BOFIT

BOFIT Weekly Review Yearbook 2022

The Bank of Finland Institute for Emerging Economies (BOFIT)

BOFIT Weekly Review
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BOFIT Weekly Review 2022

7 Jan 2022 BOFIT Weekly 2022/01
Russia

- Russian economic growth expected to slow this year
- Employment in Russia returns to pre-recession levels as unemployment drops to historical lows
- The 2021 harvest was smaller than in previous years

14 Jan 2022 BOFIT Weekly 2022/02
China

- Despite intense suppression strategy, covid infections in China on the rise
- China tries to boost international investor interest in green bonds
- Bailing out bad-debt-manager Huarong is a costly proposition

21 Jan 2022 BOFIT Weekly 2022/03
Russia

- Russian markets fall as geopolitical tensions rise
- Russian export earnings and imports recovered quickly in 2021, large private capital outflows
- Russia's foreign currency and gold reserves hit record high
- President Tokayev consolidates power in Kazakhstan

28 Jan 2022 BOFIT Weekly 2022/04
China

- China's economic growth slowed at the end of 2021
- Forecasters lower China's GDP growth forecasts for 2022 and 2023
- China's central bank cuts interest rates to deal with slowdown in lending and economic growth
- China's population growth fell close to zero last year

4 Feb 2022 BOFIT Weekly 2022/05
Russia

- Ruble continues to weaken despite higher oil prices
- Death rate in Russia hit historical high last year; covid infections soar
- Russia's National Welfare Fund continues to grow

11 Feb 2022 BOFIT Weekly 2022/06
China

- This year's Lunar New Year travel numbers remained at low levels
- IMF calls on China to implement far-reaching reforms to achieve sustainable growth
- China's public sector deficit shrank last year
- Hong Kong's economy returned to positive growth last year

18 Feb 2022 BOFIT Weekly 2022/07
Russia

- Russia posted good economic growth in 4Q21; manufacturing particularly strong
- Central Bank of Russia tightens its monetary policy
- Strong growth in bank lending fuels Russian domestic demand
- Russia and China strive to increase their bilateral trade

25 Feb 2022 BOFIT Weekly 2022/08
China

- China posts record trade surplus in 2021
- Relaxation of capital controls and increased foreign trade help boost international use of the yuan
- China's imports from Ukraine quadrupled over the past four years

4 Mar 2022 BOFIT Weekly 2022/09
Russia

- Ruble and stock markets tumble on Russia’s February 24 invasion of Ukraine
- Russia’s unprovoked attack on Ukraine draws massive economic sanctions from the West
- Russia was Finland’s sixth-largest export market in 2021

11 Mar 2022 BOFIT Weekly 2022/10
China

- Russia sanctions affecting China as well
- This year’s economic goals rolled out at National People’s Congress
- Covid case rates up in mainland China and Hong Kong
- Finland’s imports from China increased during the pandemic

18 Mar 2022 BOFIT Weekly 2022/11
Russia

- Russia’s invasion also causing economic damage to Ukraine
- Russia imposes currency controls to deal with the ruble’s collapse
- Russia on shaky ground in its ability to service foreign debt
- Western countries impose more sanctions on Russia
- Russia rolls out various measures in response to Western sanctions
- No large increases in Russian government sector spending planned at the moment; budget revenues on the rise this year

25 Mar 2022 BOFIT Weekly 2022/12
China

- While China's industrial output growth accelerated in the first two months of this year, construction activity and apartment sales declined
- China approves fiscal stimulus policies for 2022
- American firms operating in China more pessimistic about short-term business outlook

1 Apr 2022 BOFIT Weekly 2022/13
Russia

- Latest BOFIT forecast for Russia sees GDP contracting by 10 % this year with imports down by half
- Russian markets supported by administrative measures
- Prices continue to soar in Russia
- CBR keeps its key rate at a record high 20 % level

8 Apr 2022 BOFIT Weekly 2022/14
China

- Shanghai’s covid lockdowns likely to affect international supply chains
- China stays with its diversified energy import strategy; natural gas consumption and imports on the rise
- Growth of China’s CIPS payment system remained brisk last year

14 Apr 2022 BOFIT Weekly 2022/15
Russia

- Capital controls enable ruble recovery
- Export earnings fattened Russia’s Q1 current account surplus; substantial capital outflows
- March PMI indicators suggest Russian economy already contracting
- No growth this year for Russia’s foreign reserves or the National Welfare Fund
- The EU and US put more economic sanctions on Russia

22 Apr 2022 BOFIT Weekly 2022/16
China

- China's economy sees strong start, weak finish, in the first quarter
- Inflation in China remained subdued in March
- PBoC slightly lowers bank reserve requirements and publishes list of economic support measures
- China's debt growth accelerated slightly in the first quarter

29 Apr 2022 BOFIT Weekly 2022/17
Russia

- Trends weakened in many branches of the Russian economy in March
- Timely CBR support measures avert banking sector panic
- Russian federal budget revenues and expenditures rise; inflation undermines purchasing power
- Russian military spending increased last year

6 May 2022 BOFIT Weekly 2022/18
China

- Latest BOFIT forecast sees modest Chinese economic growth this year
- Yuan loses ground against the US dollar
- China's real estate sector continues to struggle
- Growth in China's foreign trade slowed in March; exports to Russia fell

13 May 2022 BOFIT Weekly 2022/19
Russia

- Major forecasts for the Russian economy anticipate a large contraction this year along with sharp drops in exports and imports
- CBR further lowers key rate
- Russia legitimises parallel imports of many goods as imports collapse

20 May 2022 BOFIT Weekly 2022/20
China

- Chinese economy stumbled in April
- Foreign investment by Chinese firms remained depressed last year
- Hong Kong GDP shrank in the first quarter of this year

25 May 2022 BOFIT Weekly 2022/21
Russia

- The ruble continues to appreciate
- Russia's economic downturn is felt in government budget revenues; military spending soars
- Russian oil production volumes fell in April
- Impacts of Ukraine invasion on Russia's economy already apparent in March

3 Jun 2022 BOFIT Weekly 2022/22
China

- China shifts focus from fighting covid to economic stimulus
- Borrowing demand remains subdued despite PBoC efforts to boost bank lending
- Finland's imports from China continued to climb in the first quarter

10 Jun 2022 BOFIT Weekly 2022/23
Russia

- Russian economy began to contract in April
- EU issues a new round of sanctions for Russia
- Russian central bank further eases monetary policy
- Pensions raised in Russia to keep up with inflation
- Finnish-Russian trade contracts sharply

17 Jun 2022 BOFIT Weekly 2022/24
China

- Covid case numbers on the rise again, strict lockdown measures hit firms operating in China
- China's economic growth remained sluggish in May
- Taiwan's economy has weathered the covid pandemic quite well

23 Jun 2022 BOFIT Weekly 2022/25
Russia

- Russian central bank lowers key rate to 9.5 %
- Russian government budget revenues weaken; high inflation erodes stimulus effects
- Russian imports plunge; value of exports remains high

1 Jul 2022 BOFIT Weekly 2022/26
China

- Mainland China's stock markets have been on a rise for the past two months
- Domestic production struggles to keep pace with growth in consumption of grain crops in China
- India tightens its monetary policy

8 Jul 2022 BOFIT Weekly 2022/27
Russia

- Russian economy continued to slide in May
- Russian ruble has strengthened substantially
- Russian government driven to technical insolvency
- G7 countries move to reduce Russian export earnings
- As the world's largest wheat exporter, Russia plays a major role in food security of Africa and the Middle East

15 Jul 2022 BOFIT Weekly 2022/28
China

- Slow growth for China's household loan stock
- China's goods exports to Russia decline while bilateral trade deficit rises
- India binges on Russian oil

22 Jul 2022 BOFIT Weekly 2022/29
Russia

- Outlook for Russian businesses grows cloudier in June
- Partial release of balance-of-payments data gives general picture of Russia's import decline and large capital outflows
- Russian inflation slowed slightly in June on reduced increases in prices of fruits and vegetables
- Russian federal budget revenues continue to deteriorate
- Russian GDP growth slowed in the first quarter of this year

29 Jul 2022 BOFIT Weekly 2022/30
China

- China posts weak second-quarter growth, likelihood of return to high growth for the rest of the year wanes
- China relaxes restrictions but holds to its dynamic zero-COVID policy
- Forecasters downgrade China's 2022 GDP growth forecast, see high growth rates for India and predict a lower-than-expected contraction of the Russian economy

5 Aug 2022 BOFIT Weekly 2022/31
Russia

- Big differences across sectoral contractions in Russia
- CBR lowers key rate further to 8 %
- Banking sector conditions stabilise in Russia

12 Aug 2022 BOFIT Weekly 2022/32
China

- Relations between mainland China and Taiwan grow tense
- Yuan-euro exchange rate hits levels not seen for years
- China's leadership omits mention of the numeric GDP growth target
- India on verge of surpassing China as world's most populous country

19 Aug 2022 BOFIT Weekly 2022/33
Russia

- Russia's federal budget sees exceptional drop in revenues in July; spending continues to rise
- CBR considers ways to support fixed investment and reduce forex dependency
- Russia seeks new oil export markets
- Russia posts declines in gas production and gas exports
- Ukrainian Black Sea grain shipments resume with UN-brokered agreement between Ukraine and Russia

26 Aug 2022 BOFIT Weekly 2022/34
China

- China's economy continued to sputter in July
- China's central bank lowers interest rates; inflation rate still below official target ceiling
- Drought leads to hydropower production issues and restrictions on electricity use in China
- China takes on struggles of small banks

2 Sep 2022 BOFIT Weekly 2022/35
Russia

- Russian economic trends seem to have stabilised in July
- Russia facing harsher economic outlook for the rest of this year
- Employment in Russia has continued to rise
- EU ban on imports of Russian coal goes into effect
- Finnish goods trade with Russia falls by half

9 Sep 2022 BOFIT Weekly 2022/36
China

- Covid hotspots strain China's provincial economies
- China posts large current account surplus in first half; capital outflow continues
- United States and China reach initial agreement on reviewing financials of US-listed Chinese firms, but bilateral tensions persist

16 Sep 2022 BOFIT Weekly 2022/37
Russia

- Russia posts another large current account surplus in August
- Russia's federal budget revenues down in August
- Russian GDP falls, but trends vary widely across individual sectors
- Russian pipeline gas exports to EU effectively cease

23 Sep 2022 BOFIT Weekly 2022/38
China

- China posts relatively weak August growth figures; housing construction decline continues
- Putin and Xi met in Samarkand as trade between their countries has strengthened
- Finnish goods exports to China contracted in the second quarter

30 Sep 2022 BOFIT Weekly 2022/39
Russia

- “Partial mobilisation” creates confusion, markets tumble in Russia
- Russian economic trends remained stable in August
- Russia plans for federal budget deficits from 2022 to 2025
- Russian central bank further eases monetary policy
- Government fixed investment soars in Russia as corporate fixed investment remains weak

7 Oct 2022 BOFIT Weekly 2022/40
China

- Forecasters lower their predictions for Chinese growth this year
- Yuan loses ground against the dollar
- European Chamber reports tougher Chinese business environment

14 Oct 2022 BOFIT Weekly 2022/41
Russia

- Latest BOFIT forecast sees Russian economy contracting by 4 % this year and imports falling by 25 %
- Russia’s current account surplus contracted in the third quarter of this year
- Weak developments expected for Russian government sector revenues and expenditures
- IMF anticipates significant slowdown in global growth next year; Russia’s recession likely to be milder than earlier expected

21 Oct 2022 BOFIT Weekly 2022/42
China

- China’s 20th National Congress affirms major existing policy trends
- China postpones routine releases of economic data
- China attempts to contain its real estate sector crisis and support the economy through increased funding
- United States tightens rules on semiconductor exports to China

28 Oct 2022 BOFIT Weekly 2022/43
Russia

- Weaker revenues and higher spending reign Russia’s federal and regional budgets
- Russian export earnings start to decline, recovery in imports continues
- Overall condition of Russia’s banking sector remains murky

4 Nov 2022 BOFIT Weekly 2022/44
China

- BOFIT expects relatively low growth for China over the next two years
- Xi Jinping consolidates power; current economic policymakers passed over for inner circle posts
- China reports surprisingly brisk GDP growth in the third quarter

11 Nov 2022 BOFIT Weekly 2022/45
Russia

- Contraction of Russian economy accelerated in September
- Russian real household incomes slide
- CBR kept key rate unchanged and released updated economic forecast
- China’s exports to Russia continued to rise in October

18 Nov 2022 BOFIT Weekly 2022/46
China

- China’s October economic figures suggest extensive economic problems
- As the latest covid wave hits China, the government makes adjustments to covid rules
- Use of the yuan in international foreign currency trading rises

25 Nov 2022 BOFIT Weekly 2022/47
Russia

- Russian federal budget revenue streams at low level; spending continues to rise
- Contraction of Russian GDP continued in the third quarter
- Russia needs to find new export markets for oil ahead of EU sanctions entering into force
- Growth in Indian imports from Russia begins to plateau

2 Dec 2022 BOFIT Weekly 2022/48
China

- Latest wave of protests in China distinctly different
- Reducing emissions and slowing climate change also matters for Chinese economic performance
- China’s central bank lowers reserve requirement for commercial banks
- Finnish exports to China face headwinds

9 Dec 2022 BOFIT Weekly 2022/49
Russia

- EU import ban and G7 price cap on Russian crude oil enter into force; EU plans further sanctions
- Russian economy continued to contract in October
- Russian households cut back on spending, durable goods most affected
- Finland’s trade with Russia has collapsed

16 Dec 2022 BOFIT Weekly 2022/50
China

- Tough November for China’s economy as covid situation worsens and export demand evaporates
- China abandons zero-covid policy
- Poorer employment opportunities for young Chinese and internal migrants

23 Dec 2022 BOFIT Weekly 2022/51
Russia

- One-off payments boost Russian federal budget revenues in November, spending continues to grow
- Central Bank of Russia keeps key rate unchanged
- EU and US further expand economic sanctions on Russia
- Rosstat releases latest quarterly GDP figures for this year
- Rising investment in Russia slows economic slide, but sees increased role of state-owned enterprises and the government

30 Dec 2022 BOFIT Weekly 2022/52
China

- China sets out economic policy priorities for 2023 and longer-range outlines for 2035
- US-China technology competition intensifies as trade structure shifts
- China’s installed base of industrial robots surpassed one million last year

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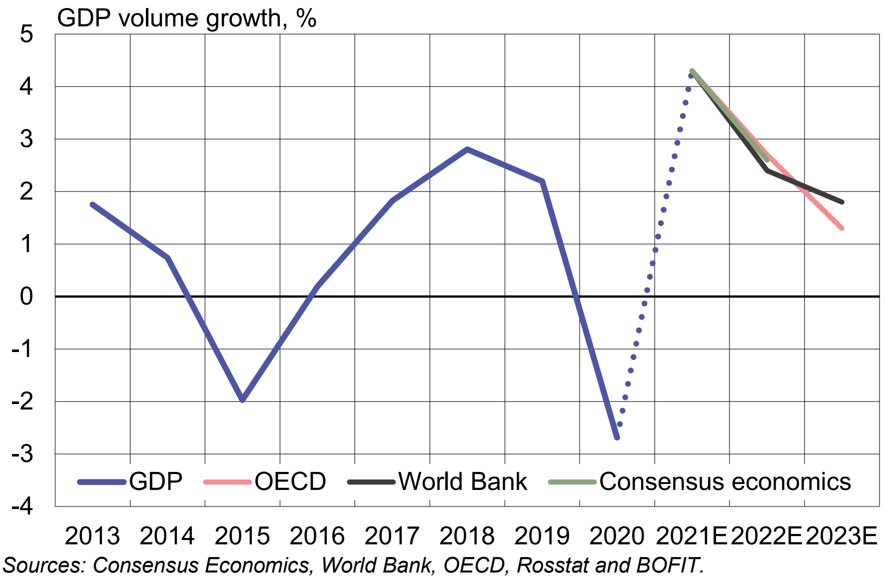
Russia

Russian economic growth expected to slow this year. The Russian economy recovered briskly last year from the Covid Recession, with GDP returning to pre-crisis levels already last summer. The preliminary estimates from the economy ministry suggest Russian GDP grew by 4.7 % y-o-y in the first eleven months of 2021. Growth accelerated a bit again in November, driven e.g. by the mineral extraction sector (includes oil & gas) and weather conditions that lead to an unusually extended harvest season. Signs of economic overheating began to appear towards the end of 2021 as e.g. inflation spiked and labour markets tightened. Rosstat's initial estimate shows that consumer prices rose by 8.4 % y-o-y in December. The unemployment rate remained at a historically low level of 4.3 % in November.

Russia's economic growth is expected to slow gradually. Recent forecasts expect Russian GDP to grow by 2–3 % this year and just 1–2 % in 2023. Economic growth faces numerous risks in the coming years. Even if covid infections have declined in Russia in recent weeks, the pandemic situation is still uncertain and could weaken economic growth both globally and in Russia. Persistent high inflation could erode the purchasing power of Russian households. In addition, heightened geopolitical tensions could increase uncertainty and hurt economic growth.

Russia's growth prospects over the longer term are bleak. Potential GDP growth is generally estimated to be in the range of 1–2 % a year. Russia's growth outlook is clouded by demographic challenges, a problematic business environment that constrains investments and productivity levels that are low by international standards. While these long-term issues have been well-recognised and Russia has launched numerous development programmes and strategic action plans to deal with them, the growth-enhancing impacts of the plans have been modest to date. The current narrowly-drawn economic policy framework focuses heavily on select state-led development projects. Observers note that the framework's possibilities to significantly improve conditions for Russia's long-term growth are limited. The challenges to Russia's long-term growth and economic policy are discussed in more detail in a recently released BOFIT Policy Brief.

Major forecasts released in December see Russian GDP growth slowing this year



Sources: Consensus Economics, World Bank, OECD, Rosstat and BOFIT.

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Employment in Russia returns to pre-recession levels as unemployment drops to historical lows. The 2020 recession was brief and rather shallow, causing the number of employed persons to decline by a relatively moderate 2–2.5 %. Employment has been on a recovery path for over a year now. Since last summer the number of employed persons has been slightly over 72 million, i.e. roughly at 2019 levels before the slump caused by pandemic and a drop in oil prices.

The recovery has come mainly from reviving employment in wholesale and retail, hotels and restaurants, construction, as well as education and manufacturing, i.e. the same branches that shed the most jobs during the depths of the 2020 recession.

Russia's informal labour market has been particularly flexible. According to Rosstat's labour force survey, the number of employees working in the informal labour market fell in 2020 by about 4.5 % and increased by about the same amount last year. Thus, changes in the informal employment caused almost the same share of the drop in total employment in 2020 and recovery last year as did the formal labour market. The number of persons working in the informal labour market has returned to around 14.5–15 million, about a fifth of all persons employed.

With employment recoveries, the number of unemployed persons declined from 4.5 million in the final months of 2020 to 3.2–3.3 million in recent months. In the same period, the unemployed share of the labour force declined from over 6 % to less than 4.5 %. This means the unemployment rate currently stands at historic lows. In addition, the numbers of laid-off persons and persons working part-time have returned to 2019 levels.

The number of persons more loosely connected to labour markets than the unemployed also changed considerably in the economic downturn in spring 2020 and recovery in 2021. In Rosstat's labour force survey they mainly include persons who have not been looking for a job but would be ready to start working. In the International Labour Organization's (ILO) definition this group constitutes potential labour force. In Russia they comprised nearly 1.5 million persons in the final months of 2020 but no longer more than 1.1 million last autumn.

Russian unemployment hit record lows at the end of 2021

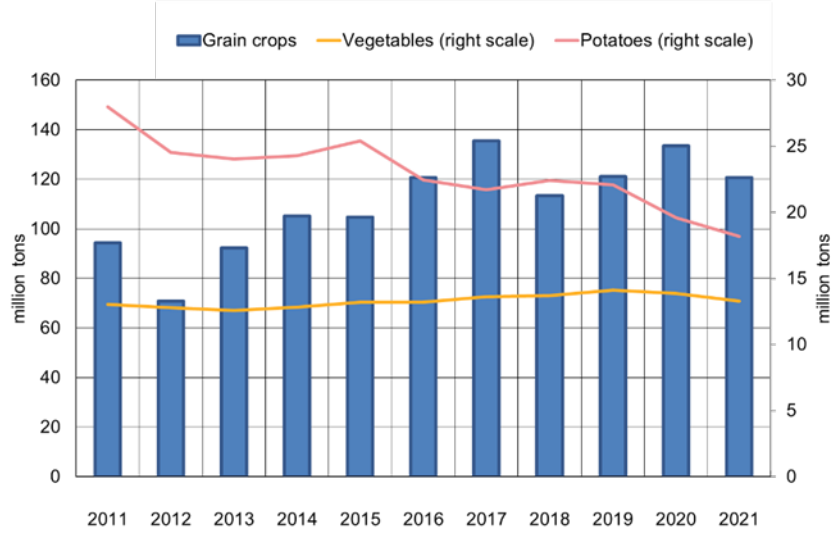
Sources: Rosstat and BOFIT.

The 2021 harvest was smaller than in previous years. According to preliminary figures released by Rosstat, Russia's grain harvest last year was about 121 million metric tons. In comparison to the bumper 2020 harvest, the volumes harvested were down by about 10 %. Over 60 % of Russia's total grain harvest consists of wheat. In recent years, barley and maize together accounted for about a quarter of total grain harvest.

The commercial potato crop last year amounted to 18 million tons, which was about 7 % less than in 2020. Although the potato crop yield per hectare has risen over the past two decades, the area of land under cultivation has contracted sharply. For this reason, the statistically reported potato crop has continued to shrink. In the early 2000s, Russia's annual commercial potato crop was about 29 million tons. Thanks especially to greenhouse production, vegetable cultivation took off dramatically in the early 2000s. In recent years, however, the vegetable harvest has remained consistently at a level of just under 14 million tons a year. Commercial vegetable growers also saw smaller crops in 2021, down by about 4 % from 2020.

Russia's agricultural companies hold a dominant position in grain cultivation. About 70 % of Russia's grain is harvested from fields cultivated by these firms. In contrast, over half of the potatoes and vegetables in Russia are grown in household gardens or plots of private citizens. Last year's relatively weak grain and vegetable harvest contributed to increases in food prices in the second half of 2021.

Russia's harvest of commercial crops contracted last year



Sources: Rosstat, CEIC, BOFIT.

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China

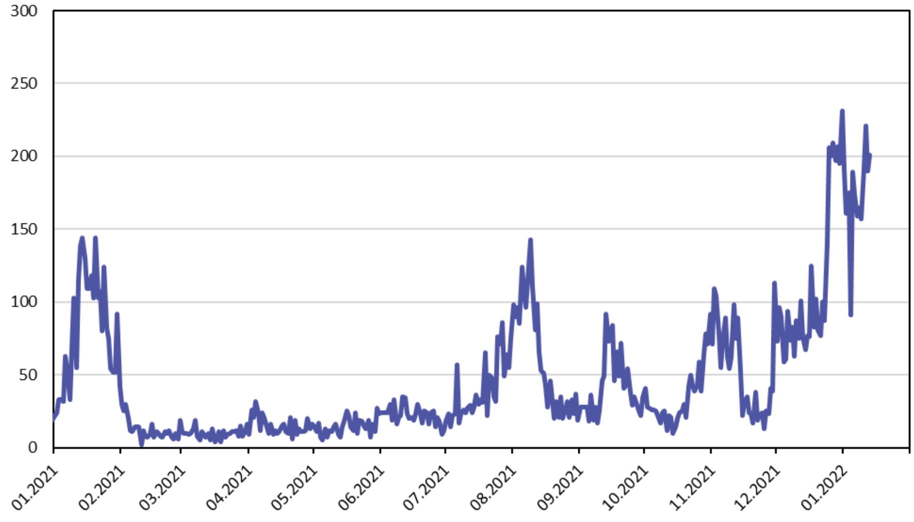
Despite intense suppression strategy, covid infections in China on the rise. Although the numbers of confirmed covid-19 cases in China are still miniscule (150–250 cases a day), the country has resorted to strict local suppression measures to deal with new fast-spreading strains of the virus. At the end of December, officials put 13 million people in city of Xian in home quarantine. The stay-at-home strategy worked with the rate of new infections in the province falling below ten a day. However, infection rates have climbed in recent days in other regions (e.g. Henan province, Tianjin municipality bordering Beijing and Guangdong province), causing them to impose harsher covid restrictions. Current measures to combat covid have hurt both local economies and global production chains (e.g. the Micron and Samsung microchip foundries in Xian were forced to reduce production). Even so, current measures are estimated to have relatively modest impact on the economy at the national level as they are short in duration and geographically limited.

Vaccination programmes rolled out quickly last year in China. Health officials report that as of Saturday (Jan. 8) 1.2 billion Chinese (about 86 % of the population) had received two doses of vaccine. China has yet to approve any vaccines developed abroad. The most-used domestic vaccines are those developed by Sinovac and Sinopharm. Pfizer-Biontech, whose mRNA vaccine is still awaiting approval by the Chinese authorities, made already last summer an agreement with the Shanghai-based Fosun Pharmaceutical on a joint venture to manufacture vaccines in China.

China's vaccine exports soared last year. Prior to the covid pandemic, the value of exported vaccines intended for human immunisation averaged just $10 million a month. In the third quarter of 2021, the value of vaccine exports averaged $2.2 billion a month. In October and November, the value of monthly exports fell to $1.4 billion. In terms of vaccine doses shipped, China has exported the most of any country. In addition to its own vaccines, China manufactures vaccines or components for export under licence.

The Sinovac and Sinopharm vaccines are the most-used Chinese vaccines outside China. Both have received use approvals in over 50 countries, mainly emerging and low-income economies. Certain countries have also agreed on local manufacture of Chinese vaccines. Beijing-based Bridge Consulting tracks Chinese vaccine uptake globally. China has sold a total of 1.65 billion doses to foreign customers. China has also committed to donating 150 million doses to other countries. About 60 % of sold and donated vaccine doses have gone to countries in Asia. The countries purchasing the most Chinese vaccines are Indonesia (259 million doses), Pakistan (132 million), Iran (110 million), Turkey (100 million) and Brazil (100 million). The largest recipients of donated vaccines are in Southeast Asia. China has sold 136 million doses to African nations and committed to donate 37 million doses. Some countries like Brazil, Thailand, Malaysia that have bought Chinese vaccines announced that they are discontinuing their use due to the poor levels of protection against new covid variants such as delta and omicron.

Covid case numbers in China have increased in recent weeks



Sources: National Health Commission of China, CEIC and BOFIT.

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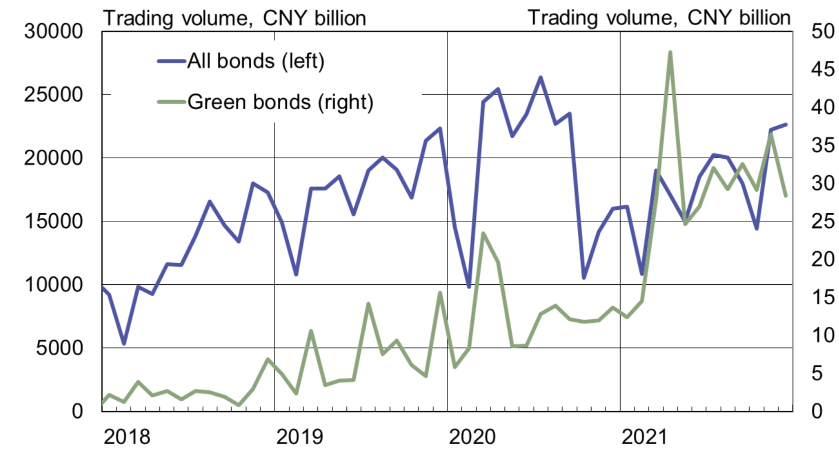
China tries to boost international investor interest in green bonds. In April 2021, China harmonised its national criteria for determining the activities that qualify for green bond status. The People's Bank of China, in conjunction with the National Development and Reform Commission (NDRC) and the China Securities Regulatory Commission (CSRC), published the 2021 edition of the *Green Bond Endorsed Projects Catalogue*. Suitable projects categorised as eligible for green investment include energy saving technologies, elimination or monitoring of emissions, protection of natural endowments and recycling, zero-emission transportation, clean energy, environmental protection and adaption to climate change.

The biggest change from the original 2015 edition of the catalogue is that green bonds can no longer be issued to finance "clean coal" or other fossil-fuel-related projects. The new criteria, much more closely aligned with internationally accepted green bond norms, is hoped to raise the interest of international investors. According to the PBoC, the outstanding domestic balance of green bonds last September was over 1 trillion yuan (about $160 billion), nearly 25 % higher than a year earlier. Over $63 billion in new green bonds were issued in the first nine months of 2021, already exceeding the total amount of issues for the previous record year of 2019.

To further grow the share of green financing in the financial sector, the PBoC last November launched a carbon emissions reduction facility. Under the central bank's new policy instrument, banks are eligible for low-interest financing from the PBoC if they finance corporate emissions reduction projects. The PBoC reports that by the end of last year it has issued funds worth of 85.5 billion yuan (just over $13 billion) via the facility.

China has also boosted its cooperation with the EU on green financing. China is a founding member of the International Platform on Sustainable Finance (IPSF), launched by the EU in 2019. The IPSF seeks to establish globally applicable criteria for green financing in order to attract capital for investment in projects that are environmentally sustainable. Founding IPSF members also include Argentina, Canada, Chile, India, Kenya and Morocco. The membership has since grown to include Hong Kong, Indonesia, Japan, Malaysia, New Zealand, Norway, Senegal, Singapore, Switzerland and the UK. The member countries represent about half the global population and account for about 55 % of global greenhouse emissions.

Trading in Chinese green bonds picked up steam last year, even if trading volumes overall remained quite modest



Sources: CFETS, Macrobond and BOFIT.

Bailing out bad-debt-manager Huarong is a costly proposition. Huarong is one of four state-run asset management companies created in the wake of the Asian financial crisis in 1999 to deal with the wave of non-performing loans swamping China's state-owned banks. With money granted by the government, Huarong acquired the non-performing loans of ICBC. As asset management firms were later allowed to expand into other areas, Huarong began to offer a selection of financial services and listed on the Hong Kong stock exchange in 2015.

The company fell into deep troubles after years of debt-driven expansion and unprofitable investments. Huarong's total debt obligations are unclear, as it has numerous subsidiaries and little available information on their ownership structures or financing arrangements. Huarong executives purportedly were involved in vast corruption. Huarong's former CEO Lai Xiaomin, received a death sentence for taking bribes and was executed in January last year. The company cut back on its other businesses after regulators demanded in 2018 that state-owned "bad banks" focus on their core mission of financial clean-up.

The latest problems emerged in April, when the company missed the date for submitting its 2020 financial statements. Trading in Huarong shares were suspended, bond prices dropped and issuances of new foreign debt ceased. In August,

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Huarong announced a restructuring programme that would involve state-backed strategic investors, in particular the Citic Group. Huarong proposed to sell ownership stakes and units in its subsidiaries. Huarong ultimately revealed that its 2020 losses amounted to 103 billion yuan ($16 billion) and that its capital adequacy ratio stood at 6.3 % at the end of June 2021, well below the required minimum of 12.5 %. The company claims it debt problems are due to the unchecked expansion of the Lai Xiaomin era.

A rescue package valued at 42 billion yuan ($7 billion) was announced in November and completed in December. Huarong also received permission from regulators to issue 70 billion yuan ($11 billion) in new bonds. The finance ministry remains Huarong's largest shareholder with a 28 % stake, while Citic has increased its holdings to 23 %. According to media reports, the finance ministry plans to transfer part of its stake to Citic, also a company entity entirely owned by the finance ministry.

The state-led bailout is seen as a sign that officials put high priority on getting Huarong's problems under control. Foreign investors have followed the progress of the bailout as Huarong is one of the largest Chinese firms issuing foreign debt. Huarong has been able to access cheap financing as investors treated the company as a government-backed borrower. Huarong and its subsidiaries hold offshore bond debt amounting to roughly $20 billion, which according to S&P represents about 10 % of the offshore bond debt of Chinese financial firms. Until now Huarong has paid all its debt payments on time. When trading in the company's shares resumed on the Hong Kong stock exchange at the beginning of this year, the share price dropped to about half its April level.

Many massive investments by large Chinese firms (including investments abroad) have proven unprofitable in recent years. Many of these poor bets were placed by firms tied to the state. The Chinese government has intervened directly in the struggles of core financial sector players, e.g. taking over the now-defunct Baoshang Bank and failed Anbang Insurance Group. The newest bailout round has required huge cash infusions, which means money has been diverted from more productive projects. The government has sought to quell investor expectations of implicit guarantees for state-owned firms by letting payment defaults of state firms increase. Balancing actual risk pricing and stability in financial markets has proven to be hard. There is a risk that problems emerging from individual firms can spread and disrupt financial markets, especially as ownership and debt relationships in the Chinese market are often unclear.

After a 9-month trading suspension, Huarong shares nosedived last week on the Hong Kong stock exchange as trading resumed

Sources: Macrobond and BOFIT.

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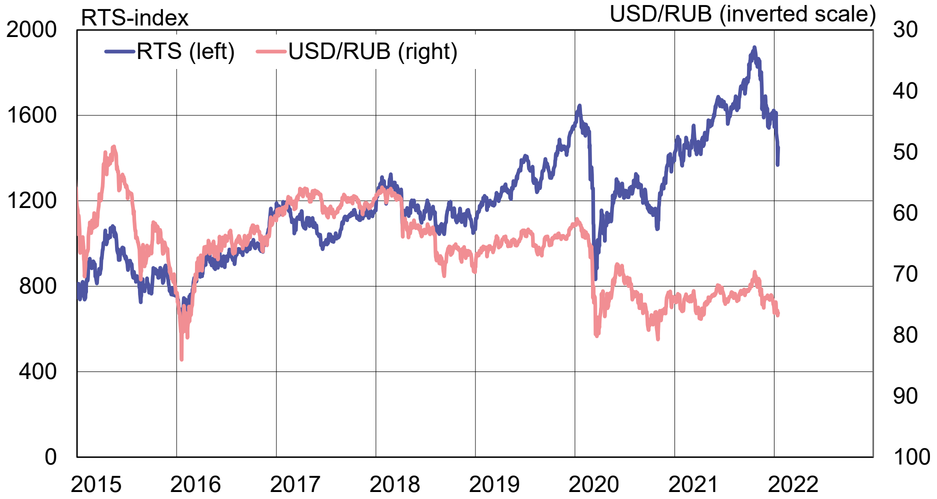
Russia

Russian markets fall as geopolitical tensions rise. The declining market trend, which began at the end of October, has become steeper in recent weeks. The dollar-denominated RTS stock index has fallen by about 10 % since the start of this year and about 25 % from its all-time high last October. The ruble has also lost a bit of ground against both the dollar and euro since the start of this year, despite a rise of nearly 20 % in the price of Urals-grade crude oil to levels not seen in years. In addition, the price of Russian credit default swaps (CDSs), derivatives based on Russian state treasuries, has increased sharply in recent weeks.

The share of foreign investors in the Moscow Exchange (MOEX) has increased in past decade and foreign investors accounted for about half of the equity market trading volume at the end of 2021. MOEX reports that the share of American funds in particular has increased in the holdings of international investment funds of Russian equity, reaching nearly 60 % by the end of last year. About 20 % of Russian government treasuries were held by foreign investors at the end of 2021, down from a peak of 35 % in 2018.

Western sanctions have restricted Russian access to international funding. For example, Russia's dollar-denominated foreign debt has been halved since the end of 2013. Russia has also sought to reduce its exposure to possible new rounds of US sanctions by reducing its dollar dependence. In November 2021, Russia held just $2 billion in US treasury bills, down from over $100 billion in 2017. The US dollar's share of Russia's foreign currency reserves has fallen from 45 % in 2013 to 16 %. The share of exports priced in dollars has fallen from 80 % to under 60 %.

Share prices tumbled on the Moscow Exchange and the ruble lost ground against major currencies in recent weeks



Sources: Macrobond, BOFIT.

Russian export earnings and imports recovered quickly in 2021, large private capital outflows. Preliminary balance of payments figures from the Bank of Russia show a strong recovery in the country's earnings from exports of goods and services, i.e. by about 40 % last year from the 2020 recession. Export revenues came close to matching the peak levels of 2011–2014.

Export earnings from energy commodities (crude oil, petroleum products and natural gas) rose by nearly 60 % on the recovery in export prices. Earnings from other goods (mainly low-processed products) increased by about a third from the 2019–2020 level, also mainly on higher export prices. Indeed, export earnings on other goods hit an all-time high. Energy's share of Russia's earnings on exports of goods and services bounced back to a roughly 45 % share, approaching the pre-2020-slump levels of around 50 %, but still not near the roughly 60 % share of the early 2010s. The share of other goods increased from well below 40 % in the latter half of the 2010s to around 45 %.

After strong growth, Russian spending on goods imports in 2021 exceeded the 2019 level by nearly a fifth, but did not quite reach the record highs of 2012 and 2013. Import spending on services excluding travel recovered to 2019 levels, albeit below the highs of 2013 and 2014. Travel spending also started to recover, but was still just a third of what it was in 2019.

The rise in Russian export earnings in 2021 far surpassed the recovery in spending on imports, driving the goods trade surplus to a top level – over 10 % of GDP. Even though the category of dividend payments and interest payments on debt by Russia's corporate sector increased substantially, the current account surplus still hit a record high of nearly 7 % of GDP.

The financial account between Russia and the rest of the world remained significantly in the red last year (i.e. a large net capital outflow) despite the CBR receiving a notable sum of IMF special drawing rights (SDRs), corresponding to nearly 1 % of GDP, as part of the IMF's global support arrangement. The net outflow of capital from the private sector increased to more than 4 % of GDP. In particular, outward corporate direct investment increased, far exceeding inward FDI flows to Russia's corporate sector. Companies continued to make substantial foreign portfolio investments and grant loans to borrowers outside Russia. The outflow of foreign portfolio investments in Russian firms, as well as repayments of Russian firms on their foreign loans, remained considerable.

Russia showed a large current account surplus and large private sector capital outflows in 2021

	USD billion								% of GDP							
	2014	15	16	17	18	19	20	21 (preliminary)	2014	15	16	17	18	19	20	21 (preliminary)
Current account	**58**	**68**	**24**	**32**	**116**	**65**	**36**	**120**	**2.8**	**4.9**	**1.9**	**2.0**	**7.0**	**3.9**	**2.4**	**6.9**
- Exports of goods & services	563	393	332	410	509	482	380	544	27.1	28.7	25.8	26.1	30.7	28.4	25.6	31.2
- Imports of goods & services	429	282	266	327	344	353	304	378	20.6	20.6	20.6	20.8	20.8	20.8	20.4	21.7
Trade balance, goods	189	148	90	115	195	166	94	186	9.1	10.8	7.0	7.3	11.8	9.8	6.3	10.7
- Exports of goods	497	341	282	353	444	420	333	490	23.9	24.9	21.9	22.4	26.8	24.8	22.4	28.1
- Imports of goods	308	193	191	238	249	254	240	304	14.8	14.1	14.9	15.1	15.0	15.0	16.1	17.4
Trade balance, services	-55	-37	-24	-31	-30	-37	-17	-20	-2.7	-2.7	-1.9	-2.0	-1.8	-2.2	-1.1	-1.1
- Exports of services	66	52	51	58	65	62	47	55	3.2	3.8	3.9	3.7	3.9	3.7	3.2	3.1
- Imports of services	121	89	75	89	95	99	64	75	5.8	6.5	5.8	5.6	5.7	5.8	4.3	4.3
Other current account items	-76	-43	-42	-51	-49	-64	-41	-46	-3.7	-3.2	-3.2	-3.2	-3.0	-3.8	-2.7	-2.6
- income on investments and credit	43	34	37	42	49	50	41	69	2.1	2.5	2.9	2.7	2.9	2.9	2.8	4.0
- expenditure on investments and credit	101	66	70	82	86	100	75	111	4.9	4.8	5.5	5.2	5.2	5.9	5.0	6.4
Financial account & net errors	**-123**	**-66**	**-15**	**-9**	**-76**	**2**	**-49**	**-56**	**-5.9**	**-4.8**	**-1.2**	**-0.6**	**-4.6**	**0.1**	**-3.3**	**-3.2**
Government (excl. central bank)	30	-10	4	12	-7	21	2	-7	1.4	-0.7	0.3	0.8	-0.4	1.3	0.1	-0.4
Private sector total (A+B)	**-151**	**-58**	**-19**	**-23**	**-68**	**-21**	**-50**	**-72**	**-7.3**	**-4.2**	**-1.5**	**-1.4**	**-4.1**	**-1.2**	**-3.4**	**-4.1**
A. Banks	-86	-34	1	-23	-33	-18	-22	-3	-4.1	-2.5	0.1	-1.5	-2.0	-1.0	-1.5	-0.2
B. Other private sector, incl. net errors	-65	-23	-21	1	-35	-3	-29	-69	-3.1	-1.7	-1.6	0.0	-2.1	-0.2	-1.9	-4.0
- Direct investment	-38	-14	11	-9	-24	6	2	-23	-1.8	-1.0	0.8	-0.6	-1.4	0.4	0.2	-1.3
- to Russia	18	6	31	27	6	29	8	31	0.8	0.5	2.4	1.7	0.4	1.7	0.5	1.8
- from Russia	55	20	20	36	30	23	6	54	2.7	1.5	1.6	2.3	1.8	1.3	0.4	3.1
- Portfolio investment	-18	-8	-4	-10	-2	-7	-27	-24	-0.9	-0.6	-0.3	-0.6	-0.1	-0.4	-1.8	-1.4
- to Russia	-12	-5	0	-5	-1	-4	-15	-11	-0.6	-0.3	0.0	-0.3	0.0	-0.2	-1.0	-0.6
- from Russia	6	3	4	5	1	2	12	13	0.3	0.2	0.3	0.3	0.1	0.1	0.8	0.7
- Foreign currencies in cash *	9	14	5	6	7	8	2	2	0.4	1.0	0.4	0.4	0.4	0.5	0.1	0.1
- BoP net errors and omissions	8	3	-5	3	2	-1	4	-1	0.4	0.2	-0.4	0.2	0.1	-0.1	0.3	-0.1
- Other items under B. Other private sector	-26	-18	-27	10	-18	-10	-10	-23	-1.2	-1.3	-2.1	0.7	-1.1	-0.6	-0.6	-1.3

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

Sources: Bank of Russia, Rosstat and BOFIT.

Russia's foreign currency and gold reserves hit record high. At an estimated $630 billion, Russia had the world's fifth largest foreign currency and gold reserves at the end of 2021. The value of Russia's forex reserves grew by about 6 % last year, and roughly 21 % of Russia's reserves consisted of gold (presently valued at $133 billion). During the first weeks of 2022, the reserves have risen even higher. They stood at $638.2 billion on January 14.

Countries with larger forex and gold reserves than Russia at the end of last year were China ($3.427 trillion), Japan ($1.406 trillion), Switzerland ($1.083 trillion as of end-November) and India ($633 billion). Central banks that target a specific exchange rate often maintain large forex reserves. While the Russian ruble now floats freely, the CBR still is charged with currency operations in the market on behalf of the finance ministry according to the government's budget rule when the oil price differs from the defined level. In addition, the dollar-value of Russia's forex reserves is affected by swings in the price of gold and changes in the exchange rates of other major currencies relative to the US dollar.

The structure of the CBR's forex reserves diverges considerably from other central banks. As of end-June 2021, euro assets made up 32.3 % of reserves and dollar assets just 16.4 %. In 2018, the CBR converted a substantial amount of its dollar assets into Chinese yuan (BOFIT Weekly 3/2019). As of June 2021, 13.1 % of Russia's reserves consisted of yuan-denominated assets, while gold accounted for 21.7 %. IMF figures show that the yuan's share of the central bank reserves

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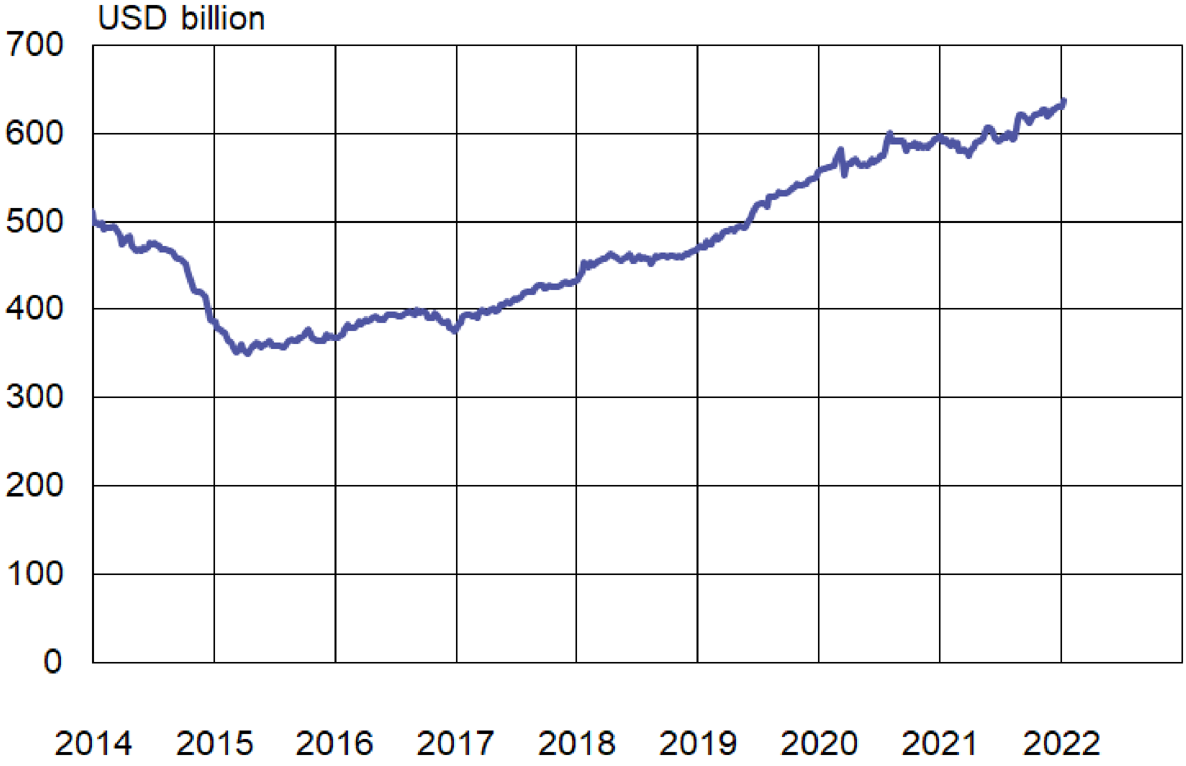
averaged just 2.6 % in June 2021. The CBR's yuan assets represent about a quarter of all yuan assets held by central banks outside China (which were $314 billion at the end of June 2021).

The value of Russia's foreign currency and gold reserves have swollen to nearly 15 % of GDP



Sources: Central Bank of Russia, IMF and BOFIT.

President Tokayev consolidates power in Kazakhstan. Rising fuels prices at the beginning of January ignited a wave of protests across Kazakhstan. To bring the violent protests under control, President Kassym-Jomart Tokayev requested assistance from other countries in the Collective Security Treaty Organization (CSTO). A CSTO peacekeeping force of nearly 2,000 soldiers, mostly Russian, were flown in and the protests quelled within a few days. There is very little independent reporting on what actually happened in the country in recent weeks, but it appears that the relatives of former president Nursultan Nazarbayev and their supporters have been removed from key economic and political leadership posts.

Kazakhstan's economy is highly dependent on exports of crude oil, natural gas and products of other extractive industries. Notably, uranium mining has seen huge growth over the past decade, making the country currently the world's largest producer and exporter of uranium. Indeed, over half of all global uranium exports have come from Kazakhstan in recent years. State-majority-owned Kazatomprom accounts for about half of the country's uranium production. The rest of the country's uranium production involves joint ventures with Russian, Chinese, Canadian, Japanese and French mining firms. Foreign investors have also played a major role in boosting Kazakhstan's oil production. For example, Tengizchevroil, the country's largest oil producer, is a joint venture of state-owned KazMunayGaz, Chevron and ExxonMobil.

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Weekly Review
4 • 28.1.2022

BOFIT

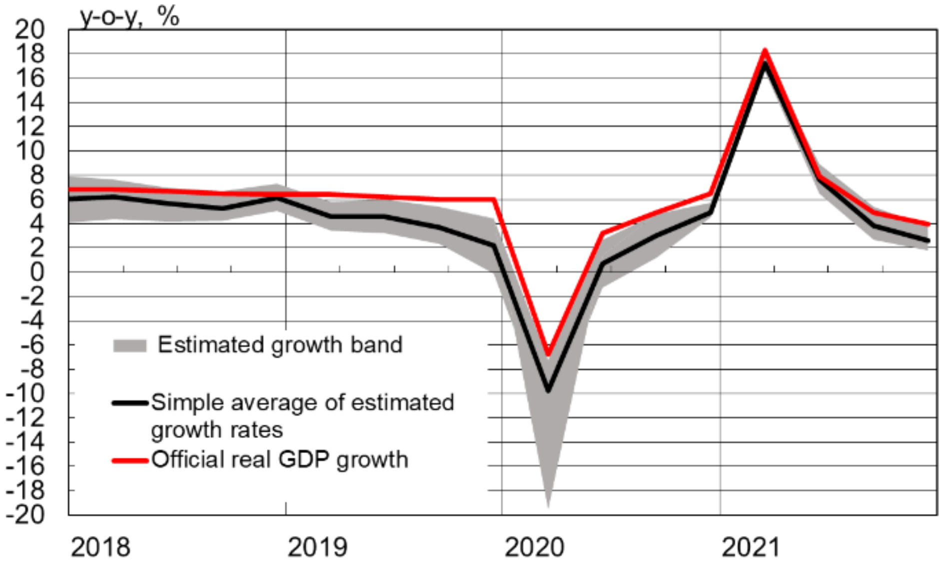
China

China's economic growth slowed at the end of 2021. China's National Bureau of Statistics (NBS) last week released its economic figures for the fourth quarter of 2021. According to official estimates, 4Q GDP increased by 4 % y-o-y and as much as 1.6 % q-o-q. Given the low basis reference of 2020, the 8.1 % growth for all of 2021 was well in excess of the government's "over 6 percent" annual GDP growth target.

China's official growth figures have long aroused scepticism, and indeed, the 4Q21 figures do not quite match up with other reported growth indicators. For example, the Bank of Finland's alternative GDP growth estimate suggests that China fourth-quarter growth was considerably lower. Similar findings have been presented by other institutional forecasters such as the London-based Capital Economics research consultancy. Still during the first half of 2021, the pace of economic growth in alternative forecasts closely tracked China's officially announced growth figures.

The 4Q numbers from NBS indicate recovering domestic consumer demand and strong exports. They also show that fixed investment demand contracted and restrained GDP growth – an exceptional reversal for China. From the supply-side perspective, growth was led by industrial production. Retail and wholesale experienced only slight growth, and were even beaten out by agricultural output. Growth in the hotel and restaurant field was slack, while activity in the construction and real estate sector contracted.

China's officially reported 12-month GDP growth and the Bank of Finland's alternative growth rate



Sources: China National Statistics Bureau, CEIC and BOFIT.

Forecasters lower China's GDP growth forecasts for 2022 and 2023. The IMF this week released its updated forecasts. The IMF now sees China's GDP growing by 4.8 % this year, down from its 5.6 % forecast last October. Earlier this month, the World Bank lowered its forecast for 2022 from 5.4 % to 5.1 %. Other institutions have also cut their China forecasts. A big factor in the general reduction in outlook has been the spread of the highly contagious omicron variant of covid in China. It is expected that resulting lockdowns and restrictions will reduce economic growth as China continues to pursue a strict suppression strategy in dealing with covid. A second commonly mentioned reason was the unexpectedly abrupt slowdown in Chinese economic growth in the second half of 2021 as problems in the real estate sector emerged. The challenges facing China's real estate sector are expected to continue this year. Forecasts for 2023 are currently also around 5 %.

China has yet to release an official national GDP growth target for 2022, but several provincial governments have declared annual growth targets. The lowest target ("above 5 %") has been set by the Beijing municipality, and the highest ("around 9 %") by Hainan province. The economically important Shanghai municipality and Guangdong province are targeting 5.5 % growth, the Jiangsu and Shandong provinces over 5.5 % growth, and the Zhejiang province around 6 % growth. Released regional targets suggest that national target could well fall in the 5–6 % range, which is higher than the current forecasts from most international institutions.

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Forecasts for China's GDP growth in 2022 and 2023 (% p.a.)

	2022	2023	
IMF	4.8	5.2	1/2022
World Bank	5.1	5.3	1/2022
JP Morgan	4.9	5.3	1/2022
Fitch	4.8	5.3	1/2022
Goldman Sachs	4.8	4.6	1/2022
HSBC	5.6	5.8	1/2022
Nomura	4.3	4.7	1/2022
BOFIT	4	3	9/2021

China's central bank cuts interest rates to deal with slowdown in lending and economic growth. On the same day that the National Bureau of Statistics released its December economic figures (Jan. 17), the People's Bank of China lowered its key reference rates. Both the reverse repo rate used in open market operations and rates of the medium-term lending facility (MLF) programme were cut by 10 basis points. The PBoC said it was going to use its monetary toolbox more widely this year in order to avoid a collapse in lending, as well as to support economic growth and stability. The growth in the bank loan stock slowed throughout 2021.

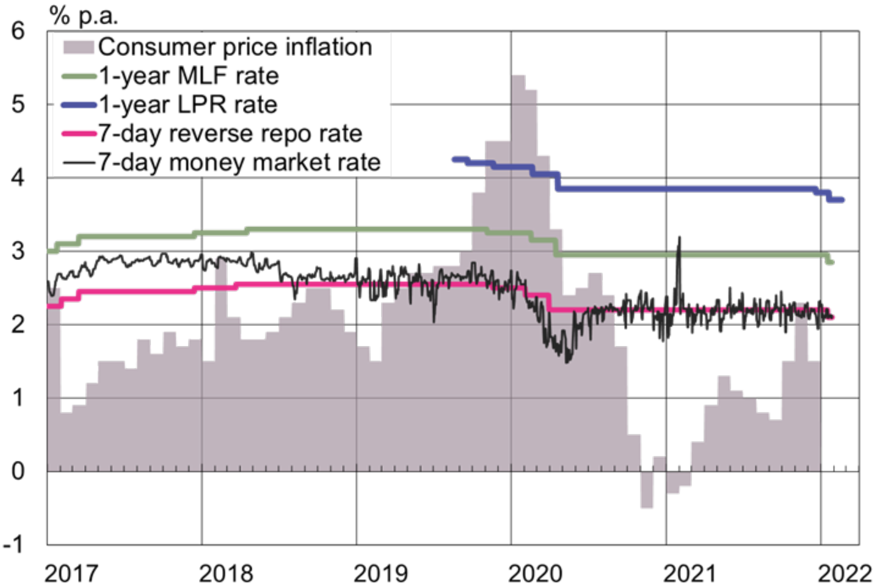
Although bank reserve requirements were lowered already in December (BOFIT Weekly 50/2021), the rate cuts were the first since spring 2020 when the covid crisis hit China. The 1-week reverse repo rate fell to 2.1 % and 2-week rate to 2.25 %. The central bank's MLF programme provides credit to commercial banks against collateral. The one-year MLF rate was lowered to 2.85 %. New MLF lending in January amounted to 700 billion yuan, which exceeded the 500 billion yuan in maturing MLF loans. The central bank typically boosts liquidity ahead of the Chinese Lunar New Year in anticipation of increased money demand. This year, the week-long holiday begins on January 31.

The reference loan prime rate (LPR) was also lowered. The one-year LPR was cut by five basis points already in December and another 10 basis points in January to its current level of 3.7 %. The 5-year LPR, which is the reference rate for housing loans, was lowered in January by five basis points to 4.6 %. The relatively small reduction is seen as a signal that the government wants to support the market for housing loans, but is unwilling to provide broader stimulus to the heavily-indebted real estate sector. The drop in monetary policy rates is also reflected in bond rates. In these last days of January, the one-year government bond rate stands at 2 % and the rate for corporate bonds with AAA ratings are averaging 2.5 %.

The current modest inflation does not constrain accommodative monetary policy. Consumer price inflation slowed from 2.3 % in November to just 1.5 % in December. Despite waning acceleration in producer prices, producer price inflation was still 10.3 % in December. For all of 2021, the rise in consumer prices was just 0.9 %, a level well below the 3 % target ceiling set for last year.

The stock of bank loans grew by 11.3 % last year, down from 12.5 % in 2020. The growth rate was below the 12.8 % nominal GDP growth in 2021. Growth in the stock of household credit (mainly housing loans) slowed faster than in the stock of corporate loans. The PBoC's broad measure of aggregate financing to the real economy (AFRE) grew last year by 10.3 %, down from 13.3 % in 2020. Growth in the stock of corporate bonds slowed substantially and the contraction in the stock of shadow banking sector instruments accelerated. At the end of last year, the PBoC's AFRE measure stood at 275 % of GDP, a 6 percentage point decrease from a year earlier.

Policy rates, money market rates and consumer price inflation



Sources: CEIC, PBoC, NBS, National Interbank Funding Center and BOFIT.

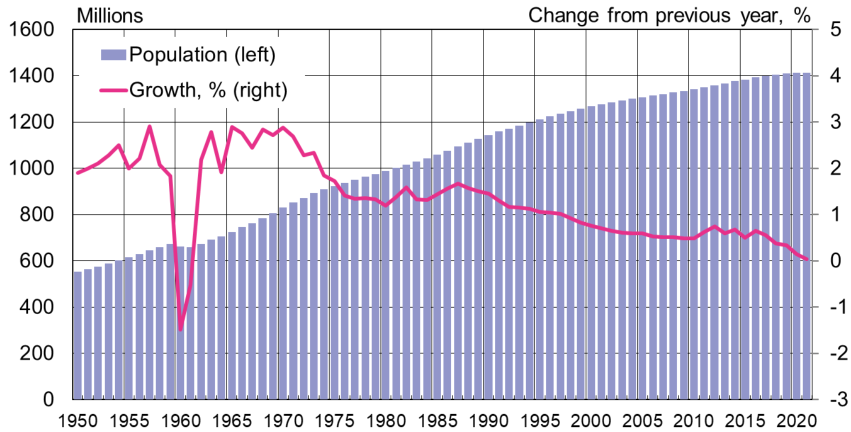
China's population growth fell close to zero last year. The National Bureau of Statistics reports that the number of people living in mainland China at the end of 2021 was about 1,423,600,000 people. Last year's 10.6 million births and 10.1 million deaths translate to a net population increase of only 480,000 people. The on-year population increase (0.03 %) was the lowest since 1960–61, when population decreased due to the Great Famine. China's demographic structure is changing rapidly. The birth rate continues to fall, the population is aging, and the working-age cohort shrinks every year. China's decreasing labour force makes it increasingly difficult for the country to maintain high economic growth.

Despite official efforts to incentivise people to have children, China's birth rate has continued to slow in recent years. The one-child policy was replaced with a two-child policy in 2016. Last year, the permitted number of children per family was increased to three. The relaxation of rules on family size seems to be having little impact. Not only is raising children seen as a costly endeavour, finding balance between working life and family life is challenging and the covid pandemic has exacerbated uncertainty about the future.

China's latest five-year plan, announced last year, calls for reforms to improve the working lives of pregnant women and women with young children. Chinese law guarantees 98 days of paid maternity leave, but recently a number of provinces have extended this period. For example, the length of maternity leave is now 190 days in Henan and Hainan provinces, and 158 days in Sichuan and Guizhou provinces as well as Beijing. In some provinces, the length of maternity leave increases with each child. Many provinces also grant 5–15 days of extra leave to parents with a child or children under the age of three. In addition to the additional parent leave, some provincial governments have also resorted to direct monetary incentives. In the Jilin province, married couples planning to have children are eligible for loans of up to 200,000 yuan ($31,400), as well as interest cost reductions as the number of children increases. In some cities, families with more than one child are eligible for direct housing assistance or the possibility of larger housing loans with favourable conditions.

Expensive day care services and lack of access to day care – especially for very young children – are among the biggest obstacles to increasing the birth rate. At present, families rely on the grandparents to provide much of the day care for small children. The government, which would like to see older people extend their working lives, wants to gradually raise the retirement age to offset some of the contraction in the size of the labour force. Thus, the need for affordable day care services continues to increase.

China's population growth fell almost to zero last year



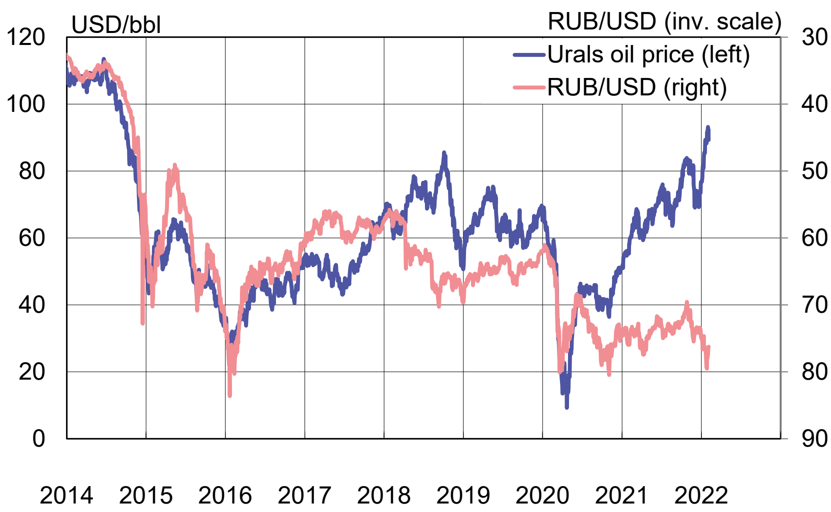
Sources: NBS, Macrobond, BOFIT.

Russia

Ruble continues to weaken despite higher oil prices. The world-market price of Urals-grade crude oil has soared in recent weeks, breaking the $90-a-barrel barrier in late January. Oil prices have not been this high since autumn 2014. Nevertheless, the ruble's exchange rate has continued to decline, reaching near-record lows against the US dollar. The ruble averaged 77 rubles to the dollar this week, while the euro-ruble rate has been about 86. The Central Bank of Russia announced on January 24 that it was temporarily suspending its "fiscal rule" currency-buying on behalf of the finance ministry to rein in financial market volatility.

Most of the ruble's drop reflects the recent intensification of geopolitical tensions. The expectations of monetary policy tightening in the US have caused depreciation pressures on many emerging-economy currencies. Russian economy also faces uncertainty from the sharp increase in covid infections in recent weeks.

Despite soaring oil prices, geopolitical risks have driven down the dollar-ruble exchange rate



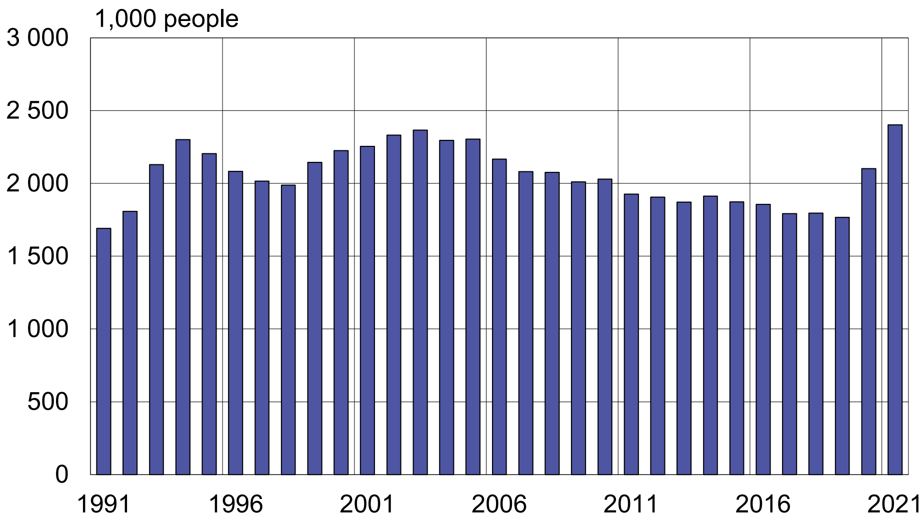
Sources: Reuters, BOFIT.

Death rate in Russia hit historical high last year; covid infections soar. Preliminary Rosstat figures put Russia's population at the end of 2021 at 143 million people (does not include population of Crimean peninsula, which was illegally annexed by Russia in 2014). When net migration is included, the population shrank by about a half percent last year. The natural change in Russia's population (excluding net migration) hit a historical low in 2021 with the population declining by over 1 million people. Russia's birth rate again shrank slightly and the mortality rate soared. Deaths exceeded 2.4 million, the highest level in the entire post-Soviet era. Deaths last year were about 600,000 more than the annual average between 2015 and 2019. In 2020, about 290,000 more people died than the 2015–2019 annual average.

In particular, deaths among the elderly population have spiked during the covid pandemic. In 2020, the death rate among Russians over the age of 64 was about 260,000 persons higher (20 %) than the average of 2017-2019. That number corresponds to roughly 1 % of the entire 64+ age cohort. Deaths among the working-age population also increased. Among working-age population, in 2020 died about 60,000 people (15 %) more than in 2017–2019 on average. The UN reports that the death rate for Russia's working-age population was already nearly twice that of the European average before the covid pandemic. In 2020, the life expectancy of an average Russian fell to 71.5 years, down from 73.3 years in 2019.

According to official reports, Russia has had 12.3 million confirmed covid cases, or roughly 8 % of the population. Official covid deaths number about 330,000 since the start of the pandemic. With the emergence of the omicron variant, the number of reported covid cases has surged since early January and is currently running above 150,000 a day. The good news is that the daily number of covid-caused deaths has been declining. As of end-January, 55 % of the population had received two vaccine doses. The Russian government says that it has no plans at this time to implement any additional nationwide restrictions or lockdowns to deal with the pandemic.

Russia's death rate reached its highest level in post-Soviet history last year



Note: Figures do not include Crimean Peninsula, which was illegally annexed by Russia in 2014.
Sources: Rosstat, BOFIT.

Russia's National Welfare Fund continues to grow. The value of the assets in the National Welfare Fund (NWF) stood at $182.6 billion at the end of 2021. In the official reporting, which uses last year's official GDP forecast, that amount corresponded to 11.7 % of GDP. The ratio of NWF assets to GDP can be expected to decline to around 11 % when Rosstat's actual 2021 GDP figure comes in.

Government's excess revenues from oil & gas taxes are transferred annually from other state accounts to the NWF. The excess oil & gas tax revenues are defined as the revenues collected on that part of the oil price that exceeds the reference price defined in the NWF savings rule. Last year there was nothing to transfer, however, as no extra earnings accrued in 2020 due to actual oil price slightly below the reference price. NWF assets were also not used last year to fund government budget spending because the budget moved from deficit into slight surplus.

The size of the NWF was affected by a couple of other factors. First, the value of NWF assets fell in the final months of 2021 due to a drop in the price of Sberbank shares owned by the NWF (Sberbank shares represent about a quarter of total NWF assets). Second, fluctuations in the ruble's exchange rate last year also affected the valuation of the Fund's assets in rubles. About 65 % of the assets are held in foreign currencies. These forex assets basically comprise liquid deposits at the central bank equivalent to nearly 7 % of Russian GDP at the end of last year. In addition, the ratio of NWF assets to GDP declined as GDP rose due to economic recovery and quite high inflation.

Similar to 2018 and 2019, the excess oil & gas tax revenues amassed last year were substantial – equivalent to about 2.5 % of GDP. The reference price for Urals oil last year was $43.30 a barrel, but the realised average price was $69. The excess revenues raised will be transferred to the NWF later this year (in recent years the annual transfer has occurred in spring or summer). Excess tax revenues from oil & gas are also expected this year. This year's reference Urals price in the budget is $44.20 a barrel. The average Urals price in January exceeded $85. Moreover, oil prices significantly higher than the reference price are expected for the rest of this year.

With the NWF's increasing size, plans have been drawn to invest some assets e.g. in the form of loans to fund infrastructure projects. Such illiquid assets, which in earlier years have been tied mostly to projects for long periods (excluding the ownership stake in Sberbank), represent about 13 % of the NWF's total assets. It was recently decided that such project funding, which earlier was available when NWF's liquid assets exceeded 7 % of GDP, is now available if the value of the NWF liquid assets exceed 10 % of GDP. Liquid assets, however, now also include the budget estimate for excess oil & gas revenues in the current year. Moreover, the increase does not preclude funding of infrastructure projects already planned within the framework of 2.5 trillion rubles allocated for 2022–2024, an annual amount equal to 0.5–0.6 % of GDP.

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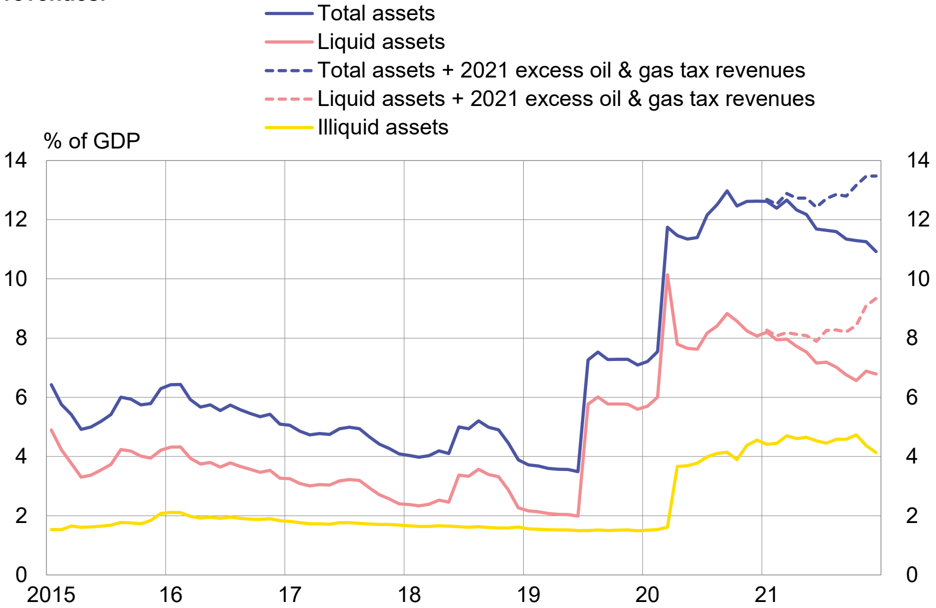
Russia's National Welfare Fund continues to swell as high oil & gas prices bring excess government tax revenues.



Sources: Ministry of Finance, Rosstat and BOFIT.

China

This year's Lunar New Year travel numbers remained at low levels. According to the Chinese zodiac, the Year of the Tiger arrived on February 1. In pre-pandemic years, Chinese would travel back to their home districts to celebrate the week-long New Year holiday. Due to covid restrictions largely implemented now at the local level, the number of travellers was as modest as last year. The increasing official case numbers, especially in Beijing, Zhejiang province and Guangdong province, prevented many internal migrant workers from returning to their home districts. Fewer than 30 million people a day travelled by car, train, plane or ship in the week preceding this year's Lunar New Year holiday. In pre-covid times, the daily traveller numbers would have been closer to 80 million.

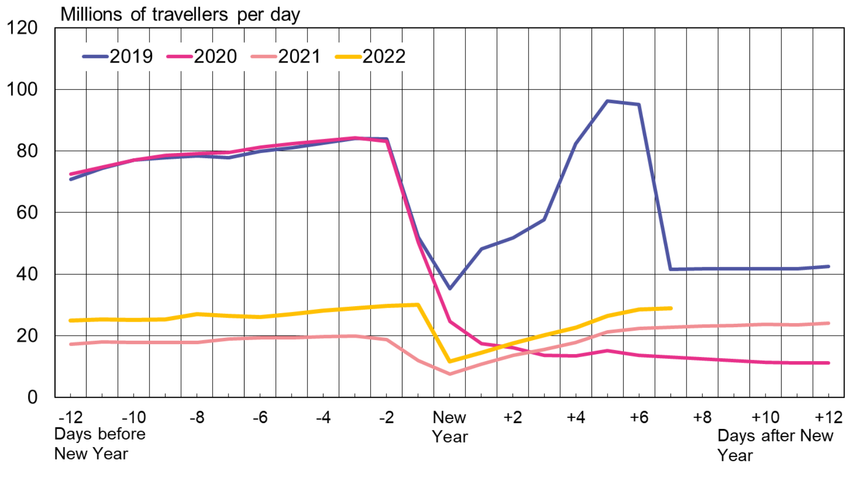
Domestic tourism was even weaker than last year. China's culture and tourism ministry reports that the number of domestic tourist trips during the New Year week fell to 251 million, down 2 % from last year. Spending by holiday tourists amounted to just 290 billion yuan ($46 billion), a decrease of 4 % from 2021. Compared to pre-pandemic levels in 2019, domestic tourist travel this year was down by 26 % and tourist spending down by 44 %. In a departure from normal practice, China's ministry of commerce has yet to release the headline numbers for retail sales and restaurant sales figures during the New Year holiday.

The opening of the 24th Winter Olympic Games in Beijing on February 4 failed to bring hoped-for boosts to tourism and private consumption. General admission tickets for Olympic events went unsold (even to Chinese spectators) due to covid restrictions. The only people in the stands this year are holders of invitation tickets. In addition, the movements of participating athletes, supporters and organisers are tightly regulated. Economic growth is further affected by the shutting down of polluting industries in 60 cities to improve air quality during the games. The Winter Olympics in Beijing and Zhangjiakou will continue through February 20.

The slowdown in economic activity is also apparent from the major purchasing manager indices (PMIs): the PMI published by China's National Bureau of Statistics (NBS) and the one compiled by IHS Markit. Markit uses a smaller sample and mainly covers small and medium-sized companies from the private sector. The NBS PMI also includes China's giant state-owned enterprises.

The NBS PMI readings remained just barely above the growth indicating level of 50 for both the manufacturing (50.1) and the services sector (50.3). Since last autumn, the services employment subindex has been clearly weaker than in pre-pandemic years. The outlook for the service sector has continued to weaken since the beginning of this year. In contrast, the manufacturing employment subindex has remained slightly higher during the pandemic, and the outlook for large firms in particular has remained rosy. Markit's Manufacturing PMI for January fell to 49.1. The Services PMI was still above the 50-point mark (51.4), but down from December (53.1).

Lunar New Year travel in in China was down again this year



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

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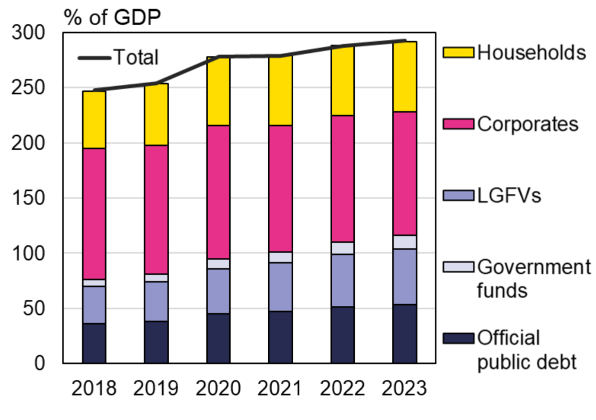
IMF calls on China to implement far-reaching reforms to achieve sustainable growth. At the end of January, the IMF released its annual Article IV Consultation for China, which provides an overview of China's economic policy and economic trends. Support measures for the economy were cut back last year from 2020, and the fiscal policy stance in particular became more stringent. Ongoing flabby consumer demand and the slowdown in real estate investment led to an overall deceleration in economic growth. The IMF cut its 2022 GDP forecast to 4.8 %, but still sees growth accelerating slightly in the following years as consumption revives. Over the medium term, the IMF expects Chinese growth to slow as the population ages and productivity growth remains tepid.

Over the short term, the IMF recommends more accommodative fiscal and monetary policies. Support measures should focus on improving social safety nets as they boost consumption and reduce the need for households to save. Weak social safety nets (e.g. less than half of workers in urban areas have unemployment insurance) have hampered recovery in consumer demand and exacerbated income disparities. Over the medium term, the focus should fall on broader tax reforms and extending social security. This would encourage consumption-driven growth, narrow income inequality and broaden the revenue bases of the central and provincial governments. Raising the pension age would support the economy and help slow growth in pension spending. Monetary policy should be based on interest rate measures. This would help put an end to the use of targeted monetary policy measures that were again widespread during the pandemic – an approach that misallocate financing away from profitable enterprises. A more flexible exchange-rate regime would improve the effectiveness of monetary policy and help protect the economy from external shocks.

The spread of problems in the real estate sector, which constitutes the largest short-term risk, can even threaten financial stability. Yet even now, information is scarce on the nexus of banks, developers and the shadow banking sector. Higher corporate indebtedness has increased the financial sector vulnerability as the country moves beyond the pandemic. Continuation of financial support measures, however, worsens credit misallocation and delays acknowledging bad loans. Risks are elevated by the uncertainty among investors about the continuation of state support to troubled firms. Over the longer term, risk will come from the efforts to decouple the US and Chinese economies. Decoupling threatens to erode already low productivity. The IMF further warned that political uncertainty is heightened by regulatory measures in the technology and real estate sectors that further reduces the operating possibilities of private firms. This could lead to a rapid deceleration in productivity if state firms gain an increasingly prominent role.

Reforms aimed at top-line issues such as productivity and innovation have not proceeded as hoped. The IMF has long stressed the importance of reforming state-owned enterprises and improving the operating environment for private firms. Rebalancing of the economy away from heavy industry and construction to consumption-driven growth has reversed in recent years. Turning this trend around is essential if the country is to increase productivity, assure equitable income distribution and implement a greener growth model. The IMF considers it imperative that China accelerate its emission-reduction targets (the current goal is to begin reducing emissions after 2030). In addition to vast environmental benefits, the economic costs of reducing emissions now would be considerably smaller than waiting. In addition, the positive impacts of technological development would be realised sooner. Given the vast need for green financing, it makes little sense to rely on state firms. Thus, the IMF is calling for employing private capital. The IMF also restated its perennial recommendation that China urgently improve its reporting of macroeconomic data.

IMF estimate and forecast of indebtedness of China's nonfinancial sector



The IMF total "augmented" general government debt supplements the China's official public debt figure with the debt of local government financial vehicles (LGFVs) and state funds.
Sources: IMF Article IV report and BOFIT.

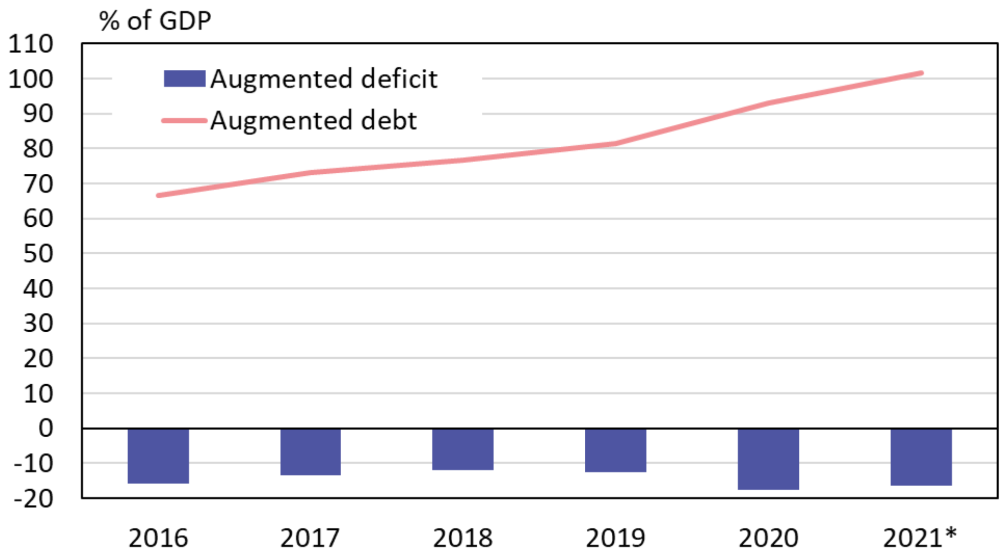
China's public sector deficit shrank last year. China's finance ministry reports that the combined budget revenues of central and local governments rose by over 10 % y-o-y last year in nominal terms, about two percentage points more than forecasted. Major tax revenue streams, including corporate taxes and value-added taxes, were up sharply from 2020. Many other tax revenue streams also increased. Tax revenues currently account for about 85 % of budget revenues in China.

