

# Monthly Report

Russia Losing Half of its Foreign Reserves

Russia's War Economy

EU Investment in China: Past, Present and Ways Ahead

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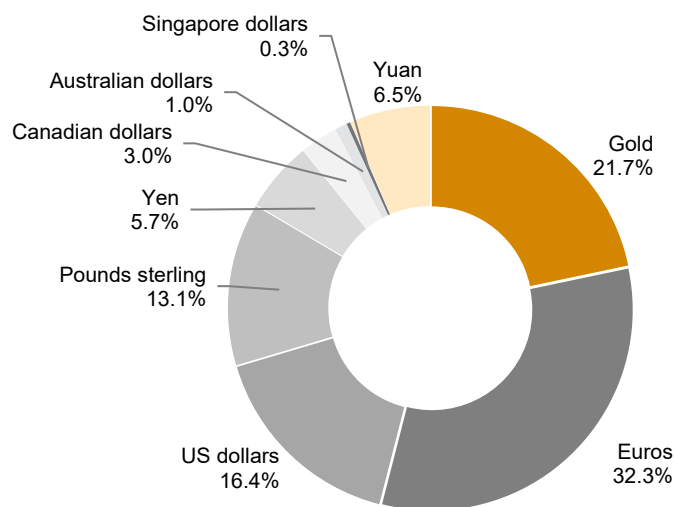
## Chart of the Month: Russia losing half of its foreign reserves

BY VASILY ASTROV

As of 18 February 2022, Russia's foreign exchange reserves officially stood at USD 643.2bn – the fourth largest in the world. At around 40% of Russian GDP, they comfortably exceeded the country's gross external debt (28%) and were supposed to cushion the impact of any cuts to external financing imposed by the West. Besides, over the past few years Russia has reduced the share of its reserves denominated in US dollars to a mere 16% (as of mid-2021),<sup>1</sup> with more than half held in either euros or gold (Figure 1).<sup>2</sup>

**Figure 1 / Russia's foreign exchange reserves, by currency on 30 June 2021**

in % of market value



Note: The balance of accounts in Swiss francs was negligible. The Special Drawing Rights (SDR)-denominated net claims of the Russian Federation on the International Monetary Fund (IMF) are accounted for in the breakdown in the proportions determined by the IMF for calculating the SDR value.

Source: Central Bank of Russia.

However, on 27 February the Western countries imposed a ban on transactions with the Central Bank of Russia (CBR) and froze its foreign reserves held in Western jurisdictions. These were by far the harshest sanctions imposed on Russia over its invasion of Ukraine. According to the Russian finance minister Anton Siluanov, some USD 300bn of reserves (which would correspond to 47% of the total) have been frozen as a result. Russia was clearly not prepared for this: had it reckoned on such an

<sup>1</sup> The latest data on the structure of reserves refer to 30 June 2021.

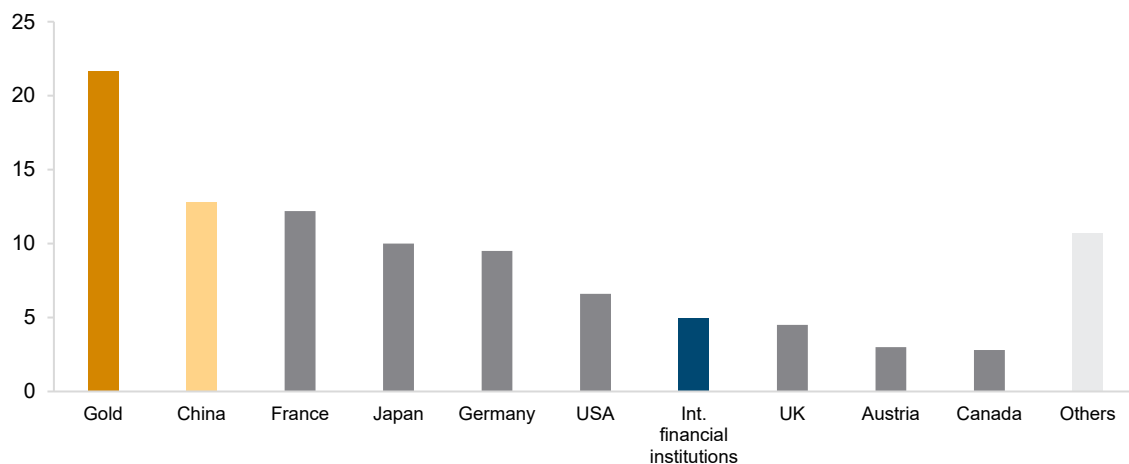
<sup>2</sup> Presumably, the calculation was that the West could be split in the case of a crisis escalation, and the EU would not act as strongly against Russia as the US.

eventuality, it would not have kept such a large chunk of its reserves in Western jurisdictions. Of the remaining reserves still at CBR's disposal, nearly half is accounted for by gold (held within Russia), which may not be easy to sell in the current circumstances.<sup>3</sup>

With the scope for interventions drastically reduced, the CBR had little choice but to resort to a sharp hike in the policy rate (to 20%, from the previous 9.5%) and wide-ranging capital controls. The success of these measures has been limited at best. At the time of writing, the rouble had lost nearly half of its value, which will have a devastating short-term effect on Russian economic growth, inflation and living standards.

**Figure 2 / Russia's foreign exchange reserves, geographical distribution on 30 June 2021**

in % of total



Source: Central Bank of Russia.

While undoubtedly damaging to the Russian economy, the decision to freeze Russian foreign reserves may have unpleasant side effects for the West itself, opening up the possibility of a nationalisation of Western assets in Russia. Besides, the reputation of highly rated Western government bonds as a supposedly safe asset may suffer in the long run, with third countries becoming more wary about asset freezes of US dollar holdings.

<sup>3</sup> The CBR has stopped publishing statistics on reserves. Its web page states that 'international reserves as of February 18, 2022 accounted for \$643.2 billion. These data will be used in all publications in the next three months', [http://cbr.ru/eng/hd\\_base/mrrf/mrrf\\_7d/](http://cbr.ru/eng/hd_base/mrrf/mrrf_7d/)



# Russia's war economy

BY VLADISLAV INOZEMTSEV\*

*Following the harsh economic sanctions imposed by the West, the war-time economic policy adopted by Russia will shape its economy for at least the next six months. It involves, among other things, the discriminatory treatment of foreigners and foreign-based entities from 'unfriendly countries', the creation of a de facto two-tier banking system, a separation of the rouble and foreign currency markets, and possibly the expropriation of foreign-owned property. It will not, however, forestall the most serious economic crisis in the history of modern Russia.*

We do not yet know how Putin's irresponsible attempt to conquer Ukraine will end; but in just a few weeks, one side effect of it has been a catastrophic collapse of the entire Russian economy. From 21 February to 10 March, the value of the US dollar rose from 75.7 roubles to 132-134 roubles; the Central Bank of Russia (CBR) key rate was raised from 9.5% to 20%; and the stock market essentially ceased to exist. The aggregate wealth of the 100 richest Russians shrank by at least USD 200bn; more than 200 foreign companies pulled out of Russia, taking with them business worth billions of US dollars; the biggest banks were cut off from global payment systems; and the country lost international air travel. The US and the UK announced a halt to their purchases of Russian oil, and the European Union declared a very significant reduction in gas imports. The main international rating agencies drastically lowered Russia's credit rating by 3-6 notches, and the VISA and Mastercard payment systems stopped servicing Russian cards abroad. Russia has become the country with the highest number of sanctions measures – and yet few thought that many sanctions would be applied at all.<sup>1</sup>

The most important blow to Russian finances – and one that defined the new situation in the country – was the freezing of the CBR's reserve assets in US and European jurisdictions. Now, it is hard to say exactly what proportion of the reserves has been blocked: estimates range from 50% to 55% of the total amount of USD 643.2bn. However, it is safe to say that the CBR has kept control of its reserves in gold (3,200 tonnes, or 74m ounces, the value of which is now about USD 147bn), the funds held in Chinese assets (ranging from USD 76bn to USD 98bn, according to various sources) and cash dollars, euros and pounds sterling totalling just over USD 30bn. The problem, however, is that cash and gold are not suitable for foreign exchange interventions, and Chinese yuan still needs to be converted into US dollars – but it is not quite clear how this can be achieved if the accounts are frozen. Faced with this problem, the CBR and the government have begun to develop options to respond to the pressure exerted by the sanctions. The enforced closure of the markets in Russia has created a new reality – one with which the country will live for at least the next six months.

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<sup>1</sup> On 24 February, the day the war started, I wrote an ultra-radical article for the Spanish *La Razón* newspaper, proposing a raft of sanctions. By the time the article was published, on 27 February, almost all the sanctions – and more – had already been implemented.

## BANKING SECTOR AND FOREIGN EXCHANGE

Today, it is not yet clear how soon and how hard the real sector of the Russian economy will be hit. However, the war-time economic policy within which the domestic financial sector – and in part the real sector – will operate has already been set out.

First of all, economic agents have been classified into several distinct categories. Foreigners and foreign-based entities associated with **48 'unfriendly countries'** have had their rights removed: they may not be repaid in foreign currency; there are limits on money transfers to companies and private individuals acting in those countries' jurisdictions; they temporarily cannot earn interest on federal government bonds; and they no longer have the right to sell such bonds. In actual fact, we are talking about selective default, although that is not explicitly stated.<sup>2</sup> In any case, a variable attitude to different groups of investors – a kind of differentiation between 'friends' and 'adversaries' – is a fundamental innovation in Russian economic practice: we saw nothing of the sort, for example, during the sovereign default crisis of 1998. The economy is no longer free of politics – not even in the wording of economic regulations.

The next important feature is the **transition from a real banking system to one that is rather fictitious**. For the last decade, under the leadership of Elvira Nabiullina, the CBR has been pursuing a consistent policy of tightening control over the banks: more than 650 Russian banks – two thirds of the total – have been ensnared by this policy. But the innovations announced on 22 February radically change the situation: banks are now allowed not to adjust the value of their assets – stocks and bonds will remain on their balance sheets at the market prices achieved on 21 February. Foreign exchange, including obligations to customers, will be accounted for at the pre-crisis exchange rate. At the same time, a number of regulations have been scrapped, including such fundamental ones as the amount of risk per borrower (or related group of borrowers) and the capital adequacy ratio and macroprudential risk premiums for a number of categories of retail loans issued since 1 March. These measures are due to remain in force until 1 October. This date is, in my opinion, completely arbitrary, and nobody knows what shape the economy will be in at the beginning of the fourth quarter. It is clear, however, that the 'zombie banks' will work almost unregulated for half a year, which could well lead to widespread abuse.

Another characteristic feature of the new order will be a **'two-tier' banking system**: each large bank that is under sanctions will be surrounded by several medium and small banks that have no connection to it – they will have not a single owner or shareholder in common. Thus, the clients of the large banks will open accounts in non-sanctioned financial institutions, obtain loans and conduct export-import transactions through those new accounts. The informal nature of the relationship between the banks and the ambiguous position of their clients will, in my view, also create difficulties. For example, creditors will be unable to formally insist on collateral, in order to avoid being seen to be participating in foreign trade transactions. The amount of bank credit for such transactions will increase many times over – first of all, because now all import deliveries and transportation services will have to be paid for in advance. In any case, informal relations in the economy will soar.

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<sup>2</sup> Western investors are acting on that same principle: for example, on 7 March, Morgan Stanley said the Russian Federation was likely to default on its obligations, noting that this could happen by the middle of April. That is, payments that have already been stopped are not deemed to constitute full default.

An important aspect of the new economic order will be a **near-total halt to credit activity**. The Russian economy is used to interest rates of below 10%, so the transition to 22-26% will not be an easy one. It will be another blow to businesses that are already facing a rise in the cost of raw materials and components and a fall in demand. Households will not be able to afford mortgages at such high rates of interest.<sup>3</sup> I would venture to guess that 2022-2023 will be a very tough time for the Russian banks. They are already facing a steep rise in borrowing costs; meanwhile, the government has been strongly advising them not to renegotiate the terms of loans provided earlier. In a normal situation, the problem could be resolved by large-scale funding from the CBR at close to zero rates of interest: that is what all central banks did during the pandemic. But in Russia, in time of crisis, interest rates typically go up, not down.

Finally, the CBR has administratively **separated** (albeit incompletely and inconsistently) **the markets for roubles and foreign exchange**. On 8 March, several new measures were announced:

- › a six-month moratorium on the sale of foreign currency to households;
- › a ban on the withdrawal of foreign currency deposits over USD 10,000 (and the de facto forced conversion of any higher amounts into roubles);
- › a 12% tax on the purchase of foreign currency;
- › the separation of cash and non-cash currency markets; and
- › the conversion of all foreign currency deposits into US dollars.

The export of foreign currency in cash is also limited to USD 10,000 (previously, one could take any sum out of the country, provided it was declared and there were documents to explain its origin). Meanwhile, for some unaccountable reason, the euro has become a 'second-class currency', with a ban on the import of euro cash into Russia.

These steps on the part of the CBR are evidence that it is ready to employ any tools to reduce pressure on the foreign exchange market and prevent currency outflows. Given that in 2018-2021, the net capital outflow reached USD 44.2bn, the task would appear a difficult one. It should also be borne in mind that investors will now leave Russia, in the hope of rescuing at least some of their money.

## STOCK MARKET AND FOREIGN PROPERTY

Nor should the stock market be overlooked. The scale of the **blow to the Russian stock market** is hard to gauge at present, since trading was suspended in Moscow immediately following the announcement of the start of the invasion of Ukraine (and on Western floors on 2 March, after many Russian securities had depreciated almost to zero). This blow came just as a significant number of Russians were thinking about investing: since the beginning of 2021, over 9.3m private accounts have been opened on the Moscow Stock Exchange, bringing the number of Russian stockholders to 18m. It would appear that some 50-75% of their investments today can be written off, and this will put people off making such investments for years to come.

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<sup>3</sup> President Putin has already stated the need to preserve preferential mortgages, but I am not sure about either the success of this programme or the attractiveness of investing in real estate.

The other side of the coin has been a sharp fall in the capitalisation of the biggest Russian companies, which before the crisis acted as a de facto source of liquidity. Loans were backed by shares, and investment decisions were made taking into account the cumulative net worth of big asset owners. Today, after the fall in stock prices, artificially 'fixing' the balance-sheet value at pre-crisis levels will not deceive bankers and will not induce them to extend credits. The business environment in Russia in 2022 will not be about accumulating wealth, but rather about preserving it; and this will also be an important factor in the coming economic downturn.

The last significant element of the war-time economic model is the **expropriation of the property** of companies that have voiced disagreement with the course being pursued by the Russian government. The State Duma deputies proposed – and later the government supported – the idea of nationalising the assets of those companies that have closed their operations in Russia. This will probably affect primarily manufacturing, logistical and trading assets. Among those firms that have left the country are practically all the large car producers (Volkswagen, BMW, GM, Renault, Volvo, etc.), oil companies (Shell and BP), trading conglomerates like IKEA, and the fast-food chains McDonald's and KFC.

It is too early to talk about how nationalisation will be carried out, but it is obvious that not all companies will be able to resume operations. The more complicated the production process, the harder it will be to find a firm ready to take it on: for example, in the case of car factories, it is likely that the only bidders will be Chinese corporations, while in the energy sector the Russian oil majors will probably be in pole position. That said, in logistics and trade, the situation could be less complicated. In my opinion, the only thing that can be said unambiguously is that no restoration of relations with those Western companies that are leaving Russia will be possible in the foreseeable future. The expropriation of their property will result in a complete rethink of investment decisions, including by Russian companies.

## OUTLOOK

Could these various measures succeed in keeping the situation in the Russian economy under control? I think not. The authorities are now faced with several important tasks: to prevent extremely high annual inflation (of over 50%); to support businesses and avoid mass unemployment; and, if at all feasible, to reduce capital outflow by de-dollarising the economy as far as possible. Here we may recall the CBR's demand for exporters to convert 80% of their currency earnings into roubles and the cancellation of VAT on the sale of gold bullion, which – with some effort to popularise the notion and to make precious metal transactions easier – could become a currency substitute.

