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BOFIT Weekly

18 • 6.5.2011

Russia

CBR keeps raising rates. The Central Bank of Russia increased its key deposit rates and certain credit rates by 25 basis points, effective Tuesday (May 3). The deposit rates now stand at 3.25 %. The minimum interest rate for one-day and seven-day repo auctions increased to 5.5 %, while fixed repo rates still remained unchanged at 6.75 %. Since the CBR halted its monetary easing policies last summer, deposit rates have been raised three times (the first hike occurred in late 2010) and various CBR credit rates twice (first hike on March 1).

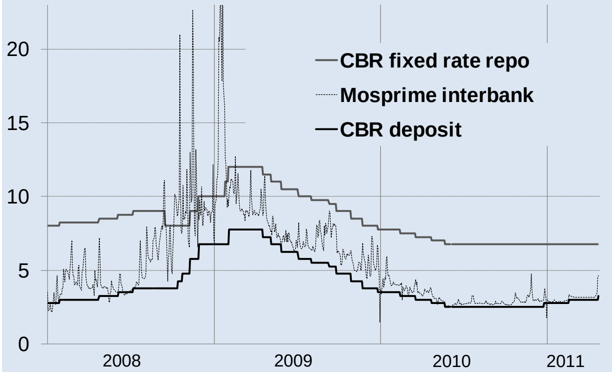
Russia's banking sector currently has plenty of liquidity, and from the standpoint of tightening monetary policy CBR deposit rates exert much greater influence than CBR credit rates. CBR deposit rates provide a basis for setting interbank rates.

The latest hikes signal, as the CBR stated, concerns about high inflation expectations. It sees the surge in food prices subsiding but inflation sustained by monetary factors.

Bank reserve requirements, which have been raised three times since the beginning of February, were allowed to remain unchanged in the CBR monetary policy assessment in April. Central bank bonds, which, along with required reserves and other deposits, are among the CBR's main monetary policy debt instruments, have not been sold by the CBR quite as actively as last year.

This year the high world prices of oil and Russia's other basic export commodities have driven large current account surpluses, which exceeded the unusually high net capital outflows. This has continued pressure for monetary tightening. The CBR was active in buying foreign currency in the first four months of this year to partly contain ruble appreciation pressures, thus increasing liquidity in the system. Partly the CBR has conceded to the appreciation pressure by allowing the ruble to rise about 5 % this year against its dollar-euro currency basket.

One-day money market rates in Russia, %



Source: CBR

Russia imposes ban on gasoline exports. The ban arose from the current fuel shortage in Russia and will last at least through May. Shortages have been reported in about ten regions, including the City of St. Petersburg. Deputy energy minister Sergei Kudryashov said most of the shortage concerns gasoline; diesel fuel supplies are guaranteed. The export ban naturally balanced the situation.

The government also decreed that, effective May 1, the export tax on gasoline increased to $408 (≈ €270) per metric ton, a 44 % increase from April.

In fact, the volume of Russia's gasoline exports has been on a declining trend for several years, and only a small amount of gasoline produced is exported. In the second half of 2010, only 5–6 % of production went to exports. For all of 2010, Russia exported slightly less than 3 million tons. Gasoline export earnings of just $2 billion accounted for 0.4 % of Russia's total export earnings.

Gasoline production in Russia has remained fairly stable in recent years, while gasoline consumption has risen steadily. As the gap between production and consumption has shrunk, production dips such as in February and March, can more easily impact consumption than earlier.

Lukoil's deputy CEO Leonid Fedun said the current shortage reflects mainly domestic price regulation and increasing domestic demand for gasoline caused by the increasing number of cars in Russia. Indeed, the stock of passenger cars grew even in the recession in 2009, when the stock exceeded 33 million. In 2010, domestic car production and net imports recovered to nearly 2 million cars.

Russian officials also noted distribution problems caused by different gasoline prices in different regions. Kudryashov said another reason for the current shortage has been the introduction of new technical standards for Euro 3 low-sulphur refining introduced in January. Some refiners have been unable to meet the new rules, which have hampered refinery operations.

Gasoline producers, like crude oil and fuel oil producers, face a two-front pricing scheme. Export prices are typically higher than domestic producer prices. The difference in gasoline prices, which has historically ranged from €50 to €90 a ton (15–25 % of export prices), began to widen last summer and by winter had reached about €160 a ton (≈ 30 % of the export price). The state uses export duties to adjust for the price differential.

Retail gasoline prices have risen modestly in Russia in recent years, even as the recession came to an end last year. In January 2011, the retail price rose to its pre-crisis peak, partly due to a rise in the excise tax, and was up about 15 % y-o-y. In February, the government limited gasoline price hikes, causing prices to drop slightly, while prices surged again at the start of May, with 95-and-more-octane gas now over 26 rubles (€0.65) a litre. Prices vary considerably across regions, with the average price ranging last winter from 22 to 30 rubles a litre (not counting a couple of remote regions).

