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BOFIT Weekly

Yearbook 2010

Bank of Finland, BOFIT
Institute for Economies in Transition

EUROJÄRJESTELMÄ
EUROSYSTEMET

BOFIT Weekly
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BOFIT Weekly – Russia 2010

8.1.2010	BOFIT Weekly 1/2010
	CBR lowers interest rates again, inflation rate slowing. Pensioners saw real increases even as wage growth stagnated in 2009.
15.1.2010	BOFIT Weekly 2/2010
	Economy ministry says Russian GDP contracted 8.5 % last year. Economy ministry issues more upbeat 2010 forecast. 2009 federal budget deficit smaller than expected; 2010 budget outlook brightens. Moscow stock exchanges posted strong recovery last year.
22.1.2010	BOFIT Weekly 3/2010
	Russia continued to manage trade and current account surpluses in 2009. Capital exports from Russia fell in 2009; capital inflows turned positive in the fourth quarter. Russia's foreign indebtedness declined slightly in 2009. Plans to develop Russia's Far East.
29.1.2010	BOFIT Weekly 4/2010
	Reforms in the Russia's banking sector. Birth pangs for new Russia-Belarus-Kazakhstan customs union. Russia and Belarus agree on oil supplies.
5.2.2010	BOFIT Weekly 5/2010
	Especially fixed capital investment posts sharp drop last year. Grey economy slightly increases its contribution to GDP during the downturn.
12.2.2010	BOFIT Weekly 6/2010
	Stimulus to continue this year. Viktor Yanukovich wins presidency of economically struggling Ukraine.
19.2.2010	BOFIT Weekly 7/2010
	Gulf of Finland harbours playing greater role in Russian shipping. Government moves to support single-enterprise towns.
26.2.2010	BOFIT Weekly 8/2010
	January economic numbers offer little optimism. CBR lowers key rates by a quarter of a percentage point; rouble under pressure to rise. Banking sector growth flat-lined in 2009.
5.3.2010	BOFIT Weekly 9/2010
	Finance ministry pushing for return to tight fiscal policies. Decisions postponed on investment in development of massive Shtokman gas field.
12.3.2010	BOFIT Weekly 10/2010
	Innovation − Russia's answer to economic modernisation. Finland-Russia trade contracted sharply in 2009.
19.3.2010	BOFIT Weekly 11/2010
	Persistent rate hikes for municipal services continue. Impacts of global economic meltdown vary among CIS countries.
26.3.2010	BOFIT Weekly 12/2010
	BOFIT semiannual forecast sees Russia back on GDP growth track in 2010–2012. February's economic figures still vague. Climate change to play a larger role in Russian economic policy. BOFIT forecast for Russia 2010-2012, published 25.3.2010

BOFIT Weekly – Russia 2010

1.4.2010	BOFIT Weekly 13/2010
	CBR lowers key rates again. New North Caucasian Federal District to tackle regional problems.
9.4.2010	BOFIT Weekly 14/2010
	First quarter sees jump in current account surplus. FDI inflows into Russia declined by about half in 2009. High crude oil prices drive rebound in Russian stock market.
16.4.2010	BOFIT Weekly 15/2010
	Growth in budget spending accelerated in the first quarter. Russian car industry sees faint light at end of tunnel.
23.4.2010	BOFIT Weekly 16/2010
	Social issues top Putin's annual government address to the Duma. Customs union and need for economic modernisation drive changes in Russia's customs policy. Customs duties to decrease gradually.
30.4.2010	BOFIT Weekly 17/2010
	Russian economic growth slowed in the first quarter. Russia issues new bonds in international markets. Russia and Ukraine reach strategic deal on gas.
7.5.2010	BOFIT Weekly 18/2010
	Recent forecasts reflect uncertainties in forecasting Russian economic trends. Split views on whether CBR will lower interest rates further. Declining population clouds Russia's development prospects.
14.5.2010	BOFIT Weekly 19/2010
	Russia sees slight rise in oil production in first quarter. Russian poverty declined in 2009 even amidst economic recession. Finnish exports to Russia continue to decline.
21.5.2010	BOFIT Weekly 20/2010
	New economic data gives conflicted view of economic recovery. Bank lending continued to decline in the first quarter, but turning point may now have been reached. Foreign firms sign anti-corruption pact.
28.5.2010	BOFIT Weekly 21/2010
	Ministries wrangle over assumptions as drafting of 2011 federal budget gets underway. 2010 budget performance better than expected. Teething problems hobble Russia-Belarus-Kazakhstan customs union.
4.6.2010	BOFIT Weekly 22/2010
	CBR lowers most key rates a fourth of a percentage point. Government moves to lower inflation. No breakthroughs at EU-Russia summit.
11.6.2010	BOFIT Weekly 23/2010
	Ruble weakens. Efforts continue to make Moscow a financial hub. Putin's 10-year economic programme scrutinised.

BOFIT Weekly – Russia 2010

18.6.2010	BOFIT Weekly 24/2010
	Cabinet adjusts this year's federal budget. Framework for next year's federal budget gradually takes shape. Apartment construction activity is waiting to revive.
24.6.2010	BOFIT Weekly 25/2010
	Recovery of domestic demand reasonable in late spring, strong rise in imports. Gazprom cuts gas deliveries to Belarus by 60 %. Further whittling down of strategic firm list.
2.7.2010	BOFIT Weekly 26/2010
	In search of solutions to rising pension costs. International Monetary Fund expects fiscal restraint from Russia.
9.7.2010	BOFIT Weekly 27/2010
	Russia-Belarus-Kazakhstan customs union now operational. Innovation city legislation moves ahead.
16.7.2010	BOFIT Weekly 28/2010
	Russia posts current account and capital account surpluses in the first half of 2010. Russia's financial markets yo-yo in first half. Russia on schedule in deregulation of its electricity markets.
23.7.2010	BOFIT Weekly 29/2010
	Russian economy shows moderate recovery. Economic recession still reflected in the structure of Russian imports.
30.7.2010	BOFIT Weekly 30/2010
	Russia grain harvest afflicted by major drought. Government moves to improve corporate operating conditions.
6.8.2010	BOFIT Weekly 31/2010
	Falling unemployment and rising consumer confidence signal economic recovery. Government tackles budget deficit.
13.8.2010	BOFIT Weekly 32/2010
	Finnish exports of machinery & equipment to Russia down this year; other exports up. Russian energy exports on the rise.
20.8.2010	BOFIT Weekly 33/2010
	Pace of economic recovery varies across Russian regions. Improved regulation for Russia's financial markets.
27.8.2010	BOFIT Weekly 34/2010
	Increasing share of Russia's imports coming from China. Public-sector economy records surplus in the first half.
3.9.2010	BOFIT Weekly 35/2010
	Economy ministry expects annual GDP growth to hold at around 4 % over the next three years. Growth in household deposits accelerated in the first half of the year. Internet use varies from region to region.
10.9.2010	BOFIT Weekly 36/2010
	Rise in food prices led to higher inflation in August. Fixed investment in Russia increasingly directed towards the energy sector.

BOFIT Weekly – Russia 2010

17.9.2010	BOFIT Weekly 37/2010
	New GDP data show economic recovery slowed this year. Domestic production of passenger cars surges; imports recover more slowly.
24.9.2010	BOFIT Weekly 38/2010
	Russian economy posts weak summer growth; imports revive. Slight increase in number of Russian visitors to Finland.
1.10.2010	BOFIT Weekly 39/2010
	BOFIT forecast anticipates rapid growth of Russian economy overall during the 2010–2012 period. Central bank withdraws support measures imposed during the financial crisis. BOFIT forecast for Russia 2010-2012, published 29.9.2010
8.10.2010	BOFIT Weekly 40/2010
	Revised federal budget raises revenue and spending projections. Russia improves its ranking in international creditworthiness comparison.
15.10.2010	BOFIT Weekly 41/2010
	Russian central bank reduces its currency market interventions. Russia's current account surplus contracting this year. Russian consumer preferences have changed over the past 20 years.
22.10.2010	BOFIT Weekly 42/2010
	Chief of government administration and deputy prime minister Sergei Sobyanin takes over as Moscow mayor. Preparations continue for launch of Russia-Belarus-Kazakhstan common economic area.
29.10.2010	BOFIT Weekly 43/2010
	Economic growth subdued in September. Cabinet approves sales of shares in state-owned firms. Russia shows little progress in fighting corruption.
5.11.2010	BOFIT Weekly 44/2010
	Further rate hikes for municipal services ahead. Russia pushes for development of the Arctic.
12.11.2010	BOFIT Weekly 45/2010
	Cargo shipping via Russia's Baltic Sea ports and major ports of the Baltic countries on the rise. Bad year for Russian farmers.
19.11.2010	BOFIT Weekly 46/2010
	FDI inflows to Russia unchanged from 2009. Recession and state stimulus measures evident in 2009 performances of Russia's biggest firms.
26.11.2010	BOFIT Weekly 47/2010
	Ruble exchange rate dips. Insurance sector continues to play a minor role in the Russian economy.
3.12.2010	BOFIT Weekly 48/2010
	Federal budget expenditures set to rise in 2011. Sluggish recovery in natural gas demand affects Gazprom. Meeting of Russian and Chinese prime ministers focuses on energy issues.

BOFIT Weekly – Russia 2010

10.12.2010	BOFIT Weekly 49/2010
	Prices of food items rise rapidly.
	Big foreign acquisition in Russian food industry.
	PISA performance of Russian 15-year-olds again below international average.
17.12.2010	BOFIT Weekly 50/2010
	Revamped mandatory health insurance scheme set to debut in two weeks.
	No evidence of investment boom in Russia.
23.12.2010	BOFIT Weekly 51/2010
	Further limits imposed on foreign labour in Russia.
	Economic growth stalls in the third quarter.
30.12.2010	BOFIT Weekly 52/2010
	Russia, Belarus and Kazakhstan settle on operating principles for Single Economic Space.
	On next year’s big tax changes.

BOFIT Weekly – China 2010

8.1.2010	BOFIT Weekly 1/2010
	China revises official figure for 2008 GDP growth upwards to 9.6 %. 2009 a good year for Chinese stocks. China's 2009 exchange rate policy in review: dollar peg stayed firm as currency controls were relaxed.
15.1.2010	BOFIT Weekly 2/2010
	China tightens monetary policy. China's exports and imports recover to pre-crisis levels. Year starts with no big law changes, while introduction of new tort law looms.
22.1.2010	BOFIT Weekly 3/2010
	China posted strong growth in 2009. Inflation picks up. Foreign currency reserves increased at near-record rate in 2009.
29.1.2010	BOFIT Weekly 4/2010
	China rising as science superpower; huge growth in research activity. China leads the world in car sales. Record harvest in 2009.
5.2.2010	BOFIT Weekly 5/2010
	China's influence in iron ore and base metal markets heightened by financial crisis. China's coal imports exceptionally large in 2009. Market capitalizations of energy companies in developing countries soar.
12.2.2010	BOFIT Weekly 6/2010
	China's smaller current account surplus last year helped ease global imbalances. Foreign trade continued to recover in January despite rise in trade frictions. Crisis turns China's Russia trade balance negative.
19.2.2010	BOFIT Weekly 7/2010
	PBoC continues to tighten its monetary stance. Many cities and provinces increase their minimum wage definitions. OECD: China still has plenty of room to implement sweeping reforms.
26.2.2010	BOFIT Weekly 8/2010
	Land deals highly profitable for the state. Chinese data show only marginal Finnish direct investment in China. Other BRIC countries lag far behind China in international patent applications.
5.3.2010	BOFIT Weekly 9/2010
	Yuan exchange rate still firmly pegged to the dollar. Fixed capital investment and migration from the countryside seen as the biggest contributors to China's productivity gains. Share prices level off; daily trading volumes down.
12.3.2010	BOFIT Weekly 10/2010
	China again targets 8 % GDP growth for 2010. Local administrations borrowing actively and raising China's overall public debt.
19.3.2010	BOFIT Weekly 11/2010
	China's 2009 state budget comes in on target. China's international arms exports on the rise. China increases its share of Finnish foreign trade.

BOFIT Weekly – China 2010

26.3.2010	BOFIT Weekly 12/2010
	BOFIT expects robust economic growth to continue; economic policy challenges persist. American companies highlight difficulties of doing business in China and increasingly press for changes in trade policy. BOFIT forecast for China 2010-2012, published 25.3.2010
1.4.2010	BOFIT Weekly 13/2010
	Geely acquisition of Volvo signals China's growing power and dynamism in the global car industry. China's big banks posted record profits in 2009.
9.4.2010	BOFIT Weekly 14/2010
	China and US continue to seek resolution on yuan's valuation. Share prices recover from slight drop in late January.
16.4.2010	BOFIT Weekly 15/2010
	As expected, China displayed impressive growth in 1Q10. Rise in consumer prices slowed in March. China posted rare trade deficit in March; currency reserves continue to climb.
23.4.2010	BOFIT Weekly 16/2010
	Global crises hit FDI flows in China. China tries to cool housing market through administrative rules.
30.4.2010	BOFIT Weekly 17/2010
	IMF new outlook forecasts robust Chinese economic growth and return of excessive current account imbalances. Stock index futures trading launches in China. China's presence grows in international institutions.
7.5.2010	BOFIT Weekly 18/2010
	China takes further measures to tighten its monetary stance without raising key interest rates. Chinese banks seek more capital. World's Fair boosts Shanghai's economy.
14.5.2010	BOFIT Weekly 19/2010
	Few surprises in April economic numbers. Price inflation kicked up in April. China's trade returns to surplus in April.
21.5.2010	BOFIT Weekly 20/2010
	China's main stock market indices retreat to levels of a year ago. China-Japan bilateral trade blossoms amidst tensions. China helping Nigeria develop its energy infrastructure.
28.5.2010	BOFIT Weekly 21/2010
	Strategic and economic dialogue finds answers on China-US relations. Pegging of yuan exchange rate to dollar creates illusion of stability.
4.6.2010	BOFIT Weekly 22/2010
	Pressure for higher wages spreads. Industrial output growth appears to be slowing. Despite the global recession, American firms in China thrived last year.

BOFIT Weekly – China 2010

11.6.2010	BOFIT Weekly 23/2010	
	China's foreign trade surplus balloons again. China reduces import tariffs. Chinese demand has benefitted Finland during the global economic downturn.	
18.6.2010	BOFIT Weekly 24/2010	
	China looks at business opportunities in Greece. Consumer price inflation accelerated in May. Mainland China and Taiwan set to lower bilateral tariffs and eliminate other barriers to trade.	
24.6.2010	BOFIT Weekly 25/2010	
	China returns to a more flexible exchange rate regime. The last of China's big state owned banks takes the IPO plunge. China continues car industry subsidies.	
2.7.2010	BOFIT Weekly 26/2010	
	Wage disputes and strikes dog Japanese firms operating in China. National audit office concerned about burgeoning debts of local administrations. Unfair treatment of foreign firms starts to worry European companies operating in China.	
9.7.2010	BOFIT Weekly 27/2010	
	Slide on Chinese stock markets continues; PMI suggests slowdown in growth. China's regulators warn on risks to banking sector; informal banking has a large role. China's communist party membership approached 78 million last year.	
16.7.2010	BOFIT Weekly 28/2010	
	Modest slowdown in Chinese economic growth. China and Latin America continue to increase cooperation.	
23.7.2010	BOFIT Weekly 29/2010	
	Yuan strengthens slightly against dollar, but drops against euro; international use of yuan on the increase. Germany concerned about China's treatment of foreign firms. China's fourth large state bank debuts on Shanghai and Hong Kong exchanges.	
30.7.2010	BOFIT Weekly 30/2010	
	China's real estate markets show signs of cooling. China's popularity as a tourist destination continues to grow. BRICs active in using protectionist measures during recent global financial crisis.	
6.8.2010	BOFIT Weekly 31/2010	
	IMF recommends China move ahead with broad range of reforms to increase domestic consumer demand. Real incomes continue to rise. China's economic growth slowing as expected.	
13.8.2010	BOFIT Weekly 32/2010	
	July economic figures indicate expected slowdown. Inflation accelerated in July; housing prices show signs of stabilising. China's trade balance soared in July.	
20.8.2010	BOFIT Weekly 33/2010	
	China surpasses Japan to become world's second largest economy. China enjoys good summer grain harvests despite unusual weather. Hong Kong economic growth beats expectations.	

BOFIT Weekly – China 2010

27.8.2010	BOFIT Weekly 34/2010	

State remains top source for bank capital.
Uncertainty over trends in housing prices.
China's oil imports expected to grow.

3.9.2010 BOFIT Weekly 35/2010

China's four large state banks again post substantial profits.
Oil pipeline deliveries from Russia to China set to begin this year.
Sharp jump in level of China's car imports.

10.9.2010 BOFIT Weekly 36/2010

International yuan use rises; no major changes in the exchange rate.
Wages in China's manufacturing sector nearly on par with Mexico.
European firms want Chinese officials to focus on easing market access and consistent application of the law.

17.9.2010 BOFIT Weekly 37/2010

August upswing in industrial output surpasses expectations; domestic demand remains strong.
Rising food prices cause consumer price inflation to accelerate.
Uncertainty over the global economy hurts China's export numbers.

24.9.2010 BOFIT Weekly 38/2010

US repeats criticism of China's exchange rate mechanism, slow yuan appreciation against the dollar.
Japan releases Chinese captain; incident tests bilateral relations.
China only BRIC to move up in international competiveness rankings.

1.10.2010 BOFIT Weekly 39/2010

BOFIT sees Chinese economic growth increasingly driven by domestic consumer demand.
Finland's exports to China up sharply last year.
BOFIT forecast for China 2010-2012, published 29.9.2010

8.10.2010 BOFIT Weekly 40/2010

China hosts meeting of the UN climate conference working group in Tianjin.
Energy cooperation tops agenda of Medvedev's China visit.
Steady growth in China-North Korea trade.

15.10.2010 BOFIT Weekly 41/2010

China's import growth outpaces exports in the first nine months of the year.
Yuan continues to appreciate slowly.
China's currency policy overshadows EU-China summit.

22.10.2010 BOFIT Weekly 42/2010

China posts robust 3Q growth.
Inflation accelerated in September; PBoC hikes reference rate first time in nearly three years.
Meeting of CPC Central Committee affirms next five-year plan framework.

29.10.2010 BOFIT Weekly 43/2010

China cuts this year's export quota on rare earth metals by 40 %.
China's consumer spending showing signs of subsiding.
Even with rapid growth in inland provinces, living standards vary considerably across China's regions.

BOFIT Weekly – China 2010

5.11.2010	BOFIT Weekly 44/2010
	Yuan finding ever greater use in international trade. Commodity imports stay strong this year; imports of energy commodities on the rise. Burgeoning trade between China and ASEAN countries.
12.11.2010	BOFIT Weekly 45/2010
	China tightens monetary stance as inflation picks up. China posts large foreign trade surplus again. China holds onto its position in international comparison of business environments; Russia drops a bit in the rankings.
19.11.2010	BOFIT Weekly 46/2010
	China-US tensions over economic imbalances take centre stage in G20 discussions in Seoul. Rising labour costs in coastal provinces putting pressure on manufactures to shift production inland.
26.11.2010	BOFIT Weekly 47/2010
	China steps up inflation fight while Hong Kong’s monetary authorities struggle with soaring real estate prices. Chinese stock markets driven by global economic events.
3.12.2010	BOFIT Weekly 48/2010
	Current account surplus swells in the third quarter. China’s growing demand for raw materials reflected in pace of foreign investment.
10.12.2010	BOFIT Weekly 49/2010
	Asian participants shine in latest PISA evaluations. Computer use rising quickly in China. China wins its first WTO case against the EU.
17.12.2010	BOFIT Weekly 50/2010
	Chinese inflation continued to accelerate in November. Steady growth in China’s industrial output. Robust growth in foreign trade registered in November.
23.12.2010	BOFIT Weekly 51/2010
	Cancun climate change conference slogs towards new international agreement; China approves emissions reporting requirement as part of final package. China further eases rules on foreign trade payments.
30.12.2010	BOFIT Weekly 52/2010
	China ends 2010 with an interest rate hike. Media abuzz over Chinese readiness to bail out eurozone’s troubled economies. Is calm returning to China’s housing markets?

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1 • 8.1.2010

Russia

CBR lowers interest rates again, inflation rate slowing. The Central Bank of Russia's latest 0.25-percentage-point interest rate cut went into effect December 28. It was the tenth rate cut of 2009. The CBR hopes the rate cut will help revive bank lending even though earlier cuts have yet to produce results. The CBR last year cut rates overall by 4.25 percentage points. The minimum credit rate for one-day repos, the CBR's main financial instrument, currently stands at 6 %.

Inflation slowed substantially last year, falling to 8.8 % y-o-y in December according to preliminary figures. The decline gave the central bank another reason to lower rates. At the end of 2008, 12-month inflation was still running at 13.3 %.

The CBR further justified the rate cut as part of its efforts to stem the flow of short-term capital into the country which have put unwanted appreciation pressure on the rouble. With the spike in oil prices, capital inflows into the country picked up towards the end of the year on expectations of rouble appreciation.

Russia had to dip into its currency reserves between autumn 2008 and last autumn, after which the reserves started to recover in tandem with oil prices. Russia ended 2009 with about $440 billion in currency reserves, some $10 billion more than at the start of the year.

During autumn 2008 and early 2009, the CBR intervened actively in the currency markets to prop up the rouble. Once oil prices came back, the central bank could take a more hand's off approach and watch the rouble's value stabilise. While the rouble's nominal value declined almost 5 % against the euro last year and 3 % against the dollar, the rouble appreciated in real terms against both the euro and the dollar. At year's end, one euro bought 43.39 roubles and one dollar 30.24 roubles.

The average price of Urals-grade crude oil in December was $75 a barrel, up from just $45 a barrel last January.

Pensioners saw real increases even as wage growth stagnated in 2009. New Rosstat figures show the average monthly wage in Russia was 19,200 roubles (€440) in November 2009. While nominal wages were up 8 % y-o-y, real wages were down nearly 1 %. 2009 saw the end to a decade of rapid wage growth, during which real wages climbed about 15 % a year.

The highest average wages were paid in oil and gas producing regions and big cities. The Yamal-Nenets region topped the list with an average monthly wage of 44,000 roubles (€1,010), five times more than the lowest average wage paid in the Caucasus region of Dagestan. Monthly wages averaged 32,600 roubles in Moscow and 24,400 roubles in St. Petersburg.

The best paying jobs were found in mining and minerals extraction (including oil and gas) and finance, where average salaries ranged from 35,000 to 46,000 roubles a month. The lowest paying work was found in the textile industry (9,400 roubles/month), agriculture and education.

Pensioners, on the other hand, saw real gains last year. At the end of November 2009, the average monthly pension was 9 % higher in real terms than a year earlier. Even with the boost, however, Russian monthly pensions remain modest, averaging just 5,400 roubles (€125).

The official subsistence minimum in the first half of 2009 was 5,187 roubles (€120) a month. The economic development ministry estimates about 14 % of the Russian population lived below the subsistence minimum in 2009, a two-percentage-point increase from 2008.

After falling throughout the 2000s, the number of unemployed began to rise in summer 2008. The unemployment rate, however, stabilised last summer. In November, the number of unemployed as calculated with ILO methodology was 6.1 million workers and the unemployment rate was 8.1 %. The November 2008 unemployment rate was 7.0 %. The relatively minor shift in the unemployment rate can be attributed e.g. to extensive cutbacks in working hours and pay cuts that show up in wage trends.

Unemployment rates vary tremendously from region to region. The official unemployment rate in Moscow was 1.8 %, while the unemployment rate was 50 % in the Caucasus region of Ingushetia and 30 % in Chechnya.

Russian official unemployment figures fail to give a true picture of the employment situation. For example, instead of layoffs, Russian firms prefer to simply stop paying some or all of the worker's wages. As a result, wage arrears, a huge issue during Russia's economic struggles in the 1990s, emerged again in late 2008. Rosstat figures (which do not track small firms) found that wage arrears in 2009 roughly doubled from the previous year. Towards the end of 2009, however, the stock of wage arrears started to fall and in November it was only 35 % bigger than a year earlier. Wage arrears constitute less than 2 % of the wages in sectors tracked by Rosstat. Unlike the 1990s, when government finances were in chaos, public sector wage arrears are currently negligible.

The unemployment figures are also distorted by the large amount of unregistered workers. By some estimates, some 4–10 million foreign nationals without work permits live and work in Russia. Most members of this foreign workforce come from former Soviet republics on Russia's southern borders. Citizens of these countries can enter Russia without a visa. In addition, permitted foreign workers have been hit by Russia's economic downturn. The permit quota for foreign workers was 2 million in 2009. This year the quota has been reduced to 1.3 million workers.

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1 • 8.1.2010

China

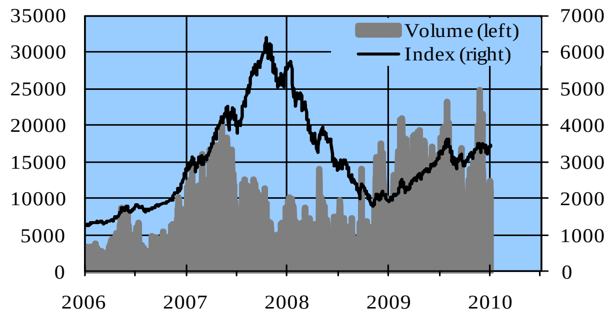
China revises official figure for 2008 GDP growth upwards to 9.6 %. The National Bureau of Statistics now puts its estimate of 2008 GDP at 31.4 trillion yuan (€3.05 trillion). The NBS's upward revision was mainly due to a bigger estimate of the size of service sector, which upon revisiting was seen as accounting for 42 %, rather than 40 % of GDP. The contributions of industrial activity and agriculture were correspondingly lowered. 2008 GDP is now estimated to have increased 9.6 % in real terms, up from an earlier estimate of 9 %. Although economic growth slowed in 2008 relative to previous years, China's ability to post consistent and sustained real GDP growth rates near 10 % is an impressive achievement given global economic conditions.

The manufacturing purchasing managers index (PMI) reading for December provided more evidence of sustained economic growth. The sentiments of purchasing manager's outlook for industry was nearly as bright as before the global economic meltdown, with managers in 17 of 20 industrial categories reporting positive outlooks. Production levels and order books were growing, while inventories of finished goods continued to shrink. Improvement in the production outlook, however, has added pressure to production costs; the price of industrial inputs continued to rise in December.

2009 a good year for Chinese stocks. The Shanghai exchange's A-share index gained nearly 75 % in 2009, ending the year above 3,400 points. The index still needs to climb another 3,000 points, however, before it matches its all-time high reached two years ago.

Perhaps more significant than the recovery in share prices are record-high daily trading volumes. While the increase in share prices might partly be due to government stimulus, the rise in share prices is hardly unique. Similar recoveries in share prices were seen in many emerging markets in 2009.

Shanghai A-share index and daily trading volumes (in millions of shares)



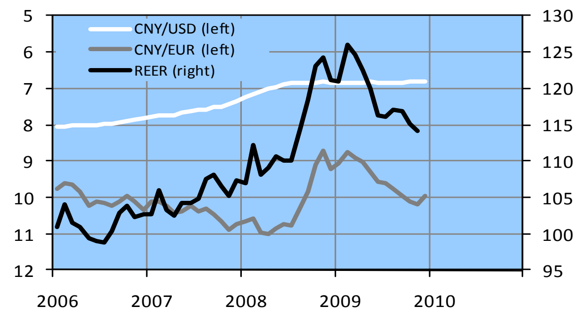
Source: Bloomberg

China's 2009 exchange rate policy in review: dollar peg stayed firm as currency controls were relaxed. After China abandoned its ten-year peg of the yuan to the US dollar in summer 2005, it allowed a 21 % appreciation of the yuan against the dollar by summer 2008. Given the weak global economic outlook, China reverted to a de facto pegging to the dollar to support its sagging export industries. In 2009, China vigorously defended the fixed exchange rate policy, even if it was clear by last autumn that the country's economic growth was substantially higher than the rest of the world's. International criticism of China's foreign exchange policy increased towards the end of the year with Asian countries joining Europe and the US in decrying China's exchange rate policy. The yuan's exchange rate fell sharply against the euro and also saw a large drop in the real effective (trade-weighted) exchange rate against the currencies of its main trading partners.

History suggests real exchange rate appreciation is a natural aspect of a country's economic development; artificially low exchange rates are hard to sustain over the long run. An exchange rate can either rise as a result of nominal appreciation or due to relatively higher inflation than in other countries. In addition to trade policy aspects, the end of deflation in the late 2009 ensures the issue of the yuan peg will remain top on government's policy agenda this year. Judging from trends in current rates for one-year non-deliverable forward contracts (NDFs), markets expect the yuan to appreciate over the next 12 months from 6.83 to 6.64 yuan to the dollar.

China's government, in turn, has repeatedly complained about the dollar's continuing slide and has increased trials to pave the way to international use of the yuan. The trials have included currency swaps with other central banks, permission to use the yuan as a currency of payment in China's main export hubs and in trade among Asian countries, as well as the issuance of yuan-denominated bonds in Hong Kong. Late last month, it was reported that China would allow yuan-denominated direct investment in Hong Kong from mainland China.

Dollar-yuan, euro-yuan exchange rates (inverted scale); real effective exchange rate (up indicates yuan appreciation)



Sources: BIS and Reuters

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Russia

Economy ministry says Russian GDP contracted 8.5 % last year. The economy ministry reports 2009 saw the largest drop in economic output since the break-up of the Soviet Union. Russian real GDP fell to a level last seen in 2006–2007.

On-quarter GDP growth returned already last autumn. Preliminary economy ministry figures put seasonally adjusted third-quarter growth at 1.1 % q-o-q and fourth-quarter growth at 1.9 % q-o-q.

Economy ministry issues more upbeat 2010 forecast. Russia's economy ministry revised upwards its outlook for the economy in 2010 in light of improvement in the global economy and higher oil prices. Under the new forecast, GDP should rise 3.1 % this year, instead of 1.6 % as earlier projected. The revision is in line with most international experts tracking Russia: the consensus expectation is that GDP growth will exceed 3 % this year.

Under the ministry's latest forecast, the average price of crude oil is expected to amount to $65 a barrel instead of the previous estimate of $58 a barrel. Inflation should fall faster than previously anticipated to a range of 6.5–7.5 % by year's end. The average exchange rate of the rouble is assumed to strengthen this year to a rate of 28.3 roubles to the dollar, rather than 33.9 roubles to the dollar used in the previous forecast. An increase in the trade surplus will be a big reason for the appreciation.

2009 federal budget deficit smaller than expected; 2010 budget outlook brightens. According to preliminary finance ministry figures, last year's budget deficit corresponded to 6.4 % of GDP, more than one percentage point less than the earlier forecast. The improved budget performance was largely driven by a rebound in global oil prices that boosted government tax revenues well above forecast.

In nominal terms, total federal budget revenues fell 25 % from 2008, while spending exceeded the 2008 level by 28 %. The significant increase in spending was largely due to government stimulus measures to deal with the recession and expenditures to make up for the constantly growing deficit of the pension fund.

Most of last year's budget deficit was financed out of the reserve fund for taxes on oil and gas. The finance ministry said the government used 2.7 trillion (€61 billion) in reserves so that 1.8 trillion roubles (€41 billion) of the fund still remained unused at the end of the year. Now the finance ministry says it will use the remaining money to cover this year's budget deficit.

Russia's second buffer fund – the national welfare fund – had assets of 2.8 trillion roubles (€65 billion) at the end of the year. Like last year, reserve fund assets will be used to cover the pension fund deficit.

The 2010 federal budget law approved in November was based on the economy ministry's earlier forecast and assumed a budget deficit of 2.9 trillion roubles (€67 billion), or 6.8 % of GDP. Budget revenues were estimated to be 6 % less in real terms than in 2009, while expenditures were 10 % less than last year. Despite the improved economic outlook and higher tax revenues, no increases in budget spending are planned. The increase in revenues will be used to reduce the budget deficit. According to estimates, this year's budget deficit could shrink to 3–4 % of GDP.

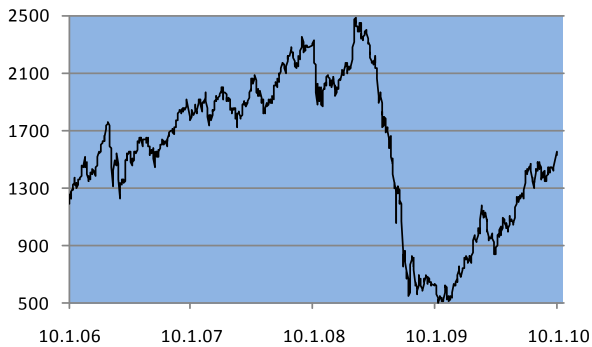
The deficit will be financed with reserve fund assets and bond issues. According to the finance ministry, the government currently plans to raise $17 billion from international financial markets. Russia's combined domestic and foreign debt will rise to 12.8 % of GDP this year, compared to 9.8 % of GDP at the end of 2009. Of this amount, public foreign debt represented a mere three percentage point share (€26 billion).

Moscow stock exchanges posted strong recovery last year. Following the international trend, Russian share prices bounced back last year. Notably, price volatility on the Moscow exchanges was higher than in most countries.

After peaking in summer 2008, the RTS index went into a seven-month-long nose-dive that ended last January. Since then, the RTS has clawed back about half of its losses and now stands at a level about 130 % above the 2009 bottom. The recovery in share prices has been driven by a number of factors, including higher prices for oil company shares following the rise in global oil prices, as well as the general recovery of the global economy.

In the US, the S&P 500 index recovered 70 % from its lows by the end of 2009. The Shanghai A-share index gained back about 75 %, while Brazil's Bovespa index climbed 80 %.

Performance of the RTS index over the past four years



Source: Bloomberg

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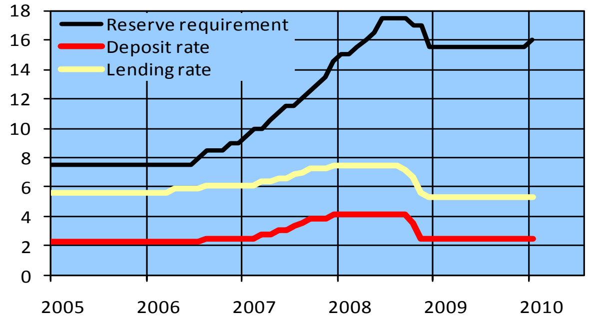
China

China tightens monetary policy. The People's Bank of China announced it was lifting the reserve requirement for banks by a half percentage point, effective next Monday (Jan. 18). The change means large banks will have to place 16 % of deposits with the central bank, while smaller banks will have to provide 14 % of deposits. Over the past two weeks, the central bank has also nudged up yields on government paper. It was the first time in over a year that the PBoC has appreciably adjusted monetary policy.

When China's economic growth slowed last year as the global financial crisis impacted exports and investment, the country succeeded in implementing substantial and timely fiscal and monetary stimulus policies that rapidly restored the economy to a path of robust growth. The stimulus to a large extent relied on increasing availability of credit, which, in turn, set off rises in share and real estate prices. Consumer prices have been rising month-to-month since last summer. The on-year change in prices turned positive in November, ending a deflationary episode that lasted nine months. China's leaders began to discuss tightening the monetary stance about a half year ago in anticipation of impending inflation.

Rather than raising the price of money through interest rates, China's monetary policy has largely relied on limiting money supply growth quantitatively through e.g. increased reserve requirements and stricter lending guidelines for banks. The current tightening measures largely indicate China's decision-makers are shifting their emphasis from preserving growth and employment to fighting inflation and staving off a bubble in asset prices. Although rate hikes are expected in the future, also a more flexible exchange rate and a bit of yuan appreciation should make it easier for officials to fine-tune monetary policy. Future price developments will determine how quickly and how much monetary tightening occurs. Decision-makers also consider export trends when setting exchange rate policy.

China's main monetary tools: deposit and credit reference rates (12-mo., % p.a.), reserve requirement (% of deposits)



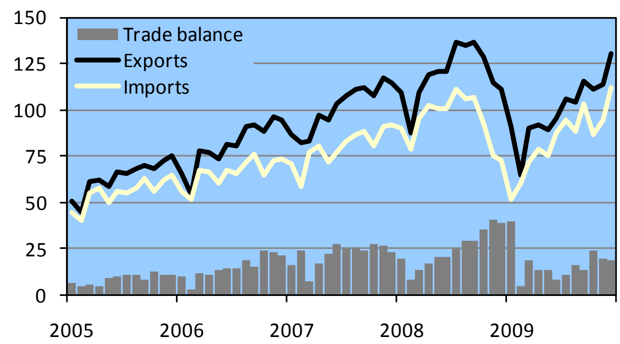
Sources: PBoC ja CEIC

China's exports and imports recover to pre-crisis levels. China's posted impressive foreign trade figures for December: imports rose to $112 billion and exports to $130 billion, a figure close to the all-time record set in summer of 2008. The trade numbers reinforce the view that recovery of the global economy is under way and China's economic growth is accelerating.

The value of imports in December soared 56 % y-o-y, while the value of exports was up 18 %. The rapid growth reflected last year's unusually low reference point when world trade was staggered by the global financial meltdown. Recent import figures affirm the return of higher prices for energy and raw material inputs compared to the situation a year ago. It also appears that the import volumes of many raw materials are higher than a year ago.

China's trade surplus last year was about $200 billion, or $100 billion less than in 2008. The surplus was still substantial and many worry that it may again increase as conditions in the global economy normalise. On the other hand, China's fast growth and the recent increase in its imports could mean that the era of massive trade imbalances is over. Yuan appreciation either through a nominal revaluation or higher inflation than in countries that trade heavily with China could also balance the situation. Growth in the trade surplus would exacerbate international trade disputes.

Monthly exports, imports and trade balance (US$ billion)



Sources: China Customs and Bloomberg

Year starts with no big law changes, while introduction of new tort law looms. The start of the year saw the entry into force of numerous minor ministerial declarations, as well as operating rules for the security services and a law governing the behaviour of Chinese diplomats abroad. The absence of any big laws and reforms evidences how focused the state bureaucracy has been on dealing with economic issues.

In December, legislators approved a far-reaching tort law that is set to enter into force in July 2010. The law establishes liability and compensatory damages for e.g. negligent construction leading to building collapse and injuries caused by the use of defective products.

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Russia

Russia continued to manage trade and current account surpluses in 2009. According to preliminary figures from the Central Bank of Russia, Russia posted a $48 billion current account surplus, or slightly less than half that of 2008. The current account surplus amounted to 4 % of GDP. The trade surplus was $110 billion, or 38 % smaller than in 2008. It amounted to 9 % of GDP. Exports and imports both contracted sharply last year. The value of exports declined 36 % to $303 billion. The value of imports fell 34 % to $193 billion.

Last year, crude oil, oil products and natural gas accounted for 63 % of Russian exports, down slightly from a 66 % share in 2008. The reduced share mainly reflected a drop in the price of crude oil and a reduction in the volume of natural gas exports. The value of crude oil exports fell 37 % as the average world-market price for Urals-grade crude fell from a record of $95 a barrel in 2008 to $61 a barrel last year. Higher production levels, however, helped boost by about 1 % the volume of crude oil exported in 2009. The value of natural gas exports contracted 40 %, due in part to reduced demand on Russia's export markets.

Russia continued to run a deficit in services last year, although the services deficit shrank from $25 billion to $20 billion. Exports and imports of services both fell 18 %. The largest sector of service exports was transport services, while the largest service imports category was tourism.

Capital exports from Russia fell in 2009; capital inflows turned positive in the fourth quarter. Preliminary CBR figures show the private sector last year exported $52 billion in net value from Russia. That amount was 60 % less than in 2008, when private sector capital exports hit a record $133 billion. Last spring, officials still expected net capital exports to reach $70–90 billion in 2009. An improvement in the economic outlook and easing of liquidity on international financial markets helped boost investment flows to emerging markets, including Russia, in the last three months of the year.

Banks expatriated a gross amount of $44 billion from Russia last year; most of it going to paying down foreign loans. Non-bank, i.e. the rest of the enterprise sector, exported a gross amount of $58 billion, part of which went to paying down loans. The sector received direct foreign investment worth $38 billion ($63 billion in 2008).

Russia's foreign indebtedness declined slightly in 2009. Russia ended the year with a debt situation far better than had been anticipated at the start of 2009. The year started with concerns that banks and other firms faced huge challenges in servicing their foreign debts.

Russia's total foreign debt as of end-2009 was $470 billion, down from $480 billion at the end of 2008. Government debt remained practically unchanged at $30 billion. Banks reduced their foreign debt obligations by $41 billion to $126 billion, mainly by paying off old loans and refraining from new borrowing. Debt for the rest of the enterprise sector increased by $18 billion to $300 billion.

Russia's government foreign debt corresponds to just over 2 % of GDP, while private-sector foreign debt is about 34 % of GDP. This year the state plans to borrow about $17 billion from international markets to cover a projected budget deficit. The borrowing would raise the government's foreign debt to around 4 % of GDP.

Plans to develop Russia's Far East. Russia seeks to broaden its markets and strengthen its strategic position in Asia and the Pacific region by developing its far eastern economy. The government's development strategy published last year states that the Russian Far East's problems include isolation of its economic activities and infrastructure from the rest of the country, as well as poor port, rail and air transport infrastructure and low labour productivity compared to the rest of Russia.

The Far East Federal District is extremely sparsely populated. It accounts for 36 % of Russia's surface area, but is home to just 7 million inhabitants, or about 5 % of the Russian population. The Far East Federal District is made up of the Sakha Republic (Yakutia), Chukotka Autonomous Okrug, the Kamchatka, Khabarovsk and Primorsky krais, as well as the Amur, Sakhalin, Magadan oblasts and the Jewish Autonomous Oblast.

The government's development strategy seeks to focus investment on the mining and energy industries in particular. The Far East Federal District, already a significant producer of hydrocarbons and minerals, currently has a number of new projects under planning. In December, Russia's state-owned pipeline operator Transneft opened the first section of the Eastern Siberian-Pacific Ocean Pipeline (ESPO). Prime minister Vladimir Putin has described the project as "geopolitical," suggesting a large change in Russia's oil transmission infrastructure, which up to now has largely been geared to supplying oil to Europe. The emphasis of Russian oil production is shifting eastward to new oil fields in Eastern Siberia and the Sakhalin.

To revive the shipbuilding industry in Russia's Far East, state-owned United Shipbuilding Corporation plans to build two massive shipyards on the Pacific shores.

Vladivostok will host the 2012 Asia-Pacific Economic Cooperation Forum as part of efforts to boost the international image of Russia's Far East. Vladivostok infrastructure projects, including construction of a huge congress centre, are valued at over 280 billion roubles (€6.7 billion). The project is Russia's second largest infrastructure project after the Sochi Olympics.

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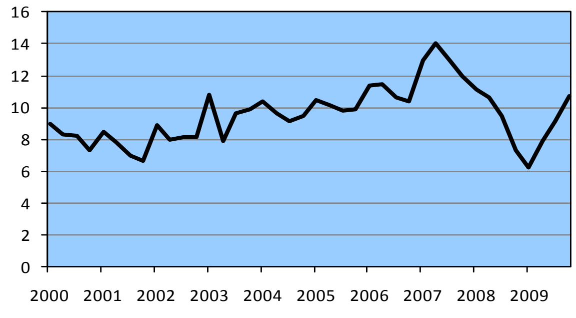
China

China posted strong growth in 2009. Despite impaired GDP growth from the global financial crisis and distinctly lower GDP growth in the first half, China's GDP growth roared back to an impressive rate of 10.7 % y-o-y in the fourth quarter. Much of the growth acceleration, however, can be attributed to the low comparison figure of 4Q08. On-quarter seasonally adjusted growth is estimated to have been about the same in the fourth quarter as in the third quarter. For all of 2009, real GDP growth was 8.7 %.

Given that China's demand-side statistics are yet to be released, evaluation of supply-side figures suggests that last year's growth was sustained by increased activity in the service sector. Industry and agriculture appear to have grown at rates below overall GDP growth. China's statistics officials have found monitoring the service sector highly problematic, however. So much so, in fact, that most revisions of GDP figures can be attributed to new data on service sector performance becoming available.

China's sizzling economic growth is expected to continue; most forecasters predict the Chinese economy will grow 9–10 % this year in real terms. The structure of growth, however, seems to be shifting. As the government is not increasing stimulus spending this year, investment growth will slow. On the other hand, the normalisation of foreign trade should help boost GDP growth overall.

Real GDP growth quarterly, y-o-y change (%)



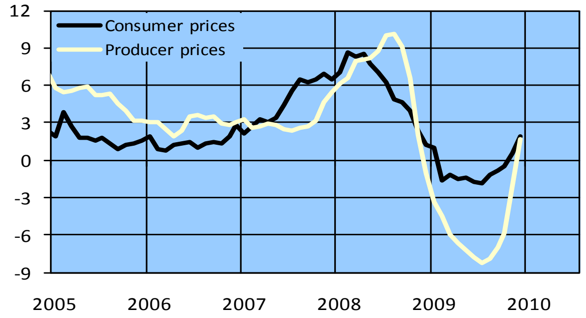
Sources: China National Bureau of Statistics and BOFIT

Inflation picks up. Consumer prices rose 1.9 % y-o-y in December, up from 0.6 % y-o-y in November. After a year-long slide, December producer prices rose 1.7 % y-o-y. November producer prices contracted about 2 % y-o-y.

The rise in prices was fuelled by huge expansion of credit (up 32 % y-o-y) in 2009. The total loan stock of financial institutions at the end of 2008 was roughly equal to China's GDP; the size of the loan stock at the end of 2009 corresponded to about 125 % of GDP. The counterpart of the growth in policy-driven bank lending, the broad money supply (M2) increase was 28 % last year – a rate that exceeded considerably the range of 16–18 % for the latter half of the 2000s. Researchers have established a strong link between money supply growth and inflation in China.

The recent flare-up in the inflation rate has forced the government to tighten its monetary stance. This week the regulatory authorities ordered China's largest commercial banks to cut back their lending.

Consumer and producer price inflation, y-o-y change (%)



Sources: China National Bureau of Statistics and Bloomberg

Foreign currency reserves increased at near-record rate in 2009. As of year's end, China's foreign currency reserves stood at about $2.4 trillion, or about $450 billion more than at the end of 2008. Growth in reserves was only slightly outpaced by the $460-billion record increase of 2007. Interpreting changes in reserves at this point is complicated by the fact that the 2009 balance-of-payments data have yet to be released and the fact that China does not publish information about the structure of its reserves.

About $200 billion of the reserve growth came from the goods trade surplus, or about a third less than in 2008. Foreign direct investment inflows into China amounted to $90 billion (down 3 % from 2008), while FDI outflows from China climbed to $43 billion (up 7 %). Thus, the net effect of FDI on reserve growth was around $50 billion. Dollar investments are estimated to make up 60–70 % of China's foreign currency reserves. Thus, the average strengthening of the euro relative to the dollar last year appears to have slightly increased the value of China's currency reserves.

A notable aspect of monetary policy is that other capital movements have substantially increased currency reserves and the quantity of money circulating in the economy. As the balance-of-payments figures for the capital account are unavailable, the best guess of observers is that particularly domestic actors such as Chinese banks and importers are behind the rise in capital imports, even if foreign investors have incentives to move money to China on the expectation of future yuan appreciation. Capital imports in December appeared to increase sharply, but due to the drop in the euro, China's currency reserves grew only about $10 billion.

Editor-in-Chief Seija Lainela

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Russia

Reforms in the Russia's banking sector. Under a decree from the Central Bank of Russia that entered into force at the end of December, banks participating in the deposit insurance scheme must disclose their most important shareholders. Banks have until the end of March to post information about owners with stakes larger than 1 % on either their own website or the CBR website. Banks earlier only had to report the identities of owners to the CBR, but many large and foreign-owned banks have disclosed their ownership also to the public. About 87 % of banks registered in Russia belong to the deposit insurance scheme.

The Deposit Insurance Agency, tasked since autumn 2008 also with restoring troubled banks to financial health, recently completed its first restructuring (Nizhegorodpromstroibank). The DIA is in the process of restructuring 14 other banks. The DIA works with small banks and a few mid-sized banks.

State development bank VEB is involved with restructuring of four banks placed under its control in autumn 2008. One of them, Svyaz-bank is planned to be merged with the Russian Post. In 2007, Svyaz-bank began to open mini-branches at Russian Post offices. The merger plan was okayed at a December meeting of VEB's governing board, which is chaired by prime minister Vladimir Putin. The Russian Post has a broad office network, so the new Postal Bank, with 42,000 offices, would immediately become Russia's largest bank. The current number one, Sberbank, which is owned in part by the CBR, has nearly 20,000 branches nationwide. Creation of the Postal Bank is a non-trivial task that could take, according to experts, years to implement. Representatives of VEB, the CBR and the Russian Post are to prepare a step-by-step plan on establishing a Postal Bank by end-March.

Birth pangs for new Russia-Belarus-Kazakhstan customs union. The customs union launched at the start of the month eliminates trade duties among the members. Common external customs tariffs enter into force at the beginning of July.

Under the customs union rules, imports of certain products to Russia that earlier did not require an import license now require a license. These products include wine and certain alcoholic spirits (previously only vodka required an import license), vitamins and telecom equipment used e.g. in construction of 3G mobile networks. In addition, the import procedures for mobile phone handsets and computers were affected as the import of encryption technology they may incorporate now requires a preliminary notification to security officials.

As importers only learned about the planned changes a few weeks ago, imports of many of the above-mentioned products has been halted. The situation is aggravated by the fact that some of the procedures for granting licenses are yet to be finalised and necessary authorities to be appointed.

Operators erecting new mobile phone networks are worried the rules will delay network roll-outs. The big teleoperators have appealed to the authorities to issue procedures for granting import licenses as soon as possible.

The situation for alcoholic beverages improved over the last two weeks after customs officials issued temporary import permits. This eased the predicament of importers, who faced high warehousing fees at the border.

The customs union commission, the top decision-making body of the union, continued work this week in Moscow setting out operating principles and dealing with such issues as how tariff revenues should be divvied up among the members. No agreement was reached on the matter as Belarus was dissatisfied with a proposed 5 % share. Kazakhstan would get 8.5 % of import tariff revenues and Russia 86.5 %. The commission also tackled organisation of the customs union and the possibility of establishing a common super-national customs authority to coordinate operations of member country customs agencies.

Russia and Belarus agree on oil supplies. After month-long negotiations, Russia and Belarus reached a deal this week on Russian oil supplies for the current year. Under the previous agreement, which ran until the end of last year, Russia provided crude oil to Belarus at below-market prices by exempting Belarus part of the Russian export tariff. Russia wanted to increase the export tariff at the start of this year, but Belarus argued the duty violates the rules of the three-country customs union launched at the start of the year.

The Belarus economy benefits significantly from Russian oil. Of the 21 million tons of oil it imported last year, Belarus used about a quarter for domestic needs and refined the rest into various oil products it exported to Russia and elsewhere. Under the new arrangement, Belarus can import up to 6.3 million tons of crude oil duty-free, i.e. the amount it uses domestically. Thereafter, any crude oil to be refined for export would be subject to the full Russian export tariff.

In conjunction with the talks, Belarus deputy prime minister Vladimir Semashko and his Russian counterpart Igor Sechin gave a statement confirming the stable flow of Russian transit oil via Belarus to Europe. It was agreed the compensation Russia pays to Belarus for transmission will go up 11 % this year.

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China

China rising as science superpower; huge growth in research activity. A *Financial Times* story on Monday (Jan. 25) compiled data from Thomson Reuters and Web Science database to show Chinese researchers published about 112,000 scientific articles in peer-reviewed journals in 2008. US researchers led the pack with the most published articles (333,000). Among the BRIC countries, China has made the most impressive gains in research publications, with notable strengths in the areas of chemistry and materials science. The quality of the science in Chinese papers still is variable, but clearly the Chinese are increasingly working across borders with members of the international research community and a growing number of foreign researchers are publishing jointly with their Chinese colleagues. Generally speaking, the quality of Chinese research is improving.

Brazil has also made huge strides in increasing its output of scientific articles, with particular expertise shown in the areas of agriculture and bioscience. In contrast, India, and in particular Russia, failed to live up to expectations of increasing research prowess.

China's heavy investment in education and R&D during the past decade is now coming to fruition with China joining other research leaders. The return of the Chinese researchers who have studied and worked in North America and Europe are playing an important role in China's development. China has also been successful in translating basic science advances into commercial applications. This phenomenon is reflected, e.g. in the large increase in international patent applications.

China leads the world in car sales. China surged past the US last year to become the world's largest car market, with car sales up almost 50 % from 2008. In addition to selling slightly over 10 million passenger cars, over 3 million trucks, busses and other large vehicles manufactured in China were sold on the domestic market. Crossover SUV sales doubled to two million vehicles last year. In addition to growth in personal wealth in China, government tax breaks for cars with small engines and fleet purchase by different levels of the state administration have fuelled a huge increase in the number of cars on the road. By some estimates, government entities purchased hundreds of thousands of passenger cars last year.

Nearly all large international carmakers have production in China, which is only possible if they agree to establish production as a joint venture with a Chinese partner. In 2009, such joint ventures accounted for about half of all passenger car production in China. Among the foreign carmakers, the GM and the Hyundai have made substantial gains in market share, and are poised to challenge China's traditional market leader Volkswagen, which last year saw its share of the market contract to around 15 %.

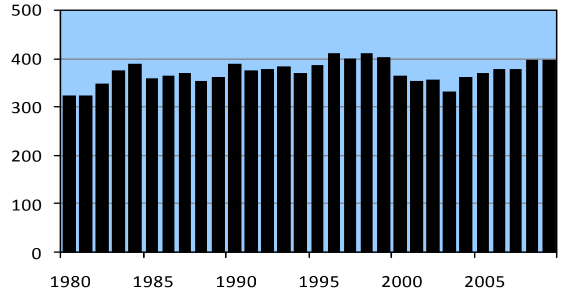
Car manufacturing is an official pillar of Chinese economic policy. By forcing foreign carmakers into joint ventures with Chinese companies, officials have sought to improve the expertise of domestic players. Chinese firms have also bought foreign car factories and brands, e.g. Volvo is expected to become entirely Chinese-owned next month and parts of Saab technology and select models have been acquired. China has had a bumpy learning curve in its foreign acquisitions. The English Rover has failed to catch on in the Chinese market. After acquisition by the Chinese SAIC, workers at the South Korean Ssangyong Motors went on strike and SAIC found itself in a fight with the Korean government over theft of proprietary technology.

Although car exports, which has been strongly supported by the government throughout the 2000s, have grown rapidly, nearly all cars manufactured in China are sold on the domestic market. Car exports suffered a huge setback last year when the volume of car exports shrank to just 100,000 cars, about half of 2008 car exports. Even though Chinese carmakers are regular participants at the major car shows in Europe and the US, sales have been hampered by failure to meet safety standards. By some estimates, only about a thousand Chinese-made cars were imported into the EU last year.

The rise of the personal automobile has been accompanied with increased emissions. China's large cities are now plagued with air pollution and constant traffic jams despite huge investment in public transport. To improve the situation in Beijing, officials are encouraging commuters to get back on their bicycles by establishing dedicated bike paths and a city-operated rent-a-bike network.

Record harvest in 2009. The harvest of major crops (grains, potatoes and beans) reached 531 million tons last year, breaking the previous year's record by a million tons. Despite the bumper harvest, grain exports declined by a million tons from 2008. Meat production continued to recover from the tribulations of 2006, reaching 75 million tons last year. China is largely self-sufficient in agricultural production.

China's grain harvest in kilograms per capita, 1980–2009



Source: China National Bureau of Statistics

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Russia

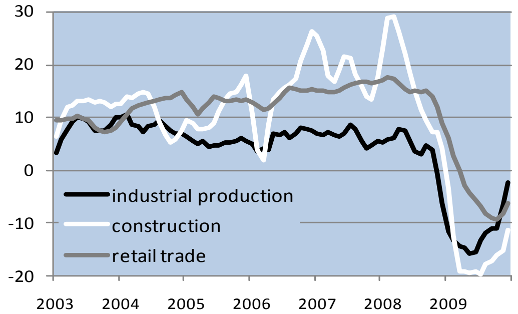
Especially fixed capital investment posts sharp drop last year. Preliminary Rosstat figures indicate Russian 2009 GDP amounted to 39 trillion roubles (€885 billion). In other words, GDP contracted 7.9 % in real terms, slightly less than the economy ministry's initial estimate put out at the end of December.

Fixed capital investment relative to GDP (investment ratio) fell last year by two percentage points to 20 %. According to Rosstat monthly observations, fixed investment fell 17 % last year, although the rate of contraction slowed as the year wore on. In December, fixed capital investment was down just 9 % from a year earlier.

Private consumption contracted less that capital investment, so its share of GDP increased to 54 %. Consumer demand as indicated by the trend in retail sales fell 6 % y-o-y, while services declined 4 %. Public consumption increased slightly, due in part to the economic stimulus package. Its share of the economy relative to GDP increased to 20 %.

Disposable incomes grew 2 % in real terms, reflecting pension hikes. Real wages fell 3 % y-o-y.

Output trends for three core sectors of the economy (% change y-o-y, 3-month moving average)



Source: Rosstat

Manufacturing output fell overall 16 % in 2009, but the decline began to moderate starting from the summer. The largest drops were registered in manufacturing categories for transportation vehicles (38 %), electrical equipment and appliances (32 %) and machinery and equipment (28 %). Contraction in specific product groups was sharpest in passenger car manufacture (down 59 %) and appliances (about 40 %). In contrast, food production was essentially unchanged from the 2008 level. Construction fell 16 % y-o-y, with the smallest drop in apartment construction (down 7 % y-o-y).

Crude oil production increased last year by slightly more than 1 % as new fields in eastern Siberia came on stream. Russian oil output reached a record level in 2009, 494 million tons for the year or an average of 9.925 million barrels a day. Based on the daily production average, Russia nosed out Saudi Arabia last year to be the biggest oil producer in the world. Unlike Saudi Arabia, however, Russia has virtually no elasticity in production as oil production is operated at full capacity. Russia last year lost the top spot in natural gas production to the US as gas production in Russia declined 12 % on reduced demand from its key export markets. Russian gas production last was at about the same level as it was a decade ago.

Agricultural output last year increased just over 1 %, helped by a respectable grain harvest (97 million tons) that was just 10 % smaller than the record grain harvest of 2008. Meat production increased 7 %, even if the number of livestock declined slightly.

Freight transport declined 10 % overall, with the largest drops seen in road freight and inland water shipping (17 %). Rail freight transport fell 12 %. Sea shipping rose by 6 %. Sea shipping of grain cargoes more than doubled, coal shipping was up 20 % and liquid cargoes grew 9 %.

Grey economy slightly increases its contribution to GDP during the downturn. Rosstat's new head Alexander Surinov reports the grey economy now accounts for about a fifth of Russia's economic output. The value of grey economy output last year was estimated at around 7.8 trillion roubles (€180 billion). The grey economy's share of the overall economy has been fairly steady in recent years. After expanding rapidly the start of the 2000s, then declining briefly, the grey economy has been growing again with the economic downturn. The size of the grey economy is estimated by inference based on Rosstat's monitoring of macroeconomic indicators. Estimates of the grey economy by some observers, however, range as high as half of Russian GDP.

Rosstat grey economy measures include illegal economic activity (e.g. illegal drugs trade), hidden transactions (e.g. tax evasion), unreported work (e.g. odd jobs by individuals), as well as small-scale private food production. Rosstat official figures include estimates for hidden transactions, unreported work and artisanal food production. The last two categories are even tracked by survey.

According to Surinov, the recent growth in the grey economy has gone hand in hand with the financial crisis and increased unemployment. Unemployed individuals must find ways to make up for lost wages. Russia's official unemployment rate averaged 6.3 % in 2008 and 8.4 % last year.

Rosstat plans to launch a small firm research project next year. The goal is to develop person-specific income monitoring to improve estimates of the actual extent of grey economic activity.

