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Russia

Major forecasts for the Russian economy lowered. Following the Russian economy ministry's lowered forecast in late summer, the IMF and the World Bank cut their forecasts for Russian GDP growth this year to 1.5 % and 1.8 %. The IMF's October figure reduces its April figure by nearly two percentage points. Like the economy ministry, the IMF and the World Bank expect Russia's GDP growth will revive to over 3 % in 2014 as long as the world economy and global trade recover. The draft of the Central Bank for the annual monetary policy programme notes that for a basic forecast one could also consider a more cautious path that puts GDP growth at about 2 % in 2014 and about 3 % in 2016. The forecasts assume a slight decline in the oil price in the next few years.

The rates of economic growth under the IMF and World Bank forecasts require on-going moderate growth of consumption and revival of investment growth. The IMF expects the volume of Russian exports to increase about 3 % a year if export growth outside the energy sector remains relatively brisk. The IMF says Russian imports would grow 2–3 % this year and about 5 % p.a. in coming years.

The IMF and World Bank caution that their Russia forecast figures are subject mostly to downside risks relating to the global economy and the oil price, as well as factors that could depress consumption and investment in Russia. Earlier Russia's economic growth was supported by e.g. the rising oil price and increased utilisation of production capacity. The IMF emphasised that Russia's future growth rate depends on improving productivity and investment, which calls for an improved investment climate. The state's role in the economy should also be diminished.

Russia's foreign trade and current account figures weaken further. Preliminary balance-of-payments figures from the CBR indicate that the current account surplus contracted to just over $1 billion (0.2 % of GDP) in the third quarter of this year. The surplus for the past four quarters shrank to below 2 % of GDP. The decline in the size of the current account surplus reflects a shrinking goods trade surplus, a gradually deepening services trade deficit and increased interest payments on debt to foreign creditors. Russia's current account figures were the grimmest since 1998, when the current account last showed a deficit.

The value of exports of goods and services in the third quarter was about the same as a year earlier. Earnings declined on exports of crude oil and petroleum products, as well as other non-energy commodity exports such as metals. The drop in total export earnings was prevented mainly by growth in services exports and a recovery in natural gas exports.

The value of goods and services imports in the third quarter was only slightly larger than a year earlier. Goods imports alone, however, were slightly lower than a year earlier. Services imports continued to boom, driven in part by spending of Russian travellers abroad (up over 25 %).

Russian exports and imports valued in euros, % change from four quarters previous

Source: Central Bank of Russia

Capital outflow from Russia has continued and weakened the ruble. Preliminary balance-of-payments figures from the CBR show the net outflow of private capital abroad picked up in the third quarter. This was most pronounced for the corporate sector (excluding banks). For the past four quarters, the net outflow from the private sector was about 2.5 % of GDP, while the net outflow from the corporate sector (excluding banks and foreign currency held as cash) was nearly 3 % of GDP.

Corporate direct investment (DI) outflows from Russia increased substantially in the third quarter. For the first time in over a year they exceeded DI inflows to Russia's corporate sector from abroad (this excludes the TNK-BP deal in March, which generated a one-time DI net outflow equal to 2 % of annual GDP). In the past four quarters, more DI flowed into the corporate sector (3 % of GDP) than out of the corporate sector abroad (2 % of GDP). Fictitious transactions by the corporate sector and unrecorded capital outflows have remained steady at 2–2.5 % of GDP.

The ruble's exchange rate has increasingly reflected the effect of capital outflows as the current account surplus has shrunk. With the net direction of capital flows outbound, the ruble has faced depreciation pressure since late spring. While the CBR refrained almost entirely from intervening in Russia's foreign currency market from autumn 2012 to early summer this year, it has since slowed the rate of ruble depreciation somewhat by purchasing relatively small amounts of rubles every trading day. In any case, the ruble's exchange rate has declined since May by 5–6 % against the CBR's dollar/euro currency basket used to steer the external value of the rouble as well as the CBR's trade-weighted currency basket.

Bank of Finland • Institute for Economies in Transition, BOFIT
P.O. Box 160, FI-00101 Helsinki
Phone: +358 10 831 2268 • Web: www.bof.fi/bofit

Editor-in-Chief Seija Lainela • Email: Seija.Lainela@bof.fi

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China

International financial institutions lower their forecasts for China. The IMF's latest World Economic Outlook (WEO, October 2013) slightly lowers its previous forecast, and now sees the world economy growing 2.9 % this year and 3.6 % in 2014. A leading cause of the downward revision in the growth forecast was lower growth in emerging economies, due in large part to a decline in commodity prices and lower potential growth. The slowing of growth, combined with a possible tightening of United States' monetary policy and rising interest rates will complicate economic policy in emerging economies also in the future.

