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BOFIT Weekly

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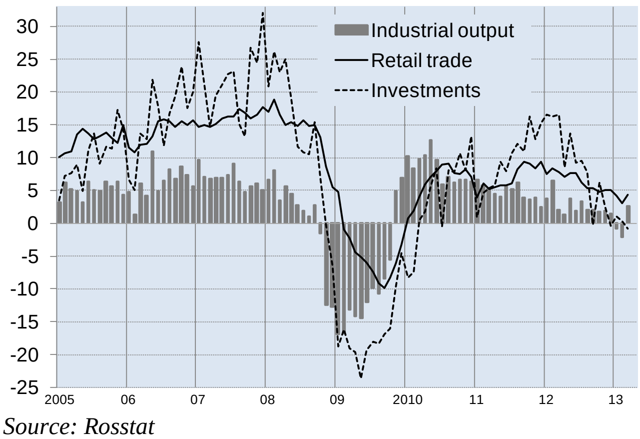
Russia

Russia's economy revived in March; government considers measures to boost recovery. After a bumpy start in the first two months of this year, the economy ministry estimates that workday-adjusted and seasonally adjusted GDP grew in March and was up over 2 % y-o-y. Manufacturing output also rose nearly 3.5 %. Nevertheless, first-quarter growth was only about 1 % y-o-y for GDP and manufacturing. The slow growth in the mineral extraction sector last year turned to decline in the first quarter. While oil production volumes were unchanged, gas production fell from a year earlier. Exports of oil, petroleum products and natural gas were all down slightly.

Retail sales, which account for nearly 40 % of domestic demand, rose nearly 4.5 % y-o-y in March. Rising consumer demand has been sustained by still good gains in real household incomes. Fixed capital investments, which got into sharply slowing growth last year, were unchanged y-o-y in the first quarter.

Despite increased retail sales activity and industrial output, households and businesses have turned gloomier about future prospects. The fitful economic performance in the first quarter of this year has given more impetus to discussion in Russia as to whether the economy is poised for recession or whether there are signs of recovery. President Putin this week arranged a discussion of possible stimulus measures with the prime minister, the finance and economy ministers, central bank chairman, chief economic advisers, select Duma deputies and several economic experts (including former finance minister Alexei Kudrin). The meeting emphasised that fiscal balance would not be sacrificed. Economy minister Andrei Belousov and finance minister Anton Siluanov noted that there are grounds to reduce bank lending rates which have risen further in recent months. Putin charged the cabinet with preparing a proposal by May 15 on measures to secure economic growth.

Change in volume of industrial output, retail sales and fixed investments from 12 months previous, %



Source: Rosstat

Russia's heavy bureaucracy adds to costs of doing business and constrains entrepreneurship. Surveys show that burdensome bureaucracy persists year in and year out as one of the most difficult aspects of Russia's business environment. A study from the Higher School of Economics estimates that official inspections alone (e.g. fire inspections, health inspections and tax audits) cost roughly 800 billion rubles to the economy in 2011, an amount that corresponded to nearly 1.5 % of GDP. Moreover, the HSE researchers noted that, despite the inspection activity, firms frequently violated regulations because the sanctions are often arbitrary. According to Opora, an organisation that represents the interests of small and medium-sized enterprises, many regulations are so outdated that compliance is practically impossible. Oversized bureaucracy also incentivises corruption. Many companies find it preferable to bribe officials in order to avoid the time and costs associated with inspections and audits.

Bureaucracy also reduces the motivation of Russians to start their own businesses. According to the latest GEM entrepreneurship comparison, Russia ranked last among the 69 countries studied in terms of persons contemplating starting a business. Only 2 % of Russian respondents said they had considered starting their own business, when the average for countries with similar income level was around 26 %. The share of entrepreneurs that had businesses ongoing in Russia was also slightly lower than in most other countries of the comparison. GEM researchers note that heavy bureaucracy and lack of access to financing are among the biggest obstacles growing a business in Russia.

Economy ministry has ambitious expectations on raising Russia's business friendliness. President Putin has laid out as one of the major administrative goals to lift Russia's overall ranking into the top 20 countries in the World Bank's annual *Doing Business* survey over the next several years. *Doing Business 2013* ranks Russia (represented by Moscow), 112th out of the 185 countries surveyed.

Doing Business rates business friendliness by a number of criteria. Administration is now trying to push rapidly improvements in these criteria through legislative and regulatory reform. A summary released by the economy ministry two weeks ago estimated that if all the legal and regulatory changes accepted so far and slated for this year are actually realized, Russia's *Doing Business* ranking would rise. In the category of getting a building permit, for example, Russia would jump 161 places to 17th position. For getting an electrical hook-up to a warehouse, Russia would rise 121 places to 63rd, and registering a business would climb 31 places to 70th. Thus, Russia could theoretically climb to 44th place in the overall rankings by 2014, assuming business environments in other countries stay the same. Realisation of this improvement naturally requires that the new measures are actually implemented also in practice.

