Weekly Review
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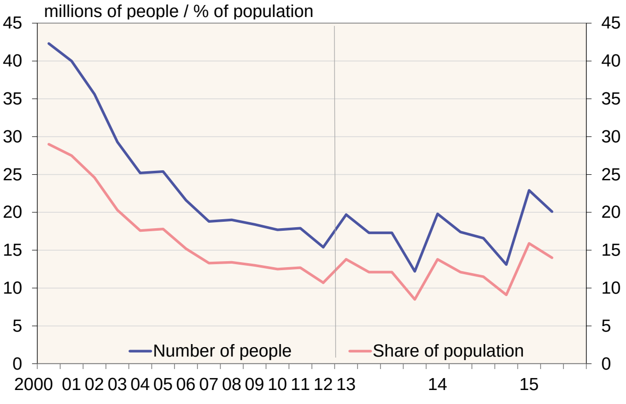
Russia

Number of people in Russia living below minimum subsistence level up markedly. Largely stemming from last winter's burst in inflation, real household incomes have been 4–5 % smaller on an on-year basis since last spring. Real wages are down about 9 % since the start of the year. Based on consumer price inflation, pensions have shrunk on-year about 4 % in real terms. Real incomes of pensioners and other people with small incomes have actually contracted more than official figures indicate as food prices this year are up over 20 % y-o-y (consumer prices overall are up 16 %). In 2014, spending on food accounted for over a third of Russian household spending but close to one half in the case of the one fifth of households that have lowest income.

The number of Russians living below the official minimum subsistence level has declined for years, but this year's contraction in real incomes reversed that trend. In the first half of 2015, close to 22 million people (about 15 % of the population) were living below the minimum level, erasing 8–9 years of gains against poverty. The officially defined monthly subsistence minimum in the second quarter was 10,800 roubles (about €160) for a working individual and 8,200 roubles (€120) for a pensioner. Rosstat's income surveys have found that the share of households with children of all households living below the subsistence level had increased to 63–64 % in recent years (36 % of households surveyed).

People living below the official minimum subsistence level



Source: Rosstat.

Russian domestic demand down over 10 %. First-half data on demand-side GDP components confirm the view that private consumption contracted nearly 10 % y-o-y and that fixed investment slid by 8 %. Moreover, similar to the 2009 recession, a reduction in inventories strongly curbed both domestic output and import volumes; the import volume was down 30 % y-o-y in the second quarter. The drop in demand was also reflected in wholesale, which saw sales volumes drop 10 % in January-August.

Russia behind China in most international comparisons. The latest World Economic Forum (WEF) Global Competitiveness Report 2015-16, which rates competitiveness among 140 countries, ranks Russia 45 and China 28. Overall country scores are based on performance in twelve pillars that are derived from 114 indicators gathered from survey and statistical data. Both Russia and China received their highest rankings for market size. Russia's other strengths included a high share of population with higher education, as well as wide coverage and use of telephones and internet which are among the indicators depicting ICT infrastructure and "technological readiness". These subcategories, however, were nearly the only ones where Russia outperformed China, i.e. Russia only outscored China in 25 out of the 114 indicators. Russia ranked weakest in institutions, market competition and quality of its roads. Russia's and China's rankings were also nearly the same in the latest IMD Competitiveness comparison.

The competitiveness rankings also utilise indicators from the World Bank's Doing Business comparison, which considers the challenges facing firms in terms of the encountered regulatory environment and bureaucracy based on ten example processes. Russia and China ranked 62nd and 90th, respectively. Both countries were at the bottom end with regards to construction permits and getting hooked up to the electrical grid. In terms of property registration and starting a business, Russia ranked considerably higher than China, while in trading across borders it was far behind China. The poorest performances for both Russia (136) and China (100) were recorded in Transparency International's Corruption Perceptions Index.

International comparison indexes sum up vast complex realities that are difficult to measure, let alone compare across countries. To their credit, they provide a fast and easy general overview of relative conditions in different countries. When interpreting such rankings, however, one should remember that these comparisons often rely on proxy variables and focus only on conditions in the largest cities. Specific focused measures may have huge impacts on the country's rankings, even if little changes in the broader picture (as has sometimes been the case e.g. for Russia). Indexes are constantly developed further, but this also complicates comparisons over time.

International rankings of Russia, China and Finland, 2014–15

	WEF Competitiveness (x/140)	IMD Competitiveness (x/61)	WB Doing Business (x/189)	TI Corruption (x/174)
Russia	45	45	62	136
China	28	22	90	100
Finland	8	21	9	3

Sources: WEF, IMD, WB, Transparency International.

