Weekly Review
23 • 10.6.2016

BOFIT

Russia

Rise in Russian consumer prices slowed in January-May. May consumer prices were up less than 3 % from December, whereas the comparative figure in 2015 was well over 8 %. As in the previous two months, May consumer prices were up 7.3 % y-o-y. The last time such a relatively lower 12-month inflation score was seen in April 2014.

Food prices have been the strong mover in consumer prices in recent years. The fall of the ruble at the end of 2014 and Russia's countersanctions in August 2014 that brought import bans of certain foods, sent food prices to a level 19 % higher on average in 2015 than in 2014. This year, food prices have risen considerably slower in on-year terms than prices of other consumer goods and services. Part of this reflects an increase in domestic food production and a partial shift of demand from imported food items to cheaper domestic products. Food prices were up 5.6 % y-o-y in May, while prices of services and non-food goods were up 8.4 % y-o-y.

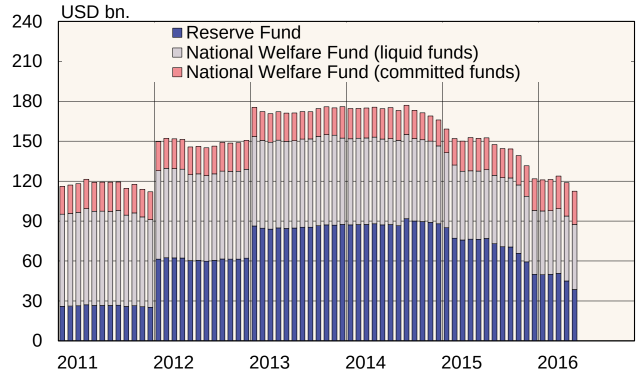
Consumer price inflation in recent months has been 3.7 percentage points lower than the CBR's key rate (at 11 % since August 2015), making the key rate clearly positive in real terms. Central Bank of Russia forecast has consumer prices up 6–7 % y-o-y at the end of this year, and the Bank expects to reach the 4 % inflation target by the end of 2017.

Russia dips further into its reserve funds. Another 390 billion rubles ($6 billion) was lifted from the Reserve Fund in May to cover the budget deficit. The Reserve Fund at the end of May was valued at 2.55 trillion rubles ($39 billion or 3 % of GDP). So far this year, about 800 billion rubles has been withdrawn from the Fund, and budget plans call for a further draining of 1.3 trillion rubles by year's end. While the federal budget assumes an average oil price of $50 (3,165 rubles) a barrel, the actual average price of Urals-grade crude in January-May was $36 (2,560 rubles).

The value of the National Welfare Fund stood at 4.8 trillion rubles ($73 billion or 6 % of GDP) as of end-May. So far this year, about 7 billion rubles ($100 million) has been used to cover pension expenditure.

The entire Reserve Fund and about two-thirds of the National Welfare Fund are counted as part of Russia's foreign currency reserves. The CBR oversees these assets and invests them in low-risk, highly liquid currency-denominated securities as it does with the rest of the nation's currency reserves. The value of Russia's foreign currency reserves does not automatically fall when money is withdrawn from the reserve funds. When the funds are used to cover expenses in rubles, the central bank exchanges foreign currency for rubles and the currency reserves remain unchanged. The value of Russia's foreign currency reserves, which has risen slightly this year, stood at €388 billion at end-May.

Value of Russian oil funds



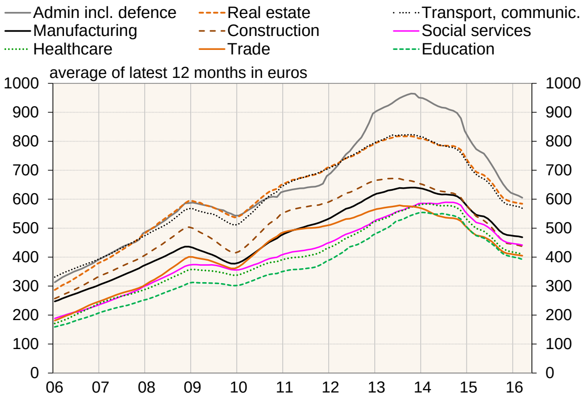
Sources: Macrobond, Russian Ministry of Finance and BOFIT.

Declining ruble exchange rate has sharply lowered external value of wages in all branches. The average monthly Russian wage between April 2015 and March 2016 was €500. In manufacturing, it was about €470, lower than in China (roughly €600), and if compared to EU countries with lowest incomes, lower than in Romania (€550) but still higher than in Bulgaria (about €400). Russian manufacturing wages vary tangibly. The low-income branches are textiles and clothing with €240 and woodworking with slightly over €300. High-income branches comprise basic metals and chemicals where the average is around €600 a month.

The best-paying fields overall are oil refining (€1,300 a month), oil & gas production, pipeline transmission and finance (each around €1,000 a month). Russia's low-paid fields include trade, education and the health services branch (about €400 a month), and construction (€440). Public administration jobs, including administration in social services and defence paid around €600 a month.

Estimates say unrecorded wages account for about 15 % of the average pay package. Rosstat estimates of unrecorded production connote the share of unrecorded wages varies very much across branches. In particular, pay in the construction and trade branches is better than official figures indicate.

