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Russia

Drafting of 2020 Strategy continues – economic policies discussed. In February, prime minister Vladimir Putin set up 21 working groups to prepare the national "Strategy for Social and Economic Development of Russia until 2020." The working groups are tasked with creating development scenarios for various branches of the economy in the wake of the financial crisis.

The Strategy should be ready ahead of the upcoming Duma elections in December and the presidential election in March. The Strategy would discuss how well the economy has been managed in recent years and what needs to be done in the years ahead. The work is supposed to be as transparent as possible; preparation of the strategy can be followed at the 2020 Strategy website (in Russian).

The working groups will be coordinated by two well-known liberal economists: Vladimir Mau, rector of the Academy of National Economy and Public Administration, and Yaroslav Kuzminov, rector of Moscow's Higher School of Economics. The working groups will deal with various aspects of the economy and society, including macroeconomy, healthcare system, pension reform, tax policy, state administration, education and the financial sector. The working groups comprise over 1,100 members from the public sector, business and research institutions. They also include foreign experts.

Yaroslav Kuzminov would like to see the working groups indentify ways to achieve economic development in conditions with scarce public resources. This is unfamiliar territory for Russia, where oil earnings permitted a vast expansion in public spending during the second half of the 2000s; most notably the social sector. Social spending is expected to keep increasing at 8 % a year, which will provide a substantial drag on the budget, so it is important to find ways to make delivery of social services more efficient.

In their first preliminary reports, the working groups identified factors dragging down economic performance. Fixing these problems will require fundamental changes in the relations of the state and the business community. State-owned companies unbeholden to market rules often dominate in the corporate sector. There is little competition, the economy is not open enough internationally and the share of shadow economy is significant.

Vladimir Mau commented that development of Russia's political and economic institutions seriously suffered in the past decades as Russia could earn money from exporting commodities and did not need to concern itself with raising productivity. Yevgeni Yasin, scientific director of the Higher School of Economics said Russia's largest challenge is its lack of competitiveness on world markets: Russia is not a modern innovator like advanced economies, nor is it a low-cost producer like many developing countries.

Experts also offer criticism of Russian policies during the boom years preceding recession. Wages in low-wage sectors as well as pensions saw dramatic increases, which fuelled inflation and increased imports, as domestic producers were unable to satisfy burgeoning demand. These measures served to aggravate the effect of the global downturn on Russia.

Russia has a long tradition of preparing economic roadmap programmes that have varied in importance over the years. The significance of the 2020 Strategy may be in the fact that it draws attention to the need to adjust economic policy and develops policy alternatives. The working groups most probably won't produce any totally new policies, as the views they present have occurred repeatedly in policy debates in Russia.

CBR raises interest rates again. On May 30, the CBR surprised the markets with a 25 basis-point increase in the deposit rate. The one-day deposit rate is now 3.25 % and the one-month deposit rate is up to 5.5 %. The goal of the rate hike was to reduce liquidity in the banking sector and relieve inflationary pressures. Ongoing heavy capital exports were also seen as a justification for the hike. The CBR left credit rates untouched this round.

Rates were hiked just four weeks ago. The CBR board meets once a month to deal with monetary policy issues and review key rates.

Russia to lift ban on grain exports from start of July. Russia banned grain exports in August 2010 after a poor harvest due to summer's exceptional drought. Last year's grain harvest totalled a mere 61 million tons, 37 % less than in 2009. The purpose of the export ban was to calm rocketing food prices on the domestic market.

The export ban seriously depressed domestic grain prices. Grain in Russia is currently selling in the range of 5,200–5,400 rubles (€130–135) a ton, or about 40 % below the current world price.

The CBR expressed concerns that ending the export ban could drive up food prices and inflation. In announcing the ban lifting, prime minister Putin said the government remained ready to take further measures if the impact on prices was substantial.

The agriculture ministry's forecast for 2011, released in March, sees for this year a grain harvest of around 85 million tons, which is about average for the past decade. Russia still has about 6 million tons of grain in its reserves. An average harvest would be sufficient to support exports, as domestic demand averages about 75 million tons a year.

With the exception of 2010, Russian wheat exports increased rapidly throughout the 2000s and made Russia one of the world's main grain exporters.

