

The Dragon and the Bear

How China-Russia Cooperation Impacts Global Markets

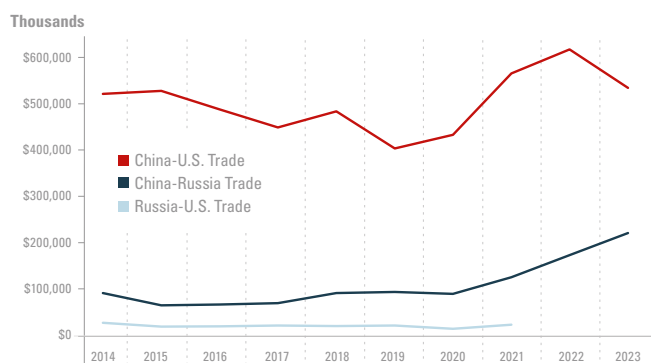
Cross border banks, securities investment firms, and companies that trade in either country should watch how scenarios play out and consider three key questions:

1. Is growing China-Russia cooperation a short-term backstop to tensions with the West or part of a longer-term trend of integration for the two largest countries in Eurasia?
2. Will China and Russia develop new multilateral structures similar to the Chinese Belt and Road Initiative (BRI), or work within established ones to serve their own agendas?
3. Recognizing the long history shared by China and Russia and the current drivers of closer cooperation, how will the West now respond?

Data suggests that China has doubled down on trade relations with Russia.

Trade between the two countries surpassed \$220 billion in 2023, up from \$125 billion in 2021 while trade between the U.S. and China fell from \$562 billion to \$531 billion during that same period. By comparison, Russia-U.S. trade, which ended due to sanctions in 2022, averaged \$22 billion annually from 2014 to 2021 (see figure 1).¹

Figure 1: Value of Bilateral Merchandise Trade, 2014-2023



Source: <https://wits.worldbank.org/faqs.html#Databases>

Meanwhile, the U.S. expanded the number of Russian entities subject to sanctions, including the Moscow Stock Exchange, effectively halting trading in USD and EUR on the bourse.² It also added to the scope of sanctions certain products imported to Russia via third party countries – a move largely thought to be aimed at the flow of technology products from China.³

How Does It Impact Firms?

This geopolitical topic has important macroeconomic themes, given Beijing, Moscow, and others want to move away from U.S. dollar-denominated trade by [shoring up their local currencies](#).

Firms should consider the following scenarios:

- **Strategic:** Sudden legal/regulatory changes due to sanctions and other bilateral agreements.
- **Operational:** Changes to the found of natural resources essential to supply chains and keeping these resilient.
- **Payments and Cash Management:** The ongoing evolution of payment messaging systems and changes to currency composition of reserve holdings.

To address the above scenarios, let's first look at demographics and trade flows between the two countries to date.

1. The World Bank: World Integrated Trade Solution database. Available <https://wits.worldbank.org>

2. <https://www.reuters.com/markets/europe/moscow-exchange-stop-trading-dollars-after-latest-us-sanctions-2024-06-12/>

3. <https://www.reuters.com/world/us-widens-russia-sanctions-targets-semiconductors-sent-via-china-2024-06-12/>

Lay of the Lands: Trade, Investment, and Payments

Although China and Russia constitute approximately one-fifth of the world's land area, population, GDP, and trade, China has a lopsided total in each category with the notable exception of land area (see figure 2).

Figure 2: % of World in 2023

	Land Area	Population	GDP (Nominal)	Trade
CHINA	6%	18%	17%	12%
RUSSIA	11%	2%	2%	2%
UNITED STATES	7%	4%	26%	11%

Sources: CIA, IMF, and WTO Data

Net Foreign Direct Investment (FDI) flows for both China and Russia (see figure 3) show a mass exodus of foreign capital from Russia from 2022. China also saw a considerable drop in its rate of FDI inflows in 2023.⁴ These changes in investment flows illustrate how geopolitical tensions, such as U.S. and E.U. sanctions directed at China, and Russia's invasion of Ukraine, translate into capital flight. Such movements can also be anticipatory, as seen in

Russia's net FDI outflows of \$25 billion in 2021, before its invasion of Ukraine. Capital movements can also shift more gradually, as reflected in Chinese net FDI falling 42% (from \$26 billion to \$15 billion) between 2022 and 2023.

