EUROJÄRJESTELMÄ
EUROSYSTEMET

BOFIT Weekly

9 • 4.3.2011

Russia

Concern over rising inflation driving central bank policy. As part of its inflation-fighting efforts, the Central Bank of Russia on Tuesday (Mar. 1) raised deposit rates and several key credit rates by a quarter of percentage point. The deposit rate now stands at 3 %, and the one- and five-day repo credit rates are up to 5.25 %. The CBR expects the hike in deposit rates to mop up at least some of the vast excess liquidity in banking sector. Unfortunately, with the sector awash in liquidity, banks feel practically no need to turn to the central bank for financing. As a result, the rate hikes are expected to have little impact on market rates or inflation.

The CBR also boosted its bank reserve requirements by a half percentage point. The move increases the reserve requirement for foreign liabilities of banks to 4.5 % and to 3.5 % for domestic liabilities. The increase in the reserve requirement for foreign liabilities is intended to discourage possible short-term capital flows into the country driven by the interest rate hike.

Higher oil prices have increased the influx of foreign currency into Russia in recent months. With the ruble gaining nearly 6 % against the dollar and nearly 3 % against the euro since the start of the year, the CBR has been actively buying up forex to contain appreciation pressure on the ruble. Russia's foreign currency reserves increased by $13 billion to $492 billion in the first two months of 2011.

CBR first deputy chairman Alexei Ulyukaev explained that, given the current circumstances, the most effective short-term remedy to quell inflation is allowing the external value of the ruble to rise. The CBR has long used interventions to keep the ruble's exchange rate within a fluctuation band against its euro-dollar currency basket. In recent years, the central bank has tolerated larger swings in the ruble's external value, and the CBR further widened its band limits on March 1. The wider band limits are seen as an accommodation to appreciation pressure on the ruble.

Finland's exports to Russia up last year; re-exports not growing. Customs Finland figures show Finnish exports to Russia increased 16 % last year with an overall value of €4.7 billion. Finnish imports from Russia were up by 30 % to €9.2 billion. Russia's total imports climbed last year 37 %, while exports rose 31 %.

Russia was Finland's third-largest export market, accounting for 9 % of total exports. Finland's top export destinations were Sweden (11 % share of total exports) and Germany (10 %). Russia was Finland's largest source of imports with an 18 % share of imports. The next largest sources of imports were Germany (13 %) and Sweden (10 %).

Finland's largest individual export goods categories were paper and cardboard, which represented 10 % of exports to Russia. These were followed by medical and pharmaceutical products (8 %), iron and steel (8 %), and industrial machinery and equipment for general use (7 %). All groups registered robust growth relative to 2009. Strong growth was seen in the iron and steel product group, which saw the value of exports soar 540 %. About 77 % of the value of the group's exports came from oil and gas pipelines.

Energy products represented 82 % of Finnish imports from Russia, a three-percentage-point increase from 2009. Crude oil alone accounted for 50 % of imports. Higher oil prices largely caused the 43 % increase in the value of imported crude oil. The volume of oil imports was up 5 %. Natural gas accounted for 11 % of total imports and electricity 6 %. The categories for chemical products, as well as iron, steel and other metals both represented 5 % of total imports. Sawn timber and cork represented 4 % of imports.

The rise and fall of so-called re-exporting activity has had a profound impact on Finnish export statistics. Re-exports are goods produced in a third country that are recorded as Finnish imports when brought into Finland prior to their re-export to Russia, when they are recorded as Finnish exports. Re-exporting soared during the 2000s until 2009. The identification of all re-exports is impossible, but Customs Finland issues an annual estimate. The newly published 2009 estimate saw the value of re-exports contracting 70 % from 2008. In 2006–2008, re-exports accounted for about a third of all Finnish exports to Russia. In 2009, they were roughly a fifth of Finnish exports to Russia (estimated value €788 million).

According to the latest export figures the decline in Finland's top re-export categories – passenger cars and mobile phones – continued in 2010. Exports of passenger cars were down 70 %, and exports of mobile phones dropped 25 %. This suggests that re-exports were on decline or in any case did not grow in 2010.

The value and volume of road transhipments via Finland to Russia increased 17–18 % last year. The value of transhipped goods was just under €17 billion − nearly four times the value of Finland's total exports to Russia. Even with the growth, however, the volume of transhipped goods was just half of pre-crisis levels. The largest product categories were machinery and equipment (about 20 % of the value of transit shipments) and passenger cars (14 %).

Although Russian total imports increased sharply in 2010, Russian customs figures show imports of passenger cars had fallen to a level of about a third of the 2008 level. This is seen in the decline of Finland's re-exports and transhipments to Russia from the peak years of 2006–2008.