Budget spending last year roughly matched the 2020 level, despite the policy adopted a year ago by China's decision-makers to increase the budget expenditure by 2 %. Growth slowed in some of the biggest spending categories, including education, social security and employment. Spending on healthcare, environmental protection, agriculture and culture declined, while growth in debt-servicing costs remained brisk.

China's official definition of general government expenditures and revenues is narrowly drawn and does not correspond to internationally accepted practices. For example, China's official figures exclude the extensive off-budget activities of local governments such as the use of local government financing vehicles (LGFVs) and numerous public funds. The IMF produces broader, internationally more comparable figures for China's general government. The IMF figures show that the public sector deficit has been running at over 10 % of GDP for many years. Last year's deficit amounted to 16 % of GDP, or about one percentage point less than in 2020. With persistent large deficits, cumulative public sector debt already equals slightly over 100 % of GDP.

The fiscal conditions of Chinese local government vary widely. An increasing number, however, are struggling under massive debt, especially with the current contraction in the real estate sector and consequent depression in sales of land use rights (an important funding source for many local governments). Even so, the State Council has been lately prodding local governments to take on more debt and invest in infrastructure projects to assure that economic growth targets are hit.

IMF estimates using a broad definition of deficit and indebtedness of China's general government



**) estimate.*
Sources: IMF Article IV Consultation Report and BOFIT.

Hong Kong's economy returned to positive growth last year. Hong Kong posted 6.4 % GDP growth in 2021, slightly exceeding its pre-pandemic GDP. Goods exports provided the main engine of economic growth, rising an impressive 26 % y-o-y. Exports of machinery & equipment were brisk, and accompanied with a significant boost in related capital investment. Import growth (up 24 %) lagged export growth slightly, but the trade balance still remained in deficit. Although retail sales grew by around 8 %, they were still well below pre-pandemic levels. Consumer prices rose by 0.6 %.

In its press release on this year's Article IV Consultation for Hong Kong, the IMF forecasts growth continuing at the same rapid pace this year. The short-term outlook is clouded by the covid pandemic, however, with the current surge in omicron-variant cases. In recent days, record-breaking case numbers exceeding 600 infections a day have hit Hong Kong. In line with its zero tolerance policy, which is also followed in mainland China, Hong Kong had to tighten already harsh restrictions to keep covid in check. Public gatherings are now limited to two people and the use of covid passports has been expanded to include shopping centres. Family get-togethers are also limited. Beauty salons and houses of worship have been closed.

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The latest figures from Hong Kong's census and statistics department show that the SAR's population fell by slightly over 1 % last year to around 7.4 million. Hong Kong experienced a net out-migration of about 75,000 people in 2021. The rather modest drop seems to indicate that neither the tightening of Hong Kong's security laws nor the covid pandemic have done much to precipitate a mass emigration from Hong Kong. The business sentiment survey of foreign firms released by the American Chamber of Commerce in Hong Kong last month found that the majority of respondents were upbeat about Hong Kong's prospects. On the other hand, 44 % of respondents said they were considering leaving if the strict covid restrictions persisted much longer.

Russia

Russia posted good economic growth in 4Q21; manufacturing particularly strong. Russia's economy ministry released estimates for the recovery of GDP from the 2020 recession. In the fourth quarter of last year, GDP was up by nearly 5 % y-o-y and about 4.6 % for all of 2021. By the ministry's calculations, 2021 GDP growth from two years previous was 1.8 % and nearly 3 % in the fourth quarter.

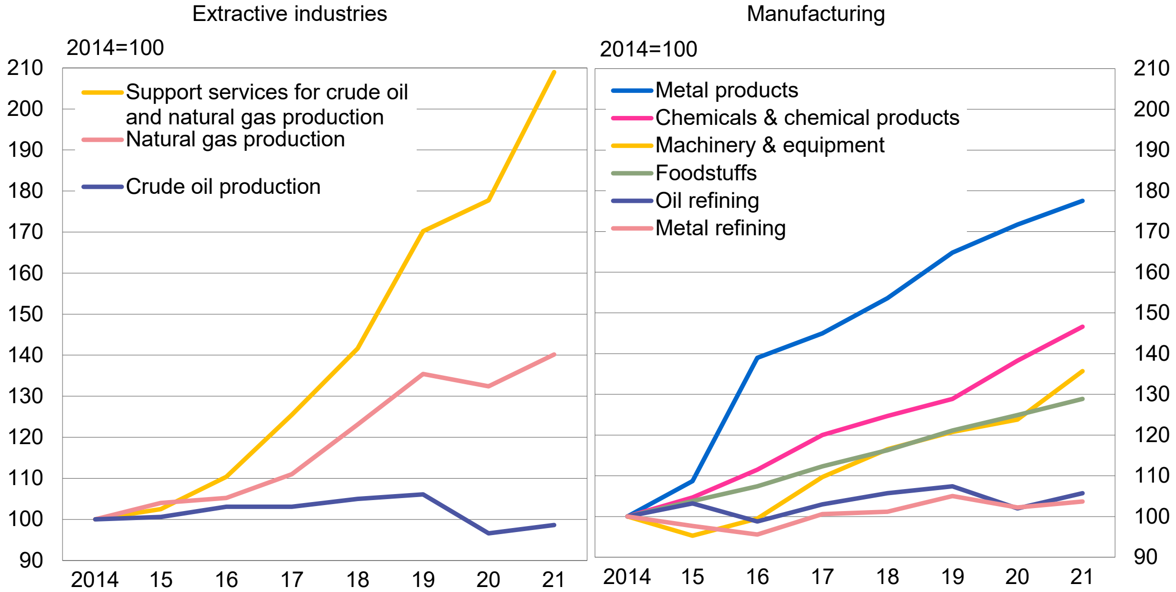
The recovery in household consumption of goods and services slowed in 4Q21. Growth from two years previous in the fourth quarter was less than 0.5 %, down from about 1.5 % in the first three quarters of 2021. Consumption in November was depressed by a roughly week-long covid shutdown, as reflected in lower retail sales. While retail sales revived in December, they were still up by only about 3 % from two years previous, a weaker performance than the 4–5 % growth in January-October.

Household real incomes overall were up by about 1.5 % from two years previous in 4Q21. Growth was about 2 % for all of 2021. The pace of recovery in real household incomes varied considerably last year, due in part to a directed one-time payout to pensioners and select government employee groups in conjunction with the Duma election last autumn as well as the timing of social support spending during 2020. Excluding pensions and other social support measures, there was essentially no growth in real incomes from two years previous either in 4Q21 or all of 2021. On the other hand, real growth in household wage income from two years previous was over 4 % both in 4Q21 and all of last year.

With a 6 % bump in 2021, construction increased rapidly among production activity branches. This came on top of the 2020 figures which have been revised upwards and showed a slight increase also in 2020. Goods transport increased by over 5 %, recovering roughly to the 2019 level. Output continued to rise in the mineral extraction sector in the final months of 2021 as crude oil production recovered, due largely to relaxation of OPEC+ production ceilings and continued strong growth in natural gas production.

Brisk growth in manufacturing output in the final months of last year translated to growth over 10 % from two years previous. Growth in 2019–2021 averaged 3.3 % a year. Some of the largest manufacturing branches experienced brisk growth over the past two to three years, including the chemical industry and machinery & equipment. Russia's pharmaceutical industry has reached a decent size having led growth in manufacturing, e.g. 20 % a year in 2019–2021.

Some of the large industrial branches in Russia have posted good growth in recent years



Sources: Rosstat and BOFIT.

Central Bank of Russia tightens its monetary policy. To tame high inflation, the Central Bank of Russia (CBR) on February 11 raised its key rate by 100 basis points to 9.5 %. The rate hike was of the same magnitude as in December. It was

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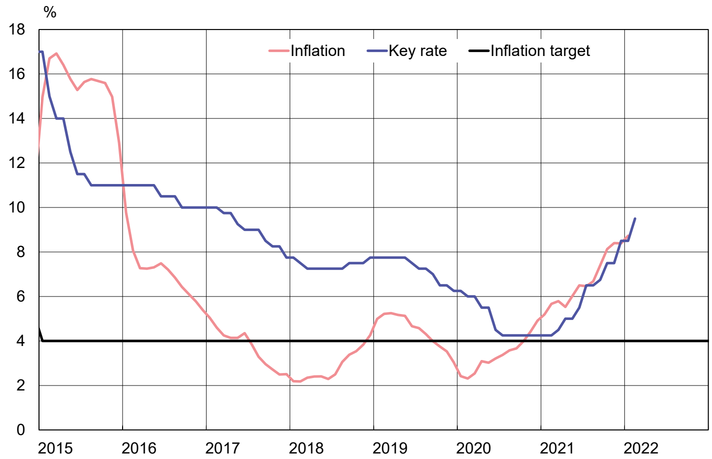
the eighth hike in the key rate since last March. The key rate has not been this high since April 2017. In its forward guidance, the CBR did not rule out the possibility of further hike at its next meetings.

January consumer prices rose by 8.7 % y-o-y, a pace well above the CBR's 4 % target level. Food prices were up by 11.1 % y-o-y in January, while other goods rose by 8.7 % and services by 5.4 %. The acceleration in inflation is a global phenomenon and due to multiple factors, some of which are transitory (BOFIT Weekly 51/2021). Inflation risks are still elevated, but the CBR expects 12-month inflation to decrease to 5–6 % p.a. (4–4.5 % earlier) in 2022. The CBR also sees inflation returning to its 4 % target level in mid-2023.

The CBR also slightly modified its outlook on Russian economy. The 2023 GDP growth projection was reduced from 2–3 % earlier to 1.5–2.5 %. The 2022 and 2024 growth forecasts remained unchanged at 2–3 %. The average of the key rate is expected to be this year in the range of 9–11 % (7.3–8.3 % earlier) and 7.5–9 % in 2023 (5.5–6.5 % earlier).

The CBR raised its key rate again to tame high inflation



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

Strong growth in bank lending fuels Russian domestic demand. The stock of household loans grew last year by 23 % and the stock of corporate loans by 12 %. Growth in housing loans remained brisk, thanks in part to continued policy measures to support mortgage borrowers. As a result, the interest rate on loans for newly constructed housing has remained remarkably low. In December, a quarter of new housing loans qualified for government loan subsidy programmes.

While rapid growth in consumer credit has supported domestic demand, the pace of growth has heightened concerns about the ability of borrowers to make their payments. The CBR has sought to quell growth in consumer credit through tightened macroprudential regulations. While these measures have yet to have much impact on slowing growth in consumer credit, the combination of macroprudential measures and central bank rate hikes is expected to reduce growth rates in the coming months.

The CBR suggests that the current rapid growth in corporate credit may reflect a revival in fixed investment demand. The household credit stock is almost entirely denominated in rubles, while about 23 % of corporate loans are in foreign currencies (mainly euros or dollars).

Corporate deposits rose significantly last year, partly reflecting improved corporate profitability due to higher export prices. The stock of household deposits grew slightly faster than in 2020. The rise in rates paid on deposits and volatility in stock and bond markets increased the popularity of bank deposits, especially in the final months of last year. About 20 % of household deposits and 30 % of corporate deposits are in foreign currencies.

Increased loan demand helped boost banking sector profitability, which was up by about 50 % from 2020. In addition to growth in income from interest, commissions and fees, moderate level of provisioning boosted the sector's profits last year. When the covid pandemic hit in 2020, banks significantly increased their loan loss reserves. So far, however, rapid economic recovery and various payment extensions and government interest subsidies have kept credit losses at low levels. The share of non-performing corporate loans fell substantially last year.

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Bank lending and deposits were up sharply in 2021

	Stock as of 1.1.2022 RUB billion	yoy change in Dec. 2020, %	yoy change in Dec. 2021, %	average rate in Dec. 2021, %
Household lending	25 068	14	23	10.8
- Housing loans*	11 711	21	25	5.8
- Consumer loans*	11 595	9	20	
Corporate lending	52 654	10	12	8.5
Household deposits	34 695	4	6	6.5
Corporate deposits	28 304	16	18	7.4
Public sector deposits	6 264	9	57	

Sources: Central Bank of Russia and BOFIT.

Russia and China strive to increase their bilateral trade. As part of the February 4 meeting of presidents Vladimir Putin and Xi Jinping at the opening of the Beijing Winter Olympics were signed e.g. a joint policy decree and a "road map" to increase bilateral trade to a level of $200 billion a year by 2024.

Media reports indicate that the road map sees growth in China's exports to Russia in such categories as cars, rail system and subway components, construction materials, textiles, as well as fruits and vegetables. The growth potential for Russian exports to China would come largely from agricultural products, metals and energy products. China-Russia bilateral trade (goods and services) last year amounted to about $150 billion. China accounted for 14 % of Russia's total goods exports and 25 % of total goods imports. Russia represented 2 % China's total goods exports and 3 % of total goods imports.

New oil & gas contracts were also announced in conjunction with Putin's visit. Gazprom and CNPC said that they had agreed on additional gas supplies of 10 billion m^3 a year over 25 years. Fulfilment of the agreement apparently requires additional investment on Gazprom's part and no starting date has yet been announced. The gas supply is set to grow also through the Power of Siberia pipeline, which should hit full capacity of 38 billion m^3 a year by 2024. Last year, Russia exported about 14 billion m^3 of natural gas (pipeline gas and LNG) to China. China accounted for about 6 % of Russia's gas exports. Russia accounted for about 8 % of China's gas imports.

Rosneft and CNPC also announced a 10-year agreement on delivery of a total of 100 million tons of crude oil. Russia last year exported about 70 million tons of crude oil to China. China accounted for 30 % of Russia's oil exports. Russia accounted for 16 % of China's crude oil imports. Russia's economic relations with China and other major economies are discussed in our latest BOFIT Policy Brief.

China's share of Russia's foreign trade is much larger than Russia's share of China's foreign trade

Sources: CEIC, Russian Customs, BOFIT.

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Weekly Review
8 • 25.2.2022
BOFIT

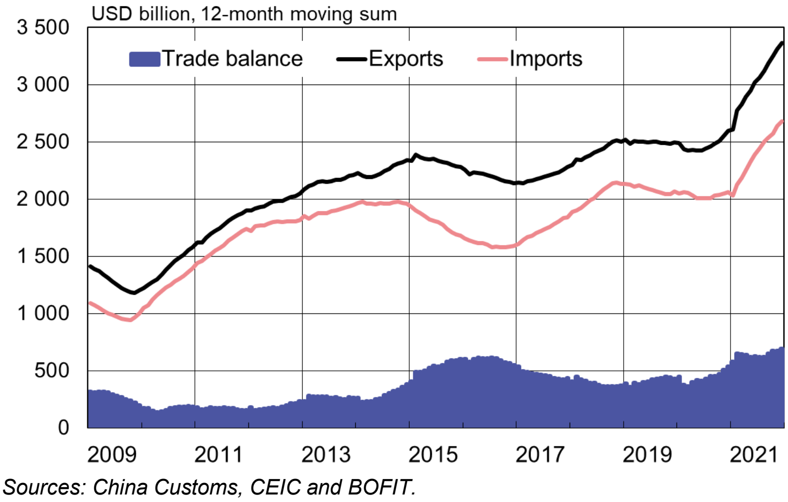
China

China posts record trade surplus in 2021. China's goods exports last year rose to $3.37 trillion, a 30 % increase from 2020. Imports also climbed by 30 % to $2.68 trillion. The trade surplus reached a record $690 billion, a 28 % increase from 2020. During the first two years of the covid pandemic (2020 and 2021), China's goods exports rose by 35 % in dollar terms and imports by 30 %. Some of the growth in the value of imports and exports during the pandemic reflects higher prices; export volume growth was lower than growth in dollar-measured value. In November 2021, China's export volumes were up by 18 % and import volumes by 8 % from December 2019. China has increased its share of global trade with growth in export volumes outstripping global trade growth (up 6 %).

Balance-of-payments figures show that last year's current account surplus was just under 2 % of GDP. The current account surplus has been boosted by a decrease in the services trade deficit. The pre-pandemic services trade deficit, i.e. the difference between imports and exports of services, typically ran around 2 % of GDP. It shrank last year to just 0.5 %. Services imports have plummeted during the pandemic as the spending of Chinese tourists abroad has collapsed. Tourism accounted for half of pre-pandemic services imports.

The Regional Comprehensive Economic Partnership (RCEP) free-trade agreement entered into force at the beginning of this year. The RCEP comprises China, Japan, South Korea, Australia, New Zealand and the countries in the ASEAN economic community. Even if China already previously had bilateral trade agreements with several RCEP countries, this is its first trade agreement with Japan. Under the agreement, 86 % of China imports from Japan will be tariff-free (currently 8 %). Correspondingly, Japan will raise its share of tariff-free Chinese imports from 60 % to 88 %. Even with its share shrinking over the past decade, Japan remains among China's most important trading partners (6 % of China's foreign trade). A goal of the RCEP is to open the services sector to foreign competition. The partner countries commitment to open at least 65 % of their service sectors to fellow members could have significant impacts on education, finance and cultural services in China.

China's foreign trade soared last year



Sources: China Customs, CEIC and BOFIT.

Relaxation of capital controls and increased foreign trade help boost international use of the yuan. SWIFT, the Society for Worldwide Interbank Financial Telecommunication, reports that in January the yuan became the fourth-most-used global payments currency, accounting for 3.2 % of all payments. The yuan still distantly lags the US dollar (39.9 % share), euro (36.6 %) and British pound (6.3 %). Its use has increased from January 2020, when the yuan was sixth in the international use ranking, trailing the Japanese yen and Canadian dollar. Hong Kong is China's main offshore yuan trading hub, accounting for over 75 % of offshore yuan payments in January. The next biggest yuan payment intermediaries were the United Kingdom (6 % share), Singapore (3 %) and South Korea (3 %).

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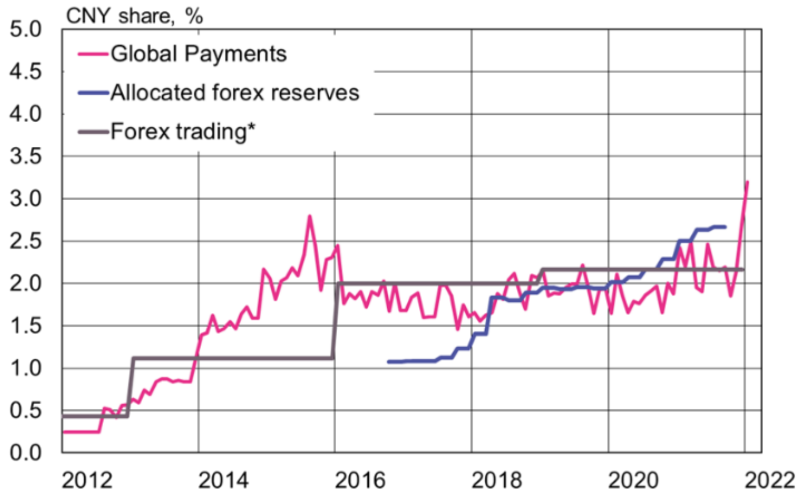
The rapid growth in Chinese foreign trade has support international use of the yuan. Notably, trade with Russia has shifted increasingly from transactions in dollars to transactions in euros or yuan. Still in recent years, for about 15 % of China's foreign trade have been in settled in yuan. At the peak in 2015, a third of foreign trade transactions were conducted in yuan.

Gradual capital market opening and increased foreign ownership especially in mainland-China bond markets has increased international yuan usage. The People's Bank of China reports that foreign investors held $642 billion in mainland China bonds (up by 23 % y-o-y) at the end of 2021. Even so, that represents just 3 % of China's overall bond market. Foreign ownership is concentrated in government and policy bank bonds that are also included in international bond indices. Central banks have also added to their yuan-denominated reserve holdings, most notably Russia's decision to shift its reserve assets out of dollars into other currencies. IMF figures show that 2.7 % ($319 billion) of allocated forex reserves globally were in yuan in September 2021. Figures from the Central Bank of Russia show that 13 % ($78 billion) of its currency reserves were in yuan in June 2021. That amount represented a quarter of all yuan central bank forex reserves globally.

Foreign participation in China's stock markets has increased since 2019, when shares of mainland China firms were included in international stock market indices. The value of foreign ownership in mainland China equites was $619 billion at the end of 2021, roughly 4 % of China's stock capitalisation. Foreign investor trading and holdings have been boosted by the Stock Connect arrangement between Hong Kong and the Shanghai and Shenzhen bourses. The Stock Connect arrangement between Shanghai and London, launched in 2019 (BOFIT Weekly 26/2019), has yet to generate much enthusiasm. Currently, investors only have access to the depository receipts of four Chinese firms. Chinese investors have zero access firms on the London Stock Exchange. To ameliorate the situation, China Securities and Regulatory Commission (CSRC), updated its rules for the Shanghai-London Stock Connect in February. The programme is also being expanded to Switzerland and Germany, as well as to firms listed on the Shenzhen Stock Exchange.

Increased international use of the yuan has been expedited with a payment infrastructure created by China. Even if it still only accounts for about 0.3 % of international payments traffic, China's yuan-based Cross-border Interbank Payment System (CIPS) has experienced robust growth since its 2015 launch. Introduction of the digital yuan and cross-border testing of its use can make global use of the yuan easier in the future and reduce transaction costs. Ultimately, international use of a currency is determined by the issuing country's economic fundamentals, financial market openness, legal frameworks and credibility. Without further lifting its capital controls, the digital currency itself is unlikely to boost international yuan use significantly.

While still relatively minor, international use of the yuan continues to rise



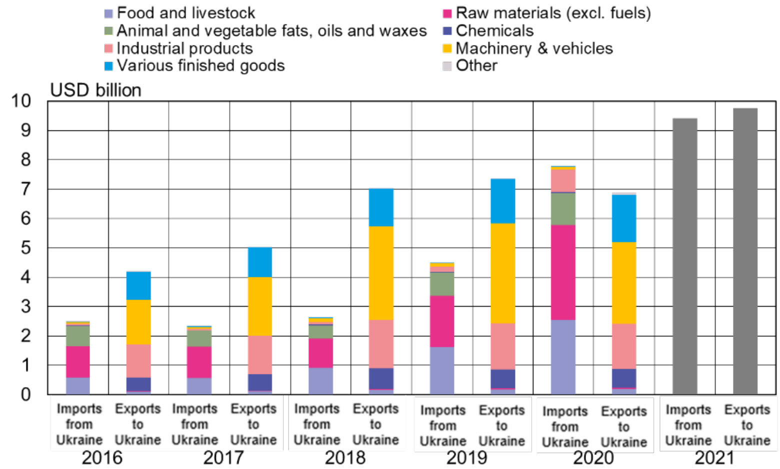
**The most recent BIS Triennial Central Bank Survey of Foreign Exchange was in 2019.*
Sources: BIS, IMF, SWIFT, Macrobond and BOFIT.

China's imports from Ukraine quadrupled over the past four years. China-Ukraine bilateral goods trade has grown briskly in recent years. China last year exported $9.8 billion in goods to Ukraine, while importing goods worth $9.4 billion from Ukraine. China's exports to Ukraine nearly doubled over the past four years, while imports quadrupled. Despite robust growth, Ukraine-China trade represents only about 0.3 % of China's foreign trade. China, in contrast, accounts for about 15 % of Ukraine's foreign trade.

Chinese exports to Ukraine are dominated by electronic goods such as mobile phones, computers and other machinery & equipment. The bulk of Ukraine's consumer goods imports such as clothing, footwear and bicycles come from China. China is also a big provider of medicines (e.g. antibiotics). China mainly imports commodities from Ukraine such as iron ore, agricultural products and basic metal products. Grains (mainly maize, barley and wheat) accounted for half of China's agricultural product imports from Ukraine in 2020. The only important high-tech product that China imports from Ukraine is jet turbine engines. China buys nearly half of Ukraine's iron ore production, barley, jet turbine engines and vegetable oils.

In 2018, China opened a Belt and Road Initiative trade and investment centre in Kyiv that was the harbinger of increased Chinese corporate investment, especially in Ukrainian ports. For example, China's giant state-owned food processor, the COFCO Group, invested $50 million in the Port of Mariupol to triple its ship loading capacity. China has also established a direct rail connection with Ukraine. Since July 2020, a weekly container train has been running between Wuhan and Kyiv. A second regular container train connection between Guangdong and the Pivdennyi seaport near Odessa was inaugurated in June 2021. It can take roughly 20 days for a container train to make the 9,000 km journey with a standard load (45–50 containers). China's overall foreign direct investment in Ukraine is still relatively small, however. In total, China and Hong Kong have invested just over $100 million in Ukraine, or about 0.3 % of Ukraine's total FDI stock. Ukraine's corporations registry shows that Chinese own fewer than 500 firms in Ukraine, and of those, just 40 have annual earnings exceeding $1 million.

China's imports from Ukraine have quadrupled in just four years



Sources: UNCTAD and BOFIT.

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Weekly Review
9 • 4.3.2022

BOFIT

Russia

Ruble and stock markets tumble on Russia's February 24 invasion of Ukraine. The ruble's exchange rate has fallen to historical lows this week. Western sanctions have blocked the Central Bank of Russia from supporting the ruble through sales of its foreign currency reserves. The sanctions have hit hard the ability of Russia's banking sector to borrow on international markets. Regular Russians, panicked at the thought of their savings evaporating, have drained their bank accounts and hoarded cash.

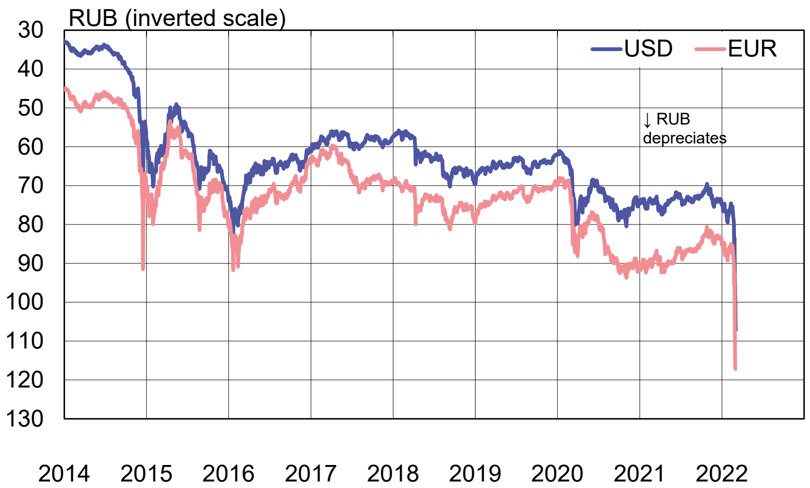
To deal with the double-whammy of a freefalling ruble and bank runs, the CBR raised its key rate to 20 %. The CBR also vastly increased the amount of liquidity available to the markets and pulled back on banking regulations to prevent a collapse of the banking sector. President Vladimir Putin issued a decree on capital controls that requires e.g. export firms to sell 80 % of their forex earnings to support the ruble. There are also restrictions on the amounts that can be transferred to foreign accounts and taken out of the country in the form of forex cash. Russian firms and private individuals can still pay their invoices to foreign firms in foreign currencies, however.

The MOEX, the Moscow Exchange's ruble-priced share index, lost a third of its value on February 24 – the largest one-day drop in the history of the Moscow bourse. The collapse of the stock market affects the wealth of many Russians as the Moscow Exchange last year had about 15 million retail customers. The Moscow Exchange has been closed all this week, but Russian shares listed on foreign stock exchanges have seen their prices decline sharply this week.

The Russian government has decided to support the Russian stock market by purchasing 1 trillion rubles worth of shares of Russian firms with money from the National Welfare Fund. In addition, the possibilities of foreign investors to repatriate their investments in Russian assets are restricted.

World oil prices soared over the past week. The Brent crude oil price this week climbed above $110 a barrel for the first time since summer 2014. The price of Russian crude (e.g. Urals) has been considerably lower. The US and several other countries have promised to release crude oil from their strategic reserves to quell the price rise. At their meeting on Wednesday (Mar. 2), the representatives of the OPEC+ countries, which includes Russia, reaffirmed their commitment to not increasing oil output any faster than they had agreed earlier.

The ruble's exchange rate collapsed after Russia invaded Ukraine



Source: Reuters, BOFIT.

Russia's unprovoked attack on Ukraine draws massive economic sanctions from the West. The new sanctions include restrictions on the financial sector, export bans and sanctions targeting specific individuals. The sanction schemes are largely coordinated by the EU and US, but individual Russian banks, for example, may get different treatment with respect to specific sanction measures. The purpose of wide-ranging sanctions is to increase the costs to Russia for staging an unprovoked attack on its neighbour and reduce the amount of funds available to finance war.

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Weekly Review
9 • 4.3.2022

BOFIT

The financial sanctions of the EU and US effectively deny a significant part of the Russian banking sector of access to financing and payment traffic outside Russia. Sberbank and VTB, among Russia's largest banks, already had limited access to financing from the EU and US. Now the US has, among other things, banned all dollar-based transactions with Sberbank and confiscated all of VTB's assets in the US. The EU's sanction measures led to the expulsion of seven Russian banks from the SWIFT banking communications system, but this measure does not concern e.g. Sberbank or Gazprombank. EU sanctions also prevent the access of privately-owned Alfa Bank for financing from EU countries. US sanctions extend to the privately held Moscow Credit Bank.

Significant sanctions have even been imposed on the central bank of Russia. Sanctions mean that the central bank has very limited access to Russia's currency reserves invested abroad, even if this money is needed to prop up the ruble's exchange rate. Supply of euro cash to Russia is also banned. Also financing of a number of Russia's state-owned enterprises has been affected, including Russian Railways (RZD) and truck manufacturer Kamaz.

The EU and US have introduced a range of export bans that include dual-use products that can be used for civilian or military purposes, as well as a broad swath of high-tech products. The US earlier announced that semiconductors manufactured with American equipment or software made in the US, or products containing such semiconductors, can no longer be exported to Russia. The world's top semiconductor producers, particularly those in Taiwan, have announced that they will comply fully with the sanctions regime. In addition, exports of aircraft and related components to Russia are now banned. Boeing and Airbus have already announced that they will no longer supply spare parts to Russia, making servicing of aircraft all but impossible. A huge share of planes in the Russian airline fleets are leased from abroad, particularly Ireland. Leasing firms may seek to move these planes from Russia.

Sanctioned individuals typically face being shunned from the business community and a freezing of their assets. Earlier EU and US sanctions already included punishments for top management in Russian firms, particularly oligarchs with business empires. That list has now been extended. The EU, US and UK took the unprecedented measure of imposing personal sanctions on Russia's head of state, president Putin, as well as Russian foreign minister Sergey Lavrov. Any identifiable assets of these two held abroad have been frozen.

Sanctions on Belarus were increased after the country made itself available to Russia for staging the invasion of Ukraine from the north. It now appears that Belarussian troops are even participating in the invasion. As a result, several Belarussian banks have been added to the sanctions list. The EU's latest import bans now cover about 70 % of Belarussian exports to the EU. Products added to the import sanctions list include wood, steel and iron. In addition, the earlier announced sanctions on imports of potassium carbonate (potash), along with fertilizers that contain potash, have been severely tightened.

The new round of sanctions targets many of Russia's largest banks

Bank	Total assets, RUB billion end-2021	Share of Russian banking system	Financial ban (EU, US or both)	SWIFT ban	SDN (US)	Payment transaction ban (US)
Sberbank	38,631	37 %	X			X
VTB	19,485	19 %	X	X	X	
Gazprombank	8,620	8 %	X			
Alfa Bank	5,726	6 %	X			
Russian Agricultural Bank	4,264	4 %	X			
Moscow Credit Bank	3,482	3 %	X			
Otkrytie Bank	3,315	3 %	X	X	X	
Sovkombank	2,074	2 %	X	X	X	
Promsvyazbank	Unknown	Unknown	X	X	X	
Raiffeisen Bank Russia	1,812	2 %				
Rosbank (Société Générale)	1,597	2 %				
Rossiya Bank	1,315	1 %	X	X	X	
Tinkoff Bank	1,288	1 %				
Unicredit	1,220	1 %				
Novikombank	677	Less than 1 %		X	X	
Eximbank (Roseximbank)	214	Less than 1 %			X	

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Total banking sector	104,023					
VEB.RF	3 898			X	X	

The Specially Designated Nationals and Blocked Persons List (SDN list) targets persons and institutions that US entities may not do business with or otherwise provide financing and technical support. The list is maintained by the US Department of the Treasury.

Sources: EU, US treasury department, CBR and various news outlets.

Russia was Finland's sixth-largest export market in 2021. Preliminary figures from Statistics Finland show that the value of Finland's exports of goods and services to Russia last year amounted to 4.4 billion euros. Russia accounted for 5 % of Finland's exports. Machinery, equipment & transport vehicles accounted for about a third of exports. Chemical products and metals were also major export goods. Services represented 11 % of exports last year. Tourism services, which traditionally accounted for the bulk of services exports, nearly vanished during the covid pandemic.

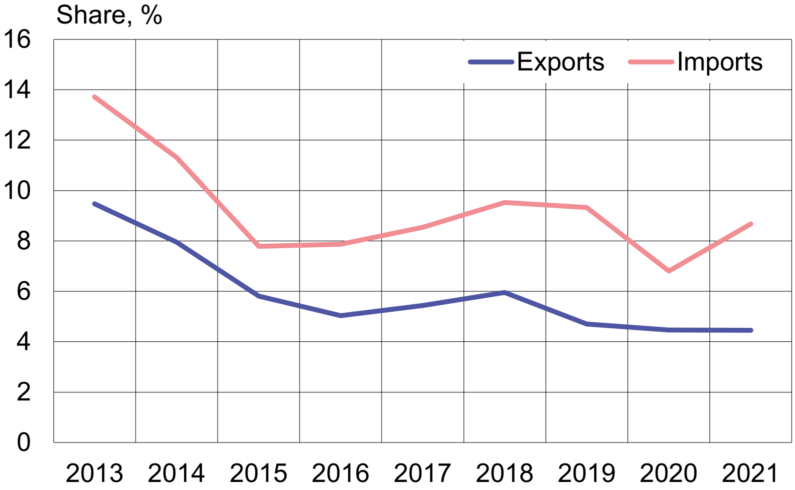
Last year, the value of imports of Finnish goods and services from Russia was about 8.5 billion euros. Russia accounted for 9 % of Finland's total imports. Mineral products, mostly crude oil, account for 60 % of Finland's imports from Russia. Russia has long been Finland's top supplier of crude oil and natural gas. Other major import products included metals and chemical products. Services represented 6 % of imports.

In 2019, Finnish parent companies had a total of 295 subsidiaries in Russia. Their combined net sales amounted to 6.5 billion euros. In 2020, Russian parent firms had 20 subsidiaries in Finland with combined net sales of 3.2 billion euros. They employed roughly 740 people.

Finnish goods exports to Belarus last year were worth 80 million euros, and Belarus represented 0.1 % of Finnish exports. The value of goods imports was about 20 million euros. In 2019, Finnish parent companies controlled 15 subsidiaries in Belarus with combined net sales of 260 million euros.

Finnish goods exports to Ukraine last year were worth 215 million euros or 0.4 % of total Finnish exports. The value of goods imported from Ukraine was about 90 million euros. In 2019, Finnish parent firms had 39 Ukrainian subsidiaries with total net sales of about 200 million euros.

Russian share of Finland's foreign trade (goods & services) has contracted over the past decade



Source: Statistics Finland.

China

Russia sanctions affecting China as well. In the first two weeks after Russia's unprovoked invasion of Ukraine, China sought to strike a balance with both sides in its political statements. Russia's actions were not officially condemned, yet Ukraine's sovereign rights to self-determination and territorial integrity were seen as givens. It now appears China's tightly controlled state media is tilting clearly in Russia's favour. While China has offered to act as an intermediary between Ukraine and Russia in peace talks, the matter has not moved any further.

Sanctions imposed on Russian banks and the exclusion of seven Russian banks from the international SWIFT financial messaging system also impact the operations of Chinese banks, who face the threat that the United States will impose secondary sanctions to foreign banks that violate the sanctions regime and thereby lose access to US financial markets and dollars. While most Chinese banks have been reluctant to comment on the situation, ICBC, China's largest bank, announced that it was immediately ending the granting of dollar-based letters of credit for Russian trade. Letters of credit are used widely in Russia and China's bilateral commodities trading. In addition, Bank of China announced it was suspending some funding to Russia related to trade. A part of US sanctions on Russian banks do not enter into force until March 26.

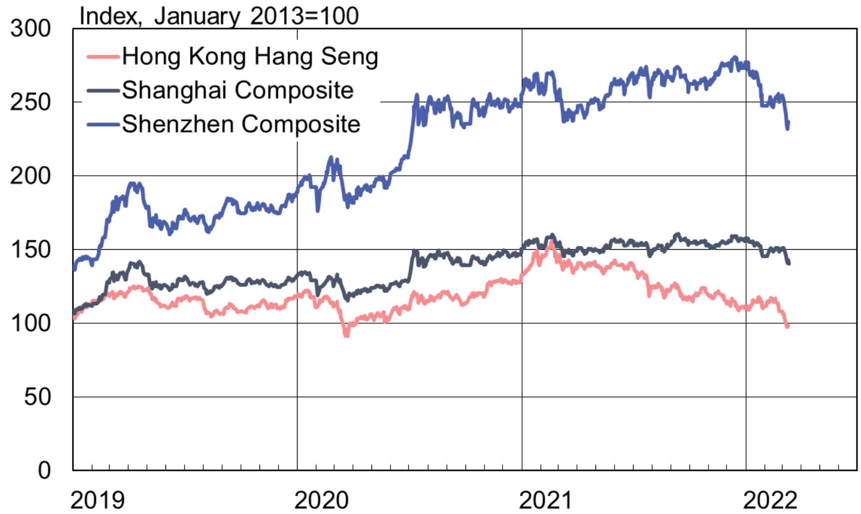
The complication of payment traffic between Chinese and Russian banks reflects directly on companies engaged in bilateral trade. Several Chinese firms have noted difficulties in commodity trading, referring directly to the suspension of dollar-based letters of credit. According to the *Financial Times,* sanctions and the ruble's collapse have cut Chinese exports of smartphones to Russia by at least half. On Thursday (Mar. 10), Russian officials claimed that, due to sanctions, China is refusing to sell them aircraft parts. Moreover, many international shipping companies have ceased ship to and from Russia, and some European ports such as Hamburg now refuse to handle any containers destined for or coming from Russia. Such measures significantly hamper Russia-China trade. In trade policy, China announced a lifting of all bans on Russian wheat imports on the very day of the Ukraine invasion (Feb. 24).

Following the World Bank's announcement, the China-driven Asian Infrastructure Investment Bank (AIIB) last week said it was halting operations involving Russia or Belarus. AIIB granted a total of $800 million in loans to Russia during 2019 and 2020. The loan applications currently under consideration are worth about $300 million. Two loans to Belarus for a total of roughly 200 million euros are also under consideration. The New Development Bank (formerly the BRICS Development Bank) announced it has suspended all new lending to Russia.

In recent weeks, Chinese financial markets have been reacting both to current world events and a worsening domestic covid situation. The drop in share prices last week has continued this week. Since the February 24 invasion, the Shanghai exchange is down by 7 %, Shenzhen by 9 % and Hong Kong by 12 %. The yuan's exchange rate has remained stable against the US dollar. While *Bloomberg* says that foreign investors sold off more Chinese bonds in February than ever, it is unclear how much of the sell-off occurred after Russia attacked Ukraine.

Commodity prices in China have risen in line with climbing world market prices. China's current pricing mechanism translates increases in global crude oil prices to higher prices at the gasoline pump, and as a result, China is experiencing record-high fuel prices as in many countries. China's pricing mechanism, however, freezes domestic fuel prices when the price of crude oil on global markets hits $130 a barrel. On Wednesday (Mar. 9), the National Development and Reform Commission (NDRC) called on the country's large state-owned oil refiners to halt exporting fuels in April to prevent fuel shortages at home.

Stock market indices in mainland China and Hong Kong have fallen in recent weeks



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

This year's economic goals rolled out at National People's Congress. On Saturday (Mar. 5), the 2,980-member People's National Congress convened for a week-long plenary session in Beijing. As part of the opening-day presentations, premier Li Keqiang laid out the government's working programme, including this year's economic growth targets. The official national GDP growth target was set to 5.5 %. It came as no surprise, as the provincial 2022 growth targets announced in January already indicated that the national target would be in the range of 5–6 %.

Stimulus measures will be needed even if China's growth target this year is fairly modest from a historical perspective. Economic growth has been dragged down especially by the on-going struggles of the real estate sector and lockdowns caused by the highly contagious omicron variant. China's growth outlook is also clouded by the sharp rise in commodity prices and external demand uncertainty stemming from Russia's attack on Ukraine. China officially speaks more vaguely about a triple pressure: "falling demand," "supply disruptions" and "diminished expectations." The working programme accentuates that economic stability is the government's crowning priority, which will undoubtedly guide all its policy decisions this year.

In addition to the GDP growth target, the working programme laid out other targets for this year. Urban areas are expected to create 11 million new jobs and the unemployment level is expected to remain below 5.5 %. Disposable household incomes should keep pace with economic growth, while on-year inflation should hold at around 3 %. The target ratio of budget deficit to GDP will shrink from 3.2 % last year to 2.8 % this year. As in 2021, this year's quota for local government special bonds will be 3.65 trillion yuan ($580 billion) to fund various projects.

Unlike in earlier years, no special targets have been announced for reducing energy consumption. Instead, the emphasis this year is on securing energy supplies. Premier Li stressed China's need to increase domestic production of oil, natural gas and coal, replenish national stockpiles, as well as stabilise price trends. The shift in policy emphasis is likely to impede measures to reduce carbon emissions for at least the rest of this year.

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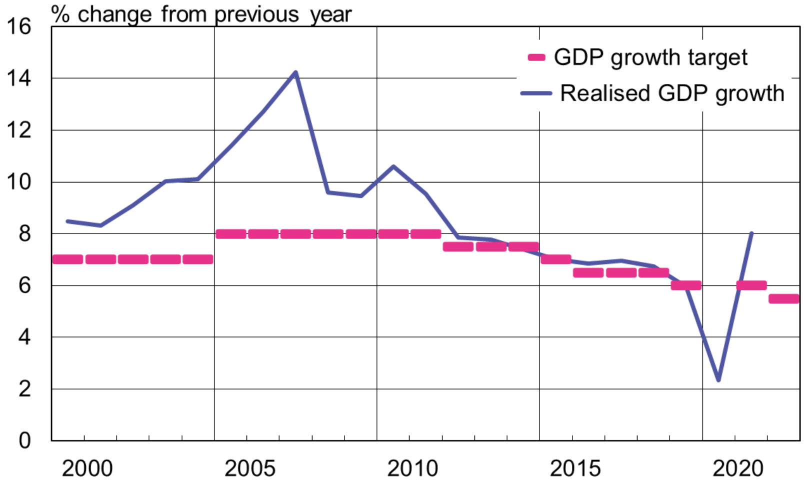
China's 2022 GDP growth target has been set at 5.5 %



Actual annual targets: "about 7.5%" in 2014, "close to 7%" in 2015, "6.5-7%" in 2016, "about 6.5%" in 2017 and 2018, "6–6.5%" in 2019, no target in 2020 and "over 6%" in 2021.

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

Covid case rates up in mainland China and Hong Kong. China's National Health Commission reports that daily cases this week exceeded 500 for the first time since March 2020. The case numbers are still remarkably low for a country of 1.41 billion people. At the advent of the covid pandemic in January-February 2020, China's infection rate averaged around 2,000 a day. Not a single covid death has been reported in China since January 2021.

China has used a "zero covid" suppression strategy that has incorporated strict lockdowns and restrictions on movement. While these measures have become more targeted over time, China still has outdoor movement bans in some communities e.g. in Beijing, Shandong and Jilin. Factories, schools and public spaces remain closed in some regions. China has recently begun to discuss cutting back on its zero-covid policy and learning to live in a world where the covid-19 virus is endemic. Even so, foreign travel, for example, is not expected to open up for a long while.

Vaccination rates in mainland China are generally high, but vary across regions. As of end-February, over 85 % of the Chinese population had received two doses of vaccine and 38 % had received their third booster shot. China has not approved the mRNA vaccines used in the West, preferring to stay with more traditional inactivated virus vaccines manufactured in China. The Chinese vaccines, most notably from Sinovac and Sinopharm, have shown waning resistance to the delta and omicron variants. China is currently developing its own mRNA vaccines.

The covid situation in Hong Kong got out of hand quickly. The region's 7.4 million population has this month witnessed daily case numbers in excess of 50,000 and nearly 300 daily covid deaths. Until very recently, Hong Kong had managed to keep its case numbers extremely low (typically a few dozen cases a day) through strict covid policies and mandatory quarantines for anyone seeking to enter the region. Hong Kong residents also have access to the Pfizer-BioNTech mRNA vaccine, but the overall vaccination rate is relatively low. At the beginning of March, roughly 70 % of the population had received two doses of vaccine and about a quarter had received their booster. Notably, the vaccination rate for Hong Kong's elderly population is low.

Hong Kong has imposed very strict limits on public gatherings and all its residents are to be tested three times during March. In addition, the government is trying to ramp up hospital capacity. As a worsening of the covid situation hurt the economy, Hong Kong is distributing consumption vouchers to their residents again this year. Despite the efforts, institutional forecasters have significantly cut their growth projections for Hong Kong, some even predicting a recession.

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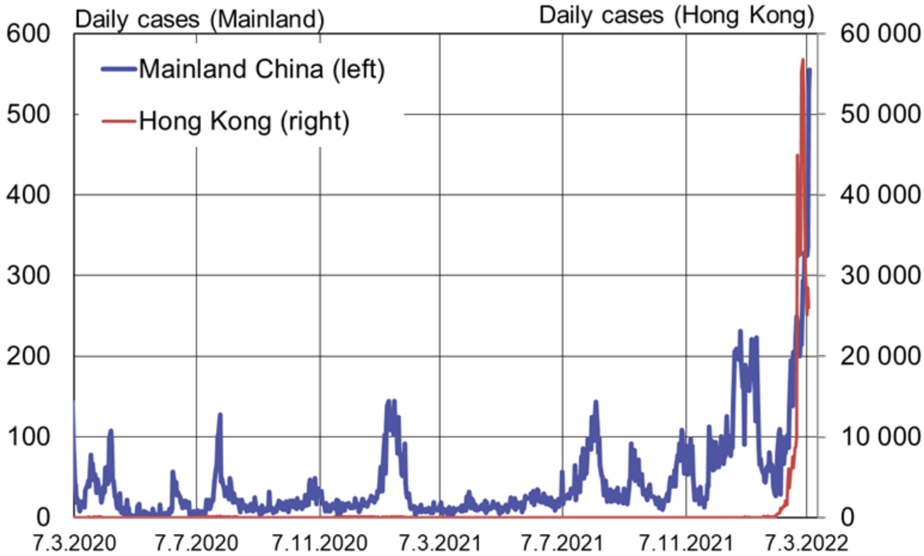
Daily covid case numbers in mainland China and Hong Kong are currently running at the highest levels in two years



Sources: China National Health Commission, Johns Hopkins University, CEIC and BOFIT.

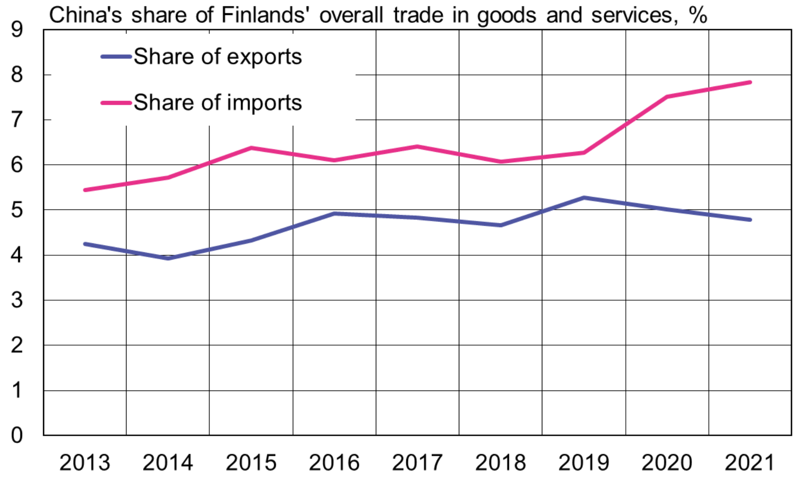
Finland's imports from China increased during the pandemic. Statistics Finland reports that the value of Finnish exports of goods and services to China last year amounted to 4.7 billion euros, or 9 % more than in 2020. As Finland's total exports of goods and services increased by nearly 15 % y-o-y, China's share of Finland's total exports declined slightly to just under 5 %.

Pulp used in papermaking accounted for 24 % of all Finnish exports to China. Another major share (22 %) consisted of different kinds of machinery, equipment and measurement devices. The value of services exports was just under 1.4 billion euros, or 29 % of Finnish exports to China. In the pre-pandemic year of 2019 before travel restrictions were imposed, the value of Finnish services provided to China was nearly 1.8 billion euros, or 35 % of all Finnish exports to China.

The value of Finnish imports of goods and services from China rose last year to over 7.6 billion euros, a 20 % increase from 2020. China's share of Finland's total imports has grown during the pandemic to nearly 8 % last year. Some 37 % of imports consisted of phones, computers or other electrical machinery and equipment. Clothing and other finished goods made up 13 % of imports, and services about 16 %.

As of 2019, Finnish parent companies had established a total of 254 subsidiaries in China, a number representing over 10 % of all Finnish subsidiaries outside the EU. Their total net sales in 2019 were around 13 billion euros and employed a total of 62,600 people. The workers at Finnish subsidiaries in China represent about a fifth of the total personnel working for Finnish subsidiaries outside the EU.

China's share of Finland's total imports rose to nearly 8 % in 2021



Sources: Statistics Finland and BOFIT.

Russia

Russia's invasion also causing economic damage to Ukraine. The waste and destruction of Russia's unprovoked attack on Ukraine includes harm to an economy that was just emerging from the acute impacts of the covid pandemic.

On March 9, the IMF approved Ukraine's request for a $1.4 billion loan under the Rapid Financing Instrument (RFI) facility. The RFI provides quick assistance to countries suffering from such events as a natural disaster or an armed conflict. While the fog of war makes forecasting difficult, IMF staff researchers currently expect Ukraine's economy to contract by about 10 % this year.

By shifting to the new programme, Ukraine Stand-by Arrangement, which started in June 2020, was cancelled. Ukraine received about $700 million in SBA funding in November 2021 (BOFIT Weekly 47/2021). Ukraine borrowed $2.8 billion under its latest SBA program, which started in 2020.

Ukraine also needs money to cover its projected public sector deficit. The IMF puts the country's financing needs this year at around $4.8 billion. With the country's access to capital markets effectively shut down, many international financial and other institutions have announced various financial assistance packages for Ukraine. The World Bank, for example, announced on March 7 that it was loaning Ukraine $350 million. Japan also declared it was providing a $100 million loan, while the Netherlands and Sweden together came up with $139 million in guarantees. In addition to loans, many countries (with the UK being the largest donor) have gifted a total of $134 million to Ukraine.

On March 11, the EU granted Ukraine the first 300-million-euro (about $330 million) tranche of a 1.2-billion-euro loan under the EU's Macro-Financial Assistance (MFA) programme. Ukraine is supposed to receive its second 300-million-euro MFA tranche this week.

Russia imposes currency controls to deal with the ruble's collapse. Because sanctions limit the Central Bank of Russia's possibilities to use its foreign currency reserves to support the ruble, Russian export firms are now required to convert 80 % of their forex earnings to rubles. The requirement increases the supply of foreign currency on Moscow's foreign currency exchange, especially due to the current rise in export commodity prices. Nevertheless, market trading activity has become thinner than ever and the market exchange rate of the ruble has fluctuated wildly.

In order to prevent capital flight, severe restrictions have been imposed on cross-border capital flows, and the ruble has ceased to be a fully convertible currency. There are restrictions on taking foreign currency out of Russia in the form of cash, and international bank transfers are extremely limited. All major business transactions with representatives of "unfriendly countries" must first be cleared with a committee established by the government. These include payments of interest and principal on corporate foreign debt.

Determining the market valuations of listed corporations or banks is not possible, as the Moscow Exchange has been closed for three weeks. The CBR announced this week that the trading halt would continue for at least the rest of this week. Part of the CBR's reluctance to allow a reopening of the exchange is the fact that there are many potential sellers and few potential buyers.

The CBR has slightly modified its method for calculating the official ruble-dollar exchange rate. It is now based on trading prices for an entire day's market session. Over the past three weeks, the ruble has lost almost 30 % of its value against the dollar. The ruble-euro exchange rate published by the CBR continues to be calculated from the official ruble-dollar rate and dollar-euro rate. Due to market conditions, The European Central Bank does not currently post a euro-ruble reference rate.

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The ruble has depreciated significantly against the US dollar over the past three weeks

Source: Reuters.

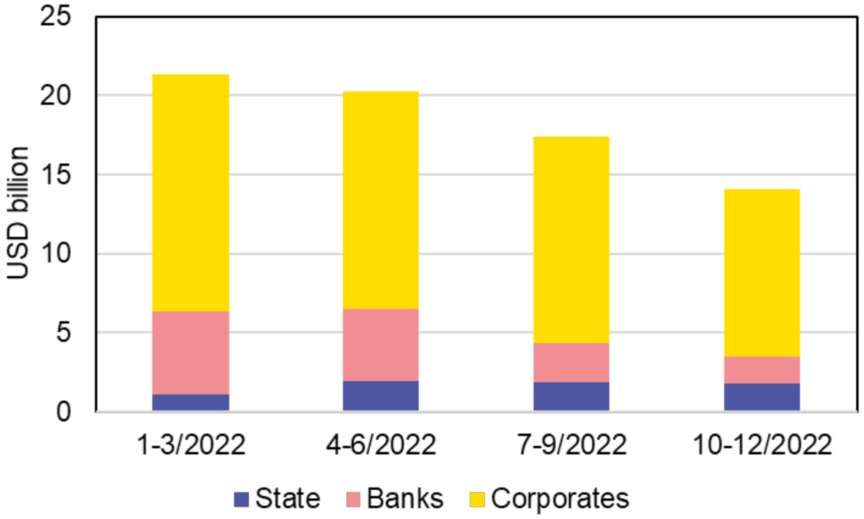
Russia on shaky ground in its ability to service foreign debt. The restrictions imposed to support the ruble and Russia's financial markets have made it difficult for firms to conduct normal financial transactions internationally. The CBR reports that $6.8 billion foreign debt of Russian corporates and about $1.4 billion in foreign debt of Russian commercial banks comes due in March. In April, about $4.4 billion in corporate and bank foreign debt payments come due. According to press reports, large firms such as Gazprom, Rosneft and Norilsk Nickel have generally made their foreign debt interest payments in a timely manner.

In contrast, there is uncertainty on Russian government's willingness and capacity to handle its foreign debt payments in timely fashion. This month, for example, the finance ministry paid the interest on its ruble-based loan bonds (OFZs), but all payments to foreign investors were then frozen in their ruble accounts in Russia. Unless the foreign investors are allowed to access their interest income, the situation may effectively be characterised as a payment default.

The interest payments on two government foreign-currency bonds came due on Wednesday (Mar. 15), and it was unclear whether investors would receive their money. It now seems the payments were wired on time. If Russia had failed to make timely payment, the parties would have a 30-day grace period to resolve how the payments will be made. Capital controls, sanctions and the looming economic crisis have already resulted in downgrades in the international credit ratings of Russian firms and commercial banks. A government debt default would have caused further downgrades. A total of just over $500 million in government foreign debt payments come due this month.

The CBR reports that Russia's foreign debt as of end-September 2021 totalled $490 billion, nearly 75 % of which was denominated in foreign currencies. Some $50 billion of the foreign currency debt was owed by the state or central bank. Commercial banks owed forex-denominated foreign debt of $55 billion and non-bank corporates about $140 billion to other creditors than direct investors. The rest of the foreign currency debt consisted of liabilities to direct investors.

Russia faces hefty foreign debt payments in the first half of this year



Sources: Central Bank of Russia and BOFIT. Chart includes payments on interest and principal.

Western countries impose more sanctions on Russia. Over the past two weeks, the US, EU and UK have expanded their sanctions regime against Russia (for earlier sanctions, see BOFIT Weekly 9/2022). The new sanctions are again largely coordinated, even if there are differences in the details of some measures. The new sanctions include investment restrictions, bans on exports and imports, as well as targeted sanctions on specific firms and individuals. Many other countries, including Canada, Japan and Switzerland, have joined the sanctions at least partially. In addition, G7 countries have decided to strip Russia of it Most Favoured Nation (MFN) status in trade with G7 members. MFN status assures countries of equitable treatment when their products are imported to a G7 country. The loss of MFN status means that G7 members are e.g. free to place higher import tariffs on Russian products than on imports from other countries.

Under the latest round of sanctions, the EU and US have banned (with a few exceptions) new investment in Russia's energy sector. The EU, US and UK also banned exports to Russia of various luxury goods such as fancy cars and expensive jewellery. The number of individuals and state-owned corporations subject to sanctions has also increased, and includes people from Russia's business community, defence sector and politics (e.g. bans on doing business, freezing of assets and travel bans).

Western countries have also moved to restrict imports from Russia. The EU has banned imports of certain steel products valued at about $3.6 billion. US product bans include imports of e.g. Russian vodka, seafood and diamonds. The value of such imports amounts to about $1 billion. For its part, the UK has decided to impose a 35 % import tariff on many Russian import goods, including steel products, copper, aluminium, fertilisers and car tyres. The value of products subject to import tariffs has been about $1.2 billion. These measures together affect about $5.8 billion in Russian exports (1 % of Russia's total exports of goods and services in 2021).

Some Western countries have even cut back on their energy imports from Russia. The US and Australia have banned outright imports of Russian crude oil, petroleum products, natural gas and coal. Canada has banned imports of Russian crude oil and petroleum products, and the UK has announced plans to cease imports of Russian crude and petroleum products over the course of this year. 5 % of Russia's crude oil exports and 10 % of its petroleum product exports last year went to these countries. Based on preliminary 2021 figures, this amounts to around $12 billion (2 % of Russia's total exports of goods and services last year).

Many large Western energy companies have announced that they are pulling out of the Russian market and suspending purchases of Russian oil and gas. Media reports indicate problems selling Russian oil on global markets in recent weeks. For example, the price gap between Urals-grade crude and North Sea Brent crude has never been this wide. The price of Urals crude this month has averaged $20 a barrel lower than the Brent price. Hundreds of Western firms representing many branches have announced that they are pulling out of the Russian market or cutting business ties with Russia altogether.

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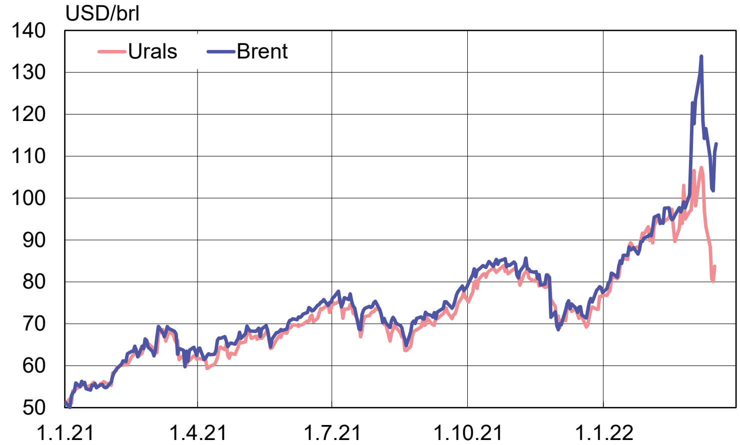
The price of Urals crude, Russia's main export oil grade, is now considerably cheaper than the benchmark Brent grade



Source: Bloomberg.

Russia rolls out various measures in response to Western sanctions. Russia has responded to Western sanctions by restricting exports of goods in order to both mitigate harm to Russia and amplify harm to Western economies. Russia has also closed its airspace to the aircraft of many countries.

The government's decree of March 9 forbids the export of various products that have been previously imported to Russia until the end of this year. The ban applies to wide range of goods that includes certain pharmaceutical products, as well as various types of machinery, equipment and transport vehicles. Exports of some of these products to other member countries of the Eurasian Economic Union (EAEU) is allowed with official permission.

As for goods originating from Russia, the government has banned the export of many wood products until the end of this year to destinations such as EU countries that have been determined to be "unfriendly" to Russia. The value of these exports was $500 million in 2019 (0.1 % of Russia's total exports of goods and services). 65 % of that was exported to Finland. Russia's ministry of industry and trade has recommended putting a temporary end to fertiliser exports and ending altogether the export of certain chemicals to the EU. The value of these exports was about $8.5 billion in 2019 (2 % of Russia's total exports). Further restrictions have been imposed on exports of grain and sugar, and their export even to other EAEU countries has been severely restricted. The goal is to assure availability of domestic supplies of grain and sugar and limit the rise in their prices in domestic markets.

According to media reports, the government has also discussed a temporary lifting of tariffs on critical import goods to assure their availability and quell price increases. The proposed list of critical goods includes vegetables and grain products, certain raw materials for such industries as pharmaceuticals, textiles and construction, as well as spare parts for airplanes.

There is also discussion in Russia on how to treat foreign firms that are planning to leave the market. One proposition brings up the possibility for imposing an accelerated bankruptcy process on foreign firms meeting certain criteria that attempt to leave the market and putting a Russian administrative firm in charge to continue the firms operations. No decision on the matter has yet been reached, however. The possibilities for foreign investors to repatriate capital from Russia are already severely limited.

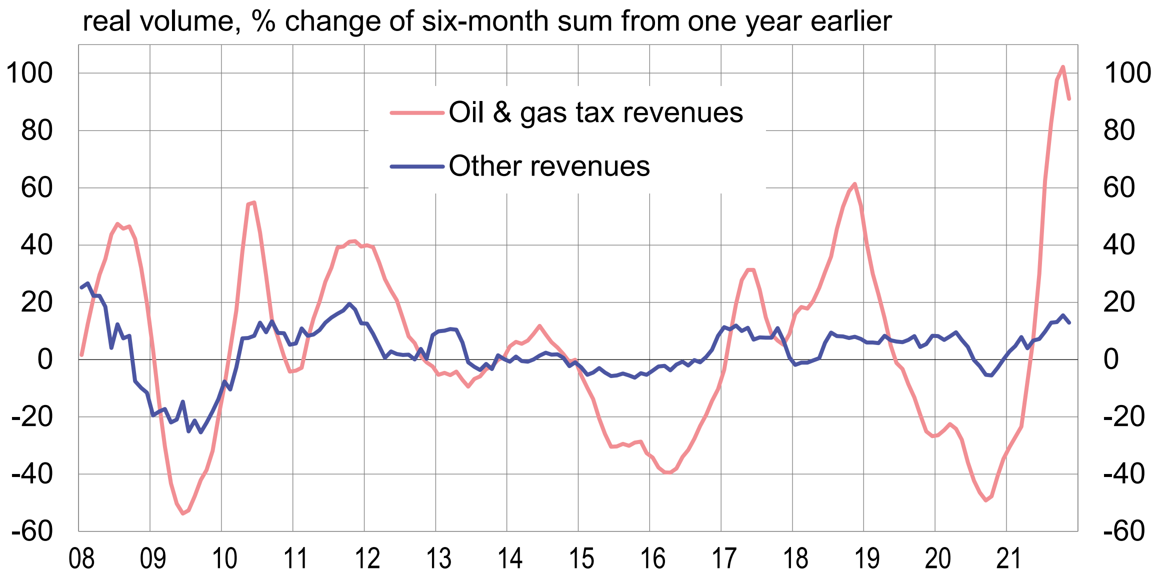
No large increases in Russian government sector spending planned at the moment; budget revenues on the rise this year. Despite facing a deep recession, Russia's leaders have so far not moved very strongly on government sector spending stimulus. Government sources note that this year's increase in federal budget spending is now scheduled at 0.8 % of 2021 GDP. While there are small additional spending allocations to different sectors of the economy as well as limited tax breaks, the emphasis in the spending increases is on unemployment benefits and development of railways.

In addition, president Putin promised increases in social supports for families with children, which would require the equivalent of 0.3 % of GDP. Under the Russian constitution, pensions must rise at least as fast as inflation. The rise in consumer prices, which is expected to accelerate this year to at least 20 %, implies that the increase in pensions will require increased budget outlays equalling at least 1.5 % of GDP. At the same time, the acceleration in inflation this year has led to a situation where even with these hikes government budget spending will decline in real terms.

Russia can afford further increases in spending over the short term. Despite the recession, the rise of budget revenues this year looks likely to considerably outstrip inflation. This is because export tariffs and production taxes on the oil & gas sector are measured in dollar terms. Such revenues last year constituted 20 % of total government budget revenues. They already soared this year in rubles largely on the ruble's sharp fall. Markets also expect prices of oil & gas to be higher this year than last year. A significantly smaller downward impact on oil & gas revenues will arise from the EU countries' freshly adopted policies aimed at reducing energy imports from Russia as well as decisions of certain other countries and some firms to end Russian oil imports. Tax revenues from oil & gas will fall next year if the market expectations of lower oil & gas prices come to pass and the ruble's exchange rate sinks no more (mainly due to the requirement that Russian firms convert 80 % of their export currency earnings to rubles). Other budget revenues will be drawn down this year by the contraction of GDP. While high inflation makes the nominal figures look better, these revenues will decline in real terms.

The government decided to invest assets equivalent to 0.8 % of GDP from the National Welfare Fund (NWF) in order to support share prices of traded companies. The combination of NWF liquid assets and last year's oil & gas tax revenues wating to be transferred to the fund stand at nearly 15 % of GDP after the sharp drop in the ruble's exchange rate. However, these assets are in foreign currencies and part of the country's forex reserves managed by the central bank. Sanctions imposed by EU countries and the US include bans on dealing with Russia's central bank, which means that the use of the NWF is also effectively stopped.

Russia's government sector revenues have soared recently on high oil prices (consolidated budget comprising federal, regional and local budgets plus state social funds)



Sources: Russian Ministry of Finance and BOFIT.

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BOFIT

China

While China's industrial output growth accelerated in the first two months of this year, construction activity and apartment sales declined. China's National Bureau of Statistics (NBS) reports that industrial production grew by 7.5 % y-o-y in real terms during the first two months of this year. Growth picked up significantly from the second half of 2021. Real growth in retail sales also accelerated from the second half of last year, rising to nearly 5 % y-o-y in January-February. Nevertheless, retail sales growth was still a bit lower than in pre-pandemic 2019.

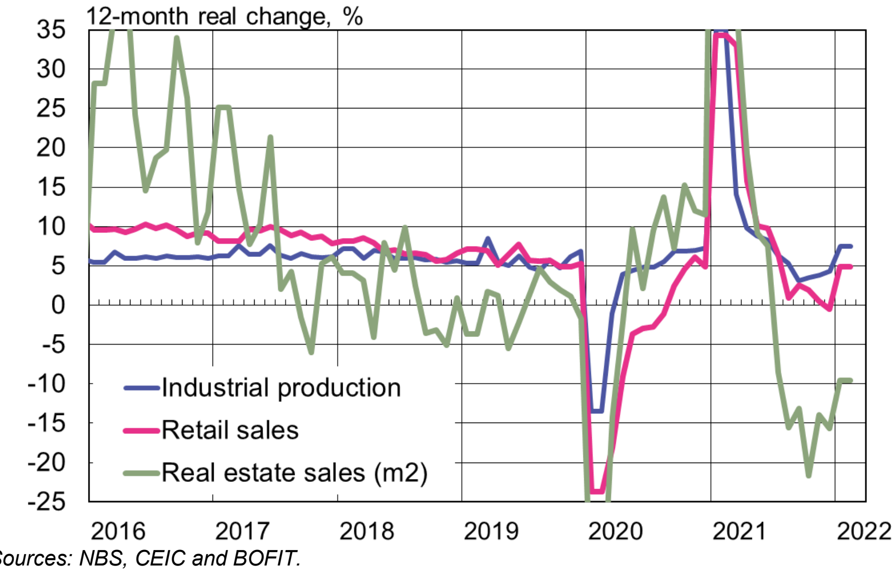
The troubles in the real estate sector persisted as large privately-held developers continue to struggle under mountains of debt and limited access to financing. New construction starts have fallen on-year since last spring. New construction starts, measured in floorspace, was down by 12 % y-o-y in January-February. In recent months, many regions have made it easier to purchase an apartment e.g. by reducing the required down-payment percentage and encouraging banks to make housing loans. Real estate sales nationally still fell by 10 % y-o-y in January-February.

Official figures can no longer be counted on in reliably tracking investment trends. The NBS said that nominal growth in fixed asset investment surpassed 12 % y-o-y in January-February, and despite reduced construction activity, investment in the real estate sector rose by 5 %. Assessing growth in real terms has become impossible as the officials no longer publish fixed investment price indices. The NBS also releases seasonally adjusted month-on-month (m-o-m) fixed investment growth figures, but they have little relation to year-on-year figures. For example, the m-o-m growth rates indicate that last year's level of nominal investments was still about 15 % less than in 2019, but the y-o-y rates give a level that was 8 % higher.

Despite relatively brisk economic development in January-February, uncertainty has risen recently with the invasion of Ukraine and rapid spread of covid in China. Share prices on China's stock exchanges plummeted in the first two weeks of March. Stocks recovered after vice premier Liu He gave assurances that economic policy would be geared to boosting the economy and supporting financial markets. Liu also called for a plan to reduce risks surrounding property developers.

China has reported an average of about 2,000 new covid cases daily over the last two weeks, a significant level of transmission in light of the country's strict "zero-covid" suppression policies. Several major cities (e.g. Shenzhen) have imposed city-wide bans on movement, while many others (e.g. Shanghai) have ramped up regional restrictions. The restrictions have diminished demand for services and caused occasional production disruptions also for large multinational firms.

Growth of industrial output and retail sales was relatively strong in January and February, while apartment sales continued to fall



Sources: NBS, CEIC and BOFIT.

China approves fiscal stimulus policies for 2022. China's official GDP growth target this year is "around 5.5 %." As part of efforts to hit that target, the plenary session of the National People's Congress at the start of this month approved increases in fiscal stimulus for 2022. Budget expenditures are now slated to rise by 8 % from last year, while budget revenues should grow by less than 4 %. A major impediment to higher revenue growth is ever-lighter corporate taxation even as tax cuts and payment relief granted during the 2020 Covid Recession have been partly extended into this year. On the spending side, some growth is explained by the fact that more spending than usual approved already last year was carried over to this year. Very little information on increased spending has been made available at this point, but support for small and medium-sized enterprises is expected to increase and defence spending should rise at roughly the average pace of other spending.

Off-budget stimulus measures are also planned. Since the start of the year, local governments have been urged to increase their infrastructure investments, which typically rely on off-budget funding. While this year's quota for special purpose bonds has not been raised from last year, the People's Bank of China made the unprecedented move of making 1 trillion yuan in its profit reserves available for public use, along with another 650 billion yuan in profit reserves accumulated from earlier years by other state financial institutions and state monopolies. Nearly half of this 1.65 trillion yuan pot of money will apparently go to financing off-budget capital investment projects. Thanks to these budgetary and off-budget public measures, the analytics firm Gavekal Dragonomics estimates the measures in total should increase fiscal stimulus by around 3 % GDP from 2021.

China's fiscal policies have long skewed to the stimulus side to spur the GDP growth towards the high economic growth targets set by China's leadership. The IMF estimates that China's broadly defined public sector deficit corresponded to 16 % of GDP last year and, due to a long string of major deficits, government debt now amounts to roughly 100 % of GDP (BOFIT Weekly 6/2022). At the same time, some local governments are struggling with indebtedness. With the ongoing decline in the construction sector that began last year, local government income from the sale of land-use rights continues to dry up. In its budget summary, China's finance ministry noted that the pronounced deficits posted by some cities and other local governments were putting increased pressure on basic public service spending, public sector wages and the ability of local governments to cover their day-to-day expenses.

American firms operating in China more pessimistic about short-term business outlook. The American Chamber of Commerce in China (AmCham) earlier this month released its 24th annual survey of American firms operating in China. The survey, based on responses collected in November 2021 from 353 member American firms operating in China, finds that respondent firms were experiencing improved business conditions at the end of the second year of the pandemic slog, but were more concerned than earlier about the outlook for Chinese economic growth, particularly over the near term.

Fewer firms (37 %) than last year believed that China's investment environment was improving. In AmCham's two previous surveys, half of responding firms said that the investment environment was improving. The shifts in the political climate and increased harshness of the regulatory environment were given as the biggest reasons for increased uncertainty. As in the 2021 survey, firms mentioned increased tensions between China and the United States as the top challenge to their operations. For the first time, US-China and geopolitical tensions also made it into the top-three human capital challenges. The surveyed companies reported that for example competent Chinese workers willing to work for an American employer have become increasingly scarce.

The regulatory burden has increased and the regulatory environment in China has become more complex. Some 40 % of firms were pessimistic of trends in the regulatory environment over the near term. A third of respondents said that uncertainty had increased and considered the risk of a regulatory infraction to be a major issue for their operations. Nearly 80 % of firms said their operations had been affected by China's latest regulatory crackdown, particularly the new laws on cartels and data security.

The number of firms that feel less welcome in China doubled from last year's survey. While the unease has been broad-based across sectors, the largest concerns came from the technology sector. Despite this, two-thirds of respondents said they still plan to increase their investments in China during 2022 and half of responding firms said they hoped to increase staffing. As in the previous two years, most firms (83 %) said they had no plans to move their China operations to another country.

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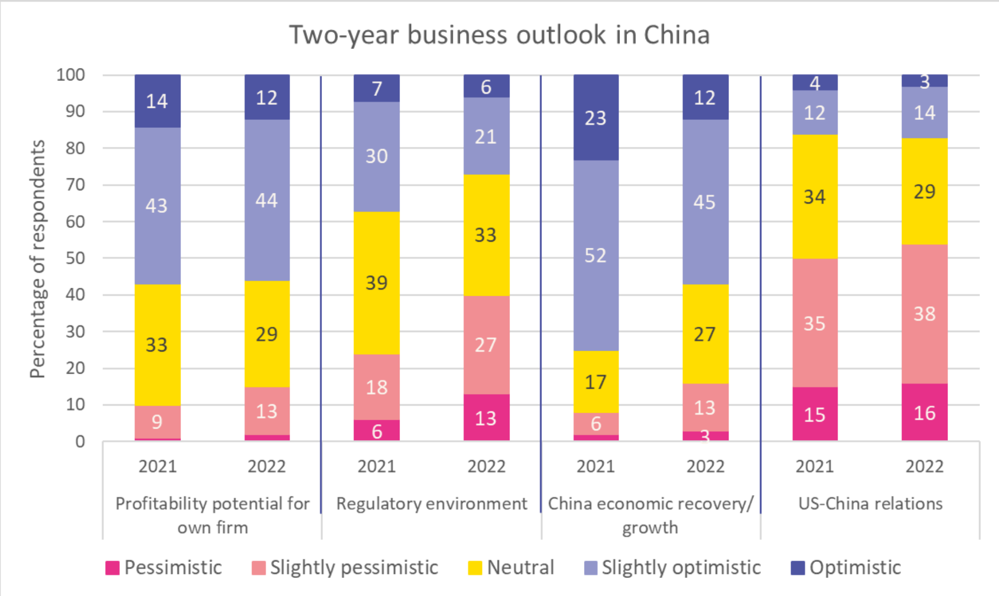
American firms operating in China have become increasingly pessimistic about the business outlook in the years ahead



Sources: AmCham China Business Climate Survey Report 2022 and BOFIT.

Russia

Latest BOFIT forecast for Russia sees GDP contracting by 10 % this year with imports down by half. Russia's unprovoked attack on Ukraine has plunged the Russian economy into uncertainty and recession. International community has imposed severe economic sanctions on Russia and Russia has responded with its own measures. The Russian economy is set to decline despite higher oil prices than in 2021. Markets expect energy prices to settle back to lower levels next year.

Our newest BOFIT Forecast for Russia 2022–2023 sees Russian economic activity declining to levels of a decade ago due to huge uncertainty, sanctions and Russia's own restrictions. The long-term growth outlook has also weakened further. Russian imports will contract along with the economic decline, the ruble's devaluation, foreign export bans and the voluntary cessation of exporting to Russia by numerous foreign firms. The anticipated 50 % drop in imports this year would push import figures down to levels last seen in the mid-2000s.

Private consumption should contract this year to levels of a decade ago as high inflation (likely at least 20 % p.a.) chews through real household incomes. The distress in companies will reduce employment and cut real wages. Fixed investment should contract to levels of roughly 15 years ago. Foreign firms operating in Russia will cut their capital investments to a minimum (the share of fully or partly foreign-owned firms has been 15 % of total fixed investment in Russia). Public investment is likely to increase, but its impact should be fairly limited. The reduction in inventories will sharply exacerbate the contractions in GDP and imports.

Growth of the global economy provides support for Russian exports. The EU is, however, moving ahead with plans to reduce its energy dependence on Russia. While there is some room to grow exports of Russian oil to other markets, gas exports are largely constrained by the pipeline infrastructure. Russia has also imposed its own export restrictions. High export prices and reduced imports should further increase the current account surplus, which already had reached nearly 7 % of GDP last year. The surplus will shrink next year as export prices are expected to fall and EU countries reduce their energy imports from Russia.

Public sector revenues could increase in real terms this year. Thanks to a weak ruble, strong earnings in the oil & gas sector from dollar-denominated production taxes and export duties (a fifth of government budget sector revenues last year) will boost government revenues. Crude oil and gas prices this year are higher than last year. Next year total budget revenues will decline in real terms as GDP, oil prices and the ruble's exchange rate no longer support revenue growth and inflation remains high.

With the announced spending increases, the budget will show a large surplus this year, but government spending will decline in real terms. There is room to increase spending, as the current liquid assets of the National Welfare Fund and the upcoming transfer of last year's excess budget revenues to the Fund together amount to nearly 15 % of GDP at the ruble's current exchange rate. On the other hand, these assets are held in foreign currencies and considered part of Russia's foreign currency reserves. Their use is restricted by EU and US sanctions directed at the Central Bank of Russia. The government has stated that if needed, these funds can be used by changing them to rubles through a special arrangement with the CBR.

The mainly downside risks to this forecast are exceptionally large due to the uncertainties flowing from e.g. war, sanctions, inflation and fixed investment. There is nevertheless some leeway for the government to boost public spending.

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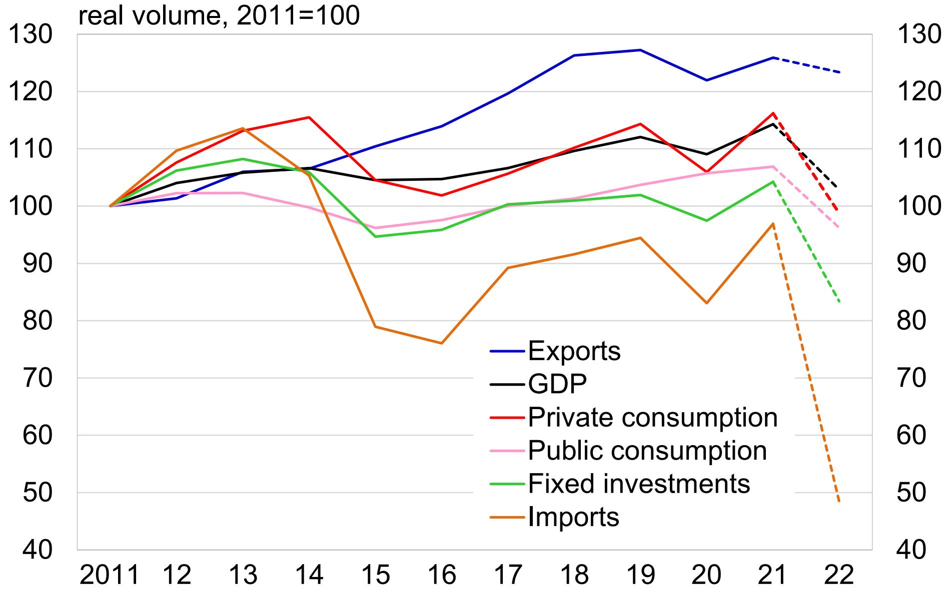
BOFIT

Russian GDP, imports and the main demand components are set to fall this year to levels not seen for several years



Sources: Rosstat and BOFIT.

