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Russia

Private demand down sharply in Russia. Following December's shopping spree sparked by the ruble's fall, the volume of seasonally adjusted retail sales fell three months in a row. Thus, first-quarter retail sales were down nearly 7 % from 1Q14, due in part to another shopping spree in February and March 2014. Food and non-food goods sales both contracted by virtually the same amount in 1Q15.

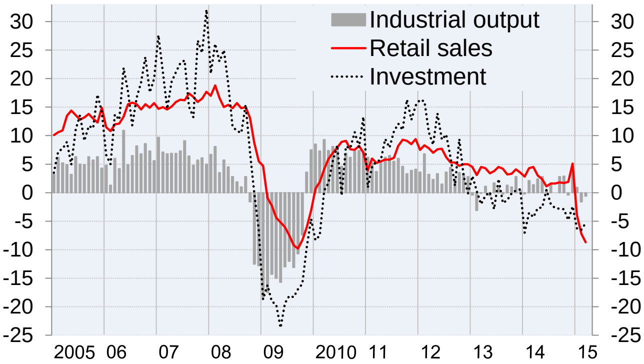
Although nominal wages were up 6.5 % y-o-y in the first quarter, Russia's nearly 17 % inflation rate meant that real wages had declined more than 8 % since 1Q14. The February 1 pension hike that increased February pensions to over 13 % y-o-y in nominal terms moderated the drop in real household incomes.

Fixed capital investment has been sliding down for about two years now. The rate of decline increased in 1Q15, when investment was down 6 % y-o-y. The corresponding change in the construction sector was -5 % y-o-y.

Industrial output in the first quarter was down only about 0.5 % y-o-y. Higher production of coal, oil and metallic ores increased output of mineral extraction industries to over 0.5 % y-o-y in the first quarter. Exports of oil and petroleum products were also up.

Manufacturing output in the first three months of the year was down about 1.5 % from a year earlier. In addition to continuous growth in oil refining, production of certain other basic commodities increased notably. Part of this growth may be due to the weak ruble. For food production, Russian countersanctions and other import restrictions are also likely having an effect. In any case, the contribution of the ruble is fading as the ruble's real exchange rate rebounded strongly in the past three months on high inflation in Russia and the rise in the ruble's nominal exchange rate. On the other hand, domestic industries should get considerable support from defence spending, which was up over 50 % y-o-y in the first quarter.

Change in core indicators of domestic demand and industrial output, % y-o-y



Source: Rosstat

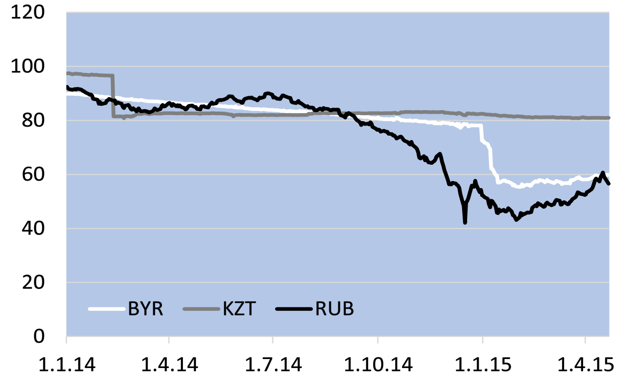
Import disputes in the Eurasian Economic Union. Kazakhstan announced last week that it would pull certain Russian food items off the shelves as they failed to comply with Kazakhstan's food safety regulations. Soon thereafter, Russia's Federal Service for Veterinary and Phytosanitary Surveillance responded by similar measures for some Kazakhstan dairy products. Several Belarusian meat producers have faced import bans from Russia since late last year for similar reasons and Belarus imposed corresponding restrictions to some Russian foodstuffs. In addition, Russia has inspected food shipments entering the country from Belarus to prevent abuse of EEU privileges to circumvent Russian bans on European food products.

In early March, Kazakhstan imposed a 45-day import ban on Russian petroleum products. As Kazakh imports are subject to an annual import quota of duty-free petroleum products from Russia, Kazakhstan officials said the ban was needed to rebalance fluctuations in demand. They noted that, without the break, the rapid growth in imports would have caused the entire year's quota to be filled too early. For January-February, the volume of exports of Russian oil products to Kazakhstan increased nearly 70 % y-o-y.

The ruble's collapse late last year increased other EEU members' imports from Russia. This raised discussion in Kazakhstan on whether to impose a temporary ban on imports of certain Russian products. Belarus president Alexander Lukashenko has also been unsatisfied on the effects of the ruble's collapse and demanded e.g. increasing the role of US dollars and euro in trade with Russia. Additional dissatisfaction in Belarus has arisen from changes in Russian oil taxation at the start of this year that have reduced the benefits of bilateral oil trade for Belarus.

