EUROJÄRJESTELMÄ
EUROSYSTEMET

BOFIT Weekly
15 • 13.4.2012

Russia

Inflation rate hits record low in March. March 12-month inflation was a mere 3.7 %, sharply below the 6.1 % rate registered in December 2011 and 9.5 % in March 2011. After periods of extremely high inflation in the 1990s, Russia's inflation rate has subsided steadily as the economy stabilised, macroeconomic conditions improved and officials got a handle on fiscal and monetary policy tools.

The current lull in inflation is likely to be short-lived, however, as it is largely the result of a political decision to postpone this year's scheduled hikes in regulated rates for municipal services until July (such rate hikes typically enter into force in January). In addition, annual increases in some excise taxes were divided into two steps: e.g. the excise tax on alcohol was increased 10 % in January, while a further 20 % hike takes place at the beginning of July.

Unofficial means for price regulation of certain products have been applied as well. For example, oil refineries agreed with the government to refrain from hiking wholesale prices of gasoline until March. Electrical power producers also agreed to hold back temporarily on hikes in wholesale prices of electricity. The price freeze meant that March retail prices for gasoline were unchanged from December. Since the presidential election in early March, producers have begun to gradually increase wholesale prices for gasoline and retail prices are expected to follow soon.

The government's official inflation target this year is 5–6 % at year's end. Central Bank of Russia chairman Sergei Ignatyev said hitting this target will be quite difficult with the upcoming hikes in regulated rates this summer. Many observers expect Russian inflation rate will exceed 6 % at year's end.

Capital outflows from Russia remain strong. Preliminary CBR balance-of-payments figures show the net value of private-sector capital outflows in the first quarter amounted to $35 billion, about as high as in the fourth quarter of 2011. Officials seemed caught off guard by the persistence of capital gushing from the country in the first quarter.

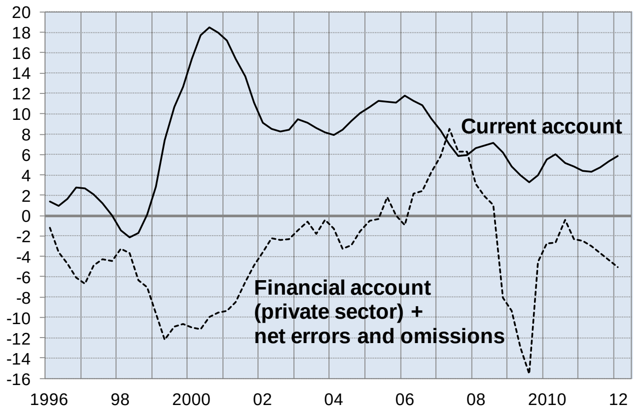
Capital outflows during the past six months equalled about 8 % of GDP for the period. For the past four quarters, capital exports amounted to about $96 billion or around 5 % of GDP. Russia has only seen capital exports at considerably higher levels twice in recent history: during the 1998 Russian financial crisis and during the 2009 global recession.

A substantial share of capital exports show up in the balance-of-payments reporting as "doubtful transactions" and as "net errors and omissions." The transactions consist of phoney export or import deals that allow the export of earnings and evasion of tax liabilities. These "grey" capital exports continue to be significant. In the past four quarters, they exceeded $45 billion, i.e. 45 % of net capital exports were categorised as grey.

First-quarter foreign direct investment into Russia's enterprise sector was down from 1Q2011, while DI outflows from Russia abroad were essentially unchanged (excluding the banking sector for which the CBR releases separate figures). Over the past couple of years, DI outflows from Russia have been much bigger than FDI inflows into the country. In the past four quarters, Russian DI outflows amounted to roughly $70 billion and FDI inflows into Russia were $44 billion. In addition, repatriation of portfolio investment in Russia picked up. Borrowing of Russian firms on international markets continued ($27 billion in the past four quarters).

Banks exported about $33 billion in net terms during the past four quarters. This notable outflow of capital from the banking sector increased in the first quarter. However, capital export statistics include also domestic transactions involving loans from Russian banks to large Russian firms that are registered abroad.

Current account balance and balance-of-payment figures for private sector net capital inflows, % of GDP, average of last four quarters



Sources: CBR, Rosstat

Russia has been a net capital exporter for most of the past 10 years. Some observers explain this as a reflection of the fact that the domestic economy lacks sufficient investment opportunities to absorb the flood of export earnings. In other words, Russia's capital exports indicate structural issues in the economy, the lack of adequate infrastructure and a weak investment climate. Russian firms prefer to ship capital abroad where they enjoy better property protection and lower investment risk. Russian firms and households have recently been particularly active in real estate deals abroad.

