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BOFIT Weekly

37 • 14.9.2012

Russia

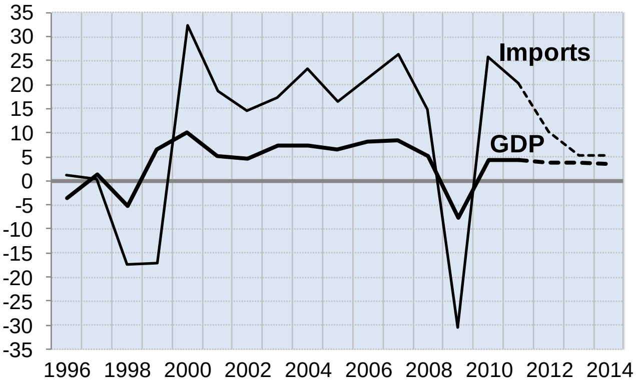
BOFIT forecast sees Russian economic growth slowing but still relatively high. Having recovered to the pre-crisis levels of 2008, the Russian economy continued to expand rapidly in the first half of the year. GDP grew at a 4.5 % annual rate. Imports increased fairly well, although growth tapered off in the second quarter.

The latest BOFIT forecast for 2012−2014 sees the Russian economy growing at over 3.5 % per annum this year and next, before slowing slightly in 2014. The oil price is assumed to decline just under 10 % during the forecast period. Russian imports have rebounded sharply from the 2009 recession; import growth is expected to moderate to around 10 % this year and around 5 % in 2013 and 2014.

Growth in private consumption will slow slightly, but remain relatively brisk. Consumption is supported e.g. by hikes in public sector wages. The recovery in fixed investment is expected to slow slightly this year due to global uncertainties, but should begin to gather steam next year. The volume of Russian exports will increase very slowly, reflecting oil production constraints and rising domestic demand that will limit further increases in exports of crude oil and petroleum products. Projections for growth of natural gas exports in the next few years have been lowered.

Most of the risks in the forecast are on the downside. Increased troubles in the global economy could cause a drop in the oil price and weigh on Russian export volumes, as well as hurt Russian consumer confidence and postpone investments. If food prices continue to rise for an extended period, it would add to loss of consumer purchasing power. On the other hand, uncertainties over global oil supplies could cause a rise in the oil price that would benefit Russia.

Growth of Russian GDP and import volumes, BOFIT forecast for 2012–2014, %



Sources: Rosstat and BOFIT

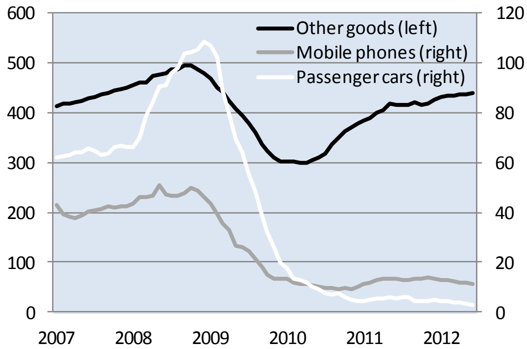
Fixed investment remained focused on the energy sector in the first half. The overall volume of fixed investment rose nearly 12 % y-o-y in the first half of 2012. As in previous years, investment growth in energy outpaced general investment growth, with investments in oil and gas production rising nearly 20 % y-o-y, electricity production 15 % and oil refining over 40 %. After a boom during the past couple of years, investment in energy pipeline infrastructure dropped. Nevertheless, the energy sector retained a 44 % share of fixed investments, unchanged from a year earlier (these part-year fixed investment figures do not include investment by small businesses or in the grey economy). That share in total fixed investments is smaller, a third in 2011, up from around 25 % in 2008.

Fixed investment in manufacturing (excluding oil refining) exceeded 10 % growth in 1H2012, the highest pace in several years. Its share of fixed investments rose to 14 % (excluding small business and grey economy investment). Its share of total fixed investments was 11 % in 2011, down from 14 % in 2008.

Modest first-half growth in Finnish exports to Russia. In the first half of 2012, the value of Finnish exports to Russia increased 5 % y-o-y. The growth in exports was especially boosted by a nearly 20 % increase in machinery exports. Exports of textiles and metals grew even slightly faster. In contrast, exports of chemical products contracted slightly in 1H2012, due to a drop in pharmaceutical exports. The biggest declines continued in the categories of electrical equipment and car exports which were mainly due to changes in transport routes. Especially car exports to Russia are practically re-exports of cars manufactured in a third country. The lion's share of cars imported to Russia via Finland, however, are classified as transit freight. The volume of cars shipped as transit freight through Finland also contracted nearly 40 % y-o-y in 1H2012, causing an overall decline in transit freight of 10 %.