It is rather too soon to be making any forecasts about the state that the Russian economy will be in towards the end of the year. The only thing that can be said with any certainty is that most of the Western sanctions will still be in place. The CBR reserves will remain frozen, and may never be returned: most likely, they will be largely used as reparations for Russian aggression against Ukraine. The US and the EU will stop, or severely restrict, imports of Russian energy. The assets of Western companies that have ceased operations in Russia are likely to be nationalised, which will lead to a deluge of lawsuits against the Russian state and complicate any transactions with Russia. The probability of default(s) also looks very high – not so much because of the impossibility of servicing the obligations of both the state and companies, but rather because of a reluctance to do so. I would agree with those who predict that the problems in the Russian economy will come to the fore only gradually, so

that the country will feel the full impact only in early autumn. Therefore, it seems to me that the emergency measures taken by the CBR with regard to regulating the banking system and the (non-)exchange and (non-)export of foreign currency will not be lifted in September-October 2022, but will be extended for at least another six months.

I envisage the following main stages in the unfolding economic crisis: first, a 15-18% jump in consumer prices in March, due to panic buying. After that, the growth in prices will slow for a while, but it will pick up again as the inventories of stores and producers run out – very likely in the next 2-4 months. By that time, wages, pensions and social benefits will have been partly indexed, which will also fuel inflation. From August to the end of 2022, inflation will run at around 3-4% per month, and we should see official inflation of around 30-35% for the year as a whole.

This year, the economic recession of 10-12% will be the deepest since the mid-1990s, driven by a 20-25% drop in export revenues, a sharp downturn in public and private investment, and a significant drop in household demand. The closure of businesses owned by Western investors will also make a substantial contribution to this downturn; it seems highly unlikely that they will reopen this year. The disposable income of households will fall by 12-17% this year – more than in the eight years since the occupation of Crimea – because the increase in nominal wages will be unable to compensate for the inflationary shocks.

Putin's invasion of Ukraine, the resulting sanctions imposed on Russia by the West and the withdrawal of foreign companies have all served to trigger the most serious economic crisis in the history of modern Russia.<sup>4</sup> No matter how bullish the authorities may be about the possibility of overcoming it, and no matter how much they might fantasise about the success of this new economic policy, the blow dealt to the Russian economy cannot really be parried. We are talking about the complete destruction of an economic environment that has been built up over the last 20 years. This devastation is not instantaneous, but it is unassailable.

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<sup>4</sup> I assume here that the crisis of the first half of the 1990s was sparked by the leadership of the USSR, not Russia.

# EU investment in China: past, present and ways ahead

BY NINA VUJANOVIĆ

*Its significant economic reforms and the opening up of its markets have rendered China one of the largest trade players in the world. However, EU FDI in China has been relatively modest. The preferential treatment received by state-owned enterprises and conditions stipulating the transfer of technology remain major obstacles to FDI. Implementation of the Comprehensive Agreement on Investment with the EU and the Regional Comprehensive Economic Partnership agreement with other Asian and Pacific countries may, however, change EU investment patterns in China in the future.*

China is one of the biggest contributors to world population, global GDP and trade. Since the country's integration into global value chains – a process that gained momentum after its entry into the World Trade Organization (WTO) in 2001 – China has become one of the biggest traders in goods. This is also reflected in the high level of trade embeddedness between the EU and China, especially in terms of the export of high-tech goods to the EU (Stehrer and Vujanović, 2022). Over the past 40 years, China has undertaken significant economic reform, has joined the WTO, and has signed multiple trade and investment agreements. However, despite both its economic growth and its reforms and multilateral efforts, China has remained a modest recipient of foreign direct investment (FDI).

This article explains the reasons for this. It provides an overview of FDI inflows and the obstacles that multinational enterprises (MNEs) face, and offers possible future avenues for EU FDI in China.

## CHINA'S ENVIRONMENT FOR FDI REMAINS HIGHLY RESTRICTIVE

China had a closed economy for a very long time, but since the 1990s it has engaged in comprehensive market reform. As a result, we have witnessed the privatisation of some small and medium-sized enterprises. As an illustration of this trend, state-owned enterprises accounted for about 78% of overall industrial production in 1978; by 2004, that figure had dropped to 24% (Lee, 2009). China was also ranked as the top country in terms of the privatisation process from 2008 to 2015 (Estrin and Pelletier, 2018).

Along with these reforms, various bilateral investment treaties were signed between China and most of the current EU member states. Table 1 lists the bilateral investment treaties signed with today's EU member states over the last 40 years.

**Table 1 / Bilateral investment treaties signed between China and individual EU members**

The EU 27 partner country	Date of signature	Date of entry into force
Malta (2009)	22/02/2009	04/01/2009
France (2007)	26/11/2007	20/08/2010
Portugal (2005)	12/09/2005	26/07/2008
Czechia (2005)	12/08/2005	09/01/2006
Spain (2005)	14/11/2005	07/01/2008
Belgium-Luxembourg Economic Union (2005)	06/06/2005	12/01/2009
Finland (2004)	15/11/2004	15/11/2006
Latvia (2004)	15/04/2004	02/01/2006
Germany (2003)	12/01/2003	11/11/2005
Netherlands (2001)	26/11/2001	08/01/2004
Cyprus (2001)	15/01/2001	29/04/2002
Romania (1994)	07/12/1994	09/01/1995
Lithuania (1993)	11/08/1993	06/01/1994
Slovenia (1993)	13/09/1993	01/01/1995
Estonia (1993)	09/02/1993	06/01/1994
Croatia (1993)	06/07/1993	07/01/1994
Greece (1992)	25/06/1992	21/12/1993
Slovakia (1991)	12/04/1991	12/01/1992
Hungary (1991)	29/05/1991	04/01/1993
Bulgaria (1989)	27/06/1989	21/08/1994
Poland (1988)	06/07/1988	01/08/1989
Austria (1985)	09/12/1985	10/11/1986
Denmark (1985)	29/04/1985	29/04/1985
Italy (1985)	28/01/1985	28/08/1987
Sweden (1982)	29/03/1982	29/03/1982

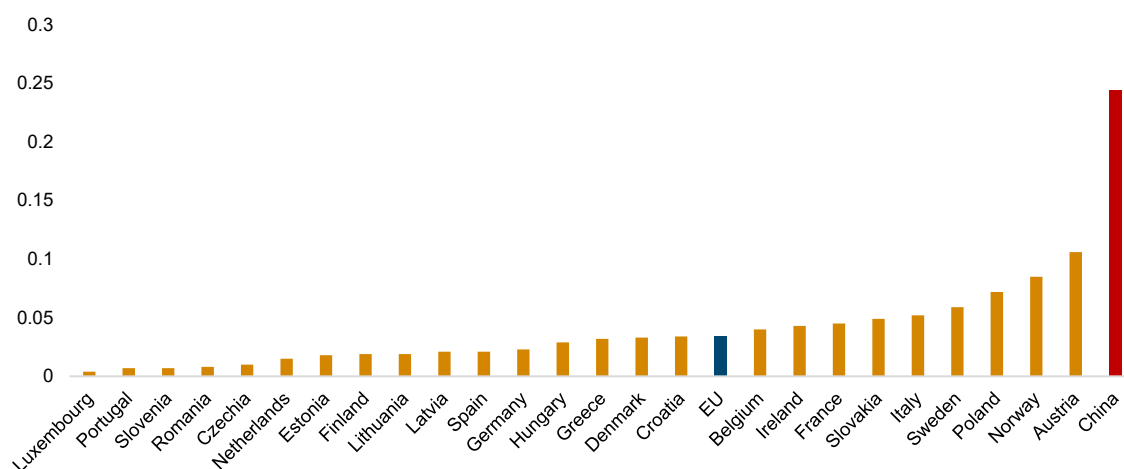
Source: UNCTAD.

The results of the country's reforms are visible from the data. The Organisation for Economic Co-operation and Development (OECD) FDI Regulatory Restrictiveness Index (FDI RRI) for China had a value of 0.44 in 2010, but by 2019 that figure had almost halved (to 0.24). However, this score still places China as the ninth most restrictive country in the world for foreign capital; the FDI RRI in China is significantly higher than in the EU countries (Figure 1). This does vary according to industry: those most protected from FDI include high-tech knowledge-intensive services,<sup>1</sup> such as radio/TV broadcasting and media (almost completely closed to foreign investors, with an FDI RRI value close to 1), as well as fixed and mobile telecommunications (FDI RRI ~ 0.7).

This suggests that various barriers to the operation of MNEs in China are still in place. Many large firms in China were only registered as private companies after the reform process; in fact, they only underwent a process of corporatisation – i.e. large state-owned enterprises were incorporated into industrial conglomerates controlled by the state (Hsieh and Song, 2015). Thus, the privatisation process in China never really achieved the success it enjoyed in developed economies because of factors related to poor institutions and the lack of a competitive environment (Estrin and Pelletier, 2018).

<sup>1</sup> Eurostat categorises services into knowledge-intensive and other services. Knowledge-intensive services encompass high-tech, market, financial and other knowledge-intensive services, [https://ec.europa.eu/eurostat/statistics-explained/index.php?title=Glossary:Knowledge-intensive\\_services\\_\(KIS\)](https://ec.europa.eu/eurostat/statistics-explained/index.php?title=Glossary:Knowledge-intensive_services_(KIS))



**Figure 1 / OECD FDI regulatory restrictiveness, 2019**

Note: The FDI RRI approximates the restrictiveness of a country to FDI and is measured based on limitations that refer to foreign equity, screening mechanisms, restrictions on the employment of foreigners as key personnel and operational restrictions. The FDI RRI takes a value of between 0 and 1, whereby a value of 1 indicates total restrictiveness to FDI and 0 indicates no restrictiveness.

Source: OECD.

Many private firms still enjoy a solid connection with the government by virtue of their previous ownership structure (Garcia-Herrero and Xu, 2017) and the benefits obtained from their political connections (Milhaupt and Zheng, 2014). Furthermore, the core sectors of the economy are 'reserved' for the state (Molnar and Lu, 2019); meanwhile further reforms have gone in the direction of sharpening firms' global competitiveness, rather than creating a level playing field. State-owned enterprises enjoy favourable treatment, such as preferential financing, explicit and implicit guarantees, subsidies and insider state information (OECD, 2016; Garcia-Herrero, 2017). This has long served to demotivate investors.

In addition, many multinational enterprises have been incentivised to transfer their technology to China, in return for certain tax subsidies (Du et al., 2011; 2014), a practice that has been heavily criticised both globally and by the WTO. Du et al. (2014) found that those multinational firms in receipt of tax benefits were transferring more technology to local firms than were multinationals that did not have such benefits. As multinationals typically possess the most sophisticated technology and have the highest rates of R&D globally, the handicap of the intellectual property rights regime in China has also presented a major obstacle to their investment in the country. The next section explains the scope of FDI in China, with a focus on the EU.

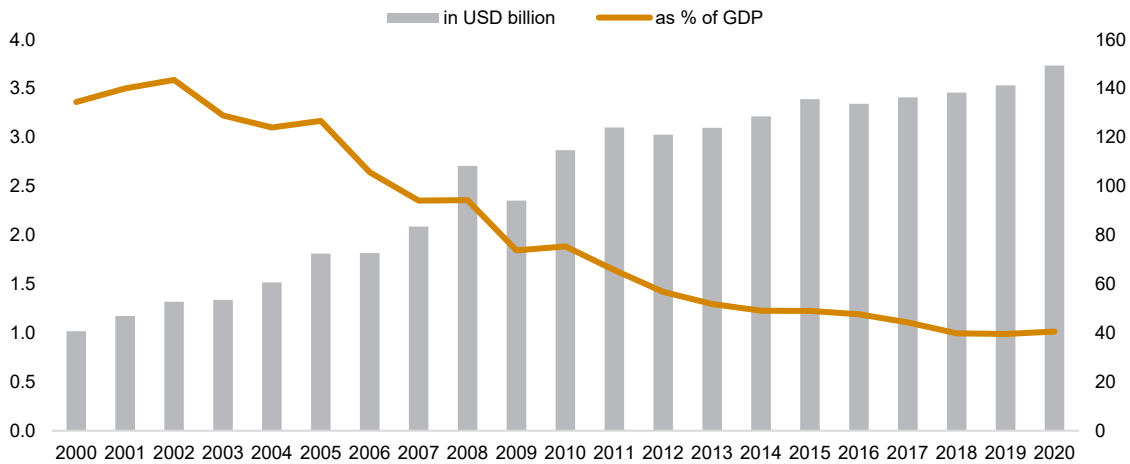
## THE EU IS ONLY A MINOR PLAYER IN TOTAL FDI IN CHINA...

Over time, despite its restrictiveness, China has become the second-biggest recipient of FDI in the world, after the US (UNCTAD, 2021). In 2020, when global FDI decreased by 35% (UNCTAD, 2021; Vujanović et al., 2021) – the biggest decline ever experienced – FDI inflows to China actually increased by about 6% (Ministry of Commerce of the People's Republic of China, 2021; UNCTAD, 2021). That year, China received USD 149.3bn in foreign investment, of which 85% was in the Eastern region (UNCTAD, 2021; Ministry of Commerce of the People's Republic of China, 2021). However, considering



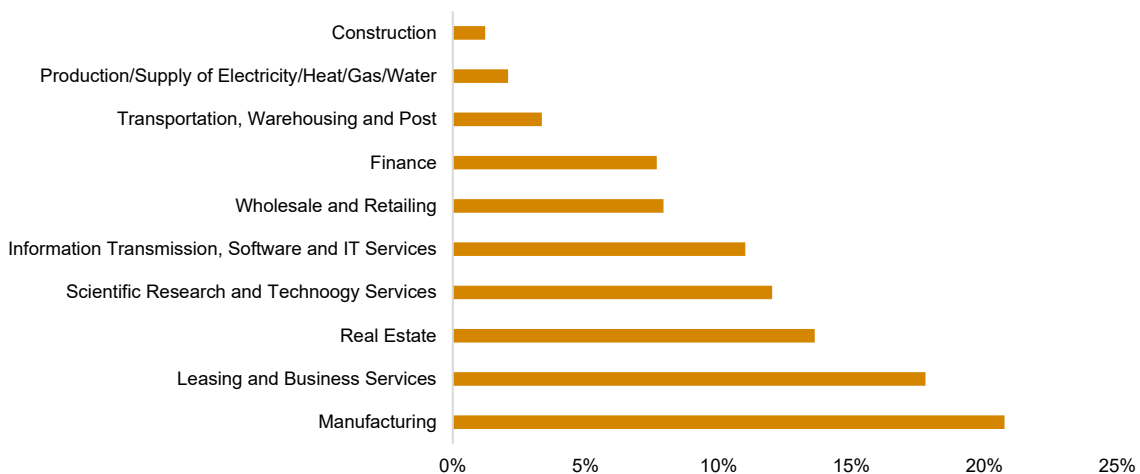
the amount of global FDI and the fact that China accounts for about 18% of global GDP and of the world’s population,<sup>2</sup> it is a relatively modest FDI recipient. FDI in China has, on average, amounted to about 8% of global FDI over the last two decades, which corresponds to about 2% of its GDP (see Figure 2).<sup>3</sup>

**Figure 2 / FDI inflows to China (right) and their percentage of its GDP (left)**



Source: Ministry of Commerce of the People’s Republic of China (FDI), World Bank (GDP).

**Figure 3 / The most important industry recipients of 2020 FDI in China, as a percentage of total FDI**



Source: Ministry of Commerce of the People’s Republic of China.

<sup>2</sup> Source: <https://databank.worldbank.org/source/world-development-indicators>

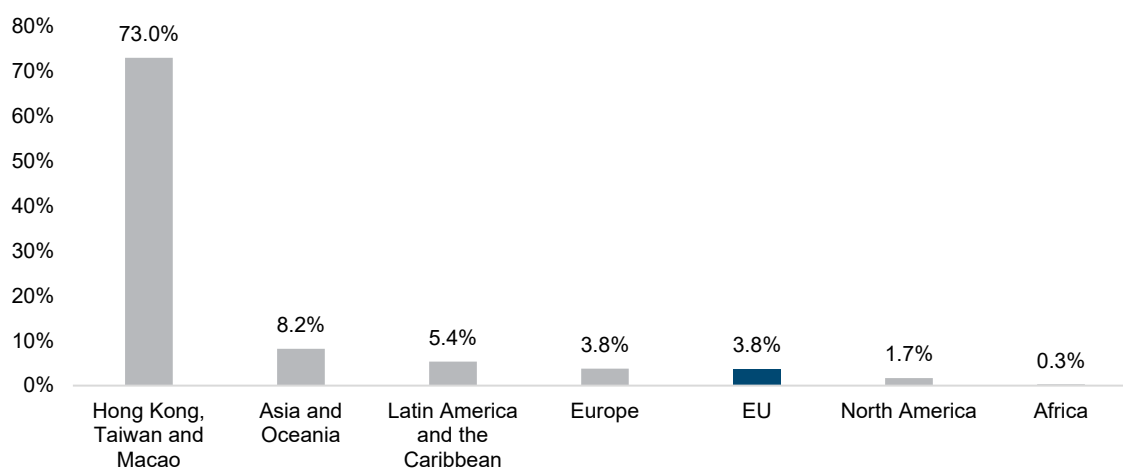
<sup>3</sup> The pandemic year 2020 was exceptional for FDI inflows. FDI inflows declined in Europe by -80% and in the USA by -40%. Meanwhile, China experienced an annual increase of 6% (UNCTAD, 2021). Hence that year, FDI inflows to China amounted to 15% of global FDI, 5.7 percentage points more than in 2019.