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

BOFIT Weekly
9 • 4.3.2011

China

National People's Congress lowers growth target. The annual two-week National People's Congress, starting on Saturday (Mar. 5), is set to discuss general policy issues, macroeconomic policy, budgets and critical legislative amendments. Topping this year's agenda is the specification of China's 12th five-year plan (2011–2015).

Last weekend, premier Wen Jiabao said that China will target average GDP growth of 7 % a year during the upcoming five-year plan. While the growth target of the previous five-year plan (2006–2010) was a half-percentage point higher, the realised average GDP growth in the period was 11 % p.a. Moreover, even if a half-percentage-point reduction appears marginal in this context, it reflects a rethinking of China's economic and social ambitions. Indication of the coming change was already evident in last autumn's party central committee framework document for the next five-year plan (see BOFIT Weekly 42/2010), which stressed the need to shift the growth emphasis from capital investment to private consumption, a move that almost inherently calls for lower economic growth. Other themes in the next five-year plan include reductions in income disparity, investment in high technology and innovation, development of strategic branches of industry and energy efficiency. This National People's Congress may also tackle labour market issues such as improvements in wage guarantees for workers and collective bargaining rights.

The uprisings in North Africa and the Middle East have added a topical edge to this year's meeting. China's leaders have called for resolution to the country's existing problems (e.g. rising inflation), while tightening censorship and cracking down on planned public demonstrations.

Next five-year plan should clarify China's environmental goals. The recent statements of China's premier and environmental minister suggest a shift away from high growth towards a sustainable growth paradigm. While environmental goals have long been on the political agenda, robust economic growth has consistently taken precedence.

Chinese quality of life has been seriously affected by degraded air and water quality. The NBS reports that only about 70 % of measurement points of potable water supplies complied with minimum drinkability criteria last year and that only 77 % of urban waste water was treated. Air quality was reportedly "satisfactory" in 83 % of China's big cities, but that figure is more an indicator of the laxity of China's air-quality standards. The smoggy air of China's large cities would not be considered satisfactory in developed countries.

China participates in UN climate talks with the group of developing countries not subject to binding climate goals. Even so, China has targeted reduction of "carbon intensity" (CO_2 emissions relative to GDP) to 40–45 % of its 2005 level by 2020. In the same period, China also plans to increase the share of biofuels in national energy production to 15 % and increase forestation of the country by 40 million hectares.

China's integration with international climate talks progressed at the Cancun summit late last year when China agreed to an evaluation of its environmental policies under the ICA consultation and evaluation process.

Strong growth in Finnish exports to China. Customs Finland reports that the value of Finnish exports to China climbed to €2.7 billion last year. Exports to China were up 45 %, compared to an overall 16 % increase in Finland's exports. China took 5 % of Finnish exports, surpassing the UK as Finland's sixth largest export destination.

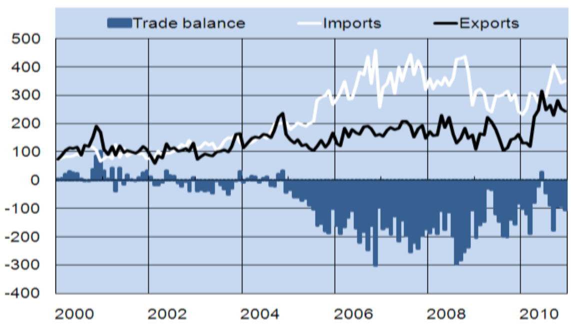
The value of imports from China in 2010 was €3.8 billion. Imports grew a modest 9 %, even as Finland's imports overall rose 20 %. Although China's share of Finnish imports contracted to 7 %, China retained its position as Finland's fourth most important import provider. Finland continued to run a trade deficit with China, but the trade gap contracted by a third in 2010.

Hong Kong and Taiwan together accounted for less than 1 % of Finland's foreign trade.

Finland saw growth in all its main goods exports categories to China with the exceptions of telephone equipment and motors. Finns exported to China last year a wide range of machinery, paper industry products, metals and furs. Large sales of paper mill equipment boosted export figures significantly. The value of fur exports doubled from 2009, while chemicals exports increased by 20 %.

The modest growth in imports reflected an 18 % decline in telephone and radio equipment. Imports of telephone equipment still accounted for a quarter of Finnish imports from China. Last year, Finland also imported various kinds of electrical equipment, office and IT equipment, clothing and metals from China.

Monthly Finland-China goods trade (EUR million)



Source: Customs Finland

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