BOFIT Weekly
19 • 8.5.2015

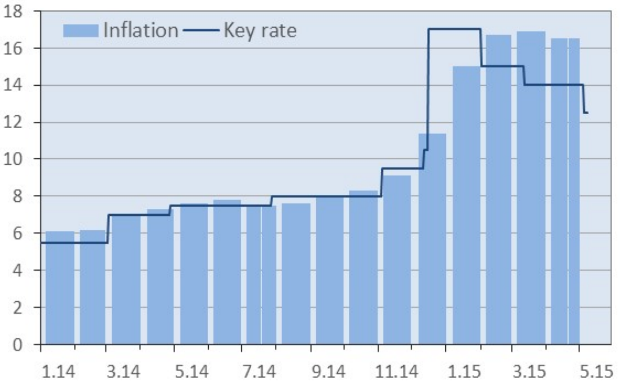
Russia

CBR lowers key rate. Effective Tuesday (May 5), the Central Bank of Russia lowered its key interest rate by 1.5 percentage points to 12.5 %. It was the third rate cut this year. The central bank said the move reflected lower inflation and a continuing weak outlook for growth.

The CBR said it now expects inflation to cool faster than it had predicted earlier this year due to the ruble's recent exchange rate rebound and a sharp decline in consumer spending caused by the drop in real incomes.

In April, the rate of inflation was 16.4 %, down slightly from March. The CBR expects that inflation will fall to 8 % by April 2016 and reach the target level of 4 % in 2017.

Inflation and CBR's key rate, %, 1.1.2014–8.5.2015



Sources: Rosstat and CBR

The CBR also noted that interest rates generally have fallen a bit since its previous key rate cuts in January and March. Even so, the central bank conceded that interest rates remain relatively high. While the situation is favourable for attracting ruble deposits, it slows the expansion of credit needed to promote economic development.

Russia launches its own national card payment system. Russia moved ahead with its own card payment system after Visa and MasterCard blocked payment processing for US-sanctioned Russian banks amidst the Ukraine crisis in March 2014.

To avoid interference with domestic payment transactions, the Duma amended the law on payment systems to require that all card transactions taking place in Russia be processed in Russia's national processing system. After that, Russia began to erect the physical system needed for the processing of card transactions. Credit card companies had until end-March this year to migrate to the new system.

Visa and MasterCard, which account for 95 % of Russian card payments, are currently migrating their payment processing operations to the Russian system. They were prompted to move on rapidly with the transfer, as according to the law, a credit card company processing its transactions outside Russia will have to deposit such a large collateral guarantee with the CBR that it would make its operations in Russia unprofitable.

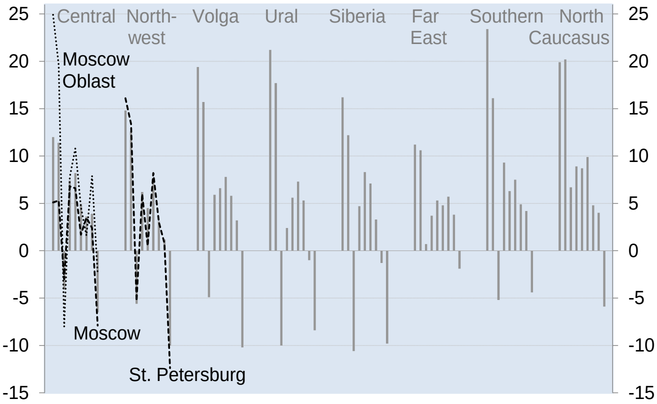
Russian officials say the next step in the creation of the national payment card system is the issue of a Russian credit card by the end of this year. The long-term goal is to gain international circulation for the Russian credit card.

Consumers under major strain in Russian regions, industries struggle. Russia has experienced a nationwide slump in private consumption. In the first quarter of this year, the volume of *retail sales*, a focal indicator of consumer purchasing power, showed on-year declines in all eight of Russia's federal districts. Decreases were almost as large or larger than in the crisis year 2009.

Retail sales last year shrank in 15 of Russia's 83 administrative regions. Conditions have continued to degrade this year. In the first quarter of 2015, retail sales fell on-year in 73 regions, with drops greater than 10 % registered in 18 regions. The biggest drops were registered in Murmansk Oblast, the Republic of Tatarstan and Novosibirsk Oblast.

The slight first-quarter decrease in *industrial output* was not distributed evenly across Russia. Output fell most sharply in the Central Federal District, where the drop in output was 10 % y-o-y. The district includes the Moscow Oblast, which saw a drop of 23 %, the City of Moscow (down 15 %) and the Kaluga Oblast (down 7 %), famous for its car-manufacturing cluster. The biggest output drop in the Northwestern Federal District was seen in St. Petersburg (down over 7 %). In all other federal districts, output was essentially unchanged.

