SUOMEN PANKKI FINLANDS BANK EUROSYSTEM 1811

Weekly Review
47 • 20.11.2015

BOFIT

# Russia

**CBR monetary policy programme foresees drop in inflation and heavy reliance on Reserve Fund.** The Central Bank of Russia's latest monetary policy programme keeps in place almost all the outcome of its September economic forecast, with the basic scenario largely unchanged. The difference is a cut in the figure for 2015 imports; now the volume of imports is expected to drop 26–30 % this year along with related adjustments in demand components. The 2016 forecast remains unchanged – including the assumptions on the average price of Urals oil ($50), GDP contraction (0.5 % to 1 %) and the drop in imports (about 2 %). CBR governor Elvira Nabiullina pointed out that the GDP forecast, in fact, entails that economic recovery will begin in the second half of 2016.

The CBR expects inflation numbers to become lower so that consumer prices in the first quarter of 2016 will be *8 % higher y-o-y* (12-month inflation is currently at nearly 15 %) as the spike in prices last winter enters the 12-month calculation. The CBR's inflation target is *4 % by the end of 2017*, and as long as on the projected track the CBR is ready to gradually reduce its key rate.

The dependence of banks on the central bank for maintaining liquidity has decreased this year due to a contraction in bank lending from last year and a return of household deposits. The CBR now expects its receivables from liquidity provision to shrink considerably by the end of 2016 and further on as the credit stock of banks is foreseen to increase slowly (next year 4–7 %) and banks should enjoy incoming money boosts as the government dips into the Reserve Fund to cover budget deficits.

The CBR estimates that Russia's current account surplus will continue as imports remain depressed, and anticipates foreign currency reserves to remain roughly unchanged. The central bank expects to restart its programme of buying small amounts of currency to gradually build up its foreign currency reserves from about $370 billion currently to $500 billion. The forex purchase programme was active in early summer this year. Nabiullina said the goal of the programme is to create a safety buffer, but that reaching the reserve's planned size should take at least five years.

**Russia's consolidated budget deficit fairly small so far this year.** The consolidated budget (which combines federal, regional and municipal budgets, plus state social funds) showed a January-September deficit of about 1.5 % of GDP. Government revenues have not suffered quite as much as Russian officials earlier estimated for the whole year. Revenues have been less weak than expected for oil and gas (even if these revenues were down nearly 20 % y-o-y), as well as other revenues to the federal budget and regional budgets. Total government revenues increased by about 1.5 % in nominal ruble terms.

The deficit has remained rather small despite high outlays early in the year which have made spending less back-weighted than in previous years. Russia's traditional end-of-year spending spree should be more subdued this year, but could still significantly increase the deficit. The finance ministry this summer forecasted that the 2015 consolidated budget deficit would be around 5.5 % of GDP. The Accounts Chamber of the Russian Federation has since given a slightly more modest deficit projection of 4.5 % of GDP.

**Role of state-owned enterprises rising in Russia.** Seven of the top ten companies listed among the largest Russian firms of 2014 based on sales were state owned, according to *Expert*, a Russian business weekly. The list shows that the role of state-owned enterprises (SOEs) has increased sharply in recent years. SOEs in 2007 accounted for just over 30 % of the total sales of Russia's 400 largest firms. By 2014 that figure exceeded 40 %, nearly matching the sales of privately held Russian firms on the list. In ruble terms, SOE sales corresponded to nearly a third of GDP. The largest foreign-owned company, telecom specialist Vimpelcom, ranked 21st. Energy company Fortum, the largest Finnish-owned firm making the list, ranked 176th.

The situation is quite similar in terms of market capitalisation. SOEs accounted for over half of the combined value in Expert's top-200 market cap list in banking, oil & gas, electricity and machine-building sectors.

Russia's corporate sector continues to be fairly concentrated. The total sales of Russia's 400 largest firms last year amounted to 52 trillion rubles ($1.4 trillion), with the ten largest firms generating over 40 % of that. Companies in the oil & gas sector contributed about a third of the largest firms' sales, while 10 % came from banks.

Firms in the defence sector posted some of the biggest sales gains in 2014 (e.g. the sales of United Shipbuilding Corporation increased significantly). The largest profits in ruble terms were posted by the big oil & gas companies and Sberbank. The five firms with the largest profits accounted for 70 % of the total profit of the 400 largest firms.

The 2015 *Forbes 2000* list of the world's biggest companies ranks Russia's Gazprom at 27th place. 27 Russian companies made the Forbes list this year.