Russian markets supported by administrative measures. After a nearly month-long closure, the Moscow Exchange has been opened gradually. Trading has still been quite limited, however. For example, foreign investors must wait until today (Apr. 1) to sell any of their shares. Even with the lifting of the ban on selling shares, however, foreign investors cannot repatriate their assets from Russia due to capital controls. The restrictions on the stock market were intended to quell market volatility. The Russian government also made an earlier decision to support the stock market by purchasing Russian shares using 1 trillion rubles (0.8 % of GDP) in government assets. At end-March, the ruble-based MOEX index was up by 9 % from the end of February, when the stock exchange was shut down.

The ruble's official exchange rate set by the CBR has recovered to near pre-war levels in recent days. Much of the ruble's comeback reflects the impacts of restrictions and guidance imposed by Russian officials. The demand for ruble is mainly created by Russian export firms that are required to convert 80 % of their forex earnings into rubles. Exporting firms are enjoying massive export earnings as commodity prices are high and (for the moment at least) sanctions only are directed at a small slice of Russia's exports. The conversion of rubles into other currencies is strictly regulated, so the supply of available rubles is relatively small. The European Central Bank has suspended the publication of a euro reference rate for the ruble as it views it is not in a position to set a reference rate that is representative of prevailing market conditions.

The current market trends seem quite disconnected from the rest of the economy. A company survey by Russia's Gaidar Institute for Economic Policy (IEP) found that the business expectations of industrial firms saw a sharper decline in March than in any earlier Russian economic crisis. Rosstat's March company survey also found that the six-months-ahead outlook of manufacturers was bleaker than at the start of the covid pandemic.

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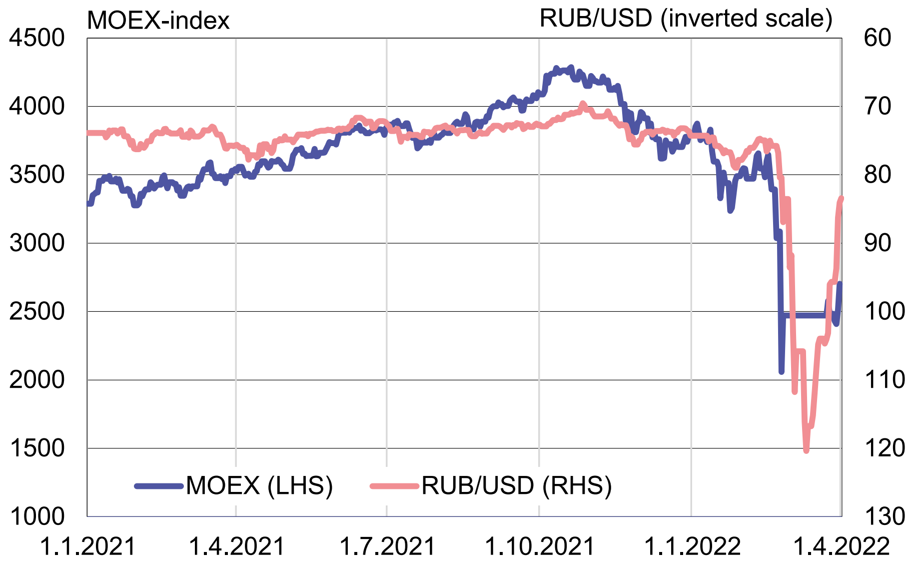
Russian stock markets and ruble exchange rate have been supported by administrative measures



Sources: Macrobond, BOFIT.

Prices continue to soar in Russia. Consumer prices have skyrocketed since Russia's invasion to Ukraine last month. Import prices shot up with the ruble's collapse. Prices of many food items have also been driven up as households have hoarded products in fear of deficits. Only few consumer products are directly affected by sanctions.

Consumer prices were 8.9 % higher last week than at the start of January. There are large differences in the price shifts of various products and product categories. Large price increases, for instance, have been seen for sugar (up 46 % from the start of the year), carrots (up 42 %), tomatoes (56 %), onions (43 %), cabbage (64 %) and bananas (54 %). Although part of the price increases are seasonal in nature, wintertime per se does little to explain most of the upsurge. Prices of many durable goods have also risen sharply, even for goods that are manufactured also in Russia. Television prices are up by 31 % from the start of the year, passenger cars up 21–29 % and smartphones 17 %. On the other hand, administratively set rates for utilities and services such as heating, public transport and household natural gas supplies have seen only small adjustments.

A company survey made by the CBR at the beginning of this month found that its indicator for corporate inflation expectations for three months ahead produced the highest reading ever since the survey was launched in 2002. According to the various forecasts collected by the CBR in the second week of March, inflation should hit 20 % this year. The international economic survey firm Consensus Economics expects 12-month inflation in Russia to be around 22 % in December 2022.

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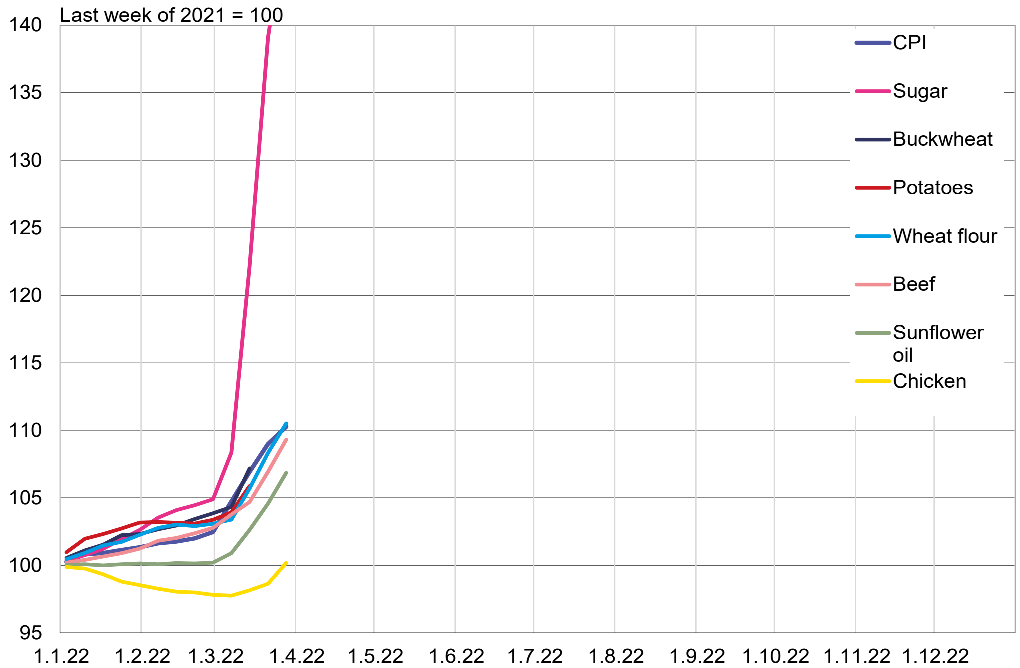
Russia has seen steep price increases for many staple foods in recent weeks



Source: Rosstat.

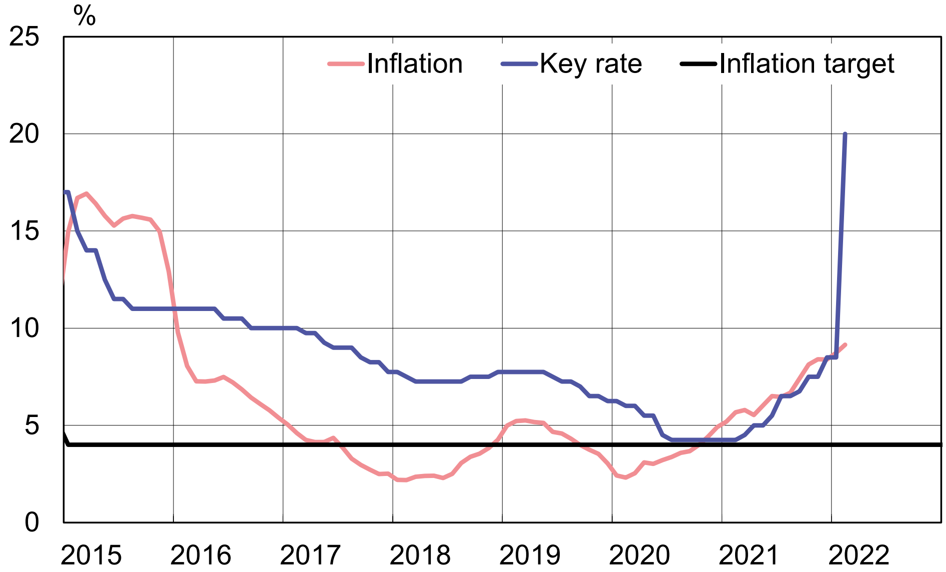
CBR keeps its key rate at a record high 20 % level. At its scheduled meeting on March 18, the Central Bank of Russia's board decided to keep the key rate unchanged at the unprecedented level of 20 %. At the end of February, the CBR was forced to raise the key rate from 9.5 % to deal with the collapse of the ruble in the wake of Russia's invasion to Ukraine and to prevent a run on bank deposits. Since the key rate hike, Russian banks have increased their deposit rates for ruble accounts, which has reduced depositors' enthusiasm to pull rubles out of banks and hoard ruble cash. CBR governor Elvira Nabiullina stated that the rate hike was a temporary measure to stabilise the situation and that the rate would eventually be lowered.

Inflation has flared in Russia since the start of the war on Ukraine. Russia's economic development ministry estimates that consumer prices at the start of March were up 14.5 % y-o-y. The CBR expects inflation to remain higher than previously expected both this year and next. Nabiullina underscored the importance of avoiding price controls, as that could slow economic adjustment to the new conditions and eventually lead to a reduced and lower quality supply of goods and services. While the CBR expects Russian GDP to contract over the coming quarters, it is set to publish its new GDP forecast in April.

Nabiullina also announced that the central bank will temporarily purchase government bonds on the Moscow Exchange to assure liquidity and mitigate volatility as trading restarts. The purchased bonds would be sold off on the financial markets once the situation stabilises.

President Vladimir Putin has proposed Nabiullina for a third five-year term as central bank governor. The Duma is expected to confirm Nabiullina's appointment in the near future. Nabiullina assume the CBR governor post in 2013.

The CBR's main reference rate, the key deposit rate, continues at the historically unprecedented level of 20 %



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

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BOFIT

China

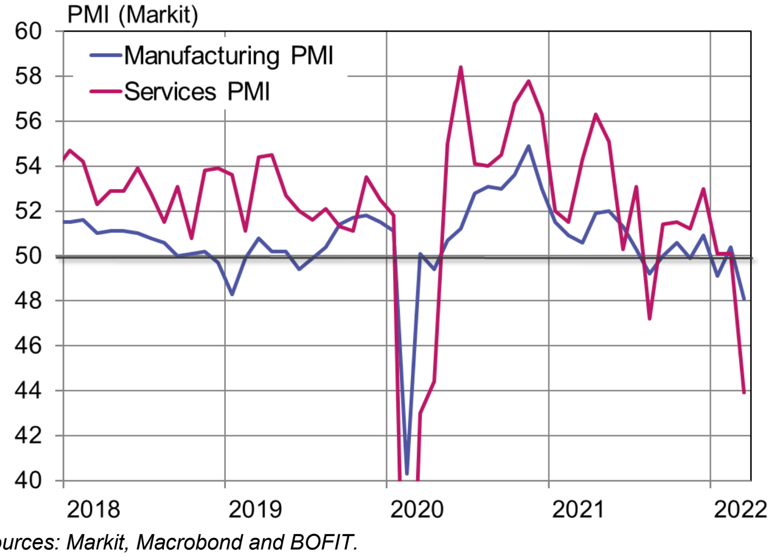
Shanghai's covid lockdowns likely to affect international supply chains. The first large-scale lockdown to curb the spread of covid-19 infections in Shanghai was introduced in late March. Lockdowns were initially applied separately to the eastern and western sides of the city. On Monday (Apr. 4), the lockdown was extended citywide. The official numbers for covid infections in China (including asymptomatic cases) have reached their highest levels ever. They are well above the figures of February 2020 when the pandemic began to spread outside the city of Wuhan. About 80 % of China's reported covid cases in recent weeks have been found in Shanghai, which is testing all of its population multiple times.

Full or partial city lockdowns have not been confined to Shanghai and some level of restrictions are applied in most big cities in China. Shenzhen, for instance, went into lockdown for a week in March. The lockdowns and other covid restrictions were reflected in the March purchasing manager indices, that showed readings below the neutral level of 50. Markit's Caixin services PMI plummeted from a 50.2 reading in February to 42.0 in March. The lockdown of Shanghai was not captured in the March PMI surveys, however. According to many observers, the current situation could impact the economy more than the lockdowns of early 2020 which focused on the city of Wuhan and surrounding Hubei province. Given the economic significance of Shanghai and its surroundings, several forecast institutions have lowered their 1Q and 2Q growth forecasts for China this year.

The Shanghai lockdowns are expected to further disrupt international supply chains. Lockdowns have already reduced road transport and changed cargo movements in areas surrounding the Port of Shanghai, the world's largest bulk cargo and busiest container port in the world. Road freight has been diverted to trains or ships when possible, as well as some international freight to other Chinese harbours. The Port of Shanghai has so far managed to keep in operation. Indicators for port waiting times show no substantial delays in container handling, but some indicators suggest significant drop in freight volumes. Air freight to Shanghai has also sharply diminished. In coming weeks, the impacts of the covid lockdowns are assumed to be reflected in production and warehouse logistics figures, especially if the lockdowns continue.

The American Chamber of Commerce in Shanghai (AmCham Shanghai) released a flash survey of its member companies at the end of March. Of the 167 firms responding to the survey, 120 had operations in Shanghai. 99 % of respondents said that the latest covid surge had affected their businesses. 60 % of all respondents (and over 80 % respondents in manufacturing) said that covid lockdowns, lack of materials or labour shortages had forced them to cut production. Over half of surveyed firms (86 % in manufacturing) said that the situation had affected their supply chains. At the same time, over half expect negative impacts on their revenues this year. Nearly 80 % of firms expressed dissatisfaction with the long duration of Chinese covid quarantines and nearly 70 % with China's strict restrictions on entry to the country. The EU Chamber of Commerce in China also made clear that China's "zero covid" strategy is causing ever greater strains on firms and their logistics inside China and between China and the rest of the world.

Markit's Caixin Manufacturing and Services PMIs both declined in March to levels last seen in early 2020



Sources: Markit, Macrobond and BOFIT.

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BOFIT

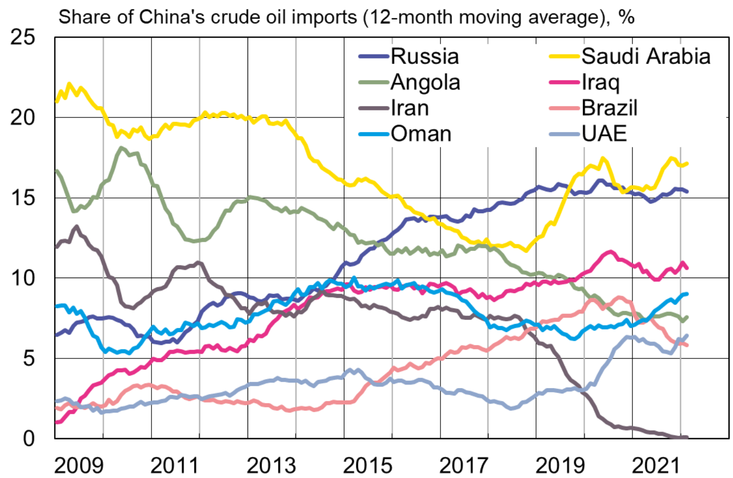
China stays with its diversified energy import strategy; natural gas consumption and imports on the rise. China is the world's biggest energy consumer. It also remains by far the largest consumer of coal for primary energy production (56 % of energy consumption last year). China's next largest primary energy sources are crude oil (nearly 20 %), natural gas and hydropower (each about 8 %). Despite the world's largest renewable energy production capacity, renewables still satisfy a relatively small slice of consumption. As growth of energy consumption in China has outstripped production, the country's dependence on fossil fuel imports has risen.

China's coal consumption was up by nearly 5 % last year. Most of the coal consumption was filled domestically, as China last year produced over 4 billion metric tons of coal. Coal imports last year rose to 320 million tons (7 % of consumption), an increase of more than 6 % y-o-y. China imposed a ban on Australian coal imports in 2020 and shifted its supply emphasis to Indonesia, which last year accounted for 60 % of coal imports. Russia was the next largest coal supplier, accounting for about 15 % of China's coal imports last year.

China's crude oil consumption rose by 4 % last year. China has proven oil reserves of 26 billion barrels (1.5 % of global reserves), and its domestic production was sufficient to cover 28 % of the country's oil consumption last year. China, the world's largest oil importer since 2017, last year imported 510 million tons of crude oil (over 10 million barrels a day), a 7 % drop from 2020. China typically ramps up its oil imports when world oil prices are low, taking the opportunity to restock its national reserves. When prices rise on the world market, China accordingly reduces its import volumes. With crude oil, in particular, the international supply sources are highly diversified to prevent overdependence on a particular supplier. Saudi Arabia continues to maintain its status as China's largest oil supplier. Last year, Saudi Arabia accounted for about 17 % of China's supply, Russia 15 % and Iraq 10 %. Due to US sanctions imposed on Iranian oil imports at the end of 2018, China's Iranian oil imports have collapsed (according to official figures). It is a poorly kept secret, however, that many small refiners in China import Iranian oil, but declare as the country of origin a third country such as Oman, UAE or Malaysia.

Natural gas consumption in China rose last year by 13 %. Domestic production covered nearly 60 % of consumption. Over two-thirds of China's natural gas imports last year came in the form of liquefied natural gas (LNG). China last year imported 18 % more LNG than in 2020, while pipeline gas imports were up by 22 %. Nearly 40 % of China's LNG supplies last year were imported from Australia. The US produced 12 % of China's LNG imports, Qatar 11 % and Malaysia 10 %. Russia accounted for less than 6 % of China's LNG imports last year. China also gets pipeline gas from Central Asia, Myanmar and Russia. Turkmenistan provided nearly 60% of pipeline gas last year, followed by Russia at 18 % and Kazakhstan at 10 %. Russia's share of pipeline gas imports has soared after Power of Siberia, the first gas pipeline between the two countries, came on stream in late 2019.

China pursues a diversified crude oil import strategy



Sources: China Customs, CEIC and BOFIT.

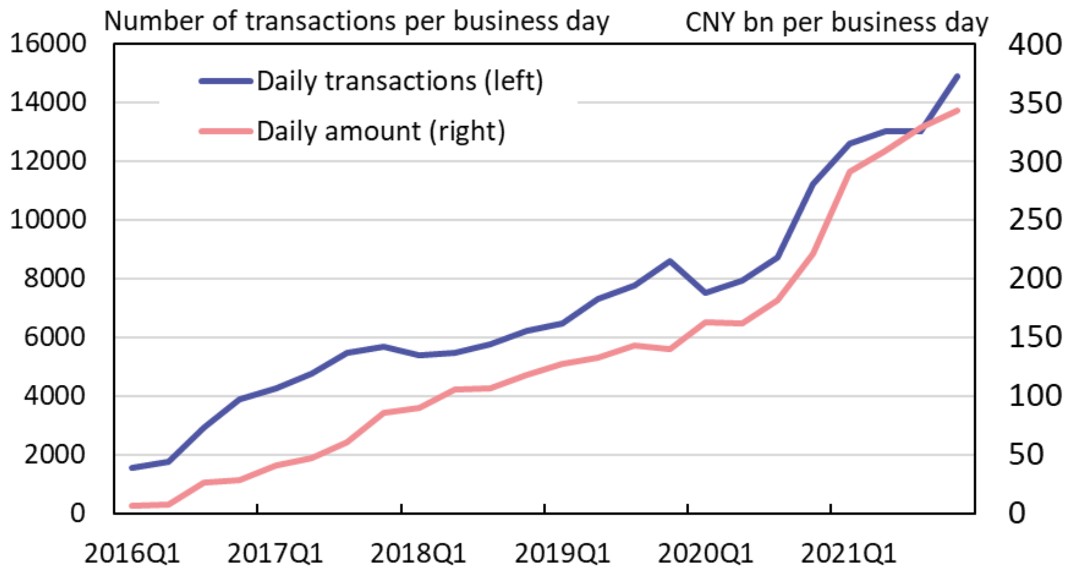
Growth of China's CIPS payment system remained brisk last year. The People's Bank of China reports that its yuan-based Cross-border International Payment System (CIPS) handled nearly 15,000 payments a day in the fourth quarter of 2021. The system processes on average transactions worth 343 billion yuan each business day. The number of payment transfers grew by about 30 % y-o-y, while their cumulative value was up by around 50 %. The pace of growth in both volume and value matched that of 2020. While very little information about CIPS transactions is published, it is known that growth has been partly fuelled by the relaxing of capital controls between Hong Kong and mainland China through such arrangements as the Stock Connect and Bond Connect programmes between exchanges.

CIPS, launched in autumn 2015, is primarily intended to promote cross-border payments in yuan internationally. In its current form, CIPS only can be used for yuan payments. The system includes both direct participant and indirect participant banks. Direct participant banks act as payment hubs that route payments of indirect participant banks.

According to the CIPS website, the system comprised 76 direct participant banks at the end of March 2022. Of those banks, 26 were Chinese banks or payment firms operating inside China, 35 were foreign subsidiaries of Chinese banks operating abroad and 13 were Chinese subsidiaries of foreign banks operating in China. In addition to these participants, the Hong Kong monetary authority's Central Moneymarkets Unit, a clearing and settlement facility for exchange fund bills and notes, is also a direct participant. Most of the direct participants located abroad (i.e. foreign subsidiaries of Chinese banks) are sited in international financial hubs, but there are also direct participants in countries such as Laos, Hungary, Russia and Zambia. As of end-March, there was a total of 1,228 indirect participant banks operating in 104 countries. Most banks were based in China (542) or elsewhere in Asia (404). There were 169 indirect participant banks in Europe, 44 in Africa and 69 elsewhere in the world.

The Society for Worldwide Interbank Financial Telecommunication (SWIFT) reports that the yuan was the world's fifth-most-used payment currency as of end-February, accounting for over 2 % of all international payment traffic. That share surpassed 3 % in January. CIPS and SWIFT are fundamentally different systems. CIPS is built for transferring money, while SWIFT transmits payment information, and does not perform clearing or settlement functions. In reality, CIPS and SWIFT are mutually supporting. CIPS relies heavily on SWIFT for transmission of payment information. For example, all participating Russian banks are indirect participants in CIPS and must transmit their payments information via SWIFT.

Use of China's yuan-based Cross-border International Payments System (CIPS) has grown rapidly since it was launched in late 2015



Sources: CIPS, People's Bank of China and BOFIT.

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BOFIT

Russia

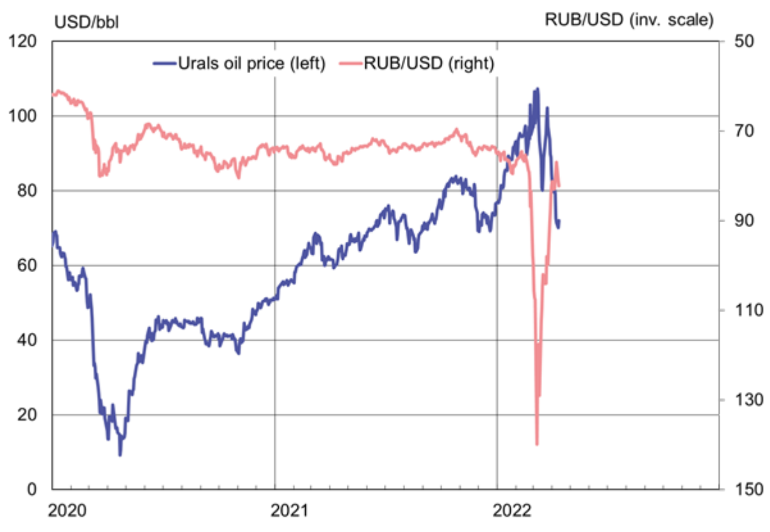
Capital controls enable ruble recovery. The ruble's exchange rate crashed immediately after Russia invaded Ukraine. As Western sanctions restrict the access to central bank's foreign currency reserves, the authorities have resorted to strict capital controls to support the ruble. In particular, a requirement to repatriate export earnings has boosted forex supply in Russian markets. Demand for foreign currency, however, has also been severely limited as forex purchases and the possibilities of taking forex out of the country are restricted (BOFIT Weekly 13/2022). Sanctions targeting Russian banks and Western export restrictions have further reduced euro and dollar demand within Russia.

As a result of these measures, the ruble's exchange rate has bounced back to near its pre-invasion levels. Some media reports claim large Russian firms have had trouble finding buyers for their repatriated forex. The ruble's appreciation has allowed the CBR to cautiously pull back on some of its forex guidance, although the relaxation has had little impact on the overall situation.

Capital controls and Western sanctions have complicated Russia's ability to service its foreign debts (BOFIT Weekly 11/2022). A presidential decree issued on March 5 allows Russian entities to repay foreign currency loans taken from "unfriendly" sanctioning countries in rubles. While the finance ministry has since granted large firms temporary exemptions to make payments on interest and principal in forex, Western sanctions have impeded or prevented some of the payments from going through. For example, Russian Railways (RZD), steelmaker Severstal and potash fertiliser producer Uralkali have been unable to make timely coupon payments.

Capital controls and support measures announced by the central bank and the government have calmed Russia's financial markets to the extent that the CBR was able to lower its key rate to 17 % as of last Monday (Apr. 11). While ruble appreciation has eased domestic inflation pressures, Western sanctions have cut imports and forced up domestic prices. March consumer prices were up by 16.7 % y-o-y and 7.6 % m-o-m. Price increases have been particularly hefty for fresh foods and some durable consumer goods.

Both the ruble exchange rate and the price of Urals crude have settled back to pre-invasion levels



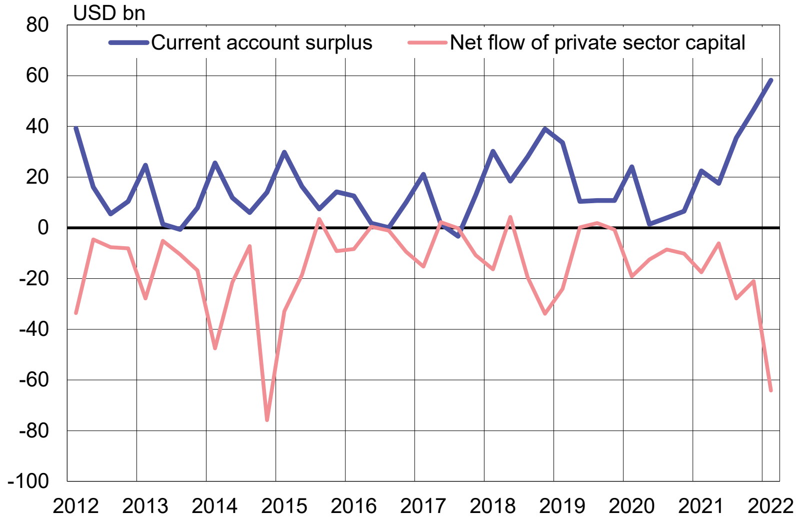
Sources: Reuters and BOFIT.

Export earnings fattened Russia's Q1 current account surplus; substantial capital outflows. The CBR's unusually thin preliminary balance-of-payments report shows that the value of Russian exports of goods and services in the first quarter of this year increased by 50 % y-o-y to 157 billion dollars. Export revenues have soared on high prices for oil and other global commodities. Western sanctions have had a limited effect on Russian exports as they only apply to a small percentage of Russian exports. The value of imported goods and services amounted to 90 billion dollars, up 14 % y-o-y. Most of the growth likely came from the start of the year. Indicative evidence suggests that Russian imports plunged in March.

The rapid growth in export earnings, combined with more moderate import development, boosted Russia's current account surplus to a historical high of 58 billion dollars in the first quarter. The four-quarter total (2Q21 to 1Q22) corresponded to roughly 10 % of Russian 2021 GDP.

Considerable amounts of capital flowed out of Russia in the first quarter. The net Q1 capital outflow of the private sector was 64 billion dollars. Most capital outflows apparently occurred before Russia's February attack on Ukraine as capital controls were implemented in March. Similar large outflows of capital were last seen in late 2014.

Russia posted a historically large current account surplus in the first quarter, but capital outflows from Russia were substantial



Sources: Central Bank of Russia, CEIC and BOFIT.

March PMI indicators suggest Russian economy already contracting. Readings of the Markit Economics purchasing manager indices for March show contractions in both manufacturing and service branches. The readings were lower than in March 2020, when the outbreak of the covid pandemic began to affect the global economy. The manufacturing PMI, which had a reading of 48.6 in February, fell to 44.1 in March. The services PMI dropped from 52.1 in February to 38.1 in March. Readings below 50 are usually construed as evidence of a contracting economy. The March composite PMI reading was 37.7, suggesting a broad-based contraction in actual production was already underway in March. Even so, industrial output still grew by 6.3 % y-o-y in February and manufacturing was up by 6.9 %. The volume of retail sales rose by 5.9 % in February.

Rosstat this week also released figures on the structure of 2021 GDP. The Russian economy grew by 4.7 % last year. On-year growth accelerated in the fourth quarter of 2021 to 5.0 %. Seasonally adjusted GDP grew by 1.5 % q-o-q. Russian GDP surpassed 4Q19 GDP already in 2Q21, indicating Russia's initial recovery from the Covid Recession was fairly swift.

Branches hit hardest by the covid pandemic and lockdown measures in 2020 experienced the highest growth last year. For example, the value added of the hotel and restaurant branch was up by 24.1 % in 2021, while wholesale and retail sales rose by 8 % and construction by 5.8 %. Mineral extraction industries grew by 4.2 %, and manufacturing value added was up by 4.5 %.

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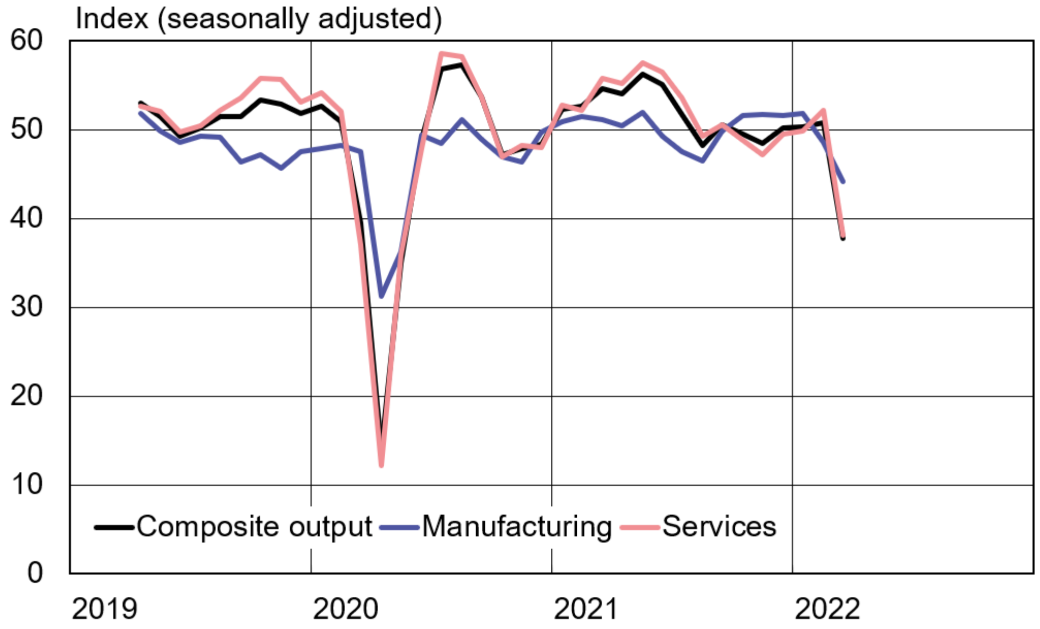
Russian purchasing manager indices showed a distinct downturn in output in March



Sources: Macrobond, Markit and BOFIT.

No growth this year for Russia's foreign reserves or the National Welfare Fund. Russia's foreign currency and gold reserves experienced gradual growth still in 2021 as the central bank made currency purchases on behalf of the finance ministry based on the government's fiscal rule. Under the government's fiscal rule, when the price of oil has exceeded the rule's rather low reference price, excess oil & gas tax revenues have been set aside on a current basis and converted into foreign currencies, and eventually deposited in the National Welfare Fund (NWF). This arrangement has been in place for several years. In late January the CBR suspended these forex purchases, referring to the need to reduce financial market volatility.

With Russia's attack on Ukraine in late February, the EU, US and UK, among others, prohibited transactions with Russia's central bank, effectively blocking the CBR from operating with its currency reserves. This is especially because a large chunk of Russia's foreign currency reserves is held in euro- or dollar-denominated assets. Euro-denominated assets rose by the start of this year to over a third of the reserves, their highest share ever. The US dollar component shrank considerably last year, standing at just over 10 % at the start of this year. The share of China's yuan jumped to more than 17 %. Gold continues to account for almost 22 % of reserves. After several years of CBR gold-buying, the quantity of gold in the reserves remained quite steady last year.

Russia's currency reserves have not increased this year. In dollar terms, the value of the reserves has fallen slightly, standing at 606 billion dollars as of April 1. Part of the decline represents the slight drop in the value of the euro relative to the dollar.

The NWF's liquid assets are part of Russia's foreign currency reserves. The liquid assets have remained quite steady this year at around 115 billion dollars (also as of April 1), or about 7.5 % of 2021 GDP. In addition, there is a considerable amount of oil & gas tax revenues accumulated last year which according to normal practice under the fiscal rule would be transferred to the NWF later this year.

Last week the government decided that, instead of the fiscal rule mechanics, forex and gold purchases could be this year done more flexibly as the finance ministry sees fit. Last week the government further confirmed the policy shift that part of the excess oil & gas tax revenues no longer have to be saved for the NWF but can be used to cover government expenses. In late March, the finance ministry informed that the government could, as needed, use the NWF's forex and gold assets. This would happen by converting the assets into rubles via mutual arrangements between the finance ministry and CBR without having to resort to market operations with the forex reserves.

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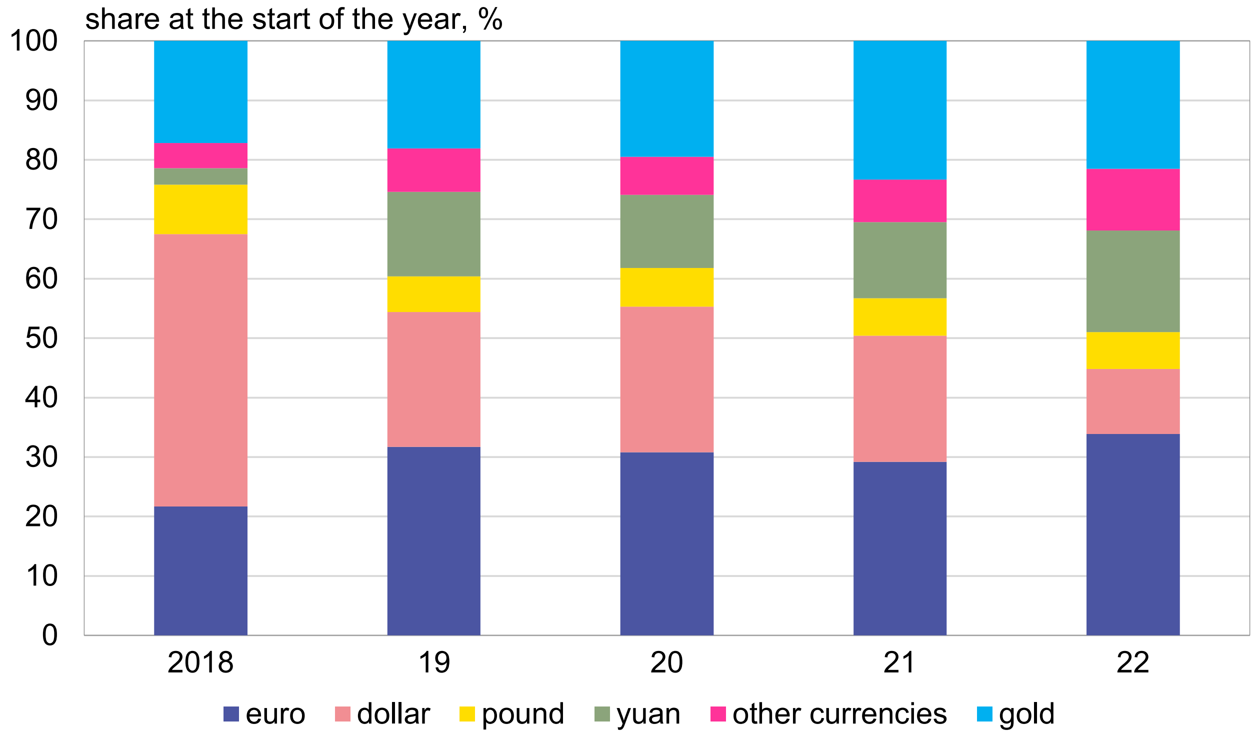
The euro and yuan components of Russia's foreign reserves grew in 2021



Sources: Bank of Russia and BOFIT.

The EU and US put more economic sanctions on Russia. On April 8, the EU approved a fifth sanctions package against Russia that includes a variety of new restrictive measures. In addition to banning imports of Russian coal and other solid fuels as of August 2022, the latest round of sanctions also bans imports of certain other goods such as wood products, paper products, fertilisers and car tyres. The total value of the proscribed articles in Russian imports to EU countries amounts to about 13.5 billion euros a year. The EU previously banned certain imports of iron and steel goods from Russia. The total value of imports items banned under EU sanctions represent about 4 % of Russia's total exports.

The EU also decided to strengthen its bans on exports to Russia. Among others, the latest sanctions forbid the export of certain electronic products, software, machinery and transport vehicles to Russia. In addition, the EU has banned Russian ships from docking at EU ports as well as the operation of Russian and Belarussian road transport carriers within EU territory. The bans make exceptions for items such as energy, medicines, farm produce and processed foods.

The EU also expanded its sanctions on Russia's financial sector. Full transaction bans were imposed on four large banks (VTB, Novikombank, Sovkombank and Otkrytie). The target banks were earlier kicked out of the SWIFT payments system, but now their assets in EU countries are also frozen.

The EU also implemented various additional measures to eliminate earlier loopholes used to circumvent sanctions. Sanctions on specific individuals and their family members were also extended. The EU's Russia sanctions list currently targets 1,091 individuals and 80 organisations.

The latest US sanctions package, announced on April 6, impose full blocking restrictions on Russia's largest state-owned bank, Sberbank, and Russia's largest privately-held bank, Alfa Bank. The new sanctions also proscribe any new investments in Russia (earlier investment was only banned for the energy sector). In addition, the US extended sanctions targeting individuals, including e.g. members of Russia's security council. Many other countries, including the UK, Australia and Japan, have increased their own economic sanctions on Russia in recent weeks.

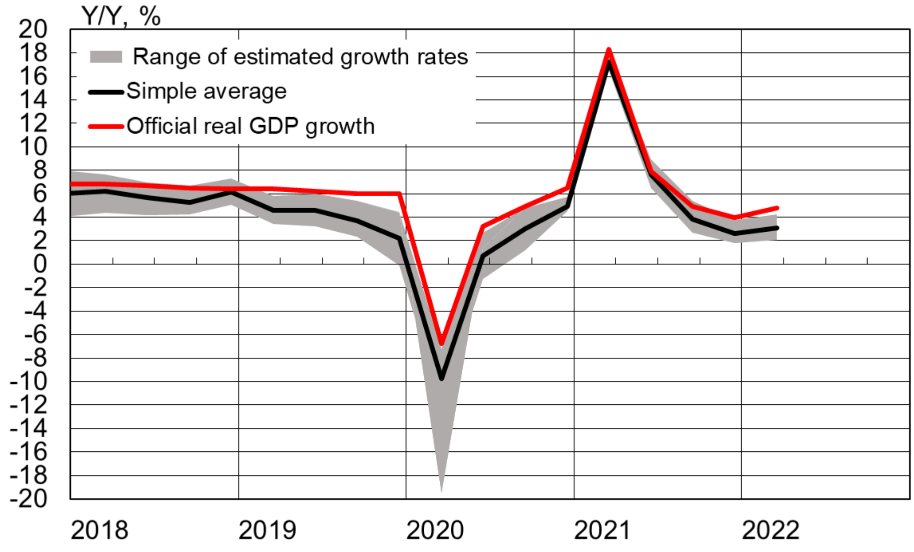
China

China's economy sees strong start, weak finish, in the first quarter. China launched a new round of stimulus measures this winter to boost economic growth. According to China's National Bureau of Statistics, real GDP growth accelerated from 4.0 % in the fourth quarter of last year to 4.8 % in the first quarter of this year. The Bank of Finland's own alternative calculations also suggest that Chinese GDP growth accelerated in the first quarter, even if the pace of growth was substantially lower than the official figures suggest.

Monthly data split first quarter growth into two parts. The economy grew rather briskly during January and February. In March, growth slowed rapidly as covid infections increased and cities around China tightened covid-restrictions to deal with spread of the virus. After growing at 5 % y-o-y in real terms in January and February, retail sales contracted in March by 6 %. Growth in industrial output slowed from 7.5 % in January and February to 5 % in March, and output of foreign firms even contracted. Growth in fixed investment also slowed in March. Labour market surveys showed that the unemployment rate rose to nearly 6 % in March, close to the level seen in early 2020. In the real estate sector, building starts and apartment sales each contracted by about 20 % y-o-y. The troubles of deeply indebted real estate developers struggling since last autumn will only increase.

The economic slowdown is likely to continue in April with spreading covid, lockdowns and the government's "zero covid" suppression strategy. Many major institutional forecasters have lowered their forecasts for Chinese growth in recent weeks. Most now expect GDP growth to come in well below the official about 5.5 % target set for this year. The IMF's World Economic Outlook, released this week, offers a significantly lowered forecast for global growth and sees China's growth only reaching 4.4 % this year and 5.1 % next year.

Bank of Finland alternative calculations suggest actual Chinese GDP growth has been lower that official figures



Sources: China National Bureau of Statistics, Macrobond and Bank of Finland calculations.

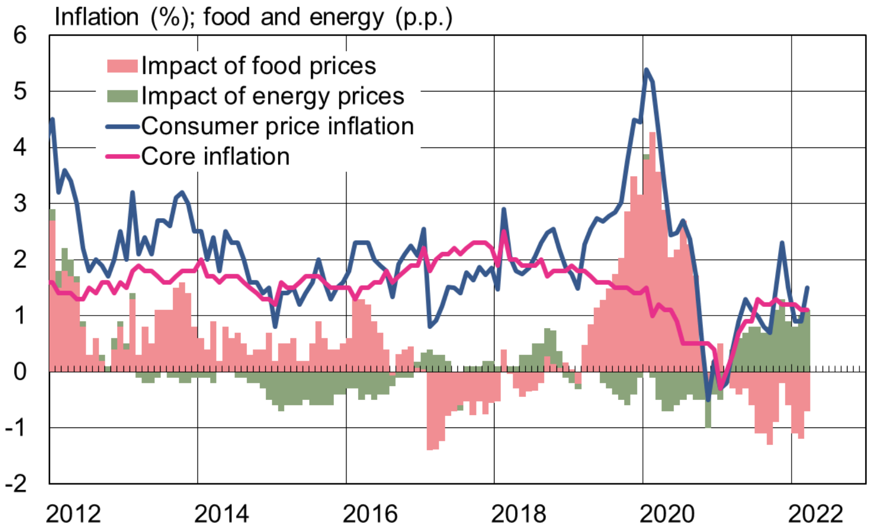
Inflation in China remained subdued in March. March consumer prices rose by just 1.5 % y-o-y, well below the inflation rates seen for example in the euro area and the United States. Food prices are the largest category in Chinese consumer prices. Indeed, food accounts for nearly 30 % of Chinese consumer price index, which is well above the levels of the euro area (around 20 %) or the US (15 %).

In recent months, a dip in food prices has helped China avoid a sharp spike in inflation, with the price swing led by pork prices. Swine production was rocked in 2019 and 2020 by the African swine fever virus, which ultimately caused pork prices to more than double and boosted inflation in the first half of 2020 to over 5 %. Pork prices only settled back to normal levels in autumn 2021. Because inflation is measured as the change in prices from 12 months previous, pork price inflation in the first quarter was still strongly negative (-40 %). Pork accounts for a large part of the Chinese food basket and China accounts for about half of all global swine production. It is both the world's largest pork producer and pork consumer. In March, overall food prices were still 1.5 % cheaper than a year earlier.

As in other countries, energy prices have been rising in China, where its impact on inflation in recent months has been about one percentage point. In contrast, core inflation, which excludes the impacts of energy and food prices, has remained steady at around 1 % in recent months (1.1 % in March).

The rise in prices of energy and other commodities has been a major driver of producer price inflation, which has been high in recent months. Producer price inflation peaked in October 2021 at 13.5 %, but has steadily decreased since. The March rise in producer prices was 8.3 % y-o-y. The largest price rises were still in the energy sector, particularly prices for coal, crude oil and natural gas (all up by about 50 % in March). The 2022 Government Work Report presented at the National People's Congress in early March stresses safeguarding the availability of energy through increasing domestic production, boosting national security reserves and stabilising price trends.

Falling food prices have subdued the overall rise in Chinese consumer price inflation this year



Sources: NBS, Macrobond and BOFIT.

PBoC slightly lowers bank reserve requirements and publishes list of economic support measures. The People's Bank of China announced on April 15 that it was lowering the reserve requirement ratio (RRR) of commercial banks by 25 basis points, effective as of April 25. In addition, rural banks and some smaller city banks will be entitled to an additional 25-basis-point reduction that seeks to support lending to small enterprises and farms. The central bank does not specify which banks are entitled to the extra cut. Neither change applies to banks already subject to the lowest-allowed 5 % reserve requirement. According to the PBoC, the weighted average reserve requirement for the banking sector will drop from 8.4 % to 8.1 %.

The move was widely anticipated. The PBoC said the reserve requirement cut was needed to support growth of the real economy and reduce financing costs. The overall impact, however, will likely be small as the RRR reduction is quite modest. The PBoC last cut the RRR in December by 50 basis points.

The government earlier announced other monetary policy measures to support the economy. Some additional information on these was contained in a list of 23 measures published by the PBoC and the State Administration of Foreign Exchange (SAFE) on Monday (Apr. 18). Some measures are meant to bring relief to firms and households dealing with the new covid wave and lockdowns, while others are intended to prop up the economy and different sectors more broadly. The more concrete measures include postponements in their housing loan payments for households affected by covid restrictions and interest support on bank lending to small firms (1 % of the value of net lending increase until summer 2023). In addition, the PBoC's relending programme will be continued (and expanded if needed). The programme, which was used also in 2020 as part of the government's covid stimulus response, is aimed on smaller banks to help them provide cheap loans mainly to small business in sectors hit by covid restrictions. Banks are also encouraged to increase their lending to gig workers.

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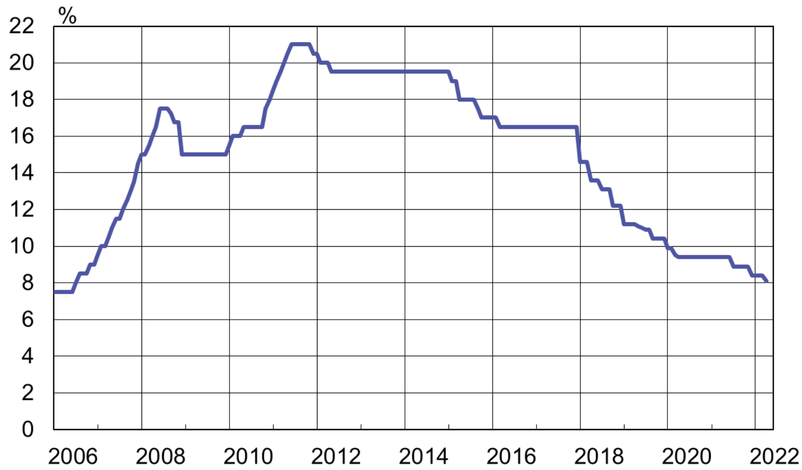
Several items on the list reiterate familiar vague government aspirations, so their impacts will remain unclear until more concrete measures, if any, result. The list calls for assuring financing availability in numerous priority areas such as agriculture, “clean” coal production, logistics, technological innovation and green energy. In addition, commercial banks are encouraged to boost their lending to the private sector, developers, local government financial vehicles (LGFVs) and policy banks to investment projects. To facilitate foreign funding, the measures aim at e.g. supporting corporate borrowing from foreign lenders and better facilitating foreign portfolio investors in China.

While China’s slowing economy has put pressure on the central bank to further ease its monetary stance, it has kept both its policy rate and the LPR reference bank loan rate unchanged during February-April. The central bank has been relying on more targeted stimulus measures to support the economy. China’s accommodative monetary stance already runs counter to the tightening seen in most major economies. Further easing and rate cuts would likely fuel capital outflows and put depreciation pressure on the yuan.

The PBoC’s weighted average reserve requirement ratio for commercial banks has been trending downward for the past decade

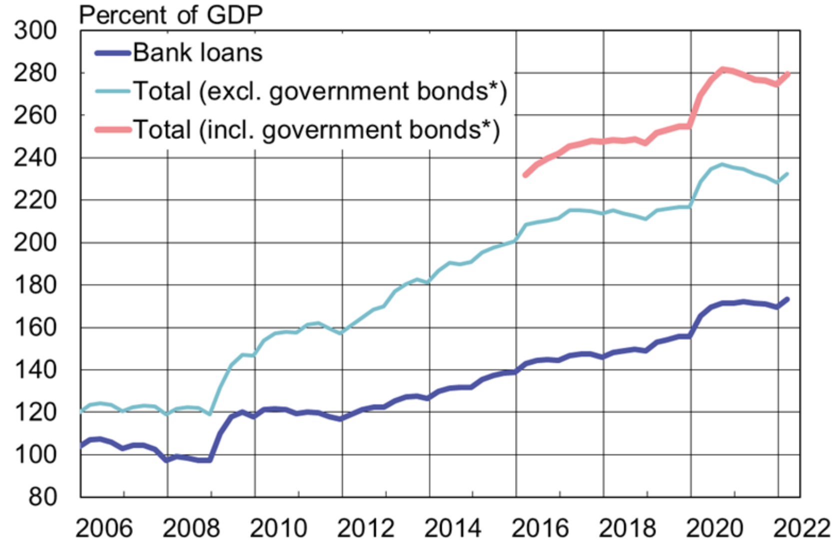


Sources: PBoC, CEIC and BOFIT.

China’s debt growth accelerated slightly in the first quarter. PBoC figures show that aggregate financing to the real economy (AFRE) was up by 10.6 % y-o-y at the end of March. Growth picked up from the second half of 2021, and in 1Q22 slightly exceeded nominal GDP growth. After falling for over a year, China’s total domestic debt-to-GDP ratio again began to rise in 1Q22. As of end March, total debt-to-GDP ratio stood at 279 %.

The central bank’s broad AFRE definition includes bond liabilities of corporations, the central government and local governments. Growth of both corporate and government debt accelerated in the first quarter. On the other hand, the reported stock of shadow banking instruments (entrusted loans, trust loans and banker’s acceptances) continued to dwindle as it has for years. Bank lending also seems to be slowing. Growth in the stock of bank loans at the end of March was up by about 11 % y-o-y.

China's total domestic debt-to-GDP ratio increased in the first quarter



*Sources: People's Bank of China, CEIC and BOFIT. *) General bonds issued by central and local governments. The IMF puts China's actual public debt at 102 % of GDP as of end-2021.*

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Russia

Trends weakened in many branches of the Russian economy in March. The economic disruption from Russia's war on Ukraine and Western economic sanctions was reflected immediately in Russia's financial markets. Over the subsequent weeks, signs of damage also began to appear in the real economy, but the development varied across branches.

The current shock wave started off with a brief spurt in consumer demand as shoppers stocked up for possible shortages and price rises. This is a familiar consumer behaviour in Russia when there is widespread anticipation of hard times ahead. As a result, March retail sales were still up by 2 % y-o-y, largely on foodstuff purchases. Inventories of many staple items such as vegetable oil and sugar were drawn down to exceptionally low levels. Most of the growth spike in non-food goods sales took place already in February, and sales were falling by March. March sales of new cars declined by 63 % y-o-y, approaching levels close to those experienced in the depths of the Covid Recession of spring 2020. An exception in the non-food category was online retail, which was 1,5 times higher in March than a year earlier. Online retail constituted 8 % of total retail sales.

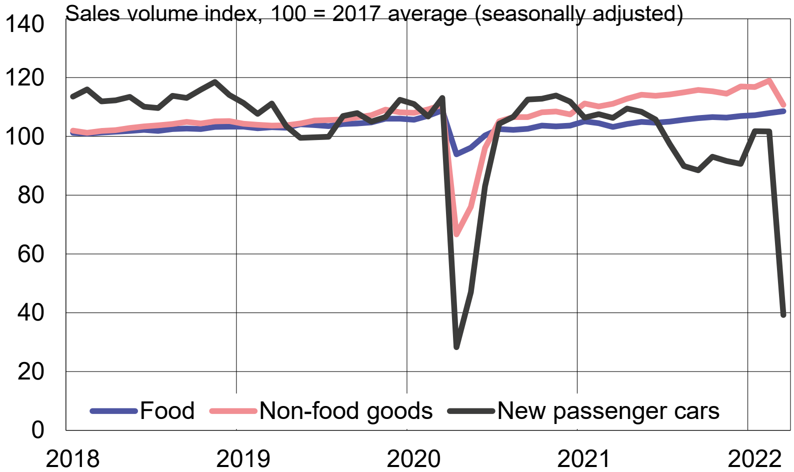
The recent spike in consumption was one factor fuelling March inflation, with consumer prices climbing by 17 % y-o-y. High inflation has already begun to erode household purchasing power with average Russian real disposable household incomes shrinking since the start of this year. In the first quarter, real incomes declined by slightly over 1 % y-o-y. The average pension in March was 8 % smaller in real terms than a year earlier, even with the pension hike at the start of February. Weakening income trends are expected to reduce consumer demand in the months ahead.

Industrial production grew by 3 % y-o-y in March, but development within industry was diverging. While extractive industries still saw rising production in March, finance minister Anton Siluanov noted that Russian oil production could decline by 17 % this year if Western countries decide not to buy Russian crude. In 2020, during the Covid Recession, Russian oil production fell by 9 %. The level of manufacturing production has declined since the start of this year, and in March the fall accelerated. Manufacturing is suffering from a lack of imported components. Car manufacturing fell by nearly 50 % y-o-y in March.

Air transport is among the branches hardest hit by sanctions. The volume of air freight fell in March by over 80 % y-o-y. The transportation sector overall grew by 3.5 %.

The Russian economy is expected to weaken considerably in the months ahead. Recent forecasts see Russian GDP contracting by 8.5–15 % this year. Many forecasters expect Russia's economic contraction to continue next year. Due to the massive uncertainty created by Russia's attack on Ukraine, the risk of an even gloomier trend is possible.

Sales of non-food goods declined in Russia in March with new passenger cars leading the fall



Sources: CEIC, Rosstat, Association of European Businesses, BOFIT.

Timely CBR support measures avert banking sector panic. Russia's invasion of Ukraine and the new Western sanctions that followed threatened to cause a massive run on bank deposits in Russia. The Central Bank of Russia responded with aggressive measures that included raising its key rate, imposing capital controls, shutting down the Moscow exchange for nearly a month, providing extra liquidity to banks, as well as temporarily reducing supervisory measures for banks to support the banking sector. Thanks to the CBR's timely moves, conditions on Russia's financial markets stabilised last month.

A striking change is the brevity of banking sector data released by the CBR for February and March. They show household bank deposits contracting in February by a record 3.5 % m-o-m, then plateauing in March. As of end-March, household bank deposits were about the same as at the start of the month. Due to the lack of alternative investment opportunities and the offering of high deposit interest rates, banks managed to attract ruble deposits. The stock of household bank deposits at the end of March was down just 6.4 % from the start of the year.

The stock of corporate bank deposits remained essentially unchanged during February and March. In particular, the figures for corporate deposits revealed a shift from forex deposits to ruble deposits. The shift was largely driven by the government requirement that firms convert most of their export earnings to rubles. Growth in budget revenues led to the explosion of public sector bank deposits in March.

Rising interest rates and general uncertainty are reflected in bank lending. While the stock of corporate lending was largely unchanged in March, the CBR estimates that new lending was down by about a third. In addition, new consumer loans were also down by about a third from January. Numerous government interest subsidy programmes and loan repayment holidays have supported corporate and housing lending. Due to extremely rapid growth last year (BOFIT Weekly 7/2022), on-year growth in total bank lending remained high in the first quarter of this year.

Key indicators for Russia's banking sector in the first quarter of 2022

	Total loans Jan.1, 2022, trillion rubles	Total loans Apr. 1, 2022, trillion rubles	Change in January-March 2022, % ytd	Change in March 2022, % y-o-y
Loans to households	25.068	25.763	2.7	24
- housing loan component*	11.711	12.430	3.4	27
- consumer loan component*	11.595	11.899	2.1	21
Loans to corporations	52.654	55.373	2.0	13
Household deposits	34.695	33.267	-6.4	2
Corporate deposits	38.304	40.633	2.2	18
Public sector deposits**	6.264	9.747	56	

*Sources: Central Bank of Russia and BOFIT. Figures include loans and deposits in all currencies. * February ** compiled from multiple sources.*

Russian federal budget revenues and expenditures rise; inflation undermines purchasing power. Nominal revenues to the federal budget were up by 35 % y-o-y in the first quarter, and were still up by 17 % y-o-y in March. Due to the spike in inflation, however, revenues were down in real terms in March as consumer prices rose by 17 % y-o-y and industrial producer prices were up by 27 %.

The rise in nominal revenues was largely driven by higher revenues from oil & gas taxes. These revenues, which are mostly denominated in dollars, increased in the first quarter by over 80 % y-o-y. In March, growth was over 100 % due to the soaring price for Urals oil and the dollar's appreciation against the ruble (both up by about 40 % y-o-y). The increase in the Urals oil price in rubles was up by nearly 100 %. The coming months look less favourable to government revenues, however, as the price of Urals crude is currently down and the ruble has strengthened back to pre-invasion levels. Tax revenues from oil & gas accounted for over 40 % of federal budget revenues in the first quarter.

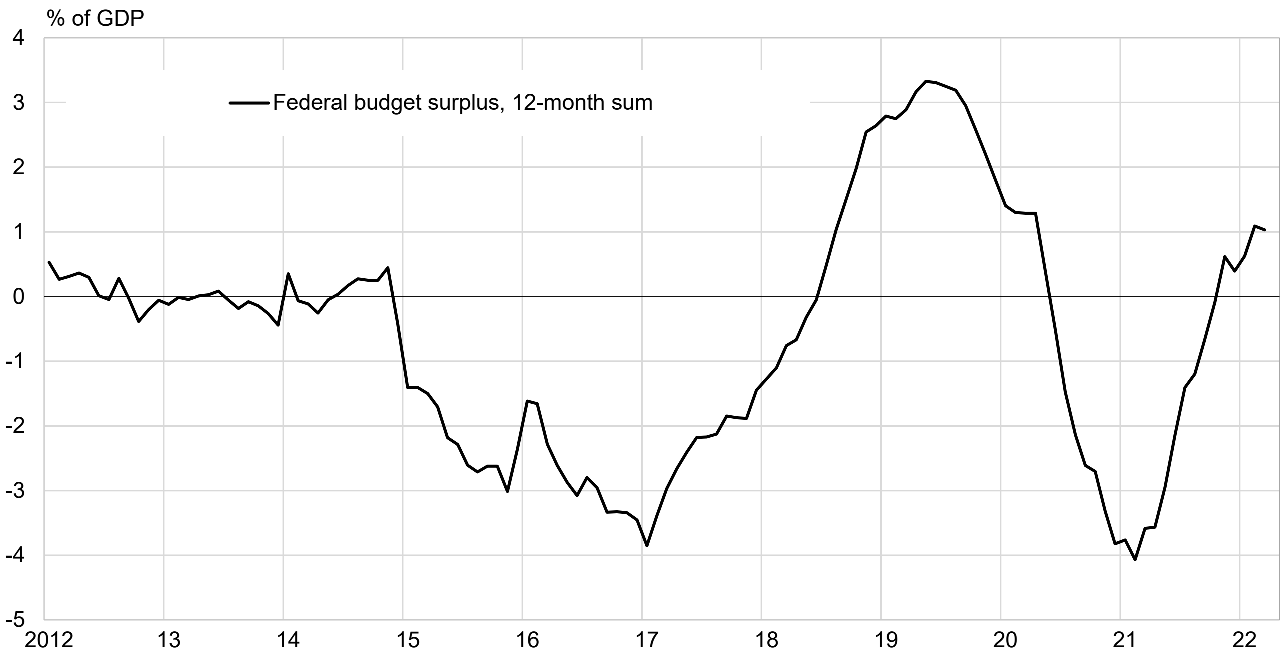
Other budget revenues, which were up by 14 % y-o-y in the first quarter, fell in March. The drop had yet to reflect the economic downturn, as revenues from value-added taxes, excise taxes and corporate profit taxes were up strongly in March. VAT revenues accounted for nearly 40 % of federal budget revenues in the first quarter. Revenues from some of the government's other budget revenue streams fell sharply.

Nominal federal budget expenditures were up by 20 % y-o-y in the first quarter. The March increase was nearly 30 %. Military spending was raised by 17 % in the first quarter, with a similar pace each month. Spending on domestic security and law enforcement rose slowly. After a sharp decline in 2021, spending on television and radio broadcasting recovered to levels near their 2020 peak.

Growth in the federal budget surplus has stabilised this year. The 12-month surplus in March amounted to about 1 % of GDP.

Finance minister Siluanov said that for the time being additional budgetary support this year will be on the order of roughly 2 % of GDP. According to Siluanov, the figure includes supplementary budget spending, investments in the economy funded from the National Welfare Fund and postponed tax payments (e.g. corporate profit tax payments). President Vladimir Putin this week proposed granting a one-year postponement of the mandatory social contributions of employers for firms operating in most branches.

Growth of Russia's federal budget surplus slowed this year



Sources: Russian finance ministry and BOFIT.

Russian military spending increased last year. New figures released by the Stockholm International Peace Research Institute (SIPRI) show that Russia's 2021 military spending amounted to 66 billion dollars, or about 4 % of GDP. Military spending in fixed prices was at its highest level in five years. Russia hit a post-Soviet peak in military spending in 2016, when it corresponded to 5.4 % of GDP. At that time, the military budget included a substantial government support package to pay off the loans of military industry contractors.

Russian military spending adjusted for the size of its economy is relatively high by global standards, even approaching the levels of Middle Eastern countries. Russia's military spending in recent years has averaged around 4 % of GDP, which exceeds the averages of the US (3.5 %), China (1.8 %) and EU countries (1.5 %).

In terms of gross military spending, Russia lags well behind the spending of the world's biggest economic powers. US military spending last year reached 800 billion dollars. SIPRI put China's spending last year at 290 billion dollars. Total EU military spending amounted to 260 billion dollars. Ukraine's military spending has soared since Russia's illegal annexation of the Crimean peninsula in 2014. SIPRI estimates that Ukraine's military spending last year was about 6 billion dollars, which was roughly on par with the level of Finnish spending.

SIPRI also issues estimates of global arms trade. According to the latest SIPRI estimates, Russia last year was the world's third largest arms exporter after the US and France. Russia's top arms customers in 2017–2021 were India (28 % of arms exports), China (21 %), Egypt (13 %), Algeria (11 %) and Vietnam (4 %).

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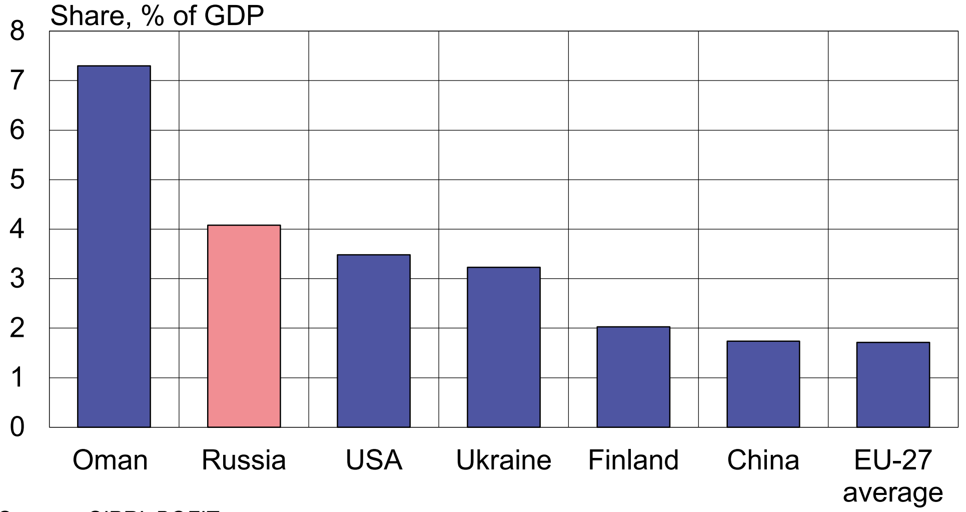
Relative to the size of its economy, Russia's military spending was quite high by international standards in 2021



Sources: SIPRI, BOFIT.

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BOFIT

China

Latest BOFIT forecast sees modest Chinese economic growth this year. In our Forecast for China 2022–2024, released last week, we anticipate China's GDP growth to reach just 2 % this year. Measures to boost the economy should begin to take effect in the second half of this year, which, combined with a rebound in consumer spending, should lift Chinese growth to 4 % in 2023. Growth then slows to 3 % in 2024. Growth figures are rough estimates, and they provide a sense of trends in China's actual output. This year the difference between the government's official GDP growth figures and actual situation is expected to widen. Officials are under tremendous pressure to report growth figure in accordance with the government's target of "about 5.5 %" of GDP.

Economic growth this year is defined to a large extent by the spread of covid and strict measures to deal with it. Increased uncertainty and strict zero-covid policies will depress consumer spending, interfere with normal business operations and create a host of logistical challenges. Recent purchasing managers' indices suggest that both manufacturing and services activity contracted sharply in April. However, there is little indication that China is yet ready to abandon its zero-covid suppression strategy and pursue an alternative approach. We expect highly contagious virus variants to spread widely in China and that many cities will face temporary lockdowns as they attempt to implement the zero-covid strategy.

Public sector investment should soar this year as China is easing fiscal policy to support growth. The bulk of responsibility for stimulus spending, however, falls on local governments, many of which are already saddled with large deficits and massive debt. The willingness and ability of local governments to implement a broad stimulus may also not comport with Beijing's wishes, especially when local government will need to use large amounts of resources on covid measures. The latest wave of the pandemic has complicated investment projects and represents yet another blow to China's struggling real estate markets and construction. This reduces local government revenues, particularly from the sale of land use rights.

China has begun to loosen its monetary stance to support growth. Despite a relatively modest rise in consumer prices that leaves room for further easing, the People's Bank of China must weigh any accommodation against the financial stability risks. Moreover, China's monetary policy direction contradicts the general trend in other major economic blocs. Rate hikes, particularly in the US, have already increased capital outflows from China. If China lowers interest rates when the rest of the world's central banks are raising, the spread between China and others will widen rapidly, causing increased capital outflows that put further depreciation pressure on the yuan.

Large uncertainty clouds the economic outlook. If covid lockdowns become widespread or the current covid wave continues longer than expected, economic growth would slow even further. On the other hand, if the spread of covid is brought under control relatively quickly or China adopts a more modest covid strategy, growth could be higher than forecast. The real estate sector's financial woes continue to worsen, and they could spill over into the financial sector. China's current tightrope act that seeks to appease both the politically important considered Russia and the economically critical West might end. How China ultimately sides could profoundly affect its economic future.

The stage is set for president Xi Jinping to be nominated this autumn for his third term as the leader of the country. The state's role in the economy and society has increased during Xi's term as party leader. Decision-making has become increasingly concentrated in the hands of a single individual. Such concentration of power can lead to bad policies with unfortunate economic consequences. China's long-standing pragmatism on economic matters has increasingly become tainted by political and ideological posturing that risks inappropriate or even damaging policy actions. The current line of stability and excessively ambitious GDP growth targets still continue to dominate economic policy, leaving little room for the government to push ahead with critical economic reforms.

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Weekly Review
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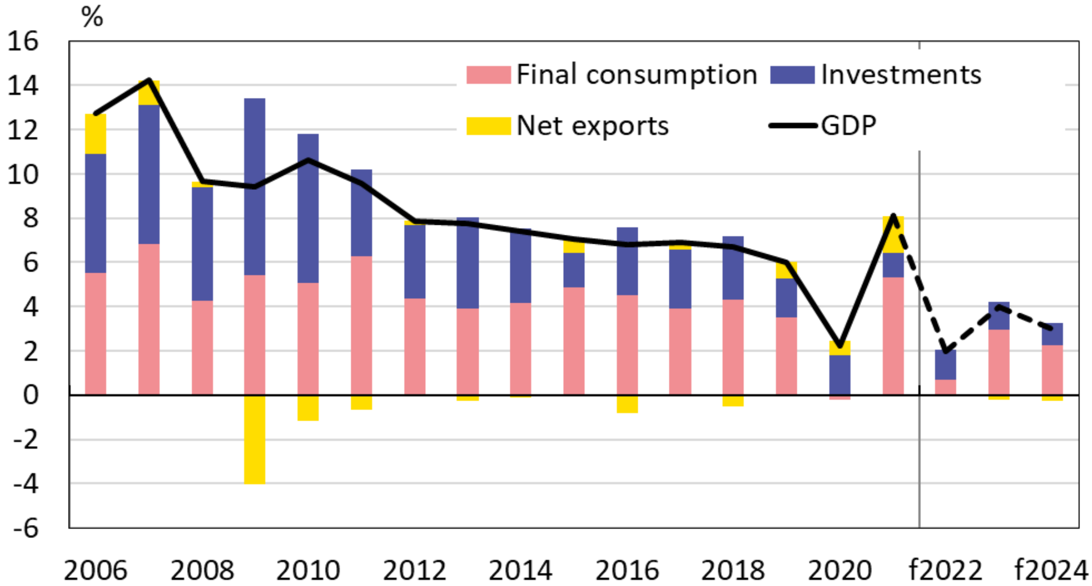
Realised official Chinese GDP growth, main contributors to growth and BOFIT forecast for 2022–2024

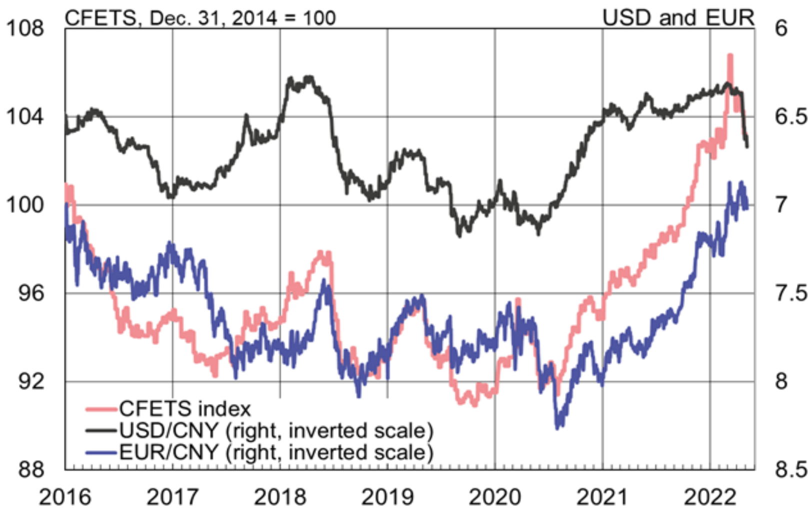


Sources: China National Bureau of Statistics, CEIC and BOFIT.

Yuan loses ground against the US dollar. The yuan has been on a downward trend since mid-April, losing 5 % of its value against the dollar and 2 % against the euro. China also releases data on the performance of the yuan against a trade-weighted currency basket with a delay of a few days. The China Foreign Exchange Trading System (CFETS) RMB index shows that the yuan lost about 2 % of its value in the final two weeks of April. The falling exchange rate reflects growing global uncertainty, China's weakening growth prospects and rising interest rates outside China that could trigger capital outflows. The yield on the US 10-year treasury note, now around 3 %, exceeds that of China's government bond for the first time since 2010. In February-March, the net flow of foreign portfolio investment to mainland China's equity and bond markets turned negative.

At the end of April, the PBoC announced that it was lowering the foreign currency deposit reserve requirement for commercial banks from 9 % to 8 % in mid-May. The slight freeing up of bank forex reserves could relieve some depreciation pressure on the yuan. The PBoC can, as needed, intervene to prevent violent swings in the exchange rate through e.g. issuing guidance orders on the forex trading of commercial banks.

The yuan has depreciated sharply against the dollar in recent weeks



Sources: Macrobond, CFETS and BOFIT.

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China's real estate sector continues to struggle. First-quarter apartment sales fell by 14 % y-o-y when measured by volume (floorspace) and by 23 % when measured by value (yuan). In addition, construction starts declined by 17 %, sales of land use rights fell by 42 % and apartment completions were down by 11 %. The situation in the real estate sector does not appear to be improving. In March, nearly all indicators for the sector were worse than in January or February. Prices of apartments in large and mid-sized cities continued to fall.

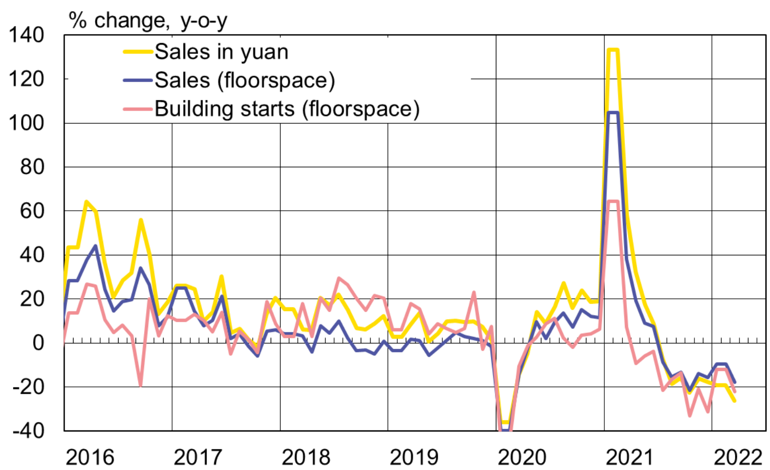
The financial status of many of China's largest developers remains shaky. Developers and construction firms account for the largest share of Chinese offshore dollar-denominated bonds, the total return of which declined 19 % in the first quarter. So far this year, Chinese bond defaults are at around 6 billion dollars, and all originate from the real estate sector. Bloomberg notes that the troubled developers also have outstanding onshore yuan bonds worth about 70 billion yuan (over 10 billion dollars) maturing by the end of this year. The amount of bonds issued by developers has declined steadily since last summer, and the yield on developer-issued bonds has risen to historical highs.

Bloomberg lists 18 Chinese developers that have not managed to release their 2021 financial statements. For example, Sunac China, currently the country's number-four developer, has been unable to publish even unaudited financial results. As stated by the firms, the biggest cause behind these auditing delays are covid restrictions, but the situation at some developers (including Sinic, Sunshine 100 and Fantasia) has been further complicated by the loss of key personnel.

The problems of the giant developer Evergrande are hardly over. Evergrande announced in March that it would release by the end of July a restructuring plan for repaying its foreign creditors, but at the same time it also struggles to deal with payments to domestic creditors. The latest settlement was reached at the end of last month, when investors granted a six-month extension on 574 million yuan (88 million dollars) in coupon payments on bonds issued by Evergrande's subsidiary, Hengda Real Estate Group. Evergrande's net sales last year fell by nearly 40 % y-o-y, and the group has yet to announce a sales target for this year. It has also not released any monthly sales figures since September 2021. Evergrande did announce last month, however, that 95 % of its projects were still ongoing.

Chinese officials are clearly concerned about the struggles of companies in the real estate sector. Zero-covid policies will continue to impact construction activity and demand for new housing in coming months. This year's high GDP growth target seems increasingly unachievable without major stimulus. On April 18, the PBoC and financial supervision authority released a 23-point list of actions including to encourage banks to support local government infrastructure projects and high-quality building projects, as well as loan more money to developers. Officials encourage the tailoring of housing loan policies to local markets, as well as the need to grant breaks on loan payments to borrowers affected by covid restrictions.

Building starts and apartment sales have continued to decline this year



Sources: NBS, CEIC and BOFIT.

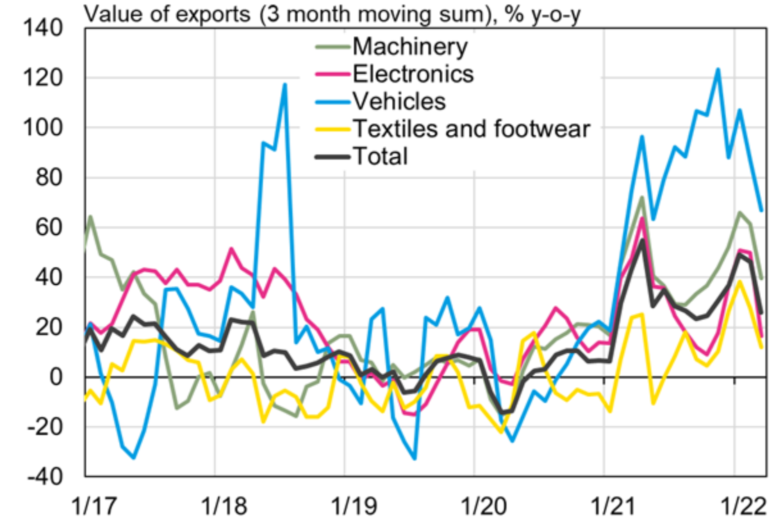
Growth in China's foreign trade slowed in March; exports to Russia fell. The latest foreign trade figures released by China Customs show that the value of goods exports in January-March grew by 16 % y-o-y, while the value of imports rose by 11 %. In February and March, growth in foreign trade slowed. March imports grew by just 1 % y-o-y. The logistical problems caused by covid lockdowns worsened in April and May. According the PBoC's latest balance-of-payments figures, goods and services trade growth was roughly in line with the customs statistics. In January-March, the value of goods and services exports rose by 18 % y-o-y and the value of imports by 16 %. The relative size of the current account surplus remained unchanged at 1.8 % of GDP.

In the wake of Russia's attack on Ukraine, the value of China's goods exports to Russia contracted by 8 % y-o-y in March. China's exports to Russia accounted for 1.4 % of total exports. Nearly half of China's exports to Russia consisted of machinery, equipment and electronic devices. The value of machinery and mechanical appliance exports to Russia rose in March by 13 % y-o-y, while the value of electronics exports to Russia fell by 29 %. The value of exports of transport vehicles (12 % of China's total exports to Russia) was up by 33 %, while the value of textile exports was down by 19 %.

Surging commodity prices boosted the value of Chinese goods imports from Russia by 26 % y-o-y in March. Imports from Russia represented 3.4 % of China's total goods imports. Mineral products (mainly crude oil) accounted for 80 % of the value of Russian imports. Their declared value according to China Customs was up by over 40 % y-o-y. The value of other goods imported from Russia declined.

The rise in the value of Russian imports came entirely from higher prices; the volumes of all major energy commodities imported from Russia declined. The volume of China's crude oil imports from Russia fell by 14 % y-o-y in March. Russia's share of China's crude oil imports remained steady at 15 % as China's total oil imports were down by 14 %. The volumes of other energy imports from Russia in March were also down, e.g. coal (-31 % y-o-y) and liquefied natural gas (-2 %).

The growth in Chinese exports to Russia slowed in the first quarter in all major goods categories



Sources: China Customs, CEIC and BOFIT.

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Russia

Major forecasts for the Russian economy anticipate a large contraction this year along with sharp drops in exports and imports. The latest batch of forecasts released in April and May see the Russian economy contracting by roughly 10 % over the course of this year or continuing partly into next year. Most forecasters expect the recovery in GDP to begin only in 2024. Due to large discounts on Urals-grade crude oil in recent months, Russian forecasts see relatively little increase in the average oil price this year compared to 2021 (Bank of Russia expects 9 % higher oil prices, while Russia's economy ministry sees an increase of 20 %).

