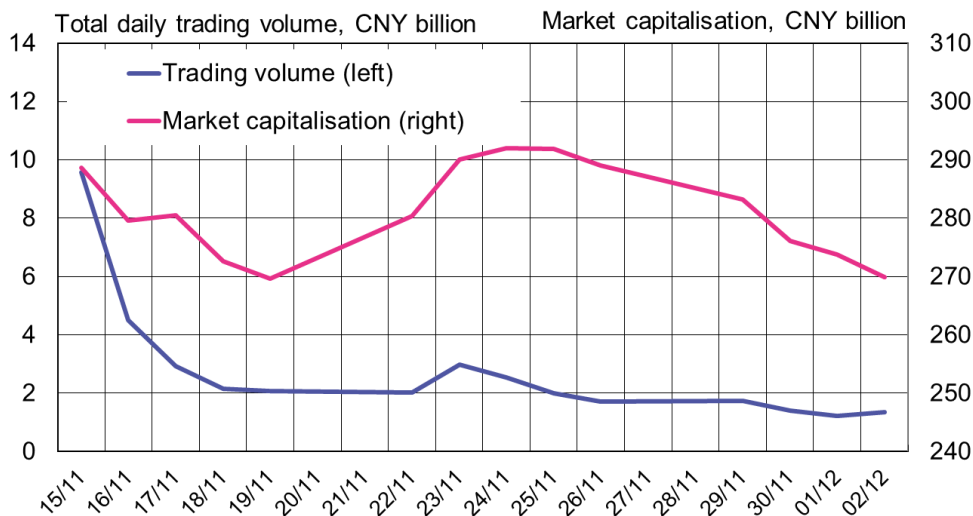
Sources: BIS, CFETS, Macrobond and BOFIT.

Trading on new Beijing Stock Exchange finishes third week. Trading on the Beijing Stock Exchange launched on November 15 with trading in shares of 81 firms. The new exchange's special mission is to help small, innovative growth firms meet their financing needs. Trading is restricted to professional and institutional investors. On the first day of trading, the total turnover was 9.6 billion yuan (1.5 billion US dollars) and the market capitalisation of traded firms was settled at around 290 billion yuan (46 billion US dollars). The Beijing exchange is still a small potato, however. The market capitalisation of the Shanghai Stock Exchange, for example, is more than 170 times greater than that of the Beijing Stock Exchange. Since its strong opening day, the daily turnover on the Beijing exchange has drifted downward and stabilised at around 2 billion yuan.

The opening day included ten new companies and 71 firms previously listed on China's over-the-counter exchange, the National Equities Exchange and Quotations or NEEQ ([BOFIT Weekly 36/2021](#)). The share prices of the newly listed firms soared on average by about 200 % on the first trading day. Even with mandatory 10-minute halts in trading, there is effectively no limit on how much prices can change on their IPO day. After the first day of trading, however, share prices are limited to daily fluctuations of no more than 30 %.

One firm has been added to the Beijing list since the first trading day. Firms must meet certain requirements prior to listing on the Beijing Stock Exchange. These include having been listed for the preceding twelve months on the NEEQ innovation list, a market cap of at least 200 million yuan (\$30 million) and net assets worth at least 50 million yuan (\$7.7 million). A firm must issue at least 1 million shares in its IPO, must have at least 200 shareholders, and a quarter of shares must be held by public investors. The minimum public ownership requirement for larger firms (share capital over 400 million yuan) is 10 %. Listing rules can also be modified with the consent of the China Securities Regulatory Commission (CSRC).

After a strong start, the daily total trading volume on the Beijing Stock Exchange has fallen to around 2 billion yuan.



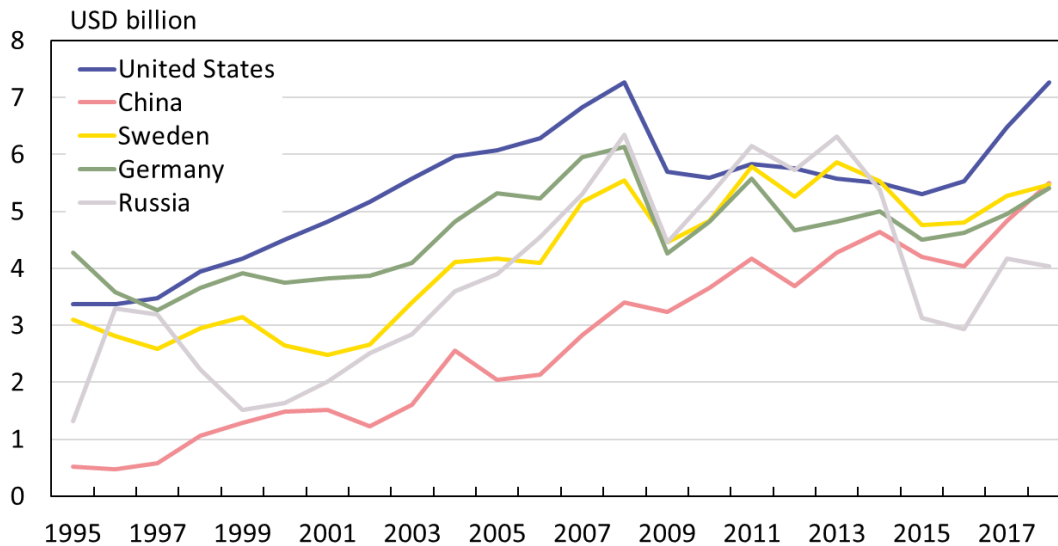
Sources: Beijing Stock Exchange, CEIC and BOFIT.

China nears euro area in terms of consumed foreign value added of goods and services. The OECD released its latest [Trade in Value Added](#) (TiVA) assessment in mid-November. The figures cover 66 economies and 45 unique industrial sectors between 1995 and 2018. China's final consumption of foreign value-added has risen rapidly in recent decades, and in 2018 was already 75 % of the foreign value added consumed by the United States and 90 % that of the euro area. Of the foreign value added China consumed in 2018, 12 % came from the United States, 8 % from Japan, 7 % from South Korea, 5 % from Germany and 5 % from Australia.

The consumption of Chinese value added abroad has risen briskly and OECD figures show that other countries now consume as much Chinese value added as American value added. The co-dependency of China and the US is highlighted by the fact that the largest consumer of Chinese value added is the US (24 % share in 2018). Japan was the second largest value added consumer with an 8 % share and other countries' shares were below 5 %. Correspondingly, China was the largest source of foreign value added for the US.

