Section 6 Central and South American economy and Russian economy

1. Central and South American economy

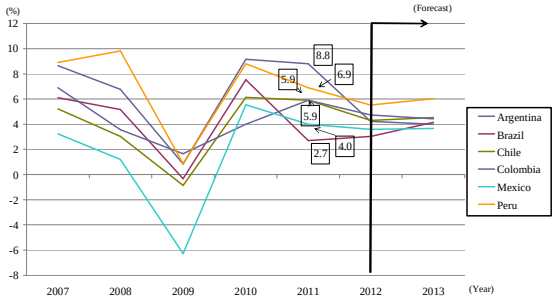
(1) Overview

(A) Central and South American economy with slower pace over the latter half of 2011

Real GDP growth rate of Central and South American countries (including Caribbean countries) was 4.5% throughout 2011 and slowed from 6.2% in 2010. The overheating economy which had grown until the first half of 2011 also slowed due to tight fiscal-monetary policies as well as sluggish external demand after the summer of 2011. According to the forecast for 2012 by the IMF, stable growth of 3.7% is expected throughout the region (see Figure 1-6-1-1).[172]

Figure 1-6-1-1

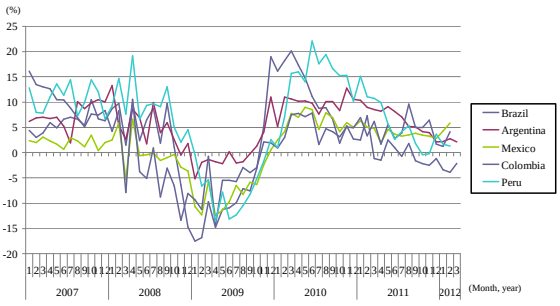
Real GDP growth rate of Central and South American countries and the forecast (IMF)[173]



Note: The number is real GDP growth rate in 2011. Chile is 5.924%, and Colombia is 5.929%.
Source: *WEO* (IMF).

Figure 1-6-1-2

Industrial production index of Central and South American countries (comparison to the same month of the previous year)



Note: All values are the ratio to the same month of the previous year. As an unadjusted value, the value in 2002 is set to 100 for Brazil, the value in 2003 is set to 100 for Mexico, the value in 2006 is set to 100 for Argentina, and the value in 1994 is set to 100 for Peru.
Source: IBGE (Institution of Brazilian Geographical Statistics) for Brazil, INEGI (National Statistics, Geography and Informatics Institute) for Mexico, INDEC (Instituto Nacional de Estadisticay Censos) for Argentina, INEI (National Institute of Statistics and Inform) for Peru, CEIC Database.

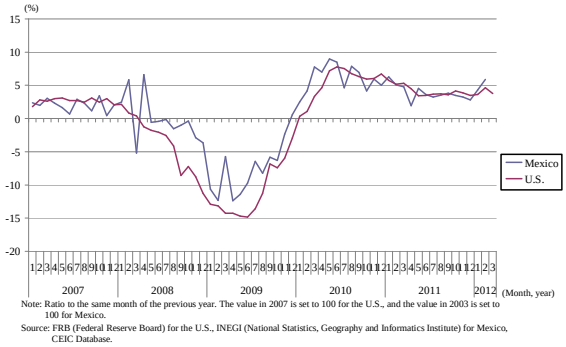
The Brazilian economy, in particular, significantly slowed in the latter half of 2011 due to gradual

172 *WEO, April 2012* (IMF), *Global Economic Prospects January 2012, Latin America & the Caribbean Annex* (World Bank (2012))

173 IMF (2012) uses the numerical value of official statistics by the Argentine government, but points out that the real GDP growth rate may be actually lower and the rate of increase in the consumer price index may be higher.

increase in policy interest rates for inflation control as well as the worsening international financial situations after August 2011. The industrial production index of each country fell over the latter half of 2011, and that of Brazil has remained at a lower level compared to the previous year since early autumn (see Figure 1-6-1-2). On the other hand, in the case of Mexico, which is strongly tied to the U.S. economy (the U.S. share in the value of Mexico's exports is 75% to 80%)[174], the index has retained positive figures (see Figure 1-6-1-3).

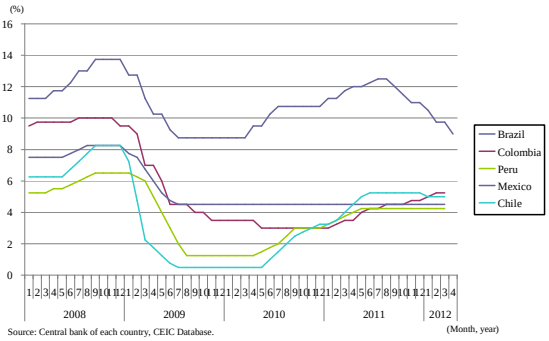
Figure 1-6-1-3
Industrial production index - Mexico and the U.S.



Note: Ratio to the same month of the previous year. The value in 2007 is set to 100 for the U.S., and the value in 2003 is set to 100 for Mexico.
Source: FRB (Federal Reserve Board) for the U.S., INEGI (National Statistics, Geography and Informatics Institute) for Mexico, CEIC Database.

In Brazil, the policy interest rate was reduced on six occasions from August 2011 and stands at 9% as of April 2012. Similarly in other Central and South American countries, the policy interest rates have been kept unchanged in many countries since the latter half of 2011 due to a growing sense of uncertainty in the world economy, though the rates were raised until the first half of 2011 to prevent the economy from overheating (see Figure 1-6-1-4).

Figure 1-6-1-4
Policy interest rate of Central and South American countries



Source: Central bank of each country, CEIC Database.

(B) Limited financial impacts of the European debt crisis

A downgrade of U.S. government bonds in August 2011 and the worsening of the European debt crisis resulted in a sharp decline in securities investment by foreign investors which had been

174 The value is calculated based on Global Trade Atlas data.

experiencing a boom to that point (see Figure 1-6-1-5). In September, not only the Brazilian real but also other major Central and South American currencies such as Mexico's peso and Chile's peso sharply declined, and foreign exchange intervention was partly implemented by buying the country's own currency with foreign currency reserves (see Figure 1-6-1-6).[175]

Figure 1-6-1-5
Inward securities investments in Brazil

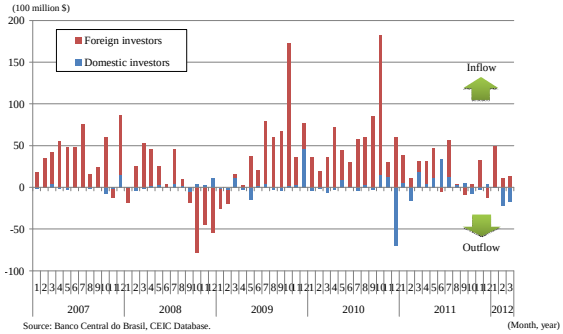
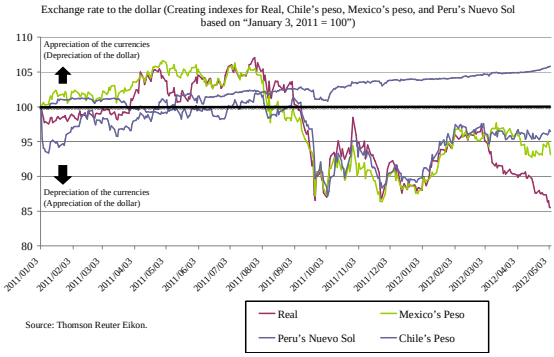


Figure 1-6-1-6
Exchange rate of Central and South American currencies to the dollar



Spanish banks have a large presence in Central and South American regions, and represents about 40 % of credit to Brazil and Mexico by foreign-registered financial institutions (see Figure 1-6-1-7 and Figure 1-6-1-8). Therefore, credit contraction may be caused due to rapid separation of risk assets in Central and South America which is implemented as a part of bank recapitalization in Europe. However, it is said that Spanish banks have a high degree of independence in their overseas business in local regions, and, in Brazil and Mexico, a certain limit has been set for financing between a parent company and its subsidiaries to ensure the maintenance of the subsidiaries' capital. This suggests that there is relatively little risk of sudden suspension of capital inflow from European banks.[176]

175 *Global Economic Prospects January 2012 Finance Annex* (World Bank (2012))
176 *Global Economic Prospects January 2012, Latin America & the Caribbean Annex* (World Bank (2012)), *Mexico Banks Resilient, But Global Risks Need Care* (March 30, 2012) (IMF (2012))

Figure 1-6-1-7

Credit to Brazil by foreign-registered financial institutions

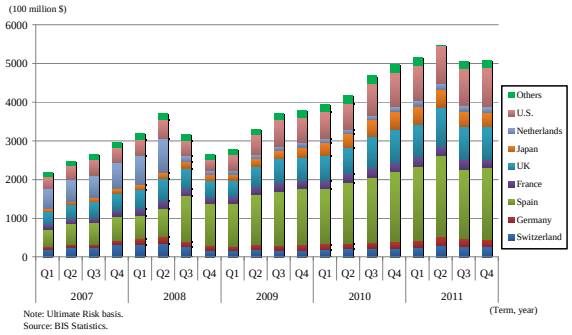
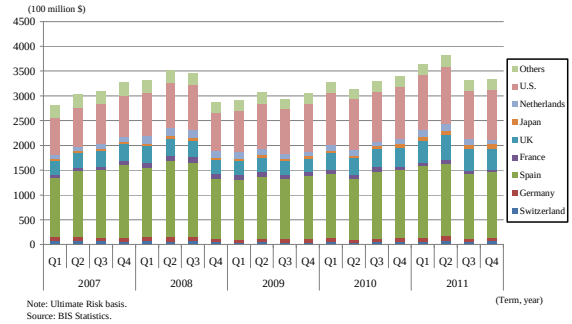


Figure 1-6-1-8

Credit to Mexico by foreign-registered financial institutions



Though many Central and South American countries show a current-account deficit (see Table 1-6-1-9), there is a larger amount of inflow of foreign direct investment and the risk of sudden capital outflow is limited as a whole. For example, while the current account of Brazil is a deficit of $52.6 billion and that of Mexico is a deficit of $8.8 billion (2011), foreign direct investment in Brazil is $69.5 billion[177] and that of Mexico is $19.4 billion (2011), exceeding their current-account deficit.[178]

177 Including the investment in real estate

178 For details, refer to the Banco Central do Brasil (http://www.bcb.gov.br/), or the Directorate General of Foreign Investment of the Secretariat of Economy (http://www.economia.gob.mx/comunidad-negocios/inversion-extranjera-directa).

