

# China: Deepening economic ties with Russia

The balance of economic power has clearly shifted to the east from the west since the global financial crisis in 2008. Although China's exports to the US and EU remain large in terms of absolute size, the growth potential of other newly emerging markets such as ASEAN, Africa and South America is immense (Chart 1). Another super partner emerging for China is Russia, which formally joined the WTO at end-2011. As import tariffs fall over time, the market potential for China to develop stronger bilateral trade ties with Russia is enormous given the advantage of geographical proximity.

Russia was China's ninth largest trading partner in 2012 and China is Russia's largest trading partner. The two countries have set a goal to more than doubling trade volumes to \$200bn by 2020. To reach this goal, volumes would need to grow by about 11% per year, easily achievable in our view, given that volumes have already grown 17% on average over the past five years. China's and Russia's nominal GDP have been growing 14.4% and 14% respectively on average over the past five years.

China's trade with Russia was roughly balanced in 2011 and 2012. We reckon this is no coincidence as China and Russia's needs complement each other. While China offers a large market for Russian goods; Russia provides "safety of supply" for China, particularly in primary goods and energy. Going forward then, the focus will not be about addressing trade imbalances, as is the case in Africa, but on how to strengthen trade ties in specific sectors.

The biggest category of Chinese exports is machinery

## Increasing exports of high value-added goods

China's export mix has shifted since its WTO accession in 2001. China is now the second largest machinery exporter in the world after the US and machinery is China's largest revenue earner (Chart 2). As a percentage of total exports, machinery has risen to 42% from 32% in 2001. Textile revenues have

Chart 1: Growth of Chinese exports in 2012

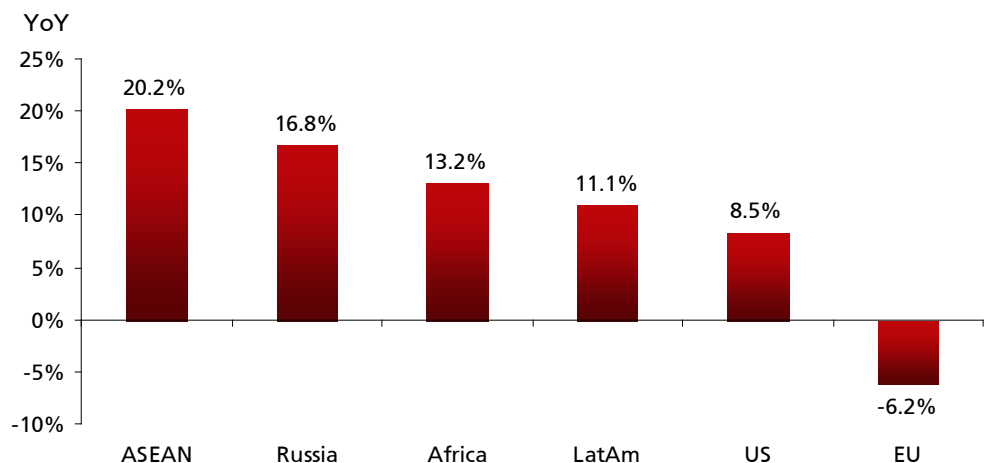
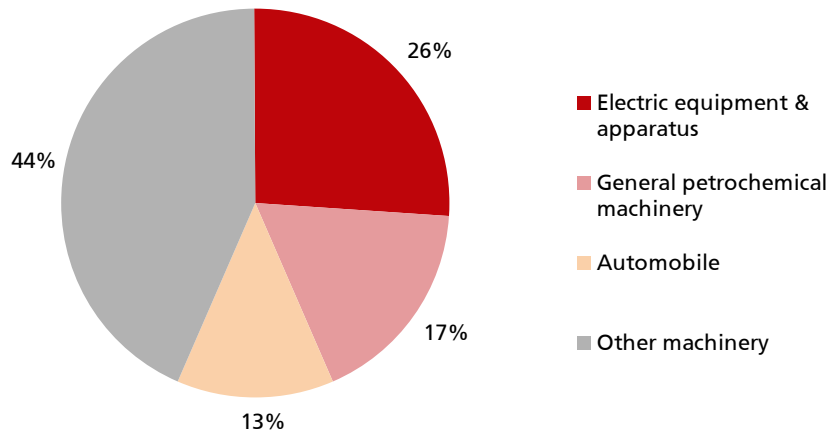


Chart 2: China's machinery exports (2012)



fallen to 12% from 19% on the same time frame. Although textile exports grew by 5x between 2001-2012, machinery exports grew by more than 10 times.

