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# BOFIT Weekly
**20 • 16.5.2014**

# Russia

**Gazprom demands Ukraine pre-pay for gas deliveries.** After Ukraine failed to come up with the $1.3 billion Gazprom had demanded by its May 7 deadline for gas supplied in April, Gazprom said that as of June 2 it would only supply gas to Ukraine on a prepayment basis.

Ukraine refuses to pay the new hiked rate of $485 per 1,000 cubic metres that Gazprom introduced at the beginning of April. Ukraine says that if Gazprom does not back off on pricing, it will take the matter to the international arbitration court in Stockholm (Arbitration Institute).

Ukraine also refuses to pay Gazprom for earlier gas deliveries until the new price is agreed. Ukraine stopped paying its gas bills last autumn. According to Gazprom, Ukraine now owes it a total of $3.5 billion (including April deliveries). Ukraine claims it owes less.

At the end of April, the IMF granted Ukraine a $17 billion credit facility. The IMF last week released the first $3.2 billion tranche of the support programme to Ukraine. The money can be used for such purposes as debt servicing.

The Ukraine-Russia price dispute could affect the supply of gas piped to Europe via Ukraine. Representatives of Ukraine, Russia and the EU are still discussing the situation.

**Gazprom cuts gas price for Lithuania.** Lithuanian officials late last week announced that a gas price deal extending to the end of 2015 had been reached. Lithuanian prime minister Algirdas Butkevičius implied the discount amounts to at least 20 % off on Lithuania's current rate for Russian gas of $465 per 1,000 $m^3$. Butkevičius said the new rate roughly corresponds to the price Lithuania's neighbours are paying for Russian gas.

Now that the deal has been reached, Lithuania will most probably withdraw its filing with the arbitration court in Stockholm (Arbitration Institute) accusing Gazprom of discriminatory pricing policies.

**Russia requests consultation with WTO on EU energy policy.** Russia's complaint focuses on how the EU's Third Energy Package treats Russian energy infrastructure within the EU. Under the Third Energy Package rules, an energy supplier cannot own distribution infrastructure. The EU says the rule is intended to increase competition within the EU energy market.

In Russia's view, the Third Energy Package conflicts with the EU's own WTO commitments as it violates the principles of equal treatment and market access. The rules directly affect Gazprom's operations in Europe, including the planned South Stream pipeline that would bring gas to Europe via the Black Sea.

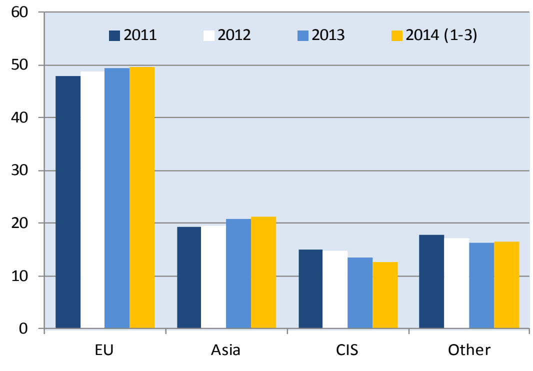
For its part, the EU Commission is investigating Gazprom's possible price manipulation and competition rule violation in the EU market. The EU Commission notes that Gazprom charges its European customers widely varying and often unreasonably high prices for the same product. The Commission launched an official investigation two years ago and is expected to present its findings within a few weeks.

**Russian goods trade contracted in January-March.** The first-quarter contraction in the value of imports of 7 % y-o-y reflects Russia's current economic slowdown and the ruble's slide. The value of goods imports from CIS countries dropped 20 % in the first quarter while the volume of these imports fell as much as over 40 % in January-February only. CIS countries, however, accounted for just over 10 % of Russian imports. EU countries supplied over 40 % of imports and Asian countries nearly 30 %. Foodstuffs were the only major import category to show growth in value terms in the first quarter. The value of imports in other major categories, i.e. machinery & equipment and chemical products declined sharply.

The value of goods exports contracted 2 % y-o-y in the first quarter. The export prices of nearly all Russia's major export commodities (crude oil, petroleum products, natural gas and metals) were slightly lower than a year earlier. Export volumes of crude oil and aluminium contracted sharply. Export volumes of natural gas and raw timber increased. Over half of Russian goods exports go to the EU. Asia's share is just under 20 % and CIS countries' a bit over 10 %. The value of exports was nearly double that of imports, driving the goods trade surplus to over $50 billion in the first quarter.

Russia's services trade increased slightly in January-March from a year earlier. Services represent nearly 30 % of total imports and just over 10 % of total exports. Russia's services trade deficit was $10 billion. The EU accounts for over 40 % of Russia's trade in services. Turkey is Russia's largest single services trade partner.