According to the CBR and World Bank, Russia's total imports should drop by about a third this year, while the IMF expects a decline by about a quarter. The CBR and IMF see the volume of Russian exports falling by a fifth this year, while the World Bank's forecast, which includes announced import bans on oil & gas and a considerable drop in Russia's other exports, says the decline could be as much as a third.

Household consumption is expected to fall by about 10 % this year (CBR and World Bank). Inflation, which erodes household purchasing power and dampens consumption, is widely expected to average about 20 % this year and continue next year at 7–10 % (CBR) or even more rapidly at 13–14 % (IMF and World Bank). Fixed investment is generally expected to fall by nearly a fifth this year.

Forecasters at the IMF and World Bank expect Russia's government budget spending to rise significantly this year (although inflation will swallow the increase) and a turn of budget balance into deficit. Depending on budget revenue expectations, this year's budget deficit could be limited to about 2 % of GDP (World Bank), or plunge to around 4 % of GDP if, among other things, the government goes ahead with proposed tax breaks (IMF).

Few forecasts include predictions of unemployment. The consensus forecast compiled by the CBR expects the unemployment rate to climb this year to nearly 8 %, while the IMF sees unemployment exceeding 9 %.

Recent forecasts see Russian GDP contracting substantially this year and Russian imports falling sharply

		2022	23	24
GDP			% change	
Bank of Russia	4/22	-8.0 − -10.0	-3.0 − 0.0	2.5 − 3.5
Ministry of Economy	4/22	-8.8 (-12.4*)	1.3 (1.1*)	4.6
IMF	4/22	-8.5	-2.3	1.5
World Bank	4/22	-11.2	0.6	1.3
EBRD	5/22	-10.0	0.0	
Consensus Economics	4/22	-10.0	-0.7	
Russian imports of goods & services			% change	
Bank of Russia	4/22	-32.5 − -36.5	-2.5 − 1.5	2.0 − 4.0
IMF	4/22	-23.2	1.9	2.6
World Bank	4/22	-35.2	4.1	6.2

* lower variant

CBR further lowers key rate. On April 29, following improving conditions on financial markets and falling price instability risks, the Central Bank of Russia lowered its key rate by 300 basis points. The key rate currently stands at 14 %. Markets expected rate cut as the CBR earlier said that it would lower the key rate when the situation stabilised. The CBR stated that it sees room for further rate cut this year if the economy develops in line with its expectations.

The ruble's exchange rate plunge after Russia invaded Ukraine, along with domestic hoarding and supply bottlenecks, have caused inflation to soar in Russia. The CBR estimates that consumer prices at late-April were up by 18 % y-o-y. Inflation pressures have eased in recent weeks, however, with strengthening of the ruble and easing of demand. After skyrocketing in March, household inflation expectations moderated in April and now are similar to those of last autumn.

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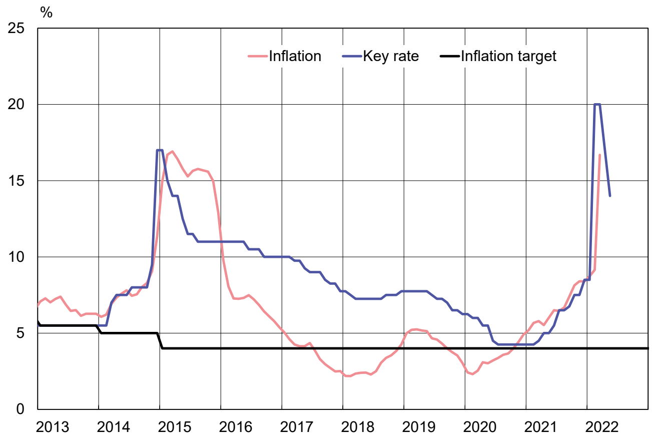
According to the CBR's forecast, annual inflation would be between 18 % and 23 % this year and fall back to around the central bank's inflation target of 4 % p.a. in 2024.

The CBR has lowered the key rate twice since the sharp hike after the invasion of Ukraine



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

Russia legitimises parallel imports of many goods as imports collapse. Parallel importing refers to imports without the permission of the intellectual property owner that circumvent authorised distributors of the goods. Russian law on parallel imports has generally required that offenders pay compensation to the intellectual property owner and destroy the improperly imported goods. As of May 7, however, parallel imports of many goods are now permitted in Russia. The decision to legalise parallel imports covers a wide range of items from cosmetics to car parts and gaming consoles. For some goods, the dispensation only applies to certain trademarks of companies based in countries deemed "unfriendly" to Russia.

The Russian government's purpose in allowing parallel imports is to make imported goods available domestically and harm foreign companies that produce the goods. Western sanctions on Russia ban the export of many goods to Russia. In addition, many firms have decided on their own to suspend or cease their Russian businesses.

Russian Customs has halted its release of foreign trade figures, but the export figures of other countries indicate a substantial decline in Russian imports in March. The combined dollar-value of goods exports to Russia from Germany, France, the US, Japan, Korea, China and Turkey was down by nearly 40 % y-o-y in March. These countries traditionally account about half of the goods Russia imports. Finnish Customs reports the value of Finnish goods exports to Russia was also down by about 40 % y-o-y in March.

Russia is not highly dependent on imports in basic necessities such as staple foods and fuels, but most sophisticated consumer and investment goods – particularly high-tech products – are mainly imported. The unavailability of such goods, many of which are critical in production processes, could reduce Russian output significantly in many branches (BOFIT Policy Brief 4/2022). It is often difficult for Russian producers to provide adequate substitutes for imported goods. Indeed, while Russia has had strong import substitution policies in place for several years, the country's dependence on imports has not decreased (BOFIT Policy Brief 3/2022).

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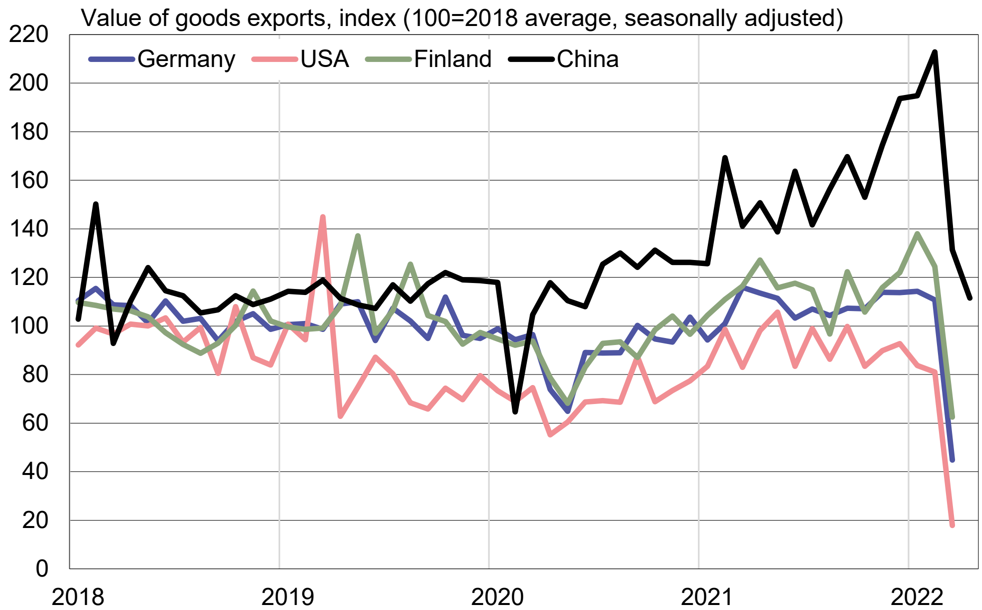
Many countries have significantly reduced their goods exports to Russia this year



Sources: Macrobond, Finnish customs, BOFIT.

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China

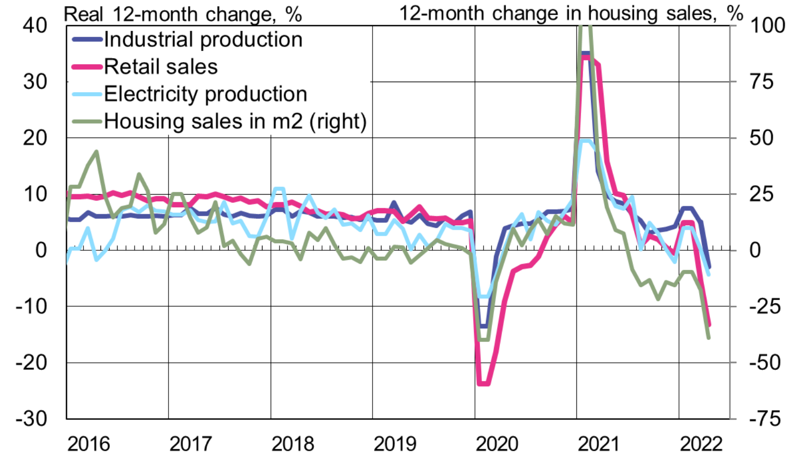
Chinese economy stumbled in April. Covid lockdowns and the resulting uncertainty and supply-chain disruptions caused China's key economic indicators to plummet in April. The National Bureau of Statistics reports that the value of retail sales went down by 11 % y-o-y last month, or at least 13 % in real terms. Value of catering service sales shrank by 23 % y-o-y, while car sales were down by 32 %. Retail sales have underperformed the rest of the economy throughout the pandemic. Based on month-on-month NBS growth figures, the volume of retail sales last month seems to be around the same level as it was three years ago.

Led by a decrease in manufacturing activity (down 5 %), industrial output contracted by 3 % y-o-y in April. NBS figures show that industrial output plunged from March, but still the level of output was roughly 18 % higher than three years ago. The decline in construction and sales of real estate became steeper in April. New building starts, measured in terms of floorspace, fell by 44 % y-o-y, while real estate sales fell by 39 %.

Foreign demand also slowed down last month. The value of China's goods exports (in US dollars) rose by 4 % y-o-y, while the value of imports was up by 1 %. Last year the value of China's foreign trade rose by 30 %. The value of exports to Russia in April fell by 26 % y-o-y (down by 8 % in March). The value of imports from Russia still rose by 57 % y-o-y, however, reflecting soaring global prices for energy and other commodities.

The unemployment rate, which is based on urban surveys, climbed to 6.1 % in April. The unemployment rate in China has risen since last autumn when it stood at 4.9 %. China's unemployment figures, however, do not necessarily give a clear picture of labour market conditions. Data from official survey show an unusually stable unemployment rate in the range of slightly under 5 % to just over 6 % throughout its entire history. Youth unemployment (16 to 24 year-olds), however, has climbed recently and reached 18.2 % in April according to official survey figures.

Industrial output and electricity production growth turned negative in April; retail and housing sales contracted further



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

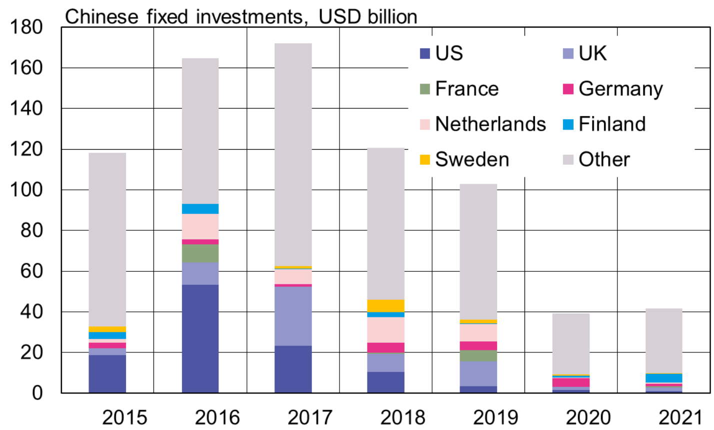
Foreign investment by Chinese firms remained depressed last year. UNCTAD figures put the value of global foreign direct investment (FDI) in 2021 at just over 1.7 trillion dollars. It represented a 77 % increase from the previous year, which saw a historical decline in FDI due to the covid pandemic. In China's case, however, inward FDI has increased throughout the pandemic period. Figures from China's commerce ministry show that FDI inflows to China last year amounted to about 173 billion dollars, a 16 % increase from 2020. During the first four months of 2022, nearly 75 billion dollars in inward FDI flowed into China, a 26 % increase from a year earlier.

According to China's commerce ministry, the value of outward FDI last year amounted to 114 billion dollars, a decline of 15 % from 2020. A recent study from Germany's Mercator Institute for China Studies (Merics) found that Chinese FDI flows to Europe (EU-27 plus UK) rose by a third last year to around 10 billion euros. Most of the investment growth came from a single 3.7-billion-euro investment project in the Netherlands. The Chinese also actively invested in the UK, Germany and France. Chinese investment last year focused particularly on battery production for the automobile industry, health technology and IT. Shenzhen-based Mindray made a substantial investment in Finland last year with the 560-million-euro acquisition of the Turku biotech firm HyTest Invest Oy. In May 2022, National Silicon Industry, the Chinese owner of the Finnish silicon wafer-maker Okmetic, announced it was investing nearly 400 million euros in construction of a new chip production facility that will double Okmetic's capacity.

China Global Investment Tracker (CGIT) follows all Chinese foreign investments over 100 million dollars. The value of these tracked large investments totalled 42 billion dollars last year, an amount roughly similar to 2020 investments but nearly 60 % less than in pre-pandemic 2019. Most of the investment went to the energy and transport sectors. Chinese companies invested just 1.1 billion dollars in the US, a small fraction of investments in the EU and UK (combined value 9.8 billion dollars).

Stricter capital controls and rules on foreign investment in China, along with stricter monitoring of Chinese investments, particularly in North America and Europe, have driven the general drop in Chinese outward FDI. The investment appetite of Chinese firms may also have been diminished by weakening economic conditions, ongoing struggles with the covid pandemic and draconian restrictions on travel. However, commerce ministry figures show that during the first three months of 2022 Chinese firms sent 27 billion dollars in FDI abroad, a 9 % increase from a year earlier.

Chinese firms held back on major foreign investments last year



Figures include all investments over 100 million dollars.
Sources: China Global Investment Tracker and BOFIT.

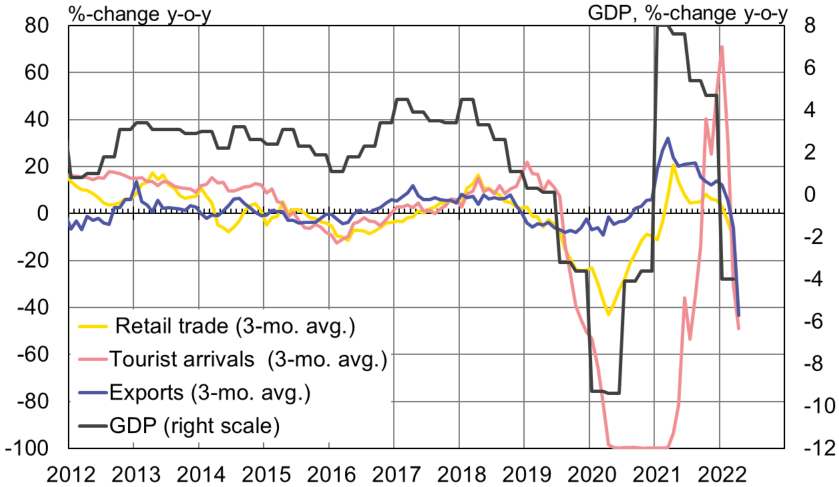
Hong Kong GDP shrank in the first quarter of this year. The Hong Kong statistics department reports that GDP contracted by 4 % y-o-y in the first three months of 2022. The decline was driven mainly by reduced private consumption due to a wave of covid infections that started early this year and subsequent lockdown measures to slow the spread of covid. The volume of exports also fell in the first quarter. The contraction in exports intensified towards the end of the first quarter. The value of exports fell by 9 % y-o-y in February and 17 % in March.

The Hong Kong economy is expected to recover in the second quarter. Covid infections have dropped significantly in Hong Kong and the government has included large spending increases in its 2022 budget. A return of travellers could also support growth. Foreign travellers have been allowed to visit Hong Kong since the start of May, and the mandatory hotel quarantine has been reduced to seven days. On the other hand, mainland China's struggles with covid are reflected in the Hong Kong economy as it is by far the most important trade and business partner and main source of visitors. The special administrative region only expects GDP to grow this year by 1–2 %.

Hong Kong's political leadership is changing, and its new chief executive vote was held on May 8. The special administrative region's former security chief, John Lee, was the sole official candidate for the post. He was chosen by the election committee gaining 1,416 votes of 1,428 total votes cast. Lee's term as the chief executive begins in July when Carrie Lam completes her five-year term. Beijing's grip on Hong Kong is expected to tighten further under Lee.

China's tightening grip on Hong Kong is also reflected in the just-released Reporters Without Borders 2022 World Press Freedom Index, in which Hong Kong fell to 148th place in the 180-country rankings. Hong Kong was still at 80th place just last year and at 34th place in 2010. China ranked 175th this year.

Hong Kong GDP contracted in the first quarter



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

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Russia

The ruble continues to appreciate. The ruble's official exchange rate dropped sharply after Russia invaded Ukraine, falling as low as 120 rubles to the dollar at one point. Since then, the ruble has climbed back to pre-war levels. Indeed, the official ruble-dollar rate reached 57 rubles this week, its highest level since spring 2018.

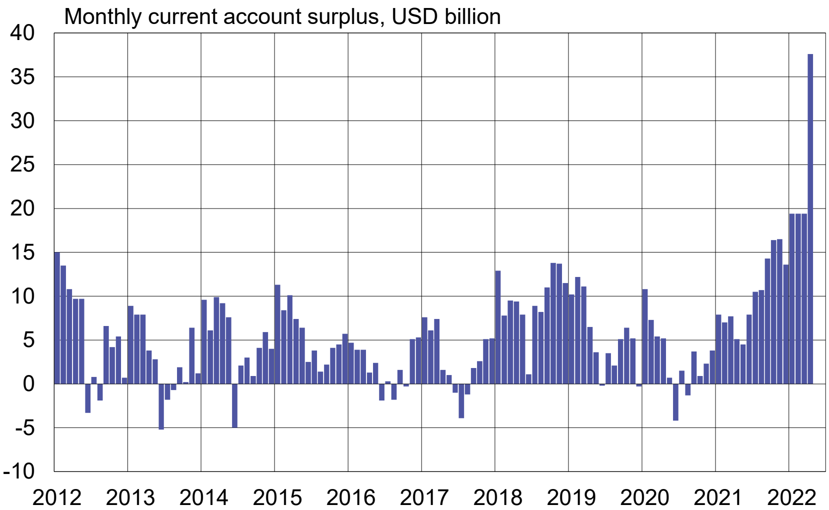
The two major drivers of ruble appreciation in recent weeks have been Russia's historically large current account surplus and the government's imposition of emergency rules on the foreign exchange market. Preliminary figures released by the Central Bank of Russia show that the current account surplus hit an exceptionally large 37 billion dollars in April. Currency markets remain subject to several restrictions, even if some rules have been eased with improving market conditions. The restrictions are designed to artificially support the ruble's exchange rate.

High global commodity prices support Russia's export earnings. The average price of Urals blend crude oil in April was over 10 % higher than a year earlier, even if Russian crude currently sells at large discounts relative to other oil blends. Sanctions have only cooled Russian exports to a limited extent because they only apply to certain exports. Russia's economic development ministry estimates that Western import bans, as well as restrictions on Russian shipping and road transport, affect about 20 % of Russia's exports. At the same time, Russian imports have contracted dramatically. Imports face a double-whammy of depressed demand and lack of supply due to sanctions and decisions by large international firms to pull out of Russia on their own accord.

With the stabilisation of forex markets, Russia decided to relax the requirement on forex earnings conversion of export companies this week. The initial requirement implemented at end-February mandated that exporting firms convert 80 % of their forex earnings to rubles. The requirement is now lowered to 50 %. The move should ease appreciation pressure on the Russian currency. The demand of Russian firms for foreign currency, however, continues to be dampened by weak import development, capital controls and the ongoing risk that additional sanctions could be imposed.

While ruble appreciation lowers inflationary pressures in Russia by holding down import prices, this effect has been blunted by strong Western sanctions that have significantly restricted the supply of imports. Moreover, ruble appreciation reduces the amount of rubles the Russian government collects from dollar-denominated export taxes.

The ruble's exchange rate has been supported by April's huge current account surplus



Sources: Central Bank of Russia, Macrobond, BOFIT.

Russia's economic downturn is felt in government budget revenues; military spending soars. Nominal federal budget revenues were up by 34 % y-o-y in the first four months of 2022. Revenue growth in April was about 30 %. The revenue rise in March and April was entirely driven by taxes on oil & gas. As in March, budget revenues from oil & gas taxes, which are for an overwhelming part defined in dollars, were up by over 100 % y-o-y in April. Tax revenues from oil & gas taxes take a while to reflect changes in oil prices, so the rise in April largely reflects the high on-year gains in oil prices in previous months and the ruble's very low exchange rate in March.

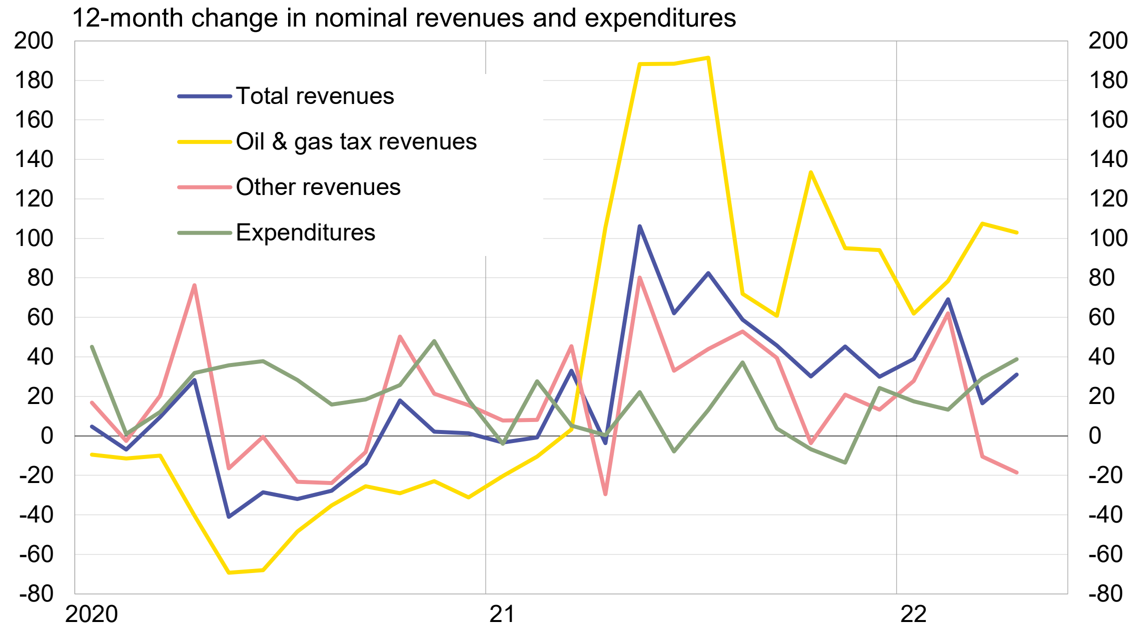
Near-term expectations are weaker if the ruble does not weaken considerably. With significant discounts, the price of Urals-grade crude oil in April was only about 10 % higher than a year ago. Moreover, Russian crude oil production contracted significantly in April. Oil & gas tax revenues accounted for nearly half of federal budget revenues in January-April.

The drop in other federal budget revenue streams became sharper in April, with revenues falling by almost 20 % from a year earlier. This was due to the fact that revenues from value-added taxes were down by nearly half, reflecting the economic downturn and import collapse. Other tax revenues still increased by nearly 20 % y-o-y. Despite such increases, it should be noted the high inflation erodes gains in nominal budget revenues or expenditures (consumer price inflation hit 18 % y-o-y in April and industrial producer prices were up 27 % y-o-y in March).

Nominal spending growth in the federal budget accelerated in April to 40 % y-o-y. The on-year spending increase for the January-April period was 25 %. Nearly half of the April rise in spending came from spending categorised as defence, which was up by roughly 150 % from a year earlier. Defence spending was also up by nearly 40 % y-o-y in January-April. Spending on domestic security and law enforcement rose by 6 % y-o-y in the first four months of this year. Measures to soften the effects of economic distress are also evident in federal budget spending. Spending on various sectors of the economy was up by 40 % y-o-y in January-April.

The federal budget this year is still slightly in surplus. The surplus in April for the past twelve months corresponded to about 1 % of GDP.

Growth in federal budget revenues has slowed since February; non-oil revenues are down and spending growth is up



Sources: Russian Ministry of Finance and BOFIT.

Russian oil production volumes fell in April. The International Energy Agency (IEA) reports that Russian crude oil output averaged around 10 million barrels a day in the first three months of this year. Russian oil output dropped last month to around 9.1 million barrels a day. When natural gas liquids are included, Russia's overall oil output in April averaged about 10.3 million barrels a day, a decline of roughly 10 %. Oil refining volumes reportedly declined sharply in March and April.

Deputy prime minister Alexander Novak says that he expects oil production to rise significantly in May and that production levels should further increase in June. Other forecasts are more pessimistic, however. The base scenario in the latest forecast of Russia's economic development ministry sees oil production contracting by 9 % this year. The IEA estimates that Russian oil production could decline to a level of around a 7 million barrels a day by the end of this year.

If production contracts further in the second half of this year, a recovery to the output levels of 2021 could be difficult. In any case, Western financial sanctions and export bans imposed on Russia will significantly limit investment in the oil sector in coming years.

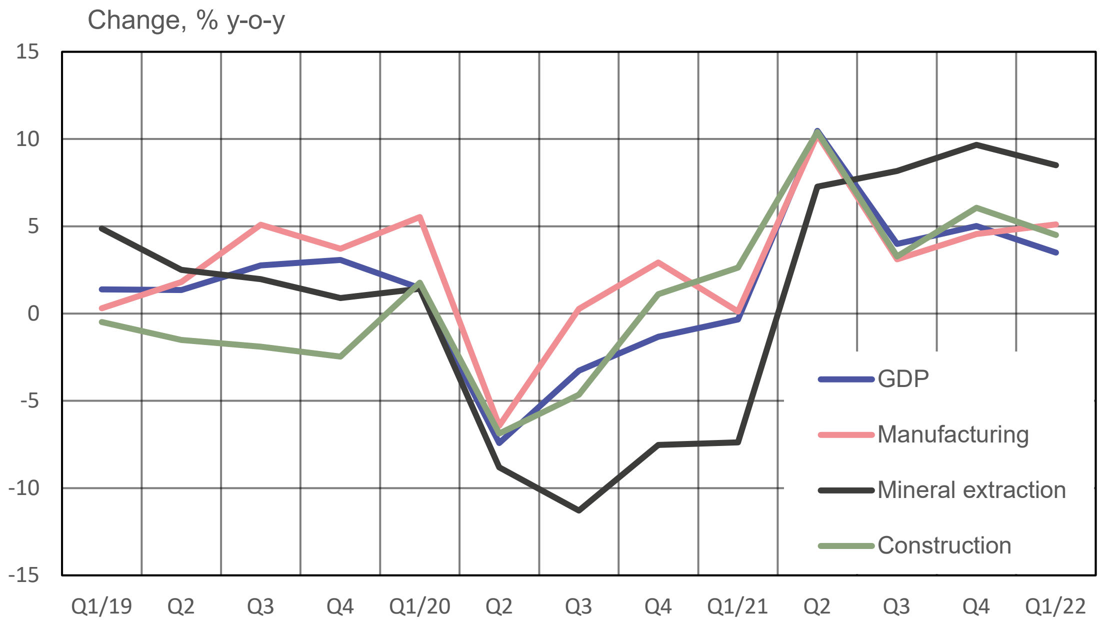
The contraction in output largely reflects a demand shock to Russian crude. Many Western oil buyers now avoid Russian products, even if the oil trade is not directly subject to sanctions. The crash in demand for Russian crude can be seen in Russian export prices. The average price of Urals crude in April was roughly 30–35 dollars lower than North Sea Brent crude. This price gap has persisted throughout May.

Russian Customs does not release timely data on exports of crude oil or petroleum products. The figures compiled by the Centre for Research on Energy and Clean Air (CREA) show that oil exports from Russian ports contracted sharply in March and April, but the export volumes have been rising in recent weeks. The rebound in exports largely reflects growth in shipments to Asia. Russia's economic development ministry expects crude oil exports to shrink this year by only about 1 %, while exports of petroleum products could drop by about 20 %.

Impacts of Ukraine invasion on Russia's economy already apparent in March. Rosstat preliminary figures show Russian first-quarter GDP growing by 3.5 % y-o-y. Rosstat figures further show that the impacts of the Ukraine invasion in late February already began to drag down Russian economic growth in March. Industrial output, for example, grew by nearly 6 % y-o-y in 1Q22, but only by 3 % in March. Manufacturing output growth, which was up by 10 % y-o-y in January and 6 % in February, contracted by 0.3 % in March. The growth trend in the mineral extraction sector was fairly stable throughout the 1Q22, with output up each month by 8–9 % from a year earlier. Retail sales grew by 3.6 % y-o-y in January-March overall, but only 2 % in March alone, pointing to a weakening consumer demand.

The effects of the war on the Russian economy are expected to be much more pronounced in the second quarter of this year. Russia's economic development ministry and the central bank expect the GDP to hit bottom in the third or fourth quarter of this year, with the possibility of subsequent slow recovery next year. Several international forecasters expect the contraction in Russian GDP to continue also next year.

Growth faded in the first quarter for Russian GDP and in the economy's core sectors



Sources: Rosstat and BOFIT.

China

China shifts focus from fighting covid to economic stimulus. The number of new reported cases of covid-19 infections in China has declined significantly in recent weeks. Officials claim that daily new infections are now running at about the same level as at the start of February before the current omicron wave hit. With covid abating, pandemic restrictions have generally been eased around the country, including Shanghai. However, in a few areas, tighter restrictions have been implemented, including for the city of Langfang on the outskirts of Beijing. Covid lockdowns impacted the Chinese economy strongly in April (BOFIT Weekly 20/2022). The latest readings of the main purchasing manager indices show that companies continued to struggle in May.

China's leadership has become increasingly concerned about the country's faltering economy as this year's GDP growth target of "around 5.5 %" could be unachievable. In an extraordinary teleconference with over 100,000 local decision-makers last week, premier Li Keqiang demanded they take action now to prevent the economy from contracting in the second quarter of this year. Participants also included top ministerial-level economic decision-makers.

The government proposed several new economic support measures last week, including larger tax refunds, extending the reductions in corporate social security contributions to the end of this year and extending reduction eligibility to new branches, tax cuts for automobile sales, increased subsidies to airlines, the tourism sector and farms. Spending on infrastructure projects will also be boosted. Provincial governments have been encouraged to launch projects as fast as possible and finance them by issuing this year's entire quota of special purpose bonds by the end of June. In order to improve the access to financing of small and medium-sized enterprises (SMEs), the government presented various forms of support such as rent reduction and lower electricity rates. State-owned companies have been encouraged to pay their invoices from SMEs in a timely manner. While the list of proposed measures is long, it's unclear which measures are truly new. By some estimates, the stimulus measures correspond to around 1.7 % of GDP.

Shanghai has proposed its own package of support measures that include accelerating real estate construction and incentives for apartment buyers. Firms in certain branches will be eligible for support if they promise to retain their workers or take on new workers who have either just graduated or have been unemployed for over three months. In addition, support will be offered to SMEs, as well as individuals for purchases of household appliances, equipment and cars.

It appears that the responsibility for implementing stimulus measures has yet again fallen upon the shoulders of local governments. While China's rich metropolises such as Shanghai have money available for stimulus measures, many local governments are floundering in debt that could well limit their stimulus efforts. The central government has promised the equivalent of about 60 billion dollars in supplemental transfers to provinces to cover new stimulus spending. At the same time, all responsibility for covering the costs of covid testing and vaccination has been shifted to provinces. Many provinces earlier covered their costs of covid testing from employee health insurance funds. According to some Chinese estimates, the covid testing costed over 20 billion dollars in the first four months of this year. The finance ministry has demanded that local governments set aside sufficient funds to allow for extensive covid testing and vaccination also in the future.

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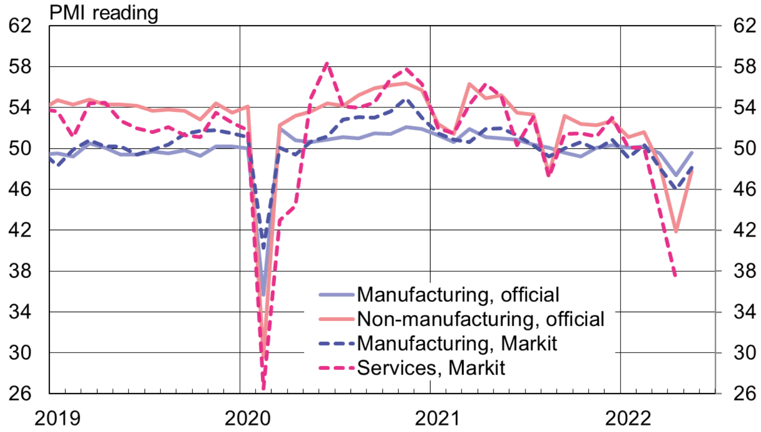
China's purchasing manager indices (PMIs) suggest weak economic conditions persisted in May



Sources: Markit, CFLP, Macrobond and BOFIT.

Borrowing demand remains subdued despite PBoC efforts to boost bank lending. The government meeting last week produced a flurry of promises about measures to support the economy, but many still lacked details. Several of the proposals presented rely on increased bank lending. The People's Bank of China now seems focused on dealing with hobbled economic growth. It has apparently pulled back from its earlier push to restrain the growth of indebtedness and lower risks to financial stability. The PBoC finds itself in a somewhat tricky situation, however, as application of its main monetary policy tools such as interest rate cuts risk yuan depreciation and capital flight. Keeping track of China's monetary policy stance has become even more difficult, as central bank measures have become increasingly targeted, including such actions as issuing narrow bank specific guidance on lending amounts or guiding bank interest rates.

Among its targeted measures, the central bank said it would this year double the size of its quota for its small business relending facility. At the end of last year, the relending facility totalled 1.235 trillion yuan (170 billion euros). Under the programme, the PBoC provides financing to commercial banks to lend the money further under favourable terms. In addition, the PBoC committed to providing emergency loans to airlines totalling 150 billion yuan. The PBoC earlier announced a 200-billion-yuan lending facility for scientific innovation, a 100-billion-yuan quota for the coal industry and a 40-billion-yuan quota for elder care. Commercial banks grant loans to eligible firms at below-market rates. Afterwards the central bank reimburses the loans to the banks.

The PBoC and the China Banking and Insurance Regulatory Commission (CBIRC) last week also met with representatives of China's largest commercial banks to encourage them to increase and speed up lending to various sectors, particularly smaller businesses. Suggestions included offering loan extensions to small firms, sole proprietorships, lorry drivers and households affected financially by covid restrictions. The government promised that banks will be supported to offer extensions. The government also said that policy banks will increase their lending by 800 billion yuan to support infrastructure projects. Earlier in May, the government already promised that large state-owned banks would increase their lending to SMEs this year by 1.6 trillion yuan. According to the government's announcement, state funds would offer guarantees for such loans and cover any possible payment arrears or defaults.

The 5-year loan prime rate (LPR), the reference rate for housing loans, was lowered in May from 4.60 % to 4.45 %. The purpose of the rate cut was to stimulate demand for housing loans. The 1-year LPR rate (3.70 %), that is used as a reference for shorter-term loans, as well as other policy rates were kept unchanged. The level of reference rates alone, however, is not determinative of the rates at which banks ultimately lend. Earlier in May, the PBoC said commercial banks could grant housing loans to first-time buyers at 20 basis points below the 5-year LPR rate. Moreover, mortgage rates are set at the provincial level, and many cities have recently lowered their minimum interest rate requirements. In April, banks were guided to lower their deposit rates by ten basis points to prevent further erosion of their profitability.

Despite the government measures, demand for loans remains low. This could blunt the effects of the just-announced support measures. In April, the stock of bank loans saw its lowest growth since 2017. On-year growth in the loan stock slowed to 11 %. A large share of lending went to the corporate sector. The stock of loans granted to households shrank. Most household lending consists of housing loans, the demand for which has collapsed along with apartment sales. According to media reports, the increase in corporate borrowing did not necessarily always involve firms. To meet their corporate lending quotas, some banks just exchange bills with each other that are counted as corporate loans.

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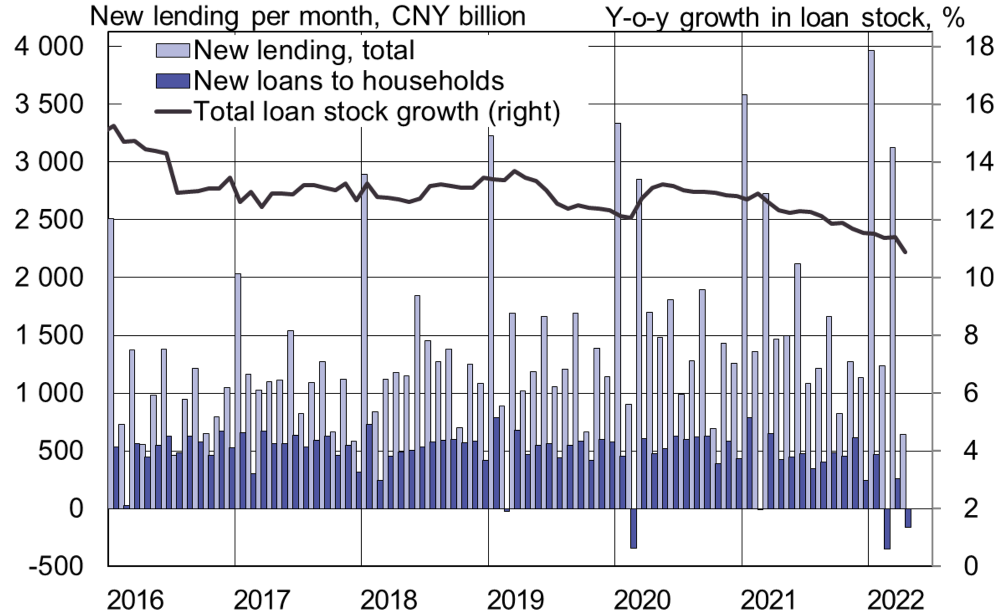
China last month saw a significant drop in bank lending



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

Finland's imports from China continued to climb in the first quarter. The value of goods exported from Finland to China in the January-March period reached 910 million euros, a 7 % increase from a year earlier. Finland imported goods worth nearly 1.9 billion euros from China in the first quarter, a 40 % increase from the first quarter of 2021. Finland's trade deficit with China nearly doubled in 1Q22. China accounted for nearly 9 % of Finland's total imports and about 5 % of total exports.

The value of goods exports fell on year in the two most important product categories (machinery, equipment & vehicles down by 23 % y-o-y, raw materials down by 6 %). These two categories combined account for 60 % of total Finnish exports to China. The value of chemical product exports grew by nearly 90 % (12 % share of exports) and manufactured goods 120 % (15 % share). The biggest import increases measured by value were in chemical products (up by 218 %), as well as fuels and lubricants (up by 128 %).

The value of goods trade has been boosted by higher prices. Export prices in Finland grew in the first quarter by 25 % y-o-y and import prices 27 %. In particular, prices soared for energy products and other raw materials. Export prices of industrial products were also up by 25 % on-year in the first quarter. Even if Finnish goods trade overall grew briskly in value terms (imports up by 35 % and exports up by 22 %), the volume of imports was up by just 6 % and the volume of exports contracted by 3 %.

During the first three months of this year, Finland exported services to China worth just under 260 million euros, or 20 % less than in 1Q21. Overall, Finnish services exports grew by 21 % y-o-y to 6.8 billion euros. Imports of services from China grew by 27 % to 350 million euros. Imports of services from China grew more than Finland's overall service imports (22 %).

The total value of EU exports to China, measured in euros, rose in the first quarter by just 2 % y-o-y, which was less than Finland's exports to China. As export prices rose at the same time by 14 %, export volumes actually decreased by 12 %. In euro terms, total EU imports from China rose by about the same amount as Finland's imports from China (up by 40 %). Import prices increased by 19 %, and thus the volume of imports rose by 15 %.

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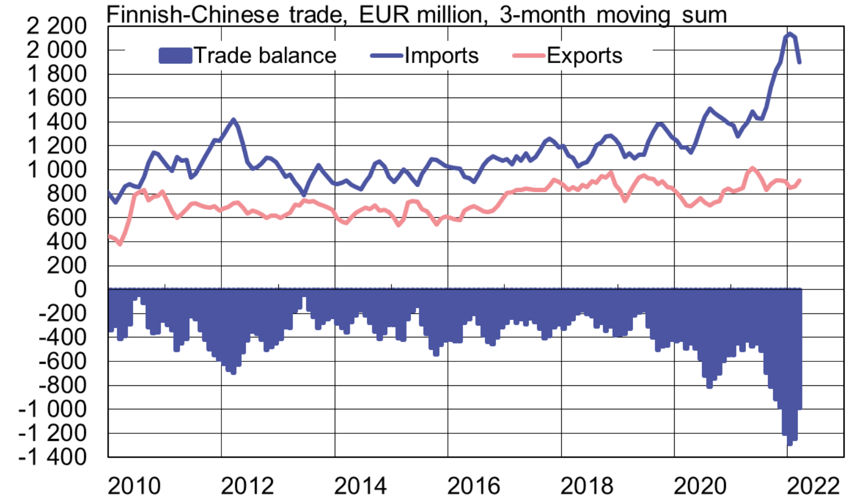
Finland's trade deficit with China has climbed to record levels in recent months



Sources: Finnish Customs and BOFIT.

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Russia

Russian economy began to contract in April. The impacts of Russia's unprovoked attack on Ukraine are now beginning to emerge on a wider scale throughout the Russian economy. The scale of impacts varies from branch to branch. A preliminary assessment from Russia's economic development ministry suggests that Russian GDP contracted by 3 % y-o-y in April.

The war has especially cut consumption as Russian purchasing power has been eroded by soaring prices. The volume of retail sales contracted by 10 % y-o-y in April. New car sales have evaporated in recent months. The Association of European Businesses (AEB) estimates that new car sales were down by 84 % y-o-y in May.

Industrial output also declined in April by 2 % y-o-y. Extractive industries have been hit by reduced export demand for Russian oil. Oil refining fell by 10 % y-o-y in April.

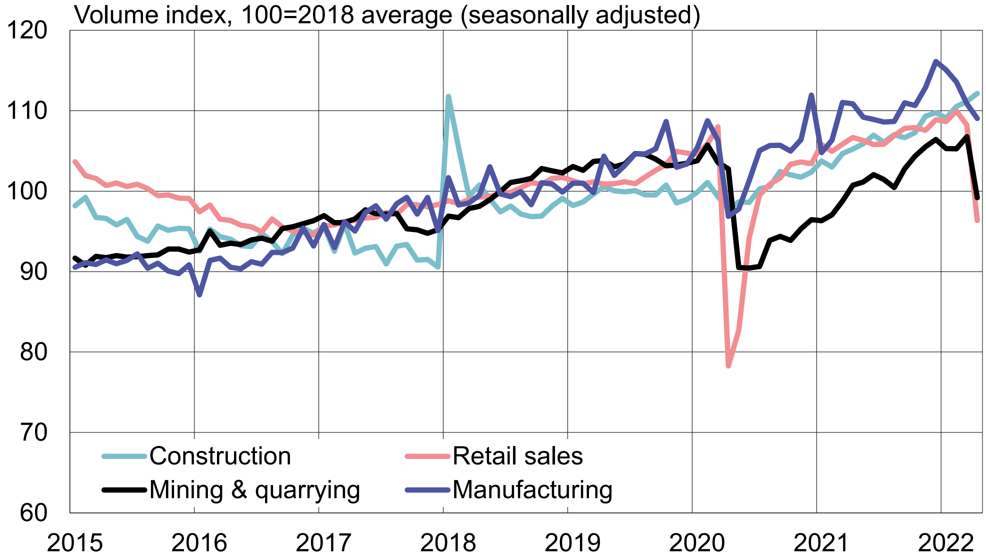
Manufacturing trends are mixed, and largely reflect component shortages and supply issues. Russia's component importing has been debilitated not just by EU and US sanctions but also decisions on the part of many major international firms to pull out of Russia. Car manufacturing in Russia was down by over 60 % y-o-y in April. In addition, manufacturing of other transport vehicles and electrical devices contracted by nearly 10 %. A few branches, most notably pharmaceuticals, experienced strong growth in April.

Russia's transport sector has suffered from the impacts of the war in Ukraine and sanctions. The total volume of transport fell by 6 % y-o-y in April. Air freight dropped by 85 % as many countries have closed their airspace to Russian aircraft. In addition, the EU and US have banned the export of aerospace products and services to Russia.

Construction and agricultural output still supported economic growth in April. Driven by strong residential housing construction, construction activity overall was up by 8 % y-o-y in April. Agricultural output rose by 3 %.

Russia's economic trends are expected to weaken in coming months. The latest forecasts see Russian GDP contracting by 8–15 % this year. Many forecasts expect Russian GDP not to return to positive growth even next year. We assess Russia's economic situation in greater depth in a new post this week on the BOFIT blog (in Finnish).

Russia's most core economic sectors declined in April



Sources: Rosstat, BOFIT.

EU issues a new round of sanctions for Russia. On June 3, the European Union announced its sixth round of sanctions that included significant new import bans and export restrictions. With a few small exceptions, seaborne imports of Russian crude oil and petroleum products to EU countries fill be forbidden. While pipeline imports of oil remain outside the sanctions regime for the moment, Germany and Poland, the two biggest importers of Russian oil in the EU, have announced they are voluntarily terminating their Russian oil imports by the end of this year. The EU's ban on crude oil

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imports enters into force on December 5, and the ban on petroleum products on February 5, 2023. The ban on imports of coal from Russia, decided already in April in conjunction with the EU's fifth sanctions package, goes into effect in August. Imports of natural gas from Russia have yet to be subject to EU sanctions.

The import ban has been reinforced by a complete ban on the purchase, transfer, and financing of oil and oil products that originate in Russia, as well as a ban on insuring maritime transport of Russian oil. With the participation of UK, the ban on insuring and reinsuring Russian oil shipments makes it very difficult to insure any tankers carrying Russian oil globally. The new restrictions also extend to exports of various business services and certain chemical products. The purpose for banning imports of Russian oil and imposing export restrictions is to reduce Russia's export earnings and federal budget revenues, and ultimately degrade Russia's ability to continue its war of aggression on Ukraine.

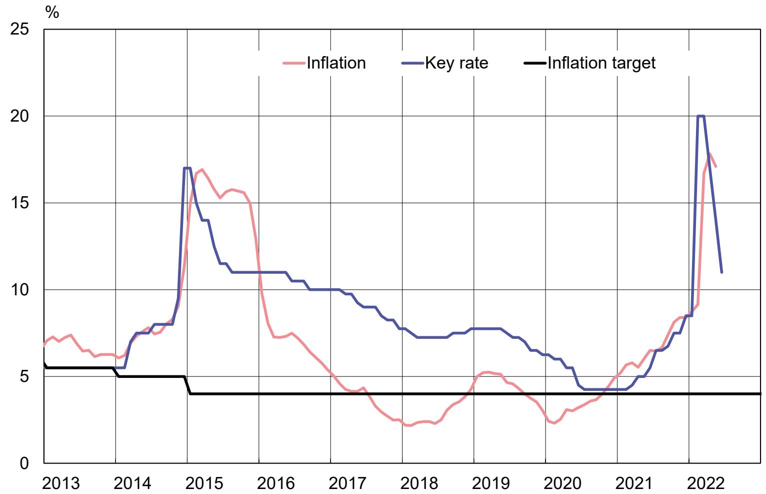
The EU also decided to prohibit provision of payment transmission services to three Russian banks (Sberbank, Rosselkhozbank and Credit Bank of Moscow). The decision implies that these banks will be cut off from the SWIFT financial messaging system for international payments.

Russian central bank further eases monetary policy. At an unscheduled meeting on May 26, the Central Bank of Russia decided to lower the key rate by 300 basis points to 11 %. This was a third consecutive rate cut and altogether the key rate has now reduced by 9 percentage points since the beginning of April. The CBR guidance keeps open the possibility of further rate cut at its upcoming meetings. The CBR's next scheduled rate review meeting is today (June 10).

According to the CBR, inflation pressures have been eased by reduced inflation expectations of households and firms, as well as ruble appreciation. The ruble's exchange rate plummeted in the wake of Russia's February 24 invasion of Ukraine, but, following currency controls and current account surplus, ruble's external value is now higher than its pre-invasion level. The rise in prices has been further mitigated by growth in bank deposits and reduced credit growth.

Although May consumer prices in Russia were up by 17 % y-o-y, inflation has slowed in recent weeks. Food prices in May were up by 20 % y-o-y, non-food goods 19 % and services 10 %. Consumer prices in May were up 12 % from the start of the year. The CBR's forecast sees 12-month inflation slowing to 5—7 % in 2023 and returning to its 4 % target level in 2024.

The CBR again lowered its key rate



Sources: Macrobond, CBR, Rosstat and BOFIT.

Pensions raised in Russia to keep up with inflation. Pensions were raised at the beginning of this month by 10 %. The same increases were made to the minimum wage and official subsistence minimum, a move that affects a range of social support payments. Pensions saw an 8.6 % increase at the start of this year. The increases are meant to compensate pensioners for rising consumer prices. Indeed, the latest hike was specifically intended to offset the fierce jump in prices caused by Russia's attack on Ukraine.

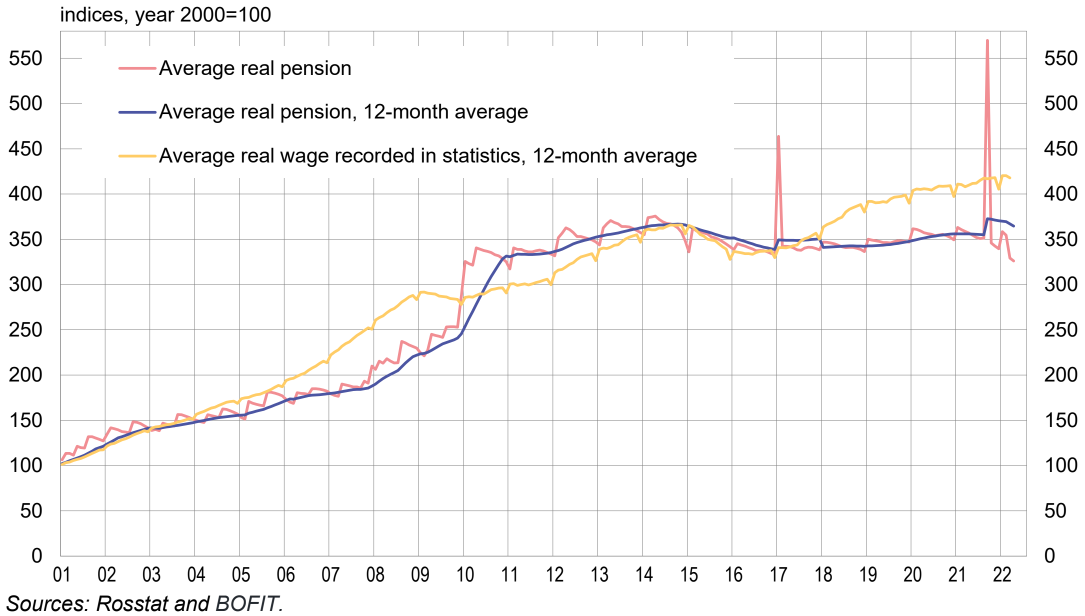
Since the economic boom of the 2000s, which featured large real term gains in pensions, the pension policies have been mainly geared to keeping pace with inflation. Pensions have indeed remained rather unchanged in real terms for several years, even with two additional one-off payments to pensioners decreed by president Vladimir Putin on the eve of the Duma elections in 2016 and 2021. Among other amendments made in 2020, pensions were indexed in the Russian constitution. The amendment did not specify, however, a reference indicator for the indexing.

Pensioners who are not working are entitled to indexed increases in their pensions. The government says that there are about 35 million non-working pensioners and about 15 million people eligible for the latest increases in social benefits. The finance ministry estimates that the extra funds to finance the pension hikes and social support increases this year will amount to an equivalent of 0.3–0.4 % of GDP. The additional funding needed to cover these costs next year is expected to be roughly 0.6 % of GDP. Over 90 % of the extra spending will go to pension hikes. The increases will be paid out of the state social fund budgets. As the state social funds are dependent on the federal budget to finance spending especially now when they are losing revenues due to the economy's recession, they will receive the extra funds needed from the federal budget.

Pensions were earlier raised also with a view of not leaving them too much behind from the general wage growth. For the past several years real wages have risen notably faster than real pensions. During much of the past decade, the ratio of the average pension to the average wage recorded by statistics (not including grey economy wages) held steady at about one third. During 2020 and 2021, that ratio fell below 30 %. The latest pension hike should for a while help the relative position of pensioners to wage-earners as real wages at least in the corporate sector are expected to fall in Russia as the economy has entered recession. President Putin has ushered that certain special groups of workers in government budget sector will also receive pay increases.

With the latest hike, the average Russian pension at the nominal exchange rate is currently about 230 euros a month. In terms of purchasing power, however, pensions go more than twice as far in Russia as the average price level is much lower than in the euro zone.

The average real pension in Russia has remained at about the same level for many years and lagged real wage growth since 2018



Sources: Rosstat and BOFIT.

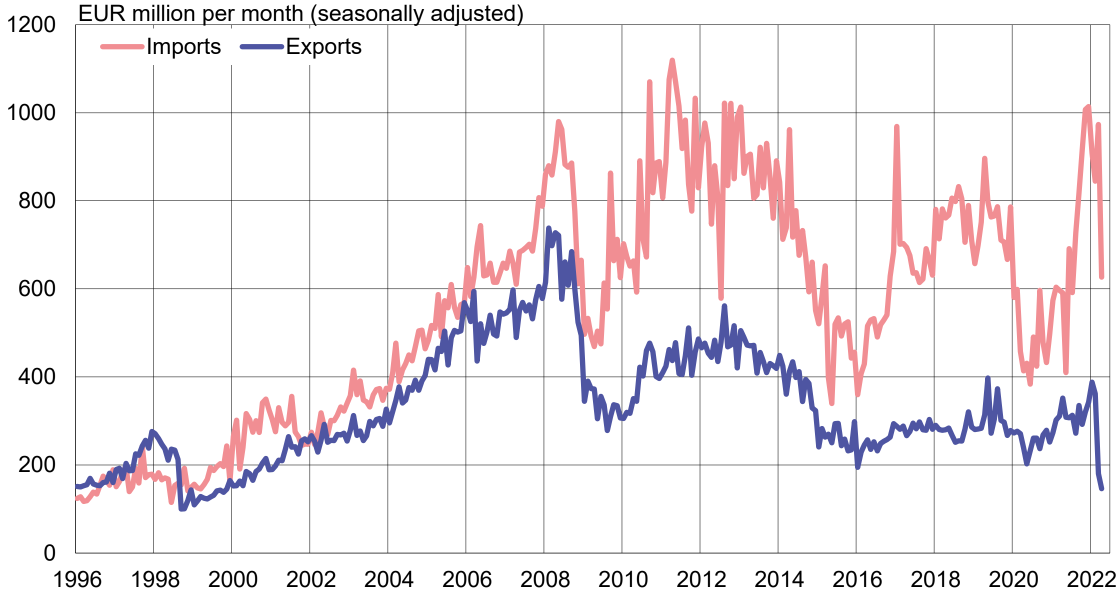
Finnish-Russian trade contracts sharply. Preliminary figures released by Finnish Customs show that Finland's goods exports to Russia fell by 58 % y-o-y in April. Lower demand, EU export restrictions and voluntary withdrawals from the Russian market by Finnish firms led to a decrease in exports. The declines in exports registered in April occurred across-the-board, affecting nearly all goods categories. For example, the value of exports in the machinery & equipment category fell by 83 % y-o-y, while the value of exports of electrical devices was down by 91 %. An exception was the increase in exports of copper matte, a less refined form of copper. Copper matte accounted for nearly 60 % of exports. The value of Finnish goods exports to Russia in April was just 140 million euros, its lowest level in over two decades.

The value of Finnish goods imports from Russia grew in April by 3 % y-o-y to 530 million euros. Growth was largely driven by rising commodity prices. The volume of nickel imports from Russia also increased. Non-ferrous metal giant Norilsk Nickel owns a production unit in Finland. Many of Finland's top imports from Russia have already ceased. Imports of raw timber were discontinued already in March. Crude oil imports contracted sharply in March and April. Finnish

Customs reports that no crude oil was imported from Russia in May. In addition, pipeline gas and electricity imports from Russia have stopped. Finnish coal imports will cease latest at the start of August under the EU ban on coal imports.

Total volume of EU goods exports to Russia contracted by 52 % y-o-y in March. In contrast, the total value of EU goods imports from Russia doubled in March due to high global commodity prices.

Finland's goods exports to Russia fell in April to levels not seen since the early 2000s



Sources: Finnish Customs, BOFIT.

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China

Covid case numbers on the rise again, strict lockdown measures hit firms operating in China. China succeeded in slowing the spread of covid-19 in May with extremely strict lockdown measures started in March. Covid lockdowns were generally eased across the country last month. Last week, however, the number of covid cases was up again, most notably in Beijing. Lockdown-weary Shanghai, too, has seen a new spike in cases, with officials announcing last weekend that nearly all city residents must get tested for covid. Just as experts had warned, China's zero-covid suppression strategy seems to be ineffectual against the highly contagious coronavirus omicron variant.

Tough measures to deal with the spread of covid have broadly affected the business community. China's National Bureau of Statistics reports that the number of firms declaring losses in March was back up to levels not seen since the start of the pandemic in early 2020. The number of loss-making companies remained very high in April. The total amount of loss in the first four months of this year was slightly higher than in the same period in 2020. It appears that larger firms have been better at dealing with the situation than small firms. In particular, business has been reasonably good for raw material producers as raw material prices are now very high. In contrast, the situation for small and medium-sized enterprises (SMEs) is more concerning. A survey of Chinese SMEs conducted by Beijing University and the tech firm Ant Financial found that the profit margins of SMEs were just 1.6 % in the first quarter, a sharp decline from earlier. Nearly 40 % of small firms said that their cash flow was insufficient to get them through the next month, when the same share a year earlier was 30 %. Many large firms appear to be delaying their payments to subcontractors as a way to maintain their cash flow buffers. The Chinese government is also concerned of the situation, and it has tried to help SMEs by providing tax breaks and other forms of payment relief, as well as encouraging state-owned enterprises to speed up their payments and commercial banks to increase lending.

Covid restrictions have affected foreign firms operating in China. Surveys conducted in April and May by the American and EU Chambers of Commerce in China, as well as the Finland-China Business Association, all found similar sentiments among international firms operating in China. Covid lockdowns have hurt nearly all international firms. Many of them have faced production chain disruptions. They also generally anticipate lower net sales this year, reduced profitability and postponed fixed investments. Over 20 % of European firms reported that they were considering shifting their planned investments away from China to other countries due to China's zero-covid policies. Nearly all respondent firms said they would like to see China replace its zero-covid policies with less draconian responses such as opportunities to spend mandatory quarantines at home, increased uptake of the leading international mRNA vaccines and higher vaccination rates. China's restrictions on international travel have also affected the operations of foreign firms in China.

China's economic growth remained sluggish in May. With covid restrictions in China's biggest cities more relaxed compared to April, industrial output showed signs of recovery in May. However, the National Bureau of Statistics reported that growth remained at just under 1 % y-o-y and that the level of industrial output was still lower than in March.

Chinese consumers have been taking a beating. Retail sales activity was down by 7 % y-o-y in May in nominal terms (down 11 % in April). Retail sales are estimated to have fallen by about 9 % in real terms, even though the NBS hasn't released real retail sales growth figures for recent months. The value of sales of catering services fell by 21 % y-o-y in May. Growth in online sales has also slowed this year. The value of online sales increased by just 3 % in the first five months of this year.

Consumers boosted their savings as spending opportunities were reduced by covid lockdowns and heightened uncertainty. Figures from the People's Bank of China show that households boosted their bank savings in January-May by 7.86 trillion yuan, an increase of over 50 % from a year earlier. With the slowdown in the housing sales, household borrowing also cooled. During the first five months of this year, new bank loans to households amounted to 1.33 trillion yuan, a more than 60 % drop from the same period last year. The value of January-May real estate sales was also down by 31 % y-o-y.

Foreign trade revived in May as covid lockdowns were relaxed. The value of goods exports in dollar terms rose by 17 % y-o-y, while the value of imports was up by 5 %. Trade volumes this year have not grown as quickly as trade values. China Customs reports that the average volume of goods exports in January-April was roughly on par with the same period a year earlier, while the volume of imports fell by about 8 %. At the same time, the value of exports grew by 12 % and the value of imports by 8 %. In addition, the foreign trade figures compiled by Germany's Kiel Institute for the World Economy show the volume of Chinese exports in January-April was roughly the same as a year earlier, but up in May.

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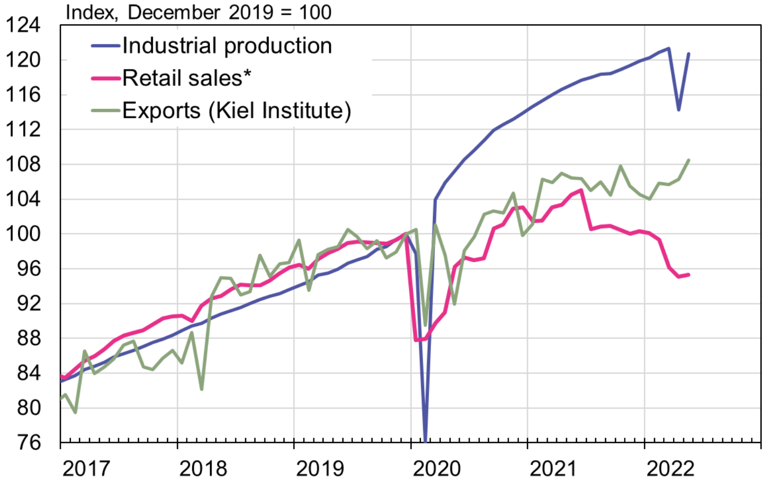
Inflation is currently not a major concern in China. The 2.1 % rise in consumer prices in May was unchanged from April, as was core inflation (excludes food and energy prices) at 0.9 %. On-year growth in producer prices has slowed since the second half of 2021, falling to 6.4 % in May.

China's industrial output well exceeds pre-pandemic levels, but the volume of retail sales has been declining for the past 12 months



*) Nominal growth in retail sales deflated by the consumer price index.

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

Taiwan's economy has weathered the covid pandemic quite well. The Taiwan Statistical Bureau reports that the Taiwanese economy has not contracted in any quarter during the covid pandemic, and even posted robust annual growth in the past two years (3.4 % in 2020 and 6.5 % in 2021). A factor underpinning strong growth has been the relatively small number of covid infections in Taiwan. Case numbers began to spike in April and by the first weeks of June were averaging 69,000 new cases a day. Despite the high case numbers, however, the numbers of daily covid-related deaths are small. Most covid cases display mild symptoms, so covid restrictions have been eased considerably. The quarantine period for travellers arriving in Taiwan has just been cut from seven days to three.

Taiwan is a mid-size, open economy with exports central to its success. China, by far Taiwan's most important export partner, accounts for 27 % of Taiwan's exports. Microchips are its most important export product. Taiwan, which actively seeks to reduce its dependence on China, has recently boosted its exports to other countries, most notably the EU, US and ASEAN countries. Taiwan's officials expect exports to remain strong this year – even while global and Chinese economic growth are expected to slow down. Accelerating inflation, deteriorating covid situation and the resulting decline in domestic demand, however, have dimmed Taiwan's economic outlook for the rest of this year. At the end of May, Taiwan officials cut their GDP growth forecast for this year from 4.4 % to 3.9 %.

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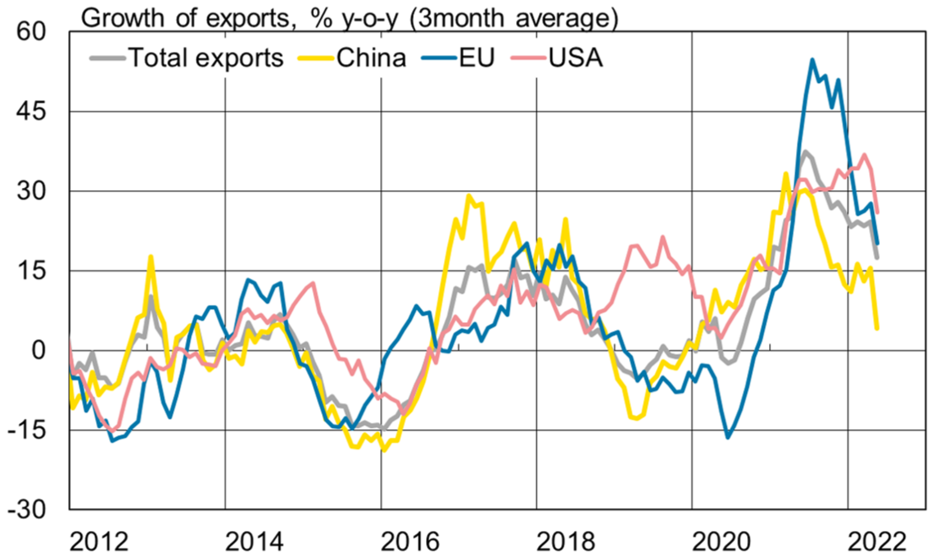
Taiwan's exports have continued to grow this year



Sources: Macrobond and BOFIT.

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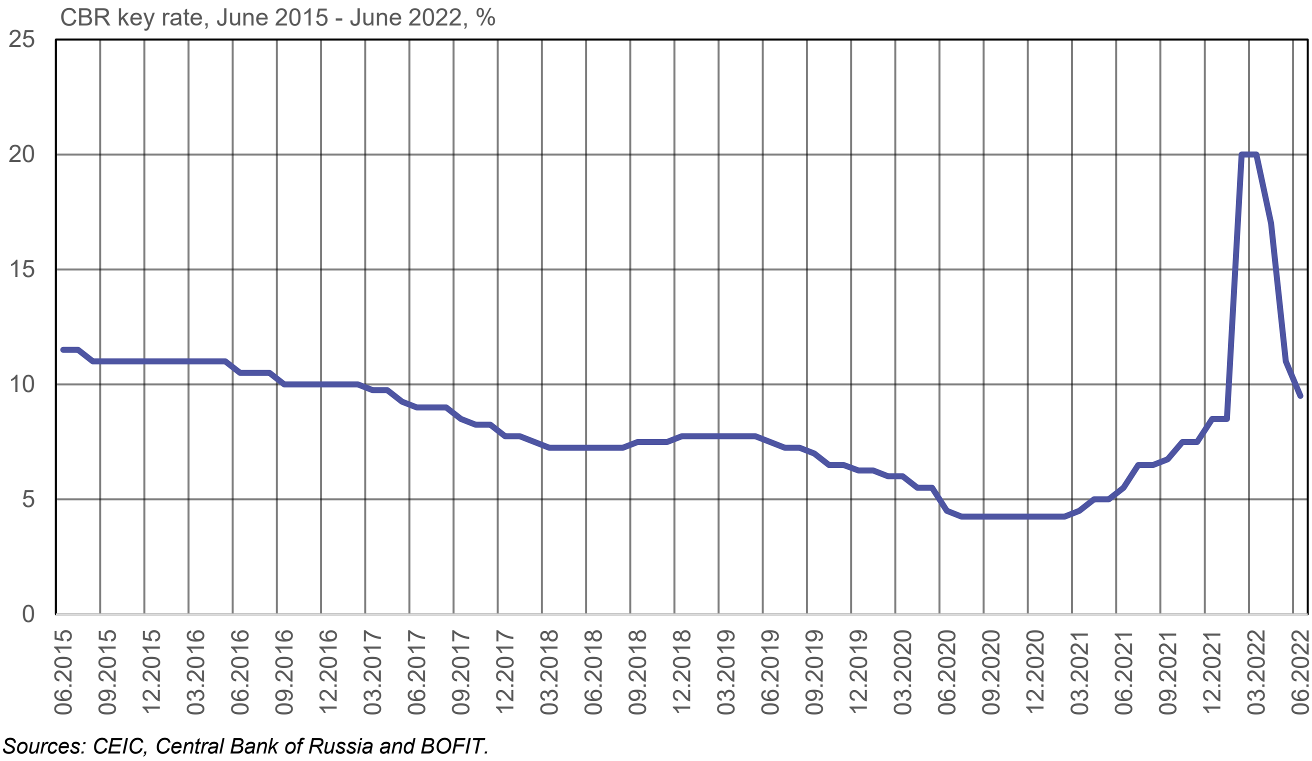
Russia

Russian central bank lowers key rate to 9.5 %. Based on data from May and early June, the Bank of Russia's executive board concluded on June 10 that a 150-basis-point rate cut was appropriate as the pace of month-on-month inflation had plateaued. The halt reflects the ruble's appreciation and an abatement of the panic-buying experienced at the start of the Ukraine war. Inflation expectations have also subsided. Experts interviewed by the media also commented that their expectations were generally in line with the CBR's rate cut decision.

12-month inflation fell from 17.8 % in April to 17.1 % in May. The CBR currently forecasts average inflation this year in the range of 14.0–17.0 % and 5.0–7.0 % next year. In 2024, inflation should approach the CBR's inflation target of 4 %. The CBR expects the key rate to average between 10.8 % and 11.4 % this year, 7.0–9.0 % in 2023 and 6.0–7.0 % in 2024.

Inflation risks to the Russian economy are driven by fiscal policy making now. The risks for higher inflation include a rising budget deficit, a citizenry ready to increase consumption spending when saving money is not as useful as before and external factors such as sanctions. Experts interviewed by the media say that ruble's exchange rate poses inflation risks. While a strong ruble helps tame inflation, the risk exists that inflation could roar back if the ruble loses value and import prices soar. However, the CBR notes that high risk premia on credit interest rates and Russia's massive trade imbalance could slow down inflation.

The CBR raised its key rate to 20 % at the end of February. After a series of cuts, the key rate is now near its pre-war level



Sources: CEIC, Central Bank of Russia and BOFIT.

Russian government budget revenues weaken; high inflation erodes stimulus effects. May federal budget revenues were up by just 10 % y-o-y in nominal terms. The rise was gravely insufficient to keep pace with inflation, which has increasingly chewed away at the purchasing power of budget revenues and spending. The inflation that is relevant for the government purchasing power is proxied mainly by consumer prices and industrial producer prices on domestic deliveries (they were up on the average by about 24 % in May). In the first four months of this year, nominal budget revenue growth was still 34 % y-o-y.

The rise in oil & gas tax revenues subsided to around 40 % y-o-y in May after spiking in previous months. Nearly all of the government's oil & gas tax income is defined in US dollars, so the May slowdown can be largely tied to the fact that the

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discount price of Urals blend in April was a moderate 13 % higher than a year earlier and the ruble's exchange rate was just a couple of percent lower than a year earlier.

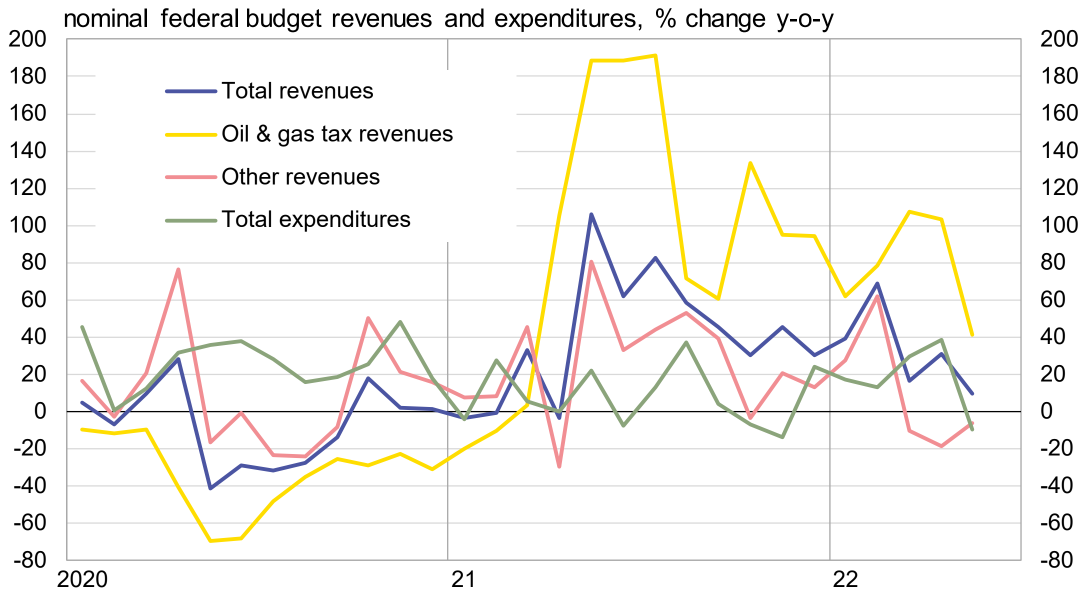
Nominal decrease of non-oil revenue streams to the federal budget eased notably. For the January-May period, they were up by just 3 % y-o-y. Collections of value-added tax revenues, which all go to the federal budget, were strong in May. However, they were insufficient to lift the VAT revenue by more than 7 % y-o-y for the first five months of this year. Other federal revenue streams shrank by 2 % y-o-y in January-May.

After rising in March and April, federal budget spending fell in May from 12 months earlier, partly a reflection of the rather high base level of May 2021. Nominal spending during January-May this year was nearly 20 % higher than in the same period in 2021. Russia has ceased to publish data on any spending categories. The cumulative budget surplus for the last 12 months was slightly over 1 % of GDP in May.

The May drop in budget expenditures is likely to be transitory as this year is seeing supplemental budget spending. While no specific figures have been released on the overall amount of supplemental spending, approved additional federal budget spending this year should equal at least 3 % of GDP. Statements and media releases from the cabinet and finance ministry indicate total supplementary budget spending should amount to several percent of GDP. The extra spending includes inflation adjustments for pensions, increased social support for families with children, as well as many smaller allocations to various sectors of the economy and infrastructure. In addition, assets from the National Welfare Fund have been earmarked for recapitalising a few banks and corporates. The ceiling on credit guarantees of state development bank VEB has been increased considerably this year. Companies have also been granted the possibility of postponing this year's scheduled social tax payments until next year.

The real stimulus impact sought by supplementary budget measures is bitten by inflation. The information on the amounts of decided and planned spending increases so far this year, as well as the amount of postponed tax payments, suggests the issue is valid indeed. Placing the amounts in the context and scale of the entire government budget sector (consolidated budget), it appears inflation will this year erode most or nearly all of the nominal incremental sum that is composed of spending increases coming from earlier spending estimates as well as supplementary spending and postponed tax payments.

Nominal increases in revenues to Russia's federal budget have slowed to much below inflation



Sources: Russian Ministry of Finance and BOFIT.

Russian imports plunge; value of exports remains high. Western sanctions on Russia, combined with the voluntary decisions by international corporations to exit the Russian market and difficulties such as financing foreign trade transactions have caused Russia's imports to collapse in recent months. Russian Customs has ceased to publish foreign trade figures, so the changes in Russian imports must be deduced from the export data of Russia's trading partners.

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The statistical data of Russia's trading partners reveal that exports to Russia (i.e. Russia's imports) plunged in the months after the invasion of Ukraine. Notably, exports to Russia also declined among countries not sanctioning Russia, including China and Vietnam. Taiwan and South Korea, major suppliers of semiconductors, have seen a dramatic drop in their exports to Russia that has also caused production problems in Russia. In particular, Russian industries that rely heavily on imported components (e.g. car and home appliance manufacturers) have been struggling.

Large drops in exports to Russia from EU countries were registered in April. For example, exports to Russia from Germany were down by 64 % y-o-y, France (down 78 %), Italy (down 48 %) and Spain (down 74 %).

The value of Russian exports rose throughout the spring. Crude oil prices have remained relatively high, even if the difference between the price of Russian Urals blend and North Sea Brent has widened to 20–30 dollars a barrel. Russia has succeeded to some extent in redirecting its EU oil exports to countries in Asia. India, in particular, has increased its purchases of Russian oil.

Russia's burgeoning current account surplus well reflects the collapse of imports and growth in the value of exports. According to preliminary figures released by the CBR, Russia posted a current account surplus in the first five months of this year of 110 billion dollars, a surplus roughly three-and-a-half times larger than the surplus posted in the same period last year. For all of 2021, Russia's current account surplus was 122 billion dollars, the equivalent of 6.9 % of GDP.

Exports to Russia have also collapsed for many of its key Asian trading partners, even those not participating in sanctions (export values in US dollars, December 2021 = 100)

Sources: National statistics authorities and BOFIT.

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China

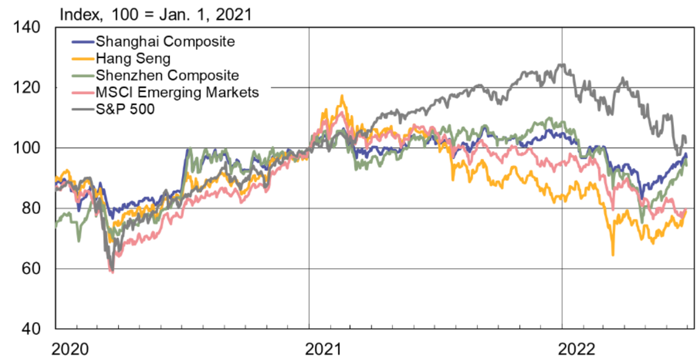
Mainland China's stock markets have been on a rise for the past two months. Dragged down by uncertainty, share prices of companies listed on Chinese stock exchanges took a beating in the first four months of this year. By the end of April, the Shenzhen Composite Index was down by 26 % from the start of the year, the Shanghai Composite Index down by 16 % and Hong Kong's Hang Seng Index off by 12 %. The drop in share prices reflected, among other things, covid lockdowns, ongoing problems in the real estate sector and uncertainty over government regulation especially in regard to the technology sector. Russia's war in Ukraine and drop in US stocks were also visible in the performance of Chinese share prices. Foreign investors increasingly sold their Chinese shares in the early months of this year via the Hong Kong Stock Exchange's Stock Connect programme with mainland China stock exchanges.

Following the drops at the start of this year, share prices on Chinese stock exchanges rebounded sharply in recent months. From the start of May to end of July, the Shenzhen Composite Index was up by 19 %, the Shanghai Composite Index up by 12 % and Hong Kong's Hang Seng Index by 6 %. The return of market confidence has been supported by government commitments to support the economy, stabilize the housing market and slow down with the regulation on technology firms. The highly disruptive covid lockdowns of Shanghai and other big cities have also ended during the period. In addition, the China Securities and Regulatory Commission (CRSC) announced at the end of April that it would seek to stabilise markets by encouraging institutional investors to buy more shares. In June, share purchases by foreign investors through the Stock Connect programme in Mainland China have also increased again.

Mainland China's stock exchanges will become more accessible to foreign investors as the July 4 expansion of the Stock Connect programme will allow foreign investors to invest in exchange-traded funds (ETFs) listed in Mainland China's exchanges. The expanded Stock Connect programme gives foreign investors access to 53 ETFs on the Shanghai bourse and 30 ETFs on the Shenzhen exchange. In addition, four Hong Kong ETFs will be opened to mainland Chinese investors. Hong Kong officials have described the expansion of the Stock Connect programme as a "gift" from Beijing to Hong Kong in commemoration of the 25th anniversary of the UK's handover of Hong Kong to China and to further facilitate the integration of Hong Kong financial markets with the mainland. The Stock Connect programme began in 2014 with the possibility of limited trading in shares between the Shanghai and Hong Kong exchanges. The Shenzhen Stock Exchange joined Stock Connect in 2016. The Beijing Stock Exchange is not part of the programme.

Trading on mainland China's newest stock exchange, the Beijing Stock Exchange (BOFIT Weekly 48/2021), has gotten off to a bumpy start. Since the launch in November 2021 trading volumes and market capitalisation of the Beijing bourse have fallen significantly. The Beijing Stock Exchange is mainly for smaller companies with high growth prospects, with trading limited to "professional" and institutional investors. The biggest drop in the market caps of listed firms occurred in April this year as the Shanghai covid lockdowns persisted. Nevertheless, the number of listed firms continues to grow. This year has seen the addition of another 17 firms, bringing the total to 99. The biggest jump in the number of listings took place between May and June with the addition of ten firms.

