EUROJÄRJESTELMÄ
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Russia

Election results unlikely to affect Russian economic policy. Preliminary results from last Sunday's (Dec. 4) Duma elections show United Russia garnered nearly 50 % of the vote (United Russia won 64 % of the vote in the 2007 Duma elections). Despite a loss of 77 Duma seats, United Russia maintains its dominance as the largest party. The largest gains in the elections were achieved by the Communists, who took over 20 % of the vote. Parties close to United Russia, the Liberal Democratic Party and A Just Russia, also posted gains.

While the election result has been characterised as a vote of no confidence for United Russia, the outcome is unlikely to impact current economic policies directly. The budget framework for 2012–2014 was set and approved before the elections, including plans to significantly raise defence spending in coming years. The budget framework calls for relatively small federal budget deficits that eventually vanish by 2015. The days of massive budget surpluses and a ballooning stabilisation fund are gone. Many observers expect short-term social spending to increase with the approaching presidential election in March.

When the new Duma convenes in January, its agenda will probably include ratification of Russia's WTO accession. Over its five-year term, the Duma must tackle challenging issues such as reforms of pension, health care and education systems, as well as energy sector taxation. None of these topics were prominent campaign issues.

Changes in taxation on the way. The mandatory social security contribution of employers will drop next month from its current 34 % of wage bill to 30 %. This adjustment in the rate remains in force until the end of 2013. (The rate was 36.5 % up to 2005, when it was lowered to 26 % and raised again to 34 % in at the start of 2011.) Finding an appropriate rate for the employers' contribution has been a thorny topic within the cabinet. On one hand, the government wants to support entrepreneurship by keeping the mandatory contribution as low as possible, but on the other hand social security contributions are insufficient to cover the actual costs of the system. Specifically, extensive underfunding of the pension fund has meant that a large share of pension payments has needed funding directly out of the federal budget. The funding need will increase further next year when the social security contribution is lowered again.

A number of taxes will be raised to compensate for reduced social security payments. Russia amended its tax code in November to allow hikes in the tobacco and alcohol excise taxes in the 2012–2014 period. The excise tax on tobacco will triple by 2014, bringing it into line with the European average. The biggest increase in alcohol taxation applies to distilled spirits, the excises tax of which will double by 2014. Also the gasoline excise tax will be increased notably more than the rate of inflation during 2012–2014. The biggest excise hikes will probably be imposed only next summer instead of January.

The extraction fee (resource use tax) for natural gas is significantly lower than the extraction fee on crude oil. This gap will be narrowed by doubling the current resource use tax on natural gas by 2014.

The finance ministry is currently reviewing the grounds for the numerous tax breaks granted to firms. The ministry's assessment shows that the overall value of tax breaks granted to firms in 2010 amounted to around 700 billion rubles (17 billion euros), an amount equivalent to about 10 % of combined federal and regional tax revenues. Of that, about 170 billion rubles constituted temporary relief on the resource use tax granted to oil and gas producers. Some 100 billion rubles was given in the form of property tax reductions for Russia's "natural monopolies," which include the railway network, oil and gas pipeline operators, and electrical power grid operators. Another 100 billion rubles came in the form of depreciation-related reductions of corporate profit tax. Next summer, the finance ministry will present recommendations on dealing with tax breaks and incentives. Some relatively small tax reductions that have been prone to abuse will be abolished already at the start of 2012. The overall goal of the ministry's assessment, however, is not to reduce tax breaks so much as to better focus their application.

Revived Russian consumption supports Finland's exports. Consumption in Russia has recovered rather rapidly since the 2008–2009 financial crisis. This is reflected clearly also in Russian imports. Imports measured in euros were up 25 % y-o-y in January-September.

Finnish exports to Russia have also shown a gradual recovery. In January-September, the value of exports was up 16 % y-o-y. Growth in export of investment goods, in particular, was brisk in the first nine months of the year, exceeding 30 % y-o-y. But as exports of investment goods declined sharply during the economic crisis their level is still far below pre-crisis levels.

In contrast, exports of consumer goods from Finland to Russia already exceed pre-crisis levels. The share of consumer goods in Finnish exports to Russia exceeded 10 % in January-September, up from pre-crisis level of 5 %. Food and medicines were among the biggest export categories.

This year has seen large increases in clothing exports and also transit shipments of textiles via Finland to Russia. The value of clothing exports increased 50 % y-o-y in January-September, while the value of textile and clothing transit shipments doubled. The value of total road transit transport from Finland eastward increased by 27 % y-o-y, but remained well below pre-crisis levels.

