BOFIT Weekly
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Russia

Signs that Russian economy's decline may be stabilising. The on-month contraction in seasonally adjusted industrial output as well as a core part, i.e. manufacturing output, was smaller in June than in earlier months. The drop in output from June 2014, while still large, was also lower than in late spring. On the other hand, the on-year drop figure of June was moderated by the fact that there were more workdays last month than in June 2014.

The slide in manufacturing accelerated in spring. In addition to a cooling of the defence-spending boom, the deepening reflected e.g. the fact that the rate of growth in exports of certain basic commodities decelerated after a very strong start this year.

While other mineral extraction categories have shown growth, a large drop in natural gas output has depressed the overall extraction figure. Crude oil production has continued to climb on a strong increase in exports.

The fall in fixed capital investments eased slightly in June, but remained deep. The latter also concerns construction where earlier high growth in housing construction cooled in May and June.

Key output and demand figures for Russia, % change y-o-y

	2014	2015 Q1	April	May	June
Industrial output	1.7	-0.4	-4.5	-5.5	-4.8
- manufacturing	2.1	-1.6	-7.2	-8.3	-6.6
- mineral extraction	1.4	0.7	-0.8	-0.9	-0.9
- crude oil	0.8	1.2	1.2	1.3	1.6
- natural gas	-4.3	-6.2	-1.9	-9.1	-9.1
Construction	-4.5	-4.7	-5.2	-10.3	-10.0
Investments	-2.7	-3.6	-4.8	-7.6	-7.1
Transport, incl. pipelines	-0.1	-1.6	-1.3	-4.0	-3.4
Retail sales	2.7	-6.4	-9.6	-9.2	-9.4
- food	0.0	-6.4	-8.7	-8.8	-9.1
- non-food	5.1	-6.6	-10.4	-9.6	-9.7

Source: Rosstat

Consumption, real incomes and household borrowing in Russia remain down. The seasonally adjusted volume of retail sales in June still remained virtually unchanged and was thus down nearly one tenth from a year earlier. The gradual slowing in the inflation rate since last winter's price spike slightly helped restrain the drop in real household incomes. In addition, nominal wages, despite the recession, revived in both the private and public sectors. Even so, wages were up 6–7 % y-o-y in May-June, while consumer prices were still up 15–16 %.

While households have reined back consumption, their net borrowing has turned negative. Over the past 12 months, the stock of household loans granted by banks has not changed, i.e. households' loan repayments to banks have equalled their borrowing. Since the start of this year, however, household debt repayments have far outstripped borrowing – in fact to the extent that was seen during the 2009 recession.

Additionally, after the drop at the end of last year, household funds have flowed into banks so strongly that the flow of money from households to banks has exceeded the flow of money from banks to households in an exceptional manner. Households have been increasing their deposits to a remarkable degree by winding down their ruble and forex cash holdings.

Exports of Russian military technology hold steady. Russia's Federal Service for Military-Technical Cooperation (FSMTC) reports the value of military technology exports last year amounted to $15.5 billion, about the same as in the previous two years. The export order book also remained at the $50 billion level as in previous years.

The FSMTC reports that nearly half of Russia's exports of military technology consisted of aerospace technology, while about a quarter was made up of technology for use by ground forces. Russia's Federal Customs Service reports that $4.8 billion in weapons and ammunition was exported last year. Russia's largest export markets for military technology are in Asia (e.g. India and Vietnam).

Russia's total goods exports amounted to about $500 billion last year, of which military technology represented 3 % (or about 9 % of exports other than oil and gas). The share of military technology exports has remained roughly stable in recent years.

The industry and trade ministry says Russia's defence sector generates some 4 % of GDP and employs over 2 million people.

Exports of Russian military technology (USD billion); share of total goods exports (%)

Sources: FSMTC and Central Bank of Russia

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China

More liberal access for foreign investors to mainland China's financial markets. The People's Bank of China announced a rule change last week that eases access of certain foreign institutional investors to mainland interbank bond markets. All foreign investors earlier needed permission from the PBoC to invest in Chinese bonds. Now central banks, international financial institutions such as the World Bank, and state-owned investment funds may invest in mainland bond and repo markets without quotas or permits.