Despite the overall FDI drop for both countries after 2022, signs of increased Chinese FDI into Russia are not yet apparent. Although Russia is the fifth largest recipient of investment from the BRI (over \$38 billion cumulatively from 2013-2023), only 14% of this investment has occurred since 2020.

Nearly all projects since 2020 have involved natural gas production and only one – involving Chinese investment into a Russian methanol plant – has occurred since 2021.⁵ However, since peak BRI in 2017 China has adopted more stringent lending criteria as the country aims to reduce its debt overhand and strides toward recovery. In the [first quarterly](#) we show how it's not only reduced the number and value of loans but has also taken steps to solidify due diligence of prospective projects and ensure its recourse to repayment.⁶

Bilateral trade has clearly deepened between China and Russia (see figure 4 on the following page) and is most evident in the significant increase in imports by China of energy and mining resources from Russia since 2021.

Figure 3: Net Foreign Direct Investment Flows, China and Russia, 2018-2023 (USD Millions)

		2018	2019	2020	2021	2022	2023
CHINA	Inflows	\$138,306	\$141,225	\$149,342	\$180,957	\$189,132	\$163,253
	Outflows	\$143,037	\$136,908	\$153,710	\$178,819	\$163,120	\$147,850
	Net FDI	\$(4,731)	\$4,317	\$(4,368)	\$2,138	\$26,012	\$15,403
RUSSIA	Inflows	\$13,228	\$32,076	\$10,410	\$38,639	\$(15,205)	\$8,364
	Outflows	\$35,820	\$22,024	\$6,778	\$64,072	\$11,510	\$29,110
	Net FDI	\$(22,592)	\$10,052	\$3,632	\$(25,433)	\$(26,715)	\$(20,746)

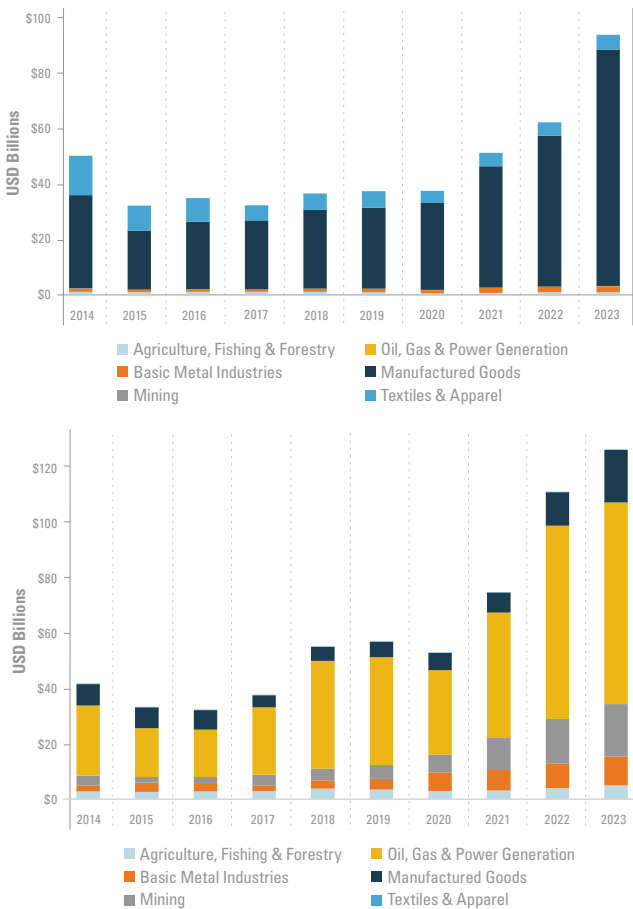
Source: UN Trade & Development

4. UNCTAD World Investment Report 2024.

5. China Global Investment Tracker

6. BBH FX Quarterly Q1

Figure 4: China-Russia Trade by Product/Sector, 2014-2023 (USD Thousands)⁷



Source: The World Bank

Payments

While payments data does not conclusively show a dramatic shift away from USD payments as would be expected with China-Russia deepening, an IMF study⁸ reports that the Chinese RMB has steadily risen to 2.5% of all SWIFT transactions, with the USD and EUR accounting for approximately 40% each. China's Cross-Border Interbank Payment System (CHIPS), which settles international claims through an independent international yuan payment and clearing system, holds limited immediate potential as an alternative to SWIFT. For CHIPS to become an effective alternative, Beijing and Moscow would need to make multiple, long-term agreements on difficult issues such as data sharing and currency convertibility.

