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# BOFIT Weekly

13 • 1.4.2011

# Russia

**BOFIT forecast sees brisk GDP growth in 2011-2013 for Russia, despite slowing.** The recovery of Russian output from one of the deepest drops globally slowed temporarily in autumn 2010 but continued in winter. Imports, in contrast, recovered in 2010 faster than predicted due in part to an exceptionally hot and dry summer that decimated agricultural production in particular.

The latest BOFIT Forecast for Russia sees GDP rising briskly and even stronger import growth. GDP growth should reach 5.5 % this year, due e.g. to a rise of prices for oil and Russia's other key exports in 2009-2010, as well as the relatively low GDP level of 2010. Starting from the first half of 2011, GDP growth is projected to decelerate gradually as the impact of the earlier rise of export prices on the economy ebbs and prices in the forecast period remain at the level of early this year (we assume an average oil price of about $100 a barrel). GDP growth is expected to be 4.7 % in 2012, and just over 4 % in 2013.

Consumption growth is forecast to pick up and become the main driver of economic growth. This should help spur a recovery in agriculture, which experienced a sharp decline in 2010. The brisk rise in wages should continue, with inflation and the upcoming elections next winter adding to the pressure to raise public sector wages and pensions. Household saving is expected to fall from its recession height. Growth in purchasing power is restrained by inflation, which has accelerated to nearly 10 % due to rising food prices. Consumption growth is also curbed by a slow decline in unemployment, as underemployment in firms is higher than before the recession.

Public spending is expected to rise slowly. This view is supported by government extra revenue which flows from a higher oil price than assumed in the budget. That will also make it easier for the government to meet its target of returning the state budget to balance by 2015.

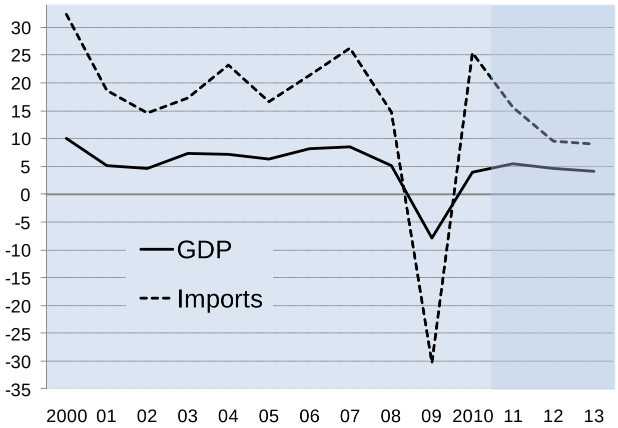
The volume of exports is expected to grow rather slowly in relation to global trade as exports of crude oil and fuel oils are not expected to increase. Natural gas and other basic export commodities should mend some of the slack.

Investment is expected to recover strongly this year and next year as production capacity utilisation climbs back this year to pre-crisis levels. Banks have sufficient liquidity to meet the financing needs of investors. As in the 1998 recession, inventories have had a large impact on GDP, with inventories first declining and then rising. The economy has now largely moved beyond this down-up cycle.

Imports, which are expected to increase about 15 % this year and about 10 % p.a. in 2012-2013, will restrain GDP growth. The Russian economy's propensity to import, while high, should ease off gradually. On the other hand, appreciation in the ruble's real exchange rate should encourage imports. The current account surplus should be sufficient to support appreciation of the ruble's nominal exchange rate even if import prices would rise substantially.

This forecast carries with it inherent upside and downside risks. Oil prices could rise from the level assumed, while the impact might be slower due to oil taxes. Higher-than-expected inflation from e.g. higher food prices could shrink the consumption base. Import growth could possibly outstrip the projection.

**Changes in Russian GDP and import volume, %**




*Sources: Rosstat and BOFIT Forecast 2011–2013*

**Russians travelling abroad more, including Finland.** Based on at-border interviews of travellers, Statistics Finland reports that during the 2010 May-October summer tourist season, the number of Russian tourists visiting Finland rose 18 % y-o-y after contracting still in 2009–2010 winter season. In the May-October period, the total number of visits increased 5 %. For the 12-month period from November 2009 to October 2010 over 2.4 million travellers, or 40 % of all travellers visiting Finland came from Russia. Some 63 % of Russian trips were day journeys; the share of Russians of nights spent by foreign visitors in Finland last year remained at 14 %.

During the May-October 2010 tourist season, Russian tourists spent on average about €270 during each visit, or about 11 % more than in the 2009 tourist season. Balance-of-payments figures from the Bank of Finland show that in 2010 Finnish earnings on tourism from Russia amounted to a total of €750 million, or more than a third of all earnings from tourism (€2.2 billion). Tourism earnings from Russian visitors were up about 20 % from 2009. Tourism earnings overall rose 8 % in 2010.

