Weekly Review
27 • 6.7.2018
BOFIT

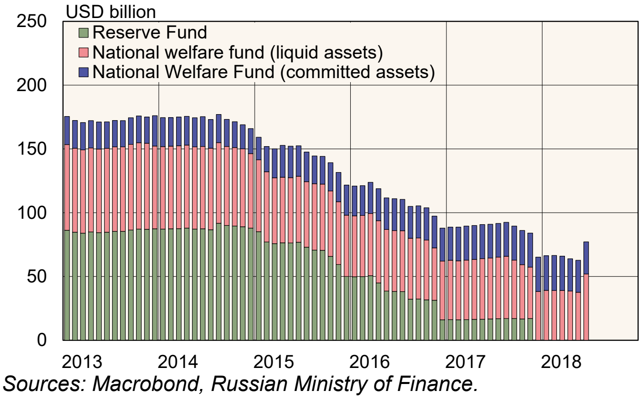
# Russia

**Russian oil fund topped up with last year's oil revenues.** In June, the National Welfare Fund received a 900-billion-ruble boost (14 billion USD) from oil income saved last year, i.e. budget revenues from higher-than-anticipated oil & gas tax revenues. Under the current budget rule, revenues from oil & gas taxes in excess of the threshold average Urals oil price (about 40 USD a barrel) received to the federal budget must be set aside in the fund.

As of end-June, the National Welfare Fund held assets worth a total of 4.8 trillion rubles (77 billion USD or about 5 % of GDP). About two-thirds of them were liquid (i.e. easily converted to cash) currency-denominated assets and counted as part of Russia's foreign currency reserves. The remainder is invested e.g. in long-term deposits in state-owned banks and for financing infrastructure projects of domestic companies.

With the changes for this year's budget law approved at the end of June, Russia's federal budget is now expected to record a surplus of 480 billion rubles on higher oil prices instead of deficit as anticipated before. Thus, fund assets should not be needed to cover budget expenditures, but the fund could be further replenished. Russia's other fund for oil tax revenues, the Reserve Fund, was drained last year and closed.

**Russia's oil funds**



*Sources: Macrobond, Russian Ministry of Finance.*

**CBR injects more money into troubled banks.** The Central Bank of Russia last year had to take over three large private banks – Otkritie, B&N Bank and Promsvyazbank – to ensure their continued operations. The CBR announced last week that it was investing another 43 billion rubles to capitalise Otkritie Bank. The bank will immediately be forced to use most of the infusion to cover losses in its pension funds that result, among other things, from the drop in the value of shares in its Rosgosstrakh insurance company.

The CBR also made 3-5 year temporary deposits totalling 174 billion rubles in a number of banks undergoing restructuring. These deposits are set to be used for reorganizing and concentrating weak assets in troubled banks and companies owned by them onto balance sheets of select troubled banks. Finally, the select banks are planned to be merged under an asset management company established on the basis of Trust bank, into which all the weaker assets of the troubled banks will be marshalled. The current plan is to restore Otkritie Bank to health and sell it to private investors.

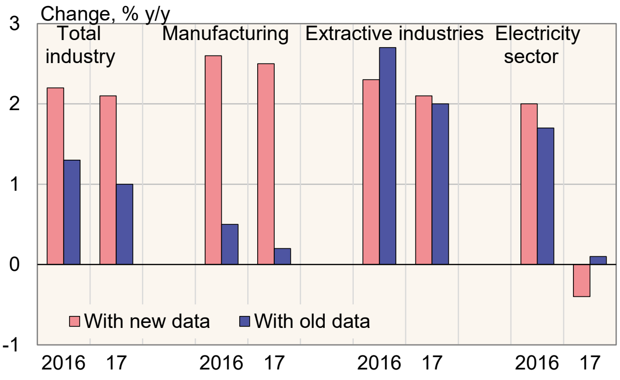
The CBR is now using a total of 217 billion rubles (3.5 billion USD) in extra funds to support banks it has taken over. CBR governor Elvira Nabiullina stated in early June that the central bank had thus far spent 760 billion rubles (12 billion USD) on recapitalising troubled banks. It had also provided troubled banks 1.86 trillion rubles (30 billion USD) as deposits. Thus, the CBR to date has used over 45 billion USD (about 3 % of 2017 GDP) in supporting the three banks that it took over last year. Some of this amount, however, should be recovered when assets in banks acquired by the CBR are sold off as well as in the planned privatisations of the banks.

**Revised Rosstat figures give a significantly brighter view of recent industrial output growth.** Revised 2016–17 data show that Russian industrial output, rather than the 2.3 % reported earlier, grew by 4.3 % over the two-year period. The adjustment was due almost entirely to large improvements in performance of manufacturing firms. Instead of the earlier-reported 0.7 %, manufacturing output in 2016–17 rose by 5.2 %. Some of the biggest improvements were seen e.g. in the chemicals, metal products and machinery & equipment categories.

Rosstat said the changes were due largely to revised figures received from the companies this year and last year which replaced the earlier preliminary monthly data. In addition, estimates of the production of small firms are replaced by data gathered on a quarterly or yearly basis. Revised figures were previously published once a year. Rosstat now plans to publish revised figures on a quarterly basis.

Due to the higher industrial output assessment, Rosstat revised upwards also its 2016–17 growth indicator for the output of five core sectors of the economy by roughly one percentage point. The CBR has evaluated that the GDP growth figures for 2016 and 2017 might be revised up by 0.2–0.3 of a percentage point.

