Weekly Review
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Russia

Russian central bank keeps rates unchanged. The Central Bank of Russia last week decided to keep its key rate at 11 %, a level held since the start of August. The CBR noted that, while inflation risks remain significant, it expects inflation to slow from the current rate of 15.6 % to below 7 % by October 2016. The markets were slightly surprised by the CBR's announcement that it will start lowering rates if inflation slows as expected.

Regarding inflation risks, the CBR reminded of high inflation expectations and a possible weakening in the global economy. Low oil prices would drag down the ruble and translate to inflation. The CBR reiterated its assessment that there is also an inflation risk stemming from a possible relaxation of fiscal policy, e.g. if there would be a decision to revisit indexation of various social benefits paid out by the state. Presently, the 2016 index adjustments for pensions and many other social payments are on track to be lowered significantly from previous years.

Russian firms borrow modestly. Russia's troubled economy and financial market sanctions have contributed to a collapse this year in the issued volume of international corporate bonds and syndicated loans. Media reports estimate that the value of syndicated loans granted this year between January and September amounted to $2.7 billion, a 70 % drop from the same period in 2014.

Moreover, companies have been paying off existing eurobonds much faster than issuing new ones. In the first nine months of this year, only five eurobonds, totalling about $700 million, were issued. Bond issues in January-September 2013 and 2014 amounted to $47 billion and $10 billion, respectively. Gazprom and Norilsk Nickel last month held successful issues of one-billion-dollar eurobonds, suggesting international investors may be regaining some appetite for Russian debt.

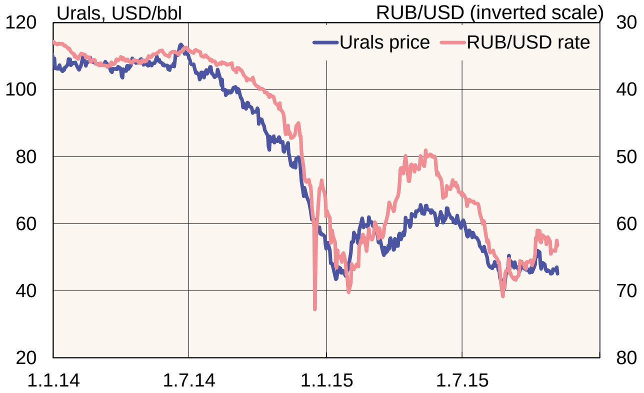
Companies have not retreated from the domestic bond market. For January-September, nearly 1.5 trillion rubles ($25 billion) in debt securities were issued, i.e. slightly more than in the first three quarters of 2014. Large firms in the oil and gas sector dominate the market.

Corporate borrowing from domestic banks fell significantly on-year in the first nine months of 2015. As of end-September, the valuation of the corporate loan stock in rubles has risen by about 20 % over the previous twelve months (i.e. a few percentage points above the inflation rate). The lion's share of growth came from the impact of ruble depreciation on the value of forex loans. Slowing growth in the loan stock and ruble depreciation have also increased the share of forex loans in the overall corporate loan stock. Some 45 % of the loan stock of the top ten corporate lenders were forex loans at the end of September. The share of forex loans in the total corporate loan stock was about 30 %.

Credit is granted mainly to large, wealthy firms. CBR data show that the loan stock of small and medium-sized firms has shrunk even in nominal terms during 2015. Lending is highly concentrated among big banks. The ten largest lenders account for about 75 % of the stock of corporate loans.

Ruble remains weak. While the ruble has recovered slightly from the low it reached at end-August on a slight rise in oil prices and fading capital outflows from Russia, the ruble-dollar rate has in past days still stood at around 63 and the ruble-euro rate around 69. Thus, the ruble is still clearly weaker than it was a year ago, having lost over 30 % of its value against the dollar and over 20 % against the euro. The ruble has also lost about a fifth of its value in real terms from a year ago in relation to both the euro and the trade-weighted currency basket of Russia's main trading partners.

Ruble-dollar exchange rate and price of Urals crude oil



Source: Reuters

The first step towards liberalisation of ruble's exchange rate was taken 25 years ago. Starting from November 1, 1990, the commercial ruble exchange rate was set to 1.8 rubles to the dollar by president Mikhail Gorbachev's decree. The commercial rate (more favourable than the official exchange rate) was used in converting corporate forex income to rubles. Thereafter, the ruble's exchange rate was gradually liberalised. In November 2014, the CBR announced it would no longer steer the ruble's external rate.

The ruble's use in Russia's international payments has gradually increased. In the first half of this year, over 10 % of Russian exports and nearly 30 % of Russian imports were settled in rubles. The ruble is mainly used in trade between Russia and CIS countries, but a rather large share of Russian imports from the EU are also settled in rubles. In addition, about a fifth of Russian foreign debt is in rubles.

