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Russia and the slowdown of the Chinese economy

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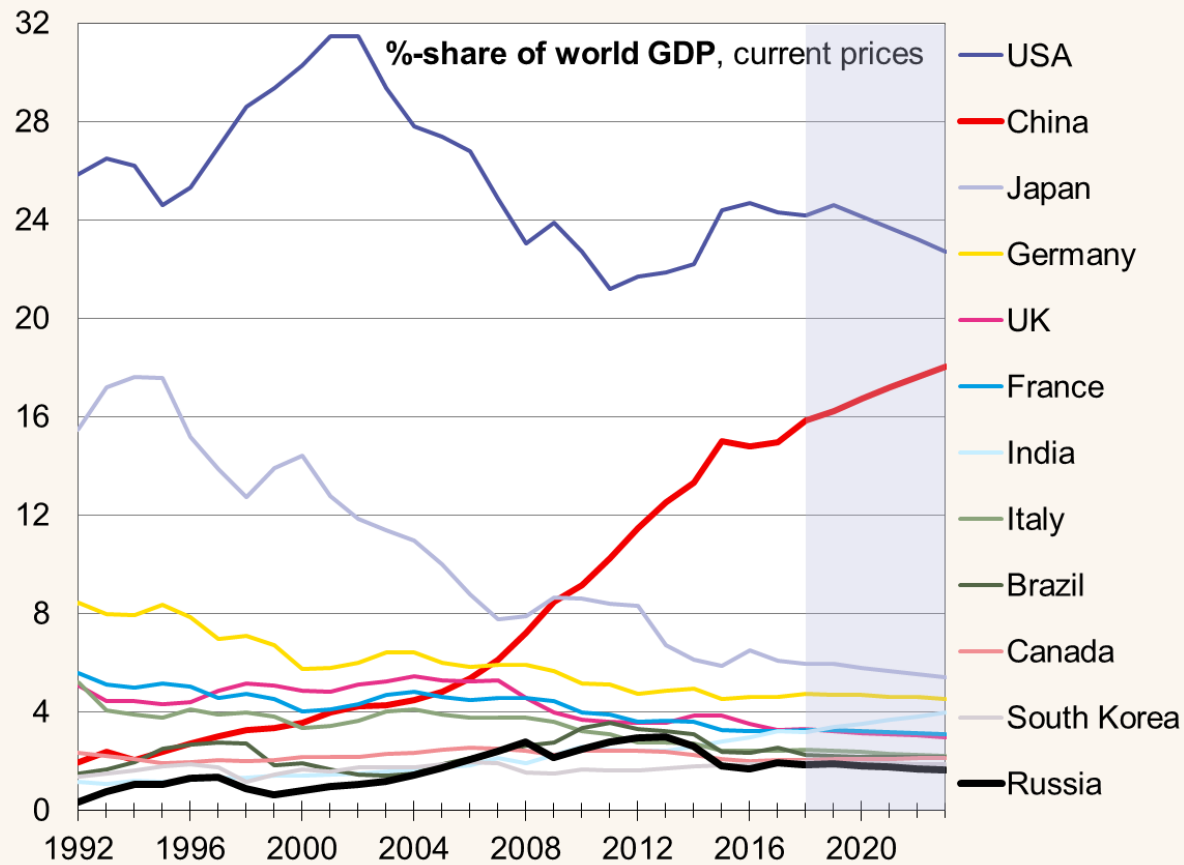
The third Ghent Russia colloquium October 4th 2019



