Weekly Review
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Russia

Russian inflation slowed substantially in 2016. Consumer prices were up 5.4 % y-o-y at the end of December, the lowest pace for 12-month inflation since spring 2012. Inflation was nearly 13 % at the end of 2015.

Most of the slowdown in inflation came from a relatively modest rise in food prices, up just 4.6 % last year compared to 14 % in 2015. Food makes up a very large part of the price basket of consumer goods and services. Last year, food (including alcoholic beverages) was 38 % of the basket, a slightly larger share than in previous years. Two food categories distinctly supported overall price moderation. Prices of greens, root vegetables and fruits, which rose rapidly in 2015, were at the end of 2016 considerably below the level of end-2015. Meat and meat products, which for many years have represented nearly 10 % of the consumer basket, only rose slightly compared to the rise in 2015. This was also reflected in the small increase in the price of the official minimum food basket (up a bit more than 3 % last year, compared to almost 9 % in 2015), even if prices of milk and dairy products were up nearly 10 % in 2016.

The rise in prices of non-food goods also slowed, but was still 6.5 % at the end of December. Among them, overall disinflation was mostly supported by a notably milder rise of prices than in 2015 in two categories: passenger cars and clothing & textiles (9 % and 7 % basket shares, respectively).

The prices of services rose 10 % in 2015, but less than 5 % last year. A marked effect came from housing costs which rose considerably more slowly than in recent years (they make up 9 % of the consumer price basket). Especially increases in natural gas rates for households were again below inflation.

The most distinct factor underlying the slowdown in inflation was the ruble's recovery in the course of 2016. The average exchange rate for 2016 was only around 5 % less than in 2015, when the fall was 25 %. In addition, the rise in producer prices moderated significantly, which also reduced pressure to raise consumer prices.

No changes in Russian social entitlements for the time being. The national minimum wage will increase by 300 rubles to 7,800 rubles (€120) a month, but only in June 2017. The labour ministry notes the change will affect about 900,000 wage-earners, over 70 % of whom work in the public sector. The minimum wage was last increased in June 2016. Although the minimum wage has been increased substantially in previous years, it remains well below the average subsistence minimum. The monthly subsistence minimum nationally for working-age people is 10,700 rubles (€170), but varies considerably across regions.

As its name implies, the minimum wage sets a national minimum. Regions are free to mandate higher minimum wage levels. For example, the official minimum wage in Moscow at the end of last year was 17,300 rubles (€270), only slightly less than the local subsistence minimum. The level of the minimum wage also affects many social entitlements.

At the beginning of February, pensions will be adjusted to reflect last year's realised inflation rate. However, no similar index adjustment is planned for maternity assistance (*matkapital*). The lump sum benefit paid to families with two or more children is 453,000 rubles (€7,100). It is designed to support e.g. improving family housing conditions.

Costs to firms from regulatory practices discussed in Russia. Official inspections and Russia's new security-related laws were focal topics last year. Mikhail Abyzov, minister charged with improving administrative transparency, said that Russia annually conducts 2 million official inspections that cost the equivalent of 5 % of GDP. Inspections generate considerable paperwork and tie up company employees for processes that often last several weeks.

Inspections are numerous, but ineffective. As an example, Abyzov noted that deaths from alcohol poisoning in Russia are 20 times higher than the OECD average. In December, nearly 80 people died from poisoning in the Irkutsk region from drinking bath liquid, which, despite its labelling, contained methanol. Following the tragedy, the local deputy director for consumer protection was arrested and a national month-long ban was put on retail sales of several high alcohol-content products not intended for human consumption. Cosmetics boutiques and pharmacies criticised the breadth of the ban and its ineffectiveness in dealing with the problem.

Official inspections can be scheduled or unscheduled. A survey of the Russian union of industrial firms found that about 90 % of firms experienced scheduled inspections conducted in 2015, but about half of firms also experienced at least one surprise inspection. Some 14 % of surprise inspections had been "requested" by competing firms and about 20 % by officials. A new study from the St. Petersburg European University finds a negative relationship between the number of inspections and corporate profitability, even when companies can prepare themselves for planned inspections. Inspection problems have been discussed for years, and the government is trying to solve them with a priority project.

The costs of legislative amendments relating to national security have also raised discussion. Russia's tighter anti-terrorism legislation (the Yarovaya laws) approved in July, includes a requirement that firms offering telecom and data transfer services retain managed data and turn over on request such data to security officials. While estimates on the storage costs vary, an expert group estimate given to the government says they will cost firms about 5.2 trillion rubles (€70 billion). The law should enter into force in June 2018. Another law that came into force recently requires that firms handling personal data must store the data in Russia, creating more costs for firms, especially foreign firms. At the end of 2016, Russian officials shut down the LinkedIn website after inspectors declared it out of compliance with the law.

