Weekly Review
27 • 8.7.2016

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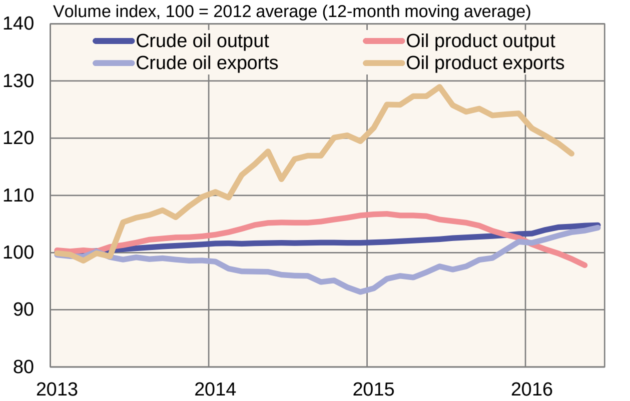
Russia

Russian oil production growth slows. Preliminary figures from Russia's energy ministry show oil output (incl. gas condensates) grew 2 % y-o-y in the first half of 2016. Output growth has slowed in recent months, with June on-year growth slightly above 1 %. Most forecasts expect Russian oil output to rise about 1 % this year.

Production growth has come largely from smaller oil companies such as Tatneft and Bashneft. Although it only accounts for a small share of Russian oil production, the oil output of gas producer Novatek has soared this year with the opening of a new field. Output has declined for Russia's biggest oil producers Rosneft and Lukoil.

Crude oil exports have also increased this year, but the pace has been slowing slightly. The energy ministry estimates that the volume of crude oil exports was still up 7 % y-o-y in the first half of 2016. In contrast, exports of oil products have declined sharply this year due to e.g. duty hikes.

Russian output and exports of crude oil and main oil products



Sources: Rosstat, Ministry of Energy, Russian customs

Debate on oil taxation continues in Russia. The finance ministry has prepared a proposal that calls for shifting the emphasis from taxing production and exports to taxing oil company profits. The approach has long been recommended to Russia as it would encourage greater investment in production than the current tax model. The finance ministry estimates that the tax model would lead to a slight reduction in oil company tax burden and lower budget revenues. Changes in oil taxation have been under discussion all year, but no decisions are expected before autumn at the earliest.

The previous overhaul of oil taxation took place at the end of 2014, when it was decided to gradually shift the tax emphasis from exports to production. High export duties on crude oil were considered to result in artificially low crude prices for domestic and Belarussian oil refiners (export duties are not applied to trade within the Eurasian Economic Union). The government also decided to direct export duties more on less refined oil products in order to discourage their exports.

Most Russian oil tax earnings come from the mineral extraction tax (MET) and export duties. The MET consists of a base rate on produced tonnage and multiplier factors derived from world market oil prices, the ruble-dollar exchange rate and certain factors related to production site characteristics. Crude oil export duties also include a base rate and a variable component that depends on the world market price of oil. Export duties on oil products are based on the crude oil export duty (this year they range from 40 % to 82 % of the crude oil export duty depending on the product). Under the 2014 tax revision, the government decided to gradually raise the MET and lower most export duties. This year's planned reduction in the crude oil export duty was abandoned, however, due to lower-than-anticipated budget revenues.

Oil companies, of course, also pay general taxes like profit tax and excise taxes. It has been estimated that as much as 90 % of oil company profits go to taxes. The collapse in oil prices, however, has reduced the relative contribution of oil & gas revenues to the federal budget. In the first five months of this year, they accounted for 36 % of budget revenues. In 2014, oil & gas still provided over half of revenues.

Some tax rates on Russian crude oil and oil products

	2014	2015	2016	2017
MET base rate, RUB/t	493	766	857	919
Crude oil export duty, % of oil price in excess of $25/bbl (on top of the base rate of $4/bbl)	59	42	42	30
Export duties on select oil products, % of crude oil export duty				
Light oils	65	48	40	30
Gasoline	90	78	61	30
Fuel oils	66	76	82	100

Sources: Ministry of Finance, Rosneft

EU and Russia decide to keep sanctions in place. The EU last week decided to continue sanctions on Russia through January 31, 2017. These sanctions were first imposed on August 1, 2014 in response to Russia's involvement in Ukraine. The sanctions restrict access of certain Russian firms and banks to financing, ban arms trade, as well as limit exports of dual-use goods and oil-production-related products and services. The EU has announced it will lift the sanctions when the conditions of the Minsk accord are in place.

For its part, Russia will continue bans of food imports from e.g. the EU, US, Norway and Ukraine through December 31, 2017. In addition, Russia has extended its restrictions on transit transport from Ukraine to Kazakhstan and Kyrgyzstan. Ukraine this week said it would keep in place its Russia sanctions to the end of 2017 and that it plans to react also on the extended transport restrictions.

Russia has lifted its ban on arranging tours to Turkey and said it will review the possibility of lifting other sanctions on Turkey as president Erdogan has apologised for the shooting down of a Russian fighter jet last November.