China's stock exchanges experienced large drops in the first four months of this year but began to recover in May



Sources: Macrobond, BOFIT.

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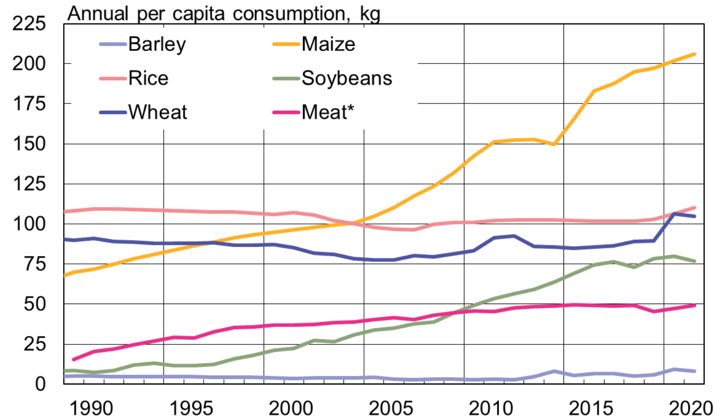
Domestic production struggles to keep pace with growth in consumption of grain crops in China. Over the past two decades, consumption of key grain crops in China has risen from less than 400 million metric tons a year to around 750 million tons. Rice and wheat, long the top grain crops in China, began to see a challenge from maize in the 1990s as maize consumption soared. The Chinese currently consume nearly 300 million tons of maize a year, which is about the same amount as rice and wheat combined. Consumption of soybeans has also increased from about 25 million tons a year at the start of the 2000s to a current level of around 110 million tons a year.

Much of the rise in demand for these crops has been driven by the rise in demand for livestock feed as Chinese eat more meat. Nearly 90 % of soybeans and 75 % of maize is used as feed for industrialised meat production. According to the UN's Food and Agriculture Organization (FAO), Chinese per capita meat consumption has risen to about 50 kilograms a year, well above the global average (34 kg/year) or the average for emerging economies (27 kg/year), but still below the average for developed economies (nearly 70 kg/year). The 2019 outbreak of the African swine fever epidemic cut pork consumption by nearly a quarter, shifting demand to beef and poultry. Chinese domestic pork production and domestic consumption levels have gradually returned. Meat consumption overall is expected to rise further in the years ahead, further increasing demand for feed crops.

China's domestic production of maize and wheat has been insufficient to deal with burgeoning demand since 2018, so nearly 10 % of maize and wheat consumption has been covered by imports in recent years. In addition, the lion's share (roughly 80 %) of soybeans and barley consumed in China are imported from abroad. Among other things, pollution of water and soils and excess use of fertilisers have degraded the quantity and quality of domestic arable land. These factors, combined with increasingly frequent extreme weather events, have hampered the ability to increase domestic production.

Grain imports have soared over the past five years. While China has only accounted for about 3–4 % of global wheat and maize production for many years, it has lurched to around 10 % of global consumption of these crops in recent years and become the world's fourth largest grain importer. Increased meat consumption has also boosted meat imports. Last year, over 20 % of beef consumption was covered by imports. Domestic production still goes a long way of providing other staple meats, even if their imports are also up (e.g. China covers about 7 % of its pork and lamb consumption from imports, as well as about 5 % of its poultry consumption). The biggest suppliers of agricultural products to China last year were located in South America (30 % in 2021) and North America (22 %). The combined share of the rest of Asia and Oceania was 29 %, Europe 17 % and Africa 2 %. Europe's share, which has nearly doubled over the past decade, has grown steadily.

Per capita consumption of maize and soybeans in China has risen sharply in recent decades



* Pork, lamb, poultry and beef.

Sources: USDA, FAO, Macrobond and BOFIT.

India tightens its monetary policy. The Central Bank of India's Monetary Policy Committee (MPC) decided to raise the repo rate, India's main monetary policy rate, to 4.9 % on June 6. The committee also announced it would focus on dismantling earlier stimulus measures to bring inflation back into the target band (between 2 % and 6 %) while still working to sustain economic growth. Inflation in March-May ran at around 7 % a year, still well above the upper target level. Monetary policy has tightened sharply since the decision at the May MPC meeting to wind down monetary stimulus measures as the latest wave in the covid pandemic began to subside.

According to the MPC, the acceleration in India's inflation rate reflects, among other things, the rise in global commodity prices and global supply chain disruptions caused by the pandemic. Prices have risen across the board in recent months,

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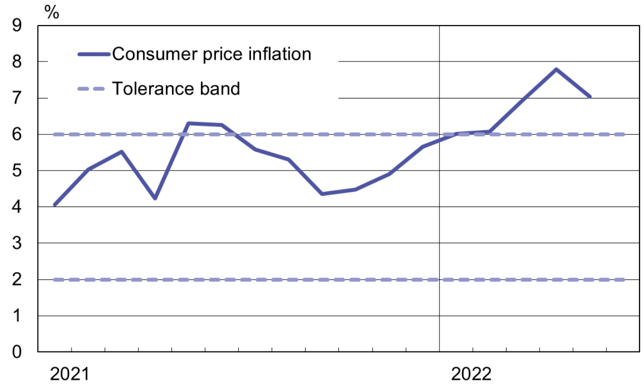
affecting prices of food, fuel and many other consumer products. The Central Bank of India expects inflation to be back within its target band within the coming six months. The inflation outlook, however, remains uncertain due to global geopolitical tensions and turmoil in global commodity markets.

The Indian economy has grown rapidly in recent months. Recent reports indicate that economic growth reached 8.7 % for fiscal year 2021–2022 (April 2021 – March 2022), putting GDP above its pre-pandemic levels. Monthly indicators also suggest that economic growth remained brisk throughout the spring. Growth was particularly robust in the service sector as covid restrictions eased. The MPC expects the pace of GDP growth to be 7.2 % in the current fiscal year 2022–2023.

Inflation has exceeded the upper limit of the Central Bank of India's inflation target range for much of this year



Sources: India's Ministry of Statistics and Programme Implementation, Macrobond and BOFIT.

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Russia

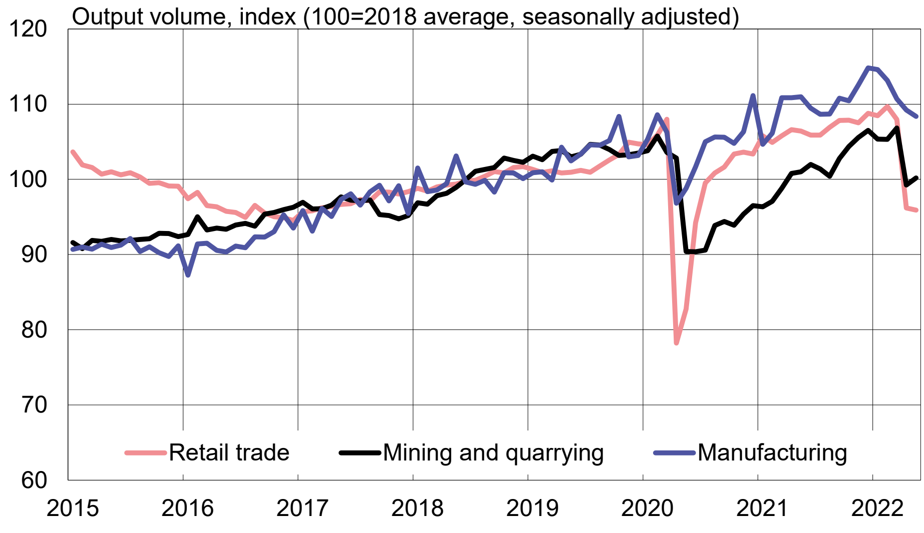
Russian economy continued to slide in May. The broader impacts from Russia's invasion of Ukraine in late February have gradually emerged throughout the Russian economy. High inflation erodes Russian purchasing power and depresses consumption. While military production appears to have supported industrial output, most branches are struggling. The preliminary estimate from Russia's economic development ministry suggests that May GDP shrank by 4 % y-o-y. The June survey of Consensus Economics found that the average of Russian GDP forecasts sees a GDP contraction of 8 % this year and 2 % next year.

Rising uncertainty and evaporating purchasing power have depressed consumer demand. Retail sales volumes were down by 10 % y-o-y in May. Russian consumer prices rose by 17–18 % y-o-y in April and May. The average real monthly wage (inflation adjusted) shrank by 7 % y-o-y in April. Russia's unemployment rate remained at a historically low level of 3.9 % in May.

Rosstat figures show that industrial output contracted by 2 % y-o-y in May. Mining & quarrying (includes oil & gas) was down by 1 % and manufacturing down by 3 %. Trends within manufacturing were mixed. Passenger car manufacturing, for example, nearly ceased with Russia producing fewer than 4,000 cars in May. Russia was producing over 112,000 cars a month just a year ago. While production of e.g. train cars and excavators declined substantially, on-year production of certain types of turbines, RF electronic devices and pharmaceuticals grew by several fold in May.

Russia's Center for Macroeconomic Analysis and Short-Term Forecasting (CMASF) finds a larger contraction in Russian industrial output in recent months when military production is excluded. CMASF estimates industrial output fell by 4 % in May. Russia's lower-house Duma this week approved a law amendment that allows the government to impose special measures on firms to fulfil military needs. Firms can be compelled, for example, to manufacture goods for the military, repair military equipment or provide the military with transport.

Many branches of the Russian economy experienced further contractions in output in May



Sources: Rosstat, BOFIT.

Russian ruble has strengthened substantially. Before Russia's invasion of Ukraine in late February, the ruble-dollar exchange rate stood at about 75 rubles to the dollar. The ruble initially plunged on the initial wave of uncertainty caused by the war and increased Western sanctions. At its nadir in early March, the ruble fell to around 120 rubles to the dollar. Currency restrictions imposed by the Central Bank of Russia quickly reduced demand for foreign currency at the same time as forex supply increased after firms were required to repatriate their export earnings. In combination, these measures helped propel the ruble-dollar back to pre-invasion levels by mid-April. The ruble's exchange rate continued to strengthen in the May-June period. At the end of June, the CBR's official ruble-dollar rate approached 51. A strong ruble, however, reduces the ruble-denominated profits of export firms as well as the government's oil tax revenues, which are typically denominated in dollars. First deputy prime minister Andrei Belousov recently stated that the "optimal" exchange rate currently is somewhere in the range of 70–80 rubles to the dollar.

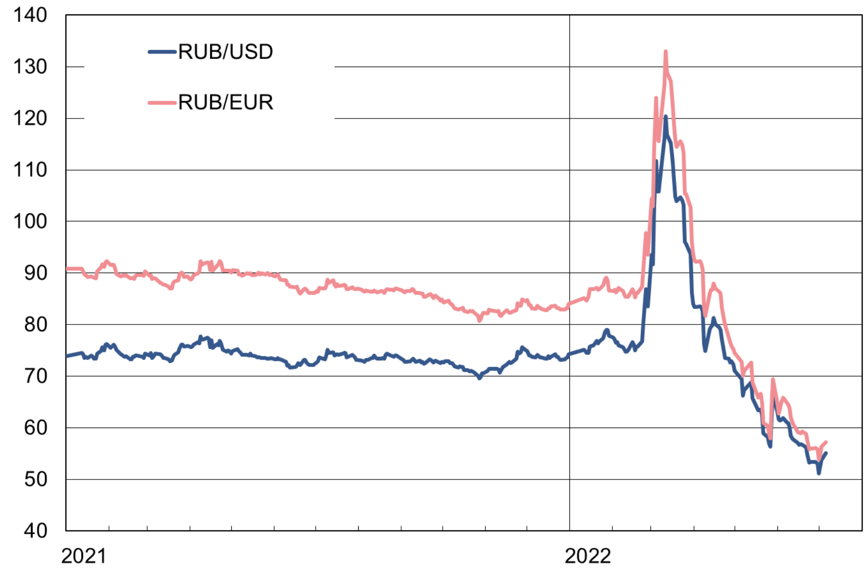
The Russian government has tried to quell ruble appreciation by easing some of the capital controls introduced at the start of the Ukraine invasion. The initial requirement that firms repatriate 80 % of their export earnings was lowered to 50 % and eventually eliminated altogether. Russian export earnings in recent months have remained high, mainly on hefty export prices for crude oil and natural gas. At the same time, imports have contracted by about 50 % from a year ago, reducing forex demand.

The exceptional growth in the current account surplus partly reflects the limited ability to use forex assets under current conditions. Western sanctions have restricted Russian imports. Sanction-related risks have also dampened the willingness of Russians to move capital abroad. As a result, it has also become possible to relax the rules on taking money out the country. In recent days, the maximum monthly amount private individuals can transfer to foreign accounts has been raised to 1 million dollars. Bank transfers can be made by private Russian individuals and citizens of "friendly" states. Bank transfers by EU citizens and firms are still subject to restrictions, however.

On Tuesday (July 5), president Vladimir Putin signed a decree on currency controls empowering a joint commission of the central bank and finance ministry with the authority to set repatriation requirements on foreign currency earnings. The same decree forbids the transfer of dividends and corporate profits in the form of foreign currency.

The absence of large foreign financial institutions in Moscow currency exchange trading is reflected in the depressed trading volumes. Western sanctions have also limited the possibilities for the CBR to intervene in forex markets. Forex trading on the Moscow bourse in May and June was down by about 45 % y-o-y. Due to capital controls, the official ruble rate in Moscow does not necessarily reflect the ruble's exchange rate outside Russia.

The ruble has experienced remarkable appreciation against both the dollar and the euro in recent months



Source: Central Bank of Russia.

Russian government driven to technical insolvency. The 30-day grace period for about 100 million dollars in Russian foreign debt that came due at the end of May was reached on June 27 without Russia making its payments. The international credit rating agency Moody's declared the Russian government in default on its foreign debt. Russia has resources to pay its debts, but lacks the ability to use those resources. While soaring oil & gas prices have boosted Russia's foreign currency export earnings in recent months, the sanctions imposed on Russia for its war on Ukraine have significantly limited its ability to make international payments and effectively blocked Russia from paying its foreign debts.

The immediate impacts from payment defaults are limited. War and Western sanctions had already largely barred Russia from international financial markets. While Russia does not necessarily need additional financing at the moment due to large inflows of export earnings and sovereign savings, technical insolvency hurts the access of the Russian government and

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Russian corporations to international financing in the longer term, thereby raising borrowing costs when Russia returns to international financial markets.

The declaration of insolvency is also symbolically touchy for Russia. The Russian government attempted to circumvent the default by various means, e.g. requesting that creditors accept payment in rubles even if it did not conform to the lending terms. Government default can remind ordinary Russians of the severe financial crisis in 1998.

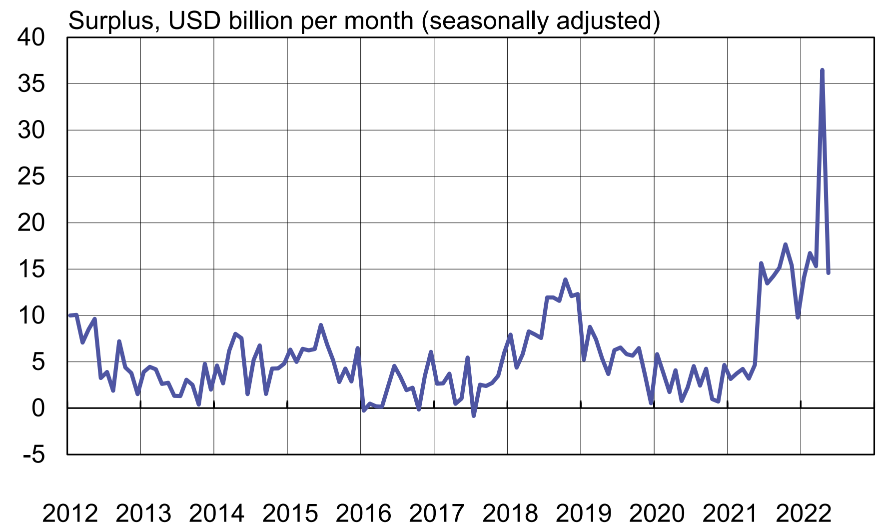
G7 countries move to reduce Russian export earnings. At the G7 summit held in late June, much of the discussion focused on dealing with Russia's war in Ukraine and the knock-on effects to the global economy. G7 leaders considered various measures to curb Russia's export earnings, efforts to support Ukraine and ways to constrain the impacts of the war on the world economy.

The G7 agreed on banning imports of gold from Russia. Gold is among Russia's most important export commodities after oil and natural gas, even if it only accounts for a few percent of the value of Russian exports. The war and sanctions have, however, already limited Russia's gold-exporting possibilities. G7 leaders also discussed the idea of imposing a price ceiling on Russian oil to limit Russian export earnings. Mounting uncertainty and sanctions are already gradually eroding Russia's export earnings. After posting a current account surplus of nearly 40 billion dollars in April, Russia's current account surplus fell to 15 billion dollars in May. Several import restrictions on Russian commodities such as wood and coal enter into force in July-August. The oil import restrictions the EU announced at the beginning of June enter into force after transition periods of six to nine months.

The G7 leaders reiterated their support for Ukraine. The countries committed to giving Ukraine this year a total of slightly over 30 billion dollars in economic and humanitarian aid. Ukraine urgently needs the aid as the state has seen its revenues dry up since Russia launched its brutal war. Even with massive foreign donations, a large part of state spending must be financed by the National Bank of Ukraine (central bank), which further increases the vulnerability of the Ukrainian economy.

The G7 leaders agreed on a number of measures to mitigate the impacts of the war on global food security. Most notably, Russia's war on Ukraine has diminished wheat supplies on the global market as Ukraine is a major wheat exporter. Russia is not only preventing grain exports from Ukrainian ports, it has also destroyed Ukraine's grain reserves, burned fields and illegally confiscated Ukrainian agricultural products. The war already threatens also Ukraine's 2023 grain harvest. The sanctions of G7 countries on Russia do not apply to exports of agricultural products.

Despite a large drop, Russia's May current account surplus was still substantial



Sources: Macrobond, Central Bank of Russia and BOFIT.

As the world's largest wheat exporter, Russia plays a major role in food security of Africa and the Middle East. Russia is a major global producer and exporter of grains. Figures from the UN's Food and Agriculture Organization (FAO) show that in 2020 Russia accounted for about 11 % of global wheat production and 19 % of global wheat exports (making Russia the world's largest wheat exporter that year). In addition, Russia is a globally significant exporter of barley, sunflower oil and sunflower seeds.

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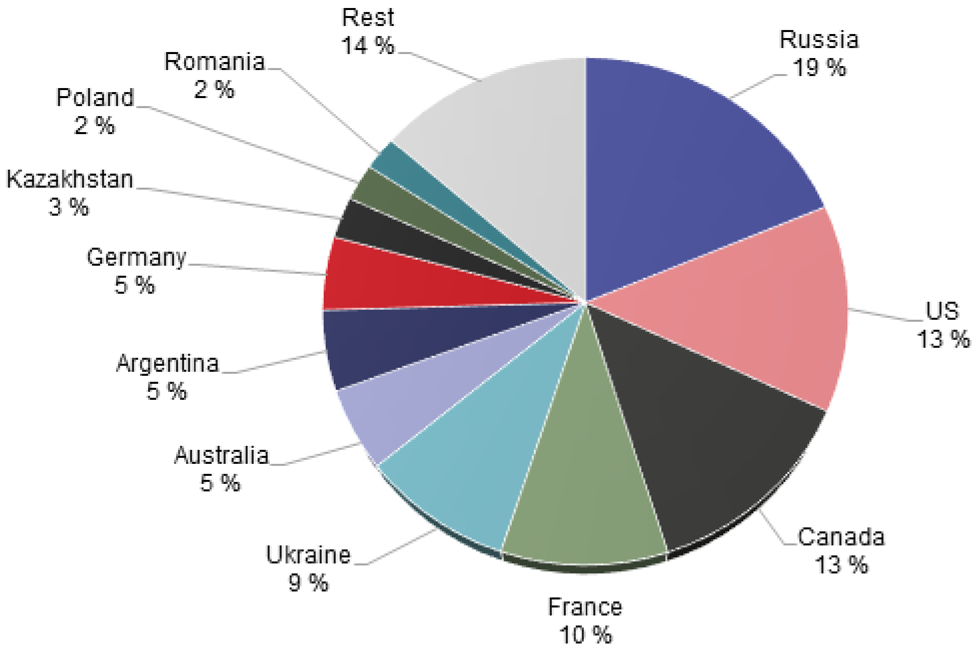
Wheat was Russia's top crop in 2021 (36 % of all land in Russia under cultivation was devoted to growing wheat), followed by sunflowers (12 %), tame hays and legumes for forage (12 %) and barley (10 %). Most grain production occurs in Russia's European half. The Central Federal District, the Volga Federal District and the Southern Federal District together accounted for about 70 % of Russian grain production in 2021. Agricultural enterprises play a large role in grain production, as they cultivated about 64 % of the land devoted to wheat cultivation in 2021. The role of farms in production of certain grains is quite significant, while that of household production is small. Farms accounted for about 36 % of the land devoted to wheat production in 2021, while households accounted for less than 1 %. On the other hand, household plots accounted for about 76 % of Russia's potato production and 63 % of vegetable production in 2021.

Russia plays an important role in global grain exports, particularly for countries in Africa and the Middle East. According to a March 2022 UNCTAD report, in over 20 African nations the share of Russia in their wheat imports was at least 30 %. The African nations most dependent on Russian wheat imports are Benin (100 %), Sudan (about 70 %), Ruanda (over 60 %), Tanzania (over 60 %) and Madagascar (over 60 %). Many Middle Eastern and African countries also import large amounts of grain from Ukraine.

Russia has blocked Ukraine's grain exports by preventing Ukraine from shipping from its Black Sea ports. At the beginning of June 2022, Ukrainian officials estimated that Russia's grain thefts from Ukraine had reached 500,000 metric tons, an amount worth 100 million dollars.

The world's top ten wheat exporters in 2020 (share of total wheat exports globally)



Sources: FAO and BOFIT.

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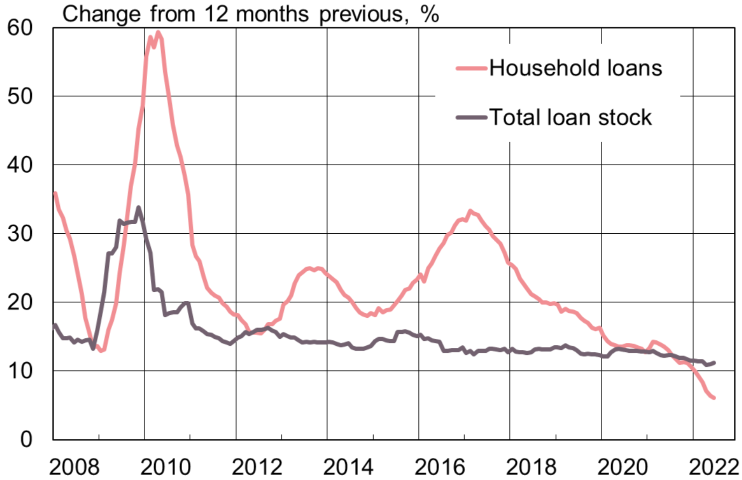
China

Slow growth for China's household loan stock. Loans to households represent nearly 30 % of the Chinese banking sector's loan stock, with the lion's share of household loans used for buying apartments. Apartment prices have fallen in many cities and apartment sales have declined since last summer. Already troubled real estate developers have seen their sales revenues continue to dwindle. New housing starts and sales of land-use rights have declined for nearly a year. Moreover, Chinese households themselves are increasingly uncertain about their future earning prospects and the degraded economic outlook caused by China's zero covid policies this year. People now try to build up their savings and are reluctant to take on additional debt. On-year growth in the total volume of bank loans granted to households reached a record-slow pace last month.

Concern about China's slowing economy has spurred officials to encourage banks to increase their lending. Although lower than in June 2021, 12-month growth in the total bank loan stock increased slightly to 11.2 % last month. With officials again embracing debt-fuelled stimulus, the banking sector finds itself at the forefront of lending. Banks offer financing to keep businesses afloat and finance public infrastructure projects. The acceleration in bank lending in June was mainly driven by growth in longer-maturity corporate loans, which is likely an indication of increased lending precisely in response to new stimulus policies. Companies also report an increased eagerness on the part of banks to offer them loans. The total bank lending stock corresponded to 176 % of GDP at the end of June.

Rising payment defaults resulting from the ongoing woes of China's real estate sector and covid lockdowns have overshadowed banking sector profitability this year. Officially, the amount of declared non-performing loans (NPLs) on bank balance sheets remains small and has only fluctuated slightly in recent years. On the other hand, appraising the actual NPL situation is difficult, especially in light of the fact that during the first wave of the covid pandemic in 2020 and again this year, borrowers have been granted grace periods and banks are permitted to delay NPL recognition beyond the usual 90 days. Chinese banks also often grant new loans to borrowers for the purpose of extinguishing their old loans delaying recording the loans as non-performing. Observers have long considered China's NPL situation to be less rosy than official figures suggest. The NPL ratios vary considerably from bank to bank. In this respect, China's massive state-owned banks are better positioned than smaller banks. Smaller banks typically serve small and medium-sized enterprises (SMEs), i.e. those businesses that have borne the brunt of impacts from covid shutdowns and restrictions. The sectors to which the loans are granted also influence descriptions of their performance. For example, international credit rating agency Fitch and the Asian Pacific investment bank Natixis report that payment defaults on loans granted to China's real estate sector have grown significantly over the past two years.

12-month growth in bank lending to households has slowed to a crawl



Sources: PBoC, CEIC and BOFIT.

China's goods exports to Russia decline while bilateral trade deficit rises. China Customs reports that the value of goods exports to Russia shrank by 17 % y-o-y in June. In response to Russia's invasion of Ukraine in late February, China's exports to Russia during the March-June period contracted by 15 % y-o-y. The value of goods imported from Russia grew by

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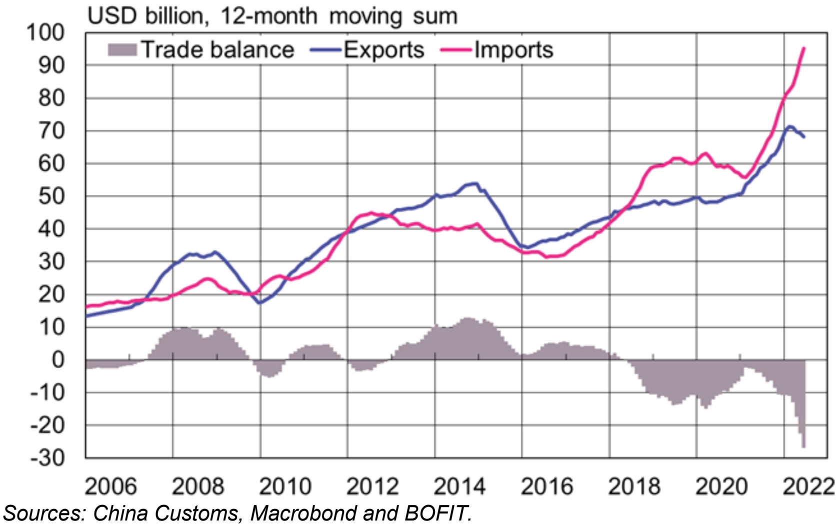
56 % in June (up 54 % y-o-y in the March-June period). Much of the growth in the value of imports can be attributed to higher prices. China has been running a goods trade deficit with Russia for years, due to rising energy imports. Simultaneous growth in imports and falling exports has caused China's trade deficit with Russia to widen rapidly.

The value of China's goods exports to Russia has contracted since the start of the Ukraine invasion in all major categories. The category-specific breakdown of China-Russia bilateral goods trade is available only up to May. Thus, for the March-May period, China's exports to Russia in the machinery & equipment category (22 % of the value of exports in 2021) were down by 9 % y-o-y and in the electronics category (21 % of exports in 2021) by 33 %. Exports of cars from China to Russia (7 % of exports in 2021) fell by 8 % y-o-y while textiles (12 % of exports in 2021) were down by 14 %. Only the value of exports of chemicals (6 % of the value of exports in 2021) was up in March-May by 43 % y-o-y.

About 75 % of the value of China's imports from Russia are energy products. For March-May, the value of energy imports grew by 77 % y-o-y. The growth in import volumes of the main energy products have been much more modest. For example, China Customs reports that the value of crude oil imports from Russia grew by 72 % y-o-y in March-May, but the import volume was up by just 11 %. The value of coal imports grew by 67 %, but the volume of coal imports shrank by 14 %. During March-May, China saw its imports of liquefied natural gas (LNG) from Russia climb by 39 %, while imports of petroleum products were up over 600 % y-o-y. Their share of energy imports, however, is relatively small. The latest estimate from the CREA research group shows that China has become Russia's top energy customer since Russia's invasion of Ukraine. As of early July, China has imported 21 billion euros worth of Russian oil, an amount that roughly corresponds to the combined imports of Russian oil by next four largest customers (Netherlands, Germany, Turkey and India).

Unlike its trade with Russia, the value of China's total goods exports rose in June by 18 % y-o-y (measured in US dollars). Exports to all of China's major markets were up. Growth in goods imports was much weaker, growing by just 1 % in value. China's overall trade surplus hit a record high in June. Import volumes of key commodities continued to fall. For example, the volume of China's crude imports in June were down by 11 % y-o-y.

The value of China's goods exports to Russia is falling even as the value of imports from Russia continues to soar



Sources: China Customs, Macrobond and BOFIT.

India binges on Russian oil. By some unofficial estimates, India is purchasing over 1 million barrels of Russian crude oil daily, which amounts to nearly a quarter of India's total oil imports. Before Russia's attack on Ukraine, Russia accounted for less than 1 % of India's oil imports, but since then imports of Russian oil have soared.

The powerful growth in India's imports of Russian oil reflects the fact that Russia is selling its oil at a discount due to Western sanctions. In recent months, Russia's Urals blend oil has been about a third cheaper than North Sea Brent blend. Some market rumours claim that demand for discounted Russian oil has become so great that Indian traders are no longer able to purchase the quantities they seek.

India's imports of oil from Russia requires some special arrangements as Western countries have complicated buying oil from Russia by e.g. limiting the use of Western currencies in paying for Russian oil and denying Russian oil tankers access to Western ports. It is also rumoured that India has been paying for its Russian oil in Chinese yuan and that Russia is willing to take payment for oil in high-value commodities such as gold. Traders can also disguise the country origin of oil by pumping oil from one tanker to another while at sea.

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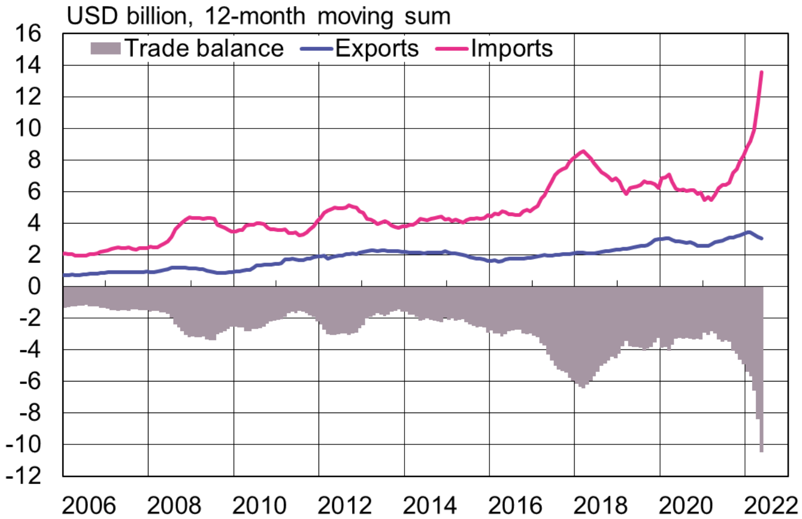
India's oil-buying spree has drawn criticism from Western countries, who note that the profits of Russia's oil sales go to financing Russia's war on Ukraine. Indian officials respond that snapping up bargains is reasonable, especially when many European countries continue to purchase Russian oil. In a recent phone conversation, India's prime minister Narendra Modi and Russia's president Vladimir Putin discussed areas to strengthen trade relations, particularly with respect to agricultural products and pharmaceuticals as well.

India's Russian oil-buying began to confront new hurdles in June after the EU decided to ban insurance on tankers that carry Russian oil. The EU has included India in its discussions on imposing a price ceiling on Russian oil. The idea is that countries that buy oil from Russia collectively agree to purchase that oil at a generally agreed discount from the market price. Such an arrangement would limit Russian oil income without ending trade in Russian oil. The imposition of a price ceiling is still in the planning phase.

India has run a modest bilateral goods trade deficit with Russia since the turn of the millennium. That deficit exploded, however, with Russia's attack on Ukraine. The value of Indian goods exports to Russia fell in March-May by over 50 % y-o-y. In contrast, the value of imports from Russia more than tripled in the same period. India mainly imports energy products from Russia (about half of the value of imports in 2021, over half of which was crude oil) and industrial supplies (about a third of imports). For its part, India exports industrial supplies to Russia (nearly a third of the value of total exports in 2021), investment and consumption goods (each accounting for about a fifth of total exports), as well as foodstuffs.

The value of India's goods imports from Russia has skyrocketed in recent months



Sources: India Ministry of Commerce, Macrobond and BOFIT.

Russia

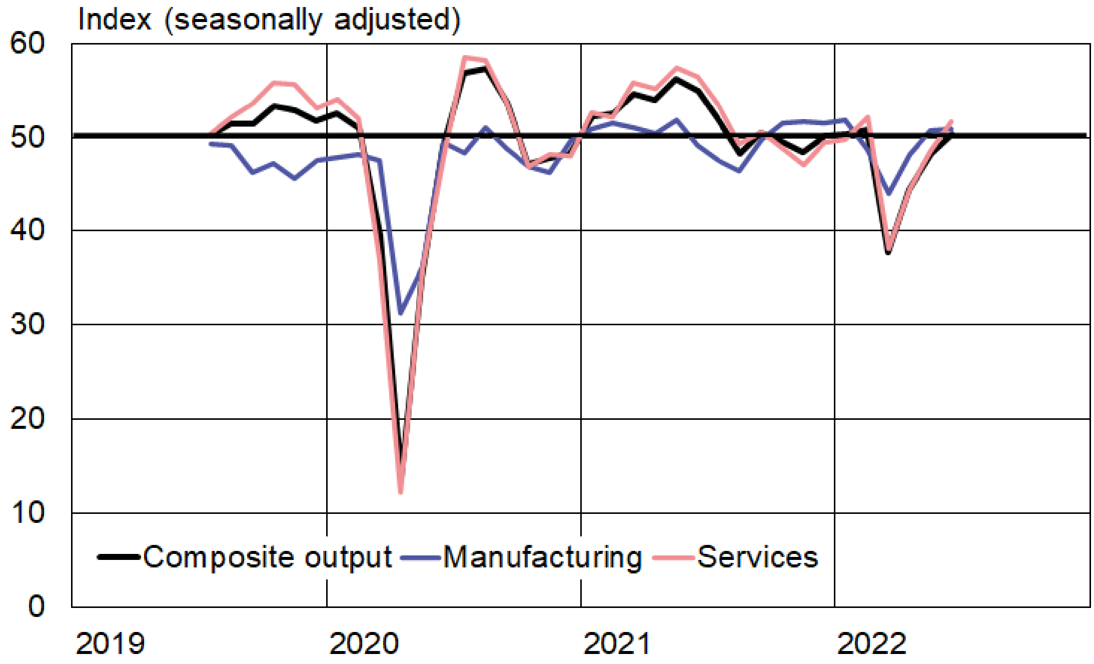
Outlook for Russian businesses grows cloudier in June. The monthly PMI readings, which are based on surveys of Russian purchasing managers by market intelligence provider S&P, give a sense of business sentiment about their near-term prospects. S&P's June PMI readings for manufacturing and services were both above the neutral reading level of 50, indicating an improvement in economic activity compared to May. However, while domestic orders were rising, export orders continued to fall. The latest composite output PMI reading was also over 50. Nevertheless, it is hard to ignore that growth was driven by services and that manufacturing output continued to drop.

Every four months, S&P also releases a survey from private companies in a dozen countries about their business expectations for the next 12 months. The June survey reports Russian companies were the most pessimistic among the twelve countries and noted that business conditions had become significantly more challenging since the February invasion of Ukraine. Firms had problems with soaring commodity prices, difficulties in finding foreign customers caused by sanctions and feeble domestic demand. Many firms said they were having trouble getting parts, components and other inputs from abroad. Many companies are planning to reduce their fixed investment plans due to bleak prospects.

The Bank of Russia publishes monthly a relatively detailed monitoring of corporate payment activity. The July 7 report shows that the volumes of incoming and outgoing payments in June were 7.2 % lower (seasonally adjusted) than the averages for the first quarter of this year. While nearly every branch saw a contraction in payments traffic, the drops were sharpest in industries dependent of foreign demand. Corporate payments traffic is usually a good predictor of nominal GDP developments.

Russia's economic outlook has thus stabilised somewhat from the initial weeks following Russia's invasion of Ukraine and uncertainties caused by sanctions, but difficulties continue to prevail in many branches. In addition, the future outlook continues to worsen.

Russian purchasing manager indices (PMIs) showed a stabilizing situation in June



Sources: Macrobond, S&P and BOFIT.

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BOFIT

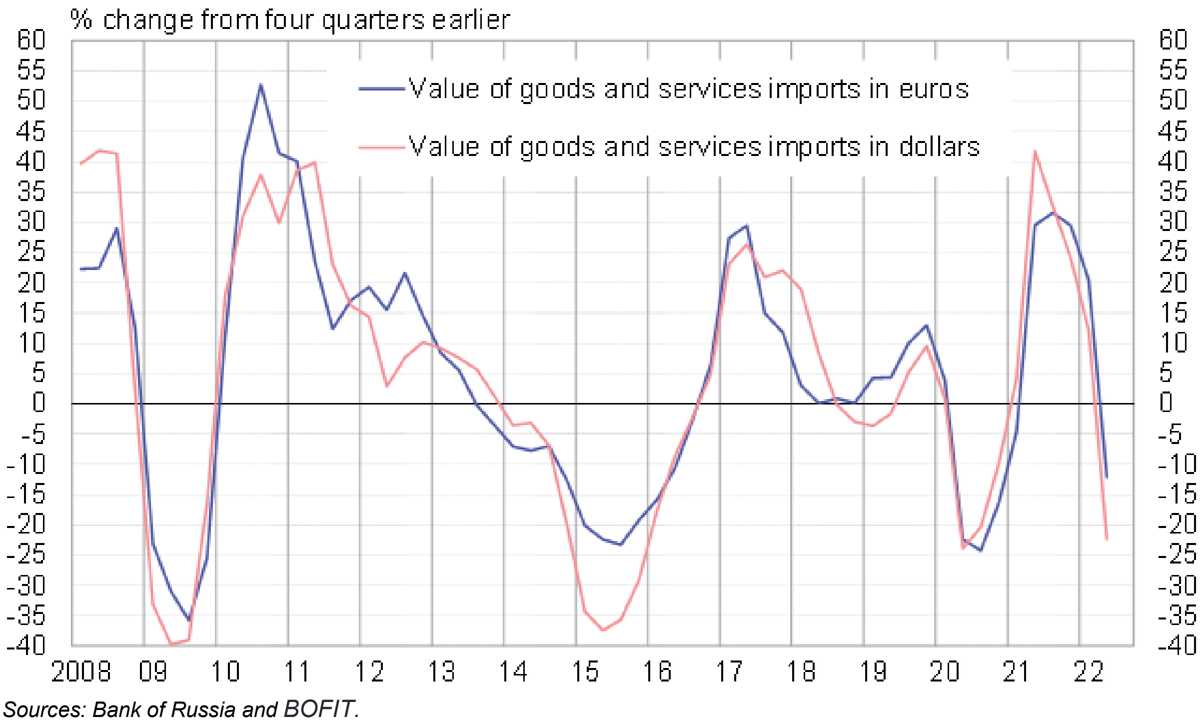
Partial release of balance-of-payments data gives general picture of Russia's import decline and large capital outflows. After a several months' pause, the Bank of Russia released balance-of-payments data on foreign trade. The figures for goods and services trade were not broken down, however. Russia's revenues on exports of goods and services in the second quarter were up by 20 % y-o-y in dollar terms. It should be noted that the dollar has strengthened considerably from a year earlier against Russia's other foreign trade currencies. In euro terms, export earnings for goods and services in the second quarter were up by 35 % y-o-y. The rise in Russia's export earnings has been basically driven by higher world prices for Russia's main export commodities.

Russia's released figures confirm that imports to Russia have declined with the ongoing economic recession and foreign export sanctions. Russian spending on imports of goods and services was down in the second quarter by over 20 % y-o-y in dollar terms and 12 % in euro terms. The decline was rather small given that export figures for EU countries show that in March-May EU countries earnings from goods exports to Russia were about half of what they were a year ago in euro terms. Russian figures thus reflect more moderate drops in Russia's imports from other countries (notably China and Turkey).

With the rise in export earnings and declining imports, Russia's trade surplus for goods and services hit a record of nearly 160 billion dollars in the first half. The running four-quarter surplus rose in the second quarter to around 13 % of GDP. Other revenues and expenditures on the current account were slightly in deficit as usual. In any case, Russia's current account surplus has hit new highs this year. The surplus was over 10 % of GDP during the latest four-quarter period.

Regarding the financial account with the rest of the world, the CBR's balance-of-payments figures released this year only include a lump figure for the financial flows of the private sector, government and central bank. The figure also comprises the CBR's transactions with its foreign currency and gold reserves (publication of the transactions data is still suspended e.g. in the balance-of-payment figures). Anyhow, the financial account showed large deficits in the first and second quarters, hitting record highs (130 billion dollars for the first half). The deficits refer to a substantial net outflow of capital from the private sector as the government and central bank financial flows abroad are generally relatively small and the March western sanctions banned transactions with the CBR. The large financial account deficit this year resulted both from large capital outflows that reduce foreign debt and other liabilities and large capital outflows that increase foreign receivables.

Russia's imports have dropped significantly in recent months



Sources: Bank of Russia and BOFIT.

Russian inflation slowed slightly in June on reduced increases in prices of fruits and vegetables. The 12-month rise in consumer prices fell from 17.1 % in May to 15.9 % in June. Over half of the cooling in inflation could be attributed to a slowdown in the rise of prices of fruits and vegetables.

The slowing rise in food prices (18 % y-o-y in June) largely reflects higher crop yields this year in southern Russia than in 2021, as well as the fact that Russia has eliminated import tariffs on certain fruits and vegetables. In addition, exports of some food commodities such as sugar have been restricted since the invasion into Ukraine in February. The reduced inflationary pressure on non-food goods reflects the subsiding of panic buying at the outbreak of the Ukraine war as people rushed to buy durable goods such as computers and home appliances. Exports are also restricted for certain goods such as construction materials. The strong ruble has also slowed inflation by making the prices for imported goods cheaper.

Russian inflation soared in March and April in response to the invasion of Ukraine. More recently, inflation has been moderating. Services were the only main inflation category to see a slight increase in June. The pace of services inflation largely reflected higher prices for transport services. For example, a number of Russian air carriers have seen pressures to raise prices as several countries have closed their airspace to Russian aircraft. On the other hand, Russian airlines have managed in some regions to increase their domestic business as demand for domestic tourism has risen due to complications with foreign travel. Services inflation was also raised by the fact that telecom operators, who have lost much of their access to foreign technology and equipment, have passed their increased costs on to consumers.

Russian federal budget revenues continue to deteriorate. Nominal revenues to the federal budget in June were up by a meagre 1.5 % y-o-y. This translates to a very large drop in real terms as the 12-month rise in consumer prices and industrial producer prices averaged 14 % in June.

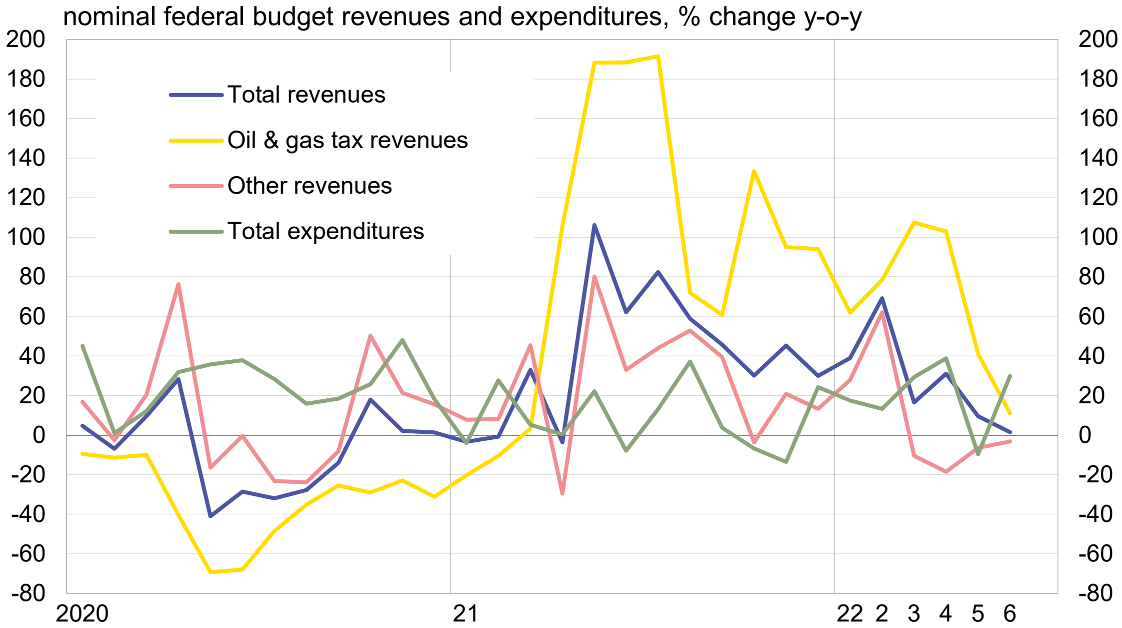
Revenues from production and export taxes on the oil & gas industry, which are largely set based on global prices in dollars, were now up by just over 10 % y-o-y. The world market price for Urals-blend oil in May and June was up by about 20 % y-o-y, but strong ruble appreciation along with a contraction in production and exports of gas & oil had a diminishing effect on these budget revenues. Other federal budget revenues declined in June by 3 % y-o-y, a smaller drop than in previous months.

Following a May dip, federal budget spending rose sharply in June. The budget was still in surplus for the first six months of this year while the last 12-month surplus contracted in June to less than 1 % of GDP.

The budget revenue outlook for the rest of this year is lame. Revenues other than those from oil & gas tax revenues (55 % of federal budget revenues in January-June) decrease as the country slides into recession. Government revenues from oil & gas taxes will be supported by the price of Urals as long as the price remains at the rather high level of recent months (even if Urals is discounted on world markets due to sanctions). On the other hand, revenues are depressed by lower oil & gas output, reduced exports and the high ruble exchange rate compared to last year.

Given Russia's weak budget revenue prospects, e.g. the finance ministry expects the federal budget deficit to exceed 1 % of GDP even if the rise of budget spending with its supplements would remain well below the pace of inflation. Resolving the setup between budget deficit and increases in spending may become even more challenging for the entire government budget sector if non-oil revenues to the consolidated budget (federal, regional and municipal budgets plus budgets of state social funds) drop off substantially. These revenues have accounted for about 80 % of total consolidated budget revenues. The budgets of regions and municipalities, as well as social fund budgets, are to a large extent reliant on transfers from the federal budget and have few possibilities to take on new debt.

The 12-month change in Russia's nominal federal budget revenues declined close to zero



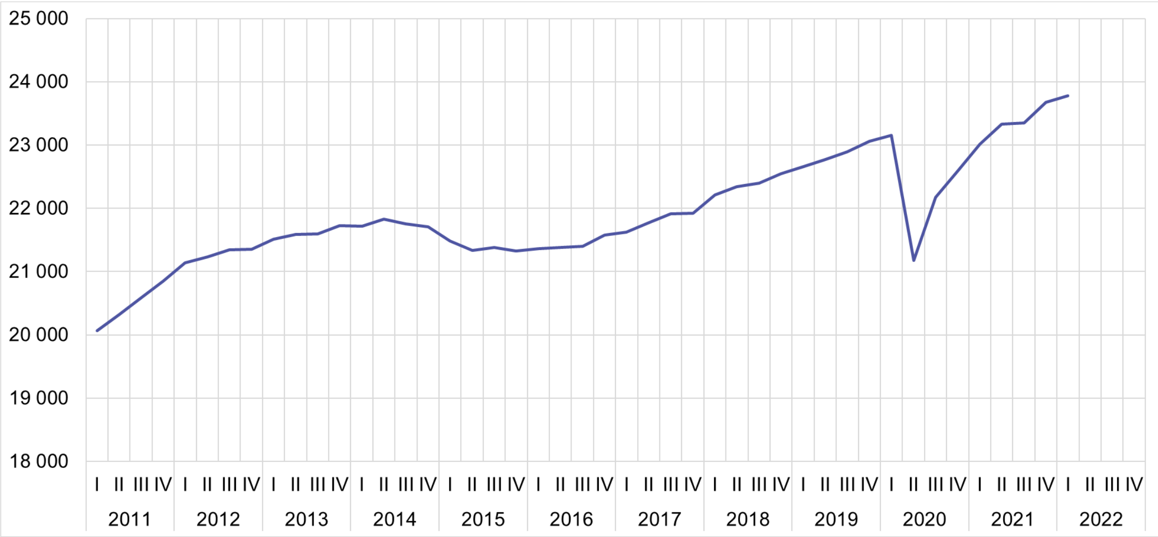
Sources: Russian Ministry of Finance and BOFIT.

Russian GDP growth slowed in the first quarter of this year. The latest Rosstat figures show that seasonally adjusted GDP in the first quarter increased by 0.5 % from the previous quarter. Seasonally adjusted growth in the fourth quarter of 2021 was still 1.4 %. Private consumption increased by 0.5 %, while public consumption was unchanged from the previous quarter. Capital formation contracted by 1.4 % – in recent years a weaker score was seen only in 2Q20 when the first wave of the covid pandemic hit Russia. With fixed investment growth at 3.0 %, it is evident that companies have significantly drained their inventories in response to war and sanctions. Otherwise, it is still difficult to discern from Russia's national accounts in the first quarter any other major impacts caused by Russia's February 24 invasion of Ukraine or the impact of sanctions.

Rosstat did not release national accounts data on exports and imports while sufficient data is available to conclude that net exports in 2016 prices rose markedly in the first quarter of this year. Measured this way, the level of net exports was, however, still lower than in 2020.

GDP showed growth of 3.5 % y-o-y in the first quarter, in line with Rosstat's earlier preliminary estimate. Real value-added growth in some branches was quite high, particularly in the extractive industry sector (8.6 %). Exports of extractive industry products, including oil & gas, were exceptionally large in the first months of this year. Growth in manufacturing was 5.1 %, while growth was fairly similar also in other sectors of the economy. Value-added in construction was up by 4.7 % y-o-y, retail and wholesale trade grew by 3.7 %, while transportation sector rose by 5.4 %.

Russian GDP hit an all-time high in the first quarter of 2022 (RUB billion in 2016 prices)



Sources: Rosstat and BOFIT.

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China

China posts weak second-quarter growth, likelihood of return to high growth for the rest of the year wanes. China's National Bureau of Statistics reports that GDP contracted by 2.6 % q-o-q in the second quarter due to extensive covid lockdowns in several Chinese cities. While NBS figures show that on-year GDP growth in the second quarter was slightly positive (0.4 %), many observers argue that growth was probably lower. BOFIT's own alternative calculations suggest that China experienced negative on-year growth in the second quarter. According to official NBS figures, growth declines were apparent in provinces subject to severe lockdowns this spring. For example, GDP was down by 14 % y-o-y in Shanghai, 5 % in Jilin and 3 % in Beijing.

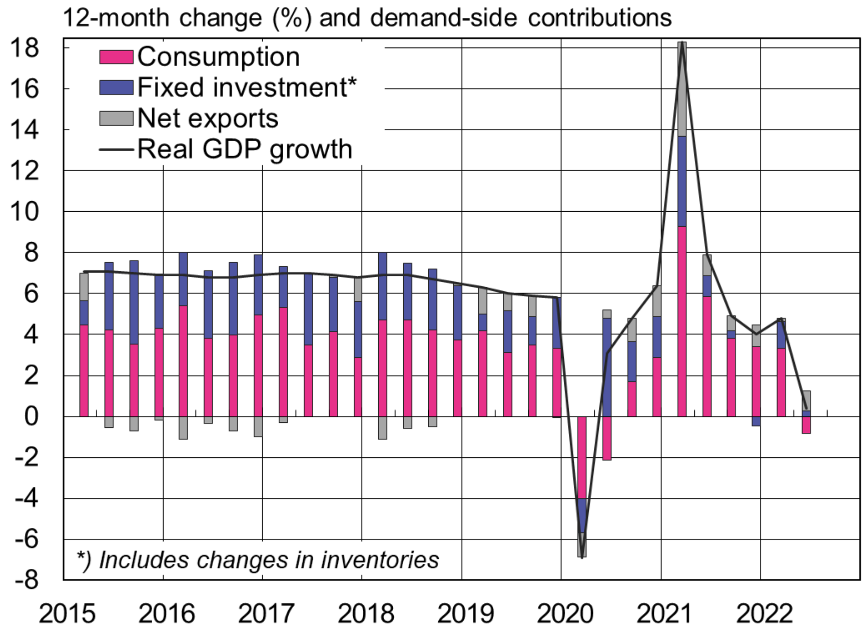
A strong export trend supported growth in the second quarter. In contrast, domestic consumer demand contracted from a year ago and its contribution to GDP growth was negative. Monthly indicators show the sharpest contraction in consumer demand occurred in April and May. In June, nominal growth in retail sales was 3 % y-o-y. Accounting for inflation, real growth was still quite subdued (consumer prices in June rose by 2.5 % y-o-y). Industrial output picked up from April and May, and hit 4 % y-o-y real growth in June.

While Chinese economy bounced back swiftly from the Covid Recession of spring 2020, it is unlikely to repeat this. Consumer confidence is faltering and construction activity is declining. Measured in terms of floorspace, the volume of construction started in June was down by 45 % y-o-y and real estate sales by 18 % y-o-y. The cooling of the housing market has only worsened the financial desperation of developers and the real estate sector. Due to unexpectedly sluggish global growth and high inflation, demand for Chinese exports is expected to weaken and thus is unlikely to serve as an economic backstop as it did in 2020.

Poor data availability makes it difficult to track fixed investment in China. The NBS reports that fixed asset investment (FAI) was up 6 % y-o-y in nominal terms in the first half of this year. However, with the cessation of reporting in fixed investment prices, real growth has become difficult to assess. If producer prices provide any indication, the real growth in fixed investment has been slow at best as producer prices in June were up by 6.1 % y-o-y and by 7.7 % for the first half of the year. The FAI figures are inconsistent with the national accounts figures for investment.

Despite hopes that investment-driven stimulus will push economic growth in the second half of this year closer to the government's official "about 5.5 %" annual growth target, it looks increasingly unlikely. The currently planned increase in investment is not nearly as large as would be required to offset low growth in consumer demand. It has becoming harder to find profitable investment projects in China, so any massive investment stimulus will increase the public-sector debt burden, economic imbalances and increase risk levels.

China's official second-quarter GDP growth fell close to zero



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

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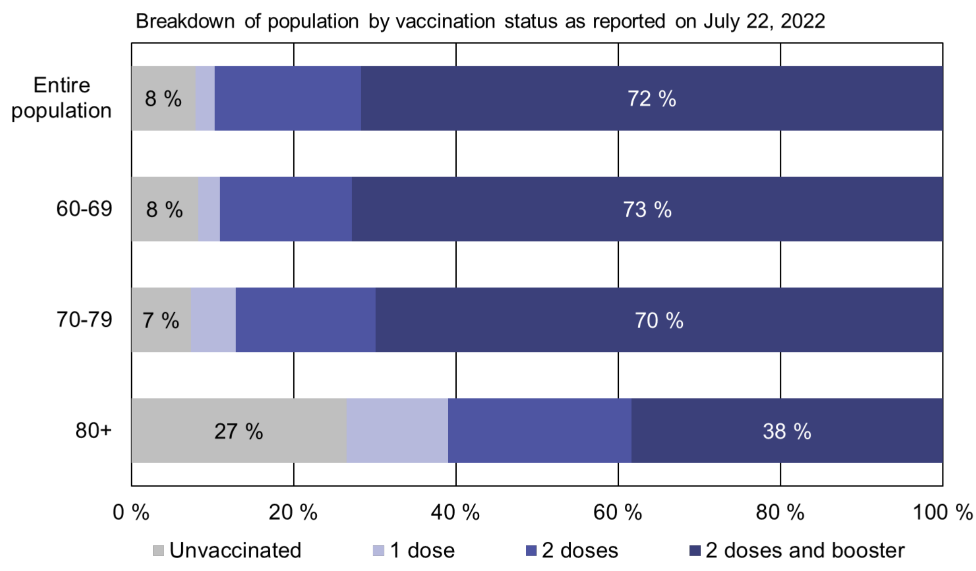
BOFIT

China relaxes restrictions but holds to its dynamic zero-COVID policy. After around two months of covid lockdowns, Beijing officially returned to "normality" on May 29 and Shanghai lifted its lockdown on June 1. Changes were also made in government policies, most notably easing quarantine requirements. Since June, overseas arrivals and close contacts now face shorter mandatory quarantine periods. Internal border inspections and restrictions have also been reduced. Following the relaxations, infection rates have increased in June and July with China reporting an average of 890 daily confirmed cases last week, out of which 80 % were asymptomatic. Several local governments blame their rising infection numbers on travellers returning from abroad who now only face a mandatory quarantine period of 7 rather than 14 days.

Despite the easing of restrictions, China's leadership stresses the need to maintain "dynamic zero tolerance" against the SARS-CoV-2 virus. While entire cities are less likely to be put under covid-related lockdowns, this month differing levels of restrictions remained in place in 41 cities affecting over 200 million people. Also residents in Beijing, Shanghai and several other metropolises must still get tested every second or third day to enter most indoor public spaces. Even when lockdowns are limited to districts within the city, residents still face disrupted lives. Just this week, four of Shanghai's districts were locked down for a week due to rising covid cases.

The combination of stimulus, testing and lockdowns does little to relieve the uncertainty generated by China's zero covid policies. High vaccination rates could help with the way forward, but China still has a way to go to reach sufficiently high levels. Experts claim that sufficient protection level from the covid vaccines used in China is only achieved after three doses. 90 % of China's population has received two shots, but only 72 % of persons eligible for their third booster shot have taken it. Just 38 % of China's over-80s cohort have received their booster and 27 % are still completely unvaccinated. The vaccination passport systems adopted in many countries are unlikely to find acceptance in China, where vaccination mandates have already generated considerable public resistance. For example, the city of Beijing recently presented a plan for a vaccination passport that would be required in spaces such as gyms, movie theatres and libraries. Even with a limited range of place affected by the requirements, it met with a considerable pushback by citizens. Officials quickly retracted the original plan, suggesting that the programme could be voluntary instead.

Most of China's population has had their third covid vaccination, but vaccination rates for over-80s are still lagging



Sources: National Health Commission of China, BOFIT.

Forecasters downgrade China's 2022 GDP growth forecast, see high growth rates for India and predict a lower-than-expected contraction of the Russian economy. In its latest World Economic Outlook (WEO) released this week, the IMF predicts the global economy growing by 3.2 %, a significant reduction from last year's 6.1 % growth. In the initial estimates released in January, the IMF had been expecting 4.4 % global growth this year, so the predictions have been significantly lowered during the spring. The growth estimates for emerging economies are slightly higher than for other countries, but variations in growth percentages are noticeable. The IMF now expects China's 2022 GDP growth to come in at 3.3 %, India's at 7.4 % and Russia's economy is expected to contract at a rate of 6 %. The growth figures are overshadowed by the gloomy economic outlook caused by the spread of covid, war in Ukraine and the ongoing inflation.

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The April WEO already cut growth by 0.4 percentage points from the January figure, which was 4.8 %. The new WEO cuts the predicted growth for China this year by an entire percentage point compared to April with the estimate now being 3.3 %. Early in 2022, before the covid situation worsened in China, the growth forecasts for most institutional forecasters were significantly higher, running in the range of 4–6 % (BOFIT Weekly 4/2022). Following covid lockdowns and economic contractions in the spring, all major institutional forecasters have reduced their forecasts for China. GDP growth is now generally expected to remain in the range of two to four percent this year.

The Russian economy is still expected to contract sharply this year, but slightly less than expected at the outbreak of the Ukraine war. The IMF's latest forecast lifts its previous estimate by over two percentage points from the April WEO. Among the investment banks, JPMorgan this month raised its previous forecast from a contraction of 5 % this year to just 3.5 %. Much of the reduction in the Russian decline reflects rising oil prices and persisting demand for Russian oil. Additionally, Russia's labour markets have remained stable and private consumption has remained relatively strong. According to forecasters, war and sanctions will continue to affect the Russian economy next year and the contraction in GDP, albeit more modest, will continue.

India stands out as a country with one of the highest growth predictions for the year. The GDP growth projections for this year are around 7 % according the IMF, OECD and various investment banks. While India's high growth seems locked in, forecasters have lowered their estimates by several percentage points throughout this year. In January, the IMF predicted India's growth will reach 9 % and the World Bank estimated growth of 8.3 %. Expectations of India's future growth are slightly more modest, with most forecasters putting India's 2023 GDP growth estimates in the range of 4–6 %.

2022 GDP forecasts released this spring and summer generally see Russia's GDP contracting, China's growth slowing and India showing high GDP growth predictions

	IMF	World Bank	OECD	Fitch	BOFIT	JPMorgan	Goldman Sachs	ADB	Nomura
China	3.3 %	4.3 %	4.4 %	3.7 %	2 %	3.7 %	3.3 %	4 %	3.9 %
Russia	- 6 %	- 8.9 %	- 10 %	- 12.5 %	- 10 %	- 3.5 %	- 10 %		
India	7.4 %	7.5 %	6.9 %	7.8 %				7.2 %	7.2 %
Release date	*7/2022*	*6/2022*	*6/2022*	*6/2022*	*3-4/2022*	*5-7/2022*	*3-7/2022*	*7/2022*	*7/2022*

Sources: IMF, World Bank, OECD, Fitch, BOFIT, JPMorgan, Goldman Sachs, ADB and Nomura.

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Russia

Big differences across sectoral contractions in Russia. Russia's economy ministry reports that June GDP was down by nearly 5 % on year while April GDP had been down by nearly 3 % when the economic decline began. For the second quarter, the economy ministry found a 4 % contraction from 2Q21.

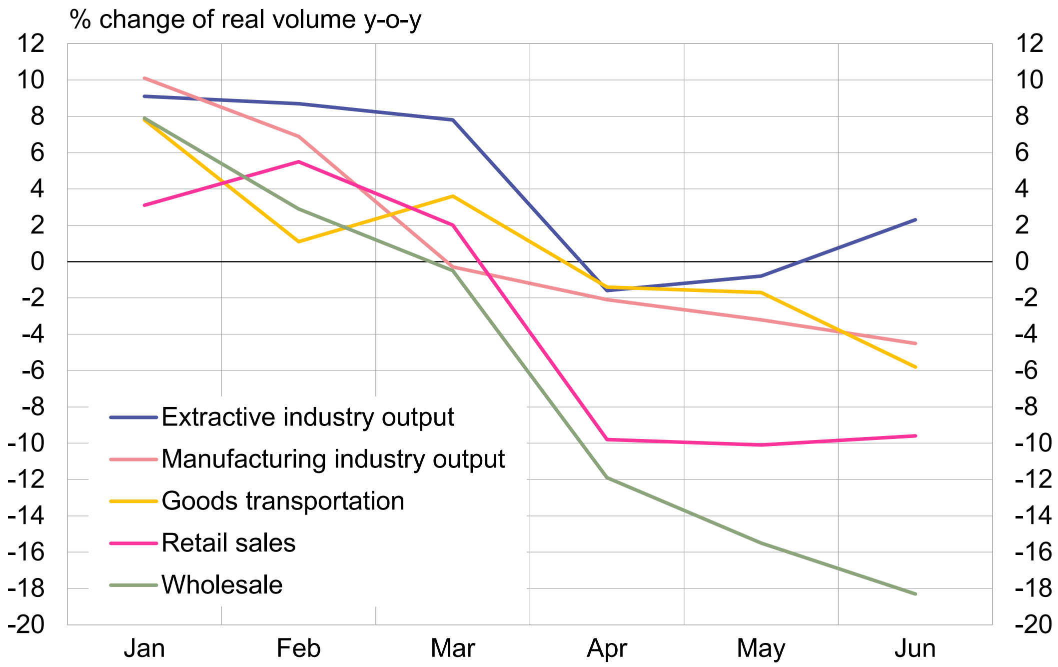
There are still large differences in the tracks of various sectors of the economy. After declining last spring, extractive industry output rose in June, which largely came from the April drop in oil output and its accelerated June recovery. Services supporting extractive industries enjoyed continuous considerable growth.

Despite a notable recovery in petroleum products, manufacturing output continued to decline in June, falling by 4.5 % y-o-y. Most of the on-year drop in manufacturing output also in June resulted from the collapse of domestic car production, but significant declines in recent months in metal production and fabrication of metal products, as well as the chemical industry, have also had tangible impacts.

Construction activity, which has diminished since April, slid down in June to the same level it had been a year earlier. The slide in goods transport became steeper in June, falling by nearly 6 % y-o-y. The sharp drop in wholesale activity began to level off, but wholesale volumes were still down by a whopping 18 % y-o-y in June.

Household consumption has fallen sharply. Second-quarter household spending on goods and services was down by 7.5 % y-o-y in real terms. Seasonally adjusted figures show that the volume of retail sales remained unchanged in June, but the sales were down by about 10 % y-o-y. Household disposable income fell by just 0.8 % y-o-y in the second quarter, although real wages were off by 5–6 %. Consumption was drawn down by rising savings in the second quarter. Households showed similar patterns during Russia's recessions in 2015 and 2020.

While the contraction of Russia's industrial output has been relatively moderate this year, commercial activity is down sharply



Sources: Rosstat and BOFIT.

CBR lowers key rate further to 8 %. The Central Bank of Russia surprised markets with its much larger-than-expected 150-basis-point cut in the key rate to 8 % from 25th July. In the weeks before Russia's invasion of Ukraine, the key rate was 8.5 %. Following the February invasion, the CBR raised its key rate to 20 % to contain ruble depreciation and soaring consumer prices.

The ruble has strengthened significantly in recent months due to restrictions placed on the foreign currency market by Russian officials and Russia's giant current account surplus. Inflationary pressures have also been reduced by falling

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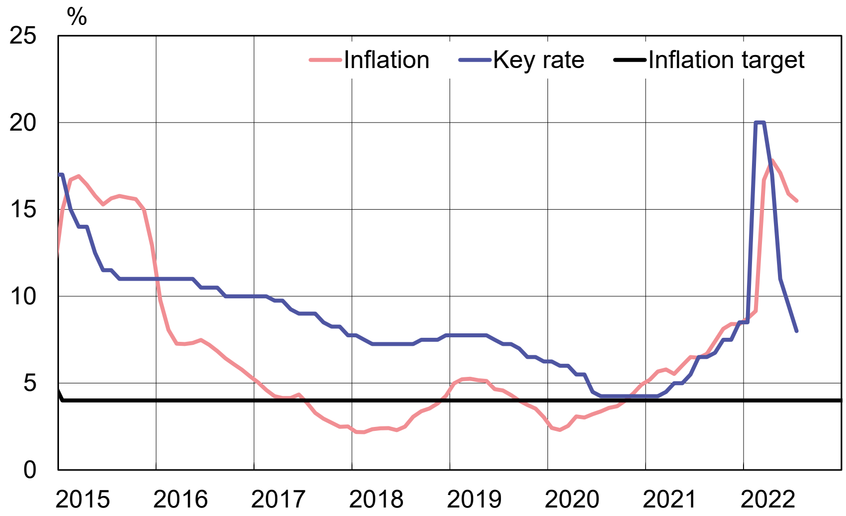
domestic demand as the economy has slipped into recession. Even if inflation has slowed in recent months, the CBR estimated that consumer prices were up by nearly 16 % y-o-y in mid-July. The steep rate cuts have plunged real interest rates deep into negative territory.

Domestic demand has fallen because of increased uncertainty caused by the war and poor economic development. Consumer demand has also been depressed by a high savings rate. Not only do Russians tend to save in the face of a weakening economy, the CBR notes that some of the increased saving is unavoidable. Russian consumers are unable to buy desired goods due to Western sanctions and the retreat of foreign businesses from the Russian market.

The CBR now forecasts that Russian GDP will contract this year and next by a total of 5–10 %, and that moderate growth will return in 2024. The central bank sees 12-month inflation running at 12–15 % at the end of this year and 5–7 % at the end of 2023. The CBR also expects the key rate to average 7.4–8 % during the rest of this year, implying a potential for additional, but less dramatic, rate cuts in the coming months.

Real interest rates in Russia are significantly negative due to a sharp drop in the key rate



Sources: Macrobond, CBR, BOFIT.

Banking sector conditions stabilise in Russia. With the invasion of Ukraine in February 2022, fears of new sanctions and increased general censorship have caused a scarcity in data on banking sector activity. The CBR's monthly releases currently only cover a few key indicators for the sector as a whole. The available data suggest that Russia has avoided a widespread financial crisis and that conditions in the banking sector are stabilising. The impacts of war, sanctions, a yoyoing key rate and general economic uncertainty reduced bank lending activity in the March-May period. The stock of corporate loans stopped shrinking in June, thanks largely to subsidy programmes for large, systemically important firms. The slight growth in the housing loan market has helped reboot household lending in June.

Rates on new loans have fallen because of the CBR's rate-cutting, which began in April, as well as government subsidy programmes. The stabilisation of financial markets has also made conditions more conducive for borrowers. A June survey on bank lending found that terms for household loans had relaxed considerably from March. There was still no strong sign of a revival in credit demand, however, and household savings appear to have risen further in May and June. Household savings deposits were up by 6 % y-o-y in June.

Although the CBR no longer releases information on bank financial performance, observers say that the first six months of this year were extremely challenging for banks focused on serving households. Corporate lending, in contrast, relies more on variable-rate loans that help banks protect their margins.

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China

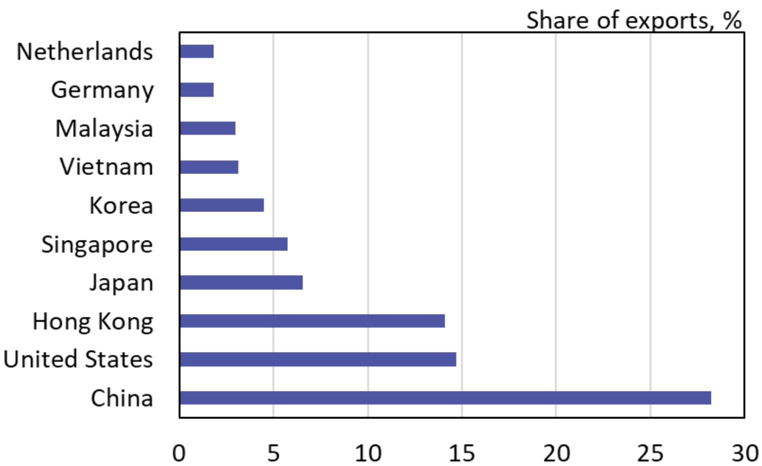
Relations between mainland China and Taiwan grow tense. Following last week's visit to Taiwan by Nancy Pelosi, Speaker of the United States House of Representatives, China announced measures targeting Taiwan and the US. China cut off bilateral climate talks with the US, as well as froze lines of regular military communication and suspended cooperation on legal issues such as the return of illegal immigrants. China also imposed import bans on certain Taiwanese foodstuffs and cut off sand exports to Taiwan. The measures are expected to have only a minor impact on Taiwanese economy. Foodstuffs account for a tiny part of Taiwan's exports to China, and similarly, only a tiny fraction of the sand used in Taiwan (mostly in construction) is imported from mainland China.

The reunification of Taiwan with mainland China has been a long-term target for the Communist Party of China (CPC). On Wednesday (Aug. 10), Beijing published a new white paper on Taiwan. The last such statement was published in 2000. Although Beijing seeks a peaceful reuniting, the new statement no more contains promises that Beijing will not send military personnel to Taiwan or that Taiwan will enjoy broad autonomy after reintegration.

Even if the economic impacts from the increased tension are currently limited, further escalation of the situation could have serious implications for the global economy. Taiwanese firms, most notably TSMC, produce over 60 % of the world's semiconductor microchips. Although some of the firms' production is located elsewhere, a large share of global production of the most sophisticated semiconductor chips takes place in Taiwan. Because microchips are essential components for many products, production disruptions in Taiwan would directly and broadly affect international production chains. Western countries have sought to attract microchip production to secure supplies. TSMC has been investigating possibility of building a semiconductor microchip fabrication facility in Germany, and broke ground this summer on a new chip fab in Phoenix, Arizona. This week the US approved tens of billions of dollars in subsidies for the chipmaking industry. A condition for receiving subsidies is that companies do not increase their high-end chip production in China.

Taiwan has strong economic ties with mainland China. Nearly 30 % of Taiwan's goods exports last year went to mainland China. Microchips account for over 60 % of Taiwan's exports. Hong Kong's share of exports is also large (14 %), and part of that might be reexported to mainland China. Over 20 % of imported goods come from mainland China. In addition, Taiwanese companies have plenty of production facilities and other investments on the mainland. For example, Taiwan's Foxconn is China's largest private sector employer.

Nearly 30 % of Taiwan's goods exports last year went to mainland China



Sources: Taiwan Customs Administration and BOFIT.

Yuan-euro exchange rate hits levels not seen for years. The yuan has appreciated substantially against the euro over the past two years, a trend that has continued throughout this summer. At the beginning of July, the euro stood at 6.7 against the yuan. The exchange rate was last this strong in 2015, when it was 6.5.

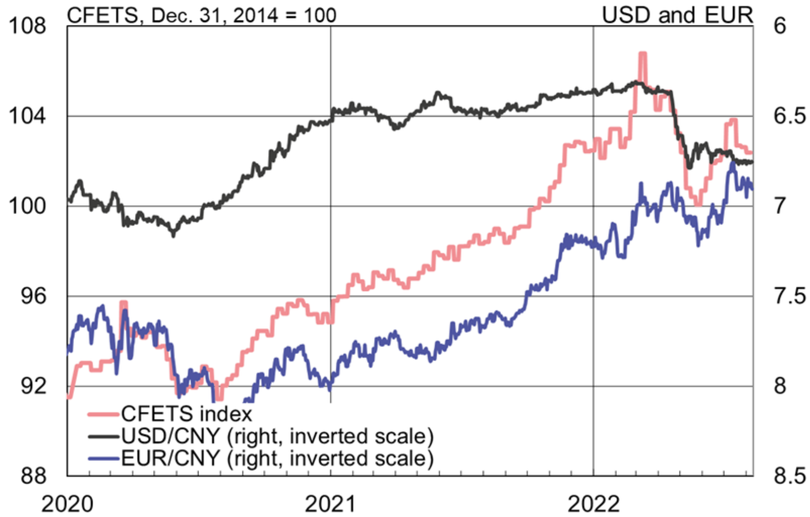
In contrast, the yuan has shown no signs of appreciation against the US dollar since a brief weakening at the start of May. Between end-2020 and May this year, the yuan-dollar rate fluctuated in the 6.3–6.5 range. In recent months, it has bounced between 6.7 and 6.8. Despite the recent depreciation, the yuan-dollar exchange rate is still stronger than in 2019–2020.

Recently both the yuan-dollar rate and yuan-euro rates have been almost at the same level. This is due to the weakening of the euro as it reached parity with the dollar in July for the first time since 2002.

In recent weeks, the yuan has also gained value when measured by the CFETS index, a currency basket weighted by main trading partners. The US dollar and the euro have the largest weights in the index.

The appreciation of the yuan against the euro has made products imported from Europe cheaper for Chinese consumers, while imported Chinese products have become more expensive for European consumers. While this situation could hurt China's export industries, which are already suffering from the impacts of covid and covid lockdowns, the dollar remains China's most important foreign trade currency.

In recent months, the yuan has appreciated against the euro but not the US dollar



Sources: Macrobond, CFETS and BOFIT.

China's leadership omits mention of the numeric GDP growth target. After a session of the Communist Party of China's politburo on July 28, the party leadership issued an official statement that strikingly omitted mention of the existing numeric GDP growth target. Even if the zero-covid suppression strategy has depressed economic growth, the politburo decided not to abandon its covid policy. Thus, instead of repeating the numeric GDP growth target for this year, the politburo offered an aspirational target of "best final result." The change, if permanent, is welcome as it relieves politicians and officials at all levels of the burden of hitting a specific growth target at any price.

The "about 5.5 %" GDP growth target announced in March was already considered daunting at that time without the help of massive stimulus measures. During the spring, economic growth was hampered further by covid lockdowns and the downturn in the real estate sector. Even official figures show low GDP growth in the second quarter (0.4 % y-o-y). For China to reach its 5.5 % growth target this year, second half growth would have needed to exceed 8 % p.a. The major institutional forecasters cut their growth outlooks for China substantially below the official target already earlier this year (BOFIT Weekly 30/2022).

India on verge of surpassing China as world's most populous country. According to the UN's latest forecast of global population growth, India's population will be larger than China's next year. In 2023, both countries will have populations of roughly 1.4 billion people, which together would represent about a third of the planet's human population.

China's population is expected to begin shrinking at some point this year. The decline is largely a reflection of China's low fertility rate, which has remained below two births per woman since the 1990s. To achieve a stable replacement rate over the long term, a country's fertility rate must be 2.1. China's fertility rate fell to 1.2 last year.

China pursued its one-child policy, introduced in 1980, for nearly four decades. Restrictions on family size have been relaxed in recent years in order to slow the rapid greying of the Chinese population. In 2016, couples in urban areas were granted the possibility of having two children, and last year the limit was increased to three children. Despite the policy shift, the number of births has continued to decline.

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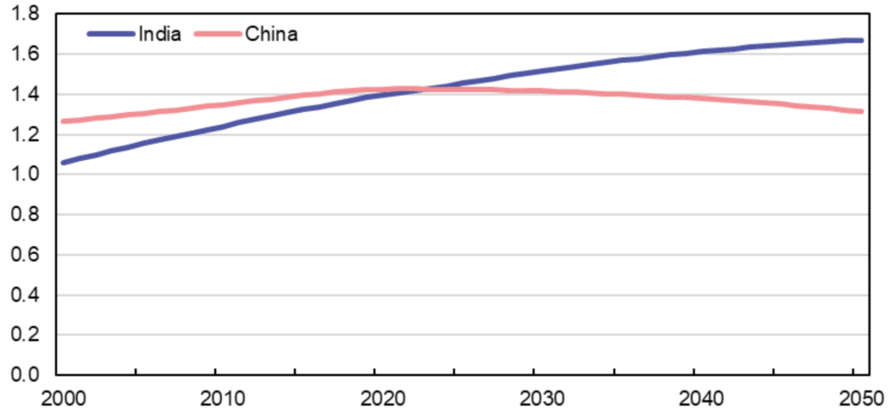
India's fertility rate has also been falling in recent years. The current fertility rate is 2.0, which is less than the long-term stable replacement rate. India's population is expected to keep growing for a while, but at a fairly slow pace. Its population should begin to decline in the second half of this century after reaching the 1.7 billion level.

As with China in recent decades, the engine of population growth in India has been reduced mortality due to longer lifespans. The UN predicts that India's average life expectancy will rise to 72 years next year, which is about 10 years longer than at the start of the millennium.

India's increased life expectancy is particularly a reflection of improvements in healthcare that have lowered infant and maternal mortality rates, as well as deaths from infectious diseases. The government has pushed on multiple fronts ranging from vaccination to improved hygiene in prevention and care for diarrhoea, a traditional cause of infant mortality in India. Thanks to these changes, deaths of children under one year of age has been halved in India over the past two decades.

Longer lifespans and falling births imply rapidly ageing populations for both India and China. Under the UN model, the current population median ages of 28 years for India and 39 for China will each rise by about 10 years by 2050.