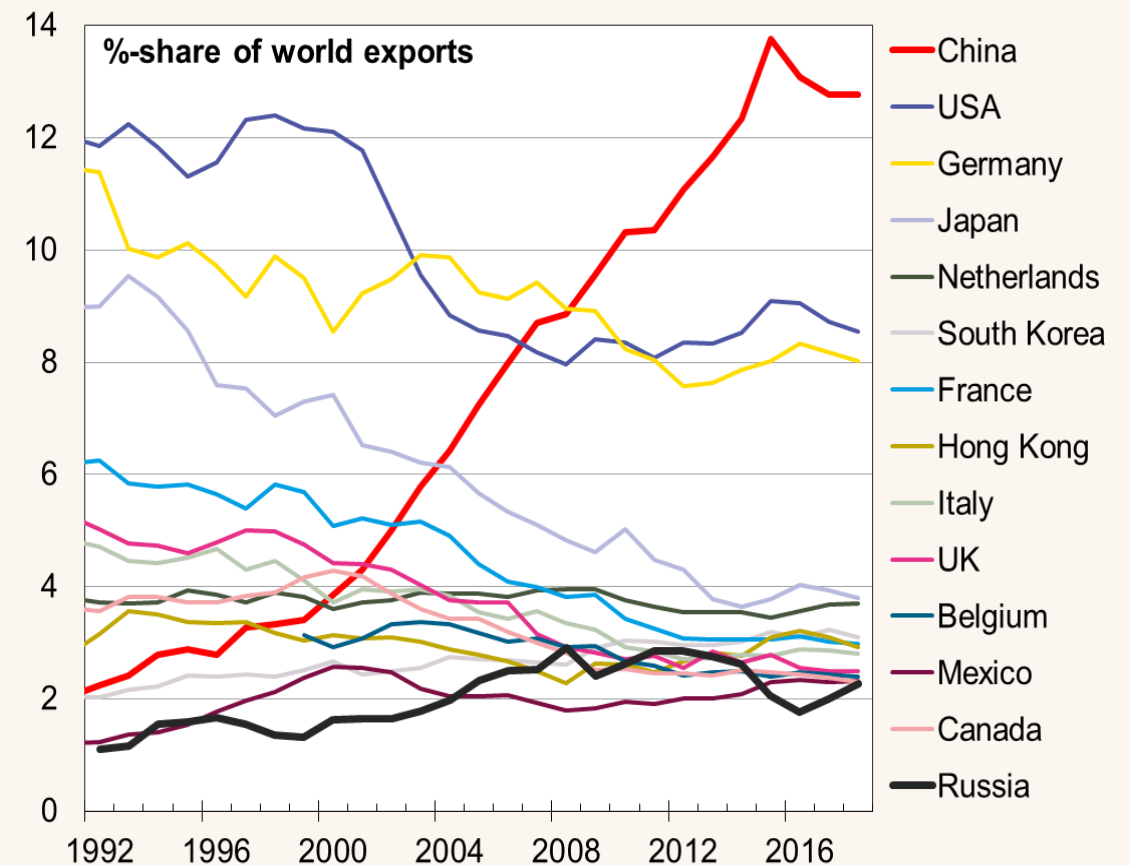
Overview

- Russia-China economic relations have been driven by China's economic dynamics, over the past decade, when relations performed well and China's economy and energy demand was growing strongly
 - No significantly closer institutional relations between the countries
 - Economic relations centred around Russian oil exports and electronics and consumption goods imports from China
- Going forward, this will continue to be the case, however, China's growth is slowing down
 - Russia's exports to China even more one-sided
 - More tense Russian relations with the West
 - Adjusting to China's slowdown will be a major challenge for Russia

