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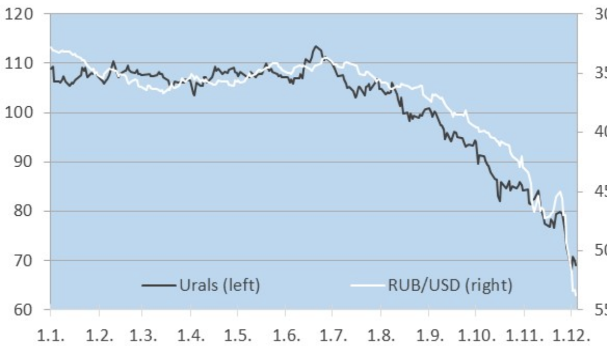
Russia

CBR intervenes in currency markets as ruble's slide hastens. The ruble's slide accelerated this week with the sharp drop in world oil prices. The trend has been affected also by recent cuts in economic growth forecasts of ministries. In just eight days, the ruble lost about 14 % of its value against the euro and dollar. As of December 5, the dollar-ruble rate was 52.7 and the euro-ruble rate 64.8.

Price of Urals crude (USD/ barrel) and dollar-ruble exchange rate, Jan.1–Dec. 4, 2014 (decline indicates ruble weakening)



Source: Thomson Reuters

The CBR spent $700 million of its reserves during its December 2 intervention, explaining the ruble's exchange rate had diverged substantially from an exchange rate justified by Russia's economic fundamentals. The central bank noted that the plunging exchange rate and its large fluctuations increase the risks of degrading the stability of the banking sector and reinforcing inflation expectations. Yesterday (Dec. 4), the CBR lowered its interest rate on forex repo credits to increase liquidity on the forex market.

The CBR last intervened in the market to support the ruble on November 10, after which it announced the ruble would be allowed to float freely. It reserved the right to intervene to support the ruble in extreme circumstances.

Russia approves duty on retail trade facilities. As of July 2015, changes in the tax code will enter into force in three "federal level" cities (Moscow, St. Petersburg and Sevastopol on the Crimea), allowing them to apply a new trade duty (*torgovyi nalog*) to retailers. Other Russian regions would eventually also be able to apply the trade duty with further changes in the tax code.

Revenues from the trade duty go directly to municipal budgets and municipal officials have a certain degree of flexibility in setting the amount of the duty. The duty is based on shop floorspace. For example, Moscow retailer with floorspace of over 50 square meters would pay a trade duty of 1,200 rubles (about €20) per square meter per year.

Given resistance to hikes in value-added tax rate during next year's budget preparations this autumn, the plan was to introduce a municipal sales tax on all goods. The tax was intended to boost revenue of municipalities struggling with budget deficits. After municipal sales tax found little support, a "business" tax was proposed instead. The business tax would have applied to over 20 categories of service-sector activities and all Russian municipalities could impose the tax.

The business tax bill encountered vigorous opposition when it was published last month without discussions with the business community. During its November reading in the Duma, the business tax was whittled down to the more modest trade duty. President Putin said the trade duty was needed because many large retail chains in Moscow pay no taxes at all. Large Moscow retail chains quickly disputed the president's claim.

According to officials, the trade duty would affect only companies evading taxes, since the trade duty can be deducted from other taxes paid by the retailer.

Russia's ban on food imports causing friction among customs union partners. Russia's Federal Service for Veterinary and Phytosanitary Surveillance (Rosselkhoznadzor) claims that banned products are continuously being brought into Russia through Belarus. A common ruse is to disguise cargo as transit freight headed for Kazakhstan. As there are no customs inspections on the internal borders of the Russia-Belarus-Kazakhstan customs union, movement of goods is difficult to monitor within the union. To prevent illegal imports, Rosselkhoznadzor announced at the end of November that all transit freight coming from Belarus would be inspected at the Russian border – a rule that violates customs union principles. Despite the announcement, customs union members are aiming at deepening economic integration at the start of next year, when the customs union will become the Eurasian Economic Union.

Still in August, Russia planned to substitute many of the items covered under the food import ban with products from Belarus. For example, the customs union doubled Belarus' quota for meats imported from outside the customs union in order to assure an adequate supply of raw material for preparation of meat products destined for the Russian market. Rosselkhoznadzor has, however, in past months reported a number of veterinary and phytosanitary rule violations in Belarus meat products and other foods. In response, the agency imposed temporary import restrictions on numerous Belarus food exporters at the end of November. Belarus president Alexander Lukashenko strongly criticised Russia's actions.

Rosselkhoznadzor head Sergei Dankvert says even more rigorous food security inspections lie ahead, noting that even if the August ban on food imports is lifted, food imports will still be subject to greater scrutiny. Officials are currently drafting new rules forbidding public-sector entities from purchasing food items prepared outside the customs union. The new regulations are to be introduced at the start of 2015.

