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BOFIT Weekly

42 • 18.10.2013

Russia

World Bank now sees Russia as a high-income country. As part of its annual income comparison, the World Bank this summer reclassified Russia from a middle-income country to the high-income group.

World Bank classifications use Gross National Income (GNI) per capita and recognise four groups: low-income, lower middle-income, upper middle-income and high-income countries. Under the World Bank methodology that uses nominal exchange rates, Russia's GNI per capita last year was $12,700. That was enough to lift Russia into the league of rich countries, defined in 2012 as a minimum of about $12,600 per capita. Russia's GNI per capita is on par with Poland and Croatia. Last year's GNI per capita was $9,800 for Kazakhstan, $6,500 for Belarus and $3,500 for Ukraine.

Finnish GNI per capita was $46,900 last year, while the figure for the United States was $50,100.

Wealth in Russia is concentrated in the hands of a few, while income distribution is more even. Credit Suisse's *Global Wealth Report 2013* ranks Russia the country with the most uneven wealth distribution in the world. The study found that just over 100 people have a net worth exceeding $1 billion, and that the wealth of these individuals together represents about 35 % of all the wealth held by Russians. The corresponding share of billionaires globally is 1–2 % of total wealth. Russia is the number-two country in the world after the US by its number of billionaires.

Looking at average per capita wealth, Russia ranks rather poorly from a global perspective. The average per capita wealth in Russia was estimated at $8,700, when the world average is nearly $34,000. Russia is one of the rare countries, where average per capita wealth is smaller than the per capita GDP. The wealth distribution for Russia shows that 94 % of adults have net wealth of less than $10,000. That share is about the same as in e.g. India and Africa.

Income distribution in Russia is far more even than property distribution. According to the *CIA Factbook*, Russia ranks 52nd out of 136 countries in terms of income inequality (inequality is highest in the top ranking countries). Income distribution is more uneven e.g. in the US and most developing countries than in Russia.

The average net worth of a Chinese, according to the Credit Suisse wealth report, was $16,400, with far more even wealth distribution in China than in Russia. The report notes wealth in China was allocated fairly evenly at the start of the 2000s due e.g. to the virtual non-existence of inheritable property. In recent years, the wealth gap has widened rapidly. The divergence is partly driven by uneven income gains. The *CIA Factbook* ranks China 29th and Hong Kong 11th in income disparity.

Strong pressures to crack open the National Welfare Fund piggy bank. The government has announced it will use stimulus measures to revive economic growth, but the tight budget situation means that the measures must be financed also from sources other than the federal budget. As a result, attention has turned to tapping assets amassed in National Welfare Fund from taxes and fees on oil & gas production and exports.

National Welfare Fund assets were initially set aside to fund liabilities that will arise in coming years from changes in the pension system. For this reason, most assets were invested as cautiously as possible in high-grade, low-risk foreign securities. The most significant exception was an investment of about 400 billion rubles in state-owned banks to stabilise the financial sector during the 2008 financial meltdown. The Fund currently holds about 2.9 trillion rubles (about €65 billion). The state's second large oil money fund, the Reserve Fund, sets aside money to cover budget deficits. It currently holds about 2.8 trillion rubles.

President Putin announced a change in investment policy regarding the National Welfare Fund last June. He said that 450 billion rubles (about €10 billion) in Fund assets would be used to finance three large projects: Moscow Ring Road III, construction of the Moscow-Kazan high-speed rail line and modernisation of Siberia's railways.

At the beginning of October, Putin also promised that the National Welfare Fund could be accessed for other purposes than the three above-mentioned projects. The organisations interested in such financing include state hydropower company Rushydro, electrical power distributor Rosseti and nuclear power company Rosatom. The government's decision last month to limit rate hikes of infrastructure companies in coming years has fuelled interest of these companies in financing.

The economy ministry has proposed that financing could also be allocated to high-tech projects, including shipbuilding and aerospace industries, as well as space technology companies. According to recent finance ministry proposals, National Welfare Fund assets could be invested in bonds issued by domestic companies. Risks would be greater than under the current investment model, but the yield potential would also be higher.

Due to the ever-deteriorating outlook for the pension system, National Welfare Fund assets could soon also be needed for their original purpose, i.e. funding pensions.

The finance ministry stresses that the National Welfare Fund money invested in the projects must really be paid back. The ministry is particularly sceptical about the viability of the big transportation projects and worries about lowballing of investment calculations.

