EUROJÄRJESTELMÄ
EUROSYSTEMET

BOFIT Weekly

8 • 20.2.2015

Russia

Russian inflation soars. January consumer prices rose 15 % y-o-y. Inflation last ran this high in 2008. Food prices were up 21 % and other goods 11 %. The Russian government, concerned about the rapid inflation, has adopted numerous measures to deal with the situation. The Federal Anti-Monopoly Service and regional officials have been tasked with monitoring price trends and taking steps to rein in inflation. Their opportunities for trimming inflation are limited, however, as the biggest drivers of inflation are outside their scope of influence. For example, the economy ministry notes that of last year's 11.5 % inflation, over 4 percentage points came from the ruble's decline and over 1 percentage point from the ban on food imports.

The latest economy ministry forecast shows that the biggest impacts of banning food imports are only becoming apparent this year. It predicts the rise in food prices will accelerate in the first half of the year. About a quarter of the overall inflation will come from the ban on food imports.

Although Russian law only allows price controls for northern regions, officials in other regions have given guidelines to sellers and producers, and even regulations on the pricing of basic foodstuffs. Sellers and producers are committed e.g. to limiting profit margins or price increases. Some large retail chains have gone so far as to temporarily freeze their prices of basic goods.

Officials are also concerned about the sharp rise in prices of medicines. Prime minister Dmitri Medvedev warned last week that medicine prices could rise as much as 20 % this year. Health ministry price monitoring found that in January regulated prices of life-saving medicines were up 4 % and other drugs 15 %. The ministry is encouraging regional officials to be on the lookout for price gouging. Recently, the government expanded the list of medicines whose prices are regulated and is currently preparing a decree on regulating prices of medical equipment. Russia still imports a large share of its pharmaceuticals.

Oil companies have complained to the government about substantial hikes in pipeline prices, which have been driven up by prices in the domestic metal industry. Export earnings of the metal industry in ruble terms have risen with the collapse of the ruble, which has made the industry to increase its exports and hike domestic prices. Trade and industry minister Denis Manturov last week called on the metal industry to change its pricing policies. If this doesn't happen, he said, the government would have to impose heavy duties on metal exports and even "resort to other measures."

The government has imposed an export duty on wheat since the start of this month. The minimum duty is €35 per metric ton, and remains in force until the end of June. The limits on exports are seen as a way to lower the rapid rise in domestic prices and boost supply. Before imposing the export duty, wheat exports were limited by informal methods such as slowing the processing times of quality certifications and reducing rail transport. Grain exporters have complained to the government about the practices.

Russia to dip into its sovereign funds. At the end of January, Russia's sovereign funds amounted to $160 billion. Tax revenues from oil and gas have been accumulated to the funds since 2003. While the government largely stayed out of its funds last year, this year it is planning to draw on them more actively to support the economy.

Prime minister Medvedev last week signed a decree permitting the use of up to 500 billion rubles from the Reserve Fund to cover this year's budget deficit. The Reserve Fund was established indeed to cover budget deficits during economic downturns. As of end-January, the Reserve Fund stood at 5.9 trillion rubles ($85 billion). The money is invested in liquid foreign-currency-denominated assets, and is included in Russia's foreign currency reserves.

The government's support program approved earlier this year should get funding up to 550 billion rubles this year out of Russia's second major sovereign savings fund, the National Welfare Fund. The money will be used to capitalise banks, which will then redirect the money to finance large infrastructure projects and provide credit to firms. The National Welfare Fund was initially established to meet future pension obligations. The Fund was, however, used to support the economy already in the 2009 financial crisis.

The National Welfare Fund held assets worth 5.1 trillion rubles ($74 billion) at the end of January. Most of the Fund is kept by the CBR and is also counted as part of Russia's foreign currency reserves. About a quarter of the Fund's assets have been allocated in various forms to domestic banks for lending forward to companies. There has been huge demand for this money in recent months, as banks and firms actively pursue government grants and support.

Although the assets of the two funds are mainly in the form of foreign currency held by the central bank, the foreign currency reserve does not automatically shrink if the finance ministry withdraws money. The finance ministry uses the foreign currency for buying rubles from the CBR, and thus the value of the CBR's foreign currency reserve remains unchanged.§

Allocation of National Welfare Fund assets, 31 Jan. 2015

Form in which asset is held	US$ billion
Deposits with CBR	56.3
Deposits with state development bank VEB	9.1
Preferred bank shares (VTB, Rosselkhozbank, Gazprombank)	4.0
Ukrainian sovereign bonds	3.0
Deposits with VTB for infrastructure projects	1.5
Securities to fund infrastructure projects	0.1
Total	***74.0***

Source: Russian finance ministry

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
*The information is compiled and edited from a variety of sources.
The Bank of Finland assumes no responsibility for the completeness or accuracy of the information, and opinions expressed do not necessarily reflect the views of the Bank of Finland.*

