Weekly Review
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Russia

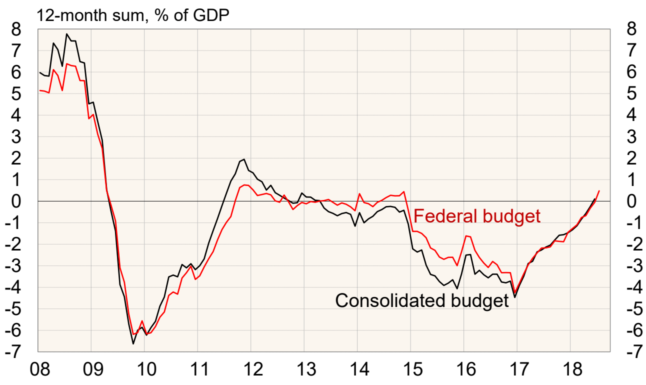
Russia's public finances in overall balance. Revenues to the consolidated budget (federal, regional and local budgets plus state social fund budgets) increased by over 15 % y-o-y in the first half of this year. The rise of oil & gas tax revenues from higher oil prices accounted for nearly half of the revenue increase. The revenues stood for about a quarter of total consolidated budget revenues.

Other budget revenues increased by about 10 % y-o-y, with the top four revenue streams rising by 12–15 %. While the share of the top four sources in total revenues decreased slightly, the share was still nearly 60 %. The top four breakdown is led by the mandatory social contributions by firms (20 %), value-added taxes (17 %), corporate profit taxes and personal income taxes (each roughly 10 %).

Consolidated budget spending increased in the first half of this year by well over 5 % y-o-y, driven by a clear pick-up in spending in the second quarter. Spending on healthcare and education increased fastest (about 15 % y-o-y), in line with the Russian leadership's current guidelines on raising budget spending in these categories. Spending on civil administration rose well over 10 %, while revised figures show spending on defence, domestic security and law enforcement increased by 6 %. Spending on social security rose by just 4 %, due e.g. to the fact that general increases in old-age pensions were limited this year to levels slightly above the inflation rate.

The government sector deficit contracted last year and in the first half of this year. Over the 12-month-period ending in June, the budget showed a slight surplus of 0.1 % of GDP.

Russian government sector budget balance, 2008–2018



Source: Russian Ministry of Finance.

CBR suspends foreign currency purchases tied to the fiscal rule until the end of September. Since the beginning of 2017, the Central Bank of Russia has purchased daily a pre-announced amount of foreign exchange on behalf of the finance ministry. Under the government's current fiscal rule, excess tax revenues from oil & gas going to the federal budget (this year excess revenues will accrue when Urals crude is above $40.80 a barrel) will be transferred to the National Welfare Fund. As a rule, the liquid assets of the National Welfare Fund are invested in forex assets. As rising oil prices and ruble depreciation have increased budget revenues, the daily amounts CBR has been buying on behalf of the finance ministry have increased.

Earlier CBR buying suspensions have only lasted a few days. The current announcement calls for an exceptionally long suspension till the end of September. The CBR says the measure is intended to dampen increased volatility on financial markets and enhance the predictability of monetary authorities' actions. Finance ministry representatives, however, assert the fiscal rule will be strictly followed and the CBR will continue to provide the agreed amount of forex from its own reserves.

Some market observers have noted that the measure could slightly support the ruble's exchange rate, although any large impact is unlikely. The ruble-dollar rate has fallen about 8 % since the beginning of August.

Caspian Sea states make progress in jurisdiction of territorial waters. On August 12, the five littoral states surrounding the Caspian Sea (Azerbaijan, Iran, Kazakhstan, Turkmenistan and Russia) signed a convention on administration of rights to the water resources and territorial bounds, easing construction of underwater oil & gas pipelines crossing the territorial zones and banning access of non-littoral military forces to the area. The convention makes the parties committed to protecting the Caspian Sea's rich biodiversity, for which some areas are already seriously polluted.

The long-awaited agreement, over 20 years in the making, still leaves open critical questions about rights to natural resources underlying the vast seabed. The Caspian basin's huge oil & gas potential has long been recognised and is already partly utilised. For example, the Kashagan oil field on Kazakhstan's coast was discovered in 2000. It accounts about 10 % of the country's oil production at present, and that share is expected to keep growing. Jurisdiction over some Caspian Sea oil & gas deposits is disputed, and the new agreement does not reconcile the situation.

Under the new treaty, construction of oil & gas pipelines only requires permission from those countries through which the pipeline runs, and not all littoral countries as earlier. Concerns have been raised, however, about the effectiveness of eased permissions if other littoral countries can use environmental laws to dispute oil & gas pipelines located in the area. The issue is especially important for Turkmenistan, which has long planned a pipeline from its Caspian Sea oil & gas fields to Azerbaijan and further to European markets. Kazakhstan is also planning to connect its oil field pipeline to Europe via Azerbaijan. Russia and Iran, which look askance at competition on Europe's energy markets, earlier used environmental protection rules to block pipeline projects proposed by others. Discussions among the parties to the convention are expected to continue to resolve outstanding issues.

