Weekly Review
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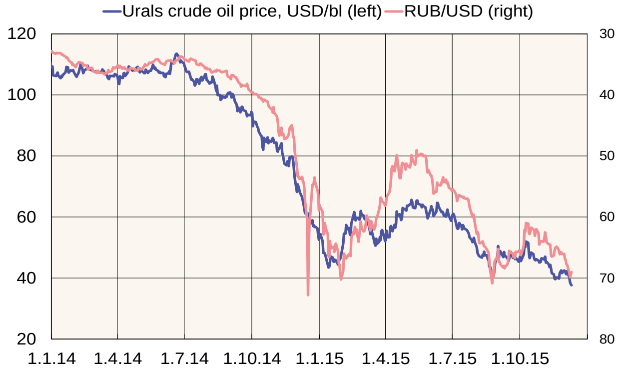
Russia

Cheap oil hurts ruble. The recent slide in crude oil prices has again affected the Russian ruble's external value. The price of Urals-grade crude oil has fallen by nearly 25 % since mid-October. Today (Dec. 11), the price of Urals crude went under $38 a barrel (Brent crude close to $39/bbl). In the same period, the ruble has lost over 10 % against the US dollar. One dollar currently buys 69.9 rubles and one euro 76.6 rubles. Since the start of this year, the price of Urals crude has slid nearly 30 % and the ruble-dollar rate about 35 %.

In recent months, the Central Bank of Russia has refrained entirely from intervening in forex markets to support the ruble's value. The value of the CBR's foreign currency reserves has fluctuated this year between $310 billion and $320 billion. The value of CBR currency reserves at the end of November was $317 billion. In addition, the value of its gold reserves was about $48 billion. In its monthly meeting today, the CBR kept its key rate at 11 %, where it has been since early August. The central bank cited inflation risks as the reason for maintaining the current level of the key rate.

Price of Urals crude oil and ruble's exchange rate, 2014–2015



Source: Reuters

Low oil prices challenge Russian government finances. The houses of the Russian parliament (Duma and Federation Council) during the past two weeks approved the draft 2016 federal budget. In its decisive second reading of the bill, the Duma reallocated about 2 % of the total spending to other categories, including e.g. new spending to remodel or replace dilapidated school buildings.

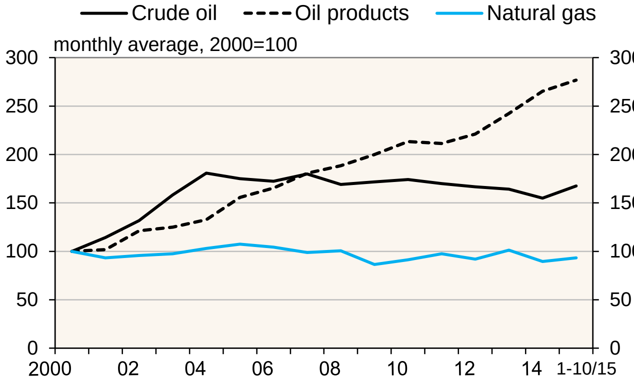
As in previous years, the government's draft of total federal budget expenditures and revenues was accepted as is. Thus, revenues (measured in nominal rubles) are set to rise 3.7 % from this year's current budget estimate. Revenues from taxes on oil & gas will increase by less than 3 % if the assumption holds that next year the average price of Urals crude will be $50/bbl and the ruble's exchange rate 63.3 rubles to the dollar. Other revenues will increase nearly 4.5 % if GDP grows 0.7 %. The federal budget deficit would then amount to 3 % of GDP, i.e. the maximum deficit size that president Putin has said he would accept.

While the parliament considered the budget bill, finance minister Anton Siluanov noted that the recent drop in oil prices threatens the budget. Siluanov said federal budget revenues at the current low oil price and ruble exchange rate would undershoot the freshly approved budget revenue projection by an amount equivalent to roughly 2 % of GDP. In that case, the finance ministry would call for spending cuts. If further cutting amidst lower revenue would not be made, the Reserve Fund would not be sufficient to finance the deficit until the end of 2016.

Russian energy export volumes at crossroads. In volume terms, the export performance of Russia's oil sector this year has exceeded expectations. Early this year, Russia's economic forecast predicted the volume of crude oil exports would rise by about 1.5 % this year and exports of oil products would drop 1 %. In reality, exports of crude oil increased remarkably in the first half, and even more for oil products. Growth in the volume of crude oil exports also remained strong after mid-summer. For January-October, oil exports were up nearly 8 % y-o-y. Exports are still clearly below the levels of 2004–2011, however. The volume of oil product exports have contracted substantially since mid-summer, while the volume exported in January-October was still up nearly 5 % from the same period in 2014. In its September forecast, the economy ministry predicted that export volumes of crude oil and oil products would decline 1–2 % next year.

The volume of natural gas exports fell in the second half of 2014 by 30 % y-o-y as exports to non-CIS countries fell and exports to Ukraine nearly vanished. Gas exports remained rather low through the spring, but since have recovered on increased demand from non-CIS countries. Ukraine, which has sought to wean itself from dependence on Russian gas, has purchased only a very small amount of Russian gas this year. Russia's September economic forecast sees the volume of natural gas exports rising in coming years, but still not coming near the high levels of previous years, e.g. 2003–2008.