Change in retail sales volumes in federal districts and Russia's biggest cities, % y-o-y, 2007–1Q2015



Source: Rosstat

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China

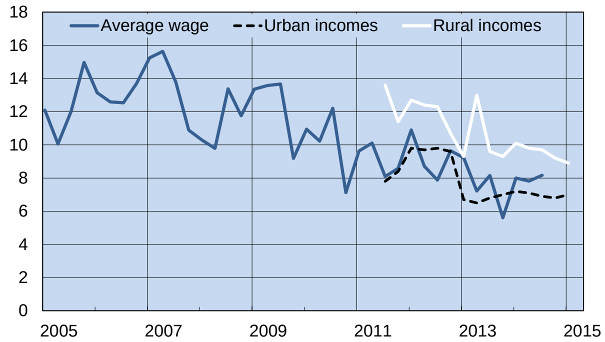
Chinese wage growth remains robust. Even with the overall slowdown in Chinese economy, wage growth has slowed only modestly. Factors supporting real wage growth, in addition to economic growth itself, include China's shrinking labour supply and low inflation.

The latest official figures show the average monthly wage in the third quarter of 2014 was 4,460 yuan (€550 at the time or €640 at the current exchange rate). The average nominal wage showed a gain of 10 % y-o-y and the real wage 8 %. Nevertheless, differences across sectors and provinces are large. Average wages in Beijing and Shanghai were 80 % higher than the national average. Wage levels were below average in most interior provinces.

A second wage divide can be seen between the countryside and cities. The latest China Household Finance Survey found that the average monthly wage in rural areas was less than 1,100 yuan (€160) in January-March, while the average wage in urban areas exceeded 2,850 yuan (€400). The National Bureau of Statistics put the average monthly wage of China's more than 160 million internal migrant workers at around 3,000 yuan (€430) for the first quarter.

In dollar terms, Chinese labour costs are perhaps already on par with Malaysia and Thailand, and several times higher than in their poorer Asian counterparts. The growth of China's domestic markets and the shift of production to cheaper interior provinces still attract production investment to China, but labour-intensive export industries are now looking elsewhere.

Real growth in average wages and disposable incomes, %



Sources: Macrobond, BOFIT

Policy changes to support China's labour markets. The government said late last month that it would seek to ease labour market conditions through measures such as tax breaks and access to preferential loans for businesses, as well as reduced red tape in setting up a business. The tax breaks are aimed at companies that employ job-seekers who have been unemployed for half a year or more and migrant workers returning to their home districts to start a business.

Figures released last week showed lower growth in job creation in urban areas. First-quarter job growth was the weakest since 2009. The number of new jobs created was 3.24 million, a decrease of nearly 6 % y-o-y.

Huge regional differences could also be seen in the employment situation. In China's eastern provinces, the number of open jobs and applicants decreased by roughly the same extent. In the central parts of the country, the number of open jobs fell faster than the number of people seeking work. For all of China, the number of open jobs was down 16 % y-o-y in January-March, but the number of people seeking work was also down 15 %. As a result, the official unemployment rate in urban areas showed virtually no change, standing at 4.05 % as of end-March.

China's official published unemployment rate continues to hover in the range of 4.0–4.3 % as it has for the past decade. The figure understates the actual unemployment situation. Chinese officials themselves rely on a classified indicator that gives a more realistic description of the unemployment rate. Observers note, however, that while the unpublished indicator puts unemployment about a percentage point higher, it too does not seem to have fluctuated much over the past decade. The government support measures may indicate softening of the labour markets. Officials point out that supporting employment is a fundamental goal for economic policy. As long as the employment situation remains relatively good, officials seem willing to show greater flexibility in setting growth targets. Indeed, China needs to focus more on actual trends in prices and employment than meeting specific GDP growth targets.

China ends export duties on rare-earth metals. At the beginning of May, export duties were abolished for 17 metals classed as rare-earth elements (REEs), as well as tungsten and molybdenum. The move is expected to have little impact on global prices, however, as the loss of duty revenue is to be offset by a resource tax of 7–27 %, based on metal sale price. In addition, export duties on certain aluminium products were abolished. China's aluminium industry has long struggled with overcapacity issues.

China abolished REE export quotas in January. The quotas were reduced in 2010 that had caused REE prices to spike globally. The WTO last year condemned the quotas as a rule violation. China is not involved in any similar major trade disputes at the moment.

China used export quotas and taxes to protect its domestic processing industry. Officially the quotas are claimed to reflect the environmental impacts of producing REEs. The government has sought to reduce overcapacity in the REE industry by consolidating production into six large firms and shutting down illegal mining operations. The latest measures are hoped to reduce widespread grey production and REE smuggling, while boosting profitability in the sector. China, with under 25 % of the world's REE reserves, accounts for over 80 % of the global production.

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