Russia and China are increasingly mismatched economies

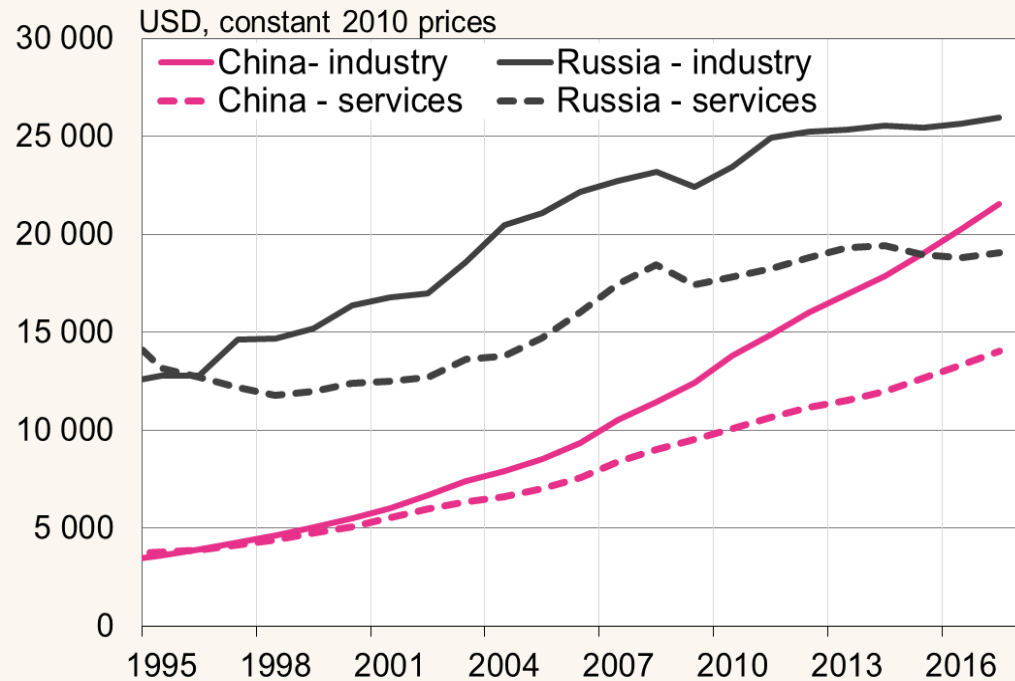


Source: IMF WEO



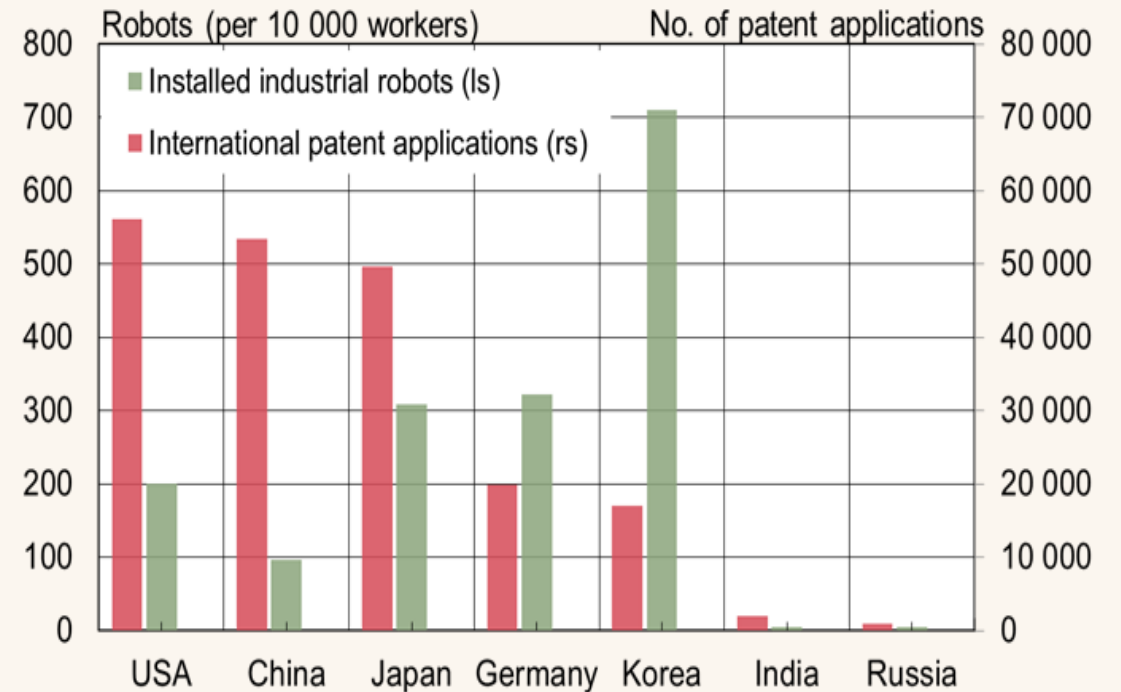
Level of China's technological development has rapidly caught up with Russia

