Weekly Review
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Russia

New data show distinctly milder recession in Russia than earlier reported. Revised Rosstat GDP figures for 2015 show GDP contracted just 3 %, rather than 3.7 % as reported earlier. The new figures for key demand components indicate that a smaller drop in private consumption from 9.5 % to slightly below 9 % was largely responsible for reducing the GDP contraction. Private consumption accounts for about half of Russian GDP. The GDP number also improved as there was a change in the statistical discrepancy figure that is contained within the demand components. On the supply side, the largest components mitigating the fall in GDP were trade and the construction sectors, as well as public administration.

The upwardly revised 2015 GDP figure did so far not impact Rosstat figures for the first half of 2016. The first data for the third quarter of the year confirm that domestic demand in Russia was no longer very much smaller than in 3Q2015 (private consumption was down about 3 % and fixed investments down about 0.5 %). After a weak first half, Rosstat reports that the volume of Russian exports of goods and services in the third quarter was up by nearly 7 % y-o-y. Goods and services imports declined by no more than 3 %.

GDP, imports, demand components in 2012–2016, % change

	2012	13	14	15	1-3Q16
GDP	3.5	1.3	0.7	-3.0	-0.7
Imports	9.7	3.6	-7.6	-25.5	-6.6
Private consumption	7.4	4.4	1.8	-8.8	-4.2
Public consumption	2.5	1.4	-1.5	-2.6	-1.3
Fixed investments	6.0	0.9	-0.3	-8.4	-4.4
Exports	1.4	4.6	0.5	3.7	0.4

Source: Rosstat.

Russian employment numbers rose, while unpaid leave and part-time work increased. Despite recession, Rosstat's employment survey finds the number of people employed declined just modestly in 2015 and increased slightly last year. The biggest employment gains were seen in the fields of education, healthcare and social services. The employment rate among people aged 15–72 rose to around 66 %.

The survey finds the good employment trend has been reflected in a significant reduction in the number of people outside the workforce but wanting to work. In addition, the number of unemployed persons, which rose in 2015, dropped tangibly in the final months of 2016. The official unemployment rate was 5.4 % for the October-November period.

In contrast, Rosstat's monitoring of firms in Russia found that the number of workers on unpaid leave in the survey increased by about 4 % between autumn 2014 and autumn 2016. Their share of all workers on payrolls in the companies covered by the survey, already notable earlier, reached 8.4 % last autumn. About a third of workers on unpaid leave worked in manufacturing businesses. Their share of workers in manufacturing was nearly 17 %. Unpaid leave in industries producing machinery, equipment & transport vehicles affected nearly a fifth of workers in that sector. The number of workers employed part-time in surveyed firms also increased. Part-time workers made up about 2.5 % of all those employed in autumn 2016 and about 3 % in the manufacturing industries.

Center for Strategic Research report finds little progress in economic reforms. A new report from the Center for Strategic Research (CSR), which is headed by Russia's former finance minister Alexei Kudrin, came out at the end of December. The report is based on expert assessments of Russia's progress in implementing economic reforms. Special attention was given to measures proposed in the unofficial "2020 strategy for developing the Russian economy" laid out by a vast group of experts in 2011. The report findings will be used by the CSR in drafting its 2018–24 economic development programme at the request of president Putin.

The report claims that less than a third of the reform measures laid out in the 2020 strategy have been implemented. In addition, measures already in place are mostly technical and deeper systemic reforms have been largely avoided. Monetary and fiscal policy are areas where the most reform success has been achieved. Examples include the shift to a floating ruble exchange rate and introduction of the "budget rule". In many key areas of the economy not a single proposed reform has been fully implemented, and the response in some cases has even directly contradicted the reform proposal. These areas include shifting to a new growth paradigm, improving the business environment, reducing the state's role in the economy, improving the quality of institutions and stemming Russia's brain drain.

The report noted several obstacles to reform. A central problem is Russia's administrative structure. The president alone has sufficient authority and resources to push through reforms. Given the vast amount of needed reforms, it is impossible that all could be personally shepherded by the president. Several respondents pointed out that reforms have been complicated also by other factors. Earlier high oil prices provided an easy excuse for putting off reforms, while in recent years geopolitical developments have led to a reordering of national priorities, with economic issues getting moved to a back burner. In addition, reforms face increasing resistance by different interest groups aiming to preserve their own advantage. On preparing development programmes, the report notes that the priorities should be formulated more carefully and precisely and resources mainly focused on realising these priority goals.

To enable reform implementation in the future, the report proposes e.g. the establishment of a new body to coordinate reform policies. It would have its own budget, staff and authority over ministries to implement reforms.