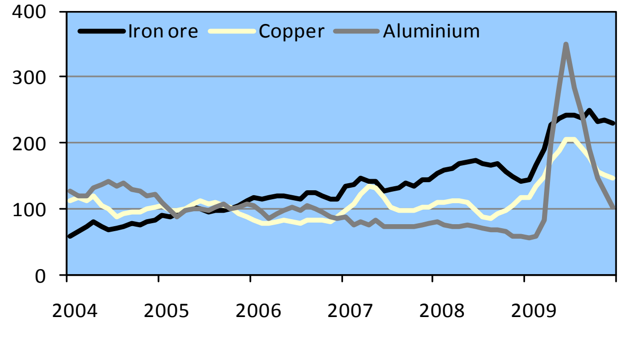
China

China's influence in iron ore and base metal markets heightened by financial crisis. China's demand for imported iron ore and base metals experienced large fluctuations last year. Iron ore imports, after rising steadily over much of the past decade, surged after the global financial crisis struck. Copper imports, however, were flat for years before the crisis then took off suddenly last year and subsequent month-to-month fluctuations in import volumes were huge. Aluminium imports declined in 2008, sky-rocketed in the first half of 2009, and then returned to earth in the second half of 2009. Similar fluctuations did not occur for imports of copper ore or aluminium oxide during the crisis period.

While some the large swings in metal imports have to do with product-related factors, the collapse of global prices in the second half of 2008 has been an important driver of the increase. Domestic demand has been sustained by state infrastructure projects and companies have been replenishing their inventories when prices and shipping costs have been low. The state also has been building up its strategic reserves. China's own mining industry still suffers from low productivity and poor quality.

Commodity imports provide both a good example of China's increasing significance in world markets and a reminder of the sorts of surprises Chinese actions inject into various industries and markets. Prices of base metals dropped sharply in the second half of 2008, then recovered, thanks in part to huge demand from China. In recent weeks, metal prices have fallen again, reflecting worries that e.g. China has already begun to tighten its economic policies, which reflects into demand for metals. As resource-hungry Chinese firms make acquisitions or buy significant stakes in companies around the world, China's role in international commodity markets continues to increase.

3-month moving average of Chinese import volume of iron ore, copper and aluminium, 2005 = 100.



Source: CEIC

China's coal imports exceptionally large in 2009. China imported 130 million metric tons of coal, an amount equivalent to its total coal imports between 2006 and 2008. While that amount compared to just 4 % of China's domestic coal production, 2009 marked the first time in at least 30 years that China was a net importer of coal.

China accounts for over 40 % of global coal production and coal consumption. China's emphasis on coal is driven largely by a policy of energy security and independence, as it has about 14 % of global coal reserves (it ranks third in reserves after the US and Russia).

China has traditionally imported most of its coal from Indonesia and Vietnam. Last year, however, a ten-fold jump in coal imports from Australia made the southern continent China's top coal supplier. Coal imports from Russia have also increased dramatically. The four above-mentioned countries combined now account for 80 % of China's coal imports. As with other resource reserves, the Chinese have been investing ever more actively in foreign coal mines. During 2009, for example, the State Investment Company invested in troubled Mongolian and Indonesian coal producers.

The rapid growth in coal imports is due to several factors. Coal imports became increasingly attractive as prices rose on the domestic market while the world price of coal and shipping costs plummeted in the aftermath of the global economic meltdown. Observers also point out that colder-than-usual weather towards the end of the year made it difficult to transport coal from China's main production areas to areas where demand for coal is high. Moreover, a number of small coal mines were closed for safety reasons.

Official figures, however, show China's domestic coal production increased slightly faster last year than in previous years, and growth in coal consumption was down slightly from before. As there was no significant change in import volumes last year of other energy products such as crude oil, it appears the Chinese have been stockpiling domestic or foreign coal for commercial and/or strategic reasons. China does not disclose coal reserve data.

Market capitalizations of energy companies in developing countries soar. A recent survey by PFC Energy found that PetroChina had a market capitalisation at the end of December of $350 billion, making it the world's largest energy company, surpassing the American ExxonMobil. The Brazilian Petrobras rose to third place and the Chinese Sinopec was sixth. Russia's largest energy company, gas giant Gazprom, ranked ninth in the survey. The global financial crisis has spurred the rise of emerging market energy companies as share prices have rebounded more strongly in emerging markets than in the US or Europe, where share prices are still burdened by the fallout from the financial crisis.

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Russia

Stimulus to continue this year. Last year's federal budget featured 1.2 trillion roubles (€27 billion) for fighting the effects of the economic crisis. The amount represented 12 % of budget spending and corresponded to 3 % of GDP. The Central Bank of Russia also provided stimulus money.

Of this sum, 300 billion roubles went to support the enterprise sector. About 340 strategic or otherwise economically important firms were eligible for support. Most of the support came in the form of loans. The biggest bailout went to struggling carmaker AvtoVAZ. The banking sector received 280 billion roubles, not counting additional infusions from the central bank. The bank support was channelled to needy banks via two state-owned banks, VTB and development bank VEB. Another 200 billion roubles in support was transferred from the federal budget to help balance regional budgets.

Stimulus measures to social sector included 36 billion roubles for additional employment measures. Some 230 billion roubles in budgeted stimulus money unspent last year will be used this year.

The 2010 budget has stimulus measures totalling about 195 billion roubles (€4.7 billion), about a fifth of last year's stimulus component. A large part of the money will again go to the production sector, with economically or strategically important firms getting a total of 63 billion roubles. Some 31 billion roubles will go to vehicle procurement: the state will buy 20 billion roubles of domestically built vehicles and 11 billion roubles will go to support consumer purchases of domestically made cars. The housing fund will get 15 billion roubles for apartment construction and basic building renovations. Troubled *monograds*, one-company towns, will get 10 billion roubles. The remaining 56 billion roubles of the stimulus will be set aside for use as needed.

To support domestic producers, the government imposed numerous import controls. According to an economy ministry survey, Russia has resorted more to protectionist measures than other countries during the financial crisis. The resulting increase of 5–10 % in import tariffs for 39 % of product categories has not necessarily favoured consumer interests. When an increase in the import tariff on used cars effectively shut down their import, domestic carmakers responded by raising their prices by a third.

By government calculations, the stimulus mitigated Russia's GDP contraction last year by two percentage points, as well as stabilised social conditions and kept rising unemployment from spiralling out of control. Russia's rapid response to troubles in the financial sector increased the credibility of Russian economic policy.

The government's stimulus measures have been criticised for excessively focusing on providing support to non-viable behemoth Soviet-era enterprises as it reinforces old structures instead of creating a 21st century economy. The government, however, feels compelled to support inefficient firms for social reasons and to prevent important industrial branches from completely dying out.

Viktor Yanukovich wins presidency of economically struggling Ukraine. Opposition leader and former prime minister Viktor Yanukovich achieved a narrow triumph over Ukraine's current prime minister Yulia Timoshenko in Sunday's (Feb. 7) second round of Ukraine's presidential elections.

One of the main election themes was how to deal with the severe impact of the global recession on Ukraine, including rapid growth in unemployment. According to preliminary estimates Ukraine's GDP contracted 10 % y-o-y in 2009. Ukraine's GDP performance fluctuated considerably in the 2000s, but overall the growth averaged a hefty 7 % a year.

The average unemployment rate in the first nine months of the year was 9.4 %, up from 6.5 % in the same period in 2008. The employment situation improved somewhat in the second half of 2009.

Investment was down 36 % from 2008, while construction declined for the second year in a row (down 48 % from 2008).

Industrial output fell 22 % during 2009, while agricultural output remained unchanged on balance with meat and milk production increasing 4 %. The grain harvest was 2 % below the 2008 record harvest. Consumer demand as reflected in retail sales slid 17 %.

The value of exports to non-CIS countries plummeted 43 % in January-November 2009, driven down by a 58 % drop in ferrous metals, one of Ukraine's main export products. The value of imports declined 53 %.

Preliminary figures show the average monthly wage last year was 1,900 hryvnia (€170) and that real wages fell 9 %. December consumer price inflation slowed to 12 % y-o-y. In December 2008 inflation was still running at 22 %.

Ukraine struggles with financial problems and has difficulties in catching up on payments of its late gas bills to Russia. At the end of 2009, the IMF declined to transfer to Ukraine a $2 billion credit tranche of the $16 billion stand-by facility it had granted to Ukraine. The reason was that Ukraine had not met its commitments under the agreement.

The consensus forecast among international institutions is that Ukraine's GDP will grow almost 3 % this year.

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China

China's smaller current account surplus last year helped ease global imbalances. China's current account surplus fell last year to slightly less than 6 % of GDP. The current account surpluses corresponded to 11 % of GDP in 2007 and 10 % of GDP in 2008. Much of the decline in the surplus reflected a reduction in the trade surplus for goods. Moreover, surpluses contracted on the income account and for current transfers, while the deficit in services trade increased. The current account surplus relative to GDP was also decreased by rapid GDP growth.

On the other hand, more money entered China via the capital and financial accounts, even if direct investment in China ($90 billion) contracted and direct investment flows out of China ($56 billion) took off. Although there was no further breakdown of the capital and financial accounts, newspapers report the financial account surplus was due largely to a pull-back by Chinese firms on international portfolio investment.

The State Administration for Foreign Exchange (SAFE), which operates under the central bank, has earlier released balance-of-payments data only in late spring or early summer. Besides faster reporting, SAFE now plans to release quarterly balance-of-payments information.

Main balance-of-payments categories and foreign currency reserves, (US$ billion)

	2007	2008	2009
Current account	372	426	284*
Capital and financial accounts	73	19	169**
Net errors and omissions	16	-26	–
Increase in reserves	462	418	453
Reserves on Dec. 12	1,528	1,946	2,399

Source: SAFE

** Preliminary figure. ** Includes net errors and omissions.*

Foreign trade continued to recover in January despite rise in trade frictions. China Customs valued exports in January at $109 billion and imports at $95 billion. Both exports and imports were up sharply from a year earlier when the global trade melt down and extended holidays from Chinese New Year started in late January. Seasonally adjusted figures for both exports and imports show contraction of a few per cent from December, but still improvement over November.

China's trade disputes with its partners, especially the US, have increased, as China's economy has continued to grow rapidly and the yuan's exchange rate has been kept tightly pegged to the dollar. Since November 2009, the United States has imposed four anti-dumping tariffs on Chinese products and China has raised tariffs on two US products. Several complaints are also under review by the WTO. China-US relations have been further chilled recently by the announcement of US plans to sell advanced weapons systems to Taiwan and president Barack Obama's plans to meet with the Dalai Lama.

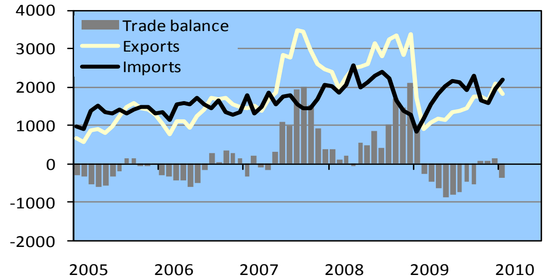
Crisis turns China's Russia trade balance negative. During 2007 and 2008, China ran large trade surpluses with Russia. China's exports to Russia withered last year, creating a trade deficit. Lower demand for Chinese products in Russia reduced China's exports to Russia by nearly half from 2008 to just $18 billion. The value of China's imports from Russia fell 11 % to $21 billion.

Russia is a minor trading partner for China, accounting for only about 2 % of China's imports and exports. For Russia, however, China is a major trade partner, accounting for 14 % of goods imports and 6 % of Russian exports. Russian and Chinese customs figures differ. By China's figures, it had a nearly $3 billion trade deficit with Russia last year. Russian figures show China running a $6 billion surplus. Import accounting practices (e.g. insurance and shipping fees, CIF) account for part of the discrepancies.

Machinery and equipment accounted for nearly 30 % of China's exports. The share of clothing, textiles and footwear approached 30 %. The remaining 40 % of exports were divided rather evenly among various raw materials and manufactured goods. Imports from Russia, in contrast, were composed almost entirely of raw materials and unfinished goods. Crude oil and other energy products accounted for half of all imports from Russia, followed by base metals (18 %) and forest products (14 %). The remainder was mostly intermediate goods. Machinery and equipment accounted for less than 2 % of imports from Russia.

Official Chinese figures show direct investment from Russia last year amounted to about $30 million, a miniscule share of China's total $90 billion in FDI in 2009. Investment in Russia by Chinese firms in 2009 amounted to about $400 million, increasing China's total FDI stock in Russia to almost $2 billion. The flow of FDI by Chinese firms outside mainland China reached $56 billion last year, and the total investment stock increased to $184 billion (Hong Kong's share 63 %).

China's monthly trade with Russia , US$ million



Sources: CEIC and China Customs

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Russia

Gulf of Finland harbours playing greater role in Russian shipping. Russia's Association of Commercial Seaports reports that Russian ports last year handled 496 million metric tons of cargo, a 9 % increase from 2008. The increase in seaborne freight reflects increased shipping of exports of oil and oil products, coal, metals and ore concentrates, and grains. In contrast, exports of fertilizers, raw wood and containerised freight have fallen. Russian ports are largely geared to exports, with over 90 % of cargoes handled heading for export. Measured both by tonnage and value, the largest cargoes were crude oil and oil products. Dry goods accounted for nearly 40 % of the freight handled at Russian ports.

In terms of tonnage, Novorossiysk, located on the Black Sea, is hands down Russia's largest port. The next biggest ports are the ports of Primorsk and St. Petersburg, located in the eastern Gulf of Finland. Primorsk is geared almost entirely to shipping of oil and oil products, and is Russia's largest oil shipping port. The port of St. Petersburg, in contrast, is versatile cargo handler and imports account for about a third of freight handled. Russia's other Baltic ports largely focus on export operations.

The opening of new ports and expansion of old ones in recent years has increased the importance of Baltic ports for Russia. The combined seaborne freight volumes at Baltic ports last year already matched the volumes of Russia's Black Sea ports.

Cargo handling volumes at select Russian ports in 2009

Federal District	tons, mil.	% change
Total	***496***	***9***
Northwestern, e.g.	***223***	***4***
Primorsk	79	5
St. Petersburg	50	–16
Vysotsk	17	8
Ust-Luga	10	53
Kaliningrad	12	–20
Murmansk	37	30
Southern, e.g.	***181***	***14***
Novorossiysk	124	9
Far East, e.g.	***92***	***15***
Vanino (Khabarovsk)	24	14

Source: Russian Association of Commercial Seaports

Government moves to support single-enterprise towns. In December, the government anti-crisis commission finalised a list of troubled *monograds* (one-company towns) entitled to federal support. First deputy prime minister Igor Shuvalov said that in addition to the 10 billion roubles (€240 million) in direct budget spending for these towns this year, the budget investment fund will grant an additional 10 billion roubles in loans. Towns entitled to support will themselves prepare and submit development proposals that must be approved by the government to allow the release of federal money. The government's goal is that regional and local governments, as well as enterprises, will participate in financing of the development programmes.

A total of 20 cities are listed for bailouts. Among them are the cities of Togliatti, Baikalsky and Pikalevo. Togliatti, home of struggling carmaker AvtoVAZ, features regularly in the Russian national press (see *BOFIT Weekly 42/2009*). AvoVAZ, which produces the iconic Lada, now suffers from aging production technology and has been kept on life support with massive injections of federal funding. In mid-2009, the carmaker employed 102,000 people. Since then it has cut its workforce by 25,000 (14,000 through retirement and 7,000 through moving workers to subsidiaries and outsourced enterprises). The development proposal of Togliatti's local administrators includes a plan to create a special economic zone and establish industrial parks.

The agency for restructuring of housing loans, established last year, has developed a support programme to help residents hit with unemployment in one-company towns. The goal is to help them move to jobs elsewhere by providing cheap apartment loans and assistance in selling the old apartment. The workers of AvtoVAZ were the first to qualify for such support. They are offered the chance to move to jobs in the town of Tikhvin in the Leningrad region to work at its new train car manufacturing facility.

The top employers in the 23,000-resident town of Pikalevo, located near St. Petersburg, used to be an aluminium oxide plant and a cement plant, which ceased operations in 2008. After dissatisfaction with high unemployment and large wage arrears culminated last summer in protests that attracted national attention, the industry ministry spent time putting together a proposal to companies on refurbishing production in Pikalevo. The upgrades would cost about €300 million, and state guarantees would be offered for their financing.

The town of Baikalsky (population 17,000) was built in the 1960s when a pulp and paper mill was erected on the shores of Lake Baikal. The mill, once legendary for its pollution of the world's deepest freshwater lake, was shut down in 2008 after tighter environmental regulations made profitable operations difficult. After strong local protests, the Russian government relaxed environmental rules in January and the mill is set to resume operations this year. Environmental groups and others strongly oppose the reopening. In any case, the mill would operate at a loss that would be compensated from the budget.

Revda, a mining town of 9,500 in the Murmansk region, is the only settlement on the government's list set to close, as the town's sole employer, the mine, has exhausted its reserves. Revda's residents will be assisted in moving elsewhere.

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China

PBoC continues to tighten its monetary stance. The People's Bank of China will raise reserve requirements by a half percentage point from next Thursday (Feb. 25). Big banks will have to place 16.5 % of their deposits with the central bank and smaller banks 14.5 %. Reserve requirements were also raised a similar amount in January. The PBoC sees reserve requirements as a relatively cheap, but effective, monetary policy tool; it pays 1.6 % interest on these mandatory deposits of banks. The central bank has also been siphoning liquidity out of the system through increased bond sales. Moreover, officials have issued direct orders to banks (window guidance) to slow growth in bank lending.

As part of last year's stimulus efforts, the central bank allowed exceptionally high growth of the money supply. As of end-December, M2, the broad measure of money supply, was up 28 % y-o-y. Average annual growth of M2 has been below 20 % in recent years, and according to newspaper reports, the PBoC this year is targeting the M2 growth of 17 %.

The rapid growth in the money supply has fuelled inflationary pressures. January consumer prices were up 1.5 % y-o-y, and up 0.6 % from December. Prices have risen on-month nearly continuously since last August. This trend is expected to continue this month as celebrations of Chinese New Year typically increase demand and raise prices. In addition to consumer prices, producer price growth has accelerated sharply in recent months.

The PBoC's monetary tightening moves were widely anticipated; rapid economic growth has returned and inflationary pressures have been on the rise. Further tightening measures are expected. Allowing the yuan exchange rate to appreciate would also alleviate part of the price pressures.

Many cities and provinces increase their minimum wage definitions. Provinces and cities throughout China are considering hikes in the minimum wage, following decisions by the cities of Beijing, Chongqing and Dongguan, as well as the Jiangsu province. The minimum wage hikes are in the range of 10–12 %. Under the change, the minimum monthly wage in e.g. Beijing will rise to 880 yuan (€94) at the beginning of April. Minimum wage limits only apply to urban areas; they vary not only across provinces but also within provinces.

The increase in minimum wage will most strongly impact production costs in labour-intensive branches highly reliant on use of migrant workers. There are no official estimates of how many people are actually paid minimum wage, but researchers looking at the issue found that 85 % of migrant workers and local workers getting monthly salary were paid at least the minimum wage in 2005. Minimum wage limits exist also for hourly workers, but the studies found little evidence of compliance.

OECD: China still has plenty of room to implement sweeping reforms. The OECD's *Economic Survey of China 2010* released at the beginning of February provides a comprehensive discussion of the Chinese economy and the biggest challenges facing its economic policymakers. The report takes a clear stand on the kinds of changes needed in the various sectors of the economy. China's spectacular economic growth has long been driven by the private sector. While the role of market forces in the economy has grown dramatically, further development requires on-going structural reform. The presence of the public sector is still unjustifiably large in many sectors.

To modernise and strengthen China's financial sector, the survey calls for e.g. increasing the emphasis of inflation targeting in monetary policy, opening up the financial system to foreign competition, developing corporate bond markets, creation of a deposit insurance scheme to balance competitive conditions and enhancement of financial oversight.

Public sector involvement is still common even if competition in the product markets is adequate in many sectors. The recent global crisis has again enhanced China's old-fashioned industrial policies. The report found that the extent of state intervention in the economy is on par with Russia. The OECD says China should more precisely define the roles of the state and large state-owned enterprises as the current arrangement distorts competition and could limit the possibilities for economic growth.

In considering the labour market challenges, social security and health care, the OECD noted persisting disparities (regional differences; cities vs. the countryside; migrant labour, etc.) and the need for uniform national practices. Migrant labour, which can represent up to 40 % of the labour force in cities, is a particular concern. Increased spending on education would promote greater economic equality and make it easier to achieve development goals in labour markets and social security. Creation of a uniform pension scheme for urban and rural residents would call for a greater role of the central government. In addition, there is strong demand for raising the current minimum retirement ages (55 for women and 60 for men). The study found earning disparities were no longer growing and even narrowing, even if regional differences remain huge by international standards.

Unlike many countries, China is exceptionally well positioned to continue reforms. Its public finances are in excellent shape, so there are no major barriers to implementing reforms − even with high spending demands ahead in the short term.

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Russia

January economic numbers offer little optimism. Although Russian industrial output was up 8 % y-o-y in January, industrial output on month declined 20 % from the previous month. Research institutes estimate the seasonally adjusted decrease was around 1 %. Estimation of trends is difficult as Rosstat at the start of the year changed the structure of its industrial output series to comply with EU practices. Simultaneously, the year 2008 was taken as the new base year for the series. Last year's numbers have yet to be calculated according to the new methodology, so comparisons with last year will not necessarily give a realistic picture of what is going on. Rosstat will publish the recalculated 2009 series during the second quarter of 2010.

Fixed investment in January was nearly 9 % less than a year earlier. This year's exceptionally harsh winter partly explains the dearth of investment.

Retail sales, an indirect measure of consumer demand, increased a mere 0.3 % y-o-y in January. Real wages, on the other hand, were up 3 % and real incomes 7 % compared to a year earlier. The unemployment picture was bleaker than officials had hoped. January unemployment rose to 9.2 %, up from 8.2 % in December. Unemployment could keep rising for the first quarter of the year, which typically is hardest for employment.

CBR lowers key rates by a quarter of a percentage point; rouble under pressure to rise. Effective February 24, the CBR's refinancing rate fell to 8.5 % and the one-day repo-credit minimum to 5.75 %. Part of the Central Bank of Russia's justification for the cut was that inflation continues to subside. January consumer prices were 8 % higher than a year earlier (compared to 8.8 % in December).

The central bank also wants to dampen appreciation pressures on the rouble. Driven by high world oil prices, the rouble has soared against its dollar-euro currency basket since last week − despite massive dollar purchases by the central bank to bring the situation under control. The rouble's exchange rate last week dipped below its lower fluctuation range limit for the first time since November 2009, when the central bank announced it was shifting to a narrower fluctuation band. The new lower limit of the band was 35 roubles and the upper limit 38 roubles against one unit of the currency basket. The CBR apparently shifted its band limits last week gradually to 34.75 and 37.75 roubles per unit. The rouble is at its strongest since January 2009. As of February 26, the rouble-euro exchange rate was 40.5 and the rouble-dollar rate 30.1.

Banking sector growth flat-lined in 2009. Russia's total banking sector assets amounted to 29.4 trillion roubles (€677 billion) as of end-2009, a nominal increase of 5 % from 2008. In real terms, however, the value of assets was down from 2008. The relative smallness of the Russian banking sector can be seen in the fact that total bank assets equal more than 70 % of GDP, which is less than in any other developed country − and even many emerging economies. Growth in total assets at the beginning of the year was largely due to state support measures and rouble depreciation. At the end of the year, household deposits rebounded as real interest rates turned positive, thanks largely to falling inflation. In pre-crisis years, Russia's banking sector grew an average of 40 % a year.

Despite government efforts to get banks to increase lending, banks have yet to rise to the task. Bank lending declined almost 3 % in nominal terms last year. The stock of loans to households contracted 11 %, while the stock of loans to enterprises ended the year at about the same level that it started the year. The credit crunch was not a reflection of tight liquidity in the banking sector but product of the global economic doldrums and the need of banks to maintain strong balance sheets.

The CBR reports the share of non-performing loans in the overall loan stock increased from 2 % to just over 6 %. The central bank does not expect this share to increase much further, however. Estimates of the stock of non-performing loans vary widely. Many experts are more pessimistic than the CBR. They claim that if loan restructurings are factored in, the stock of non-performing loans could be as much as 15–20 % of the total loan stock.

Last year, Russian banks, like banks in many other countries, focused on maintaining solvency and rebuilding their balance sheets. The main funding source for banks were household deposits, which grew during the year at a nominal rate of 27 %, or almost twice as fast as in 2008. At year's end, household deposits corresponded to 19 % of GDP, which is not much compared to most emerging economies. This is one of the reasons why Russia's banking sector will still be unable to meet the needs of domestic borrowers when economic growth returns.

Instead of lending out the funds raised from depositors, banks used the money for paying down debt. As a result, the share of funds from the central bank in the banking sector's total assets fell to below 5 %. At the start of last year, central bank funds of banks reached an exceptionally large 12 % of total assets. This was due to crisis financing provided to banks by the CBR. The amount of banks' outstanding foreign debt fell last year by about a quarter. Banks invested their surplus liquidity in e.g. bonds, almost doubling such investment over the year. At the end of the year bond investments accounted for 12 % of the banking sector's total assets.

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China

Land deals highly profitable for the state. China's land and resources ministry reports that the sale of land use rights last year brought in 1.6 trillion yuan (€170 billion) for the government. Sales of land use rights were up from previous years, amounting to about 3,200 square kilometres (more than the area of Luxembourg). Revenues from sales of land use rights have become an important source of funds, especially for China's local administrations.

Two forms of land ownership are allowed in China. For the first, collectives (typically villages) hold farmland and the residential land in villages. The second form is government-owned land, which covers rest of the land including all urban land. A village farmer can obtain 30-year land use rights for agricultural land. Although land use contracts should to be renewed at the end of each lease period, Chinese property law allows considerable wiggle room for interpretation (e.g. cost of a lease renewal is not specified). Owners of land use rights are free to sublet the land to others or sell their land use rights (in practice only to a person from their village). It is also possible to inherit land use rights. The state has tried to improve the situation for farmers in recent years by e.g. making it more difficult to use farm land for building factories or residential housing construction and increasing compensation for eminent domain actions. Oversight of regulations, however, is still deficient.

With respect to land not held by collectives, the state sells land use rights as temporary rights. The land use rights for commercial purposes allow leases of up to 40 years, for industrial use up to 50 years and residential use up to 70 years. Land use rights are typically offered at auction. The state began to set minimum prices for industrial land at the beginning of 2007. Minimum prices were lowered in May 2009 to support the economy. Land designated for industrial use is divided by area into 15 price categories. Since the 2009 change, minimum prices range from 42 yuan (€4.5) to 588 yuan (€64) per square metre.

Chinese data show only marginal Finnish direct investment in China. China's trade ministry reports the stock of direct investment in China by Finnish companies at the end of June 2009 totalled just $626 million, giving Finnish investment a less than 0.1 % share of direct investment in China. In 2000s, about $50 million has flown yearly from Finland to China as investment. Chinese figures show that Swedish direct investment in China was nearly triple that of Finland, while Danish investment was nearly double.

Tracking of direct investment has become challenging in this internationalising world, so the figures are highly suspect. For example, balance-of-payments figures of the Bank of Finland show that stock of direct investment in China by Finnish firms is worth about €2 billion. Other Finnish estimates put the amount of investment to about €5 billion.

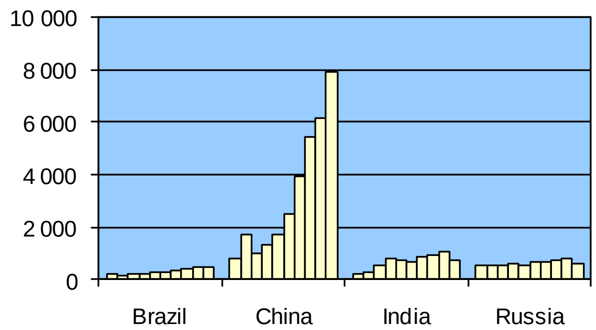
Other BRIC countries lag far behind China in international patent applications. Even if the international Patent Cooperation Treaty (PCT) only offers one way to have a patent application pending in multiple countries at the same time, the number of applications in a given country provides insight into the globalisation of firms and their expansion plans. The most fascinating trends in patenting activity are currently found in several Asian countries.

In the global recession's wake, the overall number of PCT patent applications shrank last year by 4.5 % to 156,000 applications according to preliminary data. Of these, nearly a third came from the United States, almost a fifth from Japan and 11 % from Germany. The amount of patent applications from the United States and Germany declined sharply, while the flood of patent applications from Japan continued to grow. Patent application from fourth-place Korea looked set to keep rising. Close on Korea's heels in fifth place is China. The 8,000 Chinese patents was nearly a third higher than in 2008. Chinese telecommunications giant Huawei was bumped from its number-one spot in submitting PCT patent applications by the Japanese Panasonic. The global list of the 100 companies most active in patenting include two Chinese firms – Huawei and telecommunications company ZTE.

If the number of PCT patent applications says anything about the technology level of a country and international advancement in the 2000s, China stands head and shoulders above its other BRIC brethren (Brazil, Russia and India). The other BRICs combined had total PCT filings of less than a quarter of the patent applications produced in China. In India and Russia, the number of patent applications filed last year even declined sharply from 2008.

Finland, with nearly 2,200 PCT applications last year ranked 13th. The Nokia Corporation accounts for almost a third of Finland's patent activity.

Number of PCT applications in BRIC countries, 2000–2009



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EUROJÄRJESTELMÄ
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BOFIT Weekly
9 • 5.3.2010

Russia

Finance ministry pushing for return to tight fiscal policies. Finance minister Alexei Kudrin last week warned that Russia should not expect as rapid growth of oil revenues as in the 2000s. Hence, the government must be prepared for declining tax revenues from oil production and exports.

Russian oil production increased on average 4.5 % a year from 2000 to 2008, while future output growth is projected to reach 1-2 % a year at best. Furthermore, the trend in global oil prices is expected to moderate. Oil tax revenues will also suffer from significant tax relieves granted to new oil fields in Eastern Siberia to enhance investment. In 2007–2009 tax earnings on crude oil accounted for 30–36 % of the revenues of the total budget system (federal, regional and local budgets). From now on this share is expected to shrink.

From 2000 to 2006, Russia followed strict fiscal discipline. With the approach of the Duma and presidential elections in 2007 and 2008, however, fiscal prudence was cast to the wind with budget spending up in 2008 by over 10 % in real terms. The 2009 economic stimulus drove up spending another 20 %, and gave Russia its first deficit budget in a decade.

Public spending as a share of GDP rose last year to 41 %, up from 34 % in 2008. The comparable figure for Finland in the 2000s was around 50 %.

Budget spending this year is nearly 10 % less in real terms than last year. The finance ministry hopes to freeze budget spending at this level for the next few years. Efforts will again be made to increase expenditure efficiency by e.g. tying expenditure into the government's long-term economic policies so as to reduce the allure of short-term spending sprees. Spending cuts may be hard to achieve, as a good deal of spending increases in recent years have gone to fund permanent hikes in e.g. social security and pensions.

The official government estimate this year sees the budget deficit reaching 7 % of GDP (assuming an average Urals oil price of $58 a barrel), compared to last year's deficit of 6 % of GDP. The government hopes to reduce the deficit to 4 % of GDP next year and 3 % in 2012.

Starting next year, Russia will return to the three-year rolling budget planning approach it launched before the financial crisis. The finance ministry would also like the government to limit the size of the budget deficit by law as previously. Revenues from oil and gas will continue to be set aside in rainy-day funds once the budget is balanced.

Decisions postponed on investment in development of massive Shtokman gas field. Last month, the Shtokman Development Company announced it was moving back its initial gas production date for the supergiant Shtokman gas field by three years to 2016. Liquefied natural gas (LNG) production is now slated to start in 2017, also three years later than originally planned. Even the new dates, however, will not be confirmed until 2011, when the final investment decisions on the project are taken. Many observers see little impetus to move ahead on the expensive project at the moment given the uncertainty and increase in supply on the world gas market. Greatest scepticism has been directed at the proposed LNG facility for shipping gas to the east coast of the US. To Europe Shtokman gas would be transmitted in part via the Nord Stream gas pipeline.

The Shtokman gas deposit, discovered in 1988, has an estimated 3.8 trillion m^3 of gas in place as well as 37 million tons of gas condensate. It is located about 550 kilometres northeast of Murmansk in the Barents Sea. The Shtokman project licence is held by Gazprom subsidiary Sevmorneftegaz and development of the field is led by the Swiss-registered Shtokman Development Company, a joint venture of Gazprom (51 %), France's Total (25 %) and Norway's StatoilHydro (24 %).

The economic downturn has diminished demand for gas in Europe at the same time as supply of Middle Eastern LNG and unconventional gas production in the US are increasing. This has cut into Gazprom's position in the European gas market. In 2009, the volume of gas exported to Europe by Gazprom fell 11 %.

The competition for market share has driven Gazprom to modify its pricing regime dating back to the 1970s. This winter Gazprom has agreed to a partial shift to pricing based on spot prices with its large European customers (e.g. Eni and E.On Ruhrgas). Russian gas has so far been sold under inflexible long-term contracts that tie the price of gas to oil. Currently these contract prices are considerably higher than spot prices, which has driven many European customers to the spot market where the supply of LNG has increased. Gazprom will not give up long-term pricing entirely in its new pricing regime. It will also continue to require that its customers commit to paying for a minimum amount of gas each year whether or not they take the full quota.

Gazprom also finds itself in a showdown with Russian customs over gas export tariffs. Customs has long held that Gazprom should be taxed according to export volumes rather than the current arrangement where tax is based on the value of gas Gazprom reports it exported. The confidential relationship of Gazprom and its clients makes it impossible for customs officials to verify Gazprom's reports.

Gazprom, for its part, is asking for tax relieves for several of its gas fields. The finance ministry has resisted the request, arguing that tax revenues from gas have fallen in recent years as the rouble-denominated resource use tax on gas has not been adjusted since 2006.

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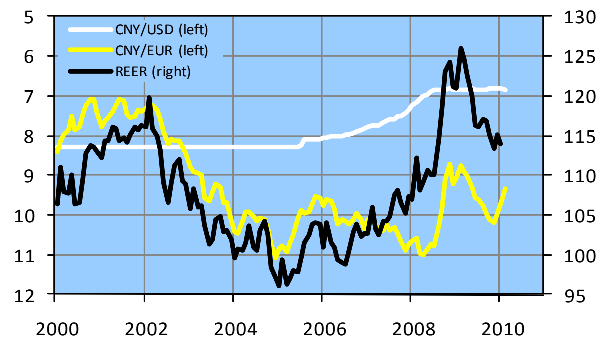
China

Yuan exchange rate still firmly pegged to the dollar. Despite growing pressure, China's leaders have yet to abandon their exchange rate policy of a de facto pegging of the yuan to the dollar. The yuan's real effective (trade-weighted) exchange rate (REER), an indicator of price competitiveness, has weakened sharply over the past twelve months, enhancing the price competitiveness of Chinese goods. An IMF assessment of the G20 economies this week found the yuan "substantially undervalued". The IMF noted that China's efforts to resist natural appreciation were complicating domestic economic policy making by increasing inflation and rising asset price pressures.

China locked down the yuan-dollar exchange rate in July 2008 in the midst of the global financial meltdown. The goal of the peg was to support China's labour-intensive export sector and stabilise the situation generally. While the yuan forward market is anticipating yuan appreciation, Chinese export firms interviewed by Bloomberg this week at the East China Fair said their businesses could tolerate only very limited yuan appreciation this year.

Dollar-yuan, euro-yuan rates (inverted scale) and REER (rising trend indicates yuan appreciation)



Sources: Reuters and BIS

Fixed capital investment and migration from the countryside seen as the biggest contributors to China's productivity gains. The Conference Board's recently released annual productivity statistics show labour productivity, the amount of output per worker, rose just over 8 % in China last year. Using the same measure, productivity in the US increased a mere 1 %, while productivity declined in most of Europe. Productivity was down nearly 4 % in Russia due to the financial crisis.

Due to global economic turmoil the fluctuations in productivity in 2009 were exceptionally large, which in most of the countries reflected companies' possibilities to adjust work force when demand contracted. However, China succeeded to increase output and productivity by its well-timed stimulus of public sector demand.

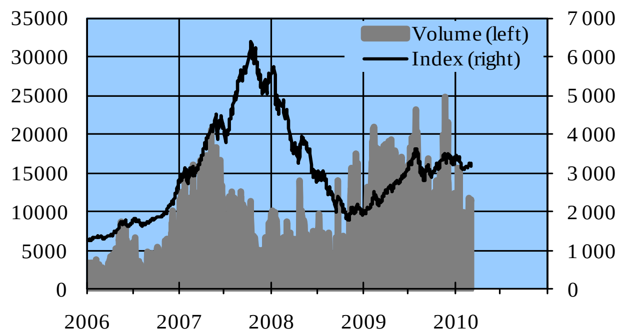
Productivity gains are much easier to achieve in developing economies than in industrialised countries. The Conference Board estimates that Chinese productivity in 2009 was just 15 % that of the United States. Russian productivity was 37 % of the US.

Productivity comparisons are somewhat unreliable, however, as most developing countries have yet to compile reliable data on actual numbers of hours worked. Moreover, output per worker in itself is a rather rough measure of productivity as it overlooks the implications of capital inputs (capital investment). According to Conference Board figures, over seven percentage points of China's 9 % GDP growth in 2008 came from capital investment, while only about half a percentage point came from increases in the size and skills of the labour force. The remaining one-and-a-half percentage points of growth were attributed to total factor productivity (TFP), a catch-all residual that contains any unidentified factors that might affect productivity. In China, it appears that the TFP largely derives from the migration of labour from low-productivity agriculture to high-productivity industries and service jobs in the cities.

Even though as a catch-all TFP is difficult to interpret, it is widely seen as the preferred measure for capturing elusive contributors to productivity. Looking at TFP, the Conference Board figures suggest China's productivity growth slowed in 2008 relative to earlier years. A similar observation was made in the OECD's *Economic Survey of China* published last month.

Share prices level off; daily trading volumes down. Prices on Chinese stock exchanges have been quite steady since last July's mini-collapse, when China's central bank announced it was restricting bank lending for the rest of the year. Moreover, daily trading volumes are down substantially from last year. Share prices rose slightly this week despite a tepid PMI reading showing less improvement in February than in earlier months.

Shanghai A-share index and trading volumes, yuan million



Source: Bloomberg

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Russia

Innovation − Russia's answer to economic modernisation. Innovation has become the magic word in Russian economic policy as decision-makers struggle to find ways to reduce the country's growing dependence on exports of energy and commodities. Last month, president Dmitri Medvedev implored Russia's largest companies to increase their spending on research and development.

The presidential initiative calls already this year for establishment of an innovation city. The research centre would be partly state-funded and concentrate on advanced research. The decision on where the city will be built is expected soon. The R&D city should include high-quality housing and support services for 30,000–40,000 people, as well as enterprise incubators and marketing services. It is hoped that a city containing Russia's top thinkers will attract foreign investors with experience in marketing innovations, as well as top international researchers.

The ministry of economy is pushing for a diverse range of supports and tax breaks for innovation activity. The government is also planning to support the establishment of several regional innovation clusters. The economy ministry is currently gathering proposals from regional administrations on what kinds of clusters should be established. It cited the Kaluga automobile industry cluster located southwest of Moscow as a successful model. The Kaluga cluster is anchored by a Volkswagen production facility set up in 2006.

According to the government's view, nearly all demand for innovation comes from either the state or large enterprises. Thus, the government needs to foster innovation e.g. with the help of state procurement. In competitive bidding the government could make innovation intensity more important than price in determining which products it purchases.

The lack of R&D spending by businesses and as a share of GDP are problems for Russia. Russian R&D spending corresponds to just over 1 % of GDP, far less than the nearly 3 % of GDP in the United States and nearly 2 % in the EU. Unlike in most developed countries, in Russia R&D is largely publicly financed. Given the current economic circumstances no significant increases in budget spending should be expected.

The new innovation policy has been widely criticised for its lack of clear objectives. As a result, critics claim, the most likely outcome of the current initiatives will be a wasteful allocation of public resources. State's concentration on purely organisational questions of innovation once again overlooks the real hindrances to development of any business activity in Russia: difficult operating environment plagued by bureaucracy and corruption. Creation of innovation clusters will not solve this problem.

Finland-Russia trade contracted sharply in 2009. Customs Finland reports the value of Finnish exports to Russia declined 47 % last year to €4 billion. Imports from Russia also were down 31 % to €7 billion. Finnish exports to Russia fell more than Finnish exports overall (down 32 %), while imports from Russia contracted roughly the same amount as Finnish exports overall.

The shrinkage of exports to Russia slowed in the fourth quarter of 2009, with exports down 40 % y-o-y. The value of imports from Russia in 4Q09 was unchanged from a year earlier, due largely to rising oil prices.

Russia last year accounted for 9 % of Finland's exports and 16 % of imports. Russia was Finland's third-largest export market after Germany and Sweden, and far and away Finland's largest source of imports. Russian customs figures show that Finland accounted for about 3 % of Russian exports and over 2 % of imports. Finland has lost a bit of its market share in Russia in recent years. Russia's largest sources of imports last year were China (14 %), Germany (13 %) and the US (6 %).

Nearly 80 % of Finland's imports from Russia are energy products. Finland's exports to Russia feature paper and paper products (10 %), telecommunications, radio and television devices (9 %), pharmaceuticals (8 %) and cars (8 %).

Structure of Finland's exports to Russia, 2009

	€ mill.	%
Machinery and transport equipment	1,645	41
Chemicals and related products	866	21
Basic manufactures	689	17
Miscellaneous manufactured articles	280	7
Foodstuffs	256	6
Fuels and lubricants	227	6
Other	81	2
Total	*4,044*	*100*

Source: Customs Finland

Finnish exports figures include goods produced in third countries that are transhipped through Finland and counted in statistics as Finnish exports. When these re-exports are subtracted, Finland's exports to Russia are considerably smaller than the figures above suggest. A recent Customs Finland survey examined the extent of re-exporting in 2008 and found that about 30 % of the value of Finnish exports to Russia that year consisted of re-exports. The largest re-export categories were passenger cars, mobile phones, and radio, television and video equipment.

Road transit freight moving through Finland to Russia declined 53 % in 2009. Customs Finland put the value of transit freight at €14 billion, which was over three times more than the value of Finland's exports to Russia. Machinery and transport equipment accounted for 30 % of transit freight, despite a nearly 80 % decline in transit of passenger cars.

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China

China again targets 8 % GDP growth for 2010. The annual ten-day National People's Congress (NPC) convened on March 5 in Beijing, bringing together 3,000 delegates to help determine the country's social and economic policy directions, as well as approve major legislative and judicial changes. Although the People's Congress is officially China's highest decision-making body, its traditional function has been to rubber-stamp proposals set out by the top leadership.

In his address, premier Wen Jiabao stressed that China needs to accelerate the shift to balanced economic growth. China's GDP growth target remains 8 %, a target that seems readily achievable in light of the economic performances of January and February. In contrast, the government's 3 % consumer price inflation target seems overambitious. Inflation accelerated in February to almost 3 % y-o-y and shows no signs of slowing with current price pressures.

Several speakers at the NPC noted 2010 will be challenging for economic policy. Rapid growth and jobs must be secured, while rising inflation increases pressure to tighten economic policies. Moreover, there is concern about the shakiness of recoveries in China's key export markets. According to the premier new public investment will not be approved as easily this year as last year. Oversight of public projects will be tightened to prevent abuse of public funds.

Central bank governor Zhou Xiaochuan said the current yuan-dollar peg was temporary; China eventually needs to adjust its exchange rate policies. International use of the yuan in global trade will continue to increase as opportunities to conduct trade in yuan are expanded this year.

A number of other interesting themes were raised at this year's NPC session, including a proposal to gradually dismantle China's household registration system (*hukou*), which limits the possibilities of workers to find work elsewhere in the country and change domicile. Energy conservation will receive a higher profile. Speakers praised the on-going thawing of China-Taiwan relations. Amendments to China's electoral law and budget laws are also under consideration.

Local administrations borrowing actively and raising China's overall public debt. Implementation of fiscal policy in China is largely delegated to lower administrative levels. The role of provincial and local administrations has been further increased by the current economic crunch as a large chunk of infrastructure investment in the stimulus package has been on regional and local administrations' responsibilities. However, the law forbids local governments from running deficit budgets. To get around the balanced-budget requirement and secure project funding, many local governments have established front companies to borrow money from banks to fund local projects.

Nobody has a clear idea of the total liabilities of China's local administrations, but most agree that the amount of debt is substantial. A rough estimate from Chinese investment bank CICC finds the aggregate debt loads of local governments grew by 2.8 trillion yuan (€300 billion) last year, bringing the total amount of debt held by localities up to 5.6 trillion yuan (€600 billion). Northwestern University's (US) Victor Shih puts local administration debt even higher at 11.4 trillion yuan (€1.2 trillion).

One gets a very different picture of China's public sector debt when the debts of local governments are included. The IMF, for example, so far does not include local obligations in its own calculations of China's gross government debt, which it says equalled about 21 % of GDP at the end of 2009. CICC estimates the gross debt of local administrations at around 17 % of GDP and Shih puts it at 33 %. No matter who, if anybody is right, it appears China's total gross public debt is at minimum near 40 % of GDP and may be considerably higher. While even the high-end amounts are modest relative to most countries, the uncertainty over local debt gives pause. On the bright side, China's public sector is wealthy and holds vast financial and land assets.

Given the uncertainty over the amount of credit extended, it is nearly impossible to estimate how much money has gone into productive investments that will produce revenues or services to pay off or justify the investments over time. There is a strong suspicion that local administrations have used some of their stimulus borrowing to speculate in real estate and the stock market. If prices in these markets decline, it may damage the ability of local administrations to pay back their investments and add to the stock of non-performing loans held by banks. China's finance ministry this week implied it would be issuing regulations forbidding local administrations from giving loan guarantees to their own financing companies. However, it is difficult for local governments to avoid their obligations since both the debtor enterprises and creditor banks are largely owned by the public sector.

The predicament of localities gives insight into the undeveloped state of China's financial markets, the lack of transparency and need for comprehensive reform of public sector budgeting. As part of financial sector reforms, the transparency of the provincial administration finances would be improved by allowing them a limited right to issue debt paper with a requirement that they open their books to investors and credit rating agencies. This would subject provincial administrations to greater oversight from both the central administration and the markets. The change would also provide firms, banks and households with alternative investment opportunities.

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Russia

Persistent rate hikes for municipal services continue. Rates for municipal services such as heating, gas, electricity, water supply, housing and housing services (e.g. trash pick-up) remain government regulated in Russia. As in previous years, regulated rates were again hiked at the start of this year on the basis of a cabinet decision. Moscow residents, for example, this year get to pay 26 % more for municipal services than they did in 2009. Rates for municipal services last year increased an average of 20 % throughout Russia.

Prices of municipal services have been raised since the collapse of the Soviet Union, but it has only been in recent years that nominal rate hikes have exceeded the inflation rate. The goal of the recent large rate hikes has been to bring rates into line with their true market value.

Starting in January 2010, electricity rates for residential households went up 10 %, while the price of electricity paid by industrial users went up 8 %. Electricity rates for households increased an average of 25 % last year.

Rate-setting for electricity in Russia is entirely regulated for households and partly regulated for corporate customers.

An average of 8 % of Russian consumer spending went to housing and municipal services in 2009. As a whole, services account for 25 % of consumer spending. Another 38 % of consumer spending went to food (including alcohol), while spending on durable consumer goods was about 37 %.

Some citizen groups have opposed the drastic rate increases. In Kaliningrad, for example, observers estimated that between 7,000 and 12,000 people last month demonstrated their opposition to the rate hikes for municipal service as well as higher fares for public transport.

Consumer prices rose at an average rate of 13 % a year during 2000–2009. Consumer price inflation slowed in Russia during 2009 to a record-low rate of 9 % a year. In February 2010, consumer prices were up just 7 % from a year earlier.

Impacts of global economic meltdown vary among CIS countries. According to Interstate Statistic Committee of the Commonwealth of Independent States (CIS Stat) the gross domestic product of the CIS countries contracted on average 7 % last year. The largest drops in economic output were registered in Ukraine (down 15 %), Armenia (down 14 %), Russia and Moldova (both down 8 %). The GDP of Belarus was unchanged from 2008. GDP increased in Kazakhstan (growth of 1 %), Kyrgyzstan (2 %), Tajikistan (3 %), Uzbekistan (8 %) and Azerbaijan (9 %). No figures for Turkmenistan were available.

The impact of the global crisis in CIS countries was largely determined by the impacts of world commodity prices, export volumes and the amount of remittances from citizens working abroad.

The drop in global commodity prices had its strongest impacts on the economies of Russia, Kazakhstan and Ukraine, which saw prices of their major exports severely depressed in the first half of 2009.

Despite the collapse in the price of oil and a resulting 39 % drop in the value of oil exports, Kazakhstan has managed to sustain positive, albeit lower, economic growth last year. During 2000–2007, Kazakhstan averaged economic growth of 10 % a year. During the years 2000–2007 growth in investment averaged 26 % a year. Last year, investment growth slowed to 2 % and the unemployment rate was 6.3 %.

The global economic crisis for Belarus largely has meant a contraction in foreign trade with Russia. In 2008, 73 % of all Belarus exports went to Russia. In 2009, Belarus exports to CIS members and to non-CIS countries contracted about 35 %. Despite the plunge in foreign trade, Belarus saw growth in other parts of its economy. For example, fixed capital investment increased 9 % last year, and retail sales were up 3 %.

Azerbaijan's relatively robust economic performance can be attributed to the rise in oil exports of recent years. From 2000 to 2009, Azerbaijan's GDP increased at an average rate of 16 % a year. Growth in investment in that period averaged 34 % a year.

Uzbekistan's economy was partly spared from the global economic crisis by the same factors as Azerbaijan. The country grew its energy exports by 42 % in 2009 compared to the previous year. Even if oil prices were down last year, higher export volumes offset the drop in earnings per barrel. The Uzbek economy remains relatively closed and dominated by agriculture – further reasons the country largely avoided the effects of the global meltdown. There was also evidence of robust growth in some sectors (e.g. investment was up 25 % and construction 33 %).

Kyrgyzstan, Tajikistan and Moldova are among the poorest and least-developed CIS nations. The relatively steep declines during the current economic crisis are most reflected in declines of remittances from abroad. According to a World Bank estimate, remittances sent home by citizens working abroad account for about a third of GDP in Kyrgyzstan and Moldova, and about half of Tajikistan's GDP. Remittances have also accounted for 10–15 % of Armenian GDP in recent years. The biggest contributor to this drop has been the rise of unemployment in Russia and the resulting lay-offs of foreign workers from CIS states.

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China

China's 2009 state budget comes in on target. The National People's Congress last week approved the realised state revenues and expenditures of 2009, as well as the 2010 budget plan. The 2009 state budget, which covers central government, provincial and local administrations, produced a deficit of 950 billion yuan (€100 billion or 2.8 % of GDP) − exactly the figure China's leadership approved in March 2009. State revenues and spending were both slightly lower than the original budget forecast.

China's 2010 budget should also show a deficit and is in line with the stimulus policies adopted in autumn 2008. State spending will be up 11 % this year and the deficit will stay at 2.8 % of the estimated GDP in 2010 (37.5 trillion yuan). The deficit, however, could be smaller than forecast as China has budgeted for very modest 8 % revenue growth this year, which is even smaller than last year.

The annual budget report only specifies about a third of state spending. The revenues and spending of provincial and local administrations are described in aggregate even if they account for 80 % of state spending. About one third of the local spending is financed by the central government transfers. Part of these transfers are identified and earmarked for specific projects, some are dedicated for general purposes and about two-thirds of transfers are unspecified in the budget report.

Even Chinese central government officials themselves find it very difficult to monitor the state budget as provincial and local administration budgets are highly opaque. Even worse, local governments operate extensively off budget (see *BOFIT Weekly 10/2010*).

China's international arms exports on the rise. Figures released by the Stockholm International Peace Research Institute (SIPRI) show China last year exported the most arms since 1995, raising China to seventh among the world's top arms sellers. The US retained its position as number-one arms exporter, with Russia still in second place despite a 25 % contraction in export volumes. Russian exports to China have been shrinking as China has ramped up its own arms production. China still bought arms from abroad, with 90 % coming from Russia, 2 % from Ukraine and the rest from Europe (motors and radar systems).

Pakistan, which has purchased over 40 % of all China's exported arms during the 2000s, remained the top arms customer. The Pakistani air force relies almost exclusively on Chinese aircraft and weapons systems. Army tanks are Chinese designed and the Pakistani navy has acquired four Chinese frigates. Moreover China has sold missiles and radar systems, and has helped Pakistan modernise its own arms industry.

After Pakistan, China's second largest export market is Iran, which has accounted for about 15 % of China's arms exports during the 2000s. Egypt and Bangladesh each accounted for about 5 % of arms purchases and Myanmar 4 % (even if, as SIPRI reports, China has not supplied any weapons to Myanmar since 2005). Slightly over 10 % of Chinese weapons exports during the 2000s went to the African continent (excluding Egypt), although arms sales in the region have diminished sharply in recent years.

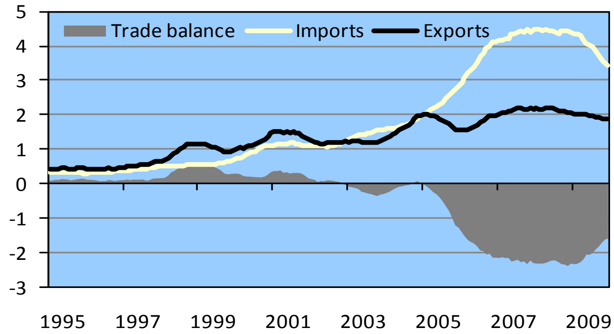
China increases its share of Finnish foreign trade. Figures from Customs Finland show Finland's 2009 imports from China, valued at €3.4 billion, declined 21 % from 2008. Finnish imports overall declined by nearly a third last year. China's share of Finland's imports overall increased nearly a percentage point to 8 %, putting China in fourth place after Russia, Germany and Sweden as a source of imports. Finland's 2009 exports to China, valued at €1.9 billion, contracted over 10 % from 2008 (Finnish exports overall were down a third last year). China's export share increased to 4.1 %, surpassing France and Italy to become Finland's seventh largest export destination.

Two-thirds of Finland's imports from China fell under the machinery and equipment category. In many of the product groups within the category, China was the main source of imports to Finland. For example, 45 % of imported phones and radio devices came from China and nearly a third of office equipment. Some 13 % of Finland's total imports from China consisted of clothing, and over a third of clothing imports came from China.

The machinery and equipment category also accounted for about two-thirds of Finnish exports to China. Other important product groups included pulp and paper, and ores and metals. Although a fifth of paper pulp, ores and metal scrap went to China, China's share of Finland's critical machinery and equipment exports represented just over 10 % of total Finnish exports.

Hong Kong and Taiwan had a combined share of about 1 % of Finnish foreign trade.

Finland-China trade, 12-month moving sum, € billion



Source: Customs Finland

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Russia

BOFIT semiannual forecast sees Russia back on GDP growth track in 2010–2012. The stabilisation of the international economic situation and the return of higher commodity prices support Russian consumption and export demand this year. As a result, BOFIT's latest forecast for Russian 2010 GDP raises last autumn's outlook for GDP growth of 3 % to 6 %. Furthermore, the sharp growth partly reflects the depressed levels of output a year ago. During 2011–2012 growth should slow to 4–5 % a year.

Russian real GDP growth, y-o-y, %

	2007	2008	2009	2010	2011	2012
GDP	8.1	5.6	-7.9	6	5	4

Sources: Rosstat and BOFIT.

Cautious growth in capital investment by companies is an expected result from the gradual normalisation of financial markets. Nevertheless, the increase in capital investment this year should be quite modest. Investment is expected to pick up in 2011–2012.

On-year export volumes should increase sharply this year and then slow in coming years as production constraints are reached. Energy now accounts for about 65 % of Russian exports − and little change in the structure of exports is expected any time soon.

Imports this year are forecast to rise as consumer demand recovers. Slight appreciation of the rouble should raise demand for imports. Indeed, the real exchange rate of the rouble has rebounded to levels of late 2008.

Despite the bright 2010 outlook, the Russian economy faces substantial risks from exposure to shocks from international commodity and financial markets. There are also clear threats to the recovery of domestic consumption if wage growth stagnates and unemployment levels rise. In the outer years, low economic growth could become the norm as long as needed structural reforms are postponed and the operating environment for companies does not improve.

February's economic figures still vague. Most key economic indicators suggest the Russian economy pulled back in February. The economy ministry estimates seasonally adjusted GDP shrank 0.9 % m-o-m in February (compared to a rise of 0.3 % m-o-m in January). On-year GDP growth was 3.9 % in February.

Economy ministry figures further show industrial output slid 0.6 % m-o-m in February, while construction was down 5 % m-o-m.

The exceptionally cold winter partly explains the slowdown in economic activity (e.g. the decline in construction activity). However, lack of access to finance also continues to restrain investment.

Economy minister Elvira Nabiullina said that the shakiness of the economic recovery may persist until summer when domestic demand should start to return. Fixed capital investment is still dead in the water. February investments were down a bit less than 1 % from January. Retail sales were also off about 1 % m-o-m.

Climate change to play a larger role in Russian economic policy. Russia's Security Council Meeting on Climate Change on March 17 showcased a policy speech by president Dmitri Medvedev on the challenges ahead. The Security Council requested that the cabinet draft measures for adapting to global warming such as revision of construction standards for permafrost areas and incentives for companies to take climate change into consideration in their operations.

During the session, Medvedev proposed continuous climate monitoring of the Arctic region and requested the government to examine the possibility of launching the Arktika satellite cluster to monitor and study polar climate and natural resources. The Arktika project was finalised and presented to the cabinet in 2008.

Medvedev further noted that Russia must be ready to respond to the political conflicts that may arise from climate change. In particular, he noted the activities of several countries to employ Arctic hydrocarbon and other resources as well as new sea routes. Countries bordering the arctic region are pushing for an increased presence and seeking to limit Russia's possibilities to exploit Arctic natural resources.

On a separate note, Medvedev warned developed countries might resort to limiting Russia's export opportunities in the name of climate change by imposing protectionist measures that distort competition. In the US, for example, there is currently a debate over imposing additional tariffs on imports from countries that fail to implement adequate measures to deal with greenhouse gas emissions.

Following the Security Council meeting, natural resources minister Yuri Trutnev announced that as one of the retaliatory measures Russia could limit exports of raw timber through the implementation of higher export tariffs, which was originally pushed back to the start of 2011. Trutnev said Russia has postponed the export tariff increase at the request of its trading partners for years, even though the change is needed to promote domestic processing of raw timber. He said that once Russia's trading partners begin to protect their markets from Russian products, there is no longer a need to put off the tariff hike.

In his meeting with Finnish president Tarja Halonen in St. Petersburg on Monday (Mar. 22), prime minister Vladimir Putin said current tariffs on exports of raw timber would remain in force until the end of this year as decided earlier.

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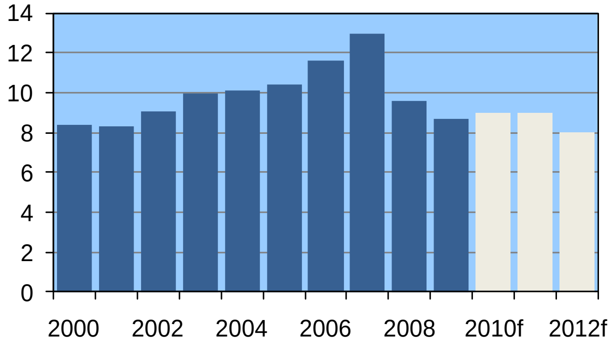
China

BOFIT expects robust economic growth to continue; economic policy challenges persist. BOFIT's latest forecast sees China's GDP increasing 9 % in real terms during 2010 and 2011. Compared to last autumn's forecast, 2010 GDP growth has been revised up one percentage point in light of the improved economic conditions. GDP growth is expected to slow to 8 % in 2012. The size of China's economy is now on par with Japan's. As China's economy continues to grow, increases of 10 % a year will become ever harder to achieve.

