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Russia

CBR leaves key rates unchanged. At the monthly board meeting of the Central Bank of Russia held Monday (June 10), the board decided to leave unchanged at 5.5 % the minimum rates on one- and seven-day repo auction credit. The CBR again lowered its longer-term credit rates (over 180 days) by 25 basis points for the third time in a row. Long-term credit rates now range between 7.25–7.5 % depending on the quality of the loan guarantee.

Although the central bank has faced strong pressure to lower rates to boost economic growth since late last year, it has so far not budged on its most important steering rates. CBR chairman Sergei Ignatyev has noted on repeated occasions that the current economic conditions present a macroeconomic quandary. On one hand, Russia's healthy employment situation and high inflation would justify stringent monetary policy. On the other hand, however, both the slowing economic growth and an impending decline in inflation would call for a looser monetary stance.

The CBR has over the recent months slightly eased monetary policy by lowering long-term credit rates. There is little actual demand for such credit, however, and the CBR explains the main reason for the rate cuts is to bring the longer-term rates closer to rates of its short-term instruments. The incremental rate realignment is part of CBR efforts to increase the impact of its rate-setting policies in the market.

The CBR board noted that its decision to keep key rates unchanged was based on evidence that inflation has been accelerating. Reading from both May and early June indicated that 12-month inflation was running above this year's inflation target. At the end of May, inflation was 7.4 %. CBR analysts expect inflation to slow in the second half of this year to a level within the bank's 5–6 % target range for 2013. Given that the CBR's key steering rates already have negative yields in real terms, the CBR rates will only be lowered once inflation actually begins to subside.

Much of the credit for the CBR's prudent and independent monetary policy goes to departing chairman Sergei Ignatyev, who steps down on June 23 as he completes his third (legal maximum) term as CBR head. President Putin has tapped Elvira Nabiullina, his current economic adviser and former economy minister, to take over as CBR chairman. Ignatyev has agreed to continue as a senior adviser at the central bank at Putin's request.

No big tax changes ahead: Russian unveils tax policy framework for 2014–2016. The cabinet last week took up its annual tax policy framework discussion by reaffirming several measures it adopted last year. No major changes in tax policy are likely over the next few years. The mandatory social contribution of employers will remain at 30 % of the worker's wage. Russia will keep its flat 13 % income tax rate in the coming years rather than adopt a more progressive income tax scheme.

Changes, however, are planned for a number of taxes and fees in the oil & gas sector. The government reaffirmed its earlier decision to raise natural gas production fees by over 10 % a year, which has generated a boisterous debate. Starting in 2016, the fee would be based on both the domestic wholesale price for natural gas and export prices of oil and gas. The government wants to reduce the difference in the production fee rates levied on Gazprom and other gas producers. The size of the reduction depends on the extent to which other producers will be allowed to export their gas.

The guidelines are quite general as regards taxation of oil production and oil exports, one possibility being that export duties on crude oil could be gradually lowered while production fees could be increased. The fees, taxes and duties generated by the oil & gas sector constitute a significant share of public sector revenues.

Hikes in excise taxes will continue. The planned increases in excise taxes on various motor fuels are based on the fuel type and grade. As part of Russia's anti-smoking efforts, the government plans to raise the excise tax on tobacco products about 30 % a year through 2016. Annual increases of 20–25 % in the excise tax on alcohol are also scheduled for 2013–2015, but the hike in 2016 would be much more modest. The Russia-Belarus-Kazakhstan customs union limits hikes as it aims at harmonising excise taxes to discourage smuggling.

Further postponing of production at Shtokman gas field. Gazprom deputy board chairman Andrei Kruglov stated at the end of May that development of the Shtokman gas field located 650 kilometres north of Murmansk in the Barents Sea will be postponed due the current upheaval in the world gas market. The gas produced from the Shtokman field was originally planned for export, particularly to the US market. However, US is currently experiencing a boom in production of shale gas and other unconventional gas. Production under the harsh conditions of the Shtokman field would not be profitable at present.

Gazprom CEO Alexei Miller says Gazprom's main markets for LNG are located in Asia and the Pacific Rim, so the company is currently planning an expansion of its LNG terminal on Sakhalin Island, as well as a new LNG facility to be built in Vladivostok. Both facilities would be supplied with gas from currently producing Sakhalin fields and the new Sakhalin 3 fields under development. The exact timing of when Sakhalin 3 production will be inaugurated is still not set.

According to press reports, Gazprom is planning a smaller LNG facility on the Gulf of Finland. The gas would be supplied via the Nord Stream pipeline, and the liquefied gas would be sold to customers in Europe. Gazprom would use the LNG sales to offset lower domestic demand.

