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BOFIT Weekly
14 • 5.4.2013

Russia

CBR's latest rate cuts have marginal impact. The Central Bank of Russia kicked off April by moving up its monthly monetary policy meeting by about two weeks from the typical mid-month scheduling. As the markets anticipated, the CBR lowered rates, but not all. The CBR's most important credit rate, the 1- to 7-day repo auction minimum, remained at 5.50 %. The rate cuts were focused mostly on longer-term credit rates that allow non-marketable securities as collateral. The credit rates were lowered by 25 basis points to 7–8 %.

The CBR based its decision on a projected slowdown in inflation in the second half of this year (12-month inflation was 7 % at the start of April) and the view that the chances of a further economic slowdown have increased. The CBR said the rate cuts would not significantly affect money market rates, but instead move rates on the longer-term loans closer to the rates of the CBR's basic operations.

Demands from Duma deputies and government circles for interest-rate reductions have increased as economic growth has slowed. Companies complain that high interest rates make it hard for them to operate (the average rate on ruble loans up to one year hit 9.6 % in February). Some experts note that, given the current state of the economy, the CBR's rate cuts will only affect bank lending rates slightly. Russia's high interest rates mainly reflect high risks associated with lending. Thus, interest rate cuts are likely to do little to promote capital investment as long as companies are uncertain about future business prospects.

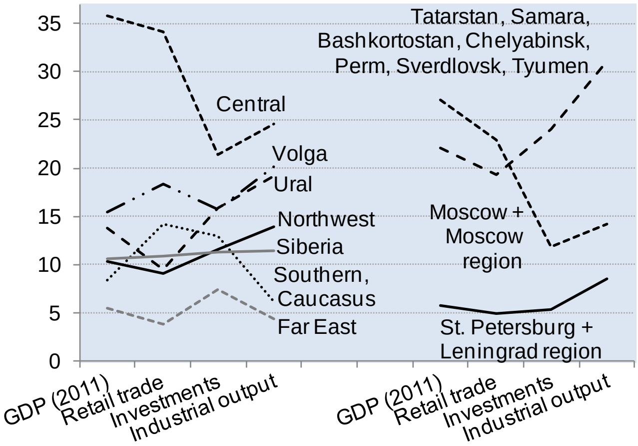
Russian regions posted rather uneven economic performances last year. In the Central Federal District that includes Moscow and in the eastern parts of Russia, growth in retail sales slowed last year, but even so growth averaged 5–8 %. In Moscow and the Moscow region, growth slowed sharply (below 2 % for Moscow). Nevertheless, the concentration of consumer activity in these regions still accounted for 23 % of all retail sales in Russia. In Northwest Russia, retail sales growth picked up, especially in St. Petersburg (up 8 %), as well as in the southern parts of Russia and all the way to east of the Urals (7–8 %). In January and February this year, retail sales growth outside Moscow, the Moscow region and St. Petersburg was still quite rapid.

Capital investment growth tended to stabilise in most regions. In St. Petersburg, investments fell (as in 2011), as did investments in the Far East Federal District as spending around the APEC summit dried up. Investments in the City of Moscow and the Moscow region picked up notably.

Growth in industrial output moderated in all eight Federal Districts. In the western parts of the country, output was up 4–6 % with the exception of the Northwest Federal District (up 2 %). In January-February, output growth weakened except in the Southern Federal District.

The economy ministry's long-term growth scenario sees highest growth in the next few years in the Southern and Far East Districts. Growth in the Northwest and Central Districts should also be slightly higher than farther east.

Shares of Federal Districts and largest regional concentrations in the Russian economy in 2012, %



Source: Rosstat

Russia seeks to boost exports by easing border formalities and increasing state subsidies. The cornerstone of the government's recently approved programme to promote foreign trade involves strengthening Russia's position in the global economy through more exports, especially machinery and equipment. Russia has tried for years to diversify and increase the added-value component of its exports, but to rather little avail. Oil, petroleum products and gas still account for 70 % of all Russia's goods exports, and the rest is mainly other commodities like metals and wood.

Now exports boost is to be achieved through improving customs services and border crossings. These are seen as major obstacles to exports. Indeed, nearly all of the over 400 billion rubles (€10 billion) allocated from the federal budget for 2013-2018 will go to smoothing border traffic. More efficient border traffic, in turn, is hoped to reduce export costs and increase the competiveness of exports. No specific measures to improve efficiency are mentioned.

The programme also includes state support such as export credits and guarantees, and assistance from state agencies in marketing and information gathering. Despite finance ministry opposition, the programme allocates 20 billion rubles (€0.5 billion) in subsidies from the federal budget. The finance ministry argues that no new money is needed for export subsidies as only a fraction of currently budgeted subsidies has been used.

