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BOFIT Weekly
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Russia

GDP grew rapidly in the first quarter. Preliminary Rosstat figures show GDP grew 4.1 % y-o-y. The economy ministry's earlier-released preliminary figures indicated 4.5 % growth. Seasonally adjusted GDP climbed at a good pace in the first quarter, up 1.3 % q-o-q. GDP was only a couple percentages below its 2Q08 peak.

The rate of first-quarter GDP growth was dragged down by a sharp drop in capital investment and the ongoing boom in import growth. Growth was fuelled by brisk consumption growth, and according to preliminary figures rapid growth in the volume of exports.

Manufacturing industries fared variably during the recession. Many of Russia's primary domestic producers, including producers of oil, gas and electricity, as well as farmers, were scarcely touched by the global financial meltdown. In contrast, construction and manufacturing were hit hard by the downturn.

Manufacturing output overall fell from its quarterly peak about 25 % before hitting bottom. Despite a rapid recovery, production in 1Q11 was still well below the 2008 peak. The structure of manufacturing appears not to have returned to its previous stand, so far, as many branches sustained different impacts from the recession.

One of the largest manufacturing branches, Russia's food industry, contracted only slightly in the recession and has seen steady growth, for a year at levels above the pre-crisis level. Production, however, dipped in 1Q11.

At the other extreme, the machinery & equipment industries and the construction materials industry, which produce largely for domestic investors, saw steep declines in the recession and are still about 25 % off their pre-crisis peak; even if one part of the machinery & equipment segment, defence production, saw growth of over 10 % a year throughout the recession. Government subsidies for consumption and production have helped manufacturing of vehicles rebound to levels of the summer 2008 peak.

Developments in branches manufacturing both for the domestic market and exports were varied. Production of oil products was relatively scarcely touched by the recession, and production has grown, at levels surpassing pre-crisis highs. The chemicals industry and the plastics & rubber industry, as well as metals production rebounded from deep dips well with chemicals and plastics & rubber industries surpassing pre-crisis levels. Production in the hard-hit forest industries remain far off their 2008 highs, partly due to a decline this past winter.

Study explores rise in Russian living standards, increased income disparity and changes in consumption patterns. A joint survey conducted by the Moscow Higher School of Economics (*Vyschaya shkola ekonomiki*) and Russia's leading economy magazine *Expert* examined changes in the living standards of the Russians and their material well-being between 1990 and 2009. Living standards and well-being were determined using a variety of measures related to e.g. incomes and income distribution, purchasing power and consumption patterns, as well as the kinds of household goods stocked in Russian homes.

Per capita consumption was estimated to have risen on average 45–50 % between the early 1990s and 2009. Depending on the statistical data used, however, the results vary considerably. The study found that purchasing-power-adjusted income per capita increased 45 %, while the volume of consumption per capita more than doubled according to GDP-based consumption figures (the difference is not explained by increased savings).

The relatively modest change of purchasing power in relation to the time span is explained by the drop in household income after the collapse of the Soviet Union. Real incomes only began to increase after the 1998 financial crisis and really only took off in the roaring boom of the 2000s. The researchers also note shortcomings in the data that diminish their reliability and comparability of Soviet-era figures with figures based on current methods.

Thus, regarding incomes, either 40 % or 80 % (depending on the measure) of Russians enjoy higher real incomes than 20 years ago; in any case, the income of every fifth wage-earner has not improved since the end of the Soviet Union. Professor Yevgeni Yasin of the Moscow Higher School of Economics says Russia has split into two parts. In comparison with OECD countries, the survey recalls quick growth of income disparity; the Gini coefficient for Russia in the past 20 years has risen way faster than in any OECD country, and is on par with Turkey and Mexico.

Consumer purchasing power has mostly grown, but also diminished, depending on the good. Compared to the Soviet era, a consumer could buy 70 % more durable goods in 2008 and 25 % more food. The consumer could also buy two to three times more cigarettes, alcoholic beverages, cars and clothing, but only a third as much services related to housing such as heating and electricity.

Although household wealth has grown, the mere number of traditional household appliances has changed little. On the other hand, the numbers of entertainment electronics devices and cars have skyrocketed. There are currently about 50 cars and 160 televisions per 100 households in Russia. The average amount of living space per capita has risen about 40 % over the past two decades to a current level of about 22 m^2 per capita. In Finland, the corresponding figure in 2009 was 39 m^2 per capita.

Household spending on child care and education, which were provided for free during the Soviet era, has increased substantially. Private health care spending has increased many-fold in real terms. The survey notes that the World Health Organization (WHO) data says private spending constitutes about 40 % of all health care spending, a level above the EU average.