Real annual GDP growth (2000–09), forecast (2010–12), %



Sources: China National Bureau of Statistics and BOFIT

Chinese economy will become more and more dependent on domestic consumption demand. The international financial crisis exposed the vulnerability of China's economy to external shocks, so officials have increasingly begun to emphasise the need for structural reform of the economy. Growth in investment demand last year was exceptionally strong, and the pace of growth will slow as fewer state-sponsored investment projects break ground. On the other hand, go-aheads on private-sector investment projects put off during the crisis period are expected to increase as the global economy recovers. In the sphere of foreign trade, China is expected to strengthen its position as the world's largest exporter even as its competitive advantage from low production costs gradually erodes.

Despite the bright economic outlook, planning and implementation of economic policy will be complicated. While ensuring rapid economic growth and job creation, China must also deal with growing inflation pressures. As inflation accelerates, the Chinese government is led to consider hikes in reference rates to preserve the value of citizen's savings, even if higher rates might depress investment growth and boost flows of speculative capital into China. The yuan is under strong appreciation pressures. Allowing the yuan to appreciate would both reduce pressure for higher prices and defuse trade disputes.

The stock of non-performing loans (NPLs) held by banks could increase in coming years as the quality of many loan portfolios was degraded by the financial crisis. The situation could be further exacerbated by the bursting of a possible housing bubble. Because the banking sector is almost entirely under state control, responsibility for dealing with NPL problem would end up in the lap of the central government. China's state finances are in good shape even taking into account the heaviest estimates of local administrations' debt, but possible tax increases would reduce purchasing power and slow consumption growth.

American companies highlight difficulties of doing business in China and increasingly press for changes in trade policy. China-US relations have experienced increased friction since the Chinese government last November announced its "indigenous innovation" public procurement programme favouring companies that conduct their R&D in mainland China. While Chinese officials profess the programme is geared to stimulating innovation activity in China, international scepticism over the true purpose of the programme has increased and some observers see the move as a barrier to trade. China is not a signatory to the WTO agreement on public procurement, which makes it hard for signatory countries to pressure China to change its public procurement policies.

The American Chamber of Commerce in China this week released a poll of 203 of their members that found 38 % of firms believe the new programme will make it harder for them to operate in China. The same survey a few months earlier got this response from just 26 % of firms. Some 57 % of companies involved in high tech and IT believed the impact would be negative. Surveyed companies were concerned that state companies follow public procurement guidelines in violation of China's WTO commitments. Other international companies have also complained about the loss of competitiveness in China.

Google, owner of world's top internet search engine, decided this week to move its China operations out of Shanghai to Hong Kong. The inability of the Google and China to find agreement highlights the challenges foreign companies face operating in China. In addition to serious security breaches of its computer systems that resulted in capture of customer data, Google was forced to agree to official censorship demands to operate. Besides Google, other large international firms operating in China also report computer intrusions.

China-US economic relations have been dogged by recent claims of dumping and trade restrictions, along with tariff increases and other retaliatory measures. In April, the Obama administration will report to Congress on the world economy and exchange rate trends, where it must take a stand on China's exchange rate policy. The countries' next minister-level strategic dialogue is slated for May.

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Russia

CBR lowers key rates again. Effective Monday (March 29), the Central Bank of Russia dropped the refinancing rate 0.25 percentage point to 8.25 %. The one-day repo minimum credit rate now stands at 5.5 %. CBR rate cuts are expected to continue in the coming months as inflation in Russia keeps falling and the recovery of financial markets remains slow.

The CBR's second motive for lowering rates is to stem inflows of short-term capital into the country. The central bank has been constantly buying dollars to limit ruble appreciation, thereby increasing liquidity in the money market. Liquidity has also been boosted by the release of reserve funds to finance the budget deficit.

To soak up excess liquidity, the central bank in recent months has been issuing its own bonds (OBRs), with state-owned banks the most active buyers. The central bank had over 600 billion rubles (€15 billion) of OBRs on issue in March, up from about 30 billion rubles last October.

Banks' liquidity situation is good, and their main problem has become where to find reasonable places to park money when the economic outlook is uncertain and there is little room for degradation of loan portfolio quality. Thus, instead of lending to borrowers, banks are paying back their loans, in particular the emergency funding taken during the financial crisis. CBR began to lend non-collateralised money to banks in October 2008 when the financial crisis hit. The stock of this lending peaked in February 2009 at 1.9 trillion rubles (€48 billion). This amount has since fallen to just 70 billion rubles. Similarly, budget assets auctioned to banks as deposits by the finance ministry during the crisis have been gradually withdrawn. Both borrowing from the CBR and finance ministry are more costly than market financing at the moment.

The CBR's biggest concern lately has been the lack of bank lending. Without large loan portfolios, banks suffer reduced profits even if they easily meet capital adequacy standards.

With the economy on the mend, the CBR is incrementally taking away the crisis funding it extended to banks. It is now considering limiting the availability of unsecured loans and cancelling the relaxation of reserve requirements introduced during the financial crisis. Only banks in severe distress currently touch the CBR's pricy unsecured loans. The arrangement is not anymore necessary for the functioning of the banking sector.

New North Caucasian Federal District to tackle regional problems. On January 19, 2010, president Dmitri Medvedev created the North Caucasian Federal District by splitting the Southern Federal District into two parts. Russia's original seven federal districts were created in 2000 based on an initiative of then-president Vladimir Putin. Each federal district has its own presidential envoy to facilitate communications between federal and regional levels and oversee that regions in the federal district uphold federal law.

The new North Caucasian Federal District comprises seven regions: the republics of Dagestan, Ingushetia, Kabardino-Balkaria, Karachay-Cherkessia, North Ossetia-Alania and Chechnya, as well as the Stavropol Krai. The federal district's administrative centre is located in Pyatigorsk, in Stavropol Krai. Medvedev tapped Krasnoyarsk Krai governor Alexander Khloponin as presidential envoy.

Medvedev said the creation of the new federal district was justified in light of the region's lack of economic development, high unemployment and corrupt administrators – all issues deserving great attention.

The North Caucasian Federal District includes some of the poorest regions in Russia. Rosstat figures show the average monthly wage in 2009 for all of Russia was about 18,800 rubles (€470), but in North Caucasian Federal District the average wage was just 11,300 rubles (€285).

The economies of regions in the North Caucasian Federal District are largely based on agriculture. Mining makes a small economic contribution in some regions, and some regions produce modest amounts of oil and gas.

The North Caucasian Federal District is Russia's second most densely populated region after the Central Federal District which includes Moscow. The average population density in the North Caucasus Federal District is 54 persons per square kilometre, compared to just 8 persons/km^2 for the Russian Federation as a whole.

In January 2010, the unemployment rate in the North Caucasian Federal District was 19 %, or ten percentage points more than the average for the Russian Federation. The unemployment situation was worst in the Ingushetia and Chechnya republics, where unemployment was 56 % and 43 %, respectively.

Russia's Ekspert RA rating agency identified Ingushetia and Chechnya as the regions with the riskiest investment environments anywhere in Russia. Almost all other regions in the North Caucasus Federal District also rank below 60 out of Russia's 83 regions in terms of investment climate and risks. The sole exception from the perspective of investment and development is the Stavropol Krai, home to famous mineral waters and spas.

In recent years, the Russian government has poured substantial amounts of development resources into the republics in the North Caucasus region, with particular emphasis on the reconstruction of Chechnya. The government is currently running three support programmes for regions in the North Caucasian Federal District. The programmes focus on reducing unemployment, upgrading the quality of the housing stock and improving transport connections. Presidential envoy Khloponin has until summer to prepare a development strategy for his federal district.

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China

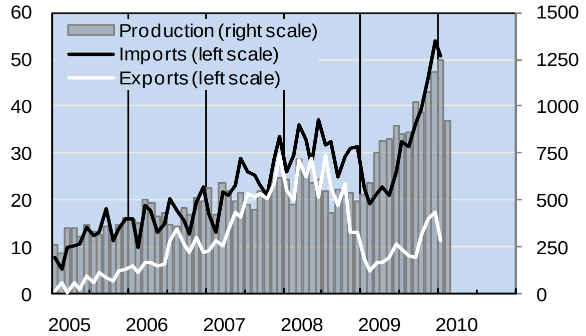
Geely acquisition of Volvo signals China's growing power and dynamism in the global car industry. After months of negotiation, the Chinese Geely (more specifically Zhejiang Geely Holding Co.) and US-based Ford Motor Co. this week reached final agreement on the conditions under which Volvo's passenger car production will shift to Chinese ownership. With much of the Western car industry in the red and struggling, loss-making Volvo went to its Chinese buyer for just $1.8 billion, less than a third of what Ford paid for Volvo a decade ago.

Geely has promised to preserve Volvo headquarters in Gothenburg, Sweden, along with Volvo's main production facilities in Sweden and Belgium. Geely wants to quickly ramp up production of the Swedish make in China to serve the domestic market. Geely is China's largest private independent carmaker, with production in China, Russia, Ukraine and Indonesia. Geely's earlier foreign acquisition was geared to companies with car-part production technology and related licences. Geely manufactured 330,000 passenger cars in 2009, which was just a few thousand vehicles less than Volvo's sales worldwide last year.

Geely has ambitious expansion plans. It wants to increase Volvo sales in China ten-fold in the coming five years from just over 20,000 cars this year to 200,000 cars in 2015. Bloomberg says Geely wants an initial sales push to official cars. Chinese bureaucrats have developed a taste for Audis and BMWs, and Geely wants to change this.

Geely's evolution as a carmaker is impressive. Yet, even while the acquisition of Volvo represents the largest Western purchase by any Chinese carmaker, Geely is still a relatively small player in China. Last year, the company ranked just tenth in terms of passenger car sales. Leader Volkswagen and its Chinese joint-venture partners SAIC Motor Corp. and China FAW Group Corp., posted sales last year of 1.4 million vehicles.

Production of passenger cars in China, exports and imports, thousand units per month



Sources: China Association of Automobile Manufacturers/CEIC

China's carmakers generally weathered the global financial crisis in 2008 and 2009 unscathed, thanks mostly to generous government stimulus measures. Some 10.3 million passenger cars were manufactured in China last year. Although growth in automobile production slowed to 5 % in 2008, car production was up over 50 % last year and the number of cars produced in January-February this year was double the amount produced in the first two months of 2009.

China's big banks posted record profits in 2009. Industrial and Commercial Bank of China (ICBC), China Construction Bank (CCB) and Bank of China (BoC) collectively posted 2009 profits of 320 billion yuan (€35 billion). All three banks have been publicly listed for several years. The Agricultural Bank of China, just preparing for listing, declared 2009 profits of 65 billion yuan (€7 billion). Profits of China's four large state banks rose 15–30 % y-o-y in 2009.

During the global financial crisis, the market capitalisation of China's four large state banks put them among the world's largest banks. Last year was also exceptional for Chinese banks as public sector stimulus measures caused a sizzling 32 % growth in the credit stock. This is clearly reflected in bank profitability. Although the average net interest margin of Chinese banks narrowed a half percentage point last year from the relatively low 3 % of 2008, huge lending volumes and their rapid growth helped banks post strong numbers. Performance was also influenced by the fact that the blow-back effects from the recent explosive growth in credit have yet to show up on bank balance sheets. Indeed, ratio of non-performing loans (NPLs) to the total loan stock declined last year to below 2 %.

Future health of China's banking sector will largely depend on the performance of China's economy overall and specifically the performance of corporate clients. The government seeks this year to limit lending growth to just under 20 %.

Although experts do not see the banking sector facing any immediate problems, FitchRatings, for example, has noted several serious issues lurking in the mid- to long-term. First, banks are learning to sell their loans onwards or parcel them in with wealth management products. This in turn, allows the banks to further extend their lending activities. The problem is that such activity is poorly reported and it creates a risk of overextending the economy as a whole. A longer term threat is the degradation of bank loan portfolios from NPLs. Companies presently account for 80 % of bank lending, so there is a danger recently reported corporate profitability is illusory and based on cheap borrowing. Finally, many companies have heavily invested in real estate. So, major downward corrections in these markets could have devastating consequences.

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Russia

First quarter sees jump in current account surplus. According to the preliminary figures released by the Central Bank of Russia, the country's first quarter current account surplus climbed to $34 billion, or more than three times the amount of the 1Q09 surplus. The current account surplus in the first quarter was the largest since 1Q08. The value of exports rose almost 60 %, driven by a roughly 80 % rise in the value of crude oil, natural gas and oil exports. The value of imports rose 18 % y-o-y. Import growth is expected to accelerate as the economy recovers, shrinking the current account surplus.

The services account continued to run in the red. The services deficit in the first quarter amounted to around $4 billion, or slightly more than a year earlier.

There were no substantial shifts in Russia's foreign debt in 1Q10. According to CBR preliminary estimates, Russia's total foreign debt at end-March stood at $474 billion, or $2 billion more than at the start of the year. Russia's overall indebtedness relative to GDP was a mere 38 %, which is quite modest in international comparison. Government debt remained at $31 billion, or about 2 % of GDP. Foreign debt held by banks amounted to $129 billion and that of other types of firms $302 billion.

FDI inflows into Russia declined by about half in 2009. According to revised CBR balance-of-payments data, inflows of foreign direct investment into Russia last year amounted to $39 billion, down from $76 billion in 2008. Russia's FDI outflows last year amounted to $46 billion. According to UNCTAD, the UN's Conference on Trade and Development, FDI flows globally last year contracted by nearly 40 %.

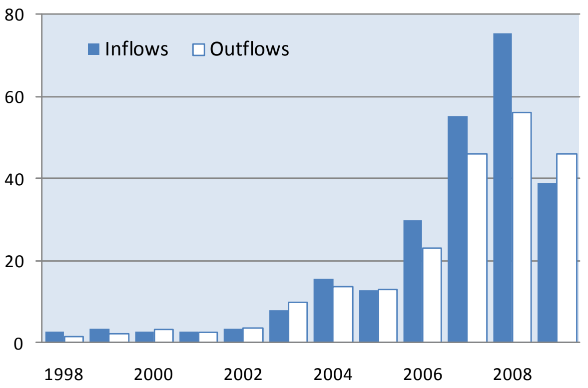
FDI flows into Russia equalled 3 % of GDP last year, a typical number by international comparisons − slightly more than the average for developed countries, and slightly less than the average for developing countries.

Although Rosstat compiles its statistics on foreign direct investment using different principles than the central bank, Rosstat figures also unambiguously showed a sharp drop in FDI inflows into Russia last year. Rosstat reported that in 2009 industrial firms were the biggest receivers of FDI, accounting for 26 % of all FDI. Some 22 % of FDI went to the retail and wholesale trade, while extractive industries (including oil drilling) received 20 % and real estate 17 %. The shares of investment in industry and trade have been on the increase over the past few years, while the shares of mining and other extractive industries, as well as the real estate sector have been declining.

The government hopes FDI inflows into Russia will recover within the next two to three years to a pre-crisis level of $60–70 billion a year. The government claims that relaxing the rules related to foreign investment is important in attracting further investment. While Russia is currently planning to simplify some administrative procedures for investors, experts do not see them having much impact.

A crucial factor influencing FDI inflows into Russia is the price of crude oil. When the oil price is high, foreign investors find Russia attractive.

FDI flows into and out of Russia, US$ billion

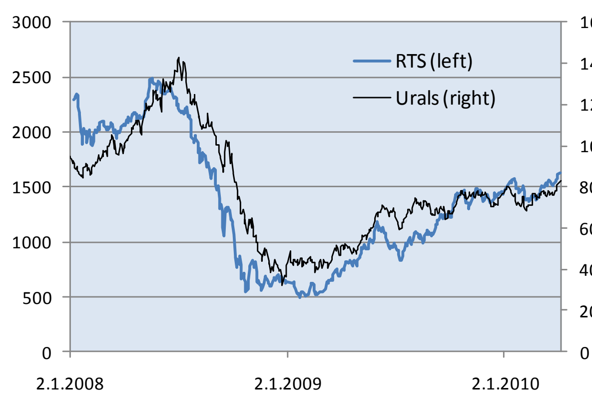


Source: Central Bank of Russia

High crude oil prices drive rebound in Russian stock market. The RTS, Russia's main index for share prices, is up over 10 % from the start of 2010. One reason the RTS has outperformed most of the world's major stock exchanges recently has been the global rise of crude oil prices.

Even with the rapid rise in Russian share prices since the start of last year, analysts say the RTS still has room to climb as the P/E ratios suggest Russian companies are still cheap by international standards.

Urals oil price (US$/bbl) and RTS stock index



Source: Bloomberg

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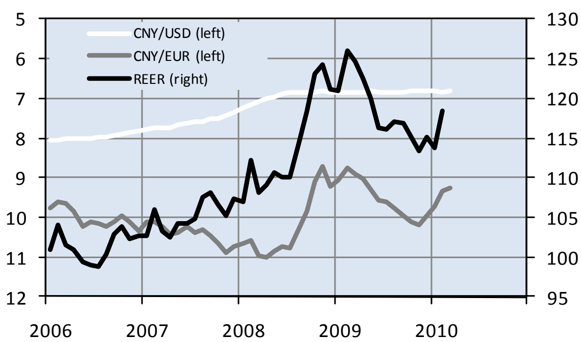
China

China and US continue to seek resolution on yuan's valuation. China-US relations have been strained in recent months with US decisions to go ahead with an arms deal with Taiwan, president Barack Obama's decision to meet with the Dalai Lama, Google's problems in China, embargo policy against Iran and trade policy disputes that are largely due to China's decision to continue to keep its exchange rate firmly pegged to the US dollar. Further tensions were anticipated with the Obama administration's proposed release in mid-April of a report that could have accused China of manipulating its currency to promote exports. It appears, however, that the US government has decided to keep a lid on the report at least temporarily.

The delay in the report release anticipates the meeting of presidents Hu Jintao and Obama next week in Washington DC, the upcoming G-20 meetings, as well as the US-China strategic dialogue meeting in May. The delay gives China a breathing room to deal with its exchange rate policy before the US officially calls it a currency manipulator and moves ahead with trade sanctions. Yesterday (Apr. 8), US treasury secretary Timothy Geithner took an unexpected detour in his return from India to meet with premier Wen Jiabao.

Observers widely agree China needs to adopt a more flexible exchange rate regime simply to balance its own economy and to promote healthy development of its financial markets. Unfortunately, the situation has degenerated into a face-saving competition that has put needed decisions on the back burner. Many groups in China readily embrace a return to the pre-crisis exchange rate regime that existed in early 2008. This change alone would add sufficient flexibility to China's exchange rate policy and prevent future disputes from getting out of hand.

Dollar-yuan, euro-yuan exchange rates (inverted scale); real effective exchange rate (2005=100). Upward trend indicates yuan appreciation



Sources: Reuters, BIS

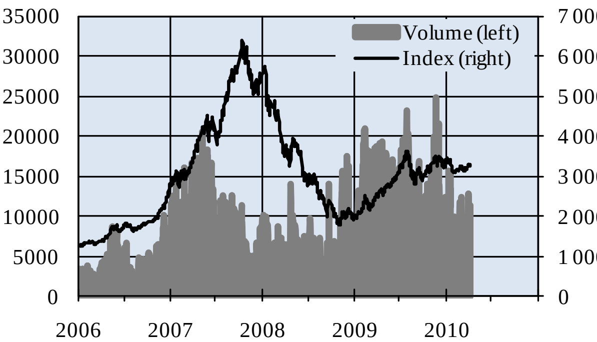
High-growth China leads the rest of the world in exiting the global recession and its loose monetary stance has fuelled inflationary pressure. In such conditions, the yuan's real effective (trade-weighted) exchange rate (REER), which takes into account nominal exchange rate changes and inflation differences between China and its trade partners, is doomed to appreciate. Such appreciation is a natural part of economic development. This situation somewhat ties the hands of economic policymakers, whose options are to allow nominal appreciation of currency or accept relatively higher inflation than in other countries.

Share prices recover from slight drop in late January. The Shanghai A-share index has climbed in recent weeks to a level of 3,300 points after hitting a low of around 3,100 at the start of February. The trend in share prices has been fairly stable since summer 2009. Expectations of monetary tightening are influencing the price trend. China's monetary policy officials have held reference rates steady even as the real economy has recovered and inflation accelerated. Markets also discuss the plans of China's large, mostly state-owned, banks to hold share emissions and bond sales to raise capital.

Although Chinese share prices were up nearly 75 % last year, the Shanghai share index is still 3,000 points lower than its peak in 2007. Chinese share prices have historically been rather poor predictors of economic events. Share prices can be significantly affected by official behaviour such as changes in the level of the stamp tax on share trades.

The dynamics of Chinese share prices also diverge from the world's other major stock exchanges due to limits on cross-border capital flows. These restrictions largely explain e.g. the difference in share prices of a Chinese company listed on Hong Kong and mainland China stock exchanges. Chinese stock market will only integrate with the world's other large stock exchanges if China continues to relax rules on capital movements.

Shanghai A-share index and daily trading volumes, yuan million



Source: Bloomberg

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Russia

Growth in budget spending accelerated in the first quarter. Measured in nominal terms, first-quarter federal budget expenditures rose 28 % from the first quarter of 2009, about the same pace as total expenditures in 2008 and 2009. This happened despite the fact that nominal growth in this year's budget spending is limited to 3 %. Growth of spending at the start of the year, however, does not necessarily forecast the trend for the year as a whole as budget spending this year is decidedly more front-loaded than in previous years. The reasons behind this are the substantial transfers to cover the growing pension fund deficit and the need to bring forward payments of other budget outlays.

A long-standing problem with administration of the federal budget has been that allocation of annual funding has not gotten moving until the second or third quarter of the year. For this reason, administrators have found themselves repeatedly with large amounts of unspent funds as year's end approaches. The move to dole out money quickly often has led to inefficient use.

Federal budget revenues increased 13 % y-o-y in nominal terms in the first quarter. The bigger-than-expected income accumulation came from higher prices for exported oil that boosted oil tax income as well higher income from other taxes, which reflects the economic recovery under way.

The 1Q10 budget deficit equalled slightly more than 3 % of estimated GDP for the period. For all of 2010, the budget deficit is now expected to be less than the original approved target of just under 7 % of GDP. Expert estimates at the moment largely fall in the range of 3–5 % of GDP. The expectations of a smaller deficit are based on the assumption of higher oil prices as well as improved forecasts of economic performance this year. Experts do not expect spending to rise substantially above the approved budget even with the improved revenue outlook.

Some 170 billion rubles (€4.3 billion) in reserve funds were used to cover the budget deficit in the first quarter. After the transfers, the value of the reserve funds stood at 4,180 billion rubles (€106 billion).

Russian car industry sees faint light at end of tunnel. Russia's car industry grew rapidly throughout most of the 2000s as incomes rose and foreign players entered the market. Rosstat figures show passenger car production increased an average of 8 % a year between 2003 and 2008. Highest growth was posted for vehicle assembly from foreign-made parts; that business grew an average of 97 % a year between 2003 and 2008.

The car business was hit particularly hard by the economic crisis. In 2009 car production was down 60 % y-o-y to just 595,000 vehicles. The figure includes cars assembled from foreign components, which was down 53 % according to Autostat that compiles data on the auto sector. Total 2009 output of the Russian car industry (including lorries, tractors, etc.) was the lowest in 38 years.

Autostat figures also show that Russia's largest passenger car manufacturer in 2009 was AvtoVAZ, maker of the legendary Lada. AvtoVAZ production was 295,000 cars, or about half of Russia's total passenger car production. Renault currently owns a quarter of AvtoVaz. The company's largest plant is located in the Samara region in the city of Tolyatti.

Russia's second-largest carmaker is Avtotor, which assembled about 60,000 cars in 2009, or about 10 % of Russian car production. Avtotor's brands include BMW, Kia, and several of General Motors' Cadillac and Chevrolet models. Avtotor's main assembly plant is located in the Kaliningrad enclave.

Avtoframos, which is almost entirely owned by Renault, is Russia's third largest carmaker, producing last year 49,500 cars, or 8 % of Russian car production. Avtoframos operations are concentrated in Moscow.

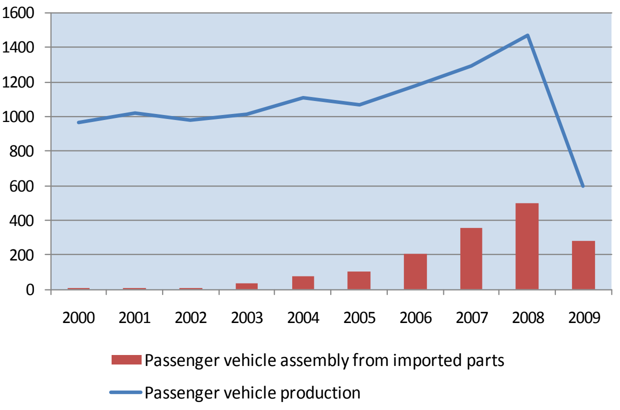
When the two next largest carmakers, Volkswagen and Ford, are added to the above-mentioned list, these companies account for over 80 % of Russia's car production.

Autostat's forecast anticipates recovery in the sector would be well underway this spring. Recent evidence backs this view; Autostat figures show AvtoVAZ increased its March sales 70 % m-o-m and 13 % y-o-y.

Russian car imports fell 74 % in 2009 to 472,500 units. Some of the contraction was due to a protectionist hike in the foreign car import tariff, which was raised 30–35 % depending on the car type.

Russia accounted for 3 % of car registrations worldwide in 2009. China accounted for 16 % and the EU 27 %.

Russian passenger vehicle production (thousands)



Sources: Rosstat, Autostat

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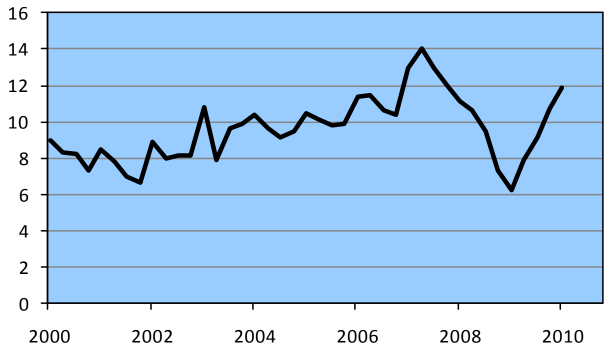
China

As expected, China displayed impressive growth in 1Q10. The National Bureau of Statistics reports China's GDP grew 11.9 % y-o-y in the first quarter in real terms. While growth was largely driven by higher industrial output, some growth needs to be attributed to the relatively low comparison period a year earlier. In the first quarter, estimated seasonally adjusted GDP was up 2.5–3 % from 4Q09. Growth is expected to slow down towards the end of the year, and many forecasters predict GDP growth will come in at around 10 % this year.

Real industrial output rose in the first quarter nearly 20 % y-o-y. Most notably, Chinese heavy industry rebounded from last year's doldrums. Two indicators of demand showed continued strength: retail sales were up 18 % and fixed investment climbed 26 % in nominal terms. Fast investment growth is expected to ease off as officials reduce the pace of launching new public investment projects and commercial bank lending is more restricted than last year. Indeed, the growth in the loan stock slowed in March from previous months.

Quarterly change in real on-year GDP growth, %



Source: China National Bureau of Statistics

Rise in consumer prices slowed in March. March consumer prices were up 2.2 % y-o-y. The pace of rising prices slowed from February, which saw the usual spike in consumer prices from Chinese New Year's festivities. Inflation, however, is expected to pick up again in the coming months as the economy is awash with liquidity following a period of easy credit. Pressure on consumer prices is also increased by producer prices, which were up 5.2 % y-o-y in March. Moreover, officials hiked fuel prices this week by about 4 %, which adds to inflationary pressure to consumer prices due to higher cost of transport.

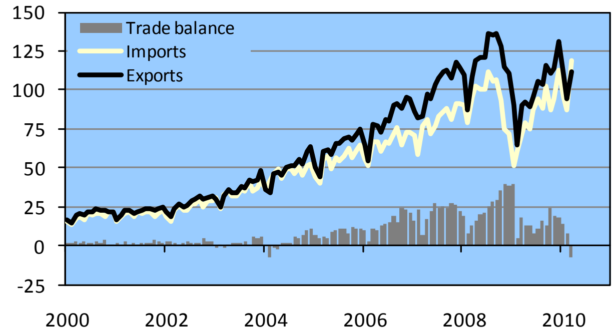
Real estate prices' rise accelerated in January-March to 11 % y-o-y, despite the fact that officials have sought actively since December to restrain runaway real estate prices by numerous measures. It is feared that a real estate bubble is forming and that bursting of that bubble could seriously impede construction investment and damage overall economic growth. Although real estate prices are rising in nearly every city, there are substantial differences among large cities and across city districts. Official figures show real estate prices in China have risen as fast as the disposable incomes of city-dwellers in the last four years. However, most observers agree the official real estate index underestimates the actual rise in real estate prices. The impact of a bursting real estate bubble on the financial sector could be limited, however, due to the fact that the use of debt financing in real estate deals is relatively small in China.

China posted rare trade deficit in March; currency reserves continue to climb. China showed a $7 billion trade deficit for March. The value of imports was up 66 %, while export growth was 24 % y-o-y. It was China's first monthly trade deficit since early 2004. The higher value of imports reflected higher global prices for energy and commodities, as well as higher import volumes of raw materials and other goods.

Although the fluctuations in exports and imports and the trade deficit were influenced by the timing of the Chinese New Year holidays this year, China's trade surpluses have been on a shrinking trend for over a year now. For the first quarter, the trade surplus was a mere $15 billion, down from $40–$63 billion in 1Q07–1Q09. The declining trend reflects financial distress in many of China's export markets, and, perhaps more significantly, growth in domestic production and demand. However, China's trade balance is expected to quickly return to surplus. Nevertheless, if raw material imports continue at current levels and world commodity prices hold up, China will have a smaller trade surplus than the $200 billion (4.0 % of GDP) posted in 2009.

The shrinking trade surplus has meant lower growth in China's currency reserves. In 1Q10, China's foreign currency reserves grew by $48 billion to nearly $2.45 trillion.

China's monthly foreign trade, US$ billion



Source: Bloomberg

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EUROJÄRJESTELMÄ
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BOFIT Weekly

16 • 23.4.2010

Russia

Social issues top Putin's annual government address to the Duma. Russian prime minister Vladimir Putin stated in his annual address to the lower-house Duma on Tuesday (Apr. 20), that healthy state finances allowed Russia to move swiftly to avert the worst shocks of the financial crisis without need for external funding. Despite a sharp drop in revenues last year, budget spending was not cut, and part of outlays were redirected towards social spending. The average real disposable income even grew last year, largely due to hikes in pensions and public-sector wages. Pensions were up 11 % in real terms. The government bailed out the banking sector and Russia's ailing car industry. Banks have already started to pay back their emergency credit packages.

The government's goals for the coming two years include stabilisation of the economy, better use of budget funds, support for technological innovation and enhanced social spending e.g. on education, healthcare and housing.

The prime minister surprised listeners when he announced that the health insurance contributions of employers will go up at the start of next year by two percentage points to 5.1 %. Initially, the hike was intended to finance reform of the health insurance system, but due to the delay of the reform the finance ministry together with the corporate sector has supported putting off the increase for two years. Putin said the extra revenues in the first two years would go to improving health care infrastructure, e.g. refurbishment of hospitals, construction of information databases and purchases of medical equipment.

Customs union and need for economic modernisation drive changes in Russia's customs policy. The three-year framework for Russian customs policy approved by the cabinet last month has been published. The need to renew customs policy was made timely by the launch of the Russia-Belarus-Kazakhstan customs union in January.

The new customs policy emphasises Russia's need to find effective ways to promote its position within the customs union in order to safeguard its sovereign interests. Russia's most serious problem is a dysfunctional customs agency. The government is concerned that the elimination of inspections within the customs union will encourage third-country importers to prefer importing via Belarus and Kazakhstan, rather than deal with Russian customs at the border. This is due to the fact that the customs practices of Belarus and Kazakhstan a far more up to date and functional than Russia's. In the cabinet meeting, Putin criticised Russia's current customs practices that harm export and import activities in ways that prevent otherwise successful firms from expanding. As an example, Putin mentioned the Finnish Nokia Tyres company in Vsevolozhsk.

Customs inspections on the Russia-Belarus border will cease on July 1, 2010. Customs inspections on the Russia-Kazakhstan border will end on July 1, 2011. The three customs union prime ministers are expected to sign protocols on how the custom union will function on May 21, 2010, so there is a rush at the moment to finalise practices. One of the biggest unresolved issues is how to treat Russian crude oil exported to Belarus.

The government's customs policy will retain its function of protecting domestic producers. However, the new goal is to integrate customs policy with industrial policy in acknowledgement of the need to modernise the Russian economy. Selective protectionist policies should encourage domestic high-technology production or reward high-tech firms for establishing production in Russia. High-tech production would initially be protected by high import tariffs, while duties would not be charged for needed production inputs. Customs practices would also be simplified.

As a rule, Russia will use import tariffs to protect products that have a chance of eventually becoming competitive. The currently competitive production would be protected as needed, in particular to avoid changes in the market situation. Uncompetitive production would get least protection, and in this case import duties would mainly have fiscal significance.

Customs duties to decrease gradually. In the government meeting discussing customs policy, prime minister Putin said Russia needs to establish a timetable for eliminating increases on customs duties imposed during the financial downturn.

Putin said customs duties had been raised during the recession on a limited basis in instances where protection of domestic producers was essential. The hike in import tariffs applied to 10 % of imports coming from outside the CIS area. Import duties were raised e.g. for cars and over 120 machinery and equipment categories. On the other hand, customs duties were lowered on items needed for domestic production such as car parts and video displays. The cut concerned 3 % of imports from outside the CIS area.

The average import tariff rate (taking into consideration lower rates granted in special cases) fell one percentage point last year to 10.6 %. The decline was due largely to special discounts granted on certain import tariffs. The level of import tariffs is expected to decline further this year and next year.

According to the customs policy paper, the two-year postponement of a hike in raw timber export duties complies with Russia's national interests, and was justified with a view to enhancing trade relations. In the medium term, the government will have to revisit the issue as it is a decisive factor in building new wood processing capacity and adding value to forest industry exports.

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China

Global crises hit FDI flows in China. The State Administration of Foreign Exchange (SAFE) released its revised 2009 balance-of-payments figures this week. The trade surplus contracted last year, bringing down the current account surplus considerably from 2008. The flow of portfolio investment into China, on the other hand, was up last year.

The net inflow of foreign direct investment into China last year was just $78 billion. The decline reflected a lower level of new investment and pulling out of existing capital investments in China. The investor retreat was probably driven by liquidity problems faced by international corporations during the financial crisis. Chinese enthusiasm for direct investment abroad also diminished slightly last year. FDI outflows were $44 billion, down from $53 billion in 2008.

Chinese officials adopted new balance-of-payments accounting methods in 2009. The change was intended to make it easier to determine real foreign currency flows by dropping valuation change in foreign currency reserves from balance-of-payments figures. Valuation changes in reserves arise from fluctuations in exchange rates and changes in the value of financial instruments such as treasuries and bonds in which reserves are held. The significance of the valuation change entry stems from the immensity of China's currency reserves. At the end of 2009, the value of investments and changes in exchange rates during the year resulted in an increase in currency reserves of about $55 billion, or nearly the size of Finland's entire state budget. China's new statistical practices follow international best practices.

Balance of payments and currency reserves, US$ billion

	2007	2008	2009
Current account	372	426	297
Goods trade balance	315	361	250
Other	57	65	47
Capital and financial account	74	19	145
FDI inflows	138	148	78
FDI outflows	-17	-53	-44
Other	-47	-76	111
Net errors and omissions	16	-26	-44
Change in currency reserves	462*	418*	398
Valuation change in reserves	–	–	55
Currency reserves on Dec. 31	1,528	1,946	2,399

* No information available on valuation change.
Source: SAFE

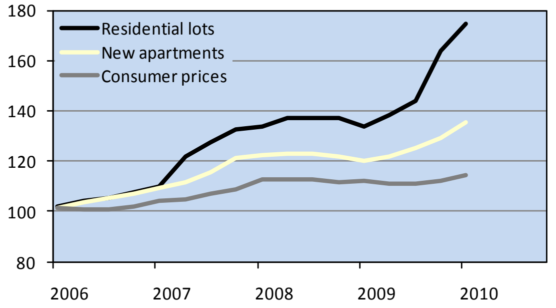
China tries to cool housing market through administrative rules. During the first three months of 2010, prices of new apartments in 70 Chinese cities were up on average 13 % y-o-y. The nearly 5 % q-o-q rise in 1Q10 translates into an on-year rise of 20 %. The price trend varies considerably across cities, however. Apartment prices in Beijing are soaring, but the situation appears to have stabilised in Shanghai while in Guangzhou prices for new apartments actually declined in March. Getting a true picture of overall situation is difficult as the statistical data are of poor quality, difficult to interpret and sometimes contradictory. Many observers believe the official figures understate the rise in housing prices.

The average price of lots zoned for residential housing has risen even faster than housing prices themselves. In January-March, urban lot prices were up by nearly a third from 1Q09.

Perhaps the surest sign of the dire nature of the situation is that officials continue to implement harsher measures to deal with overheating in the housing market. Earlier, the government sought to rein in expansion of credit and reinstated the time housing sales are subject to tax to the pre-crisis level. The latest measures apply directly to housing loans and seek to prevent speculation in the housing market. The cash down-payment requirement for second apartment buyers has been raised to 50 % and the minimum interest rate on housing loans has been increased. The cash down-payment for first-time buyers of apartments has been raised to 30 % if the purchased apartment's floor space exceeds 90 m^2. Banks must now demand proof from housing buyers that they have lived at least a year in the city where they plan to buy an apartment.

To cool booming prices for lots and increase the housing supply, the government will continue to increase the supply of available lots and construction of affordable housing. The central government has also put local administrations, which have actually been suspected of price manipulation, accountable for getting housing prices under control.

Price trends for new apartments and residential-zoned lots in major Chinese cities; consumer prices; index 2005Q4=100



Sources: CEIC and BOFIT

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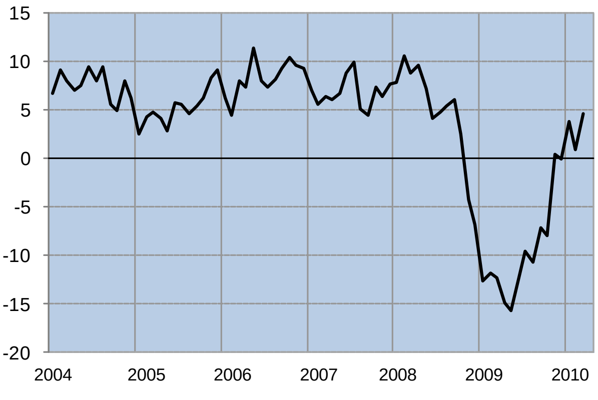
Russia

Russian economic growth slowed in the first quarter. Preliminary seasonally adjusted figures from the economy ministry show the rate of GDP growth in the first quarter of this year slowed substantially from the pace of the third and fourth quarters of last year. On-quarter growth was nearly 2 % in 3Q09 and 4Q09, but tentatively a mere 0.6 % in 1Q10. Preliminary figures from the ministry showed GDP growth reached 4.5 % y-o-y in the first quarter, however, against an on-year drop of nearly 10 % in 1Q09.

The economy ministry's seasonally adjusted figure for retail sales volume, a good indicator of trends in private consumption, rose in the first quarter by nearly 1 % from the previous quarter. On-quarter growth was a bit lower than in 4Q09. As in the course of 2009, growth in retail sales continued to lag growth in real disposable incomes and real wages. Some of this can be attributed to the fact that households have stayed more inclined to save than before the recession. Capital investment and industrial output fell slightly on a seasonally adjusted basis in the first quarter after having risen in the second half of 2009.

Output of five core sectors of the Russian economy (industry, agriculture, trade, construction and transportation), on-year change of volume (%)



Source: Rosstat

Russia issues new bonds in international markets. After completing a global financial "road show," the Russian state returned to international bond markets after a decade-long hiatus. The new Russian bonds, with maturities of 5 and 10 years, are dollar-denominated Eurobonds with a nominal value of $5.5 billion. Demand for the bonds well exceeded supply. The coupon rate on the five-year bond ($2.0 billion issued) was 3.6 % and the ten-year bond ($3.5 billion issued) had a rate of 5.0 %. The rates are historically low for Russian sovereign debt.

The bond issue helps international lenders price loans to Russian firms looking to raise cash by providing a reference. At the moment, the Russian state is in a good position to cover the budget deficit this year by drawing from the state reserve fund and borrowing from the domestic market. The finance ministry said the state may not resort to any further international borrowing this year, and that it has cut its estimate of its foreign borrowing needs in 2011−2012 to around about $7 billion a year. Increased state borrowing from domestic markets would also encourage lower inflation rates.

The international credit ratings agencies FitchRatings and Standard & Poor's (S&P) gave the sovereign bond issues a rating of BBB. In justifying the ratings, they noted that Russia's budget deficit this year would be smaller than earlier anticipated and that Russia's deficit is expected to keep shrinking in coming years. Moreover, the fresh debt issue leaves more of the state's reserve fund as a buffer against any substantial drop in world oil prices. Russia's current account surpluses and foreign currency reserves are further expected to remain large. S&P added a caveat that the current sovereign rating could be downgraded if Russia fails to demonstrate strict fiscal discipline in the coming years. It noted largest risks to Russia's economic growth continue to be obstacles to foreign direct investment, the unclear outlook for the banking sector and cuts in public investment.

Russia and Ukraine reach strategic deal on gas. The parliaments of Russia and Ukraine this week approved an agreement committing Russia to provide Ukraine with gas at an approximately 30 % discount. In practice, the deal means that Russia will eliminate its export tariff on most of the gas going to Ukraine. The gas discount will stay in place until 2019. The elimination of the export tariff is expected to reduce Russian budget revenues this year by about 100 billion rubles (€2.5 billion) or about 0.25 % of GDP.

The drop in the price of imported gas eases Ukraine's current fiscal distress. The Ukrainian state presently funds the difference between the import price and the regulated rates charged to domestic customers out of the state budget. By some estimates, the deal saves Ukraine about $4.4 billion (€3.2 billion) a year over the next decade. Ukraine's prime minister Mikola Azarov said the deal will help to significantly reduce the 2010 budget deficit to around 5 % of GDP. The government sees its sudden progress in deficit reduction will qualify Ukraine for an extension of its IMF support package, needed to prop the country that is still struggling with the effects of the financial crisis (see *BOFIT Weekly 6/2010*).

In exchange for the gas discount, Ukraine extended Russia's lease on the Sevastopol naval base for the Black Sea fleet until 2042.

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China

IMF new outlook forecasts robust Chinese economic growth and return of excessive current account imbalances. The IMF's latest World Economic Outlook (WEO), themed "Rebalancing Growth," forecasts a faster-than-earlier-expected rebound in the global economy and a 4.2 % rise in world output this year. The global recovery will be uneven across countries, however, with high-growth in developing countries driving the recovery while developed nations experience low growth, bogged down by rising sovereign debt and financial market instability.

The IMF estimates that China's annual GDP growth will continue at a 10 % pace − well in line with other recent estimates. The Fund warns, however, that growth in Asian countries is highly dependent on recoveries in developed countries. The IMF prediction of 4 % GDP growth for Russia this year is more cautious than most other recent estimates.

Although the much-discussed global imbalances eased considerably last year, the IMF believes that imbalances – namely the US current account deficit and China's current account surplus − will again start to increase as the global economy recovers. The IMF projection (see WEO database) sees the US current account deficit rising from $420 billion (equivalent to 2.9 % of GDP) last year to nearly $640 billion (3.5 % of GDP) in 2015. Similarly, China's current account surplus is expected to rise from $300 billion (5.8 % of GDP) in 2009 to about $760 billion (8.0 %) in 2015.

The WEO makes mention of earlier experiences of countries making the shift from a model of export-driven growth with recurring current account surpluses to a more balanced growth model driven by domestic consumer demand. The message for China is clear. Economic policy can be designed to significantly influence current account balances without sacrificing economic growth. Growth in domestic demand, in turn, can be supported by fiscal policy to compensate for the effects of real exchange rate appreciation. Despite the short-run problems, a stronger currency could actually boost or force companies to focus on improving the quality of their products and services in the long-run. In addition, structural reforms can help bring down current account imbalances, while supporting economic growth.

Stock index futures trading launches in China. Trading in share index futures got underway in China in mid-April. The futures contracts are based on the market valuations of the 300 largest A-share listed companies on the Shanghai and Shenzhen exchanges (CSI 300). The China Financial Futures Exchange, founded in 2006, is responsible for oversight of futures trading and the products traded. Not counting commodity futures, the new stock index futures are the first futures product traded on China's nearly non-existent derivatives market since trade in state debt futures ended in the mid-1990s. The emergence of futures markets is considered an important step in the development of China's financial markets.

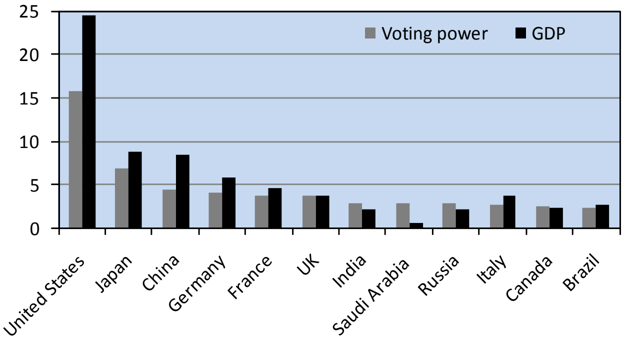
Indeed, a lot has been happening on Chinese financial markets in recent weeks. A pilot programme allowing selected brokerage houses to engage in short selling and margin trading was introduced at the beginning of April. A short sale involves borrowing shares from a brokerage and then selling them with a requirement to buy them back at some point in the future. This allows investors to make money on declines in share prices. Short selling was forbidden temporarily in several developed countries during the financial crisis. In addition to short selling, margin trading was allowed on trial basis. It is basically trading on borrowed money. Up to half of the share price can be borrowed and shares can used as collateral. Both trading formats have been under consideration for several years.

The Shanghai A-share index trend has been relatively steady since last summer with the index value staying above 3,000 for the entire period. The index value has dropped about 7% during April.

China's presence grows in international institutions. Last week, the World Bank revised quotas and voting shares to better correspond to the current size and significance of countries in the global economy. After the change, the voting share of developing countries increased by over three percentage points. More than half of the new voting power went to China. China's voting share of 4.4 % is the third largest voting share after the United States (15.9 %) and Japan (6.8 %). Quotas and voting shares will be revisited in 2015.

The IMF also plans to alter the voting structure. Although the reform is not yet in place, it is clear that China's role will increase in the IMF.

Countries with largest World Bank voting shares and their share of global nominal GDP, %



Source: IMF World Economic Outlook

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Russia

Recent forecasts reflect uncertainties in forecasting Russian economic trends. While most of significant forecasts released in April and early May clearly expect GDP growth ahead for Russia this year, slight differences are apparent. The World Bank expects 2010 growth in the range of 5-5.5 %, the IMF 4 %, the EU Commission 3.7 % and Russia's economy ministry (tentatively) 4 %.

The differences in GDP growth forecasts partly diverge from the differences in expectations about recovery of the global economy and global trade. Most of the differences in Russia growth estimates also contradict the differences in assumptions on the average world oil price this year that range from $76 to $85 a barrel. The oil price is an important determinant of Russian economic growth.

Instead, the divergence in the GDP forecasts appears to reflect different expectations of post-recession development of domestic demand (consumption, investment and inventory levels), which is challenging to assess. Some differences also concern the degree to which increased domestic demand may increase imports. The four forecasts above all see the strongest pull this year coming from growth in private consumption (e.g. economy ministry 4.4 %, EU Commission 4.8 %). On the other hand, predictions for investment growth are less certain (economy ministry 2.9 %, EU Commission 4.5 %).

Inflation is not expected to decline further, coming in around 6-8 % at year's end. The ruble's nominal exchange rate is expected to appreciate (or at least appreciation pressure will prevail). The economy ministry expects that relatively high inflation and ruble appreciation will drive up the ruble's real exchange rate by 12 % this year.

Split views on whether CBR will lower interest rates further. The Central Bank of Russia again lowered interest rates on April 29 by a quarter of a percentage point. Currently, the minimum one-day repo credit rate stands at 5.25 %, the largely symbolic refinancing rate at 8 % and CBR rates for bank deposits at 2.5-3.25 %.

The CBR reiterated that declining inflation will permit lower interest rates. It emphasised the need to support domestic consumption as Russia's economic recovery is not yet on a stable path. The rate cut was primarily intended to revive bank lending, which showed little growth in March and April according to the CBR. On the other hand, several banks still face stagnant demand for credit.

The CBR said the possibility inflation will pick up in the second half of the year cannot be ruled out. As a result, earlier expectations that interest rates will continue to fall are now accompanied by expectations that the use of interest rate policy to stimulate the economy is gradually over.

On the other hand, indeed, the CBR still needs to deal with abundant liquidity in the banking system. This is evidenced by the fact that banks continue to maintain large deposits with the central bank (550-640 billion rubles or €14-17 billion in the first week of May) despite a drop in the deposit interest rates. The CBR has continued to soak up liquidity by issuing its own bonds (OBRs). Currently, the value of OBRs issued stands at nearly 850 billion rubles or just under €22 billion.

In addition to growing bank deposits, liquidity in the economy has also been increased by CBR interventions in the domestic currency market to limit ruble appreciation and the use of the state reserve fund to cover the budget deficit. In March and April, the CBR currency reserves increased by some $30 billion, standing at just over $460 billion at the end of April. Even so, the ruble has been allowed to strengthen against its dollar-euro currency basket. The ruble has gained about 8 % against the basket since the start of the year.

Declining population clouds Russia's development prospects. As of January 2010, Russia's population stood at roughly 142 million, making it the world's ninth most populous country.

The expected average lifespan in 2008 was 62 years for Russian men and 74 years for Russian women. The average expected lifespan in OECD countries is about ten years longer. Expected lifespans in Russia vary considerably across regions. The average lifespan for a Moscow resident is 73 years, but just 61 years for a resident of the Republic of Tuva in southern Siberia.

A number of forecasts have been made of trends in the Russian population. Rosstat's middle scenario sees the population declining by about 2.5 million between now and 2030. The low-end forecast, which closely matches the UN projection, sees Russia's population shrinking by about 14 million to 128 million in 2030. The US Census Bureau anticipates that Russia's population will decline by 9 million over the next decade and by 18 million by 2030.

There are multiple reasons for Russia's declining population including high mortality rates, low birth rates and a steady contraction in the number of women of fertile age.

The age structure of Russia's population is also changing. The UN predicts the percentage of working aged persons in the population will fall from 57 % at present to 49 % in 2030. The fall in working aged persons means growing strain on the economy's dependency ratio.

Russia's shrinking labour force was already apparent before the global financial crisis hit. In 2007 and 2008, for example, the unemployment rates in Moscow and St. Petersburg dipped below 2 % and labour shortages emerged in a number of fields, particularly those requiring highly skilled labour.

Under Russia's national population programme, officials have been presenting a range of measures to stem the depopulation of Russia, e.g. hoping to encourage immigration.

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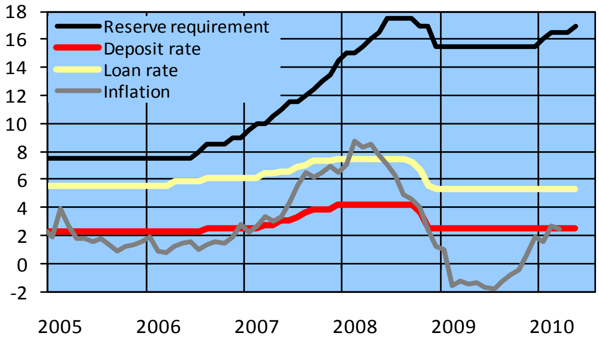
China

China takes further measures to tighten its monetary stance without raising key interest rates. The People's Bank of China last week announced it was raising reserve requirements for commercial banks next Monday (May 10). The reserve requirement, which is the money banks must keep on deposit with the central bank and cannot lend further, will rise to 17 % for large commercial banks and 15 % for smaller lending institutions.

The real interest rate for a year loan taking into consideration consumer price inflation is presently about 3 %. Looking just at interest rates, it would appear China's monetary policy stance remains loose in light of current economic growth. Although the PBoC has yet to raise reference interest rates to cool the economy and restrain inflation, the monetary screws are being applied through other measures. The hike in reserve requirements was already the third this year and the central bank has issued direct orders to commercial banks to reduce lending. Banking inspectors have turned their attention to the quality of loan portfolios held by commercial banks, paying special attention to loans granted during the stimulus to new firms set up by local administrations.

According to a fresh PBoC survey, most Chinese bankers do not expect any big changes in monetary policy from the first quarter to the current quarter. On the other hand, Chinese households do anticipate a pick-up in consumer price inflation. Growing amount of survey respondents expressed a view that housing is overpriced. The survey found that a large share of households now plan to save more, which means that the contribution of the household sector to China's high savings rate will persist unchanged (at least by this measure).

Reserve requirement for large banks (% of deposits), 12-month reference rates (% p.a.) and consumer price inflation (% change from a year earlier)



Sources: PBoC and NBS

Chinese banks seek more capital. With the boom in lending from last year's stimulus policies, Chinese banks now find themselves struggling to meet capital adequacy requirements. The capital adequacy of several large banks has already dropped slightly below the minimum 11.5 %. Complicating the situation is the fact that a large share of the new loans could turn into non-performing loans (NPLs) over the next two years. Larger NPL portfolios would only aggravate the capital adequacy problems of banks. In today's changing conditions, banks are suddenly finding they have insufficient capital even though on-year growth in the aggregate stock of bank loans slowed from 32 % at the end of 2009 to 22 % in March. Moreover, the profitability of China's large banks actually rose quite sharply in the first quarter compared to 1Q09.

Three of China's four large state-owned banks are exchange listed. All have announced plans to raise money from the markets through share issues and convertible bond sales valued at tens of billions of dollars. Chinese sources report the Agricultural Bank of China, the smallest of the four state banks, is planning its IPO in July on the Shanghai and Hong Kong stock exchanges. Recent information suggests the IPO could raise about $20 billion.

Cash-starved banks are now rushing to the stock markets to find money; a flood of new bank share issues is planned in coming weeks. This situation, combined with tighter monetary policies and uncertainty over the international economy, has driven down share prices on Chinese exchanges. Central Huijin, a part of the state investment corporation, has promised to buy up large blocks of new bank shares to help banks raise capital. State participation should ultimately reduce the potential share of offerings on the open market.

World's Fair boosts Shanghai's economy. The Shanghai World's Fair, set to run for the next six months, opened last week. In addition to the most of world's countries represented, international organisations and corporations are also active participants. The promoters expect the exhibition to attract 70–100 million visitors. Admission ticket sales alone should be 10–15 billion yuan (€1.1–1.6 billion). The arrangers announced in March that sales of promotional goods had already reached 8 billion yuan. In addition, Shanghai's service sector expects tourists will spend lavishly.

Chinese media estimates put the costs of arranging the event at about 400 billion yuan (€45 billion). The sum corresponds to 1 % of China's 2009 GDP and about a quarter of Shanghai's 2009 total output. The true costs, however, are quite difficult to isolate as they are so fragmented. Exhibitors, for example, pay the costs of setting up and operating their exhibit. Moreover, Shanghai has invested for years in infrastructure in anticipation of the World's Fair (building e.g. metro connections) which will serve Shanghai residents long after the event is over.

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Russia

Russia sees slight rise in oil production in first quarter. Crude oil production increased in the first three months of this year by 3 % compared to 1Q09. A major milestone was passed at the end of April with the official opening of the first oil field in the Russian sector of the Caspian Sea. The Korchagin oil field is owned by Lukoil, Russia's largest private oil company. Lukoil, which discovered the deposit in 2000, has mapped several sub-Caspian oil fields, but is holding back on their development. A number of oil industry specialists warn that development of Caspian Sea hydrocarbon resources remains unprofitable until Russia eases substantially the current tax regime for oil production and exports.

Russian oil output has shown little growth in recent years and production volumes are not expected to rise much in the future. Russian oil production increased 1.5 % in 2009 from the previous year. The increase was largely due to the launch of production of the Vankor field owned by Rossneft, Russia's state-dominated oil giant. Production in the Sakhalin region also grew slightly. Russia produced a total of 480 million metric tons of oil last year; an average of 9.6 million barrels a day. Rosstat figures show crude oil exports last year rose slightly from 2008 to 248 million tons (4.9 million barrels a day).

Because taxes on oil production and oil exports in Russia are based on production volumes, and not corporate profits, investment in new oil fields is presently driven not by expectations of trends in oil prices but expectations about tax policies for the sector. While Russia's tax and export duty schemes for crude oil are effective and transparent, they do nothing to encourage investment in development of new oil fields, which by definition are more and more challenging to reach and develop.

To attract new investment, export tariffs on oil were eliminated for several oil fields located in East Siberia (including Vankor) late last year. The tax holiday is expected to last only until the end of this year. While Russians are constantly discussing the possibility of permanently lowering oil export tariffs and carrying out a complete overhaul of tax system, any quick decisions towards this seem highly unlikely. Oil and gas provide significant revenue streams to the federal budget.

Russian poverty declined in 2009 even amidst economic recession. Rosstat reports the number of people living below the poverty line shrank last year by 400,000 persons, i.e. several tenths of a per cent. About 18.5 million persons or 13.1 % of the population lived in poverty at year's end. People in Russia are classed as living in poverty when their income falls below the official minimum level set for to their group and region. Last year, the poverty line averaged 5,153 rubles (€117) a month.

The reduction in the number of people living in poverty last year largely reflects substantial increases in pensions that statistically compensated for wage declines. Some estimates suggest that without the pension increases the percentage of the population living in poverty would have risen to 17 %.

The pension hikes were part of a government social package approved before the financial crisis. Pensions for the oldest cohorts, in particular, were boosted last year by giving more weight to working years during the Soviet era.

As elsewhere, poverty in Russia is particularly trying for families with children. Rosstat said that in 2008 about 18 % of children lived in poverty, compared to 8 % of pensioners and 13 % of working-age people.

Poverty in Russia has fallen by more than a half over the past 18 years. In 1992, following the collapse of the Soviet Union, the share of Russians living in poverty peaked at 34 %. The share has fallen steadily since Russia's 1998 financial crisis, which briefly caused poverty to spike to 29 % in 2000. Since 2007, the share of persons living below the poverty line has been below 14 %.

Poverty is measured differently across countries, so international comparisons of poverty are difficult. Russia's official figures show the share of persons living in poverty is lower than in many other countries with similar GDP per capita. Some Russian experts believe that the official figures systematically underestimate poverty and that the more accurate estimate would be five or six percentage points higher than the official figure.

Finnish exports to Russia continue to decline. The value of Finnish exports to Russia slid 16 % y-o-y in the first two months of this year to €500 million. Exports to Russia contracted significantly more that Finnish exports overall (down 4 % in the period to €6.8 billion). Russia, which accounted for 7 % of exports, was Finland's fourth largest export destination.

The value of imports from Russia rose in the first two months of the year by 33 % from the same period in 2009 to €1.3 billion. Finland's total imports contracted 3 % in the same period to €6.9 billion. Russia's share of Finland's total imports rose to 20 %. The next largest sources of imports to Finland were Germany and Sweden.