Table 1-6-1-9

Current account balance of Central and South American countries and foreign direct investment, etc. in those countries

	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
Current account	- 48 019.7	- 52 696.4	- 14 383.1	10 643.6	22 532.7	36 277.2	46 754.2	14 384.9	- 31 786.1	- 17 602.2	- 56 713.4
Export	362 835.8	348 208.3	352 033.6	383 502.1	472 976.6	568 867.6	677 818.5	763 972.4	880 079.3	687 209.0	873 074.6
Import	- 362 706.9	- 354 520.3	- 329 766.6	- 340 738.3	- 415 053.5	- 492 050.6	- 587 096.4	- 698 759.8	- 836 299.5	- 629 859.5	- 823 131.6
Trade balance	129.0	- 6 312.0	22 267.0	42 763.8	57 923.1	76 817.0	90 722.1	65 212.7	43 779.9	57 349.5	49 943.1
Trade and service balance	- 16 065.0	- 24 710.1	8 621.8	30 681.5	45 431.5	64 401.8	77 236.9	46 988.5	10 227.8	23 015.2	- 157.5
Income balance	- 53 160.8	- 53 970.9	- 52 326.2	- 57 490.4	- 67 064.7	- 78 987.2	- 92 510.7	- 96 552.0	- 106 254.1	- 98 342.1	- 114 968.1
Transfer balance	21 206.1	25 984.5	29 321.3	37 452.5	44 165.8	50 862.1	62 027.7	63 948.4	64 240.2	57 724.8	58 412.3
Inward foreign direct investment	78 254.9	70 919.5	54 642.2	41 982.2	65 817.4	72 750.7	70 600.4	110 111.4	128 464.4	77 559.2	112 310.6

Unit: Million $

Note: Caribbean countries are excluded.

Source: *Statistical Yearbook for Latin America and Caribbean 2011* (ECLAC (United Nations Economic Commission for Latin America and the Caribbean)).

In early 2012, securities investment from foreign investors has started to show signs of recovery, and currencies which experienced a rapid decline have also started to strengthen (see Figure 1-6-1-6). While the Brazilian government is increasingly concerned about the appreciation of the real and criticizes monetary easing measures taken by advanced economies, it expanded application of the Tax on Credit Operations, Exchange and Insurance (IOF, 6% of tax rate) to overseas borrowings and overseas bond issuance by Brazilian companies[179] and reduced the policy interest rate (75bp) on April 18. The Central Bank of Brazil (Banco Central do Brasil) suggests further additional monetary easing. Moreover, there is a concern about the direction of the European debt problems including Spain. Such matters have again been causing the depreciation of the real (see Figure 1-6-1-6).

(C) Central and South American economy highly dependent on primary products

One of the characteristics of the Central and South American economy is high dependence on primary products.[180] Therefore, if the European debt crisis worsens in the future, it could not be ruled out that any exporter of primary products may face downward pressure on the economy through a decline in commodity prices.[181]

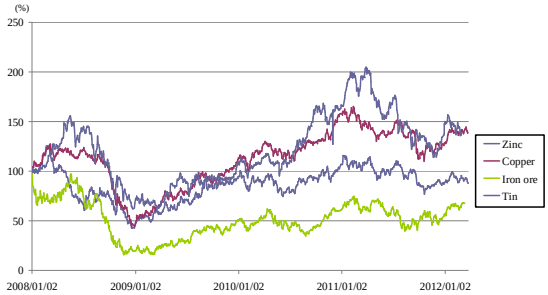
According to the change in metal prices such as zinc, copper and iron ore, metal prices sharply declined in the fourth quarter of 2008, started to rise in the beginning of 2009, and then remained on an upward trend until the middle of 2011. This enabled metal-producing countries to achieve economic growth. Afterwards, metal prices declined due to the European debt crisis, etc., but have been rising again since the end of 2011 (see Figure 1-6-1-10).

179 When introduced, IOF was applied to the borrowings and bond issuance with up to two years, but the government expanded application to those with three years on March 1 and furthermore to those with five years on March 12.

180 *Regional Economic Outlook: Western Hemisphere* (IMF (2011))

181 *Global Economic Prospects January 2012, Latin America & the Caribbean Annex* (World Bank (2012))

Figure 1-6-1-10
Metal price



Note: Creating indexes based on "January 2, 2008 = 100". An unadjusted value is the final value.
Source: Thomson Reuter Eikon.

Central and South American countries rank high especially in production of metal minerals, which are key export products in many countries (see Table 1-6-1-11). Especially in South America, even in Brazil and Argentina where diversification of export products is progressing relative to other countries, primary products account for about 60% of total exports. In Mexico and Central America, in contrast, the percentage of primary products was about 50% of total exports in the past but decreased to about 25% in 2010.[182] For example, Mexico's exports to the U.S., Mexico's largest trading partner, are diversified: electric machinery (such as TVs and mobile phones) ranked first at $60 billion (22% share in 2011); automobiles ranked second at $45.7 billion (17% share, similarly); and mineral fuels (crude oil) ranked third at $45.7 billion (17% share, similarly).

(2) Trends in the Brazilian economy

(A) Slowdown in the Brazilian economy and the sluggish manufacturing industry

Quarterly GDP growth rate (comparison to the same month of the previous year) significantly slowed down over the latter half of 2011 due to increases in the policy interest rates which had continued until the first half of 2011 (see Figure 1-6-1-4 above) and other factors. Though the Central Bank of Brazil reduced the policy interest rate at the end of August 2011, the consumer price index declined to 5.1%, which is within the range of target set by the Central Bank of Brazil (4.5%±2%), in April 2012, following its peak of 7.31% (year-to-year basis) in September 2011 (see Figure 1-6-1-12). Currently, however, the consumer price index has increased from 0.21% to 0.64% (comparison between March and April).

182 *Regional Economic Outlook: Western Hemisphere* (IMF (2011))

Table 1-6-1-11

Metal minerals production volume by country

(Thousand tons, %)

Rank	Iron Ore			Bauxite			Copper		
	Country	Production Volume	Share	Country	Production Volume	Share	Country	Production Volume	Share
1	China	880,000	39.3	Australia	68,414	32.7	Chile	5,390	33.9
2	Australia	394,000	17.6	China	44,000	21.1	Peru	1,275	8.0
3	Brazil	300,000	13.4	Brazil	28,100	13.4	U.S.	1,180	7.4
4	India	245,000	10.9	India	18,000	8.6	Indonesia	996	6.3
5	Russia	92,000	4.1	Guinea	17,400	8.3	China	995	6.3
6	Ukraine	66,476	3.0	Jamaica	8,540	4.1	Australia	854	5.4
7	South Africa	55,313	2.5	Russia	5,475	2.6	Russia	725	4.6
8	Iran	33,000	1.5	Kazakhstan	5,310	2.5	Zambia	697	4.4
9	Canada	31,700	1.4	Suriname	4,000	1.9	Canada	491	3.1
10	U.S.	26,696	1.2	Venezuela	2,500	1.2	Poland	444	2.8
	World Total	2,240,000		World Total	209,000		World Total	15,900	

Rank	Lead			Zinc			Tin		
	Country	Production Volume	Share	Country	Production Volume	Share	Country	Production Volume	Share
1	China	1,850	44.7	China	3,100	27.7	China	115	44.2
2	Australia	625	15.1	Peru	1,509	13.5	Indonesia	55	21.2
3	U.S.	369	8.9	Australia	1,290	11.5	Peru	38	14.4
4	Peru	262	6.3	U.S.	736	6.6	Bolivia	19	7.4
5	Mexico	158	3.8	Canada	699	6.2	Brazil	13	5.0
6	Russia	97	2.3	India	695	6.2	Congo	9	3.6
7	India	95	2.3	Kazakhstan	480	4.3	Vietnam	4	1.3
8	Bolivia	73	1.8	Bolivia	422	3.8	Malaysia	2	0.9
9	Poland	70	1.7	Mexico	390	3.5	Australia	1	0.5
10	Canada	65	1.6	Ireland	386	3.4	Russia	1	0.5
	World Total	4,140		World Total	11,200		World Total	260	

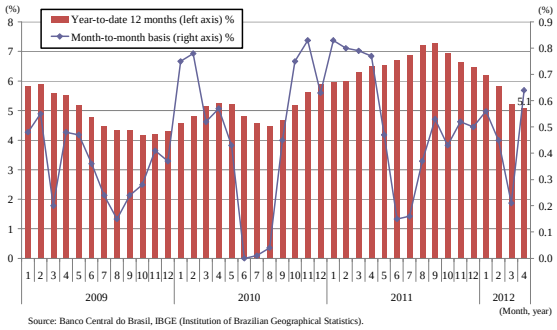
Rank	Silver			Nickel			Molybdenum		
	Country	Production Volume	Share	Country	Production Volume	Share	Country	Production Volume	Share
1	Mexico	4	19.1	Russia	262	18.7	China	94	42.3
2	Peru	4	15.8	Indonesia	203	14.5	U.S.	48	21.6
3	China	4	15.2	Australia	165	11.8	Chile	35	15.8
4	Australia	2	8.1	Philippines	137	9.8	Peru	12	5.6
5	U.S.	1	5.5	Canada	137	9.8	Canada	9	4.0
6	Chile	1	5.5	New Caledonia	93	6.6	Mexico	8	3.5
7	Bolivia	1	5.5	China	79	5.7	Armenia	4	1.9
8	Poland	1	5.1	Colombia	72	5.1	Russia	4	1.7
9	Russia	1	5.0	Brazil	67	4.8	Iran	4	1.7
10	Canada	1	2.6	Cuba	65	4.6	Mongol	3	1.4
	World Total	23		World Total	1,400		World Total	221	

Note: Values of bauxite, lead and silver are based on 2010 data, and the rest are based on 2009 data.

