

Russia

Russia's decade-long reform of electricity sector largely successful. The over-ten-year reform of the national electrical power generation and transmission system has now reached its concluding phase. From the start of this year, electrical power rates in Russia have been largely deregulated, with the price of electricity set daily on a national electricity exchange. Retail-level rates for households will remain regulated at least through 2014.

A central goal of the reform was to effect large investments in electrical power generation and transmission. That goal is largely achieved as production companies are carrying out the investments that they agreed to undertake in the privatisation deals.

The reform affects all aspects of the electricity sector (generation, transmission, distribution, wholesale and retail trade). The break-up of state-run monopoly RAO United Energy Systems (UES) led to the creation of 15 production companies, of which 13 were privatised during 2007–2008. Only hydropower and nuclear power plants will remain in state ownership. In addition, Russia has a number of privately owned power companies that were never part of UES Holding. Competition among power companies is hoped to keep down wholesale prices of electricity.

The grids formerly owned by UES were reorganised into eleven regional operators. The state will continue to hold a majority stake in these operators, but the possibility of partial privatisation has not been ruled out. In contrast, the trunk grid and system operator will stay in state ownership due to the monopolistic nature of their operations.

The reform has made Russian electricity markets quite liberal by international standards; the price of electricity is set by a market made up of many individual producers that compete with each other. The critical details for the functioning of the markets, however, are just being formed, and there are big future challenges related to supervision and regulation. Without effective and transparent official oversight, the desired outcome of increased competition among firms – as in any sector of the economy – will not result.

High oil prices buoy the ruble. The ruble last year posted 7 % nominal appreciation against the euro and declined 3 % against the US dollar. In real terms (i.e. taking in differences in national inflation rates), the ruble strengthened 15 % against the euro and 4 % against the dollar. Ruble appreciation largely reflected higher oil prices.

The Central Bank of Russia steers the external value of the ruble using a dollar-euro currency basket. For the last couple of years the CBR has shown a willingness to tolerate larger swings in the ruble's exchange rate and greater

restraint in intervening in currency markets. In the first half of 2010, the CBR largely bought foreign currency to counter ruble appreciation pressures. In the second half, CBR operations focused more on supporting the ruble's external rate.

The central bank raised its deposit rates by a quarter of a percentage point on December 27 but left lending rates unchanged. The market expects the CBR will soon raise lending rates to decrease inflationary pressures. The CBR last adjusted its steering rates in June 2010. In 1H10, interest rates were lowered almost monthly to prop up economic growth.

Current account surplus continued to swell in 2010.

Preliminary CBR balance-of-payment figures show that Russia's 2010 current account surplus was \$73 billion, or 47 % more than in 2009. The value of exports increased 31 % to \$398 billion, while the value of imports climbed 30 % to \$249 billion. The value of crude oil exports rose 33 %, and accounted for 34 % of Russia's total exports. The Russian economy remains hugely dependent on energy raw materials. Crude oil, oil products and natural gas together accounted 63 % of total exports last year.

The CBR estimates Russia's net capital exports amounted to \$38 billion last year, a third less than in 2009. Most capital exports came from non-bank companies. Capital exports accelerated in 4Q10 to \$23 billion. The rapid growth in capital exports in the second half of the year surprised observers, who had expected the strengthening ruble to inhibit capital outflows. Officials are concerned that the increased outflow of capital indicates that illegally earned assets or assets for which taxes have not been paid are being transferred out of the country. This is supposed to take place in the form of payments for fictitious foreign trade deals. The finance ministry and CBR are currently preparing a proposal on tightening oversight of import and export payments.

FDI inflows into Russia last year amounted to \$29 billion, about the same as in 2009.

Russia's foreign currency reserves grew 9 % last year to \$479 billion. Currency reserves are sizable by international standards, sufficient to cover 18 months of goods and services imports. The reserves of most developed countries on average are sufficient for about two months of such imports.

Russia's public foreign debt as of Dec. 31, 2010 amounted to \$34 billion, a 10 % gain for the year. Public debt was boosted by the government's \$5.5 billion euro-bond issue last April (the first such borrowing since the 1998 ruble crisis). Russia's public foreign debt remains minuscule by international standards – a mere 3 % of GDP.