Growth in Finland's imports from Russia reflects rising oil prices. Crude oil prices in January-February 2009 were about $30 lower than in January-February 2010, when the average price for a barrel of oil was $74. Last year, energy accounted for 87 % of the value of Finland's imports from Russia.

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BOFIT Weekly

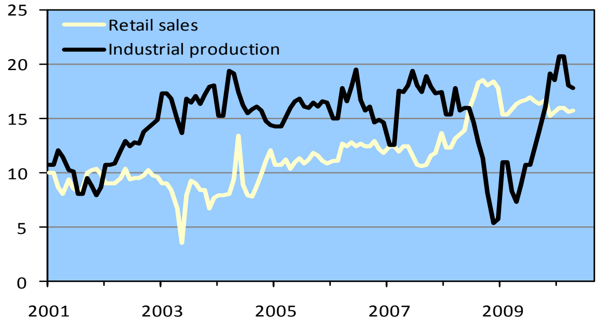
19 • 14.5.2010

China

Few surprises in April economic numbers. China's National Bureau of Statistics reports that robust industrial output growth continued in April, climbing 18 % y-o-y in real terms. The transport equipment industry saw output increase by over a third in the January-April period. The monthly manufacturing purchasing managers index (PMI) suggested that the situation continued to improve from March to April. Purchasing managers reported a sharp rise in domestic orders, with a slightly lower increase in export orders. The situation for China's industrial producers is expected to remain healthy also in the months ahead.

Retail sales, an indicator of trends in Chinese domestic consumer demand, were up 15 % y-o-y in real terms in April. Particularly rapid growth was registered for products that qualified for state support. For example, car sales were up 40 % y-o-y in nominal terms in the first four months of the year. Appliance sales were nearly as brisk because the state subsidies for purchases by rural residents were improved in the start of 2010. In addition, several cities last autumn launched their own highly popular "swap your old appliance for a new one" campaigns.

Real industrial output and retail sales, 12-month %-change



Sources: NBS and BOFIT

Price inflation kicked up in April. Consumer price inflation accelerated in April to 2.8 % y-o-y, up from 2.2 % in March. The rise in prices is expected to continue to pick up in coming months. The rise in producer prices also accelerated in April to 6.8 % y-o-y. The increase in producer prices was due largely to higher commodity prices. Regarding asset prices, housing price growth accelerated further in April. In mid-April, officials introduced a number of regulations designed to curb the rise in housing prices. The impacts of the new regulations should become apparent in coming months.

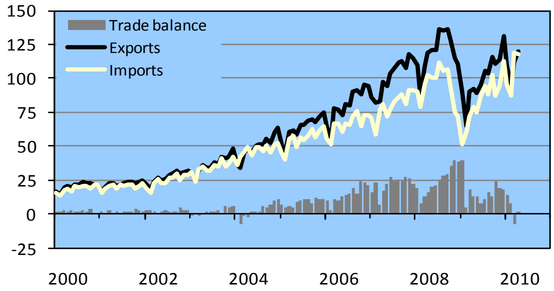
The accelerated rise in prices largely reflects higher liquidity in the economy due to China's massive stimulus package last year. Rapid expansion of the money supply puts upward pressure on prices. Some economists estimate the feed-through time for the inflationary impacts to become manifest is about 18 months in China's case. Although on-year growth in the broad money supply (M2) slowed to 22 % in April, the rate of monetary growth was still sharply higher than in recent years. Thus, the feed-through to higher prices should be visible still next year.

China's trade returns to surplus in April. China's exports in April amounted to $120 billion (up 31 % from April 2009), while imports amounted to $118 billion (up 50 %). As a result, China's atypical $7 billion trade deficit of March was quickly replaced in April with a $2 billion surplus. China's total exports in the first four months of the year were valued at $436 billion and imports at $420 billion. The resulting trade surplus for the period was $16 billion. In the first four months of 2009, the corresponding surplus was $76 billion.

Given that China's economic crisis was at its worst in the early part of 2009, pre-crisis trends provide a valuable perspective on China's recovery. China's exports in January-April 2010 were some ten billion dollars higher than in the same period in 2008, but the value of imports was more than $50 billion higher in 2010, even if imported commodities have remained cheaper this year than in the early 2008. The trade surplus in January-April 2008 was about $57 billion.

Export trends remain dependent on recovery of China's main markets, while the imports situation is expected to fluctuate as commodity prices change and Chinese enterprises adjust their raw material inventories. Because of China's high economic growth relative to the rest of the world, growth in imports can lead to a shrinking trade surplus due to slow recoveries in China's main export markets (particularly Europe and the United States, which are struggling to deal with large fiscal deficits). Using a time-series model to forecast exports and imports simply by their past development, the trade surplus this year could fall by half to just over $100 billion from about $200 billion in 2009.

China's exports, imports and trade balance, US$ billion



Source: China Customs

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Russia

New economic data gives conflicted view of economic recovery. Rosstat's preliminary figure released at the end of last week suggests Russian GDP grew 2.9 % in the first quarter of 2010 compared to 1Q09. The number was substantially lower than the economy ministry's earlier estimate of 4.5 % y-o-y issued at the end of April.

Rosstat figures show no clear direction in domestic demand trends in the first quarter of this year. Retail sales volumes, for example, were up more than 1 % y-o-y, while the amount of fixed capital investment fell 5 %. Industrial output rose 6 % in the first quarter, while construction activity plunged nearly 9 %. Russian customs estimates the volume of imports increased 13 % y-o-y in the first quarter, putting domestic producers under greater competitive stress. According to preliminary estimates, the volume of Russian exports climbed 20 %.

Analysts' interpretations on Rosstat's low GDP growth figure vary. One group expects actual growth will be higher when Rosstat revises its number in coming months. Another group sees that Rosstat may have decreased its GDP contraction figure for the first quarter of 2009, which would have increased the comparison basis for the 1Q10 growth figure.

The most recent data suggest that in the first quarter of 2010, Russia's seasonally adjusted GDP remained at about the same level as in the fourth quarter of 2009. Depending on the seasonal adjustment method used in calculation, GDP either grew or declined slightly from the previous quarter.

Bank lending continued to decline in the first quarter, but turning point may now have been reached. Central Bank of Russia figures show the stock of loans to enterprises at the end of the first quarter stood at 12.4 billion rubles (€314 billion), a nominal decline of approximately 5 % from a year earlier. The stock of loans granted to households contracted nearly 9 % in nominal terms during the year, and at end-March stood at 3.5 billion rubles (€89 billion). The loan stock shrank even more in real terms as on-year inflation in the first quarter was some 7 %.

Growth is, however, expected to have returned or return soon. Modest gains in the nominal on-month growth of the loan stock were registered in March and April.

CBR first deputy chairman Gennady Melikyan expects that the lending stocks of commercial banks will increase this year some 15–20 % in nominal terms, despite a weak start of the year. The decline in interest rates and economic recovery should support bank lending. The average interest rate charged on loans by banks has been falling steadily since peaking during the financial crisis in 2008. The average interest rate fell to 11.8 % in March.

With the slowing of inflation, the central bank has been directing banks since last spring to lower what it considers excessive interest rates on ruble deposits. Interest paid on deposits may now not exceed by more than 1.5 percentage points the average of the deposit rates paid by the ten largest banks. In March, the average deposit rate paid by Russian banks was 6.9 %.

Last month, the CBR also began to deal with what it considers excessive interest rates paid by banks on foreign currency deposits. While the central bank has not imposed a ceiling on such deposit rates, banks report that the CBR considers rates of 7 or 8 % p.a. to be too high.

Foreign firms sign anti-corruption pact. At the end of last month, some 61 multinational companies operating in Russia signed or committed to signing an anti-corruption pact wherein they declared commitment to refraining from giving bribes. In addition to swearing off direct bribery, the signatories promised to refrain from covert forms of bribery such as "charity donations." The signatories also agreed to refrain from contributing to political parties. The agreement encourages measures to make local partners of foreign firms refrain from bribery as well.

The impetus for the pact was provided by a group of German companies, which is why most of the initial signatories are German. They include Mercedes-Benz Russia, Deutsche Bank and Siemens. The pact is open-ended and should grow as it has the support of organisations such as Association of European Businesses, which unites European companies operating in Russia.

Bribery remains a serious problem for Russia. According to the economic security department of the interior ministry, the size of the average individual bribe more than doubled last year to 23,000 rubles (€690).

An April survey by Russia's independent research institute, the Levada Center, found that 55 % of respondents considered the most typical bribe-giver to be any person dealing with a public official. Some 30 % of respondents think that bribes are typically paid by common people who have no other options for resolving their problems. About 10 % of respondents think bribes are mainly paid by criminals buying influence. Some 15 % of respondents reported that they had paid a bribe at some time during the past twelve months.

In April, president Medvedev signed a new anti-corruption strategy for 2010–2011. The strategy update deals with e.g. corruption relating to budget procedures at different levels of state administration.

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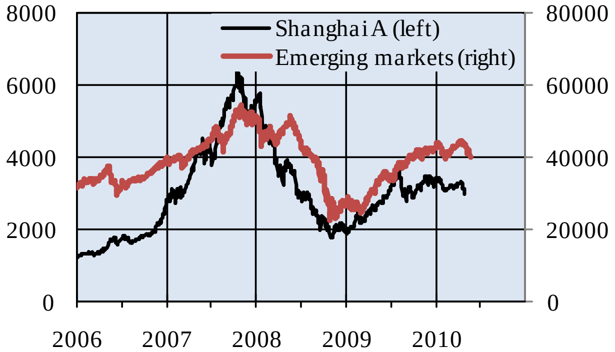
China

China's main stock market indices retreat to levels of a year ago. Share prices of companies included in the Shanghai exchange's A-share index have shed more than 10 % of their value in the past month. Share prices have been depressed by the European debt crisis, official measures to calm China's overheated real estate market and a modest tightening of the country's monetary stance. Since worries about Europe emerged last month, the Shanghai A-share index has fallen more than any other emerging market share index.

The Shanghai A-share index, which has been fairly stable since last august until recent decline, is off 23 % from its peak in November 2009. The rise in share prices has been stifled by the dilution effects from a flood of new share issues. The share of tradable stocks available has increased to about 68 % of the growth in total market capitalisation, compared to a share of 40 % last year. The average price-to-earnings ratio (P/E) of companies listed on the Shanghai stock exchange has fallen to about 20, its lowest point in over a year. The average P/E ratio for companies listed on the Shenzhen stock exchange is 32, while P/E ratios on the Hong Kong stock exchange are now 15. Ratios for both exchanges are at levels similar to May 2009.

Shanghai A-share index and MSCI emerging markets index



Sources: Bloomberg and Morgan Stanley

China-Japan bilateral trade blossoms amidst tensions. Although China-Japan relations are still plagued by memories of the 1937–45 war, relations have generally improved over the last four years. In recent months, however, new bumps in relations have emerged. Japan has sent several protests to the Chinese government concerning naval incidents in disputed maritime areas. Japan last week also demanded China cease with efforts to build up its nuclear arsenal, which China considered completely unfounded and irresponsible. This month has seen some positive signs in relations as Japan announced it was easing visa requirements for Chinese citizens. The Japanese now expect Chinese tourism to boom in coming years. The events of recent months will doubtless be discussed at the end of this month, when China's premier Wen Jiabao visits Japan. High-level meetings between the two countries were quite rare before 2006, when the two countries agreed to hold regular get-togethers.

Japan is important trading partner for China. China imported more goods from Japan last year than any other country. Some 13 % of Chinese imports came from Japan last year, and that share in January-April 2010 appeared little changed. Japan is also important market for Chinese goods, as some 8 % of all Chinese exports go to Japan. China has run a trade deficit with Japan for many years.

Japan is an important source of direct investment for China, although investment flows have been decreasing in relative terms. China's trade ministry reports that at the turn of the millennium slightly less than 10 % of FDI inflows into China came from Japan, but that share has contracted in recent years to around 4 %. The Chinese have made practically no FDI in Japan, which traditionally has been a difficult operating environment for foreign firms.

China helping Nigeria develop its energy infrastructure. China and Nigeria agreed initially last week on construction of three oil refineries and one petrochemical plant in Nigeria. Both sides hope to finalise the agreement within the next few months, despite the fact that several key issues need to first be resolved, including which country will be the primary operator. By some estimates, Chinese financing for the projects amounts to $23 billion. China sees the investment as a good way to bring Nigerian oil and gas resources into its sphere of influence.

Even though Nigeria is one of Africa's largest oil producers, it currently imports most of its refined oil products. Given the obvious need of oil refineries, international energy companies have proposed several plans to construct refineries for the country throughout the past decade. To date, none of these projects has moved ahead.

Although the volumes of crude oil China imports from Nigeria have grown rapidly in recent years, Nigeria remains a minor player as an oil supplier to China. Oil imports from Nigeria accounted for considerably less than 1 % of China's total oil imports and Nigeria was only the seventh largest African source of oil for China.

China currently produces slightly less than half of the crude oil it uses. Although domestic output has risen slightly in recent years, China's thirst for oil has meant ever-increasing dependence on imported oil. About half of China's oil imports come from the Middle East and some 30 % from African nations.

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Russia

Ministries wrangle over assumptions as drafting of 2011 federal budget gets underway. The Russian government's medium-term goal is to reduce gradually the size of federal budget deficits created in the wake of the recent economic crisis by freezing real expenditures at around the 2010 level. Last year's federal budget deficit equalled about 6 % of GDP. Finance minister Alexei Kudrin hopes to see a balanced budget by 2015. If the average price of crude oil on the world market remains above $70 a barrel, Kudrin notes that budget balance could occur sooner.

The average price of crude oil is a fundamental budget assumption as revenues from fees and tariffs on production and export of oil and gas account for about 40 % of total budget revenues. Following its traditionally cautious line, the finance ministry has proposed a $70 a barrel assumption for next year. The ministry observes that if oil price is at the $70 level, the 2011 budget deficit would correspond to 4 % of GDP. If the oil price is higher, the budget deficit would shrink correspondingly.

The economy ministry, in contrast, wants to support higher public investment and proposes that the budget be based on an assumption of $76 a barrel, which would allow higher spending. The economy ministry is assuming that 2011 GDP will grow 3.5 %. If public investment is smaller, the ministry argues GDP growth would be lower.

As part of the budget preparations, the government last week approved next year's basic tax policy framework proposed by the finance ministry. One of the most important issues is to promote new industries and innovation by tax policy measures. Innovative enterprises, including IT firms, that work with universities and in special economic zones will be targeted for tax breaks. The policy framework also allows for the possibility of temporarily eliminating mineral extraction fees on production in new oil fields in the northern parts of Russia.

The government last week approved the finance ministry's long-pending proposal on more effective use of budget resources. The reform incorporates the much-disputed notion of "performance-based" budgeting, which is seen by proponents as a way to improve the use of resources and efficiency of the functioning of the public sector. Under the system, spending will mostly be based on programmes that can be evaluated by a range of performance criteria. The reform will enter into force as part of the 2012 budget.

Kudrin said improvements in public sector efficiency will create huge savings. In e.g. healthcare and road-building savings could amount to as much as 30 % of the sectors' expenditures and in defence procurement to some 15–20 %.

2010 budget performance better than expected. Finance minister Kudrin says the federal budget deficit at the end of this year will likely come in below 5.4 % of GDP, a sharp drop from the original projection of nearly 7 % of GDP. In the first half of this year, Urals-grade crude oil has averaged around $76 a barrel; $18 higher than the 2010 budget assumption.

Kudrin stated that if Urals oil averages $95 this year, the federal budget deficit can be covered entirely from the reserve fund. As of end-April, the reserve fund stood at 3.8 trillion rubles ($130 billion).

May 18 was the tenth anniversary of Kudrin's ascent to the post of finance minister. He is credited with the restoration of state finances in the wake of the 1998 financial crisis as well as the stringent fiscal policies pursued thereafter.

Teething problems hobble Russia-Belarus-Kazakhstan customs union. The prime ministers of the three customs union members met last Friday (May 21) in St. Petersburg to sign agreements on 30 customs union procedures, only to fail to reach unanimous agreements on all the issues. The customs union, which launched at the start of the year, was supposed to be fully functional on July 1. On Tuesday (May 25), prime minister Vladimir Putin announced the operations cannot start full-scale at the proposed date.

The biggest dispute concerns customs duties on Russian crude oil supplies to Belarus. Belarus wants to purchase all its crude oil from Russia exempt for Russia's oil export tariff starting on July 1. Russia wants to continue with the current arrangement of tariff exemption only for oil meant for Belarus' domestic consumption. Russian crude oil is the basis for a booming oil-refining business in Belarus, as most imported oil is refined and re-exported. Russia has low enthusiasm for relinquishing its export tariffs within the customs union.

The import of used cars also remains an open question. Unlike Belarus and Kazakhstan, Russia protects its domestic car industry. Other issues include protection of Russia's aerospace industry and Russia's demand for a reduction in the maximum amount to duty-free goods that can be imported by private individuals.

Prime ministers of the three countries met today (May 28) in St. Petersburg to further discuss the problems. If all the questions cannot be resolved by July 1, one of the possible outcomes is that the customs union will be implemented in a curtailed form. Another option is that implementation will be postponed. There is even a chance Belarus will be excluded from the union.

Putin surprised the world with his announcement of the three-country customs union in June 2009. Given the short implementation period, administrators have had to scramble to introduce required changes in the system, which has caused new headaches in Russia's foreign trade practices.

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China

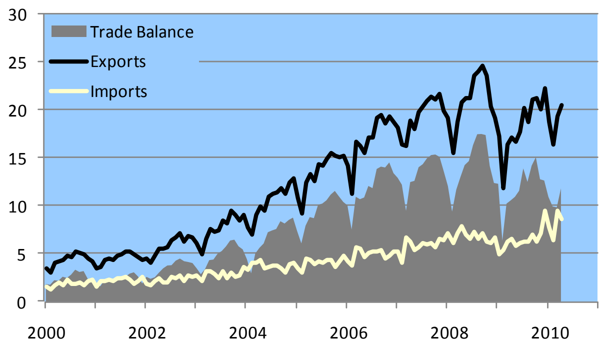
Strategic and economic dialogue finds answers on China-US relations. The latest strategic and economic dialogue got underway on May 24 in Beijing. It was the second such meeting since presidents Barack Obama and Hu Jintao agreed to broader dialogue in April 2009. Wide-ranging discussion touched on current economic issues, the nuclear weapons programmes of Iran and North Korea and energy matters Although the issues of China's exchange rate policy, US weapons sales to Taiwan and Obama's meeting with the Dalai Lama in February simmered in the background, the actual agenda focused on the inflamed situation on the Korean Peninsula and Europe's debt crisis.

The strategic dialogue provides an important forum for exchanging views on improving trade relations. The parties revisited US restrictions on exports of high-technology to China which have been in place since 1989. The Chinese argue that changed circumstances justify relaxation of US rules and that allowing high-tech imports would help balance trade between the two countries. China's Ministry of Commerce reports that only 8 % of China's imports from the United States can presently be classed as high-tech.

The main US concern was China's protectionism. The US representatives pointed out that China's public sector procurement rules continue to heavily skew in favour of Chinese firms even after easing of the rules in April. China and the US also decided to establish a joint laboratory to research clean energy and support research into non-polluting energy technologies.

The countries will next meet at the G20 summit in Toronto at the end of June. The next China-US bilateral strategic dialogue is scheduled for early 2011.

Trends in US-China trade, US$ billion



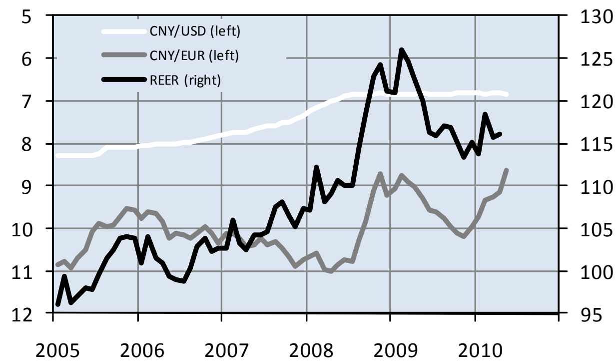
Sources: CEIC and China customs

Pegging of yuan exchange rate to dollar creates illusion of stability. The yuan has gained nearly 9 % against the euro this month as contagion from the Greek debt crisis spread and the single currency faltered against the dollar. After a couple years of cautious relaxation of exchange rate policy, China's monetary officials reinstated a firm peg to the dollar in summer 2008 to provide stability during the global financial crisis. With consumer price inflation now accelerating in China, the county's relative price competitiveness measured by its real effective exchange rate (REER) is falling. Despite large fluctuations of yuan's real exchange rate during the current crisis, which is due to swings in the exchange rates of major currencies, the underlying trend is upwards and yuan's real exchange rate has been gradually appreciating since 2005. The yuan's real exchange rate in April was about 5 % higher than in July 2008, when the yuan was repegged to the dollar.

With the appreciation of the real exchange rate, reduction of the trade surplus and uncertainty about export markets in Europe, many observers now question whether China will postpone even further its decisions to increase flexibility of the yuan's nominal exchange rate although further delays would increase the likelihood of retaliatory trade policies. While other concerns (North Korea, Europe) occupied the agenda of the China-US strategic dialogue (see previous item), the currency issue is coming to a head.

The main reason for allowing the yuan greater exchange rate flexibility, of course, is that the dollar peg constrains China's monetary policy so that the authorities cannot use monetary policy to support balanced domestic development in China. It is telling that while Chinese economic growth now leads the world and domestic inflation is accelerating, real interest rates are falling. Real deposit interest rates in China are also now in negative territory.

Dollar-yuan, euro-yuan rates (inverted scale) and real effective exchange rate (2005=100); rising trend indicates yuan appreciation



Sources: Reuters, BIS

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Russia

CBR lowers most key rates a fourth of a percentage point. Effective June 1, the Central Bank of Russia's refinancing rate fell to 7.25 % and the minimum rates for the CBR's main financing instruments, the one- and seven-day repo credits, declined to 5 %. The central bank also lowered its one-week deposit rate a half percentage point to 2.75 %.

The CBR has been steadily lowering interest rates about once a month since April 2009. In just over a year, the refinancing rate has fallen 5.25 percentage points. In the same period, 12-month inflation has slowed seven percentage points to 6 %. In announcing the latest rate cuts, the central bank said the current level of interest rates will most probably remain unaltered for some months.

The CBR has lowered rates to promote bank lending, which finally is beginning to revive after a long spell of contraction. The impacts of the measures will again be modest, however, due to the exceptionally strong liquidity situation of banks and the lack of good borrowers. Large firms are still reluctant to launch long-term investment projects in the current economic climate.

Instead of lending, banks have resorted increasingly to depositing their money with the central bank. The CBR hopes lowering the deposit rate will discourage this trend.

Government moves to lower inflation. At Tuesday's (June 1) expanded cabinet meeting on price formation, the government decided on next year's hikes in regulated prices of natural monopolies. The rates for gas used by households will rise just 15 % at the start of next year, rather than 21 % as previously agreed. Rates for home heating will go up 12–14 % and electricity 13–15 %. Rate hikes for municipal services are limited to 15 %, and railway freight 8 %. Producers had requested larger hikes than the government ultimately granted.

The government also abandoned its stated goal of raising industrial rates for natural gas to the same level as the gas export price (excluding export tariffs and transmission costs) by January 2011. The new target is for domestic industry to pay 55 % of the export price for natural gas (excluding export tariffs and transmission costs). Prime minister Putin also gave assurances that gas provided to Russian households would remain cheaper than gas sold to industry.

The wholesale price of electricity has been gradually deregulated over recent years. During this week's cabinet meeting, Putin confirmed that price regulation would be phased out at the start of 2011. The government, however, recommends the state-owned electricity companies eliminate unnecessary costs to reduce pressures for further rate hikes. The prime minister added that private electricity companies have a duty as well to help rein in costs and pressures to rates. Putin noted the federal anti-monopoly service (FAS) is mandated by law to limit the rates private companies charge in regions where there is no competition in the electricity market. He encouraged the FAS to actively apply its mandate.

Russia privatised 20 regional electrical power utilities in 2008. Some of these utilities were sold to foreigners. As part of the deals, buyer companies committed to a specific level of annual investment. The government is now preparing a regulation that would permit delays in investment as needed in order to prevent large hikes in consumer prices next year.

The car industry, oil pipeline manufacturers and Russian railways have recently complained to both the prime minister and the FAS about soaring metal prices. Two weeks ago, leading companies in the metals industry announced plans to raise prices 25–30 %, effective July 1. The matter was taken up at the cabinet meeting, and the prime minister committed the parties to signing long-term supply agreements to prevent sudden price spikes. Putin also stated domestic prices cannot be raised tens of percents in current economic conditions, even if world market prices are rising fast. The FAS was tasked with preparing alternative long-run pricing schemes to be used in contracts between companies.

No breakthroughs at EU-Russia summit. At the summit held Monday and Tuesday (May 31–June 1) in the southern Russia city of Rostov-on-Don, European Council chairman Herman Van Rompuy and Russian president Dmitri Medvedev signed a joint statement that in general terms defines the parties' cooperation in economic and social modernisation.

The aim of the partnership from the side of the EU is to support president Medvedev's goal of modernising Russia. The parties promised to promote trade and competition e.g. with the help of Russia's WTO membership and enhance cooperation in the fields of high technology, innovation and energy efficiency. In addition, the EU and Russia will seek to improve the Russian judicial systems, strengthen fight against corruption and increase civil society dialogue. The last three goals were included in the statement on the initiative of the EU.

There was no progress in lifting visa requirements for travel between the EU and Russia. In a surprise move, Russia submitted to the EU its own proposal on eliminating the visa requirement, which resembles the Russia-Israel visa-exemption agreement.

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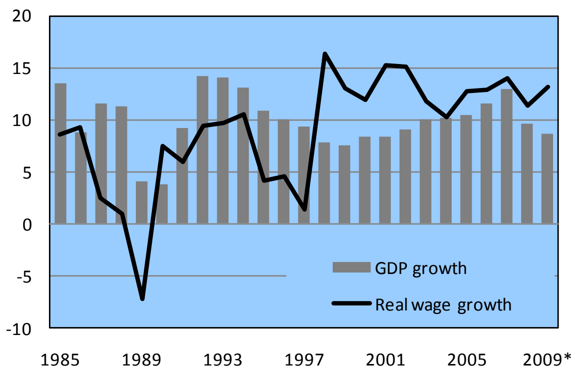
China

Pressure for higher wages spreads. Last week, the world's second largest carmaker, Honda Motors, had to close all four of its plants in China after workers at its Foshan transmission plant on the southern coast went on strike for higher pay. Although Honda responded this week by offering the 1,900 strikers a 24 % hike in starting wages, some strikers balked at the offer. The hike would have raised the minimum starting monthly wage to 1,900 yuan (€230). In addition to Honda, the Taiwanese electronics assembler Foxconn, which has seen a rash of suicides by frustrated workers, announced an across-the-board 30 % wage hike for all its workers in China. The recent wage concessions by manufacturers have put pressure on other firms to raise wages.

Labour unions and employers have reported an increase in work stoppages generally. China's sole official trade union, the All-China Federation of Trade Unions (ACFTU), reports the strikes reflect increased awareness among workers about their rights and pay levels at other firms. Since the rise in real wages stalled in 1998 in the wake of the Asian financial crisis, real wages have steadily risen by more than 10 % a year. Current estimates show real wages rose 13 % last year. China's wage figures are by no means comprehensive, however, as they exclude e.g. wages at private firms. Even with high growth in wages, Chinese wages are still low by international standards.

Real wages and GDP growth, 12-month change, %



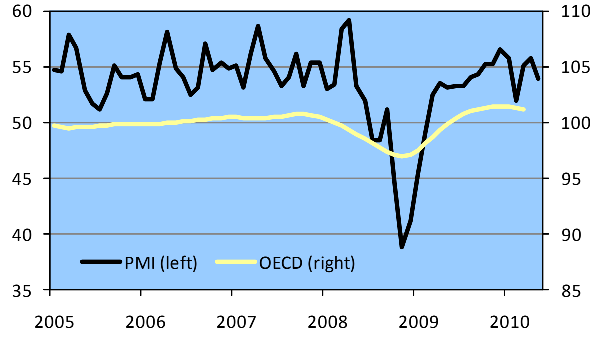
(*real wage growth for 1-3Q09)
Source: National Bureau of Statistics

Industrial output growth appears to be slowing. China's official monthly manufacturing purchasing managers' index (PMI) suggest the situation improved more slowly in May than in recent months as growth in domestic orders slowed.

The PMI indicates that the majority of industrial firms have been hiring additional workers each month since summer 2009. The positive employment outlook for wage-earners and evidence of shortfalls in skilled workers in certain fields connive in increased labour strife.

The decline in industrial growth relates to an overall slowdown in the Chinese economy as the effects of the government's massive stimulus package begin to fade. Thus, the nearly 12 % growth experienced in the first quarter is unlikely to return anytime soon and GDP growth should slow for the rest of this year. The OECD leading indicator also expects Chinese growth to return to its long-term trend.

PMI (value above 50 indicates outlook improved from previous month) and OECD leading indicator (100 = trend)



Sources: CFLP and OECD

Despite the global recession, American firms in China thrived last year. The American Chamber of Commerce in China annually releases a wide-ranging business climate survey of American companies operating in China. The latest survey, published at the end of April, found that 2009 was good for most companies. Two-thirds of responding firms reported increased production, over half of firms saw growth in revenues and over 70 % of companies were profitable. The share of profitable firms has been unchanged for the last four years. Some of the good performance can be attributed to last year's surge in domestic demand. Some 60 % of companies declared their main purpose for operating in China was to serve the large domestic market. Less than 20 % of firms operating in China said they were there primarily for exporting purposes.

Although most American firms see a possible slowdown in Chinese economic growth as their biggest risk, confidence in the future was extremely strong. Some 90 % of interviewees were optimistic about their business outlook over the next five years, which is reflected in their near-future investment plans. Nearly 80 % of firms expect China to remain one of their three most important investment destinations. The findings are likely to be applicable to other foreign companies operating in China.

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Russia

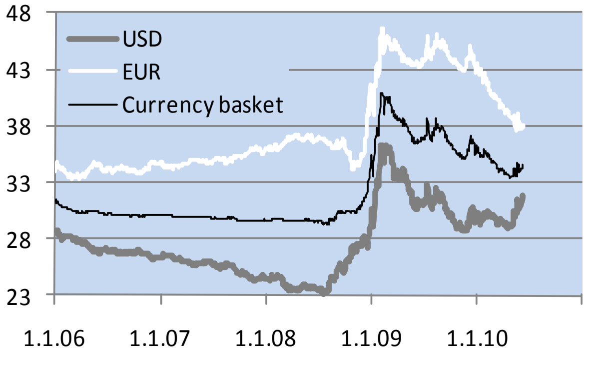
Ruble weakens. The ruble appreciated from late 2009 to April of this year against its dollar-euro currency basket, but for the past month it has been losing value.

The ruble has declined against the dollar since it peaked at around 28 rubles to the dollar in April. On Friday (June 11), one dollar bought 31.6 rubles. The ruble-dollar rate has returned to the same level as in September 2009. The ruble has strengthened slightly relative to the euro since April. On Thursday, the ruble-euro rate stood at 38.0, or about the same level as late 2008.

Day-to-day, the Central Bank of Russia uses its market operations to hold the ruble within a three-ruble-wide trading band. It adjusts the position of the range as the situation warrants. Whenever the CBR buys or sells foreign currency in excess of $700 million, it considers the market situation has changed significantly and moves the trading band up or down in five kopek increments. Since the CBR announced the adjustable trading band in November 2009, the band has been regularly notched down whenever ruble appreciation pressure rose. When the trading band was introduced, trading range was 35–38 rubles per unit of the dollar-euro currency basket. The trading range is currently 33.40–36.40 rubles per unit.

CBR first deputy chairman Alexei Ulyukayev last week noted that the ruble's appreciation run was over. Russia's export volumes and export prices are no longer rising at the same pace as in recent years, while imports are increasing. As a result, the trade surplus and net inflows of foreign currency will fall.

Ruble exchange rate: euro, dollar and currency basket



Source: Central Bank of Russia

Efforts continue to make Moscow a financial hub. President Dmitri Medvedev said last week that efforts to make Moscow one of the world's top financial centres should be stepped up as the new international post-crisis circumstances have actually improved Moscow's chances of establishing itself as a financial player.

The idea of making Moscow into a global financial centre was hatched during Russia's high-growth period a couple years back. At the start of 2009, the government approved plans to create a financial hub in order to spur development of Russia's financial markets and establish it as the main financial crossroads serving the CIS and eastern-most Europe and making it one of the most important regional financial centers in Eurasia. Without the project, proponents warned Russia's small national financial market would wither and vanish.

Russian financial markets are still stunted and lacking adequate legislation. The notion of creating a financial hub may boost preparation of the long overdue laws and other regulations. The government last year set out a programme with timetables for preparing and implementing some 50 measures to develop the functioning of the markets, financial supervision and tax policy, among others.

The work is behind schedule, due in part to time lost wrestling with the financial crisis. Also, interest groups have divergent views on the bills under preparation. Bill proposals include a new stock exchange act, legislation to centralise clearing of securities trades and a securities repository, as well as laws to prevent insider trading and manipulation of security prices. Finance minister Alexei Kudrin said legislative package for the finance centre could be completed in two or three years.

Medvedev noted development of the finance centre demands more than new infrastructure; it involves changes in taxation and customs rules, as well as creation of an effective independent judiciary and strong property rights.

Putin's 10-year economic programme scrutinised. A conference held last week in Moscow reviewed the accomplishments of the economic programme launched in 2000 at the start of Putin's first presidential term. The programme's most famous drafters include former economy minister German Gref and finance minister Alexei Kudrin. They said that about 40 % of the goals of the decade-long programme had been met. In the plus column, Russia's state finances were put in order and the large foreign debt retired. The ambitious goal of doubling GDP was actually achieved (if calculated as GDP per capita measured in dollars). Much of the progress in these areas, however, can be attributed to soaring world oil and gas prices.

On the down side, attention was called to the lack of progress in diversifying Russia's production structure, raising competitiveness and reform of state administration. Even less headway has been achieved in institutional reforms such as judicial independence, development of civil society and guaranteeing property rights. Gref attributed part of the failure to inattention to reforming the power structure.

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China

China's foreign trade surplus balloons again. China Customs reports the country's foreign trade surplus surged to nearly $20 billion in May. In comparison, the total trade surplus for the first four months of this year amounted to $16 billion. May's near-record exports came at a time when imports declined slightly from March and April. Exports to China's main export markets, Europe and North America, rose sharply from earlier months. The May trade surplus, while large, was by no means exceptional as it was close to the monthly average racked up during the export boom of 2006–2009.

China reduces import tariffs. Last week, the WTO released its third Trade Policy Review (TPR) for China. The purpose of the review is to evaluate the development and implementation of China's trade policies, as well as their impacts on the global trade system. The TPR noted that China has worked to diversify its economy and reduce dependence on manufacturing by cutting back on regulation of the service sector. The reforms have also made it easier for foreign companies to operate in China's service sector, especially in the fields of telecommunications and tourism. In addition, China has reformed its tax system to make it more fair by harmonising income tax rules to domestic firms and foreign firms operating in China.

The WTO noted that China has lowered tariffs somewhat over the past two years. The average import tariff fell from 9.7 % to 9.5 % between 2007 and 2009. On the other hand, there are still many barriers to exports. During the observation period, China tightened its rules on exports of strategic rare earth metals and products that cause pollution or waste energy. On the other hand, China lowered its export tariffs on certain goods (e.g. rice, steel, wheat) in July 2009 to ease the impacts of the global financial crisis on exports.

China has yet to accede to the WTO Agreement on Government Procurement. The review found virtually no changes in the public procurement procedures in recent years, and that China's procurement procedures are still skewed significantly in favour of domestic suppliers. The US, in particular, has been highly critical of the situation. Moreover, China still uses many of its own standards rather than international standards, which is a drawback to both domestic and foreign companies engaging or hoping to engage in foreign trade. In addition, the WTO would like to see improvements in transparency of China's economic policies and their formulation.

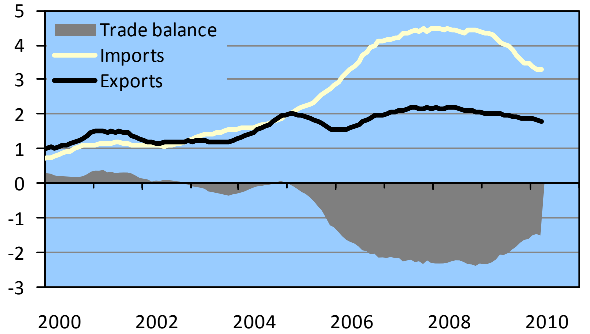
Chinese demand has benefitted Finland during the global economic downturn. Like many other countries, Finland's experience of the global downturn has been mitigated by the robust growth of China's domestic economy during the darkest moments of the international financial crisis. The value of Finnish exports to China last year contracted just 10 %, while Finland's exports overall fell by about a third. In the first quarter of 2010, exports to China continued to show a slight contraction. During the crisis, the value of goods imports from China shrank significantly. The contraction appears to have finally stopped as imports rose slightly in the first three months of this year. Finland's 2009 trade deficit with China declined by about 25 % from 2008. Pure time-series forecasts suggest the deficit will remain at about the same level this year as last year.

About 4 % of Finnish exports go to China, and it is the seventh largest destination for Finnish exports. The lion's share of exports consists of machinery and equipment (65 % in 2009). Other important export items include paper industry products, metals, chemical products, different kinds of measurement devices and furs. The structure of Finnish exports to China last year remained essentially unchanged, although the relative shares of chemical and electrical devices rose slightly and the share of mechanical machinery declined.

China is Finland's fourth most important provider of goods, accounting for 8 % of Finland's imports. Although machinery and electrical equipment accounted for more than 60 % of Finland's imports from China, the structure of imports is substantially more diverse than Finland's exports to China. Finland's other prime import items from China are clothing, footwear, leather goods, chemical products, furniture and toys.

Finnish president Tarja Halonen visited China at the end of May to honour the 60th anniversary of the establishment of Finnish-Chinese diplomatic relations. During her trip, Finland's trade delegation signed a number of deals with the Chinese in the area of environmental technology. The total value of the deals was estimated at around €200 million. In addition, firms preliminarily agreed on deals worth more than €1 billion.

Finland's trade with China, 12-month moving sum, € billion



Source: Finnish Customs

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Russia

Cabinet adjusts this year's federal budget. The cabinet met last week to consider a 2010 supplemental budget. Federal budget revenues are on track to exceed the original budget forecast by 12 % if the world oil price holds at around $75 a barrel during the rest of the year. Nearly half of the additional earnings from higher oil prices (17 % above the original estimate) will be offset by ruble appreciation.

About 40 % of the additional revenues will be allocated to this year's budget spending, which will match last year's spending in real terms. Nearly half of the additional expenditures will be transfers to the state pension fund. For the entire 2010, federal budget spending outside pensions, social supports and transfers to social funds will shrink about 7 % in real terms from last year. Social spending, however, will increase this year to over a third of Russia's total public spending or 14 % of GDP (included in this category, pensions rise to 10-11 % of GDP).

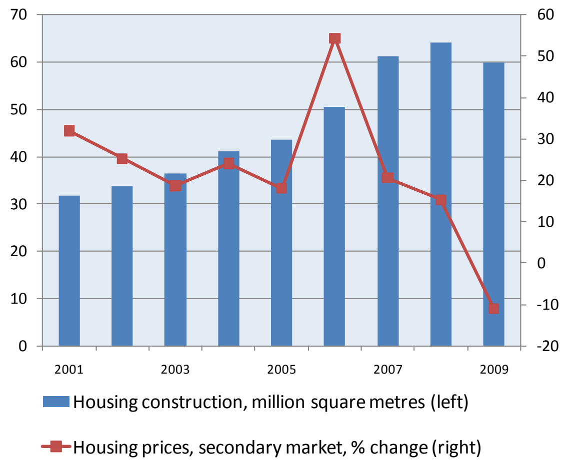
The supplemental budget estimates the federal budget deficit this year will, as recently noted by the finance ministry, come in at 5.4 % of GDP. This amount cannot be covered entirely by the state reserve fund; slightly more than 60 % of the deficit will be covered from the fund, which will then not be exhausted. Finance minister Alexei Kudrin said the cabinet no longer considered dipping into the national welfare fund to cover this year's deficit. The current plan calls for covering about a third of the deficit with domestic borrowing. In April, the government raised about 7 % of the forecast deficit through international bond issues. No further international borrowing is planned for the rest of this year.

Framework for next year's federal budget gradually takes shape. In drafting the 2011 federal budget, the finance ministry has had to go with an assumed average oil price next year of $75 a barrel. Finance minister Kudrin added that this gives ground to lower next year's deficit target from the current 4 % of GDP.

On the other hand, the government faces considerable spending pressure, which, if anything, will be heightened by the upcoming Duma elections in December 2011 and presidential election in March 2012. The latest economy ministry forecast assumes public sector wages will keep up with inflation and pensions will be raised in step with wage growth in the entire economy. Deputy finance minister Anton Siluanov also announced a substantial increase in defence spending in 2011-2013. Calculations from the Economic Expert Group, closely linked with the finance ministry, assume public spending will grow slightly faster than GDP in 2011.

Apartment construction activity is waiting to revive. Measured in square metres, apartment construction grew at an average of 8 % a year during 2000–2008. The recent recession caused a drop in housing construction, which, Rosstat reports, fell 7 % in 2009 and 8 % y-o-y in 1Q10. 2009 saw the construction of 701,300 new apartments with a total floorspace of 60 million square metres.

2001–2009 apartment construction, million m^2 (left) and housing prices, % change (right)



Source: Rosstat

Housing prices in the secondary market soared during 2001–2008, rising an average of nearly 30 % a year. Along with the economic recession they fell 11 % in 2009. In the first quarter of 2010, housing prices were up 2 % y-o-y.

The average national price for an apartment on the secondary market was 59,000 rubles per square metre (just over €1,400) in the first quarter of 2010. Moscow remained Russia's priciest housing market by far. The average price for a square metre of Moscow apartment was 165,000 rubles (€4,000). The average price for a square metre of apartment in St. Petersburg was slightly more than half of the Moscow price, 84,000 rubles (about €2,000).

Central Bank of Russia figures show considerably more housing loans have been granted this year than in recession-burdened 2009, but still significantly less than before the recession. The stock of housing loans is still slightly smaller than at the end of 2008. The average interest rate on an apartment loan has fallen this year slightly, and currently stands at about 14 % p.a.

President Dmitri Medvedev rolled out his new housing construction programme in 2008. Medvedev said that nearly four-fifths of Russians live in apartment buildings, many of which were built during the Soviet era. According to Medvedev it was particularly important to increase construction of detached houses suitable for families to strengthen Russia's middle class.

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China

China looks at business opportunities in Greece. Chinese vice premier Zhang Dejiang led a delegation of Chinese business leaders to Athens this week. Zhang said his government encourages Chinese firms to seek out opportunities in Greece. While some 11 cooperation agreements were signed in the presence of Zhang and Greek deputy prime minister Theodoros Pangalos, details are sketchy.

Reports suggest the main deals involved supplying Chinese goods or services to the Greek market. Greek shipping lines announced that they will buy eleven bulk cargo carriers from Cosco, a Chinese conglomerate involved in shipbuilding and maritime transport. The ships will be built in China. Cosco will also lease several cargo ships to Greek shipping lines. Cosco last year launched cargo handling operations under a 35-year agreement in the Athenian port of Piraeus. In addition, China's BCEGI construction company was tapped to convert a Pireaeus tower block into a luxury hotel and mall.

The Chinese, in turn, committed to buy Greek olive oil. Greece is one of the world's largest producers of olive oil, and consumption of vegetable oils has grown strongly in China in recent years.

Consumer price inflation accelerated in May. The National Bureau of Statistics reports consumer prices in May were up 3.1 % y-o-y, a slight pick-up from 2.8 % in April. Upward pressure to consumer prices is brought in part by the rapid rise of producer prices, which were up in May 7.1 % y-o-y, the highest rate seen since the start of the global financial crisis. Producer prices have been driven by global commodity prices, which are up from a year ago.

Rising labour costs are also putting upward pressure on consumer and producer prices. Minimum wage levels set by provinces and cities have been hiked widely about 10 %. Recently, high-profile firms have made large wage concessions as workers have demonstrated or went on strike because of low pay levels. The concessions could fuel demands for wage hikes at other firms.

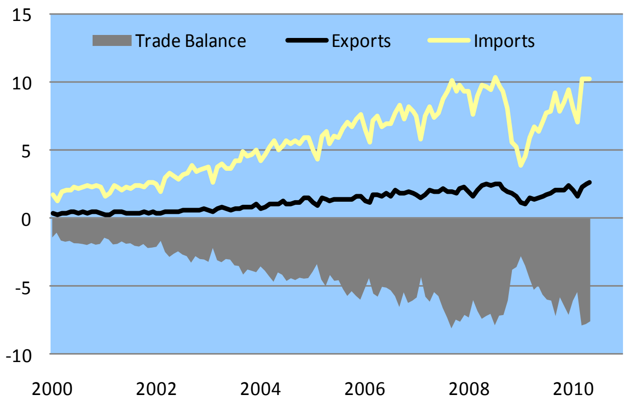
The massive liquidity boost from the government's stimulus package is also contributing to widespread upward pressure on prices in China. Of the asset prices, housing prices started to soar already last year. As there is a long lag in the effect of money supply growth on consumer prices, China's rapid M2 expansion during the stimulus should assure the pressure on prices continues. It looks almost certain that consumer price inflation will exceed the government's 3 % target this year. The speed-up in inflation has pushed real interest paid on Chinese bank deposits into negative territory which increases pressure on the government to raise interest rates.

Mainland China and Taiwan set to lower bilateral tariffs and eliminate other barriers to trade. China and Taiwan are finishing up work on an Economic Cooperation Framework Agreement (ECFA). Under the ECFA, China commits to lower customs tariffs or elimination of other barriers to trade involving about 500 products and services from Taiwan. China's tariff cuts apply to e.g. car parts, petrochemicals, machinery and textiles, which together account for about 15 % of Taiwan's exports to China. Access to the service sector will increase in e.g. the banking sector, scheduled flights between the two countries and IT services. Taiwan will also get the possibility to establish Taiwan-owned hospitals in certain provinces in China. In response, Taiwan will lower tariffs on about 200 products from mainland China including textiles, petrochemicals and machinery. Taiwan's president Ma Ying-jeou hopes that China will not demand Taiwan throw open its markets to Chinese farm produce or Chinese labour. The ECFA should be signed by early July and would enter into force on January 1, 2011.

Taiwan hopes the ECFA will give it the possibility to establish free trade agreements with other countries. Taiwan has traditionally been ineligible for free trade agreements as most countries do not recognise Taiwan as an independent nation. The tariff cuts will also improve Taiwan's competitiveness relative to countries that already enjoy free trade agreements with China, and could encourage companies based in Europe, the United States and Japan to use Taiwan as a route to markets in mainland China.

Export-dependent Taiwan already began to recover from the global financial crisis in spring 2009 with revival in its exports to China. About 27 % of Taiwan's exports last year went to mainland China, Taiwan's main trading partner. Some 14 % of Taiwan's imports came from China. About 9 % of mainland China's imports came from Taiwan and 2 % of China's exports went to Taiwan.

China's trade with Taiwan, monthly, US$ billion



Source: China Customs

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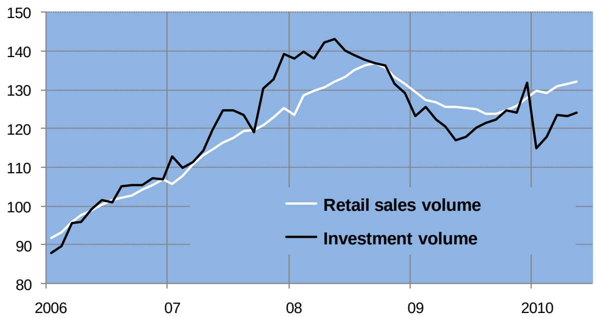
Russia

Recovery of domestic demand reasonable in late spring, strong rise in imports. The volume of retail sales and fixed capital investment rose more slowly in seasonally adjusted terms in April and May than in any month since the recovery of last autumn. Nevertheless, the rate of retail sales growth was still not very much below 0.5 % m-o-m. If the volume of retail sales, a good indicator of private consumption, grows at this rate to the end of the year, annual growth would reach over 5 %. For investment growth, the respective annual outcome would be a couple of per cent.

The recovery in consumption has been propped up by wage growth this year to the effect that real wages were up 6-7 % y-o-y in April and May. Large pension hikes in December and January were followed with another increase in April. Employment also increased this spring more quickly than the usual seasonal rise. Constraining consumption growth, on the other hand, household bank deposits continued to show much stronger growth this spring than the slight uptick in bank lending to households.

The recovery of demand in Russia has translated into a renewed appetite for imports, reminiscent of the pre-recession years. The value of imports in April and May was about 40 % larger than the nadir reached a year earlier and about 10 % below the pre-crisis levels of April and May 2008.

Seasonally adjusted retail sales and capital investment volumes, index (2006 = 100)



Sources: Rosstat and BOFIT

Gazprom cuts gas deliveries to Belarus by 60 %. Russia's state controlled gas giant Gazprom last week gave Belarus a five-day deadline to pay up on its late gas bills. On Monday (June 21), Gazprom started to carry out its gas cut-off threat by reducing gas transmissions to Belarus by 15 %. On Tuesday, the reduction of gas supplies was increased to 30 %, and on Wednesday to 60 %. Gazprom CEO Alexei Miller said that the cut could be deepened as far as 85 %. Russia claims Belarus is in arrears in its gas bills by $192 million. Belarus says it owes $187 million.

Belarus has been paying last year's rate for gas − $150 per thousand cubic metres, ignoring the fact that the price of gas is set by contract with Gazprom. Under the latest contract, the price of gas in the first quarter of 2010 was $169/1,000 m^3 and $184/1,000 m^3 for the second quarter of 2010. Belarus is still benefiting; the average export price of Russian gas in 4Q09 was $238/1,000 m^3.

At their meeting on Tuesday, Belarus president Alexander Lukashenko conceded to Russia's foreign minister Sergei Lavrov that his country was in arrears on its debts and asked for a postponement in the payment schedule. Among the reasons for the delay, Lukashenko explained that his country's economy had suffered from the global financial crisis. The Belarus president then went on to point out that Gazprom also owes Belarus $260 million in oil pipeline transit fees and that if the money was not forthcoming Belarus would cut gas transmissions from Russia to western Europe. Gazprom's representative conceded that the company owed Belarus the transmission fees, but said the company's payment delay was due to Belarus' own behaviour.

Gazprom is the largest single gas seller in the EU, accounting for approximately 40 % of gas imports to the EU area and providing nearly 25 % of all gas consumed in the EU. Russia's main gas transmission pipelines to western Europe run through Ukraine and Belarus. About 80 % of the gas travelling from Russia to western Europe goes via Ukraine, while by far most of the rest goes via Belarus.

Russia has given assurances to its customers in western Europe that there is still available capacity in the gas pipelines that run through Ukraine, so there is no imminent threat to gas transmissions even if the volume of gas piped via Belarus diminished for a while. Even so, Lithuania noted the cut was already felt in the country's gas imports.

Further whittling down of strategic firm list. Last Friday (June 18), president Dmitri Medvedev signed a decree reducing the number of state stock companies designated as strategic from 208 to 41, as well as the number of listed unincorporated state enterprises (sc. unitary state enterprises) from 230 to 159. On the same day, he announced the decree at the St. Petersburg International Economic Forum, reflecting the issue that the change makes it possible to decide on privatisation of the companies removed from the list.In 2004, the list of companies considered strategic included more than 500 state-owned enterprises and over 500 unincorporated state enterprises. For their part, sectors designated as strategic still include energy, defence and media. The law on strategic sectors entered into force in 2008 (see BOFIT Weekly 13/2008). The law restricts foreign investor activity in the specified sectors.

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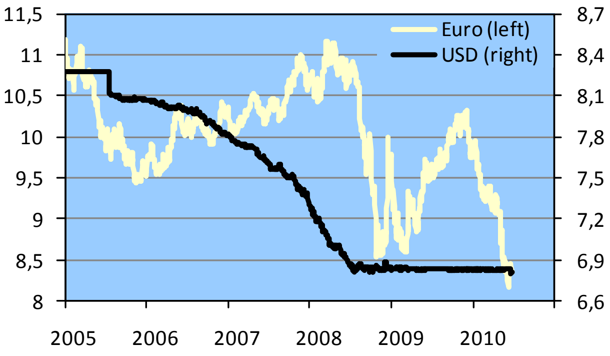
China

China returns to a more flexible exchange rate regime. The People's Bank of China announced last Saturday (June 19) that it was increasing the flexibility in the yuan exchange rate. The new exchange rate policy basically reinstates the regime in force from July 2005 to July 2008, during which the yuan appreciated 21 % against the US dollar. When the signs of the global finance crisis began to emerge in summer 2008, China instituted a hard peg of yuan to the dollar. During that time, China's monetary authorities repeatedly emphasised the measure was temporary. When markets opened on Monday (June 21), the yuan's exchange rate strengthened slightly, but weakened a bit on Tuesday. During the two-year peg, the official exchange rate was set at 6.83 yuan to the dollar. On Wednesday, (June 23) one dollar bought 6.81 yuan.

Euro-yuan, dollar-yuan exchange rates



Source: Reuters

Current prices for nondeliverable yuan futures suggest the yuan's exchange rate will strengthen 2–3 % over the next twelve months. While most studies on the yuan's exchange rate in recent years have found the yuan undervalued, there is a huge disagreement among experts as to just how much (see BOFIT Focus/Opinion 4/2010). While the current focus is on the strengthening, the PBoC points out that the yuan exchange rate could also weaken, which could e.g. staunch inflows of speculative capital to China and familiarise Chinese firms with two way currency movements and risks.

The shift in the exchange rate regime was not unexpected as strong demand for Chinese exports has returned and inflation in China is accelerating. Yuan strengthening would reduce inflationary pressures as the yuan price of imported goods should fall. On the other hand, a stronger yuan will erode price competitiveness of Chinese exports. This effect will be offset somewhat in production sectors that import components from abroad as such components will become relatively cheaper. Moreover, most foreign firms operating in China primarily serve China's domestic market and thereby benefit from cheaper imported inputs.

The last of China's big state owned banks takes the IPO plunge. One of China's largest banks, state-owned Agricultural Bank of China (ABC) will make its stock market listing debut in mid-July with an initial public offering of 15 % of its shares on the Hong Kong and Shanghai stock exchanges. ABC expects to raise US$23 billion in new capital from the IPO. China's three other large state banks held their IPOs and initial listings in 2005 and 2006.

The timing of IPO is problematic. Only two months ago, ABC still hoped to raise about $30 billion. Since then, Chinese share prices have shed about a fifth of their value. Moreover, ABC is the least profitable of China's big banks and its loan stock has probably more non-performing loans than the other three large banks despite a massive bailout a couple of years ago in which the government pumped in tens of billions of dollars to bolster the bank's balance sheet.

Even with its problems, investors may not be able to resist the attraction of the ABC's 320-million strong customer base, its network of nearly 24,000 branch offices and undisputable growth potential. ABC has signed several cooperation agreements with international banks and the preliminary subscriber list includes sovereign wealth funds of Middle Eastern oil-producing countries. The ABC listing should be the world's largest IPO ever.

China continues car industry subsidies. At the beginning of June, China announced a decision to continue with part of its stimulus measures of last summer by extending a car industry support package, scheduled to end in May, to the end of this year. The measure is designed to promote environmentally friendly car production and car sales, as well as reduce urban air pollution.

The subsidy to car buyers that exchange their old car for a new one is increased from 6,000 yuan (€700) to a maximum of 18,000 yuan (€2,000) per car purchased. In addition, the state will grant buyers of cars with small-volume engines (less than 1.6 litres) a subsidy of 3,000 yuan and a tax deduction that lowers the standard 10 % consumption tax to 7.5 %. In five Chinese cities (Shanghai, Changchun, Shenzhen, Hangzhou and Hefei), buyers of electric cars will get a 60,000 yuan (€7,000) support and buyers of hybrid cars a 50,000 yuan (€6,000) support per car purchased. The state supports will be paid to carmakers, who will correspondingly reduce prices for their electrical models. Support to car buyers will be reduced after the carmaker has sold 50,000 electric or hybrid cars.

Although manufacturing and sales volumes of passenger cars have fallen off recently, car sales were still up 56 % y-o-y for the January-May period.

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Russia

In search of solutions to rising pension costs. Recent years have seen a sharp increase in federal budget spending to cover Pension Fund shortfalls. Nearly half of the expected 2.4-trillion-ruble (€63 billion) federal budget deficit this year will go to supporting the Pension Fund.

As the pension funding problem looms large, the delicate question of raising the retirement age has finally been touched upon in public discussion. Russians still enjoy a Soviet-era legacy that allows women to retire at 55 and men at 60. Indeed, the actual average retirement age for men today is only 54 and 52 for women. This is due to the fact that 30 % of retirees come from professions with lower retirement ages such as mine workers, lumberjacks, paramedics and pilots.

At last month's international financial forum in St. Petersburg, finance minister Alexei Kudrin said that the general retirement age would have to be raised in coming years. The increase could be phased in gradually over 5–10 years. With the approach of the 2011 Duma elections and the 2012 presidential election, however, observers are largely in agreement that the difficult decisions will be postponed for a couple years. Health and social affairs minister Tatyana Golikova said last week that it looks likely that there would be no change in the retirement age before 2015. Golikova noted that it could be difficult for the population to understand the fairness of a hike in the retirement age when the life expectancy of a Russian man is still only about 60 years. No official proposals on the new retirement age have been put forward.

There are currently about 38 million pensioners in Russia. Of them, about a quarter (10 million persons) continue to work after retirement. Despite recent substantial hikes in pensions, Russian pensions are still paltry. The average monthly retirement pension in April was just 7,600 rubles (€200), less than half of the average wage of 20,400 rubles (€530). Working during retirement years has no impact on eligibility for receiving pension payments.

Since 2005, the Pension Fund has seen growing deficits. For the past couple years, the drain on the Pension Fund has been driven by large hikes in pensions as economic policy is focusing on social issues. The real on-year hike in pensions was 18 % in 2008 and 11 % in 2009. Pension hikes have continued this year and in the first quarter pensions were up 22 % q-o-q in real terms as the oldest pensioners received a major increase in their pensions at the start of the year.

The Pension Fund deficit was financed out the federal budget to the tune of 540 billion rubles in 2008 and 990 billion rubles in 2009. This year, deficit funding from the budget is expected to hit 1.15 trillion rubles (€30 billion). Next January, the employer pension contribution will rise six percentage points to 26 % of the total wage bill, which should defuse the Pension Fund issue somewhat.

Russia's pension system was fundamentally overhauled in 2002. The change abandoned the traditional pay-as-you-go system funded by employers for a three-pillar multi-source scheme. A worker's pension is now formed by three elements: the first pillar comprises the insurance part and the second pillar the funded part of the pension, both financed via employers' pension contributions. The worker can designate whether the insurance element will go to a state-managed or privately managed pension fund. Finally, the third pillar is a non-state voluntary contribution by the worker. The reform is regarded as a failure, partly due to its ongoing underfunding as the employer pension contribution was lowered substantially in 2005.

Problems have also arisen with the second pillar that allows the worker to elect between a state-operated or privately operated pension fund. Measured in real terms, the cumulative value of fund contributions of workers has been constantly falling as the average return on invested contributions has remained significantly lower than inflation. The cabinet is currently considering changes to the pension system, and should decide on them next year.

International Monetary Fund expects fiscal restraint from Russia. In its annual statement on the Russian economy released on Monday (June 28), the IMF credited Russia's leaders for their rapid stimulus response to the global financial crisis, noting that the measures were made possible thanks to the government's prudent fiscal policies in previous years. By setting aside revenues from oil earnings in the Reserve Fund, the Russian government was able to implement a sizeable stimulus package without resorting to borrowing.

