Weekly Review
1 • 8.1.2016

BOFIT

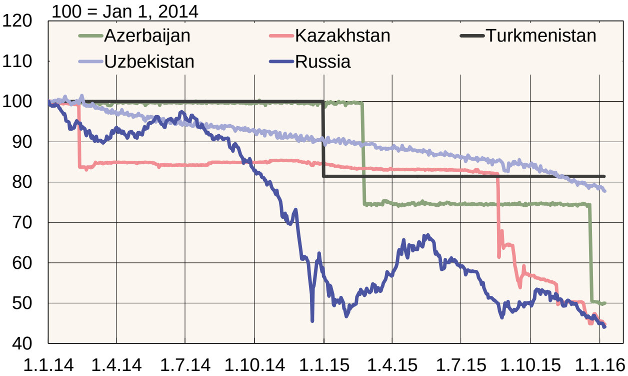
Russia

Lower oil prices hurting values of ruble and other CIS currencies. At end-December, ruble hit new lows for the year pulled by declining oil prices. The ruble has renewed its slide in recent days as oil prices have tested lows not seen in over a decade. Yesterday the USD/RUB rate closed at 75 and EUR/RUB rate at 82 rubles.

Low oil prices have socked not just the ruble, but the currencies of other CIS energy-exporting countries. Oil and natural gas (the price of which tends to follow oil price changes with a lag) account for 60–95 % of exports of Azerbaijan, Kazakhstan and Turkmenistan. Natural gas is an important source of export earnings also for Uzbekistan. The currencies of these countries have been long de facto pegged to the US dollar, but in 2014–15 they experienced significant devaluations.

Besides putting pressure on exchange rates, the drop in oil prices severely hurts budget revenues in these countries, creating pressure to cut public spending. Fortunately, most CIS energy-producing countries built up large funds during years of strong oil and gas revenues and still expect positive economic growth (with the exception of Russia) despite slowdowns. With elderly leaders in Kazakhstan and Uzbekistan approaching retirement, the prospect of bumpy power transitions could add to economic uncertainty.

Dollar exchange rates for select CIS currencies, 2014–2015



Source: Macrobond.

Russia's national payments card system moves ahead. Under amendments to the payments system act in spring 2014, all card payments made in Russia need to be settled through a national payments clearing system. As a result of the change, Visa and MasterCard, which dominate the Russian credit and debit card markets, have moved to settling payments made in Russia using the national settlement system, which is owned by the Central Bank of Russia. The driver of the change has been the desire of Russian officials to bolster the country's economic independence and support financial institutions that have been targeted with sanctions by Western countries. The national payments card system will also feature Russia's own Mir payment card.

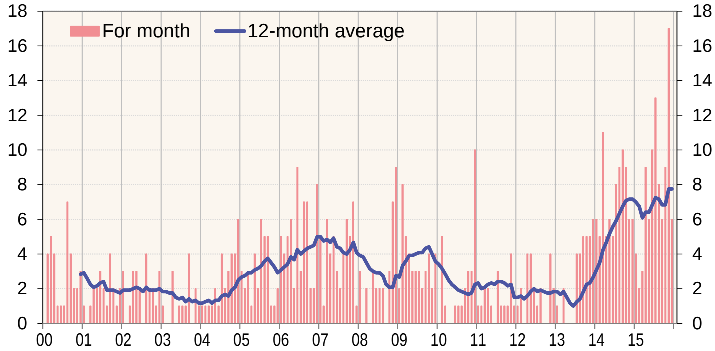
On December 15, Bank Rossii, which was targeted with Western sanctions in summer 2014, became the first bank to issue a Mir payments card. At the same time, six other banks were announced to issue their own Mir cards. Among the 35 Russian banks currently participating in the Mir system are giant state bank Sberbank and VTB24. Officials expect national use of Mir cards to ramp up during this year. Use of the Mir card in international payments, on the other hand, may remain limited.

Russia's banking sector weakens. The troubles of the real economy are beginning to manifest in banking sector performance. While banks overall are still profitable, the number of loss-making banks rose notably in the first eleven months of 2015, with nearly 30 % of banks operating in the red. Growth in delinquent payments and credit losses are one factor in this shift. The volume of delinquent loan payments rose by almost 50 % in January-November 2015. At the start of December, delinquent payments of Russian firms and households reached 2.63 trillion rubles, or to nearly 7 % of the stock of granted credit. So-called problem loans, which represented less than 7 % of the total loan stock at the start of the year, exceeded 8 % by the beginning of November.

Boosted by considerable government support, the average ratio of bank's own capital to total assets in the banking sector has risen to 13 %. There are large variations, however. At the beginning of November, 129 banks had equity ratios below 12 %. Large deficiencies in calculating the capital have come to light in several bank insolvencies.

The CBR has increased its efforts to clean up the banking sector. Since June 2013, over 200 credit institutions have lost their licenses (93 in 2015). Most of the banks have been covered by the deposit insurance scheme. Consolidation of the banking sector continues, and today Russia's 20 largest banks hold about 75 % of all banking sector assets. At the beginning of December, 740 banks operated in Russia.

Number of banking licence cancellations in Russia, 2000-2015



Source: Banki.ru.

