Weekly Review
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BOFIT

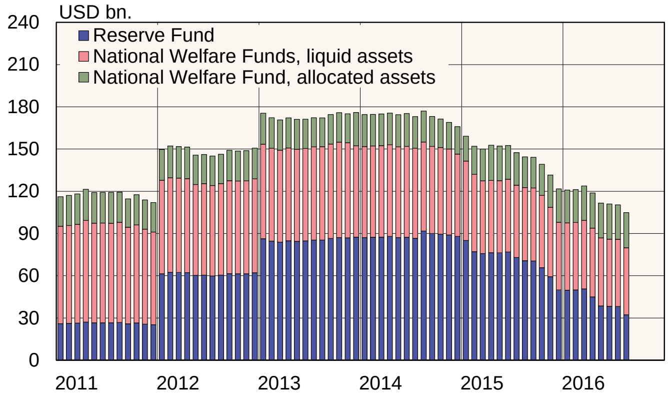
Russia

Budget deficits drain Russia's Reserve Fund. In August, the government withdrew 390 billion rubles ($6 billion) in assets to cover the federal budget deficit. Even so, the Reserve Fund still held at month's end about 2.1 trillion rubles ($32 billion, or nearly 3 % of GDP). This year the government has withdrawn 1.2 trillion rubles to cover budget expenses and plans to use another 900 billion rubles by the end of the year. The 2016 budget assumes an average price of $50 (3,165 rubles) a barrel for Urals-grade crude oil, but the realised average for January-August was only $40 (2,690 rubles).

The value of Russia's other oil fund, the National Welfare Fund, was 4.7 trillion rubles ($73 billion) at end-August. Russia's finance ministry has stated that the National Welfare Fund could be tapped to fund budget deficits, even if such use deviates from the fund's original purpose. About a third of that fund is already tied up in e.g. long-term bank deposits and corporate bonds. So, Russian oil funds in total currently hold liquid assets worth about 5.2 trillion rubles ($80 billion, 7 % of GDP). Last year's spending as well as this year's budgeted use of the funds amounts to 2.1 trillion rubles.

Foreign currency and gold reserves are not directly connected to the budget discussion as their primary purpose is to provide liquidity to cover foreign obligations in the event of a severe sudden shock. The liquid assets of Russia's oil funds are included in the forex reserves, because the Central Bank of Russia administers these assets under the same principles as the other forex reserves. Notably, when oil earnings are used to cover ruble-denominated expenditures, the value of Russia's forex reserves does not change. At the end of August, the value of Russia's foreign currency and gold reserves stood at $393 billion, an increase of $25 billion from January.

Russian oil funds



Sources: Macrobond, Russian Ministry of Finance, BOFIT

More Russian firms added to US sanctions list. On September 1, the US Treasury Department announced an extension of sanctions on Russia for occupation of Crimea. Several Russian firms were added to the sanctions list mostly due to doing business in Crimea. These include firms related to the construction of the Kerch bridge between Russia and Crimea, like Mostotrest, one of Russia's biggest construction companies. Other additions to the blacklist include defence and maritime firms active in Crimea.

Russia lifted its ban on charter flights to Turkey at the start of this month. Sanctions that remain in place include bans on food imports from Turkey and restrictions on Turkish business activity in Russia.

CBR registers new national credit-rating agency ACRA. Under Russia's credit-rating companies act of June 2015, all credit-rating agencies giving national ratings must register with the CBR by January 1, 2017. Registration requires that the credit-rating institution be domiciled in Russia and, among other things, that its commits to complying with Russian legislation and remains free of geopolitical influence. The change in the law reflects Russia's disappointment with the downgrades of international credit-ratings agencies after its economy faltered in 2014–2015, as well as desire to build up national arrangements in e.g. payment cards and payment clearing systems (BOFIT Weekly 1/2016).

In late 2015, at president Putin's bequest, a new Analytical Credit Ratings Agency (ACRA) was established. The CBR registered ACRA on August 25, allowing it to officially begin operations. The CBR said it was also considering the applications of several other ratings agencies.

The new law has made it challenging for the big three international credit-ratings agencies to operate in Russia. Credit ratings agency Moody's announced earlier this spring that it was pulling out of Russia.

Putin visits Uzbekistan. President Vladimir Putin visited Uzbekistan this week to extend his condolences for the death of the country's long-time president Islam Karimov and to meet with Uzbekistan's prime minister Shavkat Mirziyoyev. The successor of Karimov is not yet designated and some observers have expressed concerns about a possible behind-the-scenes power struggle in the Central Asian country. Mirziyoyev is considered a top contender for the president's post.

Throughout the Karimov era, Uzbekistan emphasised its independence and largely shunned regional cooperation projects such as the Eurasian Economic Union. Unlike other Central Asian countries, Uzbekistan has had less extensive economic relations also with China, choosing instead to balance between its large neighbours in relative isolation. Uzbekistan has a fairly closed economy and holds only minor economic significance for Russia and China. Uzbekistan accounts for just 0.5 % of Russian foreign trade and even less of China's foreign trade. Russian and Chinese firms have invested in some oil & gas projects in Uzbekistan. Repatriation of guest worker earnings from Russia last year accounted for nearly 5 % of Uzbekistan's GDP.

