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BOFIT Weekly

7 • 15.2.2013

Russia

Despite demands, CBR refrains from lowering rates. At its February 12 meeting, the Central Bank of Russia's board of directors decided to leave reference rates untouched. The CBR's most potent monetary instrument, the one-day minimum auction repo credit rate remains at 5.5 %. The central bank justified its decision by pointing to a pick-up in inflation, which was running at a 7.1 % annual rate in January (well above the CBR target range of 5–6 % this year). Although the CBR expects inflation to slow this summer, higher prices could fuel inflation expectations and increase inflation risks in the future.

The CBR noted little change in economic conditions in recent months: industrial output growth remains flaccid and the pace of growth of capital investment continues to decelerate. On the other hand, the utilisation of industrial capacity is at a fairly high level, and low unemployment (see third item) and household borrowing fuel domestic demand. Total economic output is at or near a level considered normal for the Russian economy. The CBR pointed out that in such conditions the possibilities of monetary policy to influence economic growth are quite limited.

The central bank's full-throated defence of its decision to leave rates unchanged was a response to demands from the business community and commercial bankers for lower rates. The cabinet has also discussed rates with the CBR; several ministers have claimed rates are too high. Recent forecasts see Russia's economic growth slowing a bit this year, and demands for lower rates are based on the desire to enhance growth.

The CBR released its first quarterly Monetary Policy Report in January. The CBR hopes the publication will increase transparency by disclosing its principles and the reasoning behind its decisions.

Rapid credit expansion last year. The stock of credit issued by banks rose 19 % in 2012, reaching a level above 27.7 trillion rubles (€690 billion) at year's end. The stock of corporate loans increased 13 %, while the stock of loans granted to households climbed nearly 40 %.

Big banks, in particular, stepped up their lending to households. Despite high growth in borrowing, Russian households still carry relatively little debt relative to their counterparts in advanced economies. Household borrowing equalled 12 % of GDP in Russia, compared to an average of 65 % of GDP for EU countries.

The structure of Russian household borrowing is distinctly different from most developed countries; housing loans constitute less than 30 % of household borrowing. That corresponds to about 3 % of GDP, compared to 45 % in the EU. Most loans granted to households (60 %) are unsecured consumer loans. Such loans skyrocketed nearly 60 % last year. Banks are very active in selling loans to households and developing new loan types. The average annual rates on short-term credit last year was around 25 %.

The National Bureau of Credit Histories (NBKI), Russia's leading credit bureau, reports it database contains information on 60 million borrowers, up from 47 million a year ago.

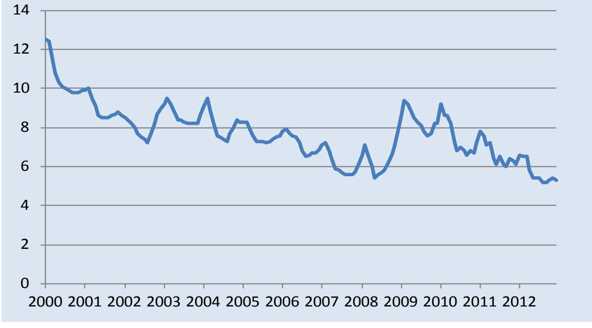
The CBR is increasingly concerned about rapid growth of consumer credit. During 2012, the stock of households' non-performing loans rose just over 7 % overall, while the share of non-performing consumer loans rose about 25 %. Debt servicing could emerge as a serious issue in Russia as an average of nearly 20 % of household income goes to debt servicing. In developed economies, debt servicing takes 10−15 % of household income.

Unemployment at record lows. Rosstat reports Russia's unemployment rate fell in December to just 5.3 % of the labour force. The figure is calculated using the ILO's methodology. Unemployment dropped below 6 % last spring – the first time unemployment dipped below the 6 % mark since the late-boom years of 2007 and 2008. The fact that unemployment has fallen so low suggests there is little reserve labour capacity left in the Russian economy. Indeed, Russia's big cities suffer from labour shortages.

Russia's lowest unemployment rate, 2.9 %, was posted in the Central Federal District, which includes Moscow. Unemployment in the City of Moscow was just 0.6 % of labour force. In St. Petersburg, the unemployment rate was only 1.1 % and 4.0 % on average in the Northwest Federal District. The highest unemployment rate posted in the Northwest Federal District was 8.6 % in the Murmansk region. The highest unemployment numbers in Russia were posted in the Northern Caucasus region, which includes Ingushetia with an unemployment rate of 47 % and Chechnya at 29 %. Some regions in the Siberia and Far East Federal Districts experienced relatively high unemployment rates of around 10 %.

Unemployment rates in rural areas are typically double that of cities. Unemployment among 15–24-year-olds was 14 %. Among all the unemployed, some 33 % are classed as long-time unemployed (i.e. out of work for over a year).