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China

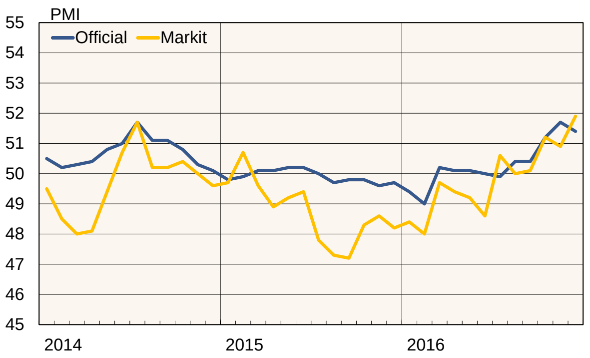
Even with no major shifts in Chinese economic outlook in December, the discussion on 2017 economic growth targets takes a new tone. The government's official purchasing manager indexes (PMIs) for December declined slightly from their November readings. The manufacturing PMI fell from 51.7 in November to 51.4 in December, while the services PMI went from 54.7 to 54.5. An index reading above 50 indicates expansion from the previous month, while a reading below 50 signals a contraction in output.

The private Caixin/Markit manufacturing purchasing managers index, which focuses more on sentiment in small and medium-sized firms, saw a rise in its December reading to 51.9. While the official and private PMI indexes showed conflicting directions in December, their readings suggest economic conditions improved in 2016.

China's 2016 GDP figures will be released on January 20. Earlier information suggests that economic growth in 2016 likely slowed modestly from the 6.9 % pace of 2015. The growth is expected to slow further this year, as the debt situation worsens, uncertainty in the real estate sector continues and the net outflow of capital persists limiting possibilities to stimulate the economy. Rising market interest rates and possible disputes over trade policy with the incoming Trump administration have further clouded China's growth prospects.

Yet even with lower growth, however, the performance of the Chinese economy should far exceed the global growth rate. Therefore, proponents of reform policies and sustainable growth welcome some recent comments on China's growth targets. *Bloomberg* reported a couple weeks ago president Xi Jinping saying to economic decision-makers of the Communist Party of China he is ready to abandon the current GDP growth target of 6.5 %, if reaching the target means excessive debt load and greater risk to economic stability. Last week, a member of the People's Bank of China's monetary policy committee called for more flexible growth targets. This week the lead editorial in *Caixin*, China's leading business magazine, took a strong pro-reform stance and rejected the current blind pursuit of growth targets.

China's manufacturing purchasing manager indexes



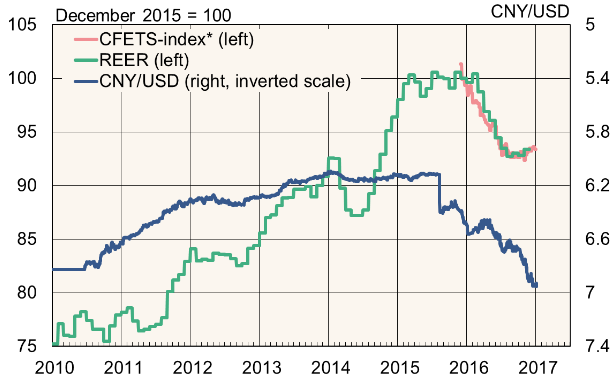
Source: Macrobond.

China adds several currencies to its currency index. The People's Bank of China announced last week that from the start of 2017, its China Foreign Exchange Trade System (CFETS) RMB currency basket would be expanded from 13 currencies to 24 currencies. The added currencies are the Korean won, Turkish lira, Mexican peso, South African rand, Hungarian forint, Polish zloty, Swedish krona, Danish krone, Norwegian krone, as well as the Saudi Arabian riyal and United Arab Emirates dirham, which are both pegged to the dollar. The practical effects of basket expansion on the CFETS RMB index are likely to be minor. Moreover, it is still unclear whether there is any real need for the RMB currency index announced in December 2015 or what purpose it serves. The use of an index based on a large currency basket is not user-friendly, and dollar's central role remains in any case. On every trading day, the PBoC announces its daily "fixing" rate against the dollar, and allows yuan to fluctuate within a 2 % band from the fixing that does not trigger central bank's automatic intervention. Market-makers report their anticipated fixing rate for the next day, which since the summer 2015 reform should be based on the previous day's ending rate and forecast forex supply and demand in the markets. Besides the CFETS RMB index, the PBoC publishes indexes based on BIS and SDR currency baskets.

During 2016, uncertainty over the performance of the Chinese economy accelerated capital outflows and caused the yuan's exchange rate to weaken 6 % against the dollar and 4 % against the euro. The real effective (trade-weighted) exchange rate, or REER, which reflects the price competitiveness of Chinese goods, was down 7 % y-o-y in November.

To quell depreciation pressure on the yuan, China has tightened capital controls and increased their oversight as well as intervened in forex markets. Interest rates are rising on both domestic money markets and in Hong Kong, where the offshore CNH 7-day interbank rate today (Jan. 5) rose to 18 %. Media reports suggest that China is planning further measures to deal with depreciation pressure on the yuan. The yuan's exchange rate has strengthened in recent days. Today, one dollar bought 6.88 yuan and one euro 7.26 yuan.

Yuan CFETS and REER indexes, CNY-USD exchange rate



*) Using original 13-currency basket.

Source: Macrobond.

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