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BOFIT Weekly

32 • 12.8.2011

Russia

Ruble falters and share prices slump. After being relatively steady since the spring, the ruble's external value plummeted in recent days as jitters on international markets spread to emerging markets.

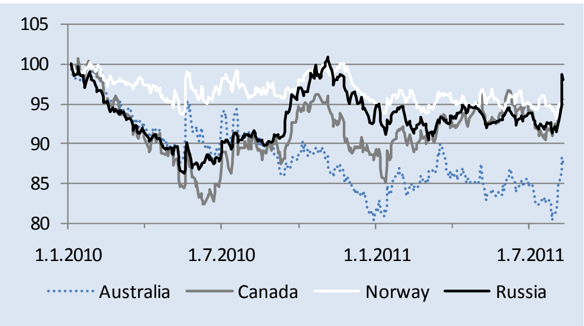
The ruble has lost about 6 % of its value since August 1 against the Central Bank of Russia's dollar-euro currency basket. The drops witnessed this week were the largest since January 2009. Currency trading volumes were also exceptionally large as both domestic and foreign investors dumped rubles. Relative to its dual-currency basket, the ruble is now at the same level as in late 2010. On August 12, one dollar bought 29.4 rubles and one euro 41.9 rubles.

On Tuesday (Aug. 9), the CBR intervened for the first time this year in an effort to stem ruble depreciation. Observers estimate the central bank burned through $200–700 million to support the ruble.

The CBR's foreign currency and gold reserves have continued to grow since the start of the year. As of end-July, Russia's currency reserves stood at $534 billion, up from $479 billion at the start of the year.

The ruble's slump partly reflects the global drop in crude oil prices that began at the end of July and picked up steam this week. As of August 11, the price of Urals-grade crude oil stood at $107.0 per barrel, down from $115.6 on August 1. In the first half of this year, Urals oil averaged $109.1 a barrel.

Exchange rates of commodity-exporting countries' currencies vis-à-vis the euro, 1.1.2010=100 (declining trend = appreciation vis-à-vis the euro)



Source: ECB

As on stock exchanges around the world, Russian share prices plummeted this week, with the RTS index shedding 15 % of its value. After the drop, the RTS index was down 27 % from its post-crisis peak in April. The RTS currently stands at the same level as in October 2010. Observers report that foreign investors, in particular, have been shifting their assets out of Russia on worries that declines in oil and other commodity prices will continue.

The rise in consumer prices stalled in July, reflecting the summer drop in food prices. 12-month inflation was 9 %, down from 9.4 % in June.

Russia continued to export capital in the first half of the year. Preliminary CBR balance-of-payments figures show Russia exported a net of $31 billion in private capital in the first half of 2011. Banks exported $12 billion in capital in the first half of the year, while non-banks exported $19 billion. In 1H10, private capital exports amounted to $12 billion, and were $34 billion for all of 2010.

Capital exports of banks in the first half largely reflected large loans granted by state-dominated Sberbank to Russian firms. Such loans are booked as capital exports when paid outside Russia.

Foreign direct investment enjoyed a robust rebound in the first half of this year as Russia received $27 billion in FDI, an increase of 50 % from 1H10. Despite the strong growth, direct investment inflows into Russia were still smaller than FDI outflows for the third year in a row.

Russia increases government borrowing. The government approved on Thursday (Aug. 11) a state debt policy programme for 2012–2014, prepared by the finance ministry. The policy message stresses that the federal budget is likely to remain in the red through 2014 due to growth in spending, even if revenues remained strong due to high world commodity prices.

The federal deficit will be financed largely through borrowing, which will increase sharply from current levels. The increase in indebtedness is expected to be quite manageable, however, as Russia currently has a small debt burden relative to GDP. Even so, the programme warns that the increase in indebtedness and debt-servicing costs carries risks, especially if growth in the global economy suffers another major setback.

Domestic bond issues will finance nearly 90 % of the deficit, which translates to an average of about 2.0 trillion rubles ($70 billion) a year in borrowing. Foreign bond issues will amount to about 200 billion rubles ($7 billion) a year. Russia's public debt is expected to rise to 12 trillion rubles ($410 billion) or 17 % of GDP by the end of 2014.

Russia's finance ministry reports that Russia's public debt stood at around 4.6 trillion rubles (about $160 billion or 9 % of GDP) at the end of June. Of that, domestic investors held 3.6 trillion rubles ($125 billion) and foreign investors $37 billion.

Russian officials say the country's creditworthiness has been underrated by the major international credit ratings agencies given its low debt-to-GDP ratio. Russian bonds are barely considered investment grade, on par with the sovereign debt of Mexico or Brazil.

