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# BOFIT Weekly
5 • 30.1.2015

# Russia

**Standard & Poor's downgrades Russia's creditworthiness to speculative grade.** On Monday (Jan. 26), Standard & Poor's lowered Russian sovereign foreign currency borrowing to BB+, a notch below investor grade. Speculative-grade bonds are evaluated to have higher risk. S&P based the downgrade on e.g. Russia's deteriorating growth outlook, reduced possibilities for monetary policy to react to developments, as well as increased risks to the external balance and government finances. Russia's creditworthiness is now on par with Bulgaria, Indonesia and Turkey.

Fitch and Moody's, the two other big international ratings agencies, also lowered their ratings of Russia this month, but both still keep Russia barely in the investment-grade realm. All ratings agencies hold negative outlooks for the Russian economy.

The downgrade came as no big surprise to the markets. On the following day, the ruble weakened only slightly and Russian stock indices were roughly unchanged. The reduction in the credit rating complicates the availability of credit and raises borrowing costs, although the Russian government has no plans at the moment to increase its foreign debt. The borrowing of Russian firms from abroad has largely dried up already because access to credit has been limited due to factors such as increased uncertainty and economic sanctions.

**Foreign debt of Russian banks and companies shrank last year, repayments ahead.** The largest drop in foreign debt occurred in the second half of the year, and at year's end the debt stood at $548 billion, or slightly less than 30 % of GDP.

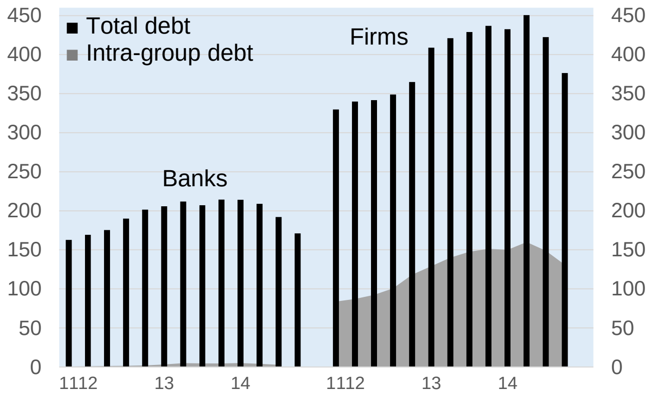
*Bank* foreign debt was reduced over the course of the year by $43 billion and stood at $171 billion at the end of the year. Most of the reduction came from paying down existing debt mainly in the second half of the year, due to the limited access of banks to foreign credit (caused e.g. by financial sanctions). The ruble's slide also notably reduced the size of bank debt as reported in dollars because about 15 % of the debt was actually denominated in rubles.

*Corporate* foreign debt declined last year by $60 billion to $376 billion. Most of the contraction came from the drop of the ruble, since about a quarter of corporate foreign debt was denominated in rubles. Moreover, unlike banks, about a third of corporate debt consists of debt within corporate groups, i.e. loans from foreign parent corporations or subsidiaries to Russian subsidiaries and parent companies. Many corporate groups have postponed payments on such debt. Other debt was repaid by Russian firms in rather moderate amounts last year, but there was an uptick in debt repayment in the second half.

According to the latest published information on payment maturities of debt owed by Russian banks and firms (situation at the beginning of October 2014), they face foreign debt repayment obligations in 2015 on principal totalling $108 billion and interest payments of $20 billion. Banks must pay down debt of $37 billion and firms $71 billion, of which payments not related to intra-group debt amount to $48 billion.

Given the scarcity of refinancing opportunities of banks and firms, certain firms burdened with foreign debt last year sought and were granted financing from government funds and the CBR. It looks for now that repayment of debt under these circumstances also this year will not have to be financed fully out of state coffers, as banks and firms have assets abroad that act as a source. For example, the short-term deposits of banks and firms abroad were about $120 billion at the beginning of last October.

**Foreign debt of Russian banks and firms, end of quarter (31 Dec. 2011 – 31 Dec. 2014), USD billion**




*Source: Central Bank of Russia*

**Federal budget turned to slight deficit in 2014.** Budget revenues increased by 11 % last year. There was a bigger rise in revenues in these nominal terms during the final months of the year, reflecting the continued slide of the ruble, which boosted dollar-denominated oil tax revenues, and a backlog of other revenues. Federal budget expenditures also rose by 11 %. The budget deficit corresponded to 0.5 % of GDP.

Growth in federal budget spending would have stayed below 4 % and the budget would have been clearly in surplus (nearly 1 % of GDP) without the 1 trillion rubles in support granted to the deposit insurance agency in December. Needs have already risen for the agency to use the grant for supporting operational banks that meet the criteria for eligibility. Budget spending caused by the support measure was financed by giving the grant to the agency in the form of government bonds that the agency turns over to select banks. The banks, in turn, can use the bonds as collateral when securing credit from the central bank.