The IMF did raise serious concerns about budget trends, however. The IMF noted soaring increases in public spending in 2007–2009 (first in anticipation of the Duma and presidential elections, then in response to the global financial crisis), and is worried that these new spending commitments won't be squeezed even as the recovery progresses. This trend to greater spending could be seen e.g. in this year's supplemental budget approved by the cabinet a couple weeks ago. The IMF said that if the government is serious about its goal of balancing state finances by 2015, budget cutting should have started this year.

One big problem is that much of the additional spending, like pension hikes and public sector wage increases, is permanent. As a result, the IMF sees it necessary for Russia to cut costs by increasing public sector efficiency. The IMF has said for years that Russia can achieve huge savings by moving ahead with structural reforms, especially in healthcare and social services. The IMF also encouraged Russia to raise the retirement age.

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China

Wage disputes and strikes dog Japanese firms operating in China. After strikes at carmaker Honda a month ago, Toyota and Nissan plants also experienced production shutdowns due to strikes at subcontractor facilities in late June. Honda agreed a month ago to a 24 % pay raise for workers at its parts supplier. About the same time, Taiwanese electronics manufacturer Foxconn, heavily criticized for poor working conditions in its plants in mainland China, announced a 30 % pay hike. (see BOFIT Weekly 22/2010).

The wage component is typically quite small relative to the final cost of a product for a foreign producer operating in China. As a result, firms targeted for strikes mainly suffer lost earnings from production interruptions. Large wage hikes as such do not constitute an immediate threat to the plans of foreign manufacturers in China, as higher wages can still be readily offset by increases in productivity. The disputes between Japanese carmakers and their Chinese work forces have already convinced some Japanese companies in other fields to place the management of their China operations in Chinese hands.

The upward pressure on wages has been driven in part by acceleration in inflation and rising housing prices. The labour market in China's coastal cities has tightened as higher wages and new employment opportunities in China's interior have reduced the stream of migrant labour to the industrialised east coast.

China's demographics play an important role in labour market dynamics. China's one-child policy and its aging population have already capped the size of the labour pool. As a result, competition for workers will increase in coming years. The tighter labour supply is noticeable in the under-30 age group. Work stoppages over labour conditions are not exceptional in China, and the latest labour unrest is hardly the last, even if the local press has restricted coverage of recent actions to prevent its spread.

National audit office concerned about burgeoning debts of local administrations. In its annual audit of China's governmental finances released last week, China's National Audit Office (NAO) expressed concerns about the rapid build-up of debt by local administrations. The NAO audited the financial statements of 18 provincial governments, 16 city governments and 36 regional district administrations. While the audit covered more than half of China's provinces, it only covered a tiny fraction of cities and district administrations. The audit report found that the debts of local administrations last year totalled some 2.8 trillion yuan (€290 billion or 8.3 % of GDP), just over a third of which was taken on last year. The debts of nearly half of the audited local administrations exceeded their total annual revenues.

Under Chinese law, local administrations are required to have balanced budgets, although a small exception was made last year. However, local administrations are under huge pressures and also have large incentives to maintain high economic growth. This has led to the wide-spread violation or circumvention of budget rules by e.g. establishing off-budget enterprises. A study by China's banking supervision authorities found that banks had granted loans to off-budget firms in the amount of 7.4 trillion yuan (€750 billion or 22 % of GDP) at the end of 2009.

In addition, NAO auditors found questionable entries and irregularities in the accounts of nearly all ministries and large national projects. They noted billions of yuan in public funds had vanished or were misallocated. Moreover, accounting practices did not always comply with official guidelines.

Unfair treatment of foreign firms starts to worry European companies operating in China. At the end of June, the European Union Chamber of Commerce in China (EUCCC) published its annual survey of member companies operating in China. Over 500 of the approximately 1,500 EUCCC members responded to the survey. The survey found that responding members expect strong economic growth to continue in China and see their China operations as an increasingly important part of their business strategy. About a third of respondents reported that China is currently their main investment focus, while 68 % of respondents ranked China among the top three countries for their investment focus by mid-decade. About a quarter of firms said they maintained R&D centres in the mainland. However, such R&D centres exist largely only to localise existing products for the Chinese market.

European companies expect increasing competition on the Chinese market, so profit growth should lag market growth. Companies still consider their competitive strengths relative to Chinese firms to be quality, innovation, industrial design, technology, organisation and management of production processes. However, their leads in these spheres have narrowed in recent years. One indication of how things are changing is the increased number of Chinese managers in top positions in firms owned by European companies.

The outlook for European firms in China is clouded by increased regulation of foreign firms by officials that has added uncertainty to the operating environment. About 60 % of firms expect the situation to get worse or remain the same. Only 10 % saw conditions improving over the next couple of years. Although problems stemming from official intermeddling vary from branch to branch, the biggest complaints of European companies remain the same from year to year: the shifting interpretations of the law and regulations, difficulties with registration, the lack of intellectual property protection, complicated visa and work permit practices, and the implementation of national standards at the local level.

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Russia

Russia-Belarus-Kazakhstan customs union now operational. The tri-nation customs union established at the start of this year, began operations on July 6 after the member countries ratified a customs code setting out the union's principles. It was touch-and-go to the last minute as to whether Belarus would ratify the code as it continued to dispute Russia's terms for the customs union. Indeed, even after signing, Belarus continues to dispute Russia's insistence on collecting export tariffs on crude oil it delivers to Belarussian refineries. Belarus most probably will pursue its demand for a rule change even as the union gets underway.

The customs union details are fuzzy as preparations are still in progress and many national regulations defining customs procedures are missing. For example, Russia's new customs regulations act, which will add needed detail to the customs union's customs code, is still under Duma consideration. Meanwhile, old customs rules remain partly in force. With the situation up in the air, companies involved in foreign trade may again encounter problems as it is difficult to know what regulations apply in a particular instance.

In early July, the member countries adopted common import duties that had been negotiated over the past six months. The customs codes of Belarus and Kazakhstan have been more liberal and the countries have generally had lower import tariffs than Russia. The common external duties of the customs union are mainly based on Russian duty rates, and as a result, Belarus and Kazakhstan faced hikes in many of their customs tariffs. Some of the hikes will enter into force only after a transition period, during which Belarus and Kazakhstan will keep their lower import duties on e.g. passenger cars. If low-tariff goods are brought into Russia, the tariff difference must be paid at the Russian border.

In principle, border inspections shifted from the common borders between Russia and Belarus to their outer borders last week. Inspections at the Russia-Kazakhstan border will shift to Kazakhstan's outer border on July 1, 2011, as the control of Kazakhstan's outer borders has still to be strengthened. However, customs union members will continue to conduct border inspection between their countries as long as national duties on certain products remain lower than common customs union duties.

Contrary to a custom union's general principles, in the Russia-Belarus-Kazakhstan union goods imported to the customs union can be declared for customs clearance only in the domicile country of the importing firm. The regulation will be in force for an unknown period.

From July, private individuals may bring in customs-free goods worth €1,500 and weighing up to 50 kilograms. Before the change, Russia allowed duty-free imports worth up 65,000 rubles (nearly €1,700 at the current exchange rate) and weighing up to 35 kilos. Kazakhstan, in particular, pushed for laxer regulations.

Since July 1, the parties divide the import duty take in the following shares: 88 % to Russia, 4.7 % to Belarus and 7.3 % to Kazakhstan.

The next step in regional integration will be the inauguration of the Russia-Belarus-Kazakhstan common economic space, currently set for 2012.

Innovation city legislation moves ahead. At the beginning of July**,** the Duma approved the first reading of bills to establish Skolkovo near Moscow as an "innovation city." The idea of establishing a science city dedicated to research and commercialisation of high technology emerged early this year in presidential administration as one of the means to diversify the Russian economy and reduce dependence on natural resource industries.

Skolkovo is to bring together public and private R&D efforts as well as foreign expertise. The city will pursue five research themes: energy efficiency, nuclear technology, space technology, medical science, and "strategic" IT technology and software. It is hoped the tech town will attract top researchers and innovative companies from around Russia and the world. To house the research talent and their families, a full-service community with first-class housing and research facilities for 25,000–30,000 people will be built. The first phase of construction should be finished in 2012.

The benefits for a company to operate in Skolkovo stem largely from the fact that the city is to be much business friendlier than Russia in general. The city will be administered by a non-profit organisation with certain local and state administrative authority. Immigration, tax and customs authorities as well as police will have special branches in the city with greater flexibility to operate than regular authorities. Firms establishing in the area will also enjoy major tax breaks.

Construction costs over the next two years are currently put at 50–60 billion rubles (€1.3–1.5 billion), but also higher sums have been mentioned. Construction is funded from the federal budget. Other investment may come from private sources.

Many experts have criticised the Skolkovo project for its lack of specifics. Construction of an expensive science city will be carried out without any assurances that the hoped R&D will ever occur. Furthermore, the granting of numerous administrative exemptions to one town highlights how poor Russia's business environment is in general.

The Duma will hold its second, and decisive, vote on legislation on the innovation city this autumn. The legislative package, submitted on a presidential initiative, is expected to pass easily.

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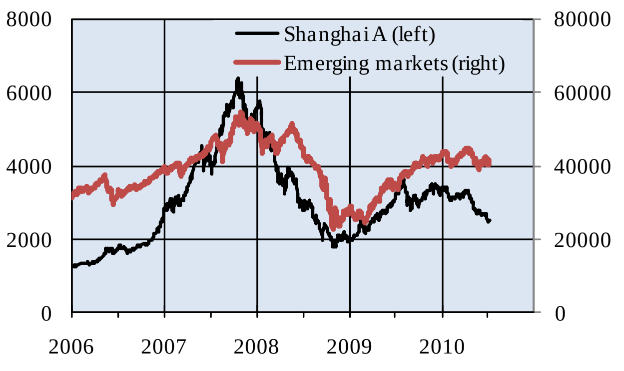
China

Slide on Chinese stock markets continues; PMI suggests slowdown in growth. Share prices on China's main Shanghai stock exchange have been caught in a downward spiral over the past two months. The Shanghai A-share index has shed about 18 % of its value since end-April, and is down nearly 30 % from its peak in November 2009. Among the factors mentioned for contributing to the drop are the sovereign debt crisis, a pick-up in China's inflation rate and tighter rules governing real estate markets. Measured in terms of market capitalisation, the share of market-tradable shares relative to all shares rose by 9 % since the start of the year, slowing the general rise in share prices. The price-to-earnings (P/E) ratio of companies traded on the Shanghai stock exchange has declined to around 18. In comparison, the average P/E ratio of companies in the Shenzhen stock exchange's A-share index is 31, and about 15 for companies traded on the Hong Kong stock exchange.

May and June also saw declines in the purchasing managers' index (PMI), an indicator of industrial sentiment. The fall suggests slowing economic growth. The June index value slipped to 52.1 points, a drop of 1.8 percentage points from the previous month. Nevertheless, the index remains above the critical 50-point level, which suggests the outlook for industrial producers is still improving, even if growth is lower than in previous months. The stock of finished goods was the only one of the 11 sub-indices to rise in June from the previous month. The sub-indices for new orders and new export orders declined, implying a softening in both domestic and international demand.

Shanghai A-share index and MSCI emerging markets index



Sources: Bloomberg and Morgan Stanley

China's regulators warn on risks to banking sector; informal banking has a large role. The China Banking Regulatory Commission (CBRC) is concerned about loans to companies established by local governments and lending to the real estate sector. Local governments have established off-budget companies that then borrowed money from commercial banks to finance projects to support local economic growth (see BOFIT Weekly 26/2010). China's officials have now responded by issuing banks direct orders to limit their lending to such firms after their loan stock increased over 70 % last year. The biggest headaches come from local projects that fail to generate sufficient income to pay off the loans and instead need additional public-sector financing.

The rapid growth in lending has been reflected in the ratio of bank loans to deposits (loan-to-deposit ratio). In many large banks, the ratio now exceeds the official ceiling of 75 %. The on-year growth in the loan stock has slowed sharply since March relative to last year's record growth. However, the stock of yuan-denominated loans in May was still 22 % higher than a year earlier. The value of new yuan-denominated loans issued in January-May totalled 4,013 billion yuan (€471 billion).

A huge informal banking sector operates side by side with the official banking sector in China. Informal bankers tend to specialise in short-term lending to small borrowers. Some estimates put the total loan stock of the informal banking sector at about 20 % of the size of the loan stock of China's official banking sector. The bulk of lending by state-owned banks goes to large firms, so despite far higher interest charges on their loans, small borrowers use informal banks for part of their financing. The higher interest rates also attract deposits. Informal financial institutions affect both macroeconomic and stabilisation policies as limiting access to credit in the official sphere may drive borrowers to the informal sector, which is harder for officials to regulate or monitor.

China's communist party membership approached 78 million last year. Membership in the world's largest political party, the Communist Party of China, now nearly matches the population of Germany. Party membership, which held fairly steady from the early 1980s until 2008, increased to 6 % of the population last year.

Out of the over 20 million Chinese seeking party membership last year, about 2 million were approved. Party membership criteria require the applicant to be over 18-years-old, accept the party rules and actively participate in the party organisation. In 2009, 24 % of the party membership was younger than 35 and 36 % had earned university degrees.

Membership in the communist party offers extensive networking opportunities with China's leadership class. In addition to career advancement, party members enjoy enhanced healthcare and retirement benefits.

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Russia

Russia posts current account and capital account surpluses in the first half of 2010. Preliminary balance-of-payments figures from the Central Bank of Russia show the current account surplus in the first half of the year reached $50 billion, or nearly three times the surplus of 1H09. Nevertheless, the current account surplus fell in the second quarter from the first quarter as import growth revived.

The value of goods exports in the first half of 2010 reached $188 billion and good imports $104 billion. Exports rose 51 % y-o-y in nominal terms and imports 26 % y-o-y. The growth in exports was mainly driven by higher oil prices. In 1H09 the average price of Urals grade crude was $51 a barrel, well below the $76 a barrel of 1H10.

The services trade deficit was $9 billion in the first half. Export of services climbed 11 % in nominal terms and imports of services were up 13 % y-o-y.

The capital account, which has mostly been in the red since 2008, was back in surplus in the second quarter of 2010, raising the first half surplus overall to $4 billion. The rebound in the capital account has been driven by a drop in capital exports by banks. Russian banks actively paid down their foreign loans last year, which was reflected in the capital account balance. In contrast, banking sector capital exports were just $2 billion in 1H10, down from $28 billion in 1H09 and $43 billion for all of 2009. Also government bond issues in April reinforced the capital account to the tune of $3.4 billion in the first half of the year.

There was a sharp improvement in foreign investment inflows to Russian companies in the second quarter. Total FDI inflows for the first half amounted to $19 billion. Investment growth can be seen to reflect growing investor confidence for the Russian market.

Russia's foreign currency reserves grew by $43 billion in the first half, and stood at $461 billion on July 1.

Key Russian balance-of-payments figures, US$ billion

	January-June 2010	January-June 2009	2009	2008
Current account	50	18	50	104
Trade balance	84	43	111	180
Capital account	4	-30	-45	-131

Source: Central Bank of Russia

Russia's financial markets yo-yo in first half. Although the lending of Russian commercial banks contracted between March 2009 and March 2010, lending revived a bit in recent months. CBR chairman Sergei Ignatiev reports that the loan stock grew 3−4 % in the second quarter of 2010. The stock of bank lending to companies stood at 12.77 trillion rubles (€338 billion) at the start of June, up slightly from January 2009. The stock of loans to households, which stood at 3.6 trillion rubles (€95 billion) at the start of June, was still about 10 % smaller than at the beginning of last year.

With the contraction in bank lending, bond issues have become an important source of financing for many of Russia's large enterprises. The stock of ruble-denominated bonds on issue grew modestly in the first half of 2010. Growth was clearly slower than last year, when the amount of corporate bonds on issue increased by more than 40 %. Demand for bonds denominated in major international currencies (eurobonds) also increased slightly in the early summer. At the end of June, both Sberbank and VEB successfully placed a total of $1 billion in eurobonds.

Russia's main stock market indices (the RTS and MICEX) tend to track the rise and fall of world oil prices quite closely − and the stock index performance in 1H10 has been no exception. At the start of July, the stock exchange indices and the market capitalisation of exchange-traded companies dipped along with the price of crude oil to a level lower than at the start of the year. Compared to the lows of first half of 2009, however, the share indices are still more than 150 % higher.

Russia on schedule in deregulation of its electricity markets. Since the start of July, just 20 % of the electricity sold on wholesale electricity markets in Russia remains subject to regulated rates. In January 2011, pricing on the wholesale market is to be fully deregulated. On the other hand, household electricity rates will continue to be regulated until 2014 at the earliest. The pricing for electrical power transmission is to move from regulated rates towards market-based pricing in January 2011. Electricity rates were supposed to be hiked about 30 % this year, but the government decided to impose a 15 % ceiling on electricity rate hikes as part of its economic stimulus measures. The eventual size of rate hikes this year still remains unclear.

The shift to market-based pricing is part of Russia's ongoing reform of the electrical power sector. Russia has largely succeeding in keeping to its reform timetable in the electricity sector, even in the midst of the financial downturn. The reform of the electrical power sector is exceptionally wide-ranging. The goal is to privatise production and deregulate pricing to attract new investment on a large scale to the electrical power production and distribution sector.

Most electrical power producers were sold to investors at privatisation auctions in 2007–2008. The state retains majority stakes e.g. in national power transmission companies and the national grid system operator.

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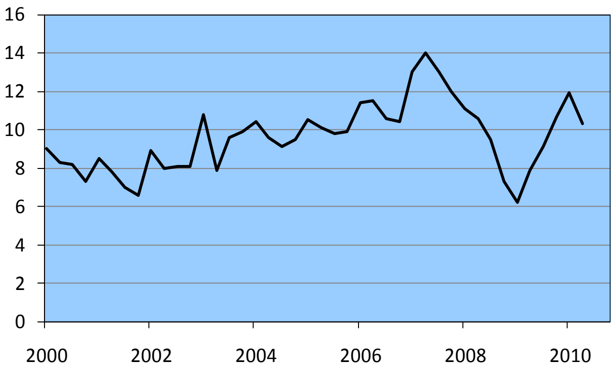
China

Modest slowdown in Chinese economic growth. The National Bureau of Statistics reports China's GDP increased 11.1 % y-o-y in the first half of this year. Growth in the first quarter was 11.9 %. Growth in the second quarter was about 10 % y-o-y. The decline in growth rates from exceptionally high to more sustainable levels was expected and reflects the efforts of Chinese officials to reduce lending, especially to the real estate sector and for new public investment projects. Growth in both the loan stock and money supply slowed in the second quarter.

Industrial output was up nearly 18 % y-o-y in real terms in the first half. Even so, slowdown in growth was apparent especially in June when industrial output was up less than 14 % y-o-y. Domestic demand is supported by steady growth in retail sales, which climbed over 18 % y-o-y in nominal terms in both June and the first half of 2010.

Real GDP growth by quarter, % y-o-y



Sources: China National Bureau of Statistics and BOFIT

Chinese consumer price inflation for June was running at 2.9 % y-o-y, a slight drop from May's 3.1 % reading. The rise in producer prices also slowed to 6.4 % y-o-y in June. The rapid lending growth last year and the first months of this year significantly increased liquidity in the economy, but lower economic growth should ease inflationary pressures, especially if growth slows further in the second half of this year.

The value of Chinese exports was up nearly 44 % y-o-y in June, while the value of imports climbed nearly 35 %. Demand for Chinese exports was strong in both developing and developed markets. Chinese exports to the United States have already exceeded the record set in September 2008, while exports to the EU have recovered to a level close to that of summer 2008. At the same time, China's total imports are already higher than in summer 2008. The trade surplus grew slightly from May to $20 billion in June. China's foreign exchange reserves stood at $2,454 billion as of end-June. The lower growth in foreign reserves (up $7 billion in the second quarter) reflected China's smaller trade surpluses and probably also changes in exchange rates.

China and Latin America continue to increase cooperation. China penned loans-for-oil agreements with Venezuela and Brazil this spring. Brazil's state oil company Petrobras has offered a decade of oil supplies to the Chinese state oil company Sinopec in exchange for a $10 billion loan from the China Development Bank (CDB). The Brazilian supplies will represent about 10 % of Sinopec's annual imports. CDB will also lend $20 billion to Venezuela, Latin America's largest oil producer and China's fourth largest oil supplier. China-Venezuela cooperation has been on the increase in recent years as evidenced e.g. by the recent launch of a China-built satellite in Venezuela and sales of Chinese military aircraft and arms to Venezuela.

Before this year, China had a free trade agreement with only one Latin American country, Chile. March saw the inauguration of a China-Peru free trade agreement. Under the new agreement, duties were eliminated on 90 % of Peruvian export goods and 62 % of Chinese goods. Products that remain subject to customs duties are those that are critical to employment in Peru such as textiles, footwear and metal-working machinery. These categories account for about 10 % of China's exports to Peru. China, in turn, wanted to exclude from the agreement wood and paper products, as well as certain agricultural products.

This spring, China-Argentina relations were clouded by Argentine dumping allegations. The situation culminated in April, when China responded with a ban on the import of soybean oil from Argentina. China is the world's largest consumer of vegetable oils, and imports most of its soybean oil from Argentina and Brazil. During the import ban China encouraged companies to find alternative soybean sources e.g. in the United States. Argentina last year accounted for 77 % of all of China's soybean oil imports. This week the leaders of China and Argentina met in Beijing to sign $10 billion deals that include projects related to fishing, energy and railways. However, no solution was found to lift the soybean oil import ban.

Latin America took about 5 % of China's exports last year. Of that, about 25 % went to Brazil. Imports from Latin America accounted for 6 % of China's total imports. Of that, Brazil accounted for 35 % and the next four countries combined (Argentina, Chile, Peru and Venezuela) accounted for the next 35 %. China's exports to Latin America this year in January-May averaged 70 % more than a year earlier, although last year's level was low due to the financial crisis.

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Russia

Russian economy shows moderate recovery. Preliminary figures released by the economy ministry show GDP overall rose more than 4 % in the first half compared to 1H09, when the recession was at its nadir. Even so, GDP was 6−7 % below its 1H08 level preceding the global recession.

The production level of manufacturing industries has partly recovered from last year's deep slump. Energy production exceeded the level of 1H08, largely due to crude oil production. Rosstat reports the overall rise in industrial output, adjusted for differences in the number of workdays and seasonal fluctuations, was 4 % for the first six months of this year. That translates to an annual growth rate of more than 8 %. On the other hand in June, output in manufacturing industries and industrial output generally contracted, defying expectations.

Growth finally returned to the recession-battered construction sector in the second quarter. Output growth slowed in agriculture, which is now burdened by an unusual dry spell.

Retail sales volumes, a good indicator of trends in private consumption, recovered in the second quarter to the same level as 2Q08. Seasonally adjusted, retail sales continued to rise in June at nearly the same rate as in April and May. The volume of food sales in the second quarter was up 5 % from both 2Q09 and 2Q08. Sales of non-food goods were also up 5 % from 2Q09, but down 5 % compared to 2Q08. Fixed capital investment continued to recover in June, raising second quarter growth to about 5 % from 2Q09.

Growth in domestic production has been limited by growth in imports, which according to preliminary figures surged in the late spring. Following large export growth figures in the first quarter that were driven mostly by higher natural gas exports, preliminary figures suggested only modest export growth in the second quarter.

Economic activity in core sectors, % volume change, y-o-y

	Quarters 2009 1.	2009 2.	2010 1.	2010 2.	2010 1st half
Industrial output	-16	-14	10	11	10
- extractive industries	-5	-3	7	5	6
- manufacturing industries	-24	-21	12	16	14
- electricity, gas and water	-5	-6	8	3	6
Agricultural output	2	1	4	2	3
Construction	-19	-19	-8	0	-3
Retail sales	0	-5	2	5	3
Goods transport	-17	-18	12	13	12

Source: Rosstat

Economic recession still reflected in the structure of Russian imports. The Federal Customs Service reports that imports from non-CIS countries in January-June had a value of $80 billion or about €60 billion, which translates to an increase of nearly 30 % from the first half of 2009. The value of imports was still about a fifth less than in the first half of 2008 ahead of the recession.

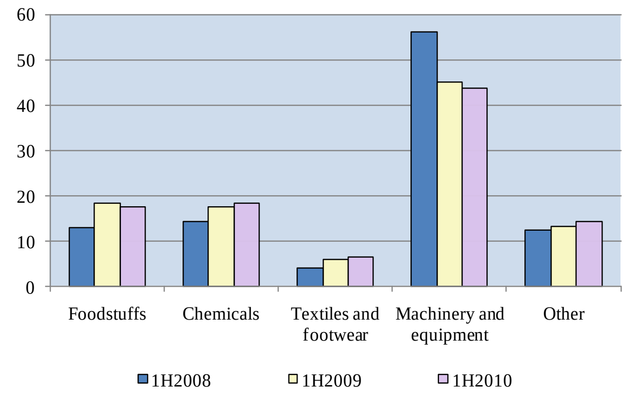
Imports in all main product categories increased relative to the first half of 2009. Imports of machinery and equipment, the largest product category, grew by about a fourth for both land vehicles and other machinery and equipment (including durable consumer goods). Chemical products and imports of textiles and footwear grew by a bit over a third, while food imports were up by a fifth.

The structure of imports has changed somewhat from the previous year. The share of all transport vehicles continued to shrink towards one-tenth (down from nearly a quarter in the first half of 2008). The share of other machinery and equipment (including durable goods) rose slightly to nearly a third, but was still less than two years ago. Mechanical devices represented the largest product group in the machinery and equipment category (40 % of machinery and equipment imports).

Due to their fast growth chemical products and non-categorised products increased their share in total imports. Pharmaceuticals, and plastics and rubber comprise the largest product groups in the chemicals category. The share of foodstuffs fell slightly from the previous year, but was still notably larger than in the first half of 2008. The share of textiles and footwear imports remained at the previous year's level, thus larger than two years ago.

The shift in the structure of imports reflects last year's impact of the global financial crisis on Russia's foreign trade. Demand for investment products and durable consumer goods fluctuates more strongly during the recession, while demand for foodstuffs remains less flexible.

Structure of Russia's non-CIS imports, % share



Source: Russian Federal Customs Service

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China

Yuan strengthens slightly against dollar, but drops against euro; international use of yuan on the increase. Since China announced on June 19 the return to a more flexible exchange rate regime and an end to the US dollar peg, the yuan has only shown modest appreciation against the dollar. On Thursday (July 22), one dollar bought 6.78 yuan, slightly less than it did during the 2-year fixed peg rate of 6.83. In other words, the yuan has appreciated only 0.7 % against the dollar since the official delinkage. Even with the People's Bank of China allowing two-way swings, the largest change between two days in the yuan-dollar rate in the past month has been 0.4 %. The strengthening of the euro against the dollar in recent weeks has seen the yuan lose value against the euro (down 3.1 % between June 19 and July 22).

At the beginning of July, the US Treasury Department released its semi-annual report on the economic and exchange rate policies of its most important trading partners. The report did not claim that China engages in exchange rate manipulation. The US government considers the change in China's exchange rate policy a significant step, but notes that it is important how much and how fast the yuan appreciates. The Treasury said the yuan is still undervalued and that it will closely monitor the yuan's rate of appreciation. The release of the report was postponed from April in the current year.

On July 19, the central banks of China and Hong Kong penned agreements that further promote yuan-based banking services in Hong Kong and therefore the international role of the yuan. Certain yuan-based banking services have been offered in Hong Kong since 2004. Since 2009, designated firms have been permitted to open yuan accounts for settling foreign trade in the Chinese currency. The new agreements free up account transfers in yuan and increase the possibilities for companies to convert between yuan and other currencies. In addition, yuan accounts can now be opened also by financial institutions other than banks, such as insurance companies.

The PBoC also signed an agreement on bilateral currency swaps with Iceland's central bank early in June. The value of the swap deal was 3.5 billion yuan (€402 million). During the global financial crisis in 2008–2009, China signed six currency swap agreements with different economies, offering them yuan-based financing.

Germany concerned about China's treatment of foreign firms. As part of German chancellor Angela Merkel's visit to China last week, the two countries signed deals worth a total of $4.4 billion, including an R&D alliance to develop steam and gas turbines between the German Siemens and the Chinese Shanghai Electric Group Company. During the visit, the CEOs of two German firms (BASF and Siemens) openly criticized their hosts for unequal treatment of foreign companies operating in China. They were particularly resentful that foreign companies are forced to surrender critical technical know-how to Chinese firms to gain access to the Chinese market. The Germans were also peeved with the favouritism shown toward Chinese firms in public procurement − a long-standing sore subject with China and its major trading partners, especially the US. China last week submitted proposed revisions to its joining the Government Procurement Agreement (GPA) of the World Trade Organization. According to US trade representative Demetrios Marantis China has made substantial improvements from its first proposal in 2007. Joining the GPA would open China's massive public procurement markets to international firms and give Chinese firms access to the markets of other GPA signatories.

Overall, the financial crisis has had little impact on Sino-German trade. Over the past decade, about a fifth of China's exports to the European Union have gone to Germany. Of China's imports from the EU, 41 % have German origin. Germany is China's most important trading partner in Europe. In January-June 2010, the value of China's exports to Germany rose 44 % y-o-y. Germany's largest airline Lufthansa also reports that air freight volumes for the first time reflect strong exports to China.

China's fourth large state bank debuts on Shanghai and Hong Kong exchanges. Trading in shares of Agricultural Bank of China (ABC) launched on China's main Shanghai stock exchange on July 15, and was followed the next day with trading on the Hong Kong stock exchange. ABC is the last of China's four giant state-owned banks to go public, partly because it has been the least profitable of the four big banks (see BOFIT Weekly 25/2010). The issue price of a single A-series share was 2.68 yuan (0.30 euro) at the Shanghai opening, while the issue price on an H-series share was 3.20 yuan (0.40 euro) in Hong Kong. The share price development was flatter than expected. The price of an A-share on the Shanghai exchange on the first day of trading rose less than 1 %. On their first day, H-shares, however, rose 2.2 % on the Hong Kong exchange. Growth of 5−6 % had generally been expected.

Some 40 % of ABC's A-shares offered on the Shanghai stock exchange went to state-owned strategic investors such as insurance giant China Life Insurance. About half ($5.45 billion) of the IPO offering in Hong Kong went to eleven foreign institutional investors, of which the Qatar Investment Authority was one of the most significant.

If the underwriters exercise their overallotment option, the value of IPO could become the world's largest ever ($22.1 billion). Even without the option exercise, the value of the IPO should exceed $19 billion. During January-June, over 170 companies listed on the Chinese stock exchanges.

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30 • 30.7.2010

Russia

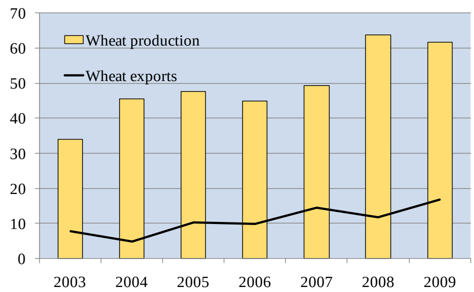
Russia grain harvest afflicted by major drought. A state of emergency has been declared for 23 of Russia's 83 regions as this summer's exceptionally hot weather continues. The heat wave has damaged over 10 million hectares of farmland, about a fifth of Russian's land area dedicated to grain production. This year's grain harvest is estimated to be some 85 million tons. The harvest would be close to the average for the past decade. Russia posted its largest harvest of the 2000s in 2008 (108 million tons). The 2009 harvest was 97 million tons.

The current focus of the government is on securing adequate domestic supplies. Russia presently consumes about 75 million tons of grain annually. It has 24 million tons of grain in stores, including the state intervention stores of about 10 million tons. The Russian state plans to begin selling grain from its stores around August-September to hold down the exceptionally fast price rise caused by the drought. Russia's grain stores were built up as a result of bumper crops over the past two years. Due to the lack of modern storage facilities, however, much of that grain could soon spoil, giving the government incentive to empty its stores.

Well over half of the Russian grain harvest consists of wheat. As a result of the good harvests the export volumes of wheat increased 25 % a year on average during the late 2000s. In 2008, Russia accounted for 14 % of world wheat exports. That put it on par with Canada in second spot behind the United States, world's biggest wheat exporter.

Russia's state-run United Grain Company reports that in 2009 nearly 25 % of Russia's grain exports went to Egypt, followed by Turkey (11 %), and Saudi Arabia and Syria (7 % each).

Russian wheat production and exports, million metric tons



Source: Rosstat

Government moves to improve corporate operating conditions. Last week the cabinet approved draft legislation to be submitted to the Duma on reducing the number of operating permits and licences required of businesses. Permit applications today require the applicant to expend considerable time and money. Under the proposed bill, permits would be required for 49 types of business activities, reducing by over half the number of types of businesses needing permits. Russia has reduced the number of activities requiring permits gradually during the past years. At the end of the 1990s, permits were almost universally required to set up any business. Under the proposed legislation, such acts as setting up a pharmacy will no longer require a licence from January 2013; informing officials of a new business will be sufficient. The number of business activities requiring permits should continue to fall. Licensing requirements will remain in place, however, for e.g. companies involved in finance, telecommunications, radio, TV, and atomic energy.

The proposed bill harmonises and clarifies the principles for granting licences, thereby reducing official discretion and opportunities for corruption. The agency granting a licence cannot charge any other fee than the delivery fee set by law. From the start of next year, permit applications can be submitted online. A big improvement for established firms is that licenses will no longer be for set periods but rather ongoing.

An economy ministry decree last summer to ease setting up of businesses allows certain firms to begin activities before all permits are in place. The companies will be subject to inspections after the start of operations. There are already 20 branches, including retail sales and catering, under the new scheme. A recent ministry survey found the rate of companies setting up business in these branches had increased over the past year. The economy ministry plans to broaden the number of branches eligible for the simplified scheme.

A law limiting the number and duration of official inspections of small firms went into force last year, but it only affects a small part of inspections. Important inspections by authorities involved e.g. in customs, tax, finance, transportation, competition regulations or occupational safety are excluded. The economy ministry is currently preparing a proposal on expanding the law to include most official inspections. The ministry notes that quite often the officials fail to observe restrictions set by the law.

The number of products requiring mandatory certifications has fallen over recent years. Currently, about 1,000 products must be certified and for another 1,300 a declaration of quality is required. In March, cosmetic products, food and alcoholic beverages were taken of the certification list and placed under the somewhat lighter scheme based on declarations. The government seeks to further reduce the number of products with mandatory certifications and streamline the declaration process.

The above measures are part of government efforts to improve the operating environment for firms through deregulation and hence reduce opportunities for official graft. The economic development ministry has been authorised to review the rules issued by other ministries to evaluate their impact on company operations.

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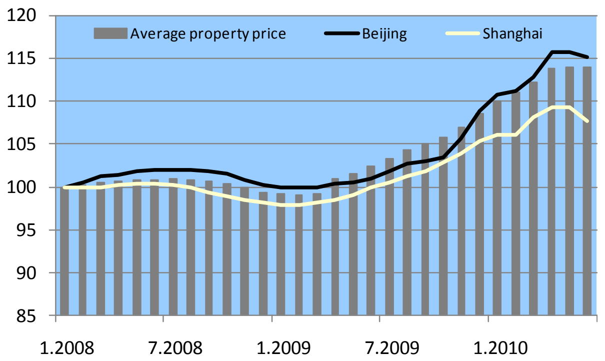
China

China's real estate markets show signs of cooling. Property prices in 70 major Chinese cities fell 0.1 % m-o-m in June. The on-month rise in May prices was just 0.2 % or 2.4 % at an annualized rate. Price trends continue to vary widely across provinces and cities. In Shanghai, apartment prices were down 1.4 % m-o-m in June (which translates to an annualized rate of nearly 17 %), while in the northeastern city of Jilin on the Russian border, prices rose 1.7 % m-o-m.

Beijing and Shanghai property price index and index of average property prices in 70 major cities (1.2008=100)



Sources: CEIC and BOFIT

Based on the overall trend in housing prices, it seems fair to say that official measures have succeeded in cooling the real estate markets so far. In April, the government set higher down-payment requirements, tightened conditions on housing loans, and announced it would continue to increase the supply of land for development. Even if prices have yet to stage a substantial decline, the volume of housing sales has fallen sharply. Most potential buyers evidently are waiting to see what trend in housing prices emerges in the coming months.

Apartments in Chinese cities are generally quite expensive relative to western cities if housing prices are compared to income levels. However, Chinese income levels have risen faster than apartment prices, so housing has become cheaper relative to income. Real estate is also seen as an attractive investment as real interest rates on savings deposits have stayed very low or even negative. As the growth of liquidity in the Chinese economy has slowed in reaction to the government's tighter policy stance, real estate prices have also stabilised.

Due to the slowdown in economic growth and trends in housing prices, some analysts predict China will loosen its administrative rules for the real estate market towards the end of this year. Chinese officials, however, have recently stressed the importance of continuity in economic policies. Because investments related to construction are a significant part of GDP, local administrations may be reluctant to further chill conditions in real estate markets. A government decision to construct cheaper housing for low-income families, however, supports housing production.

China's popularity as a tourist destination continues to grow. According to the United Nations World Tourism Organization (UNWTO), China is the world's fourth most popular destination of foreign tourists after France, the US and Spain. Last year 127 million tourists visited mainland China, only about 4 % fewer than during the pre-crisis year of 2007.

The number of tourists in mainland China has grown over 50 % in the past ten years. Most tourists to China by far come from Hong Kong, Macao or Taiwan. Combined, tourists from these areas account for about 84 % of all tourists visiting mainland China. The most non-Chinese tourists come from Japan and South Korea. In the first half of 2010, the number of foreign tourists visiting mainland China was about 25 % higher than in 1H09. The uptick reflects the recovery in the global economy and among other things the opening of the Shanghai World Expo, which organisers expect to attract some 70 million visitors. Although the World Expo only began in May, tourism in Shanghai as of end-June was up by nearly a third compared to the same period a year earlier.

The Chinese government this week announced it would begin to support companies involved in tourism e.g. by easing conditions on their loans. The state also encouraged tourism companies to obtain financing by issuing bonds and shares.

BRICs active in using protectionist measures during recent global financial crisis. At the end of June, the International Chamber of Commerce (ICC) and the Peterson Institute for International Economics (PIIE) jointly published a report on barriers to trade imposed by G20 countries during the economic crisis. By September 2009, G20 countries had imposed 172 protectionist measures such as protective tariffs. These measures represented about 35 % of all protection measures implemented or considered around the world at that time. Most of these protectionist measures were imposed in early 2009, when their impacts on other trading partners were at their peak.

The G20 report ranks the countries on the basis of how many protectionist measures each country has imposed, as well as the products and trading partners these measures influence. The comparison shows Russia resorted most to protectionist measures among the G20 countries during the financial crisis. Of the other BRIC countries, India ranked third, Brazil fifth and China sixth.

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31 • 6.8.2010

Russia

Falling unemployment and rising consumer confidence signal economic recovery. Rosstat reports Russia's unemployment rate declined to 6.8 % in June, a significant drop from January, when it reached one of its highest points during the crisis, 9.2 %. The unemployment rate was, however, high for young people: among 15 to 24-year-olds unemployment was 16 %.

The improvement in business conditions is evidenced by the fact that wage arrears, after doubling in 2009, now appear to be falling. Rosstat estimates the amount of monthly wage arrears fell by half in 1H10 from 1H09.

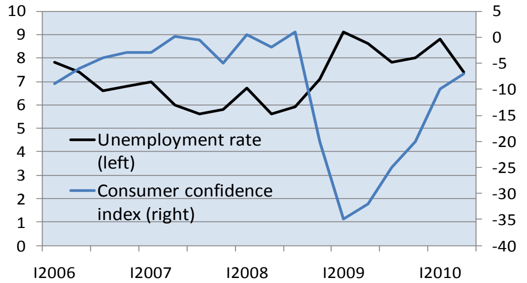
Income development was positive in the first half of 2010. The average monthly wage in June was 21,600 rubles (€550). Wages have risen 12 % in nominal terms and 6 % in real terms from June 2009. The average monthly pension payment in June was 7,600 rubles (€190). In real terms, the average pension was 39 % higher than in June 2009, reflecting substantial hikes in pensions at the beginning of the year.

The official "subsistence minimum" in the first quarter of 2010 was 5,520 rubles (€140) a month. Rosstat estimates 15 % of the Russian population lived below the subsistence minimum. Before the financial crisis in 2008, 13 % of the population lived below the minimum.

Rosstat's index of consumer confidence in the second quarter recovered to its highest level (-7 %) after plummeting in the first quarter of 2009. Rosstat's sampling in the quarterly survey covers 5,000 persons nationwide. The survey includes a number of questions that pertain to expectations about the country's general economic condition and the respondent's own economic situation. If the sum of factors yields a negative index value, as it most often has in recent years, a pessimistic outlook dominates consumer expectations.

The question on how respondents saw their personal economic situation found that 15 % expected their personal situation to improve over the next twelve months, while 13 % expected their situation to get worse and 59 % saw their situation remaining unchanged.

Quarterly measures of unemployment rate (%) and Rosstat consumer confidence index (%)



Source: Rosstat

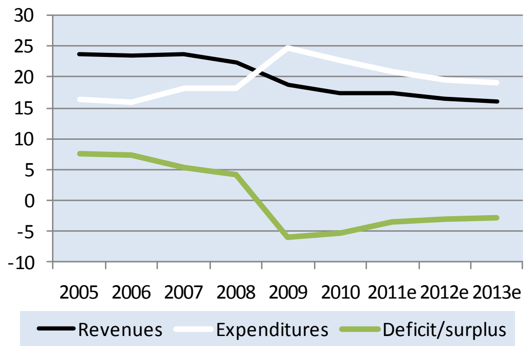
Government tackles budget deficit. On July 29, the cabinet approved the 2011–2013 federal budget framework. The government wants to reduce next year's budget deficit to 3.6 % of GDP and to 2.9 % by 2013. The government forecasts this year's budget shortfall will amount to 5.4 % of GDP.

Federal budget revenues next year will amount to 8.6 trillion rubles (€218 billion) or 17.4 % of GDP, while expenditures will amount to 10.4 trillion rubles (€264 billion) or 20.9 % of GDP. The share of revenues to GDP will rise slightly from this year's level, while the share of expenditures will fall about two percentage points.

Both revenues and spending relative to GDP are expected to fall in 2012 and 2013. According to finance minister Alexei Kudrin, the contraction in revenues as a share of GDP reflects the fact that Russian oil and gas production is no longer increasing as rapidly as in the 2000s. This means that tax and export tariff revenues from oil and gas will also not increase at their previous pace. Budget spending as a share of GDP will contract due to tighter expenditure control, falling to 19 % in 2013.

In nominal terms, budget spending will rise next year by 2 % from 2010 − a decrease in real terms. Budget revenues are expected to rise 11 % in nominal terms.

Federal revenues, spending and deficit/surplus, % of GDP



Source: Ministry of Finance

The budget calculations assume modest economic growth: 3.4 % of GDP in 2011, 3.5 % in 2012 and 4.2 % in 2013. The budget assumes the world price of the Russian brand of crude oil will average $75 a barrel next year and $78 and $79 a barrel in the out-years. The ruble is assumed to appreciate somewhat over the next three years.

Budget spending increased dramatically over the past five years, as did Russia's budgetary dependence on oil and gas revenues and susceptibility to swings in world commodity prices. The Russian Alfa-Bank estimates that the crude oil price would have to be $123 a barrel this year for the federal budget to achieve balance. Next year, budget balance will be achieved at $111 a barrel. As recently as 2008, a crude oil price of $62 a barrel was sufficient to produce a balanced budget in Russia.

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China

IMF recommends China move ahead with broad range of reforms to increase domestic consumer demand. In its latest Article IV consultation report, the IMF mission said it looked forward to broader and deeper reforms in China so that China's current economic structure led by investments and exports would be increasingly driven by domestic consumption and, thus, rebalancing the economy. To bolster private consumer demand, the IMF recommends e.g. allowing real appreciation of the yuan's exchange rate, reducing worker social contributions and lowering taxes on consumption. The IMF further hopes China will continue with reforms in order to reduce precautionary saving by citizens. The reforms include e.g. increasing coverage of the pension system, guaranteeing free secondary education and improving the quality of healthcare − especially in poor regions. In addition, the enthusiasm for companies to save could be reduced e.g. by improving access to finance and encouraging firms to increase dividends paid out of their profits.

Despite several strikes this summer and labour shortages emerging in some areas, the IMF believes that there is still an oversupply of labour in China at the national level. Recent wage concessions have not been exceptional relative to wage hikes of recent years. According to IMF, the rise in wages will be curbed as the companies leave coastal provinces and move inland in search of cheaper labour.

The IMF fears that the reduction in global imbalances that occurred as part of the financial crisis has been temporary and that the imbalances will begin to re-emerge in coming years as China's main export markets in Europe and the United States recover. Furthermore, interest earnings from foreign investments flowing into China (mainly from investments of the PBoC currency reserves) will increase as interest rates globally begin to rise. Chinese officials, in turn, believe that domestic consumer demand will rise just enough for the current account surplus to remain at around the current 4–5 % of GDP.

The IMF annually conducts Article IV consultations with its members, but report findings cannot be released without the approval of the inspected country. China sharply disagreed with some findings of the 2007, 2008 and 2009 IMF reports and forbade their release.

Real incomes continue to rise. China's National Bureau of Statistics reports disposable monthly incomes of urban-dwellers increased to over 1,600 yuan (€185) in the first six months of this year. In the countryside, average disposable incomes reached 515 yuan (€58). Incomes of city denizens climbed 10.2 % y-o-y in real terms, while real growth in rural areas was 12.6 %. During the last five years, urban incomes have risen nearly 50 %, while rural incomes have grown about four percentage points less. Income transfers have risen rapidly, but their share of received income has remained roughly the same. In 2009, income transfers increased 15 % in cities and 22 % in the countryside.

Minimum wage levels in 27 Chinese provinces and cities have been increased this year. The biggest adjustment, a 28 % hike, was made in Hunan province.

Although Chinese income levels have risen, accelerating inflation and soaring housing prices relative to income levels have increased pressure for higher wages. The need for higher wages was partly the reason for recent work stoppages this summer (BOFIT Weekly 26/2010). Chinese awareness of wage disparities has also been heightened by the extensive media coverage of the strikes. With rising wage costs, foreign firms may begin to move production away from high-cost coastal zones where most foreign manufacturers have traditionally operated. For example, the Taiwanese Foxconn, a target of work stoppages, has decided to shift part of its production to Henan province in central China to reduce production costs.

The increase of Chinese incomes will support domestic demand which diminishes China's dependence on exports.

China's economic growth slowing as expected. The Manufacturing Purchasing Managers Index (PMI) is a leading indicator of most recent economic trends. The latest number released at the start of August shows a calmer trend in the wake of sizzling growth early this year. In July, the official PMI shrank for the third month in a row to 51.2. Moreover, the sibling index published by private banker HSBC dropped to 49.4. An index value below 50 indicates that the majority of survey respondents report the situation for their firm has worsen from the previous month, while a value above 50 indicates expanding production.

The official PMI survey indicates that lower growth was due to a slowdown in growth of domestic and export orders. However, the survey also found evidence of reduced cost pressures on manufacturers even if input prices continue to rise. The number of people employed in the manufacturing sector rose in July.

The calming of economic growth was already evident in second-quarter figures; extrapolation of seasonally adjusted quarter on quarter GDP growth only amounted to about 8 % on-year growth, down from growth of nearly 11 % in the first quarter. Estimates vary considerably, however, as China still does not release reliable and proper quarterly data on GDP trends. In any case, lower growth indicates normalisation of the situation, which should reduce pressure on policymakers to tinker with current economic measures.

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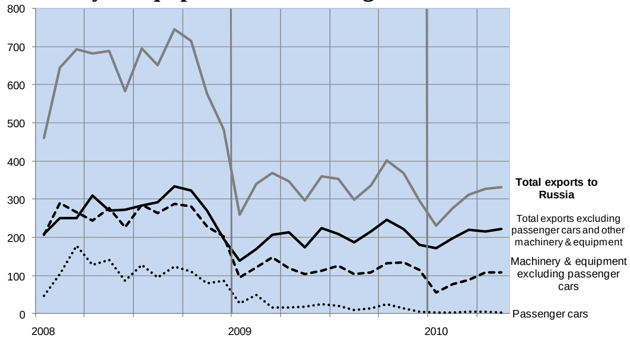
Russia

Finnish exports of machinery & equipment to Russia down this year; other exports up. Customs Finland values Finnish exports to Russia during January-May at €1.5 billion, or 8 % less than in January-May 2009. Finland's total exports were worth €19 billion, up 4 %. Nearly 8 % of Finland's total exports went to Russia, making Russia Finland's fourth largest export destination after Sweden (12 %), Germany (11 %) and the Netherlands (8 %).

The drop in Finnish exports to Russia this year involved two major goods categories: passenger cars and other machinery and equipment (see chart). Re-export of passenger cars, which plummeted over 80 % in 2009, fell further this year, to a very low level. Passenger cars constituted 17 % of all Finnish exports to Russia in 2008, but that share fell to 6 % in 2009 and little over 1 % in the first five months of 2010. This year an even larger proportion of passenger cars than in previous years have moved on wheels through Finland to Russia as transit cargo, which is not subject to customs duties and the respective clearance (transit cargo of cars also declined in 1Q10 from 1Q09).

Passenger cars declared as Finnish exports to Russia are in practice 100 % re-exports, and also recorded in Finland's import statistics (goods for re-export are imported and subject to import duties and the customs clearance). Passenger cars have been clearly the largest product category in Finland's re-exports to Russia. The exact levels of other re-export goods such as mobile phones and home appliances are harder to assess. In any case, their exports to Russia are also sharply down this year. Customs Finland's most recent survey of 2008 found that re-exports accounted for about 30 % of Finnish exports to Russia.

Finnish monthly exports to Russia: total exports, cars, other machinery & equipment, and other goods; EUR million



Source: Customs Finland

Omitting passenger car exports, Finland's exports to Russia contracted less than 2 % in the first five months of 2010. The May figure was the first monthly figure to show on-year growth compared with last year's very low level. Machinery and equipment remained the top product category. Exports of machinery and equipment (excluding passenger cars) fell by a quarter and their share continued to fall (an over 35 % share in January-May 2009 dwindled to below 30 % in January-May 2010). Declines were registered in almost all product groups in the machinery and equipment category for the January-May period.

Finland's exports to Russia outside the passenger car and machinery and equipment category increased 14 % y-o-y in January-May. Exports in the chemical products category were up 18 % overall, and every product group in the category showed growth. The share of chemical products increased to over a quarter of Finland's exports to Russia. Exports of paper and cardboard products climbed 20 % to account for more than a tenth of Finnish exports to Russia. Exports of food products increased by 25 %, raising the food category's share to 8 % of total exports.

Export trends reflect Russia's economic conditions. Although Russia's total imports have increased this year, demand for investment goods have yet to take off. Imports of passenger cars have continued to contract this year, while domestic car production has soared.

Russian energy exports on the rise. The energy ministry estimates Russia's crude oil exports in 1H10 were 122 million tons, about the same as in 1H09. On the contrary, oil production rose about 3 %. Russian customs reports that 110 million tons of crude oil were exported to non-CIS countries in 1H10, or about 6 % more than in 1H09. The increase corresponds closely to the loadings recorded in January-May at the Pacific coast Kozmino oil terminal, which began operations at the end of 2009. Instead, oil exports to the CIS, particularly Belarus, contracted sharply. Last year crude oil exports grew 2 % and production was up 1.5 %. About a third of Russian crude exports was shipped via Primorsk on the Gulf of Finland.

Exports of diesel fuel and heavy fuel oil, especially to non-CIS countries, climbed sharply in 1H10. Russian customs figures show a total of 65 million tons of refined oil products were exported – a 12 % increase from 1H09. The export volume of oil products grew 5 % last year. Coal exports in 1H10 were up overall well over 10 % from 1H09. Coal exports to non-CIS countries were up just above 10 %, while exports to CIS countries grew rapidly.

The volume of natural gas exports fell sharply a year ago due to the mild winter, decreased consumption from the economic downturn and gas squabbles between Russia and Ukraine. Gas exports in 1H10 were 92 billion cubic metres, or about 50 % more than in 1H09. Gas exports to non-CIS countries (mainly the EU and Turkey) rose 16 % in 1H10 to just under 60 billion m^3. Pre-crisis first-half exports to non-CIS countries were typically above 80 billion m^3. The very fast growth in gas exports to CIS countries this year partly reflects a recovery from last year's delivery slump. Russia's gas exports to CIS countries in 1H10 exceeded 30 billion m^3.

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China

July economic figures indicate expected slowdown. China's National Bureau of Statistics (NBS) reports industrial output in July increased 13 % y-o-y in real terms. Growth was slightly lower than in June, following the gradual slowing trend of recent months from sizzling growth in the first months of the year. Despite the recent lower growth, industrial output was still up 17 % y-o-y for the first seven months of the year.

Evidencing robust domestic demand, investment in fixed assets rose in January-July 25 % y-o-y in nominal terms. Nearly half of all fixed asset investment was made by state-owned enterprises. Although the pace of investment growth by state firms slowed to 20 % y-o-y in the first seven months of the year (down from 40 % growth in the same period last year), growth in fixed asset investment by the private sector accelerated slightly. Growth in fixed asset investment overall slowed during the previous twelve months as officials cut back on lending to fund new public investment projects.

In addition to investments, retail sales provide evidence as to the overall strength of consumer demand. Retail sales of consumer goods were up over 18 % y-o-y in nominal terms both in July and in the January-July period. Following a burst of high growth in retail sales at the start of the year, growth in consumer spending has slowed a bit. Rising household disposable incomes are expected to support continued growth in retail sales.

Inflation accelerated in July; housing prices show signs of stabilising. The NBS reports the rise in consumer prices picked up in July to 3.3 % y-o-y (2.9 % y-o-y in June). Among consumer goods, food prices have shown a sharp rise in recent months. Although the inflation rate in July hit its fastest pace in two years, inflation is only expected tocontinue at a modest pace in coming months. The rise in producer prices slowed to 4.8 % y-o-y in July, down from 6.4 % y-o-y in June. The rise in producer prices has been driven in recent months by large hikes in commodity prices that now appear to be abating.

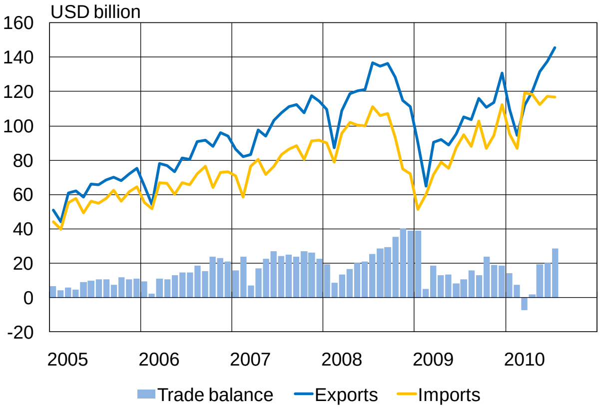
Average apartment prices in 70 of China's large and mid-sized cities showed virtually no movement between June and July. Average housing prices in June fell slightly from their May level. The stabilisation of housing prices is seen as an indication that official measures initiated at the start of the year and stepped up in April to cool runaway growth of housing prices have begun to bite. Although prices are still expected to start dropping in coming months, builders and the markets have taken the stagnation of housing prices rather calmly. According to a recent survey the apartment builders currently are economically in very good shape, and official statistics show that builders have relatively low levels of bank loans by international standards. Apartment buyers also shy away from excessive reliance on bank loans. Unlike in many developed countries, the Chinese prefer to make large downpayments from their savings and use the housing loan to cover the rest of the apartment purchase.

China's trade balance soared in July. Chinese exports steamed ahead in July, despite an uncertain outlook for the global economy. China's July exports exceeded their precrisis peak, with the value of exports hitting $146 billion (see chart). Exports were up 38 % y-o-y (44 % in June). Imports also exceeded their former apex of summer 2008, although it now appears growth in imports has hit a plateau for the time being. The value of imports since March has remained in the range of $110–120 billion a month. The value of imports in July was $116 billion, or 23 % higher than a year earlier (35 % in June).

With diverging trends in China's exports and imports, China's trade surplus surpassed $27 billion in July, causing revived speculation that the yuan should be allowed to appreciate faster against the dollar.

Seasonal factors explain part of the slowing of imports and increased exports in recent months. The slowing of import growth is also in line with the country's overall slowdown in economic growth. The strong growth in exports of recent months, however, is harder to explain as exports are mainly driven by struggling markets in Europe and United States. The structure of exports does not offer any additional information concerning the drivers of growth as nearly all of China's main export branches appear to be experiencing robust export growth. Nevertheless, the manufacturing purchasing manager's index has indicated a slowing in growth of export orders since March. In July, the PMI showed only a tiny increase in orders from the previous month, indicating export growth should cool in the months ahead.

Monthly figures for Chinese exports, imports and trade balance; USD billion



Source: Bloomberg

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Russia

Pace of economic recovery varies across Russian regions. Industrial output growth varied widely across regions in the first half of the year. While Russian industrial output (including mineral extraction, manufacturing and supply of electricity, gas, heat and water) was up 10 % y-o-y in the first half the highest growth (35–40 %) was registered in the industrial oblasts of Kaluga, Kaliningrad and Ulyanovsk. In those regions, manufacturing increased 40–50 %, spurred partly by strong growth in the car manufacturing.

Industrial output growth exceeded 20 % in several industrial towns around Moscow and to the east in the Volga Federal District (e.g. Bryansk, Orlov and Perm oblasts).

In Russia's Northwest Federal District industrial output increased at about the national average. Above-average growth was registered in the Republic of Karelia (16 %), while growth reached 9 % in the Leningrad oblast, 8 % in the city of St. Petersburg and 5 % in the Murmansk oblast.

Russia's most important energy-producing areas are situated in Western Siberia in the Khanty-Mansi autonomous okrug, the Yamalo-Nenets autonomous okrug, and the Sakhalin oblast in the Far East Federal District. In these regions, mineral extracting industries (including oil drilling) account for 50–65 % of GDP. Industrial output growth turned positive in all these regions in the first half of 2010. Growth was highest in the Sakhalin oblast due to increased crude oil output. Industrial output in Khanty-Mansi was modest as oil production levels flattened. Khanty-Mansi oil production accounted for over half of Russia's total oil production in 1Q10.

Economic indicators for select cities and regions, % change from same period a year earlier

	Moscow		St. Petersburg		Perm		Khanty-Mansi	
	2009	1H2010	2009	1H2010	2009	1H2010	2009	1H2010
Industrial output	-17	-9	-20	8	-11	22	-1	1
Construction	-19	-2	-23	0	-18	4	-20	-2
Retail sales	-3	5	-5	4	-6	-5	-17	-4
Unemployment, yearly average	3	2	4	3	10	9	7	8

Source: Rosstat

Industrial output fell further in seven of Russia's 83 administrative regions. Production declined e.g. in the politically unstable Caucasian regions of Chechnya, Dagestan and Ingushetia, as well as in the economically backward Altai and Khakasia republics in Siberia.

The contraction of industrial output continued also in Moscow. Most GDP generated in the Moscow city derives from services. Retail sales increased 5 % y-o-y in 1H10, somewhat above the national average.

Improved regulation for Russia's financial markets. As its spring session came to an end in July, the Duma approved several laws on financial market regulation. The most important was the law on insider trading and stock price manipulation. The law defines insider information and insiders, as well as penalties for use of insider information. The maximum sentence for share price manipulation is seven years in prison. The legislative package is to be phased in over the next three years. During the transition period, stock price manipulation will not be a crime punishable by imprisonment.

