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BOFIT Weekly

4 • 24.1.2014

Russia

Russia's 2013 federal budget slightly in the red. The finance ministry reports the realised 2013 federal budget deficit was 0.5 % of GDP, somewhat less than originally planned.

Budget revenues last year amounted to 13.02 trillion rubles (€290 billion) and spending 13.33 trillion rubles (€296 billion). Realised revenues were slightly above and actual expenditures slightly below budget. The revenue boost came especially from higher-than-expected world crude oil prices that increased revenue under Russia's progressive oil tax regime. Other tax and fee revenue streams lagged their budget targets due to Russia's unexpectedly severe slowdown in economic growth last year.

Finance minister Anton Siluanov said he was for the most part satisfied with last year's budget performance. He said it was positive that there was no need to dip, as many had feared, into the Reserve Fund built up from oil and gas earnings to cover the budget deficit. He was disappointed, however, that only 200 billion rubles (€4.4 billion) in oil and gas revenues were allocated to the Reserve Fund last year. Siluanov said that, given the prevailing high oil prices, the Reserve Fund should have received almost a trillion rubles. Under an amendment to the law enacted a year ago, oil revenues not anticipated in the budget are no longer automatically allocated to state funds, but may be used to cover running costs of the government.

Despite the good budget picture, disconcerting trends emerged. The government has long sought to reduce its dependence on revenues from energy (mostly taxes and fees on crude oil production and oil exports). These presently account for about half of all federal budget revenues. Progress in weaning the budget off its dependence on oil is measured by calculating an alternative budget deficit that excludes state revenues from oil and gas. Siluanov noted this non-oil budget deficit should be limited to 5–6 % of GDP. Last year's non-oil deficit increased from 2012, reaching 10.2 % of GDP. The size of the non-oil deficit highlights the sensitivity of the state budget to a drop in global oil prices.

Russia's current account surplus contracted to 1.5 % of GDP in 2013. Preliminary balance-of-payments figures released by the Central Bank of Russia show a smaller current account surplus than at any time since the 1998 financial crisis. The goods trade surplus fell by 8 %, but still exceeded 8 % of GDP. The services trade deficit continued to deteriorate, as did deficits for the other current account categories such as dividend and interest payments.

Growth in export earnings halted last year. Income from goods exports fell as export earnings from crude oil and metals fell. Services exports, however, continued to rise.

Spending on imports was up around 5 % for the year, even if growth fell close to zero in the fourth quarter. Spending by Russians while on travel buoyed import growth. Other spending remained flat in on-year terms after summer.

The current account is expected to keep on shrinking this year.

Russia's balance-of-payments, main categories in 2011–2013

	USD billions			% of GDP		
	2011	2012	2013 (preliminary)	2011	2012	2013 (preliminary)
Current account	**97**	**72**	**33**	**5.1**	**3.6**	**1.5**
- exports (goods & services)	573	590	592	30.2	29.3	27.7
- imports (goods & services)	410	445	473	21.6	22.1	22.2
Trade balance (goods)	197	192	177	10.4	9.6	8.3
- exports	515	528	522	27.2	26.2	24.5
- imports	319	336	344	16.8	16.7	16.1
Services trade balance	-33	-47	-59	-1.8	-2.3	-2.8
- exports	58	62	70	3.1	3.1	3.3
- imports	92	109	129	4.8	5.4	6.1
Other items	-66	-74	-85	-3.5	-3.7	-4.0
Financial account + e&o	-85	-37	-55	-4.5	-1.8	-2.6
State (excl. central bank)	-2	16	7	-0.1	0.8	0.3
Banks	-24	19	-6	-1.3	0.9	-0.3
Other private, incl. e&o	-59	-75	-56	-3.1	-3.7	-2.6
- direct investments	-16	0	-19	-0.8	0.0	-0.9
- to Russia	50	43	78	2.6	2.1	3.7
- from Russia	66	43	97	3.5	2.1	4.5
- portfolio investments	-11	-10	-11	-0.6	-0.5	-0.5
- to Russia	-6	-8	-11	-0.3	-0.4	-0.5
- from Russia	4	2	0	0.2	0.1	0.0
- fictitious transactions	-33	-39	-27	-1.8	-1.9	-1.3
- errors and omissions (e&o)	-9	-10	-12	-0.5	-0.5	-0.5
- other items	9	-16	12	0.5	-0.8	0.6

Source: Central Bank of Russia

Capital exports from Russia increased slightly in 2013. Net capital exports abroad amounted to €55 billion. For the first time since the 2009 recession, net capital exports were larger than the current account surplus, which devalued the ruble over the course of the year. The increase in net capital exports came mainly from the banking sector's increased capital exports (mainly in the form of deposits and credits abroad) and reduced capital imports.

On the other hand, the net capital outflows for the rest of the private sector fell last year, even if they were still substantial. Direct investment inflows into Russia increased partly, but not only, due to the huge transactions related to the TNK-BP/Rosneft ownership deal. All growth in DI outflows from Russia can be attributed to that oil deal. The increase in corporate borrowing was also largely driven by money borrowed from abroad to finance the TNK-BP/ Rosneft deal.

