

Russia

Russia's current account surplus shrinks and capital outflow declines. Preliminary first quarter data from the Central Bank of Russia show a current account surplus of \$28 billion, a slightly lower amount than in first quarter of the previous three years. The surplus for the four most recent quarters exceeded 3 % of GDP, which was the smallest surplus since the beginning of 1999.

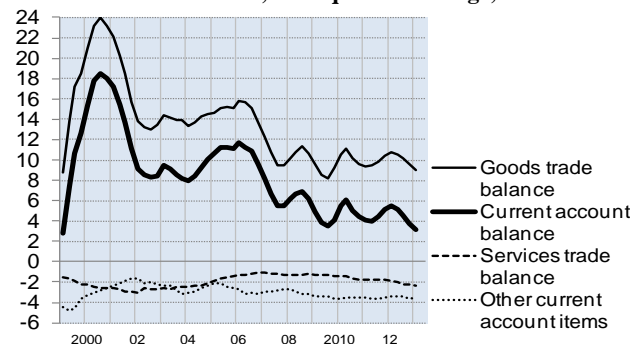
Russia's current account surplus began to contract about a year ago as export revenue growth began to flag while fair growth in spending on imports continued. In the first quarter of this year, earnings on exports of goods and services fell for the first time in over three years. The on-year decline in goods exports was a few per cent, dragged down both by exports of crude oil, petroleum products, natural gas and other commodities. In contrast, services exports continued to rise.

Spending on imports increased about 6 %. Imports of services, including spending of Russian travellers abroad, rose about 15 %. Import growth was down significantly.

Net private capital outflow from Russia in the first quarter amounted to \$26 billion, or slightly less than in 1Q2012. Capital exports by the banking sector increased substantially. The CBR noted that an increase in domestic forex deposits forced banks to rebalance their forex positions.

The net capital outflow from the corporate sector fell to its lowest level in several years. Direct investment inflows and outflows of the corporate sector as well as borrowing from abroad showed an exceptional increase, partly from the big deal between Russia's largest oil company Rosneft and multinational BP.

Current account balance, four-quarter average, % of GDP



Source: Central Bank of Russia

Russia's massive grey economy contributes significantly to social sector underfunding. Social affairs minister and first deputy prime minister Olga Golodets stated last week at a conference at the Higher School of Economics in Moscow that only about 45 % of Russia's working age population pays taxes, social contributions or pension payments. Studies at several research institutes put the share of the

workforce employed by the grey economy at 24–30 %. The narrow tax base is a big factor driving the large deficit the state pension fund runs. To make up for lost fund revenues, social contributions and pension payments have been hiked several times with varied success.

Russia's decline in unemployment is essentially the flip side of growth in grey sector employment. Even for declared employees, companies now pay an increasing share of wages under the table. This is partly a reaction to the 2011 hike in the mandatory social contribution of employers from 26 % to 34 % of the wage bill. Although the government backed off last year and lowered the contribution to 30 %, companies have remained unwilling to declare the full extent of their wage payments. The hike in the mandatory social contribution decreased income tax revenue and imposed financial losses on the public sector overall. At the beginning of this year, the pension contribution of sole proprietors was doubled. Their representative organisations complain this is forcing an increasing share of sole proprietors into the grey sector.

Payment of wages under the table and companies that operate off the books are typical for Russia, and they are intertwined with other problems of the economy. There is little incentive to pay taxes or register a business as the state cannot guarantee that companies can operate securely or will receive fair treatment from officials. Neither companies nor workers trust that their tax contributions will always be used for their stated purpose.

What constitutes middle class in Russia? The Moscow-based Independent Institute for Social Policy (IISP) reports that nearly 20 % of Russian households qualify as "middle class". IISP researchers say the share of middle-class households has increased about one percentage point annually since 2004, and that the structure of Russia's middle class has shifted since the late 2000s. The share of people employed by companies in the private sector, entrepreneurs, and professionals has been shrinking, while the share of public sector experts, managers and representatives of power organisations has been increasing (power organisations include e.g. those ministries that operate directly under the president such as the interior ministry, justice ministry and defence ministry). These public-sector groups now make up about 20 % of the Russian middle class.

IISP researchers use several criteria to define membership in the middle class, including wealth, education level, work quality, and the household's own assessment of its social status. On the basis of wealth alone, 28 % of households qualify for the middle class, up from 21 % in 2004. Households' own appraisals of their status has also risen overall, even if there were pronounced differences across groups. Entrepreneurs are more pessimistic about their fortunes now than in 2004, while civil servants and representatives of power organisations feel much more confident about their status.