Source: *Minerals Yearbook* (US Geological Survey).

Figure 1-6-1-12

Brazil's consumer price index



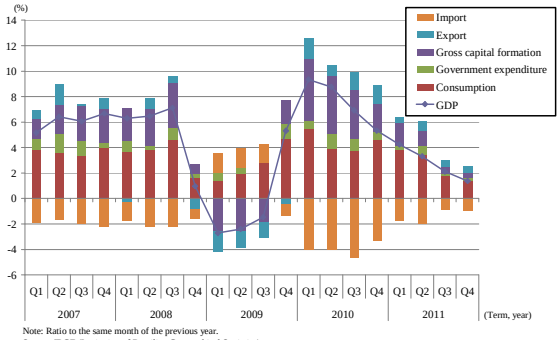
Source: Banco Central do Brasil, IBGE (Institution of Brazilian Geographical Statistics).

Meanwhile, the growth rate of industrial production turned negative (see Figure 1-6-1-2), and the GDP growth rate also turned negative only in the manufacturing sector. This shows a serious effect particularly on domestic manufacturing industries (see Table 1-6-1-14).

On the other hand, consumption makes consistent positive contributions to economic growth in Brazil (see Figure 1-6-1-13). Below, we examine mainly the emergence of a middle class which plays a prominent role in the consumer market in Brazil and the industrial policies for manufacturing industries proposed in the last twelve months.

Figure 1-6-1-13

Brazil's real GDP growth rate (by contribution)



Note: Ratio to the same month of the previous year.

Source: IBGE (Institution of Brazilian Geographical Statistics).

Table 1-6-1-14

Brazil's real GDP growth rate by industry (2011)

			2011				
			Q1	Q2	Q3	Q4	Full year
GDP			4.2	3.3	2.1	1.4	2.7
By industry	Agriculture and livestock industries		3.3	-0.6	6.9	8.4	3.9
	Manufacture industry		3.8	2.1	1.0	-0.4	1.6
		Mining	3.3	3.0	2.7	3.8	3.2
		Manufacturing	2.9	1.7	-0.6	-3.1	0.1
		Construction	5.5	2.3	3.8	3.1	3.6
		Electricity, gas, and water	5.0	3.4	4.0	3.0	3.8
	Service industry		4.0	3.7	2.0	1.4	2.7
		Commercial activity	5.4	5.5	1.7	1.3	3.4
		Transport and postal activities, and warehousing	4.6	3.2	2.1	1.4	2.8
		Information	4.5	6.0	4.4	4.6	4.9
		Finance and insurance	6.3	4.9	3.0	1.5	3.9
		Others	3.5	3.4	1.5	0.7	2.3
		Real estate	1.7	1.5	1.4	1.3	1.4
		Administrative activity and urban development	2.0	3.0	2.8	2.0	2.3
By demand element		Private consumption	6.0	5.6	2.8	2.1	4.1
		Government expenditure	1.8	3.5	1.2	1.3	1.9
		Gross fixed capital formation	8.8	6.2	2.5	2.0	4.7
		Export	4.0	6.2	4.1	3.7	4.5
		Import (-)	13.4	14.8	5.8	6.4	9.7

Note: Ratio to the same month of the previous year (%).
Source: IBGE (Institution of Brazilian Geographical Statistics).

(B) Emergence of a middle class

Household consumption accounts for 65% of GDP in Brazil as of the fourth quarter of 2011 (Note: this value is calculated based on IBGE (Institution of Brazilian Geographical Statistics), CEIC Database). A middle class is expected to serve as a driving force for future increased consumption.[183]

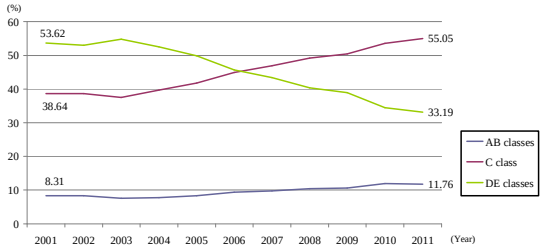
Recently in Brazil, as shown in Figure 1-6-1-15, there has been a remarkable increase in population ratio equivalent to a middle class with income of not less than 1,734 real but less than 7,435 real a month (referred to as "C class" in the same Figure), which accounts for about a half (55%) of the total population in 2011. After the Lula administration implemented the poverty program named "Bolsa Familia"[184] in 2003, the population ratio of DE classes started to decline and was exceeded by that of C class in 2007. Moreover, both a wealthy class and a middle class have increased not only in population ratio but also in total population (see Figure 1-6-1-16). The Gini coefficient also suggests continuing reduction of inequality (see Figure 1-6-1-17).

183 Based on the forecast by Fecomercio SP
http://www.braanz.com/brazilian-news/284-class-c-predicted-to-have-a-40-increase-of-gdp-by-2020.html

184 *Report on the Brazilian economy* (IDE-JETRO (2004))
http://www.ide.go.jp/Japanese/Research/Region/Latin/Brazil/2004/200402.html

Figure 1-6-1-15

Brazil’s income-class population ratio

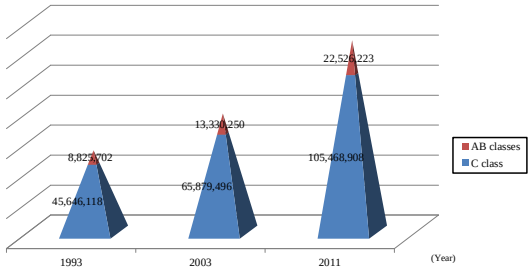


Source: *New Middle Class Prospects in Brazil* (FGV).

AB classes: Income of 7,475 real and more a month
C class: Income of not less than 1,734 real but less than 7,435 real a month
D class: Income of not less than 1,085 real but less than 1,734 real a month
E class: Income of less than 1,085 real a month
As of May 2011 (From FGV)

Figure 1-6-1-16

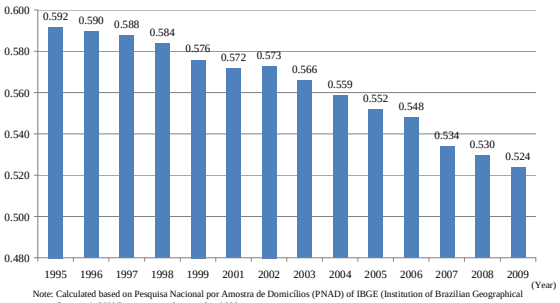
Brazil’s population by income class (AB classes and C class)



Note: Unit in person.
Source: *New Middle Class Prospects in Brazil* (FGV).

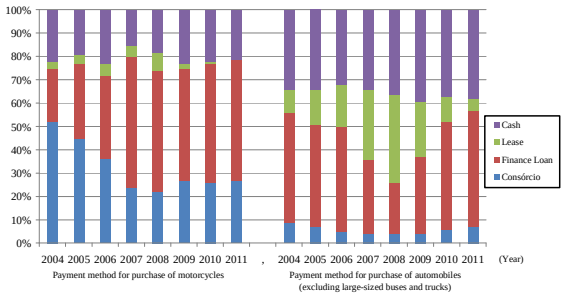
Figure 1-6-1-17

Gini coefficient



Note: Calculated based on Pesquisa Nacional por Amostra de Domicílios (PNAD) of IBGE (Institution of Brazilian Geographical Statistics). PNAD was not implemented in 2000.
Source: IBGE (Institution of Brazilian Geographical Statistics), CEIC Database.

Figure 1-6-1-18
Payment method for purchase of motorcycles/automobiles



Source: ANEF (Brazil's association of auto-financing companies).

In Brazil, installment buying is such a common payment method for purchase that the payment amount per installment is placed on the price tag of ordinary commodities (such as home electric appliances, clothing and shoes). According to the payment method for purchase of motorcycles and automobiles, typical commodities for installment buying (see Figure 1-6-1-18),[185] cash payment accounts for a certain ratio, but mostly financed loans is used. It is considered that financed loans have played an important role for the increases in the middle class.[186]

(C) Economic stimulus package in Brazil

(a) "Brasil Maior"

The Brazilian government launched the "Brasil Maior" in August 2011 as a measure to prevent a decline in industrial competitiveness resulting from the appreciation of the real. The Brasil Maior includes three main pillars: "Promotion of investment and innovation", "Trade policy" and "Protection of domestic industry" to be carried out until 2014, and the concrete measures are to be established under an ordinance to provide interim measures in the future.

According to local reports, Mr. Pimentel, Minister of Development, Industry and Trade stated about the suspension of employer social tax (INSS) in the clothing, footwear, furniture, and software sectors that "reduction in costs of maintaining the labor force would result in the maintenance of domestic employment" and he would examine whether the tax suspension should also be applied to other sectors after evaluating the effects on public finances. Mr. Mantega, Minister of Finance, said, "We must take any measure to strengthen domestic industries in addition to continued measures to stabilize the real. Not foreign companies but Brazil's domestic industries should receive the benefit of the Brazilian market."

185 Motorcycles are utilized for transportation for common people especially in the northern region of Brazil (with relatively lower income levels than the southern region of Brazil) and for a delivery service named "Motoboy". (*White Paper on International Economy and Trade 2011: Section 2 of Chapter 2* (Ministry of Economy, Trade and Industry))

186 *JAMAGAZINE (March 2010)* (JAMA) "Current status of motorization and the motor industry in Brazil" (Kobe University/Research Institute for Economics & Business Administration, Shoji Nishijima)

(b) Tax reduction measures

On December 1, 2011, the Brazilian government announced and implemented tax reduction measures including the following (Table 1-6-1-20) as one economic stimulus package.