Most FDI in China flows to the manufacturing sectors (20.8%), Leasing and Business Services (17.8%), Real Estate (13.6%), Scientific Research and Technology Services (12%) and Information Transmission, Software and Information Technology Services (11%). This clearly shows that, alongside manufacturing (which has traditionally been an important sector in China – especially high-tech industries), the high-tech knowledge-intensive services are important recipients of FDI in China, claiming 21.7% of FDI in total. This is also mirrored in the fact that the manufacturing sector is the driver of Chinese exports globally (Stehrer and Vujanović, 2022). Figure 3 shows the most important FDI recipients in China.

Although FDI is fairly well spread across the sectors of the economy, there is rather a low level of diversification of FDI in China in terms of investor origin. The latest available UNCTAD data show that FDI inflows to China originate mostly from Hong Kong, Taiwan and Macao (73%), with Hong Kong alone accounting for 71%; meanwhile, the rest of Asia takes up only 8.2% of total FDI inflows to China. Latin America and the Caribbean follows, with 5% of the total. Only about 4% of total FDI inflows originates in Europe, and other parts of the world contribute negligibly to FDI in China (Figure 4).

Hong Kong, the main contributor to FDI in China, is a special case, as has been explained by Casella (2019). Much of the FDI from Hong Kong is actually conduit FDI: it originates in third destinations that use Hong Kong (in the form of special-purpose entities)<sup>4</sup> as an intermediate location, through which to enter China.<sup>5</sup> This calls for caution in interpreting the large FDI streaming from Hong Kong, and also caution with respect to the shares of investors from other countries.

**Figure 4 / FDI inflows to China in 2020, by origin of investors, as percentage of total FDI**



Note: UNCTAD reports FDI data on Hong Kong, Taiwan and Macao separately from data on China.

Source: UNCTAD.

<sup>4</sup> Special-purpose entities (SPEs) channel funds between entities outside their location and optimise the investment strategies of multinational corporations (OECD, 2015) before reaching the final destination.

<sup>5</sup> Casella (2019) estimates that ultimate investment from Hong Kong amounted to only 12% in 2016, while the reported figure is 48%. The author explains that the first percentage represents 'ultimate investor', while the second reported 'direct investor'. Casella (2019) calculates the conduit probability to be 78% for Hong Kong.

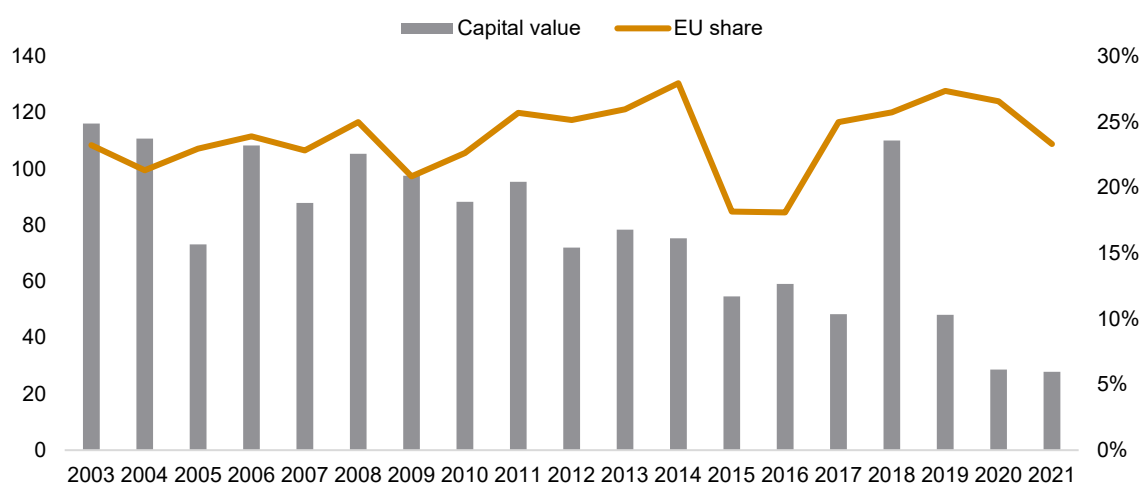
Over the past decade, EU FDI in China has been quite stable: inflows to China amounted to USD 4.9bn in 2010, rising to USD 5.6bn in 2020, with small oscillations in between. Although over these years, EU FDI in China increased by about 16%, this investment represents a very small share of total FDI inflows to China (only 3.8% in 2020). Most EU FDI to China stems from three countries: Germany, the Netherlands and France (Ministry of Commerce of the People's Republic of China, 2021).

### ... BUT IS MUCH MORE IMPORTANT IN GREENFIELD INVESTMENTS

As indicated earlier in the text, global FDI in 2020 experienced a record decline, though it rose by about 6% in China. The story is rather different for greenfield FDI: globally, it decreased sharply, by 29% in terms of the number of greenfield projects and by 33% in terms of value; but the decline was even steeper in China – 52% and 40.5%, respectively. Unlike mergers and acquisitions, which can sometimes be very volatile due to various one-off transactions and cross-border deals (Vujanović et al., 2021), greenfield investments are usually fairly stable, since they encompass newly established foreign subsidiaries with their distribution channels. Also, they are typically more productive and bring greater economic value in terms of intangible assets and productivity-enhancing activities.

Despite the fact that the EU's share of overall FDI flows to China is relatively small, a quarter of the greenfield FDI in China originates in the EU. Figure 5 presents the capital value of the total greenfield projects in China (left-hand axis) and the percentage share of these values originating in the EU (right-hand axis).

**Figure 5 / Capital value of the greenfield projects announced in China in USD billion (left), and share of EU greenfield FDI as a percentage (right)**



Note: Data for 2021 are preliminary.

Source: author's own calculation, based on fDi markets database.

The reason that China accounts for such a large share of European greenfield investments could be the greater protection of intangible assets offered by this mode, as opposed to other entry modes: mergers and acquisitions, for example, involve partnerships with local entities (UNCTAD, 2015). Empirical evidence shows that foreign firms transmit less knowledge to the local economy if a company is

established abroad via greenfield investment (Balsvik and Haller, 2010). Multinational enterprises are better able to prevent their technology from being copied if their establishments are fully foreign-owned and if their reliance on local supply chains is limited.

However, as throughout the world, the COVID-19 pandemic led to a sharp decline in EU greenfield FDI in China in 2020 of 45.6% in terms of the number of projects and 42.2% in capital value – the biggest drop recorded since 2003. Moreover, 2021 saw little recovery in this respect: despite an increase in the number of EU greenfield projects in 2021 (28.6%), compared to 2020 their project value fell by 14% and the number of jobs created by them decreased by 9%. Hence, the pre-pandemic levels have not yet been reached.

## COMPREHENSIVE AGREEMENT ON INVESTMENT AND THE FUTURE OF FDI

The above analysis has shown that there is considerable scope for further FDI in China by EU member states. Despite the significant reforms that have taken place in that country, the large share of state ownership and the forced technology transfers have acted as major stumbling blocks for EU investors. That led to the conclusion in principle (pending ratification by the European Parliament) of the Comprehensive Agreement on Investment (CAI) at the end of 2020 – the culmination of seven years of negotiations between the EU and China. The aim of the CAI is to abolish enforced technological transfer, put EU and Chinese investors on an equal footing and make them independent of China's internal policies. The CAI allows for the scrapping of quantitative restrictions, equity caps or joint ventures requirement in China, while in return the EU agreed to keep its market open (European Commission, 2020).

However, the surge in optimism proved short-lived, as the European Parliament halted the efforts to ratify the CAI in May 2021 after Chinese sanctions on several parliament members.<sup>6</sup> Given that there has been no announcement of a revival of the CAI, the chances are that, in the short term, EU FDI in China will continue on the same trajectory as in the past.

Still, looking further ahead, there may be a greater incentive to invest in China. This is due to the establishment of the largest trading bloc in history via the Regional Comprehensive Economic Partnership (RCEP) agreement, which was signed in November 2020 by the ASEAN+3,<sup>7</sup> New Zealand and Australia and entered into force in January 2022. It may motivate efficiency-seeking FDI, whereby investors seek to enjoy the benefits of free trade between the RCEP members, thus benefiting from lower production costs by sourcing inputs across the borders of the RCEP region. Furthermore, export-platform FDI may increase. Investors may seek to establish affiliates in one RCEP member but export their goods (cheaply) across the trading bloc, since the tariffs on 90% of the goods will be eliminated over the next 20 years (Stehrer and Vujanović, 2022). If the RCEP agreement has a negative impact on trade between the EU and China (also in the wake of the near-shoring trends in trade caused by COVID-19 and trade wars), then we are likely to witness greater FDI as an alternative strategy to trade.

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<sup>6</sup> This came in retaliation to the EU's restrictive measures against China over the violation of the human rights of the Muslim Uyghur minority.

<sup>7</sup> Ten ASEAN member states, China, Japan and the Republic of Korea.

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# Monthly and quarterly statistics for Central, East and Southeast Europe

The monthly and quarterly statistics cover **22 countries** of the CESEE region. The graphical form of presenting statistical data is intended to facilitate the **analysis of short-term macroeconomic developments**. The set of indicators captures trends in the real and monetary sectors of the economy, in the labour market, as well as in the financial and external sectors.

Baseline data and a variety of other monthly and quarterly statistics, **country-specific** definitions of indicators and **methodological information** on particular time series are **available in the wiiw Monthly Database** under: <https://data.wiiw.ac.at/monthly-database.html>. Users regularly interested in a certain set of indicators may create a personalised query which can then be quickly downloaded for updates each month.

## Conventional signs and abbreviations used

%	per cent
ER	exchange rate
GDP	Gross Domestic Product
HICP	Harmonised Index of Consumer Prices (for new EU member states)
LFS	Labour Force Survey
NPISHs	Non-profit institutions serving households
p.a.	per annum
PPI	Producer Price Index
reg.	registered
y-o-y	year on year

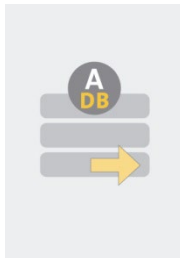
The following national currencies are used:

ALL	Albanian lek	HRK	Croatian kuna	RON	Romanian leu
BAM	Bosnian convertible mark	HUF	Hungarian forint	RSD	Serbian dinar
BGN	Bulgarian lev	KZT	Kazakh tenge	RUB	Russian rouble
BYN	Belarusian rouble	MKD	Macedonian denar	TRY	Turkish lira
CZK	Czech koruna	PLN	Polish zloty	UAH	Ukrainian hryvnia

EUR euro – national currency for Montenegro, Kosovo and for the euro-area countries Estonia (from January 2011, euro-fixed before), Latvia (from January 2014, euro-fixed before), Lithuania (from January 2015, euro-fixed before), Slovakia (from January 2009, euro-fixed before) and Slovenia (from January 2007, euro-fixed before).

Sources of statistical data: Eurostat, National Statistical Offices, Central Banks and Public Employment Services; wiiw estimates.

### Online database access



**wiiw Annual Database**



**wiiw Monthly Database**



**wiiw FDI Database**

The wiiw databases are accessible via a simple web interface, with only one password needed to access all databases (and all wiiw publications).

You may access the databases here: <https://data.wiiw.ac.at>.

If you have not yet registered, you can do so here: <https://wiiw.ac.at/register.html>.

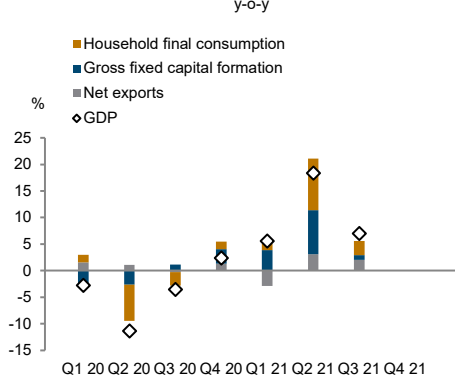
### Service package available

We offer an additional service package that allows you to access all databases – a wiiw Membership, at a price of € 2,300. Your usual package will, of course, remain available as well.

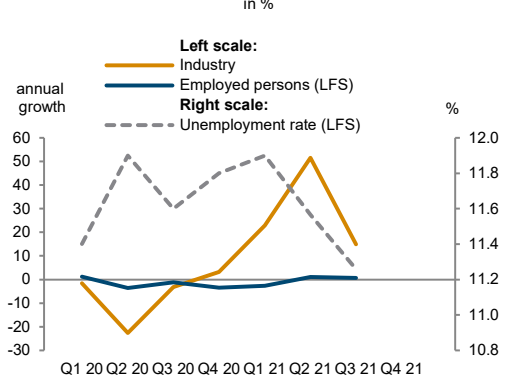
For more information on database access for Members and on Membership conditions, please contact Ms. Barbara Pill ([pill@wiiw.ac.at](mailto:pill@wiiw.ac.at)), phone: (+43-1) 533 66 10.

# Albania

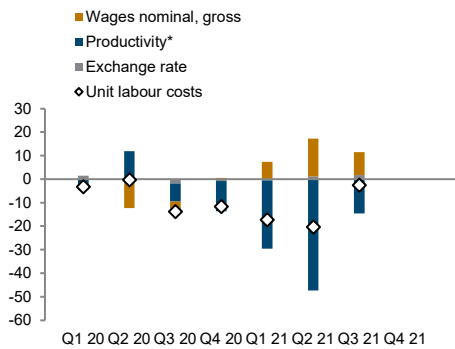
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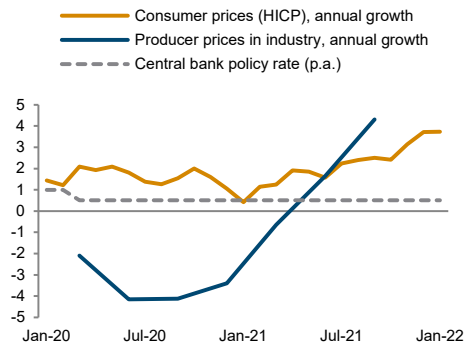
**Real sector development**



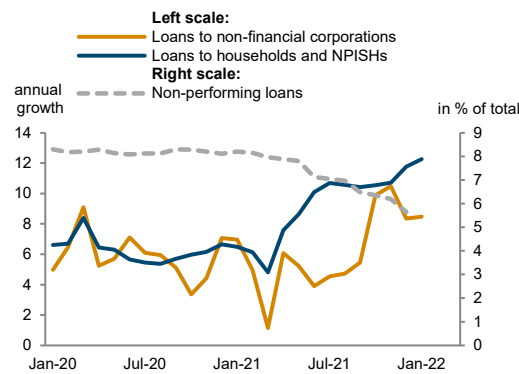
**Unit labour costs in industry**



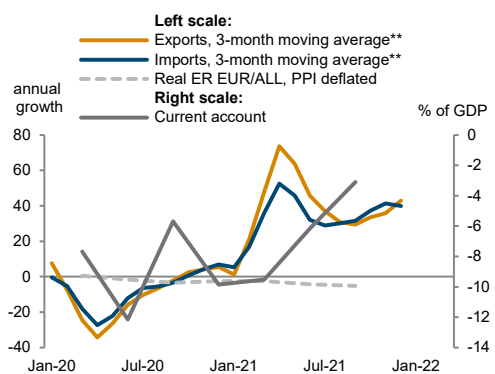
**Inflation and policy rate**



**Financial indicators**



**External sector development**



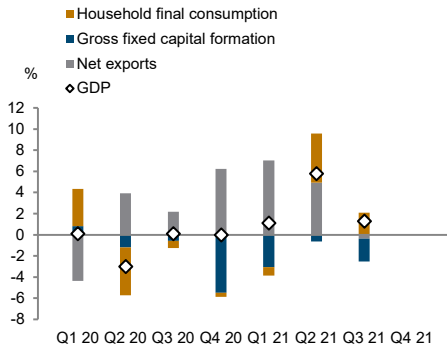
\*Positive values of the productivity component on the graph reflect decline in productivity and vice versa.  
 \*\*EUR based.

