Weekly Review
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BOFIT

Russia

Russian Megafon plans to delist from London stock exchange. Under a plan released on July 16, one of Russia's largest mobile phone operators, Megafon, will offer to buy out the shares of minority shareholders for a total of about $1.3 billion. About 80 % of the company's shares are held by billionaire Alisher Usmanov and Gazprombank. Megafon stated that in the future it will be more oriented to building up digital services in Russia which may require high-risk investment and close cooperation with state-owned enterprises.

Megafon announced in May that it was partnering with Gazprombank and state-owned Rostec in a joint venture to produce digital services and blockchain-based solutions for Russian corporate clients. The decision to delist reflects a change in corporate strategy, but probably also concerns about publicity issues relating to information on state enterprises and a possible widening of sanctions. Usmanov has been gradually shifting his assets to Russia.

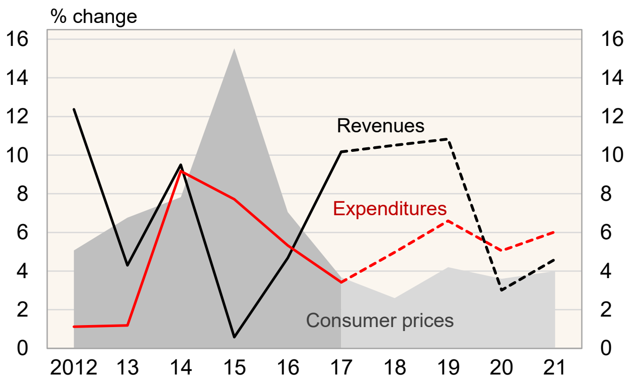
Russia's near-term plans for government sector finances taking shape. The finance ministry's government sector budget framework for 2019–21 foresees that rapid growth in revenues of the consolidated budget (federal and regional budgets, and state social funds) will continue still in 2019. Federal budget revenues are expected to rise substantially faster (about 15 % p.a.) this year and next compared to revenue streams to the other budget categories thanks to relatively high oil prices and a hike in the value-added tax. All oil tax revenues and VAT revenues will continue to go to the federal budget.

Revenue growth of regional budgets is expected to keep going at about 2 % faster than inflation. Part of this growth would come from letting regions retain gradually increasing shares of certain excise tax revenues. This dovetails with plans to start reducing transfers from the federal budget to regional budgets. Social fund revenue growth is also expected to outpace inflation, while federal transfers to the Pension Fund should remain roughly at current levels. Rates of social taxes going to the funds will generally stay unchanged, at a total of 30 % of workplace wages. The finance ministry notes some of the increase in government sector budget revenues will come from improved tax collection based e.g. on ongoing digitalisation. Collection of VAT, labour income taxes and social taxes has improved over the past couple of years.

The proposed framework assumes growth of about 2 % above inflation in government sector spending. Highest growth is seen in federal budget spending (excl. transfers to other budgets), but estimates of regional budgets do not yet include (at least fully) funding of the national projects listed in president Vladimir Putin's May inauguration Decree. This could lead to regional changes in taxation and budget transfers. Government sector wage increases are generally speaking outlined to match inflation.

Increases in social fund spending from next year onwards are expected only to roughly match inflation. Both the finance ministry and the labour and social affairs ministry say that the proposed gradual increase in the retirement age in a bill currently before the Duma could also produce budget savings to an extent that pensions for retirees who do not work could possibly be increased in coming years by an average of 6–7 % a year.

Russian government sector budget revenues and expenditures



Sources: Ministry of Finance, Ministry of Economy and Rosstat.

Changes in financing of Russian housing construction. Under a change in the law since July 1, construction firms may no longer finance their construction activity by selling unfinished apartments directly to consumers. This buy-early approach has long been popular in Russia because it lowered the sales price for the apartment-buyer while providing builders with a source of cheap financing. The drawback of this approach is that it has been very difficult for the buyers to recover their money if the apartment is never finished for some reason. Russia's ministry of construction, housing and utilities reports that there are currently over 80,000 such problem cases (the actual number may be more than double that according to some experts).

The amendment requires buyers to deposit the payment for the future apartment in a separate bank account linked to a specific building permit. The money can only be released to the construction company upon completion of the apartment, but the deposit makes it easier for companies to borrow to cover construction costs. Buyer deposits are covered by banks' deposit insurance up to 10 million rubles (140,000 euros). The law also tightens up e.g. other financing and solidity requirements for builders.

The change in the law is expected to improve the legal protection of apartment buyers and drive unscrupulous building companies out of the market. On the downside, the arrangement may reduce construction activity and drive up the apartment prices as financing becomes more expensive for many builders. The total volume of residential apartment production in Russia last year was about 80 million m². One of the goals of president Putin's May Decree is to raise the volume of housing production to 120 million m² a year.

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China

Yuan depreciation continued in July. The dollar-yuan rate saw last week its largest monthly shift after the ending of the de facto pegging of the yuan to the dollar in 2005. As of today (July 27), the yuan was down 6 % from the start of June. Over the same period, the dollar's trade-weighted exchange rate has remained essentially unchanged. The yuan has lost 6 % also against the euro since the start of June. The yuan's nominal effective exchange rate (NEER) is about where it was at the start of this year.