Unemployment rate, %



Source: Rosstat

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China

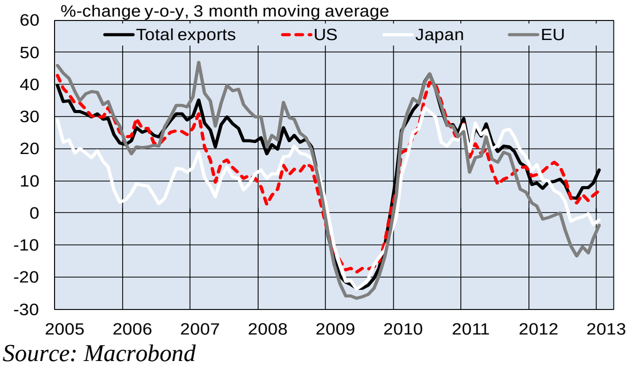
The modest recovery in Chinese exports to Europe, US and Japan indicate caution still warranted. As the world's largest exporter of goods, China's trade activity has become a barometer for the condition of the global economy. The on-year foreign trade performance in January, however, tends to exaggerate actual conditions as the Chinese New Year holiday week fell last year in the end of January and this year it took place this week. On the surface, the trend in Chinese foreign trade at the end of 2012 suggests a slight recovery in the global economy has been underway despite ongoing uncertainty in some of China's key markets. Exports to the US appear to be returning to the around 10 % a year growth trend, while exports to the EU stopped contracting relative to the December-January period a year earlier. The numbers for Europe do not change significantly if computations are in euros instead of dollars. While China's exports to Japan have been hurt by territorial island disputes and poor performance of the Japanese economy, Chinese exports to South Korea have revived.

Substantial export growth was mostly evident in Southeast Asia, where a powerful expansion in trade with Taiwan may indicate a revival of processing trade in Asia. Chinese export growth to Africa accelerated to nearly 20 %. Growth in exports to Latin America have long been slowing; even the boost in growth in the fourth quarter to 6 % y-o-y does not yet indicate recovery of demand in the region.

China's imports in November–January rose at an average of 10 % y-o-y, but a big pick-up came only in January. The January leap in imports, measured in value terms, partly reflected the timing of the Chinese New Year's holiday and hikes in world prices for iron ore and oil. So for the time being, imports depict a relatively modest outlook for Chinese economic growth.

In addition to the foreign trade figures, China's January purchasing manager index readings suggest modest growth in trade ahead. Both export orders and import indicators were below 50, indicating a pessimistic growth outlook.

Exports to China's main markets



Source: Macrobond

The domestic value added of China's exports is about 70 %. The share of domestic value added in China's exports is relatively small by international standards, but nothing exceptional. Countries with the highest domestic value added component of exports are typically resource-based commodity producers, while those with lower domestic value added such as countries in Europe tend to export finished goods. These assessments come from the latest release of the OECD/WTO *Trade in Value Added* database.

The share of domestic value added in exports provides insight into China's role in international production chains. Production chains typically originate in countries producing raw materials and end in countries where final assembly or sales occur. China's exports tend to be finished goods, so China is at the end of international production chains like most European countries. It falls somewhere between Germany and Finland. The lowest domestic value added in China is in electronics, chemicals and construction exports, while the highest domestic value added is found in the wholesale and retail sales, and finance exports.

Calculations by the OECD and WTO indicate that the share of services is about a fifth of the Chinese exports, and slightly over half of them represent domestic value added. Services constitute such a large share of exports after including the service component bundled with export goods (e.g. smartphone software). The services value added component is largest in electronics exports, and smallest in farm products and mining industry exports.

China's economic changes reflected in shifts in FDI flows. China's trade ministry reports foreign direct investment flows into China last year amounted to $112 billion, a slight reduction from 2011. The poor growth outlook for the global economy largely explained the contraction, but there were also domestic factors involved. Investments in the electronics and textile industries continue to decline, reflecting China's rapidly rising production costs. Uncertainty over the direction of real estate markets has reduced investment in the real estate sector. In contrast, investment growth in the service sector remained robust, reflecting expectations of a structural shift to a consumption demand-driven economic model. Despite the changes, a large part (43 %) of FDI was still directed to goods manufacturing. The service sector's share was about 30 % and the real estate sector 22 %. The lion's share of investment still came from Hong Kong.

FDI outflows from China have boomed in recent years. The value of investments was $77 billion last year, up from $69 billion in 2011. Figures do not include financial sector investment, which has been running at $5–10 billion in recent years. That data will be released later in the spring. A large share of Chinese investments abroad are directed to neighbouring countries, but investors are also increasing the prowl farther afield, especially in the search for raw materials investments.

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