SUOMEN PANKKI FINLANDS BANK EUROSYSTEM 1811

Weekly Review
48 • 2.12.2016

BOFIT

Russia

Oil & gas sector still dominates Russian business. The Russian business weekly *Expert* finds that firms operating in the oil & gas sector continued to dominate in its annual list of Russia's 400 largest companies. The 21 companies in the oil & gas sector making the Expert-400 list together accounted for nearly a third of net sales and nearly two-thirds of earnings. Profitability in the sector was supported by ruble depreciation that softened the impacts of falling oil prices.

Total net sales of Russia's largest firms rose 13 % last year to 61 trillion rubles ($1 trillion). Net sales were up most in the chemicals industry (up nearly 30 %) and most sluggish in the machine-building industry (up just over 2 %). Machine-building also had the only money-losing firms, which were mainly in Russia's struggling car industry.

The overall share of state-owned enterprises in the Expert-400 fell slightly to just under 40 % in terms of net sales. Foreign firms accounted for just over 10 % of large firm net sales. Most large foreign-owned firms operated in consumer sectors such as telecommunications and retail trade.

Russia's largest firms in 2015

	Net sales (USD billion)	*Branch*	*Owner*
Gazprom	96.0	Oil & gas	state
Lukoil	84.9	Oil & gas	private
Rosneft	67.6	Oil & gas	state
Sberbank	43.7	Banking	state
RZD	24.8	Transport	state
VTB	19.7	Banking	state
Surgutneftegaz	16.4	Oil & gas	private
Magnit	15.6	Commerce	private
Transneft	13.4	Transport	state
X5	13.3	Commerce	private

Source: Expert.

Russian government takes on wage arrears problem. Prime minister Dmitri Medvedev told a cabinet-level meeting on wage arrears last week that total wage arrears were less than 1 % of the total monthly payroll sum of the firms monitored. At the beginning of November, some 70,000 people, or less than 1 % of the workers in monitored firms, were owed delinquent wages. During the current downturn, wage arrears have seen a relatively mild increase. About half are concentrated in the manufacturing sector. Nearly 30 % of the arrears were owed by firms that had filed for bankruptcy.

Olga Golodets, deputy prime minister with social affairs portfolio, said that in the course of a month wage arrears sometimes increase to over four times the amount reported in the official end-month monitoring statistics. She noted that the official labour agencies on the average deal with almost 800,000 wage payment cases each month.

The government would like to see a more permanent solution to this problem. Medvedev referred to raising the fines on employers in wage arrears and increasing compensation paid to the workers as well as the interest rate charged on the late wages. Golodets noted a proposal was under consideration to establish the right to recover wages before taxes in bankruptcy proceedings.

Medvedev recalled the hard times in the 1990s and the prolonged times it took to settle wage arrears. For example in 2004, wage arrears were roughly a tenth of company monthly payrolls monitored, and about 4 million workers at slow-paying firms were affected. During the 2009 recession, wage arrears rose to around 2 % of total payrolls and the number of workers affected by wage arrears reached 500,000.

Finland's exports to Russia shrank further. The value of Finnish goods exports to Russia was down 8 % y-o-y in 3Q16, and down 3 % y-o-y for September. Machinery & equipment and chemicals form the majority of exports. Exports continued contracting in nearly all main product categories mainly due to reduced Russian demand and the weak ruble. The direct impact of EU export restrictions is limited, as they concern just 0.5 % of exports. The share of food items subject to Russia's import bans was about 5 % of exports to Russia before the ban, but now exports of such food items have nearly ended. President Putin recently said that the import bans should be kept in place as long as possible.

There are small signs of recovery in exports of tourist services, with the number of overnight hotel and inn stays of Russian visitors to Finland showing annual growth in September – the first rise in nearly three years. The number of border crossings to Finland via the eastern border, however, has continued to fall slightly. For the second quarter, total services exports to Russia were still down over 30 % y-o-y.

Latest survey by the Finnish-Russian Chamber of Commerce finds that 40 % of Finnish companies that operate in or export to Russia expect their sales in Russia to increase over the next six months. Only 10 % said they anticipate a further contraction. Especially exporting firms but also firms operating in Russia consider the ruble as their main problem.

The latest Team Finland survey reports that Finnish firms are encountering trade barriers most often in Russia. The number of obstacles reported for Russia was more than twice higher than for China, which had the second highest reporting of trade barriers. Russia's share of trade barriers has also grown (partly due to sanctions). Problems with customs procedures were the most cited trade barriers for Russia.

The value of Finnish goods imports from Russia contracted in the first nine months of 2016 by 2 % y-o-y. In September, it was at the same level as a year ago. Crude oil accounted for the bulk of imports. Services imports in 2Q16 were at about the same level as a year earlier.

Finnish goods exports to Russia in 2015 were €3.3 billion and services exports €1.2 billion. Both contracted 30 % y-o-y. Goods imports from Russia amounted to €5.6 billion and services imports €0.6 billion. Russia represented nearly 6 % of Finnish goods and services exports and 8 % of imports.

