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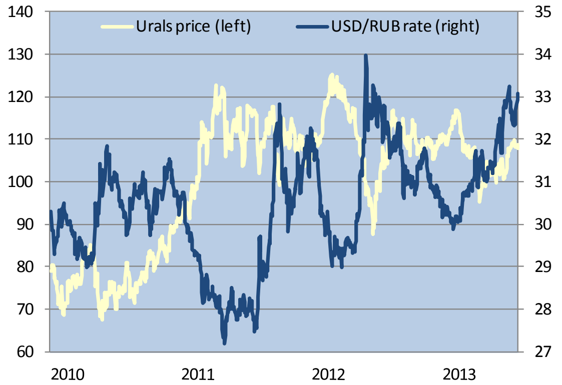
BOFIT Weekly
31 • 2.8.2013

Russia

Ruble continues to slide; Moscow stock exchange down for the year. The ruble this year has lost nearly 8 % of its value against the dollar and 9 % against the euro as of end-July. One dollar was worth 33.1 rubles and a euro bought 43.8 rubles. The ruble slid throughout much of the first half of this year with the contraction in Russia's export earnings and capital outflows. The Central Bank of Russia sold substantially larger amounts of dollars from its foreign currency reserves in June and July than in previous months to support the ruble's exchange rate. Dollar sales in July alone exceeded $4 billion, a level of intervention not seen since autumn 2012.

Although the price of Urals-grade crude oil has hovered above $100 a barrel in recent months, continued uncertainty on international financial markets has depressed stock prices in Russia as in many other emerging markets. On Wednesday (July 31), the Moscow Exchange's MICEX index was down 9 % from the start of the year.

Price of Urals crude ($/bbl) and dollar-ruble exchange rate (rising trend indicates ruble weakening)



Source: Bloomberg.

Credit expansion in Russia tapering off. The loan stock of banks increased 18 % y-o-y in the first half of this year. Total corporate and household borrowing rose at slower pace than earlier, reflecting general trends in the economy. The growth in corporate borrowing as of end-June was just under 12 % or half the growth rate registered last year.

The stock of household loans increased 34 %, down from 44 % last year. Even this lower growth is still a headache for the CBR, which considers household credit growth of around 20 % a year sustainable. Nearly two-thirds of household borrowing consists of unsecured consumer loans. The average interest rate on household loans with maturities of less than 12 months was 25 % for households and 10 % for corporate loans in June.

The stock of non-performing household loans has risen rapidly and the trend is expected to continue. New estimates find that about a third of the income of indebted households now goes to servicing debt. The CBR is planning measures to rein in the growth of unsecured consumer credit through such measures as restricting actual interest rate costs and limiting the share of income that can be devoted to debt servicing.

Household deposits grew by 22 % y-o-y in the first six months of the year, about the same pace of growth as in 1H2012. The share of foreign currency deposits remained at just under a fifth. Corporate deposits rose at 23 % y-o-y, slightly faster than last year. The ratio of loans to deposits for the banking sector overall slightly exceeds 90 %.

Total assets of the banking sector at the end of June stood at just under 53 trillion rubles (€1.24 trillion), an increase of about 20 % from last year. Total banking sector assets equalled about 79 % of GDP at the beginning of this year, which is still fairly modest compared to advanced economies and many emerging economies as well.

Russia had 1,091 credit institutions operating at the end of June which is eleven fewer than in June 2012. Russia's banking sector is highly concentrated as the five largest banks control about 51 % of total banking sector assets. All of these banks are majority-owned by the state. Some 248 banks have foreign investors, and foreign investors hold majority stakes in about half of them. Foreign banks, however, control less than 20 % of total banking sector assets. Of these, Rosbank and Unicredit rank among Russia's ten largest banks in terms of total assets.

Russian customs intends to change the treatment of TIR road transport. Russian customs announced that, as of mid-August, TIR (Transports Internationaux Routiers or International Road Transport) freight will be treated the same as other transit freight in terms of e.g. mandatory payments into escrow to cover customs duties and taxes. The TIR convention was created under the auspices of the UN and it includes Russia. Shipments under the treaty enjoy expedited treatment at border crossings. Under the TIR systems, national organisations act as guarantors of payment of customs duties and taxes, so separate escrow accounts or other collateral to secure payment is unnecessary.

Russian customs claims the local TIR representative, Russia's Association of International Road Transport Carriers (ASMAP) owes a substantial amount in unpaid customs duties and taxes. ASMAP denies the claim and states that the planned measures of Russian customs violate Russia's international commitments. Russian importers fear that the planned change would increase the duration and cost of transport. It would also hamper the government's objective to simplify customs procedures as manifested in the Road Maps aiming to enhance the Russian business environment.

A large share of road transit freight moving from Finland to Russia falls under the TIR system. Finnish Customs reports that the total value of transit goods shipped to Russia via Finland last year amounted to €20 billion or about 10 % of Russia's total imports. In the first six months of this year, the value of transit freight and shipment volumes have, however, fallen visibly from a year earlier.

