Weekly Review
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Russia

Russian output up in September; consumption continued to fall. Rosstat reports that seasonally adjusted industrial output rose considerably in September to its fastest growth since December 2014. Output of extractive industries increased for the third month in a row on continued growth in oil and gas production. Seasonally adjusted manufacturing output increased for the first time this year.

Agriculture typically makes its biggest contribution to GDP in the third quarter, so the notable rise in agricultural output in August and September helped brighten the economic growth picture overall. Thanks to the good September performance, economy ministry figures show mild seasonally adjusted 3Q GDP growth from the previous quarter, even if the 3Q GDP fall was 4.3 % y-o-y.

The on-year drop in fixed investment in September was smaller than during the summer. In contrast, the volume of seasonally adjusted retail sales continued to contract in September, falling over 10 % y-o-y. The slump in retail sales of non-food goods deepened, while retail food sales have also been down 9–10 % y-o-y since spring. Rosstat also reports that sales of services to households this year have contracted slightly less than retail sales. At the same time, Russian tourism abroad, which accounted for about 5 % of private consumption in 2014, has shown a significant decline. GDP demand figures show total volume of private consumption in the first half was down nearly 9 % y-o-y.

Consumption suffered in August and September as seasonally adjusted real household incomes continued to contract. Uncertainty about the future has prevented bank borrowing of individuals from turning to rise, while the savings rate has remained quite substantial.

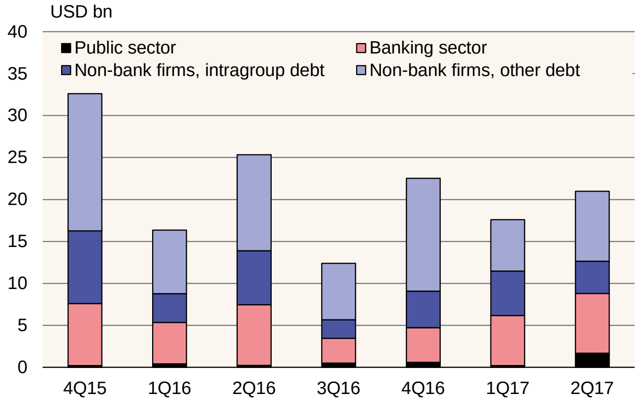
Russia's foreign debt fell in the third quarter. Preliminary Central Bank of Russia figures put Russia's foreign debt at $522 billion as of end-September, down by just over $30 billion from end-June. Approximately half of the debt reduction apparently came from actual loan payments and about half from ruble depreciation. As of end-June, about a fifth of Russian foreign debt was held in rubles.

Nearly $40 billion in foreign debt came due in the third quarter. While banks largely stuck to their payment schedules, non-bank corporations apparently have rolled most of their debt. Nearly 40 % of non-bank corporate debt is "intragroup" debt resulting from arrangements between parent companies and their subsidiaries. The proportion of intragroup debt in the non-bank sector has risen slightly in recent months, which may indicate other foreign debt has been partly refinanced through increased intragroup loans.

The scheduled debt payments coming due over the next three months exceed $30 billion. About half of that comes due in December. However, nearly a third of this maturing debt is intragroup debt, so extended payment schedules and rollovers are expected. Based on its company survey, the CBR expects that the actual amount of payments may be even smaller.

In the coming four quarters (4Q15-3Q16), a total of $87 billion in foreign debt principal comes due. Russia's foreign currency reserves stood at $371 billion at end-September. A common rule-of-thumb suggests that a country's reserves need to be sufficient to cover at least 100 % of its short-term foreign debt to avoid liquidity problems.

Scheduled Russian foreign debt principal payments



Source: CBR

Ukraine's private creditors accept debt restructuring. Ukraine's private creditors voted on October 14 to accept the debt restructuring negotiated earlier. Under the deal, creditors agreed to write down 20 % of the nominal value of Ukraine's $18 billion debt. Loan payback times were also extended by a four-year moratorium on repayment of Ukraine's debts to private creditors. Ukraine's IMF programme assumes payments to private lenders can be reduced by $15 billion over the next four years. The restructuring as approved is not sufficient alone to fully meet this goal as it only provides $11.5 billion in debt relief in that time.

A $3-billion Ukrainian government bond held by Russia comes due on December 20. Russia says it expects the bond to be repaid in full at that time. Russia also notes that Ukraine's latest deal with private creditors is inapplicable to the bond, as it was granted by a sovereign entity. The distinction is important as it governs whether the IMF can continue to release loan tranches to Ukraine. Even if Ukraine is in default on payments to private entities, IMF lending can continue. Default to a public entity, however, would mean suspension of the loan programme. Ultimately, the IMF board must decide on whether or not the bond is public debt. The bond was issued in Ireland in December 2013 and purchased entirely by Russia's National Welfare Fund.

After approval of the debt restructuring, the international credit ratings agency Standard & Poor's raised Ukraine's foreign sovereign debt rating to B-, which, while still considered speculative grade, was an improvement from the earlier rating of Selective Default (SD).

