EUROJÄRJESTELMÄ
EUROSYSTEMET

BOFIT Weekly
10 • 11.3.2011

Russia

Public finances improved last year. Public sector revenues (federal, regional and municipal budgets, as well as state social funds) increased 17 % in nominal terms, substantially better performance than expected. Expenditures were up 8 % in nominal terms. Thus, the overall public deficit shrank to 3.6 % of GDP, down from 6.3 % in 2009.

The rapid rise in revenues represented a partial rebound from a 16 % drop in revenues in 2009. In nominal terms, revenues were still lower than in pre-crisis 2008 and about the same level in real terms as in 2006.

It was with the realised price of Urals-grade crude oil averaging $78 a barrel last year (compared to a budget assumption of $58 a barrel) that revenues well exceeded the budget plan. In addition to taxes from oil production and oil export duties, government coffers were replenished by corporate profit taxes that had fallen dramatically during 2009. The public sector's energy dependence began to increase again last year as taxes collected from the oil and gas sector comprised nearly a quarter of total revenues.

Revenue from value-added taxes and excise taxes also bounced up as industrial production and imports returned to growth. Income tax revenues and mandatory social contributions from employers did not fall much during the recession, so there was much less room for recovery.

Nominal growth in public spending slowed over the past two years, and spending has risen only about 3 % in real terms since 2008. Federal spending (excluding transfers to regional budgets and social funds) and spending of regional and local administrations declined slightly in real terms last year.

In contrast, spending from Russia's social funds was boosted by the ongoing rapid rise in pensions and other social security spending. Their share of public spending increased dramatically. Spending on the economy shrank as stimulus funding implemented during the recession was wound down. Most other major spending categories – except for health care – remained unchanged in real terms.

Major public spending categories

	2009			2010		
	RUB bn	share %	change %	RUB bn	share %	change %
Public administration	1 054	6.6	-4.4	1 178	6.8	11.8
Economy	2 782	17.3	23.2	2 324	13.4	-16.5
Defence	1 191	7.4	14.1	1 280	7.4	7.4
National security	1 246	7.8	14.1	1 339	7.7	7.5
Social security	4 546	28.3	20.7	5 863	33.9	29.0
- pensions	3 235	20.2	25.5	4 436	25.6	37.1
Education	1 778	11.1	6.8	1 894	10.9	6.5
Health care	1 653	10.3	6.9	1 709	9.9	3.4
Housing	1 006	6.3	-12.8	1 072	6.2	6.5
Total	16 048	100.0	13.4	17 301	100.0	7.8

Source: Finance ministry

Borrowing of Russian state likely to be lower than forecast this year. High global prices for crude oil will sharply reduce the projected federal budget deficit this year and thereby shrink the state's projected borrowing needs. Finance minister Alexei Kudrin announced that the federal budget deficit this year is on target to come in below 2 % of GDP at about 1 trillion rubles ($35 billion). The original budget plan foresaw a 2011 deficit of 3.6 % of GDP or 1.8 trillion rubles.

The Russian state does not plan to use revenues from oil and gas taxes accrued in the reserve fund to cover the budget deficit as it has in the last two years. Instead, Russia will focus on rebuilding the reserve fund with revenues from oil and gas taxes in the current environment of higher oil prices. As of end-2010, the reserve fund held assets of 775 billion rubles ($27 billion). Kudrin expects the reserve fund holdings to nearly double by the end of this year. The reserve fund hit its all-time high of $143 billion in August 2008.

The government's initial plan this year was to cover the budget deficit by borrowing some 1.7 trillion rubles in ruble-denominated loans both at home and abroad, along with up to $7 billion in foreign currency denominated loans. The finance ministry now plans to cut this year's borrowing by 500 billion rubles. In order to allow the reserve fund to build up again, borrowing will exceed the budget deficit.

Late last month, the Russian state held its first ever ruble sovereign bond issue. The ruble-eurobond, which has a 7-year maturity and 7.85 % coupon, raised 40 billion rubles (about $1.4 billion) and was heavily oversubscribed. The finance ministry now plans to continue with ruble sovereign bond issues in coming years in order to promote the emergence of a ruble-bond market segment. The finance ministry hopes to use ruble bonds as a means to raising the ruble's profile in international financial markets and eventually see the ruble gain acceptance as an international reserve currency.

At the end of last year, Russia's public debt reached 4.2 trillion rubles (about $138 billion), or nearly 10 % of GDP. Foreign debt represented about 30 % of public debt.

Consumer prices up 9.5 % y-o-y in February. The CPI rise last month was nearly as fast as in January. On-month inflation, however, slowed from 2.4 % m-o-m in January to 0.8 % in February. The January figures were affected by annual hikes in regulated prices for housing and related services such as electricity, gas, water and heating. Regulated prices were raised at the start of the year an average of 9 % from December.

