BOFIT Weekly
31 • 31.7.2015

Russia

Views of Russian authorities differ slightly on outlooks for the economy's recovery; oil prices and the ruble slide. Several official authorities in Russia last spring proclaimed the worst of Russia's economic contraction was over. Yet, prime minister Dmitri Medvedev last week stated that the Russian economy may return to growth only late this year or early next year. Economy minister Alexei Ulyukayev, on the other hand, repeated his ministry's earlier assessment that the economy was still on course to enter recovery in the third quarter of this year. The ministry now sees inflation moderating a bit faster than in its late spring forecast. This improves their outlook for real household incomes and private consumption.

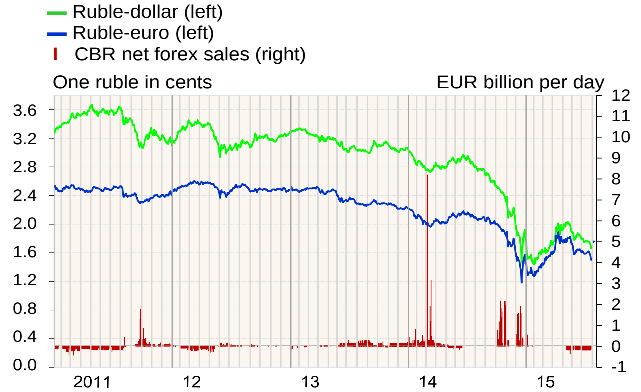
Alexei Kudrin, who served as finance minister from 2000 to 2011, expects the economic contraction to continue in the fourth quarter of this year, even if more slowly than until then, and growth to return in the first half of 2016. Kudrin noted that the drop in economic output accelerated in the second quarter of this year, adding that fixed capital investment continued to fall much.

Observers note that expectations of recovery have moderated as more recent figures on the deepening of the economic contraction have emerged. The economy ministry estimates GDP in the second quarter was 4.4 % lower than a year earlier, even if seasonally adjusted GDP only contracted slightly in June.

The oil price has also declined, after recovering from the plunge of the second half of 2014 to around $65 a barrel in early May. The latest slide sharpened at the end of June. This week the Urals price dipped below $55/bbl.

The drop in oil prices and financial uncertainty in China especially since mid-June have eroded exchange rates in other emerging economies as well as the ruble's exchange rate which this week was down about 15 % from end-May against both the euro and the dollar.

Ruble exchange rates and CBR forex sales on Russian market



Source: Central Bank of Russia

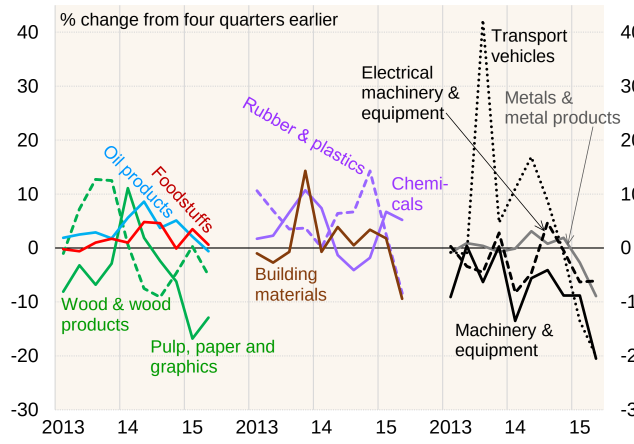
On Tuesday (July 28), the CBR, citing increased market volatility, suspended its daily forex buying on Russia's forex market. The CBR in mid-May initiated the buying policy in order to gradually rebuild the country's foreign currency reserves. From the standpoint of the ruble's exchange rate, the currency buying, usually $200 million a day, has had no decisive impact.

Output down in most manufacturing branches. In the second quarter of this year, manufacturing output was down over 7 % y-o-y, a distinct deepening from the start of the year. Lower fixed capital investment, in particular, has meant that falling production of machinery and equipment has now entered its third consecutive year. Production of transport vehicles has also plunged this year, following an earlier boom that observers attribute largely to higher defence spending, The industry and trade ministry reports that Russia's military-industrial complex output rose 10 % in 2013 and over 15 % in 2014. Production of metals and metal products has contracted considerably this year as well, despite increased metal exports.

Russia's building-materials industry, as well as the pulp and paper industry, was in a slump. Even the long-booming rubber and plastics industry has fallen.

Despite a sharp reduction in sales of domestic processed foods, food industry production has enjoyed mild growth this year as food imports have declined precipitously. Exports of oil products grew sharply in the first half of the year, but output growth came to a halt due to the domestic recession. Growth in the chemical industry recovered on higher exports this year. Moreover, output of "other chemical products" rose to a boom in the first half. Some observers say this could reflect an increase in the production of explosives (defence spending was up nearly 40 % y-o-y in the first half of 2015).