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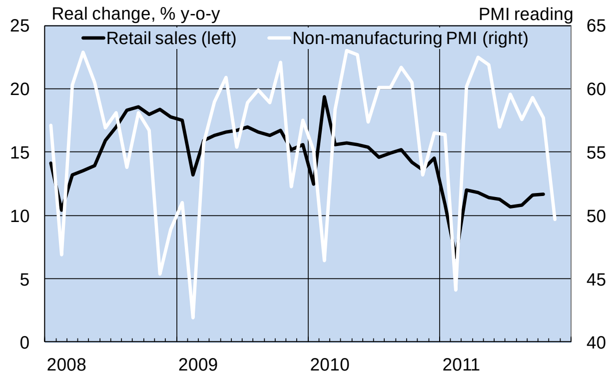
China

Growth also slowing in service branches. The latest reading of China's official purchasing managers' index (PMI) for the non-manufacturing sector dropped below 50 from a reading of nearly 58 in October. Although part of the drop registered by the China Federation of Logistics and Purchasing (CFLP) could be due to seasonal factors, the reading was accompanied by other strong indicators the economy is slowing. The CFLP's earlier-released November reading of the PMI for the manufacturing sector also dipped below the critical 50-point mark.

Getting an idea about conditions in the service sector is difficult due to the lack of good statistical data. Retail sales growth has gradually faded from earlier years, but even so was still up nearly 12 % y-o-y in September-October. The indicators of confidence of business-owners show growth subsiding from the first half. The biggest confidence drops were registered in the real estate and construction sectors, while confidence exceeded the average in data processing and hotel and restaurant services.

Services currently account for about 42 % of China's GDP, while industry generates about 48 % of GDP and primary production 10 %. Although agriculture and fishing have steadily declined relative to GDP, primary production still employs 38 % of China's 780-million-person labour force. Services employ about 34 % of the labour force and industry 28 %.

Real growth in retail sales and CFLP non-manufacturing PMI

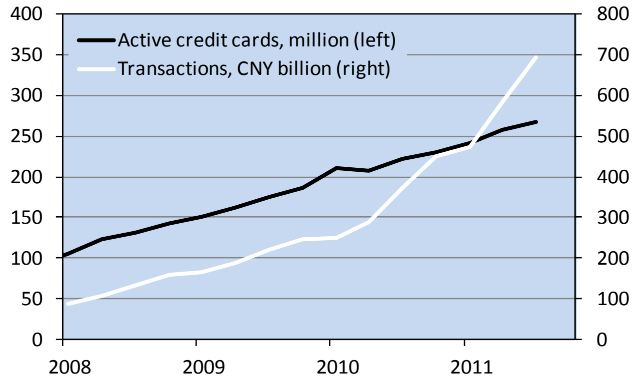


Source: Macrobond

Soaring credit card use – and overdue credit card payments. According to the People's Bank of China, the value of credit card payments over six months late exceeded 10 billion yuan (€1.2 billion) at the end of September. Overdue payments have risen quickly; at the beginning of the year the stock of late payments stood at just 7 billion yuan. The loss exposure for commercial banks from late payments and probable defaults, however, is relatively small compared to the size of banks' overall assets.

The biggest driver of soaring credit card debt is the rapid proliferation of credit cards. In the last four years, the number of issued cards has more than tripled. As of end-September, Chinese held 268 million active credit cards meaning one in five Chinese carries a credit card. An average credit limit per card is 9,000 yuan (about €1,000). In addition to the rapid rise in the amount of credit card holders, paying with a credit card has become much more common. Card use doubled in the January-September period compared to a year earlier, which in part might reflect overall tightened liquidity situation.

Number of credit cards and monthly value of transactions



Sources: CEIC and PBoC

Entertainment industry facing challenges in China. Official pronouncements declare that popular entertainment is an engine of Chinese economic growth that supports domestic demand and helps soften the image of China abroad. Not all is well in Chinese entertainment heaven, however, after the recent imposition of new restrictions by the State Administration of Radio, Film and Television (SARFT). International entertainment shows and scifi/fantasy programmes that refer to Chinese history face censorship. Some popular Western music has been banned on the basis of bad taste. To the chagrin of advertisers, SARFT has forbidden the showing of ads in the middle of TV programmes from the start of next year, and many popular shopping channels will be unavailable.

China's entertainment field experienced dizzying growth in recent years. Local tv channels focusing on entertainment rapidly outstripped their state tv counterparts in viewership. 520 feature-length films were produced in China last year, a level that exceeded the US and came second after India in quantity. Over half of the approximately 235 billion yuan in net sales of China's 250,000 ad agencies was generated by state-owned ad agencies. By unofficial estimates, China's advertising market this year surpassed Japan as the world's second largest after the US.

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