Table 1-6-1-19

Key points of "Brasil Maior"

1. Promotion of investment and innovation
(A) Extension of BNDES PSI (Brazilian Development Bank's investment maintenance program) until December 2012, which was established to prevent a financial crisis
(B) Improvement of BNDES's financial support program
(C) Increase of credit of R$2 billion to increase FINEP (Financier of Studies and Projects)'s innovation portfolio
2. Trade policy
(A) Export promotion by reducing PIS (Social Integration Program) and COFINS (Social Security Financing Contributions) charged on exporters to 4% of the export value
(B) Strengthening of trade defenses (strengthening of antidumping and safeguard by shortening an investigation period, strict measures such as denial of import license in case of false declaration of origin, and stricter control to avoid illegal imports)
(C) Increased requirement of compulsory certification by means of cooperation among INMETRO (National Institute of Metrology Quality and Technology), SECEX (Secretariat of Foreign Trade), and RFB/MF
(D) Suspension of *ex-tarifalios* for used machine and equipment
(E) Increase of the number of trade analysts involved in trade remedy investigations (from 30 to 120)
(F) Creation of fund to finance export of small and medium companies (Proex Financiamento)
3. Protection of domestic industry
(A) Suspension of the employer social tax (INSS) (20% of total payroll) in the clothing, footwear, furniture, and software sectors (On the other hand, this tax will be replaced with a temporary tax on gross revenue of 1.5% (2.5% in the software sector) to supplement reduced tax revenue.) R$ 25 billion is expected as an effect of the tax reduction for two years until the end of 2012.
(B) Establishment of preference margin up to 25% in government procurement for domestic goods

Source: MDIC, *JETRO SENSOR, December, 2011* .

Table 1-6-1-20

Brazil's major tax reduction measures

IOF: Tax on Credit Operations, Exchange and Insurance		
	Former tax rate	New tax rate
Stock investment by foreign investors	2	0
Overseas transaction of depositary receipt by Brazilian companies	2	0
Investment by non-residents in long-term bonds with a redemption period of more than 4 years	6	0
Personal loan	3	2.5
Investment in venture capital	2	0
IPI for White goods: Industrialized Products Tax (until June 30, 2012): Notes		
Stove burner	4	0
Refrigerator and freezer	15	5
Fully- and semi-automatic washing machine	20	10
Washing machine (simplified version)	10	0
PIS: Social Integration Program, COFINS: Social Security Financing Contributions		
Pasta	9.25	0
Wheat flour and bread	0	0

Unit: (%)

Note 1: The period of tax reduction for wheat flour and bread will be extended until December 31, 2012 from December 31, 2011.

Note 2: The period of tax reduction for white goods was extended until June 30, 2012 from the March 31, 2012.

Source: Brazil's Ministry of Finance, *TSUSHOKOUHOU* (JETRO).

(c) Relaxation of financing regulations

Though the Central Bank of Brazil had adopted credit control measures to cool the overheated economy from the end of 2010 until the summer of 2011, it loosened financing regulations in November 2011 to prevent a decline in domestic consumption. Specifically, the reduction of its loan-loss charges necessary for financing and the reduction of interest rates of a certain automobile loan were implemented.

(D) Automobile industrial policy (Industrialized Products Tax (IPI) increase)

Items for trade with Brazil's three major trading countries/regions reveal Brazil's trade structure of mainly exporting primary products and importing industrial products (see Tables 1-6-1-22 to 24). In addition, domestic manufacturing industries had been losing their competitiveness due to the appreciation of the real until the middle of 2011.

Table 1-6-1-21

Export to and import from Brazil's three major trading countries/regions

			(Million $)
Three major exporting countries/regions	2011	Three major importing countries/regions	2011
EU27	52,877	EU27	46,415
China	44,315	U.S.	33,962
U.S.	25,805	China	32,788

Source: Global Trade Atlas data.

Under such circumstances, on September 15, 2011, the Brazilian government announced the policy: 30% increase in IPI tax rate for domestic or imported cars without an average 65% of regional local content of the country or Mercosur based on revenue as well as mandated investment in local activities

related to technology development for at least 0.5% of gross revenue in Brazil.[187] For example, 7% of IPI is imposed on a passenger car with an engine size of 1,000 cc, but 37% of IPI is to be imposed if the car does not reach such requirements, except imported cars from Mercosur and Mexico with a concluded auto agreement.

Mr. Mantega, the Minister of Finance, stated that this measure was taken due to a concern about the situation where "automobile enterprises in the country have increasing inventories and have ordered a collective holiday" and "Brazil exports employment to other countries". Mr. Pimentel, Minister of Development, Industry and Trade stated that this measure was "aiming to enable automobile enterprises not only to sell but also to manufacture cars in Brazil". Moreover, Fecomercio SP, for example, speaks positively of this policy, saying, "It is positive and necessary to take all measures to contribute to strengthening Brazilian industries, to create employment in the country, and to contribute to domestic technology development.", because automobile enterprises manufacturing cars in the country feel threatened by Chinese and South Korean automobile manufacturers which have been rapidly expanding their market shares.

Table 1-6-1-22

Trade with the EU

Export	2011	Import	2011
Iron ore	9,153	Machine	2,611
Coffee beans	4,361	Electric equipment and TV	1,079
Conditioning feed	4,085	Automobiles	1,063
Crude oil	3,888	Surgical goods	969
Machine	2,832	Mineral fuel and bituminous oil	968
Soybean	2,794	Organic chemicals	692
Iron and steel	2,376	Optical instruments, precision measuring instruments, and camera	559
Lumber and pulp	2,258	Plastics and plastic products	467
Vegetable, fruit, and nut	1,625	Iron and steel products	338
Precious metal	1,499	Aircraft	280

Unit: Million $

Note: HS Code Double digits

Source: Global Trade Atlas.

Table 1-6-1-23

Trade with the U.S.

Export	2011	Import	2011
Crude oil	5,780	Fuel oil	2,194
Coffee beans	1,796	Coal and coal powder	1,861
Iron and steel products (semi-finished products)	1,711	Engine and turbine and their parts for aircraft	1,751
Pig iron and iron	1,061	Drug for human and animal	1,114
Lumber and pulp	934	Measuring instruments	816
Aircraft	650	Gasoline	802
Engine component for automobiles	634	Ethyl alcohol	791
Hydrocarbon and its derivatives	588	Feed, nitrogen, phosphorus and potassium	671
Ethyl alcohol	567	Construction machinery and excavator	650
Marble and granite	480	Aircraft	554
Others	11,602	Others	22,758

Unit: Million $

Source: MDIC.

187 This measure was initially scheduled to be effective on September 16 and valid until the end of December 2012, but it became effective on December 16 after three months from the announcement because STF (Supremo Tribunal Federal) ruled that it was illegal to make this measure effective immediately.

Table 1-6-1-24

Trade with China

Export	2011	Import	2011
Iron ore	19,797	Transceiver (including TV)	1,684
Soybean	10,957	Computer	1,320
Crude oil	4,883	Computer component and accessories	1,120
Lumber and pulp	1,300	Telephone component	1,027
Raw sugar	1,157	Semiconductor integrated circuit	809
Soybean oil	760	Motor and generator	781
Aircraft	619	Iron and steel products	756
Cotton and cotton fabric	569	Mobile phone	702
Alloy	436	Transceiver devices	618
Frozen chicken	423	Complex chemicals and sulfonamide	596
Others	3,413	Others	23,375

Unit: Million $

Source: MDIC.

This measure was valid until the end of 2012 and the new automobile industrial policy for 2013 and afterwards was announced in April 2012. Under the new policy, existing or newly entering automobile manufactures in Brazil, can be subject to up to 30% of IPI tax reduction according to the procurement amount of components and raw materials produced within the borders of Brazil or Mercosur and equipment related to such production. In addition, any enterprise which made an investment in R&D activities in the science and technology sector can be subject to an additional 2% of IPI tax reduction. Therefore, IPI is to be reduced by up to 32%. As a requirement of the application, strict calculations of regional local content and the limitation of enterprises subject to the tax reduction[188] are scheduled.

Table 1-6-1-25

Outline of IPI tax increase

	Former tax rate	New tax rate
Flexible-fueled and gasoline-fueled cars with an engine size of less than 1000 cc	7%	37%
Flexible-fueled cars with an engine size of less than 2000 cc	11%	41%
Gasoline-fueled cars with an engine size of less than 2000 cc	13%	43%
Flexible-fueled cars with an engine size of 2000 cc and more	18%	48%
Gasoline-fueled cars with an engine size of 2000 cc and more	25%	55%

Source: *TSUSHOKOUHOU* (JETRO), Automobile department of CCIJB.

188 The regional local content currently includes expenses not directly related to production including advertising expenses. However, the new policy excludes this and, in addition, limits enterprises subject to the tax reduction (it is necessary to meet three of the following four requirements):

a. Investment in R&D and activities related to innovation; b. Investment in engineering and basic engineering; c. Completion of production process in the country; and d. Compliance with Energy Efficiency Labeling by INMETRO (National Institute of Metrology Quality and Technology) (Energy efficiency standards: disclosing energy efficiency-related information to consumers) Enterprises newly entering into Brazil are subject to slightly relaxed requirements, but in the end will be treated in the same manner as existing manufacturers (details will be determined later).

Column 5　Automobile industry in Brazil

The number of automobiles sold in Brazil (the number of newly registered automobiles) increased by 3.4% to 3.63 million units in 2011 from 3.51 million units in 2010. The number of imported cars has increased, and according to a ANFAVEA (National Association of Motor Vehicle Manufacturers; Brazil) document. While the number of domestic cars was 2,854,923 units and the number of imported cars was 660,141 units in 2010, the number of domestic cars was 2,775,221 units (decrease by about 2.8%) and the number of imported cars was 858,027 units (increase by about 30%) in 2011.

