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BOFIT Weekly

29 • 19.7.2013

Russia

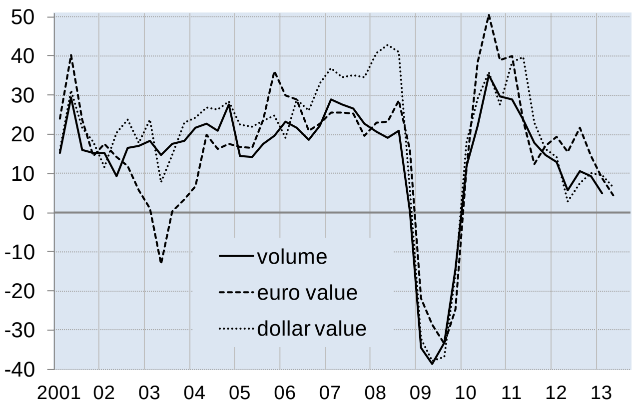
Russia sees export earnings and current account surplus shrink in the first half of this year. Preliminary balance-of-payments figures show Russia's export earnings fell in both the first and second quarters by 2–3 % y-o-y. Apart from a surge in exports of services, export earnings in the biggest export categories were flat or down. Revenues from exports of gas remained unchanged, while earnings from exports of oil, petroleum products and other goods declined. The reason was that both export volumes and prices declined.

Growth in Russian spending on imports continued to slow in the second quarter, even if growth was still running at 5–6 % a year. The value of goods imports increased only about 2 %. Spending by Russian travellers abroad as well as other services imports rose nearly 20 % in the first half. Services imports accounted for over 25 % of all spending on imports.

Due largely to the weak trend in export earnings, the goods trade surplus has been contracting but still exceeded 8 % of GDP in the previous four quarters. Due to on-going deficits in services trade and other current account categories, the current account surplus fell below 2.5 % of GDP (4–6 % during 2010–2012). In the second quarter, the current account surplus reached its lowest level since the end of the 1990s.

The flow of private capital abroad continued in the second quarter and was slightly larger in net terms than in previous years. Looking at the last four quarters, however, the net outflow of capital has fallen clearly from last year and was 2.5 % of GDP. Outflows created by means of fictitious business transactions and unrecorded capital outflows together remained around 2.5 % of GDP.

Russian imports of goods and services (percentage change from four quarters previous)



Sources: Rosstat, CBR

Amendments to law give the CBR supervision of the entire financial sector. Following its passage in the Duma on July 5, the Federation Council on July 10 approved major changes to Russia's Central Bank Law. The amendments call for integrating the functions of the Federal Financial Markets Service (FFMS) with the CBR. The CBR will now regulate all parts of the financial market, not just traditional credit institutions. New areas to be supervised include securities and insurance markets, pension funds, credit cooperatives, firms involved in microcredit and credit ratings agencies. The CBR will also supervise share and other securities offerings of corporations to assure they follow regulations, including e.g. shareholder protection. The amended law enters into force on September 1. Supervision of certain mandatory insurance such as medical insurance will not be performed by the CBR.

The need to enhance financial market regulation and supervision has long been under consideration, as well as the notion of creating a single super-regulator as in the case of the UK's Financial Services Authority. The idea started to gain support last summer, when FFMS head Dmitri Pankin noted that his agency needs substantially more resources to oversee increasingly complex markets. An integrated organisation is expected to be able to more efficiently supervise financial markets than the current separation of organisations, e.g. in overseeing consolidated corporate groups that cover various blocks of the financial sector.

Other amendments to the central bank act include the emphasis on stability of the ruble and prices as the fundamental monetary policy goal in creating conditions to economic growth. Arrival at this notion was preceded by discussions on the emphasis between price stability and economic growth. The CBR will also have the right to offer loans of over one year to banks. The terms of the CBR chairman and other board members will be extended from four to five years and the number of board members increased from 13 to 15.

CBR: Basel III requirements in place at the start of 2014. The CBR recently proposed slightly delaying the scheduled launch of Basel III capital adequacy requirements from October 1 to January 1, 2014 to coordinate the launch with the EU and the US.

The CBR is proposing partly less onerous capital adequacy requirements than the relatively tight requirements envisioned earlier. Even the new proposals are in line with Basel III capital requirements recommended by the Bank for International Settlements (BIS). The BIS guidance calls for an overall capital ratio of 8 % (Tier I + Tier II), while the CBR wants to maintain its current overall capital ratio requirement of 10 %. The large international credit ratings agencies recently noted that under the stricter requirements proposed earlier some of Russia's 20 largest banks would have needed more, in a case or two considerably more, paid-in capital or other Tier I assets in coming years.

