BOFIT Weekly
19 • 11.5.2012

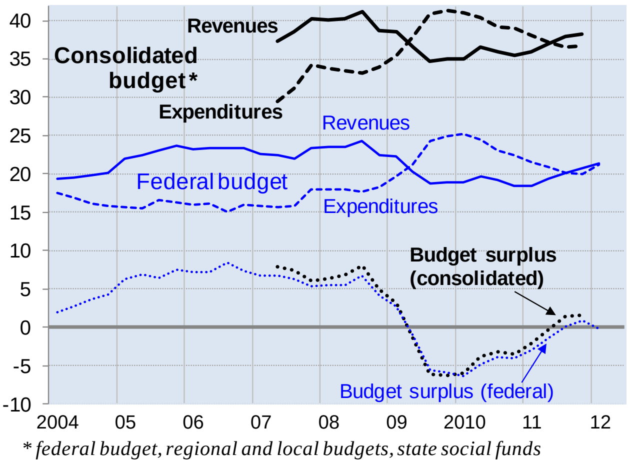
Russia

Government finances may be close to balance this year. The finance ministry says in the draft federal supplemental budget for this year, recently discussed by the cabinet, that the budget would produce just a tiny federal budget deficit this year (0.1 % of GDP). If the pattern of previous years holds, overall state finances, i.e. consolidated budget (federal budget, regional and local budgets, plus state social funds) would also be close to balance.

The reduced deficit projection reflects substantially higher-than-expected revenue growth relative to the budget forecast approved last December. The revised revenue estimate is largely driven by the assumption that the price of Urals-grade crude oil will average $115 a barrel this year rather than the original budget assumption of $100 a barrel. The additional revenue over the original federal budget amounts to over 1 % of GDP. In nominal terms, revenues would be up more than 10 % from last year.

Naturally, a budget balance this year will also require that budget spending does not increase much from the spending approved in December. The fresh supplemental federal budget draft (the only one so far this year) will only slightly add to spending (though from 2011 it is up 17 %).

State budgets: revenues, expenditures and surplus, % of GDP, average of last four quarters



Source: Ministry of Finance

Tax policy guidelines for 2013–2015 take shape. The cabinet last week approved a taxation policy framework, although some modifications may arise when drawing up the state budget policy framework for the 2013–2015 period. The three-year state budget guidelines are made every year, published usually in July and considered by the cabinet in September. In fact, taxes may be adjusted e.g. from year to year as needed.

The fresh tax policy framework does not deal with the level of taxation as regards the largest tax revenue streams (i.e. value-added tax, labour income tax, and corporate profit tax), and these are generally expected to remain unchanged. Moreover, the policy does not discuss oil production fees, or export tariffs on oil and gas. The mandatory social contributions for employers on worker wages, which represent 17 % of total state revenues, would remain at the current level of 30 % of the gross wage. During the past year, officials have made suggestions to hike the social contributions after 2014. The finance ministry notes the social contributions may still be affected by pension reform, expecting to see the pension reform plan this year.

The natural gas production fee, which presently generates less than 1 % of state revenues, would be doubled for Gazprom and quadrupled for other producers. This would effectively unify the production fee rates paid by Gazprom and other producers. The fee would be just over 1,000 rubles ($35) per thousand cubic metres in 2015. The average price for exported gas from Russia in the first two months of this year was about $350 per 1000 m³.

Hikes in excise taxes on motor fuels, tobacco, as well as beer, wine & spirits will continue through 2015, when the excise on tobacco and alcohol should be 2–2.5 times as high as currently. Taxes on expensive privately owned real estate and high-volume cars will also increase.

Putin's promise about tax breaks spurs wave of joint oil development projects with international firms. During his final days in the role of prime minister, Vladimir Putin oversaw the creation of three major joint ventures with state oil company Rosneft for development of arctic oil and gas resources. In mid-April, then prime minister Putin publicly promised that new continental shelf projects would enjoy exemptions from export tariffs and substantial reductions in other tax obligations. Thereafter, Rosneft announced three joint ventures in rapid succession. The ventures to identify and develop arctic hydrocarbon deposits involve the American ExxonMobil, the Italian Eni and the Norwegian Statoil. Although the promised tax breaks have yet to be enshrined in law, the prime minister outlined the needed amendments in a decree on May 3.

The three agreements should bring a substantial infusion of international expertise and investment to discovery and development of hydrocarbon resources in Russia's arctic regions. Moreover, the deals enhance Rosneft's position as Russia's premier oil producer. Under the deals, Rosneft provides the joint ventures with licences to explore certain areas and the foreign partners contribute their expertise and capital. Rosneft will hold a majority stake in each joint venture, and the agreements grant Rosneft to gain knowledge also by participating with its partners in projects outside Russia.