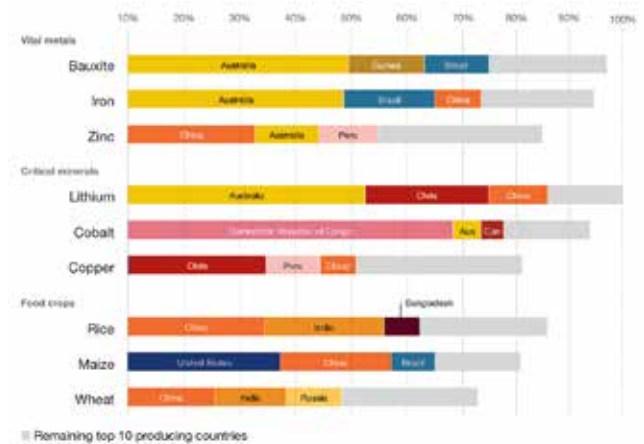
Lastly, the G7 recently stopped short of outright confiscation of approximately \$300 billion of frozen Russian Central Bank reserves held in the West.⁹ While proponents have argued for these funds to be used to rebuild Ukraine, critics argue that confiscation undermines the USD and EUR status as "safe haven" currencies, ultimately weakening them over the long term.¹⁰

Key Questions to Consider

1. Short-term Back-stop or Long-term Trend?

Strong evidence points to China-Russia integration being a long-term trend. Consider first, the natural resources component of their relationship. While the importance of energy and mining resources to China-Russia trade is apparent, a recent PwC report¹¹ examines certain key critical commodities that are exposed to climate-related risks such as heat and drought. Within countries like China, production of these commodities is sufficiently concentrated to exacerbate these risks. For example, China is one of the top three producers of nine critical global commodities (see Figure 5). China and Russia combined produce about 35% of global wheat.

Figure 5: Production Concentration of Nine Essential Commodities



Source: CapIQ, PwC

Furthermore, wheat production is heavily concentrated among a limited number of regions within each of the top three producers (see figure 6 on the following page).

Given this risk, greater long-term trade integration of densely populated, heat and drought-exposed China with the thinly-populated massive landmass of Russia appears to mitigate future commodity supply risk for China.

7. The World Bank: World Integrated Trade Solution database. Available: <https://wits.worldbank.org>

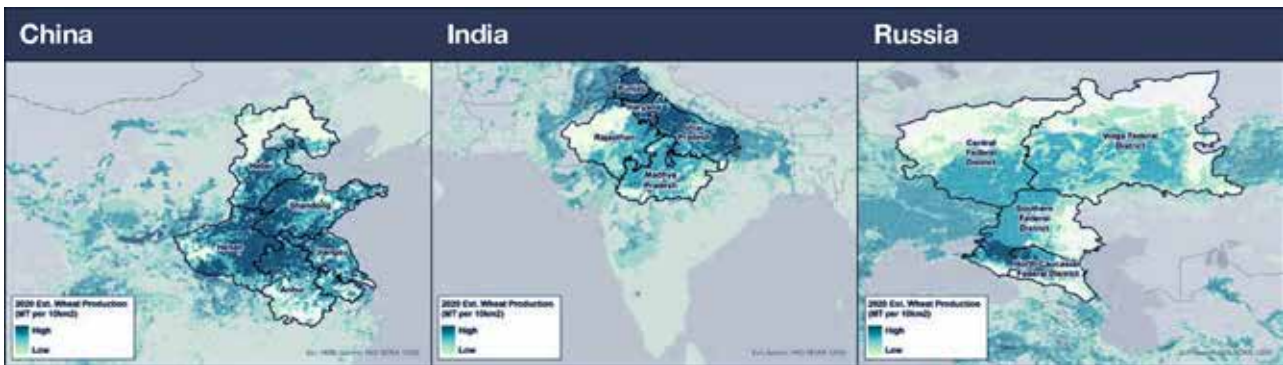
8. Perez-Saiz, H., Zhang, L., & Iyer, R. (2023). Currency Usage for Cross-Border Payments. *IMF Working Papers*, 2023(072), A001. Retrieved Jul 8, 2024.

