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BOFIT Weekly

31 • 5.8.2011

Russia

Decent harvest outlook. Russia's agriculture ministry is currently projecting a 2011 grain harvest in the range of 85–90 million metric tons, a considerable improvement over last year's drought-depressed figure of 61 million tons. The 2009 harvest topped 97 million tons, while the bumper 2008 harvest holds the record at 108 million tons.

Russia is expected to export about 18 million tons of grain this year, including some 16 million tons of wheat. The government last August banned the export of certain grains, including wheat and oats, due to the poor harvest. The ban was only lifted at the end of June. In 2009, Russia exported 22 million tons of grain, of which 18 million tons was wheat. Russia that year was the world's third largest wheat exporter after the United States and Canada.

With last year's poor harvest, the state substantially increased agricultural subsidies, including increases in interest support for loans to producers and assistance in rescheduling of loans. Producers were also given money for fodder to avoid massive slaughter of livestock.

After the depressed 1990s, agricultural subsidies were increased throughout the 2000s in Russia. Today they are close to EU levels (due in part to reductions in EU farm subsidies in the same period). The OECD estimates that subsidies represented 22 % of farm income in Russia in 2008–2010, when the OECD average was 20 % and the EU average 22 %.

Agricultural subsidies are still an open issue in Russia's WTO accession talks. Russia wants to boost subsidies in coming years and then gradually return them to their current level within 5–7 years.

Passenger car production and car imports surging. In the first six months of this year, 818,000 passenger cars were produced in Russia, a 77 % y-o-y increase. First-half production exceeded more than half of the production set in 2008.

According to Autostat, the leading tracker of Russian car industry, in 2010 the number of foreign-make cars produced in Russia exceeded domestic-make units for the first time ever. Foreign-make cars were 52 % of total production.

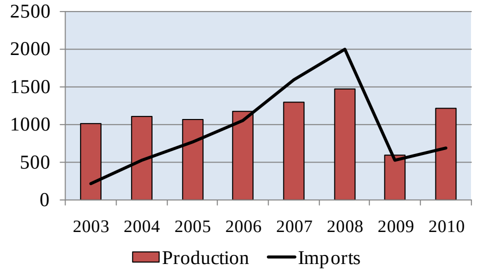
AvtoVaz, Russia's largest car producer and maker of the ubiquitous Lada, produced 295,000 cars in the January-June period, and accounted for 36 % of domestic production. Production was up 35 % y-o-y. AvtoVaz has been rapidly losing market share, however; last year it accounted for 45 % of Russian car production. Production of foreign car makes increased sharply in the first half of this year on a quadrupling of output from Hyundai, GM, Nissan and Toyota plants located in the St. Petersburg region. Their production climbed to around 99,000 cars or 12 % of total national production. In addition, Avtotor's assembly plants for BMW, Kia, Opel and some others in the Kaliningrad enclave accounted for 14 % of Russia's total car production. Volkswagen's Kaluga plant accounted for 7 % of total production.

Demand for new cars built or assembled in Russia was boosted by a trade-in programme launched in 2010. The "cash for clunkers" programme enjoyed about 30 billion rubles (€750 million) in funding and 600,000 new cars were sold under the programme. The largest beneficiary was AvtoVaz, which raked in 77 % of the programme's total funding. The programme ended in June.

The International Organization of Motor Vehicle Manufacturers reports that about 2 % of global car production was based in Russia in 2010. China accounted for 24 % of world car production and the EU 26 %.

Passenger car imports rose 93 % y-o-y in January-May to 371,000 vehicles. Even so, imports were far below the peak levels of 2008. This was due largely to the 30–35 % duty imposed on car imports in the midst of the 2009 recession.

Passenger car production and imports (thousands)



Sources: Rosstat and Russian Customs

Some progress in Russia's WTO negotiations. Late last month in Geneva, Russia's multilateral talks with the WTO working group tackled thorny outstanding issues, including automobile assembly plants, meat import quotas and agricultural subsidies. The most progress was achieved on the farm subsidy front.

Although Russia has failed to keep to the ambitious accession timetable laid out at the start of this year, it remains technically possible that Russia could be approved for WTO membership before the end of December. As long as outstanding issues can be resolved by November, Russia's petition for accession could be brought before the WTO General Council meeting in December.

Membership requires unanimous approval of the General Council, which includes Georgia, a declared opponent of Russian membership. Switzerland has served as a mediator in the Russia-Georgia dispute, but the three-party talks have yet to reach a solution.

