

Russia

Russia posts large consolidated budget surplus in the first half. Revenues of Russia's consolidated budget, which comprises the federal budget, regional and local budgets, as well as state social funds, have continued their recovery very well since last year. Revenues in the period were up 30 % from 1H10. In real terms, however, revenues were still considerably below the pre-crisis level in 2008.

Consolidated budget expenditures increased 11 %, matching last year's pace of growth. In real terms (CPI adjusted), expenditures were up less than 1.5 %. The increase in revenues pushed the budget surplus as high as above 7 % of GDP. Of that, the federal budget surplus accounted for a little less than 3 % of GDP, while regional and local budgets accounted for an equal amount. The big surplus was not simply due to the pace of spending; indeed, spending in the first half this year is not becoming lower than it typically is in the first half of the year. On September 7, finance minister Alexei Kudrin observed that the federal budget seemed headed for a zero balance in 2011 as revenues are expected to well exceed original budget projections, due e.g. to higher-than-assumed oil prices and improved oversight of the VAT system.

The fastest growing revenue categories in the consolidated budget were mandatory social contributions based on wages, up more than 50 % from 1H10. Social contributions were hiked substantially from the start of this year; however, the government has since decided to reduce social contributions from the start of 2012 (see [BOFIT Weekly 25/2011](#)). Revenues were also lifted by higher prices for energy exports; revenues from production taxes and export tariffs on oil, oil products and gas soared over 40 %. These revenues accounted for over a quarter of consolidated budget revenues and nearly half of the federal budget revenue. VAT revenues grew nearly 40 %, while revenues from corporate profit taxes rose about a third. There was continued rather little growth in revenues from personal income tax and property taxes.

Federal budget expenditures increased 10 %, excluding transfers to regional budgets and state social funds (which, unlike in previous years, declined a bit). Regional and local budget expenditures also increased about 10 %, roughly the same rate as in 2010. While the rapid rise of social funds expenditure slowed, expenditures were still up by nearly a fifth.

The fastest growing spending categories in the consolidated budget were public administration and the economy (14 %), which, like last year, saw considerable increases in funding on e.g. transport and roads. Spending on education rose nearly as fast, after a slow-growth period in 2009–2010. Defence spending growth rose to 11 %. Social spending also grew 11 %, much less than in previous years. Pension spending remained unchanged now, while other social

spending was up by nearly half. Expenditures on national security and law enforcement, as well as healthcare, increased about 6 %. Public spending on housing rose a mere 2 %.

Oil production rises but exports decline. Russian crude oil production has increased on average about 1.5 % a year since 2005. Rosstat reports that in January–July this year, production was up nearly 1 % y-o-y. Russian oil production today slightly exceeds that of Saudi Arabia, which is the second largest producer. Russia exports about half of its crude oil production. Despite the increase in production, however, export volumes have remained roughly the same since 2005 at about 250 million tons a year. Exports of oil products, in contrast, have risen strongly in recent years. In particular, there has been an increase in exports of lightly taxed heavy fuel oil. Last year, Russia exported about 72 million tons of heavy fuel oil and about 41 million tons of diesel oil. Total exports of oil products amounted to about 133 million tons.

Crude oil exports shrank 5 % y-o-y and exports of oil products fell 7 % y-o-y in the January–June period. The contraction in exports largely reflected robust growth in domestic demand. Refining of heavy fuel oil and diesel oil in Russia increased about 7 %, but export volumes contracted sharply (down 8 % and 6 % y-o-y, respectively). The upcoming change in export duties next month (see [BOFIT Weekly 35/2011](#)) should show up in the second half figures as a slight drop in the volume of heavy fuel oil exports and a corresponding increase in the volume of crude oil exports.

Finnish exports to Russia up briskly in the first half. Measured by value, goods exports from Finland to Russia climbed 27 % in the first half from 1H10. If the major re-export goods are excluded (i.e. passenger cars and mobile phones), exports grew at 25 % y-o-y. Even so, the level was still about 15 % below pre-crisis 1H08.

Recovery in exports in the machinery & equipment category continued, with growth rebounding to nearly 30 % (excluding passenger cars and mobile phones). Again, the value of exports was still some 40 % below pre-crisis 1H08. Among the largest sub-categories of machine exports, growth was notably fast as regards exports of power machines and electrical machines. Other categories of exports than machinery & equipment rose over 20 %, recovering to their 1H08 level. Exports in the plastics and rubber branch, for example, grew briskly.

Transit goods from third countries transported through Finland to Russia (which are not recorded as imports or exports) increased in January–June. Road-transported transit goods were up 14 % by volume and nearly 30 % by value. The value of transit goods was €10 billion or about 10 % of Russia's total goods imports. This share has gradually been declining in recent years.

China

Western banks reduce their holdings in Chinese banks.

