Weekly Review
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Russia

Russian state reduces stake in Rosneft. The sale of almost a fifth of the state-majority controlled Rosneft oil company is a part of Russia's privatisation plan. Given the pressures from western sanctions and low oil prices, the sale of Rosneft shares to foreign investors, announced on December 7, came as a surprise to many. Preliminary reports said the buyer is a joint venture of the Qatar Investment Authority (QIA) and the world's second largest oil trader, Swiss-based Glencore (in which QIA is the largest shareholder). The joint venture buys 19.5 % stake in Rosneft. The deal, worth around €10.5 billion, has already been included in this year's federal budget income figures.

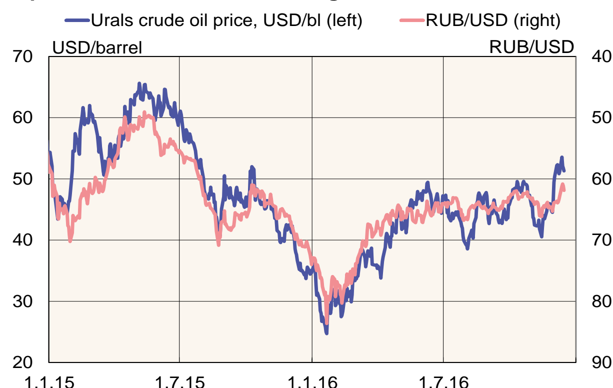
Implementation of Russia's privatisation programme has been repeatedly postponed due to unfavourable market conditions. Pressure to restart the programme was given impetus from low oil prices and rising federal budget deficits. The government earlier this year sold for example its majority stake in the Bashneft oil company to Rosneft, as well as its 10.9 % stake in diamond giant Alrosa to private investors. In all sales, the federal government, a regional government or a state-owned enterprise continues to have majority control. The Russian state still has a 50 % stake in Rosneft.

Russia and OPEC agree to reduce oil output. The Organization of Petroleum Exporting Countries, OPEC, announced on November 30 that it had reached agreement with its member countries on reducing crude oil production by 1.2 million barrels a day, effective January 2017. The agreement to cut oil output is conditional on non-OPEC countries' participation. On the same day, Russia's energy minister Alexander Novak said his country would gradually reduce crude oil production by 0.3 million barrels a day during the first half of 2017 as long as OPEC members hold to the agreement. On December 10, Russia and ten other non-OPEC countries announced that collectively they would reduce production by 0.5 million barrels a day. Russia reaffirmed that its contribution to the cuts would be 0.3 million barrels a day.

Crude oil prices rose on world markets after the OPEC announcement. The price of Urals-grade crude was up about 16 % in dollar terms to around $52 a barrel. Higher oil prices have lifted the ruble's exchange rate about 6 % against the dollar and the euro. The exchange rate now stands at about 61 rubles to the dollar and 65 rubles to the euro.

Many observers do not expect the agreed production cuts to hold, as OPEC members have not stuck to earlier agreements after oil prices have increased after cuts announced. The production cuts also come at a time when oil production is hitting historical highs. In November, Russian output was 11.2 million barrels a day, a post-Soviet record. A deal among OPEC members, Russia and other non-OPEC members is exceptional to the extent that it holds.

Oil price and ruble-dollar exchange rate



Source: Reuters

Duma and Federation Council approve federal budget and state social fund budgets. Russia's lower and upper houses of parliament accepted the government's proposals for 2017–2019 federal budget total revenues and expenditures. The federal budget accounts for roughly a half of all general government revenues and spending (consolidated budget). If the relatively cautious budget assumption of $40 a barrel for Urals crude holds, budget revenues over the next three years would stay at slightly over 15 % of GDP, i.e. at the low level of this year (does not include the proceeds from Rosneft share sale).

Federal budget spending would contract slightly even in nominal terms, with its share of GDP falling below 19 % next year. With this, the budget deficit begins shrinking notably from this year and should fall to around 3.2 % of GDP next year. Two-thirds of next year's deficit would be funded out of the Reserve Fund and the National Welfare Fund. Over half of the deficit in 2018 would be covered from the National Welfare Fund.

If the oil price exceeds the assumed price by $10, it would add roughly 1.5 percentage points of GDP to revenues. If conditions permit, finance minister Anton Siluanov said, the federal spending could be increased next year through e.g. higher subsidies to the economy.

Government defence spending is covered entirely by the federal budget. It should shrink even in nominal terms from 2015–2016, although much room has been created for the defence industry to take on government-guaranteed bank loans. The current plan also calls for cuts in spending on domestic security and order (currently 95 % funded out of the federal budget).

After the defence spending boom of past several years, transfers to the Pension Fund will again become the largest single federal budget spending category by far – nearly a quarter of all spending, even if the rise has been quelled by working pensioners remaining without inflation adjustments. Spending from the Pension Fund and other social funds will, especially next year, rise notably faster than general government spending overall.

