Weekly Review
2 • 12.1.2018

BOFIT

Russia

Russia depletes its second oil fund. The remaining assets of the Reserve Fund, about 17 billion dollars (1 trillion rubles) were allocated in December to cover the federal budget shortfall. As decided last summer, the Reserve Fund is now closed and the National Welfare Fund remains Russia's sole oil fund. Russia decided to divide its sovereign oil wealth fund into two funds in 2008. The Reserve Fund was intended for covering budget deficits, while the National Welfare Fund was intended to finance pensions. During 2015–2017, Russia drained roughly 90 billion dollars from the Reserve Fund to cover budget spending.

The value of the National Welfare Fund fell by 7 billion dollars last year, mostly due to financing of pensions. At the start of 2018, the Fund held assets of 65 billion dollars (3.75 trillion rubles). Nearly 40 billion dollars are liquid assets, with the rest invested in e.g. long-term deposits in state-owned banks or infrastructure projects. The Fund will be filled with last year's higher-than-expected oil revenues of about 14 billion dollars (840 billion rubles) according to finance minister Siluanov. Therefore Russia's liquid oil fund assets total around 50 billion dollars (3 % of GDP).

Fund assets of about 19 billion dollars (1.1 trillion rubles) are planned be used this year to cover budget deficit, but the budget is based on a cautious oil price assumption of 44 dollars a barrel. Only a small depletion of Fund assets is planned for 2019–20.

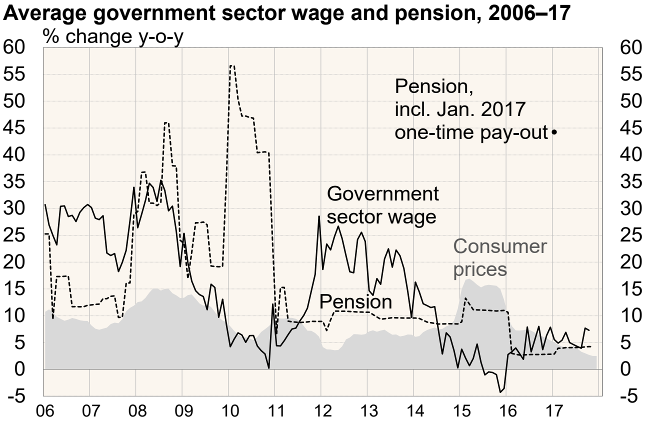
State gives small income hikes and tiny tax reliefs to Russians. Wages and pensions paid out of government budgets at various levels fell sharply in real terms in 2014–16 on small nominal cost-of-living adjustments (COLAs) especially compared to inflation that flared up in 2015. General COLAs were reintroduced last year for pensions and most focal forms of social support. This year they and the general increase for civil servants will be closely COLA-based (projected inflation under 4 %). The increases are small relative to huge hikes of earlier election periods (2007–08 and 2011–12).

After a freeze for the past four years, president Putin last spring proposed a general increase in government sector wages. Civil servants working at the federal, regional or local level received general increases on 1 January 2018. Wages for those government sector workers for whom Putin in spring 2012 ordered large and long upward adjustments will continue to rise rapidly. The general hike in the minimum wage at the start of the year also gives a boost for some budget-sector workers. The increase was over 20 % and a further hike (some 15 %) was just promised by Putin for 1 May (instead of 1 January 2019 set up to now). That will raise the minimum wage for the first time to the official subsistence minimum.

Old-age pensions were also raised already on 1 January, while the zero-hike policy for working pensioners continues. The hikes to recipients of government pensions and social pensions, irrespective of working status, come in spring. The maternity capital pack is extended to 2021. Its use in buying or building a home or paying for child care have been eased. Part of low-income families with small children will now receive monthly maternity support for up to 1.5 years per child.

All pensioners will now be eligible for a revised land tax discount that applies e.g. to small home plots. Uncollectable tax arrears, their increases and fines levied on private persons for property, land or vehicle taxes incurred before 1 January 2015 will be erased from the record. The same applies to all taxes of current and former no-company individual entrepreneurs and practitioners (except excise taxes, foreign trade taxes and taxes on resource extraction), as well as their belated mandatory social taxes from before 1 January 2017.

Average government sector wage and pension, 2006–17



Sources: Rosstat and BOFIT.

Sistema to pay damages to Russian oil giant Rosneft in Bashneft deal. Bashneft, a mid-sized oil company was privatized at the start of the 2000s to the leaders of Bashkortostan. A few years later the company was acquired by business tycoon Vladimir Yevtushenkov, owner of the Sistema conglomerate. In 2014, Bashneft's assets were seized by the government on the premise that the privatisation was illicit. In 2016, the government decided to have a second go at privatisation of Bashneft and it was sold to state-owned Rosneft.

Last spring Rosneft started court cases against Sistema for abuses during its Bashneft ownership. With support from president Putin, the companies finally reached an agreement last month with Sistema paying Rosneft 100 billion rubles (1.4 billion euros) in damages. Sistema is set to receive help to meet its obligations from the state-owned Russian Direct Investment Fund (RDIF). The RDIF and the China Investment Corporation are minority partners in Sistema's children's goods retailer Detsky Mir. Detsky Mir's December share offering was cancelled due to the Sistema court case.