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
The information is compiled and edited from a variety of sources. The Bank of Finland assumes no responsibility for the completeness or accuracy of the information, and opinions expressed do not necessarily reflect the views of the Bank of Finland.

Weekly Review
1 • 8.1.2016

BOFIT

China

Chinese stock markets nosedive. On Monday (Jan. 4), the first trading day this year, share prices fell 7 % on mainland China stock markets. The new automated trading circuit-breaker mechanism kicked in on its first day in use, causing share trading to be suspended in the afternoon. The circuit breaker again shut down trading on Thursday (Jan. 7), just a half hour into morning trading. For the day, share prices were down 12 % in Shanghai and 15 % in Shenzhen from December 31. Share prices on the Hong Kong stock exchange were also down 7 % from the start of the year. Late Thursday evening, the China Securities Regulatory Commission (CSRC) suspended for now use of the circuit breaker.

The circuit breaker was introduced at the start of the year to halt share and derivatives trading in Shanghai and Shenzhen for 15 minutes whenever the CSI 300 index rises or falls more than 5 % during intraday trading. Trading is suspended for the rest of the day if the shift exceeds 7 %. The brake mechanism was introduced to promote healthy market development, but on Thursday the CSRC said it had not achieved the expected effect and rather amplified market volatility. Some observers have claimed that the threshold for the circuit breaker is just too low. Last summer alone, trading would have been suspended 20 times had the circuit breaker been in place. Indeed, the introduction of the circuit breaker may have added to market volatility; the threat of trading disruption forces investors to speed up their trades.

The market jitters this week were partly due to the expiration of a six-month ban on selling shares imposed on major shareholders after last summer's market plunge. The CSRC announced yesterday that it would keep the sales ban partly in place and limit share sales of major shareholders to 1 % of a company's shares. Media reports also claim that state financial firms have again been purchasing shares to prop up prices as they did last summer. Some observers have commented that December's weak purchasing managers' index (PMI) reading may have contributed to the collapse in share prices. On the other hand, nothing about the PMI reading was very surprising. Yet again, any real economy links to the share price meltdown are hard to identify.

Trends in mainland China's main stock market indices

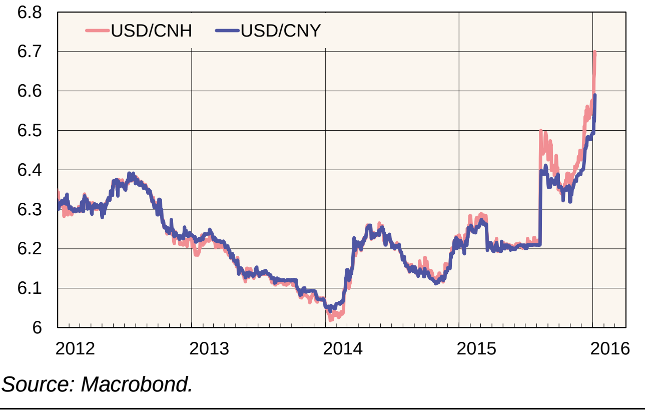
Source: Macrobond.

Volatility of yuan exchange rate increases as system overhaul proceeds. Nervousness this week also seized the foreign exchange markets. On Thursday (Jan. 7), the yuan-dollar rate was down 1.5 % from the start of the year in Shanghai and down 1.7 % on Hong Kong's forex market. Since the mini-devaluation last August, the yuan has stayed consistently weaker in Hong Kong than in mainland China, suggesting that depreciation pressure on the yuan has increased considerably since August.

While the main reason for the weakening pressure is the uncertainty stemming from the slowdown in economic growth, the trend on the forex market also reflects changes in the foreign exchange rate system itself. Last August, in connection with the yuan's mini-devaluation, the People's Bank of China announced that its calculation of the daily dollar-fixing rate would be adjusted to better reflect actual market conditions. In December, the PBoC published 13 core currency partners in its composite CFETS currency index, designed to give a wider insight into the yuan's trend than the dollar-yuan rate alone. While publication of the index carries the possibility that volatility in the yuan-dollar rate could increase, its role in actual policy making is still unclear. The latest change came this week as the opening times of China's forex markets was extended so that trading in Shanghai concludes at 11.30 pm instead of 4.30 pm as earlier. The change is expected to smooth yuan trading on Chinese and European markets.

Although the recent weakening of the yuan has shaken markets, increased yuan exchange rate volatility is part of a normal system adjustment and a sign that China is developing in the direction of advanced economies. The Chinese economy has evolved to such an extent that its relatively tight foreign exchange rate policy would be too costly to pursue and, hence, more flexible rates are needed. The shift is not straightforward, however, as the country will occasionally revert to traditional methods in rate setting. Late last year, for example, some foreign banks were temporarily forbidden to make certain forex operations to prevent arbitrage of exchange rate differences on the Shanghai and Hong Kong yuan markets.

Mainland and Hong Kong (offshore) yuan-dollar rates



Source: Macrobond.

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
The information is compiled and edited from a variety of sources. The Bank of Finland assumes no responsibility for the completeness or accuracy of the information, and opinions expressed do not necessarily reflect the views of the Bank of Finland.