Value added per worker in China and Russia



Source: World Bank WDI

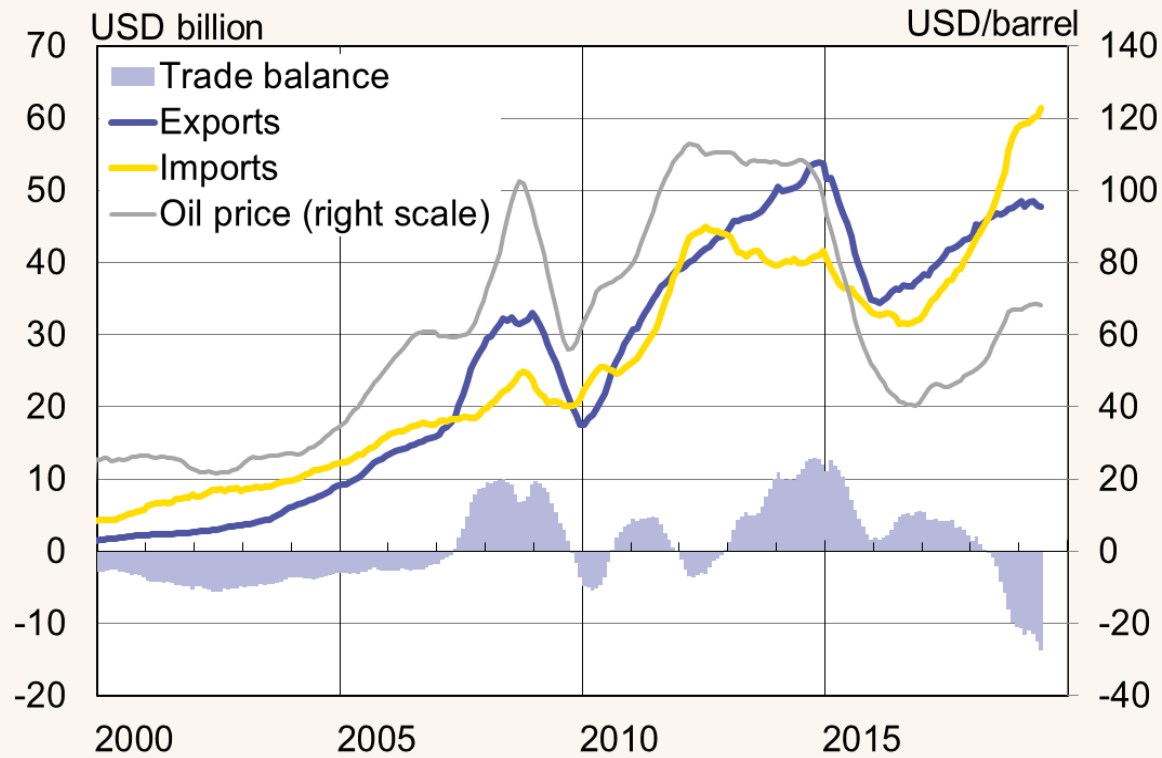
Number of international patent applications (PCT) in 2018 and industrial robots per worker in 2017



Sources: WIPO and International Federation of Robotics

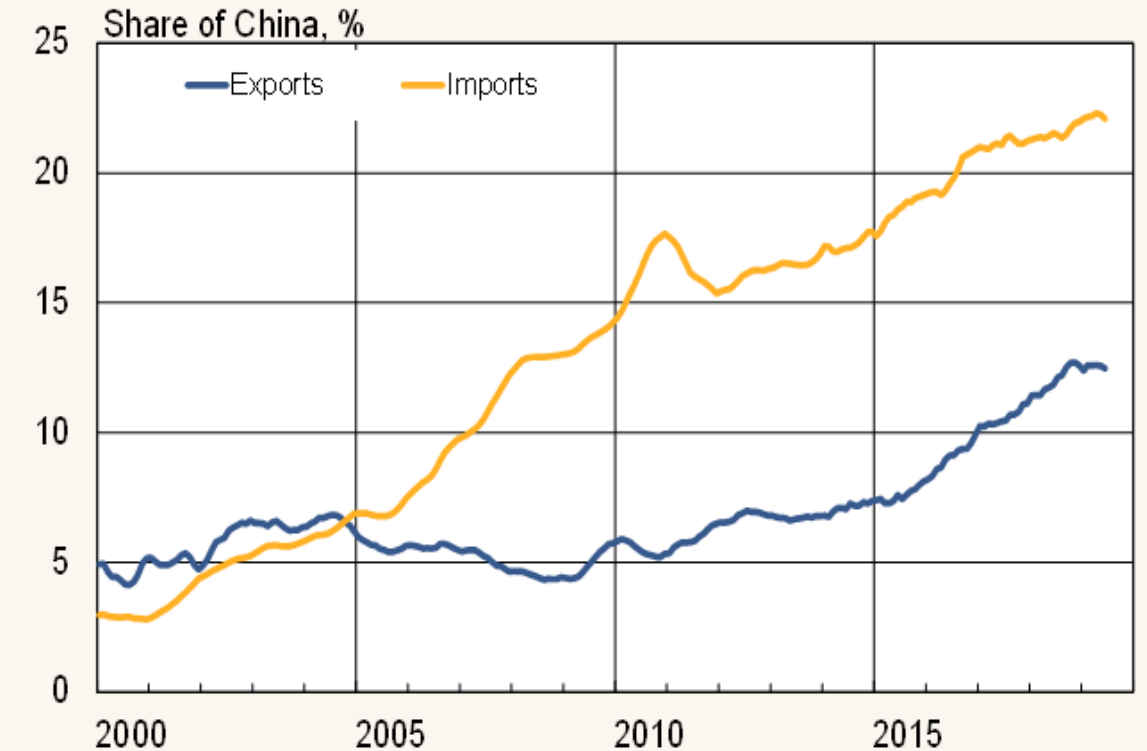
Russia-China trade is growing mainly due increased oil exports from Russia

