EUROJÄRJESTELMÄ
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BOFIT Weekly
1 • 4.1.2013

Russia

New leg of ESPO pipeline commissioned. Russian oil pipeline operator Transneft commissioned the second part of the Eastern Siberia–Pacific Ocean (ESPO) pipeline on Christmas Day (25 December). Phase 2 runs from Skovorodino near the Chinese border to the Port of Kozmino on the Pacific coast near the Russian city of Nakhodka. The operational first leg of the pipeline, ESPO1, runs from oil fields in eastern Siberian to Skovorodino. The opening of ESPO2 means that more expensive rail shipment of oil to the Kozmino oil terminal can be phased out. Pipeline capacity overall also rises as the capacity of the ESPO1 trunk pipeline has also been raised.

Russia has given high priority to boosting oil supplies to growing Asian energy markets, for which the ESPO pipeline is constructed. Some 15 million tons of crude oil coming through the ESPO1 pipeline continues to be diverted annually from Skovorodino to China. The rest will continue on to the Kozmino terminal, and from there loaded onto tankers and shipped mainly to the United States, Japan and China. The pipeline's annual capacity of 45 million tons corresponds to about a fifth of Russia's current oil exports.

The ESPO pipeline helps Russia diversify oil exports in particular from newly developed fields in northwest Siberia. The European Commission is concerned about the effect of the ESPO pipeline on oil deliveries to Europe via the Druzhba pipeline running through Belarus and Ukraine. In December, as part of the EU-Russian energy dialogue, the European Commission requested that Transneft disclose details of its investment plans. Since the opening of the Ust-Luga oil port in the Gulf of Finland last March, the volume of oil moving through the Druzhba pipeline has diminished and occasionally caused problems e.g. for oil refineries in the Czech Republic.

Russia hopes to use the ESPO pipeline to encourage regional development in Russia's Far East. The pipeline will deliver oil to the region's operating refineries as well as new refineries under construction.

Project to enhance Russia's appeal to investors has yet to improve business environment. Last month, economy minister Andrei Belousov reported to the cabinet on progress in increasing Russia's attractiveness to investors under a plan approved last spring. The "roadmaps" set goals and define measures to e.g. improve the functioning of the construction industry, make customs procedures more efficient and increase company access to energy.

The roadmaps are meant to help in attaining goals set by president Vladimir Putin, which would take Russia from 112th place to the top 20 countries in the world for business by 2018 as measured on the World Bank's annual *Doing Business* survey.

Belousov said the reforms have been the slowest in the construction sector. As of end-2012, the Duma should have approved 16 amendments to laws to improve the situation. Only two had been approved. Companies report that one of the biggest problems for them is getting building permits.

Amendments to laws regulating customs operations have seen some progress, even if their impacts have been marginal. A survey of companies dealing with customs found that 70 % of respondents had not noticed any speed-up in customs transactions last year.

Belousov claimed tangible improvements in access to the power grid. From the start of next year, companies should be able to connect to the grid more quickly. A timetable for gradual cuts in connection costs is under preparation.

Russian-Belarus-Kazakhstan customs union takes protectionist measures to deal with increased imports. The tri-nation customs union commission announced last week that it was imposing a temporary hike in the import duty for combine harvesters to 27.5 %. The tariff had just been lowered to 5 % in autumn as part of Russia's WTO membership. Pre-accession import duties were 15 % for new harvesters and 25 % for used.

The commission justified the hike by a spike in imports and loss of market share of domestic harvesters. The bulk of imported harvesters come from manufacturers in Belgium, Germany and the United States.

The temporary duty will enter into force at the end of February and remain in force until early July. Under WTO rules, a country can temporarily restrict imports when it causes severe damage to domestic producers. The customs union commission is currently studying whether the current case involves dumping. After the investigation, final measures will be considered.

Russia is also considering protectionist measures for other domestic branches affected by lower import duties under WTO membership. Rules are currently being drafted for e.g. restrictions on foreign pharmaceutical manufacturers in public procurements. A draft resolution would allow the exclusion of a foreign-made medicine if at least two domestic similar medicines are listed in official pharmacopeia. Under Russia's WTO commitments, the highest import duties on pharmaceuticals would fall from the current ceiling of 15 % to no more than 6.5 % in 2014. Foreign-made pharmaceuticals account for a substantial share of the market in Russia. For example, about 70 % of medicines purchased by hospitals are supplied by foreign manufacturers.

The agriculture ministry reports that imports of meat and dairy products rose substantially since autumn. In autumn, the import tariff e.g. on pork products was cut from 15 % to zero on imports within the quota, and the average duty on dairy products fell from 25 % to 15 %.