9. <https://theconversation.com/g7-plan-to-use-russias-frozen-financial-assets-to-help-ukraine-fund-the-war-an-economist-weighs-up-the-risk-and-rewards-233251>

10. <https://www.chathamhouse.org/2024/05/confiscating-sanctioned-russian-state-assets-should-be-last-resort>

11. <https://www.pwc.com/gx/en/issues/esg/how-does-climate-change-affect-natural-resources.html>

Figure 6: Concentration of Wheat Production



Source: IFPRI, FAO and PwC

Russia, while currently a self-imposed pariah, has long-term strength from a resource perspective as the world's second largest producer of dry natural gas, second to the U.S. Meanwhile, China has doubled down on supplying key commodities such as cobalt, pushing down global prices to deter production elsewhere,¹² giving it future leverage to restrict these global supplies.

Russia's invasion of Ukraine also appears to have accentuated existing connections between China and Russia, which would logically strengthen over time from a resources perspective.

2. Replace Existing Multilateral Structures or Reform Existing Ones?

President Xi has prioritized Four Pillars for China's future development: BRI (2013), the Global Development Initiative (GDI, 2021), the Global Security Initiative (GSI, 2022), and the Global Civilization Initiative (GCI, 2023).¹³ Each new initiative is a partnership and/or framework aimed at transforming existing global structures and China's centrality therein. BRI, now in its second decade, is the clearest example of China creating a new, competing multilateral construct in which to advance its interests; the latter three (GDI, GSI and GCI) are in their early stages and should be of importance to China's allies and adversaries alike.

Other activities, however, point to China and Russia working within existing multilateral institutions to advance their priorities. Two specific examples support this claim. Firstly, China and Russia have effectively used their membership in the World Trade Organization (WTO) to bring cases against other WTO members for unfair trade

practices. China has done so in 26 cases and Russia in 8, and while fewer than those brought by the U.S. and EU, both China and Russia have been members of the WTO for a shorter period.¹⁴

Secondly, China has displayed significant new heft within the United Nations (UN) recently, from embedding its BRI within multiple UN agencies and aligning it with the UN's 2030 Sustainable Development Goals, to winning sufficient support from emerging and middle-income countries to block debate in the UN Human Rights Council over its treatment of the Uyghur minority.¹⁵ Furthermore, China and Russia are increasingly seen as important allies within the UN's Security Council: they joined in March 2024 to veto the U.S. resolution calling for 'immediate and sustained ceasefire' in Gaza.¹⁶

Such moves demonstrate that both countries are adept (particularly China) at adapting to specific institutions and using them to their advantage.

3. How Will the West Address Closer Cooperations?

The "long arc" recognizes the long history shared by China and Russia (formerly the U.S.S.R.), which has oscillated between periods of strain and alliance in the post WWII era (see figure 7 on the following page). Recognizing this history and current drivers of China-Russia cooperation can help understand how the West might respond. With relations at an apex, options for the West to drive a wedge between their growing trade and resource cooperation appear more limited now than at the height of the Cold War in the early 1970s.