Value of China's goods trade with Russia



Source: China Customs, Macrobond

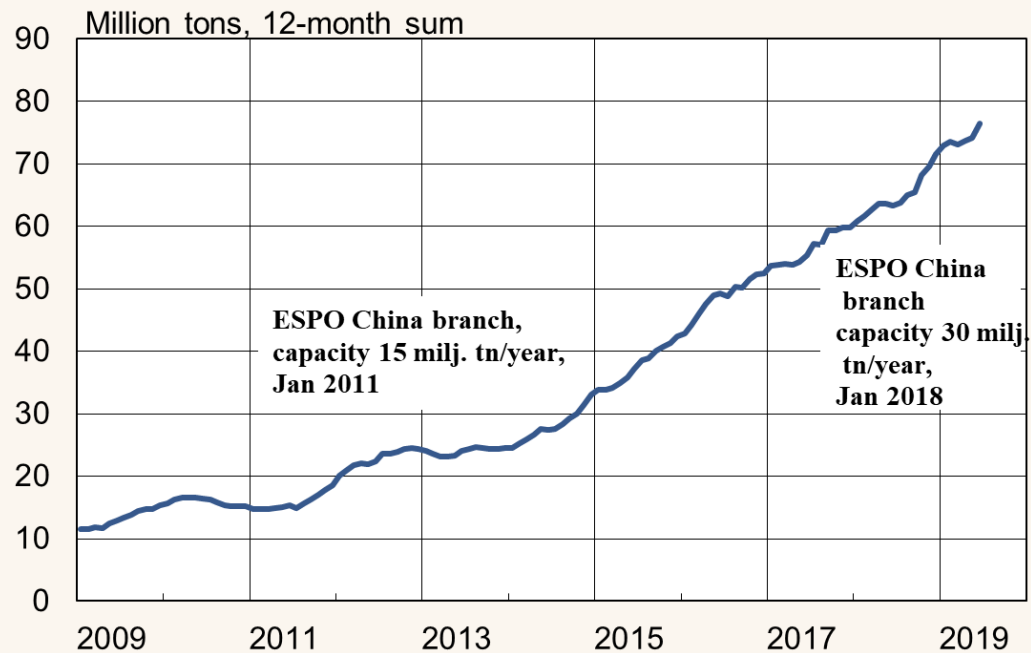
Share of China in Russia's foreign trade



Economic relations dominated by Russian energy exports

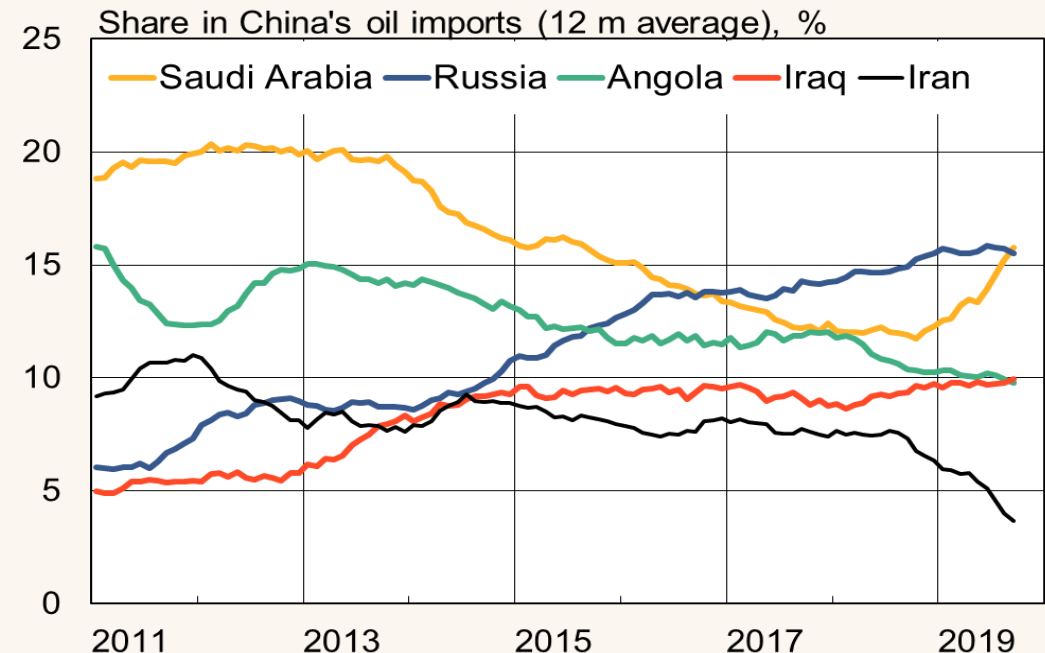
- In 2011-2018, around 70 % of Russian exports to China were mineral fuels
- China's share of Russian oil exports grown from 5 % in 2009 to over 25 % in 2019

