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BOFIT Weekly
11 • 18.3.2011

Russia

Short-term impacts of Japan disasters on the Russian economy likely to be relatively small. The biggest impacts for Russia are expected to be felt through prices of energy exports. World oil prices have fallen in recent days, and capital is expected to flow out of Russia as in other emerging markets. The ruble exchange rate weakened a bit this week. Looking ahead, Japan's recovery and partial substitution of nuclear power with other forms of energy should support prices for oil and gas.

The direct impacts via trade should be small as Japan only accounted for 3 % of Russia's exports last year and 4 % of imports. The biggest immediate impact will likely be on imports of Japanese cars to Russia; 44 % of cars imported to Russia last year were Japanese brands.

Large differences in regional industrial growth. Industrial output rose last year in 79 of Russia's 83 regions. Some 39 regions saw industrial output recover to pre-crisis levels. Russia's industrial output increased 8 % overall last year.

Growth was particularly brisk in regions focused on heavy industry, machine-building and assembly work. Many of these regions were situated in the Volga Federal District, including Ulyanovsk (23 % growth), Udmurtia (20 %), Perm (18 %) and Samara (16 %), as well as regions near Moscow, e.g. Oryol (21 %) and Kaluga (45 %). Industrial output growth in Kaluga led the nation, thanks in part to the opening in April last year of a joint assembly plant of Peugeot, Citroën and Mitsubishi. In Russia's biggest oil producing regions, industrial output growth slightly lagged the national average. Industrial output was up 2 % in Moscow, and 9 % in St. Petersburg.

The contraction of industrial output continued in the republics of Chechnya and Ingushetia, which are among the most backward regions in the Russian Federation. Industrial output also fell in the northern Nenets and Chukotka autonomous okrugs. The two regions defied the industrial output trend during the 2009 downturn, posting exceptionally high growth. Growth in Nenets came from the inauguration of a new oil field, while in Chukotka growth was driven partly by sharp increases in gold and silver production.

The biggest fixed capital investments last year were made in the Tyumen region in western Siberia, which took 11 % of total capital investment in Russia. Tymen is home to Russia's biggest oil and gas production areas – the Khanti-Mansi and Yamal-Nenets autonomous okrugs. Above-average investment was also made e.g. in the City of Moscow and St. Petersburg, as well as the Moscow oblast and the Krasnodar region, which includes Sochi, the site of the 2014 Winter Olympics. The above mentioned regions together accounted for 31 % of Russia's total fixed investment.

Despite rise in capital investment, no growth in construction activity last year. Rosstat reports fixed capital investment increased by 6 % y-o-y in 2010, after declining 16 % 2009. Growth was still modest compared to 2000–2008, when growth averaged 13 % a year.

The low level of capital investment is problematic for the Russian economy. Investment last year represented 21 % of GDP. While that share is average for an EU member, it is low for an emerging economy, where investment rates typically are in the range of 25–35 %. The rate is around 40 % in China and India. With the high economic growth of recent years, Russia's investment rate rose from 17 % in 2000 to a peak of 22 % in 2008.

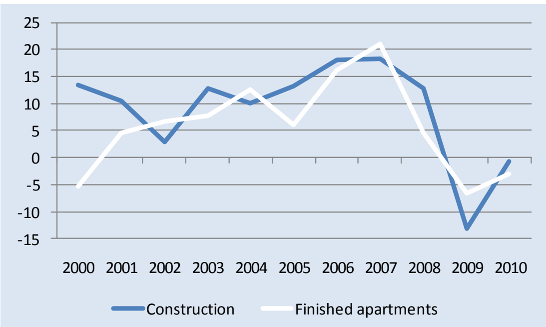
The financing structure used by Russian firms differs from most countries. Rosstat reports that in Russia 59 % of investment by firms last year was made out of pocket or with funds from other firms in the same conglomerate. About 19 % was financed from federal, regional or local budgets. Only 9 % of investment was financed with bank loans. Foreign direct investment was the source of financing of 4 % of all investment.

The private sector accounted for 46 % of investment, while the share of public sector (including public-private alliances) was 38 %. Firms either wholly or partly foreign-owned accounted for 16 % of investment.

The energy sector continued to dominate fixed capital investment. Some 16 % of investment went to oil and natural gas production, and a similar share went to manufacturing, where the biggest investments involved oil refining, basic metal industries and the food industry. Some 26 % of total investment went to the transportation and telecommunications sectors, including 9 % to pipeline transmission and 6 % to railways. Some 9 % of investment went to electricity production and transportation, and a similar amount to the real estate sector.

