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BOFIT Weekly
21 • 27.5.2011

Russia

Eurasian Economic Community rides to the rescue of struggling Belarus. The Belarus central bank devalued the Belarus ruble by 36 % on Tuesday (May 24). The devaluation was expected as the country's economic situation, particularly its external balance, has worsened dramatically over the past year.

In 2010, the current account deficit widened to $8.5 billion, or 16 % of GDP. Foreign debt (public debt and private debt that consists largely of state-owned corporations' debt) increased by nearly 30 % to around 50 % of GDP. Belarus' foreign currency reserves dwindled by 25 % this year as companies and private individuals shifted their money into foreign currencies on fears of an impending devaluation. The rise in consumer prices accelerated to 18 % y-o-y in April; last year inflation was 8 %.

The central bank steers the Belarus ruble's external value against a currency basket composed of the US dollar, euro and Russian ruble. Over the past couple of months, it has been possible to trade the Belarus ruble at rates determined by the interbank and over-the-counter markets. The exchange rate for the Belarus ruble in these markets has been substantially lower than the official exchange rate. While the devaluation brought the official exchange rate down to levels close to market rates, it did not calm foreign exchange markets as demand for foreign currency continues to exceed supply. As part of the devaluation, the central bank re-imposed limits on interbank and over-the-counter currency trading so that the deviation may be no more than 2 % from the official rate.

Russia has supported the Belarus economy for years by selling it natural gas and crude oil at low prices. Belarus has refined most part of the oil for export, which has made petrochemical products an important source of foreign currency. Over the past couple of years, Russian efforts to wean Belarus off its cheap oil dependence have been one factor contributing to the current economic malaise of Belarus.

Belarus asked Russia in March for $6 billion to cover its current account deficit. Last week, Russia responded with an announcement that Belarus would be eligible for a $3 billion loan from the crisis fund of the Eurasian Economic Community. The money would be paid out in tranches over three years. The crisis fund board will make its final decision on the loan in early June. The Eurasian Economic Community is composed of Russia, Belarus, Kazakhstan, Kyrgyzstan, Tajikistan and Uzbekistan. Russia is the main financier of the EurAsEC crisis fund.

The loan conditions call for Belarus to adopt more flexible foreign exchange policies, and specifically a devaluation of the ruble. Belarus must also provide its own financing by privatising assets in the corporate sector (some 70 % is still state owned). Russian finance minister Alexei Kudrin reported Belarus had accepted the conditions and committed to sell off $2.5 billion a year in state assets over the next three years.

The first divestiture may be a 50 % share in state gas pipeline operator Beltransgaz, which, among other things, pipes gas from Russia to Western Europe. In 2006, Russia's Gazprom acquired a 50 % stake in Beltransgaz as part of a deal on gas supplies and pricing for 2007–2011. Gazprom, which has been eager to purchase all of Beltransgaz, will apparently get the remaining stake for around $2.5 billion.

The loan from the Eurasian Economic Community will only provide Belarus with temporary relief as the country continues to face daunting structural problems. The country still operates for the most part as a command economy, largely enabled by the fact that cheap commodities from Russia served as a de facto form of economic subsidy. The IMF has recommended that Belarus move ahead with structural reforms (such as privatisation), adopt a more flexible foreign exchange policy and reduce state spending. Public spending surged last year in the run-up to the December presidential elections, including large hikes in wages and corporate subsidies that significantly added to Belarus's economic troubles.

Important listing of Russian firm on Nasdaq. Russia's biggest search engine company, Yandex, debuted on May 24 on the technology-oriented US Nasdaq exchange with a $1.3 billion initial public offering. On the first day of trading, the company's shares rose strongly from the IPO starting price of $25 a share, closing at $36. It was the largest technology IPO in the US since the Google IPO in 2004.

Nasdaq information states Yandex had 64 % of the market for Russian search engine activity in 2010. In second place was Google with a 22 % market share and Mail.ru with an 8 % market share. In Russia Yandex sees Mail.ru as its biggest competitor; in addition to search services, Mail.ru provides Russia's most popular email service.

Since the listing boom of 2006 and 2007, there have been relatively few listings of Russian firms on foreign stock exchanges. Most Russian companies that have listed abroad in recent years have listed on the London Stock Exchange. There are 30 Russian firms on the London Stock Exchange. Most of them operate in the metals and mining sector and the oil and gas sector. The biggest Russian companies on the London Stock Exchange are Gazprom, Rosneft and Lukoil.

At present, five Russia-domiciled companies are listed on the New York Stock Exchange. The actual number of US-listed Russian companies is likely larger. For example, Yandex is domiciled in the Netherlands.