As shown in Column Table 5-1, South Korean cars show excellent progress in import sales and domestic production is growing. Moreover, Chinese cars have recently come on the market though figures have not been reported. In 2011, sales of Japanese cars increased by 2.8% and sales of South Korean cars increased by 8.4% from the previous year respectively, while sales of the so called Big Four's cars (see Column Figure 5-2) decreased by 2.1% from the previous year.[189]

Column Table 5-1

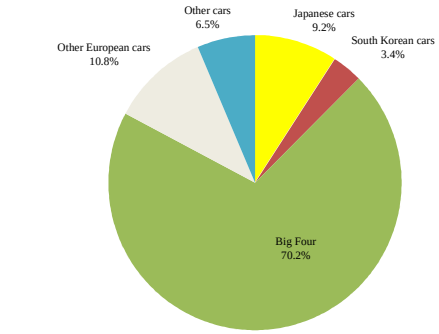
Import sales units by nationality of manufacturers

(10,000 units)	2008	2009	2010	2011
Import sales units	37.5	48.9	66.6	85.8
1st	6.8 (U.S (A))	7.1 (South Korea)	8.6 (South Korea)	10.5 (South Korea)
2nd	4.9 (U.S (B))	6.3 (U.S (A))	7.8 (Italy)	9.1 (Italy)
3rd	4.2 (France)	5.9 (Italy)	7.5 (U.S (A))	8.8 (U.S (A))
4th	3.4 (South Korea)			

Source: Automobile department of CCIJB.

Column Figure 5-2

Brazil's automobile sales share (2011)



Source: ANFAVEA (National Association of Motor Vehicle Manufacturers; Brazil).

The Big Four is the general term for four European and the U.S. automobile manufacturers that have production bases in Brazil and hold about a 70% share in the Brazilian market. The reasons why the Big Four came to dominate the Brazilian market are as follows.

Firstly, there is superiority in the variety of cars brought to the Brazilian market. For example, low spec cars, which are affordable for Brazilian people, have been brought to the market based on market research (one manufacturer of the Big Four produced a car with a safety-conscious and a low spec

189 Increase-decrease rate is calculated based on ANFAVEA (National Association of Motor Vehicle Manufacturers; Brazil) data.

engine as well as with a new look) to establish their status as transportation for lower-income people. Furthermore, flex-fuel vehicles specific to Brazil (which can run on pure ethanol, pure gasoline or any combination of both[190]; 86.4%[191] of new passenger and commercial cars registered in Brazil in 2011 are flex-fuel vehicles) were introduced early.[192]

Secondly, local subsidiaries manage themselves to develop their Brazilian market strategies from a long-term perspective. For example, faced with economic crises in the 1980s, each manufacturer basically made its business decision not to withdraw from the Brazilian market. Then, as a measure to reduce costs, two manufacturers of the Big Four established joint venture companies for production in Brazil, which produced their vehicles for about seven years (the joint venture was dissolved due to resolution of the economic crises).

Thirdly, we must focus attention on a long history between Brazil and such European and the U.S. enterprises. The statement "Brazil is a European market." has existed since the colonial period. Moreover, the U.S. enterprises entered Brazil in 1913 and 1925, and before and after World War I. Such a long history caused the Big Four, which had already established their industrial bases in the country, to be protected by the government under the rule of the Brazilian military government (from 1964 until 1985).[193]

(E) Trade conflict arising concerning automobiles

(a) Non-automatic import license

In May 2011, the Brazilian government imposed non-automatic import licensing requirements[194] on imported cars. Major countries exporting finished cars to Brazil include Argentina and Mexico (finished cars imported from these countries are subject to a 35% tariff exemption) and South Korea. In particular, Argentina exports more than 90% of its finished cars to Brazil and experiences significant effects of the import licensing.[195]

Argentina had already introduced a non-automatic import license in 2008. The list of products subject to the license were initially limited and continued to be expanded afterwards to include automobiles in December, 2010. In January 2011, a new regulation was introduced to set 80% of the previous year's imports to Argentina as an upper limit of imports.[196] As of May 2011, about 600

190 As a response to the shock caused by the oil crisis, ethanol fuels were made from "sugar cane" cultivated in Brazil. Ethanol fuel is superior to gasoline in price, and inferior in fuel consumption (which is unsuitable for large cities such as Sao Paulo with frequent traffic jams). *JAMAGAZINE (March 2010)* (JAMA) "Current status of motorization and the motor industry in Brazil" (Kobe University/Research Institute for Economics & Business Administration, Shoji Nishijima)

191 *Carta da anfavea (2012/No. 308)* (ANFAVEA) (http://www.anfavea.com.br/)

192 Japanese flex-fuel vehicles have been brought to the Brazilian market since 2006. The Big Four has already brought flex-fueled vehicles in 2003. Quarterly magazine *International Trade and Investment (2008)* (Institute for International Trade and Investment)

193 *JAMAGAZINE (March 2010)* (JAMA) "Current status of motorization and the motor industry in Brazil" http://www.jama.or.jp/lib/jamagazine/201003/03.html

194 The system requires application with information including import business operator, export business operator, and price and quantity of imported products.

195 In 2011, the value of exports of passenger cars (HS8703) from Argentina is $505.3 billion to Brazil and $536 billion to entire world.

196 *The 2011 Report on Compliance by Major Trading Partners with Trade Agreements* (Ministry of

products have become subject to the license.[197] It is thought that such matters had an influence on the Brazilian measure.

Automobile manufacturers located in South America, including Japanese manufacturers, have established their automobile manufacturing plants in both Argentina and Brazil in consideration of exchange rate fluctuations, etc. to produce different types of cars to be exported to each other. Trade restriction between both countries would make it impossible to supply customers across a border.

In May 2011, both countries mutually negotiated this problem and announced their agreements: "It was agreed to set a work agenda on a structural theme paying special attention to sensitive and strategic sectors for both economies" and "Non-automatic import licenses under application will be gradually permitted."

However, a backlog of cargo in both countries' customs holdings has still not been cleared. In particular, permission to import automobiles produced in Argentina tends to be granted late due to reasons attributable to the Brazilian authorities, and there seems to be problems with the export of automobiles, shoes, beverages and foods from Brazil to Argentina.

(b) Brazil-Mexico Auto Pact

With respect to this agreement, Brazil has considered it problematic for years that there is "discrimination between the inside and outside the country" because 30% local content is set as a requirement for the zero-tariff under the Brazil-Mexico Auto Pact, despite the 60% local content of Mercosur. Due to this circumstance, a Brazilian newspaper[198] dated February 2, 2012, reported that the Brazilian government had decided to destroy the Brazil-Mexico Auto Pact. Both countries reached an agreement on the following matters as a result of mutual consultation, and a new Brazil-Mexico Auto Pact took effect on March 19, 2012. It was agreed: to set an upper limit of duty-free exports as an tentative measure for a three-year period and to abolish the upper limit after that period; to increase local content which is a requirement for the zero tariff from the current 30% to 35% in the immediate future and to 40% on March 19, 2016; and to examine the possibility of increasing local content to 45% by March 18, 2016.

Table 1-6-1-26

Automobile trade between Brazil and Mexico

Unit: 10,000 $

Increase-decrease rate is represented in %

	Export	Increase-decrease rate	Import	Increase-decrease rate	Trade balance
2000	50,516	133.1	1,716	463.9	48,799
2001	52,123	3.2	8,264	381.6	43,859
2002	77,909	49.5	5,479	-33.7	72,430
2003	111,868	43.6	3,085	-43.7	108,783
2004	129,550	15.8	1,145	-62.9	128,405
2005	131,807	1.7	2,727	138.1	129,081
2006	131,704	-0.1	31,815	1066.8	99,888
2007	87,409	-33.6	52,336	64.5	35,073
2008	66,694	-23.7	100,631	92.3	-33,937
2009	43,463	-34.8	92,582	-8.0	-49,119
2010	61,252	40.9	126,065	36.2	-64,813
2011	37,212	-39.2	207,070	64.3	-169,858

Note: Increase-decrease rate is year-to-year comparison.

Source: Global Trade Atlas.

Economy, Trade and Industry (2011))
http://www.meti.go.jp/committee/summary/0004532/2011_01_12.pdf

197 Refer to the column "Expansion of non-automatic license in Argentina" described below.

198 Valor Economico newspaper

Mexico is an export base to the Americas for many automobile manufacturers including the Big Four and Japanese automobile manufacturers. An upper limit of duty-free exports to Brazil may have a serious impact on their business in the Brazilian market.

Argentina has also represented its intention to call for the revision of the Argentina-Mexico Auto Pact in response to the agreement between Brazil and Mexico.

Table 1-6-1-27

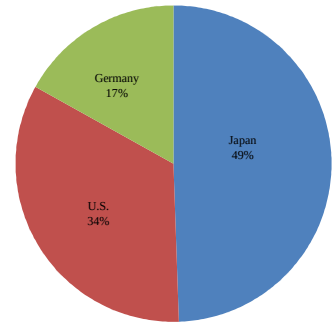
Mexico's automobile exports

	Year	Export by destination						
		North America	Central America and Caribbean	South America	Europe	Asia	Others	Total exports
Japanese cars	2010	303755	8417	93757	10121	13575	10022	439647
	2011	296378	13144	151297	20929	7751	8130	497629
	Rate of increase	-2.4	56.2	61.4	106.8	-42.9	-18.9	13.2
U.S. cars	2010	952451	683	66597	34109	0	15309	1069149
	2011	1012828	1632	103644	51702	0	46457	1216263
	Rate of increase	6.3	138.9	55.6	51.6	0.0	203.5	13.8
German cars	2010	163778	509	36835	126483	22983	133	350721
	2011	211748	504	51642	148157	17787	149	429987
	Rate of increase	29.3	-1.0	40.2	17.1	-22.6	12.0	22.6
Total	2010	1419984	9609	197189	170713	36558	25464	1859517
	2011	1520954	15280	306583	220788	25538	54736	2143879
	Rate of increase	7.1	59.0	55.5	29.3	-30.1	115.0	15.3

Source: AMIA.
Unit in units, Rate of increase is represented in %.

