SUOMEN PANKKI FINLANDS BANK EUROSYSTEM 18 11

Weekly Review
28 • 14.7.2017

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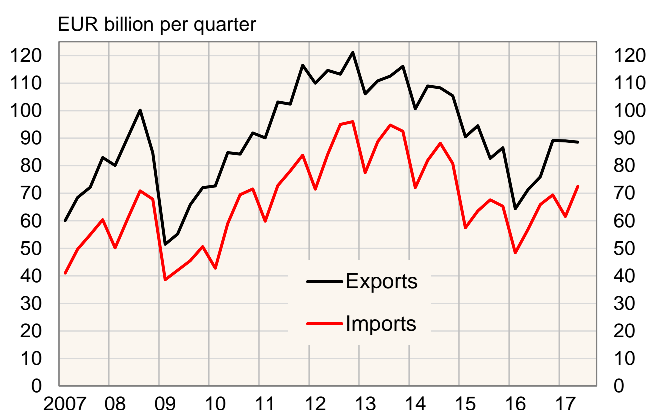
Russia

Recovery in Russian export earnings and imports continued in second quarter. Balance of payments figures from the Central Bank of Russia (CBR) show Russian earnings on exports of goods and services rose by over 20 % y-o-y in 2Q17. The good performance resembled the strong rebound in the first quarter, but both quarters measure their on-year growth against very low levels in the first part of last year. Earnings were up for exports of both energy and other goods, which also in the second quarter was driven to a significant degree by increases in export prices. Exports earnings on services also continued to rise.

Russian spending on imports of goods and services was up about 25 % y-o-y in both the first and second quarters. Spending on goods imports was up about 30 % y-o-y. In euro terms, spending on imports was about the same as in 2011 for both total imports and goods imports. Service imports increased more slowly, but within the category, imports of travel services (i.e. purchases of goods and services by Russian travellers abroad) were up about 30 %.

Following a common pattern, the Russian goods trade balance in the second quarter was strongly in surplus and the services balance was in deficit. The rest of the current account, however, was slightly more in deficit than usual. Much of the higher deficit reflected outward dividend and interest payments on investments made from abroad in Russia's corporate sector. The current account balance overall was slightly in the red.

Russian foreign trade (goods and services) 2007–2017



Source: CBR.

Capital outflows from Russia paused. Preliminary 2Q17 balance of payments figures indicate that the net private sector capital flow turned slightly in favour of Russia, a rather exceptional situation in recent years.

The net flow of capital to Russia's corporate sector (excluding banks) was notably positive. This was due mainly to direct investment flows both into and out of Russia. In the second quarter and the first half overall, foreign direct investment flow into the corporate sector was up slightly from recent years (if the sale of a large stake in Rosneft oil company, which greatly boosted the 4Q16 FDI figures, is omitted). On the other hand, FDI inflows in the first half only equalled about 2 % of Russia's half-year GDP. Russian firms, in turn, made considerably less direct investments abroad in the second quarter than in previous years.

Second-quarter capital outflows from Russia's banking sector were rather hefty as banks continued to pay down their foreign debts at a brisk pace.

Russia's deposit insurance agency is given the administration of Yugra Bank. In terms of total assets, Yugra is Russia's 30th largest bank. It has been placed under temporary administration by Russia's Deposit Insurance Agency (DIA), with its payments frozen for three months. During the period of temporary administration, the DIA will decide whether to restructure the bank or wind it down. Yugra Bank grew quickly in recent years through aggressive pursuit of deposits from the general public and channelling them to lending to companies. The bank's main owner is a company registered in Switzerland that is itself owned by Russian businessmen.

In May, the Duma approved a bill that shifts the burden of financial restoration of troubled banks and restructurings from the DIA to the CBR. A separate fund created with CBR assets was established to finance restructuring efforts. The new system will be introduced not until end of this month, which could make Yugra Bank its first client.

The DIA financial restoration programmes covered 25 banks in the early part of this year. In addition, the DIA is responsible for winding down banks that have lost their licences. The number of banks undergoing bankruptcy proceedings increased in both 2015 and 2016 by almost 30 %, reaching 295 by the end of last year. The DIA has found it increasingly difficult to deal with these processes in a smooth manner, and the time spent on winding down banks and the costs of the processes have risen substantially.

The prime mission of the DIA is to guarantee the deposits of private individuals up to 1.4 million rubles when a bank loses its license. The number of deposit insurance claims has increased almost as fast as the pace of bank licence cancellations. Banks that lost their licences last year included several mid-sized deposit banks, and the DIA received 11 insurance claims costing a total of more than 10 billion rubles each. For all of 2016, a total of 564 billion rubles (7.6 billion euros) was paid out of the deposit insurance fund. The fund's assets were insufficient to handle all the payments, so the DIA was granted cheap credit from the central bank to cover the difference.