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China

China's economic growth continued to slow in the second quarter. The National Bureau of Statistics reports a further slowdown in Chinese GDP growth. GDP growth decelerated from 7.7 % y-o-y in the first quarter to 7.5 % in the second quarter. The overall rate of growth was met with little surprise as observers have been adjusting their expectations in recent months. Just last winter, most observers still expected growth this year to exceed 8 %, but as the spring wore on forecasts were repeatedly revised downward. For example, the IMF last month dropped its forecast to 7.8 %, and most of the other forecasts are also around China's official growth target of 7.5 %. Forecasts for Chinese growth next year have also been cut, with the consensus range for GDP growth now at 7–8 %.

Domestic demand drove second-quarter growth. Nearly half of economic growth came from consumer demand sustained by an incessant rise in wages. Just over half of economic growth came from investment growth, which somewhat surprisingly picked up in the second quarter. Investment growth was largely driven by public procurement. Growth in industrial investment, in contrast, continued to slow as a number of sectors struggle with overcapacity issues. Although exports remain critical to the Chinese economy, the contribution of net exports to economic growth has been fairly modest for several years now. The impacts of exports are mainly manifested indirectly through effects on domestic consumption and investment demand.

The government has refrained from major stimulus measures despite the recent downturn. It appears that the current pace of growth is sufficient in the eyes of China's new leadership as it focuses on restructuring of the economy. Finance minister Lou Jiwei remarked in July that even a lower growth rate than the current one would still be sufficient to keep unemployment at bay.

China's GDP growth

Source: NBS

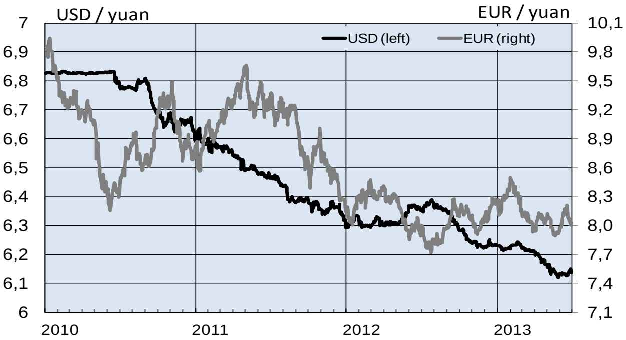
China announces new round of measures to deregulate capital movements. The People's Bank of China announced last week that firms operating in China can now grant yuan-denominated loans to their foreign affiliates. In addition, yuan-denominated foreign trade settlement procedures were relaxed. The reforms allow for companies to aggregate yuan payments arriving on different days.

The China Securities Regulatory Commission (CSRC) announced in July that it was extending its Renminbi Qualified Foreign Institutional Investor (RQFII) programme to Singapore and London. The RQFII programme was launched in 2011 in Hong Kong and extended earlier this year to Taiwan. China's financial markets are strictly regulated for foreign investors, but RQFII firms can invest in certain yuan-denominated securities in mainland China. At the same time, the CSRC announced it was raising the overall quota for its foreign investor programmes to $150 billion. The change is not expected to have immediate impact on capital inflows as only slightly more than half of the previously allotted $80 billion quota has been used.

Yuan exchange rate stable since May. Although the yuan has overall gained about 1.5 % against the dollar this year, its value has been essentially stable since late May at 6.13 yuan to the dollar. In the first half of the year, capital poured into China, causing the yuan to appreciate. On any given day, the PBoC allows the daily yuan-dollar exchange rate to fluctuate no more than 1 % from the midpoint rate it sets every morning. If there is pressure for yuan to appreciate or depreciate more than the limit allows, the PBoC intervenes. The PBoC has usually prevented yuan appreciation by purchasing currency from the market in its currency reserves.

An examination of the PBoC's currency reserves purchased in the second quarter shows its currency purchases were rather small and there appears to have been a slight net outflow of capital from China. Under these circumstances, the trend in the yuan exchange rate suggests only modest appreciation pressure on the yuan. Forward contracts indicate a weakening of the yuan ahead based on interest rate differentials, but a Reuters survey this month found that most banks expected the yuan to appreciate during the coming 12 months.

Nominal dollar-yuan and euro-yuan exchange rates



Source: Reuters

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