Weekly Review
5 • 5.2.2016

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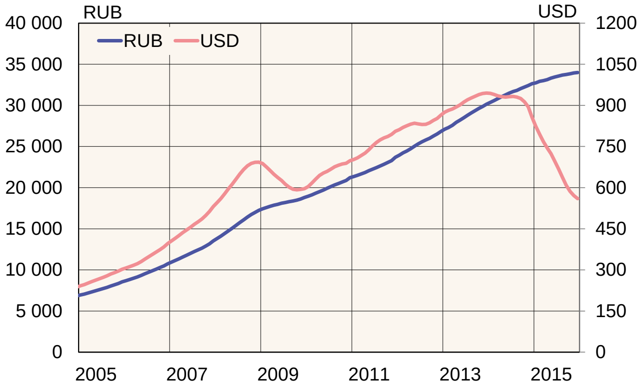
Russia

CBR keeps rates unchanged, but adjusts guidance. At its scheduled meeting last Friday (Jan. 29), the Central Bank of Russia's board decided to leave the key rate unchanged at 11 %, the same level it has been at since August 2015. The CBR estimated that annual consumer price inflation was 10 % in January, which meant that real interest rates have turned positive for the first time in a year. The central bank expects inflation to slow further to less than 7 % by January 2017 and to reach the 4 % inflation target by the end of 2017. The CBR noted, however, that risks to deviating from the target at end-2017 have increased. The CBR indicated that the oil price is a key risk to price stability, because a drop in the oil price causes the ruble to weaken and fuels inflation expectations.

The CBR's reference to the possibility of tightening monetary policy slightly surprised the markets. In December, the central bank signalled that it would begin gradual lowering of rates if inflation moderated in line with its forecast. The latest CBR announcement pointed to the possibility of monetary tightening in coming months if inflation risks further amplify. It further noted that the oil price is likely to be lower than in its December baseline forecast of $50 a barrel in 2016–2017, so Russia's GDP development is expected to be even weaker than earlier predicted. In December, the central bank forecasted that GDP would still contract 0.5-1 % this year and return to modest growth in 2017. The CBR board's next meeting on interest rates is set for March 18.

Measured in dollars, Russia's average wage declined over 30 % last year. Preliminary data show the average monthly wage in Russia in 2015 was 34,000 rubles ($560, €500). Nominal wages increased 4.5 % on average, while high inflation and ruble depreciation eroded the purchasing power of wage earners. Real wages contracted over 10 %, and measured in dollar terms, the average monthly wage was down more than 30 % from 2014.

Average monthly wage in Russia (12-month moving average)



Sources: Macrobond, BOFIT.

Wages remained highest in the oil & gas and fishing industries, but average nominal wages range widely across industries. The average monthly wage in the oil refining industry was nearly 2.5 times higher than the average wage nationally, and about half the average in the textile industry.

Based on ILO methodology, Russian December unemployment was 5.8 %. Although the total unemployment has increased only slightly, the regional variations are large. The unemployment rate in the Central Federal District has remained below 4 %, while unemployment has risen to 12 % in the North Caucasus region. In the Republic of Ingushetia, the unemployment rate exceeds 30 %. Unemployment is especially a problem for the young. About 20 % of Russian 20—24-year-olds were unemployed in December 2015.

While wage arrears rose significantly in the past year, the level is still low.

Tight budgets and uncertainty currently dominate Russian economic policy. Persistent low oil prices and the weak economy have forced Russian policymakers to balance between budget cuts and stimulus measures. Public sector cuts will require painful, unpopular measures, so implementation has been resisted as long as possible. Recent statements from Russian leaders on the country's economic situation and outlook exude a puzzling optimism, given that GDP last year contracted nearly 4 % and the oil price in January was down about 40 % from a year earlier.

Spending cuts are currently under preparation led by the finance ministry, but a large part of budget spending is ruled out from cuts. On the other hand, the economy ministry is drafting an economic support programme for this year. The programme seems to be largely cosmetic, however, as few additional funds are expected to be allocated to finance it.

The notion of raising money for the budget through privatisation of state-owned enterprises is back on the agenda. Privatisation plans have been under preparation for years, but the actual privatisation sales of large firms have been postponed due to market weakness. The situation is unlikely to improve this year. The terms that president Putin has imposed on privatisation sales further limit the pool of potential buyers. Even in the best case, the impact of privatisation sales on the budget would be limited and temporary.

The reluctance to tackle difficult reforms can also be seen in the government's long-term plans. Russia's structural economic problems have been long recognised and e.g. the list of economic goals of the recent national security strategy again includes improving the investment climate and business environment, as well as increasing productivity. In practice, these goals have remained secondary, with the emphasis instead on import substitution and other measures restricting business operations.