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China

China's growth prospects for 2013 improving. The two just-released readings of manufacturing purchasing manager indexes (PMI) suggest slight improvement in December. The official index reading was 50.6, the same as in November, and the third month in a row the index reading was above the critical 50-point mark. The parallel HSBC China manufacturing PMI was up a point to 51.5, its highest reading in 19 months. The HSBC index gives greater weighting to smaller firms than the official PMI. Both surveys indicate current growth is driven by domestic demand; there were no signs in either index of a pick-up in export orders.

China's official non-manufacturing sector PMI for December rose slightly from November to 56.1. The expansive trend in the service sector highlights the importance of domestic demand at the moment.

The outlooks suggest better economic times ahead this year. The World Bank's latest forecast published in mid-December sees China's GDP growth accelerating from 7.9 % in 2012 to 8.4 % in 2013. Previous World Bank forecasts anticipated economic growth some tenths of a percentage point lower. The pick-up in growth reflects implementation of public investment programmes last autumn and gains in household incomes.

The World Bank sees only modest price pressures currently in China; it predicts the average inflation rate will accelerate from last year's below 3 % to slightly over 3 % in 2013.

Due to uncertainty in export markets and the strong growth in real wages now driving domestic consumption, the World Bank expects the current account surplus to contract this year to 2.2 % of GDP. The 2011 current account surplus was 2.8 % of GDP. The World Bank estimates China's 2012 current account surplus was 2.3 % of GDP.

Over the longer term, China's shift to consumption-driven growth combined with a reduction in the labour supply will reduce the growth potential of its economy. The World Bank forecasts 8.0 % growth for China in 2014.

GDP growth forecasts for China released in December, %

	2011	e2012	e2013	e2014
World Bank	9.3	7.9	8.4	8.0
CICC	9.3	7.7	8.1	8.0
BOFIT*	9.3	8	8	7
JPMorgan	9.3	7.6	8.0	
Mizuho	9.3	7.7	7.8	

**) released in September*

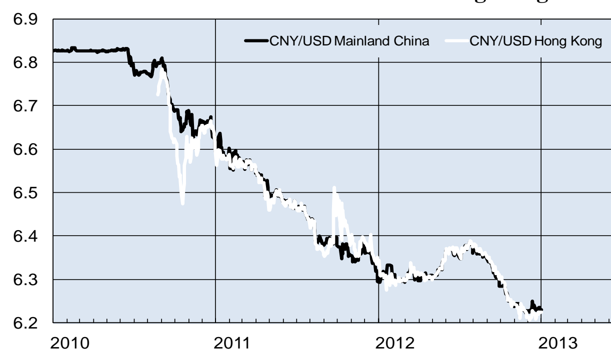
2012 saw a slight easing of monetary policy and dismantling of several regulatory structures. Inflation slowed during 2012 to around 2 % in December, a level substantially below the government's official target of 4 %. The broad measure of money supply (M2) rose as predicted and was on target. Despite falling inflation and lower economic growth, the People's Bank of China only modestly eased monetary policy last year, as the economy still continues to digest the after-effect of the 2009 stimulus efforts. Key reference rates were lowered twice last summer a total of about half percentage point. The one-year deposit reference rate now stands at 3.0 % and the one-year credit rate at 6.0 %. Minimum reserve requirements for commercial banks were lowered last spring a percentage point, but are still high by international standards. The current reserve requirement for big banks is 20 % of deposits and for small banks 16.5 %.

In conjunction with the rate cuts, the PBoC last summer relaxed rules on interest rates to allow commercial banks to set their own rates more flexibly. After the latest adjustment, banks can offer loans at a rate as low as 70 % of the reference rate and pay interest on deposits as high as 110 % of the reference rate. The phasing out of rate controls is an important aspect of increasing competition in domestic financing markets. It is also a prerequisite for freeing up capital movements and international acceptance of the yuan.

Despite a three-month depreciation episode last summer, the yuan strengthened about 1 % against the US dollar last year. In April, the yuan's daily fluctuation band was expanded to 1 %. Growth in China's currency reserves slowed last year, reflecting conditions in the global economy and the fact that the yuan has been allowed to float more freely on foreign exchange markets.

China took small steps last year in promoting international use of the yuan. The latest step is a pilot programme that permits use of the yuan in cross-border loans for companies operating in the Qianhai special economic zone in Shenzhen near Hong Kong. Media reports state that the first loans should be issued in the coming weeks.

Yuan-dollar rates in Mainland China and Hong Kong



Sources: Reuters and Bloomberg

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