Population trends for China and India (in billions)



Sources: UN World Population Prospects Database and BOFIT.

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Russia

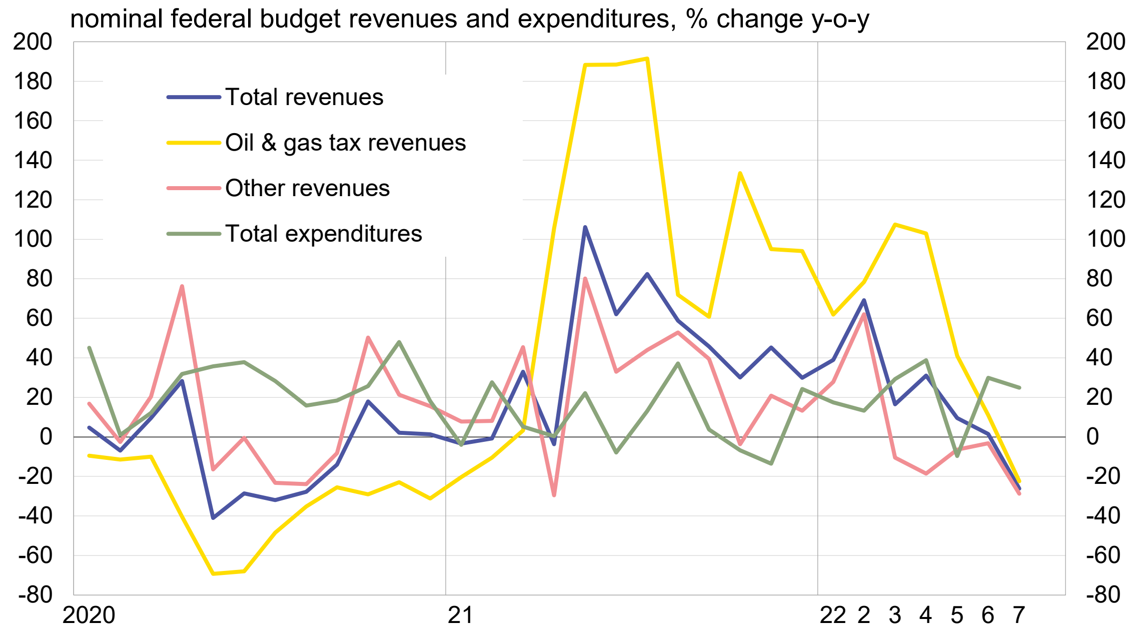
Russia's federal budget sees exceptional drop in revenues in July; spending continues to rise. Federal budget revenues in July declined by 25 % from a year earlier. Tax revenues from oil & gas production, as well as export tariffs on oil, oil products & gas, fell for the first time this year, dropping more than 20 % y-o-y. While the dollar price of Urals blend crude oil was notably higher still in June and July than a year earlier, it was considerably lower in ruble terms from a year earlier. The ruble valuation of oil & gas tax revenues (almost entirely denominated in dollars) has declined in recent months on ruble appreciation. The ruble's exchange rate against the dollar in June-July was up 27 % y-o-y.

Federal revenues other than from oil & gas taxes fell by nearly 30 % y-o-y in July. Budget revenues from imports plunged on the sharp drop in imports and a strong ruble. Revenues from value-added taxes (VAT) on imports were down by about 40 % y-o-y in May-July, while revenues from import tariffs were off by about 60 %. VAT revenues collected from domestic production have swung wildly from month to month this year, despite much less volatile production and consumption. The domestic VAT revenues were up over 50 % y-o-y in May and June, but were down by 40–50 % y-o-y in April and July. The swings in VAT streams probably reflect variations in collection as well as possible fluctuations in VAT refunds.

While it is hard to get information on Russia's federal budget spending at the moment, total budget spending in July was up by 25 % y-o-y. For all of the January-July period, spending growth exceeded 20 % y-o-y, outstripping the inflation rate. Fairly comprehensive information from the Russian Expert Economic Group on the federal budget's large spending categories such as social spending and spending on various sectors of the economy indicates that spending in these categories has increased moderately this year. The rapid growth in other spending suggests fast rise in such major spending categories as defence and domestic security & law enforcement.

Russia's federal budget has turned into red, and the deficit for July was particularly large. For all of 2022, the deficit is on track to hit a couple of percent of GDP if spending increases this year do not exceed 20 % and the price of Urals and the ruble's exchange rate, which affect oil & gas tax revenues, as well as other budget revenues remain at the levels similar to recent months.

Russia's federal budget revenues plummeted in July. Budget spending, in contrast, has risen in recent months



Sources: Russian Ministry of Finance and BOFIT.

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CBR considers ways to support fixed investment and reduce forex dependency. According to the Central Bank of Russia's recent draft documents on 2023–2025 monetary policy and financial market development, a key task of monetary policy and financial markets will be to support the economy's adjustment to a very challenging operational environment. The central goals are to keep inflation moderate (4 % p.a.), provide financing for important investment projects and reduce the reliance of Russia's financial system on "unfriendly countries."

The CBR evaluates that it could introduce various regulatory and other measures to support fixed investment. It states that all public sector support measures should be based on a *taxonomy* with criteria for eligibility favouring projects that promote technological sovereignty and modernisation of the economy. The CBR also wants to see household savings channelled more effectively to funding fixed investment through such measures as increased pension saving, expanding pension fund investment possibilities and greater access of private persons to direct acquisition of corporate shares and bonds.

To mitigate financial system vulnerability, the CBR could introduce regulatory measures that reduce the use of currencies of "unfriendly countries" by the banking sector or as the payment currency in contracts. Moreover, capital controls should be limited to unfriendly countries and international payment possibilities using "friendly" currencies encouraged. The financial sector should increase its use of domestic credit ratings and locally-developed software. The CBR said that it is not planning to acquire the assets of Russian financial institutions that are frozen abroad.

In the CBR's base forecast scenario, Russian GDP is expected to contract by a total of 5–10 % this year and next, and then return to modest positive growth of 1.5–2.5 % a year in 2024 and 2025. The CBR sees private consumption during 2022 and 2023 falling by 5–10 %, while fixed investment should decline by 4–12 %. The central bank also estimates that the volume of exports will fall by 20–30 % and imports by 25–35 %. In its more optimistic scenario, the CBR forecast sees the economy adjust to the harsh operating environment more quickly than expected. Under its pessimistic scenario, world economic growth falters and additional sanctions are imposed on Russian exports. No scenario foresees easing external conditions.

Russia seeks new oil export markets. Russian oil production still showed modest growth early this year, but many of Russia's traditional customers for crude oil reduced their purchases after the Ukraine invasion. The drop in export demand, in turn, led to oil production cuts in April (BOFIT Weekly 21/2022). Although Russia has not released any production figures since, international organisations estimate that Russian oil production has rebounded to near pre-war levels this summer.

The International Energy Agency (IEA) reports that Russian crude oil production averaged 10.5 million barrels a day (mb/d) in 2021. Roughly 4.7 mb/d of crude oil was exported, while 2.8 mb/d was exported in the form of petroleum products. The EU is Russia's biggest export market for both crude oil and petroleum products. The IEA says that Russian oil exports to the EU, UK, US, Japan and Korea have contracted by about 2.2 mb/d since the Ukraine invasion. About two-thirds (1.5 mb/d) has found new buyers (mostly in India, China and Turkey). In total, Russian oil exports have declined by about 0.6 mb/d. The tanker tracking analysis from CREA also indicates that Russian oil exports have declined sharply since the invasion.

The IEA estimates that EU import bans that will be in effect at the start of next year should leave Russia with about 1.3 mb/d of crude oil and 1 mb/d of petroleum products to be sold on markets outside sanctions regimes. Due to the logistical challenges in serving new markets, it is impossible for Russia to reroute the entire volume of exports. Thus, the IEA expects Russian oil production to contract sharply next year. OPEC estimates are more circumspect. They see Russian oil production rising by 1 % this year and contracting by only about 3 % next year. The OPEC forecast also adds a caveat that its estimate contains considerable uncertainty.

About 80 % of Russian oil is exported by sea. For this reason, the ban on insuring ships that transport Russian oil that the EU and UK are currently negotiating, could have huge impact on Russian oil exports globally.

Russia posts declines in gas production and gas exports. Rosstat reports that Russian gas production contracted in the first six months of this year by 7 % from 1H21. Gas giant Gazprom announced that its gas production was down by 12 % y-o-y in January-July. Gazprom, which accounts for about two-thirds of Russian gas production, holds a monopoly on pipeline gas exports. The significant drop in Gazprom's gas production largely reflects declines in export volumes. Gazprom says that its exports to Europe (including Turkey) fell in January-July by 35 % y-o-y. Although exports to China have grown rapidly, volumes remain quite modest.

Gas exports to EU countries collapsed this summer. Gas transmission via the Yamal pipeline running through Poland has halted altogether, while transmission via Ukraine now is limited to a single compressor station (Sudzha). In addition, a small fraction of the capacity available for the NordStream 1 pipeline, which runs along the bottom of the Baltic Sea to Germany, remains in use. EU pipeline gas imports from Russia were down in July by about 75 % y-o-y. Dramatic production cuts are inevitable for Gazprom if exports remain at this low level.

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BP figures show that Russian gas exports in 2021 totalled 241 billion cubic metres. Of that, 202 billion m^3 was traditional pipeline gas. About 83 % (167 billion m^3) was exported to Turkey and Europe, 13 % to former Soviet states and 4 % to China. Roughly 40 billion m^3 of liquefied natural gas (LNG) were exported from the Sakhalin island and Yamal peninsula. About 44 % of Russia's LNG exports go to Europe, 22 % to Japan and 6 % to China.

Russian gas exports are very dependent on the European market. The sole export pipeline running to Asia, the Power of Siberia pipeline to China, has yet to reach full capacity. When the Power of Siberia pipeline reaches its full capacity of 38 billion m^3 a year, China could account for 20 % of Russia's gas exports. The share of gas going to China can rise higher than that over the next few years only if gas exports to Europe correspondingly decline. Under current plans, a second export pipeline to China, the Power of Siberia 2 pipeline, would be in operation in 2030 at the earliest. Even with the completion of the new pipeline, China could take about up to half of the gas volume exported by Russia to Europe before the war.

Gazprom's shut-offs and reductions in gas transmission have caused gas prices to spike to record levels in the EU. The rise in gas prices has temporarily offset the losses to Gazprom caused by the decline in export gas volumes.

Ukrainian Black Sea grain shipments resume with UN-brokered agreement between Ukraine and Russia. On July 27, 2022, Ukraine, Russia, Turkey and the UN signed an agreement allowing resumption of Ukrainian grain exports, as well as Russian fertiliser and food exports, via the Black Sea even as the war in Ukraine continues.

Under the agreement, three Ukrainian ports (Odessa, Chornomorsk and Pivdennyi) will be kept open for cargo ships. Ukrainian vessels will escort cargo ships into international waters of the Black Sea to the Bosporus Strait in order to assure that the ships avoid mines set in the course of the Ukraine war. The cargo ships are then inspected in Istanbul and permitted to proceed on their own after clearing inspection. Ship inspections are performed by a team organized by the Joint Coordination Centre, including officials from Ukraine, Russia, Turkey and the UN. The agreement includes restrictions and rules on how the cargo ships must move on the Black Sea and types of permitted cargoes.

By 18th August, 18 cargo ships have departed from Ukrainian ports. Their arrival to the ultimate destinations have raised concerns, however. The first ship to leave Ukraine had sailed for Lebanon, but on August 15 docked in Tartus, Syria, home to a Russian naval base.

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China

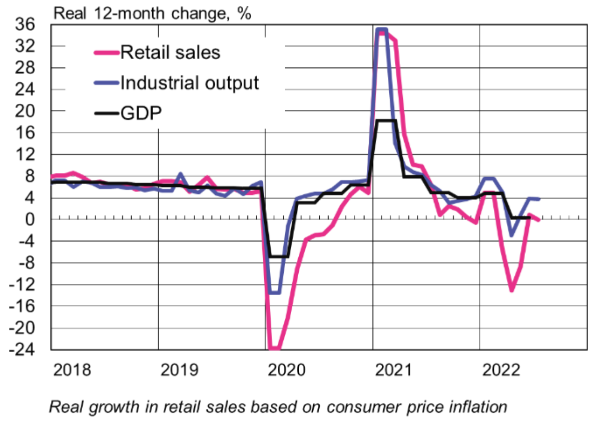
China's economy continued to sputter in July. With consumers uncertain about the future and a troubled real estate sector, July economic growth underperformed June across the board. Retail sales, a rough indicator of private consumption trends, rose by just 2.7 % y-o-y in nominal terms. China does not release real trade growth figures, but it can be inferred from July's consumer price inflation number of 2.7 % that real growth was close to zero. Total service sector output in July contracted from June, and was up by only 0.5 % from a year earlier.

Nominal fixed investment in the first seven months of this year rose by 5.7 % y-o-y. In January-June growth was still over 6 %. Investment in infrastructure increased by over 7 % y-o-y in January-July, while real estate investment contracted by more than 6 %. July real estate sales (measured in terms of both floorspace and yuan) were down by about 30 % y-o-y, and new building starts were down by 45 % y-o-y. The decline in China's real estate sector has lasted about a year. Most larger cities saw slumping apartment prices last month.

July industrial output growth was about the same as in June (up 4 % y-o-y), and driven mainly by energy production and mining & quarrying activity. Manufacturing growth, in contrast, slowed by over half a percentage point from June to less than 3 % y-o-y. Certain green energy products such as electric vehicles and solar panels, however, experienced strong growth in July.

Robust export growth boosted China's foreign trade figures. The value of exported goods in July climbed to 330 billion dollars, an increase of 18 % y-o-y. Low domestic demand kept import growth fairly restrained. The value of goods imports totalled 230 billion dollars, up 2 % from a year earlier. China is unlikely to sustain its blistering export growth in the coming months as China's main export markets see faltering consumer demand and lower economic growth due to eroded purchasing power and the challenges of dealing with high energy prices.

China's economic growth remained modest in July



Sources: NBS, Macrobond and BOFIT.

China's central bank lowers interest rates; inflation rate still below official target ceiling. On August 15, the People's Bank of China (PBoC) lowered its key policy rates for the second time this year (the first cuts were in January) in response to July's weak economic indicators. The medium-term lending facility rate (1-year MLF) was dropped by ten basis points to 2.75 %, and the 7-day reverse repo rate used in PBoC operations fell to 2 %. The central bank's MLF programme provides commercial banks with secured medium-term credit. On Monday (Aug. 22), the PBoC also cut its lending prime rate (LPR) in an effort to stabilise the economy. The 1-year LPR was reduced by five basis points to 3.65 %. The 5-year LPR, which is used as the reference rate for housing loans, was lowered 15 basis points to 4.3 %. The cut in the 1-year LPR was the first since January, while the 5-year LPR was last reduced in May. The purpose of the rate cuts is to ease the interest burden on debtors and bring relief to the struggling housing market.

Consumer price inflation rose to 2.7 % p.a. in July (2.5 % in June), but was still low enough to permit monetary easing measures. The government has set a 3 % ceiling for its inflation target this year. Most of the inflationary pressure in July came from rising food and energy prices. Slowing economic growth kept price increases at bay in other sectors. Core inflation, which does not include prices of energy or food, decreased to 0.8 % in July (from 1 % in June). July producer price inflation was down by nearly two percentage points from June to just 4.2 %.

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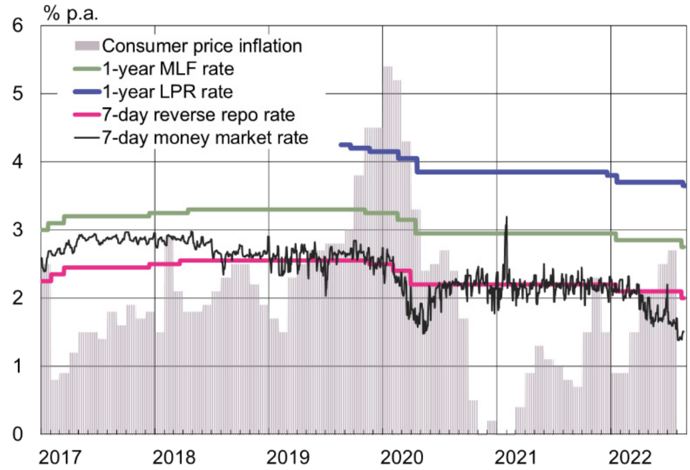
China's main policy interest rates and market rates have all dipped recently



Sources: CEIC, PBoC, National Interbank Funding Center and BOFIT.

Drought leads to hydropower production issues and restrictions on electricity use in China. China experienced a record heat wave in recent weeks that led to record high temperatures and drought in central and southern China. This has especially affected the province of Sichuan which depends heavily on hydropower for electrical power generation. Approximately 80 % of all power produced in Sichuan is generated at local hydropower plants. With river levels dropping, the provincial government has limited electricity use in homes, offices and shopping centres, and called on factories using large amounts of electricity to shut down operations for a week. The disruptions affect especially producers of metals, fertilisers, semiconductors, automobiles and batteries.

The power shortages have also affected provinces on China's eastern parts that depend on Sichuan hydropower, including Shanghai, Zhejiang and Jiangxi. At the start of this week, Shanghai shut off lights from its landmarks on the Bund and measures have been reported also in the provinces of Jiangsu, Anhui and Zhejiang, some of which have imposed restrictions on factories, reduced lighting on public spaces and called for citizens to save electricity. However, electricity rationing itself is nothing new for China. Just last winter, provinces across China imposed restrictions on electricity use to deal with shortfalls in coal supplies (BOFIT Weekly 40/2021).

Hydropower, currently China's biggest source of renewable energy, accounted for about 16 % of the country's electricity production last year. Sichuan province is the largest producer, accounting for 26 % of all electricity generated with hydropower. Overall Sichuan's hydropower plants generate about 4 % of China's total electricity supply. The problems of recent weeks have highlighted possible vulnerabilities related to hydropower, raising doubt about its dominance as a renewable energy source. In addition to summer heat swings, the dry inland winter season can limit hydropower generation.

To assure energy security in the future, China has to also rely on other energy sources to generate electricity. Most of the production still relies on non-renewable energy sources, which does not fully align with China's climate targets. Over 60 % of China's electricity production is generated with coal. Despite large investments, wind power last year generated just 7 % of China's electricity while solar represented 2 %.

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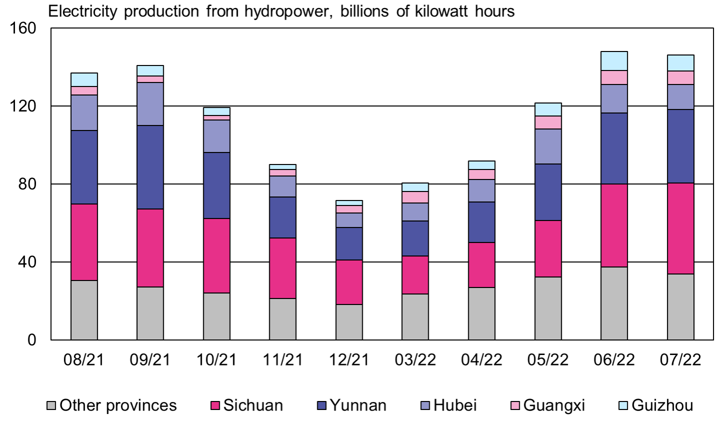
Most of China's hydropower generation comes from southern China, where risk of fluctuating temperatures and droughts has increased



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

China takes on struggles of small banks. Last spring, five smallish banks in the Henan and Anhui provinces suddenly refused customer access to their deposits. It eventually emerged that this was caused by a massive embezzlement scheme. According to media reports, deposits were transferred to the bank's largest shareholder on the basis of falsified lending contracts. The freeze on deposits touched off a wave of protests that lasted almost three months. Officials eventually promised that small depositors would be repaid. Hong Kong's *South China Morning Post* reported this week that many small depositors, who should have already been repaid their deposits, are still waiting.

Official actions have been scrupulously monitored as China has a huge number of small banks. The fear is that a broad swath of depositors will begin to pull their assets out of small banks, which could quickly escalate to larger problems. In mid-June, officials tried to calm depositors by announcing that the risk exposures of other small banks were under control. China established deposit insurance scheme in 2015 and it should cover close to all bank deposits.

The plight of China's small and mid-sized banks entered the public discussion with the failure and seizure of the regional Baoshang Bank in 2019. Since that event, the government has stepped in to rescue a number of small and mid-sized banks, and spent at least 500 billion yuan on clean-ups by autumn 2020 (BOFIT Weekly 40/2020). The government feared that the covid pandemic would drive more banks into difficulties as some borrowers have suffered profoundly from covid shutdowns and other restrictions, and for which insolvency seems inevitable. The supports offered to firms in form of cheap loans and temporary suspensions of payments on principal and interest may also have weakened the quality of bank lending portfolios. Officials encouraged small and mid-sized banks a couple of months ago to acknowledge and jettison non-performing loans (NPL) on their balance sheets. To help off-load NPLs, the China Banking and Insurance Regulatory Commission (CBIRC) relaxed its rules in July to allow the country's large bad banks to help small and mid-sized banks by taking over their non-performing assets. China is also building up a financial stability fund to deal with systemic risk.

The bulk of China's banking sector is controlled by four massive partly-state-owned banks. While they garner most media attention, China has over 4,000 smaller banks. Much of the banking sector's rapid growth over the past decade came from small and mid-sized banks, as well as shadow banking activities. Over the past five years, banking sector growth has calmed and total assets of the banking sector have increased at about the same rate as nominal GDP growth. Shadow banking has been on the decline for several years due to tighter regulation of the sector. Foreign banks play a minor role in China's banking sector.

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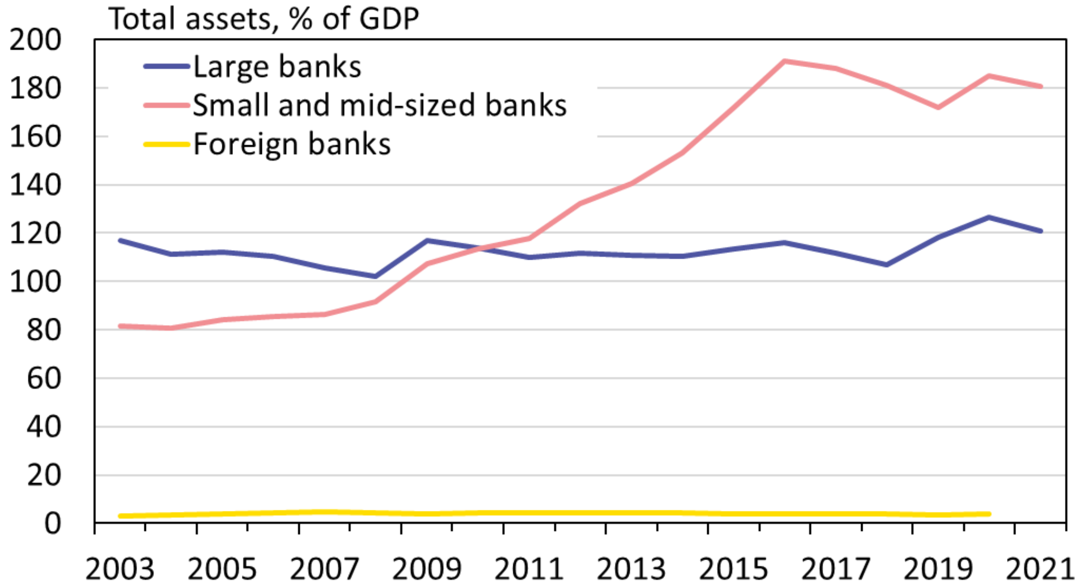
China's small and mid-sized banks experienced relatively high growth in the previous decade



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

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Russia

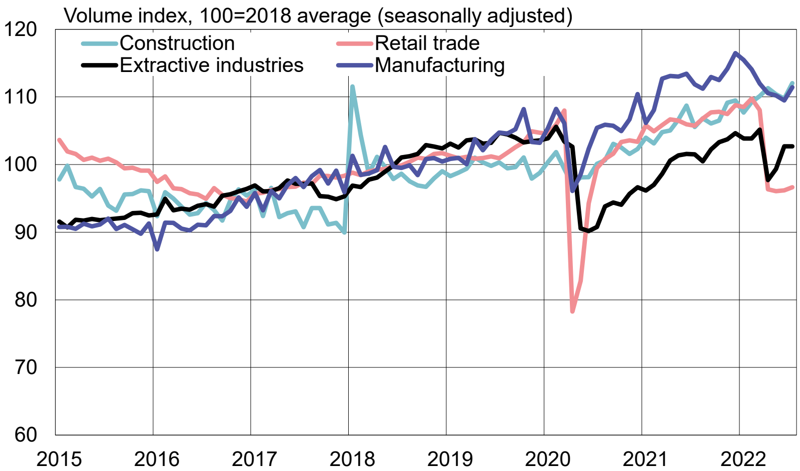
Russian economic trends seem to have stabilised in July. Although retail sales and many branches of manufacturing experienced weaker growth in July, the Russian economy garnered support from oil production and construction activity. The preliminary assessment from Russia's economic development ministry shows GDP contracted by 4.3 % y-o-y in July and 1.1 % y-o-y for the first seven months of this year.

While retail sales, a rough indicator of consumer trends, have plateaued in recent months, the volume of retail sales in July was still down by 9 % y-o-y. Even with inflation cooling slightly in recent months, July consumer prices were still up by 15 % y-o-y. Rosstat's preliminary estimate for June shows that the average real wage contracted by 5 % y-o-y, while real disposable household income fell by 1 % in 2Q22. Labour market conditions have remained stable. Unemployment in July remained near a historical low of 4 %.

Industrial output contracted in July by just 0.5 % y-o-y. Extractive industries helped cushion the blow, however, posting positive growth in 1 % y-o-y in July. Crude oil production grew by 3 %, while production of liquefied natural gas (LNG) was up by 25 % y-o-y. Other natural gas production contracted by 24 %. Russian crude oil exports have performed strongly in recent months, while pipeline gas exports have collapsed. Manufacturing output overall contracted in July by 1 % y-o-y, but output trends fluctuated widely from industry to industry.

Construction and agricultural production supported growth in July. Construction activity increased by 7 % y-o-y in July, while agricultural output rose by 1 %. The transportation sector faltered with freight volumes falling by 5 % y-o-y.

Construction and extractive industries have supported Russian economic output, while retail sales and manufacturing trends were weaker



Sources: CEIC, Rosstat and BOFIT.

Russia facing harsher economic outlook for the rest of this year. The preliminary figures from Rosstat show Russian GDP contracted by 4 % y-o-y in the second quarter. Thanks to strong growth in the first quarter, however, GDP was down by just 0.4 % y-o-y in the first half. International research institutions and Russian forecasters all expect the Russian economy to shrink much further in the second half of this year.

Russian GDP forecasts have shifted somewhat in recent months, moving the time when the Russian economy hits bottom further into the future. Forecasters now expect a bit more modest economic decline this year and a bleaker outlook next year. Most forecasts put the contraction of the Russian GDP somewhere in the range of 5–8 % this year and 2–4 % next year. BOFIT's updated *Forecast for Russia* comes out at the end of this month.

Russia's booming current account surpluses are expected to continue both this year and next. The latest Consensus Economics survey of major forecasts finds an average current account surplus of 196 billion dollars this year and 124 billion dollars next year. The Central Bank of Russia expects the current account surplus to hit 243 billion dollars this year and 125 billion dollars next year. The CBR preliminarily puts the current account surplus for the first seven months of this year at 167 billion dollars.

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Recent Russian GDP forecasts for 2022–2023 (change in volume of GDP)

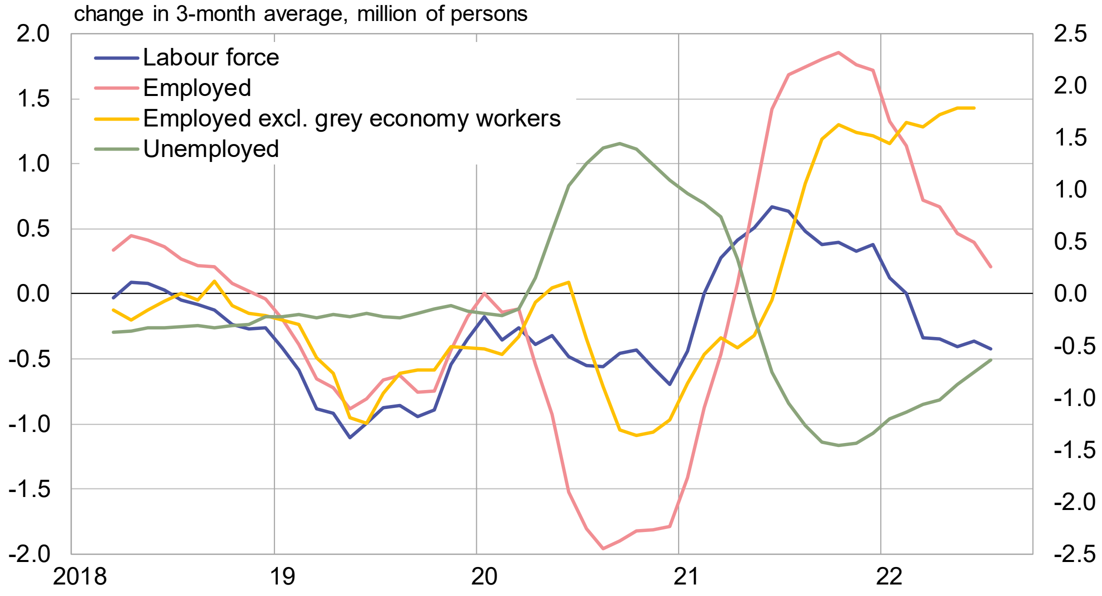
	2022	2023
IMF (7/2022)	-6.0 %	-3.5 %
Consensus Economics (8/2022)	-6.9 %	-2.6 %
CBR (8/2022)	(-6) –(-4) %	(-4)-(-1) %

Employment in Russia has continued to rise. Rosstat's second-quarter labour force survey finds that the number of employed persons rose further on-year despite the economic downturn. On the other hand, the increase in the number of employed persons that has continued for over a year has slowed substantially over the course of this year. About 72 million persons were employed in Russia in the second quarter, and the employment rate for the 15–72-year-old cohorts was 65.5 %. The survey is based on the International Labour Organization (ILO) methodology.

The number of unemployed persons continued to fall in the second quarter, but at a slower rate than last year and in the first quarter. Russia had fewer than 3 million unemployed persons, less than 4 % of the labour force. A significant upsurge in part-time workers (less than 40 hours a week), however, continued. The number of persons who potentially could enter the labour force (persons not actively seeking a job but ready to work) continued to fall, standing at around 1 million in the second quarter.

The number of persons working in the formal labour market has increased briskly this year, a pattern somewhat atypical during Russian recessions. Like in previous recessions, however, the number of persons employed in the grey economy has dropped sharply. Of the over 13 million persons working in the grey economy in the second quarter, about 95 % worked exclusively in the grey economy. The latter group represents about 17–18 % of all employed persons.

The number of employed persons in Russia has continued to rise, albeit more slowly than last year and early this year



Sources: Rosstat and BOFIT.

EU ban on imports of Russian coal goes into effect. The EU's ban on imports of Russian coal entered into force on August 10. The EU decision to ban Russian coal, which was made last April, included a transition period to allow EU countries to continue importing Russian coal under existing contracts, but permitted no new agreements. The ban on Russian coal imports was adopted by the EU, UK and the US. Japan and South Korea have announced that they are also limiting the amounts of coal they import from Russia. Over a quarter of Russia's coal exports went to EU countries in 2021, and about 20 % to South Korea and Japan. China accounted for just under 25 % of Russia's coal exports.

Rosstat reports that coal production fell by 2 % y-o-y in the January-June period. Information taken from various sources suggest that Russian coal exports have yet to decline at all. Instead, the growth emphasis has shifted the EU to Asia. Much of the export growth has been driven by huge discounts on the price of Russian coal. The gradual loss of Western customers has forced Russian coal producers to cut their export prices in a manner similar to Russian crude oil sales on the world market. The discounts on Russian bituminous (black) coal relative to bituminous coal produced elsewhere hit record levels in spring and summer.

As of August 10, EU sanctions also ban the provision of financial services and insurance to vessels that transport Russian coal, regardless of destination. The move has caused a major upheaval in the maritime insurance industry and could well impact Russian coal exports overall. Nearly all Russian coal going to Asia must travel by ship. Media reports suggest that the maritime insurance ban has halted exports almost entirely in recent weeks.

Coal exports only have a marginal significance to the Russian economy as a whole, but they are critical at the local level. The rise in Russian coal production has been driven by exports. In recent years, about 60 % of Russia's coal output has been exported. Production is concentrated in Western Siberia, particularly the Kemerovo oblast. Coal production is dominated by a few large energy and coal companies. The roughly 30 *monogorods* (single-industry towns) that produce coal are largely sustained by their earnings from coal exports.

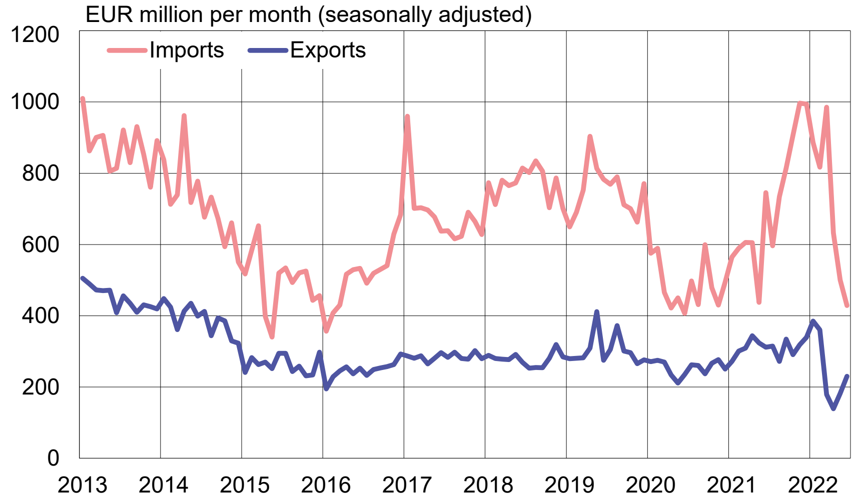
Finnish goods trade with Russia falls by half. Since March, the value of Finnish exports to Russia has fallen to about half of pre-invasion levels. After a massive drop in April, however, exports recovered slightly. For the first half of this year, Finnish exports to Russia were down by 23 % y-o-y. In the wake of Russia's invasion of Ukraine, i.e. March-June, Russia's share of Finnish exports fell to less than 3 %.

The value of Finland's imports from Russia has also fallen by about half in recent months from pre-invasion levels. Measured by volume, many crucial import goods such as crude oil and petroleum products has contracted even more, but the value of such imports has been sustained by high prices. Indeed, the value of Finland's imports from Russia was up in January-June by 24 % y-o-y. Russia accounted for 7 % of Finnish goods imports in March-June.

EU exports to Russia in March-June were down by about 50 % from pre-invasion levels. The European Commission reports that sanctions imposed on EU exports to Russia cover about 28 % of all EU exports to Russia. The overall value of EU imports from Russia actually increased slightly during the period on soaring commodity prices after the invasion of Ukraine. The European Commission estimates that the current EU sanctions regime on Russian imports applies to 51 % of EU imports from Russia.

Some of the sanctions now in force had yet to enter into force in June. For example, the restrictions on imports of timber and wood products only entered into force in July and the ban on coal only in August. The import ban on crude oil enters into force in December, while the ban on importing petroleum products is set for February 2023.

Finland's goods trade with Russia has declined by about 50 % since Russia's February invasion of Ukraine



Sources: Finnish Customs, BOFIT.

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China

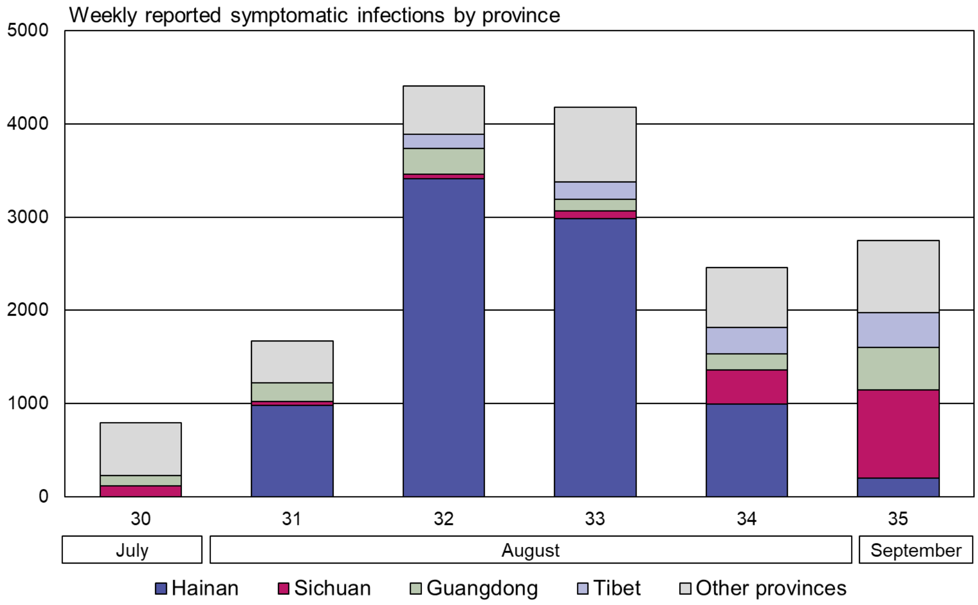
Covid hotspots strain China's provincial economies. While covid case numbers in mainland China have remained modest by international standards in recent months, regional lockdowns and clusters of infections have been on the rise in recent weeks. Several major cities were put into lockdown last month, and the situation has worsened lately. Covid rules still complicate travel within China and have interfered with the start of schools this autumn. Nevertheless, China has not wavered from its "zero covid" policy, and the negative economic effects from rolling lockdowns are expected to continue.

Sichuan province seems to be getting the worst of it at the moment. The 21 million residents of Chengdu, the provincial capital, have been ordered to stay in their homes. No end date has been announced for the end of the lockdown in Chengdu, the largest Chinese city to face a lockdown since Shanghai in May. Additionally the province suffered a 6.8 magnitude earthquake this week. Chengdu residents were unhappy with covid policies that forbid them from leaving their residential areas even during the earthquake.

Hainan Island, where covid cases began to rise in early August, has also become a cluster of infections. As the island is a top travel destination for mainland Chinese, the measures put in place left thousands of tourists stranded. To deal with the situation, Hainan's local government ordered hotels to offer stuck tourists a 50 % discount on their room rates. The Hainan case highlights the covid-era risks of domestic tourism and may partly explain why domestic tourism has yet the recover to pre-pandemic levels. China's three-day Mid-Autumn Festival, which kicks off tomorrow (Sept. 10), is expected to increase domestic travel significantly this weekend.

Several other provinces have witnessed local lockdowns and infection outbreaks. Last month, Tibet and Xinjiang reported infection chains that likely originated with domestic tourists. The number of infections in Guangdong province continues to rise, and two of China's biggest cities, Shenzhen and Guangzhou, have imposed restrictions on certain city districts. Many universities have also prohibited students starting the autumn semester from leaving campus.

China's covid infections were highest in Hainan province in August. This month has seen rising infection rates in Sichuan and Guangdong provinces



Sources: China Center for Disease Control and Prevention, CEIC and BOFIT.

China posts large current account surplus in first half; capital outflow continues. China's preliminary balance-of-payments figures show a current account surplus of 80 billion dollars for the second quarter. China's goods exports have boomed throughout most of the covid pandemic, while the services trade deficit has shrunk as most Chinese cannot travel abroad. The result is a robust trade surplus overall. The second-quarter goods trade surplus was 176 billion dollars, while the services deficit was 21 billion dollars. Correspondingly, the capital account deficit has risen in recent years as foreign

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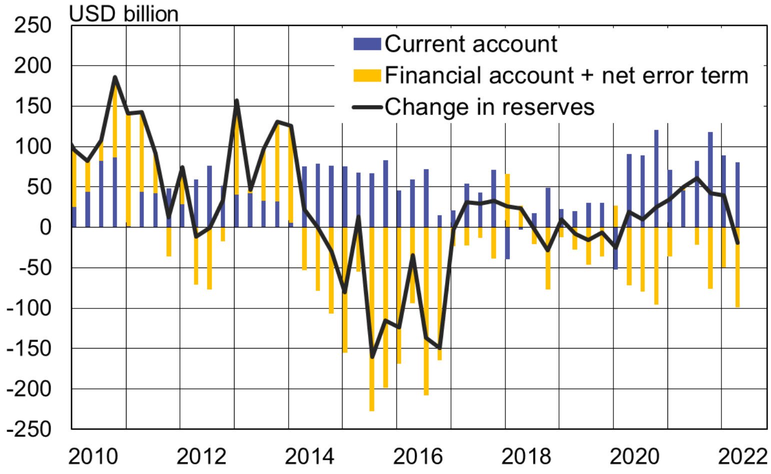
investment in China has been more profitable than Chinese investment abroad. The Chinese also cut back on their foreign investment during the pandemic.

The financial account shows that foreign direct investment outflows from China exceeded FDI inflows in the first six months of this year. The second quarter FDI surplus (15 billion dollars) was smaller than in the first quarter (60 billion dollars). Although the current account and FDI entry were both positive, China's foreign currency reserves fell by 19 billion dollars in the second quarter. Thus, it seems that capital has been flowing out of China either on record (through other investment categories in the financial account) or off record (net errors and omissions term). More detailed financial account information, along with revised current account items, will be released later. The figures for the Stock Connect and Bond Connect programmes also indicate that the net outflow of capital from China has persisted since February. The outflow of capital has picked up as the economy has been losing steam, and the PBoC's monetary policy stance is diverging from the US in particular, which has recently seen large rate hikes from the Federal Reserve.

During 2020–2021, the value of China's foreign currency and gold reserves increased rapidly as the economy bounced back from the Covid Recession in spring 2020 and strong export sector growth boosted the current account surplus. However, China's reserve assets have shrunk this year. They were down by nearly 200 billion dollars from the start of the year, standing at about 3.05 trillion dollars at the end of August.

China's main balance-of-payments categories and change in reserve assets



Sources: SAFE, Macrobond and BOFIT.

United States and China reach initial agreement on reviewing financials of US-listed Chinese firms, but bilateral tensions persist. On August 26, the United States and China announced that they had reached agreement on a dispute that had threatened to force Chinese firms to depart US stock exchanges if they did not open their audits to US officials for inspection. As US officials have yet to conduct inspections of the audit documents, it remains unclear whether any Chinese firms will be delisted from US exchanges. Tensions between the two counties were recently exacerbated by the Taiwan visit of Nancy Pelosi, the US House of Representatives speaker, and new measures announced by the US intended to impede the development of China's high-tech sector.

The accounting dispute was becoming an acute issue for Chinese firms listed in the US. The three-year deadline for audit compliance was approaching under a US law passed in 2020 mandating audit inspections for all listed firms (BOFIT Weekly 50/2020). Chinese officials continued to insist that the audit documents of Chinese firms are confidential and should be stored in China. The dispute on auditing rules has been the subject of talks going back decades. With agreement reached, US officials can this month travel to mainland China and Hong Kong to begin inspection of the audits of the listed firms. The firms have used 16 different accounting firms that are subject to the inspections. The inspections must be completed by November so that officials have time to write up their findings before next year's deadline. It is still unclear whether the officials will be able to meet their deadlines.

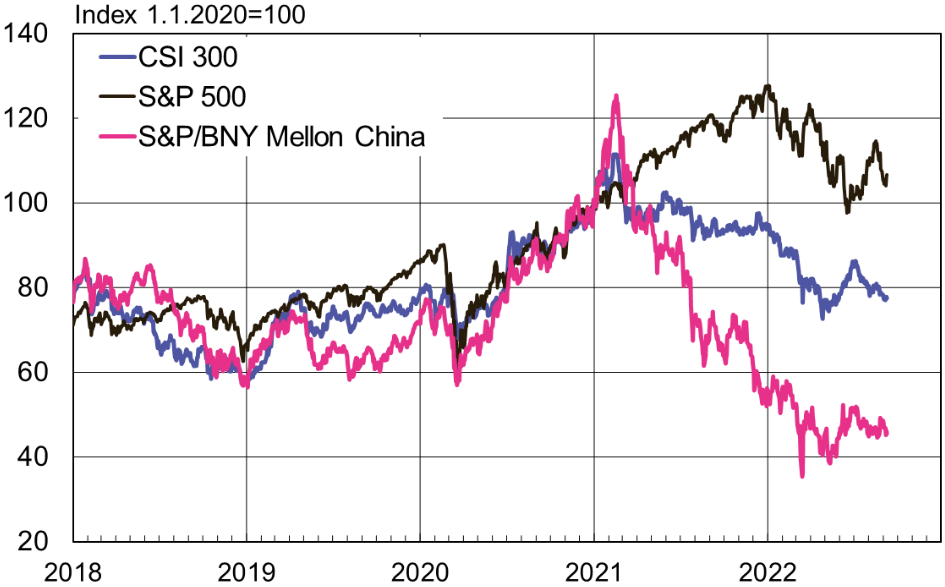
Officials report that nearly 170 Chinese firms could face delisting from US exchanges. In August, five large Chinese state-owned enterprises (Chalco, China Life, PetroChina, Shanghai Petrochemical and Sinopec) announced that they were voluntarily leaving the New York Stock Exchange. As of last March, the main US stock exchanges (NYSE and NASDAQ) listed a total of 261 Chinese firms, with a combined market cap of $1.3 trillion. Some of these firms, however, use auditors outside China, where US officials can inspect their audits and therefore do not face a risk of having trading in their shares suspended. The audit disclosure disputes, technology export restrictions and heightened tensions between the two countries have depressed prices of Chinese shares listed on US exchanges.

The US has tightened its technology export restrictions for China in recent months. Citing national security concerns, the US added seven Chinese aerospace and semiconductor firms to its entity list in August. US firms are banned from doing business with firms on the list. Five other Chinese firms, which were put on the entity list already in July, were the first firms to be added on the basis of allegedly supporting Russia's military. According to media reports, the export restrictions on microchips to China have been tightened to affect a broader share of high-tech chips.

In August, the US Congress passed a law to encourage domestic production of semiconductor chips and related research (CHIPS and Science Act). The broad financial package is hoped to attract new high-tech investment to the US. The act is also geared to reining in China's development by requiring firms that benefit under the act to refrain from investing in advanced semiconductor production in China for the next ten years.

There are no signs that China-US trade frictions are easing. While US is conducting a review of the tariff hikes imposed by president Trump during 2018 and 2019, the tariffs remain in place. Policymakers in the US apparently discussed the possibility of lowering tariffs as a way to cool inflation, but media reports suggest that the plan was subsequently abandoned. China is also keeping its punitive tariffs on US products in place for the time being.

The index of Chinese firms listed on US exchanges (S&P/BNY Mellon) has underperformed both the US S&P 500 and China's CSI 300 indexes



Sources: Macrobond and BOFIT.

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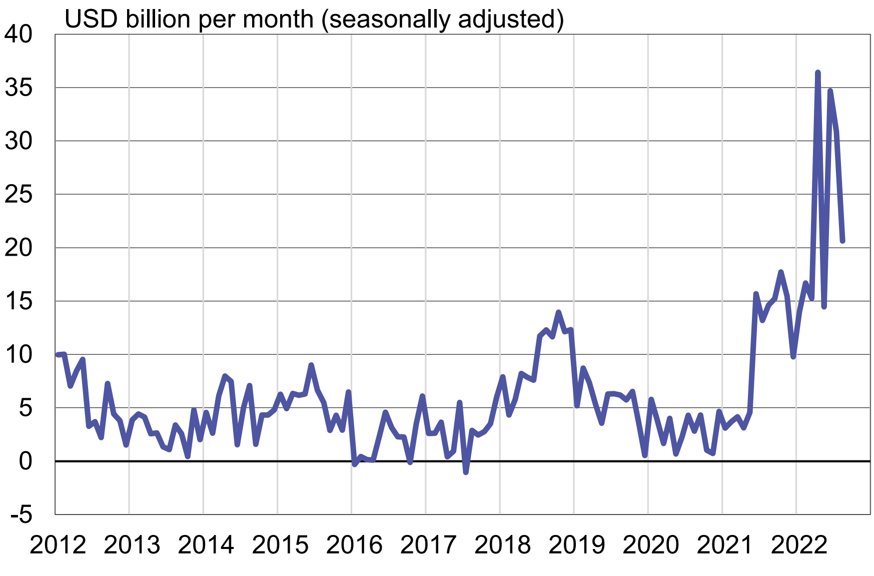
Russia

Russia posts another large current account surplus in August. Preliminary figures from the Central Bank of Russia show an August current account surplus of 16.5 billion dollars. While surplus was smaller than in some previous months, it was still high compared to long-term average. The cumulative January-August surplus was about 180 billion dollars. Russia's current account surplus has fluctuated wildly in recent months. This is likely due to the exceptional circumstances of war in Ukraine, but could also reflect data issues. In post-invasion months, Russian Customs ceased to release foreign trade data and the CBR has shifted to reporting a bare-bones version of balance-of-payments data.

A just-released BOFIT Policy Brief attempts to create a broad picture of Russian foreign trade in the first four months following the invasion of Ukraine. As Russia has ceased to release trade figures, the analysis draws on the mirror trade figures of Russia's main trading partners. Russian imports contracted sharply after Russia attacked Ukraine, but recovered somewhat by June. Even so, the value of imports in June was still down by nearly 40 % from the pre-war level. Imports of technology products plunged dramatically. Export restrictions imposed by the EU, US and other countries have focused on exports of high-tech products to Russia.

On the other hand, Russian export revenues have risen after the invasion due to soaring commodity prices. As many EU import bans on Russian goods have transition periods, the impacts of such bans in the early months of the invasion were limited. For example, the ban on imports of Russian crude oil is set to enter into force this December, and the ban on imports of Russian petroleum products only takes effect in February 2023. The volume of Russian crude oil imported by EU countries has declined to some extent in recent months, but this has been offset by the increase in import volumes of China and India.

Russia continued to post a large current account surplus in August



Sources: Macrobond, Central Bank of Russia and BOFIT.

Russia's federal budget revenues down in August. Nominal federal budget revenues were down by about 10 % y-o-y in August. Part of the revenue drop was cushioned from the July fall by a relatively small 3 % decline in oil & gas tax revenues. The price of Urals blend crude oil was about 9 % higher in July and August compared to a year earlier. The ruble-value of oil & gas tax revenues (almost entirely defined in dollars), however, saw a downward impact from the fact that the ruble was about 25 % higher on-year against the dollar. Oil sector production and exports have avoided a downward slide in recent months.

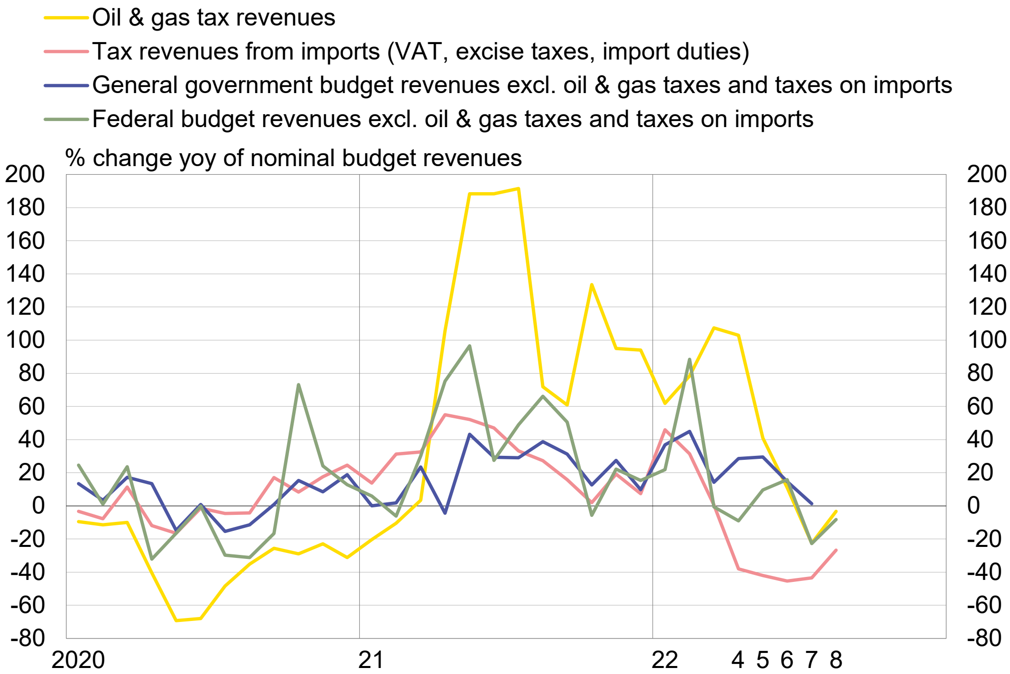
The decline in federal budget revenues other than from oil & gas taxes moderated in August to about 14 % y-o-y. The moderation, however, came completely from sharply higher value-added tax collections from domestic production. VAT gives a large revenue stream, but the monthly collections have varied very strongly this year. Even with a lower decline of revenues from taxes levied on imports, the rate of decline remained substantial. All other federal budget revenues were also deep down.

Revenues to the government sector budget overall (excluding tax revenues from oil & gas taxes and taxes on imports) have performed better than the federal budget this year. Regional and local budget revenues experienced robust growth in spring. Government sector revenue streams, however, weakened significantly in summer as revenues to state social funds turned clearly lower than a year earlier. The rise in revenues to regional and local government budgets also slowed considerably.

On-year growth in nominal federal budget expenditures was exceptionally slow in August. Growth for the January-August period was 20 % y-o-y. Calculating from available partial data, observers indicate that undisclosed federal budget spending rose sharply this year, suggesting an unavoidable increase in defence spending by as much as 50–70 %. In any case, the federal budget surplus for January-August was already quite small, and the last 12-month period saw a slight deficit.

Overall government sector budget expenditures rose in January-July by well over 20 % y-o-y. The rise accelerated notably in the second quarter as large amounts of supplemental spending from regional and local budgets went especially to supporting various economic sectors. Even if non-pension social spending rose sharply in the second quarter, the rise in total spending of state social funds cooled and considerably lagged inflation.

Russia's government sector revenues have performed weakly in recent months



Sources: Russian Ministry of Finance and BOFIT.

Russian GDP falls, but trends vary widely across individual sectors. Recently revised Rosstat figures show that Russian GDP fell by 4.1 % y-o-y in the second quarter. The estimate for first quarter GDP growth remained unchanged at 3.5 %.

Economic growth trends varied wildly from branch to branch in the second quarter. Manufacturing value-added fell by 4 % y-o-y, while wholesale and retail sales were down by 14.1 %. Extractive industry value-added declined by 0.8 %. Construction activity was up by 3.4 % and public services grew by 5 %.

Second-quarter GDP (seasonally adjusted) contracted for the second consecutive quarter, falling by 1.9 % q-o-q. First-quarter GDP fell by 0.3 % q-o-q. The contraction of the Russian economy began well before the invasion of Ukraine as GDP level peaked in 2Q2021. The contraction in Russian GDP was much faster in the first half of this year than in 2014, when Western countries imposed sanctions of Russia e.g. for the illegal annexation of Crimea.

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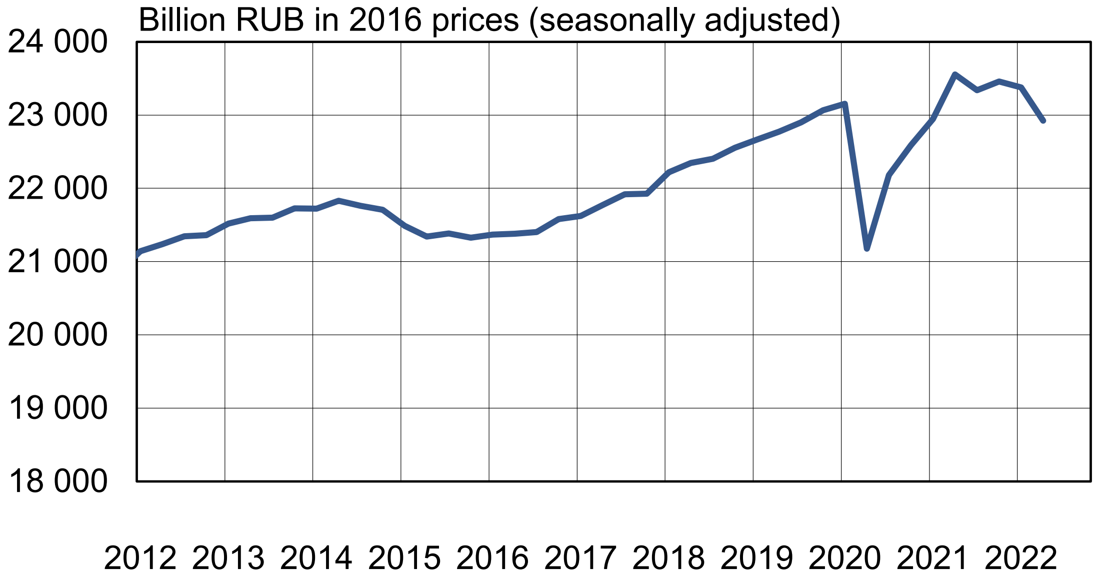
Russian GDP has declined this year



Sources: Macrobond, Rosstat and BOFIT.

Russian pipeline gas exports to EU effectively cease. On September 2, Gazprom shut off all gas flow in the Nordstream 1 gas pipeline running along the bottom of the Baltic Sea from Russia to Germany. Gazprom said the reason for the shutdown was technical. Kremlin press secretary Dmitri Peskov said the gas cut-off was retaliation for Western sanctions. In any case, the shut-off surprised no one; Nordstream had operated at fluctuating capacity all summer.

Gazprom has been reducing its pipeline gas exports to the EU for about a year. The gas giant last spring began dragging its feet on replenishing its own gas storage facilities in Europe. In October 2021, Gazprom ceased selling its gas on spot markets, causing gas market prices to rise in Europe. Russia halted in April its gas transmission via the Yamal-Europe pipeline running through Poland. In May, gas flows via the Sokhranvika metering station on the Ukraine-Russia border were shut down due to war activity. With Nordstream 1 offline, only a small amount of Russian pipeline gas transmitted via Ukraine or Turkey presently reaches EU countries. According to a Gazprom press release, the company's exports to the EU in January-July contracted by 50 % from the 2021 level.

EU countries have largely succeeded in finding alternatives to Russian pipeline gas. Eurostat reports that EU gas imports only declined by 3 % y-o-y during first six months of 2022.

The collapse in demand for gas exports to Europe is reflected in Russian gas production. While gas production was only down by 5 % y-o-y for the first half of this year, it fell by 24 % in July. The collapse in exports is clearly evident in Gazprom's production figures, which saw output decline by over 30 % y-o-y in June, July and August. The dramatic declines in production levels indicate that Russia has completely filled its available storage facilities. Russian gas production needs to be lowered considerably for the rest of the year if exports to the EU remain at August levels.

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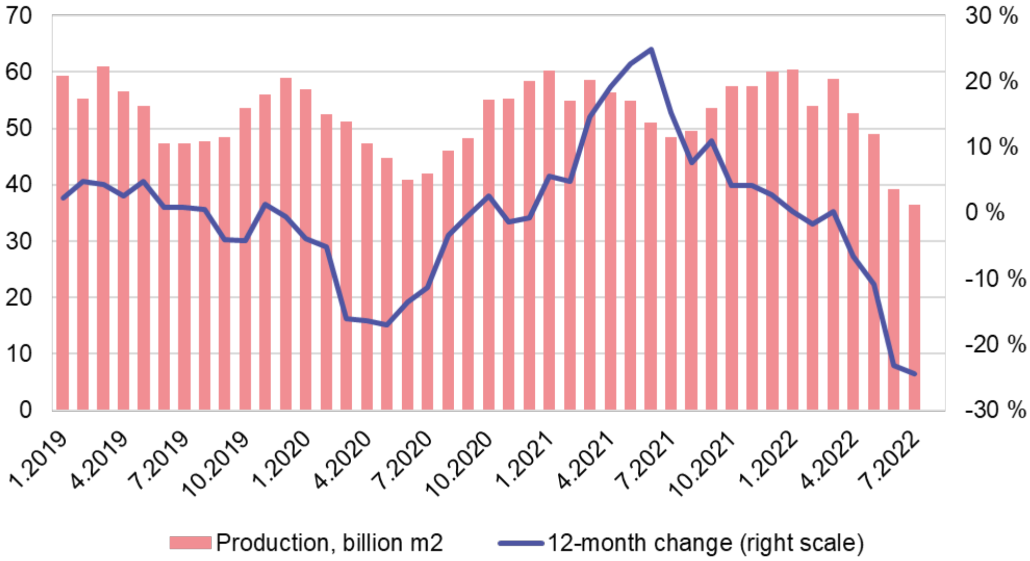
Russian natural gas production has fallen rapidly in recent months



Sources: Rosstat, CEIC, BOFIT. Production figures do not include associated gas extracted from oil wells.

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China

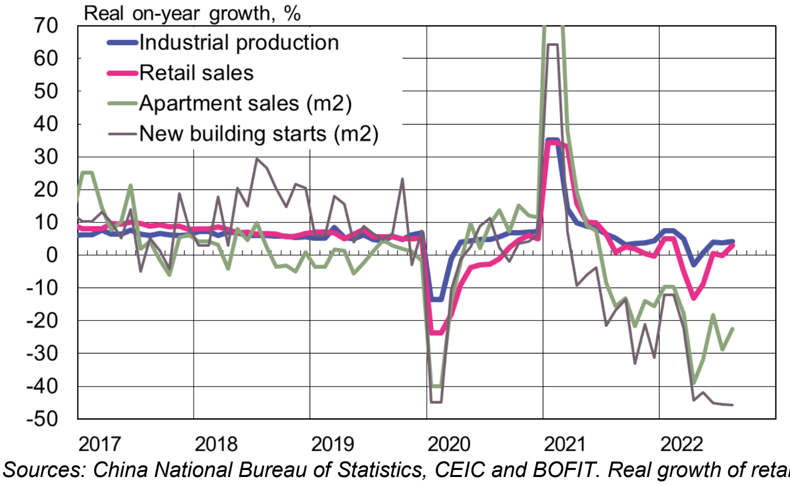
China posts relatively weak August growth figures; housing construction decline continues. The main monthly indicators for the Chinese economy show that growth strengthened in August relative to the June and July, and especially January-May, when covid restrictions and lockdowns severely depressed economic activity. Housing construction continued to decline in August, however, and the combined uncertainty from zero covid policies and real estate sector problems depressed domestic demand.

In nominal terms, retail sales growth accelerated in August to over 5 % y-o-y. Although China's National Bureau of Statistics has discontinued releasing figures for real retail sales growth, it is possible to roughly estimate, based on August consumer price inflation of 2.5 % (2.7 % in July), that retail sales grew by just under 3 % y-o-y in real terms. The recovery in automobile sales and last year's low basis reference largely accounted for the acceleration in on-year retail sales. Reductions in the car sales tax helped boost car sales by 16 % y-o-y in August. Fewer cars, however, were sold in January-August than in the same period last year. The NBS reports that seasonally adjusted nominal retail sales fell slightly from July to August. Retail sales have slowed on-month since June.

Thanks to a boost from export growth, industrial output has outperformed retail sales this year. The 12-month growth in industrial output accelerated to just over 4 % in August. Export growth significantly slowed in August, however, from early summer. While the value of exports rose by 7 % y-o-y in dollar terms (18 % in June-July), the value of imports in August was unchanged from August 2021. The volume of trade has grown more slowly than the value of trade. Figures from China Customs show that the volume of goods exports grew 3 % on average in January-July, while the volume of goods imports contracted by 8 %. The slowdown in export growth is expected to continue with the ongoing weakening of global demand.

The financial angst of China's real estate developers is now entering its second year. The decline in construction activity and housing sales has depressed economic growth generally – and no quick fix to the situation is expected. The government has yet to move ahead with wide-ranging support measures or developer bailouts. New building starts in August were down by 46 % y-o-y (measured by floorspace), while apartment sales were down by 23 %. Reliable overall statistics on housing prices are unavailable. The NBS tracker of housing markets in China's 70 large cities showed that August apartment prices (for existing apartments) were down in 61 cities compared to August 2021. The NBS tracker reveals a broad-based drop in apartment prices not seen since 2015.

The declines in construction activity and housing sales in China have continued for over a year



Sources: China National Bureau of Statistics, CEIC and BOFIT. Real growth of retail sales based on consumer price inflation.

Putin and Xi met in Samarkand as trade between their countries has strengthened. On September 15, Xi Jinping and Vladimir Putin conferred in the Uzbek capital at a meeting of the eight-nation Shanghai Cooperation Organization (SCO). The topics discussed by the presidents included improving the logistics connections between the countries like construction of a new natural gas pipeline and ways to boost energy exports from Russia to China. Both parties expressed an interest for greater use of national currencies in their trade relations. Putin also sought closer scientific and technological cooperation. The high-level talks continued this week with a Russian security council secretary Nikolai

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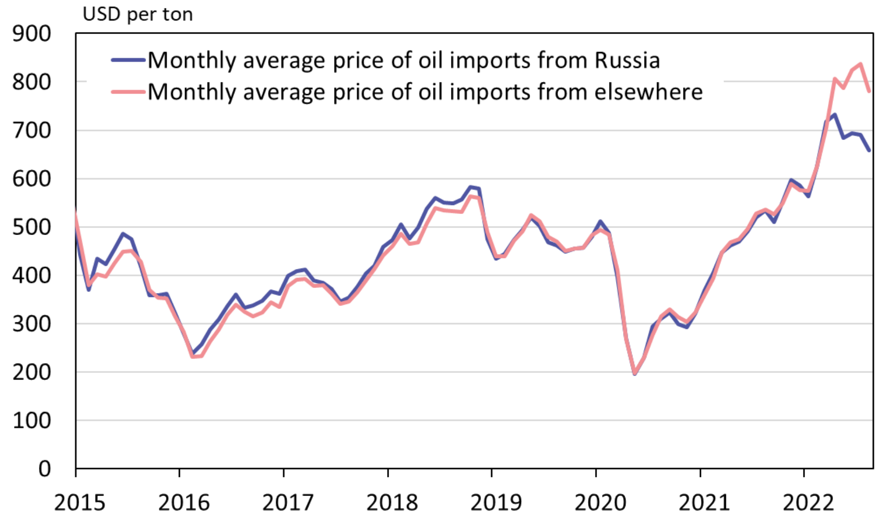
Patrushev and China's chief foreign policy diplomat Yang Jiechi getting together at the 17th strategic security summit in Nanping, a city in Fujian province in southeastern China.

The value of China's imports from Russia has risen to record levels in recent months. While the rise in the value of China's imports from Russia largely reflects soaring global energy prices, import volumes have also increased. In July-August, the volume of China's crude oil imports from Russia was up by nearly 20 % y-o-y. The price of Russian oil sold to China came with an average 16–17 % discount relative to the price of oil imports from elsewhere. Russia's share of China's oil imports exceeded 20 % in August. China has stopped to release gas pipeline transmission volume data, but reports that imports of liquefied natural gas (LNG) from Russia were up by nearly 30 % y-o-y in the July-August period. With tepid overall economic growth, however, LNG imports from elsewhere declined and Chinese buyers resold some of their LNG purchases on to others, including European buyers, in July and August.

The value of Chinese exports to Russia climbed in August to the same level as last December. Among largest export product categories, the value of plastic and chemical product exports has risen fastest (90–150 % y-o-y). The trend might reflect soaring prices for crude oil, a basic input for the plastics and other petrochemical products. Some of the large export categories such as clothing and machinery & equipment contracted in March-June, but bounced back in July-August. China releases only little information on goods exports volumes. The available data show that China has ceased all passenger car exports to Russia, while export volumes of other kind of vehicles also seem to have decreased.

China and Russia conduct an increased share of their bilateral trade in yuan. Overall, the yuan has seen a large increase in its use in Russia as access to Western currencies is restricted. The Society for Worldwide Interbank Financial Telecommunication (SWIFT) reports that nearly 4 % of yuan international payments traffic involved payments to or from Russia. Russia had the third largest share of international yuan payments after Hong Kong (over 70 %) and the UK (over 6 %). The growth in yuan payments has been very rapid. Prior to the invasion of Ukraine, Russia did not rank among the 15 largest yuan payment centres and its share of international payments in yuan was below 0.3 %. Russian firms, which have limited foreign financing options, are now showing a distinct interest in yuan-denominated financing. In August and September some Russian firms have issued yuan bonds on the Russian bond market. Firms include oil giant Rosneft, 15 billion yuan (2.2 billion euros); gold mining company Polyus, 4.6 billion yuan (0.7 billion euros); and aluminium giant Rusal, 4 billion yuan (0.6 billion euros).

China has been able to purchase Russian oil at a substantial discount since April



Sources: China Customs, CEIC and BOFIT.

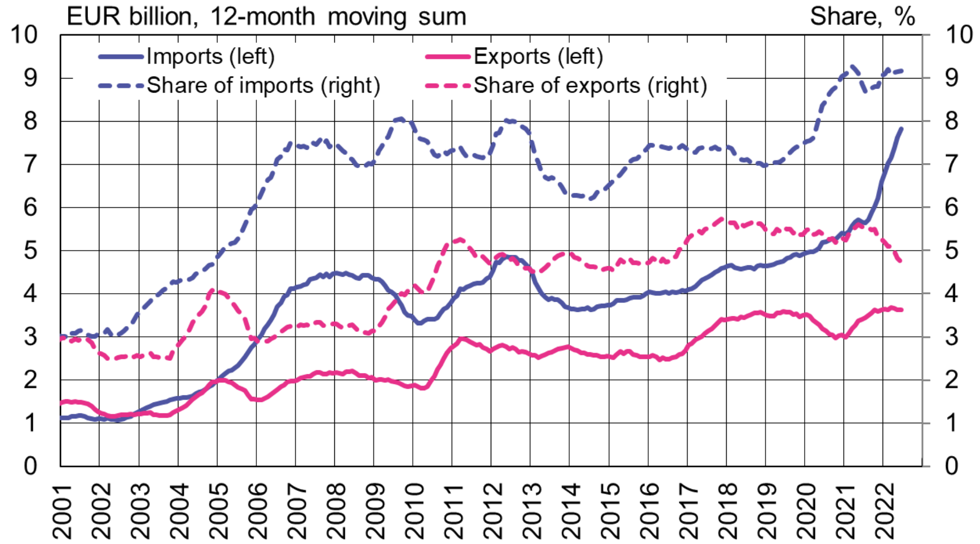
Finnish goods exports to China contracted in the second quarter. The value of goods exported from Finland to China in April-June amounted to 930 million euros, a nearly 6 % decline from a year earlier. Nearly 40 % of Finland's exports to China consisted of raw materials. Their value was down by 18 % y-o-y in the second quarter. The overall value of Finnish 2Q exports rose by 27 % y-o-y. China's share of Finnish exports fell to 4.5 %.

Finland imported goods valued at 2.1 billion euros from China in the second quarter, a 47 % increase from 2Q21. Finland's imports from China increased slightly faster than imports overall (38 % y-o-y). China accounted for just under 9 % of Finnish imports. Roughly 60 % of Finland's second-quarter imports from China consisted of machinery, equipment & vehicles. The value of imports in this category was up in the second quarter by over 50 % y-o-y. The biggest growth was in imports of generators and engines, electrical machinery and equipment, as well as machinery and equipment for general industrial use.

The value of exports of Finnish services to China in the second quarter amounted to nearly 300 million euros, an 18 % decrease from a year earlier. Finland imported services from China valued at 365 million euros in 2Q22, an increase of 16 % y-o-y. Finland has run a services trade deficit with China since the outbreak of the covid pandemic in 2020. China's strict zero covid strategy has effectively killed Chinese tourism to Finland and complicated exports of many other services to China.

A discussion on the dependence on Chinese production has recently emerged also in Finland. The foreign trade figures published by Finnish Customs show that the largest China-dependent goods categories are machinery & equipment, textiles, furniture and other household products. 65 % of the laptop computers and almost half of phones imported to Finland last year came from China. Even if their share of total imports is marginal, Finland also relies heavily on China for certain metals and chemicals. The value-added figures give a similar picture: Finland uses value-added produced in China most in textiles and clothing, base metals, computers, as well as electrical and other devices. China represents a smaller share of services imports than goods imports. Finland, however, imports from China relatively more computer programming, consulting and IT services, as well as scientific and technical services, than e.g. Germany, the UK or the US.

Finland's goods imports from China have risen considerably faster in recent year than exports to China



Sources: Finnish Customs and BOFIT.

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Russia

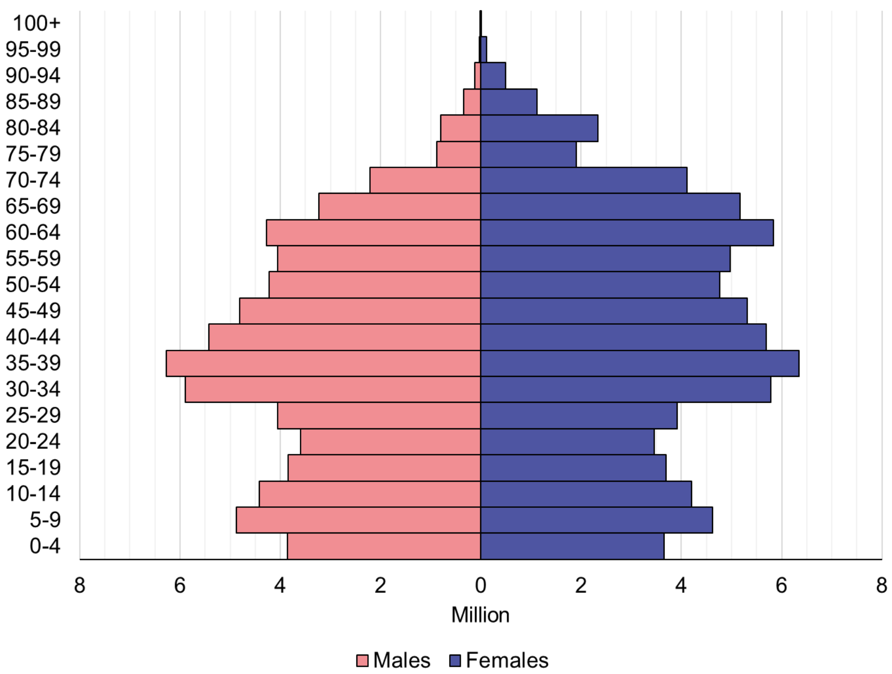
“Partial mobilisation” creates confusion, markets tumble in Russia. In an effort to move additional manpower to the front in the Ukraine war, president Vladimir Putin declared a “partial mobilisation” on September 21. The decree requires persons in the reserves with previous military training and necessary skills to report to mustering centres. While defence minister Sergei Shoigu stated publicly that the goal of the mobilisation was to recruit 300,000 soldiers, the public part of the decree itself contains no numbers on troops. Media reports suggest that the government’s goal is to boost Russia’s active military by 1 million in three waves by the end of this year.

Although rumours of a potential mobilisation have circulated for months, Putin’s decree surprised many. Share prices plunged on Russian stock markets on the announcement. As of Thursday (Sept. 29), Russian share prices were down by about 12 % from before the announcement.

The manpower quotas applied to some Russian regions are so large that they require recruitment of individuals who have never performed military service or received relevant training. It further appears that some of the first wave of recruits have already been sent to the front. About 200,000 Russians have already left Russia to avoid conscription. Popular destinations include Armenia, Georgia and Kazakhstan. Slightly over 60,000 Russians entered Finland via its eastern borders between September 21 and 29. Daily border entries were up by about 90 % from pre-mobilisation levels. During the same period, about 32,000 Russians returned to their home country.

Russia’s mobilisation can have also important economic implications. If the country mobilises, say, 1 million men by the end of this year, and another 300,000 leave the country by then, it would remove roughly 7 % of Russia’s 20–39-year-old men from the labour pool. Many firms have asked officials to exempt or defer the conscription of their employees.

Russia has about 10 million more women than men. Gender disparity widens for older age cohorts (population pyramid as of 2022)



Sources: United Nations and BOFIT.

Russian economic trends remained stable in August. Primary production, construction and certain industrial branches related to construction and defence (e.g. cement production and metal fabrication) supported the Russian economy in August. Driven by crude oil and liquefied natural gas, production of extractive industries was up in August by 1 % y-o-y. Natural gas production excluding LNG decreased by over 20 %. Agricultural output accelerated briskly, with production climbing by 9 % y-o-y in August. Construction activity rose by 8 % y-o-y in August.

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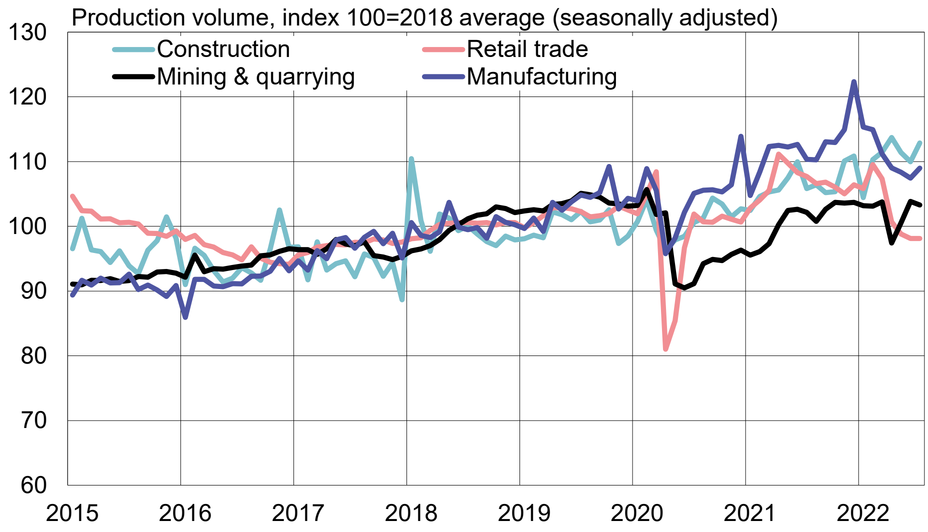
Consumer-driven branches continued to perform poorly. The volume of retail sales in August was still down by 9 % y-o-y. Although inflation has slowed in recent months, consumer prices still rose by 14 % y-o-y in August. The rapid rise in prices has eroded consumer purchasing power, and the average real wage in July shrank by 3 % y-o-y. The labour market situation remained stable. The number of persons employed in August was about the same as in August 2021, and the official unemployment rate remained at a historically low level of around 4 %.

Industrial trends were weakest in branches most affected by sanctions or otherwise dependent on imports and foreign firms. For example, the EU ban on imports of Russian timber and wood products entered into force in July. The wood industry experienced a roughly 20 % y-o-y drop in July and August. Passenger car production, which is highly dependent on imported components and international firms, remained in the doldrums in August with production down by 70 % y-o-y.

Russia's ministry of economic development estimates that Russian GDP contracted by 4 % y-o-y in August and 1.5 % in the first eight months of this year. The OECD forecast released this week sees Russian GDP contracting by 5.5 % this year and 4.5 % next year. The EBRD's September forecast expects a drop of 5 % this year and 3 % next year.

Extractive industries and construction supported the Russian economy in August, but retail sales remained weak



Sources: CEIC, Rosstat and BOFIT.

Russia plans for federal budget deficits from 2022 to 2025. The government recently approved a preliminary 3-year budget proposal (2023–2025) that foresees federal budget revenues rising by 9 % this year. The largest revenue boosts should come from taxes on the production and export of oil & gas, which the finance ministry expects to climb by nearly 50 % this year. Oil & gas revenues accounted for nearly half of all federal budget revenues in January-August. Federal budget revenues are expected to contract by 6 % next year on a roughly 25 % drop in oil & gas revenues. Total revenues are expected to grow modestly in 2024–2025, even if oil & gas earnings contract by a couple percent in both years.

Federal budget spending under the plan should grow by 17 % this year. Due to high inflation, real spending growth is likely to be much more moderate. In 2023–2025, nominal budget spending would remain roughly at the 2022 level, i.e. decrease in real terms. Under the preliminary budget proposal, the share of defence and national security as well as social expenditure in budget spending are slated to rise next year. Spending cuts are planned e.g. for categories of national economy and administration (including for example, roads and other infrastructure projects).

