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BOFIT Weekly

19 • 10.5.2013

Russia

Gazprom's eroding dominance in Russia's domestic gas market. Russian natural gas production dropped slightly last year to a level of 655 billion m^3. Gazprom's share of Russian gas production also continued to slip, falling to around 74 %. Just a decade ago, Gazprom still accounted for 88 % of Russian natural gas production. In recent years, privately held gas producer Novatek and several oil companies in particular have increased their contribution to domestic gas production. Gazprom's biggest emerging competitor on the domestic market appears to be the state-owned oil giant Rosneft, which has announced plans to more than double its current gas production by 2020. According to a Rosneft strategy paper, production growth is largely limited at the moment by the lack of access to trunk and distribution pipelines owned by Gazprom. Gazprom only grants other producers the possibility to transmit their gas via its pipelines on a limited basis.

There has recently been an active discussion on the status of Gazprom in the Russian economy. Several gas producers are seeking to challenge Gazprom's export monopoly by constructing LNG export terminals in the Arctic and on the Pacific coast. Gas producers (particularly Rosneft) are also demanding greater access to Gazprom's pipelines or a break-up of Gazprom's production and transmission functions into separate corporations. The investigation launched last autumn by the EU anti-trust authority into whether Gazprom has abused its dominant market position is also challenging Gazprom's traditional operations model.

By production volume, Gazprom is the world's biggest exchange-traded gas producer. Because Gazprom plays a major role in the Russian economy, plans to reform it are difficult to implement. *Forbes* magazine ranks Gazprom as the world's 17th largest listed company. The next largest Russian company in the Forbes rankings is Rosneft at 59th place. Gazprom's high ranking reflects its eye-popping profits. The company's declared profit for 2012 was $40 billion, the third highest of all international firms after Exxon Mobil and Apple. Gazprom's profits are also huge relative to the size of Russia's economy; Russia's federal budget revenues in 2012 totalled about $420 billion.

Gazprom's 2012 profits, however, shrank nearly 10 % from 2011. The financial result was mainly hurt by lower sales volumes, which declined in 2012 by about 7 % to 482 billion m^3. Over half of the gas volume supplied by Gazprom went to Russia's domestic market.

Gazprom reports that its average prices last year were €71 per thousand cubic meters for Russian customers, €235 for customers in the CIS area, and €297 for customers elsewhere in Europe. As there is no spot market pricing of gas supplied by pipeline, prices paid by European energy companies to Gazprom vary considerably from country to country. Media reports suggest that the ultimate price of gas including transmission costs ranged from $313 to $564 per 1,000 m^3 in the first half of 2012 depending on the buyer.

Privatisation of Russia's VTB Bank continues. Russia's second largest bank, VTB Bank, held a share emission on the Moscow Exchange at the end of April. Post emission, state ownership in the bank shrank from 75 % to 61 %.

The additional capital raised from investors should help VTB continue the strong growth it has enjoyed during the past few years. VTB has grown through acquisitions of several banks in Russia and abroad. VTB Bank is part of the VTB Group, which includes the VTB24 Bank that serves households and small businesses. VTB24 has witnessed explosive growth and now is Russia's fifth largest bank both in terms of total assets and lending.

The Russian government's target for the VTB share offering was to increase the bank's capital base by at least 100 billion rubles (€2.5 billion), while retaining at least a 60 % stake in the bank. VTB said that the emission was fully subscribed, with over half of the subscribed shares going to just three investors: Qatar Holding, Norway's sovereign wealth fund manager Norges Bank Investment Management and the State Oil Fund of Azerbaijan.

VTB Bank IPO on the London Stock Exchange in 2007 involved the sale of 15 % of the bank's shares. Another 10 % of shares were sold on the London and Moscow stock exchanges in 2011. Under the Russian government's privatisation programme, the state hopes to divest all of its VTB holdings by 2016.

VTB holds the majority stake in Russian Commercial Bank (RCB), which operates in Cyprus and mainly serves Russian clients. Bank operations have been complicated by the limits on capital exports imposed by Cypriot officials. Russian finance minister Anton Siluanov announced last month at the G20 meeting in Washington DC that Russia is ready to renegotiate the terms of the €2.5 billion loan that Russia granted to the Cyprus government in 2011, provided that RCB's assets in Cyprus are released. Siluanov reported that talks on the matter continue.

RCB's share emission and dividend policies have raised eyebrows in some quarters. In 2009, RCB arranged a directed emission for a company owned by VTB Group's upper management. The emission raised $39 million for a 40 % stake in RCB, which earlier had been fully owned by VTB. Less than a year later, RCB distributed $130 million in dividends to its shareholders. While the size of the 2010 RCB dividend was never released, RCB reportedly paid out dividends of $100 million to shareholders last year. RCB does not release precise information on the entities or persons who own the 40 % share of the bank that was sold off.

