Weekly Review
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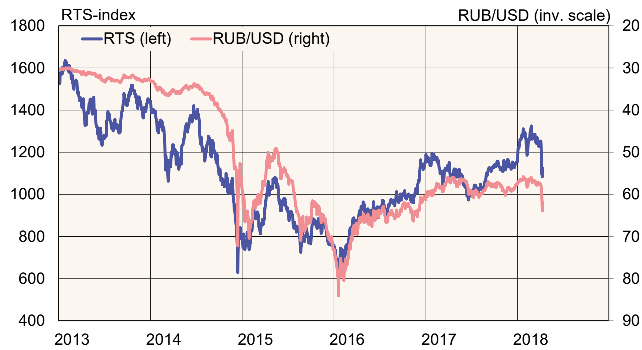
Russia

Russian markets dive after US imposes more sanctions. On April 6, the United States added 24 Russian businessmen and public officials, along with 15 Russian companies, to its sanctions list. Half of the blacklisted firms (including Rusal, one of the world's largest aluminium producers) are owned by Russian oligarch Oleg Deripaska, who now finds himself also on the list. Entities subject to the sanctions face freezing of their assets in the US and Americans are now generally prohibited from dealings with them. Non-US persons could also face sanctions if they knowingly facilitate significant transactions of listed entities.

The initial market reactions in Russia were strong with the Moscow exchange's RTS index falling 12 % in the beginning of the week and the ruble losing about 10 % of its value against both the dollar and the euro, but yesterday there was a visible correction upwards. The biggest losers have been listed firms hit directly by sanctions, but also many other Russian firms, e.g. metal producers and banks, saw their stock prices tumble. In addition to last week's new round of sanctions, markets were spooked by a proposed US bill to sanction Russian sovereign debt and heightened tensions between Russia and the US in the Syrian conflict. Market jitters should continue in the coming days, but calm gradually if further complications do not arise.

Russian RTS index and ruble-dollar exchange rate



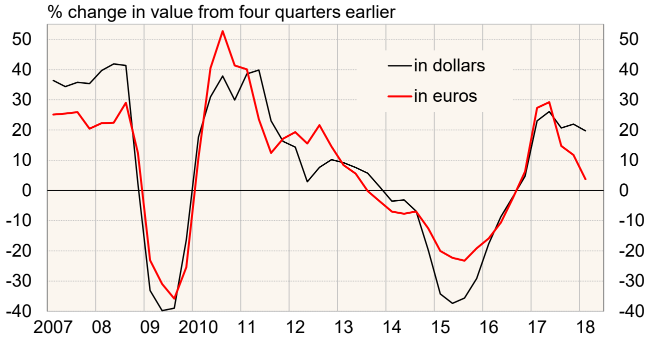
Source: Macrobond.

Russia's import recovery slows; outflows of private capital increase slightly. Measured in US dollars, the official currency for reporting the value of Russian foreign trade and balance-of-payments data, imports of goods and services rose by 20 % y-o-y in the first quarter. Measured in euros, however, spending on imports increased by only about 4 %, as the euro's exchange rate has appreciated against the dollar by an exceptional amount over the past year. Growth in goods imports was slightly lower than growth in services imports, which included growth of Russian travel spending abroad slowing down but still increasing by 14 % (in euro terms).

Russia's earnings on exports of goods and services rose by 20 % in dollars, but by only a few per cent in euros. At this pace, earnings rose from goods exports both overall and separately for energy and non-energy. For the past four quarters, the current account surplus was up to about 2.5 % of GDP.

After growing slightly in the second half of 2017, the net outflow of capital from the corporate sector abroad increased further in the first quarter. Apart from foreign direct investments into Russia, there were net capital outflows in all major foreign debt and receivable categories of the corporate sector.

Russian spending on goods and services imports



Source: Central Bank of Russia.

Russian natural gas production grew briskly last year. After declining three years in a row, Russian natural gas production increased 8 % last year reaching 690 billion cubic metres (including associated natural gas production). Due to limited storage possibilities, gas production trends are largely dictated by demand. Last year demand was supported by domestic economic recovery and brisk export growth. Russia's economy ministry expects gas production to decline slightly this year and increase by around 1–2 % a year in 2019 and 2020.

Russia, which accounts for nearly a fifth of total global production, is the world's second largest natural gas producer after the United States. About 90 % of Russian gas is produced in the Yamal-Nenets Autonomous Okrug, where large part of Russian gas reserves are also located. Liquefied natural gas (LNG) is produced on the Sakhalin Island and the Yamal Peninsula with the total production capacity currently standing at about 15 million metric tons (20 billion m^3), or about 5 % of global LNG production.

About a third of Russian natural gas production is exported. While natural gas is an important export commodity for Russia, it is not nearly as important as oil. Export earnings on gas amounted to just over 40 billion dollars last year (compared to over 150 billion dollars on oil and oil products), or about 11 % of Russia's total earnings on goods exports.