On August 29, Bank of America reported it was selling off half of its 10 % stake in China Construction Bank (CCB). The sales reflect harsher capital adequacy requirements globally under the Basel Committee for Banking Supervision's latest reform (Basel III). Bank of America will get about €6 billion from the sale. BofA already earlier sold parts of its original stake in CCB, which at one point amounted to 19 % of all CCB shares.

Most available shares of CCB were picked up by Chinese government agencies and entities, including the State Administration of Foreign Exchange (SAFE), China's National Social Security Fund and Citic Securities, China's largest brokerage and subsidiary of state-owned investment bank Citic Group. The Chinese state currently owns 59 % of CCB via Central Huijin, a unit of China's sovereign wealth fund. As a result, no substantial changes in the state's dominant role in CCB are expected. The sovereign funds of Singapore and Qatar also bought smaller stakes in the offered shares.

Foreign banks have been able to acquire stakes in China's large state banks since 2005. Western banks in recent years sold shares in Chinese banks as they struggled with their own economic challenges. For example, UBS and Royal Bank of Scotland sold their stakes in Bank of China, while Allianz and American Express divested their holding in ICBC during the 2008–2009 financial crisis. Goldman Sachs sold part of its stakes in ICBC in September 2010. In many cases, strategic partnerships continue despite the sale of shares.

China gains in international competitiveness ratings.

The World Economic Forum (WEF) released its annual assessment of country competitiveness (*Global Competitiveness Report 2011–2012*) at the beginning of September. China has climbed in the rankings to become the world's 26th most competitive country, up one notch from last year. Russia dropped three places in the rankings to 66th place. The index is compiled from interviews with about 13,000 corporate leaders and competitiveness scores allocated for 12 different criteria. Score weightings are adjusted for each country to take into account economic development.

China's competitiveness is sustained by large markets (2nd in market size) and macroeconomic environment (10th), which was supported e.g. by China's high savings rate. Other competitive advantages included innovation (29th) as well as health and primary education (32nd). A significant improvement was seen in development of financial markets (up 9 places to 48th). China's weak points continued to be technological readiness (77th) and higher education and training (60th), even if it has been moving up slowly in the

rankings. Corporate leaders said their biggest headaches came from inflation and access to financing.

Russia's competitive advantages were market size (8th), infrastructure (48th) and higher education and training (52nd). Russia's competitive weaknesses were institutions (128th), financial market development (127th) and goods market efficiency (128th), which the WEF found particularly disconcerting. Managers complained they were plagued by corruption and inefficient state bureaucracy.

China's share of Finland's foreign trade appears to be settling.

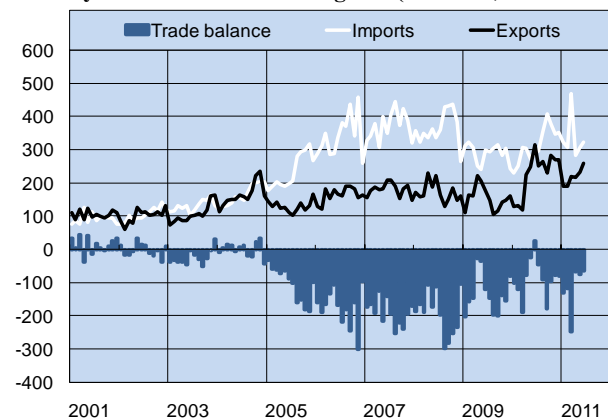
The value of Finland's imports from China climbed to €2.0 billion in January-June, an increase of more than 20 % from a year earlier. Exports to China climbed 12 % y-o-y to €1.3 billion, yielding a trade deficit of €700 million, or over €200 million more than a year ago.

Nearly half of Finnish imports from China are composed of various kinds of electronic devices such as mobile phones, televisions, computers and electrical appliances. Clothing accounts for a 13 % share of imports, and perennially remains an important import category. Transportation vehicles accounted for about 5 % of imports. China provided 37 % of all electronics and over a third of all clothing and footwear imported to Finland.

Finland's exports to China were led by industrial machinery and equipment (36 % of total exports – by far the biggest category) and electrical machinery (14 %). Pulp accounted for 12 % of exports in the first half, while paper was less than 5 %. Nearly a quarter of all of Finland's pulp exports now go to China. Hides and furs represented 8 % of Finnish exports to China in the first half. In that industry, nearly 30 % of exports now go to China.

Despite brisk growth, China is no longer increasing its share of Finnish foreign trade as in previous years. Its share of Finland's total imports fell slightly below 7 % in the first half. Finnish exports to China covered less than 5 %. The combined share of Hong Kong and Taiwan was 0.5 % of Finland's total imports and about 1 % of exports.

Monthly Finland-China trade figures (€ million)



Source: Customs Finland