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

Weekly Review
48 • 2.12.2016
BOFIT

China

China's State Council issues contingency guidelines on local government debt problems. The contingency guidelines require local governments to report risky borrowing, placing them in one of four "debt risk" categories. The State Council repeated its stance that the central government would not bail out indebted local governments, and that they must instead manage the debt themselves. If a local government is unable to handle its debts, the State Council said it expects them to refrain from new investment projects, suspend on-going projects or sell off assets. In addition, other public expenses could be cut and staff laid off. Local governments have been encouraged to think about beforehand how to pay off loans they take. The new guidelines are intended to help reveal risks, create response plans for crisis situations and improve risk awareness of local government financiers.

The IMF estimates that the indebtedness and other liabilities of local governments totalled roughly 40 % of GDP at the end of 2015. Local governments this year have issued about two times more bonds than a year ago. Some of these assets have been used to pay off more expensive bank loans. The debt situation varies considerably across provinces, however. A finance ministry official interviewed by the Caixin news agency in November said that debt levels of some local governments were alarmingly high, along with a degraded ability to service that debt. Despite the risks, the yields on local government bonds are nearly the same as government bonds, and the government's latest measures did little to change the situation. If local governments find themselves in great difficulties, the central government might be forced to bail them out, even if it had given repeated warnings that it would not.

Over a million patent applications filed last year in China. The latest survey from the UN's World Intellectual Property Organization (WIPO) notes that over 1.1 million patent applications were submitted to China's patent office in 2015. While the number of patent applications globally rose over 8 %, they were up 19 % in China. China's growing significance on the R&D front was evident in the fact that the number of submitted patents to China's patent office equalled the number of the next three countries combined (United States, Japan and Korea). China's patent office also received the most applications for trademark and industrial design protections.

Last year over 1.2 million patents were granted globally, an increase of 5 % from 2014. Most of the increase came from China. China's patent office granted nearly 360,000 patents last year, making it the largest patent office in the world, surpassing the United States. WIPO estimated that there were 10.6 million patents in force last year, of which 25 % were in the United States, 18 % in Japan and 14 % in China.

China's central and local governments strongly support patent activity, which has led to an emphasis on quantity, rather than quality, of patent applications submitted. Moreover, the Chinese still mostly seek protection under domestic patents. The number of international patent applications severely lags e.g. the US, Japan and Germany. Nevertheless, it seems that China is developing rapidly both in terms of patent quality and international applicability. The Chinese telecom giants Huawei and ZTE have for years been ranked among the three largest international patent seekers (PCT).

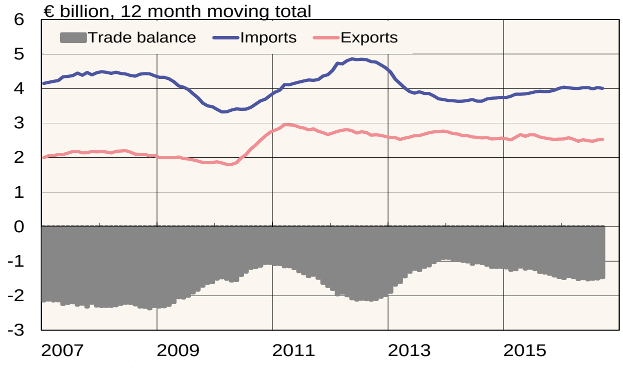
Chinese R&D spending amounted to 2.1 % of GDP last year. In the US, R&D spending is 2.7 % of GDP and the OECD average is about 2.4 % of GDP.

Finnish exports to China outperform Finnish exports generally. The value of goods exports to China in the first nine months of this year matched their 2015 performance, while Finnish exports overall were down about 5 %. Goods imports from China, like good imports generally, were at about the same level as in 2015. Exports to China of timber (up 56 % y-o-y) and paper pulp (up 12 %) increased, while fur exports declined (down 59 %). In January-September, 30 % of Finland's pulp exports and 43 % of fur exports went to China. Nickel exports to China increased by nearly 20 times from the previous year, and represented 1 % of the value of total exports to China. There was little change in the structure of imports. Finland mostly imports machinery and equipment (about half of imports from China), as well as clothing and footwear (16 % of imports). China accounted for 5 % of Finnish goods exports and 7 % of imports.

Finnish services exports to China rose to 11 % in the first half of 2016, while the total services exports held at the 2015 level. Services exports to China on-year amounted to nearly €1 billion, or about 40 % of the value of total goods exports to China and 4 % of Finland's total services exports. The value of services imports from China exceeded €800 million, or roughly 4 % of Finland's total services imports.

In the first nine months of the year, the number of overnight stays of Chinese travellers in Finnish hotels increased 20 % y-o-y, but still only represented about 4 % of all overnight stays of foreign visitors. Overnight stays of foreign visitors overall increased by 2 %. Figures from international tax-free shopping specialist Global Blue show that Chinese travellers accounted for 31 % of Finnish tax-free sales in the first nine months of this year, and were second only to Russians.

Finland-China trade



Source: Finnish customs.

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