Output in major manufacturing branches



Source: Rosstat

Bank of Finland • Institute for Economies in Transition, BOFIT
P.O. Box 160, FI-00101 Helsinki
Phone: +358 10 831 2268 • Web: www.suomenpankki.fi/bofit_en

Editor-in-Chief Jouko Rautava • Email: Jouko.Rautava@bof.fi

BOFIT Weekly
31 • 31.7.2015

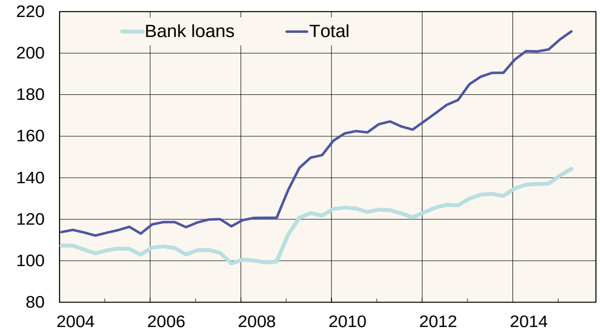
China

Increase in domestic indebtedness in China continues to outpace economic growth. Total social financing, the broader definition of the credit stock used by the People's Bank of China, was up 12 % y-o-y in 2Q15, while nominal GDP growth was 7.1 %. Even so, growth of the credit stock slowed from a year earlier, when it ran at nearly 17 %.

April-June figures also indicate the structure of China's credit stock is changing. On-year growth in the stock of bank loans remained at around 13 %, while growth of other financing formats was up just 11 %. Lending outside the formal banking sector has slowed significantly. Notably, growth in loans from trust firms fell below 2 % y-o-y.

Funds raised through share emissions are also included under the total social financing concept. The rise in share prices and new IPOs on China's stock exchanges helped fuel growth in the category in the first half. Assets raised through share emissions, however, represent just 5 % of the increase in China's total credit stock in 1H15.

Credit stock to GDP, percentage of GDP



Sources: Macrobond, BOFIT

China restricts peer-to-peer lenders offering loans to share purchases. The China Securities Regulatory Commission (CSRC) announced this month that it was banning share purchases financed through online loan-shopping services, so-called peer-to-peer (P2P) lenders. High-interest P2P services are considered high risk as they offer investors a quick way to go deep in debt. There are over 2,000 P2P services providers in China. They have traditionally provided financing to small firms, but recently have seen strong growth in providing money for buying shares on margin.

P2P services represent a tiny fraction of the informal credit financing of share purchases. Most of the money comes from various investment vehicles, including high-leverage umbrella trusts. Bank and investment firms, for example, have channelled funding to umbrella trusts via their wealth management products. Banks' direct stock investments in China are not permitted. While the scale of unofficial financing used for share buying is unknown, most estimates range between 1.7 and 3 trillion yuan (€250–440 billion), or 3–6 % of the value of stock markets.

Formal brokerage-provided margin financing at end-July amounted to 1.4 trillion yuan (about 3 % of total stock market capitalisation), down from the June peak of 2.3 trillion yuan. Debt finance through official channels is subject to more regulation and stringent conditions relative to informal financing. Investors have been able to borrow about twice the value of their own input in margin buys and investments are limited to certain shares. In January, the CSRC amplified the rules that brokers can only lend to well-heeled investors with at least 500,000 yuan of their own money to invest. On July 1, the CSRC reneged on the rule and borrowing conditions were eased as the government undertook to deal with the collapse in share prices.

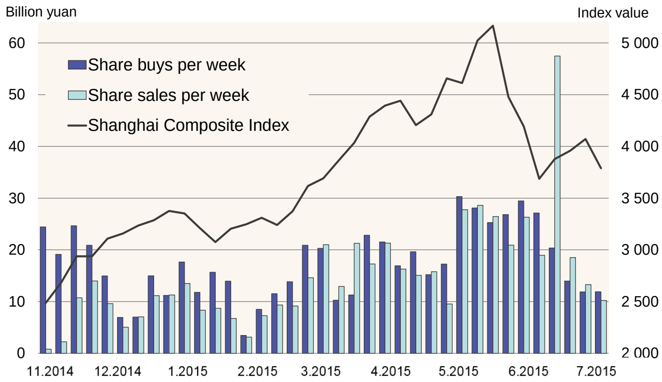
Markets stabilised this week after Monday's (July 27) plunge in Chinese share prices.

Foreign investors reduce their stock investments in mainland China. PBoC figures show yuan assets held by foreign investors in June were worth 4.42 trillion yuan (€645 billion), or about 10 billion yuan less than in May. The decline reflected decrease in stock holdings, which slid nearly 10 % from May. Of all foreign yuan investments in June, 14 % were share investments. Foreign investments in assets other than shares increased.

In recent weeks, the volume of share selling has outpaced buying under the Stock Connect arrangement (see chart below) that allows reciprocal access to trading on the Shanghai and Hong Kong stock exchanges. Share trades by foreign investors in the Stock Connect system in June-July accounted for roughly 1 % of the Shanghai exchange trading volume. Qualified and renminbi-qualified institutional investors can also invest in Chinese stock markets under the QFII and RQFII programmes.

Total foreign investments in the Shanghai exchange via Stock Connect amounted to 126 billion yuan at the end of July, or less than 0.5 % of the exchange's market capitalisation. Similarly, mainland Chinese share investment flowing to the Hong Kong exchange via the program constituted less than 0.5 % of Hong Kong's market cap.

Volume of foreign investor trades on Shanghai exchange under Stock Connect programme (17.11.2014–29.7.2015)



Source: CEIC

Bank of Finland • Institute for Economies in Transition, BOFIT
P.O. Box 160, FI-00101 Helsinki
Phone: +358 10 831 2268 • Web: www.suomenpankki.fi/bofit_en

Editor-in-Chief Jouko Rautava• Email: Jouko.Rautava@bof.fi