Rosstat reports that Russians made over 39 million trips abroad last year, an increase of 15 % from 2009. Some 25.5 million trips were to non-CIS countries. The most popular non-CIS destinations were Finland (3.4 million visits, or 9 % of all trips), Turkey (8 %), Egypt (6 %) and China (6 %).

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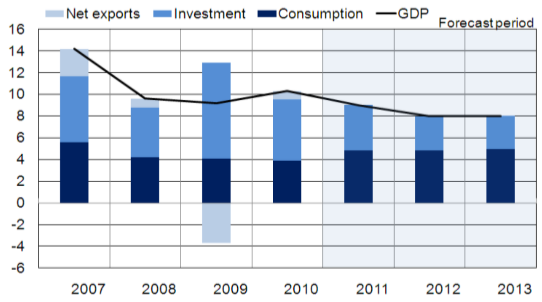
# China

**BOFIT's latest forecast sees China's GDP growth slowing to 9 % this year.** China used massive public investment to sustain robust economic growth throughout the international financial crisis. Credit growth due to increased borrowing, rapid money supply growth, and higher prices for food and other commodities have caused inflation to pick up. As a result, the focus of economic policy has shifted from propping up growth to fighting inflation. Given tighter monetary policies, the latest BOFIT Forecast for China sees real GDP growth slowing this year to 9 % p.a. Growth is expected to slow further to around 8 % p.a. in the coming two years (2012 and 2013). Such growth is still quite robust given the size of the Chinese economy, which now significantly affects trends in commodity prices and the global economy. China's GDP grew 10.3 % last year to 39.8 trillion yuan ($5.88 trillion /€4.44 trillion), surpassing Japan to become the world's second largest economy after the United States.

**GDP growth and contribution of demand components, %**




*Sources: CEIC and BOFIT*

Domestic demand, buoyed by rising incomes and a higher yuan exchange rate, will drive GDP growth in the forecast period. Private consumption has only accounted for about 35 % of GDP in recent years which leaves plenty of room to expand the role of consumption in the economy. Investment is expected to grow more slowly, with the investment rate falling few percentage points in the forecast period from the current 46 %. Urbanisation, new infrastructure and structural changes in the economy, however, will continue to support investment demand.

Now the world's largest exporter, China's exports are expected to grow slightly faster than 7 % p.a., the predicted growth in global trade. Given GDP growth substantially higher than in other countries, China's import growth should outstrip its export growth. China's current account surplus equalled about 5 % of GDP last year. In the forecast period, the current account surplus may decline slightly, but the trend will largely depend on foreign trade prices.

Underlying problems lurk even with the robust growth of the past two years. These are already becoming apparent with the pick-up in inflation and problems emerging in the real estate sector. For policymakers, inflation has become the top concern and missteps in monetary policy could very well destabilise growth. The murkiness of real estate sector data also challenge officials in shaping appropriate policies. Even though China has an on-going need for new housing, there may be substantial overhang of unsold apartments on the market. In such circumstances, a price collapse could reduce housing production and lower economic growth, which would have knock-on impacts on local administration budgets and the banking sector. Forecasting trends in China's real estate markets is especially difficult due to the poor quality of available data and huge differences in practices across provinces.

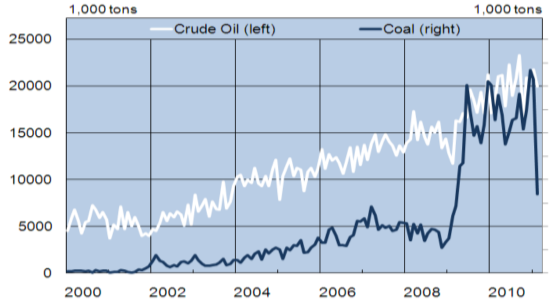
**China now the world's second-largest coal importer.** China's National Bureau of Statistics reports that China produced about 3 billion metric tons of coal last year, or about 45 % of global production. China's coal production increased 8 % and consumption rose 5 % last year. China is by far the world's biggest coal producer and consumer.

Despite a doubling of domestic coal production over the past decade, it has not kept up with soaring demand. As a result, China's coal imports increased 30 % last year, and as coal prices surged, the value of coal imports rose 60 %. Despite the rapid growth, coal imports in 2010 reached 170 million tons which only accounts for 5 % of China's total energy consumption.

Although coal production is a minor aspect of the Chinese economy, it has profound global impacts. China is now the world's second-largest coal importer after Japan, and during 2000–2008 China accounted for about 75 % of growth in global coal demand. Import growth was especially high in 2008–2009, when demand for coal outside Asia contracted sharply due to the global recession.

Coal provides about 70 % of China's primary energy consumption, and crude oil about 18 %. The volume of China's crude oil imports increased 17 % last year, accounting for 7 % of China's total energy consumption.

**Volumes of crude oil and coal imports to China**




*Source: CEIC*

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