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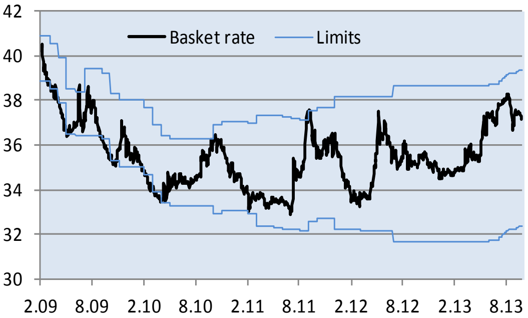
Russia

CBR moves closer to a free-floating ruble. The Central Bank of Russia has used a managed float since 1999 to guide the ruble's exchange rate. In recent years it has gradually allowed the market to play a larger role in determining the rate. The CBR employs a dollar-euro currency basket in steering the ruble's external value. The ruble fluctuates within a 7-ruble-wide corridor relative to the basket. To smooth daily movements, the CBR has intervened in the currency markets also when the rate has been close to the midpoint of the corridor. On October 7, the CBR decided to intervene only when the ruble's value approaches the upper or lower limits of the float boundaries. The CBR last month reduced the amount of money available for daily volatility smoothing.

The corridor shifts automatically to provide the ruble with extra room to rise or fall whenever central bank interventions (other than daily volatility smoothing) reach a certain amount. This is interpreted as a profound change in market conditions that the ruble rate must accommodate. The fluctuation band has shifted twelve times since the start of June, and last month the CBR modified the trigger mechanism to make it even more sensitive to market shifts.

The CBR seeks to achieve a free-floating ruble by 2015, when it will turn its monetary policy focus wholly to inflation targeting. The CBR would still defend the ruble's exchange rate in exceptional circumstances.

Ruble exchange rate against dual-currency basket and corridor limits, 27 February 2009 – 21 October 2013 (rising trend indicates ruble depreciation)



Source: Central Bank of Russia

As part of measures to increase the transparency of its operations, the CBR this month published for the first time detailed information on the guiding principles of its exchange rate policy.

Observers note the consistency with which the CBR's policy of incremental ruble deregulation has been carried out over the past couple of years. The latest measures may reflect devaluation pressure on the ruble and signal a desire of policymakers to let the ruble depreciate more freely.

Gradual liberalisation of the ruble exchange rate brings increased volatility and higher risk in e.g. foreign trade. The ruble has lost about 8 % of its value against the euro and over 4 % against the dollar since the start of the year. The drop is evident e.g. in the financial results of some of the foreign corporations operating in Russia.

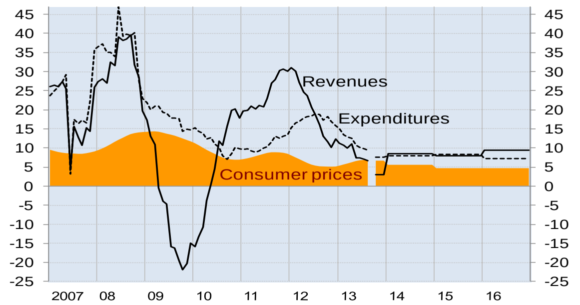
Russia's government budgets face hard times ahead. The finance ministry's latest estimates show growth in revenues to the consolidated government budget (combined federal, regional and municipal budgets, and state social funds) compared to earlier years will slow considerably in coming years even if growth recovers from this year's exceptionally low growth to over 8 % from next year onwards. Government revenues relative to GDP declined this year and should then remain just below 36 % of GDP.

The latest revenue projection is based on the economy ministry forecast that sees GDP growth accelerating next year to over 3 % a year. Government revenues from oil and gas are not expected to rise if the oil price hovers around $100 a barrel. Production and exports of oil & gas are expected to rise very slowly in coming years. Thus, the state is raising revenues through hikes in various minor taxes such as excise taxes. The finance ministry says achieving expected revenue levels also requires better tax collection and efforts to reduce the size of the shadow economy.

The finance ministry estimates that the rise in government spending will slow in coming years, remaining at around this year's 8 % pace. The share of spending in GDP will only shrink slightly in 2014 and 2015. The share this year should be slightly less than 37 % of GDP.

While the deficit target for the consolidated government budget has been slightly increased, the deficit estimate for 2014 and 2015 is still just 1 % of GDP. Government debt (including state-granted guarantees) relative to GDP will increase by about two percentage points and the state Reserve Fund will grow slowly. Government debt at the end of 2016 should be just over 14 % of GDP and the Reserve Fund and National Welfare Fund combined should equal nearly 8 % of GDP.