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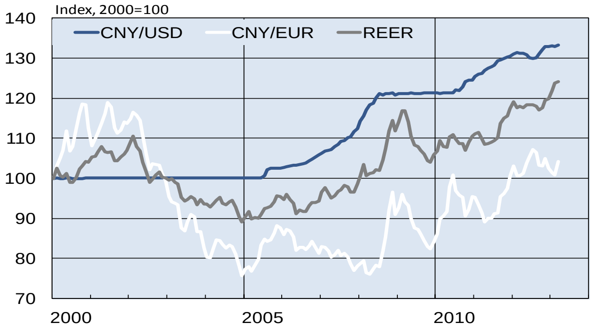
China

Yuan appreciates, international use continues to rise. The yuan's exchange rate has appreciated 2 % against the US dollar since the start of this year. On Thursday (Apr. 25) one dollar bought 6.17 yuan. The yuan has also risen 3 % against the euro this year. One euro bought 8.07 yuan. Despite the assertion of the People's Bank of China that the yuan's external value is determined relative to a basket of currencies of China's main trading partners, the exchange rate movements suggest that the yuan still basically tracks the dollar's exchange rate. The yuan-euro exchange rate has followed the ups and downs of the dollar-euro rate.

The exchange rates of floating currencies are driven by supply and demand. However, the yuan does not float freely and it is affected by capital controls and exchange rate policy. The PBoC every morning sets an initial exchange rate from which the value of the yuan can vary up to one percent during the course of the day. If the yuan appreciates or depreciates more than 1 %, the PBoC will intervene by buying or selling currency from its reserves until the yuan is brought back within limits. This year's interventions have mostly involved buying currency on heavy demand for yuan. At the moment, capital flows are heavily skewed towards China and the country's trade surplus continues to grow.

The real effective exchange rate (REER), which takes into consideration inflation differences and trade shares with a country's main trading partners, is generally considered a better indicator of the price competitiveness than the nominal exchange rate. Since the yuan's nominal exchange rate has appreciated and China's inflation has been running higher than in its main trading partners, the yuan's REER rose nearly 4 % in the first quarter of this year. Price competitiveness of goods produced in China has been further diminished by rising production costs such as higher wages.

Nominal yuan-dollar, yuan-euro and yuan real effective exchange rate (REER); rising trend indicates yuan strengthening



Sources: BIS and Reuters

China continues to take steps to promote international use of the yuan. Since the beginning of April, it has been possible to exchange yuan directly for Australian dollars, eliminating the requirement of going through a third currency. Australia's central bank announced this week it would begin to hold 5 % of its currency reserves in yuan-denominated bonds and treasuries.

Chinese companies rule the roost in latest Forbes Global 2000 list. *Forbes* magazine reports that the world's biggest company this year is Industrial and Commercial Bank of China (ICBC), with the number-two spot going to China Construction Bank. Also making it into the top ten were Agricultural Bank of China (8th largest) and PetroChina (9th). Joining the four Chinese companies in the top ten spots were the American firms JPMorgan Chase, GE, Exxon Mobil and Berkshire Hathaway, along with Royal Dutch Shell (Netherlands) and HSBC Holdings (UK). Ranks were based on sales, profits, assets and market value.

Looking at the 100 largest publicly traded firms, nearly a fifth were from Asia (mainly China, Japan and South Korea). Eight mainland Chinese firms made it into the top 100. As a rule, the Chinese firms making the list were state owned, and the state is a major owner in all of China's biggest companies. The role of state-owned enterprises in the Chinese economy had been gradually declining from the launch of economic reforms in 1978 until the 2000s. Many China observers point to a shift back towards state capitalism under the administration of former president Hu Jintao.

The size ranking of companies depends on which criteria are taken into consideration. Companies in the financial sector tend to dominate the *Forbes Global 2000* list, which takes into account total assets. In contrast, industrial firms were more likely to make it in top of the *Fortune Global 500* list, which uses revenues as the size metric. Chinese companies ranking in the top 10 in the Fortune rankings included oil and petrochemical refiner Sinopec (5th), PetroChina (6th) and electrical power company State Grid (7th).

Chinese firms included in top 100 of the Forbes Global 2000 rankings for 2013

Corporation	Ranking
ICBC	1
China Construction Bank	2
Agricultural Bank of China	8
PetroChina	9
Bank of China	11
Sinopec	26
Bank of Communications	54
Ping An Insurance Group	83

Source: Forbes

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