CIS countries are a focus of international cooperation, and specifically the formation of a Eurasian Union based on the current customs union. The programme also states that Russia needs to be more active in international organisations such as the WTO to strengthen its presence in global trade policy-making and to secure its national interests.

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China

Banks show higher-than-expected profits for 2012. The combined profits of China's four largest commercial banks, Industrial and Commercial Bank of China (ICBC), China Construction Bank (CCB), Bank of China (BoC) and Agricultural Bank of China (ABC) last year amounted to 720 billion yuan (€90 billion), an increase in profits of 15 % from 2011. A large part of bank revenues were generated from the margin spread, i.e. the difference in interest paid by borrowers on loans and interest paid to depositors. Lifted by strong profits, ICBC is acquiring a 20 % stake in the Taiwanese SinoPac Bank. Since the beginning of this month, Taiwan has allowed investments from Mainland China in its financial sector.

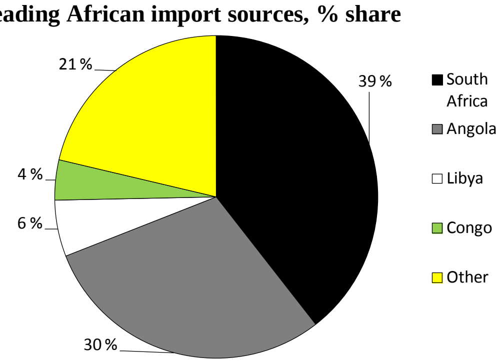
The continued robust growth in commercial bank profits came as a mild surprise to many observers. The media report that competition has increased among banks, since the People's Bank of China last summer gave commercial banks greater flexibility in rate-setting by allowing greater divergence from reference rates. Another surprise has been that the wave of non-performing loans from the 2009 and 2010 stimulus has failed to materialise or even have significant impact on bank balance sheets. In fact, the non-performing-loan ratios of the big banks fell again last year. At the moment, the ratio of non-performing loans to the total loan stock of these big banks averages around 1 %.

President Xi's Africa tour highlights the rapid expansion of China-Africa relations. Trade between China and the African continent, which increased nearly 20-fold during the 2000s, grew by about 20 % y-o-y last year to $200 billion. The rapid growth has made China Africa's top trading partner and Africa now accounts for 5 % of all of China's foreign trade. China mainly imports raw materials from Africa that it converts into a vast array of consumer and investment goods. China overall runs a trade deficit with the African continent. Relations are not limited to trade, as China has become a major investor in large projects in Africa. Chinese direct investments in African countries increased last year by 50 % to over $3 billion.

South Africa is China's largest African trading partner, accounting last year for 18 % of China's exports to Africa and 39 % of imports from Africa. South Africa is an important source of e.g. iron ore and precious metals for China. Chinese companies are involved in a number of major investment projects in South Africa, including platinum mines and cement plants. During the visit, China Railway Construction Corporation announced it had signed a memorandum of understanding on construction of high-speed rail in South Africa. President Xi also visited Tanzania and the Republic of Congo. In Tanzania, the Chinese committed to financing and constructing a large port project. In the Congo, discussions centred around conceptual plans for developing bilateral trade further.

China's role in Africa is not seen by all in an entirely positive light. Some critics claim the Chinese have a colonialist attitude, that they ignore environmental standards and do not hesitate to make deals with corrupt officials. Moreover, competition from Chinese firms tends to put domestic producers at a disadvantage. Critics aside, it is also clear the Chinese have invigorated African economies that have long been in the doldrums. The Chinese see economic opportunity in places where European and North American investors see problems.

China's leading African import sources, % share



Source: CEIC

Chinese arms exports continued to rise last year. The Stockholm International Peace Research Institute (SIPRI) reports that China last year surpassed Germany and France to become the world's third-largest arms exporter. The world's two biggest arms sellers are still the United States and Russia, which sell far more weapons than China. Most of China's customers are found in the developing world. The biggest buyer by far is Pakistan, which has bought the full range of Chinese arms, including tanks, jet fighters, helicopters, ships, submarines, radar systems, missiles and bombs.

Although China spends huge sums on development of weapons systems, the country is still the world's second biggest arms buyer after India. Following the Tiananmen Square protests of 1989, the United States and the European Union imposed a ban on arms sales to China that is still in force to this day. The embargo has forced China to turn to Russia for most of its arms purchases. The countries have an uncomfortable relationship in this respect. Russia claims China has been reverse engineering its own versions of Russian weapons systems and military aircraft. Despite these claims, Chinese media report that the countries agreed last month that Russia will supply China with four Amur-class submarines and 24 Sukhoi SU-35 jet fighters.

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