Consolidated public sector revenues and expenditures, and consumer price inflation, 12-month moving average, % y-o-y



Sources: Rosstat, Ministry of Finance, Ministry of Economic Development

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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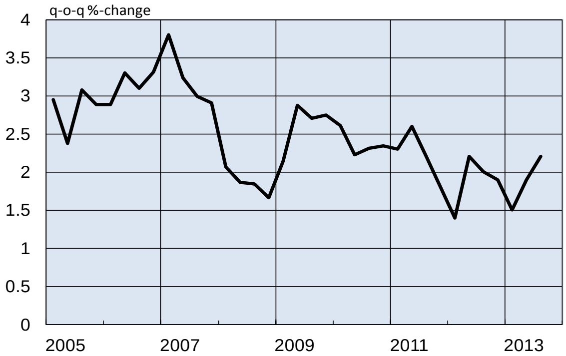
China

China's GDP growth accelerated in the third quarter. China's National Bureau of Statistics reports GDP rose in real terms 7.8 % y-o-y in the third quarter, and 2.2 % q-o-q. 12-month growth accelerated slightly from the second quarter, while on-quarter growth accelerated sharply (see chart). China's growth target for this year is 7.5 % and most international institutions and investment banks expect 2013 GDP growth to come somewhere in the range of 7.5–8.0 %.

Change in real GDP growth from previous quarter, % (seasonally adjusted)



Sources: BOFIT (2005–2010); NBS (2011–present)

The revival in economic growth largely originates from a pick-up in the pace of growth in fixed capital investment. During the summer, China's leadership was concerned about meeting its growth targets for this year so it implemented a "mini-stimulus" to accelerate economic growth. The stimulus was mainly directed at fixed capital investment. Growth in disposable household income has slowed this year from previous years, which has also dragged down domestic consumer demand growth. While the contribution of net exports to GDP growth has long remained quite modest, the economic significance of exports to the Chinese economy is much larger, as export earnings drive both domestic investment demand and consumer demand.

China's government this week announced that it was satisfied with the current pace of economic growth and indicated that GDP growth was on target for this year. The government is probably redirecting its economic policy focus back to long-term structural economic reforms.

Private consumption to GDP ratio increased in 2012. The NBS finally released its long-awaited 2012 GDP data this month. One fascinating jewel in 2012 data was that private consumption accounted for 36 % of GDP, a full percentage point increase from 2011. Public consumption was unchanged from previous years at just over 13 %.

Nevertheless, last year's figures did not show any significant shifts in the structure of the Chinese economy. Fixed capital investment still accounted for slightly below 46 % of GDP. Instead, private consumption was given room by inventory investment, which saw its share to decline a full percentage point to 2 % of GDP. China's trade surplus for goods and services increased slightly from 2012, but net exports still remained below 3 % of GDP.

China's GDP grew 7.7 % in 2012. About half of that growth came from consumption and half from investment. The contribution of net exports was essentially near zero. The continued reliance on capital investment this year to sustain economic growth could actually increase the share of investment in GDP this year.

Some researchers claim that China's private consumption relative to GDP is actually much higher than official figures suggest as a significant share of private consumption never gets recorded and some private consumption is recorded as corporate investment.

Lower income growth in China. The NBS reports that real disposable incomes of urban households increased slightly less than 7 % y-o-y in the first three quarters of 2013. Income growth, especially in wages, has slowed this year. The average per capita monthly income for an urban household was 2,240 yuan (about €270). In the countryside, the rise in household incomes remained brisk, rising nearly 10 % y-o-y. While the rise in incomes has long been higher in the countryside than in cities, the rural average monthly income was still just 850 yuan (about €100) per capita.

In addition to officially tracked earnings, the Chinese earn large amounts of under-the-table income. A research study published in September found that total grey-income equalled about 12 % of GDP in 2011, or nearly 4,500 yuan per capita. Off-the-books earnings, however, are not distributed evenly. Most of the money goes to the richest households, which, the study suggests, have higher actual incomes. Thus, income disparities in China are considerably greater than official figures show. The study was based on interviews with 5,000 households.

Thanks to relatively high economic growth and rising earnings, the number of super-rich individuals in China continues to rise. *Forbes* latest global billionaire survey found 150 Chinese with net wealth exceeding $1 billion. Wang Jianlin, China's richest man and chairman of the Dalian Wanda Group, made his money in the real estate sector. With net assets of about $14 billion, he is ranked as around the world's 60th richest person. China's richest woman is Yang Huiyan with net assets of about $7 billion. She, too, is a real estate mogul.