

Russia

CBR leaves key rate unchanged. On October 28, the board of the Central Bank of Russia decided to keep its key rate at 10 %, where it has been since September 19. The CBR reiterated that no further rate cuts should be expected this year, but the key rate can thereafter fall if there are signs that inflation is cooling as expected and inflation risks are abating.

The CBR said 12-month inflation slowed to 6.2 % at end-October, but noted that much of the slowdown reflects transient factors such as this year's good harvest. The ruble's exchange rate has also appreciated and inflation expectations are rather high. The CBR said holding the key rate unchanged should reduce inflation expectations and encourage saving.

The recovery in output is unstable and has been uneven across branches and regions. The CBR said most barriers to growth are structural, so a moderately tight monetary stance should not prevent economic recovery.

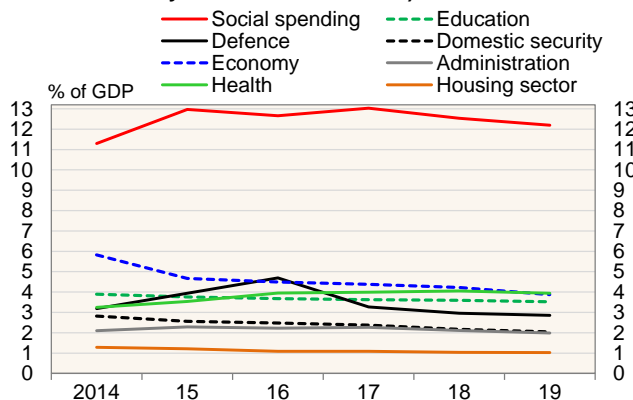
The CBR's inflation target is still 4 % at the end of 2017, but possible risks to reaching that figure include inertia of inflation expectations, lower household savings, higher real wages, pending decisions on mid-term fiscal policies, and volatility in commodities and financial markets. The CBR's next regular board meeting is set for December 16.

Russia's special supplement to defence spending also affects next year. In the budget policy framework for 2017–2019, the finance ministry foresees that defence spending will decrease sharply after this year's large increase. The draft of this year's supplemental federal budget, currently before the Duma, sees defence spending rising to its highest level in over 20 years to 4.7 % of GDP. Defence accounts for over 13 % of consolidated budget government spending this year. Spending on domestic security is 6.7 %. The respective shares of federal budget spending are nearly 24 % and 12 %, or almost 36 % combined. There is no reason to add any so-called secret spending of approved budgets to the above draft budget figures as in draft budgets the sum of all main categories adds up to total spending. The Stockholm International Peace Research Institute (SIPRI) estimates that defence spending has for years been roughly one percentage point of GDP higher than presented in official budget data.

The massive supplement to this year's defence spending is a very special measure. The additional money will go to paying off defence industry bank debts that are guaranteed by the state. Finance minister Anton Siluanov said this enables new borrowing by the companies to facilitate e.g. implementation of the armament programme. For new borrowing, the ceiling on state guarantees for 2016 will increase sharply.

The ministry estimates that social spending will rise to 36 % of total consolidated budget spending. That share would rise even higher without the earlier decision that pensioners who are working no longer receive inflation adjustments to their pensions.

Main categories of government spending (consolidated budget, finance ministry estimates for 2016–19)



Source: Ministry of Finance.

Russia's middle class hit by recession. A new Sberbank survey finds that the number of Russians that see themselves as middle class has declined sharply over the past two years. A study from the Institute of Sociology of the Russian Academy of Sciences (ISRAS) finds that the "core" middle class has suffered relatively more than lower income households.

It is difficult to evaluate trends or the size of the middle class in any country, because there is no clear agreement as to what constitutes middle class. In Russia, the middle class is a concept dealt with widely in studies of the Russian Academy of National Economy and Public Administration (RANEPA) and ISRAS. In these studies, the concept of middle class incorporates factors such as income, property, education, profession and personal experience. Some 10–20 % of the total population has been estimated to form the core middle class in recent years. Under broader definitions, the size of the middle class expands to 20–40 % of the population. RANEPA estimates that the percentage of households that would rank as middle class has remained largely stable throughout the past decade and a half. ISRAS found that it had grown from 30 % to 40 % over the past decade.

Due to data availability, international comparisons typically focus on income or wealth. A popular approach is to define a middle-class household by daily income: in the range of \$10–20 for middle class and \$20–50 for upper middle class (adjusted for purchasing power and household size). Using this definition, the Pew Research Center, for example, finds the Russian middle class increased from 28 % in 2001 to 37 % in 2011 and the upper middle class from 9 % to 36 %. In 2011, 18 % of the Chinese population was middle class and 4 % upper middle class; the figures for the US were 7 % and 32 %.

When wealth is compared, the middle class typically is smaller, because wealth is more unevenly distributed. A Credit Suisse survey classifies a household as middle class or higher if it has assets of at least \$50,000 (PPP). Under this criterion, 4 % of the Russian population were middle class in 2015 and 0.5 % above that. In China, the share of middle class was 11 % and in the U.S. 38 %.