The plan foresees federal budget deficits running from 2022 through 2025, with annual deficits in the range of 1–2 % of GDP (for a total of about 7.7 trillion rubles or roughly 130 billion dollars at the current official rate). The budget deficit would be financed with money from the oil reserve fund (National Welfare Fund) and additional borrowing from domestic markets. The liquid assets in the National Welfare Fund are presently invested in foreign currency instruments and therefore Western sanctions restrict Russia's access to them. Instead, the finance ministry could transfer its frozen assets to the central bank in exchange for rubles.

Russia's finance ministry returned to the bond market this month for the first time since the Ukraine war began. On September 14, the finance ministry issued 10 billion rubles worth of 10-year government bonds. The finance ministry balked, however, on its planned 30-billion-ruble bond issues on September 21 due to low demand.

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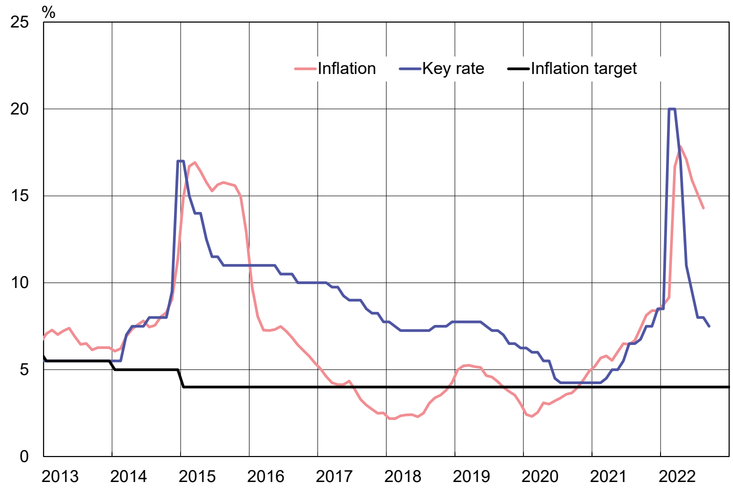
While the Russian government should have little trouble financing the projected deficits over the next three years, the budget framework could be based on overly optimistic assumptions. Finance minister Siluanov already noted that this year's budget deficit can be higher than expected. Changes to the budget proposal are possible before its final approval.

Russian central bank further eases monetary policy. On September 16, the Central Bank of Russia lowered its key rate by 50 basis points to 7.5 %. It was the fifth consecutive rate cut since the early April peak, and overall represents a drop of 12.5 percentage points. The CBR said that it now sees less space for further rate cuts, which analysts interpreted as a signal that the rate-cutting cycle is coming to its end.

On-year inflation remains high in Russia. August consumer prices were up by 14 % y-o-y despite a slowdown in the month-to-month rise in prices. Prices for food and non-food goods climbed by 16 % y-o-y, while prices for services were up by 10 %. In individual product categories, the biggest price rises were seen for sugar (45 %), detergents and cleaning agents (33 %), grain products (30 %), pasta (25 %) and butter (24 %).

The CBR also provided an updated inflation forecast for this year in conjunction with the rate cut announcement. Central bank expects 12-month inflation to be in the range of 11–13 % this year (12—15 % in the previous forecast), 5—7 % in 2023 and return to the CBR's inflation target of 4 % p.a. in 2024. The central bank left its GDP forecast for this year unchanged (i.e. a contraction of 4–6 %), but indicated that the forecast will likely improve in its October forecast update.

The Central Bank of Russia further lowered its key rate this month



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

Government fixed investment soars in Russia as corporate fixed investment remains weak. Rosstat reports that fixed investment rose in real terms as much as by 4 % y-o-y in the second quarter even with Russia's invasion of Ukraine.

However, the second-quarter fixed investment was largely driven by increased state budget spending by federal, regional and municipal governments. At the same time, there was a pull-back in corporate fixed investment. When Russia's high inflation in investment goods and services is taken into account, there was no real growth in corporate fixed investment. The dearth of corporate fixed investment reflects the very bleak future prospects facing many companies. On top of the recent developments, Russia's fixed investment trend has been really weak for many years.

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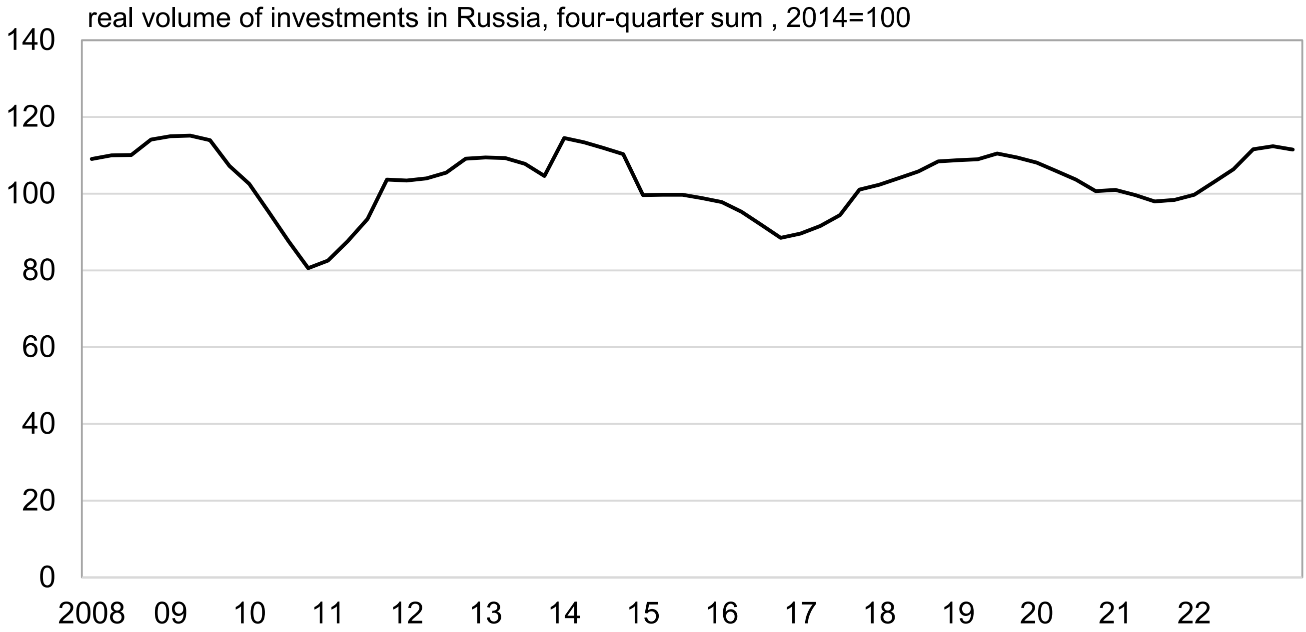
Fixed investments in Russia has been weak for very many years



Sources: Rosstat and BOFIT.

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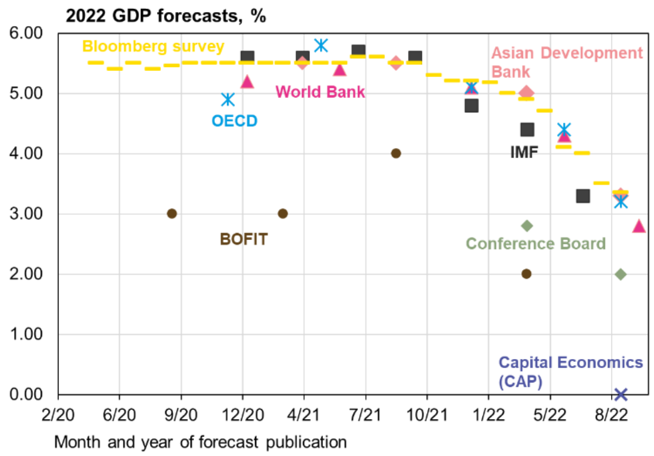
China

Forecasters lower their predictions for Chinese growth this year. Most major institutional forecasters last spring still expected Chinese GDP growth in the range of 4–5 % in 2022. The World Bank's forecast team now expects the Chinese economy to grow by just 2.8 % this year. The OECD revised its estimate downward last month to 3.2 % and the Asian Development Bank (ADB) anticipates 3.3 % growth.

Investment banks are also more pessimistic about China's growth prospects. The Economist's poll of forecasters' expectations of China's 2022 GDP growth had already fallen by the end of August to 3.6 %. In Bloomberg's survey, Chinese growth expectations this year were reduced to 3.4 % in September. The Conference Board and Capital Economics, both grounding their China projections on their own alternative growth estimates, offer even more dismal GDP growth numbers. The Conference Board lowered its 2022 growth forecast last month to 2 %, while Capital Economics dropped its forecast to *zero*. BOFIT's April forecast for China expected 2 % this year. We release our revised outlook at the end of this month.

The main factors dragging down growth expectations are production closures caused by covid lockdowns, weak trends in private consumption and the ongoing distress of China's real estate sector. The global economic outlook has also weakened, most notably in the US and Europe – a situation that implies lower growth prospects for Chinese industrial output and exports. China's leadership apparently abandoned the pretence of unrealistic growth targets already last July, when the Politburo issued a statement lacking any mention of a numerical GDP growth target ("around 5.5 %", published in March). Instead, the various levels of government were encouraged to pursue "the best possible outcome." Most forecasting institutions still expect GDP growth in the range of 4–5 % in 2023.

All major forecasters have cut their 2022 forecasts for Chinese GDP growth



Sources: Various forecasting institutions and BOFIT.

Yuan loses ground against the dollar. Dollar appreciation depressed the yuan-dollar exchange rate in the end of September to levels not seen since 2008, when the yuan-dollar exceeded the 7.2 mark. The People's Bank of China called on market participants to support the yuan, causing the yuan's exchange rate to appreciate slightly. On September 30, one dollar bought 7.11 yuan. The yuan has depreciated 12 % against the dollar since the start of the year. Chinese markets have been closed this week due to the National Day holiday.

The yuan's slide against the dollar is largely the result of dollar's strength. The yuan has strengthened against most other major currencies, 11 % against Japanese yen and 2 % against euro since the start of the year. The euro-yuan rate is currently about 7.1. The USD's trade-weighted index (DXY) was up by 17 % from the start of the year, while yuan's nominal effective, or trade-weighted, exchange rate (NEER) was at the end of September on the same level as at the start of this year. The yuan's real effective exchange rate (REER), which takes into account differences in inflation rates of China's main trading partners, has weakened by 3 % this year.

The PBoC has made several attempts at slowing the yuan's decline against the dollar. On September 15, the central bank lowered its foreign exchange reserve ratio requirement from 8 % to 6 %. Effective September 28, the FX forward trading reserve requirement was resurrected and set at 20 %. Use of the FX forward reserve requirement was suspended in 2020 (BOFIT Weekly 42/2020). The PBoC's measures basically increase costs of short-selling of the yuan and aim to discourage

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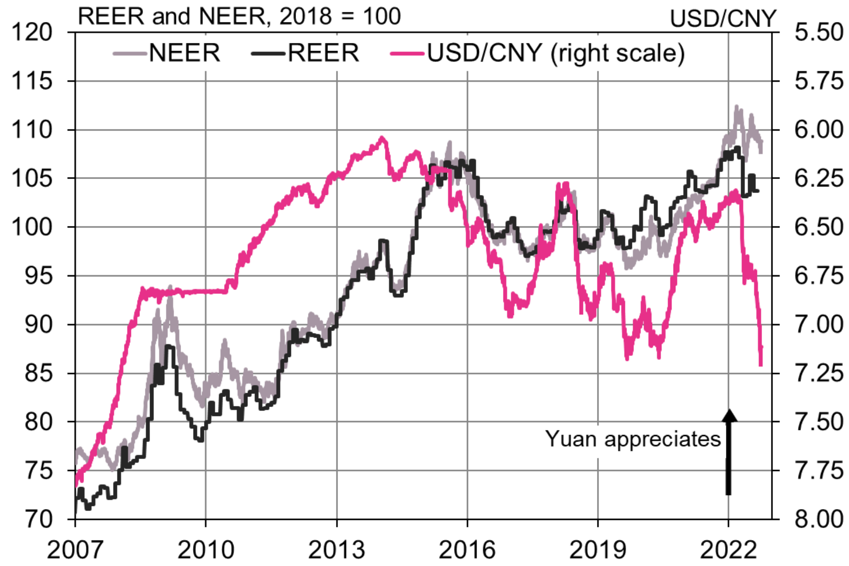
speculation on the currency. Shorting can be a profitable for investors when a currency faces an extended depreciation episode, but large-scale short-selling increases in deprecation pressure of the currency and can lead to a snowballing effect. In any case, the measure has signalling function, i.e. the PBoC uses it to indicate its level of satisfaction with the current exchange rate. When these measures proved insufficient to stop the recent slide of the yuan against the dollar, the PBoC released a warning on one-way forex speculation and encouraged key market participants to seek balance in the market. Reuters reports that China's big state-owned banks were ordered to be ready to sell their dollars to prop up the yuan if the situation persists.

As the US Federal Reserve has continued to raise interest rates and tightened monetary policy in an effort to deal with high inflation, the dollar is expected to keep strengthening for a while. The yuan depreciation and China's degraded domestic economic outlook have raised fears of a large-scale capital flight. The value of foreign-owned assets of mainland China stock and bond markets has fallen this year. China restricts movement of capital out of the country and officials can increase restrictions if the pressure to move money out of the country increases.

The yuan last month fell to its weakest exchange rate against the US dollar since 2008



Sources: Macrobond, BIS and BOFIT.

European Chamber reports tougher Chinese business environment. The European Union Chamber of Commerce in China (European Chamber) released its latest position paper at the end of September. The paper provides a broad overview of the current Chinese business environment and challenges facing foreign firms operating in China. The European Chamber paper finds that the business environment for European firms operating in China has been severely impacted by changing circumstances and increased uncertainty. Ideology now takes precedence over economic issues, which is reflected in China's strict covid policies, unpredictable rule changes, bias favouring domestic producers and political quest for economic "self-sufficiency."

Russia's invasion of Ukraine has caused many firms to reassess their risk exposures in China. While very few European firms have decided to move their entire production from China, the European Chamber notes that companies are increasingly isolating their China operations and arrangements from their other operations. Many firms consider making their future investments in other countries. An important priority for many companies is to diversify supply chains to limit production disruptions even if it raises costs. Possible reputational damage related to China has also increased as European perceptions of China have soured.

China's zero-covid policies have isolated China by making it harder to conduct business or otherwise permit the normal engagement of Chinese and Europeans. Many European expats have left China and skilled foreigners to replace them are hard to find. In recent years, the investment flows from Europe to China have decreased and the investments have been concentrated to a handful of large European firms. The latest calculation from research and analytics specialists Rhodium Group show that just ten companies in recent years have accounted annually for an average of 80 % of all European investment in China. Investment of car companies accounts for about a third of that investment. According to the European

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Chamber, there are basically no newcomers to China, and it is unlikely that this situation will change as long as China's strict covid policies remain in place and significantly limit business travel.

The European Chamber's latest paper offers 967 constructive suggestions, many of which have already been on the table for several years. A leading suggestion is that China refocus its policy emphasis back to reform and opening up of the economy. This policy reorientation would raise corporate and investor confidence, as well as improve China's growth outlook over the long run. Greater regulatory transparency is also needed, and capricious regulatory changes should be avoided. The European Chamber also would like to see officials to pay better attention to the views of their colleagues in other ministries, government agencies, firms and research institutions in decision-making. The operations of state-owned enterprises should be reformed to make them more market-based and forced to compete without unfair advantages. More effort is needed in vaccinating the population against severe covid and increasing opportunities for international air travel.

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Russia

Latest BOFIT forecast sees Russian economy contracting by 4 % this year and imports falling by 25 %. While Ukraine bears the heaviest humanitarian and economic losses from Russia's brutal attack, the aggressor economy is also suffering – particularly over the long term. War has put Russia in recession.

BOFIT's just-released Forecast for Russia 2022–2024 sees Russian GDP contracting by 4 % this year. Despite temporary measures to avoid an acute financial crisis at the start of the invasion and a strong rise in export prices resulting in a smaller-than expected contraction of the Russian economy in the first half of 2022, the economic contraction is expected to speed up in the second half of this year. While reduced private consumption and dwindling inventories will hurt economic growth, strong growth in net exports will still support the economy over the coming months. Thus, the volume of imports should contract this year by 25 %, while the volume of exports only falls by 5 %.

Russia's economic distress is not expected to ease next year as its economy contracts by another 4 %. Next year's growth prospects will be considerably degraded when the EU's oil import bans take effect (the crude oil ban begins in December and the petroleum products ban at the beginning of February 2023). The volume of exports is expected to contract by 10 % in 2023. No significant recovery is expected in 2024. War, sanctions and Russia's political obsession with self-sufficiency imply a significant reduction in Russia's potential growth rate over the long term.

The Russian economy is expected to contract by 4 % in 2022 and by 4 % in 2023

	Russian real GDP volume, annual change, %,				
	2020	2021	2022	2023	2024
GDP	-3 %	5 %	-4 %	-4 %	1 %
Private consumption	2 %	2 %	-9 %	-1 %	
Public consumption	-3 %	5 %	2 %	0 %	
Gross capital formation	-4 %	9 %	-15 %	1 %	
Exports	-4 %	3 %	-5 %	-10 %	
Imports	-12 %	17 %	-25 %	5 %	

Sources: Rosstat for 2019–2021, BOFIT for 2022–2024.

Russia's current account surplus contracted in the third quarter of this year. Preliminary balance-of-payments figures from the Central Bank of Russia show that earnings on exports of goods and services amounted to 153 billion dollars. The value of exports contracted from previous months. Falling oil prices, a sharp drop in natural gas export volumes, as well as the implementation of several EU import bans (e.g. timber and coal) reduced export revenues. The value of exports in the first nine months of this year was up by 21 % y-o-y.

The value of Russian imports of goods and services in July-September was 85 billion dollars. Imports recovered slightly from the previous quarter, but were still down by about 20 % from pre-invasion levels. Several factors contribute to the contraction in imports: Russia's economy has gone into recession, many countries have imposed bans on exports to Russia, sanctions against Russia's financial sector have limited international payment traffic and many foreign firms have pulled out of Russia altogether. In the first nine months of this year, the value of goods and services imports declined by 11 % y-o-y.

While Russia's 3Q current account surplus was smaller than the all-time high of the previous quarter, it was still an eye-popping 52 billion dollars. The cumulative surplus for January-September was 198 billion dollars.

The financial account continued deeply on deficit, although the July-September deficit of 52 billion dollars was slightly smaller than in previous quarters. The deficit for January-September amounted to 195 billion dollars, the largest deficit since these figures were first published in 1994.

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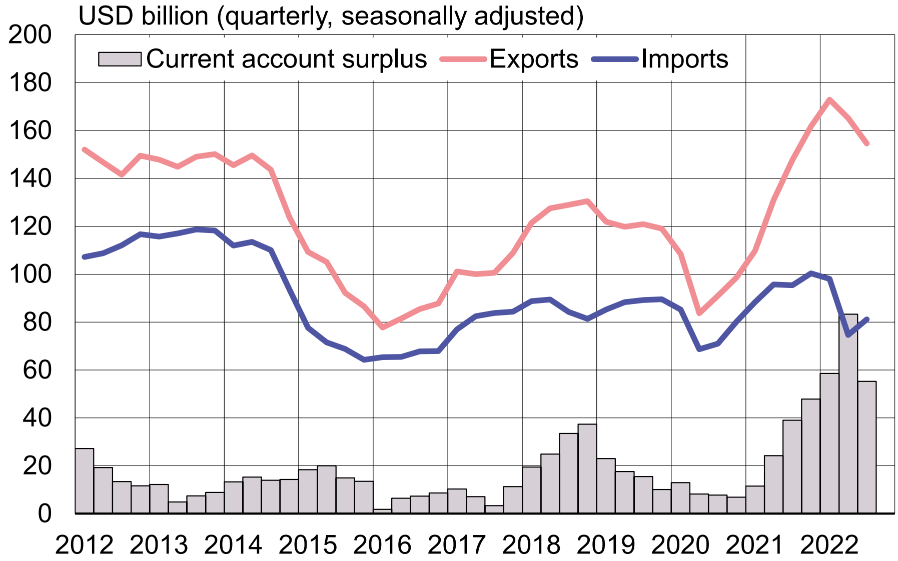
Russian current account surplus declined in the third quarter of this year, but was still huge



Sources: CBR, Macrobond, BOFIT.

Weak developments expected for Russian government sector revenues and expenditures. In Russia's government budget sector framework for 2023–2025, the finance ministry expects revenues to the consolidated government budget (federal, regional and municipal budgets plus government social funds) to rise by 10 % in nominal terms this year but only about a half percent next year. The revenue swings reflect see-sawing oil & gas tax revenues, which largely reflect a rise in the price of Russian Urals blend crude oil and an assumed fall of the price next year. Income from oil & gas taxes represented 19 % of consolidated budget revenues in 2021.

Other consolidated budget revenues are expected to increase by 6–7 % in 2022–2023, i.e. lag inflation. In the economy ministry's forecast, which is the basis for budget revenue estimates, inflation is forecast to slow significantly next year, but due to this year's high inflation, consumer prices would rise on average by 10 % p.a. over 2022–2023. Producer prices for domestic industrial supplies would rise by about 7 % p.a. Budget revenue projections are based largely on the economy ministry's GDP forecast, which is clearly more optimistic for this year and especially next year than in nearly all other major forecasts.

The limit on federal budget deficits (equivalent to 1 % of GDP this year and 2 % next year) determines the frame for all consolidated budget spending. Regional and municipal budgets as a whole, as well as social fund budgets, are to be kept very close to balance after transfers from the federal budget because there is little chance for them to borrow considering the scale of the consolidated budget.

Revenue projections and efforts to rein in the deficit are expected to result in an increase in consolidated budget spending of 15 % in nominal terms this year but less than 4 % next year. As spending is expected to rise this year and next only slightly faster than inflation, the real spending would rise by less than 1 % p.a. in 2022–2023. On the other hand, a large amount of government guarantees has been reserved for this year to support bank lending to corporate customers.

If the economy contracts more than the economy ministry forecasts and consolidated budget revenues are weaker than calculated, it will be challenging to further scale down the already tepid spending plans in the current wartime and recessionary conditions. The alternative is larger budget deficits.

Large turns in the structure of the consolidated budget are coming. Spending on domestic security and law enforcement, 95 % of which comes directly from the federal budget, is set to skyrocket to a new level this year and next. Defence spending and spending on administration will also grow rapidly this year. Different sectors of the economy are at least so far scheduled to receive very little additional budget spending even with a recession at hand.

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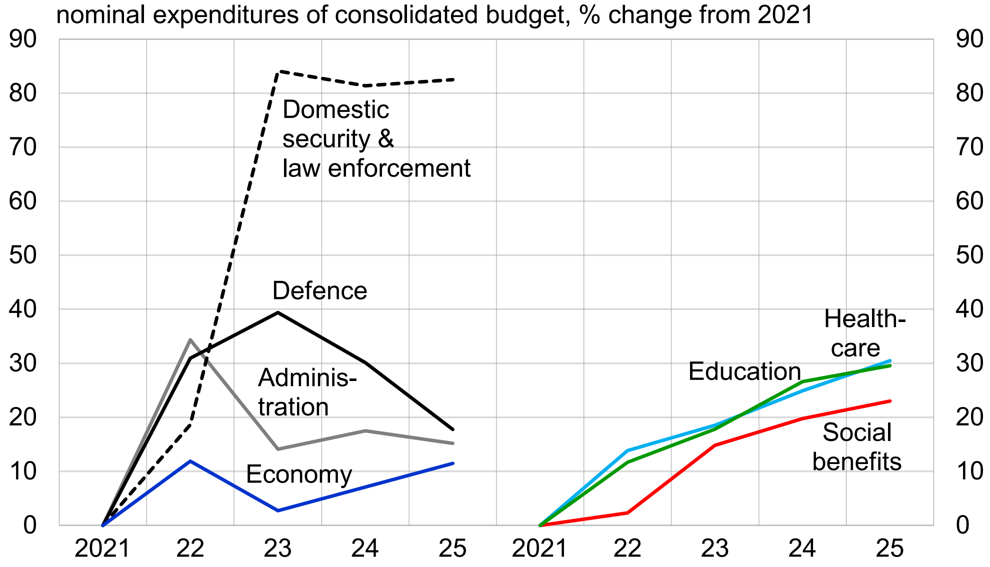
Large changes in Russia's government sector spending towards domestic security & law enforcement, as well as defence



Sources: Russian Ministry of Finance and BOFIT.

IMF anticipates significant slowdown in global growth next year; Russia's recession likely to be milder than earlier expected. The IMF's latest World Economic Outlook predicts that the world economy will grow by 3.2 % this year and 2.7 % in 2023. The updated forecast lowers the July 2023 global growth forecast by 0.2 percentage points. While economic effects of Russia's invasion of Ukraine have been the biggest single factor in dragging down growth, the Fund also notes the impacts from significant monetary tightening in major economic blocs.

The IMF has raised its projections for Russia from its July forecast, and now expects Russian GDP to contract by only 3.4 % this year and 2.3 % next year. The IMF still expected last July that Russian GDP would shrink by about 9 % during the 2022–2023 period. The Fund expects war to severely impair Russia's long-term growth potential, with the Russian economy expected to grow by just 0.7–0.8 % in 2026–2027. In the October 2021 WEO, Russia's long-term growth potential was still estimated at 1.8 % p.a.

Ukraine has suffered massive humanitarian and economic losses from the war. The IMF expects Ukraine's GDP to fall by 35 % this year.

The IMF sees the Chinese economy growing by 3.2 % this year. Growth next year should accelerate to 4.4 % next year as harsh covid restrictions are gradually eased. China is rare among large economies in that it expects to see growth accelerate next year. For example, the IMF sees the Indian economy growing by 5.3 % this year, but slowing to 4.9 % next year.

Global inflation should subside as global growth slows. The IMF forecast assumes that in 2022 higher energy prices, among other things, will boost inflation worldwide to 8.8 %. Inflation will be lower, however, in advanced economies. Inflation is expected to slow next year to 6.9 %. Inflation will slow down more in advanced economies.

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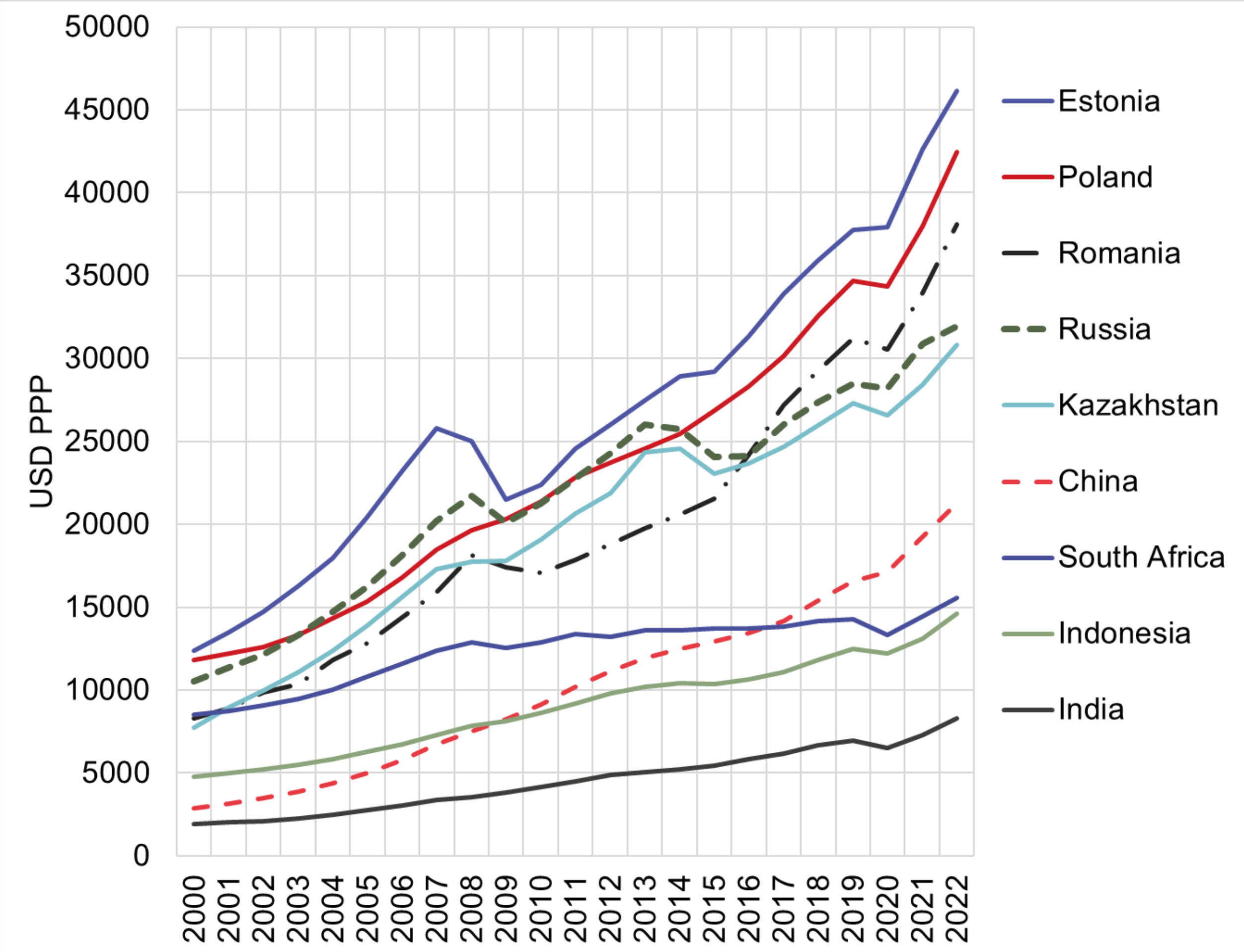
Trends in growth in nominal GDP per capita (purchasing power parity-adjusted, US dollars) has varied considerably across countries. German GDP per capita is expected to reach 63,850 dollars this year. Finnish GDP per capita should hit 58,650 dollars.



Source: IMF.

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BOFIT

China

China's 20th National Congress affirms major existing policy trends. With China's National Congress of the Chinese Communist Party (Oct. 16–22) winding up, it appears Xi Jinping will continue as party head for a third term. Perhaps the most important messaging from this congress is that major policy trends already in place will remain undisturbed. Security issues and ideology have been given more emphasis than earlier, while economic matters have been largely relegated to the back burner. Self-sufficiency in high-technology fields and supply chain security now have high priority. While Xi reiterated that reforms and opening-up policies would continue and that markets and the private sector matter, further government encroachment into Chinese economic life is expected to continue. Xi also gave no indication that changes in the zero-covid strategy were planned. China will continue to improve its military strength and capabilities. On Taiwan, Xi Jinping repeated China's official policy stances. Xi warned that turbulent times may lie ahead, so China needs to be prepared.

Many of the policy targets stated this week originate from the previous party congress in 2017 (BOFIT Weekly 42/2017). China will continue to strive for leadership in the spheres of education, science, technology, culture, sport and health, as well as join the elite group of innovation-driven countries by 2035. The party will also continue its quest to reduce poverty and significantly increase the share of middle-income earners. Increases in the birth rate, the quality of senior care and pensions were also targeted. Raising the retirement age, a long overdue reform, was also mentioned. Xi reiterated that narrowing China's income and wealth disparities are in core of "common prosperity." Monitoring means of accumulating wealth will be stepped up to assure assets were acquired through legitimate avenues.

While China did not announce any specific numeric long-term GDP growth target, the party set an implicit GDP target, i.e. China's GDP per capita should match the average for developed countries by 2035. Given that reaching this target would put China roughly on par with Finland in terms of GDP per capita, most observers see this ambitious target as unrealistic. IMF figures show that China's purchasing power parity adjusted GDP per capita in 2021 was about a third that of advanced economies. For China to meet its new GDP per capita target, the economy would have to grow roughly 7 percentage points faster each year than the average GDP growth in advanced economies (assuming population growth trends are similar).

China postpones routine releases of economic data. Although China Customs was scheduled to release its foreign trade figures last Friday (Oct. 14), and the China National Statistics Bureau was supposed to release its headline macroeconomic indicators (including GDP) on Tuesday (Oct. 18), both agencies balked at the last minute on publishing their data. Neither has announced future publication dates nor any reason for the postponement. However, the delays are clearly linked to the ongoing party congress. The latest GDP growth figure is expected to be well below China's official target. This provides an obvious political basis for the postponement, but the issue could also be technical. Most observers expect that the figures will be released next week after the congress adjourns. The postponing of routine data releases is highly exceptional for China.

China attempts to contain its real estate sector crisis and support the economy through increased funding. The latest government measures directed at the real estate sector seek to assure that construction projects in progress get finished and encourage consumers to buy apartments. Extensive operations to bail out developers are not contemplated. Several provinces and municipalities have eased apartment purchase requirements by e.g. dropping purchase restrictions and reducing the required minimum downpayment amount. The central bank has allowed lower interest rates for first-time apartment buyers. Starting this month, tax breaks on profits from the sale of an existing apartment will be allowed for individuals that purchase a new apartment in the same city.

A number of construction projects have been suspended due to the financial troubles of developers. It is common in China to purchase a new apartment before construction has started. Investors in some provinces and municipalities became nervous last summer about the slow progress of projects, and threatened to stop making mortgage payments until building activity restarted. Such payment boycotts have continued in autumn.

China's policy banks (Agricultural Development Bank of China, China Development Bank and China Exim Bank), in particular, are tasked with financing investment projects. The government announced in June that policy banks should increase their lending to infrastructure projects by 800 billion yuan (BOFIT Weekly 22/2022). Later last summer, the government added another 600 billion yuan in total to the lending pool. The proposed 1.4 trillion yuan (200 billion euros) lending pool corresponds to 1.2 % of Chinese GDP. According to media reports, policy banks have been ordered to earmark 200 billion yuan for struggling developers to enable them finalise housing that is already sold but not yet completed. The government will also provide interest support for these loans.

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To encourage provincial-level infrastructure investment, the central government in recent years has permitted provincial governments to finance infrastructure projects with off-budget "special purpose bonds." The key selling-point of such bonds is that they theoretically pay for themselves with the profits from the investment. As most of the allotment for new special-purpose bonds this year has already been used, the government announced in late August that unused special bond quota from previous years will be tapped to allow provinces to issue another 500 billion yuan in total during the remaining of the year. The allowed uses for special-purpose bonds have been expanded in recent years, and today they can be used to finance a wide variety of projects. The biggest problem is usually finding profitable projects in which to invest.

Regions have also increased their off-budget debt using local government financing vehicles (LGFVs). LGFVs have been active this year in purchasing land-use rights from the regions. To curb this practice, the finance ministry last week intervened by prohibiting state firms and local governments from purchasing land-use rights on credit. Land sales constitute a significant share of local government revenues. Due to the cooling of construction activity, such revenues have declined significantly.

Commercial banks have also been encouraged to increase their lending to developers. In late September, Bloomberg reported that the People's Bank of China and the China Banking and Insurance Regulatory Commission (CBIRC) have ordered the country's six largest state-owned banks to increase their real estate financing by 100 billion yuan each by the end of this year. The increase applies to housing loans, loans to developers and developer bonds. In August, the government ordered China Bond Insurance to insure new bonds issued by approved developers. Developers, in turn, must put up their assets as collateral for the insurance guarantee. In addition to the state financing programmes, many provinces have established their own crisis funds.

The financial problems of developers are unlikely to ease as the housing market cools and problems spread to other firms. Private developers are experiencing the most distress and the government's role in the real estate sector is increasing as state-owned enterprises and provincial governments come to the rescue of insolvent firms. Government measures have so far failed to revive apartment sales, so their impacts on the real economy are likely to remain small.

More Chinese choosing to save and fewer planning to buy an apartment

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

United States tightens rules on semiconductor exports to China. On October 7, the United States issued new bans on exports to China of advanced semiconductors and devices for chip manufacture. Special government permission is required for companies seeking to avoid the export controls, which are based on national security. The purpose is to prevent China from getting its hands on technologies that can be used to in advance weapons systems.

The US first implemented technology export bans on China during the Trump administration (BOFIT Weekly 40/2020). The latest US Department of Commerce export controls apply to critical advanced chips that are difficult to acquire elsewhere. The controls even grant the US government power to forbid exports of chips manufactured outside the US that incorporate US technology. The comprehensive export ban applied to Huawei and its subsidiaries in August 2020 now extends to 28 other Chinese firms on the US entity list. In addition to chips and semiconductor manufacturing equipment, the ban applies to US citizens, US permanent residents and firms that support Chinese chip manufacturers without a special permit. Media reports note that the extension of bans to employees has caused confusion in many firms. The Dutch

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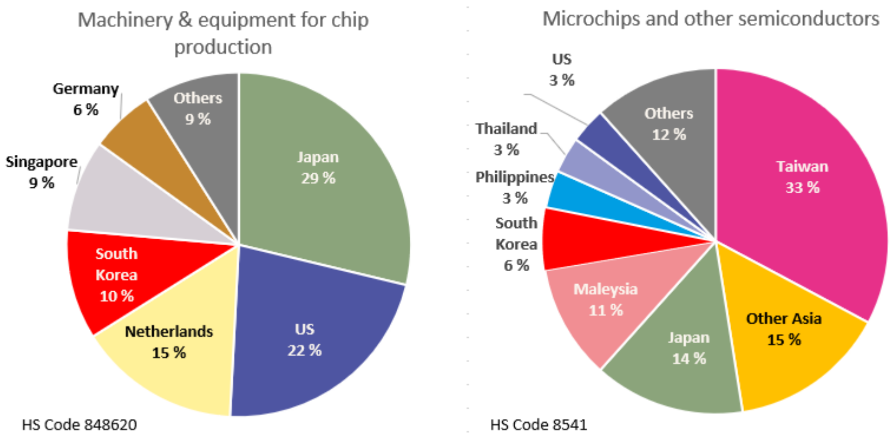
semiconductor equipment manufacturer ASML has ordered all its American employees to refrain from dealing with Chinese customers until the extent of the controls are determined.

The ban is expected to cripple the operations of Chinese chipmakers, as well as cause hardships for China's big tech firms, by reducing the availability of semiconductors. It looks increasingly unlikely that China will achieve its declared goal of self-sufficiency in advanced technologies, particularly semiconductor production. On the other hand, the ban will also hurt American firms as China traditionally has been an important export market. Over a third of net earnings of some large American chipmakers have come from China in recent years. The world's largest chipmaker is Taiwanese TSMC, which controls over 50 % of the global market. Next comes the Korean Samsung (17 % market share), the Taiwanese UMC (7 %) and US-based GlobalFoundries (6 %). Chinese chipmaker SMIC ranks fifth in the world with a market share close to 6 %. Most of the equipment for chip manufacturing is produced in Japan, the US and Europe.

Japan, Taiwan and the US were the top providers of semiconductors and semiconductor production equipment to China in 2019



Sources: Comtrade, Macrobond and BOFIT.

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Russia

Weaker revenues and higher spending reign Russia's federal and regional budgets. Due to various revenue streams other than oil & gas tax revenues, the slide in nominal federal budget revenues eased in September to just 4 % y-o-y. Over the past three months, however, federal revenues were down by 14 % y-o-y. The drop was about the same for oil & gas tax revenues as for other budget revenue streams.

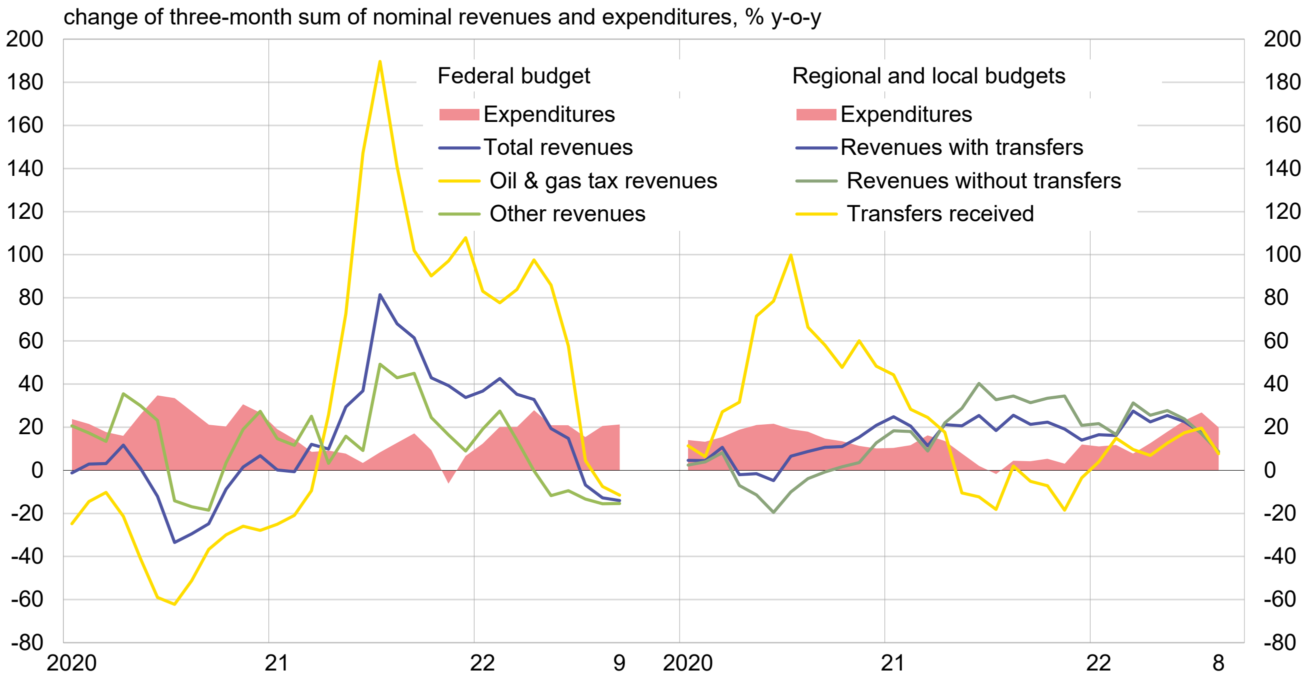
Nominal growth in federal budget spending accelerated again in September, rising above 30 % y-o-y. For the past three months, nominal spending growth exceeded 20 %. Growth was also rather high in real terms as the rise in consumer prices and producer prices for industrial goods supplied to domestic users slowed on average to slightly over 10 %. The budget deficit for the previous 12 months widened to 0.7 % of GDP in September.

Revenues to regional and local government budgets (not including federal budget transfers) increased rapidly last spring. During June-August, the nominal increase slowed to under 9 % y-o-y. Transfers from the federal budget to regions and local governments have been released variably. Their on-year increase in June-August was quite modest. The rise in budget spending accelerated notably in late spring and early summer. Despite a modest rise in August, growth in spending in June-August was up to 20 % y-o-y. When budget transfers are included, the 12-month surplus in August corresponded to 0.8 % of GDP.

Compared to the finance ministry's estimate for all of 2022, the rise in federal budget revenues in January-September was in line with the overall 2022 estimate. While oil & gas tax revenues have outpaced the 2022 forecast, other budget revenue streams have been underperforming (decrease of 4 % y-o-y) the 2022 estimate (decrease of 1 %). Spending has risen by over 20 %, slightly higher than the full 2022 estimate (17 %).

The on-year rise in regional and local government budget revenues (not including transfers received from the federal budget) was substantially higher in January-August than regional governments and the finance ministry have expected for the year. Transfers from the federal budget were up, however, even if the annual estimate also sees practically no increase in transfers (the federal government may have front-weighted its transfers to regional and local governments to deal with the current uncertainty). Regional budget spending has also risen slightly faster (16 % y-o-y) than the projected increase for this year (13 %).

Budget revenues have headed down for Russia's federal, regional and local government budgets, while spending has increased



Sources: Russia's Ministry of Finance, BOFIT.

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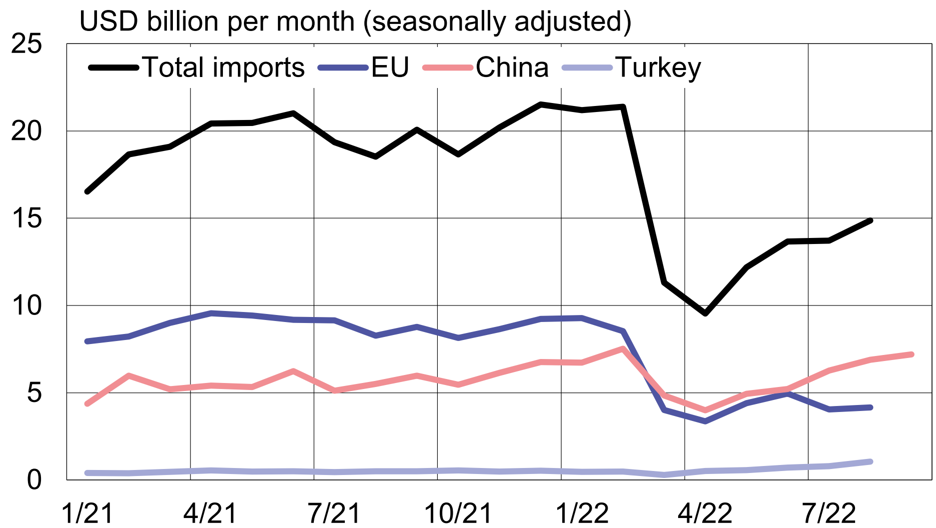
Russian export earnings start to decline, recovery in imports continues. Although Russian Customs ceased publication of foreign trade statistics after the invasion of Ukraine, it is possible to estimate Russian foreign trade with alternative data such as the "mirror" trade figures of Russia's trading partners.

Based on data garnered from Russia's main trading partners, it would seem that, despite the war, the value of Russia's goods exports increased last spring. The strong export performance reflects high global commodity prices, multi-month transition periods in import restrictions on Russian goods, as well as Russia's success in finding alternative export markets, particularly in Asia. The value of exports, however, appears to have turned to decline in recent months. Nevertheless, the value of Russia's exports in August was roughly on par with pre-invasion months. There were large differences across countries, however. The value of exports from Russia to the EU was down by about 20 % in August from pre-invasion levels. The value of Russian exports to China, in contrast, was up by about 50 % in August-September from pre-invasion levels. In India's case, the value of Russian exports was in August-September up five to six times from pre-invasion levels.

Russia's goods imports contracted sharply last spring after the invasion of Ukraine, but have come back somewhat since. Based on the mirror figures of Russia's trading partners, the value of Russia's imports in August was down by about 30 % from pre-invasion months. Imports contracted in response to lower demand in Russia. Sanctions have limited trade possibilities and payment traffic with Russia. Many firms have also voluntarily decided to cease their operations or leave the Russian market altogether. Import figures also vary across countries. The value of Russia's imports from the EU was down in August by about 50 % from pre-invasion levels. Russian imports have contracted also from countries not participating in sanctions. For example, imports from Thailand were down by 35 % in August and imports from Vietnam down by 60 %. Russia's imports from China, however, have recovered to pre-invasion levels. Imports from Turkey have doubled from pre-invasion levels.

Based on the mirror statistics of Russia's main trading partners, Russian goods imports appear to have revived in recent months



Sources: Eurostat, Macrobond, UN Comtrade, BOFIT.

Overall condition of Russia's banking sector remains murky. With data on balance sheets or income statements no longer published on a regular basis, assessments are based on less granular data by the Central Bank of Russia. Figures for Russia's banking sector overall show that the loan stock of banks grew slightly from January to September, partly a reflection of programmes to support housing loans and lending to businesses. Lending in foreign currencies has diminished and some banks have converted existing forex loans to ruble loans.

There was a brief contraction in household deposits during the initial February-March panic after Russia invaded Ukraine, as well as a second slight contraction at the end of September, when people fleeing the country withdrew large amounts of cash from their bank accounts. Growth in the stock of corporate deposits has been supported in particular by repatriation of export earnings in the energy sector.

As the war continues, it has become clear that sanctions could impact Russian payments in Western currencies for years to come. Russian officials have responded by strongly encouraging a move away from dollar-based payments and payment

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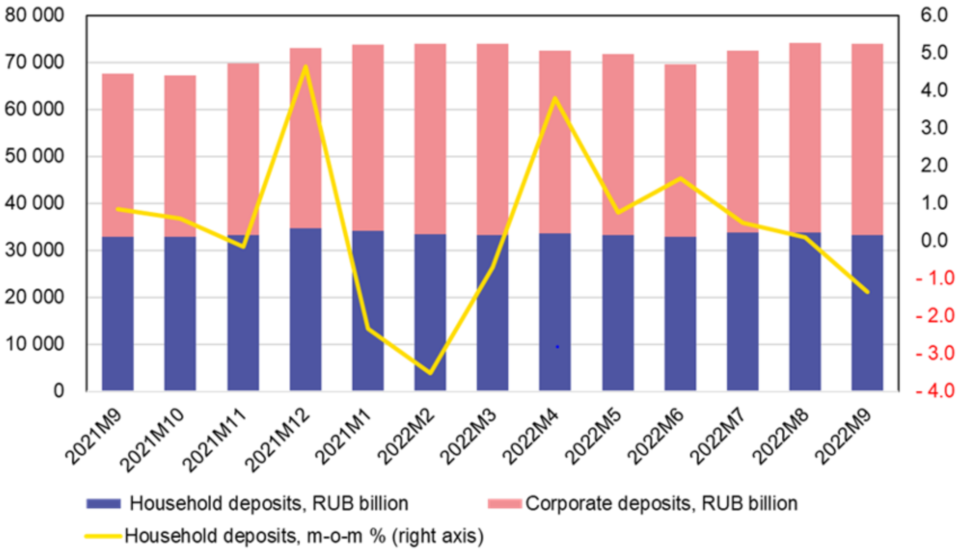
systems. Payments domestically are handled by the payment transfer system owned by the CBR. The ruble and other currencies such as the Chinese yuan are encouraged for those engaging in foreign trade. Demand in Russia for "unfriendly currencies" (essentially dollars and euros) has declined somewhat, while demand for the Chinese yuan has grown rapidly. The yuan's share of currency trades on the Moscow currency exchange had risen to 30 % at the end of September.

The threat of expanded sanctions and hikes in service charges in foreign currency accounts have reduced the popularity of dollar- and euro-denominated investment products and loans. Before the war, over a quarter of bank accounts were forex accounts. By August, that share had fallen to just 12 %. Yuan-denominated deposits have yet to gain wide popularity. Circumventing the use of Western currencies in international transactions, however, is difficult and expensive. In August, three-quarters of new forex lending was still granted in unfriendly currencies. The information has been compiled from CBR publications as data on the ruble-forex split in payments and loans is no longer released.

Bank deposits in Russia have barely increased at all this year



Sources: Central Bank of Russia, BOFIT.

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China

BOFIT expects relatively low growth for China over the next two years. China is experiencing its third year of pandemic disruption and zero-covid policies. This situation has increased uncertainty among consumers and firms, hurting service-sector demand and boosting youth and migrant unemployment. In addition, real estate sector problems have reduced real estate investment and construction activity – and no quick fixes are in sight. As the global economy slows during the forecast period more than previously expected, growth in export demand also slows, adding to pressure from structural factors that already have long been a drag on economic growth. BOFIT's latest Forecast for China 2022–2024 sees China's real GDP growth falling to around 2 % p.a. this year and recovering to around 3 % in 2023 and 2024.

China's latest released official GDP figures again appear to exaggerate actual growth. Thus, it is unlikely that official statistics will fully express slowing growth figures in the forecast period. Our forecast sees China's growth over the next two years to be roughly in line with global economic growth. China has ceased its role as the engine of global growth.

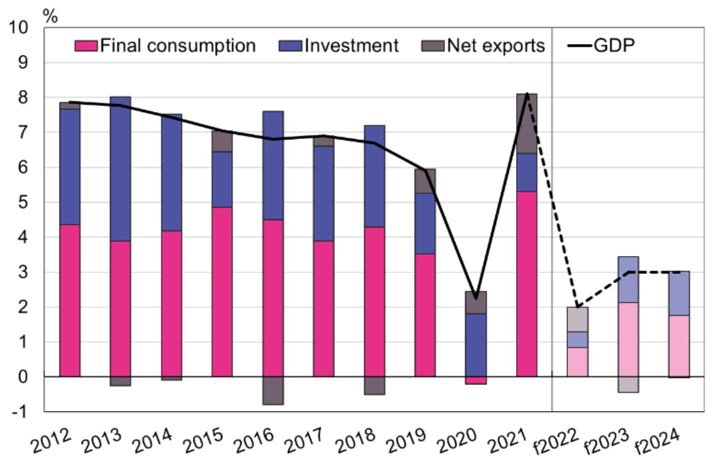
We expect growth in consumer demand and fixed investment to remain low this year due to covid restrictions and problems in the construction sector. Growth in net exports, however, will still support overall demand growth this year. Export growth should slow considerably next year and the contribution of net exports to economic growth turns negative. Consumer demand is expected to account for a larger share of economic growth next year than this year. Sustained and more balanced economic growth would require policy measures that support a transition to a more consumption-driven economic paradigm. We expect the ratio of consumption to GDP to decline slightly this year from 54 % in 2021, and only rise slowly in 2023 and 2024.

Improvements in productivity are needed to sustain future growth as China's population begins to shrink and rapidly ages out of the workforce. Moreover, China's current reliance on investment-driven growth can no longer deliver the profitability it once did. Economic issues now take a backseat to party control and national security. The business environment continues to degrade. Rapid indebtedness has reduced the available room for economic stimulus. Among the most affected are local governments with weak financial situation and high indebtedness.

The downside risks associated with our latest forecast are again heightened. The concentration of power in the hands of Xi Jinping increases the potential for policy missteps or poor policy generated in the absence of any dissenting voices. The risks confronting the financial sector continue to rise with increasing indebtedness, problems in the real estate sector and zero-covid policies. Geopolitical risks have been exacerbated by Russia's invasion of Ukraine and China repeating its long-term goal of uniting Taiwan with mainland China. This has caused many countries and firms to re-evaluate their dependency on China in an entirely new light. Intensified competition among the major economies and ongoing technological decoupling have increased the uncertainty facing foreign firms operating in China as well as firms linked to China via their supply or production chains. On the upside, higher growth for China is possible if it relaxes its zero-covid policies and opens its borders sooner than our basic scenario assumes.

Our latest China forecast was presented at BOFIT's China briefing on October 31. The event included discussions on the consequences of China's rising debt, Finland's dependence on China and increased competitive frictions among the global superpowers. A video of the event, which was conducted in Finnish, is posted at the above link.

BOFIT Forecast for China 2022–2024 and growth contributions



Sources: China National Bureau of Statistics and BOFIT.

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BOFIT

Xi Jinping consolidates power; current economic policymakers passed over for inner circle posts. China's seven-day National Congress of the Communist Party of China wound up on October 22. As expected, Xi Jinping was overwhelmingly endorsed for a third term as party head and country leader. All of the other six members appointed to the Politburo Standing Committee (the party's highest body) are seen as Xi loyalists. They are Li Qiang (63), Zhao Leji (65), Wang Huning (67), Cai Qi (66), Ding Xuexiang (60) and Li Xi (66). Li Qiang, former Shanghai party secretary, is expected to become China's new premier when Li Keqiang steps down next March. None of the men picked for the Permanent Committee is seen as Xi's successor. Some of the other 25 appointed members of the politburo are also known to have some connection to Xi, and typically have demonstrated loyalty in their previous party posts. The concentration of power in the hands of a single individual and the purge of other factions from highest bodies has increased the possibility of capricious actions and inappropriate policy responses by the government.

In addition to giving the premiership to the man who oversaw the Shanghai lockdowns earlier this year, a number of central economic policy posts have been affected by the shakeup, even if they had yet to reach the mandatory retirement age of 68 for such posts. Current central bank governor Yi Gang failed to make the central committee list, as did the top banking and insurance regulator and central bank party secretary Guo Shuqing and finance minister Liu Kun. All three men were seen as too market-oriented and reform-minded.

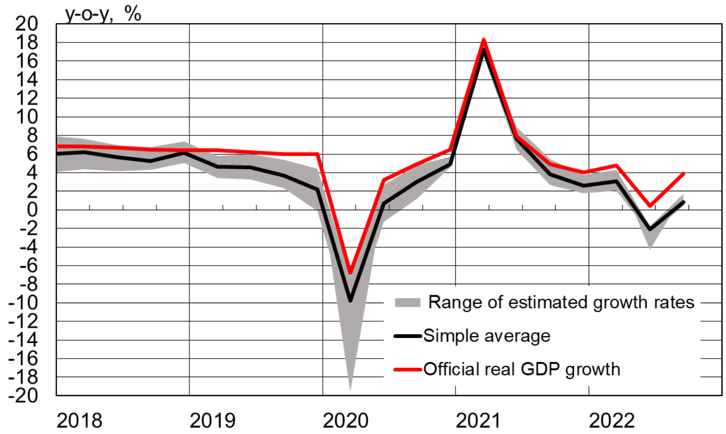
China reports surprisingly brisk GDP growth in the third quarter. Following the adjournment of the National Congress, China announced on October 23 that third-quarter GDP growth rose by 3.9 % y-o-y in the third quarter. In q-o-q terms, growth was also close to 4 %. BOFIT's own alternative estimates, however, indicate that actual 3Q GDP growth was likely lower than official figures suggest. The disparity between official and alternative figures has increased substantially this year.

Monthly indicators show that consumer demand weakened again in September. Nominal growth in retail sales fell from 5 % y-o-y in August to 2.5 % in September. Because real growth figures for retail sales are no longer released, it must be proxied by consumer price inflation, which was 2.7 % y-o-y in September. Weak demand was also reflected in imports, which fell in September by 0.4 % y-o-y in dollar terms. Export growth slowed throughout the third quarter, falling to annual pace of 5.6 % in September. In contrast, industrial output revived slightly, climbing above 6 % in September. Production increased most in such branches as transport vehicles, solar panels, generators and aluminium alloys. Larger production decreases were seen in metal containers, portable power tools and semiconductor chips.

China's zero-covid policies have been particularly hard on economic growth, leading to production stoppages, restrictions on movement, increased uncertainty and lower demand (especially in retail sales and service branches). In addition to weak demand, developers continue to struggle with financing, limiting any chances of recovery in the real estate sector. The third quarter saw a drop of 45 % in new building starts and a 22 % decline in real estate sales from 3Q21. A record slowdown in growth of the household loan stock also reflects the agony of the real estate sector. In September, the stock of household loans grew by just 4.5 % y-o-y (at the end of 2021, growth was still well in double digits). Lending to households represents just under 30 % of the total bank lending stock. On-year growth in the stock of corporate loans increased to 14 % in September.

Media reports continue to mention new and widening covid measures. China's official purchasing manager indices for manufacturing and services fell in October below the neutral reading level of 50 points, implying a contraction in economic activity is underway. London-based Markit's PMI readings for manufacturing and services, which cover relatively more privately held firms and firms operating in the export sector, have both been below 50 since September.

Alternative calculations suggest that China's GDP growth this year again substantially undershot official figures



Sources: NBS, Macrobond and BOFIT.

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Russia

Contraction of Russian economy accelerated in September. Preliminary figures from the economic development ministry show Russian GDP contracted by 5 % y-o-y in September, a slightly higher pace of decline than the 4 % recorded for July and August. For the January-September period, the ministry estimates GDP shrank by 2 % y-o-y. Russian GDP was still growing briskly in January and February prior to the invasion of Ukraine.

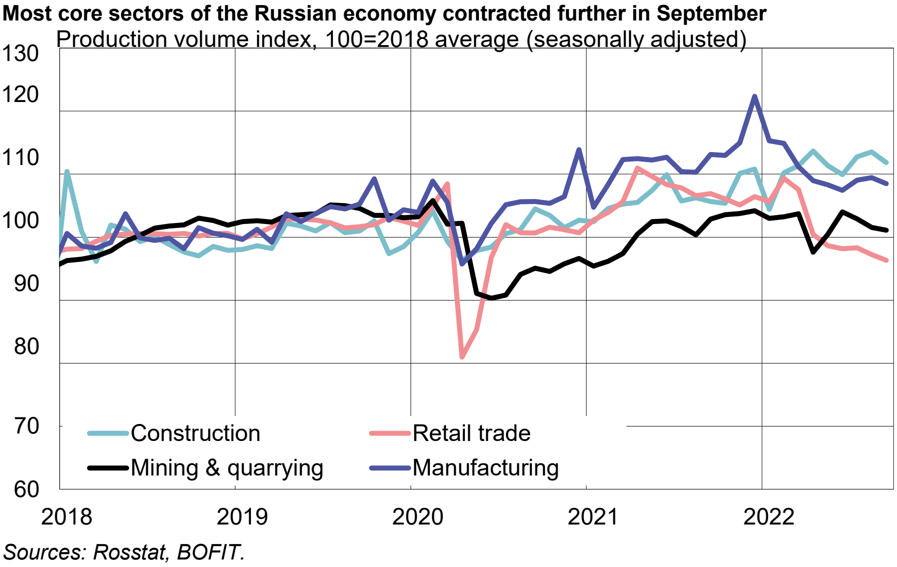
September deterioration was led by consumption. The drop in consumer demand deepened with the volume of retail sales down by about 10 % y-o-y in September. Consumer demand was quelled by reduced purchasing power as real incomes shrunk by more than 3 % y-o-y during July-September. Consumption was further depressed by the partial mobilization that started in late September.

The decline in industrial output deepened in September. Production of mining and quarrying industry contracted by 2 % y-o-y. While crude oil output was up slightly, growth slowed to just 0.5 % in September. Production of all other major mining products contracted. The drop was led by lower output of natural gas, which was down by 26 % y-o-y (not including LNG). The drop in manufacturing output accelerated in September to 4 %.

Agriculture and construction continued to prop up the economy in September. Agricultural output rose by 7 % y-o-y, while construction, despite some cooling, was still up by 6 % y-o-y in September. Housing construction activity, however, slipped into decline in September, falling by 8 % y-o-y.

The economic impacts of the partial mobilisation, which started in late September and was stated as completed at end-October, are already apparent. Russian company surveys from October reveal that about a third of respondents said that the mobilisation had affected their employees. An even larger share of firms said they expected the mobilisation to affect negatively the labour market and demand in coming months.

Most core sectors of the Russian economy contracted further in September



Sources: Rosstat, BOFIT.

Russian real household incomes slide. The drop in household incomes gained slight momentum in the third quarter, falling by 2.5 % y-o-y in real terms. The drop so far has been less precipitous than in the recessions of 2015–2016 and 2020. Real disposable incomes, i.e. income after taxes, interest payments and other necessary payments, were down by nearly 3.5 % y-o-y.

The on-year drop in wage income, which represents nearly 60 % of household income, slowed in real terms to less than 3 % in the third quarter. Real wages in the corporate sector were fairly stable all summer even with the kick-in of economic recession and a sharp decline in government subsidies to companies. Real wages in the government sectors, in contrast, were down by about 6 % y-o-y in the third quarter.

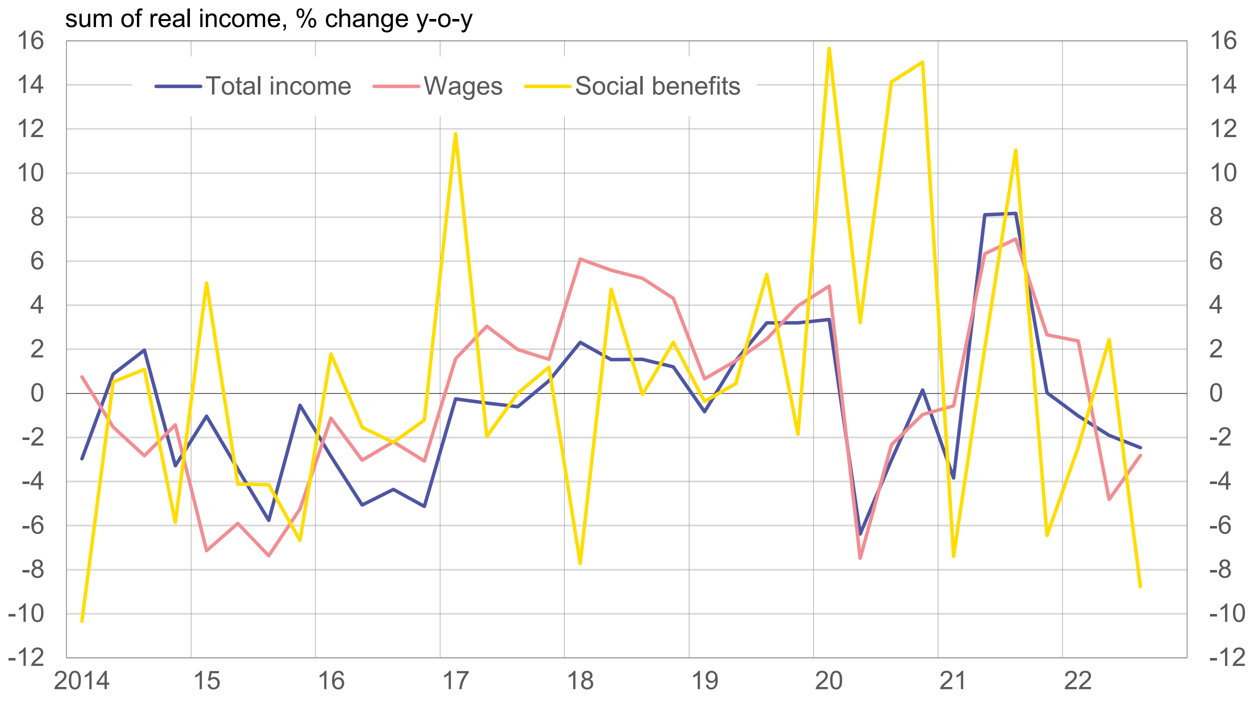
High inflation has also meant that government social support programmes have not managed to keep up with the loss of household purchasing power. For the first three quarters of this year, the value of social support benefits was down by 3 % y-o-y in real terms. Notable variations of social benefits within several past years have depended partly on the speed at which the country's leadership has responded with additions to social support. For example, an extra pension increase to compensate for higher inflation was implemented on 1 June. Instead, social supports plunged on-year in real terms in the third quarter. Some of this drop reflects the high basis of autumn 2021, when pensioners received large one-time payouts. Social supports represent about a fifth of the sum of Russian household's income.

The on-year decline in household capital income in the third quarter was notable. Both dividend income and household interest income were apparently down. While bank deposits have increased somewhat from last year, deposit interest rates have fallen back since last spring and real interest rates are strongly negative.

Real incomes of individual entrepreneurs increased last year and even this year. So far, this year is completely opposite to the decreases seen in previous recessions. Furthermore, economic activity this year has fallen especially in trade branches which have accounted for over half of the sales income of small private businesses. It appears that small business owners, in anticipation of a prolonged recession and very weak prospects, may have decided to pull out income from their businesses while they can.

Other household income, which accounts for over 10 % of total household income, increased sharply in the third quarter – a pattern quite distinct from previous recessions. Income in the "other sources" category, which is not itemised, includes statistical discrepancies in household incomes, spending, saving and borrowing.

The drop in Russia household real incomes to date has been fairly moderate



Sources: Rosstat and BOFIT.

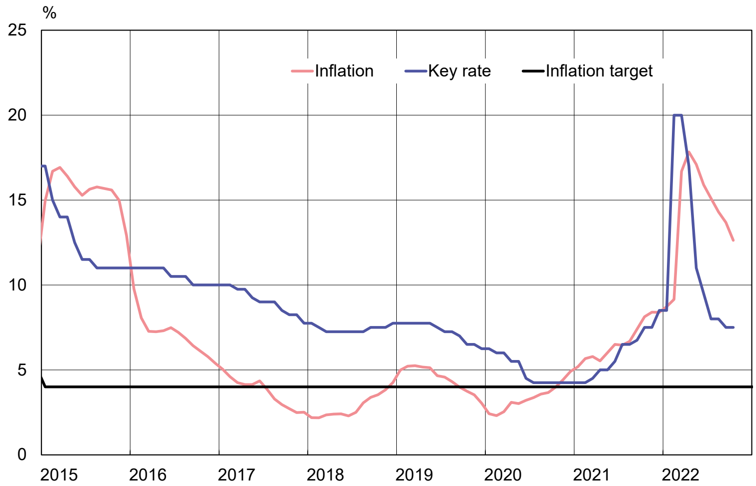
CBR kept key rate unchanged and released updated economic forecast. October 28, the Central Bank of Russia decided to keep its key rate at 7.5 %. Most analysts expected the decision as the CBR had signalled in September that it was near the end of the current rate-cutting cycle. The CBR dropped the key rate five times between April and September by a total of 12,5 percentage points.

On-year inflation in Russia is still high. Even with a slower rise in prices than in previous month, consumer prices were up by 13 % y-o-y in October. Food prices were up by 12 %, non-food goods by 13 % and services by 11 %. The product categories that saw the largest increases were detergents and cleaning agents (up 32 %), sugar (31 %), insurance (30 %), butter (22 %) and grain products (21 %). The inflation expectations of firms and households are high and have grown slightly since summer.

The CBR released also its updated economic forecast for 2022–2025. The previous forecast released in July expected the economy to contract by 4–6 % this year, while the latest outlook sees GDP contracting only by 3–3.5 %. The forecast for the next years remains unchanged, i.e. the economy is expected to contract by 1–4 % next year and grow by 1.5–2.5 % a year in 2024 and 2025. Domestic demand is forecasted to weaken less than previously expected this year. Household consumption is expected to contract by 3–3.5 %, while investment could even rise in the range of 0–1 %. Exports should contract by 15–16 %, while imports decline by 22.5–23.5 %.

The CBR now expects to finish out this year with 12-month inflation running in the range of 12–13 %. The inflation forecast for other years was unchanged. Inflation stabilises in the range of 5–7 % by the end of 2023 and returns to the CBR's 4 % inflation target in 2024 and 2025. The CBR expects its key rate to settle in the range of 4.5–6.4 % next year and 4.1–4.8 % in 2024.

The CBR decided to leave its key rate unchanged in October



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

China's exports to Russia continued to rise in October. The value of Chinese goods exports flowing to Russia declined sharply last spring following Russia's attack on Ukraine, but it has recovered to pre-invasion levels in autumn. The growth in exports has slowed in recent months following summer's brisk recovery. Preliminary figures for October show exports were still slightly higher than in September. China is now clearly Russia's largest source of imports, accounting already for more than a third of Russia's goods imports last summer.

Within China's exports to Russia in March-September, fastest growth was recorded for chemical products, possibly a reflection of high commodity prices. Exports of motor vehicles have grown rapidly, particularly exports of vans and car parts. In contrast, exports of machinery & equipment grew more slowly than total exports and have barely managed to make up for last spring's decline. It thus appears that China has not compensated (so far at least) at a substantial scale for Russia's loss of technology imports from other countries.

China and other East Asian countries have been key suppliers of Russian technology imports. Nearly half of Russia's imports of electrical equipment came from China in 2019. The ten ASEAN member countries and Taiwan have also been major suppliers of electrical and electronic devices to Russia. Japan and South Korea have been particularly important suppliers of motor vehicles and ships for Russia. Russia's technology imports from East Asia are discussed in our latest BOFIT Policy Brief.

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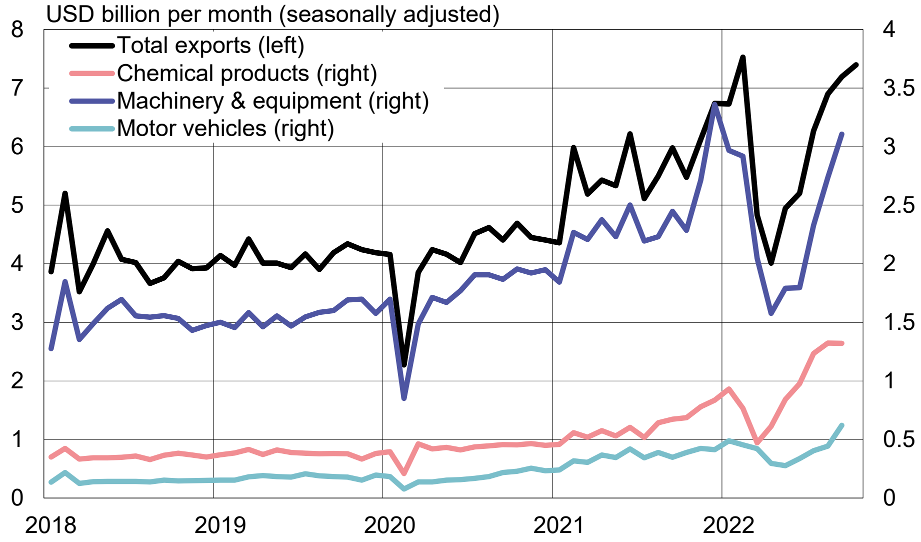
China's goods exports to Russia rose slightly further in October



Sources: Macrobond, BOFIT.

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China

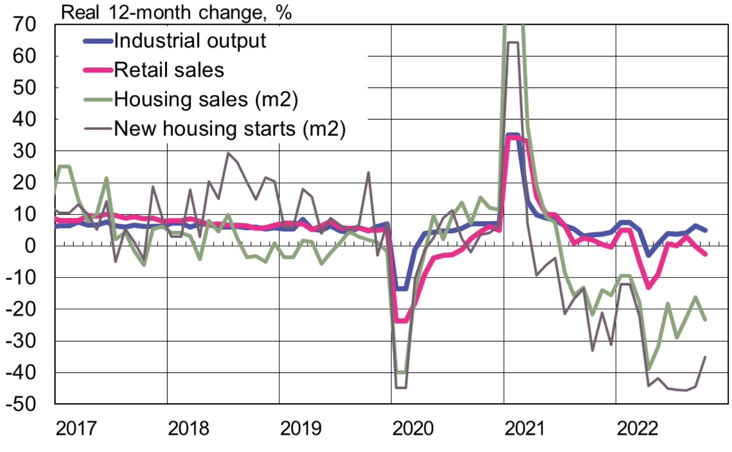
China's October economic figures suggest extensive economic problems. Following surprisingly strong third-quarter growth figures, the reported October numbers reveal much weaker performance. The drivers of problems facing China include production disruptions due to zero-covid policies, depressed domestic demand caused by increased uncertainty, a floundering real estate sector and most recently a gloomy outlook facing the export sector.

Nominal growth in retail sales turned negative in October, shrinking by 0.5 % from a year earlier. Based on October consumer price inflation (2.1 % p.a.), real growth in retail sales was strongly negative. The rise in both food and energy prices slowed in October. Core inflation, which excludes these two most volatile categories remained unchanged from September at 0.6 %.

Producer prices began to decline in October and producer price inflation was-1.3 %. On-year growth in industrial output slowed to 5 % last month. The slowdown in growth was broad-based across many production branches. Exports went into a downturn, contracting by 0.6 % y-o-y in dollar terms in October. Imports contracted by 1.1 %. Import and export prices have both risen in recent months at around 10 % y-o-y, although the rate of rise has slowed. Export volumes declined on-year in both August and September. Import volumes have declined every month since February. October foreign trade volume data will be released later.

October data on real estate sector activity reveal that building starts and the volume of apartment sales continued to contract year-on-year. Growth in the stock of housing loans slowed to below 4 % y-o-y. The People's Bank of China and the China Banking and Insurance Regulatory Commission (CBIRC) last Friday (Nov. 11) presented financial institutions a 16-part plan to help stabilise the real estate sector. The plan seeks, among other things, to support the completion of existing construction projects and secure financial stability by preventing larger defaults. Financial institutions are requested to ease off on lending and grant extensions to payment times. However, the measures do not resolve existing problems so much as kick the can down the road. In addition, the downturn in the real estate sector is strongly linked to China's zero-covid policies. As long as households experience high uncertainty and have weak confidence in the future, the outlook for demand in the housing market will remain subdued.

The downward trend in China's economic growth continued in October



Sources: NBS, CEIC and BOFIT.

As the latest covid wave hits China, the government makes adjustments to covid rules. The number of confirmed covid cases has soared in recent weeks. The average daily number of confirmed covid infections exceeded 20,000 this week, with the lion's share of infections being asymptomatic. No new covid deaths have been reported in China since last spring. While confirmed cases are now found in every province, about two-thirds of them have been identified in the southern province of Guangdong, China's largest provincial economy. The provincial capital, Guangzhou, has imposed lockdowns of several districts. According to data compiled by Gavagal Draconomics, nearly all of China's 100 largest cities surveyed were implementing tightened covid restrictions at the end of October. Such wide-scale restrictions were last seen in March. The current restrictions, however, are generally more relaxed than last spring.

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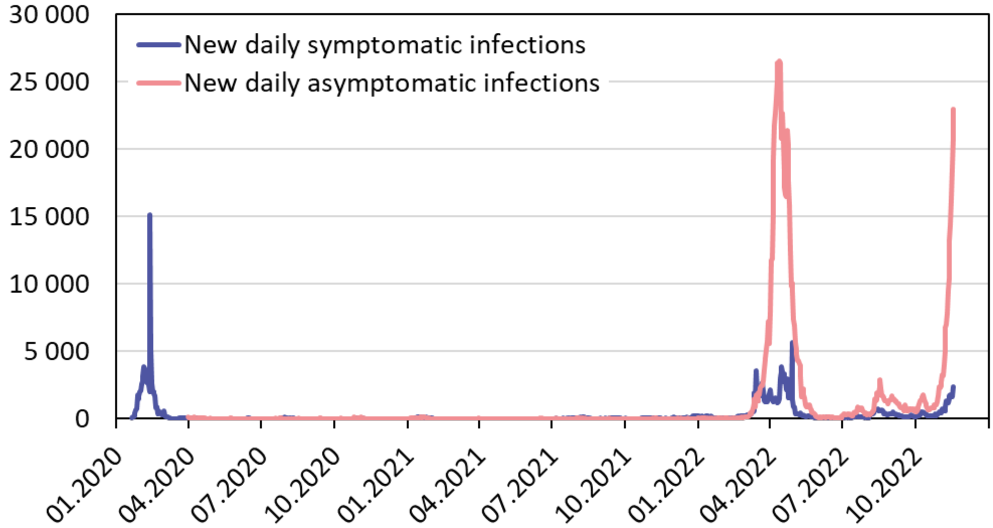
Even as the latest covid wave has gathered steam, officials announced on November 11 a total of 20 covid rule changes designed to “optimise”, rather than phase out, zero-covid policies. The changes include a reduction of two days in the mandatory facility quarantine time for exposed individuals. Exposed persons now have to spend five days at an official quarantine facility and three more days in isolation at home. The same rule applies to people coming from abroad. The required two PCR negative tests to passengers has been reduced to one. Mass-testing of entire cities will now only be required in certain instances. Tracing of people who have been in close contact with a person exposed to covid-infected person has been suspended. Officials also emphasised the need for increased healthcare capacity, covid vaccinations and the availability of equipment for covid treatment. The local governments implemented new regulations immediately. For example, riders of public transport in Shijiazhuang are no longer required to show a negative covid test result. Pupils in Shanghai primary and middle schools are now only covid-tested three times a week, instead of five.

The economic consequences of China’s strict covid policies have been significant. They have interfered with the lives of people, broadly affected business operations and caused unrelenting uncertainty in all sectors of society. The new rules should somewhat ease the situation. While the rule changes are welcome, zero-covid policies remain in place. Officials say the changes are mainly intended to ease the situation for local governments as the old rules were extremely costly to implement. The new rules free up local government resources for more effective use. Many local governments were already stretched financially and drowning in debt before the covid pandemic. Their financial problems are evidenced, for example, in the accounts receivable of covid-test producers, which have doubled within a year to over 5 billion euros.

China has recently witnessed a new spike in its official covid infection figures



Sources: China’s National Health Commission, CEIC and BOFIT.