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

Editor-in-Chief Jouko Rautava• Email: Jouko.Rautava@bof.fi

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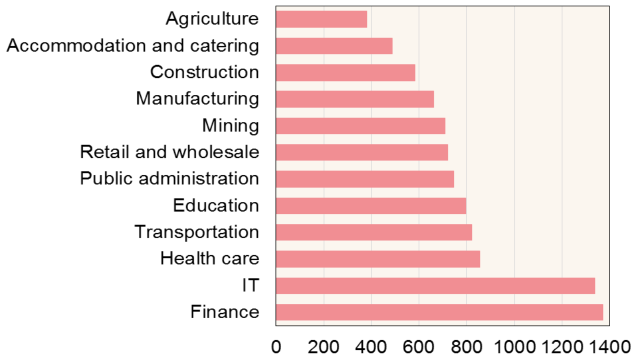
China

Rapid rise in Chinese wages continues. China's National Bureau of Statistics (NBS) reports that the average monthly wage in urban areas rose about 10 % last year to 5,170 yuan (€740). The rise in nominal wages picked up slightly. Mainly due to falling inflation, the rise in real wages accelerated to nearly 9 %. Wage trends varied considerably across branches. The fastest wage rises were seen in education (18 %) and public administration (17 %), while average wages fell 4 % in the mining sector. Highest average wages by far continued to be paid in the financial and IT sectors. Rural wage growth last year was slightly higher than in cities, but the average rural wage is still well below the average urban wage.

The acceleration in nominal wage growth has raised doubts about the reliability of Chinese wage data. Household survey data suggest that nominal wage growth has slowed to 8 %. Even with problems stemming from incomplete coverage and inaccurate reporting, it seems clear that wage growth remained strong last year. Wage growth this year is expected to hold at about the same pace as last year.

Minimum wage adjustments across China also reflect the rapid rise in wages. Over the past five years, the average minimum wage has gone up about 12 % a year, about one percentage point faster than the rise in the average urban wage. Minimum wages vary considerably across provinces and even within provinces. The highest minimum wage is in Shanghai (2,190 yuan a month; 21 yuan an hour) and the lowest in certain prefectural-level cities in Guangxi province (1,000 yuan a month; 9.5 yuan an hour). Regions set minimum wages on their own, but government rules require wage levels must be reviewed at least every two years. Many regions adjust their minimum wage every year.

Average urban-area monthly wages by sector in 2015, in euros



Sources: CEIC, NBS

Compared to other countries, the rise in wages and average wage levels in China has been brisk. For example, wages in many industrial branches already exceed those of most countries in Southeast Asia. Office worker wages have also made substantial gains. The consulting firm Willis Towers Watson (WTS) noted last spring that white-collar workers earn considerably more in China than in emerging economies in Southeast Asia. WTS estimates that the entry-level wage for a white-collar worker in China is about 30 % of the US level and that top management pay in China is nearly on par with the US.

Annual report of China's central bank stresses need to keep on with financial reforms. The People's Bank of China's 2015 annual report released last month emphasises reforms to further open up China's capital markets and increase yuan convertibility. Initiatives include the QDII2 programme that would give qualified individual Chinese investors an opportunity to invest directly in international markets. Existing investment programmes are directed towards institutional investors and private investors are limited to investing overseas via fund management companies or banks. The exchange-rate mechanism will also be improved and markets are given a bigger role in setting interest rates.

The PBoC aroused international attention when it said it was considering the possibility of allowing trading of foreign firm shares in China. Qualified foreign firms would be permitted to issue depository receipts (a standard way for firms to issue shares outside their home countries). The central bank did not, however, give further details or a time frame for the reform plan.

The PBoC said that monetary policy will become more flexible, but more targeted this year. The PBoC characterises its monetary stance as "prudent," a term it has used since 2011. The central bank also promised to improve communication to increase policy transparency.

China's NBS updates GDP calculation methods. Under the new method of GDP reckoning, corporate spending on research & development activities is treated as gross fixed capital formation rather than consumption. Following the change, China's gross domestic product is about one per cent larger than earlier stated. The NBS said that the impact on GDP growth is marginal. Last year's growth figure remained at 6.9 %, and 1Q16 annual growth at 6.7 %. The NBS this week announced the change and published revised annual GDP figures going back to 1952. Following the change, 2015 GDP increased from 67.671 trillion yuan to 68.551 trillion yuan. The change also slightly reduced the share of domestic consumption in the economy. At this stage, the new accounting method applies only to national, not regional, GDP figures.

Under the revised system, R&D activity is recorded following the newer international SNA 2008 standard. China's national GDP accounting is not fully compliant with many of the newer standards. It is estimated that it still e.g. underestimates the contribution of services to the economy. The NBS recently said it was looking at ways to improve national accounting to better incorporate "new economy" branches such as biotechnology, online retail and robotics.

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P.O. Box 160, FI-00101 Helsinki
Phone: +358 10 831 2268 • Web: www.suomenpankki.fi/bofit_en

Editor-in-Chief Jouko Rautava• Email: Jouko.Rautava@bof.fi