Source: wiiw Monthly Database incorporating Eurostat and national statistics.  
 Baseline data, country-specific definitions and methodological breaks in time series are available under:  
<https://data.wiiw.ac.at/monthly-database.html>

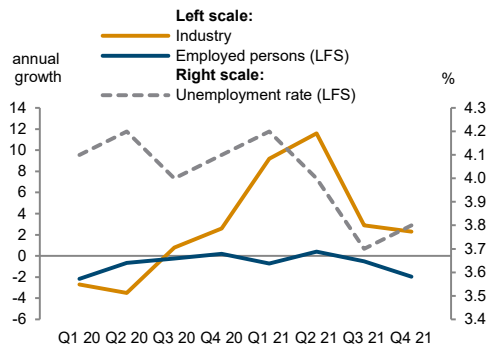


# Belarus

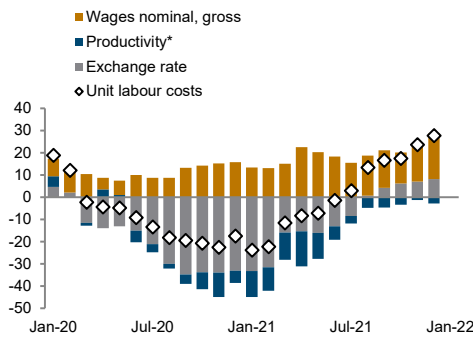
**Real GDP growth and contributions**  
y-o-y



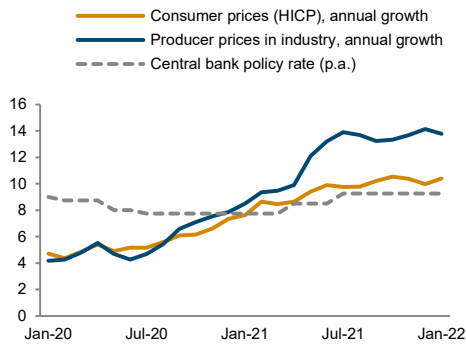
**Real sector development**  
in %



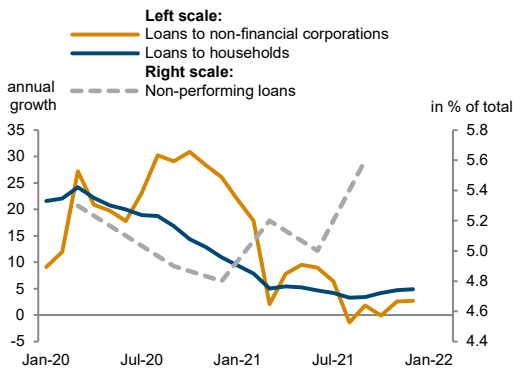
**Unit labour costs in industry**  
annual growth rate in %



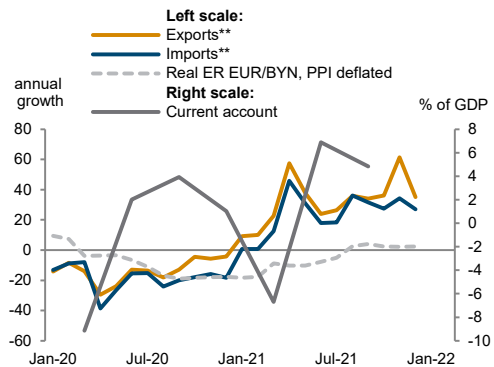
**Inflation and policy rate**  
in %



**Financial indicators**  
in %



**External sector development**  
in %



\*Positive values of the productivity component on the graph reflect decline in productivity and vice versa.  
 \*\*EUR based.

Source: wiiw Monthly Database incorporating Eurostat and national statistics.

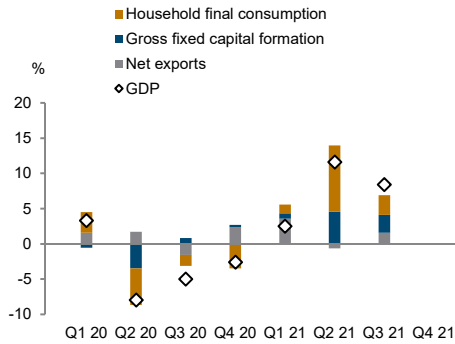
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# Bosnia and Herzegovina

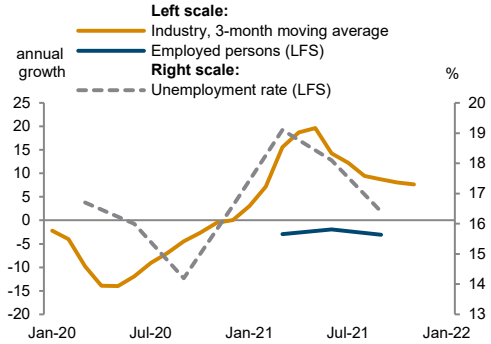
### Real GDP growth and contributions

y-o-y



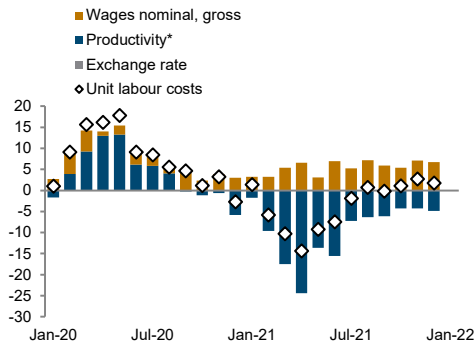
### Real sector development

in %



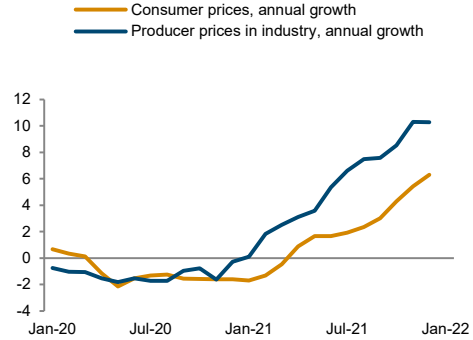
### Unit labour costs in industry

annual growth rate in %



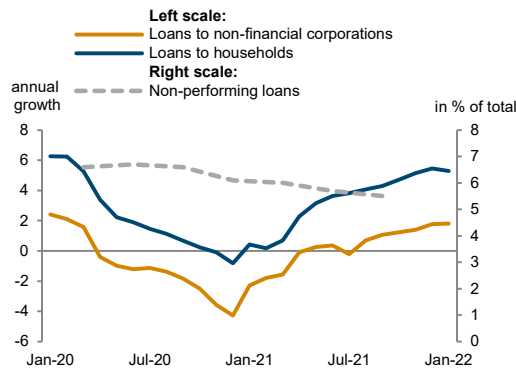
### Inflation

in %



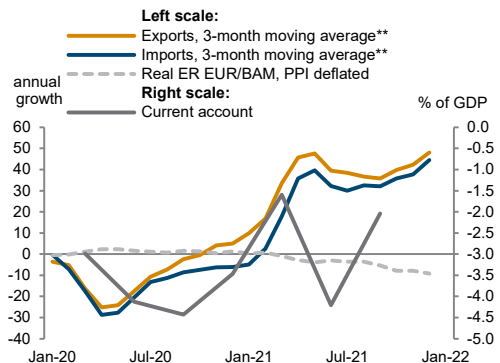
### Financial indicators

in %



### External sector development

in %



\*Positive values of the productivity component on the graph reflect decline in productivity and vice versa.

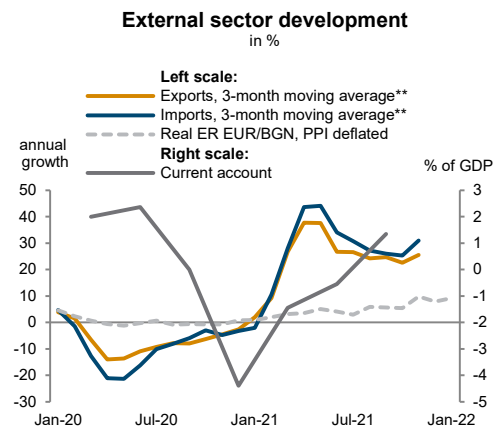
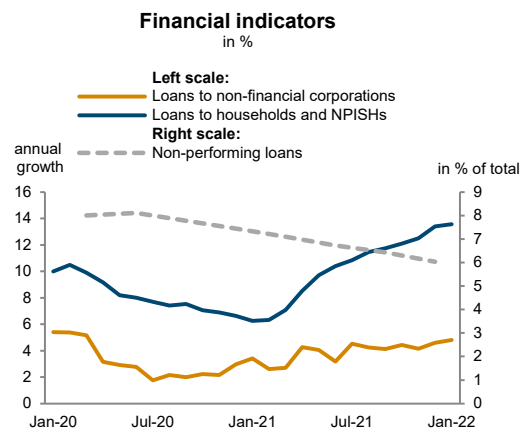
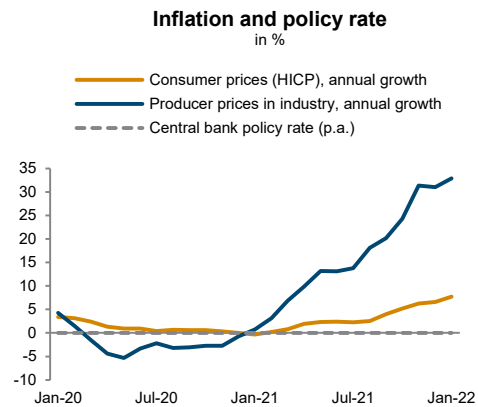
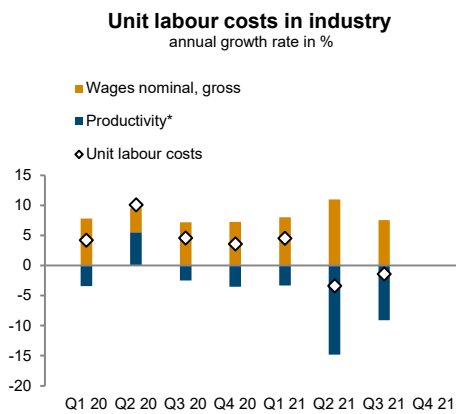
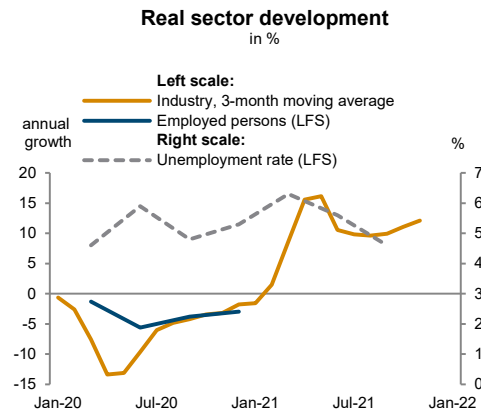
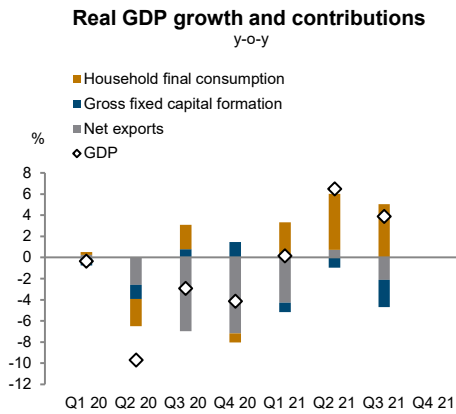
\*\*EUR based.

Source: wiiw Monthly Database incorporating Eurostat and national statistics.

Baseline data, country-specific definitions and methodological breaks in time series are available under:

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# Bulgaria



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 \*\*EUR based.

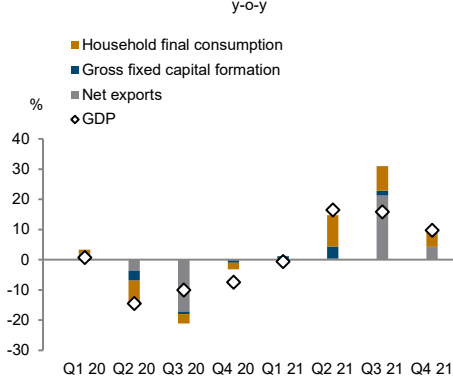
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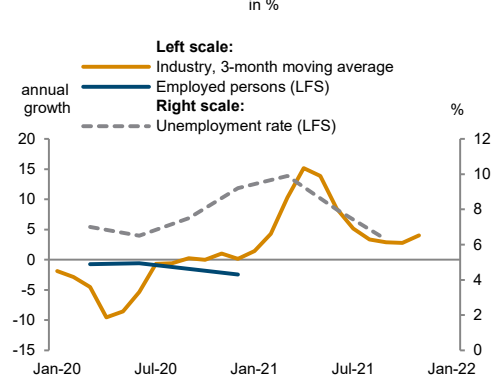
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# Croatia

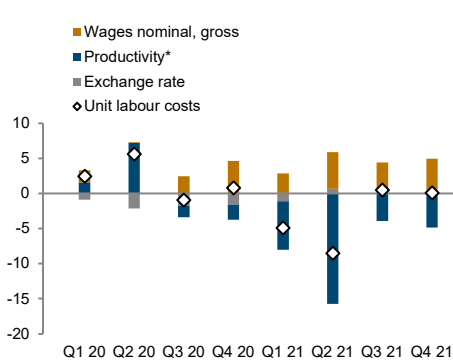
## Real GDP growth and contributions



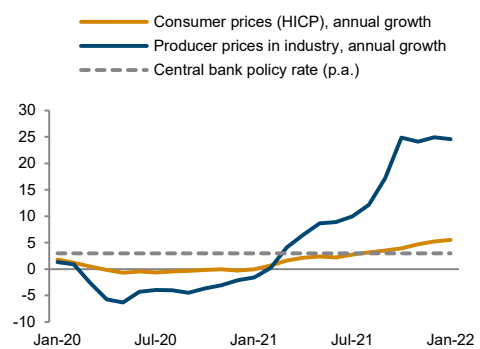
## Real sector development



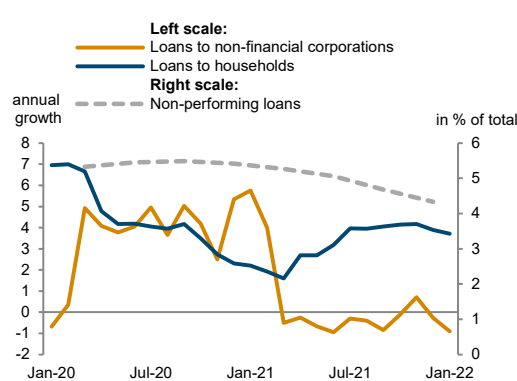
## Unit labour costs in industry



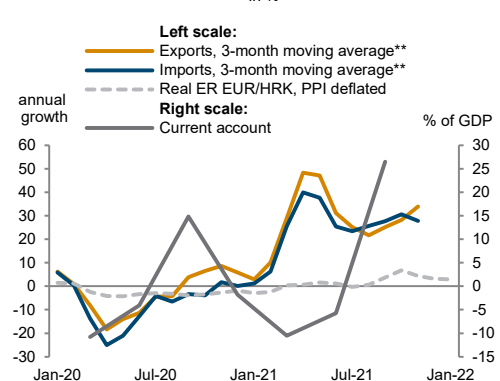
## Inflation and policy rate



## Financial indicators



## External sector development



\*Positive values of the productivity component on the graph reflect decline in productivity and vice versa.

\*\*EUR based.