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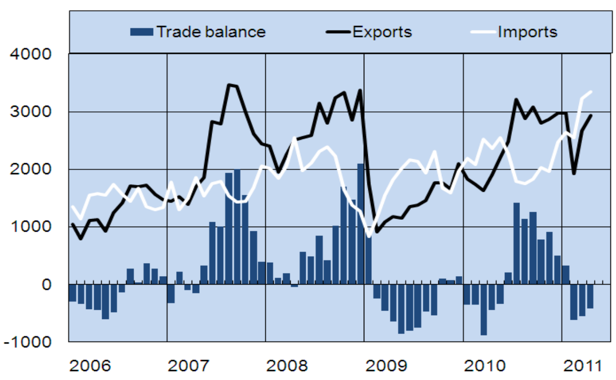
China

China's exports to Russia grow rapidly. China's exports to Russia in the first four months of 2011 amounted to nearly $11 billion, a 48 % increase from the same period a year earlier. Exports to Russia increased substantially faster than China's exports overall (27 %). China's imports from Russia amounted to nearly $12 billion in the period, a 30 % rise from January-April 2010. Imports from Russia increased at about the same pace as China's imports overall. The trade deficit with Russia for the first four months reflects seasonal factors; China is still on track to post a trade surplus with Russia this year. While Russia's share of China's exports grew slightly on-year in January-April, Russia remains a minor trading partner for China, accounting for only 2 % of exports and imports.

China's exports to Russia are quite diverse. The leading export categories include machinery and equipment, as well as textiles, clothing and footwear. The value of exports of transportation vehicles soared 135 % from 1Q10, but was still just over $400 million. China's imports from Russia were composed almost exclusively of energy, raw materials and low-value-added products. The share of machinery and equipment imports was just a few per cent.

For the January-March period, 6 % of China's crude oil imports came from Russia. Oil imports from Russia actually decreased in the first quarter 13 % y-o-y compared to 1Q10, even if import capacity was increased substantially with the January inauguration of the Siberia-Daqing pipeline. China's total oil imports rose 12 % y-o-y in the first quarter of this year. While the bulk of China's coal imports come from Russia, coal imports overall are dwarfed by domestic production. Coal imports were down considerably in the first quarter for Russia and other countries.

Monthly levels of China-Russia trade, USD million

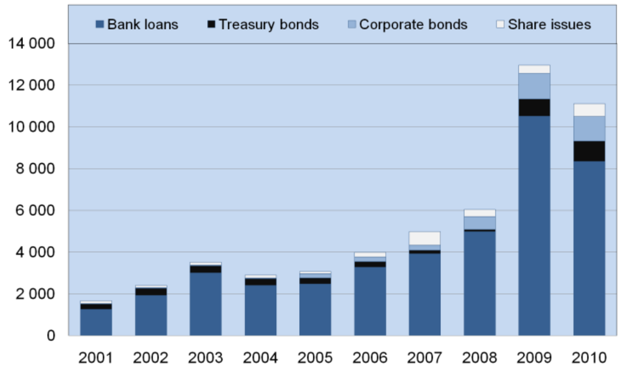


Source: CEIC Data

Growing importance of securities on China's financial markets. According to the quarterly monetary policy report of the People's Bank of China, the volume of financing for households, enterprises and the public-sector branches doubled in 2009 to about 13 trillion yuan due to the global financial crisis. Most of the financing was dispersed in the form of bank loans. In 2010, bank loans accounted for about 75 % of total financing, state treasury bonds 9 %, corporate bonds 10 % and equity financing raised on stock markets for about 5 %. The relative shares of corporate bonds and share issues of the total financing structure increased from 2009.

According to the National Bureau of Statistics, in 2010 over 60 % of corporate fixed asset investment was financed with retained earnings. The next largest sources of credit were domestic loans (15 %), state budget (5 %) and foreign capital (nearly 2 %). About 15 % of financing came from other sources. The financing structure for fixed investment in China has not shifted significantly in recent years.

Structure of China's credit markets (CNY billion)



Sources: PBoC and CEIC Data

Drought continues nationally; critical rice production areas experiencing worst dry spell in over 50 years. Now more than 200 days into a severe drought, rainfall in the central and lower zones of the Yangtze Basin remain about half their seasonal average. The drought affects irrigated crops, which include much of the rice produced in China. As a result, grain prices have risen on world commodity markets in recent weeks. The agriculture ministry is considering increasing the amount of land dedicated to rice-growing to counter an expected shortfall.

Drought has caused village water supplies to dwindle and forced the government to restrict heavier barge traffic on the Yangtze River. The water level is currently about three meters below normal.

To ease conditions, more water is being released from the Three Gorges Dam. China faces a challenging water future; the country's limited fresh water resources are not only allocated quite unevenly from a geographic perspective but also polluted in many cases. The World Bank estimates that potable water supplies per capita in China are only a quarter of the world average.

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