Weekly Review
22 • 31.5.2019

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Russia

Russian industrial output growth accelerated in April. After three months of lower growth this year, industrial output growth accelerated in April to 4.6 % y-o-y. For the January-April period, industrial output grew by 2.8 % y-o-y.

Growth in mineral extraction industries has slowed slightly from the strong performance of 2H18, but on-year growth during the first months of this year was still close to 5 %. Production of crude oil and natural gas rose by 3.5 % in January-April.

Growth in manufacturing output accelerated in April, even if on-year growth in January-April was just 2.2 %, less than half the growth pace of the mineral extractive sector. The outcome of the first four months of the year was quite weak in the machinery & equipment category, likely due to a substantial cut in government procurement spending. In contrast, rapid growth continued in many industries producing consumer goods, including food and pharmaceuticals.

The rise in nominal wage growth has slowed this year. In January-April, wages were up 6.6 % y-o-y. On-year growth in real wages in the first four months of the year was 1.4 %. Even so, the contraction in real disposable incomes continued.

Changes in the country structure of Russian inward and outward foreign direct investment. Flows of foreign direct investment, especially inbound FDI flows to Russia, have continued to decrease in recent years. The role of EU countries other than Cyprus as immediate sources or recipients of the FDI increased. The shares of large EU economies, however, are relatively small.

When considering the ultimate source or recipient countries of FDI flows in Russia's case (no published overall data), it is important to remember that Russian investors move large amounts to countries that provide favourable treatment and then repatriate the money to Russia as direct investment. The FDI inflows to Russia from foreign firms also often move indirectly via third countries.

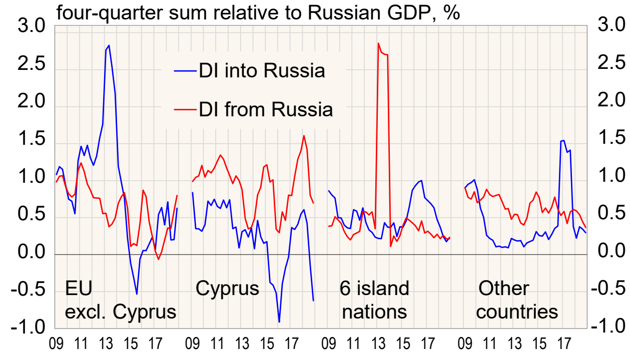
As regards the pattern of recent years for EU countries other than Cyprus, most FDI inflows to Russia came from the UK and Luxemburg, while outbound FDI from Russia went especially to Austria and also the UK. Russians have pulled out significant amounts of their FDI from the Netherlands. The FDI flow from Russia to Cyprus remains substantial. Cyprus is still overwhelmingly the largest FDI recipient from Russia. In turn, FDI made earlier from Cyprus to Russia have been wound down (negative flows) in recent years.

Somewhat reminiscent of Cyprus, several other small island states have received considerable amounts of Russian FDI. While FDI flows between them and Russia overall have declined clearly in recent years, the roles of certain island havens such as the Bahamas, Jersey, British Virgin Islands and Bermuda continue to create a notable share of business. The popularity of Gibraltar, as well as Saint Kitts and Nevis islands, was short-lived in the early years of this decade.

The role of other countries as immediate FDI sources or recipients has remained more stable. The top of these countries for Russia are Singapore and Switzerland. The shares of e.g. the US, Japan and China remain much smaller.

The two big peaks in FDI flows in this decade basically reflect ownership changes related to state oil giant Rosneft.

FDI flows into and from Russia, 2009–2018



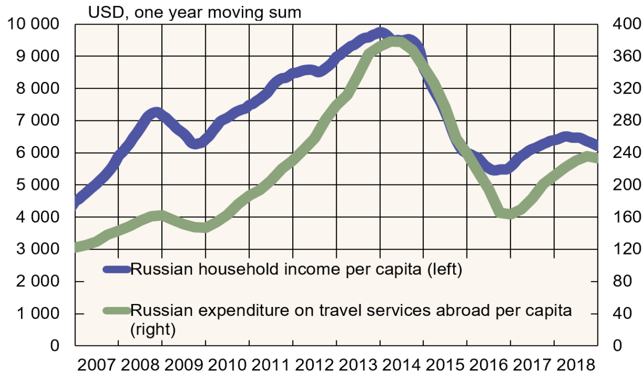
Sources: Central Bank of Russia, Rosstat and BOFIT

Russian expenditure on travel services abroad grew slightly last year. The Central Bank of Russia reports that Russians last year spent 34 billion dollars on travel services abroad, a 9 % increase from 2017.

Turkey, Germany, Spain, Thailand and Italy topped the list of countries in Russian travel spending. Russian tourism abroad is highly dependent on the purchasing power of income earned in Russia. In 2014–2016, the ruble's external value declined along with the collapse in oil prices, but since then it has remained rather stable. As nominal wages have grown, Russian wage-earners have seen a slight improvement in their foreign purchasing power.

Foreign visitors last year spent 12 billion dollars on Russian travel services, a 27 % increase from 2017. Earnings on tourism services were boosted last summer by Russia's hosting of the FIFA World Cup championships.