China

China tightens measures to deal with overheating of the housing market. Access of real estate developers to external funding has been severely restricted since the past month. The financial magazine *Caixin* reports that the National Development and Reform Commission (NDRC) has cancelled bond issues by builders in mainland China and Hong Kong. The China Securities Regulatory Commission (CSRC) is withholding permission from mainland construction companies seeking to stage IPOs on the Hong Kong exchange. Officials are also in the process of drafting stricter guidelines for construction company bond issues. Without bond financing, it becomes harder to purchase land use rights, the prices of which have soared recently. By stricter rules, the government may also be trying to better shield investors from the increased risk in the branch and costly bailouts.

The new restrictions follow ad hoc attempts to deal with the overheating problem in dozens of cities. Measures such as higher downpayment requirements and limits on the number of apartments private persons could own were insufficient to stem the rise in prices. These measures are reminiscent of actions after the stock market collapse in summer 2015, when the state intervened heavily in the market.

The government's measures are geared to slowing the rise in apartment prices, which in China's big cities were still up on average 17 % y-o-y in September. The National Bureau of Statistics last week took the unusual step of releasing mid-month price figures for October. They showed a slowdown in price growth in urban apartment prices from September.

The housing price boom has been fuelled by easy access to housing loans. The stock of housing loans held by the banking sector at the end of September stood at 18 trillion yuan (25 % of GDP), an increase of 33 % y-o-y. In the third quarter, 70 % of new bank lending went to households, mostly in the form of housing loans. The People's Bank of China has attempted to quiet the rapid growth in housing loans through use of its suasive policy tool known as "window guidance." Media report that the PBoC last month invited representatives of the largest commercial banks to a meeting in Beijing, at which banks were encouraged to tighten their housing loan criteria and improve monitoring of loan performance.

PBoC figures show that the average interest rate on a housing loan was 4.6 % p.a. in June, about one percentage point lower than in summer 2015. Notably, many apartment buyers have borrowed their downpayment money from peer-to-peer lenders or used other financial arrangements provided by the shadow banking sector, where interest rates are considerably higher than those of regular banks.

China reaps good grain harvests this year. The National Bureau of Statistics reports that China has enjoyed bountiful grain harvests this year, even if the summer harvest was 2 million tons less than in 2015. The summer harvest, only represents about a fifth of the annual harvest, however.

Harvests overall have increased substantially in recent years. China produced 621 million tons of grain in 2015, compared to 546 million tons in 2010. The larger harvests reflect increased land area under cultivation and adoption of more efficient farming practices (e.g. new cultivar varieties, acquisition of modern farm equipment, wide use of irrigation systems and targeted fertiliser use).

China's obsession with staple crop production reflects the national self-sufficiency policy. In practice, soy beans are only staple China has to import in large quantities. The rapid growth in harvest size and the state subsidy arrangements have led to massive inventories in the state's grain stores. For example, China's maize (corn) reserves now represent about half of all global reserves. The government this year has tried to auction off maize stored from previous years, abandoned its generous system of price guarantees and reportedly ceased to buy maize harvested this autumn. The price of maize in China, which still exceeds world prices, is now falling and expected to decline further. Many foreign producers worry that Chinese maize will flood onto the global market and depress the world price.

Domestic meat production is down from last year, while meat imports from abroad are increasing. China will apparently become the world's largest pork importer (it has long been by far the world's largest pork producer and consumer).

President Xi Jinping increases his power as party leader. The final communique from last week's four-day plenum of the Central Committee of the Chinese Communist Party said that Xi Jinping had been elevated to the status of "core" party leader. While the new status is informal, political scientists say the move grants Xi unconditional authority within the party and the right to veto party decisions. Xi's predecessor, Hu Jintao, was never granted core status, but his predecessor, Jiang Zemin was. As a result, some interpret Xi's elevated status as a drop in Jiang's post-presidency influence.

From the standpoint of badly needed economic reforms, the developments on the political front are quite interesting. President Xi openly praised an anonymous letter from an "authoritative" person that was published on the front page of *China Daily*, the party's main paper. The letter strongly criticised debt-fuelled growth policies and demanded comprehensive economic reforms. The emerging economic policy framework depends, however, on the outcome of the party conference to be held in the latter part of 2017. At that time, in addition to other changes in party posts, there will be the membership rotation of the Politburo's seven-member Standing Committee. Xi's status upgrade should give him more personal discretion on who gets picked.

The prospects for comprehensive market reforms, however, are overshadowed by the fact that domestic surveillance has increased under Xi's leadership, leading to greater censorship, a variety of morality campaigns and changes in the business environment that directly conflict with development of a market economy. Moreover, in spite of Xi's increased clout, ongoing differences within the party over the direction of economic policy and its implementation will persist.