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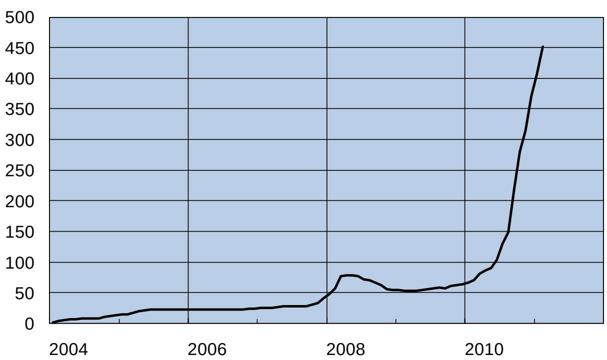
China

Yuan rapidly gains international acceptance. An important sign of yuan adoption is the rapid growth of yuan-based financial services in Hong Kong. Yuan deposits in March climbed about 10 % m-o-m to 451 billion yuan (US$ 69 billion), and were up over five times from April 2010. Growth in yuan currency trading and bond sales remained strong.

The Bank of International Settlements (BIS) reports that one year ago, the yuan's share of international currency trading was less the 1 %, or about the same level as the Russian ruble. The top-traded currency was the US dollar with an 85 % share. The second-place euro had a nearly 40 % share. (Note that a currency may have an up to 100 % share of trading out of a total 200 % as there are always two sides to a currency trading transaction.) The second-tier reserve currencies include the Japanese yen and the British pound which accounted for 10–20 % shares of currency trading. The yuan is now emerging from the small currency group to status that better reflects the world's second largest economy.

Yuan deposits in Hong Kong, RMB billion



Source: Hong Kong Monetary Authority

There are many reasons for the yuan's surge on international foreign exchange markets. These include the opening up of China to foreign investment, steady economic expansion, the gradual lifting of currency controls and expectations of yuan appreciation. Currency controls still fragment international yuan markets into three parts. In addition to the official on-shore market (CNY) and the offshore market based in Hong Kong (CNH), there is considerable indirect trading in the offshore dollar-settled non-deliverable forward market (NDF market). The latest BIS estimates from April 2010 show that the NDF market was double in size relative to the CNY market. The CNH had only about a tenth of yuan trading.

Due to currency controls, the USD/CNH rate has typically been the high side of the spread with the USD/CNY spot rate. Adding the complexity is the "Dim Sum" offshore CNY/RMB bond market in which RMB bonds are issued and settled in Hong Kong. Interest rates on Dim Sum bonds have recently been running about two percentage points lower than interest rates in mainland China, so international firms find such bonds the preferred mode of yuan financing. Corporate bond issues in mainland China declined 15 % last year. This shift in the markets is seen as transient, however. Things will even out as soon as China's official goal of free yuan convertibility is achieved.

Values of Chinese brands gaining in world markets. The *2011 BrandZ Global Top 100* survey based on Millward Brown's Optimor model adds twelve Chinese firms to the list: five in banking, two in insurance, two in telecommunications, two in internet services and an oil company. The world's largest mobile service provider, China Mobile, broke into the top ten, becoming the world's ninth most-valuable brand (brand value estimated at $57 billion).

Five Chinese firms made the list for the first time: China Life Insurance (ranked 33rd); Agricultural Bank of China (43rd); leading instant messaging software Tencent/QQ (52nd); Ping An Insurance (83rd); and China Telecom (91st). Others continuing in the list besides China Mobile were ICBC (11th), China Construction Bank (24th), China's top search engine company Baidu (29th), Bank of China (37th), PetroChina (78th) and China Merchants Bank (97th).

In total, the Chinese companies accounted for about $259 billion, or 11 % of the value of the world's top 100 brands. The top spots in the brand-value list were taken by computer-maker Apple ($153 billion) and search engine giant Google ($111 billion).

Production in China earlier focused on competitive advantage based on low production costs. The current rise of Chinese brands reflects the country's progress up the value chain to high-skill production, increased product reliability and creation of trusted, high-quality brands. The challenge for companies in China is how to cut through the massive number of domestic brands and exploit the rising brand-awareness of Chinese consumers. As a result, companies are grappling with issues related to image-building and innovation in products and services as a path to sustained competitive advantage.

Branding has been China's official government policy since 2004 as part of efforts to promote exports. Most of China's leading brands are controlled by state-owned firms that enjoy state subsidies and a competitive advantage on the domestic market (and sometimes even monopoly status). Even so, the Chinese face a long slog in matching top brands in Europe and North America. Given their large cash reserves, Chinese firms could choose to enter Western markets through corporate acquisitions, but cultural differences have often interfered with the merger process.

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