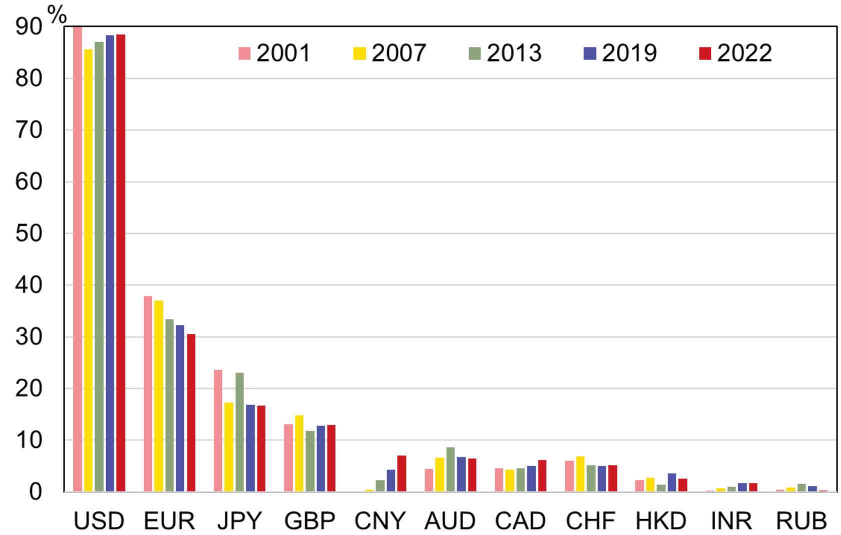
Use of the yuan in international foreign currency trading rises. Last month the Bank for International Settlements (BIS) released its Triennial Central Bank Survey of foreign exchange and over-the-counter (OTC) derivative markets. This year’s survey found the yuan’s share of international foreign exchange trading was 7 % in April, with the yuan rising to become the world’s fifth-most-traded currency. As two currencies are involved in any currency trade, the sum of currency trades adds up to 200 %. Thus, the respective currency shares in April were 88 % for the US dollar, 31 % for the euro, 17 % for the Japanese yen and 13 % for the British pound. The yuan’s share in the April 2019 survey was 4.3 % (8th most exchanged currency) and 4 % in the 2016 survey.

Most yuan trading and overall international forex trading is based on foreign exchange (FX) swaps and spot agreements. A tenth of yuan trade involves option contracts, which is more than the average in international FX trading. Most yuan trades are done against the dollar (94 % of all yuan trades). In addition to yuan-dollar currency pair, the BIS also reports yuan-euro trading. In this year’s survey, euro was the counterparty currency involved in 2 % of yuan trading. From a geographic standpoint, the most forex trading is conducted in the UK, which is also the second largest yuan trading hub. The most yuan trading is done in Hong Kong, and the next largest yuan trading hubs are in mainland China and Singapore.

Use of the ruble in forex trade has collapsed, falling from nearly 2 % in 2013 and 1.2 % in 2019 to just 0.2 % in April 2022. The Indian rupee’s share remained around 2 % and the Hong Kong dollar’s share fell from 4 % in the 2019 survey to just under 3 % this year. 94 % of ruble trades are done against the dollar, and the dollar is even more dominant counterparty currency in rupee trading (97 % of turnover). The bulk of the ruble forex trading is concentrated in the UK.

The survey also addresses trade in OTC interest rate derivative markets. The yuan plays a significantly smaller role in derivatives trading, and in April its share was only 0.6 %, smaller than e.g. the New Zealand dollar or the Czech koruna (shares summed to 100 %). Practically all yuan OTC derivatives trade consists of interest rate swaps. The UK is also the global hub for interest rate derivatives trading. Only 0.2 % of trade is conducted in mainland China and 5.6 % in Hong Kong.

The Chinese yuan (CNY) plays a small, but growing, role in global currency trading



As two currencies are involved in each transaction, the sum of shares in individual currencies in foreign currency trades totals 200%. Sources: BIS and BOFIT.

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Russia

Russian federal budget revenue streams at low level; spending continues to rise. As in September, nominal federal budget revenues dwindled by about 4 % a year in October. Even though the price of Urals-blend crude oil was lower for the first time this year in September and October compared to a year earlier, oil & gas tax revenues were up notably. The rise in oil & gas revenues came from an extra mineral extraction tax collected from Gazprom. Without the additional payment, oil & gas tax revenues and total budget revenues dropped by about 20 % y-o-y. Gazprom has been ordered to pay the extra tax for a three-month period. The total sum corresponds to about 0.8 % of GDP.

The on-year drop in other budget revenues increased to 20 % in October. Increases in value-added tax revenues from domestic production cooled off and revenues from import duties and taxes on imports remained deep down. The downslide of other budget revenue streams has become deeper in recent months.

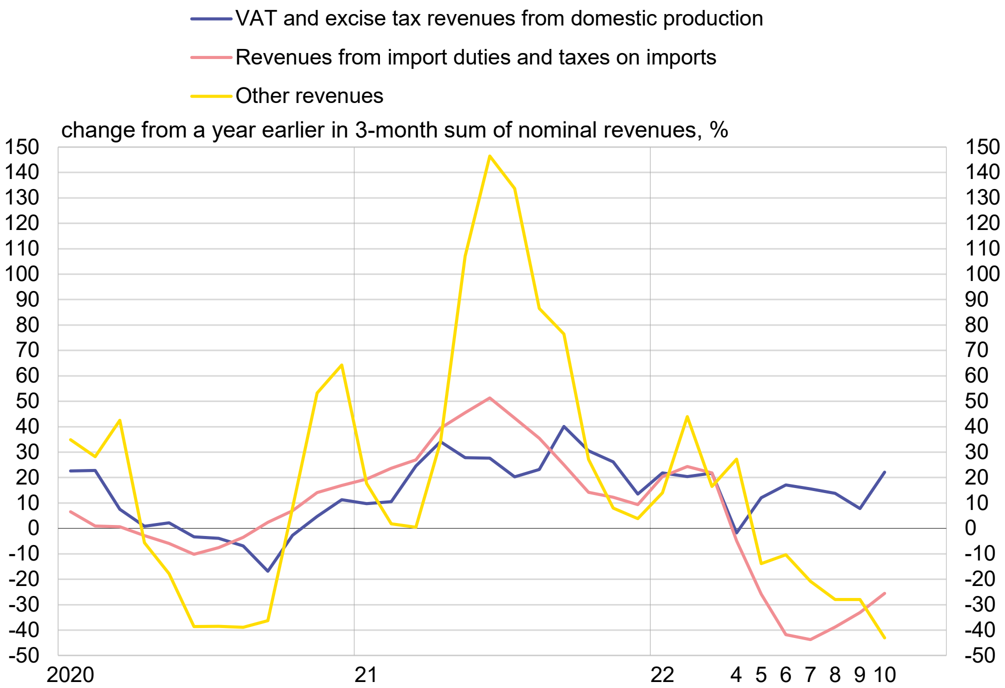
The on-year rise in federal budget spending remained brisk in October, at over 25 % y-o-y. Unlike in previous years, the rise in spending has not been subject to formal limits as Russia has abandoned its fiscal rule for this year. The government has also been given new authority to increase spending this year without requiring legislative amendments to the budget.

The budget's surplus has been reduced in recent months by the lower revenues and increased spending. For the past twelve months, the budget showed a deficit due to last December's usual very large deficit. The 12-month deficit was in October to over 1 % of GDP, or slightly below the target set for this year.

Thanks to the budget surplus posted in January-October, the government had little cause to draw on the National Welfare Fund for funding this year. The government has actually set aside assets equal to nearly 2 % of GDP even without a fiscal rule in place. At the end of October, the assets of the Fund categorised liquid and on deposit with the Bank of Russia corresponded to nearly 6 % of GDP.

Reliance on the fund this year may be much less than planned earlier because the government has begun borrowing actively from the domestic market. The value of government bonds issued since mid-October corresponded to about 1 % of GDP. Over two-thirds of that has been issued over the past two weeks. Russia has apparently turned to the bond market to finance debt repayments coming due in December and December's anticipated spending surge.

Federal budget revenues from sources other than oil & gas taxes have seen sharp declines



Sources: Russian Ministry of Finance, BOFIT.

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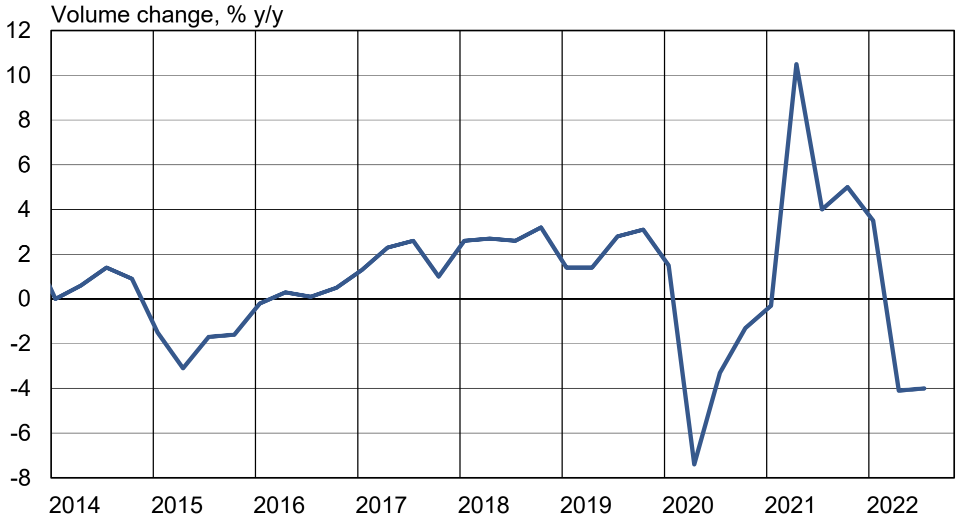
Contraction of Russian GDP continued in the third quarter. Preliminary Rosstat figures show that Russian GDP contracted by 4 % y-o-y in the July-September period (second quarter contraction was 4.1 % y-o-y). The economic impacts of Russia's invasion of Ukraine are now clearly reflected in the country's main economic indicators, particularly domestic demand. Branches dependent on imported inputs and components from foreign suppliers have also been struggling.

Wholesale trade was sharply impacted in the third quarter, falling by 23 % y-o-y. The volume of retail sales shrank by 9 %. Freight traffic fell by nearly 6 %, while manufacturing output was down by 2 %. Supported by large harvests this year, agricultural output rose by 6 %. Construction activity remained robust, climbing by nearly 7 % y-o-y. Russia supports construction in many ways, including subsidised loans.

The most recent forecasts see Russian GDP shrinking by 7–8 % during 2022–2023. The average of the 19 institutional forecasts compiled by Consensus Economics finds Russian GDP contracting by 4.2 % this year and 3 % next year. Our latest BOFIT Forecast for Russia released in October sees Russian GDP declining by 4 % both this year and next.

Russian GDP continued to contract throughout the third quarter



Sources: Rosstat, Macrobond, BOFIT.

Russia needs to find new export markets for oil ahead of EU sanctions entering into force. The EU ban on imports of Russian crude oil enters into force on December 5. The ban applies to seaborne imports of crude oil from Russia. Crude oil is imported to EU from Russia also via pipelines. The largest buyers of pipeline oil, Germany and Poland, have announced that they will suspend also pipeline oil imports next month.

Thus, Russia should find new customers for nearly a quarter of its crude oil exports. The volume is roughly the same as the combined increase in Russian oil exports to China, India and Turkey since the start of the Russo-Ukraine war. It is not necessarily easy for Russia to manage another such a large shift to these markets. So far Russia has not found any other new significant buyers for its oil.

At the same time the EU import ban enters into force, a price cap for Russian sea-borne oil agreed by the G7 is also set to enter into force. EU and British companies that dominate the markets can then provide shipping, financing and insurance services only for such shipments of Russian oil that have been purchased at a price within the cap. The goal of the price cap is to reduce Russian export revenues, but avoid eradication of Russian oil from the global market as such a move could trigger a sharp rise in global oil prices.

Russia has said it will not abide by the price cap. While the price cap mechanism could further limit the possibilities for Russian oil exports, it is impossible to gauge the precise impacts at this point as few details have been released. Media reports suggest that in the most recent discussion a range of 65–70 dollars a barrel has been proposed for the cap. The price of Urals blend has averaged 75 dollars a barrel this month. The impacts of the EU import ban and price cap mechanism are analysed in our latest BOFIT blog post (in Finnish, English version to be released next week).

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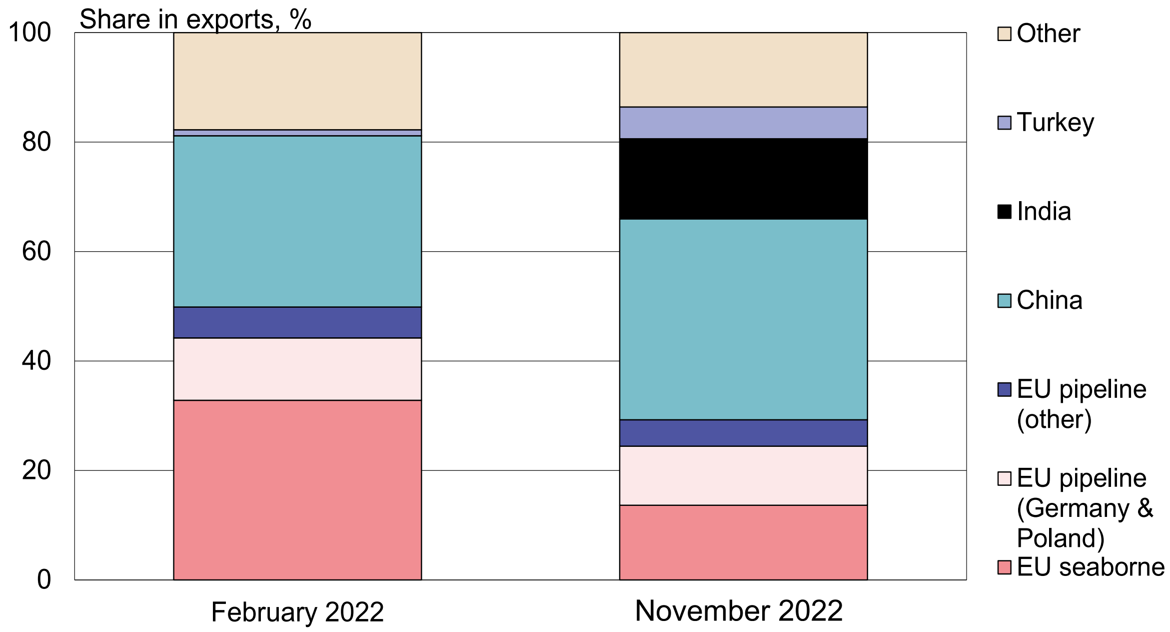
Russia is set to lose a big share of crude oil export demand as the EU sanctions are entering into force



Sources: Bloomberg, Eurostat, JPMorgan, BOFIT.

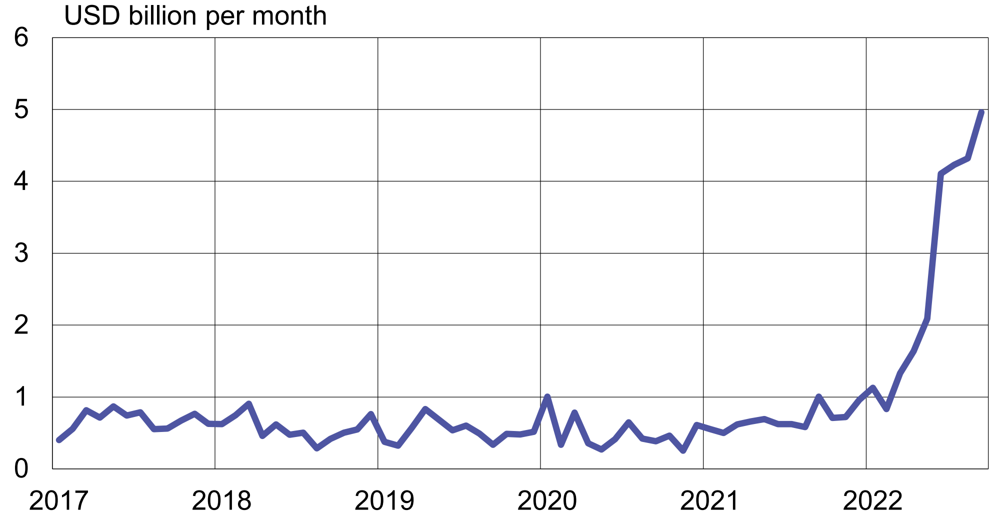
Growth in Indian imports from Russia begins to plateau. Indian goods imports from Russia have skyrocketed this year. The value of imports in September was nearly five times higher than in September 2021. At the same time, Indian exports to Russia have performed much weaker, increasing the bilateral trade deficit for India.

Crude oil largely accounts for India's soaring imports from Russia. India has substituted purchases of especially Middle Eastern oil with Russian oil sold at discounted prices. India's oil imports from Russia were expected to fade already in early autumn after increased shipping costs began to make purchases of Russian oil less attractive to Indian buyers. The G7 price cap on crude oil could impact shipments of Russian oil to India.

India has announced that it does not intend to participate in the price cap system and will continue to import Russian crude oil. US treasury secretary Janet Yellen commented this month that India is free to buy oil from Russia outside the price cap framework as long as it does so without using Western financing, maritime insurance or shipping.

India and Russia discussed bilateral economic relations during the recent visit to Moscow of India's external affairs minister Subrahmanyam Jaishankar. Jaishankar and Russian foreign minister Sergei Lavrov said they were both satisfied with the recent increase in bilateral trade and that the countries would seek to further develop their economic relations over the long term. Nevertheless, Jaishankar expressed also concerns about the Ukraine invasion and widening bilateral trade imbalance.

India's goods imports from Russia have soared this year



Sources: Macrobond, BOFIT.

China

Latest wave of protests in China distinctly different. Last weekend saw a wave of protests around China triggered by an apartment building fire in the city of Ürümqi, capital of the western province of Xinjiang. Ten people died in the fire due to covid lockdown restrictions that complicated rescue efforts. Protests are hardly unusual in China, but they are typically localised and involve a narrow issue such as unpaid wages at a particular manufacturing facility. Such demonstrations are insignificant relative to China's massive population.

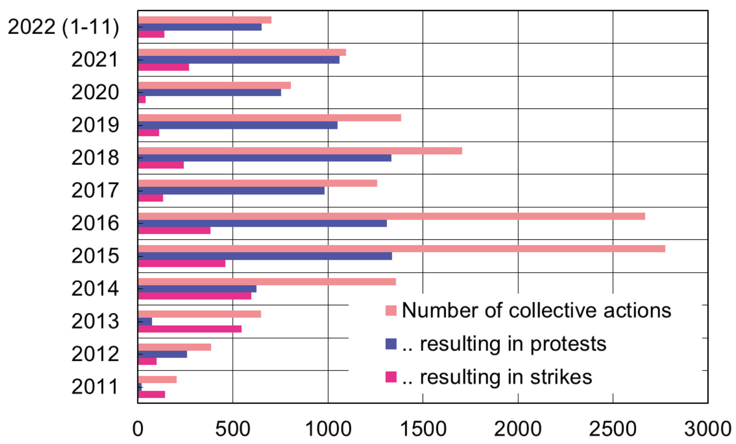
The Hong Kong-based non-governmental organisation China Labour Bulletin (CLB) has tracked collective labour actions in China since 2011. As of November this year, they had registered nearly 15,000 labour actions over the past 12 years, including nearly 9,500 protests and over 3,100 strikes. According to the CLB, about 80 % of Chinese protests recorded since 2011 involved fewer than 100 people, and only five protests had attracted at least 10,000 people. The last big demonstration in 2018 involved teachers in the city of Harbin in northeastern China demanding better pensions. Most of the 701 labour protests recorded this year had involved fewer than 100 people. Only 128 protests with over 100 people had been recorded this year until November and none involved over 1,000 protesters.

The wave of demonstrations last weekend was atypical in many ways. According to media reports, they drew thousands of people to the streets in at least ten cities, including Beijing, Shanghai and Guangzhou. The *Financial Times* estimates that the number of participants likely numbered in the tens of thousands. Students also arranged on-campus protests, including at the prestigious Tsinghua University in Beijing. Motivations for protests include dissatisfaction with zero-covid policies, but also unhappiness with China's leadership generally, the stifling of free speech and excessive censorship. The protests have been dubbed the "A4 Revolution" or "White Paper Protests" as protesters in city streets and on university campuses have shown their outrage by holding up blank sheets of A4-size paper.

Public gatherings were obstructed early this week with police presence ramped up in many cities. However, on late Tuesday (Nov. 29) evening, protests in Guangzhou turned violent. According to media reports, participants in last weekend's protests in many cities have been tracked down by the police and brought in for questioning. Under the guise of worsening covid situation, university students were requested by officials to return to their home districts and study remotely online. Tsinghua University organised free busses for students to ferry them directly to Beijing airports or train stations.

China's leadership has laid blame for the deleterious effects of lockdowns on local officials and tried to calm the population by responding to certain concerns about zero-covid polices. Over the past few days, government officials have announced that covid restrictions should not interfere with ambulance transport or rescue efforts, that the barricading of buildings to hold residents inside must cease, that vaccination rates among the elderly need to be increased and that the basic needs of people during lockdowns should be better considered.

China sees frequent protests each year related to collective labour action, but protests are typically small and concern local issues



Sources: China Labour Bulletin and BOFIT.

Reducing emissions and slowing climate change also matters for Chinese economic performance. The COP 27 UN Climate Conference held last month in Egypt, adjourned with little progress towards climate goals. The biggest achievement was a general agreement on establishment of a loss and damage fund that could be used to compensate poor countries for harms caused by climate disruption. While China officially supports establishment of the fund, it said that funding should come from developed economies responsible for most of the planet's historical anthropic carbon legacy. China's role in the fund is unclear. It has not committed to providing funding or the notion that reparations should go only to the poorest countries. During the COP 27 meeting, China and the US representatives met separately and agreed to resume their bilateral formal climate dialogue that had been on ice since August.

China is the world's largest polluter, generating 27 % of global carbon dioxide emissions and a third of greenhouse gas emissions. In 2020, China announced that its CO_2 emissions would peak by 2030 and thereafter decline so that carbon neutrality would be achieved by 2060. China's goals, however, are insufficient to keep global warming at the 1.5°C target agreed under the 2015 the Paris climate agreement. To reach the Paris target, China needs to achieve carbon neutrality at least a decade earlier. China has, however, continued to increase its coal-fired power generation and domestic coal production referring to energy security and self-sufficiency. Even if new coal plants pollute less than old ones, they still need to be phased out as quickly as possible. China's CO_2 emissions continued to rise last year, increasing by 5 %.

The World Bank released its China Country Climate and Development Report in October. The report, which deals with the costs of climate disruption and policy recommendation on emissions reduction, notes that the climate risks facing China are enormous and cloud the country's long-term growth prospects. A large part of the population and economic infrastructure is located in areas susceptible to climate risks. For example, a third of Chinese GDP is generated in coastal areas sensitive to the effects of storms, flooding and coastal erosion. In the interior of the country, the biggest threats are heat, drought, and water insecurity, all of which hit agriculture particularly hard. The direct losses from natural hazards are already materialising and have averaged around 0.5 % of GDP per year. The risk scenarios in the report suggest those costs could exceed 2 % of GDP by 2030. The costs hit poor households hardest.

Unlike advanced economies, the report notes that China is poised to separate economic growth from emissions growth much faster and at a lower income level. The precondition for success, however, is implementation of broad structural economic reforms. The transition would make a large chunk of China's carbon-intensive capital stock useless, displace workers in polluting sectors and raise energy prices at least in the short-term, with the benefits accruing later. For China to reach its 2060 carbon neutrality goals would require first defining shorter-term targets and starting from phasing out the use of coal in energy production. According to the report, the power and transport sector alone requires 14 trillion dollars (about 1 % of annual GDP) in increased investment by 2060. The cost rises to 17 trillion dollars in the scenario with accelerated emission reduction and achieving the emission peak before 2030. Nevertheless, investment would necessarily be frontloaded. The economy could adjust faster and avoid some of the foreseeable costs if decarbonisation policies are combined with structural reforms that rebalance the allocation of capital and labour, and reduce the barriers to market entry and exit for firms. The report stresses that the economic impacts of decarbonisation are likely to be manageable in China and could even promote growth by improving air quality, enhancing health and increasing productivity.

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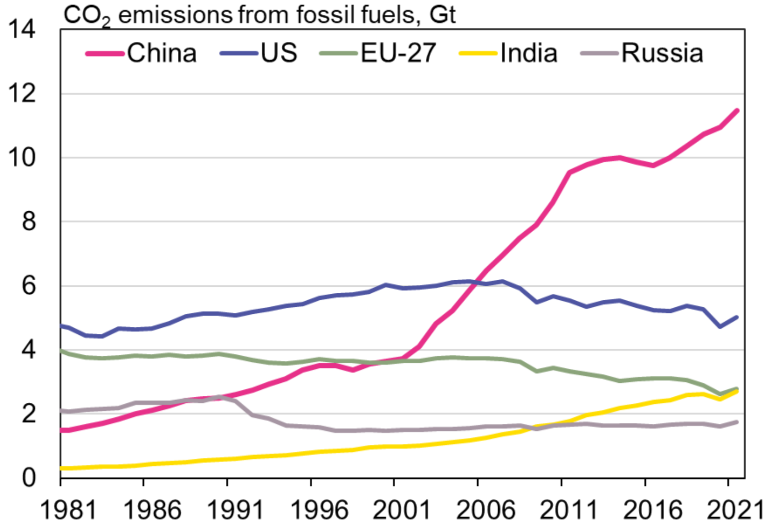
China's CO_2 emissions continue to rise. Achieving carbon neutrality by 2060 would require massive measures



Sources: Our World in Data CO2 Greenhouse Gas Emissions dataset and BOFIT.

China's central bank lowers reserve requirement for commercial banks. Following State Council comments chaired by Premier Li Keqiang a couple of days earlier, the People's Bank of China last week announced it would lower the reserve requirement ratio (RRR). Effective December 5, the general reserve requirement for commercial banks will fall by 25 basis point for large and mid-sized banks. Smallest banks are already at the lowest RRR bound of 5 %. The RRR will drop to 11 % for large banks and to 8 % for mid-sized banks. The RRR for individual banks can deviate from the general level and a large share of banks are entitled to some sort of reduction in their RRR. According to the PBoC, the weighted average RRR in the banking sector after including these exceptions will fall to 7.8 %.

The PBoC justified the RRR cut as providing support to the real economy and increasing liquidity in the financial system. The tiny rate cut in itself is not expected to have perceptible impact on the economy and China's financial markets are hardly lacking in liquidity at the moment. For example, interbank market rates are lower than PBoC policy rates. The current problem is largely a lack of demand for financing. The growth in the stock of household loans has slowed considerably this year, growing at just 3.6 % y-o-y in October. Housing loans constitute the bulk of household borrowing. The total stock of bank loans grew by just under 11 % y-o-y in October. Officials last month encouraged banks to continue supporting small firms affected by the covid pandemic through deferring interest and loan payments. The PBoC noted that reducing the reserve requirement helps the banking sector also in this task.

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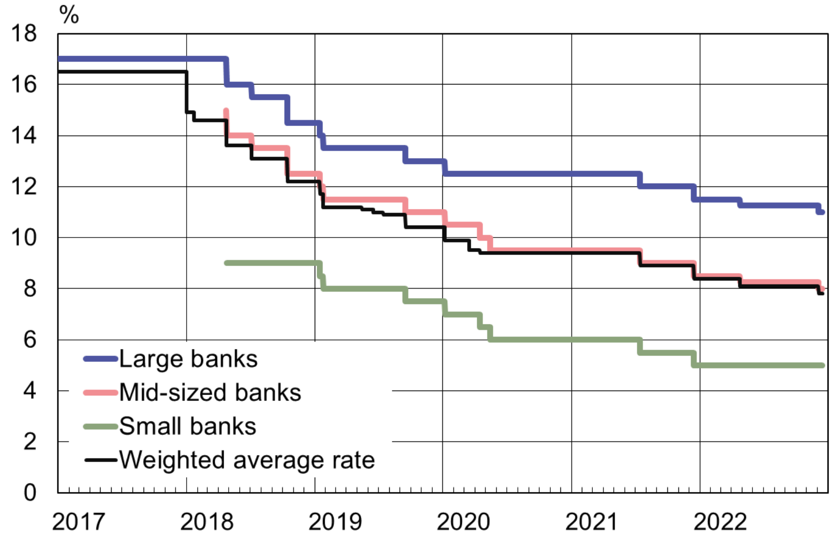
The People's Bank of China slightly cut its general reserve requirement ratio for banks for the second time this year



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

Finnish exports to China face headwinds. Last week saw the release of a review on Finnish exports to China. The review was prepared in cooperation with Business Finland, Finland's ministry of economic affairs and employment, Finland's ministry of foreign affairs and BOFIT. China has emerged over the past two decades to be one of Finland's most important export markets. Even so, Finnish exports have not been able to keep up with rapid growth of Chinese demand. Measured in foreign value-added consumed by China, Finland has lost a larger share of the Chinese market than any of the other 65 countries tracked in the OECD trade in value-added statistics. At the same time, Finnish exports have remained concentrated in the hands of the few businesses that account for the lion's share of exports to China.

The structure of Finnish exports to China has also changed dramatically. The export portfolio has shifted from machinery & equipment to raw materials and intermediate products. In countries like Sweden, Denmark or Austria, the share of commodities and intermediate products has fallen in their exports to China. Part of the major change in the structure of Finnish exports is due to the fact that Finnish firms have shifted much of their machinery & equipment manufacturing activity to China. Statistics Finland reports that about 250 Finnish subsidiaries operate in China with combined net sales of 13 billion euros in 2021. In terms of net sales, about 80 % of subsidiaries operate in the fields of machinery, metals, electronics and the electrical industry. Statistics Sweden reports that the share of the subsidiaries of Swedish firms operating in China in these fields is 55 %, while the total net sales of Swedish subsidiaries in China amounted to about 20 billion euros last year.

As part of the review, a survey was conducted in summer 2022 to the largest Finnish exporters to China. Those firms reported that over the past ten years China business operations have also led to increased manufacturing, investment, R&D activity and personnel hiring in Finland. Respondents noted, however, that China's business environment has become more challenging and the outlook is gradually becoming less rosy. Companies were most concerned about China's zero-covid policies, geopolitical tensions, increased regulation, unfair competition and favouring of Chinese production. A recent Team Finland business survey of Finnish firms in China, conducted between late October and early November, had similar findings.

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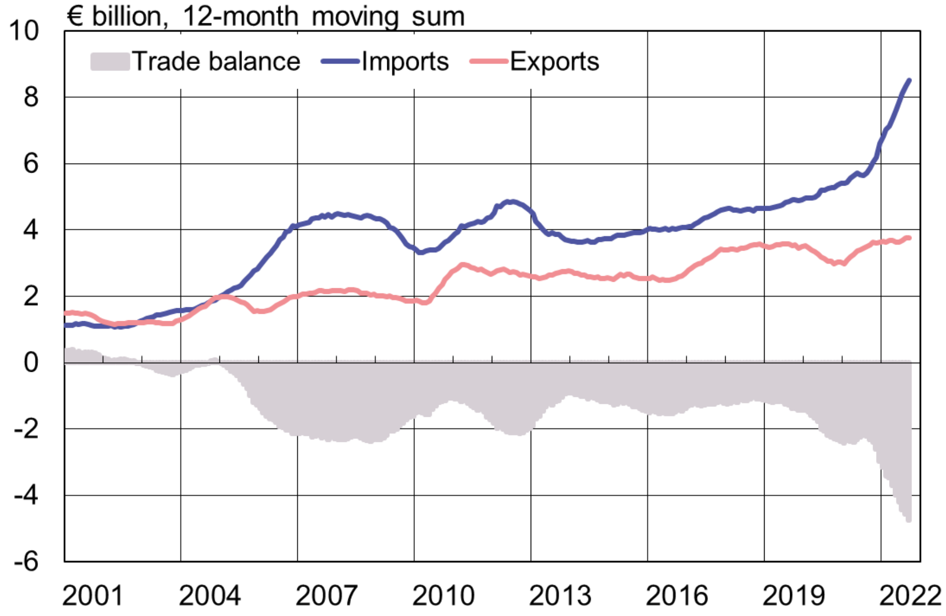
Value of Finnish goods exports to China has grown modestly while goods imports have soared



Sources: Finnish Customs and BOFIT.

Russia

EU import ban and G7 price cap on Russian crude oil enter into force; EU plans further sanctions. The ban on seaborne shipments of Russian crude oil to EU countries went into effect on Monday (Dec. 5). The ban does not apply to crude oil transmitted by pipeline. Germany and Poland, the largest European buyers of Russian pipeline crude, have announced that they will also suspend their pipeline imports. A few EU buyers (Hungary, Czech Republic and Slovakia) will at least temporarily continue to import Russian pipeline oil. Most of EU crude oil imports from Russia, however, are now ending. Russia must find new buyers for about a quarter of its crude oil exports. The import ban on Russian petroleum products enters into force in February 2023.

The G7 countries also imposed a price cap on seaborne Russian crude. Under the agreement, maritime services related to the transport of Russian crude oil can only be offered for oil priced below the price cap. The price cap is currently set at 60 dollars a barrel, but could be revised later. Russian Urals-blend crude was already trading below the cap price before the cap entered into force. Russian officials have discussed countermeasures to address the price cap, but nothing has yet been decided. A similar price cap for petroleum products should enter into force in February 2023.

The European Commission this week proposed its ninth package of Russia sanctions. Among other things, the latest round names a number of Russian individuals, companies and banks not previously sanctioned, as well as further export restrictions. For example, the export of drone engines to Russia or potential third-country suppliers is banned. In addition, new export controls and restrictions particularly on dual-use products are planned, including chemicals and IT components.

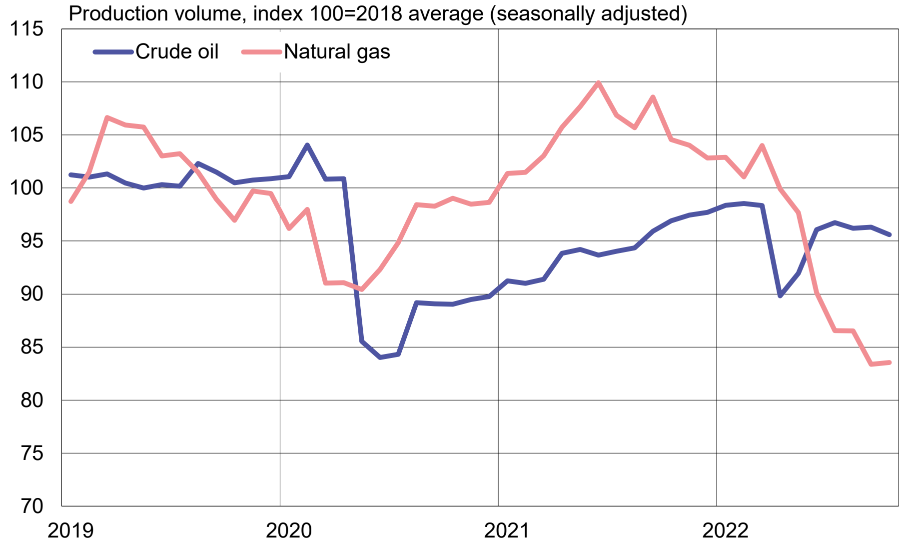
Russian economy continued to contract in October. First estimates released by the economic development ministry and Rosstat put the decline in Russian GDP in recent months around 4–5 % y-o-y. The preliminary October numbers from the economic development ministry suggest the contraction continued unabated last month. Most recent forecasts see Russian GDP contracting by 3–5 % p.a. both this year and next.

Weak consumer demand continues to hobble Russia's economic performance. The volume of retail sales in October was still down by 10 % y-o-y. Russian consumers have seen their purchasing power eviscerated by persistently high inflation. In October consumer prices rose by 13 % y-o-y. The Russian labour market remains tight, with the unemployment rate remaining in historically low level at 4 % in October. Russia's partial mobilisation of reserves shrank the labour force as several hundred thousand working-age men were either sent to the front or fled the country.

Economic development was supported in October mainly by industries related to the mobilisation of reserves and military production as well as construction. While branches such as clothing manufacture (particularly special clothing), fabrication of metal products, as well as manufacture of electronic and optical devices grew rapidly, manufacturing overall contracted by 2 % y-o-y. Construction activity accelerated in October, climbing at 10 % y-o-y. This was supported by other branches than housing, as residential housing construction contracted by 11 % y-o-y in October.

Mining & quarrying activity (includes hydrocarbon extraction) contracted in October by 3 % y-o-y. Crude oil output continued on a slightly declining trend. After falling for most of the year, natural gas production stabilised in October.

Russian crude oil production has declined slightly this year, while natural gas production fallen quite significantly



Sources: CEIC, BOFIT.

Russian households cut back on spending, durable goods most affected. Household spending on goods and services fell by 7 % y-o-y in real terms in the second and third quarters. Household purchasing power has been reduced by the spike in inflation that followed immediately from Russia's invasion of Ukraine. Consumption has notably been affected more than just the drop in real household income, which deepened as late as in the third quarter and just to 3.4 % y-o-y. As in previous recessions such as the covid recession of 2020, the drop in consumption partly reflects a significant shift to increased saving in households.

Goods purchases, which in normal years represent about 80 % of household spending, have plunged even more. Retail sales, which according to Rosstat accounts for nearly 95 % of household spending on goods, has remained down by 9–10 % y-o-y since April.

Retail sales of food items, however, have only declined by a couple percent. In the main food sales categories, the clearest drops have been seen in fish and dairy products, while sales of meat products have remained largely unchanged. Sales of alcoholic spirits continued to rise and were up by over 7 % y-o-y in the first nine months of this year.

In contrast, retail sales of non-food goods were down by about 15 % y-o-y in the second and third quarters. Along with the collapse in sales of passenger cars, there have also been sizeable drops in sales of household appliances and mobile phones but also construction materials and clothing. The sale of medicines continued to increase, albeit considerably slower than in the early months of this year.

Household purchases of services have held up relatively well, although their growth has slowed. Sales in services provided to households mainly by companies averaged real on-year growth of less than 1 % in the second and third quarters.

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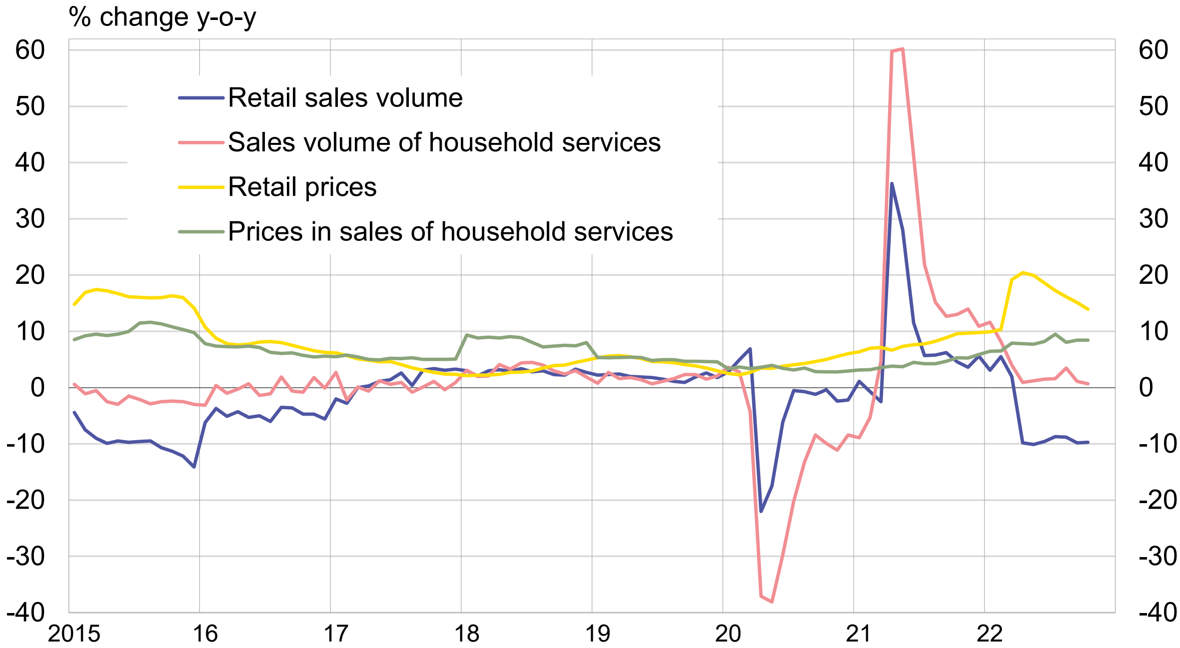
Russian retail sales have fallen as prices rose sharply. Services have seen a similar but clearly milder pattern



Sources: Rosstat and BOFIT.

Finland's trade with Russia has collapsed. The value of Finnish goods exports to Russia in September fell by 76 % y-o-y to just 80 million euros. It was the lowest value in exports to Russia in the history of monthly data published by Customs Finland that starts in 1996. Exports mainly consisted of machinery, equipment and related parts.

The value of Finnish goods imports from Russia in September contracted by 66 % y-o-y to 260 million euros. The biggest imports from Russia were nickel concentrates and petroleum products. The EU earlier banned e.g. imports of Russian timber and coal. Although the crude oil import ban entered into force at the start of this week, Finland did not import any Russian oil even in September. The ban on imports of Russian petroleum products enters into force in February 2023.

As of end-September, Russia only accounted for 1 % of Finland's goods exports and 3 % of Finland's goods imports. Russia's share in Finland's goods trade was last this low in the 1940s.

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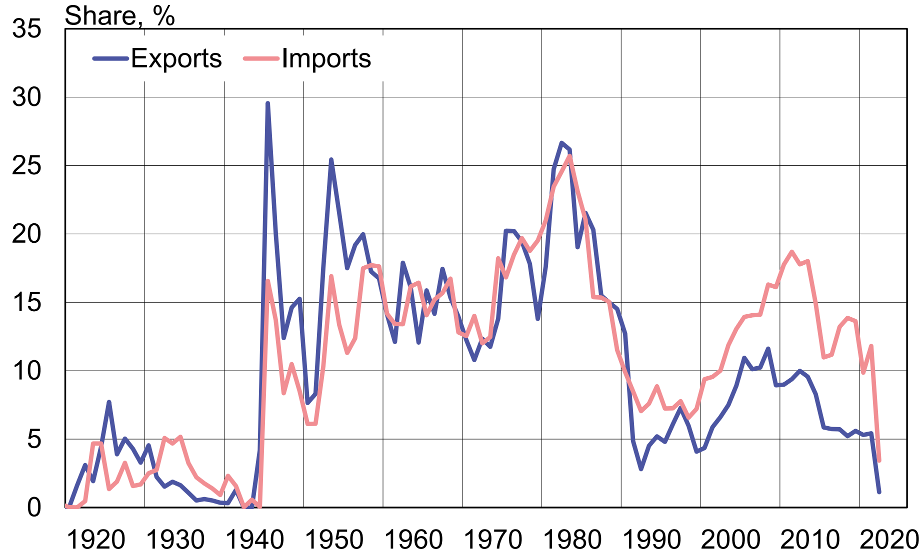
Russia's share of Finland's goods trade in September fell to levels not seen in eight decades



Sources: Finnish Customs, BOFIT.

China

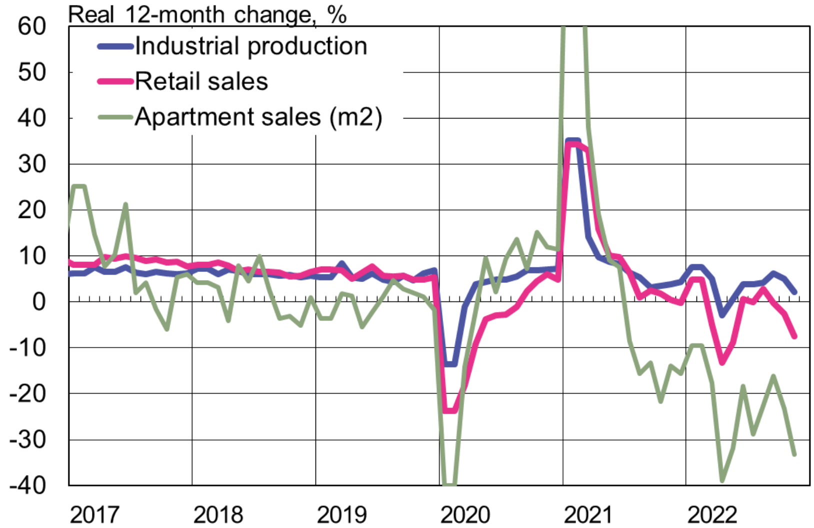
Tough November for China's economy as covid situation worsens and export demand evaporates. China's declining retail sales, a proxy for consumption demand, highlight the impacts of the latest wave of covid infections and efforts to deal with the pandemic. According to the China National Bureau of Statistics (NBS), the nominal contraction in retail sales accelerated to near 6 % in November. Taking price changes into account, retail sales likely contracted by 7–8 % y-o-y in real terms. Growth in industrial output slowed sharply from 5 % y-o-y in October to just 2.2 % in November.

The volume of exports has shrunk on-year in every month since August, a trend that is seen to continue in November. The value of exports in November fell by 9 % in dollar terms, while the value of imports dwindled by 11 %. Exports to the United States fell by 25 % y-o-y. Measured in dollar terms, Russian trade continued to rise. The value of China's exports to Russia in January-November was up by 13 % y-o-y (total exports up by 9 %) and the value of imports from Russia increased by 47 % y-o-y (total imports up by 2 %).

The acceleration in inflation is not a concern in China's case. The rise in consumer prices slowed to around just 1.6 % p.a. in November, down from around 2 % in previous months. Core inflation, which excludes food and energy prices, remained steady at 0.6 %. The rise in food prices also slowed. Producer price inflation remain negative in November, matching October's drop of 1.3 % p.a.

China's troubled real estate sector saw no improvement in November. New construction starts were down by over 50 % y-o-y, and the volume of real estate sales (measured in floorspace) was down by a third from a year earlier. New construction starts in the January-November period were at their lowest level since 2009. Apartment prices are also falling, even if the official NBS figures show only a slight drop in prices (an average of about 3 % y-o-y).

All of China's main monthly economic indicators declined in November



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

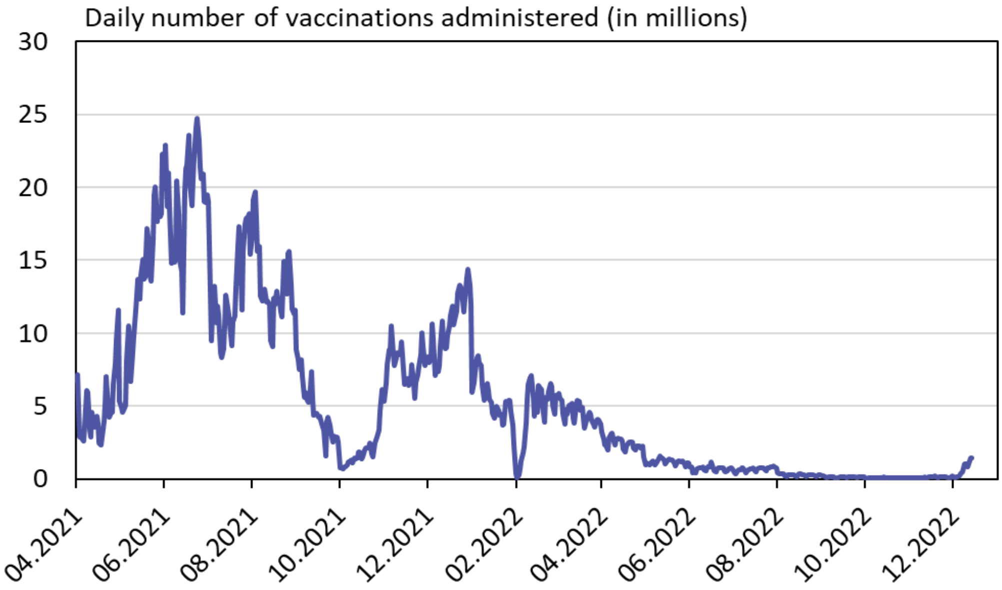
China abandons zero-covid policy. With China experiencing its largest covid wave ever, citizens took to the streets in late November to protest the hardships caused by the government's strict zero-covid policies (BOFIT Weekly 48/2022). In the wake of exceptionally widespread protests, officials announced that they were significantly relaxing covid rules. Infected persons with mild cases can now recover at home, quarantine periods have been significantly shortened, covid testing has been reduced significantly, requirements for showing recent negative PCR test result to use regional public transport or enter public spaces has been eliminated, and the of sentry or venue scans for covid status has been eliminated. The phone app used to track people's movements and covid exposures was decommissioned this week.

While it is hard to get a clear picture of the situation, the rapid about-turn in covid policy amidst China's biggest covid surge ever has likely boosted the number of covid infections to levels never experienced in the country. Current statistical data are not comparable to earlier data as testing has been significantly curtailed and China has completely abandoned its efforts to track asymptomatic cases. Officials might also be under pressure to report lower infection rates and covid deaths than in actuality. Insurance companies have ceased to offer new covid insurances. The use of mandatory isolation and special covid quarantine sites is being adjusted in some cities to better treat the sick. Several media reports claim that the capacity of Beijing hospitals, which is already stretched, has been further burdened by increased numbers of hospital staff infected with covid. Due to the lack of staffing, infected doctors and nurses have been forced to remain on the job. Some cities report that fever-reducing medicines are in short supply.

The explosive spread of covid has many fearing that China's healthcare system will be overwhelmed. China has limited bedspace in its hospitals, and even fewer intensive-care units relative to population, even if the immune protection from vaccines or having covid is still poor in the most at-risk groups. Officials last month promised to speed up vaccination of the elderly, but even a smooth-running vaccination campaign will take months given that China has 260 million people over the age of 60 and nearly 40 million people over 80. On Wednesday (Dec. 14), officials announced that person over 60 or otherwise belonging to an at-risk group are eligible for a covid booster shot. The vaccination protection of people under 60 has question marks too as many received their last vaccination shot last winter and since spring 2022 relatively few vaccinations have been administered. Moreover, the efficacy of covid vaccines developed in China is likely lower than that of vaccines used in the West, particularly mRNA vaccines.

China's zero-covid policies have long been considered ineffective against the newer, more virulent strains of covid. In addition, massive-scale PCR testing, supervision, contact tracing and quarantining at sites outside the home has been extremely costly. Many local governments have now face a financial squeeze due to the government's extreme suppression approach. However, China remains ill-prepared for opening up and its economy faces major uncertainty over the short-term.

Vaccine uptake in China has been quite low since spring 2022



Sources: National Health Commission of China, CEIC and BOFIT.

Poorer employment opportunities for young Chinese and internal migrants. According to official figures, 747 million people were employed in China last year, of which 63 % had jobs in urban areas. The number of employed persons has fallen now for seven years in a row. The service sector last year provided already nearly half of all jobs. Even with a constantly declining share, the agriculture sector still accounted for over a fifth of employment last year. The remainder, nearly 30 %, are employed in construction or industrial sectors. This share has remained relatively stable in recent years.

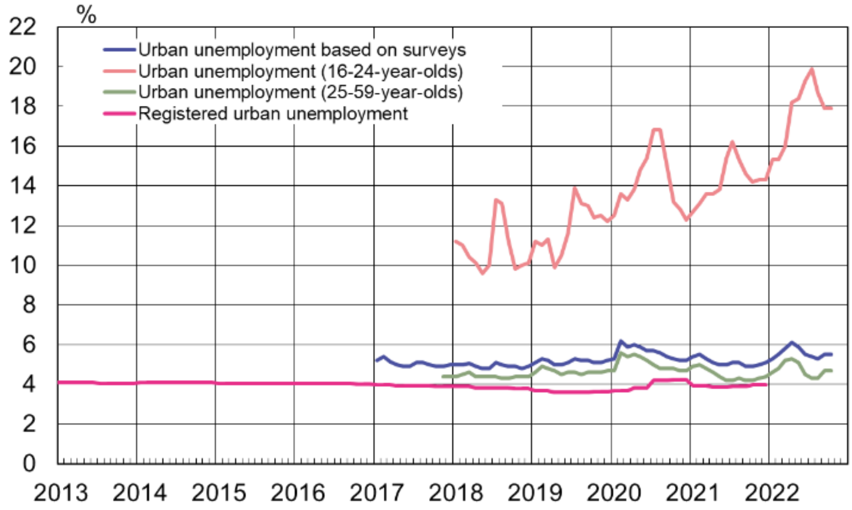
China had a total of over 290 million migrant workers last year. That number grew steadily for 15 years up to 2020, when the number of statistically recorded migrant workers fell as the covid pandemic led to job cuts in cities. Over half of migrant workers are employed in the eastern parts of China. Since 2018, the service sector has been the biggest employer of migrant labour. Conversely, the share of migrant workers in industry has shrunk over the years. Jobs for migrant workers are usually the first to go in an economic downturn. Covid restrictions limited the employment opportunities for migrant workers particularly in service jobs. In addition, the NBS reports that there were still more than 10 % fewer jobs in industrial firms in October than at the end of 2019.

Part of the reason that China's unemployment rate has been so steady is that official unemployment figures do not include migrant workers who lose their jobs. Since the beginning of 2000s, China has published quarterly assessments of urban unemployment based on registration data. That figure held consistently around 4 % for many years. However, to be registered as an unemployed, a person must be under 60 and be officially domiciled in the same urban area as the employer in order to meet the criteria for receiving unemployment benefits. Thus, migrant workers domiciled elsewhere than the city where they live and work are not included in the unemployment figures.

Since 2017, the NBS has also been publishing a monthly survey-based estimate of urban unemployment. The survey extends to all urban workers, including migrant labourers and persons with a registered domicile in the city but who actually live in the countryside. However, even this statistic does not include migrant workers who have lost their jobs and left the city to return to their rural home district. It also omits the roughly 150 million self-employed Chinese who earn their living as sole proprietors.

Youth unemployment in cities recently peaked at a record 19.9 % last July. Younger cohorts have typically been employed in such fields as tutoring, technology and real estate. Earlier, about a quarter of persons employed as private tutors were under 25 and tech firms offered generous intern programmes for young people. Employment opportunities have dried up in these fields in recent years due to increased regulation and oversight. Officials are now scrambling to counteract the decrease in job opportunities by e.g. increasing the annual intake quota for civil servants as well as urging universities to raise the number of persons admitted to post-graduate programmes.

Chinese youth unemployment has climbed rapidly in recent years



Sources: NBS, CEIC and BOFIT.

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Russia

One-off payments boost Russian federal budget revenues in November, spending continues to grow. Budget revenues saw November spikes that lifted revenues significantly relative to November 2021. Gazprom paid one part of its large October-December extra tax on gas production and the government's dividend income for the first half of the year from state-owned firms, especially Gazprom, rose very sharply. While total nominal revenues in September-November otherwise fell by 6 %, Gazprom's production tax payment boosted them to an increase of 6 %.

Gazprom's production tax payment contained the drop in revenues from oil & gas taxes, which otherwise fell by 26 % y-o-y in September-November. The price of Urals-blend crude oil in October-November was about 15 % lower than a year earlier and the ruble exchange rate, which is used to convert oil & gas taxes denominated in dollars, was up 15 % y-o-y. Revenues from export duties on natural gas plunged. Revenues from crude oil production, which accounted for 74 % of all oil & gas tax revenues in January-November, began to decline in October and November.

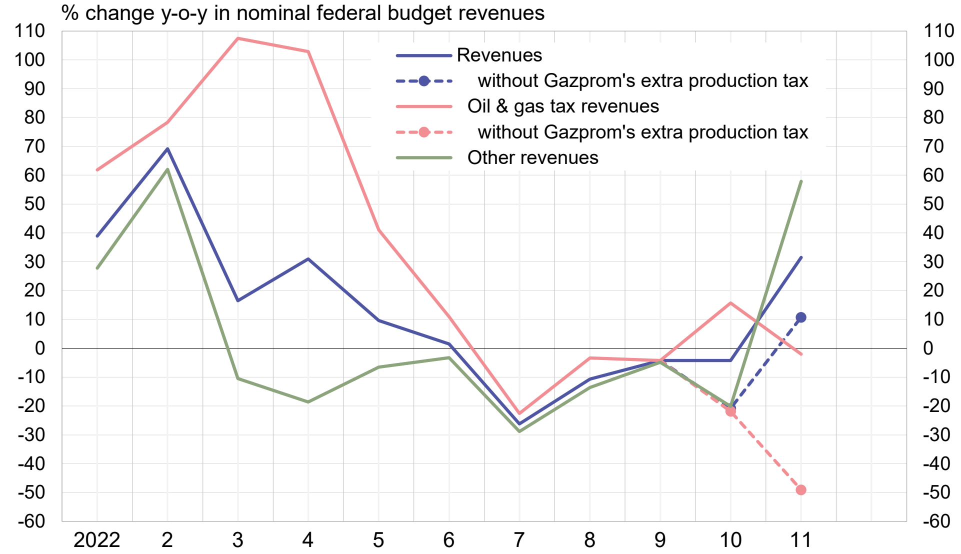
Other federal budget revenues rose fast in November, driven largely by dividend income and the timing of VAT payments by domestic producers. Import duties and taxes, similar to previous months, were down about 25 % y-o-y in November.

The rise in nominal federal budget spending slowed in November, but was still over 20 % y-o-y. Spending in January-November was up by nearly 22 % y-o-y, indicating that spending this year will likely overshoot the estimate presented in the autumn.

The federal budget deficit over the last 12 months remained in November at around 1 % of GDP. The surplus for January-November was under a half percent of GDP. Finance minister Anton Siluanov's recent estimate that the deficit for all of 2022 would be about 2 % of GDP suggests that the government's end-of-year spending will be at least as large as usual.

With the deficit in sight, the finance ministry has continued to sell debt securities to domestic banks at a brisk pace. Sales since mid-October equal over 2 % of GDP. For the time being, the CBR seems not to have dispensed plenty of liquidity to banks for that. Dipping into the National Wealth Fund to cover the budget deficit will probably remain quite limited.

Extra production tax payments from Gazprom helped mend Russia's weak federal budget revenues



Sources: Russian Ministry of Finance and BOFIT.

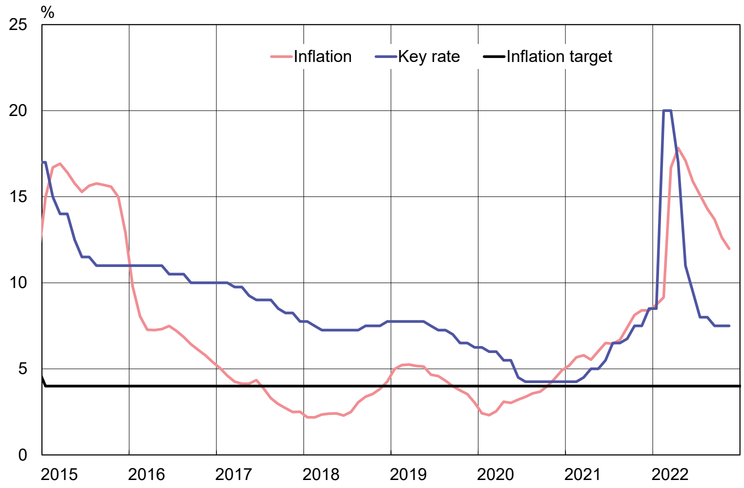
Central Bank of Russia keeps key rate unchanged. On December 16, the CBR decided to keep the key rate at 7.5 %. The decision was generally expected by market analysts.

Inflation peaked in Russia this year in April in the wake of the invasion of Ukraine. While on-year inflation has since slowed, November consumer prices were still up by 12 % y-o-y. Food prices were up by 11 % y-o-y, non-food goods by 13 % and services by 11 %. Among specific product groups, the largest price hikes were registered in foreign travel (up 67 %), detergents and cleaning agents (31 %), insurance (29 %), sugar (22 %) and pasta (21 %). Inflation expectations of firms and households remained elevated.

November core inflation, which excludes e.g. typically very volatile items (like energy and food), was 15 %, or slightly higher than consumer price inflation. The difference is largely explained by bumper harvests this year and export bans on certain food products since the start of the Russo-Ukraine war. Food prices, which have considerable weighting in consumer price index, have risen slower than prices of non-food goods and services. Core inflation includes nearly 80 % of products in the consumer prices index. In many other countries, core inflation tends to be a bit lower than consumer price inflation.

The CBR noted the inflation risks coming from Western economic and financial sanctions, as well as the risk of further tightening of sanctions. Declining import affects production and reduces supply, especially if the industry's production relies on foreign technologies or other inputs subject to sanctions. Employment is currently high, which could create pressure to raise salaries and drive up inflation. On the other hand, the savings rate of households is also high, which could reduce household spending and inflationary pressures. The CBR currently expects 12-month inflation to slow to a range of 5–7 % in 2023 and reach the central bank's 4 % inflation target during 2024.

With inflation dropping, the CBR decided to keep its key rate unchanged at 7.5 %



Sources: Macrobond, CBR, Rosstat and BOFIT.

EU and US further expand economic sanctions on Russia. On December 16, the EU approved its ninth round of economic sanctions targeting Russia for its illegal war against Ukraine. The assets of nearly 200 persons and firms have been ordered frozen and sanctions imposed on three new Russian banks. Restrictions on exports to Russia were further expanded to include various technology products and chemicals in order to restrict Russia's military capabilities. Exports of drones to Russia via third countries is also restricted to prevent Russia from using third countries to evade sanctions. The EU has also decided to criminalise circumvention of sanctions.

The US this week also added to its sanction list (the Specially Designated Nationals or SDN list) the names of several new Russian individuals, banks and corporations. The newcomers included Vladimir Potanin, a main owner of base metal giant Norilsk Nickel. The sanctions do not extend to the Norilsk Nickel corporation.

Rosstat releases latest quarterly GDP figures for this year. Rosstat's latest batch of economic figures show Russian GDP contracted by 3.7 % y-o-y in the third quarter. The preliminary estimate of 3Q drop in GDP was 4 %.

With the new quarterly data and revision of older figures, path of the seasonally-adjusted quarterly GDP was altered considerably. Earlier figures had Russian GDP contracting in the second quarter by 1.9 % q-o-q. Now the 2Q drop was a stunning 5.2 %. The combined impact of war and sanctions was thus larger and more immediate than previously thought. In the third quarter, however, Russian GDP grew by 0.4 % from the previous quarter. In addition, the 2020 GDP figures, which include the Covid Recession, have changed considerably under the latest revision. Traditional seasonal-adjustment methods do not always reflect the full impacts of major external shocks. This year's seasonally adjusted GDP figures will likely be further revised as Rosstat continues to process its economic data.

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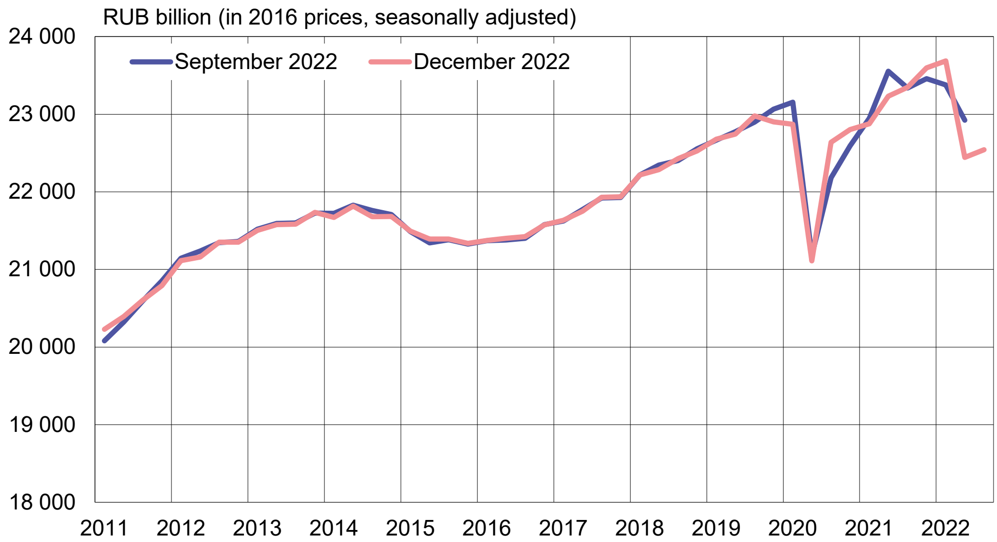
The trends in production branches that contribute to GDP have been quite varied. For example, wholesale and retail sales contracted by 19.3 % y-o-y in the third quarter, while the transportation sector shrank by 4.1 % and manufacturing by 2.4 %. Construction activity was up by 6.6 % and agricultural output rose by 5 %.

Revised quarterly GDP figures released this month have significantly altered the GDP growth trend reported for 2022



Sources: Rosstat and BOFIT.

Rising investment in Russia slows economic slide, but sees increased role of state-owned enterprises and the government. Real growth in fixed investment exceeded 3 % y-o-y in the third quarter, down from over 4 % in the second quarter. Large weapons systems are not included in Russia's investment figures (but are included in fixed capital formation in the GDP data which do not show larger increases than in investments in the first half of this year or all of last year).

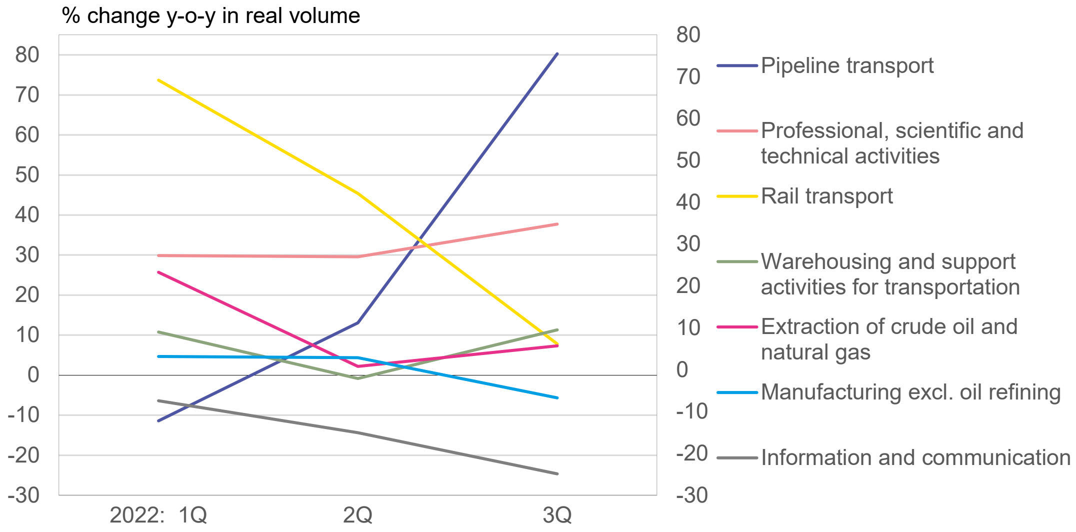
Growth slowed in investment by large and mid-sized firms, as well as government budget sector investment, from over 6 % y-o-y in the second quarter to around 5 % in the third quarter. For January-September, these investments, recorded statistically in the course of each year, accounted for nearly 80 % of total investment (and in the below-specified sectors and industrial branches, for which within-year data are available only on this basis, 80–97 % in 2021). Rosstat's estimate of other investment, which includes investments of small firms, households and the shadow economy, fell slightly on-year in the third quarter after having declined by several percent in the second quarter. For these investments to show a weaker picture than total investment is quite exceptional.

Continuing projects already underway may have helped sustain investment. Financing of investment from federal and regional budgets increased in April-September by 50 % y-o-y in nominal terms. Investment has risen especially in those sectors of the economy dominated by state-owned firms. Investment in pipeline transmission for oil & gas has risen fast, largely for increases in domestic consumption of gas. Investment in production of crude oil and natural gas has recovered from 2021. Investment in rail transport has increased rapidly, even if the pace slowed in the third quarter from a very strong surge in the first half of the year. Increases in investment in these three sectors contributed nearly 45 % of total investment growth in the second quarter and all growth in the third quarter.

The investments of large and mid-sized manufacturing firms (excluding oil refining), which grew briskly last year, turned to decline in the third quarter (down by about 6 % y-o-y). Investment in an overwhelming number of industrial branches, which already declined on-year in the second quarter, mostly saw even steeper declines in the third quarter. On the other hand, certain key industrial branches continued to invest heavily throughout the second and third quarters. These include the chemicals industry, metal refining and construction materials. In addition, investment in fabrication of metal products returned to growth in the third quarter and investment in production in transport vehicles other than automobiles soared. The increases in investment in these fields probably come at least partly from Russian government orders for additional military hardware.

Despite being in recession, among large investment sectors of large and mid-sized firms investment rose from last year in firms providing warehousing & support activities for transport, and especially professional & technical services. Information and communication branches, particularly telecommunications, have seen investment plummet this year after a few years of growth.

Investment of large and mid-sized Russian firms has risen in some branches, but manufacturing (excl. oil refining) turned down



Sources: Rosstat and BOFIT.

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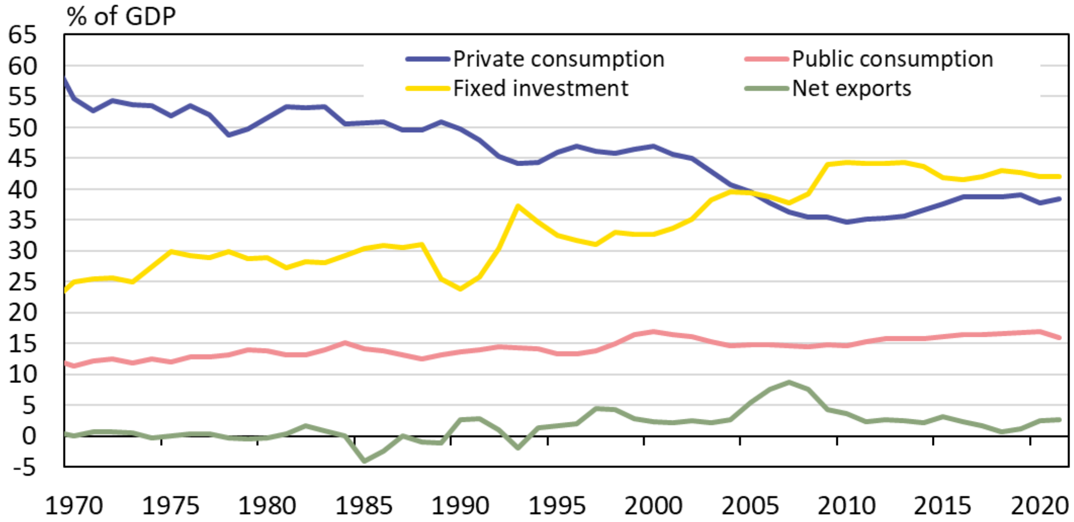
China

China sets out economic policy priorities for 2023 and longer-range outlines for 2035. In mid-December, the nation's top economic decision-makers, including president Xi Jinping, met in Beijing for the annual Central Economic Work Conference. Economic policy for 2023 was laid out at the meeting. The key priority in the coming year will be on accelerating economic growth after the current covid wave abates. In particular, China seeks to strengthen consumer demand by increasing household disposable incomes. The conference saw also important to halt the contraction of the construction and real estate sector that has been underway for well over a year. Another goal is improving the operating environment for private and foreign firms, while more targeted funding will be directed to SMEs, technology, innovation and green development. Fiscal policy should be geared to "forcefully" supporting growth, while in monetary policy emphasis will be on targeted measures that promote consumption and help the real estate sector. As usual, the conference determined the annual GDP target for next year, but the actual figure will only be revealed publicly in March at the National People's Congress. Some observers expect next year's GDP growth target to exceed 5 %.

Two days before the Economic Work Conference, the Central Committee of the Communist Party and the State Council released outline for boosting domestic demand by 2035. Most of the proposed measures are designed to encourage consumption, which the government hopes to become the engine of economic growth as the the current paradigm of growth driven by fixed investment that seems to have run its course. China's leaders hope the shift also increases economic stability and makes China less vulnerable to external shocks. Measures to boost consumption include raising household incomes, narrowing the income gap and reducing the development disparities between the countryside and cities. The government will also seek to increase support to parents to help cover the costs of raising and educating their children, as well as support the electrification of transportation and encourage climate-friendly consumption. The policy outlines also cover investment, where China seeks to improve efficiency of investment and increase industrial investment. Despite years of political rhetoric about raising domestic consumption, China has made little progress in that direction. Moreover, the country has suffered setbacks in its efforts over the past three years of the covid pandemic.

While private consumption in China is a smaller contributor to GDP than in advanced economies, China's fixed investment rate (gross fixed capital formation to GDP) remains stunningly high by international standards



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

US-China technology competition intensifies as trade structure shifts. In mid-December, the US Department of Commerce added 36 Chinese firms to its entity list. Exporting US technology or goods and components manufactured using US technology to firms in the entity list is banned without special licence. Yangtze Memory Technologies Co. (YMTC), a company once slated to become a key supplier of flash memory chips, was included in the new listing. As a result, the entity list now includes all of China's main chipmakers. Of these new firms, 21 (including YMTC) are now subject to a wider ban that includes third-country firms if their products rely on a sufficiently large percentage of components manufactured with US technology.

Protectionist measures in both countries have increased. In October, the US extended its semiconductor export restrictions on China (BOFIT Weekly 42/2022). The revised guidelines, however, call for more narrow application than earlier feared, and only affect US citizens or people with residence permits who are directly responsible for the exports of products or services to China. It does not apply to e.g. people performing routine administrative functions. China said it had filed a complaint this month with the World Trade Organization (WTO) about the new restrictions. Reuters reports that China is also planning a new spending package valued at more than 1 trillion yuan (143 billion dollars) to support China's domestic semiconductor industry over the next five years. More detailed information is not yet available. The US announced in August a similar support package for its domestic semiconductor industry.

On the bright side, the long-running spat over the audits of Chinese firms listed on US exchanges seems to be settling. In December, the US Public Company Accounting Oversight Board (PCAOB) announced that it had gained access to the auditing information of Chinese firms in Hong Kong. Chinese officials had earlier blocked the efforts of US officials to inspect the financial audits of Chinese firms listed on US stock exchanges, thereby risking delisting in the US (BOFIT Weekly 36/2022).

The cumulative 12-month value of bilateral goods trade approach an all-time high in October, even as China's share of US imports declined. In January-October, the value of total US goods imports was up by 20 % y-o-y, while the value of China imports rose by 14 % y-o-y. The value of US goods exports to China rose by just 2 %. The on-month value of bilateral trade declined in October.

With the US-China trade war entering its fifth year, changes in the countries' bilateral trade structure have become visible. Both countries imposed substantial tariffs on each other's imports of critical product groups. According to a data analysis by the Peterson Institute for International Economics (PIIE), the value of US imports from China of products subject to a 25 % additional tariff, had, as of August 2022, fallen by 22 % from the pre-trade war period, while imports of similar products from other countries had increased by 34 %. For products subject to a 7.5 % additional tariff, US imports from China were only down by 3 % from the start of the trade war, and up by 45 % for similar products imported from other countries. On the other hand, products not subject to punitive tariffs saw the value of US imports from China increase by 50 % from the pre-trade war period. These products account currently for nearly half of US imports from China, up from just a third before the start of the trade war. The PIIE study noted that customs data provide little indication about value-added contribution of Chinese manufacturers or third-country intermediaries to US imports. Although the final assembly of many goods now takes place outside China, the Chinese value-added contribution could nevertheless be as large as it was previously.

A considerable amount of US production has been offshored to China, and China has become a major market for American firms. Available statistics suggest that the situation has stayed relatively stable, even if company surveys indicate that many firms increasingly voice their intent to site new investments outside China. The latest US figures for domestic firms and their foreign subsidiaries date back to 2020. The total net sales of all US foreign subsidiaries fell by 8 % y-o-y and the workforce was reduced by 2 % in 2020 due to the covid pandemic. US subsidiaries operating in China displayed a roughly similar trend. The number of subsidiaries remained constant, but the number of workers was cut by 5 % and net sales declined by 7 %. However, the net earnings of US subsidiaries operating in China rose by 2 % in 2020, while the earning of all US foreign subsidiaries fell down by 15 %. In 2020, the sales of US firms and their subsidiaries in China amounted to 525 billion dollars, just over three times the value of goods and services exported to China (167 billion dollars). China accounted for 7 % of the international sales of US firms and their foreign subsidiaries, as well as 9 % of their international workforce.

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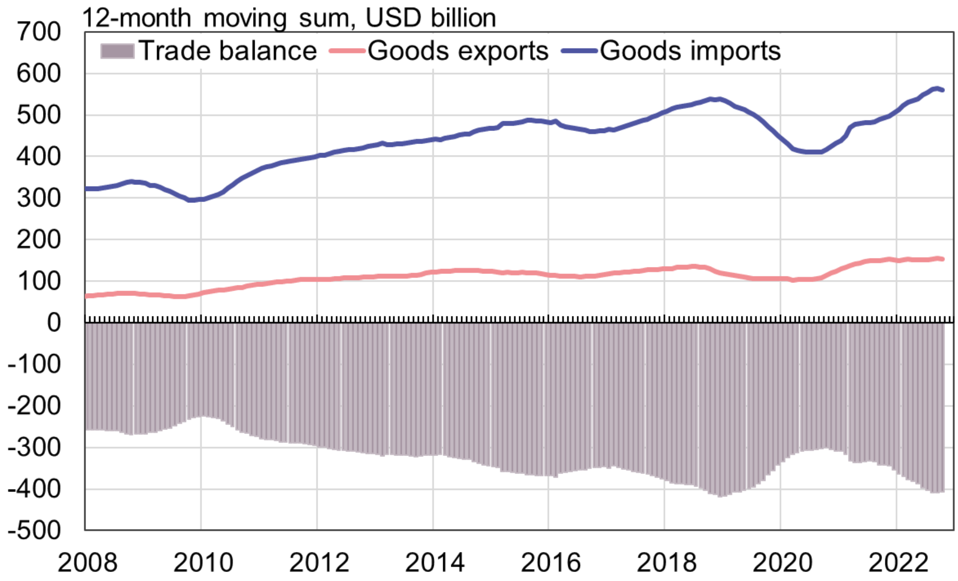
Despite the trade war and massive trade imbalance, US-China trade approached an all-time high in October



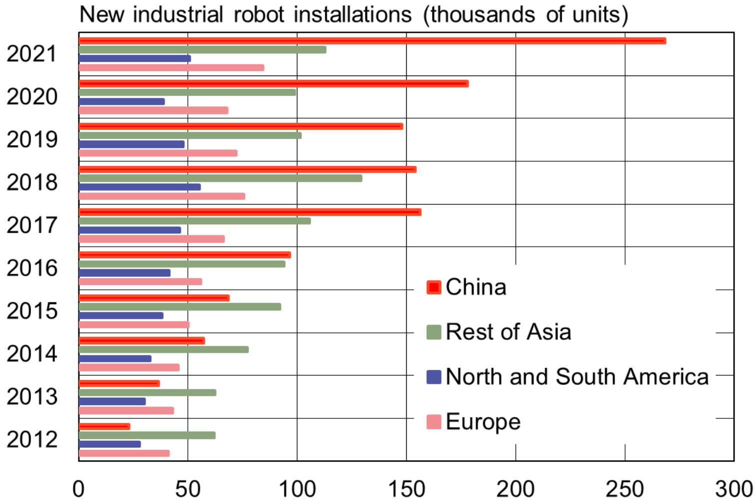
Sources: US Census Bureau, Macrobond and BOFIT.

China's installed base of industrial robots surpassed one million last year. The International Federation of Robotics reports that over 500,000 new industrial robot units were installed worldwide last year, an all-time record. Over half of the units, nearly 270,000, were installed in China, which was 100,000 units more than in 2020. The next largest installations of new industrial robots last year were in Japan (47,000), the United States (35,000) and South Korea (31,000).

China's installed base of industrial robots now exceeds one million units. The global installed base of industrial robots is about 3.5 million units, so about a third of the world's installed base of industrial robots operate in China. However, considering the number of robots relative to the number of industrial jobs, the biggest user of industrial robots is South Korea (1,000 installed industrial robot units per 10,000 workers in 2021). Using this comparison, China is only fifth in the world (322 units per 10,000 workers) after Singapore, Japan and Germany. In any case, China has already surpassed the US (274 units) and doubles the relative amount of robots in Finland (161 units). While China is continuously increasing domestic production of industrial robots, the bulk of industrial robots are still made in Japan or Germany. Moreover, many of the components used to build robots still have to be imported, slowing China's ambition of becoming self-sufficient.

The biggest uptake of new industrial robots in China last year continued to be among manufacturers of electrical and electronic equipment and devices. These fields last year installed 88,000 new robots, a nearly 40 % increase from 2020. The largest units increase, however, was in the automobile industry. Carmakers last year installed 62,000 new robots, or double the amount they installed in 2019 and 2020. Robotization of the car industry is expected to continue strongly over the coming years as human labour costs continue to rise and car factories are repurposed for production of electrical vehicles (EVs). China expects EVs to account for over half of its car production by 2035.

China installed a record number of new industrial robots last year



Sources: International Federation of Robotics and BOFIT.

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