BOFIT Weekly
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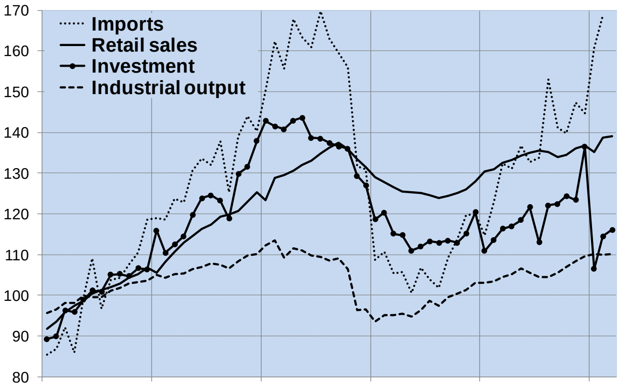
Russia

Insecurity characterises first-quarter economic performance. After a feeble January, the Russian economy bounced back in February and March. Recovery was apparent in retail sales, the main item of domestic demand. The volume of retail sales increased in the first quarter almost 5 % y-o-y and reached the pre-crisis peak of autumn 2008. The volume of food sales, however, was up just 1 % y-o-y, while sales of non-food goods roared ahead. Retail sales of non-foods were up 8 % y-o-y.

High inflation, in particular, may threaten the development of consumption in the near future. It has eroded real household incomes, dragging them down 3 % y-o-y in the first quarter according to statistics. However, the increase in the social tax in January may have caused employers to go “grey” and pay a bigger part of salaries under the table, i.e. without registering them, which might explain part of the decrease in income.

Investment recovered in February-March, but was still down more in 1Q11 than in 1Q09 or 1Q10. Investment is still more than 20 % below the pre-crisis peak.

Seasonally adjusted core demand and production items (volume indexes, 2006 = 100)



Sources: Rosstat, BOFIT, World Bank

Industrial output was up nearly 6 % y-o-y in the first quarter, and manufacturing was up over 10 %. Production of mineral extraction industries saw low growth with only tiny increases in crude oil and natural gas output.

The recovery in GDP growth that began in winter, continued relatively brisk. The economy ministry preliminarily estimates that GDP increased 4.5 % y-o-y in 1Q11.

The boom in imports continued with the value of imports rising about 40 % y-o-y in the first quarter. The seasonally adjusted value of imports actually exceeded pre-crisis levels. Preliminary data also suggest the volume of imports reached back to pre-crisis levels.

Budget revenues up sharply; slight increase in spending. Finance ministry figures show the federal budget is on track to take in 1.46 trillion rubles (€36 billion) in additional revenues above its original forecast. Most of the revenue boost is attributed to higher tax revenues on crude oil due to the surge in world prices.

The higher revenues will be used to reduce the budget deficit, which is now expected to stay below 1.4 % of GDP this year. Part of the unexpected earnings will be transferred to the Reserve Fund to cover future fiscal shortfalls. At the end of 2011, the finance ministry expects the Reserve Fund to reach 1.5 trillion rubles, which corresponds to about 3 % of GDP.

At the end of last week, the government approved its first supplemental budget for 2011; federal budget spending will rise about 360 billion rubles (€9 billion) in reflection of higher tax revenues. The spending hike represents a slightly greater than 3 % increase from the original figure.

Most of the extra spending will go to the social sector; some 74 billion rubles will be used to cover the deficit in the Pension Fund in anticipation of a possible extra increase in pensions at the end of the summer. If inflation exceeds 6 % in the first half of this year, pensioners get an additional raise. It is now expected that the index trigger will be activated; consumer prices were up 3.8 % in the first three months of the year.

Some 62 billion rubles (€1.5 billion) of the supplementary budget will be invested by the state as foundation capital in a “Direct Investment Fund” currently being put together. President Medvedev introduced the idea of establishing a national investment fund at the last summer’s economic forum in St. Petersburg. The fund’s purpose is to participate in important projects that foreign investors carry out in Russia and thereby attract foreign investors. The fund will be administered by Vnesheconombank and its capital will gradually be raised to $10 billion. Project participation of the fund would typically be 10–25 %.

IMF commends Russian officials for efforts to stabilise banking sector during financial crisis. Although state support measures strengthened large banks and reduced competition among banks, the IMF said the Russia’s banking sector overall is rapidly recovering from the recession. However, the sector’s development will also in future depend on global business cycles. The IMF noted that while bank supervision still does not conform to international standards, the situation should be improved by legislation currently before the Duma.