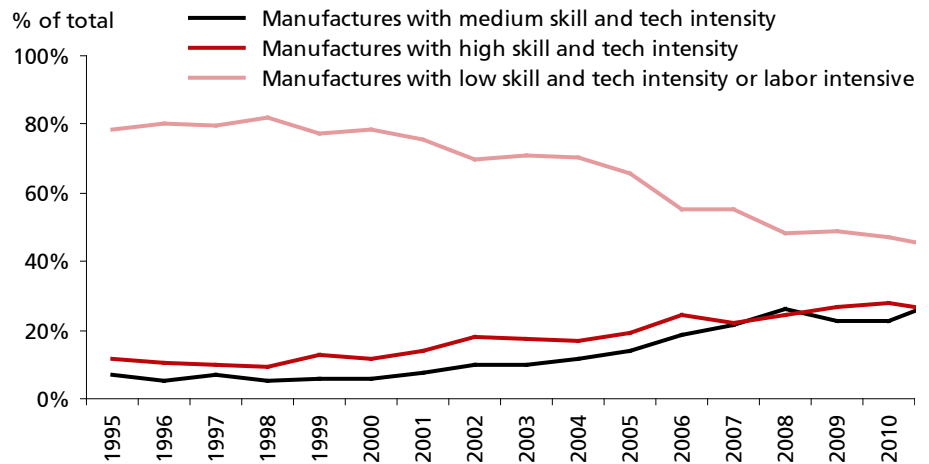
China's exports to Russia are similar to its global exports mix. Textiles and machinery accounted for 16% and 33% of China's total exports to Russia respectively in 2012. However, China's exports to Russia have seen more explosive growth than exports elsewhere. Between 2001-2012, China's textiles exports to Russia grew by 9x, while machinery exports grew a whopping 57 times! China now accounts for approximately 15% of Russia's total machinery imports, up from just 2% in 2001. As border tariffs come down after WTO accession, Russia should import even more machinery from China. It is likely to import more and more high value-added goods over time (Chart 3).

**Energy cooperation**

Not surprisingly, the biggest category of Russian exports is fuels & mining products. Fuels & mining products as percentage of total exports have increased from 62% in 2001 to 72% in 2011.

Russia is one of the world's largest oil exporters. Currently, most of Russia's energy exports go to Europe, where recession prevails and consumer demand

Chart 3: Russia's imports from China



is weak. On top of that, Russia is increasingly insecure about its European gas customers after a large number of energy pricing disputes between 2005 and 2010. It is only reasonable that Russia strives to diversify its export markets. China is the natural choice, given its geographical proximity and seemingly insatiable demand for energy. Meanwhile, China's energy imports are also highly concentrated – more than half are imported from the volatile Gulf region and Africa, with less than 10% currently sourced from Russia.

Common interests are clearly there. Both countries want diversification for strategic purposes, not just in oil and gas, but in other primary goods as well. Russian coal exports to Europe compete with exports from Qatar and the US, and so Russia has recently turned to the Asian Pacific markets, especially China. The next steps, of course, will be to lower the costs of diversification. This is why building and improving cross-border infrastructure is so important. Little wonder this topic has topped the agenda of high level bilateral discussions. The section of the East Siberia-Pacific Ocean oil pipeline (ESPO) to China has been completed in September 2010. Opened in 2011, ESPO will provide China with fifteen million tons of oil annual through 2031.

**Building and improving cross-border pipeline infrastructure is crucial**

### Tourism

Bilateral tourism is another key 'trade' possibly. China has become the second largest tourist destination of Russians while Russia has become the third largest tourist destination for the Chinese. China hopes to strengthen tourism ties with Russia to bring the total number of bilateral tourists to five million by 2015.

Some Chinese provinces have become key destinations for Russian tourists, including Hainan Island in southern China. Over the past few years, Hainan has relaxed its tourism policies to encourage Russian tourists to visit and stay longer. These include relaxing restrictions on the number of people in tourist groups and extending the visa-free period for Russian tourists. In Beijing and Shanghai, tourists including Russians currently benefit from a 72-hour visa-free period.

**The two nations designated last year as the "Year of Russian Tourism in China", which introduced China to Russian tourists**

To demonstrate the importance of tourism, the two countries designated 2012 as the "Year of Russian Tourism in China". Over 200 activities were held throughout the year. According to the Russian Federal Agency for Tourism, the number of Chinese tourist arrivals in Russia rose 47% YoY to 343,000 in 2012. Meanwhile, 1.3 million Russian tourists visited China in 2012. Russian tourists made up of about 9% of foreigners visiting China in 2012, compared to 15% for Japan, 13% for South Korea and 8% for the US. Another tourist rush is expected in 2013's "Year of Chinese Tourism in Russia". China's President, Xi Jinping, attended the event's opening ceremony during his first overseas visit after assuming office.

### Closer financial linkages

Russia could well become China's largest trading partner within a decade. This forms the basis of moving away from USD and using RMB to settle bilateral trade. Decreasing reliance on the dollar for settling trade with China had been a policy goal of the former Russian president, Medvedev. As early as December 2010, Moscow Interbank Currency Exchange opened direct trading between the renminbi and the Russian ruble, marking the first trading of RMB in overseas exchanges.

China's new President, Xi Jinping, chose Russia as his first stop after the NPC meeting. This is not a coincidence, rather a symbolic step in fostering a strategic alliance for the long haul.

Sources: Data for Charts 1 and 2 are from CEIC; data for chart 3 are from UNCTAD

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