Average monthly wage in various branches



Source: Rosstat.

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China

Surveys show Chinese firms hiring less. For over a year, purchasing manager indexes compiled by various organizations have been indicating that firms in both the industrial and service sectors have not been hiring at the same pace as earlier. The international staffing company Manpower repeated a similar theme in its latest survey. The number of firms planning to employ additional workers has fallen for years, and today is almost as low as during the roughest part of the 2009 financial crisis. The drop in hiring applies to all sectors, including finance, manufacturing, construction and mining, services, transport and trade.

The findings of employee surveys also comport with business surveys. For example, the People's Bank of China's quarterly survey of bank depositors notes that the employment expectations of depositors have weakened since last autumn.

The expectations of continued slowdown in the Chinese economy, lower corporate profitability and higher wage costs (a driver of increased production automation and the shifting of labour-intense production to countries with cheaper labour costs) are just a few of the many factors shaping company hiring prospects. In coming years, many jobs will vanish as production is planned to be reduced in sectors plagued with overcapacity, certain state-owned enterprises are restructured and the number of people serving in China's military is reduced.

The quality of Chinese official labour market statistics has room for improvement, not to mention how actual unemployment or labour supply and demand are assessed. Survey-based figures indicate overall employment trends but fail to specify e.g. in the number of workers on payroll. It is particularly disconcerting from the government's standpoint that firms in the service sector are increasingly reluctant to hire new personnel. A cornerstone assumption of economic restructuring policies is that service sector will take up much of the slack as workers are forced out of downsized heavy industry and other branches.

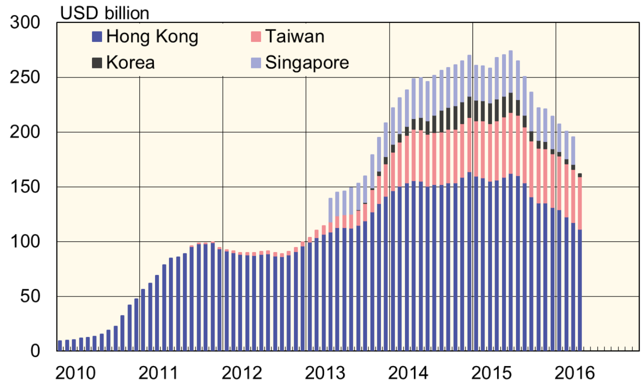
Official figures show that China's registered unemployment rate has hovered around 4 % for over a decade. Many people have little incentive to seek assistance or report themselves as unemployed, however. Another official unemployment survey, which the government only started to publish in 2013, looks at urban unemployment rates in 31 major cities. By this alternative measure, unemployment has remained at just over 5 % over the past three years. As official data only include the urban residents, there is virtually no information on unemployment and underemployment in rural areas or concerning internal migrants (i.e. the most flexible and mobile participants in the Chinese labour market). At the beginning of June, the consulting firm Fathom said overall unemployment in China's economy could reach 12 % this year, up from 10 % in 2015 and around 5 % in 2013. Unemployment is a delicate subject for China's leadership.

Exchange rate depreciation and poor foreign trade performance reduce international yuan use. SWIFT, the Society for Worldwide Interbank Financial Telecommunication, reports that in April the yuan was used in 1.8 % of all international payments by value. The yuan was the world's sixth-most-used payment currency, just behind the Canadian dollar. Last summer the yuan climbed to fourth place among the most-used payments currencies. Moreover, yuan's use in Chinese foreign trade has diminished. In March-April, only 17 % of China's foreign trade was conducted in yuan. The corresponding figure last year exceeded 25 %.

With the yuan's falling exchange rate, yuan deposits in designated yuan trading and clearing centres outside mainland China (offshore yuan) have diminished. This trend partly reflects the PBoC's decision last January to impose reserve requirement ratios (RRRs) on offshore yuan deposits in order to calm currency speculation. The PBoC also announced last week that as of July 15, RRRs will be based on average deposits for the quarter rather than deposits at the end of the quarter. By some estimates, the move will further reduce yuan deposits at offshore centres.

The overall readiness of firms and financial institutions to conduct business in yuan has nevertheless improved in recent years. SWIFT figures show that over 1,100 foreign financial institutions (37 % of all financial institutions with payments traffic in China or Hong Kong) already use the yuan.

Yuan deposits in Hong Kong, Singapore, Seoul and Taipei



*Sources: Macrobond, BIS, national central banks and BOFIT (*Singapore data available on a quarterly basis up to 2016Q1)*

China's foreign trade performance remains tepid. China's customs figures show May goods exports, measured in dollars, contracted at 5 % y-o-y, the same rate as the average of the previous four months of this year. After contracting by more than 10 % y-o-y in the first four months of this year, May imports remained at the same level as a year earlier. China's trade performance is strongly influenced by fluctuations in exchange rates and commodity prices. When goods trade is considered in terms of trade volumes, both export and import volumes increased an average of 2 % y-o-y in January-April. Moreover, especially foreign trade value figures are muddled up by the changes in trade flows in which the participants are circumventing China's capital controls.

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