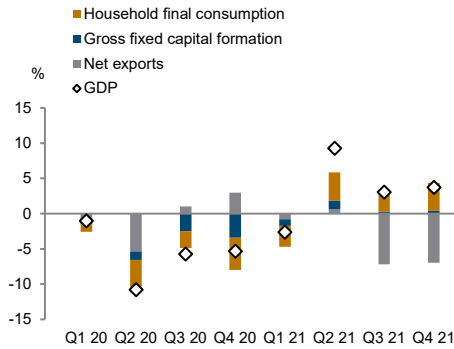
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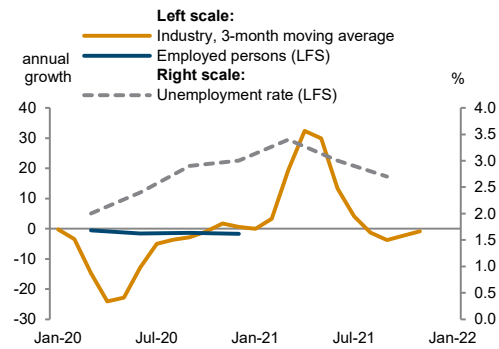
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# Czechia

**Real GDP growth and contributions**  
y-o-y



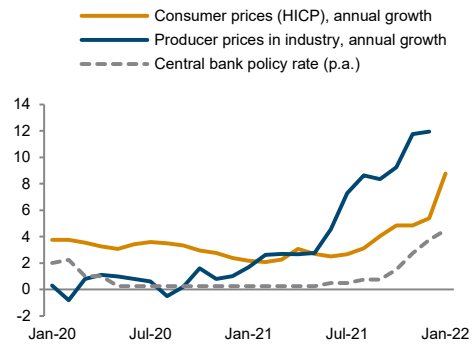
**Real sector development**  
in %



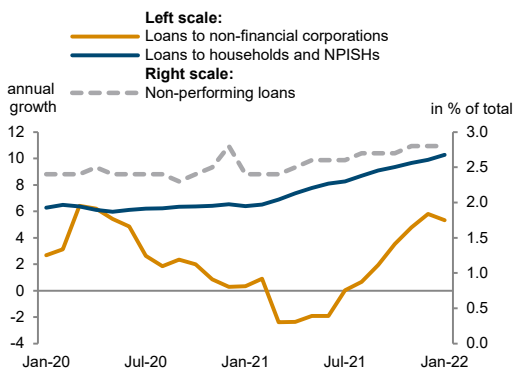
**Unit labour costs in industry**  
annual growth rate in %



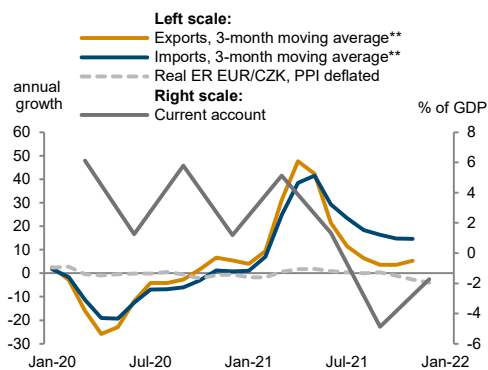
**Inflation and policy rate**  
in %



**Financial indicators**  
in %



**External sector development**  
in %



\*Positive values of the productivity component on the graph reflect decline in productivity and vice versa.  
\*\*EUR based.

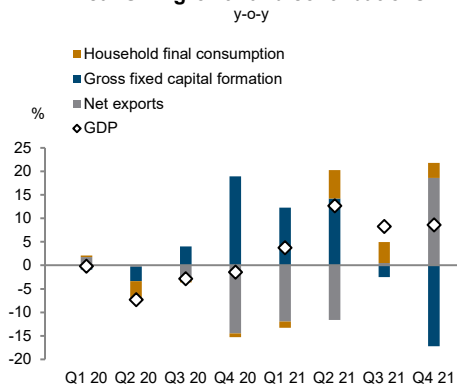
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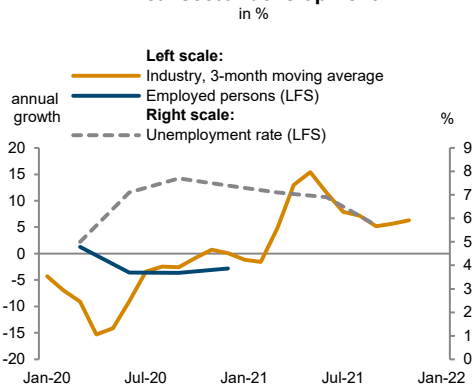
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## Estonia

### Real GDP growth and contributions



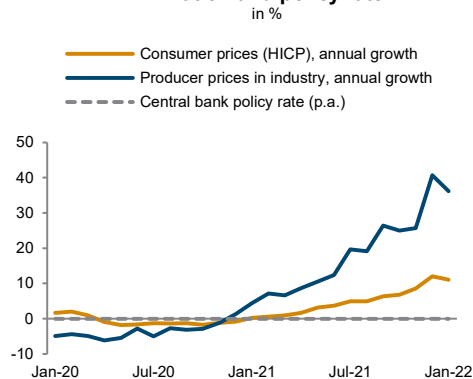
### Real sector development



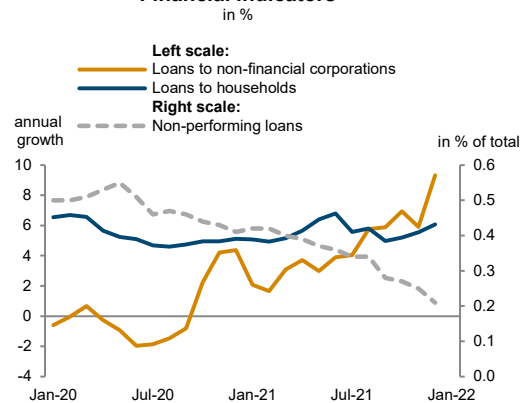
### Unit labour costs in industry



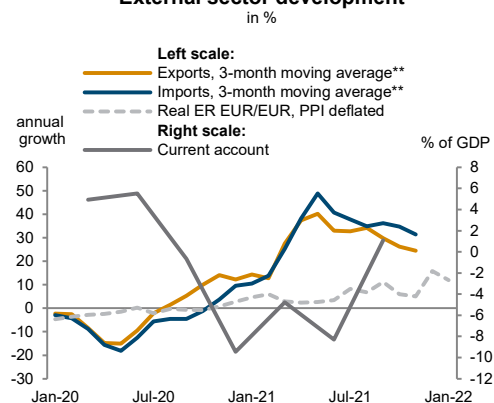
### Inflation and policy rate



### Financial indicators



### External sector development



\*Positive values of the productivity component on the graph reflect decline in productivity and vice versa.

\*\*EUR based.

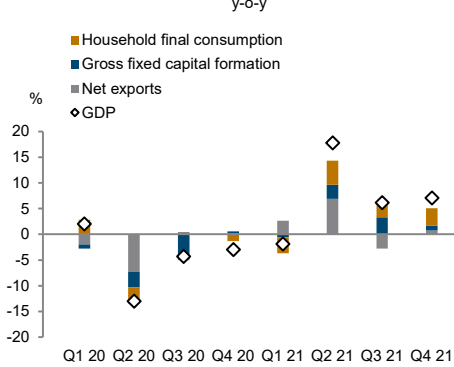
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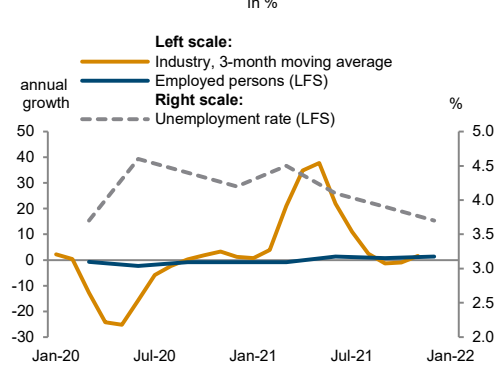
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# Hungary

**Real GDP growth and contributions**



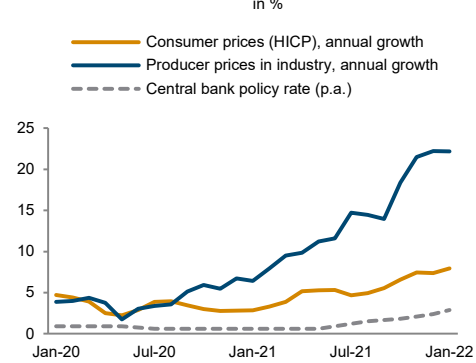
**Real sector development**



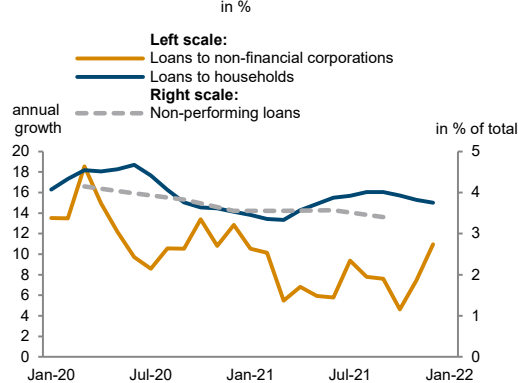
**Unit labour costs in industry**



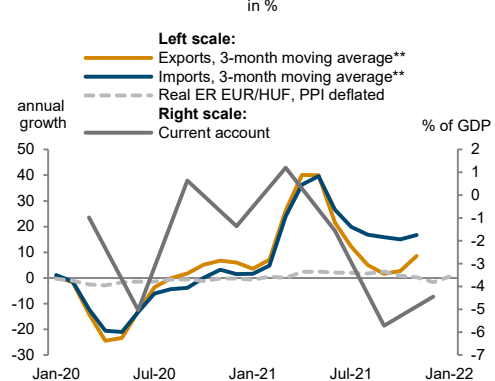
**Inflation and policy rate**



**Financial indicators**



**External sector development**

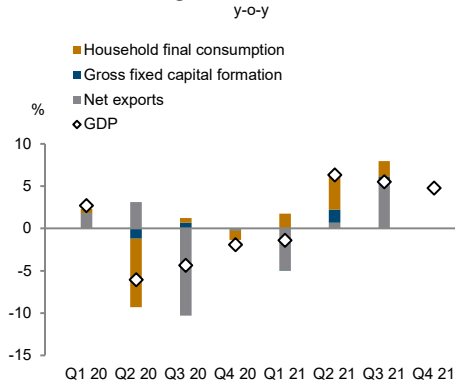


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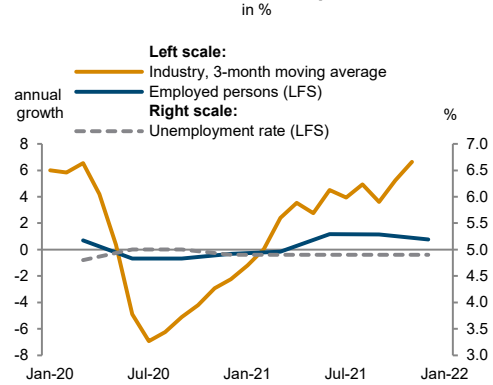
Source: wiiw Monthly Database incorporating Eurostat and national statistics.  
Baseline data, country-specific definitions and methodological breaks in time series are available under:  
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# Kazakhstan

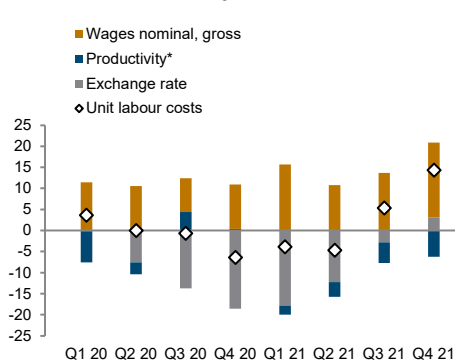
## Real GDP growth and contributions



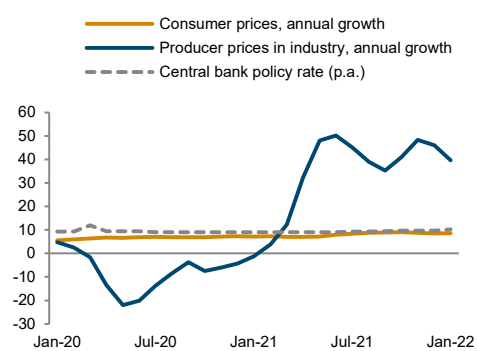
## Real sector development



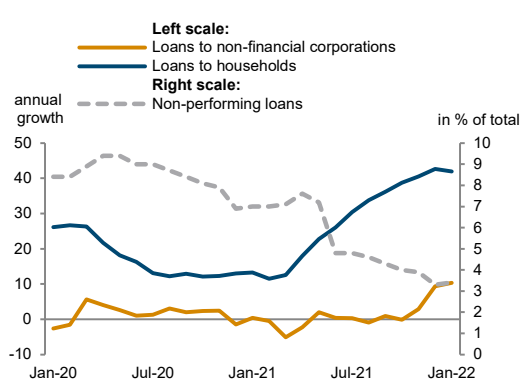
## Unit labour costs in industry



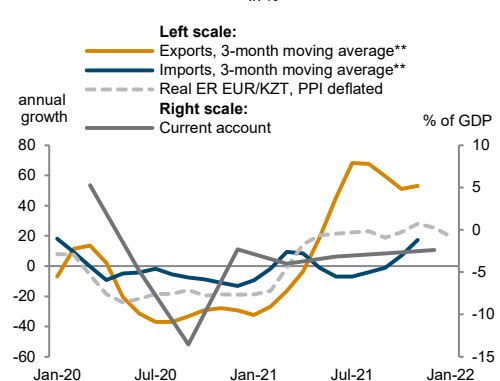
## Inflation and policy rate



## Financial indicators



## External sector development



\*Positive values of the productivity component on the graph reflect decline in productivity and vice versa.

\*\*EUR based.

Source: wiiw Monthly Database incorporating Eurostat and national statistics.

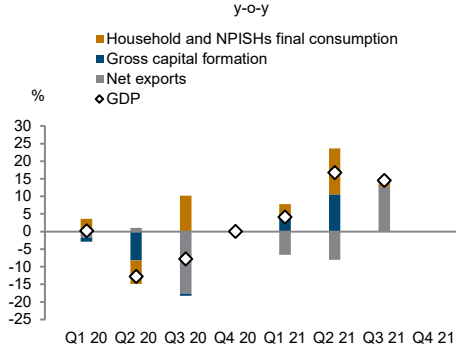
Baseline data, country-specific definitions and methodological breaks in time series are available under:

<https://data.wiiw.ac.at/monthly-database.html>

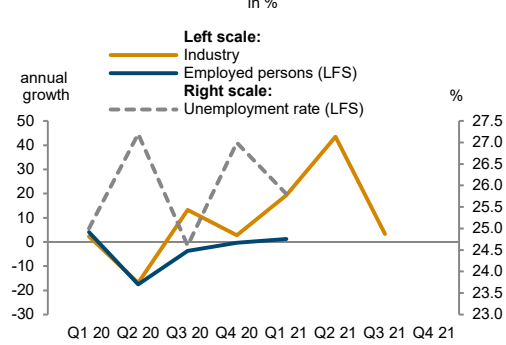


# Kosovo

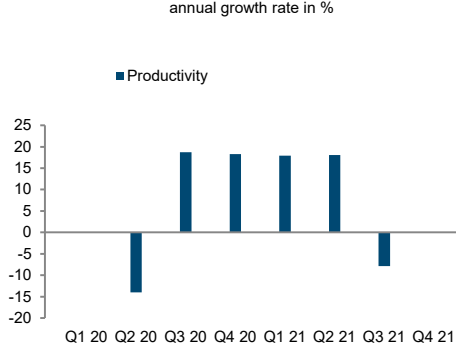
**Real GDP growth and contributions**



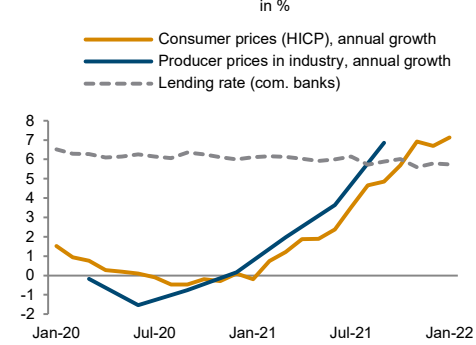
**Real sector development**



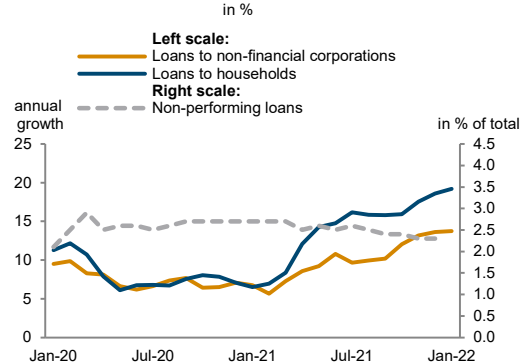
**Productivity in industry**



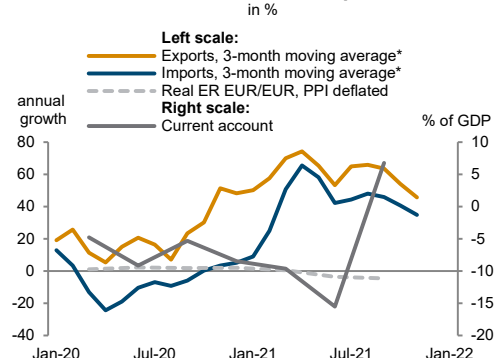
**Inflation and lending rate**



**Financial indicators**



**External sector development**



\*EUR based.

