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BOFIT Weekly

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Russia

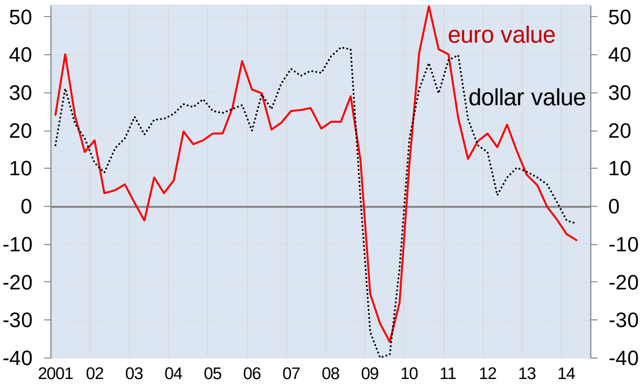
Ruble finds support from Russian foreign trade and calming capital flows. Preliminary balance-of-payments figures from the Central Bank of Russia show revenues from exports of goods and services in the second quarter rose slightly from a year earlier, largely on higher earnings from energy exports. At the same time, however, earnings on other goods exports continued to shrink and earnings on services exports, particularly tourism, went into decline.

Russian spending on imports in 2Q2014 was still down from a year earlier. In value terms, goods imports were off 7–8 % y-o-y. There was no longer growth in spending of Russian travellers abroad. Overall, slightly higher export earnings and lower spending on imports lifted the current account surplus, which for the past four quarters equalled 2.5 % of GDP.

With most critical tensions subsiding in the second quarter, capital outflows from Russia and the ruble partly cooled off. While the flight to foreign-currency cash diminished sharply and the CBR estimated grey capital exports contracted substantially, capital outflows from banks remained large as their foreign debt declined to an exceptional degree. Russian corporate borrowing internationally was minimal. Foreign direct investment flows into Russia and DI outflows from Russia were largely unchanged with outflows continuing to slightly outpace inflows.

The current account surplus and calming of capital flows have supported the ruble. The ruble's nominal exchange rate against its trade-weighted currency basket rose 7 % in the second quarter. Since the ruble's slide ended, the cost advantage for Russia has narrowed significantly with the ruble's real effective exchange rate in June just 4 % below early 2013, when it hit its all-time peak.

Russian imports of goods and services, % change from four quarters earlier



Sources: Rosstat, CBR

Russia decides on oil sector tax reform. The government has spent past months preparing changes to tax policies for oil production and oil exports. Although cabinet members hold diverging views, the finance and energy ministries struck a deal late June on tax reform in the sector that also won the blessing of state oil giant Rosneft, a critic of the reform initiative. The new policies shift the tax emphasis by lowering export duties and raising production taxes.

The new rules will begin to be rolled out at the start of 2015 and gradually implemented over the next three years. The export duty on crude oil will fall from 59 % at the moment to 30 % by the end of 2017. Export duties on refined petroleum products will also go down. At the same time, resource extraction taxes will nearly double.

The Eurasian Economic Union, which currently includes Russia, Belarus and Kazakhstan, has been a major reason for the reforms. When the EEU was created in May, the founding countries agreed on gradual integration of their energy markets. By keeping its existing tax regime in place, Russia stood to lose significant amounts of budget revenue from the elimination of export duties to EEU member states. Russia currently subsidises the Belarus economy by exempting some oil exports from the duties. The shift away from export duties to taxing production will reduce the support Belarus now enjoys. Oil exports from Kazakhstan currently carry a lower duty than Russian oil. If Russia did not cut its export duties, Russian oil companies could start to export oil at lower cost via Kazakhstan.

Unlike most oil-exporting countries, taxation on Russia's oil sector focuses on the value of an oil company's production rather than its financial performance. The value of production is defined according to world oil prices. While experts in Russia and elsewhere have long called on Russia to move to a system based on taxing corporate profits, the latest reforms still balk at such a shift.

TIR system gets more time again at Finnish-Russian border. Russian customs had planned to phase out the expedited customs formalities under TIR (Transports Internationaux Routiers or International Road Transport) procedures at Finnish-Russian border crossings at the beginning of July. In late June, however, Russian customs announced that transports carrying TIR carnets would be recognised until the beginning of December. Russia initially planned to end TIR procedures altogether already last August. Russian officials, however, have postponed the implementation date several times, particularly at Finnish-Russian border crossings, where the bulk of TIR freight crosses into Russia.

Many fear the termination of TIR procedures will slow road freight and increase costs of foreign trade. There is anecdotal evidence some Russian road freight has already shifted to routes via Belarus, where the TIR system will remain in place. Belarus is also a member of the customs union with Russia and Kazakhstan.