Observers wonder why there was no thorough debate before a significant change in the Fund's investment policy was made. They also doubt whether the three large transportation projects already announced are the most efficient choices for enhancing economic growth.

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China

PBoC and ECB make currency swap deal. Under the currency swap arrangement made this month, the European Central Bank gains the possibility to swap up to €45 billion for yuan. The agreement remains in force three years. The yuan is not a freely convertible currency, so the availability of yuan internationally is limited. Under the deal, the risks associated with yuan settlements in the eurozone are reduced as the ECB can provide yuan and thereby ensure the stability of financial markets.

The People's Bank of China has made swap deals with about 20 central banks as part of its efforts to promote international use of the yuan. The PBoC last summer signed a swap agreement with the Bank of England. London has long been an active supporter of developing a yuan settlement market and has been eager to introduce the yuan into regular market transactions. Facilitating yuan-based transactions is today viewed as an important competitive factor among international financial centres.

China inflation accelerates in September; housing prices soar. China's National Bureau of Statistics reports the rise in consumer prices accelerated from 2.6 % in August to 3.1 % in September. Food prices, up over 6 % y-o-y in September, drove most of the increase. There has also been a slow, but steady, rise in prices of non-food goods over the past nine months; the on-year increase in September was slightly below 2 %. Food prices have a large impact on Chinese inflation figures as they make up about a third of the consumer basket used to measure Chinese consumer price inflation. Shifts in global energy prices, on the other hand, are usually mitigated or slow to appear as domestic energy prices are regulated.

Lower world commodity prices and over-capacity in certain industrial branches kept producer prices in overall decline in September. Producer prices have been declining since the start of 2012.

Housing prices in 70 of China's large cities climbed over 8 % y-o-y in August – the fastest rise in over two years. It appears that the official measures to cool property prices no longer have much effect. Prices rose fastest in the major metropolises, and the latest surveys indicate a further acceleration in prices in September. According to stock market press releases, several large builders are reporting that they had already sold their entire target for the year by September. Despite brisk sales, some builders appear to be struggling as they are deeply indebted and financing costs have been rising faster than revenues according to some media reports.

China disappointed with flat-lining of export growth in September. Markets were clearly disappointed to learn that the value of China's September exports in dollar terms was unchanged from September 2012. Flagging growth in exports was seen to indicate the fragility and unevenness of the global economy recovery. China's exports to e.g. Germany, France, Italy, Brazil, as well as many important Asian countries went into decline. Exports to the US and UK, in contrast, were strong. After a long while, exports to Japan also began to revive. The weak export growth also reflects the large number of holidays falling in September; i.e. there were fewer working days than in September 2012. In January-September, China exported 8 % more goods than in the same period a year earlier.

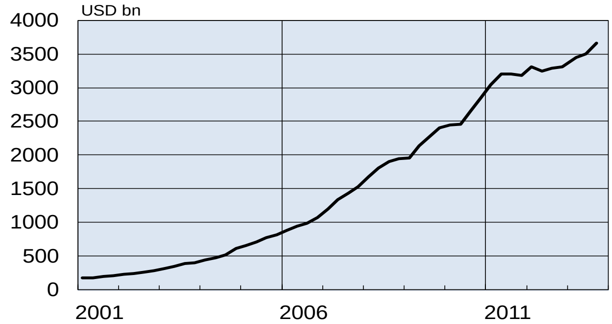
Goods imports were up 7 % y-o-y in September, and imports for January-September rose at the same pace. The steady rise in imports in recent months suggests that China's near-term economic growth outlook is on relatively stable footing. The increase in energy and metal imports likely signals a pick-up in construction activity and inventory growth. This was reflected in higher prices for sea freight.

China's trade surplus shrank to $15 billion in September. The trade surplus for January-September amounted to $170 billion, about $20 billion more than a year before.

China's rising foreign currency reserves hint increased appreciation pressure on the yuan. As of end-September, China's foreign currency and gold reserves hit $3.66 trillion, an increase of about $160 billion from the end of June. Even though detailed balance-of-payments figures will be released later, it is already clear that higher reserve growth is driven by an increase of tens of billions of dollars in capital imports compared to April-June on top of the rise of the value of euro-denominated investments in dollar terms. During July-September, capital outflows from other emerging economies increased.

The balance-of-payments figures indicate strong demand for China's currency that is putting appreciation pressure on the yuan. After remaining stubbornly at 6.12 since July, the yuan-dollar exchange rate jumped to 6.10 this week.

Growth in China's currency reserves since 2000, USD billion



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