While cooperation among EEU members is not always smooth, president Putin envisions nevertheless deeper cooperation. At the EEU meeting last month, Putin suggested it was timely to start exploring the possibility of adopting a common EEU currency. The EEU should also expand in May with Kyrgyzstan's accession.

Dollar rates for Russian ruble, Belarus ruble and Kazakhstan tenge, (100 = 1 Jan. 2013)



Source: Macrobond

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China

China offers stimulus by lowering bank reserve requirements. On Monday (Apr. 20), the People’s Bank of China lowered the reserve requirement ratio (RRR) by a full percentage point. The RRR requirements of large banks fell to 18.5 % and to 15–16.5 % for other credit institutions. The PBoC has begun to apply the reserve requirement ratio as a targeted policy tool, granting reduced RRRs to certain banks (e.g. those focused on serving small businesses and farm lending). The RRR can even be bank-specific. RRR represents the amount of a bank’s deposits held by the central bank. A higher RRR reduces the bank’s ability to lend.

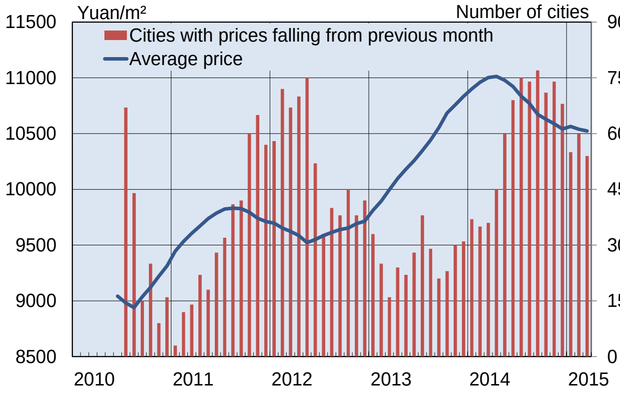
In the absence of a functional interest-rate system, the RRR is the central bank’s primary instrument for regulating bank lending. Prior to 2015, the RRR had been unchanged for nearly three years, but this year it has been lowered twice for a total of 1.5 percentage points. The PBoC over the last six months has also twice lowered reference rates for loans and deposits. The PBoC also has lowered interest rates to banks on short-term (reverse repo) credits, with the result that short-term rates on the interbank market fell substantially in March. The PBoC has also granted banks short- and medium-term credit through other financing vehicles (SLF, MLF).

With the roles of various monetary instruments and their impacts unclear, China’s current monetary policy is hard to discern. The country is shifting, however, to interest-rate-based monetary policy. A prerequisite is the upcoming rollout of a deposit insurance scheme. The facts that banks will need to pay deposit insurance premiums and follow interest-rate-based monetary policy may also justify lower RRRs.

Chinese real estate markets remain shaky. SouFun, a private company that gathers information about real estate markets in China, reports that housing prices overall continued to slide last month. Average apartment prices were about 4 % lower in March than a year earlier, when prices hit their peak. The price slide has appeared to be stabilising. Still, of the 98 cities SouFun tracks, 54 saw price declines in March.

Rules on housing investment were relaxed in March to support housing sales. Now apartments bought more than two years prior to sale are exempt from sales profit tax, instead of at least five years prior to sell as before. Further, the required downpayment for a second apartment was lowered from 60–70 % to 40 % for second apartment buyers still subject to a mortgage on their first apartment. Since autumn, any buyer who has paid off the existing mortgage on their apartment can purchase a second apartment on the same terms as a first apartment buyer. The downpayment for first apartment buyers is 30 %. The impacts of the measures remain unclear at this point. Many builders and city governments have already found ways to circumvent the tightened rules of 2010.

Average apartment price and number of tracked cities where prices fell from previous month



Sources: SouFun, Macrobond

Real estate developer Kaisa defaults on bond payments. Kaisa Group Holdings Ltd. this week failed to make interest payments on two separate dollar bonds. It was the first time a Chinese real estate developer defaulted on debt owed to foreign creditors.

As the underlying causes of Kaisa’s problems remain unclear, the episode has clearly eroded the credibility of companies operating in the real estate sector and other branches suffering from overcapacity. Given that access to new credit will become more difficult to these companies and China’s slowing economic growth, Kaisa is unlikely to be the last company in trouble.

China suspends implementation of bank cyber-security requirements. The US and China have quarrelled over China’s intended measures related to net security and terrorism. China’s new regulation proposal called for e.g. requiring IT-system suppliers in certain branches to retain data on Chinese citizens on servers located in China. Moreover, companies would have had to grant officials access to secret information. The rules implied banks should start favouring domestic suppliers in future IT procurements.

Recent information suggests the planned regulations will not be applied to Chinese banks as such. Large US tech firms considered the proposed regulations less of a data security issue than a trade policy strategy meant to bolster the competitive advantage of Chinese firms. Establishing and maintaining local server clusters would be very expensive for foreign firms. Chinese banks have themselves expressed concern that rules limiting them to domestic data security firms would weaken their existing data security technology significantly.

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