**Russia's largest firms by sales in 2014**

| | Sales, RUB billion | Market cap, USD billion | Ownership |
|---|---|---|---|
| 1. Gazprom | 5,477 | 55.5 | State |
| 2. Lukoil | 4,718 | 35.4 | Private* |
| 3. Rosneft | 3,681 | 40.9 | State |
| 4. Sberbank | 2,167 | 25.4 | State |
| 5. RZD | 1,402 | n.a. | State |
| 6. VTB | 926 | 15.5 | State |
| 7. Surgutneftegaz | 891 | 20.3 | Private* |

*Source: Expert.* *Private domestic investors

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# China

**IMF head calls for including yuan in SDR basket.** IMF managing director Christine Lagarde last week declared her support for including the yuan in the Fund's Special Drawing Rights (SDR) basket. Lagarde's comments lean on the recommendations of the background report by the IMF experts. In their view, the yuan now meets all the criteria for inclusion in the SDR basket. The IMF board will meet on November 30 to decide on whether to include the yuan in the SDR basket. If they give the green light, technicalities still prohibit the yuan's SDR linkage before October 2016 at the earliest.

The decision hinges on the free usability of yuan. China in recent months has rapidly dismantled currency controls and deregulated its financial and forex markets to meet IMF criteria. The IMF notes that now Chinese officials have eliminated remaining operational barriers to wider use of the yuan. The yuan already met the IMF "major exporter" criterion in the last quinquennial review of SDR; i.e. the size of China's export share in global commerce was already sufficient.

As the fifth SDR currency, the yuan would be on par with the US dollar, euro, British pound and Japanese yen, and thereby signal the heightened role of China in the global economy. How the IMF decision affects international acceptance of the yuan will depend on how other actors perceive China's and the yuan's development. While becoming an SDR currency is unlikely to have much immediate economic impact, the decision supports China's reform policies and increased use of the yuan over the long term. Since joining the WTO, China has demonstrated that it can follow international trade rules. It is hard to imagine that China would want perception of the yuan in a worse light than other major currencies.

While the trend to greater international use of the yuan is unquestionable, the transition to the new operating environment is unlikely to be straightforward or free of setbacks. This week the People's Bank of China instructed clearing banks abroad (window guidance) to limit the capital exports from China. The measure helps to support the yuan's exchange rate ahead of the IMF's SDR decision.

**No clear direction for China's housing market.** The tracking of average housing prices last month in 99 Chinese cities by the private real estate portal SouFun indicated a modest sustained increase in housing prices since last spring. The trend was uneven, however, as prices declined in about half of the tracked cities and price drops affected more cities than in September. Housing prices mostly rose in China's largest cities. Official figures on price trends comport with SouFun's findings.

Even if official figures indicate that support measures for housing markets reversed the first-half drop in volume of apartment sales, the overall outlook for the housing sector looks rather bleak when investment figures are included. Measured in liveable floorspace, the volume of new housing starts in January-October was down 15 % y-o-y. Plot purchases of builders this year are down a third from last year.

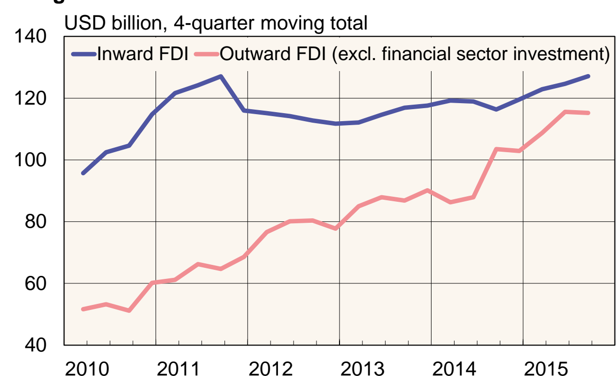
The importance of the real estate and construction branches to the overall economy is accentuated by the fact that companies in the field are deeply indebted. As such, the sector still constitutes a major threat to the overall economy.

**Foreign direct investment flows to China on the increase.** Figures released by China's commerce ministry show that foreign direct investment into China in the first ten months of this year amounted to $104 billion, an increase of 8 % y-o-y. After several years of slack growth, inward FDI this year were up significantly. Most FDI to China are channelled via financial centres or tax havens, so the true country of origin does not show up in bilateral figures. Aside these investments, the biggest FDI sources were South Korea, Japan, the United States and Germany.

The volume of new outward foreign direct investment (OFDI) from China (excluding financial sector investments) in January-October was $95 billion. Investment has increased 11 % y-o-y, even if investment in the third quarter was about the same as in 3Q14. In 2014, 70 % of China's OFDI went to Asia, 9 % to Europe, 9 % to South America and 7 % to North America. The largest part of China's OFDI goes to financial centres such as Hong Kong or tax havens such as the Cayman Islands. Again, the ultimate destination of investments cannot be discerned from official figures and some investments may be recycled back to mainland China.

Interpretation of Chinese FDI figures is further complicated by the fact that official figures published by the commerce ministry only include approved new investments. The figures lack data on repatriated investments and thus the net flow of investments. Balance-of-payments FDI data are also suspect. For example, net OFDI has remained flat for several years now. Given that Chinese investments in e.g. Europe and North America have targeted branches where investments are by their nature extremely long term, it is quite unlikely that repatriation of Chinese investment has grown at the same rate as the volume of new investment.

**Foreign direct investment flows to and from China**




*Source: China's Ministry of Commerce*

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