SUOMEN PANKKI FINLANDS BANK EUROSYSTEMET 1811

Weekly Review
22 • 1.6.2018

BOFIT

Russia

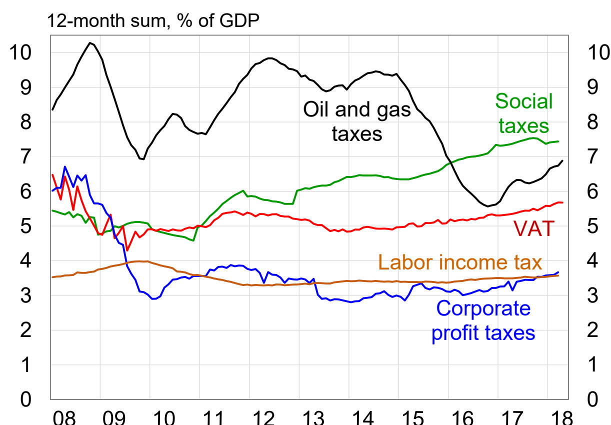
Russia's government sector deficit shrinks, the reserve fund will increase. In the first quarter of this year, revenues to the consolidated budget (federal, regional and local budgets plus state social funds) were up by more than 10 % from a year earlier. The rise in revenues was nearly as fast as last year.

Budget oil revenues increased by well over 20 % y-o-y, which was about the same pace as last year. The oil revenues comprise five categories: taxes on production of crude oil and natural gas, and export duties on oil, oil products and natural gas. Export duties on oil and oil products, as well as the taxes on crude oil production are partly determined by export prices, which have been substantially higher this year than last year. Oil revenues in the first quarter increased their share to nearly 25 % of total consolidated budget revenues. The share has not been this high since 2015.

Other revenues to the consolidated budget continued to rise by nearly 8 % y-o-y in the first quarter, even if revenues from excise taxes plunged as the tobacco industry's output fell sharply last year. The biggest revenue streams (mandatory corporate social taxes, value-added taxes, corporate profit taxes, income tax) all increased by roughly 15 % y-o-y. This suggests that tax collection has improved further, as there have been no increases in these taxes. Value-added tax revenues have also grown due to imports which continued to recover rather briskly still early this year.

Consolidated budget spending continued to rise slowly in the first quarter, just 3 % y-o-y. Spending on healthcare and education, as well as spending on general administration increased remarkably fast. Spending on defence, domestic security and law enforcement, as well as various economic sectors, grew rather slowly.

Major revenue streams in Russia's consolidated budget, 2008−2018



Source: Russian Ministry of Finance.

The consolidated budget deficit has contracted over the last twelve months to less than 1 % of GDP. Under the new federal budget rule, "excess" oil revenues are to be saved and transferred to the single reserve fund that Russia maintains since the start of this year, i.e. the National Welfare Fund, by autumn of the following year. Excess oil revenues arise when the realised oil price exceeds the annual base calculation price set in the rule. Both this year and last year have seen large inflows of excess oil revenues. The reserve fund holds liquid assets equivalent to more than 2 % of GDP, but last year's excess oil revenues have yet to be transferred to the fund. Overall, the Russian federal government had assets in the central bank equivalent to more than 6 % of GDP at the end of March.

EU and Gazprom resolve long-running gas dispute. An investigation by the European Commission launched in autumn 2012 found that Gazprom broke the EU's competition regulations in many central and eastern European member countries. Commission findings on the matter were delivered to Gazprom in April 2015. Gazprom delivered its response in spring 2017. Last week (May 24), the Commission issued its final ruling in the matter. The ruling mandates that Gazprom, under threat of a fine, modify its contract practices within the EU. Among other things, Gazprom must allow the sale of gas to third parties, commit to upholding market pricing and ease gas deliveries to the four EU member countries dependent on Gazprom pipeline supplies. Observers note that Gazprom has already modified most of its operational practices to conform with EU standards and that the company has promised to abide by the Commission's decision.

Gazprom last year accounted for about 43 % of EU gas imports. About 44 % of natural gas from Russia reached the EU via Ukraine, 24 % via Belarus, and about 30 % via the Nord-Stream gas pipeline, which runs under the Baltic Sea.

Russia to require unique identifiers for many consumer products next year. At the end of 2017, the Duma approved a law on unique identifier codes for products sold in Russia. At the moment, the unique product identifiers are being used in a few pilot projects, e.g. fur products. Under a cabinet decision made in early May, the first wave of unique identifiers will become mandatory next year for products that include tobacco products, clothing, footwear, perfumes and automobile tyres. The system of mandatory unique identifiers is planned to be extended later to include other products such as pharmaceuticals.

The identifier must include information e.g. on the product classification and its origin as well as give the item its unique identity. The unique identifier system is to be based on Russian encryption technology and should be implemented by a company partly owned by Rostec, a massive conglomerate operating e.g. in the defence sector. The identifier system is hoped to reduce smuggling, the grey economy and counterfeit goods. Many firms, especially SMEs, fear that system will increase costs and force them to raise prices.

Bank of Finland • Institute for Economies in Transition, BOFIT
P.O. Box 160, FI-00101 Helsinki
Phone: +358 9 183 2268 • Web: www.bofit.fi/en

Editor-in-Chief Jouko Rautava• Email: Jouko.Rautava@bof.fi
The information is compiled and edited from a variety of sources.
The Bank of Finland assumes no responsibility for the completeness or accuracy of the information, and opinions expressed do not necessarily reflect the views of the Bank of Finland.

