Weekly Review
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Russia

Russian firms issuing more eurobonds. Financial institutions and non-financial corporations have issued 1.1 trillion rubles ($17 billion) in new domestic bonds this year, which is slightly less than year ago. The share of public offerings in debt issuances continued to decline, however, with just over half of bonds issues public in January-August. State development bank VEB, for example, issued $600 million in domestic bonds in July, which was sold mainly to domestic banks. An increasing share of Russian debt issues lack international credit ratings, which could be due to the growth in use of asset-secured bonds. Russia's new law on pledged securities entered in force in July 2014, making it easier to issue also other asset-backed than mortgage-backed securities.

At the same time, the appetite and opportunities of large corporations to issue Eurobonds seem to have grown. In January-August, Russian banks and corporations issued $7.1 billion in eurobonds, up from $1.8 billion in the same period last year. E.g. steelmakers Evraz and NLMK issued in June Eurobonds of $500 million and $700 million, respectively.

The Moscow stock exchange's ruble-based share index is up 14 % this year and hit new highs in line with a mild recovery in oil prices. Share trading overall, however, remains as sluggish as last year. The index of corporate bond market is up 9 % and trading in debt securities has risen sharply this year. Growth in the domestic bond market has been supported by the improved liquidity situation of banks and government borrowing. The finance ministry has this year issued new sovereign debt according to schedule totalling 519 billion rubles.

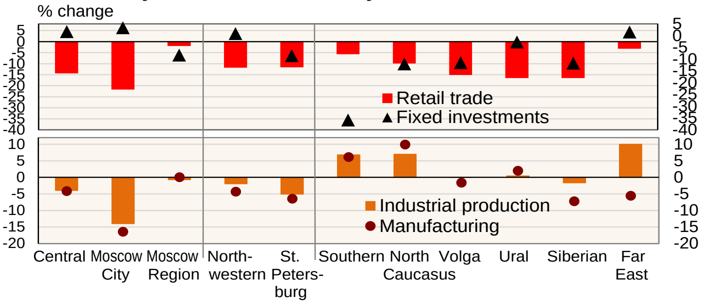
Economic contraction has slowed down in Russia's regions. An on-year drop in retail sales was seen in nearly all of Russia's federal districts in the first half (but less than in January-June 2015). In the greater Moscow area (City of Moscow plus surrounding Moscow oblast) and the Ural Federal District, the volume of retail sales was still down 7–9 % y-o-y. In nearly all other federal districts and St. Petersburg the slid was about 2–4 %.

Fixed investment in the first half was slightly up on year in the greater Moscow area, in the Central Federal District and St. Petersburg and even substantially up in other parts of the Northwestern Federal District as well as Ural Federal Districts. In the Southern and Volga Federal Districts, investment still showed severe declines.

Industrial output (manufacturing and mineral extraction) in the first half grew significantly on year in greater Moscow, the Central Federal District, St. Petersburg and especially in the Southern Federal District. Most other federal districts were unchanged from a year earlier.

Russia's economic development deteriorated visibly in 2014 and the development has been quite variable across regions during past years (see chart below). Retail sales have contracted throughout the country, and are down over 20 % in Moscow. The investment trend also has been quite uneven. In some federal districts, investment has been flat or growing slightly, while the investment volume dropped 36 % in Southern Federal District over the past two years. Industrial output has fallen in western Russia, but grown in the Southern and Far East Federal Districts.

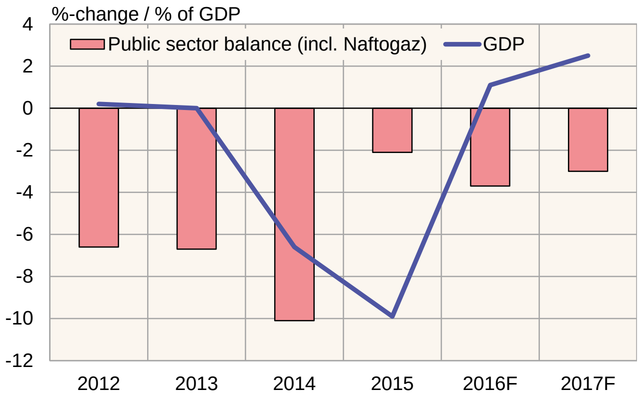
Real change in core sectors for federal districts and major cities from January-June 2014 to January-June 2016



Source: Rosstat.

IMF disburses new loan tranche to Ukraine. At its meeting on Wednesday (Sept. 14), the executive board of the International Monetary Fund voted to grant Ukraine the third tranche of its four-year $17.5 billion Extended Fund Facility (EFF) agreed in March 2015. The current tranche is worth about $1 billion. During 2015, Ukraine received about $6.7 billion from its EFF. The release of the third tranche was delayed considerably from the original schedule. As required by the conditions of Ukraine's EFF, the country has e.g. increased regulated energy rates, decreased public sector deficit and improved stability of the banking system. The IMF is however, worried on the course of Ukraine's fiscal policy and its progress in fighting corruption. Several international financial institutions, including the World Bank, are conditioning their lending to Ukraine in part on the IMF's continuation of its EFF with Ukraine. Ukraine's GDP growth is expected to reach 1.5 % this year and 2.5 % next year.