The efforts of Russia's president and cabinet to make Moscow an international financial centre provided the impetus to push through the legislation that has been under preparation for a decade. As a financial centre Russia will have to comply with international norms and regulations for financial markets.

A new regulation by the Federal Financial Markets Service (FFMS) which oversees securities markets entered into force at the beginning of July. The regulation more than triples the minimum capital requirements for securities brokers and fund management companies to 35 million rubles (€900,000). The capital requirement will be boosted to 50 million rubles on July 1, 2011. The competition authorities complained that the move would promote monopolisation of markets as it will knock out about 20 % of market participants and make it more difficult for new companies to enter the market. In particular, small regional firms will be pushed out. The Financial Markets Service responds that the reforms will eliminate shady "one-day" firms.

An amendment to the law entered into force in July that allows financial rehabilitation of troubled insurance and securities trading companies. The goal is to help such companies avoid bankruptcy where possible, and clarify the bankruptcy process where needed to avoid excessive harm. Similar practice is already used in the banking sector.

The act on consolidated financial statements, which has been under preparation since 2004, was finally approved in July. The law requires banks, insurance companies and listed firms operating as a group to prepare consolidated financial statements following International Financial Reporting Standards (IFRS). The central bank has required banks prepare consolidated financial statements according to international standards since 2004. Under the law, stock-market-listed companies must adopt the new practice starting from 2015. The reform is expected to increase foreign investor interest in Russian firms.

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China

China surpasses Japan to become world's second largest economy. Based on the second-quarter GDP, it was announced this week that China surpassed Japan to become the world's second largest economy after the United States. China's 2Q10 GDP was estimated at €1.04 trillion against Japan's €1.00 trillion. China breezed ahead of the Japanese economy, which has long seen lower growth. China's ascendance as the world's second largest economy signals its increasing economic importance and role in global policymaking.

In terms of GDP per capita, however, the Japanese still remain larger economy than China. Chinese GDP per capita was only about €2,800 in 2009, less than a tenth of the Japanese figure (€29,000). China's figure reflects the country's huge population and low wages.

Using the World Bank's measure of GDP adjusted for purchasing power parity (PPP), China was already the world's second largest economy in 2001. The PPP adjustment considers differences in price levels.

The World Bank's June forecast found that China should overtake the United States in terms of PPP-adjusted GDP in 2020. Measured in terms of non-adjusted GDP, it will take the Chinese at least a decade more to surpass the US, which currently has a GDP of about three times that of China.

China was one of a handful of countries in the world to exhibit strong economic growth last year. Between 2000 and 2008, China accounted for about 15 % of all growth in the global economy. Last year, China became the world's largest exporter, when its exports surpassed those of Germany. China accounted for about 10 % of global goods exports last year.

China enjoys good summer grain harvests despite unusual weather. Although a number of provinces in China have been afflicted with exceptional droughts or flooding this year, the National Bureau of Statistics reports the summer grain harvest still reached 123 million metric tons, which was on par with last year. The summer harvest of key crops accounts for about a quarter of China's entire annual harvest. The main harvest takes place in the autumn. China's economy ministry expects this year's autumn harvest to be a bit smaller than last year. The rice crop, in particular, is likely to diminish due to a doubling of pest damage in the rice paddies from 2009.

China is largely self-sufficient in terms of basic agricultural production, and maintaining food self-sufficiency is a central policy pillar of China's central administration. As a result, China is a leading producer globally in such crops as potatoes, rice, tea and wheat. China is also the world's second largest producer of maize after the United States. In addition, the Chinese state maintains massive grain reserves, which it can release as needed to preserve price stability on the markets or assure adequate food supplies in years of poor harvests.

Although China produces vast amounts of farm produce, nearly all production is consumed domestically. The exception among these major crops is tea – about a quarter of China's tea production is exported. With severe droughts and heat waves causing major crop reductions in Russia, and the country's decision to ban wheat exports at least until the end of the year, wheat prices have spiked on the world market. As a result, China is expected to offer more of its wheat harvest on international markets this year.

Although China generally imports only small amounts of agricultural products, it imports substantial amounts of soy beans and various vegetable oils.

Agriculture accounts for slightly over 10 % of Chinese GDP, and official figures show agriculture employs about 40 % of the labour force.

Hong Kong economic growth beats expectations. Hong Kong's census and statistics office reports continued strong, albeit lower, second-quarter economic growth. The Hong Kong economy grew 8 % y-o-y in real terms in 1Q10 and 6.5 % in 2Q10. Given the better-than-expected growth in the first half, the IMF at the start of July revised upwards its 2010 forecast one percentage point to 6 %.

The first-half growth was driven by recoveries in Asian markets and the US. Exports of goods and services climbed nearly 20 % y-o-y in both the first and second quarter. Investment was up 15 % y-o-y in the second quarter, compared to 8 % in the first quarter. Domestic consumption rose 4.6 % y-o-y in the second quarter propelled by economic recovery and income growth.

At the end of May, the Hong Kong special administrative region and mainland China signed their seventh supplement to the Closer Economic Partnership Agreement (CEPA). The purpose of CEPA is to reduce trade barriers between mainland China and Hong Kong. The new agreement enters into force in January 2011, which should improve the operational possibilities in mainland China for Hong Kong firms operating in the service sector. The seventh supplement to the CEPA expands coverage to 44 service-sector branches.

The original CEPA was signed in 2003. Every year thereafter more trade barriers have been removed through supplement agreements. The fourth, fifth and sixth supplements also focused on eliminating barriers to the service sector, which is critical for Hong Kong.

At the beginning of the summer mainland China and Macao also signed the seventh supplement to CEPA.

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Russia

Increasing share of Russia's imports coming from China. Russian customs reports that in the first half of 2010, the value of total imports hit $95 billion, an increase of 32 % y-o-y for the period. Imports from CIS countries climbed 56 %, while imports from EU countries were up 19 %. The high growth rates represent a recovery after a sharp dip caused by the recent economic downturn.

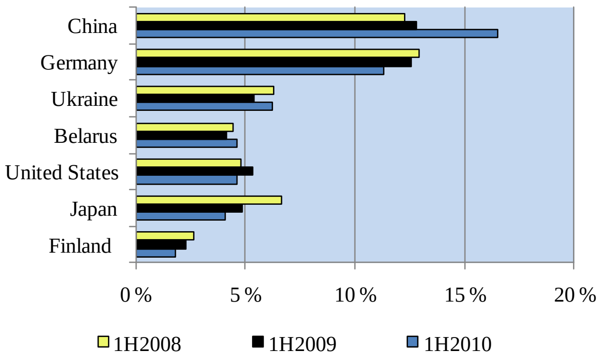
Russia's largest source of imports was China with a 17 % share, followed by Germany (11 %), Ukraine (6 %), Belarus (5 %) and the United States (5 %). Finland accounted for just under 2 % of Russian imports. CIS countries together accounted for 15 % of Russia's imports, while the EU provided a 40 % share.

Russian imports from China increased in the first half of 2010 by 71 % y-o-y. The economic development ministry of Russia reports that 75 % of imports from China consisted of machinery & equipment and transport vehicles, 8 % chemical products and 4 % foodstuffs.

During the 2000–2008 period, the value of Russia's imports from China grew at an average rate of 52 % a year. In the same period, Russian imports overall increased at an average pace of 28 % a year. During last year's economic downturn, Russian imports from China contracted 34 %, while Russian imports overall shrank 37 %.

Russia saw substantial increases in imports also from some other countries in the first half of 2010, including traditional raw-material exporting CIS countries such as Turkmenistan (170 %), Uzbekistan (121 %) and Kazakhstan (81 %).

Percentage shares of Russia's main import providers and Finland in Russian imports



Source: Russian customs

Russian exports in the first half reached $189 billion. The EU remained Russia's prime export destination with a 55 % share. The share of the CIS was 14 %. Russia's top export destination in the EU was the Netherlands (14 % of total exports), home to the Port of Rotterdam, a major location for oil refineries and oil transhipment. Italy accounted for 7 % of Russian exports and Germany 5 %. China had a 5 % share.

Public-sector economy records surplus in the first half. Russia's public-sector economy, which includes federal, regional and local budgets, as well as social funds, showed a small surplus (1.3 % of GDP) in the first half of 2010. Although the federal budget deficit was 2 % of GDP, surpluses in regional budgets and social funds were sufficient to compensate for the shortfall. Regional budgets and social funds typically operate in the black as any deficits are covered by transfers from the federal budget. As the bulk of public spending in Russia traditionally occurs in the second half of the year, the public-sector economy is expected to end the year in the red. The finance ministry expects the deficit to hit 5 % of GDP.

Public-sector revenues increased rapidly in January-June, up 25 % y-o-y in nominal terms and 20 % in real terms. In real terms, however, revenues are notably lower than before the recession. Higher-than-expected growth in revenues was due largely to crude oil export prices and GDP growth that were above budget assumptions, as well as lower appreciation of the ruble against the dollar.

Revenues from export tariffs for crude oil and oil products, as well as crude oil extraction taxes were up sharply in the first half. Such revenues accounted for about 25 % of public-sector revenues and about 45 % of federal budget revenues (i.e. a return to pre-recession levels). Revenues from the corporate profit tax were also up sharply, providing a much-needed boost especially to regional budgets. Revenues from the value-added tax, which were down only slightly during the recession, grew strongly. Revenue streams from social and income taxes also displayed stable increases.

Public-sector spending increased 10 % y-o-y in nominal terms, which translates into real spending growth of 4 % y-o-y in the first half. Compared to pre-recession 1H08, spending was up 10 % in real terms. Spending equalled 35 % of GDP. Federal spending growth was driven in particular by an increase in transfers to the state pension fund. Expenditures of regional and local budgets increased 5 % in nominal terms, but declined in real terms.

In accordance with prime minister Putin's uncompromising stance, social spending continued to soar in the first half (38 % y-o-y). Social spending now accounts for 37 % of all public spending.

All other spending categories besides social spending were as a whole held to their same nominal levels as in 1H09. Spending on economy was down sharply as the government cut back on stimulus spending and agricultural supports. Other major public spending categories (in order of outlays: education, health care, domestic security, defence, public administration and housing) saw nominal growth in spending of 4−7 % y-o-y in 1H10.

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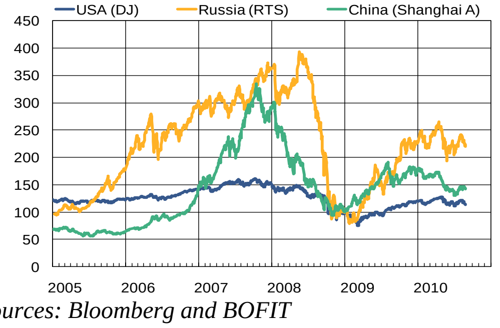
China

State remains top source for bank capital. Prices on Chinese stock markets are currently affected both by the weakened economic outlook and an ample supply of tradable securities on the market. In particular, banks are aggressively trying to raise money from the markets. Agricultural Bank of China, for example, just finished its IPO − the world's largest IPO ever ($22 billion). The IPO of China Everbright Bank is on track to raise about $3 billion in fresh capital. Many banks currently face the prospect of capital inadequacy caused by last year's lending spree. In response, they are struggling to shore up their capital bases. Besides share emissions, banks are issuing convertible bonds that can be exchanged for shares.

The state's role in the current balance-sheet bolstering has been striking. The domestic operations of the state sovereign wealth fund investor China Investment Corporation (CIC) are run largely through its subsidiary Central Huijin Investments Ltd. Central Huijin announced plans to sell just under $28 billion in yuan-denominated bonds on the interbank bond market. The money raised will be used, among other things, to reinforce the capital bases of China's large state-owned banks. What is notable is that the banks receiving funds are the same banks that are buying Huijin debt. Huijin is major owner of the four giant state banks as well as China Everbright Bank.

Main share index trends in China, Russia and the US, Dec. 31, 2008 = 100



Sources: Bloomberg and BOFIT

Uncertainty over trends in housing prices. China's National Bureau of Statistics (NBS) announced Monday (Aug. 23) it had discovered serious errors in its data for Shanghai apartment prices. The NBS, which is largely reliant on company reporting in its surveys, recently discovered that certain Shanghai firms had deliberately falsified their reporting or failed to provide data. The NBS did not specify how many firms had acted improperly or the overall impact of the irregularities on its housing figures. Although the NBS said the bad reporting was limited to Shanghai, it is possible that companies elsewhere also failed to report properly. As in many countries, Chinese companies are required by law to respond truthfully to official surveys.

Even without the uncertainty introduced by Shanghai's housing numbers, real estate price trends in China are hard to track. Even if data collection is clearly complicated due to China's size and big differences in housing prices across neighbourhoods and cities, the confused picture of housing price trends offered by official sources is still surprising. The NBS, for example, claims that the average price for a square metre of apartment in an average Chinese city has been declining since April, while the influential National Development and Reform Commission (NDRC) sees apartment prices continuing to rise. Many companies also publish their own price indices.

While the construction sector generally expects prices to fall 10–20 % in 2H10, China's leadership is concerned about a possible full-on collapse in housing prices. In response, officials are requiring companies operating in the construction sector and commercial banks to undergo stress tests to determine their ability to remain solvent in the event of a serious downturn. In the worst-case test scenarios, apartment prices are assumed to fall 60 %. Media reports claim such an event would have only a minor impact on the overall stock of non-performing loans of China Construction Bank, the country's largest issuer of housing and construction loans. Mid-sized Bank of Communications and China Merchants Bank anticipate their non-performing loans ratio to total loans would increase just 1–2 percentage points in the event housing prices fall by half. These figures are hardly convincing.

China's oil imports expected to grow. China's crude oil consumption rose to nearly 220 million metric tons in 1H2010. Of that, 55 % was imported. Oil consumption increased nearly 20 % y-o-y in 1H10. China is the world's second largest oil consumer after the US, and imports most of its oil from the Middle East (50 %) and Africa (30 %).

Due to strong economic growth, China's oil consumption has outstripped domestic oil production. In addition, the oil demand is increased by filling the strategic oil reserves. In 2009, 52 % of the oil consumed in China was imported. To secure future oil supplies, China is encouraging companies to lock down their international supplies. This year, Chinese firms have entered into oil supply contracts with e.g. Nigeria, Brazil and Venezuela.

Although refinery production was up in the first half, growth in domestic demand for oil products lagged production, which allowed China to export oil products. In 1H10, exports of oil products increased 40 % y-o-y. By some estimates, exports of oil products in the second half are expected to grow by as much as 25 % compared to first half of this year.

Coal remains China's top energy source, fuelling 70 % of all energy consumption. Oil meets about a fifth of China's energy needs and natural gas a mere 4 %.

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Russia

Economy ministry expects annual GDP growth to hold at around 4 % over the next three years. Russia's economy ministry has submitted to the cabinet its latest revised macro-forecast running through 2013. After approval by the cabinet, the forecast will serve as the basis for the preparation of the next year's budget.

The economy ministry expects GDP to increase 4 % in real terms this year, with very similar growth in 2011 and 2012. Growth is then expected to accelerate to 4.5 % in 2013. Due to this summer's exceptional drought, this year's GDP growth will be almost one percentage point lower than otherwise expected.

Given the low investment growth in the first half of the year, the economy ministry now estimates investment in fixed assets will increase a mere 2.5 % in real terms this year. Fixed investment is expected to climb to 10 % p.a. in 2011 as large investment projects of state-owned enterprises get underway. Gazprom should account for nearly 20 % of total fixed asset investment next year.

Retail sales, an indicator of consumption, are expected to increase at about 5 % p.a. in real terms this and next year. The improved employment situation led to an upward adjustment in the estimate. The unemployment rate was 7 % in July.

With rapidly rising food prices, the economy ministry expects consumer price inflation to reach 7–8 % this year, which is a bit higher than earlier forecasts. The ruble's real effective exchange rate (REER, the exchange rate against the currencies of Russia's trading partners when corrected for inflation differentials) is expected to appreciate nearly 11 % this year and almost 6 % next year.

Growth in household deposits accelerated in the first half of the year. The Central Bank of Russia reports that household deposits in July were up 30 % y-o-y in nominal terms. Growth accelerated to near pre-crisis levels after dipping below 20 % during the downturn. The deposit stock in Russia has grown rapidly in the 2000s, driven in part by a 10 % average annual growth in real incomes. Russia's deposit stock is still small by international standards, however. The combined deposits of Russian household, company and other sectors equal 30 % of GDP, compared to the OECD average of about 100 %.

The recent deposit growth has also been influenced by higher real interest rates and slowing inflation. Nominal interest rates for deposits peaked at around 10 % last October and real rates turned positive for the first time since the late 1990s. Now real interest rates are again returning to negative territory as deposit rates are falling. The average deposit rate in July was 6 % while on-year inflation is expected to accelerate to 7–8 % by the end of the year.

Rosstat estimates that Russians saved about 16 % of their disposable incomes in 1H10. Savings were held in rubles and foreign currency, mostly in the form of bank deposits or cash. A June survey by Russia's National Agency for Financial Studies found that about half of Russians had no savings at all.

Rosstat reports that 64 % the ruble-denominated savings of private persons are held as bank deposits, 28 % as cash and the rest as securities. The share of deposits has generally been crowding out cash holdings in recent years, despite the short-lived rush to cash during the financial crisis. Generally speaking, growth in the share of savings held as deposits signals increased confidence in banks.

Both the maturity of time deposits and preference for holding rubles provide insights into the expectations of households. Positive economic trends encourage savers to move their money out of foreign currency accounts and into ruble accounts and hold a larger share of their savings as long-term deposits. The opposite occurred during the economic downturn: the amount of savings in foreign currency accounts rose to a third of total deposits. Previously, the trend had been falling, reaching a nadir of 13 % at the beginning of 2008. Foreign currency deposits presently account for just over 20 % of household deposits.

About two-thirds of domestic deposits are time deposits of more than a year. With the exception of some deceleration during the economic downturn, the share of long-term deposits has increased in recent years.

Bank deposits are still concentrated with Sberbank, Russia's largest bank, which holds 48 % of household deposits. Sberbank's share of deposits, however, has decreased in recent years. Sberbank still held 60 % of all household deposits in 2004.

Internet use varies from region to region. As of end-2009, about 40 million adult Russians (34 % of the adult population) logged on to the Internet at least once a month. While the share of Internet users in Russia is small relative to most developed countries, Internet use has been climbing rapidly and was up 20 % y-o-y in 2009. The highest growth was in the countryside, where Internet access still remains spotty. About 80 % of Russian Internet access takes place from home.

IT expert Yandex Corp. and pollster FOM report that Internet use is highest in Russia's big cities. In the eleven cities in Russia with populations greater that 1 million, an average of 51 % of the adult population went online at least once a month. In contrast, only 20 % of rural residents used the Internet. Internet use is highest in Moscow (59 %) and St. Petersburg (57 %).

Internet use was lowest in the Siberian Federal District, the Southern Federal District (which includes the Caucasus region), as well the Volga Federal District in central Russia. Some 28–29 % of the adult population used the Internet in these federal districts.

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China

China's four large state banks again post substantial profits. The first-half financial statements released by China's quartet of large state-owned banks (Agricultural Bank of China, Bank of China, China Construction Bank, Industrial and Commercial Bank of China) indicate profits were up 25–40 % y-o-y. The four banks posted combined pre-tax profits of approximately 330 billion yuan (€37 billion). The banks also reported that their stocks of non-performing loans had declined relative to the total loan stock. However, there was modest erosion in their capital adequacy ratios.

Despite the good headlines, there are a number of disconcerting facts concerning China's state-regulated banking system. Because the state strictly regulates interest rates on deposits and lending, and thus the spread, the profits of commercial banks are largely determined by how actively they issue loans. In addition, the state has in recent years generously poured new capital into commercial banks, which could potentially lead to serious moral hazard problems.

Chinese officials use the measures familiar in developed countries to rein in bank risk exposure and bank lending but also continue to resort to lending quotas. However, during the economic stimulus programme, the significance of lending quotas has diminished. Bank lending as of end-July already exceeded the year's official lending quota.

Even though China's big banks are exchange-listed, the bulk profits will ultimately end up in state hands. Banks not only pay slightly over 20 % in profit tax to the state, but the state itself is also the biggest recipient of dividend payments. The biggest banks paid out about two-thirds of their last year's profits in the form of dividends.

Oil pipeline deliveries from Russia to China set to begin this year. After years of tough negotiations, China's state oil company CNPC and Russia's state-owned oil pipeline operator Transneft finally agreed in September 2008 to build an oil pipeline running from Russia to China. Construction got underway in spring 2009 after the China Development Bank granted Transneft and Russia's state-owned Rosneft oil company a total of $25 billion in credits against future oil supplies. The pipeline to China branches off from the 4,000-kilometre East Siberia-Pacific Ocean (ESPO) pipeline. ESPO's eastern-most section is still under construction.

At the end of August, Russian prime minister Vladimir Putin travelled to Skovorodino in Russia's Far East Federal District for the official opening of the 60-kilometre section of the oil pipeline on the Russian side of the border. Putin noted his Chinese counterparts are expected to finish within the next few months a 930-kilometre section extending to the city of Daqing in the Heilongjiang province of northeastern China. Completion of the pipeline will help Russia diversify away from its current emphasis on supplying oil to Europe and serve China's growing appetite for imported oil. Under the current agreement, Russia is obliged to supply 15 million tons of oil annually via the new pipeline over the next 20 years.

In the first seven months of this year, China imported a total 137 million metric tons of crude oil, about 25 % more than in the same period in 2009. Oil imports from Russia increased by 10 % to about 10 million tons, or 7 % of China's total oil imports. Over the last years, 5–6 % of Russia's oil exports have gone to China. Oil shipments from Russia to China have so far been largely handled by rail or via pipeline from Kazakhstan. The new oil pipeline will significantly boost shipping capacity into China. Rosneft plans to deliver oil by pipeline to China from the East Siberia Vankor oil field, which began producing last year.

The process of getting an oil pipeline running directly from Russia to China has been complicated. This highlights the central roles of energy and raw materials in Far Eastern Russia's economic and political evolution and tensions lurking just below the seemingly calm surface of Russia-China economic relations. Beyond oil, the two countries have long discussed the possibility of a natural gas pipeline from Russia to China. Despite numerous memoranda of intent, no concrete deal has been reached. While this could change as Russia's long-range plans of development of its natural gas industry through 2030 mention implementation of a trans-Altai gas pipeline project during 2015–2018, observers are largely sceptical.

Sharp jump in level of China's car imports. China imported nearly 200,000 cars in the first six months of 2010, three times the amount imported in 1H09. Most imported cars came from Germany (60 %), followed by Japan (20 %) and the UK (5 %). Imports were up sharpest from Germany and the UK, quadrupling in the January-July 2010 period from the same period a year earlier. Imports accounted for 4 % of cars sold in China in the January-July 2010 period. Car imports accounted for just 1 % of China's total imports.

All of the world's large car producers now build cars in China. In earlier years, China's domestic car production was sufficient to meet domestic demand. The rapid growth of imports this year is believed to largely reflect booming demand for luxury cars. Among the factors driving growth in China's car market are rising consumer demand and state subsidies for new car purchases.

China has had the world's largest car market since 2009, when 12 million cars were sold, a 50 % increase from 2008.

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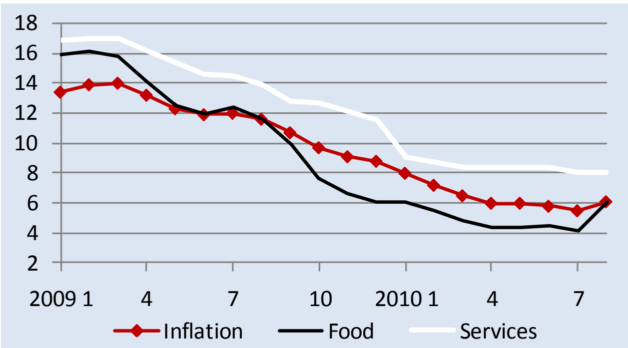
Russia

Rise in food prices led to higher inflation in August. Russia's consumer price index, climbing from 5.5 % y-o-y in July, reached 6.1 % y-o-y in August. Inflation declined steadily from spring 2009 to July 2010, due in part to the economic recession and a second straight year of ruble appreciation. Inflation this year has been the lowest since the breakup of the Soviet Union.

Russian inflation remains high by international standards, however, driven in part by steady hikes in prices of municipal services as the government aims to bring prices into line with their production costs. Food items constitute a large share (nearly 40 %) of Russia's consumer basket. As a result, food prices have a major impact on consumer inflation. Food normally constitutes a much smaller share in consumer baskets in developed countries (e.g. the average share for EU countries is around 20 %).

Consumer price inflation and prices of food and services, 12-month %-change



Source: Rosstat

Higher food prices drove the acceleration in August inflation. Food prices were up 6.1 % y-o-y in August on expectations of an impending lousy grain harvest. Among individual food items, the sharpest price hikes were registered for buckwheat (up 31 % from the previous month), wheat flour (up 11 % m-o-m) and millet (up 8 %). Prices of milk products climbed over 3 % m-o-m and sugar nearly 5 %. A recent investigation by the Federal Antimonopoly Service found the rapid increase in food prices was due to hoarding by individuals and companies withholding products from the markets in anticipation of higher prices later.

The agriculture ministry's latest forecast shows Russia is on track to harvest 60–67 million metric tons of grain this season, which is well below the average annual grain harvest for the past decade (2001–2009) of 88 million tons. Russia annually consumes 77–78 million tons of grain, and it is estimated that Russia currently has 18–25 million tons in grain reserve from previous years. The figure includes the state emergency reserves.

Prime minister Vladimir Putin announced last week that the export ban on grain exports imposed on August 15 would remain in force at least until September 2011 to assure Russians have adequate grain supplies. Early this week, president Dmitri Medvedev walked back the announcement a bit, noting the export ban could be lifted when the size of this year's grain harvest will be known. Use of the state's 9.5 million ton emergency reserves to stabilise prices was discussed all summer. On Monday president Medvedev announced that the emergency reserves would not be touched before the end of the year.

Fixed investment in Russia increasingly directed towards the energy sector. Rosstat reports that the volume of fixed investment in the first half of the year rose just over 1 % from 1H09. Rosstat tracks in more detail fixed investment of large and mid-sized firms, which account for about 70 % of total fixed investment. Their investments continued to shrink at a rate of about 10 % y-o-y in the first half of 2010. Last year, their investments declined over 15 %, roughly the same pace as fixed investment overall.

Some 40 % of the investments by large and mid-sized firms in 1H10 went to production, transportation or distribution of energy (mainly oil, natural gas and electricity). In addition, 3 % of investment went to oil refining. The energy sector's share of investment has grown in recent years. The sector accounted for 30 % of large and mid-sized firms' investments in 2007–2008 and 35 % in 2009. The sector's share in total fixed investments was 25 % in 2007–2008 and 30 % in 2009. Investment in production of electricity and pipeline capacity has risen briskly during the recession. At the same time, investment in crude oil and natural gas production decreased about 15 %. This decline is reflected in low growth forecasts for oil and gas production in the next few years.

The share of manufacturing industries (excluding oil refining) in the investments tracked by Rosstat fell slightly during the economic downturn. The share was 13 % both last year and in the first half of this year. Investments in manufacturing industries in the first half of this year continued to contract, and were down about 25 % from the pre-crisis level of 1H08. Expectations of a recovery in investment are quite cautious as industrial firms still have more idle production capacity than they did before the downturn.

The development of overall investment has also been dragged down by a continued fall of investment in the real estate sector. The volume of investment in the sector in the first half was about half of the level two years earlier. The real estate sector's share of total investment has fallen to just over 10 %, compared to a nearly 20 % pre-recession share.

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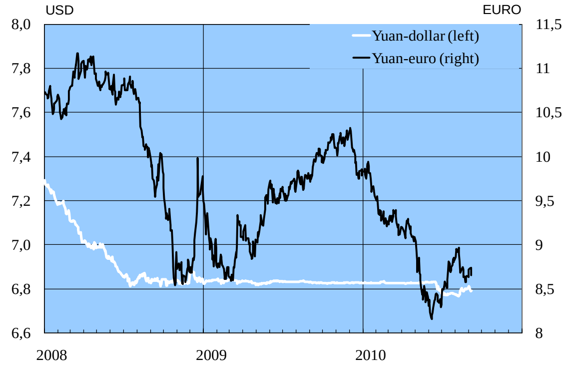
China

International yuan use rises; no major changes in the exchange rate. The use of the yuan in foreign trade has increased the need and demand for yuan-denominated financial instruments. In response, the People's Bank of China has launched a trial programme that lets permitted foreign banks participate in yuan bond trading on the interbank market. The international significance of the yuan has been enhanced this year with the opening of China's corporate debt markets. McDonald's Corp. became the first non-financial company to test the waters in China's yuan bond market with a 200 million yuan ($29 million) issue in August and Russian aluminium giant Rusal has announced plans to issue its own yuan bonds. Although these issues are relatively small, the diversification and rapid rise of use of yuan instruments indicate China's commitment to raising the international profile of the yuan.

The yuan's rate against the US dollar has defied expectations since China abandoned its 6.83-yuan peg in mid-June. Instead of rising, it has fluctuating and appreciated only slightly against the dollar. Even so, reforms in currency trading are moving ahead. The yuan is now tradable on the interbank market along with US dollars, euros, yen, HK dollars, pound sterling and Malaysian ringgit (added last month). Bloomberg reports it will soon be possible to use Russian rubles as well.

Euro-yuan, dollar-yuan rates, 2008–2010 (falling trend indicates yuan strengthening)



Source: Bloomberg

Wages in China's manufacturing sector nearly on par with Mexico. Figures of International Labour Organization (ILO) show that manufacturing wages rose particularly fast in China, Romania and Russia during 2003–2008. In the same period, manufacturing wage growth in Indonesia and Mexico was quite low. The average monthly wage for a manufacturing worker in 2008 was €75 in Indonesia, €230 in China, €320 in Romania, €400 in Russia and €700 in Poland. The average monthly manufacturing wage in Finland in 2008 was €2,900.

China's manufacturing wages nearly doubled during 2003–2008, while wages went up just 25 % in Mexico. The average wage of a Chinese manufacturing worker in 2002 was less than half the average wage paid to his or her Mexican counterpart. That difference narrowed to just 20 % by 2008. Singapore-based electronics-maker Flextronics reports that China's current wage levels already match Mexican levels. This is due in part to the fact that Mexican wage growth has stalled since 2007.

Chinese manufacturing sector wages have risen 24–30 % this year, partly in response to strikes. Despite higher wage costs, China still offers substantially cheaper production opportunities than the US or Europe, and has a huge and burgeoning domestic market. If Chinese real wages continue to rise sharply, it is likely companies will continue to move production inland from coastal southern China to take advantage of lower production costs. International companies could also seek production opportunities in countries that offer a superior cost advantage to China. However, the significance of China's domestic market for foreign companies operating in China is important. A survey by the American Chamber of Commerce in China found that over half of US firms in China operate solely to serve China's domestic market. Only a fifth of firms reported they were in China primarily for export reasons.

European firms want Chinese officials to focus on easing market access and consistent application of the law. Despite improvements in the operating environment, a new report from the European Union Chamber of Commerce in China suggests foreign firms still face substantial challenges in conducting even basic business activities in China. The problems facing firms stem from barriers that include market access, burdensome permitting procedures, intellectual property right violations as well as inconsistent application of laws and regulations. The EU Chamber of Commerce in China annually reports on the experience of European firms in China with a view to developing the business environment in ways that make China more favourable to foreign investors. The 2010 report was released last Thursday (Sept. 2) in conjunction with the meetings of EU foreign policy chief Catherine Ashton with Chinese political leaders in Beijing.

In the first seven months of this year, FDI inflows into China amounted to $58 billion, a 20 % increase from the same period in 2009. Although the EU is China's largest trading partner, in recent years only around 2 % of FDI outflows from EU went to China. FDI inflows from the EU to China represented only about 5–7 % of China's total FDI inflows. The bulk of investment in China comes from Hong Kong, which accounted for over 60 % of China's FDI inflows in the first seven months of this year. FDI last year accounted only for about 3 % of China's total fixed investment.

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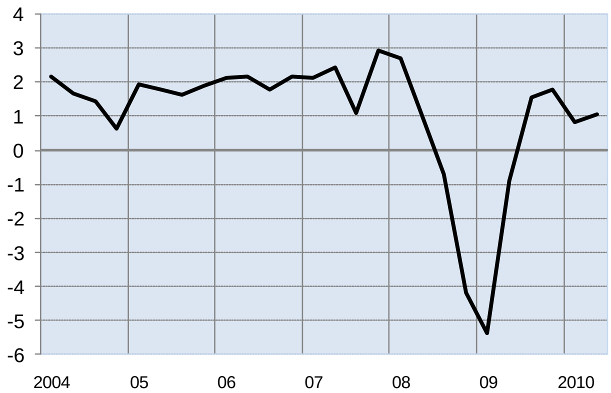
Russia

New GDP data show economic recovery slowed this year. Rosstat last week released revised GDP figures covering the 2003–2010 period. The new data show that, after the Russian economy rebounded robustly in the second half of 2009 from a severe contraction that hit bottom in the first half of the year, GDP volume growth slowed in the first quarter of 2010 (see chart). Preliminary data suggest seasonally adjusted GDP grew about 4 % in annualised terms in 1Q10 and, according to preliminary data, also in 2Q10. As in earlier years, this year's figures are subject to reassessment.

GDP in the second quarter of this year was up over 5 % from its 2Q09 nadir, but still about 6 % below the pre-crisis peak of 2Q08. The new data confirm how hard the Russian economy was hit by the global financial crisis. The Russian economy entered about a year-long tailspin in late summer 2008, when GDP and private consumption, a key demand component, contracted 11 %. Capital investments fell 20 % and imports 40 % (all figures seasonally adjusted).

There is little difference between Rosstat's earlier GDP data and its revised figures in the context of long-term trends. Earlier estimates of GDP growth in 2003, 2004 and 2005 were left unchanged, while the growth figures for 2006 and 2007 were raised and GDP growth in 2008 downgraded. Since the beginning of 2006, the level of the GDP volume has been revised upward slightly as private consumption grew even faster in pre-crisis years than originally estimated. Since 2007 private consumption ran about 2 % higher than stated in earlier official figures.

On-quarter change in Russian GDP volume (seasonally adjusted), %



Source: Rosstat

Domestic production of passenger cars surges; imports recover more slowly. Rosstat reports that in the first half of 2010, 488,000 cars were produced in Russia – a jump of nearly 70 % from the production low of 1H09 when car production was down 60 % from 1H08. In the first half of this year car production was still down about 30 % from 1H08.

The share of cars produced in Russia relative to the supply of new cars available in Russia (production and net imports) increased in 1H10 to over two-thirds (55 % a year earlier). Assembly of foreign makes soared 85 % y-o-y, lifting them to a 32 % share of supply. Production of domestic makes increased 53 % y-o-y to 36 % of supply.

AvtoVaz, Russia's largest carmaker, which is a quarter-owned by the French Renault and the rest mainly by Russian shareholders, churned out nearly 218,000 cars in January-June. That corresponded to 30 % of the total car supply and a 56 % y-o-y increase. All cars manufactured by AvtoVaz are made under the Lada brand. During 2009-2010, Avtovaz received 75 billion rubles (about €2 billion) in government support, the largest share of a 170 billion ruble (nearly €4.5 billion) support package for carmakers.

In March this year, the Russian government started its own "cash for clunkers" programme, under which it granted 10 billion rubles (€280 million) 50,000 rubles (about €1,300) in discount coupons to each buyer that traded in his or her at-least-ten-year-old used car and bought a new car. The key provision was that the new car had to be manufactured or assembled in Russia. The wildly popular programme has been extended twice with additional support infusions of 11 billion rubles in July and 13.5 billion rubles this month. The purpose of the programme was to revive Russia's recession-clobbered car industry. For example, programme subsidies helped drive the programme Lada sales in the first half of the year to about 69,000 units.

Because of government support to domestic carmakers and increased tariffs on imported cars of 30-35 %, fewer cars were imported (251,000) in 1H10 than in 1H09. Following a sharp decline in imports in the first quarter, however, growth in car imports rebounded 45 % y-o-y in April-July. The Russian customs service reports that 98 % of imported cars were new and nearly 70 % of them were either Japanese or South Korean makes. During the first seven months of the year, nearly 39,000 cars were imported into Russia from Uzbekistan, which appears to have become a considerable channel for car imports this year.

Transhipments of cars via Finland to Russia shrank 8 % y-o-y in the January-June period, and had a value of €1 billion. The contraction reflected the slow pace in the first quarter. In the second quarter, transhipments of cars to Russia revived sharply. During the January-June period, about 88,000 cars were transhipped via Finland, 35 % of Russia's total car imports.

Only about 1,200 cars were re-exported via Finland to Russia in 1H10, down from about 10,500 in 1H09 and 48,000 in 1H08. Re-exports are imported goods that are cleared through Finnish customs before rolling on to Russia.

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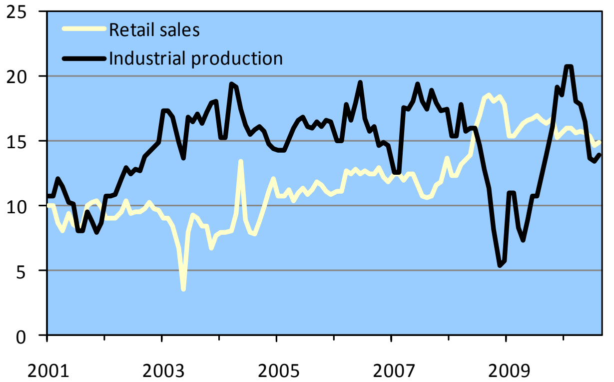
China

August upswing in industrial output surpasses expectations; domestic demand remains strong. China's National Bureau of Statistics (NBS) reports industrial output in August climbed 14 % y-o-y in real terms, when the output rose 13 % y-o-y in July. Growth exceeded several economist estimates indicating that domestic and international demand are now recovering after slowing in the first half of the year. Industrial output for the January-August period was up 17 % relative to the same period a year earlier. The index of manufacturing purchasing manager sentiment (PMI) strengthened slightly in August, reversing steady declines of the previous three months. The PMI goes up when a greater share of purchasing managers believe their company's current work situation has improved from the previous month.

Retail sales continued brisk, rising in August 15 % y-o-y and in January-August 16 % y-o-y in real terms. Chinese officials report retail sales figures both in yuan terms and y-o-y growth rate. This year, the method for calculating the yuan figure was changed, so the reported values are not directly comparable with figures from earlier years. The chart below is based on 12-month growth figures.

Fixed asset investment, together with retail sales, provide a glimpse of economic demand. In January-August fixed asset investment growth has steadily slowed down, due in part to reduced investment in public projects. The rate of growth, however, remained solid (real growth of 22 % y-o-y in the January-August period).

Industrial output and retail sales, real y-o-y %-change



Sources: National Bureau of Statistics and BOFIT

Rising food prices cause consumer price inflation to accelerate. The NBS reports August consumer prices were 3.5 % higher than in August 2009. 12-month consumer price inflation was 3.3 % in July and 2.9 % in June. The acceleration in inflation is due largely to the higher food prices in recent months. Prices of other products have remained fairly stable. Growth in producer prices slowed slightly in August. Looking at asset prices, the NBS noted the average apartment price in China's 70 largest cities remained essentially unchanged in August – the third month in a row with housing prices showing no movement. NBS housing price figures are recently considered suspect by many observers.

The price of food has a substantial impact on consumer price inflation as it accounts for about a third of the shopping basket that is the basis of the consumer price index. It is difficult, however, to ascribe the sharp rise in food prices to domestic factors as China is largely self-sufficient in basic food production, and the agriculture ministry is currently saying that harvests of critical grain and tuber crops should be quite good. The rise in domestic food prices reflects at least to a certain extent price trends on world markets, which have seen food prices soar in recent months. In late 2007 and early 2008 when the grain prices spiked globally, the prices in China were affected as well.

Uncertainty over the global economy hurts China's export numbers. The value of Chinese exports fell from $146 billion in July to $139 billion in August. Seasonally adjusted, the value of exports fell for the third month in a row. A contraction in exports indicates inventories in Europe and the United States, which were lowered during the financial crisis, have been rebuilt and approaching normal levels. The decline in exports of production goods in August may also be evidence of weakened recovery prospects of the global economy. Among China's top export good categories, the only significant export growth in August from July was registered in clothing and footwear.

The value of imports in August was $119 billion, about the same amount as in July. The monthly value of imports has remained in the range of $110–120 billion since March. Measured on-year, however, growth was 35 %. China recently has been a huge importer of copper, crude oil, soybeans and machinery and equipment. Higher prices for certain critical metals used in production have also contributed to the rise in the overall value of imported goods.

With export growth down slightly and imports continuing to grow steadily, the trade surplus contracted from $29 billion in July to $20 billion in August. Despite the decline, China's trade surplus remains massive by world standards and has renewed calls by other nations for a stronger yuan.

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Russia

Russian economy posts weak summer growth; imports revive. This summer's exceptional heat wave and drought contributed to Russia's poor economic performance. Private consumption, the largest component of aggregate demand, appeared to falter, as reflected by retail sales. The seasonally adjusted volume of retail sales rose quickly in the first half, then slowed, and fell in August back to the May level. Sales of non-food goods declined throughout the summer, while food sales dipped in August. The summer drop came even if a good pace of growth in real wages continued. The rash of hoarding of certain types of foods at the end of the summer on rumours of impending price hikes did not prevent the dip either.

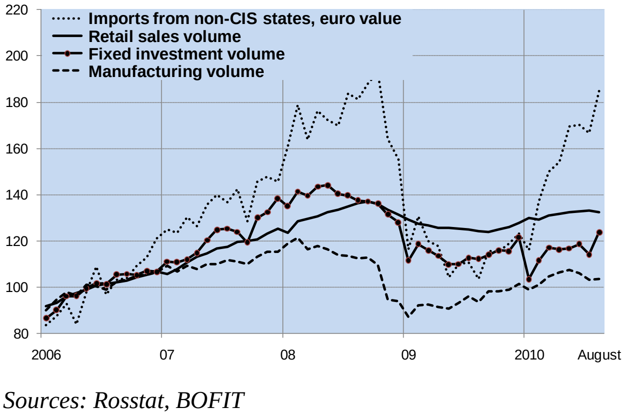
Fluctuations in the pace of fixed asset investment and construction in the first half and the summer have given certain evidence of gradual recovery. Fixed investment was up 6 % y-o-y in the summer, while construction maintained its summer 2009 level.

Summer was tough on domestic industrial and agricultural producers, however. Industrial output overall was slightly lower than at the end of spring. After experiencing rapid growth during January-May, manufacturing industries saw seasonally adjusted output contract a few per cent during the summer. Production levels of both oil and gas remained nearly unchanged. Agricultural output contracted. As of end-August about 30 % less grain had been harvested than at the same point in 2009.

After a break in early summer, growth in imports resumed in August. In summer, the seasonally adjusted value of imports from non-CIS countries was about a third larger than in the last months of 2009.

Weak demand and imports have depressed GDP gains. Preliminary economy ministry figures show GDP up nearly 4 % y-o-y in the January-August period.

Core demand and production categories, seasonally adjusted, indices (2006 = 100)

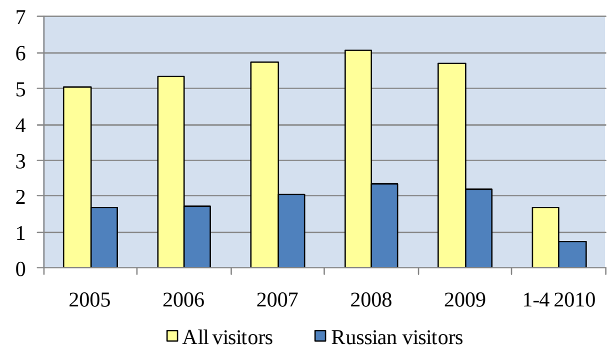


Sources: Rosstat, BOFIT

Slight increase in number of Russian visitors to Finland. According to the latest Border Interview Survey by Statistics Finland, in the first four months of 2010 Russians made 720,000 trips to Finland, accounting for about 46 % of all trips made by foreign visitors. One factor boosting the Russian figure is the fact that over half of Russian visits are one-day shopping trips. Russian tourists visit Finland year-round, while tourists from most other countries tend to visit Finland in the summer. As a result, the summer numbers will give a somewhat different picture.

Visits by foreigners to Finland increased 9 % y-o-y overall in January-April, while trips of Russian visitors were up 3 %. In 2009, both the total number of visitors and Russian visits fell 6 % from the previous year.

Number of visits to Finland from abroad (millions of visits)



Source: Statistics Finland

During the first four months of 2010, Russian visitors spent in Finland an average of €240 per visit, or 3 % less than in the same period a year earlier. Bank of Finland balance-of-payments figures show that earnings on Russian visits totalled €628 million in 2009 or about a third of total expenditure by foreign residents visiting Finland (€2 billion).

Rosstat reports that in the first half of 2010, Russians took nearly 16 million trips abroad, an increase of about 13 % y-o-y. The most popular non-CIS tourist destinations for Russians were Finland (9 % of total visits), Egypt (8 %), Turkey (7 %) and China (6 %). Finland's touristic dominance has contracted from 14 % in 2009 and 16 % in 2008. Finland's proximity to Russia largely explains the popularity of cross-border shopping jaunts. Russians also make frequent shopping trips to China.

Data from Russia's border guard service show that in the first half of 2010, about 10 million foreign citizens visited Russia. The number of visitors was up 2 % y-o-y. About 6 million visitors were citizens of CIS countries. About 420,000 Finns travelled to Russia, making Finns the largest non-CIS visitor group. Slightly over half of Finns went to Russia for business purposes.

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China

US repeats criticism of China's exchange rate mechanism, slow yuan appreciation against the dollar. President Barack Obama again asserted measures by China's officials to boost the yuan's external value have been inadequate and that the yuan remains undervalued against the dollar in prevailing market conditions. The US administration has hounded China for years about its undervalued currency and is discussing adjustments in trade policy unless China permits faster yuan appreciation. President Obama and Chinese premier Wen Jiabao met to discuss the matter this week during the UN General Assembly.

The US points to China's long-running trade surpluses (over $100 billion in the January-August period) as evidence that China deliberately maintains an artificially low exchange rate of the yuan. A weak yuan enhances price competitiveness of Chinese export goods but also adds to inflationary pressure that depresses real incomes of Chinese workers.

Since China lifted its two-year-long dollar peg of the yuan in June, the yuan has gained less than 2 % against the dollar. The yuan was allowed to appreciate about 20 % against dollar after 2005, but in 2008 China's officials repegged the yuan to the dollar as the country prepared to ride out the global financial crisis. In the wake of president Obama's broadside on China's currency policy, the yuan appreciated against the dollar to about 6.7 this week. Yuan futures contracts anticipate further yuan strengthening of about 2 % over the next twelve months.

A second area of interest is the yuan's increasing international role, which is creating greater demand for the currency and adding pressure to let the yuan appreciate. Last month, China opened its interbank bond market to central banks with which it has bilateral currency swap agreements. The value of the swap agreements presently totals about $120 billion and signatories include the central banks of Argentina, Belarus, Hong Kong, Iceland, Indonesia, Malaysia, Singapore and South Korea. Unconfirmed reports say Malaysia's central bank just purchased yuan bonds for its currency reserves under the arrangement.

Japan releases Chinese captain; incident tests bilateral relations. Two weeks ago, Japan's coast guard boarded a Chinese fishing vessel in disputed area of the East China Sea with rich natural gas fields. The Japanese claim the Chinese provoked the incident when their ship collided with the coast guard vessel. The Chinese ship captain was released today (Sept. 24). On Wednesday (Sept. 22), premier Wen Jiabao had threatened retaliatory measures unless Japan quickly released the Chinese captain. China had already scrubbed a high level visit and protests were staged in front of the Japanese embassy in Beijing. Last week, after China increased its buying of Japanese treasuries, the Japanese claimed their central bank had been forced to intervene in the markets to drive down the price of an already-strong yen.

Before the incident, relations between the Asia's two largest economies had improved dramatically. Chinese and Japanese leaders met regularly, cooperation between the two countries was on the rise and trade and tourism blossomed. Many observers thought the two countries had reached agreement already in 2008 on the disputed gas fields in the East China Sea, but Japan's economy ministry continued to assert discussions were ongoing.

China only BRIC to move up in international competiveness rankings. The World Economic Forum (WEF) Global Competitiveness Report 2010–2011 was released September 9. China moved up from 29th place to 27th place, while India (51) and Brazil (58) both dropped two notches. Russia remained in 63rd place. The report gave China especially high scores for the competitive advantage conferred by its domestic market size (ranking 2) and macroeconomic conditions (ranking 4), which it credited largely to a high national savings rate. China's ranking for financial market development was lifted 24 places to 57, which largely explains the country's overall improvement in the competitiveness index (GCI) rankings. China's ranking was also affected by the ongoing problems in financial markets elsewhere. China continued to get low marks in technological readiness (78) and higher education and training (60), despite slight improvement in both areas. Business leaders felt the biggest obstacles to success were access to finance, constantly changing administrative procedures and corruption.

Russia's competiveness was bolstered by having the world's eighth largest domestic market, and gains in infrastructure and higher education. Factors contributing to Russia's poor competitiveness include institutional weakness, slow development of financial markets and inefficient goods markets. Companies blamed corruption, lack of access to finance and tax policy as their biggest obstacles to business success.

Like China and Russia, the biggest competitive advantage of Brazil and India was domestic market size . Brazil occupied a rear position in terms of macroeconomic conditions, efficiency of its goods and labour markets and its education system. India's competitiveness was impaired by poor infrastructure, public economy problems, low levels of health care and education and an inefficient labour market. Business leaders said doing business in Brazil was hampered by the tax regime. The biggest drawbacks in India were corruption and poor infrastructure.

The report is based on some 13,000 interviews with business leaders and the GCI. The countries tracked in the index are evaluated under twelve major criteria. The weighting of competitiveness criteria vary from country to country depending on its level of economic development.

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Russia

BOFIT forecast anticipates rapid growth of Russian economy overall during the 2010–2012 period. While the initially strong recovery of the Russian economy from last year's deep recession slowed somewhat this year, growth should pick up in the later part of the year. The annual GDP growth figure will be below 5% for 2010. This year's growth has been supported by a steady rise in the price of oil last year. Quarterly growth should slow next year. However, the annual growth figure for 2011 should reach 6 % due to this year's low comparison level.

Russian real GDP, yearly change, %

	2007	2008	2009	2010	2011	2012
GDP	8.5	5.2	-7.9	5	6	5

Sources: Rosstat (2007-09), BOFIT forecast (2010-12)

Consumer demand will drive economic growth as real wages continue to rise, and pension growth should nearly match wage growth. The savings rate, which rose in the recession, is not expected to advance further in the years ahead. Employment may grow slowly after contracting only a couple per cent in the recession.

Robust investment growth is not expected to return until next year, because e.g. firms currently still have more excess capacity than before the recession. Banks are liquid to the extent that they should be able to accommodate (at least partially) the return of investment credit demand.

The volume of Russian exports is expected to increase relatively slowly, despite the rapid expansion in global trade. The main limiting factor is the low growth in Russian oil production, which is determinative of growth in exports of crude oil and oil products. Natural gas exports, on the other hand, are expected to increase.

Rapid growth in the volume of imports (up over 20 % in 1H10 from the deep cave of 1H09) should slow starting in the second half of this year. We still anticipate annual import growth to continue in excess of 10 % in 2011 and 2012 as consumer demand continues to rise and investment recovers. The economy's propensity to import is expected to be high, at pre-recession levels. Imports should continue to benefit from the gradual strengthening of the rouble's real exchange rate, which is due to the current account surplus. Even so, Russia's current account surplus is sensitive to the rate of import growth and oil prices.

The forecast is subject to large uncertainties. Russia's economy remains highly dependent on energy and commodity prices, as well as trends in global financial markets. Moreover, the outlook for investment is clouded by uncertainties about demand and Russia's operating environment. Higher-than-expected import growth would cause GDP growth to fall short of our forecast. (BOFIT Forecast for Russia 2010-2012).

Central bank withdraws support measures imposed during the financial crisis. When the financial crisis hit in autumn 2008, the Central Bank of Russia increased its supply of credit to banks by easing rules on which securities it would accept as collateral, extending loan periods and guaranteeing interbank lending. At the height of the crisis, the CBR even granted banks non-collateralised credit. The emergency measures are gradually being withdrawn. As the bank balance sheets have returned to health, the need for government assistance has waned.

A 2009 financial emergency decree that allows banks that suffer losses in two consecutive quarters still to take deposits will run until the end of this year. Under normal conditions, a bank that operates for six months in the red is forbidden from taking further deposits. At the end of June, Russia had 85 such banks out of a total of approximately 1,040 banks. There is a debate in Russia at the moment over whether there is justification for extending the emergency policy into next year.

The CBR continues to develop its banking regulatory framework. This spring, the central bank gave more detailed recommendations for banks concerning their financial dealings with owners and other insider groups such as executive officers and directors. For example, loans to bank owners should not exceed 20 % of a bank's capital. Observers note that this level of lending is still commonly exceeded in the Russian banking sector. An amendment to Russia's banking laws now in the drafting stage would give greater specificity to what constitutes an insider and broaden CBR supervisory oversight of bank business transactions with members of insider groups.

The CBR has recently focused its attention on the rising market risk generated by corporate bonds held by banks. Rather than make direct loans to companies during the recession, to avoid increasing credit risk banks preferred to purchase corporate debt issues.

The CBR recently reported that the share of non-performing loans (payments at least 90 days in arrears) to total loan stock has not appreciably changed over the current year and remains at just under 10 %. However, because Russian statistical methods differ from international practice, observers suspect that the actual stock of non-performing loans held by banks is closer to 20 % of the total loan stock.

Russia's banking sector on average is quite well capitalised. The sector's own capital to total assets was 19 % this summer. Over the past five years, this ratio has never dipped much below 14 %. The minimum capital requirement set by the CBR is 10 % for large banks and 11 % for small and mid-sized banks.

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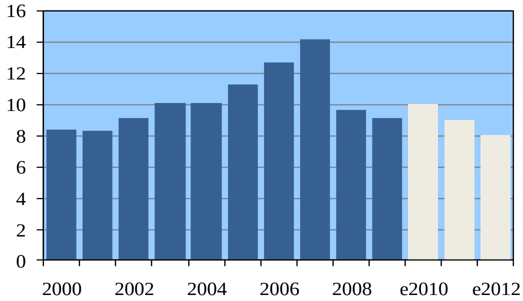
China

BOFIT sees Chinese economic growth increasingly driven by domestic consumer demand. Growth in first half of 2010 outstripped our earlier expectations due to surprisingly robust growth in both domestic and international demand. Growth slowed in 2Q10, however, and is expected to continue to slow through the end of the year. Even so, the higher-than-expected growth in the first half made us revise our projection for 2010 overall GDP growth up to 10 % (BOFIT China Forecast 2010–2012). Our growth expectations for the next two years remain unchanged. China is already the world's second-largest economy. As such, growth must inevitably slow as the economy's sheer size hinders it from consistently attaining the blistering double-digit annual growth rates of the past.

Real GDP growth and BOFIT forecast 2010–2012, %



Sources: NBS and BOFIT

In coming years, the role of consumer demand will increase as the main driver of China's economy. Growth in consumer demand will be supported by strong income growth and government measures to reduce China's high savings rate. Official statements concerning the upcoming five-year plan (2011–2015) emphasise the importance of boosting domestic consumer spending. The expected yuan appreciation in the next two years should further contribute to higher domestic consumption levels. As urbanisation of the Chinese population proceeds, the rapid rise in domestic investment demand should continue, even if the historically high fixed capital investment growth achieved during the stimulus will not be surpassed.

In the first half of the year, international demand for Chinese products increased. Although such demand fuels growth in China this year, the contribution of net exports to GDP growth will wane in the face of strong import growth in 2011 and 2012. The current account surplus as measured in dollars will remain large. However, relative to GDP it is not expected to return to 2006−2008 level, but rather remain in a more modest range of 4–6 %.

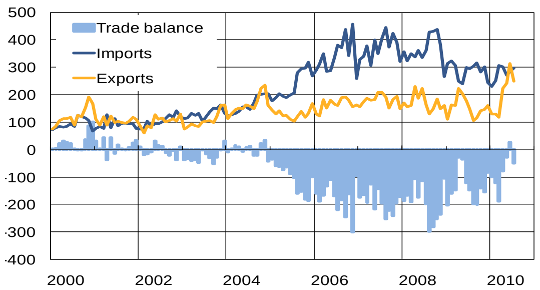
The rise in consumer prices this year has remained at a modest 3–4 %, and there is no threat of a significant acceleration in inflation on the horizon. If consumer inflation remains around 3 %, real deposit rates stay negative and increase pressure on officials to raise reference rates. While apartment prices are expected to decline for the remainder of this year, builders and actors in the housing market generally remain quite sanguine about the outlook. A sudden sharp drop in prices, however, would curtail construction investment dramatically and erode the quality of commercial banks' loan portfolios and reduce sales of land-use rights, a major source of revenue for local governments. If the high-end debt projections of last spring materialise, local administrations might have to cut down their investment expenditures. In addition international calls for more rapid yuan revaluation could result in trade policies specifically targeted against Chinese products.

Finland's exports to China up sharply last year. Customs Finland reports the value of Finnish goods exported to China in the first seven months of the year rose 18 % y-o-y to €1.4 billion. Exports rose rapidly especially during the April-July period. In June alone, Finland exported €310 million worth of goods to China. In January-July, Finland imported about €1.9 billion in goods from China, (down 4 % y-o-y). The rapid growth in exports helped Finland achieve a trade surplus with China in June. For January-July, the trade deficit year-on-year was down by more than a third to €300 million.

The rapid growth in Finnish exports to China relates to increased demand for some of Finland's core exports, particularly pulp used in papermaking and certain types of machinery and equipment. In particular exports of paper machines and related equipment have been brisk in recent months. Nearly a fifth of all pulp exports and over half of all paper machinery exports from Finland this year went to China. The strong revival in Finnish exports lifted China's share of Finland's total exports to 5 % in January-July. As a result, China has surpassed Great Britain as Finland's sixth largest export destination. China's share of total imports to Finland fell a percentage point to 7 %.

While Customs Finland's figures extend only through July, foreign trade figures from China include August. Even though the figures are not directly comparable, they indicate that Finnish exports to China continued strong.

Finland's goods trade with China, € million



Source: Customs Finland

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Russia

Revised federal budget raises revenue and spending projections. Late last month, the government submitted its proposal for the budget of the federation to the Duma. This week, the government also discusses the supplemental budget for 2010. The draft documents together anticipate nominal revenue increases of 6-7 % y-o-y this year and next year. The revised revenue estimates are 13 % higher for 2010 and nearly 20 % higher for 2011 than the amounts used in last year's budget planning and the framework approved late last year by the Duma.

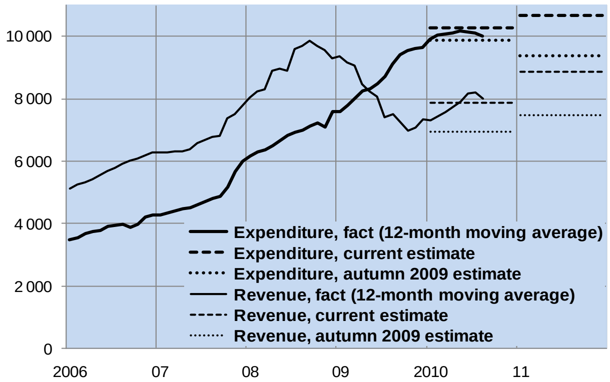
Revenue projections have been boosted by an upward revision of the assumption for the average price for Urals-grade crude oil; now $75 a barrel in 2010 and 2011 (the earlier 2010 assumption was $58-59 a barrel in the autumn 2009 budget process). Estimates for GDP growth and imports were also raised for both years. The economy ministry now expects GDP to rise 4 % this year and 4.2 % in 2011. Tax hikes, especially the ones directed to gas production, oil production in Eastern Siberia and gasoline, will also increase revenues. The weaker-than-assumed performance of the ruble exchange rate reduced export duty income projections, especially for crude oil and fuel oil, which are important revenue sources to the budget.