Figure 1-6-1-28

Share of exports from Mexico to South America by nationality of manufacturers (2011)



Source: AMIA.

Column 6 Expansion of non-automatic license in Argentina

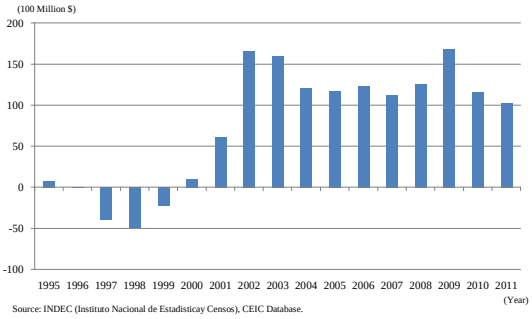
Argentina introduced a non-automatic license in 2008 and afterwards has greatly expanded the list of products subject to the license.[199] 13 countries including Japan represented their concerns in the joint statement at the WTO Council for Trade in Goods held on March 30 2012, and other countries also represented their concerns later.

Argentina has been strengthening the non-automatic import license in 2012 to maintain its trade

199 *The 2011 Report on Compliance by Major Trading Partners with Trade Agreements* (Ministry of Economy, Trade and Industry (2011))

surplus.

Column Figure 6-1
Argentina's trade balance



The Federal Administration of Public Revenue (AFIP) announced the regulation on January 10, 2012 that the Anticipated Sworn Declaration of Imports (DJAI) would be required prior to each and every import transaction of consumption goods, and the regulation came into effect on February 1, 2012. This import transaction pre-application system (DJAI system) includes three pillars: submission of DJAI to AFIP via the Internet; submission of the designated form to the Secretariat of Interior Commerce via E-mail; and acquisition of a non-automatic import license for the relevant products. Furthermore, The National Administration of Drugs, Foodstuffs and Medical Technology (ANMAT) and The National Service of Agrifood Health and Quality (SENASA) decided to examine import through the DJAI system.

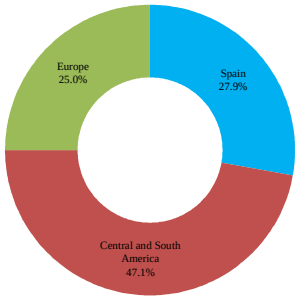
As for export and import of services, pre-application with the Services Prior Sworn Statement (DJAS) has been required since April 1, 2012 when a service is received in Argentina from a foreign service company or when a domestic service company provides a service abroad. AFIP seems to intend this measure to control the movement of foreign currencies resulting from service transaction with foreign countries. The relevant companies apply for the information of service agreement on the AFIP's website in the same manner as the import transaction pre-application system for consumption goods (DJAI system) in order to undergo examination by AFIP and related institutions participating in the DJAS system. The DJAS number obtained after the examination needs to be registered in the Foreign Exchange Transaction Control System. The DJAS system covers a wide range of business, public and technology services including computing and information services, patent and trademark, royalties, copyright, signing bonuses for soccer players, etc. The DJAS must be filed if the value of the service to be provided: is for an amount of $100,000 or more; or if individual installments are for the amount of $10,000 or more.[200]

200 In 2011, the value of service imports was $16,423 million, the value of service exports was $14,193 million, and the trade deficit was $2,233 million. INDEC http://www.indec.gov.ar/

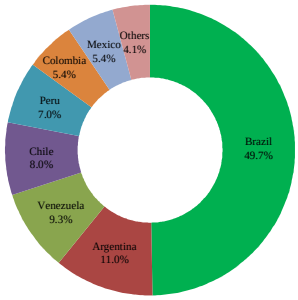
Column 7 Example of European communication company developing in Central and South America

This company is a communication company based in Spain and has developed its business for Central and South America (Brazil, Argentina, Chile, Peru, Colombia, Venezuela, Ecuador and other Central American countries) as well as Europe and the U.S. The total consolidated sales (2011) increased by 3.5% from the previous year. By market, while Spain decreased by 7.6% and Europe decreased by 1.3%, Central and South America increased by 13.5% from the previous year. The Central and South American market represented a great contribution to the total increase. In particular, while Brazil increased by 28.7% and Argentina increased 3.3%, Mexico decreased by 12.3% from the previous year. The company explains that this is due to the revision of mobile phone charges implemented in the second quarter by the government. However, OIBDA (Operating Income before Interest, Depreciation and Amortization[201]) in Mexico remained in surplus. As examined above, in 2011, Central and South America, and especially Brazil, made great contributions to the increases of sales for this company despite the European debt crisis and severe competition among communication companies.

Column Figure 7-1
Sales share of Spanish communication companies by region (all markets- left; Central and South American markets- right



Source: Prepared by the Ministry of Economy, Trade and Industry based on companies' annual reports.



Source: Prepared by the Ministry of Economy, Trade and Industry based on companies' annual reports.

2. Russian economy

(1) Strong economy

The Russian economy significantly shrank due to the 2008 global financial crisis, but achieved a brisk recovery supported by an increase in energy prices including crude oil. The real GDP growth rate in the fourth quarter of 2011 increased by 4.8% from the same quarter of the previous year, and the Russian economy has enjoyed continued strong growth despite a slowdown in growth of the world's leading economies due to the European debt crisis (see Figure 1-6-2-1). The growth rate in 2011

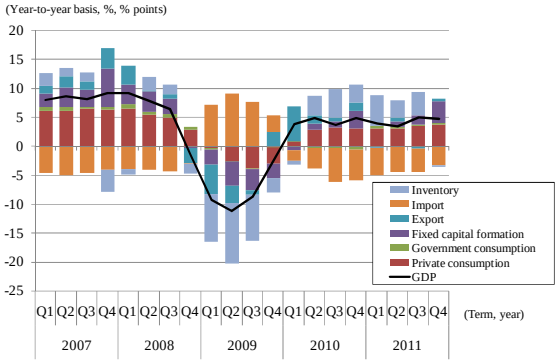
201 OBIDA: By adding tax, interest and depreciation to operating income. Abbreviation of "Operating Income Before Interest, Depreciation and Amortization". OBIDA is similar to EBIDTA in concept. In OBIDA, the calculation is started with net operating income. In EBIDTA, the basis for calculation is net income. While OBIDA takes advantage of showing profitability of the main business, EBITDA takes advantage in showing overall corporate profitability. Both are simple measures to show how much cash flow a company generates from working capital.

remained unchanged with an increase from 2010 by 4.3% on a year-to-year basis.

(A) Economic growth led by rising energy prices

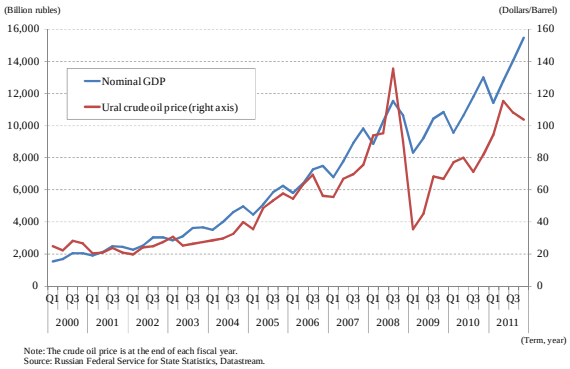
The largest driving force of the Russian economy is the rising price of energy which accounts for about 70% of total exports[202]. Figure 1-6-2-2 shows Russia's nominal GDP and crude oil price. The Russian economy has achieved remarkable growth along with rising energy prices including crude oil since the end of the Russian financial crisis in 1998. On a real basis accounting for the effects of inflation, the Russian economy recorded ten consecutive years of positive growth from 1999 to 2008 and an average growth rate of 6.7% for the same period, far higher than the global average of 2.8%. Crude oil prices, which had sharply declined in the latter half of 2008 due to the global financial crisis, increased again after bottoming out in the first quarter of 2009, and therefore the Russian economy has been returning to a growing trend.

Figure 1-6-2-1
Russia's real GDP growth rate



Note: Real GDP growth rate by setting 2008 as base year.
Source: CEIC Database.

Figure 1-6-2-2
Russia's nominal GDP and crude oil price



Note: The crude oil price is at the end of each fiscal year.
Source: Russian Federal Service for State Statistics, Datastream.

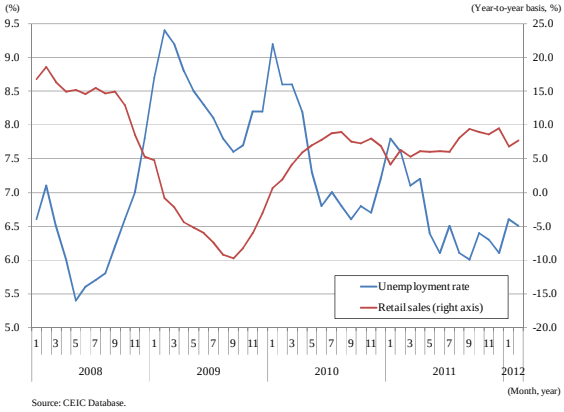
202 Refer to Figure 1-6-2-11.

(B) Favorable consumer spending

Rising energy prices caused high export prices to increase corporate earnings and improve the employment situation, with the result that the unemployment rate, which rose to the 9% level immediately after the global financial crisis, has fallen to the 6% level (see Figure 1-6-2-3). Wages have also risen significantly and nominal wages have risen at a pace exceeding the consumer price growth rate.[203] Improved employment and income situations have activated consumer spending to result in economic growth. Russia's real GDP growth rate by demand category (see Figure 1-6-2-1 above) shows that consumer spending has been steadily leading the economic growth except in 2009 when the economy shrank considerably due to the global financial crisis. In addition to the improved employment situation, a decline in inflation rate to the lowest level on record since the breakdown of the former Soviet Union in 1991 due to a decline in food prices, etc.[204] has resulted in favorable consumer spending supported by an increase in real incomes (see Figure 1-6-2-4). Furthermore, credit to individuals, which had decreased from 2008 to 2009, started to increase again in 2010 and have greatly increased by an average of 24% year-on-year since 2011, which also supports favorable consumer spending (see Figure 1-6-2-5).