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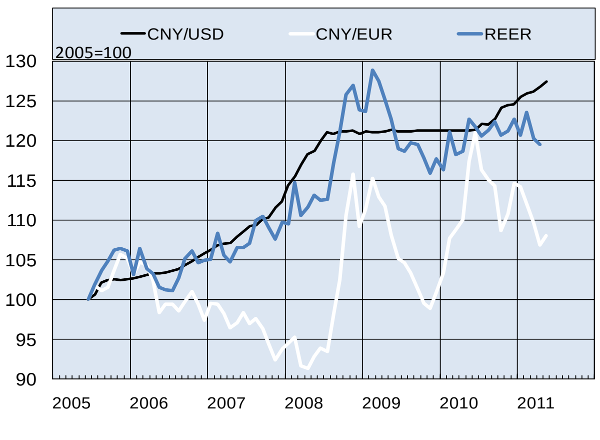
China

United States again refrains from accusing China of manipulating the yuan's exchange rate. Last week the US Treasury Department released its Semi-Annual Report to Congress on International Economic and Exchange Rate Policies. The report evaluates the policies of major trading partners. A central issue is whether trade partners are artificially manipulating their exchange rates to boost competitiveness. China's exchange rate policies have long been mentioned as a matter of large concern, and the report released last Friday (May 27) was no exception.

As previously, the report stated that the yuan remains significantly undervalued; a situation evidenced by China's rapid accumulation of foreign currency reserves and the fact that the yuan's real effective (trade-weighted) exchange rate has not appreciated despite China's productivity gains. The report further notes the IMF's forecast that China's current account surplus will continue to grow in coming years.

Once again, the treasury department refrained from directly accusing China of exchange rate manipulation. Such a charge would oblige the US to implement a range of retaliatory measures against China. The US decision to back away from charges on exchange rate manipulation reflects the fact that the yuan has to some extent decoupled from its dollar peg, appreciating 5 % in nominal terms against the dollar since July 2010. With inflation currently running higher in China than in the US, the yuan has gained about 9 % against the dollar in real terms. The report notes that China needs to keep its public commitments to increase flexibility of the yuan exchange rate and limit further growth in external imbalances.

Yuan-dollar, yuan-euro exchange rates and real effective exchange rate



Sources: BIS, Bloomberg

The yuan has lost about 7 % of its value against the euro since last July. BIS figures show China's nominal effective (trade-weighted) exchange rate at the end of April was 3 % lower than in July 2010.

China keeps on buying gold. In a report released in May, the World Gold Council (WGC) noted that Chinese demand for gold increased sharply in the first quarter of this year. The WGC attributed the rise in gold demand in China to the pick-up in inflation and low deposit rates. The People's Bank of China last year relaxed gold import restrictions on banks, thereby allowing an increase in the supply of gold investment products. The price of gold has risen to an all-time high not just on the Shanghai Gold Exchange but in world markets generally ($1,532 oz., June 3).

In January-March, China's purchases of gold bullion and coins increased to 90 tons, surpassing India, traditionally the world's biggest gold buyer. China's gold-buying was up 123 % from 40 tons in 1Q10. In 1Q11, India purchased 86 tons of gold, an 8 % increase from a year earlier.

China's purchases of gold jewelry increased about 20% in the first quarter to 143 tons. India purchased 207 tons of gold jewellery in the same period (an increase of 12 % y-o-y). The combined total of investment and jewelry gold made China in January-March the world's second largest buyer of gold at 234 tons (an increase of 47 % y-o-y), while India retained its status as biggest buyer at 292 tons (up 11 %).

China has been the world's largest gold producer since 2007. Last year, it produced 360 tons of gold – an increase of 9 % from 2009. The WGC estimates that China's total demand last year was 700 tons, of which about 340 tons were imported. Chinese officials do not release information about gold imports. Chinese gold producers and investment companies recently appear to be active in investing in gold mining operations elsewhere in Asia and in Africa.

Construction and transport projects most afflicted by corruption. During the first quarter of 2011, nearly 2,000 people were charged with corruption in a variety of projects in the construction branch. China's official Xinhua news bureau recently reported that during 2003–2009 over 200,000 corruption cases were filed.

By international corruption standards, China is in the mid-range in country comparisons. For example, China ranked 78 of 178 on Transparency International's Corruption Perception Index (CPI). Even so, China's corruption level is hardly satisfactory.

In recent months, premier Wen Jiabao has urged making the battle against corruption a political priority. Fighting against corruption is complicated by the government's hostility towards those who criticise it.

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