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Russia

CBR: Firms and banks able to service their foreign borrowing. The Central Bank of Russia reports that non-bank corporations and banks have sufficient assets to service their debts at least to the end of 2015, even if shut off altogether from international financial markets.

A just-released CBR Financial Stability Survey finds that, as of end-September, non-bank firms and banks (including state-majority-held) owed $614 billion (30 % of GDP) to foreign creditors: $422 billion by corporations and $192 billion by banks. By the end of this year, corporations must pay down $39 billion in foreign debt (including interest) and banks $414 billion. Corporations next year must make payments on principal and interest of $77 billion and banks $42 billion.

The foreign loans of *non-bank enterprises* broke down into 22 % Eurobonds, 29 % syndicated loans and 49 % bilateral loans.

Oil and gas companies accounted for the bulk non-bank enterprise sector loans (64 % of all loans). Some 35 % of foreign loans taken by these companies mature before 2016, while the loan due dates of firms in other branches is divided more evenly. Large export earnings denominated in dollars should help ease the burden in the oil and gas sector. The CBR pointed out that the sector nevertheless could be forced to reduce or postpone investment to service debt.

Moody's estimates that a significant part of large corporations will be able to service their debts e.g. out of substantial cash reserves at least this year and next. Many companies have anticipated coming foreign payments, e.g. by actively purchasing forex during the first half of this year (which boosted recorded capital exports). Debt servicing, however, has become challenging for some firms due to the lack of new financing from abroad. Moving ahead, firms must borrow from domestic sources with higher costs to service their debts.

The foreign debt of *banks* consisted of 62 % state-bank debt, 24 % private bank debt and 14 % foreign-owned bank debt. Most bank debt is long term, and will mature more than three years from now. A survey carried out by the CBR in September on Russia's 30 largest banks found banks generally capable of servicing their foreign debt at least through the end of 2015, even if certain banks could run into trouble from maturity mismatches with forex revenues and expenditures.

Russia reinstates authority of investigating officials to file criminal charges for tax violations independently. The changes president Putin signed into law on October 22 were effective immediately and abolish the 2011 reform introduced during the Medvedev administration. Under the 2011 reform, criminal charges for tax violations could only be laid by tax authorities. The amended law allows investigators (e.g. police) to press charges after requesting a statement from tax officials. Charges can be pressed even if the tax authority finds no evidence of tax code violations.

The 2011 reform was part of a general liberalisation of the Criminal Code aimed at reducing the powers of officials to exert pressure on firms. Other reforms included limits on the time the accused can be held during a criminal investigation and easing criminal penalties.

The business community saw the 2011 reforms as extremely important in reducing opportunities for authorities to harass companies. The number of criminal charges filed against companies for tax violations was reduced significantly. According to officials, however, the reform made it more difficult to investigate tax crimes.

Putin submitted his proposal on stiffening the law to the Duma last autumn, raising a long-running controversy thereafter. Not only have representatives of the business community declared their opposition to the move; prime minister Medvedev and several ministries also came out against it. Opponents say the change will again worsen the operating environment for firms. Indeed, companies have perceived deterioration in their operating environment in many ways over the past couple of years.

Russia must increase oil drilling to preserve production at current levels. Energy minister Viktor Novak said that oil drilling needs to increase 5–7 % a year to hold production at current levels, a challenge made all the more difficult with Western drilling companies leaving the country. Russia would have to build up its own state-of-the-art oil drilling capacity, yet investment is limited at the moment by low oil prices and lack of access to international lenders.

Oil production has already peaked at oil fields in the European parts of Russia and begun to decline in Western Siberia. Novak said production at the newer fields in Eastern Siberia is unable to make up for the loss of production elsewhere, nor are there enough new projects on the horizon to ease the situation.

The production emphasis is shifting to ever more remote or challenging areas for resource extraction and requires new technology (e.g. shale oil production). Russia lacks the necessary know-how and technology; development of new deposits was planned to a large extent to be based on collaboration with Western companies now subject to sanctions. If sanctions continue much longer, they will impact Russia's future oil production capabilities.

ExxonMobil pulled out of its arctic cooperation with Rosneft in September after the companies identified a promising deposit during exploratory drilling in the Kara Sea. Shortly thereafter, the French Total announced it was cancelling a planned joint shale oil venture with Lukoil. Shell also suspended its cooperation plans in shale oil extraction with Gazprom Neft.