EUROJÄRJESTELMÄ
EUROSYSTEMET

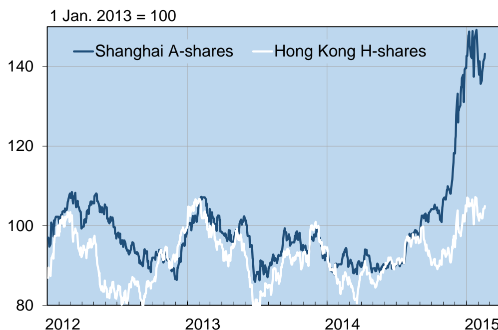
BOFIT Weekly
8 • 20.2.2015

China

Prices for shares listed in Shanghai higher than in Hong Kong. The sharp rise in prices on the Shanghai stock exchange at the end of last year has moderated. At the close on Tuesday (Feb. 17), the Shanghai Composite Index stood at the same level as on December 31. On Wednesday, Chinese exchanges began the week-long Lunar New Year hiatus.

Shares listed on the Shanghai exchange have risen rapidly, creating a situation whereby the same share in Shanghai is more expensive than in Hong Kong. The value of A-shares of Chinese firms listed in Shanghai has risen over 40 % since last September, while the rise in H-shares of Hong Kong's China Enterprise Index are up less than 10 %. The price-to-earning ratio (P/E), an indicator of share priciness, is now about 16 for Shanghai A-shares, but below 9 for Chinese companies listed on the Hong Kong exchange. In January, the shares of the same big firms listed on both the Shanghai and Hong Kong exchanges were on average 26 % pricier in Shanghai. Up to last autumn, Hong Kong-listed shares tended to carry a premium.

Shanghai A-share and Hong Kong H-share indexes



Source: Macrobond

The stock connect experiment launched last November on the Shanghai and Hong Kong stock exchanges offers investors (in theory, at least) equal access to both markets, so one would expect diminished price differences and fewer arbitrage opportunities. Trading in Shanghai-listed shares via the Hong Kong exchange has not been entirely seamless, however, and Chinese firms are still relatively unknown to foreign investors. Only 35 % of the 300-billion-yuan (USD 50 bln.) quota for foreign investors on the Shanghai exchange has been used, and foreign investors have on average accounted for less than 2 % of the Shanghai exchange's daily trading volume. The rapid rise in Shanghai share prices has largely been driven by the increased interest in share trading of private Chinese individuals. Only Chinese investors with large investment funds are permitted to invest in Chinese shares via the Hong Kong exchange, and just 10 % of the 250 billion yuan quota has been used.

Prices on mainland China's number-two exchange, the Shenzhen stock exchange, continued to rise in the first weeks of this year, and now are up about 15 % from the end of last year. There are also plans for a partial opening of the Shenzhen stock exchange to foreign investors via the Hong Kong exchange. Shenzhen has listed numerous growth firms, while large state-owned enterprises dominate the Shanghai exchange. This is also apparent in share pricing: the average P/E ratio of Shenzhen A-shares is 37.

Capital controls liberalisation continues in Shanghai free trade zone. The People's Bank of China has given firms and banks in the Shanghai Free Trade Zone (SFTZ) permission to seek funding from abroad without the need for a prior permission from the central bank or being subject to rules on loan length or currency. Additionally, the ceiling on foreign financing has been raised. At current interest rates, a foreign loan is cheaper now than a domestic loan. However, under the old rules, companies in the SFTZ tended to borrow very little from abroad, even if Chinese firms have generally been eager to get foreign financing. The new rules continue to limit the use of this financing channel.

The first full year of operation for the SFTZ, which was established in autumn 2013, has been disappointing for most firms. Deregulation of capital movements is still in midstream; use of the yuan in international transactions other than foreign trade is still forbidden and the deregulation of interest rates for yuan deposits has not proceeded as planned. Nevertheless, the SFTZ has seen reforms that make it easier for firms to deal with the rest of the world. At the end of January, the government agreed to extend certain eased restrictions in the SFTZ to the rest of the country. Their impacts will be limited, however.

Three new Shanghai-style free trade zones (Guangdong, Fujian and Tianjin) were approved last December. These new zones will also facilitate business between mainland China and the rest of the world. The new free trade zones should be operational next month, bringing new competitiveness and dynamism to China's reform policies and opening up to the world.

China's New Silk Road Fund opens for business. This week saw the official launch of a fund to finance projects of China's "New Silk Road" initiative. The initial capitalisation of the fund is about $40 billion. The funds come from China's foreign currency reserves, key policy funds and the China Investment Corporation, Export-Import Bank of China and China Development Bank.

The purpose of the fund is to provide financing and financial services for projects that support China's plans to build a "new silk road" between Southeast Asia and Europe for trade on both land and sea. China hopes this mega-project increases cooperation among the countries in the Silk Road belt, boosts Chinese FDI outflows and promotes international use of the yuan.

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
The information is compiled and edited from a variety of sources.
The Bank of Finland assumes no responsibility for the completeness or accuracy of the information, and opinions expressed do not necessarily reflect the views of the Bank of Finland.