After the General Council approves membership, Russia must ratify its accession documents, which could take several months. Moreover, it takes another month after ratification for membership to be official. Given these constraints, Russia's could join the WTO in the first half of 2012 at the earliest.

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China

Chinese economy registers slight slowdown. Although China's GDP still climbed a respectable 9.5 % y-o-y in the second quarter, there are numerous signs that growth overall is slowing. The official index of manufacturing purchasing managers (PMI) suggested dimmer but still positive trend, dropping slightly to 50.7 points in July. The reading was still around 53 points a half year ago. The alternative PMI released by HSBC, which is based on smaller sample and covers a larger share of small and medium-sized enterprises, dropped below the critical 50-point threshold to 49.3 points, indicating that manufacturing output was already in decline in July.

Despite evidence that growth in the service sector remains brisk, the duelling PMI numbers gave an inconclusive picture. The official PMI showed output of services revived in July from June, while the HSBC PMI portrayed the growth in services as slowing.

The latest data on foreign trade volume suggests that domestic factors such as the pick-up in inflation and monetary tightening, as well as the evaporation of foreign demand are depressing growth. The growth in on-year volumes for June imports and exports fell substantially from previous months; import volume was up just 3 % y-o-y and exports up 6 %.

Foreign banks with established local branches will be allowed to expand into local mutual fund products. The China Securities Regulatory Commission (CSRC) announced in June that foreign banks operating in China and Chinese private mutual fund companies can sell Chinese mutual fund products starting October 1. The new rules also make it possible to charge a wider selection of service fees than was previously possible. Indeed, there are relatively few services yet available in the mutual fund market because fund managers have not been allowed to charge higher fees for value-added services. As a result, Chinese investors have typically invested abroad via large international asset management firms.

Chinese commercial banks and securities brokerage houses were previously the only institutions permitted to sell Chinese mutual fund products. Chinese private mutual fund operators traded indirectly via banks, which meant their operations were outside the scope of CSRC regulation. A range of estimates of the size of China's mutual fund market has been presented; e.g. the *Financial Times* reports that registered mutual fund companies administer assets worth about 2.4 trillion yuan (€262 billion).

Officials hope that allowing foreign banks to get into the mutual fund business will increase competition in the field and reduce the dominant market position of Chinese commercial banks. Rules concerning the operations of foreign banks are strict in China, and the market share of foreign banks has remained under 2 %. A PricewaterhouseCoopers survey released in June found that foreign banks operating in China are optimistic about their future prospects, despite the strict regulatory environment. Banks believe China's markets will continue to open up and international acceptance of the yuan will create new growth opportunities. On the other hand, China's tight monetary stance has made it hard for foreign banks to lend and strict regulation remains a big challenge for the markets.

Investments in real estate markets remained brisk in the first half of the year. Construction investment grew 33 % y-o-y in January-June. This was partly due to huge state investments in construction of affordable housing and the fact that real estate continues to be seen as a good investment by Chinese. The volume of foreign investment grew significantly. Foreign direct investment doubled from a year ago to 33 billion yuan ($5 billion). Foreign investors were focused on various types of commercial space.

Prices for commercial space have risen fastest in coastal provinces. Sales of commercial space increased 20 % y-o-y in January-June. Apartment sales were somewhat slower, rising 12 % y-o-y. Investment in commercial space and apartment buildings overall increased nearly 40 %.

Despite the government's tightening measures, the rise in housing prices remained brisk in the first half. Housing prices rose an average of 7 % y-o-y in the period. Tightening measures to date have had their strongest impact in the major metropolises such as Beijing and Shanghai. Over the past two months the on-year rise in housing prices in the metropolises have been around 2 %.

Large regional cities have seen a greater rise in housing prices in recent months. The 5 % y-o-y pace is faster than in the major metropolises. The government not only plans to extend its housing purchase restrictions from major metropolises to other cities and large towns, it also expects further tightening measures.

The risk persists of a housing bubble in China. Construction activity remains an important economic driver, accounting for 12 % of GDP last year. The IMF earlier warned of the contagion effects of a housing crash on the economy and the banking system.

Housing prices remain high relative to household incomes. Although the framework of the current five-year plan calls for construction of 10 million affordable apartments this year, construction has only just begun. The estimated cost of the new housing is $200 billion, of which more than half will be provided by the private sector. The public sector will contribute $75 billion, with some $60 billion coming from local administrations and the remainder from the state budget. The ability of local administrations to fund their contribution is doubtful in some cases, so the central government is planning to help out by allowing certain local administrations to issue bonds.

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