Figure 1-6-2-3

Russia's retail sales and unemployment rate



203 In a comparison between January 2010 and December 2011, the nominal wage growth (up 72.2%) largely exceeds the consumer price growth (up 13.6%).

204 In 2010, the consumer price growth rate marked 8.8% because grain prices soared due to drought resulting from record high temperatures, but in 2011, the consumer price growth rate fell to a record low at 6.1% due to a decline in grain prices resulting from a rich harvest.

Figure 1-6-2-4

Russia's consumer price growth rate

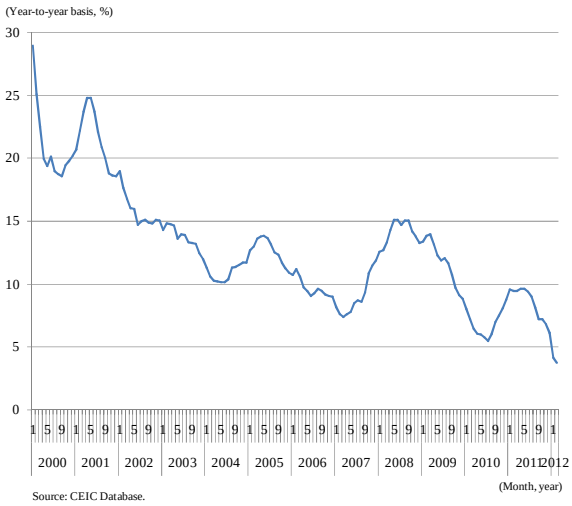
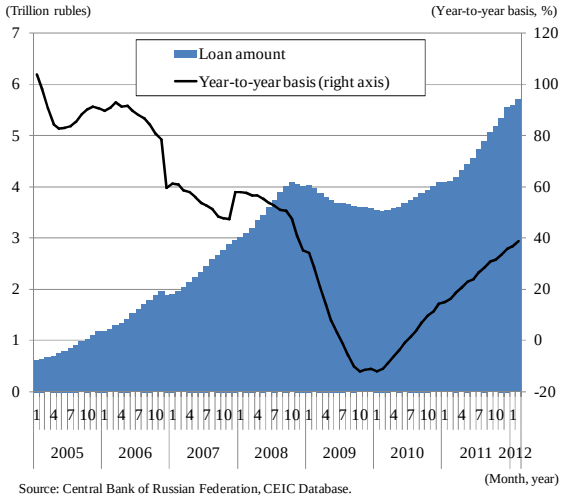


Figure 1-6-2-5

Russia's credits to individuals



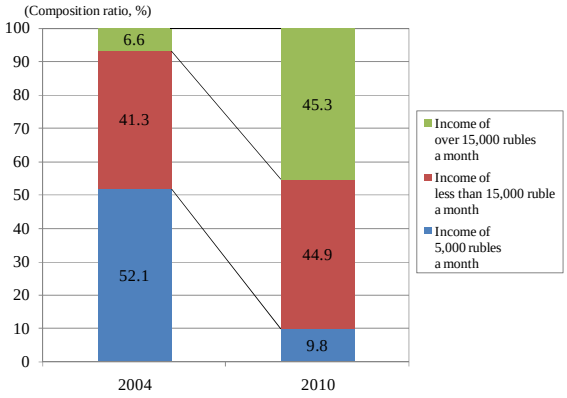
(C) Notable income growth

Income levels have risen notably in Russia. The income class of over 15,000 rubles (about 39,000 yen) a month increased to 45.3% of the population in 2010 from 6.6% in 2004 (see Figure 1-6-2-6), and as of the first quarter of 2012, real wages have also become 3.3 times higher than in the same quarter of 2000.[205] Russia's consumer spending has shown steady growth even after 2011 when European debt problems became more pronounced and car sales in 2011 reached 1.42 million units, up 15% from the previous year (see Figure 1-6-2-7). As just described, consumer spending is occurring in a favorable environment and a steady growth led by consumer spending is expected also in 2012.

205 Estimated based on the real wage growth rate compared with the same quarter of the previous year (the index calculated by setting the value in the same quarter of the previous year to 100) announced quarterly by Russian Federal Service for State Statistics.

Figure 1-6-2-6

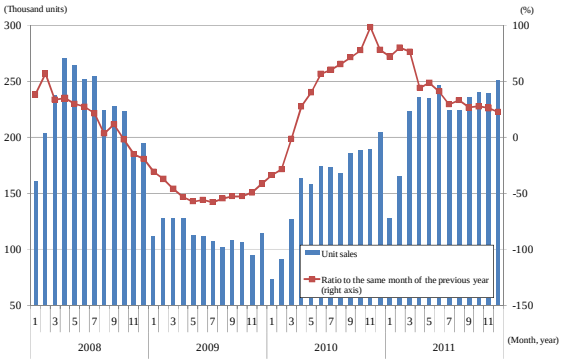
Russia's population composition by income class



Source: Russian Federal Service for State Statistics.

Figure 1-6-2-7

Russia's car sales



Source: Marklines.

(2) Immediate risks and problems

(A) Public finance

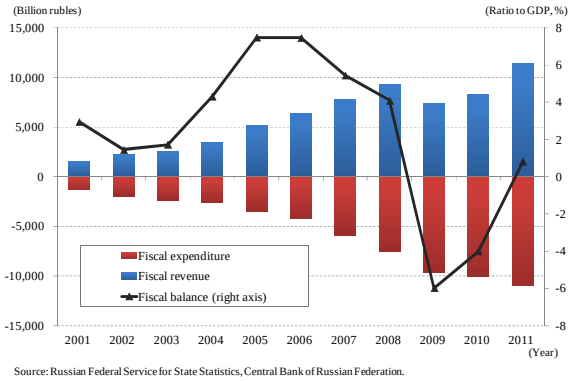
Fiscal balance, which had fallen into negative territory due to the global financial crisis in 2009, was back on the recovery track because high energy prices caused an increase in tax revenue from energy which accounted for about a half of annual government revenue[206] (see Figure 1-6-2-8), and in 2011, a fiscal surplus was recorded for the first time in the three years since 2008. On the other hand, in the federal budget for 2012 to 2014 prepared by the government of the Russian Federation, expenditure is scheduled to increase to 14.1 trillion rubles in 2014 from 11.8 trillion rubles in 2012 due to a large increase in the defence budget[207], and it is expected that the fiscal balance will fall into negative

206 According to the Ministry of Finance of the Russian Federation, revenue from crude oil and gas was 5.5 trillion rubles which account for 49.5% of the budget revenue in 2011, 11.1 trillion rubles.

207 According to the federal budget draft for 2012 to 2014 prepared by the government of the Russian Federation, Russia's defence budget will increase to 2.7 trillion rubles in 2014 from 1.5 trillion rubles in 2011.

territory again in 2012.[208]

Figure 1-6-2-8
Fiscal balance of the government of Russian Federation (ratio to nominal GDP)



Source: Russian Federal Service for State Statistics, Central Bank of Russian Federation.

Under this federal budget, furthermore, it is expected that fiscal deficits excluding revenue from crude oil and gas will slightly increase to 6.7 trillion rubles in 2014 from 6.5 trillion rubles in 2012, and this shows that Russia's fiscal structure is vulnerable to fluctuations in resource prices. The federal budget for 2012 expects the fiscal deficit in 2012 to be 1.5% of GDP based on the assumption that the crude oil price is set as $100 per barrel. However, the World Bank estimates that the fiscal deficit in 2012 may become between 3.1% and 5.3% of GDP if the crude oil price falls to between $80 and $60 per barrel.[209]

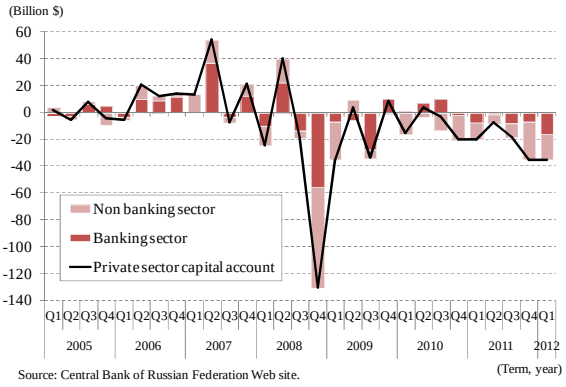
(B) Finance

Capital is currently outflowing from Russia due to selection of global risk assets which has been in progress under the situation where the European debt problems become more serious in 2011 as well as a heightened sense of uncertainty about future economic policies before the presidential election in March 2012 (see Figure 1-6-2-9). In the first quarter of 2012, capital balance of private sectors exhibited $35.1 billion of excess outflow and, in particular, capital outflow of the banking sector increased to $16 billion from $6.7 billion in the previous quarter. According to results as of the end of September 2011 complied by the Bank for International Settlements (BIS), European banks account for 66% of foreign banks' exposure to Russia (including credit and derivative transactions).[210] Therefore, capital may outflow further depending on the recapitalization of European banks[211].

208 In addition, Mr. Putin (then Prime Minister) announced his plans for the administration on February 13, 2012: "Building justice: A social policy for Russia" to increase salary in the public sector including teachers of national universities, doctors and scientists, increase the amount for scholarships for university students and graduates, and increase the amount of child allowance. Implementation of these plans may further increase fiscal expenditures.
209 *Russian Economic Report No.26 September 2011* (World Bank (2011))
210 Consolidated Banking Statistics at end-September 2011 (BIS (2011))
211 Any bank of EU member countries is obliged to increase its core capital adequacy ratio to 9% by the end of June 2012 based on the agreement at the European Council held in October 2011.

Figure 1-6-2-9

Capital inflow and outflow of Russia's private sector



Source: Central Bank of Russian Federation Web site.