Economic growth in China in recent years has largely been predicated on fixed capital investment financed with credit. This has worsened the imbalances in financial markets, as well as the disparity between private consumption and fixed capital investment. The IMF estimates that China's public sector overall runs an actual budget deficit of about 10 % of GDP if all commitments are included. In comparison, China's official deficit is reported to be just over 2 % of GDP. Such underlying structural problems and risks to the financial markets have dampened the government's enthusiasm for economic growth rates above the current level.

GDP growth forecasts for China, %

	2012	2013	2014	2015
IMF	7.7	7.6	7.3	7.0
WB	7.7	7.5	7.7	7.5
ADB	7.7	7.6	7.4	-
BOFIT	7.7	7.5	7	7

The IMF, WB and ADB forecasts were all released in October 2013. The BOFIT Forecast for China is from September 2013.

The IMF expects China's government to attempt a correction of its economic imbalances. This means a gradual slowing in economic growth to 7 % over the next two years (see table). The flip-side benefit of reforms and lower economic growth is that China could see more sustainable gains in living standards. The managed slowdown is also the best choice from the global economy's standpoint as cheaper commodities more than make up for China's lower import growth. Continuing imbalances could lead to a sharp slowdown in the Chinese economy and a lengthy recession that would cut global GDP by as much as 1.5 %. Under the IMF's basic scenario, China's current account surplus rises from 2.5 % this year to 3 % in 2015.

In October, the World Bank (WB) and the Asian Development Bank (ADB) also released new growth forecasts for China that were substantially lower than their earlier forecasts. Besides China, both forecasts cut their growth outlooks for other emerging economies in East Asia and the Pacific. Despite this, the World Bank estimates that the region will account for about 40 % of this year's world economic growth and a third of growth in world trade.

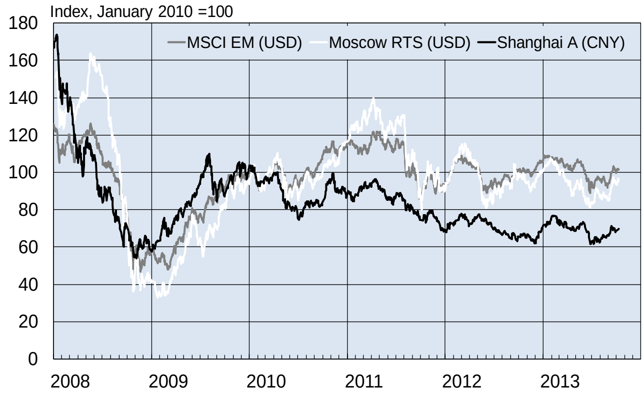
Share prices on China's stock markets bounce back from June lows. When liquidity dried up in June, China's interbank market tightened dramatically, causing share prices to plunge. Share prices on China's stock exchanges have clawed their way back during late summer, and are still continuing to rise. In many other countries in East Asia, share prices rose sharply in September.

Share prices have been on a long downward trend on both the Shanghai and Shenzhen stock exchanges. Following the international financial crisis, share prices rebounded to a high point in 2009. Since then they have largely been in decline. The market capitalization of the average Shanghai A-share listed company has declined about 30 % from the start of 2010. Stock price gains have also clearly been weaker in China than in other emerging economies on average. For example, the Morgan Stanley Capital International emerging markets index (MSCI EM) and the Moscow Exchange's RTS index now sit broadly at the same level as in early 2010. Moreover, the MSCI EM index includes the Shanghai stock exchange and without inclusion the index would be on higher level.

A number of explanations have been offered to explain the weakness of Chinese share prices. China's economic growth and growth in corporate profits have slowed. Listed firms have not necessarily been particularly transparent on their actions and investors find it hard to trust the information companies disseminate. Companies also dedicate a large part of their profits to investment at the expense of shareholder dividends.

Overall, Chinese shares have failed to yield expected returns. As a result, many have found it preferable to put their money in real estate, where prices have been soaring in recent years despite state efforts to slow the rise in prices.

Stock exchange trends in Shanghai and Moscow, as well as MSCI Emerging Markets index



Source: Bloomberg

Editor-in-Chief Seija Lainela • Email: Seija.Lainela@bof.fi
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Bank of Finland • Institute for Economies in Transition, BOFIT
P.O. Box 160, FI-00101 Helsinki
Phone: +358 10 831 2268 • Web: www.bof.fi/bofit