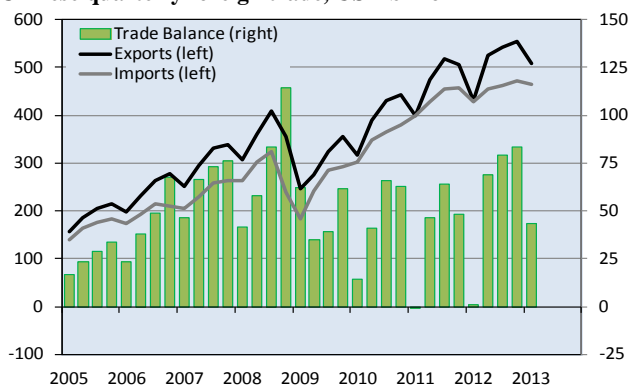
China

Robust export growth in the first quarter. China customs reports the value of exports rose to slightly over \$500 billion, an increase of nearly 20 % y-o-y. Exports were up sharply to countries in Southeast Asia, as well as to Taiwan and Hong Kong, which operates as intermediate port for Chinese goods. Exports to the United States grew 7 %. Export growth to Europe remained stagnant and exports to Japan contracted. A number of economists monitoring the Chinese economy have expressed suspicions that some Chinese companies may be fudging their export numbers. They note that companies have incentives to exaggerate their exports either to gain tax benefits or to repatriate capital back to China to take advantage of the yuan's strengthening against the dollar in recent months. China customs is investigating the matter.

The value of China's imports grew significantly slower than exports in the first quarter, and was up by less than 10 % y-o-y. Imports from the US increased some 20 %, and also imports from Taiwan rose rapidly. Imports from Europe and Japan fell sharply. China has benefitted from the drop in global commodity prices, which has reduced the value of imports from most of China's trading partners that supply it with raw materials.

The strong growth in exports and feeble growth in imports generated a trade surplus of \$44 billion in the first three months of this year. If export growth remains strong and import growth remains weak, the trade surplus for 2013 will be substantially larger than last year.

Chinese quarterly foreign trade, USD billion



Source: China customs

Chinese tourists off to see the world. The number of Chinese tourists travelling abroad increased about 20 % last year, nearly keeping pace with the record growth of 2011 and 2010. If the growth in tourism continues to rise at its current rate, the number of Chinese tourists travelling

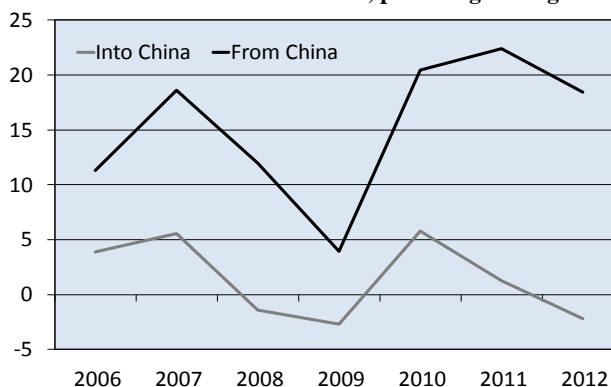
abroad should exceed 100 million this year. The Chinese show a great willingness to spend money on travel. According to the UN's World Tourism Organization (UNWTO), spending by Chinese tourists exceeded \$100 billion last year, putting them at the forefront internationally as income generators for tourism-dependent businesses.

More than two-thirds of all Chinese tourists headed to Hong Kong or Macao, which official Chinese statistics treat as foreign destinations. Japan, Korea and Taiwan were also popular with Chinese tourists. Europe and the United States each accounted for roughly 2 % shares of Chinese tourism. About 60,000 Chinese travellers spent at least one night in a Finnish hotel or hostel last year.

In contrast, the interest of foreign tourists in China shows signs of waning. The number of foreign tourists visiting China last year shrank about 2 %, and China's National Tourism Administration reports that the loss of tourists continues this year. Several studies have shown that foreign tourists visiting China are increasingly disappointed with the experience. The most recent surveys of tourists reflect discontent with the degradation of China's natural environment and water quality. Recent international news coverage has done little to promote China's attractiveness to potential tourists. This winter's air pollution events and the outbreak of H7N9 avian influenza may give many people who think of a trip to China further cause to consider an alternative tourist destination.

China's competitiveness as a tourist destination has declined slightly in the World Economic Forum's survey. Of the 140 countries surveyed, China still makes it into the top third of tourist destinations with a ranking of 45th place. The WEF study shows that China has a huge potential as a tourism destination thanks to its natural and cultural attractions. China does well in terms of air, rail and bus connections, as well as price competitiveness and availability of competent service staff. To attract more tourists, China needs an attitude shift on how it treats tourists, better hotel accommodations and more focus on cleaning up the environment.

Tourist travel into and out of China, percentage change



Source: CEIC