The government wants to shrink the budget deficit next year to 3.6 % of GDP (down from about 5 % anticipated for this year). On the other hand, based on the improved revenue outlook, the government has increased its expenditure estimate. The supplemental budget plan calls for nominal spending grow of 6 % this year 4 % next year. In real terms, spending would actually contract in both years about 2 % (less than the drops projected in last autumn's budget proposal). Notably, the spending target next year increases 14 % from the level agreed in the original budget framework approved at the end of 2009.

The cabinet's new proposed spending framework brings several changes. Of the largest spending categories, especially transfers to the state pension fund will be increased (nearly 30 % in nominal terms). Spending on defence, domestic security and law enforcement will increase slightly faster than expenditures on average. Spending on various sectors of the economy will contract about a tenth as stimulus measures introduced during the economic crisis are withdrawn. Transfers to regional budgets will also be cut by about a tenth.

Under the government's proposed budget, real growth in defence spending will take off next year, while spending on national security and law enforcement will stay the same in real terms. Spending on universities goes up substantially. Overall, other federal spending than transfers to other public sector budgets will increase 2 % in real terms. Transfers to regional budgets will continue to decline, as will transfer of funds to the pension fund (even if only temporarily). Pensions and wages of federal civil servants will stay unchanged next year in real terms.

Federal budget revenue and expenditures, RUB billion



Source: Ministry of Finance

Russia improves its ranking in international creditworthiness comparison. Russia's credit standing among the 178 countries ranked in last month's issue of *Institutional Investor* magazine climbed five notches to 45th place, immediately after Brazil, Mexico, Ireland and Spain, and slightly ahead of India and Portugal. The ranking of many countries in Western Europe have declined since September 2009 (e.g. Greece's ranking plunged 45 places to 81st place), while many developing countries moved up in the rankings (e.g. China rose 10 places to 23rd place). Topping the list were Norway, Canada, Switzerland, Singapore, Germany and the United States. Finland ranked 10th.

Institutional Investor's rankings are based on assessments of international bank and financial institutions as to a country's likelihood of defaulting on its debt servicing obligations.

Russia's external financing situation is good. As of end-June, Russia's central government foreign debt stood at $35 billion, a mere 3 % of GDP. In the corporate and banking sector, Russian foreign debt amounted to $408 billion, of which corporate debt accounted for $286 billion and bank debt $122 billion. Russia's total foreign debt as of end-June was $456 billion. At the same time, Russia's foreign currency reserves stood at $488 billion, or more than enough to cover the entire foreign debt.

Rather than finance budget deficits with foreign borrowing, the Russian state has preferred to dip into the country's stabilisation fund reserves built up from taxes on oil export earnings. As of end-August, the total amount of money in fund reserves stood at $127 billion. The funds held a total of $152 billion at the beginning of this year and $225 billion at the beginning of 2009.

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China

China hosts meeting of the UN climate conference working group in Tianjin. The meeting, which runs from October 4-9, focuses on final preparations for the upcoming UN climate summit to be convened at the end of November in Cancun, Mexico. China's willingness to arrange the working group meeting has generally been interpreted as a promising signal for Cancun as it has never previously hosted such a high-level meeting on environmental issues. Developed countries now expect China, which refused to commit to binding emission reductions at last year's Copenhagen summit, to intensify its efforts towards the climate change. China, in turn, urges developed countries do more to curb their own emissions. China is the world's largest energy user and last year surpassed the US as the world's largest producer of carbon dioxide emissions.

Somewhat surprisingly, China has become a pioneer in production of clean technology. China last year led the world in investment in renewable energy ($35 billion), while investment by the US, the previous leader, amounted to just over half of Chinese investment last year. While fossil fuels still account for over 90 % of China's total energy production, China's goal is to increase its share of energy produced from renewable sources from 9 % to 15 % and add 40 million hectares of forested area by 2020. China has also an objective to achieve a 20 % reduction in energy consumption measured as a share of GDP under its current five-year plan (2006–2010). At the end of last year, reductions were just over 4 percentage points from the target. China is under pressure to meet these targets.

China generates over 75 % of its electricity from fossil fuels, mostly coal. Among other non-renewable energy forms, nuclear power accounts for about 2 % of power generation. The use of renewable energy sources continues to grow. Hydropower today accounts for about 20 % of electricity generation and wind power about 1 %. China has doubled the amount of electricity produced by wind power over the past five years, making it the world's second largest wind-power producer after the US. China is now the world's biggest hydropower producer as a result of massive dam-building efforts.

China's dependence on coal is unlikely to diminish much in the future as robust economic growth continues to drive energy demand. Moreover, it will be years before renewable energy production can compete profitably with coal. The use of renewable energy is constrained by geography; energy demand is concentrated in south and southwestern China, while most power plants are located in northern or western provinces. In addition, remote power plants have little incentive to connect to the national grid due to the high costs associated with long-distance power transmission.

Energy cooperation tops agenda of Medvedev's China visit. Agreements on strategic cooperation in coal, natural gas and nuclear power were signed at last week's meeting of Russian president Dimitry Medvedev and Chinese president Hu Jintao. Both leaders also participated in a ceremony marking completion of construction of the oil pipeline from Russia to China. When the pipeline becomes operational next year, it will supply China with 15 million tons of oil annually for a period of 20 years. Despite years of planning of a similar gas pipeline, the Russians and Chinese have yet to begin construction as pricing principles remain unresolved. According to Russian deputy prime minister Igor Sechin, the parties will likely find a satisfactory solution already by next June. He also noted that Russia is ready to provide China with as much gas as it needs.

Expansion of China-Russia economic cooperation outside the energy sector was also discussed. Russia wants to diversify its trade with China (75 % of China's imports from Russia are raw materials). Exports from China are dominated by machinery and technical equipment. China's exports to Russia this year have increased considerably faster than imports from Russia. Exports rose over 70 % y-o-y in January-August to $18 billion. While imports were also worth about $18 billion, they grew 30 % y-o-y.

Steady growth in China-North Korea trade. At North Korea's largest meeting of the communist party in 30 years, the stage was set last week for succession of current leader Kim Jong-il by his third son Kim Jong-un. The country's leader consolidated the family dynasty by making several new appointments within the party. China, North Korea's only ally, congratulated Kim Jong-il for his re-election as party secretary general and announced plans to move ahead with bilateral relations that have been stalled in recent years by North Korea's nuclear ambitions.

With the exception of last year, China's published figures show trade with North Korea has risen steadily. Exports to North Korea in January-August were up by a third on-year to $1.3 billion. The value of imports was $650 million (up 20 % y-o-y). Key goods exported to North Korea include oil, coal, machinery, equipment, textiles and grain. China's top imported goods from North Korea include certain metallurgical products and minerals.

It is difficult for outsiders to evaluate the North Korean economy in the absence of statistical data. Officials publish no economic statistics, so available figures are largely based on foreign estimates. Total trade, however, can be inferred using mirror statistics. These indicate that in 2008 North Korea's total trade was about $5.6 billion, with a trade deficit of about $1 billion. China is North Korea's main trading partner, accounting for about 40 % of exports and over half of imports in 2008. At that time, China and South Korea together accounted for about 80 % of North Korea's foreign trade.

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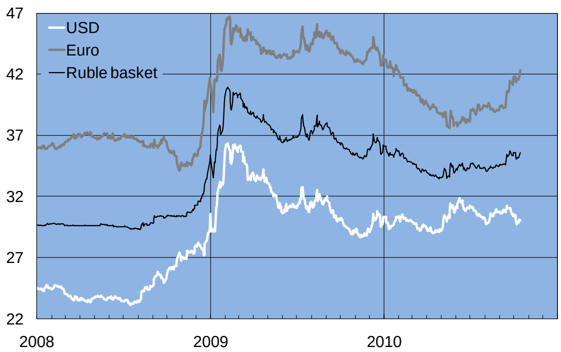
Russia

Russian central bank reduces its currency market interventions. The Central Bank of Russia announced that, effective October 13, 2010, the ruble would be permitted to fluctuate in a wider trading band. The external value of the ruble will remain tied to the dollar-euro currency basket that provides the CBR's reference in steering the ruble exchange rate. The fluctuation band was now expanded from three rubles to four rubles. The CBR also announced more active shifts of the fluctuation band. The band was previously moved in 5-kopek increments whenever currency interventions exceeded $700 million. The CBR considered this magnitude of pressure on the exchange rate to reflect changes in economic fundamentals that necessitate a change in the exchange rate level. Now the amount of intervention needed to justify moving the band has been lowered to $650 million. The new decisions will have little impact on CBR operations as it has largely refrained from interventions recently.

The changes conform with the 2011–2013 monetary policy programme prepared by the CBR and recently approved by the government. Under the programme, the CBR seeks to further reduce interventions in the currency markets, which will lead to greater volatility in exchange rates. The programme takes the view that pressures for a stronger ruble caused by current account surpluses will weaken in coming years as surpluses shrink. Imports are expected to grow rapidly, while Russian exports will grow slowly due to very modest increased in crude oil production. Moreover, the global price of crude oil is not expected to rise much further. Hence, the exchange rate trend will be increasingly sensitive to capital movements.

The ruble has lost nearly 7 % of its value against the euro since May, when it hit its strongest point against the euro this year. The ruble has lost much less ground against the dollar this year. Indeed, the dollar has lost 2 % of its value against the ruble since May. The ruble has lost 5 % of its value relative to its currency basket since May.

Ruble rate vis-à-vis US dollar, euro and currency basket



Source: Central Bank of Russia

Russia's current account surplus contracting this year. While the value of imports has grown rapidly as the recession recedes, the value of exports has increased more slowly due to the moderate rise in crude oil prices. Preliminary CBR figures show the third-quarter current account surplus was just under $8 billion, down from $19 billion in the second quarter and $34 billion in the first quarter. The overall surplus for January-September was $61 billion. However, compared with January-September 2009, the surplus almost doubled.

Balance-of-payment figures show a capital account deficit for January-September of $7 billion, due e.g. to the fact that more foreign direct investment was made from Russia abroad than from abroad to Russia. The capital account deficit was boosted also by unpaid export earnings and fictive securities transactions. The amount for this entry reached $20 billion in the first nine months of the year, which suggest a large flow of unregistered capital exports. The export of unregistered capital is also partly reflected in the net errors and omissions item, which was €9 billion.

The foreign currency reserves grew by $45 billion from the start of the year to the end of September. The value of reserves stood at $501 billion on October 8.

Russian consumer preferences have changed over the past 20 years. At the end of September, Rosstat published the results of its extensive panel study of household income and expenditure. The study was conducted last year and covered some 48,000 households located in diverse Russian regions.

The structure of Russian consumer behaviour evolved significantly between 1990 and 2009; today's structure closely comports with that of countries at a similar level of economic development. Russia's current level of consumption makes it a mid-level consumer economy by global standards. In 1990, Russian households spent 41 % of their income on food; last year that share had fallen to 35 %. Relative to developed countries, however, Russian households still spend a sizable chunk of their income on food. Some 46 % of income went to non-food goods purchases in 1990, compared to 38 % in 2009. The share of services doubled from 13 % in 1990 to 27 % in 2009. The strong growth in services indicates just how underdeveloped the service sector remained during the Soviet era and how rapidly the sector expanded thereafter.

The eating habits of Russians are definitely healthier. Russians eat more fruit, vegetables and fish than 20 years ago. Meat consumption has held fairly steady, while the relative share of bread and potatoes has diminished.

Many home appliances have become standard in the last two decades. In 2009, there were over 100 refrigerators, 100 washing machines and over 200 mobile phones per 100 households. There were also about 50 cars and 50 computers per 100 households last year.

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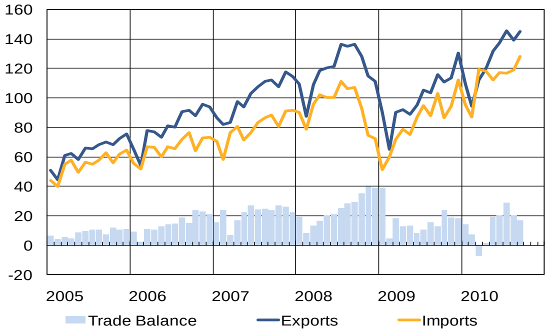
China

China's import growth outpaces exports in the first nine months of the year. With higher growth in imports than exports, China's September trade surplus fell by 15 % from August to $17 billion. The value of exports was $145 billion and imports $129 billion. Both exports and imports rose by a quarter from September 2009, when the global financial crisis was still strongly impacting China's foreign trade. Imports and exports each rose 35 % in August. When seasonal variation is removed, growth in imports in September was highest since the start of the year. Export growth, which spiked in May-June, stabilised during August-September.

China's trade surplus fell about $15 billion in January-September, declining some 10 % from the same period in 2009. The value of imports increased more than 40 % to $1.01 trillion, while the value of exports climbed 30 % to $1.13 trillion. China's largest sources of imported goods are Japan, the EU, South Korea, Taiwan and the United States. Imports from these countries rose 30–40 % y-o-y in January-September. Chinese exports to the US were up by a third from a year earlier, and the US accounted for about a fifth of China's total exports.

China's monthly exports, imports and trade balance, USD billion



Source: Bloomberg

Yuan continues to appreciate slowly. Since the dollar peg was abandoned in June, the yuan has strengthened about 2 % against the dollar to 6.66. Yuan appreciation is expected continue based on prices for 12-month non-deliverable forward contracts, which see the yuan-dollar rate reaching 6.45, a level 3.3 % stronger than the current rate. The yuan-dollar rate in Hong Kong is already 3 % higher than the prevailing mainland rate on expectation of a yuan rise. Forex trading in Hong Kong includes parties unable to trade on mainland China's forex market.

There is growing criticism internationally that China is not letting the yuan appreciate fast enough, which drives imbalances in the global economy. As China's trade surplus remains large, its currency reserves ballooned to a record $2.6 billion in September. At the same time the US struggles with faltering economic growth and a yawning current account deficit. In the euro zone and Japan, concerns focus on the loss of competitiveness of exporters, because even if the yuan has strengthened against the dollar, it has lost value against the euro and yen.

The currency disputes have not stayed in the realm of rhetoric. In September, the Bank of Japan attempted to stem the yen's rise by purchasing dollars, but the impact of the operation proved short-lived. Thailand imposed a tax on interest income and sales profits to parties outside the country to rein in capital flight. China openly warned the US of a trade war after the US House of Representatives passed a bill last month, which, if it becomes law, would make it possible for the US to impose trade sanctions on countries that engage in currency manipulation.

China's currency policy overshadows EU-China summit. China's premier Wen Jiabao again found himself defending China's foreign exchange policy on October 6 at the EU-China summit in Brussels. To skirt the currency dispute discussion, he offered to help indebted euro-area countries by bond purchases. Other topics included the disadvantaged position of foreign firms operating on China's market, intellectual property violations and China's ban on exports of rare earth elements, which are critical to a number of 21st century technologies.

During the January-September period, the EU was China's most important trading partner, taking a fifth of China's exports and providing 12 % of China's imports. China's January-September figures show exports to the EU rose 35 % y-o-y, while imports from the EU climbed 33 %. The trade surplus with the EU rose in January-September by more than a third to $103 billion. The EU is China's second largest trading partner after the US. EU figures show EU exports to China climbed sharply in the first half of this year, when China's share of EU foreign exports was 9 %. 18 % of EU imports from outside the Union came from China. The lion's share of EU exports to China (60 %) was machinery and equipment, most notably cars and aircraft. The leading EU imports from China were computers, computer components and mobile phones.

In addition to the yuan's exchange rate, the EU's fight against price dumping has frayed EU-China trade relations recently. Cheap imports from China have upset many European goods manufacturers, who find themselves at a competitive disadvantage and demand protection through import duties. Chinese imports to the EU under scrutiny this year include wireless modems, fine paper and car tyres. The EU already collects import duties from China on e.g. steel fasteners, bicycles, clothing and footwear. The EU continued heavy import duties on fibreglass last month. China, in turn, filed a complaint with the WTO concerning EU tariffs on shoes.

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Russia

Chief of government administration and deputy prime minister Sergei Sobyanin takes over as Moscow mayor. On Thursday (Oct. 21), the Moscow city council elected Sergei Sobyanin to replace Yuri Luzhkov, who was sacked last month by president Medvedev. Sobyanin's previous posts also include chief of staff of the presidential administration, Tyumen regional governor and head of Medvedev's presidential campaign.

Moscow and St. Petersburg are administratively classed among Russia's 83 federal administrative regions. As a result, the mayors of these two cities are treated as regional governors. From 1995 to 2004, regional governors were elected by direct vote. In 2005, however, the law was changed so that regional parliaments elect governors from candidates proposed by the president. The president has the discretion to sack a regional governor at will.

By many measures, Moscow is Russia's most important federal region. Official figures put Moscow's population at 10.5 million, or about 7 % of the Russian population, making it the most populated of any federal region. The city generates more than a fifth of Russia's GDP. The next most important regions by economic output are the oil and gas producing Tyumen region and the Khanty-Mansi autonomous okrug, which each account for nearly a tenth of Russian GDP.

Moscow's economic growth has outstripped the average growth of Russia's regions throughout the past decade. The city has the lowest unemployment rate in the country. The unemployment rate was just over 1 % this summer, which was well below the 7 % national average. Moscow also has the country's fourth highest wage level. The official average monthly wage in July was 41,600 rubles (about €1,070), or nearly double the national average of 21,800 rubles (about €560). The highest wages are paid in oil and gas producing regions.

Moscow is unchallenged as the nation's financial and administrative centre, and many of Russia's biggest companies have their head offices in the capital city. Moscow accounts for 17 % of retail sales nationally, as well as 13 % of all construction activity. Moscow's fixed capital investment represents about a tenth of total fixed capital investment in Russia, and the city is Russia's financial hub and home to the country's biggest banks.

Moscow has posted budget deficits in recent years. Last year's deficit was 150 billion rubles (about €4 billion) on revenues of 1.010 trillion rubles (€24 billion) and expenditures of 1.160 trillion rubles (€28 billion). Moscow accounts for about 18 % of total budget revenues and expenditures of federal regions and municipalities.

The Russia-based Expert Rating Agency has consistently ranked Moscow among top regions since it began rating regions' investment climate in 1995. The overall rating consists of both the region's potential and risks. In the latest 2008–2009 rating, Moscow was seen as offering the best investment potential in all of Russia. Investment potential is based on such factors as availability of labour, infrastructure and access to finance. Concerning risks, Moscow fared worse. It was designated as Russia's sixth least-risky region for investors. Factors increasing the risk for Moscow included local legislative environment, which was seen as one of the poorest in the country.

Preparations continue for launch of Russia-Belarus-Kazakhstan common economic area. Prime ministers of the three countries met last week in Moscow to continue preparations for a common economic area (CEA), which would be formed on the basis of the customs union that started functioning last July. The CEA is slated to begin operations on January 1, 2012. The participants would like to see all relevant treaties drafted and in final form by the end of this year. For goods, labour and capital to move freely in the CEA, participant countries must extensively coordinate their economic policies.

The agreements reached at the prime ministers' summit largely concerned practical matters that were relatively easy to agree on, such as the CEA's unified technical regulatory principles, legal issues related to employment-based migration and cooperation on fighting illegal immigration. However, there are pricklier issues yet to be resolved. The hope of having all treaties ready this year seems rather optimistic.

Meeting participants also touched on creation of a common economic policy. Such policy would involve e.g. common limits on government debt for each member state, as well as on budget deficits and inflation. No decisions were reached on such matters.

The prime ministers did manage to agree in principle on thornier issues such as rail shipment, pipeline transmission and certain energy policy issues. The biggest disputes involve Belarus and Russia. Belarus finds it unacceptable that, despite the existence of a customs union, Russia charges export duties on a significant share of the crude oil it supplies to Belarus. The duty is levied on that part of oil that Belarus refines and exports to third countries. Russia has said the export tariff will be removed upon inauguration of the CEA. The parties now agreed to remove the export duty as soon as Belarus ratifies the CEA treaties. This should be quite doable before the CEA becomes operational. Belarus has also demanded that it be allowed to purchase natural gas from Russia at the same low regulated price applied in Russia's domestic market. Russia has consistently rejected the Belarus proposal.

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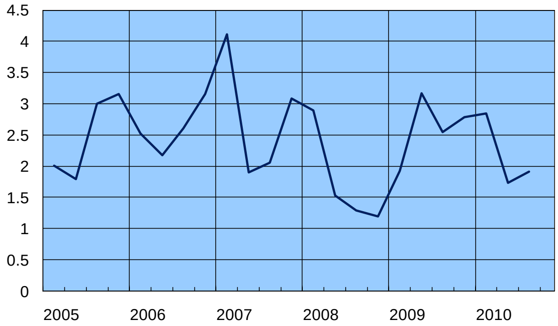
China

China posts robust 3Q growth. China's National Bureau of Statistics reports GDP climbed 9.6 % y-o-y in the third quarter. The strong growth was no surprise in light of leading indicators. Our estimate for seasonally adjusted output figures for the third quarter appeared to be about 2 % higher than in the previous quarter, suggesting economic growth picked up slightly in the third quarter.

Industrial output in the third quarter rose slightly below forecast at 13 % y-o-y. Retail sales, in contrast, increased 19 % y-o-y, exceeding forecasts. In the first nine months of this year fixed asset investments were up 24 % y-o-y. The confidence indicators for September also indicated domestic demand is spurring economic growth. Confidence was particularly high in retail sales, construction and the real estate sector.

Economic growth is expected to remain brisk in the near term. The leading indicator of production published by China's National Bureau of Statistics has declined in recent months to near-normal levels after hitting record levels at the start of the year. The latest IMF forecast sees Chinese GDP growth hitting 10.5 % this year and 9.6 % in 2011. The World Bank forecasts GDP growth of 9.5 % this year and 8.5 % next year.

Real GDP growth (on-quarter, seasonally adjusted, %)

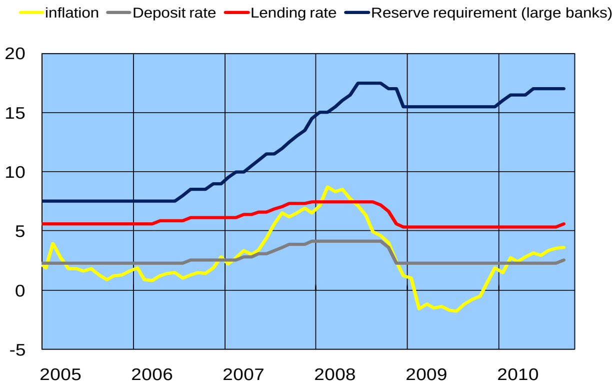


Source: BOFIT estimates based on quarterly national accounts

Inflation accelerated in September; PBoC hikes reference rate first time in nearly three years. Consumer prices continued to accelerate in September, reaching 3.6 % y-o-y. Consumer price inflation was 3.3 % in July and 3.5 % in August. September's price rise was the fastest since the emergence of the global financial crisis. The inflation spike was driven by rising food prices which constitute a substantial component of China's consumer price index. The rate of rise of producer prices continued to slow in September. Average apartment prices have remained largely unchanged in recent months.

The People's Bank of China tightened its monetary stance this week by raising its one-year lending and deposit rates each by a quarter of a percentage point. The deposit rate now stands at 2.50 % and one-year lending rate at 5.56 %. Reference rates were last raised in 2007. Earlier this year the PBoC has increased reserve requirements of commercial banks and provided direct instructions to banks in order to guide monetary growth. Effects of tightening monetary policy can be seen in the slowing y-o-y growth rate of the broad money supply (M2). As of end-September, M2 growth stood at 19 % y-o-y.

Reserve requirement (% of deposits), 12-mo. reference rate (%) and consumer price inflation (% change, y-o-y)



Sources: PBoC and NBS

Meeting of CPC Central Committee affirms next five-year plan framework. Over 300 members of the Chinese Communist Party's central committee convened last weekend in Beijing for a closed session. Topping the agenda was discussion on setting priorities for China's next five years of economic and social development (2011–2015). The Central Committee acts as a forum for discussion and as a decision-making body for crucial issues related to party policy, the economy and political appointments.

The committees' goals under the 2011–2015 plan include replacing of China's current model for economic growth led by investment and export-driven production with a growth model driven by domestic consumer demand. The roles of technology and innovation are emphasised in reform of economic structures. Other areas of emphasis include reducing income disparities of urban and rural residents, development of strategic industrial areas and promotion of energy efficiency measures. The 5-year plan will be finalised next March at the annual People's Congress.

The Central Committee made a politically significant promotion of deputy prime minister Xi Jinping to deputy chairman of the influential Central Military Commission, making Xi the heir-apparent to president Hu Jintao, who is expected to step down from his party leadership position in 2012.

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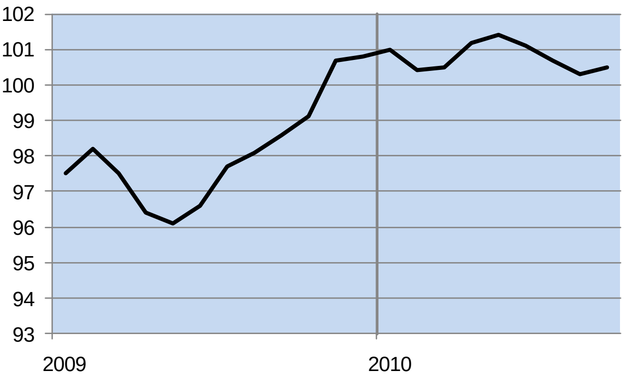
Russia

Economic growth subdued in September. Preliminary seasonally adjusted figures from the economy ministry suggest GDP, after shrinking about 1 % over the summer, grew only slightly in September.

Industrial output, a key indicator for GDP that summarises domestic production, rebounded and increased nearly 1 % on a seasonally adjusted basis in September. Manufacturing also revived thanks largely to increased production of oil products, metals and metal products and cars. The resurge of Russia's domestic car industry is boosted by the government's "cash for clunkers" programme that provides discount coupons to consumers ready to trade in their used car and buy a new domestically produced model.

Defying expectations, retail sales, which reflect private consumption, fell for the second month in a row in September - down about 1 % on a seasonally adjusted basis. Real wage growth in both August and September was essentially stagnant, due to the pick-up of consumer price inflation. Real household incomes overall contracted in August-September. On the other hand, the recoveries in capital investment and construction that began in late summer continued. Preliminary estimates show export volumes have remained soft since mid-summer. Inferring from value data, imports continued to rise in September.

Seasonally adjusted monthly GDP as calculated by the economy ministry, Dec. 2008 = 100



Source: Russian economy ministry

Cabinet approves sales of shares in state-owned firms. At its October 21 meeting, the government approved a programme to sell shares in numerous large state enterprises over the next five years. Although the programme is referred to as a privatisation programme, it does not seek full divestment of large state enterprises into private hands. The state will retain a controlling voting share in companies or a so-called "golden share."

The sale of shares will raise money for company investments and federal and regional budgets. Under the plan, shares in 900 companies would be sold by 2015. Using current traded share prices, the sales would raise a total of about 1.8 trillion rubles or €42 billion at the current exchange rate. Although the sale of shares in many state firms has been off the table for years, persisting large federal budget deficits have forced the government to consider the option.

The draft federal budget for 2011−2013 presently before the Duma anticipates that revenues from privatisation sales will cover 17 % of projected deficits over the next three years. Sales of shares on the tentative list of companies would double that share to about a third assuming the government sticks to its budget deficit targets.

Beyond selling shares to private investors, the programme aims at making state companies operate more efficiently and accelerating structural economic changes.

Some of the biggest names on the list in the making include Russian oil giant Rosneft, Russian Railways (RZD), state airline Aeroflot, the state-stake in S7 Airlines, the operator of Moscow's Sheremetyevo International Airport, state shipping company Sovkomflot as well as the federal electrical transmission grid operator. The list further includes Russia's largest state-owned banks, Vneshtorgbank and Sberbank, as well as agriculture bank Rosselkhozbank, which emerged as a major bank after state capitalisation measures. National oil pipeline operator Transneft and Zarubezhneft, a company focused on Russia's international oil and gas supply, have been taken off the list.

The list includes "strategic enterprises" which can only move ahead with privatisation after president Medvedev removes them from the list of strategic enterprises. The restrictions limit the amount of shares foreign investors can hold in a strategic enterprise.

Russia shows little progress in fighting corruption. On Wednesday (Oct. 27), Transparency International released its latest Corruption Perception Index rankings. Russia ranked 154 out of 178 countries, making it the 24th most-corrupt country surveyed. Nine countries were found on par with Russia, including Kenya and Tajikistan. China ranked 78th, matching graft levels with those of e.g. Columbia and Greece. Denmark was the least-corrupt nation. Finland was fourth.

The Corruption Perceptions Index value, which runs from 0 to 10 (0 = completely corrupt, 10 = no corruption), was 2.1 for Russia this year. In 2009, Russia ranked 146th in the same survey with an index value of 2.2.

President Medvedev authorised a national anti-corruption programme in 2008. The programme was updated in April this year.

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China

China cuts this year's export quota on rare earth metals by 40 %. China claims the reduced export quotas are part of its long-range commitment to cleaning up the environment, increasing energy efficiency and promoting sustainable use of valuable natural resources. Western countries believe China is leveraging its strategic dominance in rare earths to persuade foreign firms into transferring high-tech production to China.

As China has reduced exports of rare earth metals (also known as rare earth elements, REE) by 5 to 10 % a year since 2006, REE prices have skyrocketed. China last year accounted for 97 % of global production of rare earth metals. Demand of rare earth metals continues to rise as they are critical to many 21st century technologies.

The concern globally is that China will abuse its dominant position as supplier of rare earth metals. Japan claims China had been restricting REE exports to Japan since the start of September forcing the world's biggest REE importer to seek new suppliers. India and Vietnam have already boosted production and the US and Australia are planning to do so.

Despite tighter export quotas, exports of rare earth metals from China have increased overall this year. January-September exports already exceeded the 30,000 ton export quota ceiling for this year. Last year's total REE exports were 44,000 tons. China's proven rare earth reserves are the largest in the world (36 %), followed by Russia (19 %) and the United States (13 %).

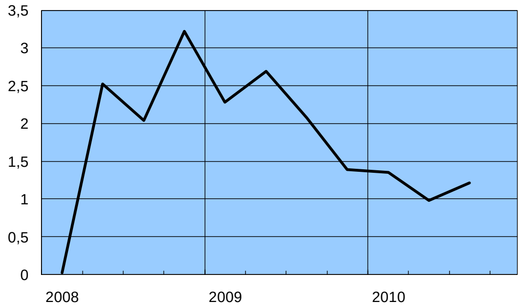
China's consumer spending showing signs of subsiding. Although the volume of retail sales rose 15.2 % y-o-y in September, China's consumer spending seems to be moderating. Taking seasonal and price level fluctuations into account, urban consumer spending growth was up less than 1.5 % q-o-q in the third quarter. Seasonally adjusted retail sales volume in 3Q10 was unchanged from 2Q10.

Fading consumer demand is an unpleasant surprise for China's economic policymakers, particularly as one of the policy objectives has been promotion of consumer demand. Weak consumer demand increases China's already large current account surpluses at a time when many countries are complaining about yuan undervaluation and China's exchange rate policies.

Just over a third of China's GDP goes to consumption. The lack of a consumer culture is generally blamed on structural problems such as a poor social safety net and income disparities. The abundance of cheap labour in rural areas prevents real wage gains that would promote mass consumption, while those making large incomes in cities have a relatively high marginal propensity to save.

Rapid economic growth and an aging population will eventually reduce the size of the national labour pool, forcing up wages and ultimately stimulating consumption. China's official efforts to narrow income disparities and improve social security could also encourage consumption if implemented. Observers have yet to identify any factors that might quickly revive consumption.

Urban consumption growth
(q-o-q, %, real, seasonally adjusted)



Source: BOFIT estimates based on NBS quarterly data

Even with rapid growth in inland provinces, living standards vary considerably across China's regions. To outsiders, it appeared little was done during the past decade to correct the severe imbalances in China's economic development. Coastal provinces were treated as the engines of China's economic miracle. Indeed, at the start of the 2000s, they accounted for about 90 % of foreign trade and 60 % of fixed capital investment.

During the past decade several of China's inland provinces experienced rapid economic growth. The economies of China's five poorest provinces experienced per capita growth rates throughout the 2000s that matched the pace of growth in China's five richest coastal provinces. In recent years, some provinces in central and western China posted economic growth rates well above those of the coastal region. For example, on-year economic growth exceeded 20 % in 2009 in the Chongqing, Inner Mongolia and Ningxia provinces, which was well above the growth rates posted in Beijing, Tianjin and Jiangsu.

Rapid economic development in China's central and western provinces reflects a shift in production structure from agriculture to industry. In coastal provinces, the economic contribution of the service sector has increased relative to industrial production. For example, services last year accounted for over 75 % of GDP in Beijing, over 60 % in Shanghai and just under half in Tianjin.

Despite rapid development in provinces in interior China, disparities in living standards across provinces remain huge. Shanghai's GDP per capita last year was 78,000 yuan (€8,500), while GDP per capita in Guizhou province in central China was just 10,300 yuan (€1,100).

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Russia

Further rate hikes for municipal services ahead. Rate hikes for municipal services provided to households (heating, water, gas and electricity) have been limited to 15 % next year by a decision of president Dmitri Medvedev. The decision was made because a number of municipalities increased rates for municipal services several-fold at the start of this year after rate-setting authority was transferred from federal officials to regional and local authorities. At the same time, municipalities were encouraged to increase households' payments for municipal services to full cost-recovery level.

After a massive public outcry at the start of the year, president Medvedev order a roll-back of the biggest hikes. Russians were particularly dismayed by the fact that the rate hikes did not translate into improved service quality. Instead, the infrastructure for delivering municipal services continues to crumble due to a lack of investment. The regional development ministry has noted that in practice the country's entire infrastructure for municipal services needs to be modernised. Russian experts say poor quality infrastructure is the reason for the delivery of municipal services being about 25–30 % less efficient that in the EU. For heating energy the difference amounts to 40 %, water supply 20 % and electricity production 5 %.

Officials plan to continue increasing municipal services rates considerably faster than inflation as they have done in recent years. The government expects consumer price inflation will reach 6–7 % next year. It plans to raise rates households pay for gas by 5 % with another raise coming in the summer. Electricity rates will go up 10 % and water on average 18 %. These hikes would meet the presidential requirement of the 15 % maximum rate increase for municipal services next year.

Consumer prices in October 2010 were up 7.5 % y-o-y. At the same time, rates for municipal services increased 15 %.

Households are responsible for much of energy waste. One proposed solution is to base billing on actual consumption instead of standardised usage. As it is still unusual to have apartment-level metering, the government seeks to motivate a switch to meters during a two-year grace period. The reform would enter into force at the beginning of 2013, when households still without meters for water and gas would be subject to 20 % higher rates.

It is estimated that 15 % of the population currently receives some housing support. To qualify, household housing costs must exceed a regionally defined share of the household income (the highest possible limit being 22 % of income). Russian households spend an average of 12 % of household income on municipal services.

Russia pushes for development of the Arctic. Russia has recently witnessed a sharp increase in interest of the Arctic region. This year, the country has arranged a number of international conferences on the Arctic economy, natural resources and environmental challenges. A major economic advance took place in September when Russian foreign minister Sergei Lavrov and his Norwegian counterpart Jonas Gahr Støre signed a treaty on territorial borders and resource exploitation for a 175,000 km^2 block of the Barents Sea and Arctic Sea. The territorial issue had been pending since 1970.

The Arctic region consists of all the area north the Arctic Circle. The total area of the Arctic exceeds 30 million km^2 and represents about 6 % of our planet's surface area. Even so, its resident population is only about 4 million. The Arctic Council provides an intergovernmental forum for countries with territories north of the Arctic Circle (Canada, Denmark (Greenland), Finland, Iceland, Norway, Russia, Sweden and the United States).

A 2008 US Geological Survey study estimated 22 % of the world's undiscovered oil and gas reserves lie within the Arctic region. The undiscovered oil in the Arctic region would represent about 13 % of global reserves, while natural gas about 30 %. The lion's share of natural gas deposits is located in Russian territory, most notably in the West Siberian Basin, the Timan-Pechora Basin and the South Barents Basin.

It is estimated that over 80 % of natural resources in the Arctic region are located in sub-sea areas, which partly explains the lack of utilisation of the areas. The region's harsh environment, lack of infrastructure and the sheer magnitude of investment needed to develop the area have limited plans to exploit natural resources.

Russians nevertheless believe in the Arctic region's potential. Russia's natural resources ministry says that over the next two years Russia will invest 2 billion rubles (about €48 million) to study the area.

The Arctic holds value not just for natural resources. A recent report from the Arctic Monitoring Assessment Programme, a working group of the Arctic Council, found the ice mass has been shrinking steadily for decades; by 2007 the summer ice mass was about 40 % smaller than in 1979–2000 on average. As a result, the Northeast Passage, which runs from the Atlantic via the Arctic Ocean to the Bering Straits and the Pacific Ocean, is expected to become a viable shipping route. Sovkomflot Shipping, which is owned by the Russian state, completed its first trial navigation of the Northeast Passage in September. The trip from Murmansk to Ningbo in China took 22 days, or half the time the same trip would take following the southern route through the Suez canal. Even with reduced Arctic sea ice, the route would require icebreakers most of the year.

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China

Yuan finding ever greater use in international trade. Although the value of China's exports now represents about 10 % of world trade, the yuan presently only accounts for about three-tenths of a per cent of settlements according to a June report from the Bank of International Settlements (BIS). China's currency controls have significantly limited usage of the yuan in international settlements.

This is changing, however, as China continues to gradually relax currency restrictions. The Qualified Foreign Institutional Investor (QFII) programme has opened up foreign investment in China on a limited basis, while the Qualified Domestic Institutional Investor (QDII) programme allows some investment abroad by Chinese institutions. More recently, banks' possibilities to offer financial services abroad in yuan have been improved.

The yuan's popularity as a settlement currency now seems to have taken off since a trial scheme for yuan trade settlement was expanded last year. Yuan use as a payment instrument in foreign trade is increasingly permitted in a number of Chinese provinces, and there are no longer any geographic limits regarding the foreign partner.

Bloomberg reports the value of foreign trade settlements in yuan surged 160 % q-o-q in the third quarter. The yuan's share of China's foreign trade (exports and imports) is still just 2.4 %, so there is plenty of room to grow.

Commodity imports stay strong this year; imports of energy commodities on the rise. China's demand for metals exploded during the financial crisis as Chinese companies took advantage of depressed global commodity prices. The volumes of iron ore and copper imports soared about 50 % last year, while aluminium imports were up 150 % from 2008.

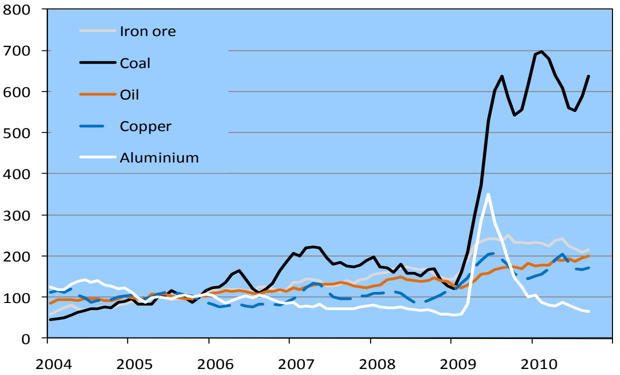
The volumes of iron ore and copper imports this year remain roughly at 2009 levels. For the first nine months of the year, China imported 460 million metric tons of iron ore and 3.3 million tons of copper. China imports about a third of its iron ore and about half of its copper. Imports covered about a sixth of aluminium demand in China last year, up from 6–7 % in previous years.

Imports of energy commodities were up from 2009. During January-September, China imported about 40 % more coal than in the same period last year, when the import volume had already tripled from 2008. Crude oil imports rose in January-September by 25 % y-o-y. Despite robust growth in coal imports over the last two years, the share of imported coal relative to China's total coal demand is marginal. In contrast, over half of the oil consumed in China is imported.

A dip in world commodity prices and shipping costs last year helped drive a sharp increase in commodity imports. This year, however, price for iron ore and base metals have recovered. The spike in demand was also driven by stimulus money meant to boost national infrastructure construction last year. Some imported raw materials have evidently been stockpiled in the state strategic reserves. The extent of the stockpiling is not known, however, as officials don't release any figures on the reserves.

Strong import growth has further increased China's presence in global commodity markets, so fluctuations in Chinese demand have had significant impact on commodity prices.

China commodity imports, index 2005=100, 3-mo. moving average



Source: CEIC

Burgeoning trade between China and ASEAN countries. The value of trade between China and the ASEAN countries (Brunei, Philippines, Indonesia, Cambodia, Laos, Malaysia, Myanmar, Singapore, Thailand and Vietnam) totalled $211 billion in January-September, an increase of 44 % y-o-y. Much of the increase can be attributed to higher Chinese imports, which nearly doubled in the period from last year. Exports from China to ASEAN countries were up 36 %. China typically runs a trade deficit with ASEAN countries; the deficit was $12 billion for January-September.

Trade has been boosted by a new free-trade agreement that entered into force in January. The China-ASEAN free-trade area (CAFTA) is the world's third largest after European Union and North America (NAFTA).

China-ASEAN cooperation has recently focused on logistics and infrastructure, as well as energy and raw materials. ASEAN countries have benefited from China's rapid economic advance as they provide many of the raw materials China desperately needs.

Direct foreign investment flows between China and ASEAN countries has also increased in recent years. ASEAN countries account for about 5 % of China's total FDI stock.

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Russia

Cargo shipping via Russia's Baltic Sea ports and major ports of the Baltic countries on the rise. Russia's largest Baltic Sea ports saw cargo-handling in January-September rise 11 % y-o-y. The sole decline in volume was seen at the Port of Primorsk, which specialises in exports of oil and oil products. Primorsk handled 58 million metric tons of cargo (including 53 million tons of crude oil) in the period, a decrease of 2 % y-o-y. Russian oil exports this year remain at about the same level as in 2009. In the January-August period, crude oil exports amounted to 165 million tons.

In the first nine months of the year, the Port of St. Petersburg handled 43 million tons of cargo, an increase of 15 % y-o-y. Growth was driven by higher shipping of metals (up 49 % y-o-y) and container cargo (up 35 %). About 55 % of cargo consisted of general and container freight. Oil products accounted for 28 % of cargo.

At the Port of Ust-Luga, which is still under construction, the cargo-handling volume increased 16 % to 8 million tons. About 75 % of freight consisted of coal and coke. Ust-Luga, sited on the south shores of the Gulf of Finland near the Estonian border, is on its way to becoming a major gateway for car imports to Russia. More than 48,000 passenger cars passed through the port in January-October. For all of 2010, the port is expected to handle about 60,000 passenger cars, up from 17,000 in 2009. Increasing car imports via Ust-Luga are a reason car transshipments through Finland have decreased.

Ust-Luga is planned to become the largest multi-purpose port in the territory of the former Soviet Union. The current plan calls for an annual cargo-handling capacity of 180 million tons when the port is completed in 2018. A big challenge in developing the port has been the lack of adequate roads and rail infrastructure. The freight capacity of rail lines into the port was a mere 9 million tons last year. The goal is to increase rail capacity to 32 million tons next year and 117 million tons by 2020.

Cargo shipments via the Port of Kaliningrad increased 14 % during the first nine months of this year to about 11 million tons. Kaliningrad is also a multi-purpose port, capable of handling e.g. bulk and liquid cargoes.

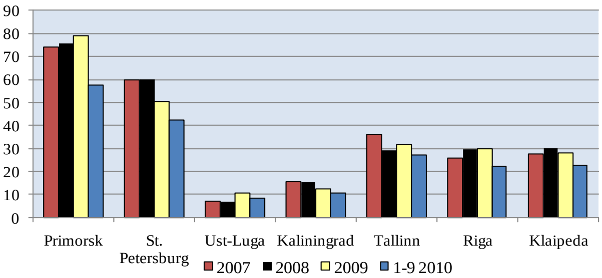
The trends at ports of Baltic countries are varied. At the Port of Tallinn, freight shipments in January-September rose 17 % y-o-y to 27 million tons. Growth was largely based on increased handling of liquid and dry bulk cargoes. Slightly over 70 % of the freight handled at the Port of Tallinn in 2009 was of Russian origin, mainly oil and oil products.

Freight shipments at the Port of Klaipeda, Lithuania's largest port, rose 12 % y-o-y to 23 million tons. Most of the business in 2009 was transshipping of oil and oil products from Russia and Belarus. Russian share of Klaipeda's total freight was 12 % and Belarus 24 %.

Riga and Ventspils, Latvia's two largest ports, have experienced less robust development. The volume of freight handled in January-September at the Port of Riga remained at the 2009 level of 22 million tons. The freight volume at the Port of Ventspils contracted 9 % to 19 million tons. Ventspils, the terminal for an oil pipeline from Russia, has long served as loading point for Russia oil.

Finnish Transport Agency reports the total volume of export and import freight at Finnish ports in January-September was 67 million tons. Growth from the previous year was 12 %.

Cargo shipped via certain Baltic ports, million metric tons



Source: Figures from individual ports

Bad year for Russian farmers. The agriculture ministry reports that, due to last summer's exceptional drought conditions, Russia's agricultural 2010 output will be about 10 % less than in 2009. Total crop production is about 20 % lower than last year. Grain production is expected to fall to around 61 million tons, or about a quarter less than the average of 83 million tons a year during the 2000s. Production hit 97 million tons in 2009, which was still below the record 2008 harvest of 108 million tons.

Wheat production is forecast to fall this year by a third to 41 million tons, while barley production will halve to 8 million tons. The worst crop losses were experienced in the Volga Federal District and the Central Federal District surrounding Moscow. Harvests in the North Caucasus Federal District and the Southern Federal District were about as large as last year.

The agriculture ministry said this year's grain harvest combined with the grain reserves built up from previous years is sufficient to satisfy domestic grain demand. Russia is targeting a grain harvest of 85 million tons in 2011, even if the drought has delayed autumn sowing especially in the Volga Federal District, which may diminish next year's harvest.

The government would like to see a larger harvest next year in order to allow the country to resume grain exports, which have been suspended since August. The grain export ban was originally to last through December, but has now been extended to spring 2011.

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China

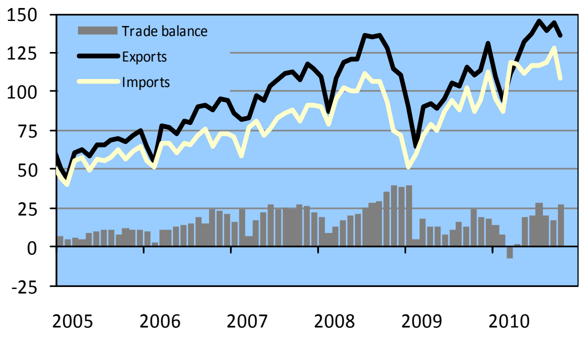
China tightens monetary stance as inflation picks up. Consumer price inflation accelerated from 3.6 % y-o-y in September to 4.4 % in October. The pick-up in inflation was largely driven by higher food prices. Producer price inflation also accelerated, rising from 4.3 % y-o-y in September to 5 % in October. The on-year rise in housing prices dropped below 9 %.

Unexpectedly strong expansions in credit and the money supply underpinned the inflation increase. It now appears the government will overshoot its 2010 targets for money supply growth and inflation (3 %). Just before announcing the latest inflation numbers, the government raised reserve requirement on all banks by a half percentage point. Reserve requirements for China's largest banks were also raised earlier. The deposit reserve requirement for largest banks currently stands at 18 %.

Development of the real economy remained strong paving the way for tighter monetary policy. Industrial output continued to climb at 13 % y-o-y, while retail sales growth slowed a bit to 14 %.

China posts large foreign trade surplus again. The value of October exports hit nearly $136 billion (down from $145 billion in September), while imports amounted to $109 billion ($128 billion in September). Imports and exports were up about one quarter compared to last year. After an initial strong rebound from the worst effects of the global economic crisis, growth in foreign trade now appears to be moderating. The fading effects of the stimulus package may also explain some of the slowdown in import growth, while the low growth outlook for the global economy has slowed down the export growth.

Monthly trade balance, exports and imports, US$ billion



Source: Bloomberg

The trade surplus rose from $17 billion in September to $27 billion in October. Seasonal factors account for part of the growth. The World Bank noted in its China Quarterly Update that surpluses could become a constant problem for China in coming years unless China's policymakers tackle structural reforms to promote growth driven by services and consumption and move away from the current export-driven model.

China's trade surplus and currency policies are currently under discussion at the two-day G20 summit in Seoul, South Korea. The summit agenda includes finding ways to reduce global trade imbalances and foreign exchange issues. This week China has allowed faster revaluation of the yuan against the US dollar. China is currently flooded with export earnings and speculative capital, which has forced officials to increase controls on capital imports.

China holds onto its position in international comparison of business environments; Russia drops a bit in the rankings. *Doing Business 2011*, the latest annual business climate survey made as a joint project of the World Bank and the IFC, was released November 4. China's business environment ranked 79 out of the 183 countries surveyed (rank 78 last year). Russia's ranking in this year' s Doing Business survey slipped from 116 last year to 123, while India's ranking was 134 (135 in 2009). Singapore topped the list, while Finland ranked 13 (11 last year). Doing Business rankings use a combination of indicators that measure business regulation, property protections and their impacts especially on local small and medium-sized firms. The heavy-handedness of regulations is measured by e.g. number of permits required, time it takes to process a permit application, and costs of permits.

Contract enforcement in China, registering property, as well as trading across borders are relatively simple and cheap compared to many other countries. On the other hand, applying for construction permits and starting a business were seen as complicated and expensive. Although China's ranking fell in seven out of nine categories, reforms in corporate taxation helped China preserve its place among the top 80 countries.

In Russia, contract enforcement and registering property was also easier than in many other countries. Although Russia has not taken steps backward in light of doing business criteria, its ranking declined due to more robust reform policies made by the countries that used to be behind Russia.

The latest Doing Business report introduces a new category: a five-year measure of how business regulations have changed within individual countries in light of the Doing Business criteria. The results were encouraging; 85 % of surveyed countries saw improvements in their business environments. China ranked 15th in terms of how much it had improved conditions for business over the past five years. The winner in this new category was Georgia. India's reforms in recent years entitled it to a rank of 40 and Russia's to 43.

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Russia

FDI inflows to Russia unchanged from 2009. The Central Bank of Russia reports that in the first half of 2010, foreign direct investment inflows to Russia amounted to \$19 billion, or about the same level as in 1H09. In the first half of 2008 prior to the global recession, the value of FDI inflows was more than double (\$44 billion). FDI outflows from Russia abroad amounted to \$23 billion, or about \$1 billion less than a year earlier and \$10 billion less than in 1H2008.

Rosstat figures on the structure of investments show the largest share of FDI in Russia went to the manufacturing sector, which received 37 % of all FDI. Mining and mineral extraction industries received 17 %, while wholesale and retail attracted 15 % of FDI inflows.

As in previous years, Cyprus dominated as Russia's top source of FDI, accounting for 23 % of total FDI inflow. Next came Germany and the Netherlands with 16 % and 12 %, respectively. Finland was 7th with a 4 % share. The largest amount of Finnish investments went to the rubber and plastics industries (48 % of Finnish investment), driven by production investment by Nokian Tyres. 23 % of Finnish investment went to the timber and paper industries.

National and international statistics on foreign investment do not always show the actual investing country. For example, capital flows can move through a subsidiary registered in a third country. Cyprus has been Russia's top source of FDI for years due largely to the massive number of Russian firms registered there. Last month, president Dmitri Medvedev signed an agreement with Cyprus to eliminate double-taxation between the countries. The agreement frees Russian firms from taxes in Russia on capital income repatriated from Cyprus. At the same time, Cypriot officials committed to increased reporting on Russian financial activity to the Russian tax authorities.

Russia's cabinet members meet regularly with representatives of foreign investors. Last October, prime minister Vladimir Putin met with members of the Foreign Investment Advisory Council (FIAC). FIAC was established in 1994 with a mission to promote foreign investment in Russia. The Council has currently representatives of 42 international companies. The FIAC's latest report on Russian modernization and innovation development was presented at the meeting. The report was compiled from interviews with international investors operating in Russia. Among the central challenges to investment noted by respondents were Russia's lack of adequate infrastructure and lack of domestic demand for high-tech products. Another perceived challenge was the Russian education system, which offers high-level theoretical knowledge, but little training in practical business skills.

UNCTAD's *World Investment Prospects Survey 2010–2012*, which appeared in September, sees Russia becoming the world's fifth largest destination for FDI in 2010–2012, after China, India, Brazil and the United States. UNCTAD statistics show Russia's FDI ranking improved from 15th to 6th place between 2005 and 2009. China has long ranked in the top seven FDI targets globally and last year rose to the second place after the US.

Recession and state stimulus measures evident in 2009 performances of Russia's biggest firms. *Expert*, Russia's leading business weekly, recently released its 13th annual compilation of the country's 400 largest firms based on sales volume. According to the survey, in 2009 Russia's 20 biggest enterprises included nine companies in the energy field, four metals producers, two banks and two telecoms (see table). The state held significant stakes in nine of the companies (shown with an asterisk). New members of the top 20 were two electrical companies and a retail chain.

Russia's top 20 firms in 2009 based on sales volume

1	Gazprom / gas*	11	VTB / finance*
2	Lukoil / oil	12	Tatneft / oil*
3	Rosneft / oil*	13	Transneft / oil pipeline operator *
4	RZD / railways *	14	Norilsk Nickel / metals
5	Sberbank / finance*	15	Yevraz Group / metals
6	TNK-BP / oil	16	X5 / retail sales
7	Sistema /conglomerate	17	Vympelkom / telecom
8	Surgutneftegaz / oil	18	KES / electricity generation
9	MRSK / electricity distribution*	19	Svyazinvest / telecom*
10	Severstal / metals	20	Rusal / metals

Source: Expert 39/2010

Thanks to rapid growth, state-controlled banks managed to improve their ranking on the list last year. The improvements reflected the use of state banks to channel stimulus funds into the economy. Sberbank's earnings increased 40 % last year and VTB's earnings soared 45 %. As a result, banking became the second biggest sector in the list after oil and gas.

Oil company sales fell an average of 7 % last year. Gazprom's sales fell 9 % last year to 3 trillion rubles or €68 billion. *Fortune* magazine's list of the top 500 companies in the world based on net sales ranked Gazprom 50th last year.

Mergers and acquisitions helped retail companies to grow and expand into more Russian regions last year. Sales of the biggest retail chains increased 6 % on average, well off the pace of sales growth prior to the global financial crisis.

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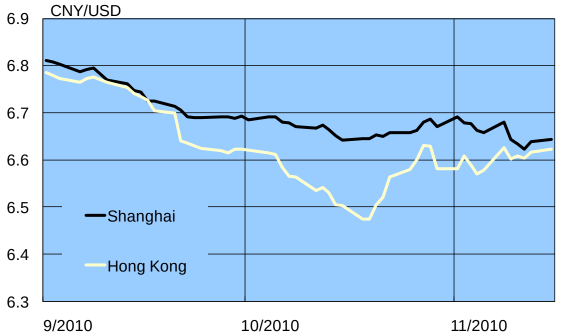
China

China-US tensions over economic imbalances take centre stage in G20 discussions in Seoul. The United States, which has long held that the yuan has been deliberately undervalued, kept the issue front-and-centre at the two-day G20 Summit in Seoul last week. The G20 leaders committed, in principle, to move towards market-based exchange rate regimes. Talk of a pending international currency war was calmed with a statement calling for all member countries to refrain from devaluation competitions. There was a consensus that the issue of current account imbalances needs to be addressed, specifically China's huge current account surpluses and the United States chronic current account deficits. Solutions to the economic imbalances will be sought through the Mutual Assessment Process (MAP) drafted by the IMF. The first MAP results will be discussed next year.

The G20 Summit outcome can be seen favourable to China as the final communiqué on exchange rate flexibility remained amorphous. Furthermore, the MAP may reduce exchange rate bickering by shifting the discussion towards economic policies in general. The pick-up in Chinese inflation, however, will keep the exchange rate issue on the agenda in China's domestic debate.

The yuan-dollar exchange rate weakened slightly after the Summit on both the official Shanghai currency market and in Hong Kong. The difference between the official exchange rates on the mainland and in Hong Kong has also narrowed in recent weeks. The gap between the two rates reflected, in part, expectations of yuan appreciation, as the increased demand for yuan led to an insufficiency of the currency's supply on the Hong Kong market. The special administrative region's monetary authorities have since then balanced the liquidity situation through currency swaps with the People's Bank of China.

Yuan-dollar rate in Shanghai and Hong Kong



Source: Bloomberg

In futures trading, the 12-month yuan-dollar swap rate increased to 6.48 on Monday (Nov. 15). Given the current rate of 6.64, the markets expect the yuan to appreciate about 2.5 % next year.

Rising labour costs in coastal provinces putting pressure on manufactures to shift production inland. China's National Bureau of Statistics reports that monthly disposable incomes of city-dwellers averaged 1,590 yuan (€170) in January-September. In the countryside, monthly disposable incomes were 540 yuan (€58). Real incomes of urbanites increased 7 % y-o-y in the period. In rural areas, real incomes climbed about 10 %. Wage growth has slowed slightly since the first half of this year, when officials boosted the minimum wage in 27 provinces and cities.

Official figures show that large wage differences between coastal and inland provinces persist. The average east coast wage last year was about 3,100 yuan (€335) a month. In provinces in central and western China, the average wage was just two-thirds of that. For example, the average monthly wage in Shanghai in 2009 was about 4,900 yuan (€520), while in the Jiangxi province in southern China it was just 2,000 yuan (€216). Wage differences nationally have decreased slightly in recent years. Between 2005 and 2009, average wages went up about 80 % in central and western China and increased by about 70 % in coastal provinces. In some of China's inland provinces, wages last year jumped as much as 15–17 % y-o-y.

The first half of this year saw repeated reports of strikes and disputes over pay in coastal provinces and cities. Chinese workers demanded higher pay as the acceleration in inflation and soaring housing prices have increased the cost of living. It also became harder for firms to attract cheap migrant labour from the countryside as easily as earlier, which only added to pressures to raise wages in coastal areas.

Facing ever-increasing labour costs, labour-intensive industries have begun to transfer their operations inland. Companies that keep their production in coastal provinces, in turn, are shifting their efforts to making products with higher value-added content. The financial crisis is assumed to even accelerate this structural change as the collapse in export production forced many clothing and electronics manufacturers to re-evaluate their profitability models.

Among deficiencies in China's official wage statistics are the absence of any information on wages paid by private firms and the omission of information about wages paid to migrant workers. Some observers have suggested that Chinese statistical officials manipulate the wage figures for political purposes. For example, the average wage in Tibet, one of China's poorest regions, is officially the third highest in China just after Beijing. What is likely lifting the average wage in Tibet is the government's massive administrative apparatus.

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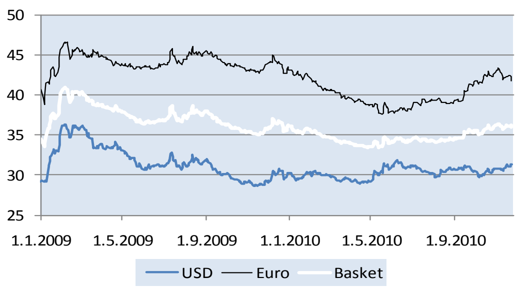
Russia

Ruble exchange rate dips. The gains in the ruble's external value from last spring have been wiped out by declines over the summer and autumn. Since September the Central Bank of Russia has occasionally propped up the ruble by selling foreign currency. The drop in the ruble exchange rate has surprised many as the world price of oil, which is typically closely linked to the performance of the Russian economy, has remained solidly north of $80 a barrel.

