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Russia

State set to divest a majority stake in rail freight company. Freight One Company PGK (*Pervaya Gruzovaya Kompaniya*) is a subsidiary of the 100 % state owned Russian Railways. The sale of PGK shares has been long planned, but the Russian government has found it difficult to agree on the terms of the sale. The sale of stakes in companies owned by the Russian Railways is part of the government's privatisation programme.

A 75 % stake (minus two shares) in PGK will be sold at an auction to take place this year. Qualified buyers must be companies registered in Russia to engage in rail freight operations and own at least 15,000 rail wagons. The requirements limit the pool of potential buyers to Russia's largest freight firms. Interested buyers include three of Russia's oligarchs, whose business empires include shipping fleets. PKG is valued at around 154 billion rubles (nearly €4 billion).

PGK, which carries over 20 % of Russia's rail freight, is Russia's largest rail freight company.

Russian rail operations can be divided into three categories. State-owned Russian Railways controls most of the track and rail network, and handles the lion's share of rail passenger traffic and part of freight business. The second category is made up of firms that belong to industrial companies. They have own rail lines that connect their often remotely located production operations to the national rail grid. Gazpromtrans is a typical rail company in this group. The third group consists of mostly private firms, sometimes with multinational ownership, that only own rolling stock.

Customers demand lower gas prices from Gazprom. Over the past couple of years, several western European energy companies have pushed Gazprom to renegotiate their gas pricing arrangements. Gazprom supplies gas under 10- to 25-year contracts, where the gas price is tied to prices for certain oil products. Over the past two years spot-market prices for gas have been lower than the prices in the long-term contracts.

In 2010, Gazprom agreed with some European gas buyers (e.g. the German E.ON, the Italian Eni and the French GDF) that part of their gas supplies would be provided at spot-market prices through to 2012. Gazprom has not been willing to decrease its prices significantly, and negotiations are continuing.

In summer 2010, the Italian Edison took the initiative by bringing its gas price dispute with Gazprom to the Stockholm Arbitration Institute. The parties settled last month before the Arbitration Institute's decision, with Edison getting lower prices.

Edison is relatively small customer; it annually purchases less than 2 billion cubic metres of gas from Gazprom. An Edison press release noted that the revision would be worth about €200 million for the company.

The German energy giants E.ON and RWE have also turned to arbitration for contract modification. Granting similar discounts would cost Gazprom billions of euros in potential income. E.ON annually purchases 15–20 billion m^3 of gas from Russia; RWE around 9 billion m^3.

Gazprom last year supplied 24 % of the gas used in Europe. Gazprom lost market share in recent years as it was forced to compete with new gas sources such as shale gas, which has lowered spot-market prices for natural gas globally. In recent months, Gazprom clawed back a bit of market share due to supply disruptions in the Middle East.

Gazprom lowers price of gas sold to Belarus; similar discount for Ukraine unlikely. On Monday (Aug. 15), prime minister Vladimir Putin announced that Russia would reduce the price of gas sold to Belarus. The deal goes into effect from the start of next year simultaneously with the launch of the common economic space between Russia, Belarus and Kazakhstan.

Under the new pricing scheme, the price of gas sold to Belarus will be based on Gazprom's European prices lowered by a coefficient negotiated by Gazprom and Belarus gas monopoly Beltransgaz. Belarus prefers the gas price to be lowered all the way to Gazprom's domestic price level as the countries will be part of a common economic space. Gazprom's domestic price in regions near the Belarus border is currently about 40 % of the $286 per thousand cubic metres paid by Belarus. President Dmitri Medvedev advised Gazprom to reach agreement on the price well before year's end to avoid the risk of supply disruptions.

In 2006, when Russia and Belarus agreed on gas supplies for the next five years, it was also agreed that Gazprom would purchase a 50 % stake in Beltransgaz. As part of this year's gas supply negotiations in January, the two countries agreed that Gazprom would purchase all outstanding Beltransgaz shares. The sale of Beltransgaz has been instrumental in putting the pricing issue to rest.

At their meeting last week, president Dmitri Medvedev and Ukrainian president Viktor Yanukovich were unable to make progress on resolving the gas pricing issue. Ukraine demands rescission of its 2009 agreement on the grounds that the agreed base price, which is corrected quarterly, is unconscionably high. The high price was negotiated by Ukraine's previous prime minister Yulia Timoshenko. The price Ukraine pays in 3Q11 is $348 per thousand cubic metres of gas, which is above what EU buyers are currently paying.

