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Russia

CBR expects GDP growth below 2 % in 2014-16, persistent inflation may require tighter monetary policy. At last Friday's (Feb. 14) board meeting, the Central Bank of Russia decided to keep its "key rate" at 5.5 %. The CBR aims to get inflation down from slightly above 6 % at the moment to 5 % by the end of this year. Factors that should restrain inflation include weak demand and restrictions on hikes in administratively set energy and utility rates. The central bank estimates the ruble's devaluation over the past few months contributes up to 0.5 percentage points to the inflation rate. The central bank stated that it is ready to tighten its monetary stance if inflation accelerates above targets e.g. due to heightened inflation expectations.

The CBR's fresh economic forecast lowers its earlier prediction of Russian GDP growth this year to a range of 1.5–1.8 %. Growth is now expected to pick up a bit in 2015–2016, but still remain at around 1.7–2.0 %. The CBR expects growth in private consumption to slow this year to just above 3 %, while fixed capital investment should recover to around 1.5 % growth. The volume of Russian exports is expected to rise 2 % at most on a relatively slow recovery in global demand. The CBR expects imports to rise 4 % at most this year. Import growth is restrained e.g. by the ruble's weaker real exchange rate.

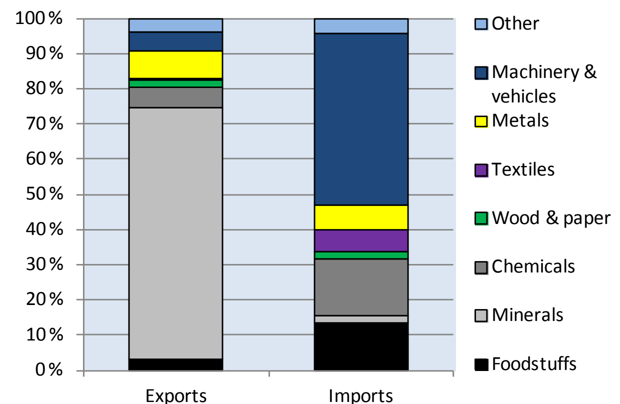
Russian foreign trade figures weaker in 2013. The value of goods exports in 2013 contracted by 1 % y-o-y to $523 billion. The reduction in exports reflected drops in export volumes and prices of crude oil and metals, as well as a contraction in exports to CIS countries. Exports to Belarus fell 20 % y-o-y on economic weakness. The 13 % drop in exports to Ukraine reflected largely political tensions. In contrast, exports of petroleum products and natural gas to non-CIS countries grew briskly. Export volume of gasoline increased by more than 50 %, while natural gas exports were up over 20 % from a year earlier. Gazprom reports its share of the European market increased last year to a record 30 %.

Over 70 % of Russian goods exports last year consisted of oil, petroleum products and natural gas. Metals and chemicals were the next largest export good categories. Even machinery & equipment accounted for over 5 % of total goods exports last year. The top export destinations were the Netherlands, Italy and Germany. EU countries took over half of all exports, while Russia's customs union partners Kazakhstan and Belarus, accounted for 7 %.

Growth in the value of goods imports slowed last year to below 3 % y-o-y with the level of imports reaching $344 billion. Chemical products and foodstuffs continued to drive import growth, even as imports of machinery, equipment and vehicles declined slightly. Looking at individual product categories, there was a drop of nearly 20 % in imports of passenger cars, while imports of milk more than doubled.

About half of imports still consisted of machinery, equipment and vehicles. Chemical products and foodstuffs were other major import categories. China continued to be Russia's top source of imports, accounting for 17 % of Russia's total imports last year. EU countries accounted for just over 40 % of imports to Russia, whereas the share of the customs union partners Belarus and Kazakhstan in Russian imports was 7 %.

Structure of Russian foreign trade in 2013, %



Source: Russian customs

Investment plans of Russian companies getting more meagre. Rosstat's annual investment survey finds that just 49 % of firms responding (compared to 56–60 % in the previous three years) are planning to increase their fixed capital investments this year. Companies planning to reduce their investments increased to 31 % from 23–26 % during the previous three years. The survey polled over 10,000 firms, including 6,400 large and mid-sized companies.

The investment plans of companies surveyed apparently reflect largely investment of privately held companies, suggesting that growth in private company investment could slow down a bit this year. Economy minister Alexei Ulyukayev reported investment of private firms increased by 7 % last year. However, state-owned enterprises account for a large share of capital investment in Russia. Ulyukayev noted that the 20 % cut in investment of state enterprises last year was the main reason the investment growth overall dropped to zero last year.

