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BOFIT Weekly

39 • 26.9.2014

Russia

Russia to keep tight fiscal policies in place next year. The draft federal budget approved by the cabinet last week (Sept. 18), upholds the budget rule adopted in 2012 that says the deficit may not exceed 1 % of GDP. In the face of heavy pressure to spend, the government limited the overall real rise in budget expenditures to a few per cent, (i.e. after inflation is taken into account). Finance minister Anton Siluanov said holding to agreed principles in both fiscal and monetary policy forms a foundation of certainty for the Russian economy on which economic actors must be able to rely.

The structure of budget spending has been aggressively modified to allow higher spending in such areas as defence and national security, as well as to boost certain sectors of the economy. Much of the spending in the final category will go to building new production or expand existing capacity to substitute for imports, especially in the defence and agriculture sectors. The measures are part of Russia's new emphasis on economic self-sufficiency. Redirected financing will also go to developing the Crimea and the Far East region, as well as funding large infrastructure projects such as Moscow's new ring road. The government sees giant state-funded infrastructure projects as a way to revive economic growth. The total proposed budget is 15.5 trillion rubles, or slightly over €310 billion.

Notably, the government refrained from any major tax hikes and did not even mention its much-derided sales tax proposal. The value-added tax will remain at its current 18 % rate.

The budget proposal, however, includes a controversial decision to increase budget revenues without raising taxes by transferring to the federal budget pension contributions collected next year for the funded part of the pension system. The arrangement was first introduced in this year's budget and has been heavily criticised. Observers note that it ruins the 2002 pension reform, which transitioned the Russian pension scheme from a pure pay-as-you-go system to a partially funded system. Under the system, one part of the collected pension contributions are used to pay out current pension obligations, while the other part is invested in long-term instruments to fund the future pensions of current workers. The feasibility of the partly funded pension system has been put under question since last year, when it was first decided to use pension contributions for funding budget outlays.

The final decisions on the budget in the Duma are slated for October. As the Duma is also considering government revisions to the tax code, changes in tax rules are to be expected in the future. The draft tax code proposal includes changes in taxation of oil production and oil exports, as well as dividend income. The Duma is also considering a bill to hike taxes on primary housing and other residential real estate e.g. by bringing appraised property values closer to market valuations.

Increasing Russia's agricultural output will take time. Russia has made boosting agricultural output and national food self-sufficiency top priorities since imposing a ban on imports of certain Western farm produce and processed foods. Official Russian statements on the ban characterise it as a tremendous opportunity to increase domestic farm production now that competing imports are off the market.

The agriculture ministry proposed in August that annual agricultural production subsidies be increased 50 % from the current 200 billion rubles (€4.2 billion). Funding needs next year are most acute for certain crops, especially potatoes and other major cultivars. In capital-intensive meat production, the bulk of new subsidies would be needed as interest support for investment loans. The draft 2015 budget just approved by the cabinet provides 20 billion rubles, far less than the requested 100 billion rubles.

In any case, subsidies would not transform Russian agriculture overnight. Increasing farm output will take time; anywhere from two to six years depending on the product. If Russia's import bans are lifted after a year as currently planned, it is not worthwhile for producers to invest in boosting output due to uncertainty about future demand.

Russia, like a number of countries in the northern hemisphere, is expecting a bumper grain harvest this year. The cereals harvest is estimated to be around 104–106 million metric tons, which would nearly match the all-time record set in 2008 of 108 million tons. Russia's annual grain harvest over the last ten years has averaged 84 million tons.

Russia demands, and gets, a delay in the launch of the Ukraine-EU free-trade agreement. On September 16, the EU and Ukraine ratified their earlier-approved association and free-trade agreements. Before ratification, representatives of the EU, Ukraine and Russia held talks on the possible impacts of the agreements. Russia noted that the free-trade deal is not compatible with the CIS countries' free-trade agreement, in which Ukraine is a member. As a result, Russia insisted that the launch of the free-trade agreement be delayed from November this year to the end of 2015.

Russia's biggest fear about the EU-Ukraine free-trade agreement is that it would allow EU goods to flow into Russia via Ukraine duty-free. At the beginning of the week, the Russian government published a decree to impose import duties on Ukraine trade if Ukraine went ahead with the launch of its EU free-trade agreement before the end of 2015. Russia also said it would take retaliatory measures if Ukraine adopts standards or regulations that harmonise trade practices with EU requirements.

Despite the delay in the implementation of the free-trade agreement, the EU will unilaterally keep in place the reduced import duty rates granted to Ukraine in May.