China's oil imports from Russia



Source: China Customs, CEIC

Share of China's oil imports by country (%)

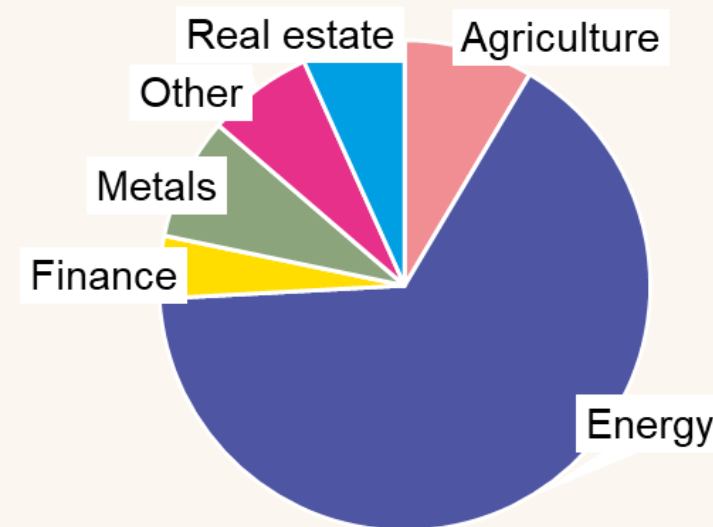


Source: China Customs, CEIC

Investments between the countries minor

- China's share of Russian FDI inflows below 1 %, with the exception of 2014-2015. At the end of 2018, China accounted for less than 1 % of the total FDI stock in Russia (CBR)
- Russia's share of Chinese ODI in official statistics has remained below 1 %, except in 2015, when it was 2% (MoC)
- In CGIT database Russia's share of large Chinese ODI flows in 2005-2018 is 2 %
- Russian direct investment in China is negligible
- In addition, China's policy banks have provided significant credits for some major energy construction projects involving China