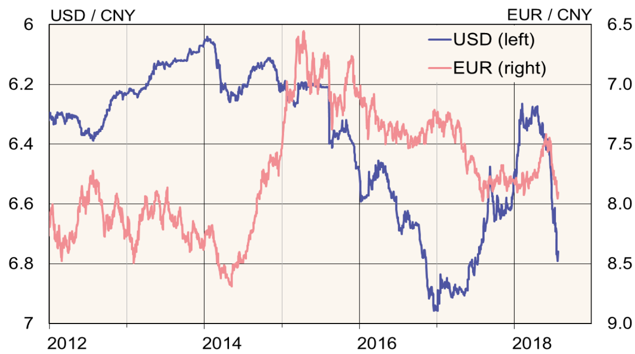
Chinese exchange rate moves are still relatively modest. This year the yuan's average daily fluctuation against the dollar has been only 0.2 %, compared to e.g. fluctuations of 0.4 % for the yen and euro and 0.6 % for the rouble against the dollar.

The yuan depreciation has also tightened tensions in trade policy talks. US president Donald Trump last week accused the Chinese of artificially devaluing their currency to support exports. China's foreign ministry says the drop is due to market factors, and China does not intend to devalue its currency to stimulate exports.

The exchange rate trend also reflects dollar strength and conditions on China's domestic market. The US Federal Reserve moves to higher interest rates, whereas China's monetary stance is becoming more accommodative to boost growth in the presence of market uncertainties.

Even so, officials seem to be refraining from intervening as they did after the mini-devaluation of the yuan in summer 2015. The State Administration of Foreign Exchange (SAFE) reports that pressure to move capital out of the country today is considerably lower than three years ago. China has a range of measures available if needed to prop up the yuan.

Yuan-dollar and yuan-euro rates



Sources: Reuters and ECB.

PBoC grants commercial banks credit to buy corporate bonds. Media reports assert that the People's Bank of China is using its medium-term lending facility (MLF) to provide collateralised loans to banks to be invested in bonds of non-financial corporations. Economics & finance magazine *Caixin* reports 1-to-1 MLF credit is available for purchase of bonds rated AA+ or higher and 2-to-1 for lower-grade bonds. In other words, PBoC is not buying corporate bonds directly to hold on its balance sheet, and commercial banks carry the risks. Collateral accepted for MLF loans was expanded in June to include corporate bonds with ratings of AA to AAA- (see BOFIT Weekly 23/2018).

Media reports say that the PBoC exercised its window guidance policy last week in requesting that commercial banks provide estimates of their planned corporate bond purchases for July. On Monday (July 23), the central bank granted 502 billion yuan ($74 billion) in new one-year MLF loans that *Caixin* claims were allocated for this purpose. Earlier this month, 189 billion yuan in MLF loans were issued to fund rollovers of maturing loans.

The rate on a one-year MLF loan is currently 3.3 %. On Monday, one-year AAA+ corporate bonds traded on the interbank market paid 4.0 %, and riskier AA- bonds 6.7 %.

Risks have emerged this year in the non-bank corporate sector with the increase in corporate bond defaults. The defaults have made investors particularly skittish about investing in high-risk bonds. At the same time, the yield spread for high and low quality bonds has increased. Companies are also finding it harder to access credit as the shadow banking sector has come under increased official scrutiny. China's Banking and Insurance Regulatory Commission (CBIRC) last week issued guidance to banks on "actively lowering" financing costs for small firms and improving access to financing. Large banks were requested to take the lead on this.

More Chinese companies make Fortune Global 500 list. This year's *Fortune Global 500* (largest 500 firms in the world measured by total revenue converted to dollars) contains 111 Chinese firms (includes companies headquartered in Hong Kong). Nine Taiwanese firms made the list, along with seven Brazilian firms, seven Indian firms and four Russian firms. In 2000, only ten Chinese companies made the list. By 2017, that number had reached 109. 126 US firms made this year's list, along with 52 Japanese firms. The rankings are based on revenue and profits from the most recent financial year ending March 31 or earlier.

US retail giant Walmart continued to hold the top spot with annual revenues exceeding $500 billion. As in 2017, the second-, third- and fourth-place rankings went to China's state-owned energy giants State Grid, Sinopec Group and China National Petroleum, with revenues in the range of $326–349 billion. Of the 22 Chinese firms making it into the top 100, only Huawei (at the 72nd spot) is privately-held. Privately-held Anbang, CEFC, HNA and Wanda that last year were included in the *Global 500*, were left out this year. Despite high-enough revenues to make it to the list, *Fortune* said the firms were removed due to e.g. operational difficulties, and some of them being under legal or regulatory investigation.

US-based Apple, with profits over $48 billion, was the most profitable firm on the list. All big four of China's state banks (ICBC, CCB, ABC and BOC) made the top 10 most-profitable list.

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