For Finland in 2018, the United States was the main consumer of Finnish exported value-added with share of over 10 %, while China was on par with Sweden and Germany, each with a roughly 8 % share. Russia was the fifth largest consumer of Finnish value added with nearly 6 % share. Despite China's sizeable and steadily growing percentage share of Finnish value added consumed abroad, Finnish value added consumed globally has increased modestly, especially since the 2008 global financial crisis. As a result, Finland's share of China's foreign value added consumption has shrunk to below 0.3 % in 2018. It was three times higher at the start of the millennium when China joined the WTO (for more, see [BOFIT's latest annual China Information Blast](#), presentation slides and video in Finnish).

The United States is the largest consumer of Finnish value added



Sources: OECD TIVA 2021 and BOFIT.

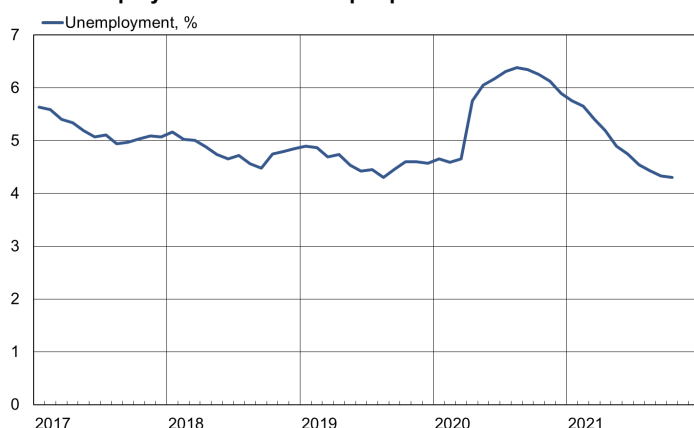
Russia

Russian economic growth remained brisk in October. According to Rosstat's preliminary estimates, GDP grew in the first nine months of the year by 4.6 % y-o-y. The economic development ministry reports that growth accelerated slightly in October, with GDP growth reaching 4.9 % y-o-y. Growth in industrial output largely supported economic growth in September and October. Industrial output grew by 7.1 % y-o-y in October and by 5 % for the January-October period. Growth in manufacturing output has slowed in recent months, while extractive industries have helped boost industrial output overall. October production of natural gas was up by 12 % y-o-y and coal by 11 %. The volume of oil production has also risen with the gradual lifting of production ceilings under the OPEC+ agreement.

One-time payments to pensioners and select groups disbursed in September ([BOFIT Weekly 35/2021](#)) helped boost retail sales in September and October. Even so, the pace of retail sales growth has gradually slowed. The volume of retail sales in October was up by 4.1 % y-o-y. The covid situation in Russia has rapidly degraded. The government declared a week of paid leave in early November that was coupled with restrictions on e.g. the hours that restaurants and bars could be open ([BOFIT Weekly 43/2021](#)). The restrictive measures have had only a marginal impact on economic trends, however.

The rapid economic recovery is reflected in wages and price trends. The unemployment rate fell in October to a historical low of 4.3 %. Nominal wages rose in January-September by 9 % y-o-y. Consumer price inflation has accelerated sharply in recent months. November consumer prices were up by 8.4 % y-o-y. Foodstuffs and construction materials experienced the steepest price rises.

Russian unemployment has fallen to pre-pandemic levels

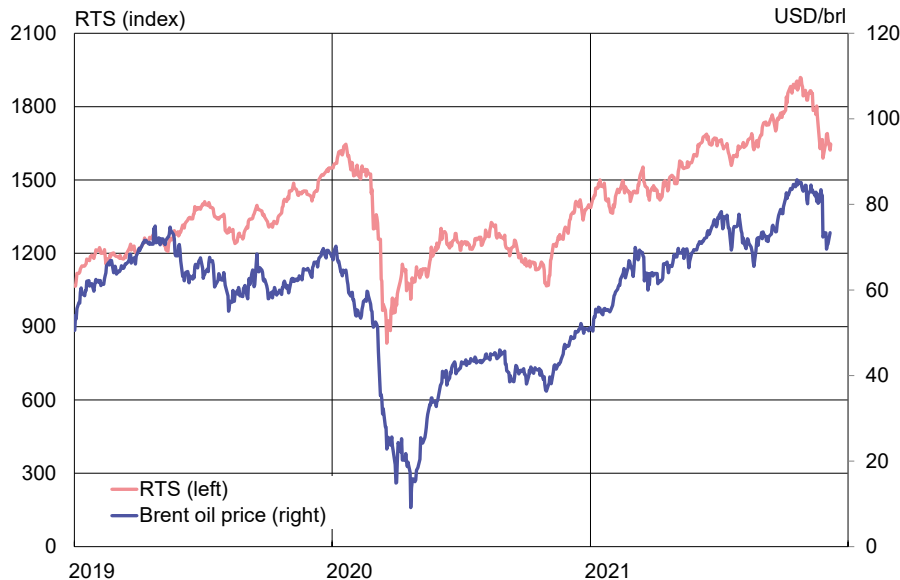


Sources: Rosstat, CEIC and BOFIT.

Moscow stock indices and oil prices still up for the year. The Moscow Exchange has been lifted this year by a strong updraft from rising oil prices. News of the omicron variant of COVID-19, however, panicked investors on November 26, triggering a plunge in international stock exchanges and depressing oil prices. On the day, the dollar-based RTS index of the Moscow bourse fell by 5 % and the Brent oil price by 12 %. The slide in the RTS index, however, had already begun on October 26, when the index hit its highest level since May 2011 and concerns over geopolitical tensions began to affect market sentiment. Despite recent drops in the Moscow exchange, share prices are still up by 14 % and Brent crude by 30 % from the start of the year.

The sharp gains in Russian exports and rising oil prices have pushed Russia's current account surplus to record levels. The current account surplus for the past four quarters corresponds to roughly 5 % of GDP. Russia's foreign currency reserves have also climbed to historic highs. Geopolitical tensions, on the other hand, have hurt confidence in the ruble. The ruble's exchange rate has now at the same level as at the start of the year against the dollar and is up by only 9 % against the euro. Capital continues to flow out of the country, particularly from the corporate sector. The net outbound flow of private-sector capital over the past four quarters corresponds to roughly 4 % of GDP. The need to purchase foreign currency within the framework of the government's fiscal rule has also restrained Ruble's appreciation.

