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BOFIT Weekly

6 • 6.2.2015

Russia

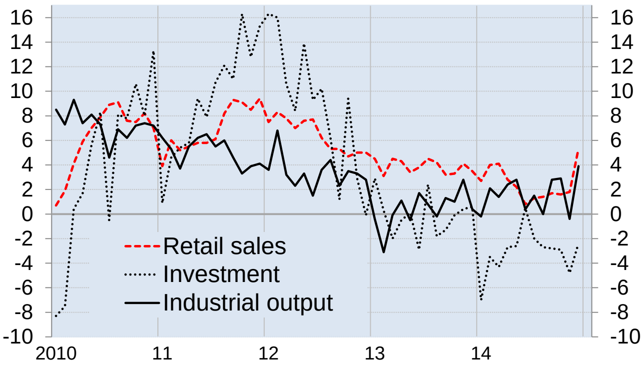
Russian GDP grew by just 0.6 % last year. 2014 saw a marked slowdown in the pace of economic growth last year from 1.3 % in 2013. Private consumer spending was the main factor supporting growth, but also the contraction in imports boosted the growth contribution of net exports.

Private consumption increased more slowly than in 2013 with a growth rate of 1.9 %. Real disposable income of households shrank last year for the first time since 1999, falling by about 1 %. Fixed capital investment also contracted last year by 2.5 %. In 2013, investment still managed to post meagre positive growth.

Russian output shows transient spike in December. Industrial output growth accelerated in December, particularly in a couple of manufacturing branches. Some experts suggest that the acceleration largely reflected the ruble's depreciation, which drove substitution of imports with domestic products. Mineral extraction sector output continued to show fairly good growth, and was up about 3 % y-o-y.

The volume of retail sales rose sharply in December. Consumers rushed to buy durable goods in response to the ruble's weakening in an effort to stave of their loss of ruble purchasing power. In the fourth quarter of 2014, real disposable incomes of households fell 3.5 % y-o-y.

Change in domestic demand and industrial output, % y/y



Source: Rosstat

CBR surprises with 2 p.p. cut in key rate. The key rate was lowered to 15 % starting from Monday (Feb 2). The Central Bank of Russia said the rate cut was possible because its 6.5-percentage-point increase of the key rate in December to 17 % has already calmed to some extent inflation expectations and devaluation expectations. The CBR views that the pick-up in inflation at the end of last year is temporary and largely a reflection of the ruble's decline.

The CBR noted that inflation may accelerate further in the months ahead until the economy has adjusted to the new external environment. After that weak demand should slacken the inflation rate. Data for January showed an on-year rise in consumer prices of as much as 15 %, up from 11.4 % in December. The CBR expects inflation to be back below 10 % in January 2016.

The CBR also motivated the rate cut by the weak economic development which needs support. It noted a lower key rate should improve corporate borrowing, which is one of the aims in the government's new support programme.

The rate cut caught most observers by surprise. Some see lower rates as a welcome form of stimulus although doubting whether a two-percentage-point reduction can have much impact. Others have viewed the preceding hike of the rate as a sign of primarily shifting back towards the old monetary policy focus of stabilising the ruble's exchange rate.

Russian government approves economic support programme. The aims of the programme adopted last week include stabilising Russia's economic conditions, supporting import substitution as well as improving diversification of the structure of Russian exports. Special emphasis is made on securing the activities of core branches and companies, supporting the banking sector and protecting social entitlements. The programme includes financial support and measures aiming to reduce bureaucracy and regulatory burdens. Many Russian economic experts have, however, criticised the programme for failing to address properly Russia's fundamental need for structural economic reforms and measures for restoring growth.

Total programme costs this year are estimated to exceed 1.3 trillion rubles (€17 billion), of which just over 200 billion rubles are designated as government guarantees. Half of the actual support funding should come out of the federal budget and half out of the National Welfare Fund.

Up to 550 billion rubles will come from the National Welfare Fund, or about 10 % of the fund's present value. The money will be used to recapitalise banks and provide more funding for the VEB development bank to boost lending. Banks receiving capital infusions, in turn, must forward the funds for the financing of major infrastructure projects.

Some 450 billion rubles in federal budget spending will go to social programmes and transfers to regional budgets, while 100 billion rubles will go to support various industrial branches. Most of the support is slated for agriculture, farm machinery and the car industry. The details and timing of budget funding have yet to be decided.

The programme does not abandon previously announced budget spending cuts and hence the support measures should be financed by cutting and making other spending more effective. The economy ministry would like to see the support measures implemented as fast as possible, while the finance ministry favours a more patient approach. According to media reports, initial agreement was reached on support measures worth just over 20 billion rubles to be implemented in the first quarter of this year.

