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BOFIT Weekly
35 • 2.9.2011

Russia

New regime for export taxes on petroleum products. Russia has long contemplated reform of how it sets export duties on oil products. After a request of prime minister Vladimir Putin to the relevant ministries in July, the cabinet decided on the issue last week. The revised "60/66" duty scheme will enter into force on October 1. The new approach unifies export duties on petroleum products, which are tied to the crude oil export duty. The unified rate is 66 % of the crude oil export duty, which is reviewed monthly to reflect world market price changes. Under the new scheme the export duty on light fuel oil (diesel oil, jet fuel) will be lowered a percentage point, while the export duty on heavy fuel oil will rise by about 19 percentage points.

The new tariff does not apply to gasoline, which already carries a stiff export tariff. The gasoline export duty was raised in May from 70 % to 90 % of the crude oil export duty after a domestic shortage of gasoline emerged in Russia that caused prices to spike.

A goal of the revised schedule is to reduce exports of heavy fuel oil, which account for about half of all oil product exports. Oil companies have been attracted to exporting heavy fuel oil precisely because of the low duties, even if heavy fuel oil is only about 3 % more expensive than crude oil. The low export duty even gave oil companies incentive to export slightly processed crude oil as heavy fuel oil.

The increased duties are intended to encourage oil companies to increase the value-added component in their refining operations by producing light fuel oil products rather than heavy fuel oil. Under the cabinet's plan, export duties on heavy fuel oil and crude oil will be unified by 2015.

The government, which has long struggled with lowering the crude oil export duty, is expected to decide on the matter soon. A change is hoped to encourage oil companies to increase their investments. Taxation of crude oil production and exports is strict and highly progressive with respect to the oil price. At high oil prices the state captures about 90 % of any increase in the oil price.

Lapses in banking supervision. Major abuses by Russian banks have come to light over the past year. It has been nearly a year since the default of Moscow-based Mezhprombank, which went down with 80 billion rubles (€2 billion) in debt (including unsecured loans from the Central Bank of Russia to support the bank during the 2008–2009 recession). Sentiments about Mezhprombank flared last month with news that the bank's head, billionaire Sergei Pugachev, had fled to London. The CBR also pulled the AMT Bank's licence in July, forcing Russia's Deposit Insurance Agency to pay out its largest settlement ever to depositors − 12 billion rubles (€300 million). There is also continuing concern over the struggling Bank Moskvy. Last February, the City of Moscow sold its 46 % stake in the bank to state-owned VTB Bank. Details of the poor condition of Bank Moskvy slowly emerged after the deal, making the CBR grant a low-interest loan of 295 billion rubles (€7 billion) to complement the capital infusion of 100 billion rubles (€2.5 billion) from VTB.

In all of the above instances, the issue is fraudulent bookkeeping that misstates e.g. tier-1 capital, reserves or loan collateral, or loans granted to fictional firms or entities closely tied to the banks. Gennady Melikyan, CBR deputy chairman in charge of banking supervision since 2006, said the CBR was aware of the malfeasance long before the bank licence cancellations, but due to the lack of formal evidence to establish fraud the CBR was unable to act.

The IMF, among others, has encouraged Russia to bolster its banking supervision with appropriate legislation. Bank supervision has developed substantially in recent years, but there are still gaps in the system.

Though widely praised for his work, Melikyan gave notice in July, and chairman Sergei Ignatyev accepted his resignation last week. Melikyan's predecessor was Andrei Kozlov, who was shot in Moscow in 2006.

China Construction Bank announces plans to establish subsidiary in Russia. The board of China Construction Bank (CCB) decided on August 19 to put up about $150 million in capital to set up a banking operation in Russia. The large amount of capital allows the bank the possibility to get a general licence immediately. A general licence allows the bank to provide services to businesses and households. In terms of capital, the new bank would join the ranks of Russia's 100 largest banks.

CCB is mainly owned by the Chinese state. It is China's second-largest bank, and its assets at the end of 2010 amounted to 11 % of China's banking sector's total assets. The bank's IPO was in 2005, and as of end-2010 CCB was the world's second largest bank in terms of market capitalisation. About 35 % of CCB shares are held by non-Chinese.

Two Chinese banks currently operate in Russia. Both are subsidiaries of large state-owned banks. Although one has a general licence, they only rank among Russia's 280–300th largest banks in terms of total assets. The CBR categorises both as small banks.

Some 220 banks with foreign capital currently operate in Russia. About half are majority owned by a foreign entity. Three foreign-owned banks are included in Russia's top ten banks measured in terms of total assets. The Italian Unicredit Bank ranks eighth, followed by the French Rosbank in ninth place and the Austrian Raiffeisenbank in tenth. The three banks combined account for 5 % of the banking sector's corporate lending, 7 % of household lending and 3 % of household deposits. The respective shares for Russia's largest bank, Sberbank, are 31 % of both corporate and household lending, and 47 % of household deposits.

