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# BOFIT Weekly

**9 • 28.2.2014**

# Russia

**Russian insurance markets enjoyed modest growth last year.** Total premium payments to Russian insurance companies increased 11 % in 2013, while claim disbursals were up 13 %. With inflation last year running at over 6 %, real growth was about half the nominal rates. Standard & Poor's Rating Services expects growth in Russia's property and casualty insurance markets continues to slow a bit this year.

Fastest revenue growth last year was seen in the life insurance, casualty insurance and voluntary-contribution pension plans. While these types of insurance are still fairly rare in Russia, they are expected to rise dramatically in coming years as the economy grows and the Russian insurance market gains sophistication.

The relative size of insurance markets in various countries can roughly be judged by the ratio of insurance premia paid relative to GDP. Russian insurance premia last year only amount to 1.4 % of GDP. The figure for most developed economies exceeds 4 %.

**Boom in car insurance claims spooks Russian insurers.** One reason for the increase in compensation payments was a Russian supreme court ruling from last July that extended consumer protection regulations to cover also insurance business. After the change, courts handling insurance claim disputes have in almost all cases decided in favour of the client. Before the change, the great majority of court decisions were in favour of the insurance company.

The biggest headaches are generated by mandatory traffic insurance; rates for such insurance are set administratively. Insurance companies have begged officials for relief.

The rising amount of claims paid out has caused many insurers to limit or cease offering mandatory traffic insurance. The companies are also using various tricks to increase their premium income or escape claims. Certain insurance companies have begun to demand that their car insurance clients also purchase at least one other insurance policy such as life insurance. The Federal Antimonopoly Service (FAS) disapproves of this business approach and is looking into it. Insurers are also trying to duck insurance claims by locating their collision claims inspection offices in remote locations that are difficult to reach. The FAS has sought to correct the situation by proposing that all traffic insurance providers accept claims and inspections even if they come from people that bought their mandatory traffic insurance from a different insurer.

Vladimir Tchistyuhin, deputy head of the Financial Market Service of the Central Bank of Russia that supervises insurance markets, says the problems now facing insurance companies are due in part to the fact that the companies themselves continue to violate the rights of insurance buyers, fail to pay claims and use unclear contract language in their insurance documents. The FAS has decided to deal with this by establishing a consumer protection unit.

**Ukraine stares into the financial abyss.** The current political upheaval and uncertainty cast a shadow over Ukraine's short-to-mid-term economic prospects. The Ukrainian hryvnia has lost around 30 % of its value against the dollar this year and hit all-time lows. The central bank has imposed limits on capital movements.

The National Bank of Ukraine held foreign currency and gold reserves worth $17.8 billion as of end-January. The sum is only enough to cover just over two months of imports. The internationally recommended minimum is enough money to cover at least three months of imports. Ukraine's financial situation has become even more desperate as the government has to this year pay a total of $8.2 billion on principal and debt servicing of foreign loans and domestic forex loans.

The IMF reports that Ukraine's total public sector deficit last year amounted to around $10.5 billion, or 7.7 % of GDP. A substantial part of the deficit was generated by subsidies paid to Ukraine's state gas monopoly Naftogaz. The subsidies hold down rates paid by households and industrial enterprises.

The IMF and EU have promised bridge loans to help Ukraine get through its current financial distress. The main condition for such lending, however, is that Ukraine installs a functional government with whom it is possible to agree on preconditions for the financing. The IMF prematurely suspended Ukraine's access to its credit facilities at the end of 2012, when Ukraine failed to comply with borrowing conditions such as ending gas-sector subsidies.

Russia says that Ukraine's $15 billion loan package announced in December will remain on ice until the country installs a new government. Russia already disbursed to Ukraine $3 billion in December and had planned to pay out the remaining $12 billion by the end of this year.

**Servicing of Ukraine government foreign debt and domestic forex bonds, US$ million**

| | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 |
|---|---|---|---|---|---|---|
| **Principal** | 7,069 | 5,378 | 7,131 | 2,837 | 4,222 | 532 |
| Bilateral loans | 190 | 103 | 111 | 111 | 423 | 13 |
| Multilateral loans | 5,879 | 4,276 | 2,056 | 476 | 499 | 519 |
| Other | 0 | 0 | 696 | 1,000 | 0 | 0 |
| Foreign bonds | 1,000 | 1,000 | 4,268 | 1,250 | 3,300 | 0 |
| **Interest** | 1,513 | 1,338 | 1,259 | 1,137 | 1,030 | 736 |
| **Total** | **8,582** | **6,716** | **8,390** | **3,974** | **5,252** | **1,268** |
| Domestic forex loans | 2,100 | 1,500 | 1,500 | 1,400 | 0 | 0 |