Prices for food and housing are among the most important drivers of inflation in Russia. Food prices in February were up 14 % y-o-y and housing prices 12 %.

It is expected that food prices will continue growing fast at least for the first part of the current year.

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

EUROJÄRJESTELMÄ
EUROSYSTEMET

BOFIT Weekly
10 • 11.3.2011

China

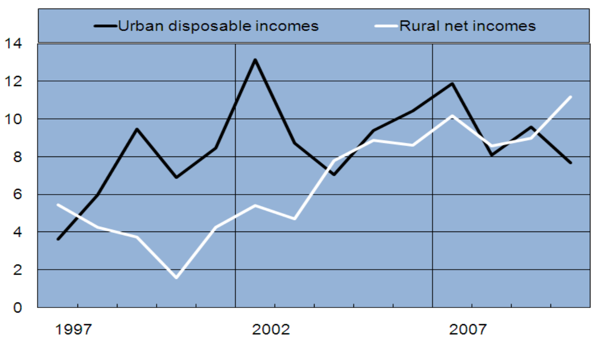
China posts foreign trade deficit for February. The value of China's exports last month was $97 billion, a 2 % increase from a year ago. With imports rising about 20 % to $104 billion, China produced a surprising $7 billion trade deficit last month, the largest monthly trade deficit since February 2004. Although China's Lunar New Year holidays largely explain the February numbers, both exports and imports saw far less growth than expected.

China's foreign trade surplus typically rises as the year wears on, so few doubt that monthly trade surpluses will soon return. The size of this year's trade surplus will largely be determined by China's own rate of economic growth. High growth and raw material imports have sustained soaring commodity prices. The volume of imports in January rose 35 % y-o-y, while exports grew 24 %.

There is huge interest in China's export trends, as the post-New-Year's exports figures could provide indications not just about the condition of the global recovery but also how fast labour prices are rising in China and whether the much-discussed move of light industry away from China's coastal provinces inland and to other Asian countries is gaining momentum.

Incomes rising faster in the countryside than in cities. In 2010, the real net incomes of rural dwellers increased 11 % y-o-y, while disposable incomes of urbanites were up 8 %. Even so, the income gap between the countryside and cities remains large. City folk had annual disposable incomes of 16,500 yuan (€1,830), or triple the net incomes of rural residents (5,100 yuan, €570). The official standard minimum wage rose 23 % to 870 yuan (€100) a month.

Real disposable incomes 1997–2010, %-change y-o-y (CPI deflator)



Sources: NBS, BOFIT.

Human resources and social security minister Yin Weimin said the new 5-year plan will target base real income growth of at least 7 % annually in both the cities and the countryside. The minimum wage growth target is 13 % a year or higher. The goal of raising household incomes is a cornerstone of China's latest economic policies, which emphasise private consumption over capital investment and exports. In order to promote household incomes, minister Yin also suggested as-yet-unspecified changes in the current wage bargaining model.

China's growth strategy based on cheap migrant labour is gradually being phased out. The number of migrant workers registered increased less than 6 % last year. New work opportunities for migrant workers in their home districts have become available with the rise of entrepreneurial activity in China's interior provinces. Along with a general rise in Chinese income levels, the emphasis on labour supply seems to be shifting to higher-value-added industries and away from cheap labour industries where labour shortages are already apparent.

China solidifies its position as world's biggest energy consumer. According to preliminary NBS figures, China's energy consumption increased about 6 % in 2010. Preliminary figures from the International Energy Agency (IEA) show China surpassed the United States already in 2009 as the world's largest energy consumer.

China's statistics for energy consumption show average annual growth of 6 % over the past 30 years. Growth in energy consumption and production peaked in 2003–2004, when growth in energy consumption actually outstripped GDP growth. Since 2004, the rate of energy consumption growth has gradually slowed, but still remains quite high by international standards. Due to China's consistently high economic growth, energy intensity (the ratio of energy consumption to GDP) has fallen. Despite this, the country remains among the world's 30 worst countries in terms of energy efficiency. China presently accounts for about a fifth of global energy consumption, which is in line with its share of the world population. Energy consumption per capita in the United States is five times higher than in China.

Coal accounts for about 70 % of China's primary energy consumption, and about 17 % comes from oil. As such China's energy intensity remains exceptionally high. The country's carbon dioxide emissions increased about 150 % in the past decade and now China accounts for almost a quarter of global CO_2 emissions. While China has increased its focus on natural gas and various forms of renewable energy in recent years, the road ahead is long. The NBS reports coal consumption increased 5 % in 2010, while oil consumption, which is largely used to fuel transportation, climbed 13 %. Natural gas use was up over 18 % last year. China's installed wind power capacity is now about a quarter of global wind power capacity, and last year China's investment in new wind farms represented about half of the world's total investments in wind power. Even so, wind power represents less than 1 % of China's primary energy consumption.

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