EUROJÄRJESTELMÄ
EUROSYSTEMET

# BOFIT Weekly

**1 • 7.1.2011**

# Russia

**Public economy reforms under preparation.** The Russian government last year drafted a number of reforms for implementation in 2011 and 2012. The changes reflect the need for greater efficiency in the public sphere and better use of budget funds.

Russia is shifting to a "target-based" budgeting process for the public sector. The lion's share of budget funding will be allocated to some 50 programmes run by various ministries. Financing will be determined on the basis of how well each programme hits its established targets. The new approach will be first applied in the drafting of the 2012 federal budget.

A second area of public economy reform focuses on organisations receiving state funding. Organisations will be classified according to whether they depend solely on state funding (e.g. ministries and state agencies), or if they are allowed to receive some of their funding from other sources (e.g. scientific and cultural institutions). The reforms are designed to clarify operations of these organisations and set their financing principles in the law.

Public procurement is an area where abuses and corruption have been constantly increasing. According to various authorities, the prices of goods and services purchased via the state procurement system are substantially higher than prices for the same items purchased on the open market. Earlier attempts at reforming the government procurement system included adoption of web-based competitive bidding, but generally there has been no improvement in the situation. The economy ministry is currently working with the Federal Anti-trust Service on a sweeping reform of the public procurement system.

Last year saw active public discussion – also within the government – concerning state's increasing involvement in Russian business. According to the government, the role should be diminished. One of the reasons for the increase was that the recession made the state to acquire assets (e.g. shares of companies in financial trouble were transferred to state banks). This year the state hopes to sell off its stakes in many large firms. In many cases, however, the state will retain its majority stake, so the impact is expected to be minor. Furthermore, it remains to be seen how sales of smaller, less important state-owned firms will proceed.

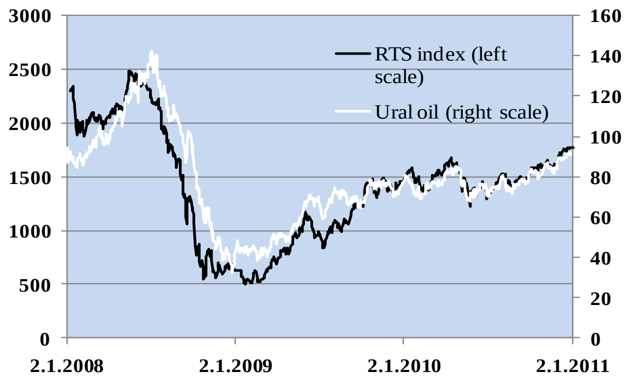
The government has ordered regional and local administrations to prepare their own privatisation programmes by July 2011. The goal is to make regional and municipal governments get rid of assets that are not necessary for carrying out their legally mandated operations. The government aims the sell-off of assets to start from production facilities, banks and regional media. Moscow, under the leadership of its new mayor Sergey Sobyanin, has already begun to prepare for extensive divestment of assets.

**Russian stock exchange posts positive performance in 2010.** The Moscow RTS stock exchange index continued its recovery from the low point it hit in early 2009. Over 2010, the index rebounded more than 20 %. Russia's number-two MICEX index was also up over 20 % last year. In December 2010, the indexes reached their highest levels in two years.

The trend of Russian share indexes was similar to that of many emerging market stock exchanges, even if the overall rise in Russia outpaced the average for emerging markets. The S&P 500 index, which is composed of traded companies with the largest market capitalisations in the US, rose 13 % last year. The Dow Jones Industrial Average was up 11 %.

The RTS index trend closely tracked last year's rise in global crude oil prices, which started the year at around $80 a barrel and ended the year above $90. The RTS index is heavily weighted to Russian oil and gas companies; the four biggest (Gazprom, Lukoil, Rosneft and Surgutneftegaz) represent about 40 % of the market capitalisation of all RTS companies. On the other hand, the country's two largest financial institutions, Sberbank and VTB, represent about 18 % of the market capitalisation of companies in the RTS index.

**RTS share index and Urals oil price (USD/barrel)**




*Source: Bloomberg*

The most significant stock market reform last year was the act on insider trading and share price manipulation. The act was approved last summer and its main parts enter into force on January 27, 2011.

The Duma has just taken up legislation on basic infrastructure of securities exchanges, i.e. organisation of stock market trading, clearing procedures and securities custody. The legislation should be ready this year.