Chinese FDI flows to Russia by sector,
accumulated flows 2006-2018

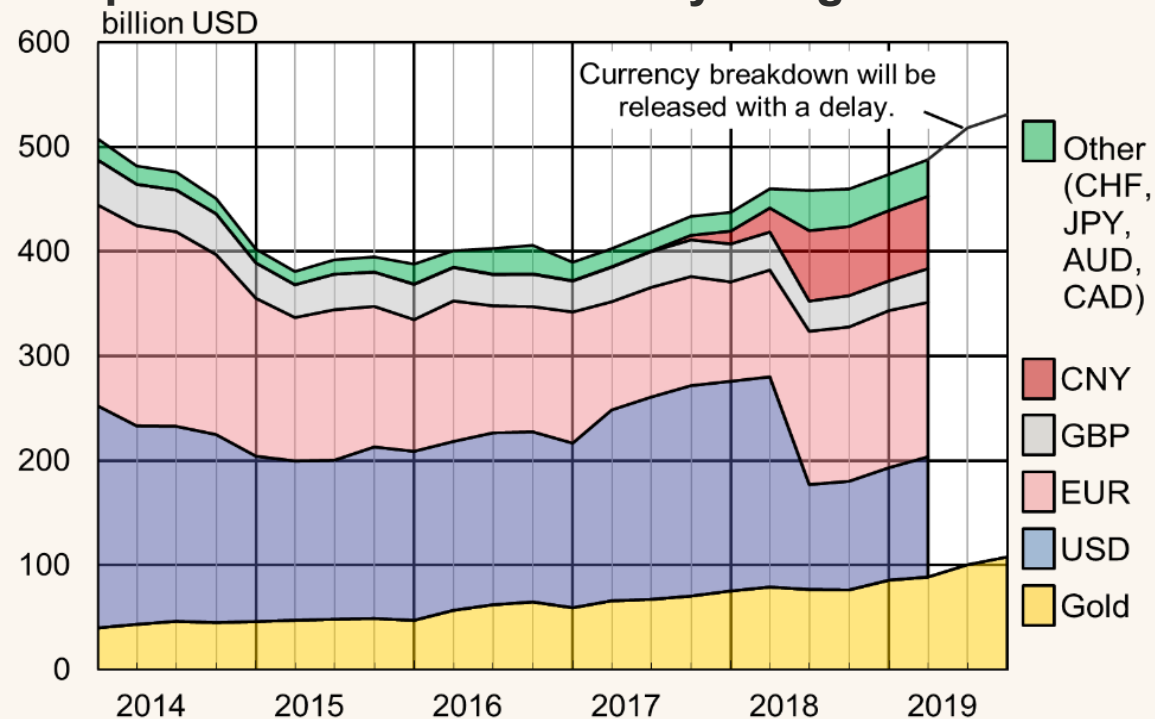


Source: China Global Investment Tracker (CGIT)

Opposing the US dollar dominance a common interest

- Russia has intensified de-dollarization especially after US sanctions in 2014; for China, yuan internationalization has for long been a foreign policy priority
- Russia has helped China in its yuan internationalization aspirations
 - It is a member in all the major Chinese initiatives set up this decade partly aiming to promote yuan internationalization: BRI, AIIB and BRICS New Development Bank
 - Russia currently holds third of global yuan reserves

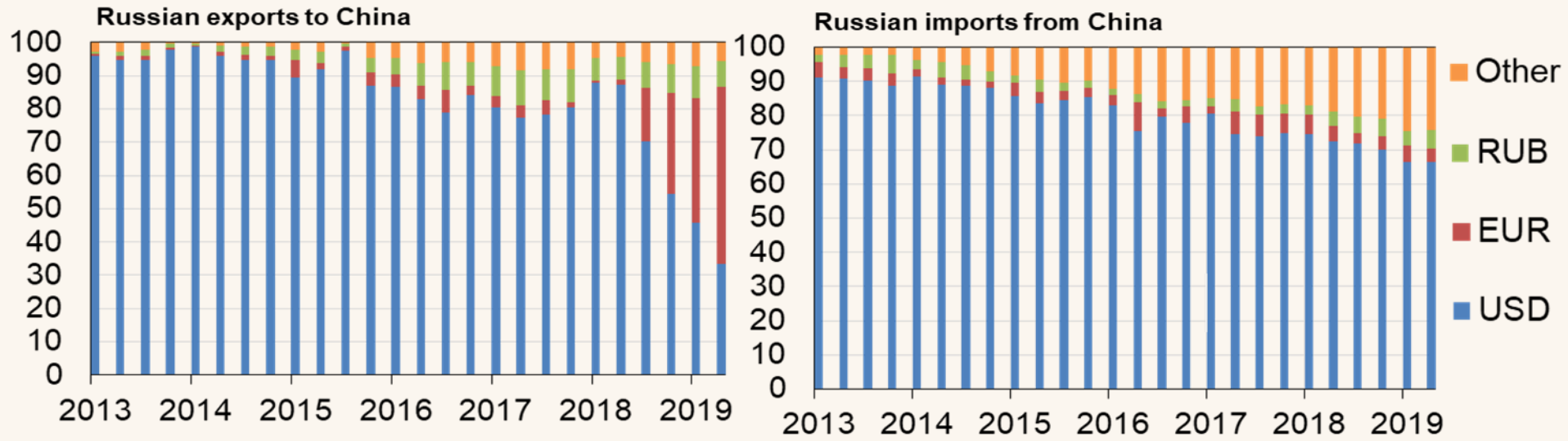
Composition of Russia's currency and gold reserves



Source: CBR

Use of the yuan and euro increased in bilateral trade

Invoicing currency composition in Russia-China goods trade (% of total)



