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BOFIT Weekly

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Russia

Foreign strategic investment law continues to evolve. Amendments approved in November to a 2008 law should ease some restrictions on foreign investment in Russia. The "Law on Foreign Investments in Legal Entities of Strategic Importance to the National Defence and State Security of the Russian Federation" identifies "strategic sectors" where foreign investors need approval of a special commission headed by the prime minister if the foreign investor's holdings in the strategic Russian firm would exceed 50 %. The amendments entered into force on December 18, 2011.

The original law required foreign investors seek permission to invest in companies in fields involving e.g. radiation sources or data encryption. With the changes, companies involved in civilian applications of radiation sources (e.g. medical and food processing industries) are no longer considered strategic. Privately owned banks have also been dropped from the list, even if they use encryption technology as a regular part of their operations. Notably, insurance companies using encryption technology are still considered strategic.

Investment in strategic sectors involving natural resources has also been eased. Now foreign private investors only need to petition the Commission on Strategic Investment if the foreign shareholder's stake would reach at least 25 % of the firm. Earlier, the threshold was 10 %.

The law imposes greater limits on participation of foreign state-owned firms than private investors. The amendments now ease the regulations in the case of "high-level international financial institutions." The government will release a list of organisations that is expected to include e.g. the European Bank for Reconstruction and Development (EBRD) and the International Finance Corporation (IFC).

The status of Russian investors has also improved as commission approval is no longer required if the "foreign" investor is a Russian-owned firm registered abroad. About a third of all the investment applications submitted to the commission have been foreign-registered Russian firms.

In its three years of operation, the commission overseeing investment in strategic sectors by foreign investors has processed a total of 136 applications. Eight applications were rejected.

Turkey grants Gazprom permission for construction of South Stream gas pipeline in its territorial waters. Gazprom chairman Alexei Miller reports that Turkey has granted the necessary permits for construction of the South Stream undersea pipeline. Construction should begin within the next 12 months. The pipeline, which is jointly owned by Gazprom, Italy's Eni, France's EDF and Germany's Wintershall, will run from the Russian Black Sea coast across the seabed, emerging in the Bulgarian town of Varna. From there it will continue further to various European countries. Gas transmission is expected to begin in late 2015 and full transmission capacity of 63 billion m^3 a year will be reached in 2018.

Gazprom says the purpose of South Stream (like North Stream, which opened last November) is to increase the number of routes for Russian gas supplies to Europe. At the moment, about 80 % of Gazprom's shipments to Europe transit Ukraine and most of the rest through Belarus. In recent years, Gazprom has encountered problems with transit shipping through Ukraine and Belarus due to pricing disputes. The problem was settled with Belarus last year as Gazprom acquired the Belarus national pipeline operator Beltransgaz as part of a deal guaranteeing Belarus could purchase gas at discount for the next three years. Gazprom has sought for years to buy itself also into the Ukraine's gas pipeline monopoly Naftogaz e.g. by offering in exchange to supply Ukraine with gas at a lower price, but there has yet to be an agreement.

In a conversation with prime minister Vladimir Putin late last year, Miller noted construction of the South Stream pipeline was cheaper for Gazprom than continuing to tranship gas through Ukraine given the price Ukraine requires from Naftogaz ownership, the existing gas network's need for repair and Ukraine's demands for gas discounts. Putin, nevertheless, encouraged Gazprom to keep negotiating with Ukraine as it is a strategic partner of Russia. Putin said Ukraine's pipeline transmission capacity will be needed as European demand for gas continues to rise, especially as some countries are currently phasing out nuclear energy.

Operation of the South Stream pipeline could be problematic for Gazprom in light of the EU's "Third Energy Package." The new legislation calls for an open gas distribution grid, which may require that Gazprom make available some of its transmission capacity to other gas producers. Gazprom has sought (so far unsuccessfully) to get a special exemption status for South Stream and aboveground sections of the North Stream pipeline.

The EU is planning its own Nabucco pipeline to compete with the South Stream pipeline. It would bring gas from Central Asia and the Middle East to Europe.