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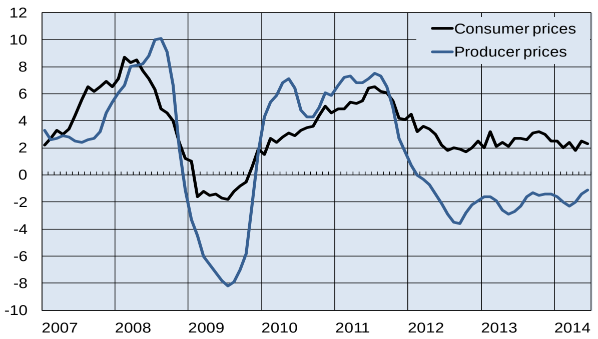
China

Stable inflation picture continues. June consumer prices were up 2.3 % from a year earlier. March consumer prices, in contrast, rose just 1.8 % y-o-y. Much of the increase in inflation reflects rising food prices, which were up 3.7 % in June. Prices of non-food goods rose 1.7 %, unchanged from its long-standing trend. The decline in producer prices slowed from 1.4 % in May to 1.1 % in June.

With the exception of real estate prices, prices in China have been quite stable over the past two years. The inflation outlook remains subdued, which means inflation is not a top concern for monetary policymakers at the moment.

Consumer and producer prices in China, %- change y-o-y



Source: Macrobond

Local government indebtedness continues to rise. A press release from China's National Audit Office (NAO) in late June claimed that the indebtedness of local administrations has continued to climb since last June, but appears to be slowing. In a monitoring sample consisting of nine local administrations and city governments, debt levels rose about 4 % between June 2013 and March 2014, a sharp slowdown in the piling-on of debt seen earlier. Higher revenues from land sales have helped local governments avoid higher borrowing. The NAO press release did not specify which local governments were included in the sample, making it difficult to judge how it reflects the overall financial conditions of local governments.

Officials are unable to offer precise figures on local government debt after June 2013 as determining indebtedness at the various levels of government is a demanding and time consuming process. The NAO's latest comprehensive debt survey, published last December, showed indebtedness of Chinese local administrations increased briskly after 2010, reaching 17.9 trillion yuan (€2.1 trillion) in June 2013.

Chinese figures also point out that about 2.4 trillion yuan (€300 billion) in local government debt is set to mature over the present year. Many local governments may have to borrow more just to service their existing debts.

Germany dominates China-EU trade. German chancellor Angela Merkel wound up her three-day visit to China on Tuesday (July 8). The visit was important from an economic standpoint; Germany is China's top European trade partner, accounting for about 30 % of China's foreign trade with the EU and 4 % of China's total foreign trade.

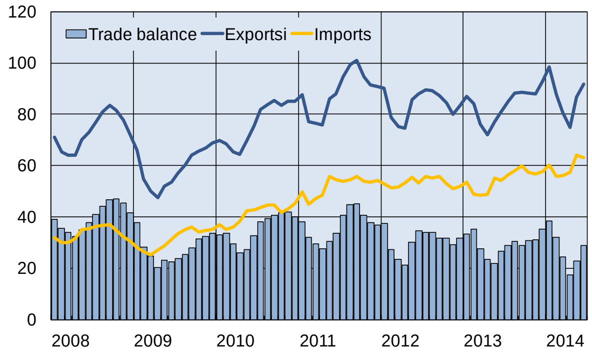
During the visit, China and Germany signed a number of deals, including a roughly €2 billion commitment from German carmaker Volkswagen to build two new plants. Volkswagen and General Motors dominate in China, which has the world's largest car market at the moment. Promoting international use of the yuan was also high on the agenda. German investors were granted an 80 billion yuan (€9.5 billion) quota under China's Qualified Foreign Institutional Investor (QFII) programme that allows foreign investors to participate on the Shanghai and Shenzhen stock exchanges.

The EU is China's largest trading partner, and Germany is China's fourth largest trading partner after the United States, Japan and South Korea. About 43 % of China's EU imports last year came from Germany. Some 20 % China's exports to the EU went to Germany. The largest share of China's foreign car imports came from Germany, accounting for about a third of all passenger car imports and nearly a fifth of all German imports.

China mainly exports to Germany goods in the electronics and machinery & equipment categories. Over half of the solar panels imported to Germany come from China, but last year's solar-panel tariff dispute reduced EU solar-panel imports from China. During 2010 and 2011, nearly 10 % of imports from China were solar panels. That share fell to 2 % last year.

Chinese foreign trade figures show China has long run a trade deficit with Germany. Imports last year exceeded exports by about $27 billion. The EU overall runs a trade deficit with China, however. German figures do not reflect the Chinese view. German figures show its imports from China exceed exports. The discrepancies in trade figures reflect differences in such areas as recording practices and treatment of complex global production chains.

China-EU trade, three-month totals, USD billion



Source: Macrobond

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