The Moscow exchange and oil prices are still higher than at the start of this year



Sources: Macrobond and BOFIT.

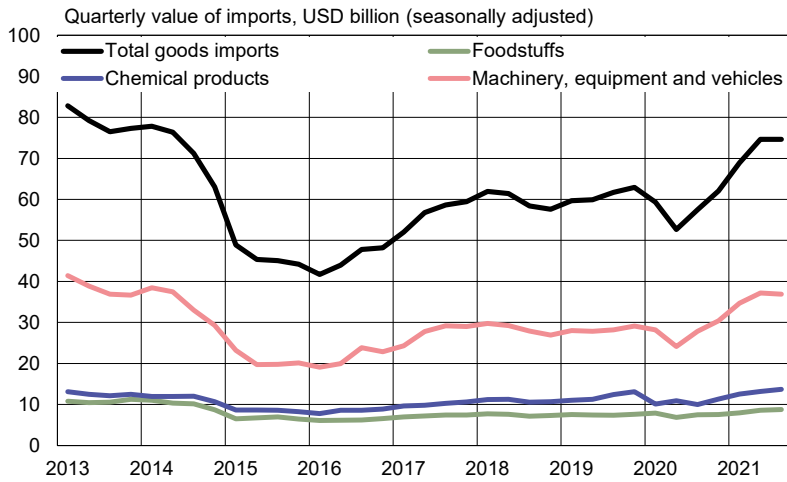
Russian goods export growth lost momentum in the third quarter; import growth flat. The value of Russian goods exports approached historic highs in the third quarter of this year. The value of total exports grew by 70 % y-o-y as demand for commodities and commodity prices soared on world markets. While the value of exports also grew on-quarter, growth slowed considerably in the third quarter.

The export volumes of crude oil, Russia's top export, continued to rise briskly in July-September, even if the volume of oil exports was still well below pre-pandemic levels. For the first nine months of the year, the oil export volume was down by 6 % y-o-y. Russian oil production continues to be constrained by the conditions of the OPEC+ agreement, even if production ceilings have been gradually lifted. The price of Urals crude continued to rise in the third quarter to an average of around \$70 a barrel. Pipeline gas exports are up sharply this year. Nearly the same amount of pipeline gas was exported in the third quarter as two years ago. The price of natural gas also rose substantially in the third quarter. Export volumes of liquefied natural gas (LNG) in contrast have declined slightly this year. Crude oil, petroleum products and natural gas combined have accounted for about half of Russian goods exports this year.

Growth in the value of Russian goods imports faded in the third quarter compared to the second quarter, but imports were still up by 30 % y-o-y. The slowdown in import growth was due largely to a pull-back in imports of machinery, equipment & vehicles (a category that accounts for about half of Russian goods imports). The rise in the value of imports of foodstuffs and chemical products in particular was still quite rapid in the third quarter from previous months partly due to higher import prices. Chemical products accounted for 18 % and foodstuffs 12 % of goods imports this year.

The value of Russian goods exports was \$340 billion for the first nine months of 2021. 38 % of Russian goods exports went to EU countries, 14 % to China, 9 % to countries in the Eurasian Economic Union (EAEU) and 4 % to the US. The value of goods imports was \$220 billion. The EU accounted for 33 % of Russia's imports, China 24 %, the EAEU 8 % and the US 6 %.

Growth in Russian goods imports hit a third-quarter plateau as imports of machinery, equipment & transport vehicles levelled off



Sources: CEIC, Russian customs and BOFIT.

China

China sets out priorities for 2022 economic policy. The Central Economic Work Conference convened in Beijing last week (Dec. 8–10) to decide economic policy priorities for next year. The main priority was set to be maintaining economic stability. All central government and local government officials were encouraged to actively implement measures that promote stability. The theme of stability has topped the economic agenda for few years now ([BOFIT Weekly 52/2020](#)). In addition, the work conference also decides the GDP growth target for 2022, although the official target will be approved and released later. It was announced, however, that the economic growth figures will be kept within an appropriate range.

The final statement from the working conference noted that domestic demand and expectations about future demand were deteriorating, and that the external environment is becoming increasingly complex and uncertain. The conference recommended measures to support the economy through tax breaks, increased support to small and medium-sized enterprises (SMEs), funding for innovation, “green development,” as well as a moderate boost in funding for infrastructure projects. They also called for healthy development of the real estate sector, improvements in the rental market, as well as increased construction of affordable housing. However, fiscal policy should be sustainable and local governments should not take on new off-budget (i.e. concealed) debt. Monetary policy should remain flexible and appropriate for the circumstances.

PBoC lowers bank reserve requirements, but no large relaxions in overall monetary stance. On Wednesday (Dec. 15), the People’s Bank of China lowered its reserve requirement ratios (RRRs) for commercial banks by a half percentage point. The change applies to all banks except those small banks that already enjoy the lowest RRR available (5 %). RRRs in China are based on bank size. The general RRR for large banks now stands at 11.5 %. The central bank can grant concessions on RRRs to banks that meet certain criteria in their lending structure. Most banks are currently entitled to a one-percentage-point reduction in their RRR. In addition, the PBoC makes bank-specific determinations of the appropriate RRR. The PBoC’s average weighted RRR for the banking sector now stands at 8.4 %.

