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BOFIT Weekly

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Russia

Russian markets calm. The Central Bank of Russia intervened actively to support the ruble at the end of last week and early this week, selling an average of $2.9 billion of its currency reserves daily. The price of interventions to stabilise the currency have averaged around $400 million a day earlier this year. The CBR spent about $500 million on Tuesday and Wednesday (Mar. 18 and 19) propping up the ruble, and they are finally seeing some ruble appreciation. Yesterday (Mar. 20), one euro bought 49.97 rubles and one dollar 36.12 rubles.

The Moscow stock exchange has settled down a bit during this week with the RTS index recovering some of last week's losses. While the RTS is still down about 12 % from the start of the month and 22 % from the start of the year, share prices in Russia are still well above their 2009 nadir (see chart).

Moscow RTS index (January 1, 2009 – March 20, 2014)

Source: Reuters

Rising uncertainty has boosted capital exports from Russia. The economy ministry estimates net capital exports from Russia in January and February totalled $35 billion. Observers expect net capital exports in the first quarter to reach $50–70 billion. Net capital exports for 2013 overall amounted to $63 billion ($28 billion in 1Q2013).

CBR board offers dim economic outlook. At its March 14 meeting, the CBR board decided to hold its key rate at 7 %. The key rate had already been raised two weeks earlier. The CBR stated in its press release that ruble depreciation had increased the likelihood of higher inflation. The CBR now expects inflation to exceed its own year-end target of 5 %. In such circumstances, the board stressed that the central bank's primary task must be to restrain inflation. The bank also noted its duty to assure stability of financial markets, especially in the face of rising uncertainty in the international operating environment.

The CBR believes Russia's economic outlook has deteriorated substantially over the past month. It said it was highly likely that sluggish growth, economic uncertainty, tepid corporate profitability and tightening bank lending will hurt investment. Moreover, the CBR now expects lower real wage growth and reduced consumer confidence will diminish consumer demand. The board noted that any boost in economic growth from the ruble's recent devaluation was insufficient to offset these negative impacts.

Russian ministries draft measures to finance the Crimean economy. Unofficial government sources say the Russian government faces annual funding costs of about $3 billion (€2.2 billion) to finance the Crimean economy. The cost includes budget transfers to lift Crimean income levels to Russian standards and major investments in construction and maintenance of infrastructure.

Crimea is quite poor relative to Russian regions and consistently posts budget deficits. The average income per inhabitant last year was a mere 10,800 rubles, or less than a third the Russian average (37,000 rubles). Public sector wages, pensions and social entitlements in Crimea are also considerably lower than in Russia. President Putin has promised to raise them promptly as part of Crimea's integration. The Crimean social sector's annual financing needs are estimated to be at least 50 billion rubles (€1 billion).

The biggest spending allocation for Russia, however, will go to upgrading Crimea's poor infrastructure and integrating the Black Sea enclave with e.g. Russia's energy and transportation grids.

Russia's federal budget spending this year will reach nearly 14 trillion rubles (about €280 billion). Crimea-related costs in the federal budget, however, represent less than 1 % of total federal budget expenditures.

Gazprom's share of the European natural gas market increased last year. Although EU natural gas consumption declined about 1 % overall in 2013, Gazprom figures show its gas exports to the EU and Balkan countries increased 19 % to a total of 139 billion m^3. Gazprom controlled nearly 29 % of the EU gas market – its highest market share since 2008. The boost in market share reflects such factors as Gazprom's recent willingness to lower prices and higher LNG spot prices in Europe.

Gazprom has been compelled to follow the lead of Norway's Statoil and allow gas spot prices a greater role in price formation in a number of contracts renegotiated with European buyers over the last few years. Pricing in long-term supply contracts was earlier based almost solely on global oil prices. Observers note that Gazprom's average price for gas supplied to its European customers last year was already close to European spot prices.

Gazprom is currently again negotiating gas prices with certain European buyers. Buyers continue to insist that Gazprom drop its contract term requiring buyers to pay for a preset minimum amount of gas even when they have no need for it.