Gazprom's planned gas supplies for Europe and pipeline transmission capacity, billion m^3

Gazprom's agreed supply contracts for 2020–2025	158
Transmission capacity via Ukraine	143
Transmission capacity via Belarus	35
Transmission capacity to Finland	7
Blue Stream (to Turkey), transmission capacity	16
North Stream (operational), full capacity by 2015	55
South Stream (planned), full capacity by 2018	63
Total transmission capacity	319

Source: East European Gas Analysis

Editor-in-Chief Seija Lainela

Bank of Finland • Institute for Economies in Transition, BOFIT
P.O. Box 160 • FI-00101 Helsinki
Phone: +358 10 831 2268 • Email: bofit@bof.fi • Web: www.bof.fi/bofit

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China

China's leadership contemplates financial sector reforms. An official press release from the two-day National Financial Work Conference this week in Beijing reveals that reform of the financial sector is both important and a source of great tension. China's monetary policy will be shifted to support growth as global demand weakens. Liberalisation of capital movements, promotion of international acceptance of the yuan and reforms in the financial sector will be continued to secure long run economic growth. However, any changes will be made in cautious steps so as to maintain stability. Competition in the banking sector will be increased by allowing greater private and foreign ownership. Supervision of the financial sector will be tightened and prudent bank risk monitoring strengthened. The vision laid out by China's leaders incorporates specific proposals included last autumn in the IMF's assessment for China under its Financial Sector Assessment Programme (FSAP).

Some details of the reforms were included in the plan of the China Securities Regulatory Commission (CSRC). The near-term objective of the CSRC is development of China's relatively small bond markets to improve corporate access to financing by e.g. the elimination of some bureaucracy related to arranging bond issues. Opportunities for foreign investors to participate in Chinese stock markets will be increased by raising investment quotas under the Qualified Foreign Institutional Investor (QFII) programme. The CSRC also approved a plan by Citigroup and Chinese investors to establish a jointly owned investment bank in China.

China seeks to attract more high-tech foreign production. At the end of 2011, China's National Development and Reform Commission (NDRC) and the Ministry of Commerce released a new list of foreign investment targets in China. The list serves as a tool for guiding foreign investment flows. Production branches on the list are divided into forbidden, limited and promoted branches.

The new list supports investment in high-tech and high value-added branches such as the advanced textile and chemicals industries, machinery & equipment, as well as services, biotechnology and recycling. Certain branches that were earlier limited are now opened up to foreign investors. In addition, there is an effort to reduce investment in fields with high labour intensity, high raw-material intensity or business based on traditional technologies. For example, investment in the traditional car industry producing combustion-engine vehicles will no longer be promoted, but investment in production of electric or hybrid vehicles will continue be promoted. The changes go into effect on January 30. The list was last overhauled in 2007, but is fine-tuned every year.

Inflation unchanged in December. The National Bureau of Statistics reports that consumer prices rose 4.1 % y-o-y in December, down slightly from 4.2 % in November. Although inflation was essentially unchanged from November, upward pressure on prices has eased. The inflation rate is expected to fall in the first half of 2012.

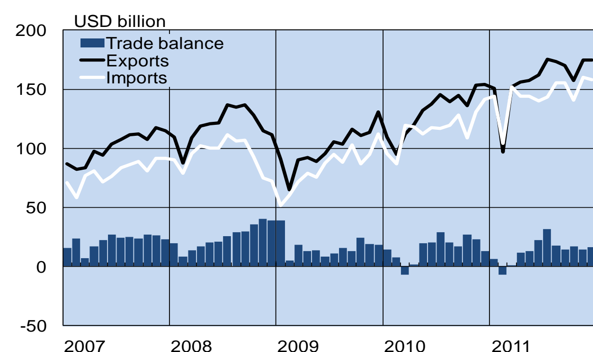
China's foreign trade surplus shrank in 2011. China exported goods worth nearly $1.9 trillion last year, an increase of 20 % from 2010. The value of imports increased by 25 % to $1.74 trillion, reducing the goods trade surplus to $155 billion from $185 billion in 2010. China's goods trade surplus peaked in 2008 at nearly $300 billion.

The trade volume figures confirm the general view of slowing growth in foreign trade. In 2010, the volume of Chinese exports rose 30 % and imports 24 %. Figures for the first eleven months of 2011 show export and import volumes each grew about 10 %. The fade in export growth in the second half of last year largely reflects problems in China's export markets. It is also evident that growth in China's productivity is no longer as sufficient as before to offset rapidly rising costs. The lack of adequate productivity gains compared to cost increases is also moderating export growth. Although growth in imports has slowed somewhat after a strong stimulus-fuelled episode, the current pace of economic growth continues to be sustained by robust growth in domestic demand and increased purchasing power. The yuan's real effect exchange rate appreciated nearly 5 % last year.

Growth in China's exports to Europe, its largest export market, has slowed sharply. As a result, the EU's share of China's total exports fell below 18 % in December. While growth in exports to the US has also decelerated, it did not face similar problems as exports to the EU last year. The US's share of exports is now almost on par with the EU, and Japan's share of China's exports is 8 %.

In 2011, the EU accounted for about 12 % of China's imports, Japan 11 % and the United States 7 %.

China's foreign trade



Source: Bloomberg

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