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

BOFIT Weekly
19 • 11.5.2012

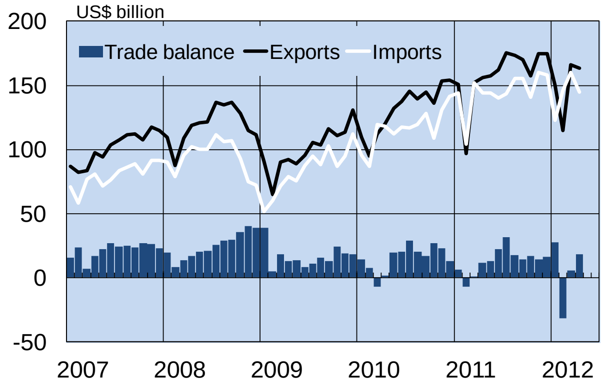
China

Trade surplus swells on slowing import growth. China's overall foreign trade growth in April was lower than expected, reflecting Europe's ongoing difficulties and the gradual slowing of the Chinese economy. Nevertheless, the value of China's goods exports in April was still $163 billion, up 5 % from a year earlier. Imports of $145 billion in April were essentially unchanged from year earlier. Adjusted for seasonal factors, the import performance looks particularly poor. However, it was largely attributed to lower commodity prices, above all metal prices, which were down substantially from last year. Volumes of commodity imports, in contrast, continued to rise.

The trade surplus surpassed $18 billion in April. The cumulative surplus for the first four months of this year reached $20 billion, up from $11 billion in the same period last year.

The slowing growth in foreign trade was evident in both traditional trade sectors and assembly industries (which accounted for roughly 40 % of exports in January-April). Many Asian countries have recently noted slowdowns in export growth.

China's exports, imports and trade balance, US$ billion



Source: Bloomberg

Mobile phone subscriptions surpass one billion. In the first quarter 2012, the number of mobile phone connections in China increased 14 % y-o-y to over one billion. The number of land line subscriptions, in contrast, dipped to below 300 million.

Smartphone internet use has soared. Last year, 3G (third generation) connections increased 146 % to 150 million connections. China only introduced Internet-enabling 3G services in 2009, so the high growth for smartphones should continue. 4G services, which give full broadband connectivity, are now being introduced on a trial basis. China needs new investment to develop its mobile phone networks as data transfer rates on mobile phones in average are ten times slower than in the developed world.

China Mobile, which provides over two-thirds of all Chinese mobile phone connections, is by far the world's largest mobile phone operator. Its main competitors are the dominant land-line provider China Telecom and the fast-growing China Unicom. The Chinese state is the majority shareholder in all three companies.

Samsung has recently found particular success on the Chinese mobile phone market, gobbling up nearly 25 % of market share according to Gartner Inc. China's former market leader, Nokia, has seen its market share dwindle to below 20 % and now has the second largest market share. Huawei and ZTE, China's own mobile phone giants, hold third and fourth place, each with market shares on the order of 10 %. Fifth-ranked Apple now has a market share surpassing 7 %.

The increasing adoption of smartphones has caused an explosion in the market for phone applications, particularly mobile gaming. China has become a critical market for game-makers. For example, the Finnish Rovio, developer of Angry Birds, reports that China is now its second largest market after the United States. Net sales of China's own mobile gaming industry grew nearly 50 % last year to 3.9 billion yuan (€480 million). China also exports mobile applications abroad, especially to markets in Korea and Japan.

Chinese hoard gold. Figures from the World Gold Council show that China was the world's second largest gold consumer after India in 2011. China, however, is on track to become the world's biggest gold consumer this year as Chinese gold buying has been rising rapidly in recent years, while Indian growth has been much lower. In the first quarter of the year, Chinese buying remained strong: Chinese gold purchases from Hong Kong were up many times from a year ago. About half of the world's gold is consumed by jewellery making, while 40 % goes to investment and 10 % to industrial applications.

Most gold in China is purchased by private consumers and investors. IMF figures show China's gold and foreign currency reserves contain 1,054 metric tons of gold, which the central bank has increased last time in 2009. China's central bank is the world's fifth largest gold owner after the US, Germany, Italy and France.

In addition to buying gold abroad, China has been the world's largest gold producer since 2007. China last year produced 360 tons of gold, or nearly 13 % of global production. China's declared gold reserves are the world's third largest.

The value of gold traded on world markets has reached record levels in recent years. Gold is seen as a secure investment and demand for gold tends to rise whenever the global economy struggles.

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