Russian household income and Russian expenditure on travel services abroad



Sources: Rosstat, Central Bank of Russia and BOFIT

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China

Officials take over troubled Chinese bank. Faced with insurmountable financial difficulties, Baoshang Bank, which operates mainly in Inner Mongolia, was taken over last Friday (May 24) by the China Banking and Insurance Regulatory Commission (CBIRC) and the People's Bank of China. Officials explained the takeover was justified by the need to protect the interests of small depositors and other customers.

Baoshang's day-to-day operations have been farmed out to state-owned China Construction Bank. The central bank also announced it will give liquidity support for the troubled bank. Baoshang's most recent annual financial statement was filed in 2016.

Excessive credit risk, a high-growth strategy and overreliance on funding from the interbank market sealed Baoshang Bank's fate. The bank's solvency has been weaker than that of most rivals, and has been declining for years. On paper (according to the latest available figures), the bank still enjoyed decent profitability, but the decline in the quality of its lending portfolio is not necessarily reflected in profits. The share of non-performing receivables on the balance sheet increased, but the bank only reported a modest less-than 2 % share at the end of 2016.

Baoshang experienced rapid growth this decade. During 2013–2017, its total assets more than doubled and lending to the public nearly tripled. Deposits, however, failed to keep up with the lending spree, making Baoshang extremely dependent on borrowing from other banks. The bank's debts to other banks nearly quadrupled during 2013–2017.

Baoshang is small enough that its collapse will probably not have major systemic implications. Yet it still ranks among China's top 50 banks and employs a staff of about 8,000. The size of the bank's balance sheet is only a couple per cent larger than that of ICBC. However, the incident could have wider implications, if it weakens public confidence in other small regional banks. China's banking system is mostly in government hands, but Baoshang's majority owner was a private entity called Tomorrow Holding Group.

China has a number of small and mid-sized banks whose growth has been similar to Baoshang's in recent years. However, they generally seem to have better solvency ratios and they have not expanded as fast as Baoshang.

According to the CBIRC statistics, there are about 4,000 banks currently operating in China. The five largest commercial banks control about 40 % of the banking sector's total assets. China's twelve joint-stock banks represent about 20 % of sector assets. There are around 130 city commercial banks that control just over 10 % of sector assets, as well as three policy banks that have a combined 10 % share. Other banks, mostly rural banks and the postal bank, account for about 20 % of banking sector assets. In recent years, small and mid-sized banks have rapidly expanded their balance sheets.

China's monetary policy not particularly loose this year. While the PBoC has lowered reserve requirements for banks this year, the net effect of its applications of various monetary instruments has been to reduce net liquidity in the system. In China, a broad range of policy instruments is used to adjust the monetary policy, so the overall monetary stance has to be evaluated as the combined effect of all tools.

Reserve requirement ratios (RRRs) were lowered twice in January, which was estimated to add about 1.5 trillion yuan in liquidity to the system. In May, the central bank announced a targeted RRR cut affect about 1,000 rural banks (implemented in three phases between May 15 and July 15.), which is expected to increase the liquidity by CNY 280 billion.

The net impact of open market operations (OMOs) this year (as of May 28) has been to reduce liquidity by about CNY 610 billion. The PBoC has granted commercial banks CNY 400 billion in medium-term lending facility (MLF) funding this year, considerably less than maturing MLF debt (CNY 1.73 trillion).

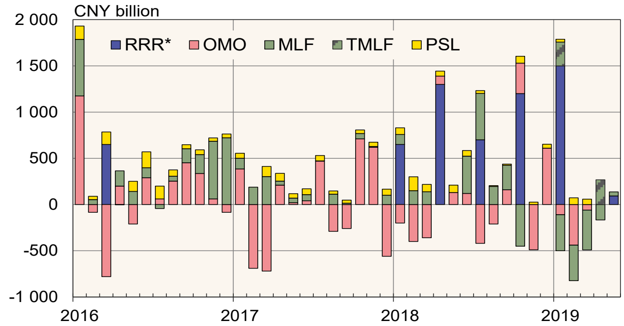
Since the beginning of the year, the central bank has used its new targeted medium-term lending facility (TMLF) to provide banks funding at slightly lower rates for small business lending. At total of CNY 520 billion in TMLF credit was issued in the first four months of this year.

The overall impact on liquidity in January-May from the monetary policy measures has been fairly modest (estimated at about CNY 200 billion or USD 30 billion). In the same period last year, increase was clearly higher (estimated at CNY 1.6 trillion or USD 240 billion). The figures do not include pledged supplementary lending (PSL) provided to three policy banks.

The PBoC has kept interest rates unchanged this year. For example, the rate on the one-year MLF credit is 3.3 % (TMLF credit at 3.15 %) and the rate on the 7-day reverse repo used in open market operations is 2.55 %. Other central bank rates have also remained unchanged. This week, PBoC governor Yi Gang said that the central bank could finally waive the announcement of loan reference rates. Restrictions on interest rate pricing of commercial banks were lifted, at least nominally, already in 2015.

The decrease in central bank funding may reflect lower financing demand from commercial banks. A cautious monetary stance that resists easing might also reflect increased devaluation pressure on the yuan due to the intensified trade war.

Impact of PBoC monetary policy measures on net liquidity



** Estimate based on PBoC announcements (omits bank-specific changes)*

Sources: PBoC, CEIC and BOFIT.

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