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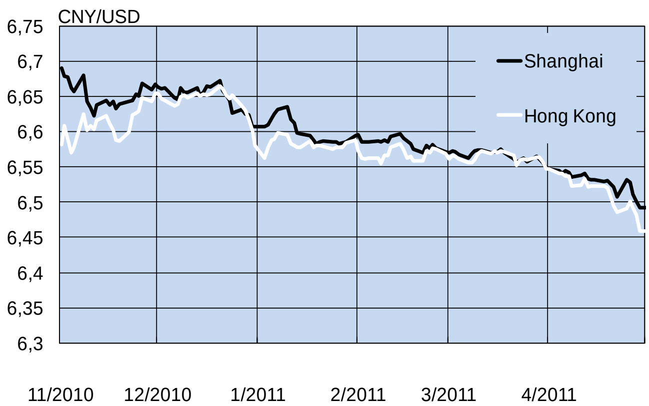
China

Yuan appreciation against the dollar gains steam. The yuan's exchange rate has fallen below the 6.5 yuan-to-the-dollar. Yuan futures are trading at a year-end target below 6.4, suggesting markets expect the appreciation trend will continue. The widening spread between the official exchange rate (CNY) and the Hong Kong offshore rate (CNH) also indicates rising appreciation pressure. The recent trend confirms the People's Bank of China's message that greater exchange rate flexibility will be allowed to reduce inflationary pressures.

The change in exchange rates is still so small that it has no impact on the external imbalance of the Chinese economy or the current account surpluses that have chafed trade relations. The yuan has continued to devalue against the euro and has remained fairly stable against the Japanese yen. The US dollar's weakness in the currency markets reflects the US Federal Reserve's decision to stay with its accommodative monetary stance. In China, monetary tightening is in full swing, and the eurozone has begun to exit the recession with a rate hike.

Yuan-dollar exchange rate



Source: Bloomberg

Korea's central bank hopes to invest some of its reserves in yuan-denominated securities. It has applied to the PBoC under the Qualified Foreign Institutional Investor (QFII) programme. Three other central banks (Norway, Malaysia and Hong Kong) are already on the QFII list.

Data for China sixth census suggest changing population structure. New census data released on April 28 show China's population has become increasingly urbanised, population growth has slowed, and the age structure is changing. China's population grew about 6 % from the previous 2000 census, with the rate of growth slowing. The number of people living in cities increased more than 10 %.

Part of the slowing in population growth is a consequence of China's one-child policy. The number of children under 14 years fell 6 percentage points (pp) from the previous census to 17 % of the population, while the share of people over 60 increased 3 pp to 13 % of the population. These new figures show the number of people of working age in China has yet to shrink. However, in e.g. Shanghai, the share of individuals over 60 now exceeds a fifth of the total city population, which is adding to pressures to develop senior care institutions. Traditionally, children have been expected to care for their elders in China, but this arrangement has become fairly challenging for both the young and old due to the one-child policy.

For the first time, the census was based on the actual residence to get a better picture of the degree of Chinese urbanisation, given that many migrant workers from the country live in cities. In 2010, over 250 million Chinese lived elsewhere than their registered domicile, which meant that the number of migrants has grown over 80 % from the previous census. The huge number of migrant workers burdens development of city healthcare services, energy supply and infrastructure.

World Bank warns of real estate market risks to the Chinese economy. The World Bank's latest quarterly survey for China finds the government's balancing between increasing housing prices driven by market pressures and the need to apply monetary tightening measures could lead to a slowdown in construction activity. The slowdown could impact on big industries such as steel and cement that serve the construction sector. Construction investment is a substantial part of GDP, and local governments play a huge role in determining construction investment. The World Bank analysts note that a substantial slowdown in construction would have broad macroeconomic consequences and could erode bank balance sheets. Fear of slowdown in property construction is diffused by the Chinese government's ambitious social housing construction goals set forth in the current five-year plan.

Official tightening measures such as increasing cash downpayment on housing, stricter lending rules and trial introduction of real estate taxes in few large cities have failed to stem the rise in housing prices. According to Soufun Holdings Ltd., a small uptick was registered in April when prices in 77 Chinese cities rose 0.4 % m-o-m. In Shanghai, housing prices rose 0.32 % from the previous month and 2 % y-o-y. In Beijing the drop in April was 0.14 % from March, but an increase of 4 % y-o-y.

It is difficult to determine the overall state of the housing market due to regional differences and changes in the statistical methodology at the start of this year that makes it difficult to compare new figures with previous years.

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