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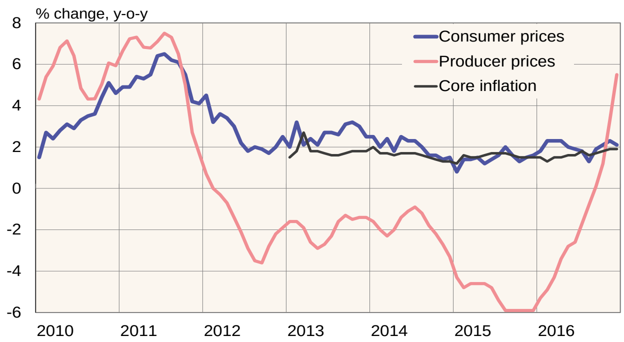
China

Chinese producer prices up 5.5 % y-o-y in December. The recovery in producer prices in China reflects higher commodity prices, the yuan's weakening against the dollar and higher capacity utilisation. In contrast, the rise in consumer prices slowed to 2.1 % y-oy in December. Core inflation, which excludes food and energy prices, remained unchanged from the November 1.9 % figure.

Higher producer prices have reduced worries about deflation and the need for additional stimulus.

12-month inflation in China

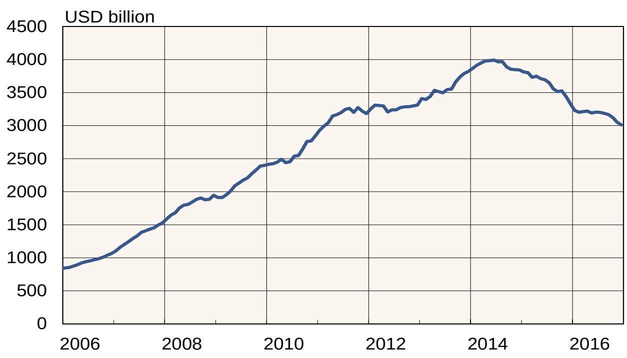


Source: Macrobond.

China's currency reserves fell to $3 trillion last year. Since 2014, China's large trade surpluses have not been sufficient to cover the deficit caused by capital outflows. Even with a brief idling period in the first half of 2016, China's foreign currency reserves have been shrinking steadily. Last year reserves declined by about $320 billion.

The reduction in reserves poses no threat to China's external liquidity. Reserves are still large relative the country's short-term foreign debt and value of imports. Nevertheless, the outflow of capital, shrinking reserves and depreciation pressure on the yuan feed a vicious cycle that leads to recurring market disturbances and further tightening of capital controls that make the current situation untenable.

China's foreign currency reserves 2006–2016, USD billion



Source: Macrobond.

After a bumpy start, most of 2016 was smooth sailing for mainland China's stock exchanges. At the end of last year, China's main stock indices were down about 10 % y-o-y. This reflects the crash in share prices in January 2016 induced partly from the failed introduction of an automatic circuit breaker mechanism to interrupt trading. The mechanism was decommissioned after four days of chaos. After January, China's main share indices rose over 15 %. Chinese stock exchanges this year have seen a much calmer start.

The market capitalisation of the Shanghai stock exchange at the end of 2016 was about $4.1 trillion (40 % of GDP), while the market cap of the Shenzhen exchange was $3.2 trillion (30 % of GDP). In terms of market capitalisation, they were the fourth-and fifth-largest exchanges in the world after the New York Stock Exchange, NASDAQ, and the Tokyo Stock Exchange. Although share trading volumes today are less than half their 2015 peak, the Shanghai exchange is still second after the NYSE, and Shenzhen is number four directly after the NASDAQ in trading volume. At the peak of the 2015 stock craze, the Shanghai and Shenzhen exchanges were the world's largest in terms of trading volume.

IPOs have accelerated in recent months. Last year, a total of more than 200 new listings took place on the Shanghai and Shenzhen exchanges, with several hundred firms still awaiting listing dates. Since summer 2015, when the stock market slide began, IPOs have often been postponed for months. Reform of the listing process and moving to a registration basis have long been under preparation.

Foreign investors remain reluctant to trade in mainland China's stock markets via the 2-year-old Hong Kong-Shanghai Stock Connect arrangement or the Shenzhen-Hong Kong Stock Connect, which launched in December. In 2016, only 1.5 % of the Shanghai exchange's turnover involved trading of foreign investors using Stock Connect. For Shenzhen, the share was just 0.5 % in December. Moreover, most trading activity was churn, so Stock Connect has done little to increase foreign investor participation. Trading of large mainland Chinese investors in Hong Kong rose in 2016. In December, trading of Chinese investors via the Shanghai and Shenzhen exchanges accounted for 9 % of the Hong Kong exchange's daily turnover.

Mainland China's major stock indices, 1.1.2015–12.1.2017

Source: Macrobond.

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