SUOMEN PANKKI FINLANDS BANK
EUROJÄRJESTELMÄ
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Russia

Large differences in economic recovery in Russian regions neighbouring Finland in 2010. Industrial output was on the upswing last year in the City of St. Petersburg, the Leningrad and Murmansk regions, and the Republic of Karelia. Rosstat reports that St. Petersburg, which suffered one of its biggest drops in industrial output in 2009 (a decline of 20 % compared to a national drop of 9 %), saw its industrial output rebound 9 % last year (compared to a national average of 8 %). Recovery in manufacturing last year was observed especially in auto assembly (more than 200 % growth), which suffered a massive drop-off in 2009.

The City of St. Petersburg is surrounded by the Leningrad region, where industrial output, after suffering a 6 % drop in 2009, climbed 15 % in 2010. Growth was driven by e.g. increased vehicle production: passenger car and tractor production grew around 100 % from the 2009 level. In addition, manufacture of tyres for passenger cars increased about 50 %. Many auto component makers operate in the Leningrad region, including the Finnish Nokian Tyres.

In the Republic of Karelia, industrial output last year rose 11 % y-o-y (industrial output contracted 10 % in 2009). Growth was led by e.g. the timber and pulp & paper industries. In the mining-dominated Murmansk region, industrial output rose 4 % y-o-y (down 6 % in 2009). Compared to the national average, industrial output in the region was tepid throughout the 2000s, averaging only about 1 % a year.

Investment growth in 2010 was quite varied across regions close to Finland. The volume of investment in the Leningrad region soared 32 % (and grew 8 % even in the crisis year 2009). Investment nationally contracted 16 % in 2009 and increased 6 % in 2010. Investment was up 15 % in Karelia (down 32 % in 2009) and up 6 % in St. Petersburg (down 17 % in 2009). In Murmansk, investment fell 22 % in 2010, after declining 18 % in 2009.

Growth in retail sales, a good indicator of private consumption trends, was stronger in Finland's neighbouring regions than the national average (just over 4 %). In St. Petersburg, retail sales rose 6 % (down 5 % in 2009), 11 % in the Leningrad region (down 2 % in 2009), 5 % in Karelia (down 5 %) and 3 % in Murmansk (down 3 %).

The average income in the four regions was slightly higher than the national average. The official average monthly salary in Russia in November 2010 was 21,000 rubles (€530). In Murmansk and St. Petersburg, the average salary was about 28,000−29,000 rubles (€700−720). Murmansk wages were higher due to its industrial structure and focus on the relatively well-paid mining industry. In the Leningrad region and Karelia, the average monthly wage was 25,000–26,000 rubles (€500–530).

Russia's official unemployment rate averaged 7 % nationally in the November-January period (2010–2011). In contrast, it was just 2 % in the City of St. Petersburg and 6 % in the Leningrad region. Unemployment was 9 % in the Murmansk region and 11 % Karelia.

Government approves development strategy for banking sector. The strategy laid out by the government and central bank extends through 2015 and follows up earlier strategy documents released in 2001 and 2005.

The new strategy focuses on making banks more active participants in modernisation of the economy, improving the quality and efficiency of banking and banking services, assuring stability of the banking sector and increasing competition and transparency. The broad tasks facing the government are still developing effective legislation and improving the business environment, and a little more specifically, inter alia, developing banks' corporate governance and risk management, banking supervision of e.g. banking conglomerates, reducing bureaucratic red tape and improving the consumer's position and protection. Improving banking legislation should make the banking system conform to most international standards by 2015.

The strategy calls for reducing state ownership in the banking sector in the medium term. This would happen over a three-year period for Russia's largest, second-largest and fourth-largest banks (Sberbank, VTB and agriculture bank Rosselhozbank), which together account for nearly 40 % of the entire banking sector. However, during that period the state will retain its majority stake in these banks. In the longer term, the strategy calls for further reduction of state ownership in the above-mentioned banks. Similar divestiture is planned for Post Bank, which is in formation, although the Russian state aims at divesting its majority ownership within five years from the bank's establishment. State-owned companies are called to prepare plans to divest stakes in banks in the medium term. Gazprom, which owns the country's third-biggest bank (Gazprombank), is mentioned in the strategy. The plan also calls for regions and municipalities to gradually divest holdings in banks.

To achieve the essential goal of banking sector stability the minimum capital requirement for banks will continue to rise. The strategy calls for an increase to 300 million rubles (€7.5 million) starting in 2015. Under current law, the minimum capital requirement goes up at the start of next year from 90 million rubles to 180 million rubles.

By 2015, the total assets of Russia's banking sector are expected to exceed 90 % of GDP. Currently, total assets equal about 75 % of GDP, which is lower than in developed countries and even many emerging economies. At the same time, corporate and household borrowing, which is also low relative to the size of the Russian economy, is expected to rise from 40 % of GDP at present to 55−60 %. Tier 1 capital should rise from 10 % to 15 % of GDP.