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China

Full convertibility of Chinese yuan coming soon? On Monday (May 6), the State Council announced plans to release later this year a specific set of measures and timetable to increase yuan convertibility. Greater yuan convertibility basically means that controls on capital flows into and out of China will be relaxed. Convertibility is essential in promoting international use of the yuan. Although the announcement of specific measures and targets was significant, it was hardly surprising. International use of the yuan has gradually been liberalised during the past few years and a number of administrative agencies have already signalled that the government's goal is to achieve full yuan convertibility by the end of 2015.

When restrictions on capital movements are eased step by step, opportunities to circumvent remaining capital controls increase. Indeed, this seems to be precisely what is happening in China as capital inflows increased substantially during the first four months of this year. The State Administration of Foreign Exchange (SAFE), which operates under the auspices of the central bank, last week declared it was imposing limits on bank lending in foreign currencies. Commercial banks currently have lent about double the amount in foreign currency as they hold in foreign currency deposits. Corporations have been enthusiastically piling on foreign currency debt as the yuan is expected to appreciate further. Chinese officials have also stepped up monitoring of firms engaged in foreign trade. By overstating export prices, export firms are believed to be sneaking capital into China and evading capital controls.

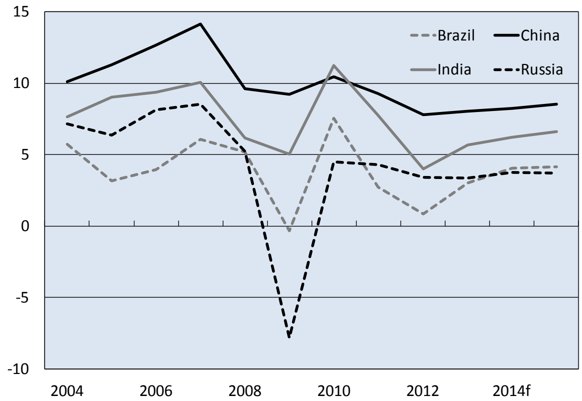
Large forex inflows have forced the People's Bank of China to buy up foreign currency to dampen yuan appreciation pressures. As forex purchases increase the supply of yuan circulating in the economy, the PBoC this week announced that, after an 18-month break, it would resume issuing of bills to soak up liquidity and slow money supply growth.

Solid consumer and investment demand in China driving growth of the global economy. The IMF's latest [World Economic Outlook 2013] suggests the outlook has deteriorated both in developed and emerging economies. However, outlook looks brighter for next year as growth returns to the euro zone and the US recovery finds stable footing.

The IMF outlook cuts its growth forecast for China and now expects growth to hold at around 8 % this year and next. Achieving sustainable, balanced growth requires increase in the share of consumer demand. Chinese investment as a share of GDP is exceptionally high by international standards.

The IMF would like to see China focus more on risks created by rapid credit growth and take measures to deal with its overcapacity in certain industrial sectors. However, it will not be easy to curb lending growth in the midst of a major structural change of the financial system. About half of all new lending in China now takes place outside more tightly regulated traditional bank lending channels, and is thus partly immune to regulatory measures.

GDP trend and forecast 2013–2015 for BRIC countries, %



Source: IMF World Economic Outlook 2013

Trade between China and North Korea has soared in recent years. China's imports from North Korea increased 70 % a year during 2011–2012 in certain product categories of metal, energy and transport vehicle production. At the same time, China's exports to North Korea grew annually by nearly a third. Coal constitutes the bulk of China's imports from North Korea, while its exports are dominated by petroleum products. China, by far, is North Korea's largest trading partner. Observers estimate that China accounted for over two-thirds of North Korea's foreign trade last year.

The rapid growth in trade between China and North Korea since 2010 has increased suspicions that North Korea is circumventing international sanctions by routing trade through China. The UN and several member countries have imposed trade sanctions on North Korea over the past decade. Sanctions were significantly tightened in 2010 after North Korea shelled a nearby South Korean island. Following the incident, Japan and South Korea pulled back sharply from foreign trade with North Korea. It appears that North Korea has managed to make up part of the lost trade by turning to China.

Recent events in North Korea have pushed China to taking a harder line towards North Korea. Under the guidelines laid out by China's transportation ministry, the new UN ban on military material shipments will be enforced and it has added several new North Korean firms to the sanctions list. In addition, the Bank of China has closed the accounts of a North Korean bank.

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