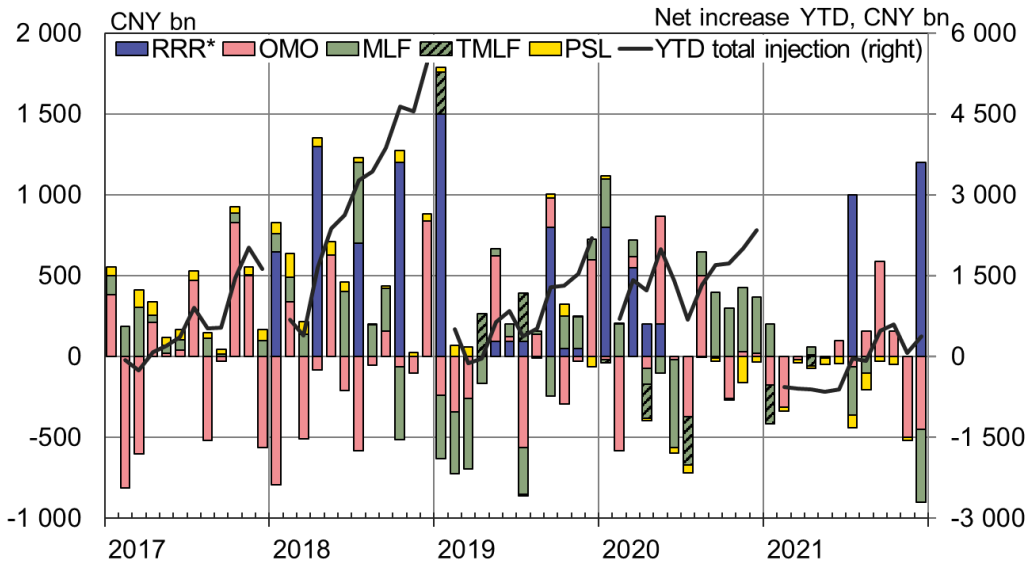
According to the PBoC, the cut in RRRs is intended to support the real economy and reduce financing costs. Despite these objectives, PBoC states it will not mean a shift in the monetary policy stance that will remain “sound”. The measure freed up 1.2 trillion yuan (\$190 billion) in bank liquidity. Much of the liquidity boost was immediately absorbed as 950 billion yuan in 1-year MLF loans granted by the central bank to commercial banks came due on the same day and 500 billion yuan in new MLF loans were issued.

Bank RRRs were last lowered in July, but other major aspects of Chinese monetary policy have remained untouched this year. In its operations, even with the easing of reserve requirements, PBoC has increased market liquidity far less than in recent years. This year up until December 15, the net liquidity impact from open market operations (OMO) has been negative and fewer MLF loans (and targeted TMLF loans for a specific purpose) were granted than matured.

China’s main reference rates have not been adjusted this year. The PBoC this month decided to keep unchanged its rate on MLF loans (2.95 % on a 1-year loan). The LPR rate, the reference rate for bank loans, is set relative to the MLF rate so there has been less pressure to change it this month (the LPR rate is set on the 20th of each month). The PBoC, however, decided this month to cut its relending rate for banks by 25 basis points (e.g. the 1-year rate fell to 2 %). The relending programmes are a more targeted instrument aimed at small and mid-sized banks to allow them to provide affordable loans for specific purposes such as lending to the SMEs. The banks can then apply for PBoC relending funds.

While the RRR for yuan deposits was reduced, the PBoC raised the RRR for forex bank deposits on December 15 from 7 % to 9 %. The move can take appreciation pressure off the yuan, but its impact is seen to be quite modest with respect to the banking sector and the forex market. Adjustment of the forex RRR was reintroduced this year and it was raised previously in June. The yuan’s has appreciated significantly this year ([BOFIT Weekly 48/2021](#)).

The net increase in market liquidity effected through various PBoC monetary policy measures is much more diminutive this year than in previous years



12/2021 as of Dec. 15 * Based on PBoC announcements (bank-specific changes not included)

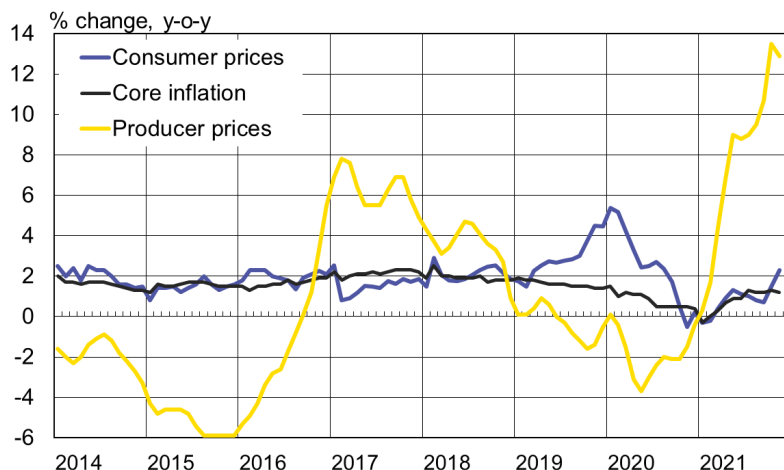
Sources: People's Bank of China, CEIC and BOFIT.

Chinese inflation accelerated and economic growth slowed in November. China's National Bureau of Statistics reports that November consumer prices were up by 2.3 % y-o-y. As recently as September, consumer price inflation was still below 1 %. The pickup in inflation is due to energy prices, which were up strongly this autumn, while the almost year-long deflation in food prices came to an end in November. Core inflation, which excludes energy and food prices, has remained stable at around 1 % y-o-y since last spring. Rising energy prices are also reflected in the sharp rise in producer prices in recent months. Even so, the increase in consumer prices is still well under the 3 % inflation ceiling set for 2021.

Energy prices are up in China. Fuel prices in particular have risen with global crude oil prices. Moreover, household utility prices jumped in October and stayed up in November. Looking at food prices, fresh vegetables climbed by over 30 % y-o-y in November. On the other hand, China's favourite meat, pork, is over 30 % cheaper than year ago as pork prices have normalised during this year from the major shock in pork production and prices caused by the African swine fever virus in 2019.

Inflation has accelerated at the same time as economic growth is waning all major monthly economic point downwards. On-year real growth in retail sales, slowed to 0.5 % in November, implying weakening domestic consumer demand. Industrial output growth remained below 4 %, which is well below pre-pandemic levels of 5–6 %. Nominal growth in fixed investment slowed slightly. To support economic growth, the PBoC slightly relaxed its monetary stance this month by reducing the reserve requirements for commercial banks.

The jump in core inflation has been driven by soaring energy prices



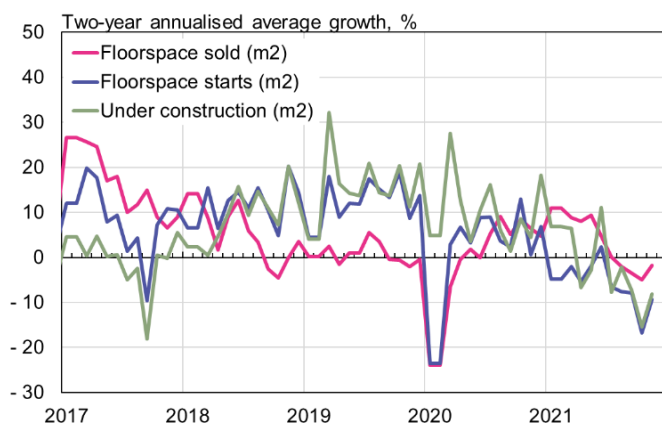
Sources: China National Bureau of Statistics, Macrobond and BOFIT.

