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BOFIT Weekly

38 • 23.9.2011

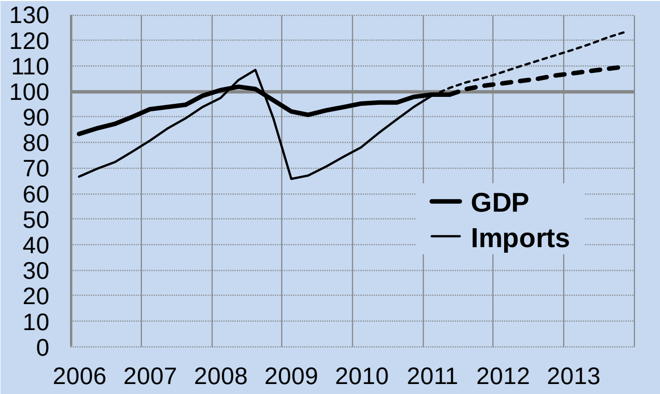
Russia

BOFIT forecast sees relatively strong, but slowing, economic growth ahead for Russia. In the latest BOFIT forecast for Russia, GDP keeps on climbing rather briskly, even with a mild slowdown over the next two years. The Russian economy is expected to return to the pre-crisis GDP level of 2008 as soon as this autumn.

BOFIT forecasts Russian GDP will grow at a rate of nearly 4.5 % p.a. this year and next year, before slowing to below 4 % (i.e. close to the trend growth) in 2013. The average oil price assumption has an important impact on the growth forecast as the Russian economy remains rather dependent on the price of crude oil. In our latest forecast, we assume a slight decline in the world price for crude oil over the forecast period. The assumed average price of $110 a barrel in 2011 slides to $105 a barrel in 2013.

Imports to Russia are forecast to rise rapidly in coming years, although their growth rate will slow. Rising domestic demand continues to drive strong growth in imports, but this growth to some extent reflects recovery from the recent recession. As a result, imports still rise nearly 20 % this year but as the situation normalises in 2012 and 2013, import growth will slip below 10 % a year. The volume of imports will surpass the 2008 pre-crisis peak level sometime this winter.

GDP and import volume, 2008=100



Sources: Rosstat, BOFIT forecast 2011–2013

Most of the caveats for the current forecast concern the downside risks. Deterioration of the international economic situation can cause crude oil prices to drop along with prices of Russia's other main export commodities. A modest reduction in the volume of Russian exports can also be possible, as well as a decline in capital inflows into Russia. Uncertainty in the global economy can make Russian consumers more cautious and increase uncertainty among investors. Both occurrences would hurt domestic demand.

CBR adjusts key interest rates. On September 15, 2011, the Central Bank of Russia lowered some of its credit rates by 25 basis points and raised deposit rates by 25 basis points. The CBR's main monetary instrument, the minimum auction-based one-day repo credit rate currently stands at 5.25 %. Longer-term minimum repo credit rates were also lowered. The CBR kept the overnight credit rate and its largely symbolic refinancing rate at 8.25 %.

Along with auction-based credits, the CBR provides banks with fixed-rate loans as needed at rates above auction rates. Banks typically resort to fixed-rate credit in circumstances when standard financing is not sufficient. The CBR e.g. grants loans of up to three months with a 7 % interest rate. The loans can be collateralised with non-traded securities (e.g. corporate paper) while other central bank financing requires the borrower to put up market-traded securities as collateral. This form of financing eases access to credit of in particular smaller banks. In August, the central bank introduced a new 3-month credit that can be backed by gold. The credit carries an interest rate of 6.75 %. It seems, however, few banks can actually offer gold as collateral.

The CBR has been criticised for providing a baroque palette of credit instruments distinguished e.g. by interest rate, maturity and required collateral. As rate changes usually only affect some instruments, the effectiveness of rate changes in monetary policy suffers due to reduced signal value and impact. The CBR justifies its wide selection of instruments by the high heterogeneity of the banking sector. Instruments are designed to influence specific parts of the market. Some banks, for example, lack access to the interbank money market. The CBR's position on the issue seems to be evolving; it recently shortened its instrument menu by phasing out certain longer-term credit formats.

In conjunction with credit rate cuts, the CBR raised deposit rates so that the one-day and seven-day central bank deposits now carry a rate of 3.75 %. The interest rate decisions narrowed the margin between CBR credit and deposit rates, which has been relatively big (even if it has shrunk in recent years). The CBR has moved to reduce the credit/deposit margin to stabilise fluctuations in market rates, which have been large in particular when the banking sector has encountered tight liquidity situations. Observers expect a tightening in liquidity if the international financial situation continues to deteriorate. Reduction of interest-rate margin is also seen as a step towards the central bank's goal of increasing the role of interest rates in steering monetary policy.