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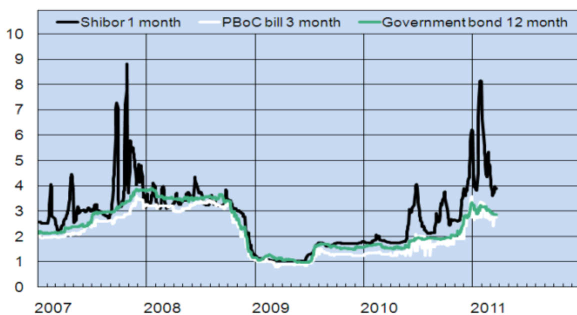
China

China's central bank continues monetary tightening. The People's Bank of China (PBoC) announced that effective today (Mar. 25), the deposit reserve requirement ratio will increase by 0.5 percentage point as part of efforts to quell credit growth and inflationary pressures. Following the rate hike, the ratio is 20 % for largest banks and 16.5 % for other banks. The increase in the reserve requirement is the third this year, and follows the PBoC's February move to raise key reference rates by a quarter of a percentage point. Even as the global economic outlook has been clouded by the unfolding events in Japan and Libya, China's leaders are moving ahead with monetary tightening as worries over rising domestic inflation take priority.

Boosting the reserve requirement is a far cheaper way for the PBoC to mop up excess liquidity in the system than by issuing central bank debt securities. The PBoC currently pays only about 1.6 % p.a. on mandatory reserve-deposits, while the market rate for e.g. three-month paper has been running at around 2.8 % p.a. in recent weeks. Banks hate the move, of course; with more of their money stagnating in a low-yield central bank account, they see their potential profits reduced.

Liquidity varies hugely from bank to bank. Recently, small banks in particular have reported liquidity shortages. The liquidity situation is reflected in money market rates. In the second half of 2010, market rates rose sharply; in recent weeks they have fallen. Unlike advanced economies, where interest rates play a major role in monetary policy, China still relies largely on regulation of the credit stock. The pressure to shift to a more transparent monetary policy based on interest rates continues to increase as China's financial markets evolve.

Money market rates in China



Source: Bloomberg

China approves 2011 deficit budget. The finance ministry presented its proposed 2011 budget to the National People's Congress that ended last week. Revenues to the public sector (central and local administrations) are expected to rise 8 %, while expenditures will increase 12 %. The resulting budget deficit of 2 % of GDP is a half percentage point lower than the forecast last year. Indeed, the realised 2011 deficit could be even smaller as China tends to be cautious in its forecasting of GDP growth. Formulating an accurate picture of China's public economy is challenging as revenues and spending by local administrations are not specified accurately.

This year's budget is about improving living standards and raising private consumption. China is contemplating an increase in the minimum monthly taxable income threshold from 2,500 yuan to 3,000 yuan. Central administration spending has been boosted by about 15 % this year in such areas as construction of affordable housing, education, social security and healthcare. National defence, science & technology and energy-saving will also see funding increases of more than 10 % this year.

China's public sector revenue and expenditures (% of GDP)

	2007	2008	2009	2010	2011*
Revenues	19.3	19.5	20.1	20.9	20.3
Spending	18.7	19.9	22.4	22.5	22.3
Balance	0.6	-0.4	-2.3	-1.6	-2.0

Public sector = central and local administrations.
**Estimate, GDP based on 2011 budget deficit (900 billion yuan).*
Sources: China Ministry of Finance, CEIC, BOFIT.

Libya crisis should have little impact on China's energy supply. China is the world's second largest oil consumer after the United States, accounting for about 10 % of total world consumption. China today imports about half of its crude oil, with imports rising 17 % last year to 239 million metric tons. Libya provided about 3 % of China's crude oil imports last year.

The Libyan crisis illuminates the challenges China faces in its efforts to secure oil supplies from politically unstable regions. China's trump card over other resource competitors has been its ability to provide cheap skilled labour and financing while steering clear of domestic politics of the target country. China has acquired rights to oil fields in developing countries by offering payment in infrastructure projects that Western actors are otherwise reluctant to fund due e.g. to corruption issues.

However, most such projects have been realised largely with Chinese labour, annoying their foreign hosts. The unwillingness to hire local labour is part of the reason China lost its production rights in Angola, the biggest foreign supplier of oil to China, and Libya in 2009. Poor management led to the failure of several projects in Nigeria. In recent weeks, China has had to evacuate about 36,000 Chinese workers from Libya without guarantee that Chinese investments in the country will be recovered. It is estimated that there are about 75 Chinese firms operating in Libya with projects worth a total of $19 billion.

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