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China

Monetary screws keep turning as PBoC moves to include customer margin deposits as part of banks' reserve requirements. Investment bank analysts and media sources report the People's Bank of China is moving ahead with a requirement that customer margin deposits will be included under the minimum reserve requirements. Margin deposits are held by the customer firm's bank as collateral related to customer's payment commitments to another firm or bank. News sources report that margin deposits account for anywhere between 2 % to over 20 % of a bank's total deposit stock.

The stiffened reserve requirement will erode bank profit margins. Currently, the reserve requirement, i.e. the share of deposits a bank is required to keep with the central bank, is 21.5 % for large banks. At the moment the PBoC pays an interest rate of only 1.6 % p.a. on mandatory reserve deposits, while the reference rate for a one-year bank deposit is 3.5 %.

Banks are under orders to increase reserve deposits during the coming autumn until their new reserve requirement including margin deposits is met. Investment banks estimate the change will suck about 900 billion yuan in liquidity (€100 billion) out of the markets. To achieve a similar effect simply by raising the traditional reserve requirement, the PBoC would have to increase the requirement 2 or 3 times by a half percentage point. If inflation calms, the central bank might postpone other monetary policy tightening measures in coming months.

Because the new margin deposit requirements relate mainly to off-balance-sheet bank lending, the change is seen as broadening the monetary policy impact of reserve requirements. Authorities have recently managed to limit on-balance-sheet bank lending, but off-balance-sheet lending has increased fast. The recent measures show how difficult it is for officials to regulate rapidly evolving markets with administrative measures. With the deregulation of markets, at some point interest-rate policy will become a more important tool in PBoC operations.

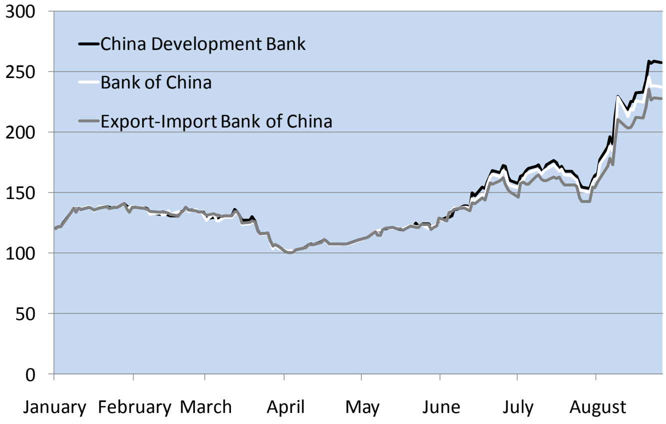
Chinese banks not spared from insecurity of global financial markets in recent weeks. During August, the perceived riskiness of Chinese banks appeared to increase dramatically if measured by pricing of credit default swaps (CDSs). The price of a CDS indicates the risk premium that is demanded by investors on international financial markets when they invest in a Chinese bank. A rise in the risk premium means that Chinese banks have to pay more for financing when they borrow on international financial markets.

Using CDSs as a measure, the risk premium of China's big banks has increased to about 2.5 %, when the risk premium was running at around 1 % as recently as late spring. Despite the recent rise in the risk premium for large Chinese banks, it is still not particularly high by international standards. The risk premia for Chinese banks at the moment are at a level comparable to the risk premia paid by large German or French banks.

Also other countries' risk premia have increased since the summer. The rise in China's risk premia appears connected more to the general jitters on international financial markets than any specific bad news about Chinese banks. The profitability of China's largest banks rose in the first half of this year to record levels. According to media reports, the profits of the five largest banks were up by more than 25 % from last year.

The profitability figures of Chinese banks are routinely criticised for their opaqueness as they are thought to disguise large problem areas such as the lending risks of loans to local authorities. Even so, last summer's IMF Article IV consultation report said that China's banking system was on a steady footing. The banking system is stable, unless China encounters a large simultaneous shock on many fronts (e.g. a sharp drop in economic growth combined with a collapse in real estate prices and a spike in interest rates). The IMF, however, points out that its analysis was based on incomplete knowledge about Chinese banks.

Price of 5-year credit risk swaps for large Chinese banks in 2011, basis points



Source: Bloomberg

Growth in domestic demand compensates for slowdown in export orders. The manufacturing purchasing manager indexes (PMIs) published by the China Federation of Logistics and Purchasing and the Hong-Kong-based HSBC investment bank both rose slightly in August after a long slump. The end of the decline in PMIs was interpreted as a reflection of strong domestic demand in China. Companies reported in the latest surveys that their export order books have shrunk due to uncertainty in the global economy.

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