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China

China's central bank lowers reserve requirement. The People's Bank of China cut the reserve requirement ratio for commercial banks on Thursday (Feb. 5). The ratio, which determines the amount of deposits a bank must hold in reserves in the central bank, was lowered by half a percentage point. Certain small banks specialised in lending to farms and small businesses, or financing water management projects, were entitled to a one-percentage-point cut. The PBoC also announced that the reserve requirement ratio for the state-owned Agricultural Development Bank of China would go down 4.5 percentage points. After the cut, the benchmark reserve ratios of the PBoC are 19.5 % for large banks, 17.5 % for small and mid-sized banks and 16 % for rural banks. The reserve requirement ratio for individual banks can vary.

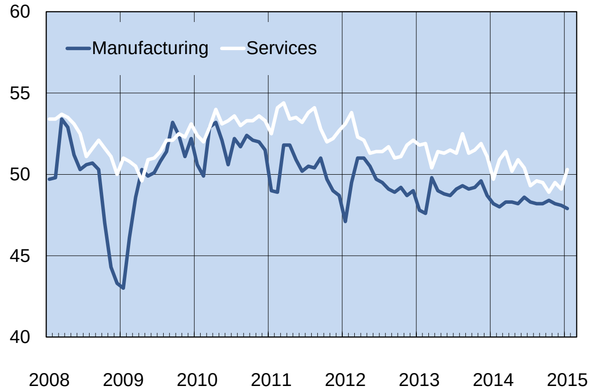
The last time the reserve requirement ratio was lowered was in spring 2012. Because monetary policy in China is not yet implemented through interest-rate policy as in the developed world, the ratio is still considered a key instrument of monetary policy. China's central bank has kept the reserve requirement ratio relatively high by world standards on concerns that easing monetary policy could e.g. result in overheating of stock markets or add to China's debt problems. Another reason for large reserve requirements is China's lack of a comprehensive deposit insurance scheme. The PBoC is currently drafting guidelines for the rollout of a new deposit insurance scheme, however.

China's economy continued to slow in January according to purchasing manager indexes. The latest reading of the official index of manufacturing purchasing managers (PMI) compiled by China's National Bureau of Statistics fell to 49.8 in January. The alternative PMI reading produced by HSBC uses a greater weighting for small, privately owned firms. It dipped below the 50-point level already in December, and stayed there in January. Of the key sub-indices of the NBS manufacturing PMI, Employment Index (manufacturing jobs) and New Order Index (export orders) post readings below 50 in January. The Employment Index hit 47.9, its lowest reading since the beginning of 2013.

A PMI reading below the "neutral" level of 50 points in theory should be reflected in seasonally adjusted output data that show a drop from the previous month. In practice, however, the correlation between industrial output and PMI readings is somewhat messier. The NBS figure for on-month changes in industrial output has been relatively strong even when PMI readings have been under 50. In any case, the ongoing slowdown in growth of industrial output remains clear. NBS figures for actual production in January-February will not be available until March.

Service sector growth, in contrast, appears quite resilient, even if growth has slowed a bit. The services PMI value was 53.7 in January. Even if growth in labour demand in the service sector also appeared to come to a halt in the second half of 2014, demand appeared to recover at least briefly in January.

Employment Index for Manufacturing and Services PMIs



Source: Macrobond

China's current account surplus grew slightly last year. The goods trade surplus ballooned last year, driven in particular by lower world commodity prices that made imports cheaper. Even so, the soaring services trade deficit meant that the current account surplus only grew slightly. The explosion of Chinese tourism was the single largest factor driving the rising services trade deficit. Chinese tourists last year spent $165 billion abroad, or nearly 25 % more than in 2013. The size of current account surplus relative to GDP rose from 1.9 % in 2013 to 2.1 % last year.

There was a distinct shift in capital flows last year from 2013. Preliminary figures show that China experienced a net outflow of capital in 2014, and that the outflow accelerated in the fourth quarter.

The value of China's gold and foreign currency reserves increased last year by $118 billion to around $4 trillion.

Balance-of-payments highlights for China, USD billion

	2011	2012	2013	2014
Current account	136	215	183	214
Goods trade balance	244	322	360	472
Services trade balance	-62	-90	-125	-198
Other	-46	-17	-52	-60
Capital and financial accounts	266	-32	326	-96*
Net errors and omissions	-14	-87	-78	-
Change in currency reserves	388	96	431	118

** Includes errors and omissions.*

Sources: SAFE, Macrobond

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