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China

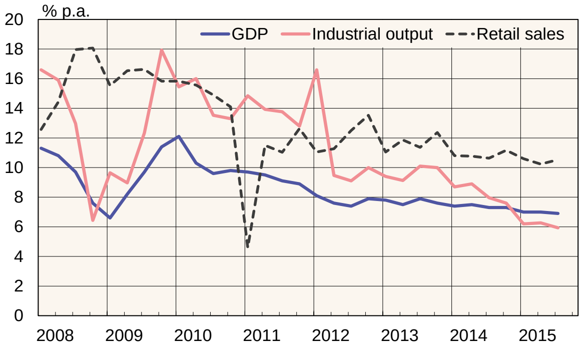
China's growth remains strong and structures continue to change. China's National Bureau of Statistics reports that GDP grew 6.9 % y-o-y in the third quarter. For the first six months of 2015, GDP growth was 7.0 % y-o-y. GDP growth in the third quarter was up 1.8 % q-o-q, a growth pace matching the second quarter.

The supply-and-demand structure of the Chinese economy continues to shift as economic reforms are implemented and living standards rise. China's growth depends increasingly on domestic consumption. CNBS does not yet release a quarterly breakdown of GDP demand components, but it reports consumer demand in January-September was responsible for 58 % of GDP growth (up from 49 % a year earlier). Steady income gains also support rising consumption. Average per capita disposable income was up 8 % y-o-y in January-September. Even as the contribution of fixed investment declines relative to consumption in overall demand, China's investment rate remains exceptionally high.

The evolution of economic structures is also seen in the output figures. Growth in manufacturing and construction was significantly lower than in services. Industrial output growth dipped below 6 % y-o-y in September and new housing starts measured by floorspace fell sharply from a year earlier. In contrast, retail sales, an indicator of services output, rose nearly 11 %, and online retail sales rose by 35 %.

The latest figures indicate a fairly steady situation in China, despite the turmoil in stock and currency markets in the third quarter. Economic growth continued its gradual slowdown and economic structures shifted. While China's official unemployment data is poor, no information suggest any significant weakening in labour market conditions.

Growth in China's GDP, industrial output and retail sales, %



Source: Macrobond

Central bank forex interventions and capital outflows from China have increased. The US treasury department's semi-annual exchange rate policy report also considers China's capital flows. The newest edition finds capital outflows from China accelerated in August to $200 billion, up from $70–80 billion in July. For the first half of the year, $250 billion flowed out of China, up from less than $30 billion in 1H14. Estimates do not include FDI.

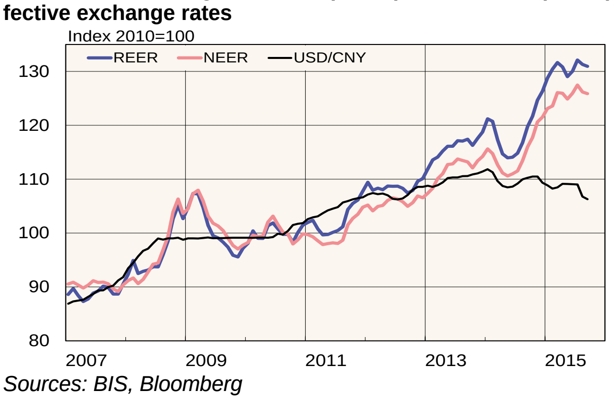
China does not publish information on its forex operations, but the PBoC has largely refrained from daily interventions since summer 2014. After the exchange rate change in August, the central bank re-entered the forex market. The report estimates that PBoC interventions in July-September totalled $229 billion. In particular, the central bank slowed the slide of the yuan during the August turbulence by purchasing $136 billion worth of yuan.

The value of China's foreign currency reserves fell by $180 billion in the third quarter to $3.514 trillion. Media reports claim that the PBoC and commercial banks have also indirectly supported the yuan through forex derivative instruments (such measures are not directly visible in changes in currency reserves). Some observers believe the central bank also intervened in September in CNH trading outside mainland China to keep the CNH exchange rate near the CNY rate and dampen expectations of yuan depreciation.

Yuan weakened slightly in the late summer. The real effective (trade-weighted) exchange rate (REER), which takes into account inflation differences between China and its main trading partners, was down 1 % in September from its July peak. Compared to a year ago, the REER was up 9 %. Similarly, the nominal effective exchange rate (NEER) strengthened in September by 9 % y-o-y, but weakened slightly from July. On Friday (Oct. 23), one dollar bought 6.36 yuan and one euro 7.06 yuan. Compared to a year ago, the yuan has weakened 4 % against the dollar and gained 9 % against the euro.

For years, complaints that China was deliberately undervaluing its currency were common. But after a long episode of yuan appreciation, most of this criticism has died down. Even the US treasury department has changed its view in this respect, commenting that the US no longer considers the yuan significantly undervalued. The treasury department notes, however, that the yuan's exchange rate is still below its medium term valuation. The report sees yuan appreciation continuing over the long run, even though in the short run the yuan faces depreciation pressures on e.g. capital outflows driven by stock market volatility.

Yuan-dollar exchange rate; real (REER) and nominal (NEER) effective exchange rates



Sources: BIS, Bloomberg

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