Ukraine's GDP growth and public sector deficit, 2012–2017



Sources: Ukraine statistics officials and Consensus Economics.

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China

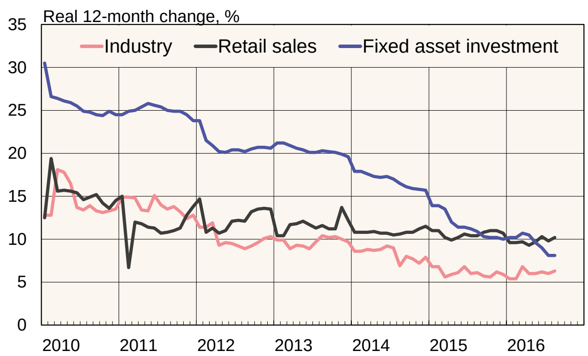
No big changes in Chinese economic trends over the past months. Industrial output growth accelerated slightly in August to over 6 % y-o-y, with retail sales growth climbing above 10 % y-o-y, an increase from July. The rapid slowdown in fixed asset investment (FAI) that had raised concerns in recent months moderated in August; private and public investment growth were both up from July. Infrastructure and real estate construction received the most investment. Monitoring investment developments is, however, getting even fuzzier than before. Apparently, due to the government campaign last year to buy huge amounts of shares to prop up stock prices, a large group of previously privately controlled shareholding firms are now classified as public, which distorts the picture concerning the development of both private and public investments.

The value of China's imports rose 2 % y-o-y in August, the first positive growth figure since autumn 2014. The long-term drop in the value of imports reflects the decline in global commodity prices as Chinese figures show that import volumes rose 3 % y-o-y in the first seven months of the year. While the value of exports was down 3 % y-o-y in August, the volume of exports in January-July was up by 3 %.

Price trends are not a cause for concern for policy makers. Consumer price inflation slowed a bit in August to 1.3 % while producer prices, which have fallen for 54 months in a row, were down less than 1 % y-o-y in August. On month, however, producer prices have begun to rise.

Even if growth in electrical power production accelerated to nearly 8 %, which should suggest an improving economic outlook, the overall economic picture remained decidedly mixed. Figures on freight and passenger traffic suggest a substantial slowdown has occurred this year. A People's Bank of China company survey found that corporate confidence in the economy and their view on the business climate have fallen this year to levels lower than measured in 2008–2009. Moreover, even part of the pickup in industrial output was due to transient factors such as the halving of the sales tax on small cars. The tax cut expires at the end of this year.

Industrial output, retail sales and fixed investment in China



Source: Macrobond

Outlook for Chinese banks gets bleaker. Chinese banks have released their financial statements for the first half of this year. The overall condition of Chinese banks has deteriorated by several measures and large banks expect their condition to worsen in the near future. Provision of basic banking services remains the main generator of bank earnings. For large banks, the interest rate spread between loans and deposits continued to narrow in the first half. The average credit interest rate was 3.8 %, while the average deposit rate was 1.7 %, causing on-year profit growth of large banks to essentially cease. However, their profits were still rather hefty, totalling nearly 500 billion yuan ($75 billion) for the period.

The slowing economy and structural change are particularly worrisome for banks as they erode the ability of borrowers to pay back their loans. Even if banks this year have accelerated their write-downs of non-performing loans (NPL) compared to earlier years, the NPL stocks of China's four largest banks have grown rapidly, reaching approximately 750 billion yuan ($110 billion) at the end of June. The declared NPL ratio remains relatively low (1.5–2.5 %), but the true amount of NPLs is likely substantially larger given the traditional reluctance of banks to recognise NPLs and preferring instead to roll over bad loans. The IMF estimates that 15 % of the borrowing of China's exchange-listed firms is likely to end up classes as NPLs. In addition, there has been an increase in overdue payments beyond 90 days. The economic condition of smaller banks is reportedly even more challenging than that of the larger banks.

China's banking regulations require that banks hold reserves equal to at least 150 % of their NPL portfolio. Regarding the largest banks, the NPL provisions of ICBC in June fell to 143 %, while the reserves of CCB and BoC were still slightly more than the minimum requirement. It is unclear whether China's main bank regulator, the CBRC, will intervene on rule violations. Already at the start of the year, officials were suggesting that the requirement could be lowered to 120 %. Although no decision on the issue has been published, market participants speculate that regulation are not being strictly enforced at the moment.

Despite the headwind facing banks, China's Postal Savings Bank is preparing for an IPO listing on the Hong Kong stock exchange. The emission, currently valued at $7–8 billion, would be the largest IPO listing this year globally in terms of market capitalisation. The IPO is believed to offer a 15 % stake in the bank's shares and with the largest buyers expected to be the state-owned China Shipbuilding Industry corporation and Shanghai International Port Group, which both have committed to purchase slightly over $2 billion in shares. China Post Group will continue to be the bank's largest owner after the IPO. China's Postal Savings Bank at the end of last year was the world's 22nd largest commercial bank measured by total assets and its network of 40,000 branch offices was the largest in China.

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