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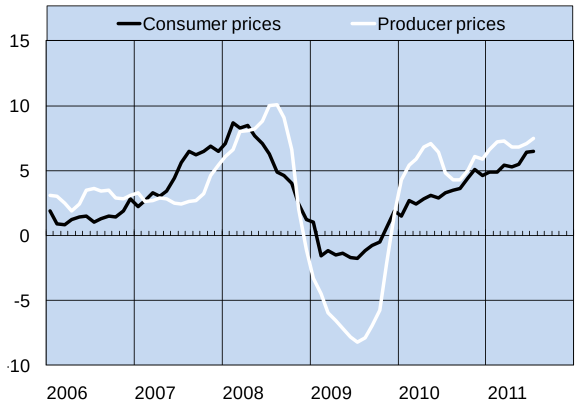
China

Inflation limiting China's economic policy choices. July consumer prices hit 6.5 % y-o-y, up from 6.4 % in June. July prices rose 0.5 % on-month, up from 0.3 % m-o-m in June. Consumer price inflation was driven by rising food prices, which were up nearly 15 % y-o-y, while the average price for the other items in the shopping basket rose 2.9 % y-o-y. Housing prices climbed 5.9 % y-o-y, but showed virtually no change from June to July.

Despite high inflation, China's leadership is not expected any time soon to further tighten its monetary policy stance as inflation is not expected to accelerate further. While the rather bleak outlook for the global economy lessens commodity price pressures, the current situation also poses risks to China's growth prospects.

Yuan strengthening against the dollar is also quelling rising import prices. On Thursday (11.8.), the yuan-dollar exchange rate fell below 6.40 for the first time since the unification of yuan exchange rate in the beginning of 1994.

Chinese inflation rates, 12-month percentage change



Source: Bloomberg

Growth in industrial output and retail sales in July slowed as expected. July industrial output climbed 14 % y-o-y in real terms, a percentage point lower than in June. Seasonally adjusted industrial output rose 0.9 % m-o-m in July, the smallest monthly increase this year. While growth in e.g. the textile industry was below 9 % y-o-y, cement production, which reflects levels of construction activity, increased 17 % y-o-y. Electricity production was up 13 % y-o-y in July, suggesting that China's economic growth was fairly broad based.

The value of retail sales in July was up 17 % y-o-y, or a half percentage point lower than in June. The pick-up in inflation ate into real growth in retail sales; the 12-month rate fell below 11 % in July. In addition, seasonally adjusted on-month changes suggest the slowdown continued from the previous months.

There were few surprises in investment trends in July. Fixed capital investment was up 25 % y-o-y in January-July in nominal terms, or about the same growth pace as seen earlier this year. Manufacturing accounted for over a third of total fixed capital investment, while investment in housing was about a fifth. Monthly investment statistics do not reflect the national accounts figures as they include e.g. land buying transactions.

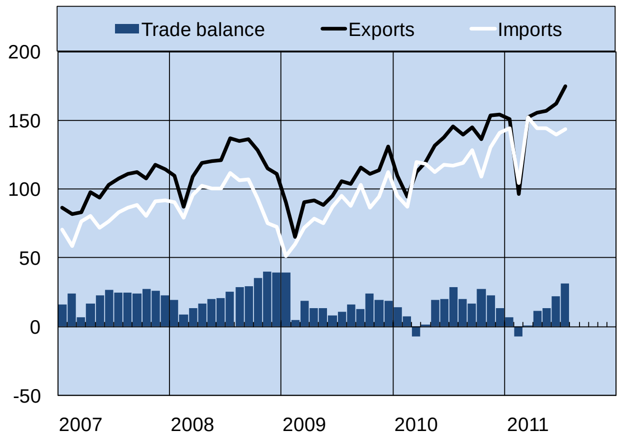
China's trade surplus ballooned in July. The value of China's exports climbed 20 % y-o-y in July to $175 billion. The value of exports in January-July was up 23 % y-o-y. Despite the damage inflicted by natural disasters and the Fukushima nuclear accident, growth in Chinese exports to Japan held steady relative to 2010. Exports to Japan climbed an average of 24 % in January-July, about the same as in the first seven months of 2010.

The debt problems in Europe and the United States were reflected in a slowdown in China's exports to both regions. Exports to the EU still rose 18 % in January-July, but the growth was down from 37 % in the same period last year. Growth in exports to the US was up 16 %, compared 30 % growth in the same period last year.

The value of imports into China reached $144 billion in July, an increase of 23 % y-o-y. In January-July imports were up 27 % y-o-y. The high value of imports largely reflected high commodity prices in the first half of the year; import volumes increased only modestly.

The recent global economic nervousness will eventually show up in China's trade figures. China still showed a $32 billion trade surplus in July, which was about 10 % bigger than in July 2010. The trade surplus once again boosts China's large foreign currency reserves, which adds appreciation pressures on the yuan.

Monthly foreign trade for China, US$ billion



Source: CEIC

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