Most Russian natural gas exports are still transmitted by pipeline, with about two-thirds going to EU countries. Other major markets include Turkey and Belarus. Practically all of Russia's LNG production currently goes to East Asian countries, which are not yet served by Russian pipelines. Completion of the first phase of the Power of Siberia gas pipeline from Russia to China is set for late 2019.

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China

President Xi repeats his commitment to reform and easier access to China's markets. In his speech to the Boao Forum for Asia on Tuesday (Apr. 10), president Xi Jinping reaffirmed his commitment to gradually opening of China's economy to the world. He noted China and other countries have benefited from decades of China's ongoing opening process and continuation of the process will remain important in the future. While Xi did not mention the deterioration in US-China trade relations, he implied that China is responding to concerns raised by the Trump administration.

Xi, for example, promised that this year China would implement measures to open up its financial services markets as promised last November. The moves include elimination of foreign ownership restrictions on banks and financial services firms. Deregulation of foreign insurance companies will also be accelerated. In industrial fields, China plans to ease rules "as fast as possible" for foreign-owned car manufacturers, the aerospace industry and shipbuilders. These are fields in which foreign firms are currently required to form joint ventures with Chinese firms to gain access to the Chinese market. China also plans to lower import tariffs on certain goods – most notably cars, which currently are subject to a 25 % import tariff.

Investing in China should become easier once the government revises its "negative list," which specifies those branches in which foreign investment is restricted and requires special government permission. Other investments will be treated like domestic investments and not require government clearance beforehand.

Violation of intellectual property rights has topped the US litany of complaints in the current trade dispute. China is addressing these concerns by reopening the state intellectual property office and increase punishments for violators. China will also seek to accelerate its compliance with the WTO Government Procurement Agreement, which it committed to as part of its WTO accession in 2001.

Several of the reforms presented by president Xi have been earlier proposed but never made it to the implementation stage. The US said it was encouraged by Xi's message, but would still like to see words backed with action. The EU Chamber of Commerce in China has wishes similar to the US and seeks more detailed information with which to evaluate the policy shift. News reports are conflicting as to whether China and the US are already in talks on resolving the impasse.

China launches trading of yuan-denominated oil futures on Shanghai futures exchange. China last year surpassed the United States to become the world's largest oil importer. Decade-planned trading in yuan-denominated oil futures finally launched on the Shanghai futures exchange on March 26. The oil futures are the first Chinese derivative contracts in which international investors may freely trade.

Oil sold on global markets is traditionally priced in US dollars, with trading fundamentals set by the price of the benchmark West Texas Intermediate (WTI) grade in New York and Brent oil in London. The new yuan-denominated futures provide an opportunity to establish an Asian benchmark grade based on one of the grades most used by Asian oil refiners. The derivative instruments will help Chinese firms manage costs and hedge from price swings. At the same time, the move should help strengthen the yuan's role in international commerce. Reuters reports that the futures trade is also a first step in China's efforts to internationalise the yuan's use as a viable payment currency for the oil trade alongside the dollar.

The first wave of trading included Chinese investors and international players from e.g. Switzerland and the US. The appeal of yuan-denominated oil futures depends to a great extent on international use of the yuan, which will require a toning down of China's capital controls. Up to now, complex trading rules and barriers to capital movements have effectively prevented foreign investors from participating in Chinese securities markets.

China seeks to increase soy production. China buys two-thirds of the soybeans sold on the global market. Soy meets large share of the protein feed input in Chinese meat production. China's domestic production can only cover a small fraction of soy demand, however. China's current 2016–2020 five-year plan calls for reduction the country's dependence on imported soy by encouraging farmers replace maize with soybeans. By 2020, the area under cultivation for maize should decline to 13 % below the 2015 level, while soybean acreage should rise by 40 % from that level.

Overproduction of maize has been a problem in China. The subsidised guaranteed maize price was earlier so high that it encouraged farmers to grow maize whether or not there was any demand for it. Chinese soybean farming is today largely supported through farm subsidies. Also soy import tariffs are speculated to be another way of encouraging soy farming as it would raise prices for domestic producers. Over a third of China's soybean imports come from the United States. With trade tensions flaring, China has threatened to impose 25 % tariffs on US-produced soybeans. Import restrictions imposed on soybeans, however, would impact Chinese meat production and fuel inflation. Moreover, this huge soy amount would be difficult to cover with imports from other countries. Chinese firms, not multinationals, are today the main soy importers to China.

Soybean production rose by 12 % in 2017, while maize production declined by about 2 %. The volume of soybean imports, however, grew by about 14 %, while maize imports declined by nearly 11 %. The threat of a trade war has confused the outlook of the year and is likely to affect prices of soybeans and maize.

While most guaranteed prices for agricultural products have been abolished, they remain in place for wheat and rice.

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