Finnish imports from Russia fell 12 % y-o-y in the first half mainly due to lower commodity prices. Russia remained Finland's top source of imports in the period, accounting for over 17 % of Finland's total imports.

Finnish exports to Russia of mobile phones, automobiles and other goods, € million (12-month moving average)



Source: Customs Finland

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China

BOFIT China forecast sees lower economic growth ahead. The latest GDP figures released by the National Bureau of Statistics show a slowdown in China's annual growth to 9.3 % in 2011. BOFIT forecasts deceleration of Chinese economic growth will continue, with GDP growth falling to 8 % in 2012 and 2013, and to 7 % in 2014.

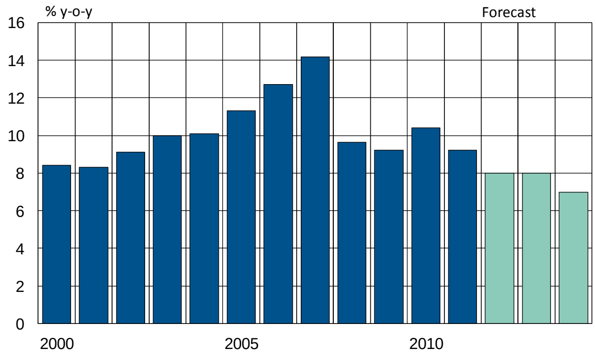
China's on-year GDP growth slowed in the first six months of this year to 7.8 %, and even in August there were still no signs of the expected pick-up in growth. Industrial output growth tapered off significantly in the spring, but still remained at about 9 % for the summer months. Growth in the service sector, on the other hand, has been relatively stable, with retail sales holding at 11 % y-o-y real growth. Fixed capital investment growth also signals relatively stable domestic demand.

Deterioration of the global economy, particularly the problems in European export markets, directly influenced the moderation of growth in the Chinese economy. Although officials relaxed monetary policy in spring and early summer, China's leaders have been cautious about moving ahead with a second round of economic stimulus. The main reason is that the stimulus package of 2008–2009 led to excessive bank lending that has created widespread debt problems and uncertainty in real estate markets. An interesting issue is how the timing of stimulus measures is influenced by the upcoming transition of power as China's new president and premier are slated to take their posts next spring. The BOFIT forecast for China sees the leadership moving ahead with stimulus measures that boost economic growth to around 8 % this year and next.

Growth in coming years will be constrained by China's massive resource needs and structural aspects of the economy. Commodity markets cannot support earlier high levels of demand growth without a major increase in raw material prices, and also environmental problems will increasingly restrain growth. The halt and coming decline in the working-age population implies that China's labour markets will be unable to support growth as in the past. Moreover, China's investment-driven model has reached the end of its road.

Although the BOFIT forecast for China, particularly for 2013–2014, is below the consensus outlook, it is quite benign given the challenges China faces. Below-forecast growth constitutes a real risk. China's investment ratio has now reached 46 %, so the associated danger of overcapacity has become a central concern in many circles. Any significant drop in investment at this point would cause an immediate and substantial drag on economic growth. Adding to concerns is the fallout from excessive bank lending during the previous round of stimulus and deterioration in the global economy. The difficult task of managing liberalisation of the economy together with political developments ensures that interesting times undoubtedly lie ahead.

China's GDP growth and BOFIT forecast for 2012–2014



Sources: China National Bureau of Statistics, BOFIT

Oil and lower commodity prices lead to a contraction in the value of imports in August. The value of China's imports in August was $151 billion, nearly 3 % less than in August 2011. In July, imports were still growing at a rate of 5 % y-o-y. The contraction was largely caused by a collapse in the volume of oil imports and a decline in commodity prices.

The volume of crude oil imports to China dipped 13 % y-o-y, completely reversing the 12 % y-o-y growth posted in July. Just 18 million tons of crude oil was imported to China in August, the lowest level seen since October 2010. The value of oil imports fell 21 % y-o-y. The difference between value and volume reflects a decline in the price of imported oil.

The volume of iron ore imports rose 6 % y-o-y in August (6 % y-o-y in July as well). Despite the increase in volume of iron ore imports, their value fell 21 % y-o-y as the import price has continued to drop since last December. Among other critical raw material imports, the growth in the volume of copper imports slowed to 5 % y-o-y, even as the import volume in July was still up 20 %. The value of copper imports declined 12 %, while the value of aluminium imports continued to soar.

China's exports overall were up 3 % y-o-y in August, and had a total value of $178 billion. The growth in exports marked a slight pick-up from July's 1 % growth figure. However, exports to China's key markets in the EU and Japan both continued to show substantial on-year declines.

Due to the contraction in imports and the modest growth in exports, China's foreign trade surplus in August was $27 billion, making the cumulative trade surplus for the year $121 billion in August. In the January-August period in 2011, the trade surplus was $95 billion.

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