The financing troubles of developers in China’s real estate sector continue. The massive Chinese real estate developer Evergrande continues to make international headlines after it defaulted at the start of this month on \$83 million in coupon payments on its foreign debt. The payments originally came due on November 6, but Evergrande was given a 30-day grace period to pay up. When the grace period expired, Fitch downgraded Evergrande and two of its subsidiaries to “restricted default.” The classification applies to firms that have yet to officially enter bankruptcy or restructuring processes, even with defaults on debt or interest. Evergrande has established a seven-member risk management committee comprised largely of persons with government ties. The arrangements are strongly connected e.g. to Guangdong’s local administration. After Evergrande’s default, PBoC governor Yi Gang announced that investors and creditors rights would be fully respected under the law in terms of payment priority. Nevertheless, the debt restructuring process is likely to be long and complicated.

This month a second large Chinese developer, Kaisa Group, failed in its attempt to get investors to agree to swapping \$380 million in maturing debt for bonds maturing at a future date. After investors rejected the deal and failed to receive their coupon payments on December 7, Fitch also downgraded Kaisa Group to restricted default.

The struggles of Chinese builders are seen widely across the real estate and construction sector. Since last summer, both construction activity and real estate sales have declined. The role of the real estate sector in the Chinese economy, the current turmoil and the possible impacts of a sectoral crisis on China’s national economy and the euro area are discussed in our latest [BOFIT Policy Brief](#). At worst, the impacts on employment and consumer demand could be massive, increasing uncertainty and social unrest. If China’s economic growth slows significantly and uncertainty spreads abroad, the impacts on growth in the euro area could be severe.

The downturn in China’s real estate sector can be seen in the figures for construction and sales volumes



Sources: NBS, CEIC and BOFIT.

Russia

Russian inflation rises to levels not seen for years. November consumer prices were up by 8 % y-o-y. Food prices, one of the biggest drivers of inflation, rose by 11 % y-o-y. Prices of non-food goods rose last month by 8 % y-o-y and prices of services by 5 %. The acceleration in inflation is a global phenomenon and largely reflects transitory supply issues. The rapid recovery in demand has also contributed to higher prices as production capacity in Russia is approaching its limits.

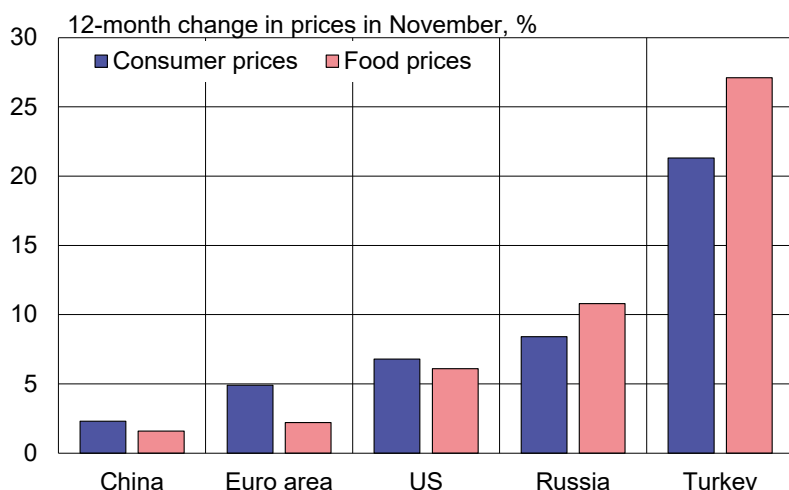
The spike in food prices appears mainly due to temporary factors. World prices for food and agricultural inputs such as fertilisers have soared. In Russia's case, the upward price pressure also reflects the poor performance of domestic agriculture. Farm production contracted in the third quarter by 6 % y-o-y due to poor weather and other factors. Russian food imports are restricted by the import restrictions Russian government imposed in 2014 on several Western countries.

Transitory effects have impacted prices of services and non-food goods. Bottlenecks in global production and logistical problems have been manifested in Russia as rapidly rising prices for e.g. materials used in construction, automobiles and electronics. Prices of travel services have risen rapidly this autumn with the lifting of travel restrictions and the imposition of "non-working days" between October 30 and November 7 to quell the spread of covid.

Inflation has also been boosted by the rapid return of domestic demand. The Russian economy recovered to pre-pandemic levels in the second quarter and there has since been little excess production capacity in the economy. Moreover, the unemployment rate is at a historically low level. There are labour shortages in certain branches and wages are rising rapidly. Higher inflation and ruble depreciation have lifted inflation expectations, which has caused many Russian consumers to accelerate their purchases of durable goods.

In addition to the Central Bank of Russia's efforts on the monetary front, the Russian government has invoked its own anti-inflation measures over the past 12 months e.g. by setting price ceilings on basic commodities (sugar, sunflower oil and fertilisers), export restrictions and export tariffs (e.g. grains, metals and raw timber), as well as paying subsidies to domestic producers (sugar and sunflower oil). In its recent analysis, the CBR warned about problems that could arise from the government's direct and indirect price controls. Over the longer term, such price controls may depress fixed investment and production as well as encourage expansion of the grey economy. According to the analysis, a better way of dealing with the social impacts from a transitory spike in inflation is to provide targeted support to low-income households.

As elsewhere this year, inflation has surged in Russia.



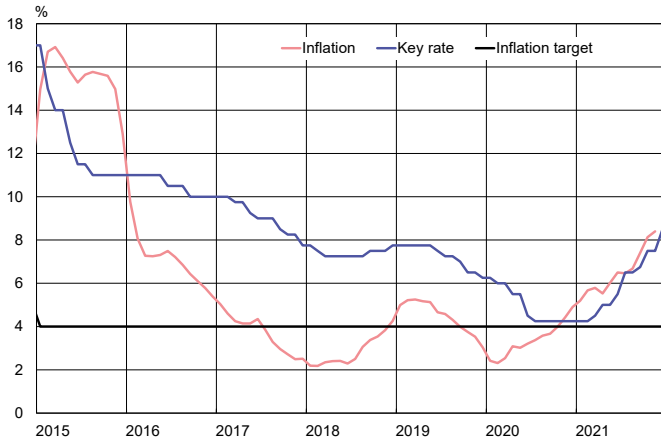
Sources: National statistical agencies, BOFIT.