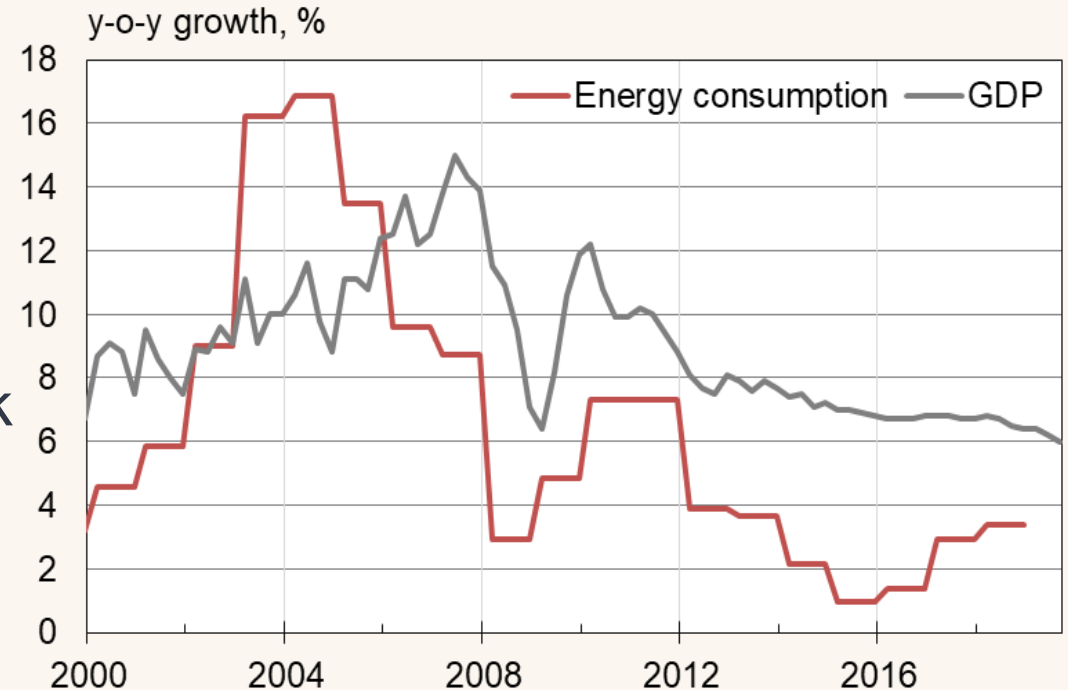
Source: CBR

- Russia has mostly turned to euro in its de-dollarization as yuan not fully convertible and China's capital controls as well as legal property rights issues limit yuan's global use
- Yuan share in international payments, currency trade and global forex reserves around 2%

China's growth and energy demand are slowing

- China's growth is slowing down mostly due domestic factors
 - Rather a permanent, not transitory phenomena
 - Along with slowing investments, growth in raw materials and energy demand also slowing
- Uncertainty related to actual growth and risk build-up has increased the possibility of even an abrupt slowdown
- Growth slowdown will likely affect also Chinese ODI and financing, as money is increasingly needed at home

Energy consumption and GDP growth in China



Source: NBS, CEIC

For Russia, growth of export volumes to China has been critical

- Russia's total crude oil export volume is currently about 14 % higher than in 2009, but without China would be 11 % below the 2009 level
- Energy will increasingly dominate Russian exports to China
 - Deliveries of LNG from the Yamal Peninsula to China by sea started last year and the Power of Siberia gas pipeline will be operational at the end of this year

Change in the volume of Russia's oil exports, %



Source: Russian Customs, CEIC

China's slowdown likely to have a negative impact on Russia

- China's energy demand has supported oil prices that are of key importance to the Russian economy
 - China's oil consumption growth accounted for over 40 % of global oil consumption growth this decade
 - In the long run, a 10 % increase (decrease) in international crude oil price is estimated to increase (decrease) the level of the Russian GDP by 1–2 pp (Rautava 2004, Beck et al. 2007, Korhonen & Ledyeva 2010, Kuboniwa 2014, Feldkircher 2015 and Faryna & Simola 2018)
- Taking into account the real economy effects, Chinese shocks on the Russian economy are usually found to be relatively small
 - A 1 % decline in China's GDP after 5 years results in a 0.1-0.2 % GDP decline in Russia (Dizioli et al. 2016 and Faryna & Simola 2018)
- A “hard landing” (taken into account oil price effects) in China would have stronger effects also on Russian growth (Gauvin & Rebillard 2018 and Dieppe et al. 2018)
- In addition, the effects of China's slowdown are amplified when financial market spillovers are taken into account (see Dieppe et al. 2018)

Summary

- China's growth slowdown will affect the whole world, Russia is no exception
- Russia especially vulnerable, given its one-sided export structure and tense relations with the West since the illegal occupation of Crimea in 2014
- While increased trade with China, which should be seen only as a natural development, has supported growth in Russia, it has also reinforced Russia's dependence on commodity exports
 - Closer economic relations with China have largely been based on energy projects where the Russian state and state owned companies play a key role enhancing the already too big role of the state in the Russian economy
- Important to acknowledge possible negative spillover effects of China's slowdown to Russian economy and the consequences this might entail

Thank you!