Private sector foreign debt grew by nearly 4 % last year to \$436 billion. Banking sector foreign debt increased from \$127 billion to \$145 billion, while non-bank corporate debt fell from \$294 billion to \$291 billion.

China

Chinese GDP up 10.3 % last year. In the fourth quarter of 2010, China's GDP climbed 9.8 % y-o-y, a slight pick-up from 9.6 % registered in the third quarter. Based on seasonally adjusted estimates, quarterly growth slowed in the first half of 2010 and then faintly picked up in the last quarter (reaching a rate of 2.3 % q-o-q in 4Q10).

China's National Bureau of Statistics put the value of China's total economic output last year at 39.8 trillion yuan (US\$5.88 trillion, €4.44 trillion). In nominal terms, China surpassed Japan in 2010 to become the world's second largest economy in terms of GDP after the United States.

In 2010, there were still no signs of such structural change in Chinese output that many would like to see as manufacturing and construction were up over 12 %, while growth in the service sector held below 10 %. Perhaps most striking were the 16 % growth posted by heavy industry and the 32 % increase in car manufacturing. Agriculture and other primary production showed increase of just over 4 %. Primary production represented about 10 % of Chinese GDP, manufacturing 43 % and services 47 %.

Although demand-side macroeconomic data are not yet available, published indicators suggest a slow-down in investment growth while retail sales climbed 15 % in real terms, suggesting robust spending on the part of private consumers. Per capita disposable incomes increased 8 % in cities and 11 % in rural areas.

China's GDP growth, % p.a.



Source: China National Bureau of Statistics

On-year inflation dropped to 4.6 % in December.

While the rise in prices of fruits and vegetables accelerated last month, inflation in food prices overall slowed to below 10 % y-o-y. The government continued efforts to stem the rise in food prices, including a variety of measures to boost availability of staple foods and imposition of price controls. Food prices on world markets have risen in recent months due to reduced crop yields and harvest fail-

ures in major producer countries. China recently backed out of several large contracts for maize deliveries due to high world market prices.

The latest confidence indicators suggest both companies and households expect higher inflation rates ahead. As an indication of inflationary pressures, growth in the Chinese credit stock and money supply (M2) accelerated to around 20 % p.a. in December, a rate significantly higher than in pre-crisis years.

The focal point of monetary policy has shifted from supporting economic growth to fighting inflation. The People's Bank of China continued to tighten its monetary stance by raising the minimum reserve requirement a half percentage point to 19 %, effective from yesterday (Jan. 20). The country's leading English-language newspaper, *China Daily*, said the PBoC plans to reduce the 2011 lending quota for banks by 10 %. Monetary tightening measures last month involved raising reference rates for deposits and credit.

China continues to attract FDI as its own investments abroad take off.

The financial crisis in 2009 was accompanied with a sharp reduction in foreign direct investment (FDI). Last year's recovery saw a healthy rebound in FDI with investment inflows to China reaching \$106 billion, a 17 % increase from 2009. FDI growth in the country's central and western provinces as well as in the service sector outpaced the national average.

Even as rapidly rising labour costs have been driving low-wage manufacturing to other countries, China's technological development and growing domestic markets continue to attract investments in advanced production. For example, it was reported in December that the Korean Samsung and LG are engaged in an over \$6 billion project to build state-of-the-art liquid crystal display manufacturing plants in Eastern and Southern China.

About 55 % of FDI inflows into China come from Hong Kong. Other Asian countries are also substantial FDI contributors, including Singapore (5 % share), Japan (3 %), Korea (3 %) and Taiwan (2 %). The EU accounts for about 6 % of FDI inflows to China and the United States some 3 %. Estimates of FDI inflows to China should be taken with a grain of salt, however, as nearly a fifth of investment flowing into China originates from tax havens.

China's outward foreign direct investment (ODI) really took off in 2008, and exceeded \$48 billion in 2009. China's direct investments abroad in 2010 amounted to \$59 billion. These figures do not include ODI from the financial sector (about \$9 billion in 2009).

About three-quarters of investments of Chinese firms in 2009 went to the Asia-Pacific region, 13 % to Latin America and 6 % to Europe. North America and Africa each had shares of about 3 %. Country-specific data for 2010 have yet to be released.