Central Bank of Russia continued to tighten monetary policy. Last Friday (Dec. 17), the Central Bank of Russia (CBR) hiked its key rate by a full percentage point to deal with accelerating inflation. The new rate is 8.5 %. The CBR began to tighten its monetary policy last March and has since raised the key rate seven times. The key rate was last time this high in September 2017. In its forward guidance, the CBR did not rule out the possibility of further hike at its next meetings.

November inflation hit 8.4 % p.a., well above the CBR's 4 % inflation target. The acceleration in inflation is broad based and due to multiple factors, some of which are transitory. Inflation risks are still elevated, but the CBR expects inflation to slow to 4–4.5 % by the end of 2022.

The CBR also updated its forecast for the Russian economy, noting that it now expects the GDP growth of 4.5 % this year. In its October forecast, the CBR was expecting 2021 growth in the range of 4–4.5 %.

Central Bank of Russia continued to tighten monetary policy to counter rising inflation.



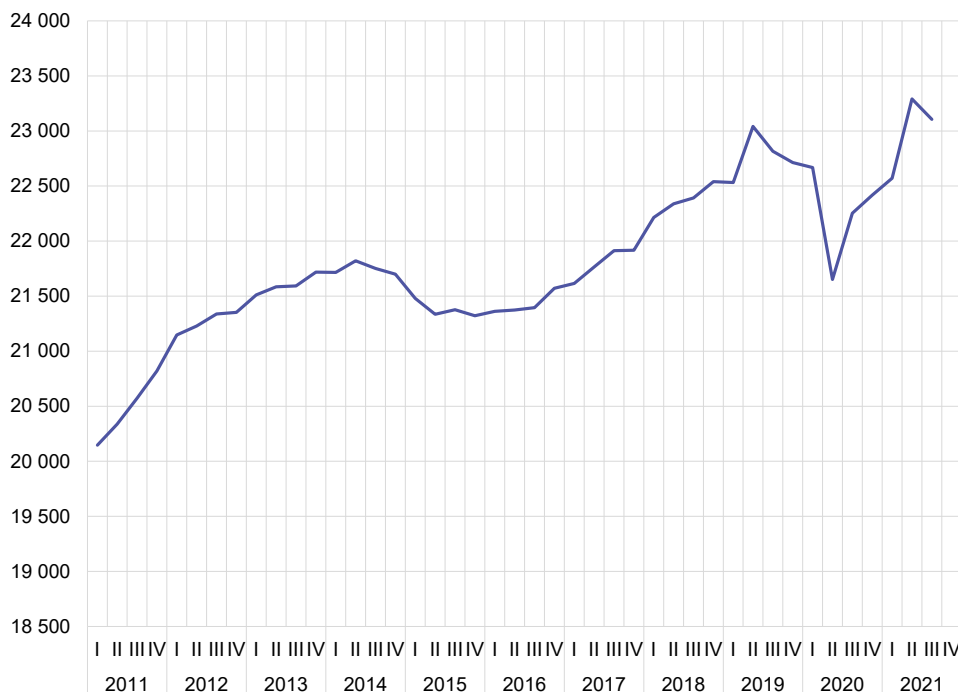
Sources: Macrobond, CBR, Rosstat and BOFIT.

Recovery in services boosts on-year GDP growth; seasonally adjusted GDP contracts from previous quarter. Russian third-quarter GDP was up by 4.3 % y-o-y and up by 0.6 % from two years previous. Russian GDP already exceeded the pre-pandemic level in the second quarter. In this sense, Russia has already recovered from the Covid Recession of 2020. The economic development ministry estimates that on-year GDP growth accelerated to 4.9 % in October ([BOFIT Weekly 49/2021](#)).

On-year third quarter growth in value added was highest in such branches as hotels and restaurants (up 16.7 %), minerals extraction (8.4 %) and transportation (7.1 %). Covid restrictions prevented consumption of many services in the second half of 2020, so the rapid growth in service branches this year is unsurprising. In addition, rising oil prices and decisions by the OPEC+ group of oil producing countries to raise crude oil production ceilings are reflected in a strong recovery in the mineral extraction sector ([BOFIT Weekly 29/2021](#)).

While Russian GDP grew on year, it contracted by 0.8 % q-o-q when seasonally adjusted. Production was down in several branches, including minerals extraction, manufacturing and retail sales. The rise of the corona virus and a new round of covid restrictions reduced economic growth. Demand for services also weakened as people voluntarily limited their movements.

Russian GDP has risen by about 12 % over the past decade, seasonally-adjusted GDP volume in 2016 prices, RUB billion



Sources: Rosstat and BOFIT.

Fixed investment in Russia has grown. Growth of the real volume of fixed investment, which accelerated in the second quarter, continued its fairly good rise in the third quarter. In second quarter, fixed investment was up by over 5 % from two years previous and third quarter by about 2.5 %. For the first three quarters of this year, total fixed investment was up by 4.3 % from two years previous, while investment of large and mid-sized firms as well as the state was up as a whole by 6.5 %.

In January-September, fixed investment of large and mid-sized mineral extraction firms, however, was down by over 4 % from two years previous. Indeed, capacity utilisation in the mineral extraction sector is still very low. While nearly half of extractive industry investment went to oil production, fairly similar to previous years, the volume of investment was down by nearly 10 % from two years previous. Investment in gas production, instead, was up 6 % from two years previous. Investment in technical support services for the oil & gas industry, a major investment category, recovered during the first three quarters of this year, but was still clearly down from two years previous. Fixed investment in production of petroleum products has risen by about 4.5 % from two years previous. Investment in pipeline transmission of oil and gas, which rather often fluctuates considerably from year to year, was up from 2020 but down from 2019.

Fixed investment of large and mid-sized manufacturing firms (not including petroleum products) was up by over 6 % from the first three quarters of 2019. The recovery in manufacturing has in the course of this year become quite broad-based. In several branches, however, growth simply reflects a recovery from last year's investment drought. Of the main investment categories, metal refining took a wide lead with investment up by over 30 % from two years previous. Other notable investment driving manufacturing branches include pharmaceuticals (fixed investment growth of nearly 50 % from two years previous), the automobile industry (up by 30 %), production of other transport vehicles (up 18 %), as well as mechanical wood processing (up 36 %). Investment spending from government sector budgets has risen slightly further this year in real terms, but unlike 2020, significantly less than fixed investment overall.