Bank of Finland • Institute for Economies in Transition, BOFIT
P.O. Box 160, FI-00101 Helsinki
Phone: +358 10 831 2268 • Web: www.bof.fi/bofit

Editor-in-Chief Seija Lainela • Email: Seija.Lainela@bof.fi

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China

Official and unofficial PMI readings for July give mixed picture of Chinese economy; decision-makers still convinced China will hit its growth targets. The July reading for China's official purchasing manager index (PMI) rose slightly to 50.3 points, up from 50.1 in June. The PMI from HSBC that also came out this week dropped a half point to 47.7, its lowest reading in nearly a year. Readings below 50 points indicate deteriorating business conditions.

The difference between the two CPI readings may be explained by the fact that the official index is more heavily weighted with large firms serving China's domestic market than in the HSBC index, which reflects more the outlooks of smaller firms and the predicament of export-oriented firms. The sub-indexes of the official main PMI also put the situation for small and medium-sized firms below the critical 50-point mark, while the sub-index for larger firms rose to 50.8. Both indexes found that unemployment rose and export orders still fell in July.

The Chinese government decided at the end of July to support growth through such measures as tax breaks for small firms, construction of low-income housing and acceleration of spending on railway investment. Additional measures are possible in the second half of this year. On the other hand, the modest level of stimulus measures indicates that China's leaders still believe that the country will hit its 7.5 % GDP growth target this year without the need for large stimulus and the risks that come with it. Short-term growth prospects are not the sole concern of China's leadership as they must deal with risks in the financial markets and move ahead with economic reforms. This was clear from the press reports on this week's politburo meeting.

China attempts to figure out true scale of local government indebtedness. The National Audit Office (NAO) announced last week it will conduct an audit on public sector debt including both central and local administrations. The State Council initiated the audit in response to concerns over public sector indebtedness. Especially the true debt levels of local governments remain unclear as a large share of debts has been left off the balance sheet through the use of financial companies owned by local administrations.

It appears that China's leadership is using the audit to get a better picture of the sustainability of local government finances ahead of the possible launch of a new round of stimulus spending and measures to deregulate the financial markets. The OECD and IMF have long encouraged China to adopt greater transparency of local administration finances to provide a better basis for fiscal and monetary policy decisions. The IMF says that the room for stimulus is clearly less than China's official figures suggest.

The last national audit conducted in 2011 found that the debts of local administration equalled about 27 % of GDP at the end of 2010. The National Audit Office performed a more limited audit of 36 local administrations in June this year. The audit found that the debts and debt servicing costs continued to grow after 2010, despite less official stimulus spending in the wake of the global financial crisis. In its latest country report, the IMF estimates that public sector debt currently stands at about 45 % of GDP, but many investment banks and research institutions put the public sector debt somewhere between 50 % and 70 % of GDP. China's debt ratio is not particularly high compared to many developed economies, but the levels of debt have soared in recent years.

The audit is apparently being used also as a means to motivate local administrations to get better control of their finances. Furthermore, China's leaders have begun to focus on public sector investments. Last week, for example, China imposed a restriction on public sector construction of office space over the next five years. The limits are intended to rein in unproductive investment of public funds.

EU and China resolve dispute over solar panel duties. The EU-China dispute over solar panels reached a resolution last week as the countries agreed to implement new rules on import duties of solar panels. The deal is to be in effect until the end of 2015. The EU imposed an 11.8 % import duty on Chinese solar panels in June of this year that was set to rise to 47.6 % in August (see BOFIT Weekly 23). The agreement allows Chinese firms to avoid the hikes in import duties.

Under the terms of the deal, panels cannot be sold in the EU area below a minimum price. According to Reuters, the minimum price is close to the average sale price of solar panels in July. In addition, solar panels imported from China will be under a quota. If Chinese producers exceed the quota, the 47.6 % import duty will be imposed. The *Financial Times* estimates the quota represents about 60 % of the EU area's solar panel market this year. Chinese firms control about 80 % of the market at the moment, so the deal should provide a bit more room for other solar panel manufacturers to compete.

Many European solar panel manufacturers are unhappy with the ruling as they feel the minimum price is still too low. Differences among EU member states on the matter could undermine the EU Commission's bargaining position, however. Germany and the UK, for example, have opposed the import duties.

Trade policy disputes are expected to dominate China-EU trade talks. EU trade commissioner Karel De Gucht said China is willing to engage in discussions on China's planned tariff on wines imported from Europe.

Editor-in-Chief Seija Lainela • Email: Seija.Lainela@bof.fi
Bank of Finland • Institute for Economies in Transition, BOFIT
P.O. Box 160, FI-00101 Helsinki
Phone: +358 10 831 2268 • Web: www.bof.fi/bofit