Volumes of Russian oil & gas exports



Sources: Russian customs and CBR

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China

Beijing's abysmal air quality reinforces importance of Paris climate summit. The two-week UN climate summit in Paris, COP21, which convened at the start of this month, appears to be making more headway than the 2009 COP15 summit in Copenhagen. Political decision-makers from 195 countries this week continued to work on a final document based on a draft proposal from last week. The biggest open questions have to do with the timetable for meeting emission reduction targets and amount of financial support developed economies are willing to give developing countries in assisting with their climate efforts. The final document should be ready by 6pm today (Dec. 11).

China's role in Paris has changed from earlier climate summits, where it opposed binding commitments and timetables. This time around, China wants to see approval of a final document. Not only has China committed to reducing its CO_2 emissions by 2030, but has promised to launch a nationwide emissions trading scheme (cap-and-trade) in 2017. The NDRC, which is responsible for the emissions trading scheme, announced that the scheme will apply to about half of all China's carbon emissions. Nearly 10,000 firms representing six branches of the economy will participate. Given that China is the world's largest source of carbon emissions, its commitments are however rather modest.

China's huge air pollution problems and environmental degradation have become hot topics in the current domestic policy debate, and underlie the country's about-face at the Paris talks. Moreover, the slowing economy and structural changes have made it easier to reach emission targets. By some estimates, the economic slowdown and efforts at improving air quality mean that Chinese carbon consumption has already peaked.

Beijing's recent air quality readings give some indication of the seriousness of China's pollution problems. On Tuesday (Dec. 8), officials issued the highest-possible air quality warning with harmful particulate readings in some places exceeding by 40 times the level considered safe under WHO recommendations. While it was the first time a red alert on bad air had ever been issued in Beijing, many residents observed that the air quality has been worse, e.g. the previous week. On Tuesday, factories and construction sites were shut down, driving of private cars restricted and heavy transport vehicles banned altogether. Schools were ordered to remain shut and people were advised to stay indoors.

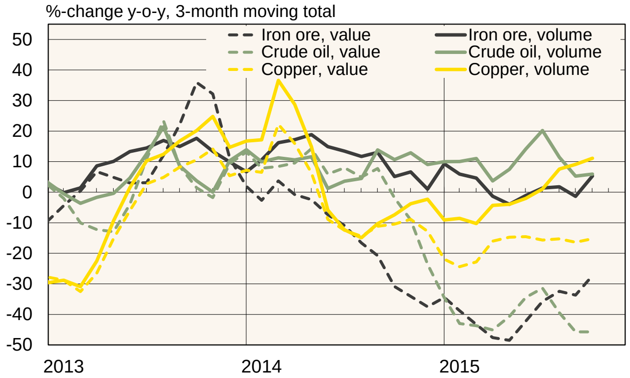
Air quality alerts were also issued in a number of cities in Beijing's surrounding provinces, leading to restrictions on driving and factory production. For example, several cities in Hebei province issued red alerts. The measures are expected to impact December's economic output figures.

Cheap oil and shifting exchange rates jostle China's foreign trade numbers. China's goods exports in November amounted to $197 billion, a 7 % y-o-y decrease. Goods imports fell 9 % to $143 billion. In the first eleven months of this year the value of Chinese exports fell 3 % and the value of imports 15 %. The trade surplus for January-November 2015 amounted to $543 billion, an increase of 64 % y-o-y.

The value of China's exports to the US in the first eleven months of this year increased 4 % y-o-y, while exports to Japan fell by 8 % and exports to EU countries contracted by 5 %. At the time, the yuan strengthened against the euro and yen. If China's exports to EU countries are measured in euros, they were up 14 % y-o-y in January-November. Measured in yen, exports to Japan were up 6 % y-o-y.

The drop in commodity prices was the main factor dragging down the value of imports. The value of China's oil imports in January-November was over 40 % less than in the same period last year. In volume terms, China this year has imported over 300 million tons of oil, or about 9 % more than the first eleven months of 2014. Imports of iron ore in the same period were up 2 % by volume, even if the dollar value of iron ore imports this year was down 38 % y-o-y. In January-November, the volume of imported pulp increased 12 % y-o-y. In contrast, coal imports have fallen significantly (down 24 % by volume and down 41 % by value).

Changes in selected commodity import volumes and values, %



Source: Macrobond

China experiences increased labour unrest in November. *China Labour Bulletin* (CLB), a Hong-Kong-based publication, reports that the number of strikes and labour protests in November exceeded all previous records since 2011, when the bulletin first began to publish figures. The CLB counted 301 protests in November, up from around 200 a month in previous months. Given China's massive labour force, the numbers seem small. Nevertheless, they appear to reflect the deteriorating economic situation.

Most of the demonstrations were over unpaid wages. Looked at nationally, it is clear that the protests are concentrated in the construction sector. In the southern coastal Guangdong province, the most protest activity was seen in manufacturing, highlighting a wave of wage non-payments and abuses stemming from factory closures, mergers and shifting of production elsewhere.

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