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

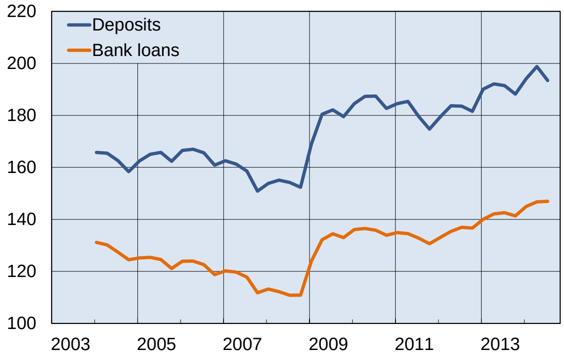
Rollout of deposit insurance scheme proceeds in China. The People's Bank of China has released a draft of its proposed deposit insurance scheme, saying it expects initial comments on the plan by the end of the year. The PBoC said the deposit insurance scheme could be in place as early as next year. The current proposal calls for fully insuring all deposit accounts up to 500,000 yuan (about €65,000). The current deposit insurance coverage in the EU, for example, has been €100,000 per deposit account since 2010.

Deposit insurance is an important stabilising factor for financial markets as interbank competition is increased through deregulation of deposit interest rates and the lifting of capital controls. The PBoC last month raised the ceiling on bank deposit interest rates to allow more flexible interest rate pricing. Commercial banks can now offer higher deposit rates relative to the PBoC's reference rate. The introduction of a deposit insurance scheme would also permit ending interest rate regulation altogether.

If a bank becomes insolvent, its depositors would be reimbursed from a fund to be built up from insurance contributions collected from financial institutions. China has never had a deposit insurance scheme, but the state has in practice guaranteed deposits by preventing bank collapses and providing capital infusions to stave off bank runs. Deposit insurance would also balance out competition in the banking sector and in principle allow failed banks to go bankrupt.

The PBoC reports the proposed ceiling of 500,000 yuan per account would cover over 99 % of individual deposit accounts and about half of total deposits in Chinese banks under the proposed deposit insurance scheme. China's deposit stock is one of the world's largest. At the end of October, the deposit stock was about 112 trillion yuan (about €14 trillion), about half of which was household deposits. Chinese deposits are also substantial – nearly 200 % of GDP.

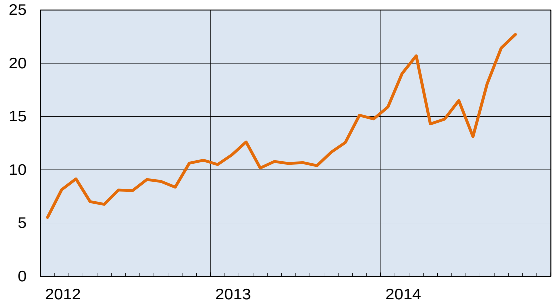
Bank deposits and loans, % of GDP (4-quarter moving total)



Sources: CEIC, Macrobond

Yuan use continues to increase in Chinese foreign trade. In October, 23 % of Chinese foreign trade payments were denominated in yuan, a sharp increase from just 5 % in 2012. And the yuan's importance in international payments continues to rise. SWIFT, an organisation to promote secure international financial messaging services, reports the yuan was the world's seventh most-used currency in international payments in September with a 1.7 % share.

Share of yuan payments in China's goods trade, %



Source: Macrobond

China has signed bilateral currency swap agreements and established yuan clearing banks to make it easier to conduct business in yuan. Currency swap deals have already been signed with nearly 30 countries. The PBoC increasingly sets the yuan exchange rate directly for many currencies. Direct currency exchange of the yuan and Singapore dollar was introduced at the end of October, and direct dealing in yuan and the South Korean won began this week. The yuan-euro exchange rate has been set directly since September. The significance of direct currency trade, however, is marginal at least as concerns the smallest countries due to low volumes.

China last month announced the establishment of a number of new clearing banks around the world. The PBoC has designated two state banks as yuan clearing banks: ICBC for Toronto and Doha, and the Bank of China for Sydney and Kuala Lumpur. The ICBC has also set up a yuan-clearing bank in Los Angeles. Clearing banks are also important in the development of yuan-denominated financial instruments. The linking of the Hong Kong and Shanghai stock exchanges should also somewhat increase demand for yuan and yuan-based financial instruments.

China seeks to increase the use of the yuan as a reserve currency in order to facilitate borrowing from international financial markets. The PBoC reports that the yuan is currently the world's seventh largest reserve currency. The British government, for example, issued a loan of 3 billion yuan (€390 million) in yuan-denominated bonds in October in order to add yuan in its currency reserves. The yuan's significance as a reserve currency is still, however, minor. Most of the world's currency reserves are in dollars and euros. If yen and British pound are included, the four currencies make up 93 % of the international currency reserves.

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