12. Emont, Jon. "China is Winning the Minerals War." *The Wall Street Journal*: May 21, 2024.

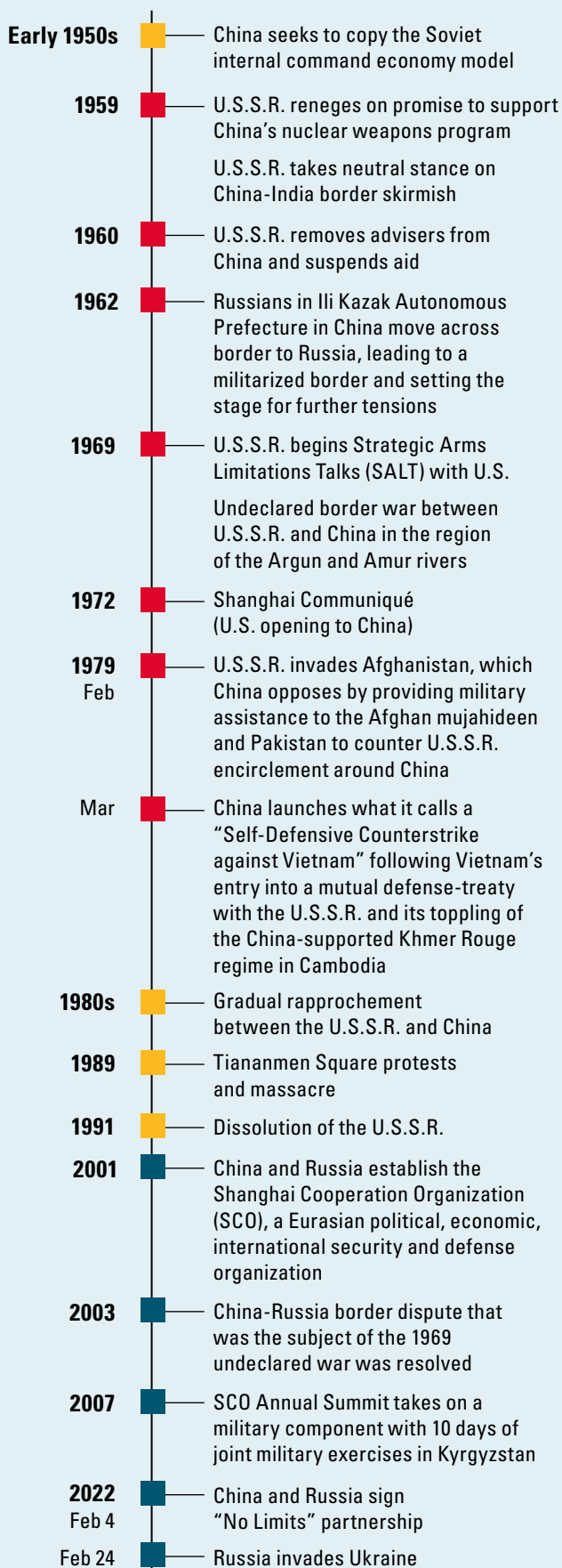
13. Economy, Elizabeth. "China's Alternate Order And What America Should Learn From It." *Foreign Affairs*, May/June 2024.

14. https://www.wto.org/english/tratop_e/dispu_e/dispu_by_country_e.htm#complainant

15. Economy, Elizabeth. "China's Alternate Order And What America Should Learn From It." *Foreign Affairs*, May/June 2024.

16. <https://news.un.org/en/story/2024/03/1147856>

Figure 7: Timeline of China-Russia Relations



■ = Tensions are high ■ = Relations are OK ■ = Tensions are low

The relationship has rarely been one of equals. Today's asymmetry is stark as China is the world's second largest economy, while Russia is its eleventh (slightly larger than Mexico's but smaller than Canada's). By comparison, in 1972 the U.S.S.R. was a global superpower and China was emerging from decades of isolation. The countries have essentially traded places, with Russia now under a degree of economic duress to find a buyer for its energy supplies in the face of Western sanctions.

During the 1960s the relationship between the U.S.S.R. and China deteriorated because of ideological divergences over adherence to Marxist principles and support for world revolution. Unresolved border issues and the U.S.S.R.'s engagement in arms-control negotiations with the U.S. further exacerbated these tensions. For China, militancy in foreign affairs involving the U.S.S.R. allowed a distraction from the failures of Chairman Mao's Great Leap Forward in which an estimated 20 million Chinese died of starvation from 1959-1962. Against this backdrop, French President Charles DeGaulle shared with U.S. President Nixon in 1969 his view that the U.S.S.R. was increasingly paranoid about China and that U.S. rapprochement with U.S.S.R. was possible because the U.S.S.R. feared it could not fight both the West and China at the same time.¹⁷

Ultimately, the West (led by the Nixon administration) capitalized on this internal communist rift by opening to China in 1972. By bringing China into the world economy, the U.S. created a counterbalance to the U.S.S.R. This counterbalance facilitated key goals for the U.S. at the time: extraction from the Vietnam conflict and advancement of arms control and détente with the U.S.S.R.

Conclusions

This time is different. While cracks of daylight may appear between China and Russia over the latter's invasion of Ukraine, longer-term, deeper integration can be expected out of both choice and necessity. Western firms, investors and governments should, therefore, expect China and Russia to grow only closer over time.

Further, a close personal connection between leaders Xi and Putin (to date they have met over 40 times) reflects pragmatism. According to an article in *Foreign Affairs* magazine, that "Chinese and Russian elites share a conservative, statist worldview... They have both concluded that authoritarian regimes are better at dealing with modern challenges. They both want their countries to regain lost status and territory."¹⁸

17. Isaacson, Walter. *Kissinger: A Biography*. New York: Simon & Schuster, 2005. p.169.

18. Torigian, Joseph. "Xi Jinping's Russian Lessons: What the Chinese Leader's Father Taught Him About Dealing With Moscow." *Foreign Affairs*, June 24, 2024.

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