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China

Chinese yuan is now the most used emerging economy currency in foreign exchange trading. The latest currency market survey from the Bank for International Settlements (BIS) found that the yuan was involved on one side in 4% of all forex trading in April 2016. The yuan now ranks as the eighth most traded currency, up from eleventh place in 2013. The yuan surpassed the Mexican peso, making it now the most traded emerging-market currency. BIS noted that the daily volume of forex markets was $5.1 trillion in April. The US dollar was used in 88 % of actual trades, while the euro's share fell a couple percentage points from the previous survey to 33 % (as the method used tracks both sides of the transaction, the total percentage adds up to 200 %).

The Society for Worldwide Interbank Financial Telecommunication (SWIFT) reports monthly on the use of currencies in international payments. The July report found that 2 % of cross-border payments globally were conducted in yuan, placing it in fifth place just behind the Japanese yen among world's most important currencies in international payments. The rankings were led by the US dollar (41 %), euro (31 %), British pound (8 %) and Japanese yen (3 %).

The role of the Russian ruble in forex trading and in international payments has declined in recent years. BIS reports that the ruble today is involved in only 1 % of forex trades and that its ranking has declined from 12th place three years ago to 18th place at present. The ruble has failed to make it into the SWIFT top 20 currencies since spring 2015.

China's G20 summit in Hangzhou finishes up. The 9-page communiqué from the G20 summit (September 4–5) in Hangzhou referred in vague terms to supporting economic growth in a challenging global environment. Themes of cooperation expressed in the "Hanzhou Consensus" included opposing protectionism and reviving international trade. The G20 members committed to refraining from deliberately weakening of their currencies to improve their price competitiveness.

The summit naturally put heavy emphasis on international cooperation and the institutions that facilitate it. G20 praised China's cooperation with the Paris Club of creditors in restructuring public debt. It was hoped that China would join the Paris Club in light of the large debt receivables by China from many developing countries. The touchy issue of China's steel production overcapacity was moved to a working group backed by the OECD.

Only hours before the summit, China and the US, which together account for 38 % of global greenhouse emissions, announced they have ratified the Paris agreement on climate change. The move put pressure on other G20 members that have yet to ratify the agreement. The climate agreement, finalised last December, requires ratification of at least 55 countries that collectively account for 55 % of global greenhouse emissions to enter into force. With the addition of China and the US, 26 countries have now ratified the agreement. The Paris agreement calls for holding the average global temperature to less than 2 degrees Celsius above pre-industrial times and requires signatory countries to publish their emissions targets and data. In spite of some pressure, the G20 summit participants failed to agree on a timetable for phasing out subsidies on fossil fuels.

More free-trade zones for China. At the end of August, the Chinese government approved the establishment of new free-trade zones (FTZs) in seven inland provinces. China's first FTZ was established in Shanghai in autumn 2013 and it was followed in December 2014 with FTZs in Fujian, Guangdong and Tianjin. With seven new FTZs, the number them rises to eleven and they now expand from the coast to inland provinces. The nature and roll-out schedules of the latest round of FTZ pilot programmes have yet to be specified. Despite mixed reactions to FTZ trials, the new FTZs will increase pressure for business deregulation throughout China.

European firms fear state's role in the economy is increasing in China. At the beginning of this month, the European Union Chamber of Commerce in China (EUCCC) released its latest position paper on China's current five-year plan (2016–2020). The EUCCC said the plan actually increases the state's role in the economy, and thus runs counter to many of China's professed economic goals and its long-term opening strategy, which imply reducing the state's role.

The Chamber said that increased government involvement could be seen in current plans to develop state-owned enterprises (SOEs). China's SOEs already enjoy preferred status relative to other firms operating in China, yet, according to the EUCCC, many of the targets in the current five-year plan seek to further strengthen their position. The Chamber added that new SOEs continue to be formed and that old SOEs continue to establish major new subsidiaries. Political involvement in SOEs has increased as party committees operating in SOEs have been granted greater authority. The state's over-involvement is further evidenced by its dealing with overcapacity issue. Instead of dealing with the access of SOEs to cheap credit, reckless borrowing behaviour and wasteful investment, the government has chosen instead to get involved in regulating SOEs directly and determining the amount of capacity to be taken off stream. The EUCCC also pointed out that China uses heavy-handed measures to guide the operations of private firms through e.g. subsidy policy, which does not result in the best outcomes for the Chinese economy.

The Chamber called for reciprocity in opening up to foreign investment, pointing out that Chinese firms can operate rather freely in Europe compared to the operating possibilities of European firms in China. The Chamber also demanded a speed-up in the current EU-China investment agreement talks so that a deal could be finalised within a year at the latest.

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