The ruble's use in overall international payments remains marginal and has decreased recently. SWIFT, the provider of global financial communication services, reports that the ruble's share of all international payments this year has been just 0.2 %, making it less popular than e.g. the Turkish lira or the South African rand.

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China

China's latest five-year plan features two-child policy and economic reforms. At the end of October, the Central Committee of the Chinese Communist Party finalised its proposed 2016–2020 five-year plan. The draft plan emphasises the importance of sustainable high growth, thereby implying a need to continue economic reforms and open the economy further to international competition. In the financial markets, capital movements are to be freed further and international use of the yuan promoted. Foreign investment will be attracted through implementing a "negative list" access model that more clearly delineates branches where foreign firms are not allowed to invest and deregulates all other branches.

The decision to end the controversial one-child policy, introduced at the national level in 1979, has attracted considerable attention. From now on, a Chinese couple can as a rule have two kids. Although the motivation for the decision is China's aging population, encouraging more births will not bring rapid demographic change. Indeed, it remains to be seen what effect the change will have on the birth rate, given that the costs of having a child and the challenges of arranging day-care make the one-child option attractive to many parents. The decision however provides perspective on China's development and the possibility to focus on implementation of other reforms.

In other respects, the latest plan themes are familiar and general in nature, e.g. eliminating poverty, narrowing income inequality, improving healthcare and increasing vocational training opportunities. There are also plans to widen social security and pension coverage, as well as intent to gradually increase the retirement age. The new five-year plan places heavy emphasis on improving the environment but there is no room for political reforms in the draft.

The National People's Congress is expected to ratify the new five-year plan when it convenes next March.

Growth targets problematic for guidance of Chinese economic policy. The Chinese leadership's recent speeches on the new five-year plan often reference an earlier goal of doubling 2010 GDP and per capita incomes by 2020. Reaching this goal requires average annual GDP growth of at least 6.5 % over the next five years.

These days, however, such numeric growth targets no longer serve economic policy goals. For example, corporate production decisions are driven by other considerations. The irrelevance of growth targets should become even more apparent as economic reforms proceed. Indeed, striving by all possible means to meet numeric growth targets has led to inappropriate investment and piles of unneeded debt as it seems clear that high employment could have been sustained even at lower levels of growth. Thus, there are strong arguments that China should replace growth targets with economic policy targets that apply directly to employment or inflation.

The sensibility of tight growth targets can also be considered in the context of the data. Even if growth over the coming years remains at just 5 % p.a., China's 2020 GDP would be about 85 % larger than in 2010 and the GDP doubling target would be met in 2022. Such an achievement for the massive Chinese economy can only be seen as impressive, and even more so if achieved through sustainable policies.

Starting this year, numeric growth targets were no longer set for Shanghai and dozens of smaller cities. This is to emphasize the quality instead of the rate of growth.

China sets a low bar ahead of Paris climate conference. With the Paris climate conference set to begin at the end of November, China revealed its climate targets: reducing of carbon dioxide emissions from at the latest 2030 onwards, a reduction in CO_2 intensity (CO_2/GDP) of 60–65 % from the 2005 level and an increase in the contribution of renewable energy sources to 20 % of primary energy consumption by 2030. The goals are considered relatively modest and easily achievable for China. At their recent meeting, Chinese president Xi Jinping and French president François Hollande agreed to review their climate goals at five-year intervals. As China's environmental problems have become a hot topic in domestic politics, emission targets also provide political cover for China's leaders.

In addition to earlier announced emissions targets, president Xi announced during his visit to the United States in September that China would introduce a nationwide emissions-trading scheme by 2017. When implemented, China's emissions-trading scheme would become the world's largest. Experimentation with emissions-trading schemes has been conducted in a number of Chinese cities, but their results have hardly been impressive. China has also promised to provide $3 billion to support clean energy production in less-developed countries.

The now-concluding 2011–2015 five-year plan called for a reduction in CO_2 intensity of 17 % from the 2010 level and an increase in renewable energy to 11 % of primary energy consumption. The World Resources Institute estimates that China is well on track to meet its targets. Already last year renewable energy accounted for over 11 % of energy production.

China is the world's biggest polluter. Coal is the largest source of China's CO_2 emissions and still represents about two-thirds of primary energy consumption. Coal production has fallen this year, in part due to the economic slowdown and structural changes in the economy. China hopes to replace coal with other energy sources such as natural gas, nuclear and renewables.

According to the REN21 Global Status Report, China had the world's largest renewable energy production capacity (a quarter of global production capacity) last year and China invested the most in renewable energy sources. Over half of China's renewable energy last year came from hydropower and about a quarter from wind power.

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