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China

Yuan trading band widens as expected. The People's Bank of China announced last Saturday (Mar. 15) that it was widening the yuan's trading band to allow market forces a greater role in setting the Chinese currency's external value. The yuan can now appreciate or depreciate up to 2 % against the PBoC's daily fixing against the US dollar. Prior to the change on Monday (Mar. 17), the permitted maximum fluctuation was 1 %. The widening of the trading band did not come as a surprise. The PBoC had issued numerous statements and made preparations anticipating the shift. The fluctuation band was last widened in April 2012.

Even with the band widening, the PBoC still holds considerable power in steering the yuan's exchange rate. For example, it decides the daily exchange rate fixing that sets the average rate from which the currency may diverge. When there is pressure for the exchange rate to exceed its 2 % appreciation or depreciation limit, the central bank intervenes by buying or selling foreign currency to keep the yuan within the trading band.

Yuan-dollar exchange rate (black); trading band limits (grey)

Sources: Macrobond, PBoC and BOFIT

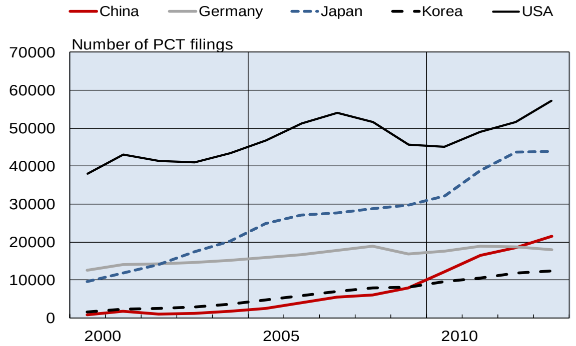
China surpasses Germany in patent applications. The World Intellectual Property Organization (WIPO) reports that about 205,000 cross-border patent applications were submitted last year under the Patent Cooperation Treaty (PCT) it oversees. The number of international patent filings was up overall by about 5 % from 2012. The US and Japan together accounted for nearly half of all patent applications. The number of Chinese patent filings continued to rise fast last year, giving China a share of over 10 % of total patent applications. China surpassed Germany as the third-most active patent-seeker.

The innovation and value contents in Chinese patents are likely less than in filings of leading industrialised countries, so WIPO figures probably exaggerate China's innovation abilities. Nevertheless, China's surge in patent activity suggests it is following the path to technological advancement blazed by Japan and South Korea.

Japan's Panasonic this year beat out China's ZTE, which had topped the leader board the previous two years for companies with most patent applications filed. Third place last year went to another Chinese telecom giant Huawei, last year's runner-up.

With over 21,000 patent applications last year, China stands head and shoulders over fellow BRICs India and Russia. Indian firms increased slightly their number of submitted patent applications to almost 1,400. Russia had just under 1,100 filings, about the same as in 2012. Finnish firms submitted 2,100 international patent applications, about 200 fewer than in 2012.

Leading countries in international PCT patent filings



Source: WIPO

China raises public spending, especially on healthcare and defence. The National People's Congress last week approved the proposed 2014 budget and realised 2013 budget. Public sector spending will increase this year nearly 10 % to 15.3 trillion yuan (€1.8 trillion). At 14 trillion yuan (€1.7 trillion), revenues should rise several percentage points less than spending. The budgeted public sector deficit will be 2 % of GDP. Last year's budget also forecasted a 2 % shortfall, but the actual deficit was slightly less due to higher-than-expected economic growth. Spending on public administration has increased faster than revenues in recent years.

The growth in healthcare spending will increase by about 15 % this year. The biggest increases will go to expanding rural healthcare services. Pensions and other social spending will also rise as China's population ages. Improvements in the social safety net will help reduce the Chinese compulsion of saving for a rainy day. Defence spending will increase 12 % to nearly €100 billion.

It is difficult to assess China's public sector finances in light of the large gaps in budget reporting and lack of transparency. However, the public sector deficit is larger than stated as local governments' substantial off-budget activities are not included. Off-budget debt has increased rapidly and is officially estimated at 32 % of GDP. Local administration revenues and expenditures are not itemised in the budget, so it is impossible e.g. to tell if there are any changes in spending allocation at the local level.

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