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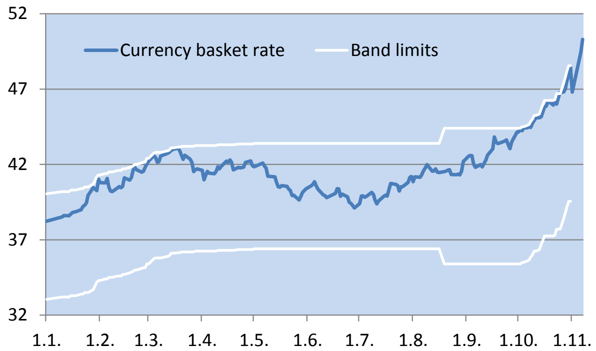
Russia

Ruble hits record low – free float approaches. Since the start of September, the ruble has weakened about 15 % against its dollar-euro currency basket. The Central Bank of Russia again returned to the currency markets last month to smooth the ruble's slide, burning through nearly $30 billion in its foreign currency reserves. By month's end, CBR currency reserves stood at $428 billion. Even if Russia's foreign currency reserves are still prodigious by international standards, the last time they were so low was in autumn 2009.

Apparently reacting to the rising market uncertainty in recent days, the CBR unexpectedly imposed an upper limit on daily market interventions of $350 million (there was no ceiling earlier). With the change, the ruble's exchange rate can at times exceed its fluctuation band limits. In practical terms, much of the functional significance of the band has been lost. The change is seen as a major step towards a free-floating ruble. The CBR has gradually liberalised the ruble regime during recent years, and the transition should be finalised at the start of 2015.

Ruble-currency basket rates and trading band limits, (Jan. 1–Nov. 7, 2014)



Source: CBR

CBR raises key rate. On Wednesday (Nov. 5), the CBR hiked its key rate 1.5 percentage points to 9.5 %. The central bank said the move was needed as a response to higher inflation and rising inflation expectations, which are affected in particular by ruble weakness and the ban on food imports. Ruble weakness, for its part, is mainly due to lower crude oil prices and economic sanctions. The boost in the key rate is also seen as part of efforts to slow ruble devaluation.

Consumer prices were up 8.3 % y-o-y in October. Food prices rose 11.5 % and non-food goods 5.7 %. The CBR expects 12-month inflation to stay above 8 % at least in the first months of 2015. The CBR said lower economic growth has so far not decelerated inflation as the growth slowdown is due to structural factors such as capacity constraints.

While the hike in the key rate was not unexpected, its size surprised most observers. The move is generally considered appropriate in fighting inflation and securing financial sector stability amidst the current uncertainty. The rate hike, however, will also likely depress Russia's prospects for economic growth.

Ukraine and Russia work out deal on winter gas supplies. At EU-sponsored talks last week, Russia and Ukraine reached agreement on natural gas supplies for the next five months. Gas supplies had been interrupted since last June. Moving ahead, Gazprom will transmit only prepaid gas to Ukraine's state gas company Naftogaz. The gas price of approximately $480 per 1,000 cubic meters is based on a 2009 agreement. With Russia's export duty discount included, Naftogaz will pay about $380/1,000 m^3. Even with the duty reduction, Ukraine will still pay a somewhat higher price than e.g. the average price Germany pays on Russian gas imports.

Ukraine plans a 4-billion m^3 gas purchase for the rest of the year, which amounts to a prepayment of $1.2 billion. Naftogaz also committed to pay $3.1 billion by the end of the year to cover last winter's unpaid gas bills.

It has been left to a Stockholm arbitration court to hear complaints and cross-complaints of Naftogaz and Gazprom with regard to gas pricing, delivery conditions and Ukraine's unpaid gas bills.

Finnish exports to Russia continue to decline. The value of goods exports fell 13 % y-o-y in the January-August period on the ruble's severe weakening and weaker demand. Exports were down over 20 % y-o-y in August, reflecting partly Russia's imposition of import bans on certain foodstuffs. Finland's food exports to Russia fell to half of their last year's level as a result of the ban.

Finnish firms have gloomy expectations also on the near-term outlook for exports to Russia. A just-released Finnish-Russian Chamber of Commerce survey notes that export prospects have not been as weak since January 2009. Firms see political tension and the collapse of the ruble as the main problems for exports. An earlier survey of the Finland's Central Chamber of Commerce found that about 1 % of its member firms are subject to the EU export bans to Russia or the Russian import bans.

The numbers for Russian tourist visits to Finland have continued to slide in recent months. Both crossings at the Finnish-Russian border and overnight stays of Russian tourists in Finnish hotels and inns were down about 10 % from a year earlier. A survey by the Finnish Commerce Federation found the share of short day trips has increased this year in Russian tourism. Russians also spend less than previously on goods and services in Finland.