In the wake of the financial crisis, Russian officials announced stepping up supervision of market actors e.g. by increasing licensing requirements, raising capital requirements and devoting greater attention to risk management.

BOFIT Weekly
1 • 7.1.2011

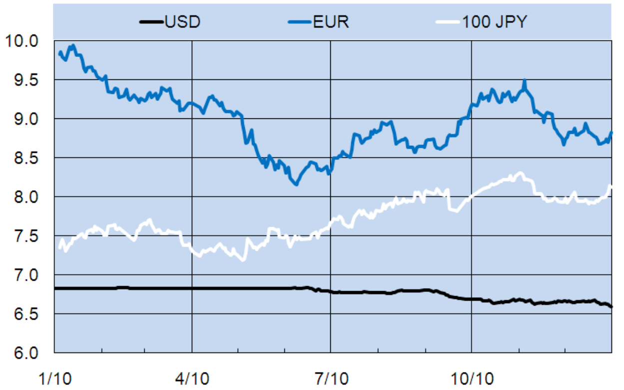
# China

**Yuan strengthens against US dollar in final week of 2010.** The yuan ended 2010 at a yuan-dollar rate of 6.59. In contrast, the yuan-euro and yen-euro rates weakened slightly at year's end. For 2010 overall, the yuan appreciated 3.6 % against the dollar and 11 % against the euro, while losing about 10 % of its value against the yen. Yuan appreciation vis-à-vis the dollar and euro comports with China's rapid economic growth and tightening monetary stance. Financial markets expect yuan appreciation against the dollar to continue.

China ended its fixed peg of the yuan to the dollar in June 2010. The yuan was pegged at 6.83 to the dollar in July 2008 in reaction to the global financial crisis. As was evident at the G20 summit in November, many countries are dissatisfied with the slow rate of yuan appreciation. Critics note that artificial undervaluation of the yuan complicates China's own monetary policy, unfairly boosts competitiveness of its exporters and makes recovery more difficult for other economies.

China's decision at the start of 2011 to relieve export firms of their obligation to repatriate export earnings from abroad potentially could reduce appreciation pressure on the yuan. The change also potentially affects how foreign earnings that drive China's current account surplus get invested. Exporters will now participate in investment decisions along with the monetary authorities. The change may have little actual impact in current circumstances, however, as expectations of yuan appreciation reduce the interest of export firms in foreign investment.

**Yuan rate vis-à-vis dollar, euro and yen in 2010**




*Source: Bloomberg*

**China increases dividend demands on state-owned enterprises.** China's central government last November moved to increase dividend requirements for some 120 large state-owned enterprises from the start of 2011. The dividend requirement for large enterprises in the energy and telecommunications sectors and tobacco industry will rise from 10 % to 15 % of profits. For other state-owned firms the duty rises from 5 % to 10 %. A 5 % dividend requirement will apply to companies in the defence sector. A dividend requirement depending on economic condition will also be extended to more than 1,600 other corporations under China's central administration.

The measures originate in a dividend policy launched on a trial basis in 2007. China made dividend payment mandatory for large firms operating under the central administration at the start of 2008. The arrangement exempts listed subsidiaries of state enterprises.

The more robust dividend policy has been widely welcomed. It levels the competitive playing field between state firms and private companies, and lowers the motivation for state firms to over-invest. Moreover, higher dividends provide additional revenues that the state can channel to socially beneficial investment. Although the new requirement could potentially generate tens of billions of dollars in revenues for the state, officials interviewed by the *Financial Times* noted that China's State-owned Assets Supervision and Administration Commission (SASAC) has had huge problems compelling large companies to pay out dividends.

**2010: An uneventful year for Chinese shares.** Despite China's strong economic growth, the price of shares on the Shanghai stock exchange ended the year down 15 % from the start of the year. In comparison, prices were up more than 10 % on average for shares trade on emerging market exchanges. Russian shares were up over 20 % last year. The last of China's four giant state banks to list, the Agricultural Bank of China, held its IPO in August. In general, dilution caused by an increase in the amount of market-tradable shares together with monetary tightening tended to depress share prices.

**Shanghai A, MSCI emerging markets and Moscow RTS indexes, January 2007=100**


*Source: Bloomberg*

Bank of Finland • Institute for Economies in Transition, BOFIT
P.O. Box 160 • FI-00101 Helsinki
Phone: +358 10 831 2268 • Email: bofit@bof.fi • Web: www.bof.fi/bofit
Editor-in-Chief Seija Lainela