The ruble is currently about 5 % weaker than in August against the euro-dollar currency basket used to steer the exchange rate. From last April the rouble is down over 7 %. Since the start of the year, the ruble has lost about 3 % of its value against the dollar and strengthened about 3 % against the euro.

Dollar's, euro's and euro-dollar currency basket's exchange rates against the rouble



Source: CBR, BOFIT

The ruble's decline reflects an increase in capital outflows from Russia combined with zero growth in inflows of capital, in part due to the country's high inflation rate and relatively low interest rates. November's inflation rate was unchanged from the October rate of about 7.5 % y-o-y.

CBR chairman Sergei Ignatyev told the Duma at the start of the week that the net value of private capital outflows from Russia in the first ten months of the year amounted to $21 billion, which was above the CBR's own projection of a net outflow of private capital of just $22 billion for all of 2010. The net flood of capital leaving Russia surged to $8 billion in September and October. Ignatyev was at a loss to explain the sudden jump in the outflow of private capital from Russia. Banks are apparently not behind to flight of foreign currency. Instead, non-bank firms seem to be using forex to buy assets and make deposits abroad. Some observers suggest the increase in capital flight may reflect uncertainty among the political and business elites after president Medvedev's September sacking of Moscow mayor Yuri Luzhkov.

Net exports of private capital from Russia amounted to $57 billion in 2009 and $134 billion in 2008. In 2006 and 2007, Russia enjoyed net private capital inflows.

Insurance sector continues to play a minor role in the Russian economy. To get a clue as to just how diminutive Russia's insurance sector is, consider that total insurance premia paid by policyholders in 2009 equalled only about 2.5 % of GDP. In other BRIC countries, the average was about 4 % of GDP. In a developed county such as Finland, the share was about 9.5 % of GDP. Life insurance policies are particularly rare in Russia, even if life insurance accounts for a significant share of insurance sector activity in most countries.

Last summer's drought and wildfires had little impact on the insurance sector. The government estimates that only 15 % of structures and 20 % of crops destroyed last summer were insured.

Buying insurance has traditionally been unpopular in Russia, and during the recent economic downturn insurance was shunned more than ever. Russia's Federal Service for Insurance Supervision reports payments of insurance premia declined about 8 % in 2009 (excluding mandatory health insurance that partly passes through insurance companies). Although insurance company revenues grew 5 % in the first half of 2010, that was still well below growth exceeding 15 % a year from 2005 to 2008. Respondents to a survey by Russia's National Agency for Financial Studies last summer attributed their recent low interest in insurance to their poorer financial condition and their perception that insurance is expensive and unnecessary. Throughout the 2000s, premia collected for mandatory insurance such as vehicle insurance grew considerably faster than premia from voluntary policies.

Russia's highly dispersed insurance sector is now consolidating as the number of insurance companies declines. As of end-June, there were 660 insurance companies in Russia, down from 830 just two years ago. The Duma last summer approved amendments to the insurance act calling for a quadrupling in the minimum capital requirements for insurance companies from July 2012. For example, the base capitalisation for a life insurance company will go up from the current 60 million rubles (€1.4 million) to 240 million rubles (€5.7 million).

Russia's insurance sector is mostly in the hands of private insurers. The Russian government has gradually reduced its remaining stake in the country's largest insurer, Rosgosstrakh and in September the last remaining state shares were sold to the company's biggest shareholder. Russia's second largest insurer, Ingostrakh, was privatised in the 1990s. The third largest company, Sogaz, which controlled about 9 % of the market last year, belongs to Gazprom.

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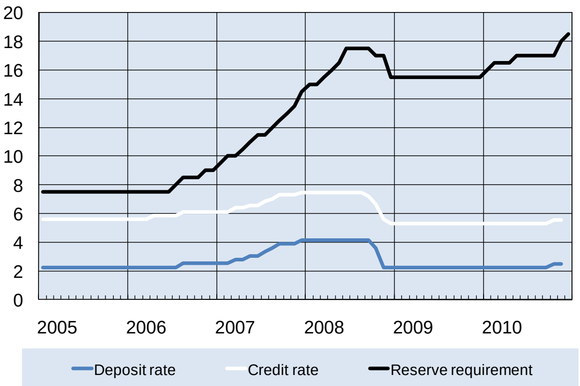
China

China steps up inflation fight while Hong Kong's monetary authorities struggle with soaring real estate prices. China's economic policymakers have reacted strongly to October's pickup in consumer price inflation to a rate of 4.4 % y-o-y. Although the price of food, which accounts for the largest share of household spending, was the main inflation driver, clothing and housing were also higher.

At the end of last week, the People's Bank of China announced it would further hike bank reserve requirements by a half percentage point. It was the second hike in just two weeks. The reserve requirement for the four giant state banks goes up to 18.5 % at the beginning of December. In addition to a 0.25 % hike in reference rates last month, China has imposed tighter currency controls on banks to deal with capital flowing into the country. Officials have also intervened to restrain speculation in staple food items by opening state reserves to secure adequate food supplies on the market and assist in food support to China's poorest groups. In the case of meals provided to students, additional subsidies not only serve a real nutritional need but also reduce the likelihood of student unrest.

12-month reference deposit and credit rates, reserve requirement for largest commercial banks, %



Source: People's Bank of China

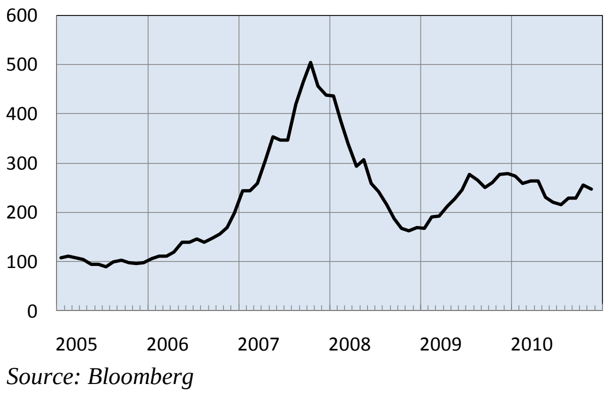
Also Hong Kong's monetary authorities tightened terms for housing loans in an effort to calm real estate prices. Given the Hong Kong dollar's fixed peg to the US dollar (currency board) and free capital movements, Hong Kong has been forced to follow the relaxed monetary stance of the US Federal Reserve and it cannot calm a sizzling real estate market by interest rate hikes. The dilemma is highlighted by the fact that the Hong Kong economy grew in the third quarter nearly 7 % y-o-y while US GDP growth was mired at around 2.5 %. China, in contrast, retains room to manoeuvre in its monetary policy as it still has rather strict capital controls and its exchange rate regime provides more flexibility.

Chinese stock markets driven by global economic events. Fluctuating prices on China's stock exchanges in recent years have provided investors with a real roller-coaster ride. In 2006–2007, the value of the Shanghai Composite Index, the main index of mainland China's largest stock exchange, quintupled. With the global financial meltdown in 2008, Chinese share prices lost three-quarters of their value. The markets then clawed back gains, despite sporadic drops when international events intervened.

Shares fell again last spring after the Greek crisis and problems with Europe's public economy sent shockwaves through the market. During that episode, the Shanghai Composite Index shed nearly a quarter of its value. Chinese share prices rebounded after EU members committed to a stabilisation package and credit facility for its most troubled economies. The positive news was reinforced by announcements that China's industrial enterprises saw profits double from a year earlier.

China's main exchanges hit another downdraft in recent weeks. The drop this time is in part due to domestic factors. The fall in share prices reflect fears that tighter monetary policy to quell inflation pressures will slow economic growth faster than the markets had anticipated. China's stock markets have traditionally been sensitive to official monetary and fiscal measures.

Shanghai Composite Index (2005=100)



Source: Bloomberg

Recent international events have added to the declines in Chinese share prices. PIIGS concerns are again front and centre and North Korea's shelling of a South Korean island on Tuesday (Nov. 23) have only added to market nervousness. In familiar fashion, China's highest leadership issued a measured statement on recent events on the Korean peninsula − even as the world looked to China for help in defusing tensions.

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Russia

Federal budget expenditures set to rise in 2011. Under the draft budget approved by the Duma on November 24, budget revenues are expected to climb in 2011 to 8,845 billion rubles (€215 billion), a nominal increase of 12 %. The draft budget assumes, among other things, that next year the oil price will average $75 a barrel (Urals grade), GDP will grow 4.2 %, inflation will decline to 6.5 % and the average ruble exchange rate will be 30.5 rubles to the dollar. Tax increases will augment revenues slightly.

The projected budget deficit is 3.6 % of GDP. Expenditures will shrink in real terms, even if they rise in nominal terms by 4 % to 10,659 billion rubles (€260 billion). Transfers to regional budgets and social funds will fall even in nominal terms. At the same time, direct revenue to the social funds will be raised with a hike in the social contribution taxes from 26 % to 34 % effective January 1, 2011. Federal spending (excluding transfers to regions and social funds) will increase by over 10 %. The sharpest hikes are planned for defence and debt servicing. For the first time, part of transfers to regional budgets are included under other federal expenditure categories, making comparison with earlier expenditure items problematic.

Breakdown of 2010 and 2011 federal budget expenditures (RUB billion, nominal change from previous year)

	2010		2011	
	RUB bn	%	RUB bn	%
Public administration	800		864	8
Economy	1,600		1,760	10
Defence	1,277	7	1,517	19
Law enforcement & national security	1,109		1,216	10
Social policy	3,316		2,941	-11
- Transfers to social funds	2,737	30	2,432	-11
Education	444		517	16
Health care	430		466	8
Housing	223		217	-3
Debt servicing costs	280	59	390	39
Culture	75		82	10
Media	55		61	12
Environment	13		17	26
General transfers to regional budgets	576		570	-1
(other transfers to regions are included in the above items)				
Total transfers to regional budgets	*1,336*	*-10*	*1,259*	*-6*
Total	10,233	6	10,659	4

Source: Ministry of Finance

Sluggish recovery in natural gas demand affects Gazprom. Gazprom has lowered its projected natural gas production target for the year from last spring's target of 529 billion cubic metres to 515 billion m^3. Ahead of the global financial crisis, the company was producing more than 550 billion m^3 of gas a year. Gazprom estimates its gas exports to non-CIS countries will slightly exceed 140 billion m^3 this year, about the same as last year.

According to the EU Commission, the EU now gets 30 % of its natural gas supplies from Russia. Demand for Gazprom gas in Europe, however, has been hit by the economic recession, increases in gas production elsewhere, and the relatively steep pricing of Gazprom's long-term supply contracts. Currently, Gazprom long-term contract prices are well above spot market prices.

Unsurprising, many of Europe's natural gas customers have bridled at Gazprom prices and the yoke of long-term delivery contracts that commit them to purchasing a specified amount of gas no matter how demand fluctuates. Gazprom bases its pricing on world trends in oil product prices. At the beginning of this year, Gazprom conceded to temporary adjustments in its contract terms with its biggest customers to take spot-market prices into consideration. Buyers now expect Gazprom's discounts to continue.

Gazprom announced at the end of November that it was cutting back on its investment plans for next year by 10 % due to the weakened market conditions. Next year's investment will amount to 816 billion rubles (€20 billion), down from 905 billion rubles (€22 billion) this year.

Meeting of Russian and Chinese prime ministers focuses on energy issues. At their November 23 meeting in St. Petersburg, prime ministers Vladimir Putin and Wen Jiabao displayed interest towards growing energy cooperation. As examples of growing cooperation Putin noted the Skovorodino-Daqing oil pipeline, which is set to start operating at the beginning of the year, and that Russian crude will be refined at a refinery under construction in the city of Tianjin, China. The refinery, which has an estimated construction cost of $5 billion, is being built by the Chinese-Russian joint venture Eastern Petrochemical Company. China National Petroleum Corporation (CNPC) owns 51 % and the Russian Rosneft 49 %. The joint venture also plans to establish a chain of gas stations in China.

In connection with the meeting, the heads of Rosneft and CNPC signed a cooperation deal on R&D on new oil and gas sources. The work will be overseen by a joint venture, Vostok-Energy, in which Rosneft owns 51 % and CNPC 49 %.

More than a dozen other bilateral deals were also signed at the prime minister meeting. They included an agreement on construction of reactors 3 and 4 at China's Tianwan power plant by Rosatom engineering subsidiary, Atomstroyexport (an exporter of nuclear energy equipment and services) and the Chinese Jiangsu Nuclear Power Corporation. Atomstroyexport built the first two reactors at Tianwan. Other deals at the meeting had to do with e.g. increasing border surveillance and customs practices.

Although the prime ministers discussed the price of gas supplied via the Altai gas pipeline to China, no final price was agreed. Gazprom said the export deal will be signed by mid-2011 and gas will start flowing in 2015.

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China

Current account surplus swells in the third quarter. China's current account surplus doubled to $102 billion in the July-September period as compared to the third quarter of 2009. The current account surplus for 3Q10 amounted to slightly more than 7 % of GDP. For the first nine months of the year, the current account surplus was $204 billion, an amount equal to about 5 % of GDP for the period. For all of 2009, the current account surplus relative to GDP fell to slightly below 6 %. The 2008 current account surplus was a stunning 10 % of GDP.

The third-quarter growth in the current account surplus was driven by the recovery in international demand and export growth that exceeded import growth. Appreciation expectations for the yuan might have also added to the surplus, by a rising influx of illegal cash flowing into the country disguised as payments for goods or services. Overlooking valuation adjustments, China's currency reserves climbed by $107 billion in the third quarter.

Although China's current account surplus is considerably smaller than in peak years, the third-quarter figures reaffirm the growing perception among observers that global imbalances have been widening as the recovery in the global economy has gotten underway. This view, in turn, increases appreciation pressure on the yuan. China's State Administration for Foreign Exchange (SAFE) recently announced that China aims to reduce its current account surplus to 4 % of GDP over the coming years. The IMF, however, doubts this target can be reached without broad reforms to rebalance the Chinese economy. The IMF's own estimate is that China's current account surplus will climb to 8 % of GDP by 2015 without action to stimulate domestic consumer demand.

China's balance of payments and currency reserves, US$ billion

	2009Q1-Q2	2010Q1-Q2	2010Q3
Current account	135	127	102
Capital account	1	2	
Financial account	60	88	
omissions	-10	-39	
Increase in currency reserves	186	178	107
Currency reserves	2,132	2,454	2,648

Source: SAFE

China has announced plans to publish information on capital and financial accounts on a quarterly basis, but such figures for 3Q10 are not yet available. The January-June figures show foreign direct investment inflows into China doubled from 1H09 to $56 billion. In net terms, China had an FDI surplus of $37 billion in the first half as inflows exceeded outflows. The net surplus was more than double compared to the 1H09. FDI from China increased 50 % y-o-y in the first half of 2010 to $19 billion.

China's growing demand for raw materials reflected in pace of foreign investment. Fresh balance-of-payments figures show Chinese investment abroad recovered briskly in the first half of this year from last year's collapse. Notably, Chinese FDI outflows have been soaring in recent years. Last year China rose to fifth in the world in terms of FDI spending abroad. Much of China's investment reflects the country's growing appetite for raw materials, international expansion of Chinese firms and efforts to acquire technology and know-how. Some 75 % of Chinese FDI was directed at the Asia-Pacific region. South America was next with a 13 % share, followed by Europe with a 6 %, share and North America and Africa, each with 3 % shares.

To facilitate growth in mergers and acquisitions, the Chinese government has used a range of measures to support the international expansion of Chinese enterprises. For example, the government increasingly provides consulting services for companies considering international expansion. China's growing interest in Africa and South America essentially reveals its exploding demand for raw materials. China often includes major infrastructure projects when investing in developing countries as part of its efforts to secure long-term guarantees of supply of resources. In developed countries, China's corporate shopping spree has not always been met approvingly. First-world companies struggling in the midst of the global economic downturn are worried about being targeted for acquisition by Chinese buyers. On the other hand, surveys indicate that Chinese companies often find themselves at a loss in understanding Western business culture.

This year China's corporate acquisitions have focused especially on oil, mining and power generation. China's largest state oil companies have been on the move in Canada, as well as in numerous countries in Africa and South America. A couple of huge, but unconfirmed, deals involve Sinopec taking a $7.1 billion stake in Repsol's Brazilian unit and a $4.7 billion investment in Syncrude Canada. CNOOC, for its part, has confirmed its commitment to an approximately $3 billion investment in both Bridas Corp and Pan American Energy in South America. In the mining sector, state-owned East China Minerals purchased an iron ore mine in Brazil and Chinalco signed a partnership agreement with Rio Tinto on developing iron ore production in Guinea. China's Huaneng Group, the world's second largest electricity producer, reports plans to invest $1.2 billion in US electrical power producer InterGen.

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Russia

Prices of food items rise rapidly. The on-year rise in consumer prices accelerated in November to a rate above 8 %. The increase was led by a sharp spike in food prices, which soared by over 11 % y-o-y. The price of Rosstat's basket of staple food items, which consists of basic food items for a person living on the subsistence minimum, climbed nearly 20 % y-o-y in November.

Thus far Russia's leaders have not reacted to the current situation like in 2008 when price controls were placed on targeted staple food items to deal with spiking global commodity prices. Substantial increases in staple food items may strengthen the pressure on the government to raise pensions and public sector wages, especially as low-income groups devote an even larger share of their spending on food than the average Russian share of 40 %. So far, the 2011–2013 federal budget calls for adjusting public sector wages to keep up with inflation and keeping pension growth slightly faster than inflation.

Big foreign acquisition in Russian food industry. On December 2, US-based PepsiCo announced plans to take a 66 % stake in the Russian Wimm-Bill-Dann (WBD) dairy and juice products company. Founded in 1992, WBD is the largest producer of milk products in the CIS area and a major producer of soft drinks. The deal was valued at $3.8 billion. All of the original WDB founders agreed to sell shares, and PepsiCo plans to continue share-buying in the future.

WBD has nearly 30 % of Russia's dairy products market and it controls over 20 % of the juice market. The acquisition makes PepsiCo Russia's largest company in the food and beverage market. PepsiCo also earlier purchased several Russian juice-makers and prior to the WBD acquisition it already controlled over 30 % of the Russian juice market. The WBD deal still requires the blessing of Russia's competition officials before it can be finalised.

International firms have a strong presence on the Russian food and beverage market. In June, the French Danone and the Russian Unimilk merged their activities in Russia. The new entity controls about 30 % of the national market for dairy goods, approximately the same share as WBD. The remaining 40 % share of Russia's dairy goods market is served by small local dairy producers.

Rosstat reports that in 2004–2009, foreign direct investment into the food and tobacco industries accounted for 2–5 % of Russia's total FDI inflows.

Russia's food industry contracted sharply in the 1990s, but roared back in the 2000s. The food industry accounts for about 15 % of Russian manufacturing activity. Last year the food industry employed 1.2 million people, about 17 % of all workers in the manufacturing sector.

Foodstuffs and agricultural produce accounted for more than a fifth of Russian imports at the start of the 2000s. By 2006–2008 that share had shrunk to 12–14 %. Last year it climbed back to 17 %. In comparison, China and Brazil only import 4–5 % of their agricultural produce. Finland imports 6 % of its food.

PISA performance of Russian 15-year-olds again below international average. The OECD this week published 2009 PISA evaluation of 15-year-old students in the areas of reading skills, mathematics and natural sciences in 34 member countries and 31 partner countries and regions. Russian students performed below the participating countries' average in all three categories of the survey. PISA tests have been organised every three years since the first round in 2000. Russia has consistently ranked below average in PISA comparisons.

In the latest PISA study, which had a special focus on reading literacy, Russian students ranked 43rd (on par with Turkey and Dubai) out of the 65 countries and regions surveyed. The reading framework was organised into three parts: finding a particular piece of information in a text, understanding core relationships of information in a text and deeper assessment of the text based on the student's own experience and knowledge. The third aspect of the reading framework proved particularly challenging for Russian students.

Russian students placed 38th in math and 39th in natural sciences (on par with Greece and Croatia). Math and natural sciences tasks were broken into six levels of difficulty, based on e.g. the ability to apply theoretical knowledge to practical situations. Only 18 % of Russian students were able to solve problems in the three toughest problem groups in the math and natural sciences categories. Some 49 % of Finnish students, who again placed in the top-tier of the PISA comparisons, were able to solve the hardest problems and 46 % of the toughest problems in natural sciences.

Russian officials concede their failure in education and reliance on old-fashioned teaching methods – especially when it comes to giving students the skills needed to abstract and apply learned knowledge to practical situations.

A report from UNDP found that Russia spends considerably less per student on secondary education than the OECD average. On the other hand, Russian class sizes are smaller than the OECD average. UNDP found that in 2006 average class size in Russia was just 18 students, compared to the OECD average of 24 per class. The ratio of teachers to students was 1 to 10 in Russia in 2006, compared to an OECD average of 1 to 13.

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China

Asian participants shine in latest PISA evaluations. Shanghai, South Korea, Hong Kong, Singapore and Japan all made it into the top ten in the latest OECD 2009 PISA survey of education performance of 15-year-olds in reading skills, mathematics and natural sciences. Participants included 34 OECD members and 31 OECD partners. Shanghai debuted as the first mainland Chinese participant in the comparison; other parts of mainland China have yet to take part in PISA testing. The theme of the 2009 PISA evaluation was reading literacy, including a new category testing digital literacy. The emphasis was on reading comprehension and application of text information.

Shanghai ranked number-1 in all three main testing categories. South Korea scored second in reading, followed by Finland, Hong Kong and Singapore. Of the large economies, Brazil performed clearly under OECD average with an overall ranking of 53. Kyrgyzstan came in last. India has yet to participate in PISA tests.

Selected 2010 PISA results, points (ranking)

	Reading	Mathematics	Natural Sciences
OECD average	493	496	501
Shanghai	556 (1)	600 (1)	575 (1)
South Korea	539 (2)	546 (4)	538 (6)
Finland	536 (3)	541 (6)	554 (2)
Hong Kong	533 (4)	555 (3)	549 (3)
Singapore	526 (5)	562 (2)	542 (4)
Canada	524 (6)	527 (10)	529 (8)
Japan	520 (8)	529 (9)	539 (5)
Russia	459 (42)	468 (38)	478 (39)
Brazil	412 (53)	386 (57)	405 (53)
Kyrgyzstan	314 (65)	331 (65)	330 (65)

Source: OECD

PISA tests not only provide a basis for comparison of national school systems but also insights into factors outside school that influence a student's ability to learn. The most successful school systems managed to deliver consistently high-quality education to a large number of students. In the lead countries it was not simply a matter of students posting high testing scores but also smaller pools of students performing poorly on the tests.

In most countries, the socioeconomic backgrounds of students correlated with success in school. However, in the top-performers, socioeconomic background seems to be less important (notably Finland, Shanghai, Hong Kong, Japan and South Korea). Math will be the theme of the 2012 PISA study (results available in 2013).

Computer use rising quickly in China. The average city resident in China now owns 0.7 computers and 1.9 mobile phones. Measured in terms of subscriber connections, China has become the world's biggest internet user with 420 million connections. There is still plenty of room for growth; China has only 0.3 internet connections per resident, less than half the average for developed countries.

While computer use has become a seamless feature of daily life in many Chinese cities, access to computers is still limited in the countryside. In wealthy cities in the east-coast computer use is comparable to developed countries. In western rural areas, on the other hand, there are still only 2.5 computers for every 100 people. Although the government has sought to reduce the city-country IT divide e.g. through infrastructure investment and IT training, the interest of rural residents in adopting digital lifestyles is still lacking. Lower rural incomes relative to cities also reduce the ability of individuals to invest in IT.

The ubiquity of internet use has created huge challenges for Chinese censors. Following the alleged Chinese hacking of IT giant Google, Google CEO Eric Schmidt opined that China's attempts to prevent free information exchange on the internet are ultimately futile. The current Wikileaks episode provides an extreme example of how difficult it is to manage information dissemination or even the public discussion. However, a government press release in June shows a continued government determination on the issue. In the release it is said that China will block all writings threatening national unity also in the future.

China wins its first WTO case against the EU. China filed a complaint with the WTO in July 2009 protesting the EU's 87 % protective duties imposed on steel fasteners (e.g. screws and bolts) from China. The WTO faulted the EU's vague antidumping calculations and handed its decision to China. The ruling was seen as a setback for the EU antidumping efforts. China has earlier won some WTO cases against the US and the winning streak is expected to bolster China's position in the WTO. The WTO court is still dealing with the EU counter-case against China's import duties on steel fasteners.

In a recent report, the WTO found that China continues to lead in WTO antidumping filings. In the first half of 2010, 23 of the 69 antidumping investigations involved complaints against China. In 1H09, 33 of 97 investigations involved charges against China. Next came the EU (11 investigations) and the US (5 investigations). In 1H10, India led in filing of antidumping claims (17 claims), followed by Turkey (9 claims) as well as Argentina and China (7 claims each).

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Russia

Revamped mandatory health insurance scheme set to debut in two weeks. President Dmitri Medvedev last week signed into law reforms of Russia's healthcare provision that require mandatory participation. The reforms are part of a larger, long-planned overhaul of the healthcare system.

Among the most intractable aspects of Russia's current healthcare system are underfunding and huge differences across regions in terms of both scope and quality of healthcare delivery. Basic healthcare (health centres, hospitals and ambulance services) for which municipalities are responsible suffers from chronic under-resourcing. Mandatory health insurance contributions from employers and regional administrations to regional and federal health insurance funds are insufficient to cover spending on healthcare. As a result, a large share of healthcare outlays is covered by federal budget subsidies. This federal funding, though, is not directed straight to municipalities but to regional administrations that often withhold some of the money allocated to municipal healthcare. Regional administrations also sometimes fail to pay enough into the health insurance fund for the non-working population.

The new act transfers the responsibility for basic healthcare from municipal administrations to the regional level. Furthermore, regional administrations are charged with a duty to provide adequate financing to cover the health insurance of the non-working population. The employer contribution is currently 3.1 % of the wage bill. It rises next year to 5.1 % in an effort to reduce the need to pay out subsidies from the federal budget.

Starting next year, all health insurance payments will be collected in the federal health insurance fund, from which monies will be distributed to individual regions. This is intended to reduce the inequality in healthcare among regions.

The original mandatory health insurance scheme created in the early 1990s was supposed to produce competing insurance companies and thereby improve the efficiency of both the health insurance and healthcare providers. This competition goal was never realised. Russia currently has over a hundred companies offering health insurance that use a very simple business model: they charge a provision for transferring the money allocated from health insurance funds to hospitals. Many of the insurance companies only serve the enterprises that set them up.

The new system lets the insured independently select their health insurance provider, as well as the institutions proving care and their doctors. The facility providing care can be public or private, and the new system encourages insurance companies to compete for customers by offering varied service palettes. Insurance companies are now tasked with assuring care for the insured and oversight of the quality and appropriateness of care. Experts see emergence of competition on the strongly regulated mandatory health insurance markets as an ambitious challenge in today's Russia. Implementation of the system demands a substantial effort, including new kind of regulation and oversight of health insurance provider operations and giving the public enough information to enable the choice of an insurance provider.

The new system also seeks to make no-cost care available to people outside their home district – something currently impossible. Starting in May 2011, electronic chip cards will be issued to all Russians that will make it possible for them to receive care anywhere in the country. The new law even sets a deadline (25 days) for reimbursement of care-providing organisations for treating a non-resident.

No evidence of investment boom in Russia. A recent study by Moscow's Higher School of Economics found that Russian exporters were the group of companies that most often made fixed capital investments this year. The study was based on responses to Rosstat's annual survey of over 10,000 corporate leaders on their investment activities and plans.

Some 95 % of participating firms in extracting industries said they had invested in fixed assets this year, a modest increase from last year. In manufacturing, 85 % of firms reported having made fixed investments, about the same as last year. All oil refiners participating in the survey reported having made fixed investments in 2010.

Most respondents reported that economic uncertainty had decreased substantially. Last year, 48 % of firms considered economic uncertainty the biggest obstacle to investment. While that number this year fell to 32 %, firms are still cautious about their investment plans.

The investments of most firms (67 %) involved replacement of old production equipment with modern plant facilities. The share was as big as 70 % among large and mid-sized companies. The most common reason for the investment was that the old machinery was simply worn out and no longer worked properly. An alternative to investment would have been ceasing production. About 60 % of respondents said they used machinery that was over 10 years old; 19 % said their machinery was over 20 years old. The oldest equipment was found in coal mining, ore excavation and metals production.

Firms still finance the lion's share of capital investments out of pocket. Only 31 % of firms this year reported having taken loans to finance investments.

Preliminary Rosstat data suggest the pace of investment has continued to pick up this year, even if investment levels have yet to return to pre-crisis levels. Fixed investment in January-October was up nearly 5 % y-o-y.

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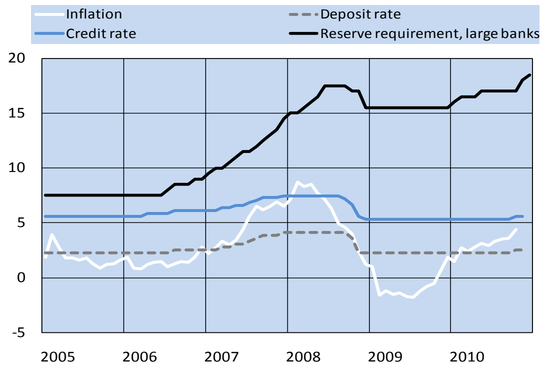
China

Chinese inflation continued to accelerate in November. Consumer prices picked up to a rate of 5.1 % y-o-y. Food prices (up over 10 %) showed the sharpest gains, while clothing prices exhibited a slight decline. Core inflation which is calculated without the volatile food and energy prices was 1.5 % y-o-y.

The rate of consumer price inflation continued to exceed the target of the People's Bank of China (3 % for 2010 and 4 % for 2011). As part of its inflation-fighting efforts, the PBoC raised the reserve requirement for large banks to 18.5 % of deposits. This autumn, the PBoC also hiked reference rates for deposits and credit. The officials also introduced price controls on certain goods and services. China experienced similar inflation spikes over the past decade, most recently in 2008. In each episode, officials managed to get inflation under control. China's inflation rate fluctuations are large compared to most developed economies.

Reserve requirement (% of deposits), 12-mo. reference rate (% p.a.) and consumer price inflation (% change y-o-y)



Sources: PBoC and NBS

Steady growth in China's industrial output. China's National Bureau of Statistics reports industrial output in November climbed 13 % y-o-y in real terms. Industrial output growth has held steady for several months in a row. In contrast, the Chinese purchasing managers index of manufacturing (PMI), the main indicator of industrial confidence, has been strengthening since July. The survey on which the PMI is based found that output growth was driven by new orders from both domestic and export markets, as well as replenishing of inventories. The survey noted a sharp rise in industrial input prices in recent months. Perhaps most disconcerting from the consumer's standpoint is that higher prices for production inputs tend to drive consumer price inflation.

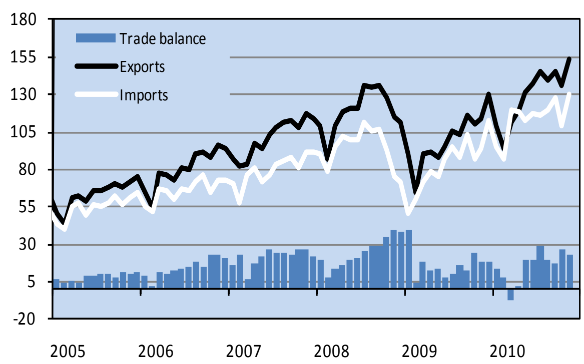
Real growth in retail sales slowed slightly in November to 14 % y-o-y. In nominal terms, fixed investment rose in the January-November period by 25 % y-o-y. Investment activity slowed slightly from the beginning of the year due to the reduction in state-sponsored infrastructure projects, even if investment in housing construction was up 30 % y-o-y. Foreign direct investment, which represents a marginal share of fixed investment, was up by over a third to about $10 billion in November. For the January-November period, FDI increased 17 % y-o-y. Growth has been driven by investment in the service sector, the share of which is nearly half of total FDI.

Robust growth in foreign trade registered in November. Imports climbed 38 % y-o-y in November to $130 billion and exports 35 % y-o-y to $153 billion. The export growth figures were boosted both by growth in the world economy and last year's low reference point. Slightly higher growth in imports than exports reduced the foreign trade surplus for the first eleven months of the year by 4 % to $170 billion.

As in previous months, exports to China's top markets (the European Union and the United States) continued to surge, rising slightly over 30 % y-o-y. Part of the upswing reflects delayed orders for the Christmas season. Western retailers this year broke with tradition by postponing their orders to the last minute (i.e. November). Highest export growth figures, however, were posted for emerging economies such as India (up 44 %), Russia (75 %), Brazil (43 %) and South Africa (60 %). These country-level differences in Chinese exports highlight the fact that the global recovery is stronger for many developing nations than in the developed world.

Chinese import growth also picked up in November on higher imports of iron ore and other raw materials, as well as increased domestic demand and higher world commodity prices. Imports from EU countries and the US were strong in November.

Monthly trade balance, exports and imports, US$ billion



Source: China customs

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Russia

Further limits imposed on foreign labour in Russia. Russia sets every year quotas for the number of foreign citizens working in the country. Since 2007, the quota was extended to workers coming from countries without a visa requirement. With the economic recession, the quota figure has been slashed repeatedly. In 2007, the work permit quota was 6 million. In 2009, it was still nearly 4 million, but this year it was only 1.9 million. The health and social affairs ministry announced that the quota will next year drop to 1.7 million persons.

The United Nation's Population Fund UNFPA has published an estimate according to which approximately 8 million foreigners live in Russia at any given time. Estimates from the Russian Federal Migration Service found that more than 70 % of foreigners to Russia came from CIS countries. While no visa is required for CIS citizens travelling to Russia, work permits are required.

The Federal Migration Service puts the number of foreigners working in Russia at around 5 million people, most of whom work illegally. It estimates that there are about 1.5 million Ukrainians, 1.2 million Uzbeks and 800,000 Tajiks working in Russia.

The largest work permit quotas have been allocated to St. Petersburg, Moscow, the Moscow region and the Krasnodar okrug, where construction of the venues and infrastructure for the 2014 Sochi Olympics is underway. Over 50 % of the quotas have been granted for construction and mining workers as well as unskilled workers.

Foreign professionals that command high salaries are exempt from the quotas thanks to a change in the law that went into force in July. The legislation is designed to make Russia attractive to top-tier expertise with a view to boosting Russia's modernisation efforts.

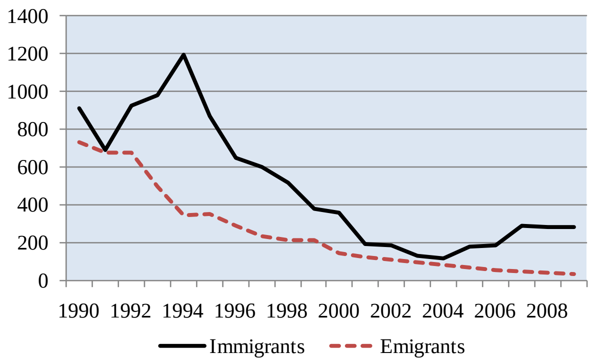
Under Russian legislation, foreign citizens are not allowed to work in government service, or sell medicines or alcohol. Working as a market seller is also forbidden.

Many foreigners working in Russia send part of their earnings home. A World Bank survey released in November found that Russia was the fourth largest source of foreign individuals' repatriations of earnings to their home countries. The biggest source of repatriated earnings was the United States, followed by Saudi Arabia and Switzerland.

The Central Bank of Russia reports that the amount of repatriated personal earnings from Russia to home countries rose to more than $8 billion, an increase of 17 % y-o-y in the first half of 2010. For all of 2009, repatriated earnings amounted to $16 billion, a 29 % drop from 2008.

Rosstat reports that last year 280,000 people immigrated permanently to Russia and 32,000 left the country permanently, resulting in a net immigration gain for Russia of 248,000 (the figures do not include guest workers). In the first nine months of this year, net immigration was 125,000 persons, a decline of 31 % y-o-y compared to the same period in 2009. Russia has seen positive net immigration ever since the break-up of the Soviet Union. In 2005–2007, there was a surge in immigration as the Russian economy flourished. The rate of immigration has since levelled off during the recent recession.

Russian permanent immigration and emigration, 1990–2009, thousands



Source: Rosstat

Economic growth stalls in the third quarter. Rosstat estimates that GDP grew just 2.7 % y-o-y in the third quarter. Economic growth was still above 4 % in the first half of the year. For all of January-September, on-year growth was 3.7 %. Seasonally adjusted GDP even contracted by 1 % q-o-q in the third quarter.

The economy ministry recently lowered its GDP growth forecast for 2010 to 3.8 %. To meet the forecast, growth would have to revive significantly in the fourth quarter. Sector-specific data suggest the economy picked up slightly in October and November.

Agriculture, which was hit by drought, was a leading driver of the third-quarter contraction. Without agriculture, on-year GDP growth would have been over 4 % in the first half of 2010. On the other hand, the recovery of mineral extraction industries (including oil and gas), manufacturing and transportation from their lows a year earlier slowed, which is due to gradual increase of the year-earlier base of comparison. GDP growth was bolstered by recoveries in the retail, wholesale, service, construction, real estate and financial sectors.

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China

Cancun climate change conference slogs towards new international agreement; China approves emissions reporting requirement as part of final package. A compromise was reached at the climate change negotiations held in Cancun, Mexico (Nov 29–Dec 10). Progress was made on the principles on how to combat climate change, and a compromise that was finally reached is thought to work as a basis for a wider international agreement. The agreement was seen as a rescue of the credibility of the United Nations Framework Convention on Climate Change (UNFCCC), which has widely been criticised after last year's failure at Copenhagen.

China's climate negotiators have reminded several times that China is still a developing country with GDP per capita well below that of the developed world. Hence, China's carbon dioxide emissions will keep on rising in the upcoming years to allow economic development and raising living standards of Chinese people. China offered no specific dates as to when it might be ready to commit to binding emissions reductions, but has set its own national environmental targets, including a 40–45 % reduction in carbon intensity by 2020 and an increase in the share of energy produced from renewable sources from 9 % to 15 %. In the international climate negotiations China saw measures that will facilitate technology transfer as the most critical. However, this remains problematic for developed countries due to difficulties in protection of intellectual property rights. China also sees preserving the structure of the climate change talks essential, and expects that the burden of emissions reduction will be maintained on the shoulders of wealthy industrialised countries also on the second term of the Kyoto Protocol.

China was widely scapegoated last year after the Copenhagen collapse. This year, however, it got involved early on in the negotiation process and showed a far more cooperative spirit, e.g. by hosting a climate working group meeting in Tianjin in October in the run-up to the Cancun summit (BOFIT Weekly 40/2010). China said at the Cancun meeting that it was ready to accommodate the US on its proposed Measurement, Reporting and Verification (MRV) scheme for emissions. The MRV has been a deal-breaker for the US, which sees it as essential to bringing transparency to emissions reduction. Other progress in Cancun included incorporation of earlier emissions reduction pledges into a formal UN document. The final text included a commitment to limiting the increase in the average global temperature to two degrees Celsius, even if the proposed measures at the conference came nowhere near what is needed to achieve that goal.

Countries from the developed world committed in principle to the establishment of a climate fund designed to support the adjustment of developing nations to climate change and emissions reduction. The developed world promised to pay $100 billion a year into the fund through 2020, and committed to provide $30 billion in direct supports to the developing world during 2010–2012 for the purpose of reducing emissions.

Extension of the Kyoto Protocol, which expires in 2012, remains an open question. As the US never ratified the Kyoto Protocol, it gave Russia, Japan and Canada an opening at the Cancun meeting to announce plans not to renew the treaty. Dealing with extension of the Kyoto Protocol was postponed to next December's climate summit in Durban, South Africa.

China further eases rules on foreign trade payments. The number of firms allowed to make and receive payments in yuan in their conduct of foreign trade increased more than 20-fold this month to nearly 70,000. The yuan programme now includes enterprises from 16 provinces, meaning in effect that only China's most western provinces still do not participate in the arrangement. The government launched the programme in June to free up payment traffic related to exports. The People's Bank of China reports that the popularity of the programme has increased fairly quickly during the last few months.

The latest changes in the currency controls regime have made it considerably easier to use the yuan as a payment instrument in foreign trade. Increasing number of companies involved in Chinese foreign trade can now handle payments for both exports and imports in yuan. From the standpoint of a foreign company engaged in trade with China, access to yuan has improved as international banks around the world have begun to accept deposits and offer yuan-denominated financial services.

An impediment to yuan use in foreign trade has been that currency controls sharply restrict capital movements between mainland China and other countries. Currency controls force foreign companies to surrender investment income as they are unable to freely invest yuan earned from trade in mainland China's financial markets. China actively supports the emergence of Hong Kong as the leading yuan trading centre outside mainland China, and growth accelerated rapidly this autumn. In October, the volume of yuan-denominated deposits in banks operating in Hong Kong grew nearly 50 % from September.

While the yuan is traded also elsewhere than Hong Kong outside mainland China, that trading takes place on a smaller scale. A notable newcomer to yuan-trading is the Moscow MICEX, which recently launched yuan-ruble trading. The MICEX is geared to serving Russia-China bilateral trade by reducing transaction costs and risks associated with currency exchange. The yuan is now traded in US and Hong Kong dollars, euro, yen, British pounds and Malaysian ringgit.

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Russia

Russia, Belarus and Kazakhstan settle on operating principles for Single Economic Space. The purpose of the Single Economic Space (SES) is to deepen cooperation that started with the Russia-Belarus-Kazakhstan customs union. At the December 9−10 meeting of the three presidents in Moscow, the final outstanding clusters of issues on how the economic space would function were agreed upon. The latest agreements pertain to a single economic policy, implementation of measures in the financial markets to allow free movement of capital and rules on foreign currency regulation. The three key areas were left unresolved at previous meetings during autumn, when unanimous agreement was reached on 14 other agreement areas. Resolution of the final three issue clusters was precondition to moving ahead with implementation of SES on January 1, 2012 and giving a year time for preparation.

Consensus was possible because the final documents were significantly narrower and less binding for member countries than originally envisioned. Member countries were also granted many regulatory exemptions. For example, the draft agreement for single economic policy included strict limits on e.g. the size of national budget deficits. No such limits were included in the final document. From the final agreement on common anti-trust policy, key products like gas, electricity, oil products and pharmaceuticals were omitted. They will continue to be regulated at the national level.

On the eve of the meeting, the final obstacle to formation of the SES was removed when Russia and Belarus reached agreement on rules for export of Russian crude oil to Belarus. The parties agreed that Russia will abandon export duties on crude oil going to Belarus. As compensation, Belarus is to credit Russia with export duties it collects on oil products it refines and sells to third countries. Belarus further agreed to harmonise its export tariffs on oil products with Russia. The new arrangement enters into force at the start of 2011.

Although the SES is set to launch at the beginning of 2012, it is to be expected that the launch is more of a formality, just like the 2010 launch of the customs union. Cooperation in all spheres does not commence at once but integration occurs incrementally over several years. The Russian government says the transition periods granted to member states end in 2017.

President Dmitri Medvedev said the goal of the SES project is to eventually form a common Eurasian Union similar to the EU. He said other countries, especially Ukraine, are most welcome to participate in the SES.

At the meeting of CIS leaders in Moscow held at the same time, the leaders of CIS countries agreed on creating a common free-trade area. Medvedev characterised the agreement as a first step towards economic integration within the CIS.

On next year's big tax changes. The finance ministry reports tight constraints on federal finances mean that increases in several tax rates can be expected in coming years as growing social spending, defence outlays and economic modernisation outlays make significant budget-cutting impossible.

Effective January 1, the mandatory social contribution of employers will rise from the current 26 % to 34 % of payroll. The contribution includes the mandatory pension insurance, health insurance and social security insurance. The hike in the social contribution of small firms involved in goods production or providing social services will be postponed until 2013 as part of an effort to support small business.

The tobacco excise tax will rise 40 % and the alcohol excise tax 9–10 % next week. While alcohol taxes are a touchy subject in Russia, it is planned that from 2012 onwards the alcohol excise tax would increase substantially faster than inflation. The excise tax on gasoline will also rise in coming years.

Energy taxation is a long-standing issue in Russia. Natural gas – produced mainly by Gazprom – has been traditionally taxed much less heavily that crude oil. The finance ministry has called for higher taxation of natural gas for years. From the start of 2011, the resource extraction fee for natural gas will finally go up 61 %. From 2012, it is planned that the fee be tied to the crude oil extraction fee. The finance ministry hopes to launch a wide-ranging overhaul of taxation of the oil sector in 2012. Crude oil taxation would not be reduced by the reforms, but taxes would be timed to better reflect the production cycle of crude oil fields.

The finance ministry is planning increase in the value-added tax rate, but is opposed by the economy ministry. The VAT rate on most goods and services in Russia is presently 18 %.

There are no plans to raise the flat income tax rates of 13 % for workers and 20 % for corporations, or the 9 % tax on dividends.

To broaden the tax base, the finance ministry has proposed a clean-up in Russia's complicated tax-break system. For example, large tax breaks in recent years have gone to the energy sector for development of new oil and gas fields. As lawmakers often discover, once temporary tax relief is granted, it is difficult to take away. The system has also become cumbersome and susceptible to abuse.

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China

China ends 2010 with an interest rate hike. The People's Bank of China hiked key interest rates by a quarter of a percentage point on Christmas Day (Dec. 25). The 12-month deposit rate rose to 2.75 % and the credit rate to 5.81 %. The hikes were not symmetric; other time deposit rates went up 0.30–0.35 % in response to worries over the corrosive effects of negative deposit rates. As with the previous rate hike in October, the narrowing of bank interest margins favoured depositors.

The rate hikes came as no surprise. Observers generally expected the PBoC to continue tightening the monetary stance as output growth remains robust and inflation reached 5.1 % y-o-y in November. Inflation concerns were heightened by modest accelerations in the expansions of the credit stock and money supply over the last two months. Both rates increased almost 20 % y-o-y in November. While consumer price inflation was largely driven by higher food prices, seasonally adjusted on-month changes in prices throughout the autumn indicate some spread of inflation also to non-food goods and services.

In addition to the two rate hikes (total increase of 0.5 percentage point), China in 2010 raised reserve requirements on banks six times. As of end-December, the reserve requirement for large banks stood at 18.5 % of the value of deposits. After a slight weakening of the yuan over a five-week period, the yuan bounced back against the US dollar in the past two weeks. Monetary policy tightening is expected to continue in the first half of 2011.

Media abuzz over Chinese readiness to bail out eurozone's troubled economies. A meeting of EU and Chinese leaders in December in Beijing received wide media coverage after Chinese authorities mentioned they might be willing to purchase debt if necessary to support troubled eurozone economies. The Portuguese press, for example, reported that China was ready to finance a big part of Portugal's projected borrowing needs in Q1 2011.

Risk, yield and liquidity are critical criteria for investments of foreign currency reserves. Some 60–70 % of China's over $2.6 trillion currency reserves are invested in dollar-denominated paper, 25–30 % in euro instruments and the rest in British pounds, yen and other Asian currencies. Promises to support European markets reflect the fact that Europe remains China's largest trading partner and, hence, the importance for China in promoting stability in the area. However, the Chinese never publicly made concrete commitments to such investment.

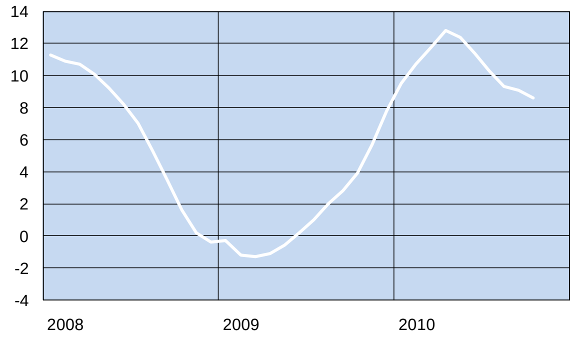
The Beijing meeting renewed China's hope the EU would grant market-economy status and lift its ban on arms exports.

Is calm returning to China's housing markets? China's National Bureau of Statistics reports apartment prices in 70 of China's biggest cities climbed 8 % y-o-y in November (a slight slowing from summer). The volume of finished apartments was down 4 % y-o-y in November and the volume of new apartment starts measured as square metres of floorspace was down 17 %. The decrease in the rate of housing price growth is widely welcomed even if the lower trend in the volume of finished apartments and housing starts raises concerns about the market's ability to keep up with demand. On the other hand, concerns have emerged about the risk that the inventory of unsold apartments could reach unreasonable levels and trigger a drop in apartment prices. Determining the true condition of China's housing markets is a non-trivial exercise given large regional differences and opaque statistics.

In a recent report, the Chinese Academy of Social Sciences (CASS) suggested that housing prices in many of China's big cities have reached unsustainable levels. The report states that real estate prices in 35 big cities were overvalued by nearly a third. The situation in the housing sector reflects structural problems and cyclical factors. China's rapid industrialisation and urbanisation have caused housing demand to soar in the country's main growth centres. In addition, stimulus measures during the global economic crisis supported apartment sales.

China's central administration introduced several measures to tighten credit and cool overheated housing markets during 2010. Efforts were made to contain rising apartment prices by e.g. increasing the size of the down-payment for first-time apartment buyers and instituting a ban on purchasing more than two apartments on borrowed money. Officials are now planning a trial real estate tax to further dampen speculation. Important measures to support housing supply at the local level should include allocating of land for housing, encouraging construction of affordable housing and restoration of landfill areas to make them safe construction sites. CASS researchers consider the official measures so far unclear and inconsistent.

Apartment prices in China, %-change y-o-y



Sources: NDRC, Bloomberg

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Central Bank of Russia / Exchange rates 2010
http://www.cbr.ru/eng/currency_base/dynamics.aspx

Date	USD	Euro
1.1.2010	30,1851	43,4605
12.1.2010	29,4283	42,6681
13.1.2010	29,3774	42,6149
14.1.2010	29,6409	42,9497
15.1.2010	29,4299	42,7764
16.1.2010	29,5603	42,5905
19.1.2010	29,5963	42,5654
20.1.2010	29,5184	42,5094
21.1.2010	29,6941	42,1478
22.1.2010	29,7486	41,9485
23.1.2010	29,7458	42,0576
26.1.2010	30,0946	42,5808
27.1.2010	30,3136	42,7058
28.1.2010	30,2921	42,5574
29.1.2010	30,3631	42,5842
30.1.2010	30,4312	42,4637
2.2.2010	30,3996	42,219
3.2.2010	30,183	42,051
4.2.2010	29,8779	41,7633
5.2.2010	30,0054	41,6115
6.2.2010	30,4666	41,7179
9.2.2010	30,5158	41,6937
10.2.2010	30,3735	41,6998
11.2.2010	30,2462	41,6551
12.2.2010	30,1245	41,5085
13.2.2010	30,1595	41,1737
16.2.2010	30,2207	41,1092
17.2.2010	30,1176	41,1467
18.2.2010	29,9761	41,2561
19.2.2010	30,1138	40,8825
20.2.2010	30,151	40,6285
25.2.2010	30,0309	40,6498
26.2.2010	30,0521	40,5012
27.2.2010	30,0388	40,7566
28.2.2010	29,9484	40,8047
2.3.2010	29,93	40,7377
3.3.2010	29,9779	40,5271
4.3.2010	29,814	40,6007
5.3.2010	29,8217	40,7215
6.3.2010	29,8366	40,5211
10.3.2010	29,7499	40,4866
11.3.2010	29,7249	40,3367
12.3.2010	29,5195	40,2469

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13.3.2010	29,3897	40,261
16.3.2010	29,3353	40,3272
17.3.2010	29,4242	40,2347
18.3.2010	29,1927	40,283
19.3.2010	29,2223	39,9586
20.3.2010	29,2565	39,8357
23.3.2010	29,3389	39,6339
24.3.2010	29,4707	39,8238
25.3.2010	29,5764	39,7152
26.3.2010	29,6572	39,5301
27.3.2010	29,5142	39,3808
30.3.2010	29,6309	39,8654
31.3.2010	29,3638	39,7028
1.4.2010	29,4956	39,5713
2.4.2010	29,4394	39,7255
3.4.2010	29,2194	39,6303
6.4.2010	29,2097	39,3922
7.4.2010	29,2416	39,2568
8.4.2010	29,294	39,1866
9.4.2010	29,4003	39,1524
10.4.2010	29,3232	39,2286
13.4.2010	28,9428	39,4982
14.4.2010	29,0294	39,4829
15.4.2010	29,0444	39,6253
16.4.2010	28,931	39,4387
17.4.2010	29,0325	39,2723
20.4.2010	29,1969	39,2873
21.4.2010	29,1381	39,2199
22.4.2010	29,0906	39,0919
23.4.2010	29,1288	39,0413
24.4.2010	29,2743	38,7445
27.4.2010	29,0882	38,8706
28.4.2010	29,0623	38,8534
29.4.2010	29,3801	38,7817
30.4.2010	29,2886	38,702
1.5.2010	29,1537	38,6986
5.5.2010	29,2982	38,6004
6.5.2010	29,6812	38,5143
7.5.2010	30,2971	38,6833
8.5.2010	30,7193	38,949
12.5.2010	30,3609	38,5948
13.5.2010	30,2048	38,194
14.5.2010	29,8597	37,8412
15.5.2010	30,0575	37,7282
18.5.2010	30,6986	37,7562

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19.5.2010	30,3946	37,6224
20.5.2010	30,6953	37,4206
21.5.2010	30,7523	38,0406
22.5.2010	31,0576	39,0115
25.5.2010	30,8754	38,6159
26.5.2010	31,4293	38,6046
27.5.2010	31,3538	38,5119
28.5.2010	30,8786	37,9869
29.5.2010	30,4956	37,6316
1.6.2010	30,74	37,8133
2.6.2010	31,0702	38,033
3.6.2010	31,19	38,1111
4.6.2010	30,8938	38,0117
5.6.2010	31,0685	37,8476
8.6.2010	31,7798	37,9165
9.6.2010	31,62	37,8333
10.6.2010	31,7302	37,943
11.6.2010	31,5742	38,0217
12.6.2010	31,4471	38,0982
16.6.2010	31,4595	38,3303
17.6.2010	31,1566	38,4192
18.6.2010	31,1854	38,2614
19.6.2010	30,884	38,256
22.6.2010	30,7267	38,267
23.6.2010	30,896	38,033
24.6.2010	30,9694	38,0242
25.6.2010	31,0149	38,2352
26.6.2010	31,0761	38,3324
29.6.2010	30,9833	38,3139
30.6.2010	31,1954	38,1863
1.7.2010	31,2554	38,2097
2.7.2010	31,3703	38,3031
3.7.2010	31,1942	38,9928
6.7.2010	31,1124	39,0305
7.7.2010	31,1124	39,1021
8.7.2010	31,0922	39,1326
9.7.2010	30,9479	39,1615
10.7.2010	30,7953	39,1285
13.7.2010	30,8823	38,8716
14.7.2010	30,8543	38,7345
15.7.2010	30,539	38,809
16.7.2010	30,5619	38,9053
17.7.2010	30,4615	39,3258
20.7.2010	30,5739	39,4373
21.7.2010	30,4058	39,5306

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22.7.2010	30,4059	39,2145
23.7.2010	30,5205	38,9503
24.7.2010	30,3839	39,1253
27.7.2010	30,3006	39,1999
28.7.2010	30,2391	39,3139
29.7.2010	30,2066	39,335
30.7.2010	30,2173	39,3671
31.7.2010	30,1869	39,4694
3.8.2010	30,1861	39,4653
4.8.2010	29,9681	39,45
5.8.2010	29,7958	39,3781
6.8.2010	29,8633	39,2404
7.8.2010	29,8312	39,3593
10.8.2010	29,8186	39,611
11.8.2010	30,0239	39,5235
12.8.2010	30,205	39,4417
13.8.2010	30,4493	39,3009
14.8.2010	30,4199	39,2173
17.8.2010	30,5199	39,0868
18.8.2010	30,4514	39,1148
19.8.2010	30,4257	39,0514
20.8.2010	30,4636	39,03
21.8.2010	30,5099	39,0923
24.8.2010	30,6041	38,9131
25.8.2010	30,7559	38,8662
26.8.2010	30,8958	39,0894
27.8.2010	30,8227	39,1911
28.8.2010	30,6969	39,0311
31.8.2010	30,664	39,0291
1.9.2010	30,8669	39,0127
2.9.2010	30,8001	39,1654
3.9.2010	30,6858	39,2901
4.9.2010	30,6922	39,3505
7.9.2010	30,5771	39,472
8.9.2010	30,7319	39,3215
9.9.2010	30,8873	39,2948
10.9.2010	30,8801	39,1868
11.9.2010	30,8937	39,1917
14.9.2010	30,6831	39,3235
15.9.2010	30,7049	39,5264
16.9.2010	30,7407	39,9107
17.9.2010	31,0223	40,3166
18.9.2010	31,0826	40,8115
21.9.2010	30,9809	40,5416
22.9.2010	31,0814	40,6483

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23.9.2010	30,9826	41,2254
24.9.2010	31,0031	41,538
25.9.2010	30,948	41,2599
28.9.2010	30,6119	41,222
29.9.2010	30,6013	41,0884
30.9.2010	30,403	41,3481
1.10.2010	30,5126	41,4392
2.10.2010	30,5094	41,6606
5.10.2010	30,496	41,9747
6.10.2010	30,436	41,7156
7.10.2010	29,8929	41,4017
8.10.2010	29,6334	41,3564
9.10.2010	29,9086	41,6717
12.10.2010	29,8317	41,66
13.10.2010	30,0763	41,5895
14.10.2010	30,1269	42,0451
15.10.2010	29,9315	42,1585
16.10.2010	30,1243	42,3939
19.10.2010	30,5237	42,3577
20.10.2010	30,4151	42,2983
21.10.2010	30,7968	42,4411
22.10.2010	30,7348	42,8781
23.10.2010	30,4977	42,5351
26.10.2010	30,2258	42,4975
27.10.2010	30,4	42,4658
28.10.2010	30,5682	42,1841
29.10.2010	30,6786	42,4316
30.10.2010	30,7821	42,7256
2.11.2010	30,7738	42,9848
3.11.2010	30,7941	42,9147
4.11.2010	30,7709	43,1654
9.11.2010	30,8029	42,9854
10.11.2010	30,8612	42,7798
11.11.2010	30,6925	42,3004
12.11.2010	30,5107	42,059
13.11.2010	30,7722	41,8779
14.11.2010	30,8414	42,2311
16.11.2010	30,8632	42,1715
17.11.2010	31,056	42,2175
18.11.2010	31,3487	42,2863
19.11.2010	31,1999	42,4069
20.11.2010	30,949	42,3568
23.11.2010	30,995	42,6367
24.11.2010	31,2642	42,4036
25.11.2010	31,2929	41,9168

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26.11.2010	31,2842	41,6956
27.11.2010	31,3539	41,6192
30.11.2010	31,3061	41,5682
1.12.2010	31,3335	41,0814
2.12.2010	31,4555	41,062
3.12.2010	31,3518	41,2276
4.12.2010	31,2641	41,3374
7.12.2010	31,2867	41,7677
8.12.2010	31,2238	41,6525
9.12.2010	31,243	41,272
10.12.2010	30,9831	41,2106
11.12.2010	30,8604	40,9394
14.12.2010	30,9006	40,8042
15.12.2010	30,7447	41,2932
16.12.2010	30,7199	40,8851
17.12.2010	30,7528	40,6798
18.12.2010	30,6682	40,7979
21.12.2010	30,7746	40,5055
22.12.2010	30,7188	40,472
23.12.2010	30,7187	40,3582
24.12.2010	30,5922	40,1706
25.12.2010	30,5778	40,1548
28.12.2010	30,4495	40,0594
29.12.2010	30,272	40,0226
30.12.2010	30,3592	39,9011
31.12.2010	30,4769	40,3331