The British HSBC, one of the world’s largest banks, announced Monday that it was terminating its retail banking business in Russia. HSBC will now concentrate on corporate and investment banking activities in Russia, just like Swedbank, Barclays and Morgan Stanley that recently pulled out of retail banking in Russia.

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China

Trucking firms protest rising costs. International news agencies report that truckers held protests and halted movement of goods in some parts of the world's largest container port in Shanghai. The actions by mainly independent trucking companies were in response to rapidly increasing costs. The companies have to face higher fuel prices and various taxes, tolls and fees charged by officials and harbour operators. The Shanghai city government, after arresting many striking drivers, caved to demands last weekend by demanding that harbour operators eliminate or lower certain fees imposed on truckers.

China's taxi firms, also hit hard by higher fuel prices, last week forced the government to concede permission to charge higher fares and work rule changes, as well as help with certain expenses. Inflation is an exceptionally delicate subject in China. Domestic news coverage made no mention of the events in Shanghai.

China's government this year has already raised fuel prices twice (a total rise of about 10 %). The increases were smaller than the rise of crude oil prices on the global markets or what the government's new and more flexible fuel pricing policy adopted in 2009 would have suggested. Although the price of imported oil was about one third higher in March than a year earlier, the price of transport fuels has increased only 12–17 % in the same period. As a result, the government must compensate oil refiners for losses caused by higher oil prices to assure that they continue to meet their supply obligations. This week, the price of a litre of regular gasoline averaged around €0.80 in China, €0.70 in the US and €1.60 in Finland.

European companies want easier access to China's massive public procurements market. The recent publication on public procurement of the European Union Chamber of Commerce in China criticises the current system as inconsistent and discriminatory. The report finds foreign firms do not receive equal treatment in public procurements. European firms interviewed for the report complained that information about upcoming projects was not revealed in time and that the criteria for supplier selection remain unclear. Lower-level administrations often decide on procurements, which increases supplier costs in bid preparation and lowers transparency. Moreover, European bidders have little opportunity to appeal when a decision appears unfair.

The report estimates that the value of all forms of public procurement in China corresponds to 20 % of GDP. China itself has suggested far more modest numbers. China has observer status in the WTO government procurement agreement (GPA) and is seeking full member status. GPA countries rejected China's 2007 and 2010 applications for full membership.

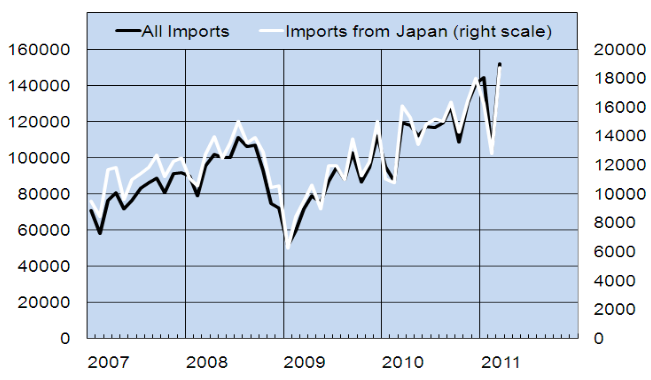
Trade ministers of China, Japan and South Korea met to continue work on drafting an investment policy agreement. The agreement has been under preparation for several years. While the details have yet to be made public, such investment agreements typically call for elimination of barriers to investment between the party nations and seek protection for investments and intellectual property. At the same time, the ministers accelerated drafting of a trilateral free-trade agreement. The countries form a core of foreign trade as Japanese and Korean electronics makers and firms serving the car industry have production in China. Japan and South Korea together last year accounted for over 10 % of China's exports and nearly a quarter of China's imports.

All three partners already have free-trade agreements with the ASEAN-countries. Current negotiations are part of the Asia's economic integration, driven in part by rapid wealth accumulation in the region. In addition to regional and bilateral free-trade arrangements, there has also been modest progress in integration of Asia's financial sector with the ASEAN+3 regional liquidity support facility (Chiang Mai initiative), which entered into force a year ago. Progress in integration, however, remains problematic due to national differences, competitive strains and dependence on markets in the developed world. Another brake to integration is fear of Chinese dominance.

The disasters in Japan, which will take years to deal with, added colour to the ministers' meeting. The investment agreement would improve the opportunities for Chinese and South Korean firms to participate in Japan's reconstruction. Production stoppages in Japan in recent weeks have led to component shortages at car plants and electronics factories around the world, also in South Korea and China.

Foreign trade figures show trade between China and Japan in March was not impacted by the event in Japan; China's imports from Japan showed the same trends as imports from elsewhere.

China total imports (left scale) and imports from Japan (right scale), USD million



Source: CEIC

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