According to Yanukovich, Ukraine is ready to take the matter to court. In July, Gazprom CEO Alexei Miller said that the price of gas is negotiable as long as the merger of Gazprom and Ukraine's gas monopoly Naftogaz can be agreed.

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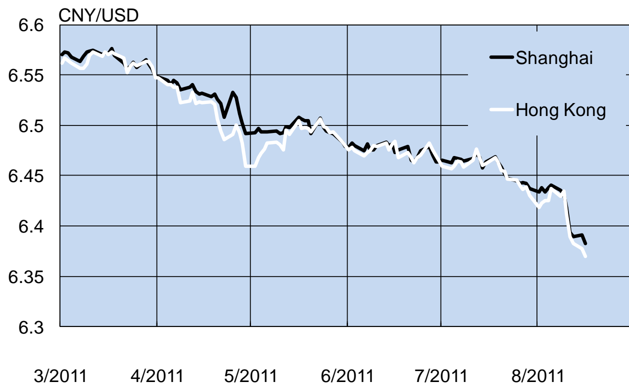
China

Economic turmoil in the United States and Europe add to yuan appreciation pressures. Investors skittish over the debt crisis in advanced industrialised countries have begun to look to investment opportunities in emerging markets such as China. Demand for China's state bonds sold on the Hong Kong's Dim Sum market (yuan-denominated bonds) exceeded expectations last week, when the Chinese state issued 20 billion yuan (€2.2 billion) in new bonds. The high demand for the bond issue reflects strong investor confidence in Chinese economy.

China's deputy prime minister Li Keqiang promised this week that much of the capital movements related to investment activity between Hong Kong and mainland China will be deregulated.

The yuan has strengthened 0.7 % this month against both the dollar and the euro. Today, one dollar bought 6.39 yuan and one euro 9.18 yuan.

Yuan-dollar exchange rates (mainland and offshore)



Source: Bloomberg

World economy worries and inflation depress Chinese share prices. The global drop in stocks continued to be reflected on the Shanghai stock exchange. On Friday (Aug. 19), the Shanghai A-share index for shares sold to domestic investors was down 19 % from its peak in November 2010. The B-share index, which tracks company shares that can be traded by foreign investors, was down 20 % from its recent April peak. The decline in share prices in China in recent weeks was set off by Standard & Poor's decision to downgrade US sovereign debt. In response, Shanghai's A-share index tumbled last week to its lowest point this year.

The Shanghai A-share index comprises over 900 firms with a total market capitalisation currently worth of €1.8 trillion. The average price-to-earnings ratio (P/E) is about 14.

The index for dollar-denominated B-shares geared to foreign investors once closely tracked the A-share index. Since the end of 2009, however, the B-share index has outperformed the A-share index and reacted more sharply to global markets. The B-share index is composed of 54 Chinese firms. With a value of €9 billion, its total market capitalisation is much lower than the A-share index. The average P/E for B-shares is presently around 15.

Shanghai A- and B-share indices, January 2007=100

Source: Bloomberg

Summer grain harvest was 126 million tons. Despite a severe drought in the first half of the year followed by major flooding, China's summer grain harvest was still up 2.5 % y-o-y. The summer harvest accounts for about a quarter of the year's total grain harvest, most of which is harvested in autumn. The total harvest last year amounted to 546 million metric tons.

China is the world's largest producer and consumer of many farm products. The country is largely self-sufficient in grain production as well as several other staples. With the exception of certain critical ingredients, China imports relatively little food from abroad. Among the top imported foods are soybeans and various vegetable oils. A tiny sliver of China's agricultural production ends up as exports. The biggest export categories are fresh fruits, vegetables and fish.

In 2010, agriculture generated about 10 % of GDP and provided livelihoods for some 300 million people (40 % of China's labour force). The supply of arable land is quite limited − about 160 million hectares for all of China which translates to about 0.54 hectares per farmer.

The government's top priorities in farm policy include self-sufficiency in domestic grain production, higher wages for farmers, as well as rural development. Raising rural wages is a way to reduce the yawning earnings disparity between the countryside and urbanites, as well as stave off potential social unrest. The quality of food and food safety has recently gained attention as the agricultural sector continues to develop and wages rise.

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