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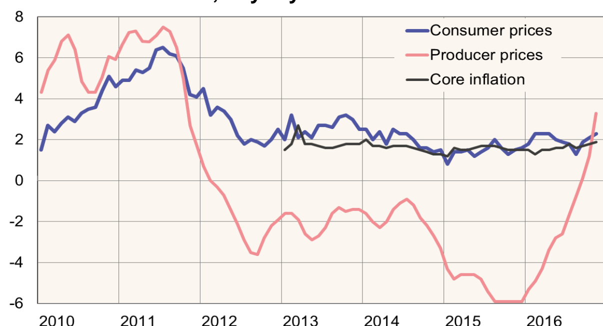
China

Chinese producer price inflation accelerates, other economic indicators unchanged. Producer prices, which started rising on-month already last spring, have since seen an acceleration in the increase. November producer prices were up 1.5 % m-o-m. The on-year deflation trend ended this autumn, and producer price inflation reached 3.3 % y-o-y growth in November. Most of the increase in producer prices reflects higher prices in mineral extraction industries and other commodities. Consumer price inflation rose slightly in November to 2.3 % y-o-y.

There were few surprises in November's real economy indicators. Industrial output continued to grow at 6 % y-o-y, while real growth of retail sales remained at 9 %. Real growth of fixed investment was about 8 %. Private sector investment has revived since summer.

Price trends in China, % y-o-y



Source: Macrobond.

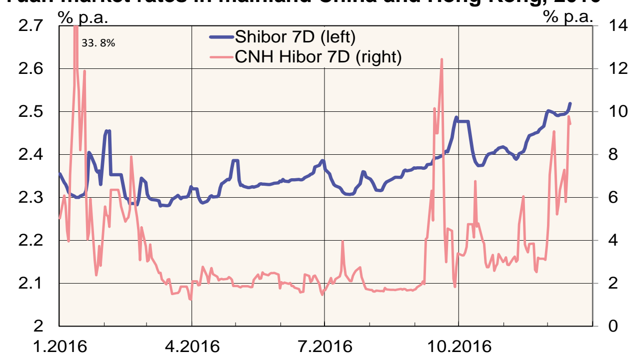
Market interest rates on the rise in China. Short-term market interest rates (e.g. Shibor 7D) were up about 0.2 percentage points in the first half of December compared to mid-July. Along with tighter restrictions on cross-border capital movements, higher rates dampen currency outflows and support the yuan's exchange rate against other currencies. Yuan interest rates in Hong Kong have risen more sharply than in mainland China. Interbank rates (e.g. CNH Hibor 7D), which were below 2 % in August, have been on average 7 % in December. Rising interest rates in Hong Kong have helped keep the yuan off-shore rate near mainland China's on-shore rate.

The People's Bank of China have kept unchanged its reference rates for deposits and credit, as well as its deposit reserve requirements. Nevertheless, the PBoC's liquidity operations have recently focused on long-term lending which could have caused nominal interest rates to rise. Behind the interest rate rise might also be the PBoC's window guidance policy. However, the recent pick-up in inflation means real interest rates have fallen in recent months. The rapid growth in lending in November also suggests that the monetary policy tightening has only been marginal at most.

Many companies have resorted to short-term credit to roll-over their old debts. If interest rates continue to rise, it could affect their financial stability. Moreover, if real interest rates begin to rise meaningfully, it would be harder for China's leaders to reach their 6.5 % GDP long-term annual growth target. However, rising interest rates should restrain rising indebtedness and strengthen economic fundamentals.

Many expectations and pressures afflict China's forex and financial markets. Administrative regulation and tighter currency controls imposed this autumn do not resolve the basic causes of market distress, and instead create uncertainty over the direction of policies. The stated goal of China's market reforms is to shift to interest-rate based monetary policy and allow greater exchange rate flexibility. Given the current circumstances, it may be time to take steps in that direction. The situation on financial markets underscores how a pursuit of a numeric GDP growth target complicates efforts to formulate and implement appropriate economic policies.

Yuan market rates in mainland China and Hong Kong, 2016



Source: Macrobond.

China takes market economy status issue to the WTO. Last Sunday (Dec. 11), China celebrated its 15th anniversary since joining the World Trade Organization. In China's view, other countries agreed during its accession negotiations that it would be treated initially as a non-market economy and would be granted market-economy status automatically after 15 year of membership. The largest advanced economies, i.e. the US, EU and Japan, however, have yet to grant China such status. The US, in particular, has stressed China's failure to make sufficient progress in market reforms. On Monday (Dec. 12), China filed a complaint to WTO and announced its request to engage consultations with the US and EU to resolve the matter. If the parties fail to agree, the dispute would move to the WTO for resolution. If so, the decision would likely be handed down in spring 2018. The parties could still resolve the dispute among themselves earlier.

The granting of market-economy status to China is largely a political gesture to recognise the country's progress in market-economy reforms. In practical terms, market-economy status means little as it applies only to anti-dumping measures. It is easier to impose anti-dumping measures on countries with non-market-economy status. Japan and the US are keeping their anti-dumping procedures unchanged, while the EU is changing its practices so that market-economy status will no longer have any affect how import duties are imposed.

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