Editor-in-Chief Seija Lainela

Bank of Finland • Institute for Economies in Transition, BOFIT
P.O. Box 160 • FI-00101 Helsinki
Phone: +358 10 831 2268 • Email: bofit@bof.fi • Web: www.bof.fi/bofit

SUOMEN PANKKI FINLANDS BANK
EUROJÄRJESTELMÄ
EUROSYSTEMET

BOFIT Weekly
15 • 13.4.2012

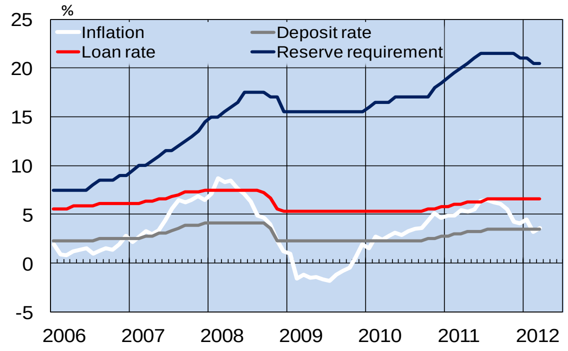
China

Inflation picked up in March; cautious easing of monetary stance. China's National Bureau of Statistics reports consumer prices rose 3.6 % y-o-y in March. Although inflation accelerated slightly from February, the pace of inflation was well below 2011 levels (as recently as last September inflation was running above 6 % y-o-y). The lion's share of inflation was driven by rising food prices, while non-food prices increased only modestly. China has an official 4 % inflation target this year – a target generally considered realistic. Producer prices were lower in March compared to a year earlier, so they exert no inflationary pressure on consumer prices.

Falling inflation and weakening growth prospects gave the National People's Congress this March sufficient latitude to declare a shift in the emphasis of economic policy this year from inflation-fighting to bolstering economic growth. To stimulate economic growth, the People's Bank of China has eased lending guidelines for commercial banks and lowered reserve requirements for all commercial banks by a half-percentage-point in both December and February. The PBoC announced last month it was lowering the reserve requirement for over 500 bank branches that deal with providing finance for the agricultural sector.

Although the PBoC has not adjusted reference rates since last July, in public there has been discussion about lowering reference rates and even phasing out interest-rate regulation altogether. By setting a ceiling on deposit rates and a floor on credit rates, the PBoC currently guarantees commercial banks a minimum profit margin. Such rate regulation reduces the possibilities of banks to compete. This practice is rare elsewhere in the world, as is the Chinese practice of setting branch-specific reserve requirements. China is finding that such micromanaging of monetary policy is increasingly difficult as it proceeds with market reforms.

Inflation and key monetary policy instruments, %



Sources: NBS and PBoC

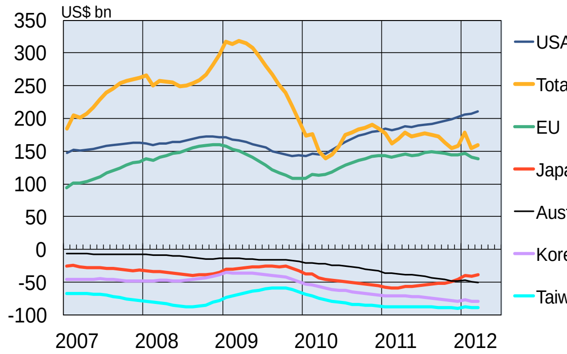
United States now tied with EU as China's top export destination. The overall trend of China's foreign trade in the first quarter provides no particular surprises. Despite wide swings around Chinese New Year, the picture concerning first-quarter trade developments was more or less as expected. Exports and imports climbed 7–8 % y-o-y in 1Q2012. Just as in 1Q2011, trade was overall near balance.

Growth in imports of raw materials and energy was strong throughout the first quarter of 2012. Although the volume of steel imports were down nearly 20 % y-o-y in the January-March period, the volume of iron ore imports was up 6 %. Copper imports were up 50 % and aluminium imports up nearly 40 % y-o-y. The volume of crude oil imports climbed 11 % y-o-y. The value of imports of machinery and equipment was about the same as in 1Q2011, indicating a slowing in the growth of investment demand.

The performance of China's exports proves some clues on the unevenness of the global recovery. For example, growth in exports to the US and Japan were in double digits, while there was practically no growth in exports to European markets. Exports to Germany and France were essentially unchanged from a year earlier. The value of exports to Italy fell by nearly a third, and exports to Spain were down. Europe and the United States each accounted for over 17 % of China's exports in the first quarter. Japan, China's third largest export destination, bought over 8 % of China's exports.

As of end-March, China's 12-month trade surplus amounted to approximately $160 billion. The bilateral trade surplus with the US was $210 billion and appeared to be growing, suggesting that the issue of the US trade imbalance with China will likely get greater play as the US presidential election approaches. China's trade surplus with the EU has contracted slightly to around $140 billion.

China's trade balance with its main trading partners, 12-month running total, US$ billion



Source: Macrobond

Bank of Finland • Institute for Economies in Transition, BOFIT
P.O. Box 160 • FI-00101 Helsinki
Phone: +358 10 831 2268 • Email: bofit@bof.fi • Web: www.bof.fi/bofit

Editor-in-Chief Seija Lainela