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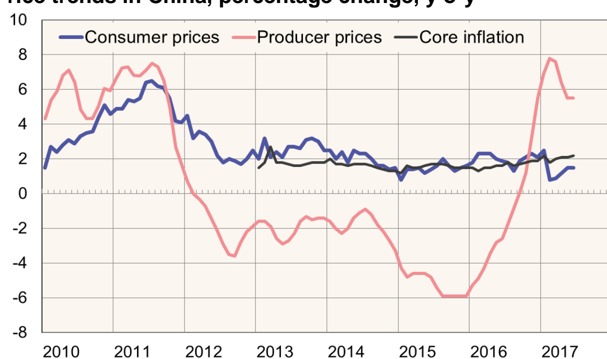
China

Consumer price inflation holds steady in China. As in May, June consumer price inflation was 1.5 % y-o-y. Core inflation, which excludes food and energy prices, also remained steady. This year's official inflation target is 3 %, so price trends at the moment do not restrict macro-level policy.

Producer prices have fallen each month since April, but 12-month producer price inflation in June was still up 5.5 %. Producer prices track energy and commodity prices, so a slowdown in the on-year rise in producer prices is expected.

Price trends in China, percentage change, y-o-y



Source: Macrobond

Yuan use as a reserve currency unchanged; use in international payments declines. Fresh IMF figures show that the value of yuan-denominated currency reserves globally at the end of March was 83 billion dollars. This is slightly more than in December 2016, when the IMF first published information on the yuan as a reserve currency. At that time, yuan assets worth of 79 billion dollars was reported by COFER respondents that separately account RMB holdings. The yuan's share of allocated foreign currency reserves fell slightly, however, to 0.93 %. When also other than currency reserves are included, the yuan's share of official reserve assets rose slightly from the December figure to 0.76 %.

The European Central Bank said last month that it had made the yuan a reserve currency in the first half of this year. The value of the ECB's yuan investments is only 500 million euros, or 1 % of the value of its foreign currency reserves, making the yuan addition a largely symbolic gesture.

SWIFT, the global association for secure interbank financial transfers, notes that yuan payments accounted for 1.6 % of international transfers in May, or about the same share as the Swiss franc. In late 2015, the yuan was used in 2.3 % of international payments. In the first six months of this year, less than 13 % of China's foreign trade was conducted in yuan, down from 19 % in 1H16 and 26 % in all of 2015.

Funding deficit threatens pension system; China must move ahead with reforms. China's pension system needs reform to put its funding on a sustainable footing. China's population has been aging rapidly due to the one-child policy introduced in 1979 and rising life expectancy. The World Bank notes that China's old-age dependency ratio in 2016 rose to 14 persons aged 64 and above per 100 working-age persons (Finland 34). The measurement method overlooks the fact that retirement ages in China are well below 64. While currently the situation is still manageable, the greying of China gives reformers little opportunity for delay. The UN forecasts that China's old-age dependency ratio will hit 44 by 2050 (i.e. 44 people over 65 for every 100 working-age persons).

China's pension system consists of the state pension system, corporate pensions and voluntary worker pension savings arrangements. Payment into the government pension system is mandatory for urban workers. An urban-dweller pays a mandatory work pension payment equal to 8 % of his or her gross wage into a personal pension account. The employer then contributes an amount equal to 20 % of the gross wage to the pension fund. The pension is paid in part from the pension account and in part from the pension fund. All people who have paid into the pension system for at least 15 years are entitled to a pension. Large, wealthy firms also pay into a corporate pension scheme. In rural areas, government pensions are small and contribution to the system is not compulsory. For this reason, most people do not pay into the pension system and do not receive pensions.

Without reform, the current system will suffer from a severe financing deficits as the numbers of elderly Chinese grow. China's human resources and social security ministry reports that pension fund spending in 2015 rose faster (up 20 %) than revenues (up 17 %). The same year, China announced the elimination of the public-sector exemption from pension contributions. Last year, pension funds gained the right to invest in equities. Both measures are intended to increase pension fund revenue streams. In January-May 2017, fund revenues increased slightly faster than expenditures. Investment of pension fund assets in domestic shares is problematic in terms of system sustainability due to the high risk of speculative stock market bubbles in China.

China's low retirement age poses a huge challenge. Women are generally eligible for retirement between 50 and 55. The retirement age for men is usually 60. By one estimate, raising the retirement age by one year increases annual pension revenues by 4 billion yuan and reduces pension costs by 16 billion yuan. An increase in the pension age would ease the financing deficit, which by some estimates could be as much as 1.2 trillion yuan (155 billion euros) by 2019.

Progress in reform is slow. The government is expected to issue information on pension reform this year, even if preliminary reports suggest that implementation would not begin until 2022, after which the retirement age would be gradually increased over the next 30 years. At that time, the pension age would reach 65 for men and 60 for women. A planned hike in the pension age for women threatens to further lower China's already low birth rate and labour force participation rate of females. Chinese families have traditionally relied on grandmothers to provide child care as there are few possibilities for getting children into organised daycare.

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