Moscow has been the core driver of investment growth nationally this year, accounting for over 50 % of Russia's total fixed investment on-year growth in the first three quarters of this year. Investments in Moscow grew by over 20 % y-o-y, and the capital's share of Russia's total fixed investment was nearly 20 %. The large investment sectors in Moscow are transport & warehousing, information & communications, as well as finance. While transport and information & communications investments in Moscow were up by 24–29 % y-o-y, investment in the finance sector climbed up by more than 60 %. In combination, these three Moscow's top investment categories accounted for a third of the rise in the country's total fixed investment from the first three quarters of 2020.

Fixed investment in Russia has briskly recovered from last year's relatively mild dip.



Sources: Rosstat and BOFIT.

China

China updates its negative list on foreign investor access to China; US imposes new investment restrictions on Chinese companies. On Monday (Dec. 27), China released a revised version of its negative list, which enters into force on Saturday (Jan. 1). The negative list specifies those branches or activities in which foreign ownership is restricted or forbidden. The number of restricted items has been lowered from 33 to 31. Restrictions on foreign ownership in automobile manufacturing have been dropped altogether and foreign carmakers no longer need to form a joint venture with a Chinese partner to build passenger cars in China. The limits on the number of vehicle joint ventures has also been eliminated. Manufacture of radio and television equipment and components are no longer regulated. The negative list governing foreign investment in China's free trade zones was also updated. It reduces the number of off-limits activities from 30 to 27.

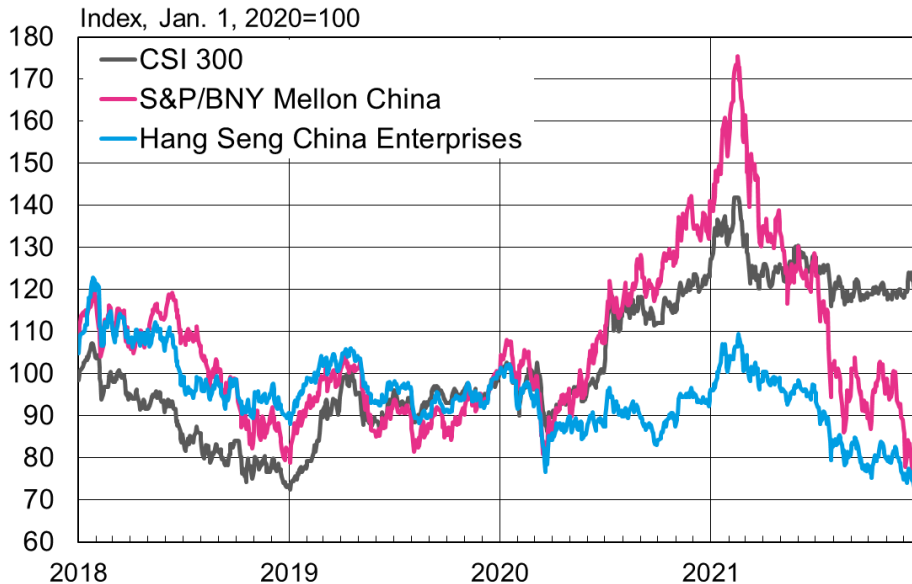
The updated lists provided more detailed explanatory notes about the foreign listing of Chinese firms operating in branches restricted from receiving foreign capital in China. Most firms have resorted to variable interest entity (VIE) structures in which the Chinese parent company establishes a foreign subsidiary (typically in a tax haven) to be listed on a foreign stock exchange in a third country that typically shares profits generated by the parent. From now on firms will have to seek official permission to list on a foreign exchange and comply with stricter requirements. Foreign investors cannot participate in company operations or management, and are subject to limits on foreign ownership (the ceiling on foreign ownership in China is currently 30 % and a single foreign shareholder may own no more than 10 % of the company's shares). VIEs are not strictly forbidden, however, and have been used by hundreds of Chinese firms, including tech giants such as Alibaba. A representative of the National Development and Reform Commission (NDRC) said that the foreign ownership limits would not apply retroactively to such firms.

At the beginning of December, the US Securities and Exchange Commission (SEC) finalised its rules for requiring auditing inspections of companies listed in the US and declaring if they are owned or controlled by a foreign government. Noncomplying firms can be delisted from US exchanges after three years. The new rules were implemented under the Holding Foreign Companies Accountable Act enacted at the end of the Trump administration ([BOFIT Weekly 50/2020](#)). The rules also demand more detailed information about firms using VIE structures. Mainland Chinese and Hong Kong-based firms listed in the US have a long-running dispute over allowing SEC officials to inspect their auditors. Chinese officials have said that the secrecy was needed to protect national security, but have recently indicated they are trying to resolve the issues and improve cooperation with the US on the matter.

In May, three giant Chinese telecom operators were delisted from the New York Stock Exchange. China Mobile recently announced plans to list on the Shanghai Stock Exchange. Observers note that the move is largely a symbolic gesture. The firm is already listed in Hong Kong and it only plans to list roughly 4 % of its shares on the Shanghai bourse. China Telecom listed earlier this year in Shanghai. Markets were shaken in early December with the announcement of ride-hailing firm Didi's plans to leave the New York exchange and list instead on the Hong Kong exchange. A couple days after Didi listed on the New York exchange in late June 2021, it became the target of an investigation by Chinese cybersecurity officials, who removed its apps from the market in China. Didi's proposed listing in Hong Kong still requires approval from the Chinese authorities.

The United States has also restricted investment in Chinese firms based on their connections with the Chinese military industry. On December 16, the US treasury department named eight new Chinese firms that are now off limits to US investors (including drone manufacturer DJI) due to their involvement in human rights violations in Xinjiang. Several dozen Chinese firms were already on the US investment ban list. Earlier in December, AI software provider SenseTime was put on the list. SenseTime postponed its IPO, but debuted yesterday (Dec. 30) in the Hong Kong exchange. All of the named firms were already on the US "entity list," which restricts exports of US products and technology.

The share prices of Chinese firms listed in the US (S&P/BNY Mellon China Index) and Hong Kong (Hang Seng China Enterprises Index) have declined this year. In mainland China (CSI 300 Index) the share prices have been more steady.