The last interest rate adjustment was in late May. The CBR board is set to meet again at the end of October to decide on possible monetary policy measures.

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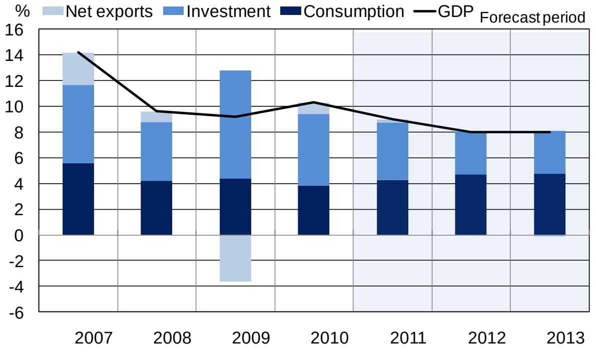
China

BOFIT forecasts gradual slowing of Chinese economic growth. China's gradual tightening of monetary policy over the past year to fight inflation has had the expected effect of a mild slowdown in economic growth. Growth overall, however, remains strong. The latest BOFIT forecast for China sees GDP growth of 9 % this year. In 2012 and 2013, BOFIT expects annual growth to decline to 8 %. The forecast assumes that the economic slowdown and uncertainty in Europe and the US do not escalate further, as these economies together take 36 % of Chinese exports.

China's growth continues to be based on investment – currently the equivalent of 45 % of GDP! While private consumption's share is currently below 35 % of GDP, consumption is expected to play a greater economic role in coming years. The assumption of higher consumption share is supported by the annual 9 % growth in real wages and the political pledges to sharply hike minimum wage levels. The volume of China's foreign trade should climb about 10 % a year during 2011–2013. Strong domestic demand should keep imports growing slightly faster than exports. Thus, foreign trade (net exports) will make a relatively small contribution to economic growth (see chart). China posted a current account surplus of 5 % of GDP last year. In the next three years, the current account surplus may shrink slightly.

GDP growth and contributions of demand-side factors, %



Sources: CEIC, BOFIT

Despite the monetary tightening of the past year, inflation continues to run at around 6 % p.a. The robust economic growth and strongly negative deposit rates mean any relaxation of monetary policy is unlikely in the near future even with the dark outlook for the global economy. A stronger yuan exchange rate, in contrast, would calm price pressure and promote structural change by bolstering household purchasing power.

Beyond the turbulence in the global economy, China's outlook is clouded by problems in its housing sector and the rapid indebtedness of local administrations. Supervision authorities must also deal with the deregulation of money markets and currency markets.

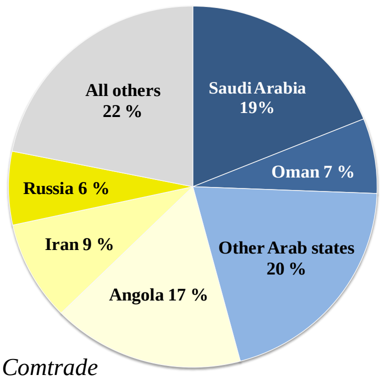
Oil accounts for most of China's imports from North Africa and the Middle East. For the Chinese economy, the biggest worries emerging from the recent unrest in North Africa and the Middle East are security of oil supplies and potential increases in world oil prices. About 45 % of China's crude oil imports come from North Africa and the Middle East. After the US, China is the world's second largest consumer of oil. China's domestic oil production today only covers about half of its consumption.

Oil and petroleum products account for over three-quarters of China's imports from Arab countries in North Africa and the Middle East. Among these countries, Saudi Arabia is China's most significant trading partner. Crude oil imports from Saudi Arabia last year accounted for 19 % of China's $135 billion in oil imports. Oman, Sudan, Iraq, Kuwait and Libya also rank among China's top ten oil suppliers. China's imports from Arab countries in 2010 were valued at $67 billion (5 % of China's total imports). China's exports to these countries were $63 billion (about 4 % of total exports). The biggest export categories were machinery & equipment and electronics.

China is eager to promote cooperation in the region, especially with the oil-rich Arab states of the Persian Gulf. China has bilateral trade agreements with all Arab states. In May this year, the second round of talks between China and the Gulf Cooperation Council (GCC) was held, in which also a free-trade agreement was discussed. GCC members include Bahrain, Kuwait, Oman, Qatar, Saudi Arabia and the United Arab Emirates.

Economic cooperation with China provides Arab states with an alternative to Western investment. China has long practiced a policy of non-interference in the region's internal conflicts. Recent political unrest in the region, however, is seen as a challenge for this policy as China occupies the world stage through increasing presence in trade relations and greater investment in conflict countries.

Breakdown of China's crude oil imports by country, 2010



Source: UN Comtrade

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