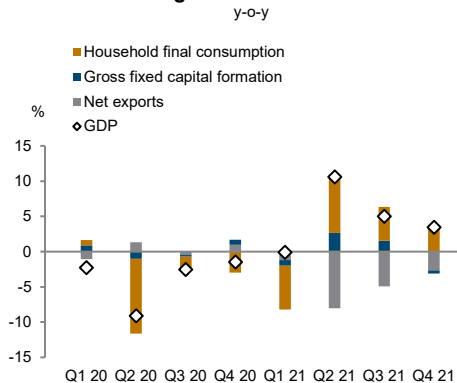
Source: wiiw Monthly Database incorporating Eurostat and national statistics.

Baseline data, country-specific definitions and methodological breaks in time series are available under:

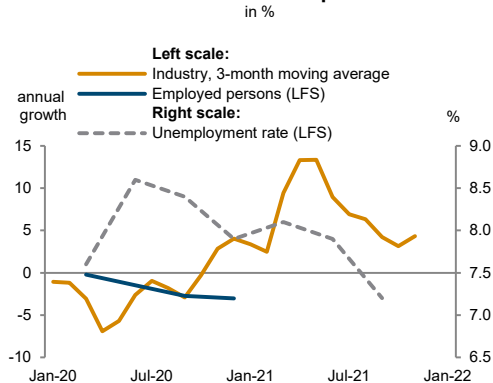
<https://data.wiiw.ac.at/monthly-database.html>

# Latvia

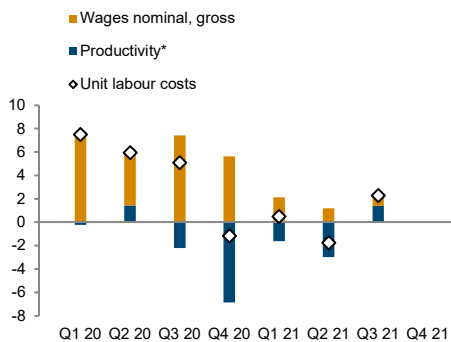
**Real GDP growth and contributions**



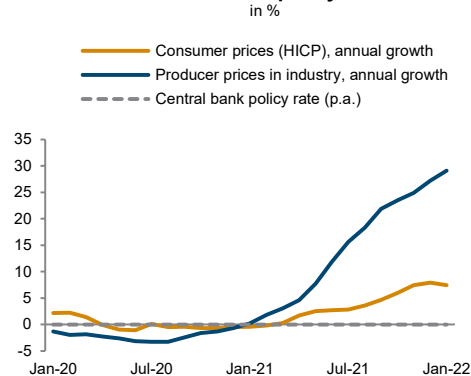
**Real sector development**



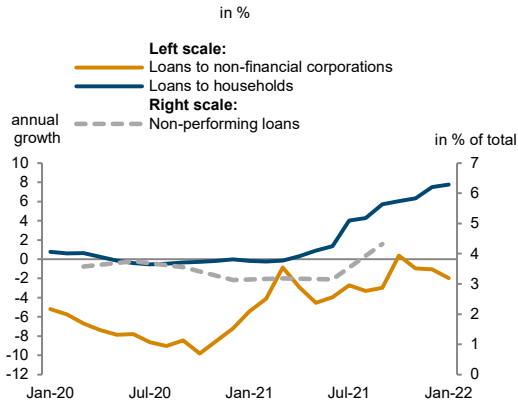
**Unit labour costs in industry**



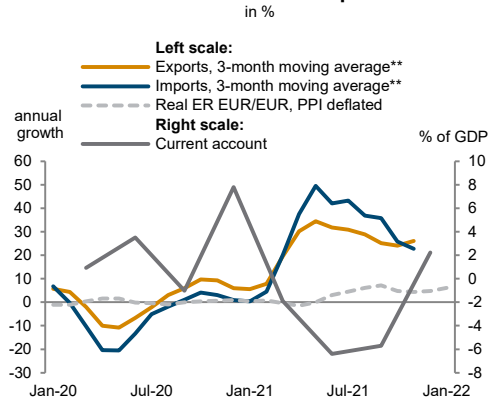
**Inflation and policy rate**



**Financial indicators**



**External sector development**

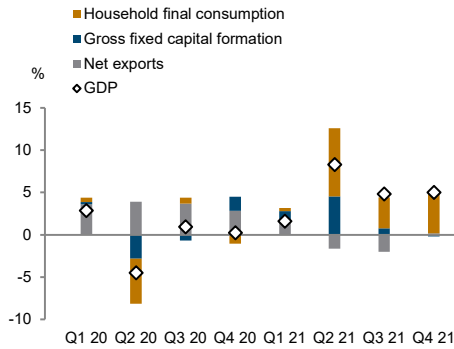


\*Positive values of the productivity component on the graph reflect decline in productivity and vice versa.  
 \*\*EUR based.

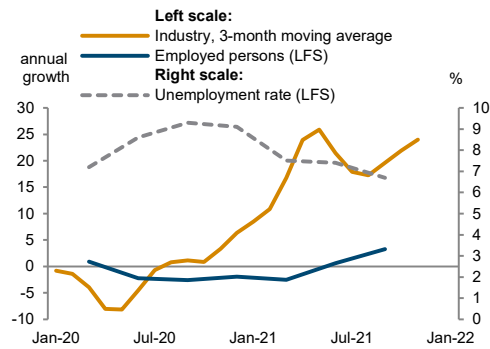
Source: wiiw Monthly Database incorporating Eurostat and national statistics.  
 Baseline data, country-specific definitions and methodological breaks in time series are available under:  
<https://data.wiiw.ac.at/monthly-database.html>

# Lithuania

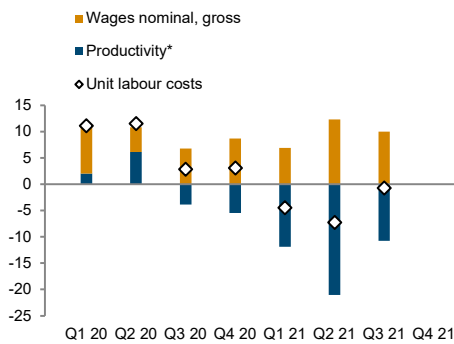
**Real GDP growth and contributions**  
y-o-y



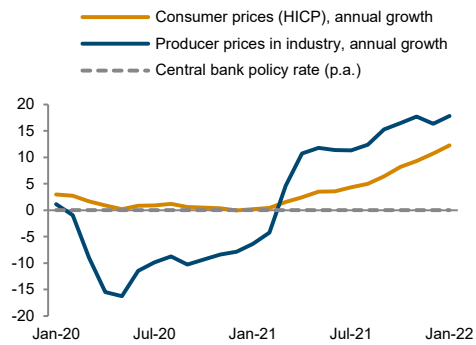
**Real sector development**  
in %



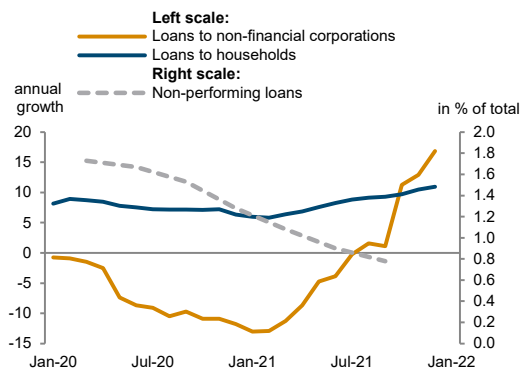
**Unit labour costs in industry**  
annual growth rate in %



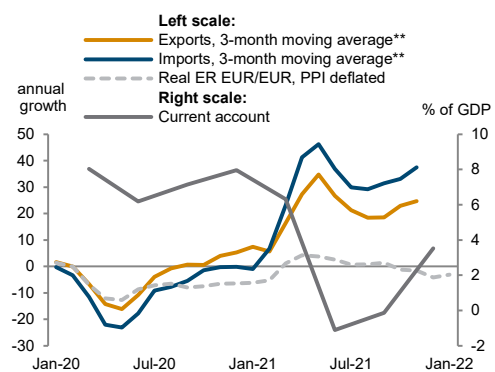
**Inflation and policy rate**  
in %



**Financial indicators**  
in %



**External sector development**  
in %



\*Positive values of the productivity component on the graph reflect decline in productivity and vice versa.

\*\*EUR based.

Source: wiiw Monthly Database incorporating Eurostat and national statistics.

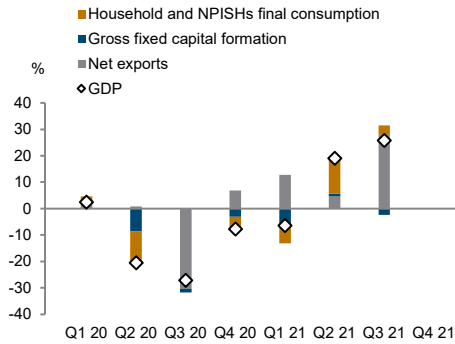
Baseline data, country-specific definitions and methodological breaks in time series are available under:

<https://data.wiiw.ac.at/monthly-database.html>

# Montenegro

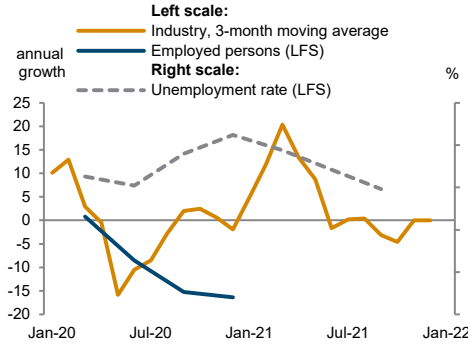
### Real GDP growth and contributions

y-o-y



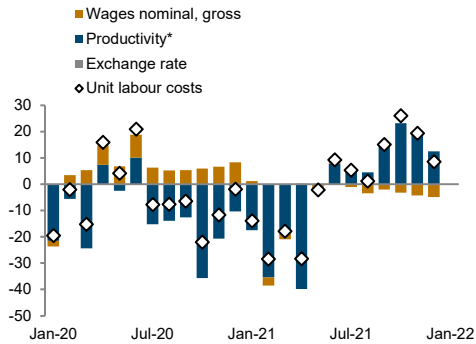
### Real sector development

in %



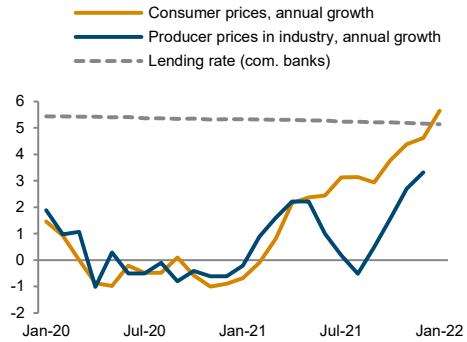
### Unit labour costs in industry

annual growth rate in %



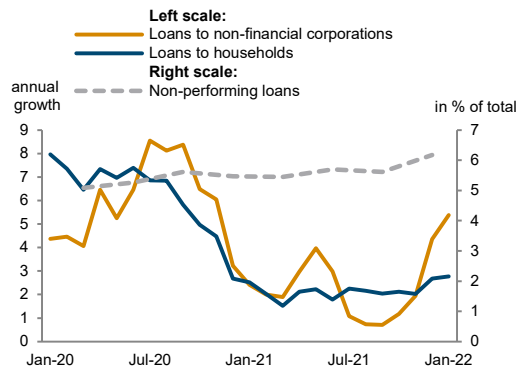
### Inflation and lending rate

in %



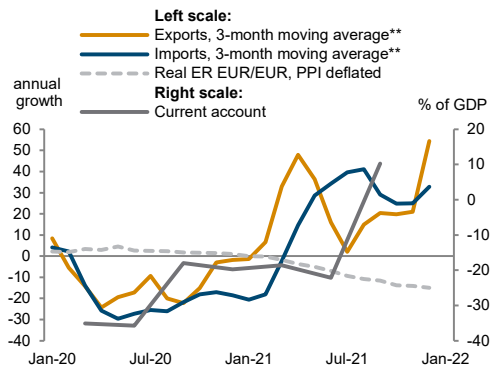
### Financial indicators

in %



### External sector development

in %



\*Positive values of the productivity component on the graph reflect decline in productivity and vice versa.

\*\*EUR based.

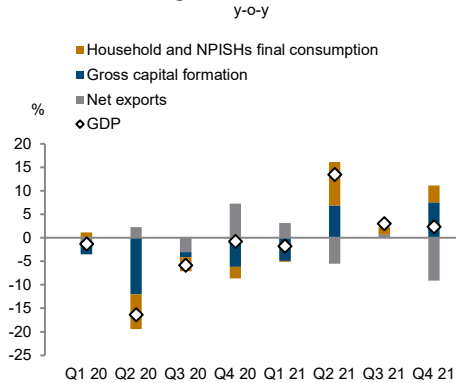
Source: wiiw Monthly Database incorporating Eurostat and national statistics.

Baseline data, country-specific definitions and methodological breaks in time series are available under:

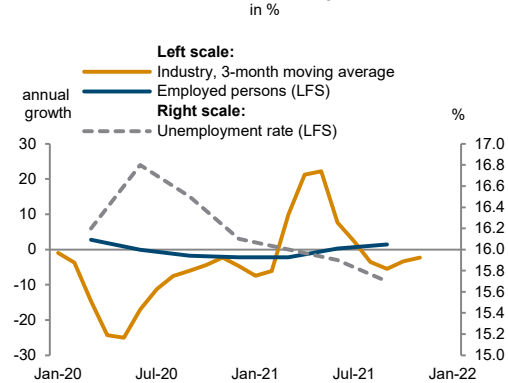
<https://data.wiiw.ac.at/monthly-database.html>

# North Macedonia

**Real GDP growth and contributions**



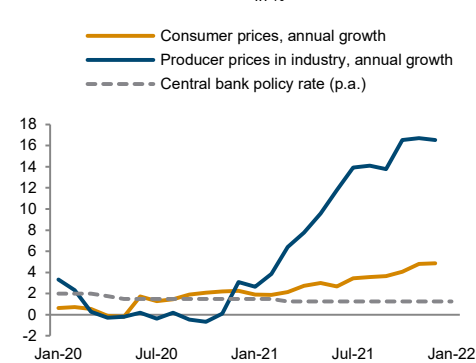
**Real sector development**



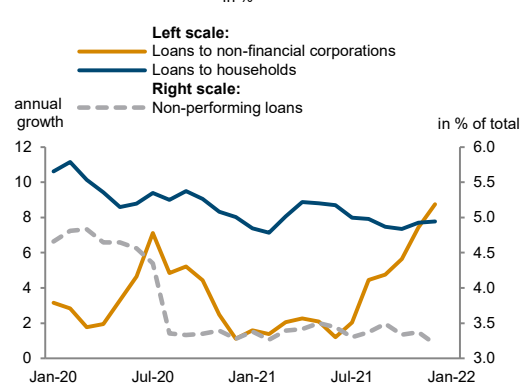
**Unit labour costs in industry**



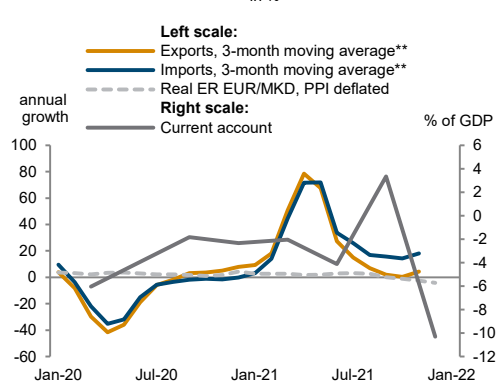
**Inflation and policy rate**



**Financial indicators**



**External sector development**



\*Positive values of the productivity component on the graph reflect decline in productivity and vice versa.  
\*\*EUR based.