On the other hand, it is possible to intervene in the exchange market by buying rubles in case of a sudden change in exchange rates because Russia held $516.8 billion of foreign reserves as of the end of September 2011, and Russia has recorded a massive current-account surplus[212]. Therefore, it is assumed that the Russian financial market is unlikely to fall into severe confusion.

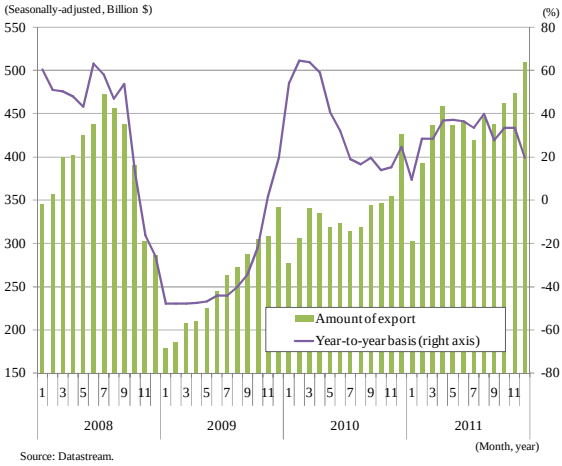
(C) Trade

Export has remained at a high level of more than a 20% increase over the previous year due to high energy prices, despite the world economy being in a downward phase (see Figure 1-6-2-10). On the other hand, relevant ratio of energy to Russia's exports of goods is 69% and this reveals Russia's heavily energy-dependent export structure (see Figure 1-6-2-11), and Russia's exports to EU account for 54% of total exports due to geographical proximity, etc. This also demonstrates Russia's heavily Europe-dependent export structure similar to that of Switzerland (see Figure 1-6-2-12). Therefore, if European debt problems become serious or resource prices decline, the Russian economy may suffer a negative impact from a decrease in exports to Europe or a decline in export prices.

212 In 2011, current-account surplus is $98.8 billion, up 39% from 2010 ($71.1 billion), and stands at a high level by about 6% of GDP on a nominal basis.

Figure 1-6-2-10

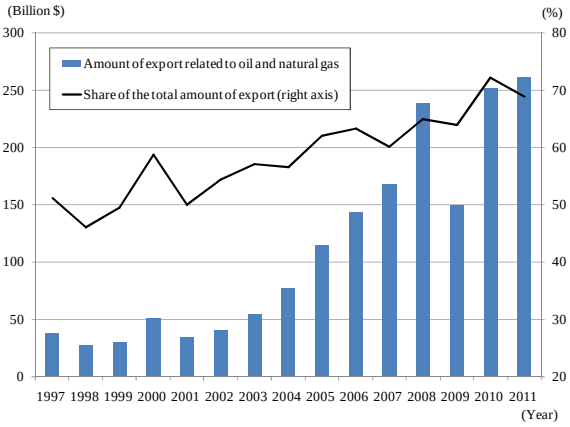
Russia’s exports



Source: Datastream.

Figure 1-6-2-11

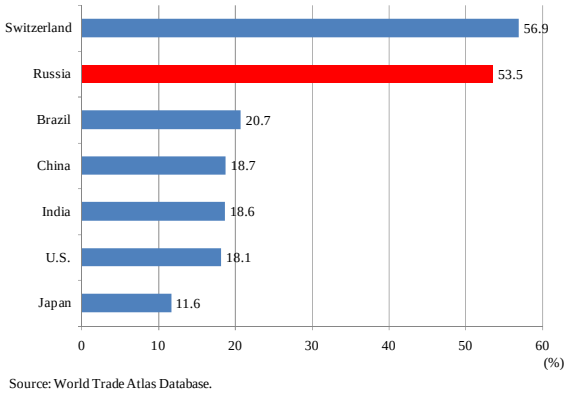
Relevant ratio of oil and natural gas to Russia’s exports of goods



Note: Export related to oil and natural gas means the export categorized as HS Code 27.
Source: Global Trade Atlas Navigator.

Figure 1-6-2-12

Ratio of exports to EU27 to total export of major countries (2011)



Source: World Trade Atlas Database.

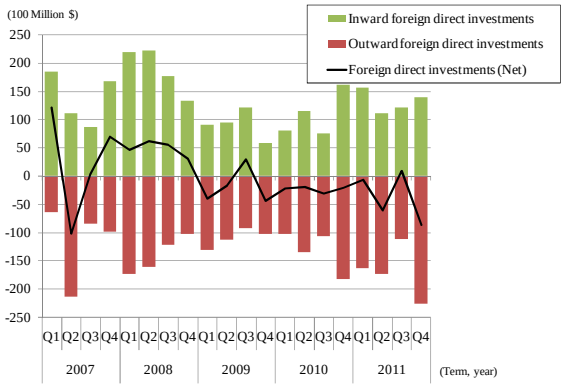
(D) Investment

According to Russia's inward and outward foreign direct investments figures (see Figure 1-6-2-13), both inward and outward investments have largely increased throughout the 2000s. After the global financial crisis in 2008, however, outward foreign direct investments have exceeded the level of before the crisis, while inward foreign direct investments have been relatively sluggish. It is pointed out that there is room for further improvement in the Russian investment environment. The World Bank has published the annual report "Doing Business" since 2004 by annually evaluating and ranking the business environment around the world, and Russia ranked low in the latest report published in December 2011: 120th among 183 countries. When compared to BRICs countries, Russia ranked lower than China by 30 in the overall ranking and ranked much lower than India and Brazil in terms of investor protection as well as export and import procedures (see Figure 1-6-2-14).

Russia was admitted to the World Trade Organization (WTO) at the WTO ministerial meeting held in December 2011 and will officially become a WTO member by the end of 2012 through the ratification procedures being taken within the country. Furthermore, Russia will host the APEC summit meetings for the first time in September 2012. It is expected that in the future the Russian trade and investment environment improvethrough this international framework.

Figure 1-6-2-13

Russia's inward and outward foreign direct investment



Source: Central Bank of Russian Federation.

Figure 1-6-2-14

Business environment assessment for BRICs countries

	Russia	Brazil	China	India
Overall ranking	120	126	91	132
New start of business	111	120	151	166
Construction authorization	178	127	179	181
Electricity procurement	183	51	115	98
Patent acquisition	45	114	40	97
Borrowings	98	98	67	40
Investor protection	111	79	97	46
Tax system	105	150	122	147
Export and import	160	121	60	109
Contract performance	13	118	16	182
Bankruptcy proceedings	60	136	75	128

Note: Ranking is set in 183 countries worldwide.
Source: *Doing Business 2012* (World Bank).

(E) Relations with Japan

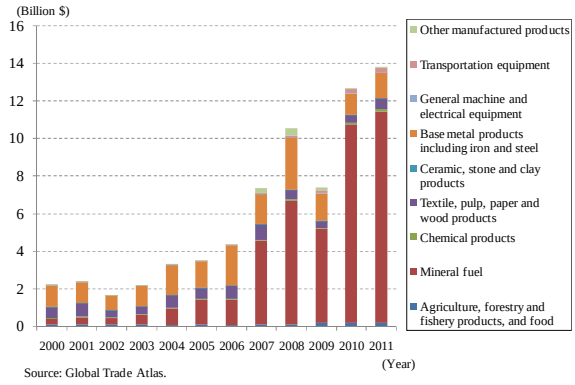
(a) Trade relations

The trade between Japan and Russia has been steadily expanding throughout the 2000s except for a steep decline due to the global financial crisis in 2009 (see Figure 1-6-2-15 and -16).

As for Japan's imports from Russia, the proportion of mineral fuels has increased and has accounted for more than 80% of total imports since 2010. Of these, crude oil has come to about twice the value of 2009 (on a total weight basis, crude oil decreased following a sharp increase in 2010 and returned to the same level as 2009 in 2011).

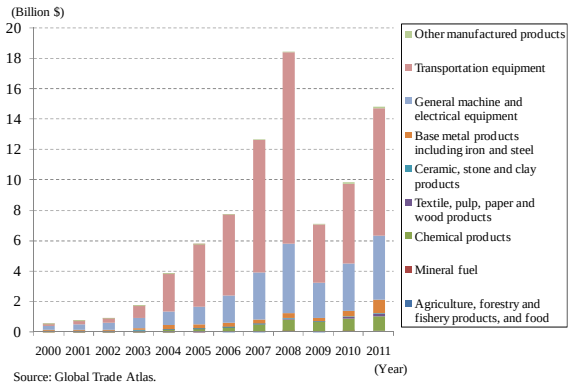
As for Japan's exports to Russia, transportation equipment accounts for half of total exports. Of these, despite a significant decline in 2009 due to a large increase in tariffs and economic measures to protect domestic cars implemented by the Russian government as along with the global economic crisis, export of automobiles is recovering since then thanks to steady consumer spending.

Figure 1-6-2-15
Items of import from Russia



Source: Global Trade Atlas.

Figure 1-6-2-16
Items of export to Russia



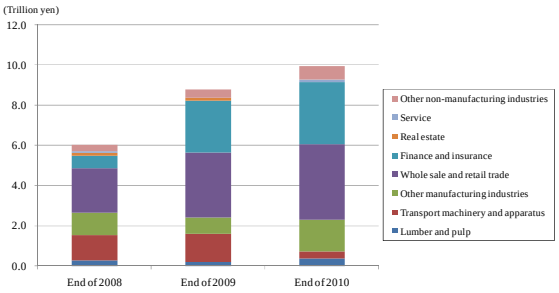
Source: Global Trade Atlas.

(b) Investment relation

In recent years, Japanese investment has extended to various industries including wholesale/retail as

well as manufacturing, and the balance of direct investments has steadily increased. There is vigorous advancement into wholesale/retail industries stemming from steady consumer spending, and in addition, there is further advancement into finance and insurance industries due to high demand for capital (see Figure 1-6-2-17).

Figure 1-6-2-17
Balance of direct investments in Russia by industry



Source: *International Balance of Payments Statistics* (Bank of Japan).