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China

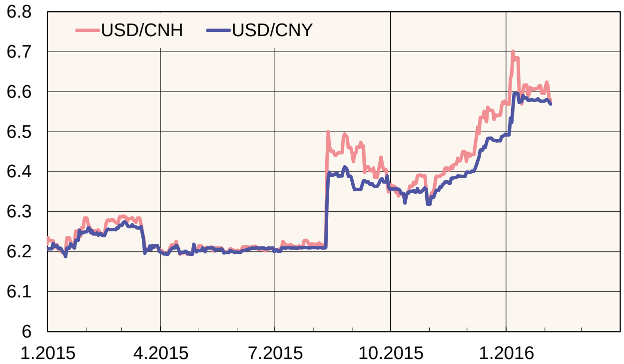
Reforms to Chinese exchange rate policy expected. The yuan started the year by weakening almost 2 % against the dollar, but since then the People's Bank of China has kept the yuan-dollar rate fairly stable. In past two weeks, off-shore yuan trading in Hong Kong (CNH) saw the yuan weaken against the dollar widening the gap between the CNH and on-shore mainland yuan (CNY). On Thursday (4th of Feb), the gap almost closed pointing again to an intervention by the Chinese authorities.

The government has employed stricter capital controls to contain capital outflows from the country. Press reports say PBoC measures include limiting the sale of bonds by foreign institutions on the interbank market and urging commercial banks to limit customer attempts at moving yuan assets out of the country. Additionally, the granting of new foreign investment quotas for qualified domestic institutional investor (QDII) and renminbi qualified domestic investor (RQDII) programmes have been on hold since March 15.

Since January 25, the reserve requirement have been applied also to deposits in Hong Kong and other yuan trading centres, thereby increasing costs of yuan trading. As the possibility of investing in yuan-denominated assets outside mainland China is limited, foreign banks often simply deposits their yuan in mainland China banks. Mainland China banks operating in Hong Kong have also been instructed to cease offering off-shore interbank loans, rising interest rates substantially in Hong Kong at times.

Some economists have recently recommended stricter limits on capital movements as a cure for the falling yuan exchange rate. China's economy and financial system, however, have opened to such an extent that restricting capital outflows is now difficult and contradicts the country's strategy of opening up. In lieu of stricter capital controls, China needs to find a way to shift to a more flexible approach to exchange rate formation. A more flexible exchange rate would allow deregulation of capital movements to continue, but would also demand clearer domestic monetary policy.

On-shore CNY (Mainland China) and Off-shore CHN (Hong Kong) yuan-dollar rates



Source: Macrobond

Chinese wage growth remains robust. The National Bureau of Statistics reports that the per capita monthly disposable income in China at the end of 2015 was about 1,870 yuan ($280). Incomes were up nearly 9 % y-o-y in nominal terms and 7 % in real terms. The income difference between urban and rural Chinese are still huge; urban workers made nearly three times more than their rural colleagues.

Data from the household income survey show that wage earnings account for about 61 % of urban disposable incomes, and 44 % for rural incomes. Business earnings in cities represented 10 % of total income, while in the countryside, they accounted for a third of total income. Income transfers accounted for 17 % of urban income and 19 % in rural income. Property income was noteworthy mainly for city-dwellers.

The household income survey further found that urban wages in December were up nearly 8 % y-o-y. Based on this, the average monthly wage in the public sector and government-owned businesses was about 6,100 yuan ($930). The official wage data for 2015 have yet to be released.

While official figures for private sector wages are unavailable, they are typically lower than public sector wages. The average wage reported in December for migrant workers was 3,070 yuan ($470). According to press reports, the entry-level wage at an electronics assembly plant in Guangdong province is 2,100 yuan ($320) a month and later rises with overtime to 3,200–4,500 yuan ($480–680). Guangdong's regional minimum wage is just under 1,900 yuan ($290). According to the *China Labour Bulletin*, minimum wages in mainland China are about half minimum wage levels in Taiwan or Hong Kong, but substantially higher than in other Asian emerging economies.

Chinese P2P lender proves to be pyramid scheme. Prior to its collapse last week, the peer-to-peer (P2P) lending service Ezubao, which was only founded in summer 2014, managed to accumulate assets worth 50 billion yuan (€7 billion) from nearly a million Chinese investors on the promise of 9–15 % returns. As in a classic Ponzi scheme, there were almost no real investment targets. Money from late investors was used to pay early investors and the company's founder and other key personnel took their share of the money raised. Government investigators have yet to determine how much money has been permanently swindled from investors and how much can be recovered.

The availability of P2P lending services exploded last year. An investor survey found that P2P loans, due to their "guaranteed" high returns, were the number-three favourite form of investment in China. By some estimates, the P2P lending market rose last year to nearly 1 trillion yuan (€140 billion) or about four times the 2014 amount. Regulations for the P2P lending industry are still in drafting phase.

As the number of loosely or not at all regulated financial vehicles has soared in recent years, the number of financial abuses has grown and new fraud cases will surface.