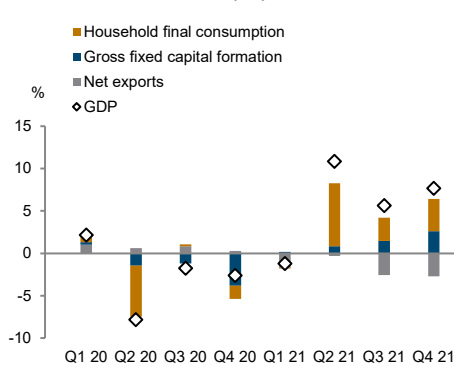
Source: wiiw Monthly Database incorporating Eurostat and national statistics.

Baseline data, country-specific definitions and methodological breaks in time series are available under:

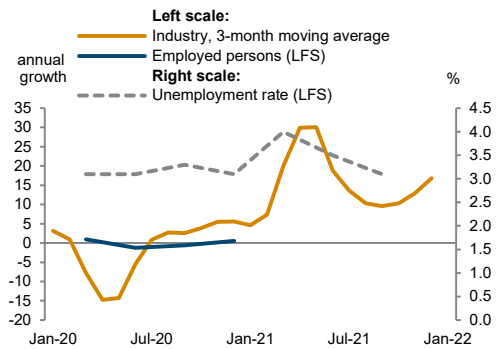
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# Poland

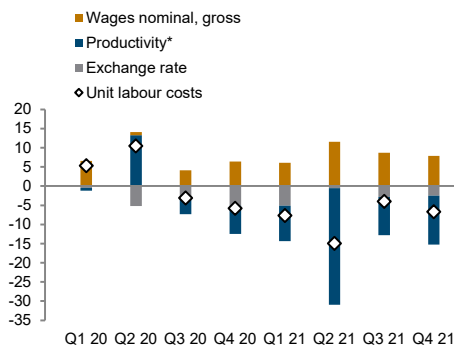
### Real GDP growth and contributions



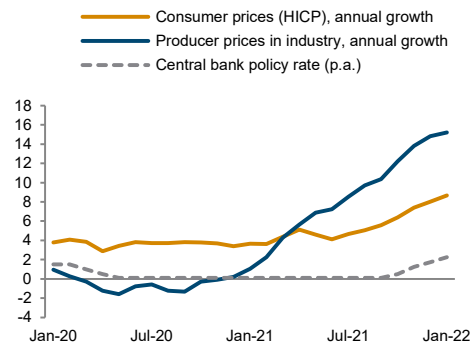
### Real sector development



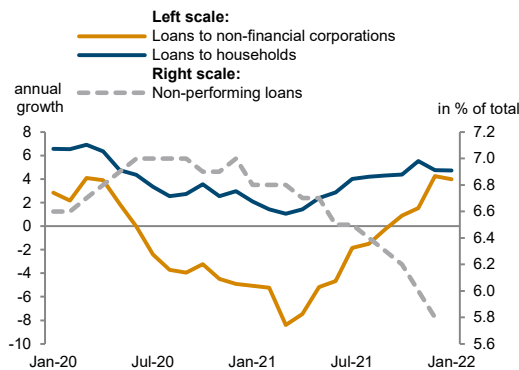
### Unit labour costs in industry



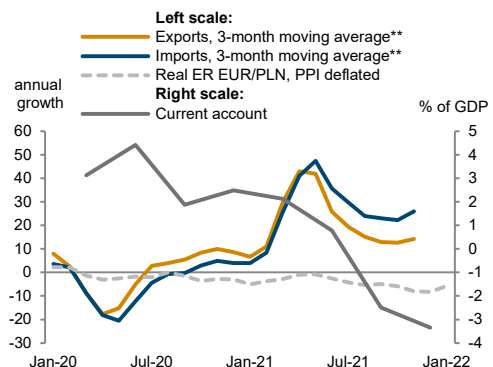
### Inflation and policy rate



### Financial indicators



### External sector development



\*Positive values of the productivity component on the graph reflect decline in productivity and vice versa.

\*\*EUR based.

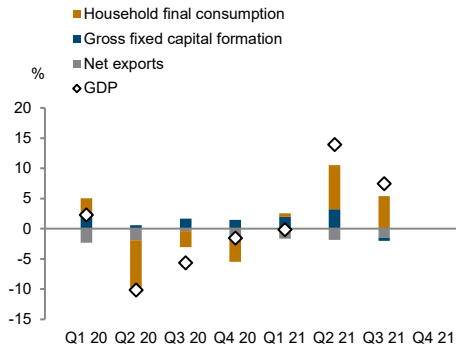
Source: wiiw Monthly Database incorporating Eurostat and national statistics.

Baseline data, country-specific definitions and methodological breaks in time series are available under:

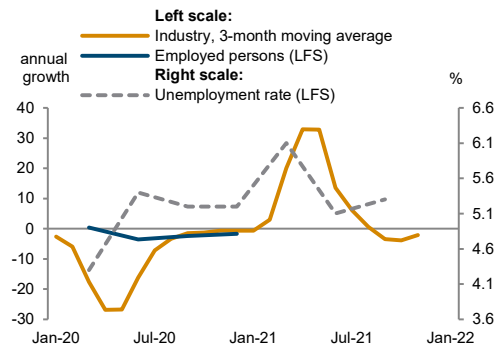
<https://data.wiiw.ac.at/monthly-database.html>

# Romania

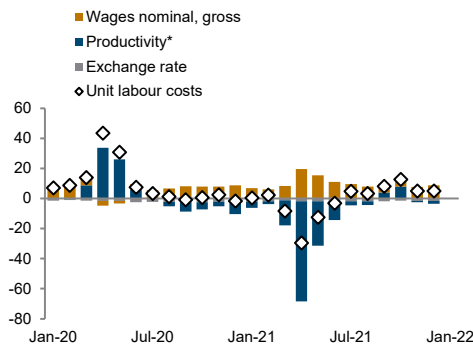
**Real GDP growth and contributions**  
y-o-y



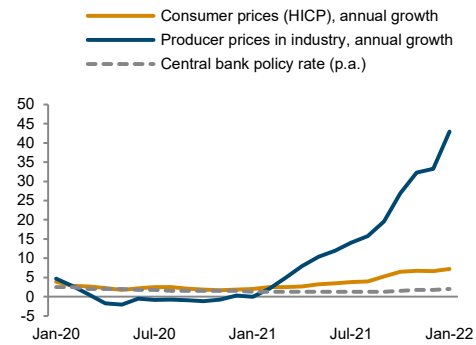
**Real sector development**  
in %



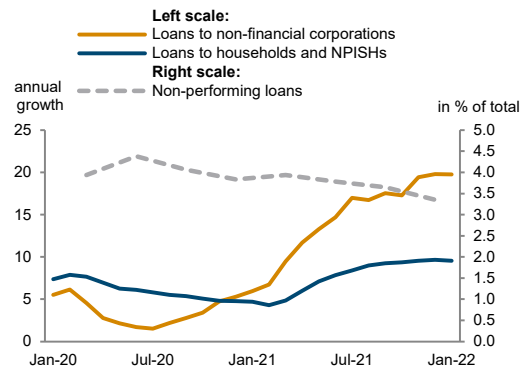
**Unit labour costs in industry**  
annual growth rate in %



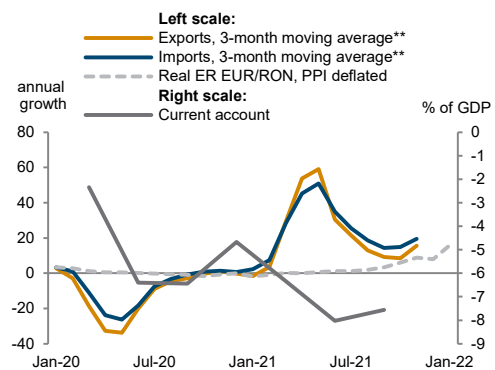
**Inflation and policy rate**  
in %



**Financial indicators**  
in %



**External sector development**  
in %



\*Positive values of the productivity component on the graph reflect decline in productivity and vice versa.  
\*\*EUR based.

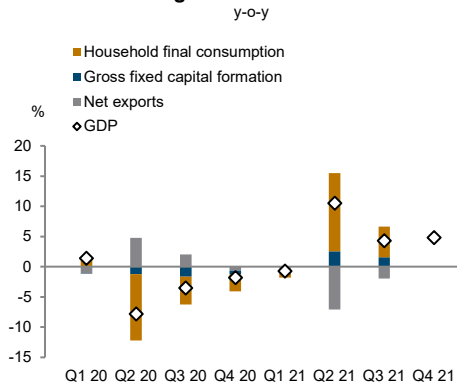
Source: wiiw Monthly Database incorporating Eurostat and national statistics.

Baseline data, country-specific definitions and methodological breaks in time series are available under:

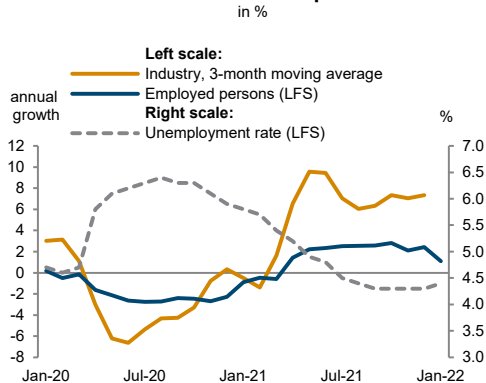
<https://data.wiiw.ac.at/monthly-database.html>

# Russia

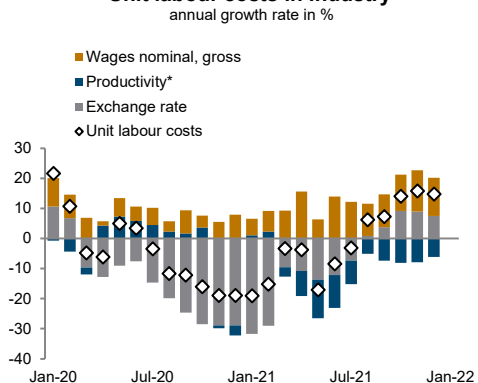
## Real GDP growth and contributions



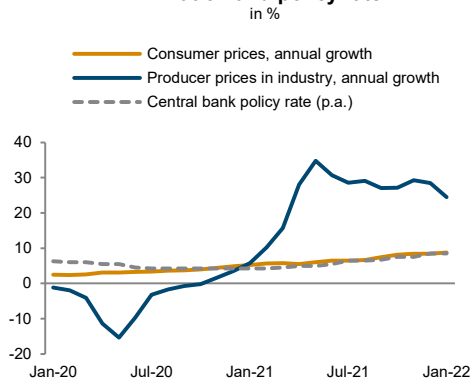
## Real sector development



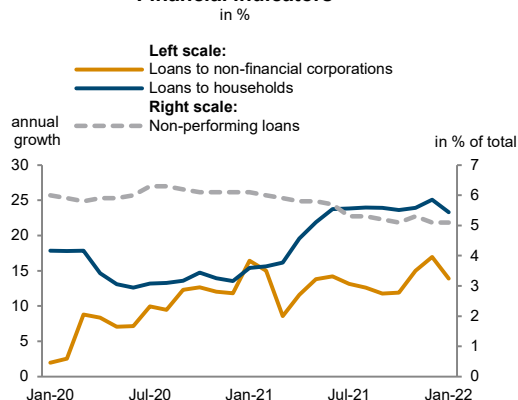
## Unit labour costs in industry



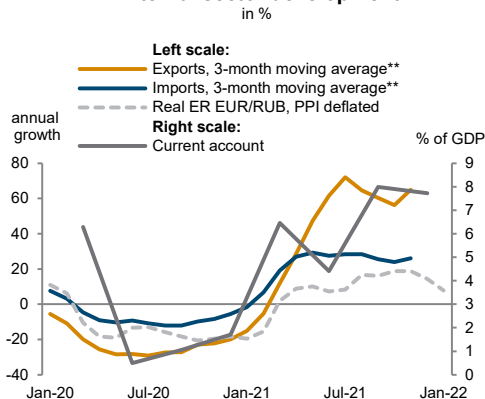
## Inflation and policy rate



## Financial indicators



## External sector development



\*Positive values of the productivity component on the graph reflect decline in productivity and vice versa.

\*\*EUR based.

Source: wiiw Monthly Database incorporating Eurostat and national statistics.

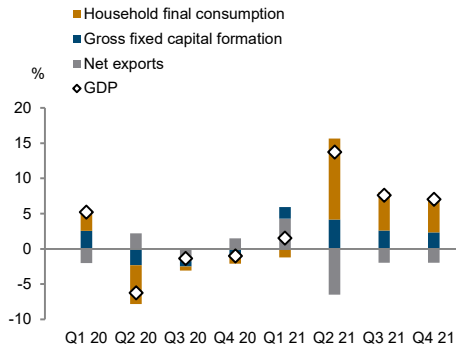
Baseline data, country-specific definitions and methodological breaks in time series are available under:

<https://data.wiiw.ac.at/monthly-database.html>

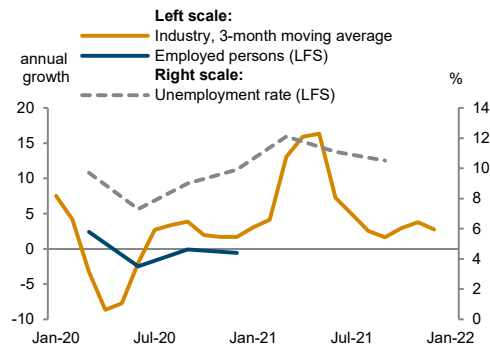


# Serbia

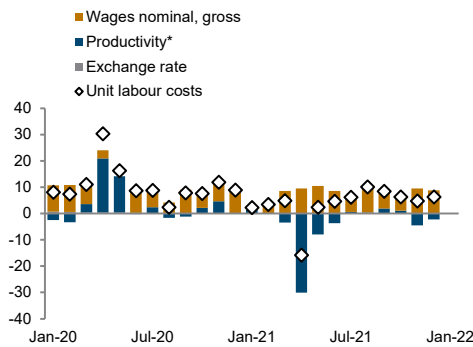
**Real GDP growth and contributions**  
y-o-y



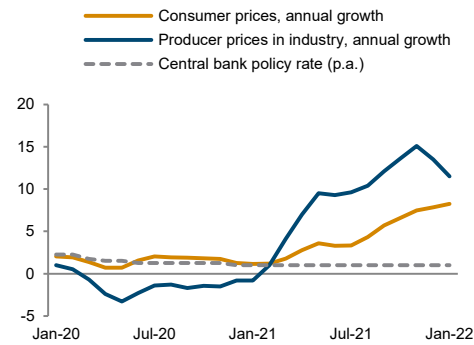
**Real sector development**  
in %



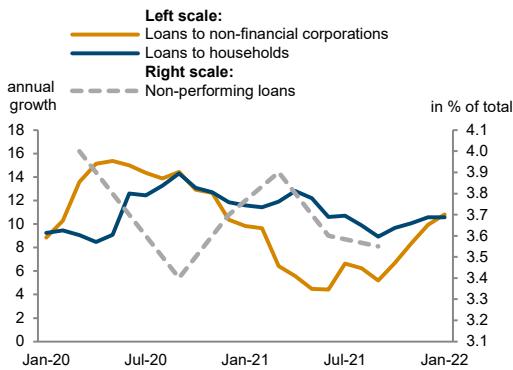
**Unit labour costs in industry**  
annual growth rate in %



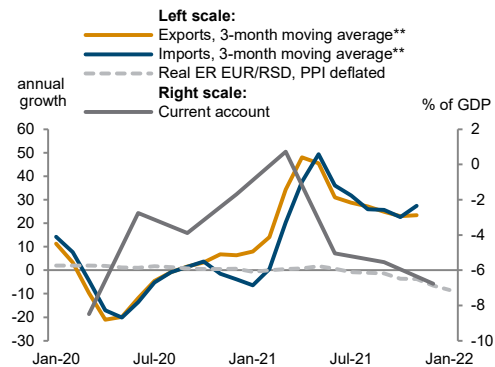
**Inflation and policy rate**  
in %



**Financial indicators**  
in %



**External sector development**  
in %



\*Positive values of the productivity component on the graph reflect decline in productivity and vice versa.  
\*\*EUR based.

