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BOFIT Weekly

5 • 31.1.2014

Russia

Russian economic growth slowed sharply last year. Growth slowed in the first half of last year, but picked up a bit in the fourth quarter. The economy ministry's preliminary estimate puts GDP growth for all of 2013 at 1.4 %.

Manufacturing, which enjoyed a strong recovery after the 2009 recession, saw practically no growth last year. It was unchanged also in the fourth quarter from 4Q2012. Extractive industry growth remained at just over 1 %, mostly a reflection of a recovery of natural gas production. Agricultural output saw strong growth thanks to a bumper grain harvest.

Growth in retail sales slowed to about 4 %. This was due mainly to the end of the boom in sales of non-food goods on lower growth of real household incomes and credit.

Growth in fixed capital investment stalled completely last year. Export volume growth recovered on higher exports of petroleum products and natural gas. Import growth slowed and was quite modest relative to recent years when imports bounced back from the 2009 recession.

Key Russia economic indicators, %-change

	2009	2010	2011	2012	2013
GDP	**-7.8**	**4.5**	**4.3**	**3.4**	**1.4**
Industrial production	-9.3	8.2	4.7	2.6	0.3
- extractive industries	-0.6	3.6	1.9	1.1	1.2
- crude oil	1.2	2.2	1.2	1.4	0.9
- natural gas	-12.2	11.7	3.1	-2.4	2.1
- manufacturing industries	-15.2	11.8	6.5	4.1	0.1
Agricultural production	1.4	-11.3	23.0	-4.8	6.2
Retail sales	-5.1	6.5	7.1	6.3	3.9
- food	-1.9	5.1	3.4	3.6	2.5
- non-food	-8.2	8.0	10.8	8.6	5.0
Construction	-13.2	5.0	5.1	2.4	-1.5
Fixed investments	-13.5	6.3	10.8	6.6	-0.3
Exports (goods & services)	-4.7	7.0	0.3	1.4	3.5*
Imports (goods & services)	-30.4	25.8	20.3	8.8	3.3*
Imports, euro value (goods & services)	*-29.3*	*37.4*	*21.4*	*17.6*	*2.8*

* January-September 2013

Sources: Rosstat, Ministry of Economy, CBR

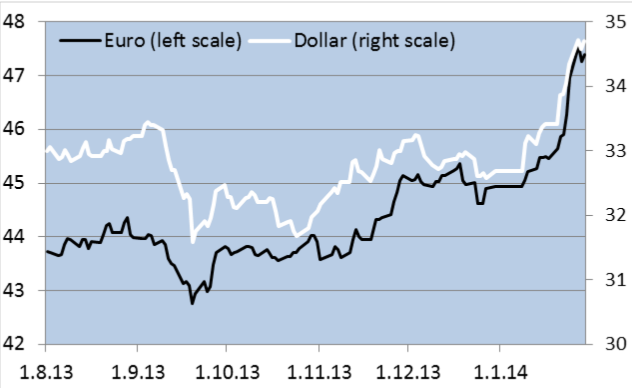
Ruble nosedives. Over the first four weeks of 2014, the ruble shed about 5–6 % of its value against the euro and the dollar. For all of last year, the ruble lost about 12 % of its value against the euro and 7 % against the dollar. The ruble has not been this weak since its devaluation in early 2009 following the global financial crisis.

The ruble's slide picked up momentum last week as general uncertainty in emerging markets increased. That pace continued to accelerate this week. Current CBR policy allows the market more say in formation of the ruble's exchange rate, but the central bank has still intervened in the currency markets to smooth its decline. The CBR's operations to control the ruble's descent have been exceptional in recent weeks. On Tuesday (Jan. 28), the CBR spent $1.1 billion on buying rubles and on Wednesday another $400 million. Indeed, before Tuesday's big sell, the CBR this month was blowing through an average of $260 million a day.

On the other hand, the CBR has not reacted to the exchange-rate drop by adjusting steering rates. Interbank market rates have also held steady. The Moscow Exchange has been on a downward trend lately, but share prices are nowhere near last year's lows.

The ruble's decline has largely domestic roots, reflecting the bleak growth outlook for the Russian economy. However, it has been given an extra tailwind from the agitated state of emerging markets. The CBR's adoption of a more liberal exchange rate policy has permitted this trend.

Euro-ruble, dollar-ruble exchange rates, 1.8.2013–29.1.2014 (rising line indicates ruble weakening)



Source: Central Bank of Russia

Russia seeks to attract Japanese investment in Far East agricultural sector. Deputy agriculture minister Oleg Savelev says plans to apply the special economic zone concept to farming in the Russian Far East are under consideration. Farms within special economic zones would enjoy a variety of tax breaks and other incentives. The Japanese Hokkaido Bank has expressed interest in the initiative and is currently putting together an investor group to discuss the creation of special economic zones in the Khabarovsk and Primorsk regions. The Japanese would like to farm such row crops as buckwheat, soybeans, and feed corn in Russia. The first trial plantings are already completed.