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China

US-China trade talks produce no results; new round of import tariffs takes effect. Trade talks between mid-level officials from China and the United States continued in Washington, DC on August 22–23, but failed to deliver results. On the second day of meetings, the US imposed its earlier threatened 25 percentage-point round of tariff increases on $16 billion worth of Chinese imports. China responded immediately by imposing similar import duties on the same dollar amount of select imports from the US.

If trade tensions further escalate, the US says it will go ahead with import tariff hikes on another $200 billion worth of Chinese imports. Public hearings by the US Trade Representative's office, currently underway to finalise the list of targeted products, should be wrapped up on September 5. If the tariff hikes on the list are implemented later in September as planned, China has promised another round to tariff hikes affecting $60 billion worth of US imports.

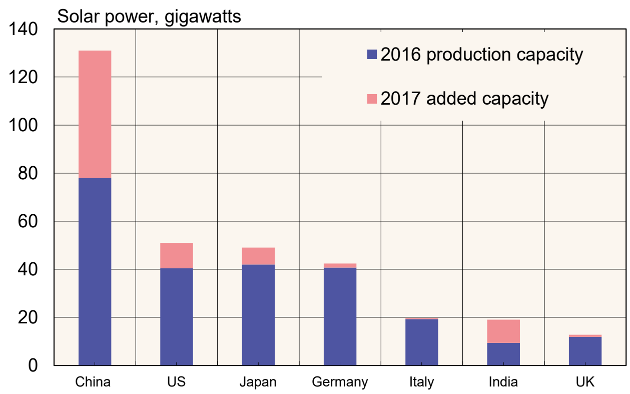
China has held the line on further yuan devaluation amidst the trade policy wrangling. The yuan has actually rebounded by about 2 % against the dollar since hitting a low in mid-August. At the start of this month, the People's Bank of China reinstated use of a "counter-cyclical factor" in determining the yuan's appropriate reference exchange rate, thereby helping prevent further devaluation. On Friday (Aug. 31), one dollar bought 6.83 yuan.

EU could remove its import restrictions on Chinese solar panels. Chinese solar panel producers have been required by the EU for the past five years to sell their products within the EU-area at prevailing prices, or at least a minimum price defined by the European Commission. If the price went below the official floor, Chinese imports were subject to heavy import duties. Over the years, the price floor has been lowered gradually. The temporary import restrictions have been extended through a series of expiry reviews, with the latest period ending at the beginning of September. Reuters reports that the European Commission now plans to let the anti-dumping import duty scheme expire on its own and allow solar panel producers to set whatever prices they wish.

China's solar energy sector has grown briskly thanks to generous state support. Last year, for example, China added 53 gigawatts of solar power production capacity. The increase accounted for over half of the increase in solar power production capacity globally, and was roughly equivalent to the generation capacity of 30 Finnish Olkiluoto nuclear power plants. China's total installed solar power base in 2017 had a production capacity of 130 gigawatts, or about a third of installed solar capacity globally, placing China well ahead of its closest competitors, Japan (49 GW) and the US (43 GW).

Some solar power generated in China goes to waste due to inadequate demand, a lack of storage capacity and transmission grid limitations. Concerns over inefficient investment and overcapacity have arisen recently. Government support has been implemented through bank sector financing, which has allowed some solar firms to expand by taking on massive debt. At the beginning of June, Chinese officials announced an immediate end to subsidies for new solar power projects and the elimination of all production incentives. The decision was generally seen as a shot in the arm to sector as it forces companies to produce efficiently and invest wisely. The reduction in state support has long been a prerequisite to lifting of anti-dumping tariffs in export markets.

Countries with most solar power production



Sources: BP, Macrobond.

Higher rents yet to appear in China's official inflation numbers. Various market operatives report that rents, particularly in China's biggest cities, soared over the summer. A study by Chinese real estate brokers further shows that July rental prices in Beijing were up on average over 20 % y-o-y. Rents climbed by nearly 40 % in some areas.

China's rental markets are generally considered underdeveloped. Most people own their own apartment. Soaring rental prices have pushed the government in recent years to make renting more attractive. Beijing's rental market is currently dominated by a handful of brokers and tenant rights are inadequate e.g. in resisting capricious rent hikes.

As of mid-August, rental brokerages in Beijing agreed jointly to constrain the rise in rents by offering 120,000 new apartments on the rental market and refrain from cynical bidding wars. Media reports claim that rental brokers have lately promised apartment owners high rental prices to capture apartments to their own listings. Beijing rents are the highest in China, currently an average of about 92 yuan (13 euros) per square metre.

The higher rents have yet to show up in official inflation statistics. The rental expenditure category of the consumer price index shows rents even in big cities rising at a steady pace of 2–3 % a year in recent years. In the worst case, the failure of the government's methodology for calculating inflation in capturing large increases in rents or housing prices leads to improper dimensioning or timing of policy actions.

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