Although construction activity began to recover in the second half of 2010, 2010 overall still saw construction slightly lower than in 2009, when production fell 13 %. Residential housing production was down 3 % last year from 2009, when housing production was off 6 %.

Construction activity and finished apartments, %-change y-o-y



Source: Rosstat

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China

For China, the most immediate impacts of the Japanese disasters are likely to be felt in trade and tourism. While Japan struggles with the triple-whammy of the 9.0-magnitude Tohoku earthquake, subsequent tsunami and nuclear power plant failures, the initial impacts on China appeared minimal. Even so, it is becoming clear that the ongoing crisis could significantly impact bilateral trade and tourism. Japan is a part of highly integrated international production chains in such industries as cars and electronics, so problems with Japanese component supplies can also have significant knock-on effects for Chinese manufacturers. China will be exposed to movements in commodity (particularly energy) markets, but China's heavily regulated financial system remains fairly insulated from shocks to the international financial system. As elsewhere, the security safeguards of China's nuclear power industry are now under the extreme scrutiny.

To assist with the crisis, China has dispatched rescue teams and supplies to Japan, and has pledged to help Japan with reconstruction. Chinese firms are in a good competitive position to help with reconstruction and China could also play a substantial role in financing reconstruction. Chinese airlines have increased flights to Japan to help with evacuation of Chinese nationals.

Japan accounted last year for 7 % of Chinese exports and 13 % of imports. China was Japan's largest trade partner, accounting for about a fifth of foreign trade. Over half of bilateral trade involved machinery & equipment, and electronics products. In addition, the two countries enjoy an extensive tourism relationship. Japanese last year made 3.7 million trips to China, while the Chinese made 1.4 million visits to Japan. The two countries each account for about a sixth of the other country's foreign tourism.

National People's Congress approves 12th five-year plan. The annual two-week National People's Congress (NPC) was concluded last Monday (Mar. 14). The approved five-year plan 2011–2015 aims for sustainability by rebalancing China's growth model to put greater emphasis on domestic consumption and better distribution of wealth. The average annual GDP growth target was lowered to 7 %, half a percentage point below the previous five-year plan. Realised annual growth over the 11th five-year plan slightly exceeded 11 % as exports and investment soared.

The current five-year plan puts private consumption ahead of investment as the main driver of economic growth. Services are also expected to contribute to a greater share of GDP. To reduce the disparity in living standards, the government will spur domestic demand with measures such as supports to farmers and urban poor, and by investing in healthcare and affordable housing. Science and technology, as well as education, will be geared to promote innovations.

At the news conference held on the final day of the NPC, premier Wen Jiabao announced an inflation target of 4 % for this year. Mr. Wen said China's exchange rate policy and yuan appreciation will not play a central role in reaching the inflation target. Instead, the yuan will be allowed to appreciate gradually. He further stated that threading the balance between robust job creation and putting the brakes on inflation presented a great challenge that will be made harder by international factors such as lax monetary policy in the United States, high world commodity prices and rising domestic wage levels.

Despite the lack of official discussion of political reforms on the NPC agenda, the upcoming change in leadership in China next year and the ongoing political unrest in North Africa provided an interesting back-narrative to the meeting. Wen defended the right of people to criticise and keep an eye on government officials, but refused to find parallels between the situations in China and North Africa. The government cracked down on freedom of assembly during the event, as well as tightened rules for journalists.

12-month inflation still below 5 % in February. China's National Bureau of Statistics reports that consumer prices in February were 4.9 % higher than a year ago, i.e. unchanged from the 12-month rate in January. The single most important factor driving inflation was again rising food prices (up 11 % y-o-y). Producer price inflation accelerated in February to 7.2 % y-o-y.

It appears that the monetary tightening measures introduced last year have begun to affect consumer prices, while producer prices continued to soar due to increased commodity prices. Growth in the credit stock slowed in February to 16.2 %, matching the 2007 pre-crisis level.

In the first two months of this year, China's industrial output grew 14 % y-o-y. Industrial output growth was slightly higher than at the end of last year. Growth in retail sales fell three percentage points from year's end to 16 % y-o-y. Lower growth in car sales diminished growth in both industrial output and retail sales.

China now the world's biggest industrial producer. At the start of the week, both the Financial Times and Bloomberg referenced a report by IHS Global Insight that found the value of China's industrial production in 2010 slightly exceeded that of the US. The US and China each now account for about a fifth of global industrial production. In China, that manufacturing value-added (MVA) is achieved with about 100 million workers. The same of MVA is achieved in the United States with just over 11 million workers. The IHS Global Insight comparison used last year's output measured in US dollars and nominal exchange rates.

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