Non-resident investors continued to repatriate their earlier portfolio investments in Russia's corporate sector.

The balance-of-payments item "fictitious transactions" includes a variety of illegal activities such as transactions related to tax evasion. Capital exports created by using these transactions fell slightly last year.

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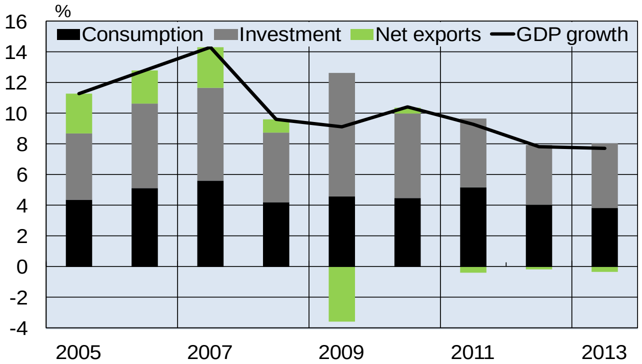
China

China's fourth-quarter GDP growth matches expectations. The National Bureau of Statistics reports economic growth of 7.7 % y-o-y in the fourth quarter of 2013. Growth slowed slightly from the third quarter as the effects of the government's mini-stimulus last summer faded. GDP growth for all of 2013 was 7.7 %, the same as in 2012, i.e. it surpassed the 7.5 % bottom limit of the government's GDP growth target for last year.

GDP growth and contributions of key demand components



Source: NBS

Growth in domestic consumption slowed slightly last year on sluggish income gains, while capital investment accounted for an increasing share of economic activity. Over half of last year's growth came from investment growth supported by last summer's mini-stimulus. If official figures are credible, this suggests China made little progress last year in rebalancing its economy towards a more consumption-driven model. Indeed, the investment ratio (capital investment to GDP) rose slightly. Some observers discount the official figures, however, noting that consumption likely plays a larger role than reported. For example, firms book some of their consumption spending as investment.

Economic growth was restrained by the contraction in net exports. Nevertheless, exports remain important for China; robust exports tend to attract further investment and bolster consumption demand.

Although economic growth has slowed significantly in recent years, it has been high enough to assure high employment. Indeed, lower future economic growth is not particularly problematic in this respect as the pool of working-age people shrinks and the structure of the economy evolves. The official GDP growth target for this year has yet to be announced, but most observers expect 7.5 % or 7.0 %. Most forecasts for China anticipate a moderate deceleration in growth. For example, the IMF's forecast released this week sees growth slowing to 7.5 % in 2014 and 7.3 % in 2015.

Income growth in China slowed last year; income disparity remains high. The NBS statistics show that growth in household disposable income remained fairly strong in 2013, even if it slowed a bit from 2012. Growth in real incomes of urbanites slowed by nearly three percentage points to 7 % y-o-y. Real wages in the countryside continued to increase rapidly, reaching 9 % last year. Wages have risen faster in the countryside than in cities since 2009, although the earnings gap between town and country is still substantial. The average disposable monthly income of city-dwellers was 2,200 yuan (€270), while rural folk averaged 740 yuan (€90).

Income trends are guided to some extent by provincial minimum wage decisions. Last year, most provinces raised the minimum wage by 8–15 %. Shanghai currently has the highest monthly minimum wage – 1,620 yuan (€200). Shenzhen, however, will surpass Shanghai at the beginning of February when its minimum monthly wage goes up to 1,800 yuan (€220). The hikes largely affect labour-intensive branches such as textile manufacture.

Wage hikes promote the shift to an economic growth model driven by consumption and services. The downside is that higher labour costs depress corporate profitability. Real wages have been rising faster than productivity gains in China and producers have been unable to shift the full increase in labour unit costs to product prices (see BOFIT Discussion Paper 3/2014). This situation has somewhat depressed corporate profit margins, forcing a shift in labour-intensive industries to areas with lower labour costs. The shrinking cohort of working-age Chinese in the future and rising education levels will continue to put upward pressure on wage levels.

The official NBS calculation of China's gini coefficient, a rough indicator of income disparity, was 0.473 last year (0.474 in 2012). In other words, it seems that the income disparity in China was just about as severe as earlier. A notable shift last year, however, was that food prices rose substantially faster than other product categories. This change most strongly affects the purchasing power of low-income individuals.

Somewhat perversely, China's income disparity indicators could get some relief through flight of the rich. A recent survey from the research firm Hurun found that 64 % of the polled rich people (net worth over €1.2 million) had already moved or were planning to move abroad, preferably to the US or Europe.

The Chinese are famously avid savers, but the savings rate has reached world-beating levels in recent years. Apartments, education, health care and retirement are only some of the things that motivate Chinese saving. Last year urban households set aside about a third of their disposable income. Reducing income inequality and improving the social safety net could help reduce Chinese savings rates and accelerate structural reform of the economy.

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