Even without special economic zone status, a number of Chinese and a few Korean agricultural firms already farm in the Russian Far East. The Chinese firms operate as tenant farmers, leasing or otherwise occupying at least 600,000 hectares of farmland. The firms also employ local residents.

Increasing exports to Asia is important for farming in Russia's Far East. It is not economical to ship produce across seven time zones to the European side of Russia.

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

Year of the Horse enters on uncertain note. Starting today (Jan. 31), China's financial markets will be closed until February 6 for the Lunar New Year holiday. Markets have been jittery in recent weeks, not least on concerns about losses on trust and wealth management products. A coal company defaulted at the end of January on 3 billion yuan (€360 million) in trust loans. Although development of China's financial sector would need increasing market discipline and reduced moral hazard, it seems that trust product investors were once again bailed out with only minor interest income losses. The trust product in question promised a 10 % return. Details of the bailout and which organisations are involved are still matters of speculation.

A second contributor to the late-January angst was the tightening of liquidity on money markets. Demand for cash always increases ahead of Chinese New Year's holiday and this time around the People's Bank of China was prepared. It boosted the money supply and the spike in short-term money market rates was short-lived. The rate rise was smaller than during the liquidity tightening last December.

The yuan continues to face appreciation pressures. After appreciating in December, the yuan has stayed consistently around 6.05–6.06 yuan to the dollar, i.e. close to the strong-end of its narrow fluctuation band. At their lowest, January share prices on the Shanghai exchange were down as much as 12 % from their early December highs. Chinese stock markets have performed poorly already for a long time and recently have been battered on expectations of higher interest rates.

Uncertainty from emerging economies such as Turkey and Argentina has not been directly reflected on Chinese markets. Instead, China's cooling economy and financial market distress have contributed, along with the US Federal Reserve's decision to cut back on QEIII bond purchases, to the overall uncertainty afflicting many emerging economies. After an already bumpy Year of the Snake, investors are preparing for quite a ride in the Year of the Horse.

China had record large grain harvest last year. The total grain harvest last year exceeded 602 million metric tons, up from 590 million tons in 2012. Following a sharp drop in harvests in the early 2000s, China's grain harvests have risen each of the past ten years, averaging about 3 % per year. The growth reflects a larger amount of land area under cultivation and efficiency gains in production. Increased use of irrigation, artificial fertilizers and pesticides, as well as the adoption of advanced farm equipment and high-yield plant strains have boosted grain output per hectare on average about 20 % from a decade ago.

China seeks to be largely self-sufficient in key agricultural products. Domestic production, however, has failed to keep up with rising demand and changes in consumer preferences. In recent years, China has had to increase imports of agricultural products from abroad. In particular, imports of grains, soybeans, vegetable oils and sugar have risen substantially. At the same time, less and less farm produce has been available for export, so export volumes of agricultural products have been on the decline with the exceptions of a few vegetables, soy oil, honey and tea.

China's changing demographics brings challenges. The National Bureau of Statistics reports that China's population grew 0.5 % last year to 1.361 billion people. Population growth has held steadily at around 0.5 % for several years now. The one-child policy introduced in the 1970s is the main reason for the depressed birth rate. However, rising wealth in recent years appears to be further depressing population growth. As a result of low replacement rates and longer lifespans, the Chinese population is now aging rapidly. An older population is a challenge for the Chinese economy in that its shrinking labour force reduces the country's output potential. Sustained economic growth now must come through higher productivity gains instead.

The retirement age in China is 60, so the working-age population is typically measured according to the number of 15- to 59-year-olds. The cohort of 15- to 59-year-olds started to contract in 2012. During 2013, the pool of working-age people declined by 2.5 million, down about two percentage points to just over 67 % of the total population. The UN estimates that 15- to 59-year-olds will account for less than 60 % of the Chinese population within 20 years. The decline in the working-age population increases pressure to raise the retirement age.

At the same time, the share of the population over 65 has been rising rapidly and is approaching 10 %. The aging of the population has forced China's leadership to consider ways to improve the pension scheme in order to secure basic income for the elderly. Many consider the current pension arrangement unfair and underfunded.

In response to the distorted age structure of the population, China's leadership late last year offered concessions on the one-child policy. A couple would have the right to have a second child if at least one of the parents is an only child. It is unclear how much the reform will affect the birth rate and it will take years for impacts to be felt. The policy change might have an impact on gender imbalance at birth. China's gender imbalance remained unchanged last year with roughly 118 boys born for every 100 girls.

The rate of urbanization has slowed in recent years, but the general trend of people moving to cities remains strong. The share of the population living in cities grew more than a percentage point to 54 % last year. Urbanisation improves labour availability and delays the impacts on companies caused by the demographic shift.

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