**Total industrial output and core sector output, 2016−17**



*Source: Rosstat.*

Weekly Review
27 • 6.7.2018
BOFIT

# China

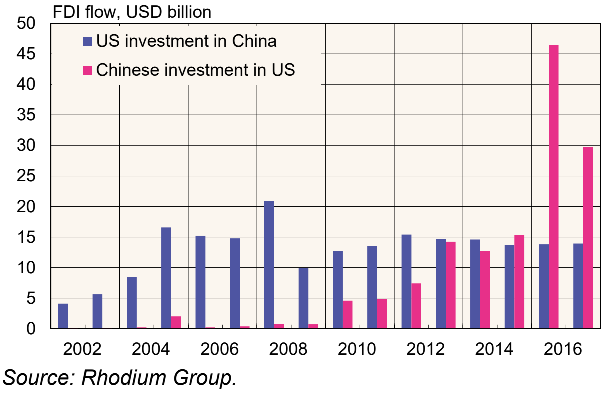
**Hardest aspects of US planned restrictions on Chinese investment fall away, but trade war still on.** President Donald Trump last week rescinded his threat to impose major restrictions on Chinese investment in the United States. Instead of pushing for specific restrictions on Chinese investment, Trump expressed support for a bill expanding the existing evaluation process of all foreign investments. Nevertheless, the US today (July 6) went ahead with the 25 % tariffs on certain Chinese imports announced in June. China has said it will respond with countermeasures.

Foreign investors currently need US government permission to operate in any branch considered critical to national security. Permits are granted by the inter-agency Committee on Foreign Investment in the United States (CFIUS). Last November, an overhaul of CFIUS's mission was proposed under the Foreign Investment Risk Review Modernization Act of 2018 (FIRMMA), which sought to expand widely the type of entities subject to CFIUS scrutiny. A proposition that keeps strengthened CFIUS oversight of outgoing investment and operation of US firms abroad is winning acceptance. To be rejected, a foreign investment in the US would no longer need to pose a threat to national security. Congress could give final approval to FIRMMA this summer.

The US seeks to restrict Chinese investment, particularly the sectors set to benefit from China's industrial policy flagship "Made in China 2025." China wants to use the programme as a springboard to technological leadership in fields such as aerospace, IT, artificial intelligence and pharmaceuticals. China has financially supported high-tech firms in their international expansion, as well as in acquisition of firms possessing high-tech capabilities. While Chinese investment and acquisitions of foreign firms has exploded, China still seeks to restrict inward foreign investment both with official and unofficial means.

While difficult to glean bilateral investment from official figures, the Rhodium Group claims 2016 was a record year for Chinese FDI flows to the US ($47 billion). The volume of new investment dipped in 2017 to $30 billion. In the first half of this year, the US received less than $2 billion in Chinese FDI.

**China-US bilateral direct investment flows, 2001–2017.**



*Source: Rhodium Group.*

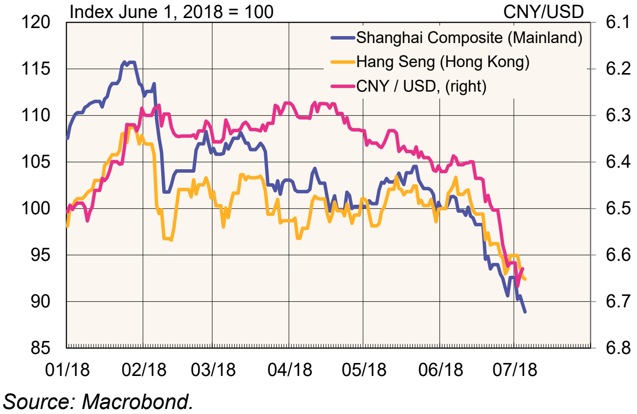
**China's negative list cut to 48 branches restricted or banned to foreign investors.** Chinese officials last week released an updated version of the "negative list," which identifies branches where foreign ownership is restricted or banned. The current list whittles the list from 63 branches last year to just 48. The new list takes effect on July 28. The list reaffirms government pledges to eliminate the ceiling on foreign ownership in certain fields of finance in 2021 and restrictions on vehicle manufacture by 2022. Branches considered strategically important remain on the list. These include mining and refining of rare earth metals, cloud computing and the oil & gas sectors.

The official announcement of the new negative list followed president Trump's announcement that he was backing off from an earlier plan to restrict Chinese investment in the US. Shortening the negative list was among the demands that the US presented in May on the current trade dispute. Having a branch deleted from negative list does not automatically translate to convenient market access for foreign firms. Foreign firms repeatedly point out that they are subject to stricter reporting and regulatory requirements than comparable domestic firms in several branches.

**Chinese market jitters emerged in June.** Over the course of June, the yuan's exchange rate dropped 3 % against the US dollar, its deepest low in six months. The trade-weighted yuan is worth 2 % less than at the start of June. On July 2, one dollar bought nearly 6.7 yuan. After slightly appreciating, the yuan dropped again today (July 6). Stock indices have fallen continuously since the slide began in early June. Mainland China's Shanghai Composite Index is down 11 % from early June. Hong Kong's Hang Seng general index has fallen 8 % and the China Company Index by 11 %.

Market reactions were triggered by renewed tensions in trade policies and increased concerns about China's domestic demand. May investments and private demand were both weaker than expected. At the beginning of July, the Standing Committee of the National People's Congress presented a plan for wide-ranging income tax cuts. The tax reform, intended to spur private consumption, would enter into force in October.

**Chinese share prices and yuan plunged in June**



*Source: Macrobond.*