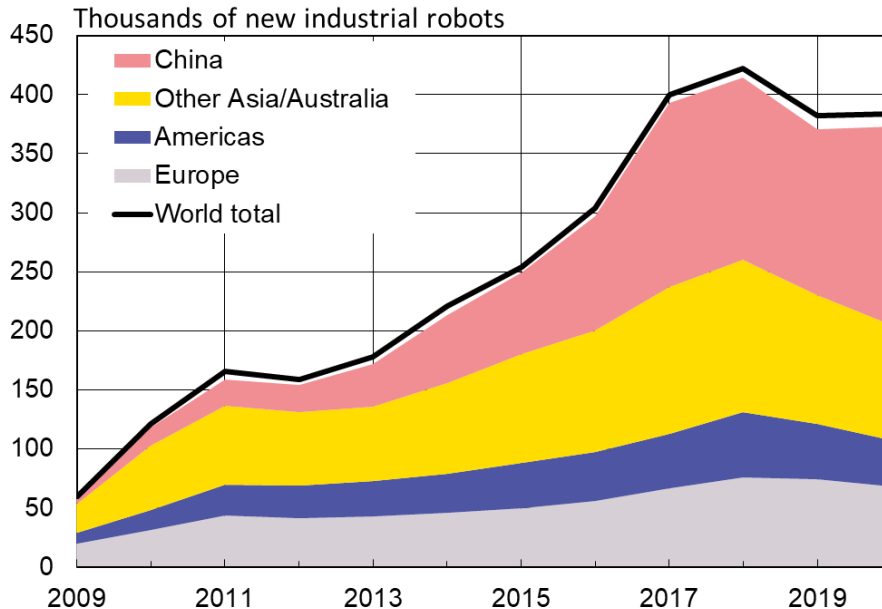
Sources: Macrobond and BOFIT.

Strong increase in use of industrial robots in China. The latest figures available from the International Federation of Robotics show that China installed 168,000 new industrial robots in 2020, a 20 % increase from 2019. China accounted for nearly half of the world's installed base of industrial robots in 2020 and it was the only country among the big robot adopters where the number of new installed robots increased. China has been the world's largest market for industrial robots since 2013. At the end of 2020, China had 940,000 industrial robots in service. With the increasing use of robots in China, the relative number of workers per robot is now almost on par with the US, but still well behind South Korea, which robot-wise is in a league of its own.

China has designated industrial robots as a strategic branch of industry and it has been heavily subsidising both production and R&D efforts e.g. under the Made in China 2025 industrial development plan. Even so, domestic robot models accounted for just 30 % of the Chinese market in 2019. Japanese robot makers, in particular, have achieved a strong position in the Chinese robot market. Japan is the world's largest exporter of industrial robots and China is its largest export market. Japanese robot manufacturers, as well as robot manufacturers from other countries, have extensive production in China. However, many critical robot parts are still built outside China.

Rapidly risen labour costs have added to the push for automation of production in China. Moreover, fields like electronics that already rely heavily on robots for e.g. microchip production, have only increased their robot intensity. While installation of new robots in China's car industry has tapered off in recent years, their sheer numbers are still impressive.

Most new industrial robots are installed in Asia



Sources: International Federation of Robotics and BOFIT.

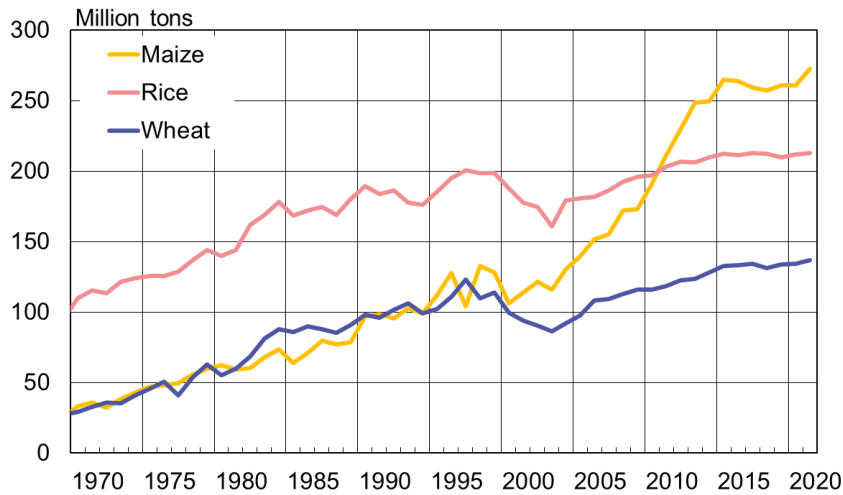
Maize boosts this year's grain harvest in China. China's National Bureau of Statistics reports that the country's total grain harvest this year amounted to 683 million metric tons, a 2 % increase from 2020. Both in 2019 and 2020, the on-year growth of the grain harvest remained below 1 %. Over 90 % of the total grain harvest in China consists of maize, rice and wheat. The 2021 maize crop saw the biggest jump, up nearly 5 % from 2020 to 273 million tons. In contrast, wheat production this year was up by just 2 % and rice production by just 0.5 %. The 2021 harvests were impacted by record rains (particularly in Henan province) and the extended drought in northwestern provinces.

Maize prices soared last winter, and in response many farmers decided to devote more land to cultivation of maize. The average price of maize this year was up 25 % from 2020 and 40 % higher than in 2019. The area of land devoted to maize cultivation in 2021 increased by 5 % y-o-y, while the area of land devoted to cultivation of rice fell by 0.5 %. The total area of land under cultivation this year increase by nearly 1 % to 118 million hectares (1,180,000 km²).

China is largely self-sufficient in production of maize, rice and wheat. Grain cultivation in China is most extensive in the country's eastern provinces, most notably Heilongjiang, Henan and Shandong. 12 % of China's land area is under cultivation, which is more than e.g. Russia (just over 7 %), but far less than e.g. Vietnam (23 %), Thailand (33 %) or India (over 50 %). China has long struggled with soil quality and sufficiency issues caused by e.g. contamination and overuse of fertiliser.

China's meat production has largely recovered from the 2019–2020 African swine fever epidemic. China's hog population has this year returned to normal levels, about 450 million. This has also normalized pork prices, which have been on average about 40 % y-o-y lower during the second half of the year. China is the world's largest pork producer, and over half of all meat production in China is pork. Beef, lamb and poultry prices are up just slightly from a year ago. In the first eleven months of this year, meat production overall was up by more than 20 % from the same period in 2020. Meat imports have also gradually declined since summer.

Increased maize cultivation in 2021 resulted in a bumper crop of 273 million metric tons



Sources: NBS, CEIC and BOFIT.

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