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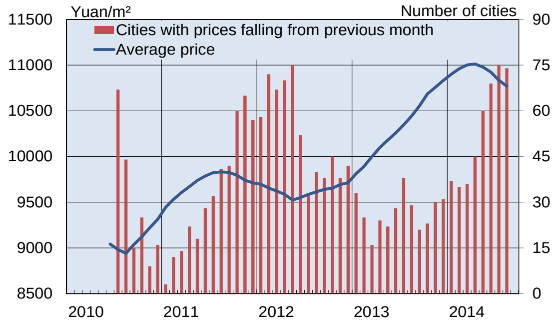
China

Worrisome trends in China's housing markets. SouFun's independent property research arm, which produces data on China's private real estate markets, reports that in August the average apartment price in China had fallen about 2 % from its April peak. In August, on-month prices fell in about three-quarters of the 98 cities surveyed by SouFun. Regional differences are huge, however, as the average August apartment price (price per square metre of liveable floorspace) for the country as a whole was under 10,800 yuan/m^2 (€1,360/m^2), compared to the Beijing average of about 32,700 yuan/m^2 (€4,140/m^2). Prices also declined in Beijing, Shanghai and Guangzhou.

Official figures support the notion that China's housing markets have cooled. In addition to an overall drop in apartment prices, housing sales measured both in terms of total floor space and value fell in January-August over 10 % from the same period a year earlier.

Over the past few years, officials have tightened borrowing requirements on builders and limited housing purchases by raising the required minimum down payment amount in response to the boom in real estate markets. The practice of buying several apartments was also discouraged. With economic growth now slowing, provincial and municipal governments are rolling back these restrictions. Real estate investment accounts for 10–15 % of GDP, and the budgets of many provincial and local governments rely on the sale of land use rights for a substantial share of their budget revenues.

Average housing prices and number of surveyed cities (98-city sample) where housing prices fell from the previous month



Sources: SouFun, Macrobond

Alibaba stages massive IPO. Last Friday (Sept. 19) saw the debut listing of Chinese Internet retailer on the New York Stock Exchange. On its first day out, Alibaba raised a total of $25 billion from investors, making it the largest IPO in history. After the IPO, Alibaba's founder and former English teacher, Jack Ma, became China's richest person. China's rising role as a driver of growth in the global economy can be seen in the fact that two previous IPO records were set by Chinese state banks, ABC in 2010 and ICBC in 2006.

The price of Alibaba shares rose 38 % on their first day of trading. At the closing bell, the company market capitalisation stood at around $230 billion. In terms of market cap, Alibaba whizzed by its main competitor, web-seller Amazon. Unlike other Internet retailers, Alibaba provides sellers with a platform for both selling and handling payment transactions. Alibaba's revenues derive mainly from advertising and service charges.

Investor enthusiasm for owning American depositary shares (ADRs) of Chinese firms listed on US exchanges has remained largely undaunted by Chinese scandals in recent years involving accounting fraud, improper company valuations and other abuses. In Alibaba's business sector, Chinese officials limit the ownership rights of foreigners, which can only access the underlying shares through Variable Interest Entities (VIEs). Observers warn, however, of risks inherent to VIE arrangements. Any disputes between Chinese and foreign investors, for example, may have to be resolved in Chinese courts. Moreover, Alibaba's new shareholders have no voting rights in corporate matters; they merely have the right to receive dividends.

China accounts for over half of growth in global greenhouse emissions. The UN climate summit got underway on Tuesday (Sept. 23) with headlines decrying the rapid rise in Chinese greenhouse gas emissions. According to a report of the Global Carbon Project, China last year accounted for 28 % of global CO_2 emissions. Second place went to the United States (14 %), followed by EU (10 %), India (7 %) and Russia (5 %). Global emissions rose 2 % in 2013. Emissions growth was highest in emerging economies such as China (up 4 %) and India (up 5 %). US emissions rose 3 %, while EU emissions fell 2 %. In per capita terms, China's CO_2 emissions surpassed the EU for the first time last year. On a per capita basis, US emissions are still 2.3 time higher than China's, and Russia 1.8 times higher than China's.

China's 2020 carbon intensity target calls for a reduction of carbon per unit of GDP, narrowly defined to include only emissions from energy consumption and industrial activity, to about 50 % of 2005 levels. This target would not, however, result in an overall reduction in China's carbon emissions. A large share of Chinese emissions still comes from coal. China says it will phase out the use of the dirtiest forms of coal, as well as limit emissions in the steel and cement industries. China also hopes to ramp up sustainable energy production. While consumption of renewable energy rose nearly 30 % last year, renewable energy only accounts for a small share of China's overall energy picture. Over 90 % of the energy consumed in China last year came from combustion of coal, oil or natural gas.

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