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China

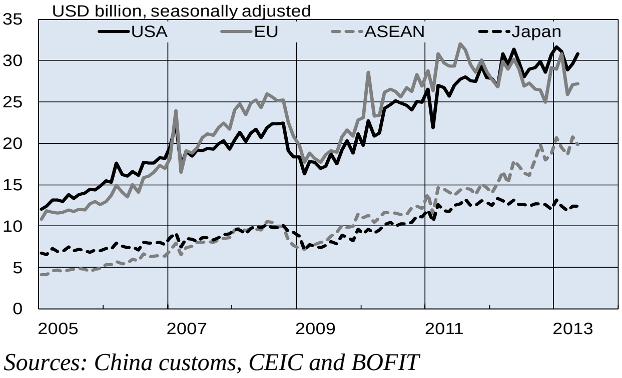
No signs that Chinese economic growth accelerated in May. Just-released May figures from the National Bureau of Statistics show economic growth trending unchanged from previous months. Growth in industrial output held at a modest pace of 9 % y-o-y. Looking at demand-side indicators, growth in fixed capital investment slowed slightly, while growth in retail sales remained basically unchanged from earlier months. Various corporate surveys suggest that growth will continue to be rather slow also in the near future.

China's on-year growth in goods exports slowed in May. However, the interpretation of the foreign trade data is difficult, as some firms apparently have exaggerated their export numbers to circumvent capital controls and move capital back into China. Officials have reacted to the problem and there is evidence that firms have reduced their efforts to evade capital controls for the time being. Chinese goods imports fell in May, while the foreign trade surplus remained at around $20 billion for the month.

May inflation slowed to 2.1 %, due largely to a slower rise in food prices. The rise in prices of non-food items has remained below 2 % for already about 18 months. Although inflation remains well below the official inflation target of the People's Bank of China, the central bank has been warning all spring that inflation could accelerate later this year.

Given the relatively weak economic figures, a number of institutions over the past two months have lowered their forecasts for Chinese GDP growth this year and next. For example, the IMF and OECD last month dropped their forecasts for 2013 to below 8 %. Most forecasts currently fall into the range of 7.5–8.0 % GDP growth for 2013 and 7.0–8.5 % for 2014. Despite China's relatively low growth by recent historical standards, its leaders do not seem particularly concerned about the situation.

Chinese goods exports to US, Japan, EU, ASEAN countries



Sources: China customs, CEIC and BOFIT

Obama and Xi commit to improving bilateral relations through increased cooperation. China's new president Xi Jinping and US president Barack Obama met in their official capacities for the first time last weekend at a retreat hosted by Obama near Palm Springs, California. The visit of president Xi affirmed the perception that China's new leader is less conservative in his approach to international relations than predecessor Hu Jintao. Much of official décor was replaced with a more laid-back approach. Obama and Xi held free-ranging talks over the two-day visit, discussing mutual challenges facing their nations.

The two leaders agreed to increase military cooperation by establishing regular meetings between their armed forces. *China Daily* reports that China will participate next year for the first time in a US-led joint military exercise. Communication and joint cooperation between the armed forces of both countries are important to maintaining balance in the Asia-Pacific region. China wants to increase its presence in the Pacific in areas where the US has traditionally enjoyed a dominant presence. At the moment, the US military is involved in a shift to the Pacific region, and US arms exports to Taiwan and military commitments with Japan have caused friction between China and the US. President Xi, however, said during his visit that there is room for two great powers in the Pacific.

US-China relations have been frayed in recent months by cybersecurity breaches, particularly hacking focused on stealing sensitive data or disrupting operations of corporations and government agencies. US observers claim that Chinese cyberattacks geared to theft of American technology and proprietary research damage US international competitiveness and national security. Xi gave assurances that China is committed to strong cybersecurity.

The US and China also want to work together on slowing climate change and preventing North Korea from further expanding its nuclear weapons programme. The commitment to reduce carbon dioxide emissions was timely. According to an IEA report released Monday (June 10), China has the highest growth in carbon emissions globally, even if the rate of growth is slowing as Chinese energy efficiency improves. Carbon emissions in the United States have been falling with the shift away from coal to shale gas that is changing the structure of US energy markets.

The meeting was also important as it helped establish personal relationships between statesmen and promote dialogue between countries that will exert profound political and economic influence globally in coming decades.

US-China trade has enjoyed robust growth, with the US now rivalling the EU as China's top export market. In the first quarter, Chinese imports from the US grew slightly faster y-o-y than exports to the US. The situation slightly reduced the US trade deficit with China, but the unbalance is still high ($220 billion in 2012).

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