**Breakdown of Russian goods trade (imports + exports) by region, %.**




*Source: Russian customs*

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# China

**April's economic figures as expected, even as worries about the real estate sector deepen.** April's industrial output growth of nearly 9 % y-o-y matched the March figure. Growth in retail sales remained at around 10 %. The readings of key purchasing manager indices (PMIs) released earlier also signalled no significant changes in industrial or service sector conditions in April from previous months. GDP growth was 7.4 % y-o-y in the first quarter.

While economic output appeared stable overall, trends in the housing sector and construction activity are raising concerns. The situation varies across provinces, but a number of key indicators suggest a distinct cooling in the housing market. During the January-April period, the volume of new housing starts was down 25 % y-o-y, while the value of housing sales was off by 10 %. The stock of unsold apartments continued to rise and the decline in housing prices spread to more cities.

Real estate sector difficulties are driving the slowdown in construction activity, which has led to a deceleration in annual growth of cement production to below 4 % and steel output to around 5 %. The slowdown in the housing market partly explains the first-quarter slowdown in fixed capital investment growth. Real estate investment last year accounted for a quarter of total fixed capital investment. Because capital investment represents such a large share of GDP in China, the housing slowdown has a profound impact on the headline growth figure.

The slowdown in growth and problems in the real estate market are naturally reflected in the financial sector, where growth in lending continued to slow in April. Despite the slowdown, bank lending and other credit provision showed strong growth as a share of GDP in January-March, and rising debt levels remained on an unsustainable course.

Ultimately, the biggest headaches for China's economic policymakers are how to maintain high levels of employment and keep inflation low. 12-month inflation has remained around 2–3 % over the past two years, and the inflation outlook remains subdued in light of April's figure of 1.8 %. No reliable unemployment figures are available for China, but labour market signals do not seem to indicate any erosion of the employment situation.

If the employment situation remains good despite lower economic growth, the government will not have to resort to special measures to stimulate growth. From the standpoint of sustainable growth, curbing rising debt and focusing on reforms are more important than obsessing on meeting growth targets which may no longer correspond to the needs of the labour market or the environment. Providing reliable unemployment data would increase transparency of Chinese economic policy.

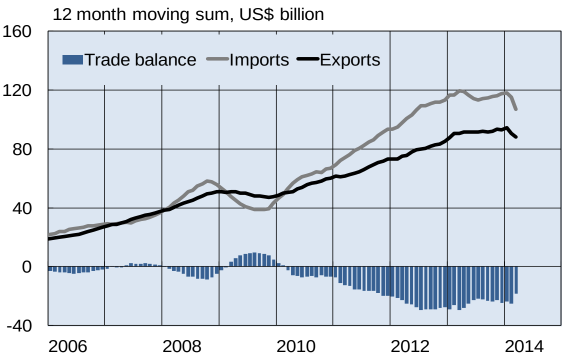
**Premier Li visits Africa amidst dip in trade.** During his eight-day, four-country tour of Africa last week, China's premier Li Keqiang met with leaders in Angola, Kenya, Nigeria and at African Union headquarters in Ethiopia. During the visit ending Sunday (May 11), China increased its promised concessional loans from $20 billion to $30 billion and announced it would provide nearly $4 billion in funding for construction of a railway line from Nairobi to Mombasa.

China's official news agency Xinhua noted the main purpose of the visit was to support Africa's development beyond cooperation only in exploiting the region's natural resources. This might be a way to address some of the criticism that China has faced over its activities in Africa, including charges that Chinese companies engage with corrupt governments, have poor environmental track records and mistreat workers.

China is Africa's most important single trading partner country, due largely to China's voracious demand for raw material inputs. For the same reason, China runs a huge trade deficit with Africa. As the supply of raw materials varies across countries, China's imports are concentrated in only a few African states. South Africa and Angola last year accounted for nearly 70 % of China's imports from Africa. Angola is China's second largest oil supplier after Saudi Arabia. Nearly 45 % of Angolan exports go to China. Most Chinese exports to Africa went to wealthier countries such as South Africa (18 % of exports to Africa), Nigeria (13 %) and Egypt (9 %). Chinese exports to Africa are mainly consumer electronics or investment goods.

Although China-Africa trade has boomed over the last decade, Africa's share in Chinese foreign trade remains modest. Exports to Africa last year amounted to around $90 billion, just 4 % of China's total exports. The value of imports was $120 billion, about 6 % of China's entire imports. The value of imports increased last year by less than 4 %, which was clearly lower than in previous years. Causes of the slowdown include the drop in world commodity prices and China's slowing economy. China's imports from Africa were down nearly a third in the first quarter.

**China's trade with African countries**




*Source: Macrobond*

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