*Sources: National Bank of Ukraine, Ukraine finance ministry, Fitch Ratings*

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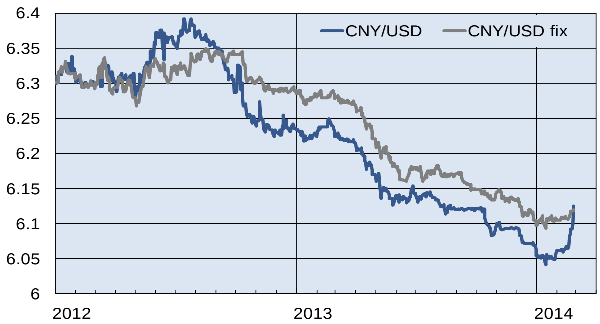
# China

**Yuan decline may signal move to wider trading band.** The drop in the external value of the yuan against the US dollar in late January and early this month caught the market off guard. Most actors were expecting the yuan to continue its slow but steady rise. Even with increased uncertainty in China's financial markets, the depreciation of the yuan is striking in light of January data that show a rising foreign trade surplus and increased capital imports. By most accounts, there should have been little downward pressure on the yuan. Indeed, market interest rates had been falling in China in recent weeks, the opposite of what would be expected from a market shaken by increased uncertainty.

Indeed, many observers speculate that the yuan's decline has been engineered by China's central bank to disabuse market participants of their slavish reliance on yuan appreciation. Before this week, the yuan's market exchange rate had been stronger than the daily parity rate (fixing) for nearly 18 months, knocking frequently the border of a fairly tight 1 % trading band. The central bank has long indicated its plans to widen the band and allow greater exchange-rate volatility. In this respect, recent events are omens of an impending widening of the trading band, which was last broadened in April 2012 from 0.5 % to 1.0 %.

**Dollar-yuan exchange rate and PBoC fixing rate**




*Source: Macrobond*

**China makes it easier to start a business.** The government just announced it is eliminating the minimum capital requirement for new firms altogether. The change makes it easier to set up a new business in China.

The minimum capital requirement before the change depended on the type of business. For example, the minimum capitalisation for joint stock companies was 5 million yuan (€620,000). The reforms do not apply to 27 financial sector branches.

China also phases out annual mandatory inspections of all firms and instead allows them to submit their annual reports online. Officials then perform spot audits to determine how businesses are performing.

The changes are part of the reform package announced by the Central Committee last autumn, which aims to create a more business-friendly environment that encourages entrepreneurship and economic dynamism. The rise of privately held firms should also motivate state-owned enterprises to step up their game if they want to stay competitive. State-owned enterprises still hold the upper hand as they enjoy for example access to substantially cheaper financing.

The number of firms operating in China has exploded. In 2012, the number grew by 1 million to 8.3 million firms. There was a notable uptick in formation in of privately held corporations, which now account for 80 % of all firms in China. However, it's hard to distinguish between private and public firms as many private firms are closely involved with the public sector.

**Investors' risks realizing in China's shadow banking sector.** The discussion of financing arrangements outside the formal banking system has dominated the headlines in Chinese business media for the past two months. In January, an over-indebted coal company defaulted on its trust loan. Trust companies collect funds from private individuals and firms via commercial banks and lend the money forwards as trust-loans. In this case, the losses of investors were covered by an unknown third party. It is highly likely that the government was involved in the last minute arrangement. The episode has raised a profound discussion on moral hazard and the realization of risks of investor liabilities in the shadow banking sector. Investors have so far avoided significant losses on trust-products. This has lead to insufficient risk assessment and degraded market discipline due to investor reliance on the notion that a third party like a bank or public official will provide a bail out.

Recently, a second heavily debt-burdened coal company went insolvent after it failed to make its payments on trust products coming due on February 8. Investors of Jilin Trust, which manages the loan to the coal company, could face losses if officials decide to take a hard line. Ultimately, these investor losses will be settled later after the company restructuring later on. It would mark the first case where investors absorb significant losses on their trust investments. Credit losses in the shadow banking sector are likely to rise in any case as solvency ratios have decayed rapidly in recent months, especially in industrial sectors suffering from overcapacity. A record amount of loans issued by the shadow banking sector are slated to mature this year.

The proportion of trust products in China's total credit stock has risen rapidly. Banks use trust products to circumvent lending quotas, and investors snap them up because they offer better returns than bank deposit rates. The total stock of trust products increased 46 % last year and now represents about a quarter of all new credit issues. Trust products have become an important financial vehicle for private firms that lack access to bank credits.

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