Weekly Review
22 • 1.6.2018

BOFIT

China

Tighter regulations affect income generation of China's insurance sector. The size of China's insurance sector (total balance sheet assets) grew in the first quarter of this year by 6.5 % y-o-y to just over 17 trillion yuan ($2.7 trillion). The size of China's insurance sector is now nearly eight times larger than it was a decade ago. Insurance premia fell by 16 % y-o-y in the first quarter. The biggest drop was in life insurance, which accounts for over 60 % of all insurance payments. Investment income rose in the first quarter by more than 15 %.

Some insurance companies have strongly bolstered their growth in recent years through the sale of "wealth management products." These *universal insurance* products differ from traditional insurance by promising investors high and guaranteed rates of return. Companies have been expanding abroad and outside their core business. Last year, however, measures targeting the insurance and shadow banking sectors have tightened the income generation of insurers, especially regarding the wealth management products. Growth has slowed and some insurance companies have been forced to sell their assets. In particular, unlisted firms struggle to pay promised returns to investors. The government has promised better access of foreign entities to Chinese markets, which should even increase the competition. Regulation is also being tightened (see below).

Anbang Insurance provides a telling example of the insurance sector's current problems. Anbang expanded rapidly and was China's third largest insurance company in the first half of 2017. It controlled directly or indirectly nearly 60 firms when encountered with severe financial difficulties and was taken over by government. In April, the government spent 61 billion yuan ($10 billion) re-capitalising Anbang. In May, Anbang founder Wu Xiaohui was convicted of financial crimes and sentenced to 18 years in prison.

New rules require Chinese insurance companies to reveal their ownership structures. The newly merged banking and insurance regulator CBIRC released new rules in May that substantially increase the disclosure obligations of insurers. Insurance companies must now provide detailed information about their ownership structures, main business activities and risk management practices. The new rules enter into force on July 1.

Complex webs of ownership and corporate arrangements in China's financial sector have increased stability risks. The new rules require insurance companies, among other things, to reports all entities that hold more than 5 % of a company's shares, as well as declare who actually holds decision-making powers in the firm. For the first time, insurance companies must reveal information about their liabilities, assessments of balance sheet items and future cash flows.

US threatens further tariffs on China. On Tuesday (May 29), the White House announced that it was imposing 25 % import tariffs on certain Chinese goods totalling about $50 billion a year. The new tariffs reflect on-going disputes over intellectual property protection. The White House has promised a detailed list by June 15, and that the tariffs would come into effect "soon thereafter". Bilateral trade talks are nevertheless set to continue during June 2–4, when US commerce secretary Wilbur Ross visits Beijing.

Despite underdeveloped markets, mainland China shares now included in MSCI indices. Starting today (June 1), share index producer MSCI includes some 233 A-shares listed on mainland Chinese exchanges in its international indices. The decision was taken last summer. Only 5 % of the adjusted market capitalisation of the Chinese shares are included, indicating the large remaining barriers to market access and market-based trading on Chinese exchanges. The index update will take place in two phases. Half of the Chinese share weighting will be included now and the other half at the beginning of September. For example, after the update, the MSCI Emerging Market index's 31 % China weighting still only contains 0.8 percentage points from mainland China A-shares. The weighting of Chinese A-shares in the MSCI All Country World Index will only be about 0.1 %.

Mainland China's stock markets are the world's second largest after the United States. International indices have traditionally taken their China weighting from shares listed in Hong Kong and outside mainland China. Foreign holding of Chinese shares concentrates on these shares. China's stock markets differ from Western stock markets in their lack of institutional investors. Furthermore, the state is heavily involved and intervenes actively in trading. MSCI has warned of the risks associated with Chinese markets such as the volatility caused by the market structure and poor social, environmental and corporate governance.

Thus, the inclusion of Chinese A-shares in international indices is largely a symbolic gesture, an expression of Western hopes that China will continue to open up its markets to the world and adopt market-based reforms. Several observers say that it is unlikely that the index update will immediately significantly increase capital inflows from abroad. Foreign shareholding under the joint Stock Connect programmes of the Hong Kong stock exchange and the Shanghai and Shenzhen bourses is currently about $73 billion. All in all, foreign ownership in China's stock markets is about $190 billion, or 2 % of the total market capitalisation.

China is updating its rules on trading in China depositary receipts (CDR) in mainland China, which would give large foreign listed Chinese firms the possibility to issue such certificates also on domestic markets. The issuance of CDRs would help to facilitate the planned cooperation between the Shanghai and London exchanges. Central bank governor Yi Gang said in April that trading under the cooperation programme could begin already this year.

Bank of Finland • Institute for Economies in Transition, BOFIT
P.O. Box 160, FI-00101 Helsinki
Phone: +358 9 183 2268 • Web: www.bofit.fi/en

Editor-in-Chief Jouko Rautava• Email: Jouko.Rautava@bof.fi
The information is compiled and edited from a variety of sources. The Bank of Finland assumes no responsibility for the completeness or accuracy of the information, and opinions expressed do not necessarily reflect the views of the Bank of Finland.