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China

IMF holds its China forecast unchanged, but warns of rising risk from slowing growth. In its latest World Economic Outlook (WEO) this week, the IMF slightly lowered its July estimate for growth of the global economy this year and next. The IMF now sees the global economy growing 3.1 % this year and 3.6 % next year. The global economy expanded by 3.4 % last year. The slight deterioration in the growth outlook was mainly due to the slowdown in emerging economies and countries dependent on commodity exports. The expected US rate hike, declining commodity prices, reduced capital imports and the accompanying depreciation pressure on currencies added to uncertainty facing specifically emerging and developing countries that produce commodities. China as a major consumer of energy and commodities plays a significant role in the WEO forecast.

The IMF expects Chinese economic growth to slow from 7.3 % in 2014 to 6.8 % in 2015. For 2016, the IMF forecasts growth of 6.3 %. Thereafter growth slows to around 6 % a year through 2020. China has to balance between stimulus measures to prevent a hard landing, stopping soaring indebtedness and continuing market reforms. IMF noted that China should move ahead with reforms giving e.g. greater prominence to interest rate policy in setting monetary policy and moving gradually to a floating exchange rate. Given the size and global importance of China's economy, growth below forecast poses a significant risk to world economic growth overall.

The October WEO revised downward the IMF's Russia forecast, which now sees a contraction of 3.8 % this year and further contraction of 0.6 % next year. Russia's feeble growth prospects also seem locked in over the longer term; the IMF now predicts growth will remain at 1–1.5 % a year from 2017 to 2020. The reasons for poor growth performance included low oil prices, on-going sanctions and long-term structural problems. The IMF made its usual appeal for Russia to improve its business environment, even if conditions in reality still seem headed in an opposite direction.

The WEO report sees the average price of oil (Brent grade) rising from $53 a barrel this year to $66 in 2020.

Yuan surpasses yen as the world's fourth-most-used currency in international payments. SWIFT, the Brussels-based provider of global financial communications services, reports that in August the Chinese yuan accounted for 2.8 % of the value of international payments, putting it ahead of the Japanese yen for the first time as the world's number-four payments currency. Given the slim margin of difference in valuations of yuan and yen transactions, the ranking could shift back and forth in coming months. Nevertheless, China's growth prospects and the increasing interest in adopting the yuan point out to yuan establishing its position. Still ahead of the yuan in international use are the British pound (8 % of international payments), the euro (27 %) and the US dollar (45 %).

The rise of the yuan's use in international payments has been rapid. In just the past three years, it has overtaken seven currencies used in international payments. The yuan is now the most-used currency in Asia Pacific for payments with China and Hong Kong.

Development of China's market infrastructure has also helped support wider acceptance of the yuan. As a latest measure, this week the People's Bank of China announced that the new China International Payments System (CIPS) was now operational. The system facilitates international yuan clearing for businesses.

Greater access to China's bond and forex markets. Prime minister Li Keqiang last month announced forex trading by foreign central banks in the mainland China interbank markets could commence soon, though no exact schedule was set. In the following days, the central bank added that foreign central banks would also be allowed to engage in derivative trades on the interbank forex market. In July, access to China's interbank bond markets was granted to central banks and international financial institutions.

Officials announced last month that they were easing issuance rules for "Panda" bonds (yuan-denominated bonds issued by a foreign agent in mainland China). Hong Kong branches of HSBC and the Bank of China will become the first issuers under the new rules as the PBoC approved issues of 1 billion yuan ($157 million) and 10 billion yuan, respectively. Panda bond issues have been available since 2010, but only a few were ever issued due to the strict rules. Interest of foreign banks and firms in Panda bonds has been hurt by restrictions on capital movements, accounting practices that depart from international standards and lengthy approvals.

Despite market turbulence, China has implemented a slew of financial market reforms this year. Forex market uncertainty, accelerated capital outflows and plunging stock markets, however, have also pushed officials to set new limits and tighten old ones. Still, there is no reason to assume the pace of reforms should slow or that there will be excessive delays in implementation of announced reforms.

The rising difficulty of supervising an increasingly complex economic system has added to reform pressures. The increasingly negative "net errors and omissions" term in the balance of payments indicates a rise in capital outflows circumventing official channels. Capital controls are also bypassed via the trade account. The leadership remains committed to reforms because they want the yuan to have a reserve currency status in addition to being a trading currency. Many recent reforms have been aimed at locking in the yuan's acceptance into the IMF's Special Drawing Rights (SDR) basket currency. The SDR issue will determine China's operations on forex and financing markets in the near future.

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