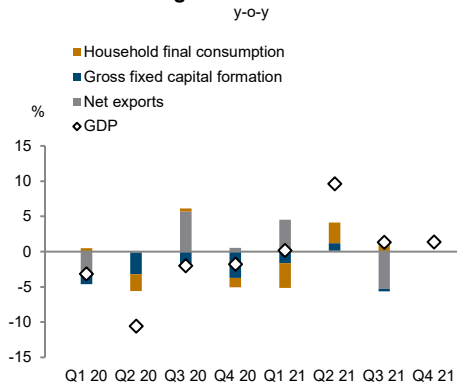
Source: wiiw Monthly Database incorporating Eurostat and national statistics.

Baseline data, country-specific definitions and methodological breaks in time series are available under:

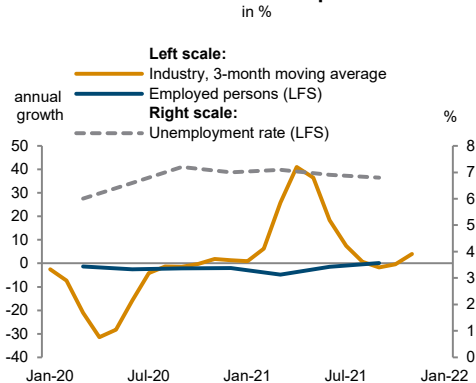
<https://data.wiiw.ac.at/monthly-database.html>

# Slovakia

## Real GDP growth and contributions



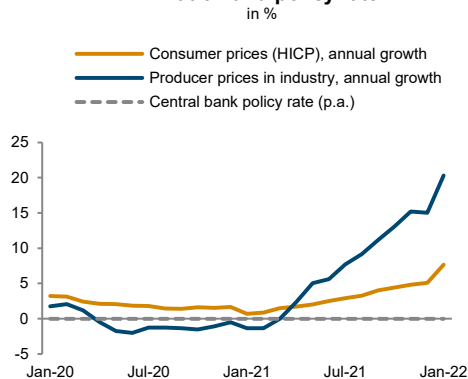
## Real sector development



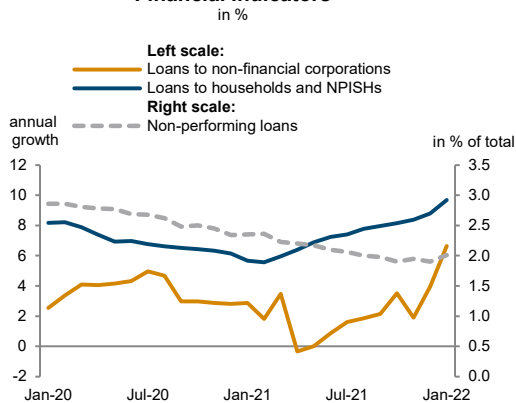
## Unit labour costs in industry



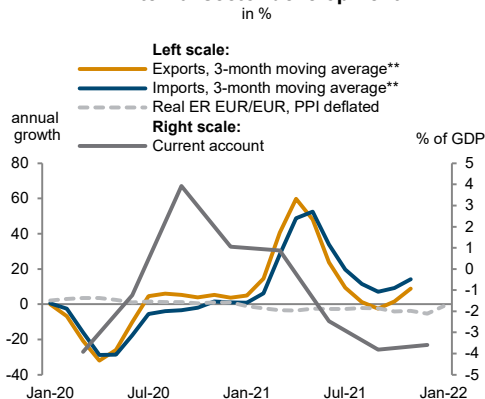
## Inflation and policy rate



## Financial indicators



## External sector development



\*Positive values of the productivity component on the graph reflect decline in productivity and vice versa.

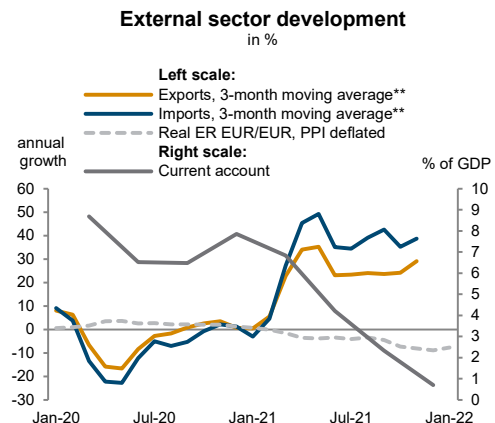
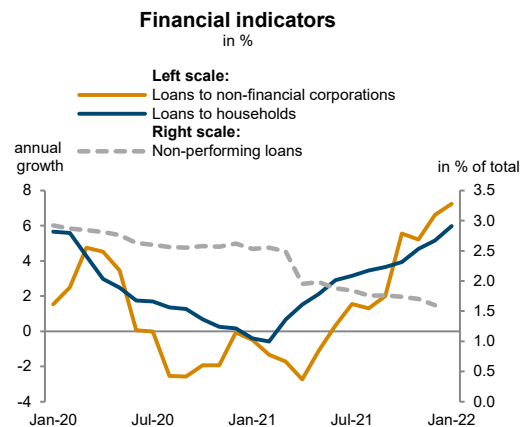
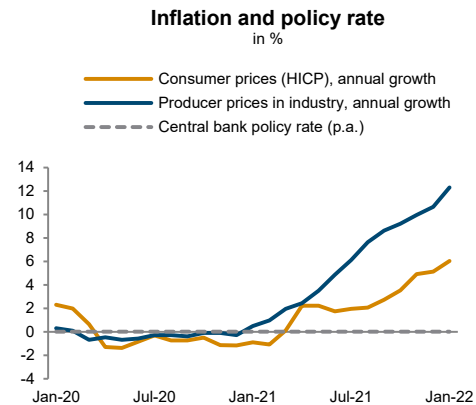
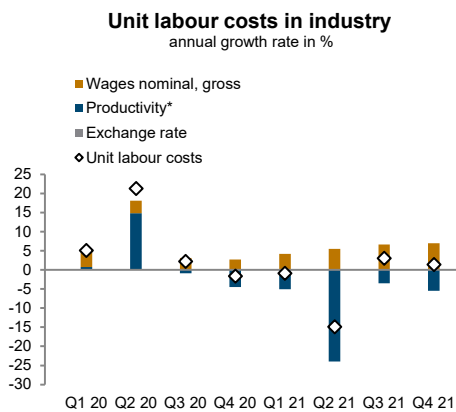
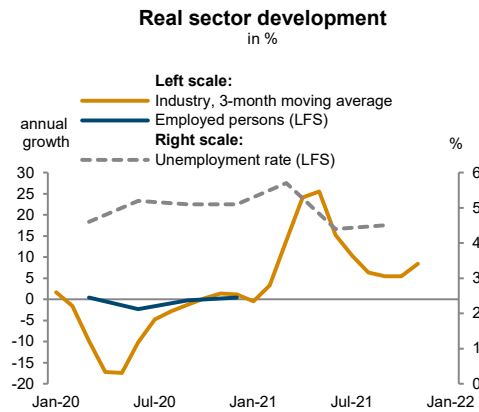
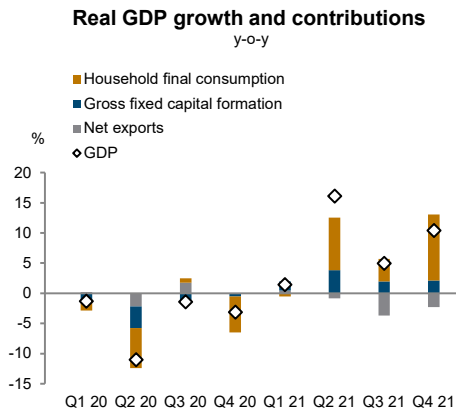
\*\*EUR based.

Source: wiiw Monthly Database incorporating Eurostat and national statistics.

Baseline data, country-specific definitions and methodological breaks in time series are available under:

<https://data.wiiw.ac.at/monthly-database.html>

# Slovenia



\*Positive values of the productivity component on the graph reflect decline in productivity and vice versa.  
 \*\*EUR based.

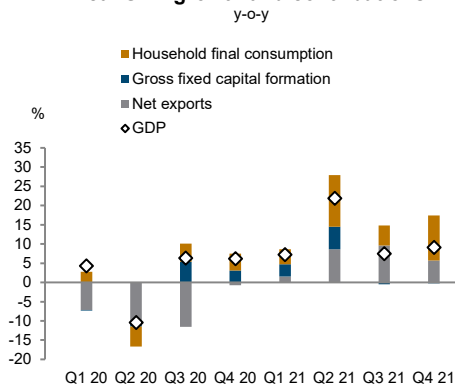
Source: wiiw Monthly Database incorporating Eurostat and national statistics.

Baseline data, country-specific definitions and methodological breaks in time series are available under:

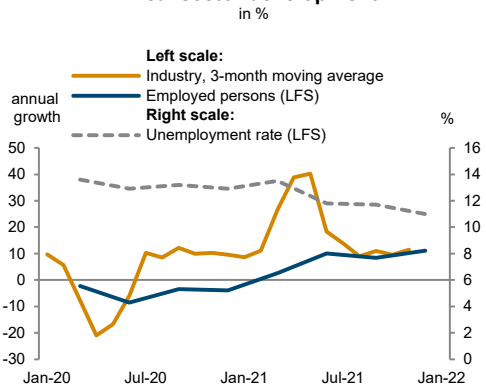
<https://data.wiiw.ac.at/monthly-database.html>

# Turkey

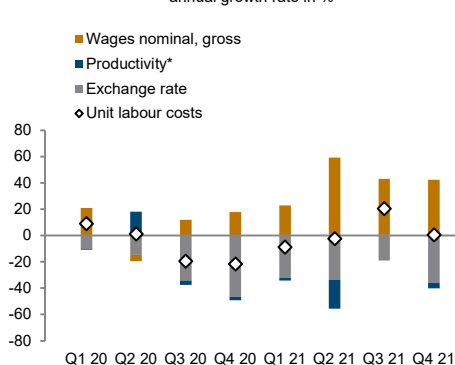
## Real GDP growth and contributions



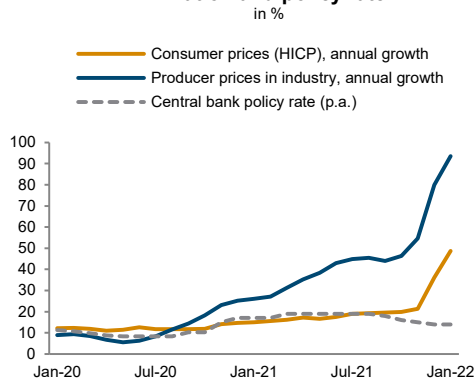
## Real sector development



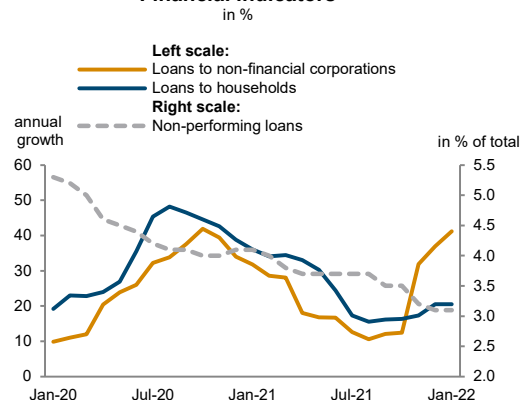
## Unit labour costs in industry



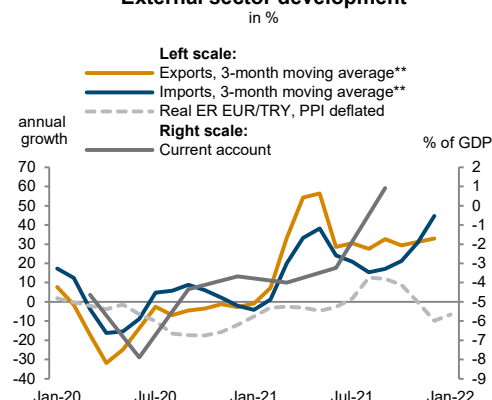
## Inflation and policy rate



## Financial indicators



## External sector development



\*Positive values of the productivity component on the graph reflect decline in productivity and vice versa.

\*\*EUR based.

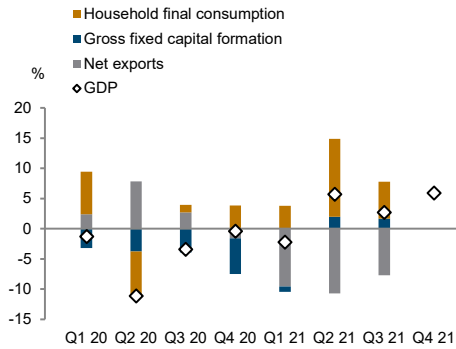
Source: wiiw Monthly Database incorporating Eurostat and national statistics.

Baseline data, country-specific definitions and methodological breaks in time series are available under:

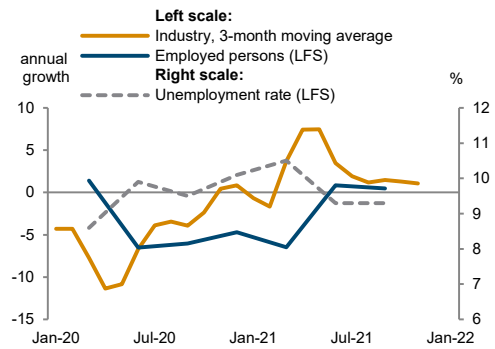
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# Ukraine

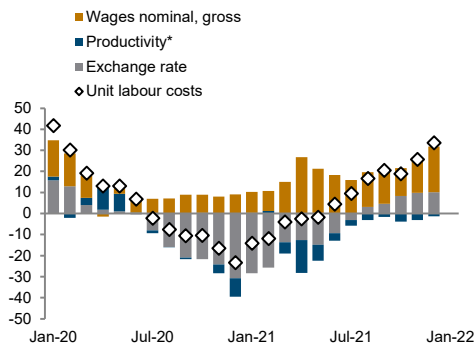
**Real GDP growth and contributions**  
y-o-y



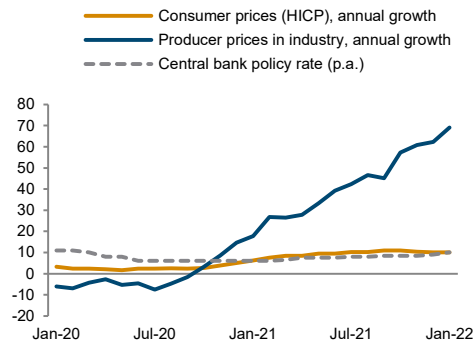
**Real sector development**  
in %



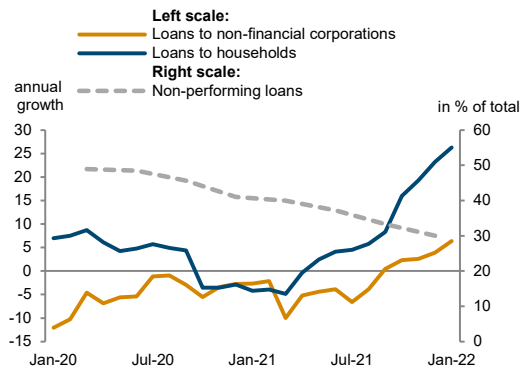
**Unit labour costs in industry**  
annual growth rate in %



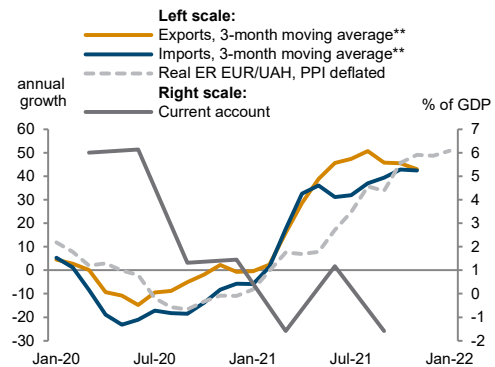
**Inflation and policy rate**  
in %



**Financial indicators**  
in %



**External sector development**  
in %



\*Positive values of the productivity component on the graph reflect decline in productivity and vice versa.  
\*\*EUR based.

Source: wiiw Monthly Database incorporating Eurostat and national statistics.

Baseline data, country-specific definitions and methodological breaks in time series are available under:

<https://data.wiiw.ac.at/monthly-database.html>

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