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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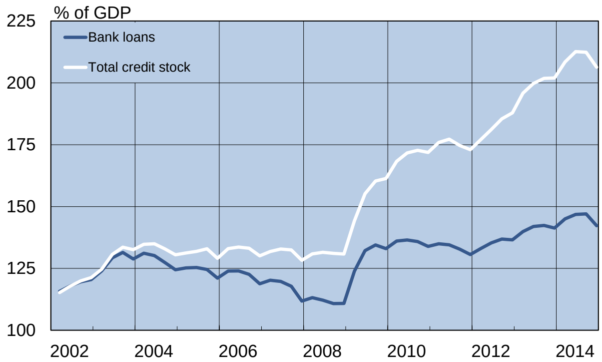
# China

**Growth of lending of China's shadow-banking sector still outpaces lending growth of formal banking sector.** The broad-stroke Chinese notion of lending, "social financing," covers formal bank lending as well as a variety of instruments used in the shadow banking sector, which has seen its role increasing in China's bank-centred credit system. Growth in the volume of formal bank lending last year slowed to below 13 % y-o-y, while the stock of informal financing instruments was up 18 % y-o-y at the end of 2014.

Nevertheless, growth in lending in the shadow-banking sector has actually slowed. Officials have managed to make headway in cracking down on growth of the most problematic shadow banking instruments, trust loans, through increased supervision. On-year growth in trust loans remained at 11 % in 4Q2014. However, while growth in the stock of entrusted loans has also declined, an inter-company loan in which banks act as intermediaries for a fee, the loan stock anyhow increased 30 % from December 2013.

Given the slowdown in bank lending growth, China's ratio of domestic debt to GDP began to fall towards the end of the year. The ratio of total credit (including non-government and non-financial debt) to GDP, however, still exceeds 200 %, which is remarkable for a lower middle-income country like China.

**Ratios of bank loans and credit to GDP for China, %**




*Sources: Macrobond, BOFIT*

**Yuan rises to fifth-most-used currency in international payments.** The international payments transfers network SWIFT reports that the Chinese yuan accounted for 2.2 % of the value of global payments in December. The yuan surpassed both the Australian dollar and the Canadian dollar to become the world's fifth-most-used currency in international payments. So, the yuan is closing in on the Japanese yen (2.7 % share). The US dollar continued to dominate international payment traffic at 44 %, followed by the euro at 28 %. The British pound accounted for almost 8 % of the value of transfers in December.

The Russian ruble's ranking has long been dropping in the SWIFT Top 20 list of payments currencies. The ruble fell to 19th place in December, highlighting the trends of the Russian and Chinese currencies in recent years. In January 2012, the yuan ranked 20th in the SWIFT Top 20, while the ruble stood at 14th place.

**Profits of Chinese industry showed record drop in December.** Profits of large industrial firms fell 8 % y-o-y in December. On-year profit margins have been shrinking since October. While profits still rose for the year whole, profit growth in 2014 amounted to only about 3 %, down from about 12 % in 2013.

While declines in prices of oil and other commodities helped boost the profit margins of some Chinese producers, prices of the end products of many industrial firms have fallen sharply. Thus, the overall impact of lower commodity prices has been negative for many industries. Profitability also varies considerably across sectors. Hardest hit have been producers of basic commodities (e.g. mining, as well as oil and fuel production). At the same time, producers in such branches as machine-building and automobile manufacture, along with companies generating electric power and heating, have seen profits rise on lower input prices.

**Pensions reformed and wages increased in Chinese public sector.** The major reform of public sector pensions announced in January aims at unifying the pension schemes of public sector employees and workers in other sectors. Chinese public sector workers earlier were exempted from making pension contributions, while other workers had to pay 8 % of their wages to pension funds. Public sector contributions were paid out of the state budget.

The *Financial Times* reports that pensions of public sector employees are about 80–90 % of their wage income. Pensions in other sectors are typically about half of the wage. The decades-old double standard in the pension scheme was widely viewed as unfair and favouring state employees. The pension reform calls for a mandatory 8 % contribution from the wages of public sector workers. Public sector pensions will also be brought closer into line with the pension schemes of other workers by reducing the pension size relative to earned wages of future public sector retirees.

Along with the pension reform, officials announced substantial wage hikes for public sector workers. The increases affect China's approximately 40 million public sector workers, as well as some 15 million retired civil servants. Wages of public sector employees were last reviewed in 2006. The new plan is to review public sector wage levels roughly every two years. The wage hikes are not only sufficient to cover the extra costs of the pension reform, but will increase the net wages of state workers. The move is intended to reduce the temptation of civil servants to take bribes and stimulate consumer spending.

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