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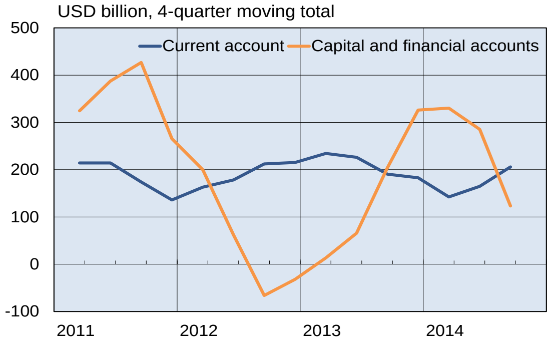
China

China posts increases in both current account surplus and financial account deficit. Preliminary balance-of-payments figures show China's current account surplus continued to rise in the third quarter of 2014. The September current account surplus was $82 billion ($40 billion in September 2013). The cumulative current account surplus for the first nine months of this year was $162 billion, up 17 % from the same period in 2013. The four-quarter moving surplus was $206 billion, or 2 % of GDP. A record goods trade surplus (driven in part by falling import prices) boosted the current account surplus. Signs of waning export demand emerged in late October with the release of the latest manufacturing purchasing manager index (PMI). The data is not yet reflected in balance-of-payments figures, however.

The combined capital account and financial account total, an indicator of capital transfers and investment of the current account surplus abroad, turned negative in the second quarter of this year. The third quarter deficit was $82 billion. The shift over the past twelve months has been quite dramatic; last year in the same period the combined capital and financial account surplus was about $81 billion. Capital inflows to China continued to diminish in the third quarter, while capital exports increased as the current account surplus was invested abroad. The capital account deficit since the start of 2014 amounted to $4 billion. The last time China was a net capital exporter was in 2012.

Current, capital and financial account balances



Source: CEIC

China to allow competition in payment card market. The Chinese government last week announced that domestic and foreign firms that meet authorities' requirements can open their own clearing companies for processing card transactions in China. As the Chinese UnionPay is the only provider of yuan-denominated transaction clearing for bank- and credit-card payments at the moment, foreign card companies have to rely on UnionPay for clearing yuan transactions. Details about qualification criteria for card-clearing operators or a timetable for the rollout of the competitive arrangement have yet to be released. Two years ago, the World Trade Organization (WTO) found that China discriminated against foreign payment card companies by granting UnionPay a monopoly on clearing yuan payment card transactions.

Card-based payments are on the rise in China. The People's Bank of China reports UnionPay last year processed over 15 billion card-based transactions. In 2013, card-based payments rose 48 % y-o-y to over 32 trillion yuan (€3.8 trillion). The number of bank and credit cards in use has doubled over the past four years. A total of 4.5 billion cards has been issued.

China's shadow banking sector grows rapidly. The annual Global Shadow Banking Monitoring Report 2014 of the Financial Stability Board (FSB) ranked China's shadow banking sector as the world's third largest at the end of 2013, with a size of $2.7 trillion. The United States had the largest shadow banking sector ($14 trillion), followed by the United Kingdom ($4.7 trillion). According to the report, Russia's shadow banking sector, like its financial sector overall, was relatively tiny ($80 billion). The FSB shadow banking asset comparison considered 23 jurisdictions.

China's shadow banking sector grew 38 % in 2013, only outpaced by Argentina in the FSB comparison. Many observers find the rapid growth of China's shadow credit industry disconcerting. Growth in the US was 1 %, while the sector contracted in the UK. Shadow banking overall increased 2 % globally last year.

The report also examines development of a wider concept that covers all financing outside the regular banking system (excluding insurance companies, pension funds and public financial institutions). The extent of these forms of financing reflects financial market sophistication and the variety of investment instruments available. The rapid rise of the wider non-bank credit intermediation in e.g. China is worrisome as it could outpace the ability of financial supervision authorities and regulatory framework to keep up.

China accounted last year for 4 % ($3 trillion) of the $75 trillion in non-bank credit intermediation in the G20 and euro area as a whole. Relative to its economy, China's non-bank financing was modest, just 31 % of GDP (survey average 120 % of GDP). However, the growth of non-bank financial assets for China has been quite rapid. Growth last year was 34 %, far surpassing the 7 % average of the countries surveyed.

Assets relating to the non-bank credit intermediation represented 9 % of China's entire financial sector assets at the end of 2013. In comparison, the average ratio in the FSB report was significantly higher, 25 %. Banks hold 72 % of financial assets in China, compared to the survey average of 46 %. Insurance and pension assets in China represented just 4 % of financial assets. The survey average was 18 %.

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