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China

Inauguration ceremonies held for China-led Asian Infrastructure Investment Bank. China and 20 other Asian and Middle Eastern countries gathered last Friday (Oct. 24) in Beijing to sign the founding articles for the Asian Infrastructure Investment Bank (AIIB). Other large Asian countries involved in the project include India, Thailand and Malaysia. Indonesia, South Korea, Japan and several other invited countries have decided not to participate at this point.

The bank's initial capitalisation will be $50 billion, with China the largest contributor. Further rounds of AIIB capitalisation are planned, however, and more countries can join in to become stakeholders. AIIB's starting capital is the same as that of the BRICS countries' New Development Bank (NBD), established last July. The capitalisation of the region's longest operating development bank, the Asian Development Bank (ADB), is currently $175 billion, with Japan and the United States holding the largest stakes (31% combined). China holds a 6 % stake in ADB. China has been a proponent for new multinational development banks as they could provide alternatives for investing the country's foreign currency reserves and to use the new banks to create export markets for its infrastructure-building expertise.

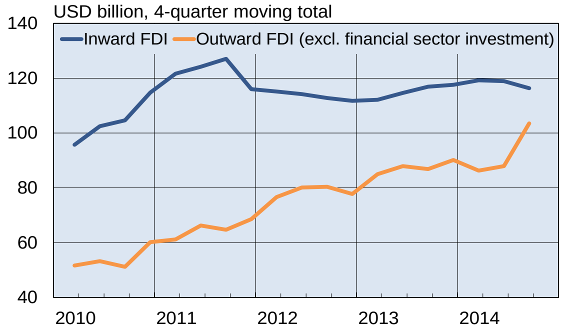
The AIIB is scheduled to open its doors at the end of next year. Several developed economies and other international lenders have expressed concern over AIIB shortcomings in such areas as project transparency and issues related to environmental protection and labour rules. In any case, Asia has a huge infrastructure deficit. The ADB estimates, for example, that the regional investment demand for infrastructure development in 2010–2020 exceeds $8 trillion. The World Bank adds that rectifying India's infrastructure gap alone will cost nearly $2 trillion.

Sharp increase in Chinese outward FDI flows. China's commerce ministry reports Chinese foreign direct investment outflows in the third quarter amounted to about $31 billion, a 97 % increase from 3Q2013. Chinese FDI outflows in the first nine months of this year amounted to $75 billion, a 22 % increase from the same period last year.

China's outward FDI flows have grown rapidly in recent years. UNCTAD says China's outward FDI flows in 2013 ($101 billion) moved the country into the world's top-three FDI providers, which it now shares with the United States ($338 billion) and Japan ($136 billion). A number of Chinese reforms have aimed at boosting the volume of outward FDI. China relaxed its rules at the beginning of September so that most firms are now able to make direct foreign investments by simply reporting it to the officials. All foreign investment earlier involved the often-lengthy process of getting an official permit. Officials say the change affects the bulk of investment flows. However, commerce ministry approval is still required for investment in certain countries and branches.

Inward FDI flows to China fell to $24 billion in the third quarter, a drop of 10 % y-o-y. Inward FDI was last this low in 2010. The reduction in investment reflects not only the slowdown in the Chinese and global economies, but also uncertainties surrounding the regulation of foreign firms. Inward FDI flows amounted to $87 billion during the first nine months of 2014, about the same as a year before. For the first time third-quarter inward FDI flows were less than China's outward FDI flows.

Chinese inward and outward FDI flows, 4-quarter total



Source: CEIC

Annual meeting of Chinese Communist Party Central Committee focused on problems concerning rule of law in China. The theme of finding ways to improve rule of law in China made its debut at the plenum of the Central Committee. The final session on October 23 was accompanied with a communiqué emphasising the need to govern in accordance with the Constitution; creating a stronger system to assure implementation of Constitution and oversight in accordance with it; safeguard the legitimacy of government actions; promote transparency in government affairs; attach liability to officials that break the law; and strengthen the internal rules and mechanisms of the Communist Party. Contrary to expectations, the meeting offered no new information on progress in economic reforms.

The latest plenum themes highlight the extent of problems at each level of China's justice system. The emphasis on enforcing discipline and measures to maintain law and order were also in keeping with the anti-corruption campaign launched last year. While initiatives at the party congress included limiting the influence of regional leaders in relation to local courts, there was little concrete information on planned reforms of the court system.

Anti-corruption campaigns cannot, in any case, solve systemic problems over the long term. In the worst case, the administration might find itself paralysed by such campaigns due to lack of clear procedures and rules. Many already suspect China is headed in this direction. The goal of the meeting was "the socialist rule of law with Chinese characteristics," not the most encouraging phraseology for launching efforts to secure "transparent rule of law."