The survey found that the biggest factor limiting investment was again the lack of available out-of-pocket funds (nearly 60 % of firms). Other most commonly cited reasons for not investing were still the high cost of credit, risks associated with investment, uncertainty about the Russian economy (26–27 % of firms) and lack of demand for a company's products (just over 20 % of firms).

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

China's central bank drains liquidity to slow credit growth. Over two days this week, the People's Bank of China sold a total of $18 billion in 14-day forward repurchase contracts (repos) to sop up excess yuan liquidity in the money market. It was the first time in nearly eight months that the PBoC stepped in with repo sales to drain liquidity from the banking system. The key 7-day rate on the interbank market fell to 3.6 % at the end of the week.

January's rapid credit expansion, a drop in market rates after the Lunar New Year holidays and yuan weakening against the dollar in recent weeks are all behind the PBoC response. China's central bank is increasingly concerned about the indebtedness of Chinese firms and local administrations. Thus, despite moderate inflationary pressures, the central bank is not pleased with recent financial market developments. Consumer price inflation remained at 2.5 % in January and producer prices continued their nearly two-year slide, falling to 1.6 %.

From the standpoint of monetary policy and reform policy it was interesting that growth in traditional bank deposits appears to have slowed substantially. Growth in the deposit stock slowed from 14 % y-o-y in December to 11 % in January. Growth in bank lending, however, continued to grow at a 14 % pace. Even if the quality of the figures is suspect, the overarching reason for the reduction in deposits (beyond seasonal factors) may be that private individuals and companies alike seek forms of investment in the shadow banking sector that pay better yields than traditional bank deposits. Online companies offering investment opportunities have seen a rapid growth in their popularity.

The situation concerning China's monetary and macroprudential policies remain quite byzantine and intractable, which is why China's monetary policymakers may be more and more eager to move ahead with liberalisation of deposit interest rates and let the market play a greater role in determining the yuan's exchange rate. The changes would provide Chinese policymakers with more effective interest-rate policy. The economic conditions for making the shift could hardly be more favourable than now.

Profits of Chinese banks continue to soar. The China Banking Regulatory Commission (CBRC) reports banking sector profits increased last year by about 15 % to 1.4 trillion yuan (€170 billion or the equivalent of 2.5 % of GDP). While the rate of rising profitability has slowed from year to year, it remains impressive. Banks make most of their profits from providing basic banking services, i.e. they make money on the spread between what they pay out for deposition and what they charge for loans. Although China ended regulation of lending interest rates last summer, interest-rate margins of banks have remained roughly unchanged. China still tightly regulates deposit interest rates, which diminishes competition between banks.

It has been expected that the amount of non-performing loans on the books of commercial banks could take off as projects financed with money from the massive 2009–2010 stimulus go belly up. While the stock of non-performing loans grew slightly last year, they remained at around 1 % of the entire loan stock. By many estimates, however, the actual stock of non-performing loans is far larger. The problem is that banks are reluctant to admit that loans are non-performing.

China's banking sector continues to be dominated by four largely state-owned banks: Industrial and Commercial Bank of China, China Construction Bank, Agricultural Bank of China and Bank of China. Together they hold slightly less than half of total assets of China's banking sector. Their share of the banking market has been shrinking lately, however, as a number of mid-sized Chinese banks have shown rapid growth. China's four large state banks rank among the world's 20 largest banks by just about any metric.

Investment in China's real estate sector accelerates. The National Bureau of Statistics reports that investment in real estate development last year totalled 8.6 trillion yuan (€1 trillion), or 20 % more than in 2012. Over half of investment took place in the eastern part of the country, but investment in the western part of the country has been rising faster. The importance of construction to the Chinese economy has steadily increased in recent years. Real estate development exceeded 15 % of GDP last year. It was under 10 % of GDP just five years ago.

Construction activity has picked up from a year ago. The volume of new residential floorspace was up 15 % y-o-y in December. China's building craze is largely driven by rising housing prices, which have been favourable for builders since late 2012. The NBS reports prices of new apartments in 70 of China's large and mid-size cities rose on average by 9 % last year. In the major metropolises, the rise in housing prices has been even steeper. Growth in the stock of housing loans accelerated to 20 % (up from 12 % in 2012), further fuelling demand. China still regulates the interest rates charged on housing loans to limit demand and prevent overheating of the housing market.

According to a Standard Chartered Bank survey released at the end of January, real estate companies expect the sector to remain in growth mode. Even so, the urge to build has declined from the last survey six months ago, a reflection of such factors as tighter financing conditions. Most of the companies responding to the survey said it had become harder to get bank loans in recent months, which could force companies, especially the smaller developers, to seek financing from the grey lending market. If construction companies turn to grey-market financing, it will increase their financing costs and make them less capable of weathering a period of flat or falling housing prices.

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
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