The interbank bond markets of mainland China have grown rapidly in recent years to nearly $6 trillion and now rank among the world's largest. At the moment, foreign bond holdings (mainly central banks) represent just a couple of per cent of the bond market. Foreign investors can freely invest in yuan-denominated Dim Sum bonds issued in Hong Kong, although the market is considerably smaller than the mainland bond market.

Yuan clearing banks and foreign banks participating in yuan-settlement operations have had the right to invest in the mainland interbank bond market since 2010. Last month, the PBoC also granted such banks access to mainland market for bond repurchase agreements (repos). Yuan assets raised from repo issues can also be repatriated outside China. The Singapore branch of the Industrial & Commercial Bank of China (ICBC), which has yuan-clearing status, last week became the first foreign institution to issue bond repos in mainland China. More than 100 banks located outside mainland China can now have access to domestic interbank bond and repo markets.

In addition, a new investment fund cooperation programme was launched at the start of July. It lets asset management firms in mainland China and Hong Kong sell shares of officially approved funds on each other's markets. The arrangement gives Chinese private investors the opportunity to invest in foreign mutual funds and the opportunity for Chinese mutual funds to sell their wares to international investors. The current investment quotas covered by the programme (both directions) are 300 billion yuan ($49 billion). About 850 mutual funds in mainland China and 100 funds in Hong Kong are eligible for the programme.

Foreign investors have been able to invest in certain Shanghai-listed shares via the Hong Kong stock exchange under the Stock Connect arrangement launched late last year. A similar linkage is planned for the Shenzhen and Hong Kong exchanges. Outside these programmes, foreign portfolio investment in mainland China has been limited to special programmes for qualified foreign institutional investors (QFII) and renminbi-qualified foreign institutional investors (RQFII). The granted investment quotas for both programmes have been raised sharply this year. The total quota under the QFII programme at the end of June stood at $76 billion (up 30 % y-o-y), while the quota for the RQFII programme reached 391 billion yuan ($64 billion), up 112 % from June 2014.

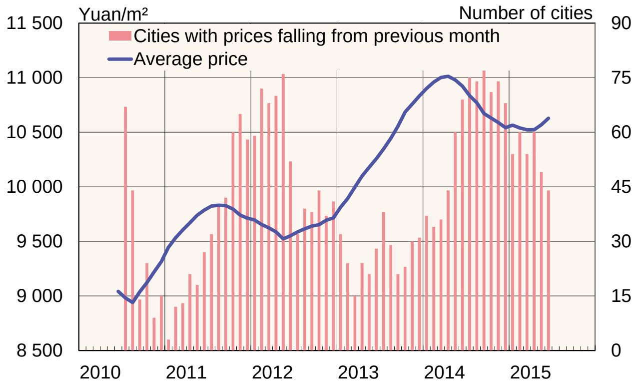
China's housing market shows signs of recovery. SouFun, a private real-estate information tracking service, reports average apartment prices showed a slight uptick overall in the second quarter. Apartment prices were still down 3 % y-o-y in June, however, and 3.5 % below their peak in April 2014. Two other major private real-estate tracking firms also detected a rise in average apartment prices in June.

SouFun noted price declines from the previous month in 44 of the 99 cities tracked, compared to last autumn when prices were down in three-fourths of the cities tracked. China Real Estate Information Corporation reports prices rose in about half of the 288 cities it monitors. China's National Bureau of Statistics also noted in its housing price survey of 70 cities that prices for new apartments were up in 27 cities in June (compared to 20 in May). Notably, rises were seen in the major metropolises such as Beijing, Shanghai and Guangzhou (each up 2 % in May), as well as Shenzhen (up 7 %). Still, prices continued to fall in almost half of the cities tracked by the NBS. Prices fell in smaller cities that, in particular, are suffering from an oversupply of apartments.

Officials last autumn sought to support the housing market by easing rules on purchasing of a second apartment. The PBoC has lowered its key rates this spring and summer, as well as reserve requirement ratios for banks. Certain local governments have also purchased unsold apartments and resold them to low-income households at discounted prices.

Growing uncertainty on stock markets could increase demand for the perceived relative safety of real estate investment. Indeed, a China Household Finance Survey conducted at the end of last month suggests households may be increasingly pulling out of the stock market and investing instead in an apartment.

Average housing prices and number of surveyed cities (99 city sample) where housing prices fell from previous month



Sources: SouFun, Macrobond

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