Bashneft's seizure was at the time seen by some to have parallels with the Yukos case and many view also the current case as a negative sign of Russia's business climate. The current court case was actually already second related to Rosneft's Bashneft deal. The former economy minister Alexei Ulyukayev was recently convicted for demanding a bribe from Rosneft CEO Igor Sechin for supporting the deal.

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China

China's central bank re-adjusts its exchange rate mechanism. On Tuesday (Jan. 9), the yuan dropped 0.5 % against the US dollar to a level of 6.53 after the People's Bank of China announced changes in setting the daily fixing price for the yuan-dollar rate. Under the latest PBoC guidance, banks that participate in setting the daily fixing rate no longer need to include the *countercyclical factor* which according to market participants has supported the yuan's external value. The central bank refrains from intervening in forex markets as long as the yuan's daily deviations from the fixing rate are less than 2 %. The fluctuations have actually been considerably smaller.

The PBoC introduced the use of the vaguely defined countercyclical factor last May arguing it would be needed to prevent excesses by the markets. With the dollar's depreciation over the past year and confidence returning to the yuan, the central bank saw it possible to return to its old scheme that is based more on pure of supply-and-demand conditions in the market. Of course nothing prevents the reintroduction of the countercyclical factor if conditions change.

China's stated goals are a much freer formation of the exchange rate and deregulation of capital movements, but progress in this direction has been sporadic at best. While liberalisation of capital imports has continued, controls on capital exports have tightened. Last week, Chinese officials restricted the amount of foreign currency private individuals could annually withdraw from their domestic accounts while abroad to 100,000 yuan (USD 15,400), and just 10,000 yuan (USD 1,540) per day. Earlier limits were based on individual accounts. The total amount of currency exchange per person remains at 50,000 dollars per year, but monitoring of such transactions has also been intensified.

China's foreign currency reserves grew last year by nearly 130 billion dollars to 3.14 trillion dollars. This was due in part to fluctuating exchange rates. In 2015–2016, China's currency reserves shrank by over 830 billion dollars.

New limits on China's financial markets. The China Banking Regulatory Commission (CBRC) decided at the start of this year to restrict *entrusted* loans, whereby banks or specialised lenders move money owned by one firm to another firm. In the worst-case abuses, the company issuing the entrusted loan just borrows from a bank to make a loan for another firm that fails the bank's lending criteria. As the middle man is such arrangements, the bank typically pockets fees for e.g. setting up the loan and loan guarantee, but often fails to supervise the loan's performance. The new rules prevent banks from active involvement in the entrusted loan business. Firms will no longer be allowed to purchase securities or derivatives with entrusted loans.

The new regulations are part of a crackdown on the shadow banking sector. Shadow banking is estimated to have doubled over the past ten years and now accounts for roughly 15 % of private-sector financing under China's total social financing (TSF) definition. The growth in entrusted loans has been stunning. The stock of entrusted loans is now nearly 14 trillion yuan (USD 2.1 trillion) and accounts for over half of the shadow banking sector's TSF. The restrictions on entrusted loans extend earlier measures by the PBoC and supervisory agencies to quell off-balance-sheet lending and speculation on margin.

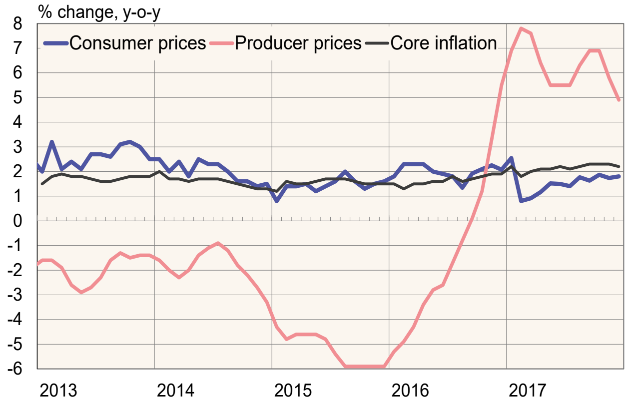
The new regulatory reforms rolled out this year also affect other parts of China's financial markets. New bond-trading rules to be introduced after a one-year transition include a requirement for written contracts on all bond repo and derivative transactions as well as leverage ratio restrictions on all buyers. Off-book trading and speculation on margin are common practices in China's roughly 67 trillion-yuan (USD 10.3 trillion) bond markets.

Reuters reports that the PBoC plans this year to limit the issuance of negotiable certificates of deposit (NCDs). Banks have been advised to obtain central-bank permission on their 2018 NCD quotas, which, combined with their interbank liabilities, may not exceed one-third of the applicant bank's total liabilities. The value of outstanding NCDs last year reached 8 trillion yuan (USD 1.2 trillion). NCD issues are popular particularly among small lenders for financing of longer-term investments, often via the shadow banking sector.

China posts moderate consumer price inflation in 2017; producer prices climb. Consumer prices last year rose by just 1.6 %, well below the government's target ceiling of 3 %. In December, the 12-month rise in consumer prices was 1.8 % y-o-y. Core inflation, which omits changes in energy and food prices, was 2.2 % in 2017. Upward pressure on prices last year was provided by higher prices for services and fuel. Food prices fell slightly.

Spurred by higher prices for commodities and the improved fortunes of extractive industries, producer prices rose by 6.3 % last year. The 12-month rise in producer prices began to fade towards the end of the year subsiding to just 4.9 % in December. The on-month rise, however, increased in every month of the second half of the year.

Price trends in China



Source: Macrobond, BOFIT

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